

**Taking the High Road:
Local Government Restructuring
and the Quest for Quality**

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A full copy of this report and a searchable database of the case studies can be found at Professor Warner's Local Government Restructuring web site:

<http://www.crp.cornell.edu/projects/restructuring/>

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Executive Summary

All local governments face challenges to improve service delivery. This report outlines two alternative strategies—the "high road" which uses new management innovations to increase internal productivity, and the "low road" which focuses on downsizing and contracting out. While other studies have focused on contracting out, this study provides a longitudinal look at contracting and presents detailed case studies of municipalities, which have brought back in house previously privatized services. These case studies provide empirical evidence on the problems associated with contracting and the potential for internal restructuring as an alternative.

Contracting is costly. Research on problems with contracting out in the for-profit sector is shown to have parallels in governmental contracting. Difficulty of contract specification (especially for complex services), the cost and difficulty of monitoring contract performance, and limited cost savings are some of the problems that cause governments to bring previously privatized work back in house. Broader public values—responsiveness to changing citizen demands, maintaining high standards of public service delivery among the workforce—also can be compromised with privatization.

While competitive bidding is associated with some cases of contracting back in, for many governments' dissatisfaction with privatization was so strong that no effort was made to rebid the contract. In many of these cases new patterns of labor management cooperation within the public sector resulted in improved efficiency and service quality at lower costs than private contracts. Taking the "high road" of restructuring through improved labor-management cooperation can provide better quality service with fewer risks and greater social rewards. For those public officials who truly wish to "reinvent government" internal management reforms deserve a closer look.

Rapid changes in the economy on the one hand and the unrelenting demand for public services on the other have placed new pressures on all levels of government to "banish bureaucracy" and "reinvent" the public sector. Reinventing government is a noble and desirable goal, but many reform efforts have failed by focusing too heavily on downsizing the public workforce through the privatization of government services. While privatization can take many forms, the most common practice is for governments to "contract out" services to private organizations. In these situations the government continues to use public funds to pay for services, but the responsibility for production of the service is shifted to a private firm.

In some instances, privatization through contracting out is part of a larger ideological crusade to reduce the absolute size of government.[\[i\]](#) In other cases, contracting out is driven by management fads imported from the private sector, where the practice is commonly used but remains poorly understood.[\[ii\]](#) A third influence is the general shift in American society towards greater mistrust of government coupled with a renewed faith in the textbook model of free markets.[\[iii\]](#) When combined with advice from popular management books and magazines to become more "businesslike" in their

operations, many public managers find the lure of contracting out to be irresistible.

Are the proponents of contracting out right? To what extent have the economic and organizational benefits actually followed? This study attempts to answer these questions by looking at local governments' experiences with contracting in the United States. The report begins with a review of several academic studies that assess the impact of contracting out on individuals, organizations, and communities. Unfortunately, many of these studies show disappointing results with contracting out in both the public and private sectors. To better understand why contracting out often has not lived up to its promise, this report looks at several case studies from across the country where public officials have chosen to bring work back in house following a period of privately produced service. Finally, the report looks at one important but underutilized alternative to privatization, namely, the refashioning of labor-management relations through innovative "partnership" programs. These programs demonstrate that the efficiency of public services can be improved significantly through the use of internal management reforms. Given the risks involved in privatization, labor-management partnerships should be given priority over contracting out when public managers see the need to restructure local government services.

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Contracting out imposes high costs on individuals

Proponents of contracting out argue that both public and private organizations need to "cut the fat" and get "lean and mean" in order to survive.[\[iv\]](#) Given that most government services are labor-intensive, contracting out services provides government with an indirect method of reducing the number of individuals it employs directly. When hiring decisions are no longer in public hands, privatization allows contractors to use lower priced labor without having to adhere to civil service wage scales. Government-by-contract also permits greater flexibility in determining employment levels, work rules, and health and safety standards since private firms are often subject to less restrictive regulations than public entities.[\[v\]](#)

Increased flexibility, however, comes at a price. To begin with, contracting out imposes high costs on individual workers. The overwhelming majority of government employees are individuals who have performed well and played by the rules, but often pay dearly in the form of increased job insecurity and lower wages and benefits when work is contracted out to the lowest bidder.[\[vi\]](#) Furthermore, because of the specialized nature of many private contractors, workers' opportunities for advancement and training may decline as well. The janitor who works for local government may, over time, work her way up in the system via a series of vertical and horizontal moves through different departments. In organizations that specialize in just one service, however, those ladders of opportunity disappear for all but the most skilled employees.

