



Contracting Out and Trust in the Public Sector: Cases of Management from Hong Kong

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Abstract

Contracting out generates competition and market discipline that is expected help reduce cost and improve the quality of the services. Several problems were detected in contract management of the Hong Kong Housing Authority and they were related to decision-making, monitoring, evaluation and the system of accountability. An examination based on the 'principal-agent' perspective reveals several pitfalls of contracting out in the public sector. A lack of coordination, eagerness to cut costs by accepting the lowest tender bids, improper project supervision, and inadequate manpower resulted in serious problems. This paper suggests a more careful approach to the award of contracts, monitoring and quality assurance as well as the inculcation of a spirit of trust and cooperation between the principal and agent, instead of the customary adversarial approach.

Introduction

The strategy of contracting out became popular in the public sector with the perception that governments are intrinsically inefficient. The private sector is considered to be more economic, efficient and effective than the public sector. It has been suggested that "the fix for what ails government is to change the way government does business and to make it more businesslike" (Kettl, 1993: 3). An ambitious public sector reform program introduced in Hong Kong emphasized private sector participation in public affairs and argued that "contracting out is a flexible method of introducing private sector involvement within a contractual framework" (Finance Branch, 1989: 21).¹

The use of contracts is expected to lower the cost of service provision through the discipline of the market and open competition. By contracting out, government agencies can provide services to the public by employing private firms, non-profit organizations, or even other government departments. This practice helps reduce the pressure on public organizations, allows the importation of private sector practices and expertise, delivers services more efficiently and enhances productivity. It has been used effectively by both public and private organizations for simple tasks such as cleaning and security

services. However, problems may be encountered in more complicated out-sourced projects as a result of the inability of the government agencies to effectively monitor the activities of contractors.

In the early 1990s, public construction projects in Hong Kong were contracted out to private companies on a very limited scale and were intended to mainly supplement the needs in areas requiring specialized professional expertise. By the mid-1990s, the government was expecting a surge in production of new housing units to peak in the year 2000–01. Therefore, the scale of contracting out expanded rapidly. Apart from contracting out a substantial number of projects to private companies, the scope was further extended as contracting out was allowed to cover all the activities from the design stage to the completion of projects.

This article examines the process of contracting out with reference to two cases in Hong Kong. The Hong Kong Housing Authority (HA) is responsible for planning, building and managing public housing estates as well as advising the government on all matters relating to housing. This agency uses contractors for providing some of its services, including construction, project management, design, surveying, maintenance, and development of information technology. The Building Committee of the HA oversees the construction of public housing projects in Hong Kong. In 1999, a number of cases related to impropriety and substandard results in contracts awarded by the HA were reported in the media and prompted debates regarding the process of contract management in the public sector.

The problems can be traced to various aspects of contract management such as decision-making, monitoring, evaluation and the system of accountability. The roles of the two parties— the HA and Housing Department or clients on the one hand, and the private companies as the contractors on the other— will be examined within this framework. They can also be considered as the ‘principal’ and ‘agent’ in this relationship. The main objective of this article is to consider the suitability of contracting out as a tool for streamlining the provision of public services, and its implications for Hong Kong.

The strategy of contracting out

Contracting out helps transfer the task of public service delivery to private hands while leaving the formal responsibility with the government (Rehfuss, 1989: 10). This practice is not new, and there are accounts of its use in specialist metal manufacturing functions in nineteenth-century England (Domberger, 1998: 8). Earlier, the scope of contracting out for public services was limited, and only tasks of refuse collection and cleaning of streets and buildings were outsourced to private companies (Guttman, 2000). However, it is now so common that contracting out for public services has become a major instrument of public sector reform (Domberger, 1998: 60).

There are advantages in using and mixing “markets and bureaucracies in order to achieve its objectives with regard to the provision of goods and services with a special emphasis upon the employment of tendering and contracting out” (Lane, 2000: 131). It is believed that contracting can enhance both efficiency and accountability as it combines market competition with a more rigid performance control system. Thus, contracting out can help reduce the costs of public service provision, offer the users of public services more choices and variety, and improve the performance and quality of public service delivery. Contracting out also has the benefit of ensuring flexibility for the public agencies in adjusting to new pressures and changes in service demands. In this way, public sector organizations can specialize in the so-called “core” activities and thus maximize some measures of efficiency (Reh fuss, 1989: 18–24; Christensen and Læg reid, 2001: 106; Grimshaw et al., 2002: 486–487).

