



CENTRE FOR LABOUR RESEARCH

# STATE OF SECRECY

## Outsourcing: promise and performance

**John Spoehr, John Quiggin,  
Lou Wilson and Kevin Purse**

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## **THE AUTHORS**

John Spoehr, Executive Director, Centre for Labour Research, Adelaide University

Professor John Quiggin, Australian Research Council Senior Fellow, School of Economics, Australian National University

Dr Lou Wilson, Research Associate, Centre for Labour Research, Adelaide University

Kevin Purse, Research Scholar, Department of Social Inquiry, Adelaide University

For further information about the report please contact:

John Spoehr – [john.spoehr@adelaide.edu.au](mailto:john.spoehr@adelaide.edu.au)

Work: 08 8303 3730

Mobile: 0418 805 594

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## **EXECUTIVE SUMMARY**

Not enough is known about the real impact of the outsourcing revolution in South Australia because the information needed to fully evaluate major contracts, like the United Water and EDS contracts has been shrouded by commercial confidentiality. While some minor disclosure reforms have been introduced by the State Government a state of secrecy remains. Notwithstanding these difficulties it is possible to make some important judgements about the experience of outsourcing and to put the case for greater transparency and disclosure in government wherever public monies are involved.

There is no pot of gold at the end of the outsourcing rainbow. Evaluations of outsourcing demonstrate that promised cost savings and service improvements are often exaggerated or distorted. Calculations of savings are frequently inflated and fail to take account of the hidden costs involved in outsourcing. Claimed savings fail take to take account of the very high compliance costs associated with outsourcing. The task of monitoring and ensuring compliance is very costly, requiring a high level of in-house expertise and skills. However, the skills needed for this task are no longer available within government as contractors ‘cherry pick’ key personnel from government ranks. Any attempt to measure the performance or make calculations about the real level of savings or otherwise of outsourcing, is hampered by a lack of data and independent analysis of the performance of contracts.

The existence of major problems with outsourcing contracts locally and internationally provide a timely warning to policy makers that ideologically driven outsourcing strategies are likely to produce poor social and economic outcomes. Failure to manage incidents of self-mutilation in the privately run Melbourne Women’s Correction Centre recently led to the cancellation of an outsourcing contract with the Correctional Corporation of Australia by the Victorian Government. Plans for a whole of government approach to IT outsourcing were abandoned by the Federal Government after reviews by the Commonwealth Auditor General and the Managing Director of the Stock Exchange, Richard Humphry. A water outsourcing contract between the French firm Vivendi (a partner in the United Water consortium) and the municipality of Grenoble in France was cancelled after bribery of the Grenoble Mayor by Vivendi was alleged. This experience

simply reinforces the need for the State Government to take a more critically reflective approach to outsourcing and ensure that the public interest is not compromised by imprudent and ideologically driven approaches to outsourcing.

As the expiry dates for the United Water (2010) and EDS (2005) contracts draw closer it is imperative that a comprehensive and independent evaluation of the performance of outsourcing contracts be undertaken. The evidence gathered in this report, on the experience of outsourcing locally and internationally, suggests that the public interest will be threatened by the failure to do so.

### **Transparency and Accountability**

There has been little real progress towards more open and accountable government in South Australia. Much more needs to be done to ensure adequate levels of transparency and accountability. A range of legislative and institutional reforms will be necessary to ensure that progress is made towards this end. These include strengthening the powers of the Auditor-General, legislation to ensure greater disclosure and accountability and an independent Commission to review major contracts and contractual proposals.

The mechanisms below are recommended for consideration.

#### *Public disclosure and accountability legislation*

A Public Disclosure and Accountability Act is recommended to ensure that publicly funded and/or provided services are:

- accountable and transparent;
- subject to periodic independent review and evaluation;
- adequately resourced and supported to meet defined social and economic objectives.

#### *Commission of social and economic audit*

A Commission of Social and Economic Audit is proposed under the Public Disclosure and Accountability Act. It would have wide ranging responsibilities to advise Government on measures designed to improve quality, accountability and transparency in the delivery of publicly funded or sponsored enterprises or services. It would evaluate existing government contracts in accordance with a range of financial, social, industrial and economic performance criteria. Commissioners with appropriate expertise and representatives from the PSA and other relevant bodies would be appointed by the Government to support the work of the Commission.

### **Outsourcing in General**

An examination of the budget papers shows that considerable money was spent by the Government hiring consultancy teams to develop "business cases" for outsourcing deals and to conduct "due diligence" processes before and after contracts were awarded. Such costs are often overlooked in determining the overall cost of outsourcing. Since 1997 the South Australian government has spent around \$367 million on consultants. A significant proportion of this was spent on outsourcing and asset sales advice.

Although under the State Supply Act as part of the Governments Strategic Procurement Policy agencies are required to prepare Acquisition Plans justifying the purchase of goods and services and undertake rigorous tendering, evaluation and negotiation processes (which are often scrutinised by external probity auditors) for the purchase, major outsourcing deals are notable for their weaknesses in these areas. They are also notable for changes in the scope of projects, which often occur after business cases have been developed to justify them. Following due diligence the scope often changes resulting in the Government either accepting more risk or bearing increased cost. The EDS deal is a good example of this. The scope was changed after the contract was awarded.

Outsourcing deals seldom include detailed Key Performance Indicators (KPI) and Risk Management Plans covering all aspects of the outsourcing deal - particularly the actions required if a contractor defaults. KPI are often negotiated after contracts are signed. Both KPIs and Risk Management Plans should be in place prior to the signing of contracts.

There is often confusion in outsourcing deals between obtaining value for money for the taxpayer and using the deal to achieve other Government policy objectives (e.g. employment, youth employment, economic development, technology transfer, regional employment/economic activity, industry assistance. Evaluations tend to overstate the latter benefits and understate increased costs to the community.

Agencies undertaking outsourcing should maintain sufficient in-house expertise to guarantee that contractual provisions yield appropriate benefits to the community and that those provisions are implemented. The cost of this in-house expertise should be included in any assessment of options for outsourcing.

Contractors should be required to maintain wages and conditions equivalent to those in force prior to outsourcing.

Contractors should have the same public accountability requirements, including Freedom of Information, as public service providers. Where appropriate, rights to claim commercial confidentiality should be waived, as part of the contractual conditions.

Contracts should be drawn up with the aim of making provision of the previously existing quality of service the default standard. Where reductions in service quality are proposed they should be specified explicitly.

A Consumers' Charter or similar mechanism should be provided to allow consumers of public services to seek remedies in cases where service quality is reduced without an explicit decision process.

Quality assurance procedures in outsourcing should be enhanced to ensure that all contractors guarantee compliance with taxation, workers compensation and related obligations.

Residual risks borne by the community should be evaluated and the cost of those risks included in any evaluation of outsourcing.

## **United Water Contract**

### *Review of the contract*

The State Government has indicated that it reached an in principle agreement with United on 9 May 2001 and that the review would be concluded shortly after this date. The results of the review should be made public and provided to the Economic and Finance Committee of State Parliament. Independent analysis of the results of the review should be undertaken.

### *Cost Savings to Government*

The State Government claims that savings to the Government from the contract are forecast “..to be \$66.7m for the period 1 January 1996 to 30 June 2002. They claim that “..this represents around 19 percent of the estimated internal costs had the outsourcing contract not been entered into”. This is a questionable claim given that outsourcing savings levels of this magnitude are rare in international and local experience. In the absence of independent analysis of data used to derive the Governments claim regarding costs savings no firm conclusions can be drawn about the cost benefits or otherwise of the contract, though experience suggests that they are likely to be much lower. For example we know that the State Government spent around \$367 million on consultancy fees since 1997. A significant proportion of this was associated with outsourcing.

There are risks that cost-overruns could be a feature of the contract given the ageing nature of Adelaide’s water and wastewater infrastructure. It is important that these risks be clearly identified through a systematic evaluation of annual cost savings and overruns associated with the implementation of the contract. An evaluation of the net impact of any savings or overruns should be publicly available to assist in the evaluation of contract performance.

### *Water Prices*

The State Government claimed that outsourcing would lead to 20 percent savings and that this would translate into price benefits to consumers. While there is doubt about the level of savings achieved by the United Water contract there can be no doubt that average water prices for consumers have increased faster than the rate of inflation since 1994. Over the 1993/94 to 1999/2000 period water prices for the first 136 kilolitres (kls) increased by around 59 percent or \$70.67 from \$120.00 in 1993 to \$190.67 in 2001. Prices for average use 250 kls increased by around 38 percent or \$80.93 from \$220.32 in 1993 to \$301.25 in 2001. With inflation running at around 11 percent over the 1993-2000 period it is clear that water prices have increased significantly more than inflation over the last eight years.

