Privatization and the Welfare State

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Privatizing the Delivery of Social Welfare Services: An Idea to Be Taken Seriously

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> Modern philanthropists need to remind themselves of the old definition of greatness: that it consists in the possession of the largest share of the common human qualities and experiences . . . Popular opinion calls him the greatest of Americans who gathered to himself the largest amount of American experience, and who never forgot when he was in Washington how the "crackers" in Kentucky and the pioneers in Illinois thought and felt, striving to retain their thoughts and feelings, and to embody only the mighty will of the "common people."
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> JANE ADDAMS, *A Modern Lear* (1912)

America has always been a reluctant welfare state. Government-sponsored social welfare services emerged in our history later than in many other market-oriented industrial nations, and they still command a smaller proportion of national income (Trattner, 1979; OECD, 1985). Although political leaders in Bismarck's Germany or Lloyd George's England were advocating the principle of public social welfare services before they were affordable or popularly demanded, in the United States officials still apologetically defend them long after they are in place. From Tocqueville's praise of voluntary groups and Thoreau's paean to self-reliance to Ronald Reagan's anecdotes of kindly deeds from neighbor to neighbor, the American emphasis consistently has been on the local, the pluralistic, the voluntary, and the businesslike over the national, the universal, the legally entitled, and the governmental.

This context—in which "publicization" of social welfare services is viewed as the deviation from the norm—helps to explain the current vogue of proposals to privatize social welfare services. The Reagan Administration did not invent the concept. The idea needs to be treated seriously, not because of who currently holds power in Washington, but because of the perennial fascination it has held for American thought and action.

This chapter attempts that serious treatment. It argues that advocates of expanded social welfare services (I count myself in that category) need to dissect the concept of privatization into two constituent parts. They will thereby discover that what they fear from privatization is associated primarily with arrangements under which government delegates both the delivery of services and the raising of funds to finance those services. However, versions of privatization that delegate the former but leave government responsible for the latter do not inflict the same damages. Instead, they render social welfare services in this country compatible with the dominant American ideology in a way that European social statism is not. Furthermore, empirical evidence indicates that privatized systems, appropriately designed, can deliver many social welfare services as effectively as can public ones. Therefore, the paper concludes that the American social welfare system can best be advanced by making pervasive appropriate forms of privatized delivery.

The Two Faces of Privatization

The logic that leads to this conclusion starts with some definitions. Privatization may be defined as shifting into nongovernmental hands some or all roles in producing a good or service that was once publicly produced or might be publicly produced. A diversity of arrangements falls within this broad approach. One recent survey, for example, lists: contracting out, franchises, grants and subsidies, vouchers, volunteers, self help, use of regulatory and taxing authority, encouragement of private organizations to take over an authority, reducing the demand for services, obtaining temporary help from private firms, using fees to adjust demand, and formation of public/private ventures (Hatry, 1983).

In all these approaches, the "retail level" direct delivery of services is achieved through nongovernmental institutions—nonprofit, for-profit, or even (in the case of self-help) recipients themselves. However, the arrangements fall into two distinct categories along a second dimension, which is the degree to which governmental funding supports nongovernmental service delivery. One category, which may be referred to as "governmental load-shedding," encompasses arrangements under which both the means of financing and the means of delivering a service are divorced from government. In contrast, the second—which may be referred to as "empowerment of mediating institutions"—covers arrangements under which government retains some or all responsibility for funding the service while delegating production and delivery. Budget reductions, user fees, volunteers, and reducing the demand for services fall in the first category; vouchers, contracting out, grants and subsidies, and public/private partnerships fall in the second.

This distinction is important, because, under likely projections of the future, the long-term level of public demand diverges sharply between the two governmental roles. Trends in American society suggest a steady and rising demand for collectively financed goods, and yet a long-term and rising opposition to public delivery. This means that approaches in the "empowerment" category are associated with potential growth, whereas approaches in the "load-shedding" category—as well as traditional government-provided social welfare programs—are not.

The Rising Demand for Collectively Funded Social Welfare Goods

Support for this conclusion derives from the basic economic concept that social welfare services are normal economic goods, which consumers regard in the same way they regard any other good or service that is desirable but not free. In particular, as consumers' incomes rise, individual members of American society demand more of these goods, just as they also want more personal consumption goods (for example, video cassette recorders), more leisure time, and more of other collective goods (such as defense). The formal name for this hypothesis is positive income elasticity of demand, and evidence supports the hypothesis. For example, after adjusting for inflation, per capita private charitable giving in the United States increased at slightly more than 3 percent per year from 1955 to 1983 (*Giving USA*, 1984). In the same period, federal government expenditures—of which social welfare activities claimed a large and growing proportion—increased at about 4 percent a year. Both rates of increase substantially outstripped that of per capita income, for which increases averaged slightly more than 2 percent in the same period.

Ironically, the pullback in voter support for public social welfare spending during recent years—as symbolized in Proposition 13 in California and Proposition 2½ in Massachusetts, as well as federal budget cuts during the Reagan Administration—provides further support for this hypothesis. In the 1975 to 1985 period, reductions in public social welfare spending (as well as in other forms of nondefense governmental outlays) coincided with bleak personal income growth for the average American family. Productivity growth in the overall economy stalled during the 1970s, OPEC price rises and other circumstances triggered galloping inflation, and during the early 1980s the economy endured its longest and deepest recession since the Great Depression. All these together resulted in first a stagnation and then a modest reduction in the average family's real income.[1] Cutbacks in voters' willingness to pay for public social welfare programs should therefore have been expected; these cutbacks coincided with reductions in households' consumption across the board, from new cars to vacations to visits to the dentist.

