



REPORT OF THE
STANDING COMMITTEE ON
PUBLIC ADMINISTRATION
IN RELATION TO

**OUTSOURCING AND CONTRACTING OUT:
INVESTIGATIONS IN THE UNITED KINGDOM**

Presented by the Hon Kim Chance (Chairman)

Report 13

STANDING COMMITTEE ON PUBLIC ADMINISTRATION

Date first appointed

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Members at the time of the inquiry

Hon Kim Chance MLC (Chairman)
Hon Barbara Scott MLC (Deputy Chairman)
Hon Murray Criddle MLC (resigned 29 July 1998)
Hon Cheryl Davenport MLC
Hon Dexter Davies MLC (appointed 12 August 1998)
Hon Helen Hodgson MLC
Hon Barry House MLC
Hon Ken Travers MLC (substitute member for Hon Cheryl Davenport appointed 19 August 1999)

Subcommittee

Hon Barbara Scott MLC (Chairman)
Hon Cheryl Davenport MLC
Hon Barry House MLC

Staff at the time of the inquiry

Mia Betjeman, Advisory/Research Officer (appointed 3 March 1998)
Elizabeth Lawton, Advisory/Research Officer (resigned December 1997)
Lisa Hanna, Committee Clerk (appointed 19 October 1998)
Jason Agar, Committee Clerk (resigned 16 October 1998)

Terms of Reference

See Appendix 1

Address

Parliament House, Perth, WA 6000
Telephone (08) 9222 7222
Facsimile (08) 9222 7805
Website: www.parliament.wa.gov.au

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**Report of the Legislative Council
Standing Committee on Public Administration**

in relation to

**Outsourcing and Contracting Out:
Investigations in the United Kingdom**

**CHAPTER 1
EXECUTIVE SUMMARY**

- 1.1 As part of the Standing Committee on Public Administration's ("Committee") process of agency and administrative review, it has developed a particular interest in the outsourcing and contracting out of government services. The Committee is mindful of the issues raised by the contracting out process, in particular the cost and quality of the services, the apportionment of liability, the allocation of risk, and who is responsible when disputes arise as to non-performance or unsatisfactory performance.
- 1.2 The process of privatisation, in particular contracting out, is not a new idea in Australia. Federal, State and local governments have been contracting out selected services for many years albeit with differing degrees of enthusiasm and political will. However, in comparison to other countries the contracting out and outsourcing of public services in Australia is a relatively new phenomenon.
- 1.3 In late 1997 the Committee travelled to the United Kingdom which over the past decade has a history of privatisation, particularly contracting out.
- 1.4 In the report the Committee presents an overview, rather than a detailed examination of some current issues in the United Kingdom.
- 1.5 As a result of its enquiries the Committee is of the view that there is a need for careful consideration of the way that contracting out is approached in Western Australia. The Committee's findings are summarised in Chapter 11 of this report.

- 1.6 The Committee has formulated terms of reference for further inquiry into the issues raised by contracting out. These are listed in Appendix 8.

CHAPTER 2

INTRODUCTION

2.1 As stated, as part of the Standing Committee on Public Administration's ("Committee") process of agency and administrative review, it has developed a particular interest in the outsourcing and contracting out of government services. The Committee is mindful of the issues raised by the contracting out process, in particular the cost and quality of services, the apportionment of liability, the allocation of risk, and who is responsible when disputes arise as to non-performance or unsatisfactory performance.¹

2.2 The Committee also has an obligation to continue the inquiries of the Thirty Sixth Report of the Standing Committee on Government Agencies which, amongst other matters, examined the creation, functions, powers and duties of State agencies. Much of what the Standing Committee on Government Agencies has to say in its Thirty Sixth Report deals with the processes by which an agency discharges its obligation to account:

*"The committee draws a distinction between the collective responsibility of a government and the individual responsibility of ministers to Parliament, and the accountability of government agents and instrumentalities. Responsibility is a fundamental feature of parliamentary government. Accountability is an ongoing aspect of sound, democratically based, public administration that is both external and internal."*²

2.3 The increased use of contracting out and outsourcing by government agencies means that issues of accountability become paramount. This is especially so for operational agencies whose sole or primary function is the delivery of goods and services necessary or ancillary to the execution and maintenance of government or agency developed policy and programs.

¹ Standing Committee on Public Administration June 1997 Discussion Papers: *An Introduction to Outsourcing - What are the Issues Involved?*; and *Outsourcing to the Private Sector - The United States Office of Federal Contract Compliance Programs*.

² Thirty Sixth Report of the Standing Committee on Government Agencies, April 1994: *State Agencies - Their Nature and Function*, p. 3.

- 2.4 Worldwide the growth in size, function and cost of government has led to the devolution of government operations. There has been a marked move to economic rationalist thinking by governments. Governments are moving from being owners and operators of assets to purchasers of long term services. Services have been subjected to competition and public authorities have moved from providing services to facilitating their provision.
- 2.5 The process of privatisation, in particular contracting out, is not a new idea in Australia. Federal, State and local governments have been contracting out selected services for many years albeit with differing degrees of enthusiasm and political will. However, in comparison to other countries³ the contracting out and outsourcing of public services in Australia is a relatively new phenomenon.
- 2.6 In order for the Committee to give the best consideration to the issues which contracting out and outsourcing raise, it was imperative to:
- gain more knowledge of the systems utilised in other jurisdictions; and
 - increase the level of expertise in order to deal effectively and efficiently with the volume of matters that come before the Committee.
- 2.7 Accordingly, the Committee formed the opinion that it would be most advantageous for members to meet with various representatives and policy officials in a jurisdiction that had adopted outsourcing policies, for the purpose of acquiring a better understanding of the way in which government agencies prepare, implement, monitor and review contracting out processes.
- 2.8 The Committee put a proposal to the Legislative Council for travel to the United Kingdom which has a history of privatisation, in particular contracting out, over the past decade at both a national and county level. The proposal was approved on 26 June 1997.⁴
- 2.9 The process of contracting out and outsourcing in the United Kingdom was particularly relevant to the Committee's inquiries. Contracting out has been achieved over a relatively short space of time as a result of the Thatcher Government's policies and practices, including Compulsory Competitive Tendering ("CCT") (discussed at paragraph 4.3.11 of this report).

³ Such as the United Kingdom, New Zealand and the United States of America.

⁴ Parliamentary Debates, Hansard, 26 June 1997, p. 4597.

- 2.10 Soon after the Thatcher Government took office in 1979, an Efficiency Unit was established which carried out efficiency scrutinies in government departments with the aim of improving the efficiency of civil servants and reforming management practices. As a result of this and other reviews the Thatcher Government embarked on an ambitious program of privatisation, in particular contracting out. In some instances the process was enforced by mandatory legislation such as CCT, whereas in others it was implemented by way of administrative policy. The United Kingdom regulatory and legislative context is discussed in more detail in Chapter 4.
- 2.11 Given the advent of the National Competition Policy and the Hilmer reforms in Australia⁵, Western Australia is now faced with and must consider the process, impact and results of contracting out and outsourcing as a matter of priority. The potential exists for the Committee to inquire into and apply the United Kingdom experience for the benefit of Western Australia.
- 2.12 Appendix 4 contains a list of abbreviations and phrases used in this report. Appendix 5 provides an overview of some United Kingdom government service areas where privatisation, in particular contracting out, has occurred.

⁵ *National Competition Policy Report by the Independent Committee of Inquiry*, Canberra, AGPS, August 1993, (“the Hilmer Report”).

CHAPTER 3

INVESTIGATIONS

- 3.1 Three members of the Committee visited the United Kingdom between 29 July 1997 and 15 August 1997.⁶ A list of the persons and organisations with whom the Committee members met is attached as Appendix 2. A list of the material collected in the United Kingdom and for the purposes of this report is attached as Appendix 3.
- 3.2 The Committee members focused on:
- 3.2.1 the outcomes of the contracting out, by central and local government, of essential public services such as health, transport, prisons and water, and how both the positive and negative effects of contracting out could be assessed, reviewed and monitored;
 - 3.2.2 the safeguards and balances put in place to address some of the perceived inadequacies in the contracting out process; and
 - 3.2.3 whether the processes of corporatisation, contracting out and outsourcing have been used as a stepping stone towards full privatisation of particular public services.
- 3.3 The purpose of this report is to generate public discussion about the issues surrounding public services being outsourced and privatised. The Committee presents an overview, rather than a detailed examination, of some current issues. Although on occasion the Committee refers to recent Australian discussion of the process, the report concentrates on the Committee's experiences in the United Kingdom.

⁶ Hon Barbara Scott MLC, Hon Cheryl Davenport MLC and Hon Barry House MLC along with the Committee's former Advisory/Research Officer, Ms Elizabeth Lawton, travelled to the United Kingdom.

CHAPTER 4

THE UNITED KINGDOM CONTEXT

4.1 In order to comprehend the privatisation process in the United Kingdom it is necessary to have some understanding of the types of privatisation and the environment in which privatisation operates. A brief introduction follows on the forms of privatisation, including outsourcing and contracting out, and the structure of government and administration in the United Kingdom.

What is Privatisation in the United Kingdom?

4.2 Privatisation is a popular term which may mean different things to different people. Some commentators have identified 3 general categories:

- transfer of public enterprises to the private sector (by sale of the whole, sale of part (“hiving off”) or contracting out);
- liberalisation of the market; and
- deregulation.⁷

Other commentators have suggested that the British Conservative Government, elected in 1979 and re-elected in 1983, has used more than 22 different methods of transferring public operations wholly or partially into the private sector.⁸ All aspects are different and have their own complexities.

4.3 As the people with whom the Committee members met used the term “privatisation” to describe processes that were quite different in description and scale from each other it is useful to summarise some of the main methods of privatisation:⁹

⁷ Barbara Page, *Privatisation*, New South Wales, NSW Parliamentary Library, 1986, p. 11.

⁸ Dr Masden Pirie, *Privatisation in Theory and Practice*, United Kingdom, Adam Smith Institute, 1985 and Dr Masden Pirie, *Privatisation The British Experience*, United Kingdom, R & R Taylor Pty Ltd, September 1985.

⁹ Based on categories identified in Pirie, *Privatisation in Theory and Practice*, United Kingdom, Adam Smith Institute, 1985.

- 4.3.1 **Sale:** Selling of the whole, complete parts of the whole or a proportion of an operation to the public or to the workforce.
- 4.3.2 **Gift:** Giving away the operation to the public or the workforce.
- 4.3.3 **Charging for the service:** Privatising the funding of the public operation but leaving production in the public service. Instead of the service being funded out of taxes it is funded out of user charges. An example of this is the United Kingdom National Health Service (“NHS”) where, during the British Conservative Government under Margaret Thatcher, direct user charges rose 4 times. However, increasing the charge for those who can afford it provides a means of getting more money into the health service by the direct route to subsidise those who cannot afford it.¹⁰
- 4.3.4 **Dilution:** Where there is no possibility of private sector transfer it may be possible to have design, maintenance and expansion conducted privately. Examples are private road funding (discussed at section 2.3 of Appendix 5), and the Private Finance Initiative (“PFI”) (discussed at paragraph 4.21) which facilitates the process of dilution.
- 4.3.5 **Buying out interest groups or establishing counter groups:** These methods are often used where the beneficiaries of the public sector service fight to retain their benefits. The latter method involves setting up a counter group that is larger and more effective than the resistant group. For example, the sale of state housing to existing tenants at discounts of up to 50%, may create a larger group of home owners of state housing than subsidised tenants. Further, the generation of private health care may result in the private health care sector caring for NHS patients.
- 4.3.6 **Deregulation:** Replacing state regulation with self regulation via voluntary association.
- 4.3.7 **Public supply alternatives:** Encouraging private provision of supply, for example private universities such as the University of Buckingham.¹¹

¹⁰ Dr Masden Pirie, *Privatisation in Theory and Practice*, United Kingdom, Adam Smith Institute, 1985, pp. 41-42.

¹¹ Dr Masden Pirie, *Privatisation The British Experience*, United Kingdom, R & R Taylor Pty Ltd, September 1985, p. 8.

- 4.3.8 ***Repeal of monopolies:*** This allows the extension of the private sector by repealing government monopolies, for example, the opening up of bus and coach services¹² and British Telecom¹³ to private sector competition.
- 4.3.9 ***Exit from State provision:*** For example, the United Kingdom Government encouraged people to exit from state provision of the National Health Service (“NHS”) by offering tax concessions to those who take out private health insurance.¹⁴
- 4.3.10 ***Contracting out the service:*** Contracting out occurs when a government or public agency ceases to provide a specific activity or service by directly employing its own staff and instead purchases that service or activity from a private corporation or non government agency. The description derives from the fact that the purchase is on the basis of a contract between the public agency and the private or non government agency.¹⁵ This method is also referred to as “outsourcing” and is the main method with which the Committee concerned themselves during their investigations. For ease of reference the Committee uses the term “contracting out” in this report.
- 4.3.11 Contracting out in the United Kingdom is most prevalent in local government as a result of compulsory competitive tendering (“CCT”). Services such as street sweeping, park maintenance, garbage collection and disposal, catering in schools, and the cleaning and security of public buildings have all been subjected to the contracting out process. In the hospitals, ancillary services

¹² Refer to Chapter 3 of Appendix 5, and also Dr Masden Pirie, *Privatisation in Theory and Practice*, United Kingdom, Adam Smith Institute, 1985, pp. 67-68.

¹³ Adam Broadbent, *Privatisation - The UK Experience*, Canberra Bulletin of Public Administration, 1986, pp. 297-302 and Dr Masden Pirie, *Privatisation in Theory and Practice*, United Kingdom, Adam Smith Institute, 1985, p. 69.

¹⁴ Other methods of privatisation (including vouchers, the curbing of state’s powers, divestment, the application of liquidation procedures and the consumer’s right to substitute a public service for a private one) are discussed in Dr Masden Pirie, *Privatisation in Theory and Practice*, United Kingdom, Adam Smith Institute, 1985, pp. 70-86.

¹⁵ M. Paddon and Rosin Thanki, *Australia’s Contracting Public Services: Critical Views of Contracting-Out by the Public Sector*, Sydney, University of New South Wales, 1995, p. 11.

such as cleaning and catering have been contracted out. CCT is discussed in more detail in Chapter 4 of Appendix 5 of this report.

4.3.12 The Committee notes that most of the services which were subject to the contracting out process in the United Kingdom were those traditionally defined as the “blue collar services”. Although some “white collar services”, for example information technology services, are now being subjected to contracting out processes, issues specific to blue collar occupations raised themselves for particular consideration. The Committee discusses these issues at paragraph 7.11 onwards of this report.

4.4 Throughout this report many comments are made about contracting out by reference to local authorities. This is because most of the anecdotal and research evidence in relation to contracting out focuses on local authorities due to the mandatory legislative nature of CCT. However, the Committee considers that the CCT experience of the local authorities in the United Kingdom are generally very applicable to all contracting out proposals. It should also be noted that many of the services and functions provided by local governments in the United Kingdom are similar to those provided by State Governments in Australia.

The Domestic Legislative and Regulatory Context of Privatisation in the United Kingdom

4.5 The parliamentary processes and system of government in the United Kingdom are similar to those in Western Australia. The West Australian system of government is based upon the British model known as the Parliamentary or Westminster system. The Committee is cognisant of, and refers readers to, the Fifteenth Report of the Joint Standing Committee on Delegated Legislation which conveniently summarises the United Kingdom government and administrative structure.¹⁶

4.6 Over the last decade, contracting out, by the process of competitive tendering, has been extended to areas and services previously provided directly by government and has become part of a range of techniques of privatisation.

4.7 “Market testing” is the most commonly used term for this process and has been both a management requirement and government policy administered through government programs such as the 1991 “Competing for Quality Initiative”. This initiative required

¹⁶ Fifteenth Report of the Joint Standing Committee on Delegated Legislation: *The Committee’s Investigations in Washington, London and Paris* presented July 1995.

government departments to prepare an annual programme of services, privatisation, strategic contracting out, market testing and internal restructuring.¹⁷

- 4.8 Local government has a slightly different version of competitive tendering, CCT, under which local authorities are required by law to put defined services out to tender according to a Government timetable. At the time of the Committee's visit the United Kingdom was the only European country where tendering of local government services was enforced by law. It should be noted that the United Kingdom is required to accept European Union law. Further discussion of this issue is at paragraph 4.31 of this report. CCT in local government is discussed in Chapter 4 of Appendix 5.
- 4.9 Other programmes and initiatives have been introduced by the Government over the years which, although separate policies in their own right, reflect and facilitate the process of privatisation. These include the Next Steps programme, the Citizens Charter and the Private Finance Initiative.

Next Steps

- 4.10 The Next Steps programme commenced in 1988 and revolved around the idea that the business of Government was the management and administration of an enormous variety of smaller businesses. It emphasised the purchaser/provider (or client/contractor) split in government and introduced a set of "prior options" whereby areas of activity were reviewed to see if they were still needed, and if so, whether they were suitable for agency status. As of December 1996, 129 Next Steps Agencies had been launched.¹⁸
- 4.11 Next Step Agencies are broadly the same as performance based organisations. An agency is established with its own budget, staff and chief executive. It has the ability to plan, organise and manage how it will meet ministerially agreed service delivery and performance objectives. The local authority equivalent of central governmental Next Steps Agencies are Direct Service Organisations ("DSOs").
- 4.12 As these agencies already have their own budget, staff and chief executive they are prime candidates for the application of privatisation techniques. Some Next Steps

¹⁷ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 13. (Market testing in the passport office is discussed at footnote 38.)

¹⁸ Cabinet Office, Office of Public Service, *Next Steps Agencies in Government Review 1996*, London, The Stationery Office Limited, March 1997, p. v.

Agencies and DSOs have been completely privatised and others make extensive use of contracting out service delivery to a private contractor with or without an in-house bid.

Citizen's Charter

4.13 The Citizen's Charter was launched by the Government in 1991 as a 10 year programme ("Charter Programme") to raise the standard of public services, make them more responsive to the wishes and needs of their users and improve effectiveness. Under the Charter Programme every citizen is entitled to expect that public services will:

- publish standards of service;
- be more open and provide more information;
- provide choice and consult where possible;
- be polite and helpful at all times;
- put things right when they go wrong; and
- give value for money.¹⁹

In 1996-97, six service standards were added for central government dealing with matters such as response time for correspondence, punctuality for appointments, and the operation of at least one complaints procedure. A copy of the principles of the Charter is attached as Appendix 7.

4.14 The Charter Programme covers: all central government department and executive agencies; non-departmental public bodies; nationalised industries; the monopoly privatised industries; local authorities; health and education services; the law and order field; and transport. Citizen's Charters also apply to services previously delivered by government which have been contracted out to the private sector.

4.15 There are now 42 main, or "national" charters (covering key public services), which set out the standards of service people can expect to receive and provide a complaint resolution mechanism for inadequate service. These national charters set a framework of minimum standards, which apply to all service users. But an increasing number of services are developing and improving on these standards in their own local charters, often in consultation with local users. As of September 1996 there were over 10,000

¹⁹ United Kingdom, Parliament, *The Citizen's Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, p. 3.

local charters covering local service providers, such as general practitioner medical practices, schools, police forces and fire services.²⁰

- 4.16 The Charter Unit of the Office of Public Service, Cabinet Office,²¹ helps spread best practice by assisting public services to consult their users and develop their own charters.²² In addition the Charter Unit reports regularly to Parliament on progress²³ and manages and administers “The Charter Mark” which is an award for excellence in public service.²⁴ The Government publishes an annual Citizen’s Charter Report which details service improvements across the public sector.
- 4.17 It is against these standards that the grievances of private citizens are measured. For example, the Local Government Ombudsman, in addition to its own 42 guidelines for good administration, has regard to the relevant Citizen’s Charter when investigating complaints against a local authority and/or its service providers.
- 4.18 It is generally claimed that the establishment of Citizen’s Charters has had an impact on improving quality of service and enhancing accountability by clearly reinforcing that citizens are entitled to fair, efficient services, and, if not provided, they are entitled to

²⁰ United Kingdom, Parliament, *The Citizen’s Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, p. 13.

²¹ The Committee was informed that The Charter Unit employs 30/40 people and costs approximately £5 million per annum.

²² See, for example:
The Citizen’s Charter Complaints Task Force, Citizen’s Charter Unit, Cabinet Office *Good Practice Guide*, London, H.M.S.O., 1995;
Citizen’s Charter Unit, Cabinet Office, *Complaints review arrangements in Public Services*, London, H.M.S.O., March 1997;
Citizen’s Charter Unit, Cabinet Office, *Asking your users... How to improve services through consulting your consumers*, London, H.M.S.O., April 1996; and
The Citizen’s Charter Complaints Task Force, Citizen’s Charter Unit, *Effective Complaints Systems: principles and checklist*, London, H.M.S.O., January 1995.

²³ See, for example, The Citizen’s Charter Complaints Task Force, Citizen’s Charter Unit, Cabinet Office, *Putting Things Right*, London, H.M.S.O., June 1995.

²⁴ Cabinet Office, Privy Council Office and Parliament, *The Government’s Expenditure Plans 1997-98 to 1999-2000*, London, H.M.S.O., March 1997, pp. 36-39.

complain.²⁵ One person who met with the Committee members was prompted to say that it “*showed the public that the Government has been prepared to put its house in order*”.

