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THE REGULATION OF AND ACCOUNTABILITY FOR NEW FORMS OF PUBLIC PROCUREMENT

Jean Shaoul
University of Manchester

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Further details: Fiona Wilson, Centre Secretary
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Institute for Development Policy and Management, University of Manchester,
Crawford House, Precinct Centre, Oxford Road, Manchester M13 9GH, UK
Tel: +44-161 275 2798 Fax: +44-161 275 0808
Email: crc@man.ac.uk Web: http://idpm.man.ac.uk/crc/

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INTRODUCTION

One of the most striking features of public policy world over has been the turn towards new forms of public procurement. This has taken several forms. Governments have required public agencies to put manual services such as refuse collection, catering and cleaning out to compulsory competitive tendering (CCT) and to accept the lowest cost provider. Social services departments that traditionally provided and delivered long term care in publicly owned facilities, have closed their residential centres and now purchase 'care packages' on behalf of 'clients' from the private sector corporations. More recently, professional services such as administrative, legal and financial management services have been outsourced. Governments have set up arms length companies (executive non-departmental public bodies) or broken up departments and reconstituted the separate units as agencies operating on commercial principles (a policy known as corporatisation). More recently governments have turned to private finance (PFI), known elsewhere as design, build, finance and operate (DBFO), build, own, operate and transfer (BOOT), and long term public private partnerships (PPP) for public and social infrastructure projects. Some countries plan to go even further, forming joint ventures with the private sector and exposing themselves to the same gains and losses as their commercial partners. In other instances, public sector agencies, particularly housing associations, have secured loans for refurbishment by pledging their future revenue stream and themselves in effect become the facilities management provider. As the Economist Intelligence Unit Report (1999) notes in its international review of public private partnerships, these policies are now, to varying degrees, quite widespread.

Under these arrangements, the (fragmented) public sector procures services from the private sector, including the use of the underlying assets, rather than directly providing them. Public agencies have used PFI/PPP to procure the use of a functioning sewerage system, water treatment works, prison, road, hospital or school under long term contracts and restricted its own contribution to the professional services such as clinical care or teaching. The turn to such measures has therefore reduced the scope of government activity while at the same time increasing the proportion of public revenues that are spent outside the public sector. Government and its agencies are in effect becoming **the procurer and regulator of services** rather than the provider. In Britain, the purchase of external goods and services will soon constitute more than half of annually managed public expenditure (Shaoul 1999).

These new policy measures have been introduced and justified in terms of Value For Money (VFM). The concept of VFM denotes the savings that will accrue to the public sector over the life of the contract compared with conventional public sector provision. VFM is derived from the greater efficiency that private sector management techniques will bring to the delivery of public services, the competitive forces that, it is argued, will exert a downward pressure on contract prices, and the transfer of risk to the private sector. Implicit within this is the notion that this will in turn lead to greater economic and social welfare.

The UK government has specified *ex ante* financial appraisal methodologies and procedures designed to ensure value for money. These are necessarily based on estimates of future costs and operate *at the point of procurement.* Less however has been said as to how probity, stewardship, value for money, and any additional issues of regulation, transparency and accountability that may follow from these new policy initiatives, will be demonstrated *ex post facto*.

These policies are being introduced voluntarily in the advanced capitalist countries. In the developing countries they are being introduced at the behest of the World Bank and IMF (Chussodovsky 1998). More recently, the WTO's GATS agreement seeks to open up 160 sectors to liberalisation, deregulation, free trade and competition. These sectors include transport, healthcare, education, housing and other services traditionally run by government agencies (Price Pollock and Shaoul 1999). There is therefore a huge international head of steam behind these policies. This creates the real possibility of policy promotion conflicting with policy control and regulation.

These new forms of procurement have spawned a new commercial sector known as facilities management or business services. Many of these companies, only established in the last twenty years, are now in the top 100 companies on the London stock exchange. Not only are these companies large, they are also increasingly international companies. The increasingly large scale and long term contracts being negotiated in the name of 'partnerships' mean that public agencies can only work with a relatively small number of large corporations capable of managing and operating such contracts. In so far as such an unequal power relationship between relatively small public service agencies and these major service providers reduces competition, affects the nature of the contracts and service provision, and the power to enforce contractual standards of performance, it limits the public sector's ability to obtain value for money, and thereby ensure probity and stewardship of public finances and accountability to all the stakeholders. Conversely, it de facto increases the power of the corporations to determine and control the direction of public policy. In other words, these new forms of public service procurement have profound implications for regulation, accountability and wealth distribution.

The object of this paper is to consider various aspects of regulation and financial accountability. The paper firstly draws on a diverse range of evidence from the research literature, public agencies, case studies, and business and press reports as they relate to outsourcing in the advanced capitalist countries. Secondly, the paper draws out the implications for a research agenda for developing countries. In so far as the outcomes of these new public policy measures have thus far been considered in the advanced capitalist countries, they have largely been considered in relation to how well the different policy measures have been implemented and operate in practice. The wider regulatory and accountability issues they gave rise to have largely been ignored. While the literatures and empirical evidence cited here relates to the developed countries, since this is where the work has been done and evidence exists, this is important for two reasons. Firstly, since the policies are international, the issues thereby raised are internationally relevant. Secondly, the work enables comparisons to be made between countries.