### Changes in South Australian Water Prices, 1993/94 to 2000/01

Year	Access charges	Per kilolitre charges	Total Cost	% and \$ Change from 1993
1993	Access charge of \$120 per annum First 136 kilolitres free	88 cents per kilolitre for next 114 kilolitres (kl)	\$220 for average 250 kilolitre consumption	-
1994	Access charge - \$113 per annum	20 cents per kl for the first 136 kls and 88 cents/kl from 136 to 500 kls	\$140.40 for first 136 kls	16.8% \$20.20
1995	Access charge - \$118 per annum	22 cents per kls for first 125 kls and 89 cents per kl from 126 to 500 kls	\$155.29 for 136 kls	29.4% \$35.29
1996	Access charge - \$131 per annum	25 cents per kl for first 125 kls and 90 cents per kl from 126 to 400 kls	\$172.15 for 136 kls	43.5% \$52.15
1997	Access charge - \$119 per annum	35 cents per kl for first 125 kls and 89 cents per kl for 126 kls to 400 kls	\$172.54 for 136 kls	43.8% \$52.54
1998	Access charge - \$123 per annum	36 cents per kl for first 125 kls and 92 cents per kl for 126 kls and above.	\$178.12 for 136 kls \$301.25 for 250 kls	48.4% \$58.12
1999	Access charge - \$121 per annum	36 cents per kl for first 125 kls and 91 cents per kl for 126 kls and above.	\$176.01 for 136 kls	46.7% \$56.01
2000	Access charge - \$125 per annum	38 cents per kl for first 125 kls and 94 cents per kl for 126 kls and above.	\$182.84 for 136 kls	52.4% \$62.84
2001	Access charge - \$130 per annum	40 cents per kl for first 125 kls and 97 for 126 kls and above.	\$190.67 for 136 kls \$301.25 for 250 kls average consumption	58.9% \$70.87 36.7% \$80.93

Source: SA Government Gazette, various, SA Government Press Releases

#### **‘Australianisation’ of United Water**

The lack of any Australian equity in United Water is likely to be an impediment to maximizing the development of the local water industry. While United Water remains tied to its current foreign ownership structure it will be inevitably tied to the strategic objectives set by its offshore owners. An independent review of the failure to meet the commitment to 55 percent Australian equity in United should be undertaken and a strategy developed to ensure that the objective is met within two years. A panel of independent experts should be appointed to undertake this task and advise the State Government and SA Water on options for meeting the Australianisation objective.

## **Performance standards**

There is strong evidence that the odour event at the Bolivar Wastewater Treatment Plant in mid-1997 breached provisions in the contract in relation to acceptable odour standards and requirements to notify SA Water of significant maintenance related problems. This incident illustrates some of the inherent problems associated with outsourcing. Independent investigation of the odour revealed that inadequate operation and maintenance of the plant caused it. United Water failed to acknowledge this at the time the investigation was being undertaken. They claimed that climatic factors rather than the maintenance and operation of the plant, was the principal cause. By not detecting and notifying major equipment problems at Bolivar to SA Water United failed to meet both quality and disclosure standards in the contract.

## **State Development**

### *Exports*

The broad definition of exports enables export targets to be realised through the exports of ‘related’ companies and through companies deemed to have been assisted by the presence of United Water. The Minister can make this determination responsible. There is a need to set discrete targets for both interstate and overseas exports with greater weight assigned to the latter in determining export success. Secondly the involvement of the Minister in determining whether the exports of particular ‘related’ companies are legitimate for inclusion in export calculations undermines the transparency of the process and creates an opportunity for accusations of political manipulation of results. The responsibility for approval of ‘related’ companies should rest with an independent contract review body rather than with the Minister in the first instance.

The State Government claims that export targets are being met, though it refers to increases in exports for the water industry as a whole to support this claim. It argues that “overall exports by the water industry are estimated to be \$800m for the five years since the start of the United Water contract” (SA Government Response to *The Advertiser*, 20 September 2001). It is inappropriate to claim that water industry exports in general are a

direct result of the contract. Only exports directly attributable or flowing from the activities of United Water in South Australia should be counted in calculating the value of exports flowing from the contract.

Similar flaws are likely to relate to claims about job creation where the State Government has claimed that around “2200 additional jobs have been created in the South Australian water industry as a result of the outsourcing contract and economic development initiatives” (ibid). Close scrutiny of this report is necessary to test the veracity of the State Governments claims regarding job creation flowing from the contract. It should be noted according to the State Government the United Water contract contains no specific commitments to job creation. This is surprising, as job creation targets are likely to be one of the most legitimate means of measuring the performance of the industry development commitments made in the contract.

#### *Asian Bid Vehicle*

The contract specifies that United Water will be used by CGE and Thames Water as the vehicle for tendering for projects in key countries in the Asia Pacific region. While United Water is 100 percent foreign owned there are few guarantees that the benefits of projects gained by the company will be realised locally. Until the commitment to ‘Australianisation’ of United Water is met the company’s commitment to the development of the domestically owned water industry in South Australia is questionable.

### **Government Information Technology**

The findings of three major inquiries into Commonwealth IT outsourcing indicate that there is an urgent need for very close scrutiny of the EDS contract in South Australia. One key report found that EDS, the corporation with responsibility for the Australian Taxation Office (and all South Australian Government IT services), made only minimal

savings for the government and Group 5 services contracted to Advantra would have been better off kept in-house. Group 5 includes the Department of Prime Minister and Cabinet, the Department of Industry and the Department of Communication. The Commonwealth Auditor-General's report found that it cost Group 5 seven percent more to outsource than it would have cost to keep IT services in-house.

Furthermore the Commonwealth Auditor General also found that the notional savings that the Commonwealth Departments expected to make from IT outsourcing were in reality far less than the budget cuts they received to pay for the outsourcing contracts. It was estimated that between 1997 and 2001 these Departments lost \$224 million in expected savings. The Commonwealth was able to recover approximately \$4 million in penalties imposed on CSC, EDS and Advantra leaving a deficit of \$220 million. Because of the long lead times to outsourcing some Departments had budget reductions in place two years before contracts were signed.

IT outsourcing tends to create new, expensive, senior management positions within the public sector to manage outsourcing contracts, while the State continues to pay the wages, via outsourcing contracts, of approximately the same number of people as before, who work for private IT firms.

There are significant financial costs associated with negotiating the tendering processes, which are often not factored, into outsourcing budgets. For example, in South Australia the cost of the tendering process, which delivered the State's IT, infrastructure to EDS was estimated at \$10 million.

IT Outsourcing decisions are often made in terms of current cost and are not sufficiently flexible to allow agencies to rapidly take advantage of new technological innovations.

### **Cost savings to government**

The State Government claims that the EDS contract resulted in total savings of around \$60 million over 5 years to 30 June 2001. The South Australian Auditor General has drawn attention to overcharging by EDS in relation to Mainframe billing. It is suggested

that EDS had overcharged the State Government by \$10 million as part of its \$700 million contract.

International and local experience suggests that there is a danger that further cost related concerns are likely to arise. The fact that the value of the contract has been adjusted upwards by nearly \$200 million suggests that costs were very significantly underestimated, reflecting the difficulty of adequately specifying requirements in the context of rapid advances in information and communications technologies.

### **Job creation**

According to the State Government EDS employs around 669 Full-time equivalent (FTEs) staff in South Australia. Included in this figure are an unspecified number of contractors. The Government claims that EDS has increased its workforce by around 300 FTEs since transfer. They claim that EDS has “.exceeded its four year aggregate employment target .. to 30 June 2000 by 222 percent” (Armitage, M., 20 September 2001). The extent to which this represents a significant and sustained increase depends upon the number of contractors included in the calculation. The figure may be artificially inflated by the inclusion of contractors. A more appropriate measure of employment change would be to separate directly employed persons from contractors.

## **SA FRUIT FLY ERADICATION PROGRAM**

### **Contract Management Issues**

The outsourcing of PIRSA's casual fruit fly eradication workforce occurred without any formal contract between PIRSA and the various labour hire firms involved.

There was a failure to undertake a proper evaluation of the various labour hire firms prior to their engagement and no specification of performance required of the labor hire firms. No selection criteria were laid down for the engagement of the labour hire workforce. There was no assessment criteria by which to evaluate the performance of the labor hire companies. There was a failure to adequately carry out the occupational health and safety responsibilities to the workers engaged in the fruit fly program.

## CHAPTER 1: INTRODUCTION

This report focuses on how outsourcing is fundamentally changing the relationship between the South Australian community and its government. During the post-war period the South Australian government, like other state governments around Australia became a major provider of goods and services to the community. This role emerged over time in response to the need for government to address pressing social and economic development needs. By the end of the 1970s the state government in South Australia had established an extensive range of institutions to deliver a wide range of goods and services. The ‘independent’ body set up in 1994 by the Brown Liberal Government to review public sector performance acknowledged the importance of government in the following terms.

State government businesses are important in the daily lives of South Australians. South Australians can be born in government hospitals, be educated in government schools, drive on government roads and travel in government buses. They buy water and electricity from the government, and flush toilets and stormwater into government provided sewers and drains. South Australians can buy meat slaughtered by a government business, build houses on land purchased and sold wholesale by the government with finance from a government scheme using timber grown, milled and sold by a government business. They can ship goods through government owned and operated ports, gamble at the races and in lotteries via government agencies, make wills with the government trustee and be buried in a government provided cemetery.

South Australian Commission of Audit, Vol 1, 1994, p 331

Just six years after this statement appeared in the Report of the SA Commission of Audit the role of government in the lives of South Australians has been radically transformed. The Brown/Olsen Liberal Governments have adopted many of the market-based reforms recommended by the Commission. This has included the outsourcing of Modbury Hospital, metropolitan bus services, Adelaide’s water and sewerage services,

government information technology, the leasing of ETSA, the sale of the SA Meat Corporation, the TAB and a range of other state assets.

### The First Wave of Outsourcing

The South Australian Commission of Audit laid the foundations for a market based approach to the delivery of goods and services. It argued that government should be a purchaser rather than a provider of these. While it noted the importance of government businesses and services in the lives of South Australians the Commission argued that privatisation and outsourcing brought considerable financial benefits that warranted the government embarking on a market-based transformation of the public sector.

The Commission argued that outsourcing would result in increased efficiencies and savings. It estimated that average savings of around 20 percent could be achieved (SACA, Vol 1, p 349) and on this basis, advocated extensive outsourcing of public enterprises and services. For example it recommended the outsourcing of 19 functions of the Engineering and Water Supply Department, suggesting that annual savings of \$20 million in operating costs and \$8 million in capital costs would be generated. It also argued that the adoption of outsourcing in the area of government information technology management and maintenance would produce savings of around \$50 million per annum (McPherson, K., Vol 1, p 321).

