Implementing Contracting Out of Public Services: Lessons from Estonia
Research paper
**Introduction**

Many transitional governments in the CEE region still seem to believe that contracting out is a universal panacea for solving problems concerning public administration and public services. However, the mixed evidence from all over the world makes the perspective of large scale implementation of the contracting out questionable in transitional societies in general and particularly in CEE. Recently, the Estonian public sector has contracted out several important public services to private organizations. Parking enforcement in the Tallinn’s municipality and the state-wide emergency medical service are the two cases that have stood out producing controversial results and lot of confusion among the public. The current paper aims to explore the implementation of these public policies in the transitional context of Estonia.

The objective of the paper is twofold. Firstly, to find out whether the public services should all be subjected for contracting out or is it possible to eliminate some services from being contracted by using some integrated analytical tool. Secondly, by carrying over the Estonian experience to the context of CEE, the paper tries to identify the crucial factors influencing the implementation process and the outcome of contracting out in the transitional context.

**Theoretical bases**

Since the early works of the public choice school (e.g. Niskanen, 1994) the debate on contracting out of public services has been constantly widening, changing from a mainly economic argumentation to a more sophisticated discussion, incorporating also political, legal and administrative aspects (e.g. Hood, 1997; Moe and Gilmour, 1995; Kettl, 1993). The lamenting treatments where contracting out was seen as an universal panacea for the public sector problems (e.g. Osborne and Gaebeler, 1992) have been challenged by the vast literature demonstrating the problematic nature of implementing public service contracting (e.g. Johnston and Romzek, 1999; Milward and Provan, 2000; Hodge, 1998). There exist a growing concern that the transitional context makes it even more problematic to successfully contract out public services (Brown, 2001; Keefer, 1999; Nemec, 2001). In order to understand the current context of contracting out in CEE and elsewhere, the following paper, firstly, analyzes the actual implementation process of the contracting out initiatives, and secondly, analyzes the limiting criteria determining the contracting out decision. It is proposed here that by applying the analysis of limiting criteria, it should become clear whether there exist any justifiable grounds to start implementing the contracting out process at all.

**The limits of contracting out**

The need for privatization is often explained through conventional rhetoric about efficiency, economy and effectiveness, but, as the following section suggests, there exist other important determinants that have an influential part to play. There are at least four groups of limiting arguments which challenge the universal applicability of the contracting out approach and which should be studied by governments before the contracting out process is to be implemented. These are political, legal, administrative and economic factors (e.g. Hirch, 1995; Boston, 2000).

i. **Political limits**

In reforming public administration, the state can favor, above all, some other purposes or values not identified in the conventional debate but could be achieved through contracting out (Hood, 1997). Increasing the state’s overall steering capacity, fulfilling ‘amoral’ goals or

---

1 This section is based on the previous work of the author, see Lember, 2004.
positive discrimination are some of the examples here (DeHoog, 1996; Hood, 1997). In such cases, interacting with the market does not depend on economic reasoning or an a priori superiority of the market, rather, the market is valued as long as it helps to achieve certain political goals. Hence, implementing of contracting out depends on the ability of the contracting tool to achieve political goals, either publicly declared or hidden ones.

**ii. Legal limits**

If a service includes the use of coercion and discretion, or is critical to the whole society – that is, it has an inherently governmental nature – it cannot be contracted out on an economic basis (Moe, 1987; Moe and Gilmour, 1995; DeHoog, 1996; Dudley, 1996; Boston, 2000). Several authors have emphasized that privatization may worsen the administrative as well as the political accountability in providing public services (Moe, 1987; Johnston and Romzek, 1999). The issues such as immeasurability of service outcomes, monitoring problems, public access to terms and conditions of contracts, more complex compliance and discipline mechanisms, and the lobbying of private firms have been found to have important influence on the accountability of contracted out services.

**iii. Administrative and economic limits**

According to Lane (2000), contracting out tends to work better in the case of simple and technical services, where outcomes are measurable and competition is present, whereas more problems arise with complex social services. In the case of technical services, there are more chances that the government retains a controlling position, knowing, as Kettl (1993) puts it ‘what to buy, who to buy it from, and what it has bought’ (p. 180). Hart et al. (1997) explain that the role of competition for the contract as an incentive mechanism is overestimated, and in the case of lengthy contracts, the role of ex ante competition for achieving certain outcomes is insignificant. In presence of ineffective user choice (i.e. ineffective ex post competition) and long-term contracts, the private contractor can pursue, due to the large amount of uncontractable quality factors, his own interests without fearing the termination of the contract (ibid.). The threat of contract termination as an incentive mechanism is claimed to be ‘mythical’ (Keating, 1990) especially in cases of social services with big entrance barriers like prisons. In order to overcome these principal-agent problems and to make the contracting relationship work, the government has to make substantial investments into the selection, negotiation, writing, monitoring and evaluation procedures of the contract (Domberger, 1998) which constitutes the heart of the implementation process of contracting out. At the same time, the government has to find a balance here because at a certain level these transaction costs may outdo the expected gain from contracting mechanisms (Williamson, 1996). In addition, there exist administrative factors such as weak civil service, which limit the applicability of the contracting out tool by the governments (Lember, 2004).