So long as recent reductions in social welfare expenditures reflect considerations of affordability rather than a sea change in generosity, all is well; affordability is something that time will cure. Despite the mediocre economic performance of the 1970s and early 1980s, long-run prospects for the American standard of living remain bright. In the short run, the economy has recovered—at least partially—from the depths of recession. In the longer run, the continuing process of technological advancement—currently symbolized by the proliferation of microchip devices—suggests a rekindling of the long, steady rise of per capita incomes at the rate of 1 or 2 percent a year, which has prevailed historically (Hulten and Sawhill, 1984). This rise, when mediated by the positive income elasticity of demand previously discussed, should provide a moderate but continuing increase in resources for social welfare services.

Discontent with Public Sector Delivery

The long-term increase in resources for social welfare services could be derailed, of course, if the American citizenry were turned against social welfare services by other considerations. Recent developments in voter attitudes and behavior suggest just such a danger, in the form of widespread distrust, discomfort, and loss of faith in the public sector.

Survey research repeatedly uncovers substantial mistrust of government, a mistrust encompassing both public-sector motives and public-sector competence (Ladd, 1984). When a sample of citizens was asked what proportion of each tax dollar they believe the federal government wastes, the median response was \$.48 (Kelman, 1985). Another survey probed the level of public confidence in various major American institutions, and found that only 19 percent of respondents expressed great confidence in the executive branch of the federal government—a figure half as high as for business corporations or local United Ways and one-third as high as for medicine and institutions of higher education (U.S. Senate, 1973). Since at least the early 1970s, the number of survey respondents who favored a decrease in government services and taxes has consistently outnumbered those advocating an increase by four to one (Goodman, 1983).

[1] For a synopsis of these developments, see Hulten and Sawhill (1984). A further illustration of the same process is provided by the case of "yuppies"—today's young urban professionals whose alleged selfishness led them to support President Reagan and reduced public spending despite their affluence. Statistical analysis reveals that the current generation of persons in their twenties and thirties are generally less affluent than were their parents at comparable stages in their lives, and that therefore their lower levels of support for governmental social welfare measures can be explained as lack of income rather than a lower level of idealism or generosity. See Levy and Michel (1984).

The same discontent is signaled more directly in voting patterns. The American electorate who selected Ronald Reagan had previously favored Jimmy Carter, who also ran against the Washington establishment. The political advantages of incumbency, formerly much cited by political scientists, have in recent elections proved to be liabilities.

Of course, anti-government attitudes in America are more deeply rooted and permanent than these references to the latest election results or public opinion polls suggest. Rejection of public tyranny was the act that led to the founding of the nation. Concern with limiting government dominated the development of the American Constitution, with its system of separation of powers and explicit Bill of Rights. The preservation of cultural, economic, and political pluralism has been a perennial theme in both American law and American thought—starting with the constitutional protection of states' sovereignty, extending through such historic events as the bending of draft laws to accommodate religious objectors and of public school laws to accommodate conservative religious sects, and continuing currently in developments such as bilingual education and neighborhood school districts.

A second tradition in American thought reinforces our national reluctance to turn to the public sector to solve societal problems—belief in individual initiative and the allocation of rewards to those who work to earn them (Hofstadter, 1955). When we are faced with community problems, this tradition conditions us to turn not to distant government for solutions, but to personal voluntarism and community self-help organizations. Starting with Tocqueville's famous discussion of the "principle of association" in American life in the 1830s, the origins of this approach have been attributed to reliance on volunteer groups of neighbors among pioneers settling the American frontier (Schambra, 1982).

I do not cite these hoary traditions to imply that social arrangements never do change or never should change. My point is that as societal needs evolve and new societal arrangements must be constructed, those arrangements should conform to the response style that a society has consistently favored.

Given such a consistent pattern of anti-government bias in the American response style, it is unfortunate that much of American social policy has looked to Europe for models of both specific programs and general approaches. Reflecting political, social, economic, and intellectual circumstances very different from those in the United States, most European nations have evolved an approach to social welfare services that is strongly state centered.[2] The American nation was formed in revolt against tyranny. European nation-states typically emerged when central governments imposed national unity on independent feudal states. Although class conflict has bred significant voting support in Europe for socialist and semisocialist political parties, the comparable portion of the political spectrum virtually does not exist in the United States. From such historical roots grew European political systems—and social welfare systems—in which government was simply presumed to be the logical instrument for meeting community needs.

When presented explicitly to the American public, the European welfare state approach has won few adherents outside academic circles. Consider, for example, the political drubbing of George McGovern in the 1972 presidential race, resulting in no small part from the public's swift rejection of his proposed guaranteed annual income "demogrant." Other examples include the recurrent failure of the political process to provide comprehensive national health insurance and the chronic absence of a children's allowance in the American system. In contrast, legislative and public support for successful American social welfare initiatives has been mobilized by deemphasizing their governmental nature and pretending that they conformed to more traditional American values. The characterization of Social Security retirement benefits as insurance rather than income transfers is the most prominent example; the practice of justifying social services for low-income families in the name of preparation for self-support is another.

