

# Privatization and Its Reverse: Explaining the Dynamics of the Government Contracting Process

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## ABSTRACT

Empirical evidence shows local government contracting is a dynamic process that includes movements from public delivery to markets and from market contracts back to in-house delivery. This “reverse contracting” reflects the complexity of public service provision in a world where market alternatives are used along with public delivery. We develop a methodology to link responses to national surveys and create a longitudinal data set that captures the dynamics of the contracting process. We present a framework that incorporates principal agent problems, government management, monitoring and citizen concerns, and market structure. Our statistical analysis finds government management, monitoring, and principal agent problems to be most important in explaining both new contracting out and contracting back-in. Professional managers recognize the importance of monitoring and the need for public engagement in the service delivery process. The results support the new public service that argues public managers do more than steer a market process; they balance technical and political concerns to secure public value.

## INTRODUCTION

The new public management encourages governments to be more efficient and responsive by employing market approaches to public service delivery (Eggers and O’Leary 1995; Hood 2002; Kettl 1997; Osborne and Gaebler 1992). Recent critiques of the new public management challenge the notion that market based approaches are adequate to capture the full set of political considerations that are part of local government service delivery (Box 1999; Denhardt and Denhardt 2003; Kaboolian 1998; Kelly 1998; Moore 1995; O’Looney 1993; Stark 2002). Privatization and market theories of public management are driven by

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government failure to meet economic and organizational efficiency (Niskanen 1971; Savas 2000). However, the need for public goods provision arises from market failure, and contract markets exhibit many of these same failures (de Leon and Denhardt 2000; Lowery 1998). A theoretical framework is needed which gets beyond the market versus government failure dichotomy and explores the full range of components in the public service delivery decision (Zebre and McCurdy 1999). Some scholars have used transaction cost approaches to compare the costs of direct public delivery with the contracting process (Alexander 2001; Brown and Potoski 2003; Nelson 1997). We present a broader framework that also includes attention to the uniqueness of citizen interaction and professional management in public service provision.

Pragmatic local government managers use markets in a dynamic approach; they contract out and bring unsuccessful contracts back in-house for direct public provision (Warner and Hebdon 2001; Warner, Ballard, and Hefetz 2003). They also mix public provision and private contracts for the same service (Miranda and Lerner 1995). Even with careful attention to monitoring, local government experience with contracting has not always been positive (Adler 1999; Sclar 2000). Local government practice has always involved a mix of public provision and government contracting (Sonnenblum, Kirlin, and Reis 1977). However, this behavior was reinterpreted as privatization in the 1980s as part of a broader push for market approaches to government service delivery (Henig 1990).

This enthusiasm for market solutions was reflected in new data series. The International City County Management Association (ICMA) in 1982 and the Census of Governments in 1987 began quinquennial surveys of local government contracting, and these remain the primary sources of national data. Because the presumption of government failure was so strong, and the political support for market solutions so widespread, these surveys do not attempt to capture the dynamic movement between market and government provision typical of local government practice. Rather, they focus on contracting as a one-way street, asking only which services have been contracted out.

In this article we present a methodology that links responses to the ICMA surveys to create a longitudinal data set that enables us to address the dynamics of the contracting process. We find that from 1992 to 1997, 93 percent of the 628 governments that responded in both survey years newly contracted out at least one service, and 81 percent of these governments contracted back-in at least one service. Almost three-quarters of governments engaged in both new contracting out and contracting back-in. These findings challenge the adequacy of a singular focus on contracting out. On average, governments newly contract out six services and contract back-in four services. That contracting back-in would be so common—over half the level of new contracting out—requires that researchers give attention to the dynamics of the contracting process.<sup>1</sup>

Private firms that contract out balance concerns with efficiency, quality, timing, reliability, security, and internal capacity (Nelson 1997). The new public service literature argues local government managers who use market approaches to deliver services must balance an even wider set of concerns, including accountability and public preference (Blanchard, Hinnant, and Wong 1998; Feldman and Khademian 2001; Sanderson 1998; Stirton and Lodge 2001).

<sup>1</sup> For our study, only services once provided by government are included in our definition of contracting back-in. This could include contracting back-in from nonprofit, for profit, or other government providers. In their definition of contracting-in, Welch and Bretschneider (1999) include new contracting out such as intermunicipal cooperation and governmental entrepreneurship. Our study distinguishes new contracting out from contracting back-in.

### **What is Contracting Back-in?**

The debate over privatization is shifting from an ideological debate (Savas 2000) to a proper discussion of the political, economic, and community factors that determine choice of market or government delivery (Feigenbaum and Henig 1994; Kirkpatrick 1999; Lowery 1999; Sclar 2000). The same concerns with efficiency, quality, and innovation that motivate privatization, may promote contracting back-in (Henig 1990; Warner and Hebdon 2001).

Contracting back-in can be several things. Typically it is assumed to be competitive bidding, where local employees contract to bring the work back (Martin 1999). However, in an analysis of twenty-six case studies of reverse contracting, competitive bidding explained less than half of the cases (Ballard and Warner 2000). In all of the cases, disappointment with service quality or difficulties with contract specification and monitoring were factors driving the decision to bring the contract back in-house. In most of the cases, internal process improvement by labor management cooperation was associated with contracting back-in.

Contracting back-in may reflect market success where competition increases efficiency (Lavery 1999). In other cases it reflects failure of markets to meet desired outcomes or failure of government to adequately manage and monitor contracts (Sclar 2000). It also may represent a new form of partnership between public and private actors (Freeman 2000; Rhodes 1996) where both cooperate in service provision.

