

## **The Use of Contracting in the Public Sector: Experiences from Some Asian Pacific Countries\***

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### **Introduction**

For quite a long time the public sector in many countries has regularly purchased services from private sector providers or from other public sector agencies. This practice has caused governments to adjust their role in creating socio-economic and political environments in which the private sector can operate in the most effective manner, up to the citizen's expectation, unhindered by bureaucratic red tape and distorted policies.

Contracting out in the public sector is a popular topic receiving a good deal of attention in many countries for many years. In fact, contracting out is basically a straightforward concept: It simply means that government agencies can provide services to the public by employing private firms, nonprofit organizations or even other government agencies (Rehfuss, 1989). The public sector has been using contracting for a long time, for instance the construction of public buildings, roads and other public work projects, R&D projects and other service delivery projects. Despite its simplicity, contracting is still a controversial issue. It is well known by the public sector in some countries that frequently use it, yet it is often poorly explained, researched and managed in many countries. Contracting can save a large amount of money, but it also can waste large sums. Contracting may be difficult in some countries while other countries will routinely contract.

Taking account of this fact, it is agreed among many countries that services required for the citizen must be rendered more rapidly and efficiently, and be more accessible; and, therefore, the paper will consider the following details:

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firstly, the concept of contracting; secondly, factors that should be taken into account by the public sector to guarantee the quality of services if contracting is used; and lastly, experiences of some countries of contracting in the public sector.

### **The Concept of Contracting**

In its simplest version, a contract is a promise backed by the law for a discrete transaction that contemplates only one outcome: "I will deliver these services to you, in exchange for a specific amount of money." From these simple historical beginnings the idea of contract has evolved in contemporary public and private sector transactions to include ongoing dynamic relationships between parties in which a multiplicity of futures might result, not just one. This concept is what is known as relational contracting and is central to considering the use of contracting in the public sector, because most of the contracting in the public sector, and most of the contracts that interest us, are of this kind (Scott, 1996).

Some of the contradictions and controversies surrounding contracting out arise from reactions to privatization. Privatization - which includes such activities as selling off government assets and deregulating private activities - is a highly controversial subject. Some of the reaction to privatization may have spread to contracting out. Contracting out for services such as engineering or legal personnel is traditional for most agencies and precedes by many years the current trend toward privatization. However, as one of the forms of privatization, contracting out may be receiving more attention, favorable and unfavorable, than would be the case were it not associated with privatization. For this reason, a brief analysis of privatization will help place contracting out in a broader perspective.

Privatization includes all activities that would decrease government activity, either by reducing government's total scope or by merely replacing public functions with private activity. Basically, the privatization movement is an effort (1) to reduce public expenditures, (2) to reform public expenditures by making them more efficient and effective, and (3) to turn more public services over to private operation.

Interest in privatization for its own sake may be limited to a few academicians, intellectuals, and laissez-faire economists. However, the concerns of these individuals have become linked with the growing discontent over the

results of government spending. Many people, not all traditional conservatives, are convinced that government spends too much money. Others may be not as sure that too much money is being spent but do feel that they get too little value for their tax dollar. The result is that a large group of individuals want either more economy (less spending) or more effectiveness (better results). A smaller group want both economy and efficiency and also privatization as an end in itself.

While there is no precise agreement on what privatization is, one view holds that privatization at the local level has three components: public asset divestiture (the sale of government property), private financing of infrastructure (public facilities such as buildings and projects), and private provision of services (contracting out) (Seader, 1986).

Sale of assets (divestiture) can involve sales of citywide parking or bus transit systems or, at the national level, sale of student loan portfolios to private parties who collect debts effectively (Savas, 1987).

### **Advantages of Contracting**

Governments at all levels, particularly at the local level, have for some time contracted with private companies, nonprofit organizations and other government agencies for a range of services. The rationale for contracting is straightforward, and the expected benefits include the following (Holzer and Nagel, 1984):

- cost savings,
- choice of contractor(s),
- expertise of contractor(s),
- public management flexibility offered by the contracting method of service provision.

There are several reasons why governments contract out to private companies, nonprofit organizations or other government agencies: cost-effectiveness, flexibility, responsiveness and control.