The paper is divided into a number of sections, structured in a similar way. Each section firstly summarises the evidence and then draws out the research questions that follow from it. The first section outlines the policy promoters, their objectives and the potential conflict between policy promotion and regulation. The second section analyses the scale of public outsourcing in the UK. The next section reviews the facilities management industry that provides outsourcing for the public sector. The fourth section looks at research on regulation and accountability issues in the context of outsourcing and the final section draws out some of the wider implications.

THE POLICY PROMOTERS AND REGULATION

The use of Public Private Partnerships (the term is used as a shorthand for all these new forms of procurement) is an international phenomenon promoted by global institutions such as the World Bank, IMF, the European Union and governments around the world. They differ chiefly in the ultimate ownership of the underlying asset. Private finance for public services is integral to the structural adjustment programmes imposed by the IMF and World Bank and a prerequisite for loans for developing countries (Chussodovsky 1998). Both promote the use of 'markets in infrastructure provision' (World Bank 1994), and the World Bank has adjusted its methods for appraising investment to make this easier. The World Trade Organisation's 'Government Procurement Agreement' came into force in 1996 for a number of states, including those in the European Union, and opened up public contracts to international competition. Britain has been one of the first states in the developed world to take up two key recommendations of the global financial institutions designed to facilitate the transfer of public services to private sector provision: commercial accounting practices and commercial investment appraisal procedures (Thornton 1999).

Over the past seven years the European Commission has advocated the use of public private partnerships and has used governments grants to set them up (European Commission 1998). In public private partnerships, the private sector provides services and the public sector purchases and funds them (European Commission 1997). Some of the largest projects are for transport, bridges, ports, water and sewerage (Kinnock 1998). This market was worth 720bn Ecus in 1994 (11.5% of the gross national product of the 15 member states of the European Union). The number of notices in the *Official Journal of the European Community* announcing large procurement projects has risen from 12,000 in 1987 to about 200,000 in mid1999. More recently this has been extended to health, education, and other public service provision under the WTO's GATS agreement (Price Pollock and Shaoul 1999).

More recently, the British government's White Paper on international development (DfID 2000) welcomed trade and investment liberalisation and the opening up of domestic industries and services to international competition as a means of reducing poverty. It described a range of measures that the UK was already taking and would take in the future to encourage public private partnerships between British and local firms. In 1948, it had set up the Commonwealth Development Corporation as the UK government's main instrument for investing directly in commercial enterprises in developing countries. Now private sector capital is to be introduced into the CDC so as to turn it into a partnership between government and UK private sector corporations. Other measures include an Africa Private Infrastructure Financing Facility (APIFF) for infrastructure projects in sub-Saharan Africa and a Business Linkages Challenge Fund.

It is pertinent to consider here the introduction of public private partnerships in the UK and some of the wider implications for regulation and accountability as the British government was one of the first industrial countries to embrace such policies, and information is readily available. They were first introduced in the UK as the Private Finance Initiative (PFI) by the Conservative government in 1992 to enable the financing of public sector infrastructure by private sector funds. Capital expenditure by successive governments had fallen from 15% of total government expenditure in 1976 to about 3%, as a result, initially, of the IMF imposed cuts and subsequently, explicit government policy. This had curtailed the investment programme in hospitals and schools intended to provide sufficient facilities to implement post-war social legislation on an equitable basis, and also created a backlog of maintenance and refurbishment estimated at £2bn in the case of schools. The policy, originally applied to major infrastructure projects such as roads and bridges, was extended to prisons, law courts, hospitals, schools, and other public services.

PFI covers a variety of forms of commercial partnerships between the public and private sectors whereby a private contractor provides the facility and takes on its long-term operation in line with the specification set out by the public agency. In the context of schools, for example, PFI projects involve buying asset related services for schools from the private sector and using assets – such as school buildings and other facilities including equipment relating to specific services such as information technology, heating systems and school meals, to deliver services. The contractor provides and operates the assets, sometimes generating an additional income from them, over and above the annual fee paid by the public sector for the use of the facilities. In other words, the public sector pays annually for the use of the assets over the (long) life of the assets as opposed to an initial lump sum and subsequent expenditure on an *ad hoc* basis for maintenance and refurbishment, under conventional procurement. PFI therefore has long term implications for public expenditure via its commitment to future payments.

Like many public policies, PFI did not start out with an explicit and coherent set of objectives. Rather the aims evolved gradually. Indeed it has long been recognised that the relationship between form and substance in policy making is complex: stated goals may be multiple and incompatible; stated and real goals may differ, while some goals may never be publicly stated (Connolly and Stark 1992). Launched in 1992, the case for PFI was initially a macroeconomic one. PFI was presented as a way of financing the much needed capital investment in the social infrastructure that the public sector either could not afford or could not provide without breaching the public sector borrowing limits set by the Maastricht Treaty. But this ignored several fundamental issues. Firstly, the UK was well below the borrowing limits set by the Maastricht Treaty even though it used a broader definition of public borrowing than that used by other EU member states. Secondly, as PFI is a financing mechanism, no new money would become available. Indeed the Treasury accepted that the funds available would remain the same irrespective of whether the government or the private sector raised the finance and would not therefore provide additional capital without funding from government. Thirdly, the government had expected that the effect of PFI would be to remove the financial liability associated with the PFI generated asset, be it hospital or school, from the public sector's balance sheet. But the Accounting Standards Board maintained that to do so would not be compatible with best accounting practice (Accounting Standards Board 1997, 1998). There was therefore a gap between the declared policy benefit and practice. Thus the macroeconomic case, in the context of Britain at least, is not a strong one.

