The rise of the “public services industry”

A report for UNISON by Paul Gosling

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Executive summary

1. Introduction

- According to the government's review of the "Public services industry" (PSI), private sector providers of public services now have a turnover of £79bn. But the wider social, economic and political impact of this industry remains relatively unexamined

2. The rise of the "public services industry"

- Private companies now play a major role in investing in public assets and infrastructure (under PFI and PPP deals), providing IT, facilities management and back office functions, and, increasingly, direct services to the public.

- A number of factors have led to the expansion of this market – including restrictions on direct public investment, outdated health and education infrastructure, an ageing population's increased demand for elderly people's services and the need to comply with stricter European environmental legislation.

- Key players in the "public services industry" include banks, infrastructure funds, private equity houses, consultancy firms, multinational corporations, "third sector" enterprises, and a new breed of "multi-service" firms focused on winning government contracts.

3. Policy influence

- The "public services industry" has spent significant sums of money creating a **sympathetic environment** for increased privatisation. This has helped produce a climate where there is little opposition within the main political parties to its growing role.

- **Lobbying organisations** such as the CBI Public Services Strategy Board, the PPP Forum, the Business Services Association and the NHS Partners Network have developed close relations with government and the media.

- The industry also devotes considerable sums to **sponsoring research** that supports its role, through bodies such as the Serco Institute or Aldridge Foundation, or direct funding of "think tank" activities.

- Contractors have recruited many **former government ministers and senior civil servants** as directors and advisors.

- The "public services industry" plays a direct role in **government policymaking** through bodies such as Partnerships UK and as policy advisors.

4. Concerns

- Public service delivery markets are undergoing a process of consolidation, consolidating, creating risks of market dominance and manipulation.

- Although promoted as a means of avoiding capital expenditure, private investment generates additional costs through higher ongoing **fees and charges** for services.

- **Transaction costs** generating by the complicated process of tendering, bidding, contracting and monitoring are substantial.

- Public services are generating high levels of profits for PPP consortia and private equity houses – often far beyond what might be regarded as “fair” returns on investment.

- Pressure to extract profits and pay dividends to shareholders can persuade contractors to prioritise cost-cutting at the expense of investment and **service quality**.

- Public service delivery contracts are **inflexible** and costly to alter, making it harder for services to respond to changing needs or revised policy priorities.

- Public bodies can be poor clients, not properly monitoring contracts – undermining public service **accountability**.

- The claimed advantage for PFI and PPP of **risk transfer** is entirely notional – contractor failure must ultimately be bailed out by the taxpayer, as major schemes cannot be allowed to fail.

- Reliance on **debt finance** by PFI, PPP and private equity investors has heightened the exposure of key services and the Treasury to economic risk resulting from the “credit crunch”, at a time when government finances are under severe pressure.

5. Conclusion

- Public services developed in response to market failure. But the supply of public services through a private “public services industry” leaves service users dependent on the private sector and vulnerable to market changes.

- The increasing privatisation of public service delivery often fails to produce value for money for the public sector or service users. It also increases the government’s financial exposure and the risk of personal catastrophe for vulnerable service users.

1. Introduction

The DeAnne Julius review of the "Public services industry" (PSI) was published by the Department of Business, Enterprise and Regulatory Review in July this year. The very fact that it was commissioned by business secretary John Hutton shows the importance of this market sector. Private sector delivery of services for the public generates massive profits and, the Government hopes, it will generate even greater profits in the future for UK businesses as companies use the expertise gained in this emerging home market to similarly transform public service markets in other countries.

But what is the wider social, economic and political impact of this public services industry? What happens when services delivered for decades by the public sector are handed to the private sector to operate? Who gains – and who loses? What risks do we face? This report seeks to answer these questions.

The beneficiaries are obvious – the private sector contractors, their shareholders and their other investors. Gainers include the big banks, accountancy firms, construction companies, investment funds and many private equity firms. Just how large a hold private equity firms have over the public sector will surprise many. A few private equity firms now hold a dominant position in the social care market and they are very influential in other markets, including waste management, leisure management and business process outsourcing.

But there are costs as well as benefits. The cost of financing private sector provision is massively greater than if the Government borrowed the money itself. And for all the claims that public service contracting transfers risk to the private sector, the reality demonstrated by the Metronet fiasco is that, with any important public service, it is always the public sector that continues to carry the ultimate risk, bailing out a failed private contractor.

In the midst of the global financial crisis, more commercial providers of public services are finding life difficult. This is especially true because of the extent to which the "public services industry" is heavily dependent on borrowing – both the Private Finance Initiative and private equity typically rely on loans rather than equity to finance most of their operations. As loans become more expensive on the money markets, and more difficult to obtain, so greater threats hang over the continuation of many public services.

So what will happen to those public services if these borrowers become unable to service debts at a time when the Government is under its own enormous financial pressures? The risk is that, far from saving costs for the taxpayer, the "public services industry" will cost the Exchequer a fortune it cannot afford as it bails out failed private sector contractors.

2. The rise of the public services industry

The provision of services to the public sector has become a massive industry, particularly in the UK, which is described by government as *"a global leader in opening up public service markets to competition"*.[1]

Limits on public funds for the improvement of **public assets and infrastructure** after the years of their decline from 1979 to 1997 led to a big expansion by the Labour government of the Private Finance Initiative (PFI) inherited from the Conservative government, along with the creation of the similar projects structured as Public Private Partnerships (PPPs). The PFI and PPP contracts have stimulated a massive new industry of private sector contractors to finance schemes, build facilities, manage them and provide cleaning, catering and other services.

IT, facilities management and back office functions are far along the privatisation journey. The justification for transferring these functions is that they require significant investments that the public finances cannot afford.

Direct services to the public are also increasingly open to private providers. Social care is now a "market" dominated by private sector care providers – many of them owned by private equity firms. Leisure services and waste management are increasingly provided by the private, not the public, sector. Healthcare, school support and higher and further education all have a much increased private sector involvement.

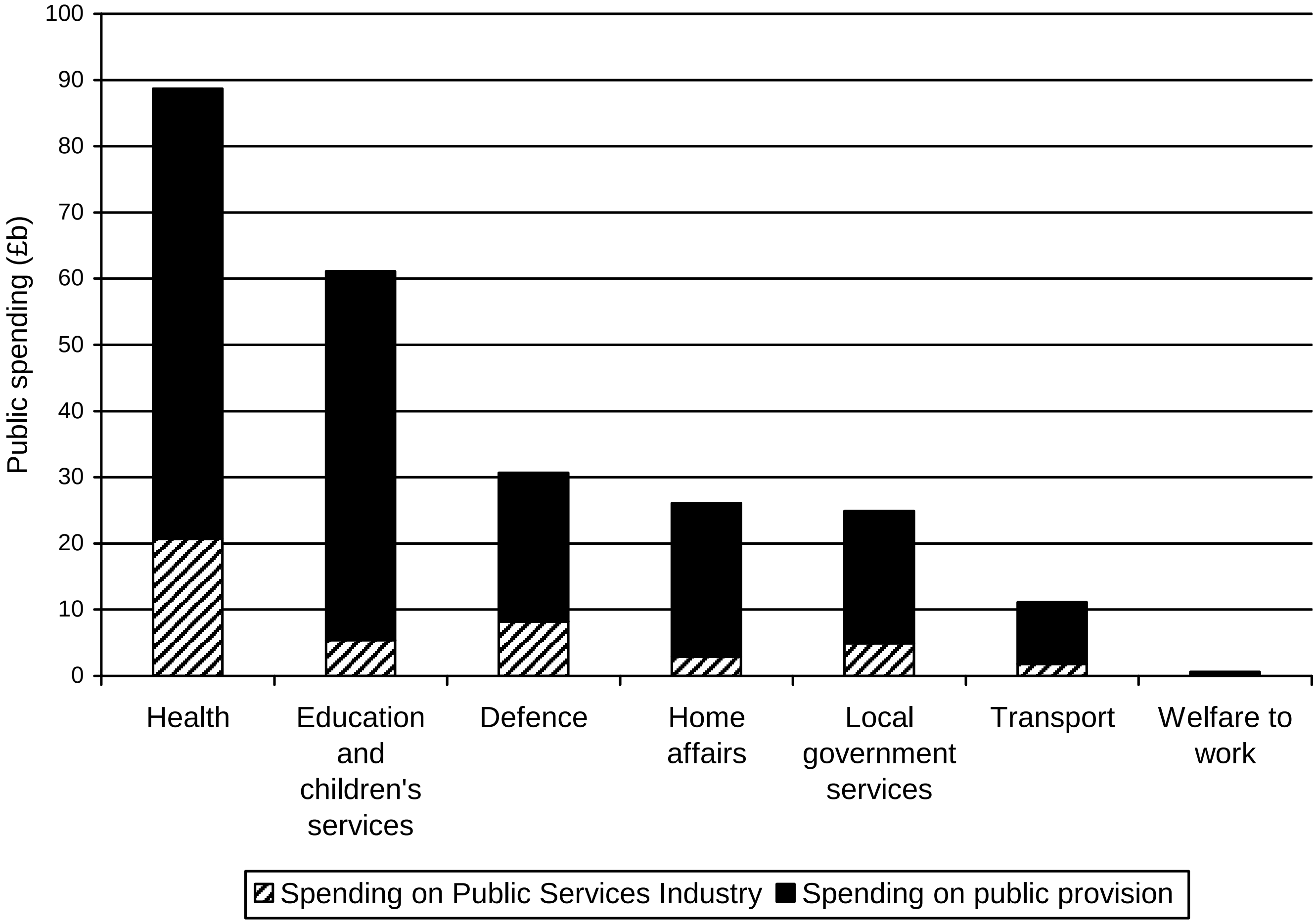
What is a public service?

The definition used by Oxford Economics in its survey of the public services market was: *"public service delivery and supporting services to public sector delivery organisations"*.

The European Union's services directive (2006/123/EC) refers to *"services of general interest"*, which include education, social protection, security, criminal justice and local government services such as refuse collection. Healthcare, social services and social housing are not included under these terms. The directive helps liberalise the cross border supply of services, creating a common internal market.

"Services of general economic interest" are commercial services with public service obligations, such as energy, transport and communications. The European Public Services Union is seeking a new EU legal framework on public services that establishes common public service principles; legal certainty and exemption for social services, health, water and education from competition regimes; and the right for local and regional authorities to provide in-house services. [2]

PSI share of total public spending in key sectors (2005-06)[3]



Estimations of the size of the public services industry vary according to which sectors are included in its definition.

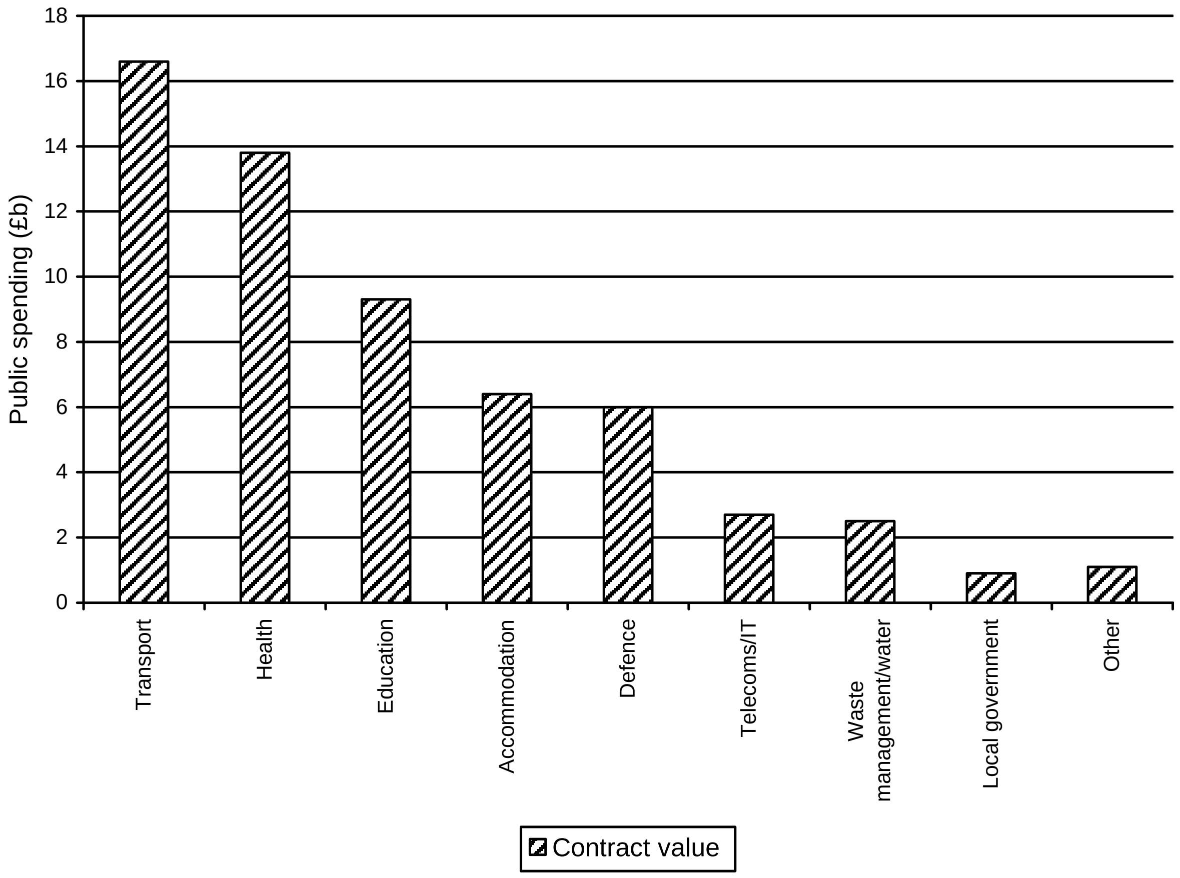
- Work commissioned by the CBI from Oxford Economics looked at the extent of private service delivery in a number of key sectors and estimated total spend in these sectors to amount to **£44bn** in 2005-06.

- Further work commissioned from Oxford Economics as part of the DBERR Review of the Public Services Industry estimated total spend in 2006-7 at **£79bn** – amounting to between a quarter and a third of spending on public services

- Estimates of the extent of public sector outsourcing produced by private consultancy Kable in 2007 estimated total spend in 2007-08 at £74bn, and predicted that this would grow to **£100bn by 2012-13**.

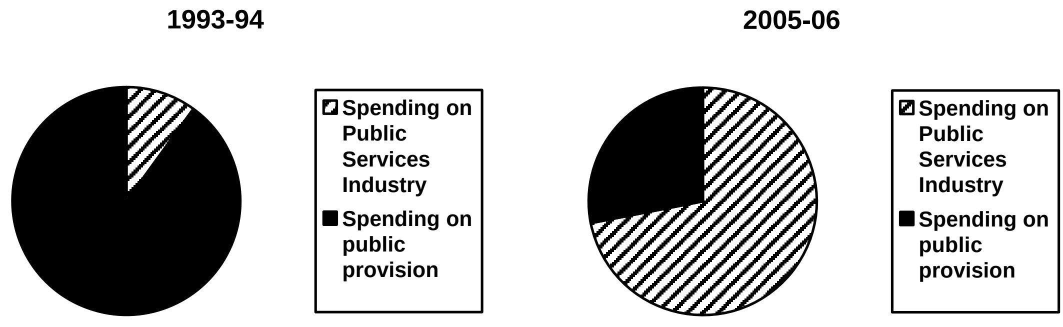
More than £50bn-worth of PFI contracts are now operational (see graph). PPP Forum shows that over £82bn in PFI and PPP projects are operational or signed-off, just from government departments and the Scottish and Welsh devolved administrations. Local government and quango projects are additional to this.

