Alternative Service Delivery

Chapter 10

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Contents

ALTERNATIVE OF WHAT: TRANSFORMATION OF PUBLIC SERVICES

Characteristics of goods and services
Changes in traditional public services

Private provision of services
Private production of public services
Development of market mechanisms in the public sector
"Third-party government"

FACTORS BEHIND DEVELOPMENT OF ASDA

TYPES OF ALTERNATIVE SERVICE DELIVERY ARRANGEMENTS

Provision and production of public services
New groups of goods and services

Most common techniques

Contracting out
Build, Operate, Transfer (BOT)
Concession
Non-profit organizations
Voucher

Sectoral differences
Country specific forms

REQUIREMENTS FOR ASDA

Legal conditions
Organizational requirements
Financial regulations
Management of services
Market environment
Criteria for assessing service delivery

ADVANTAGES AND DISADVANTAGES OF ASDA

Merits of ASDA
Arguments against ASDA

References
Box
Tables
ALTERNATIVE OF WHAT: TRANSFORMATION OF PUBLIC SERVICES

In Central and Eastern European (CEE) countries public sector and public services were rarely considered as economic entities. Under the socialist-communist regimes sources of infrastructure financing and provision of public services were mostly central budget revenues. High level of income redistribution was driven by the need for accumulating capital in the manufacturing sector and restructuring of the agrarian, non-urban labor force. This characteristic of the economy was based on the monopoly of state property and the undervalued labor costs. Public services were "free" for the consumers, so there was a lack of direct measures for efficiency and effectiveness.

The new economic and political environment is based on private economy, which nowadays already gives majority of domestic production. Decentralization of the socialist state created new government structures, where the former public sector mechanisms could not survive. So the rationale for changing methods of financing, allocating and delivering public services was complex: economic and political factors initiated systematic changes jointly.

For better understanding these changes first the characteristics of goods and services should be identified. The changing environment of these services will explain why alternatives of public service delivery arrangements were born and how did they spread in time and space.

Characteristics of goods and services

Theory of public finance explains the existence of public services by market failures. There are certain fields of economy, where private sector mechanisms do not work properly, simply because the provider is not able to receive all the returns from the purchase of the service (Mikesell, 1991, p. 2). This is the borderline between private and public goods. In the case of private goods (and services), consumption is individual and any others could be excluded from the benefits of the service. This rivalry in consumption makes the production of one group of goods and services efficient.

As it is discussed in the previous chapters private sector mechanisms lead to monopolistic positions, which raises the need for government intervention. In some sectors where the need for initial investment is high, private involvement is low, so government regulations are required to counterbalance the affects of decreasing costs. Access to information on goods and services produced by the private sector is also a governemntt responsibility. Rationale for government intervention also could be based on non-efficiency explanations, like fairness for having equal access to services for citizens being in similar position.

In the case of public services consumption is joint by nature and the exclusion of other consumers is impossible or very expensive. The non-rival character of the service means, that getting the benefits from the service, is not really influenced by the others, who at the same time also benefit from the use of the same service. Here the best examples are the radio broadcast, national parks, public transportation, etc. The other characteristic of public goods is that exclusion is simply not feasible. Examples are fire protection, national defense, lighthouse, etc., where services are collectively used. Separation of consumers who paid for the service and the non-payers is very expensive or technically impossible.

In the CEE countries there are additional features to these classical characteristics of public services. The unified public property of the socialist state has restricted the organizational
forms of public service delivery. For long decades only public (budgetary) institutions or government controlled public enterprises were the only organizations, producing public services. As these economic entities were not influenced by market mechanisms and they were under strong political control, they were the least efficiently run organizations.

Another characteristic of public services in CEE countries is the close relationship with the public administration. As the socialist state was the owner of the assets and through political mechanisms public administration was highly influenced by the single party in most of the countries, allocation of public services was also strictly controlled and "over-politicized".

Ownership and political mechanism jointly forced the centralization of the government, both at national and local levels. In most of these CEE countries the intermediate level of government was the transmission between the national state and the indirectly controlled, soviet-type local governments. These structures did not help to establish flexible, need-driven public service organizations. Service producing units were directly managed from the centers, or subcenters, which has resulted a mixed system of administrative and service delivery decisions.

All these characteristics of public services in the CEE countries proved the failure of government actions. The hardly measurable efficiency criteria were not met, but also the government was not able to correct market failures. Simply the market allocation method was replaced by political mechanisms, which did not reflect the citizens' priorities and established a centralized structure of power.

Changes in traditional public services

Transformation of traditional methods of public service delivery was started by the changes in the market environment. This was a relatively short period in the CEE countries, sometimes only a few years in the 1990s, or in some instances one-two decades. Not only this learning period is different in these countries, but also the existing market institutions differ very much. There are four main elements of the market environment, which has influenced public services:

• private organizations provide services;
• private organizations are involved in the production of public services;
• market mechanisms (user charges, tenders, contracts, etc.) are more often used in the public sphere
• need for establishing civil society: decision making processes and institutional setting of public administration and government structures have been modified.

Private provision of services

Government expenditures are continuously increasing, as the national state and local governments take over more and more responsibilities. This was especially true in the CEE countries, where the socialist state centralized most of the public services. In the 1950s government expenditures have reached 80% of the GDP, which is almost twice as high as the present level of public expenditures in economically developed countries.

Obviously it was impossible to finance this level of public expenditures, so public sector reforms started to transfer various government functions to the private sector. Privatization of
public enterprises, development of private pension funds and other welfare schemes, private education are all examples of the fundamental changes in the public sector. In the 1980s many public functions were transferred to the private sector. Transfer of public ownership to private entities was aimed to correct government failures and to reduce government spending.

In many CEE countries this privatization process has changed only the legal character of service providing entities. Direct influence on state owned enterprises was changed by indirect methods of ownership control. This privatization created new relationship between the government (politics) and the commercial unit with majority or exclusive state ownership. The real privatization started only at the second wave, when capital was raised by these state owned commercial units.