The debate on privatization has been highly ideological, relying primarily on case studies where proponents find cost saving efficiencies (Eggers and O'Leary 1995; Savas 2000) and detractors find cost overruns, corruption, and erosion in wages and in citizen voice (Hebdon 1995; Sclar 2000; Starr 1988). Although empirical analyses find only limited support for market advantages (Boyne 1998; Ferris 1986; Hirsch 1995; Milne 1997), the debate remains dominated by public choice theory and has rarely addressed the dynamic and mixed (public and private) nature of local government service delivery (Boyne 2002). Local government contracting has been treated as a one way process—toward markets—and most studies have only looked at contracting out (Boyne 1998; Ferris 1986; Hirsch 1995). Those studies that have acknowledged the possibility of reverse privatization or contracts being brought back in-house (Kodryzcki 1998; Lopez de Silanes, Shleifer, and Vishny 1997) have not given it detailed attention. Warner and Hebdon (2001) are the only ones to empirically measure contracting back-in directly, as another form of service provision, but their analysis is limited to New York state.

Reverse contracting demonstrates the complexity of service provision in a world where market alternatives are used along with public delivery. It may involve market failure, government failure, or both. To gain a better understanding of the contracting process requires an analysis of both contracting out and contracting back-in, which gives attention to economic, managerial, and political perspectives.

### **A Framework for Understanding the Complexity of Government Service Delivery**

Both theories of government failure and market failure rely on the market paradigm to define the necessary level of government intervention. Public choice theory argues liberal policies that allow market-like solutions may replace central planning and improve the efficiency of the political process (Buchanan and Tullock 1974). Through privatization,

private firms compete for public service delivery which may lead to cost savings, higher efficiency, and less government involvement (Domberger and Jensen 1997; Savas 2000). Critics of public choice challenge the separation of provision from production, the methodological individualism of aggregating individual consumer preferences to achieve the collective public good, and competition as a substitute for planning in local public service markets (Lowery 1998, 1999; Starr 1988).

The social values inherent in public services may not be adequately addressed by the economic efficiency calculus of markets (Kelly 1998; Starr 1988). The consumer notion of citizenship does not adequately address the broader social concerns of the citizen (deLeon and Denhardt 2000). Likewise, governments are more than a business; they reflect collective identity, respond to diversity, and promote social equity (Box 1999). Increasing attention is being given to the intrinsic value of interaction between citizens and government in the public service delivery process to promote democracy, community building, and a more socially equitable system of urban service provision (Denhardt and Denhardt 2000; Frug 1998; Marmolo 1998; Potapchuck, Crocker, and Schechter 1998).

To provide a better understanding of the dynamic process of government service delivery restructuring, we present a framework that includes attention to both organizational behavior and market structure.

### ***Principal Agent Problems***

Transaction cost theory in public organizations combines both individual and organizational behavior to address principal agent problems in government organization (Williamson 1996). Goal incongruence between governments and their contractors may reduce privatization or increase contracting back-in. Political pressure from government employees, unions, and budget-maximizing bureaucrats also may limit private contracts (Savas 2000; Siegel 1999). However, empirical studies have found conflicting evidence of the impact of labor opposition. In some cases it is shown to reduce privatization (Chandler and Feuille 1991; Ferris 1986; Hirsch and Osborne 2000); in others it has limited or no effect (O'Brien 1994; Warner and Hebdon 2001). Recent studies of public managers have challenged the self-interest claims of public choice theory and emphasized professional motivation for public service (DiIulio 1994; Francois 2000; Moore 1995).

### ***Management***

More professional city management, as found in the council manager form of government, may minimize the effect of politics on local decisions and lead to a higher level of privatization (Feiock and Kim 2000; Moon and deLeon 2001). The government manager must decide whether to “make or buy” a service subject to market conditions, internal pressure, and state restrictions on debt limit and taxes (Hirsch 1995, 1970; Lopez-de-Silanes, Shleifer, and Vishny 1997; Nelson 1997). Political climate also may affect managers' decisions (Savas 2001). Politics is part of public management, and good managers do not just make technical decisions. They interact in the political process (Nalbandian 1999) and facilitate public engagement (Feldman and Khademian 2001; Svava 1998).

### ***Market Structure***

Theoretically competition is the key to ensuring savings from privatization (Boyne 1998; Savas 2000). Public choice theory implies competition will be greatest in fragmented local

government settings (Tiebout 1956). Lack of alternative suppliers has been shown to be a barrier to privatization in both inner cities (Hirsch 1995) and rural areas (Kodrzycki 1994; Warner and Hefetz 2003). In order to create competition, local governments engage in mixed public and private delivery in the same service area (Miranda and Lerner 1995) and competitive bidding (Martin 1999). These movements from public delivery to contracts and from contracts back to public delivery illustrate the dynamic nature of service delivery and the pragmatism of local government managers.

### ***Monitoring and Citizen Engagement***

Contracting requires clear specification of all the attributes of a good or service (even latent ones associated with citizen voice). In addition, it requires clear criteria for evaluating performance (Eggers 1997; Poister and Strieb 1999). Performance measurement demands a professional monitoring system (Perrin 1998) to enhance the likelihood of successful contracting. In contrast, the absence of a good monitoring system may lead to higher levels of contracting back-in. However, performance measurement has been criticized for failing to measure some of the most important aspects of citizen voice and engagement that are core to the governance process (Sanderson 1998). A recent study measuring citizen voice and privatization found that governments engaging in higher levels of privatization gave more attention to technical efficiency measures but not to citizen voice (Warner and Hefetz 2002).

