

## Purchase-of-Service Contracting in Estonia

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### ABSTRACT

We examine the use of purchase-of-service contracting in transition countries, focusing on a case study of Estonian social-welfare-services contracting at the local level. Given the nature of transition economies, we expect to find the use of relational contracting to offset problems of thin markets. We find this is the case; however, we also find that the relational contracting strategy is being pursued in the context of short-term contracting. We also find that Estonian local government officials most often view the primary benefit of contracting not in terms of enhancing efficiency or effectiveness, but rather in ensuring continuous service delivery. The combination of these two findings produces a risky situation for Estonia's citizens.

**Key Words:** purchase-of-service contracting, relational contracting, public services, Estonia.

### 1. Introduction

Until the 1980s, contracting for services in Western countries was limited to a few functions. Most services were delivered through government agencies. Then a sweeping political movement, combined with an emerging theory of contract efficiency, created a faith that contracting with private organizations could produce superior results not only in terms of efficiency, but also in effectiveness, accountability and citizen choice (Gormley 1999; Savas 1987; Boyne 1998). Contracting for services became one of the main alternatives to in-house delivery systems.

The recent decades has witnessed several shifts in the course of contracting policy. The shift from Compulsory Competitive Tendering to Best Value in UK (Entwistle and Martin 2005), public procurement reform in US (Kelman 2001) and the recent reforms of EU procurement legislation are just the most prominent examples of that shift. The common denominator of these reforms seems to be a movement away from rigid and compulsory competition-based procurement processes towards more flexible policies which would, *inter alia*, allow employing more non-

competitive award processes where appropriate. The main reason for this change is that rigid competitive bidding processes have not proved to be effective nor efficient in the case of many public services, especially where there is limited or non-existent competition.<sup>1</sup>

The sweeping transition of former Soviet-ruled countries to democratic states with capitalist economies during the 1990s provided an opportunity for reform-minded advisors to suggest that the most important public-management reforms be adopted from the start of transition. These expectations were supported by the belief that the market as a governing mechanism is *a priori* more efficient than a hierarchical bureaucracy (Peters 1996). And so contracting-out for services became a major strategy for many newly independent states as they shrank budgets and reduced the influence of the state in many areas.

However, two problems have plagued the use of contracting for service in transition countries. The first is limited competition. In many (especially smaller) transition countries, there are very few domestic providers of services available. Given this problem, one could assume that the shift towards more flexible contracting mechanisms would also benefit the countries in transition. But employing more flexible contracting strategies demands that “public managers must be creative and wise in their efforts to provide incentives for administrative compliance, service improvements, and cost containment” (DeHoog 1990). At the same time, the low administrative capacity of transitional governments has been acknowledged as another important problem that limits the applicability of the contracting-out tool (Lember 2004; Nemeč et al. 2005; Tönnisson and Randma-Liiv 2008). In analyzing the contracting-out of public services in the Czech Republic and Slovakia, Nemeč et al. (2005) concluded “the decisions are non-systematic, and there is significant potential for corruption”. Although there seems to exist a common understanding that the main tool to solve the dilemma between a lacking market and a low administrative capacity is to increase government’s contracting capacity (Kettl 1993; Brown and Potoski 2003), there is little evidence present explaining the specific aspects constituting the “low administrative capacity problem” in transitional countries.

The aim of the current research is to fill in the gaps by studying social-welfare-service contracting in transition countries. We do this by examining the contracting strategies and decisions of Estonian local governments, attempting to answer three questions. First, what is the understanding of public officials about contracting for services? Second, what kind of contracting strategies are used? And third, how effectively are contracting strategies applied?

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<sup>1</sup> In the case of the European Union, the latest legislative change in 2004 was largely influenced by the growing need to use public funds as part of the demand-side innovation policy mix, where rigid and purely competition-oriented procurement tools fall short in reaching innovation policy goals. For a general overview, see ECEG (2005), and for a more specific approach, see Lember et al. 2011.

