1. What is the "Hollow State" and how does outsourcing the contract monitoring function contribute to the further hollowing out the Hollow State? Make the argument that there is a “policy paradox” inherent in “Hollow Government” that contributed to the failure of outsourcing in the Florida Division of Children and Families (DCF).

2. Assume that you have just been hired by the Florida legislature to make recommendations for a new effort to outsource the contract monitoring function for Florida’s Division of Children and Families (DCF). You are asked to incorporate the five considerations for outsourcing identified in the case study (see Figure 1, p. 545) in the plan. Based on public policy and administration theory:
   a. What would you recommend to be done differently?
   b. How would you protect and promote public values?
   c. How would you reduce political opportunism?

3. Explain the "pattern-matching “logic which the authors' used to analyze Florida's experiment in outsourcing contract monitoring. What are its strengths and weaknesses of using this methodology to analyze the case evidence?
How Hollow Can We Go?  
A Case Study of the Florida’s Efforts to Outsource Oversight of Privatized Child Welfare Services

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Abstract
How hollow government can go is a long-standing question that has not been fully answered. In particular, the literature has highlighted the importance of contracting monitoring, but has rarely examined whether or when this function can be successfully outsourced. Extending and integrating theoretic approaches that are relevant to government contracting, this article proposes six conditions that public managers must address in order to successfully outsource the contracting oversight function. The framework is then applied to the case of Florida’s experiment with contracting out financial and programmatic monitoring of outsourced child welfare services. The discontinued experiment in Florida illustrates the challenges that arise when outsourcing the contracting monitoring function in a politically charged environment.

Keywords
Hollow state, outsourcing, contracting out, privatization, oversight

“How hollow state” has become a fundamental concept in the field of public administration to describe the increasing government reliance on contracting with nonprofit and for-profit organizations for the delivery of taxpayer-funded goods and services (Frederickson & Frederickson, 2006; Kettl, 1993; Milward & Provan, 1993, 2000; Romzek & Johnston, 2002). A central question in this rapidly growing literature has been around one dimension of hollowness: the extent to which government services can be successfully contracted out. Milward and Provan (2000) submit that hollowness varies between two extremes: a bureaucratic state with no contracting at all versus a government contracts all its production capabilities. Scholars have identified many factors that affect the effectiveness of contracting out government services, such as vendor availability, market competitiveness, service characteristics (e.g., assert specificity and measurability), and government contracting monitoring capacity (Brown & Potoski, 2003a, 2003b; Cooper, 2003; Romzek & Johnston, 2002).
The importance of government’s contract monitoring capacity cannot be overemphasized (Brown & Potoski, 2003a, 2003b; Cooper, 2003; Kelman, 2002; Milward & Provan, 2000). Brown and Potoski (2003a) conclude that in response to the widespread failures of government contracting, governments can respond “by investing in the managerial capacity to identify suitable situations for contracting, negotiate strong contracts, and monitor vendor performance” (p. 162). As the most critical task of public management in the new millennium is arguably to manage networks through collaboration and contracts (Agranoff & McGuire, 2001; Milward & Provan, 2003; O’Toole, 1997), contract monitoring becomes an essential managerial function.

The literature has largely assumed that the contract monitoring function should be kept in-house (e.g., Brown & Potoski, 2003a, 2003b; Cooper, 2003; Kelman, 2002; Kettl, 1993; O’Leary, 1996; Romzek & Johnston, 2002). However, there is another dimension of hollowness: the extent to which the contract monitoring function can be successfully outsourced. If government cannot provide a service well, it can outsource the service provision. Yet, if government cannot monitor the contracted service well, can it not source the monitoring function? If government can, then under what conditions outsourcing the monitoring function will succeed?

Research on these questions is limited, but in practice some governments have tried to outsource their contract monitoring functions. The research is lagging behind partly due to the fact that outsourcing contract monitoring functions is a relatively new phenomenon so that we have limited empirical knowledge to develop and test theory. This article aims to shed light on the issue by extending and integrating theoretical approaches that have been used to address government contracting issue, thus identifying the conditions that should be met for outsourcing the contracting monitoring function to succeed. The conditions are then applied to analyze the case of Florida’s experiment with contracting out financial and programmatic monitoring of its outsourced child welfare services, one of the first major efforts to expand the hollow state in this manner. Given that outsourcing contract monitoring is relatively new and not well understood, case study is an appropriate choice of method because it “investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident” (Yin, 2003, p. 13). Following Yin’s (2003) advice, we first develop a framework of six conditions for analyzing decisions regarding outsourcing contract monitoring and then illustrate the framework with the Florida case.

Understanding Outsourcing Contract Monitoring

At least four theoretical approaches have been used to analyze government contracting decisions: Transaction cost, agency theory, core competency, and public law. These approaches are not necessarily mutually exclusive or contradictory, but they have different emphasis, domain, and community of scholars. While none of them has explicitly addressed the issue of outsourcing contract monitoring, they can be extended and integrated to do so (see Figure 1).

Four Theoretical Approaches

Transaction Cost. Despite its criticisms (Johnston & Romzek, 1999; Smith & Lipsky, 1993), the transaction cost theory has been widely used to study government contracting (Brown & Potoski, 2003a; Kelman, 2002). Its central premise is that if the combined contract price and transaction cost of a good or service (e.g., costs in vendor search, contract negotiation, and monitoring) exceed the cost of in-house production, then the service or goods should not be contracted out. The amount of transaction cost is in turn affected by service and transaction attributes such as asset specificity, appropriability, service measurability, verifiability, uncertainty, complexity, and availability of a competitive market (Argyres & Mayer, 2007; Williamson, 1985). In particular,
transaction costs are increased when goods and services to be procured are highly specific and cannot be readily substituted, and when it is difficult to oversee vendor compliance due to measurement and compliance enforcement problems.

Contracting studies based on the transaction cost approach usually assume that government should maintain its monitoring function as part of its overall contracting capacity or managerial capacity (Brown & Potoski, 2003a, 2003b; Cooper, 2003; Kelman, 2002; Kettl, 1993; Milward & Provan, 2000). Nonetheless, while the transaction cost approach casts doubts on the advisability of outsourcing oversight, monitoring can be conceived as another service that could be procured under this framework.