Studies of contracting show that when contract specification and monitoring are difficult, services are more likely to be provided in-house (Nelson 1997). The complex and changing nature of many public services requires governments to engage in relational contracting so that monitoring can be an ongoing process (Kavanagh and Parker 1999; Sclar 2000). Monitoring is costly in terms of time and information. Case studies have found the cost of monitoring to average nearly 20 percent of contract costs (Pack 1989; Prager 1994). Paroush and Prager (1999) suggest public managers decide whether to contract subject to the costs of in-house production versus contracting and monitoring costs given the possibility the contractor may deceive. The monitoring process starts with service specification and continues with government oversight and assessment of service delivery. Weak monitoring control will yield lower than expected savings (Sclar 2000; Siegal 1999).

We hypothesize that the levels of new contracting out and contracting back-in will be affected by a combination of principal-agent problems, government management, economic and market considerations, and monitoring and citizen concerns. Typically studies of the decision to make or buy look at a single point in time decision (Coles and Hesterly 1998; Nelson 1997). We believe that contracting is an ongoing process and that monitoring is a key feedback mechanism. By looking over two time periods, we capture some of those dynamics.

## **DATA AND METHODS**

### **Longitudinal Construction of the Data Set**

This research compares new contracting out with contracting back-in on managerial, political, and economic grounds. Data for this study are drawn from the ICMA 1992 and 1997 Surveys of Alternative Service Delivery Approaches, the Census of Government finance files for 1992, and the Census of Population and Housing for 1990. Every five years

since 1982, ICMA has surveyed all counties with more than 25,000 population (roughly 1,600 out of 3,100 total) and cities over 10,000 population (roughly 3,300). Roughly a third of all governments contacted respond (31 percent for 1992 and 32 percent for 1997), yielding a sample of roughly 1,400 governments each year. The ICMA data cover 64 public services and six alternative service delivery approaches: contracting to for-profit firms, nonprofit firms, or to another government or public authority; selling franchises, using volunteers, and providing subsidies for the service. In this study any alternative to delivering services entirely by government employees is considered a case of contracting out. The main alternatives to internal government provision are contracts to private for-profit firms and intergovernmental contracting. Although local governments have used contracting for a long time, on average the majority of services (58 percent) are still provided directly by in-house provision in 1997. The surveys also ask managers 68 questions about factors that are motivators, obstacles, or important in implementing alternative service delivery.

We paired responses from the 1992 and 1997 surveys to create a longitudinal data set with 628 responding municipalities. Problems with changes in survey design in 1988 do not allow further longitudinal combination. Places responding to the survey in both 1992 and 1997 exhibit higher management capacity and higher levels of contracting.<sup>2</sup>

The ICMA surveys ask only how the service is provided currently, not whether this is a new contract or longstanding procedure. To determine how much new contracting was actually occurring, we needed a method to track changes in forms of service delivery for every service for each government. We coded the data into four exclusive categories. Our method distinguished whether a service is provided entirely by government employees, by mixed public provision and private contracts, by contract exclusively, or not provided at all. We combined these exclusive alternatives over time to create a transition matrix that allows us to track changes in service delivery methods. See figure 1.

This matrix method enables us to compare stability in form of service delivery and to assess shifts in the direction of provision—towards direct public delivery or towards contracts. One challenge with this pairing approach is that respondents may not classify their service provision in the same manner in each survey year. In order to increase the reliability of the analysis, we combined the two contracting alternatives, mixed public/private and totally contracted out into contracting out. We excluded the “not provided” option from our analysis because such events are not relevant to our analysis.

The reduced matrix has nine possible combinations over the two time periods which we group into four categories: stable public delivery, stable contracts, new contracting out, and contracting back-in. Stable public delivery is found in section 1 where government delivers the service via its own employees in both time periods. Stable contracting is found in section 2 where the government is either contracting the service in part or completely to an alternative service provider in both time periods. Although this option contains movements from mixed public and private delivery to totally contracted out and vice versa, we decided to include these movements in the stable contracting category since contracting continued. This minimizes chances of recall error from survey respondents who may report

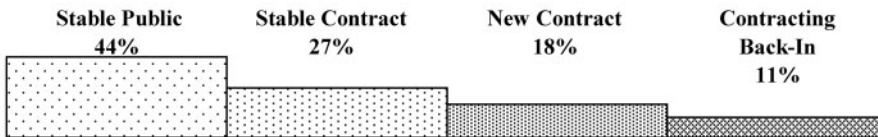
2 In the paired surveys, the number of places with a council manager form of government is significantly greater (72 percent) than in either of the full surveys 1992 (62 percent) or 1997 (64 percent) ( $\chi^2 = 20.5, p < .05$ ). Similarly, the level of contracting out is higher in the paired surveys: in 1992, 17 percent in the paired survey compared to 15 percent in the full survey ( $t = 5.05, p < .05$ ) and in 1997, 20 percent in the paired survey compared to 19 percent in full survey ( $t = 1.93, p < .05$ ).

**Figure 1**

Matrix for Tracking Stability and Movements over Time. *N* = 628 municipalities responding to both 1992 and 1997 ICMA surveys. Source: International City/County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.

