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2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

AT
25/7

My ref:

Your ref:

25 July 1984

Dear Nigel,

CONTRACTING OUT OF LOCAL GOVERNMENT SERVICES

You will recall that at E(A) on 28 February I was asked to commission a report from officials on the legislative options for securing more contracting out of local government services to the private sector and to bring forward proposals before the Summer Recess. A considerable amount of work has been done but the range of functions/activities to be considered and the number of departments involved have meant that the exercise will take rather longer than we had hoped. Treasury officials have been kept in touch with developments but I thought it appropriate that I should bring colleagues generally up to date.

The starting point for the review, as E(A) recognised, has to be the compulsory tendering regime introduced for local authority Direct Labour Organisations (DLOs) in 1980. Whilst this is generally considered to have been successful in securing its primary objective of increasing the efficiency and accountability of DLOs there is less certainty about the extent to which it has actually resulted in work being won by the private sector. There is little doubt, however, that DLOs have been slimmed down as a result of the requirement to compete for the majority of their construction and maintenance work.

It is, perhaps, significant that the main pressure for legislation to secure greater contracting out by local authorities relates to other largely manual functions, eg refuse collection, cleaning, ground maintenance and perhaps catering. The provisional view of the interdepartmental group of officials which is looking at this issue is that there appears to be no reason in principle why we should not extend to such functions a compulsory tendering regime similar to that already in force for DLOs.

Clearly we would need to look more closely at this when final recommendations come forward, but it would seem to be a logical next step for us to take. It would also meet the primary recommendation in the recent CBI paper "Effectiveness in Public Service". Colleagues should be aware, however, that implementation of such an extension of the present regime would involve departments other than my own and we would

need full commitment and support if legislation was to be effective. Contracting out of school cleaning, for example, would be very much a matter for DEs to monitor and control.

Specific action on these particular functions is not, however, going to be sufficient to generate an attitude of mind which leads local authorities to assume that the private sector will be the normal supplier of many of its services. There is, as we have already recognised, a very wide range of activities currently carried out by in-house staff which could perfectly well be handled by the private sector.

On the other hand, there are limits to the extent to which Central Government can involve itself directly in the sort of detailed accounting, monitoring and, ultimately, enforcement provisions which experience suggests are essential if a compulsory tendering regime is not to be easily circumvented by an obstructive local authority. Officials' present view is that we may need to be selective in any immediate extension of a statutory compulsory tendering regime because:

- a. the detailed accounting and monitoring arrangements required in order to control the wide range of services, functions and activities which could be involved would add considerably to the bureaucracy at both Central and Local Government levels;
- b. compulsory tendering would not necessarily be the most appropriate way of securing contracting out for some services, for example professional services such as legal and architectural services;
- c. within a statutory regime different methods of costing and of financial targeting would be required for different areas of activity.

If one assumes for the moment that this view is accepted, and that we extend a compulsory tendering regime only to those blue collar functions referred to in paragraph 3, it may be argued that a relatively small proportion of local authority staff would be made immediately subject to competition. The table at Annex a shows the broad distribution of staff resources (full time equivalents) by department/function in English local authorities. It illustrates clearly the preponderance of staff engaged in activities (notably teaching) which would not be affected by legislation. Construction is, of course, already covered by the existing DLO legislation.

It needs to be borne in mind, however, that even functions with a relatively small proportion of total local government staff can involve very large programmes of expenditure. Refuse collection and disposal, for example, with less than 2½% of total staff, involves expenditure of the order of £6-£700m. Indeed, the total volume of work put out to tender if the functions referred to in paragraph 3 were subject to a compulsory tendering regime would be as great as the £2000m worth of construction and maintenance work opened up already.

