

## HUMAN SERVICES CONTRACTING: Environmental, Behavioral, and Organizational Conditions

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### **Abstract:**

Government's practice of contracting out with outside organizations for public services has become a major recommendation for cutting costs and improving service delivery. However, few scholars have examined this alternative in terms of the requisite procedures and conditions that lead to the expected benefits. This article focuses on three conditions—competition, rational decision-making, and government oversight—that appear to be critical to the contracting process. To evaluate these conditions and their presence in human service contracting, research in two policy areas is presented—social services (Title XX) and employment and training services (Comprehensive Employment and Training Act, or CETA), as implemented in Michigan state and local government. The conclusion suggests key organizational, behavioral, and environmental factors that the pro-contracting argument overlooks.

### **Article:**

At no time in recent history has the American preference for using nongovernmental organizations been so much a part of government theory and practice. Although for some years federal and state agencies have followed OMB (Office of Management and Budget) and state directives to rely on the private sector to supply their needs, only during the Reagan administration have we seen such a major commitment to achieving public goals and providing services via private organizations. In the public administration literature, a variety of mechanisms for the privatization of public services have been suggested, including vouchers, contracting out, load-shedding, and coproduction of services (Poole, 1980; Savas, 1982; Straussman, 1981). Governments at all levels have considered or adopted most of these mechanisms to cut back expenditures in view of fiscal constraints and to "get government off our backs."

Contracting out for public services is one of the recommendations that has been utilized by various government units for many years for reasons other than fiscal restraint—for example, to avoid hiring freezes and civil service restrictions; to take advantage of well-developed private expertise; to pay off friends, relatives, and campaign contributors; and to test experimental programs with a minimum of commitment. But in the last two decades a new trend has been apparent. Contracting out has been suggested and considered more frequently as an alternative to conventional bureaucratic means for a wide variety of programs and services, often in the face of fiscal strain. Services supplied by this means run the gamut from the more traditional janitorial and sanitation services, to job training and alcohol rehabilitation programs, to highly specialized research and development (Fisk et al., 1978; Florestano and Gordon, 1980; Savas, 1982). In particular, the purchase of human services for clients has become a more common method of service delivery in state and local governments, often as a result of federal laws and regulations. For example, over half the funds for Title XX of the Social Security Act have been spent by states for purchased social services, with increasing numbers of contracts being made with private, nonprofit agencies (O'Donnell, 1978; Wedel, 1976). In these types of client services, the contractor—whether another public agency or a private (proprietary or nonprofit) agency—acts as an extension of the responsible government unit.

This article examines the subject of contracting out by first presenting the arguments for and against this approach to service delivery. Next, three conditions—environmental, organizational, and behavioral—that appear to be essential to the realization of the benefits of contracting out for services are delineated. To

determine if these conditions are likely to be met in the human services, research on contracting in two state-level Michigan departments is presented. In particular, this article focuses more on the institutional processes of contracting out than on the ultimate results of the process. The conclusion notes some critical factors that have been overlooked in previous discussions of government purchase of services.

### PRO-CONTRACTING ARGUMENTS

The conviction that contracting out should be promoted in public administration largely rests on the belief that purchased services tend to be less costly, more efficiently supplied, and better quality than services delivered by public employees (Bennett and Johnson, 1981; Fitch, 1974; Poole, 1980; Savas, 1974, 1982; Spann, 1977). In summary, the proponents of contracting out argue that private (or at least outside) supply will lead to lower government costs primarily for the following reasons:

- the elimination of waste by the revelation of the true costs of production through competition for contracts and the profit motive
- economies of scale in some jurisdictions through the reduction of overhead, start-up costs, or high personnel and equipment costs by spreading supply over a larger number of units
- the reduction of high personnel costs, primarily by avoiding public employee unions and restrictive civil service controls
- greater flexibility in the use of personnel and equipment for short-term projects, part-time work, specialized needs, experimental programs, or new problems without a commitment to sustaining a permanent bureaucracy

The anticipation of reduced costs of public services appears to be the most compelling reason for both scholars and government officials to favor contracting out. However, a second advantage is also viewed as important—that is, the delivery of better quality services. Competition among suppliers is expected to produce better service performance and results, because a direct monetary incentive exists. To use Hirschman's (1970) terms, the contract relationship offers a major advantage over the public bureaucracy, in that it allows for both exit and voice mechanisms to be activated, in the event that the service quality declines or does not meet the contract's specifications.<sup>1</sup>

Empirical research in several different service areas has, to some extent, confirmed this faith in contracting out, although not all the studies usually cited are specifically about contractual services. Generally, what limited evidence there is supports the argument that privately produced services are at least less costly (and, in a few cases, more efficient) than in-house services in fire protection (Ahlbrandt, 1973), an electric utility (DeAllessi, 1974), refuse collection (Bennett and Johnson, 1980; Kemper and Quigley, 1976; Savas, 1974, 1977a, for example), a range of municipal services under the Lakewood Plan (Deacon, 1979), and property tax assessment (Lowery, 1982).

