Changing the world of work for good

Sourcing public services - lessons learned from the collapse of Carillion

Public Administration and Constitutional Affairs Committee inquiry

Introduction

The TUC is the voice of Britain at work. We exist to improve working life and promote equality for everyone. The TUC brings together more than 5.5 million working people who belong to our 49 member unions. We support unions to grow and thrive and we stand up for everyone who works for a living.

We want an economy that works for all and that includes high-quality and decently funded public services for the benefit of the millions of our members who rely on those services and those that deliver them.

The TUC welcomes this opportunity to feed into a timely and crucial debate in the wake of the collapse of Carillion.

The compulsory liquidation of the company has created an uncertain future for the tens of thousands of workers and sub-contractors employed on contracts that Carillion held across public services, construction and transport infrastructure. And it also an anxious time for the clients, public bodies and end users that commission and rely on those services, as the official receiver seeks to find replacement contractors and joint venture partners to take over service and maintenance contracts and to complete construction projects.

The collapse of Carillion can be attributed to a range of factors, many resulting from the strategy employed by the company itself. Carillion became over-stretched, highly leveraged and, through under-bidding, left itself highly exposed to adverse outcomes on a small number of construction projects – risks exacerbated by aggressive accounting, mismanagement of pensions and prioritisation of dividend payments at all costs.

But there are questions too that go to the heart of the outsourcing culture that pervades our public services. The collapse of Carillion is part of a series of high-profile failures involving private companies delivering public services, including:

- early withdrawal of the Stagecoach/Virgin franchise on the East Coast Mainline;
- Capita's chaotic performance with a national primary care support service for GPs;
- failure of Coperforma to provide effective non-emergency passenger transport services in West Sussex NHS;
- SERCO walking away from GP out of hours contracts;
- increasing performance problems in outsourced probation services.

Each of these areas has experienced unique issues but there are also commonalities. Each can be characterised by the failure to deliver on promised savings/revenue, under-performance against contract requirements and ineffective risk transfer, with the government and the taxpayer having to step in where services fail.

Recommendations for action

The TUC has identified the following set of policy recommendations to address specific issues related to the outsourcing of public services, with recommendations applicable to both national policy makers but also commissioning and procurement practitioners across the public sector.

Review of public service outsourcing

- The TUC supports calls for a fundamental review of outsourcing, including PFI contracts, to identify the scale and nature of outsourced services across the public sector, establishing an evidence base of which contracts are held by which companies, the value of those service contracts and the length of the contracts, including break clauses where relevant.

Decision-making

- Public services provide benefits to both individual service users and wider society. Universal access, delivery according to need, services free at the point of use and delivered for the public good rather than for profit should be at the heart of any model of service delivery. The TUC believes that the public sector is best placed to provide public services that meet these criteria and should be the default model of delivery.
- Before a public service, be it national or local, can be put out to tender a thorough public interest case needs to be put forward incorporating both quality and value for money considerations.
- There should be full consultation with relevant stakeholders, staff, service users and the public on the case for outsourcing prior to the decision to undertake an outsourcing process for any public service.
- If the merits of competitive tendering a public service have been shown to be in the public interest, the procurement process should include an in-house bid from the public sector.
- Consideration should be given to the appropriate model of provider and commissioner relationships and arrangements to deliver high quality public services in each sector. In particular, this should recognise that the design of the delivery model and tendering processes, including assessment criteria, size of providers, monitoring systems and quality assurance can have a significant impact on the services delivered both now and in the future.

Standards of transparency

- The Freedom of Information Act should be applied to all providers of public services and all public sector commissioning, procurement and contract management.
- The same transparency requirements should be applied to all providers of public services, within the public, voluntary and private sector, including details on supply chains, company ownership and governance structures, employment, remuneration and tax policies and practices.
- Public sector authorities commissioning services should not be able to stop the publication of contracts or joint venture details except in cases of national security.
- The ownership of all companies, including those with offshore or trust ownership, which provide services under contract to the public sector should be available on public record.

- Public sector authorities should disclose details of relationships between providers and decision makers/influencers in public bodies commissioning and procuring services or with influence over the commissioning and procurement process.

Standards of accountability

- The public should have the 'right to recall' contracted out services due to poor quality or performance that is not in the public interest.
- Previous poor performance of bidders, including breaches of UK employment law, health and safety, environmental and tax obligations and failure to fulfil previous contracts should be taken into account during any tendering process.

Accounting practices and cost appraisal

- Where services are outsourced, standardised accounting procedures and practices for 'open book' accounting should be enforced including an annual independent audit on all public service contracts.
- There should also be a requirement to publish audited and verified statements on contractors' operational and financial performance, with access to relevant information, systems and personnel for the National Audit Office (NAO), internal public sector auditors and their external auditors.
- Regular reports on the full costs of procurement should be published, including contingency costs required to cover unforeseen circumstances, the use of external advisors, and the contract management and monitoring costs for individual contracts.
- A robust and consistent framework must be developed which is capable of measuring service quality from the experience of users, not simply performance measure against targets.