The Commission challenged the legitimacy of government's role in business enterprises arguing that fears about market failure and the inability of the private sector to adequately address equity and economic development objectives are no longer relevant grounds for sustaining public enterprises (McPherson, K., Vol 1, p 335-336). It argued that the difficulties and risks associated with government ownership and poor performance of state enterprises in South Australia warranted the introduction of extensive market-based reforms and the sale of a range of enterprises. It claimed that these reforms would increase efficiency, reduce debt and risk (McPherson, K., Vol 1, p 342-343).

This report argues that the Commission's assumptions about the role of government were fundamentally flawed and that the promised benefits of outsourcing are often not

being realised in practice. Reliance on outsourcing for the delivery of services such as health, water, electricity and transport rarely meet the range of objectives that governments and communities seek from such services.

There is no pot of gold at the end of the outsourcing rainbow. Calculations of savings are often inflated, failing to take account of the hidden costs involved in contract management and compliance. Claimed savings frequently do not take account of important externalities such as the impact of outsourcing on employment levels and conditions. Nor do they take account of the very high compliance costs associated with outsourcing. The task of monitoring and ensuring compliance is very costly. The in-house expertise and skills for this task are often lost from within government to contractors. Any attempt to measure the performance or make calculations about the real level of savings or otherwise of outsourcing is hampered by a lack of data and independent analysis of the performance of contracts.

Many important services once managed and delivered by the public sector are now being undertaken under contract by the private sector. We know very little about the results of this transformation in South Australia because the information needed to fully evaluate major contracts like the United Water and EDS contracts has been shrouded by commercial confidentiality. While some minor reforms have been introduced by the State Government to ensure greater disclosure and transparency a state of secrecy remains. Notwithstanding these difficulties it is possible to make some important judgements about the experience of outsourcing locally and nationally and to put the case for greater transparency and disclosure in government wherever public monies are involved.

As the time for the State Government to consider renewal of the United Water and EDS contracts draws closer, the imperative for a comprehensive audit and review of the performance of the contracts is increasing. The United Water contract expires in 2010 while the EDS contract expires in 2005. This report states some of the reasons why a comprehensive review of these contracts is warranted.

## CHAPTER 2: TRANSPARENCY AND ACCOUNTABILITY

The lack of data available on the performance of outsourcing contracts draws attention to fundamental problems of accountability and transparency associated with outsourcing in South Australia. There is a significant conflict existing between the need for accountability and transparency on the one hand and the application of commercial confidentiality on the other. Often commercial confidentiality is used inappropriately as a political tool to insulate governments from potential criticism.

Since 1995 the Auditor-General, Ken McPherson has raised serious concerns about the lack of accountability and transparency surrounding outsourcing contracts. In his 1995 Annual Report he stated:

Transactions between the public and private sectors are being entered into, or are proposed to be entered into, with major and ongoing financial implications for the State. These warrant adequate 'before the event' processes, which are not provided for under current legislation.

I have suggested that various precedents which already exist in legislation of this State be built upon to achieve improved accountability mechanisms in this respect - in particular, to ensure that major public/private sector transactions, including asset sales, outsourcing arrangements and special industry assistance packages, take place only *after* Parliament has had an opportunity to be informed of them and, if necessary, to make decisions about them. (Auditor-General, 1995, 12)

For the public interest to be maintained the principle of commercial confidentiality must ultimately be used sparingly. Excessive use of commercial confidentiality shrouds outsourcing in unnecessary secrecy, promoting community distrust and skepticism. Ken McPherson who drew attention to the findings of the Fitzgerald Royal Commission in Queensland and the Royal Commission in Western Australia on Commercial Activities

of Government acknowledged this point. He concluded that this experience demonstrated that “excessive secrecy can be unsafe because public interest could be prejudiced” (AG, 1995:83).

To address the need to better balance the “Government’s legitimate commercial interests with the right of the Parliament to be informed as to what is going on” the Auditor-General made a series of recommendations in his 1995 Report. These included the establishment of “a legal framework in which a ‘summary’ of all arrangements entered into that extend over more than one financial year and are over a specified minimum dollar value, be required to be tabled in Parliament”.

The summary of arrangements suggested by the Auditor-General was to contain:

- the full identity of the private sector participant;
- the duration of the contract/arrangement;
- the identification of any assets transferred to the private sector firm by the public sector;
- the results of any cost-benefit analyses;
- significant guarantees or undertakings, including loans and grants, entered into or agreed to be entered into, and any contingent liabilities.

The Auditor-General suggested an alternative and complementary approach which involved the establishment of ‘a legal framework whereby a summary of all arrangements entered into between the Government and the private sector, above a specified value, are included in public sector agencies’ annual reports to Parliament’. This approach was consistent with the recommendations of the Victorian Public Accounts and Estimates Committee (AG, 1995:89).

The Auditor-General has also pointed out there is a strong case for the introduction of legislation requiring public disclosure to the Parliament of all arrangements entered into between Government and the private sector. The provision of such information would enable an open discussion about the relative merits of outsourcing, enabling

Government, the Parliament and the wider community to evaluate the impact of particular proposals and projects.

While the State Government has agreed with the recommendation of the Auditor-General that summaries of contracts are made available to the Economic and Finance Committee of State Parliament, few such summaries have been provided. Where they have been made available, such as the United Water contract summary, they are not sufficiently detailed to enable adequate measurement of compliance with contractual obligations. In addition, other information and data on the performance of particular contracts is necessary to undertake any effective evaluations.

Following suggestions by the Auditor-General the State Government released a policy on contract disclosure in May 2001. This policy seeks to “increase accountability for, and improve transparency of, the Government’s contracting activities” (Auditor General, 2001, Part A, 116). It applies to a wide range of contracts including general goods, services and works; asset sales; consultancies; private infrastructure initiatives; industry assistance; major events and grants; and public sector executive contracts (ibid). Exemptions from the policy are applied in relation to “..genuinely confidential business information, trade secrets and intellectual property, defence, national security, public safety or government building security information, public interest and legal risk” (ibid). Currently the policy only applies to post 1 July 2001 contracts, which excludes the major contracts entered into by the State Government. The Auditor-General indicates however that the Prudential Management Group has been commissioned by the Government to “..negotiate the disclosure of contracts entered into since December 1993 which have a value of \$4 million or more” (ibid). There has been little real progress towards more open and accountable government in South Australia. Much more needs to be done to ensure adequate levels of transparency and accountability. A range of legislative and institutional reforms will be necessary to ensure that progress is made towards this end. These include strengthening the powers of the Auditor-General, legislation to ensure greater disclosure and accountability and a Commission to review major contracts and contractual proposals. The mechanisms below are recommended for consideration.

## **PUBLIC DISCLOSURE AND ACCOUNTABILITY ACT**

A Public Disclosure and Accountability Act would provide a framework for ensuring that publicly funded and/or provided services are:

- accountable and transparent;
- subject to periodic independent review and evaluation;
- adequately resourced and supported to meet defined social and economic objectives.

### **COMMISSION OF SOCIAL AND ECONOMIC AUDIT**

A Commission of Social and Economic Audit would be created under the Public Disclosure and Accountability Act. It would have wide-ranging responsibilities to advise the Government on measures designed to improve quality, accountability and transparency in the delivery of publicly funded or sponsored enterprises or services. It would evaluate existing government contracts in accordance with a range of financial, social, industrial and economic performance criteria. Commissioners with appropriate expertise and representatives from the PSA and other relevant bodies would be appointed by the Government to support the work of the Commission.

### **CHAPTER 3: PROMISE AND PERFORMANCE**

The practice of contracting with private firms for the provision of public services is a very old one. For example, the transport of convicts to Australia was undertaken primarily by private contractors. However, the First Fleet was effectively a public venture, being under the direct control of Governor Philip, while the contractors, paid on a fixed rate per convict controlled the Second Fleet. As a result of the incentive to skimp on food and medical attention, around a quarter of the convicts in the Second Fleet died, and half were unfit for work when they arrived (Clark 1962), whereas the death rate for the First Fleet had been minimal. Subsequent tightening of contractual terms reduced death rates, but also increased costs.

In broad terms, the history of convict transportation has been repeated in more recent experiments with competitive tendering and contracting. In the initial rounds of contracting, private firms have offered to deliver public services at a price far below the cost of public provision. As a range of hidden costs and problems has emerged, contractual terms have been tightened. The results have included improvements in performance, but also the loss of many of the financial savings that originally motivated the move to contracting.

The recent upsurge in private provision of public services began in the early 1980s under the Thatcher government in the United Kingdom. The Thatcher government imposed compulsory programs of competitive tendering and contracting on central government agencies and local governments. A similar approach was adopted by the Kennett government in Victoria and by the Howard government. Other governments have undertaken extensive outsourcing without adopting a comprehensive program of this kind.

The increase in support for the policy of outsourcing for the provision of public services is closely related to the increasing popularity of ‘outsourcing’ in the private sector. In both the public and private sectors, outsourcing has been adopted for a number of reasons.

First, there has been a general shift towards the belief that organisations should focus on the achievement of a single ‘core objective’ or a small number of such objectives, and should, as far as possible, avoid responsibility for peripheral activities. This belief contrasts with the ideas of the 1960s and 1970s when ‘conglomerate’ corporations, with subsidiaries engaged in many different industries were seen as a way of achieving diversification, and when government agencies typically sought to pursue very broad definitions of ‘the public interest’.

Second, improvements in understanding of the allocation of risk have led to a desire to organise contractual relationships in a way that yields better management of risk. Where specific operational risks can be distinguished from the general operations of an organisation, contracting may provide an appropriate way of managing those risks.

