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# Contestability in Public Services: **An Alternative to Outsourcing**

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Australia and New Zealand School of Government  
April 2015



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### **An appropriate citation for this work is:**

Sturgess, GL. 2015, *Contestability in Public Services: An Alternative to Outsourcing*, ANZSOG Research Monograph, Melbourne.

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## Beating the Market

In 2012, the New South Wales Independent Pricing and Regulatory Tribunal recommended reductions of almost 30% in the water service charge for metered residential properties in Sydney over the following four years. It also established a new efficiency benchmark for the statutory corporation that manages the water supply and drainage system for Australia's largest city. Sydney Water was required to find \$173 million in savings over the four year period, at the same time as it maintained standards on water quality and reliability of service.

One of the ways in which Sydney Water set about delivering these efficiency improvements in operations and maintenance was *contestability*, a strategy it described as 'meet the market, beat the market', as well as cooperation with the union and the workforce in developing a new workplace culture.

Around 40% of its mechanical and electrical maintenance had already been outsourced, and independent reviews showed a 35-40% difference in labour productivity (with comparable levels of service). Attempts had already been made to close the gap, with limited progress. In March 2012, Sydney Water resolved to outsource the remainder of these services. As explained in a press release at that time:

Around 135 positions within the mechanical and electrical group would be affected by the proposed changes, with staff offered a range of options in line with negotiated agreements.

Sydney Water's strategy is to provide customers with valued services and work to our strengths and expertise. This includes working with partners to deliver the best value maintenance services for customers. It is clear the market is the best option for meeting our mechanical and electrical needs at this time and the private sector is already providing 40 per cent of this workforce.<sup>1</sup>

These services were contracted to Thiess on 1 July 2013. Since then, Sydney Water has achieved overall cost reductions of 12% and labour productivity improvements of around 20%.

With civil maintenance, benchmarking studies showed that Sydney Water was 15-20% behind its peers. Internal efficiency reforms had already delivered a productivity improvement of around 17%, and management decided to negotiate with the workforce and the unions to see if the gap could be closed over a three year period.

A statement by Sydney Water at the time acknowledged that some of its employment conditions were much more generous than industry standards: "A new enterprise agreement is a necessary step to bring employee benefits in line with market conditions and keep costs low for customers."<sup>2</sup> The managing director of Sydney Water explained the contestability policy to the *Sydney Morning Herald*: "Our workforce will be retained where they can meet market conditions and offer best value for Sydney Water's customers."<sup>3</sup>

The challenging new regulatory environment coincided with the end of the existing enterprise agreement and an escalation in industrial conflict. In July 2012, the NSW Premier issued a statement warning the unions not to engage in 'industrial thuggery', and raising the prospect of outsourcing. Separately, the Managing Director and the union leadership decided to adopt a different strategy

and approached the Fair Work Commission. One of the Deputy Presidents facilitated a series of informal discussions, which resulted in performance data being put on the table demonstrating that Victorian water utilities were delivering comparable service levels at a lower cost.

The agreed changes resulted in compromise on both sides, and it was agreed to attempt cost reductions of 18.5% across core activities over three years. Management and unions then undertook a 'roadshow', visiting each depot to convince workers about the changes required. In a publication by the Fair Work Commission, these were described by one participant as 'hot meetings with hot conversations', but the new enterprise agreement was approved by a mass meeting of Australian Services Union members on 9 November.<sup>4</sup>

A Memorandum of Understanding had been signed with the unions on 6 November 2012, which began with the statement:

The parties recognise that, to compete, Sydney Water needs a highly motivated workforce, enabled by systematic trust and fairness.

It continued with a list of shared interests. Both sides wanted Sydney Water to be "a world class enterprise, with the customer at its heart". They both wanted to deliver high-level services to the people of Sydney and to keep down costs for the community. They were both committed to building and retaining "a workforce that is highly skilled and that is capable of delivering this world class service". They both wanted to provide conditions of work and employment that "allow Sydney Water to deliver a quality cost effective service and simultaneously allow the Corporation to attract and retain the best staff". Management acknowledged their desire to maintain an in-house workforce, and the unions agreed to work with management in delivering significant productivity improvements.<sup>5</sup>

Over the first two years, these reforms have delivered productivity gains of 12%, and by June 2015, the target of 18.5% will not only be met but it is expected to be slightly exceeded. This has been achieved through staff engagement, better supervision, improved scheduling and rostering, and the introduction of a night shift.

At the same time, key performance indicators have been maintained or improved. Service reliability, as rated by customers, has improved, and the number of properties affected by repeated supply interruptions has fallen. Water quality complaints have dropped significantly, and customer rating of water quality has improved. Workplace safety has also improved: injury rates have fallen from 80 a month to fewer than 20.<sup>6</sup>

Relations between management and unions continued to improve as they maintained contact through a series of leadership conferences and working parties. A new 'pre-consultation model' was developed, in which managers discussed workplace changes with union officials and delegates, including shift patterns and the restructuring of some divisions. One senior manager acknowledged that this had delayed reform of civil maintenance, "but it delivered a lot more...than we would normally have ended up with. ...And it's also delivered much more reliably..."<sup>7</sup> A study recently published by the Fair Work Commission reported one union official as saying:

The real success of Sydney Water is how the culture of work has changed away from a culture where people hated working there and they hated their managers... [For example, I witnessed] a conversation that happened earlier this week, where managers wanted to change the rosters,

and the workers are now drafting the rosters for the managers. People actually like going to work. Of course, they still have a blue every day, but we've really changed the culture of the workplace.

The study reported that wage rates and conditions have generally remained good. Wage increases in the 2012 Enterprise Agreement were above the state government maximum because management were able to demonstrate real productivity gains. Changes in shift patterns did result in some decline in take-home pay, but this was accepted in return for job security. The commitment to an in-house workforce turned out to be a major factor in the reform process.<sup>9</sup>

Sydney Water's reform strategy of 'beating the market' is an example of what can be achieved when public service providers are challenged to deliver best practice, when there are timely and predictable consequences for a failure to meet service objectives within an agreed budget and timeframe, and when management and staff are provided with an opportunity to work together to deliver the reforms.

'Meet the market, beat the market' is a system of performance benchmarking where the consequences are clear. The objective is not to outsource services to the private sector, but to get the best out of the incumbent providers. 'Meet the market, beat the market' is contestability.

## A Middle Way

The public don't like monopolies. And they are suspicious of them in the public sector as well as the private sector. Sometimes there is no other way of organising the production and delivery of goods and services, but we all know from experience that monopolies are generally unresponsive to the needs of customers and service users, and they pay too much attention to the convenience of management and staff.

