Out of Contract:

Time to move on from the 'love in' with outsourcing and PFI

A *'What needs to change'* Smith Institute talking points by David Walker and John Tizard

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About the authors

John Tizard is a strategic adviser, formerly a senior executive at Capita and Labour leader of Bedfordshire County Council; David Walker is contributing editor at Guardian Public and a former director at the Audit Commission.

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Foreword

The pressure on government departments, public bodies and local government to outsource public services has intensified since the 2010 election. This growing trend towards contracting out is largely being driven by fiscal austerity and the relentless search for budget savings. But also by the Conservative Party's deep-rooted belief in marketisation, privatisation and desire for a smaller state.

Contracting out has become part of the DNA of government. But, how effective has it been for the public sector and the companies concerned; has it *really* delivered the promised savings and improvements in service delivery; and what have been the social and human costs? It is these questions that David Walker and John Tizard address in this timely and insightful policy discussion paper, the first in our 2018 series of *"what needs to change"* talking points.

The authors explain that outsourcing has all too often been a good deal for business and a poor deal for the taxpayer, service users and employees. When contracts have collapsed, it is the public sector that's left picking up the pieces. This is also true with the beleaguered Private Finance Initiative (PFI) programme, which under Labour and Conservative governments became the default option for securing private investment in public services.

Some public services, like IT and refuse collection, have been outsourced for decades. Other contracts have changed hands many times and services once provided by British firms are now delivered by multinationals or private equity companies. The problem is we know very little about the contracts; what the precise terms are and how they are managed by the contractors. Moreover, as Walker and Tizard point out, we also have a yawning information deficit on how outsourcing and PFI impacts on employees and wider society.

Walker and Tizard, who both have considerable expertise and experience on the topic, argue that government should pause further contracting out and undertake a root and branch review of all outsourcing and PFI deals, warts and all. That review, they contend, must be open and thorough. As such it can help form the basis of a new deal for our public services.

While some outsourcing and PFI deals have been costly disasters and others have boosted the profits of global companies at the tax payers expense, the authors are not saying cancel all contracts from day one and exclude the private sector. Leaving aside the high compensation costs, for the authors, ending outsourcing will not in itself solve funding deficiencies or poor performance. Walker and Tizard are instead arguing for tighter and tougher regulations, renewed investment in public services and a preference for in-house and not-for-profit provision.

Outsourcing and PFI deals are becoming discredited and some of the leading companies are now questioning the viability of signing new contracts. The case for a serious rethink is now compelling. As Walker and Tizard propose, the time is right for reform and a new progressive settlement on public services. A new deal for improving our public services which is honest, open, fully costed and not predisposed towards contracting out.

Paul Hackett
Director, the Smith Institute

Executive summary

This paper examines outsourcing and the PFI; provides evidence and examples of where, how and why contracts have failed; what the costs have been; sets out the case for change and identifies the challenges ahead; and offers an agenda for reform and a pragmatic programme for action.

The highlights of the paper are:

- Contractors are ubiquitous: in many instances they have *become* the public sector. Outsourcing is big business, worth up to £100bn a year or around a half of total government spending on goods and services. Servicing PFI deals costs £10bn a year, with a further £95bn yet to pay.

- Private sector involvement is heaviest in IT, construction, waste management, building maintenance, social care and defence but also includes prison, probation, ambulances, diabetes care, blood testing, trimming shrubs in Royal Parks and applications for UK visas. Many schools and hospitals are locked into PFI deals, where catering and cleaning and IT have to be supplied by nominated companies.

- Deficiencies and deformations around outsourcing are now clearer than ever. Some contractors are in commercial trouble. PFI is now recognised as the costliest form of contracting, and not just because of exorbitant finance charges but also the rigidity and expense of its long run services element.

- To conspicuous contract failures in the NHS and the 2012 Olympics have been added probation, housing for asylum seekers, court translation services and, notoriously, assessment for social benefits and employment. Meanwhile, local authorities are chafing at the inflexibility of contracts and returning services in-house.

- The extra-contractual costs of outsourcing reduce its value for money. Paying contract staff less than a living wage – in order to win a competitive bid – has dire social consequences.

- Outsourcing has weakened employees' bargaining rights, cut productivity, clouded accountability and robbed public service of vital morale and vocational dimensions.

- Outsourcing has further fragmented services when serious complex issues require joined up responses.

- Contracts are being extended without proper consideration because Whitehall is consumed by Brexit.

- Accountability is lacking: often taxpayers and service users are unaware of who is providing their services; where to complain; and whom to hold to account. Democratic oversight and control has been diminished.

It is time to pause, reflect and adopt a new approach to delivering public services. A rethink of outsourcing and PFI is urgently needed, based on the following recommendations:

Recommendation one. Commission a root-and-branch review, examining where outsourcing has worked and why, the 'whole life' costs of contracts, effects on staff and service quality and other social and economic impacts.

Recommendation two. The government should compile a Domesday Book listing all significant contracts and create a central clearinghouse for evaluating the performance of companies across multiple contracts.

Recommendation three. A new agency is needed (absorbing the Crown Commercial Service) to regulate, share best practice and evaluate outsourcing across Whitehall and the NHS with parallel arrangements for local government and the devolved administrations. Agencies should be given powers to examine company ownership and internal transfers.

Recommendation four. With in-house provision as the default option for public services, set out new criteria for "make or buy" decisions by public bodies, writing into contracts Freedom of Information requirements, involvement of public and staff, transparent reporting of profit, labour and living wage clauses, union recognition, compliance with fair tax and boardroom remuneration. These criteria might give preference to charities and social enterprise if services are contracted out.

A new government should be bold but also recognise that unwinding private involvement in public services will be difficult: repayment costs under PFI deals are still rising and exiting contracts could be costly – and require significant expansion of public service capacity. This is already starting to happen: council leaders and politicians in the devolved administrations, for example, are already revising and reforming delivery by contract, showing what can be done. The decisions ahead are not technical. They are political, turning on a wider assessment of the public interest than has been common during the era of outsourcing.

1. Introduction

It's time for a thorough review of the public sector's relationship with contractors. If the present government won't, the next must. Outsourcing firms are ubiquitous: in many instances they have *become* the public sector. The Business Services Association says outsourcing is worth 8% of GDP (£263bn), of which between £100bn and £120bn is in the public sector, including contracts to charities and not-for-profits as well as firms. This is probably an overestimate since in 2015/16 the UK state spent a total of £192bn on services and goods, which include everything from fighter aircraft to manhole covers; however, we don't have good data and that's part of the problem. Local government paid suppliers £65bn in 2014/15, an unknown but large proportion of which was for service contracts. The National Audit Office (NAO) estimates that 50% of total spending on goods and services (£93.5bn) went on third party providers.

The PFI, first conceived in 1992 as a way to increase private financing of capital projects, has proved much more expensive than government borrowing. Continuing PFI projects (some under Private Finance 2, the revamped sister PFI which is heavily focused on schools and hospitals) now have annual charges to the public sector of over £10bn a year. The Whole of Government Accounts (the audited record of the assets and liabilities of the entire public sector) says the public is contracted to £95bn in PFI charges stretching decades into the future, a significant element of which is IT, buildings maintenance and catering. In health, outsourced services make up 40% of PFI charges.

Those figures are a lot softer than they should be. Indeed, the lack of hard data about outsourcing is one prompt for a review. Central, local and devolved government and the NHS don't collectively know who does what, where and to what effect on the public finances. And, more importantly nor does the public. We need a Domesday Book enumerating contracts, too many of which are opaque or hidden from sight: profitability gets disguised or hidden in a welter of intra-company charges and money transfers.

A central clearinghouse could evaluate the performance of companies across multiple contracts, sharing what is learnt with public bodies and enforcing contract standards, which should include auditable open book accounting and making rates of profit visible. We also need to know the ownership structures and investors, as well as the tax practices of these companies.

Private sector involvement is heaviest in IT, construction, waste disposal, transport, building, facilities management, social care, military equipment and energy supply. Companies reach deep into national defence, training RAF pilots and servicing nuclear weapons. Bristow, a defence contractor based in Houston, Texas, has taken charge of UK search and rescue operations. Preparations for Trooping the Colour are in the hands of Vinci, the French construction company. Capita collects the London congestion charge and sends out television licence detector vans. Contractors, often subsidiaries of multinationals, run accommodation for asylum seekers, applications for UK visas, prisons and custody suites in police stations, refuse and waste disposal, school building (and till recently school inspection in England) as well as NHS community, mental and sexual health services. As elsewhere in the UK outsourcing is also prevalent in Scotland under the Nationalist government.

