

DOCUMENT(S) REVIEWED:	“A School Privatization Primer for Michigan School Officials, Media and Residents”
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### **Summary of Review**

Issued by the Mackinac Center for Public Policy, “A School Privatization Primer for Michigan School Officials, Media and Residents” examines the “contracting out” of public school support services — specifically food, transportation, and custodial services. The report describes the prevalence of contracting out and sets forth the practical steps in hiring a contractor and the benefits in allowing districts to focus on their core mission of instruction. This information may help districts already committed to contracting out. However, the report presupposes that the practice is beneficial. It relies primarily on testimony from district officials rather than direct data or research. And it does not consider the significant transactions costs associated with contracting out or the risks in ceding control to an outside vendor. Overall, the report is prone to overstatement and misleading contentions, resulting in a report that greatly over-simplifies how education systems operate and the purported benefits of contracting out education-related services.

## **Review**

### **I. INTRODUCTION**

“Contracting out” to private companies is an important issue in the provision of publicly funded services, including education.<sup>1</sup> If education or a service associated with education can be provided at a genuinely equivalent quality but at less expense by a private company instead of a public enterprise, then a very compelling case can be made that the private company should be hired. Given annual spending of over \$440 billion on public education, any substantial cost savings would be economically important.

The decision to contract out educational services is ultimately a financial one and a local one: it may generate cost savings in some cases and not in others depending on the district’s circumstances. However, school district personnel need to know whether the option is worth investigating. It would be very valuable for these decision makers to have information on topics such as how common contracting out is, what practical steps must be taken, what the important considerations are, and how to determine if a contract is successful in reducing expenditures while maintaining quality. “A School Privatization Primer for Michigan School Officials, Media and Residents,”<sup>2</sup> published by the Mackinac Center for Public Policy and authored by Michael LaFaive, is an advocacy document that addresses some of these issues. This review considers the merits and usefulness of the report, noting where appropriate any weaknesses associated with the report’s presupposition that privatization will be beneficial.

### **II. FINDINGS AND CONCLUSIONS OF THE REPORT**

The report reviews contracting out of three educational services: food, transportation, and custodial services. It addresses the prevalence of contracting out each service across states, with a focus on education in Michigan. According to the report, just under 40% of districts in Michigan had contracted out at least one of the three types of services. However, based on surveys and published reports, the incidence of each service varies dramatically across states. Some states almost entirely contract out these education-related services; others contract almost none. Based on surveys of district officials about their experiences, most districts that do so are pleased with their decision to contract out.

The report then presents a justification for privatization, along with a discussion of factors influencing contract decisions in Michigan.

In addition, the report contains a lengthy guide concerning the logistics of contracting out. It includes checklists for Requests for Proposals (RFPs) from potential contractors. It also offers a description of how agencies such as teacher unions mobilize opposition to privatization. The report then outlines how districts might affirm and justify a decision to contract out services. It itemizes 10 rules of thumb about hiring a contractor and making sure that the terms of the contract are fulfilled. Finally, the appendices include a case study of a court challenge to privatization in Grand Rapids, Michigan, as well as

a catalog of possible contractors in Michigan.

Overall, the report concludes that privatization is beneficial, although it also recommends that all contracts with private service providers be intensively monitored.

### **III. RATIONALES SUPPORTING FINDINGS AND CONCLUSIONS OF THE REPORT**

The report's suggested rationale for supporting privatization largely rests on the argument that if districts do it, it must be beneficial for them. Since almost 40% of districts in Michigan do contract out, the report assumes the practice must be beneficial in these districts.

In the case of food services, for example, contracting out is supposedly motivated by the savings accompanying economies of scale and by the desire to have another organization deal with the complex regulations associated with the task. It is implied that districts not contracting out are either unaware of the benefits or face too much opposition to privatization. The report does not seriously consider the possibility that the public provision of these services might be more beneficial in at least some instances. The decision to provide a service in-house or contract it out depends on many factors. The report focuses only on the factors favoring contracting out and not those that might lead a district to prefer public provision.

There are several key points that might justify public provision of these services. One important factor is the size of "transaction costs," such as the costs of writing, administering, managing, and arbitrating the contract. None of these costs are considered in the report. For example, while the report does an effective job of itemizing the many

steps needed to secure a contract, it neglects the issue of what resources and time district officials must devote to taking these steps. It is possible that the resources needed to secure a contract exceed any potential cost-savings from hiring a private firm. Moreover, in the long run there may be a cost of being locked in to a single contractor for provision of a service. And if a private contractor anticipates that a contract might not be renewed, he or she may charge a "risk premium" to offset the loss of the contract. Again, none of these potential additional expenses is addressed in the report.

Another argument set forth in the report is that services such as food, transportation, or custodial services are, although necessary, not integral to the instructional goal of a school or district. One strand of this argument is that by divesting itself of the management and provision of these services, a district can focus on instruction and teaching. This focus, the argument continues, should help schools improve and raise achievement levels.

