

## Privatization: Issues in Local and State Service Provision

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### Summary

While many states and localities are turning to privatization as a way to provide services to their citizens, surprisingly little is known about these choices. Much of the debate over privatization pays little attention to the rationales and consequences of private vs. public service provision. With an eye toward advancing understanding about privatization, the University of Michigan's Office of Tax Policy Research (OTPR) and Center for Local, State, and Urban Policy (CLOSUP) sponsored a series of studies on privatization. This empirically grounded research can provide policymakers with a sound basis for assessing whether and how privatization should be undertaken.

This report begins by providing a historical background of privatization and a discussion of the nature and prevalence of privatization in the United States. Section II provides an overview of the empirical research on cost savings, quality, equity, employment, and political effects of privatization. The findings from the papers commissioned by OTPR and CLOSUP are presented alongside findings from other previously published research. Our review of the literature suggests the following conclusions about privatization:

- Private providers may or may not be more efficient than public providers. Whether privatization leads to greater cost savings depends largely on whether there is competition in service provision.
- The quality of privatized services may or may not be higher than publicly provided services. Governments can play an important quality assurance role by monitoring and evaluating the delivery of privatized services.
- In developing and transitional economies, privatization may reduce access to goods and services, particularly for low-income groups. Comparable studies need to be conducted to assess the distributional consequences of privatization programs in the United States.
- Privatization might lead to more rational labor market policies. However, the employment effects of privatization are more nuanced than commonly assumed by either proponents or opponents of privatization. Privatization tends to lead to substitution of high-skill for low-skill workers and reduction in total employment levels, but no change in net wages.
- Political considerations strongly influence both if and how policymakers contract-out services to private providers.

Section III addresses some of the unique considerations for state and local governments, to help policymakers and government officials understand the potential benefits, costs, and risks of privatizing particular government services. The final section of this report identifies avenues for further research. Privatization research is still in its infancy; questions abound, and there is much empirical ground yet to cover.



# I. Introduction

## HISTORICAL BACKGROUND

**G**rowth of the government sector is one of the conspicuous features of industrial economies in the twentieth century. In 1913, U.S. government spending represented 7.5 percent of U.S. Gross Domestic Product (GDP); by 1990, U.S. government spending was 33 percent of GDP. The American experience of rapid government growth is common among high-income countries. In 1913, Spanish government spending was 11 percent of GDP, and by 1990, 42 percent of GDP. Comparable figures for Japan are 8 percent in 1913 and 32 percent in 1990; for France, 17 percent in 1913 and 50 percent in 1990; and for the Netherlands, 9 percent in 1913 and 54 percent in 1990 (Heston, *et al.*, 2002).

Government growth has been influenced by many political, economic, and social factors. It has taken the form of greatly expanded government involve-

ment in education, health, pensions, unemployment assistance, welfare, and, in many countries, direct ownership of industry. Furthermore, certain traditional government activities, such as provision of national defense, now consume much higher fractions of national income than they did in earlier eras.

The rapid expansion of the public sector raises many important questions about the appropriate role of the government in a market economy. Concern over the cost of excessive government ownership of industry led to the gradual privatization (then known as “de-nationalization”) efforts of the Adenauer government in Germany in the early 1960s and the Thatcher government in the United Kingdom in the early 1980s. The perceived successes of German and British privatization efforts attracted worldwide attention and encouraged similar privatizations in France, Italy, Spain, Japan, Chile, Mexico, the former Soviet Bloc, and elsewhere.

## PRIVATIZATION IN THE UNITED STATES

Privatization in the United States took a distinct form from that of other countries. Whereas in other countries privatization involved selling off public assets, in the United States privatization largely consisted of contracting-

out public duties to private organizations. The unique nature of privatization in the United States is due to a scarcity of government assets. In the 1970s, state-owned enterprises claimed on average

6.7 percent of the labor force in other developed market economies, but only 1.5 percent in the United States. Historically speaking, “America kept private in the first place” (Donahue, 1989, p. 6).

There are several features of privatization in the United States that distinguish it from privatization elsewhere. In contracting-out services, the U.S. government retains control of planning, financing, and monitoring functions that allow it to shape how these services are provided. Thus, in the United States, private providers are subject to more government oversight and regulation than in other countries where, by virtue of their ownership of formerly public assets, private entities have more discretion in service delivery. Another distinguishing feature of privatization in the United States is the preeminent role of state and local governments (see below).

