Outsourcing in the Public Sector: a Value for Money perspective

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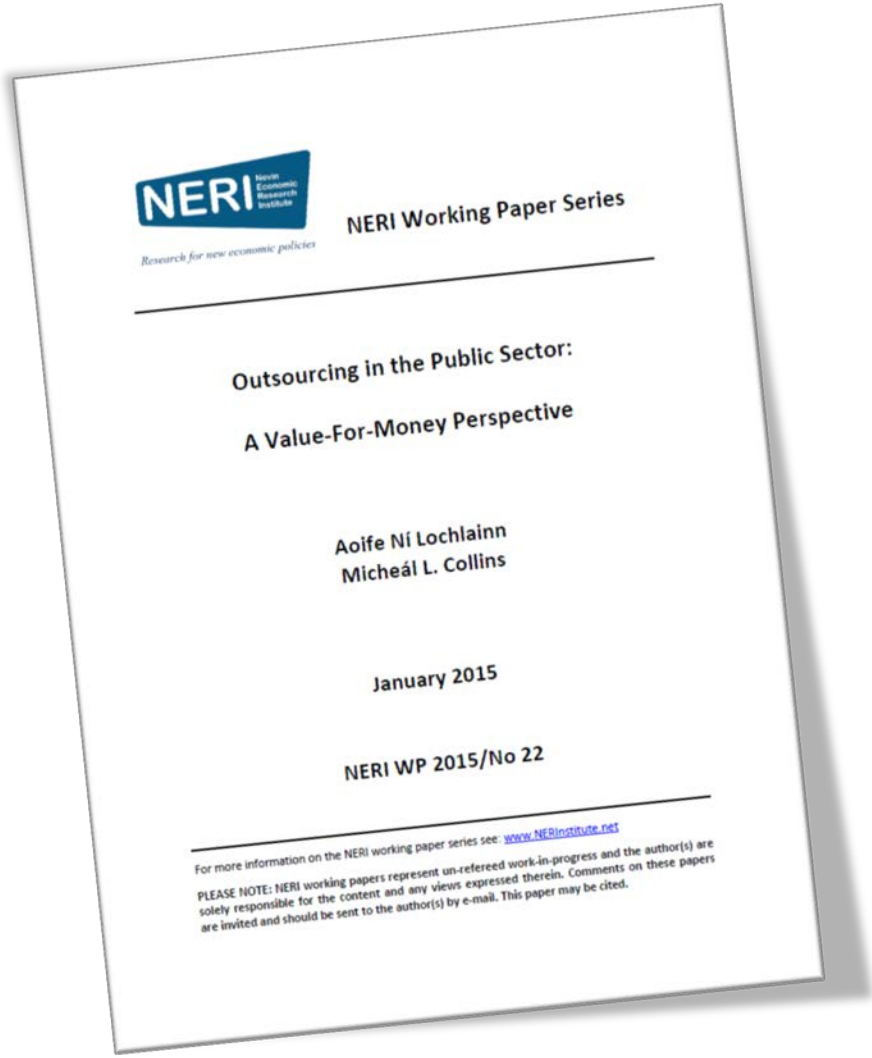
Research for new economic policies

Outline

1. Context
2. Evaluating Outsourcing Options
3. Outsourcing and Value for Money
4. Lessons from Recent Trends
5. Conclusion

- Accompanying NERI Working Paper
- Comments etc welcome
- *Research inBrief* in the weeks to come


NERI Working Paper Series

Outsourcing in the Public Sector:

A Value-For-Money Perspective

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1. Context

- A growing trend – why?
    - budget pressures
    - perceived savings
    - ideological views
- However
    - difference between knee-jerk versus sober assessments
    - important decisions
    - perspective of the state
    - necessitate evaluation and comprehensive consideration
    - anxious to point towards the need for this
- Given scale – the focus of a research project

2. Evaluating Outsourcing Options

- ‘Value for Money’
- What does this mean?
  - There is an established framework
  - International literature and national guidelines
  - At the core of assessments = the aim of providers
    - Private sector = profit
    - Public sector = cost, quality and performance
    - Not-for-profit = cost, quality and performance

Value for Money – Three E's

Economy

- "reducing cost of resources used"
- "securing the appropriate quality of inputs at the best price"

Efficiency

- "increasing output for a given input or minimising input for a given output"
- "optimising the ratios of inputs to outputs"

Effectiveness

- "successfully achieving the intended outcomes from an activity"
- "extent to which the objectives have been achieved and the planned benefits delivered"

Source: OECD (2012), Department of Finance (2007)