In addition, advocates usually believe that contracting for human services—where outputs are more difficult to measure—could lead to similar results (Bennett and Johnson, 1981; Fitch, 1974; Savas, 1982). Only a few scholars, however, have attempted to examine these kinds of services systematically in terms of supply structure in the areas of education, police services, and child day care. Even though purchased services are widely utilized in state and local governments, only very limited evidence about human service contracting has been compiled (Straussman and Farie, 1981). Seldom have the existing empirical works in other service areas gone beyond measuring the costs of outside supply to analyze service levels, service performance, and the political and administrative contexts under contracting (except for Savas, 1977a; Lowery, 1982). Outside of garbage collection, the procedures of contracting have not been studied sufficiently to shed light on the administrative problems governments may encounter in the contractual relationship. These unexplored areas of research are critical to our improved understanding of the contracting process and its outcomes. If scholarly research in this field is to be of some utility to decision-makers, we must begin to identify the environmental conditions and

administrative procedures conducive to contracting arrangements achieving the aims of improved efficiency and good quality services.

## CONTRACTING DIFFICULTIES

Not everyone agrees with some promoters' wholesale endorsement of contracting out. Observers in and out of government have suggested several problems associated with the practice.<sup>2</sup> In fact, some who recommend contracting as an efficient alternative to bureaucratic supply have suggested that it may not work equally well in all service areas (Niskanen, 1971; Savas, 1974). Other analysts suggest that the mind sets of elected officials and bureaucrats, as well as various federal, state, and local laws, may inhibit the adoption of contracting out (Straussman, 1981). While they may limit wider utilization, these difficulties do not constitute direct criticisms of the mechanism.

One of the most obvious problems with contracting is the potential for cozy or corrupt relationships to develop between public officials and contractors. These relationships may prove to be beneficial for both sides, but they may not produce cost savings for taxpayers or good quality services for consumers. Another criticism comes from defenders of public employee unions. They charge that contracting out allows government to bypass state and local unions to hire underpaid, nonunion labor (Hanrahan, 1977).

According to some, the ever-present political problem of accountability in public administration is only compounded with the addition of nongovernmental organizations carrying out the public's work. Critics have claimed that in many services it is usually more difficult to hold contractors responsible and to encourage them to be responsive to the needs of citizens, legislators, and managers (Sharkansky, 1979; Smith, 1975; Smith and Hague, 1971). In addition, the creation and implementation of coherent public policy may become a more formidable task with the extensive use of outside suppliers (Beck, 1971; Brilliant, 1973; Sharkansky, 1979). Planning for and coordinating the multitude of discrete activities of outside service agents may only add to the already confusing, overlapping, and contradictory divisions within government itself.

Some additional concerns have been raised about using nonprofit agencies to deliver human services. Voluntary institutions have been concerned about sacrificing their private autonomy to receive public funds (Gilbert, 1977; Brilliant, 1973; Manser, 1974). Some fear that the growing dependence on government contracts and grants will reduce the benefits gained from encouraging a thriving, self-supporting voluntary sector. Others wonder how church-state activities can remain separate when many church-related agencies deliver human services with government funds.

Finally, critics of privatization have suggested that contracting may not help to get government off our backs at all. Eleanor Brilliant (1973: 394) states:

Effectively, the mixing of public and private activities masks or screens the growth of government interference with the private sector and thereby makes it more palatable to average Americans. This illusion maintains the myth of less government, while government actually whittles away at the essential substance of private autonomy.

These problems or limitations of contracting caution us to examine more carefully the optimistic picture painted by contracting advocates. Perhaps a more balanced view can be gained by recognizing that the actual implementation of purchased services may not always conform to the ideal process model of contracting and may produce some unanticipated negative consequences.

## THREE CONTRACTING CONDITIONS

Proponents of contracting state that the major benefits of contracting arise from the marketlike competition that is introduced into public service provision. To obtain a contract, prospective bidders will be induced to bid near the true costs of production for the exact set of services desired by the government unit. Given responsive and responsible bidders, contracting proponents assume that awards will usually be made to the lowest bidder. The essential role of the government agency or elected body is to perform an oversight function. Not only would it

be responsible for making budgetary decisions and transferring payments to suppliers, but the unit would also choose the agents, monitor and evaluate their performance, and engage in long-range planning. Advocates believe that the threat of the government contracting with another supplier (or perhaps producing the service itself) ensures that the contractor continues to be efficient and responsive in service delivery.

This simple model of the process, however, depends upon at least three key conditions that have not been made explicit in the contracting literature: (1) competition in the service environment (or "market") and in administrative procedures; (2) government decision-making to attain the goals of cost reduction with good service performance; and (3) an effective oversight role by the government agency. Though not clearly stated in the literature, these conditions are implied by the writers on contracting and appear to be essential to the realization of the expected benefits of using outside service suppliers.<sup>3</sup>

First, contracting scholars emphasize that competition is a necessary ingredient in the contracting system (Fitch, 1974; Savas, 1974, 1982). In particular, two aspects of competition are critical to produce the expected benefits—competition in the environment of agencies and in the contracting procedures used by the government. The service environment determines the alternatives that can be considered by public officials, as well as the calculations made by prospective contractors. At least two responsible and responsive independent bidders (but preferably more) are required to produce a basis for competition. If no other firm exists to offer its services, what incentive does the single bidder have to pare costs and provide high-quality services? And how can the purchasing unit evaluate the proposed price and services when there is no direct method of comparison? (This task can be particularly problematic when the government agency itself has never produced the service.)

In addition, the procedures utilized by the government must promote, rather than reduce, competition. Wide advertising, a clear and complete specification of the services required, and the impartial consideration of suppliers throughout the process are the primary methods of ensuring that purchasing services will ultimately benefit the consumers. Usually maximum utility will be realized when government officials have an adequate knowledge of (1) potential contractors and their past performance records; (2) the services themselves, especially as they relate to the needs of clients or consumers; (3) the methods of service delivery; and (4) the costs of various components of the services. With this information, those who write the specifications (or requests for proposals) and evaluate the suppliers' bid proposals will understand what elements are essential, practicable, and sufficient for good service provision.

