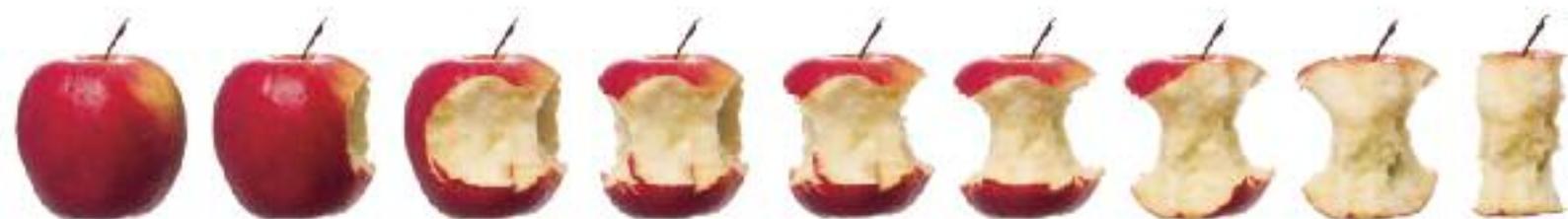


The Shrinking State:

Why the rush to outsource threatens our public services

A report for Unite by Howard Reed, Landman Economics

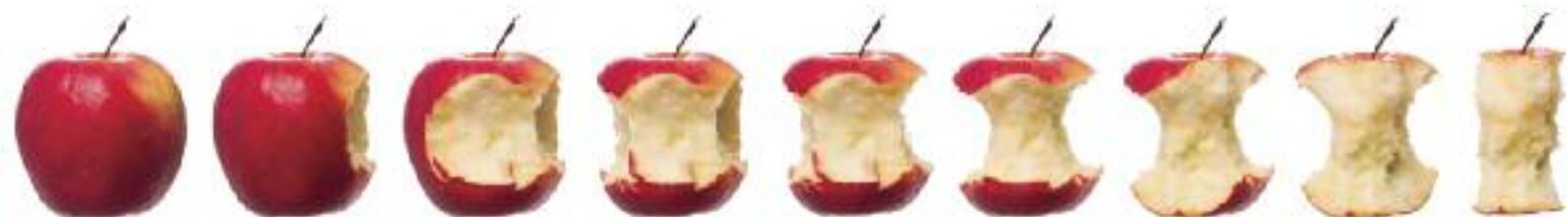
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Foreword

Our public services are under attack. The most drastic cuts programme for decades is accompanied by a set of reforms that seek to dramatically alter the way public services are delivered.

The generations-long compact between the citizen (taxpayer) and the state is set to be shattered. So deep are the changes planned by the Coalition government, the system we use to care for those in need will be swept away, probably never to be rebuilt.

Profound questions are being asked about whether the "reforms" proposed will actually work, untested as they are. Will they improve services universally – or is their real intention simply to shatter state provision?

Called upon to clarify what is the primary driver for the reform – genuine localism or out and out privatisation – the Prime Minister and the Deputy Prime Minister give widely divergent answers. While the former wants business to be the driver and the market to dominate, the latter argues for more local control by taxpayers.

What is clear is that neither party of the coalition campaigned on a platform of enforced transfer of taxpayer-funded services to the private sector, yet together, both will force the outsourcing of public services.

Other providers will be brought in, regardless of whether or not these are the most efficient or effective means by which to deliver services. A quick reference to the impact assessments accompanying the Health and Social Care Bill, which seeks to establish "any willing provider" in the National Health Service, confirms the government itself considers the NHS the best way to deliver health care in this country.

Similarly, arguments rage about the true purpose of the government's Big Society programme; the Prime Minister, at least, seems to be clear that for him the intention is to break up public services.

But why break up Britain's public services?

The rush to outsource will have a calamitous effect on the quality of public services that form the social architecture of this nation and upon which its citizens depend. Putting them beyond the scrutiny and influence of the taxpayer will undermine faith in our services. An absence of control by elected representatives over the provision and quality of services will give rise to the fear that community and citizen welfare will always play second fiddle to the self-interest of the boardroom.

This report takes an honest look at who wins and who loses in a shrunken state. We are grateful to respected economist Howard Reed for this important and insightful piece of work.

This report identifies a number of serious concerns with the government's outsourcing agenda including:

- the rushed nature of the government's programme, with little or no commitment to evidence-based policy;
- the risk of reduced transparency and democratic accountability;
- a massive shift in service provision to the voluntary sector running the risk of being the long and painful route to the privatisation of public services (while this sector has a role to play supporting the delivery of high quality public services, it ought to be seen as additional not replacement);
- the role of corporate lobbying by outsourcing companies who stand to profit hugely from the government's reforms;
- the risk that outsourcing poses to working conditions and the quality of public services. As Howard Reed shows, out-sourcing also erodes the quality of working life.

Unite is not against change. But reform needs to be based on sound, evidence-supported arguments, not tidal waves of initiatives. And sustainable change requires the involvement of staff. Public sector workers and their unions provide the knowledge, insight and experience essential to ensuring that reform is effective and deliverable.

Scything it back is not guaranteed to let better services bloom. But it will deny present and future generations of the support that has made Britain a fairer nation.

Yes, public services must keep pace with today's needs but no party has yet won the right to claim we have collectively agreed to the destruction of our social architecture.

From a world-admired fine health care service to a system meant to ensure the elderly are not left to fend for themselves. From schools which give our children a start in life to libraries which keep us learning throughout our life. Our parks and civic spaces, our advice services, swimming pools, lollipop ladies and our blood and transplant services.

These are the public services we cherish and value. These have helped build the Britain we know today.

And that is why Unite will oppose senseless attempts to shatter our national community.

**Len McCluskey, Unite general secretary
March 2011**

Executive Summary

The UK Coalition Government's November 2010 Green Paper Modernising Commissioning (to be followed by a White Paper early in 2011) signals an intention to move towards a much greater use of outsourcing in public services – that is, arrangements where services are funded publicly but delivered by the private for-profit sector, or the voluntary, community and not-for-profit (VCN) sector. These reforms are likely to go considerably beyond previous waves of outsourcing seen over the last thirty years in the UK, to the extent that direct provision by the public sector becomes the exception rather than the norm across most government-funded services.

Chapter 1: The Government's plans and their implication for public service provision

The outsourcing plans outlined in the Green Paper are being rushed through at breakneck speed, without sufficient consultation, planning, piloting or in-depth evaluation. The reforms are being implemented in tandem with the most severe period of public spending cuts since the 1970s, and are being accompanied by widespread public sector job losses. Even before the White Paper, the Government has announced major reforms to the NHS and school education which massively increase the scope for private providers to take over service provision. At the same time, several Conservative-controlled local authorities are moving towards a 'virtual council' or 'easyCouncil' model where virtually all local service provision is outsourced. And many central government functions are being outsourced en bloc.

Chapter 2: The impact of outsourcing on public service quality and costs of provision

Supporters of outsourcing argue that private (or VCN) sector provision of a public service usually argue from a simplistic economic model of service provision, claiming that outsourcing will produce improved quality and/or lower cost provision than if the service is provided in-house because public sector providers lack the economic incentives to deliver services efficiently compared with outsourced providers operating in competitive markets. However, in practice, matters are more complex than this and there are a number of other factors that should be taken into consideration:

- Most public services operate under a commissioner-provider relationship rather than the simple customer-supplier

relationship that characterises most consumer goods. When the service being provided is complex and performance of the provider is hard to monitor (as is the case with many public services), 'vertically integrated' services (i.e. in-house public sector provision) stand a good chance of performing more efficiently than outsourced services.

- The type of organisation that public service workers find themselves in may affect their motivation to do the job. Public sector (and indeed VCN sector) workers may have a 'public service ethos' or 'pro-social motivation' absent from the private sector which improves service quality.
- Private businesses have to provide a financial return to the owners of the business (e.g. shareholders) which will tend to make for-profit services more expensive than public or VCN sector providers who do not have to provide such a return.
- Trying to reduce delivery costs of public services by outsourcing may be counterproductive if it compromises the quality of service provision. For example, pressures to reduce costs can jeopardise the personalisation agenda in public services, and may increase the cost burden on other public services because many public services are interrelated (e.g. social care and health).

Existing empirical evidence on the effect of outsourcing on the cost and quality of a range of different public services suggests that, while in some cases, the introduction of competitive tendering for public service provision has resulted in an increase in efficiency, this does not mean that outsourced public services perform better overall than in-house services, because tendering has improved in-house performance as well. When public services are evaluated on the basis of quality of service provision and the cost of provision, rather than just choosing the lowest-cost provider, the public sector performs well as a provider of public services in most cases. In other areas of public service provision – particularly healthcare – empirical evidence shows that competition and outsourcing tend to lead to worse outcomes.

This report presents new evidence on the impact of outsourcing on working conditions in public services, using recent data from the UK Labour Force Survey to compare the conditions of employment of public sector, private sector and voluntary sector employees in similar jobs including childcare, healthcare, social work, cleaning and administrative jobs. Short job tenure and high turnover can have a detrimental impact on service provision because they disrupt service

delivery and the relationships between service users and providers, while long hours may endanger the safety of service providers or users. The results from analysing the Labour Force Survey show that short job tenure and working long hours are more common (and in some cases, much more common) in the private sector than the public sector, with the VCN sector somewhere in between.

Chapter 3: Outsourcing, transparency and accountability

In four key areas, the trend towards outsourcing appears to reduce the transparency and accountability of public service provision rather than increasing it (as many of the proponents of outsourcing would argue):

- i. Whereas public sector providers of public services are covered by the provisions of the Freedom of Information Act 2000, outsourced providers are not covered by the Act. This means that the greater the degree of outsourcing of public services, the less accountable the providers are.
- ii. Public sector providers have legal duties actively to promote equality under anti-discrimination legislation, but these duties do not apply to outsourced providers.
- iii. Outsourcing often results in a reduction of accountability through formal democratic processes at the local or national level (e.g. 'Free schools' and academies are outside local education authority control).
- iv. Outsourcing tends to increase fragmentation in service delivery which can increase the likelihood of 'postcode lotteries' whereby the extent and quality of service provision varies between different neighbourhoods in a more or less arbitrary manner.

Chapter 4: The role of the voluntary, community and not-for-profit (VCN) sector

In outlining its plans for public service reform the Government has given particular prominence to the VCN sector – including charities, social enterprises, mutual and worker-owned firms and trusts. VCN organisations are seen as flexible and decentralised and fit well with the Prime Minister's "Big Society" rhetoric, and certainly the VCN sector plays a hugely important role in the UK's social and economic infrastructure.