**Agency theory.** Agency theory, or the principal–agent model, focuses on the design of alternative governance structures to mitigate the agency conflict arising from the possible divergence of interests between principals and agents (Jensen & Meckling, 1976). Despite its critics (Donaldson, 1990; Waterman & Meier, 1998), agency theory has been used in contracting studies where government is the principal and contractors are the agents who may deviate from government interest given the presence of incomplete and asymmetric information (Van Slyke, 2007; Johnston & Romzek, 1999).

Prescribed solutions to the principal–agent problem include (a) establishing a contract incentive structure that motivates the agent to align her action with the goals of the principal; (b) direct monitoring by the principal; and (c) indirect monitoring by third parties. Indirect monitoring includes outsourced monitoring—hiring other organizations to do the work, as well as indirect voluntary reporting—relying on actors outside the principal–agent dyad to voluntarily report the agent’s non-compliance acts (Lupia & McCubbins, 1994a; McCubbins, Noll, & Weingast, 1989). Examples of
the latter include government reliance on restaurant patrons’ reporting health code violations and politicians’ reliance on a policy’s targeted beneficiaries to sound “fire alarms” that trigger formal investigations of noncompliance.

Among the monitoring options, principals’ direct monitoring has not been a salient topic in recent literature because it may become very costly or infeasible (Miller & Whitford, 2006), which suggests that keeping contract monitoring in-house is not without its limitations. Indirect voluntary reporting is advocated in regulatory studies as it saves the principal the cost associated with direct monitoring (McCubbins et al., 1989; Strausz, 1997), but it can also be problematic—it is often unsystematic and unreliable (O’Rourke 2003), skewing enforcement agenda away from the pursuit of serious offenders because voluntary monitors tend to report the most obvious and trivial infractions (Bardach & Kagan, 1982). Outsourced monitoring has rarely been studied, particularly in government contracting. While such indirect monitoring can be seen as helping to address principal–agent issues, it can also create new agency problems—the third-party monitor may pursue its own interest instead of the principal’s interest and it may even collude with the agent (Tirole, 1986). Overall, while agency theory suggests that the principal is generally better off performing monitoring herself (Laffont & Tirole, 1991; Kofman & Lawarree, 1993), it can be extended to study the balance or configuration of direct and indirect monitoring.

Core competency. The resource-based view of firms argues that core activities—activities that are based on resources and capabilities that are valuable, rare, difficult to imitate and substitute for—lead to competitive advantage and should not be outsourced (Prahalad & Hamel, 1990). Otherwise, firms risk losing competitive advantage and becoming “hollow corporations” (Bettis, Bradley, & Hamel, 1992). In contrast, noncore activities may be outsourced to allow firms to focus on core activities and to reduce the costs of noncore activities (Leiblein, Reuer, & Dalsace, 2002; Poppo & Zenger, 1998). Public management literature has to a large extent assumed that contracting monitoring is a core competency government must retain in a hollow state. Monitoring capacity is part of the contract-management capacity that many scholars have considered crucial for contemporary governance (Agranoff & McGuire, 2001; Brown & Potoski, 2003a; Kettl, 1993; Van Slyke, 2007; Yang, Li, & Hsieh, 2009). Milward and Provan (2000) advise that even in an extreme hollow state government should keep in-house “a system integration function that is responsible for negotiating, monitoring, and evaluating contracts” (p. 362).

Still, the core competency concept does not necessarily lead to a definite answer about the limits of the contract state because the identification of core competencies is very difficult in government given that people have political and ideological differences regarding what should be the core activities of government (Hood, 1997). Bryson, Ackermann, and Eden (2007) show that identification of core government competencies depends on the mission and aspirations shared by organizational stakeholders. For an extreme example, what would happen if the majority of the people think the mission is anarchy or giving the responsibility for all public service to the market? In that case government may not need any core competencies. Nevertheless, the core competency concept may be used to examine how contracting monitoring as a core capability can be developed and how it relates to the strategic vision of the government.

Public law. Contracting out government services poses many constitutional and legal questions and many scholars argue has gone beyond its appropriate boundary (Goodsell, 2007; Moe, 1987; Rosenbloom & Piotrowski, 2005). From the public law approach, administrative actions that dispose of the state’s special legal powers or that are inherently governmental, should be exercised only by government personnel and cannot be contracted out. Contracting monitoring is viewed by many scholars as inherently governmental. Goodsell (2007) concludes that contract management should be kept in-house because “agencies cannot be asked to act without controlling execution of their mission” (p. 685) and contract management is central to controlling the execution. The General Accounting Office in a 1990 report found that inherently governmental functions were not clearly
defined in federal documents and suggested that “key criterion in determining whether service contracts are appropriate is whether the government maintains sufficient in-house capacity to be thoroughly in control of the policy and management functions of the agency” (p. 3). The Federal Activities Inventory Reform Act of 1998 (sec. 5) defines inherently governmental functions as including the exercise of discretion in applying federal authority to bind the United States, diplomatic or military action, judicial proceeding, managing contracts, and activities that significantly affect the life, liberty, or property of private persons.

Still, the state function doctrine is “ambiguous in principle and hard to reconcile with the variations observable in practice” (Hood, 1997, p. 122). There is no consensus on what constitutes inherently governmental activities due to political and ideological differences (Luckey, Grasso, & Maunel, 2009; Rosenbloom & Piotrowski, 2005). Distinguishing inherently governmental functions from others is part of a larger debate about the proper role of the government vis-à-vis the private sector. The debate is as old as the Constitution and continues to present multiple theoretical, judicial, and administrative challenges (Kennedy & Bielefeld, 2002; Luckey et al., 2009). In addition, even when the principle of inherently governmental functions is codified into public law, it is “coincident with its negation in practice” (Guttman, 2004, p. 41). For example, while corrections management is considered by many as inherently governmental, prison privatization has been on the rise (Moe, 1987; Price & Riccucci, 2005). Nevertheless, the public law approach can be used to emphasize establishing appropriate legal provisions and procedural safeguards in outsourcing the contract monitoring function.