The private provision of government services has had a long history in the United States. In recent years, however, the breadth of privatization efforts has expanded significantly. Privatization initiatives now encompass an unprecedented range of service areas. Current privatization proposals in the United States not only include traditional issues such as trash collection, but many other service areas as well, such as elementary and secondary education and social welfare assistance, areas once considered to be exclusively public-sector domain.

## PRIVATIZATION AT THE STATE AND LOCAL GOVERNMENT LEVEL

Although some privatization has occurred at the national level, state and

*More than 80 percent of American cities currently use some form of privatization.*



local governments are responsible for the lion's share of privatization efforts in the United States. Surveys of local government officials indicate that more than 80 percent of American cities currently use some form of privatization (Greene, 2002, p. 2).

While a significant amount of contracting-out is taking place in local government, overall levels of privatization have remained somewhat stable since the early 1980s. Survey data from the International City/County Management Association (ICMA, various years) "Profile of Alternative Service Delivery Approaches" show that privatization to for-profit and non-profit firms rose only slightly, from 22 percent of all local government services in 1982 to 24 percent in 1997 (Warner and Hefetz, 2001, p. 2). However, for every eight services contracted out during that time period, five were brought back in-house, suggesting that dissatisfaction with privatization has led some cities and counties to reevaluate service delivery mechanisms (Warner and Hefetz, 2001, p. 15). One of the neglected but important facets of privatization is that, in practice, it is a dynamic and reversible process.

The use of contracting by local governments varies significantly by service area. According to the ICMA data, in 1997, more than 50 percent of local governments contracted out commercial solid waste collection; vehicle towing and storage; legal services; and the operation of hospitals, day-care facilities, and homeless shelters. By contrast, less than 5 percent of local governments contracted out crime prevention, police/fire communications, fire prevention/suppression, traffic

**Table 1. Percentage of Local Governments (cities and counties)**

**Most Commonly Contracted-Out Services**

Service	1982	1988	1992	1997
Vehicle towing and service	80	80	86	82
Operation of day-care facilities	72	34	88	79
Operation/management of hospitals	30	24	61	71
Operation of homeless shelters	n/a	43	59	66
Legal services	51	55	50	53

**Least Commonly Contracted-Out Services**

Service	1982	1988	1992	1997
Crime prevention	10	4	2	1
Police/fire communications	4	1	2	1
Fire prevention/suppression	5	1	4	3
Traffic control/parking enforcement	2	1	2	2
Prisons/jails	n/a	1	1	3

Note: Data comes from surveys conducted by the International City/County Management Association. Questions about some services were not included in all of the surveys, indicated as n/a in the table.

Source: Greene 2002, pp. 159-162.

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Chong, Alberto (Inter-American Development Bank) and Florencio López-de-Silanes (Yale University and National Bureau of Economic Research). "Privatization and Labor Force Restructuring Around the World."

Engel, Eduardo (Yale University), Ronald Fischer (University of Chile), and Alexan-

der Galetovic (University of Chile). "Privatizing Highways in the United States."

Feiock, Richard (Florida State University), Carl Dasse (Florida State University), and James Clingermayer (Murray State University). "Contractor and Sector Choice for Municipal Services Production: A Transaction Cost Approach."

Hines, James R., Jr. (University of Michigan and National Bureau of Economic Research). "Privatization and Fiscal Health."

Piehl, Anne Morrison (Harvard University and National Bureau of Economic Research). "Privatizing Prisons."



control/parking enforcement, sanitary inspection, or prison/jail services (refer to Table 1).

## EXPECTED FUTURE TRENDS

There are good reasons to believe that both states and localities will continue to rely on private contracting to provide an array of government services. New service responsibilities, together with budgetary pressures and a movement toward performance-based management, could provide an impetus for additional privatization initiatives at the state and local levels.

Some states and localities will confront the need to provide new or expanded services, as a result of mandates, devolution of government responsibilities (like social welfare assistance), and demographic changes. They may move to privatize these new areas of service responsibility, as a way to tap into the expertise and experience of non-profit and for-profit providers.

