



Exploding privatisation myths

Summary

While the recession places increased demand on local public services, they are also under mounting pressure to make savings and become more efficient. One suggestion often put forward to tackle the country's growing debt problem is to outsource or privatise our public services. This pamphlet examines this proposition and attempts to explode some of the myths and misconceptions about privatisation to show that it would cause more problems than solutions.

MYTH1 During the economic downturn, the best way to save money is to privatise public services

In reality, public money is best kept within the public sector during the downturn. For every pound of public spending in a local area, this generates an additional 64p. Outsourcing and Public Private Partnerships – often undertaken with large multinational companies – take money out of areas when local economies and communities most need to be supported. Public spending has a stabilising effect, particularly during a recession; privatisation would only undermine this.

MYTH 2 The private sector costs less than the public sector and is more efficient.

In reality, there is no evidence that the private sector is more efficient than the public sector. Outsourced services are concentrated in a few large firms which dominate the industry and have proved able to earn large profits. PFI projects often go far over budget while contracts are inflexible, binding the public sector into contracts for buildings and services which often later prove unfit for purpose. PPPs and outsourcing are too often the cause of a downward pressure on staff terms and conditions, the fragmentation of services and a divisive effect on public sector ethos.

MYTH3 Competition is the best way to improve public services

In reality, public services are too important to compete on price. Public services reduce inequality, promote economic, social, and environmental security. Competition merely leads to a race to the bottom, with providers racing to compete on costs to the detriment of service quality. Competition leads to the fragmentation of services and increased transaction costs, linked to making and monitoring contracts, accounting, auditing, legal services, advertising and shareholders' profits.

MYTH 4 The private sector is more responsive to service users' individual needs

In reality, only the public sector can respond to society's collective needs. Public services must be subject to democratic accountability and transparency. Privatisation erodes this accountability and treats vital services merely as contracts to be bundled up and sold off.

Myth 5 The public sector has a worse productivity record than the private sector

In reality, public services create public value – but this is hard to measure. It is notoriously difficult to measure public sector productivity and even harder to compare it to the private sector. An increased class size might appear to show a teacher working more productively, but it is doubtful this would improve the quality of education. Private sector productivity can be assessed by looking at the balance sheet. In the public sector, it is more about public value, with services that respond to the needs of citizens, that are sustainable, provide long-term value for money and are trusted by citizens.

Myth 6 "Back-office" functions can be outsourced without impacting on the front-line

In reality, support functions are just as important as the front-line. Without "back office function", frontline workers would not be able to do their job. The NHS would not be able to survive without the people who book appointments, analyse blood tests, process X-rays or make sure staff get their wages on time. A false division is being created between front-line and support services which is fragmenting and damaging vital public services.



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The recession has placed unprecedented strain on local public services and economies. Public services are facing increasing demand, yet are under mounting pressure to make savings and become more efficient. One suggestion often put forward to tackle the country's growing debt problem is to outsource or privatise our public services. This pamphlet examines this proposition and attempts to explode some of the myths and misconceptions about privatisation to show that it would cause more problems than solutions.

There is a strong economic and social case for public services, both in a recession and during recovery, in maintaining and creating employment, boosting skills and promoting health and wellbeing. Public services help promote economic competitiveness as well as social inclusion, yet these arguments are being lost in the race to find ways to cut spending and services.

The Push to Privatisation

'Gordon Brown has announced a £16bn sale of government assets in an effort to reduce the growing budget deficit. The Dartford crossing, the cross-Channel rail link and the nationalised bookmaker the Tote will be among items going on sale over the next two years.' [BBC News 12 October 2009](#)

Public sector organisations with more than 1,000 employees 'should conduct a systematic review of their functions, systems and processes to drive simplifications and standardisation. They should lead to significantly greater sharing of services and potentially increased outsourcing.' [Treasury Operational Efficiency Programme 2009](#)

"The power of competition and the opening up of the NHS to new providers will bring innovation and investment. And the power of choice will lead to better quality care." [David Cameron, 20 April 2009](#)

"Charities, private companies and parents' groups will also be allowed to set up schools – competing with existing primaries and secondaries for local children – and in time, though this is not yet Tory policy, to do so for a profit." [David Cameron, 6 February 2009](#)

'Non-core activities are best provided by the private and third sectors unless it is essential for them to be provided in-house.' [CBI, Doing more with Less](#)

What do we mean by privatisation?

