COMPETITION, NEGOTIATION, OR COOPERATION: Three Models for Service Contracting

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Abstract:

Contracting for public services from public or private suppliers is now a common prescription to improve government efficiency. The competitive bidding model is usually viewed as the ideal contracting process. However, this article explains that two other approaches—the negotiation model and the cooperation model—may be more appropriate under certain conditions. The primary factors that are likely to determine which of the three approaches is most suitable are (a) the characteristics of the external environment (especially the number of service suppliers), (b) the level of organizational resources (e.g., personnel, funds, time, and expertise), and (c) the degree of uncertainty about funding, future events, service technologies, and causal relationships between service outputs and desired outcomes. The main point is that there is no one best way to contract for services; rather, government units should adapt their contracting procedures to both internal external conditions to implement service contracting in an effective manner.

Article:

Cutting back, cutting out, and contracting out for public services have become government watchwords in the last decade in the face of declining federal grants, taxpayer resistance, and tax and spending limitations. Both scholars and practitioners have been entranced with the various methods of privatizing government goods and services (Bennett & Johnson, 1981; Hanke, 1987; Savas, I987; Straussman, 1981). Of the various privatization approaches, service contracting has been viewed as one of the most attractive quasi-market alternatives to traditional bureaucratic service delivery, since it has been promoted as a feasible method of reducing government expenditures and improving efficiency and effectiveness. As a result, much of the literature has focused on the advantages and disadvantages of contracting out for services (Fitch, 1974; Moe, 1987; Murin, 1985; Savas, 1987), projected and actual cost savings (Bennett & Johnson, 198I; Poole, 1980), and the frequency of use in local government (Florestano & Gordon, 1980; Hatry & Valente, 1983).

More recently, however, a growing body of literature has begun the task of examining contracting implementation itself, including contracting procedures, decision-making processes, and organizational environments (DeHoog, 1984, 1985, 1986; Ferris, 1986; Ferris & Graddy, 1986; Hunt, 1984, 1985; Schlesinger, Dorward, & Pulice, 1986). Not only are certain "hard" service areas, such as garbage collection, fire protection, and street lighting, being examined, but the "soft," more complex human services (in which people are the service focus) are also increasingly of interest (Kettner & Martin, 1986; Kramer & Grossman, 1987). These are essential areas of study, since policy analysts and public managers alike must move beyond theory and begin to address the key issues of implementation and management practice in various services.

The decision to contract with outside firms or agencies does not necessarily trigger an automatic mechanism to produce lower costs and better services. The fiscal and service outcomes are, in part, influenced by the design of the contracting process itself and are contingent on both internal and external organizational conditions. While competitive bidding has become the standard approach to service contracting, I intend to show that it has serious drawbacks under some circumstances.

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This article uses the findings of existing contracting cases and developing theoretical approaches to extend the study of contracting in two ways. First, three conditions under which some compromises in the ideal competitive contacting model must take place are identified, which form the basis for comparisons of the ideal and the two alternative models. These conditions include (a) the characteristics of the external environment — especially the number of service suppliers; (b) the level of organizational resources (e.g., personnel, funds, time, and expertise) necessary to cover the many transaction costs involved in the contracting process; and (c) the degree of uncertainty about funding, future events, service technologies, and causal relationships between service outputs and desired outcomes.

The growing theoretical literature on institutions found in economics and political science has suggested the importance of these factors in a variety of contractual relations, in terms of issues about competition, information, transaction costs, opportunism, uncertainty, and complexity (see especially March & Olsen, 1984; Moe, 1984; Ostrom, 1986; Shepsle, I989; Williamson, 1975, 1985). Recent works primarily by economists (e.g., Scharpf, 1989; Williamson, 1985) have suggested that, even in private sector exchanges, we can no longer focus exclusively on either the competitive market model or internal hierarchical organization for supplying services, but that other, more flexible forms of contracting can be viewed as appropriate compromises between the two extremes.

Second, the traditional contracting approach—the competition model —is critiqued and then compared to two alternative contracting models—the negotiation and cooperation models—which are likely to be more suitable approaches when the conditions essential to effective implementation of the competitive model do not obtain. While these models are not new to service contracting, they have not been made explicit in the existing literature on public sector contracting nor have they been related to the supplier, organizational, and service conditions. The article concludes by comparing the three contracting models in light of these conditions. It also addresses the more general question: Why adopt contracting out as an alternative to government bureaucracy when the conditions do not appear to favor the competitive model?

This discussion assumes that the choice of contracting out has already been made by elected or appointed officials, statute, or regulation, whether or not this method actually is an efficient alternative to public bureaucratic supply. If external supply has been selected, how might the contracting system be designed to promote the public agency's goals, given the nature of its external environment and its internal organizational and service constraints? This question recognizes that officials may not always have much of a choice in designing the appropriate system prior to or after a decision has been made to contract out for a particular service. Thus certain institutional constraints (e.g., legal restrictions) may require one type of contracting process. This article has, therefore, both a descriptive and prescriptive orientation. I will not only describe the key features of the models but will argue that governments should adapt, as much as is feasible, their contracting procedures to correspond to the supplier environment, contracting resources, and the degree of uncertainty. Public officials have often been told that the traditional competitive model is the only efficient way to purchase services, and many efforts in recent years have been aimed at trying to ensure more competitive systems. Yet the other two approaches offer advantages when the competitive model is unrealistic. My thesis is that there is no one best way to contract out for public services.