**Stages of contracting**

When organizing public service delivery, the government cannot rest only on ex ante analyses where the suitability of a service is analyzed in advance. As indicated above, there exist crucial implementation stages that are vital for the government to follow if the contracting out approach is chosen. Four main activities have gained most of the attention in the literature – specifying, publicizing, selecting and monitoring (Behn and Kant, 1999; DeHoog and Salamon, 2002, Domberger, 1998; Kettl, 1993. What follows is a brief overview of these stages.
Specifying
The first step the government takes is setting the broader as well the particular objectives for the contracting out decision, whereas the former indicates the political idea behind the activity (e.g. increase of steering capacity) and the latter specifies the expected outcome and outputs of the service. The crucial element at this stage is the calculation of internal, direct and indirect, costs of the governmental service provider (Wisniewski, 1992). During the specification round, it should be decided whether the contract will be input or output based, and depending upon that, the quality standards and service procedures should be linked with the outcome and outputs (Domberger, 1998). In order to enable efficient monitoring and management of the contract, the indicators for standards, procedures and outputs should be clearly articulated and measurable (ibid.).

i. Publicizing
At this stage Request for Proposal (RFP) and all the relevant documentation should be made available to the interested parties. To enhance the competitive effect, the government should invest in the advertisement and, if needed, in the market creation. Market creation could be useful if there is no such service provided in the market but where the entrance barriers are low².

ii. Selecting
Although the selection procedure tends to be regulated in detail in the public sector and the steps to be taken are mandatory, the government still has some discretionary power here, for example setting the weights for the evaluation of bids. Further, such factors as financial stability, innovativeness, reputation and previous experience should be taken into account besides the price (Domberger, 1998). After the selection of the preferred provider, the negotiation process, sometimes long and costly, starts over the specifications and performance measurements (DeHoog and Salamon, 2002), where the government, however, cannot back away from the main aspects of the initial RFP due to the fair competition principles.

iii. Monitoring
DeHoog and Salamon have stated that “Since the government unit is ultimately accountable for the cost and quality of contracted service, monitoring and evaluation must also be carried out” (2002, p. 326). There exist a wide range of monitoring and evaluation tools that can be applied – from document reviews to intervention of courts³. The government and the contractor should reach, according to the nature of the contract, mutual understanding how the performance is to be evaluated. Monitoring refers not only to the controlling function, but to the management of the contract as a whole, including choosing the appropriate balance between incentives and sanctions (Kettl, 1993). Along with the design of management tools comes the need for an internal restructuring, where the governmental officials have to change their role from implementing officials to contract reviewers.

The role of contracting out in the Estonian public administration
Contracting out of public services is an area that is neither centrally introduced nor coordinated in Estonia. The topic has been a subject in many different administrative reform plans but apart from the adoption of several new laws, there are no signs of coherent implementation of the plans. Contracting out as part of the administrative reform represents

---
² When talking about securing a sufficient level of competition, Salamon (2002) uses the term activation skills – the public managers responsible for contracting out have to be active in finding enough providers to take part in the competition (p. 16).
³ For detailed discussion see, for example, Keating Jr. (1990)
one of the initiatives that has been implemented without a sufficient analytical and legal framework. Until the Administrative Cooperation Act entered into force in 2003, different administrative decision mechanisms and mixed types of agreements were employed to contract out public services by all levels of government. Prior to the year of 2003, there was legally no difference whether the government bought pencils or contracted out a nursing center. Although the law now stipulates which kind of legal and management processes should be executed, the picture is still varied, as the services can be contracted out by applying either “administrative contract”, “administrative act” or “civil contract”. Insufficient knowledge and an unsystematic approach in contracting out public services have culminated in public scandals even in cases of technical services, such as ferry line operations (Riikoja, 2004). There are, however, many opposite examples, where the privatization of the enforcement procedure stands out as a success case (Annus, 2003). Further, some authors have stated that smaller local governments are relatively capable of handling the contracting relationship in spite of lacking competition in the market (Altnurme, 2001).