A Framework of Six Conditions

None of these approaches focuses on or provides a full explanation about outsourcing the contract monitoring function, but they do provide relevant insights that can be aggregated towards developing an overall framework of six key conditions that can be used to analyze outsourced oversight. These conditions relate to critical considerations that are relevant to thinking about outsourcing the contract monitoring function: Is it economically desirable? Is it administratively capable? Is it socially and democratically controllable? Is it politically viable? Is it legally appropriate?

- Condition 1: Governments should make an informed decision to outsource the function, retain the authority and capacity to select the third-party monitor, and ensure that it possesses the technical knowledge needed to perform oversight and has similar preferences as the agency. This may require a competitive market for monitoring expertise and a screening process to choose the third-party monitor.

This first condition relates to the economic considerations that are derived primarily from transaction cost theory and agency theory. Both theories suggest that attempts to outsource contract managing will likely encounter significant transaction costs unless significant attention is paid to ensuring that a competitive market exists for oversight organizations and that the inherent asset specificity, measurability, and uncertainty of contract monitoring are addressed (Brown & Potoski, 2003a; Kettl, 1993; Van Slyke, 2007). They also suggest that it will be important for government to have an effective screening process to carefully select the third-party monitor that is competent, with a good track record, and/or with similar preferences as those of the government. These factors are particularly important for human services, which tend to have low measurability and high uncertainty and thus require a high degree of technical knowledge about federal, state, and local program requirements (Brown & Potoski, 2004; DeHoog, 1984; Dicke, 2002; Romzek & Johnston, 2005). These factors also relate to the procedural safeguard in public law theory (e.g., the bidding rules) and the contract formulation and negotiation capacity in core competency theory.
• Condition 2: Governments should develop a clearly defined oversight protocol that establishes the specific monitoring tasks and criteria that the private monitor is to apply in its work. This protocol should be linked to the shared strategic vision and goals of the agency.

This condition relates to administrative considerations and is largely based on the core competency theory about accountability for a shared strategic vision and mission. Although the core competency perspective suggests that contract monitoring should generally be kept in-house, public managers may not have a choice when elected officials choose otherwise. When this happens, managers should consider how outsourcing contract monitoring will affect government’s overall strategy and capacity building. This is critical as managers have the obligation to protect and promote public values (Bozeman, 2007), which must be created by the public managers via proactive strategic actions (Moore, 1995). Because public managers in this situation will retain the responsibility to monitor the private monitors, it will be critical for them to also retain at least some in-house monitoring capacity and have the capability to develop a clear set of strategic goals and performance plans that the third-party monitor is to use to assess contractor performance. This also relates to the measurability issue in transaction cost theory, the direct monitoring issue in agency theory, and the legal provision in public law theory.

• Condition 3: Governments should establish effective contract provisions with the entities subject to monitoring to ensure that the third-party monitor has the authority to perform its designated oversight tasks.

This administrative consideration and condition is also based on the core competency theory, which requires government to have strong system integration capacity to deal with the chain of delegations. While added layers of authority may complicate the line of control and accountability, government can still control the delivery of contracted services and achieve financial accountability (Heinrich, 2010), as long as government can maintain a systems integration function that makes the network components work seamlessly together. More specifically, government has to make sure that the service providers will cooperate with the third-party monitor and that the third-party monitor has necessary authority to conduct its oversight tasks. This issue should also be addressed in the contract language from the public law perspective.

• Condition 4: Governments should establish provisions for direct and indirect oversight to supplement the work of the third-party monitor and help identify any performance and principal–agent problems that arise.

The social/democratic considerations relate to this condition, which is derived from agency theory. Outsourced monitoring occurs in the public sector, which is subject to social and democratic accountability pressures. Agency theory suggests that governments must establish credible accountability threats to the third-party, and that outsourced monitoring should be complemented by both direct monitoring by the managing agency (with low intensity) and indirect reporting by clients, citizens, and watchdog organizations (Lupia & McCubbins, 1994b; Van Slyke, 2007; Yang, 2009). As the clients served by child welfare agencies (typically dysfunctional families and their children) likely lack the capacity to oversee either the outsourced service providers or the third-party monitoring entity, it is important for government to assign this responsibility to other watchdog groups to help ensure that principal agent problems are controlled and these functions are effectively provided.

Condition 5: Governments should establish effective protocols with credible threats for overseeing the private monitor and ensuring that it follows the oversight protocol.
The economic, social/democratic, and legal considerations relate to this condition, which is highlighted by agency theory and public law. Agencies should develop a well-designed contract with the third-party monitor to specify how its performance will be evaluated and rewarded. To ensure credible accountability threats, government should take several steps, including retaining some in-house monitoring capacity, establishing procedural safeguards, and maintaining other monitoring channels. For example, agency theory suggests that government should effectively negotiate with the third party to apply procedural safeguards including transparency and freedom of information provisions that enable the government and watchdog groups to review and audit business and client records for compliance with contract and legal requirements (Lupia & McCubbins, 1994b; McCubbins et al., 1989), which is also in line with the constitutional and legal approach (Moe, 1987; Rosenbloom, 2007; Rosenbloom & Piotrowski, 2005). Governments may also negotiate contractual incentives with the third-party monitor such as bonuses for effectively completing oversight tasks to help align its interests with those of the government principal.

- Condition 6: Governments have enough political support to retain effective control of both the outsourced service providers and the third-party monitors to control against political opportunism by either entity.