Employment terms and protection for staff delivering public services

- Mechanisms for the protection of employment standards and collective bargaining should be promoted through the strengthening of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE), the use of public procurement arrangements, the creation of a new two-tier code of practice and the adoption of mechanisms to ensure that existing sectoral collective agreements are extended to all providers of public services.
- Procurement and commissioning should be used as far as possible to promote social, environmental and economic objectives, such as the living wage, investment in training, skills and apprenticeships, union recognition and an end to zero hours contracts and other forms of vulnerable employment, through the full use of the revised EC Directive and UK legislation including the Public Services (Social Value) Act.

Does Government make effective decisions on how to source the delivery of public services?

What framework should the Government use when deciding what the most appropriate approach to sourcing a function or service is? Are decisions made systematically and consistently?

The decision on how to source the delivery of public services must take into account two key issues. First, a point of principle about the nature of public services, the purpose they serve and the expectations that derive from that. Second, a set of practical issues that arise from the 'principal-agent' relationship at the heart of outsourcing which becomes particularly problematic when sourcing complex, relational services.

Our starting point would therefore be to state that public services are fundamentally different from other commodities and personal services. They provide benefits to both individual service users and wider society, they are paid for by the general public, they are ours by right and they promote social justice and equality through their universal and redistributive nature.

The founding principles of public services, namely universal access, delivery according to need, services free at the point of use and services delivered for the public good rather than for profit should be at the heart of any model of service delivery.

It is our view that through its democratic accountability, collective funding through taxation and long-term integrated approach, the public sector is best placed to provide public services that meet the criteria above.

However, there are also a set of practical considerations that the apply to the outsourcing of public services where there is an "arms-length relationship between commissioner and provider under what economists call conditions of imperfect information" and where "the harder performance is to monitor, and the more complex the service being provided, the less well a principal-agent relationship performs compared with vertical integration".[1]

The Institute for Government sets out ten considerations that "those introducing, adapting or overseeing contractual mechanisms in public services should ask to gain a better understanding of their costs and benefits".[2]

They state that while there are strategies that can help mitigate some of the risks, "such mitigations typically entail additional costs, which policy makers and commissioners must factor in when making judgements on the respective value for money of contractual mechanisms and 'in house' service delivery". And that policy makers and commissioners must consider "costs and risks of transition in service areas where contractual mechanisms are being introduced for the first time, or where they are being significantly extended or adapted"[3]

It is our view that this framework has not been systemically or consistently applied across the public sector. Public service outsourcing has too often been a response to top down

[1] *The Shrinking State*, Landman Economics, March 2011

[2] *When to Contract?*, The Institute for Government, January 2013

[3] ibid

policy direction and/or motivated by the search for short-term cost savings which has resulted in few of the purported benefits – efficiency, value for money, risk transfer, service improvement – being achieved.

When to contract? The Institute for Government

1. Is it difficult to measure the value added by the provider?

If a service lacks objective or quantifiable measures of the value added by the provider, it will be more difficult to price contracts and monitor performance.

2. Are service outcomes highly dependent on the performance of other services?

If services that depend on one another to achieve their outcomes are contracted out to competing organisations, it may be more difficult to incentivise and secure the necessary cooperation between providers.

3. Does delivering the service require investment in highly specific assets?

If a service requires investments in highly specialised physical or human resources, government may find it costly to attract providers and, over time, could be left vulnerable to an incumbent provider with excessive market power.

4. Is the service characterised by high demand uncertainty?

If demand for a service is not known in advance, or subject to unpredictable variation, government may find it costly to incentivise investments and/or may be left vulnerable to 'hold-up' situations.

5. Is the service characterised by high policy uncertainty?

If there are politically motivated changes in policy direction or service specification, the government may find it costly to renegotiate contracts.

6. Is the service inherently governmental?

If a service involves making key policy decisions, is central to government's law and order capability, or intimately related to government's duty to protect the public, contractual mechanisms are unlikely to be appropriate.

