Taking a Pragmatic View of Privatization

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The collection of articles on privatization published in the Winter 1997 issue of Popular Government is a welcome departure from the customary debate on the topic, tinged as that debate often is with ideological overtones that cloud managerial issues and on occasion even distort the truth. It is not that framing privatization in ideological terms is necessarily shallow or inappropriate. Clearly the topic has plenty of grist for the ideological mill. It is simply that a more pragmatic view of privatization, with few overtly ideological leanings, deserves to be aired as well. Overwhelmingly the Popular Government articles reflect such a view.

A Balance of Ideological Perspectives

None of the articles tout privatization as a panacea. None proclaim the superiority of corporate management or the private-sector work ethic. Instead, they collectively describe privatization’s promise and pitfalls. They describe noteworthy successes in privatization and acknowledge some failures as well. They offer suggestions for successful privatization, but they neither imply that privatization will be simple nor disregard the sensitive issues that it almost inevitably evokes.

The debates that take place in city halls, county courthouses, and legislative chambers are often dominated by perspectives that contrast sharply with one another and rest on preconceived notions regarding the presumed superiority of one sector’s skills or the other’s motives. When the argument pits privatize-as-much-as-possible zealots against their privatize-nothing opponents, more pragmatic views sometimes are shoved to the sidelines.

Wherever the role of government extends beyond the delivery of routine public services, the issue of privatization is apt to become especially murky. Debate shifts from questions of practicality and potential economic gain to questions of propriety (for example, in discussions concerning privatization in law enforcement and criminal justice).

Some of the most ardent foes of privatization, including public employee unions, challenge the appropriateness of privatizing any public service. Theirs is an ideological argument. Staunch opponents of privatization depict private contractors in unflattering
terms and caution decision makers against embarking on that course. They warn that it is a dead-end trail, rife with corruption, exploitation of employees, uncaring attitudes in service delivery, and corner-cutting practices that compromise workmanship for the sake of profit.

A pragmatic public official would be ill-advised to ignore warnings of corruption, exploitation, unresponsiveness, and shoddy workmanship in contracted work, because each of these can happen. The potential benefits of privatization, however, warrant something more than outright surrender to the assumption that undesirable results are inevitable.

Humorist Mark Twain once wrote about a shortsighted but adamant and unrelenting response to an unpleasant event:

We should be careful to get out of an experience only the wisdom that is in it—and stop there; lest we be like the cat that sits down on a hot stove-lid. She will never sit down on a hot stove-lid again—and that is well; but also she will never sit down on a cold one any more.¹

The trick is to learn how to recognize the difference between a hot stove-lid and a cold one—or, better yet, to figure out how to control the stove's temperature. This article suggests precautions that local government officials might take to maximize their satisfaction with privatization. Also, it offers some insights into privatization's allure and some observations about privatization's track record.

Reduction of the Burn Potential

A pragmatic view of privatization recognizes that the "burn potential" from contracting is greater in some functions than in others. The official who weighs the potential risks, great or small, against the anticipated benefits and decides to proceed is wise to take steps to minimize the likelihood of adverse consequences from privatization—in other words, to regulate the temperature of the stove—even if the burn potential is slight. Truly pragmatic officials recognize that the potential benefits of privatization are not automatic but must be earned through careful administrative action at every step. They realize that poorly developed contracts or poorly monitored contractors may produce the unsavory results that opponents of privatization predict, but they also know that public agencies are hardly immune from the array of shortcomings attributed to contractors, even if their lapses into uncaring attitudes and shoddy workmanship are not inspired by the profit motive.

What steps can lessen a government's chances of an unsatisfactory experience in service contracting? The fundamental precautions reduce to five:

1. Be sure that more than one vendor wants the business. Multiple bidders are likely to keep one another honest in their tactics and their pledges, and competitive in their bids. Unless several vendors will still be interested when the contract term expires, the government may find itself vulnerable to price escalation, declining responsiveness, and other characteristics commonly associated with monopolies.

2. Follow bid procedures precisely whenever they are required, and interject competition at other times too. Local governments should adhere carefully to legal requirements governing advertisement, sealed bids, and other procedures, as well as any local regulations supplementing these safeguards. Most provisions are designed to ensure fair competition and reduce the possibility of corruption. Although local governments in North Carolina are not required by state law to seek competitive bids for most services,² they may find that competitive procedures are beneficial, even when self-imposed.

3. Specify expectations and standards for service clearly and completely. The invitation to bid and the contract itself should clearly state the requirements for performance and the standards that will be applied to judge the adequacy of performance.

4. Establish penalties for nonperformance. Local governments should require performance bonds for major contracts to protect themselves in the event of a contractor's failure. In addition, the contract should specify penalties for substandard performance. Some governments might consider offering incentives to contractors to exceed minimally acceptable levels of performance.