Once outsourcing was mainly in back office administration and IT but over the past two decades it has encroached on the front line, into education, child care, clinical health services, enforcement and regulation. These contracting out practices, sometimes related to PFI deals, have distorted accountability and changed the dynamics of policy making in yet to be fully deciphered ways. As early as 2011, the House of Commons Treasury Committee warned that "we have not seen clear evidence of savings and benefits in other areas of PFI projects which are sufficient to offset this significantly higher cost of finance".

So, there are pressing reasons for a rigorous review and meaningful reform. Outsourcing may cause social harm. Contracted staff, for example, may be paid less than a living wage – with all the social consequences. Contracting has weakened employees' bargaining rights, clouded accountability and robbed public service of its moral and vocational dimensions.

Another reason is Brexit. Since the EU referendum, hundreds of public service contracts due to expire have been rolled forward without proper appraisal of costs and performance. They demand attention. Depending if and how the UK is to leave the EU, great gaps open up in public procurement, the competition regime and rules on state aid: we have an opportunity to revisit, revise and improve.

The state business nexus should be re-examined as a matter of civic principle. Business has usurped functions that are *essentially public* – detaining and depriving citizens of their liberty, collecting tax, assessing claims to social benefits and punishing citizens. The TV programme Panorama reported in May 2017 that the company to which Maidstone Borough Council had outsourced environmental services, Kingdom Security, paid its staff bonuses for the number of fines they issued for dropping litter!

Outsourcing has been seen to fail the acid test of reliable performance, in tagging offenders, prison maintenance, e-borders, ambulances, employment support allowance administration, GP data, care homes and housing for asylum seekers. In the market's own terms, it's in trouble. Giant outsourcing companies are unwieldy and lack internal controls. Advocates such as Professor Gary Sturgess, former executive director of the Serco Institute, are now much more cautious; he acknowledges the "public want social services to be delivered by people who are motivated by a public service". Oliver Brousse, chief executive of John Laing, recently declared PFI no longer "fit for purpose". Interserve, with revenues of over £3bn and 80,000 staff in services ranging from probation to health, has seen its market value slashed and its chief executive walk. Capita's equity value tumbled when some of its contracts were reported to be in difficulty; companies such as Carillion and Mitie (a £2.1bn company, spanning catering, cleaning and engineering) apparently can't make big enough margins on theirs. Ministers appear to share the City's view that Carillion is just "too big to fail". After the firm's share price plummeted in 2017 the government did its best to help, awarding the company substantial work in defence and through Network Rail on HS2.

Outsourcing and PFI have an undeniably partisan character. The share price of major outsourcing companies rose by more than the FTSE index when the Conservatives won the 2015 election. Investors were further buoyed by the government's National Infrastructure Plan (2016), which called on the private sector to fund at least £250bn of infrastructure projects.

The Labour Party, meanwhile, has made strong commitments on one aspect of outsourcing, PFI. According to Shadow Chancellor John McDonnell, "Labour will review all PFI contracts and, if necessary, take over outstanding contracts and bring them back in-house, while ensuring NHS trusts, local councils and others do not lose out, and there is no detriment to services or staff". Many in the Labour Party, trade unions and beyond have also opposed the wider growth of outsourcing, although the party's 2017 manifesto was not explicit. Concerns about public value, the rights and conditions of workers and the effectiveness of private delivery have coalesced. Labour is moving to contend that *the preferred providers of services should be accountable and transparent public bodies* but also that government and business should enjoy fruitful relationships across the width of procurement.

Labour councils have faced year-on-year budget cuts and in austerity many felt they had little choice but to outsource as ostensibly the cheaper option. At Labour's 2017 conference Andrew Gwynne MP, Shadow Secretary for Communities and Local Government, described councils as hollowed out and noted that if contracting diminished there would have to be much filling in. The state has lost baseline capacity to commission and negotiate. For example, Mike Clancy, head of the professional's union Prospect, argues that the debacle in outsourcing the clean up of nuclear waste "raises questions around the ability of government, especially after seven years of cutting staff and funding". This is a worrying situation that is getting worse.

PFI deals are notorious: public bodies are enmeshed in contracts that may be hard to unravel. They often lack break clauses, so renegotiation is very costly. According to the Nuffield Trust, terminating PFI health contracts alone could cost as much as £50bn. Even reviewing such deals is going to be hugely demanding; terminating them implies a large expansion of staff and capacity and risks becoming another bonanza for consultants and advisers. But that is no justification for the status quo.

The case for review is all the stronger because outsourcing has drifted unexamined into more and more services. So the time is ripe for reassessment. It might throw up positives but contracting must also be examined in the round, to include full costs and benefits and wider and longer term impacts, on labour markets, employment conditions, commissioning capacity and decision-making.

2. Time for a contract review

Reforming and re-organising the way the state has become enmeshed with private interests won't be easy. Even definitions are not straightforward. Government in its different forms interacts with business across a wide spectrum of procurement, capital and revenue; from buying paper clips to transferring entire services and, at the extreme, the withdrawal of the state through privatisation and the sale of assets. The Cabinet Office lists the top 20 suppliers to government by value as IT companies, led by Capgemini, Hewlett-Packard and IBM but does not disentangle the service, hardware, software and outsourcing elements in these contracts. Next come process outsourcers such as Capita, which also has big IT interests. The list is incomplete and fails to address services, such as primary healthcare from GPs, which has always been a weft of public and private interest.

Despite the growing questions and concern, contracts are still being let. The total value of all purchases by government (not just outsourcing) rose during 2016, notably in construction and health, falling somewhat in local government. Capita, for instance, has recently been awarded the civil service's apprenticeship scheme in a £55m four-year deal. The NHS remains subject to law enacted by the Cameron coalition government that enforces competitive tendering: United, Circle and other firms are still winning contracts. Clinical commissioners for Scarborough and Ryedale (who stated that "the final model will be shared with patients after completion of procurement") are looking at 22 bidders for physiotherapy, diabetes and cardiac rehabilitation, including Virgin Care.

The share of NHS work going to private providers may even have increased; since councils in England took over sexual health services in 2013 more have been contracted out. Councils go on outsourcing in the belief it's the way to cut costs. Companies such as RingGo, offering cashless parking payments to public bodies, are expanding. According to the Arvato UK Outsourcing Index, council spending on outsourced IT alone rose 75% in 2016 to £463m.

And yet it feels like contracting's heroic age is over. In the years since the Thatcher government made tendering compulsory, the public sector has fought back. Local authorities, for example, have shown they can manage change and secure productivity improvements, reduce costs and improve quality without contracting out. Recently councils and NHS trusts have started taking outsourced services back, for example housekeeping, cleaning and catering at the Brighton and Sussex University Hospital Trust and maintenance and repairs at Conservative-run Bournemouth Borough Council.

"Insourcing" decisions are based on arithmetic and dissatisfaction, rather than principle. The former Conservative leader of Cumbria County Council, Eddie Martin, noted "while [outsourcing] might get you an initial cheaper price, it simply doesn't last": he brought county highways and road operations in-house. A Guardian investigation of 36 public-private partnerships signed between 2000 and 2007 found 13 of them had been brought back, either after the contract ended or was terminated early. Lynn Carpenter, chief executive of Thurrock council, where a Conservative-UKIP coalition held power, called a contract with Serco to provide human resources, procurement and IT "a disaster…if you wanted something done differently they said, that'll cost you".

In what some see as a rebirth of municipal enterprise, councils are banding together to run services under one umbrella. Southwark is joining the joint IT service created by the London boroughs of Brent and Lewisham, ending its contract with Capita. Liverpool City Council has awarded its parks and green space contract to its own street scene company, expecting savings. Councils of varying political colours are setting up wholly owned local housing companies to provide both new homes for rent and sale and housing services.

Outsourcing has had spectacular failures. The performance of G4S at the 2012 Olympics and the inhumanity of Atos' benefit assessments have killed forever the claim that private provision necessarily always "works". The Ministry of Defence (MoD) terminated Capita's contract to run the military estate barely three years into its ten-year run. London's flawed Public Private Partnership for the Jubilee tube line was two years late and massively over budget.

Contractors themselves have turned out to be thickly concentrated, with only a tiny proportion of procurements going to small and medium enterprises (SMEs). The NAO estimates that taxpayers have been paying around £4bn a year to just four big companies: Capita, Serco, Atos and G4S. These global giants have become increasingly attached to a steady flow of payments from the public purse, sometimes very long term. Capita, for example, has been receiving payments from the BBC for administering television licences since 2002 – and will continue to do so until 2022. Some prison contracts last 15 to 20 years. According to the Treasury's calculations, by the time PFI contracts have all been paid off – in 30 years time – they will have cost over £300bn, more than five times their initial asset value. Conservative MP Chris Philp commented that this debt burden is unacceptably high, and that the PFI deals should be "unwound as quickly as possible".