Contracting out has society-wide consequences

Contracting out also imposes high costs on society. It is no secret that America's urban areas suffer from a host of serious social and economic problems, ranging from crime and unemployment to racial segregation and increasing class inequality. In a provocative and insightful essay published in the *Boston Review*, Daniel Luria, Vice President of the Michigan Manufacturing Technology Center, and Professor Joel Rogers of the University of Wisconsin contend that these unfortunate outcomes are the direct result of public policy choices that favor "low road" development strategies in response to new competitive pressures.^[vii] Low road employers compete by keeping costs, and therefore wages, as low as possible. When low road strategies dominate the local economy, economic insecurity, rising inequality, and poisonous labor relations often follow.

In contrast, "high road" organizations rely on better quality products and superior service to stay ahead of the competition. Management experts contend that emphasizing quality and service requires a well-trained and highly committed workforce in order to be successful. These organizational demands, in turn, translate into higher wages, cooperative labor relations, and more innovative and productive workplaces. In addition, high road employers attract superior quality workers and typically serve as better corporate citizens in the communities in which they operate.

While Luria and Rogers' research primarily looks at the business strategies of private companies, the same lessons apply to public sector employers as well. Governments, like private firms, also consciously choose to follow the high road or the low road when making employment and contracting decisions. Local governments can walk down either path, but the potential benefits to both the city and the community are vastly greater on the high road. Public officials who choose to follow the high road not only benefit directly from the efficiency gains that flow from high-performance workplaces, but they also benefit indirectly from the important social benefits that such a strategy produces. In general, high-road strategies are strongly associated with healthy and stable local communities. Strong communities, in turn, help to attract and keep the brightest people and the most dynamic businesses in the region.

Examples of how high road and low road strategies play out at the local level are presented in Boxes 1 and 2. In these cases, both New Orleans and Portland saved money by restructuring traditional service delivery methods. Portland's high road strategy, however, accomplished much more than simple cost savings. Building upon Portland's success in constructing a new baseball stadium, the city and its unionized workforce have been able to create a new level of trust and cooperation across a wide range of public services. In addition to reducing expenses, the introduction of innovative management reforms has produced major service improvements, has strengthened both management and the union, and has resulted in a far less adversarial bargaining relationship than had existed previously. In contrast, the New Orleans case vividly illustrates the dark side of low road management strategies. While New Orleans' strategy may have saved the city money, the negative impact of such a strategy on residents' quality of life far outweighs any cost savings that resulted from privatization.

The benefits of contracting out have not materialized

As the preceding discussion makes clear, the individual and social costs of contracting out can only be justified if such efforts lead to better quality and lower priced government services. Yet evidence from a broad range of studies suggests that public services do not substantively improve after contracting out.[\[viii\]](#) In an extensive review of empirical studies of privatization in the United States, for example, Professor George Boyne of Cardiff University finds that "only around half" of all studies are associated with lower spending and greater efficiency.[\[ix\]](#) Furthermore, Dr. Boyne finds that "many of the studies contain specific methodological flaws that cast doubt on the validity of the evidence on the impact of service contracts, and in some studies, the authors draw conclusions that are not substantiated by their own evidence."[\[x\]](#)

Professor Boyne's claims are substantiated by Professor Janet Rothenberg Pack of the Wharton School of Business at the University of Pennsylvania.[\[xi\]](#) In her research on fifteen cities and counties that had experimented with contracting out, about half of the places she studied had encountered "disruptive experiences" which included quality problems, attempts by firms to renegotiate or renege on contracts, and costly monitoring activities. Equally important, only half of the public officials she interviewed could continue to claim any cost savings from contracting out after just four years of privately provided service.