Cost-effectiveness. In most cases, contracting out is done because it is seen as more cost-effective. A 1981 survey of eighty-seven California local governments (thirty-nine cities, nineteen counties, seventeen school districts, and twelve special districts) showed that sixty of them reported that "reduced cost of labor, material, or overhead" was an advantage to contracting out. Only fifteen

reported that "increased costs" were a disadvantage to contracting out. One city official explained: "Our city's experience has been that the private sector can provide this particular service (refuse collection) more efficiently and economically than the city" (California Tax Foundation, 1981).

**Flexibility.** Contracting out also has the advantage of ensuring flexibility in adjusting to changes in service demands. The 1981 study of eighty-seven California local governments indicated that sixty-six of the units regarded "availability of special equipment and skilled personnel" as a major advantage to contracting out. Indeed, this was the most common reason, cited even more often than reduced cost. Special districts, such as flood control and school districts, noted this reason in over 80 percent of the cases (California Tax Foundation, 1981).

**Responsiveness and Control.** One of the major reasons for contracting out is to maximize local options. Local jurisdictions frequently do not wish to be burdened with a large staff, for this can limit the attention they can give to new problems or changed situations. A large street-cleaning crew, for example, may take time to adjust to new responsibilities for tree and ground maintenance. The crew represents a fixed investment that can only be slowly redirected. Many cities, particularly new cities, prefer not to limit their options in determining which programs to operate. They elect to keep few employees and to offer municipal service, if demanded by the public, through contracting out. A local official commented: "The fewer government employees, the fewer personnel problems. It is easier to change contractors than to change employees" (California Tax Foundation, 1981). To this official, responsiveness to changing circumstances, citizen complaints, or council initiatives is jeopardized more by the public employee system than by contracting outside. As this view becomes more widespread, the inclination to contract out will increase.

### **Contracts in the Public Sector**

In this part, some factors concerning contracting in the public sector will be considered, for example Economic Concepts of Contracts, Citizens and Contracts, and Intergovernmental Contracting.

The fundamental basis of contractual government is decentralization of decision-making authority to those with specific information that is not available at the center of government, in order to ensure this information and the skills of the people with it are marshaled in the public interest as defined by centrally determined policies. An incentive framework is needed to align the provider's interest with the purchaser's, and this includes clear definition of roles and well-defined accountability for results (Scott, 1996).

A blanket policy of contracting out cuts across these roles and accountabilities. Once ministers have forced contracting out onto government agencies, they have taken on themselves the responsibility for any performance failures that follow, and have weakened the incentives of agency heads to ensure there are not performance failures. Malicious compliance with such directives is not unknown (Scott, 1996).

### **Economic Concepts of Contracts**

Basically the new institutional economics is about transaction costs, which one of its founders, Oliver Williamson, described as the "economic equivalent of friction in physical systems" (Scott, 1996).

The viewpoint of the institutional economist is to study institutions, which are also sometimes called governance structures, as solutions to the problem of how to reduce transaction costs. In private markets, competition selects those governance structures or institutions which are the most efficient solution to the problem of transaction costs.

According to Williamson, the key characteristics of transactions which define the size and nature of these costs are asset specificity, uncertainty and frequency. A specific asset, which might also include somebody's knowledge, has a high value in its intended use but a low value in alternative uses. The owner of such an asset is therefore greatly concerned about the potential for being exploited by the other party once they have made an investment in such an asset.

This approach to institutional design abandons the traditional concept of an organization being seen as a production function whose boundaries are determined by the product definition or the production technology. It substitutes a conception wherein the decision as to whether to make or buy

something is seen in terms of solving a transaction cost problem, and the organization's boundaries are set by those services which it is efficient to make rather than to buy (Scott, 1996).

The development of a contractual approach to public administration in the last decade or so can be rationalized in terms of public sector reformers seeking to create more efficient and effective organizations through eliminating the inefficiencies inherent in traditional bureaucratic organizations in at least some areas of service delivery. They can be seen in these terms as seeking to lower transaction costs through alternative institutional structures in which the relationships between the parties take place across institutional boundaries, rather than inside integrated organizations.

### **Citizens and Contracts**

The emphasis, in that part of institutional economics which is known as agency theory, is about how politicians get public service providers to do what they want them to do, but it produces misleading conclusions if it is not recognized that any solution to this problem must serve the interests of a larger problem, which is about an effective relationship between politicians and citizens. For example, politicians commonly distance themselves from hands-on direction and control of public service delivery, and they always do this with judicial functions (Scott, 1996).