The study
The empirical analysis on parking enforcement and medical emergency service employs both quantitative as well as qualitative data. There were altogether seven interviews conducted, held with public officials as well as with the representatives of the contractors. The interviews were semi-structured and concentrated on the implementation phases of the contracting process. In addition, a number of legislative and administrative documents were reviewed, including contracts and different auditing reports. The quantitative information was drawn from state’s and Tallinn municipality’s budgets, from statistics and calculations provided by the private companies and the governmental units, and finally, from the auditing reports.

Tallinn city parking enforcement
Tallinn city municipality has a 16 years long history in administrating the fee-for-service parking enforcement of the central city area. The latest and the most comprehensive change in the area of central city’s parking enforcement was started in 2000 and completed in 2003. During the first phase, in the end of 2000, Tallinn contracted out the administrative functions the parking enforcement service. Soon, as the second phase, in the beginning of 2003, the contracting out of the controlling function followed. Both contracts are subjected to end in 2006.

The current contracting out initiative has been in the middle of a constant turmoil and it has been influenced by lots of changes in the environment, independent in their nature. In the

---

4 The only exception was the interview held with the deputy major of Tallinn, which did not follow the structure.
5 The first initiative was executed in 1989 under the Soviet occupation rules by a governmental unit, and in 1992, a year after Estonia regained its independence, the Tallinn City government decided, for the first time, to contract out the parking enforcement service (Stratum, 2002). From the first contract till the current date, the parking enforcement service has been in constant changes and turmoil. Altogether six different contractors, including municipal owned and private companies, and two governmental units have been responsible for implementing parking enforcement in Tallinn. Up to the year of 2001, when the current contractor was awarded with the contract, all institutional arrangements were abolished before three years of action either through contract termination, disbandment or restructuring. The scandals, illegal decisions and poor management has illustrated the whole era (see EPLOL, 1999).
6 The parking enforcement in Tallinn can be divided into four parts. Firstly, uncontractable functions, mainly legislative in nature, which include determination of fees, areas and other rules and also overall steering. Secondly, administrative functions of paid parking, which main feature includes organizing of tickets’ selling net, ticket provision, distribution of information to the public and gathering statistics for the government. Thirdly, controlling function inside paid parking area, including ticketing and towing. And finally, administration and control of the parking outside the paid parking area.
beginning of 2001, as the result of the enforcement procedure’s reform, the private bailiffs started to work which brought along a substantial increase in paid fees and influenced the future behavior of the car owners. In March 2002 a legal vacuum was created, by the decision of the Supreme Court, which stipulated that under the current legal framework the legal persons could not be feed. In September 2002 came into force the Code of Misdemeanour Procedure, which excluded the possibility to penalize someone anonymously. This in turn made it impossible to charge the wrong-parkers, if the thousands of daily parkers are to be taken into account. In February 2003 the new version of the Traffic Act came into force, according to which citizens have the right to park the first 15 minutes without paying for it. In order to cope with the changed legal status, the Tallinn City Council changed the legal basis of the parking enforcement system in the beginning of 2003\(^7\). The latest important change occurred in August 2004 when the City Council increased the parking area and the rates of the parking fee.

The political situation affecting the parking enforcement has been as turbulent as the legal environment. The overall parking policy has been extremely vague, causing a situation where the decisions regarding parking enforcement have never been based on longer (i.e. strategic) goals (Stratum, 2002). The first coherent policy document for parking enforcement was developed in 2002 (see *ibid.*), where, however, the administrative mechanisms were paid only a limited attention\(^8\). The current contracting initiatives were implemented without taking into account the prepared policy plan. So far, the major decisions have been made based on the logic of daily politics. During the past 16 years, there have been 11 mayors in office in the Tallinn city municipality (Tallinn City Government, 2005a); each having a different vision of the parking related issues\(^9\). Similarly, due to a large media coverage the parking issue has been a tool for the opposition parties to gain political capital\(^10\).

The aim of the contracting initiative has been revenue rising and control maintenance over the traffic, with an overwhelming bias towards the former one\(^11\). The specific goals set in the contracts agreed in 2000 and 2003 involve, *inter alia*, a) to increase the revenue for the local municipality; b) to enhance the quality of the service in terms of information distribution to the public, access to tickets, arranging parking in special occasions and data gathering; c) to get access to private investments; and d) to make the whole enforcement system more effective and efficient (e.g. EPLOL, 2000c). The political leadership was convinced that private entity is more capable and has more motivation in administrating the parking service (EPLOL, 2001a). Understandably, the same belief was shared by the private sector\(^12\).

\(^7\) If the previous system treated parking without paying as a misdeed and it resulted in a penalty, then according to the system introduced in 2003, the parking fee was changed into a local tax and parking without paying is now being penalized with an overdue charge. Another major change was associated with the accrual of the collected money – until February 2003 the whole revenue from parking enforcement accrued to the account of the contractor, after the February 2003 the whole revenue, now regarded as tax revenue, had to be transferred to the account of the city government.