More recently the government has emphasised the microeconomic case for PFI. It claims that the chief advantage of PFI/PPP lies in its ability to improve value for money. Long-term private sector involvement through a PFI project meant that there would be a continuing incentive for efficiency throughout the various stages of work, from the initial design and in some cases build, through to the operation of the building or the management of services. The private sector could bring new and innovative ideas to public sector projects. The Local Education Authorities (LEAs) and schools, for example, could benefit from the availability of commercial, financial and technical expertise from the private sector. Risks could be transferred to the private sector, for example the costs related to delays and failure to deliver services to the standard required and potential legislative changes such as in health and safety. The allocation of risks to the party best able to manage them would play a crucial role in determining value for money. The provision of a service or package of services to a school would ease the burden on management and enable it to concentrate on raising levels of educational achievement, thereby increasing efficiency. Competitive pressures in the market place would, it was argued, ensure that the public sector would get a good deal from the private sector. Taken together, these factors would provide better value for money for the LEAs, schools and the taxpayers and more than compensate for the private sector's higher cost of capital, its requirement to make a profit and the high transaction costs.

The policy was therefore part of a wider range of measures that sought to overcome perceived bureaucratic inefficiency by introducing the concepts of the market and private sector management as a general solution to perceived public sector problems. PFI followed measures such as the privatisation of the publicly owned trading enterprises, the outsourcing of non-core services through Compulsory Competitive Tendering, quasi-markets as in the case of the National Health Service, and the provision of services by executive agencies or corporations in the public sector run on commercial lines. Such measures called for a change in the culture of public services, requiring a new balance to be struck between institutional arrangements, emphasising value for money, efficiency and customer service.

But policy promotion of this sort raises questions about how such policies are to be regulated and controlled. Freedland (1998) argues that there is an inner tension within the regulatory framework. At both a micro and macro economic level, governments are expected to exert regulatory control over PFI, which he defines as a process of controlling PFI contracting, independently of the policy which encourages it. The tension arises because governments increasingly strive to engage in positive policy-driven regulation with the result that control has become enmeshed with actively promoting the adoption of policies such as PFI. These two roles, regulation and promotion, are inevitably inconsistent and bring about a certain incoherence and lack of transparency because it is difficult to exert strict regulatory control while at the same time implementing a policy of promoting and encouraging private finance contracting. 'Deep ambiguity' may be introduced into the regulatory process if:

> '…the policy in favour of private financing contracting gets bound up with a strong conviction that such contracting is *intrinsically likely* to be conducive to increased financial efficiency in the provision of public services'. (Freedland 1998, p299) [Emphasis added]

In his view, the Treasury has changed its role. Traditionally it exercised regulatory control that was designed to ensure real expenditures were not obscured nor their consequences inflicted upon successor governments, whereas now it seeks creative ways to facilitate the use of private capital, even if this involves long-term contractual commitments.

This tension is not just confined to the Treasury. The Audit Commission, the government's watchdog for local government and the National Health Service, has flagged its concern that the lack of publicly available finance for conventional public procurement (itself an explicit government policy choice) leads to the selection of projects based upon what can be done under PFI. This may in turn affect policy choices and planning to the detriment of sound planning and financial decision making. It urges those considering PFI to bear in mind:

> "… how PFI relates to the existing planning process and ensure that it should always follow, never drive, the way that planning is undertaken. PFI is a procurement tool only, not a planning tool". (Audit Commission 1998, p 56)

The British government has put in place and number of procedures designed to control and regulate PFI, based upon the requirements that PFI should deliver value for money over the life of the project, transfer risk to the private sector and be affordable (Treasury 1997). These are further elaborated in a fourteen-step process in PFI procurement (Treasury Task Force 1999). There are essentially two kinds of control mechanisms: market forces and accounting methodologies. First market forces provide a measure of control through the requirement to put the contract out to competitive bidding. This is because an identifiable market of private sector bidders, prepared to consider competing for the opportunity to undertake the financing and delivery of the project, provides the best assurance of value for money (Private Finance Panel 1995). Second there is a reliance on accounting and financial information and appraisal as control mechanisms. Despite this, there is mounting evidence that policy promotion does distort and drive the decision making process at the expense of value for money in health and education (Gaffney *et al* 1999a, 1999b, 1999c, Pollock *et al* 1999, Froud and Shaoul 1999, Edwards and Shaoul 2000, Shaoul 1999b, 1999c, Shaoul 2000b, Shaoul and Gaffney 2000). The business cases examined showed that the projects were poor value for money, very expensive, poorly appraised, and would result in service reduction without further government expenditure.