On the other hand, we are also worried about the use of competition and outsourcing in the delivery of public services. In certain parts of the public sector – in primary health care; primary, secondary and higher education; and now in disability care – Australians have made it clear that they value user choice. And where contracting has been done well, the public seem to be more relaxed about the private management of public services. Sydney Ferries is an example of a public service that has been recently franchised, where service quality remains high and the public no longer care who is responsible for its operation.

But the public do want social services to be delivered by people who are motivated by a desire to serve. They worry about the profit motive. And they are concerned that public servants may be outwitted by commercially-savvy contractors.

The public have much greater confidence in those who deliver front-line services than those who manage the finances. Understandably, they identify more closely with those who care more about service quality than those whose care about cost. Front-line staff are much more likely to identify with service users, which is one of the reasons the public trusts them more. In short, the public wants social services to be delivered by people who are motivated by a 'public service ethos'.

Monopolies are also a problem for those charged with delivering value for money in public services. With rare exceptions, mostly in the management of public utilities, governments have not employed robust performance benchmarking to ascertain whether services are being delivered well. In many cases, there are no agreed performance standards, so it is impossible to know whether providers are delivering value for money.

In general, front-line service providers are not resourced to deliver the wide range of outcomes they are required to deliver, with the result that it is impossible to hold management accountable for any failure to deliver. In too many cases, accountability is linked to process rather than performance.

Central government agencies charged with protecting public revenue and ensuring value for money in service delivery find it difficult to establish the relative efficiency of monopoly providers. This is one of the reasons they are more inclined to support market-testing and competitive tendering.

However, there are limits to the use of market-testing in driving service improvement in government. In the short term, there are issues of capability – on the supply side as well as on the part of government. Ongoing programs of market-testing are deeply disruptive. The fragmentation of delivery networks into a multitude of unrelated suppliers, as well as the replacement of incumbents with new entrants that have limited understanding of the service in question, have the potential to seriously weaken delivery systems.

In too many cases, market-testing has been used to drive down cost without due regard to service standards and workforce relations, so that instead of being a process for exploring real value for money, it turns into a race to the bottom. Understandably, staff find the process of outsourcing and market-testing deeply distressing, with a short-term impact on the quality of service delivered to the public.

Debate over the relative merits of outsourcing public services is not new. On one side there have been those, like Isaac Barré, a British Member of Parliament (and later Treasurer of the Navy), who argued in the House of Commons in 1778: “Contracts ought to be open, and offered to the lowest bidder”. On the other hand, there are those like the Irish MP and political philosopher Edmund Burke, who warned in 1780 that “The service of the public is a thing which cannot be put to auction, and struck down to those who will agree to execute it the cheapest”.<sup>10</sup>

This paper argues that there is a middle way between monopoly and market-testing. It is possible to use performance benchmarking and the prospect of prompt intervention in case of underperformance to drive increased efficiency and effectiveness, while also recognising the importance of a public service ethos, and the value embedded in many of the systems, processes and relationships through which these services are currently delivered. That middle way is contestability.

‘Contestability’ has become a buzzword in Australian policy circles in recent years, although little attempt has been made at definition. In many cases, the word has been used as a synonym for ‘competition’ or ‘competitiveness’, and in some cases as a soft alternative to ‘outsourcing’, but the concept is much richer than that.

The New South Wales state government employed the term in 2012, referring to the outsourcing of road maintenance services in the south and west of Sydney. In this case, there were no in-house bids, and the word seems to have meant competitive tendering with a view to contracting out.<sup>11</sup>

In 2013, the Queensland Commission of Audit argued that:

Better value for money in the delivery of front-line services can be achieved through contestability, as this will encourage more efficient and more innovative service delivery, whether by the public sector or the private sector (public sector service providers should not be immune from competitive pressures).<sup>12</sup>

There was nothing in this paragraph to imply a program of outsourcing; rather that services should be subject to ‘competitive pressures’. The report did go on to recommend significant market-testing, although guidance documents subsequently released by the government seemed to suggest that contestability was little more than a process of strategic planning and review.

In 2014, the Australian National Commission of Audit used the term in conjunction with ‘competition’ and ‘outsourcing’, but it was never defined.<sup>13</sup> The 2014 federal budget documents announced a formal commitment to a process of contestability:

The Government will develop and implement a Contestability Framework to assess whether a government function should be open to competition and the appropriate means for this to occur. A contestable approach can come from outside Government or from other entities within the Government.<sup>14</sup>



The Australian Department of Finance has been charged with establishing a three year program to review the functions of government against this framework, which is expected to “offer opportunities for identified functions to be delivered through alternative and contestable approaches”. This looks very much like a program of market-testing or outsourcing of support services. Certainly the public sector unions have come to see it as nothing more than outsourcing.

Contestability has a technical meaning in economics: it refers to *potential* rather than *actual* competition. This paper is concerned with contestability proper – it explores the origins of the concept, how it applies to the public service sector, and how contestability might be used to drive improvement in service delivery.

## Contestability in Private Markets

The concept of contestability was originally developed by the American economist William J. Baumol and a group of colleagues in the early 1980s. Baumol argued that it was not necessary for firms to face *actual* competition for them to behave competitively. What mattered most was *potential* competition (or the credible threat of competition, as some have described it).<sup>15</sup>

For markets to be contestable, it was not necessary for them to be populated by a large number of independent providers (as competition theory would suggest). What mattered were the barriers to entry and exit. If new firms could not enter the market without making a significant investment in assets that were unique to that market, and leave without the loss of such investments, then incumbents would have room to charge monopoly prices.

Some economists have challenged contestability theory by pointing out that in the real world, there seem to be few markets with low barriers to entry and exit. Domestic aviation, where aircraft can be readily bought and sold and employed in other markets, was offered as one example of contestability, although other factors, such as ownership of unique physical assets such as landing slots and terminals, remained significant obstacles to potential new entrants.

Whatever the value of developing the concept of a 'perfectly contestable market' as a replacement for the economic theory of 'perfect competition', contestability does have significant utility in the regulation of markets, and it is employed by the Australian Competition and Consumer Commission (ACCC).

But it is in the design and management of public service markets – a sector that has long been characterised by monopolies in supply – that contestability theory may offer the greatest scope for practical application.

