

Contracting Back In: When Privatization Fails

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Municipal service provision is an inherently dynamic process. Municipal governments are responsive to changes in citizen demand, technology, and local market conditions. Old services may be shed as private markets emerge or public need declines. At the same time, new services are created in response to new needs. For example, recycling centers and homeless shelters are new services that have become common over the last 20 years. Many new services are first provided by contracts (often to nonprofits), which provide a flexible way for governments to meet new or expanding service demand. It is not unusual, however, for these services later to be provided through intermunicipal cooperation or contracted back in—that is, brought in house for direct public provision.

Contracting out is relatively well understood, but contracting back in is not. We define it as bringing back in house any service that the local government previously contracted out. Is this a result of competitive bidding, in which government employees compete with private contractors on government bids and win? Is it contract failure, in which government brings work in house to ensure quality and cost controls? Could it be a reflection of politics—labor opposition or bureaucratic resistance to innovation? Is it a result of innovation—process improvements that increase the internal efficiency of government? Is it a response to changes in service demand where contracting out is used only at the margin to accommodate peak loads or new service needs? Reasons for contracting back in may include all of these.

This article presents an analysis of empirical data and of case studies of contracting back in to determine why government managers bring work back in house.

BACKGROUND

Every five years since 1982, the International City/County Management Association (ICMA) has surveyed municipalities from around the country to provide the most thorough national

data on local government contracting. For our analysis, we chose to eliminate from the previous survey data those local governments that did not answer a significant proportion of the questions used in the analysis. As a result, the bases we report here are lower than those reported in the published ICMA surveys.

On average, privatization (contracting out to for-profit and nonprofit firms) rose only slightly—from 22% in 1982 to 24% in 1997—across all city services, and that rise was not steady.¹ Similarly, intermunicipal cooperation, the next most common alternative form of service delivery, rose only slightly from 12% in 1982 to 15% in 1997 (Figure 4/1). Together, contracting to for-profits and nonprofits and

Selected Findings

Between 1992 and 1997, 96% of responding governments newly contracted out at least one service and 88% brought at least one contracted-out service back in house. The reasons for contracting back in include lack of a competitive market of alternative suppliers, difficulties with contract specification, and the high costs of monitoring.

intermunicipal cooperation accounted for more than 90% of all alternative service delivery (i.e., service delivery not provided entirely by public employees (not shown). Yet despite increasing political acceptance of private forms of governmental service delivery, service delivery by public employees remained the dominant form of service provision, hovering around 60%.

These relatively flat trends hide a greater dynamism in public service delivery during the same period. A look inside the ICMA data shows that governments were engaging in new contracting out for some services while at the same time bringing some previously contracted services back in house. To get a clearer picture of this dynamic behavior, we paired responding

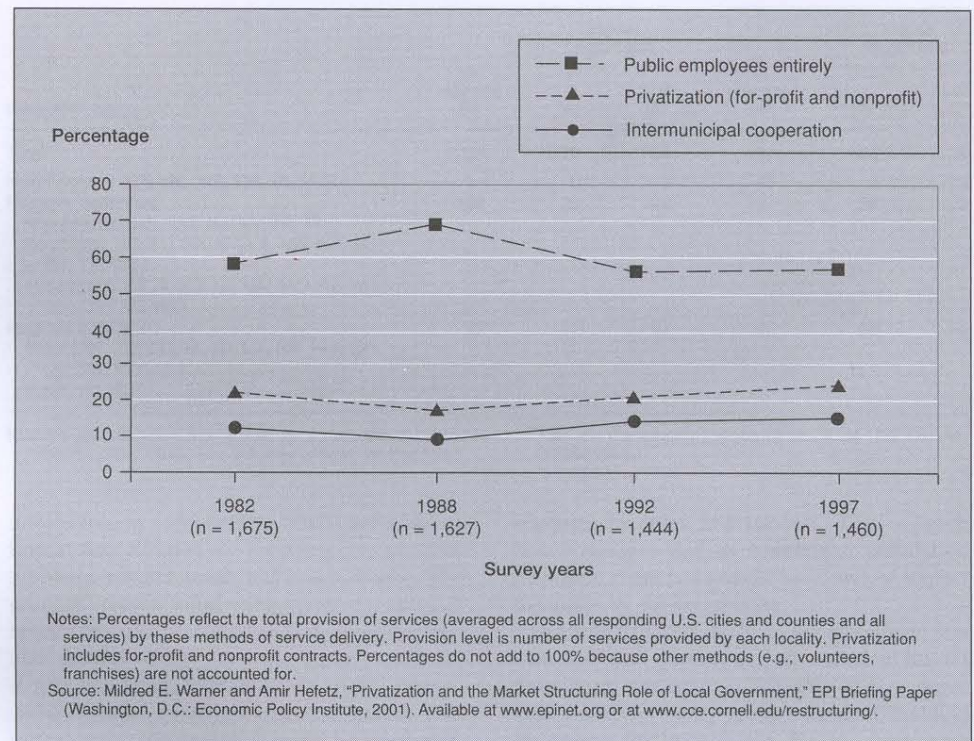


Figure 4/1 Average provision of services by service delivery methods over time

governments across ICMA survey years (1982–1988, 1988–1992, 1992–1997) to track shifts in form of service delivery for each service for each responding government;² roughly 40% of responding governments were the same in each pair of years. We found that almost all governments engaged in new contracting out (96% from 1992 to 1997) (Table 4/1). That is, at least one service that was provided in house in 1992 was shifted to being provided by contract in 1997. Contracts could be with any of ICMA’s six alternatives: for-profit privatization, non-profit privatization, intermunicipal cooperation, franchises, subsidies, or volunteers. On average across all places, eight services were newly contracted out between 1992 and 1997 in each local government. How could the level of new contracting out be so high when the overall level of contracting was relatively stable?