Value of operational PFI/PPP contracts by service sector (period 1987 to 2006)[4]

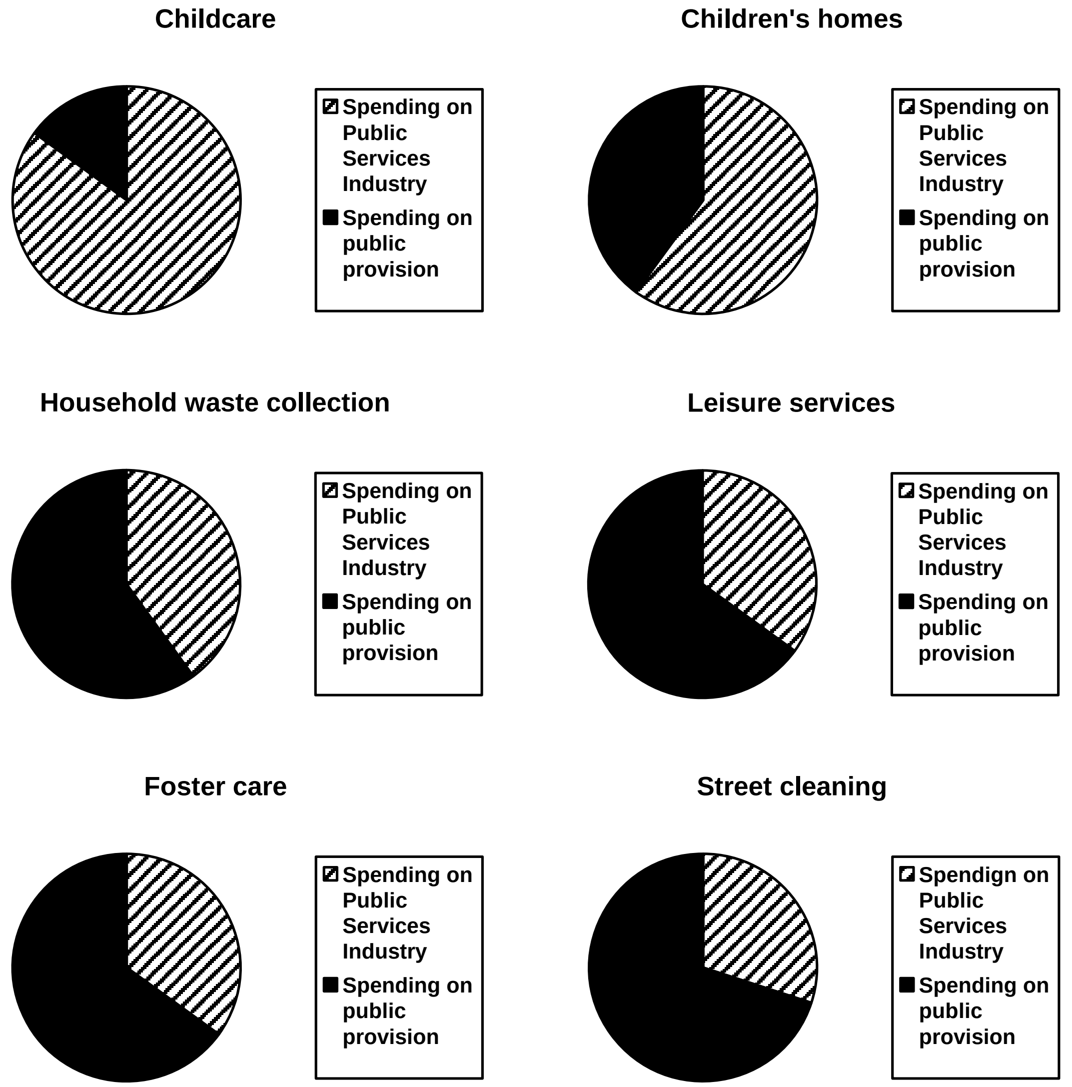


A service sector where the advance of the private public services industry has been particularly dramatic is social care:

Growth in PSI share of spending on social care[5]



PSI share of spending on key local government services[6]



2.1 Growth drivers

A number of factors are leading to the expansion of this market. As the Julius review stated, *"the demand for public services in the UK is growing faster than the economy as a whole"*. These pressures are creating major business opportunities for private companies.

- **Restrictions on public investment** mean that the Government has turned to private investors to finance improvement of public assets and infrastructure, and for the significant investments needed for IT and communications services. Maintaining the "sustainable investment rule" has meant keeping substantial capital investments "off-balance sheet" and imposing borrowing controls on local authorities and other public bodies.

- There is a continuing **growth in the elderly population,** which is predicted to rise by another 5% (more than 400,000) between late 2007 and late 2010.[7] Demographic factors make social care a very attractive sector for private equity firms. The number of beds in care homes is expected to increase mid way through the next decade.[8] Longer life expectancy is also leading to growing demand for residential supported care.

- The **increasing cost of healthcare** for governments, insurers and individuals is creating a potentially lucrative environment for the private sector. Government spending on the NHS has risen from £40bn in 1999 to £93bn in 2007, and is promised to increase by a further £20bn by 2010.[9] Private equity house Bridgepoint report that *"According to forecasts from the OECD, Britain will be spending almost £1 in every £8 of its GDP providing healthcare services by 2050, nearly 50% more than in 2005 … Such expenditure growth offers prospects for very high financial returns."*[10]

- The Government inherited **an obsolete schools estate** that was unsuited to contemporary teaching and learning needs. The cost of replacing 3,500 schools, potentially £45bn over 15 years, was regarded as unaffordable other than through PFI.

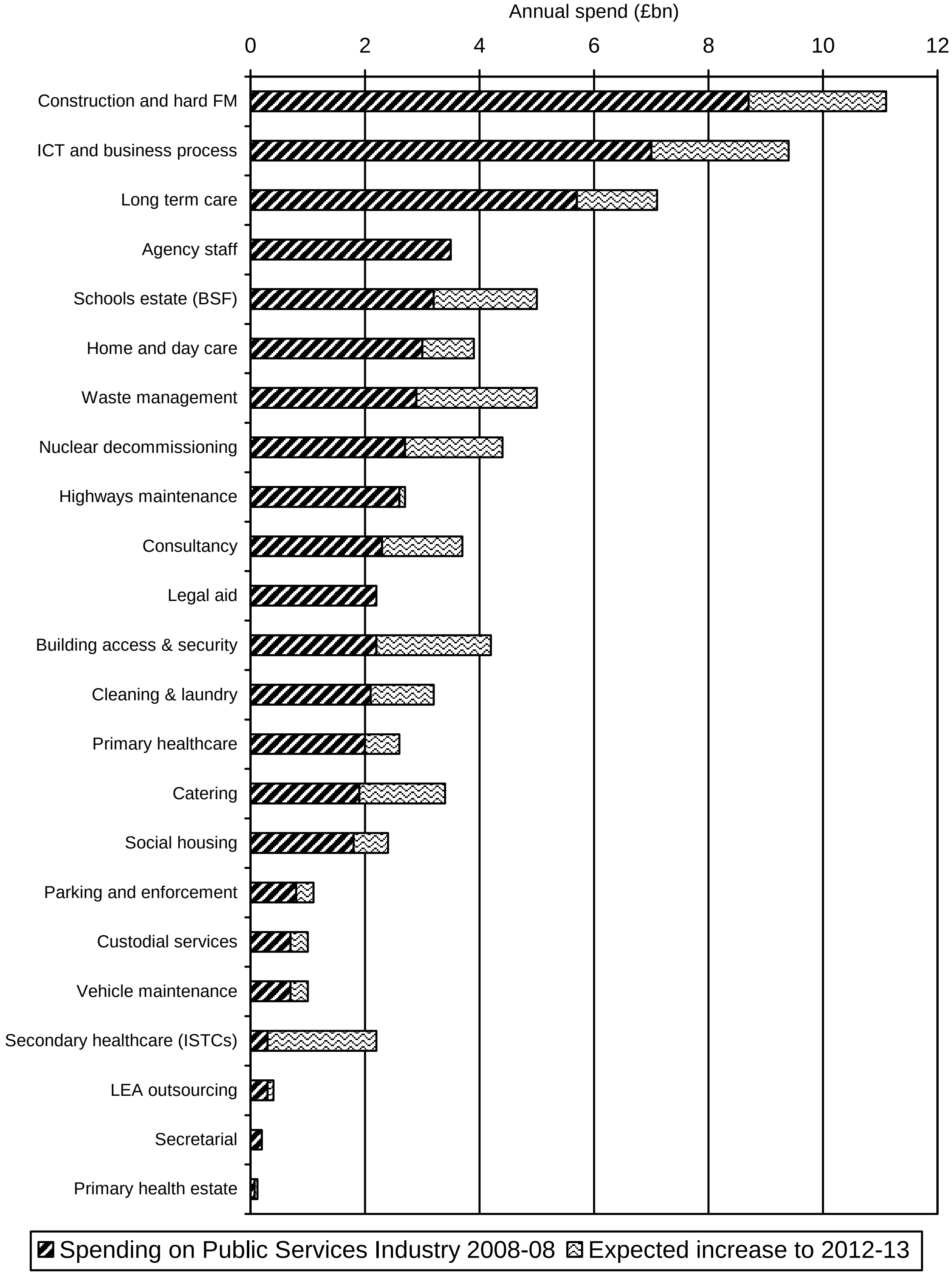
- Many GP surgeries and other **primary care facilities** are without disabled access and unsuitable for the delivery of modern healthcare. The NHS Plan of 2000 promised that up to £1bn would be spent on improving primary care, now being taken forward under the LIFT (Local Improvement Finance Trust) programme.[11]

- Increasing **environmental concern** is creating new growth sectors. For example, the UK government is seeking £10bn in private sector investment to create a viable infrastructure for meeting the requirements of the EU landfill directive. *"There are abundant opportunities in the UK for companies that provide waste management and treatment technologies and services. This is because the collection, management, recovery and disposal of waste is increasingly contracted out to private sector companies."* [12]

- The **prison population** has grown rapidly under the current Government, rising from 60,000 in 1997 to 82,000 in March 2008 – a rise of a third.[13] This has created a demand for prisons that the Government has found difficult to finance.

- The Government faces vast (£73bn and rising) and potentially unaffordable costs to **decommission nuclear reactors**.[14]

Expected growth of public services industry to 2012-13[15]



2.2 Key service sectors

Construction and "hard" facilities management
Market: **£15.9bn**, expected to rise to **£23.2bn** by 2012
Key players: **Serco**, **Morrison**, **ISS**, **Rentokil Initial**, **Carillion**, **MITIE**, **Interserve**, **Mitie**, **Balfour Beatty**, **Integral**, **Laing**, **Amey**, **Caxton**, **Operon**, **GSL**, **Wates**, **Amec**, **Bovis**, **Costain**, **Skanska**
The Julius review estimated private provision of "construction services" to the public sector at around £2bn-£3bn a year.[16] In addition to this, the management of buildings after construction is a major service sector.[17] According to Oxford Economics, the sector holds contracts valued at £16bn a year. The increase in PPP/PFI DBFO (design, build, finance and operate) contracts has been one of the main factors creating growth in the sector, with particular demand in the education, health and police sectors.[18] The facilities management sector is divided into two: hard FM and soft FM. Many of the construction companies are involved in the provision of hard FM services such as building maintenances, engineering and landscaping.

Support services and "soft" facilities management
Market: **£7.2bn,** expected to rise to **£12bn** by 2012
Key players: **Compass**, **Mitie**, **Spectrum**, **ISS**, **Rentokil Initial**, **Aramark**
Soft FM includes cleaning, catering, security, reprographics and reception services. According to Kable's categorisation this sector includes markets for "support services" such as building access and security (£2.2bn in 2007-8), catering (£1.9bn in 2007-08), cleaning and laundry (£2.1bn in 2007-8), secretarial (£200m in 2007-8), and vehicle maintenance (£700m in 2007-08). Health has been a key growth area for the contract cleaning market in recent years.[19]

ICT, business process and corporate services
Market: **£7bn,** expected to rise to **£9.3bn** by 2012
Key players: **Capita**, **BT**, **Serco**, **SBS**, **HBS**, **Vertex**, **Atos Origin**, **Liberata**, **IBM**, **Fujitsu**, **EDS**, **Xansa** (part of **Steria**)
The market for support or back office services is one of the most developed in the public sector, and is being further developed as part of the drive to make savings through "shared services" initiatives that allow government departments, local authorities and other public bodies to achieve economies of scale by pooling "back office" functions. The support service market is broken down by Kable into ICT outsourcing (worth £4.2bn a year, across the whole UK public sector); other ICT services (worth £1.7bn); and business process outsourcing (£1.5bn). According to the Business Services Association the outsourcing industry generates a combined turnover (in the public and private sectors) of about £14bn a year, employing about 340,000 people. Efficiency targets should mean that the value of these contracts decrease as they are renewed, but according to Kable this is compensated for by the fact that *"contract scope typically increases by about 5% per annum, or by about 50% over the life of a ten-year contract".*[20]

Long term care
Market: **£5.7bn,** expected to rise to **£7bn** by 2012-13
Key players: **Southern Cross**, **Four Seasons**, **BUPA**, **Craegmoor**, **Barchester**, **CareUK**
There has been a massive transfer of social care provision away from local government direct labour services to the private sector. Residential care has largely moved out of the public sector in recent years. In 1990, nearly 200,000 of the almost half a million beds in residential care homes were owned and run by either local authorities or the NHS. Today just 31,000 residential care beds are provided directly by local authorities.[21] Residential care for children is

also in the process of moving from the public to the private sectors. After many years in which the vast majority of provision was in the public sector (and most of the rest owned by charities), more than half of children's residential care places are now provided by the private sector, 33% by local authorities and 11% by the third sector. There is also a significant move towards using the private sector to arrange fostering for children, with the National Fostering Agency – owned by the private equity fund, Sovereign Capital –one of the largest suppliers of fostering services. Private equity firms – particularly Sovereign Capital and 3i – run a number of elderly and children's homes. Recent policy developments on the care of vulnerable children have encouraged children to move out of care homes into foster care. This has promoted a rush of aggressive financial buyers into the foster care sector: private equity firms now control 30% of the independent foster agency market.

Schools
Market: **£2.9bn,** expected to rise to **£4.7bn** by 2012-13
Key players: **Amey**, **Costain**, **Skanska**, **Bovis**, **Capita**, **Mott Macdonald**, **Balfour Beatty**
Under Building Schools for the Future (BSF), every secondary school in England will be rebuilt or renewed. Completing the replacement and renovation programme will take 15 years and is currently receiving £2bn to £3bn a year, through a phased programme of investment. The Comprehensive Spending Review settlement for 2008-11 gives £9.3bn for the BSF programme over three years. Half of the capital programme – that for new building – is being financed through PFI, with school refurbishments carried out through conventional procurement. The value of the total BSF scheme – and the value of contracts to the private sector – is a potential £45bn over the life of the programme. Altogether, 3,500 schools should be rebuilt or remodelled over the duration of BSF. The BSF programme is working alongside the school building programme for the Government's academies, which is also overseen by Partnerships for Schools. All the construction and renovation work is being allocated to private sector companies, which have grouped themselves into about 20 consortia to bid for the contracts. Under PFI procurement, each successful BSF bid brought together a consortium consisting of a lead bidder, a construction company, a financier, a designer, a provider of "hard FM" (building services and energy), a provider of "soft FM" (cleaning, security, catering and reception services) and an ICT provider. The facilities management dimension is likely to become more complex in the future, as requirements for BSF contracts evolve so that new schools are opened up as community buildings, elements of which can be opened up out of hours – for example, as shared use community centres, libraries and leisure centres.

Home care and day care
Market: **£3bn**, expected to rise to **£4bn** by 2012-13
Key players: Home care: most providers are small firms. Day care: housing associations and small firms.
Some councils now have no direct service home care support service. According to the Commission for Social Care Inspection (CSCI), *"since the 1990s, councils have steadily increased the proportion of home care purchased from independent sector providers, and the independent sector has grown exponentially. The percentage of home care hours delivered by the independent sector increased from 2% in 1992 to more than 73% in 2005."* CSCI describes the sector as a *"cottage industry with many small, inexperienced providers delivering (on average) 500 hours/week of care"*, but notes that *"there are signs that the sector is beginning to consolidate, as a result of councils' decisions to purchase from fewer providers and the competitive tendering processes they use."*[22]

Waste management
Market: **£2.9bn**, expected to rise to **£5bn** by 2012
Key players: **Veolia**, **Biffa**, **SITA**, **Shanks**, **FCC (Waste Recycling Group)**, **Cory, Enterprise, May Gurney and Greenstar.**
More than half of waste management responsibilities have been outsourced by local government to the private sector. Using a broader definition of "waste" than Kable (including building, mining, energy and agricultural wastes), the value of the waste management sector in the UK was valued by AMA Research at £6.8bn in 2007, with a prediction in a previous analysis of the sector that the value could rise to £14bn by 2014.[23] Analyst projections suggest the sector will grow 84% by value between 2004 and 2012. The Government is seeking significant additional private sector investment – £10bn over the next decade according to UKInvest[24] – to create a viable infrastructure to divert biodegradable waste from landfill to meet the requirements of the EU landfill directive. In addition, the Government has approved additional PFI credits of £275 million for the period 2006/7 to 2008/9 to promote investment in waste disposal facilities and to divert waste from landfill. (PFI credits are promises of payments to local authorities of grant, giving them incentives to use PFI.) The Waste and Resources Action Programme spent £73 million in 2006/07 and £74 million in 2007/08 developing markets for products made from recycled materials[25]. Despite fears about the long-term safety and health effects from incineration, the waste to energy sector is growing quickly, backed by the use of PFI schemes to produce new generating capacity.[26] In 2004/5, incineration was used to generate electricity in 15 plants and accounted for 8% of municipal solid waste – below that in other European countries. The Government's Review of Waste Strategy suggested the figure could rise to 27% by 2020. The Government also wants to see small scale power stations providing heat and electricity to local areas.

Consultancy
Market: **£2.3bn**, expected to rise to **£3.6bn** by 2012-13 (excluding ICT consultancy)
Key players: **IBM**, **LogicaCMG**, **Accenture**, **PA**, **Capgemini**, **Mott MacDonald**, **PricewaterhouseCoopers (PwC)**, **Atos Origin**, **KPMG**, **Deloitte**, **Xansa (Steria)**, **Tribal**, **McKinsey**, **Booz Allen Hamilton**, **Hedra**, **Grant Thornton**, **Ernst and Young**
Since 2001 the use of external consultants in government grew rapidly. The National Audit Office estimated that the public spent £2.9bn on external consultants (including ICT consultancy) in 2005. Kable note that while there are *"a number of initiatives"* aimed at reducing dependence on external consultants, *"progress in most of these areas appears to be slow"*. PricewaterhouseCoopers, KPMG, Ernst and Young, and Deloitte have played a central role in advising on and auditing PFI and PPP projects.[27] Several of the consultants have been involved in direct provision of services, for example, Accenture has provided IT services to government departments (very unsuccessfully in the case of the National Insurance Recording System) and several have provided business processing outsourcing (BPO) services.