Researchers at Washington State University draw similar conclusions in their 1998 study of privatization by Oregon county governments.[\[xii\]](#) Looking at county governments' experiences with road maintenance and construction contractors, Professors Brent Steel and Carolyn Long find that 42 percent of counties experienced contracting problems. The most commonly cited problem in their study was the failure of contractors to perform work in a timely manner (100 percent of cases), followed by work not performed to specifications (50 percent), contractors' failure to communicate effectively with affected citizens (36 percent), change order problems (36 percent), and work area security and safety problems (29 percent). In addition to the problems associated with contracting out, the authors estimate that the cost of contract administration was in the 10 to 15 percent range, and that "savings, if any, from contracting out may be partially or fully offset by substantial agency costs associated with the contracting process, including the expense of preparing plans and specifications to a greater level of detail, the cost of advertising and processing bids, and the cost of monitoring, inspecting, and conflict resolution."[\[xiii\]](#)

Private firms also disappointed with contracting results

A common defense of privatization is that errors in implementation, not the concept itself, are to blame for failed privatization programs.[\[xiv\]](#) These kinds of arguments make it easy to claim that the blame for failed contracts still rests with government, and that the solution lies with increasing, not decreasing, the role of the private sector in government service provision. Has the private sector's experience with contracting out been any better? Because private firms also rely on outside contractors for a wide range of goods and services, their experience with contracting out deserves a closer look by public officials than it has received.

Large-scale studies of the private sector's experience with contracting out are rare, in part because private firms are not subject to the same disclosure requirements as public entities. A recent survey of over one thousand senior business executives conducted by the global consulting group PA Consulting, however, is telling: In that survey, only five percent of firms reported "high" levels of benefit from contracting out while suffering "low" drawbacks. The most common response, representing thirty-nine percent of the cases, had been 'mediocre'.[\[xv\]](#)

Academic studies of organizational performance provide some clues as to why contracting out in the business world has failed to live up to its promises. Because contracting out is a form of restructuring that often leads to reductions in personnel, its impact on organizations is similar to downsizing. Few would disagree with the proposition that both contracting out and downsizing result in shattered careers, broken friendships, and significant losses in investments in employee training and development. For these reasons and others, academic studies of downsizing hold valuable lessons for public sector managers considering contracting out.

The strong negative effect that downsizing through contracting out has on the morale of employees should not be underestimated. In a recent study published by *The Academy of Management Review*, Professor Wayne Cascio of the University of Colorado reviewed over five hundred articles on downsizing and interviewed twenty-five senior executives from business about their experiences.[\[xvi\]](#) A principal finding from this research, says Professor Cascio, is that "study after study shows that following a downsizing surviving employees become narrow-minded, self-absorbed, and risk averse. Morale sinks, productivity drops, and survivors distrust management. In fact, this constellation of symptoms is so common that it has taken on a name of its own: *survivors' syndrome*."[\[xvii\]](#) Given the impact of downsizing on employee morale, it should be expected that performance rarely meets the company's expectations. According to 1998 survey results from the American Management Association, only 41 percent of downsizing companies reported productivity increases, and only 37 percent have realized any long-term gains in shareholder value.[\[xviii\]](#)

According to Professors Susan Reynolds Fisher and Margaret White, such disappointing results can be explained by the damage caused to an organization's "learning capacity" when an individual leaves the firm.[\[xix\]](#) Fisher and White believe that an organization's capacity for innovation and development is derived from the day-to-day interaction between employees working on common problems. The contribution of these informal networks to the health and vitality of the organization is significantly

greater than that implied by a simple head count, the authors warn, and hence managers should be wary of any restructuring effort, including contracting out, that threatens these crucial networks.

