Privatization of Public Social Services

A Background Paper

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1. Introduction

The purposes of the paper are to provide a general overview of the extent of privatization of public services in the areas of social services, welfare, and employment; rationales for privatizing service delivery, and evidence of effectiveness or problems. Examples are included to highlight specific types of privatization and actual operational experience. The paper is not intended to be a comprehensive treatment of the overall subject of privatization, but rather a brief review of issues and experiences specifically related to the delivery of employment and training, welfare, and social services.

The key points that are drawn from a review of the literature are:

- **There is no single definition of privatization.** Privatization covers a broad range of methods and models, including contracting out for services, voucher programs, and even the sale of public assets to the private sector. But for the purposes of this paper, privatization refers to the provision of publicly-funded services and activities by non-governmental entities.
- **Privatization is not a new concept.** The current rationales for privatization and their implementation strategies differ very little from earlier privatization initiatives (even as early as the 1930s). Perhaps the biggest single change in the current privatization environment in the area of social and human services is the possibility of private companies being contracted with to administer entire public-funded systems (e.g., all of welfare, all of child support, all of workforce development).
- **The real issue is not so much public vs. private--it is monopoly vs. competition.** A key issue in the current trend towards what is commonly referred to as "privatization" is the introduction of competition (e.g., public-public competition, public-private competition, competition between public-private ventures, public-nonprofit competition) to increase efficiency, reduce costs, and improve quality and customer satisfaction.
- **Privatization is not inherently good or bad--the performance or effectiveness depends on implementation.** The little empirical analysis comparing the effectiveness of public versus private service delivery shows no clear evidence that private service delivery is inherently more effective or less effective than public service delivery, although the public, private, and nonprofit sectors each have their own relative strengths and weaknesses. There are examples of success and failure in both sectors. Most of the research suggests that the key factor is whether there is clear accountability for results, clear criteria in contracts, and clear public objectives. The government is responsible for assuring that public services are effective, whether or not the services are publicly delivered.
- **Privatization does reduce the number of public employees if services formerly performed in the public sector are shifted to the private sector.** But it is not clear that workers are necessarily worse off in terms of employment, wages, morale, or job satisfaction. There are many examples of negotiated arrangements for transferring public employees to private employment or to other public agencies. There is undoubtedly, though, a clear reduction in public employee members of unions, although some number of privatized workers may join other unions.
- **It is still too soon to know whether the most recent and highly-publicized privatization efforts**

will be effective or not. There are, however, many potential problem areas (e.g., profit motivation to cream and minimize costs) that, if unaddressed in the public contracts, could reduce service quality. There are many reasons for cautiously scrutinizing the process.

2. Current State of Privatization

Similar to trends in the private sector, there is some indication that public agencies are increasingly considering downsizing and outsourcing as ways to address both financial constraints and a desire to improve performance. The Government Management Reform Act of 1994 (P.L. 103-356) states:

> To be successful in the future, government must, like the private sector, adopt modern management methods, utilize meaningful program performance measures, increase workforce incentives and flexibility without sacrificing accountability, provide for humane downsizing opportunities and harness computers and other technology to strengthen service delivery.

However, privatization is not a new phenomenon. Gurin (1989) notes that privatization of government social services has, in fact, increased at major watershed points in the history of social policy (the Progressive era in the late 19th century, New Deal, Great Society, and Reagan years), both at times of expansion and during contraction of government services. For example, during the 1970s, federal funding for social services increased greatly under Title XX of the Social Security Act, and for human development and employment services under the Economic Opportunity Act and the Comprehensive Employment and Training Act (CETA). Nonprofit organizations and for-profit businesses both emerged to fill the need for government contracted service providers. In contrast, during the early 1980s when federal funding for social programs was dramatically reduced, there was also some increase in contracting out services (in some locales) as one way to reduce unit costs and gain efficiencies despite reduced overall funding.

More recent interest in privatization of public social services is stimulated by both expansion and contraction of publicly funded programs. Federal funding for employment and training declined during the early 1990s, and this was one motivation for workforce development system redesign, which includes considering new ways to deliver services. At the same time, the 1996 welfare reform legislation increases the responsibility states have for redesigning their welfare systems and, at least in the short run, provides more federal funding for both income support and programs that promote employment. Privatization is one of the various welfare system redesigns that are being considered.

