



Community and Public Sector Union

Nadine Flood – National Secretary

4 July 2014

Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Professor Harper

Competition Policy Review

Please find attached the CPSU's submission to the Competition Policy Review.

Should you wish to discuss this submission further please contact Kristin van Barneveld on kristin.vanbarneveld@cpsu.org.au or 0420 316 825.

Yours sincerely

Nadine Flood
National Secretary



CPSU (PSU Group) Submission

Competition Policy Review

July 2014

The Community and Public Sector Union (CPSU) PSU Group is an active and progressive union committed to promoting a modern, efficient and responsive public sector delivering quality services and quality jobs. We represent around 55,000 members in the Australian Public Service (APS), other areas of Commonwealth Government employment, ACT Public Service, NT Public Service, ABC, SBS and CSIRO.

The CPSU welcomes the opportunity to provide input to the Competition Review Panel. As the majority union in the Commonwealth public service, the CPSU submission is focussed on issues of most concern to our members – namely whether the community is best served by this work being done by the Australian Public Service or elsewhere.

Broadly, the CPSU has significant concerns with the framing of these issues in the discussion paper. A key area of focus for the Terms of Reference is to *'review government involvement in markets through government business enterprises, direct ownership of assets and the competitive neutrality policy, with a view to reducing government involvement where there is no longer a clear public interest need.'* The CPSU also notes that the scope of the review states that *'government should not be a substitute for the private sector where markets are, or can, function effectively or where contestability can be realised.'* The scope recommends that the Panel should *'examine whether government business activities and services providers serve the public interest and promote competition and productivity, including consideration of separating government funding of services from service provision, privatisation, corporatisation, price regulation that improves price signals in non-competitive segments, and competitive neutrality policy.'*

The CPSU is concerned that these Terms of Reference indicate the Review has a default position favouring the outsourcing of government services. The CPSU does not believe that a reduction of government provision should be a pre-determined aim of any review, or that a competitive market for public services is automatically positive. These underlying assumptions potentially limit the scope of the Review to simply investigating how to reduce the size of direct government service provision, without appropriate consideration of the broader public interest and views of the community.

The CPSU is affiliated to the ACTU, and supports the submission of the ACTU to the review. Our submission supplements that of the ACTU by debunking the continually perpetuated myth that Australia's public sector is inefficient, and highlighting our concerns about the impact of continuing down a path of outsourced provision of public goods. This submission draws attention to key failures of outsourcing including cost, quality, competitive failures and accountability concerns.

1. Efficiency of existing public services

The community has the right to expect that Australia's public funds are spent efficiently and, despite being a low-taxing nation, Australia's public service has been judged by the OECD and World Bank as among the most efficient in the world combining low rates of taxation with highly effective provision of government services (Figure 1).¹

¹ C. Stone, 'False Economies: Bang for Our Buck', *Centre for Policy Development*, 11 November 2013, pp.4

Figure 1 - OECD nations ranked by lowest taxing and highest effectiveness (2010)²



In 2012, Australia was ranked in the 94th percentile for government effectiveness and 97th for regulatory quality by the World Bank.³ Government effectiveness measures the quality of public services, their independence and the quality of policy formulation and implementation. Regulatory quality measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

Beyond the broad figures, the performance of Australian public sector agencies and departments is continually reviewed at various levels – by the Australian National Audit Office, by the Australian Public Service Commission and by the departments themselves. These reviews on the whole provide a positive picture of public service performance, while also highlighting areas for improvement.

A good example of efficient delivery of public services is found in the largest Department in the Commonwealth public service – the Department of Human Services (DHS). DHS employs approximately 36,000 staff, responsible for delivering a range of welfare, health and other services. A 2012 Australian Public Service Commission Capability Review found that a key strength of DHS was its exceptional performance and reliability day after day in the delivery of activities of extraordinary scope and scale.⁴ The significant crisis response

² *ibid*, pp.8

³ World Bank, Worldwide Governance Indicators - 2013 Update, 20 September 2013, <http://data.worldbank.org/data-catalog/worldwide-governance-indicators>, (accessed 25 June 2014)

⁴ Australian Public Service Commission, 'Capability Review – Department of Human Services', August 2012, <http://www.apsc.gov.au/aps-reform/current-projects/capability-reviews/dhs/3-summary-assessment>, (accessed 26 June 2014)

capability of the Department, which has been particularly evident over the last few years, was also positively acknowledged.⁵

