

NERI Research inBrief

March 2015 (no 19)

Outsourcing and Value for Money

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ISSN 2009-5848

SUMMARY

Public sector outsourcing is the process of contracting out a service or a function to another body, such as street cleaning or internal IT services.

Over recent years considerations of outsourcing have gained added attention, driven by pressures on government budgets, perceptions of savings from its adoption and, in some cases, ideological views. However, we argue in this NERI Research *inBrief* (and in the accompanying research paper) that considerations of outsourcing need to be grounded in a thorough assessment of the implications for the state of its adoption. Such assessments should be comprehensive, capturing immediate and longer term impacts, and framed using the Value For Money framework.

KEY POINTS

- There are advantages for Ireland in lagging trends elsewhere on outsourcing.
- In particular, there are lessons to be learnt from experiences in other countries.
- A key lesson is the need for the state to properly evaluate any decision to outsource a public service.
- Recent trends in other countries, to re-municipalise, or insource, previously outsourced services further highlights the need for detailed evaluation.
- The VFM framework allows for the appropriate consideration and analysis of evidence.
- Used to aid decision-making, the VFM methodology facilitates a balanced approach to such assessments and promotes a whole of economy and society approach.

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Research for new economic policies

Public sector outsourcing is the process of contracting out a service or a function to another body, such as street cleaning or internal IT services. While outsourcing is frequently understood to mean contracting out to the private sector, services and functions can also be outsourced from one public body to another public body or to a non-profit making organisation. It often includes the transfer of management functions for the delivery of the service.

While outsourcing has been utilised as a mechanism for public sector provision, particularly at the local government/municipal level in many countries, there is little consensus on whether or not it is of overall benefit and what level of reductions in government expenditure it might bring.

Over recent years considerations of outsourcing have gained added attention, driven by pressures on government budgets, perceptions of savings from its adoption and, in some cases, ideological views. However, we argue in this *inBrief* (and in the accompanying research paper) that considerations of outsourcing need to be grounded in a thorough assessment of the implications for the state of its adoption. Such assessments should be comprehensive, capturing immediate and longer term impacts, and framed using the Value For Money (VFM) framework.

The Emergence of Outsourcing

Internationally, outsourcing initially focused on what might be regarded as straightforward tasks, such as cleaning and waste collection, but has since been used to provide more complex services. According to its advocates, outsourcing allows the government to retain overall control over the quality of service through contract specification, monitoring and evaluation of performance (Jensen and Stonecash, 2005). Unlike the privatisation of assets, outsourcing is easier to reverse.

The public sector provides services for the wellbeing of the general public where, for example, it is believed that the private market cannot adequately do so. Thus there

are greater risks associated with outsourcing in the public sector than the private sector; reduction of government control, the creation of powerful players in the market who may gain leverage over the sector, and the worsening of employment patterns in a sector, which leads to a decline in skills and training and development (Harland *et.al.*, 2005). The possibility of declining working conditions has been a major concern of unions and of civil society organisations, who regularly compile reports on how outsourcing may negatively impact on pay and conditions.

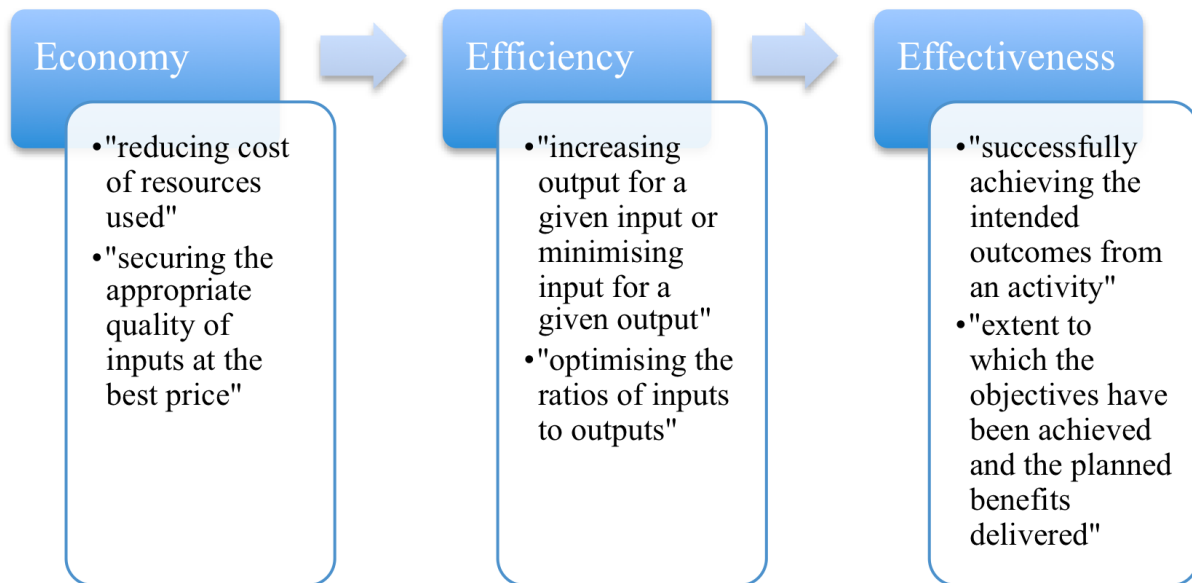
If any important public service is outsourced to the private sector, and that deliverer fails, the state will more than likely have to step back in, at least temporarily, meaning it often remains the supplier of last resort.