The recent dramatic emergence of large private corporations into the welfare field (discussed below) has raised many concerns about the appropriateness of this degree of privatization. The traditional approach to contracting in social services had been noncompetitive, quasi-grant arrangements, primarily with non-profit organizations (Hatry and Durman 1985). The increased emphasis on competition and performance contracting for the delivery of social services is consistent with private sector initiatives focusing on efficiency and customer service. Some organizations, such as the Reason Foundation, have been promoting the benefits of privatization for decades, and recently their efforts are gaining new momentum, providing technical advice and guidance to businesses and public officials on how to develop business ventures and effective public/private partnerships. In addition to welfare reform, several other recent federal initiatives also encourage more privatization, most notably in one-stop career centers and child support enforcement.

One-Stop Career Centers

The federal One-Stop Career Center initiative encourages an expanded use of vouchers and competitive selection of administrative entities (e.g., for one-stop centers). Although national regulations do not specifically endorse privatization of services, they do encourage expanded competitiveness for the selection of center administrative and service delivery agents, allowing public and nonprofit organizations as well as private for-profit companies to compete openly for one-stop service contracts.

The Massachusetts' One-Stop Career Center Initiative is a current example of the trend toward privatization in the one-stop and workforce development area. The state plan allows private firms to compete with public agencies for contracts to manage career centers, which serve as gateways to the states's new workforce development system. However, the initiative has run into opposition on several fronts due to competition for funds among rival employment and training agencies, high demand for services at the career centers, and concerns expressed by public employee unions (Boston Globe, 2/11/97).

Child Support Enforcement

Federal child support enforcement legislation also supports an expanded role for non-profit and private contractors. The 1986 child support legislation specifically encourages states to consider contracts with private companies for technical activities such as locating absent parents and maintaining tracking and payment systems. The Reason Foundation reports that, in 1995, there were twenty states and dozens of local governments that had privatized one or more child support services, and that five more states were planning to do so in 1996. These states contract out for activities such as location, collection, payment processing, distribution of payments, and fully privatized offices. Georgia and Virginia give full caseload responsibility to private providers.

The success of the private sector in increasing collections of child support payments is attributed to several factors: first private firms can bring technology and equipment to the tasks that governments typically cannot afford; second, private firms can expand or contract operations quickly as they are not bound by government personnel systems; and private firms use performance incentives, such as bonus pay, to increase collections per employee. (Reason Foundation pp 45-46)

A 1996 General Accounting Office Report (GAO, October 1996) found that in the fifteen states with some privatization of child support, there was a tendency to especially contract out collections of child support payment from hard to locate absent parents and parents with past-due support.[1] Many contractors receive payment only if they collect, often retaining a percentage of the collection (ranging from 8 to 24 percent). In general, GAO found that both the federal and state governments benefitted financially (net) from contracts that were targeted on cases that might not otherwise be worked--in effect, the private contracting supplemented what the public agency could do. The net benefit is derived from collections on AFDC cases and from federal performance incentives attached to child support collections for both AFDC and non-AFDC collections.

Welfare Reform

Increased requirements under welfare reform, coupled with spending restrictions that limit the amount of hiring that can occur in public agencies, have led some states to more seriously consider outside service contractors for welfare service delivery functions. For example, welfare officials in Nebraska and Arizona plan to increase their use of outside contractors (both for-profit and non-profit) to deliver services such as job placement and parenting skills training. (ETR 11/27/96) Other states may make similar decisions. "Private industry buzzwords such as 'streamlining' and 'cost-containment' have spilled over to the public sector, and welfare officials are moving to share risk and cut costs." (ETR 10/9/96)

The recent welfare reform law, The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, is the latest federal policy that contributes to the privatization trend. The 1996 law removes previous restrictions that essentially prohibited states from contracting out initial welfare (AFDC) intake and eligibility determination functions. This has apparently opened a new market for private companies. In the past, service delivery contracting in the social welfare arena was mainly for direct service delivery such as job training, job search instruction, and day care provision; and service providers were mostly non-profit, although some for-profit companies have provided job training or other employment services. Large for-profit companies were mainly involved as contractors for data systems. Intake and eligibility determination for welfare programs remained with public agencies.