While identifying some areas for improvement, the DHS Capability Review assessed DHS as well-placed for innovative delivery and to manage performance. It found that DHS continued to trial positive new models of service delivery based on good practice and that it consistently delivered on a wide range of activities, to the satisfaction of customers, the community and government.⁶ The Capability Review also noted that DHS was often not recognised for the important role it performed:

*'As much as the department is held in high regard by the public, the extraordinary scope of the work that DHS does is often not well recognised within the APS and throughout the broader community. Yet the department delivers on a consistent basis an extraordinary range of payments, services and activities, and any breakdown in this regard would soon manifest itself in social disruption. This is generally done out in the Network by relatively junior staff who occupy leadership roles in regional offices.'*⁷

2. Concerns about Outsourcing

As noted at the outset, the CPSU is concerned that the Terms of Reference suggest that this Review has a default position favouring the outsourcing of government services. Advocates of this position suggest that, among other things, outsourcing results in savings and provides better quality outcomes, partly through enhanced competition. The CPSU does not agree with these assumptions, noting our significant concerns about the quality of services and lack of public accountability from outsourced arrangements.

2a) Value for money

A key argument used in favour of privatisation and outsourcing is that private sector provision is inherently more efficient, resulting in cost benefits to both government and the client. The experience, however, is that purported savings and other benefits do not flow automatically.⁸

Many APS agencies use private sector providers to deliver core functions. However, the use of these private providers does not prevent cost blowouts or guarantee value for money. Six years ago, a review by Sir Peter Gershon into IT contracting recommended that the majority of the work be insourced⁹. Despite this, approximately one-in-five APS ICT employees still work as contractors¹⁰, costing on average \$186,000 a year, nearly double that of an APS ICT employee.¹¹

As well as generally costing more, outsourced contracts can have price overruns due to contract variations. In 2010, the Australian Taxation Office revealed that its five-year desktop services contract with Lockheed Martin (traditionally a defence supplier which has now re-

5 ibid

6 ibid

7 ibid

8 P. Barrett AM, 'Some Issues in Contract Management in the Public Sector', 26 July 2000, pp.4

9 P. Gershon, Review of the Australian Government's Use of Information and Communication Technology, *Department of Finance and Deregulation*, August 2008, pp.59

10 D. Hetherington, 'Social Innovation. Public Good – New approaches to public sector productivity', *Per Capita*, October 2013, pp.6

11 Australian Public Service Commission, 'Whole-of-government ICT strategic workforce plan 2010-2013', 4 April 2010, <http://www.apsc.gov.au/publications-and-media/current-publications/ict-workforce>, (accessed 26 June 2014)

engineered itself to provide not only IT services but also welfare to work services¹²) was 25 per cent higher than it had initially estimated.¹³

More specifically, outsourcing has also been found to enable price gouging. The inability to specify every aspect of a service in advance for multi-year contracts leads to contracts that allow for future adjustments with fees. As the need for these adjustments arise, the government purchaser may be at some negotiating disadvantage should the contractor demand an unreasonable price for a necessary variation, particularly if the cost of contract termination is excessive. In this way the cost of a service can significantly rise over the life of a contract.¹⁴ For example, Serco in Western Australia has been accused of massive price gouging on prison transport services, charging \$518,490 for 170 additional services over and above its set baseline monthly fee.¹⁵

There are also instances where massive costs can be incurred when the contracted provider fails to deliver on a contract. The most notable Australian example is the long running saga of the Queensland Health payroll system. The development of Queensland Government's Shared Services Initiative (SSI), a single payroll and accounting system for all Departments, was outsourced after a recommendation by an external consultant. IBM was contracted to design and deliver the system for \$98m in 2007. (This was despite the external consultant being a former IBM executive who intervened to favour IBM's bid during the tender process)¹⁶. By October 2008, IBM had not met its contracted performance goals and revised the cost of the SSI to \$181m. The SSI was abandoned and IBM's contract was reduced in scope to providing a new payroll system for Queensland Health¹⁷. On 14 March 2010 after ten aborted attempts to deliver the new system, it 'went live'. It was a massive failure which led to scores of over and underpayments. It forced the creation of an alternative functioning payroll system requiring about 1,000 employees to process data in order to deliver fortnightly payslips¹⁸. Three years later, the system continued to have glitches, requiring 800 people to be employed to process 80,000 payslips for Queensland Health. A KPMG report estimates that the total cost of the botched system will be \$1.25b by 2017.¹⁹

2b) Quality

It is important to the community that public services are high quality and the complexity in measuring outputs of the work delivered by the public service is well documented. Consequently, private sector providers have an incentive to focus on the measured deliverables in a contract, to the neglect of less easily defined outcomes. The more complex the service, the more difficult and more costly it is to effectively monitor service delivery.²⁰ In other word, where these types of complex functions are privatised, the very nature of the market means that the focus shifts from complex long term outcomes to meeting short term measurable goals that are directly linked to cost and profitability.²¹ For example, in

12 Democracy Now, 'From Warfare to Welfare: How Lockheed Martin Is Profiting From Running Welfare to Work Programs', 4 June 1999, http://www.democracynow.org/1999/6/4/from_warfare_to_welfare_how_lockheed, (accessed 4 July 2014).