Outsourcing has failed to live up to promises about "transformation", competition and cost; the market is often a cartel. Meanwhile, the business models contractors adopt rest on impoverishing employees. Outsourcing companies are all too often competing in a race to the bottom, paying staff the minimum wage (and less), some on zero hours contracts.

Yet the problem may not be the contract so much as the underlying policy. Campaigners slam Sodexo and Serco for how they run schemes to support asylum seekers; the fault may be their trying to make money when basic fees for cash and accommodation are too low and the policy which the contract is aimed at delivering is itself flawed. Many domiciliary care companies pay less than the minimum wage because they fail to recompense staff for their travel between jobs. So, are the companies just passing on cuts in council spending, minus their profit? A review of the care homes market by the Competition and Markets Authority was scathing: residents and their families are being exploited and often badly served.

We don't know the full costs and benefits because outsourcing's reach and impact are shrouded in secrecy: it is hard to probe individual contracts and see whether they have get-out clauses. A review of major contracts by the Treasury in 2012, concluded that there was "too little ownership of and interest in" them on the part of officials and ministers.

An imperative is *knowledge*. It's striking, and suspicious, how little is known. Lord Hutton, former Secretary of State for Business, Energy and Regulatory Reform (2007/08), commissioned a public services industry review from the former Serco non executive director DeAnne Julius, which in the spirit of the times was winsomely favourable, without producing much useful evidence. No comprehensive survey of the phenomenon has been undertaken. The NAO and parliamentary committees have reported intermittently, discovering all too many instances of failure and poor value.

Theresa May's government is in no fit state to take action, so it's Labour that must push to review and recalibrate. A first headline is *money and investment*. Lately, contracting has been the stepchild of austerity. Contracts are sometimes as good or bad as financial circumstances permit. Outsourcing in this sense can be seen as contingent on macroeconomic policy and decisions about tax and spending. It's also ideological. Over 40 years the push to PFI and outsourcing has been political, part of the project to shrink the state, cut tax, deregulate and sell off public service functions and assets. As that tide ebbs, the case for public provision becomes an element in the wider argument for progressive taxation, ending austerity and restoring decent services. The electorate seems willing to pay more tax, provided systems are fair and money raised is dedicated to improving the quality of service. A recent poll by the Kings Fund, for instance, found that two thirds are willing to pay more taxes to maintain NHS funding. Here is a core political choice for voters, and in all likelihood a clear demarcation line between the main political parties.

It follows that a second headline is *conditionality*. People need to be persuaded to pay more in tax, which involves making a case for spending or, better, "effective spending". Advocates of outsourcing used to argue that citizens could not trust the state to spend well, so companies had to be brought in (as if companies were automatically competitive and efficient). "Reform" came to imply competitive contracting and marketisation. Unfortunately, the consequences of large-scale outsourcing include fragmentation and inefficiency (such as the need to pay low wage contracted staff tax credits). Being effective also means people know who's responsible; and integration, so patients, citizens and service users are not pushed from pillar to post by a jostle of unjoined-up, competing providers.

A core principle of public spending must be accountability. Yet outsourcing can weaken and confuse lines of responsibility. The Local Government Ombudsman recently reported a surge of complaints from householders about refuse services occasioned by the inaccessibility and unresponsiveness of private suppliers. This lack of accountability has a long history. A decade ago the Association of Chartered Certified Accountants regretted "the ability of [PFI] accounting methods to provide adequate transparency.... which, in turn, creates problems for monitoring and evaluation, and raises serious concerns about their public accountability".

Ahead should lie tighter management of inherited contracts and better commissioning. Gary Sturgess says "management tools appropriate for buying paperclips – highly commoditised, easily specified goods and services – are not appropriate for commissioning complex support services and front line human services". He is right. In consequence procurement must be much subtler, more regulated, and in all probability much less frequent. Firms that follow those tighter rules will undoubtedly continue to play a part in public services. Where there are capacity shortages, such as IT, public bodies may have no choice but to rely on contractors, at least in the short run. But the separate elements in outsourcing should be better understood: there is a big difference between a company coming in to revamp IT architecture and provide on-call maintenance (replacing a broken laptop) and becoming a semi-permanent fixture running public call and contact centres. Yet both are often outsourced in the same contract.

A third headline is *regulation*. Market ideology says contracts are made between equal parties, disputes are for courts to adjudicate and that's that. Public service is too precious for such a desiccated approach. Key principles underlying services – such as union recognition, fair treatment of staff, accountability, transparency and open book accounting – need enforcement. This regulatory function goes well beyond the NAO's excellent reporting work and the internal consultancy provided in Whitehall by the Crown Commercial Service. The public sector as a whole needs a new proactive, knowledgeable invigilator of outsourcing with the capacity to call in and review dodgy contracts and, where necessary, stand up to pressure from global companies and their attempts at regulatory capture and divide and rule.

Definitions matter

Partnership is sometimes used as a catchall for state-private sector dealings. It can obscure debilitating disparities in power, small councils getting into bed with multinational giants, say. But relationships can be more equal and mutually beneficial. South Tyneside and Sunderland councils appointed Henry Boot PLC as "development partner" for their international advanced manufacturing plant; local authorities have traditionally used construction companies to build on their behalf. However, partnership has too often been regarded as a more politically acceptable word than contracting when the actual so-called partnerships have been little more than traditional outsourcing contracts.

When the public sector *commissions* this is to identify need based on assessments, consultation and policy objectives; allocating money to meet them; identifying the best means of meeting needs. Being a good commissioner is no mean feat. It is a different activity from procurement, although commissioning can lead to decisions on whether to "make or buy" – to provide in-house or let a contract.

The public sector has always *procured* – bought -- goods and services from companies; most building and construction is done by private firms and always has been. The Environment Agency leases vans; Swansea City Council pays a specialist firm to take waste wood from its five recycling centres. Transport for London buys tube trains from manufacturers; the MoD commissions submarines from commercial shipyards. Housing and infrastructure has always been built by companies. This is business as usual but the public sector has a right and a duty to ensure suppliers pass threshold tests – such as recognising unions or taking on apprentices.

In *franchising* a contract gives business temporary use of an asset or controlled space, with the franchisee collecting rent or revenue for a stipulated period of time. But arrangements on the railways are intentionally complex. Some train operators pay the Department of Transport to run services on track owned and maintained by Network Rail; others are subsidised. Neither the public nor passengers get consulted and the government claims what franchisees do – including their often dreadful industrial relations – are none of its concern.

Privatisation involves the outright sale of assets, often at knockdown prices. Learndirect, the training company, is a recent example. The buyers of this Labour era vocational trainer squeezed all the value they could and what remained, as inspected by Ofsted, was branded "inadequate". Privatised utilities, such as the water companies, have meanwhile boosted profits on the back of inflation busting bill increases. The annual profits of Thames Water, for example, have increased dramatically, with the FT reporting that it paid £1.2bn in dividends between 2006-15. These companies have put profits and huge pay rises for executives before customers. The Thatcherite model of regulation based on price has failed to protect consumers and to secure cost effective infrastructure investment. In many instances where major investments by utilities have been forthcoming, the companies pay zero corporation tax. Royal Mail is the most recent example of outright sale. The government allowed a restricted transaction, passing to equity holders buildings and vehicles that had been public property, even pillar boxes (paradoxically still emblazoned with the names of monarchs). Royal Mail continues, just, to have an obligation to deliver letters. But with privatisation, a communal function may simply cease. The company, meanwhile, recorded pre-tax profits of £335m in 2016/17.

With *outsourcing* responsibility (but not necessarily assets) is passed to a supplier (sometimes a non-profit). Responsibility for policy and issues such as service access and pricing and service specification ostensibly remain with the council, NHS or Whitehall department. But citizens are left dealing with private staff, who lock them up and assess them for social benefits – what were previously quintessentially public tasks. We may not know who to hold to account when there are problems.

The *PFI* is a hybrid of privatisation and outsourcing. Firms cover the capital cost of a building (a hospital or accommodation for soldiers and their families, for example) in exchange for a state commitment to make revenue payments stretching across future years; lucrative deals are then bulked up by all too often over-the-odds fees for maintenance and associated services.