Budgetary pressures, stemming from poor economic conditions and reductions in federal aid, may push other states and localities to privatize services as a way to reduce costs or mask cutbacks in service provision (Donahue, 1989, p. 136).

Last but not least, national legislation, such as the Government Performance and Results Act of 1993, the Government Management and Results Act of 1994, and the National Performance Review's "reinventing government" initiative of the mid-1990s, could prompt some states and localities to rethink the way they deliver services. Some states and localities

may turn toward privatization in order to bring performance-based management to the public sector (Winston, *et al.*, 2002, p. 6).

## II. Characteristics of Privatization

As governments consider privatization they face numerous difficult tradeoffs. Privatization has important implications for the efficiency of, quality of, and access to goods and services. The decision to privatize a particular activity can also affect employment conditions and political support. In order to provide a framework for policymakers and government officials to think about the potential benefits and risks of privatizing a particular activity, this section summarizes the state of knowledge about privatization, based

on a review of the literature and papers sponsored by OTPR and CLOSUP. The results presented here are a reflection of what information the authors were able to gather, and do not necessarily capture all of the empirical findings about privatization.

## EFFICIENCY/COST SAVINGS

A basic tenet of economic theory is that competition leads to the production of cheaper and higher quality goods. Economic theory suggests that contracting-out services should result in cost savings for governments, as the pressures of competition force service providers to work more efficiently. This is thought to hold true for competition broadly, not only for competition by for-profit organizations (Winston, *et al.*, 2002, p. 15).

It is difficult to generalize about the efficiency consequences of privatization,

### "Privatizing Prisons"

Anne Morrison Piehl

Concerns about quality and public accountability make the contracting out of certain types of government services difficult. The perceived risks of delegating coercive authority to private entities make the privatization of prison facilities and management especially controversial. Using Bureau of Justice statistics, the author analyzes trends in the management and organization of correctional facilities. She finds that states are contracting out custodial confinement in order to accommodate a new or fluctu-



ating need for prison space. The author contends that concern about quality and public accountability leads states to favor the privatization of less coercive prison services (boot camps, substance abuse treatment, medical facilities, reception centers, etc.) for low-risk (minimum-security) inmates.



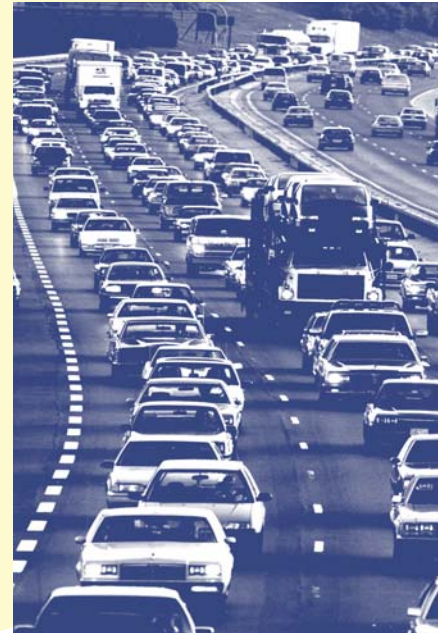


## “Privatizing Highways in the United States”

*Eduardo Engel, Ronald Fischer, and Alexander Galetovic*

How the bidding and contracting process is managed can influence whether expected quality improvements of privatization play out in practice. Contract design is especially important when service provision is characterized by a high degree of risk or uncertainty, since outcomes may be much more variable. This paper focuses on the lessons learned about privatizing highways in the United States, based on experiences related to the construction of the Dulles Greenway in Virginia and the express lanes on California Route 91 in Orange County. The

authors recommend that governments contract out highway construction services through a present value revenue (PVR) auction, where firms compete on the basis of toll revenues in present value terms. The authors contend that PVR auctions allow governments to reduce costs, ensure quality services, and minimize demand uncertainty, without sacrificing contract flexibility. The findings are particularly useful for state and local authorities that want to build new highway infrastructure. The findings may also be applicable to the privatization of other government services that are characterized by high investment costs and demand uncertainty, such as airport, train, and metro infrastructure.



because of the methodological limitations of proving a universal assertion about either public or private institutions (Donahue, 1989, p. 57). In order to compare the costs of public and private provision, researchers need to control for a broad range of variables that affect service costs, such as the density of the service area, and the quality and frequency of service. Thus, researchers can only infer some general tendencies from comparing similar tasks performed by public and private actors.