At the same time, some of the pitfalls of contracting out in the public sector must be recognized. For example, there seems to be cost savings in the contracting of easily specified services, such as refuse collection, but there have been increases of costs and reductions in quality where services are complex (Aulich, 2001: 154–155). Besides, market competition may create perverse incentives, increase rivalry and destroy trust relationships. Improper handling of competitive tendering and outsourcing can result in higher costs and/or lower quality output. In fact, the reduction in costs may be offset by less readily quantifiable costs such as damage to the quality of service provision, or an erosion of the public sector ethos among workers (Grimshaw et al., 2002: 479).

Contracting may generate additional costs and new problems which are absent in the traditional form of direct service provision, and lead to transaction costs. First, there is the cost of investing in the development of capacity to act as a “smart buyer.” If the government does not develop its capacity to act as a smart buyer, it can result in inefficient and ineffective programs, which can produce substantial transaction costs such as pollution, and can in turn undermine public trust and confidence in government itself (Kettl, 1993: 194). Hence, if organizations are to maximize the benefits of contracting, they must understand the nature of the costs, and how they might be minimized (Domberger, 1998: 51).

The management of contracts and the relationships between the two parties is a more complex phenomenon, and the “principal-agent perspective” can be useful in this respect. It involves the interaction between two actors, namely, the principal and the agent, who “agree to cooperate with each other in a contractual relationship that requires the principal to pay the agent for actions the agent makes on behalf of the principal” (Halachmi, 2000: 157). To a certain extent, shirking of duties is virtually inevitable in principal-agent relationships. Principals supply incentives to induce the agents to work, but the latter may have additional interests that they seek to satisfy first. In fact, they have more opportunities and incentives to shirk than principals have to control them, and

monitoring their behaviour involves high cost. Some shirking persists, irrespective of the degree of monitoring (Kettl, 1993: 24). Lane (2001) views this tendency as “post-contractual opportunism,” and suggests that short-term contracts can eliminate the extensive post-contractual opportunism connected with long-term contracting, but that may be vulnerable to pre-contractual opportunism. Pre-contractual opportunism can occur when an agent hides information that is relevant to the negotiation and signing of a contract, with problems resulting from asymmetric knowledge.

Performance measurement is another area of concern, and it can impose another set of costs onto government organizations (Peters, 2000: 36). Contractual arrangements can also allow managers to take a checklist approach to accountability, which means “if it is not specified, it is not my responsibility” (Christensen and Lægveid, 2001: 114), resulting in a lower level of effort by staff. In particular, attempts by principals to secure “contract compliance” may simply lead agents to “work to contract” (Boyne, 1998: 700). Hence, there are fears that after contracting out, the quality of services might deteriorate and the level of personal responsibility reduced. These issues will be examined with reference to two cases of contracting out in the construction of public housing units in Hong Kong.

The Hong Kong Housing Authority and contract administration

The HA was established in 1973 with the mandate of planning and building public housing as well as managing public rental housing estates, transit centres and even non-domestic facilities such as shopping centres, market stalls and car parks (HKHA, 2004). The Secretary for Planning, Housing and Lands serves as the Chairman of the Authority and the Director of Housing is the Vice Chairman. There are 3 official and 22 non-official members appointed by the Chief Executive of the Hong Kong Special Administrative Region. A number of standing committees are appointed to discharge its functions. Among them, the Building Committee (BC) oversees the housing projects from planning to completion stage. It advises the Authority on the most efficient and cost effective means of implementing the construction programmes as well as monitors the progress of these programmes (Select Committee, 2004: 14, 16–19, 248).

The BC comprises of 15 to 18 members serving on a part-time basis, and they are appointed by the HA on the recommendation of the Chairman. The Committee holds regular meetings and special meetings to discuss and approve discussion papers submitted and prepared by the Housing Department (HD). It is impossible for the members to examine the details of the proposals under consideration, in particular their technical aspects. In monitoring the progress of work, the Committee relies on the monthly progress reports prepared by the HD, which is only required to report on projects that were delayed by three months or longer (Ibid: 18–19, 21).

The HD is the executive arm of the HA. It is responsible for providing executive support to the Authority in planning and implementing public housing programs. All papers submitted to the HA and its committees are prepared by the staff of the HD. The Department is expected to ensure that proposals presented before the BC comply with the existing principles of the Committee. Before submitting to the relevant committees for consideration and/or approval, these papers have to be discussed and cleared at meetings held every week.

