

Private delivery of public services: the struggle for legitimacy

There is huge potential for greater private sector involvement in the delivery of public services, according to CMPO's Paul Grout. But as he shows here, private delivery of public services is faced with widespread scepticism by the public and the considerable challenge of demonstrating when and why it is the best option.

The White Paper proposes to throw open the door to private and voluntary (third sector) delivery of public services. In David Cameron's words, it 'says loud and clear that it shouldn't matter if providers are from the state, private or voluntary sector – as long as they offer a great service'.

Coincidentally, and extremely conveniently, this will enable access to new forms of external finance at a time when the public finances are in poorer shape than they have been for decades and without much hope for rapid recovery. The White Paper states 'there is substantial external capital available that could improve the quality and availability of public services', and that as part of this process, 'work is under way to develop effective measures of the social impact of investment'.

It is clear that the potential for private and third sector involvement in the delivery of public services is huge. The non-public sector's involvement in the delivery of services to the public sector has grown enormously in the last 30 years. For example, the business department's 'public services industry review' (Julius, 2008) estimated that the turnover of the public services industry (defined as private and third sector delivery to the UK public sector) was £79 billion in 2007/8. Of course, the public services industry defined thus is not the same thing as the delivery of public services to the public sector, which is a smaller and far more contentious part of the industry.

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Despite some horror stories (for example, London Underground), which quite rightly capture enormous attention, the general theme of private delivery of public services is that, on average, privatisation, partnerships and outsourcing have been reasonably successful. Sadly, the thorny question of how to identify in advance when private provision is likely to succeed and when it will not has proved exceptionally difficult. But looking at the chequered history of publicly provided projects, it is clear this was always going to be a tough challenge.

But given the coalition government's push for more delivery and financing by the private and third sector, it appears that

these sectors will have a significant and growing role to play. If all goes to plan, this could help to soften short-term financial constraints by providing investment; it could also keep costs down in the long term if open services bring more competition and better, cheaper services.

Hence, the government argues, this is a win all round. Sadly, things are never this straightforward. The third sector is only around 2% of government spending so while voluntary provision is growing rapidly, the government is going to have to look mainly to the private sector to contribute to the short-term financial hole.

But here is the big problem. The prime minister may wish to shout loud and clear that it should not matter if providers are from the state, private or voluntary sector, but for the man or woman in the street, it clearly does seem to matter. Surveys and focus groups frequently show that the private delivery is greeted with scepticism by the public.

A private company will always struggle to justify profit from delivery of public services unless it is legitimised

For example, recent research by Ipsos MORI showed that 'the idea of private provision of public services tends to be greeted with suspicion. In general, alternative service provision by the private sector is rejected by many, both because the remit of private provision is perceived to lack a public sector ethos and because the profit motive is usually considered unacceptable in public services.'

In contrast, not-for-profit delivery is perceived in a positive light although there is no large body of evidence showing it is better. For example, Ipsos MORI found (as part of the same investigation) that many people felt strongly that the voluntary sector should have more of a role in achieving social outcomes (even though the public has little knowledge of the sector).

There is a genuine conflict between, on the one hand, what the government wants and what private delivery can offer in the right circumstances and, on the other, what the public think of it and want from it. This is likely to be one of the biggest constraints on the growth of private sector delivery of public services. Saying it should not matter who provides is not enough. The fact that the public are reluctant to accept private sector delivery of public services is something that has to be taken seriously. Far too little is done to deal with these constraints of 'political economy'.

In particular, the political economy constraints have to be recognised when delivery mechanisms are designed and monitored. This is a big issue and here I can only flag the general problem. But I will cite two examples and suggestions that may help to foster private delivery.

The White Paper speaks extensively about making data available to support individual choice of mode of delivery. But often the dearth of public sector information is a core problem for private delivery. The White Paper talks about private and voluntary sector agencies investing upfront and bearing the consequent financial risk that comes hand in hand with 'payment-by-results'. This has clear advantages since the public sector does not need to fund upfront and payment-by-results creates incentives for quality delivery.

But while better data may enable the end-users to make the best choice from their perspective, we also need data to know which mechanism is really best. The cost to the public sector agencies of private delivery is the whole-life cost of the private project. To know if this is a cheaper method, we need to compare the whole-life cost of the private option with the whole-life cost of the public alternative. The problem is that no one keeps a record of the whole-life cost of public activities. The whole budgeting structure in the public sector does not lend itself to this way of doing things.

This is the classic problem that has bedevilled public-private partnerships. As the National Audit Office has pointed out: first, central government rarely collects data from local government funded projects or devolved funding; second, the costs of services for conventionally procured buildings are rarely monitored, making whole-life costs very difficult to compare; and third, different procurement routes collect data on different bases. So while it is clearly important to provide quality data for users, we need better data about public sector delivery to get beyond assertion and case studies.

The challenge for the government is to overcome public hostility to the idea of running any public services for private profit

Another problem is the need to ensure that profits are perceived to be 'legitimate'. I do not mean by this that profits are earned legally as opposed to illegally, although obviously we should also ensure this is so. I mean that payment mechanisms should not be designed to provide maximum incentives but consideration should also be given to how the payment mechanism affects perception of profit.

Unless private profits are generally perceived to be the legitimate reward for better delivery and hard work, then there will always be pressure for government agencies and regulatory bodies to reduce returns and public pressure to retain public provision will remain.

Crudely put, a private company will always struggle to justify profit from delivery of public services unless it is legitimised.



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Fixed price contracts with penalties do not help here because then the way to maximise profit is to deliver the minimum that is acceptable and cut costs wherever. Even if the contract achieved the best outcome, it is hard for those outside the negotiations to know for sure.

In contrast, a reward structure that is heavily based on quality improvements will at least provide a positive association between quality and profitability even when there is uncertainty about how hard it really was to earn the money. Although payment systems that heavily reward quality improvements may be sensitive to subjective assessments of how hard improvements are to achieve and may increase the focus on measurable quality outcomes at the cost of harder to measure outcomes, the gain in perceived legitimacy of profit may still be worth the cost.

So if the government really wants to make service and not sector the benchmark (and help fill a funding hole along the way), then it may not be enough to open the door. The government should confront the political economy problems of private delivery if it wants to encourage people to walk through willingly.

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Further reading

Paul Grout (2009) *Private delivery of public services*, CMPO (<http://www.bristol.ac.uk/cmpto/publications/publicservices/ppfinal.pdf>)

DeAnne Julius (2008) *Public services industry review – Understanding the public services industry: how big, how good, where next?*, BERR (Department for Business Enterprise and Regulatory Reform), predecessor of BIS (Department for Business, Innovation and Skills)