However, this claim — that contracting out allows a school district to focus on its core mission — is not substantiated. Anecdotally, testimony from the Superintendent of the Houston Independent School District is cited as an example of how privatization is a "simplifier," but no research evidence is provided. I am, in fact, not aware of any research evidence on this point (i.e., research that considers the relationship between academic performance and the extent of private contracting). It is equally plausible that a contractor will be a distraction to a district if, for instance, it performs poorly.

The other line of reasoning in this argument is that education systems are too vast, with too many workers not involved in the core mission of teaching children. However, no

evidence is presented that these ancillary workers are unproductive or that education systems would be more efficient if their number were reduced. In applying this argument to Michigan, the report contends that contracting out becomes necessary because of deteriorating economic conditions. Yet, if contracting out is the better approach, it should be adopted regardless of whether the state is doing well or poorly.

The report also cites survey evidence of the opinions about contracting out from officials of districts that did contract out services. The survey responses presented in the report show three-quarters claiming that the contract generated cost-savings, with one-fifth being unsure. Separately, district officials reported being highly satisfied with their decision to contract out.

However, these self reports do not constitute adequate evidence either of benefits or of satisfaction. No comparison is made with the satisfaction levels of district officials who do not contract out services. Nor does the satisfaction felt by these district officials constitute evidence that the contract has yielded cost savings. No evidence on the dollar amounts of any such cost savings is reported.

The report also contends that private firms have the capacity and willingness to take over each of these services, so a lack of adequate providers should not hinder districts from contracting these services out:

As with the transportation and food industries, the custodial services industry appears capable of meeting any increased demand from school districts for services (p. 23).

However, this is simply asserted: no systematic information or data are presented on

excess capacity. Instead, even as the report declares that such information would be very difficult to obtain, it nevertheless claims that:

A Michigan school district that wishes to solicit bus service bids from private firms will probably find willing bidders even if no local firm seems likely to make an offer (p. 21).

Basic economic theory would suggest otherwise: in order to draw forth an extra supply of bus fleets, higher salaries for bus drivers will be necessary. This would raise costs.

Contrary evidence is generally not considered. For example, no investigation is made either of the number of terminated contracts or of the failed attempts to hire a contractor at lower cost than existing, public realm provision of these services. Similarly, no mention is made of the likelihood that private contractors will “cherry-pick” the easiest services and leave the public enterprise to provide the more expensive ones. For example, a private firm might provide transportation services in urban areas but not in rural ones where students are more sparsely located.<sup>3</sup>

Finally, the only research that the report cites on cost savings is two studies on contracting out transportation services (see below), but no such studies for food services and custodial services were provided.

#### **IV. THE REPORT’S USE OF RESEARCH LITERATURE**

The report’s use of research literature is tenuous and limited.

The report cites very little published evidence on whether and how private busi-

nesses can be more efficient than public enterprises. The one legitimate citation (i.e. one that uses data to test its claims) is a study of the costs of transportation services in Tennessee. This study does show substantial cost-savings in the majority of districts, but the sample is only 19 districts.

There is almost no published literature in academic journals on potential cost-savings from contracting out transportation, food, or custodial services by school districts.<sup>4</sup>

## **V. REVIEW OF THE VALIDITY OF THE FINDINGS AND CONCLUSIONS**

The report argues that contracting out of food, transportation, and custodial services is beneficial, with the single caveat that the contract must be effectively monitored. This is an overstatement, a somewhat misleading way to frame the decision over contracting out, and an over-simplification of how education systems operate.

First, the report overstates the benefits of contracting out, not least by omitting a discussion of possible additional costs. It presupposes that districts without private contracts are not operating efficiently or are constrained by public-sector unions. As discussed earlier, the evidence presented to support this supposition is far from compelling.

Second, the decision to contract out such services is largely a financial one. An accounting framework is thus necessary. The full costs of contracting out should be compared with the full costs of public sector provision, with a fundamental assumption that the quality of the service is the same. Instead, the report presumes that the benefits of contracting out exceed those of public provision. It does not systematically itemize

and compare the costs and benefits associated with each option.

Nevertheless, there is some literature on the benefits of private ownership. But this literature is not cited in the report. One of the most widely cited papers in the general academic literature concludes that private enterprises are indeed more efficient than public ones.<sup>5</sup> Other published research concludes that private provision of public services such as sewers, roads, parks, mass transit, and refuse collection is more efficient.<sup>6</sup> Notably, studies do exist of privatized public transit, and these studies typically show either cost savings or lower prices for travelers; this result might perhaps be relevant for school transportation services.<sup>7</sup>

However, favorable results for private companies are not obtained in all sectors and critically depend on local economic conditions. Private sector enterprises have a larger cost advantage in non-care sectors (such as utilities). But where the service involves personal care, the results are less clear. For nursing homes, for example, the research suggests that there is little difference between non-profit and public homes, but for-profit homes offer lower quality care.<sup>8</sup> Similarly, for-profit hospitals appear to be no more productive than public ones.<sup>9</sup> Moreover, this literature does not expressly deal with mixed enterprises, where part of the provision is public (instruction) and another part is private (food services). Rather, the literature directly pertains only to transfer of ownership of an entire operation from public to private. Hence, it is debatable whether this work would strengthen the claims made in the report.