The Dilemma of Public Goods Provision

Why did we link social welfare services to the public sector in the first place? The explanation may be found by reference to another concept from economic theory, that of "public goods" and their undersupply by the private, for-profit markets (Olson, 1965).

Economists define a public good as one that confers consumption benefits on a number of individuals simultaneously. A private good—such as a candy bar—is consumed by me alone, but the national defense protects the whole nation at the same time. So, too, social welfare programs benefit a range of persons simultaneously. Donations to a charitable cause benefit not only the donor and the recipient, but also other concerned citizens.

Economists argue that private, profit-seeking markets will produce the

[2] Partial exceptions may be observed in the Federal Republic of Germany and the Netherlands, where delivery of social welfare services through private nonprofit agencies is the norm.

socially efficient quantity of private goods, such as candy bars, by responding to consumer demand. But public goods present special problems in accumulating consumer demand to provide a market for profit-seeking producers. Although I benefit from your charitable donation, you have no way to make me pay for that benefit. If I behave in a selfish and rational manner—which is what economists assume—then I maximize my well-being by playing the "free rider" on your charitable behavior—enjoying the benefit without contributing anything myself. But then, you would reason the same way and not make your donation. Thus, the private market will have little or no effective demand to respond to by producing public goods, even though substantial actual demand is going unsatisfied.

Faced with this dilemma, economists traditionally suggest compulsory taxation as the only way to accumulate your and my demand for public goods and thereby to assure their production in socially desired quantities. This is the basic logic behind assigning public goods—including social welfare services—to the governmental sector.

Of course, moving from economic theory to the real world, we observe that the provision of public goods outside of government is not zero. Nonprofit institutions—such as private charities—operate in the United States on the scale of many billions of dollars per year (Weisbrod, 1977). Nevertheless, there are real limitations to nongovernmental arrangements for funding public goods such as social welfare services, and that multi-billion-dollar scale may be assumed to underrepresent society's full demand for those services.

To make matters worse, the fund-raising difficulties that handicap the nongovernmental financing of social welfare services as public goods are growing over time, reflecting major social and economic trends in the late twentieth century. At the root of these growing difficulties is that the success of nongovernmental, nonprofit fund-raising is typically dependent on personal relationships. A sense of personal identification between donor and donee helps to overcome the rational tendency to play the free rider. So does peer pressure among donors. Thus, the more close-knit and homogeneous the society, the more successful fund-raising is likely to be. But modern community life is increasingly impersonal and heterogeneous. We no longer live in small, scattered frontier settlements and join together in neighborhood barn raisings such as those Tocqueville observed. Most of the American population lives in urban areas with relatively little face-to-face contact with the majority of fellow community members. A high rate of geographic mobility means that relatively few of us live in communities to which we have lifelong ties. Perhaps most tellingly, there is an ever-increasing divergence in personal characteristics between recipients of social welfare services and potential donors, particularly along dimensions such as race. In such circumstances, charitable acts tend to become less self-motivating; direct personal contact and personal identification give way to impersonal acts, such as writing a check to an institutional cause. These are precisely the circumstances where the free-rider problem operates most virulently.

Another fact influencing the level of donations—particularly those of in-kind volunteer time—is demographics. Future levels of volunteer time may be expected to be affected adversely by the shrinking proportion of the American population in categories that traditionally contribute disproportionate amounts of volunteer effort. The youth population (age 15 to 19) in the year 2000 is projected to be only 7.1 percent of the national population, down from 9.3 percent in 1980; working-age females not employed outside the home are projected to decline to 16 percent from 17.1 percent in 1980; and the younger retired population (age 65 through 74) is projected to fall to 6.6 percent from 6.9 percent in 1980.[3]

The upshot of these considerations is that, throughout the last years of the twentieth century, the absolute level of resources generated privately for public-regarding purposes such as social welfare will probably increase modestly, but the relative ability of such activities to fund themselves will continually decrease. Voluntarily financed provision of social welfare services will continue to play some role in the American system of social problem-solving, but a gradually decreasing one.

Load-shedding under the Reagan Administration

From this set of circumstances comes terror on the part of advocates of social welfare services in the face of much of Ronald Reagan's rhetoric about private-sector initiatives. Reagan's dominant approach to privatization can appropriately be placed within the category of load-shedding—that is, turning over to the private sector both the delivery and the financing of social welfare services.

Among several bits of evidence supporting the characterization in the previous paragraph, the most straightforward is that President Reagan's public statements on the subject have consistently praised private projects that provide the type of services for which federal funds simultaneously were being substantially cut—by 38 percent over a three-year period in a sample I examined in an earlier paper (Bendick and Levinson, 1984). More to the point, his cuts in programs in which the government acted to empower private service deliverers have been as deep as those in pro-

[3] See Bendick and Levinson (1984). That reference also discusses parallel changes in the business community, which is another important source of charitable giving.

grams in which government both financed and delivered services. Examples of these "empowerment" programs include the federal agency Action (which provides technical assistance, training, research and development, publicity, and other services in support of such volunteer-based programs as Foster Grandparents, Young Volunteers in Action, and Volunteers in Service to America); the Urban Development Action Grant program (which provides financial subsidies to make private inner-city economic redevelopment commercially feasible); postal subsidies for nonprofit organizations (which are central to nonprofit fund-raising efforts); and federal financing to encourage private adoptions in place of publicly supervised foster care.