Now that welfare agencies can contract out the entire welfare system, including intake and eligibility determination, large for-profit companies are moving into the welfare service delivery market (e.g., EDS, Lockeed Martin, IBM). States are also more seriously considering privatization options because of concerns over cost and the need to meet specific federal goals fairly quickly. Large companies had already gained a foothold into some of the human service agencies, primarily through health care and child support enforcement, for data systems and, more recently in child support, for service delivery functions. "Before the new welfare law, moving people from welfare to work was the domain of nonprofit organizations and three relatively small businesses (America Works, Curtis and Associates, and Maximus). Now, some large companies see a potentially multibillion-dollar industry that could run entire welfare programs for states and counties." (Bernstein, 1996)

The three small for-profit companies referred to in the New York Times article (Bernstein, 1996) are:

- **America Works**: $7 million in contracts in New York City, Albany NY and Indianapolis; provides supportive services for the first four months a welfare client is on a job. The client receives minimum wage, but the employer pays America Works a higher wage, similar to the arrangement with temporary employment agencies. In addition, the government agency pays America Works $5000 per successful placement (defined as one that lasts 4 months).
- **Curtis & Associates**: $9.2 million in business last year in selected sites in 11 states, including California, New Jersey, Indiana, Vermont and Wisconsin; provides a job club model for agency clients; sells training manuals and materials.
- **Maximus, Inc.**: $100 million total government contracts, much but not all in the welfare area; has contracts for child support enforcement activities in 6 states, a $10 million contract in California to recruit recipients into HMOs, and welfare-to-work contracts in selected sites in California, Massachusetts, and Virginia; has also had many contracts for data systems development in the human services area.

The most recent development, in fact, is a dramatic increase in the extent to which larger companies are seeking out welfare business on a major scale, going beyond their traditional contracts related to information systems and technology to work preparation, and now possibly including contracts for entire welfare systems including intake and eligibility determination as well as employment and social services.[2] "Big companies are concentrating on lucrative contracts that require ...large scale participation." (ETR 10/9/96) The New York Times article (Bernstein, 1996) offers the following information about these "giant" private corporations now seeking welfare contracts:

- **Andersen Consulting**: $4.2 billion global management and technology consulting company that is an affiliate of the big accounting firm; now has contracts in 14 states, mostly for child support and child welfare activities. Marketing a profit-sharing approach to welfare, and recently won contracts for running welfare in two Canadian provinces.

- **Electronic Data Systems**: $12.4 billion information technology services company. Began with computerization of Medicaid billing and welfare reporting systems. Now has contracts in 20 states. EDS was recently awarded a new contract by the state of Texas which focusses on reengineering eligibility determination and service delivery for health and human services programs and securing a new computer system for the state.[3]
- **Lockheed Martin Information Management Services**: a nonmilitary division of the $30 billion dollar Lockheed Martin Corporation; has child support enforcement contracts in 16 states plus the District of Columbia; also has contracts in 20 states to convert various welfare benefits to an electronic debit card system. Now launching a major new "welfare reform/self-sufficiency line of business." (Bernstein 1996).

Wisconsin and Texas are the most prominent examples today of the privatization trend in welfare.

Wisconsin's latest major welfare reform effort, called W-2 (Wisconsin Works), for example, is based on market competition for delivery of services. Public, private and non-profit entities can compete for contracts to deliver the entire welfare system in specific localities. In the initial round of competition, proposals were submitted not by individual companies or agencies, but by consortia. Four (or five) consortia were formed to bid on the W-2 contracts and each consortium included at least one major private company, and public or non-profit agencies. The initial round did not produce many proposals, though, in part because of the very complex and inflexible criteria and requirements included in the state solicitation. Nonetheless, four contract consortia have been selected, and each will be responsible for the entire welfare administration in the four geographic areas within Milwaukee.