Private production of public services

Private entities are involved in the production of public services. That is the government takes the responsibility of providing the public function, but the actual delivery of the service is done by private organizations. There are various schemes, how private organizations might participate in public services. This chapter on alternative service delivery arrangements will describe many of them. The best examples are from the public utility sector, but many communal and human services are also run by private or non-profit organizations.

Development of market mechanisms in the public sector

Transformation of traditional public sector mechanisms is pushed by the methods, developed in the private sector. The purposes of these changes are to express the costs of public services for the consumers, to introduce higher motivation in the public sector and to increase the responsibility and transparency of public bodies' decision making processes.

The costs of public services are indicated by user charges. Fees, user charges and tariffs work as price mechanisms for public services, where the actual costs are not always calculated, so they are not expressed towards the consumers. "Free" services are never utilized efficiently, which have also increased public expenditures. Pricing services not only makes consumers' decisions more rational, but also increases public revenues.

As most of the public goods and services were heavily subsidized, introduction of charges was not easily manageable. There are various methods, how control over prices were changed with new mechanisms. The most frequently used method is simple decentralization of charge setting authority. As public services were transferred to local governments, charges on water, sewage, district heating, waste collection, rents, etc were also decentralized. There are nationally defined regulations on calculating the prices (e.g. maximized percentage of profit) or national government subsidies still exist (in the water sector, or for capital investments).

Cooperation with private entities have modified the operation of public organizations. First of all political mechanisms should be adjusted to the requirements of the public sector. In order to have clear contracts with private service providers, the objectives and specifications of the services should be carefully designed. Sometimes it was not easily manageable for the governments, as service characteristics were simply inherited, outcomes of former decisions. Transparency of public decisions raised the claim for proper selection of private contractors, so tendering procedures are also crucial elements of the changing market environment.
"Third-party government"

This term is used for those independent regulatory bodies, which take over the functions of traditional public administration. (Salamon, 1988). There are various organizational forms (agency, council, board, etc.), which work as regulatory bodies, incorporating professional and public elements of decision making. These quasi government organizations try to make the public control more efficient, but at the same time keeping the professional standards high.

Together with other private sector mechanisms, these independent regulatory bodies have transformed the traditional public administration and regulatory mechanisms of public services. There is a tendency to destroy the rigid borderline between public and private sector and these third type of government forms (neither public, nor private) are new examples of communication between the two spheres.

This way the government involvement in providing public services can be assured, without increasing the state's administrative apparatus. (Salamon, 1987) If there is an existing institution, the government can rely on their activities. Their expertees, organizational structures help to provide more efficient, diverse services on a competitive basis. Third party government raises the problem of accountability to the public and requires new methods of audit and control.

All these changes in traditional public services slowly developed the environment for alternative ways in service delivery. Lessons in privatization, slowly spreading market based mechanism for financing services, private organizations with the promise of managing services more efficiently, greater public control by the civil society all led to innovations in public services. The following section will summarize the factors pushing alternative service delivery arrangements.

**FACTORS BEHIND DEVELOPMENT OF ASDA**

The most important factor pushing new forms of service delivery is fiscal stress on public budgets. Cutbacks in expenditures and increase of public revenues did not provide sufficient sources for financing the traditionally accepted level of public services. So government entities were forced to increase the efficiency of their services. One potential form of achieving higher efficiency is to utilize the advantages of the private sector entities, that is to develop alternative service delivery arrangements.

Spreading of ASDA in the public sector has coincided with the general trend of privatization. Ideological movements starting from the late 1970s have emphasized the advantages of privatization. In the period of economic crisis, when public budget deficits were high and quickly increasing one of the feasible solutions was the restructuring of public services. Transformation of public enterprises into joint stock companies, transfer of services to the market were the clear examples of privatization. But there was less visible change in the public sector, when national and local governments more extensively used private producers and market incentives in providing public services. ASDAs are the examples of this type of privatization.
Privatization ideology was based on an extending market environment. Especially in the CEE countries, where no market incentives were used in the public sector, first it was necessary to introduce fees, user charges and to have private sector, which is able to provide public services. Privatization or "municipalization" of public assets helped the transformation of public property. As soon as the ownership rights have changed, there was an immediate need for establishing other market mechanisms and regulations.

So very quickly the national subsidies on public services have disappeared and the price setting mechanisms were decentralized or transferred to public bodies. In the field of communal services, public utilities and in the social housing sector most of the local governments were authorized to define the user charges or the rents. National services (e.g. energy supply) were under control of public bodies. This process of decentralization and introduction of private sector mechanisms very much vary in the CEE countries.

On the consumers' side higher need for individual choice of public services was the main incentive, pushing ASDA. Public services are always directed towards the most frequent needs of the typical consumer. Variations in the level and form of public services very much were constrained by the available resources. In the period of budget restrictions and polarization of the demand for services there is a high pressure for adjusting public services to individual needs.

This not necessarily means better performance of services, but the adjustment process might produce new types of public services. Within social services, education, health sector there are variations of individual needs, which can be satisfied only through more diverse forms of services. When governments provide grants for these non-profits or sign contracts for taking over public functions, they help individual choice through alternative forms of service delivery.

Another factor pushing ASDA is the inefficient operation public service delivery institutions. Traditionally budgetary or contributory organizations are managed through their inputs (labor, materials, etc.), while the environment of these public entities is under a strong output control. Politicians, individual consumers are interested in the level of the service, the benefits achieved through government actions.

Properly designed performance indicators of service quantity and quality can be easily used for contracting with private organizations. As soon as the requirements on the service level are defined by the government (service provider), the organizational forms of production might be discretionary. Under well designed service level agreements and contracts both public or private entities are able to satisfy the needs of the client.

