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Outsourcing in the Public Sector: A Value-For-Money Perspective

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ABSTRACT

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.

This paper examines the evidence on outsourcing through the framework of Value for Money (VFM). This 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 and risks of contracting-out should be assessed in a comprehensive way. Used to aid decision-making on activities, projects and policies the paper argues that the VFM methodology allows the reviewer to take a balanced approach to such assessments. By not prioritising one criterion over another, VFM promotes a whole of economy and society approach.

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INTRODUCTION

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 (Moschuris and Kondylis, 2006)¹. Outsourcing is considered a form of privatisation by some, as the “residual gains from the process accrue to the private provider even though the government retains control of elements of the service delivery” (Bel and Costas, 2006). Others prefer to differentiate it from “privatisation”, as a transfer of asset ownership does not take place (Jensen and Stonecash, 2005). Hodge (1999) describes the “roots of contracting out” as stemming from the privatisation movement, particularly in the US and the UK: in the latter, introductory competitive tendering was a key component of the Thatcher government’s privatisation programme.

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 (Jensen and Stonecash, 2005). 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.²

Services contracted can be simple or complex. The outsourcing of complex public services, such as can be found in the health or IT sectors, in particular has attracted criticism (Cordella and

¹ The following terms can also be referred to as outsourcing, “subcontracting, contracting out, staff augmentation, flexible staffing, employee leasing, professional services, contract programming, consulting and contract services” (Moschuris and Kondylis, 2006).

² See for example Huw and Podro (2012).

Willcocks, 2010). Krugman (2003) focuses on the military service sector and its role in Iraq, where significant services have been outsourced to private military contractors leading to a “logistical mess” and private failure. Cordella and Willcocks (2010) note the mixed record of IT outsourcing in the 1990s in the public sector in the UK, including some high profile examples such as the Child Support Agency and the Wessex Regional Health Authority. They suggest that this “mixed record” seems to have extended into the 2000-2009 period with other high profile projects or agencies/service such as the National Identity card and NHS (Cordella and Willcocks, 2010). On the other hand, there are numerous studies which provide positive evidence on the efficiency of outsourcing in various public sectors and services (Moschuris and Kondylis, 2006; Jensen and Stonecash, 2005; Domberger, 2001; Blom-Hansen, 2003). While there is strong evidence of the reduction in costs for government, there is less agreement on where those savings are drawn from. Are cost savings made through increased efficiency or through transferring the “cost burden” from government to employees and service users (Fraser and Quiggin, 1999)?

This paper will examine the evidence on outsourcing through the framework of Value for Money (VFM). This framework allows for the consideration and analysis of evidence through focusing on three main criteria, *Economy, Efficiency and Effectiveness*.

The paper is structured as follows: The first section will briefly outline the main theories which have been advanced to support private ownership and outsourcing. The paper will then address the concept of Value for Money and its use in the assessment of policy proposals. The third section will examine evidence on outsourcing through the framework of VFM and the final section takes a look at international trends in outsourcing, insourcing and re-municipalisation. This paper highlights the complexity of decision-making on outsourcing and argues that the merits and risks of contracting-out should be assessed in a comprehensive way.

THEORETICAL BASIS FOR OUTSOURCING

Whether outsourcing is considered a form of privatisation or not, theories advanced to advocate its use as a policy instrument draw on similar themes, namely, the existence of competition, incentives and the profit motive, and the lack of political interference (Bel and Costas, 2006; Jensen and Stonecash, 2005). According to Jensen and Stonecash, much of the empirical work on outsourcing is inconclusive on whether or not these are the only factors at play and that as yet, no generalisable theory of outsourcing exists. Rather, each outsourcing exercise and its success or failure will depend on the specific characteristics of the service concerned and its environment (Jensen and Stonecash, 2005).

In assessing the role of the state in service delivery, advocates of privatisation/outsourcing argue that a distinction should be made between the provision of public services and the production of public services. The former being a clear example of government responsibility and the latter being more suited to the private sector (Blom-Hansen, 2002). This view of the state as “enabler” rather than “provider” underpinned outsourcing policy in the UK in the 1990s (Cordella and Willcocks, 2010: 83). Theoretical explanations for the superiority of the private production of services usually rest on two main factors, ownership and competition (Domberger and Jensen, 1997; Blom-Hansen, 2002). Outsourcing of public services found particular favour in the 1980s. However, it has been argued that the policy rationale for

government outsourcing during this time was influenced by political concerns rather than purely ideological ones (Hefetz and Warner, 2008). More recent work on the topic has suggested decisions to outsource became more “pragmatic”, rather than “ideological” (Bel and Costas, 2006). The ownership factor is based on the assumption that private ownership will result in more efficient production.³

Economic theory on privatisation developed in the latter half of the previous century, in tandem with the spread and acceleration of privatisation policies (Florio, 2004). Principal-agent theory provided the main rationale for privatisation, supported by theories on Government failure from a public choice perspective and property rights advocates (Cook and Fabella, 2002). Arguments emanating from property rights advocates point to the lack of incentives for public servants and bureaucrats to operate efficiently. Rather, they are incentivised to operate on their own behalf, pursuing their own interests and manipulating the power of the state to that end. As public servants may not feel the consequences of their own decisions, they are not public-interest maximisers (De Alessi, 1987). Broad public-service objectives and soft budget constraints provide no incentive to perform well and lack the threat of bankruptcy and thus job loss (Jensen and Stonecash, 2005).

Principal-agent literature is also concerned with incentives. Public servants are not the beneficiaries of any increases in company value and thus lack the profit motive. This means that they have no incentive to minimise waste and operate the company/service efficiently (Jensen and Stonecash, 2005; Schleifer, 1998). Public choice theory, as developed by Buchanan and Tullock in the 1960s argues that all agents and parties to a decision operate from financial self-interest (Buchanan and Tullock, 1962). Thus, bureaucrats make decisions based on their own self-interest rather than the need to make a profit. Political decision-making may also act against the public interest and may not reflect the public will, due to corruption and possible capture by sectional interests. On the other-hand, governments are also incentivised to increase efficiency in public companies and providers due to the pressures of regular elections.⁴ More explicitly, political objectives such as the widening of the private sector and the shrinking of the role of the state are voiced by Virginian public choice advocates and found political support in the 1980s governments of Thatcher and Reagan in particular.

The assumption that public servants or politicians behave on the basis of self-interest and allow greed or laziness determine their decisions has been challenged in the literature. They may be “imperfect public-interest maximisers”, but to assume that there is no place for “enlightened public intervention” demonstrates a bias and should in fact be an empirical question rather than a theoretical assumption (Willner and Parker, 2007).

The competition argument has also provided theoretical justification for outsourcing (Blom-Hansen, 2002; Bel and Costas, 2006, Warner and Hefetz, 2008). Opening up a service to competitive tendering exerts pressure to maximise efficiency and thus increase performance (Blom-Hansen, 2002).

³ Mulreany (1999:6) provides a good explanation of the distinction between productive and allocative efficiency and its relevance to the debate on privatisation. For example, where a public monopoly becomes a private monopoly, it may “bring improved productive efficiency but reduced allocative efficiency and the overall effect on efficiency will depend on the relative size of these countervailing effects”.