7. Is there an existing supply of high-quality providers?

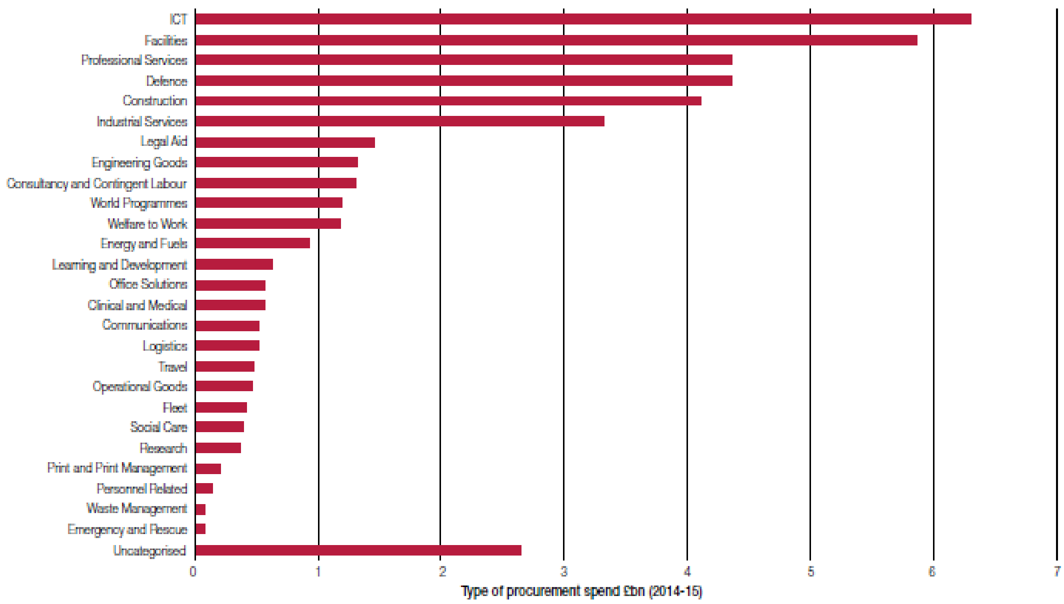
8. Is there an existing workforce (either in the public or private sectors) with adequate skills and capabilities to deliver high-quality services?

9. Does the government have the organisational capability to design and monitor the use of contractual mechanisms?

The failure of public bodies to adhere to the framework set out by the Institute for Government derives from "a range of theoretical and practical considerations that call into question the case for public service outsourcing, including:

- Structural issues related to the imperfect nature of public service markets;
- The 'principal-agent' problem resulting from the commissioner / provider split;
- A paucity of evidence on the benefits of outsourcing in terms of cost effectiveness, quality and service improvement;
- Barriers to accountability and transparency that should be integral to public services in a democratic state."[4]

This is increasingly problematic as more complex public services are being delivered by private providers through contractors, as the NAO's table[5] below illustrates.



According to the National Audit Office, the sourcing framework most commonly employed by the public sector is not fit for purpose, stating that "the traditional model of contracting demanded a clear specification, an orderly competition, a transparent and easy to use service level agreement tied to a payment mechanism that incentivises performance, and an

[4] *Outsourcing public services*, New Economics Foundation, 2015
[5] *Government commercial and contracting*, NAO, Spring 2016

assurance regime by the contract manager to ensure contractual compliance. The reality of complex service provision means this model needs reform."[6]

We would argue that the principal/agent problem means that it is unlikely an outsourcing solution would ever be appropriate for most areas of public service delivery. Moreover, the failure to apply a rigorous decision-making framework such as that outlined by the Institute for Government creates significant barriers to the state's ability to manage and deliver high quality public services.

The Institute for Government states that "if a service lacks objective or quantifiable measures of the value added by the provider, it will be more difficult to price contracts and monitor performance". [7]

Experience from outsourcing to date has shown that quality outcomes are often difficult to specify, measure and price, particularly in 'relational' services based on high-quality human relationships.

For example, in the provision of outsourced employment services, offender rehabilitation and probation services and adult social care, it has been difficult to contract on the basis of quality. In the absence of effective information on service quality, commissioners have been forced to rely on price per task, leading to tightly drawn contract specifications that encourage contractors to focus on volume to maximise revenue, hence the rise in 15-minute domestic care visits.[8]

Even when using differentiated prices through a Payment by Results system, the incentives have proved ineffective in addressing quality issues and evidence suggests that outsourced employment and probation services have failed to improve outcomes for the hard to reach clients.[9]

The Institute for Government's framework also raises questions about the impact outsourcing may have on wider public service reform, stating that "services that depend on one another to achieve their outcomes are contracted out to competing organisations, it may be more difficult to incentivise and secure the necessary cooperation between providers".[10]

In many cases, the marketisation of public services has led to a fragmentation of services, with increasing competition between providers that creates barriers to the collaboration and integration required to deliver essential public service reform.

Most obviously, this is occurring in health and social care, where the NHS market, intensified by the 2012 Health and Social Care Act, is getting in the way of the delivery of more joined up health and social care services and the delivery of new models of care promoted in the Five Year Forward View.

[6] ibid
[7] *When to contract?,* The Institute for Government, January 2013
[8] *Why we need social innovation in home care for older people*, CRESC, 2016
[9] *Outsourcing public services*, New Economics Foundation, 2015
[10] *When to contract?,* The Institute for Government, January 2013

In 2015, NHS England faced calls from providers to exempt 'vanguard' areas from requirements to tender services, amid fears that procurement processes could undermine efforts to establish integrated primary, community and acute care models.[11] In 2017, the Chief Executive of NHS England informed the Public Accounts Committee that the move towards more integrated health services through Sustainability and Transformation Partnerships will effectively end the purchaser / provider split in the internal NHS market.[12] The sourcing of services through contractual mechanisms in the NHS is failing to secure the necessary cooperation between providers.