		Current Survey			
		1. Public Employee Entirely	2. Mix Public/Contract	3. Totally Contract	4. Not Provided
		Towards Contracting Out →			
<b>Former Survey</b>	1. Public Employee Entirely	1. Stable Public Public → Public	3. New Contract Public → Mix	3. New Contract Public → Contract	Shedding Service Public → Not Provided
	2. Mix Public/Contract	4. Contract Back-in Mix → Public	2. Stable Contract Mix → Mix	2. Stable Contract Mix → Contract	Shedding Service Mix → Not Provided
	3. Totally Contract	4. Contract Back-in Contract → Public	2. Stable Contract Contract → Mix	2. Stable Contract Contract → Contract	Shedding Service Contract → Not Provided
	4. Not Provided	New Service Not Provided → Public	New Service Not Provided → Mix	New Service Not Provided → Contract	Service Not Provided
		← Towards Public Provision			

**Percentages (on Average per Government) for Boxes 1 – 4**



such partial contracting differently in the two survey years.<sup>3</sup> New contracting out is found in section 3 (shaded darker) where services previously delivered entirely by government employees now are delivered by contracts (either by mixed public/private or totally by contracts). Contracting back-in is found in section 4 (shaded lighter) where previously contracted services are brought back-in for entirely public delivery. Averaging across all 628 governments we find 44 percent of services are stable public provision, 27 percent are stable contracts, 18 percent are new contracts, and 11 percent are contracted back-in. See figure 1.

<sup>3</sup> ICMA gives six different contracting options and allows respondents to check more than one method of delivery. Our interest is not in the differences between how governments contract but whether they contract or not. By combining categories we reduce the decision options to use of any contracting or none. Thus recall error with respect to type of contracting is not a problem for our analysis.

**Table 1**  
**Opposition and Monitoring Indices Components and Means, U.S. Cities and Counties**

	Mean 1992	Mean 1997
Opposition index	.21	.22
Has your local government encountered any obstacle in adopting private service delivery?		
Opposition from elected officials	.21	.22
Opposition from local government line employees	.31	.34
Opposition from department heads	.17	.16
Restrictive labor contracts/agreements	.14	.17
Monitoring index	.34	.34
Does your local government use any techniques to systematically evaluate its private service delivery?		
Citizen satisfaction	.33	.32
Cost	.48	.45
Compliance with delivery standards	.39	.43
Conducting citizen surveys	.10	.15
Monitoring citizen complaints	.36	.35
Conducting field observations	.38	.35
Analyzing data and records	.36	.36

Source: International City/County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.

Note: N = 621, number of municipalities responding to both 1992 and 1997 ICMA surveys. Seven cases were dropped due to missing values.

**Model and Independent Variable Definition**

This study measures the impact of principal agent problems, government management, market structure and monitoring on the level of new contracting out, and the level of contracting back-in across all surveyed services. In addition, control variables for population, fiscal stress, and government type are included.

**Principal Agent Problems**

Goal incongruence between government principals and their agents may lead to lower levels of new contracting out and higher levels of contracting back-in. We include both internal and external measures of principal agent problems. We create an opposition index that includes managers’ answers to ICMA questions on opposition from government officials, employees, department heads, and the presence of restrictive labor agreements. The index is the proportion of positive answers to these four questions.<sup>4</sup> See table 1. Most managers report opposition from one or less of these sources as reflected in an average opposition level of just over 20 percent. Opposition is highest from line employees, reported by one third of municipal managers, and next highest from elected officials. Opposition from politicians and employees may reflect governmental resistance to change or dissatisfaction with prior contracting experience. We distinguish former (1992) and

4 This index and the other indices used in this article are created by summing positive responses to component questions and dividing by the total number of questions in the index.  $1/Q \sum_{i=1}^n f_i$  where  $f = 1$  if checked “yes” to question and 0 if not, and  $i = 1, 2, \dots N$ , questions.



**Table 2**  
Model Variables—Descriptive Statistics, U.S. Cities and Counties

Variable	Mean	SD
Number of services newly contracted out	6.3	6.0
Number of services contracted back-in	3.7	3.7
Number of services provided, 1992 and 1997	35	9
Number of movements (in and out)	10	5.6
Percent new contracting out, 1992 to 1997	18	16
Percent contracting back-in, 1992 to 1997	11	11
Opposition index, 1992	.21	.29
Opposition index, 1997	.22	.28
Percent employed in public admin., 1989 <sup>a</sup>	4.6	3.0
Percent for profit contracting, 1992	.17	.12
Council manager dummy, 1990 <sup>b,c</sup>	.72	.45
Attempt to decrease costs, 1992 or 1997 <sup>c</sup>	.83	.38
Political climate, 1992 or 1997 <sup>c</sup>	.30	.46
Competitive bidding, 1992 or 1997 <sup>c</sup>	.26	.44
Insufficient number of suppliers, 1992 or 1997 <sup>c</sup>	.24	.43
Monitoring index, 1992	.34	.36
Monitoring index, 1997	.34	.37
Kept complaint mechanism in-house, 1992 or 1997 <sup>c</sup>	.23	.42
Population, 1990 <sup>a</sup>	64,365	139,734
External fiscal pressure, 1992 or 1997 <sup>c</sup>	.59	.49
Per capita expenditure (\$), 1992 <sup>d</sup>	.88	.61
County	.17	.38

Source: International City/County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.

Note:  $N = 621$ , number of places responding to both 1992 and 1997 ICMA surveys. Seven cases were dropped due to missing values.

<sup>a</sup>U.S. Bureau of the Census. 1990. *Population and housing*. Washington, DC: U.S. Department of Commerce.

<sup>b</sup>U.S. Bureau of the Census. 1992. *Census of government: Organization file*. Washington, DC: U.S. Department of Commerce.

<sup>c</sup>Dummy variable = 1 if government checked yes to question in 1992, 1997, or both, otherwise = 0.