⁴ Palcic and Reeves (2011) provide a good outline of the theory on privatisation.

Transaction cost theory, which provides an important factor in the theoretical basis of outsourcing (Bisman, 2008), is concerned with the type of service, asset specificity and the nature of the contract (Warner and Hefetz, 2008). Also important is the nature of the risks of contracting where no competitive marketplace exists or where monopolies are likely to develop (Bel and Costas, 2006). Transaction costs include administration costs, monitoring costs⁵ and costs which arise from asymmetric information and opportunistic behaviour (Paroush and Prager, 1999).

As will be discussed in later sections, there is significant empirical evidence to support the theory that outsourcing can reduce costs to Government. The magnitude of these costs, how they are attained and whether they endure, provoke much debate. Whether or not these cost savings are at the expense of quality of service is also topic of discussion. However, while there is broad agreement on the incidence of cost savings, the empirical evidence does not support the view that private sector organisations are inherently more efficient (Jensen and Stonecash, 2005). Jeffreys (2012) argues that given the decades of outsourcing, there should be greater evidence to support the theoretical debate on outsourcing.

While there is evidence to suggest that efficiency is greater in private sector production, it is spread and the analysis is complicated by the difficulties in comparing production in the two sectors (Hodge, 1999). There are also few studies which have examined the impact of outsourcing over time (Jeffreys, 2012). Methodological problems arising from differences in how outsourcing is defined and statistics collected internationally and the difficulty in making comparisons over time in enough identical organisations which outsource some services and not others lead Jeffreys (2012) to argue that “it must also be considered possible that the absence of solid evidence proving the advantages of outsourcing is because the much vaunted advantages are few and far between” (Jeffreys, 2012).

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 (OCED, 2012). VFM can be used to guide decisions on whether or not to outsource a public service (Visconti, 2014) and to make comparisons between providers. The use of VFM has become more prominent in recent years, due to the need to demonstrate that public money is being spent optimally. Sectors such as international development, which are heavily dependent on public support, have been increasingly using VFM to demonstrate that public money is being spent wisely and to provide evidence of the effectiveness of their programmes to sceptics (OECD, 2012).

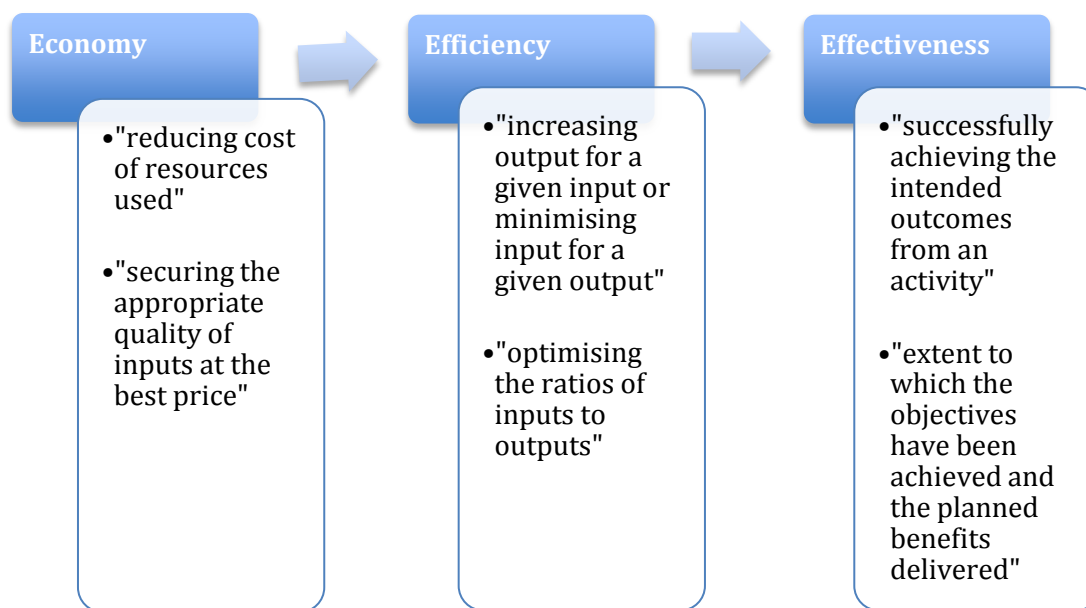
VFM draws on assessments based on three criteria, *Economy*, *Efficiency* and *Effectiveness* (the three E's). Economy is a measure of the cost of inputs into the production or delivery of a good/service/activity. In the case of outsourcing of public services, Economy measures the costs to Government 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

⁵ Monitoring costs can also be referred to as conversion costs (Smirnova and Leland (2014)

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 (ITAD, 2010).

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). The goals and thus strategies of public and private organisations are different, with the latter aiming to create private value and the former aiming to create public value (Cordella and Willcocks, 2010). Therefore, it is important to distinguish between the use of VFM in the public sector and in the private sector, in particular in sectors such as healthcare, which may place a greater emphasis on quality and performance. Visconti (2014) draws a distinction between how quality is considered in the public and private sector. In the latter it can be viewed as a cost. Assessing VFM in the same manner in both may lead to “suboptimal contracting”. Cordella and Willcocks (2010) argue that despite the “all too many government-inspired documents already issued on Value for Money”, public value is much more difficult to define than private value. Private value can be determined through financial measurements, whereas public value relates to effectiveness and the achievement of public goals (Cordella and Willcocks, 2010).

Figure 1: Value for Money – The three E’s



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

VFM analysis often uses quantitative data or tools, such as cost-benefit or cost effectiveness analysis but it is not obligatory and qualitative analysis is often utilised where numerical data is not available or not suitable (OECD, 2012). VFM is most effective when it can be used to assess an activity/programme against stated and intended objectives. However, it can be difficult to

isolate and specify objectives in public sector organisations. Like ‘public value’, “objectives such as promoting the public interest are difficult to pin down” (Mulreany, 1999: 12). The possibility of multiple objectives, the relative importance of each one and the relationship between them also complicates the evaluation process. Where objectives are more easily attainable, an organisation can appear more effective, especially in comparison with an organisation whose objectives are more difficult, or in some cases conflicting⁶ (Mulreany, 1999).

Equity is often included in the criteria and is sometimes referred to as “the fourth E” (OECD, 2012; Pobal, n.d.). In this paper equity will be not considered separately. Figure 1, drawing on documents from the Department of Finance and the OECD, provides some definitions for the three criteria.

As mentioned above, VFM cannot be reduced to one element, such as Economy; rather it must reflect a balance between the three dimensions. As should be clear from Figure 1, both the Economy and Efficiency criteria feed into Effectiveness. Concentrating on making improvements to one criteria without due regard for the possible negative effects on another criteria could risk undermining VFM. For example, if costs were to be reduced at the expense of Effectiveness, VFM would be weakened (OECD, 2012). To help clarify the relationship between Effectiveness and Economy and Efficiency, the OECD (2012) has set out a number of questions (Figure 2) which can guide analysis.

Figure 2: Economy and Efficiency considerations as part of VFM

Economy	Can we get the same or equivalent inputs for less money? Would using cheaper inputs risk the effectiveness including sustainability? Would using cheaper inputs risk greater maintenance costs over the life of the project?
Efficiency	Can we get the same results while saving on how we manage the activities? Would making savings to how the project is managed risk reducing effectiveness including sustainability? Would making savings on how the project is managed risk incurring other costs?

