CHAPTER 22

CONTROLLING LOCAL GOVERNMENT EXPENDITURES

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CONTENTS

22.1 INTRODUCTION. Since the inflation of the 1970s, a steady stream of fiscal crises have plagued state and local administrators. These problems created interest in cutback management. Much of the cutback-management literature focuses on pragmatic suggestions dealing with short-term fiscal stress. Expenditure control techniques such as hiring freezes, travel restrictions, across-the-board cuts, and construction delays are common responses. These techniques deal with immediate problems and are used in the hope that the fiscal strain is temporary.
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Spurred by conservative political philosophy, mistrust of big government, and the apparent long-term nature of the fiscal crisis, another expenditure-control school of thought has emerged. This perspective takes a long-run view and questions the traditional role of government. It reexamines how government implements policy. Techniques of privatization are advocated as means to control government spending.

In a general sense, privatization rationalizes government by introducing market models and techniques to the delivery of public services. The method most commonly associated with privatization is contracting.

This chapter examines privatization as a method of expenditure control. In the first section, its philosophical underpinnings are explored. The following sections introduce and assess techniques of privatization such as load shedding, contracting, franchising, self-help, and volunteers. Contracting receives special attention.

These methods contain or control costs. The user charge is another technique commonly associated with privatization. Fees help control expenditures by influencing citizen demand. In addition, fees can be used to structure financial information for expenditure control. The organizational entity designed to do this is known as a revenue center. Revenue centers help focus management attention on the bottom line and stimulate cost-control incentives much as the profit motive would. Hence, the final section of the chapter will be devoted to user fees and revenue centers.

It should be noted that expenditure control alone will not solve the fiscal crisis. Private contractors, for example, will deliver only those services they are paid to deliver. Hence, approaches to fiscal stress should include both expenditure control and revenue enhancement. This chapter and Chapter 21 (Enhancing Local Government Revenues) complement each other and should provide pragmatic fiscal officers with helpful insights and useful fiscal tools.

22.2 PRIVATIZATION. Privatization is a tricky concept that has been used in a multiplicity of contexts. For example, the demise of the cold war has sparked interest in privatization among former members of the communist block. They view privatization as a way to evolve toward a market economy (Savas, 1990). In this chapter, privatization refers to the process of rationalizing government by using market or marketlike mechanisms. At its best, privatization brings the benefits of competition to the public sector.

Advocates of privatization believe that government as sole producer is an unresponsive, inefficient monopoly. They want to enhance productivity by redesigning and restructuring public expenditures. Only in this way can the sustained problem of government inefficiencies be dealt a blow.

Most state and local governmental organizations receive budget allocations and supply services such as police protection, solid-waste collection, education, street lighting, and libraries. In this context, government both provides (pays for, decides how much) and produces (delivers) the service. Privatization scholars maintain that notions of provision and production must be disconnected (Kolderie, 1986). Government's essential responsibility lies with determining the mix and level of public services and financing these services (i.e., provision). Production or service delivery, on the other hand, is not an inherent function of government. Further, most expenditure-control and cost-containment gains center around production efficiencies (Kolderie, 1982).

In the private sector, production efficiencies are stimulated by competition and the profit motive. Firms in a competitive environment tend to optimize. Optimal production depends, in part, upon the technology of the product (economies of scale). Public enterprise, however, tailors production to particular service areas (city limits). For example, a city's geographic boundaries will dictate the number of trucks and dump sites used in garbage collection. Optimal production efficiencies, however, may be associated with either a larger or smaller service area. Furthermore, given traditional public budgeting systems, there is an incentive to maximize budget size rather than seek efficiencies. If production is disentangled from size restrictions, a competitive environment created, and the profit motive introduced, efficiency will be enhanced without affecting government's central fiscal responsibility.

The essential role of government is that of service arranger. As service arranger, government takes on the role of assigning consumer to producer (Savas, 1987, pp. 58–94). In this framework, a variety of alternative service-delivery systems can be considered. Furthermore, profit, nonprofit, or another governmental entity may be responsible for supplying services.[1]

It should be noted that efficiency and effectiveness are goals that are sometimes at odds with equity and accountability. Notions of equal access and equal treatment are at the heart of many public-sector organizations. They are not part of the inherently unfair market. The market is successful because it excludes those who cannot pay and, through business failure, weeds out the inefficient. As quasi-market mechanisms, the techniques of privatization have this disadvantage. In addition, norms and values such as citizenship and loyalty are alien to privatization. Privatization cannot lead to better citizens—just smarter consumers (Levin, 1984).

Although equity may not be a critical norm to the private sector, its importance cannot be overlooked in the political arena. A mayor might be committing political suicide if she advocated closing a neighborhood school because it was inefficient. Hence, equity is a goal properly considered by government, and is part of pragmatic politics. Public officials and managers would do well to keep the equity objective firmly established as they consider privatization. Fortunately, with care and foresight, equity norms can be compatible with production efficiencies. As service arranger and provider, government makes the decision about who is served and the level of service. These specifications can be written into contract or franchise agreements.