Unfortunately, privatization in the sense of load-shedding is equivalent to a reduction in the quantity of service provided. There is simply no way that private sector initiatives will voluntarily replace the funding removed by these cuts.

This point was well illustrated in an Urban Institute study of the financial support given nonprofit organizations such as hospitals, universities, social service agencies, and neighborhood organizations (Salamon and Abramson, 1982). The study estimated that such organizations stood to lose approximately $33 million in federal support over fiscal years 1982 to 1985, if President Reagan's then-current budget proposals had been adopted. To maintain current service levels, private giving would have had to grow over that period at a rate of 30 to 40 percent per year, three times more rapidly than it had grown over the previous several decades. At the same time, if these organizations were to expand to fill gaps in services left by an additional $115 billion in proposed cuts in federal programs in the same fields, it would have been necessary for private giving approximately to double during these years, a rate eight times greater than the highest rate of growth ever experienced. The likelihood of that occurring is slim.

Load-shedding would not only result in substantial reductions in the total quantity of social welfare services but would also generate adverse effects in terms of the nature and distribution of those services.

One problem arises in matching needs and resources over time and space. As discussed earlier, private charitable donations drop during a recession—just at the moment when the need for social welfare services grows along with the unemployment rate. Similarly, volunteers are most plentiful in affluent suburbs, while social welfare needs are most abundant in low-income, inner-city locales. The federal government can run a countercyclical deficit to expand its expenditures during recession and also can redistribute resources from affluent areas to poor areas. Nonprofit sources of funds typically are not well situated to do either.

A further problem with reliance on nonprofit fund-raising arises in the form of differences in values or culture between donors and recipients. Affluent donors often set different priorities in how resources are to be spent than do low-income recipients.[4] Thus, for example, corporations are more likely to fund a program to bring low-income children to hear the symphony than they are to fund a low-income community advocacy agency, whereas the preferences of the low-income community might well be the reverse.

Furthermore, in typical public programs, if a recipient can demonstrate eligibility for assistance, then he or she is legally entitled either to benefits or at least to due process and the absence of discrimination in competition for benefits. Privately financed programs, in contrast, more typically take the legal form of gifts, so that if a recipient behaves in some manner of which the donor disapproves, withholding assistance offers a powerful means of coercion. President Reagan's speeches frequently describe a world in which an indigent individual might depend on a volunteer doctor for medical services, a local church for food assistance, and a corporation for a college scholarship. The potential loss of individual freedom and dignity in such situations is substantial.

In sum, governmental load-shedding in social welfare services—such as that in which the Reagan Administration has engaged—is potentially disastrous from the point of view of meeting urgent social welfare needs. The total quantity of services, their targeting, and their effectiveness are all at risk.

The Efficiency of For-Profit Service Delivery

But suppose that we separate the two aspects of the provision of goods and services—financing and delivery. Do these dire predictions for privatized financing extend to programs involving public financing but privatized delivery—arrangements labeled "empowerment of mediating institutions" earlier in this chapter? To answer this question, I turn to empirical studies of what differences delivery systems make, starting with arrangements that utilize the profit-seeking private sector.[5]

Contracting

Consider, to begin, what is in many senses the simplest privatization arrangement—contracting out. Much of the impetus for for-profit contracting out of social welfare services comes from the analogy to government contracting in general, where it is in fairly widespread use. A 1973

[4] See Brown (1984); Bendick (1978); Bendick and Levinson (1983).

[5] This section draws heavily on my earlier paper: Bendick (1982b).

survey of more than two thousand municipalities, for example, found that each of twenty-six types of public services were contracted out by at least 1 percent of sampled cities, and four types of services—refuse collection, street lighting, electricity supply, and engineering services—were contracted out by more than 10 percent of cities (Kirlin, Ries, and Sonenblum, 1977).

Minimizing cost is the usual reason cited for the use of privatization in such cases. The potential for cost savings is seen as arising from several sources: competition among firms that may create pressure for efficiency not present in a monopoly municipal department; a relative freedom from "red tape" and other procedural constraints; and the ability of private firms to hire, fire, compensate, and therefore motivate and utilize workers with greater flexibility than can government departments constrained both by civil service rules and strong unions.[6]

Empirical experience generally supports these contentions. When controlled evaluations have been undertaken, verifiable cost savings were observed, if not universally, more often than not. For example, in refuse collection, two independent studies have estimated cost saving at about 25 percent (Savas, 1982). A 1981 survey found that 69 percent of local governments in California reported that contracting out led to reduced costs, while only 17 percent reported increased costs. The survey also revealed that 41 percent of the municipalities indicated service quality improved under the contracting arrangement, as opposed to 18 percent noting poorer service quality (Hatry, 1983).

In extrapolating from these generally favorable findings to social welfare services, it is important to note the nature of the services encompassed within this pool of experience. Contracted-out municipal functions are predominantly straightforward, immediate, measurable, amenable to monitoring, and technical in nature—such as refuse collection, data processing, and streetlight maintenance. As one moves from such examples to (relatively rare) examples of contracting out for the more complex, undefinable, long-range and "subjective" services characteristic of the social welfare field, the record of successful experience rapidly thins.