The answer is that new contracts were balanced against contracts being brought back in house. Most governments that contract out also contract back in. From 1992 to 1997, 88% of governments had contracted back in at least one service (Table 4/1).³ On average across all places, five services were contracted back in during that five-year period (more than half the level of new contracting out reported above). Because the ICMA surveys measure only how a service is currently provided, not changes over time, this pairing of survey responses over time is subject to errors in recall. However, when responses are averaged across all responding governments and all services, we can get a sense of the rough magnitude of contracting out and back in.

To determine which forms of service delivery were the most stable, we compared service provision for the most recent ICMA survey period,

1992–1997, by the three most common alternatives: public provision, intermunicipal cooperation, and for-profit privatization. Figure 4/2 clearly shows that provision of services by public employees entirely is the most common and the most stable—more than two and a half times as stable as either for-profit privatization or intermunicipal cooperation. On average more than half of all services provided by public employees in 1992 were still provided that way in 1997. By contrast, only one fifth of services provided by cooperation or privatization in 1992 were still provided that way in 1997.

There are important differences in the movement pattern for each alternative form of service delivery. While public provision is the most stable form of service delivery, the largest movement within public provision (23% of services) is toward some form of contracting out, either intermunicipal cooperation or privatization. Within the privatization alternative, the largest movement (29%) is represented by new privatization (e.g., new contracting out). However, transferring service delivery from privatization toward either intermunicipal cooperation or public provision (i.e., contracting back in) is also quite high (23%). This may explain why the overall level of privatization has barely risen despite high rates of privatization. Within the cooperation alternative, there is a balance between new contracting out (i.e., new cooperation, 16%) and contracting back from cooperation to public provision or to the private sector (19%). The remaining movements involve service shedding or new service provision. These movements are also higher for privatization and cooperation than for in-house provision.

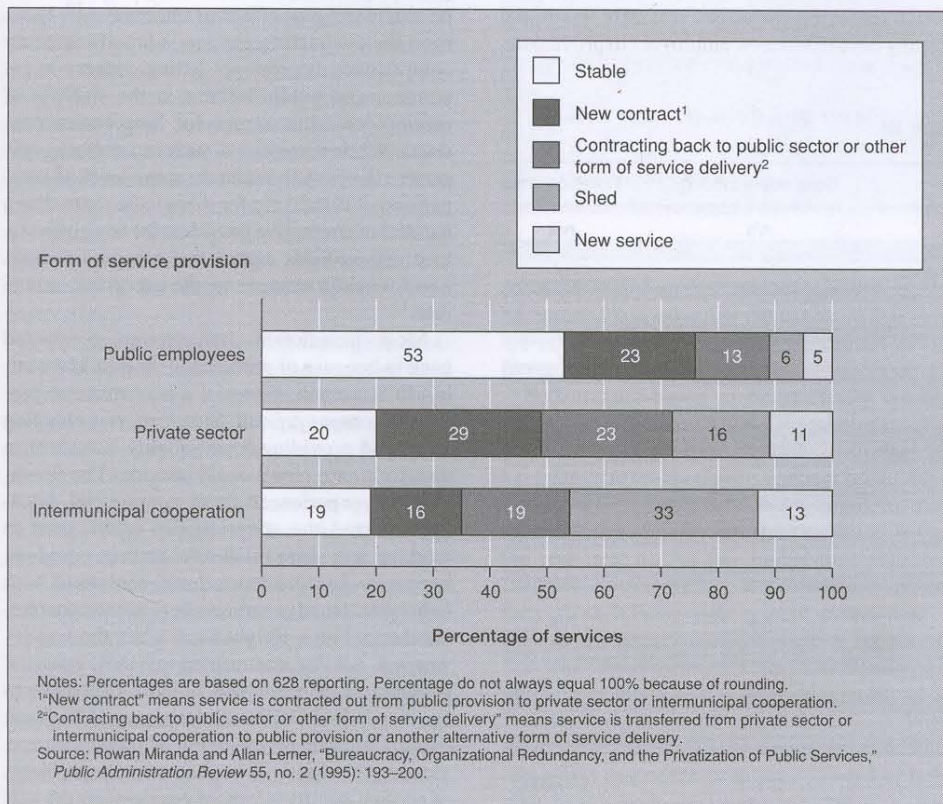
Is instability in form of service provision a problem? Not necessarily. Part of the instability in privatization and cooperation is due to the flexibility of these forms in enabling governments to meet changes in citizen demand for services in local market conditions. However, part of the instability also reflects problems with the contracting process itself. The remainder of this article focuses on contracting back in to better understand why contracting out can fail.

Table 4/1 LEVEL OF NEW CONTRACTING OUT AND CONTRACTING BACK IN AMONG U.S. CITIES AND COUNTIES

Year	New contracting out			Contracting back in		
	1982–1988	1988–1992	1992–1997	1982–1988	1988–1992	1992–1997
Percentage of places contracting out and contracting back in.....	93% (n = 749)	97% (n = 638)	96% (n = 628)	97% (n = 749)	92% (n = 638)	88% (n = 628)
Average number of services contracted in or out.....	5.7 (n = 62)	7.7 (n = 65)	7.9 (n = 64)	7.1 (n = 62)	5.3 (n = 65)	4.6 (n = 64)

Source: Mildred E. Warner and Amir Hefetz, "Privatization and the Market Structuring Role of Local Government," EPI Briefing Paper (Washington, D.C.: Economic Policy Institute, 2001).