(a) The Techniques of Privatization. Most techniques of privatization focus on the production process. They involve the use of market or quasi-market mechanisms to enhance efficiency. Their purpose is to control government spending through cost containment or cost shifting. Competition provides the incentives that insure production efficiencies when alternative service delivery methods are used.

(i) Load Shedding. Load shedding, exit, or service shedding is a drastic form of privatization. It is also most clearly linked with the conservative, shrink government political philosophy. Under load shedding, government transfers total responsibility for service provision to the private sector (either profit or nonprofit).

Clearly, wholesale service shedding would shrink government and reduce expenditures. Advocates believe that this would restore government to its proper size. The country would be better off if the tax burden associated with big government was lifted. At its best, load shedding would restore individual and family responsibility. For example, citizens would take responsibility and save for their old age rather than rely on big government programs such as social security or medicare.

[1] For a useful discussion with local government examples, see Savas, 1987, pp. 95–116.

Also, advocates maintain that government withdrawal would free up business initiative. In Denver, for example, there is a successful private nonprofit drug, alcohol, and criminal rehabilitation program that receives no governmental funding. One of its innovative approaches to financing includes operating gas stations and restaurants using resident labor (Hatry, 1983, p. 72).

Advocates view service shedding as a solution to big government. Most citizens, however, want state and local governments to provide traditional services. Furthermore, load shedding severely challenges equity norms. Those least able to afford service would be hurt first. Sections of a city that could not fully support recreation facilities, libraries, or emergency medical service would do without. This is particularly problematic when dealing with health and human services that are targeted at the needy.

A type of load shedding experiment has been used by state mental hospitals that released patients into the community. The marked increase in homeless, displaced mental patients is symptomatic of the problems with service shedding. Neither the family nor the nonprofit charitable sector has the resources to take full responsibility.

Aside from the overriding equity issue, critics question the staying power of services completely transferred to private concerns. Also, although the cost to government drops, the cost to individual citizens may actually increase (i.e., higher-priced recreation facilities).

Given the real problems with load shedding, can it be taken seriously? Unfortunately, a severe fiscal crunch may force governments to drop some functions and relinquish them to private enterprise (either intentionally or by default). Services most appropriate for load shedding are those for which benefits accrue primarily to individuals and where people can easily be excluded. Under these conditions, a market could develop (perhaps in a limited way) to replace services dropped by government. Hence, a softball complex would be a candidate for load shedding before police patrols. Recently, airports have become candidates for load shedding (Bunnell, 1990.).

In addition, it is possible to incorporate equity norms. If a debt-ridden municipal golf course catering to the middle class closed, the private sector would probably step in. Middle-class golfers have the capacity to support the sport. On the other hand, the private sector may never meet the demands of low-income children if their neighborhood pool closed. Furthermore, the pool may provide widespread community benefits by easing tensions through healthful recreation for children and adolescents. Finally, some regulatory activities can be shifted to the private sector. For example, building inspections could become a responsibility of the insurance industry.

(b) Contracting. The most common form of privatization is contracting (i.e., government purchase of a service in whole or in part). Contracting does not take away public responsibility for program funding and, thus, does not replace tax revenue. Rather, at best, it promotes efficient use of these dollars. There are several contracting models. The entire service can be contracted out. Part of agency activities, such as support services or management, can also be contracted.

Since contracting involves only the question of production, its support is widespread and crosses ideological boundaries. Liberals and conservatives alike support efficiency in service delivery. As a technique that focuses on production, it also has nearly limitless applications. Almost every local government service has been contracted out. Examples include data processing, hospital management, vehicle repair, wastewater treatment, fire protection, solid-waste collection, street lighting, tax assessing, vehicle towing and storage, prisons, and insect control. Further, use of contracting by local government has grown substantially over the last decade (AICR, 1985, p. 6).

(i) Advantages of Contracting. Contracting is popular and successful because it can reduce costs. Private organizations can perform traditional local government functions at substantial savings. Although limited, empirical evidence supports this hypothesis. After considerable empirical investigation, private garbage collection systems were found to be between 14 and 124 percent cheaper than public systems. Further, a resident may have to pay as much as 58 percent more for municipal collection than for contract collection (Savas, 1987, p. 124). Public sector solid-waste delivery was more expensive because it used more people, had higher absenteeism, and used poorer technology.

The most comprehensive and methodologically sound study to date found substantial cost savings (sometimes more than 50 percent) among seven or eight contracted local government activities (Stevens, 1984, p. 398). Surprisingly, differences in service quality, wages, or fringes were unrelated to contract cost savings. Relevant factors included shorter vacations, younger work force, higher turnover rates, and greater use of part-time employees. Contractors were also more likely to use the least qualified person to do the job. For example, unlike municipal employees, janitorial duties included only cleaning, not simple maintenance such as changing fuses (*ibid.*, p. 402). Finally, the survey identified superior management practices among contractors.