It is still unclear whether there will be a sharp increase in private companies assuming major responsibilities for work-welfare programs though, even in a state like Wisconsin. Wisconsin had, even before the latest reforms, already moved more towards privatization of welfare services, especially for work-related activities. In Milwaukee, for example, Manpower Temporaries, Inc. was, until recently, a primary contractor for administering a Welfare Job Center, delivering job placement services and coordinating services provided by other, mainly non-profit and public contractors. While the nature of the work was similar to Manpower's traditional business, the private firm's role has gradually shrunk in part because of the difficulty it had working with clients with serious employability barriers and collaborating with a disparate network of public and private organizations. (Employment and Training Reporter, 9/18/96)

Texas has received considerable attention recently because of its proposed privatization of the Texas Integrated Enrollment System (TIES). The TIES system was intended to integrate and streamline eligibility determination for fifteen programs, including AFDC/TANF, Food Stamps, and Medicaid. Officials in Texas emphasized that their objective was not to contract out government functions arbitrarily, but rather to improve efficiency and customer service in government through increased competition. Contracting with private, for-profit companies for Medicaid claims processing, child support payment tracking, and other information systems requirements are already accepted practices in Texas government.

The proposed privatization of TIES differed from other privatization initiatives because the eligibility determination functions to be contracted out were traditionally carried out by state employees. This change raised two concerns: the potential loss of jobs for state employees; and the appropriateness of having private rather than public employees make decisions related to program eligibility. The TIES privatization was strongly opposed by public employee unions, which launched a major public relations campaign to gain public support to oppose the state's plan (Houston Chronicle, April 14, 1997). The potentially large size (estimated at $2.8 billion over 7 years) of the TIES privatization contract attracted major private corporations such as EDS and Lockheed-Martin, each in partnership with state agencies as part of the bidders' teams (Texas Department of Human Services [TDHS] with EDS and Texas Workforce Commission [TWC] with Lockheed-Martin).

Implementation of the contracting process for TIES was delayed for nine months pending federal approval of the state's draft "Request for Offers." The 1996 federal welfare reform did not prohibit non-government employees from determining eligibility for TANF, as had been the case for AFDC. However, the historic restriction still remained for other federal assistance programs, particularly Food Stamps and Medicaid, which were unaffected by the 1996 legislation. The state privatization plan, therefore, required special federal approval as an exception to policy. In May 1997, the Clinton administration ruled that privatization of Food Stamp and Medicaid eligibility was not allowable under federal law.

At about the same time as the federal administration's decision, the Texas legislature was reshaping the TIES project. HB 2777, which was enacted in June 1997, directed the Texas Health and Human Services Commission to coordinate the TIES effort in consultation with TDHS and TWC. As a result, these state agencies have terminated their teaming arrangements with private sector vendors. Recommendations developed by TDHS in partnership with EDS during the bidding process will serve as a starting point for the reengineering efforts required in the $3.7 million 15-month contract awarded to EDS (Kinsey, 1997). Thus, Texas has turned to an incremental approach for integrating and improving eligibility systems, and will build upon lessons learned and innovations proposed during planning of the TIES procurement.

Employment and Training

Throughout the history of employment and training programs, contracting has been a common model for delivering services, often including intake and eligibility determination as well as training, job placement and other employment-related services. MDTA, CETA, YEDPA, Job Corps, and now JTPA all involve extensive contracting for service delivery--Job Corps is totally contracted, and Center operators include some small and large for-profit companies (e.g., ITT Industries; BDM International/Vinnell; ResCare, Inc.). In fact, the majority of federally-funded E&T services since the 1960s have been contracted out by the administering public agency. Most of the E&T service contractors have been non-profit or public entities (e.g., community colleges, public school districts, vocational schools, employment service). In some localities, for-profit companies have also provided services under contract (e.g., proprietary training institutions and schools, for-profit companies operating job clubs or job placement services). The best-known for-profit companies today that have contracts to provide job placement services to welfare recipients are America Works and Curtis and Associates.

Ironically, Job Corps is the only major federally-administered E&T program and the only one that is totally contracted out. It has also been found to be among the more effective programs. In part the success of Job Corps is attributed to its mix of public direction, oversight, monitoring, and clear competitive contracting with performance expectations (Gurin 1989). The government role in policy development, planning, monitoring and oversight is a critical factor in the Job Corps success. Job Corps centers can't affect their performance measures by screening applicants (i.e., "creaming") or by securing jobs for applicants because they have no control over this (Donahue 1989).