Privatisation is a broad term that covers several concepts

- **Full privatisation.** The handing of control and/or ownership of public services to the private sector.
- **Public-private partnerships (PPPs)** refer to collaborative relationships between public bodies and private companies, including PFI.
- **Private Finance Initiative (PFI) partnerships.** Method of providing new public buildings and projects such as schools, hospitals, roads and homes by using private sector money up front that is later repaid with interest by the state. A private sector consortium designs, builds, finances the project - and then operates it for a period of at least 25 years. The consortium's fees are paid from public money, with an element of that fee dependent on it meeting performance standards throughout that period.
- **Outsourcing to private and not for profit organisations.** Awarding a contract to a private, voluntary sector organisation to supply a service previously run by a public sector body such as a council or hospital.



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MYTH1 During the economic downturn, the best way to save money is to privatise public services

REALITY During the downturn, public money is best kept within the public sector

As the public sector faces pressure to squeeze spending, politicians, commentators and contractors have called for more public services to be transferred to the private and voluntary sectors in the belief that this would save money.

As recent global economic developments have severely questioned the credibility of free-market economics, it is surely time to reconsider the view that the private sector has all the answers. The push to transfer services and assets to the private sector is rarely done as a result of evidence-based policy, but driven more by political will. Indeed, a report by private insurers Zurich says that 'government policy has moved from encouraging partnerships towards mandating them'. A more worrying development is the increasing influence the private sector has on decisions affecting public services. A spokesman from investment managers, Brewin Dolphin recently stated that outsourcing is now such a part of the political culture that there is little chance of the process being reversed. "Consultants and outsourcers are so entrenched in the system that they're actually the ones sitting there and making the decisions for the government."¹

It is also time to give full consideration to the role that public spending plays in local economies. A recent TUC Touchstone pamphlet highlighted research which shows that for every pound of public spending in a local area, this generates an additional 64p.² Outsourcing and PPPs – often undertaken with large multinational companies – takes money out of areas at a time when local economies and communities most need to be supported. Public spending has a stabilising effect, particularly during a recession; privatisation and outsourcing would only undermine this.

MYTH 2 The private sector costs less than the public sector to deliver services and is more efficient

REALITY There is no evidence to show that the private sector is more efficient than the public sector

In the pursuit to do 'more for less' the argument is often heard that the private sector can run services better than the public sector because it is more efficient and has better skilled managers.

It is also claimed that the profit motive is the greatest guarantee of efficiency. Yet, the fact that the private sector, unlike the public, must pay a dividend to its shareholders means that funds are always diverted into profits. And the private sector has certainly shown it can make a decent profit from the public purse.

The public service industry is a highly profitable market for the private sector with an annual turnover of nearly £80bn. Large companies such as Compass, Serco and Capita have made huge profits from the privatisation of public services and dominate the market. Local authorities account for a fifth of Capita's business, which describes itself as "the UK's leading outsourcing company". Support services firm Serco, which runs prisons, railways, school inspections and London's congestion charge recorded a 33% increase in pre-tax profit in the first half of 2009 to £83.4m.

¹ Moneyweek, *Profit from the fiscal crisis with outsourcing*, 4 September 2009

² TUC, *Speaking up for Public Services*, 2009



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The report by insurers Zurich into outsourcing indeed warns against the risk of the outsourcing market consolidating and becoming dominated by a few large providers. It says: 'Big is not always beautiful and can bring risks in itself ... Co-operation between authorities can in effect force a monolithic market place of suppliers that may give short-term gains but close down future opportunities to spread risk.'³

The box below highlights the particular case of the Private Finance Initiative (PFI). PFI contracts are notoriously inflexible, limiting the ability of public sector bodies to strategically plan for the future as they are contractually bound to pay for a building and a pattern of service provision which could later prove inappropriate and unfit for purpose. The box below also explores one of the main arguments used to promote the PFI, that risk is supposedly transferred from the public to the private sector. Experience shows that governments remain accountable to deliver services regardless of how well the PFI project or company fares.