One interesting example is provided by the growing phenomenon of privatized correctional services. The for-profit private sector has long occupied a small role in the operation of detention facilities in such forms as contracted-out laundry or food services. Nonprofit agencies have also

[6] On the other hand, costs could increase in a contracting-out arrangement if the administrative costs of letting and monitoring contracts are large; if private bidders are so few that little competitive pressure exists; if union, civil service, or other constraints prevent the public agency from reducing its own labor force and costs when some functions are contracted out; or if corruption arises in the contracting process.

been active in providing juvenile housing and remedial treatment. However, a dramatic expansion of these roles is now being attempted in the form of contracting out the entire operation of adult correctional facilities to for-profit corporations. Currently, about two dozen privatized detention centers exist in the United States, and the number is expected to double in the next two years.[7]

As with the previous examples, the main benefit of privatization in correctional services seems to be that of saving time and money. For example, a private detention center run by the Corrections Corporation of America for the Immigration and Naturalization Service (INS) was built in six months, whereas officials estimate that construction within the public sector would have required five years. Once in operation, the facility charges the INS $23.84 per inmate-day, a figure 10 percent lower than the $26.48 average cost in the INS's own facilities.

How are these cost savings achieved? Part of the answer seems to be found in ways that do not directly affect inmate welfare. For example, staff compensation paid by the corporation averages $500 per year lower than the comparable federal civil service scales, and employee benefits are more limited. Other sources of saving, however, may be assumed to be more at the expense of the "quality" of jail services experienced by inmates. For example, the Corrections Corporation of America provides each employee with 160 hours of training, most of it on the job; each federal jail employee receives 240 hours of formal full-time training before commencing work. Other services, such as a resident psychiatrist, are also less common in privatized facilities.

Parallel outcomes were observed in the largest single experience with contracting out for the delivery of complex human services—experiments with educational performance contracting during the early 1970s (Gramlich and Koshel, 1975). The concept is to delegate classroom instruction in regular public elementary and secondary schools to for-profit firms, allowing these firms considerable freedom in instructional methods. Typically, contractors implemented a variety of proprietary learning systems, computerized instruction, incentive pay to students, and other techniques not in widespread use in public schools. The firms were compensated not on the basis of costs, but on the basis of students' educational gains as measured on standardized achievement tests.

More than one hundred school districts experimented briefly with educational performance contracts using their own funds, and the federal government financed a more carefully controlled study in twenty localities. The experience was universally disappointing. In the controlled studies, test scores in subjects for which firms were paid showed only modest

[7] This information and that in the following paragraphs are drawn from "Trends in Private Jails—Controversy Breeds Studies," *Urban Outlook* 7 (March 15, 1985): 1–3.

gains (for example, about 7 percent in language and mathematics). At the same time, scores fell in subjects for which firms were not paid. Consistent with these results, none of the participating school districts chose to renew their contracts, the private firms lost money, and relations between contractors and school boards often closed on an acrimonious note.

Vouchers

Moving from contracting arrangements for the privatization of service delivery to the use of vouchers makes the situation even more problematic. In the context of public programs, a voucher may be defined as a transfer of income to a citizen to enhance that person's ability to purchase a specified type of good or service. The rationale for using vouchers instead of unrestricted cash transfers is that taxpayers wish to restrict the use of their donations to activities they approve of. The rationale for using vouchers instead of direct governmental provision of the good or service is, first, that recipients should be allowed some consumer choice among goods or services within the eligible category, and, second, that goods can be provided at lower cost.

One recent demonstration program illustrates both the strengths and the weaknesses of the voucher approach. The Experimental Housing Allowance Program (EHAP) was a social experiment (complete with control group) conducted with 30,000 households in twelve cities during the 1970s.[8] Housing allowances—vouchers intended to increase housing consumption by low-income families—were being proposed as an alternative to direct governmental provision of housing, such as in public housing projects.

On questions of housing costs and housing quality, the empirical findings of EHAP were encouraging. For example, the average cost of providing a standard quality two-bedroom housing unit in Pittsburgh in 1974 was estimated to be $4,155 a year for units provided through government-operated public housing. A comparable unit provided by the private market and paid for by a housing allowance cost $1,869 annually, only 45 percent as much. Low-income families generally proved to be efficient shoppers, obtaining good value for their money and needing little assistance in searching for or negotiating for units. Landlords proved generally cooperative, and no major supply bottlenecks or price inflation was evident. Control of the program could be maintained for relatively modest administrative costs (between 10 and 20 percent of total program costs). At least in the majority of housing markets, vouchers seemed better for everyone—taxpayers, recipients, and housing suppliers—than public construction and operation of low-income housing.

[8] The following discussion is based on Bendick (1982c); and Struyk and Bendick (1982).

While housing vouchers thus seem a success in terms of cost, efficiency, and straightforward aspects of housing quality, the story becomes more complex and the lessons more cautionary when other program objectives are considered. The reason housing vouchers were provided rather than cash was that taxpayers wished the additional purchasing power to be used only for housing. In practice, recipients elected primarily to substitute their vouchers for money they were already spending on rent and thus, in effect, to divert their new income to other uses. Only about 20 percent of the face value of vouchers went toward increased housing expenditures. This substitution was legal. The nonhousing uses made of the money often were of the sort that taxpayers might approve (additional food, clothing, and medical and dental care, for example); nevertheless, the objective of controlling recipient behavior was not achieved.

The principle this example illustrates is that provision of social welfare services through the voucher mechanism is a double-edged sword. On the one hand, harnessing the efficiency of private markets may lead to lower costs, better quality, or both. On the other hand, the more consumer control is given to voucher recipients, the less taxpayers are able to impose their own preferences on the behavior of recipients. Use of the private market through vouchers may thus be efficient in narrow terms but ineffective in more ambitious terms.