5. Monitor a contractor's performance carefully. Local governments should establish procedures for monitoring a contractor's performance to be sure that desired results are being achieved.

These five steps address in only a general way the more detailed prescriptions available to officials who plan to contract for government services.³ A good strategy would be based on these fundamentals but would also draw on the detailed prescriptions.
A Choice of Mechanisms, Not an Abdication of Duty

As Bluestein and Gray⁴ and others⁵ point out, service provision and service production are separable elements in the chain of service delivery. “Provision” is what governments do when they decide what services citizens will receive, prescribe the quality of the services, and collect the revenues necessary to pay for them. In other words, a government provides for a service if it arranges for that service to be received. “Production” is the actual delivery of the service.

A government may arrange for a service and choose to deliver that service using its own employees, thereby handling both provision and production. That is the traditional route for many government services. On the other hand, a government may specify the level and the quality of a desired service and collect the revenues necessary to pay for it but arrange for the actual delivery of that service by another entity, perhaps another unit of government, a not-for-profit organization, or a private, profit-seeking contractor. In its most extreme form, privatization removes government from both provision and production of services—in essence, taking government out of the picture altogether. More customarily, however, the term refers to something less extreme. In the United States, privatization generally refers to the delivery of public services by a private company under contract with a unit of government.

The popular book Reinventing Government asserts that the difference between service provision and service production is the difference between steering and rowing. In describing this difference, the authors draw on the work of E. S. Savas, a staunch advocate of privatization. Savas notes, “The word government is from a Greek word, which means to steer. The job of government is to steer, not to row the boat. Delivering services is rowing, and government is not very good at rowing.”⁶

Savas’s harshness aside, his contention underscores the fact that the role of service provider can be separated from that of service producer. A decision to privatize the rowing, however, neither relieves the government of ultimate responsibility for a given function nor removes its liability. In other words, contracting for a service in hopes of shifting the responsibility to an outside company is a misguided move; it will not bring that result politically or financially. Disgruntled service recipients will and should continue to call the government if a contractor fails to satisfy their complaints. Legal actions may now target the contractor but will not necessarily exclude the government.

Contracting for a service does not wash the government’s hands of responsibility for a given function or service. It is not an abdication of duty. It is simply a choice of one mechanism of service delivery over another.

The Allure of Contracting

Apart from contracting’s ideological appeal to many proponents of privatization, its allure is that in some instances it may be an avenue to quality services at a lower cost than government employees can achieve. This is sometimes the case but not always.

Case studies touting contracting successes are often less equivocal. Many suggest, perhaps even declare, that contracting is a better choice every time. A collection of pro-contracting case studies can be rather persuasive.

Matters are not quite that simple, however. A further search of case studies usually uncovers at least a few examples that go the other way, proclaiming the success of decisions to turn over to public employees services that were previously performed by contractors. The change is declared to have improved services while saving dollars.

How can such disparate findings be possible, and what guidance can a public official hope to gain from them? Two lessons are embedded in the seemingly contradictory evidence of case studies.

The first lesson is that a good contract operation can probably beat a poorly managed in-house operation, and a well-managed in-house operation can probably beat a poorly managed or exorbitantly priced contract operation. Case studies are rarely random. The most interesting cases describe dramatic results, the kind that are most likely when the need for improvement is greatest. A good operation, whether in-house or contractual, is less likely to be targeted for change than one that is struggling. A change from a poor example of the current mode of operation—either in-house or contractual—to a good example of the other mode will produce the dramatic results that make a good story.

The second lesson flows from the first: do not place too much faith in isolated studies focusing on single jurisdictions. They can be misleading. It is unwise to abandon a good contract on the strength of a case study touting an in-house success. It is equally unwise to get caught up in the wave of enthusiasm for priva-
tization and abandon a good in-house operation. On the other hand, a viable option exists if the current mode of operation is unsatisfactory.

Studies of service contracting that encompass more than one jurisdiction are less vulnerable to misinterpretation than case studies of a single jurisdiction because they are more likely to include data from contract and in-house operations that reflect good, average, and poor examples of each mode. Their results are usually expressed as “tendencies,” in acknowledgment that all examples of one mode of operation are not superior to every example of the other mode. Almost always, some cases will defy the general tendency.

Broad-based studies, though sometimes producing less dramatic results than single-jurisdiction studies, have generally contributed to the allure of privatization, for some of the most rigorous ones have yielded results favoring contractual arrangements for service delivery. In a famous study conducted at Columbia University two decades ago, researchers found the collection of solid waste by municipal crews to be, on average, 35 percent more expensive than collection by contract haulers. Why? The primary explanations were these:

1. Municipal sanitation departments tended to use more crew members to perform a given amount of work.
2. Municipal workers tended to have more absences.
3. Municipal departments tended to use less productive vehicles and serve fewer households per hour.

