

Payment on Performance

**The Use of Competition and Contracting in Improving Public
Services**

**A Submission
by
The Serco Institute**

**to the
West Australian Economic Audit Committee**

27 February 2009

*'If policy analysts carry bumper stickers, they should read. . .
Payment on Performance.'*^{*}

Preface

This submission draws on the practical experience of Serco Group plc, one of the world's leading public service contractors, as well as government and academic research, on the use of competition and contracting in public services. The majority of examples are drawn from the United Kingdom, in part because over the past two decades, that country has led the world in the development of public service markets, but also because of the author's close study of that market over the past ten years.

This submission is not concerned with the privatisation of public services, nor with public service markets that rely on vouchers (or equivalent direct payment mechanisms). Rather, it addresses markets where public services are commissioned from private and voluntary providers through contract.

We have not presumed to advise government on *what* services should be put to market – in our view, that is a decision that should be made by government – although we have provided a list of some services around the world that have been contracted (not all of which have been successful).

On the other hand, the Serco Institute does have useful contributions as to *how* governments can commission public services under contract so that they achieve their social objectives in a more cost effective way. Our recommendations are based on Serco's own experience in delivering complex public services in numerous countries around the world, over more than 40 years; published case studies, contemporary and historical, of both success and failure; an ongoing dialogue with public servants and other private providers; and practical application of academic research.

Gary L. Sturgess
Executive Director,
The Serco Institute

* Jeffrey L. Pressman and Aaron Wildavsky, *Implementation*, 1973.

Preface	1
Executive Summary	3
1. What Kind of Market?	8
2. The Benefits of Competition and Contracting.....	10
2.1 Value for Money	10
2.2 Service Improvement	15
2.3 Risk Transfer	16
2.4 Increased Accountability.....	18
2.5 Strengthening Core Services.....	20
2.6 Enhanced Capacity	21
2.7 Enhanced Capability	21
2.8 Stimulating Innovation	21
3. How Do Competition and Contracting Work?.....	25
3.1 The Drivers of Change	26
3.2 A Fresh Start	30
3.3 Management Reform.....	33
4. Ensuring That Competition and Contracting Are Done Well	39
4.1 Exemplary Failures.....	39
4.2 Best Practice	43
5. Models of Reform.....	57
5.1 Compulsory Competitive Tendering (UK, 1980s; Victoria, 1990s).....	57
5.2 Market Testing (UK, 1993-1997)	58
5.3 Prior Options (UK, 1993-1997)	58
5.4 The Yellow Pages Test (USA, 1996-).....	60
5.5 Competitive Sourcing (USA, 2003-2007).....	60
5.6 Intervention (USA, 1990s - ; UK, 1999-2002)	61
5.7 Market Testing (Japan, 2004).....	67
5.8 The Mixed Economy (UK, 1997-)	68
6. Examples of Public Service Contracting	69
6.1 Criminal Justice	69
6.2 Emergency Services	74
6.3 Education	75
6.4 Health	78
6.5 Social Services	80
6.6 Regulation and Revenue Collection	81
6.7 Transportation	82
6.8 Scientific Research.....	83
6.9 Local Government	84
6.10 Corporate Support.....	85
The Serco Institute.....	87
Endnotes.....	88

Executive Summary

The Benefits of Competition and Contracting

Governments use competition and contracting in the commissioning of public services for a variety of reasons – in the pursuit of greater value for money, with the direct objective of driving through service improvements, to transfer risks that are better managed in the private sector, to increase accountability, to professionalise support services that are vital to mission success, to release highly trained staff to concentrate on front line public services, to boost capacity during times of peak demand, to acquire specialist capabilities that do not need to be retained in-house, and with the explicit intention of stimulating innovation.

Are the anticipated benefits always delivered? Clearly not – commissioners and contractors are human too. However, independent research from around the world confirms that, done well, competition and contracting are capable of significantly improving value-for-money and transferring risk. The evidence that these tools are capable of delivering these other benefits is anecdotal, and yet there is not a sufficient body of experience to give us confidence that they can be so used.

How Do Competition and Contracting Work?

We have identified three drivers of change that, while related, facilitate and motivate transformation in somewhat different ways. *Competition* stimulates a search for innovative new solutions and the fact of having won a competition bestows senior management with a mandate for change, even where the in-house team wins the bid. The process of negotiating and signing a legally binding *contract* creates a shield that gives managers space to manage, at the same time sharpening lines of accountability. The establishment of agreed performance indicators with direct financial consequences means that contract managers are obliged to understand their business fully. And while most of the benefits come from competition rather than privatisation, there are some advantages in having

corporations involved in a public service system – in scaling up innovations, and in providing the discipline of a valued brand name.

Some of the benefits appear to come from the fresh start that competition and contracting allows. However, there appear to be very few management reforms that are universal across the range of contracted public services – in some cases, for example, contractors introduce multi-skilling, while in others they rely on specialisation. The solutions appear to be tailored to the service in question.

Ensuring They Are Done Well

To a considerable extent, whether competition and contracting meet government's expectations depends on how well they are done. What lessons have been learned over the years in using these tools?

Political context: Potential investors in a new public service market place a great deal of importance on the vision and determination of political leaders; however, they will also be concerned that contracting initiatives are politically sustainable. A market that develops steadily and wins broad community support will be of greater interest to companies seeking to make a long-term investment than a programme marked by brief bursts of activity and political controversy.

Mature public service markets cannot develop where there are serious questions about the integrity of decision-making processes, and where processes and decision-making become highly politicised through lobbying.

Designing markets: Traditionally, public service contracting was viewed as a series of discrete procurements, however with the deepening and widening of capabilities and opportunities, public sector commissioners are paying more attention to the design of markets overall.

The discipline of market design requires commissioners to consider what kind of market they want to create – the level at which choice should be exercised, the funding tools that are most appropriate to the service in question and how closely providers need to be regulated.

In emerging markets in particular, it is desirable to engage early with potential suppliers to understand their needs and communicate government's intentions. The scale, scope and duration of contracts must be considered, in the interests of deepening the market, increasing competition and ensuring that providers have a pipeline of opportunities in sight.

Where public sector comparators are used as a benchmark of performance and where public, private and voluntary providers compete for contracts, government needs to ensure that there is a level playing field between the different sectors.

Social policy considerations: There is clear evidence that some private and voluntary sector providers do have a public service ethos, but whether this is the norm within a public service market depends on what kind of providers are selected and how contracts are managed by public officials.

Given that these are *public* services, it is unsurprising that governments often include social outcomes among the key performance indicators. Private providers understand the need to deliver their customers' requirements and are willing to respond, although commissioners must also be careful not to weaken procurement and contractual tools by overburdening them.

Commissioning not procurement: As public service markets mature, it has been recognised that effective commissioning demands much higher level skills than traditional procurement does. The scope of commissioning may or may not involve market design, but it certainly demands public servants who are skilled in contract design as well as procurement. Among other things, commissioners must understand the needs of policymakers and providers, making sure that technical procurement considerations are not allowed to triumph at the expense of service outcomes. Commissioning implies an ongoing obligation, which includes managing the relationships between government and its suppliers.

Effective competition involves choosing a procurement model that is best suited to the services and the market in question. Among other things, this will require the commissioner to reconcile the tensions between maximising competition, minimising bid costs and ensuring that there is early engagement between the commissioner and the probable provider.

Clarity over objectives and ensuring that there is an appropriate balance between price and quality considerations are two of the greatest challenges in good procurement. This may involve them in actively managing the customer's side of the procurement so that requirements are not allowed to drift and become confused as the procurement progresses. Effective commissioners must also be aware that a poorly designed and managed procurement can generate 'bid fever', so that bidders systematically underestimate risk and/or overestimate their capability.

Contract design: Designing a contract that is appropriate to the service in question and the current capabilities of commissioners and contractors is a complex task. Consideration must be given to the scale and scope of the

services that will be included within the contract, the extent of risk transfer, and whether cost-plus or fixed price remuneration is more appropriate. Commissioners now have a variety of contract models from which they can draw – standard term contracts, framework contracts, and joint ventures, to name just a few.

The performance regime – which lays down the financial and reputational incentives that direct the way in which services are performed – lies at the heart of a successful public service contract. In recent years, there has been an attempt by commissioners to specify high level outputs rather than detailed inputs, since it leaves greater scope for innovation. In some markets, public officials are now moving to commission outcomes (with an associated transfer of risk), although this is challenging and these models are still in the early stages of development.

Contracts for complex public services cannot be administered through financial incentives alone: the role of reputational and relational incentives must also be explored when commissioners are designing contracts.

Contractual relationships: Those responsible for managing the competition, preparing the bid and negotiating the contract must have the ongoing delivery of the service firmly in mind. Negotiators who see contractual close as the end of the process will behave very differently from those who see it as just the beginning.

At the most basic level, commissioners must ensure that there are sufficient experienced officials to monitor performance effectively, but not so many that they are encouraged to meddle with the detail of delivery. Contracting for complex and closely integrated public services demands a different frame of mind and new forms of governance built around effective partnerships rather than simple concepts of ‘contracting out’.

Capability: The development of commissioning capabilities within government will demand the recruitment and retention of individuals with appropriate skills, through suitable remuneration, challenging work and a promising career path.

In smaller governments, it may be necessary to concentrate high level commissioning and procurement capabilities in a central agency, although in such an event, great care must be made to ensure that these officials understand the needs of policy and operational specialists in line departments and agencies.

One of the reasons why a public service industry has matured so quickly in the United Kingdom is that capable and experienced public servants have transferred

and been retained and promoted by the private providers. This is also one reason why the leading companies have developed a strong public service ethos.

Models of Reform

In seeking to expand the use of competition and contracting, governments often establish an overarching framework within which public servants can operate. The submission identifies eight models of reform that have been employed over the past two decades in the United States, the United Kingdom, Australia and Japan. Not all of these have been successful.

Examples of Public Service Contracting

Finally, we have provided a catalogue of public services that have been purchased under contract in recent decades – in criminal justice, emergency services, health, education and social services, regulation and revenue collection, transportation, municipal government, scientific research and corporate support.

We have provided this list, not because we believe the West Australian government should adopt them all, but to direct the committee to a body of research that might inform its deliberations.

1. What Kind of Market?

Private and voluntary providers may be involved in the delivery of public services in different ways, and a market model that is appropriate to one public service may not be suitable to another. In part, which market model is appropriate is a function of the service in question – it is difficult to conceive how one might employ vouchers in the prison service, for example.

However, in other cases, what is acceptable is defined solely by past experience. Compared with other countries, Australia has an extensive system of (partial) education vouchers, largely because of a 19th century debate over religious education. Until recently, the National Health Service in the UK was immune from fundamental reform, because of its origins in the social reforms introduced in traumatic aftermath of World War Two. And most of Denmark's fire and ambulance services are provided by a private, for-profit firm, because of its close involvement in the modernisation of local fire services in the 1920s, sponsored by the then socialist government.

For the purposes of this submission, we have identified four different market models:

- (i) A privatised market, where end-users negotiate directly with competing providers and the role of the state is restricted to industry regulation and limited funding through the social welfare system;
- (ii) A state-funded market, where end-users negotiate directly with approved suppliers, and funding is provided by the state through vouchers (or equivalents);
- (iii) A franchise model, where end-users purchase services from private monopoly providers franchised and regulated by the state;
- (iv) A commissioned market where services (usually delivered as government monopolies) are purchased on behalf of end users by the state (or other agencies acting for government) from private or voluntary sector providers.

Of course, this is a simplification and the range of market models can be categorised more finely and in other ways. For example, there are two very different kinds of commissioned markets – those where a single government agency buys from a number of different suppliers (one-to-many), and those where a number of different government agencies compete in the market for services from a multiplicity of suppliers (many-to-many).

This submission is concerned with commissioned markets. It seeks to address the benefits of competitive tendering and contracting in public services, and identify some of the reasons why these policy instruments work as well as they do. It explores the conditions for successful competition and contestability, it discusses some of the models that governments have used over the years to introduce competition into public services, and in conclusion, it lists some of the services that have been contracted in particular sectors.

Competitive tendering and contracting tend to be used with core public services such as prisons, where there is no prospect of light-handed regulation or the use of vouchers. It is also used in contracting for support services, such as IT support or the management of business processes, where the services in question are intimately interconnected with the front-office functions of government. And it has often been used early in the development of new public service markets, where confidence within government in the delivery of services by the private and voluntary sectors is still low, and where political risks are high.

There are benefits and disbenefits of this approach compared to other market models. If it is done well, contracting provides commissioners with greater control over performance than the use of light-handed regulation, and it is capable of being used more confidently with core public services. On the other hand, because government is more deeply involved in the specification of the service offering, it is likely to result in less innovation.

2. The Benefits of Competition and Contracting

Much of the debate over the merits of competition and contracting focuses on the alleged financial benefits, and analysis seems to confirm that they are particularly effective tools for improving value-for-money. However, in different countries, at different times, governments have used competition and contracting to accomplish a variety of objectives.

2.1 Value for Money

The vast majority of studies agree that, when done well, competition and contracting deliver better value-for-money, although the scale of these benefits and the conditions under which they are delivered remain a matter of ongoing discussion.

International, cross-sectoral studies

In November 2007, the Serco Institute published a survey of 196 studies by government and academic sources from 12 different countries, across five sectors. These sectors were chosen because they had produced the largest number of studies and the most vigorous methodological debates. In brief, the Institute's survey concluded:

- In defence support, studies from Australia, New Zealand and the United States reported savings in the range of 20 to 30 percent, although in some cases, they had been much higher.
- In health support services, financial benefits in excess of 20 percent had been reported in England, in Australia and in Denmark. However, in other jurisdictions, where competition had been pursued less vigorously, the savings did not appear to have been as great.
- Of ten studies of US prison contracting, all but one found positive benefits associated with contract management, and these were mostly in the range of 5-15 percent. The financial gains in the UK appear to have been more than 20 percent, and perhaps as high as 30 percent.

- Competition and contracting in household refuse collection had been most extensively studied, with financial gains in the majority of the studies in North America, the United Kingdom and various European countries clustering around 20 percent.
- The results from the study of municipal services were more mixed, in part because of the much wider range of services involved. The range extended from 5 percent to as much as 25 percent in some studies. Results from the use of compulsory competitive tendering in UK local government indicated savings that were towards the bottom end of this range.¹

In another recent literature survey, Australian academics, Jensen and Stonecash wrote: 'while there is still some ongoing debate about the magnitude of the cost change associated with outsourcing, there seems to be some consensus about the direction of the change'.² And Graeme Hodge, from Monash University's Mt Eliza Business School, concluded that there were real costs savings of around 8 to 14 percent.³

United Kingdom

In July 2008, the UK Department for Business Enterprise & Regulatory Reform published a major report on the public service industry. Among other things, that review, chaired by the distinguished economist, Dr DeAnne Julius, commissioned a literature review by Professor Paul Grout of the Centre for Market and Public Organisation at the University of Bristol. Grout's survey concluded that savings were in the order of 20 percent, and while the evidence concerning the impact on quality was weaker and more limited, the few rigorous studies available pointed to similar or improved service quality.⁴

And a 2007 study commissioned by the UK's Audit Commission[†] from the Centre for Local and Regional Government Research at Cardiff University, concluded that 'under the right conditions, competition and contestability can be very useful tools in securing better performance. But the picture is mixed.'⁵

United States

The sector that has been most closely studied in the United States is defence support, with reports by the Government Accountability Office (GAO), the Center of Naval Analyses, RAND and academics showing significant savings.⁶ Of greater relevance to a government concerned with domestic policy is the 'Competitive Sourcing' initiative, introduced by the Office of Management and Budget as part of George W. Bush's 'President's Management Agenda'. For the

[†] The Audit Commission is responsible for auditing sub-national government in England and Wales.

most part, this involved market-testing 'commercial' or corporate support functions. Net savings were identified, although because of the narrow range of functions exposed to competition, the gains were not great.⁷

Competitive tendering of state government functions has been strongly resisted by public sector unions in the United States, and even where there has been significant reform (as in Florida), there do not appear to be any independent studies of the financial outcomes.

Municipal contracting was closely analysed in the 1980s, with the most comprehensive studies exploring the correlation between local government spending across hundreds of American cities and the extent to which local authorities used private and not-for-profit contractors. The results are complex, but generally confirm that contracting was associated with lower per capita spending.⁸

Australia

It has been some years since this question was studied closely in Australia, and the last major study was undertaken by the Industry Commission in 1996. A survey of 203 empirical studies from Australia and overseas reported that 75 percent of studies found savings and the savings ranged from 10 to 30 percent in over half the services studied. A survey of Commonwealth Government budget sector agencies undertaken for the Industry Commission found average savings of 16 percent. Moreover, savings tended to accrue over time.⁹

Qualitative Impacts

It is self-evident that if competition reduces costs, but simultaneously reduces the quantity and/or quality of service by a similar amount, then there has not been an improvement in value-for-money. Service quality is notoriously difficult to measure, but from those studies that have addressed this question, it is clear that financial savings can be made without a diminution in quality. Indeed, in some cases (two of which are addressed in Section 2.2 below), service quality has improved at the same time as costs have been reduced.

Employment Conditions

Similarly, if costs are reduced solely through a reduction in the terms and conditions of existing workers, then this does not represent an improvement in productivity, but rather a transfer of wealth from employees to shareholders and/or taxpayers.

In the UK, the terms and conditions of employees in outsourced organisations have been largely protected under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE), which preserve jobs, workers' entitlements and union coverage during the process of transfer. Terms and conditions can still be renegotiated with workers and their representatives following transfer, through the usual processes of industrial bargaining. TUPE applies to subsequent transfers following re-competition, as well as the initial outsourcing.

In spite of some initial private sector concerns about the impact of this policy, it has not prevented extensive contracting of public services, and in some ways has facilitated it:

- The strength of union opposition has been considerably diminished since one of their major concerns has been directly addressed;
- The cost to government has probably been reduced, since it has not been necessary to fund redundancy payments up front, nor has it been necessary to cover the contingency of contractors making some or all of their workforce redundant if they lose the rebid at the end of the contract period;
- The policy has facilitated a progression from contracting relatively simple services where skills can be readily purchased in the open market (such as cleaning and catering) to complex services where the essential capabilities are unique and available only within the organisation that is being subjected to competition (such as national metrology research). If it were not for TUPE, there could be no effective competition or re-competition of such a service.

Sustainability

Some have claimed that the benefits of competition cannot be extended over time. This is almost certainly true where the same range of services is being put to competition repeatedly, and there are no significant technological breakthroughs. In those circumstances, competition tends to focus on profit margins and/or on the terms and conditions of workers, neither of which will result in satisfactory outcomes for customer or contractor over the medium to long term.

On the other hand, where in later competitions, the scale or scope of services is expanded, greater risk is shifted to the provider, and/or commissioners allow greater scope for innovation (for example, by specifying high-level outputs rather than detailed inputs), then opportunities will arise for ongoing value-for-money savings.

This has been evident in contracting for defence support in the UK, where the scale and scope of services have been expanded in successive rounds of competition and contracting over a period of several decades. Likewise, in prison management, where the initial round of contracting for the management of public facilities delivered savings in the order of 10–15 percent, followed by a further 20–30 percent when the Private Finance Initiative was introduced, allowing private firms to bid for the design, construction and financing of facilities, as well as for their operation.

System Effects

One of the expected benefits of introducing competition into a public service system is an improvement in the efficiency of the system overall, as public providers seek to retain services that have been or might in the future be contested, as public sector organisations respond to the pressure of being benchmarked against alternative providers, and as lessons are learned and disseminated across the system as a whole.

Some US studies have sought to explore the possibility of system effects, comparing the overall costs of jurisdictions that rely heavily on competition, with those that do not. Five studies have pursued this effect in local government services, and three in prison management. While most of these studies have found significant correlations between contestability and system-wide costs, it has not been possible to establish whether there is a causal relationship.¹⁰ (It is possible that governments that are in financial crisis and thus needing to constrain expenditure, use competition and contracting along with many other tools, or that governments that had already adopted a fiscally conservative policy were also more inclined to use competition and contracting.)

However, there is strong anecdotal evidence of this effect. In the UK, public officials have commented on the benefits that prison contracting had for the system as a whole. In his 2001 report for government on offender management, Patrick Carter (now Lord Carter), wrote:

It is widely accepted, by management and unions alike, that the competition offered by the new private prisons and the market testing of existing establishments has made the prison system more efficient and effective as the public sector has sought ways to improve its working practices and become more competitive.¹¹

And although opposed to privately-managed prisons, the president of the Prison Governors' Association acknowledged that 'despite my moral objections to placing prisons in private hands, I have to admit that the shock to the service of privatisation did start it on a path to recovery'.¹²

2.2 Service Improvement

There is much less evidence on the value of competition and contracting in improving service quality, for several reasons: for the most part, governments have not used it for this purpose, most often using competition to drive through cost savings; and it is also much more difficult to measure qualitative change, so that much less effort has been spent in grappling with this question. However, there are two market sectors in the UK where some research has been done, and from which conclusions might be drawn about how competition and contracting might be used to improve the quality of public services.

Local Education Authorities

In 1999, the UK government launched a comprehensive programme of auditing Local Education Authorities (LEAs), the unit of local government with direct responsibility for local schooling. From the outset, the national government made it clear that it would intervene in LEAs that were identified as failing, and proved themselves over time to be incapable of self-improvement.

