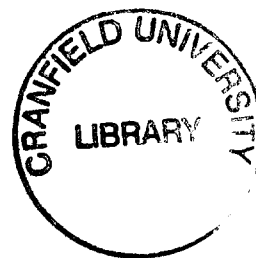




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**THE 1988 LOCAL GOVERNMENT ACT
AND COMPULSORY COMPETITIVE TENDERING**

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Traditionally private sector firms have been invited to tender for local authority contracts, for example to supply stationery, undertake major construction projects and install computer systems. Since 1980 local authorities have also been required to put out to tender most building, highways and maintenance work. The 1988 Local Government Act, however, extends compulsory competitive tendering to a wide range of services previously in the main supplied in-house by public sector employees or what are now usually referred to as 'direct service organisations' (DSO).

This article considers why compulsory competitive tendering was introduced, considers the evidence on the benefits from competitive tendering, details the services affected, and discusses the consequences for local government.

Why compulsory competitive tendering?

Since 1979 the Government has introduced a major programme of privatisation of which compulsory competitive tendering is a part. In its 1979 Manifesto the Conservative Party wrote: 'The reduction of waste, bureaucracy and over-government will yield substantial savings..... local direct labour schemes waste an estimated £400 million a year....' Throughout the 1980s the Government has accused local authorities of inefficiency in the provision of services.

Yet apart from building, highways and maintenance work the Government eschewed direct intervention in local authority decisions on contracting. Instead, the Government advertised the cost savings that some authorities

achieved by experimenting with competitive tendering. The most notable example was Southend-on-sea council in Essex which, following a competitive tender, contracted with a private company in 1981 to take over all refuse and cleansing services. The reported saving was £490,000 per annum. A similar level of saving was reported by Wandsworth council in southwest London. In February 1982 Wandsworth engaged Pritchard Industrial Services under a 5 year contract for street cleansing and shortly afterwards introduced private contractors for the provision of caretaking in public halls, housing maintenance repairs and horticultural services. The cost savings resulting from competitive tendering are reputed to have contributed significantly to Wandsworth's ability to hold down its rates at a time of rate inflation in other London boroughs (Burnett, 1984).

By 1984 councils which had put services out to competitive tender had made total savings for local taxpayers estimated by the Treasury to be in the region of £7 m (Treasury, 1984). In 1987/88 of authorities responding to the *Local Government Chronicle* (supplement, 8 July 1988) annual survey on competitive tendering, savings of £1,226,508 were identified, though some authorities reported minimal cost reductions and in the odd case increases. These savings came after major gains in labour productivity in local government following the squeeze on budgets from the mid-1970s. For example, a large rise in the volume of refuse to be collected in the four years to December 1984 coincided with an 18% reduction in local authority refuse collection staffing. This implies a previously high level of inefficiency in local authority services.

However, despite evidence of major financial gains, relatively few councils resorted to competitive tendering. By early 1985 only 41 of 456 councils in England and Wales were reported to have chosen to use private contractors for any of their main services, though a larger number had undertaken feasibility studies (*Guardian*, 5 March 1985, p.32). By the following year only 24 authorities had contracted-out refuse collection. Moreover, interest in the idea of competitive tendering in local government appeared to be declining. In part this resulted from the threat of industrial action by public sector trades unions whenever the subject was raised by councils. In further part it was a consequence of political opposition to competitive tendering by the Labour Party. Only one Labour controlled authority, Delyn district council in Wales, introduced private contractors to undertake refuse collection. A further reason, less easy to assess, was the claim that competitive tendering led to a lower quality of service.

Frustrated by the unwillingness of most local authorities to experiment with competitive tendering, in 1985 the Government published a discussion paper (Department of Environment, *Competition in the Provision of Local Authority Services*, 1985). This recommended legislation to force county, district and parish councils and joint authorities, joint boards, joint committees and similar local public bodies to put out to competition the provision of a number of services - including school meals and other catering, refuse collection and street cleaning, the cleaning of schools and other public buildings and vehicle maintenance. The annual value of the services involved was estimated to be £2.5 bn.. The Government also made it clear that this list was provisional and that competitive tendering

might eventually be extended to other areas including professional services such as architecture, legal work, quantity surveying, data processing and printing and the management of leisure facilities.

