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CONTRACTING OUT: WHAT WORKS, WHAT DOESN'T AND WHY?

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ABSTRACT

Contracting out, as an economic policy instrument, began to gain attractiveness in both developed and developing countries following the apparent successful results in United Kingdom and United States. The rhythm of contracting out in Sub-Saharan Africa has increased in order to enhance service delivery. The purpose of this study is to give a critical review of the theoretical framework of contracting out. The specific objectives include: to examine major extant and/or evolving contracting out theoretical paradigms and their relevance to the public sector management; challenges encountered in contracting out and factors influencing successful contracting out. The review discusses gaps in the literature and the directions in which future studies may address these gaps.

Keywords: Contracting out, Transaction cost theory, Principal-agency theory, Public choice.

Contribution/ Originality

The paper critically reviewed the contracting out theoretical framework specifically focusing on the strengths and weaknesses of each theory. The gaps in the literature were indentified and the directions future studies should address were outlined. The institutional and capacity issues have been identified. It also exposed the critical need for capacity within the government to develop and monitor contracts.

1. INTRODUCTION

In the past, governments pursued the public interest by organising and subsidising private initiatives, contemporary contracting out adopts private provision, measured by private measures of performance and efficiency when pursuing ends. Contracting out is the term used to describe the situation where an outside party is hired to carry out the work involved in providing a service but overall control of standards and accountability to the public remain with the authority (Butt and Palmer, 1985). This development makes contracting process-from negotiation to oversight to remedies for breach a key accountability mechanism in modern government. It exposes the critical need for capacity within the government to develop and monitor such contracts.

After the Great Depression, widespread disenchantment with the private sector led to popular support for entrusting public institutions with greater responsibilities and the government grew noticeably. By the late 1970s, however, the pendulum had swung in the other direction: there was newfound enthusiasm for private markets and competitive practices (http://books.google.com/books?id=8S243SHvoC&pg=PA7&PG-PA7&dq.) Privatisation programmes began to replace the big and rapid expansion of public sector activities of the 1960s and 1970s (Obadan, 2008). The contracting out reforms have been variously called "the new governance", "third-party government", "government by proxy", "indirect government" and even " the end of government as we know it"(Kamarck, 2007). As governments try to downsize and local budgets shrink, questions regarding the sources of public service provision become more acute: which delivery model is technically superior and provides the best quality? The question of which sector, or combination of sectors, is best at offering public services has become even more relevant and controversial overtime. The expansive and detailed contracting out debate is given under Section 3.3 of this article below.

Present-day contracting out cannot be comprehended without locating it within the appropriate theoretical framework. With contractual governance here to stay, the real question is not whether to contract out at all, but to what ends, using which strategies and under what constraints. Therefore, this paper seeks to put this sudden and dramatic turn to the private in broader historical, conjectural and theoretical milieu. This paper undertakes a state-of-the-art review of contracting out theories as a prelude to an in-depth study of the contracting out policy implementation in Zimbabwe. The objective is to provide insights into the many issues that have underlined the contracting out debates: theoretical frameworks and arguments for and against contracting out.

2. METHODOLOGICAL APPROACH AND RESEARCH DESIGN

This study undertook documentary search and made use of the data collected. Both the print and electronic media have done a remarkable job in providing the information on the subject understudy. Content analysis was utilised in order to give the collected data scholarly interpretation.

3. CONCEPTUAL DEFINITIONS: PRIVATISATION, CONTRACTING OUT, OUTSOURCING, PUBLIC AND PRIVATE

3.1. Private and Public Sectors Contrasted

The Italian legal and political philosopher Norberto Bobbio has noted that the public-private distinction is one of the great dichotomies in Western jurisprudence and politics. Like war and peace or individual and collective, the public-private dichotomy serves as an influential intellectual template ordering much of thinking about the nature of society, polity and economy (Freeman and Minow, 2009). Most researchers construe the "private" sector as energetic, nimble and efficient on the one hand, or greedy, unaccountable and corrupt on the other, while the "public" sector is imagined as virtuous and public-spirited or alternatively lazy, wasteful and stupid (ibid). These writers advised that crude ideological frameworks will fail to generate solutions to the genuine weaknesses in the contractual governance system to the extent they pose false 'either-or' alternatives.