However, it is questionable whether a large-scale expansion of VCN provision of public services is sustainable at the same time as grant funding for activities currently undertaken by

the sector are being substantially cut. Most VCN sector organisations seeking to supply public services are small-scale enterprises; they will be in competition with large scale private contractors with turnovers of billions of pounds, who have the advantage of experience in bidding for contract, economies of scale and access to low-cost finance. There is an obvious risk that many VCN providers will not be able to provide public services on a financially viable basis in the long run, and will be bought up by private sector providers. If this happens, the current vogue for voluntary sector delivery of public services could turn out to be a long and painful route to privatisation.

Chapter 5: The role of corporate lobbying

Large-scale private sector companies which specialise in the provision of outsourced public services – such as Serco, Capita and Invensys – are in a position to profit hugely from the Government's reforms, both through winning new contracts for service provision, and through taking over failing VCN sector providers. It is in the commercial interests of private sector outsourcing providers to lobby politicians to promote greater use of their preferred model of public service delivery, and there is substantial evidence that lobbyists have driven policy development in health, education, auditing and other areas.

Chapter 6: The alternative

Given the clear drawbacks and problems with the Government's plans to expand outsourcing, it is important to develop a clear alternative which opposition politicians, civil society groups and members of the public, unhappy with the current direction of policy, can appeal to. This report suggests three alternative delivery models:

- i. "Insourcing" (Association for Public Service Excellence, 2009) whereby local authorities have taken previously outsourced services back in house, resulting in improved performance, cost efficiency savings, improvements in community well-being and satisfaction, benefits to the local economy, more flexibility and better service integration;
- ii. Improving outsourced public services by taking steps to encourage a fairly treated, well-managed and fully engaged workforce (IPA, 2010);
- iii. Improving in-house provision of public services without resorting to outsourcing, by collaboration between public

service employees based on a clear public service ethos married to an achievable and forward looking business strategy (Wainwright and Little, 2009).

In each case, there are four particular things which service providers – in whatever sector – need to get right to ensure good quality public services:

- A good quality, well-engaged, fairly remunerated and positively motivated public sector workforce is essential. Approaches which treat the workforce simply as a production cost to be minimised are unlikely to produce satisfactory results.
- There is no reason why the public sector cannot deliver high quality and efficient public services without having to resort to outsourcing. Indeed, to the extent that mass outsourcing disrupts good quality in-house supply arrangements, it is likely to reduce the quality of service provision.
- It is important to look at the provision of each service as part of an integrated package of public services. Simply parcelling up and contracting out each service in isolation is unlikely to deliver the best results.
- Public service reform needs to be driven by the needs and aspirations of service users and the service delivery workforce, involving both groups in the design and planning of services where possible. Reform is less likely to be successful where the process is driven externally by unaccountable lobbyists rather than being effected organically by those who are involved in public services on a day-to-day basis.

Introduction

In May 2010 a Conservative-Liberal Democrat Coalition Government took office in the United Kingdom, ending a thirteen-year period of Labour Government. The Coalition's headline policy thus far has been a programme of cuts in public expenditure unparalleled since the 1970s¹, aiming to eliminate the structural deficit in the public finances within four years. The resulting shrinkage in the public sector will reduce overall employment in the public sector by 330,000 posts (according to the Office for Budget Responsibility, which produces official government fiscal estimates),² and already, over 150,000 job losses have been announced by councils for 2011³ (with many more to come). However, another set of reforms with even wider implications for the way public services are delivered was announced by the Government with the publication of the Green Paper *Modernising Commissioning* in November 2010⁴, and a call to evidence to inform a White Paper on the future of public service delivery (scheduled to be published in March 2011). The Green Paper signals the Coalition Government's intention to move towards a much greater use of **outsourcing** in public services – that is, arrangements where services are funded publicly but delivered by the private for-profit sector, or the not-for-profit voluntary and community sector.

Outsourcing has been an increasing feature of UK public service provision since the early 1980s, first under the Compulsory Competitive Tendering (CCT) reforms of the Conservative Government under Margaret Thatcher, which opened up large swathes of local government services (such as social care, refuse collection and office support services) to bids from private sector providers, and later into new areas such as NHS services, prison services and schools under Labour from 1997 onwards. However, the reforms announced in the Green Paper (and the forthcoming White Paper) are likely to go considerably beyond anything attempted before in the UK, to the extent that direct provision by the public sector becomes the exception rather than the norm across most government-funded services.

This report aims to assess the likely impact of the increase in public service outsourcing which will result from implementation of the Coalition Government's plans. The research contained here examines what the evidence from previous waves of outsourcing tells us about the cost, quality and responsiveness of public services provided by the private sector – or the voluntary and community and not-for-profit

(VCN) sector – compared with direct provision by the public sector. Wherever possible I draw on both the latest empirical evidence and economic theory to place the discussion in a rigorous academic context, while remaining mindful of the political imperatives behind the promotion and expansion of outsourcing under the current Government.

The structure of the report is as follows. Chapter 1 looks in more detail at the Coalition's plans and their implications for public service provision in the UK. Chapter 2 assesses the evidence base on the impact of outsourcing on public services, including new evidence from the UK Labour Force Survey on the relationship between which sector provides public services and what working conditions are like. Chapter 3 looks at the effects of outsourcing on the transparency and accountability of public services. Chapter 4 looks at the increasing role that the VCN sector plays in public service provision, and what the implications of this are. Chapter 5 looks at the influence that corporate lobbyists have had on recent and current government policies aimed at promoting outsourcing. Finally, Chapter 6 combines conclusions regarding the impact of outsourcing on public services with an alternative vision for service provision which puts the achievement of high quality and the empowerment of the public service workforce centre stage.

1 The Coalition Government's plans and their implications for public service provision

1.1 The Modernising Commissioning Green Paper and the forthcoming public service reform White Paper

The Coalition Government's call for evidence on its White Paper on public service reform, expected to be published in March 2011, asks for evidence from all interested organisations on how reform might be moved forward in the following areas:

- a) Promoting independent (i.e. private sector, or VCN) provision in "key public services";
- b) Developing new rights for communities and public employees to buy and run services – for example through forming mutual or social enterprises to buy out the services previously provided by the public sector;
- c) Attracting external investment and expertise into the public sector (i.e. from the private or VCN sectors) to deliver better and more efficient services;
- d) Extending innovative payment and funding mechanisms, such as personal budgets and payment-by-results commissioning;
- e) Increasing democratic accountability at a local level (through decentralisation of mechanisms for regulatory oversight of services, and the provision of more information about service quality);
- f) Maintaining continuity of service and managing risks arising as a result of these reforms.

The call for evidence for the White Paper was published at the same time as the *Modernising Commissioning* Green Paper, which focuses specifically on the role of the voluntary and community not-for-profit sector in delivering public services:

"This Green paper... takes forward commitments made in The Coalition: our programme for government [the Coalition agreement negotiated between the Conservatives and Liberal Democrats before the current government was formed on 12 May 2010] to 'support the creation and expansion of mutuals, co-operatives, charities and social enterprises, and enable these groups to have a much greater involvement in the running of public services'." (Cabinet Office, 2010)

While the above quote makes it sound that the public service

reform agenda is all about increasing the role of the VCN sector in delivering public services (and indeed, the VCN sector is discussed in detail in Chapter 4 of this report), the White Paper call for evidence makes it clear that the reform agenda is in fact about expanding private for-profit provision as well as VCN sector provision. For example, one of the questions contributors to the call for evidence were asked is, "can you identify specific opportunities for bringing private sector investment and expertise into the delivery of public services?"

In common with many of the reforms that the Coalition Government is introducing across a range of areas, the process for designing and legislating the reforms is very fast-paced – so much so, in fact, that it breaches the Government's own guidelines on consultation processes, which specify a minimum of twelve weeks between the announcement of a call for evidence and the deadline for the submission of evidence⁵. This call for evidence was announced on 26th November 2010 with a closing date for submissions of Wednesday 5th January – less than six weeks, including the Christmas and New Year bank holidays when many offices close for at least one week. It is difficult to avoid the impression that major reforms to the structure of public service provision are being rushed through without sufficient consultation, planning or in-depth evaluation. Nor is any attempt being made to pilot any new forms of outsourcing that might be recommended in the White Paper before rolling them out nationally (at least in England)⁶.

In advance of the White Paper, Prime Minister David Cameron has explained how he sees outsourcing of public services as part of his "Big Society" initiative, in an article in the Daily Telegraph timed to coincide with a major speech by him on the same issues:

"The Big Society... is about rebuilding responsibility and giving people more control over their lives... I would argue that our plans to devolve power from Whitehall, and to modernise public services, are more significant parts of our Big Society agenda than the work we're doing to boost social action..."

Ours is a vision of open public services, and we will make it happen by advancing some key principles. The most important is the principle of diversity. We will create a new presumption – backed up by new rights for public service users and a new system of independent adjudication – that public services should be open to

a range of providers competing to offer a better service. Of course there are some areas – such as national security or the judiciary – where this wouldn't make sense. But everywhere else should be open to diversity; open to everyone who gets and values the importance of our public service ethos. This is a transformation: instead of having to justify why it makes sense to introduce competition in some public services – as we are now doing with schools and in the NHS – the state will have to justify why it should ever operate a monopoly.

(David Cameron, “How we will release the grip of state control”, Daily Telegraph, 20 February 2011)

1.2 The political context: Spending cuts, job losses and a pay freeze

The Government's public sector reform agenda will be implemented in tandem with the most severe cuts to planned public spending since the 1970s. The June 2010 'Emergency' Budget set out plans for a fiscal tightening of around £113 billion in nominal terms between the fiscal years 2010-11 and 2014-15⁷. Of this, £81 billion is being accomplished by spending cuts, with the rest achieved by tax rises. In current prices, a total of £73 billion of public expenditure cuts are planned, comprising:

- £16bn of reductions in benefit and tax credit spending;
- £48bn of cuts in spending on other public services;
- £9bn of reduced debt interest payments.

This means that over the current Parliament, public service provision will be under cost pressures, unprecedented for the last three decades, at the same time as an ambitious drive for reorganisation of and greater outsourcing of services. One immediate consequence of this is job cuts. The Office for Budget Responsibility estimates that the cuts will result in a net reduction of 330,000 in public sector employment over the period. However, in February 2011 the Guardian reported that councils in England had already announced plans for job reductions of over 150,000 posts – with almost half still to publish their plans⁸. This is on top of a reduction of 77,000 public sector jobs in 2010⁹.

In the 2010 Budget, the Chancellor of the Exchequer George Osborne also announced a two-year pay freeze for all employees earning over £21,000 per year (with a flat rate £250 increase for employees earning under £21,000).