## 2. Theory of purchase-of-service contracting

According to Williamson, a contract can be defined as “an agreement between buyer and a supplier in which the terms of exchange are defined by a triple: price, asset specificity, and safeguards” (1996, 377). This definition refers to a classical contracting situation, which “assumes that quantity, quality, and duration are all specified” (*ibid.*). Purchase-of-service contracting (or contracting-out) can be regarded as a situation where governments define “what services are to be available and to what standard”, and then delegate the actual provision of public services to third parties (Skelcher 2005, 351). Still, not all purchase-of-contracting cases can be understood as classical contracting situations. Today one can distinguish between three basic alternatives in assigning public services to the private sector (DeHoog 1990; DeHoog and Salamon 2002). At one end, there is so-called conventional contracting, which stems from the idea of classical economics, where it is assumed that competition is the key to success in contracting-out public services and where all the details (input, process, quality, output, outcome) are specified in advance. At the other end, there is relational contracting, which assumes that long-term collaboration, and the trust that develops from mutual cooperation rather than from competition, is the most effective motivational factor for successful contracting. Here the parties acknowledge that due to high uncertainty, some or a large part of the details cannot be specified in advance, and parties engage with risk-sharing and joint decision-making. In between these ends, there stands negotiated contracting, which includes elements from both extremes.

### 2.1 Conventional contracting

According to the conventional approach, stemming from the works of the public-choice school, traditional public organizations either oversupply public goods or produce public goods at marginal cost, which is too high for being Pareto efficient (Lane 2000). The reason behind this claim is that politicians do not have all the information about how bureaucrats act and there are not usually sufficient motivational mechanisms present to secure an efficient supply of public goods. It is claimed that as human behavior is primarily motivated by selfishness, there is, therefore, a need for competitive pressures to redirect it towards public interests (Boyne 1998). The logic of the contracting mechanism in the mix of public-service provision is that in order to win the contract, the private contractor is motivated to make the best possible offer. During the contract, the private provider does everything to fulfill government’s wishes because a) if not, the government as the purchaser can terminate the contract and b) from a longer perspective, the contractor wants the contract to be renewed. At the same time, the private provider tries to be as innovative and efficient as possible in order to enhance its profits. To win the contract, the private provider may also promise to increase the standard of quality of a contracted service. As traditional contracting assumes *ex ante* specification of all relevant details, it enables the government to measure the results and thus makes the service-provision system more accountable. Hence, it is believed that competition for contracts as an administrative mechanism a) enables governments to overcome the problems of

information asymmetry and X-inefficiency, b) allows the revelation of the true costs of public services and c) motivates contracting parties to work more effectively.

## *2.2 Relational Contracting*

If the conditions necessary for the competitive process cannot be met, relational contracting has been suggested as an alternative strategy for purchasing-of-service contracting. It should be preferred when there is a history of cooperation between partners or when there is uncertainty, resource scarcity and asset specificity involved (DeHoog and Salamon 2002; Williamson 1985). For that reason relational contracting – sometimes used as a synonym for public-private partnerships or network management (see Hodge and Greve 2007) – assumes long-term cooperation, risk-sharing between partners and joint procedures in decision-making. The other advantages of relational contracting are purported to stem from lower transaction costs, greater flexibility in reacting to changing circumstances and better use of professional expertise (including the encouragement of innovation<sup>2</sup>) (DeHoog 1990). In relational contracting, the goal of both parties is to develop a stable partnership, which is not based on competition and adversarial relationships but on inter-organizational trust (Sclar 2000; Greve 2007). The goal is to avoid agency problems, which arise “when two parties have divergent interests or objectives and the agent has an informational advantage over the principal” (Ferris and Graddy 1998, 227). This is especially relevant and therefore a promising perspective for social services, where active purchase-of-service contracting is common but where competition is often limited at best (see e.g. Van Slyke 2003).

## *2.3 Negotiated Contracting*

Negotiated contracting is a more informal alternative to conventional contracting, where there is no formal bidding process, but where the government negotiates all important aspects of contracts with a small number of potential providers (DeHoog and Salamon 2002). The basis for a relationship is the legally binding contract, which includes all important service and monitoring aspects. Compared to conventional contracting potential, providers have more influence to shape the whole process of service provision.