Primary healthcare
Market: **£2.1bn**, expected to rise to **£2.8bn** by 2012-13 (excluding GPs and dentists). An additional **£1bn** is being spent on replacing GP surgeries and other primary care infrastructure under the LIFT programme.
Key players: **Care UK**, **UnitedHealth**, **Humana**, **Atos Origin**, **Kaiser Permanente**, **Laing** (through **ExcellCare**), **GSL**, **Babcock & Brown**, and **Carillion.**
By Kable's analysis, excluding GPs and dentists, procurement of primary care services amounts to £2.1bn in 2007-08, rising to £2.7bn in 2012-13 if proportions remain constant. Current policies favour an increasing share for the private sector. Under the Department of Health's Alternative Provider Medical Services (AMPS) programme, primary care trusts can contract

primary care contracts with providers who are not existing general practioners.[28] A number of private sector companies are expected to bid for contracts worth £1.25 billion, with particular interest from private equity portfolio companies.[29] AllianceBoots – advised by former health secretary Patricia Hewitt and owned by private equity firm KKR, whose managing director is Labour peer Lord Hollick[30] – has stated that it is seeking contracts to run 152 new health centres,[31] which will provide more out-of-hours services. Other companies expected to seek contracts include healthcare divisions of private equity firms 3i, ECI Partners and Merrill Lynch Private Equity. (Merrill Lynch's parent bank had to be rescued by Bank of America, as part of the unravelling of the sub-prime and credit crunch catastrophe – but its private equity division is likely to be unaffected by the change in ownership.) Other companies that have been mentioned as possibly interested in APMS contracts include Virgin (probably backed by private equity), Lloydspharmacy (a subsidiary of the German Celesio pharmaceutical group), BUPA, Netcare (whose financial partner is private equity firm Apax Partners) and Care UK (which works closely with Alliance Medical, which, in turn, is backed by private equity from Dubai International Capital). Primary Care Trusts have used some of the largest US healthcare insurers – UnitedHealth, Kaiser Permanent and Humana – to advise on commissioning practices, database management and anticipating future service demands. UnitedHealth has been engaged in healthcare provision and in care management designed to reduce hospital admissions, as with its contract to run the pilot Evercare scheme for the Department of Health. In addition to this, spending on primary care facilities under LIFT is estimated at £70 million a year, rising to £120 million a year by 2012–13.

Housing
Market: **£1.8bn**, expected to rise to **£2.4bn** by 2012
Key players: **Home Group**, **North British**, **Wakefield**, **Anchor**, **Sanctuary**, **London & Quadrant**, **AmicusHorizon**, **Genesis**, **Places for People**, **Circle Anglia**, **Synergy**, **Riverside**.
In 1981, 30% of all homes in the UK were council housing. Now that has fallen to little more than 10%, with almost as many owned and managed by housing associations.[32] The decline of council housing has been driven by Margaret Thatcher's "right to buy" policy, which has been described as the "biggest privatisation of them all",[33] and the growth of housing associations, with councils under pressure to sell off their council homes to housing associations, under large-scale voluntary transfers (LSVTs). Councils have been given financial incentives to sell and have found their ability to finance new social housing strongly restricted, creating pressures on them to agree to housing associations providing the required additional housing stock. While some housing associations see themselves as part of the voluntary or third sector – with many, for example, belonging to the Social Enterprise Coalition – others see themselves as businesses, whose difference from a PLC is merely that they do not distribute profits to shareholders. These trends have also been accompanied by a "marketisation" of social housing rents – increasing rents to market levels. Spending on subsidies on the building of council homes has been cut from £5.6bn in 1980/81 (at 2002 prices) to £0.2bn in 2002. However, as rents have increased and subsidy on the building of homes has been cut, so more public spending has been diverted to the payment of housing benefits – which has increased from £3.8bn to £12.5bn in 2003/4 (both at 2002 prices).[34] In total, over three million council homes (3,089,277) have been sold by local authorities, either through right-to-buy or as transfers to housing associations, between 1979 and the end of the 2006/7 financial year. The highest number of properties sold in a single financial year was 230,130, in 2003/4.[35]

Custodial services
Market: **£700m**, expected to rise to **£1bn** by 2012.
Key players: **GSL**, **Serco**, **Sodexho, GEO, Reliance, UKDS.**
The private sector operates 10 prisons, two young offender institutions and seven immigration removal centres on behalf of government departments. The growth in use of the private sector reflects, in part, the big increase in the prison population under the current government – it has risen by a third, from 60,000 in 1997 to 82,000 in March 2008.[36] The private sector now manages 10% of the current prison capacity.[37] The commercial value of the sector is likely to increase substantially in coming years, as the work of the Probation Service comes under greater competitive pressure. Some £250 million a year is predicted to be spent annually by 2012 by the Probation Service on the monitoring of adult offenders. According to Kable's projections, most of this expenditure will go to the third sector. The electronic monitoring of tagged offenders has created a £100 million a year sector, the main beneficiaries of which are Securicor and Serco (through its Premier division).

Tertiary education
Market: **£650m** (on PFI deals only); plus **£1bn** from Train2Gain by 2010/11**.**
Key players: **INTO (part of Espalier), Kaplan, IBT, INSEARCH, A4E, Capita, Centre for British Teachers (a charity), VT (part of Vosper Thorneycroft), BPP, Cambridge Education.**
Private sector involvement in higher education in the UK is *"the fastest growing privatisation in Europe"*.[38] In the period 1995 to 2004, private sector investment in tertiary education grew by 85%, while public spending grew by a mere 6%. The private sector now pays for 30% of investment in UK higher education, compared to an average of 16% across the EU. The nature of private sector involvement in tertiary education ranges from operating feeder colleges for university entrance; running higher education colleges as private companies; providing language tuition to foreign students at higher and further education institutions; joint ventures to provide vocational training; the design, build, operating and financing of halls of residence; joint ventures for exploiting university research; and private sector financing of university research. There were 33 higher and further education PFIs as at 2006.[39] New deals currently being negotiated are worth £3bn.[40] UCU has expressed concerns that further education colleges themselves may be tempted to convert into private companies, following comments by Ioan Morgan, principal of Warwickshire College, who said: *"Some colleges could opt-out and try to become private companies. Why not?"* The Government's Train2Gain programme, flowing from the Leitch review of skills, will see all adult vocational training being provided through Train2Gain, which will provide contestability – private sector competition – to all public sector provision from 2010. This means, in many instances, that FE colleges will have to compete against the private sector for the right to continue providing core studies. In addition, there are an increasing number of private sector organisations that are accredited providers of degrees and other qualifications. Buckingham University was established in 1976 as a private sector university and approved in 1983 by the Privy Council to issue degrees. The College of Law – like Buckingham University, private but not for profit – was given permission by the Privy Council in 2006 to award law degrees. In 2007, two colleges owned by the BPP Group, a PLC, were approved by the Privy Council to award law and and business degrees and postgraduate qualifications.[41] BPP says that it is better able to concentrate on education provision because it is not also a research institution – which appears to conflict with the Government's objective of increasing British research skills.

Secondary healthcare
Market: **£280m**, expected to rise to **£2.1bn** by 2012-13
Key players: **Alliance Medical**, **Capio**, **Tribal/Mercury**, **Nations**, **Netcare**, **Care UK**
A big increase in healthcare spending by Tony Blair's government was accompanied by a move to increase the involvement of the private sector in healthcare delivery and commissioning. Government policies encouraged the use of the private sector as alternative suppliers of healthcare services. Independent Sector Treatment Centres took over some of the work streams for simple elective surgery from the NHS, charging significantly higher fees. The work and payment structure attracted to the UK some of the largest healthcare corporations from the United States, South Africa and Canada. Recently, health ministers indicated that as many as 20 underperforming hospitals could have their management transferred to the private sector under contract.

LEA outsourcing
Market: **£320m**, expected to rise to **£400m** by 2012-13
Key players: **Serco**, **Capita**, **Tribal**, **Amey**, **Nord Anglia**, **Cambridge**
There is a growing sector of private sector managers of "failing" local education authorities and schools. The Bradford, Hackney, Haringey, Islington, Leeds, Southwark, Swindon, Walsall and Waltham Forest LEAs have all been outsourced. So too has the management of the London comprehensive school Salisbury, which has been outsourced to the US company Edison.

Leisure services
Key players: **DC Leisure Management**, **Esporta**, **Greenwich Leisure**.
The private market for health and fitness clubs is estimated at £4.4bn,[42] and is predicted to rise to £5.04bn by 2012. However, levels of growth in this sector are particularly affected by the depressed economy and lack of money for discretionary expenditure. The sector may grow significantly above long-term trends because of the effect of the London 2012 Olympics. Many local authorities have ceased running their own leisure centres – either outsourcing their operations, or selling them off. DC Leisure Management runs several council contracts. Esporta, at one point owned by the private equity firm Duke Street Capital, has bought underused council leisure centres in several parts of the country. However, there is uncertainty over the future of Esporta and the leisure centres it owns, after its parent business went into administration. An alternative model preferred by many councils is to support the creation of trusts to take over the leisure centres. As charities they have two advantages over council services: they do not have to charge VAT, so that the full service charge can be used as income, and they are exempt from council rates (which, ironically, a council must pay on its own operations). It has been estimated that over 40% of local authorities have externalised their leisure centres to trusts or social enterprises.[43] However, trusts must compete to win and retain contracts against private sector bidders. There are growing concerns that as the first round of leisure trust contracts come to an end, that many of the trusts will fail to retain contracts. The move to trust operations could therefore become in effect an unintended privatisation in two stages.

2.3 Key players

> *"A number of firms are emerging who are specialists in the general art of government contracting, and pursue contracts across a wide diversity of sectors … Clearly such firms have no initial expertise and therefore no particular substantive value added to offer within a new field … What they possess rather is a specialist skill in winning and possibly managing government contracts from politicians and civil servants."*
>
> **Professor Colin Crouch, Warwick Business School**[44]

Multi-service companies

Public sector services were delivered to meet a need. Now many companies deliver public services as economic activities, often despite them having no prior expertise and as part of a commercial strategy to deliver public services on contract across a wide a spectrum of activities as possible. This has meant there has been a significant growth in multi-purpose outsourcing supply companies. A leading example of the approach to generalist public service delivery has been **Capita**, which began as a small division of the public sector accountancy institution CIPFA. After Capita was spun off, it expanded quickly and diversified beyond its initial purpose of carrying out data processing contracts for public clients. It now describes itself as *"the UK's leading outsourcing company"* and carries out a wide variety of IT, human resource management, income collection and treasury management services. Capita also administers the congestion charge in London and has diversified into other markets, such as support for the turnaround of failing schools. Capita recently won the NHS Choices contract to promote better public health. The trend towards multi-faceted but public service-based contracting is clearest with **Serco**. It has contracts with a large number of central government departments, with local authorities and for facilities management under PPP/PFI contracts. Serco cleans streets, collects waste, operates IT systems, manages schools and hospitals, runs prisons and tells councils how to improve their schools. It is now a £2.8bn multinational business, which has interests in many countries and a vast range of public services. The Julius review notes that *"many companies span a range of PSI markets"*, citing the development of **BT** "who have grown from communications into IT services"; **VT Group** *"whose business has shifted from warship construction to providing mainstream PSI services"*; **Capgemini** *"who provide consulting, outsourcing and technology services"* and **Amey** *"who started in construction, but now provide a wide range of integrated support services"*. The contract cleaning market is increasingly dominated by "integrated facilities management" and multi-service providers such as **ISS**, **MITIE**, **Rentokil Initial**, **OCS**, and **Mowlem Pall Mall**.[45] Many housing associations increasingly have wider ambitions – including as players in the PFI and facilities management markets. For example **Sanctuary Housing** manages over 70,000 homes as well as having a number of subsidiaries including Sanctuary Care and Sanctuary Home Care, which run residential homes. Sanctuary Management Services provides facilities management services for PFI and other public service contracts, including for the NHS and higher education. But in some instances, housing associations have made substantial losses from their involvement in PFI projects, which have had to be underwritten by other housing association activities.[46]

Multinational conglomerates

Consolidation does not only happen across the public services: it also happens within public services across national markets. The Julius review noted that *"the UK is open to international firms in this area and provides a more transparent and predictable operating environment than many other countries"*.[47] Kable notes that *"several of the most significant actors are subsidiaries of* *companies hosted elsewhere in Europe"*, citing **Skanska** and **Capio** from Sweden, **Sodexo** and **Veolia** from France, as well as the recent arrival of healthcare multinationals from Canada (**Interhealth**), the US (**Nations Healthcare**, **NewYork-Presbyterian**) and South Africa (**Network Healthcare**, **Afrox**). Spanish company **Ferrovial** owns the major contractor **Amey** and the British Airports Authority, the ownership of which was recently challenged by the Competition Commission as constituting a harmful monopoly.[48] The waste industry is becoming heavily consolidated across Europe. PSIRU reported: *"In 18 months from the start of 2006 there have been 16 major mergers and acquisitions in waste management companies in Europe, with a total price of over €12.5bn.The companies which have changed hands have a total turnover of €6.6bn Euros, employing 39,000 workers."*[49] **Veolia** and **FCC** were major acquirers and both have gained a strong presence in the UK market.

Banks

Key players: **Royal Bank of Scotland, Barclays, Lloyds TSB, HBOS, Deutsche Bank, Macquarie**.

Banks play a variety of key roles in the marketisation of public assets.They provide finance, including by putting together infrastructure funds, may provide short-term and longer-term funding for acquisitions, acting as intermediaries in raising capital, for example in the issuing of bonds and advising clients and contractors in PPP and other contracts involving the public sector.

Infrastructure funds

Key players: **Innisfree, Macquarie, Barclays, Babcock and Brown, Morgan Stanley, Henderson, Goldman Sachs, 3i**.

Infrastructure funds have been formed by banks, with the backing of insurers, pension funds, hedge funds and private equity houses. By owning essential infrastructure, these funds provide investors with long-term strong returns that match the liabilities of, in particular, pension funds, especially in the context of challenging demographics. Public sector pension funds have been leading investors in infrastructure funds and, indirectly, in the privatisation of public services. Infrastructure funds own a range of privatised and other infrastructure, including hospitals, schools, airports, sea ports, energy generating and distributing companies, water companies, telecoms networks and toll roads. **Innisfree** has become the biggest owner of UK schools and hospitals, apart from the state, with responsibility for 100,000 pupils and 13,000 hospital beds.[50] Some of the infrastructure funds are dedicated operations (such as **Innisfree**), others are banks with much wider involvement in private sector ownership of public assets and, increasingly, some (such as **3i**) are private equity firms. In addition, there are some groups, notably **Ferrovial**, which specialise in the ownership of infrastructure assets, whose shareholders include investment funds.

Private equity funds

Key players: **3i, Terra Firma, KKR, Bridgepoint, Apax, Dubai International Capital, Cinven, Sovereign Capital, Three Delta, Blackstone**.

Private equity funds are different from other investors. Most (unlike infrastructure funds) are short-term owners of assets, whose motivation is short-term profit achieved by turning round failing businesses and by extracting value from businesses that have little commercial value – such as public sector owned income-generating activities and mutual businesses.They will often add value to businesses by merging competitors, to achieve higher economies of scale and raise charges by reducing competitive pressure. Private equity funds have led the restructuring of many smaller providers in many markets that were previously part of the public sector, creating widespread consolidation, in particular, in the social care, healthcare and waste management sectors. Private equity houses **KKR**, **Terra Firma** and **CVC** are heavily involved in the process of waste industry consolidation across Europe.

Small firms

The Government has promised to consider setting a target of 30% of public contracts going to small and medium sized enterprises (SMEs).[51] Yet the promise to help small firms gain more public contracts is in sharp contrast with the reality of contracting practices – which is to aggregate contracts, encourage contractor mergers, reduce competition between contractors and reward the very largest PLCs. The small firms' representative body, the Federation of Small Businesses, complains that contracts are usually too big for "micro businesses" (employing less than ten people) to bid. It wants measures to help more small firms to win contracts. Growing links between the small firms sector and the Conservative Party could mean that more will be done to support micro-businesses winning public sector work after the next election, if the Conservatives win. At present, small firms are strongly represented only in particular niche markets, such as domiciliary care, residential care (though many small firms in this sector have been bought by private equity-backed large companies) and local waste services.

Third sector businesses

Key players: **Barnado's**, **Turning Point**, **Mind**, **Greenwich Leisure**, major housing associations

In the space of ten years to 2005, the value of government contracting with the sector jumped from £4bn to £10bn, according to the National Council for Voluntary Service. A Parliamentary committee put the value of contracts even higher, at £11bn.[52] Even this may be an underestimate: Department of Health research indicates that the third sector provides £7.2bn of social services every year, and £4.7bn of health services. Across the sphere of public services, there has been a growing trend for not-for-profit organisations to take on public service provision, led by a strong commitment by Tony Blair. The argument is that community-based organisations are closer to their client group and can be more responsive to service users' demands. However, social enterprises – not-for-profit businesses, with social objectives – are subject to the same market disciplines as any other business. Consequently, Ealing Community Transport was effectively forced to dispose of its recycling business to May Gurney PLC to avoid the whole group becoming insolvent. In other ways, too, market disciplines and business logic force social enterprises, including charities, to act like PLCs when they compete against PLCs. The lobby group the Association of Chief Executives in Voluntary Organisations (ACEVO) has been particularly vocal in promoting the idea that big voluntary organisations should be allowed to compete for large public contracts. One risk of this approach is that, just as in the private sector, some contracts lose money and some businesses go broke. This has caused some housing associations to make losses on PFI contracts in which they have been involved as contractors. Those losses will usually be met from income from other activities. Another risk is that commercial activities are in effect subsidised by the unpaid labour of volunteers. Charities and social enterprises are most commonly involved in contracting in those areas of activity in which they have traditionally been involved – such as social care and support for the homeless. Social enterprises have large numbers of contracts for the management of leisure services – led by the largest, Greenwich Leisure. One particularly disturbing trend is that the traditional voluntary sector – the small, local voluntary groups that had a strong connection with their locality and membership – have become marginalised, with the big national voluntary organisations taking an increasingly prominent position as public sector contractors. These big national organisations have themselves merged and consolidated, in many senses acting in a similar way to PLCs.