Source: OECD (2012)

As part of the Irish Government’s Value for Money and Policy Review Initiative, Government departments undertake VFM reviews in order to analyse Exchequer spending and aid better decision-making (Department of Finance, 2007). The Guidance Manual for conducting reviews sets out five criteria for evaluation. These include the three established VFM criteria of

⁶ E.g. a state owned enterprise which may have both economic and social goals (Mulreany, 1999).

Economy, Efficiency and Effectiveness although Economy is considered under the Efficiency criterion. The three E's are supplemented by Rationale, Impact and Continued Relevance.

Rationale requires consideration of why a particular policy or intervention might be necessary. Here the objectives of the intervention are made clear. A common rationale for policy intervention is the existence of market failure (Department of Finance, 2007). As will be seen in a later section, the existence of market failure has led to re-municipalisation of services in many countries.

Impact refers to the wider effects of the policy or programme on a sector or on society as a whole. Related to effectiveness, it evaluates the longer-term positive or negative impacts of the policy or programme on the targeted beneficiaries and beyond, to wider society. The Continued Relevance criterion considers whether or not the programme or policy continues to meet its objectives and whether or not those objectives are still valid (Department of Finance, 2007).

While the latter three criteria are important for the consideration of many public policy decisions and programmes, they will not be used for the purposes of this paper. However, in making a decision whether or not to outsource or to in-source, they could prove valuable.⁷

ANALYSING OUTSOURCING UNDER VALUE FOR MONEY

The following sections analyse the evidence on outsourcing in the public sector using the three E criteria described above. As discussed above, VFM requires a balance between the criteria, and while in the private sector efficiency is often the most important criterion when assessing VFM, in the public sector, the criteria of economy and effectiveness are equally important.

Economy

Early studies on costs savings and outsourcing to private firms showed a positive relation between the two (e.g. Savas, 1987; Domberger and Rimmer, 1994; Domberger and Jensen, 1997; Domberger, 2001)⁸. The increase in the use of competitive tendering and outsourcing and the growing number of studies which confirmed costs savings for government led Domberger and Hensher to argue in 1993, that “the cost effectiveness of this mode of supply is no longer the subject of serious debate” (Domberger and Hensher, 1993) However, more recent empirical work has delivered more nuanced evidence (e.g. Hodge, 1999). Current research has revealed more mixed evidence on costs savings and suggests that they can vary depending on the characteristics of the service and level of competition (Bel and Costas, 2006, Bel, Fageda and Warner, 2010).

A number of large-scale surveys in the 1980s and 1990s sought to answer the question of whether private sector involvement in public service delivery led to cost savings for Government. An early 1980s paper by Borchering, Pommerehne and Schneider surveyed over 50 studies from the US, Germany, Canada, Australia and Switzerland, leading to results that

⁷ Additional considerations addressed in the Guidance Manual which could prove helpful when evaluating service delivery in the public sector are Poverty Impact Assessments, Rural Proofing and Equality Proofing, which could contribute to analysis under the Equity criterion.

⁸ As detailed by Bel and Costas, (2006). See also Clegg, Burdon and Nikolova, (2005)

provided evidence to show that private provision of services was “unequivocally more efficient” than public provision (Blom-Hansen, 2002: 420). Another 1980s survey by Savas, evaluates the “most authoritative, empirical studies”, primarily from the US, and also concluded that the private sector was more efficient (Blom-Hansen, 2002). A study by Domberger and Jensen in the 1990s, which surveyed research on contracting out in English-speaking countries, supported the conclusions of the earlier studies and reported that the cost savings to Government are “substantial” (Hensen, 2002). Finally, a 1998 survey by Boyne of approximately 40 studies on competitive tendering and outsourcing in the UK and the US came to similar conclusions, that competition and contracting out led to cost savings for government (Hensen, 2002). In a study⁹ on school cleaning services in New South Wales, Domberger, Hall and Li (1995) found that while competitive tendering generally lowered prices, the ownership of the contractor had little effect on prices; rather it was the competitive process itself which had led to lower costs. Thus, the earlier studies presented strong evidence of the potential for outsourcing to bring cost savings for Government, while later studies challenged the near universal evidence and opinion on the prevalence, scale and nature of cost savings.

Analysing cost reductions in outsourcing can be extremely difficult, partly due to the lack of data on public sector inputs and outputs (Jensen and Stonecash, 2005). Indirect costs and transaction costs for contract specification and for tendering and monitoring also need to be accounted for, as they should assist in determining whether or not a service should be contracted out (Bisman, 2008). However, even though difficulties in obtaining comparable data exist, there are many studies on whether or not outsourcing has led to any measurable reductions in government expenditure. The most common areas of research are the waste and cleaning sectors, primarily due to the fact they are the most common services to be outsourced. But the inputs and outputs in these sectors are more easily compared (Jensen and Stonecash, 2005). A meta-analysis of research in the cleaning, waste and transport services found that the majority of papers reported evidence of expenditure reductions (Jensen and Stonecash, 2005). However, there were also studies which demonstrated that cost savings had been overstated and in some cases costs had actually increased.

Bisman (2008) examines what is referred to as the ‘Golden Era’ of outsourcing in Australia (mid-1990s-2000) and finds that transaction costs were ignored in estimations and that the *ex-post* economy of outsourcing decisions was rarely evaluated. “These findings strongly suggest that claimed cost savings from outsourcing by Australian PSOs [public sector organisations] in the ‘golden era’ were anecdotal or illusory, rather than evidentiary” (Bisman, 2008). Hodge (1999) argues that post-outsourcing monitoring costs are rarely measured and estimates of such costs range from 3 percent to 20 percent.

Two studies on outsourced waste collection in the US, drawing on the same data and controlling for twelve service characteristics, including frequency of collection, volume of waste and wages, compared the cost savings from awarding a contract to a private companies and awarding a contract to in-house teams found that the private operators achieved average cost savings of 22 per cent while the public operators achieved savings of 17 per cent (Jensen and Stonecash, 2005). This points to the importance of competition in the reduction of costs rather than just ownership *per se*.

⁹ This study is detailed in a later section.

Much of the literature concentrates on regions where outsourcing is common, such as the UK, US and Australia. Hensen (2002) notes the general lack of attention in research in the area in Scandinavia, where the public sector is larger, and thus the potential for cost savings from contracting out are greater. However, there a number of Scandinavian studies which confirm the results of the larger surveys mentioned above (Hensen, (2002). Thirteen studies on municipal old age care in Sweden found cost reductions with no reduction in quality. The outsourcing of school cleaning in 189 municipalities in Denmark resulted in cost savings of up to 30 percent. A survey conducted by the five Nordic national competition authorities found evidence of large cost savings for government in the outsourcing of waste collection and old age care sectors (Hensen, 2002). However, there were also studies which challenged these results. A 2000 study on waste collection in 115 Swedish municipalities concluded that the public provision had lower costs than private provision. Another study on contracting out old age care in six Swedish municipalities found the evidence to be inconclusive (Hensen, 2002). An analysis of road maintenance in 275 Danish municipalities by Hensen supported the conclusions of the studies above, that significant savings to government could be made through outsourcing. However, the level of savings was tempered by the low level of competition in the sector and “tacit collusion” among companies operating in the sector (Hensen, 20002). Local public service markets are prone to concentration, which in turn can lead to competition failures (Warner and Bel, 2008).