Twenty LEAs were subsequently identified as 'failing', and nine of these were opened up to competition from the private sector and contracts subsequently awarded. In this case, the contracts were explicitly directed to the improvement of educational performance, and while savings were achieved in at least some of the outsourced LEAs, the primary objective was service improvement, and in some of the contracts, some of the remuneration was based on an improvement in educational performance by students.

A study by the Confederation of British Industry in 2005, found that between 2000 and 2004, the nine LEAs that were contracted to the private sector had improved more than the average of all LEAs in England. They had also improved more than the average of the 11 failing LEAs that had relied on internal intervention. And they had improved by more than the LEAs that had similarly low levels of educational attainment in 2000.¹³

Prisons

Public prisons in the UK were first opened up to competition from the private sector in 1989, and over the next five years, four newly-constructed facilities were contracted to private companies. From 1993, the government resolved to use the Private Finance Initiative (PFI) – similar to Public Private Partnerships (PPPs) in Australia – to commission the design, construction, financing and management of new prisons from the private sector.

As noted elsewhere in this submission, the privately-managed prisons have been significantly less costly than the public sector. However, when this market was originally designed, the government elected to demand higher standards of the private sector, particularly in relation to hours spent out of cell, and hours of purposeful activity. In this regard, it was heavily influenced by the recently-published Woolf Report into riots in a prison in Manchester, which had made strong recommendations about the quality of relationships between prison officers and prisoners.

As a result, prison contracting in the UK has been strongly associated with an improvement in prison standards, and Ministers and senior civil servants, as well as the Inspector-General of Prisons, have acknowledged the role that competition and contracting played in delivering the government's so-called 'decency agenda.'¹⁴

Research among inmates in public and contract prisons has confirmed these conclusions. In a 2002 survey of prisons in five UK prisons on the quality of prison life, the one contract prison strongly outperformed the public sector facilities on all five 'relationship' measures (respect, humanity, support, relationships and trust), and matched or outperformed the others on 'regime' measures (fairness, order, safety, wellbeing, prison development, family development and decency).¹⁵

A more recent academic survey has concluded that 'the most significant difference that distinguishes public from privately managed prisons is the relationship between staff and prisoners' – 'many (although not all) private prisons significantly outperform traditional public sector prisons in the areas of staff attitudes, and levels of fairness, respect and humanity towards prisoners'.¹⁶

2.3 Risk Transfer

One of the most powerful explanations as to why governments have turned to the private sector is to be found in risk management. In the past, governments relied heavily on private firms because, at various times, they were better positioned to manage technological, market, financing or operational risk. When these risks were low, governments were prepared to undertake these services themselves.¹⁷

Over the past decade, one particular form of public sector procurement – public private partnerships, involving private sector design, construction, financing and maintenance or operation – has received a great deal of attention around the world in recent years. In large part, this has been because of its effectiveness in transferring the risk of delivering on-time and on-budget.

Until recently, the best quantitative study of this effect was one commissioned by Her Majesty's Treasury from Mott MacDonald, which was published in 2002.¹⁸ However, the methodology of this study has been strongly criticised.¹⁹

One of the greatest difficulties in undertaking studies of this kind lies in good quality data concerning the performance of government construction using traditional procurement regimes. In the UK prisons sector, however, there was high quality data because of a NAO[‡] study of a major programme of construction undertaken by HM Prison Service several years before the introduction of the Private Finance Initiative.

- Of the seven traditionally-built prisons, not one was completed on time, with an average overrun of 13 percent; of the first seven PFI prisons, all were ready at or before the date specified in the contract.
- On average, construction costs of the seven traditionally-built prisons exceeded estimated costs by 18 percent. By definition, none of the PFI prisons cost the government more (since that is a condition of a PFI/PPP contract).
- Under PFI, construction times fell by 40% compared with the seven traditionally-built prisons.
- Over the first three years of PFI, total costs of operating a PFI prison fell by around 40 percent.²⁰

Two of the more significant studies on on-time/on-budget delivery of PFI/PPP projects have recently been published in Australia. In 2007, the Allen Consulting Group undertook a study of 21 PPP projects and 33 traditional projects, and concluded:

- Traditional projects were found to have cost overruns of 11.6 percent, while the extra costs of the PPP projects amounted to only 1.2 percent;
- On a time-weighted basis, traditional projects averaged a 23.5 percent time overrun, while the PPP projects were, on average, slightly ahead of time.²¹

Associate Professor Colin Duffield at the University of Melbourne has recently published another study, of 25 PPP projects and 42 traditional ones.

- PPP projects had an average cost escalation post-contract execution of 4.3 percent, compared with an average of 18 percent for the traditional projects;

[‡] National Audit Office.

- Once PPP projects reached financial close, there was on average, a 2.6 percent delay, compared with 25.9 percent during the construction phase for traditional projects.²²

It is now generally recognised that with most public services, commissioners cannot shift the ultimate risk of delivery. If a service fails to deliver what the public expects, then politicians and public officials will be held to account by the parliament, the media and the public at large. This does not mean, however, that it is not possible to shift a great deal of performance risk, and if supervised well, contracting can offer a much more effective way of managing the ultimate risk of delivery. PFI/PPP contracts are a good example of how this can be done.

2.4 Increased Accountability

In other cases, the evidence of the benefits of competition and contracting is anecdotal rather than statistical. Enhanced accountability is an example of this. Successful competition and contracting are built on the principles of performance management – specification of key performance indicators, ongoing monitoring of results, financial and reputational penalties for under-performance, and periodic rebidding (or formal benchmarking) of the service or activity.

Unsurprisingly, this has resulted in a great deal more transparency in certain aspects of public service management. Indeed, one of the greatest difficulties in comparing the relative performance of contractors and direct service organisations lies in the lack of comparable data about traditional forms of delivery. The 2007 Allen Consulting study of Australian PPP projects concluded: 'Rich data was obtained for the majority of completed PPP projects, but the availability of data for traditional projects was limited.'²³

Private contractors are usually subject to industry regulation and liable to prosecution for breaches of laws dealing with occupational, health and environmental protection, whereas in the past, traditional public sector organisations were often immune (on the assumption that such concerns could be managed through internal administrative systems). There is considerable evidence, historical and contemporary, that legislators, regulators, judges and juries are prepared to impose liabilities on private contractors that they are reluctant to extend to public services managed by government itself.

The Railways: An Historical Case Study

While the coming of the railways was welcomed as a breakthrough in mass transportation, the scale of death and injury associated with major rail accidents was deeply shocking to the public mind. Starting in the 1830s, British courts and the legislature progressively expanded corporate liability in a way that they had not been prepared to do with traditional and public transportation modes.

Between 1830 and 1847, there are only two railway negligence cases recorded in the law reports. Then in 1846, Lord Campbell's Act was introduced, allowing victims' relatives to sue. There followed an explosion in litigation, with individual awards soaring to new heights – from £4,000 in 1851 to £13,000 in 1860. In major accidents, the total cost became exorbitant – a payout of £11,000 for an accident in 1848 increased to £70,000 in 1870. Individual companies were paying up to two percent of their revenues, and yet in spite of warnings that some company would be destroyed by the financial costs of a serious accident, none ever was.

Judges and politicians actively pushed out the boundaries of the law in a number of ways: extension of vicarious liability; reversal of the onus of proof; resurrection of a medieval doctrine allowing a right of action by the relatives of a deceased person, followed by Lord Campbell's Act; and expanded liability for rights of way so that companies were responsible for the construction of embankments.

Significantly, the courts and the legislature were not prepared to extend the liability of local government for road maintenance at the same time. In 1868, more people were killed and injured on the streets of London than in accidents on the railways, and yet the Chief Justice admitted that street accidents were seldom litigated.²⁴

Contract Prisons: A Contemporary Case Study

In 1997, in a 5:4 decision, the US Supreme Court decided in *Richardson v McKnight* that prison guards employed by private contractors were not entitled to the same kind of qualified immunity enjoyed by state employees when sued by inmates under the Civil Rights Act.²⁵

The case involved two prison officers employed by Corrections Corporation of America in a Tennessee prison. An inmate sued, arguing that they had violated his Eighth Amendment right to be free from cruel and unusual punishment. The court concluded that there was nothing in the history of the common law, nor in the purposes of qualified immunity which justified the extension of the doctrine to private prison guards. While it was in the public interest for prison officers to take decisive action, this was of greater relevance to public employees than to the employees of private contractors where there was a competitive market.

The minority of the court applied a 'functional' analysis, considering the nature of the public function performed by the employee. On this basis, they concluded that private prison officers would be inhibited in the performance of their duties if not protected by qualified immunity. Legal scholars were inclined to support this position rather than the majority.

(In 2001, in another narrow decision, the Supreme Court declined to extend this doctrine to include the prison officers' corporate employers. In *Correctional Service Corporation v Malesko*, an inmate of a half-way house managed under contract, sued the corporation when an officer refused Malesko, who had a heart condition, access to an elevator. Malesko had a heart attack and fell when he was forced to use the stairs to get to his room. Such actions could only be brought against individuals. Justice Rehnquist commented that 'Whether it makes sense to impose asymmetrical liability costs on private prison facilities alone is a question for Congress, not us, to decide.'²⁶)

Some critics have argued that the defence of 'commercial-in-confidence' is sometimes raised to protect public service contracts from effective scrutiny. Of course, there are certain aspects of such contracts that do require confidentiality at certain times (particularly during bidding and negotiation), however, we agree that this argument has sometimes been given undue recognition.

There are sometimes systemic benefits from the performance management culture associated with public service contracting. In the case of the British Prison Service, for example, the government used the performance management regime developed for prison contractors as the basis for a 'weighted scorecard' comparing the performance of all correctional facilities in England and Wales.

2.5 Strengthening Core Services

Lord Robertson, the former Secretary General of NATO, has claimed that of the 2.5 million military personnel across Europe, only around two to three percent can be deployed at any one time. To some extent this is because these front-line personnel lack the logistical support necessary to keep them in the field. Competition and contracting have been actively used in military support, in part because of a desire to increase the number of uniformed personnel capable of being deployed on front-line duties – the so-called 'tooth-to-tail ratio'.

Exactly the same problem occurs in policing – highly-trained police officers waste hours each day grappling with paperwork, and with increased accountability, the challenge has become even greater. The growing complexity of support functions had added to this problem – instead of recruiting professional facilities managers or IT specialists, police forces have continued to employ men and women who have been trained for law enforcement to undertake these roles. It is for these reasons that civilians (including contractors) have been increasingly used to deliver support to the police.

Prisoner transportation provides a well-documented example of this approach. A study by the Scottish Prison Service in December 2006 concluded that the centralisation and contracting of prisoner escorting had released about 300 police officers and 200 prison officers to undertake core duties.²⁷

2.6 Enhanced Capacity

Some public services are inherently peaky, and it is not in government's interest to employ all of the staff necessary to deliver service levels at the height of demand. Military services are a classic example, which is why governments draw heavily on reservists in time of war and the private sector in support and logistics. In the UK, the Ministry of Defence speaks of using defence support contractors to provide 'surge capacity'; the Pentagon uses the term 'contingency contracting'.

In Australia, the Commercial Support Programme, initiated by the federal government in the 1990s, when Kim Beazley was Minister for Defence, was explicitly built on a policy of building civilian capability to support the military in preparation for possible future conflicts.

In Japan, one of the primary drivers of private sector involvement in prison management has been a legislative ceiling on the number of uniformed prison guards (who, by law, must be state employees). In that case, the use of the private sector to provide support services (including social services and perimeter security) has enabled government to expand its prison estate to address overcrowding without breaching this ceiling.

2.7 Enhanced Capability

In some cases, governments have elected to use contractors as a means of accessing specialised capabilities that it does not need to possess in-house. Information technology (and the associated support services) is perhaps the most obvious example of this phenomenon. Given the highly technical nature of these services, the substantial commercial risks and the high mobility of staff, there are few reasons why government agencies should deliver these services in-house.

2.8 Stimulating Innovation

The incremental nature of service innovation makes it extremely difficult to study, although the fact that large savings are being delivered as a result of competition and contracting suggests that significant innovation must be taking place. It is most obvious where major technological breakthroughs are involved – the introduction of membrane technology in the treatment of public water supplies is an example.

The Serco Institute has undertaken research into the origins of the prisons market in the United Kingdom, where there is evidence of significant innovation. As the case study below illustrates, innovation and the transfer of international best practice occurred because politicians and public officials asked for it.

Innovation in Prison Management in the UK

In the 1970s, the US Federal Bureau of Prisons had introduced unit management – a more decentralised form of managing prisoners in housing clusters – and direct supervision – which required prison officers to interact much more closely with inmates rather than looking in from isolated control rooms. In part, this was a revolution in prison design, with smaller units, softer furnishings, brighter colours and open association areas.

The UK government was able to replicate these designs in a new generation of prisons that were designed and constructed throughout the 1980s. However, they faced strong resistance to the introduction of the associated regime changes that would have required prison officers to work and eat among the prisoners, and interact with them on a more personal basis. The prison unions adopted a highly conservative stance, refusing to cooperate in these reforms, even following the major changes recommended by the Woolf Report into riots at Strangeways Prison in 1990.

The decision to contract several of these new generation of prisons provided commissioners with an opportunity to introduce direct supervision in these facilities overnight. The early prison contractors drew on North American expertise in developing their solutions, either through joint ventures, or by involving architects and prison managers in their teams.

As a result, the first privately-managed prison in the UK, HMP Wolds, drew heavily on these North American innovations in regime. As a condition of the contract, prisoners were out of their cells for around 14 hours a day (compared with much lower levels in existing facilities). Prison officers spent their working day amongst prisoners in large association spaces, even eating their meals with prisoners. They wore softer, non-military uniforms, and name tags. They called prisoners by their first names. And, as a result of a non-discriminatory recruitment policy, when the prison opened, around one third of the prison officers were female (compared with an average of around three percent across the rest of the prison estate).

The difference in regime was immediately noticed amongst prisoners themselves, with a number of them writing to newspapers condemning the armchair critics. It was also favourably written up by the Chief Inspector of Prisons and a detailed academic study.²⁸ In his second report on the prison in 1998, the Chief Inspector wrote:

‘ . . . the undoubted success of Wolds represents a threat not so much to the employment of individuals within the Prison Service but to what many refer to as the Prison Service’ culture’ regarding the treatment and conditions of prisoners. Many prisoners, with long experience of time served in many public sector prisons over many years, described to me and my team the cultural shock that they had experienced, stepping out of the usual escort van bringing them from court, into a spotlessly clean reception area, where they were treated as human beings by firm, fair and friendly staff.

'This staff style was evident not just in reception but throughout the whole prison, and I believe that it is a major contributor to the remarkable absence of tension that one experiences walking around, the low level of drugs, and the general feeling that rehabilitation really is an achievable aim for all except for the most intransigent.'²⁹

This outcome was all the more remarkable, given that operating costs for The Wolds were around five percent below those of comparator prisons.³⁰

It should be noted that the privately-managed prisons in North America do not rely on direct supervision to the same extent. The conditions that stimulated innovation in regime were unique to the United Kingdom, and much of the credit belongs to the Ministers and civil servants who grasped the opportunity available to them with the introduction of competition and contracting.

However, as noted above, innovation in commissioned markets is often constrained by the conservatism of public officials undertaking the commissioning. Under alternative models, radical innovations in public service delivery have sometimes emerged in the past. Most of the examples are historical since throughout the 20th century, governments dominated the field.

Private Innovation in Public Services

In Britain, ocean rescue was pioneered by a private charity that developed into the Royal National Lifeboat Institution, which still dominates the field without any financial assistance from government. Britain's first civilian ambulance service was created by St John's, in the face of professional hostility and political indifference. And the concept of probation originated with the London Police Court Missionaries established in the 1870s by the Temperance Society.

In Denmark, where the majority of fire and ambulance services are delivered by Falck, a private, for-profit provider (and have been for almost 90 years), a very different model has been created for delivering emergency services – one that integrates fire protection, ambulance services, roadside recovery and ocean rescue. Falck's motto is 'Always there'.

The 'riverkeeper' programme in the United States, which monitors water quality and prosecutes polluters, was a private initiative of New York environmentalists supported by law students and funds awarded by the courts following successful prosecutions.³¹

With established public services, government must remain firmly in control, and the challenge lies in how to encourage innovation within a contractual environment. This question is addressed at greater length in Section 4, but to a considerable extent, the answer lies in the specification of outcomes and high-level outputs, rather than insisting on the delivery of detailed inputs.

On the other hand, the creation of a mixed economy – with public, private and voluntary sector providers competing to provide public services in their own right but also coming together in joint ventures – opens the possibility of a different form of innovation. The UK is already seeing the emergence of complex public-private, private-voluntary, public-voluntary and public-private-voluntary hybrids, some of which may have greater strength and resilience than any of the traditional structures on their own.

One recent example of this is the public-private joint venture between Serco Group plc and Guys and St Thomas' NHS Foundation Trust in London, aimed at improving the Trust's pathology services and selling those services into the national and international market. The 50:50 joint venture brings together Serco's commercial and management expertise with the technical capabilities and international brand of Guys and St Thomas' Hospital.

3. How Do Competition and Contracting Work?

Does competition in public services result in real productivity savings or does it deliver lower costs only because it drives down workers' term and conditions? If competition does result in productivity improvement, how does it do that? How important is the contractual relationship or could these same benefits be captured through less formal relationships between commissioning and delivery agents? What difference does the involvement of private for-profit providers make?

Regrettably, there has been far too little study of these questions. In part, this is because a lack of funds to conduct independent assessment. In part, it is for reasons of commercial confidentiality – private firms are reluctant to expose their business processes to the scrutiny of their competitors. But in large part, the problem arises from the incremental nature of innovation in the service sector. Improvement tends to take place through a hundred process initiatives, rather than one major technological breakthrough.

Moreover, there is no consistent pattern to these reforms across the different services and sectors. A solution that works in one service may not be appropriate to another, so that in some cases, contractors rely to a much greater extent on multi-skilling their workforce, while in others they rely more on specialisation.

The following comment, from a review of US federal government outsourcing in the 1980s, provides a convenient summary of the diverse range of possibilities:

The techniques commonly cited for reducing costs of internal production through management reviews include the following: consolidation of functions to realize economies of scale or scope in equipment and supervision, obtaining updated equipment and utilizing improved production techniques, reorganising the structure of production and rationalizing operating procedures, increasing use of incentive pay systems where possible, and re-evaluating the grades of positions to utilize the lowest grade personnel capable of doing the job.³²

Capturing the changes taking place through competition and contracting proves to be challenging. The following discussion draws on a variety of different sources in an attempt to provide some insight.

3.1 The Drivers of Change

While there are obviously synergies between competition, contracting and commercialisation, our research suggests that each of these three factors makes a somewhat different contribution to productivity improvement.

Competition and contestability

It is well understood that in markets for consumer goods, competition forces suppliers to respond to and, indeed, to anticipate the needs of their customers. Competitions perform the same role in the public sector – an open tendering process demands that competing providers develop innovative solutions in a competitive environment, where each bid team knows that other highly experienced teams are at the same moment in time developing alternative solutions to the very same set of requirements.

In the case of public service contracting, where competing providers are responding to a common ‘statement of requirement’ issued by public sector commissioners, the tendering process is also a period of intense research and development, as bid teams bring together existing technologies, processes and capabilities in new and innovative ways.

Finally, as discussed at greater length in Section 3.2, the fact of having won a competition against alternative providers gives the management team a powerful mandate to introduce change throughout the organisation.

It may not be necessary for the contract to be won by an independent provider (private or voluntary sector) for competition to make a significant contribution to public service improvement. The available evidence seems to suggest that many of the benefits are delivered through competition rather than privatisation: ‘Public versus private matters, but competitive versus non-competitive usually matters more.’³³

Indeed, some of the benefits of competition can be secured through contestability, that is, the credible threat of competition. The NSW government was able to deliver significant productivity gains from three ‘Way Forward’ prisons, where workforce negotiations on issues such as overtime and sick leave took place under the threat of competition. The Public Accounts Committee reported significant improvements in productivity.³⁴ However, there is an important qualification to contestability – the threat must remain credible. In NSW, the government has announced its intention to market test two existing prisons, in part because the threat was no longer believable.

Contracting

Whilst often linked to competition in the reform of public services, contracting does somewhat different work, and in theory it might be possible to secure some of these benefits without exposing services to external competition. (In practice, the fact of having won a competitive tender may give the contract much of its authority as a 'constitutional' document.)

The Serco Institute's work in this field is based on a study undertaken in 2004 and 2005 with contract managers who had previously supervised the delivery of a similar service within the public sector. This began with a scoping study with 13 contract managers with a public sector background, and was followed by an anonymous, quantitative survey of 151 contract managers, 96 from the public sector and 55 with a private sector background. In the case of the former, these were the same people, managing the same jobs, but in two very different organisational environments.³⁵

Respondents told us that they had more autonomy and they felt more personally accountable under contract. In essence, the fact of winning a competitive tender and then negotiating and signing a formal contract created space within which the manager was permitted to manage. The contract served as a shield, and this 'contractual shield' mattered because it gave them greater scope for innovation, and the authority to respond quickly to new challenges as they arose. They were also able to build their own management team, hiring was quicker and easier, and management was much more personal.

In October 2007, the Confederation of British Industry's *Business Voice* magazine interviewed Vicki O'Dea, the director of HMP Ashfield, a prison and young offender institution managed by Serco.