\(^8\) The policy elaboration task was contracted out to a private consortium led by a private engineering company. The consortium involved scientists, specialists and engineers. Although the policy document was ordered by the city government, neither the city government nor the city council has approved it (Tallinn, 2005c).

\(^9\) For example Jüri Mõis, a mayor of Tallinn from November 1999 until June 2001, had an idea that the trolleybus transportation should be stopped (EPLOL, 2000a), which in turn would have affected also the parking policy. Today, no such scenarios have come into effect.

\(^10\) *Res Publica*, the leading coalition party of the central government and opposition party in Tallinn until the end of 2004, used the polemic around the parking enforcement to organize the City Council Auditing Committee to review the contracts, and based on the review demanded the termination of the contracts (EPLOL, 2004).

\(^11\) This comes especially clear from the first amendment of the contract agreed in 2000, where the only mutually agreed strategic goal is to increase the revenue from the parking enforcement. See more information about the amendment in the following sections.

\(^12\) Prior to the second contract agreed in 2003, the awarded contractor claimed that contracting out would result in “enormous savings” if the whole parking enforcement service was contracted out (EPLOL, 2001b).
The first phase

During the specification round the city of Tallinn relied mainly on its internal knowledge. According to the Request for Proposals the city foresaw the increase of revenue at the end of the first year by ca 200%. No outputs or outcome were specified besides the revenue targets. According to the city calculations, no transaction costs were anticipated to emerge, except for the first year (Tallinn City Government, 2005b).

Apart from accomplishing minimal requirements for publicizing, there were no special conferences held or other effort made in order to encourage the market to actively take part in the competition. The most important prerequisites were associated with the existence of security license and a strong financial background, whereas the winner was to be chosen based on the amount of money guaranteed for the city. There were two companies that took out the documentation and in the end one company submitted its offer13. The only bidder was announced as the winner; the contract was signed December 19, 2000 and came into force January 10, 2001. The offer of the winner was just slightly higher than required in the Request of Proposal, the fulfilling of which was made conditional upon meeting 19 extra tasks by the city government. Based on that conditional clause, the contract was changed already in June 2001, where the annual guaranteed revenue for the city was reduced by the VAT rate (plus additional 3.5% in the first year) and the contractor took over the ticket provision function14. After that amendment the contractor has the right to get 45% of the total revenue15. The second important change in the contracting relationship entered into force February 2003, according to which the guaranteed amount of revenue for the city was decreased by additional 9% and the contractor started to bear the tickets’ provision costs.

The city government of Tallinn did not determine any monitoring and evaluating processes in the contract to be executed, except for the reservation of access to the all accounting documents associated with the parking enforcement. The first time the contractor was audited was in 2004 (Kuuse, 2005). Besides the clearly stated financial commitments, incentives and penalties, the other targets of the contracts were articulated vaguely without any clear statement about performance indicators, which would allow holding the contractor accountable16. After the first contract, the city government has been able to decrease the number of its employees involved in the parking enforcement from 38 in 2000 to 13 in 2005 (Tallinn 2005d). All the current employees are responsible for parking enforcement outside city fee-for-service area, meaning that there are no special monitoring officials employed, unit created or resources allocated to control and evaluate the work of the contractor17.

The second phase

The second phase of the contracting out of the parking enforcement followed the same path as the first phase. However, some important features of the second phase must be outlined

---

13 According to the opinions of other security companies, the terms and conditions, especially the financial obligations, were too harsh (EPLOL, 2000b; 2001c)
14 The rate for VAT is 18% in Estonia.
15 According to the contractor the initial targets were based on theoretical calculations which did not take into consideration the reality, and hence were impossible to meet (Tohver, 2004).
16 At the same time no contract based penalties have been used to punish the contractor for a “poor” performance in revenue rising.
17 There was a plan to create such a post but that has not been executed. As of today, two officials are occasionally involved in monitoring the contractor’s performance, which is, however, just an extra tasks in addition to their every day duties.
The parking control service was contracted out together with mass transportation and taxi control services, which caused a situation where the price and vision offered for parking control had a minor weight in the overall decision. There was one bid submitted, by the firm holding the contract for the parking administration, which was eventually declared as the winner. Soon after the contract entered into force, the number of controllers, as anticipated in the Request of Proposals, was diminished from 32 to 8. There was a clear legal accountability system introduced to enable the private contractor to make overdue charges, which included also the establishment of a commission responsible for reviewing the complaints of the citizens. The terms, conditions and the range of the activity of the controlling service were subjected to be reviewed annually, depending mainly on the budgetary constraints set by the city council.