This issue is well illustrated by recent research by Dr. Chris Lonsdale and Professor Andrew Cox of the Center for Strategy and Procurement Management at the University of Birmingham, England.^[xx] Lonsdale and Cox believe that contracting out invariably leads to a loss of cross-functional contact between departments. "When a contract company is operating away from the firm's site there can be a loss of profitable contact between that function and others which relate to it," they argue. "While this can be addressed, many firms report that contract employees are rarely as prepared as in-house colleagues to go beyond their immediate remit and take the time to work out ideas which may be of benefit to the firm as a whole."

A further issue that Lonsdale and Cox raise is the effect that the limitations of a manager's own knowledge and competence can have on an outsourcing deal. For example, when a service is provided in-house certain aspects frequently are provided by employees in other parts of the organization, and consequently often are not recognized explicitly in the contract agreement. This oversight commonly leads to a host of additional charges not built into the original cost estimates. In one example, the authors tell the tale of a petroleum firm that was charged nearly \$500,000 in excess fees in the first month of its information technology contract because the company had wrongly assumed that these services were included in the original contract price.^[xxi] Stories such as these should not be surprising, the authors caution, because contracting is the core competency of many of the vendors that organizations must deal with. Since contracting is a primary focus of their business, these companies have learned to write contracts that shift most of the risk onto the purchaser of the service.

In summary, contracting out government services imposes high costs on individuals, local governments, and communities. In spite of these high social costs, the efficiency gains from contracting materialize only about half of the time. Furthermore, the private sector's poor record with contracting suggests that such lackluster results are unlikely to improve as public managers gain experience with administering private contracts.

In contrast, using high road strategies to reform public bureaucracies often results in improved governmental efficiency, but does so without the negative consequences that result from contracting out. Across the country, high road strategies are becoming more common as public bureaucracies borrow from new management models such as Total Quality Management (TQM) and labor-management cooperation programs in order to improve organizational performance. According to *Working Together for Public Service*, a major report published by the U.S. 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.^[xxii] Similar positive results have been reported by the International City/County Management Association (ICMA) in its study of TQM programs in local government. In that study, the overwhelming majority of governments surveyed reported strong positive results from quality improvement programs, as Table 1 shows.^[xxiii]

"Contracting back in" an important trend in public service provision

New survey evidence shows that public officials are starting to learn that privatization has its

limits. While contracting out continues to be widely used by many local governments, the practice of "contracting back in"—where governments choose to resume in-house production following a period of privately produced service—is becoming increasingly common.

The most complete source of data on contracting arrangements of local governments is provided by the International City/County Management Association (ICMA). Every five years, the ICMA surveys all counties with more than 25,000 residents and all cities with populations greater than 10,000. In addition a sample is drawn from one in eight cities and counties with fewer than 10,000 residents. On average, 1,500 municipalities respond to the survey. This survey provides a very comprehensive view of the complex mix of services offered by local governments, with questions asked for sixty-four different public services.

By matching responses from different survey years, our research team has been able to determine the degree to which local governments both contract out services to private providers as well as the frequency of contracting back in.^[xxiv] Using ICMA data we found that on average across all responding municipalities, eight services were newly contracted out between 1992 and 1997. The more interesting finding, however, was that on average five services were brought back in house during this same period. Hence while these data show that contracting out is still a common practice across the country, dissatisfaction with contracting out is widespread and causes local governments to bring services back in house.

Why do local governments choose to bring work back in house?

That so many local governments bring work back in house implies that contracting out as a model of public service provision has its own set of problems that its proponents have either underestimated or ignored. Yet the survey data alone do not tell us why governments choose to resume public production of services. To better understand the nature of contracting back in and the factors associated with it, a series of telephone interviews was conducted with public officials from across the country between June and August 1999. The case studies from those interviews are reprinted here as Appendix A.

Methodology

Using the ICMA data as a guide, local governments were selected for interviews based on a population of greater than 30,000 residents, six or more cases of contracting back in, and at least one case of contracting back in for service areas where union membership is strong. A small number of additional cases were chosen based on leads from union members or newspaper clippings.