The second major condition for efficient contracting assumed by advocates is that officials will be rational decision-makers who are motivated for whatever reasons (altruism, reelection) to adhere to the goal of maximizing cost savings, but preserving good service quality. Public officials first would be able to rank order the various alternatives according to this goal with information they have obtained about cost, quality, needs, past performance, and so on. Then they would select the best choice—the alternative that would result in the desired services at the level of least cost. This outcome, however, depends upon two key elements: (1) the common goal of cost minimization with adequate service provision; and (2) sufficient information to consider the major alternatives and to judge accurately anticipated performance and consequences of each alternative in terms of this goal.

This form of rational decision-making logically should be utilized in at least two critical contracting decisions—the choice between in-house service supply and contracting out, and the choice among outside sources. It is obvious that cost savings via contracting can be realized only if it appears probable that outside supply would lead to reduced government costs—and not only in the first year, when contractors may bid low to obtain funding. This means that services should not be purchased simply because contractors are available or because elected officials may benefit.

The third general condition required by the contracting argument is an effective oversight or watchdog role by the relevant government unit—a role that has been treated inadequately in the contracting literature. The basic principle of contract administration is that the contracting officials should monitor contractor service

performance continuously to ensure that the activities conform to the specification of the contract. Where contractors are reimbursed for their costs, particular attention must be paid to verifying expenditures in order to prevent illegal activities and any mismanagement of public funds. Opportunities should also be provided to consumers of the services to express their suggestions and dissatisfaction directly to public decision-makers. These monitoring operations are critical for spotting potential problems, keeping contractors honest, and providing technical assistance to suppliers when problems arise. For human services (and other services where cause-and-effect relationships are uncertain), independent, objective evaluations are also necessary to determine if the services are effective in meeting program objectives. These reviews of cost, performance, and effectiveness constitute essential feedback information when contracts are considered for renewal. Only by these means can public officials be certain that they are receiving the benefits they desire (Wedel et al., 1979).

This analysis of the three major requisite conditions—competition, rational decision-making to achieve cost reductions and quality services, and an effective watchdog role—leads to some obvious questions: How likely is it that these three conditions will occur in different jurisdictions and across various services? Since the positive expectations about contracting appear to rest largely on these assumptions, what will happen if these conditions are not always present? And what can be done to produce these desirable conditions and procedures where they do not exist?

As yet, these questions and conditions have not been considered or examined in contracting studies. This inattention to the process and procedures of contracting constitutes a major gap in the privatization literature. Eventually empirical studies of different services and jurisdictions may illuminate the answers to these questions and may help officials to contract out more intelligently. Research may also suggest whether these three conditions are necessary to contracting success, or whether others can be substituted for or added to these to improve efficiency and effectiveness in purchased public services.

#### CASE SELECTION AND METHODS

In an effort to begin examining the conditions of contracting in the field of human services, the procedures of contracting were studied in services under two major federal programs—Title XX of the revised Social Security Act of 1975 and Titles II and IV of the revised Comprehensive Employment and Training Act (CETA) of 1978.<sup>4</sup> These major pieces of human services legislation included provisions to allow contracting with public and private agencies. To make the research enterprise more manageable, I focused on the process of purchasing services under contract in two departments responsible for these funds in Michigan state government—the Department of Social Services (DSS) and the Department of Labor (DOL).<sup>5</sup> Although they were not selected to be strictly representative of human services, these cases may illuminate some common patterns of social and employment service contracting, because the regulation of these federal programs require the states to operate in somewhat similar ways (Benton et al., 1978; National Governors' Association, 1978; O'Donnell, 1978). However, these federally funded programs may not have produced the same processes and outcomes as would more independent state and local service areas.

Three major types of data collection methods were employed in studying the selected DSS and DOL programs: (1) preliminary, exploratory interviews with twenty officials in four state departments to establish "the lay of the land;" (2) a study of pertinent governmental documents, including a legislative evaluation of the DSS purchasing system, and many federal and state regulations concerning the programs and the contracting procedures; and (3) a series of in-depth interviews with twelve state (and, in the case of DSS, also seven county) contracting officials and twenty private (past and current) contractors.<sup>6</sup> In the last and most critical phase, the personal interview with the use of a standardized interview schedule was the most appropriate method of obtaining information about the actual contracting procedures—especially as they related to the three conditions of contracting—and the viewpoints of those most involved in the process.

#### DSS CONTRACTED SERVICES UNDER TITLE XX

Although DSS has been purchasing services from various sources for several decades, DSS contracting increased dramatically during the early seventies, in part due to more social service needs in the state, but

probably (and more importantly) because of the availability of open-ended federal funds (Derthick, 1975; Michigan House Fiscal Agency, 1976). Purchase was promoted because it was the quickest way to increase federal participation. In 1972, a ceiling of \$2.5 billion was placed on total federal matching funds, but Michigan was not really constrained by it until FY76. Clearly the social services were not purchased to reduce social spending, but to claim more federal money, to increase the number of clients served, and to provide a wider range of services to the needy. As with the older title for social services, the newer Title XX also authorized funding under the matching formula of 75% federal and 25% state monies for a range of social services to low-income individuals and families for the primary purpose of reducing dependence.