There are changes in political culture which also helped to understand and develop new, innovative methods in public service delivery. (Clark, 1983, Miranda, 1991) The traditional dichotomy of conservative (republican) and liberal (democratic) political values has been changed. As social classes slowly disappear and the economy goes through major restructuring, the political mechanisms also change dramatically. Social and fiscal issues are prioritized differently and this new combination of values create new type of political culture. It is called new fiscal populism, which stresses the high responsiveness on social problems, but at the same time seeking for new measures in fiscal policy. More efficient forms of service delivery do not necessarily mean less effective public services.
So alternative service delivery arrangements are phenomena of the complex social and economic transformation. Privatization and responsiveness on individual needs forced these innovations in the traditionally slowly changing public sector. As ASDA are developed and become widely known, internal rules and procedures of public sector are also modified. This process very much depend on values of the society and the economic environment in a country.

**TYPES OF ALTERNATIVE SERVICE DELIVERY ARRANGEMENTS**

For understanding ASDA, two main characteristics of services should be clarified:
- separation of service provision and production;
- development of intermediate groups of goods and services.

*Provision and production of public services*

There are four main actors of public service delivery: the service provider, the financing organization, the producer of the service and the consumer (See Table 1.). The *service provider* has the legal or political obligation to ensure the sufficient level of services within its jurisdiction. This does not necessarily mean, that this client organization will finance the service. The grants for using the service might be *other government* level (e.g. welfare services, unemployment benefits). Sometimes the service provider only manages the service, creates the required regulatory environment for the service (e.g. defining standards, procedures).

The third actor is the *service producer*, which is responsible for delivering the service for the consumer. Traditionally public services are provided *and* produced by government entities, but the mentioned recent changes have modified this pattern. Private and non-profit organizations are involved in the service production.

The relationship with the *consumer* under these structures are various. The consumer even does not know anything about the separation of provider and producer (e.g. contracting out in public cleansing) or the other extreme case, when the consumer selects the service producer (e.g. voucher schemes in welfare services).

Alternative service delivery arrangements are various combinations of these four actors. There are many techniques and forms how actually the service can be reached by the consumer. As it is shown in Table 1. flow of money (grants, subsidies) might come from the financing organization (central budget, social security funds, private foundations, private investors, etc.) or from the service provider, while the actual service is produced by another entity.

These institutional forms and contractual relationships will be discussed later, here is only a list of the main types of ASDA:
- contracting out a public service (e.g. collection of solid waste by a private entity);
- build, operate and transfer (BOT) schemes (e.g. construction and running of a landfill, owned by the municipality);
- concession (e.g. transferring the rights and duties to provide a service within the jurisdiction of the locality for a given period);
• non-profit organizations (e.g. involving charity and voluntary organizations in local service delivery);
• voucher (e.g. food stamps, or other indirect forms of subsidies directed towards the consumers).

The most important characteristic of the alternative service delivery arrangements, that the character of the service does not necessarily define the organizational form of service production. So public services can be produced by private organizations under various forms of alternative delivery schemes.

**New groups of goods and services**

These new forms of ASDA are based on those intermediate types of goods and services, which were identified between the large groups of public and private goods. The privatization wave of the 1980s has highlighted those new types of goods and services, which not necessarily fit into these broad categories. (Savas, 1987) has introduced two new groups of goods: **common-pool goods** and **toll goods**. This is based on the characteristics of goods and services, that is whether the exclusion might be feasible or not; and the consumption is individual or joint. Savas has proved, that there are goods and services, when the excludability is infeasible, but the consumption is private (common-pool goods); and also the other way it is possible, that exclusion can be feasible even in that case, when consumption is joint (toll goods). (Table 2.)

In the case of common-pool goods (like the rivers, air, natural parks, etc.) the property is owned by the community at large, but public consumption is limited. The economic rationale behind the constrained consumption is to avoid exhaustion of the public goods and to accumulate funds to reproduce these goods.

Toll goods (cable TV, library, mass transportation, etc.) are consumed jointly by the public, but the service can be provided by market organizations. The governments may interfere to private provision of the natural monopolies, through various actions, for example price regulations, competitive tendering.

Alternative service delivery arrangements are all based on these two forms of goods and services. Various contractual relationships and organizational forms are developed by the governments and the private sector for combining the advantages of public and private spheres.

**Most common techniques**

In this chapter the most important techniques of these innovative methods are discussed. There are many slight modification under each main types, as national legal and financial regulations forced to develop new methods. Also there are sectoral differences, as some techniques are usually connected to certain types of services. Main types of ASDA vary by country, as public functions are also different.

**Contracting out**

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The government as a client signs a contract with the private entity to provide the service for a group of consumers. These services are purchased from the contractor and they are paid directly by the government or the consumers. In the latter case the price is mostly controlled by government decisions. There is an obligation on the public bodies to monitor and control the service delivery. There are various forms of contracting out, as the time horizon of the contract varies, as methods of payments change and the risks and assets are shared between the client (service provider) and the company (service producer).

Most typically contracting out is used for operation and maintenance work, so the contracts cover relatively short periods. The length of contracts should be long enough to finance the capital, used during that period. So depending on the type of assets, required for the service, contract period may be different: in capital intensive sectors, like solid waste collection it is 5-7 years, and cleaning of the office space can be only one year. Sometimes even the national regulations do not allow local governments to sign contracts, longer than the fiscal year.

Prices are crucial points of the contracts, especially for public services, where costs are not properly accounted. There are two main types of contracts: fixed priced and cost contracts. In the latter case the local government takes the risk of costs increase. Usually contract prices are fixed, but as some cost elements or the profits are uncertain, indices can be used. It is extremely important to agree on the price adjustment indices in CEE economies, where the rate of inflation is high. Otherwise private contractors will not invest within the contract period, so the potential efficiency gains are not reached.

There are various schemes how risks can be shared among the client and the contractor. The agreed price mechanism, the ownership of the fixed assets, the replacement costs of various elements of the capital are all subjects of negotiations during the contracting period. Most typically local governments keep the ownership of the basic assets (e.g. the landfill), but the contractor should provide the equipment or other smaller capital (e.g. compactor at the landfill). If the local government wants to keep its direct control over the service producing company, simply a management contract is signed. In this case the management of the public enterprise shares the risk of running the company with the municipality.