To sum up, there are enormous institutional and economic forces driving this policy, initiated under the value for money and efficiency banner. But the active championship of such a *policy from within government departments and international financial institutions and organisations raises issues about the possible conflict of interest if the same government departments and institutions both promote and control these projects. Thus a series of major research questions focus on:*

- *The nature and objectives of the policy promoters in any specific country or situation;*
- *The decision making and control and appraisal methodologies and processes involved in such policies*
- *The extent to which regulation and accountability is compromised by policy promotion; and*
- *The extent to which the procedures designed to ensure value for money at the point of procurement do in practice deliver the value for money that lies at the heart of the policy rationale.*

SCALE OF PUBLIC SECTOR OUTSOURCING IN THE UK

This section examines the scale and growth of outsourcing in the UK in order to draw out the implications for regulation and accountability. The increase and scale, both actual and potential, of public sector outsourcing in the UK is best demonstrated by recourse to the National Income Blue Book accounts.

Over the last twenty-five years, expenditure on external goods and services for public and social services, (i.e., excluding defence and a few other functions) has risen from £5.6bn in 1997 to £53bn in 1996 without accounting for inflation, as Table 1 shows. As a percentage of annually managed expenditure (excluding capital investment and transfer payments), this has risen from 28% in 1977 to 44% in 1996. By 2000, it is likely to approach 50%. The table shows that wages have fallen correspondingly from 72% in 1977 to 56% in 1996.

Most research to date (Ascher 1987) has focused on the impact of public sector restructuring on public sector costs, employee relations and conditions. The evidence of efficiency savings from contracting out is inconclusive (Cutler and Waine 1994). While there are studies showing savings from contracting out manual services, much of this is due to the reappraisal, redesign and re-specification of the services when they were put out to tender rather than superior private sector work practices *per se*.

Table 1: Changes in the Cost Structure of Public and Social Services

	1977		1986		1996	
(£m)	**Purchases**	**Wage costs**	**Purchases**	**Wage costs**	**Purchases**	**Wage costs**
General Government and social services	5,571	14,209	17,488	32,263	53,013	67,411
As % of operating costs	28%	72%	32%	68%	44%	56%
% Increase 1977-86			214%	144%		
% Increase 1986-96					182%	94%
% Increase 1977-96					786%	374%

Source: UK National Income Blue Book (various years)
This excludes defence, and economic functions

The rest of the savings were achieved by a reduction in jobs, wages and working conditions (Bargaining Report 1990, Treasury 1986) - economy rather than efficiency. Indeed, several commentators, including the Arthur Andersen report on PFI (Arthur Andersen and Enterprise LSE 2000), make the point that with the increase in efficiency achieved by the public sector over the years, there are few operational savings that can be made by the private sector. Other research (Shaoul 1999a), using the national accounts, does not show any savings due to contracting out. Indeed, it suggests that contracting out has proved more expensive. Recalculating public expenditure for 1996, assuming the external purchasing/wages split of 1986 and up to 12% wage increase on 1991 levels for those workers who left the public sector, indicates that public expenditure would have been lower without the increased external procurement. While clearly not definitive, this does mean that the extent of the cost savings is therefore unclear as other previously cited and more detailed studies have shown.

It is worth noting that in the context of developing countries, the Department for International Development (2000) did agree to evaluate the extent to which public procurement is a cost-effective means of influencing social, health, environmental and development outcomes. It also promised to consider how far it would press for this in the EU and wider international discussions on procurement regulations and practice (Cabinet Office 2000).

Table 2 shows the amount spent on external procurement and wages in 1996 and how this has changed over the last twenty-five years for each area of government as defined by the UN. The amount currently spent on wages represents the maximum potential market size at some future date. The table therefore shows the potential additional market in each area. If we consider only public and social services, excluding defence, this was about £67bn in 1996. Capital expenditure accounted for a further £10.465bn in 1996 or 3% of total public expenditure, having fallen from 5% in the 1980s. Thus the actual and potential public sector market is large: an actual market of £53bn and up to £67bn if the entire state bill for public services and capital expenditure were to be opened up to the private sector. Education, health and public order (police, courts, prisons and probation services) are potentially the largest markets for outsourcing.

Table 2: Analysis of Cost Structure by Function

	1977		1986		1996	
(£mn)	**Purchases**	**Wage costs**	**Purchases**	**Wage costs**	**Purchases**	**Wage costs**
General	-247 -0.14%	2,050 114%	-498 -0.12%	4,548 112%	2,303 24%	7,109 76%
Public order	382 20%	1,547 80%	1,343 21%	5,058 78%	3,913 27%	10,386 73%
Education	1,412 22%	4,889 78%	4,828 29%	11,927 71%	15,088 47%	17,308 53%
Health	2,731 43%	3,644 57%	8,013 45%	9,943 55%	19,872 47%	22,404 53%**
Social security	718 39%	1,133 61%	1,939 37%	3,314 63%	6,994 48%	7,667 52%
Housing and community	382 42%	524 58%	1,143 44%	1,456 56%	2,677 67%	1,295 33%
Recreational and cultural	193 31%	422 69%	720 41%	1,017 59%	2,166 64%	1,244 36%
Total public and social services	**5,571** **28%**	**14,209** **72%**	**17,448** **32%**	**37,263** **68%**	**53,013** **44%**	**67,411** **56%**
This omits:						
Defence ***	3,681 54%	3,081 46%	11,278 61%	7,335 39%	12,606 55%	10,502 45%
Other	908 52%	991 48%	1,900 52%	2,068 48%	1,696 20%	6,762 80%
Grand Total	**10,160** **36%**	**18,281** **64%**	**31,662** **40%**	**46,666** **60%**	**67,315** **44%**	**84,675** **56%**