The persistence of savings gained from outsourcing over time has been challenged by some (Kodrzcki, 1994; Ballard and Warner, 2000) and the erosion of savings seems to be particularly prevalent in small contacting authorities (e.g. smaller municipalities). Bel and Costas (2006) suggest that this implies that there may be potential benefits to privatisation initially but that as a reform, “it is not a permanent optimum”.

An empirical analysis of waste collection services in Spain found that there were no differences in costs paid by municipalities of private or public production (Bel and Costas, 2006). As ownership had no effect on cost, what other explanations for differences in costs to municipalities existed? The authors analysed post-outsourcing market dynamics and non-privatising management reforms. They concluded that high levels of market concentration made it difficult for governments to achieve “actual benefits” from outsourcing and that cost savings can be made through inter-municipal cooperation through achieving scale economies, in particular where population levels were low. Inter-municipal cooperation is generally undertaken where provision of services is public; therefore, such cooperation can be seen as an effective public sector reform alternative to outsourcing (Bel and Costas, 2006).

The balance of research in the main supports the conclusion that outsourcing reduces government expenditure (Jensen and Stonecash, 2005). This result is upheld up by a 1996 Australian review of 203 international studies in government outsourcing, which concluded that although the majority of studies found savings, the extent of these savings was varied and in some cases there were instances of cost increases (Jensen and Stonecash, 2005). The report found that:

... 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) (Quoted in Jensen and Stonecash, 2005: 722).

Efficiency

As discussed in the section above, inputs and outputs in the public sector are difficult to measure, making efficiency improvements or reductions difficult to substantiate (Jensen and Stonecash, 2005). This partly reflects the fact that many outputs in the public sector are shared outputs, and while accounting practices have improved in some countries with the introduction of activity-based costing, this is still a wide-spread problem when attempting to calculate and compare productivity. Added to this is the problem of assessing tax payments and determining the cost of capital for public sector organisations (Jensen and Stonecash, 2005). The quality and service characteristics may not be comparable either, especially in more complex outsourced services. Thus inputs and service outputs in outsourced and in-house services may not be comparable.

Research in the US has shown that local governments only experienced efficiency gains from privatising services when accompanied by a high level of monitoring (Warner, 2008). Studies on privatisation of services at the municipal level show inconsistent results and some authors have attributed this to the high level of transaction costs of contracting. The costs of contracting and of monitoring were higher than had been previously anticipated (Warner, 2008).

Research in Spain has found no “significant differences” in terms of efficiency between public and private operators of waste, water and other sectors (PSIRU, 2010: 10). In a further focus on the provision of waste collection services in rural areas, the study found that while outsourcing did not reduce costs, inter-municipal co-operation increased efficiency and also effectiveness (PSIRU, 2010). In larger Spanish municipalities (over 50,000 inhabitants), there were no differences in efficiency in street cleaning and waste collection services between public and private providers (PSIRU, 2010). Research conducted by Bel and Mur (2009) established that while ownership did not bring any significant differences in cost, inter-municipal co-operation was found to decrease costs in municipalities with smaller populations.

By law, municipalities in Spain are required to provide most local services. Provision includes pure public and pure private direct provision, mixed public-private provision, publically-owned firms and mixed public-private firms (Warner and Bel, 2008). Private firms, publically-owned firms and mixed public-private firms all operate under private commercial law, giving them greater flexibility in management, wages etc., than direct public provision. Public firms, for example, are often used in large and medium-sized cities for the provision of waste and water services. In the case of mixed-public-private firms, the Government retains a controlling stake and partners with a private firm which has a “solid position” in the market for the particular service (Warner and Bel, 2008). This organisational form is thus a joint venture, undertaken between the government and the private firm usually on a long-term contract. According to Warner and Bel (2008), this allows for the provision of economies of scale. The government remains in control of the strategic decisions and the private firm runs the day-to-day operations. In the case of some mixed firms, the government holds a small number of shares, giving the private firm more control over strategic decisions but the local government still has the benefit of easier access to information. Both forms of mixed firm provide the benefits of lower transaction costs and lower monitoring costs. Theory on part-privatisation holds that a mixed firm will take broader government objectives into account and will give less weight to profit maximisation (Warner and Bel, 2008).

In a study of the outsourcing of warehouse and workshop functions in the military, Domberger, Jensen and Stonecash (2002) seek to ascertain the source of the cost savings and assess the extent to which the cost savings are the result of greater efficiency on the part of the private provider, or merely through the reduction of terms and conditions of employment. In this study, they were able to analyse the cost savings over a number of years, to ensure that they assessed the evidence over the lifetime of the contract. This allowed them to incorporate transaction costs, both one-off and ongoing, such as monitoring and contract management costs (Domberger, Jensen and Stonecash, 2002).

The study found that in the first year post-outsourcing, costs were reduced by 37 percent. However, this decreased to 24 percent when the contract variations over the life of the contract were taken into account. Changes in the fixed price charged by the contractors over the period of the contract might be evidence of 'hold-up' on the part of the private company, but overall, the source of the savings was found to be a reduction in capital and labour slack and use of new technology. This suggests an increase in efficiency post-outsourcing (Domberger, Jensen and Stonecash, 2002).

Overall, following outsourcing, there was a significant level of labour shedding, with employment falling from 140 personnel to 84 and a decrease in the total wage bill of 41 percent. There were also changes to the terms and conditions of employment, with wages per hour falling for both warehouse and workshop personnel of 16.5 percent and 11 percent respectively. However, wages in the administrative section increased by 16.8 percent. Thus, post-outsourcing, there was a change in the distribution of salaries. The authors did not show the salaries of the highest paid individuals for confidentiality reasons, but they did concede that the managers post-outsourcing received a much higher salary than their public sector equivalent (Domberger, Jensen and Stonecash, 2002). Worker share of outputs declined while management share increased, pointing to a transfer in benefit from workers to management. In conclusion, the authors found that the reduction in cost was 23 per cent attributable to technological change and 77 percent attributable to labour shedding and reductions in wages.

The net fiscal benefit for outsourcing for governments is generally believed to be positive. However, while theory may hold that outsourcing offers a Pareto improvement, evidence suggests that there are often losers as well as winners (Ryan, *et.al.*, 2005). If lower costs are achieved through lower working standards and a reduction in real wages for workers, it has been argued that this represents a transfer of economic rent from workers to managers and cannot be considered an efficiency gain (Quiggin (1994). In this case, that outsourcing may not yield net social benefit. Quiggin (2002) argues that the majority of savings from contracting out come at the expense of workers or reductions in the quality of service.