The empirical evidence on the cost savings of contracting-out services tends to be mixed, although overall it suggests the potential for somewhat lower costs when public services are provided by private entities. In the area of garbage collection, several researchers find efficiency gains in the private sector (Savas, 1977; Kemper and Quigley, 1976; and

Stevens, 1977). Several explanations for cost savings under privatization are suggested, including: economies of scale, better management techniques, use of advanced technology, and more efficient and flexible deployment of workers (Donahue, 1989, pp. 60-64). Other authors, however, find no efficiency gains through private provision of garbage collection services. When Hirsch controls for a broad range of variables, he finds they explain 76 percent of variation in trash service costs, making the efficiency distinction between public and private organizations statistically insignificant (Hirsch, 1965, p. 91).

The potential cost savings of privatization varies considerably by service area. In a review of major studies about water and power utilities, Donahue finds that there is no tendency for private companies to be more efficient than public

ones (Donahue, 1989, p. 75). Donahue speculates that government regulation, in the form of utility price setting, may undermine efficiency gains from utility privatization. Private actors may have less incentive to reduce service provision costs given the finite rate of return to capital in fixed-price markets.

Researchers disagree about whether there are efficiency gains/cost savings under privatization, and about how sizable the gains are. The conclusion that can be drawn from the existing empirical research is that private providers are potentially more efficient than public ones. Whether privatization leads to greater cost savings depends largely on whether competition exists in service provision (Donahue, 1989 p. 78).

There are several limitations to the existing research that are important from both an academic and a public policy



perspective. First, these analyses may be based on nonrepresentative samples, because privatization often occurs in instances where the public sector is particularly inefficient, providing a point of comparison that might not be representative of public sector provision more broadly (Winston, *et al.*, 2002, p. 17). Given this potential for selection bias, one must be careful about extrapolating results to other service areas. Second, many of the studies discussed above assess the efficiency of public and private provision based purely on direct service provision costs, and fail to take into account the administrative costs associated with privatization. During the Reagan administration, two experts estimate that contracting, evaluation, and enforcement absorbed 20 to 40 percent of all procurement spending (Donahue, 1989, p. 109). Thus, a more robust cost estimation methodology could lead to more limited cost savings estimates under privatization. Last but not least, existing literature has failed to consider how the efficiency gains/cost savings of privatization compare vis-à-vis other policies, like performance-based incentives, that can also be used to enhance economic efficiency *within* the public sector. The exclusive focus on privatization might paint a misleading picture of the options available to governments in restructuring services.

## SERVICE QUALITY

Dissatisfaction with public services has provided another impetus for privatization. Many supporters of privatization believe that marketplace competition can lead to higher quality services by

## “Contractor and Sector Choice for Municipal Services Production: A Transaction Cost Approach”

*Richard Feiock, Carl Dasse, and James Clingermayer*

Using data from the ICMA’s “Profile of Alternative Service Delivery Approaches,” the *Municipal Yearbook*, and *County and City Data Books*, the authors analyze how service characteristics affect the likelihood of privatization in local governments in the United States. The authors find that developmental and regulatory services are more likely to be pro-

vided in-house, while redistributive and allocational services are more likely to be contracted out. The authors hypothesize that the variance in contracting can be partly explained by the anticipated political benefits and costs associated with particular types of services. Governments usually opt to directly provide developmental services because these services tend to be politically popular. By contrast, governments usually contract out redistributive and allocational services because these services tend to be politically unpopular.

driving out underperforming firms.

Research on the quality of privatized services is very limited, and like that on cost savings, its results are mixed. A number of researchers assert that different sectors have different relative strengths, depending on the primary goal of the service (Winston, *et al.*, 2002, p. 17). On the whole, however, the empirical evidence suggests that the quality of privatized services might be equivalent or somewhat higher than publicly provided services. However, as noted in the discussion on efficiency, selection bias may skew the results in favor of privatization, and provide a poor basis for generalizing about service quality more broadly.