- 4.19 There are indeed examples of performance improvement but there are also examples where standards have slipped. In a 1996 report, the Audit Commission commented that, in general, local authority performance indicators have encouraged the poorer performers to improve, but the performance average has stayed about the same.²⁶
- 4.20 Claims of increased rights for service users through the Citizen’s Charter have been criticised. Some commentators have alleged that in practice, particularly in the context of CCT, such charters are extremely limited. Concerns include a claim that CCT encourages minimum quality standards rather than quality improvements. In addition, where work has been privatised, it has been alleged that contractors will always look for ways to maximise profits and cut corners. Work is often performed by less skilled and inexperienced staff and service quality inevitably suffers.²⁷

Private Finance Initiative

- 4.21 The Private Finance Initiative (“PFI”), introduced in 1992, has become one of the United Kingdom Government’s main instruments in its aim to deliver higher quality and more cost-effective public services. Its aim is to bring the private sector more directly into the provision of public services with the public sector as an enabler and, where appropriate, guardian of the interests of the users and customers of public services. PFI is focused on financing capital investment in services and exploiting the full range of private sector management, commercial and creative skills.²⁸

²⁵ And see generally: United Kingdom, Parliament, *The Citizen’s Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996.

²⁶ United Kingdom, Parliament, *The Citizen’s Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, p. 20.

²⁷ Centre for Public Services, *CCT on the Record*, London, Local Government Information Unit, January 1994, p. 18.

²⁸ H.M. Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 1.

- 4.22 PFI is the same as public-private partnerships. All government capital projects must first be tested for private finance under PFI and only if there is no interest will traditional public sector capital funding be considered for approval.
- 4.23 Under PFI a firm or consortia “designs, finances, builds and operates” facilities on long term service contracts ranging from between 7 to 35 years. These are known as “DFBO’s”. The government agency or department pays the consortia for use of the facility and for supplying and managing support services. Contracts are usually reviewed every 5 years and can allow for changes to the contract from both sides. At the end of the contract term the private consortia usually retains ownership of the facilities and equipment. DFBO’s have included prisons, hospital facilities, transport infrastructure, information systems, vehicles and equipment.
- 4.24 One context in which PFI has been utilised is the construction of prisons. At the time of the Committee members’ visit to the United Kingdom six new remand prisons were at various stages of development under the Private Finance Initiative, usually on 25 year contract terms.²⁹
- 4.25 Another context in which DFBO operates is road construction. Committee members were informed that the first 8 DFBO road contracts have beaten the public sector comparator by an average of 15%. In such contracts a private firm wins the tender and the road is repaid by the Government using a variety of methods including “shadow tolls”, in other words, money paid by the Government to the private firm according to usage.³⁰
- 4.26 PFI generates enormous amounts of expenditure. For example, in respect of public transport it is expected that over £3.7 billion will be invested by the private sector in transport infrastructure projects under PFI over the period 1997/1998 to 1999/2000. Major projects include the Channel Tunnel Rail Link, Northern Line trains and DFBO schemes for roads.³¹
- 4.27 With PFI there is a transfer of risk to the private sector - including the risk of cost overruns, design defaults, repair and maintenance costs, facilities requiring adaptation because of changes in level of use, use of vacant space and maintaining up to date

²⁹ For more discussion refer to section 5.2 of Appendix 5.

³⁰ For more discussion refer to section 2.3 of Appendix 5.

³¹ Department of Transport, *Transport Report 1997 - The Government's Expenditure Plans 1997-98 to 1999-2000*, London, H.M.S.O., 1997, p. 6.

equipment. All of this results in a higher cost for PFI contracts than public sector contracts yet PFI projects also claim to provide better value for money.

- 4.28 Whatever the consensus, or lack thereof, on the success of PFI the Committee notes that it has made United Kingdom Government agencies an identifiable structure for privatisation as the agency has already been packaged with separate accounts, personnel and support services.³²

Deregulation and Contracting Out Act 1995

- 4.29 In addition the United Kingdom Government has had to implement specific legislation to overcome legal difficulties associated with the contracting out of statutory and regulatory functions by enacting the *Deregulation and Contracting Out Act 1995*. This Act defines how far the Government can go in contracting out. For example, it enables the United Kingdom Government to contract out services such as the operation of information search centres of Companies House (the United Kingdom equivalent of the Australian Securities Commission).

- 4.30 The *Deregulation and Contracting Out Act 1995* contains general legislative powers for contracting out. The Committee observed the fact that, in the United Kingdom, contracting out is quite rigidly legislated in respect of each specific agency. This contrasts with administrative practices adopted in Western Australia in relation to contracting out.³³

The Influence of the European Union Parliament

- 4.31 As a result of joining the European Communities in 1971, the United Kingdom is required to accept European Union law. European Union law is accepted by the United Kingdom automatically if the law is of “direct effect” or by means of subordinate

³² Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 53.

³³ For example, the recent State government proposal to outsource intellectual technology services currently provided by the Information Service Directorate: Questions on Notice No 1132, *Hansard*, 5 May 1999, p. 7862.

legislation if the law is not of “direct effect”.³⁴ An example of European Union law operating in the United Kingdom privatisation process is the *Transfer of Undertakings (Protection of Employment) Regulations 1981* (“TUPE”) which applies the *European Acquired Rights Directive*.

4.32 In essence the purpose of TUPE is:

- to open up the markets to competition; and
- to protect employees.

4.33 TUPE protects employees’ jobs and conditions when their work is taken over by a new employer by requiring the maintenance of an employee’s existing terms and conditions. Some of the consequences which apply include:

- the new employer who takes over the work must keep the existing workforce. They cannot pick and choose who will transfer (Reg 5);
- the new employer must offer a comparable position with the same rates of pay and conditions of service (Reg 5);
- time spent working for the previous employer counts towards length of service with the new employer;
- any dismissals related to the transfer are automatically unfair (Reg 8);
- collective agreements and trade union recognition are automatically transferred (Reg 9); and
- recognised unions have a right to be informed about and in relation to the transfer (Reg 10(5)).

Under TUPE a duty is also imposed on the employer to inform and consult with representatives of the employees or their recognised unions.

4.34 There is some evidence that some contractors only heed the regulations for 6 to 12 months. There are also many loopholes. Committee members were informed that staff were employed on lower terms and conditions than when in the public service, even with TUPE in place. One exception is the provision of Information Technology where terms and conditions are generally higher than in the public service. The Committee

³⁴ Legal provisions of direct effect are provisions which grant rights to individuals which must be upheld by the national courts of member states of the European Union. *Fifteenth Report of the Joint Standing Committee on Delegated Legislation, The Committee’s Investigations in Washington, London and Paris* presented July 1995, pp. 20-22.

was also informed by a union representative from Newcastle-upon-Tyne that local government authorities are not subject to TUPE when contracts are awarded in-house.

4.35 Other international regulations include:

- *European Union's Public Procurement Directives*, which from 1994 govern tendering by any government or public body for goods and services; and
- the *Government Procurement Regulations of the General Agreement of Tariffs and Trade* ("GATT") which from 1993 covers all government contracting in the United States of America, Canada, the European Union and a number of other countries.³⁵

4.36 The CCT legislation in the United Kingdom was the determinant for much change, however, European Union law superimposed a set of positive outcomes particularly in relation to the protection of employees and employment conditions.

³⁵ M. Paddon and Rosin Thanki, *Australia's Contracting Public Services: Critical Views of Contracting-Out by the Public Sector*, Sydney, University of New South Wales, 1995, p. 40.

CHAPTER 5

THE AUSTRALIAN PERSPECTIVE

- 5.1 In recent years, public resources in Australia have been moved from various government agencies to corporatised entities, and through privatisation to private ownership and, therefore, private delivery. Australian government services have also been delivered through contracting out.
- 5.2 Contracting out is not a new idea in Australia. Federal, State and local governments have been contracting out selected services for many years albeit with differing degrees of enthusiasm and political will.
- 5.3 In 1992 an Independent Committee of Inquiry chaired by Professor Fred Hilmer was established by the Commonwealth Parliament to examine National Competition Policy in Australia. Since the release of the report in 1993³⁶ the term “Hilmer” has been used in Australia as a shorthand way of referring to the stage of Australian microeconomic reform which focuses on competition policy.
- 5.4 An important part of the Hilmer reform process in Australia is the creation of a more competitive environment for government business enterprises. The Hilmer Report examined the possibility that a large proportion of the services provided by government could be subject to competitive tendering and contracting.
- 5.5 In Western Australia, a strong influence for contracting out was the McCarrey Report in which the Independent Commission to Review Public Sector Finances in Western Australia recommended that: *“The government use a well planned and closely monitored competitive tendering system wherever its activities permit.”*³⁷
- 5.6 The probability of many government activities in the future being contracted out is high. There is the potential for all areas of work performed by government departments

³⁶ *National Competition Policy Report by the Independent Committee of Inquiry*, AGPS, Canberra, August 1993, (“the Hilmer Report”). At the time of the report Professor Fred Hilmer, Chairman, was Dean & Director, Australian Graduate School of Management at the University of New South Wales.

³⁷ Report of the Independent Commission to Review Public Sector Finances, *Agenda for Reform*, Western Australia, June 1993, pp. (vii) and 29-42.

being contracted out to private contractors who often offer more competitive rates to provide such services.

- 5.7 In contrast to the United Kingdom, where contracting out is promoted by legislation, current contracting out processes in Western Australia are achieved in a more flexible fashion, that is by administrative practices and policies. This can result in a greater degree of flexibility and discretion for a Western Australian contractor than a United Kingdom contractor. The Committee's investigations in the United Kingdom may provide useful insights for future direction and development of contracting out processes in Western Australia.

CHAPTER 6

CATEGORIES FOR ASSESSMENT

6.1 The Committee has identified 3 major categories under which the United Kingdom investigations can conveniently be discussed.

6.1.1 **Cost** - the cost effectiveness of contracting out, including issues such as the social cost to the community in monetary terms; the cost of managing the transition and implementation of the contracting out policy and the identification of costs in the overall assessment of financial worth.

6.1.2 **Quality of Service**, including issues such as:

- Does contracting out affect the quality of service?
- What approach should be taken with the tendering process?
- What principles should apply to the vetting of contractors and evaluation of tenders?
- What ensures effective monitoring and maintenance of at least minimum standards?
- What role, if any, should performance sanctions, termination clauses, and performance bonds play?
- Who is to be accountable when something goes wrong - the government, local government or the private deliverer of services?
- What should the objectives and allocation of responsibility be?
- What avenues of redress are or should be available? What roles do Ombudsmen, Service Charters and contract terms play? and
- With regard to improvement and future investment - what safeguards can be put in place to ensure against a decline in service and/or decline in quality of infrastructure as a contract nears its end?

6.1.3 **Organisational Culture** - the effect of contracting out on an organisation's people, policies and structures.

6.2 Members of the Committee gained a comprehensive overview of issues surrounding privatisation, in particular contracting out (in both the mandatory and the voluntary CCT forms). Appendix 5 provides an overview of some government service areas

where contracting out and privatisation has occurred. The Committee makes some general observations on the criteria identified above in Chapters 7- 9 of this report. The Committee makes some observations on other issues in Chapter 10 of this report.

CHAPTER 7

IMPRESSIONS FROM THE UNITED KINGDOM: COST

The Notion of Cost

- 7.1 Much of the current debate in the United Kingdom has focussed on the cost effectiveness of contracting out. The contracting out process has forced an analysis of cost and delivery of service and a comparison between the public and the private sectors. Many areas of the public service have been set up as business units to compete on a commercial basis and have successfully kept many service contracts “in-house” at a lower cost than both its previous operations and the private sector.³⁸
- 7.2 Over the last decade the United Kingdom Government has consistently claimed that CCT and market testing produced cost savings of 20%-25%.³⁹ However, later studies have concluded otherwise.
- 7.2.1 In 1993 a government funded University of Birmingham study found average savings of 6.5% in local authority budgets when the costs of the service after competition were compared with those before competition.⁴⁰

³⁸ One example of a business unit is the United Kingdom Passport Office, which was established as an executive agency of the Home Office in April 1991. In the 5 years prior to 1998 the United Kingdom Passport Office has coped with an increase in demand for standard passport services of 42%. By means of flexible working arrangements, it has significantly reduced its turnaround times, and improved its efficiency by 21%. There has been no increase in the passport fee since November 1992. In real terms this has meant that passports are now processed in 10 days compared with 6 weeks prior to the establishment of the business units.

³⁹ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 43; citing 1995 White Paper, *Civil Service: Taking Forward Continuity and Change*.

⁴⁰ As cited in Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 44.

- 7.2.2 Two years later a Centre for Public Services⁴¹ study for the Equal Opportunities Commission (“EOC Study”) (the only study which examined the employment impact and public costs in detail in the building cleaning, education catering, refuse collection and sports and leisure management services) revealed that tendering had a 16% increase impact on public costs.⁴²
- 7.2.3 In 1996 an internal study by the Efficiency Unit of the Cabinet Office⁴³ (based on unaudited data and limited to the effect on central government departmental budgets) found 12% average savings.⁴⁴
- 7.3 One commentator has stated that if the principles and findings of the EOC Study are applied to the Efficiency Unit findings, this produces a net impact of 10% increase in the public cost of competitive tendering by market testing and CCT.⁴⁵
- 7.4 The EOC Study emphasises that it is important to take into account the long term effect of employment changes, particularly for women, arising through CCT and contracting out which impact quite significantly and indeed may reverse apparent “savings”. Costs related to loss of taxation revenue on the income side, and additional recourse to welfare and other payments on the expenditure side suggest that the net overall effect

⁴¹ The Centre for Public Services is an independent, non-profit organisation. It is committed to the provision of good quality public services by democratically accountable public bodies implementing best practice employment and equal opportunities policies. It was established in 1973 and operates nationally from a base in Sheffield.

⁴² Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 41.

⁴³ The Efficiency Unit supports the Prime Minister’s Advisor on Efficiency. Its principal aims are to help government departments to improve the value for money of the resources they use, and maintain the impetus in opening up central government work to competition.

⁴⁴ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, pp. 44-45.

⁴⁵ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 45.

of CCT in United Kingdom local government has been a substantial overall cost to National Government.⁴⁶

7.5 The EOC Study identified 5 important ways in which competitive tendering has an impact on local and central government income and expenditure:

1. additional cost of benefits paid to those who claim unemployment and housing benefit, council tax (property tax or rates) rebates or receive low income support. There are other costs of unemployment which were identified and taken into account;
2. the loss of jobs, cuts in working hours and reductions in pay and conditions reduces earnings, resulting in a loss of income tax and National Insurance payments (social security) to the Government;
- 3 the impact on the local economy;
4. increased corporations tax paid by private contractors was taken into account, however, this had only a marginal impact on Government income; and
5. in theory lower costs should reduce council tax, however, the surpluses transferred from one of the local government DSOs to the local authority is generally treated as if authorities were drawing on their balances and does not affect the level of Government grant. It is not additional income for local authorities.⁴⁷

7.6 The Committee notes that in some instances the impact, in terms of the social and financial costs of contracting out a service, may outweigh the perceived benefits of contracting out in the first place.

7.7 Cost effectiveness may also be hard to determine when some of the claimed benefits of contracting out, such as an increase in service quality and a positive change in organisational culture, cannot always be measured in quantitative terms.

⁴⁶ M. Paddon and Rosin Thanki, *Australia's Contracting Public Services: Critical Views of Contracting-Out by the Public Sector*, Sydney, University of New South Wales, 1995, pp. 34-35.

⁴⁷ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 45.

- 7.8 In conclusion, it has been claimed that competitive tendering is not “saving” public money which could be either invested in other services or used to reduce government expenditure: “*whilst public sector employment is reduced by contracting out and private sector employment is increased, the latter is in effect being subsidised by the public purse*”.⁴⁸
- 7.9 The Committee acknowledges that analysing the impact of CCT on the costs of services can be complex.
- 7.9.1 Accounting practices in local government may vary between time periods and between services, and costings may not always be available. As an illustration, a United Kingdom Government funded review of the impact of CCT in British local government estimated that average costs savings were only in the order of 6.5% but with substantial variations between different services.⁴⁹ Clearly contracting out varies from one local government to the next.
- 7.9.2 Inadequate records may be kept and the true picture of costs may not be available. For example, the City of Westminster claims that savings from CCT have helped achieve a low council tax for residents. It was suggested that the City’s new waste collection and disposal contracts, would save council tax payers another £27 million over their duration.⁵⁰ The Committee notes that the source of these savings and what costs, if any, were taken into account, were not enumerated.

⁴⁸ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 46.

⁴⁹ Variations ranged from a 12.07% cost reduction in building cleaning to a 2.9% cost increase in school and welfare catering. Individual councils experienced differential effects on costs, ranging from cost reductions of 49.7% to cost increases of 62.4%. M. Paddon and Rosin Thanki, *Australia’s Contracting Public Services: Critical Views of Contracting-Out by the Public Sector*, Sydney, University of New South Wales, 1995, p. 14.

⁵⁰ City of Westminster, *Westminster City Council Review of the Year -Your City 1995-6*, London, p. 2.

- 7.9.3 Further, the contractor may make investments or obtain knowledge and skills which are specific to a contract. Once these costs have been incurred, both the contractor and the government can face considerable costs of exit from the contract and in changing suppliers.
- 7.10 Thus a clear picture of costs does not emerge. There are many factors to be taken into account and the determination of any cost effectiveness of contracting out requires the accurate and ongoing monitoring of all costs including those outlined at paragraph 7.5 of this report.

Broader Social and Economic Impact

- 7.11 The EOC Study also highlights the broader social and economic impact of CCT. The following is a brief summary highlighting those findings of the EOC Study which are most relevant to the public costs of CCT.
- 7.11.1 **Job Losses:** Female employment fell by 22% and male employment by 12%. Women accounted for 93% of “pre-CCT” employment in the 4 services studied and for 96% of the net job loss between 1988-89 and 1993-94 (after the initial and second terms of CCT). Since 91% of employment in the 4 services was part time, part time workers accounted for most of the total decline in employment (95%).
- 7.11.2 **Loss of hours:** Hours were reduced on average in building cleaning by 25% and in education catering by 16% with virtually all those affected being part time workers.
- 7.11.3 **Increased use of temporary workers:** Temporary workers accounted for 16%-17%.
- 7.11.4 **Multiple jobs:** The reduction in hours in catering and cleaning meant that more women had to take on several jobs of a few hours each in order to try and maintain income levels, leading to increased casualisation of the workforce. Local authorities were unable to provide accurate information on the extent of multiple jobs. However, estimates by managers ranged up to 25% of catering and cleaning staff having more than one job with the local authority.
- 7.11.5 **Loss of holiday retainer:** Many school cleaners and school meals staff are no longer paid throughout the year or receive a holiday retainer. They are paid

for only about 39 weeks of term time which represents a salary reduction of up to 25%.

7.11.6 **Black and ethnic minority workers:** The employment of black people was very low in all but 3 of the case study authorities and had remained static since 1988-89. In spite of ethnic record keeping in 60% of authorities, black workers were under represented compared to their share of the population in male and female dominated services.

7.11.7 **Disabled workers:** Both male and female disabled workers were poorly represented in the services studied. There is evidence that the number of disabled workers employed by local councils decreased during the first round of CCT tendering.

7.11.8 **Pay:** CCT appears to have resulted in a 3 tier pay structure. Most authorities (78% of contracts in the case studies) continue to pay National Joint Council rates, some DSOs (13%) have introduced a local rate. All 9 privatised contracts (representing 10% of the case study contracts) paid lower than National Joint Council rates.

7.12 There were a number of other important findings concerning casualisation of the workforce, the effects of the development of a “contract culture”, the role of equal opportunities in the CCT process and the effect on trade unions.⁵¹

7.13 The Committee was also informed by a Unison⁵² representative from Newcastle-upon-Tyne that:

- contracting out resulted in staff having their employment terminated because of their sickness;
- 99% of the low paid part time work (usually in cleaning and catering) was completed by women who were often employed in split shift arrangements. This created many difficulties for women with child rearing and other family responsibilities;

⁵¹ Centre for Public Services, *The Gender Impact of CCT in Local Government - Calculation of the National Costs and Savings of CCT*, United Kingdom, 1995, pp. 2-3; and Equal Opportunities Commission, *The Gender Impact of CCT in Local Government: Summary Report*, United Kingdom, 1995.

⁵² Refer to definition of “NALGO” in Appendix 4.

- workers employed on split shifts often experienced bullying and intimidation which was not easily overcome as that sector of the workforce was not generally unionised; and
- there was increased casualisation of the workforce, for example in Leisure Services Management 25% of the staff were casual and received no overtime, holidays or sick leave.

7.14 Of interest to the Committee was that the above findings show, amongst other things, evidence of a disproportionate impact on particular groups of employees, notably women. Many of the services selected for CCT are those in which women employees predominate. As an unintended consequence of the “occupational segregation” that characterises labour markets, women employees are thus likely to have been disproportionately affected as they are more likely to be employed in, for example, cleaning and hospitality.⁵³

7.15 The CityWorks organisation established by the Newcastle-upon Tyne City Council to address CCT issues (refer to sections 4.24 to 4.33 of Appendix 5) noted that the growing levels of poverty and polarisation in the United Kingdom reinforced the traditional case for public services in meeting social needs.⁵⁴ CityWorks enables strategies to be implemented by the local council as any generated surpluses are returned to the council (rather than shareholders in private sector enterprises) which in turn funds programs. In addition CityWorks can balance commercial objectives with social objectives when planning the provision of its services.