3. The public services landscape

A nurse directs a porter to the bedside of a patient in St Mary's Hospital, Paddington: her condition has worsened and she needs to be moved to the high dependency unit. On his tunic, the porter sports a badge – but it doesn't say Imperial College Healthcare Trust or even NHS. It says Sodexo. With headquarters in the outskirts of Paris and global revenues of £18bn, this is one of the world's largest firms.

In 2014 the NHS trust gave Sodexo a contract for soft services – portering, cleaning, patient feeding and retail -- and it now employs 1,100 people at St Mary's, Charing Cross, Hammersmith hospitals. That's only one instance of the company's penetration of the public sector, where it generates an undisclosed but significant share of its £1.8bn-a-year UK turnover and its net profit (2016) of £650m.

On contract to the Home Office, Sodexo pays cash benefits to asylum seekers. It runs cafeterias on RAF bases, for the Scottish Public Pensions Agency, in schools and museums, at the National Gallery and 19 other NHS trusts. Sodexo also imprisons 30,000 people: it runs Peterborough, Northumberland and other jails. It oversees the probation of 20,000 offenders, through 'community rehabilitation companies' – created on the dismemberment of the probation service by the former Secretary of State for Justice Secretary, Chris Grayling MP. But, many of the contracts have not been profitable enough. Some companies have threatened to pull out, while HM Prison and Probation Service complain about the quality of their work (and lack of savings). Outsourcing probation has been a debacle and not the only one: court translation services is another.

But outsourcing companies are now embedded and Labour has often seemed as keen as the Conservatives (and, in Scotland, the Nationalists) to employ them. Barry Coppinger is Labour's police and crime commissioner for Cleveland, elected in 2012. He outsources several vital functions to companies, including forensics and toxicology. Cleveland has a ten-year contract with Sopra Steria for IT and "transformational services". Before Coppinger came in, the Cleveland police authority outsourced the detention of people arrested in Hartlepool and Middlesbrough, claiming it would free up the time of 36 frontline officers. A ten-year £35m contract was agreed with Reliance, a company later renamed Tascor (part of Capita). Coppinger retendered the contract, which was let to Mitie, with Tascor (Capita) continuing as facilities management provider for police buildings, as a participant in a 25-year PFI deal. These deals are often characterised by multiple players and bedevilling accountability, making profit margins opaque. Money gets made behind a dizzying series of re-incorporations and deals.

Some of the large outsourcing firms have generously rewarded their senior executives. Mitie, chief executive Phil Bentley, for example, has a base salary of £900,000. The firm has cleaning contracts with Transport for London as well as NHS Property Services. It also runs security for John Radcliffe Hospital in Oxford and Strathclyde Passenger Transport; facilities management for the Scottish Government and Greater Manchester Police; drones survey property for the London Borough of Hammersmith & Fulham; and the Campsfield (Oxford) and Heathrow Immigration Removal Centres – 1,200 detainees - as well as providing offender healthcare in two prisons.

Take one big city council, Sheffield. Its Streets Ahead contract, worth £2bn, began in 2012, through which Amey, owned by the Spanish multinational Ferrovial, manages the city's roads, pavements and streetlights. The contract hit the headlines in 2017. Amey planned to chop down 6,000 of the city's 36,000 trees. It is alleged – the contract details are mired in secrecy and ambiguity – that councillors can't stop the company going ahead unless they make significant extra-contractual payments.

This is only one of Sheffield's outsourcing arrangements. Council property is managed by Kier (group revenue £4.1bn) and repairs and maintenance are run by the Kier Sheffield LLP (80% Kier, 20% council). Capita provides the city council's IT, administration and customer services. Veolia empties bins and disposes of waste. The building that houses council staff is a PFI, which typically has changed ownership; Vinci Facilities Catering Group the main sub-contractor on the PFI is part of one of the world's biggest construction companies. Taylor Shaw provides dinners in 123 Sheffield Schools; it belongs to the Waterfall Group, which was acquired in 2016 by Elior Holdings, a French multinational with €5.8bn turnover in 2015/16, which also runs the Autogrill franchise in French railway stations.

That picture is typical of England's cities and shires. Multinational business is now woven into the municipal fabric, though residents may not realise it. Around half of England's councils with responsibility for refuse collection use contractors. From 2001 to 2014 Liverpool outsourced customer, internet and revenue and benefits services to a joint venture with BT, which was also "strategic partner" of Lancashire County Council for multiple services. The city council has now taken back these services. Capita owns 51% of Entrust, a joint venture with Staffordshire county council, which provides school catering, support services, facilities management and specialist schooling in a 20-year deal. At a more parochial level, district councils routinely contract out both specialist services such as dog wardens and pest control as well as back office functions.

Whitehall and the devolved administrations outsource extensively. Much of government's communications and IT is run by business. HM Revenue & Customs (HMRC) turned to Concentrix, a division of the US-based Synnex Corporation and paid it £32m to reduce fraud and error in tax credits – disastrously, causing pain and humiliation for thousands and failing to meet stated objectives: the three-year deal was supposed to save £1bn but delivered only an estimated £193m.

Residential homes for both adults and children have proved particularly attractive to companies owned by global private equity, such as Acorn Group and Advent, which owns the Priory Group. Social care companies are notorious for paying minimum wages and fighting to prevent their staff organizing to improve their pay and conditions. Mitie got into this sector by buying Enara (MiHomecare) in 2011. It has struggled to meet service standards, with half of its homecare workers reported to be on zero hours contracts. Mitie recently sold the company for just £2 after the firm made significant losses.

An aggregate picture is hard to paint because, by accident or design, no single government department has overseen the phenomenon. The NAO estimated that in 2013 Atos made £700m from UK government contracts, Capita £1.1bn, G4S £700m and Serco £1.8bn. For comparison's sake the Home Office spends £10.8bn a year. Of the approximately £747bn worth of UK government spending in 2014-15, some four pounds out of ten went on pensions and welfare benefits. Nearly three pounds went on salaries for staff. The rest was spent on contracts. Many of them were for goods and services that the state never has nor is ever likely to supply itself, from tanks and ambulances to printer cartridges and laptops. Outsourcing possibly accounts for a third of the total spent on goods and services. In some sectors, private supply predominates. The CBI claimed in 2012 that 48% of hospital security, 47% of council waste management and 27% of schools catering are outsourced. Nearly all prisoner escort work is contracted out and 14% of spending on prisons. According to the Institute for Government, despite the growth of outsourcing Whitehall's overall track record in managing providers is still poor and "in some areas the government has failed to spot or tackle poor performance or over-charging".

The King's Fund estimates that NHS commissioners in England spent 7.7% of the 2016/17 budget of £102bn on the private sector. In addition, NHS providers spent £1bn on services from non-NHS organisations; outsourcing elective surgery to the private sector at a cost of £381m in 2016/17. The tentativeness of such statistics is telling: we don't know enough. NHS trusts don't compare notes; don't evaluate firms' performance. NHS regulators don't promote systemic capacity to contract and evidence on company performance is not centrally collected or shared.

4. How have we got here?

Business has been a *supplier* to the state from time immemorial. Councils, new town corporations and central government have long paid construction companies to build houses and roads. The NHS was formed in 1948 with small businesses – GPs – at its heart. Some 70 years before that, Joseph Chamberlain, mayor of Birmingham, used public and private money to build libraries, parks, schools and water and sewage systems. There's nothing new about outsourcing, either. The National Union of Public Employees, which merged into Unison in 1993, traced its origins to the efforts of municipal workers to protect their livelihoods when London vestries tried to replace them with private dustmen in the 1870s and 1880s.

What is distinctive is the rapid growth of business involvement and its scale. During three quarters of the 20th century, a rough consensus held. Security and the maintenance of order, nursing and care, teaching and finances all belonged in an inner core that the state itself would generally provide. From the 1980s that understanding was undone. Owners of capital and financial intermediaries, facing diminishing returns in markets, penetrated the state in search of new opportunities for profit. The Thatcher and Major governments obliged, selling assets, railways, energy, water, at bargain basement prices. In addition, services were themselves marketised, turned into commodities for which contracts could be drawn up and profit extracted.

Outsourcing has made public services more atomized and even less of a seamless, integrated whole. Letting hospital car parks to Euro Car Parks, for example, may sound reasonable. The firm specialises in maintaining barriers and managing the flow of vehicles. But allowing the company to set charges or manipulate hours of opening has consequences for visitors and relatives and indirectly patient care. Here, as across contracting, so much depends on the contract details, with a huge premium on how well a public body specifies, monitors and enforces – capacity that has to be paid for and whose cost is not always included in the contract price calculation. The Commons Public Accounts Committee (PAC) picked up on these deficiencies, noting in its 2014 report: "the problems with contracting out are widespread, long-standing and rooted in the culture of the civil service. The government gives too much advantage to the contractors".