Similarly, the government's own review of value for money in the UK rail industry, found that the fragmentation of rail following privatisation led to a situation where "multiple industry players, together with misaligned incentives … has made it difficult to secure co-operative effort at operational interfaces, or active industry engagement in cross-industry activities which need to be undertaken for the common good"[13]

The final point we would make regarding decision making on the sourcing of services, that is missing from the Institute for Government's framework, is the role that should be played by consultation with public service users and the workers that deliver those services.

There is a compelling case that in many situations there is disconnect between public service providers and the communities they serve. This accountability deficit creates problems such as increasing public scepticism about the decision making of public service professionals, a widening gap between public perception of service quality and objective criteria used to measure improvements and a lack of responsiveness to locally determined need. While public sector-delivered services have essential links to democratic institutions, more should be done to build links with service users and communities.

The TUC supports a model of commissioning that improves delivery and creates services that are responsive to communities by engaging service users, staff and commissioning authorities through a collaborative model of negotiation and agreement within a public sector framework - the concept behind the Public Service Users Bill promoted by the campaign group We Own It.[14]

Does the public sector have the capacity to deliver services in-house when that is the most appropriate route?

The scale of public service outsourcing undertaken to date and the hollowing out process that this sometimes entails means that capacity to provide in-house services may have been reduced to some extent.

Business analysis points to how outsourcing leads to a fundamental and, in some cases, irreversible shift in capacity from commissioner to provider. A shift that may initially take

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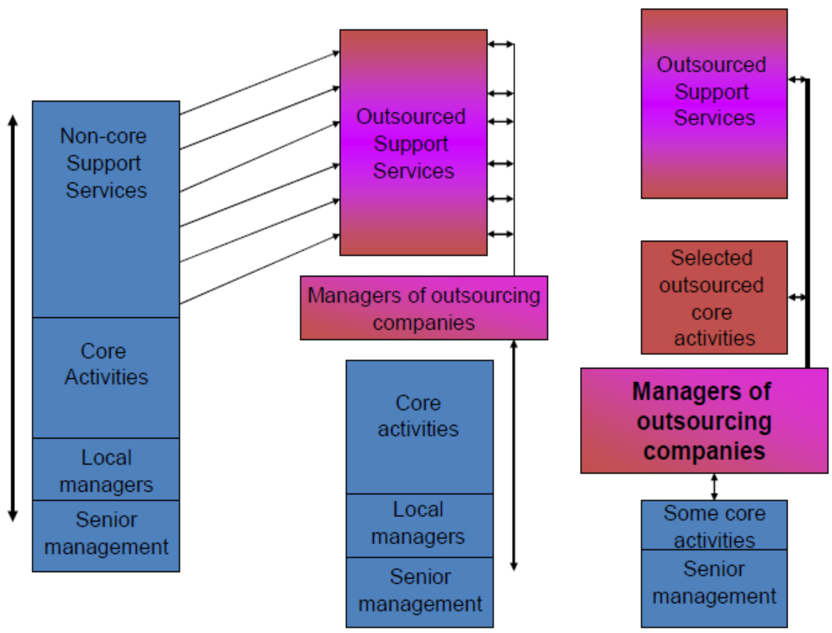
[11] *Vanguard areas call for tender moratorium*, Health Service Journal, March 2015
[12] *STPs will end purchaser/provider split, says Stevens*, Health Service Journal, February 2017
[13] *Realising the potential of GB rail*, McNulty, May 2011
[14] https://weownit.org.uk/public-service-users-bill

place around peripheral services but then escalates further into key added value areas that are traditionally the core service of the parent organisation.

According to this analysis "when outsourcing takes place this tends to imply a capacity shift that significantly alters the service value chain of the principal. In this case responsibility for the value-added service delivery involved is permanently or for a long period relocated outside the main firm, and the new value chain will henceforward directly involve the supplier firm" This process is illustrated in the diagram below. [15]

Figure 1 Representation of how decentralised services production may fragment 'vertically integrated' services and create shorter internal value chains and longer external ones through outsourcing



This hollowing out of the state through outsourcing forms a key part of current government thinking, most notably in local government through the concept of the 'enabling council'. The model of a local authority becoming a commissioner rather than a provider of services, most obviously manifested through the commissioning routes taken by Barnet and Northamptonshire councils. We believe that this poses risks to the very nature of a democratic state that should give serious grounds for concern.

We support the alternative model of the 'ensuring council' promoted by the Association of Public Service Excellence (APSE) which "endorses the role of local authorities as stewards of local wellbeing, recognises the strategic advantages of a strong core of in-house services

[15] *Shared business services outsourcing*, Working Lives Research Institute, May 2012

delivered in collaboration rather in competition with alternative providers and grounding local decisions in politics and the values of social justice."[16]

While there may be some challenges, the practical examples of public sector bodies taking services back in house in recent years shows that this should not be exaggerated. The state has not only insourced services but has made a success of them compared to costly and ineffective services previously provided by private contractors.