## Contestability in Public Services

This possibility was first raised (though not developed) by a Norwegian economist in 1993.<sup>16</sup> The following year British policy analyst Geoff Mulgan also explored its application to government, but confined himself to the dismissal of quangos and the use of recall mechanisms in local government.<sup>17</sup>

The first person to seriously explore the concept seems to have been British health economist Chris Ham, then at the University of Birmingham. In a brief article on the GP fund-holding model (otherwise known as the NHS internal market)\* published in the *British Medical Journal* in 1996, Ham argued that there was a mid-path between competition and coordination in the health sector, which he identified as contestability:

While competition as a reforming strategy may have had its day, there are nevertheless elements of this strategy which are worth preserving. Not least, the stimulus to improve performance which arises from the threat that contracts may be moved to an alternative provider should not be lost. The middle way between planning and competition is a path called contestability. This recognises that health care requires cooperation between purchasers and providers and the capacity to plan developments on a long term basis. At the same time, it is based on the premise that performance may stagnate unless there are sufficient incentives to bring about continuous improvements. Some of these incentives may be achieved through management action or professional pressure, and some may derive from political imperatives.

In addition, there is the stimulus to improve performance which exists when providers know that purchasers have alternative options...

The essence of contestability is that planning and competition should be used together, with contracts moving only when other means of improving performance have failed. Put another way, in a contestable health service it is the possibility that contracts may move that creates an incentive within the system, rather than the actual movement of contracts. Of course for this to be a real incentive then contracts must shift from time to time...<sup>18</sup>

Ham was arguing that while aggressive competition might contribute to a fragmentation of the health system by maximising the number of providers, contestability was compatible with a high level of system planning.

An academic study of aged care in Stockholm, published in 1999, recognised the possible application of Baumol's theory to public services. The author studied a program of market testing undertaken by the City of Stockholm in the early 1990s. He found that aged care services that had not yet been exposed to direct competition delivered larger cost savings than those that had been market-tested. Savings were twice as high in those services where the threat of competition was seen to be marked.<sup>19</sup>

\* GP fund-holding, a policy developed by the Thatcher government, empowered general medical practitioners to purchase secondary health services on behalf of their patients. It was suffering from heavy criticism when Ham wrote in 1996, and was abandoned by Labour on coming to power in 1997. Alternative models of the same policy were later explored by the Blair government, and implemented by the Cameron government in 2012.

Geoff Mulgan picked up contestability again when he was appointed head of the Performance and Innovation Unit in the British Cabinet Office under Prime Minister Tony Blair. But in a paper published in January 2001, he developed the concept only a little further:

Policies for contestability aim to ensure that it is possible for new entrants to enter the field. According to the theory, the possibility of newcomers entering the market encourages existing providers to improve performance and innovate. With the right design, contestability arrangements can achieve many of the benefits of competition without the substantial costs associated with quasi-markets. The policy on failing schools, failings LEAs<sup>^</sup> and the use of the private sector in the New Deal\* and ONE are good recent examples of how the threat of competitive entry can serve as a spur to performance in the public sector.

In practice, contestability doesn't work in all circumstances: in particular, there needs to be sufficient private sector (or voluntary sector) capacity to provide a credible alternative, and there needs to be accurate information to underpin judgements about success and failure.<sup>20</sup>

The principle was discussed at greater length in a report on public-private partnerships published that same year by the centre-left think tank IPPR:

Allowing for diversity could go hand in hand with efforts to make public services (or components of them) more contestable: that is, creating the possibility that new providers can be brought in to replace those who are not performing adequately in running a service. Contestability differs from the forced use of competition within public services (for example, the former Compulsory Competitive Tendering regime in local government) in a key respect. Compulsory competition insists on regular market-testing of services (usually favouring the cheapest bidder) which inhibits the development of collaborative relationships and creates an adversarial relationship between purchasers and providers. In contrast contestability provides the purchasers with the option of going to an alternative provider if they feel that this will provide citizens with a better service. Whether or not this choice is exercised is not determined according to a rigid formula.

There will always be restrictions on the extent to which this approach can take hold in the public sector: poorly performing businesses will go bankrupt in a way that government agencies will not and should not. But the issue remains of whether it would be desirable to introduce a *degree* of contestability within services, or the management of services. Our view is that there are areas in which contestability should be a lever available to public managers involved in commissioning services.

Contestability has been applied in different ways around the world. It often involves providers agreeing long-term contracts with public purchasers on the basis that the contract remains in place if the quality of the service is maintained and improved at a reasonable rate. The key point about contestability is the *latent* but real possibility that services can be switched to other organisations, acting as a continual incentive for providers to consider how they can improve their performance. This can have real impact. Citizens within a locality benefit if a failing provider is evicted and a contract transferred to a new provider; citizens elsewhere can also benefit from the knock-on effect that this has on providers in their locality.<sup>21</sup>

<sup>^</sup> Local Education Authorities, the local government authorities charged with regional management of schools in the UK.

\* A welfare-to-work initiative introduced by the Blair government in 1998.

The IPPR mentioned the prison sector, where around 10% of establishments were then managed by private providers, observing that this seemed to have been sufficient to generate true contestability.<sup>22</sup> Interestingly, in its 'General Council Statement on Public Services' in late July 2001, the Trades Union Congress also made favourable reference to contestability, acknowledging that "there are examples of public sector involvement where some services are procured from the private sector and can help to prevent the emergence of cartels that fix prices at the taxpayers' expense".<sup>23</sup>

There is no evidence that academics, policymakers or commentators in the UK have sought to develop the idea since that time. How a contestable public service system might work in practice has not been pursued in the literature, although there are a number of practical examples where contestability has been employed as a driver of reform. This paper suggests a more comprehensive model of public service contestability, exploring its potential use as an alternative to outsourcing or market-testing.

## Meanings

**Outsourcing** involves contracting out a service to a non-government provider, usually as the result of a competitive tender, with the in-house team not being allowed to bid. The result may or may not be contestable.

**Market-testing** exposes a service to a competitive tendering for the purpose of establishing its efficiency, with the incumbent public sector provider being awarded the contract if it submits the most competitive bid. Depending on design, the result may not be contestable.

**Demand-side competition** (for public services) exists where users are free to choose among providers, with services funded in whole or in part by the taxpayer. These include voucher markets, which in Australia operate in the health and education sectors and are currently being developed in disability services. Vouchers have traditionally been used where there were already a large number of independent suppliers, but the National Disability Insurance Scheme has raised challenging questions about the capability and design of the supply side.

**Supply-side competition** can be accomplished by the commissioner or lead supplier exposing parts of the supply chain to competitive tendering. In the public sector, it is important where service users cannot be allowed to have choice (for example, in prisons) or where the need for system integration makes fragmentation of the supply side undesirable.

**Contestability** is the credible threat of competition. Where governments do undertake market-testing or outsourcing, and where they establish voucher markets, it is important that the outcomes are contestable. However, contestability is also an alternative to supply-side competition.

**Commissioning** is the process through which public services are authorised and funded. This begins with decisions about service outcomes and the means through which results will be delivered. Depending on the service in question, it may involve commissioners in the design and management of systems, markets or supply chains.