Though advocates of outsourcing are often deeply ideological, it has been promoted as purely practical, as a mere matter of cost. If private firms empty bins or process passenger data more cheaply, the state would be remiss not to take them on. Capita – running lots of payrolls – claimed economies of scale, offering cuts of up to 20% on back office costs. Labour-run Blackburn with Darwen Council was one of the first to outsource its operations to the firm. In 1988, when Capita started, turnover was just £4.3m; public sector work has pumped its growth into a giant turning over 800 times as much, half its business now is with other firms.

Under Thatcher councils were compelled to tender repairs, catering, grounds maintenance refuse and cleansing. It was never just about cost. Conservative ministers had partisan motives. Contractors could pay less because they refused to recognise unions, whose membership shrank, striking at Labour's power base. Contractors often did not honour Transfer of Undertakings Protection of Employment (TUPE) regulations and forced staff out or changed their terms and conditions. After 1997 the Labour Government reinforced TUPE rights and introduced regulations to ensure that new recruits to outsourcing firms had comparable terms and conditions to those staff who had TUPE rights. However, in 2014 the Cameron Coalition watered down the regulations, and gave employers new powers to change collective agreements one year into an outsourcing deal. According to Jon Dews, an ACAS senior adviser, outsourcing presents major challenges to unions – which "can be exacerbated by poor preparation and hasty consultation arrangements, with many employees and their representatives given little clarity about what is happening. Even where there is clarity of process many aren't clear about the impact on their terms and conditions". Some companies are blatantly anti-union. Parseq, the private equity company operating call centres for local authorities, for example, refuses to talk to the GMB union about staff grievances at its Sunderland call centre.

All along, a bigger political game has been played. Under Conservative governments the public sector has been subjected to negative rhetoric, ill-judged "reform" and spending cuts. Fiscal austerity under George Osborne was a means to shrink the state in pursuit of the neo liberal ideology first imported from America in the 1970s and 1980s. A smaller state and a rigid belief in the inherent effeciency of the market remain principal drivers.

Labour too flirted with the doctrine of "government steering not rowing" (which formed the centre-piece of David Osborne and Ted Gaebler's influential *Reinventing Government*, published in 1992). Indeed, for much of the past 25 years the main direction of British public policy has been towards de-regulation and marketisation, realised in no small measure through outsourcing services.

With outsourcing, return on investment – profit – becomes wrapped into the cost of essential services. Usually it is extracted by worsening the terms and conditions of staff, running the risk of degrading the quality of their interaction with the people they are supposed to serve. An outsourced care worker has less time; the call centre operative is brusque; the bin man has no incentive to notice signs of neighbourhood stress. The theory of outsourcing holds that all services can be reduced to contractual terms. Some councils, including Conservative-led Northamptonshire and Barnet, have talked of outsourcing all services, turning themselves into mere committees of contract-letters.

Contracting out and outsourcing of public services was taken up by the World Bank and International Monetary Fund and imposed on developing countries. The EU has propagated it, too, insisting that if a contract is let, firms must be allowed to bid. In Europe, the Netherlands and the Republic of Ireland, along with the UK, have been keenest. The OECD was Jesuitical: it insisted that contracting automatically cut costs and improved services. The evidence has never borne the assertion out; in practice, quality and cost trade off one another.

In the UK, from the 1980s health authorities were told to start breaking up their work into contractable chunks, then offered for competitive tender. Government grants for social care were made conditional on local authorities' proving they were outsourcing residential care to companies and charities, which now run most children's homes, the great majority of homes for adults and provide 90% of publicly funded home care (compared with 5% in 1993). The MoD started using contractors to provide 'support services'. They now repair jets and train RAF pilots. To the German company Siemens went the running of National Savings & Investments. At least it was German until 2011 when it was acquired by the French company Atos, which in turn outsourced much work to India.

For councillors, ministers and managers the default option became outsourcing even when it contradicted or undermined both policy and even stated political objectives. Take prisons: the first contracts were let in 1992. "It is not appropriate for people to profit out of incarceration", said Labour Shadow Home Secretary, Jack Straw. Within a week of taking office in 1997, he espoused market testing. Now one in eight prisoners are in privately managed jails, some of which were built using PFI.

Labour ministers were in two minds. They relaxed compulsory tendering, replacing it in 1999 with a Best Value test, which allowed commissioners to evaluate quality as well as cost. They also introduced some regulation to protect staff. But their 1998 Competition Act still pushed outsourcing. Anxious to expand services quickly, Labour turned to business to add capacity. Between 1997 and 2010, contractors were invited into schools administration, jobs advice and non-emergency NHS surgery. It was Labour that not only appointed Atos to its huge medical assessments contracts but allowed the multinational company to swallow up competitors and establish a predominant position.

5. High water mark?

The Coalition government's White Paper *Open Public Services* (2011) now appears as the high water mark in making private provision the preferred option. The neo-liberal thrust was also evident in the 2012 Health and Social Care Act, which insisted on competitive tendering of contracts (and in the Localism Act 2011, which gave councils greater freedoms to outsource services). Yet, contracting was crumbling, its contradictions becoming ever more evident. Philip Hammond MP, said in an interview with the Independent in 2012 after the Olympics when he was Secretary of State for Defence, that government starts with a prejudice that it should learn from the private sector. However, he acknowledged that the outsourcing model was not always the best way to handle big projects.

Outsourcing is part cause, part consequence of the UK's low wage/low productivity culture. Companies win bids because their costs are lower; they often pay staff less or worsen terms and conditions – this is most prevalent in services relying on low-skilled staff. According to a major Europe-wide empirical study of outsourcing by the Danish foundation AKF in 2014: "outsourcing choices are often purposely adopted to circumvent collective agreements and regulation, allowing labour costs to be cut via downward pressure on pay and working conditions, often via a switch from public to private agreements". Research by the Smith Institute has also shown that the low paid receive a particularly raw deal from outsourcing. As a result cleaners and janitors need tax credits to survive, which pushes up the net cost to the state. But because outsourcing decisions are made by a multiplicity of bodies and not coordinated, an aggregate costing is never made. Outsourcing that cuts local employment and spending can harm the wider weal, even if it leads to reductions on the cost of the individual contract.

Contracting companies turned out to be like so many other British businesses in their focus on short-term profitability, share price and excessive boardroom payments. What price "partnership" when outsourcing chief executives are paid millions - sustained by staff on £7.50 an hour? According to the Financial Times, a £1.5m annual pay package for the chief executive of an outsourcing company is "not unusually excessive". Some even strove to avoid paying UK tax, unembarrassed by the fact their income depended on HMRC.

In recent years, however, awareness of the invisible costs of outsourcing has grown along with its inherent inflexibility. Outsourcing may even have reinforced the public sector's tendency to work in silos. Staff cleaning clinics or hospitals (or schools or Sure Start centres) ought to be part of a team; they are front line because patient and pupil wellbeing depends on them too. Passing them and their work to a company with its own imperatives and interests dilutes common purpose. Conservative East Cambridgeshire District Council ended its refuse contract with Veolia, transferring it to a council-owned trading company because it wanted more control and flexibility. Councils have been setting up wholly owned subsidiaries under the Teckal judgement (which effectively allows councils to set up in-house companies in preference to outsourcing): in 2016 Labour-run Slough Borough Council, for example, brought in-house waste and recycling from Amey, which had run its environmental services there since 2002.

Contracts must be monitored and that means commissioners have to retain expertise, the cost of which may not be factored in. Drawing up fair contracts demands commercial acumen and lawyers' hours. Successive NAO reports urged commissioners to study the contractors: due diligence means deep investigation into ownership and market conditions – work for which few public bodies are suited or resourced to do so.

Other invisible costs became apparent during the G4S fiasco at the 2012 Olympics: it's the state that must mop up when firms fail. As G4S imploded in the full glare of publicity in East London, Serco walked away from a GP out-of-hours contract and running an Essex hospital. Valerie Michie, a Serco executive, said blandly "the services we deliver in Cornwall and Braintree are no longer core to our healthcare strategy". Easy for her, but who is to pick up the pieces? This undermines the argument that outsourcing and PFI are about transferring risk; safety, core services and security remain fundamental public responsibilities, as was the case with London Underground PPP.

Surveys suggest the total volume of outsourcing has gone on growing in recent years, albeit at a slowing rate. The Health Foundation's research, for example, shows that nearly half of the additional £2bn for the NHS commissioning budget in England in 2015/16 was spent on care provided by non-NHS providers (including the voluntary sector and councils as well as companies). According to the Department of Health, the total share of spending going to these providers was 10.9% of the budget, up from 10.7% in 2015/16.