Build, operate, transfer (BOT) schemes

Public services and public utilities are capital intensive sectors of the economy, so national and local governments are always faced with the lack of sources to finance capital projects. Most typically capital costs can be recovered in some decades or the assets are used for generations. In this cases private capital should be involved in financing government projects.

If the construction is financed by private investors, the government can pay back the capital and the interest on the capital by contracting with the private company. The sources of financing the projects are user charges and other payments made by the users of the utilities. So lenders and investors in these projects mostly depend on cash flow, generated by the investment. Transfer of the right to operate the infrastructure, keeps the ownership rights at the public body. When the project costs are totally covered (depending on the type of the project after 20-25 years), the government takes over the assets and the right to run the service.
Typically BOT schemes are used for those physical infrastructure services, which generate revenues through user charges. So there are many examples in the energy sector (power plant, refineries), transportation (toll roads), water and wastewater plants, landfills and solid waste management are financed through BOT schemes.

Capital investment projects using the build, operate and transfer schemes involve three main actors: owner (government), project company and the investors, lenders (banks). In a typical process of BOT investment the local or national government together with other owners or sponsors establishes the project company. This company starts negotiations with potential investors and other participants. These other interested parties are the contractor who will do the construction work and the operator of the future facility. It should be carefully designed who are the future purchasers of the service or product and what are the conditions of supply (fuel, waste, cars, etc.) These roles are very often mixed, so BOT schemes are based on complex arrangements.

**Concession**

Contracts for public service delivery with the requirement to implement capital investments are called concessions. It is different from the BOT schemes as the service is not based on a new investment. In most countries it is restricted by law, which services can be operated through concession agreements. The concession agreement also defines the legal form of operation, so the contractor (lessee) will be responsible for the capital assets financed by the concession. This separation of assets helps to measure the capital and current costs, so the financing sources can be also identified.

The government transfers the right to set and collect the user charges or tariffs paid for the service. As concession agreements cover very long periods (in Hungary maximum 35 years) there should be clear regulations on service performance and agreements on termination of these contracts. Sometimes if the producer sets and collects the charges, concession agreements are called franchises.

Best examples of concessions are infrastructural services and public utilities. In the water sector, in solid waste management, when the government has the right and the mandate to provide the service, but very often lacks the financial resources for capital investments and service delivery, concession agreements are signed. This way advantages of more efficient commercial entities can be combined with the public responsibility for the service provision.

**Non-profit organizations**

Voluntary, charity and other not-for-profit organizations are widely used for providing public services. They work parallel to the governments, representing the third sector between the public and the private ones. In the CEE countries, where any types of voluntary organizations were prohibited or controlled, non-profit organizations started to develop with a high speed after the political changes in the late 1980s. For example in Hungary, where the (sports) clubs, associations were the only organized forms of voluntary activities 8,396 clubs were registered in 1989 (Alapítványok..., 1992). Later as the legal environment has changed other types of non-profit organization (mostly foundations) were established. By 1994 the total number of non-profit organizations have reached 40,323 (Nonprofit..., 1994).

The most important characteristics of the non-profit organizations are that they are
• institutionalized,
• independent from the government,
• non-commercial organizations, using their profits for their basic activities,
• managed by self-governing bodies and
• partly run by volunteers².

For separating non-profit organizations from other voluntary groups they should be registered, which is an advanced level of institutionalization. They are not parts of the government, which gives them political independence. But they are not typical private organizations, as the profit is not shared among their the founders or managers. The most important condition of independent operation, that non-profits are managed by self-governing bodies. Non-profits are based on voluntarism, but in many cases services provided by non-profit organizations are quite complex, so the staff is paid.

The comparative study of seven countries, show that non-profit organizations operate in education and research (24% of total expenditure), health sector (22%), welfare, social services (20%). (Salamon, 1994) According to these data, non-profit organizations also focus on public functions. So governments having good relationship with this "third sector" are able to utilize the advantages of the non-profits in providing public services. The statistics show, that 43% of the revenues at non-profit organizations are government grants. (Salamon, 1994)

In CEE countries these grants are lower, because national and local governments have not established good relationship with non-profits, yet. There is a tendency to treat non-profits equally to public institutions (e.g. in Hungary non-profit organizations receive the same amount of general grants, as other local government institutions). The basis of cooperation is the contractual relationship with the government, specifying the performance of the public services, taken over from the public sector.

Transfers and donations to non-profit organizations are regulated by tax codes. As the donations are deductible from the national taxes, very often they are maximized. These limits are expressed in the percentage of turnover, profit or taxes. In addition to these deduction after paid donations, in Hungary a new legislation was introduced in 1997, which allows to transfer 1% of personal income tax for specific purposes. (See the case study at the end of this chapter.)

Government contracts and regulations on non-profits are mostly aimed to counterbalance the failures of voluntary sector. (Salamon, 1987): This new theory of voluntary sector emphasizes four characteristics: philantropic insufficiency, particularism, paternalism and amateurism.

The non-profit organizations are not able to generate sufficient sources to provide collective goods and services. This insufficiency is reflected in the fact, that economic fluctuations might stop voluntary actions, just in those periods, when there is the greatest need for these services. This could also happen in the spatial dimension, where the available resources and the problems or needs geographically cannot be matched.

Philantropic particularism is a negative consequence of the issue oriented character of the non-profit organizations. As non-profits focus on some problems of the (local) community,

² This definition is based on Salamon, 1994.
these target groups may not be properly represented or their needs are expressed for the voluntary sector. Consequently some groups are in a favourite position, frequently those, which are able to attract communal or individual pride. This failure of voluntary sector can be expressed also as _philanthropic paternalism_. Those who have higher influence on the available resources in the voluntary sector, they define the preferences and need for these services.

Especially in the CEE countries, where non-profit organizations do not have long tradition, there is a lack of professional capabilities in service management. This _philanthropic amateurism_ in the field of some services, like health care, social services might cause some losses in financial terms. But the whole sector is still in a better position, as they can employ more qualified staff, than the public sector. As non-profit organizations focus on urgent needs, through higher charges and lower operational costs they are able to pay higher salaries and this way keeping good professionals.