13 Australian National Audit Office, Non-APS Workers, 25 June 2007, <http://www.anao.gov.au/Publications/Audit-Reports/2006-2007/Non-APS-Workers/Audit-brochure>, (accessed 25 June 2014)

14 B. Cook, V. Quirk and W. Mitchell, Report 1 - Report prepared for the Community and Public Sector Union (SPSF Group), 'Impact on Community Services of Staff and Service Reductions, Privatisation and Outsourcing of Public Services in Australian States', *Centre for Full Employment and Equity*, University of Newcastle, June 2012, pp.147

15 AAP, 'Rapist's escape from WA prison blamed on prison van security', *The Guardian*, 9 January 2014, <http://www.theguardian.com/world/2014/jan/09/rapists-escape-from-wa-prison-blamed-on-prison-van-security>, (accessed 26 June 2014)

16 M. Ludlow and P. Smith, 'IBM, Qld slug it out over botched health payroll system', *Australian Financial Review*, 8 August 2013, http://www.afr.com/p/australia2-0/ibm_qld_slug_it_out_over_botched_tnlj6VbICETb5sO8Wd9mJL, (accessed 4 July 2014)

17 R. Chesterman, Queensland Health Payroll System Commission of Inquiry Report, 31 July 2013, pp.12

18 *ibid*

19 Ludlow and Smith, *op. cit*

20 Cook, Quirk and Mitchell, *op. cit*, pp. 147

21 *ibid*, pp.107

employment services, rather than long-term employment outcomes, cost per employment outcome is the measure of success.²² Long-term investments in job seekers, long-term employer strategies and true, 'risky' innovation have been found to suffer.²³

The introduction of profit to health services is another example. In the United Kingdom, Serco was contracted to run a National Health Service out-of-hours care service in Cornwall. A Parliamentary Select Committee report found the out-of-hours service was 'not good enough' noting that Serco had struggled to ensure enough staff were available to fill all its clinic and car shifts. Serco replaced skilled clinicians with call-handlers without medical training to follow a computer-generated script to assess patients. The move triggered a fourfold increase in ambulance call-outs. A leaked email from managers to staff showed instructions on how to falsify emergency cases in order to make sure it did not miss the performance targets on which it was paid.²⁴ This example is pertinent since in Australia, Serco undertakes significant outsourced work.²⁵

These are only some examples of the failure of outsourced service providers to provide quality outcomes, and serve as a warning that private provision of public services can lead to worse outcomes for the community.

2c) Competition

Another key argument used to support privatisation and outsourcing is that private sector competition drives efficiency and innovation. However, it can also lead to a situation where the provision of services becomes dominated by a few established private firms, creating an oligopoly. Indeed, commentators have noted that 'Australia is a relatively small market, distant from other developed economies. Entering the Australian market is usually a relatively low priority for efficient international players. There is often only room for a few players with minimum efficient scale.'²⁶

Public services provided to non-paying 'customers' operate in markets that are different to those with paying customers. Any competition is largely confined to tenders and re-negotiation with contract managers.²⁷ As contracts increase in scope and complexity, commensurate with the services being outsourced, the cost and complexity of the tendering process reduces the number of competitors, with large firms eventually dominating the provision of these services.²⁸

The experience of the Australian employment services system is a classic example of a growing concentration amongst large providers. In 1997, 306 core Job Network providers were selected. After the 2003 contracts were issued, it was estimated that the 'top 12 agencies' held just under 60 per cent of the market. By 2009, the number of core providers had fallen from 306 to just 99.²⁹ A recent ANAO report indicates that it has since decreased further to just 85 providers.³⁰

22 L. Fowkes, 'Rethinking Australia's Employment Services', *Whitlam Institute*, March 2011, pp.6

23 *ibid*

24 *ibid*

25 Serco Sodexo Defence Services, 'Our Shareholders', 2014, <http://www.ssds.com.au/about-us/our-shareholders/>, (accessed 4 July 2014)