The political considerations directly relate to this final condition, which is implied by agency theory. Political institutions and dynamics shape outsourced oversight. While applications of the classic principal-agent model in government has been criticized for oversimplifying the political dynamics of a governance system (Van Slyke, 2007; Yang et al., 2009), more refined models provide relevant guidance by accounting for the existence of multiple principals and multiple agents in constantly evolving relationships (Miller & Whitford, 2006; Waterman & Meier, 1998; Waterman, Rouse, & Wright, 2004; Yang, 2009). The refined models recognize that principals can be opportunistic whereas agents can be well minded, which is applicable to government contracting because politicians may collude with contractors and prevent bureaucrats from applying sanctions. Outsourcing is often made in a web of politics that is very likely to be messy, unpredictable, and unstable, creating significant challenges for public management (Brown, Potoski, & Van Slyke, 2006; Kettl, 1993; Romzek & Johnston, 2005; Van Slyke, 2007).

Collectively, these six conditions can be aggregated into a strategic governance framework for outsourced contract monitoring that recognizes the complex interrelationships of economic, administrative, social/democratic, political, and legal forces. This framework suggests that it is essential for governments to meet those conditions if outsourced oversight is to succeed. In other words, public administrators will face tremendous management challenges if these key conditions are not met.

**The Case of Florida’s Child Welfare Outsourcing**

Florida’s experience in outsourcing oversight of privatized child welfare services provides a unique opportunity to apply our framework. The Florida effort was among the first of its kind in the nation, reflecting both dissatisfaction with the performance of the existing oversight system and a belief that virtually all public activities could and should be outsourced. Our examination is based largely on a series of evaluations of Florida’s child welfare outsourcing initiative that were directed by one of the authors over a 12-year period. Following Yin’s (2003) advice, multiple sources of evidence were collected, including (a) direct observations and site visits to the areas in which oversight had been outsourced; (b) extensive interviews with staff of the Florida Department of Children and Families (DCF), the community-based lead agencies that provide child welfare services, the third-party monitors, and community stakeholders; (c) documents such as contracts, DCF policies and reports, and evaluative reports by third-party organizations; and (d) archival
data such as performance records. To provide a fair and accurate description of the case, data tri-
angulation was used and attention is paid to sources of evidence that may have different views
such as lead agencies, third-party monitors, DCF officials, clients, and legislators. Investigator tri-
angulation was also engaged as the two authors deliberated to reach a consensus after inves-
tigating the evidence independently. The authors tried to the extent possible to be objective and
neutral in evaluating conflicting evidence. Moreover, our description and analysis of the case
was checked with various stakeholders to make sure its fairness and accuracy.

**History of Outsourced Child Welfare Services in Florida**

In the mid 1990s, the Florida Legislature mandated that the Department of Children and Families
(DCF) outsource the state’s child welfare services, including foster care and adoption services, to
community-based lead agencies. This transition was the outgrowth of long-standing legislative
dissatisfaction with the department’s performance and prior efforts to decentralize service provi-
sion. In 1996, the Legislature mandated that DCF establish pilot programs to privatize child
protection services through contracts with community-based agencies (Ch. 96-402, Laws of
Florida). To meet this mandate, DCF contracted with four nonprofit organizations that had his-
torically provided some child welfare services in their regions and agreed to provide a broader
range of services. These organizations assumed the role of “lead agencies” and expanded their
operations to assume more of DCF’s program functions. The lead agencies varied in the scope of
services they agreed to provide, generally assuming responsibility for case management and pro-
viding emergency shelter, foster care, and/or adoption services. The organizations provided these
services through a mixture of in-house staff and subcontracts with other local for-profit or
nonprofit agencies. The four pilot lead agencies signed contracts with DCF in 1997, with the pilot
to run through 2000 (Office of Program Policy Analysis and Government Accountability
(OPPAGA), 2001).

In 1998, the Legislature directed DCF to submit a plan to expand the initiative statewide and
privatize all child welfare services within 3 years by January 1, 2003 even though the pilot was still
in its early stages, the agencies were not all fully operational, and evaluations of the pilots were
inconclusive regarding their success. DCF later cancelled contracts for two of the pilot agencies
because they had failed to meet contractual requirements, and one was later indicted for Medicaid
fraud and grant theft (OPPAGA, 2001; Chapter 98-180, Laws of Florida). To comply with the
legislative directive, DCF embarked on an aggressive effort to recruit local providers that would
agree to assume responsibility for child welfare services in all 67 counties.

The 3-year time frame for full privatization was subsequently extended to December 2004 due
to difficulty in recruiting providers in some areas of the state, particularly rural regions, and the
problems experienced by the early lead agencies. DCF contract monitoring reports for November
2002 and January 2003 noted that two lead agencies that were functioning at the time were expe-
riencing substantial problems related to financial stability, data integrity, and high staff turnover
that adversely affected their performance. For example, one of these lead agencies had not submit-
ted invoices on time or maintained an adequate cash flow, and the other had experienced a 64%
turnover rate for case managers and a 60% turnover rate for supervisors in its first nine months of
operation. In addition, both agencies lacked internal measures to ensure the accuracy and timeliness
of data entered into DCF’s information system (OPPAGA, 2003, 2004a).

To address these problems, the 2003 Legislature required DCF to establish a stronger process
for determining whether local agencies were ready to assume responsibility for managing child
welfare services. DCF created a formalized readiness assessment process that used a series of site
visits, formal checklists based on national standards, and input from peer agencies to evaluate local
agencies’ readiness to assume broad financial and programmatic responsibility for child welfare
service provision. This expanded process was successful in enabling DCF to complete statewide transition to outsourced community-based child welfare services in 2005. In September 2008, child welfare services in Florida were provided by 19 lead agencies, which in turn contracted with more than 500 nonprofit and for-profit entities.

**Decision to Outsource Financial and Program Monitoring**

Florida further expanded hollow state contracting beginning in 2005 with decisions to outsource many of DCF’s monitoring functions. This effort had two stages—outsourcing fiscal monitoring for all lead agencies, and a pilot project to outsource both fiscal and program monitoring for two lead agencies. However, the initiative to outsource fiscal monitoring statewide subsequently failed and this responsibility was brought back in-house. The pilot project to outsource both fiscal and program monitoring for selected lead agencies was also problematic and was eventually discontinued.