A typical public housing project goes through six stages of development: site identification, feasibility study, design, tender, and foundation and building construction. The HD traditionally adopts the architect-led consultancy arrangement for contracted out projects. The HA appoints contractors (also known as consultants) for its projects from a list of firms prepared by the Architectural and Associated Consultants Selection Board. From September 1997, a two-envelope system has been adopted, under which short-listed consultants are required to make a technical submission and a fee submission. The two submissions are assessed independently of each other. The relative weighting between technical submission and fee submission was at first 50:50, adjusted to 70:30 in November 1998 and further to 80:20 in August 2000. The appointment of consultants has to be approved by the BC (Ibid: 42).

The HA has a list of contractors for various types of works, and invites companies on the relevant lists to compete for jobs. The criteria for inclusion in the lists include experience, technical and financial competence, previous performance, and safety records, as well as certification by the International Standards Organization (ISO) (Kong, 1996; Housing Department, February 1999). The HA ensures that there is adequate financial and technical competence for completing the work. A breach of contractual requirements may result in the removal of a contractor from the lists. In awarding contracts, the quoted cost, performance in the past 12 months, financial capacity, workload in hand, technical proposals and risk factors are considered.

When construction commences, a contract team is formed to oversee the work and monitor the performance of the contractor in meeting contract requirements. In the case of an outsourced project, the responsibility for managing the contract falls on the lead consultant and its sub-consultants, but the HD deploys staff to monitor the performance of the consultant. Monitoring takes place mainly through supervision by resident engineers in some projects and by other site staff in most cases. Depending on the complexity and remoteness of the sites, a project resident engineer may be deployed to specific sites. Site staff for outsourced projects are employed by the lead consultants on behalf of the HA on project basis (Select Committee, 2003: 47–50). Thus, there is an established system of awarding contracts and managing them. However, the following cases illustrate that there are several factors that contribute to the complexities of managing contracts in the public sector.

Two cases from Hong Kong

In August 1999, excessive uneven foundation settlement was found in two completed blocks of housing in the Tin Shui Wai area of Hong Kong. Three months later, in the course of a comprehensive building inspection, settlement problems were detected in two more Home Ownership Scheme blocks in Yuen Chau Kok. In the following six months, building problems were detected in two other projects, including the use of non-conforming and rejected construction materials in the superstructures. Some of these blocks were later demolished while remedial work was conducted on others. These incidents led to serious public concern on the quality of public housing in Hong Kong as well as the management of contracts by the HA.

The government and the HA conducted three separate investigations on the poor management of contracts and they found the frontline staff to be at fault. But the senior officials were absolved of any responsibility. The outcome of these investigations resulted in public outcry, and a no-confidence motion against the Chairlady of the HA and Director of Housing was passed in the Legislative Council.² On 7 February 2001, a Select Committee on Building Problems of Public Housing Units was appointed by the Legislative Council to investigate these incidents.

In its first report released on 22 January 2003, the Select Committee used strong words to condemn frontline staff and contractors for their involvement in the scandal. In fact, several contractors and frontline staff had already been arrested and jailed. However, the three top officials were mildly criticized for their failure to be 'aware' and 'monitor' the implementation of contracts. The wordings of the Select Committee's second report, released on 19 May 2004, were much stronger. In particular, it held the Director of Housing responsible for passive and irresponsible attitude of the HD in managing the Tin Chung Court project and failing to ensure that safety standards were met.

Tin Chung Court was one of the 22 housing projects contracted out to architect-led multidisciplinary consultants. The piling works of this project was scheduled for completion in July 1997, and to expedite this project, standard designs of building blocks were adopted. It should be mentioned that the HD does not require formal approval for projects of standard design. The piling contract of this project was awarded to the lowest bidder, Franki Contractors Ltd. (renamed as B + B Construction Co. Ltd. in March 1997), with the endorsement of the BC but without a proper evaluation of the bids. The piling works were completed on 6 July 1997 as scheduled (Select Committee, 2004: 4, 6).

In August 1999, it was found that the construction of two blocks was faulty, and the buildings were tilted. The company hired to install lifts failed to do so as the task requires perfectly vertical shafts (Hong Kong Standard, 6 December 1999). According to the results of an independent investigation into the structural adequacy of the foundations, uneven foundation settlement was found at Blocks

1 and 2 (Select Committee, 2004: 5). In November 2001, an internal investigation commissioned by the Housing Department revealed that a total of 30 piles were shorter than their recorded lengths (The Standard, 20 May 2004). This was the first instance of a serious problem since the introduction of independent consultants to monitor construction projects.