Private Finance Initiative

The total capital value of PFI and PPP schemes to date completed or signed is more than £100bn. The largest sector commitments are for transport schemes and hospitals and other health projects. As contractors typically operate on a 10% to 20% margin, this represents at least £10bn in profits alone for the construction companies. In addition professional fees – for legal services and accountancy/consultancy advice – generate substantial earnings for the firms.

Neath Port Talbot Hospital in Wales demonstrates the typical repayment set up of PFI deals, where loan repayment over 30 years (including maintenance) will exceed £445m compared with building costs totalling only £66m. Since such earlier experiences with PFI, the Welsh Assembly Government has taken a much more cautious approach to PFI than the UK Government and the initiative has been dropped in the NHS. In addition, 250 members of staff who provided cleaning and catering to the Neath Port Talbot PFI hospital were returned to NHS employment in 2009.

The Major Contractors Group (representing the biggest construction firms in the UK) estimated that at the height of the economic boom, PFI contractors were getting between three and 10 times the normal rate of construction industry profits. However, during the financial crisis, the risk was transferred back from PFI contractors to the taxpayer, with the government promising to bail them out with billions of taxpayers' funds. In March 2009, a new Infrastructure Finance Unit was set up within the Treasury to ensure that PFI projects continued after the credit crunch and to lend directly to PFI projects instead of PFI consortium borrowing from banks. The infrastructure finance unit is expected to lend about £1bn-£2bn to PFI schemes in 2009-10, meaning that taxpayers' money is being used by the government to subsidise the operation of many of the UK's largest PFI schemes.

Stephen Glaister, professor of transport and infrastructure at Imperial College London commented that: "The financial crisis has highlighted a basic truth - that private finance is only a way to borrow money that will have to be repaid by the taxpayer sooner or later. Risk transfer has proved difficult or impossible, so the taxpayer has ended up bailing out the commercial failures of the PFI companies."⁴

There is scant evidence of the private sector's ability to provide more efficient services. Even the outsourcing industry acknowledges that the efficiency argument is an elusive one. Martyn Hart, chairman of the National Outsourcing Association recently expressed scepticism about the extent of the savings which could be made from outsourcing services, like cleaning.

³ Zurich Municipal, *Public sector supply chain: risks, myths and opportunities, 2009*

⁴ *The Guardian, A bridge too far for PFI schemes, 18 April 2009*



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He stated that: "If you're cleaning a hospital, and if you're doing it to the same standard and paying staff the same thing, then where are your economies of scale?...If you're just outsourcing for cost savings there has to be somewhere where the cost savings can come." He went on to suggest that small savings might be possible from bulk procurement of cleaning products, but said that there was a danger that companies would secure their profit margins by paying staff less.⁵ Since public services are highly labour intensive, this is the area that is usually squeezed to find savings, often leading to a downgrading of pay levels, holiday entitlements, sick pay, maternity pay, and training and development.

A study by the Office of Public Management (OPM) on outsourcing in the NHS found that "little hard evidence is available to suggest that outsourcing impacts positively on value for money or quality of care. Conversely there are several examples of outsourcing having a directly negative effect on the value for money and quality of care in services."

The report from Zurich into outsourcing and PPPs found that outsourcing is often 'the cause of a downward pressure on terms and conditions, fragmentation of services and a divisive effect on the ethos of the public sector and the NHS.' But warns that 'a very wide range indeed of disasters and embarrassments caused by supplier failure' suggest that the risks of the push to outsourcing are 'potentially catastrophic and urgent'.

The problems they highlight include:

- Countless and huge examples of the loss of sensitive personal data and privacy responsibilities eg the £225 million Contact Point, child protection database issues;
- Badly managed social care contracts leading to reputational damage and legal challenges;
- The National Audit Office is investigating alleged overspending and overrun of IT contracts worth £18 billion; and
- The failure or collapse of a number of shared service agreements

PRISONS

Private prisons are performing worse than publicly run prisons. Data obtained under the Freedom of Information Act by More4 News show that four of the 10 private prisons scored the second lowest rating of 2, "requiring development", and only one above an assessment of "serious concern".

There are also disparities in the number of complaints upheld in private and state-run prisons. Rye Hill Prison, a private prison run by G4 saw a total of 22 complaints, well above the average in both prison sectors.