7.16 The Committee is of the view that it is necessary to define the core public sector activities and separate them from the trading activities of government. Trading activities have commercial objectives whereas social service functions are subsidised. The Committee notes that CityWorks appears to successfully combine the two objectives, with the commercially profitable services subsidising the social service functions.⁵⁵

⁵³ M. Paddon and Rosin Thanki, *Australia's Contracting Public Services: Critical Views of Contracting-Out by the Public Sector*, Sydney, University of New South Wales, 1995, pp. 29-33.

⁵⁴ City of Newcastle upon Tyne, *CityWorks: The Contribution We Make*, Newcastle upon Tyne, July 1997.

⁵⁵ Community Service Obligations are discussed in more detail in the Thirty Sixth Report of the Standing Committee on Government Agencies, April 1994: *State Agencies - Their Nature and Function* at pp. 12-13 and 22-24.

7.17 Whatever the debate on cost savings (refer to paragraphs 7.1 to 7.10 above) even if the economy as a whole may gain, the Committee notes that particular groups may be disadvantaged.

Remote and Regional Areas

7.18 There is a need to identify means within a private sector context of protecting commercially unprofitable but socially necessary services in remote areas.⁵⁶ The Committee was interested in how privatisation impacts on the ability of a government agency to provide services in regional and rural areas.

7.19 During its discussions with parties in the United Kingdom, Committee members noted that early contracts generally did not insist on or define standards of service and product delivery. In respect of rail transport, although contracts were awarded to service remote areas, there were no contractual stipulations as to the regularity or quantum of service. When problems with product and/or service quality arose these omissions led to many enforcement problems as the government agency had little or no recourse.

7.20 The United Kingdom government has learnt from its mistakes and now ensures that contracts specify minimum standards of service. For example, in respect of rail transport:

- line closures require the approval of the Secretary of State; and
- each contract and franchise arrangement now specifies the core level of service that must be provided.⁵⁷

7.21 The Committee was also informed that the Government provides money to support socially necessary but unprofitable services, such as local bus services (refer to sections 2.13 to 2.20.6 of Appendix 5). As noted at paragraph 7.15 of this report, CityWorks, run by the Newcastle upon Tyne Council, is also an example of successful subsidisation (refer to sections 4.24 to 4.33 of Appendix 5).

⁵⁶ Adam Broadbent, *Privatisation The United Kingdom Experience*, The Australian Director, June/July, 1986, p. 33.

⁵⁷ United Kingdom, Parliament, *The Citizen's Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, p.32. (Also see section 2.9 of Appendix 5).

7.22 There was a distinct difference between inner city and regional local governments in their approach to CCT. Of the three local governments examined by the Committee:

- the London councils of Wandsworth and Westminster vigorously pursued contracting out initiatives and did so away from in-house provision; and
- the Newcastle upon Tyne Council, as an example of a regional local government, pursued contracting out with different objectives. The NCC faced competition challenges by looking to provision of services in-house.

7.23 The Committee considers that it is possible to effect cultural change and still remain competitive within the context of a current administration. As illustrated by CityWorks, the approach of CCT is possible within the context of existing local government authorities and the administration of their services - effective contracting does not necessarily mean contracting out of an agency. The Committee believes that the CityWorks experience is a very good model for Western Australia to draw upon.

CHAPTER 8

IMPRESSIONS FROM THE UNITED KINGDOM: QUALITY OF SERVICE

8.1 There are many issues relating to quality. Key questions for the Committee included:

- Does contracting out affect the quality of service?
- What approach should be taken with the tendering process?
- What principles should apply to the vetting of contractors and evaluation of tenders?
- What ensures effective monitoring and maintenance of at least minimum standards?
- What role, if any, should performance sanctions, termination clauses, and performance bonds play?
- Who is to be accountable when something goes wrong - the government, local government or the private deliverer of services? What should the objectives and allocation of responsibility be?
- What avenues of redress are or should be available? What roles do Ombudsmen, Service Charters and contract terms play? and
- With regard to improvement and future Investment - what safeguards can be put in place to ensure against decline in service and/or decline in quality of infrastructure as a contract nears its end?

Does contracting out affect the quality of service?

8.2 A key question for the Committee was whether contracting out affected quality of service. This raises the threshold question of how to assess quality?

8.3 The Citizen's Charter proposed that user views should be the most important aspect in assessing quality of service. However there are problems with measurement as there appears to have been very little systematic evaluation by government departments. Where there has been evaluation, assuming change in service quality is difficult as performance targets may not be directly comparable with evaluations of previous years.

8.4 One survey conducted by the Efficiency Unit of the Cabinet Office after the completion of the Competing for Quality Initiative was quite revealing:⁵⁸

- there was an almost even split between persons who considered quality had improved, stayed the same, or had declined;
- there was no survey data published in the study restricting any further analysis by consumer type; and
- the survey was based on a very narrow definition of quality, making conclusions difficult to assess.

8.5 Although concerns were expressed to Committee members that some cost savings said to be produced by CCT were at the expense of service quality, there appears to be no consensus on this issue. Whilst Committee members were informed of many examples where contracting out has led to an improvement in quality there was also anecdotal evidence that in some cases quality had declined.

8.6 Some concerns included claims that CCT encouraged minimum quality standards rather than quality improvements. In addition, where work had been privatised, it was alleged that contractors would always look for ways to maximise profits and cut corners. Work is often performed by less skilled and inexperienced staff and service quality inevitably suffers.⁵⁹ A January 1994 analysis of over 5000 local government and health service contracts has shown the extent of poor quality services. In respect of all contracts awarded to private contractors, one in ten had been terminated and 23% had suffered problems.⁶⁰

8.7 It has been alleged that⁶¹:

- competition negatively affects quality of service. Despite Government arguments that the market and CCT will lead to better defined services and

⁵⁸ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 32.

⁵⁹ Centre for Public Services, *CCT on the Record*, London, Local Government Information Unit, January 1994, p. 18.

⁶⁰ Centre for Public Services, *CCT on the Record*, London, Local Government Information Unit, January 1994, p. 18.

⁶¹ Centre for Public Services, *CCT on the Record* London, Local Government Information Unit, January 1994, p. 19.

incentives to achieve standards, for contractors the incentive is to achieve profits. This conflicts with the social objectives of local authorities;

- broader social objectives are meaningless unless councils can specify qualitative criteria clearly, incorporate them in a contract and then monitor and enforce them effectively;
- contractors have no interest in an agenda where equality issues and the needs of different groups in the community are taken into account in policy making and decisions about service delivery;
- as CCT is linked to the consumerisation of services, users are treated as individual receivers of services rather than collective groups with differing needs. This results in, amongst other things, standardisation of services;
- CCT pushes the level of accountability and responsiveness further away from consumers. Users have no direct contact with contractors. Contract conditions usually mean that contractors can refuse to make any changes that are not in the contract. Once a contract is awarded consumers can only influence it when it is put to tender again;
- although the contract system enables performance to be monitored in a more systematic way, problems still occur. Local Council action such as withholding payment and claiming defaults may carry little threat to contractors especially as most budget for a level of failures. The costs of retendering for the service can also be prohibitive to councils; and
- contract failure usually occurs when service provision had deteriorated over a long period of time and financial penalties have occurred. This incurs a substantial amount of local government authority time and resources. As one commentator on CCT stated “*What termination, failures and company liquidation means for local people is rubbish on the streets, dirty schools and overgrown parks.*”⁶²

8.8 The Health Commissioner, with whom members of the Committee met, noted that in recent years more private practitioners are contracting with the mental health service particularly in middle range institutional care, for example nursing homes and hostels.

⁶² Centre for Public Services, *CCT on the Record*, London, Local Government Information Unit, January 1994, p. 20.

This creates a difficulty with controlling quality of service for very vulnerable people: How do you ensure the private sector does not exploit clients if the client is not in a position to appreciate a particular standard of service?

- 8.9 Whatever the conclusion, in the main the Committee notes that contracting has led to a greater focus on the needs of the client and the form and content of tender and contract documentation.

Approach to the tendering process

- 8.10 The approach of the contracting agency to the tendering process is crucial to the maintenance and improvement of quality. Reductions in quality can often be attributed to a failure in the tendering process through: inadequate service specification; inappropriate contractor selection; and poor contract management.

- 8.11 Specifications and contractual documents should, as a minimum, include such things as:

- the description, method and frequency of work;
- the timing of work including any requirements or restrictions on when work is to be done;
- emergency cover and stand by rosters to cover contingencies, including holidays, sickness, and unforeseen requirements;
- the equipment and materials to be used, including maintenance and capital requirements;
- the standards of work and level of service required;
- workforce qualifications;
- health and safety and equal opportunity policies;
- the procedures for monitoring, penalties and termination; and
- agreed procedures to negotiate contractual variations.

- 8.12 For example the Franchise Agreement produced by OPRAF covers⁶³:

- the contractual level of passenger service, including the provision of sufficient capacity on peak commuter services;
- the publishing of timetables;
- the conducting of customer satisfaction surveys;

⁶³ Department of Transport, *Transport Report 1997 - The Government's Expenditure Plans 1997-98 to 1999-2000*, London, H.M.S.O., 1997, p. 80.

- the quality of service;
 - the fares regulations which apply;
 - the requirement to participate in mandatory inter operator arrangements;
 - financial matters such as the support payments to be made by OPRAF;
 - franchise reviews; and
 - performance incentive regimes in those cases where OPRAF believes that the market is too weak to motivate the relevant franchise operator to respond adequately to customer demands for a punctual and reliable service.
- 8.13 Omission or uncertainties in the contract can contribute to operational difficulties, as was the case in the letting of the management of Wolds Prison (refer to sections 5.4 to 5.11 of Appendix 5). To some degree difficulties are considered to be inevitable in a totally new arrangement because of unforeseen events and circumstances, for example, the underestimation of external visits made by prisoners increased supervision costs (refer to section 5.7.1 of Appendix 5).
- 8.14 Much that is critical to quality can be quantified and specified, for example, value for money, redressing faults and responding to complaints. However, the Committee notes that the effectiveness of using contracts as instruments for defining service quality varies. It should not be assumed that the most eloquent descriptions of services will equate to what will occur in practice.
- 8.15 The Committee notes that quality specifications appear to be very effective for easily defined areas of what the government agency is buying, for example catering and laundry. However, quality specifications in other areas, for example health care, are not so effective. In the health care area the Committee notes that as the service being provided is so personal to the recipient it is essential that an appropriate internal complaints procedure is established to obtain information that contract monitoring by government staff cannot obtain.
- 8.16 On the other hand, a complaints procedure may not be comprehensive or adequately reflect service quality in cases where the recipients of the services are people with learning difficulties, such as the Westminster contract (refer to section 4.20 of Appendix 5). Indeed the Health Commissioner commented to Committee members that care issues are difficult to quantify and audit as they need to be assessed on clinical effectiveness. Complaint procedures, as an avenue of redress, are discussed at paragraph 8.45 onwards of this report.

Vetting of contractors and evaluation of tenders

8.17 A comprehensive evaluation of contractors and tenders is also necessary. Contractors with poor performance records, unstable finances and poor health and safety records have all been excluded from United Kingdom tenders. The tender evaluation team should be impartial and have the necessary skills and experience to do the job. Key factors which should be assessed include compliance with tender requirements, good performance record, adequate resources, use of qualified staff, proven health and safety record and a commitment to equal opportunities. Government guidance in the NHS states that: *“It is important to understand that competition does not mean invariably choosing the cheapest service: it means finding the best combination of quality and price which reflects the priority of service.”*⁶⁴

Effective monitoring of contracts and maintenance of minimum standards

8.18 The Committee believes that it is important that managers of contracting out create an effective quality control framework which will enable regular reviews of the work of contractors and appropriate monitoring. This is important to ensure that the service provider remains accountable. The amount of monitoring will depend in each case on the service being contracted and the balance to be achieved between ensuring that specifications are adhered to without stifling the contractor. United Kingdom Government guidance in the NHS says that effective monitoring:

- influences and maintains the supplier’s performance to specification;
- provides clear and documented evidence where necessary to invoke any break or default clauses;
- informs management at the time of re-tendering of the need for change in the work specification, supplier or contractual arrangements; and
- provides evidence of cost savings achieved for internal and external reporting purposes.⁶⁵

8.19 Further, agency staff should be trained to possess the skills to monitor contracts. In this respect the Committee recalls comments made by organisations in the United Kingdom that the process of contracting out may result in the loss of employees with the requisite management skills and expertise to effectively monitor any contract.

⁶⁴ Unison Health Group, *Guidance on Market Testing in the NHS*, London, Unison, February 1996, p. 28.

⁶⁵ Unison Health Group, *Guidance on Market Testing in the NHS*, London, Unison, February 1996, p. 21.

- 8.20 The Committee believes that effective monitoring is achieved by transparency supported by a system of internal and external reporting. The Committee is of the view that this is assisted by the services of Ombudsmen and legislative initiatives regarding freedom of information.

Performance sanctions

- 8.21 The Committee considers that it is essential that performance sanctions are built into contracts to avoid any risk that profit, rather than quality of service, is the determinant for service delivery.
- 8.22 One way for governments to ensure that contracts with the private sector are adequately performed is by the insertion of a liquidated damages clause. These are clauses which specify, in the event of a breach of the contract, that a certain fixed amount must be paid by the contractor to the government. One key advantage with this method is that it does not require court proceedings to be effective.
- 8.23 Different philosophies may apply depending on the organisation which has contracted for the services. For example, the Wandsworth Borough Council defaults contractors but is not punitive and aims to negotiate its way out of problems, only applying suspension and termination of the contract as a last resort.

Termination clauses

- 8.24 The Committee was informed that a termination clause for unsatisfactory performance is necessary. However, the Committee notes that in respect of some services for which there are few alternative suppliers, that the practical reality of a termination may mean that the service will not be provided at all.

Performance bonds

- 8.25 Government guidance in the NHS does not encourage performance bonds⁶⁶. It was alleged that the lack of promotion for using bonds is intended to make it cheaper for companies to bid for work.

However, the Committee notes that if contracts collapse real costs are incurred, as many local councils and health authorities have found out. Amber Valley Council, for example, found that they had to take over a workforce and take over a contract at no notice when a contractor went bankrupt and the performance bond was too small to cover the costs. Bonds can therefore be of real insurance value.⁶⁷

Accountability

- 8.26 Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and ministerial control over the day to day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out because the main increases in efficiency come from the greater freedom allowed to contracting service providers. At the same time it is recognised that accountability may on occasion be increased through improved departmental and ministerial control following on from greater clarification of objectives and specification of standards. Providers may also become more responsive to public needs through the forces of market competition.⁶⁸

- 8.27 As identified in the Commonwealth of Australia Industry Commission Report No 48⁶⁹ there are perhaps 3 main aspects of accountability:

⁶⁶ Unison Health Group, *Guidance on Market Testing in the NHS* (London, Unison, February 1996) p. 23. Performance bonds typically consist of an agreed amount of money paid by the contractor into a trust account at the beginning of a contract. The monies can be accessed by the contracting government agency in defined circumstances including default by the contractor.

⁶⁷ Unison Health Group, *Guidance on Market Testing in the NHS* (London, Unison, February 1996) p. 23.

⁶⁸ See further: Richard Mulgan, *Contracting out and accountability*, Australian Journal of Public Administration, 56(4): pp. 106-116, December 1997.

⁶⁹ Australia, Government, Industry Commission, *Competitive Tendering and Contracting by Public Sector Agencies - Report No 48*, Melbourne, A.G.P.S., 24 January 1996.

1. clear specification of objectives and allocation of responsibility;
2. improving information on standards and outcomes; and
3. affording an avenue of redress.

The Committee has briefly considered the first and third areas.

Accountability - Objectives and Allocation of Responsibility

- 8.28 At the outset the Committee notes the comments by Loretta Zamprogno in an article on the Commonwealth of Australia's Industry Commission Report No 48 that: "*The terms "accountability" and "responsibility" are often used interchangeably or synonymously. There is however a distinction which may become lost in the contracting out of government services. In 1996, the distinction advanced by the then Industry Commission was that "while responsibility to do certain things can be transferred, accountability for the results cannot".*"⁷⁰
- 8.29 Problems with co-ordination of allocated responsibility between government departments themselves create difficulties with allocation of responsibility between government and contractors. Committee members were informed by the Health Commissioner that problems have occurred in relation to juvenile health - nobody is prepared to define the problem, or to develop strategies on how to address it. It is alleged that there is both a lack of co-ordination and assumption of responsibility between the educators, psychologists and social workers within the system. Who takes the responsibility? Who is accountable?
- 8.30 The Committee believes that in all instances of contracting out, accountability to the consumer should remain with the government agency. In the United Kingdom if an Ombudsman's investigation results in a recommendation that compensation be paid to the complainant it is usually paid by the local authority. The local authority may then elect to pursue the private contractor who may be at fault. The Committee notes that this course of action may raise issues of "fault allocation" and responsibility may be difficult to apportion if a contract is silent or defective on the issue.
- 8.31 It would be prudent for government agencies to consider whether or not to include a contractual clause whereby, if the government agency elects to pay any compensation

⁷⁰ Zamprogno, Loretta M, "ARC Report on the Contracting Out of Government Services: Its Context and Recommendations", *Australian Journal of Administrative Law*, Volume 6, p. 75.

to a consumer, then the government agency is to be reimbursed by the private contractor in certain circumstances.

- 8.32 In this way if a member of the public has suffered damage as a result of a contractor's action or inaction the government agency which was responsible for the negotiation and monitoring of that contract, pays compensation. The responsibility for recouping the loss from the contractor then lies with the government agency.

Accountability - Avenues of Redress

- 8.33 There is a legitimate expectation that providers of public services paid for by public funds should be publicly accountable. However, the transfer of the provision of public services from government agencies to private individuals may result in a reduction in accountability. As previously noted, private service providers may not be subject to the same level of accountability as public officials.

- 8.34 As noted, while responsibility to provide services and goods can be transferred, accountability for the results cannot. The Committee notes the comments of the Industry Commission Report that a government agency must remain accountable for the efficient performance of the functions delegated to it by government including:⁷¹

- translating project objectives into detailed service specifications;
- choosing the in-house or external contractor to deliver the service;
- ensuring that the service required is actually delivered; and
- dealing equitably and responsibly with clients and the public.

- 8.35 Administrative Law is the key means by which government and the bureaucracy are directly accountable to individuals affected by their actions.⁷² However, Administrative Law remains essentially public law, as stated by an Australian commentator "*The great*

⁷¹ Australia, Government, Industry Commission, *Draft Report - Competitive Tendering and Contracting Out by Public Sector Agencies*, Melbourne A.G.P.S., October 1995, p. 4.

⁷² In Australia, Administrative Law includes the: capacity to challenge the legality of government decisions by action in the High and Federal Courts; capacity to seek judicial review of statutory decisions under the ADJR Act 1977 (Cwlth); capacity to seek a review of the merits by an independent tribunal (AAT); Ombudsman, rights of access to government held documents under the Freedom of Information Act 1982 (Cwlth); ability to seek an internal review of decision and regulation and use of information via the *Privacy Act 1988* and *Archives Act 1983*.

*private bureaucracies may be supervised by public administrators; but it is their supervisors, not they, who are governed by Administrative Law. In the current political climate this is unlikely to change. However, in the long term it may. Judicial and legislative innovation has been a characteristic of Administrative Law, and an expansion into the private sector may be one of the next steps in the growth of Administrative Law's empire.*⁷³ The Committee has already commented on the scope, advantage and disadvantage of Administrative Law mechanisms in the context of contracting out in the 2 discussion papers tabled in June 1997.⁷⁴ The Committee notes that the issue of administrative review was also examined in detail by the Thirty Sixth Report of the Standing Committee on Government Agencies.⁷⁵

- 8.36 The Committee does not address the availability or reform of principles of Administrative Law in this report but notes that there have also been a number of recent Commonwealth reports published on the issue.⁷⁶
- 8.37 In respect of accountability, the Committee considers that private firms delivering services for and/or on behalf of a government agency (which service is being funded by public monies) must expect a greater level of scrutiny than may otherwise apply. This raises the issue of commercial confidentiality in respect of government dealings. The Committee notes that this is an issue into which it proposes to further inquire.

Accountability - Avenues of Redress - Ombudsmen

- 8.38 One of the most common processes used to monitor and review privatised processes in the United Kingdom is by way of an Ombudsman.

⁷³ Douglas and Jones, *Administrative Law - Commentary and Materials*, 2nd ed. Federation Press. Cited in Andrew Finlay *The contracting out of government services: the implications for administrative law*, Ethos Law Society of the ACT, August 1997.

⁷⁴ Standing Committee on Public Administration June 1997 Discussion Papers: *An Introduction to Outsourcing - What are the Issues Involved?*; and *Outsourcing to the Private Sector - The United States Office of Federal Contract Compliance Programs*.

⁷⁵ Thirty-Sixth Report of the Standing Committee on Government Agencies, *State Agencies - Their Nature and Function*, April 1994, pp. 19-25.

⁷⁶ Administrative Review Council Twenty First Annual Report 1996 - 1997 and Administrative Review Council *The Contracting Out of Government Services: Report to the Attorney General*, Report No 42, 1998.

