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Prime Minister (2)

A topic for your

Treasury Chambers, Parliament Street, SW1P 3AG (Wednesday)
01-233 3000

weekly meeting with
the Chancellor.

PRIME MINISTER

mt

Dec 6/12

CONTRACTING OUT

We have on several occasions discussed the need to reduce the size of the public sector by contracting out as many functions as possible from central and local government and the Health Service. You will recall that MISC 14, in the summer, gave me a remit to pursue this further.

2. I discussed progress informally last week with Norman Fowler and Michael Heseltine (Leon Brittan and Nicholas Ridley were also present), and we reached a considerable measure of agreement on the next steps. These are set out in the attached note, which is cast in the form of a draft paper to Cabinet. Perhaps you could find time to discuss this with me, if necessary. Subject to your agreement, I should like to circulate it for Cabinet on 16 December, when I understand we shall also be taking Leon Brittan's paper on Civil Service manpower after 1984. As you will see, the two topics are closely connected.

3. I am sending a copy of this minute to Sir Robert Armstrong.

G.H

3 December 1982

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DRAFT CABINET PAPER ON CONTRACTING OUT

We need to intensify our campaign to encourage the contracting-out of activities in the public sector. I have an outstanding remit from MISC 14 (the Ministerial group on industrial policy) to consider this issue. I wrote to Cabinet colleagues in the summer asking for their further suggestions. I have received several interesting proposals, but the results are still patchy. I now want to make a further search for suitable candidates and enlist the support of all my Cabinet colleagues.

Why Contract Out?

Experience both in this country and in the United States suggests that the private sector, with the stimulus of the profit motive, can very often undertake operations on behalf of Government more cheaply than the Government itself can perform them. This in turn establishes private businesses with a potential for expansion including expansion overseas. It is true at national and at local level, in the Health Service and probably also in nationalised industries. There are serious obstacles. The present system was not designed to encourage contracting-out, and it needs a major push to achieve this. I am not, however, urging wholesale contracting-out at any price: only in those cases (a very large number, I should judge) where it will show a clear economic advantage.

The Target Areas

The motive is the same throughout the public sector, but the circumstances are different. We need a four-pronged approach, but in order to maintain momentum, I think Cabinet should review progress by the middle of next year. There are a few general issues on which some central co-ordination by the Treasury will be needed.

Central Government

Under the stimulus of tight manpower targets, several functions have already been contracted-out. There are a number of common services where the onus should be on departments to show why they should not be contracted out. It is within our own power to deal with any problems which may arise. In a parallel paper C82 .., the Chief Secretary has made proposals for the control of Civil Service numbers after 1984. He suggests a major interdepartmental exercise in the New Year to identify the scope for further reductions. I propose that in the course of that operation we identify the scope for further contracting-out of central government functions, and decide how to follow it up. The results are to be reported back to Cabinet in May 1983. This will also be a convenient opportunity to take stock on contracting-out generally.

Local Authorities

There has already been legislation in this Parliament to ensure that Direct Labour Organisations compete on equal terms with private sector contractors. There is scope for extending this principle, but we must expect considerable opposition from local authorities, with some refusing to co-operate. I have discussed this with the Secretary of State for the Environment and we consider that for the immediate future we should confine ourselves to urging all local authorities, wherever we have an opportunity, to follow the example of those who are already finding that contracting-out pays handsomely. We need to ensure that the successful examples are well publicised and that any apparent shortcomings are dealt with properly.

National Health Service

The Secretary of State for Social Services has already started a contracting-out campaign, beginning with a series of pilot experiments in each regional health authority, to demonstrate the scope for contracting-out initially of catering and cleaning, but extending further in due course. One obstacle until now has been the VAT paid on bought-in services but not on in-house operations. I propose to remove this difficulty (see below).

Nationalised Industries

The industries already have every economic incentive to contract-out operations where this is the most efficient solution. I recognise that there will sometimes be operational or industrial relations objections. There may also be an element of empire building. These issues should be pursued during 1983, industry by industry, probably in the course of the annual corporate planning discussions. I propose that Treasury and departmental officials collaborate in identifying the areas where the industries might be pressed to contract-out more of their operations, bearing in mind the industries' responsibility for day-to-day management decisions.