DCF had long experienced problems in measuring child welfare service performance. Numerous prior studies of Florida’s child welfare system had noted that DCF’s monitoring systems had weaknesses that had impeded their effectiveness prior to the outsourcing initiative (OPPAGA, 2002, 2003, 2004, 2006b). DCF had not fully developed a system for monitoring the lead agencies prior to the decision to outsource child welfare services, and the system was subjected to almost continual revision after the initiative was underway, with major revisions occurring in 2003, 2005, and 2007. DCF’s contract monitoring unit was also subject to almost continual reorganization and several rounds of staffing reductions, resulting in high staff turnover and high vacancy rates for monitoring positions. Furthermore, the department’s primary child welfare information system, HomeSafeNet, had been under development since 1993 and implementation was still incomplete when the transition to privatization was underway. For example, as of December 2003, when the transition to privatized child welfare services was more than half completed, HomeSafeNet was not capable of producing reports on seven of the child welfare program’s primary performance measures, and the system’s case planning and financial management components were not operational. This impeded the department’s ability to provide effective oversight because key information needed for decision making was not available (OPPAGA, 2004, 2006).

As a result of these problems, DCF was unable to monitor the lead agencies as required by its contract monitoring plans. Although each lead agency was to receive an annual contract monitoring review, two lead agencies were not monitored for Fiscal Year 2004-2005, and many of the reviews were not issued in a timely manner. This resulted in delays in both identifying and correcting performance problems and contract violations. For example, the department’s reviews determined that 12 of the 17 lead agencies in Fiscal Year 2004-2005 had not fully implemented quality assurance plans. The reviews also found that some lead agencies had failed to develop policies and procedures for subcontractor monitoring, had failed to monitor some or any subcontractors, had not required or followed up on corrective actions, and had failed to identify significant instances of subcontractor noncompliance that were later identified by the department (OPPAGA, 2006).

A related problem DCF encountered was the loss of many of its experienced monitoring staff. For example, the 2005 DCF reorganization resulted in a loss of 24 experienced contract monitoring staff statewide, out of 68 positions (OPPAGA, 2006, 2007). This loss of expertise limited DCF’s ability to fulfill its oversight responsibilities with in-house staff and contributed to the decision to outsource fiscal and program monitoring services.

**Outsourced statewide fiscal monitoring.** In 2005, DCF began to outsource financial monitoring of all lead agencies statewide. The rationale for doing so was that DCF no longer had sufficient in-house staff with monitoring expertise to adequately perform this function, and the need for effective fiscal monitoring had been highlighted by the failure of two lead agencies due largely to
overspending and inadequate fiscal controls (OPPAGA, 2006). In the fall of 2005, DCF selected two vendors through a Request for Proposal process to perform financial monitoring of the lead agencies. Each district administrator was to select one of the two vendors to monitor the lead agencies in their area. The fiscal monitors were to review the lead agencies and make recommendations to address any identified weaknesses.

However, this initiative was unsuccessful due to both limitations in the extent of department planning and poor performance by the outsourced fiscal monitors. Most notably, DCF had not finalized the specific monitoring tasks that the privatized fiscal monitors were to perform before entering into contracts with these vendors. Instead, it had developed a list of potential fiscal monitoring tasks that district administrators were to consider when negotiating the fiscal monitoring contract for each lead agency. After determining that this would result in inconsistent monitoring activities across the state, DCF developed a core set of tasks for the contracts and entered into eight separate contracts to provide fiscal oversight of the lead agencies. Nonetheless, after the fiscal monitor began operating, DCF determined that the monitor had not complied with contractual requirements; violations included using staff that did not meet specified minimum qualifications, inadequately documenting findings, and not completing required monitoring tasks. DCF administrators also determined that outsourcing fiscal oversight adversely affected its ability to control the quality and consistency of the work of the lead agencies. DCF subsequently terminated the contracts in December 2007 and reassumed responsibility for conducting fiscal monitoring of the lead agencies (Florida Department of Children and Families Office of Inspector General [DCF], 2008; OPPAGA, 2006, 2008b).

Pilot to outsource both fiscal and program oversight. The second major initiative to outsource oversight began in 2006, when two lead agencies successfully lobbied the legislature to mandate that DCF contract with outside entities to conduct both financial and program monitoring of their activities. The rationale for this action was that the management of one of the lead agencies “sought independence from the department and questioned the competence of the department’s monitors” (DCF, 2008, p. 5). Chapter 2006-30, Laws of Florida, established a 3-year pilot program to outsource DCF’s fiscal, administrative, and program monitoring responsibilities to independent third parties. The law also required DCF and the lead agencies to agree with the selection of the third-party monitors, effectively giving the lead agencies veto power over the vendor selection.

Pursuant to this law, in July 2006 DCF contracted with a certified public accounting firm to provide financial oversight of the lead agencies. This firm had previously conducted fiscal monitoring for one of the lead agencies as part of the broader effort to outsource financial oversight, and its appointment to continue this function was approved by the two lead agencies. The firm’s responsibilities included reviewing the lead agencies’ procurement and contracting practices, reviewing invoices prior to submission to DCF for payment, assessing internal controls, and reviewing client eligibility determinations for federal funding. The firm was not required to examine the lead agencies’ subcontractors, but it was to examine how the lead agencies monitored whether their subcontractors complied with contract requirements. Contrary to DCF’s experience with attempting to outsource fiscal monitoring statewide, this effort proceeded relatively smoothly for the two pilot lead agencies. The firm provided monitoring reports to DCF as required and both DCF and the lead agencies reported that the vendor made substantive recommendations to improve the lead agencies’ financial operations (DCF, 2008; OPPAGA, 2008).

Outsourcing program oversight of the two lead agencies was subject to numerous delays and implementation difficulties. DCF did not contract with an entity to conduct program oversight until November 2006 (5 months after selecting the fiscal monitor), when it contracted with a child welfare research and demonstration institute. The lead agencies had recommended the institute based on its national reputation for performance measurement and analysis. The institute then subcontracted with another entity to conduct monitoring activities and a different entity to assist the pilot
lead agencies in using data to improve, monitor, and manage child welfare outcomes. Collectively, the institute and its subcontractors were responsible for programmatic monitoring and quality assurance reviews as well as developing new performance measures to assess the lead agencies’ outcomes (OPPAGA, 2007, 2009).