As the Guardian reports "in Cumbria, the Conservative leader Eddie Martin bucked the party line in 2011 and brought nearly all outsourced services back in-house when its 10-year contracts with Capita came to an end, and the following year when a seven-year roadworks contract with Amey finished. Since then, the council has balanced its budget and boosted its response time to crises."[17]

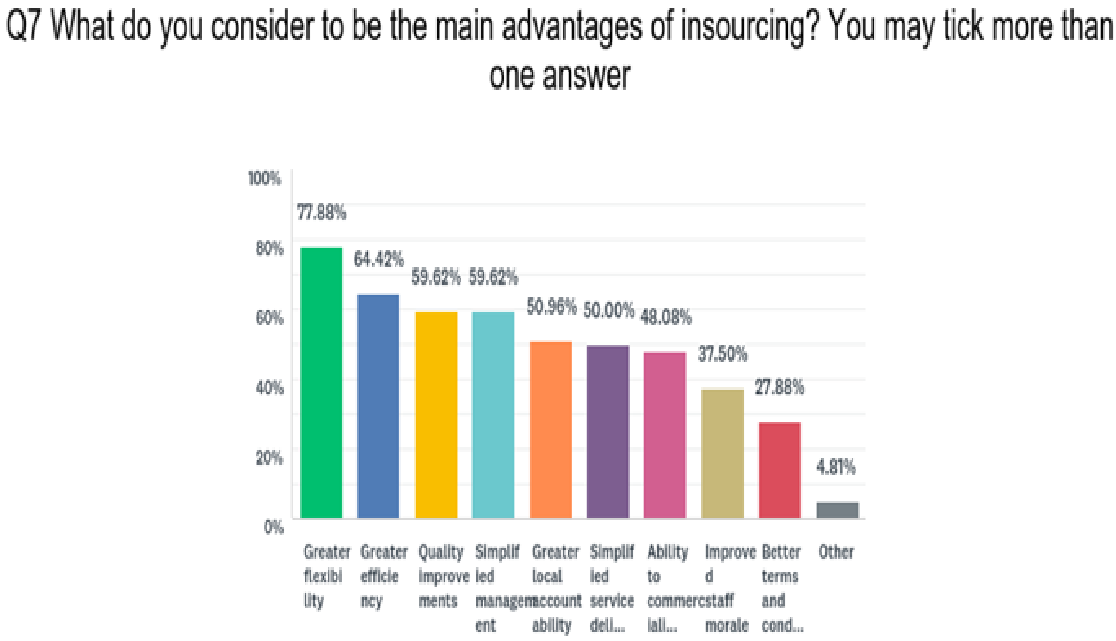
The Guardian investigation of the 36 strategic public-private partnerships (PPPs) that local authorities signed between 2000 and 2007 has found that 13 of the contracts – which ranged from seven to 15 years and covered IT, back-office functions, property management and highways – have since gone back in-house, either at the end of contract or as a result of early terminations. That means that "in more than a third of cases, councils found that delivering services in-house could save more than outsourcing to commercial companies in long-term, multi-service partnerships".[18]

In research soon to be published, the Association of Public Service Excellence (APSE) found that 73 per cent of the 211 local authority survey respondents said that they were considering insourcing, of which over 59 per cent have already insourced some services.

The top three areas of service that have been taken back in house have been buildings maintenance (housing and non-housing), waste collection (domestic bins and recycling) and parks, open spaces and grounds maintenance. Further down the list housing, transport and vehicle maintenance, highways maintenance and school meals were also being insourced.

The key reasons cited for insourcing included the need to improve efficiency and reduce service costs, improve service quality and the need to have a more flexible service. Advantages arising from insourced services were included greater flexibility, efficiency and quality.

[16] *The Ensuring Council*, APSE, May 2012
[17] *Why have councils fallen out of love with outsourcing vital services?,* The Guardian, March 2016
[18] ibid



Interestingly 84.5 per cent say there will be no cost increase and 86 per cent anticipate savings of up to £2m (range of £25 K to £2m) but some will save much more (£4m +).

It is also interesting to note the cross-party nature of this with Conservative-led and No Overall Control councils representing over 43 per cent of those taking services back in house.

APSE's research suggests insourcing is driven by pragmatic responses not necessarily ideological ones. The most commonly cited advantage of insourcing is 'greater efficiency'. This is because in-house teams can be flexed to meet emerging needs, particularly in times of austerity budgeting and it has a positive impact on resource allocation and allows local councillors to make decisions about service priorities.

What lessons need to be learned from the collapse of Carillion about how Government and the public sector manages the risk from suppliers throughout the life-cycle of outsourcing a public service?

One key lesson that must be learned is the failure to manage the risk of cost over the lifecycle of a contract. There was evidence to suggest that Carillion deliberately submitted abnormally low tender prices in order to win contracts. Competitive tendering of services means that public sector commissioners looking for short term savings effectively collude with companies seeking market advantage thereby driving prices down to unsustainable levels.

While cost savings may have been made on the face value of the contract, these costs are then managed by the contractor in ways that passes risk to others. Primarily this achieved through suppression of wages, terms and conditions of the outsourced workforce.

The TUC commissioned the New Economics Foundation and Landman Economics to look at the differences in a range of employment standards between public, voluntary and private sector for a range of different occupations in order to highlight potential impact on those standards as a result of transferring staff from the public sector to alternative providers from the voluntary and private sector.