Whether or not outsourcing leads to a reduction in employee terms and conditions is a key debate (Domberger, Hall and Li, 1995, Domberger, Jensen and Stonecash, 2002; Quiggin, 2004; Ryan, *et.al.*, 2005). Public sector job losses can occur but according to Domberger, Hall and Li (1995) are often be matched by increases in the private sector. Ryan, *et.al.* (2005) conducted a case study on outsourcing in building maintenance services in Western Australia to assess the impact of contracting out on the wages and conditions of workers. The outsourcing achieved relatively modest cost savings of between 6 and 6.5 per cent. These cost savings to Government were estimated to be the result of a reduction in the fees charged for maintenance, a reduction in the direct project related costs and a reduction in wages (Ryan, *et.al.*, 2005). Existing staff that

had been transferred to the private company had their wages and conditions maintained until the contract had run out, at which stage the company could negotiate new wages and conditions. The transfer from the public to the private sector came at a cost for some workers, in particular, the blue collar workers, whose wages and conditions declined. Some white collar workers, on the other hand, benefitted through increased opportunities for promotion. This difference in experience was explained through examining the labour market, as there was little competition for the highly skilled white collar workers they fared better than the lower skilled blue collar workers who faced intense competition during this period (Ryan, *et.al.*, 2005). Contracting out can also negatively affect the skills development of the staff, restricting training opportunities and leading to a net loss in industry skills. (Ryan, *et.al.*, 2005). Research conducted by Fernandez, Smith and Wenger (2006) provide evidence of a negative impact on public employment due to outsourcing. While this, they argue, could be described as supporting “conventional wisdom” on the topic, more surprisingly is the positive impact of outsourcing on part-time public employment. In their research, the composition of the workforce was altered by outsourcing with a growth in part-time public employment and a decline in full-time employment (Fernandez, Smith and Wenger, 2005). While Quiggin criticises the shedding of labour and reduction of wages as a transfer in economic rent, Domberger has contended that where wage reductions occur due to outsourcing, this may be “socially desirable” (Ryan, *et.al.*, 2005).

Effectiveness

Of the three E's, effectiveness is probably the most difficult to measure, particularly in the public sector. Goods are more easily evaluated than services. Service quality monitoring may be undertaken by examining a number of performance characteristics. But the assessment of these characteristics can often require subjective judgement, rather than the collection of data which can be subsequently analysed. Analysing effectiveness as part of VFM can take the form of quantitative or qualitative analysis (OECD, 2012). While quality is the most obvious of the elements which make up effectiveness, equity and accountability can also be considered as part of VFM.

In the case of quality, the evidence remains mixed. This is compounded by the difficulties in measuring quality. In some cases it has been argued that the more complex the service, the more difficult to both measure effectiveness and achieve a high quality at a low cost. Krugman (2004), for example, focuses on outsourcing in the US military, which has been widely used in Iraq, where he argues that the private companies have failed to achieve quality at the promised lower cost. Cordella and Willcocks (2010) argue that market-based mechanisms are effective where the complexity of the service and specificity of the resources are low, where they are not, outsourcing may increase the administrative complexity of service delivery, thus decreasing both efficiency and effectiveness. Research on the privatisation of nursing homes in the US found a drop in quality following ownership change and argued that concerns that lower costs are achieved at the expense of quality of service “may be justified” (Amirkhanyan, 2008: 675). The multiplicity of objectives and complex nature of such services mean that evaluation methodologies and measurements must be sophisticated.

Following a significant level of research on the cost effectiveness of competitive tendering and outsourcing in the 1980s and early 1990s, critics turned to the issue of effectiveness, or quality of service. Earlier research on effectiveness had been confined to anecdotal evidence (Domberger and Hensher, 1993). Domberger and Hensher attempted to address this lack of evidence in 1993 with a study on the performance of outsourced school cleaning contractors in New South Wales. In this research, Domberger and Hensher define 'performance' as "compliance with contract specification, public perception of service quality and other qualitative measures of service characteristics" (Domberger and Hensher, 1993: 441-2).

Outsourcing involves making two major decisions, the first is the decision on whether or not to contract out, and the second is decision on how to structure the contract in order to ensure a high performance over its lifetime (Domberger and Hensher, 1993). While the decision to contract out might be taken on the basis of a comparison of cost between the private and public providers, the decision on how to structure the contract requires a more complex assessment based on at least four elements. The first is the need to develop strict specifications for the service being outsourced. The second is the selection of the winning bid, which may not be one with the lowest cost, as this may hamper quality of service. The trade-off between price and quality is not easily determined in the bidding process (Domberger, Hall and Li, 1995). The third element is the creation of a monitoring system, including the collection and interpretation of data and the fourth is the creation of an enforcement mechanism, with the requisite penalties for poor performance or breach of contract (Domberger and Hensher, 1993). Under a highly competitive system, the relationship between the successful bidder and the public sector contractee could fall into the principal-agent problem, where contractor may have little incentive to maintain standards where the profit margin is slim. Asymmetric information from the contractor means that effective monitoring and enforcement systems must be put in place. Criteria for assisting in decision-making at the contracting stage which include the possibility of contractor deception have been developed by Paroush and Prager (1999). In this model, the contracting agency will only contract out where the cost savings are higher than the optimal monitoring expenses, including possible fines and expected losses deriving from contractor deception.

A later paper by Domberger, Hal and Li (1995) on the outsourcing of school cleaning in New South Wales was critiqued by Fraser and Quiggin in 1999 and compared with the results of two other studies on the same outsourced services in order to examine and assess the possibility of bias in the measuring of standards of quality by survey and interview. Results from the various studies that they analysed were mixed, with some finding deterioration in the quality of services and others finding no statistically significant change (Fraser and Quiggin, 1999). However, comparing the results of different studies is hampered by the fact that few of them focus on the same contracting process. The Domberger, Hall and Li (1995) study on cleaning services in schools and hospitals is an exception. In this case the authors were able to control for contract and industry characteristics. The study concluded that controlling for these factors, competitive tendering generally brought cost savings to government while maintaining quality of service (Domberger, Hall and Li, 1995). However, contrasting evidence from two separate studies in the same region surveying cleaners and principals found the opposite, service quality declined following outsourcing. According to Fraser and Quiggin (1999), few studies had allowed for the possibility of bias in the responses.

As contracting out can lead to income transfers between workers and service users to contractors and government, any analysis of the evidence on quality of service should take incentive effects into account. Fraser and Quiggin (1999) argue that one of the earlier studies on the outsourcing of cleaning service to schools may be biased due to the possible attempts by contractors to mislead inspectors on service quality. By the same token, they argue that evidence from the surveys of school principals and cleaners could be biased by the opposition of teacher unions to outsourcing and the decline in wages and conditions of cleaners.

The three surveys on the outsourcing of school cleaning in New South Wales examined by Fraser and Quiggin provide a good opportunity to compare both the source of cost reduction and the possible impact on quality. Outsourced in 1992, the contracts for school cleaning were put out to competitive tender. In the first two years of the process, the Government Cleaning Service remained as service provider to a proportion of the schools, but in 1994 all of the schools were put out to tender and the public provider was prohibited from competing with the private firms. The majority of contracts were awarded to three major contractors. In most cases, the employees were transferred from the Government Cleaning Service to the private contractor (Fraser and Quiggin, 1999).