The evidence contradicts the government's claim that the greater use of private prisons has driven up standards. Despite this Serco has been awarded a £600m contract to operate two new prisons at Belmarsh West in London and Maghull in Liverpool.

There is Another Way

In September 2009, the Secretary of State for Health announced that 'the NHS is the preferred provider' in the provision of its existing services where it can show it can do so at high quality and value. If NHS services are failing and are not improved then commissioners can open up tenders to alternative NHS, private or voluntary providers. The Secretary of State acknowledged that it is usually more efficient to fix the current service than go out to buy a new one and that it is fairer all round for staff to be given a chance to improve.

⁵ FM-World, *Outsourcing FM could save government billions*, 19 October 2009



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A study undertaken by the Association of Public Service Excellence (APSE), highlighted small but growing signs of antipathy towards outsourcing. Looking at 50 councils, APSE found that the main reasons for returning services in-house was the poor performance of contractors. In many cases contracts had been terminated early, with cost implications for the council but more significantly, with little progress made towards greater efficiency. It appears that decisions to end these contracts appear to be driven by entirely pragmatic reasons – essentially providers have failed to live up to expectations.⁶

MYTH3 Competition is the best way to improve public services

REALITY Public Services are too important to compete on price

The imposition of competition and markets in the public sector means driving a wedge between client and contractor roles and usually results in the restriction of in-house delivery. Local authorities, NHS Trusts and other public sector bodies are required to become 'commissioning' organisations, in effect to be a client and to contract the provision of services to outside organisations. Competition is therefore limited between private firms and consultants and cannot be said to be true competition.

Competition can be a powerful lever of economic innovation. But the public sector is not, nor should be subject to real competition. The allocation of resources in the public sector should never solely be about price – public services are too important. Public services reduce inequality, promote stability, and are the only proven way to promote economic, social, and environmental security.

As long as a service remains in the public sector it retains at least the potential to be directed by meeting the needs of the public. Once the private sector takes over this potential disappears, and is replaced by the priority of profit maximisation. Public services are subject to a regime of democratic accountability that embodies political choice and as such provides a different kind of scrutiny than anything that the market might deliver. Public services are an essential component of a good society. They carry with them intrinsic assumptions about equity, access and accountability; this is not the case in the market.

Privatisation and outsourcing often leads to services being fragmented, with overly complex structures which make collaboration and cooperation difficult. This slide to fragmentation means that Ministers and public sector managers lose control over the quality and delivery of services. They also lose control over the pay and conditions of workers delivering services. The OPM study on outsourcing in the NHS found that it represents a "challenge to the lines of accountability due to the increasing complexity of outsourcing arrangements and diversity of approaches."

The growth of competition also leads to increased transaction costs, linked to making and monitoring contracts, accounting, auditing, legal services, advertising and shareholders' profits. Public sector resources are used in wide range of activities, from 'stimulating the market' to encourage private and voluntary sector organisations bid for contracts, to tendering and performance management. There are also high costs associated with bidding for contracts, which can act as a barrier to market entry and creates economies of scale that favour large providers both in the private and voluntary sectors.

Competition all too often leads to a race to the bottom, with providers in all sectors racing to compete on costs. This inevitably hits the workforce in terms of pay and conditions, training and staffing levels. A study by TUPE by the Social Care Employers' Consortium looked at the recruitment and retention of the third sector social care workforce and particularly contracting out from the public to the third sector.

⁶ APSE, *Insourcing: A guide to bringing local authority services back in-house*, 2009



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It reported that, despite clear guidance that TUPE should apply to all transfers in an outsourcing situation, many local authorities still ask for a TUPE and non-TUPE price in their tenders. It states that 'tenders, especially those which have a turnaround time of a few days, are costly to prepare and having to provide two separate bids doubles the cost of staff time.' It goes on to describe the code of practice on the two-tier workforce, which was designed to ensure that in a transfer situation, new employees were treated equally to those of transferring staff. It states that the code is 'often ignored by local authorities which are cost driven.' It quotes one employer: "We lost a contract because a local authority and a new supplier ignored the two-tier workforce regulations. Now we don't mention it unless the local authority does, which isn't often."⁷