1.3 Outsourcing plans already announced in key public service areas

Although the Government has not yet published its White Paper on public service reform, it has already announced reforms to several key areas of public service provision which are cornerstones of the outsourcing agenda. Additionally, local authorities sympathetic to the Coalition's approach have pre-empted the White Paper by announcing their own ambitious plans for transformation of the way local services are delivered. The most important recent announcements on particular areas of public services at the time of writing (February 2011) are the following:

Healthcare reform: from NHS provision to 'any willing provider'

The healthcare reform white paper published in July 2010¹⁰ abolishes the previous Government's National Health Service management framework (Primary Care Trusts and Strategic Health Authorities) and instead devolves the vast majority of public healthcare funding to consortia of General Practitioners, who will now be mandated by European Union competition law to purchase healthcare services from 'any willing provider' – whether public, private or VCN sector – on the basis of lowest cost. Outsourcing of publicly funded healthcare is not a new phenomenon in the UK – for example, the previous Government expanded purchasing of healthcare from private providers via the Independent Sector Treatment Centre scheme. But the reforms in the health white paper mean that all healthcare provision beyond the GP gateway could potentially end up outsourced, and have been likened by one commentator to “a hurricane which will blow the NHS apart”¹¹.

Academies and 'free' schools: the end of local education authorities?

One of the very first major pieces of legislation to receive royal assent in the current parliament was the Academies Act 2010, which vastly extends the role of academies – schools with charitable status, run by sponsors from the private and VCN sector, outside the remit of local education authorities (LEAs) – to deliver school-level education in England. The academies programme was started by the previous Labour Government as a mechanism for relaunching poorly-performing secondary schools under new management and with an injection of additional funds (some of which were provided by the sponsor). Even then, the programme was controversial because of the reduction in democratic accountability compared with LEA schools¹². But in its new guise as

redesigned by Education Secretary Michael Gove, the programme has several new characteristics. Firstly, it is no longer aimed just at poorly performing schools but at any school which wants to apply. Secondly, the programme has now been extended to primary schools and further education colleges as well as secondary schools. Lastly, the requirement for sponsors to provide additional funding for the school has been dropped.

By January 2011, around one in ten of all secondary schools in England were academies. The Academies Act also introduces provisions for consortia of parents to establish new 'free schools' outside LEA control with public funding. These are loosely based on school reforms introduced in Sweden in the last decade.

Virtual councils and 'easyCouncils'

Outsourcing of local authority services is not a concept that originated with the Coalition Government – it has been common practice for a variety of local services since the 1980s. However, several Conservative local authorities are now considering a huge expansion of outsourcing. In particular:

- Even before the 2010 election, Barnet Council in north London announced plans to find budget savings of £25 million per year by applying the cost-cutting approach of 'no-frills' airlines like Easyjet and Ryanair to the provision of council services. The idea is that the council would provide the statutory bare minimum level of service in areas like social care; above this level, services would be funded by user charges rather than central government grant or Council Tax. The use of low-cost outsourced service provision is a key element in this strategy.
- In October 2010, Suffolk council announced plans to outsource **all** its services, including administrative functions, social care, community health and youth services to private or VCN sector providers – in the process, moving from a directly employed workforce of 27,000 to around 300 people. This 'virtual council' would extend outsourcing into areas of local authority provision never before attempted in the UK – such as care homes for children.

Barnet and Suffolk are the most extreme examples of local authority outsourcing so far, but they are not isolated cases. Many other local authorities in England – including Labour and Liberal Democrat-controlled authorities and various combinations of party control as well as Conservative councils – are planning to increase their use of outsourcing. A key

driver of the moves towards greater outsourcing is the announcement by the Communities and Local Government Secretary Eric Pickles of severe cuts in central government grants to local authorities – as much as 18% over the next two years in some cases. Moreover, as shown by the New Local Government Network and Left Foot Forward, there is a correlation between the level of deprivation in each local authority and the percentage cut in central government support – more deprived areas are being hit harder on average¹³. This means that the councils which are providing the highest volume of services in proportion to their population size are under the biggest pressure to make economies.

In the devolved administrations of Scotland, Wales and Northern Ireland the picture is somewhat different as the UK Government determines the overall grant settlement for each country but not the level of individual settlements for each local authority. However, the overall grant to each country is being substantially reduced and so in practice many of the same pressures will apply as in England.

Block outsourcing of central government employees

At the level of central government there is a very direct link between the Coalition's outsourcing drive and the consequences for employees currently employed by government departments. Recent months have seen several announcements which involve outsourcing en bloc of functions previously provided directly, for example:

- Nearly 1,000 firefighters currently employed by the Ministry of Defence at military bases have been told that, as part of the Government's strategic defence review, they have been selected to be a part of the contracting out process and could be privatised by the end of the year¹⁴.
- The Government-owned Forensic Science Service, which employs 1,600 people, is to be closed down by 2012 in favour of using outsourced provision¹⁵.
- The Audit Commission, the public sector 'quango' tasked with scrutinising local government spending, which employed 2,000 people, was abolished in August 2010, to be replaced with outsourced provision by private sector accountancy firms¹⁶.
- The Forestry Commission, which employs around 850 people in England, was under threat as a result of government plans to sell off the entire portfolio of state-owned forests in England¹⁷, until a high profile campaign forced the government into a u-turn.

2 Outsourcing and public service provision: evidence on the impact on service quality and costs

The economic case for increased outsourcing of public service provision on the grounds of efficiency has to rest on one (or both) of two possible claims being true. It could be that outsourced public services provide *higher quality* services than equivalent services provided 'in-house' in the public sector, for the same cost of provision. Alternatively, it could be that outsourced public services provide *lower cost* services than in-house service provision, without compromising quality. In the best case scenario for proponents of outsourcing, both of these claims might be true. This chapter looks at whether outsourced public services tend to be of better quality than services provided in-house, and at whether outsourcing reduces the costs of provision.

This chapter is in three sections. The first part looks at the economic theory behind the effects of outsourcing on the quality and/or cost of services provided by outsourced operators compared with in-house providers. The second section reviews the existing empirical evidence on the impact of service outsourcing on costs and quality of service provision. The final part of the chapter presents new empirical evidence on working conditions – job tenure and hours of work – for public service employees in the private sector and VCN sector compared with the public sector.

2.1 Economic theory and outsourcing

At its simplest, the idea that outsourcing provision to the private (or VCN) sector will lower the costs of provision is based on the incentives which public sector providers have to control costs compared with private sector providers¹⁸. The argument is usually based on comparing a public sector monopoly provider of public services with a private sector provider of similar services subject to competitive pressures. Supporters of outsourcing argue that public sector provision is inefficient and wasteful because the lack of competition in the public sector means that there is no incentive for public sector providers to produce a given level of services in a cost-minimising way. By contrast (so the argument goes), private sector providers are attempting to maximise profits to deliver returns to shareholders in a competitive market environment. For a given quality of public service provision and a given level of revenue for the service producer (provided by a commissioning agent such as a local authority

or a GP consortium), maximisation of profit equates to minimisation of production costs. The implication of this simple model is that costs of provision will be minimised through private sector provision.

Although extremely simplistic, this is the basic model that has underpinned the rationale for outsourcing from a purely money-saving perspective, from the early days of Thatcherite compulsory competitive tendering onwards. While it is a seductive model in some quarters, a more sophisticated reading of economic theory suggests that matters are more complex than this, and that the simple comparison between monopolistic public sector provision and competitive market provision is at best a caricature and at worst an outright distortion of the institutional mechanisms of public service provision. There are a large number of other factors that need to be taken on board to produce a more balanced picture of the economics of public service provision, in particular the following:

'Principal-agent' theory and the management of arms-length relationships

In reality the relationship between a public sector service commissioning body and a service provider is often not a simple buyer-seller relationship such as the kind we experience as consumers when buying our weekly groceries from a store, but instead requires that the commissioner monitors the quality and quantity of the outputs over a given period of time. For example, if a local authority commissions a private sector company to provide social care services it needs to make sure that an adequate quality of service is being provided, that there are no incidents of negligence, and that the company is actually providing all the services that the commissioner is paying for. However, the commissioning body will not be able to monitor every single aspect of what the private sector company is providing, but will instead have to focus on an agreed set of monitoring outputs (e.g. an annual report from the service provider, interviews with executives from the company, an inspection regime at care homes, etc.) This is an example of an 'arms-length' relationship between commissioner and provider under what economists call 'conditions of imperfect information'.

There is a whole branch of economic theory (known as 'principal-agent' theory, originally developed by Nobel prize winning economists Joseph Stiglitz and James Mirrlees) which deals with the conditions under which these kinds of relationships are economically efficient¹⁹. Models of this kind of relationship are complex, but one key finding is that it is not necessarily most efficient for the provision of this kind of

service to be handled by a separate commissioner and contractor with their own different objectives (a principal-agent relationship), rather than running the service within one organization with a unified objective (in-house public sector provision, which economists would call a 'vertically integrated' model).

In general, the harder performance is to monitor, and the more complex the service being provided, the less well a principal-agent relationship performs compared with vertical integration. This may help explain why very complex contracts such as Public Private Partnerships (used for example during the renewal of the London Underground network) have caused such controversy²⁰.

The 'public service ethos' and 'pro-social motivation'

The simplistic economic model of public service provision usually assumes that the providers of public services have a purely selfish motivation; if they can get away with providing poor-quality, high cost services, then they will do. However, in practice this may not be the case. The type of organisation that public service workers find themselves in may affect their motivation to do the job. It is entirely possible that employees in a working environment which is not a purely private sector, profit-driven culture may bring a sense of motivation and commitment to their work which is not just about a narrow definition of "what's in it for me," but instead includes some element of *altruism* – the desire to help people without requiring additional gain to oneself. This is sometimes called the 'public service ethos' or 'pro-social motivation' (see for example Francois and Vlassopoulos, 2007), and may be present among VCN sector providers as well as public sector ones. The main idea is that there may be something about many public service jobs which make them intrinsically different from jobs in the for-profit sector – and indeed how this may be a reason for people choosing to work in the public (or VCN) sector in the first place.

The private sector and returns to owners

The principal objective of a private business is to maximise the financial return to the owners of the business – the shareholders in the case of a public limited company (plc), or the partners in the case of a company owned by a private equity house. By contrast, when public services are delivered in-house by the public sector (or indeed by VCN sector organisations) the business model is not normally expected to deliver a profit to the owners. All profits can be reinvested in improving the service.