The housing voucher experience is not an isolated example. Other voucher experiences follow a parallel pattern. For example, the Special Supplementary Food Program for Women, Infants, and Children (WIC) provides a limited range of nutritious foods to low-income pregnant women, nursing mothers, infants, and young children. Distribution of these foods via vouchers at commercial grocery stores costs about 10 percent less than distributing foods at public health clinics. But the voucher system provides less control in restricting foods to allowable items rather than more popular but less nutritious ones, and it also is less successful in linking recipients and their families into the health care system (Bendick, 1978).

Similarly, on the one hand, it has been estimated that health care can be delivered by private physicians working on a fee-for-service basis at about 40 percent less cost than by government physicians working in the National Health Service Corps. On the other hand, Corps physicians have been successfully placed in medically underserved areas that were unable to attract private physicians even with voucher (Medicaid, Medicare, and other) funding available (Hadley, 1980).

Subsidies

This limited ability of privatized systems to tackle the most difficult cases or to pursue the most complex objectives is also typical of the experience of many subsidy-type privatization initiatives. The concept behind such programs is to provide profit opportunities to private firms by subsidizing some of their production inputs—those the governmental sector would like to see employed. Two major examples of such initiatives are wage subsidies to encourage the hiring of disadvantaged workers and capital subsidies to encourage firms to locate plants in economically distressed locales.

The premise is that providing subsidies to encourage private employers to hire hard-to-employ workers is a cost-effective alternative to having these workers idle and dependent on unemployment insurance or public assistance and that it is preferable to creating public-sector jobs through programs such as the Depression-era Civilian Conservation Corps or the more recent Public Service Employment Program under the Comprehensive Employment and Training Act.

The most current experience with a large-scale wage subsidy program is that of the federal Targeted Jobs Tax Credit (TJTC). Under TJTC, private firms can claim a credit against corporate income tax liabilities for up to $4,500 in wages paid to workers hired from such difficult-to-employ groups as ex-convicts, welfare recipients, the handicapped, and disadvantaged youth. The objective is to expand employment opportunities for these groups by making them relatively cheap compared to other workers and compared to the purchase of capital equipment that will substitute for labor.

Despite the generous size of the subsidy and extensive (although spotty) efforts to advertise the program, the response of the business community has been persistently disappointing. Only a small proportion of firms participate, and credits are claimed for only a small proportion of potentially subsidized workers. More significantly, about two-thirds of the claims filed are retroactive in the sense that firms hire workers without determining whether they are TJTC-eligible and then later have them certified. In such circumstances, it is presumed that the subsidy had no effect on the hiring decision (Ripley et al., 1982).

There are many reasons why employers are reluctant to participate in this program, but they can all be summarized by saying that the employers evidently feel the costs outweigh even a relatively generous subsidy. Employers may fear employees who may be unreliable, unproductive, or even disruptive (for example, ghetto teenagers). They may also anticipate extra training or supervisory costs, or union opposition. In some cases, these fears may be justified; even when they are not, they are difficult to overcome. Even larger subsidies—of which both the political and budgetary feasibility are questionable—would probably face similar unresponsiveness.

Parallel patterns of business unresponsiveness are characteristic of state, local, and federal experience with programs to encourage businesses to locate in economically distressed locales. Virtually every one of the fifty states uses a rich variety of economic development incentives to solicit new businesses in such locations and to retain and encourage expansion of existing firms. These include interest-subsidized industrial revenue bonds; tax exemptions, credits, or moratoriums; and free or below-market provision of goods and services ranging from prepared plant sites to worker training. Many local governments (often using federal funds such as Urban Development Action Grants) have become financial partners in new business ventures located in decayed parts of their cities.

The general experience with such incentives has been that their cost-effectiveness in eliciting significant change in business behavior is low. For one thing, when states and localities offer competing incentives, competitors' offers cancel each other. Then too, many of the incentives are badly designed, offering firms little value per dollar of costs borne by government (Rasmussen, Bendick, and Ledebur, 1982). But most important, in making locational decisions, firms typically are much more concerned with the production costs, risks, and convenience of a location than with special incentives. No special incentives will overcome the perceived disadvantages, for example, of an inner-city plant site that is too small to allow construction of a modern, single-story industrial building; that does not offer sufficient safety for employees, goods, or facilities; or is too far from the firm's markets, raw materials, or specialized labor pool (Bendick and Rasmussen, 1985; Schmenner, 1981). Little evidence is available to show significant amounts of job development in declining regions or distressed inner cities as a result of extensive federal, state, and local attempts at industrial location incentives (Bendick, 1982a).

These examples illustrate that economically distressed locations and hard-to-employ job seekers that for-profit firms have largely chosen to abandon are not made easily attractive. Their real or perceived drawbacks are substantial, so the size of an effective compensatory incentive would have to be quite large. Finding efficient ways to provide such subsidies is not easy, and many firms will not cooperate even when offered generous incentives. Privatization offers no simple solutions to problems that have proved resistant to public programs.

Designing Programs for For-Profit Privatization

From all this we may conclude that, in terms of efficiency gains in a simple productivity-enhancing or cost-cutting sense, for-profit privatization has only a modestly impressive record. It does a somewhat more efficient job in simple cases where goals are neatly specifiable and amenable to monitoring; it does not produce noticeably better or worse results than public provision when problems are complex—as is typical for many social welfare programs, where program goals are often ambitious and production processes not well understood.