Legislation on compulsory competitive tendering therefore arose because of the failure of most local authorities to react to what the Government saw as overwhelming evidence of efficiency gains from competition. The rationale for legislation was the same as the rationale for introducing the Poll Tax - to reduce waste in local government. Councils, including Conservative controlled authorities, reacted angrily, however, to what they interpreted as central government meddling in their decision making. The necessary legislation was therefore postponed until after the 1987 General Election but passed in 1988.

Arguments surrounding competitive tendering

The use of private contractors to provide services is part of a 'Make or buy' decision. A decision made in the private sector on the basis of quality and cost. Private sector companies such as Rank Xerox and the Midland Bank contract out a wide range of non-'core' activities where it is more efficient to do so than supply in-house. Arguably, local authorities should adopt a similar approach to contracting while taking into account any economic externalities and social goals.

Specifically the claimed benefits of competitive tendering are as follows:

(1) Competitive tendering makes the market for the provision of public goods and services periodically contestable. Competition to be the service provider when contracts are initially granted and later renewed drives down costs and maximises operating efficiency. By contrast, there is less incentive to seek out lower cost methods of working in monopoly DSOs where higher costs are met by taxpayers. The 'public choice' and 'transaction cost' literatures in economics point to inefficiency and opportunism in hierarchical public bureaucracies, leading to inflated government budgets with little incentive to economise in the use of labour and capital. Public sector employees at all levels, it is alleged, pursue economic rents or dissipate rents through lower efficiency (Parker, 1985; Mitchell, 1988). The introduction of competitive tendering enables management to reform working practices, sometimes after lengthy and fruitless attempts to introduce reforms through normal bargaining procedures. As a result of threatening to use outside contractors, Wandsworth Council in January 1981 were able to shed 39 jobs and 9 vehicles saving over £400,000 per annum.

(2) Competitive tendering divides service provision from quality regulation and facilitates the establishment of quality standards and effective policing. Where local authorities are the monopoly suppliers and regulators there is an obvious conflict of interest. Will a supplier readily draw attention to inadequacies in its own services? Under competitive tendering the local authority can specify the quantity and quality of service in the contract, and enforce the contract terms through penalty clauses and performance bonds and by appointing alternative suppliers when the contract is renewed. Sanctions that were not open to them when they were dependent upon the in-house supplier. The tendering process therefore generates

information about the service provided and its costs as well as providing incentive for the service to be supplied efficiently (Hartley, 1984, p.10).

(3) Competitive tendering switches concern away from inputs towards monitoring outputs (both quantity and quality). Whereas local authorities have tended in the past to measure services in terms of numbers employed or amounts invested or spent, there is evidence that the introduction of competitive tendering is associated with increased concern for outputs (Scullard, 1989). The Association of Direct Labour Organisations has conceded in relation to the earlier 1980 Act on building and maintenance contracting that the legislation led to 'exposure to the idea that output is valued rather than costed.'

(4) Suppliers not limited in size by politically determined local authority boundaries can specialise and achieve economies of scale and scope (Bish and Warren, 1972). The importance of this point depends, of course, upon the nature of the cost function for each local authority service.

(5) Not only are there direct financial gains from the lower cost provision of services, but the Exchequer also gains indirectly. Private contractors pay taxes - both local and central - so that part of the efficiency gains reflected in higher profits are recouped by government for taxpayers.

These possible benefits from the introduction of competitive tendering need to be balanced against possible costs highlighted by the public sector trades unions.

(1) Contrary to the view expressed earlier that competitive tendering brings benefits in terms of the specification and monitoring of outputs, critics suggest that where it has been adopted service quality has declined. The trades unions cite cases where following contracting out roads were poorly swept and dustbins were emptied less frequently. Also, they identify cases where private contractors have defaulted leaving councils with no service provision (TUC, 1984, 1986). Contractors might submit low tenders to win contracts, but once the DSO is disbanded hope to renegotiate prices.

Such 'contractor failures' should not be ignored. On the other hand, most contracts appear to operate smoothly and failures appear to be on the decrease as tendering becomes established and private contractors gain experience in costing public services. A recent detailed study of contracting-out in the UK found no strong support for the claim that the quality of service had declined (Domberger et.al, 1986). While Milne (1987, p.104) concludes: 'The introduction of competitive tendering was used by management as a device to alter services that were thought had long needed changing.' Hartley also considers that changing contract specification is a benefit of competitive tendering (Hartley, 1988, p.12). The wider argument regarding price escalation after the contract is awarded suggests that contracts should be fixed price or at least have a cost reducing incentive scheme and cost-plus contracts should be avoided. Equally in this respect DSOs which win competitive bids should be subject to the same contractual conditions as the private bidders. DSOs should be no more able to raise their prices during the contract period than private contractors. In bidding for contracts the private and public sectors should have a level playing field.