Available at www.epinet.org or at www.cce.cornell.edu/restructuring/.



WHY CONTRACTS FAIL

A series of follow-up interviews were conducted with 22 governments that exhibited high levels of contracting back in.⁴ Most of these cases (described below) represent the kinds of services most often cited as good candidates for contracting out—services for which private sources of production are relatively common (e.g., paratransit service, residential trash collection). In many communities these services pass the “yellow pages” test, in which a number of alternative private firms can be found. Since these are the kinds of services that are most often contracted out, the chances are greater that more of them may be brought back in house as well.

Only 9 cases out of 26 were the result of competitive bidding in which government employees seek to retain or regain service delivery responsibility by competing with private bidders;

Figure 4/2 Dynamics of service provision, 1992–1997

20 cases were a result of some form of contract or market failure (see Table 4/2). Often the two categories overlapped. For example, it was not uncommon for public agencies to win competitive service contracts following a failed privatization attempt. The more typical scenario in these cases, however, was for government officials to take over the service without initiating a new round of competitive bidding. In 15 cases, it was clear to local government managers that higher quality or more efficient service could be produced in house, and competitive bidding was considered unnecessary.

What are some sources of contract failure? As explained below, lack of a market of competitive alternative providers, problems with cost and quality, problems with contract specification, and problems with monitoring are the sources most commonly reported.

Lack of Competition

Continued competition is key to ensuring long-term efficiency gains. However, for many public services in many regional markets there is not a wide set of alternative private providers. Many governments engage in competitive bidding precisely to address the problem of lack of competition. But this process may create a market of only two: a public and a private bidder. Andrew Goodell, county executive of Chatauqua County, New York, from 1990 to 1997, argues that local governments must create competition when none exists. Otherwise, a public monopoly may replace the private one.⁵

In the early 1990s, Chatauqua County considered selling its landfill. Situated near the border of New York, Pennsylvania, and Ohio, the county could benefit from competition among national waste management companies who

were vying to consolidate control in the region. It could use its market position to lock in competitive rates, but it needed to structure a long-term contract because once one of the national firms gained monopoly control in the region, prices would rise. Interestingly, the political debate then shifted to the value of the local landfill as a public resource, and ultimately the county legislature voted not to privatize. In so doing, it avoided some of the problems local governments in South Georgia have faced, where they privatized solid waste only to see prices rise as Waste Management Inc. achieved significant consolidation.

In Lubbock, Texas, residential trash collection is subject to competitive bidding, and public employees are encouraged to bid for the service. However, only one-third of the service is put out to bid at any given time, and the city has no plans to privatize the whole service. According to Mildred Cox, director of public works, "We would always keep at least one third of the service in house. This way we never lose the ability to keep the private firms on their toes. Just as important, having competitive bids provides the city with important information about what constitutes efficient service."⁶

The rules governing the public sector's ability to bid on contracts vary considerably from place to place. In Pinellas County, Florida, for example, public employees are allowed to compete with private providers when a service is first put out to bid. Once that contract is "lost" to the private sector, however, only private firms have the opportunity to bid on future contracts. The county sees the start-up costs associated with bringing a service back in as too expensive to be worth the effort. Not only would the county have to hire new employees to provide the

service, but new equipment and buildings may be required as well.

Competition is one key to efficiency. David Osborne and Peter Plastrick argue that the process should *not* be a one-way street: government crews should be allowed to bid to get back services or to take in new services previously provided by the private sector.⁷ Especially in smaller regional markets or in areas of government service that require specialized equipment, government needs to maintain the capacity to provide the service in order to be able to competitively rebid. Such redundancy ensures service quality and coverage in the case of contract failure, and it provides a continuing benchmark for cost and process controls.⁸

In Charlotte, North Carolina, public employees routinely bid on contracts, and the city expects its departments to be competitive in the bidding process. Making city departments competitive means providing them with the resources necessary to assemble quality bids. In many cases, this includes allowing managers to hire outside consultants to help develop the department's proposal and allowing employees to challenge overhead costs. Cases in which services are kept in house are viewed as "victories" for the city as they help create an entrepreneurial culture inside government. Unions are typically key partners in the competitive bidding process.

Problems with Cost and Quality

Cost savings due to contracting are often overstated and are rarely supported in empirical analysis.⁹ Competitive market logic would argue that private, profit-oriented providers would be the more cost-effective alternative.¹⁰ However, the contracting process is not always truly competitive, the contract-letting process is expensive, and public interest in the stability of service provision argues for longer-term contracts. While some cities, such as Lubbock, split service districts to maintain some level of competition, it is unlikely for there to be more than a handful of alternative providers for any given service. Elliott Sclar argues that competitive markets for public services are the exception, not the rule.¹¹