26 J. Daley, *Game-changers : Economic reform priorities for Australia*, *Grattan Institute*, June 2012, pp.22

27 Cook, Quirk and Mitchell, *op. cit*, pp.143-144

28 L. Keen, 'Sims threat to big state asset sales', *Australian Financial Review*, 23 June 2014, http://www.afr.com/p/national/sims_threat_to_big_state_asset_sales_Bb6ZSGjoZ2PlpWTHTsS6L, (accessed 24 June 2014)

29 D. Finn, 'Job Services Australia: design and implementation lessons for the British context', *Department of Work and Pensions*, 2011, pp.10

30 Auditor-General, 'Management of Services Delivered by Job Services Australia', *Australian National Audit Office*, 11 June 2014, pp.13

As larger contractors acquire smaller businesses that have won contracts, consolidation of the market and reduced competition results.³¹ The creation of 'public service markets' in the United Kingdom has led to an oligopoly situation where providers like Serco and G4S are seen as 'too big to fail'.³² In Western Australia, Serco holds all the major justice contracts and has been the sole bidder for some projects, creating a similar problem.³³

In the United Kingdom, where outsourcing has been a priority for a number of years, the British National Audit Office has acknowledged that it can be difficult to maintain competitive pressure through the different stages of a contract. It concluded that complex contracts can diminish competition when the contract begins and expensive variations can reduce cost-effectiveness. Existing providers may also have an in-built advantage when contracts are up for renewal because they are seen as a safer and easier option.³⁴

The consequence of such arrangements is that public funds are being used to maximise profitability of private companies and their shareholders, with the funds available for direct provision of services being reduced commensurately. Further, lack of disclosure of 'commercial in confidence' arrangements means that public scrutiny of the cost, quality and profit margins associated with such contracts is extremely limited.

2d) Accountability

The nature and extent of accountability and transparency is one of the things that distinguishes the public sector. Public sector agencies must balance complex political, social and economic objectives – different to the constraints and influences affecting the private sector.³⁵ Public servants themselves are subject to a legislated Code of Conduct and the public can enquire through Freedom of Information about virtually all aspects of public activity.

Public accountability and transparency are eroded by privatisation and outsourcing. Privately run services do not have the same requirements of disclosure to parliament and to the general public, nor do they have the same levels of independent oversight and audit. As Emeritus Professor Richard Mulgan has noted, *'contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff.'*³⁶

The commercial interest of the contract provider is a consideration its employees must take into account, even in instances where the APS Code of Conduct extends to non-APS employees through contractual obligations. Australia's privatised meat inspection system provides an example of these tensions. The private sector inspectors, employed under the Australian Meat Inspection System, must comply with the Australian Public Service Code of Conduct and must work under Government issued work instructions.³⁷ Despite these requirements there have been a number of examples of failure and in 2012, an audit by the European Commission found that Australia's meat inspection system was not in compliance

31 National Audit Office, 'The role of major contractors in the delivery of public services', 12 November 2013, pp.14,

32 A. White, 'The rise of the shadow state: the truth about outsourcing', *New Statesman*, 3 December 2012, <http://www.newstatesman.com/politics/2012/12/rise-shadow-state-truth-about-outsourcing>, (accessed 26 June 2014)

33 C. Papas, 'Serco to run youth prison', *New Matilda*, 16 November 2012, <http://newmatilda.com/2011/12/16/serco-run-youth-prison>, (accessed 26 June 2014)

34 National Audit Office, op. cit, pp.14

35 Barrett, op. cit, pp.7

36 R. Mulgan, 'Contracting Out and Accountability', Discussion Paper 51, Graduate Public Policy Program, *Australian National University*, 1997, cited in P. Barrett AM, 'Some Issues in Contract Management in the Public Sector', 26 July 2000, pp.4

37 Department of Agriculture, 'Export Certification Reform Implementation FAQs - Australian Export Meat Inspection System', last updated 5 June 2012, <http://www.daff.gov.au/biosecurity/export/meat/elmer-3/export-certification-reform-implementation-faqs-australian-export-meat-inspection-system>, (accessed 27 June 2014)

with European food safety regulations.³⁸ The European Commission audit staff concluded that having company paid inspectors perform inspection was a conflict of interest. These arrangements led to a loss of quality control and the rejection of Australian meat by European import inspectors.