Another frequently reported study of multiple jurisdictions—a federally funded comparison of contract and in-house operations in southern California cities in the mid-1980s—discovered substantial cost savings in contractual arrangements for seven of the eight services reviewed. In-house municipal operations were more costly for street tree maintenance by an average of 37 percent, for turf management by 40 percent, for refuse collection by 42 percent, for street cleaning by 43 percent, for traffic signal maintenance by 56 percent, for janitorial services by 73 percent, and for asphalt overlay construction by 95 percent. Only for the function of payroll preparation did the analysts find no significant cost difference between municipal and contract services.

How were the contract operations able to post such impressive numbers? It was not because of poorer service quality, lower wages, or fewer fringe benefits—reasons that many would suspect. In fact, the analysts found the service quality of contract operations to be approximately equal to that of in-house operations, average monthly salaries of contract employees to be slightly higher than those of their municipal counterparts, and average expenditures per employee by contractors to be slightly greater for benefits such as retirement and insurance. The favorable cost figures for contract operations were better explained by the following:

1. Workers employed by contractors worked more days per year than municipal employees did.
2. Contractors were more likely to use part-time labor and to employ younger, less-tenured workforces.
3. Contractors were more likely to use the least-qualified personnel capable of doing the job (that is, contractors were less likely to use over-qualified workers).
4. Contractors’ first-line supervisors were more likely to have hiring and firing authority.

**Competition as the Key**

Countless case reports and, what is more important, several broad-based studies have shown private contractors to be capable of producing public services at savings—sometimes substantial ones—compared with production by municipal forces. Does this reflect an inherent superiority of the private sector for service delivery? Probably not.

The magic of privatization is competition, not some mystical quality with which all private-sector organizations are imbued. Many private-sector businesses fail each year. Competition weeds them out and forces the survivors to get better and better in order to meet the challenge of new contenders for market share. Competition encourages innovation and aggressive management practices.

Not all businesses, however, operate in a competitive environment. Some enjoy monopoly status, free from the pressures of competition. Companies that do possess monopoly status are rarely singled out as paragons of efficiency and responsiveness.

Most government services also operate in a monopoly environment. Apart from moving to another jurisdiction, service recipients confronting inadequacies can only register their complaint, try to coax the
responsible department to improve, or run for office. They cannot simply reject the current offering and switch to a competitor’s product. Given that most government services are monopolies, it should not be surprising when government departments behave like monopolies. The ramifications of such status and behavior can be significant. Monopolies, whether corporate or governmental, have fewer pressures to be innovative, to be cost-sensitive, and to remain responsive to their customers.

Some governmental units have been jolted out of their monopoly status, simply stripped of their service delivery role without recourse or thrust into competition to fend off outside vendors, sometimes through a bidding process. When forced to compete and when provided with the tools and the flexibility to compete, governmental units often have fared reasonably well. For example, when the city of Phoenix divided that community into several refuse collection zones and forced the sanitation department to bid against private haulers, the department performed poorly at first and lost the bid for zone after zone. It responded to the challenge, however, by upgrading its equipment, improving operating practices, and revising accounting methods. In time it won back the business that it had lost.

The story has been much the same for the cities of Charlotte, Indianapolis, Milwaukee, and San Diego and other units of government that have been given not only the challenge of competition but also the flexibility to respond on a level playing field. In Charlotte, for example, when the operation of a pair of water and wastewater treatment plants was put out for bid, seven international competitors plus a team representing the city of Charlotte and the Charlotte-Mecklenburg Utility Department responded. Even in the face of stiff competition, the Charlotte team won the bid with a package that relies on management practices common in competitive environments but decidedly uncommon in state or local government. Among the incentives for cost savings, for example, is the promise of “gainsharing bonuses” (shares in the savings) for employees if service quality meets expectations and costs come in under budget.

A unit of government that feels no sense of competition is likely to behave like a monopoly. Why shouldn’t it? Its customer base is assured. Its market share is 100 percent. To a large degree, it can define the quality of service and the level of efficiency that its customers must accept.

By the same token, if a vendor has no competitors eager to replace it at the first opportunity, turning over the production of a service to that vendor merely replaces a public-sector monopoly with a private-sector monopoly. The results are unlikely to be much better and may be much worse. The key is competition.

### Contracting as an Option

Blanket prescriptions about contracting are risky. It is one option for getting the job done. It may be the best option in some situations but a poor choice in others.

After examining a host of privatization studies conducted over the years, John Donahue of Harvard University refrains from too much generalization: “To ask whether bureaucrats or private contractors perform better in general is as meaningless as asking whether, in general, an ax or a shovel is the better tool. It depends on the job.”