Apparently, the piling contractor had not taken into consideration the soil data provided by the HD in calculating the settlement. Besides, the contractors tried to avoid the use of preboring machines which were not commonly available in Hong Kong and could delay the project. In fact, the tender price of B + B Construction was 24.24 percent, which was HK\$24.86 million, below the pre-tender estimate. Although preboring was mentioned as one of the means to overcome underground obstructions in the method statement submitted by B + B Construction, it was not made mandatory in the contract. The Select Committee noted from evidence submitted by some witnesses to the court that B + B Construction had all along aimed at producing an “aggressive design” so as to “secure the contract” (Ibid: 18–20).

Moreover, according to the contract, the contractor would have to pay a penalty of approximately HK\$300,000 per day in case of delay in completion.³ If the test results of the preliminary piles could not substantiate the proposed piling design, the contractor would have to revise the design parameters, which would take time and delay the progress of works. In view of this condition, B + B Construction could have been tempted to conceal the test results, and sought to justify the design with shorter piles. Since preboring could add to the cost of piling, it was not conducted at all (Ibid: 28, 33).

On 12 October 2001, the Independent Commission Against Corruption (ICAC) charged five employees of B + B Construction, one employee of the geotechnical sub-consultant and three site staff employed by the consultant architect for conspiracy to defraud, corruption, and using false documents.⁴ The HA immediately removed B + B Construction from its ‘List of Large Diameter Bored Piling Contractors’. The BC also terminated the services of the contract manager responsible for the project. The remaining work was then taken up in-house. In accordance with the proposals put forward by the independent structural consultant appointed to investigate the case, foundation strengthening works were carried out to ensure structural safety (Press Release of the Housing Authority and Housing Department, 21 October 1999). Restoration and strengthening works for Block 2 and Block 1 were completed in April 2002 and June 2003 respectively, at a total cost of HK\$150.9 million spent totally (Select Committee, 2004: 60).

Although the piling contractors were initially blamed for the short-piling incident, a closed-door inquiry revealed that lax supervision and negligence by the HD as well as other factors were also responsible. The report blamed housing officials for ignoring expert advice, and criticized the HD for accepting the design suggested by the contractor without evaluating the latter’s technical capabilities. In other words, the Department sacrificed the quality of the output

in order to minimize cost and meet the construction schedule. (Hong Kong Standard, 6 December 1999 and 23 February 2000).

The other case, construction of housing units at Yuen Chau Kok, was a design-and-build project, in which the contractor designs and carries out the piling works in accordance with the specifications in the contract. The lowest bidder, Zen Pacific Civil Contractors Ltd., was awarded the piling contract of this project. This recommendation was approved by the BC without any discussion, and the piling work was completed on 19 December 1998 (Select Committee, 2003: 67, 74, 294–297).

A comprehensive ‘building settlement monitoring exercise’ was conducted in over one hundred construction sites of the HA in mid-1999, and problems with the settlement of the structures was found in two blocks of the Yuen Chau Kok project (Ibid: 67).⁵ These two blocks were due to be completed along with other three blocks in January 2001 (Hong Kong Standard, 9 January 2000). Upon completion, the HA appointed an independent consultant team to investigate the adequacy of the foundation of these two blocks. It was found that, among the 18 Large Diameter Bored Piles (LDBPs) in each block, only three piles in Block D and one pile in Block E met the contract specification. Three piles and six piles in Blocks D and E respectively were shorter than the reported lengths by more than 10 metres (Select Committee, 2003: 67).

The HA demolished the two defective blocks. The decision was made at a special meeting of the BC, and members were informed of the results of the investigation conducted by the independent consultant team on the foundation of the two blocks, as well as the team’s recommendations on possible options. The defective piles did not meet the structural safety standards and were incapable of sustaining the design loads (Press Release of the Housing Authority and Housing Department, 16 March 2000).