"The strength of the VCS lies in its flexibility, responsiveness and accountability. These attributes can be found in small local VCS groups across the country. Large nationals have their strengths too, but they are different … Treating the big national charities as synonymous with the VCS would be a massive misunderstanding of the sector, with serious and negative results. It is no good abandoning the 'monolithic state services', as Alan Milburn once described traditional social services, only to replace them with provision from large, centralised charities … Yet there is now a serious risk that, driven by the demand for cost savings and contract 'aggregation', local authorities will drop the small local organisations that serve them so well and enable the big charities to get bigger."

Kevin Curley, National Association for Voluntary and Community Action[53].

3. Policy influence

The "public services industry" has spent significant sums of money creating a sympathetic environment for increased privatisation. These companies have helped form a climate where there is little opposition within the main political parties to the privatisation of public services.

3.1 Lobbying organisations

Lobbying organisations such as the CBI Public Services Strategy Board, the PPP Forum, the Business Services Association and the NHS Partners Network have developed close relations with government and the media.

The CBI Public Services Strategy Board
The CBI (total expenditure 2007: £23.6 million) has established a Public Services Strategy Board, chaired by **Serco** Chief Executive Kevin Beeston, and representatives of **Accord**, **Amey**, **Babcock**, **Bevan Brittan**, **BT**, **BUPA**, **Carillion**, **eaga**, **EDS**, **Enterprise**, **GSL**, **HBS**, **Interserve**, **KPMG**, **Pinnacle**, **SAP**, **Vertex**, and **Working Links**. The Board *"works with government and other stakeholders"* to create *"the right conditions to develop a thriving public services industry in the UK"*. It also runs a Public Services Forum, chaired by **Carillion** chief executive John McDonough, which *"brings business leaders together with decision makers and influencers from Westminster, Whitehall and across the public sector to discuss public services reform"*. Recent speakers at Forum events have included former Cabinet Office minister Hilary Armstrong, equalities minister Meg Munn, and business secretary John Hutton. The Board publishes reports arguing its members' case – recent publications have covered *"the power of choice in children's services"*, *"better policing through partnerships"*, *"competitive neutrality in UK public services markets"*, *"delivering choice in the NHS"*, *"delivering for local services"*, *"partnerships in offender management"*, and *"transformation through shared services"*. CBI's former director of public services Neil Bentley (now replaced by Susan Anderson) has written extensively in the UK media lobbying for greater private sector contracting.

The PPP Forum
The **PPP Forum** is the *"private sector industry body for the PPP/PFI industry"*. The PPP Forum's work is *"sponsored by 111 organisations that play a leading private sector role within the PPP industry"* from the *"corporate"* sector (including **McAlpine**, **Amey**, **Balfour Beatty**, **Carillion**, **Interserve**, **ISS**, **Laing**, **Kier**, **Serco**, **Siemens**, and **Skanska)**; *"financial"* sector (including **3i**, **Babcock & Brown**, **Barclays**, **Deutsche Bank**, **HBOS**, **HSBC**, **Innisfree**, **Investec**, and **RBS**) and *"professional"* sector (including **Clifford Chance**, **Deloitte**, **DLA Piper**, **Ernst & Young**, **Grant Thornton**, **KPMG**, **Pinsent Masons**, **PricewaterhouseCoopers**). Its objectives are to *"demonstrate the success that PFI is achieving in the delivery of modern public service infrastructure"*, *"take part in public debate … on PFI and related issues"* and *"engage with government departments and related organisations involved in developing PFI policy"*. It is committed to publicly putting forward the case for PPPs and PFI, challenging what it regards as "negative" media coverage, including by contributing to newspapers and magazines, publishing a resourced website and providing case studies. It holds annual dinners attended by cabinet ministers and permanent secretaries, and an annual four-day skiing event in Chamonix attracting *"around 200 senior executives active in the PFI industry in the UK"*. In 2008 this event was sponsored by **Innisfree**, **Henderson**, **Investec**, **Lovells** and **PricewaterhouseCoopers**. The PPP Forum is also used as a stakeholder consultee by the Treasury in discussing PPP policy development – confusing its role as a lobbying group with that of a representative industrial organisation.

The Business Services Association

The Business Services Association *"represents companies providing business and outsourced services in the private and public sectors"*. Full and associate members include **Amey**, **Serco**, **Prudential**, **KPMG**, **Pinsent Masons**, **Deloitte**, **Barclays**, **3i**, **Sodexo**, **Rentokil Initial**, **Interserve**, **Compass** and **Babcock**. It promotes *"the industry and the positive contribution it makes to the economy – driving innovation, training, efficiency, raising professional standards and improving productivity"*. The BSA has a communications and public affairs objective of *"working to shape public policy and political debate in those areas that directly affect the industry"*. It produces *"a range of publications"* that are *"aimed at building awareness and understanding of the industry amongst the Government, MPs, officials, European Commission, opinion formers and other stakeholders"*.

The NHS Partners Network

The NHS Partners Network operates under the umbrella of the NHS Confederation, representing commercial and not-for-profit providers of outsourced services to the NHS. Members include **Alliance Medical, Care UK** (now including **Mercury Health**), **Clinicenta**, the **General Health Group**, **Netcare UK**, **Nuffield Hospitals**, the **Partnership Health Group**, **Ramsay Healthcare** (formerly **Capio**) and **Spire Healthcare (**formerly **BUPA** Hospitals). Members of the NHS Partners Network have benefited from the service of lobby firm APCO UK, run by former special advisor to the Prime Minister Darren Murphy.[54] *"The Network works to raise the profile of independent NHS healthcare providers and to build greater understanding of and support for the role they play in the NHS"*, it says. When a leaked report from the Healthcare Commission aroused concerns about quality standards in ISTCs the Network *"was able to exert influence to ensure that the final version was a fairer representation"*. The NHSPN also worked closely with the CBI on its report on ISTCs and *"contributed to the editorial process to ensure that the tone and presentation of the report was as helpful as possible"*. The Network meets on a regular basis with ministers, advisors and civil servants in the Department of Health, as well as with opposition politicians. [55]

The English Community Care Association

The ECCA *"is the leading representative body for independent care homes"*, with a membership including *"organisations of varying types and sizes, amongst them single care homes, small local groups, national providers and not-for-profit voluntary organisations and associations."* Its activities include *"leading the national policy agenda"* and *"lobbying for the independent care home sector"*. Providers represented on its board include **Anchor Trust**, **Craegmoor**, **Barchester**, **MHA Care Group**, **Southern Cross**, **Voyage**, **Langton Care**, and **Care UK**. The ECCA's 2008 conference on "The Future of Care" is sponsored by **Boots Care Services**. A similar role is undertaken in Scotland by *Scottish Care*.

3.2 Research sponsorship

The Serco Institute
Serco's "research institute" publishes reports *"intended to enhance understanding, in governments and the wider community, of the role that competition and contracting can play in improving public services"*. Recent publications have focused on *"customer service in the delivery of public services"*, *"competition and contracting: learning from past experience"*, *"public sector reform: an international overview"* and *"does contestability work?"* and *"the benefits of service-led PPPs"*. The Serco Institute has also sponsored work by the **Institute for Public Policy Research**.

The Aldridge Foundation
The Aldridge Foundation was established by founder and former chairman of **Capita**, Rod Aldridge, in 2004, through a £2 million share transfer from Capita. As well as sponsoring school academies and youth volunteer schemes it will *"seek practical solutions to removing the barriers to public service reform, promoting effective partnerships between the public, private and third sectors"*. The **Centre for Public Service Partnerships** has been created at Birmingham University by the **Aldridge Foundation** along with **Balfour Beatty** under the directorship of John Tizard, previously head of strategic relations at **Capita**. The new Centre *"will provide a platform for the Foundation's thinking on the future of public services and in particular encouraging closer working between the public, private and third sectors"*. "Strategic partners" of the Centre include **4ps**, **Bevan Brittan**, the **Business Services Association**, the **CBI**, the **New Local Government Network**, **Partnerships UK**, **Royal Bank of Canada**, and the **Social Market Foundation**.

The PricewaterhouseCoopers Public Sector Research Centre
PricewaterhouseCoopers' "Public Sector Research Centre" publishes several reports a year and also sponsors work by think-tanks and others. Recent publications have looked at *"public private partnerships in Central and Eastern Europe"*, *"the value of PFI"*, *"the road ahead for public service delivery"*, and the Centre has also sponsored work by **Demos** on *"public service co-design"*, the **Social Market Foundation** on *"the death of deference"* in health and education services, the IPPR on *"public services at the crossroads"*, and the **New Local Government Network** on *"incentives for councils to build major infrastructure projects"*.

KPMG
KPMG published a report, *Achieving the potential*, arguing for greater use of public sector service charges and "co-payments". KPMG's inquiry was led by former home and education secretary Charles Clarke, who was paid for this work by KPMG.

The Institute for Public Policy Research
The **Institute for Public Policy Research** (total expenditure, 2006: £3.9 million) has been a key location for research and policy development around public service reform since its Commission on Public Private Partnerships in 1999-2001 (sponsored by **KPMG**, **BT**, **Serco**, **Nomura** and **Norwich Union**). More recently the Institute has developed work on *"private spending on healthcare"* (sponsored by **Norwich Union Healthcare** and **Genus Pharmaceuticals**) and *"public services at the crossroads"* (sponsored by **Accenture** and **PricewaterhouseCoopers**). There has been a strong flow of people from the IPPR into 10 Downing Street during the current Labour government, including former heads Patricia Hewitt becoming a powerful Cabinet minister and Matthew Taylor moving on to be head of policy for Tony Blair. IPPR's influence was so great that its chairman of trustees, Chris Powell, was

quoted as saying that it had two departments: its research and development in its own offices and the "applied department" within government.

The Social Market Foundation

The **Social Market Foundation** (total expenditure, 2006: £850,000) is one of the most influential think-tanks operating in Westminster. *"Critical to our success is the close partnership we enjoy with organisations in the private and third sectors,"* it says. Recent funders of the SMF's work have included **Accenture**, **Barclays**, **Boots**, **BUPA**, **Capio**, **Deloitte and Touche**, **Fujitsu**, **KPMG**, and **PriceWaterhouseCoopers**. Previous work has explored topics such as *"the future of the Private Finance Initiative"* (sponsored by **Bevan Brittan**) and *"how primary care should change to meet patient needs"* (sponsored by **Deloitte**). Another paper investigated the use of co-payments (also supported by **Deloitte**). Its current programme includes research on *"the future of the UK health system"* (funded by **BUPA**, **Pfizer** and **Standard Life Healthcare** along with NHS Connecting for Health), employment services commissioning and the implications for public services of *"the death of deference"* (sponsored by **Serco**). Phil Collins moved from being the director of the Social Market Foundation to join Tony Blair's private office.

The New Local Government Network

The **New Local Government Network** has been influential in encouraging the Government to adopt reforms in the management and operations of councils, including through the use of more private contractors. Its "partners" include **BT** and **Vertex**, both leading business outsource providers to councils, and **Serco**, **Amey**, **Kier**, **PricewaterhouseCoopers** and **PA Consulting**. Board members include Andrew Ford, the head of Public Sector Advisory Services and partner at accountancy firm **PricewaterhouseCoopers**, and Nick Sharman, a director and head of Local Government Services at **Amey**. **BT** has said this relationship has *"enabled BT to not only develop a thorough understanding of the current and future issues facing local government, but has also provided us with opportunities to develop relationships and engage with stakeholders within the sector at all levels"*. Vertex explained: *"NLGN provides Vertex with invaluable insight and early access to the debates that will ultimately determine the future shape of local government."* Dan Corry, the former head of the NLGN (and a former senior staffer at IPPR), is now head of Gordon Brown's policy unit.

The Centre for Social Justice

The Centre for Social Justice is a think-tank established by former Conservative Party leader Ian Duncan-Smith. Although it describes itself as "independent", it is closely associated with leading figures within the Conservative Party. Its report on looked-after children, *Couldn't care less*, was produced by a working group led by Ryan Robson, a former Conservative councillor at the London Borough of Wandsworth and founder and managing director of **Sovereign Capital**. Sovereign Capital made about £100 million from its involvement in the buying, reselling and consolidation of social care businesses, including **Tracscare.** It owns the **National Fostering Agency,** independent schools groups **WCLS** and **Alpha Plus**, **DC Leisure,** a leading operator in the market for managing council leisure centres and NHS service providers **C.H.O.I.C.E., TRACS, Alkare, Cascade** and **Parallel.**

3.3 Recruitment of former ministers and officials

As well as influencing government policy and the broader culture of debate, contractors appoint directors and advisors who have clout. Many of the largest companies have big hitters on their boards, who have political experience, knowledge and contacts.

- **Serco**'s directors included DeAnne Julius until she embarked on her review of the sector for the Government. She is also a former independent member of the Bank of England's monetary policy committee. Current Serco directors include Baroness Ford, whose previous roles include being chairman of the Lothian Health Board and a director of English Partnerships. She is also managing director, Social Infrastructure and Development, at the **Royal Bank of Canada Capital Markets**.

- Infrastructure owner **Innisfree** is another well connected company, whose chairman is Roger Brooke, a former Conservative Government-nominated chairman of the Audit Commission, who is also chairman of Accord, another leading player in the PPP market as a supplier of environmental services. Brooke founded private equity firm **Candover Investments** and has been a board member of another private equity firm, **Advent 2 VCT**. Innisfree's chief executive is David Metter, who is also a member of the Public Procurement and Efficiency Committee of the CBI.

- **Candover Investments**, and its associate business **Candover Partners**, is now a very large and highly lucrative private equity firm. Its directors include Lord Jay, a former Permanent Under-Secretary at the Foreign Office, Head of the Diplomatic Service and British Ambassador to France. Candover Investment's chairman is Gerry Grimstone, a former assistant secretary at the Treasury. Two senior Candover people – Grimstone and Martin Read (a senior adviser to Candover) – are currently leading a major efficiency review for the Treasury.[56]

- **Apax Partners** is one of the world's most successful private equity houses. Its founder is Sir Ronald Cohen, one of Gordon Brown's close associates who advised the Prime Minister on setting up a social investment fund.

- Mike Clasper has moved from private equity partners **Terra Firma** to become executive chairman of HM Revenue & Customs – one of the most powerful jobs in government. Terra Firma itself remains well connected politically – William Hague is a member of its advisory political council.

- Another senior Conservative, Sir Malcolm Rifkind, was chairman of **Alliance Medical** – which has large contracts with the NHS, and is involved with Care UK in supporting its private hospitals group – until 2006, when it was bought by the Dubai International Capital private equity fund from the Bridgepoint private equity firm.

- Former Chancellor of the Exchequer Kenneth Clarke is an adviser to private equity investment house **Centaurus Capital**. It is a major investor in **Atos Origin**, one of the largest contractors to the public sector for IT and consulting services.

- Former environment secretary John Gummer is a director of water services company **Veolia** (formerly Vivendi UK).

- Shadow international development secretary Andrew Mitchell is paid at least £35,000 a year as senior strategic adviser to **Accenture**, a leading provider of consultancy and business processing services to the public sector.

- Ed Vaizey, an influential Conservative MP and close associate of party leader David Cameron, is a director of **Edexcel**, a private sector qualifications assessment business.

- **Vinci**, a leading construction and hard FM contractor, has senior Conservative MP Quentin Davies on two of its boards.

- **3i** is not only a FTSE100 company and a powerful private equity house, it also has directors that are very influential. One of these is Baroness Hogg, who was head of Margaret Thatcher's policy unit at 10 Downing Street and whose husband (Douglas) was a senior minister under Thatcher. Baroness Hogg's annual salary as chairman is over a quarter of a million pounds a year. She was a member of Sir David Walker's committee that drew up guidelines for private equity firms' corporate governance practices, that was established in response to widespread criticisms of the sector.

- The chairman of **Jarvis** – now largely a transport infrastructure contractor – is Stephen Norris, a former Conservative government minister of transport and a senior advisor to the newly elected mayor of London, Boris Johnson.

- Accountancy firms – which have a vested interest in government policy, both as consultants on public sector contracting and as tax advisers – allocate significant resources to support political parties. Both **PricewaterhouseCoopers** and **Grant Thornton** support the private office and research facilities of shadow chancellor George Osbourne and his Treasury team, while **KPMG** second a member of staff to assist Conservative front bencher Oliver Letwin.

But the most striking display of power and influence is in the number of recent ministers who have taken up company directorships in the policy areas they previously controlled. Senior officials have also taken on senior jobs that have benefited from their public sector experience.

Alan Milburn
Alan Milburn has obtained several directorships since ceasing to be a Cabinet minister, where, among other posts, he was health secretary from 1998 to 2003. Milburn is listed in his declaration of members' interests at the House of Commons as a director of **Covidien**, which describes itself as *"a $10bn global healthcare products leader"*. He is also a member of **Lloydspharmacy**'s Healthcare Advisory Panel. In addition, Milburn is an advisor to the European advisory panel of leading private equity firm Bridgepoint, which specialises in healthcare investments. Milburn declares his income from these senior appointments as over £30,000 a year from **Bridgepoint**; over £25,000 from Lloydspharmacy; nothing listed for Covidien; and a further over £20,000 as an advisor to **Pepsico**.

Charles Clarke
Charles Clarke has become a director and adviser to several companies since ending his period in government, during which he was education secretary from 2002 to 2004 and Home Secetary from 2004 to 2006. He is a non-executive director of the **LJ Group**, which supplies

teaching materials and equipment to schools and training services, including through the Government Building Schools for the Future programme, which Clarke initiated as education and skills secretary in February 2004. Clarke is a consultant to **KPMG** on public sector reform, for whom he wrote a booklet promoting the use of co-payments – service user contributions – to the NHS and other public services. He also advises **Charles Street Securities** investment bankers/private equity fund managers. In addition, Clarke is a consultant to **Beachcroft** LLP, a legal firm that specialises in advising PFI/PPP deals.