_Voucher_

Vouchers are coupons with value, which can be used for purchasing goods or services, defined by the issuer of the voucher. This alternative service delivery mechanism combines the public decisions with the market incentives. The government provides grants for the eligible citizens in the form of a voucher and these consumers buy the services on the market. This way only the targeted population enjoys the benefits of the service. Individuals having vouchers could follow their own preferences, when they make a choice on the service producer. This is the most efficient way of quality control over the service producer.

There are various techniques of vouchers, mostly in the welfare, social sector, recreation, public utilities and cultural services. Vouchers can be used only in those areas, where the supply of services is available and individual choices are important conditions of service quality. This form has some traditions in the CEE countries from the socialists times. In the previous era, where coupons and vouchers were frequently used as substitutes for money, people have accustomed to this technique. Earlier vouchers were used to influence the activities of eligible people to the desired directions, through these administrative means. Now the vouchers might give freedom of choice within the market environment.

_Sectoral differences_

There are high variations among financial, management and organizational characteristics of alternative service delivery arrangements. Special needs of services have resulted different types of models in each sector. Also the legal and financial environment of a country has influenced the development of ASDA. In general the _closer is the public service to the market_ (the service is financed by charges, demand is specific, measurable performance, etc.), the higher the possibility to user some forms of alternative service delivery mechanisms.

Technically public services and certain types of service delivery methods are typically connected to each other. Contracting out, BOT and concession agreements are most typically used in communal (urban) services: refuse collection, water supply and sewerage, public transport. Typical areas of non-profits were described in the previous sections. Voucher schemes can be used for housing, social assistance, welfare benefits.

Based on the British example ASDA and urban services are matched in Table 3. Service delivery options give a list of potential arrangements, starting from direct public involvement
till more privatized forms. Urban services can be matched with these typical service arrangements, as revenue generating services with low externalities are more often managed through privatized models.

As each public service involves various types of activities, these elements of the service can be produced through different delivery methods (Table 4.). The most important factor differentiating techniques is whether capital investment is included in the delivery arrangement or not. Current (operation and maintenance) activities are more easily contracted out, than those service, where capital investment component is also involved.

**Country specific forms**

As government structure, functions and finances are very much different by countries, also the use and types of ASDA vary significantly. Market based service delivery arrangements are more frequently used in the Anglo-Saxon countries. Here the necessary requirements for separating provider and producer roles are more developed: long tradition of self-governments with institutions promoting transparency, strong traditions of contractual relationship, advanced market mechanisms in public utilities.

In the US and Great-Britain privatization of public utilities and communal services helped to develop extended forms of ASDA. In Great-Britain the legislation on compulsory competitive tendering forced local government public entities to compare their efficiency with the private sector. This practice has significantly changed the management of the local governments, as tendering regulations, service level agreements, performance control put new burden on the client side operation and management.

In the centralized French government structure new forms of contractual relationship with the monopolistic public utility companies have been slowly developed. Local governments have more guarantees as tendering process is regulated and various forms of mixed ownership were established. In public utility sector there are some specific widely used institutions, which were developed by the French system. Lease contracts (affermage), divided interest in financing services (régie intéressée) are frequently accepted in developing countries.

The German tradition of governance is slightly different, as the internal efficiency of public organizations is preferred, instead of using market incentives. The "New Stiering Model" of public finance management helps to measure the efficiency of public service units. There are various ownership and accounting forms of public utilities, which try to balance public functions with private sector mechanisms. Eigenbetrieb, Eigengesellschaft are widely used intermediary forms of economic entities, where the public (consumer) control is combined with the autonomy of the service producing entities.

There is no comprehensive information on the ASDA in CEE countries. These new forms of service delivery are slowly developed under the changing ownership structures, low autonomy of local governments and slow establishment of the necessary legal environment. Each country in the region put a great emphasis on the development of the civil society, so non-profit sector has increased rapidly. Contracting out practices and other forms of "privatization" techniques very much depend on the character of local governments. Some indication of changes are that Czech Republic and Hungary have passed public procurement
acts, contracting out practices are more widely known by the Polish and Hungarian local
governments.

Survey of the Hungarian local governments showed, that in the field of communal services
there are two groups of activities, where external service producers are involved (Péteri,
1994: Helyi útkeresés). There are contracts between the client municipality and the service
producer in solid waste collection (42% of localities), district heating (33%). These facts, do
not necessarily mean, that the service provider is a private entity, but at least the service
performance and finances are regulated by the contract. External organizations (that is not the
municipal administration or public institutions) provide the funeral services (61%), water
supply (49%), sewage treatment (36%). Tendering procedures were rarely used at the time of
the survey (swimming pool operation, 21%, solid waste collection, 18% of the responding
municipalities).

**REQUIREMENTS FOR ASDA**

Alternative service delivery methods are deeply embedded in the political, legal and financial
environment of local governments. Several factors of public and private spheres may support
or hinder their development. ASDAs are *not simple techniques of* service provision, but
several interrelated preconditions are required for proper use of these alternative forms. They
are

1. **legal** conditions, supporting contractual relationship among public and private spheres;
2. **organizational changes** at public authorities, developing client's role and pushing
   accountability of public decisions;
3. **financial regulations**, supporting better understanding of real costs of services;
4. **new forms of service management**, like tendering procedures and contract monitoring;
5. **market environment**, with private sector mechanisms and their consequences.

**Legal conditions**

Decentralization in the public sector in line with development of market institutions and
private organizations lead towards *contractual relationship* in service delivery. Contracts, as
agreements between equal parties, have several preconditions in service delivery. Not all of
them are available in the CEE countries, but tendencies of the past decades show clear
direction of positive changes.

Government entities, both at national and local levels have higher autonomy in defining the
*level of services*, provided for their consumers. If the unified character of public services are
changed, there is an increasing need for selecting the most efficient form of service delivery
organizations. In this respect local discretion is closely related to *property issues*, as
"municipalization" of former state owned assets gives the foundation for establishing new
organizational structures. All these changes in the legal and institutional environment should
develop in parallel with *greater authority* in managing and financing these services. User
charges, grants or subsidies on services should be defined by those entities, which are
responsible for other aspects of the service.