Betraying scant nostalgia for her 19 years in the Prison Service, she says that she finds working for a private company 'liberating'. 'Don't get me wrong, there is a lot that's good about the public service: staff training and development, race relations, offending behaviour programmes. And it does teach you to use your resources well, human or otherwise. But everything is made so difficult. If you need something, you spend time writing a business plan, persuading the area manager, and so on. Now, I just go and buy it.'

At first, such spontaneity seemed odd. O'Dea recalls a seminal moment soon after her arrival when she was showing around a Serco board member and mentioned how she'd love to soften the staff uniform. 'Why don't you?' he asked. 'Only then did it sink in that I no longer had to consult the Prison Service,' says O'Dea, whose hands-on senior managers also now wear the uniform.³⁶

In the UK, a number of official inquiries have commented on the inefficiencies generated by ongoing political intervention in service delivery, and the continuous stream of detailed instructions and demands from officials in head office.³⁷ Contracting demands that policymakers make a clear decision about their desired outcomes from a service, and then to step back to allow room for providers to deliver. While there may still be need to address urgent and unexpected issues, with a contractual shield, the opportunity to intervene on a daily basis is considerably circumscribed. Managers are free to manage.

Under a contract, accountability was also sharpened and in part this was because the contract served as a shield. Accountability within the traditional public sector model was described as being somewhat like a layer-cake:

It's significantly more challenging in the private sector, and you can't hide behind anything. . . whereas, I think in the [public sector], you're just one of the many layers and it's very easy to blame the layer above you or the layer below.³⁸

By contrast, a contract was relatively self-contained, like a balloon, with only one way in or out – through the contract manager. As a result, the contract managers reported that they felt much more personally accountable.

Another important source of transparency lay in the existence of key performance indicators, with associated financial rewards and penalties. Some of the respondents reported that while the performance measures were virtually identical to those that they had used in the public sector, there were direct financial consequences for the failure to perform. This meant that managers needed to understand what was driving performance so that they could implement remedial change. As two of our respondents said: 'It means you really know your business'.

Because the management information systems are far superior in this [contract] than any other [comparable service] in the public sector, I have far more information about the performance of what is going on, so if I do want to put some time and energy into focusing on one specific area I know exactly where to look.³⁹

Commercialisation

There are several additional benefits that may come from engaging private firms. International public service companies may have a greater capacity to transfer best practice from one country to another. As noted above, in the early history of the prisons market in Australia and the UK, North American firms played a significant role – both prison management corporations and smaller firms specialising in innovative design. In more recent years, British prison management companies have played an important role in the dissemination of

best practice from the UK to Japan, Germany, South Africa and Australia, and more recently, from Australia back to the UK.

Corporations also offer economies of scale, with competition and contracting assisting in the search for the most efficient level of organisation. Organisational economists have described the process of acquisition and divestment that takes place in capital markets, and the contracting out and in-sourcing that occurs within organisations, as part of an ongoing search for the most efficient scale and scope. In the private sector, a great deal is invested in this search, and contracting is one of the few tools available to the public sector that imitates this process. Corporations are fundamental in this search for 'efficient boundaries'.⁴⁰

Companies also offer government the ability to scale up innovations without assuming the risk of introducing a new innovation at the same time across the system as a whole. A number of writers have commented on the difficulty that the public sector has in scaling up effective innovations.

The history of efforts to replicate, sustain, and scale up from effective programs is dismal. . . Scaling up effective services requires conditions that are still exceedingly rare.

That is why effective programs have flourished only under some sort of protective bubble, outside or at the margins of large public systems. Protective bubbles can be created by foundation funding, by a powerful political figure, by a leader who is a wizard, by promises that the effort will be limited in scale and time, or by some combination of all of these. The problems arise when the successful pilot program is to expand and thereby threatens the basic political and bureaucratic arrangements that have held sway over decades.⁴¹

In our submission, the existence of two or more providers (public or private) within a system of public administration, means that there is an intermediate structure that can assume the responsibility for scaling up without compromising or challenging the system overall.

Finally, there are benefits associated with employing an organisation with a brand name, and possessing stakeholders with a commercial stake in the reputation of that brand. In the UK, prison contractors are held to account both through their profit and loss statement (that is, through financial penalties for non-performance) and through the share price (as the Chief Inspector of Prisons delivers public reports on the performance of individual establishments). It is difficult to replicate this particular discipline in organisations that are wholly government-owned.

3.2 A Fresh Start

At least some of the benefits of competition and contracting seem to come from the opportunity that they provide for an organisation to press the reset button and make a 'fresh start' with a service that is performing poorly or just coasting. In this sense, competition and contracting appears to be a successful example of 'zero-base budgeting' which was pursued, largely unsuccessfully, in the 1980s.

One study suggested that in prisons, which tend to be extremely conservative institutions, change is faster 'when sufficient numbers of new staff are transferred en masse from the training college or from another establishment'.⁴² This may be one of the reasons why competition and contracting seem to deliver transformation in organisational performance and culture.

In Australia and the UK, prison management companies elected to recruit their custodial staff in the local community, rather than drawing on professional prison guards from the public sector. This enabled them to introduce a radically different culture into the contract prisons from the outset, one that was immediately identified by prison inmates. Prisoners in privately-managed prisons referred to the public facilities as 'POA prisons', an allusion to the prison officers' union which had strongly opposed managerial and cultural reform. Indeed, one prisoner spoke of the 'humanistic change' that accompanied the introduction of prison contracting as 'Maggie Thatcher's fresh start'.⁴³

Diversification and Selection

Some of the benefits may also come from introducing heterogeneity into the system. Some organisational theorists have argued that a modest level of personnel turnover in a system, involving the introduction of participants who are not as deeply socialised with prevailing norms, has the effect of increasing exploration and improving aggregate knowledge. From this perspective, it may matter less that the new entrants are experts in the field than that they bring a different perspective. The gains to the system come from their diversity.⁴⁴

There is some evidence that such a process may have been at work in the UK prison sector in the late 1980s and early 1990s. Experienced (i.e. well-socialised) prison administrators took the view that it was unwise to encourage close association between prisoners and prison officers, opposing suggestions that prison officers wear name tags and call prisoners by their first names. It was widely believed that it would be unwise to introduce significant numbers of female prison officers into male prisons.

Prison management companies introduced each of these reforms from the beginning, contributing to a radical transformation in prison culture, many of which have since been adopted more broadly by the Prison Service.⁴⁵

A 1985 Rand study into the US federal government's A-76 program found that private contractors won competitive tenders more often than in-house teams. In trying to determine why this was so, Rand focused (among other things) on the ability of contractors to design a solution tailored to the task as described in the statement of work (SOW), rather than being influenced by traditional work practices (as in-house teams often did).

For example, at two bases we were told that government employees often do poorly in bidding because they tend to bid on the task of maintenance as they have always done it, whereas contractors bid on the task as it is described in the SOW. The task described in the SOW generally requires less work than government employees understand to be customary for vehicle fleet maintenance. As a result, government employees bid to do more work than do contractors, at a consequently higher price than the contractors bid. . . In addition, it is difficult for government managers to drastically rethink the staffing requirements they have been using for years. In many cases, this will mean loss of jobs for highly valued employees. Finally, although the designers of performance work statements talk in terms of 'throwing away the rule book' when preparing bids, long-time government employees are sceptical that this can be done with impunity.⁴⁶

In some cases, the in-house team may be constrained by instructions from senior management, who are themselves influenced by past practice. For example, in a hospital cleaning contract in the UK in the late 1980s:

The in-house tender team was advised by Management Services on the standard hours needed to clean the hospital, which were derived from Whitley [industrial] agreements. The Domestic Manager was concerned at the high number of hours included and argued it would be difficult to win the contract on this total. He was unable to overrule Management Services so as to reduce the total number of hours.⁴⁷

Mandate for Change

Under market-testing, even where the in-house provider wins the contract, the fact that the management team has secured (or refreshed) its right to manage following a competitive process, bestows upon it a mandate for change. This may give managers the authority to renegotiate the implicit terms and conditions that tend to accumulate over time in mature organisations through a process of accretion.

Organizational theorists speak of 'psychological contracts' in employment relationships, defined as 'a series of mutual expectations of which the parties to the relationship may not themselves be even dimly aware but which nonetheless

govern their relationship to each other'. These expectations are largely implicit and usually develop outside the formal employment relationship.⁴⁸

Psychological contracts are essential to the effective working of a complex organisation – the written contract of employment is simply too cumbersome to allow management and staff to adapt to changing circumstances day to day. However, if they are not periodically reviewed, they can also result in organisational sclerosis, and management may find itself incapable of refreshing the organisational structure and culture over time.

In Adelaide, the public transport authority, TransAdelaide, began to develop scheduling and rostering software for bus services in the early 1980s, but relatively few efficiency savings were obtained because of union awards (which assigned more favourable routes to staff with seniority), but also because of 'custom and practice' which locked in traditional approaches to scheduling. It was not until bus services were competed a decade later that private firms were able to rethink bus schedules and the supporting rosters and negotiate with the unions for more flexible arrangements.

Requirement Redesign

Competitive tendering requires the commissioning agency to prepare a detailed statement of requirement, which has the effect of focussing attention on the purpose, and the scale and scope of the service in question. In some cases, this is associated with a shift from process to a performance culture. In its 2001 report on Public Private Partnerships, the British centre-left think-tank, the Institute for Public Policy Research wrote:

A major potential benefit of PPPs is that they can help government to focus more clearly on the services people want, rather than simply managing existing forms of service delivery. . . . Public managers often comment that attempting to specify the nature of a planned service formally is a challenging experience – forcing out in the open issues which would otherwise remain hidden. This is an indication that the commissioning process can prove a highly effective way of concentrating minds on how to shape services to improve outcomes.⁴⁹

3.3 Management Reform

It is also useful to understand some of the management reforms that successful contractors undertake in order to deliver better value-for-money. As noted above, this is often difficult to study, because service improvement tends to be both diverse and iterative. Nevertheless, there have been some studies over the years that throw light on this issue.

Restructuring the Task

Multi-skilling or specialisation: Multi-skilling has been a significant factor in cost savings by contractors where multiple functions have been let to tender as part of a package. This is an example of reform through the exploitation of economies of scope.

However, this is not the whole story: sometimes providers find it better value to specialise. A study for the US Department of Housing and Urban Development (HUD) in the early 1980s found that private contractors in Los Angeles municipal government were 20 percent more likely to give workers specialised assignments.⁵⁰

Scheduling: Some contractors appear to have greater flexibility in the scheduling of labour and services, which better enables them to optimise the use of resources in the delivery of services. In UK local government, in-house teams and private contractors introduced annual hours agreements in grounds maintenance, so that the working week was longer during the summer months and less during winter, including a compulsory two-week holiday at Christmas.⁵¹

In other areas, government agencies have acquired reduced flexibility because of government policies introduced without reference to their efficiency implications. In the United States in the early 1980s, contract cleaners employed by the General Services Administration (GSA) were found to be considerably more productive than in-house staff. This was in part because in-house cleaners were mostly required to clean during the day, while contract cleaners largely worked at night. The GSA had converted to day cleaning in 1973 as part of the energy conservation measures introduced following the first oil crisis. No work had ever been done to determine whether these efficiency losses had been compensated by the energy savings.⁵²

A 1985 Rand study of vehicle maintenance contracting in the US Air Force found that contractors were better able to schedule repair work (and thus organise workers more efficiently) than in-house teams, who complained that they were

obliged to repair vehicles immediately. There was no reason why private contractors should enjoy additional flexibility under the Statements of Work, but it was possible that the arms-length relationship created by the contracting process led to more reasonable demands.⁵³

Overgrading: There is some evidence to suggest that wage levels fall under contracting because some public employees are overqualified for the work they are performing. A 1984 study by the US Office of Personnel Management found that 14 percent of all federal workers were overgraded.⁵⁴ A 1984 study of base support contracting for the US Department of Defense reported that ‘In most instances, this action was taken after in-house management engineers had conducted a thorough analysis of the work performed and determined that some positions were graded at a higher level than required.’⁵⁵

Age profile: Some US research has also pointed to contractors having a slightly younger workforce profile than in-house service providers.⁵⁶ One of the benefits of a younger workforce is that they have fewer accumulated fringe benefits.

Turnover rates: Overgrading and a skewed age profile may arise from a low turnover rate. In the UK, privately-managed prisons tend to have a much younger workforce and a much higher turnover rate. In some cases, turnover rates have been too high, although it is generally recognised that turnover rates in the Prison Service have been exceptionally low. To a large extent, this is because contractors are recruiting in a different part of the labour market – they have tended to recruit young people who are using this position as a step on the path to a professional career, whilst prison officers in the public sector see it as a permanent position. This appears to be one of the reasons why the unit costs in privately-managed prisons are significantly lower than in publicly-managed facilities.⁵⁷

Uniform-civilian mix: Defence agencies and police forces have been able to reduce costs by altering the mix of uniformed and civilian personnel. In the US, the Center for Naval Analyses (CNA) and the General Accounting Office (as it then was) found that the highest percentage cost savings came from competing activities done by military personnel. The CNA reported that changing the mix through competition resulted in average savings of 50 percent.⁵⁸ The Australian Department of Defence estimated that the cost of employing a civilian was 30 to 40 percent less than that of employing a member of the air force with comparable skill.⁵⁹

A similar process of civilianisation and contractorisation has taken place in the UK policing sector over the past decade, and for much the same reasons.⁶⁰

Part-time work: Contractors seem to rely on part-time workers more often where the task profile does not require full-time staff.⁶¹ Likewise, in the early stages of compulsory competitive tendering (CCT) in UK local government in the 1980s, competition was seen as having increased the casualisation of public sector work, even when the in-house team won the contract: 'There is greater use of casual staff to cope with peaks and troughs. The conditions of existing staff have partly been casualised by reducing hours and reducing the number of weeks worked per year. . . The tendency is towards a core staff, with others recruited as and when needed.'⁶²

Overtime: Private contractors and successful in-house teams tend to rely much less on overtime. For example, in the UK, privately-managed public prisons have had overtime levels half that of their public sector comparators. Reduction in overtime seems to have been a significant feature of the 1980s tendering in the NHS and local government.⁶³ However, not even this pattern can be regarded as absolute: a 1984 study commissioned by the US Department of Defense, based on 14 case studies, found that contractors were relying much more on overtime 'to allow for reductions in manpower hours.'⁶⁴

Smarter Use of Technology

Innovation and intensification: The research suggests that bidders pay considerable attention to the scope for efficiencies from new technologies. An intensive study of contracting at the Trentham army base in New Zealand found that in warehouse operation, the contractor achieved significant efficiencies through the introduction of a new technology, in that case, carousels controlled by a computerised inventory management system.⁶⁵

Again, the evidence is by no means all one way. In general, the survey for HUD did not find greater use of capital equipment among low cost Los Angeles cities (although contractors were inclined to have more pieces of equipment).⁶⁶ In the case of asphalt overlay, however, contractors used more sophisticated technology, employed fewer, more experienced workers and paid them significantly more.⁶⁷

Standardisation: Contract street cleaners in cities in Los Angeles were found to rely on a more standardised vehicle fleet (of sweepers, flushers and so on) than municipal street cleaners (1.2 different types for contractors compared with 1.8 for the latter). 'The fewer different types of equipment, the more familiar vehicle operators and mechanics can be with the equipment on hand. Also, the number of different spare parts that must be kept on inventory is minimized.'⁶⁸

Economies of scale: In many cases, private firms can spread the costs of technical improvements across a number of clients. This can give them a significant advantage over local and provincial governments, which face legal and political obstacles to offering services outside their jurisdictions.

John D. Donahue gave the example of a US garbage contractor which 'undertakes joint ventures with equipment companies to improve the design of garbage trucks, an investment that would not be rational for any but the largest municipal sanitation departments, no matter how dedicated they were to cost control.'⁶⁹ When the French private water companies first entered the Australian market in the late 1980s, it was clear that they had invested much more deeply in research and development (particularly in membrane technology) than the state-owned water utilities.

Morale and Incentives

Sick leave: In the UK prisons sector, sick leave in the contract prisons was less than half that of their public sector comparators.⁷⁰ Similar differences have been observed in Australian prisons that have been opened to contestability. In the local government Direct Service Organisations (DSOs) that won contracts under the UK government's CCT programme, absence levels were brought down rapidly following competition 'and were frequently well below those for the rest of the authority.'⁷¹

Method of payment: The method of payment can act as an incentive or disincentive to better performance. For example, in the early 1980s, the UK Audit Commission found that the 'task and finish' payment scheme being used in refuse collection had become an obstacle to greater productivity. (Under 'task and finish' schemes, workers remuneration was based on the estimated time to complete a round.) This was because they had not been regularly reviewed and changes in routes had altered the workload over time.⁷²

Input versus output controls: In the USA in the early 1980s, the General Services Administration managed its cleaners through detailed input controls that were inconsistent with industry best practice available using new technology.

The corridor stripping procedures contained in GSA cleaning guidance require dust mopping of the corridor, application of a stripping solution, agitation of the solution with a floor scrubbing machine, and wet vacuum pickup of the agitated solution. A mop is then used to rinse the floor twice with clear, cold water. After the floor dries it is ready for the first of four coats of floor finish. The GSA production rate of 1,700 square feet for this procedure is based on performing each of these steps separately. Machines are available that will perform several steps simultaneously. . . at a production rate, depending on machine size, of between 22,300 square feet and 51,500 square feet per 8-hour day.⁷³

Contractor productivity was also constrained by a requirement that they furnish a minimum number of staff hours under each contract (fixed as a proportion of the GSA's internal staffing requirements). The objective of such a rule was quality assurance. The GAO acknowledged the need for quality controls but recommended measures that imposed fewer constraints on contractor innovation, such as pre-award surveys, inspections and the like.⁷⁴

Structural Reform

Alignment of authority and responsibility: A study of US cities in the 1980s reported that contractors were much more likely than municipal agencies to make front line supervisors responsible for hiring and firing and for the maintenance of their equipment. Contract managers also relied on less formal means of communicating with workers. When pairs of cities with similar profiles were compared, contractors were significantly less likely to have foremen responsible for crews at more than one site.⁷⁵ This study also contrasted high cost and low cost cities to compare management practices regardless of what organisational arrangement was used (regardless of whether they were managed under contract or in-house). As described in a later summary of this research:

Cities with low costs (either contract or in-house) tended to require that managers be responsible for availability of personnel and serviceability of equipment. Integrated responsibility apparently reduced the tendency to 'pass the buck' when support services or equipment are not delivered in a timely, efficient manner, or when sufficient work crews were not available.

Cities with high costs tended to release managers from many direct personnel supervision responsibilities such as hiring, firing, and assessing penalties for tardiness, thus making the managers less accountable for performance.

Cities providing a service through in-house production were more likely to fall into the high cost, less-accountability group of cities because the use of more formal and elaborate personnel procedures carried over from their inherently governmental functions

...

Cities with in-house agencies also tended to utilize a government-wide central equipment maintenance system with its own set of government managers. This may have further weakened accountability of the managers of individual government service agencies by removing equipment readiness from their control. In this regard, the HUD authors concluded that cost savings from economies of scale in the communities studied were less important in restraining costs than in delineating clear lines of authority and responsibility.

The few cities with in-house production that organized themselves to preserve management lines of responsibility were better able to provide equivalent services at costs much closer to those of contract cities.⁷⁶

Flatter structures: Contractors seem to give their managers and supervisors broader responsibility than uncontested public sector providers. Supervisors working for contract street cleaners in Los Angeles were found to have a significantly greater span of control (an average crew of 13.6) than those working for municipal street cleaners (6.86). This was also reflected in a flatter management structure (1.3 layers between street workers and contract head, compared with 1.9 layers between street workers and department head).⁷⁷ Municipal work teams also had more layers of management between the worker and the department head.⁷⁸

Work Intensification

In some cases, productivity improvements have been achieved by requiring employees to work harder. In one English local authority studied in the early 1990s, 'workloads were expanded and intensified. Cleaners became responsible for larger areas, as did grounds staff, while kitchen staff were required to meet the same demand with fewer hours. . . Employees who would not or could not accept new workloads were initially counselled but in the end many were disciplined and either encouraged to leave voluntarily or sacked.'⁷⁹

Meaningful productivity reforms will not rely heavily on work intensification, although there will be some circumstances where staff have not been appropriately managed in the past, and where such changes must occur.

4. Ensuring That Competition and Contracting Are Done Well

If competitive tendering, performance targets and financial rewards and penalties are capable of providing a powerful incentive for better value for money, then it follows that if the competition is poorly designed and managed, and if performance targets are poorly specified and monitored, then these tools may serve to motivate the wrong behaviours. Even more than with traditional ‘command and control tools’ of management, it matters that competition and contracting are done well.

We have explored this question in several ways – firstly by studying a number of prominent failures and seeing what lessons were to be learned, and secondly by drawing on academic studies and on Serco’s own experience to elucidate best practice.

4.1 Exemplary Failures

In 2008, the Serco Institute undertook a study of effective public service contracting for the Efficiency Unit of the Hong Kong Government. We chose to explore this question by studying some of the great disasters in public service contracting around the (English-speaking) world over the past two or three decades.