The results of the contracting out
The actual revenue from parking enforcement has been far below the numbers disambiguated in the requests for proposal and what was agreed in the first contract. Nevertheless, it is not possible to unambiguously identify the party responsible for the unachieved revenue target due to the turbulent environment. All the major fluctuations in revenue raising, apart from the first year, can be explained by the environmental changes. There is no rational basis for benchmarking between the periods prior to the current contract and after the contract.

The city government repeatedly demonstrated its dissatisfaction regarding the situation with informing the public, especially about marking the parking areas, and access to the tickets in terms of the number of selling places. But as there are no specific guidelines and performance measures developed, the assessment on the poor performance in informing and securing access are thoroughly subjective and the contractor cannot be held accountable in these matters. Same kind of misunderstanding has occurred with fulfilling the investment plan. The contract did not specify the annual amount of investments to be made, which has given the contractor the opportunity to postpone making the investment spending.¹⁸

At the first glance, the efficiency of parking administration in terms of revenue seems to have decreased, as the ratio between administration costs and the selling turnover has increased from 28% in 2000 to 47% in 2004 (Tallinn City Government, 2005b). This claim becomes even stronger if taking into account the fact that 43% of the revenue in 2004 that came through mobile phone system did not accompany any direct costs for the contractor. At the same time the contractor has claimed that considerable investments has been made in organizing the ticket selling system, which includes eliminating the illegal trading channels (Tohver, 2004). As the environmental (i.e. independent) changes had a strong impact on the sales numbers, the both claims cannot be verified. The efficiency of parking control seems to have increased, as the ratio between the controlling costs and revenue from fees has decreased from 45% in 2000 to 32% in 2004. However, the role of the contractor in increasing the efficiency of controlling function remains unclear due to the impact stemmed from the bailiffs’ reform. Similarly to the efficiency, the influence of the contracting out initiatives on the effectiveness of parking enforcement remains unknown, as there are no targets or

¹⁸ A large portion of the investments were meant for the ticket machines. At the same time the revenue from mobile phone system grew from 0% in 2000 to 43% in 2004. This made the contractor to question on the sensibility of investing in machines, which proportion from the turnover had fallen to 3% in 2004. However, taking into account the public interest and that the government has to secure the equal access to the service for the whole public, the need for parking machines is still well founded.
performance measures elaborated for evaluating the effect of the contracting initiatives on achieving the goals of parking policy\textsuperscript{19}.

\textbf{The emergency medical service}

In 2001, as the result of adopting the new act and other documents regulating the health care provision, the Estonian state forced the emergency medical service (from this point forward referred to as EMS) providers alongside with the other medical services providers to be privatized\textsuperscript{20}. The idea of the reform was to create fully functional health care markets where the privatized, previously governmental organizations competed with private providers for contracts awarded by the state\textsuperscript{21}. Prior to the regulative change introduced in 2001, the EMS provision was under-regulated, lacking clear legal and administrative mechanisms (State Audit Office, 1999). The county governors, without any specific framework for conducting the procedures, were made responsible for contracting with the EMS providers, whereas the resource allocation decisions were made by the Ministry of Social Affairs (\textit{ibid.})\textsuperscript{22}. The basic controlling tool was the demand that the contractors had to have operational license for providing EMS (\textit{ibid.}). After the minimum legal framework was introduced and the putative privatization was finished, the state was ready to switch to the competitive contracting regime in administrating the EMS\textsuperscript{23}.

The goal of the privatization reform was to make the health care system more efficient and effective in order to treat more patients with the given amount of resources, which followed the conventional rhetoric of the overall privatization initiative in the medical care (Riigikogu, 2001). The political and policy related issues surrounding the EMS have been unstable. Financing of the EMS has through the years been depending on the political will of the parliament, which makes the EMS budgetary decisions on incremental basis without taking into account any specific framework. However, the Ministry of Social Affairs has elaborated a cost model for the EMS, which now serves as the main information tool for the EMS stakeholders\textsuperscript{24}. The policy process has been largely influenced by the Estonian Association of Emergency Medical Aid (EAEMA), whereas the internal capacity of the Ministry of Social Affairs has been weak (Adlas, 2005; Seer, 2005; State Audit Office, 1999; 2004)\textsuperscript{25}. Regardless of the fact that there exists a strategic plan for EMS, which was elaborated by the EAEMA, most crucial factors are still not in place. There is no common understanding regarding what kind of EMS Estonia should concentrate on, the functions of different parties in first level

\textsuperscript{19} According to the strategy of parking policy, subscribed by the city government but not approved by the city government or council, the main targets of the parking enforcement are to limit the number of cars parking in the city area, to improve the environmental situation of the city and to secure smooth traffic in the city area (Stratum, 2002). As of today, there is no such data available which would allow to assess the impact of these particular contracting initiatives on the strategic goals.