In the case of Hungary all these slow legal and organizational changes were recently
accelerated by two major legislative actions. The *Act on Public Procurement* is based on the
requirements of the European Union, which supports integration through free flow of
services, labor and capital. If the procedures on public purchases are transparent, contractual
relationship is more probably developed in the field of services. This might lead to wider use of alternative service delivery arrangements. Due to externalities some public services are compulsory for the customers. For example use of service organizations selected by localities in waste management or chimney sweeping are mandatory for the citizens. Parallel to these changes in the legislation these services should be tendered, so any monopolistic positions will be avoided.

Organizational requirements

Due to changes in the legal environment also the organizational structure and procedures of public authorities are modified. The client and service producing roles should be separated, as a first step towards developing new forms of service delivery. The clients' decisions should focus on the service outputs and efficiency of provision. So the potential drawbacks on owners' role or any other aspects of public decisions (increasing employment, raising revenues, etc.) should be considered, but not mixed with the need of efficient services.

New clients' role influence almost each steps of service provision. Clear priorities are needed for any decisions on selection of service producer, as without well specified objectives no alternative arrangements can be compared. New organizational forms require modified procedures of monitoring the service producers. Control in this case has a preventive role, to avoid any major difficulties the client should be aware of all the significant factors influencing the capacity of the service producer.

Another important aspect of procedures connected to alternative service delivery arrangements is to prove in any situations, when personal interest might be raised, that the decision making was clear and neutral. Motivation in some countries for introducing public procurement regulations was simply to exclude any actors who could be interested or at least preferred by public decisions.

Financial regulations

For making decisions on organizational forms of service delivery it is essential to have information on real costs of alternative solutions. Accounting regulations on public entities often do not require detailed cost measurement. Expenditures and not the real costs of organizational units are measured, which does not really help decision making. Financial information should be available by services (functions) provided, presenting the total (direct plus overhead) costs of each activity.

Accounting regulations of government entities focus on organizational units, which raises two basic problems. Cross financing of several activities within the same organization are hidden for the decision makers. Evaluation of efficiency and financial balances of departments, budgetary and contributory organizations or even public enterprises will not be professionally sound, if financial information on activities are not separated. Cost centers, or enterprise funds should be set up for measuring the real expenditures (costs) and revenues of various activities.

Another misleading factor in public accounting is the improper allocation of costs by functions. If the expenditures, raised in the public administration or expenditures required by public decisions are not shown among total costs, then no comparison of alternative service delivery arrangements can be compared. For example if the waste management is contracted
out, but the collection of user charges is still the duty of the local administration, then these expenditures should be added to the costs of the contract. On the other hand when expenditures of a service, produced by departments or budgetary institutions are measured the indirect costs of government decisions, overheads of general management and accounting departments should be involved in costs calculation.

This proper financial information is needed at several stages of decision making. First of all, when the service producer is selected and later, when basic financial conditions of a service are defined. First of all the calculation of user charges should be based on proper costs information. Not only differences by regions or subdivisions, but also the depreciation costs should be incorporated in the price of a service. Very often public services are jointly financed by grants, as difference of costs and charges. Allocation of grants to services also need basic financial information. Especially, when grants are for capital investments, that is large initial capital is needed and long term recovery of costs should be calculated.

Management of services

Introduction of new forms of service delivery will modify management practices. Under the traditional ways of service delivery the rules of administrative management might work, that is hierarchical structures support decisions. In the case of contractual relationship, when public and private entities are equal partners under the civil or semi-public law, new management system should be developed. The most important elements of this relationship are the tendering process, the contract specification and monitoring of the service.

Tendering procedures require definition of the future contracted services, transparency of decisions and clear rules of tender evaluation. Preparation of tenders is based on the specification of tendered services. In certain services measurement of outputs is simple (e.g. park maintenance, waste management), but there are some more complex services, where the activities require sophisticated indicators of quantity and quality (e.g. education, welfare services). Selection of the tendering procedure need a compromise between simplicity and transparency: negotiation procedures, tender by invitation and call for tenders need different level of advance preparation, time and administrative costs.

In the contract several aspects of the service should be specified. First of all the characteristics of the service should be detailed: definition of the activities (quantity and quality), geographical area, timing of the service provision. It is also essential to define the basis and method of payment for the services rendered. As contracts preferably signed for longer period, calculation of changes in future costs should be agreed.

Detailed contracts require new forms of contract management. The client has to calculate the costs of contract monitoring, which might be 5-10% of the total cost of a service. Under service contracts the client, as service provider is responsible for the produced activities, that is the level of service, management of complaints, any alterations from the contract and assurance of service quality. The client should be interested in continuous provision of the service, so a gradual procedure of notices and contract modification or termination should be developed.

Market environment
Dealing with private organizations is a new task for government entities. They should guarantee the safety of public services on a long run and confidentiality of private contracts should be balanced with the transparency of public decisions. Both of these components of market mechanisms require new methods at national and local governments.

Long term security of contracted services is mostly based on proper contract specification, detailed pre-tender evaluation, good tendering procedure and careful monitoring. The techniques of performance bonds might be used only in those countries, where the regulations and practices allow them and insurance companies are prepared for these services. Obviously insurance bonds increase service costs, as the contractor will include them in the price.

Transparency requirements of public actions sometimes are in conflict with confidentiality of private contracts. As budgets are public documents, expenditures allocated to the contracted service, will be known by future tenderers. Another problem is the assurance of confidentiality on business information, submitted by the tenderers. Public decisions always require elected bodies or boards, where secrecy (e.g. on a company financial position) cannot be easily secured.

Criteria for assessing service delivery

All the requirements detailed above show, that public entities should carefully assess their capacity, if they plan to deal private contractors. The client should be prepared for making decisions on alternative ways of services and also the organizational and managerial experiences should be developed for successful contractual relationship. In the case of local governments, where alternative service delivery arrangements are often used, there are several criteria for assessing the municipality's ability to work with the private sector.