This conclusion suggests two strategies for making more extensive use of for-profit providers in the delivery of publicly financed social welfare services.

The first is to examine each social welfare program in terms of the feasibility of specifying performance standards and goals. Only those programs or activities amenable to explicit, arms-length monitoring and control should be selected for such privatization. In some cases, an entire program may fall within this category. For example, many low-income housing rehabilitation programs have been successfully contracted out to private building contractors. For many other social welfare programs, however, only certain program activities can be readily delegated. Currently, the potential for contracting out activities within programs is greatly underexploited. For example, the Basic Educational Opportunity Grants program has used a private computer contractor to process applications for income-conditioned student financial assistance. Why could eligibility determination not be similarly contracted out for Food Stamps, Aid to Families with Dependent Children (AFDC), and other public assistance programs?

An alternative strategy for preparing to privatize service delivery is to alter the design of programs themselves, simplifying their structure and goals so that they become more readily monitored and managed. I believe that such modifications would also improve the effectiveness of many programs. For example, in my judgment, eliminating discretionary special needs payments and detailed budgeting would improve both the administrative efficiency and the equity of public assistance programs such as AFDC (Bendick, 1980; Bendick, 1986). Similarly, in my opinion, attempts to constrain how recipients of in-kind programs use program benefits are counterproductive (Bendick, 1978). However, not all persons concerned with social welfare policy share these opinions. The net effect of this consideration, therefore, should be to make the social welfare community reexamine the value of program complexities and explicitly to defend their necessity when it truly exists.

The Efficiency of Nonprofit Delivery

Yet another strategy for privatization of social welfare programs having goals that are inherently complex is to turn to the nonprofit sector. Research indicates that nonprofit service deliverers have a distinctly better record than for-profit firms in providing services in the interest of clients beyond what is precisely specifiable in contracts. For example, a recent examination of regulatory records in the state of Wisconsin revealed that complaints are lodged against for-profit nursing homes at a significantly higher rate than against either governmental or nonprofit homes. Similarly, a 1976 survey was conducted among family members concerning the care their institutionalized relatives were receiving in nursing homes, psychiatric facilities, and facilities for the mentally handicapped. They consistently expressed higher levels of satisfaction with governmental and nonprofit institutions than with for-profit ones (Weisbrod, 1983).

For such reasons, the use of nonprofit contractors to deliver social welfare services has precedents going back well into the nineteenth century. It has proliferated into a major approach in recent decades. Church-based social welfare agencies place and supervise children in publicly financed foster care; disadvantaged workers are trained for employment opportunities under government contracts to community-based organizations such as the Urban League; federal contracts for social welfare research are awarded to nonprofit universities; and patients are cared for in nonprofit hospitals with their bills paid by Medicaid or Medicare. In fiscal year 1980, federal support accounted for 58 percent of total revenues for nonprofit social service agencies (Salamon and Abramson, 1982). In 1979, purchase of services was estimated to consume 55 percent of expenditures in publicly financed personal social services (Hatry and Durman, 1985).

Those who advocate service delivery through the nonprofit sector usually argue that delivery will be both more efficient (provided at a lower cost) and more compassionate and effective. Innovation in private efforts, the absence of expensive and unnecessary bureaucracy, the ability to identify accurately the "truly needy" through local or personal knowledge, the utilization of "costless" volunteers or donated materials, and the managerial expertise of the private sector—all these usually are seen as contributing to these results.

Rigorous comparisons between nonprofit delivery and public sector delivery in terms of production efficiency are relatively scarce. One of the few recent studies on this subject compared state agencies and United Way agencies in terms of their implementation of the Emergency Food and Shelter Program created during the 1981–1982 recession to supplement ongoing food and shelter assistance programs for the unemployed. The two modes of delivery proved equally satisfactory in terms of program quality, targeting, and costs, but United Way programs were implemented more rapidly than counterpart state-run systems (Burt and Burbridge, 1985).

In many cases, however, such direct comparisons of cost or efficiency are largely beside the point. The major objective in using nonprofit channels is not to be more efficient in delivering a service that could be delivered in any case, but rather to reach clients or to fulfill roles that a public agency could not serve at all. For example, ethnically based nonprofit refugee groups can sometimes deliver services to new immigrants in culturally relevant styles that are difficult for public agencies to adopt. In response to a recent survey among fifty-five social service agencies in the San Francisco Bay area, approximately as often as they listed cost savings, agency directors listed flexibility, the availability of specialized expertise, and the ability to reach difficult-to-reach clientele as major advantages in contracting with nonprofit agencies (Terrell and Kramer, 1984).

The same idea has been espoused as a general approach to delivery of public services by the American Enterprise Institute under the rubric of "mediating structures." These structures are various community-based, grass-roots institutions such as neighborhoods, families, churches, and voluntary associations. Through their small scale, nonbureaucratic nature, local knowledge, and personal relationships, they can respond rapidly, accurately, and in a more acceptable manner to local and individual needs in ways that large, formal institutions such as government agencies cannot (Berger and Newhaus, 1977; Meyer, 1982). It is perhaps not always realistic to assume that nonprofit institutions can simultaneously remain as local and personal as the American Enterprise Institute envisions and also perform effectively and professionally in the purchase of service business. Nevertheless, the grain of truth remains relevant.