Patricia Hewitt
Patricia Hewitt was health secretary from 2005 to 2007. She is now senior adviser to **Cinven**, a private equity-backed private hospitals and healthcare group (payment, over £55,000 pa). She is also special consultant (payment over £45,000 pa) to **AllianceBoots**, which is owned by private equity firm **KKR**. In addition, Hewitt is a director of **BT Group**, which is providing business outsourcing, IT and telecoms services to a range of public bodies. Hewitt established the telecoms and media regulator Ofcom in an earlier job as secretary of state for trade and industry and was in charge of the National Programme for IT – in which BT won one of the largest contracts – while secretary of state for health. According to BT's submission of details to the US Securities and Exchange Commission, Hewitt will be paid an initial £60,000, but with an expected increase as she takes on more responsibilities, in return for working at least 22 days a year.

David Blunkett
David Blunkett was Home Secretary from 2001 to 2004, education secretary from 1997 to 2001 and work and pensions secretary in 2005. He is now an advisor on business development to **A4e** Ltd, for which he is entitled to be paid at least £25,000 a year, but which (according to his Parliamentary declaration of interests) he has not yet been paid. A4e describes itself as a *"market leader in global public service reform"*.

Lord Warner
Lord Warner was a health minister from 2003 to 2007, with specific responsibility for much of that time for the radical reform of the NHS – overseeing the introduction of more private sector involvement. Since he stepped down from that role he has taken on a directorship with **UK HealthGateway** and is chairman of the Government Sector Advisory Panel for **Xansa plc** – a leading provider of business outsource services to public bodies and holder of the £1bn NHS's shared business service centre contract, providing accounting and finance services to the NHS. Lord Warner is also an advisor to **Byotrol** (a provider of micro biological health treatments), **Apax Partners Worldwide** (a private equity firm, with strong connections to the Government and which has invested heavily in health providers seeking contracts with the NHS), **Deloitte** (an accountancy and consultancy firm, with large incomes from government agencies) and **DLA Piper** (a legal firm, which, like Deloitte, specialises in advising on private contracting to the public sector). Lord Warner remains influential within the NHS as chair of the NHS London Provider Agency.

Hilary Armstrong
Hilary Armstrong was secretary of state for local government from 1997 to 2001, and minister for the Cabinet Office from 2006 to 2007. She has recently taken a position as chair of waste company **SITA**'s advisory committee.

Nick Raynsford
Nick Raynsford was a local government and housing minister from 1997 to 2005. He is now non-executive chairman of local authority recruitment agency **Rockpools** PLC and of **Hometrack,** a lettings service.

Ian McCartney
Ian McCartney was a trade minister from 1997 to 1999 and again from 2006 to 2007 (he was also a Cabinet Office minister, chairman of the Labour Party and a pensions minister). Now he is a senior adviser to the US **Fluor Corporation**, an energy contractor that is believed to have ambitions to win nuclear clean-up contracts in the UK. McCartney is paid at least £110,000 a year for his advice. The former Department of Trade and Industry had responsibility for energy policy.

Stephen Byers
Stephen Byers held a variety of ministerial posts, including being trade and industry secretary from 1998 to 2001. He is now non-executive chairman of water treatment company **ACWA** and **Ritz Climate Offset Company**.

Richard Caborn
Richard Caborn was trade minister from 1999 to 2001 and was previously the chairman of the House of Commons trade and industry select committee. He is now a consultant to **AMEC,** assisting them with their work in the nuclear industry. His payment for this is at least £70,000 a year. He is also a former sports minister and now a consultant to **the Fitness Industry Association**, for which he is paid at least £10,000 a year.

Brian Wilson
Brian Wilson was energy minister from 2001 to 2003. He is now a non-executive director of **AMEC Nuclear** and is UK chairman of the renewables company, **Airtricity**.

Stephen Ladyman
Stephen Ladyman was transport minister from 2005 to 2007. He is now an adviser to **Itis Holdings**, a company selling traffic information, for which he is paid at least £10,000 a year.

Frank Field
Frank Field was welfare reform minister from 1997 to 1998. He is now a director of **Medicash**, which operates a healthcare cash plan.

Sir Michael Barber
Michael Barber was head of the Prime Minister's Delivery Unit, where he oversaw public sector reforms in health, education, transport, policing, the criminal justice system and asylum/immigration. He is now the expert partner in consulting firm **McKinsey**'s Global Public Sector Practice.

Baroness Sally Morgan
Sally Morgan was a close aide to Tony Blair when he was Prime Minister and she was director of government relations in Downing Street and subsequently was made a minister and a member of the House of Lords. She is now a director of the largest care home operator in the UK, **Southern Cross**, which has expanded substantially as a result of government reforms to the structure and funding of social care. She is a member of the advisory panel of Lloyds Pharmacy, which is expected to bid for contracts under the Department of Health's £1.25bn

Alternative Provider Medical Services programme. Morgan is also a director of **Carphone Warehouse**.

Sir Gerry Loughran
Sir Gerry Loughran was head of the Northern Ireland civil service from 2000 to 2002. After retiring he took on a number of private sector directorships. These included **Phoenix Natural Gas**, which is owned by the **Terra Firma** private equity firm, and he soon became chairman upon joining the board. While a senior civil servant, Loughran chaired the Strategy 2010 project,[57] to sell and leaseback the civil service property portfolio. After leaving the civil service, Loughran became a director and chairman of **Partenaire**, where he led the company's (unsuccessful) bid to win the £2bn Workplace 2010 contract that resulted from Strategy 2010.

Lord Wilson of Dinton
Lord Wilson of Dinton was, as Sir Richard Wilson, head of the Home Civil Service and secretary to the Cabinet – as such he had the overall responsibility for seeing that the Prime Minister's policies on public sector reform were carried out. He was afterwards appointed a director of **Xansa** (now part of the Steria group), one of the main providers of business process outsourcing services to the public sector.

Lord Turnbull
Lord Wilson's successor as head of the Home Civil Service was Sir Andrew Turnbull, now Lord Turnbull. Lord Turnbull's current directorships include **British Land** (active in the PFI/PPP market), **Prudential** (also active in the market) and **Frontier Economics** (which advises private sector clients on public sector reform). Turnbull is also chairman of **Brevan Howard Global**, an investment management company.

Sir Peter Gershon
Sir Peter Gershon was brought in by The Treasury in 1998 to reduce government expenditure and improve efficiency – he conducted a series of reviews in the period to 2004. He became a civil servant in 2000 as founding chief executive of the Office of Government Commerce. Sir Peter is now executive chairman of **Vertex**, one of the largest suppliers of business outsourcing services to the UK public sector. He is also non-executive chairman of the **General Healthcare Group**, the largest private healthcare group in the UK – owned by the private equity group **Apax Partners** and the South African healthcare company **Netcare**, which has ISTC and other supply contracts with the NHS. In August 2008 Sir Peter completed a review of ICT procurement policy for the Australian government.[58]

Chris Woodhead
Following his period as chief inspector of schools, Chris Woodhead set-up the **Cognita** group of independent schools, using funds supplied by a private equity firm, **Englefield Capital**.

Sir Steve Robson
Sir Steve Robson was one of the most controversial senior civil servants of recent years, who oversaw the privatisation of British Rail on behalf of Sir John Major. Robson went on to become second permanent secretary at HM Treasury until he retired in 2001. During his earlier career, he was seconded to **3i** while remaining a civil servant. He oversaw the Government's policy on PPPs while serving the current Government at the Treasury. Since retiring, Sir Steve has been a director at **Partnerships UK**, **JP Morgan Cazenove** (a global bank), **Xstrata** (a mining group) and the **Royal Bank of Scotland** (one of the leading

investors in PPPs) and is a member of the Chairman's Advisory Committee at the accountancy and consultancy firm **KPMG** (a leading adviser to PPP and PFI schemes).

Simon Stevens
Simon Stevens was Tony Blair's health advisor within 10 Downing Street and, with Alan Milburn, was the key architect of the NHS reform programme. He is now chairman of **UnitedHealth** UK, which has won contracts with the NHS to manage and advise primary care trusts. The company's executive director, previously chief executive, was, until late 2007, Dr Richard Smith, a former editor of the British Medical Journal. He is now working for UnitedHealth in the US.

Tom Granatir
Another US-based healthcare group with serious aspirations in the UK is **Humana Europe.** Its director of policy and research in the UK is Tom Granatir, who was seconded for six months to the NHS in its Health Inequalities Unit and was then seconded on a separate assignment with the influential health think-tank, the King's Fund.

Darren Murphy
Darren Murphy was a special advisor to Prime Minister Tony Blair from May 1997 to September 2005. After a period as head of government relations and external affairs for **AstraZeneca UK** Murphy became managing director at the London office of lobbying firm **APCO** whose clients include most of the private healthcare firms bidding to run Independent Sector Treatment Centres.

3.4 Involvement in government policymaking

Partnerships UK

The main body charged with the promotion of PPPs and the PFI, is the quasi-government agency, Partnerships UK (PUK). This was originally the Treasury PFI Task Force, which was reconstituted as a private company, in which the Treasury and the Scottish Government hold shareholdings, along with many of the main industry players. Commercial shareholders include: **Uberior Infrastructure Investments** (an investment vehicle of Bank of Scotland Corporate), **Prudential**, **Abbey**, **Sun Life**, **Barclays**, **RBS**, **Serco**, **Global Solutions** and **British Land**. PUK has a key role in the rolling-out of PFI and PPP projects. The annual expenditure of PUK is nearly £18 million. Until 2007, its chairman was Sir Derek Higgs, a powerful City figure. He was, until his recent death, also a director of **Jones Lang LaSalle**, a leading property company, and chairman of **Bramdean Asset Management**, a specialist investor in private equity and hedge funds, whose chief executive is the well-known Nicola Horlick. Current PUK chairman is Gordon Horsfield, a former executive with **PricewaterhouseCoopers**.

Partnerships for Schools

Partnerships for Schools (PfS) is the non-departmental public body set up by the Department for Children, Schools and Families to deliver the Building Schools for the Future programme. Partnerships UK is a 50% partner in PfS, sitting alongside DCSF and other non-executive directors on the Board of PfS. PUK also assists the programme by seconding staff to PfS. Building Schools for the Future LLP invests in the Local Education Partnerships that are set-up to deliver new and upgraded schools in the Building Schools for the Future programme, working with the local authority.

The Local Government Services Market

In 2004, the Government commissioned **PricewaterhouseCoopers** to provide *"an overall description and segmentation of the local government markets"* and *"provide detailed information on key markets which will be chosen on the basis of further consultation and an assessment of priority"*. During 2005 and 2006 PricewaterhouseCoopers and the Department for Communities and Local Government ran roundtables and workshops and invited comments on drafts from three hundred individuals representing organisations including **4Ps**, **Accord**, **Alfred McAlpine**, **Amey**, **ACEVO**, **Atos Origin**, **Babcock**, **Biffa**, the **Business Services Association**, **Cap Gemini**, **Capita**, **Carillion**, the **CBI**, **Cory**, **Deloitte**, **ISS**, **KPMG**, **Liberata**, **Mitie**, **Morrisons**, **PA Consulting**, **Partnerships UK**, **Rentokill Initial**, **Serco**, **SITA**, **Tribal**, and **Vertex**. No trade union or workforce representatives were consulted. The final report was published in 2006 as *"an essential companion"* to the Local Government White Paper. It recommended more *"active management of markets"* and opening up new sectors of local service provision such as libraries to *"alternative providers"*.

4ps

4ps is the agency established to provide expertise to local government, to support their involvement in PFI, PPP and complex procurement deals. It can assist councils obtain funding and accelerate progress with schemes. It was established by the representative bodies of local government and works closely with central government departments and Partnerships UK. It receives support from **Deloitte.**

Gershon Efficiency Review

Sir Peter Gershon conducted a series of cost-cutting efficiency reviews for the Government, which provided for the reduction of 84,000 civil service jobs. His 2004 review proposed reforms that included using "change agents" to increase the potential for civil service outsourcing. After completing the reviews, Sir Peter returned to the private sector where he is now executive chairman of **Vertex** – one of the largest suppliers of business outsourcing services to the public sector. His 2004 efficiency review was loaned and seconded staff from a variety of public sector contracting organisations, including **Deloitte, PA Consulting, HEDRA** (now part of Mouchel)**, Hewlett Packard** and **IBM.**[59]

NHS Co-operation and Competition Panel
The NHS Co-operation and Competition Panel has been established by the Department of Health to oversee competition between NHS bodies and the independent sector. Its first chair is Lord Carter of Coles, a Labour peer who founded Westminster Health Care **-** a leading provider of nursing and specialist healthcare. The NHS Partners Network, in a statement on behalf of the independent sector, said it welcomed his appointment as *"he has substantial commercial experience in the sector"*.[60]

The Public Services Industry Review
In December 2007, the Government's Department of Business, Enterprise and Regulatory Reform's agreed to requests from the **CBI** to establish a review of the "public services industry", under the leadership of Dr DeAnne Julius. Dr Julius was, until December 2007 (when she was appointed by BERR), a senior non-executive director of **Serco**. The Review's Advisory Panel comprised representatives of the **CBI**, **Partnerships UK**, **Cap Gemini**, **Working Links**, **Logica CMG**, **Spire Healthcare**, **ACEVO**, the **Social Enterprise Coalition**, **Babcock**, **KPMG**, **Serco**, and Birmingham University's Centre for Public Service Partnerships. Trade union representatives were invited at a later date after protests from the TUC. In July the final report of the Review concluded that *"there is a clear case for action to ensure conditions for growth of the public services industry continue"*.

4. Concerns

4.1 Market power

> *"Competition does not always work well even in private sector markets, and there are additional complexities for public services. For example there are difficulties associated with … scarcity, or lack of diversity, in supply, caused by monopoly, high market concentration among suppliers or geographical remoteness."*
>
> **The Audit Commission**[61]

Consolidation is the name of the game in the "public services industry". Big players in the public service contracting market are making themselves even larger through a steady stream of acquisitions. Smaller companies are also becoming bigger, through a process of mergers and acquisitions. Consolidation is happening wholesale – within market sectors, across market sectors and even across countries. In short, the public services industry is being controlled by ever fewer businesses, whose influence is ever greater.

In many cases, the consolidation has earned the new owners of public services massive returns – sometimes doubling the stake invested by private equity firms. But in other instances, cross-sectoral consolidation has actually opened up a company to service diversification risks that were not anticipated. When losses are incurred, perhaps because of a lack of sector experience, the result can be the withdrawal of a public service and extra costs for the public sector client.

It is evident that the process of market consolidation has the effect both of offering higher returns to service operators because of economies of scale, but also the potential to increase profits because of reduced competition. Given that the Government has said that the attractions of bringing in private sector contractors include increasing the diversity of public service supply and offering consumers more choice in public service supply arrangements, sector consolidation may be against the public interest in many circumstances.

The public sector "market" is not an easy one for potential contractors to enter. As the Federation of Small Businesses has observed, it is one that mostly excludes small firms.[62] In fact, it also typically excludes all but the largest PLCs and multinationals. It has high transaction costs for contractors (as well as for the public sector client), requiring enormous investment just to bid for contracts. This acts as a barrier to market entry and creates economies of scale that favour large providers. These barriers to entry are reinforced by the tendency for "incumbency advantages" to accrue to those providers that establish themselves in the market.

> *"If the incumbent is in a privileged position when it comes to the re-tendering of a particular contract, this may discourage participation of firms with low chances of winning, and may weaken competition overall. Where repeated selection of the same firm increases incumbency advantages … a buyer … may find itself with a rather restricted choice of suppliers in the long term. To the extent that sector bidders anticipate such an outcome, they have an incentive to reduce their price when a new requirement is first put out to tender in the expectation of little competition and higher profits in the future."*
>
> **Office of Fair Trading**[63]

CONCENTRATION IN THE PUBLIC SERVICES INDUSTRY

There has been significant consolidation of the **facilities management** sector in recent years. Carillion has acquired Mowlem, while Kier, Vinci, Jarvis, Rentokil Initial and AWG have all been restructured. Industry analysts anticipate that *"recent trends towards consolidation among existing companies will continue over the next few years, with acquisition activity remaining high. FM contracts in general are becoming larger and operated over longer terms … and FM companies need to be sufficiently large and offer a sufficiently diverse range of services in order to be able to compete for these large scale projects."*[64] The growth of "bundled" service delivery and "total facilities management" has resulted in higher contract values and *"has also led to reduced market potential for smaller FM contractors and has encouraged the current high levels of acquisitions in the market".*

As **social care** services have moved into the private sector, providers have been amalgamating into increasingly large businesses. Initially many care businesses operated just single care homes, or two or three homes. As regulatory pressures have increased, it has become increasingly difficult for these small businesses to comply with them. These often underperforming or undercapitalised businesses had their prospects improved by new management, extra finance, or by merger. Private equity houses have played the key role in this consolidation, which is likely to continue. Sector analysts Plimsoll reported in 2007: *"At least 80 UK care homes companies are prime targets for takeover and another 131 could be sold off by their parent companies."*[65]

The contracting-out of **waste management** services has been accompanied by extensive reorganisation of the private sector interests owning the waste management operators. In 2004 the Office of Fair Trading warned that *"increasing vertical integration amongst suppliers … might limit the number of competitors that can be sustained in the long term because of potentially significant scale economies in waste disposal."*[66] The Office of Government Commerce (OGC) has registered *"concern that competition is limited, with too few players dominating"* – eight to nine suppliers control at least 78 per cent of the market, and in most regions even fewer are able to bid effectively for contracts. The OGC believes that the trend to consolidation *"looks set to continue – which is likely to further reduce the number of suppliers competing for major contracts".*[67]

The private **healthcare** sector has seen significant consolidation of ownership in the last five years. As a result *The Economist* has warned that the government's aim of creating *"a vigorous external market in hospital care … may be thwarted if the private sector becomes too concentrated".*[68] Some experts have also warned against undue market power accruing to joint ventures formed between Foundation Trusts and private healthcare companies, which could leave PCTs constrained by *"the lack of competition these behemoths provide in some parts of the country".*[69]

The **leisure management** industry is consolidating to a significant extent within the UK – with DC Leisure Management (owned by the private equity house Sovereign Capital) now a leading operator of services for councils across the country. Greenwich Leisure has taken over the management of leisure centres for eleven other London boroughs, another two councils outside London and facilities for the London Development Agency and community groups.[70]

Housing associations have gone through a comprehensive programme of restructuring in recent years, to bring down the costs of administration and achieve economies of scale. Some housing associations today are the product of mergers of as many as five mid-tier associations. This has included mergers between long-standing housing associations that serviced specific localities, with associations based in other areas and regions and with what had been dedicated LSVT associations created to takeover particular councils' housing stock. In doing so, they been accused of losing touch with their founding ethos, their membership, their geographical focus and of paying senior managers at private sector rather than community sector rates.[71]

This process of consolidation may be further exacerbated as the public sector seeks to minimize the fragmentation and duplicated transaction costs resulting from contracting out by re-integrating and re-bundling services in larger, longer-term contracts. However, this struggle for cost-cutting contradicts the demands from the National Audit Office and the House of Commons Public Accounts Committee to strengthen the contract management function within the public sector, to protect the public purse and ensure that contract terms are property fulfilled.[72]

> *"The tendency in recent years has been towards aggregation of different services to increase the scale of individual commissions … medium to large service providers are in the strongest position to respond, and hence market consolidation is likely to continue across the market".*
>
> **Kable**[73]

The buying and selling of public infrastructure assets and the service concessions – which most notably characterises private equity involvement in public services – mean that public bodies can have no certainty about which organisations they are working with or their long-term objectives.