In the Box 1. there are twelve items, which should be carefully evaluated, before the public entity starts any actions in changing its traditional service delivery methods. The first group of criteria (items 1-4) are focused on the characteristics of the service: analysis of service needs, ensuring quality and fair services. The second group (items 5-7) are basic requirements on the contractor's side: experience, openness to monitoring, control. The rest of the components (items 8-12) again focus on the client's ability to manage contracts: flexibility, management culture, staff capacity.

If all these criteria are met, that is after a careful analysis the public body will give positive answers on all these questions, then it is possible to introduce alternative service delivery arrangements. This list also show those elements, where future actions should be made to increase the efficiency of contractual relationship and contract management with the private entities.

ADVANTAGES AND DISADVANTAGES OF ASDA

Traditional public sector service delivery mechanisms and alternative forms are not easily comparable. Dimensions of comparison are not equally important and characteristics of service methods very much differ by sectors and by countries. This chapter still gives a short list of positive and negative sides of alternative service delivery mechanisms. The actual importance of these arguments is very much subject of personal judgment.

Merits of ASDA
First of all new forms of service delivery all try to increase efficiency of public services. Under the traditional public sector schemes bureaucratic procedures, lack of competition, inflexible rules make services inefficient. (Batley, 1992). Market based, alternative service delivery methods are able to utilize the advantages of private management, which result savings at the service provider. This not necessarily mean cheaper and better services for the consumer, but at least transfers resources from the public sector into the private one. This shift is a very important in those countries, where public expenditures reach three quarter of gross domestic product.

In many cases there is an indirect influence of ASDA on traditional public services. Even if new forms of service delivery do not really danger the monopolistic position of large public entities, the competition in always there. This might be hidden in professional discussions or more outspoken in fight for national grants. At least the existence of a potential competitor will slightly modifies the attitude of the service providers towards the purchaser of their services.

Public services always focus on the average consumer, they are not able to meet individual needs. In the period of scarce resources traditional forms of public services are provided to the average consumer. No differences in service demand can be followed by the service delivery mechanisms. As service level is getting higher, more differentiated needs can be managed by the service provider. Consumers decision on types and levels of services will be more successfully followed by alternative service delivery arrangements. New service organizations focus on the untypical demand, as they generally do not have to deal with the most frequently raised problems.

As ASDA require new decision making rules, traditional procedures of public sector will be modified. Split of service provider and purchaser, tendering regulations make public decisions more transparent. Public money should be spent on clearly defined purposes, so there is greater chance for public control. This will also increase the accountability of elected bodies.

Very often alternative service production is used for sectors with high capital needs. Lack of public funds for long term investments raises the claim for other sources of financing. Capital projects need additional sources, which can be more easily raised in the private sector. If capital investment projects are separated from other elements of public activities and potential sources of financing of the investment can be controlled, then more capital will flow into that service.

There are other minor positive consequences of ASDA and modified procedures on other aspects of services. For example performance indicators and planned level of services will be more precisely defined. This will support public decisions, as the relationship between the administrative staff and the elected bodies will be more balanced. Operation of councils and representative bodies will be less dependent on the administration.

In each CEE countries the traditional methods of public service delivery has to be renewed. Public sector reform is a fundamental requirement of economic development, as no high public expenditures under the former organizational and management systems can be financed. In this long process of reforming deeply rooted public services, "achievements" of the socialist era the alternative service delivery arrangements play a key role. First of all they work as substitutes of the traditional public services. But also these service mechanisms give
alternative solutions of service management for the public sector, which is under heavy fiscal stress. Restrictive fiscal policy cannot be implemented without introducing new and efficient forms of service delivery.

*Arguments against ASDA*

The most frequent argument is the *lower safety* of public services. The client public body will lose the direct influence over the service producer. This factor might be counterbalanced with various techniques in a properly designed tendering and monitoring procedure. The service area can be divided among several equal contractors, performance bonds might be required and continuous control over the service producer might help to avoid bankruptcies.

Some *costs might be increased* when alternative service delivery arrangements are introduced. Tendering, monitoring of the service or potential modification of the service require additional funds, which will be a new burden on the service provider. These additional costs should be compared with savings on service expenditures and the achieved higher level of services.

Any contracts with non-public service producers will have an influence on the *client's assets*. This deterioration of machinery and equipment is a real loss for the client, which should be planned in the process of introducing ASDA. There are some methods, which help to decrease these losses, by compulsory rent, lease or sale of these assets by the future contractor.

As it was mentioned among the requirements for using ASDA, *organizational* and *managerial* conditions are very important for introducing alternative methods. Changes in the administration and adaptation of new procedures in planning and decision making on services require new efforts both at the level of politicians and the public employees.

In the *voluntary sector* there are some factors, which hinder the development of these organizations. As they were quoted earlier voluntary failure also exist. The insufficiency of these services, particularism and lack of professional skills are the known dangers of this sector.

All the arguments for and against these service delivery arrangements should be carefully measured and the balance of these factors must be evaluated in each individual organizational form and at every sector. At this stage of public sector transformation under the emerging market environment and at this level of the civil society development, there is a need for new service delivery mechanisms, which provide alternative solutions to the old unmanageable problems.
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LGTB, 1989: A Local Authority's Options for Service Delivery. Luton, Great-Britain.
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Case Study

The 1% Laws in Hungary and the Czech Republic

1. Private discretion on 1% of PIT for public purposes in Hungary

Personal income tax (PIT) is the second largest revenue item in the national budget. According to the estimates for 1996 HUF 480 Billion (US$ 2.8 Billion) will be collected by the tax administration. From this year on the individual taxpayer has the right to allocate 1% of his/her actually paid PIT for public purposes. This new law on tax allocation will provide additional sources for non-profit organizations. Free democrats (liberals in Hungary), who have initiated this legislation, emphasize that another advantage of this technique, that it will give greater say to individual taxpayer in influencing public spending.