Private contractors are a good option when the contracted service can be specified clearly and completely, the government is fairly flexible on methods of service delivery, multiple vendors are eager to secure the business, and performance can be monitored easily. They are a less suitable option when those conditions do not exist.

Even when conditions are favorable for contracting, however, that option is not necessarily the best choice in every case. A public-sector unit that is aggressively managed and granted the flexibility to operate in a truly competitive fashion may be able to outperform or at least match its rivals. Harvard’s Donahue notes that although the question of “public versus private” does indeed matter, the question of “competitive versus noncompetitive usually matters more.”

For the pragmatic official, the objective is service that meets prescribed levels of quality at a good price. Privatization is one route for getting there but not the only route. Competition, a consistently successful avenue to the twin objectives of good quality and good price, does not necessarily exclude the public sector.

Making competition rather than privatization the centerpiece of a strategy to improve performance has two positive effects: First, it puts operating officials on notice that the days of a monopoly mindset are over. The private sector and other units of government are options for service delivery that can and will be considered. Second, it announces the government’s intention to provide efficient services but does not presuppose
that the private sector is a superior agent for service delivery or that government employees are incapable of competing with business. It simply declares that the services produced by government employees must be competitive in cost and quality if those employees are to retain their service delivery role.

Delivering a challenge to public employees to meet ambitious service expectations—to be the best at what they do—in some cases may imply dissatisfaction with current performance. However, the effect on morale is likely to be far less damaging than that of a program that seemingly has given up on public employees and has the clear intent of turning operations over to the private sector. When given a fair opportunity and sometimes increased managerial flexibility, public employees have shown an ability to compete successfully. That is why city officials in Charlotte and Indianapolis, two municipalities considered to be among the leaders in contracting for local government services, prefer to label their efforts as a quest for competition rather than a drive for privatization per se.

The market can infuse competition into a public service where it does not exist otherwise. When that happens, the government and its service recipients gain certain advantages but lose something too. According to Donahue, they gain “the cost discipline of competition and the benefits of accelerated innovation” but yield “control over methods and the right to change mandates as circumstances require.” Some governments have discovered ways to achieve most of the former while relinquishing less of the latter.

One way for government to infuse competition into the delivery of public services without abandoning the production role altogether is to divide the task geographically or in some other meaningful manner and award contracts for some zones or tasks while retaining others for service by a slimmed-down public-sector department. The government retains the capability of service delivery and a greater degree of flexibility to respond to events that have not been anticipated in service contracts. Simultaneously it gains the benefits of market discipline not only in the zones served by contractors selected following a competitive process but also in the zones adjoining them, where its own employees operate. Because the government can compile performance and cost statistics for each service zone, it gains a measuring stick for evaluating the performance of every service producer.

Several cities have operated competitive systems—that is, municipal employees serving some zones for a given function and contractors serving others—for many years. A 1995 study reviewed cost statistics for five cities with long-standing competitive systems for refuse collection: Akron, Kansas City, Minneapolis, Montreal, and New Orleans. Cost increases for the systems were well below the national average over the thirteen years of the study, not just in the zones served by contractors but in adjacent zones covered by municipal crews. Competition helped both.

Still another way to gain the advantages of competition without sacrificing the benefits of in-house operation is to instill within an organization a sense of competition, even if only artificially. By insisting that departments report their performance not simply in terms of inputs and workload but, what is more important, in terms of efficiency and effectiveness, and by comparing those measures with suitable benchmarks, departments will begin to feel the challenge of competition. Comparison of expenditure and workload statistics will not achieve the desired results. Pointing out the differences between two units in total dollars spent and calls answered or applications received reveals very little of managerial significance and is unlikely to inspire improvement. Differences in unit costs, service quality, and rates of achievement are more likely to have that effect.

**Conclusion**

If the objectives are greater efficiency and effectiveness, contracting out a given service is often a good option under proper circumstances. This is a limited endorsement, however, for contracting is not an ideal arrangement for every service or every set of conditions.

In some instances, governments large enough to do so may wish to divide their service territory and arrange for contract operations in some zones while retaining direct service production in others. Such arrangements have produced many of the benefits of more conventional contracting while preserving the government’s ability to resume complete service delivery expeditiously if it ever chooses or is forced to do so. In still other cases, governments may prefer to retain a full complement of public employees but to instill in that workforce a sense of competition by comparing its performance with relevant, outside benchmarks.

There is value in competition. Privatization is one option, but not the only option, for achieving that value.
Notes


10. Stevens, Delivering Municipal Services Efficiently, 545–47.


15. Donahue, The Privatization Decision, 80.


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