Peculiarities of the state's matching requirement, however, increased the attractiveness of the federal funds and affected contracting procedures as well. Payments to service providers could be made in two ways under the law: through straight purchase, in which DSS paid providers with 75% federal and 25% state-appropriated funds; or through donated funds purchase, in which public or private donations were made to DSS for one of the services and were used as the match for the federal funds. In Michigan, except for protective services for children and adults, this latter method was more frequently employed for contracted services. Donated funds could come from other state and local public agencies, and from nonprofit and proprietary private agencies. Usually the contractors acted as their own donors and put up 25% of the contract through in-kind payments (only if they were public agencies) or cash (if they were private, nonprofit agencies). Under federal regulations, proprietaries may not act as their own donors, and even nonprofit agencies can be their own donors only if an "independent judgment" is made on the selection of the service provider.

Since the late seventies, contract decision-making became more decentralized in Michigan's DSS—allowing the county departments of social services to have greater responsibilities for assessing need, selecting services to purchase, awarding contracts, writing the contracts, and monitoring expenditures and performance. A few contracts continued to be made through the state office, but the aim of DSS was to farm most of these out to counties as well.

The ten private service providers included in the sample of contractors indicate the diversity of social services and agencies used by DSS. The services supplied to DSS clients under contracts included money management counseling, geriatric day care, family counseling, vocational and educational services for the severely handicapped, homemaker services, housing-related services, alcoholism rehabilitation, health services for migrants, and family counseling for abuse prevention. Most of these services never had been provided by DSS county caseworkers or, if they were, their expertise and resources were fairly limited and did not appear to meet needs adequately.<sup>7</sup>

#### DOL CONTRACTED SERVICES UNDER CETA'S TITLES H AND IV

Contracting structures and regulations in Michigan's DOL differed from those of DSS in several ways. First, the state's participation in CETA services for the most part was a relatively recent phenomenon. Earlier titles under the original CETA legislation provided only limited tasks and funds for state human resources units. Therefore, the unit within DOL had only limited experience with contracting for services with outside agencies. Second, each year since the 1978 revision of CETA only a small number (fewer than 20) of private agencies received service contracts of the approximately 100 contracts under the two titles. Although the federal regulations encouraged contracting with private, community-based organizations (CBOs), the state more frequently purchased services from other state and local public agencies—such as the State Department of Education and local school districts for vocational education. Third, all state CETA contracts were negotiated and administered at the state department level—not in the counties. CETA provided funds separately to local prime sponsors (usually county based in Michigan), but some of the state's contracts under the titles were also made with these units. Fourth, state officials placed a three-year limit on most contracts, since many were designed for demonstration purposes. Fifth, donations were not required for CETA contracts.

Michigan's regulation for Title IV youth contracts, however, required that contractors match some of the total amount in the second and third years of the contract. Although all CETA funds were allocated among the states

and prime sponsors according to a formula without a matching stipulation, DOL decided to use an increasing match to encourage the continuation of successful projects with local funds and support.

The CETA titles and their allowance for contracted services were not really designed to cut costs, but were aimed at improving service delivery by providing funds to the state both to coordinate CETA participants and programs and to promote model employment and training programs. These goals were established primarily to overcome some of the serious problems encountered by local prime sponsors in implementing CETA, and partly to cut state governors into the CETA block grant. Title II authorized the Special Grant to Governors to develop and operate programs that usually went beyond the scope of local prime sponsors—to assist and coordinate local prime sponsors, to conduct labor market studies, to set up demonstration projects for groups not adequately served by local units, and to provide information and linkages with unions and other CETA-related bodies. I interviewed representatives of six agencies that had received Title II contracts for the following services: preemployment services for in-school youth, job training and employment services for women, linkage services between prime sponsors and unions, and information and training services for prime sponsors. The four Title IV youth contracts provided job training for adjudicated high school dropouts, handicapped youth, and Hispanic high school dropouts. These complied with the title's intent to fund model or experimental youth projects developed under the state government.

### COMPETITION IN THE ENVIRONMENT

Competition for clients and funding sources has not held a strong position in the traditions of the social or employment services fields—at least as far as services for low-income individuals and families are concerned. Public and private agencies have not considered themselves similar to profit-making enterprises, where the desire for profits and growth can encourage competition. Instead, these agencies have emphasized that their role is to serve people whose social and economic needs have gone unmet in a particular community. They differentiate their services and target groups from each other, to avoid direct competition and overlap. In addition, only a small number of private agencies have found a stable paying "market" for their services to assist the needy.<sup>8</sup> They are very dependent upon government funds and private contributions—both sources with limited or declining resources.

Several additional factors arising out of government policies and procedures further reduced competition and choice for contracting officials. DSS's choice to decentralize contract decision-making limited officials from going beyond county borders to find appropriate providers for particular services. This was a serious problem for small and medium-sized counties where only a handful of social agencies exist. Not only have county elected officials resisted using noncounty agencies, but many service providers utilizing a variety of professionals and facilities cannot exercise the option of operating in different locations in the state. Only money management agencies, because of their greater mobility in setting up part-time and/or one-person offices, were able to compete in several counties for contracts.