Most of the interviews were with the city or county manager for that municipality. On several occasions follow-up interviews were conducted with department heads or directors of specific programs in order to develop a more detailed understanding of a particular program or service. Local union officials also were interviewed in a handful of cases. Interview times varied from ten minutes to about one hour.

In total, public officials from fifty-eight places were interviewed. Those interviews produced twenty-six cases of contracting back in from twenty-two different places (see Table 2). While these cases do not provide a large enough data set to generalize the findings to the larger population, the cases can help us

to understand the rationale behind contracting back in, as well as provide clues on the efficacy of privatization as an alternative form of public service delivery.

The bulk of the cases of reverse privatization represent the typical kinds of blue-collar work most often cited as good candidates for contracting out. With the exception of public works, wastewater treatment, and fire services, the remaining cases consist of the types of services for which private sources of production are relatively common. In most areas these services can easily pass the "yellow pages" test in which a number of local private firms can be found that offer similar services.^[xxv] It should not be surprising that the cases here represent services that are typically thought of as prime targets for privatization. Since these are the kinds of services that are most often contracted out, it follows that they have a higher probability of being brought back in as well.

A useful way of classifying the cases is to divide them according to the process by which local government resumed public service production. In nine cases contracting back in was the result of public employees submitting the winning proposal in a competitive bidding process. On twenty occasions work was brought back in house due to problems with the private contractor. Often the two categories overlap. For example, it is not uncommon for public agencies to win competitive service contracts following a failed privatization attempt. The more typical scenario, however, is for government officials to take over the service without initiating a new round of competitive bidding. In fourteen cases, it was clear to local government managers that the service could be produced more efficiently in house, thereby making competitive bidding unnecessary.

Contracting Back in Due to Failed Privatization

In the cases presented here, failed privatization was the most important reason for contracting back in. In these instances the work is brought back in house due to problems associated with the service provider or with the contracting process. Rather than return to the market and initiate a new round of competitive bidding, public managers caught in these situations feel that problems with service delivery are rooted in the contracting process itself. Because these kinds of problems can not be solved by private means, public officials choose to rule out privatization as a viable alternative and resume public production of the service.

Every case that chose to bring the service back in house without resorting to competitive bidding reported significant contracting problems. Yet even for those places where competitive bidding was used (and the contract awarded to public employees) problems with private contracts still played a role in five of nine cases. While it is difficult to generalize from such a small sample, there appear to be serious problems with contracting out. The analysis below looks at a number of the case studies to better understand how and why contract problems arise and, more importantly, why public production is chosen over competitive bidding for specific services.

Contracting Issues

Private sector models of contracting out provide a useful framework for understanding governments' decisions to produce services in house. 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, this approach also recognizes that cost estimates include more than just the monetary value placed on a good or service. In particular, this model employs the notion of “asset specificity” to incorporate the many non-tangibles that go into the decision to contract in or out.^[xxvi] Asset specificity refers to the degree to which the investments associated with production are unique to the parties involved in the transaction. Investments with a high degree of asset specificity are highly specialized and normally have few alternative uses. Examples include “hard” goods such as complex machine parts or custom-made computer programs, but “soft” goods like industry-specific knowledge and relationships with customers and clients fall into this category as well.

A high level of asset specificity decreases the probability that an external supplier will be able to produce a particular good or service in a cost-effective manner. Because of the inability of both the buyer and the seller to accurately specify what, when, and how certain functions are to be carried out, costs associated with monitoring quality often outweigh any savings that accrue from external production.

These problems are magnified in the public sector because of the multiple purposes and goals associated with public services. While it is relatively easy for a buyer to recognize a high quality pencil or machine part, judging quality becomes much more subjective when complex services are involved. Even for the cases presented in this study, where most of the services are simple, ubiquitous, and relatively easy to specify, numerous examples exist where conflicts arose because of the difficulties associated with specifying the service.