The first study, conducted by Domberger, Hall and Li (1995) focused on the first two years of the outsourcing process and compared the service provided by the Government Cleaning Service with that provided by the private contractors. The study recorded a reduction in cost of approximately 50 percent and a rise in quality of 35 percent in special schools following the introduction of tendering. In other schools the reduction in cost was around 49 percent but there was no statistically significant change in quality (Fraser and Quiggin, 1999).

Evidence recorded in a survey by Fraser (1997) points to incentives to increase quality prior to the inspections, for which the cleaners had advanced notice. The company under study was responding to monitoring by ensuring that the standard was higher prior to inspection through incentivising its employees. This calls into question the results obtained in the earlier study. The initial study, (Domberger, Hall and Li, 1995) was intended to feed into the policy process. According to Fraser and Quiggin, this provided a further incentive to the private companies to ensure that the standard of cleaning on inspection was high. The incentive to increase quality prior to inspection and “manipulate” the results did not exist for the cleaners who remained employed by the public provider (Fraser and Quiggin, 1999).

In research commissioned by the Commonwealth Bureau of Immigration, Multicultural and Population Research, Fraser (1997), surveyed 45 school cleaners to assess the impact of outsourcing on non-native English speakers. The results were in stark contrast to those reported in the earlier study. Questioned on changes in service quality, 72 percent of respondents reported a deterioration and 10 reported no change or don't know. Only one respondent reported an improvement in quality.

The cost savings noted by Domberger, Hall and Li were primarily achieved through an increase in work intensity, a reduction in the number of paid hours of cleaning. Cleaning services are, by their nature, labour intensive and the rates of pay may be externally determined (e.g. minimum wage) thus the easiest way to reduce costs in these situations is through a reduction in hours worked. Of the cleaners surveyed by Fraser, 80 percent reported a reduction in the numbers of cleaners employed post-outsourcing and 48 per cent noted a reduction in hours. All

respondents reported an increased workload and unpaid work increased from 30 percent pre-outsourcing to 60 percent post-outsourcing.

According to Fraser and Quiggin, the latter study by Egan, Montesin and Adana is least likely to have been affected by respondent bias as the cleaning services were not paid for directly by the school and they would only benefit by a rise in service quality. While all three studies are open to bias, the results demonstrate the subjectivity of measuring quality and even where an objective rise in quality may be observed, service users themselves may not experience a rise in satisfaction. The three studies also support findings in other research, which has found that reductions in costs to government often come from a reduction in wages per worker effort. These savings in wage costs accrue to the contracting authority and the contractor.

The argument that quality may deteriorate when a service is privatised (known as the quality shading hypothesis) is based on a number of assumptions. (I) That the employee is required to carry out a number of tasks and will prioritise that one which is more easily measured and rewarded. This leads to the employee increasing productivity by increasing production at the expense of quality. (II) While a private firm has more incentives to both reduce costs and improve quality, but the cost reduction incentive may be greater than the quality incentive is the latter is more difficult to measure and in particular to specify in a contract. In this case, a contractor might be able to cut quality without detection by the state. However, while there have been studies which have found some evidence of quality shading, there is little agreement on the quality shading hypothesis (Jensen and Stonecash, 2005).

Therefore, like the other two criteria, there is no consensus on whether or not contracting out can lead to a decrease in quality of service. There is evidence to support both sides. An Australian Industry of Commerce report in the 1990s found evidence of both improvements and reductions in quality but concluded that the reduction in quality could have been caused by poor contract specifications and inadequate performance monitoring.

Thus in order to ensure continued quality and effectiveness following outsourcing, the state must ensure that the contracts are adequately specified and that it engages in constant monitoring and evaluation. Both of these require the retention or recruitment of skilled staff and resources within the public sector. It is not the case that once outsourced the state can retreat from its responsibility to effectively monitor and ensure high quality service provision. The role of the state and the costs to the state continue post-contracting out¹⁰. As can be seen in the section on re-municipalisation below, where there is private failure of a large magnitude, the state may be forced to terminate the contract and possibly re-municipalise or contract-in the service. Thus, the state can be seen as a 'provider of last resort'.

Choice and Voice

One of the main arguments for the use of a market-based system in the delivery of government services advanced by its supporters is that it would give the consumer choice and voice

¹⁰ As noted by Bisman (2008), and as mentioned in the section on *Economy*, evaluations can understate or even ignore the cost of monitoring and administering contracts (transaction costs). A Danish analysis of the results of 80 different studies on the impacts of outsourcing found that many studies fail to properly account for transaction costs (Jeffreys, 2012).

(Mulgan, 1997; Warner, 2008, Warner and Hefetz, 2012). As elections occur relatively infrequently, giving 'consumer citizens' market choice and the ability to 'shop for services' in a privatised/outsourced system should theoretically provide them with a more frequent voice. However, empirical analysis of the contracting of services in US municipalities showed that consumer voice was lower in municipalities where privatisation/outsourcing was more prevalent. Outsourcing of services demands a contract between the purchaser (government) and a supplier, or small group of suppliers and in most cases the citizen is not privy to the choice of providers or the contract (Warner, 2008), thus depriving him/her of voice.

Where citizens are not privy to contract details there can be a loss of accountability. Mulgan (1997) argues that at best outsourcing involves "a trade-off between efficiency and accountability" but at worst it involves a loss of both (Mulgan, 1997: 107). Accountability in this case is defined as "the obligation of subordinates to account to their superiors for the performance of particular duties and to accept direction from the superiors of such duties" (Mulgan, 1997: 107). Public officials are the people's representatives and as such are accountable to the people through ministerial and parliamentary oversight. This political oversight is usually supported by independent state bodies, such as the ombudsman or auditors. Critics of outsourcing claim that service users are seen as customers rather than citizens. Obligations of public accountability are diminished following outsourcing as the public is no longer an owner of the service to whom the service providers should ultimately be accountable. If service users complain about the quality of a service, once the contract has been fulfilled, the service provider has no further obligations thus leaving the service user with no further possibility of redress (Mulgan, 1997). This point is emphasised in research on privatisation of schools in New York, where private providers are operating with minimal political oversight and citizen input but in collusion with the private companies who fund them (DiMartino and Scott, 2012). In addition, where markets lack the elements necessarily for the protection of consumer and human rights, e.g. whistle-blower legislation, democratic voice maybe undermined (Hefetz and Warner, 2012). Warner and Hefetz (2008) on the other hand, argue that mixed delivery, between public and private organisations if properly conducted, can address some of the accountability concerns, allowing benchmarking, and thus transparency, between both providers.

Section Conclusion

As discussed above, what differentiates the public from the private sector in the VFM process is its focus on quality and effectiveness rather than on profit maximisation and demands a balance between the three VFM criteria.

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 and contractors engage in 'hold up'. The tendency of local public service markets to become more concentrated has also been noted.

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 a cost. In some cases, especially where populations are dispersed, inter-municipal cooperation can be more efficient than private delivery. Transaction costs, including the ongoing cost of monitoring, can erode any cost savings. Mixed public-private firms can provide the benefits of outsourcing with the added benefit of decreased transaction costs.

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.