Proponents of contracting also claim that private contractors achieve efficiencies because they are free from conventional forms of bureaucratic control, such as civil service regulations or lengthy, complex procurement policies. In addition, contracts can be terminated (or not renewed) for poor performance. This flexibility gives decision makers increased control vis á vis an entrenched bureaucracy.

Finally, contracting has the potential to bring improved management both to the government (as service arranger) and to the production process itself. Contracting allows responsible government officials to operate differently. Their focus changes from administrative (serving citizens) to management (achieving objectives given limited resources). Supporters also claim that it encourages a change in goals from maximizing income (budget size) to maximizing effectiveness. Government, as contract manager, then takes on the dual role of protecting taxpayer interests and meeting client needs (Kolderie and Hauer, 1984, p. 110).

Aside from shorter vacations and greater use of part-time workers, superior management practices among contractors was significant in explaining cost differences (Stevens, 1984, p. 403). The key was management responsibility. Contractors were more likely to place responsibility for service delivery with management and workers. For example, hiring and firing decisions rested with the manager. Unlike municipalities, which dealt with equipment repair through a central maintenance system, broken-down equipment was the responsibility of contract managers. Hence, private managers had an incentive to consider preventive maintenance, and it was more difficult for them to pass the buck and blame performance failing on others.

(ii) Disadvantages of Contracting. Critics of contracting are uncomfortable with its growth and encroachment into public-sector activities. Chief among its critics are municipal and state employees who are threatened by its growth. Their organized, political resistance (often union) can be a significant roadblock to implementation (Hatry, 1983, p. 27).

Contractor profits are also a concern since their source is tax dollars. Would not those profits serve public purposes better as parks, roads, or services to the needy? Profits also serve as an incentive to sacrifice quality in favor of quantity. Furthermore, the public sector's commitment to equity can be undermined by profit-oriented contractors. Since contractors are further removed from the citizenry than public officials, it is more difficult to hold them accountable for their actions. Lucrative contract awards can also become a source of corruption (Main, 1985, p. 95).

Even if honest officials carefully administer contracts, there is no guarantee against bankruptcy and service disruption. After all, business failure is a normal and healthy part of competition. If, however, a jail, fire department, or solid-waste collection system goes out of business, the community faces a crisis. This problem can be particularly painful in the human-service sector. In Texas, for example, a private, for-profit firm operating an intermediate-care nursing home facility for indigent mentally retarded patients withdrew because it was losing money. The state was left to resolve the problem (Johnson, 1986).

Other critics question the so-called cost savings of contracting. This is clearly the case when a government monopoly is replaced with a contractor monopoly. Efficiency incentives will exist in neither case. Even in a competitive environment, costs may be understated. Local government officials may fail to consider the long-run costs of contracting out. Simple before-and-after comparisons may understate costs, since new contractors bid low to get the contract and increase the bid over time. Further, the administrative costs of determining procedures, and awarding, negotiating, and monitoring contracts are often overlooked. In addition, municipal governments are vulnerable to expensive contractor lawsuits contesting awards (DeHoog, 1984, p. 9).

Paul Starr maintains that contracting has the potential to increase the domain of special interests in the budgetary process. If programs now operated by government were shifted to private contractors, one would expect private contractors to exert pressure for higher spending. He maintains that naive privatization supporters underestimate contractors' capacity to manipulate incentive packages to their own advantage and their "capacity to influence political decisions" either by illegal means or legally through campaign contributions (Starr, 1987, pp. 5–6). Clearly, these are trends that one would expect as a system of privatization matures. Hence, it may be inappropriate to compare the relatively older public system with an immature system of private contracting.

(iii) Overcoming Disadvantages. Only time and empirical investigation will provide a thorough evaluation of contracting. Many potential flaws, however, can be corrected if contract officials understand the basic concepts.

To ensure that a contracting system is responsive to citizens' needs and responsible for service delivery, there are three conditions for successful contracting (DeHoog, 1984, p. 19). First, there must be competition both in the environment and in contracting procedures. Thus, competition will ensure that one monopoly is not substituted for another. Competition in the environment requires that at least two independent bids are considered. A single bidder has no incentives to control costs or maintain quality. Also, two or more bidders provide a basis for comparison.

Local governments should maintain at least a small capacity to deliver all services (Savas, 1987, p. 130; Hatry, 1983, p. 14). By preserving even a small role, local government enhances the competitive environment. Government can be used as a standard to compare contractor performance or vice versa. Cities that have tried this innovation usually witness productivity gains among city workers. Further, limited government capacity guards against the potentially devastating consequences of contractor bankruptcy and service disruption. For some services, such as garbage collection and street light maintenance, competition can be enhanced by dividing the city into several service areas. If several contractors and the city provide the service, the potential for service disruption is diminished and a healthy competitive environment is ensured.