8.39 In contrast to Western Australia's single Ombudsman, the Parliamentary Commissioner for Investigations, the Committee members noted the plethora of Ombudsmen that existed in the United Kingdom, each with a defined area of competence. They included:

- ***The Parliamentary Commissioner for Administration*** ("Parliamentary Ombudsman") who investigates complaints from members of the public, referred to him by Members of the House of Commons about maladministration in government departments and certain non departmental public bodies.
- ***Health Service Commissioners*** for England, Scotland and Wales who are responsible for investigating complaints against National Health Service bodies and, since April 1996, against NHS practitioners providing family health services.
- ***Prisons Ombudsman***, which was established in 1994 to investigate complaints from prisoners who have failed to obtain satisfaction from the Prison Service's internal requests and complaints system. The Prison Ombudsman is independent of the Prisons Service of the Home Office and reports directly to the Home Secretary.⁷⁷
- ***HM Inspectorate of Prisons***, who is independent of the Prisons Service and reports directly to the Home Secretary on conditions, treatment of those held and facilities available to them and other matters as the Secretary of State may direct. All prisons and young offender institutions are subject to inspection whether they are managed directly or contracted out. The Inspectorate aims to inspect every establishment at least every 5 years.⁷⁸
- ***Local Government Ombudsman***: The *Local Government Act 1974* makes it clear that the Local Government Ombudsman may investigate a complaint about an action taken "by or on behalf" of an authority within jurisdiction where the action is taken in the exercise of administrative functions of the

⁷⁷ Home Office, *Annual Report 1997 - The Government's Expenditure Plans 1997 - 1998 to 1999 - 2000*, United Kingdom, H.M.S.O., March 1997, p. 145.

⁷⁸ Home Office, *Annual Report 1997 - The Government's Expenditure Plans 1997 - 1998 to 1999 - 2000*, United Kingdom, H.M.S.O., March 1997, p. 146.

authority. This, therefore, includes the actions of firms or individuals undertaking work on behalf of an authority and includes contracts for the supply of goods and services to the council. This applies whether the external contractor is engaged as a result of a compulsory tendering arrangement required by legislation, or through voluntary action by the authority.

As noted by the Local Government Ombudsman⁷⁹:

- ▶ Contractors would need to cooperate in any investigations in exactly the same way that government authorities must do. If there was any difficulty the Ombudsman possesses the same powers as the High Court to compel witnesses to attend for interview and to require production of documents; and
- ▶ Authorities should consider whether to take some steps to safeguard their position in the event that the Ombudsman finds maladministration and injustice as a result of fault by a contractor. This could be, for example, to include in contracts a provision to enable the authority to recover from the contractor any payments made by the authority to a complainant following a finding of maladministration causing injustice. Such provisions would need to cover payments made under the terms of an early settlement of a complaint made to the Ombudsman without a formal complaint.

8.40 In general Ombudsmen in the United Kingdom:

- provide an independent assessment of complaints about services provided by, and in some cases on behalf of, the Government;
- cannot choose to investigate matters of his/her own motion - it is a “reactive jurisdiction”. The Committee notes that this is in contrast to the Western Australian Ombudsman who can initiate enquiries;⁸⁰
- can only make recommendations, although in most cases those recommendations are complied with;
- is regarded as an option of last resort. The preference is that consumers use the government agency based dispute resolution systems before referring any matter to the Ombudsman; and

⁷⁹ Local Government Ombudsman, *Summary Annual Report for the year ended 31 March*, United Kingdom, Commission for Local Administration, 1996.

⁸⁰ For example the Western Australian Parliamentary Commissioner is currently inquiring into the Western Australian prisons system of his own motion.

- may have differing approaches. For example, the purpose of the Health Commissioner is not one as an office of continual review. Rather, it is a means of redress for individual complaints compared to overlooking the systemic problems that may be prevalent within the Health System. Although it is possible for the production of a more general report from the Health Commissioner's office outlining a series of complaints regarding general hospital practice, this is more unusual.

8.41 In the United Kingdom there is a trend for companies in the private sector to embrace the Ombudsman principle as a viable and legitimate technique for resolving disputes between themselves and their customers. Commentators have suggested that this was a response by the private sector to stave off anticipated statutory controls.⁸¹

8.42 There are problems with the Ombudsman system in the United Kingdom:

8.42.1 The Health Commissioner informed Committee members that there are often difficulties with contracting out in that it is implicit that all mechanisms for redress should be extended to the private sector. The Health Commissioner often considers whether the individual has suffered any hardship or injustice. The issue may not have been specifically addressed in the contract between the NHS and the general practitioner. The Health Commissioner noted that there was a perception that a contract is not always an effective way of controlling quality and more focus on improving clinical effectiveness would save the NHS millions of pounds.

8.42.2 It is not widely known that access to the Ombudsman is available in respect of complaints about private contractors delivering public services. The Parliamentary Ombudsman noted that he had received few complaints in that context.

8.43 As noted above, in some cases Ombudsmen in the United Kingdom can investigate services provided on behalf of Government:

- In 1996 legislation was passed to extend the powers of the Health Commissioner to investigate complaints about doctors, dentists, pharmacists, and optometrists providing family health services under the NHS and enables

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Morris, *The Banking Ombudsman* - 1, 1987, JBL 131, p. 133.

the Health Commissioner to investigate complaints arising from the exercise of clinical judgment.⁸²

- The Local Government Ombudsman may investigate a complaint about an action taken “by or on behalf” of an authority where the action is taken in the exercise of administrative functions of the authority. This applies whether the external contractor is engaged as a result of a compulsory tendering arrangement required by legislation, or through voluntary action by the authority.
- The empowering statute for the Parliamentary Ombudsman gives permission to carry out investigations of complaints against departments or on behalf of departments. As a result the Parliamentary Ombudsman has jurisdiction to look at the performance of contractors who are conducting operations on behalf of a department or agency. If there is a complaint made against a department the Parliamentary Ombudsman will look at the contract between the department and the private contractor although it is the department that provides redress, not the contractor. It then becomes an issue for the department to resolve with the contractor.

8.44 In contrast the jurisdiction of the Ombudsman in Western Australia does not extend beyond the public sector nor within local government. The Committee notes that where a contractor is not part of the government, complaints cannot be made to the Western Australian Ombudsman about service delivery and members of the public cannot seek information held by the contractor unless legislation provides for this access. As complaints may only be made to the Western Australian Ombudsman about a “matter of administration” this means that the Ombudsman may be able to investigate the manner in which the relevant agency has dealt with the contractor, but this may not allow the Western Australian Ombudsman to address the complaint directly.⁸³

⁸² *Health Service Commissioners (Amendment) Act 1996 (UK)*

⁸³ Refer to Sprott, J, “Privatisation, Corporatisation and Outsourcing: Critical Analysis from the Consumer Perspective”, *Australian Journal of Administrative Law*, August 1998, Vol. 5, pp. 223-239.

Accountability - Avenues of Redress - Service Charters

8.45 Less onerous mechanisms for accountability may include service charters which provide a framework for individual complaints against private as well as public providers. The Committee discussed service charters in an earlier discussion paper where it said:⁸⁴

“ Clear performance standards and means of monitoring compliance with them may be particularly useful when services are difficult to define precisely.

Service recipients and others will be interested in these standards of performance - recognition of this can be in the form of a customer service charter. These may be broad or specific depending on the particular industry. A common feature of these charters is that they contain a series of promises or undertakings to customers about how a service will be delivered. These may encapsulate areas such as quality, choice, standards, and value.”

8.46 As noted by the Commonwealth of Australia Administrative Review Council’s Report 42:⁸⁵

“ There are a number of options open to agencies in using service charters to help define service standards including:

- incorporating key features of a charter in the contract;*
- requiring the contractor to comply with relevant parts of the government agency’s own charter;*
- requiring the contractor to comply with a minimum set of standards; and*
- encouraging contractors (perhaps by offering incentives) to develop additional standards, or making the development of suitable charter features a requirement before contract renewal.*

Service charters are most likely to be an effective means of setting and maintaining standards if they are accompanied by appropriate monitoring and evaluation of the contractor’s performance.”

8.47 Generally, Committee members received positive comments about service charters as they enable an identifiable and transparent form of redress whilst ensuring that the

⁸⁴ Standing Committee on Public Administration June 1997 Discussion Paper: *An Introduction to Outsourcing - What are the Issues Involved?*, p. 13.

⁸⁵ Administrative Review Council, *The Contracting Out of Government Services: Report to the Attorney-General*, Report No 42, A.G.P.S., August 1998.

government and the service provider focus on the needs of the consumer. Committee members were informed that they were a necessary adjunct to other methods of ensuring accountability.

Accountability - Avenues of Redress - Contract Terms

8.48 The contract between the government and the contractor can require that the contractor establish mechanisms to deal with the recipients' concerns about the service. In the United Kingdom there are a range of industry based complaints handling mechanisms which can be incorporated into each contract.

8.49 The Committee believes that every contract should ensure that contractors are able to properly deal with complaints; specify how service is to be provided; who is responsible if errors occur and how performance is to be measured.

8.50 The above commentary, in relation to the situation in the United Kingdom, raises many issues for discussion including:⁸⁶

- Are these “hybrid accountability mechanisms” sufficient and/or desirable when compared to Administrative Law mechanisms? This requires a balance between the goals of efficiency and profit over responsibility and accountability;
- Is impartial review of decision making declining?
- Are industry Ombudsmen and industry dispute resolution bodies, being industry based complaints mechanisms, without bias? and
- Is the private citizen still able to scrutinise and seek redress for aspects of contracted out services?

The Committee does not, at this stage, express a view.

Future Investment: At what cost in skills, quality and intellectual property?

8.51 There is a need to ensure that a commitment to quality continues if cost and profit is the driving force, particularly towards the end of the contractual term. The Committee was interested in what mechanisms were available to ensure an ongoing commitment to

⁸⁶ Anita Stuhmcke, *Administrative law and the privatisation of government business enterprises: a case study of the Victorian electricity industry*, Australian Journal of Administrative Law, August 1997, p. 196.

quality. For example, if the public sector has a requirement that all bus engines must not be older than 5 years then should this not also extend to the private contractor?

- 8.52 Competition is seen as the incentive to encourage business performance and improve choice for consumers. Competition in the market is often seen as promoting, indeed *requiring*, increased quality of service. Arguments are raised that once service provision has moved to the private sector, competition itself will act as a mechanism of accountability, with the pressures of the marketplace and regulatory mechanisms keeping the private sector accountable.⁸⁷
- 8.53 The Committee recognises that a contractor may make investments or obtain knowledge and skills that are specific to a contract. This may result in a prohibitive cost of exit from a contract for both the Government and the contractor. The Government, in particular, stands to lose the acquisition of knowledge by the contractor. This raises the argument as to whether potential competition (being a major argument for contracting out) continues to exist. Incumbent contractors may be advantaged and potential contractors locked out.
- 8.54 The Committee further notes that problems can occur in writing and administering a long term contract. A long term contract may lock a government into paying for an outmoded/outdated service.

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Anita Stuhmcke, "Administrative law and the privatisation of government business enterprises: a case study of the Victorian electricity industry", *Australian Journal of Administrative Law*, August 1997, p. 194.

CHAPTER 9

IMPRESSIONS FROM THE UNITED KINGDOM: ORGANISATIONAL CULTURE

- 9.1 Contracting out has been successful in changing the culture of the public service, by forcing it to examine and compile unit costs of delivery of service and to relate to “real costs”. As stated by one person who met with the Committee members: *“It has brought real work practices and real world realities into the public service and has forced different delivery models and the careful wording and scrutiny of contracts.”*
- 9.2 Prescriptive change by the United Kingdom Government was considered necessary in the very entrenched and rigid public service culture in central and local government. None of the outcomes discussed above could have been achieved without the introduction of a competitive regime such as contracting out.
- 9.3 One example of a successful cultural change is in the CCT processes of the Newcastle City Council (“NCC”). The NCC decided that the only way they could compete with private companies was to change the culture of entrenched work practices of the NCC public service. As one person who met with the Committee members phrased it: *“to change the image of a slothful chaos”*. The NCC and trade unions worked very closely together in order for the NCC to survive as a service provider. “CityWorks” came out of this brainstorming and is discussed at sections 4.24 to 4.33 of Appendix 5.
- 9.4 CityWorks has been successful amongst its citizens. The Committee members were told that the people of Newcastle felt that they “owned” the enterprise. In the NCC’s view *“CCT just happens to punctuate the existence of CityWorks”*.
- 9.5 NCC representatives with whom Committee members met stated that CCT has resulted in a *“massive boot up the backside”* for many local authorities as many had become sloppy during the 1970’s. In general CCT has led to a big improvement in the efficiency of the public sector, especially local authorities, by forcing them to look at their operations. Forward thinking authorities improved their services by questioning the purpose and delivery and whether it was what the customer wanted.
- 9.6 A “contract culture” has grown alongside CCT in many local authorities. The CCT legislation has sought to force local authorities into splitting service departments into 2 distinct roles - the client and the contractor. In some instances this has allegedly had

a negative impact on organisational culture. There is evidence of situations where staff have worked happily together prior to the client/contractor separation, only to find themselves in conflict once the “Chinese Walls” are in place.⁸⁸

- 9.7 Conflict can arise where, for example, in a climate of financial stringency the “contracting side” of an agency is permanently under financial pressure. Whereas the “client side” of an agency determines budgets and standards, it is usually separated from the “contracting side” of the agency which understands service and its cost and is committed to high standards of provision. In addition budgeting and service responsibility is usually separated from staff recruitment and employment, making it easier for cuts to be made without concern for the consequences.⁸⁹
- 9.8 This “contract culture” has allegedly led to the commercialisation of services and the subsequent erosion of public service values.⁹⁰ This is more prevalent in local authorities who have taken a literal approach with the creation and operation of their DSO’s. Representatives of the NCC claimed that CityWorks can be distinguished from traditional DSO’s. Whereas traditional DSO’s usually concentrate on fiscal objectives, CityWorks has a more sophisticated role in the NCC local council and is able to develop and deliver social objectives complementing any fiscal objectives.
- 9.9 An example of the negative impact of cultural change was provided to Committee members in the context of a “street cleaning” contract. Although the contract in question provided for the collection of street rubbish it did not provide for the collection of stray rubbish from the verge. As a result the verges became very dirty although the private contractor was not in default. When the service was conducted by the local government the “incidental service” of verge cleaning was conducted as a matter of course.
- 9.10 The contract culture is also changing the role and relevance of volunteers in varied and complex ways. Private sector organisations are becoming increasingly involved in

⁸⁸ Centre for Public Services, *CCT on the Record*, London, Local Government Information Unit, January 1994, p. 4.

⁸⁹ Centre for Public Services, *CCT on the Record*, London, Local Government Information Unit, January 1994, p. 4.

⁹⁰ Centre for Public Services, *Reinventing Government in Britain - The Performance of Next Steps Agencies: Implications for the USA*, United Kingdom, May 1997, p. 27.

contracts in traditional volunteer areas such as the development of care services with the NHS.

9.11 Volunteers are still retained in the traditional areas such as Meals on Wheels but their numbers are diminishing. When volunteer organisations seek to take over the Government's role, this has a number of effects:⁹¹

- volunteers are becoming more skilled and formalised and chief officers anticipate that the long term impact will be to enhance the status and value of volunteers. Many volunteers have reported increased satisfaction;
- at the same time, however, voluntary agencies are increasingly led by paid workers rather than management committees, with important implications for governance;
- paid workers are replacing some service volunteers, despite the overall increase in the numbers of volunteers involved; and
- there is little substantive reference to volunteers in contract specifications; the increased costs of training and support are not fully reflected in contract fees; and during the negotiation of the majority of contracts there has been no discussion with service volunteers. This results in the balance between the costs and the benefits of volunteering become precarious.

⁹¹ "Social Policy Research 119 - The impact of the contract culture on volunteers", *Findings*, York, Joseph Rowntree Foundation, June 1997.

CHAPTER 10

OTHER OBSERVATIONS

- 10.1 Governments of any political persuasion have a need to determine what its responsibilities are to the community. A government must:
- identify its community service obligations; and
 - fund them through the budget process in a very transparent way so that they can be delivered either directly by government agencies or indirectly by private or non government entities.
- 10.2 Throughout the developed world there has been a paradigm shift. Governments no longer necessarily think of themselves as service providers to the public but as the purchaser of services for the public. This was noted by the Thirty Sixth Report of the Standing Committee on Government Agencies, which examines the creation, functions, powers and duties of State agencies in detail.⁹²
- 10.3 Contracting out public services to the private sector should not be regarded as a “quick fix” to improve the incumbent government’s short term bottom line. There ought to be longer term objectives to reduce the costs of government services and to improve productivity and service quality. The United Kingdom experience indicated to the Committee that there are no textbook solutions to contracting out and each case must be assessed on its own merits in full knowledge of both the benefits and risks. Contracting out, if properly managed, may be one way of reducing costs, improving productivity and service quality. It may also enable government agencies to focus resources on work which is in the public interest and which meets community service obligations.
- 10.4 Whether or not contracting out in the United Kingdom has been successful is not a simple question to answer, and it is by its nature subject to assertion and counter assertion.

⁹² Standing Committee on Government Agencies, “*State Agencies - Their Nature and Function*”, Thirty Sixth Report, Legislative Council of Western Australia, April 1994.

- 10.5 In some instances positive results from contracting out in the United Kingdom have included cost reductions, improved efficiency, improved service, introduction of new skills and improved operating practices. On the other hand, problems which have been experienced include: a reduction in service standards; difficulties with identifying a suitable private contractor to perform the services; a drop in the morale of in-house staff; the loss of in-house expertise; and only marginal benefits in cost reduction.
- 10.6 The Committee was interested in the issue of the inability of a newly elected Government to initiate change in previously contracted out services. As discussed at paragraph 4.23 of this report, the term of most DFBO contracts can range from 7 to 35 years thus imposing Government policy on subsequent governments.
- 10.7 If an elected Government could change contractual terms and conditions, the private contractor may be less willing to invest in the future, thereby affecting the maintenance of and improvement in, service quality. It is understandable that the private sector requires contractual and commercial certainty.
- 10.8 An example of the above conflict is with regard to the privatisation of the management and construction of prisons. Despite pledges during the election campaign, the Labour Government has maintained prison DFBO contracts and continued the trend due to realistic considerations such as lack of capacity. The public sector requires some degree of flexibility.
- 10.9 As a result of its investigations in the United Kingdom and review of literature the Committee has generally noted some of the main arguments for and against contracting out:
- 10.9.1 ***Arguments for Contracting Out***
Some of the general benefits that can be achieved include the following:⁹³
- cheaper labour. The Committee notes that there is some debate about this;⁹⁴
 - cost benefits. Prices can be fixed subject to agreed variations;⁹⁵

⁹³ Based upon factors identified by Mary Kelaher, "Commercialising the public sector", *Australian Accountant*, March 1991.

⁹⁴ It must be remembered that in Australia, private contractors, as employers, are obliged to work within the industrial wage fixing system and award structures.

⁹⁵ Mary Kelaher, "Commercialising the public sector", *Australian Accountant*, March 1991.

- fewer internal resources are required to manage the outsourced service;⁹⁶
- the use of private contractors may enable public service managers to focus on strategic issues which face government;
- contracting out can buy and guarantee expertise; and
- performance sanctions can be built into the contract.⁹⁷

In addition, the competitive tendering process is meant to promote competition which in turn:

- provides a benchmark for service efficiency;
- reduces insularity;
- enables a flexible response to fluctuating demand;
- counteracts restrictive practices;
- stimulates new approaches, which may involve a “cross fertilisation” of ideas;⁹⁸ and
- promotes a change in organisational culture.

10.9.2 *Arguments against Contracting Out*

Benefits must be weighed against the risks which include:⁹⁹

- not all services are suitable to be contracted out. There will always be some functions which remain the preserve of government;
- private contractor charges can be higher than the costs of maintaining in-house service;
- potential cost benefits depend upon the competitive nature of tenders and the number of contractors in the market;
- private contractors may not be willing to maintain service levels;
- contractors may lack commitment to and involvement with the government agency;

⁹⁶ For example a single project manager or project team may be all that is required.

⁹⁷ This means that the contractor must meet the provisions of the contract or incur penalties. It is important that managers of contracting out create an effective quality control framework which will enable regular reviews of the work of contractors.

⁹⁸ In respect of the privatisation of prisons, it has been suggested that examples of good private sector performance crosses over into enhanced public sector performance, that is a “cross fertilisation of ideas” (refer to section 5.10.4 of Appendix 5).

⁹⁹ Based in part, upon factors identified by Mary Kelaher, “Commercialising the public sector”, *Australian Accountant*, March 1991.

- disruption of services may occur during the transitional stage or on forced termination in the event of default, if not planned appropriately;
- industrial implications may be a major impediment, if handled without union involvement and constructive discussion;
- a loss of management skills and expertise to effectively monitor contracts;
- difficulties in maintaining adequate independent monitoring levels;
- a loss of corporate knowledge and intellectual capital; and
- negative longer term social and economic consequences.

In addition commentators have stated that in-house provision may offer more advantages than contracting out, which advantages may include:¹⁰⁰

- direct democratic control and accountability of service delivery. It is argued that direct services can be more responsive to users in a way that is difficult once services are privatised;
- maintenance of a quality of service. It is alleged that local authorities have achieved better levels of performance under CCT than the private sector with fewer failures and terminations of contract;
- good management, enabling an integrated service for all council departments whilst maintaining a strategic overview of services across the local authority;
- promotion of equal opportunities and quality of employment. Government agencies are usually leading advocates of equal opportunities policies, and practices, something which the private sector may not generally promote;
- maintenance of close contractor/consumer relationships;
- the retention of professional and technical expertise within the government agency; and

¹⁰⁰ Drawn, in part, from Centre for Public Services, *Externalisation by Privatisation*, Sheffield, Unison, February 1997, p. 30.