This means in practice that if a public sector provider (or a VCN sector provider) and a for-profit private sector provider were delivering the same public service in exactly the same way, the for-profit provider would *have* to be more expensive (or alternatively, deliver lower-quality services for the same cost as the public sector or VCN sector) – because of the requirement to provide an additional return to the owners. While this is no doubt good news for organisations such as pension funds who invest in private companies delivering public services, in the context of severe pressures on public expenditure it hardly makes sense to be using a proportion of that expenditure to reward the owners of capital²¹. It seems more sensible to expect that the entirety of public expenditure on services is spent on the service itself – something that can only happen in the long run if the service is provided by the public sector or the voluntary sector.

When 'least-cost' delivery can be counterproductive

One problem with the drive to reduce the costs of delivery of public services by outsourcing is that a strategy of seeking to drive down costs "no matter what" may compromise the quality of service provision (or indeed impose other costs elsewhere in the public sector). For example, one of the objectives of the Coalition Government is to increase the extent to which public services are 'personalised' – that is, tailored to users' individual requirements. A good example of this is the Work Programme, the Government's replacement for the various New Deal welfare-to-work programmes initiated under the previous Government. The prospectus for the Work Programme states that it "will provide greater freedom for suppliers to give people the support they need rather than prescribing one-size-fits-all programmes from the centre... we will give delivery partners longer to work with individuals and greater freedom to decide the appropriate support for them" (DWP, 2010). Personalisation is often a good way of increasing the quality of public service delivery and there is good evidence that it works well in a welfare-to-work delivery context (Finn, 2008). However, it is not a cheap option for service delivery, as it involves a tailored solution for each public service client and more "face time" between client and adviser than a standardised service. Given that the total budget for the Work Programme is considerably less than the overall budget for the labour market programmes it is replacing, at a time when the number of long-term unemployed in the UK is expanding rapidly, there is a real danger that the personalisation aspects will not be implemented properly because of the severe cost pressures on these services.

Another problem which can arise through pursuing the lowest cost option in public service provision is that the problems that many public services have to deal with are interrelated – hence, reductions in the level or quality of provision in one service can have impacts on another public service. One of the most obvious inter-relations is between social care spending and NHS spending. In January 2011, the results of a survey of doctors in NHS hospitals suggested that “bed-blocking” – the problem whereby older patients are forced to stay in hospitals after they are fit to leave, because of inadequate provision in the social care system for their needs once leaving hospital – had increased significantly over the last 12 months²². Clearly, the lower the level of social care provision, the worse the bed-blocking problem is likely to be. And bed-blocking imposes substantial costs on the NHS because there are then less beds free to treat other patients. What this example illustrates clearly is that attempting to cut costs in one particular area of public spending may not cut overall costs – indeed, it may even increase overall costs. This is a particular issue for the cuts programme being pursued by the Coalition Government because some areas of public spending (e.g. social care, housing, benefits and tax credits) are suffering huge cuts whereas others are being maintained in real terms (e.g. NHS spending).

The previous Labour Government recognised (at least to some extent) the problems that a focus on low-cost provision as the sole criterion for the award of public service delivery contracts can cause, and replaced the previous requirement for local authorities to choose the lowest cost provider when contracting out service provision with a requirement to seek ‘Best Value’ – which allowed commissioners to look at the quality of the service being offered in tender bids rather than just the price. However, there are worrying signs that the current Government is moving back towards lowest cost as the be-all and end-all of public service provision. For example, in December 2010 the Government withdrew the “two-tier” code on terms and conditions in outsourced services, which had previously ensured that new employees working alongside former public sector workers in outsourced services got public sector benefits, such as the same pay and pensions – but this will now no longer be the case. Reductions in pay and pensions benefits for new recruits to outsourced public service jobs are likely to result in difficulties recruiting workers of the same quality as existing staff. In this context it is difficult to see how current policies will maintain the quality of public service provision.

2.2 Existing empirical evidence on the effect of outsourcing on cost and quality of public services

There is a large body of existing evidence on the impact of outsourcing public services on the costs of service provision, both in the UK and elsewhere. In general, researchers investigate this issue by comparing providers of similar public services from different sectors in a given country (or region, or local area). Some of the most important recent evidence for the UK is as follows:

- A study by the Office of Public Management (OPM) on outsourcing in the NHS found that “little hard evidence is available to suggest that outsourcing impacts positively on value for money or quality of care. Conversely, there are several examples of outsourcing having a directly negative effect on the value for money and quality of care in services” (OPM, 2008).
- A review of outsourcing in public services for BIS in 2008 by economist DeAnne Julius suggested that it was the introduction of competition between in-house providers and alternative private or VCN providers, rather than private provision per se, which led to improvements in efficiency (BERR, 2008). Similar conclusions were reached in a review by Grout (2008) for the Centre for Markets and Public Organisation at Bristol University.
- The ‘resources’ section of the website of the outsourced service provider firm Serco contains links to a large number of academic studies on the effects of outsourcing on costs and quality of service provision in areas like refuse services, prisons, municipal services, IT and health, across a range of countries²³. In general the picture is very mixed; in some cases the use of private sector outsourced provision lowered costs and/or increased quality, but in other cases, the opposite happened.
- In the case of healthcare there seem to be particular arguments against widespread use of outsourcing due to the additional cost overheads which the imposition of a market structure on the NHS causes, and the dangers of a ‘race to the bottom’ in terms of service quality. Pollock (2007) estimates that the NHS internal market carries an implementation cost of up to £20 billion per year²⁴.

Propper et al (2004) look at the effects of competition in healthcare in England on quality of outcomes (as measured by death rates following hospital admission for a heart attack) and find that competition was associated with a decrease in the quality of outcomes.

- Research by Cardiff University on the impact of outsourcing NHS hospital cleaning services to private providers finds that the levels of hospital cleanliness have declined since the introduction of compulsory competitive tendering in the 1980s (Davies, 2005; 2009).
- A report by the Commission for Social Care inspection in 2005 found that private provision of social care for older people – both residential and non-residential – was less likely to be judged ‘good’ or ‘excellent’ and more likely to be judged ‘poor’ or ‘adequate’ by inspectors than either public or VCN sector provision. Workforce turnover was substantially worse in the private sector than in the public sector (CSCI, 2009).
- Research from the UK Institute of Education found that in Sweden, the ‘free schools’ set up in the last decade, which are a template for the Government’s school reforms as contained in the Academies Act, were not associated with improved academic achievement (Allen, 2010).
- Early evidence from Barnet’s “easyCouncil” outsourcing experiment suggested that the council was spending £1.5m in the financial year 2010-11 on its reform programme, but was on course to recoup only £1.4m of savings in the financial year – less than the initial outlay²⁵.

In general the view from a wide reading of the empirical evidence is that the claims made by proponents of outsourcing that it invariably leads to lower costs and/or higher quality public services do not, for the most part, stack up. The most that can be said in favour of outsourcing is that in some cases, the introduction of competitive tendering for public service provision has resulted in an increase in efficiency. However, this does not mean that outsourced provision is better, because public sector service provision has improved just as much – if not more than – provision by other sectors in the wake of the introduction of tendering. In these cases it looks like it is the introduction of competitive pressures which is responsible for driving service improvements rather than outsourcing.

Moreover, for tendering to deliver improved outcomes it is vital that bids to provide public services are evaluated on the basis of the quality of service provision and the cost of provision, rather than just choosing the lowest-cost provider. Equally, it is vital that the overall contribution to public sector costs – including any knock-on effects on other public services such as the NHS – be taken into account, rather than just focusing on the narrow ‘bottom line’. The more this is done, the better the public sector performs as a provider of services.

Finally, in some areas of public service provision – particularly health, and probably education as well – competition can lead to worse outcomes. This means that the choice of whether to put individual public services out to tender or not – or whether to stick with a non-market model of service provision – is a complex one, and involves balancing the positive and negative effects of competition on the quality of the service being provided.

2.3 New evidence on the impact of outsourcing on working conditions

Obviously as a general rule where most goods or services are concerned, one might expect cost to be positively related to quality – hence the old adage “you get what you pay for”. Nonetheless, there is a clear sense in which the impact of outsourcing quality of public services is harder to measure than cost because direct measurement of quality via rigorous statistical methods would involve in-depth interviews with users of public services, which is expensive to do on a large scale (which is probably the reason why none of the major household-level datasets in the UK contain data on public service users’ experiences of quality).

If the data to measure service quality directly are not available, the next best approach is to measure aspects of *quality of the workforce* that are likely to be correlated with the quality of services. This is a much easier task, and hence this report presents the findings of new research using the UK Labour Force Survey²⁶ to compare the conditions of employment public sector, private sector and voluntary sector employees in some key public service occupations across several dimensions of employment terms and conditions. In particular, the research looks at:

- The proportion of employees in each sector with **job tenure of duration one year or less**. This is meant to capture the usage of short-term contracts and the extent of job turnover in each sector.
- The proportion of full-time workers (defined as those whose usual hours of week were 35 or more) who were regularly **working more than 48 hours per week**. This is meant to capture “overwork” in the sense of working in excess of the 48 hours per week specified by the Working Time Directive.

The analysis uses three consecutive years of quarterly LFS information (from spring 2007 to spring 2010) to provide an increased sample size for the analysis while still relying on relatively recent data.

A wide range of occupations are compared under the SOC2000 (Standard Occupational Classification) schema, as indicated in Table 2.1 below. In most cases the 3-digit (minor group) occupational grouping is used, to increase the sample size for accuracy of comparisons. In the case of prison service officers, the 4-digit (minor unit) occupational grouping is used. Some of the occupations chosen are specifically ‘public

service’ occupations (such as health, childcare and prison services) whereas others include jobs which are likely to be related to public services if the job is found within the public sector but not necessarily if it is found in the private sector (e.g. cleaning, ICT). Nonetheless, a comparison between public, VCN and private sector jobs is instructive in each case²⁷.