The Job Corps program operates through a partnership of government, labor and the private sector, at 111 Job Corps Centers in 46 states, D.C. and Puerto Rico. Private corporations and private nonprofit organizations-- including Teledyne, ITT, Vinnell, Management and Training Corporation, Career Systems Development Corporation, Res-Care, and MINACT--operate 81 Job Corps centers under contracts with the U.S. Department of Labor (DOL). An additional 30 Job Corp Centers are operated by the U.S. Departments of Agriculture and Interior--called civilian conservation centers--on public lands throughout the country under interagency agreements with the U.S. DOL. A nationwide network of other public, private, nonprofit, business, and labor union subcontractors provide services for Job Corps, ranging from intake and application to occupational training, job placement and post-program support services.

Child Welfare

Child Welfare privatization of service delivery also expanded greatly in the 1970s and 1980s as caseloads of child abuse and neglect rose, budgets were increasingly constrained, and public agencies' flexibility in staffing up was severely limited by personnel policies and state or local restrictions on spending. Agencies contract for various services from investigation to substitute care and therapeutic services. For example, in New York City, contract agencies take care of 70 percent of the city's children in foster care (Giuliani 1996). In fact, the majority of publicly financed social services programs in New York City are delivered through contracts. These private suppliers, mostly well-established non-profit service agencies, both secular and religiously affiliated, have provided an ongoing source of political support for the city's human service activities (Bendick 1989).

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3. Models of Privatization

As the brief discussions above suggest, there is no single definition of privatization. But for the purposes of this paper, privatization refers to the provision of publicly-funded services and activities by non-governmental entities. There are also various methods by which services can be privatized, including contracts, formal agreements, vouchers, grants, subsidies, public/private partnerships, and collaborative service delivery. In general, though, the common use of the term privatization refers to formal contracting out of services by the government to the private for-profit or non-profit sector. One way to think about privatization is to consider two separate but related dimensions:

(1) degree of market competition--ranging, for example, from open competition for all or public services, to government contracting for specific services; and

(2) role of the public sector

vis a vis other sectors--for example, government oversight of private services versus separate systems of services operated by government, for-profit and/or non-profit entities, versus public-private partnerships.

***Market Competition*.** Osborne and Gaebler in Reinventing Government (1992) quote Gov. Mario Cuomo, who stated that (p. 30) "It is not government's obligation to provide services, but to see that they're provided." Their conception of a reinvented government would involve broader service options, including using a competitive process for selecting deliverers of public services. "Competition will not solve all our problems. But perhaps...it holds the key that will unlock the bureaucratic gridlock that hamstrings so many public agencies," by encouraging innovation, flexibility, efficiency and performance. This would mean ending the tradition that certain public agencies be presumptive deliverers of services. Public agencies would have to compete against each other and against non-profit and for-profit providers for a particular services market. Even within the public sector, competition can be introduced through the establishment of franchise funds which provide certain administrative services to "customers" within the public agency.

Some of the most recent examples of privatization in the welfare and workforce development area, such as in Texas, Wisconsin and Massachusetts have adopted versions of such a broad-based competitive model where public-private teams compete for contracts. In Indianapolis, public employees are required to compete against privately owned businesses for contracts to deliver all services with the exception of police, fire, and zoning operations. Initially, city employees and their union opposed the privatization initiative and feared losing their jobs. After negotiating changes to "level the playing field," such as consulting assistance to prepare bids and streamlining the city workforce by reducing middle management, unionized employees have gone on to win 37 of the 86 contracts put out for bid by the city (Jeter 1997).

Sectoral Roles. A second dimension of the privatization concept relates to activities or functions performed by the governmental and non-governmental sectors, regardless of whether funds actually are exchanged and regardless of whether there is a formal contract or agreement. Much of the current discussion about privatization refers to for-profit businesses, but as Starr (1989) explains, there are actually four types of "private" providers: (1) personal, informal, mutual aid; (2) voluntary non-profit sector; (3) small businesses, entrepreneurial companies; and (4) corporate for-profit sector. The responsibilities and services of each may or may not result from contractual arrangements or exchange of funds.

For example, the welfare reform law of 1986 included strong language that would encourage community-based and faith-based organizations to be formal providers of services, presumably with government contracts. But underlying welfare reform's focus on individual and family responsibility is that the informal community, charities, and neighbors are also an important source of support for persons in times of need.

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4. Effectiveness and Potential of Privatization

There are strong and vocal advocates and opponents of privatization, but little empirical evidence about whether the public sector or the private sector is more effective.