(2) Where private contractors are employed public sector trades unions point to reduced wages and employment benefits, such as sick pay and pensions, alongside poorer working conditions, redundancies and the use of casual labour (thus avoiding employment protection legislation and the payment of national insurance contributions) (Hastings and Levie, 1983). Only 8% of contract workers are unionised in the UK. In contrast, in certain parts of Western Europe there are much higher levels of unionisation, which has led to national collective agreements with private employers on minimum wages and conditions. In Spain, Holland and Belgium workers have the right to keep their jobs when a new contractor takes over (Coyle, 1987). Also, in 1983 the government abolished the Fair Wages Resolution passed in 1946 and which in various forms dated back to 1891. It required contractors to pay 'fair wages', usually interpreted as agreed union rates. In terminating the Fair Wages Resolution, the Government also had to revoke Convention 94 of the International Labour Organisation which states that: 'While producers should be free to compete in matters of price, design, quality of product and service, it is unfair for competition to be based on a bidding down of workers' wages'. The last dispute in the UK under the Fair Wages Resolution before its abolition had involved privatised refuse collectors in Wandsworth.

A recent detailed study of eight cases in which catering services were put out to private contractors in the UK confirmed that in the newly liberalised market unskilled workers suffered. Generally they received lower pay in the form of bonus payments, time off and overtime, though not necessarily lower basic pay rates (Kelliher and McKenna, 1988). A study of contracting out refuse collection, however, suggested that in this service

savings were more commonly achieved through greater productivity of labour and vehicles, involving substantial reductions in numbers employed, rather than through major cuts in wages and fringe benefits (Cubbin, et.al., 1987).

(3) Competitive tendering for public service contracts is open to collusion between potential suppliers and even to out-right corruption of government officials. In the last decade a number of cases of 'rigged' tenders in the road building industry have been reported in which suppliers have agreed not to compete but instead to divide up the market. 'Regulatory capture' of local authority officials by contractors, as evidenced in public utilities in the USA (Parker, 1989) cannot be ruled out, especially where contracts do not go to the lowest bidder thus permitting 'official discretion'. What this argument seems to suggest, however, is that while local authorities may prefer to contract with established operators which have a track record in the industry, to minimise the risk of collusion and corruption tenders should be open to all suppliers, including new entrants to the market. Also, once a decision is made the bids should be available for public inspection. Disappointingly, Hartley and Huby (1985) found that only 25% of local authorities in the mid-1980s had a policy of open competition. Instead bids tended to be restricted to members of established trade associations.

(4) Competitive tendering introduces administrative costs in terms of drawing up, negotiating and monitoring contract performance. The Association of Metropolitan Authorities estimated that DSO costs rose by 7% through the employment of more estimators, inspectors and technicians

required to deal with the provisions of the 1980 Act. This criticism appears to imply, however, that there are no similar costs where DSOs operate. This is not the case. DSOs have to be managed and supervised, staff have to be recruited and paid. Often these costs have been invisible, hidden amongst general administrative expenses rather than related to departmental functions.

Public vs. Private: the evidence

Compulsory competitive tendering makes most economic sense if it results in substantial gains in efficiency. Efficiency can be defined in various ways and the 'effectiveness' of service delivery might be considered equally important where we are discussing public goods. In the studies summarised below attention has centred upon costs of provision though some of the studies also attempted to control for changes in the quality of service. These studies from the UK and elsewhere confirm that where competitive tendering has been introduced there have been considerable cost savings.

The evidence which we have regarding cost savings in the UK comes from the Audit Commission's extensive reviews of competitive tendering as well as from academic research. In one of its earliest commentaries the Audit Commission discovered, through recourse to the 'Ross' computer model developed by the Local Authorities Management Services Advisory Committee, that contracted-out refuse collection services had lower average costs. The top 25% of DSOs matched these efficiency levels but there were wide differences in costs between the most efficient and least efficient councils. Cost differences which could not be explained in terms of

geography or service quality and frequency. The Commission concluded that 8 out of 10 local authorities in England and Wales would benefit from contracting out services with potential total savings in the order of £30 m. per annum (Audit Commission, 1984). Similar orders of cost savings from private contracting were reported in other Commission surveys. For example, up to £118 m. in vehicle maintenance expenses. In addition, the Commission also reported that the cost of re-wiring council properties varied between £218 and £396 per dwelling for private contractors but averaged £600 where DSOs were not subject to competition for contracts (Audit Commission, 1984, 1987, p.4).