Finally, the report over-simplifies the education system. Schools are not simply “firms” producing students instead of cars or shoes

They are political and social entities and they are rooted in local communities, serving children whose parents need to feel that they are stake-holders in the school. If a district contracts out food services, for example, it is ceding control to an outside agency (at least for the duration of the contract). Both the district and local families have only limited control over the quality of the service — limited to the initial negotiation of the contract. Yet, control is valuable: many schools now have school health councils to address issues related to food quality and nutrition.

The issue of job security and unionization, which is a running subtext of the report, also cuts both ways. It is true that contracting out decreases the job security for public sector workers. Some of the opposition to contracting out may be “ideological” in this respect, but some of it is a rational response to the loss of control associated with contracting out. If jobs are less secure, workers will require higher pay to perform them. This extra pay could easily approximate to the wages paid to current union workers. Also, regardless of underlying motivations for opposition, a district may spend considerable time and resources responding to and mollifying it. In the end, and even assuming the report’s claims of benefits, a district may find it more efficient to provide services directly.

Finally, the report only considers political mobilization against contracting out and not business or ideological lobbying in favor of it. Both occur and both may (rightly or wrongly) shape district officials’ decisions.

## **VI. USEFULNESS OF THE REPORT FOR GUIDANCE OF POLICY AND PRACTICE**

This report is useful. It presents credible surveys of current policies across states showing that contracting out of food, transportation, and custodial services is widespread, although public provision is still more common. The report describes practical steps for issuing and monitoring contracts; these rules of thumb may help districts avoid making costly mistakes or getting locked into unfavorable contracts. Some districts may find useful the discussion of how unions sometimes oppose contracting out and the report’s catalog of service providers in Michigan. These practicalities may have deterred some districts from investigating contracting out. For districts very dissatisfied with their in-house services, this document may help them move forward with contracting out.

However, the report does not offer a balanced framework for assessing the costs and benefits of contracting out. It fails to consider “transaction costs” (e.g., the costs of writing RFPs, awarding contracts, and monitoring services). It relies on officials’ assertions as to the advantages of contracting out, yet does not fully consider the disadvantages. And it fails to make clear that the research evidence on contracting out in education is far from conclusive. As such, the report may be successful in persuading districts to consider contracting out, but this change may not be financially or otherwise appropriate for any given district.

## **Notes & References**

- <sup>1</sup> Contracting out is only one example of privatization in education: other prominent examples include the use of vouchers or tax credits for attendance at private schools. Only the contracting out of k-12 services is discussed here.
- <sup>2</sup> LaFaive, M.D. (2007). *A School Privatization Primer for Michigan School Officials, Media and Residents*. Midland, MI: Mackinac Center for Public Policy. Retrieved Feb. 13, 2008, from <http://www.mackinac.org/archives/2007/s2007-07.pdf>
- <sup>3</sup> Such “cherry-picking” by Education Management Organizations is noted by Miron, G. (2007). Educational management organizations. In Fiske, E. and Ladd, H. (Ed.) *Handbook of Research in Education and Policy*. New York: Routledge
- <sup>4</sup> This statement is based on a bibliographical literature review of the database of social science publications using combinations of: (i) privatization, contract, contracting out; (ii) bus, transport, food, janitorial/custodial; and (iii) schools, education, open.
- <sup>5</sup> See Vining, A.R. and Boardman, A.E. (1992). Ownership versus competition – Efficiency in public enterprises. *Public Choice*, 73, 205-239.
- <sup>6</sup> See Savas, E. S. (2000). *Privatization and Public-Private Partnerships*. New York: Chatham House; and Wolf, C C. (1988). *Markets or Governments: Choosing between Imperfect Alternatives*. Cambridge, MA: MIT Press.
- <sup>7</sup> Karlaftis, M. and McCarthy, P. (1999). The effect of privatization on public transit costs. *Journal of Regulatory Economics*, 16, 27-43.
- <sup>8</sup> See Chou, S-Y. (2002). Asymmetric information, ownership and quality of care: An empirical analysis of nursing homes. *Journal of Health Economics*, 2, 293-311.
- <sup>9</sup> See Rosenau, P. and Linder, S. H. (2003). Two decades of research comparing for-profit and non-profit health provider performance in the United States. *Social Science Quarterly*, 84, 219-241.

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