General

- a. The VAT anomaly applies only to the National Health service and central government departments. Local authorities already have VAT refunded to them. Nationalised industries recover it through their prices. I intend to legislate in the next Finance Bill to allow the Treasury to make an order refunding VAT to government departments and the National Health Service, where specific operations or groups of operations are contracted-out. This will remove the present disincentive to such action.
- b. Industrial relations. There is no doubt that the unions, particularly in the NHS and the Civil Service, will resist any major extension of contracting-out. We

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already expect trouble in one or two government departments. Obviously the NHS exercise cannot be launched until the present pay dispute is resolved; but in general, I think we must face up to these difficulties as they arise.

- c. Managerial obstruction. There is understandable reluctance on the part of managers to give up any part of their functions. We must take every opportunity to counter this by pointing to the efficiency gains which have already been secured in some areas by greater use of the private sector. Some of these issues affect all four sectors, and the Departments concerned will need to remain in close touch and exchange experience as the operation proceeds. The Treasury can make suitable arrangements.
- (d) Civil Service and Related Bodies (Redundancy Compensation) Bill: Some of the work Cabinet commissioned on 25 November raises issues of importance in this context - particularly on the NHS and industrial relations. The Treasury will co-ordinate the two exercises .

Conclusion

I invite the Cabinet to agree:

- a. that there should be a major and co-ordinated drive to secure further contracting-out in the public sector;
- b. that the possibilities in the Civil Service should be pursued as part of the review of Civil Service manpower after 1984;
- c. that the Health Service Ministers should carry out the proposed pilot studies in regional health authorities;
- d. that we should continue to encourage contracting-out wherever possible in the local authority area,
- e. that opportunities for contracting-out in the nationalised industries should be pursued, either as part of the examination of the 1983 corporate plans for each industry, or separately.
- f. that I should, together with the Ministers concerned with the Health Service, local authorities and nationalised industries, report progress to Cabinet in May, at the same time that the Cabinet considers the outcome of the Civil Service manpower exercise.

and to note:

- g, that I shall include a provision in the next Financial Bill to allow the Treasury to make an order refunding VAT to government departments and the National

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Health Service and

- h. that the work on the issues concerning contracting out raised by the Civil Service Etc Bill will be co-ordinated with this exercise by ~~the~~ Treasury.

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9 December 1982

Michael Scholar, Esq.,
No.10 Downing Street

Dear Michael,

USING PRIVATE ENTERPRISE IN GOVERNMENT

..... As promised, I am enclosing a further draft of the Cabinet paper on contracting-out, which the Chancellor discussed with the Prime Minister yesterday evening. This has been produced by officials and the Chancellor has not yet had an opportunity to see the new text but we shall be showing it to him on his return from Germany tomorrow lunchtime.

Yours sincerely,

Margaret O'Mara

MISS M. O'MARA

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DRAFT

USING PRIVATE ENTERPRISE IN GOVERNMENT

MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

We are committed to reducing the size of the public sector. One way of doing this is by 'privatising' public sector operations completely: we have made good progress in this, and more is planned. Other tasks must remain in the public sector, but there is no reason why they need be done by public servants. It is often more efficient to 'contract out' such tasks to private enterprise. The time has come for another major push in this direction. I wrote to Cabinet colleagues in the summer asking for their further suggestions. I have received several interesting proposals, but the results are still patchy. I now want to make a further search for suitable candidates and enlist the support of all my Cabinet colleagues.

Why Contract Out?

Experience both in this country and in the United States suggests that the private sector, with the stimulus of the profit motive, can very often undertake operations on behalf of Government more cheaply than the Government itself can perform them. This in turn establishes private businesses with a potential for expansion including expansion overseas. It is true at national and at local level, in the Health Service and probably also in nationalised industries. There are serious obstacles. The present system was not designed to encourage contracting-out, and it needs a major push to achieve this. I am not, however, urging wholesale contracting-out at any price: only in those cases (a very large number, I should judge) where it will show a clear economic advantage.