THE CONTRACTING IDEAL: THE COMPETITION MODEL

In the competition model of contracting out, the government has its choice among several bids and therefore can select the firm that will provide the specified services at the lowest cost. While this ideal is often not achieved in public services, useful benefits of the competition model may be approximated. Both the number of potential contractors (suppliers) and government agencies (buyers) is often quite small, offering less choice and independence than the market model envisions. In addition, actual contracting decisions are often based on imperfect and limited information about suppliers, probabilities of adequate service performance, the causal relationships between service outputs and outcomes, and suppliers' actual performance. Nonetheless, we assume that government officials will, as in the ideal case, attempt to maximize economic efficiency in choosing among

potential contractors.[1] Although the level of competition and information is not ideal, certainly some degree of competition is assumed to generate cost reductions. In addition, as has been pointed out in the privatization literature (Savas, 1987), public agencies may use the private sector not only because of the potential competition paring costs but also due to economies of scale and scope and the circumvention of public personnel requirements.

In its operation, then, this model seeks to promote the efficiency aims of obtaining the best quality product or service at the least-cost level. The emphasis is on the proper bureaucratic procedures and process, which include: (a) a complete specification of the required service, (b) a wide advertising and solicitation effort, (c) an objective award decision, and (d) objective cost- and performance-monitoring procedures. However, as we will see below, even when government officials adhere to these standards (which is not always the case), the competition model may not work as envisioned to produce high-quality services for a low cost. A fundamental assumption of the model is that the rules of the process and the ensuing contract will by themselves produce desirable outcomes. Yet in reality, under some circumstances officials will find that they cannot use this model easily and effectively.

LIMITATIONS IN THE COMPETITION MODEL

While it is widely recognized that the competitive approach to contracting falls far short of the "pure" market model, government contracting may approximate the imperfect market approach, as discussed earlier. In terms of the three factors already introduced and as seen in Table 1, this model is likely to be successful under the following conditions: (a) competition—when several responsible and responsive firms independently bid on the contract; (b) adequate organization resources-where the government agency and the potential suppliers have the time, staff, and expertise to participate effectively in the lengthy and sometimes complex contracting process, from early service planning to the monitoring and evaluation of services; and (c) certainty—where the government's funding levels, client or service needs, and service technology are relatively straightforward and certain. When any one of these three conditions is absent, the competitive approach may not always be appropriate for purchasing public services.

Each of these conditions is necessary for a competitive system for different reasons. First, three or more potential suppliers are essential for competition. As I queried in 1984: "If no other firm exists to offer its services, what incentives 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 method of comparison?" (p. 19). While government agencies have some relevant independent knowledge of suppliers and their services, they often rely on bidders' information to make choices, which acts as a check on opportunism.

However, in certain service areas, choice among suppliers is severely limited, due to a new service, high capital costs, or lack of professional expertise in certain smaller communities (DeHoog, 1984, 1986; Kramer & Grossman, 1987). In addition, as Williamson (1985) noted, even when these problems do not exist at the outset of a service or project, due to asset specificity, over time, the selected contractor often develops considerable expertise and capital investments that will discourage other bidders and give them considerable advantage over competitors (as well as the government agency) in any renegotiation of the contract. The problem of "small-numbers supply," as Williamson (1975) noted, means that the "buyer incurs the risk that the purchased product or service will, at some time, be supplied under monopolistic terms" (p. 52). These terms may include higher costs and poorer quality services because of lack of choice among bids.[3] The federal government has tried to stimulate (or even simulate) competition in some large defense projects where it was absent, but, as Hunt (1984) reported, these efforts have proved unsatisfactory. In the Massachusetts Department of Mental Health, even though the state tried to encourage participation, the following results of competitive bidding were disappointing: "On average each Request-for-Proposals (RFP) receives 1.7 responses; almost two-thirds of the `competitively' bid contracts had responses from only a single vendor, and only 15% had responses from more than two vendors" (Schlesinger et al., 1986, p. 252).

Second, adequate organizational resources are necessary in the competitive model because transaction costs can be high (DeHoog, 1984; Sappington & Stiglitz, 1987; Williamson, 1975). To complete all steps of the competitive bidding process in a timely manner, the government agency must have sufficient information, expertise, staff, and computational ability to make a prudent contract award and then to monitor performance during the life of the contract. Obviously, oversight is also an essential source of evaluative information for contract renewal decisions and acts as a constraint on contractor opportunism.