\textsuperscript{20} According to the law, only private legal persons and governmental rescue service agencies can be the providers of EMS. As of 1999, 59\% of the EMS providers were governmental organizations, 21\% not-for-profit organizations, 11\% for-profit-organizations and 9\% had unclear legal status (State Audit Office, 1999).

\textsuperscript{21} However, all of the providers were more or less controlled by local or central governments. As of today, most of the EMS providers are controlled by local governments.

\textsuperscript{22} All other health care providers depending on public resources, except EMS providers, compete for the contracts awarded by autonomous public law body Estonian Health Insurance Fund.

\textsuperscript{23} According their legal status, the county governors are representatives of the central government in counties.

\textsuperscript{24} It was never a classical privatization – the governmental organizations were just changed into government owned private legal persons, meaning that the government direct participatory was maintained.

\textsuperscript{25} In spite of the existence of the cost model, the estimated shortage of the EMS budget in 2005 is 30\% (Adlas, 2005).

\textsuperscript{25} During the recent years the Estonian Health Care Board, which is the subunit of the Ministry of Social Affairs, has started to make some progress by establishing special office responsible for EMS. The capacity of the office is still limited, as has been admitted by the interviewees and State Audit Office (2004).
medical aid are not clearly divided, the work of the alarm centers are ineffective (State Audit Office, 2004). Furthermore, the cost model does not take into account the changing nature of the wage conditions (Adlas, 2005).

The stages of contracting out

After the new law had taken effect, all the organizations that were or wanted to become EMS providers had to apply for the operational license, where they had to prove their ability to cope with the input requirements set by the government. The result of the licensing, which was carried out in 2001, was that all the previous and one new provider got accredited26. The license gave the providers the opportunity to deliver the service until the new state-wide bidding process was to be initiated. As of today, the bidding process has been postponed several times and has still not been carried out, mainly due to the incipient policy and the unwillingness of the state to pay the market price for the service27. All the licensed providers have been offered temporary contracts, which are subjected for annual review. Hence, the state created an EMS market without true market mechanisms. During the negotiation process the Health Care Board acts as the contracting agency, whereas the providers are represented by the (local) governmental officials or executive personnel. The negotiations comprises of only limited range of topics, concerning mainly what kind of service is the provider able to deliver for the pre-established budget allocated by the parliament (Adlas, 2005). Although the legal documents provided the Health Care Board with an opportunity to design output based contracts (määrus), the contracts employed are strictly input based and resource allocation is dependent on the cost model authorized by the ministry (Seer, 2005).

There are no output based administrative and incentive mechanisms introduced in the contracting system and the government does not measure the outputs of the service. Monitoring and controlling of EMS providers have been extremely vague until the current date (State Audit Office, 2004) and, for example, the first time the Ministry of Social Affairs audited the EMS system was in 2004. The main controlling mechanism relied upon so far is self-control, which basically means two things. Firstly, it is hoped that the medical code of ethics is strong enough to keep the system functioning (Adlas, 2005). Secondly, the government occasionally orders quality monitoring service from EAEMA regarding the input quality standards (ibid.). Currently there are only two people working as the contracting officials in the Estonian Health Care Board.

The results of contracting out

There are two main results stemming from the contracting out of EMS that should be outlined. Firstly, the current contracting regime helped the government to keep the system running at a satisfactory level and below the actual market prices, without any considerable interruptions or failures. The service has been delivered despite of its constant under-financing, mainly due to the fact that public authorities have maintained a controlling position in almost all provider organizations and there exist big providers, subunits of hospitals, who are interested in using their EMS units to get patients into their hospitals. Therefore, from the political point of view, the employed contracting structure has delivered the expected outcome.

26 As a result, there is only one private EMS provider in Estonia which is 100% based on private capital and is not controlled by municipal or state authorities.

27 One of the causes was the fear that in order to enter the market, the possible private providers make low bids and once getting stronger position demand higher price (Seer, 2005). The other reason was the fact that the government had no criteria (price and other measurable outputs) elaborated which would allow them to favor some providers over other and the resources for allocation were fixed in advance by the legislator (ibid.).
Secondly, the goals of privatization have, however, not been met. The contracting system of EMS has failed to set up a competitive environment, which would motivate the providers to deliver the service efficiently. There is no information available on what kind of service the providers deliver for the money allocated, which means that the true price of the service remains unclear. On the one hand, the government does not measure how much resources are spent on achieving the expected results. On the other hand, the government has never specified what results are expected to be reached. As Robert Poole Jr has claimed:

“There is considerable agreement on how to measure the performance of a paramedic system. It should have a rapid response time, relatively low cost per unit of activity, and high productivity (1995, p. 8).

