

CONTRACTING OUT GOVERNMENT SERVICES:  
LESSONS FROM THE PRIVATE SECTOR

Jonas Prager\*

15 April '93

Abstract

Diverse motivations induce private sector decision-makers to contract out rather than to produce in-house: economies and diseconomies of scale and scope, the competitive environment, and organizational diseconomies. But private sector firms also attend to *the costs of managing contracting out*. In contrast, public sector authorities have paid inadequate attention to the costs of the contracting out process, especially those involved in monitoring contractor compliance. Although this essay supports contracting out of government services to the private sector as a vital tool in the hands of public sector authorities, it argues that government production might be more efficient than outsourcing when contracting costs in general and monitoring costs in particular overwhelm the cost-savings that might otherwise accrue from contracting out.

---

\* Associate Professor of Economics, New York University. Funding by the C.V. Starr Center of Applied Economics is gratefully acknowledged as are the helpful comments of William J. Baumol.