The Institute studied 49 different reports of these shipwrecks, published by legislative committees and auditors-general, some of which were themselves summaries of a number of other reports. (Among other case studies, these included the Australian federal government’s IT outsourcing initiative in the late 1990s and Sydney’s cross-city tunnel.)

Procurement Design

The success of government contracting is heavily influenced by the way in which services are originally procured. If the government fails to understand or properly specify its requirements, if it creates 'bid fever', so that the winning supplier offers an unsustainable price, if government selects the wrong partner, then it will be difficult to ensure that the contract succeeds over the course of its life.

- Public officials must avoid creating a 'winner's curse', where the winning supplier inevitably bids an unsustainable price. This tends to occur where price is the sole deciding factor and where competing firms have very different understandings of the service and the associated risks.
- The right balance must be struck between the autonomy of service-level commissioners and the need for coordination at the centre of government.
- In many disasters, failure is built into the project from the very beginning because the commissioner and the contractor are not clear about the desired outcome.
- Commissioners must understand how the services in question will be delivered by staff and accessed by end-users, particularly where major re-engineering of systems and processes is involved.
- One of the most frequent causes of failure in IT procurements lies in the temptation to be overambitious and re-engineer entire systems in a single programme. 'Build dolphins not whales', as one report concluded.

Managing the Procurement

If it is to be successful, procurement cannot be implemented as a bureaucratic process: it must be actively managed. This requires procurement officials to understand and in some cases to play an active role in developing the market.

- For the most part, it is competition that delivers enhanced value, not merely the involvement of a private provider.
- In order to ensure that there is sufficient competition, it is sometimes necessary for public officials to develop the market, through intelligent design and management of the procurement process, and by inviting potential suppliers to participate.
- Commissioners must be wary of optimism bias on the part of bidders and their own procurement teams. Optimism bias is a recognised danger in tendering, where because of competitive pressures, bid teams over-estimate revenues and under-estimate risks.
- Commissioners must also manage the demand side, so that the client's requirements are not allowed to drift, becoming blurred and confused as the project develops.

- One of the most frequent findings in these studies was the lack of sufficient capacity and appropriate capability in procurement officers.

Contract Design

A successful partnership in the management of complex public services depends on much more than a well-designed contract. However, the structure of the formal agreement, the shape of the performance incentives and the way in which rewards and penalties are applied will have a major impact on the success or failure of the contract.

- Commissioners must understand government's requirements and define them in realistic terms.
- Contractual incentives must align the interests of the private provider with those of the government customer.
- Designing appropriate performance incentives requires commissioners to understand the service model (the way inputs are linked to outputs and outcomes), to identify the key deliverables and measures, and to ensure that the performance regime is flexible enough to account for different service conditions.
- Detailed specification of inputs narrows the scope for innovation, which may limit the opportunity for contractors to deliver savings and experiment with better ways of serving end-users.

Contract Accountability

For contracts to be effective, performance must be monitored, the results reported publicly and contractors motivated through financial and reputational incentives.

- Good contract accountability depends on there being a sufficient (though not an excessive) number of experienced public officials capable of monitoring performance.
- Benchmarking performance may be the only way of ensuring value-for-money in long-term contracts.
- For contractual incentives to work, rewards and penalties must be linked to success or failure in delivering government's key performance indicators.

Contract Management

With contracts for complex public services, commissioners cannot shift to providers the ultimate responsibility for successful outcomes. In these circumstances, the term 'partnership' best describes the kind of relationship that is required.

- Contract monitors must be careful not to undermine the management responsibility of the contractor. Nevertheless, the ultimate risk of delivery cannot be outsourced.
- Failure on the part of the customer and contractor to establish suitable governance arrangements can be a major source of failure in complex public services.
- When contractors themselves sub-contract a significant part of delivery to other suppliers, the customer will need to maintain oversight of the supply chain, both to ensure that service quality is maintained and that value is delivered.
- Long-term contracts and ones that involve close interaction with end-users require commissioners and contractors to work closely together in true partnerships.

Market design

Where government expects to be engaged in negotiating a succession of contracts for similar services, commissioners need to be concerned with the design and management of markets, and not merely individual procurements.

In these circumstances, commissioners must undertake market surveillance and analysis. In order to avoid over-reliance on a small number of suppliers, it may be necessary to encourage new entrants into the market and to work with potential suppliers to encourage them to develop capability. In the interest of building a deeper market, consideration will need to be given to contract size and length and deal flow. And where public, private and voluntary sector providers compete, consideration will need to be given to ensuring competitive neutrality.⁸⁰

4.2 Best Practice

The following discussion is based on Serco's own experience over forty years of providing core public services in a competitive environment around the world, and some of the insights that have emerged from government inquiries and conversations with commissioners and competitors in UK and international markets.

Political Context

Political leadership: Studies from right across the world, drawing on the insight and experience of business executives and public officials, underline the importance of political leadership.⁸¹ A recent inquiry by the UK government reported a consistent concern among stakeholders for a clear commitment by Ministers and local authorities to the long-term development of the market.

They expressed concern that changes in political direction risk undermining long run partnership arrangements, lead to delays in project delivery and increase the costs of commissioning. International firms that operate in the PSI [public service industry] across a number of countries also highlighted the importance of political will and an explicit commitment to maintain competitive public service markets to their decisions about where to invest.⁸²

In deciding whether to invest in a new market – from overseas or from a related sector – companies are particularly interested in whether the government has a clear understanding of its objectives, whether it has communicated those objectives clearly to public servants, whether there will be one opportunity or a pipeline, whether procurements will proceed to completion broadly in accordance with the published timetable, and whether they face the risk of reputation damage due to political controversy. All of these concerns can be substantially allayed through political leadership.

Political sustainability: International companies with a long-term commitment to public service markets are interested in markets that are politically as well as commercially sustainable. They are more interested in markets that develop at a manageable rate, and win broad community support, than enthusiastic bursts of activity that are not politically sustainable. For the same reason, contractors have welcomed procurements where they have been asked to deliver better services as well as ones that are more cost-effective. Issues such as the weighting given to quality, the treatment of workers, and other social policy outcomes will have a major impact on the political sustainability of a market.

Honest markets: The decision to award a contract for the delivery of public services involves a major exercise of discretion, and for this reason, it is open to corruption if not managed well. Recent investigations by the NSW Independent Commission Against Corruption into contracting by the State Rail Authority confirm that this is an area still deserving of close attention in some parts of Australia.⁸³ On the other hand, the United Kingdom has built a substantial mixed economy in public services over a period of two decades without any major corruption scandals, confirming that it is possible to construct public service markets that are free of concerns about bribery or collusion.

Politicised markets: A politicised industry raises concerns about companies whose finances are ultimately derived from the taxpayer having undue influence over policymaking. For example, there has been a longstanding concern among the opponents of prison contracting, that the creation of a prison industry would contribute to pressure for harsher sentencing policies, from which companies might expect themselves to profit. This has certainly not happened in Australia or the UK; indeed, in the latter case, one of the early market entrants, a leading North American corporation, generated a great deal of antipathy amongst parliamentarians when it sought to import political lobbying techniques from the United States, and made a decision to withdraw from the UK market.

Both of these issues – corruption and lobbying – are matters that are largely within the control of government.

Designing Markets

Markets not procurements: Traditionally, the competition and contracting of public services have been seen as a series of discrete procurements, without any consideration of the broader context within which competition occurs and contracts are managed. However, with the development of competition and contracting in the United Kingdom over the past two decades, it has become clear that there are benefits of a more strategic approach.⁸⁴

Designing markets requires public officials to reflect on the possibility that there may be alternative market models that will be better suited to the service in question. It may require them to collaborate with public officials in other jurisdictions, so that different governments or agencies are not competing at the same time amongst the same limited pool of suppliers. It may require pro-active efforts to convince international suppliers or service providers from related sectors to submit bids. It may require early consultation with potential providers to understand their needs. Or it may require an investment in capability-building to assist third sector providers to enter the market.

The above list is illustrative rather than exhaustive: the underlying point is that in order to get the best out of any engagement with independent providers, governments need to think more broadly and over a longer time horizon than the individual procurement.

What kind of market? As noted at the outset of this submission, government must make an early decision as to what kind of market it wants to create. In this submission we are largely concerned with commissioning markets, but even within that broad framework, there are a variety of different models.

For example, how closely regulated should the market be? In the United States, there are both one-to-many markets for prison management (that are confined to a single jurisdiction), and a many-to-many market (that operates across the nation as a whole, where state and local governments purchase prison places from public and private providers in other jurisdictions). In that case, the national (many-to-many) market does not function as well as the local (one-to-many) markets, in part because it is a seller's market and suppliers have been able to insist on less rigorous monitoring standards. Since the many-to-many market is, in effect, a spot market, facilities tend to be smaller and it has been suggested that this may explain why costs have tended to be higher than in the one-to-many markets. The many-to-many market also leads to prisoners being located thousands of miles away from their families (prisoners from Alaska and Hawaii have been held in facilities in Colorado), which has implications for rehabilitation and resettlement.⁸⁵

As discussed further below, in the United Kingdom, many prisoners on home detention are monitored electronically using an ankle tag, with the equipment supplied and the monitoring conducted by private firms. The decision as to which prisoners should be permitted to progress to home detention is entirely the responsibility of public officials. By contrast, in some North American states, markets have been created where prisoners can pay for early release into home detention, and private providers compete for contracts based on how much they are willing to pay government. The implications of such a market for social policy are quite different from the model that has been implemented in the UK.

Future opportunities: The prospect of a future stream of opportunities matters in the design of well-functioning markets. A pipeline is important to suppliers since it enables them to spread the costs of market entry and bidding over a succession of projects. Government benefits in having a deeper market, with multiple opportunities and the opportunity of developing procurement capability. And with suppliers facing the prospect of further bid opportunities, they will be more willing to cooperate with government in managing the contract flexibly over the medium to long term.

Market depth: In principle, deeper markets lead to stronger competition and better value-for-money for government customers. In practice, market depth is somewhat more complex than wide dissemination of the invitation to tender, and it may be necessary for commissioners to engage with potential suppliers to encourage them to enter the market.

The scale and the duration of contracts can have a major impact on the depth of the market, since large-scale and long-term agreements will result in fewer competitions. Of course, there is a balance here, since in fragmenting a service, the commissioner may lose the benefit of scale economies, and short contracts may make it difficult to stimulate innovation or transfer risk (particularly where significant private investment is involved).

In a federal system (such as Australia), or where municipal government undertakes a wide range of public services (as in the United Kingdom), there will often be problems in building deep markets at the local or regional level. In these circumstances, it may be necessary for national government to play a role in coordinating policy development and market design, or for local and regional authorities to cooperate (as the Australian state governments have done in the adoption of national policy guidelines for PPPs).

Asset specificity: Economists have long recognised that difficulties arise in contracting when one of the competitors controls an asset that is unique to the service in question. For example, it is difficult to have effective competition for the delivery of bus services where one of the parties owns the terminals and the bus shelters. The solution to this lies in the commissioner owning service-specific assets, or through regulatory or contractual provisions requiring the incumbent to transfer control on reasonable terms.

In the case of contracts for complex public services (such as the National Physical Laboratory in the UK), the problem of asset specificity arises from the existence of highly skilled personnel who are essential to the service in question, and the solution has been found in regulations providing for the smooth transfer of staff from the incumbent to the new provider (TUPE). Indeed, at the National Physical Laboratory, transition has been facilitated by creating a management company, NPL Management Limited, which employs all of the scientists and support workers. In the case of the incumbent losing a re-competition, they would transfer their shares to the new provider, and only a thin layer of senior management would be replaced. The rest of the workforce would continue to be employed by NPL Management Limited.

Fair markets: With the development of a mixed economy in public services over the past decade, public, private and third sector providers in the UK have increasingly found themselves in direct competition. In our view, this is a welcome development, since it contributes to deeper markets and a greater diversity of service solutions. However, it does raise the difficult question of competitive neutrality, most notably (but by no means exclusively) in relation to public sector pensions and taxation.⁸⁶

Competitive neutrality is also important where public sector comparators are being used to decide whether a service should be put to competition, or to benchmark performance.

Choosing partners: In the case of core public services, which involve close collaboration and are often politically sensitive, commissioners are entitled to choose the companies with which they wish to partner. In these circumstances, it is unacceptable that government should accept whichever firm offers the lowest price, regardless of culture and capabilities; and for the same reason, government should reserve the right to veto new providers who enter the market through subsequent acquisition. The selection of provider is of fundamental importance in the development of socially responsible markets.

Social Policy Considerations

Public service ethos: One of the most widely repeated concerns about public service contracting is that private sector employees are incapable of having a public service ethos. There is some ambiguity about the meaning of this phrase, but for the most part what is meant is a professional ethos associated with delivering front-line public services, such as teaching, nursing and policing.

This concern is partly based on a distinction between the service ethos involved in delivering front-line public services as opposed to back-office role. In the public debate, few have seriously tried to defend the service ethos of back office workers in government (who are often referred to in public discourse as 'bureaucrats'). This is not so much because they are poor workers, but because in undertaking purely administrative roles, they are usually not required to work directly with the public.

On the other hand, front-line workers working for private contractors do not spend their working day worrying about corporate profits – they are motivated by the services that they provide to and the feedback they receive from service recipients. Research comparing healthcare workers in NHS and private hospitals in the UK has found no difference in the ethos of the two groups.

Nurses were adamant that there was no difference in attitude or approach between those working in the public and private sectors. Interestingly, patient responses were more ambiguous. Most were quicker to describe the commitment and dedication of nurses working in the NHS than in the private sector. Patients felt that nurses working in the private sector were understandably motivated by better salaries and working conditions. Ultimately, however, they maintained the attitude of nurses towards patients did not differ significantly between sectors.⁸⁷

Prison management is one of the few services where private contractors have been asked to deliver front-line public services, and as discussed elsewhere in this report, independent research in the UK has shown that contract prisons in general perform better than state prisons on the 'decency' measures.

The evidence seems reasonably clear that public service corporations are capable of having a public service ethos. Whether or not they do depends to a considerable extent on how government manages the market.

Social versus personal outcomes: The question of who should purchase public services and whose outcomes should take precedence can be complex. At first glance, it seems obvious that society must make the decisions about the punishment of offenders, and yet while it is inappropriate to treat prisoners as 'customers', nevertheless, significant benefits have come from surveys of prisoner attitudes about their quality of life whilst incarcerated in facilities provided or commissioned by the state.

At the other end of the spectrum, while Australia recognises the primacy of parental interests in selecting schools where their children will be educated, there are also social interests that must be taken into account and addressed through regulation, or through conditions attached to grants.

The level at which a service is commissioned, and the extent to which it will be free at the point of delivery, are decisions for government. As noted in the introduction to this report, while we might be able to advise on the effective implementation of alternative models, as a provider to government, the Serco Institute does not consider it appropriate for us to express a view on issues of social policy.

Commissioning social outcomes: Since these are *public* services, private providers understand that government will want to use the contracting process to procure social outcomes. Service companies specialise in responding to their customers' requirements, so that they do not look upon these conditions as a regulatory burden. Of course, there may well be additional costs associated with delivering additional outcomes, and commissioners must be careful not to weaken procurement and contractual tools by overburdening them.

Commissioning, Not Just Procurement

With the ongoing development of public service markets, there has been growing recognition of the need for public officials to develop a much broader range of skills than those required for mere procurements. In the UK, the term 'commissioning' has been applied to this wider range of functions.

Commissioning may include the design of a public service market, the development of clear outcomes and the specification of requirements for an individual service, the negotiation of political and policy settings and the design of a procurement strategy and the selection of an appropriate team. It may be debated whether the procurement itself should be considered as an element of commissioning, or a subsidiary process.

However, it will also include the ongoing management of the partnership to ensure that it continues to deliver the government's requirements. Adrian Benepe, who is Commissioner of the New York City Department of Parks & Recreation, which engages in a considerable number of innovative public-private partnerships, argues that a commissioner must serve as a champion of the partnership within government, as well as an agent of government in overseeing the contract.⁸⁸

Good Procurement

A diversity of procurement models: The choice of procurement model must be influenced by the nature of the goods or services being procured. For example in the acquisition of defence equipment, where success will be determined overwhelmingly by the choice of technology platform, and where the costs of developing such a platform can be exorbitant, commissioners sometimes break the procurement into two stages, with the intellectual property of the chosen technology being acquired by the state, and a second competition being held for delivery of the same. In such cases, government will often choose to compensate (in whole or in part) the first stage bidders.

One of the tensions involved in the design of alternative procurement models lies in the need to engage closely with alternative providers at an early stage, so that there is collaboration in the development of appropriate solutions, whilst also wanting to maintain competition as late in the process as possible. With complex public services, where a great deal of innovation was involved and the bid costs were high, commissioners traditionally down-selected to a single bidder, with heavy reliance on the subsequent process of negotiation. In the European Union, procurements are now governed by 'competitive dialogue', which seeks to address both outcomes in parallel. In the UK, which tends to contract for more

complex services under more innovative models, this has created some difficulties, delaying procurements, driving up bid costs and resulting in the appropriation of intellectual capital.⁸⁹ In other jurisdictions (such as British Columbia), there is early down-selection to a preferred supplier in order for the commissioner to collaborate in the design of a service solution, with a second supplier being kept in reserve through a form of contestability.

Clear outcomes: The Julius Review pointed to a lack of clarity over outcomes, which leads to delays in procurement and poorly specified contracts, as a major concern among providers. The lack of clarity often becomes a problem in the course of procurement as public officials recognise that there are aspects of the service requirement that have not been fully resolved. This can be a major source of delay.

A related concern identified by Julius was the tendency for procurement to pursue multiple policy objectives: 'Having numerous objectives makes the process more complicated and costly both for those bidding and for those evaluating the bids'.⁹⁰

Price versus quality: In spite of a stated intention to give qualitative factors significant weighting, procurements can be structured, often quite unintentionally, as aggressive price-based competitions which can result in the 'winner's curse' (where the successful party bids too high). In our experience, it is often the case that those concerned about quality are in charge at the beginning of the process, while those concerned about price dominate at the end.

The winner's curse tends to emerge as a problem in competitions that are excessively focused on price, and where the bidders have very different views of the desired outcomes, the statement of requirement and the risks involved.

Competing for quality: One of the reasons why prison contracting is such a useful case study is that in the UK, and to some extent in Australia, the government asked for services to be better and not just cheaper. The introduction of contracting was used as the opportunity for demanding higher standards. Among other advantages, this makes it easier for politicians, public officials and private providers to explain the benefits of such a reform.

Competition and contracting offer an opportunity to invite the private sector to assist government in resolving some of the 'wicked' issues in public service delivery. For the most part, this is not how these instruments have been used, with cost efficiencies being given primacy.

Procurement delays and excessive bid costs continue to pose some of the most difficult challenges in the management of public sector procurements. It is not that lessons have not been learned, but that contracts have become more complex and procurement processes and capabilities have failed to keep pace.

Part of the answer undoubtedly lies in improving commissioning skills (not just procurement skills), although it is generally recognised that this will not be enough. Many of these delays can only be overcome if procurement officers assume the responsibility for actively managing the process, rather than occupying the position of the disinterested observer.

The Julius Review also pointed to the need to change the incentives facing procurement teams through increased transparency. That report suggested that bidding timetables should be published, monitored and reported, so that there are reputational consequences for project teams that significantly depart from the announced schedule.⁹¹ Similarly, transparency might be increased through the publication of procurement budgets, with procurement teams needing to bid for additional funds and provide a clear justification for delay.

Contract Design

Economies of scope and scale: Some of the greatest innovation in public service delivery has taken place where government has sought efficiencies through combining a range of different functions, rather than just contracting out the same narrow group of functions on a grand scale. In this case, contractors secure their efficiencies through economies of scope.

Fixed price versus cost plus: In the academic literature, there has often been a bias in favour of fixed price contracting, and much of the success that has been attributed to PFI/PPP arises from the fact that it involves a fixed price contract accompanied by significant risk transfer. In other cases, alliancing and risk sharing models (which have many of the characteristics of a cost plus contract) are more appropriate where early delivery is more important than cost, or where the nature of the risk is difficult to quantify up front. And there are variants of both archetypes, such as 'cost plus incentive fee' contracts. What model works best will depend on the circumstances of the case.⁹²

A diversity of contract models: Commissioners also have a wide variety of contract models from which they can draw, and these should be used flexibly, depending on the nature of the services in question, the respective capabilities of the public and private sectors and the nature of the political landscape.

The standard model is the term contract – a contract with an individual supplier to deliver a public service over a term of years. However, in the US federal government and in the IT sector around the world, commissioners have relied on framework contracts, conducting an initial competition to appoint a panel of preferred suppliers, and then conducting shorter competitions among the panel for particular tasks.

In the 1990s, the UK government pioneered the GOCO model – ‘government owned, contractor operated’ – where the management of an entire agency of government was contracted for a term of years. Where the agency in question is delivering core public services (such as the Atomic Weapons Establishment), then GOCOs demand sophisticated governance arrangements to ensure that government’s changing needs are being met. One of the most striking examples in the UK is the National Physical Laboratory – Britain’s metrology laboratory which protects the nation’s interests in the international standard-setting community – which has been managed under a GOCO arrangement for almost two decades.

Another familiar model that is often overlooked is the joint venture, where public agencies organise a competitive process to select a strategic partner to work with them in commercialising their technical expertise. The joint venture between Serco and Guys and St Thomas’ Hospital pathology laboratories is a recent example of this particular model. Of course, hybrids such as this raise important competitive neutrality issues.