There exists some information about response time, but it has never been made the subject for the contracts with the providers, which means that the performance measurement as an incentive mechanism does not influence the EMS in Estonia. Hence, in reality, although the emergency medical aid system is now being based on contracts, the process has not followed the logic of contracting management, it has never been implemented according to its initial goals and no assessment can be given of issues related to efficiency and effectiveness.

In order to put an end to a situation where providers are awarded with temporary contracts, the government is planning to increase the state's role in delivering the service by contracting the EMS service to state controlled private legal persons or to rescue agencies (Seer, 2005). This would mean that the government abandoned the idea of competitive market and increased direct control over the provision. If the current system could be described as a semi-market, where the government negotiates with different providers with different level of governmental control then the planned change would bring along a situation of government sitting in both ends of the negotiation table. This, in turn, makes the usefulness of the contracts as a legally binding administrative mechanism rather questionable.

Discussion
Parking enforcement can be mainly regarded as a technical service in its nature, at least from the point of view of revenue raising and for that reason ‘performance contracting’ should be preferred. The contracting out of parking enforcement in Tallinn followed the basic aspects of ‘performance contracting’, concentrating on revenue output. The EMS cannot be considered as purely technical, but there exist ways to measure the output and outcome of the service. The nature of the EMS contracting relationship involves many procedural requirements besides the output targets. In spite of the conventional understanding that technical services are the first ones to be contracted out, the two Estonian cases demonstrated that, at least in transitional context, this cannot be taken for granted. The services under consideration have limiting factors that could have been taken into account before the contracting decision was made.

In order to understand the possible legal, administrative and economical limits, one should make clear what the political limit of the contracting process is. In both Estonian cases the publicly declared goals – efficiency and effectiveness – did not raise any factors against the contracting initiative, as they were in accordance with the conventional contracting theory. While privatizing the EMS, the government had, however, the purpose of keeping the costs under a certain level. For that reason the government did not implement the contracting initiative in accordance with the initial plans. Hence, the contracting out of EMS had a serious

---

28 For detailed discussion on performance contracting see Behn and Kant, (1999).
political limit before the process was being initiated and by taking it into account, the current pseudo-contracting and the related problems could have been prevented.

Although contracting out of the parking enforcement and EMS involves delegation of discretionary power and especially the latter has a critical meaning for the whole society, there exist no constitutional limits for privatization of the services. Stemming from the inherently governmental nature of the services, it is, however, vital to secure the clear accountability structure of the services, which, in turn, is dependent on the administrative and economic mechanisms. In case of parking enforcement no serious economical limits can be outlined as a) the service to buy is relatively easy to specify, b) the creation of the market is feasible due to low entry barriers and the need for low-skilled workforce, and c) the service is measurable due to quantifiable outputs. The situation with EMS is more complicated, especially if the need for high-skilled workforce and market creation problems are taken into account. But in 2004, there were 26 EMS providers with 90 cars in Estonia, which indicates that there are too many small providers in the market. Furthermore, the short terms of contracts in both cases and the presence of ex post competition in EMS are the factors enhancing the probability of successful contracting. And finally, the transaction costs, which can be rather high regarding both cases, can be calculated in advance.

Nevertheless, the evidence shows that during the implementation of these contracting initiatives serious economic and administrative limiting aspects arose. The processes were designed in a way that private contractors could not be held accountable for most of the results and outcomes not achieved. No incentives or administrative mechanisms were exercised or elaborated in order to influence output of the services; the contracts foresaw only the possibility to influence the procedural matters. The non-realistic cost calculation, and price policy, non-active role of the government in market creation and too harsh financial requirements can be considered as major factors diminishing the competitive effect of the contracting initiatives. The confusing situation could have been avoided if there was clear policy principles elaborated before contracting out of the services. In other words, taking into account the fact that there exist considerable administrative shortcomings for administrating, the implementation of contracting out should have been postponed. Similarly, if the problems of administrative capability were acknowledged before the contracting decisions, the failure of accountability structure could have been foreseen.

Hence, from particular political point of view the contracting out processes of parking and EMS accomplished their initial goal. At the same time, the case studies suggest that the efficiency and effectiveness related aims have not been realized, mainly due the administrative limits.

**The Estonian experience and CEE**

The naïve belief in theories supporting privatization at any cost forces the CEE governments to make the same mistakes the “west” has been doing for more than two decades now. Several lessons can be learned from the Estonian experience in contracting out public services.

