

“Reverse Marketization”: Market Failure or Deficiency in Management?

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Abstract

Government purchase of services is considered to be a service delivery mechanism that can improve efficiency and economize costs. This mechanism has been popularized all over the world. However, at the same time, “reverse marketization” has been a common occurrence in the past few years. According to some scholars, “reverse marketization” is evidence of market failure, so they object to outsourcing contract in public services. This paper classifies market failure into four types and makes a case analysis of one of the four types. The case of reserve environmental sanitation service contracting testifies that in the model of low defect of supplier and low defect of demander, market failure will not inevitably give rise to “reverse marketization”. The direct cause is deficiency in management of the government. With regard to the actual situation of government management, this paper also puts forward the viewpoint that the government should act as “an open-minded purchaser”.

Keywords: reverse marketization, market failure, defect of supplier, defect of demander

1. Introduction

As a means of marketization, government purchase of services has ever been deemed as a panacea in overcoming government failure and improving supply efficiency of public services, and has been popularized and utilized all over the world. In 1976, the US government announced that the federal agencies were requested to investigate their own commercial activities and delivered these commercial activities to those private sectors which could provide commodities and services at a lower price (Donald F. Kettl., 2009, p.33). Ever since the 90s in the Twentieth Century, the French government purchase of public services has exhibited a developmental tendency of centralization. The government contributed funds to enable non-profit organizations and profit institutions to take major responsibilities for development service of the vulnerable, including 90% services for disabled people, 85% services for protection of the rights and interests of children and 70% services for home care. (Zhang, Ruli, & Chen, Shujie, No.11, 2010)

Outsourcing contract in public services emerged in China in 1995. Pudong New District of Shanghai entrusted Youth for Christ in Shanghai to manage the entertainment center of Luoshan City, and, afterwards, continue to undertake government service for the aged. From then on, the practice of government purchase of services began to be carried out in different cities and fields in China. It was pointed out in “Guiding Instructions of the General Office of the State Council in Government Purchase of Services from Social Power” in 2013, “All that can be done better by the society should be undertaken by social power, which will effectively resolve such issues as shortage, bad quality and low efficiency of public service products.”

Until today, marketization has already been a mainstream direction in governmental reform in China. Outsourcing of public services is more one of modes that have been extensively utilized. Nevertheless, in the past few years, the phenomenon of “reverse current” has sprung up in the domain of public service outsourcing. The survey made by the USA International City Management Association (ICMA) shows that, outsourcing services taken back by the local government before the year 1997 accounted for a small proportion among all the service supply methods, with no obvious change. However, from 1997 to 2002, the proportion of outsourcing services taken back swiftly increased from 11% to 18%, which almost doubled. (Huang, Jinrong, & Ye, Lin., No. 5, 2011) It is true that public services outsourcing in China has taken its step later, but frustrations and repetitions in public service outsourcing have not been rarely seen. Reverse current, on a large scale, in environmental

sanitation, urban management and public transportation in urban public services has pushed doubts and negation of the society on public services outsourcing to turn out to be a hot topic in public opinions.