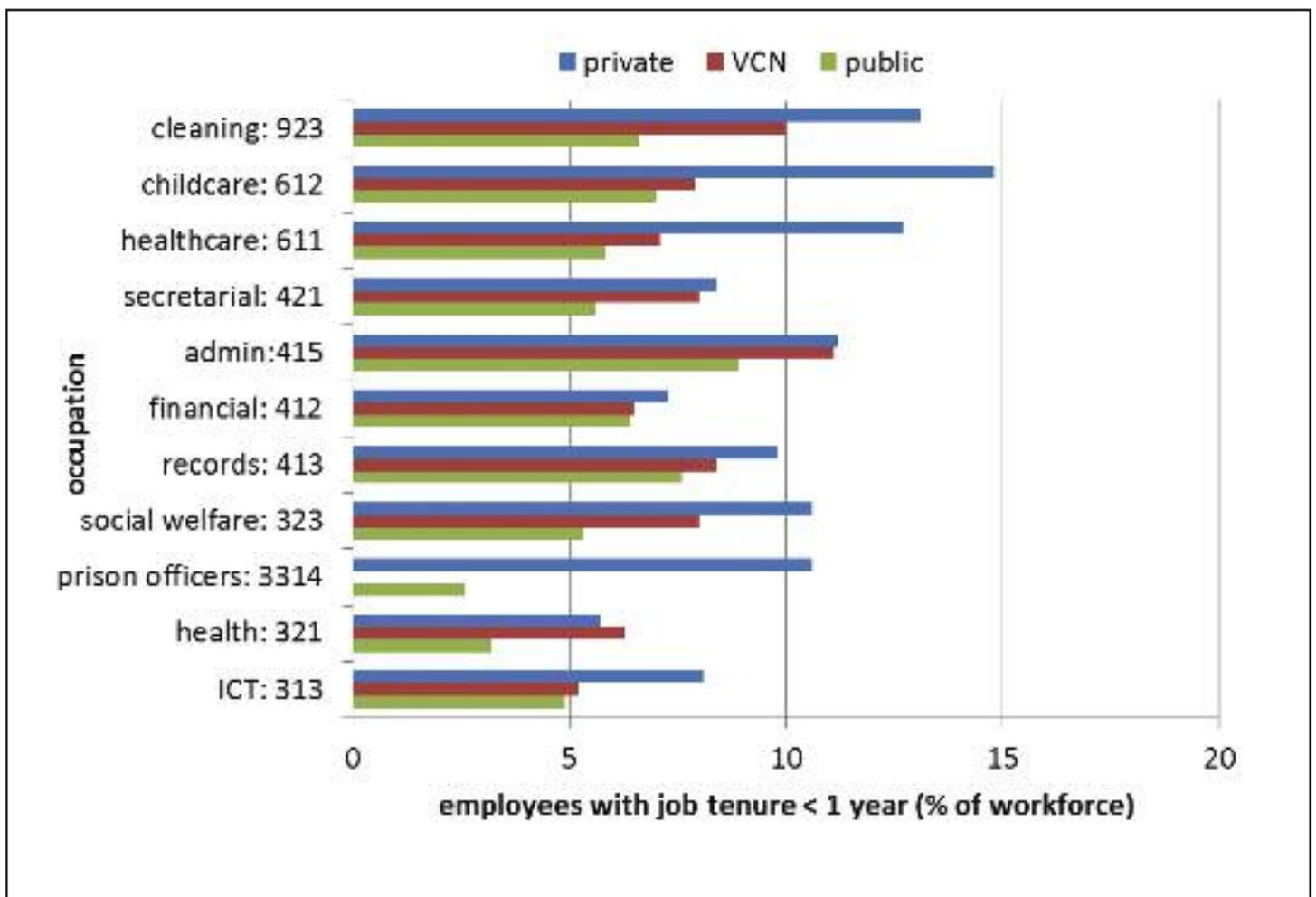
Table 2.1. Occupations used for comparison of working conditions in public, VCN and private sectors

SOC2000 Classification	Description	SOC2000 Classification	Description
313	IT service delivery occupations: IT operations technicians IT user support technicians	415	Administrative occupations – general: General office assistants/clerks
321	Health associate professionals: Nurses Midwives Paramedics Medical radiographers Chiropodists Dispensing opticians Pharmaceutical dispensers Medical and dental technicians	421	Secretarial and related occupations: Medical secretaries Legal secretaries School secretaries Company secretaries Personal assistants and other secretaries Receptionists Typists
323	Social welfare associate professionals: Youth and community workers Housing and welfare officers	611	Healthcare and related personal services: Nursing auxiliaries and assistants Ambulance staff (excluding paramedics) Dental nurses Houseparents and residential wardens Care assistants and home carers
3314	Prison service officers	612	Childcare and related personal services: Nursery nurses Childminders and related occupations Playgroup leaders/assistants Educational assistants
412	Administrative occupations: finance: Credit controllers Accounts and wages clerks, bookkeepers, other financial clerks Counter clerks	923	Elementary cleaning occupations: Window cleaners Road sweepers Cleaners, domestics Launderers, dry cleaners, pressers Refuse and salvage occupations Elementary cleaning occupations not elsewhere classified
413	Administrative occupations: records: Filing and other records assistants/clerks Pensions and insurance clerks Stock control clerks Transport and distribution clerks Library assistants/ clerks Database assistants/clerks Market research interviewers		

Figure 2.1 below compares the proportions of employees in each occupation with job tenure of one year or less, broken down by private, VCN and public sectors. (In the case of prison officers there were no VCN sector employees in the LFS, hence the missing bar.) For all the occupations listed, the proportion of employees with short job tenure is higher in the private sector than in the public sector. The greatest

discrepancy is for prison officers, where only 3 percent of officers in the public sector have job tenure of less than one year, compared with 11 percent of officers in the private sector. In most cases, the VCN sector is somewhere in between the private and public sectors, with no clear pattern emerging overall as to whether conditions in the VCN sector are more like the private sector or more like the public sector.

Figure 2.1. Short job tenure by occupation and sector, Labour Force Survey, 2007-10

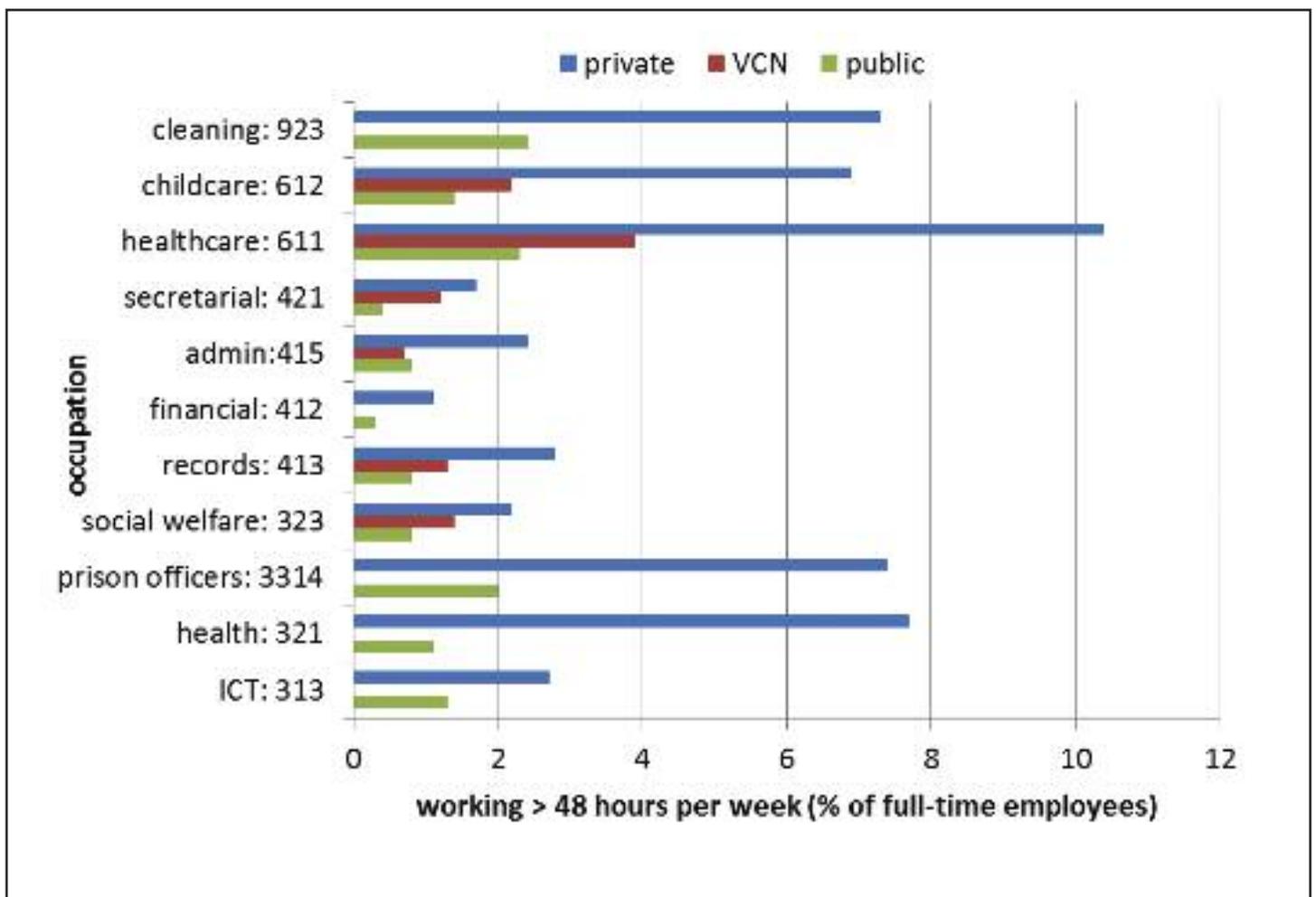


Source: author's own analysis of Labour Force Survey data

Turning to a comparison of hours of work between sectors, Figure 2.2 below shows that there is a greater incidence of full-time employees working more than 48 hours per week in the private sector than the public sector for all the occupations included in this study. In some cases the discrepancy between the private sector and the public sector is very large: for example, 10 percent of full-time healthcare and personal service workers in the private sector work more than 48 hours per week compared with only 2 percent in the public sector. Childcare workers, health professionals and prison officers show similar discrepancies. In the VCN sector the pattern is mixed: in some occupations such as ICT, cleaning and financial officers, long-hours working is non-existent in the LFS, whereas in other occupations such as childcare, healthcare and social welfare, the incidence is similar to public sector workers but slightly higher. (It is important to point out that for most occupations the number of people in the VCN sector is lower than either the public or private sectors and so the results from the VCN part of the analysis may be less reliable.)

officers show similar discrepancies. In the VCN sector the pattern is mixed: in some occupations such as ICT, cleaning and financial officers, long-hours working is non-existent in the LFS, whereas in other occupations such as childcare, healthcare and social welfare, the incidence is similar to public sector workers but slightly higher. (It is important to point out that for most occupations the number of people in the VCN sector is lower than either the public or private sectors and so the results from the VCN part of the analysis may be less reliable.)

Figure 2.2. Long hours working by sector and occupation, LFS 2007-10



Source: author's analysis of Labour Force Survey data

The results of this analysis of the Labour Force Survey data suggest that short job tenure and working long hours – two features of the working environment which we might associate, a priori with lower quality of service provision – are more common (and in some cases, much more common) in the private sector than the public sector, with the VCN sector somewhere in between on most indicators.