From these differences, the neoliberal policy recommends increased reliance on market mechanisms, this preference for exploring private over public solutions has permeated current policy issues ranging from international security, prisons to welfare and public health to highways and public parks. There are genuine advantages to relying on the private sector such as expertise, innovation, energy and flexibility. Government provision swamped with bureaucratic pathologies. By using private, the government can enhance society's capacity to deliver more of the goods, information and services. All these services should be provided through contracting out which reduces costs without losing quality performance.

3.2. Unpacking Privatisation

There are broader and narrow perspectives of privatisation. According to the broader definition, privatisation refers to all policy initiatives and measures designed to alter the balance between public and private sectors in favour of the latter (Cook and Kirkpatrick, 1988) and hence strengthen or broaden the scope of private sector activity in the economy (Bouin and Michalet, 1991). The policies and actions of the government range from denationalisation, divestiture to leasing and franchising, to deregulation and liberalisation including contracting out and public-private partnerships. Privatisation of services is usually implemented in order to take advantage of one or more hoped for benefits: reduced costs, improved services, short-term access to expensive specialised services, avoidance of services start-up costs among others.

Accordingly, the following are considered as privatisation policy instruments:

- Sale of parastatals in full to private buyers or introduction of private capital into the public sector;
- Liquidation;
- Management buy-out;
- Transferring of the provision of a good or service from the public to the private sector in which the government retains the ultimate responsibility for supplying the service, for example, franchising or contracting out of the public services and leasing of public assets (Cook and Kirkpatrick, 1988);
- Build-operate-transfer (BOT). This is used for new projects such as infrastructure projects and public utilities (Obadan 2000 cited in (Obadan, 2008)); and
- Liberalisation or deregulation of entry into an activity previously restricted to parastatals.

The narrow definition of privatisation refers to the transfer of majority ownership of state-owned companies to the private sector by the sale of ongoing concerns or of assets following liquidation (Kikeri *et al.*, 1992).

3.3. Concept of Contracting Out

It is the use of external agents through short-term agreements to undertake activities that have traditionally been carried out internally by government departments or agencies (Sansom *et al.*, 2003). Outsourcing has been used as a synonym for contracting out. Outsourcing is the strategic use of outside resources to perform activities traditionally handled by internal staff and resources (Outsourcing Institute, 1998). However, Bendor-Samuel asks: 'Is "contracting out" or "contracting" just different terminology for "outsourcing?". Contracting out is applied as a management tool where a complete market solution or outright privatisation can't be employed, for example, in Zimbabwe non-clinical services such as cleaning, laundry, security and catering have been contracted out in the health sector.

The prime objectives of contracting out include:

- Cost reduction and efficiency enhancement;
- Quality improvement; and
- Curb the power of producer interests.

The accomplishment of these objectives depends upon the following factors:-market structures, the information available to purchasers and the administrative costs of undertaking contracting transactions. Market structure posits that the central motive underlying the contractual approach is to increase competition; the problem is that competitive markets for particular services may not exist.

Table-1. Contracting out Benefits and Challenges

Contracting out Benefits	**Contracting out Challenges**
Public sector 'in-house' monopolies are inefficient bureaucracies satisfying the wishes of producer groups rather than consumers	Private contractors offer a poor quality and unreliable
Public sector inefficiency is reflected in restrictive labour practices and low productivity with its effects on rates, taxes, subsidies and government expenditures	Private contractors are liable to default, bankruptcy and are less able to respond top emergencies
There is an 'open-ended' financial commitment to public sector 'in-house' units	Private contractors put profits before people
Competition allows regular re-contracting by public procurement agents	Contractors use low bids to 'buy into' attractive contracts and eliminate the 'in-house' capacity so that the public authority becomes dependent on a private monopoly
Competition leads to new ideas, modern equipment and changes in traditional methods of working	Competitive tendering is not costless: there are costs to the public authority in specifying, monitoring and enforcing contracts
Successful firms in a competition are subject to the incentives and penalties of a fixed price contract	Private contractors achieve cost savings by cutting jobs, reducing wages and worsening working conditions
Contractors can be penalised for poor quality, delays and unreliability	Private industry cannot provide a competitive response to a major increase in demand for outside contracting
The result is cost savings and better value for money	Cost savings, if any, are short-lived and offset by reductions in the quality of services supplied.