2. Proposal of the Issue

The practical issue of reverse current in public service outsourcing has brought about new challenges to the academic world. There are mainly three aspects in foreign studies on reverse marketization. First of all, it is critical study on public services outsourcing. Disputes on public services outsourcing have always been existing which mainly contain the two aspects of performance of public services outsourcing and its social influences. It is posed by some scholars that the view that public service outsourcing can economize costs is nothing more than an illusion as quite a large amount of extra expenditure may be incurred in the process of outsourcing. Some other scholars hold the view that even if the costs are economized, the efficiency of public services is not as good as expected, as they are exchanged either by sacrificing the service quality (Oliver Hart, Andrei Shleifer, & Robert W. Vishny, 1997), or by employing low quality employees so as to cut down on personnel expenses (Susan Reynolds Fisher, & Margaret A. White, 2000). In terms of social influences, some scholars believe that outsourcing may bring about adverse effects on government responsibility and justice and breed the issue of corruption. The government may transfer responsibility together with services to the contractor. At the same time, after the government delivers outsourcing services, it will become insensitive to responses of the popular. Thus, it is difficult for the government to make positive response in service quality, environment and supervision (Norman Flynn, 1997, p.132). The issue of corruption in the process of service outsourcing even more draws attention of numerous scholars. As enormous profits are engaged in service outsourcing, there have been a lot of cases in which a large number of competitive bidding companies commit bribery to leaders of governmental sectors. Secondly, it is empirical study on reverse current in contracting. Before the 21st century, there were only some studies which acknowledged the possibility of existence of reverse current (Florencio Lopez-de-Silanes, Andrei Shleifer, & Robert W. Vishny, 1997), but there were no empirical studies. With advent of the new century, Warner and Hefetz were the first to focus on studies in this respect. They utilized data from ICMA to testify existence of the phenomenon of reverse contracting to the government. According to the data from 1992 to 1997, they found that the number of contracts taken back by the government accounted for as high as two thirds of the new outsourcing contracts. In their studies ranging from 1997 until 2002, reversion occurred in this proportion, which gave rise to negative growth in outsourcing contract (Amir Hefetz, & Mildred E. Warner, 2004). Finally, it is an analysis of reasons for reverse contracting. After Warner demonstrated that the phenomenon of reverse outsourcing indeed existed, he continued to delve into the underlying reasons. His study showed that efficiency, justice and civil expression standard were the variables for occurrence of reverse current (Mildred E. Warner, November, 2008). In the survey of ICMA in 2002, the issue of taking back contracting by contract managers was added. The survey result showed the following reasons: service quality, no expenditure economized, improvement of internal process and civil support to take back contracting by the government (Amir Hefetz, & Mildred E. Warner, 2004). The degree of importance decreased successively and progressively. A similar research in Canada manifested the reasons and orders were in full accord with that in USA (Robert Hebdon, & Jalette, P., 2008). It is observed that study of reverse marketization by scholars in Europe and America has undergone three stages and can extend to exploration in reasons for the reverse current. So far as an analysis of the current reason is concerned, it corresponds with doubts at the first stage, and partially verifies study at the first stage. However, neither the theoretical analysis nor the empirical demonstration has made a distinction between the service types of outsourcing. For different public services, the degree of publicity is different. Thus, there are different requirements on the modes of supply.

As public services outsourcing has emerged later in China, domestic studies on reverse contracting are more defective. Domestic doubts in public service outsourcing are similar with foreign countries which are mainly concentrated on market, justice, responsibility and corruption. Here, we will not say more than what is needed. Domestic specific studies on reverse contracting are even much rarer. Most studies adopt the method of case study and concentrate on a certain case to analyze dilemma in public services outsourcing in China or institutional selection logic under the reverse current. The major reasons why some services outsourced are hard to continue are changes in policies, quality of services and insufficient capacity in contract management (Chu, Yaping, No. 5, 2013). Some studies further analyze the institutional selection logic under the reverse current in outsourcing contracting. They expound, from the two perspectives of transaction and incentive structure of governments at the grassroots level, how all accountabilities, promotions and supervision mechanisms of governments at the grassroots level compel the governmental officials to select reverse marketization (Huang, Jinrong, & Ye, Lin, No. 5, 2011). Similar to the disadvantage in foreign studies, domestic studies also ignore the characters of public services in the case studies and have treated with reverse marketization without exception. In

addition, although the phenomenon reverse current also exists, occurrence of the reverse current in outsourcing of public services in China has its own peculiar reasons. It is true that the existing literature has noticed the particularity of the market of public services in China, they have not analyzed whether the phenomenon of reverse current is rational for a certain specific public service.

Indeed, not all public services are suitable for outsourcing. To a certain extent, the reverse current in public services is a rational debugging process after superheating of the market. However, this debugging is not to negate contracts outsourced. An overall view of literature both at home and abroad, reasons for withdrawing contracts by the government can be generally summarized as quality of services, no expenditure economized, improvement of internal process, civil support and changes in policies. Summary of all these reasons is refinement of some elements and the problem underlying all these reasons is directed to market failure. Naturally, governmental management is required to remedy market failure. Hence, governmental management is a precondition to cope with the issue of outsourcing. What's more, the capacity in management is a must. It is the supply mechanism of services that is transferred in services outsourcing instead of responsibility of the government. Even the new service supply mechanism also calls for the government to develop a management capacity that corresponds. If the government still adopts the traditional management tools, it is natural that outsourcing of public services will trigger a lot of management problems, especially in China where management technology is still underdeveloped.