But if volume has risen, the stock market valuation of outsourcers has been volatile and several have posted losses. As mentioned, Interserve, saw its market capitalisation slashed by half and its chief executive walked. Capita, once the darling of the stock pickers, issued profit warnings in 2017, as did Mitie.

In addition, confidence and trust in private sector involvement has suffered, not only through exorbitant executive pay but by disclosure of energetic tax avoidance. The European Strategy Unit found nine offshore funds (which own between 50 and 100% of the equity in some 335 PFI deals, mainly in education and health) had been moved into offshore tax havens. Again, it's the offensiveness of companies that rely on UK government revenues taking such energetic steps to avoid or minimise their own contribution.

6. PFI

Treasury doctrine makes a clear distinction between borrowing to build productive assets such as schools and hospitals, bridges and sea walls and borrowing to cover revenue deficits. Yet the public sector has perennially been starved of capital. The Thatcher and Major governments strangled investment then ordained that because public bodies did not invest enough business should take over. Great holes opened before 1997: hospitals crumbled, school roofs leaked and social housing was neglected.

To meet need, public bodies adopted ruses. In the 1980s Labour councils sold assets, including lampposts, then leased them back. PFI, inaugurated by the Major government, involved Treasury-approved lease and concession schemes characterised by their length (binding contracts lasting decades) and their intermingling of capital payments – interest rates higher than the state could access by borrowing directly – and revenue charges, for contracts for facilities management and IT after the construction is complete.

It was Labour's determination to get reconstruction going fast that led to the PFI boom after 1997, with new schools and NHS facilities built and operating remarkably quickly. As of December 2016, the Treasury lists 716 PFI projects, of which 686 are operational. PFIs are valued in the Whole of Government Accounts at £38bn. That is significant yet PFI was never a major component of public investment – at its 2000 peak only 16%. The 2008 recession cut PFI off at its roots; the market for corporate bonds collapsed, putting projects at the mercy of banks that would not lend.

After condemning PFI for its extravagance, former chancellor George Osborne started favouring them in capital projects submitted for Treasury approval. Some schemes have just begun – for example the Midland Metropolitan Hospital in Sandwell, a PFI with a capital value of £297m, is supposed to open in 2019; this includes outsourcing of services after the construction ends. The contractor, Carillion, stands to do well from a contract that would bring it not just interest charges but payments for the facilities maintenance – to be financed by an annual NHS payment of £20m.

Although new schemes are thinner on the ground the Whitehall mindset is still pro-outsourcing. This is in part because the government has appointed leading outsourcers such as the Conservative Baroness Ruby McGregor-Smith, former chief executive of the Mitie Group, as non-executives on departmental boards (she is at the Department of Education). It is also because Whitehall is consumed by Brexit. Hundreds of government contracts with the private sector that were due to expire are to be automatically extended because civil servants are too busy with Brexit to focus on new and better-value tenders. The NAO said that over half the contracts expiring in 2015/16 had been extended. This is expected to boost the profits of outsourcing firms as margins are usually higher towards the end of contracts.

PFI has in fact been an extraordinarily profligate way of securing capital investment. The Office for Budget Responsibility calculates that total UK government debt would be 2% of GDP higher if public borrowing had been used rather than PFI deals. But total borrowing as of July 2017 is 88% of GDP so PFI can't be said to be a huge saving. As a financial device it diverted (and continues to siphon off) revenue to banks and equity financiers through contracts thick with obscurantist detail and shrouded in secrecy. In many deals the PFI revenue costs of outsourced services is not clear.

Citizens and taxpayers unquestionably have had a rotten deal. Commonly, companies borrowed on the security of the asset to be built (its value effectively guaranteed by the NHS trust or council acquiring it), charging them the loan at a high initial level before refinancing at lower rates. Lawyers, consultants and financial advisers make gains on a succession of margins on margins. The Commons Treasury Committee found borrowing under PFI typically cost twice the rate at which the state could have borrowed. The original capital cost of reshaping the Barts hospital site in London was £1.1bn; it will have cost £7.1bn by 2048/49 when repayments will end. According to analysis by the Guardian (based on Treasury data), the state stands to pay £304bn to acquire assets with a capital value of £56bn. That sounds like the kind of excessive charges usually meted out to poor families by payday lenders.

In some NHS hospital trusts PFI charges have become an immovable annual commitment. Within 20 years hospital buildings may be redundant, yet PFI payments on them will still be due. The Centre for Health and Public Interest claims that over the next five years nearly £1bn will be paid out in interest on health PFIs (over the lifetime of the health PFIs the NHS will pay in the region of £80bn on assets initially worth £12bn).

The building the Home Office occupies in Marsham Street Westminster belongs to a company and so is not recorded as a public asset. The Home Office pays rent, service and other charges and has an option to buy at the end of the 29-year deal. The building could have been acquired much cheaper if the Home Office had itself borrowed the construction costs then, separately, sorted out facilities management.

But such very long term outsourced maintenance and security contracts are part of the reason PFI deals are attractive to financiers. A recent study on 42 private finance projects (including the Aberdeen bypass and schools) in Scotland by Jim and Margaret Cuthbert (advisers to the OECD on public sector finance) showed that while construction costs on the deals were £2.6bn the overall cost were as high as £7.6bn due to maintenance contracts lasting from 25 to 30 years, management fees and interest of up to 11.3% on borrowing. The authors concluded that the deals were too generous and that despite the secrecy surrounding the contracts, there is enough direct and circumstantial evidence to challenge claims they are value for money.

Nevertheless, spending commitments can be unwound. A lot depends on whether the value of future payments due to PFI holders could be crystallised; the state would be perfectly entitled to demand a discount on assumed discount rates. Services contracts could be reviewed; contractors might be less willing to go to litigation if it jeopardised future engagement with the government.

Labour says it would not agree any new PFIs and would review existing ones. Contractors and banks might be persuaded into flexibility if they see that PFI is not the only form of collaboration. Some are looking to local government, trading companies and local housing companies (which are able to leverage private finance alongside low-cost borrowing from the Public Works Loans Board [PWLB]). Other innovative models are emerging. In Cardiff, for example, Labour ministers have introduced the Wales Mutual Investment Model, through which the public sector can claim a share in the profits from private investment. The Scottish Government meanwhile claim their Non-Profit Distributing model has put an end to excessive earnings by companies, although this is disputed amid claims the SNP model is merely PFI rebranded. According to Unison Scotland: "however you badge these schemes, they remain private finance and cost more than if we borrowed the money ourselves. And when budgets are being cut, you're stuck with these ringfenced contracts and have to look at reducing spending on other services."

7. The public services challenge

Everything depends on fiscal policy, including the regime for borrowing. As interest rates tick up, the case strengthens for a thoroughgoing review of the state's relationship with private capital. Bank of England money (some form of quantitative easing or bonds) is now part of the picture; some suggest it could reduce dependency on borrowing and be used to buy out PFI contracts.

Councils in England are testing new ways to invest and build. According to research by the Smith Institute, many are setting up trading companies, in which they own all the shares and from which they can commission projects. If a council can secure funds through the PWLB it can lend on to the company. If the council has land it can then use it as an equity investment to get housebuilding going. The Smith Institute estimates that there are now up to 150 council owned (or part-owned) local housing companies and many examples of new local authority-owned trading companies, some operating at a large scale (the largest trading company, the Norse Group, owned by Norfolk and County Council, has an annual turnover of more than £250m).

Alongside new terms for investment should run a new deal for revenue spending. Service delivery is a patchwork. Poor procurement in the past has bequeathed contracts that may be hard to drop, at least without having to pay penalty charges and to buy out the remaining length of the contract. This happened in 1997 when Labour cancelled the Major government's nursery vouchers scheme. Administration of the policy had been outsourced to Capita and Labour had to recompense the firm for future lost profits as well as costs incurred and cost of closure, on a programme that had never even gone live.

Outsourcing is now so widespread that untangling companies from refuse, cleaning, catering, pensions administration or armed forces' accommodation is going to be difficult. Here is the London Borough of Barking & Dagenham's description of its deal with Agilisys, in place since 2015: "blended and embedded with the council, actively coordinating a mixed economy of transformation resources including permanent and interim staff, contractors and consultants, partners and suppliers". Islington, which is also Labour controlled, found that taking back control of home repairs from Kier after performance targets were not met involved extensive reorganisation, rebuilding supply chains and new procurement of equipment. Conservative Somerset became embroiled in a legal battle when it tried to wind up a joint venture with IBM; a deal that in its view had not delivered (according to the council's audit committee, the contract was overly complicated, running to more than 3,000 pages).