Contractual Incentives

The performance regime – specifying the key performance indicators and the associated rewards and penalties – lies at the heart of a public service contract. Design of these financial incentives is central to the success of the contract, and yet, in practice, effective commissioners depend on a much wider range of incentives.

A detailed study by the Serco Institute of contractual performance regimes arrived at a number of specific recommendations:

- Governments need to play an active role in capturing and disseminating best practice in the design and management of performance regimes.
- Commissioners’ responsibilities do not end once the performance regime has been designed and a contract signed. If the performance measures are unsuitable, either through flawed design or through changes in external circumstances, it is vital that the regime is changed accordingly.

- Performance measures should be drafted in consultation with operational experts who understand the impact of the proposed incentives and how the regime will work in practice. Procurement experts with no long-term commitment to effective outcomes do not have the same incentives.
- Project teams should explore a wide range of models before selecting a performance regime, based on a disciplined analysis of the risks and benefits. The role of reputational and relational incentives needs to be considered as well as direct financial rewards and penalties.
- Authorities should be incentivised to focus on quality and long-term value for money, not short-term cost-cutting measures. The focus throughout should be on delivery.⁹³

Commissioning for outcomes: If the performance regime is constructed around a plethora of low-level inputs, there will be limited scope for innovation and little effective transfer of risk. There has been a great deal of interest in recent years in the possibility of commissioning outcomes (or at least high-level outputs) rather than specifying inputs. The benefits of such an approach are obvious – they leave more discretion with the service provider, allowing them greater room for innovation. Moreover, in making providers financially accountable for delivering service outcomes, they will invest serious resources into understanding the linkages between different inputs and key outcomes.

However, the challenges in doing this are considerable. If service providers do not control all of the key variables, or if commissioners and providers misunderstand the risks associated with turning inputs into outcomes, then in spite of excellent performance, they may fall well short of the negotiated targets (or conversely, they may succeed in spite of poor performance).

At the time of writing, the UK Department of Work and Pensions was conducting a competition for the management of return to work by the long-term unemployed (modelled on Australia's 'Job Network' market). As originally conceived, private and voluntary providers would have financed a significant part of the costs up-front and recouped their investments over time as they were able to demonstrate that service recipients had been kept in employment. However, the rapid changes taking place in the jobs market as a result of the recession have profoundly altered the risks associated with this model, and fundamental changes have been required.

There are circumstances where it is more appropriate to contract for process (for example, where human rights are involved) or inputs (for example, in the early stages of a new market, where the capacity of government to commission, and of contractors to assume the risk of delivering outcomes, is not well understood).

However, some of the early attempts towards outcome commissioning do seem to promise significant advances in service delivery.

A wider range of performance incentives: Traditionally, discussion of contractual performance regimes has focused exclusively on key performance indicators and the associated financial penalties. With complex public services, this is not enough, and a combination of qualitative and quantitative monitoring is required. In the management of prisons, for example, the UK uses a limited number of contractual targets with hard targets (and an associated system of points and penalties), as well as ‘soft’ assessment by the Chief Inspector of Prisons, whose influence is exercised mainly through the publication of her reports and the consequent impact on corporate reputation. The available evidence suggests that senior managers pay close attention to the Chief Inspector’s reports.

However, commissioners are also able to exercise influence over performance through governance arrangements – memoranda of understanding, contract boards and the co-location of staff, as well as through the professional culture of those involved in delivery.

Contractual Relationships

The priority of service outcomes: Those responsible for managing the competition, preparing the bid and negotiating the contract must have the ongoing delivery of the service firmly in mind. One commentator has pointed to the dangers associated in allowing dealmakers to dominate contract negotiation.

People who view the contract as the conclusion and see themselves as solely responsible for getting there behave very differently from those who see the agreement as just the beginning and believe their role is to ensure that the parties involved actually realize the value they are trying to create. These two camps have conflicting opinions about the use of surprise and the sharing of information. They also differ in how much attention they pay to whether the parties’ commitments are realistic, whether their stakeholders are sufficiently aligned, and whether those who must implement the deal can establish a suitable working relationship with one another.⁹⁴

He argued for a new mindset in the negotiation of contracts:

- Negotiators should start with the end in mind – imagine the contract twelve months later.
- Help the other side prepare – both parties lose if the commitments are undeliverable.
- Treat alignment as a shared responsibility.
- Implementation teams on both sides of the deal should be briefed together.
- Contract negotiation should be managed as a business process.

Investment in commissioning: One of the difficulties with the term ‘contracting out’ is that it reinforces the view that once services have been contracted, the commissioner has little further interest until the contract is renewed. Whilst government must be careful not to create a burdensome bureaucracy to scrutinise the details of contract performance, at the same time, government must monitor how services are being delivered, and adjust the contractual model if required. Underinvestment in the contractual relationship is an old problem (the author having traced examples back to the 18th century). And it is by no means confined to the public sector.

Public private partnerships: Some public services are so complex, integrated and/or politically sensitive that contracting can only be successful if the parties regard it as a legitimate partnership. There is now a significant body of literature on ‘relational contracting’, some of which addresses the conditions necessary for a successful public-private partnership.⁹⁵

Capability

Commissioning: As noted above, there is widespread agreement that more needs to be done to build commissioning capability in the public sector. Purchasing these skills from private consultants is not an acceptable alternative, since unless they are well-managed, consultants’ interests may diverge from those of commissioners.

The Julius Review recommended that a Director of Service Delivery be appointed to a very senior position in all departments and agencies with a substantial service delivery function. Their involvement would not just be confined to services commissioned from the private or voluntary sectors, and it would extend throughout the full commissioning cycle and not merely at the procurement or start-up phase.

In smaller governments, where there will be fewer major procurements, there may well be a case for locating commissioning specialists in a central agency so that high quality people can be recruited and retained. However, under any such model, great care must be taken to ensure that policy and delivery specialists from line departments and agencies are fully engaged in the commissioning process.

Management and staff: One of the reasons why public service companies in the UK have so quickly developed a public service ethos, is because of the regulations providing for the transfer of public sector workers to the contractors who have assumed responsibility for these services. Major public service

companies such as Serco employ a very large number of former government employees, who brought with them their dedication to serving the public according to a professional ethos.

While senior managers do not typically transfer under the British legal provisions, a significant proportion of contract managers have a background in the public sector. In the case of the Prison Service, there was a generation of progressive and highly-trained prison governors who had reflected on the kinds of reforms they would like to undertake, but had been frustrated trying to effect change within the Prison Service. The prison contractors relied heavily on these men and women in bringing about their revolution in prison management in the early 1990s. One of the reasons why a public service industry has matured so quickly in the UK is that capable and experienced public servants have transferred and been retained (and promoted) by the private providers.

5. Models of Reform

When governments are contemplating a major programme of reform involving the competition and contracting of public services, consideration must be given to the overall political, policy and operational framework. This section provides some examples of such policy frameworks across the industrialised world over recent decades.

5.1 Compulsory Competitive Tendering (UK, 1980s; Victoria, 1990s)

In 1980, the then Conservative Government introduced legislation making competitive tendering compulsory for road construction and building renewal and repair in local government. Subsequently, through a succession of amendments to the Local Government Act, from 1988 to 1994, the scope of service subject to the compulsory competitive tendering (CCT) regime expanded to cover the full range of blue collar services, and finally a limited number of white collar ones.

CCT may have played a central role in opening up the market for public services, however, the model was flawed and resulted not only in local authorities gaming the system in order to ensure that in-house providers won, but private providers leaving the market because of unfair procurements, difficult relationships with customers, and unhappy relationships with employees and unions.

In an attempt to prevent gaming, in the mid-1990s, the Department of the Environment (which was responsible for local government at the time) established a complaints procedure to enable firms to register complaints about anti-competitive conduct on the part of local authorities about the implementation of CCT. The Secretary of State had been granted powers to act against local authorities that did not comply with the competition rules. In the result, this complaints mechanism did not work well. Companies were reluctant to complain and Ministers were reluctant to exercise their powers.

In 1996, the Victorian government also introduced compulsory competitive tendering in local government, to be applied to at least 50 percent of each

council's expenditures. There appear to be no comprehensive studies of this programme.

5.2 Market Testing (UK, 1993-1997)

Market testing was introduced by the Conservative Government in 1993. It sought to increase efficiency in public services by exposing in-house services to competition. In-house providers competed with private providers to determine which was best able to provide the service for greatest value. 'Whether the decision is taken to contract out or to retain the work in-house, the market test can ensure that the service will be delivered in the way which gives the best value for money.'⁹⁶

A market test involved:

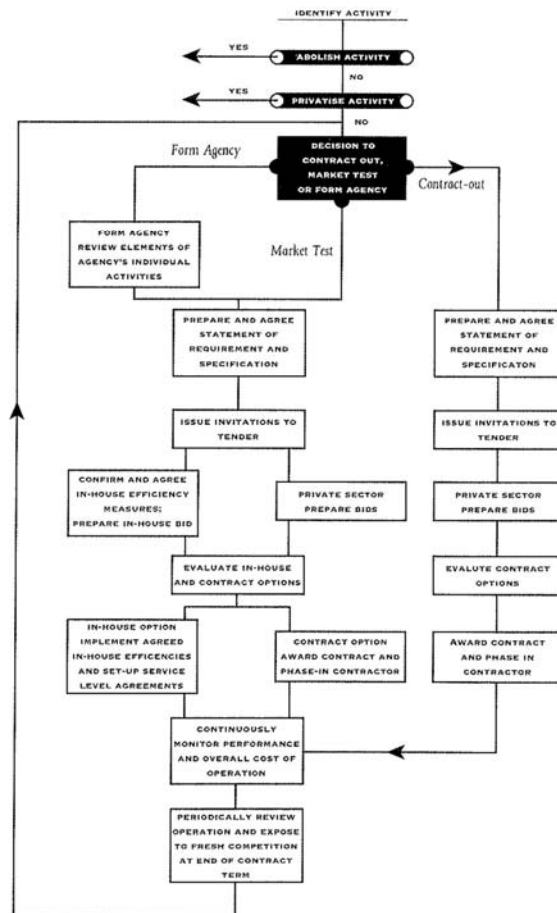
- Identifying the scope and nature of the activity to be considered
- Establishing what level of service was necessary
- Identifying baseline costs
- Assessing the market
- Developing a specification and outline contract or service level agreement
- Inviting interest from potential suppliers
- Conducting a tender and evaluation similar to a normal procurement

There are several difficulties associated with such a model which proved difficult for the UK government to overcome. A great deal of work is involved in developing a meaningful chart of accounts for many public sector activities, and the failure to do so can result in unfair comparison and competition. And unless there are robust processes for managing in-house providers following a successful competition, then they cannot avoid the consequences of irresponsible bidding. (On the other hand, there would be other benefits to government in identifying the true cost of delivering such services.)

5.3 Prior Options (UK, 1993-1997)

A key element of the Market Testing initiative was a 'Prior Options' appraisal, which required public officials to ask some even more fundamental questions prior to launching a market test. The flow diagram (from the 1993 White Paper) demonstrates the key elements:

- Should the activity be abolished?
- Should the activity be privatised?
- Should the activity not be delivered by government at all, and this contracted out?



5.4 The Yellow Pages Test (USA, 1996-)

This approach was popularised by the then Mayor of Indianapolis, Stephen Goldsmith (now a Professor at Harvard's Kennedy School of Government) in 1996:

If the city Yellow Pages show that several firms now provide services that the City is also providing, then competition is possible. The presence of private service providers also indicates that the market has established performance standards that can be written into contracts.⁹⁷

As California's Governor, Pete Wilson put it:

If a service provided by government is advertized by private companies in the yellow pages, it is a good candidate for privatization.⁹⁸

This approach was adopted by the then Australian Minister for Administrative Services, David Jull, in 1997, in his overhaul of his department which ultimately resulted in its abolition.

In recent months, Utah Governor, Jon Huntsman Jr. has resurrected the concept of the 'Yellow Pages Test' in overhauling the state's Privatization Board, and arguing that he wants to get the government 'out of the business of business'.

The weakness with the Yellow Pages Test is that it ignores the potential that governments have of developing new capabilities in the market. There were no prison management companies in the Yellow Pages until US and Australian governments started to expose their correctional institutions to competition.

5.5 Competitive Sourcing (USA, 2003-2007)

George W. Bush's 'Competitive Sourcing' agenda, first published in 2002, sought to market test tasks that were readily available in the commercial marketplace – such as data collection, administrative support and payroll services. This involved identifying positions that were 'commercial' in nature – agencies prepared inventories that were made publicly available, and interested parties were entitled to challenge the inclusion or exclusion of any particular activity. Targets were set in 2002 for competing not less than five percent of the full-time equivalent positions listed in these inventories, rising to 10 percent the following year.

Agencies prepared a business case to determine whether or not competition would be appropriate, taking into account such issues as the risk of mission failure and the potential for savings. Competitions were then conducted under the A-76 rules promulgated by the Office of Management and Budget (OMB) for competitive tendering of federal government activities. The OMB anticipated savings in the order of 20 percent.⁹⁹ Competitive Sourcing can be seen as a combination of Market Testing and the Yellow Pages Test.

The results of the programme were generally seen as disappointing. The published evidence suggests that where positions were exposed to competition, value-for-money improvements were made, with annualised savings estimated at \$1.1 billion. However, the Administration fell well short of its targets in the number of positions exposed to competition – in FY2007, for example, only 4,164 FTE positions were competed, well short of the 18,000 positions that had been committed.

In part, the initiative may have failed because it focused on positions rather than complete activities. The average number of FTEs per competition was only 38. The range of functions competed were those that had been contemplated at the outset – property management, information technology, logistics and personnel management.

And the programme seemed to deliver the greatest savings where a much wider range of functions were opened to competition – such as the Federal Aviation Administration's Automated Flight Service Stations (covering pilot weather briefings, in-flight radio communications, flight planning and search-and-rescue support), where the contract was expected to deliver savings of \$1.7 billion over ten years.

It may also be significant that 70-80 percent of competitions (measured in terms of FTEs) were won by the incumbents. It is entirely appropriate that in-house teams should win competitions where they offer the best solution, however, such a high win rate suggests that the market had not been fully developed.¹⁰⁰

5.6 Intervention (USA, 1990s - ; UK, 1999-2002)

United States

The origins of this model are to be found in standards-based education reforms pioneered in a several jurisdictions in the United States (and subsequently at federal level under the No Child Left Behind Act). North Carolina and Texas had been singled out as having achieved rapid improvements in educational outcomes throughout the 1990s, as a result of a strategy which focused on

setting state-wide standards, applying state-wide assessment tests, rating schools and rewarding those with good performance and intervening in those with sustained poor performance, increasing local control, and shifting resources to schools with more disadvantaged students.¹⁰¹

By early 1999, twenty-three states had adopted intervention policies and at least ten of these had taken over a low performing district. One severe form of intervention, known in the United States as ‘reconstitution’, consisted of disbanding the entire school faculty and reopening with new staff, structure and curriculum.

Florida: Florida’s ‘A+ Plan’ involved granting mobility to the students of failing schools. Schools with large numbers of students failing the Florida Comprehensive Achievement Test in reading, writing and math are given an ‘F’ grading. Any schools with an ‘F’ grading two years out of four were opened to competition. Parents of children attending these schools were able to transfer their children to higher performing schools, or apply for a \$3,400 scholarship (or voucher) to send their children to a private school. Failing schools were provided with additional state assistance to improve. Early reports suggested that this approach had contributed to an improvement in standards.¹⁰²

Pennsylvania: In November 2000, an ‘Empowerment Team’ appointed by the Pennsylvania state government to manage the failing school district of Chester Upland, recommended an intervention-based solution for the district’s school system. (More than two-thirds of students in the district failed the previous year’s state tests in maths and reading.) The recommended strategy included:

- a) Separate and clearly identifiable service units – the empowerment team identified schools as the key unit of service delivery and concluded that if schools and the professionals who run them were to be held accountable for performance, they must have control over the decisions that affect them – ‘Schools are where the real work of learning takes place . . . Schools should have the ability to define their own mission, select staff, allocate resources, and determine how best to achieve the academic, fiscal and other results for which they are held accountable’.

The district would become a purchaser of quality education rather than an operator of schools. To accomplish this, certain central roles were essential – the authorisation of schools, monitoring of performance, ensuring compliance with law and providing parents and the community with information on schools.

The empowerment team recommended that, to the greatest extent possible, every school in the district be converted to an independent or charter school. In March 2001, it was announced that all schools in the district would be run by one of three private education providers, Edison Schools, LearnNow and Mosaica Education.¹⁰³

- b) Clear performance targets for service levels – the Pennsylvania State Board of Education has adopted state-wide standards for reading, writing and math and is in the process of adopting new standards for science and technology. The empowerment team recommended formal adoption by the district of these standards, and the establishment of specific (and measurable) goals for performance improvement in the areas of academic performance, attendance, suspensions and graduations.
- c) Objective methodologies for measuring performance – The empowerment team noted that ‘School accountability within the traditional public education system has focused almost exclusively on inputs. . . *The one true measure for which schools have never been seriously accountable is how well they perform in ensuring that children actually learn.*’
- d) The use of an independent inspection service to assess performance – the plan proposes that there be an annual review of each school’s performance, reinforced by various student performance measures.

In the Chester Upland model, external accountability was under-scored by giving parents the power to relocate their children to another school within the district.

Parents would be able to choose the school their child attends, including the right to move their child to another public school. A school’s funding would be tied to student enrolment. In moving from one school to another, children would carry with them education dollars. The consequences for the school are not only the loss of a student but the loss of dollars, too.

- e) Publication of results – the School District Improvement Plan proposes the development of a ‘standardized, easily accessible school report card that would provide parents and the community with a basic set of information and performance data on each school within the district.’
- f) Capacity and the willingness to intervene – America’s highly decentralised system of school districts created a clear division between the units responsible for service delivery and those (at state

level) responsible for standard-setting and performance assessment. This will be reinforced under the new model, where the district will act as a monitor and purchaser of services.

- g) Escalating interventions – given the seriousness of the problem in Chester Upland, there was already a high level of state intervention. The recommended solution, later adopted and then largely abandoned, involved significant private involvement. The empowerment team recommended that contracts with schools (and private education providers) ‘should include provisions that give the district the ability to force improvements in low-performing schools and close schools that seriously under-perform.’¹⁰⁴

This was followed in 2002, by state intervention in the Philadelphia School District, which had experienced years of low educational achievement and financial crisis. The school board was replaced with a ‘School Reform Commission’, which hired a new CEO and resolved to contract the management of 30 of the lowest-performing schools to for-profit organisations and 16 to not-for-profits. Two recent studies by highly reputable institutions – RAND and the Harvard Kennedy School – have arrived at somewhat different conclusions about whether these interventions have made a difference. However, it appears that the for-profit schools have outperformed both those managed by the school district and the not-for-profits.¹⁰⁵

United Kingdom

Starting in 1999, the Blair Government pursued a similar approach in the implementation of its literacy and numeracy strategy. The UK intervention model consisted of the following elements:

- Specific and measurable performance targets. These were spelled out in the Public Service Agreements announced as part of the 1998 Comprehensive Spending Review, for example: ‘an increase in the proportion of those aged 11 meeting the standard of literacy for that age (level 4 in the Key Stage 2 test) from 63% to 80% by 2000.’
- Accountability for meeting targets. The (then) Education and Employment Secretary, David Blunkett, stated publicly that he would resign if key targets were not met (although there was significant back-tracking on this later on).
- Measurement. The Department for Education and Employment put into place a comprehensive skills testing program, with the results published annually in the form of league tables.

- Remediation. There was a significant increase in funds for teacher training, and the results of skills tests were fed back into this process so that specific teaching skills were targeted.

The performance management model for Local Education Authorities (LEAs) and schools was built on this approach. In January 1999, David Blunkett asked the Office of Standards in Education (Ofsted) to inspect all LEAs by 2001 to identify failing authorities. This was marketed at the time as opening the way for intervention in LEAs that were failing to provide adequate support to teachers and pupils:

- Independent inspection. Schools and Local Education Authorities were to be inspected once every four years by Ofsted.
- Public reporting. Ofsted publishes lists of good performing ('beacon') schools and poor performing ('failing') schools and LEAs.
- Intervention. The School Standards and Framework Act 1998 gave the Secretary of State new powers to intervene in failing LEAs. In February 1999, the School Standards Minister, Estelle Morris, stated that she expected 15 major interventions in failing LEAs. Educational institutions would be given the opportunity to respond to Ofsted reports and remedy reported deficiencies, with a clear understanding that intervention would follow from failure. The range of options included replacing management and staff, through to 'Fresh Start', which involved closure of the school and replacement of management. Teachers would be required to reapply for their jobs. Schools failing to meet government targets three years in a row would be considered for a 'fresh start'.
- Private management. The Education Secretary and the (then) Minister for School Standards made it clear that private management was an option for failing LEAs (but not schools) and have so intervened in around 20 cases. Estelle Morris actively encouraged private firms to pre-qualify for this market.

Blunkett first signalled his willingness to use new powers to let outside organisations run some LEA functions in a speech in early 1999. He flagged the possible involvement of private firms, but stated that the government would only consider contracting out services where it was clear that an LEA could not or would not do its job effectively. Within days, advertisements appeared inviting contractors to register expressions of interest for consultancy work and for the delivery of LEA functions. In this first round, six organisations were awarded framework contracts to undertake consultancy work related to LEA interventions and ten organisations were placed on the list of service providers to LEAs.