Britain's Homecare Scandal – BBC Panorama

"Care of the elderly is a lucrative industry after the doors were opened to private companies in the 1990s. Research from the London School of Economics, commissioned by Panorama, found that 70% of home care is provided by the independent sector today and is worth £1.5 billion. The figure was just 2% in 1992. English local authorities spend around £22 an hour providing elderly care, but the independent sector provides it for around half that. Panorama went to South Lanarkshire in Scotland where an online auction decided the council's new care provider. Domiciliary Care won the auction which saw bidders bidding down, not up. It's one of Scotland's largest care providers looking after more than 1,500 people. While it won with a bid to provide care for £9.95 an hour, South Lanarkshire says the decision to award the contract was based only 40% on price with 60% based on quality of care."

www.news.bbc.co.uk/panorama/hi/front_page/newsid_7990000/7990682.stm

Impact on the third sector

Supporting People Programme - evidence to the Communities and Local Government Committee

Supporting People is a government programme to fund, monitor and improve housing-related support services. The inquiry into the programme expressed concern about pressure placed on third sector organisations as local authorities focus too heavily on the cost of providing services, as opposed to considerations of quality. Evidence was provided by several charities and third sector organisations, including Refuge, a domestic violence charity, who compared "the search for the cheapest possible contract" to the approach a local authority would take to letting "a contract for pot holes or some other local authority service." The subsequent impact of competitive tendering on small, often third sector, providers and their clients is considerable:

"[Competitive tendering impacts on] small, community-based care providers. Large organisations are much more able to compete for and win Supporting People services—by contracting out their own back-office functions, developing floating support services over large geographical areas, and benefiting from economies of scale. [...] the government's own equalities agenda is being harmed. While the focus from government seems to be on the needs of local communities, the result of low-cost competition for care services is that specialist equalities groups rooted in communities will struggle.

The Supporting People Programme - Communities and Local Government Committee, 2009

⁷ Social Care Employers' Consortium, *Social Care: Has Anything Changed?*, 2008



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MYTH 4 The private sector is more responsive to service users' individual needs

REALITY Only the public sector can respond to society's collective needs

Public sector reforms are often based on the idea that public service users should be treated as consumers. In many cases, this focus is both appropriate and necessary. For instance, the emphasis in the NHS on developing 'expert patients' who will know about and take responsibility for their own conditions and are able to make informed choices is a welcome development, as is the promotion of user empowerment and independence in social care.

However, in many parts of the public sector, users do not engage with services on a voluntary basis but are subject to compulsory attendance, such as with the police or mental health service. And the public's relationships with public services are often far too complex to be classified as consumers. People do not necessarily buy the service; they may have a right to receive the service; they may be refused a service because their needs may not meet the criteria laid down. But above all, there is often a *collective aspect to public services, where the benefit extends beyond the individual, to families, schools, communities, the UK and other countries.*

It is this collective aspect of public services which requires them to be subject to democratic accountability and transparency. Privatisation erodes this accountability and treats vital services merely as contracts to be bundled up and sold off.

Barnet Council

Barnet Council is using the business model of budget airlines to plan a radical reform of public service provision. Unofficially dubbed "easyCouncil" the project is part of the borough's "relentless drive for efficiency" and could see residents paying extra for some local services.

The council's aim is to turn itself into a focal point called a strategic commissioning hub to commission public services from private and voluntary sector organisations. Barnet also plans to stop providing some services altogether - 'scaling down to a size which would mean delivering only what the local authority must deliver to achieve efficiencies' - and to outsource the rest .

The council had also planned to save £950,000 by removing onsite residential wardens (whose tasks include dealing with health and security emergencies, organising GP visits, organising social activities, and checking on residents at least once a day) from sheltered housing scheme. They would be replaced with a 'floating' support service where support workers based at hubs would visit elderly people who met eligibility criteria. In December 2009, a High Court ruling prevented the plans on the grounds that they did show due regard to the need to take account of disabled persons' disabilities.



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Academy Schools

The growth of academy schools represents a transfer of assets and power to unaccountable entrepreneurs, business and religious groups. Parent power is generally weaker in academies than in maintained schools – including reduced representation on governing bodies, weaker appeals processes for admissions, exclusions and special educational needs, and reduced capacity to withdraw pupils from acts of religious worship. Under current rules, academies must appoint only one parent or guardian on governing bodies, even though parents and guardians usually form the largest group of governors at state schools.