They would not do so if all they were trying to do was get public servants and other agents to do their bidding. The reason is that hands-off features of public administration are seen by the public to add credibility to the administrative framework and policies through greater transparency, durability, openness and nonpoliticization of administrative frameworks. In other words, things that might look inefficient as a delivery system may well be justified as highly efficient in other terms by reference to a wider surrounding relationship between legislators and citizens.

A final conceptual point concerns the element of choice and voluntarism. In the simplest conception of contract, it is something each of the parties can take or leave. In the public sector things aren't that simple. We use the language of agreements and contracts sometimes to describe things that involve a considerable degree of coercion (Scott, 1996).

## **Intergovernmental Contracting**

Contracting with other governmental units may well be more common than with private companies in some countries. This is certainly true in health and human services (perhaps with the exception of hospital operations and day-care centers). Contracting with other government agencies is also more common than with private parties in the area of public safety (with the major exception of vehicle towing and also probably ambulance service). Finally, in parks and recreation and in cultural activities, intergovernmental contracting (IGC) is more common than private contracting, although nonprofit contracting is more common than either. In both public safety and recreation and in cultural service provision, of course, public work forces are the traditional and most frequent way of providing the service.

Intergovernmental contracting (IGC) is a service delivery choice in which one governmental unit agrees to provide services to a contracting unit. A simple example of such a contract is when the county agrees to collect refuse for a city or cities within the county, normally billing the citizens directly. There are many permutations: The county may subcontract its refuse collection to a private contractor or may use property tax levies to recover its costs or may receive direct payments from the city or cities. These permutations and a wide range of practices make IGC complex and somewhat difficult to generalize about. In addition, there are several kinds of quasi-contractual agreements among government agencies, which serves to confuse the issue of IGC.

### **Intergovernmental Contracting : An Economic Model.**

There are two approaches to IGC. To many (perhaps most) jurisdictions, IGC is simply one alternative way to provide services. The matter is a simple economic choice (Rehfuss, 1989). Price is the determining factor unless some other criterion, such as convenience or availability of the service, intervenes. From this view, service delivery is a calculation. Hence, contracts are carefully examined, reviewed, and evaluated from a single point of view: whatever is in the best short-term interests of the government agency. The unit searches for alternative service delivery options and chooses the one that maximizes its

benefits or reduces its costs. A newly incorporated city, for example, must provide a permit office from which citizens and contractors obtain permits and also must issue permits. The choice is simple: Calculate the costs of having municipal employees operate a permit office and make actual inspections and then obtain estimates of the costs of contracting for engineers to check more complex building plans. Next, estimate the costs of having another government agency (if one is available) perform the services and also obtain estimates for private parties (if private contractors are available) to perform inspection work. Then, after a careful analysis, choose the best combination of quality and price for providing building inspection services.

The same principle applies if the city already has a building department, except that actual city costs can be obtained by a cost study, which would precede the comparison of private and intergovernmental costs. The procedure is relatively simple and predictable, again assuming that other government agencies or private contractors are available and willing to provide the service.

Economic calculations are the way most units make such choices. Of course, emotional or political commitments to one or another delivery system interfere with a purely "rational" choice. One example of such an "irrational", or at least noneconomic, attitude is a political preference for using city employees for all city services. Another example is antipathy toward another governmental unit, which rules out contracting.

### **Intergovernmental Contracting : A Political Unification Model**

There is another view, political rather than economic in nature, of IGC. Scholars, urban reformers, and some public officials are concerned with finding a way of improving and rationalizing the "crazy quilt" arrangement of government services in a particular geographical area, usually a large urban area (Rehfuss, 1989). Contracting with the largest government unit in the area, usually the county, or possibly the state, is desirable because it ensures a more uniform level of service or a higher quality of services. For example, the county may provide services to many municipalities at a higher or more professional level than some cities would provide on their own. If this plan is not feasible, perhaps cities can



band together to provide common services. Perhaps one city can purchase services from another.

The ideal of reformers is to have a simplified governmental system, perhaps with only a few large agencies, or even a consolidated county. This is rarely politically feasible. However, there are arrangements where many functions are provided by one unit of government or even where most functions are provided by a few. It certainly would be advantageous, for example, to have all traffic signals synchronized on a major arterial crossing several cities, to have all tax assessment done uniformly by one unit, and to have sanitary inspections of all restaurants done under one set of laws administered by one agency.