Expressions of interest were again sought in February 2000. At the same time, the Minister for Education Standards arranged to be interviewed in the *Financial Times*, inviting companies to participate in the emerging market, and made herself available to meet interested organisations. She told the press, 'The private sector wants to know we have the backbone to carry this policy through – and we have.'¹⁰⁶ Conferences and seminars were subsequently organised by the DfEE to bring together LEAs and private education service providers.

By September 2001, the government reported that it had intervened in 20 LEAs: 'In some cases, there has been full or partial outsourcing of LEA services or strategic management to a private sector provider, or joint venture delivery in an equal partnership with the private sector. In others, the solution has involved restructuring internal strategic management, partnerships with other LEAs or strengthened arrangements for involving local stakeholders and independent expertise in decision-making.'¹⁰⁷ As at February 2001, around five to ten LEAs had had all or part of their services contracted (and several more have been contracted since).

In March 2001, Ofsted reported on the first nine months of operation of the first privately-managed LEA at Islington. The report was generally favourable and 'early signs are that the new arrangements constitute better value for money':

Since the letting of the contract in April 2000, communication has been established and effective systems put in place. Even more importantly, a sense of purpose and optimism has been instilled. The task facing the LEA has been a formidable one, but, to a remarkable extent, it has been successful accomplished. The LEA is now viable.¹⁰⁸

In its Education White Paper, the government reported that Islington had moved from a 'very poor' to a 'satisfactory' rating in two years. However, other reports around this same time suggested that not all was well at Islington. According to a report in the *Guardian* education supplement, the private sector manager at Islington, CEA, had been hit by a £300,000 penalty for failing to meet GCSE targets. Only 28 percent of students had achieved the targets of five or more good GCSEs, up from 26 percent the year before, but well below the target of 35 percent.¹⁰⁹

A study by the Confederation of British Industry in 2005, found that between 2000 and 2004, the nine LEAs that were contracted to the private sector had improved more than the average of all LEAs in England. They had also improved more than the average of the 11 failing LEAs that had relied on internal intervention. And they had improved by more than the LEAs that had similarly low levels of educational attainment in 2000.¹¹⁰

The commitment to extend this model to failing schools was not pursued, and in spite of the acknowledged success of the privately managed LEAs, the government did not seek to extend the scheme. Of the nine LEAs that were originally placed under private management, only two remain, the other contracts having lapsed and not been renewed.

There was also some discussion of expanding this model more broadly across the public sector. In the second half of 2000, the Department of Health and the Prisons Service also began to explore the application of this model elsewhere in government, and with David Blunkett's appointment to the Home Office in June 2001, he began to discuss the application of the model to police forces. Around the same time, the government began to explore the application of this same model in local authorities. None of these was pursued.

5.7 Market Testing (Japan, 2004)

In 2004, the Japanese government adopted a programme of market testing for public services that borrowed heavily from the UK experience of a decade before, but added some interesting refinements. The reform took as its mandate the Prime Minister's statement that, as regards government activities, 'what can be done in the private sector, should be done in the private sector'. The intention was to expose public services to competition, with public and private bidders competing on a level playing field.

The intention was to focus on services provided by the central government, whilst also making it easier for local governments to adopt the same approach. Ultimately, all public services were to be open to review.

The primary tool for driving through reform was an innovative mechanism known as 'private challenge', allowing private firms to nominate services that could be market-tested. The intention was to allow private sector organisations to identify services for market-testing (and perhaps, the perceived obstacles to market-testing). Foreign companies could also submit proposals, although it was acknowledged that they would face some difficulties in doing so from outside the system.

This would be reviewed by a special procurement unit located within the Cabinet Office (but reporting to the Council), and barriers to market-testing would be identified. These proposals would then be sent to the relevant department with a challenge to justify why they should not be put to the market. The response would be assessed by the central procurement unit and the outcome made public.

The service in question would then be put to competition, with evaluations on the basis of quality as well as price. The evaluation criteria would be announced in advance. It is proposed to give the central procurement unit the power to investigate complaints about un-level playing fields.

5.8 The Mixed Economy (UK, 1997-)

Over the term of the Blair Administration, Labour's policymakers developed the concept of a mixed economy in public services – where public, private and voluntary sector providers, and joint ventures between these various players, competed to deliver services demanded by public service commissioners.

In an attempt to free up public agencies to operate more commercially, a plethora of new organisational structures were conceived, including hospital trusts and education academies, which were granted freedom from many of the bureaucratic constraints that bound traditional public sector organisations. In theory, they were also subject to financial discipline for the failure to meet performance targets, and the potential of being taken over or wound up. Successful hospital trusts (for example), would be able to take over or merge with other institutions.

In the case of the voluntary sector, the government legislated to make it easier to create quasi-commercial structures, changes were made to government grants to and contracts with third sector providers of public services, and significant government resources were invested in improving the tendering and commercial skills of voluntary sector managers.

In recent years, there has also been an increased emphasis on increased choice for the users of public services, with growing interest in alternative market models based around personal budgets (or vouchers).

The concept of a mixed economy in public services is a powerful one, in part because it does not express any preference for the private or voluntary sectors over the public sector. The underlying principles are competition and choice.

However, it does assume that there is a level playing field between the different sectors, and policy work on the conditions necessary for a competitively neutral market have only been undertaken belatedly. As a result, there are still major inequities, particular in relation to public sector pensions and taxation. Of course, if competitive neutrality is acknowledged as a market fundamental, then the concept of a mixed economy can serve as a powerful driver for meaningful commercial accounts for the commercial activities of government.

6. Examples of Public Service Contracting

Competition and contracting have been employed across a wide range of public services at different times and in different parts of the world. The following catalogue of examples provides some insight into the different sectors in which these policy tools have been employed. The Serco Institute does not advocate the implementation of any particular programme – that is a matter for government to decide based on local need and the perception of net benefits.

6.1 Criminal Justice

Police Support

Over the past decade, police forces in the UK have actively pursued a programme of civilianisation and contractorisation. This has been driven by a number of factors – the desire to free up warranted police officers from administrative support activities in order to return them to front-line policing; the need to professionalise certain support activities (particularly those associated with detention) in order to comply with human rights and other legislative reforms; the development of a performance management culture in the public sector, and the associated need to reform certain activities; the centralisation and rationalisation of certain policing functions, either to increase operational effectiveness, or to reduce costs; a major programme of asset renewal driven by central government; and the revolution in information technology which has created a demand for new competencies not usually possessed by uniformed police officers.

In 2008, the Serco Institute documented the diverse range of reforms that have taken place in UK policing over the past decade. They have been broadly categorised as follows:

(i) *Support services* – corporate support, such as payroll, pensions and financial management; information and communications technology; transport services, including fleet management and air support; prisoner escort; custody services, including detention.

(ii) *Specialist services* – interpreters; medical services, including forensic medical examiners; recruitment; criminal record checks; and evidence storage.

(iii) *Physical facilities and the associated facilities management* – police stations and office buildings; centralised custody suites, with some contracts covering reception, maintenance, cleaning, laundry and waste management, catering for detainees, security systems, interpreter services, forensic medical services, taking of fingerprints etc, voluntary drug-testing and management of identity parades; integrated justice centres, co-locating police, prosecutors, probation and the courts at a regional level; and specialised facilities such as training centres, stables and helicopter support.

(iv) *Criminal investigation* – In some police forces, retired detectives have been contracted to serve as civilian investigators and used to conduct interviews, take fingerprints and prepare files for prosecution. Private forensic laboratories compete with the government's own Forensic Science Service, which has been commercialised, in providing vital support for criminal investigators. Crime analysts have been extensively civilianised, though there are few contractors used in this role at present.

(v) *Crime prevention* – Many police forces have introduced Community Support Officers – uniformed personnel with less formal training than police officers, to undertake patrol work and public assurance activities traditionally carried out by highly-trained police officers. At the same time, however, local authorities and business improvement districts have appointed neighbourhood wardens to patrol local streets and address anti-social behaviour.¹¹¹

Adjudication

Court management: The public private partnerships for Perth's District Court and Victoria's County Court demonstrate some of the roles that the private sector plays in supporting administration of the courts.

Integrated justice centres: In an attempt to promote better collaboration and coordination across agencies involved in criminal justice, some UK authorities have constructed 'integrated justice centres' so that they can co-locate policing, prosecutorial, court and probation services. In some cases, the management of support services at these facilities has been contracted to private firms.

The first of such projects was the North Warwickshire Justice Centre, opened in 2005, which houses police, prosecutors, magistrates and family courts, victim and witness support, a Youth Offending Team and probation services. Her Majesty's Inspectorate of Constabulary identified both one-off savings and ongoing benefits from co-location and contracting the support services, including fewer complaints in custody, quicker transfer of prisoners, increased confidence of victims and witnesses and reduced officer time at court.

Mediation: Of course, the private sector has long played the dominant role in arbitration and mediation; the Law Merchant was, in effect, an alternative system of arbitration that ran in parallel to commercial law for hundreds of years.¹¹²

However, the Australian federal government's Family Relationship Centres are an example of a mediation system created as an instrument of social policy, that were outsourced to independent providers (in this case, community organisations) from the outset. Under legislation passed in 2005, all separating families were required to attend a Family Relationship Centre for education, counselling and mediation prior to having access to the Family Court. Some \$200 million was allocated to sixty-five planned centres, with funding tied to performance indicators.¹¹³

Corrections

Prisons: Australia was one of the world leaders in the contracting of prison management, being the first country outside of the United States to adopt this model. However, since the middle of the 1990s, few prisons (new or existing) have been opened up to competition, and (outside of the United States) the United Kingdom has become the world leader.

Victoria has had a number of prisons constructed and financed through PPPs, but the custodial services are delivered by public officials. South Australia has developed a tender for PPP prisons, due to be finalised in mid 2009, and Queensland officials have raised the possibility of privately-managed public prisons in the future.

Over the past decade, New South Wales has used the threat of competition to drive through labour reforms in several new prisons, with a consequent impact on

operating costs. However, the NSW Treasury has admitted that the mere threat of competition had ceased to incentivise union officials to negotiate, and as part of a broader programme of reform, the NSW government has announced it will put two existing prisons to tender.

As noted above, prison contracting in Australia and the UK has been overwhelmingly successful, in reducing costs, introducing innovations in design, construction and operation, and in contributing to service improvement. The evidence regarding prison contracting in the United States is more mixed.

Prisoner transportation: When court escorting was first contracted in the UK in the early 1990s, it represented a major breakthrough in the coordination of prisoner transportation, the responsibility for which had previously been divided between policing, courts and correctional agencies. This has been the situation in most jurisdictions where prisoner transportation has been contracted.

In England and Wales, the contracting of court escorts was first studied by the Home Office in 1995, shortly after the policy was first implemented. Two thirds of court clerks reported that the service had improved, while almost 30 percent thought that it was equal to what had been provided before.¹¹⁴ A survey of prisoners in 2000 reported that while there were improvements that could be made, overall, the contractors were delivering services well.¹¹⁵ And a study for the Prison Service conducted by PA Consulting at the end of the first generation of contracts in 2002 found that costs had been reduced below that of the previous in-house service, although there was potential for further savings.¹¹⁶

In Scotland, prior to reform, prisoner escorts were undertaken by 8 police forces and the Scottish Prison Service. Following a multi-agency review, these services were rationalised and contracted in 2002–2003. A study by the Scottish Prison Service in December 2006 concluded:

- Centralisation and contracting had released about 300 police officers and 200 prison officers to undertake core duties..
- Management information had improved in accuracy, consistency and quantity.
- There were 33 performance measures in the contract, with a minimum standard for each. The initial contractor matched or exceeded these standards in all but a few months.¹¹⁷

In Australia, Victoria, West Australia and South Australia have contracted prisoner transportation.

Home detention: In the UK, the private sector is involved not only in the supply and fitting of electronic monitoring devices for home detention, but also in monitoring compliance with curfew conditions. This scheme was introduced in 1999, following several years of pilots and its use is presently confined to juveniles and in the early release of adult offenders (who are typically under home curfew for 16 to 60 days).

While trials are being conducted on satellite tracking, at present the UK system is based on a more robust monitoring system that uses the telephone network. If the computer system detects a breach, the contractors first telephone the offender or make a home visit to confirm whether a violation has occurred. Once confirmed, the contractor can issue a warning, or if it is serious enough, contact the Public Protection Unit in the Ministry of Justice.

Recall rates are low – around 5 percent of the population on release. Most of these were for breach of curfew conditions and very few posed a risk of serious harm to the public.¹¹⁸

Studies have confirmed that where home detention is appropriate, it is a cost-effective alternative to imprisonment. A recent report by the Public Accounts Committee found that home detention costs the taxpayer £70 less per day than keeping an offender in prison.¹¹⁹

There are no comparative public sector costs against which to benchmark performance, since this service has been contracted from the outset. However, the latest round of competition, in 2005, reduced the cost of monitoring by 40 percent, with tougher financial penalties for poor performance.¹²⁰

Community sentencing: The voluntary sector has long played a role in supporting government in the management of parolees and offenders under community sentences. As noted elsewhere in the submission, the concept of probation was actually initiated by a third sector provider in the late 19th century.

In recent years, the UK government has also been exploring the potential for private firms and for private-voluntary joint ventures in this field. In particular, there has been interest in transferring output risk to private and voluntary providers – so that contractual payments would be based in part on the performance of offenders in remaining in work or education for a defined period of time, remaining in settled accommodation, continuing with a drug rehabilitation programme, and so on. This model is still in the very early stages of development.

Traffic cameras: In Victoria, traffic cameras are a key component of the state's road safety strategy. Speed is estimated to be a factor in more than a quarter of road crashes that result in fatalities or serious injuries. Since 2007, Serco's traffic camera system has helped to improve road safety and support civic compliance by ensuring that traffic camera and enforcement management services operate in a cost-effective way.

6.2 Emergency Services

Fire Services

Modern fire fighting was invented by the private sector, and until the 1860s, London's metropolitan fire brigade was wholly financed and operated by the insurance companies. There had been a time in the late 18th century when private fire brigades competed against one another, however by the 1830s, the insurance companies had created a single organisation to serve the population of London, at a time when parochial fire brigades across the city were still highly fragmented and sometimes refused to cross parish boundaries to fight fires.

Today there are few examples around the world of fire services being provided by the private or not-for-profit sectors. Until recently, the fire department of the City of Scottsdale, a large and rapidly growing adjunct to Phoenix, Arizona, was provided by a private corporation, Rural Metro. In Denmark, 60 percent of fire services are provided by Falck, a private, for-profit corporation, and have been since the 1920s. Indeed, municipal authorities were first encouraged to contract with Falck by a socialist government, which was seeking to modernise fire services and needed to find a way of overcoming local resistance to perceived nationalisation. Falck is so much a part of Denmark's emergency services that many Danes are not aware that it is a private corporation. Many Danes are not aware that Falck is a private for-profit provider, and even staunch critics of public-private partnerships regard it as something of an anomaly.

Some years ago, an English academic, Norman Flynn, was interviewed on Australian radio about the denationalisation of public services. While clearly uncomfortable with the privatisation and outsourcing that was taking place in Europe, Flynn found it difficult to say whether Falck's fire and emergency services were primarily public or private:

Falck is an anomaly in Europe. . . It's a complete aberration. Everybody trusts Falck like they trust the state. It's a quasi-state thing, it just happens to be privately owned. But it is a national monopoly for these emergency services. But it's interesting, because the Danes trust Falck as they trust the state.¹²¹

Ambulance Services

Ambulance services were also created through private endeavour, in this case by not-for-profit institutions, the Red Cross and St John's Ambulance. In the United States, municipal fire departments have increasingly taken over the first-responder role, although private, for-profit companies have been playing a larger role in the provision of paramedic services and medical transportation. The market leaders are American Medical Response which several years ago was providing emergency medical transportation in a fifth of America's top 200 cities, and Rural/Metro, which had around five percent of that market. In New York City, ambulance services are delivered by a mixture of public, private and voluntary providers, although there has been persistent criticism of the way in which these are coordinated and remunerated and the opportunities for gaming behaviour. Nevertheless, on 9/11, independent sector ambulances were almost as strongly represented at Ground Zero as the municipal sector, and several paramedics from private, for-profit firms lost their lives.

Japan has begun to liberalise ambulance provision, and in 2004, the Tokyo Fire Department started using private ambulances for non-emergency transportation. In Denmark, Falck provides 80 percent of ambulance services. In Germany these services are financed through taxation and user-charges levied on health insurers, but they are actually provided by voluntary medical aid organisations such as the Red Cross, the Samaritans and St John's. The independent sector also plays a major role in Norway, Finland and the Netherlands, and in Italy, a religious charity, the Misericordia, provides ambulance services throughout large parts of the country. West Australia, the Northern Territory and New Zealand are three of the jurisdictions in the English-speaking world where St John's Ambulance continues to provide emergency services.

Seamarks

England's lighthouses and seamarks today are owned by the state but managed by a third sector organisation, the Trinity Corporation, which was originally established in Tudor times. It is financed through a levy on all ships leaving English ports, collected on its behalf by the Customs Service.

6.3 Education

As noted at the outset, this submission is focused on contracted public services, and for this reason, it does not explore the rich variety of markets and quasi-markets that exist in different education systems around the world. For this reason, vouchers, private schools, charter schools, specialist schools and city academies are beyond the scope of this document. For the same reason, we

have omitted any consideration of the Victorian government's 'Skills for Victoria' initiative, which introduces voucher-style arrangements for technical and further education.¹²²

PPPs in Schools

Four Australian states are constructing new schools or refurbishing old through public-private partnerships. In the UK, there is a major programme of infrastructure renewal under the title 'Building Schools for the Future'. For the purposes of this submission, our interest lies not in the construction and financing of these facilities but rather in the services that are provided under the contracts.

New South Wales was the pioneer in PPP schools in Australia, letting a contract for nineteen schools in 2005. However, what was of particular interest to other states was not so much the construction programme as the comments of one of the principals, made to a meeting of federal and state education ministers, that the facilities management contract had provided her with a single point of contact in managing the school's physical facilities and enabled her to concentrate on delivering educational outcomes. Services provided by the private partners include cleaning, maintenance, repair, security, safety and utility for buildings, furniture, fittings, equipment and grounds.¹²³

Bursar Services in Schools

In 1996, the Department for Education and Children's Services in South Australia briefly explored the option of contracting for facilities management in schools, part of the objective being to free up principals to focus on teaching responsibilities.

It was proposed to appoint a contracted bursar or specialist schools administrator responsible for a cluster of nine or ten schools, with the services provided by staff dedicated to each school. It was expected that there would be savings through multitasking and resource sharing and it was hoped that this would result in the development of a pool of specialist school administrators. The Department for Education would avoid the management difficulties of a large tenured workforce. And principals and auditors would have the advantage of a single point of contact for support services.

Potential services included: office administration; human resource management; financial management; asset management; casual and relief teacher rostering; community and commercial development, including the hiring of school facilities; canteen support, including purchasing; maintenance and cleaning. The scheme did not proceed.

Intervention Models

The application of the intervention model to failing Local Education Authorities has been discussed in Section 5.6 above. As noted, this resulted in the introduction of private management companies into nine LEAs, and in spite of favourable results (measured in terms of student performance) only two of the original contracts remain. And while commitments to extend the same scheme to failing schools were not pursued, in several cases, private management companies were brought into the public system.

It appears that only one failing state school, King's Manor School in Guildford, was contracted out to private sector managers. In February 1999, after highly critical Ofsted reports, Surrey County Council named 3E's Enterprises Ltd as the preferred bidder to run the school. The company was the commercial arm of a special school, Kingshurst City Technical College. Nord Anglia, the US-based Edison Project and a non-profit trust, Centre for British Teachers (CfBT) were also involved in bidding to run the school. The school re-opened in September 2000, opting to use the International Baccalaureate in place of 'A levels'.¹²⁴

In the midst of the election campaign in late May 2001, the *Financial Times* broke the news that Nord Anglia was to be contracted to run Abbeylands School in Addlestone, Surrey. This was the first time that a for-profit organisation had been contracted to manage a state school. Abbeylands was performing well academically, although it had had difficulty attracting pupils. Nord Anglia wanted to reopen the school as a specialist school focused on business. The contract would run for seven years and the company would be paid a flat fee with bonuses for performance in bringing down exclusions and improving academic results.¹²⁵

On 10 June 2001, the new Education Secretary, Estelle Morris announced plans to expand the involvement of private firms in the running of state schools. The announcement made it clear that private involvement would extend beyond failing schools.¹²⁶ And yet, the strategy of using private management companies to turn around poorly performing schools was never implemented. In its place, the government introduced a system of City Academies, which seek a fresh start through the injection of private capital from charitable sources.

6.4 Health

Across the world, a great deal of healthcare is provided by non-governmental organisations, with infrastructure and services provided and funded in variety of different ways. This submission is concerned with private and voluntary sector support of health services that are overwhelmingly public in nature. It does not seek to explore quasi-vouchers such as Australia's Medicare card.