This article discusses the advantage of in house service provision in comparison to and in the context of “externalisation”. However the points raised are equally applicable when services are contracted out of the government agency. Externalisation is a new form of privatisation that has been developed in local government in the United Kingdom over the last 6 years. It has been concentrated in three areas of local government: DSO’s, white collar services and the transfer of council housing. It can take the form of management buy outs, joint ventures with private companies and the creation of a trust or co-operative.

- in-house services are primarily driven by service needs, not profit objectives. If there are any trading surpluses they are retained by the government agency.¹⁰¹

Has CCT been a success?

10.10 Whether or not CCT has been a success depends on who you ask and against which criteria it is to be assessed. It is still difficult to assess even after a number of years in practice. As one person observed to the Committee: *“The jury is still out”*.

For example, the NCC considered that:

- CCT had not been successful if measured in terms of the percentage of services transferred from the public to the private sector;
- there had been some success where the private sector did not need to invest in capital (for example building cleaning and refuse collection). However, in the NCC’s view CCT had not been a success in service areas where a capital investment was required;
- CCT was also unsuccessful because the Government assumed there was a market for all services - but in fact the private sector simply wasn’t ready for many areas of public provision;
- CCT may lead to the development of cartels. A situation has emerged, whereby although tenders were originally awarded to small companies, the companies have since amalgamated and many contracts were being run by large multi-nationals or large local interests. This can lead to cartels or large operators moving in, allegedly resulting in greater market power and a reduction in wages and conditions; and
- CCT has created added costs - termed a *“Cost of Demarcation”*. In this respect it was claimed that as CCT contracts are very specific as they do not cover incidental services which were usually provided when all services were provided by the local government.¹⁰²

On the other hand CCT has led to a big improvement in the efficiency of the public sector, especially the local authorities. In this respect representatives of the NCC with

¹⁰¹ For example, see the operation of CityWorks discussed in Chapter 4 of Appendix 5.

¹⁰² For example, a “street cleaning” contract can’t include picking up rubbish from the grass verge or flowerbeds. The Committee notes that although the streets may be cleaned with more efficiency the absence of the incidental service may lead to a public perception that there has been a decline in the quality of service.

whom the Committee met alleged that this change in organisational culture was originally not a central aim of the CCT legislation, although it was later embraced as a positive result.

10.11 Care must be exercised in using the number of complaints made by consumers as a measure of contracting out success. It is not widely known that access to the Ombudsman is available in respect of complaints about private contractors delivering public services. The Parliamentary Ombudsman noted that he had received few complaints in that context.

10.12 The Parliamentary Ombudsman was unable to make a general judgment on the effectiveness of contracting out and stated that any assessment must be made sector by sector. He noted that:

- departments have tended to give many agencies more freedom and flexibility in the delivery of services which has, in some cases resulted in major improvements in efficiency; and
- it was important that accountability and responsibility be sheeted home to the agency at the public service level.

10.13 It has been suggested that “intelligent contracting out” generally will:¹⁰³

- specify that the successful bidder give preferential treatment to existing employees before taking on new labour;
- involve pre-selection of bidders. Only businesses known to be reputable and stable should be involved in the performance of essential work;¹⁰⁴
- involve penalty clauses for non delivery of service, often with performance bonds being lodged to guarantee payment; and
- require careful specification of tasks.

¹⁰³ Dr Masden Pirie, *Privatisation in Theory and Practice*, United Kingdom, Adam Smith Institute, 1985, pp. 43-44.

¹⁰⁴ This may involve reference to some standard of quality assurance or industry accreditation.

CHAPTER 11

FINDINGS AND OBSERVATIONS

Introduction:

- 11.1 Generally the Committee is of the view that there is a need for careful consideration of the way that contracting out is approached in Western Australia. There is a need to improve accountability in the system without necessarily imposing more restrictive and inflexible Parliamentary mechanisms.
- 11.2 As a result of the investigations of Committee members in the United Kingdom, the Committee is now in a better position to consider and formulate recommendations for adoption in the contracting out process in Western Australia. Useful analogies can be drawn between the similar legislative and administrative environments in which privatisation is and may be conducted.
- 11.3 During the preparation of this report the House referred a motion to the Committee by the Hon Ljiljana Ravlich¹⁰⁵. A copy of the motion is attached as Appendix 6. The motion lapsed on prorogation of Parliament on 6 August 1999. The Committee has formulated its own terms of reference for further inquiry into the issues raised by contracting out. These are attached as Appendix 8. The Committee makes the following observations and findings.

Cost and the cost effectiveness of contracting out:

- 11.4 The Committee believes that it is necessary to define the core public services and separate them from the trading activities of government. Trading activities have commercial objectives whereas social service functions are subsidised. (Paragraph 7.16)
- 11.5 The Committee finds a clear picture of costs does not emerge. There are many factors which must be taken into account.

¹⁰⁵

Hansard, 12 November 1998, p. 3319.

- 11.6 The Committee believes that it is important to take into account the long term effect of employment changes arising through CCT and contracting out which impact quite significantly and indeed may reverse apparent savings. (Paragraph 7.4)
- 11.7 The Committee acknowledges that analysing the impact of contracting out on the costs of services may be complex. Accounting practices vary between time periods and between services, and costings may not always be available. (Paragraph 7.9) In addition cost effectiveness may also be hard to determine when some of the claimed benefits of contracting out, such as an increase in service quality and a positive change in organisational culture, cannot always be measured in quantitative terms. (Paragraph 7.7)
- 11.8 Clearly contracting out varies from one instance to the next however, the Committee believes that prior to contracting out a full social and economic audit and costs benefit analysis should be conducted. The United Kingdom experience indicates that such analyses should include: the impact of job losses; long term impact on part time workers; impact on social and family life in particular by women being forced into multiple employment in order to maintain income; increased casualisation of the workforce; fragmentation and loss of trade union organisation and power; and the impact on changes in the quality of services relative to efficiency improvements in organisation and delivery of services. (Paragraphs 7.5 & 7.11)
- 11.9 The Committee notes that there is evidence of a disproportionate impact on particular groups of employees, notably women. (Paragraph 7.14)
- 11.10 The Committee finds that there is a need to identify a means of protecting commercially unprofitable but socially necessary services. The Committee notes that in the United Kingdom the Government seeks to protect these services through government subsidies. (Paragraphs 7.18 - 7.21) Another innovative approach was that taken by the Newcastle upon Tyne City Council by establishing CityWorks. (Paragraph 7.15 & 7.16)

Quality of Service:

- 11.11 Concerns were expressed to Committee members that some cost savings were at the expense of service quality, however the Committee notes that there appears to be no consensus on this issue. There is anecdotal evidence both ways. (Paragraph 8.5)
- 11.12 Whatever the conclusion about service quality, in the main the Committee notes that contracting has led to a greater focus on the needs of clients and the form and content of tender and contract documentation. (Paragraph 8.9)

- 11.13 The Committee believes that the approach of the contracting agency to the tendering process is crucial to the maintenance and improvement of quality. The Committee notes that reductions in quality may often be attributed to a failure in the tendering process through: inadequate service specification; inappropriate contractor selection; and poor contract management. (Paragraph 8.10)
- 11.14 The Committee believes that it ought to be mandatory that specifications and contractual documents include, among other things:
- description, method and frequency of work;
 - timing of work including any requirements or restrictions on when work is to be done;
 - emergency cover and stand by rosters to cover contingencies, including holidays, sickness, and unforeseen requirements;
 - equipment and materials to be used, including maintenance and capital requirements;
 - standards of work and level of service required;
 - workforce qualifications;
 - health and safety and equal opportunity policies;
 - procedures for monitoring, penalties and termination; and
 - agreed procedures to negotiate contractual variations.
- (Paragraph 8.11 and 10.13)
- 11.15 The Committee also notes that care should be taken when drafting specifications - it should not be assumed that the most eloquent descriptions of services will equate to what will occur in practice. (Paragraph 8.14).
- 11.16 The Committee believes that it is essential that an appropriate internal complaints procedure is established to obtain information that contract monitoring by government staff cannot obtain. (Paragraph 8.15)
- 11.17 The Committee believes that a comprehensive evaluation of contractors and tenders is also necessary. This may involve reference to some standard of quality assurance or industry accreditation. (Paragraph 8.17 & 10.13)
- 11.18 The Committee believes that it is important that managers of contracting out create an effective quality control framework which will enable regular reviews of the work of contractors and appropriate monitoring. This includes ensuring that agency staff are trained to possess the skills to monitor contracts. The process of contracting out may

result in the loss of employees with the requisite management skills and expertise to effectively monitor any contract. (Paragraphs 8.18 & 8.19)

11.19 The Committee believes that effective monitoring is achieved by transparency, supported by a system of internal and external reporting. The Committee is of the view that this is assisted by the services of Ombudsmen and legislative initiatives regarding freedom of information. (Paragraph 8.20)

11.20 The Committee considers that it is essential that performance sanctions are built into the contract to avoid any risk that profit rather than quality of service is the determinant, for service delivery. (Paragraph 8.21)

11.21 Although performance bonds are not encouraged in the United Kingdom, the Committee believes that, in some circumstances, bonds can be of real insurance value. (Paragraph 8.25)

Accountability:

11.22 The Committee believes that there is a legitimate expectation that providers of public services paid for by public funds should be publicly accountable. The Committee notes that the transfer of the provision of public services from government agencies to private individuals may result in a reduction in accountability. Private service providers may not be subject to the same level of accountability as public officials. (Paragraph 8.33) The Committee believes that accountability to the consumer should remain with the government agency in all instances of contracting out. (Paragraphs 8.30 & 8.34)

11.23 In respect of accountability the Committee considers that private firms delivering services for and/or on behalf of a government agency (which service is being funded by public monies) must expect a greater level of scrutiny than may otherwise apply. This raises the issue of commercial confidentiality in respect of government dealings. The Committee notes that this is an issue into which it proposes to further inquire. (Paragraph 8.37)

11.24 Administrative Law is the key means by which government and the bureaucracy are directly accountable to individuals affected by their actions. The Committee does not address the availability or reform of principles of Administrative Law in this report but notes that there have been a number of recent Commonwealth reports published on the issue. (Paragraphs 8.35, 8.36)

- 11.25 In general, Ombudsmen in the United Kingdom provide an independent assessment of complaints about services provided by, and in some cases on behalf of, the Government. (Paragraph 8.40)
- 11.26 In contrast the jurisdiction of the Ombudsman in Western Australia does not extend beyond the public sector nor within local government. The Committee notes that where a contractor is not part of the government, complaints cannot be made to the Western Australian Ombudsman about service delivery and members of the public cannot seek information held by the contractor unless legislation provides for this access. As complaints may only be made to the Western Australian Ombudsman about a “matter of administration” this means that the Ombudsman may be able to investigate the manner in which the relevant agency has dealt with the contractor, but this may not allow the Western Australian Ombudsman to address the complaint directly. (Paragraph 8.44)
- 11.27 The Committee notes that, although Ombudsmen in the United Kingdom assist in accounting for the process of contracting out, their mandate is complaints based and therefore reactive. This does not enable a comprehensive review or monitoring of a contract. (Paragraphs 8.38 - 8.44)
- 11.28 The Committee notes that alternative, less onerous mechanisms for accountability may include service charters which provide a framework for individual complaints against private as well as public providers of services. (Paragraph 8.45)
- 11.29 The Committee believes that service charters can be an effective means of setting and maintaining standards if they are accompanied by appropriate monitoring and evaluation of the contractor's performance. (Paragraph 8.46) The Committee notes that service charters can enable an identifiable and transparent form of redress whilst ensuring that the government and the service provider focus on the needs of the client. Committee members were informed that they were a necessary adjunct to other methods of ensuring accountability. (Paragraph 8.47)
- 11.30 The Committee believes that every contract should ensure that contractors are able to properly deal with complaints; specify how service is to be provided; who is responsible if errors occur and how performance is to be measured. (Paragraph 8.49)
- 11.31 The Committee believes that it may be prudent for government agencies to consider whether or not to include a contractual clause whereby if the government agency elects to pay any compensation to a consumer then the government agency is to be reimbursed by the private contractor in certain circumstances. (Paragraph 8.31)

- 11.32 In respect to future investment, the Committee notes that there is a need to ensure that a commitment to quality continues if cost and profit is the driving force, particularly towards the end of the contractual term. (Paragraph 8.51)

Organisational Culture:

- 11.33 In respect of organisational culture the Committee notes that:
- 11.33.1 contracting out has been very successful in changing the culture of the public service, by forcing it to examine and compile unit costs of delivery of service and to relate to “real costs”; (Paragraph 9.1)
 - 11.33.2 a “contract culture” has grown alongside CCT in many local authorities. In some instances this has allegedly had a negative impact on organisational culture; and (Paragraph 9.6)
 - 11.33.3 the contract culture is also changing the role and relevance of volunteers in varied and complex ways. (Paragraph 9.10 - 9.11)

Other Observations:

- 11.34 An issue which was of interest to the Committee was the inability of a newly elected Government to initiate change in previously outsourced and contracted out services. (Paragraph 10.6 - 10.8)
- 11.35 The Committee finds that governments of any political persuasion have a need to determine what its responsibilities are to the community. A government:
- must identify its community service obligations; and
 - then fund them through the budget process in a very transparent way so that they can be delivered either directly by government agencies or indirectly by private or non government entities. (Paragraph 10.1)
- 11.36 The Committee notes that contracting out public services to the private sector should not be regarded as a “quick fix” to improve the incumbent government’s short term bottom line. There ought to be longer term objectives to reduce the costs of government services and to improve productivity and service quality. The United Kingdom experience indicated to the Committee that there are no textbook solutions to contracting out and each case must be assessed on its own merits in full knowledge

of both the benefits and risks. Contracting out, if properly managed, can be one way of reducing costs and improving productivity. It can also enable government agencies to focus resources on work which is in the public interest and which meets community service obligations. (Paragraph 10.3)

- 11.37 Whether or not contracting out in the United Kingdom has been successful is not a simple question, and it is by its nature subject to assertion and counter assertion. The Committee notes that even in respect of the same instance of contracting out the answer may depend on who you ask and against what criteria it is assessed. There are some circumstances in which contracting out has been successful, others where it has been unsuccessful and others where "*the jury is still out*". The Committee lists some relevant comments at paragraphs 10.9 and 10.10 of this report.

Hon Kim Chance MLC
Chairman

10 September 1999

APPENDIX 1

**TERMS OF REFERENCE FOR THE STANDING COMMITTEE ON PUBLIC
ADMINISTRATION**

Schedule 1 of the Standing Orders establishes the Standing Committee on Public Administration. The Terms of Reference for the Standing Committee are:

- "1. A Standing Committee on Public Administration is established.
2. The Committee consists of 6 members.
3. The functions of the Committee are:
 - (1) to inquire into and report to the House on the means of establishing agencies, the roles, functions, efficiency, effectiveness, and accountability of agencies and, generally, the conduct of public administration by or through agencies, including the relevance and effectiveness of applicable law and administrative practises;
 - (2) to consider and report on any bill referred to it by the House providing for the creation, alteration or abolition of an agency, including abolition or alteration by reason of privatization; and
 - (3) except as provided in Standing Order 339(c), the Committee shall not proceed to an inquiry whose sole or principal object would involve consideration of matters that fall within the purview, or are a function, of another Committee.
4. In this order:

"Agency" means-

 - (a) an agent or instrumentality of the State Government, established for the purpose of developing, implementing or administering any program or policy with a public purpose or any such program or policy that relies substantially for its development, implementation or administration on public monies or revenue;

- (b) any person empowered by a written law to make a decision enforceable at law whether by that person or otherwise,

and, where appropriate, includes any agency officer or employee acting, or having ostensible authority to act, as the agent or delegate of the agency, but does not include:

- (c) a House of the Parliament, or any Committee or member of either House, or any officer or employee of a department of the Parliament;
- (d) a court of law or a court of record, or a judge or other member of either court;
- (e) any person whose functions are solely of an advisory nature and the failure to obtain or act in accordance with advice given by that person does not invalidate or make voidable a decision made by another person;
- (f) a police officer or other person in the course of exercising a power conferred by a written law to arrest or charge a person with the commission of an offence, or to enter premises and seize or detain any object or thing;
- (g) a local government within the meaning of the Local Government Act 1995."

APPENDIX 2**PERSONS AND ORGANISATIONS WITH WHOM THE COMMITTEE MET**

Wednesday, 30 July 1997

The Hon Clive Griffiths, Agent General for Western Australia, London.

Thursday, 31 July 1997

Mr Clive Wilson, Deputy Health Service Commissioner, (Health Ombudsman), London.

Mr John Avery, Deputy Commissioner for Administration (Parliamentary Ombudsman), London.

Mr David Nice, Commission for Local Administration in England, (Local Government Ombudsman), London.

Friday, 1 August 1997

Mr Andrew Melville, Head of Executive Agencies, Department of the Environment, Transport and the Regions Executive Agencies Directorate, London.

Monday, 4 August 1997

Sir Christopher Ball, Chancellor of Derby University and President of National Campaign for Learning, Chairman of several local forums of lifelong learning.

Tuesday, 5 August 1997

Mr Dexter Whitfield, Director of the Centre for Public Services, Sheffield.

Professor Keith Bottomley and Mr Adrian James, The University of Hull, Centre for Criminology and Criminal Justice, Hull.

Wednesday, 6 August 1997

Representatives of Newcastle City Council:

Mr Barry Rowland, Executive Director, Director of CityWorks;

Mr Barry Phillipson, Chair of CityWorks Committee; and

Mr John Slater, Trade Union representative.

Thursday, 7 August 1997

Mr Bill Crackle, Solicitor and former Secretary of the North Western Water Authority, Lowton, Warrington.

Friday, 8 August 1997

Wandsworth Borough Council, London:

Mrs C A K Thompson, Mayor of Wandsworth;
Mr Gerald Jones, Chief Executive and Director of Administration; and
Mr R Appleton, Head of Policy Unit.

City of Westminster, London:

Mr Roger Allard, Head of Contracts and Audit in the Chief Executives Department;
and
Ms Claire Kelley, External Relations Officer.

Monday, 11 August 1997

Sir Peter Woodhead, KCB, Prisons' Ombudsman, London.

Tuesday, 12 August 1997

Mr Robert Fulton, Head of Planning and Finance Directorate, Home Office, London.

Mr Rob Young, Chief Clerk and Deputy Under Secretary and Mr Richard Kinchen, Foreign and Commonwealth Office, London.

Wednesday, 13 August 1997

Mr Robin Mountfield, CB, Permanent Secretary, Office of Public Service, London.

APPENDIX 3
MATERIAL COLLATED BY THE COMMITTEE

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APPENDIX 4

LIST OF ABBREVIATIONS AND PHRASES USED IN THIS REPORT

CCT	Compulsory Competitive Tendering
Charter Programme	A 10 year program launched by the Government in 1991 to raise the standard of public services
DSO	Direct Service Organisations
DCMF	Design, Construct, Manage and Finance contract
DFBO	Design, Finance, Build and Operate contract
Efficiency Unit	Efficiency Unit of the Cabinet Office
EOC Study	The Centre for Public Services study for the Equal Opportunities Commission.
GATT	<i>Government Procurement Regulations of the General Agreement of Tariffs and Trade</i>
Hilmer Report	<i>National Competition Policy Report by the Independent Committee of Inquiry, (AGPS, Canberra, August 1993)</i>
IT	Information Technology
NALGO	National and Local Government Officers which merged with COHSE (Confederation of Health Service Employees) and NUPE (National Union of Public Employees) in 1991 to form UNISON. UNISON is Britain's largest union.
NCC	Newcastle upon Tyne City Council
NHS	National Health Service
OPRAF	Office of Passenger Rail Franchising
ORR	Office of the Rail Regulator
PFI	Private Finance Initiative
TUPE	<i>Transfer of Undertakings (Protection of Employment) Regulations 1981</i>
Wolds	Wolds Remand Prison.

APPENDIX 5
EXAMPLES OF PRIVATISATION AND CONTRACTING OUT
IN THE UNITED KINGDOM

CHAPTER 1
HEALTH

Privatisation

- 1.1 Contracting out has been an integral part of the National Health Service (“NHS”) for many years. Since 1911 British general practitioners (“GP’s”) have contracted their services to the NHS, indeed 99% of GP’s earn the vast bulk of their income from the NHS.
- 1.2 In contrast medical specialists may operate a private practice on the side as well as working for the NHS. This is particularly relevant in the context of mental health where there are flourishing private practices of specialists who contract with the NHS to provide their services. The provision of mental health services within the NHS has focused on areas such as medium security provision for psychiatric patients requiring a measure of custodial care. Committee members were informed that this was largely a result of the public system not investing sufficient capital in that area of mental health. Many of the discussions in the United Kingdom focused on privatisation in this context.