In addition to pursuing legal action against Zen to recover the losses and damages, the HA took disciplinary action against both Zen and its sister concern, Ngo Kee Construction Co. Ltd. Zen was removed permanently from the Lists of Large Diameter Bored Piling Contractors and Demolition Contractors. This was the most severe sanction ever imposed on any listed contractor. Ngo Kee was also suspended from bidding for all projects of the HA for a period of 24 months (Press Release of the Housing Authority and Housing Department, 24 August 2000).⁶

The selection of a contractor who had no experience with LDBP foundation works in relation to high-rise buildings was the key reason for this short-piling problem. The HD did not take adequate measures in the selection process to ensure that Zen had the necessary expertise and machinery for undertaking such a project. Although technical competence was an important selection criterion, a low tender price was the principal factor considered by the HD in selecting Zen as the contractor for this project. Their bid was 15.26 percent less than the pre-tender estimate. If the pre-tender estimate was calculated on the basis that LDBPs would be used for all blocks, the tender price of Zen could have been up

to about 28.41 percent, that is HK\$25 million, less than the pre-tender estimate (Ibid: 72–73, 124).

Since Zen had no experience in relation to high-rise buildings, it had to rely on another company, Hui Hon, which took up almost the entire project at a low contract price. But they did not purchase appropriate machinery required for the job. The Select Committee found that the tight schedule for piling and the possibility of incurring substantial penalty in case of delay led the contractor to concentrate on the progress of the work so that it could be completed on time. Thus, Zen was probably tempted to complete the work on schedule at the expense of quality (Ibid: 123, 132).

Officials from the HD were responsible for contract administration and project management, as well as site inspection (Ibid: 68–69). The Investigation Panel on Staff Discipline concluded that this incident was the result of deliberate deception, poor management of the contract and the failure of the HD employees to carry out proper site inspection throughout the construction process, and recommended disciplinary proceedings against 14 housing officers (Press Release of the Information Services Department, 19 December 2000). The Select Committee was “most disappointed with the bureaucratic and lax attitude” of some of the Department’s staff in project management and quality assurance (Select Committee, 2003: 130).

Following the investigation, the HA adopted a number of measures for improving contract management. Site supervision has been strengthened by deploying resident engineers to monitor the critical stages of work, but excessive delegation of power and responsibilities are avoided. Induction and refresher training for site staff have been intensified to ensure adequate skills and experience for monitoring the work of contractors (Hong Kong Housing Authority, 2003: 63). Control of subcontracting has been tightened through the management of the main contractors by way of contract requirements and list management. New measures were introduced to monitor the performance of the subcontractors, to induce contractors to invest in new technologies, upgrade their professionalism and technical competency.

The pitfalls of contracting out

The two cases reveal a number of points regarding the problems and pitfalls of contract management in the public sector in Hong Kong. These include a lack of well-coordinated construction planning, heavy workload of the BC, excessive emphasis on lowest tender bids, inadequate project supervision and deficiencies in manpower deployment. A lack of independent audit, prevailing subcontracting practices, and a lack of quality culture in the construction industry were further impediments in the way of effective contract management. The eagerness to complete the projects on time may have induced contractors to disregard the risks. The BC has a heavy workload, and this renders effective monitoring

impossible, particularly as members of the Committee serve on a part-time basis. The problems can be understood better by considering the processes of contract award, quality assurance and monitoring.

Award of contracts

Domberger (1998) stated that there is a tendency for public sector organizations to focus on observable factors such as price, and to give less weight to the more intangible aspects such as the reputation of the contractors or quality of work. This may tilt the selection process in favour of contractors who submit low bids. After winning the contracts, contractors may attempt to renegotiate the prices upward, or compromise the quality in an effort to reduce the gap between revenue and cost. In the two cases from Hong Kong, the HA's tendency of selecting the lowest bids encouraged the contractors to quote abnormally low prices for winning the contracts and reduce costs by cutting corners at a later date. The contractors passed on the consequences of their unrealistically low bids to the subcontractors, and this only multiplied the negative effects in the outcome of the projects (Hong Kong Housing Authority, 1991).

Although the HA and HD claimed that price was not the deciding factor in awarding contracts, it was found that approximately 90 percent of contracts awarded during 1996–1999 went to the lowest bidders. HD believed that the bidders might have their own way to make their offers financially viable. The Department did not compare the bids against the pre-tender estimates that could help determine if bids were unrealistically low for the works required (Select Committee, 2003: 46–47). The tendency of saving cost by slippage of poor quality of work through inspections is a matter of great concern (Tam et al., 2000: 6). The practice of awarding tenders on the basis of the lowest price would induce contractors to cut costs or take unnecessary risks in order to complete projects on time (Hong Kong Standard, 8 December 1999).