4.2 Investment costs

While a common justification for privatising public services is that they require significant investments that the public finances cannot afford, the reality is that because their control and ownership is in the private sector there are major on-costs and large fees and charges that the public purse must pay for. Savings in capital expenditure are at the expense of increased revenue spending.

Analysis of the first 12 PFI hospitals shows that there is much higher cost incurred by the public sector because of the use of private sector funding. The cost of this, just on those 12 hospitals, is an extra £60 million a year. This equates to 20% to 25% of those NHS trusts' annual income. The study concludes: *"If this experience is generalized across the entire PFI programme ... then the extra costs of private finance for the signed PFI capital programme in hospitals worth £8.67bn is about £480 million every year."*[74] This would be enough to pay the capital costs for three extra large hospitals a year. If these costs are extrapolated across PFI procurement on all government departments (but excluding PPPs) – whose PFI programme in 2007 had a capital value of £53bn[75] – this suggests the Government is paying as much as £2.7bn annually to finance the capital costs of the PFI programme, rather than using direct procurement.

Independent Sector Treatment Centres were promoted as a means of delivering new capacity to the NHS, but *"to encourage entry into the market and to cover the cost of new buildings and refurbishments"* private companies were paid over the odds for relatively straightforward procedures.[76] First wave ISTCs were paid 11.2% more than NHS trusts, which works out at 30% more once the greater simplicity of their procedures is taken into account.[77] In addition, ISTCs are paid at guaranteed activity levels, resulting in what the Healthcare Commission and Audit Commission reported as *"widespread frustration among NHS organisations that ISTCs were paid for activity that was not performed"*.[78]

In order to pay for PFI and PPP contracts – including the higher cost of borrowing to invest and the profits to pay contractors and consultants – the public sector is faced with an affordability problem. Quite simply, when spending increases to procure and manage assets, other expenditure must be cut back.

As has been repeatedly reported, in the health sector the issue of affordability has been partially resolved by reductions in the number of beds in new replacement hospitals, compared to their predecessors. While there are new hospitals, the benefits have been seriously mitigated by the fact that fewer patients can be treated at any one time.

The impact of this extra cost of private finance is particularly severe on NHS acute trusts, which must increasingly compete for work from Primary Care Trusts under the Payment by Results system. They are hindered in this by the effect of the cost of borrowing under PFI schemes. Capital costs in the 2005/6 year for 4.3% higher for NHS trusts with major PFI projects than that allowed under the Payment By Results tariff structure.[79] In fact, while the cost of capital for the NHS is 3.5%, according to analysis conducted by accountants PricewaterhouseCoopers found the average rate of return for the private sector in a PFI contract is 7%. (However, as the Cuthberts have argued – see below – this dramatically understates the real rate of return over the full PFI contract period.) As such, even using figures that are more supportive to private contractors, PFI hospitals must cope with a doubling in finance costs.[80]

This affordability "crunch" has had a serious impact on trusts' finances. While less than a quarter of all NHS trusts were in deficit in 2005/6, half of those trusts with major PFI projects were in deficit – some very substantially. This is clearly not a coincidence. Yet, acute trusts have taken serious steps to address this affordability gap – by cutting back on the size of the hospitals. As has been repeatedly reported, in the health sector the issue of affordability has been partially resolved by reductions in the number of beds in new replacement hospitals, compared to their predecessors. While there are new hospitals, the benefits have been seriously mitigated by the fact that fewer patients can be treated at any one time.

"One for the price of two"

Jim Cuthbert, a former chief statistician with the Scottish Office, and his wife Margaret, a leading academic economist, have produced a series of analytical papers criticising the cost of PFI. The Cuthberts argue that official assessments of returns on PFI projects have used a misleading statistical analysis to artificially underestimate the real level of profit achieved on PFI projects.

The standard measure of profit achieved is the Internal Rate of Return – the return achieved on equity, though in practice, this includes share-based equity and subordinate debt. The Internal Rate of Return quoted by the Treasury and other public bodies is argued to be reasonable, typically at 15% to 20%. But, point out the Cuthberts, this ignores the reality that PFI/PPP schemes are heavily financed through debt. This high level of debt causes a long delay before shareholders take dividends on their shares. Consequently, the Internal Rate of Return will "rapidly snowball" towards the latter period of the contract.

The real Internal Rate of Return can be understood by an actual example of a hospital in England. The capital cost is nearly £70 million. Finance of over £60 million is borrowed from banks, at an interest rate just over 6%. The PFI consortium invest almost £10 million as subordinated debt, earning 15%, while the equity stake is a mere £1,000. The banks' senior debt' is paid off rapidly, leaving only the subordinate debt outstanding, which earns the consortium members a very large annual return. Without the need to pay off the senior debt towards the end of the contract period, the equity return accumulates at a much higher rate in the last years.

The effect is that a £1,000 equity stake generates dividends over the period of the contract of over £50 million. Taken with an eventual £40 million return on the subordinate debt, the consortium members will generate profits of £90 million on equity of £1,000, plus subordinate debt of £10 million.

A hospital costing £70 million has generated profits for the contracting consortium of £90 million, on top of the actual costs of the project. This, say the Cuthberts, means *"the taxpayer has got 'one for the price of two' through using PFI"*.[81]

4.8 Transaction costs

Contracting-out services may generate additional "transaction costs" such as writing contracts, monitoring performance and controlling the behaviour of contractors. These costs may outweigh any savings achieved through outsourcing in circumstances *"when asset specificity is high, contractors have incentives to behave opportunistically, the number of potential external suppliers is small, and future product requirements are uncertain*".[82]

The Office of Fair Trading observed: *"Evaluating bids is costly, in particular where the buyer's needs are complex and requirements cannot be specified in a simple way""*[83] A related point was made by the Audit Commission, which noted that *"at least some"* of the apparent savings claimed for Compulsory Competitive Tendering *"were offset by the costs associated with managing competitive processes."*[84]

Ironically, the public sector even has to incur costs to ensure that a market exists, even going to the point of subsidising some potential contractors. The Office of Fair Trading observed: *"The public sector may [need to] help firms to overcome entry barriers.*"[85] It added: *"Incumbency advantages … may have to be neutralised … by paying new entrants to invest in getting up to speed with requirements."*[86] Transaction costs for the public sector also arise from the legal obligations required of public bodies (including European Union legislation) to ensure that contracting is not corrupt or discriminatory.

Initial reports of cost-savings under **Compulsory Competitive Tendering** have been found to be *"biased upwards"* as a result of a disproportionate focus on some services, despite evidence that *"CCT appears to lead to additional spending in street cleaning and some aspects of catering"* – as a result such research may *"disguise the fact that, in some councils, competition has imposed extra financial burdens on local taxpayers."*[87]

Case study: Tower Hamlets school refurbishment

Ballast PLC, a subsidiary of Ballast Nedam, were prime contractors on a £120 million PFI project with the London Borough of Tower Hamlets for the refurbishment of schools. Facilities management was to be undertaken by a subsidiary of Ballast PLC, Wiltshier. Finance was supplied by Abbey National Treasury Services, a subsidiary of Abbey bank (then Abbey National).

The contract was awarded in 2003 and was to have run until 2007, but Ballast PLC ceased trading in 2003 after recording a half year loss of £10 million, a previous full year loss of £35 million and running a pension deficit of £25 million. Wiltshier also closed. Abbey National Treasury Services coincidentally withdrew from the PFI market, because of poor investment returns.

Ballast Nedam paid compensation of £8.2 million for withdrawing from the contract, but Tower Hamlets was left with the necessity, cost and delays involved in beginning a new tendering process. Schools suffered severe disruption as a result of the strategic decisions of two very large groups to withdraw from an unprofitable market. Ballast Nedam was recently named by the Office of Fair Trading as one of the construction companies that it issued "Statements of Objection" against.

The Audit Commission review of **Strategic Service Delivery Partnerships** warned that *"contracts will be complicated and procurement costs for all but one of these councils are just over £1 million"*. ESSU cites Southampton and Somerset approaching £3 million. Some projects did not deliver *"the core value for money benefits"* and that *"the contractor had overestimated the scope for savings"*. Partly this was a result of flawed approach to comparing costs based which *"does not include the costs associated with procuring and managing the SSP"*. They recommend that *"councils should expect to invest at least 3% of the contract value to resource client-side management"* contract management could be 2% to 7% – *"increased complexity in contractual arrangements requires higher contract management costs"*.

> *"Local authorities have traditionally failed to identify all the transaction costs involved in procurement, usually by counting the cost of consultants but under-estimating or excluding their own staffing costs and on-costs. The latter represents an opportunity cost and must be fully accounted for."*
>
> **European Services Strategy Unit**[88]

The Healthcare Commission and Audit Commission have similarly warned that tendering for **health care services** by Primary Care Trusts *"can involve significant management time and PCTs should consider this before embarking on the process"*. Citing a case where a PCT had used a tender process to seek bids for genitor-urinary medicine services, they note that *"it should not be understated that the process of going out to tender and subsequently selecting a provider had a significant financial cost to the PCT in terms of diverting management time and opportunity costs"*.

4.4 Excess profits

Private sector ownership and operation of public services is reaping profits which are often far beyond those that might be regarded as a "fair" return on initiative and investment.

Private Finance Initiative

The total capital value of PFI and PPP schemes to date completed or signed is more than £100bn. The largest sector commitments are for transport schemes and hospitals and other health projects. As contractors typically operate on a 10% to 20% margin,[89] this represents at least £10bn in profits alone for the construction companies. In addition professional fees – for legal services and accountancy/consultancy advice – generate substantial earnings for the firms.

Exceptional profits can also be achieved when firms "exit" a contract, selling on their equity stakes. **Balfour Beatty** obtained exceptional profits of £5 million in 2003 from the disposal of its interests in some early stage PFI contracts. To avert administration, **Jarvis** sold its stake in Tube Lines for £147 million, a massive return on its collateral stake of £51 million.

A comparable process of super-profit generation has taken place through the refinancing of PFI projects. Start-up PFI schemes are funded typically mostly by loans, rather than equity. This minimises the losses for investors, whose debt is ranked as a preferential debt (unlike equity). But the interest rate on a loan for a start-up PFI scheme will be quite high. As the scheme beds down, the associated risk falls markedly – with the result that the interest on the loan becomes much lower. PFI contractors have been able to refinance projects taking advantage of lower interest rates on mature schemes. In the case of **Serco** – one of the partners in the Octagon Healthcare special purpose vehicle that won the Norfolk and Norwich hospital PFI scheme – it obtained a windfall profit of £4.1 million from its refinancing. As much as 80% of contractors' profits in the early PFI projects came from refinancing. Several requests to share the benefits between contractor and client of the refinancings were rejected. There is now a requirement in PFI contracts that any refinancing windfalls must be split 50/50 between contractor and client.

Companies that set-up PFI projects usually operate through Special Purpose Vehicles jointly owned by the contractors. These "SPVs" isolate contractors from potential losses, yet can generate very high rates of return on investments. It was the use of SPVs by Enron to manipulate profits for the benefits of executives and hide losses that led to the most notorious business scandal of recent years. *"The [hospital] SPVs' only activities and income relate to their contracts with the [hospital] trusts. They are shell companies without employees and simply channel payments received from the trusts to its subcontractors, typically their sister companies."*[90] As this analysis noted, the SPV structure allows for the possibility of "transfer pricing" – diverting profits between related companies, in order to declare income in the company (or jurisdiction) that is most tax beneficial. It also creates tied relationships between the subcontractors that own the SPV and the lead contractor that limit choice and "contestability" in the awarding of service subcontracts to fulfil the main contract. In the case of Metronet, the contractor merely awarded contracts to its contractors – who owned the SPV – without any real attempt at monitoring contract performance. This meant that poor performance by subcontractors was not challenged by the lead contractor. Transport for London found the structure destroyed performance accountability.[91]

Consortium members have other ways to increase profits further. The National Audit Office found that changes to PFI contracts and exceptional work were not always charged on a reasonable basis. Despite the massive profits achieved by the companies involved in PFI, ongoing charges can be both high and petty. The NAO found that £180 million a year is paid out to PFI contractors for contractual amendments. It reported major variations in charges for what was often routine maintenance work, which had failed to be specified in the original contract.[92] While one school had to pay £320 to fit a new electric socket, elsewhere the charge was £30.81. At one hospital it cost £486.54 to fit an extra lock: at another it was £15.09. One hospital was charged nearly £50 for a new key – elsewhere it was £4. In many cases there has been no competitive tendering for variations and additional work carried out because of weaknesses in the initial contract terms. Contractors often seeking significantly higher fees as part of periodic reviews. The London Borough of Haringey faced demands of £2 million for backdated "variations" on secondary school facilities management contracts, plus a more than 50% increase in cleaning contract charges.

In the construction sector evidence has come to light of extensive collusion among businesses aimed at holding up prices and saving on bid costs. Clients – which included local authorities – were left with what the OFT termed *"a false impression of the level of competition and this may result in it paying inflated prices"*. The OFT also alleged that successful bidders in some instances made compensation payments to other companies that agreed not to compete aggressively for contracts. The allegations of bid rigging involved a range of construction projects, including hospitals, schools, universities and housing. The OFT has not published its Statement of Objections – the formal allegations – against the companies, so it is not known which allegations relate to which companies. Statement of Objections were issued against 112 businesses including some of the largest companies in the sector, including **Balfour Beatty**, **Carillion**, **JH Hallam**, **Kier Group**, **Ballast Nedam**, the **Caddick Group**, the **Hall Group**, **Henry Boot**, **Interserve** and **Willmott Dixon**.

Private equity

Returns achieved by private equity houses in leading the reorganisation of the social care sector have been phenomenal. **Sovereign Capital** bought **Transcare** for £26 million in 2004, bought four other care groups in acquisitions for a likely £20 million or so each (details of some of the purchases were not disclosed) and is now looking to sell the enlarged group for around £200 million – probably an almost 100% profit. **Allianz Capital Partners** bought the **Four Seasons** chain of residential care homes in 2004 for £775 million, selling it four years later for £1.4bn – again a return approaching 100%. **Blackstone** did even better, achieving a 400% return on its purchase and sale of **Southern Cross** residential care business.

One of the most remarkable returns was achieved by the **3i** private equity fund, which bought **Care Principles** for £1.5 million and sold it on to another private equity firm, **Three Delta**, for £127 million – a more than 80-fold return on capital. **Bridgepoint Capital** is a private equity firm that specialises in the social and health care-related sectors. One of its portfolio companies was **Tunstall**, which helps elderly people continue to live at home. It was acquired by Bridgepoint in 2005 for £225 million, merged with another Bridgepoint investment, and sold on after three years for £514 million.[93]

Private equity finance has been heavily involved in the buying and selling of the **waste management** operators. Firms' objective appears to have been short-term ownership to cut costs, improve operating margins and then to merge with competitors to improve economies of scale and market presence. According to analysis by PSIRU, average private equity ownership of the waste management companies has been a mere 2.3 years. Profits on the deals have been significant for the firms – investments of €3.5bn have yielded returns of €2.5bn, equating to average returns of 69% in less than two and a half years. Total returns are underestimates as they exclude holdings retained by **Terra Firma** in part of the **Waste Recycling Group**, which is estimated to be worth £900 million. If this potential profit is included, private equity firms would have achieved an approximately 100% return on capital.