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- c. Managerial obstruction. There is understandable reluctance on the part of managers to give up any part of their functions. We must take every opportunity to counter this by pointing to the efficiency gains which have already been secured in some areas by greater use of the private sector. Some of these issues affect all four sectors, and the Departments concerned will need to remain in close touch and exchange experience as the operation proceeds. The Treasury can make suitable arrangements.
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- b. that the possibilities in the Civil Service should be pursued vigorously as part of the review of Civil Service manpower after 1984;
- c. that the Health Service Ministers should implement the proposed pilot studies in regional health authorities;
- d. that we should continue to urge local authorities to contract out operations wherever possible,
- e. that opportunities for contracting-out in the nationalised industries should be pursued, either as part of the examination of the 1983 corporate plans for each industry, or separately.

- f. that I should, together with the Ministers concerned with the Health Service, local authorities and nationalised industries, report progress to Cabinet in May, at the same time that the Cabinet considers the outcome of the Civil Service manpower exercise.

and to note:

- g, that I shall include a provision in the next Financial Bill to allow the Treasury to make an order refunding VAT to government departments and the National Health Service and
- h. that the work on the issues concerning contracting out raised by the Civil Service Etc Bill will be co-ordinated with this exercise by the Treasury.



Recd Pol

10 DOWNING STREET

From the Private Secretary

10 December, 1982

Using Private Enterprise in Government

Thank you for your letter of 9 December, which which you enclose a further draft of the Cabinet paper on contracting out.

The Prime Minister is content for this paper to be circulated for discussion at Cabinet next Thursday.

I am sending a copy of this letter to Richard Hatfield (Cabinet Office).

M.C. SCHOLAR

Miss M. O'Mara,
H.M. Treasury

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10 DOWNING STREET

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Prime Minister

Yes no

Cabinet Paper on "Contracting out"

- i.e. on using private enterprise in
government.

The Treasury have pepped up this
paper a bit (not very much).

I am told privately that both
Mr Heseltine and Mr Fowler have
much more radical plans - but do
not want them circulated because
of the risk of "destroying 10,000
public sector jobs" leaks. P.T.O

Mr Ridley and the Chancellor
think the paper should go round
and the conclusions agreed as
it will "keep up the momentum
of this initiative."

Agree to circulation?

MCS 9/12



ce JV
Prime Minister (2)

CABINET OFFICE
Central Policy Review Staff

his 14/12

70 Whitehall, London SW1A 2AS Telephone 01-233 7765

Qa 06189

From: John Sparrow
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14 December 1982

The Rt Hon Sir Geoffrey Howe QC MP
HM TREASURY
S W 1

Dear Geoffrey,

Contracting Out: C(82)41

I offer some thoughts on your 3 December minute to the Prime Minister.

I agree that it will be useful to link the drive for more contracting out with the next Civil Service Manpower Exercise. It would be helpful to set manpower targets at levels which take account of the need to make contracting out attractive to Departments; and they should of course be allowed to score reductions in staff flowing from contracting out towards their manpower targets.

In the nationalised industries, good management will already be pursuing contracting out as one of its commercial objectives - wherever it makes commercial sense. There are dangers in getting sponsor Departments too much involved in this as in other detailed areas of management.

You may recall that in our report on unemployment, we suggested that contracting out might include a public sector equivalent of 'management buy-outs'. The idea was that there might be an open invitation to public service employees engaged in self-contained areas of work, to volunteer (individually or in groups) to become sub-contractors for their existing work. This could be a way of helping overcome the 'chicken and egg' problem that because a function is now carried out within the public sector there is often no alternative private capacity. Moreover, it

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would create a core of business for new small enterprises; and might throw up opportunities for contracting out which would not occur in main line management.

I am sending a copy of this letter to the Prime Minister.

Yours sincerely,

J.S.

John Sparrow

4 DEC 1982

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