A reasonable ideal is to have areawide functions, such as those mentioned above, provided centrally and to have purely local functions provided by local units. Local functions might include city park maintenance and local traffic enforcement. The advantage of centrally provided areawide services and locally provided local services is obvious. Centrally provided services should be cheaper, due to economies of scale; should include more professionally trained employees; should elevate service levels across the geographical area; and should simplify government structure.

A view of IGC as a device for government integration has specific effects. First, it changes the perspective of such observers as reformers and academics. They look favorably on intergovernmental (IG) contracts and less favorably on contracts with private contractors, since IG contracts involve potentially more areawide governmental integration. These observers often have substantial influence on decisions to contract and tend to establish an intellectual climate highly favorable toward IG contracts. In such a climate, there is generally little concern for costs but more concern with policies leading to some sort of integration.

The second consequence of this view is to incline governmental units, particularly smaller ones, to look (1) to a larger unit of government for the service, (2) to some sort of joint agreement between government units for providing the service, or (3) to some cooperative arrangement with another government unit to share the function. This tendency is a good deal stronger when some larger unit of government is interested in providing the service, as is the case in Los Angeles

County under the Lakewood plan. When arrangements for joint cooperative action exist, many agencies take the psychologically and often politically simpler route and join an existing group of government units or arrange with a larger unit to provide the service. Agencies frequently will not seriously search out private contractors, even though such contracting could be less expensive.

### **The Extent of Intergovernmental Contracting**

As noted earlier, the amount of IGC is substantial, particularly at the local level. Cities and counties contract from 1 percent of the time in the case of secretarial and public relations and information services to 43 percent of the time for public and elderly housing. Every governmental service is offered under IG contracts, although many are infrequently delivered by this method (Rehfuss, 1989).

In general, the services commonly purchased by IGC are those providing large-scale economies of operation, such as public housing or bus system operation; or those that require highly trained employees, such as mental health facilities. Some services are rarely contracted out to other government agencies. These services tend to be important management functions, personnel services, programs unique to the agency; or services, such as vehicle towing or fleet maintenance, that are commonly contracted to private operators.

### **Comparing Intergovernmental with Other Contracting**

The three types of contracting - intergovernmental, for-profit and nonprofit - all have different strengths and weaknesses. The public agency should be aware of these differences, both to maximize the potential strengths of each alternative and to avoid potentially ineffective arrangements.

Mere awareness of these differences, however, is not enough, for rarely does an agency have clear cut choices among these three kinds of contracting. Competition among types of contractors will not occur without attempts to encourage competing contractors. The agency may have to diversify its contractors, perhaps by dividing contracts among different types of contractors to encourage competition. Competition among types of contractors may be as useful as competition among individual contractors.

Assuming that the agency is actually able to choose among types of contractors, however, what are the strengths and weaknesses of each type? Exhibit 1 provides a general guide to each type of contract. For example, the exhibit suggests that governmental contracts are usually noncontroversial. Yet, relationships between different government units may be marked by controversy as, for example, when city and county have differing policies of dealing with stray dogs (one may impound aggressively and euthanize quickly, the other patrol only on complaint). In such cases, contracting by one party for the other will be very controversial. In another case, the exhibit suggests that nonprofit contractors are noted for their programmatic commitment.

For-profit firms possess superior strengths in internal management control; are generally associated with lower costs, owing to the search for profit, which provides the rationale for cost-cutting behavior; tend to possess a technological edge in new equipment and techniques, again owing to an effort to cut costs; and are highly flexible and adaptable, particularly in the use of their labor forces. Essentially, the profit motive, rather than imposing an additional cost on the contractor's profit, causes a more thorough search for ways to cut costs. However, this attempt to cut costs is strongest when competition exists. Indeed, it is likely that competition itself, not the existence of a private firm, is the reason that contracting out is more cost-effective.

The weaknesses of private firms are largely related to their strengths. Small contractors are often underfunded, indeed, they may add employees and equipment only after the contract is awarded. If they are not familiar with the ramifications of the contract, these firms may develop financial problems and even go bankrupt. There are many examples of this situation, and it can be most embarrassing and inconvenient to the government unit. Private firms also require substantial monitoring, because they are not as concerned with the quality of the service as are other types of contractors and may, on occasions, cut corners. Small firms are also, of course, subject to more severe labor trouble, since their employees tend to be lower paid and more marginal than those of other contractors. Finally, a common objection to for-profit contractors is their unwillingness to respond to emergency situations.