Quality assurance and monitoring

The agency is responsible for the performance and quality of service even when they are provided under contracts and must take actions to improve the service, whether or not the contractor is at fault (Rehfuss, 1989: 220–222). Domberger (1998) has warned that when a public sector organization transfers responsibility for service provision to other parties through legally enforceable contracts, it does not relinquish accountability for them. Unfortunately, this point is not always well understood by government agencies.

The two cases highlight the fact that the HA and HD did not fully understand their role and responsibility after awarding the contracts, and appeared to have

contracted out the responsibility of monitoring at the same time. Although the building problems resulted from inefficiency in the construction of housing units by the contractors, the responsibility still rests on these two agencies. Regular checking at the project sites could have prevented the problems. Public housing estates developed by the HA are exempted from the Building Ordinance which imposes stringent regulation on each phase of the construction process. Thus, apart from being a developer, the HA also assumes the role of a regulator of the construction of its own buildings. It is therefore very important for it to have an effective system of monitoring.

The HD was obviously not a “smart buyer,” and relied too much on the contractors to define what had been “bought.” Monitoring was performed mainly in the form of reporting. The Department placed too much importance on paper work and tended to supervise by documentation and monitor through paper-chase (Office of the Ombudsman, 2002: 10). Hence, the contractors were able to protect their own interests by submitting reports that did not reflect the actual situation. The HD relied on the contractors to comply with specifications in the contracts and on individual staff or consultants to adhere to the works manuals without considering whether they were familiar with these specifications and manuals. The contractors were allowed to appoint the quality control engineers to certify the standard of works. Without a full-time representative on site to oversee and co-ordinate the site supervision work for each project, the HD relied on the consultants and their staff for site supervision in the projects (Select Committee, 2003: 49, 171, 183). In other words, the HD allowed the contractors to manage themselves.

Critical issues in contracting out

The higher the level of imperfections in the market in which it buys, the greater is the need for the ‘principal’ to behave as a ‘smart buyer.’ In reality, instead of developing its own capacity to determine what to buy, the principal allows the agents to dictate terms. In many cases, public organizations handed over some of their basic functions to contractors, and this undermines their ability to be a smart buyer. The principal has relied on the agent not only to provide goods and services, but also to suggest what it ought to buy, to evaluate what has been bought, and to manage many of the steps in between.

Rehfuss (1989) developed a list of strategies for achieving success in contracting out, and also cautioned against a number of pitfalls. Public organizations should be open and direct, master all details, bear in mind that the agency is ultimately responsible for the contract, and contract out only for legitimate reasons. At the same time, Rehfuss advised to avoid contracting out when the policy is controversial, or eliminate alternative options. The slightest

hint of corruption should be responded to with serious reconsideration, and the organization must never lose sight of the reasons for contracting out. Therefore, it is important to remain focused on the basic objective that contracting out aims to provide more effective public services or at least to maintain current services at lower cost.

Generally, contractual relationships vary along a continuum from extremely flexible and trust-based to tightly specified and penalty-based. 'Partnership' contracts and 'service agreements' lean towards the flexible end, while 'contract manager' and 'service contracts' towards the tighter one (Taylor and Lewis, 1997: 29). The experience with a 'low trust/competition' relationship appears to be the most common, and reflects the competition prescription suggested by Kettl (1993). Competition between providers is at the heart of the relationship as it is supposed to ensure the best quality at the best price. Trust is lacking since competition builds on adversary interests among purchasers regarding price and quality (Greve and Ejersbo, 2002: 44–46).

Greve (2000) identified two types of contracts: 'Hobbesian' and 'Durkhemian', which are the 'hard' and 'soft' versions respectively. In the hard version, contracts are written in detail and cover all eventualities. There is a clear accountability regime indicating who is to blame if things go wrong. Sanctions are explicit and can be applied when necessary. Lack of trust is basic to the parties of the contract. The soft version implies that a contract contains expectations about objectives and demands. The contract is a tool for dialogue, more than a juridical document stating strict procedures. There is no strict accountability regime, but rather a series of "measurement points" where feedback is given and reflected upon. Trust is the basis of the long-term relationship, and short-term gains are ruled out (Greve, 2000: 49–66).