There are two main reasons why a high proportion of short-term and/or temporary workers, and a high incidence of long-hours working, might be a problem in the context of public service delivery:

- **Continuity of service.** In occupations which involve frequent personal contact between the service user and the service provider – for example social care, childcare, prisons probation services, and some types of healthcare provision – developing a good relationship between service user and provider is likely to be an important aspect of service quality. If public services are characterised by high turnover and short job tenure, this is likely to prove more difficult than if services are characterised by longer periods of employment.
- **Safety factors.** Many public service jobs involve danger, either to the employee or the person(s) receiving the service, if the job is not done properly. For example, there is potential for catastrophic errors in many healthcare job tasks. Long hours working is associated with a greater incidence of accidents and mistakes at work (Kodz et al, 2003). High turnover also increases the amount of induction training necessary for tasks to be performed adequately and is likely to lead to a greater proportion of inexperienced employees providing a public service, which could lead to problems. These problems may also be reinforced by job losses precipitated by cuts in public spending, which can contribute to high turnover and overwork for the remaining public service workforce.

A common defence of outsourcing as a strategy for public service delivery against critics of outsourcing (used by both Tony Blair and David Cameron²⁸, for example) is that public service users don't care about who the provider of public services is, as long as the services provided are of high quality. If the choice of which sector provides a public service has no impact on the quality of the service then this argument may be correct. However, if public services provided by the private sector are of lower quality than those provided by the public sector, then end users certainly should care about which sector provides the service. From the evidence presented here, it seems like the choice of sector to provide the service

does affect service quality, at least to an extent.

In summary, the new evidence presented here complements the review of previous evidence presented in the previous section by showing clearly that provision of services in the private sector is associated with a greater incidence of short-term job tenure, and of long-hours working practices, than either the public sector or the voluntary sector. This finding, based on the most recent UK data, raises clear worries about the quality of public services outsourced to the private sector compared with those provided in-house.

3 Outsourcing, transparency and accountability

This chapter looks at the implications of outsourcing for the transparency and accountability of public service provision. The analysis focuses on four areas in particular: (a) the applicability of the Freedom of Information Act; (b) the applicability of anti-discrimination legislation; (c) accountability through local democracy, and (d) the problem of uneven quality of services and 'postcode lotteries'. In each case, the trend towards outsourcing appears to reduce transparency and accountability rather than increasing it (as many of its proponents would argue).

Freedom of Information

An important legacy of the Labour Governments of 1997-2010 was the Freedom of Information (FoI) Act 2000, which (for the first time in the UK) opened up most of the activities carried out by the public sector in the UK to public scrutiny. The Act allows any UK citizen to request the provision of information concerning any aspect of the activities of the public sector, and requires public authorities to reply within 20 working days. Although there are a large number of grounds for exemption (e.g. if the information would compromise national security, or if it would take an unreasonable amount of time and resources to produce), the Act is nonetheless very widely and successfully used.

The success of the FoI Act is relevant to outsourcing because the scope of the Act is defined by the sector of the organisations concerned and not the nature of the service which those organisations provide. So, for example, a local authority providing social care services in-house is subject to the FoI Act. But a private or voluntary sector contractor providing services for a local authority is not subject to the

Act. This raises the problem that the greater the degree of outsourcing of public services, the less accountable the providers of public services are. Thus, as the FoI legislation is currently constituted, an increase in outsourcing makes public services less accountable to members of the public who want to use FoI to hold them to account.

Responsibilities to promote equality

In general, legislation designed to prevent discrimination on grounds of sex, race, disability, sexual orientation or religion applies equally to public sector, VCN and private sector bodies²⁹. However, over and above this, legislation such as the Race Relations Act, the Sex Discrimination Act and the Disability Discrimination Act has given public authorities, including public sector health and social care providers, additional legal responsibilities to actively promote equality. By contrast with anti-discrimination legislation, these positive duties apply to public sector providers of public services but *not* to VCN and private sector providers of public services. This principle is well established in case law following a judgement of the House of Lords in 2007 which ruled that a private care home providing accommodation to elderly residents was not bound by the European Convention on Human Rights when providing such care on behalf of a public authority. Hence, as the law currently stands, an increase in outsourcing of public service provision will reduce the rights of public service users compared with the current extent of outsourcing, because of the weaker legal obligations on private and VCN providers of public services.

Outsourcing and the decline of democratic accountability

Although outsourced public services are still *funded* through the public sector in most cases, the changes to the institutions through which those services are *delivered* often result in a reduction of accountability through formal democratic processes, whether at a local or national level. To give two pertinent examples:

- The new Health and Wellbeing Boards which the Government plans to use to scrutinise NHS decision making at local level will only have one democratically elected representative out of a total board membership of at least 8 to 10 people³⁰.
- As a result of the Government's education reforms 'free schools' and academies will be outside LEA control, with no representation by elected councillors on their boards of governors.

Defenders of the outsourcing reforms argue that they will create new streams of accountability at the sub-local level, based on service user involvement in delivery management. For some of the reforms – such as 'free schools' – this is certainly possible. But for others – e.g. GP commissioning in the health service – the channels of accountability to service users look much less clear. It is a source of great frustration to many campaigners who believe in a greater role for formal democratic political processes that the current government appears to view in-house providers of public services as some kind of unaccountable fiefdom along the lines of the public sector in the former Soviet Union or China – whereas in fact, we live in a democracy, and the ballot box should be a powerful mechanism for holding public service providers to account. There is a real danger that outsourcing negates this channel for democratic accountability.

Service fragmentation and the 'postcode lottery'

A wider danger for democratic accountability is *fragmentation* of the structures of service provision. Thirty years ago, the framework for provision of each public service in the UK had a consistent and holistic structure. Since then, successive waves of reform have created a patchwork quilt of different delivery, management and monitoring systems in public services. This is most obvious in the education system in England, where there is now a bewildering array of different types of school, some under local control and some operating as semi-autonomous units under the direct oversight of the Department for Education. In many public services this raises the issue of a 'postcode lottery' of provision where the quality of public service varies widely by local area.

Just to be clear, it is important not to overstate the extent to which outsourcing is responsible for postcode lotteries; it is certainly not the case that services were completely uniform across the country in the 1970s before the advent of outsourcing. But it seems likely that the current confusing structure of provision across many public services leads to additional variations in service quality. To the extent that these quality variations represent the outcomes of successful innovations which can then be copied and disseminated to other local areas, there may be a positive aspect to heterogeneity of public service provision. However, survey evidence shows that the idea of a 'postcode lottery' sits uneasily with a large proportion of the British public because of concerns about equality of public service provision³¹. An example of this occurred recently when David Cameron pledged concern at the case of a mother of a disabled child who claimed that

the child would have to be taken into care because of cuts in care services and disability benefits³². As the use of outsourcing expands and provision of public services becomes more remote from politicians, it is likely that the scope for these kinds of appeals will diminish.

4 The role of the voluntary, community and not-for-profit sector

In outlining its plans for public service reform the Coalition Government has given particular prominence to the voluntary, community and not-for-profit (VCN) sector – which (on the widest definition) includes charities, social enterprises, mutual and worker-owned firms, and trusts. The *Modernising Commissioning* Green Paper is subtitled ‘increasing the role of charities, social enterprises, mutuals and cooperatives in public service delivery’ and it is clear that these are the types of organisations that the Government wants the public to feel that the outsourcing drive is designed to benefit.

It is easy to see why the Government wants to give this impression. Whereas the state is often associated with being monolithic, unresponsive, centrally-driven, bureaucratic and unaccountable, VCN organisations have the opposite reputation to a large extent. They are seen as flexible, small-scale, responsive to and accountable to the needs of service users and their employees and managed in a decentralised way. All this fits with David Cameron’s rhetoric about the ‘Big Society’ which envisages the reduction of government intervention in the economic and social spheres to allow the expansion of VCN organisations to deliver a much greater proportion of services, both public and private. It is also a key component of the community ownership model propounded by ‘progressive conservative’ thinkers such as Philip Blond (Blond, 2010) as well as post-Blairite thinkers on the centre-left such as Alan Milburn.

Few would dispute the notion that voluntary, community and not-for-profit sector organisations play a hugely important role in the UK’s social and economic infrastructure. And there are undoubtedly many examples of the VCN sector providing first-rate public services. However, it is much more questionable whether the role of the VCN sector in public service provision can be greatly expanded on a sustainable basis at the same time as large swathes of grant funding for activities currently undertaken by the sector are being cut or

withdrawn completely. This is due to the trading conditions under which most of the VCN sector operates compared with its private sector competitors, as discussed in detail below.

Although the social enterprise sector is only a subset of the VCN sector, it is probably the fastest growing part of the sector in recent years, and so the findings from a 2009 survey of social enterprises conducted by the Social Enterprise Coalition (Social Enterprise Coalition, 2010) are very relevant for the future prospects of the VCN sector. The survey shows that the majority of social enterprises operate at small-business scales, with a median turnover of £175,000 – very small in the context of most contracts for public service provision. In the rest of the VCN sector, the average size of organisations is smaller still: 60% of organisations have a turnover of less than £50,000.

The social enterprise sector actually compares fairly well with the small and medium enterprise (SME) for-profit sector in terms of the proportion of social enterprises breaking even (higher in the social enterprise sector than the SME sector), the rate of insolvencies in the sector (lower for social enterprises than for SMEs) and the rate of growth of the sector (much higher for social enterprises than for SMEs). However, VCN sector organisations seeking to supply public services are likely to be in competition not just with private-sector SMEs, but with large scale private contractors such as Serco and Capita – both of which have turnovers running into billions of pounds. In this situation, large-scale private sector providers have the advantage of immense experience in bidding for contracts, coupled with economies of scale in areas such as personnel management, advertising and marketing and tender preparation, and access to finance at relatively low cost. VCN sector organisations will of course gain tendering experience as they go along, and may be able to grow in size to a point at which they can compete effectively with the private sector ‘big boys’.

Alternatively, where public services are highly personalised and/or specialised, it may be that small-scale providers can provide a better ‘niche’ service than large corporations. However, there is a clear danger that the current drive to expand VCN sector provision will result in the creation of a large number of providers who are not financially viable in the long run. This is particularly likely to be the case in the current trading environment, which will be exceptionally difficult for several years to come, due to the savage scale of the planned cuts in public expenditure. Additionally, plans for public sector workers to be allowed to mutualise themselves

en bloc into new social enterprises sound exciting on paper, but run the risk that the resulting companies will not be viable trading units in the long run.