Quality, Performance and Monitoring

- 1.3 Committee members were informed that, in the area of mental health, the private sector, realising the demand for such services, has been able to contract with the NHS to its own financial advantage. As a result commentators have claimed the contracts are a “*bad buy*” and that the NHS loses as it does not have the expertise to adequately judge and assess the service being provided.
- 1.4 In addition the Health Commissioner noted that the prevalence of private practitioners operating in middle range institutional care, for example nursing homes and hostel care, gives rise to a number of difficulties relating to assessment and maintenance of quality control. In particular:

- 1.4.1 there is difficulty with controlling quality of service for very vulnerable people. How do you ensure the private sector does not exploit clients if the client is not in a position to appreciate a particular standard of service?;
- 1.4.2 whereas quality specifications may be very effective for easily defined areas of what the government agency is buying, for example catering and laundry, it is not so effective in other areas such as health care. In such cases the service being provided is so personal to the recipient of the service, that it is essential that an adequate complaints procedure is established to obtain information that contract monitoring by Government staff cannot obtain; and
- 1.4.3 further, in cases where the recipients of the services are people with learning difficulties, a complaints procedure may not be comprehensive or adequately reflect service quality. Indeed the Health Commissioner commented to Committee members that issues of care are particularly difficult to quantify and audit as they need to be assessed on clinical effectiveness.
- 1.5 Problems also exist in respect of assigning and accepting both responsibility and accountability. Committee members were informed by the Health Commissioner that problems have occurred in relation to juvenile health - nobody is prepared to define the problem, or to develop strategies to address inadequacies. There is a lack of co-ordination and assumption of responsibility between the educators, psychologists and social workers within the system. A major issue confronting the NHS is *Who takes the responsibility?*

Health Service Commissioners

- 1.6 Health Service Commissioners for England, Scotland and Wales (also known as the Health Ombudsmen) are responsible for investigating complaints against NHS bodies and, since April 1996, against NHS practitioners providing family health services.
- 1.7 The Health Commissioner is accountable to Parliament for the discharge of his functions. He/she is completely independent of the NHS and Government. The Health Commissioner's work is overseen by the Select Committee on the Parliamentary Commissioner for Administration. He/she is required to present an annual report to Parliament and also produces periodic volumes of selected investigation reports containing summaries which the Health Department circulates to Health Authorities, Boards and Trusts. The purpose of the action is to improve standards of service. The Committee comments on the role of Ombudsmen in the context of contracting out at paragraphs 8.38 to 8.44 of this report.

- 1.8 The Health Commissioner does not operate as an office of continual evaluation and review, rather it is a means of redress for individual complaints. Committee members were informed that it is possible for the production of a more general report from the Health Commissioner's office outlining a series of complaints regarding general hospital practice, but this is more unusual.
- 1.9 The majority of complaints received by the Health Commissioner focus on misunderstandings, lack of communication, and the complaints handling processes. As a result of legislative amendments in 1996 issues of clinical judgement can now be investigated.
- 1.10 The Health Commissioner informed Committee members that the result of contracting out may be inefficient in that:
- 1.10.1 the services provided by private enterprise can become expensive;
 - 1.10.2 it may not be cost effective, even though there is no suggestion of patient care suffering; and
 - 1.10.3 in some situations there is a problem of a lack of a consumer market for competition, upon which the idea of contracting out is based. This may result where the "consumer" either does not have ability to respond to the "market" or there is no ability for the "consumer" to take their custom elsewhere, (for example, mental health patients).

CHAPTER 2

TRANSPORT

Privatisation - General

- 2.1 In 1992 many aspects of the Department of Transport were privatised. The contracting out of certain services within the Department of Transport itself includes accommodation, the information technology unit for licensing information, library services, catering, security and cleaning. In other words the basic support functions for the Department.
- 2.2 The IT Unit for Licensing Information within the Department was privatised in 1992-3 when it was transferred to EDS, a large American company. At the time of the Committee's inquiries the initial 5 year term had been extended by another 2 years.
- 2.3 In the area of transport there has also been a recent emphasis on private companies being invited to design, build, finance and operate certain projects such as road construction. The companies are then repaid through shadow tolls whereby they receive a certain amount of the road toll price. These entities are known as "*design build finance operate entities*" or "DBFOs".¹⁰⁶ About 8 DFBO's exist and have contracts with the Government. Committee members were informed that savings of 15% have been identified by developing roads in this manner.
- 2.4 As a result of contracting out and other methods of privatisation the total employment within the Department has been reduced by approximately 30% from 15,000 down to 11,000. However, Committee members were informed that the same outputs are still being produced with two-thirds of the people.

Railways

- 2.5 Members of the Committee were informed that the aboveground railways were not a profitable business and in order to keep them running properly, they were franchised.

¹⁰⁶ DFBO's may also be referred to as "DCMFs" - design, contract, manage and finance.

- 2.6 Privatisation of the aboveground railways is well advanced. The Committee notes that all facilities relating to the London underground railway are still publicly owned¹⁰⁷. The *Railways Act 1993* fundamentally changed the structure of the railway industry and led the way to a large section of the industry being transferred to the private sector. For example:¹⁰⁸
- 2.6.1 25 passenger train operating businesses were created, and as at March 1997, franchises for all 25 companies had been awarded to the private sector. Committee members were informed that most of the successful franchisees are associated with Scottish and French companies.
- 2.6.2 In May 1997, Railtrack, the company that owns and manages Britain's rail infrastructure - track, signaling, bridges, tunnels and stations - was floated on the stock market.
- 2.6.3 Three passenger rolling stock leasing companies were also successfully sold, generating some £1.8 billion in proceeds.
- 2.6.4 Domestic freight and parcels companies were created and sold, many to United States based companies given that US freight companies tend to have more expertise in operating large long haul freight services (as opposed to passenger services). Committee members were informed that one United States company purchased several individual companies then re-amalgamated the purchased freight companies. It was noted that this was not a successful outcome for the purposes of competition.
- 2.7 With so many different companies involved in many different areas of transport provision it is vital that the franchising process be co-ordinated and monitored very closely. To oversee the franchise process there has been the appointment of a franchise director within the Office of Passenger Rail Franchising ("OPRAF") and Office of the Rail Regulator ("ORR") who report to the Secretary of State. These are further discussed at sections 2.24 to 2.26 of Appendix 5.
- 2.8 OPRAF receives grants from central Government and purchases passenger rail services from the train operating companies who in turn purchase services from other industry

¹⁰⁷ The Committee was informed that no contractor would be willing to conduct the franchise due to the need for extensive resources to improve the infrastructure.

¹⁰⁸ Department of Transport, *Transport Report 1997 - The Government's Expenditure Plans 1997-98 to 1999-2000*, London, H.M.S.O., 1997, p. 23.

parties, including Railtrack and the new rolling stock leasing companies, usually on a 10 year contract term.

2.9 In respect of remote areas Committee members were informed that service levels are protected in a complicated way:

2.9.1 Any line closures must be first passed through the Secretary of State who calls a public inquiry. Parliament must approve the closure before any action can take place.

2.9.2 The contract and franchise arrangements ensure minimum levels of service, for example 8 trains per day.

2.9.3 The most successful rail services are, at best, breaking even. As a result the rural services are heavily subsidised by the Government as being socially necessary services. The Government has claimed that privatisation will extend the safeguards against the withdrawal of service: each franchise agreement specifying the core level of service that must be provided.¹⁰⁹

2.10 Committee members were informed that since privatisation:

2.10.1 In terms of quality, rail services are perceived as being no worse but roughly the same, although this clearly depends on who you ask. In this respect the Committee notes that private contractors often may inherit problems from the Government owned entity that they have contracted with. For example, antiquated rolling stock with hopeless air conditioning and rundown lavatories has resulted in a perceived lack of quality supplied by the private contractor rather than an “inherited” lack of quality.

2.10.2 The Government claims that privatisation is already encouraging operators to respond to passenger’s needs by, for example, operating more trains on certain lines than was provided by British Rail.¹¹⁰

¹⁰⁹ United Kingdom, Parliament, *The Citizen’s Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, p. 32.

¹¹⁰ United Kingdom, Parliament, *The Citizen’s Charter - Five Years on: A report to mark five years of the Charter programme*,(London, H.M.S.O., September 1996, p. 32.

- 2.10.3 There is no clear indication of cost savings. The view was expressed that it was too early to tell at this stage.
- 2.10.4 There have been changes in service provision as well as innovation.
- 2.10.5 Areas of reform include the use of staff in a more efficient manner. This may include a reduction of staff through changes in work operations, practices and multi skilling.
- 2.10.6 Concerns have been expressed at the increasing level of foreign ownership.
- 2.10.7 There is more efficient and effective timetabling. Punctuality figures for 1996/7 showed 92.5% of trains arriving within 5 to 10 minutes of the scheduled time, compared with 89.5% in 1995/6.¹¹¹
- 2.10.8 There is more efficient rolling stock, although some of the rolling stock needs to be replaced. Franchise agreements with the 3 companies which own the rolling stock stipulate that stock must be upgraded, maintained and efficient. However, the replacement of rolling stock was put on hold while the privatisation process was taking place. Following completion of privatisation orders were placed for new stock.
- 2.11 The Committee notes that the integration of service quality and standards in contractual documents are of paramount importance. During its discussions with parties in the United Kingdom the Committee members reported that there were problems resulting from the fact that early contractual documents did not stipulate or define standards of service and product delivery. These omissions led to many problems with product and/or service quality and the contracting entity had little or no recourse.
- 2.12 Problems with service quality can be illustrated with respect to the initial contracts awarded to provide rail services in which there were no contractual stipulations as to the regularity or quantum of service. For example, in September 1997 cuts of up to 25 per cent in some inner London commuter services resulted in a reduction of 500 trains per week by private contractor Connex South Central, a subsidiary of the French conglomerate, Compagnie Generale des Eaux. The cuts were the most severe since British Rail's passenger services were taken over by private operators 18 months previously. The private contractors stated that the cuts were legally justified as they

¹¹¹ Department of the Environment, Transport and the Regions, *Bulletin of Rail Statistics Quarter 1 1997*, London, H.M.S.O., July 1997, p. 4.

were extra to the minimum promise given to the rail franchise regulator. The Committee also notes that in 1997 Connex received a £92 million subsidy from the Government.¹¹²

Bus Services

- 2.13 Local bus services in the United Kingdom had been in decline over a long period and bus share of total transport had fallen from 39% in 1955 to only 8% in 1985. At the same time, costs and fares had been increasing and the local authority subsidy had risen in real terms from £10 million in 1972 to over £500 million in 1982.¹¹³
- 2.14 The Government believed that the controls over the provision of services which had existed since the 1930s had stifled innovation and contributed to the decline in demand. Legislation was introduced to free the industry from controls and to expose it to competition and market forces.
- 2.15 The *Transport Act 1985* abolished the previous system of road service licensing (ie a licence for each route) and allowed bus operators to run services wherever they wished on a commercial basis on new routes or in competition with other operators. Any private sector company that met certain safety criteria were able to operate bus services, although there were some limited requirements regarding registration and the adherence to certain quality performance indicators.
- 2.16 In addition new legislation empowered the local authorities to provide, under subsidy from the central government, socially necessary but unprofitable services after competitive tender.¹¹⁴ This replaces the previous system of blanket network subsidy paid by local authorities to their main operator.
- 2.17 To stimulate competition the Government privatised the 72 subsidiaries of the National Bus Company and the 10 company Scottish Bus Group. In addition all local authority owned bus operations were formed into free standing companies and required to operate in the same commercial environment as other operators. Local authorities were encouraged to sell their bus companies on a voluntary basis.

¹¹² *The Guardian*, London, 3 September 1997.

¹¹³ Department of Transport, *Bus Deregulation and Privatisation in Great Britain*, July 1997.

¹¹⁴ Department of Transport, *Transport Report 1997 - The Government's Expenditure Plans 1997-98 to 1999-2000*, London, H.M.S.O., 1997, p. 66.

- 2.18 In the 10 years since 1985/86, bus mileage has increased by some 25% outside London, with 85% currently run by private operators on a commercial basis. Bus operating costs per vehicle mile have decreased by more than a third in real terms and the local authority public transport subsidy has more than halved in real terms.¹¹⁵
- 2.19 In London itself the Government privatised the 10 major bus companies realising proceeds of £233 million. Although London Transport retains overall control of the London bus network - planning routes and setting fares - all bus services are now operated by private companies under franchise contract to London Transport. In London there has been no increase in patronage. Levels have merely been reinstated.
- 2.20 Committee members were informed that:
- 2.20.1 Bus deregulation was significant in reducing costs in and out of London without a reduction in service quality. However where staff costs were reduced there was also a reduction in conditions and wages.
- 2.20.2 Depending on whom you asked, bus services had benefited some passengers and adversely affected others.
- In metropolitan areas there were decreases in service levels immediately following deregulation. In some cases these were due to operational problems and in others they were also due to problems with passenger information. These problems resulted in marked public dissatisfaction and a significant loss in patronage. Since then service levels have increased and the early organisational problems have been overcome.¹¹⁶
- 2.20.3 Fares seem to have been unaffected except where competition has led to fare reductions. However, in metropolitan areas there have been substantial fare increases.¹¹⁷
- 2.20.4 Bus deregulation promoted innovation and the introduction of new services.

¹¹⁵ *Bus and Coach Statistics: Great Britain, 1996.*

¹¹⁶ W.S.Clough, *Bus deregulation*, Mun Engr, 5 October 1988, p. 255.

¹¹⁷ W.S. Clough, *Bus deregulation*, Mun Engr, 5 October 1988, p. 254.

Private sector contractors outside of London introduced mini buses and are able to operate more frequent services. Mini buses have now become more common. However, their use has been damaging for the British large bus building industry.

2.20.5 Bus deregulation hasn't reduced the decline in bus patronage in local areas - except in London where patronage levels have been maintained.

2.20.6 Although staff working on the London buses were unhappy because of the privatisation process that there was no major political unrest or upheaval as a result. In questioning this peaceful transition members of the Committee were reminded that since the mining strike in the early 1980's no other trade union has been prepared to take on the Government. The view was expressed that industrial relations has now become more a management issue rather than a political issue.

Performance and Monitoring

2.21 Complaints mechanisms are provided by the Citizens Charter. The Rail Charter, for example, has facilitated:

- punctuality and reliability targets for all mainline trains; and
- quality of service targets for London Underground, including standards for reliability, information and cleanliness.

The Road User's Charter has 16 targets designed to minimise the impact of roadworks, provide more lighting, safety barriers and telephones, and to ensure that roads are well maintained.

2.22 In addition private operators are contractually bound to provide complaint outlets and procedures as part of their services.

2.23 Compliance with contracts is monitored by including specifications that outline performance payments within penalties for non-performance. Specifications are written on an "out basis", with punitive sanctions available as part of the contract to ensure compliance.

2.24 Regulators have been set up as part of the Government structure. In some cases there are special requirements to give regulators some guidance as to how they are to perform their functions. For example, with regard to railways, there are now more than 100

companies involved in the provision of railway services (including sub-contractors). This necessitates a strong regulatory regime.

2.25 The *Railways Act 1993*, which laid out the groundwork for privatisation, provided for the establishment of 2 non-Ministerial government departments as part of the framework for the restructured railway. As previously mentioned, these are the Office of Passenger Rail Franchising (“OPRAF”) and the Office of the Rail Regulator (“ORR”).

2.26 In respect of OPRAF and ORR:

2.26.1 both are departments in their own right, separate from the Department of Transport;

2.26.2 at the time of the Committee’s inquiries, both had over 100 staff made up of ex-British Rail and ex-Department of Transport workers and private industry;

2.26.3 the responsibilities of OPRAF include:

:

- designating services eligible for franchising, tendering and entering into franchise agreements; and
- forming views on proposed line closures and if not in agreement, securing their continuation.¹¹⁸

2.26.4 the responsibilities of ORR include consumer protection and promotion of passengers’ interests, including powers of review over all aspects of the rail service - tracks, passenger services equipment and delivery of services; and

2.26.5 power is retained for the Minister to give some general guidance to the regulator on how it conducted its affairs, however this power only exists for a limited period from the establishment of ORR and OPRAF.

¹¹⁸ Department of Transport, *Transport Report 1997 - The Government’s Expenditure Plans 1997-98 to 1999-2000*, London, H.M.S.O., 1997, p. 79.

CHAPTER 3

WATER SUPPLY

Privatisation

- 3.1 It is important to note the division between privatisation in the strict sense as opposed to contracting out¹¹⁹. With respect to privatisation in the strict sense, the Government is no longer the service provider. An example of this is water supply within the United Kingdom.
- 3.2 Until the *Water Act 1973* there were almost 1600 separate water and sewerage undertakers. The *Water Act 1973* established 10 regional water authorities with overall responsibility for water and sewerage services in England and Wales. Each was based principally on the natural boundaries of one or more of the major river basins.
- 3.3 Privatisation of the water industry in England and Wales occurred under the *Water Act 1989* when the majority of the property rights and liabilities of the 10 water authorities were transferred to 10 new companies owned by holding companies¹²⁰ and the remainder to the National Rivers Authority (“NRA”). The NRA had assumed the water authorities’ responsibility for all matters except water supply, sewerage and sewerage disposal. The NRA was privatised and floated on the stock exchange. At the time of the Committee’s inquiries, water companies were in the top 100 companies in which to own shares. The Government retained 1 “golden share” which gave it a power of veto and enabled it to reintroduce controlled excesses where necessary for 5 years. The 5 year golden share has now expired.
- 3.4 Views were expressed to Committee members that privatisation of the water industry was publicly acceptable provided that the privatised companies were restricted to their core functions - the United Kingdom public was perceived as being opposed to any

¹¹⁹ Privatisation is also used in a generic sense as a term to describe many processes whereby a government is less directly involved in delivering services. (Refer to paragraphs 4.2 to 4.4 of this report.)

¹²⁰ Anglian Water plc, North West Water Group plc, Southern water plc, Thames Water plc, Northumbrian Water Group plc, Severn Trent plc, South West Water plc, Welsh Water plc and Yorkshire Water plc.

takeovers or foreign involvement. Regardless of this feeling, North-West Water took over North-West Electricity.

Quality of Service, Performance and Monitoring

- 3.5 So long as the privatised regulated utilities have a monopoly over services which they provide, the interest of the consumers must be protected. The Citizen's Charter therefore, applies to the services delivered by the utilities in the absence of a genuinely competitive market. Claims have been made that the Citizen's Charter has facilitated increases in service quality, for example, in 1994-5, 98.84% of water and sewerage queries were responded to in less than 20 working days, compared with 96.75% in 1991-1992.¹²¹
- 3.6 The water companies are subject to a tight and complex regulatory regime, including the Director General of Water Services (the industry regulator) whose role, through the Office of Water Services, is to consider whether the water and sewerage companies are properly carrying out their functions. The Director General monitors their performance, protects the interests of customers and controls price increases. The Director General also has the power to set service standards, resolve disputes between customers and promote energy efficiency.¹²² The Director General is independent of Ministerial control and the water industry.
- 3.7 In addition some control lies with the Secretary of State for the Environment which has vested powers to set fees, and impose environmental agency control conditions.
- 3.8 If service standards are not met consumers are entitled to compensation pursuant to a "Guaranteed Standards Scheme". The water companies can face daily penalties of £5.00 if they fail to meet these standards, which cover the keeping of appointments, account queries and requests about payment arrangements, complaints about water or sewerage services, notice of interruption of supply and restoration of supplies by the

¹²¹ United Kingdom, Parliament, *The Citizen's Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, pp. 8-9.

¹²² United Kingdom, Parliament, *The Citizen's Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, p. 37.

stated time. In 1995-96 water companies paid out £862,488 in compensation. The previous year's figure was £267,900.¹²³

3.9 Committee members asked whether the privatised system (post 1989) was a better system and were informed that it is about the same. The following comments were made in response:

3.9.1 Since privatisation, no increased revenue has been put into the system with the consequence of continued deterioration of the infrastructure. One of the major problems facing the privatised industry is leakage, for example, unlined cast iron conduits over 100 years old begin to leak. The water companies were directed by the Director General that they had to spend large amounts of money on leakage control.¹²⁴

3.9.2 Privatisation has not lowered costs to the consumer. It was stated that the consumer is being charged higher prices to cover the maintenance and/or improvement of a vast and ageing system of infrastructure.

3.9.3 Privatisation has not created greater efficiency regarding directly employed labour. In any event, service technology has improved and less labour is required.

3.9.4 Privatisation has changed the industry culture which has become commercial and business-like with less emphasis on serving the public ie: the water companies are now serving the shareholder *and* the public. Simply, if there are no shareholders, then less money is available to invest and make profit.

A view expressed to Committee members was that a commercial culture has no place in water supply and sewage to a civilised community and such supply should not be dealt with on a commercial basis.

¹²³ United Kingdom, Parliament, *The Citizen's Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996, p. 37.

¹²⁴ For example, in 1997, United Utilities, the North West water and electricity group. Heads, along with other water companies were questioned by the industry regulator about the size of dividend payments in view of the fear that payouts may be at the expense of capital investment: *The Guardian Newspaper*, 5 August 1997, p. 24.

- 3.9.5 On the other hand privatisation has worked because of this commercial culture - competition has reportedly resulted in better service. It was alleged that most people were happy with the service they receive.

However, a view was expressed that the Government should have kept a power of control and a power of veto and any change to a water company's composition should require Parliamentary approval to avoid companies "*frolicking in the overseas market*". The advice was proffered that if and when a move was made to privatise water and sewage supply in Australia, the Government should keep controls on the amount of expansion, if any, that the private utility company could make into other countries. It may be possible to achieve this by continuation of the "golden share" allocated to the Government discussed above at section 3.3 of Appendix 5.