**Procurement** is the technical process used for selecting a supplier when services are to be delivered by external providers.

## Contestable Systems

Contestability in the public service sector may be thought of as robust performance benchmarking, with providers (public or private) held accountable for the service outcomes they have agreed to deliver. The ultimate consequence for failing to deliver these outcomes within the defined timeframe and the agreed budget must be the replacement of the service provider and/or its management team.

This implies a very different kind of relationship between those who develop public policy, those who commission services, and those who deliver them. Based on a limited number of experiments in different jurisdictions in Australia and the UK (discussed below), the following would seem to be the key elements of a contestable public service system:

### ***a. Distinct service units or 'firms'***

In order for services to be meaningfully benchmarked, front-line delivery should (wherever possible) be organised into discrete units so that performance can be compared with other similar units. If the management of these 'firms' are to be held accountable, they must be given clear authority so they can deliver the agreed outcomes without persistent interference from policymakers.

Most public services are already delivered through 'firms' – hospitals, schools, prisons, local area police commands – although front-line managers are not always provided with clear performance objectives or given the responsibility and the authority for delivering those results within a defined period of time.

Contestability will work best in the public sector where 'firms' responsible for front-line delivery can be identified, and where management can be given clear objectives and discrete budgets. Managers must have effective control over the resources necessary to deliver these objectives.

It is possible that over time the boundaries of key service units may change, as governments alter their priorities. In time, the move to 'integrated health care', and 'offender management' with a focus on a reduction in reoffending, may alter the relative importance of different organisational boundaries – but in most sectors, the scope of the firms responsible for delivering services can readily be identified.

### ***b. A contractual relationship***

It is important to the success of this model that providers (or management teams) have the freedom to negotiate about objectives, timeframes and budgets. If they are to be held accountable for the outcomes, management must freely commit themselves and their staff in advance.

This implies a robust conversation over the prioritisation of outcomes, how success will be measured, the timeframe within which results can realistically be delivered, and the adequacy of proposed funding. (Such a conversation cannot be undertaken as part of the traditional budgetary process, although funding allocation must be framed by that process.)

The outcome of these negotiations should be a contractual or quasi-contractual relationship. The contracts (or 'deeds' as some have referred to the relationship between public sector entities)

should be negotiated for a term of years; and these should be much more robust than the ‘service level agreements’ that have sometimes been used between public sector agencies in the past.

Of course, those commissioning public services must also have a choice as to who will deliver (or manage delivery), otherwise providers could hold out until they secured agreement on unambitious performance targets and generous budgets and timeframes. The prospect that services might be commissioned from an alternative provider or management team is essential if negotiations are to be robust.

The negotiated agreements (or deeds) must allow providers (or managers) time to achieve their targets. The term of the deed should be long enough for providers to achieve the objectives, but not so long that they constrain contestability. This also means that service outcomes and priorities cannot radically change throughout the life of the deed without explicit renegotiation of objectives, budgets and/or timescales.

It follows that the freedom of policymakers to introduce new ideas will be constrained, but this is essential if service delivery agents and front-line management teams are to be held to account. There cannot be meaningful performance accountability if the policy environment keeps fundamentally changing.

The deeds with the different ‘firms’ should not all be negotiated at once, but introduced over a cycle of, say, five to seven years. This would enable policymakers to introduce major new initiatives on a rolling basis, with implementation scaled up over time.

### ***c. Realistic budgets***

If service providers (and management teams) are to be held to account, there must be a clearly identified and committed payment stream, reflecting a realistic budget required to deliver the results agreed under the contract or deed.

This will impose a discipline on policymakers, making it difficult for them to add significant new objectives without explicitly changing the priorities or providing additional resources. This will not be popular with policymakers, since they value the flexibility they currently enjoy, but there cannot be real accountability for results, or meaningful contestability, if the true cost of delivery is not addressed.

### ***d. System management***

To ensure that services are managed as a system, and not as a loose assortment of individual delivery units, it is important that a commissioning function is incorporated into the policy-delivery continuum.

Among other things, commissioners will negotiate with policymakers to ensure that outcomes are measurable, deliverable, prioritised and adequately-funded. They will negotiate the contracts or deeds, hold service providers to account, and manage the intervention regime in case of under-performance (discussed below).

Commissioning is concerned with the design and management of systems, and ensuring that these are suited to the program outcomes. In the corrections system, for example, the commissioner

might be responsible for the management of offenders across the entire cycle of their offending career, ensuring that the services provided through prisons, community corrections and the health and social welfare systems are integrated, so as to deliver the outcome of reducing the rate of reoffending. The commissioner would not simply be responsible for the efficient and effective management of the individual institutions through which offenders may pass in the course of their criminal careers.

This focus on the design and management of integrated systems is one of the features that distinguishes commissioning from procurement, and contestability from outsourcing. Many public service systems are like corporate supply chains rather than markets – interactions are relational rather than transactional, and commissioners have an ongoing responsibility for the overall functioning of the supply side. As Chris Ham argued in 1996, contestability provides an opportunity to introduce (potential) competition into public services, without sacrificing the benefits of system planning.

#### ***e. Performance benchmarking***

It is fundamental to contestability that performance is benchmarked over time, with management being held to account at identified review points along the way. Service providers must be given a clear statement of measurable objectives, linked to agreed outcomes, and they must bear the consequences of a failure to meet these objectives and/or the associated budget.

Benchmarking should be undertaken by independent agents with operational credibility so that there is widespread confidence in the results. While there should be a presumption in favour of publication, this may not be appropriate in all cases.

Where it is not possible to specify the full range of outcomes through a relatively small number of quantitative measures (and this will often be the case with complex public services), it may be necessary to also engage in qualitative assessment. The WA government (and more recently, NSW) has established such a regime in the corrections system with the creation of an Inspector of Custodial Services, who has responsibility for monitoring and reporting on the performance of privately- as well as publicly-managed facilities.

Performance benchmarking works best where there are a number of broadly comparable service units; several studies suggest that quality will be higher where service providers can be meaningfully benchmarked.

#### ***f. An intervention regime***

Governments have a multitude of accountability systems, while lacking a systematic approach to consequences. There can be no meaningful system of performance accountability if providers (and management teams) do not understand from the outset how they will be judged, and what the consequences will be for success or failure. This is one of the ways in which performance contracting is superior to program budgeting.

The ultimate form of intervention lies in the wholesale replacement of the provider (or senior management). Where services are capable of being delivered by private or not-for-profit providers, this should take the form of market-testing. And where the service is already delivered by an external provider under contract, this would involve the termination of the contract and the appointment of an



alternative, ideally through competitive tendering. Where the service or function is not contestable, intervention might involve the replacement of the entire management team (not just the Chief Executive), and a fresh start under new leadership.