<sup>d</sup>U.S. Bureau of the Census. 1992. *Census of government: Government finances*. Washington, DC: U.S. Department of Commerce.

current (1997) levels of opposition to determine if they make a difference in contracting direction. We include an interaction term of council manager and opposition level as we expect professional managers may be more effective in managing internal opposition.

There also may be higher opposition in places where a higher percentage of the local labor force is employed by the public sector. We include the percentage of the labor force in public administration from the 1990 Census of Population and Housing. See table 2.

Principal agent problems also are found in external relations particularly between a government and its contractors. We expect principal agent problems to be greatest with for profit contractors (as compared to nonprofit and inter-municipal contracting) as found by Brown and Potoski (2003). If principal agent problems are a concern, places with higher prior levels of for-profit contracting may have less new contracting out and more contracting back-in. We also include a political climate variable (described under management below) to capture external support for privatization.

**Management**

Professional management is a crucial determinant of local government performance (Kearney and Scavo 2001). The new public management suggests entrepreneurial managers will both experiment with contracting out and employ internal process improvements which could result in higher levels of contracting back-in (Osborne and Gaebler 1992). Thus, municipalities with the council-manager form of government are expected to both contract out more and contract back-in more than other municipalities.

Contracting levels may be affected by managerial attitudes. We create dummy variables based on ICMA managers' responses to the following questions of which factors encouraged the exploration of alternative service delivery: "internal attempts to decrease costs" and "change in political climate emphasizing a decreased role for government." We hypothesize that managers who give positive responses to either of these questions are likely to engage in more contracting out and less contracting back-in. However, if contracts fail to provide significant cost savings, managers may decide to contract back-in. The majority of government managers (83 percent) in the ICMA surveys reported attempts to decrease costs in either 1992 or 1997 or both. A much smaller percentage of managers (30 percent) reported change in political climate as an important motivator. See table 2.

**Market Structure**

Market competition is critical to ensure gains from contracting, but competitive markets for public services may not exist for all services or every locale. When contracting merely replaces a government monopoly with a private one, gains will be limited. The ICMA surveys ask if government managers face an "insufficient supply of alternative private deliverers," and almost one quarter of responding managers report they do. Competitive bidding between the public and the private sectors can be used to create competition when none exists. A quarter of respondents report they "allowed government departments to compete with the private sector in the bidding process." See table 2. We expect an insufficient supply of private suppliers to reduce the level of new contracting out and increase the level of contracting back-in. Competitive bidding should have a negative relationship with new contracting out. However, we would expect a positive relationship with contracting back-in if it is primarily a result of competitive bidding.

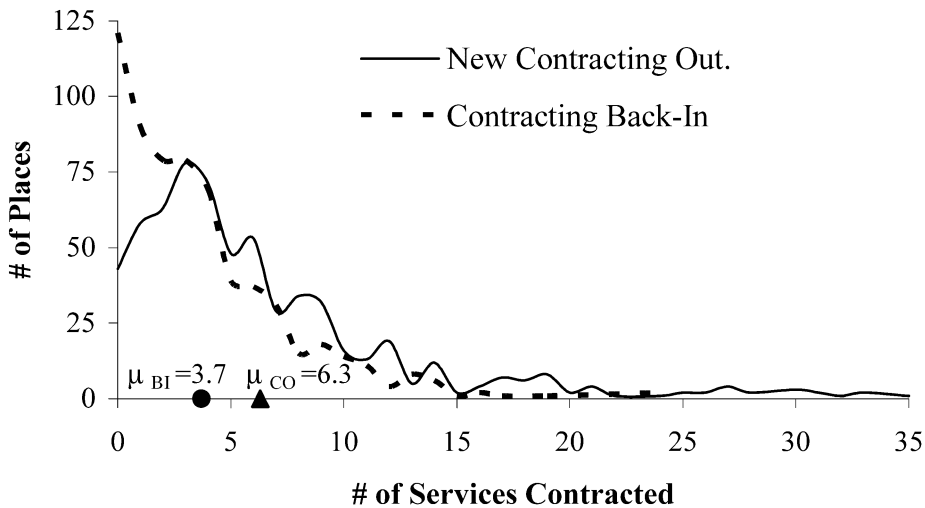
**Monitoring and Citizen Concerns**

Contracting requires a good monitoring system. The ICMA surveys ask about several monitoring aspects including costs, citizen satisfaction, and compliance with delivery standards and techniques such as surveys, field observation, data analysis, and citizen complaints. Our monitoring index is the proportion of monitoring activities reported by each manager. See table 1. Less than half of our sample reports any monitoring, but monitoring costs is the most common. Average monitoring levels are stable between 1992 and 1997, but the percentage of governments monitoring compliance with delivery standards and conducting citizen surveys increases between 1992 to 1997. The level of monitoring is higher than the level of opposition, suggesting government managers consider monitoring to be a more important factor in their contracting decisions. We expect governments that exhibit higher levels of monitoring will engage in higher levels of contracting out and contracting back-in.

Case study evidence from Ballard and Warner (2000) suggests reverse contracting is often a substitute for monitoring or a response to monitoring failure. In such cases we

**Figure 2**

Frequency of New Contracting Out and Contracting Back-In by Place.  $N = 621$  places responding to both 1992 and 1997 ICMA surveys. Source: International City/ County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.



would expect a negative association between monitoring and contracting back-in. To distinguish the effects of monitoring in those governments that monitor contracts from those that don't, we create interaction terms of monitoring and council manager form of government. A chi-square analysis of the interaction between council manager and monitoring showed governments with council managers were more likely to report medium or high levels of monitoring, while over 50 percent of places without professional managers had no monitoring at all. Higher monitoring for the council managers may lead to more contracting back-in. In contrast, for governments without council managers, who do less monitoring, contracting back-in may serve as a substitute for monitoring. The interaction terms allow us to differentiate these effects.