Most jurisdictions interviewed contracted back in because of problems with cost and quality. In Savannah, Georgia, a nonprofit fire protection company, South Side Fire, was charging more and providing lower-quality service than the city's own crews could provide. The Southside had experienced more commercial development, and the nonprofit fire crews, used to working in a more residential setting, could not keep pace. Independence, Iowa, contracted back in hospital laundry services because the contractor charged on a weight basis when the laundry was wet, not dry, and refused to handle patients' personal clothing, which is more expensive to launder. In Fort Collins, Colorado, and Charlotte, North Carolina, privatization of paratransit service for the elderly was plagued with problems of service quality—lack of courtesy on the part of drivers, problems with employee retention, and unreliable service. In Whittier, California, the city ended a five-year contract for its public

Table 4/2 CASE STUDIES OF CONTRACTING BACK IN

Place	Service(s)	Competitive bidding	Failed contract
Akron, Ohio	Road repairs	n/a	n/a
Ardmore, Oklahoma	Wastewater treatment plant		✓
Campbell, California	Buildings and grounds maintenance		✓
Charlotte, North Carolina	Paratransit service	✓	✓
Cincinnati, Ohio	Yard waste	✓	
Columbus, Ohio	School grounds maintenance		✓
Fort Collins, Colorado	Paratransit service		✓
Fort Lauderdale, Florida	Infrastructure pipe installation	✓	
Independence, Iowa	Grass mowing	✓	✓
	Laundry services		✓
Irvine, California	Seniors' meal program	✓	✓
	Seniors' care management	✓	✓
Lakewood, Colorado	Winter street sweeping		✓
Lubbock, Texas	Residential trash collection	✓	✓
Marshalltown, Iowa	Veterans' home food service		✓
Moore, Oklahoma	Public works		✓
Northbrook, Illinois	Water meter reading		✓
Pinellas County, Florida	Grounds maintenance		✓
Rialto, California	Water meter reading		✓
	Grounds maintenance	n/a	n/a
Sanford, Florida	Ambulance service		✓
	Utility meter reading		✓
Savannah, Georgia	Fire services		✓
Sioux City, Iowa	Residential trash collection	✓	
Warwick, Rhode Island	Residential trash collection	✓	
Whittier, California	Public bus service		✓
N = 22	N = 26	Σ = 9	Σ = 20

n/a = don't know/no answer.

Source: Michael Ballard and Mildred Warner, "Taking the High Road: Local Government Restructuring and the Quest for Quality," *Working Papers in Planning*, no. 194 (Ithaca, N.Y.:

Cornell University Department of City and Regional Planning, 2000). This article and a full review of each of these cases can be found on the Restructuring Local Government Web site: www.cce.cornell.edu/restructuring.

bus service because of similar quality concerns and higher costs due to higher accident rates and costs of repairs.

It is often difficult to judge when private service delivery is cheaper. Relying on bid prices is not adequate. In Charlotte, for example, bids on paratransit service ranged from \$12.60 to \$20.49 per trip. In Lubbock, bids for a portion of the city's residential trash routes varied from \$3.6 million to \$7.3 million—a difference of nearly 103%.

It is also difficult to assess the actual costs of in-house service provision without activity-based costing (ABC). ABC has been used in the private sector for years but is only recently gaining ground in the public sector. Indianapolis was a leader in this regard, using ABC to determine the direct and indirect costs of filling potholes. In so doing, the city identified areas where it could cut costs, especially in middle levels of management. Because government overhead, oversight, and management costs will not decline and may rise under contracting situations, Sclar recommends using "avoidable cost accounting" in assessing contracts. He argues that only avoidable costs should be counted in determining whether there will be savings from contracting.¹² Steve Egan, a consultant with The Mercer Group in Atlanta, Georgia, argues that once governments assess their true costs and employ a strategic management approach, they can generate sufficient savings through internal process improvements.¹³ This makes privatization unnecessary.

Problems with Contract Specification

Contracting out is common in both the public and private sectors. For businesses, the choice of whether to produce in house or to contract out is often referred to as the "make or buy" decision. While cost minimization is important, it is not the only goal. Service quality and reliability are equally important. Privatization experts recommend contracting for "best value" rather than for lowest costs and taking care to ensure that all aspects of service quality are included in the contract specification.¹⁴ (See box for additional discussion of the range of goals to consider in contracting.)

Governments should develop management expertise in contracting, but even so, some services are inherently hard to specify in a contract. These include services that are complex and require a great deal of coordination between providing departments (e.g., youth services [probation, parks and recreation, social services] or transit services [personnel, payroll, fleet management]). Many government services meet this description. In such cases a partnership approach (typical in nonprofit contracting and intermunicipal cooperation) may be more appropriate because it allows more flexibility to negotiate changes. Especially in human services where the goals may be incommensurate with each other (e.g., save money and maintain quality service, protect child welfare and protect the rights of parents), cooperation through partnership may be a better model than privatization. However, even in easy-to-specify services, if there is a high degree of asset specificity (e.g., garbage trucks for

Service Delivery Goals

Successful governments seek "best value," which recognizes a bundle of goals beyond cost efficiency.