Second, DSS's donation requirement and DOL's increasing match for Title IV youth programs obviously reduced the field of competitors and gave certain contractors distinct advantages over others, even though these funding stipulations were designed to advance other goals of the departments. These, as well as other regulations, appeared to discourage private providers from competing. Although public agencies were allowed to use facilities, salaries, or their own appropriations for the Title XX match, private agencies had to contribute cash from their own solicitation efforts or from the United Way (if they were fortunate enough to be members). Consequently, most of the counties experienced difficulty in finding agencies that could provide a particular service and make the donation.<sup>9</sup> Certainly an "independent" decision to purchase the service from nonprofit agencies could not be made, as the federal regulations required, since donation pledges were obviously contingent on being awarded a contract. (Except in one county where the county board of commissioners contributed the match, most officials could not locate cheerful givers.)

In DOL, the state's Title II program did not require any match and, despite the fact that DOL hardly advertised most of its contracts, the proportion of proposals to contracts usually was about two to one—a ratio indicating

some measure of competition. Almost all agencies awarded contracts reapplied for the maximum number of years. In contrast, after an extensive solicitation effort contacting approximately 600 potential providers, officials in the Title IV youth program received only 35 proposals for its 16 contracts, and since then have seen a decline in the number of contracts and the willingness to renew contracts. In fact, at the time of the interviews none of the private contractors had requested contracts for the full three years. Agency renewals for the second and third years appeared fairly automatic—despite some poor service performance—because of the small pool of contractors willing and able to fund part of the contract themselves. Although not all the differences between Titles II and IV in the number of proposals and renewals can be attributed to the match, this indicates that requiring matching contributions has some impact on competition for contracts.

A third way in which competition and choice can be reduced is also illustrated by the DOL case. Because of its administrative makeup and structure, DOL was not able to design and implement its own projects when outside proposals and suppliers were found to be inadequate. The bureau charged with CETA implementation (the Bureau of Employment and Training) is not a service agency, nor does it have county extensions of its operations. Therefore, it acted in a more passive role, depending upon other agencies for proposals and implementation. Theoretically at least, DSS had the potential of utilizing the county departments when other alternatives were unacceptable. (In fact, in most counties the clients used the limited expertise of county caseworkers rather than the contractors, and some counties returned certain services, such as family counseling, to DSS offices.) In a limited way, perhaps, potential competition from in-house supply may promote better service performance under contract, as well as allow the government agency to provide clients with the services it desires.

#### COMPETITION IN CONTRACTING PROCEDURES

The range of choices for decision-makers can be reduced or expanded each year during the early steps in the contracting process—in the selection of services to be purchased, based on a needs assessment; the solicitation of potential contractors; and the consideration of proposals (or bids, in other cases). The procedures in DSS and DOL were very different and they had some impact on competition and service quality.

In the past, DSS's usual procedure for determining which services to purchase was to notify various private and public agencies about the available funds and the general regulations governing the use of the funds. Few attempts were made to assess clients' needs systematically, and then to solicit only for those types of services, because Michigan had so much federal money to match. As a result, many different service providers received contracts year after year with very little review of changing needs or their performance in meeting social service goals. They frequently built up their agencies to accommodate the increased demand from government, and also established helpful relationships with the relevant state bureaucrats and legislators to guarantee the flow of funds over time.

During (and after) contracting decentralization and Michigan's fiscal constraints under Title XX, a few counties implemented mandated needs assessments, but they changed few services or contractors. The lack of alternative suppliers partially explains this, but the fact that contractors themselves are often an integral part of the assessments also contributes to the retention of the status quo. Generally clients' service needs have been measured only indirectly—filtered through participants in the social service system who have particular interests or stakes in the outcome.

The general rule at both the county and state levels has been that the DSS solicited for proposals or program descriptions only when new money became available. Before and after counties gained control of most contracting it was the case that once an agency received a contract, it usually became the only one notified for subsequent contracts—and almost always obtained renewals every year. Even for new contracts, the number of potential providers invited to submit proposals was very limited (between one and ten), depending upon the service and the size of the county. Solicitations were based on county staffs' knowledge of agencies and were fairly informal—a telephone call, word of mouth, sometimes a letter. The more formal and time-consuming

Request for Proposal (RFP) process was not required by departmental policy and, as a result, was infrequently employed.

Narrow solicitations produced few proposals for DSS consideration. In general, the competition for contracts was minimal, according to officials. In all but the four largest counties, receiving more than one proposal for a new contract was a rare occurrence. Therefore, in most counties, if it existed at all, the competition was not so much among agencies offering similar services that could be compared, but among dissimilar agencies all requesting a share of the county's allocation.

DOL's assessments of needs were much more sophisticated than those of DSS. Department officials utilized several advisory and information sources, with the results providing the basis for the solicitations of contractor proposals. DOL did not, however, consistently promote competition through its solicitation procedures. Major differences in methods were obvious when the youth contracts and Title II contracts were compared. Title IV contracts were determined by competitive and fair means—at least for one year—but only minimal competition has characterized the Title II process.

Although CETA regulations do not require it, DOL used the RFP process for the first full year of Title IV (FY 80) youth contracts in 1979. A very complete RFP was sent to approximately 600 contractors in the state to allow for the widest exposure and to include practically every possible provider. The package not only included performance goals for the projects (for instance, percentage of participants placed in unsubsidized employment), but also clearly specified the criteria (and their relative weights) by which the proposals would be judged and given awards.