Source: UK National Income Blue Book (various years)
*Notes: * Fuel and Energy - affected by trading revenue and privatisation; ** The data for Health is affected by the fact that the Trusts are classified as public authorities for employment purposes although their operational costs are listed in general government expenditure; A guestimate of £22.4bn seems reasonable here at 53% of operating costs; Negative values indicate net revenues; Increase in purchases and wage costs as a per cent of 1977; *** procurement for Defence is distorted by the fact that the purchase of ALL equipment, however large, counts as procurement not capital expenditure.*

In education, there is as yet relatively little outsourcing but it is one that Capital Strategies, a corporate finance house, believes will grow considerably on the back of a whole raft of government measures and technological developments that will change the way that education will be delivered (Capital Strategies 2000). Such policies include: the use of private contractors to run Education Action Zones and take over 'failing' Local Education Authorities, the fair funding formula that devolves a greater proportion of the schools' budget to the schools to be spent on a wide range of administrative services previously only available to grant Maintained Schools, the transfer of the management of 'failing schools' to the private sector, and the use of the Private Finance Initiative to refurbish and build new schools. Analogous policies exist in health, housing and other areas.

A National Audit Office report (1999) written in the context of the need to secure the £1bn efficiency savings in procurement over three years recommended by the Gershon Report (1999), estimates that £13bn a year is spent on civil procurement. That is about 25% of the amount identified above. Since the NAO figure excludes both defence and health, this still leaves an unexplained gap of about £20bn, which may represent in part at least taxes and other 'non-market' expenditure. Of this £13bn, financial and consultancy services account for £3.3bn, equipment and bulk orders such as paper and furniture £2.7bn, IT equipment and services £2bn, utilities £1.5bn, routine items of low value £0.3bn and other services such as publicity and facilities management (FM) £3.2bn. Of this £13bn, £9bn is classified as strategic procurement and includes goods and services such as major computer systems, £3.7bn as non-strategic and includes high volume items such as travel or freight, and £300m as the routine procurement of low value items. The clear implication is that the overwhelming majority of this expenditure relates to outsourcing, facilities management or bundles of goods and services that could be repackaged into an FM contract.

However, this £13bn leaves out the value of PFI contracts signed since the Labour government came to power. In September 1998, this was reported as £84bn in a wide variety of public services over the life of the projects and corresponded to about £3bn in annual payment per year over the duration of the contracts or about 3% of annually managed expenditure, if military spending is excluded. Since then, this figure has risen with an extra £4bn for local government announced the 2000 Comprehensive Spending Review. Thus the NAO figure considerably underestimates the amount spent and likely to be spent in the future on external procurement.

While these two sources differ in their estimates of the actual and potential size of the public sector market, they point to the large and increasing proportion of public expenditure spent on external procurement. While clearly all external purchases of goods and services by public agencies does not constitute outsourcing, the size of the market is large. It has grown quite considerably and is expected to continue to do so. Total external procurement, including various forms of outsourcing, could take a significant proportion of the 1996 public sector wage bill of £67bn if current policies continue.

It raises questions about transparency and accountability of these new policy measures, particularly the degree to which existing reporting controls and processes, designed in an earlier period to ensure probity and stewardship are appropriate. It raises questions about the definition of what constitutes public expenditure and finance. As the Public Accounts Committee has noted (PAC 2000), the National Audit Office does not have full access to all government expenditure and thus Parliament is less able than in a previous period to scrutinise how the money it sanctions - its key constitutional power - is spent. The increasing fragmentation of public services makes the overall planning and co-ordination of, and accountability for service provision more difficult. Given also that many of these contracted out services are now provided by multinational corporations, increasingly both policy making and control is passing from the national government and its agencies to international corporations.

To sum up, external procurement is already large, at half of annually managed public service expenditure and growing. It is therefore a significant element of public expenditure and implies a need to consider whether procedures designed for ex post facto accountability and regulation when most expenditure activity was carried out 'in house', are still appropriate. A series of research questions arise in the context of developing countries. These focus on:

- *The growth and extent of outsourcing in different functional areas and how it is identified and recorded;*
- *The procedures in place to measure ex post facto value for money and compare against ex ante expectations;*

- *The extent to which external procurement is subject to public audit and parliamentary scrutiny; and*
- *The additional audit problems posed by outsourcing.*

THE FACILITIES MANAGEMENT INDUSTRY IN THE UK

While most of the institutional and research documents focus on the policy and the necessary decision making and appraisal processes in the public sector, there is little discussion about the industry that will provide the services. Yet one of the control mechanisms that is supposed to deliver value for money is a competitive market reading and willing to bid for contracts.

This section therefore reviews some of the characteristics of the facilities management (FM) industry that provides outsourcing services for the public sector and its implications for regulation and accountability. It briefly summarises some of the major findings of one of the few studies that looked at the emerging private sector corporations that now occupy a dominant position in the provision of outsourcing services and that have developed as a result of these new forms of public procurement (Shaoul 2000a). It draws out the implications for public policy.