Even where several agencies are available for contracts, transaction costs can be high for clients. As Schlesinger et al. (1986) put it: "Effective competition depends on the potential for switching programs and clients from one provider to another. This ideal conflicts, however, with the goal of maintaining continuity of care" (p. 252). In the mental health field, as with other services, program managers may try to reduce competition and choice in favor of service continuity, which they prefer for the attendant avoidance of their own as well as clients' transaction costs. The problem is that the government's resources and client adaptability may be inadequate for competitive procurement to work effectively. The complexity and the legal requirements of the competitive process involve transaction costs of time, information, staff, funds, or expertise that are often in short supply, particularly in small or fiscally strained governments.

Also often overlooked in discussions of contracting are the organizational resources required for the contractors themselves to compile proposals. Those who have had experience in bidding on government contracts may have a significant advantage here, as the problem of asset specificity mentioned earlier emphasizes. At least in the case of human services, small, new, nonprofit agencies often lack expertise and administrative resources to be able to compete against experienced and well- funded agencies (DeHoog, 1984; Kramer & Grossman, 1987; Schlesinger et al., 1986). Thus the difficulty of market entry serves to limit the availability of potential suppliers.

The competition model also requires a complete specification of the desired service by the contracting government. This realistically can occur only under the third condition of certainty, when the government's needs are known well in advance, appropriate service technologies are understood, and funding for the service is secure (Hunt, 1984). Without an airtight contract including these components, determining what constitutes inadequate administrative or service components post hoc is almost impossible. Unfortunately, clear performance specifications are difficult to generate and communicate in some services, such as innovative programs, large-scale capital projects, some human, or "soft" services, or professional services (e.g., architectural, legal, or engineering services). If it is a new service or one with which the government agency has had no prior experience in supplying, this may be a particularly knotty issue, since the potential supplier may be the expert, not the government. Thus government agencies suffer under terms of incomplete information that are asymmetrically distributed to the advantage of contractors.[4]

Another limitation of competitive procurement is that it, like other efforts that focus on the key role of political institutions in structuring outcomes (March & Olsen, 1984), overemphasizes the monolithic nature of government bureaucracies engaged in contracting out. To understand how contracting really works, we must look beyond simply the stated preferences and rational choices of the organization and recognize that individuals and their relationships across organization boundaries also help to explain the success or failure of public purchasing (Cooper, 1980; DeHoog, 1986). In a similar vein, Hunt (1984) emphasized in his study of federal military research and development that the formal competitive model (his F-model) assumes rather unrealistic, inflexible roles between the government and contractors:

> The parties are thought of in an F-model as well-differentiated economically rational "buyers" and "sellers" engaged in ... a "discrete transaction." They ostensibly have no relationship apart from a simple market-regulated exchange of goods, nor either opportunity or need for transgression of their limited and predefined buyer-seller roles. (p. 248)

Rather than focusing on joint problem solving, this impersonal, rule- driven, and sometimes adversarial relationship lends itself to losing sight of goals and failing to take advantage of private expertise.

This competition model may also produce suboptimal outcomes because of contractor opportunism. In reviewing the recent literature of public choice and behavioral psychology, Mueller (1986) observed that experiments on human behavior indicate that opportunistic and illegal behavior is more likely to be found in competitive settings and that cooperative behavior is likely to be produced in cooperative settings. Thus the structure and rules of interaction apparently influence how humans behave. Applied to service contracting, the question is: How can the contracting system be designed to maximize cooperative behavior by contractors, and minimize opportunistic behavior? In the case of the competitive model, which is likely to bring out opportunistic behavior and where the stakes are often high, the system must be designed to reveal and punish such behavior severely enough to deter other opportunists. This approach requires resources not always available in government—not only resources to investigate possible violations but also the resources (including willingness) to prosecute and punish violators in a highly visible way. I found evidence in my (1984) research that "officials did not always prosecute even in clear cases of fraud because of political pressure. Instances of mismanagement of funds posed difficulties in recouping losses because of the expense involved and contractors' apparent good intentions" (p. I03).

Due to the various requisite conditions and unrealistic requirements, this competitive approach is not usually employed in contracting out for human services, professional services, or research and development, although competitive bidding may be required and some of the elements of the model may be in place (DeHoog, 1984; Schlesinger et al., 1986). However, the competition model is often used to purchase certain "hard" services, or intermediate services, for which a complete RFP can be developed by public officials (because of a high degree of certainty), transaction costs are not high, and several potential competitors are available.

TWO ALTERNATIVE MODELS OF CONTRACTING

To this point, we have seen that the competition model is likely to be effectively implemented only under fairly rigorous conditions: where a strong market of service producers exists, when resources are abundant, and when service production is certain. When these conditions are absent, two other models might be better substitutes.