Tax avoidance

Prem Sikka, Professor of Accountancy at Essex University, has analysed the impact of PFI on UK tax revenues. His conclusion is that the use of offshore company registrations and other tax avoidance structures have denied the UK Exchequer large amounts of tax income. *"Numerous practices are used to avoid taxes, including setting up complex structures in offshore tax havens which peddle secrecy, low or no corporate taxes,"* he concluded.[94]

However, even where UK investors invest in offshore and other non-UK registered funds, they might still expect to pay UK income tax on their dividends. But, Sikka found, a number of the shareholders that invest in the offshore-registered PFI infrastructure investment companies are also registered offshore. In this way, they avoid paying UK income tax as well, except where individual shareholders bring that income back into the UK. If they spend the money outside of the UK, these offshore-based shareholders in offshore-based companies can completely avoid UK tax – even though the activities that generated this tax were earned within the UK and – in the case of PFI and PPP contracts – paid for by UK taxpayers.

Companies registering offshore are also not liable to UK stamp duty or capital gains tax. PFI and PPP companies that use offshore residencies include **3i Infrastructure Ltd** (Jersey), **Allianz PFI Assets** (Jersey) Ltd, **Hermes** (based in Guernsey and a large investor in PFI/PPP projects) and **Coutts Bank** (whose Jersey division is used for trust-based shareholdings in PFI/PPP schemes).

Professor Sikka found that some companies involved heavily and profitably in PFI schemes did not pay any UK corporation tax, through their use of tax efficient structures. What is more, some shareholders also did not pay any tax on their dividend payments through the use of offshore shareholdings.

Understanding the accounts and finances of some PFI and PPP contracting companies is extremely difficult because of their use of a web of cross-shareholdings, special purpose vehicles and multiple companies. In the case of **Innisfree**, for example, Companies House shows 38 companies that use the Innisfree name and that appear to be possibly inter-related. Other companies associated with the group do not use the Innisfree name. In addition, the Innisfree group has close relationships with construction companies Skanska, John Laing, Mowlem and WS Atkins to build infrastructure that Innisfree finances, owns and is involved in managing. Innisfree also has interests in sector-specific PFI and PPP management companies, including NewSchools Ltd and Health Care Projects Ltd.

The PPP marketplace is muddled by the extent of cross-holdings, disposals and use of offshore investment companies. In 2005, **John Laing** disposed of half its interest in four PFI assets to **Allianz**. But while Allianz is a German insurance and finance group, the division that bought the assets was Allianz PFI Assets (Jersey) Ltd. Despite the partial sale, the assets (two police stations and two police firearm training colleges) were to remain under the management of a Laing company, Laing Capital Management.[95]

4.5 Quality

Part of the rationale for the "marketisation" of public services is to cut costs. Once privatised, the providers of services are motivated by the twin desires to operate the contract in accordance with the specific terms of the contract and their need to extract profits, to pay dividends to shareholders. These pressures can mean that contractors prioritise cost-cutting at the expense of service quality and conditions of employment.

In particular – and especially where contracts are awarded for short-term periods – there can be under-investment in public services, with little incentive to properly resource a service where it may become the responsibility of a rival in the foreseeable future. Obviously these pressures are at their most severe towards the end of a contract period if the contract is not to be renewed, when perhaps relations with the client and reputation are no longer priority concerns. These factors can mean that assets decline in quality, that IT and other infrastructure is not invested in and that staff are not adequately trained. It can also mean that staff are allowed to leave towards the end of a contract period – at the expense of service users, with inexperienced or too few staff to service the needs of clients.

Economic analysis suggests that *"market forces"* may not be *"sufficient to ensure that agents fulfil the objectives of principals" (ie contractors) and that this is particularly likely where "information on the quality of service actually delivered remains asymmetrical"*. Furthermore, *"it may be argued that the incentive to 'shirk' on quality is greater for private than public agents. Once a contract price has been agreed, a private firm can boost its profits by reducing service quality"*.[96]

Investment in the staff who deliver public services is a key dimension of this. The Government has recognised that terms and conditions offered by contractors *"must be sufficient to recruit and motivate high quality staff to work on the contract and designed to prevent the emergence of a 'two-tier' workforce, dividing transferees and new joiners working beside each other on the same contracts"*.[97] The Department of Health has acknowledged concerns that the "two-tier" phenomenon is *"poor employment policy"* and can *"put service quality at risk"*.[98] Nevertheless, two tier workforces now operate across much of the public service arena. As well as impacting on service quality, this means that the public sector is ceasing to accept its responsibilities for paying decent wages or providing good quality pensions – which, in turn, means that it will have to pay more in means-tested benefits in later years.

Research has also shown that private equity firms that own portfolio companies for a short period of time do not prioritise staff retention and that companies in which private equity is involved have a faster turnover of staff. Where private equity houses take over companies that are contracted to provide public services, TUPE no longer applies – allowing private equity firms to cut wage rates and pension entitlement and increase working hours. There is evidence that much of the reward for private equity investors comes at the expense of workers' pay and conditions. This mirrors criticisms of the way private equity works in taking over private sector companies. The high level of debt taken on by private equity firms often leads to cuts in jobs, as they seek to repay loans and achieve very high targets for returns. This, in turn, affects the quality of service provided, especially to vulnerable people, such as care of the elderly and vulnerable children.

QUALITY IN QUESTION

Compulsory Tendering of **local government services** raised concerns that it *"engendered short-term, low-trust relationships between principals and agents. Having won the work, contractors had good reason to minimize their efforts consistent with compliance"*.[99]

The private provision of **school catering services** has resulted in understaffing, poor pay and conditions, little training, and underinvestment, making it harder to raise nutritional standards, tackle child obesity and improve public health.[100]

The widespread contracting out of **hospital cleaning services** has resulted in staff reductions, poor terms and conditions, and under-investment in training and equipment, resulting in a fall in hospital cleanliness that has been linked with the rise in Hospital Acquired Infections.[101]

The Audit Commission found that for large scale **strategic service delivery partnerships***"variables like service quality are hard to measure and there have been occasions when performance targets have been met on paper, but the council has had concerns about the quality of service delivery that cannot be evidenced through their performance management processes*".[102]

The market for **ICT services** is one of the most developed in the public sector – it is also one of the most troubled.There is now a long history of contracts that have gone wrong- ranging from the EDS and Andersen contracts with the Inland Revenue, to the large number of revenue services contracts in local authorities that failed. ESSU report identified 105 public sector ICT contracts with £9bn cost overruns averaging 30.5%, a third of contracts suffering delays and 30% of contracts terminated.

Evidence from the National Audit Office, the Prison Service Pay Review Body, and the Prison Inspectorate suggests that cost-savings achieved by **private prisons** are largely the result of employees working longer hours, with few holidays, for lower pay and inferior pensions and other benefits.[103]

Wage rates in the **social care** sector have always been poor – even when in public sector ownership. But there is evidence of pressure to cut wage rates, working hours and staff numbers even further. (See Excelcare case study.) There is also evidence of companies bringing in workers from other countries who may be more willing to work on the UK minimum wage. The Care UK annual report for 2007 said that to avoid recruitment from within the NHS it has recruited staff from 13 countries, with "62% of employed healthcare professionals being recruited from overseas.

The shift towards a largely outsourced **home care** services has left us with a sector that is *"struggling already to provide services of sufficiently high quality"* and failing to *"recruit, train and develop care workers … to meet new demands and ways of working."*[104]

There are also worries that **voluntary sector providers** are failing to maintain conditions of employment previously provided by the public sector – a situation unlikely to change as their costs come under pressure from private sector competition in which costs are rigorously controlled. Research evidence indicates that third sector organisations are responding to the need to compete for service delivery contracts by reducing staff, cutting terms and conditions, and that smaller organisations are finding it increasingly hard to survive.[105]

Case study: Exelcare care homes

Excelcare took over ten care homes from Essex County Council in 2005. It runs these as part of a chain of 39 care homes, with 1,800 beds, in England and Wales. After taking over the Essex care homes, the operations were divided between ten separate legal companies.

A year later, Excelcare announced that it was facing financial difficulties and cut the terms and conditions of the workforce: wages were reduced by up to 40% for senior carers, with some experienced staff having to take the minimum wage, while working hours were increased from 10 to 12 hour shifts. Some staff had to obtain state benefits to compensate for pay cuts. New starters were put on reduced terms and conditions, creating a two-tier workforce. This led to an exodus of staff who refused to accept the working conditions.

But according to accounts filed at Companies House, the homes would have been operating profitably were it not for unspecified administrative expenses placed onto the balance sheet, which on average worked out at £470,000 per home. This gave rise to allegations that losses were artificially generated to justify cuts in pay and conditions for staff.[106]

THE PRIVATE EQUITY EFFECT

Private equity buy-outs lead to rapid job cuts, redundancies and a weakening of the terms and conditions of employees after buyouts.

A study by **Birmingham Business School** and the **University of Bologna** revealed that in comparison to a control group, job losses at UK private equity owned companies were 7% higher one year after takeover and rose to 23% higher after four years.

The **World Economic Forum** examined 300,000 US PE-backed firms from 1980 and 2005 found that employment in PE owned companies declined sharply in relation to the control group after buyout, and was 7% lower after two years. Five years after buy-out, employment levels were over 10% lower in PE owned companies than they would have been had they developed in the control group.

The **Centre for Management Buy Out Research** and **Nottingham University Business School** found that buy-out firms had significantly lower annual wage growth than non-buy-out firms. The study also revealed that the larger the company, the greater the downward pressure on wages.[107]

TUPE – the Transfer of Undertakings (Protection of Employment) Regulations 2006 – does not apply to takeovers that take place through a transfer of shares, including in a private equity buyouts. This leaves the workforce vulnerable with reduced protections. Workers' rights to information and consultation is also undermined, as their interests are not taken into account or protected. The TUC wants to see TUPE extended to share transfers. This would ensure that workers in companies being taken over by private equity funds will be informed and consulted about the proposed takeover plans. It would also guarantee that their terms and conditions were maintained after the buyout and that any redundancies carried out solely because of the buyout would automatically be unfair.[108]

Barnet care homes

The Fremantle Trust decided in April 2007 to dismiss and re-engage care workers who had previously been employed by the London Borough of Barnet. Their new terms and conditions were much inferior, with staff losing up to 35 per cent of income and cuts to their sick pay and holiday entitlement, even though staff had been transferred to Fremantle under the Transfer of Undertakings (Protection of Employment) Regulations five years before. Staff had been assured their terms of employment would be upheld when the not-for-profit Fremantle Trust took control of Barnet Council's care homes.[109]

Case study: Bedfordshire support services

Hyder Business Services Group Limited (HBS) – a subsidiary of the privatised Hyder water company – won a 12 year £267 million contract with Bedfordshire County Council in 2001 to modernise support services. The contract required 550 staff to transfer from the council's IT, finance, human resources, school support services and communications to HBS. The new employer refused to negotiate with or recognise UNISON or other unions. HBS promised to deliver a regional business centre to attract new work and jobs; a 45 place call centre for all services; £7.8 million investment in new IT, including an SAP integrated resource management system; £6.9 million investment in improved accommodation; a national centre for excellence in education; measurable service improvement and annual reduction of service costs of 2% (about £900,000).

The impact on jobs was detrimental. Staff who left were not replaced and new staff were employed on worse pay and conditions creating a two tier workforce. Service performance declined. Promised service improvements were not achieved, with no progress on the Regional Business Centre, the quality of school support declined, the national Centre of Excellence in Education was repeatedly delayed and HBS sold off the dedicated building. Only a part of the investment on accommodation took place. At the time it signed the contract, HBS was owned by Nomura International bank and was subsequently transferred to its private equity division, Terra Firma, which sold it on to Mouchel Parkman.

In 2004 Bedfordshire was the worst performing county council in Britain. A new chief executive was appointed to improve performance who said that a priority was to extricate itself from its contract with HBS. She said: *"The outsourcing of support functions had left the county light in financial management and client expertise."*[110] The final straw was an accounting problem that prevented the council from filing its accounts for 2003/4. In September 2005 Bedfordshire County Council paid £7.7m to terminate its 12 year contract, after just four years, bringing 546 staff back in house.[111]

4.6 Inflexibility

The privatisation of large numbers of direct service organisations undermines the ability of public bodies to provide services on a flexible basis, responding to changing demands.

A serious problem with **business outsourcing** contracts is that they can prevent clients acting flexibly to changing environments. The Audit Commission warned: *"Councils and their contractors will be unable to predict how the political and financial environment will change over the duration of the SSP [strategic service-delivery partnership], and in some circumstances SSPs may reduce the flexibility of the council in responding to these changes."* [112] It found that contracts may be obstacles to councils changing as service demands change. Public sector clients found an absence of partnership ethos where there were no financial incentives rewarding this built into the contracts. The National Audit Office has also warned that outsourcing corporate services to shared service providers *"can tie purchasers of shared services to providers that are prepared to work around purchasers' inefficient processes"* and *"entrench"* inefficiencies.[113]

A focus of Lord Darzi's **health services** review is the recommendation to provide "polyclinics" – localised treatment centres that will provide minor and planned procedures in enlarged primary care centres. These developments threaten the viability and sustainability of both some PFI/PPP hospitals and smaller primary care centres built under the "LIFT" PFI schemes. The danger is that the NHS will be committed to long-term contracts that prevent it making changes to the way it delivers care, or that reflect changes in delivery systems caused by modern technologies and treatments.

Schools locked into contracts with private catering providers or PFI consortia have faced prohibitive costs when trying to improve the nutritional standards of **school dinners**. It was reported that a number of schools in Merton may have to be exempted from new standards because of the costs of renegotiating contracts with Scolarest (a division of Compass), while schools in Islington faced penalty payments if they opted out of catering contracts agreed by Cambridge Education Associates who run education in the borough.[114]

The Local Government Association has warned that efficiency targets will be harder to meet with "between 20-30 per cent" of **local authority** non-schools spending *"tied up in external contracts with the private and voluntary sector"* as *"often contracts cannot be renegotiated over short time periods (for example waste collection contracts often run for seven years)"*. The result is to place an even greater burden on services that have not been contracted out.

"Once you have set up partnerships or outsourced service provision to make savings these contracts are then fixed with probably indexation included which makes it difficult if not impossible to extract further savings in the short term."

local authority, quoted by the Local Government Association[115]

"Those that have already sold their housing stock, transferred their leisure services to a trust and have outsourced their major process driven work (eg waste) will find it impossible to find such savings from the relatively small number of retained services."

local authority, quoted by the Local Government Association[116]

Case study: Balmoral School, Belfast

Belfast's **Balmoral School** was built under the PFI and provided to the local education authority on a 25 year contract. But unexpected falls in student numbers meant that it closed just six years after it opened.

The result is that public bodies will have to pay £9.26 million for the empty buildings over the remainder of the contract period. At least four other PFI schools have similarly had to close, despite the ongoing financial commitments.

4.7 Accountability

The weakness of public sector agencies in relation to private contractors is a recurrent concern. The sheer size and scale of some contracts means that the public sector is, in practice, weak and dependent on its private sector contractors. Far from the client controlling the contracting environment, all the power lies in the hands of the private provider. In these circumstances, contractors can insist on favourable contract conditions and the absence of any alternative suppliers means the public sector client must comply.

Service providers can dominate the contracting arrangements – particularly where the scale of the required investment means there is weak competition for contracts. Building Schools for the Future has been reshaped to fit the requirements of the market, rather than the clients. Where the financial requirement is huge – as with the Tube PPPs – the entire market for potential lenders is drawn into the contracting as co-financiers, meaning that all their demands must be met.

This imbalance of power is exacerbated by the fact that the public sector has repeatedly failed to invest sufficiently in its client function, to enable it to properly manage and monitor contracts. The Audit Commission review of business process partnerships reported that *"the level of resource is low relative to comparable data on the cost of managing external contracts"*. ESSU reports that *"lack of client and contract management resources"* is universal and *"when the financial analysis of bids and the public sector comparator are close, cost reductions are made to widen the gap in favour of outsourcing. Client and contract management are usually first in line for cuts."*[117]

> *"Councils generally lack sufficient people with the procurement, risk or contract management skills to make effective use of market mechanisms; information about local public service markets that would enable them to use or develop those markets; and information about delivery costs, management costs or service performance to determine the best service delivery option and the best way to secure that option."*
>
> **The Audit Commission** [118]

Public sector clients have in some instances shown themselves to be terribly naïve. The NAO criticised the failure of many public bodies to employ full-time contract managers, which the NAO describes as *"risking false economy"*. In Northern Ireland, local education authorities lost £4.2 million by selling land below market value. Not only did they not properly market test the value of land, but in one instance no attempt was made to check the size of a plot of land measured only by tenderer – which was actually half an acre larger than quoted for. As a result, the public sector lost a third of a million pounds. In another case, land sold for £750,000 was resold for £950,000 just four months later.

Even where the public sector client ties down a contractor to what seems to be a fair price, the risk exposure remains substantial for the client. As we have seen, a key public service contract cannot be allowed to fail and, ultimately, the public sector client must pay the price of re-establishing a service arrangement where the private sector fails to continue supplying the service. The threat to sack a bad contractor can appear to be a hollow one, when the effect of doing so is at least as financially damaging to the client as it is to the contractor.

Accountability through contracting often fails to work. Ultimately, the client can only "sack or accept" the failures of a private sector client that continually underperforms. Ironically, this is particularly true with very large contracts – such as that for the NHS patient records contracts.