## *2.4 Risks of Contracting*

Contrary to the theoretical assumptions and many supportive case studies, there exists a growing body of empirical evidence that most public services lack competition, and serious principal-agent and transaction-cost problems arise when govern-

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<sup>2</sup> In the public-management literature, innovation is often treated as synonymous to “new solutions”, “better services” or just “change” that takes place within public sector. This differs from the treatments in economics or innovation studies, where innovation is only referred to in the context of private enterprise and its effect on economic development. See Kattel and Vask 2008, but also Lember et al. 2010.

ments contract out public services (Kettl 1993; Lane 2000; Sclar 2000; Greve 2007). Critics have argued that contrary to initial expectations, competition-based public-service contracting has produced severe problems because of specification and output measurability problems, and because of the incomplete nature of contracts (Lane 2000; Hart et al. 1997). The success of purchase-of-service schemes has proven to be highly dependent on context specifics, and contracting for similar services brings along different results in different countries (Hodge 2000; Greve 2007). In general, it has been found that contracting works better in cases of technical and quantifiable services, whereas more problems occur with soft and other services involving a wide variety of non-contractable quality factors (Lane 2000; Brown and Potoski 2003). In that context, social services stand out as an example where competition has always been lacking, where specification of service-related details assumes high costs and where gathering information about providers' behavior and service outcome is a most complicated task (Van Slyke 2003; Johnston and Romzek 1999; Greve 2007). The need to avoid these transaction costs has elicited a greater reliance on relational contracting particularly in social and welfare services (DeHoog and Salamon 2002; Johnston and Romzek 2005).

However, many risks have also been identified in relational contracting. In a relationship that builds on trust and where few *ex-ante* regulations exist, the provider may, as a result of changed circumstances, start acting opportunistically. And if monitoring is subjective and if there is no threat of losing a contract, the suppliers may indeed easily use their information advantage (DeHoog 1990).

The different nature of tasks of services (i.e. routine vs. non-routine) presumes a right balance between appropriate accountability mechanisms and contracting and managerial strategies. In a contracting relationship, Johnston and Romzek (2005) distinguish between legal, political and professional accountability mechanisms that, on the one hand, should be tailored to appropriate managerial strategy (i.e. reliance on input, process, outputs or outcomes) and, on the other hand, to the nature of tasks, which can vary from routine to non-routine. For example, process-oriented routine tasks are best tailored to legal accountability mechanisms (e.g. detailed external monitoring), whereas outcome-oriented non-routine tasks tend to require professional accountability relationships (e.g. reliance on professional judgments). It is often very difficult to find this balance in case of relational contracting.

To mitigate the potential problems of classical as well as relational contracting, governments should first develop internal capacity for administrating contracting relationships (Brown and Potoski, 2003). As Kettl (1993, 180) puts it, governments, in order to be smart buyers, need to know "what to buy, who to buy it from, and what it has bought". The question of the capacity to perform contracting duties competently, efficiently and effectively necessarily involves competencies and institutional structures in at least three major areas. The first area involves deciding whether to make or buy the service and specifying the service. The second area can be divided into two. First there are the competencies and structures necessary to effectively decide on the provider for a service. This involves knowledge and design of proper bidding structures and the ability to negotiate effectively in cases where bidding is not used. Second there is the arena of contracting itself – designing and implementing an effective contract. The last area deals with the auditing and evaluation of

contracts, from the procedural safeguards put into place to deal with the contracting process to the post-contract audit and evaluation of contractor performance.

Another way to overcome contractual problems is to apply performance contracting whenever possible. In performance contracting, the primary attention is given to results and outcomes; the actual delivery process is mainly at the contractor's discretion (DeHoog and Salamon 2002; Schiavo-Campo 1999; Martin 2005). If proper goals and measures were elaborated, feasible data collection systems were introduced and responsible enforcement mechanisms were utilized, performance contracting might result in innovative solutions and enhanced accountability for service outcomes (DeHoog and Salamon 2002). However, where strong political interests are involved and low ethical standards prevail, the use of performance contracting can be a risky step to take (Schiavo-Campo 1999). Furthermore, the performance measuring capacity is not always present, and the governments tend to be reluctant in investing in capacity building (Brown and Potoski 2003). Performance contracting also puts the providers at greater financial risk than in the case of traditional contracting because of the time lag that exists between service provision and cost reimbursements (Martin 2005).

### 3. Methods

In order to assess Estonia's ability to contract effectively, we carried out interviews and examinations of contracts for social welfare services in four cities in Estonia. Descriptive information regarding the sample cities is shown in Table 1 below. The cities are relatively geographically dispersed and vary in size. The two largest cities in the country are included; together these cities comprise 40% of Estonia's population. Additionally, two smaller cities are included in the sample. One possible limitation of the generalizability of the study to other areas is that no cities from the relatively more impoverished areas of Northeastern and Southern Estonia were included. The other possible limitation is that no rural municipalities were included in the sample. Still, the sample captures the range of different sizes and locations of Estonian cities.