As one of the fastest growing sectors in the British economy, the business services sector is playing a crucial role in Britain's transformation from a high wage manufacturing economy to a low wage service economy. It is part of the new international division of labour where Africa is designated as a source of cheap raw materials, South-east Asia as a low wage manufacturing base and Western Europe as a low wage service economy. This sector differs from manufacturing in that its profit margins are low but its rate of return on capital employed is high. Hence, its stock market success.

One of the factors that encouraged the growth of the service economy was the positive encouragement given to the development of small start up companies by successive Conservative governments in the 1980s. Such companies necessarily entered markets where the requirement for capital outlay was low: the service sector. Furthermore, the growth of such companies itself created the demand for small office space and ancillary services, leading to the development of serviced office space offering a range of services that such companies could not themselves provide.

The facilities management industry includes subsectors such as building operations and maintenance, property management, support services, IT and telecoms, and the infrastructure industries that includes light rail systems such as Manchester's Metrolink that is outsourced to SERCO, and municipal airports that outsource via PFI type contracts to FM companies. But one factor that does emerge is that the privatisation of the infrastructure industries, and the much delayed investment programmes that followed privatisation and funded via higher prices as in the case of the water and sewerage industries, or subsidies in the case of the railways, has led to new business opportunities. Work that was once carried out in house by the former nationalised industries has since privatisation been subcontracted out. Thus privatisation has not simply created new private sector companies out of the former state owned enterprises. It has also spawned engineering, service and property management companies.

Some companies focus on single service contracting whereby they concentrate on a single type of service such as catering, cleaning or product maintenance. Other companies bring together several different types of services to offer a packaged or multiple service, which they manage. For example, a security company may offer alarm systems, manned services, and electronic entry systems. Management contracting companies provide a mix of delivery and management, which usually means that the purchaser deals with a number of contractors and retains overall management control. Total facilities management refers to those companies that offer a comprehensive range of services for either a specific project or business area and may in turn subcontract some aspects of the work. This will include PFI/PPP contracts. In such cases, the purchaser has no managerial control over the work. In another contracting option whereby companies act as managing agents, they provide a management only service and subcontract the delivery of services, such as property management. Thus the different types of options cover an increasing range or 'package' of services and degree of management. However, while it is possible to define FM companies in these various ways, individual companies do not always fit neatly into one service or category. In practice, FM companies deliver and provide a wide range of services either directly or by sub-contracting with the main emphasis on management rather the activity itself.

The Centre for Facilities Management (CFM 1999) reported the results of a survey of contracts awarded between 1996-98. It made the following points. There was a continuing decline in the number of single service contracts awarded and a big rise in total facilities, management contracting. More than half of the reported contracts provided a wide range of services. As a result of this packaging of services, the value of reported contracts increased, with some valued at more than £100m. This was not confined to the public sector and PFI/PPP deals but reflected an increasing number of PFI-type deals in the private sector as well. More than half the contracts were for between 3 and 5 years and the number of longer term contracts was increasing, indicating a much more secure future for the larger players in the industry and must both reflect and accelerate the concentration within the industry.

Not only had the industry grown but there were numerous mergers and takeovers as companies made acquisitions, diversified and moved in and out of different subsectors. The increasing consolidation in the industry led to a few large corporations dominating the market. In addition many of the key players were non-UK corporations. Several of the major UK corporations had been expanding internationally via acquisitions. In part this is being driven by the longer term contracts of the PFI/PPP type, whether public or private sector, which mean that purchaser will only consider the large, publicly quoted corporations, capable in principle at least of longer term survival over the duration of a thirty year contract. In part it reflects demand from international companies to source from suppliers who can provide a service in all areas that the customer operates. In part it also reflects a belief that the northern European countries, which have come more recently to outsourcing in both the public and private sectors, offer potential growth development.

This in turn means that these newly fragmented public agencies that are often new to contract specification and negotiation are dealing with international corporations that have enormous bargaining power and experience in negotiating contracts. All this in turn raises questions about the success or otherwise, from the public agency's perspective, of these contracts. This includes firstly, the extent of competitive pressure in the market place – since there are few service providers – and therefore their monopsonistic power; and secondly, their ability to monitor performance, enforce standards of performance, terminate contracts that turn out to be unsatisfactory and generally ensure that contracts deliver the value for money that was promised and envisaged at the time of procurement. As public agencies outsource and lose their in house expertise, their dependence upon existing and very powerful suppliers grows, exacerbating the unequal relationship and raising questions as to who really controls public policy making. Yet these are increasingly frontline and often vital statutory services for some of the most vulnerable members of society.

To sum up, the number and size of facilities management corporations are growing. Many are international corporations. The asymmetric power relationship between the public agency and service provider may impact on actual value for money achieved, quality and cost of service provision and control of public policy. A series of research questions therefore focuses on the supply side in developing countries:

- *The structure, concentration and internationalisation of the service provider industry in particular functional areas;*
- *The extent and nature of local commercial providers;*
- *The extent and nature of third sector or not for profit service providers;*
- *The implications of the structure of the industry for competition, its relationship with the public sector, and contract negotiation;*
- *The length and nature of contracts signed;*
- *Contract performance; and*
- *Corporate control of public policy.*

RESEARCH LITERATURE ON REGULATION AND ACCOUNTABILITY ISSUES

The academic research literature as it relates to the developed countries, while not focusing explicitly on regulation and accountability once contract have been signed, has identified a number of issues relating to outsourcing. These include: the nature of contracting; risk transfer; the relationship between the central government and the decentralised decision making units; the nature of control and accountability systems within organisations; performance measurement and monitoring and transparency after financial close. This author has examined: (i) the academic literature and government watchdog reports; (ii) considered how the extensive appraisal process works in practice (Froud and Shaoul 1998); (iii) and reviewed the literature, National Audit Office reports, press clippings and case studies as they relate to the *ex post* facto evaluation elsewhere (Edwards and Shaoul 2001). Some of the issues are summarised here.