Last, but not least, there has been a desire to reduce the core workforce of public and private sector organisations. In part, this reflects a change in fashions, as ‘downsizing’ rather than ‘empire-building’ has come to be seen as the mark of a good manager. More importantly, many organisations have found it difficult, because of legal restrictions and concerns about morale, to reduce wages and conditions for core employees. Outsourcing has enabled corporations to replace core employees with contract employees who receive less favorable wages and conditions and to increase competitive pressure on the remaining core employees.

Outsourcing, then, is undertaken for both good and bad reasons. This chapter focuses primarily on the dangers of inappropriate outsourcing. It begins with a summary of the costs and benefits of outsourcing. A number of case studies of (partially or completely) unsuccessful outsourcing are presented.

## **Costs and benefits of outsourcing**

### *Estimates of budget savings*

The primary motive for outsourcing the provision of public services to the private sector has been the desire to reduce public expenditure. Most contracts have been designed to achieve such savings and in some cases, such as that of Commonwealth IT outsourcing, agency budgets have been cut in anticipation of projected cost savings.

At least in Australia, the most widely used estimate of the cost savings associated with outsourcing has been that, on average the cost of providing public services will be reduced by 20 per cent as a result of outsourcing. This estimate is derived mainly from the work of academic and consultant, Simon Domberger and his co-workers, and has been employed by the Industry Commission (1996) and other government agencies. Domberger's research was used to justify the savings targets outlined in the South Australian Commission of Audit.

Other studies have suggested that, when the costs of tendering and contract management are taken into account, and if there are no changes in wages and conditions as a result of outsourcing, the average cost saving from outsourcing will be less than 20 per cent in most cases. Paddon (1991, 1993) criticises the work of Domberger and cites British estimates that the average cost saving was around 7 per cent. As is discussed below, the Commonwealth IT outsourcing program failed to achieve the projected savings and was drastically scaled back.

### *Service quality*

There are both political and economic reasons to expect that outsourcing will be directly associated with quality reductions. First, governments frequently use outsourcing as a cover for deliberate reductions in the quality of service and designed to cut costs. It is more politically attractive to implement reductions in service quality at the time of outsourcing than to reduce service quality first, then to call for tenders for the provision of service at the reduced quality level.

Second, the incentives for private contractors are clearly to provide the minimum service specified in the contract. Hence, if any services previously provided are not specified in the contract, or if there is room for interpretation regarding the quality of service required, it is reasonable to assume that the minimum quality will emerge. Instances of this kind are examined in the case studies presented below. This point raises serious problems for governments seeking to evaluate the performance of outsourcing. If the measures of service quality used in the evaluation are the same as those used in the contract specification, the evaluation will be biased in favor of a positive assessment. This point is illustrated with respect to the Job Network, discussed below.

Most international and Australian studies of outsourcing of public services have found that service quality deteriorated (Ascher 1987, Evatt Research Centre 1990; Rimmer 1993, Egan, Montesin and Adena 1995, Fraser 1997). Savas (1977) found no evidence of statistically significant change. The Productivity Commission (1996) cited a number of Australian studies finding that service quality either improved or remained unchanged. However, nearly all of these studies came from a single group of researchers, led by the late Simon Domberger and affiliated with the consulting group CTC Consultants, which took a leading role in the promotion and implementation of competitive tendering policies in New South Wales.

### *Wages*

In both the private and public sectors, outsourcing has been used as a device to reduce wages. Although the Productivity Commission (1996) found no systematic pattern of wage reductions following outsourcing, the ACTU submission to the same inquiry found a number of cases where wages were reduced.

Further evidence can be found in a number of decisions of the Industrial Relations Court preventing employers from reducing wages and conditions as a result of outsourcing. The very existence of decisions of this kind is evidence that, in their absence, at least some employers would seek to reduce conditions.

### *Conditions of employment*

Even more than with reductions in wages, outsourcing has been associated with changes in the conditions of employment designed to increase output per worker. Such changes are commonly referred to as the removal of 'restrictive work practices'. Most official evaluations of outsourcing have proceeded on the assumption that such changes involve a mutually beneficial increase in flexibility and productivity.

Flexibility of employment arrangements is often discussed in terms that suggest that flexibility is unambiguously desirable. In reality, flexibility in employment is, for most purposes, a zero-sum commodity. The greater the flexibility available to the manager, the less there is for the worker and *vice versa*. From the employer's point of view, the most flexible employee is one who is permanently on-call, but is paid only when called upon to work. Obviously, such employees have essentially no flexibility in managing their own time.

More generally, the productivity gains derived from the removal of 'restrictive work practices' are typically the result of an increase in unpaid working hours and in the pace and intensity of work. The main source of efficiency gains explicitly noted by Domberger, Meadowcroft and Thompson (1986) is the replacement of fixed 'task and finish' payments with piecework rates. Productivity gains from such changes in payment schedules will arise primarily from increased effort. Ganley and Grahl (1988) cite a number of cases of increases in working hours or reductions in working conditions associated with outsourcing of garbage collection.

The Industry Commission (1996) argues that it is impossible to distinguish between increases in work intensity arising from outsourcing and general changes in the labour market. This kind of obfuscation is, unfortunately, typical of the analytical approach adopted by the Industry Commission in its evaluation of microeconomic reform. A more intellectually honest statement of the position would be that outsourcing is one of a number of strategies adopted by private and public sector employers to increase the intensity of work and enhance the flexibility of employers at the expense of employees.

### *Cost shifting*

Cost shifting between levels of government has been a common practice for many years, but the emphasis on cost minimisation associated with outsourcing creates new incentives for cost shifting. An obvious way of minimising costs at one level of government is to make extensive use of services provided by another level of government on a free or subsidised basis.

Another source of cost shifting is tax evasion. Outsourcing increases the opportunities for evasion and avoidance. Public sector wage employees have fewer opportunities for evasion than any other group of income-earners. By contrast, contractors and their employees are in a very good position to evade taxes, especially if, like cleaners and garbage collectors, they work non-standard hours. The evidence reported in Tanzi (1982) indicates that evasion is insignificant among government employees and highest in the small business sector.

### *The allocation of risk*

The appropriate allocation of risk is a crucial element of successful contractual relationships of all kinds. In a well-designed contract, risks and the associated rewards, are allocated to the party best able to manage those risks. This point may be illustrated by considering a construction project. Under a fixed-price contract, the builder bears the risk of any unanticipated cost increases and receives the benefit of any unanticipated cost savings. By contrast, under a 'cost-plus' contract, these risks are allocated to the customer. In general, the allocation of risk under the fixed-price contract is superior, because the builder has more capacity to manage risk associated with the construction process.

Outsourcing is likely to be beneficial in cases where risks peripheral to the core concerns of a government agency can be transferred to a contractor who is well placed to manage those risks. On the other hand, poorly designed contracts can leave governments, and ultimately the community, in the position of bearing high risks while receiving no return. The case of CSL, discussed below, is a good example.

### *Other matters*

An examination of the budget papers shows that considerable money was spent by the Government hiring consultancy teams to develop "business cases" for outsourcing deals and to conduct "due diligence" processes before and after contracts were awarded. Such costs are often overlooked in determining the overall cost of outsourcing. Since 1997 the South Australian government has spent around \$380 million on consultants (SA Auditor-Generals Annual Report, various; Lucas, R., June 2001). A significant proportion of this was spent on outsourcing and asset sales advice.

Although under the State Supply Act as part of the Governments Strategic Procurement Policy agencies are required to prepare Acquisition Plans justifying the purchase of goods and services and undertake rigorous tendering, evaluation and negotiation processes (which are often scrutinized by external probity auditors) for the purchase, major outsourcing deals are notable for their weaknesses in these areas. They are also notable for the changes in scope of projects, which occur after business cases have been developed to justify them. Following due diligence the scope often changes resulting in the Government either accepting more risk or bearing increased cost. The EDS deal is a good example of this. The scope was changed after the contract was awarded.

Outsourcing deals seldom include detailed Key Performance Indicators (KPI) and Risk Management Plans covering all aspects of the outsourcing deal - particularly the actions required if a contractor defaults. KPI are often negotiated after contracts are signed. Both KPIs and Risk Management Plans should be in place prior to the signing of contracts.

There is often confusion in outsourcing deals between obtaining value for money for the taxpayer and using the deal to achieve other Government policy objectives (eg employment, youth employment, economic development, technology transfer, regional employment/economic activity, industry assistance. Evaluations tend to overstate the latter benefits and understate increased costs to the community.

## **Conclusion**

The recent popularity of outsourcing as a policy has given rise to numerous instances of inappropriate, poorly designed and poorly implemented outsourcing. In many cases, the benefits of budgetary cost savings have been outweighed by losses in wages, reductions in working conditions and reductions in the quality of service.

## CHAPTER 4: NATIONAL CASE STUDIES

### *NSW school cleaning*

Until 1992, the Government Cleaning Service (GCS) undertook cleaning of NSW government schools for the NSW Education Department. During 1992 and 1993, cleaning was provided on the basis of a mixture of outsourcing, with the GCS competing against private firms, and non-tendered services provided by the GCS. The majority of contracts awarded under competitive tendering went to three major contractors, Berkeley Challenge, Menzies International, and Tempo Services.

This episode of outsourcing is of particular interest because it formed the basis of one of the only peer-reviewed studies to find that outsourcing was associated with maintenance or improvement of service quality. In an article published in the English *Economic Journal*, Domberger, Hall and Li (1995) conclude that outsourcing of school cleaning yielded substantial cost savings with no reduction in service quality.