Nevertheless, we need to guard against losing real opportunities through drawing criteria too closely, especially in the light of clear evidence that the general momentum of contracting out has declined. We would not need to take everything on board at once, indeed we might not wish to do so lest we laid ourselves open to charges of major additional burdens on local authorities. But any legislation would need to be drawn widely enough to allow subsequent extensions of the regime as necessary. Officials have these points very much in mind and I am sure that colleagues will wish to consider positively the opportunities within their own areas.

In order, however, to stimulate a more general recognition of the opportunities for contracting out, officials are also examining the implications of extending a second and different statutory regime to at least some of the functions not at present thought suitable for a full compulsory tendering approach. For activities subject to this regime authorities would be required:

- a. to assess and report the full costs of in-house provision; and
- b. to take appropriate steps to ascertain the availability and cost of alternative methods of provision.

The thinking behind this proposal is that such additional provisions would be largely self-regulating through reports (the conclusions of which would be available to the public) and audit examination and would progressively generate in authorities management accounting systems which would provide a realistic basis against which to assess what the private sector can offer. Coupled with the value for money studies by the Audit Commission and the recent development of comparative statistical and financial profiles, such provisions should provide an overall framework for the development of general contracting out initiatives. Powers would be taken to add functions to either the compulsory tendering or the costing regimes as appropriate. As it happens, the CBI paper to which I have referred above, also supports some such "two-tier" approach.

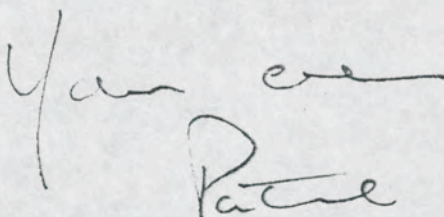
Apart from the issue of legislation, officials are also considering what other action might usefully be taken in order to advance the general cause of contracting out. The review has certainly shown that there is now a considerable body of experience of contracting out scattered among individual authorities but relatively little in the way of clear factual information available to authorities generally. Indeed, we ourselves would be assisted by the availability of more reliable information than the Press reports and third-hand anecdotes which are all that is currently available.

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The conclusion, therefore, is that consideration should be given to some selective case studies and possibility some sponsored experimental project in order to provide a basic store of knowledge. In addition, there may be scope for the production of some model standardized documentation which authorities can use or adapt as necessary. We have taken the first step in this general process of education with the publication on 20 July of the CIPFA Management Guide to Contracting Out in Local Government which was funded by my Department.

There is one further specific point which has been causing concern not only to my Department but also to Norman Tebbit and Tom King and that is the imposition by some local authorities of what are largely politically inspired conditions on either invitation to tender or contracts. Officials of our three Departments have been looking hard at this and they are hopeful that they will be able to include in their report suitable draft provisions to control this practice.

On timing I gather that preparation of the draft official paper is now well advanced and allowing for the intervention of the summer break I would hope to be able to bring a paper to E(A) by the end of September.

A handwritten signature in cursive script, appearing to read 'Patrick Jenkin', written in dark ink.

PATRICK JENKIN

PS: I am sending copies of this letter to the Prime Minister, members of E(CP) and E(A), Leon Brittan, Keith Joseph and Sir Robert Armstrong.

ALL LOCAL AUTHORITIES (ENGLAND)

% DISTRIBUTION OF STAFF BY FUNCTION/DEPARTMENT
(Excluding Law and Order staff)