Citizen voice is also important in managers' decisions to contract out or back-in. The most direct measure of citizen voice in service delivery is whether the local government "kept the citizen complaint mechanism in house." We expect governments that keep the complaint mechanism in-house are less likely to newly contract out and more likely to contract back-in.

### **Control Variables**

Larger municipalities may have more opportunity for contracting due to the wider variety of services provided and the more heterogeneous nature of citizen demand. They also may have greater monitoring and management capacity. We use the log of population from the 1990 Census of Population and Housing to control for government size. We expect both more contracting out and more contracting back-in among larger governments.

Fiscal stress also may encourage governments to explore alternative service delivery arrangements. In many states, local governments' revenue raising capacity is limited by state policy caps on the property tax. Fifty nine percent of municipalities reported "external fiscal pressures, including restrictions placed on raising taxes, e.g. Proposition

**Table 3**  
**Services with Highest Levels of Contracting In or Out**

High Contracting Back-In	High New Contracting Out
Utility billing	Building maintenance
Building maintenance	Recreation facilities
Heavy equipment and emergency vehicles	Park landscaping
Street repair	Heavy equipment and emergency vehicles
Traffic signs	Data processing
Recreation facilities	Street repair
Tree trimming	Public relations
Legal services	Tree trimming
Street cleaning	Crime prevention
Sanitary inspection	Legal services

*Source:* International City/County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.

*Note:* N = 621, number of places responding to both 1992 and 1997 ICMA surveys.

13.” Places with higher average expenditures may be more motivated to consider new contracting out. Average per capita government expenditure from the 1992 Census of Government is included as a control variable.

Counties have lower levels of council manager form of government, and this lower managerial capacity may result in more instability in contracting.<sup>5</sup> We include a dummy variable for county and expect it to be positively associated with both contracting out and contracting back-in.

**Dependent Variables**

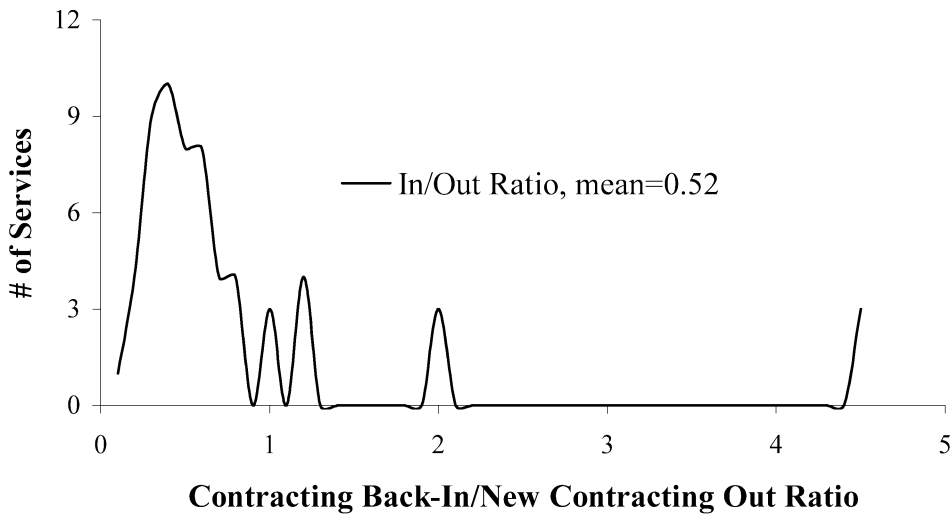
Our dependent variables are the level of new contracting out and contracting back-in as a proportion of total service provision (including stable provision). We also run a third model on the level of contracting back-in as a proportion of movements only (sections 3 and 4 of figure 1) to capture the interaction effect between new contracting out and contracting back-in. We construct these variables as an average across all services because we are interested in what factors affect the level of new contracting out and contracting back-in by place. The distribution of new contracting out and contracting back-in shows that more places contract out and at higher levels (6.3 services on average) than contract back-in (3.7 services on average). See figure 2. Many services have both high levels of new contracting out and high levels of contracting back-in (building maintenance, heavy equipment and emergency vehicle, street repair, recreation facilities, tree trimming, and legal services). See table 3.

We do not control for service type. Theoretically services which are more complex, hard to specify, and which have high asset specificity are generally not considered good candidates for contracting. Previous studies have attempted to classify the ICMA services by these criteria (Stein 1990, 1993; Miranda 1994). However, we analyzed the ratio of places contracting back-in to places newly contracting out for each of the 64 services in the ICMA survey. The in/out ratio averaged 0.52 for most services, meaning half as many governments contract back-in as contract out. See figure 3. This ratio by service is comparable to the levels of contracting back-in and new contracting out by place as shown in figure 2. Only ten services had in/out ratios greater than one. See table 4. Interestingly,

<sup>5</sup> Council manager form of government is 37 percent among counties and 79 percent among cities ( $X^2 = 77.5$ ,  $p < .000$ ).