There is a striking contrast between the findings of Domberger, Hall and Li (1995), and those of a review of cleaning services undertaken following a change of government in New South Wales, which led to an upgrading of service specifications. In reporting the results of the review to State Parliament, the Minister for Education, Mr. Aquilina, described it as ‘damning’ and stated that ‘school cleaning specifications were inadequate for young children, with grit and grime trampled into carpets because of insufficient vacuuming, food preparation areas in canteens left uncleaned and dust and shavings left to build up in woodwork rooms’ (Daily Telegraph, 22/9/95, p. 14).

The results claimed by Domberger, Hall and Li (1995) are also inconsistent with those of surveys of school principals (Egan, Montesin and Adena 1995) and of school cleaners themselves (Fraser 1997). Fraser and Quiggin (1999) observe evidence that contractors manipulated the assessment process, requiring unpaid extra work in the leadup to scheduled visits by inspectors.

### *The Job Network*

The Commonwealth Employment Service (CES) was established as a result of the White Paper on Full Employment (Commonwealth of Australia 1945). As such, the CES was an embodiment of a public commitment to full employment. Despite the persistence of high unemployment since the economic crises of the early 1970s, it was not until the election of the Howard government that this commitment was officially abandoned.

In 1998 the CES was replaced by a system of competitive outsourcing referred to as the ‘Job Network’. Under the tendering process, government, private and community organisations submitted bids to provide labour market services to groups of unemployed workers, classified in terms of need indicators such as the duration of unemployment. Success in tendering depended on willingness to meet tightly specified goals at low costs.

The results of this shift were entirely predictable. By providing sharp financial incentives to meet specified goals, the government greatly increased the probability that those goals would be met. According to the most recent evaluation (Department of Employment, Workplace Relations and Small Business 2001, p. 90):

Preliminary data on efficiency (unit cost and cost-per-outcome) indicate that the cost of assistance under Job Network is well below that of the assistance delivered under Working Nation and, in aggregate terms, less than the unit cost of assistance in the early 1990s. On the basis of preliminary net impact estimates and lower costs, Job Network appears to be delivering better value for money than the previous labour market assistance arrangements.

The same evaluation was effectively reproduced in an assessment by the Organisation for Economic Co-operation and Development (OECD) (2001) This assessment reflected the dependence of the OECD on information supplied by national governments. However, the OECD noted the failure of the Job Network to reduce long-term unemployment, a point played down by the Australian government.

The problem with schemes based on competitive tendering is that the specified goals rarely respond exactly to social needs or even to the objectives of policymakers. A competitive tendering framework encourages service providers to meet the specified goals in the most cost-effective manner possible.

At best, the sharpening of incentives encourages service providers to abandon any aspects of their service not encompassed in the goal specification. For example, grant-funded charitable providers of services to the unemployed might offer counseling and assistance for a range of family-related problems, drug dependence problems and so on. Under an incentive based system with competitive tendering, such services can only be offered to the extent that they are cost-effective in meeting the goal of obtaining employment, or if they are specifically included as part of the service specification.

A second outcome of competitive incentive systems is ‘cream-skimming’ or ‘cost-shifting’. Service providers face a strong incentive to seek out clients whose needs can be met at relatively low cost compared to others in the same payment class (the cream). Meanwhile, high-cost clients are diverted to residual ‘providers of last resort’, or receive no service at all. Cream skimming and cost shifting have been a common outcome of case-mix funding schemes for health-care providers.

At worst, competitive incentive systems promote the search for opportunities for arbitrage, that is, for the design of systems, which yield a positive profit with no net effort. In the case of the Job Network, for example, a payment was offered for successfully placing a client in employment defined as a job of at least 15 hours employment over a period of no more than 5 consecutive days. Under the rules of the scheme, the requirements for this payment could be satisfied by a service provider who simply hired the client themselves at a cost less than the payment for a “successful outcome’. According to a Senate inquiry, precisely this strategy was adopted by one of the largest service providers, Leonie Green & Associates (Commonwealth of Australia 2001).

*Commonwealth Serum Laboratories*

The case of the Commonwealth Serum Laboratories involved a combination of privatisation and outsourcing. Until 1994 the Commonwealth Serum Laboratories fulfilled a range of public functions, the most important of which was the manufacture of plasma and other blood products using blood donated to the Australian Red Cross Blood Transfusion Services. In that year, the company, renamed CSL was privatised, and given a 10-year contract to supply the Commonwealth government with blood products.

The sale price of \$300 million was superficially attractive, in view of the fact that the profits of the Commonwealth Serum Laboratories had always been modest. However, as was observed by Hamilton and Quiggin (1995), closer examination revealed a different picture. Just prior to the privatisation, the Commonwealth government had funded a new blood fractionation plant and other equipment upgrades at a cost of \$200 million, leaving net proceeds of only \$100 million. More importantly, the contract with CSL was exceptionally favorable to the private shareholders and exceptionally unfavorable to the public. Using evidence available at the time, Hamilton and Quiggin estimated that the contract involved annual payments \$50 million in excess of those made to the publicly owned Commonwealth Serum Laboratories.

As it turned out, these estimates were conservative. According to the ANAO (1995), the payments required under the Plasma Fractionation Agreement were to total around \$1 billion between 1994 and 2004, or about twice as much as estimated by Hamilton and Quiggin. Moreover, subsequent dealings with CSL exposed the difficulties of under-funded public servants seeking to negotiate with a profit-oriented monopoly supplier. As was shown by the Australian National Audit Office (1995), the Commonwealth Department of Health was totally out-manoeuvred. In particular, CSL was effectively able to double-count depreciation of the fractionation plant, which was, as noted, a gift from the Commonwealth government. Moreover, despite the claim that public ownership was too risky, the deal with CSL left the public bearing most of the risks associated with a blood products business (such as possible exposure to litigation over Creutzfeld-Jakob disease, a blood-borne virus) while receiving none of the returns.

As the generosity of contract arrangements has become apparent, the share price of CSL has soared. Foreign buyers heavily oversubscribed the float, at a price of \$2.30, but

Australian purchasers were somewhat less eager. Following the release of the Auditor-General's report the price rose to \$5, as it became apparent that CSL had an effective license to print money. Since 1999, the price has risen to \$35 valuing the entire business at \$7 billion. Some of this increase reflects acquisitions and income-earning possibilities from the group's pharmaceutical products. However, the valuation is underwritten by the monopoly rents extracted from the public under the outsourcing contracts negotiated by the Keating and Howard governments.

The attempted defense of the CSL privatisation offered by Johns (2001) reveals the blinkered and ideological thinking that led to this disaster. As Parliamentary Secretary to the Minister for Health, Housing and Community Services, Johns was largely responsible for the privatisation. He is now employed by a right-wing 'think tank', the Institute of Public Affairs. As Johns correctly observes:

The critics' argument is that the Commonwealth will be paying out \$45 million per year more for the life of the ten-year agreement than it would have, had CSL remained in Commonwealth ownership. Is this accusation sustained by the facts?

This rhetorical question appears to promise a negative answer. In fact, Johns concludes, rather lamely:

A government, which was unwilling and unable to run CSL as a private company, could not expect to recoup a present value from assets that were improved after they were sold. Of course, the basis for much of that improvement rested in the preparation of CSL for sale, in particular the new fractionation plant and the corporatization process. It may also be true that the Commonwealth could have struck a better bargain with CSL on the price of plasma products and the assignment of depreciation at the Broadmeadows plant.

To put the matter more bluntly, the Keating government's unwillingness to invest in an important public asset led to a situation where the public made a \$200 million gift to private shareholders, negotiated a deal to give the same shareholders at least another \$1 billion, and still ended up bearing nearly all the risk associated with the activity in

question. The CSL deal fully deserves the accolade of Walker and Walker (2000) who awarded it the Wooden Spoon for Australia's worst privatisation. Only a combination of a 'giveaway' privatisation with a grossly mismanaged contracting arrangement could achieve such an outcome.

### *Commonwealth IT outsourcing*

Contracting for the provision of Commonwealth public services, already extensive under the Hawke-Keating Labor government was accelerated under the Howard government, following the recommendations of the National Commission of Audit (1996). Under the *Financial Management and Accountability Act 1997*, systematic 'market testing' of all activities undertaken by Commonwealth agencies, beginning with corporate services, was required to determine whether the relevant services could be provided more cheaply by the private sector.

This general commitment was deemed inadequate in the case of information technology (IT) services. A commitment to outsource all such services was reflected in the establishment of the Office of Asset Sales and Information Technology Outsourcing (OASITO) within the Department of Finance. This group, which also had responsibility for supervising market testing and a range of asset sales including the partial privatisation of Telstra and the sale of Commonwealth office buildings, imposed a centralised outsourcing process.

In announcing the initiative, the government projected savings of \$1 billion over 7 years. As the Senate Committee on Finance and Public Administration (2001), notes, the IT outsourcing program was driven predominantly by the desire to achieve cost savings, with little concern for the achievement of appropriate contractual relationships. The central element of the process was the aggregation of units of governments into 'clusters' in order to deliver economies of scale from aggregating services within and across budget-funded agencies. Thus agencies were not only forced to undertake tendering, but were deprived of any real control over the process.

The Commonwealth Auditor General's (ANAO 2000) report into Whole of Government IT Outsourcing Initiative, first established by the Commonwealth Government in the 1997-98 Budget, suggests ways in which some service providers may have resolved this tension. The Commonwealth opted for four providers for its IT outsourcing program, one of which withdrew from the process. The Commonwealth appears to have been ill served by the remaining providers. The CSC Corporation for more than a year neglected virus protection and other key security strategies after taking up the first Commonwealth contract in 1998. The company won the Cluster 3 contract which provided IT services to the departments of Immigration, Finance, the Australian Electoral Commission, IP Australia, the Australian Government Analytical Laboratories, Australian Surveying and Land Information Group and Ionospheric Predications Services. CSC was found to have provided poor system management and back up services. Furthermore CSC had failed to obtain full security clearance for its Cluster 3 network from the Defence Signals Directorate (DSD) by August 2000, almost two years after taking up the contract.