RECENT TRENDS IN OUTSOURCING, INSOURCING AND RE-MUNICIPALISATION

The section above described the trend in the latter half of the twentieth century towards outsourcing/contracting out, in particular in municipalities. Recent years have seen reversals in that trend as expected efficiencies failed to be delivered and/or concerns over quality of service, equity and voice increased (Warner, 2008; Hall, Lobina and Terhorst, 2012). Compulsory competitive tendering in the UK and Australia was abolished and US local authority managers began to bring contracted services back in-house. Governmental reform in this area focused, not on reinstating the public monopoly but on restructuring local markets, managing monopoly and reducing transaction costs (Warner, 2008). Re-municipalisation, has increased across Europe, in particular in the water and energy sectors but also in other sectors such as waste and public transport (Hall, Lobina and Terhorst, 2012; Hall, 2012). A study of over 100 municipalities in Germany in 2011 found that there is a trend towards increased public provision of service (Hall, 2012). In times of fiscal contraction, municipalities in the UK are cutting costs through bringing some services back 'in-house' (Hall, 2012).

However, where there is no difference in cost between in-house and outsourced services, authorities may not be inclined to contract in. Smirnova and Leland address contracting out in the public transportation sector and find that even when outsourcing does not bring the promised cost savings, services are not brought back in-house (Smirnova and Leland, 2014). This can be attributed to transaction and conversion costs, i.e. the cost of contracting, monitoring and establishing performance benchmarks, which may generate risk adverse behaviour in contracting authorities (Smirnova and Leland, 2014). Path dependency and the cost of building new relationships with new service providers can dissuade an agency

from switching provider, even where there are sound cost reasons for doing so (Smirnova and Leland, 2014).

Where no formal decision is made to either continue contracting-out or to re-municipalise, it can sometimes be the case that the broader aim of ensuring a balance between increasing efficiency and other public interest objectives such as social wellbeing are formally introduced into service provision decisions and often procurement practices which allow for public sector organisations or non-for-profits compete with private providers. Examples of this can be found in New Zealand and the UK, both of which were early adopters of outsourcing policies.

The extent of monitoring has also been found to influence whether or not a government agent will continue to contract-out or decide to contract-in (Hefetz and Warner, 2004). The higher the level of monitoring, the more likely contracting out will continue and the lower the level, the more likely a decision will be made to contract back-in.

Re-municipalisation has become an important topic for trade unions and think tanks interested in public administration, governance and the public/private ownership debate. This section draws upon a number of recent publications outlining the trend towards re-municipalisation. Table 1 below was created by Hall, (2012) and shows the sectors and countries where re-municipalisation has occurred and the factors which precipitated it.

TABLE 1: Trends in re-municipalisation

Sector	Process	Country	Factor
Water	Municipalisation of services	France Hungary	Private Failure Cost Control Contract expiry
Electricity	New municipal company Nationalisation	Germany	Private Failure Cost Control Contract expiry
Public Transport	Municipalisation of contracts and concessions	UK France	Cost Private Failure Public policy objectives Control
Waste Management	Insourcing Inter-municipal co-operation	Germany UK France	Cost Control Contract Expiry
Cleaning	Insourcing	UK Finland	Cost Effectiveness Employment Contract expiry
Housing	Insourcing	UK Germany	Cost Effectiveness

Source: Hall (2012)

France

Since 2000, there has been an observable trend in the re-municipalisation of water services in France (Hall, Lobina and Terhorst, 2012). Water services are predominantly private, with up to 75 percent of the population serviced by private companies in 2000, higher than any other European country other than the UK. Water services are under the responsibility of the municipalities, which sometimes combine to form inter-municipal authorities. These municipalities or inter-municipal authorities can decide to provide the service publically through a direct public organisation or, privately, through tendering the service. The market is highly concentrated and dominated by two French multinationals, Veolia and Suez (Hall, Lobina and Terhorst, 2012). However, since 2000, 16 municipalities/inter-municipalities have replaced privately contracted companies with public sector organisations (Hall, Lobina and Terhorst, 2012).

The first re-municipalisation in this period occurred following a political corruption scandal involving a local politician and the water services company. Public concern at the lack of transparency and accusations of over-charging were reinforced by a public auditors report on the water sector (Hall, Lobina and Terhorst, 2012). Many of the cases of re-municipalisation occurred following the expiration of a private sector contract, thus ensuring that there was no compensation or penalty paid for the breaking of a contract. The most significant case was that of Paris, which chose to re-municipalise following the expiration of 25 year contracts with Veolia and Suez. A major motive for re-municipalisation was the price of water, which had doubled in real terms (allowing for inflation). The nature of the contracts, which included allowing the companies award construction and other contracts to their subsidiaries, and the lack of transparency contributed to the desire to turn to public provision (Hall, Lobina and Terhorst, 2012). Thus, the re-municipalisation brought cost savings that were greater than had been predicted. While there was a one-off transaction cost of 15 percent of annual revenues, but even taking this into account, the city saved around €35 million in the first year, which allowed it to reduce the tariff by 8 percent (Hall, Lobina and Terhorst, 2012).

Discussions on prices and accounting practices led to debates in many French municipalities and while some of them opted to discontinue private provision, others decided to continue with private contractors. According to Hall, Lobina and Terhorst (2012), the political composition of the municipalities was a determining factor in whether or not they chose to re-municipalise or continue with private provision.

As mentioned above, since 2000, 16 municipalities have taken water into public hands. Examining the policy decisions by the 12 largest water services in France, they found that 11 of these were originally wholly or partially private. Five of these have moved to a wholly public or higher proportion of public provision and none has moved from public to private provision (Hall, Lobina and Terhorst, 2012). While there is a trend towards public provision, private provision remains 'popular'.

The drivers of re-municipalisation were: The widespread public dissatisfaction over the prices charged by private water companies" reinforced by a lack of competition, perceived and proven corruption and lack of transparency (Hall, Lobina and Terhorst, 2012). Private provision in 2009 charged prices at an average of 31 percent higher than public providers. A study in 2006 found that private provision led to charges that were 17 percent higher than public provision

and a consumers' association found that the highest profit margins were recorded by private providers and the lowest by public providers.

The expiry of a good number of contracts around 2010 provided municipalities with the opportunity to re-municipalise without need for compensation or to demand lower prices from private providers where contracts were being extended (Hall, Lobina and Terhorst, 2012). A newly created opportunity (2010 legislation) to form inter-municipal public companies has allowed municipalities to replace private provision with public provision in water and other public services.

Germany

There is also a growing trend towards re-municipalisation in Germany, confirmed by a 2011 study by Leipzig University (Hall, 2012). This recent trend in contracting in of services in Germany has been mainly driven by concerns over a lack of cost savings, effectiveness and an increase in user prices, especially in the transport sector.

The electricity sector, however, is where the strongest evidence of the re-municipalisation trend is to be found. This sector developed over the past century from an initial mix of public and private companies. These municipal companies (stadtwerke) often started out as multi-service utilities, providing water, gas electricity, public transport etc. During the 1990s, many of the remaining publicly owned stadtwerke were privatised and two major German multinational companies emerged, E.on. and RWE. Market concentration dominated the electricity generation and over 80 percent of electricity was provided by just four companies. However, since 2000, a trend of re-municipalisation has emerged, with the creation of more than 60 new municipal utilities and over 190 energy concessions have passed into public ownership (Hall, Lobina and Terhorst, 2012). Many municipalities are insourcing concessions once contracts have expired. The trend towards greater public ownership and provision of electricity is expected to continue and perhaps accelerate (Hall, Lobina and Terhorst, 2012).