In Guangzhou, the phenomenon of reverse current also appears in environmental sanitation, a type of relatively mature public services in contract outsourcing. This indicates that the reason for reverse contracting may not lie in the supply mode of outsourcing or in the market, but more results from deficiency of government in management capacity. Therefore, this paper puts forward the basic hypothesis: except for the restrictive elements in the attributes of services, emergence of the phenomenon of reverse marketization, to a large extent, results from deficiency of government in management capacity. Based on this hypothesis and by analyzing the case study of "reverse marketization" in environmental sanitation contracting in Guangzhou, this paper demonstrates that insufficient capacity of the government in dealing with defects of the market is the primary reason for reverse outsourcing, and comes up with the responsive strategy of being "an open-minded purchaser".

3. The Theory of Market Failure

If the market operates in a perfect way, it might be a better choice for the government to outsource its public services to the market for its resource allocation. Nevertheless, as mentioned above, market failure is an inevitable problem in public services outsourcing. Market failure can be classified as defect of supplier and defect of demander (Donald F. Kettl, 2009, p.25).

3.1 Defect of Supplier

Defect of supplier contains three aspects. The first defect is that there is not necessarily a market that can provide a certain specific type of public service for the government. The second defect is that even if there exists such a market, its competitive level may not be high. The third defect lies in the issue of externality. First of all, due to particularity of a lot of public goods, it is hard to find a market to provide special services, such as, prison, pollution abatement, traffic, public security and community rectification and so on. Sometimes, the government has no other choice but to build a market on its own. The process of building such a market is quite difficult as the government has to define services supplied by the market when it builds the market, determine a rational price and establish a price standard. Yet, a mature market can help the government in this regard. For instance, if you want to purchase home appliances, you can go to the marketplace to pick as required. Model, price and quality standard are all determined by the market. However, in the case of prison service, the government may need to determine by itself the specific services intended. There is rarely any reference to be made to the price and also the standard of service quality should be set ahead of time. Development of social organizations in China has not yet kept up with development of social economy. Thus, in terms of public services supply, social organizations have not yet played its due role, as a result of which a lot of markets for public services are still in a state of emptiness.

Second is the issue of competition. In order for a market to win in production efficiency, competition is indispensable. A ready-made competitive market may not necessarily exist, so usually one private organization monopolizes the services. When a market is manipulated by a single supplier, the danger is foreseeable. The supplier has magnified autonomy on efficiency, quality and price, which keeps the government in an adverse condition. However, even in a market which is constituted by a small group of suppliers, there is still danger of monopoly. As several suppliers all survive on orders from the government, if one supplier succeeds in bidding at a low price, the other suppliers may no longer survive and thereby withdraw from the market. As a result, a

monopolized market comes into being. Therefore, the US government will choose to let several companies to share the contract according to a definite proportion. Of course, this is not economical as only a competitive market can bring efficiency.

Finally, it is the issue of externality. Public goods per se have externality, externality effect of interests or costs. In terms of outsourcing, the primary issue is externality of costs. When a private organization produces public goods and provides public services, it may not take into account the external costs out of consideration of pursuit of profits. It is only when external costs are accumulated to a certain quantity that they become prominent. Therefore, in most cases, it is usually the citizens who silently bear external costs or the government who pays the bill for external costs, such as, the issue of environmental pollution and the issue of social justice, etc.

3.2 Defect of Demander

Defect of demander includes the following three aspects. The first aspect is that it is difficult to define goods. The second aspect is there is great difficulty in acquiring products information. The third aspect is the issue of internality. It has been mentioned in the above text about defining goods. In case there is no mature competitive market, it is the government that is responsible for defining the services or goods to be purchased. However, once in a while, the government in itself is unable to accurately ascertain what it needs to purchase ahead of time. For example, in the case of community rectification, even the government has no clear idea about how to set the price standard and service quality in a rational way due to the expertise, intangibility and dynamic nature of community. When even a purchaser is unable to clearly define the goods it wants to purchase, there is potential danger in contract outsourcing.