Costs: *Cost savings are often a motivator for contracting.*

Flexibility: *Contracting can help government accommodate peak demand and better match staffing and workload. However, overly specified contracts may undermine flexibility while underspecified contracts may raise liability and reduce service quality.*

Speed: *Time is worth money. There is value in getting the work done faster. The private sector often can build faster than government.*

Service quality: *For complex services, quality of all components may be hard to specify. Be sure to include coordination with other related government services.*

Service access: *Will contracting expand service access or restrict it? Be sure the contractor is not maximizing profit by serving only those easiest to reach.*

Access to specialized personnel and skills: *New regulations often require specialized skills not found in house. Contracts can provide access to new expertise, common in environmental regulations and information technology upgrades.*

Access to private capital markets: *For governments that have reached their debt limits, private capital markets may provide new investment capital.*

New technology: *Contracting may provide access to new technology. Be sure to assess whether a contracted service is sufficient or if, in the long run, in-house capacity is required.*

Process innovation: *Contracts can provide process innovation. However, if the contract language is too rigidly specified, process innovation may be undermined. Too much contracting may undermine internal capacity/willingness to promote process innovation.*

Citizen access and involvement: *Freedom of Information Act provisions may not apply to private contractors unless included in contract language.*

Citizen participation and responsiveness: *Citizen participation is time-consuming but a core function of government. Will the contractor allocate sufficient resources for citizen engagement?*

solid waste management), governments should be cautious in contracting out to ensure that they are not faced with monopoly conditions in the future.

Performance-based contracts clearly specify outputs and inputs and make it easier to resolve disputes. In Lubbock, for example, a private trash hauler tried to renegotiate its contract because the weight of the trash it collected was greater than the company anticipated. Heavier loads meant the company had to pay higher-than-expected landfill fees, and the firm attempted (unsuccessfully) to shift those costs to local government.

The care management program for the Senior Services Department of Irvine, California, provides an example of the difficulties involved in specifying contracts for complex services. With about 100 active cases at any given time, the city offers assistance to seniors in need of help with health care, transportation, housing, and other social services. In 1995, public officials attempted to privatize the Senior Services Department's care management program. Despite

a competitive bidding process, the request for proposals attracted only one bidder that the city felt was sufficiently qualified to run the complex program. After reviewing the technical responsibilities contained in the contract, however, the lone qualified bidder chose to withdraw from the competition. The perception was that many of the contract services were hard to measure and difficult to administer, and that performance would be judged largely on community perceptions. Unable to attract qualified contractors, department administrators kept the service in house.

Contracts must balance detailed specifications with procedures to ensure flexibility to be responsive to changes in demand. When Moore, Oklahoma, contracted out its public works department in 1993, it made sure that minimum service levels were included in the contract. When citizens began demanding more than the minimum from their government in the mid-1990s, however, the city was unable to accommodate citizens' preferences because it was still bound

by the strict terms of the contract it had signed three years earlier.

As government managers gain experience in contract specification and management, performance-based contracting is becoming more common. Clear specification of outcomes, outputs, inputs, and processes help contractors develop clearer benchmarks and performance measures. However, performance management, a technique drawn from the private sector, may not adequately reflect public opinion.

Too often performance management focuses on the technical aspects of service delivery and not on the public participation aspects of government service. Efforts to develop performance measures that include public participation are being developed (e.g., the Sloan Foundation has supported some interesting work with the NYC Straphangers [subway riders]) but still do not adequately engage the public.

Government officials are keenly aware that public service provision is not just about efficiency; it is also about citizen participation and political voice. There is increasing recognition of the value and importance of public involvement and governmental responsiveness in service provision. Recent literature in public administration argues that service provision is inherently a political process and should not be treated as primarily a technical, performance management issue.¹⁵ It is not possible to reflect in a contract the full complexity of the government-citizen participation process—especially how the public influences the political aspects of the service provision process.

The Challenge of Monitoring

Case study evidence supports the notion that contracting back in is related to lack of competitive markets of alternative suppliers; political opposition from citizens, labor, and elected officials; and problems with service quality, cost, and contract specification. However, these reasons fade in comparison to problems posed by monitoring. A statistical analysis of all the ICMA data on new contracting out and contracting back in found that the latter was primarily associated with problems with monitoring¹⁶ (see Table 4/3),

as many governments do not monitor but instead bring work back in house when they are dissatisfied with contractor performance. Other governments that have professional managers and engage in formal monitoring still contract back in when they encounter problems with contractor performance.

The data were also analyzed to ascertain the effect of political opposition, lack of competitive markets, and lack of cost savings. Political opposition was important in reducing the level of new contracting out and increasing the level of contracting back in. However, it was only half as important as monitoring. Lack of a competitive market was important in reducing levels of new contracting out, but competitive bidding was not. ICMA does not collect data on costs of service, but we used average expenditure per capita as a proxy. Curiously, expenditures were higher among governments that engaged in more contracting out. This reflects findings from other studies that question the cost savings to be gained from contracting.¹⁷

When work is provided in house, internal process controls and monitoring systems are in place. Public employee experience and longevity help ensure that service quality is maintained—especially for services that serve so diffuse a population as to make citizen users an ineffective monitor. The civil service system was developed in part as a response to problems with service contracting and to the need for more effective systems of public service monitoring. Recent innovations in public service delivery, such as quality assurance programs, encourage intra- and interdepartmental collaboration so that complex services are evaluated and coordinated across departmental providers and citizen users. The very public nature of municipal service delivery invites public participation and political scrutiny, which further ensures governmental responsiveness.

When a service is contracted out, these internal systems of monitoring may no longer be effective. The contracting process creates an additional layer of separation between government and citizen. Quality control, service coordination, and citizen engagement need to be formally

specified in the contracting and monitoring process or else they may be lost. Recall that in the cases of paratransit contracting, one of the key complaints was lack of driver courtesy. Driver courtesy may have been assumed and not specified in the contract.