The transaction costs refer to the costs of managing the transaction between the purchaser and provider. These include the process of drawing up a specification, putting it out to tender and awarding a contract and then monitoring and enforcing that contract involves time and effort.

Information availability depends on the complexity of the services. The table below provides the costs and benefits of contracting out.

In conclusion, both the benefits and the challenges faced by using contracting out are summarised in the following quotes from an Economist article:

- *"the main reason for contracting out is functional specification.*
- *Managers should remember that contracting out has two huge benefits: competition and transparency. Even if a job stays in-house, the threat of competition forces employees to cut their costs, curb their inclination to strike and, in a surprising number of cases come up with innovative ideas. It also throws up invaluable information about relative costs (http://books.google.com/books?id-Y7gqAQAAMAAJ&q).*
- *Contracting out is very difficult to implement" (The Economist Farming out the Farm, 1994).*

4. THEORETICAL DEBATES

The phenomenon of contracting out governance is expounded from different disciplines and perspectives. These provide a rich treatment of the topic. The impetus to contract out government work is derived to a significant extent by both pragmatism and ideology (Freeman and Minow, 2009). Some supporters of contracting out see it as a way to reduce costs. They believe that private companies are more effective than government-more 'nimble' because they are not constrained by civil service rules and other legal restrictions that could impede their flexibility.

A number of theories have emerged which in one way or another influenced most of the initiatives implemented under contracting out. They include transaction cost theory, principal-agent theory, public choice theory, new public management. The tenets of these theories, their merits and demerits as well as their relevance to contracting out are discussed below.

4.1. Transaction Cost Argument

The transaction cost theory (TCT) sprung from neo-classical microeconomic theory. Adam Smith (1776), Coase (1937; 1972), Alchian and Demsetz (1972) and Williamson (1975) are the earliest protagonists of TCT. The theory started with Adam Smith's 1776 article "The Wealth of Nations". Smith assumes that markets have the ability to coordinate economic production and exchange at very low cost without government planning. Smith's basic proposal was that an economy could be coordinated by a decentralized system of prices (the invisible hand). Other writers call this 'the theory of the firm'-though the theory actually focuses wholly on the structure and operation of markets, it is unable to explain the existence of firms.

Coase in his 1937 article "The Nature of the Firm" observed that the reason organisations exist is that, sometimes, the cost of managing economic exchanges across markets is greater than the cost of managing economic exchanges within the boundaries of an organisation. The cost of using the price system involves activities such as discovering what prices are, negotiating contracts, renegotiating contracts, inspections and settling disputes (Barney and Hesterly, 2005).

However, Coase (1972) admitted that "The Nature of The Firm" was "much cited and little used". Coase failed to "operationalise his approach and he lacked precision about which transactions will be left to the market and which will be internalised within organisation" (Barney and Hesterly, 2005).

Alchian and Demsetz (1972) inquired into the utility of "team production". These authors argued that measurement problems occur as a result of team production owing to shirking. Shirking involves behaviours that range from absolute cheating to simply giving less than one's best effort. Organisations are, therefore, created to monitor the efforts of individuals that make up a team. Assigning someone the task of monitoring the performance of individuals on a team creates problems: who will monitor the monitors?

Many organisational theorists think that Alchian and Demsetz' focus on team production obscures some important issues associated with understanding the nature of the firm. According to Oliver Williamson markets (private) and hierarchies (the government) are alternative instruments for completing a set of transactions (Williamson, 1975). He views the markets and hierarchies as "governance mechanisms". Hierarchical forms of governance bring parties to an exchange under the direct control of a third party to resolve disputes.

TCT rests on two fundamental assumptions about economic actors engaged in transactions: bounded rationality and opportunism. To Herbert (Simon, 1947), bounded rationality argues that people who participate in business transactions are "intendedly rational, but only limitedly so". Given bounded rationality, complex contracting out breaks down in the face of uncertainty. Economic players cannot forsee all possible outcomes in an exchange relationship or reformulate contractual or other responses to those eventualities.

The transaction cost theory assumes that self-seeking guides behaviour of parties engaged in a transaction. For Williamson (1985)opportunism "refers to the incomplete or distorted disclosures of information, especially to calculated efforts to mislead, distort, disguise, obfuscate or otherwise confuse partners in an exchange". People and organisations must design safeguards so that they will not be victims by others.