Competition in procedures implies that government actively promotes competition. Wide advertising, a complete and clear service specifications, and impartial contract bid consideration help ensure a successful contracting process (DeHoog, 1984, p. 14). It should be noted that the equity consideration can be dealt with through contract specifications. If contractors know ahead of time that they will be evaluated using equity as a criterion, they should respond.

The second condition of successful contracting is that government officials adhere to goals of cost reduction and service quality. This condition is obvious but not always considered. In the heavily contract-dependent human service sector, for example, service to clients is the primary goal. It is common for cost norms to be ignored (*ibid.*, p. 132).

Third, successful contracting requires that government perform as an effective watchdog. Government considers the public interest by monitoring contractor performance. Monitoring systems are necessary to reduce the likelihood of service disruption and corruption.

22.3 CONTRACT ADMINISTRATION. Successful contracting often hinges on effective contract administration.[2] Indeed, privatization through contracting implies that government, in the public interest, provides feedback and guidelines to private producers. Hence, three critical aspects of contract administration will be addressed: contract specification, contract award, and contract monitoring. It should be noted that the three aspects of administration are interwoven. For example, contract specifications provide monitoring guidelines.

(a) Contract Specification. A poorly specified contract will inevitably lead to poor service. Contractors are hired to do a job, and that job is specified in the document. In a sense government gets what it asks for. The nature of government programs often makes contract specification difficult. Defense weapon systems is

[2] Proper contract administration generally requires personnel skilled in accounting, contract law, and the myriad of regulations that accompany contracting. The National Contract Managers Association is a professional organization that specializes in supporting the profession through training and a certification program.

perhaps the best example. Potholes, however, are also illustrative because it is difficult to calculate where and when they will occur (Savas, 1987, p. 268).

The key to specification is understanding desired service output. The tangibility of product output and its complexity influence specification. When outputs are tangible, specification and monitoring of desired results are fairly easy. Contract administration should be straightforward. On the other hand, complexity makes contract administration more difficult. The more complex the product, the more dimensions must be specified and monitored. Hence, complex products are better suited to public production (Ferris and Graddy, 1986, p. 333). Not surprisingly, tangibility and simplicity were important variables in explaining the incidence of contracting. The only real exceptions were human services (*ibid.*, p. 337).

Service output should be clearly defined. For example, the desired output for a park maintenance contract might be a neat and clean park. Neat might be specified as grass no higher than three inches tall, and shrubs that do not cover paths. Specifying in the contract how often the grass must be cut, crew size, type of equipment, and so on undermines management discretion, efficiency, and effectiveness.

Many problems with contracting out can be traced to abuses of specification (Main, 1985, p. 151). Contract specification can be used to support hidden agendas. For example, threatened city employees may want the contract to fail and write it up with costly conditions and restrictions. On the other hand, it is fairly easy to corrupt the process by writing a bid that favors one supplier.

(b) Contract Award. The contract award procedure should promote a competitive environment. Hence, excessive reliance on one supplier should be avoided. If competitors feel that a single firm has a lock on the contract, they will withdraw from the process. Therefore, each firm's chances of success must be high enough to ensure that a host of bidders compete.

Bid bonds and performance bonds are often required to assure serious bidding and contract performance. If a bidder declines the award, the bid bond is forfeited. Alternatively, contract default will result in a forfeited performance bond. These financial instruments are a type of insurance policy providing government with additional guarantees of contractor good faith (Rehfuss, 1989, p. 73).

(c) Contract Monitoring. Contract monitoring is a form of auditing. This process ensures that public funds are properly accounted for, that contracting agencies behave honestly, and that services are actually provided. If this role is neglected, the groundwork is set for contract abuse, corruption, and collusion among competitors (*ibid.*, p. 85). Government administrators should regularly monitor contract compliance, cost, and performance. This will ensure that contract specifications are adhered to. Further expenditure verification is a particular concern if a cost reimbursement system is used.

An effective monitoring system should take into account citizen preference. Hence, citizens should be allowed to express their opinions directly to governmental officials.

Government does not have to take an adversarial role. Honest legitimate contractors often run into problems. Technical assistance by government, after program review, can serve the public interest (Shields, 1988, p. 72).

A government that conducts oversight activities effectively provides guidelines that are both reasonable and flexible. For example, overly strict monitoring, such as demanding the purchase of certain equipment, can lead to inefficiencies or company withdrawal. On the other hand, lax monitoring opens the door to abuses. Finally, inconsistent monitoring signals can cause contractors needless headaches and influence performance. In Houston, Texas, for example, contractors providing inpatient care to indigent mentally retarded patients are subject to state and city requirements. The state requires that the doors of air conditioning closets be vented, whereas the city requires nonventing of these doors. Noncompliance with either could result in the contractor losing its license. Obviously, neither the taxpayer nor the resident is served by this inconsistency (Johnson, 1986).