The Fourth E

Equity

- Effectiveness
  - Particularly challenging for the Public Sector
    - Objectives can be obvious, but can also be broadly defined
    - Uncertainty…
    - For some services, advances via survey methods (Watson, 2013)…but, are people sure of what they want…
    - Ambitious versus easy…
    - underscores, need for clarity on rational for a public service

3. Outsourcing & VFM

Economy

"The cost effectiveness of this mode of supply is no longer the subject of serious debate" (Domberger and Hensher, 1993)

- Initial reduction in cost for contracting authority
- Reduction in cost can be eroded over time, following contracting periods
- Risk of market concentration over time

Economy

“The cost effectiveness of this mode of supply is no longer the subject of serious debate” (Domberger and Hensher, 1993)

Early studies:

- Borcherding, Pommerehne and Schneider (1980s) (“unequivocally more efficient” – over 50 studies from US, Germany, Canada, Australia and Switzerland)
- Savas, 1987; (“most authoritative, empirical studies”, US)
- Boyne, 1998 (40 studies – UK)
- Domberger and Rimmer, 1994
- Domberger and Jensen, 1997
- Domberger, 2001
- Domberger Hall and Li, 1995 (competition rather than ownership)

Economy

More recent studies:

- Blom-Hansen, 2002
  - (Scandinavia: mixed, large cost savings in waste and old age care sector, road maintenance – tempered by lack of competition – waste collection in Sweden, public provision had lower costs)
- Bel and Costas, 2006
  - (Spain, waste sector, no difference in cost – high levels of market concentration – Inter-municipal co-operation as alternative reform)
- Hodge, 1999
  - (post out-sourcing monitoring, 3% to 20% of costs, rarely measured)
- Bisman, 2008
  - (Australia – transaction costs ignored in estimation – savings “anecdotal or illusory rather than evidentiary)

Economy

Balance of research

- Supports outsourcing but is not equivocal
- Extent of savings varied
- Competition rather than ownership
- All costs must be measured

It is not a permanent optimum

(Bel and Costas, 2006)

. . . no useful 'rule of thumb' exists on the size of the probable impact of [outsourcing] on the costs of delivery. Rather, it appears each instance contains its own unique characteristics which influence its success or otherwise (in cost terms)

(Australian review of 203 international studies).

Efficiency

- Inputs and outputs difficult to measure

- Evidence of efficiency gains, but…
  - Bel and Costas, 2006 (Spain, waste collection, ownership not important, inter-municipal co-operation more efficient)
  - Warner and Bel, 2008 (benefits of mixed firms)
  - Warner, 2008 (US, high level of monitoring needed)

- Reductions in real wages = efficiency gain?

  OR transfer in economic rent from worker to manager…no net social benefit
  - Domberger, Jensen and Stonecash, 2002 (Military workshop – increased efficiency through reduction in capital, new technology and worker slack, administrative versus warehouse wage inequality increases)
  - Ryan, 2005 (Australia, building maintenance, increased efficiency through reduction in wages and conditions, increase in wage inequality)

- Evidence of price increases for customers leading to re-municipalisation

Effectiveness

- What really makes public services different…
- Difficult to monitor
- It is possible to maintain effectiveness through monitoring?
- Importance of contract design
- Effective monitoring requires skills and resources
- Costs and role for the state (should) continue

4. Lessons from Recent Trends

- A noticeable trend towards insourcing in a number of countries
- Interesting to examine this and assess why?
- Offers lessons to countries like Ireland at the start of the process…
- Just a few examples from the literature:

Public Services Insourced

- Public transport
- Waste management
- Cleaning
- Housing
- Security

Reasons Why?

- Cost savings
- Effectiveness
- Control
- Private failure

Public Services Insourced

- Electricity
- Waste management
- Housing

Reasons Why?

- Cost savings
- Effectiveness
- Control (policy)
- Private failure
- Citizen support

Public Services Insourced

- Waste management
- Water

Reasons Why?

- Cost savings
- Effectiveness
- Control
- Private failure
- Citizen support

An overview (2002-07):

- insourcing of municipal services ↑ from 11% to 18%
- new contracting-out ↓ from 18% to 12%
- Public provision of services remained at 44%

Reasons Why?

- Effectiveness
- Cost savings
- Citizen/public support

5. Conclusion

- Advantages to being behind trends elsewhere
  - Lessons to learn
- Key one: from the perspective of the state
  - a need to properly evaluate decisions such as outsourcing
- Need also for a clear rationale for outsourcing
- Not a simple decision
- Need to look across all three VFM elements
  - Now and over time

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