This RFP process, a major undertaking by DOL, was not repeated for fiscal year 1981 or 1982 programs, in part because the first solicitation was so thorough and DOL had not changed its goals for the youth grant. In addition, the process was very expensive, time-consuming, and complicated. Unfortunately, officials were not pleased with the results of the process—either in terms of the proposals received or in terms of the performance of the agencies that were awarded contracts. Most of the youth proposals were judged poorly written, ill conceived, and unresponsive to the department's needs. One official, who was responsible for the RFP and the proposal evaluation process, declared that if she had had a choice, she would have purchased services only from 2 or 3 of the 35 agencies making proposals, instead of the 16 originally awarded contracts. Nonetheless, all the funds were allocated. Since the bureaucratic system offers no incentives to states or officials who return unused appropriations, DOL gave contracts to some public and private agencies that were perceived as being unlikely to deliver well-run, effective programs.

All contractors who requested renewals for the next fiscal year were given them, even though most of the providers had not met at least some of the terms of the contracts, much less the expectations of the officials. Interviewees gave various reasons for the failures, including late starts, inadequate record-keeping systems, difficulty in meeting the service or target group enrollment requirements, Michigan's economy, slow processing by DOL contract administrators, and unrealistic expectations of program officials.

The Title II solicitation process was more similar to DSS's normal process. The RFP was used infrequently. Invitations to contractors usually were issued through informal contacts and letters, but several private contractors successfully submitted unsolicited proposals as well. (Some interviewees suggested that DOL had inadequate knowledge of private agencies, such that public agencies seemed to be given some preference in solicitations.) Some noncompetitive awards to public agencies were used on occasion, as allowed by CETA regulations, but DOL generally preferred to invite more than one contractor for proposals. Unlike the Title IV RFP process, Title II contract solicitation information was fairly brief and open-ended. Since the target groups, methods of service, and performance goals were not as precisely stated, providers were able to propose their own types of programs, the number and characteristics of enrollees, total cost figures, and the like. Instead of achieving direct competition through wide advertising for certain specific programs, DOL received several different types of proposals for different needs and groups that could not be compared easily.

With the exception of some aspects of Title IV, the contracting procedures used by DSS and DOL usually served to limit competition and avoid comparisons. In many ways, the narrow search and lack of competition were mutually beneficial for most of the key contracting officials, as well as for the contractors. One of the primary concerns voiced by almost all bureaucrats interviewed was that they be able to determine needs, make awards, and process contracts in a timely manner with a minimum of confusion and controversy. The contracting process could proceed quickly and smoothly under the following conditions: when a thorough needs assessment was deemed unnecessary; when the contracting unit did not have to reach an agreement on specific program objectives, service priorities, or proposal criteria; when an RFP and complete mailing list of suppliers were considered inappropriate; when unsolicited proposals were already on file; when only renewals were considered and given contracts; and when a thorough consideration of alternative proposals and agencies was unnecessary.

Encouraging competition and choice can lead to unanticipated outcomes. In the one county where the county board of commissioners contributed the requisite match for local DSS contracts and thereby increased the number of proposals, the county contracts coordinator complained that, as a result, the county had to endure many protests and the ill will of the agencies not awarded contracts, despite good proposals, services, and reputations. Usually more disincentives than incentives exist to promote competitive procedures. When the recent fact of declining resources of personnel, time, and money is added to these disincentives, is it any surprise that competition among responsible and responsive providers was the exception, rather than the rule? Perhaps just as significant is the fact that the competitive process used in DOL for the Title IV grant did not guarantee that the department obtained the proposals and performance that was desired, due to the limited number of potential providers and the policies that effectively discouraged some from competing.

#### DECISION-MAKING IN CONTRACTING OUT

One of the intriguing questions in this type of research is this: Why have officials chosen to contract out for services instead of using traditional bureaucratic methods of supply? For the DSS and DOL cases, the answer has two major components: pragmatic considerations and policy concerns. Clearly, decision-makers did not consult cost-benefit studies to determine the advantages of using outside agencies. Rather, federal policies encouraged service purchasing and state situations often made it necessary.

In the late sixties and early seventies, various political and administrative pressures were exerted on DSS officials to use outside suppliers to capture the large sums of available federal matching funds in order to provide more services to the needy. In addition, the local donation and the expertise of outside agencies made contracting out particularly attractive. To some extent, these funds were apparently also used to entice existing community agencies to help the needy and become part of the welfare system with a stake in continuing the programs (for example, YMCA, Big Brothers, and United Way agencies). More recently costs of services became an important concern, and the contracted services with a 25% local donation continued to look like a relative bargain—although not for the reasons contracting proponents would expect. Several respondents pointed out that contracting does not make for an entirely "free" service to the state, because many DSS personnel were involved in the processing and administration of the contracts. Most interviewees indicated that there are other reasons explaining the continuation of contracting—inertia, political pressures, and the availability of more and better quality services. They explained that there never was an objective purchasing process in DSS—that the state policies governing the types of services to be bought were unclear, inconsistent, and subject to a variety of interpretations.

DOL utilized contracting out in part because departments at the state level did not have the necessary expertise or agencies for the required and optional programs under the two titles. Clearly, contracting with established agencies gave officials greater flexibility than organizing a new agency would have. Probably more important, purchasing services meshed with DOL's (and CETA's) version of administrative decentralization—that is, that local agencies should be given contracts that could be continued through local support. Under the two titles, the federal government encouraged the states to use public and private agencies to promote greater coordination,

innovation, and experimentation. The goal of cutting costs was not seen as a major reason for using outside supply.