Unlike private goods, information of public services can't be extensively circulated in the market. Quite a lot of public goods, such as, high-tech products and information of international defense information, are neither suitable nor easy to circulate in the market. In addition, shortage of technical personnel in the government will result in incapability of the government in making independent judgment of the quality of both goods and services. In the situation with lack of information, it is hard for the government to become a sharp-sighted customer.

As a matter of fact, the issue of internality is quite common in China. Affected by the promotion tournament, the government will concentrate on vanity projects with all its efforts. The government at a lower level may alter the outsourcing projects at any time under guidance of the policies of the government at an upper level. The issue of internality is also common between coordination and communication between political officials and affair officials within the government. If the political officials who take responsibility for decision making fail to communicate with the affairs officials who take responsibility for execution and implementation, utter disorder may prevail in the management.

The degree of defect of supplier and that of defect of demander inter-combine to constitute four cases, namely, low defect of supplier --- low defect of demander, low defect of supplier – high defect of demander, high defect of supplier --- low defect of demander and high defect of supplier --- high defect of demander (Donald F. Kettl, 2009, p.29). The degree of difficulty in public services outsourcing that correspond with different combinations varies, accordingly, requirements on government management also vary. According to practical experiences, the term environmental sanitation in itself is easy to define and it is not hard to find clean companies in the market. Besides, there is no barrier to information circulation. This falls within the scope of low defect of supplier --- low defect of demander which is more suitable for outsourcing to the society. Nevertheless, reverse outsourcing to the government in environmental sanitation contracts appears in Guangzhou. The paper will make an analysis of this case in the following text and further discuss problems existing in this case.

4. Case Analysis (Note 1)

The JH Street in District A in Guangzhou initiated market-oriented reform in environmental sanitation services in 2004. By the year 2006, there had altogether three companies that provided environmental sanitation services to this street. "It is all sorts of problems that finally resulted in discontinuity in the cooperation and termination of the contracts. There were cases in which the companies didn't renew the contracts after their contracts expired, so they terminated the contracts." There was a great gap in expenditure for environmental sanitation of the JH Street. Insufficient expenditure for contracting perplexed the environmental services outsourcing of the JH Street. As a result, this project couldn't attract normative large-scale cleaning companies which lived up to the qualification requirements. A large majority of companies that participated in the tendering were some small-scale private cleaning companies with inferior qualification. As a result of insufficient expenditure, the phenomenon of "disclosure of pre-tender estimate" was discovered in the open tendering in 2006. After "disclosure of pre-tender estimate", the street office asked one of companies which had participated in the

tendering to temporarily undertake the environmental sanitation service. They only signed a contract for a duration of one year. In 2007 when the contract expired, a new invitation for bids was sent out. On May 1 that same year, another company undertook the project and the deadline for the contract was April 30, 2008. Afterwards, the governmental sector was busy with “building a national civilized sanitary city”, and had no time to improve the bidding document and hold open bidding activities, so the model of “a whole of managing and laboring” was adopted again.

It was said by the director of JH Street environmental supervision station that, “this contracting company is actually constituted by joint stocks of three people. Thus, it is a relatively small-sized and a private company”. “The project was supposed to continue to call for bids after the contract of that company expired. Yet, at that time, several reasons made the bidding interrupted. One of reasons was that the building of a civilized sanitary city was intense, so there was no time to call for bids. As invitation of a bidding cost a lot of experiences. Besides, I wanted to make everything perfect and not to make a slip-up. In the bidding document, no mistake was allowed to make. We wanted to make everything meticulous, which all cost a lot of time and efforts”. In addition to the problem of insufficient expenditure in contracting, “internal comprehensive quality and management modes of contracting companies were inappropriate. Some companies even had no idea about “the basic operational flows required by environmental sanitation”. Also, some other companies “were not familiar with the landform and geographical features of the street, so their level of work was quite low”. Therefore, on halfway during the last contract, operation of environmental sanitation companies of the JH Street was almost in a paralyzed state. The actual situation at that time was strained. Workers and companies had sharply different views, labor dispute was extremely sharp, complaints arose continuously from residents and workers were prepared to go on strike.