One of the drivers of these actions is the desire to have a greater control over local energy policy, in particular, a public desire to focus on the development of renewable energy, in which the private sector was uninterested investing. There was also a public and political acknowledgement that the municipalities were losing out of possibility of raising revenue through the energy companies. If these were in public/community hands, the profits could be re-invested into the system rather than handed over to shareholders.

The United States

Warner and Hefetz (2012) examine the trend in contracting across the US. In a study of service delivery in the US 2002-2007, they found that public delivery is the most common form of municipal service delivery at 41 percent. Contracting out accounts for 35.5 percent of all service delivery and new outsourcing contracts and new insourcing arrangements for 23.5 percent (Warner and Hefetz, 2012). Thus, in US service delivery, reverse contracting (insourcing) now equals new contracting out (Warner and Hefetz, 2012).

The United Kingdom

The UK has a long history of outsourcing, and recently that trend has continued to some extent with further outsourcing and privatisations in the health sector. However, concerns over cost and the drive to save money through fiscal consolidation has seen municipalities cutting costs through bringing some services back 'in-house' (Hall, 2012).

A report for Unison in 2011 found that 80 out of 140 councils had brought services back into house, including waste collection, recycling, street cleaning, housing management, catering, grounds maintenance, IT and accountancy. These moves happened at the expiry of contracts with private operators. The termination of PPP contracts for public transport provision in London and their replacement by direct provision was driven by private failure and VFM calculations.

Other forms of public sector and contracting reform

Where re-municipalisation has taken place, it has not necessarily brought with it a return to traditional state-driven public ownership. In many cases new forms of public ownership/management have emerged. The public-public partnership (PUP), comprising partnerships between municipal authorities and other non-profit making groups such as residents' co-operatives, is an example of an alternative to private and state-driven public ownership (Cumbers, 2013). In the Global South, PUPs have often been created in response to international pressure for public-private partnerships (Cumbers, 2013) in the delivery of key infrastructure and service provision.

New Zealand, along with the UK, was an early adopter of market based approaches to local public service delivery. This included the use of privatisation and outsourcing (Warner, 2008). Its high level of privatisation made it an exemplar to countries such as the US, which were increasing their levels of outsourcing. Local government services provided a particularly rich area for contracting out and its popularity as a policy tool meant that local government managers gained skills in contract management (Warner, 2008). However, the early stages of privatisation did not include sufficient attention to accountability, while efficiency gains were made, effectiveness suffered. This led the Government to re-assert its role and rebuild its own capacity. In order to ensure effectiveness, the Government believed that a highly skilled public sector was required (Warner, 2008). Legislation was passed in 2003 which recognised that Government must balance the competing objectives of economic development, social wellbeing, environmental management, among other things. The new law also required higher levels of civic engagement and consultation (Warner, 2008).

Section Conclusion

The re-municipalisation in France and Germany were primarily driven by concerns over price. The reduction in costs and the potential for greater efficiency through in-house service provision was also a strong driver of reform (Hall, Lobina and Terhorst, 2012). In Germany and France in particular, private companies failed to effectively deliver services at politically acceptable prices and levels of accountability (Hall, Lobina and Terhorst, 2012).

Concerns about the delivery of other public aims, such as environmental ones, and the difficulty of driving public policy change through private companies, certainly contributed to re-municipalisation in Germany. The issue of 'control', in particular, 'local control' and the achievement of public interest goals has been a crucial argument in successful political re-municipalisation campaigns.

Contrary to theory on privatisation, these examples demonstrate the public sector's flexibility and ability to identify and act in the public interest, especially where there are a range of objectives. Market concentration and weak competition in Germany meant there was little competition on price. High prices coupled with the industry's reluctance to invest in renewables gave even more weight to the re-municipalisation argument (Cumbers, 2013).

Public response to re-municipalisation, where it has occurred, has been broadly supportive. The renewed interest in local governance and community advocacy and desire for transparency has been a key element of local responses to the fiscal contraction and recession (Hall, Lobina and Terhorst, 2012).

CONCLUSION

This paper addresses the current evidence on outsourcing under a Value for Money framework. It uses the three E's (Economy, Efficiency and Effectiveness) as criteria for analysis. Used to aid in decision-making on activities, projects and policies, VFM allows the reviewer to take a balanced approach to evaluation. By not prioritising one criterion over another, VFM promotes a whole of economy *and* society approach.

On the basis of the evidence discussed in the sections above, it is clear that under VFM, a decision to outsource a public service should not be automatic. Taken on balance, while short-term cost savings may be made, effectiveness may be compromised. Moreover, if cost savings are made at the expense of workers' wages and conditions, that may not indicate improved efficiency. However, it cannot be denied that governments can make cost savings, sometimes in the order of 20 per cent, by outsourcing services. It must also be said that there is evidence to argue that efficiency will improve following outsourcing. However, where the efficiency gains come at the expense of worker pay and conditions, there may be broader social costs through loss of wages to the wider economy and there is a danger that the state may have to subsidise low wages through the welfare system. Research has also found instances of increasing inequality between higher and lower paid workers following outsourcing. The issue of declining wages and conditions and increasing wage inequality raises concerns over the equity of outsourcing.

The evidence on effectiveness is mixed, and here a government or agency must be extremely careful. To ensure continued effectiveness, increased efficiency and long-lasting economy, a strict monitoring and enforcement system must be in place. Successful monitoring and enforcement requires resources, both human and capital. Contracting agencies, regardless of size, must have the requisite skills to ensure that contractors are fulfilling their obligations and that market concentration does not stymie future procurement processes and contracts.

Local public sector markets can be prone to concentration. For advocates of outsourcing, competition rather than ownership is widely believed to contribute to efficiency gains. Thus cost savings and efficiency gains can easily be lost if monitoring and enforcement systems are not sufficiently resourced and the success of outsourcing will depend on the nature of the service being contracted out and on the market conditions and monitoring environment. Research has also found that alternative reforms, such as inter-municipalisation can provide cost savings and increase efficiency in service delivery, especially where contracting-out may prove more risky due to factors such as dispersed population.

International experience on contracting-out offers lessons to Ireland. The increasing trend towards re-municipalisation highlights the complexities involved in both the decision to outsource and the process itself. In many examples, instances of private failure have led to the state becoming the provider of last resort. Many of the campaigns to re-municipalise services were prompted by price rises that were deemed unacceptably high for citizens and by the failure of the private provider to deliver an effective service. Equity and accountability in service provision have proven important in maintaining public support in these cases. The need to maintain public control over key public services where there are a multiple of interests and goals have also been drivers towards re-municipalisation.

Where public service delivery fails the impact can be disastrous for service users and the wider community. The evaluation of the evidence under VFM and the review of international trends towards re-municipalisation demonstrate the importance of comprehensively assessing the all the factors, risks and alternative reform options before making a decision to outsource. All three VFM criteria must be considered and the appropriate balance between them must be found. Any decision on whether or not to outsource must be taken from the perspective of the state, considering the impact to the local and broader economy and society.

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