Table 1: **Descriptive information on sample cities as of 2006**

City	Population	Region
Haapsalu	11,800	West
Paide	9,700	Central
Tallinn	396,000	Northwest
Tartu	101,000	South-Central

Source: Statistics Estonia (<http://www.stat.ee/en>)

The interviews were conducted with representatives of cities' social welfare departments. The welfare departments are, along with the central government's Ministry of Social Affairs (and its agencies), responsible for the overall social policy-making and implementation. In Estonia, the local governments are the primary welfare-service organizers, whereas the central government offers only a limited number of services such as technical aid and special welfare services for the handicapped. However, the central government has the power to mandate required services at the local level.

The size and duties of the cities' welfare departments vary according to the size of a city and according to the structure of their welfare service sub-units. Haapsalu has only four people working for the welfare department and one governmental sub-unit which is made responsible for all welfare tasks not contracted out to third parties; Tartu has 50 people working for the welfare department and 4 municipal sub-units. In Paide, the respective figures are 11 and 1, whereas in Tallinn, the numbers are 27 and 7.

A three-stage research strategy was used to answer the research questions: interviews, contract examination and document review. The questionnaire we used during the interview process is shown in Annex 1. The first section of the questionnaire asks questions regarding the respondents as well as getting at their level of formal training and the use of contracting mechanisms by their department. The second section asks the respondent questions about contracting mechanisms as well as post-award and post-contractual mechanisms. The interviews were carried out in a semi-structured fashion, and they took place from March to June in 2006. Altogether ten people were interviewed: three from Tallinn, three from Haapsalu, two from Tartu and two from Paide. In all cities, at least one senior manager from the welfare department and one official responsible for contract administration were interviewed. In order to triangulate the interviewees' responses, we examined altogether 74 contracts concerning housing, rehabilitation, counseling, food programs, daily centers, transportation services and other areas. A special case protocol was developed and employed which enabled us to classify the information obtained from the contracts. More specifically, we looked for information concerning the legal status of providers, the length of contracts, contracting procedures and strategies, monitoring procedures and overall contracting rationality. Additionally, we reviewed several official documents such as strategies, legal documents, policy documents etc.

#### **4. Findings**

Contracting for services seems to be an important part of the strategy for Estonian municipality social-welfare service delivery. Between 15 and 25 percent of funds in the budget are allocated to contracting. Also, the ideology of contracting seems to have become a large part of thinking regarding social-welfare service delivery. In Tallinn, interview respondents indicated that the most important outcomes that were expected from contracting were the incorporation of professional knowledge and information, and cost effectiveness. Presumably, the officials there believe that government agencies do not provide these two outcomes or that they provide them less effectively or reliably than do private contractors. And in Tartu, officials reported

that the most important value in the contracting process was a fundamental belief in the market mechanism. This is not surprising given that city administration comes from the Reform Party, which has for years pushed a liberal reform agenda. In Haapsalu, the principal reason for contracting was to provide services. A governmental unit there provides some basic services, but all new services are contracted out. Without contracting, it was unlikely for some services to be provided. This is probably due to the seasonal nature of demand for some services like transport and housing of the elderly, infirm, and impoverished. During the long winters, a provider is definitely needed for these services. But in the late spring through early autumn, many can do without these services. Such flexibility in demand is a reason to use contracted services.

Overall, in Tartu and Haapsalu contracting for services is seen as the major tool for the future provision of public welfare services. For Paide, contracting for welfare services is a relatively new avenue; the respondents there acknowledged that the choice for contracting was a purely pragmatic decision. In Tallinn, it is believed that contracting for services at a large scale becomes problematic due to administrative problems and weak partners, which is why they are in favor of contracting back in many services.

Respondents did not feel direct political pressure influencing the contracting decision. Only in Tallinn, where the control of the local government had been very unstable, a respondent stated that there have been cases where some areas have been given extra finances to enlarge a certain activity. However, respondents admitted that for political reasons, it is easier to contract for new services rather than setting up a new in-house unit. It appears that social service networks, consisting of welfare specialists, representatives of NGOs and local as well as central government, have a big influence on the local governments' decision-making. In Paide, Tallinn and Haapsalu, the networks are places where many policy decisions about welfare services are made and which the local governments consider an important source for contracting activities.