While evidence from some of the cases suggests outright abuse by the private contractor—such as the Iowa laundry service that charged its public sector customer based on the weight of the laundry when it was wet, not dry—other cases highlight the importance of clearly defined contracts. In Lubbock, Texas, for example, a private trash hauler attempted to renegotiate its contract because the weight of the trash it collected was greater than the company anticipated. Heavier loads meant that 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 serves as a more complex example of the difficulties involved in specifying contracts. In Irvine, public officials attempted to privatize its care management program in 1995. With about one hundred 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 spite of 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, difficult to administer, and that performance would be judged largely on community perceptions rather than tangible results. This created a sense that the cost to administer the program would grow far beyond

the ability of the contractor to manage the program within the available budget. Unable to attract qualified contractors, department administrators instead chose to keep the service in house.

A related problem is that the contract language may be over-specified. Under these circumstances, contract language may be too specific to allow government to satisfy the changing needs of citizens. 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.

Another issue that is well illustrated by the Moore, Oklahoma case is the problems that occur when a single contractor is responsible for a complex basket of services. In Moore, one company was responsible for streets, drains, parks, cemeteries, building maintenance, sanitation, fleet maintenance, animal control, wastewater treatment, water and sewer line maintenance, and water meter reading. The sheer size of this contract made it exceedingly difficult for public officials to monitor service levels and quality.

Given the complexity involved in specifying contract arrangements it should not be surprising that the costs associated with monitoring contracts has been shown to be quite high.[\[xxvii\]](#) The more typical scenario, however, is for governments not to do any monitoring at all. In our research team's analysis of ICMA survey data on the subject, we found that more than half of the governments that contract out do not have any formal procedures for monitoring contract arrangements.[\[xxviii\]](#) Not monitoring contracts significantly increases the chances that either costs increase or quality suffers—or in some cases, both problems may surface. On the other hand, places that do take monitoring seriously may find that the cost of monitoring contracts equals or surpasses any anticipated savings from private service delivery.

More than one respondent from the case studies indicated that in house production was resumed because of the high costs of monitoring private contracts. In Pinellas County, Florida, for example, the county terminated its contract for grass mowing at 360 water pumping stations because of its inability to control service quality. "Servicing so many remote locations made it very difficult to monitor service quality, says the County Administrator, "so for this service it made more sense for the county to do the job."

City officials in Campbell, California report similar problems. In Campbell, the city contracted out its park maintenance functions in the early 1990s as a way to cut costs. After two years with the private contractor, however, the city chose to bring the work back in house following numerous complaints from city residents about service quality. Having residents complain to the city rather than the contractor resulted in significant time and resources being wasted by city employees. Not only were city employees required to handle residents' complaints, they then had to visit the park in question to check up on the contractor's work, contact the contractor to inform him of the problem, and finally revisit the park to ensure that the work had been re-done properly. Given that the number of complaints was significantly higher than when public employees did the job, city supervisors quickly grew tired of the extra burden created by the contracting process and brought the work back in house.

Park maintenance has remained a publicly provided service in Campbell since 1996. According to City Manager Bernie Strojny, city workers provide better service because they possess a sense of ownership that is unique to public employees. "City employees invest more," he says, "because they genuinely care

about the place they work at." In contrast, city properties are just one of many locations that the private contractor serves, which Strojny believes contributes to the contractor having less of an interest in service quality.

In both Pinellas County and the City of Campbell monitoring costs were high because public officials found themselves constantly "putting out fires" that had been "lit" by the contractor. Both places were lucky, however, in that the service in question was relatively easy to monitor by area residents. In these cases, citizens are able to serve as reasonable substitutes for direct monitoring by government. The public sector is not so fortunate, however, when service quality cannot be observed directly and citizens are unable to play the watchdog role. This was the case in Savannah, Georgia, where fire services had traditionally been provided by both the City of Savannah and South Side Fire Protection, Inc., a non-profit fire department that provided firefighting services to about one third of the city.