In recent years, as Michigan's resources became increasingly limited and social needs have grown, contracting out proved to be an even more desirable alternative. The federal funds were available for social and employment services, but the state government imposed periodic hiring freezes, cutbacks for state travel, and, finally, personnel cuts that affected only in-house supply. For the most part, the early and more recent benefits of outside supply arose from the accompanying organizational policies and pressures encouraging contracting out—not from inherent cost and service quality advantages.

In the same way that DSS and DOL officials did not use contracting for cost reasons, they did not choose among the small number of proposers on the basis of comparative costs for desired services. Except for perhaps the youth contracts, the departments often were vague in their service specifications or their award criteria. As a result, officials had to make comparisons among dissimilar services, target groups, and agencies—with decision-makers sometimes using a variety of different criteria for selection. True to the incremental model of decision-making, officials did not try to get agreement on program goals, but attempted to agree on contractors, for whatever reasons. Usually, however, the questions were these: Which of these services are most necessary? Which agencies appear to have the capacity and experience to administer the programs and provide good services to clients?

The interviews with DSS officials showed that previous state contracts and service experience were the most important factors in awards and renewals; however, DOL respondents stated that the proposals' designs to fulfill the department's request and accomplish established objectives were the basis for most decisions, at least for the original youth contracts. For both departments, however, renewals were virtually automatic and did not require much review, especially when a donation or match was forthcoming. Once a contract was made, usually it was difficult to deny a contractor another, even when service performance and contract compliance were seen as inadequate. Unfortunately, the departments' monitoring and evaluation procedures did not assist decision-makers either. Not only did officials lack relevant and critical information about the effects of various programs on clients' needs, they also depended upon providers themselves for data on service delivery, enrollments, and problems.

Comparing contract amounts and pre-unit costs of services hardly was a concern in these programs. Even when some line-item budget amounts seemed excessive, DSS officials approved them. They depended on the agencies to provide cost and service information without outside sources of objective information. In DOL, contract amounts and the budget were not examined or considered until after the awards were made on the basis of the proposal. The bureaucrats and appointed officials were not taught to think in cost terms, nor were they rewarded for scrutinizing costs when determining awards. One state DSS official who had a business degree expressed his frustration in the selection process by saying that most county officials continued to act as though they were funding agencies, not buying services. Indeed, the behavior of most officials appeared to be more like that found in grant programs than in public procurement of goods and services.

Some of the bureaucrats and contractors also suggested that political factors entered into decision-making when elected or appointed officials became involved in awards. When DSS made new contracts or tried to drop unnecessary or unsatisfactory contractors, political pressure was sometimes successfully exerted on officials to make choices in compliance with the politician's wishes. "Sweetheart" (protected) contracts were made in both departments—on behalf of the department directors and state legislators and, in DSS, in response to local elected and appointed officials. Interviewees were generally disturbed by this fact, particularly when less desirable services or contractors were forced on them.

#### GOVERNMENT'S OVERSIGHT ROLE IN CONTRACTING

Successful contracting out would seem to require an adequate system of independent monitoring and evaluation of suppliers' costs, performance, and effectiveness. (This last type of evaluation is particularly necessary in

human services, since the goals are usually to change people, their behavior, and/ or their circumstances.) These reviews should be utilized not only to ensure contract compliance, but also to provide feedback information when contracts are considered for renewal. In the interview sample, however, almost all officials and contractors agreed that their department's efforts were clearly inadequate in both respects. In response to federal regulations, officials have independently monitored client and participant eligibility for DSS and DOL programs, but have depended upon contractor self-reporting for other matters just as was often the case in selecting contractors. In the early years of DSS contracting, close scrutiny was believed to be unnecessary. More recently, in both DSS and DOL cases of abuses, more limited funds, and a desire to improve performance and accountability convinced officials that better reviews were necessary. But they had insufficient resources to monitor and evaluate contracted services properly, due to state cutbacks.

Although DSS interviewees tended to be more critical of their review procedures, both departments had some of the same problems-burdensome paperwork, inadequate evaluation measures and tools, and lack of time, staff, and travel money. Both departments emphasized client eligibility verification, did less well on reviewing expenditures, and failed in evaluating program performance and effectiveness consistently. On-site field visits by state officials were virtually eliminated in the last few years. Seldom were clients contacted about the services, and long-term follow-ups were judged to be almost impossible to do with limited funds and the types of people in the programs. (Some of these problems also existed with in-house reviews, but since the service locations were removed from contract administrators and program staff, oversight was more costly and difficult.) Officials did utilize random postaudits of expenditures and contract compliance, but their results came rather late—after mistakes had been made and renewals were awarded. DSS officials experienced some frustration in the few cases where they were prevented from prosecuting to recoup losses, both in cases of fraud (in one instance, due to political pressure) and mismanagement of funds (because of apparent good intentions as well as the time and costs involved). Interestingly, for their part contractors seemed to welcome more outside feedback and substantive evaluation, if the reviews were done fairly and thoroughly.

Moreover, DSS's and DOL's watchdog roles were rendered almost ineffective by three other factors: (1) Michigan's attorney general ruled that contractors could not be held responsible for failure to meet performance goals in contracts; (2) information that the departments obtained about compliance and performance did not always determine whether or not a renewal would be made, in view of organizational, service, and political considerations; and (3) frequently, other sources of supply were not available to meet the departments' and/or clients' needs. Consequently, few mechanisms operated to ensure that contractors were producing the kinds of services and results that were desired by officials and needed by clients.