Another issue central to the TCT is the choice of governance mechanism. The governance decision (market or hierarchical) reduces any potential exchange problems created by bounded rationality and by the threat of opportunism at the lowest cost. Market governance is the least costly way of managing economic transactions ever devised by human beings. Hierarchical governance reduces/minimises the effects of bounded rationality and opportunism. One can glean that parties to a contract, especially, the contracting party should manage problems created by bounded rationality and opportunism.

Uncertainty and transaction specific investment cause bounded rationality and opportunism (Barney and Hesterly, 2005). The greater the level of uncertainty in a transaction, the more difficult it will be to use contracts and other forms of market governance to manage that transaction and the more likely that hierarchical forms of governance will be adopted (http://books.google.com/books?id=qd2AMTw5i58&q). The existence of transaction specific investments increases the threat of opportunism (Barney and Hesterly, 2005).

In short, Williamson's answer to the question "why do organisations exist?" is that hierarchy arises to resolve the problems of market governance of transaction specific investments under conditions of uncertainty by developing codes. The TCT is applicable in make or buy decisions where specific investment increases the likelihood that a transaction will be internalised, organisation of public administration (Moe, 1991), the role of trust in economic exchanges (Williamson, 1993a) and how organisations are financed (Williamson, 1991b).

The TCT has its inadequacies. TCT focuses on cost minimisation as the organisational imperative. Or as Williamson (1991b) argues, "economising is more fundamental than strategising-or, put differently, economy is the best strategy". Resource-based theory suggests that creating and exploiting transaction specific investments under conditions of uncertainty is essential if organisations are to gain long-term success (Conner, 1991; Kogut and Zander, 1992). Avoiding opportunism and minimising transaction costs are a secondary consideration. Minimising transaction costs is of relatively little benefit if an organisation has no transaction specific assets that are highly valued by the market.

TCT tends to understate the costs of organising transactions within the organisation (Jones and Hill, 1988). Internal disputes can be resolved more efficiently through authority than the market. Lengthy and costly haggling may be more severe within a firm than between firms.TCT also undervalues the role of social and cultural forces in economic activity. Granovetter (1985) points out the transactions that are embedded within networks of social relationships.

TCT is of little help in analysing conflicting goals of those associated with the organisation. TCT explains why organisations exist but fails to address how or if those affiliated with the organisation agree on its goals. This gap prompted the development of the principal-agency theory.

However, despite the TCT's disparagement, it provokes policy makers to look inside the black box of the organisation.

4.2. Principal-Agency Argument

It seeks to comprehend the causes and consequences of goal disagreements. It draws heavily from the property rights literature (Alchian and Demsetz, 1972) and to limited extent from transaction cost theory. Like TCT, principal-agency theory assumes that humans are boundedly rational, self-interested and prone to opportunism (Eisenhardt, 1989). Both TCT and principal-agency situate emphasis on information asymmetry problems in contracting out and on efficiency as the engine that drives the governance of economic transactions (Barney and Ouchi, 1986; Eisenhardt, 1989). Agency theory, however, differs from TCT in its emphasis on the risk attitudes of principals and agents (Eisenhardt, 1989).

Originally, the theory was employed to analyse the relationship between managers and stockholders (Jensen and Meckling, 1976), for example, corporate governance such as roles of boards of directors and the role of top management compensations.

Agency relationships occur whenever one party in a transaction (the principal delegates authority to another (the agent) and the welfare of the principal is affected by the choices of the agent (Arrow, 1985). The relationship between the principal and agent is problematic in that:

i. The interests of principal and agent will typically diverge (Barney and Hesterly, 2005);
ii. The principal cannot perfectly and costlessly monitor the actions of the agent (Barney and Hesterly, 2005); and
iii. The principal cannot perfectly and costlessly monitor and acquire the information available to or possessed by the agent (Barney and Hesterly, 2005).

Coalesced, these conditions constitute the principal-agency problem-the possibility of opportunistic behaviour on the agent's part that works against the welfare of the principal.