Given this belief in the power of contracting, it is somewhat surprising that very little attention seems to be paid to developing the abilities of contract specialists. In Tallinn, Haapsalu and Paide, no personnel had taken formal courses in purchase-of-service contracting. In Tartu, there were some courses, but the content of the courses was about general principles of procurement. More training will obviously need to be a top priority if there is more emphasis on contracting as a service-delivery strategy. Another somewhat surprising result was the lack of written policies in Tallinn, Haapsalu and Paide. Tartu has formal internal rules for contracting, which are clearly oriented towards conventional contracting, but which have no implications on monitoring issues. In Haapsalu, there exists a policy on social service provision which considers contracting for services one option. This item will also deserve attention.

In terms of the bid and award process, there were significant differences that emerged. In Tallinn, Paide, and Haapsalu, most of the contracts were awarded through mechanisms other than competitive or negotiated bidding. Competitive contracting was used only when the law obliged to do so. However in Tartu, all contracts over 50,000 Estonian kroons (roughly € 3,200) had to be competitively bid.

Respondents in the former three cities felt that in the cases that were competitively bid, there was little difference in the award. This was because of the thinness of the market; in most cases, there was only one potential bidder. This problem was particularly acute in the two smaller cities. No cities had invested directly in market creation, although in many cases the current non-governmental providers had grown out from projects partly funded by the local governments.

The overall contracting “language” was more reflective of classical rather than relational contracting, assuming that competition would have an effect. The contracts were mostly short-term, the majority of them were set to be rebid after every 1-3 years. Only in some occasions were the contracts set for 4-5 years. According to respondents, however, all the cities are interested in continuing relationships, meaning that most of the contracts get renewed with the original providers.

The thin market situation produced an interesting paradox in the case of Tartu. Tartu respondents generally felt that the price was the most important bid information (it was given a weight of 55 percent in consideration of contracting), but since the competition was nonexistent or very limited at best, the costs were usually negotiated. One may reasonably ask whether the costs reflected through negotiation were the true costs of the service, given the lack of competition. Additionally, it appears that the make-or-buy decision is nonexistent for Estonian local governments. In Tartu, where price information was viewed as the most important, as well as in all other cities where costs were viewed as important, there was no costing mechanism for internal services. So it was effectively impossible to compare costs of private providers with government provision. Nor was there any internal bidding allowed in either city. The existing departments were not allowed to compete to have or keep services. From a conventional contracting viewpoint, this will tend to reduce the potential for contracting to provide cost savings through reducing the pool of competitors.

In Tallinn, Haapsalu and Paide, less attention was paid to cost in the contracting process. The primary goal of contracting according to the respondents was to maintain service continuity. Given the overall “language” of contracting in the cities and the thin markets, the concept of service continuity as a primary goal seems contradictory. Service continuity in the context of thin markets could be more easily delivered through relational and collaborative rather than adversarial relationships. One might even hypothesize that if continuity was a target in itself, vertical integration should be preferred. In the current case, there might emerge a potential strategy for providers to get the initial contract to provide a service and then to threaten not to bid for a follow-up contract unless they are paid more money than the government might otherwise be willing to pay. Or alternatively, in short-term contracts, the government might take advantage of provider asset specific investments by threatening not to prolong the contract unless the provider decreases the costs.

When discussing pre-audit procedures, Tallinn, Haapsalu and Tartu respondents found it important to receive information on the qualifications and the past service history and references of the bidders. All respondents admitted that they have a strong trust in the provider organizations’ professional skills and ethics. For these reasons, most of the contracts are re-awarded to the same partners. In most cases, we can say that this is an important quality control mechanism. But again, one must

remember the thin market situation. If a bidder was found to be not particularly qualified for the provision of the service, it is unlikely that an alternative would be available for the government. It seems that in-house provision as an alternative is more probable with bigger cities like Tallinn, which have more resources to make institutional changes when needed.

As for the actual contracting, it appears that most of the contracting was vague and more similar to a relational rather than a classical relationship. The contracts reviewed for the study mostly used pre-defined standards, process and input requirements for contract specifications and evaluation. Nevertheless, the agreements were very often declarative in their nature; no detailed specification or monitoring mechanisms were used. Contracting executed under the Public Procurement Act was more detailed, and in some cases, detailed performance standards were used. Here it appears that the contract “language” amounts to a missive to carry out a particular service.