(d) Contracting Organizations. James Ferris and Elizabeth Graddy have developed a two-part contracting model (1986, p. 337). In the first part the production method (in-house or contract) is determined. After the decision to contract out has been made, the type of producer organization is chosen. There are three types of producer organizations: profit, other government, and nonprofit. The above discussion refers primarily to for-profit firms. The other two sectors, however, provide significant levels of service. Taken together, they are responsible for over half the contracts in local services, such as mass transportation, police patrols, fire prevention, hospitals, human services, recreation, libraries, and art programs (Ferris and Graddy, 1986, p. 341). Furthermore, they have unique benefits, pitfalls, and administrative implications.

(e) Other Governments. Government contracts with other governments usually take the form of an intergovernmental service contract, a joint-service agreement, or an intergovernmental service transfer. Intergovernmental service contracts occur when one government contracts directly with another to deliver a service. A joint-service agreement is an agreement between two or more governments. Planning, delivering, and financing a service is provided jointly to the citizens of all participating jurisdictions. Intergovernmental service transfer is much like load shedding. It involves the permanent transfer of the service provision function to another government (AICR, 1985, p. 1).

Economists see scale economies as a chief advantage of intergovernmental arrangements. This is particularly true for very small governments. Small governments often cannot afford expensive capital-intensive services. Furthermore, small governments may be in a local market so tiny that real competition from private sources is impossible. Intergovernmental arrangements are also useful because public problems are not limited by arbitrary boundaries such as county lines. Hence, it is rational for local governments to deal with problems jointly. For example, metropolitan crime laboratories often rely on contracts with surrounding governments to remain financially solvent (*ibid.*, p. v). Further, there are some collective goods, such as fire and police, about which citizens may feel uncomfortable if they are placed in the hands of for-profit companies. In addition, legal questions may arise. Who can make an arrest? These problems are more easily resolved by intergovernmental agreement.

The use of intergovernmental service agreements is widespread. A 1983 study of 2069 city and county governments found that over 50 percent of the sample used either government contracts or joint agreements. Transfer was less common; approximately 40 percent used such arrangements. Cities and counties of all sizes use intergovernmental agreements. However, cities under 10,000 seem to rely on them less heavily. Interestingly, compared to private contractors, other governments are more likely to produce collective goods such as fire, police, jails, detention homes, and libraries (*ibid.*, pp. 26, 31, 56).

(f) Nonprofit Agencies. Unlike for-profit firms, nonprofit contracting agencies have few built-in efficiency incentives. Nevertheless, contracts with nonprofit agencies can save government dollars. Nonprofit agencies are often subsidized by other sources. Further, they can lower costs by using volunteers and part-time personnel. Nonprofit agencies also may be preferred by citizens because of their traditional philosophy of putting quality first (Ferris and Graddy, 1986, p. 333). There are many historic links between government and nonprofit production. In some instances such as human services, nonprofit agencies actually took the lead in service provision. Orphanages, hospitals, and soup kitchens run by religious organizations are examples. Since the onset of the New Deal, however, government's role and responsibility has grown. Currently, government is the major provider of nonprofit services.

A significant portion of city and county budgets go to health and human service programs such as day care, programs for the elderly, child welfare, hospitals, public health, drug and alcohol treatment, and mental health. Further, it is likely that the local and state roles will grow as the federal government attempts to return responsibility to the local community. In addition, issues such as vagrants sleeping on park benches, drug abuse, and hungry children are local problems. Nonprofit organizations receive the majority of city and county human service contracts (*ibid.*, p. 341). Available evidence suggests that some basic changes in contract administration could lead to greater efficiency and expenditure control. Further, human service provisions, like so many local government services, are funded through a combination of local revenue, federal, and state grants. Intergovernmental revenue sources complicate contract administration. The human service case is illustrative. Since human service delivery by nonprofits represents a large component of both the budget and nonprofit contracting, the remainder of this section will focus on the case of human services.

A recent study of human service contracting in Michigan found room for many administrative changes that could enhance expenditure control (DeHoog, 1984, pp. 54–55). Competition is the mainstay of contract cost containment. Even though nonprofit contracting lacks the profit motive as an efficiency incentive, it can reap the benefits of competition. Unfortunately, DeHoog found a lack of competition both in the environment and in procedure. Most county human services studied used a single contractor. Moreover, there was an unwillingness among public officials to create competitive procedures. The lack of concern with the monopolistic environment is not surprising, given the fact that cost was not used as a criterion of contract selection (*ibid.*, p. 98).

A key to successful contracting is proper monitoring. Human service monitoring is difficult because so much of it revolves around cost reimbursement. Open-ended human service contracts have built-in incentives to maximize reimbursement. For this form of contracting, which probably represents the largest percentage of contracted human service dollars, producers are rewarded for meeting as many reimbursable needs as possible. This represents a very different incentive structure from that described in classic contracting models. It may explain why nonprofit mental health and mental retardation centers, which began during the growth era of the 1960s and 1970s, are not noted for innovations that enhance economy or efficiency. They diversified to serve a host of client needs. These kind of contracts, which reimburse for services, are also difficult to monitor because they involve thousands of clients, shifting eligibility standards, and a multitude of services.