CHAPTER 4

LOCAL GOVERNMENT

Privatisation - General

- 4.1 CCT has been a driving force for major changes in the organisation of services in local government. CCT was first introduced by the *Local Government Planning and Land Act 1980*, which required local authorities to tender an increasing proportion of building, repair, maintenance, highways and sewer work.
- 4.2 The *Local Government Act 1988* had extended CCT to 6 other manual services (building, cleaning, refuse collection, street cleaning, catering, grounds maintenance and vehicle maintenance). This Act was extended to cover sports and leisure management with effect from 1991. The length of contracts (which was laid down by statute) varied between services, but was for a minimum of 4 years except in building cleaning (3 years) and refuse collection (2 years).
- 4.3 The *Local Government Act 1992* extended CCT to white collar services such as housing management, legal, financial, computing, personnel and construction related services, as well as to further blue collar services including security and car parking.
- 4.4 The United Kingdom is the only European country where tendering of local government services is enforced by law. It was suggested that although European examples of local government privatisation and contracting out exist there are fundamental differences:
- 4.4.1 democratic authorities can choose to outsource rather than be forced to; and
- 4.4.2 local authorities in Europe can build social provisions into contracts, to ensure that reasonable social objectives are met even where private firms do the job. In the United Kingdom this is specifically outlawed.
- 4.5 In contrast, with the exception of Victorian local government and some Commonwealth designated projects, contracting out is not mandatory for Australian local governments.
- 4.6 CCT has changed the way local councils in the United Kingdom function and the type of services that they can provide. It has had major implications for the staff that were

employed to provide those services. Although under CCT direct labour has usually won the majority of work, the impact on local government still exists even if the council wins the contract.¹²⁵

4.7 The Committee notes that, depending on who you ask and what you read, CCT has been an outstanding success, a complete disaster or of no effect at all. However, it was clear that most of the chief executives of United Kingdom local governments believe CCT has helped reform local government work practices and achieved major cost savings. It was claimed that efficiency had improved significantly with some down sides. In some areas one of these down sides was a social cost possibly resulting in some of the most needy members of the community suffering a reduction in services.¹²⁶ A more detailed discussion of the social cost of CCT in local government is at paragraphs 7.11 to 7.17 of this report.

4.8 The *Local Government Act 1988* followed on the footsteps of the pioneering of the CCT concept in a handful of “flagship” Conservative councils including the Wandsworth Borough Council and the City of Westminster. Committee members met with representatives of those boroughs and of Newcastle upon Tyne City Council.

Wandsworth Borough Council

4.9 The Wandsworth Borough Council (“Wandsworth”) was the flagship borough of the 1980s and privatised manual services well in advance of Government legislation. The council first privatised the street cleaning and refuse contracts in 1982.

4.10 The objective of its CCT strategy is, “*To ensure that the Council’s services are delivered at the highest quality and at the lowest cost.*” In doing so the public are placed first and employees second. Members of the Committee were informed by staff of Wandsworth that CCT has been:

- effective in some areas where there is a high level of savings *and* good service ratings by users for internal and external services; and
- a failure in other areas.

¹²⁵ Centre for Public Services, *CCT on the Record*, London, Local Government Information Unit, January 1994, p. 2.

¹²⁶ Wayne Collins, “UK local government - are there lessons to be learned?” *Local Government Management*, May 1996, p. 9.

4.11 Wandsworth believes that its competition based policy is unique and that CCT offers:

- the opportunity to rethink service delivery;
- the discipline of a service specification;
- the chance to pay only for what you use;
- the freedom of being a purchaser; and
- the choice of provider.

4.12 Wandsworth representatives informed Committee members that many benefits had occurred as a result of Wandsworth's CCT program:

- a reduction in local rates for local residents;
- an improvement in services delivery and a disappearance of inappropriate practices; and
- more choice for the consumer, for example longer day care is now available.

4.13 Two downsides of contracting out were highlighted to Committee members:

- workers providing the service are usually transferred, however, the management side generally take redundancy packages and management skills can be lost. In order to develop specifications, assess tenders and monitor performance the retention of expertise in public authorities is considered essential; and
- the lack of competition may negate the impetus for the decision to outsource. By way of example - refuse collection has long been a service that councils have outsourced. Whilst service quality has usually increased, quality assurance (in terms of best practice development) is difficult to achieve. This may be due to the fact that in the whole United Kingdom there are only about 3 or 4 private sector firms involved in refuse collection. The lack of competition raises the spectre of cartels.

- 4.14 Another, less enthusiastic view of Wandsworth's CCT program is provided by the Centre for Public Services.¹²⁷ In a study commissioned by NALGO¹²⁸ and published in March 1992 ("NALGO Study") the following key issues were made:¹²⁹
- 4.14.1 Wandsworth claims to have made major savings through privatisation. However, these claims should be seen in the context of several contract failures which have inevitably brought greater costs than originally anticipated. The NALGO Study noted that the failure costs are never quantified however additional monitoring costs and re-tendering costs are incurred in each case. In addition alternative means of operating the contracts have to be found in the period immediately following the sacking of the contractor.
- 4.14.2 Some of Wandsworth's contracts have been privatised since 1982 and have been subject to re-tendering. On re-tendering of some contracts (street cleaning, estate cleaning, grounds maintenance) bids were substantially higher, eroding, in effect, previous savings claimed by the council.
- 4.14.3 Financial criteria have been the main measures used in the contracting process. It is alleged that when assessing tenders the experience and commitment of the DSO's has been ignored.
- 4.14.4 On monitoring, Wandsworth is allegedly inconsistent and secretive, with no regular reports to Committee. It was stated that there was no regular form for reporting and when reports did emerge they related to a situation where a major default was about to occur or they were in response to a specific labour group request. In addition, the monitoring process in some services seemed

¹²⁷ The Centre for Public Services is an independent, non-profit organisation. It is committed to the provision of good quality public services by democratically accountable public bodies implementing best practice employment and equal opportunities policies. It was established in 1973 and operates nationally from a base in Sheffield.

¹²⁸ NALGO stands for National and Local Government Officers which merged with COHSE (Confederation of Health Service Employees) and NUPE (National Union of Public Employees) in 1991 to form UNISON. UNISON is Britain's largest union.

¹²⁹ *Competition, cuts and contractors: lessons for trade unionists from three flagship London Boroughs*, Sheffield, Centre for Public Services, March 1992.

to be fairly ineffective, with high levels of complaints yet low financial penalties. In some cases monitoring costs have been higher than first anticipated.

City of Westminster

- 4.15 The City of Westminster (“City”) was the flagship borough of the 1990's and has engaged in extensive restructuring and commercialisation of all services, including white collar services.
- 4.16 The genesis for contracting out arose in 1986/87 when Councillors began to ask questions about the quality of services - “*How do we know they are OK?*” As a means of testing value for money, the decision was made to subject the City’s services to competitive tendering.
- 4.17 According to the City, savings from CCT have helped achieve low council rates for residents. The City’s new waste collection and disposal contracts, for example, will save council tax payers another £27 million over the contracts’ duration.¹³⁰ The Committee notes that the source of these savings and what costs, if any, were taken into account, were not enumerated.
- 4.18 Members of the Committee were provided with a summary document of the service to be provided in connection with a contract to be awarded by the City for the provision of “housing with care” services for people with learning difficulties. The summary sets out in detail the standard of service which may be expected and what is to happen if the services were not provided properly.
- 4.19 In respect of the latter, the Committee notes the City’s contract monitoring procedure provides for a series of warnings prior to termination of the services. If the contractor did not provide the service in accordance with the standards, the Council would, as a first step, issue a warning requiring rectification. If the contractors did not remedy the problem properly or within the time frame specified by the City a second warning notice would be issued. Ultimately, if the contractor received more than 4 first warning notices in a 180 day period and/or more than 2 second warning notices the City would

¹³⁰

City of Westminster, *Westminster City Council Review of the Year -Your City 1995-6*, London, p. 2.

be entitled to terminate the contract.¹³¹

- 4.20 The Committee notes that in social welfare areas, where the service being provided is personal to the recipient of the service, it is essential that an adequate complaints procedure is established to obtain information that contract monitoring by City staff cannot obtain. This would be particularly so in cases where the recipients of the services were people with learning difficulties.
- 4.21 City representatives noted a number of important steps for contracting out:
- 4.21.1 establish the market. Talk to the market place to ascertain whether there is actually a market for the contract, otherwise a monopolistic situation could arise.;
 - 4.21.2 write a specification and identify the outputs and outcomes required. Do not be too prescriptive and do not tell the provider how to approach the matter. If the contractor is given the freedom to decide the best mix of service, this may result in a better price;
 - 4.21.3 Outline the contract conditions including compliance with quality assurance, health and safety considerations, liability and indemnity provisions, penalty and termination clauses, complaints procedures;
 - 4.21.4 Monitor the contract;
 - 4.21.5 Assess the contractor, in particular its financial viability and references; and
 - 4.21.6 Conduct regular reviews of the CCT program. Communicate with consumers, to obtain feedback.
- 4.22 There was a clear view among City representatives that contracted out services in the City are better delivered in terms of performance indicators and targets. Further, the City no longer has to retain and maintain as many assets (for example, depots). One of the key aspects of CCT was that assets may be sold to the private contractor.

¹³¹ Document entitled "Summary of the document which sets out in detail the service to be provided in connection with a contract awarded by Westminster City Council for the provision of housing with care services for people with learning disabilities", provided to the Committee by the Westminster City Council.

- 4.23 Another view of the City's CCT program is provided by the Centre for Public Services.¹³² In the NALGO Study published in March 1992, the following claims were made, amongst others:¹³³
- 4.23.1 The council has altered the terms of the tendering process to suit the private sector.
 - 4.23.2 Further savings have been squeezed by holding post tender negotiations with contractors.
 - 4.23.3 In some cases DSO's have been discouraged from tendering.
 - 4.23.4 Management buy outs have been encouraged with managers involved in setting up the buyouts also working on the council's specifications.
 - 4.23.5 Monitoring of contracts has been inconsistent and poor in many cases.
 - 4.23.6 The City has argued that privatisation will bring "value for money" and efficiency. This is but one side of the equation and excludes any consideration of the effect on service quality and the massive problems facing disadvantaged groups in the borough.

Newcastle upon Tyne City Council

- 4.24 One example of a successful CCT process is that involving the Newcastle upon Tyne City Council ("NCC"). It is important to remember that at the time CCT was implemented two thirds of local government were Labour and were required to implement Conservative Government policy through mandatory legislation. As the NCC moved to implement CCT the unions became heavily involved, particularly in view of the vulnerable so called "Cinderella services", such as cleaning and catering

¹³² The Centre for Public Services is an independent, non-profit organisation. It is committed to the provision of good quality public services by democratically accountable public bodies implementing best practice employment and equal opportunities policies. It was established in 1973 and operates nationally from a base in Sheffield.

¹³³ Centre for Public Services, *Competition, cuts and contractors: lessons for trade unionists from three flagship London Boroughs*, Sheffield, March 1992.

which were mainly provided by women. The Labour dominated NCC had to develop a way to legally operate within the Conservative initiated CCT system.

- 4.25 One of Newcastle's realities is the high rate of long term unemployment. The Newcastle public sector has traditionally been the largest employer and the NCC believed it had an obligation to provide jobs for its citizens, especially blue collar workers. The NCC wanted to keep delivery of services "in-house" and remain a major employer of labour in the city. The NCC and trade unions worked very closely together in order for the NCC to survive as a service provider. In 1988 "CityWorks" came out of this consultation.
- 4.26 All services subject to CCT were placed in CityWorks and provided by direct labour employed by the NCC. At the time of the Committee's inquiries CityWorks employed a third to a half of the total NCC workforce and is a major department of the NCC. CityWorks comprises 3 operational divisions: environmental and engineering services; building services; and support services.¹³⁴ Most of these provide service and support in respect of "blue collar" operations and contracts. During 1995/6 CityWorks was expanded to incorporate a number of "white collar" organisations which are or will be subjected to competition under the CCT regulations.
- 4.27 CityWorks is a diverse organisation and successful. Its services are fully costed when bidding for contracts and a 'dividend' paid to Council. In 1995/1996 CityWorks employed 5,500 people, turnover was £120,000,000 , and a £40,000,000 dividend was returned to the local community.¹³⁵
- 4.28 CityWorks has been 100% successful in bidding for tenders for 'core' in-house contracts and 30% successful in other activities, such as building. In addition, if a bid by CityWorks is successful, it can ensure consumer equity by levelling out a system where the low income citizens can be subsidised by higher income earners, giving the NCC flexibility to adopt policies relating to social, cultural and equity issues. People with whom Committee members met stated that the key to success was CityWorks' ability to balance the need to be commercially successful to comply with the CCT legislation on one hand and on the other to meet the social policies of the NCC and the public sector.

¹³⁴ City of Newcastle, *CityWorks Annual Report 1996/7*.

¹³⁵ City of Newcastle, *CityWorks Annual Report 1996/7*.

- 4.29 In addition representatives of the NCC claimed that the consultative process pursuant to which CityWorks evolved was very important to its success. Prior to implementing CityWorks much research was conducted into what was “Best Value”. This was measured against community perceptions and benchmarking. Ultimately it was determined that “Best Value” was a combination of many factors, not just price. NCC representatives noted that there was often a danger that “success” in terms of value would be assessed on price alone.
- 4.30 Furthermore, much negotiation and liaison was conducted with union representatives. Committee members were informed that unions are traditionally critical of and in strong opposition to CCT. CCT is viewed as:
- 4.30.1 being introduced with the main purpose of reducing costs;
 - 4.30.2 designed to breakup the power base of local authorities;
 - 4.30.3 attacking unions and breaking up their public service power base; and
 - 4.30.4 negatively affecting wages, conditions and the negotiation ability of employees where contracts were awarded to small, private contractors. Some of these factors are discussed at paragraphs 7.11 to 7.21 of this report.
- 4.31 Largely as a result of initial and ongoing consultation CityWorks has been successful amongst its citizens, including trade unions, as the people of Newcastle feel that they “owned” the enterprise. In the NCC’s view “*CCT just happens to punctuate the existence of CityWorks*”.
- 4.32 In addition NCC representatives noted that:
- 4.32.1 In times where it could be said that the central government (whether Labour or Conservative) doesn’t ‘trust’ local authorities because of instances of incompetence and/or corruption in the past, CityWorks would survive any scrutiny whether the criteria be “best value for money”, “efficiency” or “management”.
 - 4.32.2 Generated surpluses are retained in the local authority. CityWorks provides more local employment opportunities, higher levels of job security and better terms and conditions of employment than private sector employers and plays a key part in realising anti poverty strategies.

- 4.32.3 CityWorks could operate in any context as CCT is not the only reason for its existence. The massive cultural shift experienced as a result of CityWorks has led to good working relationships between white and blue collar staff through the use of service agreements.
- 4.33 Each council publishes details of its performance in providing services ranging from housing to rubbish collection. By using tables produced by the Audit Commission consumers can see how well their council is doing compared to others. Committee members were informed that CityWorks consistently comes out near the top.

Monitoring - Local Government Ombudsman

- 4.34 The Local Government Ombudsman may investigate a complaint about an action taken “by or on behalf” of an authority where the action is taken in the exercise of administrative functions of the authority. This applies whether the external contractor is engaged as a result of a compulsory tendering arrangement required by legislation, or through voluntary action by the authority.
- 4.35 If an investigation results in a recommendation that compensation be paid to the complainant it is usually paid by the local authority. The local authority may then elect to pursue the private contractor who may be at fault. This may result in a need to reassess the contract in place and may lead to higher costs in contracting out.
- 4.36 The Local Government Ombudsman, Mr David Nice, informed Committee members that:
- 4.36.1 Councils have their own complaints resolution procedure. It is only after that avenue has been exhausted that the Ombudsman will step in;
- 4.36.2 The office receives about 15,000 complaints per year of which approximately 25% are justified;
- 4.36.3 Housing and planning occupy approximately two-thirds of the complaints, many revolving around CCT. The other one-third are concerned with education, social services and highways;
- 4.36.4 The brief is to enquire into maladministration. There is no power to adjudicate on actual decisions;

- 4.36.5 He does not have any power of enforcement, however, in 99% of cases the local authorities implement his recommendations; and
- 4.36.6 There is no secrecy as to any findings. When a report is presented local authorities must publicise its availability in the press and make copies available to the local press and general public. Complainant anonymity is preserved. In addition the Ombudsman publishes an annual digest of cases to illustrate major complaints which focus attention on problem areas.

CHAPTER 5

PRISONS

Privatisation

- 5.1 The Prison Service became an executive agency of the Home Office on 1 April 1993. It employs approximately 39,000 staff. The Northern Ireland and Scottish Prisons Services are separate agencies. At the end of January 1997 the Service held 57,537 prisoners in 134 prisons and it employed some 40,000 staff.¹³⁶
- 5.2 The Prison Service has contracted out the management and operation of 4 prisons. At the time of the Committee's visit to the United Kingdom 6 new prisons were at various stages of development under the Private Finance Initiative, usually on 25 year contract terms. Members of the Committee were informed that the Thatcher Government's goal when privatising prisons was to have 10% of all prisons management contracted out.
- 5.3 Members of the Committee were further informed that the impetus for privatisation resulted from poor conditions, current overcrowding, an increasing prison population and the requirement for new prisons to replace old stock. A 1996 study compared operating costs and performance of three privately operated prisons with a range of comparator publicly operated prisons.¹³⁷ The study concluded that, on average, operating costs of these privately operated prisons were some 13-22% lower than those of their comparators in 1994/1995. However, the view was expressed that, in the long term, the overall nett cost may be greater.

Contracting out the management and operation

- 5.4 In 1991 Wolds Remand Prison ("Wolds") was the first prison to be contracted out to the private sector. It has purpose built accommodation for some 320 male adult prisoners and is designed to take all categories of prisoners except the most dangerous. The main purpose of Wolds is to hold adult male prisoners who have been refused bail

¹³⁶ Home Office, *Annual Report 1997 - The Government's Expenditure Plans 1997-1998 to 1999-2000*, United Kingdom, H.M.S.O., March 1997, p. 59.

¹³⁷ Cooper & Lybrand, "Review of Comparative Costs and Performance of Privately and Publicly Operated Prisons", *Prison Service Research Report No.1*, United Kingdom, HM Prison Service, June 1996, p. 20.

by the courts and remanded in custody. Bail may have been refused either to ensure the defendant reappears in court, to protect the public or to prevent interference with the administration of justice. Wolds sometimes holds convicted prisoners who have not yet been sentenced.¹³⁸

5.5 Wolds opened in April 1992 and is run by Group 4 Remand Services Ltd (a subsidiary of the international security firm Group 4) at a cost of some £4.4 million a year. The initial contract was for 5 years, with the option for the Home Office to renew on 3 occasions, each for 3 years. The Committee notes that at the time of its inquiries Group 4 controlled 2 out of 4 privatised prisons in the United Kingdom and had won contracts for the operation of 2 prisons in Victoria.

5.6 Group 4 also contracts out some of Wolds requirements for catering, educational programs, medical and probationary services to other private entities.

5.7 The National Audit Office examined how the contract was let and whether Group 4 were meeting the terms of the contract. The main findings included:¹³⁹

5.7.1 *Contract letting:*

- Bidders were required to meet specified minimum standards for security, health, safety, food, legal advice and assistance, visits and “time out of cell” which were higher than regimes operating under other remand prisons although they were standards to which the Prison Service aspires;
- the Home Office had not expected to make financial savings from the private sector operation of Wolds - the main objective was the injection of competition and new ideas. However, Group 4’s bid, at £21.52 million over 5 years, was £3.66 million less than the Prison Service benchmark; and

¹³⁸ See further: Comptroller and Auditor General, National Audit Office, *Wolds Remand Prison*, London, H.M.S.O., March 1994.

¹³⁹ Comptroller and Auditor General, National Audit Office, *Wolds Remand Prison*, London, H.M.S.O., March 1994, pp. 1-2.

- omission or uncertainties in the contract have contributed to some initial operational difficulties however, they were considered to be inevitable in a totally new arrangement. Some of these included:¹⁴⁰
 - ▶ the provision of pagers which were not covered by the contract. These were supplied by the Custodial Contracts Unit of the Home Office, but at the time of the Committee's visit discussions were occurring over who should bear the cost of these;
 - ▶ the repair of vandalism and how to determine if there had been negligence on the part of the contractor who, in such circumstances, must bear the costs; and
 - ▶ underestimation of the number of external visits made by prisoners (for example, attending hospital, funerals and weddings), for which Group 4 staff would have to provide escorts. External visits were estimated at 1 per week but in actual fact amounted to 5 or 6 per week. The additional resources have been funded by the Prisons Service.

5.7.2 *Contract performance:*

- The contract lays down minimum requirements and performance outputs which are as high or higher, than the code of standards which the Prison Service are developing. The resident Home Office Controller carries out regular checks on every aspect of prison life in Wolds including the specified outputs and minimum requirements. While these contractual requirements themselves form targets, there are no separate performance indicators against which Group 4's performance can be directly and reliably measured. Performance indicators were, therefore, being refined for future contracts and monitoring arrangements, in line with new Prison Service business plans, which were being developed;
- the standard of physical security appeared good. Staff commitment, attitude and relationships with prisoners have been widely praised;

¹⁴⁰ Comptroller and Auditor General, National Audit Office, *Wolds Remand Prison*, London, H.M.S.O., March 1994, p. 9.