The delay in selecting the contractor resulted in a substantial gap in program oversight. DCF had ceased performing program monitoring in June 2006, and the institute did not begin its work until December of that year, resulting in a 6-month period when no program monitoring occurred. Furthermore, when the institute began to carry out its monitoring role, it determined that it was unable to validate the lead agencies’ internal quality assurance data. The institute found that the lead agencies had not completed all required quality assurance activities, and it was unable to validate the information reported in the quality assurance records (Due to the dynamic nature of child welfare cases, the services provided to children can change over time. The institute was unable to verify, when it examined quality assurance records several months after the data were recorded, that the information accurately reflected the services children were receiving at the time). As a result, the institute was unable to complete the number of case file reviews required by its contract. The lead agencies also disputed the conclusions reached by the institute based on its file reviews. Due to these concerns, the institute did not submit a finalized monitoring report until September 2007, 15 months after DCF had discontinued its own program oversight of the lead agencies.

To improve the quality assurance process, the institute proposed and DCF approved reducing the numbers of cases that lead agencies were required to examine in their internal quality assurance monitoring, thus reducing the number of cases that the institute would need to review in its own oversight effort (OPPAGA, 2008). While the institute met its subsequent reporting requirements, both internal and external watchdogs raised concerns that outsourcing program oversight did not enable DCF to have sufficient knowledge of the services being provided to the children. In 2008, DCF’s internal auditor recommended that DCF eliminate the pilot project at the conclusion of the statutory 3-year period and resume responsibility for both financial and program oversight of lead agencies, citing that the state had reduced ability to assure that children receive effective and needed services when an additional layer is established between DCF managers and its service delivery providers (DCF, 2008). The Legislature’s oversight office similarly recommended in 2009 that program oversight be brought back in-house (OPPAGA, 2009). DCF, in response, discontinued the pilot project in July 2009.

Analysis and Discussion

The case evidence was analyzed with Yin’s (2003) most preferred strategy—following the theoretical propositions. The pattern-matching logic was used to compare the empirical evidence and pattern with the theoretical predictions (Trochim, 1989). Matched patterns help strengthen the internal validity of the study (Yin, 2003). Since both of Florida’s experiments with outsourced oversight were discontinued, the analysis will identify whether the six theoretical conditions were missing or inadequate in the evolution of the events. It should be noted that while the discontinuation of the experiment was due to the problems it encountered, the possibility exists that these problems were short term and could have been resolved if more time were given for involved actors to overcome the learning curve. Thus, the analysis will also address this rival explanation.

The Florida case illustrates that the motivation behind outsourcing contract monitoring is similar to the motivation behind privatizing the service delivery—that is, policymakers were convinced that DCF did not do a good job. This fact seems to be acknowledged by all stakeholders of the child welfare policy including DCF itself. However, the case also shows that the incomplete market and the added layer of authority posed challenges to the alternative—outsourcing the
contract monitoring function and expanding the hollow states. Notably, at least five of the six key conditions that our framework indicates are essential to successful outsourced contract monitoring were absent or inadequate when Florida attempted to privatize fiscal and programmatic oversight.

As to the first condition, while transaction cost, principal–agent, core competency, and public law theory suggest that it is critical for agencies to make an informed privatization decision and retain the authority and capacity to select third-party monitors, the Florida experience indicates that this may be difficult to do in practice. The Florida experiment did not follow a rational strategic planning process—it was not the case that elected officials and DCF considered the optimal conditions for outsourcing and acted accordingly. Rather, the decision-making process in Florida fit more closely the garbage can model where solutions chase problems. Privatizing child welfare services was introduced by the legislature and governor as “the” solution to poor performance on at least partly ideological grounds. The decision to outsource oversight of these functions was similar: DCF’s problems with monitoring were rightly recognized but whether outsourcing the function is a better choice was not carefully studied. On the contrary, the decision to outsource represented, in part, political opportunism of the two lead agencies who sought to escape DCF’s control. The two lead agencies exerted substantial influence in the decision to select the programmatic monitor, further weakening the state’s ability to remain in control of the process. The Florida experience is not surprising as the literature has observed that contracting out decisions are often decided politically (Brown et al., 2006; Hood, 1997; Romzek & Johnston, 2005; Van Slyke, 2007).

A challenge in expanding the hollow state is thus how to convince elected officials that the conditions conducive to outsourcing indeed matter and should be considered before political decisions are made to expand outsourcing.

On a more positive note, the Florida case indicates that it may be more feasible to meet the second part of Condition 1, ensuring that selected vendors possess the requisite technical knowledge to perform oversight, although Florida’s experience suggests this may be challenging at times as well. DCF was able to hire a nationally recognized entity with expertise in child welfare to provide program monitoring, which improved the department’s credibility with its contractors and helped the department develop more useful performance measures and less intrusive monitoring processes. However, the program monitor lacked prior experience in performing ongoing oversight of privatized service delivery, and lead agencies subsequently did not accept many of its findings, resulting in disputes about the validity of its conclusions. Hiring fiscal monitors proved to be more difficult. The inability of DCF’s selected statewide fiscal monitor to hire staff with the specified minimum qualifications and to perform designated tasks was a key factor in DCF’s subsequent decision to terminate this contract and bring the function back in-house. DCF was more successful in outsourcing fiscal oversight of the two pilot project lead agencies, in part because the third party selected to perform that role had a demonstrated track record of success and had gained the confidence of both the department and the lead agencies.