In the following text, we are going to make an analysis (market and competition are integrated into a whole) of the case step by step in the light of the six elements mentioned in defect of supplier and defect of demander.

4.1 Market Competition

“From the year 2004 to the year 2006, there were altogether three companies that provided environmental sanitation services to this street”. It can be said that the environmental sanitation service of the JH Street is a market with existing competition. However, since the market has not been developed sufficiently, the service contract has no way to attract large-sized cleaning companies. Those cleaning companies which participate in the bidding are mostly “small-sized and have inferior qualification”, not enough standardized. In District A in which the JH Street is located, marketization reform is executed and contract outsourcing of environmental sanitation services is imperative. Nonetheless, the actual situation of the market is poor and it seems that the JH Street is in an extremely passive position. Indeed, in the process of marketization, lack of competition is an issue a reformer has to face up to. At the initial stage of the reform, it is quite necessary for the managerial personnel to cultivate on the market in which they are about to purchase services. Since environmental sanitation service is a sort of service project which has no high technical content and in which quality of employees can get enhanced within a short period of time, it is not impossible to improve the market condition in the short run. However, the managerial personnel mentioned in this case passively accept the current situation of the market. As a result, those small-sized companies have the chance to sign the contract even if they “have no idea about the basic operational flow required for environmental sanitation”. This arouses people’s prejudice against contract outsourcing. Therefore, so far as this case is concerned, one of the essential reasons for reverse contracting is lack of market cultivation instead of lack of market competition.

4.2 Externality

The government may acquire what it intends to purchase when purchasing goods and services in the private market. At the same time, unexpected related problems may also arise. In the case we are talking about, not only the effect of outsourcing of environmental sanitation services is unsatisfactory, but also a lot of social issues come up. For example, workers and companies have sharply different views, labor dispute is extremely sharp, and workers are prepared to go on strike. In order to complete the project with limited funds and to make profits, the cleaning companies usually choose to reduce wages of workers, extend the time of work and enlarge the scope of work to cut down on costs of human resources. Since an enterprise has the nature of pursuing profits, it is likely to give rise to unfair negative externality to outsource public services to an enterprise. Of course, the phenomenon of shifting costs can be foreseen and taken under control. Workers’ interests are under protection by the law of labor and also the government can indicate the lowest wages and welfare of workers in the outsourcing contract. Externality of public services exists more or less, but it is likely to decrease the negative externality to the minimum if the managerial personnel can make prevention in advance and make compensation after the event.

4.3 Definition of Products

In the case of environmental sanitation services, definition of the products is relatively intuitive. Owing to visibility of urban cleaning effects, maneuverability of both setting and supervision of the quality standard of urban cleaning is relatively strong compared with other public services. What's more, before environmental sanitation services are outsourced, there is certainly a set of investigation standard for an environmental sanitation supervision station. Thus, it can be said that it is not hard to define the goods and set up the quality standard in the field of environmental sanitation services. However, in the case talked about, the fact is that "residents complain constantly". In the market theory, definition of products is to fulfill control over quality of products or services. So far as this case is concerned, as there is only definition and no supervision and no subsequent rewards and punishment measure follows up, it makes no sense at all even though the service in itself is easy to define and the quality standard is set in a clear way.

4.4 Information

The environmental sanitation service does neither engage high technology nor is it on the verge of technical possibility, so it has no high requirement for experts. Accordingly, circulation of its information in the market is relatively unhindered. However, in the case mentioned, among the contracting companies selected by the street office, some companies "are inappropriate in internal comprehensive qualification and management mode", some "have no idea of the basic operational flow required for environmental sanitation" and some "are unfamiliar with the landform and geographical feature of the street, so have a low working level". It might be true as mentioned above that the street office may be helpless in choosing its market, but training ahead of time may completely alleviate or avoid certain technical issues, such as, having no idea of the operational flow or being unfamiliar with the geographical feature of the street, etc. Therefore, it can be said that, managerial personnel's turning a blind eye to or reluctance to handle the information is one of the major influential factors which give rise to unstandardized services and unsatisfactory service effects of the contracting companies.