The trade association of contract cleaners has suggested an average saving in the order of 20% when cleansing services are subjected to competitive tendering (Hartley, 1986). Academic research broadly supports this figure. Hartley and Huby (1985) on the basis of a detailed questionnaire survey of local authorities and health authorities discovered that cost savings from competitive tendering for the same standard of service averaged 26%. The Institute for Fiscal Studies in London reported only slightly lower figures. Its study used regression analysis on data for 1983 to 1985 from 305 local councils, including 19 which had private contractors and another 10 which after competitive tenders retained the in-house service. The result was estimated average cost savings of around 22% where private contractors were used and 17% where the service was retained by a DSO. In addition, the study concluded that the bulk of the savings could be attributed to improvements in the physical productivity of labour and vehicles. The IFS found little evidence to suggest that the quality of service also declined (Domberger, Meadowcroft and Thompson, 1986, 1987).

Evidence of important financial savings from competitive tendering is not restricted to the UK. In a number of other countries the use of private contractors for public services is well established, especially in North America and Switzerland. A recent study of Canadian municipalities by McDavid (1985), in which private contractors had been introduced for residential waste collection, found that collection by DSOs was over 40% more expensive and that private collection crews were 95% more productive. In large part this was due to the use of bigger capacity vehicles with smaller crews and the use of more efficiency bonuses, though there was also evidence of higher average wages in the public sector. Interestingly in McDavid's sample both the highest single average collection cost per household, \$104, and the lowest, \$8, occurred under private collection, suggesting that privatisation alone does not guarantee lower costs.

Savings have also been reported in a series of studies of methods of refuse collection in the US. After surveying mixed residential waste services in 2052 cities, covering one-third of the US population, collection costs were found to be on average 14% higher where municipal rather than private contractors were used (Savas, 1977). This and McDavid's results are supported by a number of other studies from North America (Hirsch, 1965; Pier, Vernon and Wicks, 1974; Kitchen, 1976), though Edwards and Stevens (1978) and Bennett and Johnson (1979) discovered no statistically significant cost differences between the public and private sectors. Also in a survey of 103 Swiss cities in 1970, which included one-half of the Swiss population, residential refuse collection by private contractors was found to be on average 20% cheaper than public collection (Pommerehne and Frey, 1977).

Evidently, cost savings are associated with the amount of competition for contracts. Savas, for instance, reports that in Minneapolis in 1971 a new system of residential waste collection was introduced, with one area continuing to be supplied by the municipal department and the other by a consortium of private firms. Initially, the costs of the municipal department were 15% higher, but faced with the evidence from the private sector that costs could be reduced, this disparity had disappeared by 1975. Similarly, McDavid (1985) provides the following costs per household for residential solid waste collection - municipal \$42.29, private \$28.02, but municipal collection in mixed private-public systems \$31.31. The introduction of competition can rejuvenate sleepy public sector monopolies (cf. Primeaux, 1977; Savas, 1987, p.125), a view supported by studies of public vs private efficiency in industry and transport (Millward and Parker, 1983).

Turning to other services, there is also strong evidence that competition lowers costs. Marlin (1982) in a detailed review of local government in Japan reported a large number of cases where productivity increased sharply once private competition was substituted for public sector monopoly supply. Forsyth similarly chronicles numerous cases from the US and the Europe where the introduction of private contractors led to savings of between 20% and 60%. The services involved included the replacement of sewers, road and pavement construction, window and office cleaning and the maintenance of golf courses and parks (Forsyth, 1980). Moreover, apparently even services often considered to be core public services such as bus transport, security and the fire service can be provided more cheaply with

no necessary loss of effectiveness when the public sector loses its monopoly.

In the case of fire services, Ahlbrandt (1973) calculated the costs of public provision in cities and fire districts in Seattle-King County and some cities in Washington state. The estimated costs were contrasted with the costs of competitive supply in Scottsdale and other communities in Arizona. The results showed average fire protection costs of \$7.10 per capita under public supply compared with \$3.78 where private firms were used. A major cost advantage in favour of private sector provision was also discovered in Denmark. Here a private sector company, *Falck*, supplies emergency fire services to almost one-half of the country's population (Kristensen, 1983). On the basis of a multiple regression model, publicly supplied fire protection was found to be almost three times more expensive than provision by *Falck*. In part the cause was economies of scale, with public providers constrained in size by political boundaries. But competition was also a factor; *Falck* had an incentive to be efficient because it wanted to retain its position as the dominant private supplier. In both the US and Danish examples efficiency improvements appeared to come from fuller utilisation of fire fighting equipment and more efficient employment of labour, suggesting superior knowledge of demand characteristics under private contracting.