The DeHoog (*ibid.*, pp. 101–112) study found major flaws in the Michigan monitoring system. The system relied heavily on contractor self-report of expenditures and service progress. Actual misuse of funds could only be found by random state auditing two or three years after the fact. In addition, the meager resources available for monitoring were among the first to be cut during a fiscal squeeze. Some of the monitoring problems stemmed from the unclear lines of responsibility. The multiple funding sources gave power to the federal, state, and local governments. Each level of government had a different set of shifting concerns. As a result, contractors often felt they were overmonitored by irrational, inconsistent bureaucrats. Both the needs of the clients and the desires of the taxpayers were often neglected.

22.4 FRANCHISE. A franchise is a form of privatization similar to a contract. Under franchise agreements, however, citizens pay the firm directly for services received. Both utilities and concession stands at municipal auditoriums are candidates for franchise agreements. Franchise agreements can be exclusive or nonexclusive. Nonexclusive agreements involve several suppliers. Competition among multiple firms creates an incentive to keep costs down. Under exclusive franchise agreements, a single firm provides the services. A competitive environment can be encouraged by frequent competitive renewal cycles. The noncompetitive nature of exclusive agreements and the firm's revenue collections responsibility mandates heavy government regulatory involvement. Rates and franchise profits are usually subject to regulation.

By placing the collection of revenue and the delivery of service in the hands of private concerns, franchising clearly lowers government costs. At times, it even provides additional revenue (concession fees at recreation events). Unfortunately, the benefits of reduced government expenditures may be offset overall by higher costs to citizens. A study of solid-waste collection, for example, found franchise delivery systems to be 25 to 50 percent higher than either contract or municipal systems (Hatry, 1983, p. 32). Exclusive agreements are most often subject to this problem. Fees are often higher because it is easier for private firms to obtain rate increases. Unlike a municipal or contract service, franchise companies can legally advertise and seek public support for rate increases. If entry into the field is restricted, even firms with nonexclusive agreements will probably charge higher rates. Entry restrictions make collusion among existing firms fairly easy. Higher profits provide the incentive for collusion and higher prices. Hence, much like contracting, a competitive environment is the mainstay of an effective, low-cost franchising system.

Since firms operating under a franchise agreement collect revenue, they also have the power to exclude citizens who do not pay. Hence, equity objectives are readily compromised. For some services such as golf or softball tournaments, equity may not be a critical consideration. Emergency medical service or electricity, on the other hand, may be matters of life or death. The consequences of not serving the low-income population should be considered explicitly when entertaining a franchise system. Perhaps an individual subsidy for low-income citizens could be considered.

Finally, like contracting, a franchise system has the potential problem of firm bankruptcy and service disruption (*ibid.*, p. 34). For critical services (i.e., sewer or wastewater), governments should also monitor the fiscal health of the organization.

22.5 VOLUNTEER. Volunteerism is included under privatization because individuals outside the public sector perform services. Volunteers control expenditures by cutting costs. Occasionally, they represent the difference between service and no service. Extended library hours are an example.

There are four prerequisites for using volunteers (*ibid.*, p. 48–49). First, the task must be able to be accomplished by the volunteer. Second, there must be an adequate pool of qualified volunteers. Third, departments must be willing to use the volunteers. Finally, departments must be able to recruit and train volunteers. If job skills can be developed quickly or if many citizens enjoy the activity, volunteers are usually most successful.

Managers should consider both traditional and nontraditional volunteers. Traditional volunteers are interested in serving the community, and usually are offering their time and talent to meet higher-level needs, such as self-actualization. It should be noted that the description of a typical traditional volunteer has changed. More and more, teenagers and retired men are interested in volunteering. The number of middle-aged female volunteers, on the other hand, is declining (Turem and Born, 1983, pp. 28, 209). Nontraditional volunteers are really quasi-volunteers. Examples include community service restitution volunteers (Skinner and Shields, 1984, pp. 6–14), student interns (Shields, Rice, Chapman, and Wingard, 1983, p. 63) and citizens who are working in lieu of paying taxes (Divorak, 1982, pp. 35–43). The latter offer special promise because they may be employed in activities that traditional volunteers avoid, such as dull, routine office activities. They also are, on average, more dependable (Skinner and Shields, 1984).

22.6 COPRODUCTION. Coproduction or self-help usually refers to neighborhood delivery systems that rely upon citizen participation. A neighborhood litter clean-up campaign or an informal neighborhood system that provides medical transportation for the elderly are examples. Coproduction is similar to volunteerism; however, it implies self-interested motivation: "My community is cleaner," or "My community is safer." Since coproduction involves neighbor helping neighbor, it can improve the quality of a local community and lower government costs. It also enhances citizen community involvement and promotes values such as citizen responsibility and community pride. In addition, it can dispel the trend toward citizen dissatisfaction and alienation from big government (Levine, 1984).