However, commissioners should not immediately invoke such a severe penalty, but draw upon an escalating range of interventions, depending on the seriousness of the failure. In the case of external providers, this might involve financial penalties; in the case of public sector providers, it might involve some loss of managerial autonomy.

There should also be a system of rewards for superior performance: no delivery team can perform at its best if there is only punishment for failure and no recognition of success. In the case of external providers, this will involve financial and/or reputational rewards and contract extensions. In the case of public sector providers, it might include greater commercial freedom as well as reputational rewards.

In both cases – rewards and penalties – providers need to clearly understand from the outset what they are required to achieve, how they will be judged, and the circumstances under which interventions will occur.

#### **g. Alternative providers or management teams**

Contestability assumes that, wherever possible, the ultimate intervention should consist of the right to manage the service being exposed to competition. If this threat is to be credible, there must be a pool of alternative managers capable of stepping in, at relatively short notice, to contest the right to manage the service and assume responsibility for its delivery. If there is no alternative pool of management, then the threat of competition will not be credible.

Where a service has not traditionally been open to delivery by external providers, this will require commissioners to consciously develop such capability over time. Successful management of complex public services often requires a great deal of domain-specific knowledge, which serves as a formidable barrier to entry when external providers are invited to participate.

However, what is necessary to ensure contestability will differ from one service to another. There may be private providers of similar services who could quickly step in. In Australia, large private companies provide laundry services to private hospitals and nursing homes. Major Australian corporations already provide some (though by no means all) of the pathology services required by public hospitals.

In some cases, public enterprises from other jurisdictions might provide the contestability. The Australian state governments have not generally chosen to operate beyond their geographic boundaries, but state-owned enterprises from New Zealand provide weather forecasting and land valuation services in the Australian market. A commissioner might introduce contestability by sourcing management expertise from other governments.

In some states, private and not-for-profit providers have long been accepted as trusted suppliers of key social services, and there may be scope for them to move interstate. This has been the case in recent years with Silver Chain, a leading provider of homecare services in WA over many decades. In Queensland, Blue Care (long known as the Blue Nursing Service) has performed this role for more

than 60 years. By contrast, NSW has not had a comparable tradition of external provision in this sector, although Silver Chain has been making inroads. The management of prisons in Australia is reasonably contestable since there are already a number of private providers managing such institutions across the country.

In other cases, however, it may be necessary for government to build alternative capacity (and reduce barriers to entry caused by domain knowledge) by deliberately opening up a proportion of the services to external providers. This might be achieved through the entry of international providers (as has happened with prisons, where four overseas companies now operate in the Australian market); by encouraging existing suppliers in related markets to acquire new capabilities (as has happened in the UK and Australia when engineering support, facilities management and consulting firms have moved into service delivery); or through the transfer of skills from the public sector (which has happened through public-private joint ventures and management buy-outs).

The amount of contestability will also be influenced by the service models used. Some public-private joint ventures are more contestable than others, particularly where the private partner is asked to bring generic management capability to the partnership. The public sector partner retains control of the unique physical and human assets (by leasing equipment and seconding specialist staff to the joint venture), and contestability is introduced into management. GSTS Pathology, a joint venture between two NHS hospital trusts and a private management company, is a UK example of such a model.

### **Marks and Spencer**

British High Street retailer Marks and Spencer provides an example of a large-scale corporation that has used contestability in part of its supply chain. When the company contracted out its store maintenance in the 1980s, it divided the nation into three regions, and appointed a different company to perform the service in each area. This enabled management to benchmark performance on an ongoing basis, and it meant that they could quickly replace one of the providers if they failed to deliver an acceptable service.

### **Sydney Buses**

Sydney's bus services are divided into fifteen contract regions, with eleven operated by private providers in the western suburbs of Sydney, and four by public sector enterprise State Transit in the east. While the Independent Pricing and Regulatory Tribunal had undertaken some benchmarking over the years, none of these services was contestable because there was no intervention mechanism by which they might be exposed to competition.<sup>25</sup>

The private bus companies had been established by family companies and they had long held monopolies on their routes, with licences routinely renewed based on the historic investments involved in developing these services. Over time, many of these family businesses were acquired by large corporate providers such as Westbus and Transdev. In 2012, government signalled its commitment to contestability by exposing these routes to competition. Several of the incumbents failed to win their routes, which made the threat of competition real.<sup>26</sup> However, there are still contestability issues with some of these services because of asset specificity associated with depots and workshops.

There is very little contestability in those services operated by the public sector. In November 2012, the *Sydney Morning Herald* reported that government bus drivers had been told that unless they agreed to substantial reform in their cost structure, their jobs would be 'privatised'. The threat to the incumbent (government) provider of bus services in the city's east came in the form of a letter to employees indicating that State Transit wanted to renegotiate award conditions:

Failing to implement these reforms will mean there is a very real chance that our bus services could possibly be put out to tender in the future.

To ensure we are competitive, we need to reassess how we do things and eliminate inefficiencies to enable us to reduce our costs.<sup>27</sup>

A similar problem has developed in Brisbane's bus services, with the City Council holding an uncontested monopoly on core routes, and private providers possessing de facto monopolies at the edges of the metropolis.

### **UK Prisons**

Since November 2012, the UK Ministry of Justice has been pursuing a strategy of contestability, abandoning a previous policy that would have involved market-testing all prisons in England and Wales. In announcing the policy, the Ministry of Justice said that market-testing had 'identified the means to accelerate cost reductions' and 'set a new benchmark for running prisons' which would now be applied to all public sector prisons with the objective of maximising savings.<sup>28</sup>

This approach had first been developed in 2006 under the previous Labour government, and it was referred to at the time as contestability:

Challenging underperforming prisons and probation boards to demonstrate how they will improve, with contests held to commission alternative provision if existing providers fail to provide or deliver a satisfactory improvement plan.<sup>29</sup>

The 2014 strategy is variously referred to as the 'Benchmarking Programme' or the 'Prison Unit Cost Programme', and it builds on an earlier program known as 'Specification, Benchmarking and Costing' that commenced in 2008. It is difficult to obtain detailed information, but the key elements appear to be as follows:

- The previous policy of market-testing all prisons on a rolling basis was vital in establishing a robust performance benchmark, and in establishing a credible alternative if benchmarking does not deliver.
- Additional benchmarking work on a variety of other prison categories is being done by a dedicated team with operational credibility.
- A significant body of work has been done in recent years on the specification of service standards in prison management. This has been important in generating agreement as to service outcomes, but it is highly detailed and not necessarily appropriate for use in commissioning.
- An existing performance regime, developed over some years, enables public and private providers to be compared based on a number of weighted KPIs.