The findings show that in most cases within these occupations workers in the private sector during 2014 have been less respected, given more insecure working arrangements, and – for health and social care occupations – lower qualified than in the public sector, all while having to make do on less pay.

- Excessive hours: The private sector has a larger proportion of full-time employees who regularly work excessive overtime – over 48 hours per week.
- Shorter job tenure: Private sector employees have shorter tenures measured by months, which suggests higher turnover, than the public sector.
- More insecure working arrangements: The private sector has a larger proportion of employees who would like to work more hours than they currently are getting than in the public sector. The private sector has also a larger proportion of employees who are on short-term contracts, and a larger proportion who are agency workers or self-employed.
- Worsening insecure working arrangements: Job insecurity has also been getting worse since 2011, especially in the private sector.
- Lower qualified: Private sector employees in health and social care occupations are less likely to have a degree or other higher education qualification and in some cases more likely to have no qualifications at all.
- Lower pay: The private sector has lower pay than the public sector measured by median hourly wages.[19]

In other cases, the contractor may manage cost by withholding payments from its own suppliers. This was particularly the case with Carillion:

"Carillion also 'borrowed' large amounts of money in less conventional ways, for example, by taking longer to pay its invoices. The total owed within a year to unspecified 'other creditors' jumped from £212 million at the end of 2009 to £761 million at the end of 2016. This is effectively a form of short-term borrowing. It is risky because it makes the company much more vulnerable to a cash crunch."[20]

[19] *Outsourcing public services*, New Economics Foundation, 2015
[20] *The Collapse of Carillion*, Commons Library Briefing, January 2018

In Carillion's case, there was also a very large increase in more conventional borrowing as the company became increasingly leveraged in an attempt to address declining revenue, while maintaining its dividend payments.[21]

Is the supply side of the market for outsourced public services too concentrated? What are the risks and benefits of a concentrated market?

In its analysis of five areas of public sector outsourcing – employment services, offender management, health, local government and social care – the New Economics Foundation reached the conclusion that:

- There is a tendency towards market concentration in effective market areas, whether that is on a national or local level. Even in areas with low market entry and numerous providers, such as social care, there is a tendency toward concentration on a local level which, in the case of social care, is the effective market area.
- Within this market concentration, it is private providers that dominate. Despite current government narrative around the diversity of provision and the role of charities, community organisations, social enterprises and mutuals playing a part in provision, it is the private sector that dominates both in terms of delivering services but also in capturing prime contractor position with subsequent control over supply chains.[22]

Looking at the different sectors they found that, at the time of writing in 2015 that:

- The market in employment services is characterised by heavy concentration towards a small number of prime contractors to the extent that 60 per cent of the total contract value under the Work Programme is accounted for by the top five firms – that private provision dominated the supply chain and that there were very low levels of new market entry.
- The market for offender management services is highly concentrated. All prison contracts are held by just three companies, G4S, Serco and Sodexo, and all electronic monitoring is delivered through a single national contract, currently held by Capita.
- Three companies – Capita, BT and Mouchel dominate the market for Strategic Service Partnership contracts in local government, with a 58.9 per cent market share by contract value (of contracts awarded since 1998). The same three companies have a 63 per cent share of staff employed under SSP contracts.
- While both residential and domiciliary care tend to have more diverse markets, there are still big players with significant market share. The five largest providers in residential care account for around 17 per cent of the market, by places, and the largest twenty account for 28 per cent of the market by the same measure. In 2011–12 Four Seasons and Bupa each had a five per cent market share, each having over 20,000 beds.
- Although these larger providers do not necessarily have dominant market share when looking at the market nationally, local markets are more concentrated. This is significant because when someone chooses a provider they are rarely willing to travel a great

[21] ibid
[22] *Outsourcing public services*, New Economics Foundation, 2015

distance, with geographical considerations often taking precedence over considerations based solely on the quality or cost of any given service. For example, in the residential care market Bupa Care Homes has a market share of 25 per cent or over in 21 of the UK's 209 councils with social care responsibilities.[23]

This landscape is changing and, in some cases, becoming more concentrated as a result of mergers and acquisitions such as the purchase of Mouchel by the Kier Group in 2015.

There are significant risks associated with the excessive market power of a small number of contractors. The Institute for Government identifies that where "a service requires investments in highly specialised physical or human resources, government may find it costly to attract providers and, over time, could be left vulnerable to an incumbent provider with excessive market power". [24]

This may take the form a single provider holding a large number of contracts across a wide range of services which means that the government is exposed to significant risk if that company fails, as was the case with Carillion.

Excessive market power may also be evident through the oligopolistic power of a small number of large contractors with large market share dictating prices for specialist services, particularly through very highly priced variations once the contract has been awarded. This has often been the case with large IT contracts where, according to the Cabinet Office "there is little incentive on the supplier to improve operational and hence price efficiency; and where the supplier has done so, they have kept most of the cost savings as increased margin" and where the government has "lost sight of how the services are provided and thus is at a disadvantage in challenging value for money or instigating change".[25]

There is a more long-term concern that this may also risk a power imbalance between the commissioner and provider which, over time, leads to a fundamental capacity shift so that the long-term ability to provide core services is hollowed out, perhaps irreversibly, as highlighted above.