**Exhibit 1 Intergovernmental, For-Profit,  
and Nonprofit Contracting.**

<b>For-Profit</b>	<b>Nonprofit</b>	<b>Governmental</b>
Strength: Internal management controls	Programmatic commitment	Usually noncontroversial
Lower costs	Community support	Upgrades government professionalism
Advanced technology	Perceived expertise	Legal status clearer
	High quality of service	Occasional benefits of fiscal, governmental equalization
Flexibility, adaptability	Flexibility, adaptability	
Weaknesses: Small contractors often underfunded	Small contractors often underfunded	Often high-cost solution
Require substantial monitoring	May be difficult to control	Contractor often inflexible
Emergency response		

Nonprofit organizations present different opportunities and challenges for contracting out. They are widely (and usually accurately) perceived as having the program's or client's interests firmly in mind, even as much as the government agency does itself. This commitment results in generally high quality service and a good deal of expertise, since highly skilled professional employees are attracted to these organizations. Commitment is also related to the community support that nonprofit organizations receive, both in terms of money and labor.

Nonprofit organizations, because they are small, are often as flexible and adaptable as for-profit organizations, largely owing to the same reasons. Nonprofit pay scales are often low, they frequently use part time labor, and

employees can often perform a wider range of tasks. While smallness has advantages in terms of flexibility, it can involve the disadvantage of underfunding. Nonprofit organizations, because of their high prestige in the community and their perceived commitment to the program, may be more difficult to control by the contracting unit. How does one criticize "committed volunteers" who also happen to be influential in the community?

### **Reasons for Intergovernmental Contracting**

Contracting with governmental agencies, compared to nonprofit organizations, raises quite different concerns for policy-makers. Contracting with another governmental agency can be similar to contracting with a relative. Governments of all sizes and types tend to be like a family and thus are subject to the same pressures. All governments know the vagaries of elected political leaders, understand the activities of pressure groups, and are familiar with unruly recipients who behave more like citizens than customers. For this reason also, IGC often tends to be less controversial: There is less chance of a legal challenge, the stability of the contractor government agency is well known, and very few government agencies go bankrupt. These are immensely important advantages.

IGC often raises the professional standards of the contractee. This occurs because larger, more professional governmental units are more likely to deliver services to smaller units who may not employ as highly qualified employees.

A major advantage of IGC is the potential elimination of a number of governmental problems in the area. One example is the improvement of building inspection if the county or largest city provides the service throughout a large area. This is true both in the quality of inspection and in the application of uniform regulations throughout the area. The contract may also include long-term territorial and financial agreements, such as uniform financing of solid waste disposal plans throughout a region under the general contractual control of the county or state. This improves service levels and provides a larger and more equitable basis for the service throughout the metropolitan area.

IGC contracting has its weaknesses. It is likely to be a high-cost solution, for the contracting agency is often large, more bureaucratized, and

somewhat more inflexible in its use of manpower and equipment. Salaries tend to be higher in larger units, which means that labor costs plus overhead may be high. Large units will sometimes subsidize smaller units in order to “keep the market share” (keep from laying off public employees), but costs still tend to be higher.

## **Experiences of Two Countries**

In the last part, the cases of contracting in Thailand and New Zealand will be discussed.

### **Contracting in the Public Sector in Thailand**

Like most countries, the major public work projects in Thailand are contracted out to private contractors particularly at the local level. Local governments have probably the widest and best known range of services under contract, probably because they provide a wide variety of services that directly affect citizens that are well suited to contracting (Rehfuss, 1989). Local governments in Thailand have unique regulations to deal with contracting out problems. They are allowed to use special measures or agreements when the normal practice seems to be ineffective. For example, if the Bangkok Metropolitan Administration (BMA), which is considered to be a special form of local government, cannot find suitable contractors for road construction projects, the governor of the BMA can make an agreement with the Commander of the Army Corps of Engineers to use the Army officers and their equipment to construct roads using a BMA budget. Moreover the executives from the other forms of local government (for instance the Lord Mayor, Chairman of the sanitary district, and the Provincial Governor) can enjoy these legal provisions. They are able to use intergovernmental or nonprofit contracting.