- The benchmarking work has been driven by a need to significantly reduce costs across the corrections system, leading to the strong focus on bringing down 'unit costs'.
- Intervention might involve the replacement of the prison governor, or in extreme cases, market-testing.

## **Contestability in Management**

For the most part, contestability in public service delivery is contestability in management. If there is to be intervention in a failing public service, it is senior management that will be replaced, with staff continuing to deliver services under new leadership.

And this should be true, even where public services are delivered by private or not-for-profit providers. To avoid loss of corporate memory and monopoly problems caused by human asset specificity, it is usually desirable for key staff to transfer to the new employer. This should be the case not only with the initial contracting out, but with any subsequent changes of provider. British laws relating to the transfer of business undertakings protect employees better than Australian transfer provisions, although state governments have often introduced specific arrangements to ensure that key employees are retained.

If the arrangements to protect the workforce in the process of transition are effective, competitive tendering largely amounts to a competition for management. And this is even more the case under some of the new contracting models, such as public-private joint ventures and GOCOs (government-owned-contractor-operated), which ensure that competitive tendering does amount to a competition for management.

One of the benefits of contestability over market-testing or outsourcing is that it seeks to protect the investment in organisational systems, processes and relationships, whilst exposing providers to the threat of competition. It seeks to give the management of front-line 'firms' greater authority to manage, so they can properly be held to account for failure to deliver (and given credit for success in meeting objectives). It follows that if management fails to deliver the agreed outcomes on time and within budget, then it is management that should be held to account.

## Contestable Processes

Contestability has also emerged at the margin, as management has sought to drive operational improvements using public or private benchmarks. In some cases, reform has been underpinned by the threat that if improvements were not made, the services or functions in question would be opened up to competition from external providers. Sydney Water's strategy of meeting and beating the market is an ideal example of this form of contestability, but there was already a NSW precedent.

### NSW Prisons

For some years, the NSW government used the threat of private sector competition as an instrument in reforming prison management. In this case, a rough benchmark and potential competition came from a privately-managed prison at Junee which, according to successive Auditor-General's Reports, was operating at a significantly lower cost than its publicly-managed counterparts. By 2002-03, the last year detailed comparative data were published, Junee was being managed at around 45% below the average cost of medium security prisons in the state. While it was recognised that there was the need for some moderation of this differential to reflect the age of the publicly-managed facilities (among other things), it was generally accepted that Junee was delivering a comparable service at a significantly lower cost, and that the gap was growing.<sup>30</sup>

In 2003, there was speculation that two new correctional facilities at Kempsey and Dillwynia might be opened to competition and contract management. At the same time, the then Department of Corrective Services opened negotiations with unions over a workplace reform package, known as 'Way Forward', which included performance agreements, leaner staff-to-inmate ratios, and a targeted reduction in sick leave and overtime. Under the threat of competition, the union agreed to these changes and once a new award was signed for these establishments, the government announced that they would be publicly managed. The fact that private firms were employed to design, construct and maintain the physical facilities served to maintain the competitive pressure.

In 2005, the Public Accounts Committee reported that contestability through the Way Forward program had "resulted in significant cost savings when compared to correctional centres operating under the traditional model". These two centres had significantly reduced sick leave and overtime levels, contributing to operating costs that were closer to those under which Junee was delivered.<sup>31</sup>

This model was extended to two other Greenfield sites – Wellington in 2007 and Nowra in 2009. From 2007 to 2009, the Auditor-General reported that the Department was negotiating with the union to extend the reform package to the remainder of the prison system, but it would seem that negotiations stalled.<sup>32</sup>

In November 2008, the government announced its intention to open up the management of two existing prisons – Parklea and Cessnock – to competition, and to conduct a feasibility study into the replacement of Grafton prison with a PPP facility. According to evidence before a NSW Legislative Council inquiry, this decision had been influenced by a number of factors:

- NSW Treasury had received independent advice that market-testing these facilities could result in significant improvements in cost effectiveness;

- the Department of Corrective Services wished to establish benchmarks against which to compare the publicly-operated prisons; and
- there was a desire to encourage innovation through competition.<sup>33</sup>

As a result, Parklea prison was contracted to a private operator, but Cessnock prison was not opened to competition, and the PPP prison at Grafton did not proceed. It seems reasonable to conclude that the NSW government was using the competition for Parklea prison to increase the credibility of its threat to expose the management of the prison estate to competition if further performance improvements were not made.

## Contestable Contracts

When government does engage with external providers through market-testing, it must ensure that procurement processes are contestable, with new entrants capable of submitting competitive bids. This is one of the reasons why Australian governments have paid so much attention to competitive neutrality in the corporatisation of state-owned enterprises, and in the design and management of procurement processes.

But commissioners must also ensure that the outcomes of market-testing are contestable. If a contract is larger or longer than it needs to be, then the opportunities for the incumbent to be exposed to competition will be reduced. If contracts all come up for competition at the same time, rather than being phased over time, the market will be thinned and reputational incentives will have much less impact. Competition and contestability will be weakened as a result.

If government privatises key physical assets, or transfers unique human assets to one of the private providers without some mechanism for later transferring those facilities or staff to an alternative management team, this will create unnecessary barriers to entry and stifle contestability.

If government outsources to monopoly providers, or to a small number of companies that operate as an oligopoly, then while it may save money up front, it will create a system that is no more contestable than a public monopoly (and perhaps even less so). It will be much more difficult to sustain productivity improvements over time.

And if government contracts with external providers for part of the service, without establishing a system-wide benchmarking and intervention regime, contracting will not result in greater contestability.

The following case studies illustrate the need for commissioners to consider the design and management of the system overall, in order to ensure that the outcome of competitive tendering and contracting is ongoing contestability.

### **Victorian Prisons**

The Victorian government announced its intention to contract out the design, construction and operation of three new prisons in 1994. These facilities opened in 1996 and 1997, commissioned under PPP contracts with 20-year operating agreements. The contract for the Metropolitan Women's Prison was terminated by the incoming Labor government in 2000, following performance problems and the company's failure to adequately respond to default notices.

Until the recent surge in prison numbers, around one-third of Victorian prisoners were held in privately-managed facilities, proportionately the largest of any jurisdiction anywhere in the world. It is unclear how numbers have been distributed following the recent increase in the prison population.

In 2014, another PPP contract was awarded for a new 1,300 bed prison, with a 25-year operating contract. Depending on total prison numbers, this has the potential to increase the proportion held in privately-managed facilities to somewhere around 45%.