Turning to security, although mainstream police services remain almost everywhere a public sector monopoly, many guard services are provided by the private sector. In the UK *Securicor* and others protect money deliveries, patrol buildings and even protect military establishments

under contract. Gage (1982) in a study of guard services in Los Angeles County found that the cost was 34% higher when public sector personnel were employed to undertake the same work. In the case of express coach services, more competition from 1980 in the UK led to a fall in fares and the introduction of services which better reflected demand (Davis, 1984). *National Express*, the state owned operator, which previously held a monopoly on many routes, proved capable of markedly reducing its costs to stave off the competitive threat. More recent liberalisation of stage bus services in 1986 appears to be having a similar beneficial effect on local public transport (though some claim that service quality has suffered). The potential for dramatic cost savings is underlined by a study of bus services in West Germany cities. Oelert (1976) found public operators had costs on average 160% higher per kilometre than the private sector.

In general, the international evidence (important studies are summarised in Figure 1) supports the Government's view that competitive tendering can lead to considerable cost savings in the provision of local public services. The international evidence further suggests, however, that it is competition rather than private ownership which matters.

(Figure 1 around here).

The 1988 Local Government Act

The 1988 Local Government Act makes competitive tendering compulsory for those services outlined in the earlier DOE discussion paper. It also

empowers the Secretary of State to add to these 'defined activities' further services at a later date. On 1st July 1988 the Minister for Sport announced the introduction of an Order under the Act to include the management of sports centres for which competitive bids will be phased in after the main programme. At the same time a commitment was given to add no further services for the time being. Figure 2 provides full details of the services included under the Act.

(Figure 2 around here.)

The 1988 Act extends competitive tendering across a wide range of local government services and takes effect from 1st August 1989. Most local authorities are included within its terms - including councils, New Town authorities and most police authorities (with special terms for the soon to be abolished Inner London Education Authority, New Towns and certain police bodies). These authorities are required to expose all functional work falling within the 'defined activities', unless below a *de minimis* limit, to competition by 1 August 1990 (except for ground maintenance work which must be subject to competition by 1 January 1990). In an attempt to ensure that contracts are not so large that private contractors with more limited capacity than DSOs are inhibited from competing effectively, competition is to be phased in at six monthly intervals over the next two and a half years. The Secretary of State has also laid down specified contract periods. Too long or too short a period could limit interest amongst private suppliers thus favouring the DSOs. These limits vary for each function but range between 3 and 7 years with most being for 4 to 6 years.

In the future a DSO will have to compete for work with the private sector and in some instances voluntary bodies and DSOs from other authorities. Under the Local Authorities (Goods and Services) Act 1970 local authorities are able to undertake work for each other and a number of councils intend to take the opportunity offered by the new regime of competitive tendering to compete outside their own boundaries. DSOs may therefore face competition not only from the private sector but from within the public sector. It is not compulsory under the Act, however, for a council to give its own DSO or that of another authority the opportunity to bid for work;

tenders for works contracts cannot be limited to the public sector. At the same time, DSOs will continue to be barred from competing for work in the private sector, on the grounds that having the cushion of taxpayers funds they do not face the same commercial risks as private firms. DSOs are therefore less able than private firms to expand their businesses and reap economies of scale and scope.

The terms under which competitive tenders must be operated under the new legislation reflects experience from earlier contracting in local government and the NHS. In particular, the Department of the Environment is policing the tendering process to prevent anti-competitive clauses or conditions in council tender specifications which unduly favour DSOs. By September 1989 the Department was reported to be investigating over 150 councils (roughly one-third of the total) after complaints about bias in favour of bids from in-house units (*Economist*, 9 September, 1989, pp.35-6). Authorities which indulge in anti-competitive practices risk sanctions 'which could in appropriate cases lead to whole or partial closure of a

DSO' (DOE, 1988, p.7). Anti-competitive behaviour is interpreted as 'anything which actually has the effect, or is intended or likely to have the effect of restricting, distorting, or preventing competition.' (ibid, p.6). For example, packaging contracts in such large amounts that private contractors are dissuaded from competing; giving contractors too little time to respond; requiring detailed and sensitive information from companies which is not essential to the tendering process; requiring excessive performance bonds; rejecting lower tenders from private contractors in favour of DSOs without good reason; and, more controversially, 'taking into account any ... non-commercial considerations' such as the source of materials, contractors connections with South Africa, equal opportunities etc.. Employment of disabled persons and apprentices and trainees can, however, be taken into account (as permitted under the 1980 Act).