The ICMA surveys ask managers about their monitoring systems. While almost all respondents reported some level of contracting (see Table 4/1), fewer than half reported any monitoring. Among those who did, monitoring cost and compliance were most common (both around 80%), while monitoring citizen satisfaction was over 60% (not shown). But the frequency of these practices is only 30–40% when viewed in the context of all local governments.

Why is monitoring so limited? It may be a result of lack of experience. The logic of market-based provision suggests that formal monitoring systems may not be necessary. In a competitive market of many buyers and sellers, quality and service responsiveness is ensured through the market process itself. Adam Smith described this as the “invisible hand,” whereby consumers would purchase those services which best meet their quality/price/time needs and only providers that meet those needs would remain in business.

However, government contracts do not work like that. Far from a “many buyers, many sellers” competitive market, the government contract market is at best a quasi-market with one buyer (government) and a couple of sellers. Typically, except in the case of vouchers, the citizen does not directly choose from among competing services. Thus, the market mechanism for citizens to exercise their consumer voice does not work. Governments must accurately describe citizen needs and interests in the contract specification process.

As governments gain more experience with contracting, the need for formal external monitoring systems becomes obvious. But that does not make such systems any easier to create. Monitoring requires professional management. Even for services that are discrete and tangible such as lawn mowing, the monitoring process is not straightforward. Early stories of contract failure described cases in which mowing contracts were written with specifications that grass be mowed once every week. However, the real goal was that grass never be more than a few inches high. In a rainy summer, weekly mowing is not enough; in a dry summer, weekly mowing is too frequent. It is easy and cost-effective to monitor the height of grass; it is much more expensive, and less effective, to monitor the frequency with which a contractor shows up to mow. As government experience with contracting has grown, so has a new field of performance measurement and management.

Effective performance measurement is closely tied to contract specification. Because the competitive market does not work in the case of most government contracting, careful attention must be given to the contract specification process. Before deciding whether to contract a service, government managers must articulate the goals they want to achieve. This requires analysis, prioritization, and a way to assess and reconcile

Table 4/3 WHY GOVERNMENTS CONTRACT BACK IN

*Lack of monitoring: Contracting back in is a substitute for monitoring

*Problems with contractor performance: Lack of cost savings, poor service quality—identified by professional monitoring

*Opposition from labor, department heads, elected officials, or citizens

Problems with contract specification

Insufficient private competition

Competitive bidding: In-house crews bid to get the work back

Internal process improvement: Labor management cooperation makes contracting out unnecessary

Flexibility in responding to citizen demands

Attempts to decrease costs

Desire for more public participation in the service delivery process

*Indicates reasons that were tested and found by Amir Hefetz and Mildred Warner to be significant in a statistical model of 621 governments that responded to the ICMA surveys in 1992 and 1997; see Hefetz and Warner, “Privatization and Its Reverse: Explaining the Dynamics of the Government Contracting Process,” *Working Papers in Planning*, no. 201 (Ithaca, N.Y.: Cornell University Department of City and Regional Planning,

May 2002), submitted to *Journal of Public Administration Research and Theory*.

Source: All these reasons are found in the case studies by Michael Ballard and Mildred Warner, “Taking the High Road: Local Government Restructuring and the Quest for Quality,” *Working Papers in Planning*, no. 194 (Ithaca, N.Y.: Cornell University Department of City and Regional Planning, 2000).

competing goals. This is not merely a technical process; it is an inherently political process and it should be. Contracting is pursued to achieve goals of flexibility and speed (as in the rebuilding of highways after the Los Angeles earthquake), improved quality (as in environmental compliance when the municipality has an outmoded water treatment system), access to specialized personnel (often found in environmental services and new technologies), and the desire for innovation in processes (often found in information systems).

Time is worth money, especially for infrastructure where the benefits come sooner if the project is built earlier. Flexibility is also important. Demand for many services is not steady and contracts can be used, at the margin, to accommodate peak demand or better match staff skills with workload. While the private sector has its own internal accountability mechanisms, these mechanisms may not be sufficient for public services. Government approval loops, which were designed to stem abuses and ensure accountability, slow down the process. Government managers need to carefully consider tradeoffs between speed and accountability.

Political support, while popularly assumed to be a driving force for privatization, does not appear to be a strong motivator: only 16% of governments responding to the ICMA surveys report this as a motivating factor (not shown). Contracting is driven by the positive synergies that can result from partnerships between the public, private, and nonprofit sectors. Clear articulation of goals and specification of performance standards are essential to ensure that positive outcomes result from contracting.

Given the complex and mixed nature of government goals, the contract specification process is extremely important. Contracts should be structured so that payments are incentive based and benchmarks are easily tracked. This requires good baseline measurement. Thus, performance measurement must occur internally first, before contracting proceeds. If performance measurement must precede contracting, then contracting does not provide a shortcut for internal process improvements. Often, problems are identified at this stage and solutions found, making outsourcing unnecessary. Steve Egan now finds himself advising more on internal process improvements than on outsourcing. The promise of potential savings and process efficiencies can drive the interest in outsourcing at the outset, but the identification of internal process improvements in the early assessment process may make outsourcing unnecessary and risky in the final analysis.