And yet, in spite of outsourcing a greater proportion of its facilities than any other jurisdiction in the world, the Victorian prison system is not particularly contestable. Unless they demonstrably fail to meet acceptable service levels (as with the Metropolitan Women's Prison), incumbents hold a monopoly on the operation of these facilities that will last for 20-25 years.

This is the consequence of awarding the operating contracts as part of the PPP contracts, but it does not have to be done that way. Government might retain ownership of the prison, as was the case with Junee prison in NSW, where the operating contract is for five years, with the possibility of a three year extension. Or it might have insisted on market-testing the service contracts every five or ten years, or benchmarking performance, with the threat of market-testing in case of poor results. Both of these models were adopted by the UK government in PPP contracts for public hospitals.

At the same time, the 70% of the Victorian prison system that is publicly managed faces very little contestability from the 30% that has been exposed to competition. So while the process of awarding the initial PPP contracts may well have been highly competitive, the outcome for the system overall is that there is very little ongoing contestability.

### **South Australian Hospital Linen**

In January 2000, the South Australian government sold its Central Linen facility, including the land and assets, to Spotless Services, a private facilities manager specialising in the provision of laundry services to hotels and private hospitals. Central Linen provided laundry services to all public hospitals in the metropolitan area and most country hospitals.

The management of laundry services for public hospitals was outsourced for a term of five years, with the prospect of a five year renewal. Many existing employees transferred to Spotless, while others were offered redeployment or redundancy arrangements, and Spotless recruited replacement staff. Following contract award, Spotless invested in new linen stock and modernised some of the facilities.

The original Cabinet submission accepted that the deal involved a loss to government over ten years of \$5.8 million (net present value), but recommended that it proceed because of reduced industrial, business and employee risks. The additional cost arose from the burden of redeployment and redundancy.<sup>34</sup>

In 2010, the state was divided into three zones, an initiative that might have brought improved benchmarking and thus greater contestability into the system. It appears that three companies were shortlisted and two – Spotless and ISS – were selected. However, within a short time, ISS withdrew from the market and in 2011, a new five contract for the majority of the system, with potential for a five year extension, was signed with Spotless.

In spite of an attempt by the South Australian government to introduce greater contestability into its hospital linen services, control reverted to the company to whom the facilities had been sold ten years before. Almost certainly this was because unique physical assets – the central linen facility at Dudley Park – were owned by the incumbent, and possibly also because key staff with detailed knowledge of the system were now employed by them. A process that in principle should have been contestable had, in practice, in a non-contestable outcome.



## Public Health Pathology

The private pathology market in Australia is dominated by three large providers – Sonic Healthcare, Primary Health Care-Symbion Health, and Healthscope-Gribbles – which account for around 77% of all tests. The remainder comprises in-house services within not-for-profit hospitals, small to medium private pathology companies, and private pathology companies offering specialised services.

In 2012, the ACCC acknowledged that there were problems with market concentration, when Sonic was proposing to acquire Healthscope's business in NSW, Queensland and WA. In NSW, Sonic had 35% of Approved Collection Centres, Primary had 34%, and Healthscope had 13%. The next largest provider had only 6% and after that, providers held only around 1% of market share each. In Queensland, the concentration was much greater, with Sonic and Primary having 85% between them, and Healthscope having only 9%; the ACCC blocked a proposal by Sonic to acquire Healthscope's business in that state. The ACCC concluded that there was not a national market for pathology services in Australia, and that there were material sunk costs and economies of scale deterring entry. In short, the market was not strongly contestable.<sup>35</sup>

In both NSW and Queensland, state governments are reforming their pathology services, and the possibility of outsourcing has been discussed as one of the options. Some Victorian public hospitals contracted out their pathology services several decades ago, so there is a precedent for using private providers for at least some of these services. One of the challenges with simple outsourcing is that in some states, the existing private market for pathology is not particularly contestable. A government might achieve a reduction in cost when it initially market-tested a service, but then have difficulty in maintaining contestability over the medium to long term.

In 2009, Guys & St Thomas's Hospital (a leading NHS hospital located in the heart of London) entered into a public-private joint venture for its pathology services. With the hospital trust leasing the equipment to the joint venture and seconding the staff, the tender was in effect a competition for management capability. The creation of GSTS Pathology served to deepen the market and strengthen contestability.

At the Wesley Private Hospital in Queensland, both of the leading private pathology providers compete for each new patient as they are admitted. While there are still only two providers, the number of competition points has been maximised.

If any measures were to be undertaken by Australian state governments to introduce greater competition into the provision of pathology services in public hospitals, great care would need to be exercised to ensure that contestability issues were addressed. And since public sector pathology accounts for around 40% of the total number of tests, any such changes should also consider the impact it would have on the contestability of the private pathology market.

## Contestable Supply Chains

One way of ensuring that a system remains contestable is to avoid unnecessary concentration of ownership. It may be necessary to award prime contracts to one or two large Australian or international corporations, to capture economies of scale, to benefit from technological and managerial innovations, and/or to transfer performance risk. But if those companies or consortia are able to cannibalise their supply chain so that small and medium-sized firms are taken over, the capacity for benchmarking and for ensuring that the contracts are contestable when they come up for rebid will be lost.

This requires government to think differently about the design of its public services. If commissioners think of the supply side as nothing more than a market, they will find it more difficult to accept that they are responsible for how it operates. On the other hand, if they perceive the supply side as their supply chain, they are more likely to accept that they have an obligation to prevent unnecessary amalgamation.

### **NSW Road Maintenance**

In November 2013, NSW Roads and Maritime Services (RMS) awarded two contracts for the maintenance of roads in the south and west of Sydney. Services included asset management, routine maintenance, corridor upgrades, minor improvement works, major incident support, and event management. A third company holds an older form of maintenance contract for the northern parts of the city, which will be transitioned to the new model over time.

Contract award followed an innovative procurement process that included briefings to international consortia to encourage them to enter the market, and the use of 'competitive dialogue', rather than the traditional hands-off procurement. The tenders were awarded to two consortia comprised of major European and Australian providers.

The contracts are for seven years (with the possibility of a renewal for another three), and they are based on a collaborative partnership between the contractors and the RMS, with a performance framework containing focused indicators, including a number that are concerned with customer satisfaction. Full service commenced in March 2014.

For a number of reasons – the scale of the companies involved in the two consortia, the innovative nature of the contracts, the deep domain knowledge that will flow from these highly collaborative partnerships, and the transfer of some key personnel – these contracts have the potential to be non-contestable.

The management of RMS has taken a number of steps to counteract these effects, including relatively short-term contracts; breaking the city into three zones, with contracts awarded to two separate consortia; and strict limitations on the extent to which these consortia can pursue vertical integration through the acquisition of local firms of medium size who have undertaken road maintenance for the RMS and its predecessors over many years.