Both of these alternatives assume that a key element of contracting is the relationship between the government officials, the "buyer" or "principal," and the usually nongovernment "seller," or agent (Williamson, 1985). The conditions and rules of the interaction between the two sides and the stakes, incentives, and penalties are critical to an analysis of what each side does and how each reacts to the other. While the public contracting or purchasing officers and program managers are at the center of the government procurement system, often the success of the system depends on their ability to balance a variety of legal, political, and organizational demands and constraints (Cooper, 1980; Sharkansky, I980). This means, of course, that more than just two sets of actors are involved in actual contracting, as a simple principal-agent analysis might imply (Moe, I984). The relationship between the government and the contractors is often complicated by the fact that other participants influence, and perhaps control, the interchange (i.e., elected officials, control agencies, citizen interest groups, professional associations, or other operating departments whose jurisdictions may overlap with that of the primary government entity). These other participants may have a variety of interests and incentives to influence both the design of the system and the contract awards (e.g., political ambitions, service interests, and accountability concerns). The competition model fails to acknowledge these actors and the complexity that they introduce.

THE NEGOTIATION MODEL

A more realistic alternative to the competition model is the negotiation model. In contrast to the competitive market model, the negotiation model involves relational contracting, in which a form of consensual and incremental decision making is the norm (Scharpf, 1989; Williamson, 1985).

The Operation of the Negotiation Model

The process of negotiation begins with an announcement of the availability of the contracts, but often without a full-scale search or solicitation for all possible contractors. The suppliers who are contacted are limited to

previous contractors and possibly, to firms that have expressed an interest in obtaining a contract. Some state or local officials hesitate to solicit outside the jurisdiction for political reasons, such that often, only local firms or agencies are contacted about contracts. The desired services are not specified in very much detail, although certain elements that officials have made a priority are included. Because of their experience and expertise, the private firms or agencies have some freedom to design service plans as they see fit. They submit their proposals, the agency selects the preferred plan, and then the negotiations begin on specific changes (Cooper, 1980).

Often the question is not so much who will be selected, since it is a foregone conclusion that the identified (or previous) contractors will be chosen, but rather, the central negotiating matters will be the contract price and the type and extent of the projects or services to be undertaken. The critical negotiation phase, which occurs after the contractors have been selected, focuses on general limits for service activities, administrative control procedures, and per-unit or total amounts that the government will pay. However, just because negotiations begin with a certain supplier, it is not guaranteed that a contract with that supplier will be written and signed. During the process, certain issues may arise in which either the contractor or the government may determine that an agreement cannot be reached.

During the implementation of the contract, public officials must be flexible and involved in operations and oversight. As Hunt (1985) asserted in his work on federal program management:

> Managing under uncertainty calls for flexibility and judgment—problem solving—not routine performance of fixed procedures.... Ambiguous work statements must be clarified on the basis of shared experience and redefined as circumstances or perceptions change and the public's interest must be protected in the process. (p. 586)

In this model, the government and the contractor are on a more equal footing than in the competition model. Fisher and Ury's (1981) Getting to Yes model of principled negotiation comes close to capturing the essence of the ideal relationship between the two parties and their efforts to produce an amicable agreement. The parties may see their goals and interests very differently, but they both can achieve certain advantages by a process that adheres to the basic ground rules of fairness, truthfulness, and reason as they seek a contract beneficial to both.

In actuality public officials and contractors may act more as adversaries and may not be able to focus on interests instead of positions and personalities, as Fisher and Ury recommended. Yet both sides are constrained from leaving the negotiation process by their interest in reaching an agreement, and their lack of other alternatives. In many cases, the contractor may be fairly dependent on the government's funding, and the government dependent on the firm to supply a necessary service. Where resources are low or change rapid, the potential contractor has some leverage to use in its dealings with the government. However, the government agency has the potential of either finding/creating another supplier or producing the service itself.

A brief example from my 1984 study of human services may help to clarify how the negotiation process works. In the state social services and employment services in Michigan, the early part of the process looked very similar to a block grant process, in which the state agency had a general purpose in mind, but a variety of different types of programs and services could be designed at different funding levels and still be accepted. While some competition was present, in that the service suppliers were competing for a limited pie, little direct competition on a serviceby-service basis was involved. Thus the state could decide to contract for several types of services with different suppliers who have all been notified with the same general announcement. For example, a county might contract out with different agencies for money management counseling, family counseling, and geriatric day care using the same advertisement and the same pot of funds. Furthermore, "once a contractor, always a contractor," could have been the motto of the social service department (DeHoog 1984, p. 61). Usually, contractors were able to renew their contracts without direct competition. Common negotiating issues concerned client loads, service methods, and per-unit costs.

Advantages and Disadvantages of the Negotiation Model

The negotiation model offers several advantages for contracting for services. First, this model can be used in service areas that have few suppliers. Second, because not all of the administrative procedures for competitive bidding are required, the process entails lower transaction costs in terms of administrative expertise, staff time, information requirements, advertising, and solicitation costs. Transaction costs for negotiating contract terms and for monitoring and evaluation may be greater than under the competitive model, however. Because the contract does not clearly specify performance standards, and technologies may be poorly understood, complex, or rapidly changing, the government may need to devote more effort and resources to overseeing suppliers' actions and their outcomes.