- Legal environment does matters. One of the most crucial elements causing the failure of Tallinn’s parking case was the ambiguous legal environment. In one hand the parking related laws were changed too often and in the other hand no special legal framework was in place that insisted from the governments to follow certain core principles of contracting.
Policy process also matters. Deakin and Walsh have summed this point clearly, stating that “contracts do poorly with ambiguity in the policy process” (1996, p. 37). In case of EMS the main reason why the contracting out process was stopped was the lack of resources. At the same time 27% of the ambulance callouts do not fall under the responsibility of EMS (State Audit Office, 2004) because of the policy regulating the first level medical aid is not clear and ambulances are used for functions not inherent to the EMS. The contracting out of the Tallinn’s parking enforcement was implemented without any policy, causing the situation where the revenue raising became the only purpose of the parking enforcement.

Contracting out can cause a situation where other and sometimes more important aspects of public policy are left in the background. The Tallinn’s parking case showed that the debate has concentrated only around the revenue raising and no attention was given to the parking policy goals like clean environment or smooth traffic. In EMS case, the cost related political goal has been dominating over the performance related purposes, which can be sustainable only in the short run, as it does not motivate the providers to deliver the best possible service.

Lack of capacity to build contracting relationships. Although this is not inherent only to transitional countries (e.g. Johnston and Romzek, 1999), the Estonian case suggests that there exist some special aspects inherent to the transition countries. Poor specification and contract design, non-existence of measurable indicators, no internal restructuring of the contracting authority imply to the lack of basic knowledge about implementation of contracting out. Insufficient curricula of universities and other training organizations in Estonia regarding contracting management, contribute to the presence of the problematic situation.

The professionalism of civil servants is a crucial factor influencing the outcome of the contracting out. As the basic problems of administrative capability are the same in the governments in CEE region (e.g. Verheijen, 1998.), the situation is likely to occur in other CEE governments. Contracting out tends to be perceived by the public officials as a legal problem but not as administrative or governance problem. In responding the State Audit Office remark on weak administrative capacity of the Ministry of Social Affairs in organizing EMS, the ministry declared that a new post for a lawyer was to be created (State Audit Office, 2004). The same mentality prevailed in the Tallinn City Government. As the government’s role was limited to contract preparation and authorization only – no administrative tools were thought necessary to develop. There exists a strong mentality that after a public service is contracted out to a private party the governmental officials will no longer be accountable for the output of the service. Instead of admitting the shortcomings in governing the contractual relationship, the public is given the impression that only the contractor is responsible for the failures. The public authority should play an active role in explaining to the public the process of contracting out – involvement of citizens is a useful tool for keeping the contractor under control.

The Estonian experience demonstrates that poor design and implementation of contracting out leads to the situation where no clear understanding exists about the true costs of the service. Although, it is one of the strongest claims of the supporters of privatization that marketization helps to find out the true price of a service, the governments lacking sufficient administrative capability may not any help from contracting out.

Choosing the right direction for solving the problematic contracting relationship cannot be based on some given model. Although the Estonian EMS contracting process is incipient and the solutions planned diminish the marketization effect even
further, the Ministry of Social Affairs has chosen not to proceed with the contracting out approach, perceiving its low capability in securing the control over the market. Taking into account the non-existing internal capability, the solution should be assessed as rational. For the parking enforcement, on the contrary, the best way out seems to be organizing another competition for the contract, where also the internal governmental unit would take part in. But it can be done only when the political power truly wants to find the best solution for the problem and when it applies outside know-how.

- Taking this evidence into account, it can be argued that large state-wide market testing programs such as Compulsory Competitive Tendering in UK should not be implemented in transitional countries. Instead of that, each case should be analyzed separately through employing detailed analytical tools. And last but not least, the governments in CEE and elsewhere should apply not only economic aspects but also political, legal and administrative factors to these analyses.

Conclusion
Evidence from the Estonian case studies on contracting out seems to have followed the idea that ‘let the contracts manage themselves’, which is exactly opposite to the much quoted Kettl’s conclusion that “contracts do not manage themselves” (1993, p. 180). The Estonian cases demonstrate clearly that when contracting out of public services is carried out in the context of a constantly changing environment, without a clear policy, with a low level of know-how, the process will not produce the expected results. Although there seem to be many success cases in privatizing public services in Estonia, the main lesson to be learned from the current study is that in AD 2005 the contracting out of the services that are mainly measurable in their nature can still fail in the transition countries. The conclusion is based on the following facts: a) the effect of contracting out in terms of efficiency and cost-savings remained unknown; b) no adequate quality measurement could be done; c) the government’s controlling capability decreased; and d) the contractors could not be held accountable for the results. What is even more noteworthy, as the current study explains, some of the most problematic issues of the two cases could have been avoided if the limiting factors of the process had been analyzed ex ante. The single most important limiting factor in a transitional country like Estonia is not political, legal or economic factors, but an administrative issue, which could have been identified before the contracting decisions were made.

Literature


**Interviews**