(i) The Nature Of Contracting

The nature of contracting is complex and costly because of public sector norms about probity and such formalisation may undermine attempts to achieve value for money and better services. On the other hand, pressures from the private sector bidders for a speedy conclusion to negotiations may mean that the democratic processes are short-circuited and scrutiny may suffer. This raises the possibility that even with formalisation, insufficient control exists. The number of bidders for contracts was insufficient to ensure competitive pressure. It was not unknown for there to be only one bidder to negotiate with.

(ii) Contract Enforcement

The ability to enforce contracts depends upon the specification, validity, reliability, measurement and monitoring of performance. While there has been a huge interest in non-financial performance measurement, this has largely arisen in the context of manufacturing industry. It is less easy to measure performance in the public sector, which is concerned with the delivery of services that are usually statutory and whose characteristics are qualitative and long term. A further difficulty arises because such performance indicators as do exist, have been developed for managerial as opposed to contractual and regulatory purposes. The two do not necessarily sit well together.

(iii) Contract Termination

Contract termination may present problems. The ability to terminate a contract due to unsatisfactory performance depends upon the availability of performance measurements and adequate monitoring. Performance monitoring is costly and needs to be reflected in the overall assessment of the cost of the project. But the ability to terminate in practice may be costly since typically the purchaser may have underwritten the provider's debt in order to make the contract affordable. Alternatively, the purchaser may no longer have the in house capability to carry out the task; the contract may preclude the purchaser from retaining such staff; the provider may control such vital functions that it is impossible to transfer the contract elsewhere. Without the power to terminate a contract, the purchaser has no ultimate sanction to enforce performance standards even where these are measurable and manifestly deficient. Similar processes are at work for the renegotiation of contracts. The ever-increasing concentration in the supply of services and the existing supplier's extensive knowledge of the activity increases the power of the existing supplier over the purchaser. In other words, a monopsonistic position develops.

(iv) Risk Transfer

The notion and practice of risk transfer that lies at the heart of the value for money argument used to justify the policy is problematic. The concept raises issues of definition and measurement that are far from trivial. There are also problems that relate both to the *ex ante* and *ex post facto* transfer of risk.

While the British government intended that outsourcing contracts would transfer risk to the party best able to manage it, the accounting rules, designed to ensure that assets procured under PFI/PPP are off-balance sheet, have encouraged purchasers to try to shift risk onto providers despite the fact that government is usually more able than private providers to bear risk. The higher cost will feed through into more costly fixed price contracts may therefore reduce overall efficiency for public sector organisations. The government considered this off balance sheet treatment was crucial to its strategic plans and consequently to satisfy the government's desire to keep the assets procured under PFI/PPP off balance sheet and comply with the relevant accounting regulation, the public sector organisation must show that risk transfer has occurred. This leads to protracted and costly negotiations Hodges (2000) and an incentive to shift risk onto the private sector whether or not the terms of such risk transfer are attractive in their own right (Mayston 1999).

But despite the requirement to transfer risk to satisfy the accounting regulations for the off balance sheet treatment desired by the government, there are concerns that insufficient risk has been transferred in practice. The allocation of risk will partly depend on the power relations between the contracting bodies. For example, local authorities having fewer social care providers to negotiate with and hence less power relative to their providers, have borne more of the contractual risk (Deakin and Walsh, 1996). In the case of education projects, the main risk, demand risk, remains with the public sector (Edwards and Shaoul 2000). This may be a function of power relations or it may reflect the complexity of the nature of demand. Middleton (1998) argues that demand is much more complicated in the public sector since a free market for the service does not exist. He gives as an example, the case of demand for prison cells, where the social benefit lies in having a facility available for use but not necessarily actually in use.

In the final analysis, the nature of the demand for public services means that the public sector has been unable, for a variety of reasons, to relinquish risk and responsibility for ultimate performance. Ultimately the government cannot avoid political embarrassment and public perceptions of responsibility (Cook 2000) and may end up footing the bill when things go wrong. In the case of the failed computer systems for the Passport Agency and Benefits Agency, it proved impossible to obtain substantive redress via the contract, although in the case of the Passport Agency, an *ex gratia* payment was made (Shaoul 2000b). In the case of the Benefits Agency computer system, it was the claimants and the government that bore the cost. Interestingly in the case of the Passport Agency, the government was able to shunt the cost of failure onto the travelling public by increasing the cost of the passport. Either way, it is a travesty of the notion of risk transfer.