Where DSOs bid tenders must be open to competition and local authorities are required 3 to 6 months in advance of the tender date to provide detailed specifications for inspection free of charge and to supply copies for a reasonable charge. Where, however, all contracts are automatically awarded to the private sector, inviting bids from a select list of contractors is permitted. In this case a minimum of three private firms must be invited to bid. In so far as restricting the bidding limits competition, raises costs and, as discussed earlier, increases the risk of collusion and corruption, this provision in the Act is unfortunate.

Annual reports and separate accounts must be kept for each financial year in respect of each 'defined activity' carried out by a DSO. These must be

audited and lodged with the Secretary of State and failure to do so could lead to sanctions. Accounts are to be drawn up in accordance with agreed accounting practices laid down by CIPFA, though the Secretary of State has reserve powers to determine further items to be included. One particularly contentious issue in earlier experiments with competitive tendering was the treatment of redundancy costs if DSOs were unsuccessful in winning bids. Under the Act local authorities may take into account the costs of making labour redundant in the first round of contracts by spreading the cost over the life of the contract. Authorities may not, however, consider redundancy costs again in future rounds of competition and thereby justify rejecting lower private tenders, since 'this would appear to indicate that in-house costs are likely to remain above those of outside competitors indefinitely, and therefore the practice could be regarded as anti-competitive.' (ibid, p.6.)

Also, in setting its prices a DSO must include a 5% rate of return on capital employed based upon the current cost operating surplus (as earlier imposed for construction and maintenance work). This applies to all 'defined activities', excluding building cleaning where, in recognition of the low amounts of capital employed, the financial requirement is break even. The rate of return requirement can also be amended where it would be inappropriate, for example where private contractors are used but the authority retains ownership of the capital assets. Critics of the Act argue that the requirement favours private contractors who can set their prices to provide a lower rate of return in the first instance, hoping to raise their profit margins when the contract is renewed. There is evidence that private contractors bid on a marginal basis simply to contribute to

overheads but without the expectation, in the short-term at least, of as high as a 5% return (Audit Commission, 1987, p.7).

Consequences for local government

The introduction of compulsory competitive tendering poses a serious threat to the existence of the DSOs and thus to the provision of public services by local authorities. In response, however, the local authorities have begun to change their internal organisation and management with a view to winning competitive bids (Audit Commission, 1989). So far, and contrary to fears when the legislation was announced, they have been remarkably successful at fighting off private competition. A recent survey by the *Municipal Journal* (7 July 1989) showed DSOs winning around 80% of all the contracts so far tendered; though, as observed already, some contractors have claimed foul play and the DOE is investigating. In part the success of the DSOs can be attributed to a lack of capacity and interest in the private sector in bidding for contracts. For many tenders the DSOs have been unopposed. Some potential contractors have chosen not to bid because of the costs of bidding, the prospect of working with a council opposed to competitive tendering and low profit margins in local authority work. But a further reason is the success of the DSOs in streamlining their operations and becoming more efficient. In particular, local authorities have begun to change in the following respects.

(1) *Culture*

A major change appears to be occurring in the 'culture' of local government

leading to a move away from 'bureaucratic' and rule bound administration. As economic theory predicts, exposure to competition is bringing a more 'commercial' and market orientated approach to the management of public assets (Dunsire, et.al., 1988). To be capable of competing with private firms DSOs must be able to make decisions more quickly and with fewer political (and union) constraints. This has implications for their former pursuit of social objectives such as equal opportunities.

(2) Organisation and management

Competitive tendering requires a change in the internal organisation of local government. To avoid conflicts of interest, some local authorities are separating the client and contractor relationship within their administrations, giving the activities to separate departments and officers and/or having the DSO report to a board which is separately constituted, if ultimately still responsible to the council's Policy and Resources Committee. This organisation reduces the risk of tenders won by DSOs being judged anti-competitive by auditors or the DOE. Committees, sub-committees and even whole local government departments might eventually disappear to be replaced by smaller and cheaper 'contract management units'.