If some of the new social enterprises delivering public services turn out to be unviable, one of three things could happen. The first option is that the services get taken back into the public sector – however the current government is not likely to be keen on this and will probably include provisions in the White Paper to make it less likely. The second option is that social enterprises amalgamate or get taken over by other VCN organisations. The third – and probably most likely – option is that the services get bought up by private-sector providers. This is the most likely option because private sector providers are likely to have bigger accumulated cash reserves than VCN sector providers³³ which they can use to acquire failing social enterprise providers. This is a particularly acute issue given that in most cases, social enterprises currently providing public services do not benefit from an ‘asset lock’ provision which would stop the assets of the social enterprise being sold off to another corporate entity.

Unfortunately there is no large-scale quantitative research on the extent to which previous waves of outsourcing in public service provision have suffered from a tendency for VCN sector provision to be taken over by the private sector. However, given the difficulties of the trading environment that many nascent social enterprises will be born into, it would be no surprise if the current vogue for voluntary sector provision of public services turns out in retrospect to have been, at least partly, the long and painful route to privatisation.

5 The role of corporate lobbying

The conventional economic analyses of the impact of outsourcing on the costs and quality of service provision presented in Chapter 2 of this report are undoubtedly a useful body of evidence, but there is also a political dimension to the drive for outsourcing which it is important to explore. The previous chapter suggested that large-scale private sector companies which specialise in the provision of outsourced public services – such as Serco, Capita and Interserve – are in a position to profit hugely from the latest wave of outsourcing, both through winning new contracts for service provision, and through taking over failing VCN sector providers. The outsourcing market in the UK is already worth around £80 billion (TUC, 2010), and it is in the commercial interests

of private sector outsourcing providers to lobby politicians to promote greater use of their particular model of public service delivery.

With this in mind, we should expect to see evidence of lobbying by the private sector to increase the use of outsourcing, and in fact there is considerable evidence that this does happen. In particular:

- A number of accountancy firms such as KPMG, Deloitte, Price Waterhouse Coopers and Grant Thornton have donated the equivalent of hundreds of thousands of pounds to the Conservative Party in cash and non-cash donations such as secondments and consultancy services. The abolition of the Audit Commission in August 2010 is likely to provide extra business for at least some of these firms because public spending will now need to be audited using private sector accountancy firms rather than an in-house government service³⁴.
- Capita plc, which has given donations totalling £1.5m to the Conservative party over the last ten years, revealed in an interview with the *Health Service Journal* in November 2010 that it was “targeting” the NHS Direct telephone helpline service for takeover³⁵.
- As Shadow Health Secretary before the 2010 Election, Conservative MP Andrew Lansley received £21,000 from Care UK – one of the UK’s leading private sector providers of outsourced healthcare to the NHS – according to an investigation by the *Daily Telegraph* newspaper. Lansley went on to introduce a radical increase in the use of outsourcing in the NHS after becoming Secretary of State for Health in May 2010.
- The ‘free schools’ policy is heavily influenced by a thinktank called the New Schools Network (NSN) which was set up to champion the policy. As exposed by *Guardian* journalist Tom Clark and the Other Taxpayers Alliance pressure group³⁶, NSN received a grant of £500,000 from the Department of Education to provide “a personalised – and cost-effective – service” to anyone interested in setting up a free school. The grant was not put out to tender, in direct contravention of guidelines for UK government procurement. The director of NSN, Rachel Wolf, is a former adviser to Education Secretary Michael Gove.
- The Confederation of British Industry (CBI) lobbies heavily for greater use of outsourcing and has set up an in-house unit – the Public Service Strategy Board – specifically as a lobbying vehicle³⁷.

Lobbying of politicians by the private sector is, of course, not a new phenomenon, and the Labour party received large donations from many outsourcing companies in the period 1997 to 2010. However, if anything the process seems to be stepping up a gear under the Coalition Government. The key message to take away from an analysis of lobbying activities is that outsourcing companies are deeply entrenched in the UK's political process and are heavily involved in pushing for the expansion of outsourcing and a greater role for the private sector in service provision – whichever party or parties are in power.

6 Conclusions

6.1 Outsourcing: good or bad?

This research report has made a thorough examination of the case for and against outsourcing in the provision of public services. Given that outsourcing of public services looks set to become the norm rather than the exception across most of the public sector in the UK under the Coalition's current plans, the question of whether outsourcing is the best way to deliver public services is more pertinent than ever before. The overall conclusions of this report can be summarised as follows:

- **A major expansion of outsourcing in UK public services is being rushed through at breakneck speed.**

Across a whole range of public services, the Coalition Government's reforms are being introduced without sufficient consultation, planning or evaluation. And the way that the reforms are being rolled out nationally without any kind of pilot scheme suggests that the Government has little or no commitment to 'evidence-based' policy.

- **The expansion of outsourcing is occurring in a very difficult economic and fiscal policy context,** with almost unprecedented public expenditure cuts and job losses over the next five years. Expanding outsourcing on the scale envisaged by the Government without detrimental effects on the quality of service provision would have been difficult even in the context of the generous public spending settlements of the early 2000s. In the current climate of savage cuts to most areas of public spending, declines in service quality look almost inevitable.

- **A sophisticated reading of economic theory does not deliver clear predictions on whether outsourcing will improve services.** The difficulties of contracting between

service commissioners and outsourced service providers under conditions of "imperfect information", the possibility of 'pro-social motivation' among public sector employees, the need for the private sector to deliver additional returns to the owners of capital and the possibility that obsession with lowest cost delivery will have counter-productive effects (e.g. declines in service quality, or knock-on increases in costs elsewhere in the public sector) mean that the theoretical impact of outsourcing on service provision is ambiguous.

- **The empirical evidence on the impact of outsourcing on costs and quality of public service provision is mixed.** In some cases, outsourcing appears to improve service provision, whereas in other cases, it leads to increased costs and/or declines in service quality. In particular, there is little or no evidence that the latest wave of outsourcing reforms in health or education will improve services. New research using the UK Labour Force Survey suggests that working conditions for people in a variety of occupations related to public services are worse in the private sector than the public or voluntary sectors.
- **There are clear dangers that increased outsourcing will result in reduced transparency and democratic accountability of service provision.** In particular, there are four major concerns in this area. First, increased outsourcing places more and more public service provision outside the remit of the Freedom of Information Act as currently constituted. Second, private and VCN sector providers of public services are not under the same obligations to promote equality on grounds of sex, race, disability, sexual orientation and religion as are public sector providers and thus greater outsourcing may contribute to inequalities in society. Third, many of the mechanisms in the new outsourcing reforms seem to bypass existing channels of democratic accountability for service provision. Finally, increased outsourcing runs the risk of increasing spatial inequalities in service provision and exacerbating the existing 'postcode lottery' for service provision, unless clear mechanisms can be found to encourage the dissemination and uptake of best practice across a range of disparate service providers.
- **The voluntary, community and not-for-profit sector has a very clear role to play in supporting and delivering high-quality public services, but the current reforms exaggerate the role it can play.** There is a danger of over-expansion of the VCN sector under the Government's proposals, leading to a swathe of unviable and unstable social enterprises and mutualised delivery

vehicles which fall victim to acquisition by large scale for-profit providers – who share few, if any, of the VCN sector’s motivations or strengths – at the first sign of trouble. A mass shift of service provision to the voluntary sector runs the risk of being the long and painful route to privatisation of public services.

• **Corporate lobbying by private outsourcing companies has played a key role in the development of the current Government’s policies on public services.**

To be sure, lobbying was rife in the New Labour era as well. But the process has become more blatant and pervasive under the Coalition Government. Policies are being formulated to please corporate donors to politicians, in a most unpleasant example of ‘crony capitalism’. This is the true face of the outsourcing agenda.

6.2 The alternative: high quality public service provision

Given the clear drawbacks and problems with the current Government’s plans to expand outsourcing, is there a coherent alternative which opposition politicians, civil society groups and members of the public unhappy with the current direction of policy travel can appeal to?

One promising option for a new approach is outlined by the Association for Public Service Excellence (APSE) in its 2009 report *Insourcing: a guide to bringing local authority services back in-house*. The ASPE research looked at the increasing trend (before the 2010 election) of local authorities taking previously outsourced services back in-house, at the factors which caused local authorities to take this action and the effects on service quality. The research was based on a large number of case studies rather than a representative survey of UK local authorities. Nonetheless, a variety of different local authority services including street cleaning, housing services, refuse collection, recycling and maintenance were insourced by a number of councils and so the research draws on a reasonably wide evidence base.

The APSE research shows that the main benefits of bringing services back in-house were:

- **Improved performance** against a variety of targets. Particular benefit was derived from integrating local authority decision-making and service delivery – suggesting that insourcing may help overcome ‘principal-agent’ problems in service management.
- **Cost efficiency savings** – usually resulting from being able

to terminate poor value-for-money contracts with outsourced providers.

- **Community well-being and satisfaction** – increases in the level of satisfaction in service use where services are insourced.
- **Benefits to the local economy** through stronger local supply chains and enhanced local employment patterns.
- **Flexibility and added value**, allowing local authorities to respond more quickly to changing agendas and needs.
- **Service integration**, enabling local authorities to develop more integrated and joined-up services, which start to address the problem that attempts to reduce costs in one area of public service delivery can lead to increased costs in other areas.
- **Better and more equitable employment terms and conditions** – enabling local authorities to avoid the ‘two-tier workforce’ and promote workforce development and training opportunities.
- **Higher quality service provision**, thanks to the greater control over service provision which insourcing allows.
- **Sustainability** – enabling service delivery to take greater account of environmental considerations.

APSE’s research on the benefits of insourcing fits well with other evidence in a similar vein from several different sources, for example:

- Research by the Involvement and Participation Association (IPA) – an independent consultancy which specialises in assisting both unionised and non-unionised organisations to develop effective information and consultation processes and workforce partnership – on the role of the workforce in the future of outsourcing. This research looked at factors that determined good quality service provision in outsourced (as opposed to insourced) public services via a range of case studies, and found that most of the same criteria were present in good-quality outsourced public service provision as those which APSE identified as characterising good quality insourced public service provision. In particular, the research found that “those delivering the best public services in Britain today know that having a fairly treated, well-managed and engaged workforce is fundamental to achieving improvements in service quality and how vital involving and supporting staff through change is to achieving service transformation (IPA, 2010). What this suggests is

that successful outsourced service provision and successful insourced service provision may share many of the same characteristics.

- An in-depth account of the transformation of local service provision in Newcastle-upon-Tyne City Council in the early 2000s by Wainwright and Little (2009), who examine how trade unions commissioned their own research on how council services needed to change, and reached out to the community and to councillors. The council workforce submitted an in-house bid for delivery of services which won a tender against private competition, and a new management team was assembled to implement it. Collaboration across the council helped the changes to succeed, based on a clear public service ethos married to an achievable and forward-looking business strategy. Staff who were previously stuck in routine procedures were now relied upon to use their initiative and creativity to provide a complex and personalised service. Private sector consultancy and expertise played a role in making the strategy successful, but as a complement to, rather than a replacement for, the strengths of the in-house workforce. The Newcastle story is a powerful example of how in-house service provision can rise to the challenge of transforming service delivery, and is a clear alternative to the outsourcing model.