Recent experiences with contracting out have revealed the shortcomings of the all-embracing contract relying on competition and control. They point to the need for building trust into contractual relationships. Trust is useful for reducing uncertainty. It reduces complexity by ensuring that the social system is based on mutual expectations about future behavior of actors, thus encouraging them to select specific options of actions and reactions. Finally, trust is seen as a co-ordination mechanism based on shared moral values and norms, supporting collective co-operation and collaboration within uncertain environments (Greve and Ejersbo, 2002: 39–40). A move toward trust-based contracts seems to be increasingly common feature of contracting out in the public sector of many European countries (Greve, 2000: 62).

The arm's length relationships can be modified by the development of trust-based mechanisms. According to Domberger (1998) study, contracting out appears to yield the greatest benefits when it combines market discipline with longer-term, cooperative relationships. Another study points out that in many situations, the relationship between an organization and a contractor resembles a partnership, rather than a traditional customer-supplier relationship. In these partnerships, close cooperative relationships can be an important contributor

to the success of contract management. In particular, a high level of trust is important for establishing a cooperative relationship between an agency and its contractor, and even for establishing a workable contract (Langfield-Smith et al., 2000: 3, 76).

O'Looney (1998) suggests that contract managers should explore the possibility of trust-based management under certain conditions. One of these key conditions is clear expectations on the part of both the government and the contractors that they will be likely to continue in a contractual relationship for a long period of time. At the same time, the parties to the contract must have a desire to build trust-based relationships. In addition, it is helpful to develop congruence between the goals of the government and those of the contractors. Finally, more successful trust-based contracts will help develop structures that function according to an appropriate balance of power between the two parties. This can sometimes be the most crucial aspect of trust-based contract management, as power and the threat of its use represent the bottom-line risk to trust-based contracts. If one can overcome the power trap, other trust-enhancing activities will likely be more effective.

Concluding observations

The difficulties involved in contract management and the importance of managing it properly have been highlighted in many studies. Poor management of contracts can result in higher cost, wasted resources, poor performance and considerable public concern. "Contracts do not manage themselves" (Kettl, 1993: 180), and they must be well managed (Torres and Pina, 2001: 602). Even if principals seek to reduce agents' shirking by monitoring their behaviour, monitoring is costly and can be used and viewed in an adversarial manner. Attempts by principals to secure contract compliance may also lead agents to search for ways to shirk. Such factors might have been responsible for the problems encountered by the HA in managing contracts.

The cases of contract management in Hong Kong reflect failures on the part of the principal to select the most appropriate service providers and effectively monitor and manage the agents. Obviously there are weaknesses in the system and inefficiency in the management style of the HA and HD contributed to undesirable results. The principals did not seem to fully understand their roles and responsibilities after awarding the contracts. An even more formidable problem arose when the principal contracted out the 'responsibility of monitoring' to the agent at the same time. Along with streamlining the procedures, increasing emphasis on accountability, and improving the system of monitoring, the answer seems to lie in the inculcation of a spirit of trust and cooperation between the principal and agent.

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Notes

1. The reform document recommended various types of contractual arrangements such as service contracts, management contracts and build-own-operate schemes for facilitating the participation of the private sector.
2. The Chairlady of the Housing Authority resigned before the motion was debated, but the Director of Housing remained in office.
3. \$7.80 Hong Kong dollars is equivalent to \$1 U.S.
4. The charge against one of the employees of B + B Construction was later withdrawn. Another employee of B + B Construction was acquitted on 2 June 2003. On 17 October 2003, one employee of B + B Construction and one site staff were convicted of conspiracy to defraud. The other five defendants were found not guilty. On 31 October 2003 the two convicted defendants were each sentenced to seven years' imprisonment (Select Committee, 2004: 6).
5. "Building settlement" refers to the downward movement of a structure due to compaction, elastic compression and/or consolidation of the underlying strata. The allowable settlement which a structure can tolerate without distress is dependent on both total and differential settlement. The former affects the function of a building such as connections to services and appearance relative to neighbouring structures, such as tilt, while the latter can cause stress and probable structural damage or damage to finishes (see *Dictionary of Geotechnics*, London: Butterworths, 1983, p. 209).
6. Subsequently, two directors and the site agent of Hui Hon Contractors Ltd., the piling subcontractor, were charged with conspiracy to defraud, and the directors were convicted and sentenced to twelve years imprisonment. The site agent pleaded guilty, and was sentenced to imprisonment for three and a half years (Select Committee, 2003: 67–68).

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