**Figure 3**

Ratio of Contracting Back-In to New Contracting Out By Service.  $N = 621$  places responding to both 1992 and 1997 ICMA surveys. Source: International City/ County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.



these services included both those which would seem easy to contract out (such as utility billing, vehicle towing, and commercial waste collection) and those which are more complex (prisons, elderly, and arts programs). This suggests that, as government managers factor in the unique aspects of local alternative supplier markets, government capacity, and citizen preference, the decision to contract out may be more specific to place than to type of service.

We used the probit regression technique to transform the actual proportion of new contracting out to total provision and contracting back-in to total provision from a 0–1 scale into full scale variables following the cumulative standard normal distribution.<sup>6</sup> The first two models present the standard normal transformation (probit units) of the probability to move between public and private delivery over time as a function of a set of indicators. The third model uses the proportion of contracting back-in as a proportion of all movements (stable services for which mode of delivery did not change are excluded).

<sup>6</sup> We use the probit transformation to expand the range of our data beyond the 0–1 constraints of a proportion to enhance compatibility between the actual dependent variable and the regressors. A proportion cannot be used as a dependent variable in an OLS because its scale is limited to 0–1, but the OLS prediction is unlimited. The untransformed levels of contracting exhibit a Poisson distribution, but the advantage of Probit over Poisson is its ability to control for level of provision or level of movements (the control bases in our Probit models). However, we also ran a Poisson model (controlling for provision level as an independent variable), and it produced similar results. We also ran an OLS model with the ratio of contracting back-in to contracting out as the dependent variable. While not as consistent as the Poisson and Probit results, this model also confirmed the most important findings regarding monitoring, management, and principal agent problems. As in the reported model, the OLS results showed lower monitoring was associated with higher levels of contracting back-in, but governments with professional managers or managers who monitor had lower levels of contracting back-in. Similarly, governments facing opposition or using higher levels of for-profit contracting were more likely to contract back-in. Lack of competition, which was only significant in the contracting out model (both probit and poisson formulations), was not significant in the OLS version.

**Table 4**  
Services with Highest and Lowest Ratios of Contracting Back-In to New Contracting Out

Service with Highest Ratio (More Likely to Contract Back)	Service with Lowest Ratio (More Likely to Contract Out)
Daycare facilities	Hospitals
Utilities and gas	Payroll
Utility billing	Personnel services
Vehicle towing	Crime prevention
Homeless shelters	Museum
Commercial waste collection	Building security
Prisons	Sludge disposal
Elderly programs	Traffic control
Arts programs	Secretarial services

*Source:* International City/County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.

*Note:*  $N = 621$ , number of places responding to both 1992 and 1997 ICMA surveys.

Probit analysis uses the maximum likelihood technique to fit the best coefficients for the predictors (Norusis 1994).

## RESULTS

Our analysis confirms our hypotheses about the complexity of the government contracting process. Government managers consider a broad range of factors in the contracting decision: monitoring and principal agent problems are most important, but market structure also affects the contracting direction. Professional managers play a critical role in managing these factors. See table 5.

Our results support the importance of monitoring and citizen concerns as raised by critics of the new public management. Higher levels of monitoring are associated with higher levels of new contracting out and lower levels of contracting back-in. Similarly, governments with council managers are more likely to have higher levels of contracting out and lower levels of contracting back-in. Government managers who are successful users of contracts for service delivery understand the importance of monitoring systems that assess cost, quality, and citizen satisfaction. Governments with lower levels of monitoring are more likely to bring services back in-house. For these governments, contracting back-in appears to be a substitute for monitoring. This may reflect limited governmental capacity to monitor in general or selection of services for contracting that were inappropriate candidates for market delivery in that locale. For example, counties exhibited higher levels of contracting out and contracting back-in. This instability was predicted and likely reflects the lower levels of professional management found in counties.

There is a strong connection between professional management and monitoring. In contrast to the overall monitoring effects, we find lower levels of new contracting out and higher levels of contracting back-in among professional managers who monitor. These professional managers recognize the need for monitoring to determine if contracting back-in is required. Similarly, places which kept the citizen complaint mechanism in-house were less likely to contract out and more likely to contract back-in. Professional managers recognize the need to monitor and balance citizen concerns in the contracting process.

**Table 5**  
**Probit Results of Contracting Out and Contracting Back-In, U.S. Cities and Counties**

	Coefficients		
	Overall Services <sup>a</sup>		Overall Movements <sup>a</sup>
	New Out, 1992 to 1997	Back-In, 1992 to 1997	Back-In, 1992 to 1997
<b>Principal-agent</b>			
Opposition, 1992	-.233***	.194**	.368***
Opposition, 1997	.105	.062	.019
Manager* Opposition, 1992	.143	-.092	-.214
Manager* Opposition, 1997	-.011	-.153	-.178
Percent in public administration, 1989	-.014***	-.006*	.004
Percent prior for profit privatization, 1992	-.958***	.969***	1.881***
<b>Management</b>			
Council manager	.065*	-.056	-.135***
Attempt to decrease costs	-.084**	-.029	.037
Political climate	.019	.060**	.068*
<b>Market structure</b>			
Competitive bidding	-.007	.002	-.001
Insufficient number of private suppliers	-.104***	.012	.109**
<b>Monitoring and citizen concerns</b>			
Monitoring, 1992	-.055	-.117	-.073
Monitoring, 1997	.432***	-.435***	-.887***
Manager* Monitoring, 1992	.047	.147*	.116
Manager* Monitoring, 1997	-.154**	.162*	.349***
Kept complaint mechanism in-house	-.050*	.069**	.135**
<b>Controls</b>			
Census population, 1990	-.029**	.063***	.095***
External fiscal pressure	.013	.007	.009
Prior per capita expenditure, 1992	.005	-.009	-.012
County	.066*	.067*	.0004
Constant	.451***	-1.95***	-1.49***
<b>Model reliability</b>			
Pearson goodness of fit chi-square	$p = .000$	$p = .000$	$p = .000$

Source: International City/County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data, 1992, 1997, Washington, DC.