To protect the principal's interests, attempts must be made to reduce the possibility that agents will misbehave. This attempt has total agency costs such as the monitoring expenditures by principals, the bonding expenditures by agents and the residual loss of the principal. The residual loss acknowledges that in many situations it will be too costly for principals to completely monitor agents and too costly for agents to completely assure principals that interests do not diverge (Jensen and Meckling, 1976).

There are two important sources of agency problems indentified Arrow (1985): moral hazard which he equates to hidden actions and adverse selection which he equates to hidden information. Moral hazard involves situations in which much of the agent's actions are either hidden from the principal or are costly to observe. With regard to adverse selection, the agent may possess information which is unobservable or costly to obtain by the principal. Consequently, principals cannot fully ascertain whether or not their interests are best served by agent's decisions. Underscored here is that principals must select the best agents, whether employees or contractors and create inducements for them to behave as desired. Furthermore, principals should monitor the behaviour of their agents to ensure that they are performing their tasks well. However, it is difficult if not impossible to choose the best agent because the principal cannot thoroughly examine the employee or the contractor's skills, education, personality, background and capability. Moral hazards are caused by information asymmetry. Though this can be resolved by reports, complaints and direct observation, they do not give the full story.

Monitoring and bonding can be used by principals and agents to resolve agency problems. Monitoring should be implemented through observation of the behaviour and performance of agents by principals. Bonding refers to arrangements that penalise agents for acting in ways that violate the interest of principals or reward them for achieving principal's goals.

Given this, three important questions come to mind. Firstly, why do principals delegate authority to agents, when they know that such delegation of authority will inevitably lead to agency problems? Secondly, what specific monitoring mechanisms can principals put in place to minimise these agency problems? Thirdly, what specific bonding mechanisms can agents use to reassure principals?

4.2.1. Delegating Authority

Fama and Jensen (1983) observe that the process of making most business decisions can be divided into two categories: firstly, decision management, i.e., how a decision possibility is originally initiated and how that decision is implemented, and secondly, decision control.

4.2.2. Monitoring

Principals should monitor actions, decisions and performance implications of agents actions and decisions. Monitoring performance (output) is more efficient when tasks are not highly programmable (Eisenhardt, 1985; Mahoney, 1992).Principals should use incentives to induce agents to work in the best interests of principals. Ideally, principals would prefer an incentive scheme that fully penalises agents for shirking and opportunism. The advice about monitoring of contracts is in the quote "outsourcing is similar to delegation, you can outsource but you can't walk away" (Rehfuss, 1993). Rehfuss (1993) outlines components of a good monitoring system:

- Require that the contractor presents periodic reports (Rehfuss (1993);
- Review those reports carefully for adherence to the written contract (Rehfuss (1993);
- Compare wage rates and equipment charges for materials or rentals with the contract (Rehfuss (1993);
- Verify that all services, material, labour and equipment were actually received, used or consumed (Rehfuss (1993);
- Initiate all change orders that affect the contract (Rehfuss (1993) ;
- Whenever possible, make on-site inspections. Report the results of those inspections, comparing accomplishments to the prescribed specifications (Rehfuss (1993);
- Follow up on every complaint (Rehfuss (1993); and
- Survey citizen or user satisfaction whenever possible (Rehfuss (1993).

While there are many studies that have examined a vast array of topics, the underlying question is how do organisations deal with conflicting goals between those who delegate authority and those to whom authority has been delegated.

However, the agency theory is viewed as impracticable. Principal-agent theory holds an unrealistic view of humans and organisations (Hirsch *et al.*, 1990). Humans are primarily motivated by financial gains. It ignores the other behavioural sciences. The principal-agent theory does not adequately recognise the role that power plays in organisational and political life (Perrow, 1986). It thus neglects what Parsons (1960) calls "the central phenomenon of organisations". It neglects the considerable complexity in the environment of agencies and the many cross-cutting political pressures on administrators. Also, organisational goals are far more dynamic and evolutionary than the relatively static principal-agent model tends to capture (March and Olsen, 1989). Members of National Assembly may change their minds about which goals administrators should emphasise and administrators themselves can have their own priorities.

Taken together, transaction cost and principal-agent theories constitute a powerful theory of the organisation. Transaction cost theory explains the conditions under which economic exchanges can be most efficiently managed using hierarchical forms of governance. Principal-agent theory extends this theory of the organisation by enabling a researcher to examine, in more detail, linkages among these different transactions.