In summary, though empirical evidence is far from abundant, we are probably safe in concluding that nonprofit privatization is a feasible approach to the delivery of many complex social welfare services for which for-profit privatization would be risky because of the inability to specify precisely program goals and performance standards. Some efficiency gains might be achieved by empowering nonprofit mediating institutions as the delivery system; but, whether or not efficiency is enhanced, we can expect gains in service targeting and quality.

The Interaction of Delivery with Financing

But why, you may ask, do I give the benefit of the doubt to privatization? The record just reviewed in terms of efficiency—which was what got discussions of privatization started—suggests gains are not nonexistent but neither are they overwhelming. Why do I persist in suggesting ways to implement it? Is it really worth the bother?

Part of the answer is to be found in those relatively modest potential gains in efficiency just referred to. Even a 5 or 10 percent saving in production costs would represent billions of dollars, given the vast scale of the American social welfare system. Then, too, there are various improvements from the clients' point of view in terms of greater choice, enhanced personal dignity, greater cultural accessibility, and reduced complexity.

But the answer ultimately more important than any of these is that the questions of total quantity and mode of service delivery cannot be separated as I have done so far. History teaches that there is a very strong interaction—one that those who are trying to reduce the total quantity of public social welfare services have recognized in their strategy of privatization through load-shedding. Now is the time for those who seek to preserve and to expand the social welfare system to recognize that, when privatization takes the form of the empowerment of mediating institutions, it can be mobilized to have the opposite effect.

The first step is to unlink the popular charitable instinct from the politically unpopular governmental establishment. Analysts commenting on public opinion data frequently refer to what they consider a paradox—that in response to one set of questions, citizens regularly call for less government, but in response to other questions they demand more of the sorts of services that government typically provides (Ladd, 1984). I have emphasized that this result is neither paradoxical nor inconsistent. By restructuring social welfare programs to empower mediating institutions—both for-profit and nonprofit—we can offer exactly the combination these poll results indicate the American voting public desires.

Expanded social welfare services also can be promoted by drawing service suppliers into the political constituency that advances and defends public programs. The continual growth of the American defense industry provides a relevant model here, with large-scale and effective political support provided to the Department of Defense by military contractors.

Within the social welfare field itself, the example of New York City is an instructive one. There, most publicly financed social services programs are delivered through contracts. In turn, private suppliers—most notably well-established human services agencies, both secular and religiously affiliated—have provided much of the political lobbying in support of the city's human services activities. These, by no coincidence, are among the most generous in the nation.

A related lesson in the practical politics of social welfare services is provided by the relative popularity of in-kind assistance programs as compared to cash assistance programs. Over the decade between 1965 and 1975, for example, the proportion of total federal social welfare expenditures accounted for by in-kind transfers rose from 3 percent to 20 percent (Lynn, 1977). Food Stamps, WIC, Medicaid and Medicare, Low-income Home Energy Assistance, and tax credits for day care are several examples of in-kind programs that in recent years have been created or have experienced extensive growth, or both. During the same period, the real value of benefits in cash programs such as AFDC has steadily eroded,

and broad-scale welfare reform proposals that would have cashed out many of the in-kind programs have remained stalled. It is no coincidence that each of the in-kind programs has some large provider lobbies behind it. WIC, which has both the food production industry (producers, manufacturers, and distributors) and the medical establishment behind it, has been a particular prodigy (Rauch, 1984; Bendick, 1978).

Conclusion: A Strategy for Advocating Social Welfare Services

Current discussions of privatization of social services typically start as though what is at stake is a simple question of production efficiency: can service x be produced some percent cheaper by switching from public to private? In this chapter, my thesis has been that the choice of delivery mode is part of a more general balance affecting program quality and quantity as well as efficiency. These other effects make a case for privatization that efficiency gains alone do not.

This conclusion, in turn, implies that advocates of expanded social welfare services in the United States need to rethink their stance toward privatization. They should become fervent and creative advocates for its implementation throughout the social service delivery system. A new, privatization-based strategy for seeking the expansion of the American social welfare system would encompass three major thrusts.

The first thrust concerns how to defeat proposals for load-shedding such as proffered by the Reagan Administration. The typical current approach is to defend the budgets of existing, government-delivered programs. Instead, my logic calls for co-opting the political momentum for privatization by suggesting that empowerment versions of privatization substitute for the load-shedding versions.

The second element of the strategy is to learn to make common cause with the new political allies created by privatized social welfare programs. Suppliers can be mobilized into effective political coalitions to defend and to increase program funding.

The third element consists of investing in efforts to make the nongovernmental delivery system work. Public agencies need to be reoriented to perform skillfully as contract managers.[9] The service delivery institutions being empowered need to be strengthened to make them efficient—particularly in terms of managerial skills within nonprofit organizations.[10] And, as discussed earlier, social welfare programs need to be redesigned

[9] For one useful agenda here, see Salamon (1981).

[10] Programs such as Columbia University's joint MBA–MSW would seem to be an ideal preparation for many future managers. For in-service training needs of the current generation of managers, see Egan and Bendick (1977).

to make feasible the privatization of either entire programs or elements of them.

From such roots could grow a flourishing and politically secure social welfare system in this country—flourishing and politically secure because, for the first time, it would constitute a distinctly American welfare state.

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