Note:  $N = 621$ , number of places responding to both 1992 and 1997 ICMA surveys. Seven cases were dropped due to missing values.

<sup>a</sup>In Models 1 and 2 the proportion is based on all services. In Model 3 the proportion is based on all movements (in and out) with stable services excluded.

\* $p < .10$ ; \*\* $p < .05$ ; \*\*\* $p < .01$ .

Principal agent problems, both internal and external, show the expected effects on both contracting directions. External principal-agent problems, as reflected in the prior level of for-profit contracting, have a larger effect than internal opposition in reducing the level of contracting out and increasing the level of contracting back-in. Internal opposition exhibits the same directionality but as a lagged effect on the direction of contracting. A higher percentage of the labor force in public administration also leads to lower levels of new contracting out but has no effect on contracting back-in. Unlike monitoring where there was a significant managerial effect, we do not find an effect of managers on opposition.

Market structure was less important than monitoring or principal agent problems in explaining the level of contracting in and out. Lack of competition (an insufficient supply of alternative service providers) led to less new contracting and more contracting back-in as expected. In Model 2 there was no effect on contracting back-in because in situations with inadequate competition, services are less likely to be contracted out in the first place. However in Model 3, where only those services that changed form of service provision (movements in or out) were used as the base, an insufficient number of private suppliers was positively associated with contracting back-in. Competitive bidding was not significant in any of the models.

Managers appear to be aware of problems with markets. For example, managers who are attempting to decrease costs are less likely to contract out, and those who face a political climate emphasizing a decreased role for government exhibit higher levels of contracting back-in. These results were contrary to our expectations, but they lend support to case study and other empirical evidence that government managers are pragmatic and recognize that contracting out does not always result in cost savings (Ballard and Warner 2000; Boyne 1998; Sclar 2000; Warner and Hebdon 2001). Similarly, we expected fiscal pressure might motivate government managers to contract out services to get around debt limits and tax ceilings set by the state. However, these fiscal constraints show no significant effect on contracting level or direction. We also controlled for prior per capita expenditure and found no significant relationship between government expenditure and contracting behavior. These results lend support to other studies that show limited cost savings from privatization (Boyne 1998; Ferris 1986; Hirsch 1995; Milne 1997).

We had hypothesized that municipalities with larger populations might be more likely to contract out and less likely to contract back-in. The control variable shows the opposite result. This might be explained by market structure, political opposition, or citizen concerns. Large municipalities are more likely to enjoy internal economies of scale, but they also may face more rigid bureaucratic structures and a more heavily unionized workforce. In addition, the more heterogeneous populations in larger cities may make service delivery more complex and harder to monitor. Governmental production may meet these challenges better than private contracts.

## **DISCUSSION**

Our results show managers are pragmatic professionals who balance monitoring and citizen concerns, principal agent problems, and market structure in determining how to provide public services. Management and monitoring are important in ensuring contracting success, but our results show monitoring is critical. Cost savings are not implicit in privatization. They can only be assured through monitoring or competition. However our results give more weight to monitoring. Many public services are hard to monitor effectively. For some services in some localities, market solutions are not optimal. Contracting back-in enables governments to reverse poor contracting choices.

Principal agent problems do lead to more contracting back-in, but external challenges of for-profit contracting are more important than internal opposition. When services are provided directly by the public sector, internal accountability systems are in effect. These include civil service rules; the experience, longevity, and political insulation of



government employees; and the political power of citizens, elected officials, and special interests (Hirsch and Osborne 2000). Under contracting, new formal systems of monitoring must be created. Without them, quality performance cannot be secured. Our results confirm the importance of public management and monitoring in the contracting process.

## CONCLUSION

Previous theoretical and empirical analyses, which view the government contracting process as a dichotomy between public and private provision and government and market failure, have failed to notice the phenomena of contracting back-in. We have explored why governments that contract out service delivery also contract back-in. We argue it is time to move beyond simple market failure and government failure frameworks and instead look at the full array of factors that influence government contracting behavior. Privatization is not a one way street. Government managers contract out and back-in as they seek to balance efficiency and voice within the constraints of local market contexts.

Local government service delivery is a complex process. Even when formal monitoring systems do exist, it can be difficult to specify the full range of service attributes or allow for sufficient flexibility to be responsive to a changing environment (Kavanagh and Parker 1999; Sclar 2000). Our results support critiques of the new public management by showing how government managers balance contract monitoring and citizen voice with principal agent problems and market structure to decide whether to contract out or back-in. Contracting back-in should be seen as another service delivery alternative in the array of alternative delivery choices (Warner and Hebdon 2001). It reflects governments' role in structuring markets for public goods and governments' primary responsibility to ensure quality and citizen voice in service delivery.

The new public management has been challenged for eroding the "publicness of public service" (Christensen and Laegried 2002, 291). Public choice theory offers markets as a mechanism to improve public service delivery, but we have shown that even under contracting, market solutions are not a substitute for government planning and management. The complexity of public service delivery, the limits of market approaches, and the need to engage citizens in the provision of public goods require governments to manage markets by contracting out and contracting back-in. Our analysis provides empirical support for the new public service that argues public managers do more than steer a market process; they balance technical and political concerns to secure public value. This emphasizes the importance of planning over markets.

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