DCF clearly failed the second key condition—having a well-defined oversight protocol that is based on a strategic vision and establishes the specific monitoring tasks the outsourced monitor is to follow. As noted in the case description, the difficulty in measuring child welfare service performance was a long-standing problem for DCF, and this challenge was magnified under outsourced oversight. A primary weakness in Florida’s effort, which characterized DCF’s overall management of privatized child welfare services, was DCF’s inability to develop a functional oversight system before it contracted out both the child welfare services and the oversight of these services. This was due in part to the fact that human services tend to have low measurability and high uncertainty (DeHoog, 1984; Dicke, 2002; Brown & Potoski, 2004; Romzek & Johnston, 2005), and partly due to political pressures that led to the aggressive implementation schedule, which in turn resulted in the absence of a strategic framework: DCF had not fully developed an
accountability system before the process was begun, and the accountability system was regularly amended as the outsourcing proceeded. This demonstrates that while it is critical to establish strong accountability systems before outsourcing either direct service delivery or oversight of these services, it may be challenging and time-consuming for activities as complex as child welfare services, particularly when they are provided through a decentralized network of providers and subcontractors. Somewhat ironically, the legislature decided to outsource the monitoring function on the ground that DCF did not have an effective monitoring framework, but without developing such a framework, reliance on third-party monitors became problematic.

The lack of strategic visioning and planning is not unique to Florida. Cooper (2003) argues that too often government contracting relates to a purely reactive approach as if one runs to the store when she or he runs out of food: “Many organizations simply see contracting as one more task to be carried out rather than as a major area of endeavor for which planning and support are needed” (p. 168). He points out that public managers often need assistance to adopt a more proactive approach. Given the paramount pressure from and involvement of elected officials, as well as the uncertainties resulted from it, strategic leadership that shapes political environment in order to create long-term public values is essential (Moore, 1995). Unfortunately, such strategic leadership is difficult to create in state agencies given the political and ideological forces that are brought to bear in politics.

The case study illustrates that it can also be difficult to meet the third condition identified by our framework—ensuring that monitoring agents have the authority needed to carry out their functions. While the program and fiscal monitors apparently had access to the private provider records needed to conduct their oversight tasks, they at times lacked the ability to ensure that their findings were acted on. As noted in the case description, the lead agencies rejected the findings of the programmatic monitor, which resulted in a substantial delay in the release of its reports. Here again, the case shows that it can be difficult to manage the political aspects of hollow state management. The lead agencies, after successfully petitioning the legislature to free them from DCF’s direct oversight, similarly were able to limit the activities of the department’s third-party monitor, even after they had played a key role in selecting the entity.

Florida was more successful in meeting the fourth condition, providing for indirect and outside oversight to supplement DCF’s own contract monitoring. The Legislature’s oversight office—OPPAGA—was tasked to conduct a series of evaluations of both DCF’s oversight functions and the overall transition to privatized child welfare services. However, while such oversight was helpful in identifying systemic issues, it could not by itself make up for the failure to meet the other key conditions. While OPPAGA’s studies documented the difficulties DCF was having in managing the outsourced oversight system, third parties could not directly resolve the identified problems. Moreover, it was unclear to what extent indirect voluntary monitoring by clients and citizen groups played a role, as there was no systematic process for such monitoring.

Florida’s experience indicates that it can also be difficult to meet the fifth condition—ensuring that outsourced monitors fulfill their contracted oversight tasks with effective protocols and credible threats. DCF eventually had to discontinue contracting with its statewide fiscal monitor due to difficulties in enforcing compliance with staffing and oversight requirements. It was also unable to ensure that the programmatic monitor release monitoring reports as required under its contract. These difficulties were aggravated by the ongoing staff reductions and reorganizations of its own monitoring staff, such as the 2005 reorganization that resulted in the loss of over a third of its experienced contract oversight staff. These reductions made it more difficult of DCF to oversee the performance of its oversight vendors once the decision to privatize fiscal and programmatic monitoring was made. The literature suggests that government should keep in-house at least some production capacity so that they can learn about the costs of production and prevent contractors from colluding on pricing (Milward & Provan, 2000). Our case study indicates a parallel
lesson that government should keep direct monitoring capacity that is strong enough to control
the whole system and pose credible threats to both service providers and third-party monitors.

Florida’s experience suggests that politics may pose the greatest challenge to outsourcing con-
tract oversight and meeting the sixth condition for successfully extending the hollow state—retaining
enough political support to effectively control political opportunism by service providers, third-
party monitors and politicians. The decision to outsource financial and programmatic oversight
of the two pilot lead agencies occurred after they successfully lobbied the legislature to gain
more independence from the department, securing even the authority to participate in the selec-
tion process for the outsourced monitoring agents and the development of the monitoring tools
that were to be used to assess their operations. This can be seen as political opportunism by both
the principal and the agent of the government agency, particularly as the lead agencies subse-
quently rejected the findings of the outsourced program monitor they helped to select and prevented
the release of monitoring reports for more than 6 months. Agents in outsourcing (the lead agen-
cies) can be seen as influencing or colluding with the principal’s (DCF) principals (elected offi-
cials), thereby changing the incentive structure and decision making of the third-party monitor
(another agent).

A rival explanation of Florida’s experience is that these conditions, or challenges associated with
them, are overstated as it may simply take time for DCF and other actors to learn how to overcome
these problems. Indeed, the role of time and learning has been underestimated in contracting out
studies (Yang et al., 2009). The Florida experiment lasted less than 5 years, so we cannot completely
exclude that possibility. Nevertheless, the Florida case shows that learning is often disrupted or
constrained by the contracting politics. For example, DCF did learn from its experience and tried
to revise its monitoring framework or accountability system as the outsourced monitoring pro-
gresses, but the political environment did not provide time for any of these systems to mature
before structural changes were made again, creating a tension between political decisions, learning,
and management capacity. As Williamson (2008) observes, capabilities that could be “homegrown”
(successively built up via learning by doing) may simply be unattainable as the urgency of
real-time responsiveness becomes great.

Overall, as shown in Table 1, Florida fully met only one of the six conditions for successful
hollow state management, while it partially met two and did not meet three. Of these problems,
the case study suggests that it may be particularly difficult for public managers to meet condition
6, creating and maintaining both the institutional structures and the political support needed for
outsourced oversight to be successful. Given the inherently political nature of the public service
delivery environment, controlling political opportunism by contracted vendors is likely difficult at
best and may often be impossible in practice.