The report also found that EDS, the corporation with responsibility for the Australian Taxation Office (and all South Australian Government IT services), made only minimal savings for the government and Group 5 services contracted to Advantra would have been better off kept in-house. Group 5 includes the Department of Prime Minister and Cabinet, the Department of Industry and the Department of Communication. The Auditor General's report found that it cost Group 5 seven percent more to outsource than it would have cost to keep IT services in-house.

Furthermore the Commonwealth Auditor General also found that the notional savings that the Commonwealth Departments expected to make from IT outsourcing were in reality far less than the budget cuts they received to pay for the outsourcing contracts. It was estimated that between 1997 and 2001 these Departments lost \$224 million to expected savings. The Commonwealth was able to recover approximately \$4 million in penalties imposed on CSC, EDS and Advantra leaving a deficit of \$220 million. Because of the long lead times to outsourcing some Departments had budget reductions in place two years before contracts were signed.

Nevertheless there have been winners from the Commonwealth IT outsourcing program according to the Auditor General. The US based law firm and outsourcing consultant Shaw Pittman has received \$17 million in payments since 1996 from the Office for Asset Sales and IT Outsourcing, which represents 40 percent of the Office's budget. Shaw Pittman won a restricted tender for its work overseeing the outsourcing process despite being 44 percent more expensive than its nearest competitor.

In a submission to a subsequent Senate Finance and Public Administration References Committee inquiry into the Government's handling of IT outsourcing a potential bidder for outsourcing contracts, the Sausage Group, appeared to blame the problems with IT outsourcing on the Commonwealth's insistence on making cost savings (The Australian 13/3/2001). The Sausage Group submission commented:

The Government process forces cost minimisation through service minimisation at the expense of relationship management... the low level of contingency denies flexibility by the supplier to meet changing demands or remedy shortfalls

A report in *The Australian* (13/3/2001) suggested that the Sausage Group's submission also complained about the high levels of scrutiny by the Auditor General's report and the Senate inquiry, which were claimed to be destabilising the outsourcing industry.

The Sausage Group's openness was not shared by other private providers of IT services who were accused in the Senate inquiry's interim report in April 2000 of disregarding parliamentary accountability by failing to provide information. The majority report of the Senate inquiry (FPARC 2001) released in September 2001 found that the Commonwealth's outsourcing initiative was seriously flawed in process, planning, management, consultation and documentation. The majority report also expressed concern that inadequate attention was being paid in outsourcing IT services to the sensitive risks and complex processes of transition and the ongoing management of the outsourced business arrangement. In contrast a minority report by Government members of the inquiry released on the same day found that the Commonwealth outsourcing initiative was outstandingly imaginative and that any problems had been dealt with.

An independent report into the Commonwealth IT outsourcing by Richard Humphry, the managing director of the Australian Stock Exchange (January 2001) tended to support the Auditor General's report and the majority report of the Finance and Public Administration References Committee inquiry. The Humphry (2000) report suggested that planned Commonwealth contracts to outsource IT in welfare, science and the law posed a risk to national security and to public welfare. Outsourcing contracts for the CSIRO, the Australian Nuclear Technology Organisation and the Bureau of Meteorology should be reconsidered in terms of the potential loss of scientific talent. The Australian Antarctic Division and the Australian Geological Survey Organisation had particular needs for servicing remote locations, which needed to be considered. Outsourcing the computer needs of Australia's law enforcement agencies and the courts increased the risk of compromising security and exposing agencies to harmful consequences.

In response to the Humphry report, the government removed OASITO from control of the process. A number of partially completed tendering processes were abandoned and responsibility for outsourcing returned to individual agencies. Despite these changes, many of the fundamental defects in the process remained unresolved (Senate Finance and Public Administration Committee 2001).

## **CHAPTER 5: SOUTH AUSTRALIAN CASE STUDIES**

### **5.1 UNITED WATER CONTRACT**

South Australia is the driest State in Australia and has historically had major problems with water shortages and water quality. Water management had been a major function of Government in South Australia since the foundation of the colony. In a radical change of direction in 1995 the new Government contracted out the management and maintenance of Adelaide's water and wastewater system to United Water, a private consortium of French and British water supply companies and an Australian engineering company. United Water began its corporate life with a workforce of 400. SA Water the successor to the former E&WS water supply department, which continued to be responsible for the supply of water to non-metropolitan areas in South Australia, retained 1390 workers. The State run E&WS Department had employed 4000 workers in 1991 (E&WS 1995). The proportion of the labour force employed in water supply in South Australia had been effectively halved in the run up to the outsourcing of Adelaide's water supply services.

An agreement to outsource the management and maintenance of Adelaide water and waste water system was signed by the State Government with United Water International Pty Ltd on 18 December 1995. Once outsourced, information about the performance of United Water was claimed to be commercial in confidence by the SA Government. While printed information on the company's performance was unavailable other indicators suggested that a major problem was occurring with the implementation of the contract. Early in 1997 the Adelaide metropolitan area was surrounded by a foul smelling odour emanating from the Bolivar sewerage works in the north of the city. The 'Big Pong', or 'Major Odour Event', as the SA Government and United Water called it, forced an independent inquiry by Ken Hartley, a former employee of the E&WS. The inquiry which found that the problem was caused by understaffing leading to inadequate maintenance of critical infrastructure several years prior to the event (Hartley 1997).

#### **Performance of the contract**

The United Water contract had undergone a formal review during 2001. The State Government has indicated that it reached an in principle agreement with United on 9 May 2001 and that the review would be concluded shortly after this date. The results of the review should be made public and provided to the Economic and Finance Committee of State Parliament. Independent analysis of the results of the review should be undertaken.

The Government has made a range of claims about performance of the contract. These cannot be verified without access to relevant data and analysis, which is not publicly available. Below, we review some of the key objectives of the contract in the light of these claims.

### **Cost Savings to Government**

United Water and SA Water have agreed to share cost savings and overruns. Annual targets for these have been set. The details of these targets and performance against them are not available. The State Government claimed that savings of around 20 percent would be made from the contract.

#### *Key Issues:*

The State Government claims that savings to the Government from the contract are forecast “..To be \$66.7m for the period 1 January 1996 to 30 June 2002 (SA Government Response to *the Advertiser*, 20 September 2001). They claim that “..this represents around 19 percent of the estimated internal costs had the outsourcing contract not been entered into” (ibid). There are sound reasons to question this claim given that outsourcing savings levels of this magnitude are rare in international and local experience. In the absence of independent analysis of data used to derive the Governments claim regarding costs savings no firm conclusions can be drawn about the cost benefits or otherwise of the contract, though experience suggests that they are likely to be much lower.

There are risks that cost-overruns could be a feature of the contract given the ageing nature of Adelaide's water and wastewater infrastructure. It is important that these risks be clearly identified through a systematic evaluation of annual cost savings and overruns associated with the implementation of the contract. An evaluation of the net impact of any savings or overruns should be publicly available to assist in the evaluation of contract performance.

### **Water Prices**

The State Government claimed that outsourcing would lead to 20 percent savings to the Government and that this would translate into price benefits to consumers. While there is doubt about the level of savings achieved by the United Water contract there can be no doubt that average water prices for consumers have increased faster than the rate of inflation since 1994. Over the 1993/94 to 1999/2000 period water prices for the first 136 kilolitres (kls) increased by around 59 percent or \$70.67 from \$120.00 in 1993 to \$190.67 in 2001. Prices for average use 250 kls increased by around 38 percent or \$80.93 from \$220.32 in 1993 to \$301.25 in 2001. With inflation running at around 11 percent over the 1993-2000 period it is clear that water prices have increased significantly more than inflation over the last eight years.

## Changes in South Australian Water Prices, 1993/94 to 2000/01

Year	Access charges	Per kilolitre charges	Total Cost	% and \$ Change from 1993
1993	Access charge of \$120 per annum First 136 kilolitres free	88 cents per kilolitre for next 114 kilolitres (kl)	\$220 for average 250 kilolitre consumption	-
1994	Access charge - \$113 per annum	20 cents per kl for the first 136 kls and 88 cents/kl from 136 to 500 kls	\$140.40 for first 136 kls	16.8% \$20.20
1995	Access charge - \$118 per annum	22 cents per kls for first 125 kls and 89 cents per kl from 126 to 500 kls	\$155.29 for 136 kls	29.4% \$35.29
1996	Access charge - \$131 per annum	25 cents per kl for first 125 kls and 90 cents per kl from 126 to 400 kls	\$172.15 for 136 kls	43.5% \$52.15
1997	Access charge - \$119 per annum	35 cents per kl for first 125 kls and 89 cents per kl for 126 kls to 400 kls	\$172.54 for 136 kls	43.8% \$52.54
1998	Access charge - \$123 per annum	36 cents per kl for first 125 kls and 92 cents per kl for 126 kls and above.	\$178.12 for 136 kls  \$301.25 for 250 kls	48.4% \$58.12
1999	Access charge - \$121 per annum	36 cents per kl for first 125 kls and 91 cents per kl for 126 kls and above.	\$176.01 for 136 kls	46.7% \$56.01
2000	Access charge - \$125 per annum	38 cents per kl for first 125 kls and 94 cents per kl for 126 kls and above.	\$182.84 for 136 kls	52.4% \$62.84
2001	Access charge - \$130 per annum	40 cents per kl for first 125 kls and 97 for 126 kls and above.	\$190.67 for 136 kls  \$301.25 for 250 kls average consumption	58.9% \$70.87  36.7% \$80.93

Source: SA Government Gazette, various, SA Government Press Releases

### ‘Australianisation’ of United Water

There is a requirement in the contract that 55 percent of the equity of United be held by Australian investors within 12 months after the contract was signed. Currently no Australian investors have equity in United and there appears to be no sign that this situation will change. United was required to justify why this commitment could not be met including an independent expert report and to detail strategies for the achievement of the commitment. It is required to provide reports to the Minister every 18 months (including independent expert opinion) until the commitment is achieved.