South Side Fire consisted of a mix of volunteer and professional staff and had served Savannah's southern neighborhoods for decades. When the city annexed South Side Fire's service area in the 1970s, the company continued to provide fire services to this part of the city. As Savannah continued to grow, concerns were raised about the differences in service quality between the City of Savannah Fire Department and South Side Fire. Whereas previously the South Side consisted mainly of single family housing, over the years the South Side grew to include a number of large retail and office complexes. Responding effectively to these types of calls required a different method of firefighting than what South Side could offer. The number of city firefighters responding to calls was always the same, for example, whereas the number of South Side volunteers that responded to calls varied at each event. Over time the city increasingly became concerned with service quality and response times on the South Side. Tellingly, one of the most vocal proponents for change was the city council representative from the South Side, who argued that the quality of service was inferior to that offered by the city.

Conflicts over what should be considered quality service were only half of the problem. Just as important, the cost of the service had risen significantly over time. The city found itself paying for equipment and stations "over and over again," and the company would increase its charges to the city on a yearly basis. The extent to which South Side fire was overpriced relative to the city was made clear when City Council decided to bring the service in house in early 1998. In a last-ditch effort to save its business, the company offered to provide the service at a significantly lower price than what it was currently charging. This sudden drop in price only angered city officials, who wondered how much, and for how long, this "non-profit" organization was overcharging them.

In sum, the Savannah case makes clear the difficulties associated with contract arrangements where service quality is hard to monitor and the true costs of the service are difficult to quantify. But even in other service areas where quality and price considerations are easier to measure, the time and resources spent on monitoring can still be significant. The degree to which these additional costs outweigh the potential efficiency gains of private production is an empirical question that can only be answered on a case-by-case basis. The evidence presented here, however, suggests that these costs are often considerably higher than most governments anticipate.

Economic and Market Issues

Much of the preceding analysis presumes that, contracting costs aside, privately produced services are cheaper. Indeed, lower costs were the primary reason most governments in this study choose to contract out in the first place. Lower costs, however, usually resulted in lower quality services as well. Research by Harvard University Professor John Donahue suggests that much of the cost savings from privatization come from local governments choosing to follow low road economic strategies that rely on the lower priced labor of private firms.^[xxix] If we make the reasonable assumption that lower priced inputs result in lower quality outputs, then it should not be surprising that service quality was a major problem in a majority of the case studies.

In both Charlotte, North Carolina and Fort Collins, Colorado local governments ended private contracts for paratransit service for the elderly and disabled because of service quality problems. In Charlotte, the taxi company responsible for the service was not accustomed to working with disabled clients, and drivers viewed city charges as less desirable passengers compared to other customers. The program was plagued by similar problems in Fort Collins, where users of the service often complained about the lack of courtesy on the part of drivers. Additionally, the private contractor had numerous problems attracting and retaining quality employees, resulting in unreliable service.

The City of Whittier, California, attempted to privatize its public bus service in the early 1990s. At the end of the five-year contract, however, the city chose in house production over a new round of competitive bidding, citing poor service quality as the primary reason for the switch. The city received numerous complaints about dirty buses and unqualified drivers. Equally important, the expected cost savings from privatization quickly disappeared because of significantly higher accident rates and greater than expected costs for vehicle repairs.

The above examples of privatized transit service all relied on lower priced labor to minimize costs. Yet, in every case the low cost option proved to be unsustainable over the long run. Either quality levels slipped to such unacceptable levels that the service was no longer a benefit to citizens, or else the problems resulting from low cost provision (e.g., higher accident rates and increased liability claims) effectively erased any financial benefits from private service delivery.

An important related issue is the degree to which local governments can accurately judge when private service delivery is cheaper. Anecdotal evidence from the case studies suggests that pricing contracts is more art than science. This should not be surprising given the uncertainty that surrounds contracting, but what is surprising is the degree to which contract bids vary. In Charlotte, North Carolina, for example, bids on paratransit service ranged from \$12.60 to \$20.49 per trip. In Lubbock, Texas, 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 percent.