What steps has, and could, Government taken to maintain a competitive market amongst suppliers? Does Government have the right skills to be able to procure and manage contracts with SMEs? Should contracts or tenders be structured differently? Are there other steps it can take?

The key priority for government should be promoting the stability and security of public services and upholding the founding principles of public services, including universal standards and free access at the point of use.

The government should therefore look more at shaping a market that delivers security, stability, improved services and the public service ethos rather than promoting competition for its own sake and to insource services where, as in most cases, this would be most appropriate.

[23] *Outsourcing public services*, New Economics Foundation, 2015
[24] When to contract?, The Institute for Government, January 2013
[25] Government reviews IT contract strategy, Computer Weekly, January 2016

Evidence suggests that this is not the case. As one example, the 2014 Care Act requires local authorities to "stimulate a diverse range of care and support services to ensure that people and their carers have choice over how their needs are met and that they are able to achieve the things that are important to them. It is also about ensuring that the care market as a whole remains vibrant and stable".[26]

However, both the residential and domiciliary care markets are characterised by market volatility and poor standards of care with very little scope for users or workers to determine the nature of service provision. Commissioning of services tends to be on a price per task or spot price basis, rather than service outcomes.

More should be done to address this through the use of positive commissioning and procurement, using existing public procurement regulations and the Social Value (Public Services) Act to require more focus on social, economic and environmental outcomes. The increasing number of councils adopting UNISON's Ethical Care Charter is a positive development and evidence shows that this is having a positive impact on employment standards and value for money.[27]

Does the Government effectively monitor and manage risk for its largest suppliers, and does it have effective failure regimes in place? Does Government understand the public sector's cumulative exposure to individual contractors? Is there effective co-ordination between different public sector bodies in managing contractors?

The collapse of Carillion is an acute case but may not be isolated or the last of its kind. In January 2018, Capita issued a profit warning that led to a major fall in the value of its shares. We have seen the collapse of Southern Cross in the social care market and questions remain over the sustainability of other key players in care such as Four Seasons. Babcocks announced slowing revenue growth in recent weeks. This follows similar profit warnings and share falls for Serco, Mitie, G4S and Interserve within the last two years, illustrating the extent to which public services are exposed to market volatility – some of which arises from major contractor's exposure to risk in other global markets.

The TUC does not have confidence that the government's strategic supplier risk management (SSRM) policy works effectively and failed dramatically in the case of Carillion. The designation of Carillion as 'high risk' as a result of its financial distress did not prevent the government awarding further contracts, insisting that this would make the company's position deteriorate further, which runs contrary to the spirit of the risk management policy which seeks to reduce risk to the taxpayer by withdrawing opportunities for further work for the duration of the designation.

We do not believe that the government has an accurate map of outsourced public services more generally, either in relation to the market as a whole, at contract or even, in some cases, at company level.

[26] *Adult social care market shaping*, UK Government, February 2017
[27] *Evaluation of UNISON's ethical care charter*, University of Greenwich

As the Smith Institute puts it "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."[28]

The TUC supports calls for a fundamental review of outsourcing, including PFI, looking at which contracts are held and by which organisations, looking at contract length, incumbent performance, possibilities for renegotiation and break clauses, financial liabilities on termination, consequences for staff and a risk assessment of all contractors that have public service contractors over a certain value threshold. Until such a review is complete, there should be a moratorium on any future outsourcing or privatisation plans.

Are there limits to what can be outsourced?

Our starting point would therefore be to state that public services are fundamentally different from other commodities and personal services. They provide benefits to both individual service users and wider society, they are ours by right and they promote social justice and equality through their universal and redistributive nature.

The founding principles of public services, namely universal access, delivery according to need, services free at the point of use and services delivered for the public good rather than for profit should be at the heart of any model of service delivery.

It is our view that through its democratic accountability, collective funding through taxation and long-term integrated approach, the public sector is best placed to provide public services that meet the criteria above.

As such, we support the Smith Institute recommendation to introduce criteria for 'make or buy' decisions, with the default and preferred option being public management and ownership.

What lessons can be learned from PFI?

We believe that there are four main lessons to be learnt from the use of PFI Contracts: they tend to be inflexible, they become disproportionately expensive, they undermine the quality of employment; and they transfer risk to the tax payer but profit to the private sector.

PFI ties public sector bodies to their providers for decades at a time. The public sector is obligated to continue to pay fixed prices for fixed services, regardless of their own economic situation or whether the services are still required.