4.3. New Public Management (NPM) Paradigm

It is associated with positive action-oriented phrases like reinventing government, re-engineering, revitalising of the public service, paradigm shift, lean and mean, contracting out, off-loading or outsourcing. It is a management or ideological thought based on ideas generated in the private sector and imported into the public sector (Hood, 1995). The components of the NPM that promote markets and competition are contracting out service provision responsibilities to private providers, internal markets, vouchers, user charges or a fee, for example, in health and education where partial of full cost recovery may be applied.

A number of institutional constraints and capacity issues have been identified in the application of the NPM in African countries. Capacity concerns include the ability to manage a network of contracts, the development of monitoring and reporting systems and the difficult governance and institutional environment constraining implementation capacity.

4.4. Political Models of Contracting out: The Public Choice Theory

The theory assumes the pursuit of self-interest maximisation at the individual level and goal conflict at the organisational level. Political models resolve goal conflicts through bargaining, negotiation and coalitions- the power mechanisms of political science. The public choice theory explains explicitly these political economy dynamics. There are four principles that underlie the public choice theory:

1. Public sector actors or officials behave as if they maximise their own interests(Buchanan, 1978);
2. All social entities are fundamentally sets of individual actors (Buchanan, 1987);
3. Political interaction is to be based on voluntary exchange (Buchanan, 1978);
4. Politics as voluntary exchange requires the making of an economic constitution that is to guide the relationship between the state and the individual (Lane, 1993); and
5. Citizens provide rulers or the state with resources and power for which they expect a return of goods and services as well as laws regulating society that matches what they are giving up (http://books.google.com/books?id=IPKOKICMHAAC&PG=PA21681PG=PA216&dq).

Essentially, public choice theory challenged two fundamental and influential theories that long dominated thinking about the government and the economy. First, the public choice theory discarded the notion of welfare economics that emerged out of the Great depression of the 1930s.

The theory held that when there is market failure, the government should intervene to effectively protect the public interest. Second, public choice also rebutted pluralist political science which advocated that competition among interest groups are the most effective processes for ensuring that government adopt policy solutions that were best for the public good. As an approach to public administration and politics, public choice theory is based on microeconomic theory that views the citizen as a consumer of government goods and services. It attempts to maximise administrative responsiveness to citizen demands by creating a market system for government activities in which public agencies compete to provide citizens with goods and services. The public choice policy prescriptions include contracting out service provision, school vouchers, privately managed pensions and outsourcing of public services.

Public choice theories postulate that an idealised notion of a fully informed and perfectly altruistic government, devoted to a maximisation of the people's welfare and perfectly responsive to the preference of its constituents, has no basis in reality. Politicians, bureaucrats and managers must be construed as people using the control of public institutions to further their own interests rather than the organisation's efficiency (Buchanan *et al.*, 1980). Bureaucrats and managers want more pay, power and prestige. Shleifer and Vishny (1994) observe that policy makers usually want to have direct control over state-owned organisations so that they use them for political patronage purposes and achieving their political goals.

The public choice model adds the following insights. Firstly, it offers a coherent explanation for seemingly non-rational decision making by governments. Secondly, the public choice offers factors that hamper the achievement of public interest. Thirdly, by focussing on the power of vested interests, it demonstrates the barriers to reform that are created by pre-existing policies and by the political relationships that they endanger. Fourthly, it provides an explanation for the willingness of public officials to respond to the pressures and impressions of lobby groups.

It is thus felt that contracting out would lead to improved economic performance by clarifying the objectives of the organisation and freeing it from the burden of political interference and non-market criteria and limiting politicians' ability to redirect the organisation's activities that promote their personal agenda.

The critics have observed the following weaknesses of the public choice model. It is not able to explain how, why or when reform occurs, except through events or appearance of wise statesmen or technocrats who, for unexplained reasons, exhibit behaviour that is politically irrational. Despite revealing the significance of the rent-seeking motivations of policy and decision makers, the theory is silent on how such motivations are developed or changed with the passage of time (Grindle and Thomas, 1991; Lane, 1993; Turner and Hulme, 1997).