The research reports by APSE, by IPA and by Wainwright and Little look at three different circumstances under which good quality public services can be produced – insourcing badly performing outsourced services, improving outsourced services, and avoiding outsourcing by improving the quality of in-house public services. However, the same set of issues apply in each case, so in conclusion it is worth outlining the most important things which service providers – in whatever sector – need to get right to ensure good quality public services.

Firstly, a good quality, well-engaged, fairly remunerated and positively motivated public service workforce is absolutely essential. This means that approaches which treat the workforce simply as a production cost to be minimised are unlikely to produce satisfactory results. The workforce is not simply an overhead, but is in fact the main mechanism for achieving high quality service delivery.

Secondly, there is no reason why the public sector cannot deliver high quality and efficient public services without having to resort to outsourcing, contrary to what the rhetoric from the current Government might suggest. This does not

mean that outsourcing is always inferior to public sector in-house provision – the IPA research shows that outsourcing can produce good results as well. But it does mean that there is no reason to resort to outsourcing *en masse* to improve public service quality. Indeed, to the extent that mass outsourcing disrupts good quality in-house supply arrangements, it is likely to reduce the quality of service provision, if anything.

Thirdly, it is important to look at the provision of each service as part of an integrated package of public services which UK citizens make use of and have access to. Simply parcelling up and contracting out each service in isolation, without considering how each aspect of provision fits into the public service ‘fabric’, is unlikely to deliver the best results. There needs to be consideration of the synergies and overlaps between health, social care and welfare-to-work provision, for instance.

Finally, public service reform needs to be driven by the needs and aspirations of service users and the service delivery workforce, involving both groups in the design and planning of services where possible. Reform is less likely to be successful where the process is driven externally by unaccountable lobbyists and corporate executives rather than being effected organically by those who are involved in public services on a day-to-day basis.

Notes

¹ The Institute for Fiscal Studies offers a detailed analysis of the extent of the expenditure cuts at <http://www.ifs.org.uk/publications/5311>

² Office for Budget Responsibility, Economic and Fiscal Outlook – November 2010, http://budgetresponsibility.independent.gov.uk/d/econ_fiscal_outlook_291110.pdf

³ See <http://www.guardian.co.uk/society/patrick-butler-cuts-blog/2011/feb/02/council-job-cuts-total-hits-150000> based on job loss announcements from 260 councils in the UK, with the remaining 239 still to announce details of job losses.

⁴ Cabinet Office, 2010: Modernising Commissioning – Increasing the role of charities, social enterprises, mutuals and co-operatives in public service delivery, <http://www.cabinetoffice.gov.uk/news/modernising-commissioning-green-paper-published>

⁵ <http://www.bis.gov.uk/files/file47158.pdf>

⁶ Most of the areas of public service provision which are being targeted for outsourcing – such as the NHS, schools and local government services – are subject to the oversight of devolved administrations in Scotland, Wales and Northern Ireland, and so the precise implementation of any move towards greater outsourcing may vary in the devolved countries from the implementations pursued in England. An exception is welfare-to-work services, which are managed at UK level by the Department for Work and Pensions; the provisions for outsourcing contained in the Work Programme, which will replace most of the previous Government's New Deal schemes from 2011 onwards, will take affect across the whole UK.

⁷ See HM Treasury, Budget June 2010. http://www.hm-treasury.gov.uk/d/junebudget_complete.pdf

⁸ See <http://www.guardian.co.uk/society/patrick-butler-cuts-blog/2011/feb/02/council-job-cuts-total-hits-150000>

⁹ www.statistics.gov.uk/pdfdir/pse1210.pdf

¹⁰ http://www.dh.gov.uk/en/Publicationsandstatistics/Publications/PublicationsPolicyAndGuidance/DH_117353

¹¹ "Tory free-market hurricane will blow our NHS apart", Polly Toynbee, Guardian, 17 January 2011. <http://www.guardian.co.uk/commentisfree/2011/jan/17/free-market-bill-blow-nhs-apart>

¹² In most academies, parental representation on the governing body is lower than in LEA schools, and instead of

elected councillors, the sponsor provides a high proportion of governors.

¹³ See Left Foot Forward, "Eric Pickles' cuts target Britain's poorest areas", 13th December 2010 <http://www.leftfootforward.org/2010/12/eric-pickles-cuts-target-britains-poorest-areas/> and New Local Government Network, "Deprived councils hit hardest by cuts", <http://www.nlgn.org.uk/public/2010/local-government-settlement-deprived-councils-hit-hardest-by-cuts/>

¹⁴ http://www.unitetheunion.org/news__events/latest_news/mod_firefighters__to_go_under.aspx

¹⁵ <http://www.bbc.co.uk/news/uk-11989225>

¹⁶ <http://www.guardian.co.uk/politics/2010/aug/13/audit-commission-to-be-scrapped>

¹⁷ <http://www.guardian.co.uk/environment/2011/jan/22/poll-england-forest-sell-off>

¹⁸ For the most part this exposition ignores the VCN sector and focuses on private versus public sector provision. Some of what is said here about the private sector also applies to the VCN sector, but the VCN sector also has some unique features of its own which I cover in detail in Chapter 5.

¹⁹ For a detailed discussion of principal-agent theory see Laffont (2002)

²⁰ The transport journalist Christian Wolmar's 2002 book *Down The Tube* was one of the first in-depth exposes of the complexity and unmanageability of the London Underground PPPs. A recent post from his blog, <http://www.christianwolmar.co.uk/2010/05/rail-644-why-the-ppp-was-doomed-from-the-start/>, gives an update on the problems faced by the scheme: "the PPP was dysfunctional and unworkable, and it proved to be neither... 'fit for purpose' nor value for money. When the PPP was originally conceived, the money for investment was supposed to come from the profits of running the Tube and no subsidy was envisaged. That was laughably optimistic and it was clear very early on that there would have to be a huge subsidy. Under the PPP, the infrastructure was divided into three and contracted out, on a 30 year basis, to private consortia while the operations remained in the public sector. This led to bizarre anomalies like the trains belonging to the infrastructure companies at night but being leased during the days to the operators... the result was a constant tension between the two parties, most notably over the enormous number of closures at weekends... There were numerous other aspects of the split which

inevitably led to tensions and every small bit of work could end up needing arbitration.”

²¹ In the case of infrastructure investment through the Private Finance Initiative – established by the Conservative Government in the early 1990s but then expanded by Labour after 1997 – the problem of excess private returns is rife, as evidenced by several studies of the long-term costs of PFI schemes compared with funding infrastructure through the private sector. See for example Public Accounts Committee (2010) on PFI schemes during the recent financial crisis, National Audit Office (2010) on the use of PFI in housing infrastructure, and Gaffney et al (1999) and Pollock et al (2002) on PFI in the NHS.

²² See <http://www.guardian.co.uk/society/2011/jan/04/bed-blocking-care-cuts>

²³ See <http://www.serco.com/instituteresource/subjects/vfm/>

²⁴ Pollock, A. (2007), “What Sicko doesn’t tell you...” *Guardian*, September 2007. <http://www.guardian.co.uk/politics/2007/sep/24/health.publicservices>

²⁵ See <http://www.guardian.co.uk/society/2010/oct/26/barnet-no-frills-council-overspends>

²⁶ The Labour Force Survey is the biggest individual-level household survey in the UK, interviewing approximately 60,000 households every three months. Households are interviewed in a five-quarter ‘rolling panel’ format where they enter the panel, are followed for five consecutive quarters and then dropped. The LFS questionnaire asks about a variety of job-related information including hours of work, job tenure, seniority and promotions, skills and qualifications, and wage levels.

²⁷ Although the LFS does contain information on wage levels, it was decided not to compare pay between sectors in this analysis for two main reasons. Firstly, pay is affected by other personal characteristics (such as labour market experience, skills, and educational attainment) and so the comparison between sectors would have to control for a number of other factors. Secondly, there are substantial differences in non-wage remuneration (e.g. pension arrangements, redundancy packages and so on) between the different sectors which would make a fair comparison problematic.

²⁸ See, for example, *Guardian*, 17 January 2011: “Critics of public service reform plans should ‘grow up’, says David Cameron”, <http://www.guardian.co.uk/politics/2011/jan/17/critics-public->

[service-reform-grow-up-cameron](http://www.guardian.co.uk/politics/2011/jan/17/critics-public-service-reform-grow-up-cameron)

²⁹ See <http://www.equalityhumanrights.com/advice-and-guidance/guidance-for-service-users-pre-october-2010/health-and-social-care/what-health-and-social-care-service-providers-are-expected-to-do/>

³⁰ See www.idea.gov.uk/idk/aio/25329307

³¹ See for example research by the King’s Fund (2008) on people’s attitudes towards local variation in quality and affordability of care services for the elderly.

³² See <http://www.telegraph.co.uk/news/newstopping/politics/david-cameron/8270696/David-Cameron-very-concerned-over-plight-of-disabled-child.html>

³³ In November 2010 *The Guardian* reported that Europe’s biggest companies (excepting financial companies, many of whom have received recent government bailouts) were sitting on a cash pile of around £445 billion – up 16% since 2007 (<http://www.guardian.co.uk/business/2010/nov/30/europe-biggest-companies-cash-pile>)

³⁴ See <http://www.guardian.co.uk/politics/2010/aug/29/tory-donors-audit-commission>

³⁵ See <http://liberalconspiracy.org/2010/11/03/exposed-capita-reveals-it-is-targeting-nhs-direct-as-an-outsourcing-project/>

³⁶ See Tom Clark, “New Schools Network lacks transparency”, *Guardian*, 6 July 2010, <http://www.guardian.co.uk/education/2010/jul/06/michael-gove-new-schools-transparency>; the Other Taxpayers’ Alliance, “New Schools Network: Questions for Michael Gove”, <http://www.taxpayersalliance.org/news/new-schools-network-goves-next-fiasco>

³⁷ See http://publicservices.cbi.org.uk/public_services_strategy_board/. The website states that “The PSSB’s campaign sets out constructive ideas to improve the performance of our schools, hospitals, local government and other services. Its members are chief executives and leaders of companies which are successfully designing and providing a wide range of public services and support functions across the UK. The campaign draws on the extensive experience of private providers in rethinking how public services can operate more effectively and efficiently.”

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