The best known intergovernmental contracting of the public sector in Thailand is the R&D projects. Comparing with other countries, Thailand spends a rather small amount of money on R&D. However the figures (in Exhibit 2) show that it has the highest proportion of the public sector over the private sector.

## Exhibit 2 R&D Expenditure among Asian Countries

Country	(year)	Amount of Money (million US\$)	%GNP GDP	The Public Sector vs. the Private Sector
Indonesia	(1991)	290	0.2	80:20
Japan	(1990)	90,320	3.0	25:75
Korea	(1990)	4,536	-	11:89
Malaysia	(1989)	NA	0.8	80:20
Philippines	(1984)	25	0.1	75:25
Singapore	(1991)	464	1.1	46:58
Taiwan	(1991)	3,175	1.7	52:48
Thailand	(1991)	154	0.2	90:10

Source: Brimble and Sripaipan, 1994, 42.

The details of R&D expenditure in Thailand classified by operating units are shown in Exhibit 3.

## Exhibit 3 R&D Expenditure in Thailand Classified by Operating Units (in million Baht)

Operating Unit	Year 1987	1989	1991
Government agencies	1,381	1,700	2,565
State universities and higher ed. institutes.	809	640	794
State enterprises	272	189	170
Private sector	182	161	197
Nonprofit organizations	15	219	202
Total	2,664	2,909	3,926
% of GDP	0.22	0.17	0.20

Source: Sripaipan, 1994

## **Contracting in the Public Sector in New Zealand**

The case of New Zealand is based on the article of Jonathan Boston (Boston, 1996).

There is surprisingly little systematic data available on the effectiveness or otherwise of contracting out in the New Zealand public sector, and the qualitative and quantitative data on other forms of contracting (e.g. chief executive performance agreements, purchase agreements) are also patchy. Nonetheless, from the evidence available there can be little doubt that in many (if not most) cases the move to contract out various services previously provided in-house has brought significant benefits in terms of cost savings, improvements in productive efficiency, more consumer choice and enhanced service quality. In this regard, New Zealand's experience parallels that of many other OECD countries. For instance, several studies of the impact of contracting out various local government services (e.g. refuse collection and disposal) have recorded cost savings of between 15 per cent to 60 per cent (Boston 1996, 194). Evidence from the transport sector likewise points to substantial efficiency gains as a result of the introduction of competitive tendering for road maintenance and construction (van Barneveld, 1995).

Quite apart from this, it appears that relatively few services which have been contracted out have subsequently been brought back in-house. One notable exception is the contracting of parking control: Apparently, many of the local councils which contracted out parking control in the late 1980s or early 1990s have subsequently reverted to an in-house service. The reasons for this reintegration include inconsistent enforcement, a high turnover of contract staff, poor staff training and inadequate control over the contractors, which were mainly security firms.

The increasing reliance on contracting out has been particularly welcomed by many Maori since it has provided opportunities for Iwi and other Maori based organizations to compete for tenders to supply various services (e.g. health care, social services).

Notwithstanding the evident gains, the increased reliance on external contracting in the New Zealand public sector has also generated various concerns and criticisms (Boston, 1996; Caffery, 1995; Martin, 1995; Howden-Chapman 1993). These include:



1. the problems of contract specification and monitoring, especially in the provision of human services;
2. the high transaction costs associated with certain kinds of contracting;
3. the potentially undesirable consequences, especially in the context of uncertainty and changing patterns of demand, of specifying an organization's outputs too precisely in advance (i.e. too much specificity can limit an organization's flexibility and hence its capacity to respond to changing customer needs or meet unforeseen contingencies);
4. the adequacy of ex post facto sanctions and the dangers for principles of being more or less locked into particular supply arrangements or becoming heavily dependent on a single supplier;
5. various weaknesses in the way the process of contracting out is conducted, including a failure to ensure competitive tendering and prevent serious conflicts of interest;
6. the implications of contracting out for the location of political responsibility;
7. the implications of contracting out for the maintenance of policy learning, institutional memory and core organizational capabilities; and
8. the failure to analyse the impact of new forms of contracting on service providers and the quality of service provision.

Similar issues, needless to say, have been raised and debated in other jurisdictions (Ketti, 1993; Stewart, 1993; Rhodes, 1994). Let me offer some brief comments on several of these matters.