5. EMPIRICAL DEBATES

Germa *et al.* (2010) conduct a meta-regression analysis to empirically test if there is systematic support for the claim that private provision of water distribution and solid waste collection services achieves lower overall costs than public provision. They revealed existing theoretical and empirical literature such as public choice, property rights, transaction costs and industrial organisation. Their review of public choice and property rights literature examines the differences between public ownership and private ownership. Public ownership is characterised by incentives such as political interests and public support rather than profit. The benefits from innovations and cost reductions are marginalised because they do not accrue directly to politicians leading to excess supply or inefficiency. Private ownership is expected to, provide incentives for innovations and cost reductions albeit with lower quality of service since the existence of private property rights induces profit maximisation behaviour.

Transaction costs and industrial organisation literature focus on market structure conditions and the principal-agent problems. The transaction costs theory argues that the decision to transfer to private production can be influenced by transaction costs, contracting out costs and monitoring costs. Industrial organisation emphasises differences in aligning managerial actions and ownership objectives between private and public ownership. The alignment may be determined by market structure conditions and contractual frameworks.

Sundell and Lapuente (2012) observed that center-right politicians need more contracting out which is guided by the philosophy of Adam Smith of market competition. The center-left politicians prefer Machiavellian fashion, that is, a strategy to retain power by purchasing the electoral support of certain constituencies-electoral gains, that is, Machiavellian contracting out as opposed to Adam Smithian contracting out.

The contracting out movement is mainly rooted in public choice theory, which asserts that government agencies operate as monopolies in providing services (Savas, 1974). The result of service monopolisation is oversupply and inefficiency (Weimer and Vining, 1992). Public choice scholars argue that by allowing government firms and public agencies to compete for service contracts, the unit costs of producing the good or service will decrease and thereby improve efficiency (Mueller, 1989; Stein, 1990). The central assertion of public choice scholars is not that private provision is inherently more efficient and less expensive than public provision but rather that competition between private firms or between private firms and public agencies, creates downward pressures on unit costs (Boyne, 1998).

The empirical evidence to substantiate the forgoing support is varied. In a review of the literature on contracting out urban services in the United States, Hirsch (1995b) notes that whereas research exists in support of the cost-savings claim, the research in support of the efficiency gain claim is less robust. Lavery (1999) also finds support for the cost-savings claim. Hirsch (1995b), Lavery (1999) and Boyne (1998) all find that when research does adequately support the efficiency gain of contracting out, it is tied to the degree of competition in the tendering process, more competition leads to increased efficiency.

Stoker (1997) suggest that service delivery can become more effective if contractors are responsible for the delivery of the service and public administrators and elected officials have more opportunity to make strategic decisions and monitor service provision. This was particularly the case in former Soviet systems in which quality was less of priority than equality in service provision under the previous regimes.

Gleaning from empirical research on contracting out with the United States (Ferris, 1986), (Hirsch, 1995a) quoted by Brown (2001) categorize four sets of factors that either promotes or stalls contracting out:

- Accountability;
- Cost, efficiency and production;
- Political, legal and institutional considerations; and
- Fiscal pressures

As a whole, there are mixed conclusions on whether private provision results in reduced costs and there are no differences in costs between private and public provision. This is mainly due to lack of competitive markets structures, high transaction and contracting costs.

6. CONCLUDING REMARKS

The study has discussed the major theories of contracting out and the factors that either promote or inhibit it. What can be safely said about the empirical findings on contracting out so far is that they are far from being conclusive. Indeed, one may be tempted to recall Bouin and Michalet's conclusion in the early 1990s to the effect that:

> "the literature on comparative performance of public and private firms suggests that, although the results would seem to favour the private sector, there is no decisive evidence as regards the impact of the market structure on service delivery" (Bouin and Michalet, 1991).

There is no clear evidence in cost differences between private and public provisions across the range of structures. Contracting out in itself may not result in systematic cost reductions. Factors such as nature of service, market structure dynamics, transaction and monitoring costs, policy environment and regulatory frameworks may be more critical than the contracting out process on its own.

There is a clear need for a comprehensive and systematic analysis of the impact of contracting out in Africa. Such a study should address questions such as:

- What is the economic, political and social framework of contracting?
- How is contracting out defined by African countries?
- What are the incentives to privatise? What are the economic and political predictors of contracting out, in terms of the factors which play a role in the decision to contract out?
- What are the objectives of contracting out?
- Does contracting out reduce or increase employment? How is workers' welfare affected?

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