Primary Care Services

In the UK, general medical services have traditionally been regulated by a national agreement negotiated with the Department of Health on behalf of general practitioners (who were regarded as independent contractors) by the British Medical Association. Since 2004, the government has encouraged alternative arrangements, with Primary Care Trusts (PCTs), operating at local or regional level, contracting with a variety of providers, including corporate, third sector and other public sector organisations.

The policy has been described as involving a national programme of local procurements, with PCTs employing competition and contracting in different ways based on local conditions. Nevertheless, according to a November 2008 study, the most common reason given by PCTs for competitively tendering primary care services was the desire to improve access by filling gaps in provision. This study also found that corporate providers had a limited role in running practices. The most successful providers, in terms of winning contracts, had been GP-led companies.¹²⁷

The British government has also sought to fill gaps in the provision of out-of-hours services, by encouraging PCTs to contract for these services where GPs are unwilling to be flexible in this regard. In some cases, private firms have filled this gap by contracting for the provision of out-of-hours general medical services.

Primary Care Infrastructure

From 2001, the UK government encouraged local health authorities to establish joint ventures with private companies, known as Local Improvement Finance Trusts (LIFTs), to modernise GP premises and to build 500 one-stop health centres. By 2008, 47 LIFT companies had been established, which had delivered 210 buildings. Almost 3,000 GP's surgeries had been replaced or refurbished and 674 one-stop primary care centres had been built.

More recently, the government has directed local health authorities to start introducing 'polyclinics' – medical facilities housing a number of GPs along with diagnostic services that are expected to be open longer hours to serve a more demanding public. A recent newspaper report claimed that of 54 management contracts announced, 14 have been awarded to private firms, while a third have gone to groups of GPs.¹²⁸

Secondary Care

Support services: In the 1980s and 1990s, a number of countries, including Australia and the UK, used competition and contracting to reduce the cost of basic cleaning and catering services in public hospitals. The evidence concerning the effectiveness of these contracts has been mixed, albeit generally positive.¹²⁹

PFI/PPP hospitals: The New South Wales government established a public hospital using a PPP approach at Port Macquarie in the early 1990s. One of the features that was different about this example was that the contract included clinical services. Shortly after completion the project ran into political difficulties with a change of government and the twenty-year contract was terminated in 2005. No independent research has been published on the project and it is difficult to ascertain how much the problems were caused by political differences, and to what extent the model and its implementation were flawed. More recently, Victoria and New South Wales have commissioned PPP hospitals, with the private sector providing hard facilities management only.

In the UK, many of the hospital PPPs have also included soft FM services, such as portering, catering, cleaning and laundry. Since 1998, some 56 major health projects in Britain have been commissioned using PFI/PPP. One of the benefits of integrating the design and construction of the building with the provision of whole-of-life maintenance and the provision of support services is that the opportunity exists for introducing operational efficiencies through radical new design. At the Forth Valley hospital, the consortia has introduced robotics for the delivery of meals and linen, for the first time in the UK.¹³⁰

Regional governments in Japan and Canada have also been pursuing complex hospital PPPs, involving the private sector extensively in the supply of support services. For example, Abbotsford Regional Hospital and Cancer Centre in British Columbia, a PPP facility opened in 2008, also includes food, housekeeping, laundry and portering services in the facilities management.

6.5 Social Services

In many parts of the industrialised world, there was a massive increase in the use of non-profit organisations in the provisions of social care starting in the 1960s, although most of this expansion was in the provision of new services rather than outsourcing existing ones. By way of example, in Massachusetts, government purchase of services from the non-profit sector rose from US\$25 million in 1971 to US\$850 million in 1988.¹³¹ Recent developments, then, need to be seen in context.

Social Care

In 1997, the UK government introduced the direct payment of cash to certain beneficiaries of social care, in particular, adults with physical disabilities, in place of provision through local authority employees. From 2003, this was extended to all adult recipients of care services. Over the past year or two, this model has been discussed under the heading of 'personal budgets', with central government exploring the scope for service users to be given choice of provider.

The use of 'direct payments' in social care has been studied several times, finding that (among other things) service beneficiaries valued different outcomes from those that had been prioritised by local authorities. One study in the London Borough of Tower Hamlets found that users placed a high value on the dignity of choosing their own carer (who was often delivering quite personal services to the beneficiary), the sense of control as to who came into their home, and the flexibility of being able to make their own arrangements as to when the carer visited. On the other hand, the market was highly fragmented, and some service beneficiaries had difficulty in finding substitutes when carers moved or went on holidays.¹³²

In Australia, the private sector is already actively involved in providing homecare and community nursing, with some companies already having established a national presence. Silver Circle, for example, has established services across four states and the Northern Territory.

Adoption and Foster Care

In the 1990s, three North American states, Michigan, Kansas and Illinois, and a number of county governments privatised their adoption and foster care services, using somewhat different models. In most cases, the driver was the desire to increase the number of successful placements: the state of Kansas was prompted to act by a legal action brought by the American Civil Liberties Union.

In most if not all cases, the independent providers who entered these markets were not-for-profits.

The evidence on these contracts is mixed. Each of the programmes encountered difficulties, and while some may have delivered quality placements at a higher rate, others were evidently not value for money.¹³³

Social Housing

Some Australian governments have started to involve private companies in the provision of social housing. Spotless is involved in a \$7000 million PPP with Housing NSW to replace an ageing estate at Bonnyrigg in Sydney's western suburbs with 700 public and 1,500 private dwellings. The private consortium is responsible for design, construction, refurbishment, financing of the public housing over thirty years, as well as tenancy and facilities management.

In the United Kingdom, some private providers are also used to assist in the management of social housing, providing rent and arrears collection as well as repairs and ground maintenance. For example, at Clapton Park in the London Borough of Hackney (East London), Pinnacle is employed by residents through a Tenants Management Organisation to handle grounds maintenance, estate management, bulk refuse collection, graffiti removal, housing repairs and maintenance, tenancy management, rent arrears, anti-social behaviour case management as well as a local neighbourhood warden service.

6.6 Regulation and Revenue Collection

Regulation

In 1996, the Government of Mozambique contracted the management of its customs service for three years to Crown Agents, a commercial enterprise established by HM Customs (in the UK). Operational management commenced in May 1997, with the explicit objective of restructuring and modernising the organisation to reduce corruption, reduce clearance times and increase revenues.¹³⁴

SGS (Societe Generale de Surveillance S.A.) has provided pre-shipment inspection services for a number of governments, mostly in small developing nations. The largest of these contracts were with the governments of Indonesia, the Philippines, Pakistan, Cambodia and Peru. In most of these countries, the services were put to contract because of concerns about corruption within customs and the inability of these small nations to operate on an international basis. For example, in one country, importers were required to

pay the anticipated duty in advance and seek a reconciliation after the goods had been imported and the duty properly assessed. Prior to the contract with SGS, this reconciliation was undertaken manually, the customs service maintaining that it could not afford computers. Upon taking over inspections for this country, SGS increased receipts by 20 to 30 per cent.

Revenue Collection

When Ted Gaebler, one of the co-authors of the 1990s bestseller, *Reinventing Government*, left municipal government in California in the late 1980s, tax collection became one of his most successful business ventures. In return for a percentage of the revenue collected, Gaebler's firm identified local businesses not paying property taxes because their head office addresses lay outside the municipality. Local government officials had felt that it would not be profitable for them to track down this small number of non-paying businesses. The Queensland Treasury has used private firms to collect unpaid taxes.¹³⁵

Under compulsory competitive tendering, some municipalities in the United Kingdom have also contracted out tax collection. Capita Managed Services has had contracts with a number of UK councils to collect taxes: for example, the community charge and council tax on behalf of the East Cambridgeshire District Council; the non-domestic rate on behalf of the Royal Borough of Kensington and Chelsea; and management of the full range of exchequer services for Bromley Borough Council, including council tax and business rates.¹³⁶

6.7 Transportation

Road Management

Australia has been the world leader in the development of PPP tollroads, with the result that several key providers – Macquarie Bank and Transurban – have become major players in international markets. Transurban was probably the first company to recognise that tollroad management was a service to end users – in large part because of its need to understand the needs of the public in managing Australia's first fully electronic tollroad in Victoria. The company is now promoting that business model in North America. In Hong Kong and the United Kingdom, private companies have long held contracts for managing bridges and tunnels.

Traffic Management

Private companies are extensively involved in the management of traffic. In Britain, the National Traffic Control Centre was designed, constructed and is now operated under a public private partnership. As the operator, Serco is required to

monitor traffic and weather conditions, collect information about road works and planned and unplanned events, operate the centre and provide information through a variety of media to the police, highway authorities, the media and the general public.

In London, the congestion charging system was designed and delivered under contract, and is now managed by IBM, and proposals for heavy vehicle road user charging across the UK have all assumed substantial private sector involvement in the management.

Private providers are engaged in the management of traffic systems in a number of other countries around the world. The traffic control and surveillance system for the Hong Kong Shenzhen Western Corridor, linking Hong Kong to the mainland China city of Shenzhen, was delivered by Serco and KML Engineering. The project included the design, supply, installation and commissioning of a traffic control and surveillance system for more than 18 kilometres of highway.

Public Transportation

Of course, franchising and contract management of heavy and light rail, bus and ferry systems are commonplace around the world, although Australian state governments have been less innovative in this regard. There is no question that private companies possess the capability to manage these services. The challenge lies in designing contracts that incentivise the right behaviours, and ensuring that the parts work together to deliver an integrated service for the travelling public.

6.8 Scientific Research

In the UK, the National Physical Laboratory – the nation’s measurement institute – is managed by Serco under a ten-year contract, directly employing some of Britain’s leading scientists. NPL develops and maintains national standards on time, mass, weight and distance (among others) and represents the nation’s interests in the international standard-setting community.

In 2003, Britain’s Defence Evaluation and Research Agency was part-privatised, assuming the business name, QinetiQ. It was floated on the stock exchange in 2006. QinetiQ retains contracts with the British military for the testing of weapons systems, including electronic warfare systems and radar countermeasures.

In recent years, one of the Australian state governments has explored the possibility of a public-private partnership in the development of new agricultural and bio-security laboratories.

6.9 Local Government

Entire Local Authorities

In the United States, a number of cities have contracted virtually all municipal services, so that the role of the local authority is confined almost exclusively to commissioning. This approach has usually been adopted in areas characterised by rapid urbanisation, where newly-incorporated cities have created this model from the outset.

A series of contract cities have been created in Georgia since 2005 – Sandy Springs, a city with around 90,000 inhabitants, followed by Johns Creek, Milton and Chattahoochee Hill. Others are expected to follow. There had been an earlier example of this phenomenon in Los Angeles County, in the 1950s and 1960s. In that case, cities were permitted to incorporate on the condition that they did not deliver services themselves (driven largely by political opposition from the public sector unions in Los Angeles County). This model, referred to as ‘the Lakewood Plan’, resulted in the majority of services being purchased from the county, although academic research showed that the threat of competition had resulted in the Lakewood Plan cities spending 14 percent less on services than their self-provision counterparts.¹³⁷

There is also a North American municipality where substantial contracting was driven by the threat of receivership. In that case, from the mid-1980s, there appeared to be evidence of substantial savings.¹³⁸

Municipal Services

Local government has long been one of the most active areas of competition and contracting, in the United States, the United Kingdom and in parts of Europe. However, many of the functions were basic and readily susceptible to the Yellow Pages Test – vehicle towing, waste collection, building security, street repair, legal services and the like.

In the UK, the market for municipal services was largely created through compulsory competitive tendering in the 1980s, and in spite of strong resistance among local authorities at the time, the range of services has gradually expanded, so that complex and sophisticated services are now being put to the market.

Many of these are discussed elsewhere in this submission – congestion charging, the management of education services, tax collection and benefits payments, and business process outsourcing. Waste recycling and collection are

once again areas of pressing concern because of new penalties under European law for the failure to meet waste management targets. Two somewhat different solutions have emerged. Traditional waste management companies and new entrants are offering technological solutions, including waste-to-energy facilities. However, some local authorities are looking to innovative 'street-scene' contracts that combine waste management and recycling with grounds maintenance and street cleaning (including graffiti).

6.10 Corporate Support

It is difficult to capture and describe the vast range of support services that are now managed by private companies under contract: the following examples are illustrative of the scale of this programme, rather than attempting to be exhaustive.

Business Process Outsourcing (BPO)

BPO involves the outsourcing of business functions, both back office and, increasingly, front-of-house as well. The industry represents a development of IT-enabled change and has been particularly active in the public sector in the United States and the United Kingdom.

In the United States, ACS provides technology and billing support services for emergency medical transportation for the Houston Fire Department. In healthcare, it provides pharmacy benefits management, electronic health records, fraud and abuse detection, health cost management, medical utilisation management and health claims management. The company operates 311 customer call services for municipal governments.[§] And it provides case management and jury management systems for the courts.

Maximus processes payments and handles inquiries for childcare payments services in Georgia and Florida, and it manages British Columbia's entire Family Maintenance Enforcement Program (child support). It also manages the California Healthy Families Program, which provides health insurance to children from low-income families. The company receives and processes applications, determines program eligibility, undertakes some income screening, enrolls children in selected plans, bills and collects premium payments, and maintains the systems that interface with state eligibility systems.

London's congestion charging system was designed, implemented and, until it lost the contract recently, operated by Capita. The company also delivered the

[§] 311 numbers have been introduced in US municipal government in recent years as an integrated call centre for non-emergency services.

information systems supporting the Criminal Records Bureau, a one stop shop created by central government to assist public, private and voluntary sector organisations identify prospective employees who may be unsuitable to work with children. Capita now provides the administrative infrastructure and operates the call centre. However, the company's largest volume of business lies with local government, where it provides financial, corporate and treasury services, among others.

Shared Services

Both in the UK and in North America, over the past three or four years, central governments have sought to encourage departments and agencies, as well as local authorities, to reduce their operating costs by collaborating in the provision of corporate services, in areas such as finance, human resources, IT management and customer support. Contracting is often employed in transformations of this kind, in part because the use of a third party provider can help to overcome organisational differences.

While this ideal has proven much more difficult to implement than originally conceived, there have been some examples of outstanding success. For example, in 2005, the National Health Service entered into a joint venture with a private provider, Xansa, to provide centralised payroll, accounting, asset and supply chain management through NHS Shared Business Services. NHS trusts are not obliged to use the new service, and the joint venture has had to demonstrate the benefits. The strategy has worked, with more than a hundred public sector clients having signed up voluntarily.

Personnel Support

In North America, two companies, MPRI and Serco, manage the army's recruitment programme. Serco also works with soldiers to help them make the transition to civilian life, assists military families in long deployments and relocations, and provides counselling and support for wounded soldiers and their families.

The Serco Institute

The Serco Institute is an international research facility dedicated exclusively to the study of competition and contracting in public services. It was established in 1994 by the global service company, Serco Group plc, and conducts primary and secondary research into the conditions under which market instruments work best in the delivery of complex public services.

The Institute's research is publicly available, in fulfilment of our terms of reference, which require us to make a positive contribution to the development of politically and commercially sustainable public service markets around the world – www.serco.com/institute

In addition to our own publications, the Institute also manages an extensive online library on public service markets, which serves as a first point of reference for researchers and policymakers – <http://www.serco.com/instituteresource/index.asp>

The Serco Institute
22 Hand Court,
London, WC1V 6JF
United Kingdom

(p) +44 (0)20 7421 6773
(f) +44 (0)20 7421 6471

Endnotes

¹ Gary L. Sturgess et al, 'Competitive Edge: Does Contestability Work?', London: The Serco Institute, 2007.

² Paul H. Jenson and Robin E. Stonecash, 'The Efficiency of Public Sector Outsourcing Contracts: A Literature Review', Melbourne Institute Working Paper No.29/04, October 2004, p.9.

³ Graeme A. Hodge, *Privatization: An International Review of Performance*, Boulder, CO: Westview Press, 2000, pp. 128-129.

⁴ DeAnne Julius, 'Understanding the Public Services Industry: How Big, How Good, Where Next?', Public Services Industry Review, London: Department for Business Enterprise & Regulatory Reform, July 2008, pp.25-30.

⁵ Clive Grace, Keith Fletcher, Steve Martin and Ian Bottrill, 'Making and Managing Markets: Contestability, Competition and Improvement in Local Government', Final Report to the Audit Commission, Centre for Local and Regional Government Research, Cardiff University, 2007, p.91.

⁶ For a summary of these studies, see Gary L. Sturgess et al, 'Competitive Edge: The Evidence', London: The Serco Institute, 2007, pp.3-17.

⁷ See, for example, Office of Management and Budget, 'Competitive Sourcing: Report on Competitive Sourcing Results, Fiscal Year 2007', Washington: Executive Office of the President, May 2008

⁸ For a summary, Gary L. Sturgess et al, 'Competitive Edge: Does Contestability Work?', pp.63-64.

⁹ Industry Commission, 'Competitive Tendering and Contracting by Public Sector Agencies', Report No.48, Melbourne: Australian Government Publishing Service, January 1996, pp.10-13.

¹⁰ See Gary L. Sturgess et al, 'Competitive Edge: Does Contestability Work?', pp.42-43, 63-64.

¹¹ Patrick Carter, 'Review of PFI and Market Testing in the Prison Service', January 2001, p.3.

¹² Mike Newell, President of the Prison Governors' Association, 'Privatisation – the morale sapping sledgehammer', *The Howard League Magazine*, (May 2002), Vol.20, No.2, p.13.

¹³ Confederation of British Industry, 'The Business of Education Improvement: Raising LEA Performance Through Competition', London, February 2005.

¹⁴ See Gary L. Sturgess, 'Competition: A Catalyst for Change in the Prison Service', London: Confederation of British Industry, July 2003, pp.19-29.

¹⁵ Alison Liebling and Helen Arnold, 'Measuring the Quality of Prison Life', Research, Development and Statistics Directorate, Findings 174, London: Home Office, 2002.

¹⁶ Guy Shefer and Alison Liebling, 'Prison Privatization: In Search of a Business-Like Atmosphere?', *Criminology & Criminal Justice* (2008) Vol.8, No.3, pp.261-278 at pp.262, 264.

¹⁷ For a case study of urban water supply, see Gary L. Sturgess, 'Will Water Float? Competition and Private Provision in Urban Water Supply', Chapter 1.4 in Committee for the Economic Development of Australia, 'Water That Works', Melbourne, 2007, pp.43-50.

¹⁸ Mott MacDonald, 'Review of Large Public Procurement in the UK', London, July 2002, at [http://www.hm-treasury.gov.uk/d/7\(3\).pdf](http://www.hm-treasury.gov.uk/d/7(3).pdf)

¹⁹ Allyson M. Pollock, David Pryce and Stewart Player, 'An Examination of the UK Treasury's Evidence Base for Cost and Time Overrun Data in UK Value-for-Money Policy and Appraisal', *Public Money & Management*, April 2007, pp.1-7.

- ²⁰ Gary L. Sturgess, 'Competition: A Catalyst for Change in the Prison Service', pp.14-18; Gary L. Sturgess et al, 'Competitive Edge: Does Contestability Work?', pp.40-41.
- ²¹ The Allen Consulting Group, 'Performance of PPPs and Traditional Procurement in Australia', Final Report to Infrastructure Partnerships Australia, 30 November 2007.
- ²² Colin Duffield, 'Report on the Performance of PPP Projects in Australia. . .', National PPP Forum – Benchmarking Study, Phase II, Melbourne Engineering Research Institute, University of Melbourne, 17 December 2008.
- ²³ The Allen Consulting Group, 'Performance of PPPs and Traditional Procurement in Australia', p.5.
- ²⁴ This material is taken from R.W. Kostal, *Law and English Railway Capitalism 1825-1875*, Oxford: Clarendon Press, 1994, Chapter 7.
- ²⁵ *Richardson v McKnight* (1997) 117 S. Ct. 2100.
- ²⁶ *Correctional Service Corporation v Malesko* (2001) 122 S. Ct. 515.
- ²⁷ Scottish Prison Service, 'Prisoner Escort and Court Custody Services Contract: Post Implementation Review', December 2006, at <http://www.sps.gov.uk/MultimediaGallery/cacd677e-c916-4a61-be17-30ba3bcfac3b.pdf>
- ²⁸ A. Keith Bottomley et al, 'Monitoring and Evaluation of Wolds Remand Prison', London: Home Office Research and Statistics Directorate, 1997 and Adrian L. James et al, *Privatizing Prisons: Rhetoric and Reality*, London: Sage Publications, 1997.
- ²⁹ HM Chief Inspector of Prisons, 'Report on a Full Inspection of HM Prison The Wolds, 2-6 November 1998', London: Home Office, 1999, p.7.
- ³⁰ Jo Woodbridge, 'Review of Comparative Costs and Performance of Privately and Publicly Operated Prisons 1997-98', London: Home Office, Research Development and Statistics Directorate, 28 July 1999, p.21.
- ³¹ John Cronin and Robert F. Kennedy Jr., *The Riverkeepers*, New York: Scribner, 1997.
- ³² John C. Hilke, *Competition in Government-Financed Services*, New York: Quorum Books, 1992, p.121.
- ³³ John D. Donahue, *The Privatization Decision*, New York: Basic Books, 1989, p.78. See also Gary L. Sturgess et al, 'Competitive Edge: The Evidence'.
- ³⁴ Public Accounts Committee, 'Value for Money from NSW Correctional Centres', Report No. 13/53 (No.156), Sydney: Legislative Assembly of New South Wales, September 2005.
- ³⁵ Emma Reddington, 'Good People, Good Systems', London: The Serco Institute, 2004; Megan Mathias and Emma Reddington, 'Good People, Good Systems: What Public Service Managers Say', London: The Serco Institute, 2006.
- ³⁶ Jon Scott, 'Prison Breakthrough', *Business Voice*, October 2007, pp.42-48.
- ³⁷ For a succession of criticisms of this interference in the prison system, see Gary L. Sturgess, 'Competition: A Catalyst for Change in the Prison Service', London: Confederation of British Industry, July 2003, pp.32-33.
- ³⁸ Emma Reddington, 'Good People, Good Systems', p.29.
- ³⁹ Emma Reddington, 'Good People, Good Systems', pp.34-35.
- ⁴⁰ The term 'efficient boundaries' was first used by William G. Ouchi in 1980, and later adopted by Oliver Williamson – William G. Ouchi, 'Efficient Boundaries', Los Angeles: University of California, Mimeographed, 1980; Oliver E. Williamson, *The Economic Institutions of Capitalism*, New York: The Free Press, 1985, pp.96-98.
- ⁴¹ Lisbeth B. Schorr, *Common Purpose*, New York: Anchor Books, 1997, p.19. In our view, Schorr has correctly identified the problem, but not the solution.
- ⁴² E. Crawley, *Doing Prison Work*, Devon: Willan, 2004, p.11.
- ⁴³ Guy Shefer and Alison Liebling, 'Prison Privatization: In Search of a Business-Like Atmosphere?', pp. 270 & 272.
- ⁴⁴ See, for example, James G. March, 'Exploration and Exploitation in Organizational Learning', *Organizational Science* (February 1991), Vol2, No.1, pp.71-87, at p.79.
- ⁴⁵ These conclusions are based on a forthcoming study by the Serco Institute of the origins of the prisons market in the UK in the late 1980s and early 1990s, based on interviews with those involved at the time.