| | <u>Number</u> | <u>%</u> |
|------------------------------|---------------|----------|
| Education (teaching) | 513588 | 29.9 |
| Education (non teaching) | 361769 | 21.1 |
| Social Services | 207661 | 12.1 |
| Construction | 105862 | 6.2 |
| Recreation - Parks and Baths | 70027 | 4.6 |
| Engineering Services | 74111 (est) | 4.3 |
| Housing | 54654 | 3.2 |
| Refuse Collection & Disposal | 39653 | 2.3 |
| Fire Services | 39063 | 2.3 |
| Financial Services | 41045 (est) | 2.0 |
| Secretarial Services | 34849 (est) | 2.0 |
| Libraries & Museums | 31597 | 1.8 |
| Planning | 19925 | 1.2 |
| Architectural Services | 20323 (est) | 1.2 |
| Environmental Health | 19620 | 1.1 |
| Transport Services | 17787 | 1.0 |
| Computing | 9534 (est) | 0.6 |
| Miscellaneous Admin | 8383 (est) | 0.4 |
| Estate Services | 7070 (est) | 0.4 |
| Legal Services | 5932 (est) | 0.3 |
| Personnel Management | 4472 (est) | 0.3 |
| Management Services | 4688 (est) | 0.3 |
| Consumer Protection | 3535 (est) | 0.2 |
| Technical Services | 3666 (est) | 0.2 |
| Miscellaneous | 17517 (est) | 1.0 |

TOTAL 1716044

Note: Staff numbers include part-time staff expressed in terms of full-time equivalents.

Source: Joint Manpower Watch return March 1984.

Team for pt 10
Privatization

23 JUL 1994

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DRAFT CABINET PAPER ON CONTRACTING OUT

USING PRIVATE ENTERPRISE IN GOVERNMENT

Memorandum by the Chief Secretary, HM Treasury

On 16 December 1982 the Cabinet agreed that there should be a drive to achieve further contracting-out from the public sector. I reported progress on 21 July 1983; this paper reports further progress.

2. Introducing competition for public sector work provides a much-needed incentive for increasing value for money in the public sector. There are also other benefits, such as cost savings, reductions in public sector manpower, access to specialised expertise and greater flexibility in working practices and deployment of manpower.

3. But there are still obstacles to contracting out, and progress has been disappointing. The obstacles include union opposition, management inertia and, in the case of some local and health authorities, politically-motivated obstruction.

Local Authorities

4. Under the 1980 Local Government Planning and Land Act, local authorities are required to seek tenders for some (since October 1983 at least half) of their building and maintenance work. This has had some useful results: by 1982-83 direct labour organisations undertook less than 40 per cent of their construction work and staff numbers had fallen to 130,000 at October 1983, 13 per cent lower than in April 1981.

5. Outside this area there has been only exhortation to contract out more in the local authority field. This has not been very successful: for example only 23 contracts for refuse collection and street cleaning (saving £7m a year net) have been let compared with 16 a year ago. In consequence E(A) decided, on 28 February, that exhortation was not enough and that the Secretary of State for the Environment should prepare a report on legislative options for extending contracting out. This report is expected to be completed soon.

National Health Service

6. In September 1983 all health authorities were asked to draw up programmes to implement compulsory tendering for cleaning, catering and laundry services. The cost of these three key services in 1982-83 was around £950m, of which less than £17m was contracted out. The scope for savings is illustrated by the fact that in 12 recent contracts for cleaning and laundry services savings of £1.5m have been made. At present, the responses of the health authorities to this request are being assessed by DHSS.

Nationalised Industries

7. Unlike most central and local government activities, those of nationalised industries already take place in a commercial environment. Resultant management pressures, accentuated by tight financial disciplines, lead to the industries contracting out a wide variety of functions and services where this is the most cost-effective solution. The energy industries, for example, annually contract out over £2b of work. Corporate planning discussions and the annual Investment and Financing Review provide a mechanism for pressing the industries to do more and I am sure that we should continue to emphasise the importance we attach to this area.

Central Government

8. Some 20,000 Civil Service posts and £18m net per annum were saved by contracting out policies between 1979 and April 1984. Present manpower plans assume only a further 2,000 will be saved by April 1988. There are wide variations between the extent to which different departments have contracted out work (figures at Annex A).