Other researchers pay less attention to the question of whether any single sector consistently provides the highest quality services, and instead stress the importance of careful program implementation. The General Accounting Office (1997) asserts that the government can play a

critical quality assurance role by carefully monitoring and evaluating service provision under privatization. However, the government’s ability to fulfill a quality assurance role may vary according to the nature of the service provision. Evidence suggests that government oversight may be easier when precise performance standards can be specified in advance, the results of service provision are measurable, and substitution among contractors is possible (Donahue, 1989, pp. 97-98). When these conditions do not exist, it may be more difficult for governments to ensure the quality of privately provided services.

Two studies sponsored by OTPR and CLOSUP explore how state and local governments address quality concerns within two high-risk service areas: prison management and highway construction. In the case of prisons, researcher Anne Morrison Piehl finds that concern about quality and public accountability leads



states to favor the privatization of less coercive prison services (boot camps, substance abuse treatment, medical facilities, reception centers, etc.) for low-risk (minimum-security) inmates. In the case of highways, researchers Eduardo Engel, Ronald Fischer, and Alexander Galetovic discuss how states and localities can structure the bidding and contracting process in order to reduce the risk of cost overruns and address demand uncertainty. These papers fill a gap in the existing research by identifying some of the avenues available to government entities to ensure quality service and accountability for nontraditional privatized services.

## EQUITY/ACCESS

Privatization can have important implications for the distribution of goods and services in society. Theoretically, privatization might improve access to products by means of business expansion, which the investment-constrained public sector could not carry out. Conversely, private providers could restrict access to goods and services by withdrawing from or ignoring some markets that the public enterprise was obliged to serve (Birdsall and Nellis, 2002, p. 16).

The distributional effects of privatization have not received much scholarly attention to date. What little is known about the distributional consequences

of privatization derives from research on privatization in developing and transitional economies. In a literature review of privatization programs, researchers Nancy Birdsall and John Nellis find that privatization efforts in developing and transitional economies commonly lead to steep price increases in divested network or infrastructure industries, such as water, electricity, and sewage (Birdsall and Nellis, 2002, p. 16). In these cases, privatization reduced access to goods and services, particularly for low-income groups. Comparable studies need to be conducted to assess whether privatization programs in the United States have resulted in similar distributional outcomes.

### “Privatization and Labor Force Restructuring Around the World”

*Alberto Chong and Florencio López-de-Silanes*

Proponents of privatization argue that the public sector suffers from a bloated and inefficient labor force. Using new data from a random sample of 308 recently privatized state-run enterprises in the world, the authors evaluate the effectiveness of government labor force restructuring policies. The authors find that adverse selection undermines the effectiveness of government retrenchment programs carried out prior to privatization, reflected by lower net privatization prices and higher rehiring rates after privatization. Adverse selection problems are greater when voluntary and age-based downsizing mechanisms are used because these policies do not tar-



get the least-productive or least-skilled workers. Although the authors find evidence that compulsory skill-based downsizing is a more effective way to carry out labor force restructuring, they hypothesize that the political costs of this

policy make it somewhat impractical. Because of adverse selection, government labor force restructuring policies often do not lead to cost savings or workforce quality improvements.





## EMPLOYMENT CONDITIONS

Privatization can also lead to changes in employment, wages, and benefits for particular groups of individuals. Proponents of privatization assert that privatization leads to a more efficient and cost-effective allocation of labor. Opponents of privatization argue that privatization harms public sector employees because of employment reductions, lower wages, and less job security. Several state and local governments have faced considerable opposition to privatization from public sector unions, such as the American Federation of State, County, and Municipal Employees (AFSCME). In many cases, expected employment effects are closely related to the political feasibility of privatization initiatives (refer to discussion of ‘political considerations’).

In a paper sponsored by OTPR and CLOSUP, researchers Alberto Chong and Florencio López-de-Silanes find

evidence of labor market inefficiencies in the public sector. The authors conclude that adverse selection problems undermine the effectiveness of public sector labor force restructuring policies, leading to the firing of more productive and skilled workers. These findings provide some empirical support for the notion that privatization can lead to cost savings and workforce quality improvements through more rational labor market policies.