These problems have not been confined to the European market. Thirteen shipments of Australian meat were rejected by the United States in 2013 because they contained faeces or other matter and E. Coli was detected in three shipments.³⁹ In 2012, Vietnam rejected a shipment of frozen Australian beef that was contaminated with salmonella.⁴⁰ These examples show that when functions are outsourced, conflicts of interest are created and accountability is compromised. The meat inspection issues are creating very real risks and had a significant impact on Australia's export markets.

Compounding these concerns are the limitations on scrutiny that can result from complex contracting arrangements with the private sector.⁴¹ In particular, commercial in confidence clauses are often associated with outsourcing and privatisation. It becomes harder to assess performance and satisfy accountability requirements where data is held exclusively by the private sector or limited or excluded from wider parliamentary scrutiny. The ANAO has concluded that outsourcing reduces openness and transparency in public administration⁴² with commercial sensitivities routinely cited to justify withholding critical facts from public scrutiny, thereby undermining democratic accountability.⁴³

This lack of accountability and transparency was highlighted by a Victorian Ombudsman's report into CenITex, the shared services agency that provides ICT support to the Victorian government. In 2012, the Ombudsman conducted a detailed investigation into CenITex. The Ombudsman identified a number of failings including:

- appointments that were made on the basis of fabricated documentation;
- invoices that were paid for services that were not actually rendered;
- CenITex officers awarding contracts to their own companies, and
- in one instance, a document that had been prepared attesting to the conduct and outcome of competitive market testing process that the author knew had never actually taken place.⁴⁴

The Report concluded that the appointment of contractors with little or no understanding of probity or procurement policy, coupled with a high-pressure and results-driven environment had created a culture of short-cuts, nepotism and fraud, resulting in more than \$4 million worth of government contracts being awarded improperly.⁴⁵ The investigation led the Ombudsman to publicly question whether key government roles should be outsourced, including those responsible for procurement and human resources.⁴⁶

38 European Commission, 'Food and Veterinary Office, Australia's Response to DG (SANCO) / 2012-6361– MR PREFINAL', http://ec.europa.eu/food/fvo/act_getPDFannx.cfm?ANX_ID=7442, (accessed 27 June 2014)

39 K. Brewster, 'Aussie meat exports found with E.coli, faeces', *ABC News*, 25 May 2012, <http://www.abc.net.au/news/2012-05-25/aussie-meat-exports-found-with-e-coli/4032216>, (accessed 27 June 2014)

40 S. Nealeas and S. Elks, 'Vietnam rejects Aussie meat', *The Australian*, 9 June 2012, <http://www.theaustralian.com.au/national-affairs/policy/vietnam-rejects-aussie-meat/story-fn59nm2j-1226389599466#>, (accessed 27 June 2014)

41 Cook, Quirk and Mitchell, op. cit, pp.109

42 Barrett, op. cit, pp.20, http://www.anao.gov.au/~media/Uploads/Documents/some_issues_in_contract_management_in_the_public_sector.pdf, (accessed 26 June 2014)

43 Cook, Quirk and Mitchell, op. cit, pp.148

44 C. Webeck and L. Westcott, 'Outsourcing responsibility: risks of giving government contractors too much autonomy', *Mondaq*, 12 August 2013,

<http://www.mondaq.com/australia/x/257208/Government+Contracts+Procurement+PPP/Outsourcing+responsibility+risks+of+giving+government+contractors+too+much+autonomy>, (accessed 30 June 2014)

45 ibid

46 ibid

3. Conclusion

Australians benefit from a strong, accountable, transparent public sector that efficiently and effectively delivers the quality public services our community needs. Moves to increase outsourcing, privatisation or contestability potentially undermine these important public sector attributes that are valued highly by the community.

Evidence suggests that increased outsourcing and privatisation is likely to result in higher costs to the taxpayer, lower quality outcomes for citizens, and increased exposure to the misuse of public funds.

It is worth concluding with this note - while total value of new UK outsourcing deals rose 65 per cent year-on-year to reach £2.1 billion in the first quarter of 2014⁴⁷, there are moves in the UK to insource work. An independent report prepared for UNISON concluded that in the face of extreme budget pressures in local government 'returning services back in-house is achieving significant outcomes including efficiency savings, performance improvements and increased customer satisfaction'⁴⁸. Perhaps this is a lesson Australia should heed.

⁴⁷ <http://www.supplymanagement.com/news/2014/new-uk-outsourcing-deals-up-65-per-cent-year-on-year-to-ps21-billion>, 29 May 2014.

⁴⁸ APSE (2011) Report prepared for UNISON, Insourcing update: The value of returning local authority services in-house in an era of budget constraints, Association for Public Service Excellence, June.