While outsourcing contract monitoring is not necessarily a bad thing in and of itself, the Florida
case study demonstrates that expanding the hollow state in this direction requires critical environ-
mental conditions to be present to be successful, and it can be very difficult to meet these condi-
tions. Policymakers need to recognize that outsourced monitoring represents a new governance
mechanism that requires reinforcing other governance components such as management infra-
structure, yet Florida’s experience demonstrates that the political realities make such recognition
difficult to achieve.

Conclusion

Much of the hollow state literature assumes that contract monitoring functions should not be out-
sourced, but this assumption has rarely been explicitly theorized or tested, and in practice this pre-
scription has been violated due to political decisions. This study uses transaction cost theory, agency
theory, the core competency argument, and the public law approach to identify six conditions that
**Table 1. Florida Met Only One of the Six Conditions for Outsourcing Oversight**

<table>
<thead>
<tr>
<th>Condition Description</th>
<th>Met or not</th>
<th>Why</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Governments should make an informed decision to outsource the function, retain the authority and capacity to select the third-party monitor, and ensure that it possesses the technical knowledge needed to perform oversight and has similar preferences as the agency.</td>
<td>Partly met</td>
<td>Decision to outsource was largely politically driven, and lead agencies played a role in selecting monitoring vendor. The state was able to hire a vendor with expertise in programmatic monitoring, but had difficulty hiring vendors with requisite fiscal monitoring expertise.</td>
</tr>
<tr>
<td>2 Governments should develop a clearly defined oversight protocol that establishes the specific monitoring tasks and criteria that the private monitor is to apply in its work. This protocol should be linked to the shared strategic vision and goals of the agency.</td>
<td>Not met</td>
<td>The state had historically lacked a clear oversight protocol linked to its strategic plan and it continued to lack one when it outsourced oversight.</td>
</tr>
<tr>
<td>3 Governments should establish effective contract provisions with the entities subject to monitoring to ensure that the third-party monitor has the authority to perform its designated oversight tasks.</td>
<td>Not met</td>
<td>The third-party monitors lacked full authority to carry out their tasks without challenge by the outsourced lead agencies.</td>
</tr>
<tr>
<td>4 Governments should establish provisions for direct and indirect oversight to supplement the work of the third-party monitor and help identify any performance and principal–agent problems that arise.</td>
<td>Met</td>
<td>Florida provided for strong monitoring of the third-party monitor through extensive studies by the OPPAGA and the DCF Inspector General.</td>
</tr>
<tr>
<td>5 Governments should establish effective protocols with credible threats for overseeing the private monitor and ensuring that it follows the oversight protocol.</td>
<td>Partly met</td>
<td>While the third-party programmatic monitor generally met its contractual obligations, the fiscal monitors did not do so.</td>
</tr>
<tr>
<td>6 Governments have enough political support to retain effective control of both the outsourced service providers and the third-party monitors to control against political opportunism by either entity.</td>
<td>Not met</td>
<td>The state did not prevent political opportunism by the outsourced lead agencies, which lobbied to outsource oversight, played a key role in selecting the monitoring entity, and delayed release of its monitoring reports.</td>
</tr>
</tbody>
</table>

are necessary for successful outsourcing of monitoring functions. We use these conditions to analyze Florida’s effort to outsource oversight functions of its privatized child welfare services, an effort that has failed and been discontinued. The failure was not surprising because, as the case study shows, the outsourcing decision was politically determined and public administrators were required to create oversight structures after the fact and under less than optimal circumstances such as the absence of a competitive monitor market, low measurability of child welfare services, lack of a strategic and performance framework, loss of in-house monitoring staff, and lack of credible accountability threat.
As this case study focuses on a single state’s experiences over time, it should be noted that other states with different political and legislative structures that bear on contracting and privatization may have different experiences in meeting the conditions and managing outsourcing efforts. The validity of the proposed framework may be further verified by comparing Florida’s experience with other states that have tried outsourcing contract oversight in the same policy area. Future studies may also validate the framework by comparing Florida’s experience with outsourcing contract oversight in different policy areas such as transportation and public safety.

At the same time, this case study and the framework it develops are theoretically based. It illustrates the challenges in outsourcing oversight and may be used to analyze the experience of other governments. Florida’s experience demonstrates that decisions to outsource functions such as contract management and monitoring should be taken with great caution. Some problems, notably the political opportunism of lead agencies that sought to escape department oversight by promoting outsourcing of fiscal and program monitoring, exercising control over the selection of these agents, and then delaying the release of oversight reports by the agents, demonstrate that principal-agent problems may be endemic to such initiatives.

This article also shows that the theories of transaction cost, principal–agent, core competency, and public law are useful tools in examining the effectiveness of pushing the envelope of the hollow state and outsourcing oversight of privatized services when these theoretical approaches are extended and integrated. When applying these theories in practice, it is mistaken to treat them as purely normative and assume that outsourcing decisions are an outcome of organizational strategy and that once this strategy is chosen organizations can easily make necessary adjustments to conform to the prescribed conditions and normative guidelines. As demonstrated by the Florida experience, politics can trump such management considerations and the constraints dictated by theory.

In conclusion, as pushing the limit of hollowness will likely continue in practice, an important challenge is to develop and maintain an overall strategic governance framework that considers the mission of the government, the core competencies the mission requires, the evolving political and social institutions, the characteristics of the service, market conditions, and the administrative human capital. This is no easy task, as the political dynamics behind privatization, coupled with partisan politics, ideological divides, and term limits, often denies the possibility of a strategic approach by the government agency.

Declaration of Conflicting Interests

The author(s) declared no potential conflicts of interest with respect to the research, authorship, and/or publication of this article.

Funding

The author(s) received no financial support for the research, authorship, and/or publication of this article.

Note

1. The classic model is dyadic and static, assuming that there is only one principal and one agent, and that the agent always has an information advantage over the principal. In reality, there are always multiple principals (e.g., different legislative committees, governor, courts, interest groups, and citizens) and multiple agents (e.g., agencies doing similar things and subagencies that may have conflicts), and the knowledge distribution among the actors does not always favor the agents.

References


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