Arguments For and Against Privatization

Arguments for Privatization. There are major advantages generally put forth for contracting for services with private (non-profit and for-profit) organizations, as indicated in Exhibit 1. In general, the strongest arguments for privatization of public services are:

1. Increased flexibility resulting from a reduction of bureaucratic complexity and procedures, and

2. Reduced costs resulting from improved efficiency, especially if there is a truly competitive process with clear performance criteria.

Public decisions to privatize have in fact been motivated by a number of factors, (Hatry and Durman 1985) such as:

- discontent with the performance of the public sector;
- desire for more flexibility (e.g., personnel, operations, innovations);
- desire to reduce costs; and
- desire to "empower" service intermediaries (e.g., CBOs).

GAO (1996), for example, found that the primary reason state and local child support enforcement agencies contract out services is because of general state fiscal pressure that makes it difficult to hire more agency staff despite growing caseloads and sometimes even despite increased program funding. Motivation of public officials to privatize resulted from (1) "a desire to improve child support services," (2) "need to serve soaring caseloads," and (3) "inability to deploy additional staff." (p. 6) Some states also wanted to expand child support services in areas not well-covered in the past, or to assume operations when a public agency withdrew (usually district attorney's office). The increasing speed with which computer equipment and information systems require upgrading also provides an incentive for privatization. Equipment provided by a private contractor is not budgeted as a capital expenditure for the public agency. Contractors that provide similar equipment and software to several public agencies or state administrations can spread their costs over several projects and achieve economies of scale, which may enable them provide the service to each client at a lower cost.

Exhibit 1 ***Reasons for Using the Private Sector***
• To obtain special skills or supplement staff for short periods of time • To meet demands beyond current government capacity • To reduce costs • To improve service quality • To provide clients with more choice of providers and levels of service • Ideology--less government is better.

Source: Adapted from Allen, et al, The Private Sector in State Service Delivery. Washington, D.C. The Urban Institute Press, 1989

Arguments Against Privatization. The major concerns, summarized in Exhibit 2, voiced in opposition to privatization in the social services area relate mainly to quality of service and the impact on public sector jobs. In terms of service delivery, there are concerns that the profit motive of private companies will result in a reduction in services and a propensity to "cream," or serve those who are most easily served and most likely to succeed. Every contract has the problem of unintended adverse impacts on individuals, especially if payment is based on a fixed cost per client. The more vulnerable the client and the more involuntary the client's participation (e.g., hospitals, prisons, child welfare), the higher the risk; but a well-structured contract can cover these issues and protect those who are to be served (Hatry 1989).

The strongest opposition to privatization comes from public employees and unions representing public employees, stemming essentially from a fear that public sector jobs will be lost. The prospect of massive layoffs of government workers is one of the barriers that "keeps governments from moving into a more catalytic mode regarding privatization," according to Osborne and Gaebler (1992)--a fear, they note, that is "legitimate." The federal Office of Personnel Management (OPM) recently reported that executive branch employees covered by union agreements dropped by 13 percent between 1992 and 1997. Almost all of the decline in union representation can be attributed to the government's downsizing, particularly base closings and cutbacks at the Defense Department (Barr and McAllister 1997).

Exhibit 2 ***Major Arguments for Opposing Privatization***
• Major loss of public employee jobs • Relinquishes public responsibility for public funds. "Private business has no business allocating public funds...or monitoring the use of public funds." "Threatens fiscal accountability" • Weakens community ability to assert collective interests; decreases citizen participation in government • High potential for fraud, financial conflicts-of-interest and cost-overruns • Any resulting cost savings are directed away from taxpayers and towards the contractor. • Threatens confidentiality of private information • Financial conflicts of interest • Increases temptation to reduce quality of services and "cream" the best clients to reduce costs and maximize profit.