#### *Key issues*

The lack of any Australian equity in United Water is likely to be an impediment to maximising the development of the local water industry. While United remains tied to its current foreign ownership structure it will of course be inevitably tied to the strategic objectives set by its offshore owners. This is not in the interests of the domestic water industry. The current arrangements for reviewing progress on this commitment are inadequate as United as it lacks independence and transparency. An independent review of the failure to meet the commitment to 55 percent Australian equity in United should be undertaken and a strategy developed to ensure that the objective is met within two years. A panel of independent experts should be appointed to undertake this task and advise the State Government and SA Water on options for meeting the Australianisation objective.

### **Performance standards**

The contract requires United to adhere to a range of performance standards which ensure that it performs at “..least to the levels achieved by SA Water prior to the commencement of ..” the contract (Auditor General, December 1997, p 11). United must meet a number of specific standards relating to water and wastewater quality, sewer chokes and odours. Performance targets are set with the aim of gradual improvement in standards over time. A range of criteria was identified for measuring performance including quality, response times, completion times and meter replacement. Financial penalties were leviable if performance was below standard.

Where problems arise in the management and maintenance of the system United is contractually required to promptly notify SA Water. It is also required to meet environmental standards and must have in place strategies to “control and minimise odour and sewerage overflow problems”. SA Water monitors performance against these commitments.

*Key Issues:*

There is strong evidence that the odour event at the Bolivar Wastewater Treatment Plant in mid 1997 breached provisions in the contract in relation to acceptable odour standards and requirements to notify SA Water of significant maintenance related problems. This incident illustrates some of the inherent problems associated with outsourcing outlined earlier in this report. Independent investigation of the odour event revealed that inadequate operation and maintenance of the plant caused it. United Water failed to acknowledge this over the weeks that the independent investigation was being undertaken. They claimed that climatic factors rather than the maintenance and operation of the plant, was the principal cause. Failure to detect and notify equipment failures at Bolivar to SA Water represents a serious breach of quality and disclosure standards in the contract, raising concerns about the capacity of United to adequately and openly manage the system.

## **State Development**

United Water has committed to a water industry development strategy involving:

- Inward investment and relocation to South Australia, drawing upon the extensive business networks of CGE and Thames Water;
- A program to create strategic alliances, partnerships and joint ventures between South Australian firms and between international and interstate firms and South Australian firms;
- An innovation and technology transfer program to establish Adelaide as a regional node of a powerful international research network;
- A business support program to strengthen the foundations of the South Australian industry through export market development and access to financial and legal services;
- A human resource development program to create an adaptable and skilled workforce.

Some specific commitments made by United in the contract include:

- The establishment and maintenance of United Water's headquarters in Adelaide.
- The establishment of Thames Water International Plc's Asia Pacific regional headquarters in Adelaide;
- The relocation of Thames Water Asia Pacific Pty Ltd's procurement division and then its other operations from Melbourne to Adelaide.
- The establishment of an International Advisory Board.
- The establishment of a Business Development Office and a Water Development Group.
- The consolidation of Kinhill Engineers Ltd's water resources design and management group in Adelaide.
- The establishment of a combined research facility in South Australia.

#### *Net Export Commitment and Job Creation*

The contract commits United to the generation of around \$630 million in exports from South Australia over ten years. An additional target export figure of around \$850 million has been set. The State Government claims that export targets are being met, though it refers to increases in exports for the water industry as a whole to support this claim. It argues that “overall exports by the water industry are estimated to be \$800m for the five years since the start of the United Water contract” (SA Government Response to *The Advertiser*, 20 September 2001). It is inappropriate to claim that water industry exports in general are a direct result of the contract. Only exports directly attributable or flowing from the activities of United Water in South Australia should be counted in calculating the value of exports flowing from the contract. In this respect the Government quotes other export figures, claiming that “exports to the end of 2000 stand at \$260.5m, which is \$93m ahead of the requirement” (SA Government Response to *The Advertiser*, 20 September 2001).

A very broad interpretation of exports is used for the purpose of calculating export performance. It includes exports and import replacements by United, exports by United's ‘related’ companies. The Minister may also allow exports or import replacements by other ‘related’ companies in South Australia where it can be demonstrated that United

facilitated these. There is no stipulation that exports should be offshore exports. Performance is to be monitored through a combination of quarterly, annual and triennial evaluations. United has committed to meet any shortfall that may occur “as soon as reasonably practicable” (Auditor General, December 1997, p 29). If United Water do not deliver against export commitments they may be subject to claims for damages from the State Government. The contract “will be subject to termination for cause at the Minister’s option if there is a cumulative shortfall in the value of exports..” (Auditor General, December 1997, p 29).

Similar flaws are likely to relate to claims about job creation where the State Government has claimed that around “2200 additional jobs have been created in the South Australian water industry as a result of the outsourcing contract and economic development initiatives” (ibid). This claim is based on econometric modeling undertaken by the South Australian Centre for Economic Studies. Close scrutiny of this report is necessary to test the veracity of the State Governments claims regarding job creation flowing from the contract. It should be noted according to the State Government the United Water contract contains no specific commitments to job creation (SA Government Response to *The Advertiser*, 20 September 2001). This is surprising, as job creation targets are likely to be one of the most legitimate means of measuring the performance of the industry development commitments made in the contract.

### *Conditionality of exports*

While United is contractually committed to an industry development strategy and program the nature of this commitment is of some concern. The contract summary indicates that some elements of the program are subject to certain conditions while others are unconditional. The extent to which specified outcomes will be met is uncertain under these circumstances. United can be excused for not delivering on export targets if certain circumstances prevail. Excusable circumstances include war, disasters etc. There are however some circumstances which are less clear-cut as legitimate excuses for non-performance. These include such matters as “..the inability or commercially unreasonable refusal of businesses in South Australia to competitively meet the requirements for products or services required for specific ..projects...” (Auditor

General, December 1997, p 34). Such provisions are liable to competing interpretations and judgements thus allowing considerable room for United to justify failure to meet specific targets.

### *Definition of exports*

There are a number of concerns regarding the definition of exports contained in the contract. The broad definition of exports enables export targets to be realised through the exports of 'related' companies and through companies deemed to have been assisted by the presence of United. The Minister can make this determination. There are two major problems with this approach to defining exports. Firstly, it would be more appropriate in the evaluation of export performance to separate interstate and overseas exports as the latter are a more critical measure of export performance in a national context. There is a need to set discrete targets for both interstate and overseas exports with greater weight assigned to the latter in determining export success. Secondly the involvement of the Minister in determining whether the exports of particular 'related' companies are legitimate for inclusion in export calculations undermines the transparency of the process and creates an opportunity for accusations of political manipulation of results. The responsibility for approval of 'related' companies should rest with an independent contract review body rather than with the Minister in the first instance.

### Asian Bid Vehicle

The contract specifies that United will be used by CGE and Thames Water as the vehicle for tendering for projects in key countries in the Asia Pacific region. While United is 100 percent foreign owned there are few guarantees that the benefits of projects gained by United are realised locally. Until the commitment to 'Australianisation' of United is met United's commitment to the development of the domestically owned water industry in South Australia is questionable.

## **5.2 Electronic Data Systems**

Under a 'whole of government' IT outsourcing contract the South Australian governments IT infrastructure was outsourced to one provider, Electronic Data Systems (EDS) corporation in 1995. The SA State Government sold all of its computer hardware and IT infrastructure to EDS for \$60 million and built a \$70 million complex as a base for the company on a rental basis. In doing so the government placed core competencies required to run state agencies outside of government control. It also removed the oversight of IT infrastructure from public transparency, as the operations of EDS became commercial in confidence. The cost of the loss of transparency was evident in a recent report by South Australian auditor general who revealed that EDS had overcharged the State Government by \$10 million as part of its \$700 million contract.

Research by Graham and Scarborough (1997) and by Hood (1997) into IT outsourcing in four Australian States suggests that a key consideration for government agencies outsourcing IT is the need to retain key staff. That is, to maintain a core of internal specialised knowledge, which may duplicate that held by outsource contracted private providers.

Graham and Scarborough's (1997) research into outsourcing IT also found that the process tended to create new, expensive, senior management positions within the public sector to manage outsourced contracts. They found that governments paid the wages, via outsourcing contracts, of approximately the same number of people employed in-house. They indicated that public service managers were concerned that IT outsourcing could lock agencies into agreements with unsatisfactory suppliers, especially in areas where there were no viable alternative service providers.

The long lead times involved in the outsourcing process tended to demoralise staff in agencies targeted for outsourcing, which led to the loss of valuable employees, stifling new initiatives. These were seen as significant opportunity costs. Moreover there were significant financial costs associated with negotiating the tendering processes which were often not factored in to outsourcing budgets. For example, in South Australia the cost of the tendering process, which delivered the State's IT, infrastructure to EDS, was later estimated at \$10 million.

Graham and Scarborough's (1997) and Hood's (1997) research also pointed to the difficulties public sector managers had in assessing the cost benefits of IT outsourcing. Managers established a benchmark cost differential, which tended to second guess, the costs of changing providers and the opportunity costs associated with the outsourcing process. Managers interviewed by Graham and Scarborough (1997) found switching costs were high due to the rapidly changing technology and that cost gains tended to be very short term.