Third, this model can accommodate uncertainty and complexity by negotiating many of the details of the contract with suppliers in a way that allows for some flexibility should conditions change. All details of service delivery and technologies need not be specified in the request for proposals or advertisements. This permits some choice by potential contractors in designing projects and services that conform to the government's objectives. As the date of contract writing draws near, it may become clearer to both sides what is desirable in these areas, due to, for example, more information about funding, elected officials' preferences, or previous programs' success. While the contract may not contain all details, as in a competitively bid document, both sides may be able to reach an agreement about specific components that might not have been possible before. When negotiating with a specific contractor, government officials can take into account the suppliers' administrative, capital, and professional capacity in producing the desired service. This type of detail is not usually known in drafting the specification package.

The drawback of the negotiation model is that although more flexible than the competition model, it still may not take full advantage of the contractor's expertise, since the government has primary control over the terms of the contract. This model also requires time, expertise, and staff resources in the negotiation process and certainly in the monitoring and oversight phase. It may emphasize the adversarial nature of the process, since it tends to focus on procedural matters, and less on program outcomes. Often, only the facade of competition is maintained for public view, but the benefits of open, explicit cooperation and authority sharing are lacking here. As we shall see in the next section, the cooperation model avoids most of these problems, but incurs others that are not as likely to be found in negotiating contracts.

A problem that the negotiation model introduces, and the cooperation model more directly confronts, is that the negotiations may foster closer relations between government officials and the contractors, sometimes producing a less objective consideration of the content of proposals and providing more opportunities for contract officers to promote the needs and interests of the private agent (Cooper, 1980; Hunt, 1984). In this way, the precise "fit" of the services of the community or client group may not be quite what would be found in the more explicit proposal process of the competition model.

This approach is also more likely than the previous model to allow for political awards, since elected officials or high-level appointees can more readily violate the usual rules and practices of the contracting system (Cooper, 1980). In my 1984 study of Michigan social and employment services, for example, some contracting decisions were made on political grounds to reward certain friends and allies or in response to pressures from strong interest groups. Even when the government program managers no longer valued the services or their results, given contractor performance and fiscal strain, these contracts were difficult to terminate or reduce. Consequently, the benefits of lower cost and better quality services via service contracting may not occur where politically motivated decisions are frequent.

THE COOPERATION MODEL

The cooperation model is likely to be a viable alternative to the previous models under the following environmental and organizational conditions: (a) where there are low resources of time, funding, or existing suppliers prepared to produce the service; (b) little government expertise and/or experience in delivering a service; and (c) rapid rate of change and/or a high level of uncertainty and complexity about future events, funding, technology, or successful service methods (Williamson, 1975). While all of these conditions may not

need to be present to make the cooperation approach the most attractive alternative, it is likely that the confluence of several of these conditions will mean that the two previous models are less appropriate than the cooperative model. Many government programs currently operate under a variety of these constraints; therefore, the cooperative approach may be one that is more appropriate to their circumstances.

The Operation of the Cooperation Model

In this model, the service environment is typically characterized by only one contractor. If there are more, high capital investment or market entry costs encourage the selected supplier and government officials to agree at least informally that the contract will continue to be renewed on a sole source purchase basis. Not only are meaningful alternatives unavailable in the private sector, but there are also limited opportunities for the government to produce the service itself, due to insufficient capital outlay funds, political commitment, legal restrictions, or lack of expertise. Such circumstances emphasize incentives for firms to establish a long-term relationship with the government agency and thus continue to receive future contracts. This approach is likely to be used where multiyear contracts are in place, as in certain capital projects or consulting, research, and development services. The contractor becomes a sole source supplier and a monopolist. (For some services, the government may be the only buyer in the market, thus establishing a bilateral monopoly as well.) Only in the most unusual circumstances would it be possible that another contractor would be encouraged to enter the contracting process—and then only if the government's needs were redefined or the current supplier proved to be grossly inefficient, unreliable, or unresponsive to public agency demands.

In this relationship, the government and the contractor are relatively equal partners. Although the initial bidding or contract award process that led to the selection of the contractor may have been conducted according to the competition or negotiation model, program management and future contract renewal sessions will be cooperative in nature. The system is quite decentralized and flexible, with discretion about many contracting decisions in the hands of program managers who often develop a personal relationship with the contractor. Both sides will share information, since each has incentives to make adjustments and improvements as necessary. The contractor becomes a key actor in providing needs assessments, planning programs, and determining the methods and levels of service delivery. Both sides will try to anticipate implementation problems, yet knowing that they cannot write all possible contingencies into the contract. Throughout the life of the contract, monitoring officials may be less inclined to enforce the contract according to the letter of the agreement and more likely to assist contractors in improving their performance and overcoming obstacles. Thus fine-tuning administrative and service delivery systems is an ongoing priority for both sides. In sum, they will emphasize the program or services, clients, and outcomes in place of the proper process, procedures, and paperwork.