THE ALTERNATIVE: INTERNAL PROCESS IMPROVEMENTS

Many of the case studies of contracting back in were tied to process improvements in public management. As such, they demonstrate that public innovation is a viable alternative to private provision. Often, small changes can lead to significant savings. In Warwick, Rhode Island, for example, management and the union

worked together to redesign the way residential trash is collected, resulting in savings of more than \$1.1 million over five years. In Akron, Ohio, city workers developed a plan to combine water and sewer line repairs with road repairs. "Why do the same work twice?" asked union president Leo Armstrong. "If we're already there repairing the hole, we might as well finish the job. Not only can we get the job done faster, but it saves the city money, too."¹⁸

In other cases, efficiency gains were the result of specific management practices being brought in from the private sector. In Charlotte, North Carolina, managers of the city's paratransit service instituted a gain-sharing program for its employees that resulted in savings of more than \$160,000 in 1998. Half of this money was divided equally among the department's employees, amounting to an annual bonus of \$1,600 per employee—or about 7% of an employee's total pay.

Labor-management cooperation programs can have a significant impact on improving efficiency in unionized settings. In Fort Lauderdale, Florida, "partnership" programs between labor and management have resulted in a number of competitive bids being awarded to public employees. Fort Lauderdale's partnership programs are a product of the Cooperative Association of Labor and Management (CALM), an innovative program that employs the concepts of total quality management to increase productivity and promote cooperation and understanding between the union and city administrators.

One example of CALM's impact comes from the city's attempt to privatize infrastructure pipe construction in early 1997. When the Request for Proposals was issued, a labor-management committee quickly formed to prepare its bid for the competition. The committee was co-chaired by the union president and the director of labor relations for the city, who together co-chair all partnership committees. Having these two established veterans on the committee "help[ed] to create a safe environment for our people," says union president Cathy Dunn. "This way we can establish trust among all parties early on, and get to the real work of developing our proposal."¹⁹

The CALM committee won the contract by submitting the lowest bid. Public employees were able to beat the competition by restructuring how the service was delivered. Work schedules were changed to reduce travel and set-up time, and the size of the pipe crews doubled, following the example of successful private firms that do the same work. The results of these changes have been dramatic: In the first year alone, city crews laid more than three and a half miles of pipe, compared with an average of just one mile of pipe for privately run crews.

Recognition of the potential for internal public sector process improvement is now widely known and has been outlined in reports by ICMA, Osborne and Plastrick, and the U.S. Department of Labor. According to *Working Together for Public Service*, a major report published by the Department of Labor, labor-management cooperation programs typically result in higher-quality service, greater cost-

effectiveness, better quality of work life for employees, and improved relations between workers and management.²⁰ In a survey conducted in 1999 to determine how many local governments were actually implementing Reinventing Government principles, ICMA found very strong support among government managers for the principles of competition, consumer input, and entrepreneurial approaches. Most governments were engaged in both contracting out and training to encourage government employees to become more entrepreneurial.²¹

ENSURING ACCOUNTABILITY TO PUBLIC VALUES

At its core, local government is about quality service delivery to its citizens. Public participation in decisions about services and in their implementation is a key part of the community-building process. Many governments are experimenting with new forms of participatory budgeting and service delivery—creating a culture of engagement among citizens, employees, and elected officials in designing services and building a sense of civic culture and pride.

Skepticism and concern over corruption run high in America, but local governments enjoy greater citizen confidence than do higher levels of government. This is because the services local governments provide are more direct and tangible to citizens and because opportunities to encourage direct citizen engagement are more common at the local level.

Special care should be taken in contracting to avoid corruption. Historical experience with contracting out street cleaning in New York City reveals a process riddled with abuse—even in a service whose quality was directly visible to the average citizen.²² The "Good Government" movement in the early twentieth century was in part a response to problems with corruption, graft, and revolving doors between government officials and contractors. The civil service and the government accounting and audit procedures we have in place today were designed to prevent such abuses. The Reinventing Government movement of the 1990s challenges some of these bureaucratic accountability loops as inflexible and inefficient.²³ However, failure to prevent corruption is more inefficient in the long run.

Sclar argues that we need to further separate politics from contracting to prevent corruption and conflicts of interest, and he recommends maintaining a national registry to track firms and their principals that have been found guilty of charges related to public contracting. Revolving doors between public officials and contractors should be limited by requiring a wait of three years. He further recommends that all contracts be subject to external audit review.²⁴ In Massachusetts this is done by the state auditor, as stipulated in the Pacheco Law (Chapter 296 of the Acts of 1993).

"Privatization is just a policy tool: it can be used well or poorly," argues Adrian Moore, executive director of the Reason Public Policy Institute of the Los Angeles-based Reason

Foundation.²⁵ In some services contracting works well, but in other services contracting may undermine the very public nature of the service delivery process. For example, Freedom of Information Act protections may not apply to service contractors unless such protections are specified in the contract.

Access, engagement, and diversity are additional public benefits that come with public service delivery. Robert Putnam decries the loss of social capital in America, arguing that too many Americans are "bowling alone" and losing their habits of civic engagement.²⁶ Gerald Frug argues that city services are one means to promote community building by encouraging the diverse and heterogeneous citizenry that makes up our communities to mix with each other and practice the skills of dialogue and engagement that enhance democracy and community building.²⁷ Public parks, transportation, and schools mix residents of different neighborhoods and thus encourage awareness, tolerance, and respect for difference—skills that are the foundation of democracy. If contracting out encourages further separation, it undermines this community-building aspect of public service delivery.