### **The Contracting Process**

Despite Cabinet Office (1992) guidelines on how public agencies should conduct the process of contracting with external agents, it is evident that departments and other public organizations have not always been sufficiently scrupulous in their management of the contracting process. Investigations by the Audit Office in 1994 identified numerous deficiencies in the way consultants are sometimes engaged by departments. Such weaknesses included: the lack in some instances of written specifications or terms of reference relating to the nature of

the task to be undertaken; the failure by departments in some cases to estimate at the pre-engagement stage the likely costs and timescale for assignments; the failure in certain cases to use competitive selection methods (i.e. where there were alternative suppliers available); and the lack of specificity in many contracts regarding such matters as the ownership of material, the requirement for confidentiality and explicit standards of performance (Audit Office, 1994). To make matters worse, the Audit Office noted that departments very rarely conduct systematic evaluations of the work undertaken or supplied by consultants. Consequently, it is impossible to demonstrate whether the employment of consultants has been cost-effective.

### **The Limits to Contracting Out**

There is doubtless scope for additional contracting out in the public sector in New Zealand. Indeed, there are relatively few public services which could not, at least in theory, be contracted out to private sector suppliers. Nor is there any shortage of people advocating a greater reliance on external contracting and extolling the virtues of "hollow" government or "virtual" government. In New Zealand, for example, proposals have been advanced that governments should contract out the provision of most, if not all, departmental policy advice (West, 1994).

Another interesting manifestation of the growing emphasis on outsourcing is provided by the following example. In 1995 the chief executive of the Wellington City Council, Angela Griffin, became a part-owner and director of a new company, Interlog, which is proposing to earn money by "arranging for New Zealand local government employees to take up temporary advisory roles overseas, organizing tours of New Zealand local authorities by overseas visitors, and finding overseas experts to advise on local projects" (Evening Post, 12 September, 1995). Not surprisingly, perhaps, the potential conflicts of interest involved in such an enterprise provoked no little controversy.

There are sound theoretical, as well as practical, reasons why certain public services should not be contracted out (Boston, 1994; Rhodes, 1994; US General Accounting Office, 1991). In particular, the literature on transaction cost economics suggests that in-house provision is likely to be preferable when there

are serious difficulties with respect to contract specification, monitoring and enforcement (or, more precisely, where there is a high degree of uncertainty and asset specificity, a significant risk of opportunism on the part of agents, complex and frequent transactions, and the likelihood of small numbers bargaining). Common sense also suggests that organizations are likely to incur serious risks if they contract out their activities to such an extent that they lose control of the contracting process and no longer possess the internal capability to manage contracts in a prudent fashion. It is, admittedly, no easy task to determine precisely which public services are "inherently governmental" (i.e. services which should always be undertaken in-house by public employees or where there should at the very least be some form of in-house capacity). Nevertheless, that there are such services is beyond dispute. In my view, there is a need for some serious reflection on the limits to contracting out in the public sector and the drafting of service-wide guidelines on the kinds of services (i) which should not be subject to external contracting, and (ii) which should not be wholly contracted out.

In summary, New Zealand is just one of many countries which is experimenting with new forms of contracting in the public sector and which is now relying to a much greater extent on the private sector to provide publicly funded services. This research note has provided only a brief sketch of some of the issues generated by these changes. On the whole, it appears that most of the new developments have been positive. There remains, however, a dearth of solid empirical evidence. It is to be hoped that in the coming years some of the gaps in our current knowledge will be filled and that it will be possible to make more definitive judgments about the merits of the new contractualist modes of public management. One issue which deserves particular attention is the relative advantages (or disadvantages) of contracting with other government-owned institutions versus the private sector. Another concerns the proper limits to contracting out. Finally, it will be interesting to observe what impact, if any, the introduction of proportional representation in the latter part of 1996 has on the conduct of public management in New Zealand, including the use of contracts of various kinds.

## Concluding Remarks

The paper is concerned with the use of contracting in the public sector. The emphasis of the study is placed on the concepts of contracting in various aspects such as Economic Concepts of Contracts, Citizens and Contracts, Intergovernmental Contracting, especially Economic and Political Unification Models, and the comparison of intergovernmental contracting with other contracting. The last part of the paper presents the cases of Thailand and New Zealand as to their experience in the use of public sector contracting.

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