The contract itself will not be particularly detailed or specific; rather, it will be a flexible document. This is not only because of uncertainty, complexity, a rapid rate of change, or insufficient time and resources to enumerate all contingencies but also because of the trust that develops with a reliable contractor. Implicitly, at least, this model assumes a willingness to comply with the terms of the agreement, to avoid situations and behaviors that would damage cooperation, and to work to improve services. Neither side wishes to upset the balance of cooperation, since by establishing an ongoing agreement, both sides can reduce their level of uncertainty in an uncertain organizational, political, fiscal, technical, or service environment.

The substitute for a tight contract that embodies notions of legal accountability is a set of common professional standards that act to limit opportunistic behavior. Firms or agencies are awarded contracts only if they have an established reputation for quality services and ethical practices. During the life of the contract, the professionals on both sides of the contract relationship are afforded a great deal of discretion, since they have the skills and expertise necessary to make appropriate choices in technically complex and uncertain areas. As an analysis of the space shuttle Challenger tragedy suggests, professional controls internalized by contracting participants may be very effective in ensuring quality programs and may, indeed, be superior under some circumstances to more traditional legal and bureaucratic mechanisms of accountability (Romzek & Dubnick, 1986).

As the general literature on cooperation suggests, cooperative behaviors are not entirely prompted by the situation nor motivated by altruism and commitment to professional standards, the government agency, and/ or the public interest, of course (Axelrod, 1984). Some systems may allow for profit or fee payments to be decided by the government officials, based on the contractor's performance—not on predetermined quantitative measures in the contract (Hunt, 1985). This opportunity for managerial discretion and judgment clearly encourages the contractor to please government associates through cooperation. In addition, contractors will attempt to preserve stable, cooperative relationships with the government because it is in their long-term self-interest. As Scholz (1984) suggested in the regulatory context, such a strategy helps both sides "to achieve higher utility in the long run by abstaining from temptations to maximize short-term gains" (p. 220). Though discussing cooperation when government authority is absent, Axelrod (1984) made a key point which is applicable to contracting as well: "What makes it possible for cooperation to emerge is the fact that the players might meet again" (p. 12).

In actuality, the cooperation model may not be an approach that all officials would want to develop when they first decide to contract out for a service. Rather, this approach often develops from having had several years of a satisfactory negotiating relationship with a particular contractor. In addition, federal, state, or local laws or regulations may prohibit the use of this model. In the study of mental health contracting in Massachusetts, for example, competitive bidding has been required both for all new services and for renewals of contracts every three years (Schlesinger et al., 1986).

Examples of the cooperation model in practice have been found in several human services areas. In their review of purchase of social services contracting in the I970s Kettner and Martin (1986) went so far as to claim that the cooperation model (or partnership model, as they called it) was the standard approach until recently. As I mentioned in an earlier work (DeHoog, 1984), in two Michigan counties, social service decisions were made cooperatively with community agencies that, in concert, were very influential in selecting service priorities and contracts (p. 83). In one county, private agency representatives met monthly with county officials to discuss service needs and program changes. Their suggestions strongly influenced the decisions of the county department which prided itself in having a highly cooperative working relationship with private providers. Paperwork requirements were more flexible than in other counties, contractors were assured of contract renewals, and public officials were very sympathetic to private agency concerns. Contract choices were shaped by professional norms, notions of fairness, and client needs. Schlesinger et al. (1986) referred to the mental health partnership clinics in Massachusetts that were common in the 1950s and 1960s, in which satisfactory cooperative relationships were established in a joint public-private system of service delivery without competitive and negotiation requirements.

Hunt's (I985) description of cooperative contracting for R&D in the Department of Defense emphasized a current movement toward cooperation under conditions of little (if any) competition and high uncertainty and complexity. The J-model, or joint government-contractor effort, includes the use of the award fee contract as a flexible approach to improving the process and performance of contracting. This award fee approach allows government managers to be actively involved in program implementation and to reward contractors with fees based on managers' judgments about performance. In evaluating award fee contracting in the Air Force Systems Command, Hunt found that it fostered positive, cooperative relationships, as well as flexibility by government managers in influencing their contracted programs.

Advantages and Disadvantages of the Cooperation Model

Probably the primary advantage of this model is its emphasis on performance and program management. This model provides for a flexible contracting system that is adaptive to change and uncertainty without the constraint of artificial deadlines, unrealistic contract provisions, or complex procedures. When problems arise, decisions can be tailor-made according to the circumstances of the situation and the contractor—both during the planning (contract writing) stage and during the implementation phase of the contract. A second advantage of cooperative contracting is that the system makes full use of the service deliverers' knowledge of the service and clients and recognizes that contractors often have better information and more professional expertise than the

government does. The reliance on professional performance standards can be powerful, internalized controls on opportunistic behavior.