9. While we need to ensure that contracting out is cost-effective, I cannot believe that these figures represent the full scope for contracting out by government departments. Nor does the approach of departments match up/ to what we are requiring of health authorities and are considering for local authorities. I hope colleagues will ensure that their top management systems set up under the Financial Management Initiative will be used to identify functions which could suitably be contracted out to the private sector. In addition, I propose that departments should now be required to test the market (where they have not done so already) for a number of specified services - for example cleaning, laundry and maintenance. If my colleagues agree I will arrange for officials to consider how best to set this in hand.

Conclusion

10. I invite the Cabinet to note progress made so far and to agree that:
- (a) government departments should be required to test the market for contracting out a range of specified services; they should also use their top management systems to identify functions which could suitably be contracted out;
 - (b) the Secretary of State for the Environment should bring forward to colleagues as soon as possible his proposals on the legislative options for increasing contracting out by local authorities;

- (c) the Secretary of State for Social Services should inform colleagues of the conclusions of the assessment of health authorities' contracting out returns as soon as it is completed; and make proposals for further action;
- (d) I should make a further progress report next year.

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CONTRACTING OUT BY GOVERNMENT DEPARTMENTS

The table below shows the amount of running costs expenditure contracted out by each department.

The information was collected in the 1983-84 annual scrutiny of running costs and does not give a complete picture of work contracted out by Government departments because 'programme' expenditure is not covered. To some extent the differences in the amount of running costs contracted out shown in the final column reflect quirks in the coverage of the annual scrutiny.

| | Contracting Out Expenditure (See Notes 1 and 2) | Total Running Costs (See Note 1) | Amount of running costs contracted out |
|---|---|---|--|
| | £000s | £000s | per cent |
| Defence | 69,680 | 8,680,135 | 0.8 |
| Foreign and Commonwealth Office | 2,315 | 362,702 | 0.6 |
| Overseas Development Admin | 4,398 | 42,623 | 10.3 (Note 3) |
| Agriculture, Fisheries and Food | 1,450 | 208,387 | 0.7 |
| Trade and Industry | 7,039 | 263,612 | 2.7 |
| Energy | 236 | 31,016 | 0.8 |
| Employment | 4,231 | 342,705 | 1.2 |
| Manpower Services Commission | 2,624 | 334,554 | 0.8 |
| Transport | 2,803 | 261,364 | 1.1 |
| Environment | 5,728 | 161,600 | 3.5 |
| Property Services Agency (excluding Supplies) | 93,104 | 481,125 | 19.4 (Note 4) |
| Home Office | 18,191 | 658,494 | 2.8 |
| Lord Chancellors Department | 2,787 | 178,881 | 1.6 |
| Education and Science | 517 | 52,162 | 1.0 |
| Health and Social Security | 36,191 | 1,421,085 | 2.5 |
| Treasury | 3,497 | 68,271 | 5.1 |
| Customs and Excise | 1,794 | 375,876 | 0.5 |
| Inland Revenue | 15,370 | 902,220 | 1.7 |
| National Savings | 924 | 150,352 | 0.6 |
| Cabinet Office | 2,409 | 48,991 | 4.9 |
| Paymaster Generals Office | 289 | 12,426 | 2.3 |
| Scottish Office | 2,695 | 165,373 | 1.6 |
| Welsh Office | 261 | 41,607 | 0.6 |
| Northern Ireland Civil Service | 5,657 | 316,354 | 1.8 |
| Northern Ireland Office | 2,979 | 94,581 | 3.1 |
| TOTAL MAJOR DEPARTMENTS | 287,169 | 15,656,496 | 1.8 |
| TOTAL MINOR DEPARTMENTS | 8,115 | 393,438 | 2.1 |
| TOTAL ALL DEPARTMENTS | 295,284 | 16,049,934 | 1.8 |

Notes

1. Figures are forecast outturn for 1983-84.
2. Figures under headings contract cleaning, other agency charges, contract and consultancy services.
3. All of ODA's technical co-operation offices are specialists, for example in agriculture, employed on short term contracts to help underdeveloped countries.
4. PSA contract out 80 per cent of property maintenance and 40 per cent of major design work.