Figures like these suggest three things. First, sufficient competition is critical to cost savings when competitive bidding is used. Second, it is imperative that local governments who use competitive bidding allow public departments to participate in the bidding process so that costs can be properly benchmarked. Finally, if a public service is privately provided, it is crucial that public officials pay close attention to monitoring the price, quality, and quantity of the contractor's work throughout the term of the contract. The following section examines more closely the cases that involved competitive bidding.

Contracting Back in Due to Successful Competitive Bidding

A key variable for explaining the likelihood of contracting back in is whether or not public employees are allowed to bid against private providers. Quantitative analysis of US Census data from 1987-1992 shows that the presence of unionized employees increases the probability of contracting back in. [\[xxx\]](#)

This finding suggests that unionized workplaces are more likely to have the right to submit contract proposals, but bidding rights for public employees are increasingly common in non-unionized settings as well. [\[xxxii\]](#)

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.

Other places view the bidding process differently. In Charlotte, North Carolina, it is the norm for public employees to 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. Cases where services are kept in house are viewed as "victories" for the city, and are a source of pride for public employees.

A third example of how the bidding process works can be found in Lubbock, Texas. In Lubbock residential trash collection is subject to competitive bidding, and public employees are encouraged to bid for the service. What makes Lubbock different than most places, however, is that only one third of the service is put out to bid at any given time, and the City would never choose to privatize the whole service. "We would always keep at least one third of the service in house," says Mildred Cox, the Director of Public Works. "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."

Taking the High Road Through Public Sector Innovation

The fact that government departments often win competitive contracts highlights the ability of the public sector to improve efficiency through the use of high road management practices. There is ample room for increased efficiency in public provision so long as employees are empowered to make decisions on how the service should be delivered. By drawing on the expertise of front line workers, innovation in the design of work leads to significant cost savings. Theories of organization development concur that line

employees often know how to do their jobs best, and will excel at what they do if given the chance by management.^[xxxii] For public employees dealing with complex services and the need to keep a wide array of constituents satisfied, this is even truer.

Many of the cases of contracting back in were tied to process improvements in public management. As such, they demonstrate 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 over \$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?" asks 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."

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 gainsharing program for its employees that resulted in savings of over \$160,000 in 1998. Half of this money will be divided equally among the department's employees, which amounts to an annual bonus of \$1,600 per employee, or about seven percent 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 "helps 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." In addition to the co-chairs, the committee consisted of a supervisor, division manager, and four crew members. Each committee member is encouraged to participate fully in the development of the proposal, and any member has the right to veto elements of the plan that they don't like. "All it takes is one 'no' vote and the project stops," says Dunn.

The CALM committee won the contract by submitting the lowest cost 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 over three and a half miles of pipe, compared to an average of just one mile of pipe for privately-run crews.

The above examples clearly demonstrate that the public sector can be as effective if not more effective than firms in the private sector doing similar work. In every case, the key to public sector success is empowerment. When workers are provided the tools and the resources necessary to bring about change,

innovative policies and programs often follow. Privatization and empowerment, however, are rarely compatible. When employees are mistrustful of management, when job security is uncertain, and when departments see their colleagues' jobs sold to the lowest bidder, convincing workers to "buy in" to *any* new program is a daunting task.

Conclusion

The evidence presented here indicates that the contracting process is rarely as smooth as its proponents claim. Often poor results were due to the inability of either governments or private contractors to clearly communicate their expectations to each other. On other occasions, disappointing results were the outcome of one party or the other underestimating costs or overestimating savings from privatization. For a third group of cases, contracting back in was not the result of failure on the part of private firms, but rather successful innovation by public employees.

The latter findings suggest that taking the high road, in the form of TQM or labor-management cooperation, can provide equal or better quality service as the best private firms, but do so with fewer risks and greater social rewards. For those public officials that truly wish to "reinvent government," internal management reforms deserve a closer look than they have been getting.

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