Other research addresses the employment consequences of privatization. In *Urban Alternatives: Public and Private Markets in the Provision of Local Services*, researcher Robert Stein finds no evidence that increasing the proportion of contractual services has a negative effect on wage rates. However, increasing privatization is associated with lower levels of public employment. When services are contracted out to private and non-profit providers, a larger number

of less expensive workers are replaced with a smaller number of more expensive monitoring personnel. Due to the reduction in labor force size, total labor costs decline, but the per-worker wage increases because the composition of the labor force is skewed toward more expensive administrative and managerial workers, responsible for overseeing and monitoring contract performance (Stein, 1990, p. 179). Stein’s findings suggest that the employment outcomes are more nuanced than commonly assumed by either proponents or opponents of privatization.

Much of the research conducted to date focuses on the economic implications of employment changes under privatization. Additional research is needed to explore the qualitative aspects of employment conditions in the public and private sector, an area that has been overlooked in the existing literature, as well as the possible relationship between



## “Privatization and Fiscal Health”

James R. Hines Jr.

This paper analyzes the effect of a community’s fiscal health on privatization decisions by comparing bond ratings and Census data for roughly 4,000 municipal and county governments in the United States. The author finds that municipalities and counties in “bad” fiscal health (those with bond ratings “Baa1” and below) are significantly less likely to privatize their services than are municipi-

palities and counties in “good” health (those with bond ratings “A” and above). Contrary to capital cost theory, this evidence indicates that governments don’t base service provision decisions solely on expected cost savings or efficiency gains. Political considerations, such as the desire to use public sector employment as a form of political patronage, may influence whether governments opt to provide services in-house or to contract them out to private providers.





employment conditions and service quality.

### POLITICAL CONSIDERATIONS

Much of the existing research on privatization focuses on cost-savings rationales for contracting-out government services to private organizations. By contrast, little research has been conducted to date that explores the political environment which shapes service provision decisions. Two papers sponsored by OTPR and CLOSUP highlight how political considerations influence both if and how policymakers contract-out services to private providers. Researchers Richard Feiock, Carl Dasse, and James Clinger-mayer find that cities and localities tend to contract out the service areas that traditionally have the least political support. Researcher James Hines finds that the political benefits of public sector employment might discourage the use of privatization by local government entities. Together, these papers highlight the central importance of political considerations in service provision decision-making.

Research conducted by Mildred Warner and Amir Hefetz shows that political considerations also influence how local governments structure privatization efforts. Based on data from the ICMA “Profile of Alternative Service Delivery Approaches,” the authors find that between 1988 and 1997, the percentage of local governments allowing competitive bidding between public employees and private providers increased from 10.9 percent to 16.5 percent. The percentage of local governments offering programs to minimize the effect

of privatization on displaced public employees rose from 8.7 percent to 12.9 percent over the same time period (Warner and Hefetz, 2001, p. 6). These trends show that local government officials are particularly attentive to the political ramifications of employment conditions under privatization.

## III. Unique Considerations for State and Local Governments

In making decisions about service provision, all policymakers and government officials are confronted with the task of weighing competing goals such as efficiency/cost savings, service quality, and equity/access, along with other important considerations such as employment effects and political feasibility. There are, in addition, some unique considerations for state and local governments. In particular, balanced budget requirements, interjurisdictional competition, and market size have important implications for state and local service provision.

### BALANCED BUDGET REQUIREMENTS

Balanced budget requirements may increase the importance of cost-saving and efficiency considerations in state and local government service provision. According to the National

Conference of State Legislatures, all states (with the exception of Vermont) and Puerto Rico have a statutory or constitutional requirement of a balanced budget (NCSL, 1996, p.1). These balanced budget requirements generally force state and local governments to keep expenditures in line with revenues for a given fiscal period, and could make cost-effectiveness a paramount concern in evaluating different modes of service provision. However, in some cases, states are able to use accounting methods to maintain real economic deficits in spite of balanced budget requirements. Thus, the effects of balanced budget requirements might vary state by state.

### INTERJURISDICTIONAL COMPETITION

Interjurisdictional competition has important implications for both if and how state and local governments provide particular government services. Interjurisdictional competition can be defined as the rivalry among state or local units of government for tax base. Within a competitive environment, government services are one mechanism used by states and localities to attract or retain potentially mobile goods, services, and residents. Interjurisdictional competition can lead governments to believe they cannot raise taxes too high without risking the out-migration of high-income taxpayers and businesses (Kenyon, 1997, p. 14). Thus, like balanced budget requirements, interjurisdictional competition may push states and localities to place greater emphasis on efficiency considerations in making service provision decisions.