> *"Where customers of private firms are normally able to seek out alternative suppliers if any particular firm cannot deliver, this option does not normally exist in the case of public services. Any failure of procurement that jeopardizes the ability of the public sector to provide services to the public is highly visible, and may have significant detrimental effects. As a result, avoiding failures is a high priority for the public sector. This may lead to an overly strong incentive to limit participation in public tenders to large and reputable firms, or to stick with incumbent suppliers."*
>
> **Office of Fair Trading** [119]

An NAO study found serious problems with the retendering of the facilities services components of PFI contracts. In nearly half of the early PFI contracts examined, value for money had not been achieved, or could not be shown to have been achieved, when the facilities services elements of contracts came up for retendering. Facilities services constitute a large part of the ongoing value of a PFI contract. It is usual for contractors to be given the opportunity to tender for continuing to supply of these services, with the bid compared with market costs either through benchmarking or market testing (competitive tendering). The NAO found that where value for money had been achieved, it had involved public officials negotiating down the price proposed by the contractor. In other cases, above inflation increases in service costs had been agreed without adequate competitive pressure on contractors. A legal opinion obtained by the NAO found that original contracts had not been sufficiently well drafted to ensure that public bodies were able to competitively test prices for the renewal of facilities services.

Case Study: South West One

Southwest One is a shared service partnership, entered into with IBM by Somerset County Council, Taunton Deane Borough Council and Avon and Somerset Police. It has taken over the jobs of 1,400 staff, under a contract worth £585 million to IBM. It includes a framework agreement, through which another 33 public bodies may join Southwest One.

While the councils claim that £200 million in efficiency savings will be achieved, they and IBM have refused to provide evidence for the claim – arguing that commercial confidentiality requirements prevent this. The scale of the claimed savings are so large that UNISON believes they are not credible.

Analysis conducted for UNISON found six shortcomings in the procurement process: there was no consultation with service clients, such as schools; there was no proper scrutiny of the contract proposals; it is unclear how or whether service transformation will be achieved, because of secrecy provisions; the governance structure for Southwest One is also a secret, undermining public service accountability; the contract arrangements have undermined staff relations; and there was not full consideration at an early stage of alternative options. UNISON has called for an Audit Commission review of the contract before any other public bodies extend its operations.[120]

4.8 Service failure

The claimed major advantage of transfer of risk is entirely notional. Contractor failure must ultimately be bailed out by the public sector client: major schemes cannot be allowed to fail. Metronet, Jarvis and Dundee are notorious examples. (See case studies.) The fallacy of the risk transfer argument is also illustrated by the way that contractors use specially constructed joint venture companies to isolate the main operational businesses from the specific risk associated with the PPP or PFI contract. In this way, the failure of that joint venture does not damage the viability of the main company, which may even continue to return strong profits in a period in which a PPP contracts goes disastrously wrong.

Change in the ownership structures can also affect PPP contracts. Even before the collapse of Metronet, there had been serious problems facing two of the owners of the Tube Lines consortium – which runs the third of the London Underground upgrade contracts. Jarvis and Amey both hit serious financial difficulties which led them to the brink of collapse. Amey was bought by the giant Spanish company Ferrovial (which also now owns the British Airport Authority) – while retaining its stake in Tube Lines. Jarvis had to dispose of its Tube Lines' stake as part of its rescue strategy.

As we have already observed, the social care and waste management sectors, in particular, have seen a big involvement by private equity houses that have bought up small and medium sized operators, merged them, restructured the resulting groups, increased profitability and then re-sold the expanded and more profitable groups for large profits. In many cases, this has involved a chain of purchases and reselling of public service assets between private equity houses, with each party in the chain making significant profits. Service users and the public sector contractors that are relying on services from the provider, as well as the staff, have found that the owner of those services has changed repeatedly. This creates uncertainty and confusion.

Case study: Carter & Carter

Carter & Carter was founded in 1992 by Philip Carter, who was awarded the prize of "entrepreneur of the year" in 2007. It ran a variety of training and education courses, boasting that it was "the largest provider of learning solutions in the UK". It grew through a series of acquisitions, including Assa for £24 million, Fern Group for £14 million and Quantica, NTP and IMS for a combined £23 million. In 2005, the company's turnover was £51 million, with a declared profit of £4.3 million, following a loss of £1.9 million in 2002.

In 2006, Carter & Carter signed a memorandum of understanding with Castle College in Nottingham, to provide training in partnership with the college. But the following year, Philip Carter died in a helicopter accident. In March 2008 it went into administration, with debts of £130 million and allegations of false accounting. The company had 25,000 students on its courses and 2,500 employees. Its services were safeguarded by much of its operation being transferred to Newcastle College – with public money rescuing the failed private venture.[121]

The outsourcing of IT support services has opened-up the Government to additional security risks. With more organisations involved in the management of data, the risk of data loss is multiplied. The crisis over the loss of an HM Revenue & Customs disk containing information on all tax credits claimants was caused when the disk was despatched by a private sector mail agency. PA Consulting have been blamed by the Home Office for losing information on all prisoners, after a member of staff mislaid a memory stick. And EDS has been accused by the Ministry of Justice of allowing a hard drive to go missing, which contained personal data, including addresses, of prison staff.

The Audit Commission found that of its sample three **strategic service delivery partnerships** were terminated *"because anticipated benefits had not materialized and there was little confidence that they would"*. It judged that *"many councils erroneously considered a high proportion of risks as being transferred to the contractor. These councils either transferred too many risks, or considered that risks had been transferred when they had not."* [122]

Even contracting services to not-for-profit social enterprises is no guarantee that a public body will not end up being supplied by the private sector, or of ensuring continuity of supply arrangements (see case study, Ealing Community Transport).

Case study: Jarvis

Jarvis was on the verge of bankruptcy in 2004, after it accepted liability – jointly with Network Rail (as the successor body of Railtrack) – for the rail accident at Potters Bar in 2002 which killed seven people and injured about 70 passengers. The company was restructured, with the sale of most non-transport subsidiaries, its PFI bidding operations and its stake in Tube Lines, one of the two companies holding PPP contracts for the upgrading of the London Underground.

Jarvis was already in serious difficulty because of compliance problems on some PFI contracts, having to pay compensation for delays to building projects and having booked profits on PFI contracts too early, with the effect of boosting profits.

Jarvis emerged with a debt of £230 million, but annual profits of less than 10% that figure. At the time of crisis in 2004, Jarvis held 10% of PFI construction contracts, with a total investment value of about £3.5bn and was still winning PFI bids when apparently on the verge of bankruptcy.[123] Today Jarvis continues to trade and has a variety of public service contracts and employs more than 4,500 staff.

Case study: Dundee Student Villages

A new university hall of residence was constructed for Dundee University, structured as a joint venture, Dundee Student Villages, between the university and a private operator, Sanctuary Management Services. The halls failed to attract sufficient students to allow the company to break-even, which recorded losses in sequential years of £400,000 and £1.3 million.

The university has had to provide funding to the company from its revenues, leading to moves to make staff redundant.[124] Sanctuary Management Services is a wholly-owned subsidiary of Sanctuary Housing, a charitable housing association which operates residential housing under PFI contracts for a variety of public bodies.

Case study: London Underground

Metronet was a consortium of Bombardier, Balfour Beatty, WS Atkins, Thames Water and EDF, who were each shareholders. It won two of the three 30 year PPP contracts to upgrade the London Underground network. The capital value of the projects was about £12bn. But as a PPP, the contract did not fix price and was subject to price reviews at seven and a half year intervals: 95% of the debt was guaranteed by TfL.

Metronet (completely legally) awarded all its work through a tied supply chain to its own shareholders. According to TfL, Metronet failed to manage those supply chain contracts – presumably because the shareholders had a dominant relationship over Metronet. This, in turn, contributed to major cost over-runs. Because Metronet failed to properly manage those contracts and control costs, it was unable to recover the excess costs from TfL. This led to Metronet going into administration and TfL taking direct responsibility for the infrastructure upgrades – at considerable additional cost compared with the original budgets.

Metronet created two specially constructed companies for the Tube upgrade contracts. The liability of the five shareholders was limited to their shareholdings of £35 million each, but there was a total of £1bn at risk from the contractual dispute. It became cheaper for the shareholders to walk away than to fix the problem. The consortium partners' share prices were unaffected and they continued to win other PPP and infrastructure contracts – Balfour Beatty and Atkins have been named preferred bidder for a £2bn contract to widen the M25 contract.

TfL says it will be "some time" before the cost of Metronet's collapse will be known, but the transport union RMT estimates the extra costs to TfL will be about £500 million.[125]

Question marks also hang over the continuation and terms of the second major London Underground PPP contract with **Tube Lines**. Charges for the second seven and a half year period of the Tube Lines' contract could rise to between £5.1bn and £5.5bn, compared to the £3.1bn that Transport for London had projected for the renewed contract – though this is less than the £7.2bn that Tube Lines itself wants to charge. Under the complex PPP agreement, charges are referred to an external arbiter – the rail regulator – who has come up with initial projections of £5.1bn to £5.5bn. This means that Transport for London may have to find about £2bn that it has not budgeted for, to meet the escalating costs of the contract.

The London Tube PPP has a cost structure that is outside the control of TfL and under which the risks of contract inflation as well as contract failure are largely held by the public sector client. [126]

Case Study: Enfield Leisure Trust

East Hertfordshire's Leisure Services awarded a management contract to Enfield Leisure Centres Ltd – the Aspire Trust – in 2005. The winning bid was based on cutting staff costs by 10% and increasing income by 8%, but projections of a £975,000 saving over five years proved optimistic.

Instead the trust saved a mere £50,000 in the first year and the council had to bail out the trust in 2006 when it projected additional costs of £903,560 over five years. The parent trust, Enfield Leisure Trust, went into liquidation in 2006 and the council was forced to transfer the service to Stevenage Leisure Trust.[127]

Case study: Ealing Community Transport

Ealing Community Transport was one of the most successful social enterprises in the UK. As it enlarged, it moved into additional areas of activity under the umbrella of ECT Group.

One of these was in the management of community recycling projects, run under the name ECT Recycling. But in June 2008, this social enterprise – supposedly protected as a not-for-profit business by registration as a community interest company – was purchased by the for-profit May Gurney construction and support company, listed on London Stock Exchange. ECT Recycling and its 1,100 staff were consequently transferred from the not-for-profit sector to the for-profit sector. The manager in charge of the development of ECT Recycling moved with the business, as did its contracts with the London Borough of Ealing and Somerset Waste Partnership.

The sale is just one part of a range of disposals made by ECT Group: it also sold its half share in the Northern Ireland recycling operation Bryson Recycling to its partner, the Bryson Charitable Group; its Cuckoo Lane Health Care division became an independent nurse-led practice; and at the time of this report's publication, ECT was negotiating the sale of its three rail businesses, RMS, Weardale and Dartmoor.[128]

4.9 Economic risk

> *"Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."*
>
> **John Maynard Keynes**

Reliance on private finance makes a government very vulnerable to market conditions. There has been a substantial use of debt rather than equity for private equity acquisitions and for the financing of PFI and PPP contracts. This has several implications.

One of the most serious is that as the cost of borrowing rises and when loan finance becomes scarce – as happened in 2007 and 2008 – the business model may no longer be sustainable and the business may no longer be viable. Lenders have in the last year had less money available for making loans because of the tightening of the inter-bank lending market. This, in turn, made it more difficult and more expensive to borrow for PFI and PPP projects.

The lending market was also seriously affected by the difficulties of the so-called "monolines". Monolines provide guarantees to bond issuers, improving the credit rating of issued bonds and therefore reducing the interest rate charged. Monoline insurers such as Ambac traditionally issued bond guarantees for a narrow range of purposes, primarily for municipalities in the United States to finance public works. But the monolines expanded into other markets in recent years – notably into guarantees for bonds that backed PPP and PFI schemes and on collective mortgage securities, including sub-prime mortgages. As the monolines were forced to set aside more reserves for potential calls on the sub-prime guarantees, so they were unable to continue to fulfil the role of guaranteeing PPP and PFI bonds – compounding the shortage of funds available in the PPP and PFI market.[129]

By gearing financing to borrowing rather than equity, commercial partners have less commitment to the company, while the shareholders have preferential call on the assets of the business in the event of liquidation. This creates incentives to structure a company fulfilling public service contracts as a "special purpose vehicle", with a small equity commitment, and to abandon it if the losses become severe. This is exactly what happened in the case of Metronet (see case study).

The nature of the financing can also seriously affect the nature of charges made to customers. While shareholders' returns vary according to the performance of the company, lenders have an agreed rate of return that must be maintained whatever the performance of the company. When privatised, water companies were largely financed by equity, with shareholders content to expect long-term returns. Subsequently, much of the sector has been bought by private equity firms that demand high, short-term, returns, with purchases financed by loans that have become more expensive as the credit crunch has impacted. This suggests that water charges are likely to rise in the medium term, while private equity firms' short-term returns have been achieved by economies of scale from industry consolidation – undermining the whole principle that the then government set-out when it privatised the industry through a diversified ownership structure.[130]

Government finances are therefore put at further risk when the economy performs badly and when money becomes more expensive to borrow. If the trend towards further consolidation of the industry continues and one of the largest commercial providers collapses because of the cost of borrowing, the Government could face demands to bail out companies providing services that it had sought to distance itself from.

SERVICES AT RISK

Investment in new **school buildings** is now in doubt as the global credit crisis has raised questions over whether the BSF programme is affordable from government tax revenues, especially as banks are increasing the rate of interest charged on loans.[131]

Privately financed **social housing and regeneration schemes** have been particularly affected by changes in economic conditions. The rising cost of borrowing has meant that while the most profitable PFI and PPP projects have gone ahead, those where the primary rationale was social and commercial viability has been undermined by falling property prices.

In the process of their acquisitions and re-selling, private equity firms have changed the structure of financing in the **waste management** sector, with much higher levels of borrowing. The cost of borrowing in high risk sectors has increased in the current global financial environment, and the availability of capital has fallen, potentially reducing the profits that can be achieved in this sector in the short and medium terms. This undermines the viability of these companies.

The credit crunch has put at risk several businesses operating in the **social care** sector that have been financed using high levels of borrowing. The future of the nursing home and care businesses Four Seasons, Care Principles, NHP and Senad are uncertain because of reported tensions between their owner, the Three Delta private equity house, and its principal investors, the Qatar Investment Authority, over a disappointing rate of return and difficulties in refinancing £1.2bn borrowed for the care acquisitions. A failure to resolve these problems could lead to a loss of care services for vulnerable elderly and the need for the public sector to provide rescue finance to ensure services are maintained.

Case study: Sedgemoor care homes

Sedgemoor ran 45 care homes for sexually abused and autistic children. It was bought by ECI Partners, a private equity firm, for £13 million in 2000. Sedgemoor leased its homes and when occupancy levels fell could not afford to pay staff or rent, the company collapsed in 2007. Some of the care homes were sold, leaving many vulnerable children potentially homeless. Local authorities had to intervene to find homes for many of the children. The Adolescent and Children's Trust (Tact), the UK's largest fostering and adoption charity commented: *"Private equity firms are more interested in maximising profits for shareholders and operating for short-term gain rather than providing long-term care for the most vulnerable."*[132]

Case study: Southern Cross care homes

Southern Cross was bought by Blackstone private equity house in 2004. Blackstone carried out a major restructuring of the company, including separating the operating company from the ownership of the property – the so-called op-co, prop-co division. The restructuring gave Southern Cross the appearance of becoming a highly lucrative business and Blackstone took the company onto the stock market in 2006, netting itself a 400% return on its investment.

But the restructuring took place before the credit crunch and the collapse of property prices. The most recent Southern Cross acquisition was financed by bank lending while property prices were buoyant and without Southern Cross contracting for the forward sale of the property interests involved. When the property market collapsed, Southern Cross's negotiations for the sale of those properties fell through. Southern Cross had to make emergency arrangements with its banks for extending lending facilities, while it arranged to re-sell the properties. In the space of days, Southern Cross's share price fell from over £4 to less than £1.

With a risk of collapse hanging over the company, it was unclear what would have happened to the tens of thousands of residents – 80% of whom are funded by local authorities. Councils would clearly have had to intervene to ensure the continuing provision of care services to people who are highly dependent on the homes. But even a solution which involved care home residents moving into other homes would have been likely to be highly distressing to vulnerable elderly people.[133]

5. Conclusions

There is a reason why the public sector was created, evolved and provided services. Before the welfare state was created, essential services that were required by the public were actually only available to those who could afford them, or those who benefited from charities. This is why state education, the National Health Service and the welfare state were created. The recent direction of public services is taking society gradually back towards that old situation – as can particularly be seen by developments in social care and the NHS.

The widespread privatisation of public services is now a reality. The impact of this can be observed widely. The supply of public services through the "public services industry" makes service users dependent on the private sector and vulnerable to market changes. This means, for example, that the ownership of the services can change rapidly – as has happened in the residential care sector. It can mean that services are withdrawn – as has happened for vulnerable children in residential care. The cost of paid-for services can increase when the way the service is financed changes.

Ironically, the increased "marketisation" or privatisation of services has coincided with a commitment to reduce the burden of regulation imposed by public service regulators, such as the Audit Commission. This means that private companies taking over the running of public services can expect less close inspection and evaluation of their competence than was the case with the public bodies that used to run the services. There are also allegations – aired on Radio 4's Today Programme – that the Commission for Social Care Inspection has decided to adopt a light touch on some commercial care providers against the advice of inspectors, because the companies were seen as being good in other areas of the country. Altogether there is a worrying trend towards a reduction in the regulation of the public services industry – just when it needs to increase.

With the allegations, too, of collusion between suppliers – as with the Office of Fair Trading's investigation into the construction industry – there are fears that public bodies are not getting good value for money from contracting with the private sector. The privatisation of large numbers of direct service organisations undermines the ability of public bodies to provide services on a flexible basis, responding to changing demands, and to compare prices to ensure tendered prices represent good value.

The reality is that all too often the marketisation of public services fails to produce value for money for either the public sector, or for the citizens who depend on the services. Meanwhile, far from saving the Government money, private finance increases the costs and exposes it to massive new risks of service failures, that the Government will have to step in and resolve. The marketisation of public services represents a failure of policy that increases the Government's financial exposure and presents a potential personal catastrophe for vulnerable service users.

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