In January, the National Audit Office noted that Liverpool council are still paying over £4m a year for a secondary school that now stands empty. Between 2017/18 and the end of the contract in 2027/28 they will pay an estimated £47m, which includes interest, debt and facilities management payments, if no changes are made to the contract.[29]

Because PFI contracts lock public bodies into procuring maintenance services from the same providers for decades, they often effectively create temporal monopolies that drive up

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[28] Out of contract, Smith Institute, January 2018

[29] *PFI and PF2, a report by the Comptroller and Auditor General,* National Audit Office, January 2018

prices, without driving up investment or the quality of service delivery. PFI contracts were intended to ensure competition and reduce prices, however in practice they have done the opposite. To take one example, Veolia controls nearly half of the PFIs contracts responsible for public sector waste management. Five investment companies control nearly 50% by capital value of all PFI hospitals.[30] This is not surprising. PFI contracts tend to be highly complex, and the concomitant costs of bidding for them is high. In 2011, the Commons' Select Committee heard evidence that every failed school bid costs £2m and every failed hospital bid £12m.[31]

PFI contracts rely heavily on private sector finance – typically 90 per cent – this makes the project liable to borrowing costs significantly higher than those available where are funded by government borrowing. The Commons' Select Committee heard evidence that a PFI funded contract may be twice as expensive as one financed by the government.[32]

In addition to the costs that are incurred by PFI schemes, there is lost revenue, which could otherwise be invested in the service. The role of Special Purpose Vehicles (SPV) in financing PFI contracts allows for significant amounts of revenue leakage. The SPV holds multiple opportunities for generating income and several of these could otherwise be spent reducing costs for the public sector or reinvested in service provision. For instance, after the construction stage of a project has been completed, the SPV can often renegotiate the interest on their loans in recognition of the reduced risk to which the project is liable. Theoretically, under PF2 these savings should be split 50:50, however, these reductions rarely find their way through to the public sector.[33] Shareholders also receive between 10 and 15 per cent interest on their loans to SPVs.[34] At the same time profits are often paid out as dividends to shareholders.

In common with other forms of outsourcing, PFI contracts, often have a detrimental impact the quality of employment. Because of the motivation to reduce costs either to secure a tender or to maintain profitability, contractors will often drive down on pay, and other conditions.[35] Companies may not recognise trade unions and may take steps to evade TUPE regulations. PFI, like other forms of outsourcing, can become a mechanism for converting relatively well-paid, secure, public sector employment into low-paid, insecure, private sector work through the outsourcing of facilities management and support services.

The initial justification for PFI contracts, as with wholesale privatisation, was to transfer the risk, as well as the profits of large scale public sector infrastructure projects to the private sector. As we outlined above, there a several methods by which SPVs can capture the profits from PFI projects, however their "bankruptcy-remote" nature means that the parent company can minimise their risk should the project fail. As the recent experience of Carillion has shown, if a company of sufficient size gets into financial straits, the state remains the

[30] *The private finance initiative – how come we're still paying for this?,* The people vs PFI ,September 2017
[31] *Private Finance Initiative* – House of Commons Treasury Select Committee seventeenth report of session 2010- 2012

[32] The Guardian *Private finance: a lousy way to run UK public services,* September 2017
[33] *Equity investment in privately financed projects London*, NAO National Audit Office,2012
[34] People vs PFI https://peoplevsbartspfi.files.wordpress.com/2016/02/pfi-nationalise-the-spvs-pple-vs-barts-pfi-version-1.pdf P8
[35] *Out of contract,* The Smith Institute, Jan 2018

backstop. The nature of public sector infrastructure projects means that, as well as employing large numbers they generally serve a real need in the community. Simply letting projects to build them fail is rarely an option.

There are two ways that PFI projects could be brought in back into public ownership. Either by purchasing the contracts or by nationalizing the SPVs. This would allow for public bodies to reclaim any profit from the provision of the service, as well as any reduction in interest rates they might have negotiated once construction was complete. Depending on how the legislation was structured; regarding the level and extent of remuneration available it is possible that additional costs savings would be available here.

The government could follow the example of Northumberland Healthcare Foundation and borrow the money to purchase the PFI contracts outright.[36] There are significant costs associated with this. If there is not a break clause then the process of buying the contracts could entail significant costs or render the government liable to litigation. Investors may attempt to sue for the loss of income they expected from interest on their loans, if they feel that the level of remuneration offered did not match the expected ROI. If the deal did offer full compensation for lost interest, then the cost could erase any benefit in bringing the contract in house.

However, there is no need for the government to adopt a one-size-fits all approach. For contracts where the PFI contract has a long period to run, the government may want to issue government bonds to purchase the SPV. There is precedent for government to pay off debts without paying compensation for future interest. The process would resemble the consolidated stocks (Consols) that have been issued in the past.

Alternatively, for contracts that have a shorter period to run, or where there is a break clause, it might be possible to simply buy out the contract directly. This was the case in Northumberland. While there are costs, and risks associated with both models, they should not blind us to the massive costs and risks associated with the current status quo. The collapse of Carillion shows that the PFI model has not inoculated the public sector from risk, meanwhile PFI contracts continue to force huge spending on a rigid set of services regardless of need, or financial pressures.

[36] *NHS trust becomes first to buy out its PFI contract,* Financial Times, October 2014