



FROM: CHIEF SECRETARY
DATE: 31 July 1985

PRIME MINISTER

**USING PRIVATE ENTERPRISE: COMPETITIVE TENDERING BY
GOVERNMENT DEPARTMENTS**

In my minute of 14 January, I proposed further measures to increase competitive tendering for work from government departments to the private sector, and to make market testing mandatory for certain specified services. I undertook to report progress in the summer. Cabinet colleagues were content with the proposals; and your private secretary's letter of 26 February expressed your hope that departments would extend as widely as possible the range of services to be tested against the market. You asked for my report to identify the savings being made.

2 The new initiative was announced by Barney Hayhoe in the House of Commons on 4 March during a debate on public expenditure. He made it clear that departments would continue to ensure that as much work as possible is subject to competition, that they would be taking every opportunity for competitive tendering, and that departments' top management systems would provide a means of identifying suitable areas. He went on to list the five services for which market testing is now mandatory - cleaning, laundry, catering, security guarding (subject to Cabinet Office guidance,) and some kinds of maintenance work.

3 Following Barney Hayhoe's announcement, detailed guidance was sent to departments; and they have now drawn up plans to subject most of the specified services to competitive tendering by April, 1987. Arrangements have been made for departments to exchange information and to share experience.

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4 It will be some time before we can assess the effect of the new policy, but I hope that my next report will be able to show that good progress has been made. Competitive tendering should be a most important source of economies in departments' running costs. To keep up the pressure I think it would be helpful for us to mount a multi-departmental review of competitive tendering in Government departments, and my officials are discussing this with the Efficiency Unit. The terms of reference will need to be drawn up carefully, but a review could tell us how vigorously the policy is being operated, help to satisfy us that it is giving value for money, and ensure that it is being applied as widely as possible, as well as sensibly and efficiently, by departments. It could also pick out other services that might be added to the list for mandatory market testing.

5 Annex A shows the amount of contracting out at the end of the last financial year (1984-85) on each of the five main services. Out of total expenditure of some £378 million, an estimated £176 million (46 per cent) was contracted out at the end of that year. Progress on contracting out cleaning and maintenance was good; and satisfactory on laundry. The extent to which security guarding and catering had been contracted out is disappointing, but security considerations and other constraints mean that much of this work may have to be retained in-house. For example, although nearly half of the Services wide expenditure on security guarding is incurred by MOD, the constraints of defence security limit the use of competitive tendering in this area. Similarly, the practicalities of security and other operational constraints limit the extent to which catering in MOD establishments and Home Office prisons can be tested against the market.

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6 Net savings between April 1979, and April 1984, on those services awarded to outside contractors amounted to an estimated £20 million per year. The net savings resulting from contracting out in 1984-85 are estimated at a further £2 million per year. Staff savings resulting from contracting out since 1979 are some 21,000 posts; and there have been unquantifiable benefits from the spur to efficiency which competitive tendering gives.

7 I am sure that we should be doing better than this, and that our new initiative should begin to show results soon. But it will only do so if Ministers in charge of departments take this forward vigorously. I urge them to do so.


8 My previous reports to Cabinet have also covered the remainder of the public sector. Annex 'B' summarises the current position in the National Health Service and in Local Authorities. Clearly, there is scope for faster progress. The position in the NHS was discussed at your meeting on 'Health Policy' with Norman Fowler and others on 22 July; the point was made that competitive tendering could contribute a good deal more annual savings than has been achieved so far. In the case of local authorities, the work of the Audit Commission demonstrates that there are still large efficiency savings which could be made. Our policy of competitive tendering by local authorities is a helpful spur to efficiency. The position on nationalised industries is as reported last year; our long term objective is, of course, full privatisation.

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9 I will report next year on progress made during the current financial year.

10 I am copying this to Cabinet colleagues, Ministers in charge of departments, Sir Robert Armstrong and Sir Robin Ibbs.



PETER REES

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ANNEX 'A'

CONTRACTING OUT OF SPECIFIED SERVICES BY GOVERNMENT DEPARTMENTS

SERVICE	TOTAL COST £000	CONTRACTED OUT £000	CONTRACTED OUT Percentage
Catering - prisons & MOD	108,008	4,527	4.2
- other depts	6,916	4,548	65.8
Cleaning	69,194	58,404	84.4
Laundry	11,318 \emptyset	8,306	73.4
Maintenance	116,087	94,919	81.8
Security Guarding	66,478	4,998**	7.5
TOTALS	378,001	175,702	46.5

NOTES

\emptyset Includes cost of prison laundries (£3m).

** Property Services Agency custodian services treated as in-house (£8m).

CONTRACTING OUT AND COMPETITIVE TENDERING
PROGRESS IN THE NATIONAL HEALTH SERVICE AND IN LOCAL
AUTHORITIES

National Health Service

Most health authorities have for some time used commercial contractors to a limited extent to provide support services such as building, vehicle and equipment maintenance; security services; ground maintenance; transport services; and some laundry services. But before the present initiative very few let domestic cleaning contracts and only one hospital had a full catering contract. The total NHS expenditure in England on contracting out in 1983-84 was £207 million.

In September 1983 the Government issued a circular to health authorities asking them to test the cost-effectiveness of their domestic services, catering, and laundry services by submitting them to competitive tender to find out whether savings could be made and resources released to improve care of patients. These services cost over £950 million in 1983-84. Authorities were also asked to continue to develop the use of contractors for other support services where appropriate.