## MARKET CONDITIONS

Market conditions also influence how states and localities provide public services. A limited number of suppliers that can provide particular public services can constrain the ability of small cities and rural governments to engage in alternative forms of service delivery (Warner and Hefetz, 2001, p. 7). Communities that have a small pool of alternative providers may elect not to privatize services, either because of a lack of competent providers or due to concerns that limited competition may undermine potential efficiency gains. Researcher Robert Stein finds that when small cities contract-out service provision, they tend to contract with county government or other public sector actors due to limited availability of private sector contractor options (Stein, 1990, p. 57).

## IV. Avenues for Further Research

By exploring efficiency/cost savings, service quality, equity/access, employment conditions, and political feasibility, existing empirical research has provided some insight into the potential advantages and disadvantages of privatizing government services. However, in many cases, results are mixed or inconclusive.

Our reading of the literature identifies three broad avenues for further research about privatization. Given the prevalence of privatization among states and localities, ongoing research in this area is especially important as a matter of

academic and public policy concern. Additional research is needed to understand if, and how, balanced budget requirements and interjurisdictional competition affect service provision decisions at the state and local level (refer to text box).

Another aim of future research should be to improve understanding about the consequences of privatization more

generally. Additional research is needed to reconcile the conflicting results generated to date and to improve research methodologies. Additional research is also needed to address questions about the efficiency, service quality, and equity/access effects of privatization, not covered in the existing literature (see table below).

### Questions for Further Research about State and Local Considerations

#### BALANCED BUDGET REQUIREMENTS

- Do balanced budget requirements increase the importance of cost effectiveness in service delivery?
- Do states with more stringent balanced budget requirements engage in higher levels of privatization?

#### INTERJURISDICTIONAL COMPETITION

- Do jurisdictions compete with each other in service provision?
- Do the service provision decisions of one jurisdiction impact other jurisdictions? If so, how?

### Questions for Further Research about the Consequences of Privatization

#### COST SAVINGS

- What are the hidden costs of privatization in terms of monitoring/evaluation and substitution costs?
- Does privatization lead to cost savings? If so, what accounts for the cost reduction effects of privatization?
- How does the cost of service provision vary over time? Are initial efficiency gains of privatization sustainable over the long run?
- How do efficiency gains under privatization compare to other policies, like performance-based incentives?

#### SERVICE QUALITY

- What have been the consequences of contracting-out services on quality-of-service provision?
- How prevalent is opportunistic behavior in contracting?
- Is there a relationship between employment conditions and service quality?

#### EQUITY/ACCESS

- What have been the consequences of contracting-out services on the equity-of-service provision? Does privatization lead to cuts in services for hard-to-serve populations or areas?



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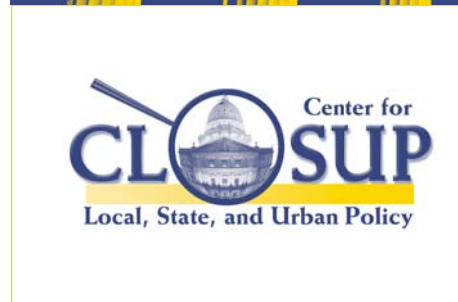
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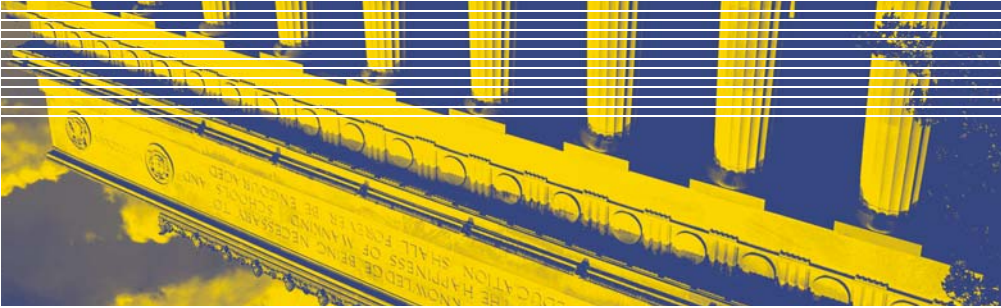
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