- there was extensive provision of medical care but drug abuse was still a major problem; and
- concerns were expressed about risks associated with lethargy and low levels of work by prisoners, and limited use of the educational, sporting and recreational facilities. However, such concerns were difficult to resolve because prisoners on remand cannot be required to work or to take part in activities.

5.8 Overall, the National Audit Office examination confirmed that there had been significant successes in the placement and operation of the contract for Wolds, but with some areas of concern. For a variety of reasons outlined in the National Audit Office report, there are difficulties in comparing performance, results and costs with those of public prisons. Costs were noted to be falling but it was too early to say how far Wolds was providing value for money (having, at that point in time, been operating for under a year) and whether there were lessons to be applied at other remand prisons.¹⁴¹ In any event it was stated that any cost differences between public and private prisons were being reduced as the public sector became more efficient.

5.9 Since this study the contracts at Wolds have been renegotiated to allow for the introduction of sentenced prisoners. This has resulted in divergence of opinion. On one hand Wolds has lost its uniqueness in specialising in remand prisoners, whereas on the other, its increased function enables overcrowding concerns in relation to sentenced prisoners to be addressed.

5.10 The Home Office, Research and Planning Unit, also commissioned a study to evaluate key aspects of the operation of the regime at Wolds and to compare these with concurrent developments in new public sector prisons (“Wolds Report”).¹⁴² From discussions in the United Kingdom the following summary of the effect of the privatisation process in relation to prisons and the findings of the Wolds Report were submitted to Committee members:

¹⁴¹ Comptroller and Auditor General, National Audit Office, *Wolds Remand Prison*, London, H.M.S.O., March 1994, p. 2.

¹⁴² Centre for Criminology and Criminal Justice, University of Hull and the Institute of Criminology, University of Cambridge, *Monitoring and Evaluation of Wolds Remand Prison and Comparisons with Public-Sector Prisons, in Particular HMP Woodhill*, London, H.M.S.O., 1997.

5.10.1 The contracting out of the management of prisons was not just about cheapness and speed but about new methods of prisons management.

5.10.2 In comparison with public sector prisons the staff/prisoner relations at Wolds was better as they were not so hierarchical and staff treated prisoners with more respect. A “management by relationship” philosophy¹⁴³ was utilised resulting in better staff/prisoner relations.

The view was expressed to Committee members that such innovation may not have been possible in the entrenched culture of the public sector as innovative practices appeared to be more easily introduced in private prisons.

5.10.3 Economies of scale were achieved at Wolds. The “management by relationship” philosophy involved direct supervision which kept supervision ratios down - 1 staff to 50 prisoners at Wolds compared to a ratio of 3 staff to 60 prisoners at some public prisons.

5.10.4 Privatisation provided a variety of good measures that could be implemented across the Government spectrum. It has been suggested that examples of good private sector performance crosses over into enhanced public sector performance - a “cross fertilisation of ideas”.¹⁴⁴ For example:

- A requirement of the Wolds contract was that prisoners must be released for 15 hours per day. Within 1 year the public sector were asked to meet the targets that the private sector were achieving; and
- Private prisons recruited staff locally. The same policy has now been initiated by public prisons in response to a need for change.

¹⁴³ This philosophy is based on direct supervision which is a style of prisoner management in operation in a number of American prisons. It is based on the view that by treating prisoners more positively in the context of closer contact with prison officers, disruptive behavior would be reduced.

For more discussion of the concept refer to: Centre for Criminology and Criminal Justice, University of Hull and the Institute of Criminology, University of Cambridge, *Monitoring and Evaluation of Wolds Remand Prison and Comparisons with Public-Sector Prisons, in Particular HMP Woodhill*, London, H.M.S.O., 1997, pp. 18-19.

¹⁴⁴ Harding, Richard *Private Prisons and Public Accountability*, 1997.

Of staff recruited locally for Wolds, 80% were women and 20% were men.

The question was asked, but not answered, - "*As the public sector becomes more efficient then is there any point in continuing?*"

Although some people have argued that change in the public sector was only achieved by the fear of privatisation, private prisons have acted as a catalyst for change. The management of prisoner/staff relations at Wolds is used as a benchmark for other prisons.

- 5.10.5 There is a weakened Union influence. Private operators employed 95% of their workforce from the general population who did not have prison experience. As the management contracts were for new prisons and not existing ones, the TUPE provisions did not apply resulting in lower wages and conditions for employees.

Wage rates differed from region to region. Compared with public prisons there were lower fringe benefits and wages for the lower levels of workers although senior management had higher salaries.

- 5.10.6 Staff at Wolds felt isolated and vulnerable in the first 2 years. As stated by one person with whom members of the Committee met "*prisoners were experienced and staff inexperienced*".
- 5.10.7 Traditional work practices were broken down quickly because of the pressure of competition for example, the gender ratio changed - Wold's recruitment of staff were 80% women to 20% men. However, there was no major breakdown of order.
- 5.10.8 A view was expressed that it was essential that there is as much openness as possible about publicising details of the contracts, the costs and any operating difficulties of the private sector prisons, to the same degree as would apply to the public sector. It was noted that the formal accountability of private sector prisons (via contractual mechanisms and the Controller), is of a high degree but the view was expressed that this needed to be matched by a greater degree

of openness and public accountability to assuage any fears of a “cover-up”.¹⁴⁵

5.10.9 The principles behind the privatisation of prisons may well disappear as private prisons lose their advantage when faced with the same problems as the public prisons, for example, at the time of visit by Committee members Wolds was becoming overcrowded.

DCMF under the Private Finance Initiative

5.11 In 1993, as part of the strategy for the further involvement of the private sector in the Prison Service, companies were invited to design, construct, manage and finance 2 new prisons, at Bridgend in South Wales and Fazakerley in Liverpool. These contracts are known as “DFBO contracts” or “DCMF contracts” and are discussed at paragraph 4.23 of this report.

5.12 The core requirement under the DCMF structure for the 2 prisons was that the supplier should provide a specified number of available prisoner places meeting the following criteria:

- the prison as a whole and each cell must be built and maintained to specified standards; and
- the prison regime and the operation of the prison must be in accordance with prison rules and other standards relating to the security of the prison and the control, health and general well-being of prisoners.¹⁴⁶

5.13 In general, the supplier was free to meet these specified standards in whatever way it chose but there were certain constraints, some of which were imposed previously (for example, agreed planning agreements) and some of which emerged in negotiation with bidders (for example, the outer perimeter wall could be replaced by a fence).¹⁴⁷

¹⁴⁵ Centre for Criminology and Criminal Justice, University of Hull and the Institute of Criminology, University of Cambridge, *Monitoring and Evaluation of Wolds Remand Prison and Comparisons with Public-Sector Prisons, in Particular HMP Woodhill*, London, H.M.S.O., 1997, pp. 57-58.

¹⁴⁶ HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 28.

¹⁴⁷ HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 28.

- 5.14 Bids were evaluated against 4 criteria: deliverability, price, quality, and innovation. All bids were judged to be deliverable. None was particularly innovative, and the final decision rested on price and quality. Contracts were awarded in 1995/6.¹⁴⁸
- 5.15 Under the DCMF structure 2 main risks were to be transferred to the contractor:
- *design and construction risk*: Payments were to begin when the cells were certified by an independent engineer that they met required standards. If the supplier failed to provide the number of available prisoner places specified in the phase-in timetable, it was liable to pay liquidated damages; and
 - *availability and operating performance risk*: Once operating, payment is only made for places that are available for use. There are no payments for sub standard places or if performance falls beneath certain levels. The supplier bears the risk of places being unavailable through, for example, prison riots.¹⁴⁹
- 5.16 Operating and regulatory risks are shared. Occupancy/demand risk remains with the Prison Service. The transfer of risk was explored during the procurement process but indicative bids demonstrated that it would produce poor value for money. Residual risk also remains with the Prison Service - because of the long-term strategic value of the prison it reverts to Government ownership at the end of the contract period.¹⁵⁰
- 5.17 The Prison Service considered that it would be valuable to assess value for money against a notional public sector comparator as there was no other benchmark available. The net present value of the public sector base case, including the likely value of cost and time overruns was estimated at over £570 million. The net present value of the preferred DCMF contracts were significantly less than that figure.¹⁵¹

¹⁴⁸ HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 28.

¹⁴⁹ HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 29.

¹⁵⁰ HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 29.

¹⁵¹ HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p.29.

5.18 The payment structure for DCMF contracts is per prisoner place per day (whether occupied or not) up to a maximum number of places. There is an option to pay for additional places at a lower rate. The basic pricing structure can be adjusted in several ways including savings arising from security technology changes and reductions for poor performance.¹⁵²

5.19 The Committee was particularly interested in the performance measures of a DCMF contract, which indicated that the supplier was required to perform satisfactorily in 5 areas:¹⁵³

- keeping prisoners in custody;
- maintaining order and discipline in a safe environment;
- providing decent conditions for prisoners and meeting their needs;
- providing positive regimes; and
- helping prisoners prepare for their return to the community.

Points are awarded for specific failures in each of these areas (for example - assaults on inmates, failure to provide meals). If points for poor performance reach specified levels they result in fee reductions. The supplier is also required to meet the targets contained in a strategic development plan for achieving continuing improvements to the custodial service.¹⁵⁴

Monitoring

5.20 Within the public prison system responsibility, in theory at least, can be clearly traced to where shortcomings occur. A line of responsibility can be traced from public prison guards through their supervisors, Governors, Minister and enabling Act to the majority will of a democratic society. However, the new contractual environment within which

¹⁵² HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 30.

¹⁵³ HM Treasury, *Private Opportunity, Public Benefit*, London, H.M.S.O., November 1995, p. 30.

¹⁵⁴ "Social Policy Research 119 - The impact of the contract culture on volunteers", *Findings*, York, Joseph Rowntree Foundation, June 1997, p. 22.

private prisons operate does not have this clear line of authority nor its culture. There is potential for a private operator to become fixated with profitability and as a corollary cost minimisation, resulting in the welfare of prisoners suffering.¹⁵⁵

- 5.21 Whilst in the United Kingdom, Committee members reviewed the complaint and monitoring mechanisms of the Prisons Ombudsman and Her Majesty's Inspectorate of Prisons.
- 5.22 **Prisons Ombudsman:** The Prisons Ombudsman was established in 1994 to investigate complaints from prisoners who have failed to obtain satisfaction from the Prison Service's internal requests and complaints system. In the words of the Prisons Ombudsman "*We are not an apologist for the prison system, not necessarily on the side of the prisoner. We must show prisoners that they can expect fairness from the system.*" The Prisons Ombudsman is independent of the Prisons Service of the Home Office and reports directly to the Home Secretary.¹⁵⁶
- 5.23 The Prisons Ombudsman does not have executive power over prisons - it is a persuasive power exercised through recommendations, for example, apologies, compensation and changing rules and procedure.
- 5.24 The Prisons Ombudsman can investigate the merits of complaints of as well as the procedures involved. He/she can investigate all decisions relating to individual prisoners made by Prison Service staff, people acting as agents of the Prison Service, other people working in prisons and members of a Board of Visitors. Complaints relating to the clinical judgement of doctors are an exception. The Prisons Ombudsman's terms of reference include contracted out prisons, contracted out services and the actions of people working in prisons but not employed by the Prison Service.
- 5.25 Committee members were told by the Prisons Ombudsman that his office received less complaints from prisoners of private prisons than public prisons. However, it was noted that this did not necessarily mean that there was no cause for grievance. Although not proven, it had been stated that many complaints from private prisons were resolved internally, via a "slush fund" from which compensation could be paid to the

¹⁵⁵ The Committee did not examine this issue in detail but refers the House to an article written on this matter in the Australian context by Davies, J "The Effect of Prison Privatisation on the Legal Position of Prisoners" *Australian Journal of Administrative Law*, November 1998, Vol. 6, p. 34.

¹⁵⁶ Home Office, *Annual Report 1997 - The Government's Expenditure Plans 1997 - 1998 to 1999 - 2000*, United Kingdom, H.M.S.O., March 1997, p. 145.

prisoner to avoid a complaint getting to the Ombudsman. In any event the Committee was told that private sector prisons have had a big influence as they had forced public prisons to improve.

- 5.26 The Ombudsman also noted that the nature of complaints received from prisoners in public and private prisons were about the same. He noted that there seemed to be a greater number of prison assaults on prisoners in private systems reported and suggested that this may be because of lower levels of supervision.
- 5.27 *The HM Inspectorate of Prisons* is independent of the Prisons Service and reports directly to the Home Secretary on prison conditions, the treatment of and facilities available to prisoners and other matters as the Secretary of State may direct. All prisons and young offender institutions are subject to inspection whether they are managed directly or contracted out. The Inspectorate aims to inspect every establishment at least every 5 years.¹⁵⁷
- 5.28 Despite pledges during election campaign, the Labour Government has renewed DCMF contracts and continued the trend due to realistic considerations such as lack of capacity. The Committee were informed that, due to length and strength of the contracts and the lower costs of the service, the Labour Government are “stuck with” outsourced prisons even though they do not agree with the policy.

¹⁵⁷

Home Office, *Annual Report 1997 - The Government's Expenditure Plans 1997 - 1998 to 1999 - 2000*, United Kingdom, H.M.S.O., March 1997, p. 146.

APPENDIX 6
MOTION REFERRED BY THE HOUSE

That the House direct the Standing Committee on Public Administration to inquire into the processes and outcomes of privatisation and the outcome of contracting out public services in the following terms:

- (1) The extent to which state government enterprises have been privatised since February 1993.
- (2) The economic and social impact of transferring state owned enterprises to the private sector.
- (3) The cost and quality outcomes of privatisation in terms of the level of savings or additional costs that have resulted from the provision of services by private contractors instead of by government.
- (4) The extent to which state government contracts or tenders have since February 1993 been awarded to -
 - (a) Western Australian companies or businesses;
 - (b) other Australian companies or businesses;
 - (c) foreign owned or controlled companies or businesses; and
 - (d) regionally based businesses.
- (5) The extent to which risk is transferred from the public sector to the private sector and to which government companies or businesses are given government guarantees before agreeing to invest in large scale public sector projects.
- (6) The extent to which policies have been introduced to guarantee the Western Australian public against financial default by private contractors.
- (7) The extent to which "contracting out" of state public services has resulted in greater competition.
- (8) The extent to which initiatives have been introduced to prohibit the practice of private companies acting as cartels, rather than competitors and thereby combining resources to tackle large scale projects.

- (9) The extent to which current tendering practices ensure that -
- (a) the process is open and fair;
 - (b) proper procedures are being followed; and
 - (c) mechanisms are in place to check the qualifications, credentials and financial backgrounds of those seeking contracts.
- (10) The extent to which appropriate checking mechanisms are in place to allow regular monitoring of the performance of contractors and that the Government has in place a set of procedures to deal with breaches of contracts.
- (11) A set of criteria or conditions which would allow the Parliament to make judgment on what constitutes "confidentiality" when referring to government contracts.
- (12) The extent to which the competitive nature of contracting out has led to employees of contractors being paid below usual rates of pay and conditions.
- (13) The extent to which government departments and agencies are prejudiced in the contracting arrangements when private contractors are able to legally pay their employees lower wages and conditions.
- (14) The extent to which the Government should specify certain minimum requirements of contracting, including the requirement to -
- (a) pay to employees a wage not less than that of an employee of the Government doing comparable work might be paid;
 - (b) subject the work under contract to the same level of public and parliamentary scrutiny as applies in the public sector; and
 - (c) the same level or nature of good corporate citizenship as that expected of government departments or agencies.
- (15) Any other matters relating to privatisation and contracting out of government services as the Committee deems necessary.

APPENDIX 7
THE CITIZENS' CHARTER

Taken from: *The Citizen's Charter - Five Years on: A report to mark five years of the Charter programme*, London, H.M.S.O., September 1996.

The six service standards for Central Government

The Government has laid down six new standards that will apply to the service provided by all Central Government departments and Next Steps Agencies.

In serving you, every Central Government department and agency will aim to do the following.

◆
1 Answer your letters quickly and clearly. Each department and agency will set a target for answering letters and will publish its performance against this target.

◆
2 See you within 10 minutes of any appointment you have made at its offices.

◆
3 Provide clear and straightforward information about its services and at least one number for telephone enquiries to help you or to put you in touch with someone who can.

◆
4 Consult its users regularly about the services it provides and report on the results.

◆
5 Have at least one complaints procedure for the services it provides, and send you information about a procedure if you ask.

◆
6 Do everything that is reasonably possible to make its services available to everyone, including people with special needs.

If a department or agency does not meet these standards, you can expect a full explanation.

These standards will apply to all Government departments and Next Steps Agencies from 1 April 1997.

They will be reviewed in 12 months' time to take account of users' comments.

The six principles of public service

Every citizen is entitled to expect:

Standards

Explicit standards, published and monitored, which individual users can reasonably expect for each service. Publication of actual performance against these standards.

Information and Openness

Full, accurate information readily available in plain language about how public services are run, what they cost, how well they perform and who is in charge.

Choice and Consultation

The provision of choice wherever practicable. There should be regular and systematic consultation with those who use a service. Users' views about services, and their priorities for improving them, to be taken into account in final decisions on standards.

Courtesy and Helpfulness

Courteous and helpful service from public servants who will normally wear name badges. Services available equally to all who are entitled to them and run to suit their convenience.

Putting Things Right

If things go wrong, an apology, a full explanation and a swift and effective remedy. Well publicised and easy-to-use complaints procedures with independent review wherever possible.

Value for Money

Efficient and economical delivery of public services within the resources the nation can afford. And independent validation of performance against standards.

APPENDIX 8
TERMS OF REFERENCE

1. The Standing Committee on Public Administration, in reference to the provision of government services by private contractors or non government agencies (“contracted service providers”), will examine:
 - 1.1 the adequacy of tendering procedures adopted by agencies in contracting out services, including the extent to which current tendering practices ensure that:
 - a. the process is open and fair;
 - b. proper procedures are being followed;
 - c. mechanisms are in place to check the qualifications, credentials and financial backgrounds of those seeking contracts; and
 - d. the proposed service provider is capable of meeting quality standards;
 - 1.2 how best to ensure that the rights, interests and responsibilities of consumers, contracted service providers and agencies can be defined and protected, including:
 - a. whether contracting out arrangements should be governed by written contracts between the government agency and the contracted service provider in all cases;
 - b. whether contracts should contain standard clauses dealing with matters such as responsibility for record keeping; complaints and dispute resolution procedures; allocation of responsibility between the contracting government agency and the contracted service provider in the event of financial loss or other loss on the part of the consumer;
 - c. the need to define standards of service, including the use of Customer Service Charters;
 - d. the extent to which appropriate mechanisms are in place to enable regular monitoring of the performance of contracted service providers; and
 - e. the extent to which appropriate mechanisms are in place to deal with breaches of contracts;
 - 1.3 what administrative law and/or other safeguards exist to preserve appropriate government accountability where government services are provided to consumers by contracted service providers;
 - 1.4 what administrative law and/or other safeguards are and should be available to consumers to seek redress from contracted service providers providing services on behalf of the government, including:
 - a. the availability of administrative law remedies;

- b. the availability of private law remedies;
 - c. industry based complaint handling mechanisms or industry Ombudsmen;
 - d. whether the jurisdiction of the Parliamentary Commissioner should be extended to ensure that it covers all contracted out government services; and
 - e. compensation schemes which may be provided by the agency;
- 1.5. how to consider the total effect of privatisation rather than considering, in isolation, the effect on the particular service which is proposed to be tendered;
- 1.6. what laws and/or safeguards are, or should be, in place in respect of access to and use of information, including:
- a. the ability of a consumer to obtain information about contracted out services;
 - b. protection of personal information collected by agencies and/or contracted service providers;
- 1.7. ministerial responsibility to Parliament for contracted out services;
- 1.8. the concept and role of commercial confidentiality, including:
- a. if commercial confidentiality should properly attach to a document in which the Parliament has an interest and, if so, when;
 - b. whether the government and its agencies, to meet its responsibilities for policy making, should have access to all files and information generated by contracted sector providers in meeting their contractual obligations;
 - c. whether and to what extent claims of commercial confidence should be accepted as limiting the right of Parliament to examine contractual arrangements between agencies and contracted service providers, including a consideration of the provisions of the Financial Administration and Audit Act 1985; and
 - d. to facilitate the creation of a set of guidelines setting out the circumstances in which agencies will treat information provided by contracted service providers as confidential; and
- 1.9. any other matters relating to the privatisation of government services as the Committee deems necessary.
2. The Standing Committee on Public Administration, noting the necessity for public accountability of all agencies will examine what laws and/or safeguards are, or should be, in place for the protection of public sector employees in reporting corruption and other organisational wrongdoing.

3. In these terms of reference:

“agency” has the same meaning as that term is given in the Terms of Reference for the Standing Committee on Public Administration as set out in the Standing Orders of the Legislative Council; and

“privatisation” includes, without limitation, sale, gift, dilution, the process of buying out interest groups or establishing counter groups, deregulation, the development of public supply alternatives, the repeal of monopolies, exit from state provision, contracting out and outsourcing, as those phrases were discussed in the Standing Committee on Public Administration’s Thirteenth Report on “Outsourcing and Contracting Out: The Committee’s Investigations in the United Kingdom”.