Source: Adapted from materials prepared by the AFL-CIO, Public Employee Department

Evidence of Effectiveness

Thus, there are strong reasons for privatization and some equally-strong concerns and fears (see Exhibit 3). Most analysts, though, concur that each sector may actually have certain relative strengths, and private sector delivery of services is not inherently better or worse than public service delivery. "Business does some things better than government, but government does some things better than business. The public sector tends to be better, for instance, at policy management, regulation, ensuring equity, preventing discrimination or exploitation, ensuring continuity and stability of services, and ensuring social cohesion... Business tends to be better at performing economic tasks, innovating, replicating successful experiments, adapting to rapid change, abandoning unsuccessful or obsolete activities, and performing complex or technical tasks. The [non-profit] sector tends to be best at performing tasks that generate little or no profit, demand compassion and commitment to individuals, require extensive trust on the part of customers or clients, need hands-on, personal attention..., and involve the enforcement of moral codes and individual responsibility for behavior." (Osborne and Gaebler 1992)

Bendick (1989) agrees, noting that private contractors are well-suited for straightforward or specialized services such as refuse collection, processing payments, data processing, and computer systems design. But, as one moves to "more complex, undefinable long-range, and 'subjective' services characteristic of the social welfare field, the record of successful experience rapidly thins." (e.g., training ex-offenders, drug addicts, mentally ill, least employable welfare recipients) (p. 15) He attributes this mainly to the "limited ability of privatized systems to tackle the most difficult cases or to pursue the most complex objectives." (p. 16) Bendick further notes the nonprofit sector is better able than the for-profit sector to deal with complex and high risk cases, mainly because it is less motivated by profit. But nonprofit deliverers are not noticeably better or worse than the public sector (p. 18) because of high risk and/or high cost associated with complex cases.

Exhibit 3 Major Potential Advantages and Problems with Delivery of Public Services by For-Profit Companies	
Potential Advantages	**Potential Problems**
• Less red tape and bureaucracy • More competition • Lower unit costs, especially if operating in multiple jurisdictions/sites	• Higher potential for corruption • Incentives to reduce service quality • Increased chance of service interruption • Possible reduced access to service for the disadvantaged

Source: Adapted from Allen, et al. The Private Sector in State Service Delivery, Washington, D.C.: The Urban Institute Press, 1989.

Unfortunately, there is very little empirical research on the relative effectiveness of the private sector versus the public or nonprofit sector in the delivery of services. Hatry conducted one of the few studies comparing public and private delivery of services, based on matched pairs of public and privately administered prisons as a case study. He found that while quality was somewhat higher in the private systems, cost results were mixed. He explains that research findings on the relative costs and quality of services between public and private systems may be biased in favor of private sector delivery. The primary reasons governments decide to privatize services relate to less than satisfactory performance by the public sector. In general, if there are no perceived problems with the public sector (e.g., high cost and/or low performance), there is usually little incentive for public officials to consider privatization. Furthermore, whenever there is a shift, either from the public sector to the private sector or *vice versa*, there is improvement. Therefore, studies that compare a newly privatized system to the pre-existing suboptimal public system will be biased in favor of privatization.

The only other study identified that compared public systems to private systems was conducted by the General Accounting Office and had similar findings. A December 1996 GAO report examined state contracting of full-service child support enforcement operations in selected local sites in 15 states. "In the three comparisons of performance we conducted, fully privatized officers performed at least as well as or, in some instances, better than public child support programs in locating noncustodial parents, establishing paternity and support orders, and collecting support owed." However, the cost-effectiveness results were more mixed for the periods reviewed.

A separate issue concerns the impact privatization has on public employees. The most vocal opposition to privatization comes from public employee unions and their concern about the dislocation of public workers (and, presumably--although unstated--the reduction in union membership). A report by the National Commission for Employment Policy (1989) found:

- Contracting out public services has caused a shrinkage in the rate of growth of the public sector work force since the mid-1970s.
- Job loss in the government is generally offset by job gains in the private sector--for every 10 jobs lost in that state and local government sector due to privatization, about eight or nine new jobs were created in that same occupational field in the private sector
- Layoffs of public employees due to privatization are uncommon; most affected workers take jobs with contractors or transition to jobs in other public agencies, usually through an agreement initiated by the government. Moving from the public sector to the private sector generally means a reduction in employee benefits, but a modest increase in wages.