(3) Employment

The threat from competition requires a new flexibility in management. DSOs must now compete with private contractors whose wages and conditions of service reflect local labour market conditions. This implies a move away from centralised bargaining on pay and conditions and freedom for the management of DSOs to determine pay and manning levels. Wages for skilled workers in high demand may actually rise, whereas unskilled wages are

likely to fall. Moreover, some local government officials are having to be retrained from being 'administrators' to being managers with special skills in contract design and inspection. Some local authorities, for example Leeds, have planned a major investment in training over the next few years. In the meantime, management with the necessary experience and qualifications is being attracted from the private sector to run DSOs. A number of councils are offering individually negotiated 'executive' salary packages, including 'fringe benefits' such as cars and performance related pay, but on fixed term contracts. This is similar to the way that senior management is recruited in the private sector and is well removed from the employment traditions of the public sector which it now threatens. The spread of individual salaries for senior managers alongside local market wages for the workforce poses a serious challenge to the role and influence of the public sector trades unions.

(4) Expansion or contraction?

Should a local authority confine its DSOs to competing for existing work or should they be expanded to bid for contracts in other local authorities? Alternatively, should the DSOs be sold-off or disbanded? In so far as DSOs are moving to being arm's length agencies of councils, the attraction of 'owning' them must diminish. If they can no longer be vehicles for achieving wider political, economic and social goals why keep them in the public sector? A number of councils in recent months have considered 'privatising' their DSOs through management and employee buy-outs of which to date there have been half a dozen (*Economist*, 9 September 1989, p.36). For example, in Bath the technical services DSO has gone private and within

a month had won over f1m. of private sector contracts as well as work for the council. It has already become one of the largest employers in the city. Unsurprisingly, the attitude of councils towards the future of their DSOs reflects their political composition with Conservative councils, in general, more favourably disposed towards sell-offs. In contrast, some Labour controlled councils, such as Leeds and Sheffield, have adopted strategies aimed at retaining as much work in-house as possible. Some authorities hope to expand their DSOs by competing for work elsewhere, though this involves taking a risk with taxpayers' funds. Failure will mean higher redundancy costs, frustrated expectations and a writing-off of the appreciable costs of preparing bids. To survive DSOs need to find a niche where they have a comparative cost advantage and this implies specialisation rather than global expansion.

(4) Improved accounting practices.

Local authority accounting practices have allowed some DSOs to get around the threat from competitive tendering in the past. The Audit Commission (1987, p.4) cites the case of : '.... one of the most notoriously inefficient [DSOs] in the country [which] shows a 10% Current Cost Accounting (CCA) return on its assets - better than all but the most efficient private building concerns'. Local authority auditors will as before be required to monitor value for money and look out for fraud and corruption. But under the 1988 Act they will also have to give a written opinion on the rate of return achieved by each DSO and confirm that the tendering system for contracts is in accordance with the legislation and fully competitive.

In the past local authority accounting practices have left much to be desired, especially in terms of identifying, quantifying and allocating overheads and in terms of inventory control. This has meant that the costs of operating DSOs could be underrecorded, especially in terms of 'support service' costs, for example the provision of stationery, payroll administration etc.. Henceforth if such accounting is seen to favour in-house bids for contracts councils could face penalties for anti-competitive practices. Local authorities are therefore having to undertake a rapid review of their accounting procedures. Also, to provide DSOs with up to date and continuous flows of relevant and timely information on revenues and costs, on-line computer systems are being installed.

Conclusions

The Government justifies the introduction of compulsory competitive tendering for local services by pointing to cost savings and there appears to be ample evidence from the UK and overseas to support this view. Monopoly supply by DSOs appears to be more expensive than supply by both public sector departments and private firms which face competition. The key, however, appears to be competition rather than ownership (see Figure 3). Interestingly, long-term uncompetitive private contracting, as existed for example in parts of the NHS up to the early 1980s, was associated with low efficiency (Ascher, 1987, p.250).

(Figure 3 around here.)

The threat of competition appears to be having a galvanising effect upon councils leading to changes in organisation and management 'culture' and this is paying-off in terms of winning tenders. To date compulsory competitive tendering is not producing the privatisation that public sector unions feared. This is not too surprising. Where DSOs have been subject to competition in the past, by shedding labour and revising working practices they have often succeeded in matching the private sector's costs (Rogers, 1987).