There is no sign of outcome-based performance contracting in Tallinn, Tartu, Haapsalu or Paide, although the respondents claimed that they are interested in outcomes. In Haapsalu, the city is actively developing standards for welfare services. In Tallinn, the standards have been developed but not yet implemented. In Tartu and Paide, the respondents made it clear that they thought that the development of standards was the proper job of the central governments’ Ministry of Social Affairs. There are some outputs specified in most contracts, such as hours to be spent on counseling or minimum satisfaction rating from clients, but the cities did not appear to evaluate the relationship between outputs and expected outcomes. Furthermore, no attempts could be found of applying incentive systems into contracts. Although it is rather complicated to introduce performance contracting to all welfare services due to the immeasurability of outcomes, there is the possibility to use it as part of a whole package in the case of some services like job placements or rehabilitative services (see e.g. Martin 2005).

In terms of implementation audits, in all cities the emphasis is on verifying the written qualifications of personnel involved in service delivery and the descriptive reports of services delivered. In the smaller cities Haapsalu and Paide, but also in Tartu, the respondents admitted that as they all know the service providers in person, they are not afraid of agency problems. There appears to be no summative evaluation that is carried out on service delivery. This is a potentially extremely important deficiency. Given that there is little competition and that short-term contracting is employed, one would expect a goal for contracting to be to improve the service delivery by the monopoly provider. Without such summative evaluation, it is difficult to see how contractors can make improvements in service delivery until after the contract is completed.

After the services are delivered and the contract is fulfilled, both cities engage in post-implementation audits. In all cases, city personnel examine reports, make random site visits, and in a few cases obtain client questionnaires. Tartu, Tallinn and Haapsalu additionally obtain unsystematic client feedback through direct communications. This is promising as a way to constrain contractor behavior and force accountability. The key to this linkage is how effectively the promise of future contracts can be tied to audit results. If contractors can be made to feel that they will lose

significantly from having any misdeeds punished, then they will be constrained to only good behaviors. But if contracts proceed in fairly the same way as before, then monitoring is not useful under conventional contracting.

## 5. Discussion

Advocates of contracting claim that transitional countries should take advantage of market incentives and introduce purchase-of-service contracting to increase the effectiveness and efficiency of public-service provision. The current study demonstrates that although contracting for public services helps local governments in transition countries to maintain service provision, problems arise from an inadequate application of appropriate contracting strategies to the context of thin markets and services with quality factors that are difficult to contract. This suggests a deficit in the contracting capacity and, as a result, unmet expectations regarding effectiveness and efficiency.

In spite of the fact that contracting for welfare services is done as short-term contracting, the contracting relationship between Estonian local governments and social-service providers can be in most cases characterized as relational. Agreements are declarative rather than detailed, service providers are granted large amounts of discretion, and monitoring is paid small attention. In some cases, the contracting procedures still try to capture the advantages offered by competitive and negotiated contracting. Taking into account the fact that competition on the Estonian welfare-service market is limited and often non-existent and that the nature of welfare services makes the evaluation of outcomes difficult, the direction towards relational contracting instead of competitive contracting should be seen as positive. In this way, the local governments have managed to create relationships that can benefit from a high degree of trust and professional ethics. However, if the contracting relationship is mainly relational, the local governments cannot expect that market discipline takes care of service provision as anticipated in the conventional theory of contracting.

The Estonian case suggests that the principles of conventional and relational contracting are used interchangeably. Although mixing relational contracting elements with classical ones should be seen as a logical step to take in balancing accountability relationships with service outcomes and transaction costs, there are at least three problems that can be drawn from the Estonian case.

First, the current contracting practices pay little attention to balancing accountability with contracting strategies. The evaluation of providers' work is concentrated around legal monitoring such as evaluating input, accounting and process factors, whereas little attention is paid to, for example, measuring client satisfaction or other political accountability measures that would inform relevant stakeholders about service outputs and outcomes. Further, the deficiency in monitoring and evaluation procedures puts Estonian cities at risk regarding maintaining accountability in welfare-service provision. A possible explanation of the situation can be that no significant scandals in contracting have occurred so far and that the local governments are not aware of emerging transaction costs and accountability problems. All the respondents indicated that until the current date, no major interruptions or problems have occurred with the contracted-out services, and because of trustful partnerships, all

issues can be solved in due course. One respondent stated that contracting out public services is actually a good way for a public authority to avoid responsibility if something bad happens with service provision.