Ciancanelli (2000) identifies the public sector as a guarantor of last resort. The requirement for the public agency to provide the service is often a statutory one for which there is no commercial substitute. At the very least, such services are usually essential services as opposed to optional extras. She suggests that this in turn raises important questions about the kind of information which such a guarantor needs to monitor the potentially risky behaviour of the private sector.

(v) Centralised Decentralisation

Researchers have identified a number of inter-related problems that raise issues of accountability and flow from the centralised decentralisation associated with outsourcing: the loss of visibility, the evasion of political responsibility, greater difficulty in co-ordinating and planning public services, and the loss of democratic involvement and control.

(vi) Information and Dissemination

Several commentators argue either implicitly or explicitly that new forms of information and dissemination are needed. Accounting in local government had primarily played a narrow stewardship role aiming to prevent fraud and the misappropriation of funds (Pendlebury, 1994), and a similar role may also be identified in central government. Consequently, the control mechanisms and accountability systems were not designed for either the decision-making or control roles envisioned in the new accounting and contracting models (Seal, 1999). In the specific case of the introduction of white-collar compulsory competitive tendering, Seal (1999) argues that there was a lack of data about support service costs so that a key part of the implementation process was the development of a new internal accounting framework. Similarly, Hilton (2000) argues that systems were previously designed to control *ex ante* intentions and were supportive of high standards of public probity. As such they tended to minimise personal incentives and to dissipate decision- making authority. Standards of materiality were set with taxpayers' sensitivities in mind. Hilton argues that although under the new procurement regime, VFM is highly prized, current probity regulations act as a constraint on VFM. While new models of control and accountability are required, any alternative model of control needs to demonstrate how high levels of effective decentralised decision making can be sustained alongside high standards of public probity (Hilton, 2000).

(vii) Audit Issues

While government procedures call for outsourcing contract to be evaluated, it is far from clear how this is to be done, and the role of the external audit. In the case of the Public Health Laboratory that had outsourced its financial management, the contractor, a subsidiary of one of the large international firms, had failed to carry out very basic internal control procedures, such as bank reconciliation. Thus there was a failure to carry out the basic tasks implicit in financial management that could have led to fraud and mismanagement. This only came to public attention when the National Audit Office as auditor published the annual report. (NAO 2000).

A number of inter-related issues arise. The first relates to how any failure is detected, reported and acted upon. The problem came to public attention via the audit due to the nature of the failure and the contract (financial management), but not all failures will. Secondly there are a series of issues related to the annual audit. Where the nature of the contract is crucial to the work of the agency and/or involves a significant financial outlay, the contract clearly needs to be included in the audit. But a problem arises if it is small relative to overall income. If commercial auditors had carried out the audit and identified the problem identified in the audit report, it may not have been detected, reported or published. Furthermore it is unclear the extent to which it is a function of the audit process to check the actual payments on an outsourcing contract against the contractual arrangements, which would provide some assurance of *ex post* value for money. Given that most contracts link the fee to performance measures, this would require the auditors to extend their role to a non-financial audit. Thus in the absence of an annual audit that includes a review of outsourcing and checks the independence, validity and accuracy of the performance indicators, it is difficult to see how VFM is to be ascertained.

To sum up, these experiences in Britain, a country that has had a long tradition of public sector probity and accountability, indicate that the adoption of such policies in developing countries where these traditions are less developed are likely to be very problematic. A number of research issues follow from this that include a review and comparison against their equivalents in the UK:

- *The ex ante appraisal procedures;*
- *The operation of such procedures in practice;*
- *The contractual arrangements and legal documents and comparison with those of HM Treasury, with specific reference to penalties and contract termination;*
- *The extent to which (and how) performance monitoring is included in the contract;*
- *The extent to which evidence exists as to the performance of such contracts and factors affecting performance;*
- *Any ex post facto evaluative procedures;*
- *The extent of ex post facto public audit and scrutiny of external procurement and finances.*

CONCLUSION

This paper has examined a range of issues derived from a wide variety of literatures. It has highlighted a number of factors that are likely to limit the ability of these new forms of public procurement to deliver the value for money that was promised or even detect whether in reality (as opposed to the estimates made at the time of procurement) value for money has been achieved in the UK. Despite the lack of evidence that these policies achieve their stated objectives, they are being exported around the globe.

Traditionally the Treasury exercised regulatory control to ensure that real expenditures were not obscured and their consequences were not unreasonably borne by future governments and generations of taxpayers. Now the Treasury is promoting a policy whose long term costs are not entirely clear and which locks public agencies into long term financial obligations and contracts that tightly define the method of service delivery thereby restricting flexibility and the ability to respond to changing circumstances. It is therefore difficult to avoid the conclusion that the championing of outsourcing and PFI/PPP compromises regulatory control and accountability processes. Without an analysis of these important issues in the context of developing countries, it is unclear the extent to which their export to and implementation in developing countries can be justified.

Irrespective of whether these policies deliver value for money, the fragmentation of the public sector, the espousal of a business ethos and the reconstitution of public services as commodities to be purchased from the private sector raise questions as to the degree to which the public agencies and the political institutions and processes any longer have effective control and regulatory power over the services they are funding. In other words, outsourcing to powerful international corporations gives them control not only of commodity production but also essential social and public services without the commensurate responsibility and accountability. It has the potential to remove the basis for democratic control and accountability at both local and national level and control the direction of future public policy.

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