Third, contracting under this model may actually limit opportunistic behavior in another way, that is, with no real competitors, there are few incentives for opportunistic behavior to receive a contract or to obtain renewals. Continuous personal interactions may also put more informal and professional pressures on contractors to perform well and comply with agency requests as they recognize their mutual interdependence. Fourth, the long-term relationship avoids the various transaction costs involved in seeking out and changing contractors. It makes the communication and translation of government requirements in the language of the contractor quite easy, since a common language is developed over time and may, in fact, be embedded in common professional training. Therefore, little time and effort is expended in correcting communication difficulties or technical, administrative, or service delivery problems.

Although these advantages represent important ways in which cooperative contracting may be preferable to the other alternatives (given the stated environmental and organization conditions), several dangers are inherent in using this model. First, the cooperative system is likely to be a fairly closed process among similar kinds of professionals who may lack objectivity and an overall view of the program. This approach emphasizes professional discretion with few systematic control mechanisms. Since other service alternatives are unlikely to exist, it may promote a tolerance for errors and problems in the contractor's administrative operation and services. After all, the government has a great deal invested in the single agency or firm. Because of the attendant climate of trust, the lack of specificity in the contract, and the complexities of the service, the costs of monitoring and evaluating services may well be somewhat lower or, at least, government officials may be less motivated to adhere strictly to the usual control and evaluative mechanisms. In fact, where resources for thorough evaluations are severely constrained, government officials may rely on the contractor's evaluations of their own services, as was found frequently in my (1984) study of human services. If external or hierarchical controls are introduced in a cooperative process, resentment and resistance are quite likely to result on the part of both the contractors and the government monitors, who are usually quite contented with the more informal system that they have developed. A case illustrating this point is the Challenger project, in which the professional aeronautics engineers at both NASA and its contractors chafed under the adoption and application of new and stricter forms of political and bureaucratic oversight (Romzek & Dubnick, 1986).

Second, and related to this issue, is the possible problem of familiarity breeding complacency when there is no realistic threat of losing a contract. Maintaining friendly, cooperative personal relationships may become more important to participants than providing high-quality services for the public. Thus threats to promoting efficient and equitable service delivery in the public interest represent the most serious drawback of this model.

Third, the contracting approach may tempt suppliers to control or manipulate information in the development of the contract when they have a significant informational advantage over the government officials. Without an independent verification of information, the government may make unwise choices that have negative fiscal and service outcomes. Consequently, the success of the cooperative system is heavily dependent on the values, skills, and knowledge of the contract officers. Because of their discretion and their continuing relationships with the contractors, they may become advocates for and defenders of "their" contractors and contracts. This behavior may be especially likely when public officials have private sector opportunities for future employment, as the Department of Defense cases suggest (Hunt, 1984).

Where this model is used, public managers must be creative and wise in their efforts to provide incentives for administrative compliance, service improvements, and cost containment. Bonuses or increased funding can be useful inducements to contractors (Hunt, 1985). In addition, upper-level managers and lateral control staffs must be able to oversee the process and intervene, if necessary, where cooperative models are used, to avoid potential abuses of the system. Officials may also consider developing an external evaluation process or a citizen advisory group to act as more objective third parties reviewing the cooperative contract arrangement.

Finally, gaining political and administrative acceptance for this approach may be more difficult than for the two previous models, even if the model would operate in an ideal fashion. From an outsider's viewpoint or from the traditional managerial perspective, these relationships can be seen as emphasizing collusion and co-optation as much as cooperation and coordination (Cooper, 1980; DeHoog, 1984; Hunt, 1984). Thus those who do not recognize the benefits of this system or object to outside provision of public services may criticize this approach much more than the competition model, whose benefits are more widely understood. In addition, a cooperative system can be used inappropriately, either as a guise for politically motivated contract decisions or when administrators wish to avoid the transaction costs of competitive bidding. The cooperative approach may have real appeal to some decision makers under these circumstances, even though greater efficiencies could be realized with either the competition or negotiation approaches.

DISCUSSION

This article has addressed the need to understand more about the structure, process, and conditions of contracting for services. The models outlined here clarify how the contracting system can be designed and implemented in three ways under different sets of conditions: the availability of suppliers, organizational resources, and service production certainty. We have seen that only under certain conditions is competitive contracting likely to be effectively implemented. The cooperation model suggests a different approach to contracting that may flourish under conditions of few suppliers, limited organizational resources, and high uncertainty. The negotiation model lies somewhere on the continuum between the competition and cooperation models, since it includes elements of each in its operation. While I have indicated how the three different models operate in contracting, it must be recognized that in reality, the distinctions between these models are often blurred.