The act on tax allocation defines the strict criteria of public purposes and organizations eligible for these donations. They are
1. public activities and religious education of churches, registered for more than three years;
2. non-governmental organizations (excluding political parties, lobbying organizations), foundations being registered for more than three years with defined activities for more than a year;
3. public foundations;
4. selected national museums and cultural institutions;
5. Hungarian Academy of Sciences;
6. government funded programs (e.g. for technical innovations, academic research, adult education);
7. theaters, museums, cultural institutions, granted by local governments within the last three years.

Preferred activities for items 2. and 3. are health care, welfare, education, cultural, research; assistance to children, youngsters, elderly, disabled; grants to national and ethnic minorities; environmental protection, youth protection, traffic safety, civil rights, public order, child and youth sport; sport for disabled. These organizations and foundations should be politically neutral ones, that is they do not get any support from political parties, they did not support any MP candidates and have no public debt (national and local taxes, social security fees, duties).

1% of PIT is administered with the annual tax declaration. These transfers are especially carefully managed, the coding systems allows only the tax authority to combine the information on the taxpayer and the selected organization. The estimated administrative costs are 5% of the potential transfer. The granted institution should publicly report on the use of the transfer.

This act was heavily discussed in the Parliament and by the public. The strongest argument against the 1% PIT transfer was, that only large organizations will benefit, as they have resources to advertise. The expected revenues for national museums and cultural institutions are very low, compared to their budget. The Catholic church, largest one in Hungary was also an opponent of this financial technique. The argument used by the church was, that they were worried by potentially decreasing regular national budget grants, if the they got significant amount of transfers.
Act No. CXXVI. of 1996 on using 1% of personal income tax for public purposes, Hungary.

2. Transferring 1% of funds accumulated in state privatization

Since 1991 the Czech government set aside 1% of privatization revenues for the non-profit sector. Due to political discussions they were not able to allocate this amount to NGOs till 1996, when the government designed three optional methods for distributing this $ 66 million:

- **flat distribution**: this simple method allocates equal sum of funds to each existing foundations. This option is not seriously supported by any parties, as it would give too small amount to the individual non-profit organizations;
- **selecting a number of foundations**: only a limited number of foundations would receive the funds, which would create new conflicts, as the entire NGO sector is eligible to these funds;
- **decentralizing the allocation**: one or several new foundations would be established to allocate the available funds for the non-profit organizations. The tricky part of this proposal is how the boards of these foundations will be set up, how they will resist to political pressures from the parties.

Criteria for Assessing Service Delivery

1. Assisting the municipality to understand the service needs
   How far can the local government continue to generate the information, that helps it understand, define and respond to the needs of its community?

2. Ensuring realistic economy and efficiency
   Can the local government ensure realistic levels of economy and efficiency through the service contract?

3. Delivering effective, quality service
   Can the client local government ensure that the effectiveness and quality of the service is guaranteed?

4. Equality of service delivery
   Can local governments ensure support for and delivery of a fair and equal service?

5. Experience, knowledge and resources for the service
   How much does the service producing organization have knowledge, practices and resources, which will help or hinder the delivery and adaptability of the service?

6. Openness to monitoring
   Can the monitoring processes be made as effective whoever is delivering the service?

7. Directness of accountability and control
   Are the alternative means of service delivery sufficiently accountable to the municipality? Can the control of the service be as effective as an internal or owned organization?

8. Knowledge and experience of the client side
   What knowledge of the locality, work and client function is necessary to effectively provide the service? Can this be communicated to other providing organizations?

9. Flexibility to response
   What situations does the authority face and wish to tackle that require radical flexibility? Are there forms of contract that can be devised to cope with this?

10. Management culture and values
    What are the key values and practices that the municipality wishes to sustain in its delivery of services?

11. Employer concern for staff and their futures
    What future for the staff involved can be explored and guaranteed by the local government?

12. Local government and staff capacity to make the change
    How willing is the municipality to support the transition into other organizational form? How capable are the staff of managing the change?

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3 LGTB, 1989: A Local Authority’s Options for Service Delivery. Local Government Training Board, Luton, UK
Table 1.

Alternative Service Delivery Arrangements

**Service provider**

**Grantor, financing organization**

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**Consumer**

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**Service producer**

**flow of money, order**

**regulation**

**services**
Table 2.

Characteristics of goods and services

<table>
<thead>
<tr>
<th>Characteristics of goods and services</th>
<th>Excludability</th>
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<tbody>
<tr>
<td></td>
<td>Feasible</td>
</tr>
<tr>
<td>Consumption</td>
<td></td>
</tr>
<tr>
<td>Individual</td>
<td>private</td>
</tr>
<tr>
<td>Joint</td>
<td>toll (club)</td>
</tr>
</tbody>
</table>

Based on Savas, 1987 and World Bank, 1994
Table 3.

Models by types of urban services

<table>
<thead>
<tr>
<th>Model of service delivery</th>
<th>Urban services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public supply</td>
<td>Sewerage, refuse disposal</td>
</tr>
<tr>
<td>2. Local (community) supply</td>
<td>Slum improvement, drainage, paths</td>
</tr>
<tr>
<td>3. Licensed competition</td>
<td>Markets, bus transport, taxis</td>
</tr>
<tr>
<td>4. Leasing, franchising</td>
<td>Water supply, gas, electricity, public transport, car parks</td>
</tr>
<tr>
<td>5. Service and management contracts</td>
<td>Refuse collection, road maintenance, vehicle maintenance, billing, construction</td>
</tr>
<tr>
<td>6. Public-private partnership</td>
<td>Land acquisition, infrastructural development with residential and commercial development</td>
</tr>
<tr>
<td>7. Voucher schemes</td>
<td>Education, social services, food, housing</td>
</tr>
<tr>
<td>8. Direct user involvement</td>
<td>Neighbourhood drainage and water systems, area improvement schemes</td>
</tr>
</tbody>
</table>

5 Based on Batley, R., 1992: Cooperation with private and community organisation. DAG, INLOGOV, University of Birmingham