Coproduction, however, can never be more than a limited solution to the fiscal dilemma. Many expensive services must be produced on a larger scale, for example, electricity. In contrast, self-help works well on projects that are small in scale. People find it economically rational to devote time and effort to help a small group work toward a goal; as the size of the group increases, however, incentives to become involved decrease (Fisher, 1984, p. 188). Thus, coproduction seems to work best in neighborhoods of property owners. If coproduction were relied upon solely, it would lead to uneven service provision along economic lines (*ibid.*, p. 189). Finally, since the organizations are loose and informal, coproduction is also subject to service disruption.

Some person-to-person human services are well suited to neighborhood-based delivery. Four types of human services have been identified as appropriate for self-help systems. They are (1) services that are in transition from large-scale to smaller operations; (2) services for the mobility-impaired; (3) services delivered by the community groups where sensitivity to ethnic, socioeconomic, and cultural norms is important; and (4) human services that influence directly livability, status, and economic viability of a neighborhood (Anderson, 1983).

22.7 USER FEES. Practical managers are drawn to fees for their revenue potential. The theoretical literature, on the other hand, stresses allocative efficiency as the chief benefit of public prices or user fees (Mushkin, 1972). Price is a market mechanism. When citizens pay a price, an immediate link between benefits and costs is established. The payment of a fee is a free expression of an individual's willingness to pay. This link between benefits and costs helps provide information and feedback. It can also help conserve resources. For example, if water is priced uniformly regardless of quantity used, the public would have no incentive to conserve. Heavy and probably wasteful water usage might result in low water pressure or shortages. This usage in turn would lead to outcries to expand water supply systems. A water price based on use would cause consumers to conserve and thus avoid or delay purchase of new water treatment plants.

Price then is a tool that can be used to regulate the quantity of service demanded by local citizens. In the water example, price is a cutback mechanism. The most important impact of price is not greater revenue but rather lower expenditures (Bird, 1976, p. 233). Fees provide a refined indicator of citizen preference and can help local officials decide what mix of services to provide.

Prices that cover costs are appropriate for government activities if (1) there are clearly identifiable individual benefits (divisible), (2) nonpayers can be excluded, (3) few benefits go to those who do not pay, and (4) there are few unacceptable inequalities (Shields, 1983, p. 171). If only the first two characteristics hold (divisibility and excludability), a full-cost fee may not be warranted but the service is chargeable, or is a candidate for a fee.

Most goods supplied in the private sector have all four characteristics. Indeed, when these conditions exist for publicly provided goods, there is often a dual public/private delivery system. Recreational facilities such as tennis courts and marinas are prime examples.

When a public service is chargeable (the first two characteristics hold), demand can be revealed through market or semimarket mechanisms. An overriding goal of most public organizations is to provide a service to its citizens. Agencies, however, seldom provide a single service, but a set of services. William Coleman (1983, p. 12) suggests "unbundling services" to determine which are chargeable. For example, police patrol services have neither identifiable individual benefits, nor is it possible to exclude nonpayers. No charge is indicated. On the other hand, police services, such as directing traffic after a sporting event or getting keys out of locked cars, have these characteristics. A charge may limit demand and reduce expenditures.

Service may fluctuate with season or time. For example, water consumption is usually highest in the morning and evening. Swimming pools and parks are busiest on summer weekends. Roads and mass-transit are more congested at rush hour. Public facilities are often judged by their ability to meet peak demand. Allocation of resources to address peak demand leaves slack periods with significant unused capacity. Economists suggest that uniform pricing mechanisms be replaced with a differential pricing mechanism (for peak and off-peak periods). This should smooth out utilization. For example, pricing water by the time of day may encourage homebound persons to wash dishes, take showers, do laundry, and so on, throughout midday. When marginal consumers change water consumption patterns, the system will feel the effect. Recent research by the Rand Corporation has proven that time-of-day electricity pricing can be implemented successfully (Acton, Mitchell, Park, and Vaiana, 1983).

Singapore has an interesting peak-pricing system to deal with rush-hour congestion. The purpose of the policy is to encourage carpooling and mass transit. Part of the inner city has been designated a congested zone during rush hour. Cars with no passengers entering the congested zone must purchase a window sticker. Cars without stickers receive tickets (Higgins, 1977, p. 579).

Peak-period pricing is a solution long supported by economists. Unfortunately, the lack of technology available to monitor peak use and cost of implementation often makes peak-period pricing difficult.

Equity or fairness is one of the most appealing arguments used by advocates of fees. Public prices are fair because people who benefit from the service are the ones who pay. Fees, unlike the regressive property tax, can be avoided (Muskin and Vehorn, 1977). For example, a golf course supported by property tax dollars would be paid for by all regardless of income. A low-income nongolfer could be excluded from supporting this activity if fees were employed. Further, a self-financed golf course frees up tax dollars to support other government functions, which may be targeted for the poor.