Most health authorities are now making progress in meeting the circular's requirements. Some 60 contracts now let to contractors will save £10.4 million a year. In a further 55 cases where the work has been awarded in-house a further £2.7 million a year will be saved. This makes total savings so far of £13.1 million a year.

In their report on Public Expenditure on the Social Services the Social Services Committee (SSC) implied that the £13m so far saved through contracting out was insignificant when compared with the overall size of the budget. The Committee may not have appreciated that the contracting out process

is far from complete, and that further savings are still to materialise from the present initiative.

The savings may be further enhanced as further rounds of tendering encourage the development of the private sector. Equally importantly the Committee also overlooks the incentives that competitive tendering gives to provide an improved service, and the more tangible benefits this brings.

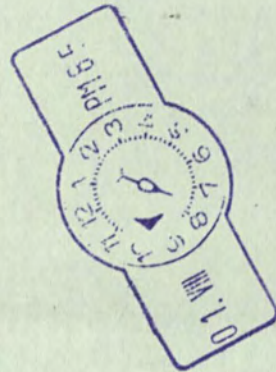
Local authorities

Local authorities are required under the Local Government Planning and Land Act 1980 to go out to competitive tender for a substantial proportion of their building and maintenance work. The present DLO regime appears to be having a significant effect on local authority cost effectiveness in the fields of construction, highways and maintenance. But it does, however, appear that the major effect has been to sharpen the cost effectiveness of in-house management rather than to achieve any major transfer of work to the private sector. Figures recently available show that there has been only a very slight increase in the proportion (to 58%) of relevant work carried out by the private sector in 1982/83 when compared with 56% in 1981-82. (This updates the figure for contracted out work of just over 60% previously assumed for 1982-83). Action has now been initiated against four authorities whose construction DLO's have failed to achieve the required rate of return on capital in three successive years. The momentum of voluntary contracting out of services, e.g refuse collection and cleaning, appears to have slumped, with only two new refuse collection contracts report in 1984/85.

Following Cabinet approval last October a consultation paper was issued on 14 February setting out proposals for extending competitive pressures to a further range of local authority activities, for banning irrelevant conditions in local authority contracts or tender lists, and for taking stronger

powers to act against abuses of the competitive process which are aimed at unfairly protecting direct labour organisations. Local authority responses have been predictably hostile to the principle of compulsion. Also there has been much comment on the more practical problems foreseen (in spite of the work of the Audit Commission which shows that there are still large efficiency savings to be made by Local authorities - the pressures of competitive tendering could bring them about). It was originally thought that legislation would be taken in the next Session to carry through the consultation process. But pressures on the legislative timetable has made this impossible. It has however been decided to include legislation to ban irrelevant conditions of contract and tender in the Local Government Bill scheduled for the 1985-86 Session.

Privatisation p 12



CONQUEROR
LONDON

Prime Minister^①

Agree a response as at X? AT 2/8

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MR TURNBULL

2 August 1985

Yes Mr

COMPETITIVE TENDERING BY GOVERNMENT DEPARTMENTS

The Chief Secretary has reported on progress.

Measured in terms of the proportion of those services which has been contracted out, (46% of all Departmental catering, cleaning, laundry, maintenance, and security guarding), progress is encouraging. We have saved 21,000 posts, worth about £200 million per year. Why then have we saved only £20 million net - a sum which is less than 5% of the total costs of these services, and around 10% of the staff savings?

Two possible reasons are, first, that contracting out is not the same as arms-length competitive pricing. All contracts will be tested in the market by 1987 and this should generate more savings. The second reason is that Departmental overheads have not been reduced in line with staff reductions. Work is in hand to release office space.

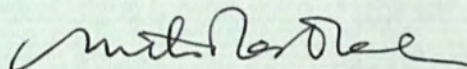
Departmental performance is patchy. MoD contract out none of their maintenance, one half per cent of their security guarding, and 5% of their catering. They wish to avoid use of outsiders in secure buildings. But why can MoD contract out 95% of its cleaning, which must also involve outsiders?

Treasury are alive to these points and will be pursuing them. I suggest, therefore, that the Prime Minister might reply along the lines:

- 7 | 1. Encouraged that nearly half of the specified services have been contracted out.

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- X
2. Noted that this has yielded net savings of less than 5% of the total cost of these services.
 3. Hopes that detailed comparisons of departmental practice will reveal ways of contracting out more, particularly in catering, and of securing greater savings.


NICHOLAS OWEN



ECL
Cc: Nick Owen

10 DOWNING STREET

From the Private Secretary

5 August 1985

Dear Richard,

COMPETITIVE TENDERING BY
GOVERNMENT DEPARTMENTS

The Prime Minister has seen the Chief Secretary's minute of 31 July reporting on progress made in increasing the proportion of services subject to competitive tendering. She has noted that nearly half of the specified services have been contracted out though this has produced savings of only around five per cent of the total cost of these services. She welcomes the steps being taken to carry this initiative forward.

I am copying this letter to Private Secretaries to Ministers in charge of Departments, and to Richard Hatfield (Cabinet Office) and Sir Robin Ibbs (Efficiency Unit).

Yours sincerely
Andrew Turnbull

(Andrew Turnbull)

Richard Broadbent, Esq.,
H.M. Treasury.

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SRW