In sum, the decision processes of the two alternative contracting models differ considerably from that posited by the traditional competitive model of contracting. While the design of the competitive bidding system emphasizes an optimization strategy in seeking and choosing among suppliers, the negotiation and the cooperation designs are more oriented toward an incremental approach in the Simon (1976) tradition. In other words, given a small number of potential suppliers, limited resources, and a high degree of uncertainty and/or complexity, officials are likely to use dependable routines, familiar suppliers, and sequential search patterns to find the contractor and services that meet the government agency's needs. Face-to-face, relational contracting characterizes both the negotiation and the cooperation approaches, while the competition model relies on the formal process of soliciting, awarding, and administering contracts. The competition model emphasizes the traditional bureaucratic control mechanisms; the cooperation model (and, to a lesser extent, the negotiation model) is based more on professional norms and standards of performance and accountability. As a result of their differing decision processes and control mechanisms, each of these three models has various advantages and disadvantages that must be carefully understood when officials adopt or evaluate service contracting.[5]

All of this leaves us with an important question: When the conditions required for effective implementation of the competition model of contracting are absent, why contract out? Given the limitation of the competition model, should not the government bureaucracy internalize service supply?

Several considerations enter into answering these questions. First, it may indeed be more efficient to use public employees. The approach developed here does not intend to imply that in all cases contracting out is a better method of service delivery. The fiscal and service outcomes of any service delivery arrangement are influenced by the design of the process itself and are contingent on both external and internal conditions. Analysts need to consider whether government agencies themselves might indeed be better service producers. However, the second answer to the question is that it may not be politically, fiscally, or organizationally feasible to use internal supply. State laws, federal regulations, or ideological preferences for using the private sector may explain why privatization is used, even when it cannot be defended on efficiency grounds. And third, the government agency may not always wish to maximize efficiency but may be interested in other goals and objectives, including client rights, public participation, and/or a set of contractors that represent various client or

service interests (Morgan & England, 1988). For example, Murin (1985) argued that purchasing services can also be used to maximize service equity, not only to cut costs or improve efficiency.

Finally, the two alternative models of contracting are not necessarily inefficient, inequitable, or unresponsive (Williamson, 1985). Rather, in the long run, if used correctly and appropriately, they can produce services and projects which meet public needs at reasonable costs. As we have seen, the cooperation and negotiation models of contracting are adaptations to very real environmental, organizational, and service constraints. Inflexible use of the competition model under such conditions may lead to very real declines in the efficiency and effectiveness of public services. Efficiency and service goals will best be achieved when the design of the contracting process is adapted to the number of suppliers, organizational limitations, and the level of uncertainty. No one model is superior to the others. Only by considering the contracting conditions and services can an appropriate model be chosen.

NOTES

1. This may not necessarily be a realistic assumption in some areas where managers may have mixed motives or where elected officials and bureaucrats involved in contract decisions may have different incentive structures.
2. In the competition model, the sealed bid usually is the ideal—the seller's offer is limited to a piece of paper submitted anonymously in response to the buyer's public announcement. In some local governments, least-cost requirements make the process even more formal, with virtually no discretion allowed by government contract officers. This, of course, has the advantage of ensuring fairness, limiting political influence, and providing for an open and objective system. However, it may also mean that in the case of inexperienced suppliers, the contract will require greater amounts of technical assistance (both administrative and service-related) from local public administrators and will likely encounter start-up and implementation problems. Most contracts in the competition model are firm, fixed-price contracts (FFP), although incentive and performance contracting are coming into vogue, despite the difficulty in administering them. In addition, the contracts are often for a 1-year period, in large part to both reduce the risk for the government in the face of inadequate performance and provide an incentive for contractors to continue good service delivery.
3. Suboptimal outcomes are more likely to occur when the purchasing agency holds monopsony or oligopsony power, as is the case in many public services. If there are no private sector buyers of the service, receiving contracts from just a few government units will mean the difference between survival and failure. Thus small-numbers supply is even more likely under monopsony or oligopsony conditions and may well produce monopolies in the long run. A large number of suppliers is not strictly necessary to produce competition if new competitors might easily enter the market. However, in many service areas, where market failures may have led to public provision of services in the first place, barriers to market entry are quite common. For example, DeHoog (1984, pp. 54-70) explained that the pool of social and employment agencies often is very small because historically few agencies offered services for the poor.
4. In addition to the failure to meet the conditions just described, this model is not a particularly flexible approach to contracting, since if the contractor fails to comply with any of the terms of either the IFB or RFP or the contract, the firm's bid will not be considered (Cooper, 1980). Thus a strong emphasis is placed on being responsive to the specifications in submitting a proposal (creative deviations not permitted) and being responsible in carrying out the terms of the contract as specified.
5. Participants in government contracting are likely to have some preferences about these approaches to contracting systems (DeHoog, 1986). Government attorneys, central procurement officers, and other oversight officials often prefer the clarity and legal controls in the competition model. On the other hand, program mangers in the social and human services often desire the flexibility and control offered by the negotiation model. Those who have had contracts in the past may favor the cooperation approach since it offers opportunities for more contractor input and participation and may ensure future stability. However, aspiring contractors would be more likely to prefer the more open and competitive system in hopes of obtaining public contracts. Indeed, as Ferris and Graddy (1986) suggested, the models may

imply that a particular sector is likely to be preferred—that is, the private, for-profit sector for the competition model, the nonprofit sector for the negotiation model, and either the nonprofit or public sector for the cooperation model.

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