Local governments also are challenged to coordinate service delivery across metropolitan regions. Consolidated government is politically unpopular, but use of contracts (with private firms or with other municipalities) to promote service integration and scale is quite popular. As noted at the beginning, intermunicipal cooperation is second only to privatization as the preferred service delivery alternative among the ICMA survey respondents. However, if both forms of contracting are undertaken primarily when it is in the self-interest of the contracting parties, higher-cost municipalities may be excluded from such agreements.²⁸ Unfortunately, intermunicipal contracting, although popular, does not appear to be an effective means to address the inequalities stemming from unequal needs or fiscal capacity at the municipal level.²⁹

"While some governmental experts stress the advantages of privatization, others stress the

advantages associated with the direct provision of services by government. With few exceptions, however, neither the private sector nor the public sector has an inherent advantage," notes Andrew Goodell of Chatauqua County, New York. The job of local government managers is complex. No wonder local government managers experiment with both contracting out and contracting back in as they strive to create a high-performance government. Good managers do both.

¹Profile of Alternative Service Delivery Approaches, survey data (Washington, D.C.: International City/County Management Association, 1982, 1988, 1992, 1997).

²Mildred E. Warner and Amir Hefetz, "Privatization and the Market Structuring Role of Local Government," EPI Briefing Paper (Washington, D.C.: Economic Policy Institute, 2001). Available at www.epinet.org or at www.cce.cornell.edu/restructuring/.

³Profile of Alternative Service Delivery Approaches, survey data (Washington, D.C.: International City/County Management Association, 1992, 1997).

⁴Michael Ballard and Mildred Warner 2000, "Taking the High Road: Local Government Restructuring and the Quest for Quality," *Working Papers in Planning*, no. 194. (Ithaca, N.Y.: Cornell University Department of City and Regional Planning, 2000). This article and a full review of each of these cases can be found on the Restructuring Local Government Web site, www.cce.cornell.edu/restructuring.

⁵Warner and Hefetz, "Privatization and the Market Restructuring Role of Local Government."

⁶Ballard and Warner, "Taking the High Road."

⁷David Osborne and Peter Plastrick, *The Reinventor's Field Book* (San Francisco: Jossey-Bass, 2000).

⁸Rowan Miranda and Allan Lerner, "Bureaucracy, Organizational Redundancy, and the Privatization of Public Services," *Public Administration Review* 55, no. 2 (1995): 193-200.

⁹George Boyne, *Public Choice Theory and Local Government: A Comparative Analysis of the UK and the USA* (New York: St. Martin's Press, 1998).

¹⁰E. S. Savas, *Privatization and Public-Private Partnerships* (New York: Chatham House, 2000).

¹¹Elliott Sclar, *You Don't Always Get What You Pay For: The Economics of Privatization* (Ithaca, N.Y.: Cornell University Press, 2000), 9-11.

¹²*Ibid.*, 65-68.

¹³Steve Egan, senior vice president, The Mercer Group, personal communication.

¹⁴Adrian Moore, executive director, Reason Public Policy Institute of the Reason Foundation, Los Angeles,

Calif., personal communication, September 2001. The Reason Foundation has many excellent resource materials on privatization on its Web site, www.reason.org.

¹⁵Richard C. Box, "Running Government like a Business: Implications for Public Administration Theory and Practice," *American Review of Public Administration* 29, no. 1 (1999): 19-43.

¹⁶Amir Hefetz and Mildred Warner, "Privatization and Its Reverse: Explaining the Dynamics of the Government Contracting Process," *Working Papers in Planning*, no. 201 (Ithaca, N.Y.: Cornell University Department of City and Regional Planning, May 2002). Submitted to *Journal of Public Administration Research and Theory*.

¹⁷Mildred E. Warner and Amir Hefetz, "Applying Market Solutions to Public Services: An Assessment of Efficiency, Equity, and Voice," *Urban Affairs Review* 38 (September 2002): 70-89. See also Boyne, *Public Choice Theory and Local Government*, which is a meta-analysis of many studies, and Sclar, *You Don't Always Get What You Pay For*.

¹⁸Ballard and Warner, "Taking the High Road."

¹⁹*Ibid.*

²⁰U.S. Department of Labor, *Working Together for Public Service*, Report of the U.S. Secretary of Labor's Task Force on Excellence in State and Local Government through Labor-Management Cooperation (Washington, D.C.: U.S. Department of Labor, 1996). Available at www.ilr.cornell.edu/library/e_archive/gov_reports/labor_management/WorkingTogether.pdf.

²¹Barry M. Feldman, "Reinventing Local Government: Beyond Rhetoric to Action," in *The Municipal Year Book 1999* (Washington, D.C.: International City/County Management Association, 1999), 20-24.

²²Moshe Adler, "Been There, Done That: The Privatization of Street Cleaning in Nineteenth Century New York," *The New Labor Forum* (spring/summer 1999): 88-99.

²³David Osborne and Ted Gaebler, *Reinventing Government: How the Entrepreneurial Spirit Is Transforming the Public Sector* (Reading, Mass.: Addison-Wesley, 1992).

²⁴Sclar, *You Don't Always Get What You Pay For*, 164-167.

²⁵Moore, personal communication, September 2001.

²⁶Robert D. Putnam, *Bowling Alone: The Collapse and Revival of American Community* (New York: Simon and Schuster, 2000).

²⁷Gerald Frug, *City Making: Building Communities without Building Walls* (Princeton, N.J.: Princeton University Press, 1999).

²⁸Mildred E. Warner and Amir Hefetz, "The Uneven Distribution of Market Solutions for Public Goods," *Journal of Urban Affairs* 24, no. 4 (2002): 445-459.

²⁹*Ibid.*; Warner and Hefetz, "Applying Market Solutions to Public Services."