The secrecy and complexity of PFI and outsourcing contracts will make it difficult to terminate contracts straight away. This is why it is important that government gets a firm grip on opening up the accounts of contractors and a true measure of the costs and benefits. There will inevitably be strong opposition from vested interests and court action to prevent moves to open windows into firms' accounting. However, by gathering the evidence and demonstrating that mistakes and miscalculations were made government should be able to present a favourable legal argument. After all, the profits made by contractors are, in principle, available to be recycled for public benefit by councils and other commissioners.

But first we need to calculate the rates of return. Part of the problem here is that outsourcing contracts typically involve complex intra-firm charges. The health division of a big IT company declares its profit with an NHS trust as small or negative, because it is required to return significant sums from its contract to headquarters in another country. The overall profitability of the company is a hard-to-disaggregate compound of revenues from private as well as public sector contracts in several countries.

Ending or diminishing outsourcing by definition means boosting the capacity of the state and rectifying historic gaps in government knowledge, skills and commercial derring-do especially in such fields as IT. In front of the PAC, the former Permanent Secretary at the Cabinet Office, Richard Heaton, said: "they ran rings round us… government was bad at contracting …the big suppliers were really good at it and had a crack team on it. Every four years they would come round the departments which did a bit of IT and we were amateurish in response". This would need to change if government is to securer a better deal.

A local authority might find bringing refuse collection in-house relatively straightforward: staff and mangers can be TUPE'd over and if necessary other managers recruited. But, for bigger contracts councils may need to bring in the necessary financial skills and commercial nous.

The Institute for Government says Whitehall departments gave up on their ability to negotiate contracts. By instinct, and to cover their backs, officials turn to the consultancies for support, meaning that KPMG, PwC and their kin earn fees from trying to unravel arrangements they had originally helped to devise. The Comptroller and Auditor General Sir Amyas Morse says Whitehall urgently needs people "who are batting for you …and you cannot assume that consultants are batting for you".

Contracts have varying termination dates. Buying them out would not only be costly: it would require ministers to find immediate replacements, to consult staff and negotiate TUPE transfers. Cutting firms out could result in a capacity crunch if done too quickly. And have security implications for the nation within the fraught context of Brexit. Take the E-Borders programme. As former Labour Home Secretary, Jacqui Smith, contracted Raytheon Systems (a US defence company) to run the scheme for collecting passenger information, analysing it and informing border officials – the contract involved a consortium of companies (including Serco and Qinetiq), which asked other companies (airlines, ferry operators etc) to hand over data, unsuccessfully as it turned out. By 2010, the Home Office decided Raytheon had failed. The contractor sued and in 2015 an out-of-court settlement awarded the firm £150m of taxpayers' money.

That was then. What should a new home secretary do with contracts characterised by the IT trade press as "all over the place"? Terminate them at once and you imperil systems critical to national security; roll the contracts forward and the inadequate and inappropriate ones will remain in place.

A necessary first step is information. The Crown Commercial Service has improved Whitehall's capability but neither the Cabinet Office nor the Treasury have reliable or complete data on contracts let in Whitehall; no consolidated data exists for the NHS, local government or the devolved administrations.

We don't know much about the duration of existing contracts or the liabilities attached to early termination; we also lack data on previous performance. Yet to avoid litigation, including judicial review, authorities would need watertight estimates of the costs and benefits of ending a contract. All this would take time and give work to advisers and barristers. Some contractors will play ball and seek to negotiate. The Association for Public Service Excellence says "safe spaces" can be created in which councils and contractors can meet without recourse to lawyers; its report on outsourcing in 2014 recommended 'pragmatic adversarialism'.

As a matter of urgency, all councils, NHS trusts and commissioning groups, Police and Crime Commissioners, Whitehall departments and other bodies should review their outsourcing and PFI contracts and ask:

- how long before the contract expires?
- how well is the contract being met?
- can it be renegotiated?
- what are the financial liabilities on termination?
- what is the cost benefit calculation and public value for termination?
- how would you manage the transfer of staff back?

On the answers depends any decision to renegotiate, terminate or leave contracts – including PFI deals -- to run their course.

For any future decisions on outsourcing, the watchwords should be *conditionality and transparency*. After public bodies have established criteria for demarcating a body of work that might be reorganised or possibly outsourced, they need to test the suitability of bidders, including their own staff. Strict tests must apply to external providers. All business should be public business. When a contract is not published or is redacted, the reasons should be clearly stated.

Full disclosure of boardroom remuneration, pay ratios and adherence to sustainability and equalities duties are necessary clauses – plus payment of corporation tax at an acceptable rate and compliance with the Fair Tax Mark by the company and its owners, its highest paid employees and investors.

The NAO has made the case for open book accounting, which means full and frank discussion with contractors about the profit margins they disclose. Nationally agreed accounting standards should also apply. Reports should include transfer payments by contractors within companies and their supply chains and be subject to independent audit. Ownership of companies should be declared and commissioners be given a contractual veto on changes.

Some councils already procure goods and services in support of their wider social and economic agendas, for example to encourage small business, social enterprises and the voluntary and community sector. They seek local recruitment, apprenticeship opportunities and supply chains (this builds on the Social Value Act, enacted with cross-party support in 2013).

A review of outsourcing could kick-start a new drive to effectiveness and efficiency and community benefit. The Labour government introduced tough national performance regimes with a plethora of targets and inspection systems. Ultimately this approach became unsustainable, leading to managers gaming the system. It is open to Labour now to reinvent inspection and regulation to ensure accountability and fill out a wider sense of value. Some argue that trust and regulation are opposites; if we trusted public servants more we wouldn't need inspectors. In fact they are symbiotic. Good staff welcome external scrutiny as a spur to quality improvement.

The Cameron Coalition whimsically destroyed the Audit Commission and its accumulated knowledge about the performance and capacity of local authorities, the police and NHS. The NAO does sterling work, but its reports are too often ignored and it has little reach into local government. We need implementation units across the sectors to pick up evidence of inefficiency and enforce remedies, sharing best practice, pushing joint cost saving procurement and offering a systemwide appraisal of contract performance.

Councils amass huge amounts of intelligence about contractors, markets and performance but it goes to waste because it is not shared. Our proposed units should collect, collate and relay performance and procurement data to councils, the NHS and the police. NHS England and NHS Improvement – the plethora of different regulatory organisations must be slimmed – should collect performance data on major companies, which often manage to conceal price differentials. An important aspect of this reform is boosting the capability and rewards of those engaged in letting contracts, raising the status of negotiators and (critically) contract monitors, which should include a range of stakeholders.

The public sector can do more to support social enterprise and start-up businesses when letting contracts. The Centre for Local Economic Strategies (CLES) argues that Brexit offers an opportunity to shift policy and mindset towards more progressive procurement, which in essence would embed social and environmental concerns into the process (although we could achieve much of this under existing EU and domestic procurement regulations). Rather than awarding contracts to remote multinationals, more localised procurement by anchor institutions – councils, hospitals and universities - could support local business and not-for-profit companies. The idea is to factor community benefits into public procurement, linked as in Lambeth and Preston to area-based economic development programmes.

The role of charity, voluntary and community and social enterprise sectors
Social enterprises, cooperatives, voluntary and community sector organisations have major roles to play in service delivery. But with the rise of competitive tendering the state has come to regard charity and social enterprise as little different from business – missing their wider social significance. They have been expected to use charitable income and voluntary labour to subsidise contracts. A review of contracting is an occasion for a reset. Some local authorities have already developed a practical but principled approach to procurement, involving charities and social enterprise, notably Lambeth, Knowsley and Birmingham.

Councils should consider giving charities grants where appropriate rather than letting contracts to secure their specialist services. This does not have to mean abandoning service specifications and targets where these are necessary.

At best, charities and social enterprise can innovate and experiment, doing things that councils and public bodies can't. They can reach and involve communities and people alienated from or missed by public bodies. The state should respect the right of charities to say "no" to taking on service provision and stick to their mission, and to campaign and challenge.

Conservative ministers advanced mutuals as a means of breaking up government, furthering their fragmentation agenda. But self-organisation by staff should remain an option – explored, for example, by Salford City Council. The Local Government Association (LGA) is also creating a mutual insurance arrangement for London councils.

8. A progressive agenda

The state should be assured enough to use the private sector where and when appropriate and to contract only on terms that reflect *whole costs*. Properly overseen, companies will go on having a considerable role, supplying goods and services and capital and, to a lesser extent than now, outsourced services.