## CONCLUSION

It became clear from the interviews that only infrequently were the three conditions assumed by contracting proponents realized in these human services. Competition for contracts was minimal—not only because of the lack of similar suppliers of services, but also because of departmental and federal regulations and procedures. Contracting awards were often made without sufficient needs assessments, wide solicitations, or fair proposal reviews. Officials were seldom concerned about cutting costs via contracting; rather, they used this method to supply certain types of services to clients. Finally, objective performance monitoring and evaluations were found to be woefully inadequate because reviews were largely dependent upon information from contractors themselves.

This study, however, shows that human service contracting does allow government units to take advantage of well-developed outside expertise. Interviewees in the DSS case believed that, in general, the contracted services provided were of good quality; DOL officials were somewhat less impressed with contractor performance. To what extent this conclusion was based on actual observation and evaluation over time is unclear. A key factor in decision-making and reviews has been a preference for professionalism—as evidenced by contractor proposals, reputations, and relationships with officials. It can be surmised that sometimes common professional training, language, goals, methods, and biases serve as a substitute for assessing the actual needs of clients and the actual outcomes of suppliers' services. On the other hand, common professional standards of behavior and a desire to

help clients have probably also served as a major constraint on contractors where the government's watchdog role has been weak. When resources are severely constrained, as they have been in Michigan in the last few years, this kind of check may work as well as any low-cost, superficial review.

Beyond these immediate substantive conclusions about the Michigan cases, this study has some broader implications because of what it suggests about contracting in general. Even though the Michigan cases demonstrate that in some service areas contracting has not been used in the ways envisioned by proponents, I do not intend to challenge the notion that contracting out can be an efficient method of service delivery. Rather, my aim has been to begin the process of specifying appropriate conditions for contracting through an analysis of the actual practices and behaviors of contracting participants. Different conditions and behaviors are likely to be found in other service systems and, consequently, may produce results that are more consistent with proponents' expectations. For example, where fiscal constraints are serious, decision-makers probably will be more motivated to use contracting out as a cost-cutting measure, particularly when they are rewarded for doing so. In addition, the role of the federal government in the programs studied here affected the goals, procedures, and incentives of officials. Certainly a different policy system would be expected to produce different processes and outcomes.

The major difficulty with the contracting prescription is that it has been widely recommended for the current ills of government with little explicit recognition of the requisite environmental, behavioral, and organizational conditions and the realities of implementation. At least three general deficiencies have been evident in the prescriptions of contracting. First, contracting proponents have failed to recognize the critical role that the service environment can play in contracting, both in terms of the pool of potential providers and the inputs and feedback of service consumers. Not enough attention has been paid to the effect that government programs, regulations, and funds have had on creating contractors, encouraging government dependency, and giving critical advantages to certain providers.

Second, contracting research has generally overlooked the political, motivational, and organizational contexts of the contracting participants. The obvious questions are the following: Why should bureaucratic behaviors change with contracting? What incentives are there to achieve cost-cutting or efficiency goals?

Third, the importance of the organizational structure, process, and procedures in contracting has been virtually ignored in public administration.<sup>10</sup> Too readily have some contracting advocates assumed that quasi-market mechanisms will almost automatically work wonders in providing services, without exploring how and why contracting is actually utilized, what procedures are critical in producing the expected benefits, and under which constraints and inducements the various actors operate.

This research indicates that some of the same problems that plague in-house supply may also characterize contractual arrangements, in large part because of the same bureaucratic structures. The realities of government mean that this alternative to traditional methods of supply is not an easy, clear-cut solution to governments' knotty fiscal problems, but with further research in several different service areas the conditions and procedures for successful contracting may be identified. With this information practitioners can try to use contracting more wisely and find ways to change inappropriate conditions and procedures into beneficial conditions.

## NOTES

1. For the more theoretical, public choice approach to this general subject of alternative methods of service delivery, see especially Bennett and Johnson (1980, 1981), Borcharding (1977), Niskanen (1971), Ostrom and Ostrom (1977), Savas (1974, 1977a, 1982), Sonenblum et al. (1977), and Tullock (1965).
2. For an explanation and discussion of alternative theoretical perspectives that suggest some additional problems of contracting out, see DeHoog (1984).
3. Contracting scholars may not all agree on my selection of these three conditions, yet they appear to be the most critical conditions to the usual argument about the process and benefits of contracting.

4. Since this research was conducted, Title XX has been changed and renamed the Social Services Block Grant, under the Omnibus Reconciliation Act of 1981, and CETA has been phased out and partially replaced by the Job Training Partnership Act of 1982.
5. Some other purchased services (for instance, day-care or home chore services) did not involve a contract in which the government selected the service provider. Rather, a relatively simple agreement about the services was made between the service user and an approved agent, with the government providing the funds.
6. Although many of the contracts in DSS and DOL were made with other public agencies (such as the Department of Education, local school districts, local prime sponsors), I included only private contractors in my interview sample. This decision was made because of the current interest in privatization.
7. This is one of the reasons that it is often difficult, if not impossible, to make direct cost and performance comparisons between in-house and purchased supply.
8. A few counseling agencies that worked primarily with middle-class clients were "persuaded" by available funds in the early seventies to add services to the needy.
9. According to one source, some found a way to get around that problem. Agencies (with the county's tacit approval) increased their directors' salaries to such a level that the donation could be paid with the difference between the pocketed amount and the contract amount. In such a way, the federal government actually paid for the match as well as its usual 75%.
10. See Cooper (1980) and Nelson (1980) for exceptions.

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