-
- ⁴⁶ Ross M. Stolzenberg, Sandra H. Berry, 'A Pilot Study of the Impact of OMB Circular A-76 on Motor Vehicle Maintenance Cost and Quality in the US Air Force', R-3131-MIL, Prepared for the Office of the Assistant Secretary of Defense/Manpower, Installations and Logistics, Santa Monica, California: Rand, February 1985, p.31.
- ⁴⁷ Stephen Bach, 'Too High a Price to Pay? A Study of Competitive Tendering for Domestic Services in the NHS', Warwick Papers in Industrial Relations, No.25, Industrial Relations Research Unit, School of Industrial and Business Studies, University of Warwick, Coventry, July 1989, p.11.
- ⁴⁸ Neil Conway and Rob B. Briner, *Understanding Psychological Contracts at Work*, Oxford: Oxford University Press, 2005, p.10.
- ⁴⁹ Commission on Public Private Partnerships, *Building Better Partnerships*, London: Institute for Public Policy Research, 2001, p.42.
- ⁵⁰ Barbara J. Stevens, 'Delivering Municipal Services Efficiently: A Comparison of Municipal and Private Service Delivery', HUD-003744, Report for the Office of Policy Development and Research, US Department of Housing and Urban Development, June 1984.
- ⁵¹ Trevor Colling, 'Contracting Public Services: The Management of Compulsory Competitive Tendering in Two County Councils', *Human Resource Management Journal*, Vol.3, No.4 (Summer 1993), pp.5,9.
- ⁵² General Accounting Office, 'GSA's Cleaning Costs Are Needlessly Higher Than In the Private Sector', AFMD-81-78, Washington, 24 August 1981, p.12.
- ⁵³ Ross M. Stolzenberg, Sandra H. Berry, 'A Pilot Study of the Impact of OMB Circular A-76 on Motor Vehicle Maintenance Cost and Quality in the US Air Force', R-3131-MIL, Prepared for the Office of the Assistant Secretary of Defense/Manpower, Installations and Logistics, Santa Monica, California: Rand, February 1985, p.30.
- ⁵⁴ Cited in Dudek and Company, 'Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers', study prepared for the National Commission for Employment Policy, May 1988, p.22.
- ⁵⁵ John Handy and Dennis O'Connor, 'How Winners Win: Lessons Learned from Contract Competitions in Base Operations Support', Logistics Management Institute Report, Prepared for the US Department of Defense, 1984, cited in Dudek and Company, 'Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers', study prepared for the National Commission for Employment Policy, May 1988, pp.28-29.
- ⁵⁶ Barbara J. Stevens, 'Comparative Study of Municipal Service Delivery', Report for the Office of Policy Development, US Department of Housing and Urban Development, February 1984, cited in Dudek and Company, 'Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers', pp.27-28.
- ⁵⁷ For a discussion of these difference, see Gary L. Sturgess, 'Competition: A Catalyst for Change in the Prison Service', pp.38-40.
- ⁵⁸ R. Derek Trunkey, Robert P. Trost and Christopher M. Snyder, 'Analysis of DOD's Commercial Activities Program', April 1996, GAO, 'DOD Force Mix Issues: Converting Some Support Officer Positions to Civilian Status Could Save Money', GAO/NSIAD-97-15, 23 October 1996, both cited in GAO, 'Base Operations: Challenges Confronting DOD as it Renews Emphasis on Outsourcing', GAO/NSIAD-97-86, March 1997, p.15.
- ⁵⁹ Australian Industry Commission, 'Cost Case Study – Amberley Air Base', Appendix F in 'Competitive Tendering and Contracting by Public Sector Agencies', Report No. 48, Melbourne: Australian Government Publishing Service, 24 January 1996, p.569.
- ⁶⁰ Alexis Sotiropoulos, 'Making Time: Freeing Up Front-Line Policing', London: The Serco Institute, 2008.
- ⁶¹ John Handy and Dennis O'Connor, 'How Winners Win: Lessons Learned from Contract Competitions in Base Operations Support', Logistics Management Institute Report, Prepared for the US Department of Defense, 1984, cited in Dudek and Company, 'Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers', pp.28-29; Barbara J. Stevens, 'Delivering Municipal Services Efficiently: A Comparison of Municipal and Private Service Delivery', HUD-003744, Report for the Office of Policy Development and Research, US Department of Housing and Urban Development, June

1984, p.16; Keith Hartley and Meg Huby, 'Contracting-Out Policy: Theory and Evidence', in John Kay, Colin Mayer and David Thompson, *Privatisation and Regulation: The UK Experience*, Oxford: Clarendon Press, 1986, pp.284-296. On the NHS in Britain, see P.B. Beaumont, 'Privatization, Contracting-Out and Public Sector Industrial Relations: The Thatcher Years in Britain', *Journal of Collective Negotiations*, Vol.20, No.2 (1991), p.97.

⁶² Department of the Environment, *Competition and Service: The Impact of the Local Government Act 1988*, London: HMSO, 1993, p.158.

⁶³ P.B. Beaumont, 'Privatization, Contracting-Out and Public Sector Industrial Relations: The Thatcher Years in Britain', *Journal of Collective Negotiations*, Vol.20, No.2 (1991), p.97.

⁶⁴ John Handy and Dennis O'Connor, 'How Winners Win: Lessons Learned from Contract Competitions in Base Operations Support', Logistics Management Institute Report, Prepared for the US Department of Defense, 1984, cited in Dudek and Company, 'Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers', pp.28-29.

⁶⁵ Simon Domberger, Paul Jensen and Robin Stonecash, 'Examining the magnitude and sources of cost savings associated with outsourcing', Sydney: Australian Graduate School of Management, 2000.

⁶⁶ Barbara J. Stevens, 'Delivering Municipal Services Efficiently', p.19.

⁶⁷ Barbara J. Stevens, 'Delivering Municipal Services Efficiently', pp.34-35.

⁶⁸ Barbara J. Stevens, 'Delivering Municipal Services Efficiently', p.25.

⁶⁹ John D. Donahue, *The Privatization Decision: Public Ends, Private Means*, New York: Basic Books, 1989, p.66.

⁷⁰ For a summary of the evidence, see Gary L. Sturgess et al, 'Competitive Edge: Does Contestability Work?', pp.45-46.

⁷¹ Department of the Environment, *Competition and Service: The Impact of the Local Government Act 1988*, London: HMSO, 1993, p.158.

⁷² Audit Commission, 'Securing Further Improvements in Refuse Collection', London: HMSO, 1984.

⁷³ General Accounting Office, 'GSA's Cleaning Costs Are Needlessly Higher Than In the Private Sector', AFMD-81-78, Washington, 24 August 1981, pp.26, 28.

⁷⁴ General Accounting Office, 'GSA's Cleaning Costs Are Needlessly Higher Than In the Private Sector', p.13.

⁷⁵ Barbara J. Stevens, 'Delivering Municipal Services Efficiently', pp.17-19.

⁷⁶ John C. Hilke, *Competition in Government-Financed Services*, New York: Quorum Books, 1992, pp.121-122.

⁷⁷ Barbara J. Stevens, 'Delivering Municipal Services Efficiently', p.25.

⁷⁸ Barbara J. Stevens, 'Delivering Municipal Services Efficiently', p.18.

⁷⁹ Trevor Colling, 'Contracting Public Services: The Management of Compulsory Competitive Tendering in Two County Councils', *Human Resource Management Journal*, Vol.3, No.4 (Summer 1993), p.9.

⁸⁰ Serco Institute, 'Competition and Contracting: Learning from Past Experience', Hong Kong: Efficiency Unit, January 2008.

⁸¹ For a North American statement of the importance of a political champion, see United States General Accounting Office, 'Privatization: Lessons Learned by State and Local Governments', Report to the Chairman, House Republican Task Force on Privatization, GAO/GGD-97-48, March 1997, pp.8-9. In North America, the term 'privatization' is used to include the contracting of public services.

⁸² DeAnne Julius, 'Understanding the Public Services Industry: How Big, How Good, Where Next?', Public Services Industry Review, London: Department for Business Enterprise & Regulatory Reform, July 2008, p.43.

⁸³ See Independent Commission Against Corruption, 'Investigation into Bribery and Fraud at RailCorp. Eighth Report: Corruption Prevention', Sydney: ICAC, December 2008, at http://www.icac.nsw.gov.au/files/pdf/Monto_Report_8_for_web1.pdf

⁸⁴ One of the earliest policy documents in the UK to adopt this approach was a 2003 report by the Office of Government Commerce, Sir Christopher Kelly, 'Increasing Competition and Long Term Capacity Planning

in the Government Marketplace', London: OGC, December 2003, located at

http://www.ogc.gov.uk/documents/report_to_Chancellor.pdf

⁸⁵ See Gary L. Sturgess and Briony Smith, 'Designing Public Service Markets', London: Serco Institute, 2006, located at http://www.serco.com/Images/Designing%20Markets_tcm3-16430.pdf

⁸⁶ Gary L. Sturgess, 'A Fair Field and No Favours: Competitive Neutrality in UK Public Service Markets', London: CBI and the Serco Institute, January 2006 at

http://www.serco.com/Images/Comp%20Neutrality_Prf6_tcm3-11584.pdf; David Walker, 'Counting the Cost: Full Cost Comparison Between Public Service Providers', London: CBI, June 2008 at

<http://www.cbi.org.uk/pdf/CBICompetitiveNeutralitybrief.pdf>

⁸⁷ Commission on Public Private Partnerships, 'Building Better Partnerships', London: Institute for Public Policy Research, 2001, pp.131-132.

⁸⁸ Personal conversation with the author, 13 February 2009.

⁸⁹ See, for example, DeAnne Julius, 'Understanding the Public Services Industry', pp.58-59.

⁹⁰ DeAnne Julius, 'Understanding the Public Services Industry', p.45.

⁹¹ DeAnne Julius, 'Understanding the Public Services Industry', pp.52-59.

⁹² For a theoretical discussion of these issues based on a study of contracting for the maintenance of Melbourne water infrastructure, see Paul H. Jenson, *Public Sector Outsourcing Contracts*, VDM Verlag Dr Müller, 2007, pp.110-151.

⁹³ Briony Smith, 'What Gets Measured: Contracting for Delivery', London: The Serco Institute, 2007.

⁹⁴ Danny Ertel, 'Getting Past Yes: Negotiation as if Implementation Mattered', *Harvard Business Review*, November 2004, pp.60-68 at p.62.

⁹⁵ For a summary, see Dilys Foster with Gary L. Sturgess, 'Practical Partnering – Making the Most of Complex Relationships', *PPP Bulletin*, No.2 (August-September 2005).

⁹⁶ Efficiency Unit, Office of Public Service and Science, 'The Government's Guide to Market Testing', London: HMSO, 1993, p.3.

⁹⁷ *The Indianapolis Experience: A Small Government Prescription for Big City Problems*, City of Indianapolis, July 1996, 4.

⁹⁸ Governor Pete Wilson, *Competitive Government: A Plan for Less Bureaucracy, More Results*, State of California, April 1996, p. 27.

⁹⁹ Office of Management and Budget, 'The President's Management Agenda', Washington: Executive Office of the President, 2002.

¹⁰⁰ Office of Management and Budget, 'Competitive Sourcing: Report on Competitive Sourcing Results, Fiscal Year 2004', Washington: Executive Office of the President, May 2005; Office of Management and Budget, 'Competitive Sourcing: Report on Competitive Sourcing Results, Fiscal Year 2007', Washington: Executive Office of the President, May 2008.

¹⁰¹ David Grissmer and Ann Flanagan, 'Exploring Rapid Achievement Gains in North Carolina and Texas', National Education Goals Panel, November 1998.

¹⁰² See Carol Innerst, 'Competing to Win: How Florida's A+ Plan Has Triggered Public School Reform', Center for Education Reform, April 2000, at http://edreform.com/school_choice/compete.htm

¹⁰³ Michael A. Fletcher, 'Private Firms Enlisted to Run Troubled Pa. School System', *Washington Post*, 23 March 2001, p.A08.

¹⁰⁴ Chester-Upland School District – School District Empowerment Team, *School District Improvement Plan*, 7 November 2000, at www.dciu.k12.pa.us/DelcoSchools/CUSD.htm

¹⁰⁵ Paul E. Peterson and Matthew M. Chingos, 'Impact of For-Profit and Nonprofit Management on Student Achievement: The Philadelphia Intervention, 2002-2008', Cambridge: Harvard's Kennedy School of Government, 2009, located at http://www.hks.harvard.edu/pepg/PDF/Papers/PEPG09-02_Peterson_Chingos.pdf; and Brian Gill et al., 'State Takeover, School Restructuring, Private Management, and Student Achievement in Philadelphia', Santa Monica, CA: RAND Corporation, 2007, located at http://www.rand.org/pubs/monographs/2007/RAND_MG533.pdf

¹⁰⁶ Jim Kelly, 'More scope offered for companies in schools', *Financial Times*, 29 February 2000, p.6.

¹⁰⁷ Department for Education and Skills, 'Schools: Achieving Success', September 2001, par.6.3.

¹⁰⁸ Office of Her Majesty's Chief Inspector of Schools, 'Inspection of Islington Local Education Authority', March 2000.

¹⁰⁹ Rebecca Smithers, 'Trial by public', *The Guardian, Education Supplement*, 4 September 2001, pp.6-7.

¹¹⁰ Confederation of British Industry, 'The Business of Education Improvement: Raising LEA Performance Through Competition', London, February 2005.

¹¹¹ See Alexis Sotiropoulos, 'Making Time: Freeing Up Front-Line Policing', London: The Serco Institute, 2008.

¹¹² Jerold S. Auerbach, *Justice Without Law?*, Oxford University Press, 1983.

¹¹³ For some of the early literature on FRCs, see Allie Bailey, 'Family Relationship Centres: Implications for Separating Families', *DVIRC Quarterly*, Edition 4, Summer 2005/06, pp.22-26; and Arti Sharma, 'Family Relationship Centres: Why We Don't Need Them', *Issue Analysis*, No.70, Sydney: Centre for Independent Studies, 12 April 2006.

¹¹⁴ D. Caddle, 'A Survey of the Prisoner Escort and Custody Service Provided by Group 4 and Securicor Custodial Services', Research and Planning Unit Paper 93, London: Home Office, 1995.

¹¹⁵ Bridget Williams, Christopher Cuthbert and Ghazala Sattar, 'Prison Escort and Custody Services: Prisoners' Experiences', Home Office Research, Development and Statistics Directorate, Research Findings No.123, London: Home Office, 2000.

¹¹⁶ PA Consulting Group, 'Better Quality Services Review of the Prisoner Escort and Custody Services', 2002, at http://www.paconsulting.com/publications/cs_open/cs_Prison_Service_PECS.htm

¹¹⁷ Scottish Prison Service, 'Prisoner Escort and Court Custody Services Contract: Post Implementation Review', December 2006, at <http://www.sps.gov.uk/MultimediaGallery/cacd677e-c916-4a61-be17-30ba3bcfac3b.pdf>

¹¹⁸ Kath Dodgson et al., 'Electronic Monitoring of Release Prisoners: An Evaluation of the Home Detention Curfew Scheme', Home Office Research Study 22, London: Home Office, March 2001, p.24, at <http://www.homeoffice.gov.uk/rds/pdfs/hors222.pdf>

¹¹⁹ Committee of Public Accounts, 'The Electronic Monitoring of Adult Offenders', House of Commons, Session 2005-06, 62nd Report, 12 October 2006, at <http://www.publications.parliament.uk/pa/cm200506/cmselect/cmpubacc/997/997.pdf>

¹²⁰ Committee of Public Accounts, 'The Electronic Monitoring of Adult Offenders', House of Commons, Session 2005-06, 62nd Report, 12 October 2006, at <http://www.publications.parliament.uk/pa/cm200506/cmselect/cmpubacc/997/997.pdf>

¹²¹ Norman Flynn with Geraldine Doogue on 'Life Matters', 2RN, 23 October 1995 at about 9.30am.

¹²² Victorian Government, 'Securing Jobs for Your Future', Melbourne, August 2008, at http://www.skills.vic.gov.au/data/assets/pdf_file/0003/15969/SecuringJobsforYourFuture-SkillsforVictoria.pdf

¹²³ For a summary of the contract, see https://www.det.nsw.edu.au/media/downloads/doingbusiness/tender_contract/contractdisc/ppp2/ppp2summary.pdf

¹²⁴ David Charter, 'Privately run state school is opened', *The Times*, 7 September 2000, p.9.

¹²⁵ Jim Kelly, 'Nord Anglia in pioneering deal to run state school', *Financial Times*, 23 May 2001, p.3; Will Woodward, 'Profit-making private company takes over running of school', *The Guardian*, 24 May 2001, p.20.

¹²⁶ Richard Garner, 'Private firms to get bigger role in state schools', *The Independent*, 11 June 2001, p.6.

¹²⁷ Jo Ellins, Chris Ham and Helen Parker, 'Choice and Competition in Primary Care: Much Ado About Nothing?', Health Services Management Centre, Policy Paper 2, University of Birmingham, November 2008.

¹²⁸ Kate Devlin, 'One in four new polyclinics to be privately run', *Telegraph*, 19 January 2009.

¹²⁹ For a brief summary, see Gary L. Sturgess et al, 'Competitive Edge: Does Contestability Work?', pp.24-31.

¹³⁰ See Briony Smith, 'Built to Serve: The Benefits of Service-Led PPPs', London: The Serco Institute, 2007.

¹³¹ S.R. Smith and M. Lipsky *Nonprofits for Hire: The Welfare State in the Age of Contracting*, , Cambridge, Mass.: Harvard University Press, 1993, p.6.

¹³² For one case study, see Claire Frew, 'Making choices in social care: Service users' experiences of the Direct Payments Scheme', London: Tower Hamlets and Queen Mary University of London, March 2007.

¹³³ See Planning and Learning Technologies, Inc, and The University of Kentucky, 'Literature Review on the Privatization of Child Welfare Services', US Department of Health and Human Services, 25 August 2006; Erwin A. Blackstone, Andrew J. Buck, Simon Hakim, 'Privatizing adoption and foster care: Applying auction and market solutions', *Children and Youth Services Review*, (2004) 26, pp.1033-1049; Frank Emspak, Roland Zullo and Susan J. Rose, 'Privatizing Foster Care Services in Milwaukee County', Milwaukee: The Institute for Wisconsin's Future, April 1996.

¹³⁴ Michael Hubbard, Simon Delay and Nick Devas, 'Complex management contracts: the case of customs administration in Mozambique', *Public Administration and Development*, (1999) 19, pp.153-163.

¹³⁵ Private conversations with Ted Gaebler and Queensland Treasury officials.

¹³⁶ Action: A Newsletter from the Capita Group. Autumn 1993, pp.6-7; Address by David Bartlett, Borough Treasurer and Deputy Chief Executive, London Borough of Bromley, and Rod Aldridge, Chairman and Chief Executive, Capita Group plc., to a conference by the Citizen's Charter Unit of the UK Cabinet Office and Coopers Lybrand, 'Service for the Citizen', London, 7-8 December 1993.

¹³⁷ Robert T. Deacon, 'The Expenditure Effects of Alternative Public Supply Institutions', *Public Choice* (1979) 34, pp.381-397.

¹³⁸ Robert T. Kleiman and Anandi P. Sahu, 'Privatization as a Viable Alternative for Local Governments: The Case Study of a Failed Michigan Town', in Paul Seidenstat (ed), *Contracting Out Government Services*, Westport: Praeger Publishers, 1999, Chapter 10.