Within local authorities major reorganisations are occurring to accomodate the effects of the new legislation. New management is being introduced and there is a new spirit of commercialism. In time more DSOs are likely to operate at 'arm's length' from their councillors and more management and employee buy-outs are likely. In raising efficiency, competitive tendering appears to be achieving what other reforms such as programme budgeting, management by objectives and efficiency audits failed to achieve over the last decade or so.

Figure 1 Summary of cost savings from private contracting for municipal services

| Author(s) | Country | Date | Function | Reported savings |
|-------------------|------------------------------|------|--|--|
| Ahlbrandt | USA (Scottsdale, Arizona) | 1973 | Fire services | Government supply 89% more costly than supply by private contractors |
| Savas and Stevens | USA | 1975 | Refuse collection | Municipal collection 29% to 37% more expensive |
| Pommerhene & Frey | Switzerland | 1977 | Refuse collection | Private contract provision some 20% cheaper |
| Blankart | West Germany | 1979 | Office cleaning | Public sector provision 42% to 66% more expensive |
| Hamada & Aoki | Japan | 1981 | Refuse collection | Municipal collection 124% more expensive |
| Gage | USA (Los Angeles County) | 1982 | Guard services | County personnel 34% more costly than private contractors |
| Kristensen | Denmark | 1983 | Fire services | Public supply almost 300% more expensive than the private contractor |
| McDavid | Canada | 1984 | Refuse collection | Public collection 40% to 50% more costly |
| Stevens | USA | 1984 | Street cleaning | Municipal cleaning 43% more expensive |
| Stevens | USA | 1984 | Street paving | Municipal work 96% more costly than private contractors |
| Stevens | USA | 1984 | Office cleaning | Municipal cleaning 73% more expensive |
| World Bank | Developing countries | 1984 | Road building & maintenance | Government work around 60% more expensive than private contractors |
| Hartley and Huby | UK | 1985 | various local government & NHS domestic services | Competitive tendering produced savings averaging 26%. |

(continued)

| | | | | |
|---|-----|------|---|--|
| Domberger, Meadowcroft and Thompson | UK | 1986 | refuse collection | Competitive tendering reduces costs by around 20% with no evidence that this is at the exepense of quality of service. |
| Domberger, Meadowcroft and Thompson | UK | 1987 | NHS domestic services | Cost reductions of 20% achievable through competitive tendering |
| Savas | USA | 1987 | commercial & administrative | public sector 38% to 45% more expensive |
| Milne | UK | 1987 | NHS catering, domestic services & laundry | Competition brought about savings of 33% to 66% |

Figure 2

Services subject to compulsory competitive tendering under the 1988 Local Government Act

| | |
|--|--|
| Refuse collection: | household and commercial waste. |
| Building cleaning: | excludes cleaning of dwellings, old people's homes, children's homes and police buildings. |
| Other cleaning: | covers street cleansing - including gully emptying; removal of litter from any land, not just streets; emptying litter bins; and the cleaning of traffic signs and street name plates. |
| Catering: | covers all catering activities except school and welfare catering and catering at institutions of further and higher education. Also, specifically excludes the delivery of 'meals on wheels' and the preparation of meals and refreshments in special and residential establishments and day centres provided that the meals and refreshments are prepared on the premises. |
| Maintenance of ground: | including plant nursery work but excluding work primarily in the nature of research or plant survival. |
| Repair and maintenance of vehicles: | but excludes repair of accident damage and the repair and maintenance of police vehicles and fire service vehicles. |
| Sport and leisure management | |

Source: Department of the Environment, *Local Government Act 1988: Part 1 and Schedule 1 Competition in the Provisions of Local Authority Services*, Circular 19/88.

Notes:

Sport and leisure management was added to the list of defined activities under the 1988 Act by Order on 1 July 1988. Competition for this activity will be phased in after the main programme is completed i.e. not before 1 January 1992. The Act empowers the Secretary of State to add further activities, subject to Parliamentary approval, though an assurance has been given that the Government has no intention to add further activities in the near future.

There is a *de minimis* limit. An activity is not to be treated as a defined activity in any financial year if the estimated gross cost, including overheads, of carrying out that activity (not individual contracts) in-house in the previous year does not exceed £100,000.

Figure 3 Incentives exist to be efficient?

| Organisation: | | DSO | private contractor |
|-------------------|----------------------------------|---|--------------------|
| Form of contract: | | | |
| Monopoly | No (losses met from tax) | No (cost inefficiency passed on in higher prices) | |
| Competitive | Yes (if cost escalation avoided) | Yes (assuming no cartels) | |

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