4.5 Internality

Internality compels the managerial personnel to concentrate on political support construction instead of managing all kinds of projects. Unsmooth communication between leaders at an upper level and affairs personnel at a lower level will bring about negative effects on management of contract outsourcing. In the case studied, it seems so too. When the contract expired in 2008, the street office was busy with "building a civilized sanitary city", so they had no time to improve the bidding document and hold an open tendering. The model of "a whole of managing and laboring" was adopted again. Of course, in reality otherwise. Building a sanitary city was the last straw that broke the camel's back. If there was no problem in market cultivation, selection of contractors and contract management at an earlier stage, there wouldn't be so much difficulty in the tendering for the next contracting period. Even if tendering had been delayed, the street office wouldn't make the decision to take back the contracting. The activity of building a sanitary city also just provided an opportunity for returning to the traditional model of "a whole of management and labor". It is true that internality exists, but it does not suffice for the environmental sanitation service to reverse the trend of marketization.

5. Concluding Remarks

We can come to the following conclusions through the above case analysis.

First of all, the phenomenon of "reverse marketization" is not necessarily and directly aroused by market failure. Market failure includes the two aspects of defect of supplier and defect of demander. These two dimensionalities inter-combine to form four situations of market failure. It is natural that different deficiency models call for different measures. It can be seen from the case analysis of environmental sanitation service outsourcing in Guangzhou that in the type of low defect of supplier --- low defect of demander, market failure is still within a controllable scope. So long as the government handles in an appropriate way, outsourcing of public services is likely to proceed smoothly. Hence, it can be said that market failure does not necessarily give rise to reverse marketization. Difference in the degree of market failure will result in different mechanisms of public services provision.

Secondly, management deficiency of the government will cause occurrence of "reverse marketization". In the model of low defect of supplier --- low defect of demander, it is totally possible for the government to let the outsourcing contract to hold up by means of cultivation of the market and by means of management of the contract relationship. Nonetheless, the street managerial personnel in the case studied haven't attempted to change the situation of the market. Instead, they passively let the state of affairs deteriorate, which finally causes the contracting to be taken back. As for those public services in which the degree of market failure is modest,

occurrence of reverse marketization may well result in disharmony between the management attitude and capacity of the government and the mechanism of provision of this new type of services.

Thirdly, the government should be an “open-minded purchaser”. In *Sharing Power: Public Governance and Private Markets*, Kettl, D. F. came up with the viewpoint of “being a sharp-sighted purchaser” for such a government that depended excessively on the private market. According to him, a contract is incapable of managing itself, so the government is supposed to manage such a contract relationship when there is defect in the market. As for the other side of this situation which is when the power of the market is not strong enough in the contract relationship, this paper poses that a manager needs to be an “open-minded purchaser”. In addition to the mastery consciousness required for a “sharp-sighted purchaser”, “an open-minded purchaser” also needs to offer support and guidance to an imperfect market, so as to promote sound development of the contract relationship. In order to become an “open-minded purchaser”, the government needs to 1) strengthen support to social organizations and positively cultivate the market of service purchase; 2) establish a responsibility mechanism of public services and bring in accountability system of service purchase; 3) lay high emphasis on management of public service contract and improve the capacity of supervision on service contract; 4) understand thoroughly the market condition of public services purchaser and establishment of the contract relationship; and 5) strengthen the capacity of organizations in learning and improve organizations’ communicative capacity and responsiveness.

Finally, it should be noted that the aim of this paper is not to negate rationality of reverse public services outsourcing. However, just as we need to deal with the upsurge of marketization in a rational way, we should, likewise, deal with any difficulty encountered in the process of outsourcing. Specific analysis should be made to specific issues. It is not a management attitude a manager is supposed to take to totally repudiate once suffered from setback. Although the case of reverse environmental sanitation contract outsourcing in Guangzhou does not represent the situation of the whole country and even the whole world, it suffices to show that the phenomenon of reverse marketization is not necessarily caused by market failure. On the contrary, this phenomenon might have resulted from management in the government per se. Moreover, this paper has only discussed one of the four models in market failure. What is the mechanism of public service provision in the other three models? What is the effect of the management capacity of the government? What kind of management capacity is the government supposed to possess? All these issues should be further discussed in future studies.

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Note

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