Second, the contracts are mostly short-term, which does not help to build trust in relational contracting. Short-term contracting increases the level of uncertainty and gives the providers little motivation to invest in their personnel or infrastructure. When the contract-administration practices emphasize trust and long-term collaboration rather than adversarial relationships, the frequent rebidding is nothing but a source of unnecessary transaction costs. This creates a somewhat schizophrenic situation where the trust and co-operation-based contract-management process is tried to be balanced with the logic of short-term contracting.

Third, Estonian administrators see contracting for services as a tool for maintaining a minimum level of service delivery. Efficiency and effectiveness are declared to be important considerations when contracting for welfare services, but in practice, there are no detailed cost comparisons made between inside units and external offers. Moreover, the participation of inside units has never been an option for the local governments in Estonia. No systematic monitoring and evaluation procedures are elaborated which would allow administrators and officials to assess the efficiency and effectiveness of the contracting tool. Management practices do not include the employment of positive or negative incentives.

To sum up, our study shows that Estonian public administrators view contracting for services in different ways than theory has indicated. They view contracting not necessarily as a tool of greater efficiency, but as a tool of service continuity. Also, the strategies used by public organizations in Estonia tend to involve relational contracting, albeit in the context of short-term contracting. This indicates that serious deficiencies are present in the ability of Estonian government officials to efficiently and effectively employ relational contracting, and as there is no adequate training system supporting the officials, there is much room for improvement in the use of contracting for services in Estonia. Given previous findings in other transition countries (e.g. Nemeč et al. 2005), one must harbor serious doubts about the usefulness of contracting in its current form in these countries. More research and comparative work is urgently needed to document deficiencies in other countries, and more training and institutional structures are needed if transition countries are ever to reap the potential benefits of contracting for services.

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**ANNEXES**

**Annex 1: Questionnaire Outline**

**Background Information**

1. How long have you worked for your government?
2. How long have you worked in government altogether (any government)?
3. How many training courses have you received regarding contracting?
  - a. What topics were covered?
4. What is your highest education?
5. What percentage of social-service budget is allocated to:
  - a. Direct provision of services?
  - b. Contracting out?
  - c. Grants?
  - d. Lump-sum support?

**Contracting Tools, Decisions, and Information Section**

6. Is there a special policy dedicated to contracting out?
7. How many people are involved in the decision-making process regarding contract awards?
8. Please describe the decision-making process surrounding contracting and the role of public-servants in it?
9. As you understand it, what information is gathered in terms of potential bidders?
  - a. Cost information?
  - b. References, quality information?
  - c. Professionalism of personnel?
  - d. Other?
10. What outcomes is your department most interested in when awarding contracts?
11. What values, beliefs and attitudes affect the contracting process?
12. Were there social goals that affected the award process for any contract on which you have worked (such as improving the role of NGOs, supporting local entrepreneurship or the specific promotion of minority-owned companies for awards)?
13. Were there political considerations that affected the award process for any contract on which you have worked?
14. Where there any investments made in order to create a market for contracted services?
15. Were there legal requirements that affected the award process for any contract on which you have worked?
16. What is the percentage of contracts allocated based on:
  - a. administrative act?
  - b. administrative contract?
  - c. civil contract?
17. What kind of audit mechanisms are in place for contracts?
  - a. Pre-award?

- b. Implementation?
  - c. Post-implementation?
18. How are the outcomes of contracts evaluated?

### Award Section

19. What percentage of contracts were made on the basis of:
- a. Competitive bidding processes?
  - b. Negotiated bidding processes (RFP then bids)?
  - c. Other processes (e.g. relational contracts)?
20. What is the average number of bids made for competitive bidding processes?
21. What is the average number of qualified suppliers available for non-competitive bidding processes?
22. What percentage of contract awards were made to:
- a. Private for-profit companies?
  - b. Private NGOs?
  - c. Government-owned profit and not-for-profit organizations?
23. How many contracting initiatives have been won by an in-house unit?
24. What percentage of contracts were:
- a. Input-oriented?
  - b. Output-oriented?
  - c. Outcome-oriented?
25. How much do the following factors influence the contracting procedures?
- a. Market situation?
  - b. Legal environment?
  - c. Political decision-making?
  - d. Other?

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