Outsourcing and Value for Money

Value for Money (VFM) is a concept which is generally understood to mean delivering the best results from a project or an activity through the most efficient use of resources (OECD, 2012). The use of VFM has become more prominent in recent years, due to the need to demonstrate that public money is being spent optimally.

VFM draws on assessments based on three criteria, **Economy**, **Efficiency** and **Effectiveness** (the three E's). Economy is a measure of the cost of inputs into the production or delivery of a good/ service/ activity. In the case of outsourcing of public services, Economy measures the costs to Government of procuring the service delivery. Efficiency measures productivity, how much is delivered for every unit input. Efficiency is increased through increasing the level of output per unit input or decreasing the level of input per unit output. Effectiveness can be measured quantitatively or qualitatively, thus making it the most difficult and fraught criteria to measure. Effectiveness is concerned with ensuring that the quality of outcomes as determined by the intended objectives, are not diminished.

Chart 1: Value for Money – the Three E's



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

The use of VFM must strike a balance between all criteria. It can be considered as a "way of thinking" about the use of resources rather than merely "a tool or method" (OECD, 2012). Striking the appropriate balance between the three E's is important, especially in the public sector, where quality and performance are essential (Visconti, 2014).

Chart 1, drawing on documents from the Department of Finance and the OECD, provides some definitions for the three criteria.

VFM Evidence on Outsourcing

Based on the many published papers on this topic (reviewed in the accompanying research paper), it is clear that the evidence on **Economy**, while not unequivocal, nevertheless supports the contention that outsourcing leads to reduction in costs for the Government. However, these results are not generalisable and there is no 'rule of thumb' on the expected magnitude of reductions, which are dependent on the unique characteristics of both the service and the contracting and competitive environment. Some analysis suggests that cost savings may erode over time as market concentration occurs.

As is the case with the privatisation of assets, the evidence also supports the idea

that it is competition, rather than ownership *per se* that is responsible for any increase in **Efficiency**. Ensuring continued efficiency requires constant monitoring, which in turn incurs costs for the state.

The extent to which cost savings are due to a diminution in wages and employment conditions is frequently investigated and while there are studies which have found negligible reductions for workers, on balance, the burden of cost reductions has fallen on workers. Some critics question whether savings achieved through reductions in wages and terms and conditions can be viewed as an increase in efficiency.

Finally, there is no consensus on the impact of outsourcing on **Effectiveness**. Difficult to measure and make comparisons between, effectiveness can be analysed both quantitatively and qualitatively. This means that reporting on quality of service can often be subjective and the results of some influential studies have been questioned on the basis that they did not take the possibility of respondent bias into account.

Lessons from Recent Trends

Given that Ireland's experience of outsourcing follows that of numerous other countries, there is merit in exploring the recent experiences of those countries and

Table 1: Trends in Re-municipalisation and insourcing in selected countries

Cost Savings & Efficiency Water services/ France Public transport/ France Electricity/ Germany Waste services/ UK IT services/ UK Housing, building services and maintenance / UK Security/ UK Highways, Public transport / UK Corporate services/ UK Cleaning/ Finland	Private Sector Failure Water services/ France Public transport/ UK Electricity/ Germany Water services/ Hungary	Control/Public Policy Aims Electricity/ Germany Water services/ France Waste services/ UK Education and social care/ UK IT services/ UK Highways/ UK Economic dev. services/ UK Building maintenance/ UK Corporate services/ UK
Employment Building maintenance/ UK Leisure services/ UK Building services/ UK Corporate services/ UK	Effectiveness Waste services, street cleaning/ UK Education/ UK IT services/ UK Housing, building services and maintenance / UK Security/ UK Highways/ UK Economic dev. services/ UK Corporate services/ UK Cleaning/ Finland	Contract Expiry Water services/ France Waste services, street cleansing, housing, building services and maintenance, IT, catering/ UK Highways/ UK Public Transport/ UK Corporate services/ UK Electricity/ Germany

Source: Table based on Hall (2012) supplemented by Hall, Lobina and Terhorst (2013) and Unison, (2011)

drawing lessons from them. Most notable in recent years has been a trend to reverse outsourcing (re-municipalisation or insourcing). A number of these recent experiences are summarised in table 1

What is striking from the table, and the re-municipalisation literature in general, is that many of the reasons why services have been returned to the public sector are the same as those used to justify outsourcing in the first place. Across many countries the potential for cost savings, further efficiency gains, more effective delivery of services, greater accountability and civic control have driven the return of services to public sector provision. The failure of commercial private operators, and the need for the state to step in and then provide the service, has also been a part of this trend.

Conclusion

There are advantages for Ireland in lagging trends elsewhere on outsourcing. In particular, there are lessons to be learnt from these experiences. A key one is the need for the state to properly evaluate any decision to outsource a public service. The

VFM framework allows for the consideration and analysis of evidence through focusing on three main criteria, **Economy**, **Efficiency** and **Effectiveness**. It highlights the complexity of decision-making on outsourcing and argues that the merits, risks and rational for outsourcing should be assessed in a comprehensive way.

Used to aid decision-making the VFM methodology facilitates a balanced approach to such assessments and promotes a whole of economy and society approach.

References

This *Research inBrief* summarises an accompanying *NERI Working Paper* which provides further details. That paper includes details of the references cited above and is available on the institute's website. Its reference is: Ní Lochlainn, Aoife and Micheál L. Collins, (2015) 'Outsourcing in the Public Sector: a value-for-money perspective' *NERI Working Paper*, 2015/22.

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