There has also been a steady growth in the number of chains and federations of academies, meaning that a single unaccountable organisation or individual is responsible for a vast array of educational provision including the development of the curriculum, admissions and staff terms and conditions.

There are also wider accountability issues related to academy schools. Accountability in public services does not end with accountability to users, as schools play a social and economic role that goes beyond the interests of parents and guardian. Taking academies out of Local Authority control disrupts admissions arrangements within local authorities and in neighbouring authorities.

At the start of the Academy Schools project, sponsors were required to provide a one-off payment of £2million. Many sponsors, however, did not pay or chose to pay 'in kind'. This requirement has now been dropped.

Myth 5 The public sector has a worse productivity record than the private sector

REALITY Public services create public value

The CBI uses government statistics to show that public sector productivity has declined by an average of 0.3% over the period 1997-2007 and that over the same period, labour productivity in the private sector increased by an annual average of 2.8%. The CBI states that these diverging trends are “undesirable and unsustainable.”⁸

Productivity measures in the public sector are notoriously problematic and we need to be very careful in interpreting data on productivity. It can be seen, for instance, that increasing class sizes in schools may lead to perceived greater productivity by individual teachers, ie the ratio of teachers to schoolchildren. But it is doubtful that increasing class size would have a positive impact on the quality of education. Standard definitions of public sector productivity are a poor measure of public value and it is more important to look at efficiency, performance and outcome.

Productivity can be assessed in the private sector by looking at the balance sheet. By definition, this is not possible in the public sector. Rather, public sector productivity is centred around the notion of public value, with services that respond to the needs of citizens, that are sustainable, provide long-term value for money and are trusted by citizens. We know that financial pressures will require a sharper focus on value for money, but cost should never be the prime driver for public services. Public services are not a drag on the UK economy; but a vital part of it, delivering health and social care, crime prevention, education, fire safety and many other important services.

⁸ CBI, *doing more with less, 2009*



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Myth 6 "Back-office" functions can be outsourced without impacting on front-line services

REALITY Support functions are just as important as the front-line

In a recent document called "Doing More with Less" the CBI claims that 'sharing back office functions can improve efficiency' and that 'non-core activities are best provided by the private and third sectors unless it is essential for them to be provided in-house.'

It is wrong to describe any public sector function as non-core or back-office. Public services are characterised by an extremely complex set of processes and relationships. For example, the gradual development of multi-agency approaches, with professionals working together across different public sector bodies create overlapping responsibilities and lines of accountability. Without so-called back office functions, frontline workers would not be able to do their job. The NHS would not be able to survive without the people who book appointments, analyse blood tests, process X-rays or make sure staff get their wages on time.

The pressure on "back-office" functions is greatest in the push to develop shared services. In many cases, shared services can be an effective way of delivering services such as HR, payroll and IT across different local authorities or public sector organisations and delivering long-term efficiency savings. Unfortunately, they are also associated with pressure to cut short-term costs and outsourcing. The Treasury's Operational Efficiency Programme which advocates the use of shared services is based by its own admission, on "proxies, estimates and assumptions" of private sector standards of delivery. The push for shared services is based on an over-reliance on economies of scale over quality.

Shared Services

"By 2016 the majority of the transactional elements of Corporate Services in the public sector will be delivered through a handful of professional shared service organisations. Some of these organisations will remain inside the public sector, but many will be outsourced." Cabinet Office, 2006.

Southwest One

Southwest One is a joint venture between IBM, Somerset County Council, Taunton Deane District Council and Avon and Somerset Police to deliver a range of services under a 10-year contract. Southwest One is 75% owned by IBM, who will make £400m over the 10 years.

The joint venture has been strongly criticised for the lack of effective scrutiny, public engagement and secrecy – the contract has been kept secret for reasons of "commercial confidentiality."

It offers shared services in IT, finance, human resources, property management, purchasing, facilities management, customer contact centres and services to schools. Southwest One has a framework agreement which enables other local authorities and public bodies to obtain services bypassing the procurement process.