The review and revision we recommend would make government more accountable, shed brighter light on spending and shrink the shadow state populated by obscure deals and "commercially sensitive" contracts. Open book accounting and common data standards will focus attention on transfer pricing and inflated profit margins. In some cases profit share and profit capping – as proposed by Labour for NHS contracts in its 2015 manifesto – could be applied. Breaking up the cartel that has sewn up major contracts would sanitise the body politic.

Reformers must start planning now to meet capacity constraints. The NHS is spending £80m a year hiring private ambulances to answer emergency calls – just one example of under provision. Renegotiating complex PFI deals will take imagination, legal and political verve and resourcefulness. Bringing contracts back in-house will put a premium on management, even when staff are transferred under TUPE.

Some may interpret moving away from outsourcing in this way as softening the intent to secure maximum economy. The rebuttal needs to be a progressive programme for service delivery, emphasising efficiency and effectiveness, but also transparency and accountability. Service renewal rests on political commitment and an end to austerity with tax and spend at higher levels (at 3 to 4% or more of UK GDP devoted to public purposes). But both tax and spend should be taut and tight. An efficient state collects taxes owed and pays out benefits due, on time, with courtesy and thanks to the work of dedicated managers and staff.

Common consent to a higher tax take comes from confidence that the state is well managed and offers a fair deal and value for money. Margaret Hodge, the former PAC chair, emphasised that spending let alone spending more, requires a convincing demonstration of its effectiveness. Government also faces persistent inflation of its costs, especially pay; a major challenge is therefore how to get the best out of our professionals (doctors, teachers, IT specialists) without "producer capture". Contestability – the threat of outsourcing – has been a tool in the public manager's kit. But it is dogmatic to assert that marketisation solves the problems of professional service delivery or deny contracting creates dilemmas and perversities of its own.

If in-house teams start to empty the bins when a contract with Amey or Veolia ends, councils must insist on strict terms for productivity – while enjoying the freedom to write into the contract pay rates that will serve their wider objective of stimulating the local economy and employment. If the MoD resumes pilot training, it should do so as part of a national capacity building programme, letting the contract in consonance with the UK's international and security profiles.

Delivery is inseparable from policy – however much management dogma insisted on sundering the two. The design of policy affects who delivers. Labour, in a hurry to create the Criminal Records Bureau, contracted with Capita on a specification that 80% of registrations would be done online, 20% on paper. The service – both Capita and Home Office elements of it -- failed when it found applications for registration were 80% on paper. The moral is that staff, service users and the public should be involved in policy design, whether services are contracted or not.

Any provider, public as well as private, would struggle when prisons are so overcrowded. If the courts sentence offenders to jail but insufficient is spent on increasing prison places, rehabilitation efforts will suffer along with prison discipline – regardless of whether it is HM Prisons and Probation in charge or G4S. Of course, prospects for rehabilitation would be helped if the probation service were a unified service instead of the fragmented half outsourced business it has become under Conservative policy.

There must also be a greater effort at streamlining, advancing efforts to collaborate, in the way the Blackpool, Lancashire and East Lancashire hospitals trusts are merging their procurement departments. The mission is reintegrating functions and organisations that have been atomised – perhaps considering new regional or even England-wide procurement, minimising cost and bringing welcome standardisation. Such reforms could be complemented by better localised procurement social clauses and further development of locally authority owned trading companies which reinvest profits into improving services.

On outsourcing the approach should be principled yet pragmatic. As a matter of principle, the state should not cede its powers to arrest and detain. The involvement of Serco, Atos, Capita and G4S has generated unease around prisons and immigrant removal centres, police custody, hospital and community health, education and benefits assessment. The role of companies in collecting and handling data – for example parking firms accessing DVLA information – should be reviewed.

As outsourced contracts fall in commissioners may decide that in-house options work best, for service users, for staff and in the wider interest. But they must retain the option to maintain a company as provider or to run a contest for secure bids. This option is important as a way of stimulating innovation or to bring in small businesses, charities and the voluntary sector.

Where public bodies move to outsource they should take conscious, evidence-rich decisions, with reasons made clear in accessible documents. They should take a power of veto on transfers of ownership, for example when a contractor is taken over and ownership changes. This implies councils and NHS trusts know what is going on in mergers and acquisitions, when financial re-engineering is usually opaque and conducted well away from publicity. They should pool their knowledge. Trade unions and professional associations also have a part to play in filling the knowledge gap and should be included in this process. Trade unions should always be fully involved in and consulted on any public service procurement from the 'make and buy' decision through to contract review and management.

9. Next steps: a programme for government

It is clearly time to for a major rethink. This seems beyond the Conservative government, which appears indifferent to mounting evidence that many deals have been poor value for money and failed to deliver. A new progressive government should:

- commission a review, to look at where outsourcing has worked and why, type of service, companies involved, the competition between them, quality of commissioning decisions, how staff have been affected
- introduce criteria for "make or buy" decisions, with the default and preferred option being public management and ownership
- review Whitehall's contracts including PFI (see page 20) and encourage the wider public sector to do the same, asking about contract length, incumbent performance, possibilities for renegotiation, financial liabilities on termination, consequences for staff – and publishing the answers and proposed actions with the aim of bring them back in house and/or to negotiate improvements where possible where these actions are in the public interest
- strengthen commercial capacity and understanding through a revamped Government Commercial Service and consider how best to share knowledge and expertise (the LGA should create similar capacity for local government, similarly the devolved administrations)
- publish a contemporary list all significant contracts and create a central clearinghouse for evaluating the performance of companies across multiple contracts, sharing what is learnt, advising public bodies and enforcing contract standards (this should be public sector wide and not solely for central government contracts)
- agree a code of practice for partnerships between the public sector and the voluntary and community sector; and similar arrangement for SMEs
- require the NHS to adopt these approaches and encourage local government and the wider public sector to do the same

For future outsourcing introduce regulations to apply to all of the public sector and encourage the devolved administrations to do the same. Such regulation would include:

- applying Freedom of Information to contractors, requiring them to give evidence to parliamentary and local authority oversight and scrutiny committees when requested
- requiring public sector bodies to consult on the business case for any proposed outsourcing in advance
- requiring a holistic cost benefit approach that addresses social, economic and environmental factors and the impact on the wider public weal
- ensuring staff, trade unions, service users and representative groups are involved in commissioning and procurement and in monitoring and review of contractors' performance
- extending the powers of the NAO and other inspectorates to cover contractors with powers to investigate the wider company beyond its contracting business
- requiring transparent reporting of operational and financial performance for contracts and assessments against the original objectives and targets and audit procedures and their publication
- requiring open book accounting to nationally set standards with independent audits
- providing the option for profit capping and profit sharing in contracts
- requiring awarding bodies to consider contractors' tax and remuneration practices and ratios into contracts deploying the Fair Tax Mark
- mandating all contractors to pay the Living Wage
- strengthening TUPE, having Fair Wages Clauses in contracts, guaranteeing pension and union membership and recognition ensuring that new recruits to contractors are employed on terms including pensions equivalent to those in the public sector
- ensuring whistleblowing policies allow staff to alert commissioners, citizens and inspectorates

Where possible government and the wider public sector should seek to negotiate similar measures into existing contracts.

Whether Brexit goes ahead or not, the government should review domestic procurement and state aid regulations. Here is an opportunity to introduce social as well as economic costs and benefits into decisions about buying goods and services. Existing EU regulations already allow flexibility, but these could be improved.

New ministers in a progressive government would not be able to press a button and reinstall public management. They would face difficult challenges around compensation, capacity, capabilities and how to regain confidence and trust. However, council leaders and politicians in the devolved administrations are having to address these issues now, showing what can be done.

The decisions ahead are not technical. They are political, turning on a wider assessment of the public interest than has been common during the era of outsourcing. That interest will be best served by a strong and coherent state, whose functions are for the most part performed by dedicated public servants with an ethic distinctly different from that motivating the managers and employees of profit seeking companies. To secure a fair deal for taxpayers, for all those who use and who provide our common services, root and branch reform of outsourcing and PFI is now urgent. The political aim should be public sector owned and managed services with a clear role for the voluntary and community, and social sectors and where there is outsourcing for this to be accountable and well regulated in the public interest.

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If you would like to know more about the Smith Institute please write to:

The Smith Institute
Somerset House
Strand
London
WC2R 1LA

Telephone +44 (0)20 3141 7536
Email info@smith-institute.org.uk
Website www.smith-institute.org.uk
Twitter @smith_institute

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