It might be said that these consortia have been awarded integration contracts, requiring them to manage the RMS supply chain. If steps had not been taken to preserve contestability in the supply chain, the RMS might have discovered at the end of the first generation of contracts that the market was entirely controlled by two large consortia, with limited scope for new entrants.

Integration contracts similar to this have emerged in a number of public service markets in recent years. The Australian government contracted with the Brotherhood of St Laurence in 2008 to serve as the prime provider in the five-year roll-out of a parenting and early childhood learning program known as the Home Interaction Program for Parents and Youngsters, in some 50 communities and several hundred providers across the nation.<sup>36</sup> An even bolder version of the integrator model can be found in the UK Work Program, where two of the large providers manage diverse supply chains of public, private and not-for-profit providers, assuming financial risk and delivering powerful management information systems. These companies deliver no job placement services themselves, and thus are not in competition with their supply chains, operating solely as system designers and integrators.

## Benefits of Contestability

Contestability seems to offer a number of advantages over reform initiatives that are heavily reliant on market-testing or outsourcing:

- As Chris Ham recognised in 1996, contestability better enables commissioners to plan and manage public service systems as a whole, at the same time as they draw upon the benefits of potential competition. Too often in the past, outsourcing has focused on driving cost reduction in the individual service units, without reference to the performance of the system as a whole.
- A comprehensive program of outsourcing or market-testing will disrupt the ongoing operation of the public sector provider, and have a serious impact on morale (and thus on performance and the retention of key staff). Contestability is challenging, but it does allow reform to take place within the existing organisation, which is provided with the opportunity to deliver services at industry benchmarks.
- Outsourcing (which precludes the possibility of an in-house bid) amounts to a declaration that the private sector is inherently better than the public sector, a proposition that is not supported by the evidence and is deeply offensive to most public sector employees. Contestability is founded on the principle that competition (or the credible threat of competition) is better than monopoly, whether the provider is public, private or not-for-profit. That will certainly be challenging for incumbents, but it is not inherently offensive.
- Contestability recognises the importance of relational aspects in social and economic organisation. Successful management of a corporate supply chain, particularly in the delivery of complex services, cannot occur if there is excessive churn among suppliers. Success lies in getting the best out of the incumbents. The investments that commissioners make in personal and institutional relationships with their suppliers are a valuable asset that should not be discarded without good reason. Contestability offers a way for public service commissioners to ensure that existing providers are delivering value for money without scrapping the value that lies in interpersonal and inter-organisational relationships.
- In complex public services, successful reform relies heavily on the cooperation of front-line management, staff and unions. Of course, incumbent providers must be challenged so that they will cooperate in the difficult process of transformation, and they must understand that there are viable alternatives. But the process of reform will be easier, and the process of transition somewhat less expensive, if management, staff and unions can be meaningfully engaged. Contestability seems to offer a way of challenging the incumbents to engage in the process of reform.

## Challenges of Contestability

Of course, there are also challenges involved in adopting a contestability approach. While the following issues are deserving of serious consideration, none of them should be regarded as an insuperable barrier to reform:

- Intentionally or unintentionally, contestability is often confused with market-testing and outsourcing. It is an unfamiliar concept, and it will take time to explain how it works, how it is different from actual competition and how it might be used to deliver better public services.
- Governments have become addicted to policy innovation, and it will take effort for them to understand the heavy cost that society pays for this churn – lack of innovation in service delivery, loss of meaningful accountability, and much less efficient and effective public services.
- The American political scientist Aaron Wildavsky observed: “No genius is required to make programs operative if we don’t care how long they take, how much money they require, how often the objectives are altered or the means for obtaining them are changed.”<sup>37</sup> To be effective, contestability demands that politicians and policymakers understand that outcomes must be prioritised, and resources must be proportionate. This will be difficult.
- Accountability means little if the consequences for failure are not predictable and proportionate. It is difficult but necessary to establish a system of escalating interventions for public sector providers, so that management has room for innovation and improvement over time.
- It will be just as important to find ways of identifying and honouring excellent performance on the part of public service providers.
- The concept of an alternative pool of management expertise within the public sector is new, and it will require some work to explore what this means, and how it might be delivered in practice.
- Contestability will place new demands on those commissioning public services, and require new capabilities, which will take time to develop.
- A contestability approach demands that managers engage with the workforce and the unions in the process of reform. This requires them to be credible in their benchmarking methodologies, clear in their commitment to quality, and honest about the challenges involved.

## Essence of Contestability

It is evident that contestability in the public service economy is capable of being employed in a number of different ways. However, there seem to be some essential elements, without which contestability may be difficult to establish or maintain.

- Contestability works best where governments are willing and able to identify the front-line 'firms' through whom services will be delivered, and to devolve meaningful authority to the management teams responsible for those firms. There cannot be meaningful accountability if the responsibility for delivery is not clearly delegated.
- Contestability will be difficult to sustain where there are a small number of firms or potential competition points. Firms should be no larger than necessary. Contracts and deeds should be no longer than necessary. And claims of alleged economies of scale must be closely scrutinised.
- Unless there is a contractual or quasi-contractual relationship between service commissioners and these front-line firms, it will be impossible to hold managers to account for performance. Contracts or deeds must clearly specify measurable performance objectives (linked to agreed outcomes), a term of years within which to deliver, and a firm budget.
- There can be no real accountability for performance if policymakers and commissioners are not willing and/or able to prioritise outcomes, provide the resources necessary to deliver the agreed results, and allow front-line managers the freedom to innovate and the time to deliver.
- Performance of all providers (public, private and not-for-profit) must be benchmarked and tracked over time. This should be undertaken by a credible and independent team, and ideally results should be reported publicly.
- There cannot be meaningful accountability if the consequences for failure to deliver are not clearly understood from the outset. Consequences should be stable and predictable (reflecting the agreed outcomes), proportionate (reflecting agreed priorities), systemic rather than heroic (applying to senior management as a whole, not merely the Chief Executive), pragmatic (directed to improving services rather than inflicting punishment), and timely (applied within a relevant timeframe).
- Contestability will be severely weakened where there are no alternative sources of supply or management expertise capable of stepping in to take over a failing service at relatively short notice. In some cases, this will require commissioners to build alternative capacity over time.

## Conclusion

While some politicians, policymakers and commentators will continue to use 'contestability' as a convenient synonym for market-testing or outsourcing, the word has a specific meaning. The concept does have application in the public service sector, offering an alternative way of using competitive tension to drive substantially better value for money without the disruptive effects of widespread market-testing.

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