Many chargeable services provided at the local level fail to comply with the last two conditions for full-cost fees. In other words, the service provides benefits to those who do not pay, or there are unacceptable inequalities. Education and libraries are examples of services that benefit the community as a whole. While individuals benefit from their education, society as a whole is better off if there is an educated labor force. The final conditions, few unacceptable inequalities, are the major stumbling block for general application of fees. Low-income citizens may be denied service. Local governments address this in a limited way by having reduced fees for children and the elderly. In addition, fees may vary by place. For example, recreation centers sometimes reduce fees in low-income neighborhoods (Shields and Rice, 1988).

22.8 REVENUE CENTERS. Aside from controlling expenditures through their impact on demand, fees can be used to restructure organizational and financial systems. One such organizational structure is the revenue center. As the name implies, revenue centers link fee revenue with an individual service. A revenue center is a public organizational entity that produces services that it either sells to the public through a fee mechanism or sells to the central administration through contract. Revenue centers are similar to an enterprise fund in public administration and profit centers in large corporations. They conduct a host of selected functions, operate in a simultaneous fashion, and collect various types of revenue. Their performance can be assessed on a bottom-line basis. An effective revenue center is self-supporting or produces a small profit (Pascal, 1984, p. 10).

A price or fee is a market mechanism that both produces revenue and provides demand information. In the private sector, a firm must carefully consider both cost and demand information when calculating a fee. Unfortunately, the public sector's budget allocation system removes the link between fee and cost data for public managers. If fee revenue goes directly to the general fund and an agency depends on budget allocations for survival, there is no incentive for management to control costs. Actually, there is an incentive to expand the use of the service and thereby justify larger budget allocation. Under this system, a manager seeking larger budget allocations would prefer the demand-maximizing benefits of a zero-or-below-cost fee. Revenue centers turn this incentive structure around and restore the link between cost data and price (fee).

A key advantage of revenue centers is their adaptability. For example, they are equipped to deal with chargeable services that the city wishes to subsidize. In this instance, the subsidy should be considered a separate revenue source channeled to the center. This has several advantages from an expenditure control perspective. First, it forces management to come up with careful and reasonably accurate cost estimates. In addition, local policymakers are forced to consider the subsidy explicitly. Fee adjustments for either inequalities or spillover benefits will then be addressed where they belong, in the policy arena. The adaptable revenue center also provides management with incentives to innovate. Innovations could take the form of cost-savings techniques or revenue-enhancing mechanisms such as selling services to other governments. Finally, revenue centers may provide the ideal framework for mixing in-house and contract production.

Grouping of functions in revenue centers can be done in two ways: by production similarities, that is, various aspects of recreation; or by constituency, that is, the elderly. The production focus has the advantage of clustering functions with production commonalities. The focus builds on and reinforces staff knowledge. In addition, a production focus is similar to existing local government divisions and hence would cause minimal organizational disruption. The constituency strategy has the advantage of being consumer and market oriented. This strategy should enhance the search for new opportunities to expand product lines (*ibid.*).

Over the last several years, the Rand Corporation has conducted pilot studies on the expanded use of fees and revenue centers. Pilot revenue centers in St. Paul have proved very successful. St. Paul's Traffic and Lighting Revenue Center reduced annual General Fund requirements by $2.5 million. The Division of Parks and Recreation Revenue Center generated a $250,000 surplus (AICR, 1985, p. 86). Clearly, revenue centers offer both cost-containment and revenue-generation potential.

22.9 CONCLUSION. This chapter examined expenditure control methods for state and local governments. The major agenda was to introduce the reader to cost-containment techniques that use private-sector principles. The public sector has long been criticized as wasteful and inefficient. As long as it was in a growth environment, these criticisms could be disregarded. In today's environment of ongoing fiscal stress, things have changed. Public officials are looking to management philosophies and techniques of the private sector to aid in coping with fiscal dilemma.

Perhaps the most important insight of the privatization literature is the disentangling of the provision and production functions. By untying provision and production it is possible to concentrate on production and introduce efficiencies through economies-of-scale, the profit motive, competition, and innovation. Furthermore, when provision remains in the hands of government, shortcomings of the market (lack of concern over equity or spillover benefits) can be overcome.

The techniques of privatization discussed in this chapter are those with the greatest potential to control expenditures. Of these, the technique with the most widespread application is contracting. It is also a technique that promises significant cost savings. The implementation of contracting can be filled with pitfalls. For example, there is no advantage to replacing a public monopoly with a contract monopoly. The competitive environment needed to stimulate cost savings is missing in both cases. This criticism is true of all privatization techniques. Hence, this chapter highlighted implementation issues, particularly as they relate to controlling costs. It also treated the question of equity and accountability pragmatically.

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