While it is clear that public employee unions are unequivocally opposed to privatization, it is not as clear whether the workers themselves are opposed, in large part because employment arrangements are often part of the privatization package. (Reason, 1996) A study of privatization cases in Britain similarly found that there had been opposition from union leaders, but not necessarily union members, mainly because workers have been offered alternative and often better deals from private contractors. (Pirie, 1985)

Finally, one of the strongest messages that can be drawn from the analytic literature is that there are successes and failures in all three sectors--public, for-profit, and non-profit. "The determining factors have to do with the incentives that drive those within the system. Are they motivated to excel? Are they accountable for their results? Are they free from overly restrictive rules and regulations? Is authority decentralized enough to permit adequate flexibility? Do rewards reflect the quality of their performance?" (Osborne and Gaebler, 1992)

Hatry and Durman agree that the key to successful privatization comes from careful public administration and understanding the potential problems inherent with contracting to a profit-motivated private business. "An agency that is capable of sophisticated administration, and explicitly addresses service quality issues, can minimize the difficulties of implementing a competitive contracting process. In none of the examples [of successful cases] of competitive contracting examined did contracting agencies report deterioration of service quality. The contracting agencies were sensitive to the issue and took specific steps to prevent it. Carefully implemented competitive contracting can achieve modest cost saving or a slowing of cost increases."

Privatization is encouraged in Reinventing Government, but Osborne and Gaebler, like other analysts, caution that "[p]rivatization is *one* answer, not *the* answer...Services can be contracted out or turned over to the private sector. But *governance* cannot..." (Osborne and Gaebler, 1992, p. 45) "There is no inherent reason why for-profit firms could not compete for most, if not all, social service delivery activities." (Hatry and Durman, 1985) But the government is responsible for assuring that public services are effective, whether or not the services are publicly delivered. Public decisionmakers need to look at the long-term capacity of government agencies to monitor and the costs of monitoring. They need an objective way to assign criteria to determine appropriate cost--the public sector does not know how to determine cost and does not understand well how the concept of risk relates to the private sector's incentives and disincentives in business ventures.

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5. Conclusions

The limited empirical research comparing the effectiveness of service provision by the public and private sectors suggests a few conclusions:

- There is no empirical evidence that the service provided by private contractors is inadequate.
- There is some evidence from research studies that the quality of services may be higher in private service delivery systems than in public systems, but very mixed evidence on whether the private sector is more cost-efficient. However, for many reasons, the findings may be biased in favor of the private sector.
- When public services are privatized, there is a reduction in the number of public employees, but there is not necessarily a reduction in total employment nor are workers always worse off.
- There are success stories and examples of failure in all sectors--public, non-profit, and private. No one model is inherently "better" than another. The key factor is whether there is clear accountability for results, clear criteria for performance, and clear public objectives.

Privatization is a way to bring the advantages of competition and flexibility to the delivery of public services. These advantages include greater efficiency, increased responsiveness to the needs of customers, and encouraging innovation. These advantages are more difficult (but not impossible) to achieve within government due to restrictions on hiring public employees and budgeting issues related to capital expenditures. As Rainey (1991) points out, "The nature of public organizations, their public character, often subjects them to more external intervention and constraint. In turn, this often imposes on them greater challenges in trying to perform efficiently and effectively."

While there is clear potential for improved efficiency, privatization also involves risk and requires careful management on the part of the public agency. The research reviewed emphasizes the importance of clear goals and accountability. Some of the highly visible problems recently encountered in large system-wide contracts probably at least partly reflect lack of accountability and performance criteria . Effectiveness tends to be very situational--it depends on the implementation of the contracting process, the contract itself, performance criteria, and ongoing monitoring.

To achieve the potential benefits of privatization, public agencies will need to clearly specify the roles of contractors, determine appropriate costs, and develop performance criteria that are tailored to the client population being addressed. Public agencies will need to consider their long-term capacity to structure and monitor privatization initiatives in order assure cost effectiveness and quality in the delivery of publicly funded social services.

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Notes

1. GAO reported that in 1996, 15 states had contracted out for full service child support collection services in one or more localities: AZ, AK, CO, GA, IA, MD, MS, NE, OH, OK, SC, TN, VA, WV, WY)

2. There is some evidence of problems with most of these (large and small) private companies (with the exception of Curtiss & Associates), including several newspaper articles chronicling various cost-overruns, delays, or poor performance. One must be cautious, however, in assuming that such problems are unique to the private sector or that they imply the private sector is ineffective. Issues of effectiveness and problems in the public and private sector are discussed in a later section.

3. Kinsey, Marcia. September 1997. *Privatization.* Center for Public Policy Priorities, Austin, TX.

Other Publications by the Authors

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