Where IT outsourcing contracts are based on current costs the capacity to respond to technological innovation is invariably limited. The cost of the tendering process and compliance costs is often overlooked, as are the opportunity costs involved. Once outsourcing has taken place agencies can become locked into providers and unable to adequately evaluate performance. Switching providers or returning to in-house provision if a provider does not meet performance standards can be costly and difficult to achieve.

A primary rationale for IT outsourcing by state agencies is usually to save money, whereas the primary rationale of a private IT provider involved in outsourcing contract is to increase profits. Constant changes in IT technology continually create labour shortages of skilled technicians, which drive up the cost of labour for private providers and put pressure on profits. Government IT contracts are typically from 1 to 5 years, which lessens the ability of private providers to offer non-material rewards like tenure to skilled employees. If an IT provider cannot reduce direct wage costs but has a contract which requires cost savings to the state, the provider must find other ways of making a profit. The consequences of this tension are generally poorer services to agencies.

### **Cost savings to government**

The State Government claims that the EDS contract resulted in total savings of around \$60 million over 5 years to 30 June 2001 (Armitage, M., 20 September, 2001). In addition they claim that this is in line with the savings target of \$100 million over the life of the contract. As detailed earlier the Auditor General has drawn attention problems with overcharging by EDS billing in relation to Mainframe billing. International and local experience suggests that there is a danger that further cost related concerns are

likely to arise. The fact that the value of the contract has been adjusted upwards by nearly \$200 million suggests that the cost of the contract was very significantly underestimated, reflecting the difficulty of adequately specifying requirements and delivery costs in the context of rapid advances in information and communications technologies. The State Government acknowledged this reality in relation to the contract stating that “..both parties have had to deal with some changing circumstances..this was to be expected given that the contract covers a very rapidly changing and evolving environment over a long period of time” (ibid). While the Government claims that “..no significant issues have arisen that might have lead the Government considering taking significant action for any remedy under the contract”, overcharging by EDS in relation to Mainframe billing is hardly an insignificant issue.

### **Job creation**

EDS has a contractual commitment to create jobs above a specified baseline level of employment. According to the State Government EDS employs around 669 Full-time equivalent (FTEs) staff in South Australia. Included in this figure are an unspecified number of contractors. The Government claims that EDS has increased its workforce by around 300 FTEs since transfer. They claim that EDS has “..exceeded its four year aggregate employment target .. to 30 June 2000 by 222 percent” (Armitage, M., 20 September 2001). The extent to which this represents a significant and sustained increase depends upon the number of contractors included in the calculation. The figure may be artificially inflated by the inclusion of contractors. A more appropriate measure of employment change would be to separate directly employed persons from contractors.

### **5.3 SA FRUIT FLY ERADICATION PROGRAM**

In South Australia a broadly based fruit fly program has been in place since 1947. Initial regulation in this area was governed by the requirements of the *Fruit Fly Act 1947*. Since the early 1990s, however, the regulation of fruit fly has been carried out pursuant to the *Plant Protection Act 1992*. Responsibility for the administration of the program currently resides with Primary Industries & Resources SA (PIRSA) under the ministerial direction of the Minister for Primary Industries.

There are two species of fruit fly, which are horticultural pests in South Australia - the Mediterranean fruit fly and the Queensland Fruit Fly. Of these, the Medfly is the more difficult to eradicate and constitutes by far more serious economic threat.

The annual value of horticultural production in SA is estimated at \$250 million and includes export markets of approximately \$100 per annum. The state's fruit fly free status has also benefited the SA community in other ways. The most obvious example is the widespread production of home garden produce. In the absence of effective fruit fly control the need for pesticide usage would be much greater than would otherwise be the case. An effective fruit fly program is essential to the economic and social well being of the state. This is especially so as far as regional areas such as the Riverland are concerned where dependence upon horticultural production is most pronounced.

Historically, PIRSA and its predecessors have relied upon toxic chemicals for the control of fruit fly. In recent years the chemicals most commonly used have been malathion, fenthion and chlorpyrifos - all of which are organophosphate pesticides. These pesticides, even at low doses, are particularly toxic to wildlife including birds, amphibians and invertebrates as well as pets such as dogs, cats and fish. At higher doses they are also hazardous to humans.

Within PIRSA, the Pest Eradication Unit has responsibility for the fruit fly program, along with other pest control programs. At the operational level the unit is comprised of six Eradication Inspector positions and a variable number of baiting and cover spraying teams. The number of baiting and cover spraying teams employed depends upon the number and seriousness of fruit fly outbreaks. During the 2000/2001 season there were nine outbreaks involving Medfly, which affected some 27,000 households in metropolitan Adelaide.

Traditionally, the employment of baiting and cover spray workers has been on a casual basis given the seasonal nature of fruit fly outbreaks. Until 1997 this casual labor force was employed directly by PIRSA. Since then the employment of baiting and cover spray workers has been outsourced to labour hire companies. This has given rise to a number

of major problems. The extent of these problems only became apparent during 2001 after public and union concerns over the management of the fruit fly eradication program attracted widespread media attention. The seriousness of these problems were such that the Minister for Primary Industries was, in May 2001, compelled to establish a series of independent reviews into the operation of fruit fly program.

### **Contract Management Issues**

One of the key issues in outsourcing is contract management. This includes the specification of the services to be provided, the stipulation of appropriate performance indicators, an assessment methodology that enables government agencies to accurately determine whether in fact the services provided are those which were actually contracted for, and measures which ensure that the public interest and taxpayers' funds are protected. These matters are often not fully considered in evaluating outsourcing proposals.

Even more critical is the issue of whether a particular service or function should be outsourced in the first place. Over the last 15 years or so, much of the impetus for outsourcing has come from an ideological presumption that the private sector is inherently better equipped to provide many of the services traditionally provided by government. As a result, the issue of whether it is socially or economically - in the broader sense - desirable to outsource government services, particularly core services, has tended to be overlooked. It is simply assumed that the private sector can do the job better. Similarly, issues such as transparency and public accountability have frequently been ignored, often with negative financial consequences.

With respect to the outsourcing of PIRSA's casual fruit fly eradication workforce the first point to note is that this occurred without any formal contract between PIRSA and the various labor hire firms involved. This is despite the fact that the cost associated with this aspect of the fruit fly program has been in the order of \$3,600,000 over the last three years.

Not surprisingly, the failure to address this most fundamental requirement of contract

management has been compounded by a range of other deficiencies associated with the use of labour hire arrangements. Firstly, PIRSA failed to undertake a proper evaluation of the various labor hire firms prior to their engagement. Secondly, there was no specification of performance required by the labor hire firms. Thirdly, no selection criteria were laid down for the engagement of the labour hire workforce. Fourthly, there was no assessment criteria by which to evaluate the performance of the labour hire companies.

As a consequence of these failures PIRSA lost effective control management over the fruit fly program at critical stages, particularly during the 2000/2001 outbreaks. This in turn gave rise to the widespread breakdown of public confidence in the government's handling of this issue of fundamental importance to the state's horticultural industries.

### **Occupational Health and Safety**

Nowhere was this lack of control more evident than in the management of the program's occupational health and safety obligations.

One of the reasons underpinning the increased use of labor hire arrangements in Australia is the attractiveness to managers of off loading their occupational health and safety responsibilities. This is often reinforced where workers' compensation schemes offer financial incentives for firms with lower than average claims costs relative to those of other firms in the same industry. The logic here is simple - if high risk activities can be outsourced then any injuries and associated claims costs are not attributed to the outsourcing firms, even though these firms may be responsible for failing to manage the hazards that result in injury. This in turn means that the outsourcing firms are more likely to attract a bonus, or avoid a penalty, even though they have done nothing to improve health and safety conditions in the workplace.

Whether a desire to off load health and safety risks was part of the motivation that led PIRSA to outsource its casual labor requirements is unclear. What is clear, however, is that PIRSA has failed to carry out the occupational health and safety responsibilities owed to the workers engaged in the fruit fly program. Instead there has been widespread

confusion between PIRSA and the labor hire firms over their separate and joint responsibilities in this area. Had these workers being directly employed by PIRSA this confusion may not have arisen.

Legally, part of the responsibility for many of the occupational health and safety deficiencies that have been identified rests with the labor hire firms that have been used by PIRSA. As the direct employer of PIRSA's casual workforce these firms have clear responsibilities under South Australia's occupational health and safety laws to ensure the health and safety of these workers while at work.

Having said that, it is quite evident from the consultant's report, commissioned at the instigation of the Minister, that there have been widespread and systemic failures in relation to PIRSA's management of its occupational health and safety responsibilities. This was most obvious in the area of chemical safety. Inadequate or non-existent training in relation to the hazards associated with the chemicals used in the fruit fly program, misleading and incomplete hazard information on these chemicals, a failure to provide appropriate personal protective equipment were among the many deficiencies documented.

PIRSA also failed, as the contract manager, to take practicable steps to ensure that the labor hire firms it engaged took the necessary measures to safeguard the occupational health and safety of the workers it supplied to work on the fruit fly program. As a consequence PIRSA was unnecessarily exposed to the risk of common law claims. This is because government agencies and private companies who engage workers from labor hire firms may be liable to negligence actions in the event of work related injuries to these workers. That this has not eventuated to date has been more a case of good luck than good management.

## **Conclusion**

As indicated earlier, the downside effects of outsourcing are frequently ignored. In the case of SA's fruit fly eradication program there is no doubt that the outsourcing by PIRSA of its casual workforce, and the problems this has given rise to, have contributed

to a lack of public confidence in the government's administration of the program and placed the state's fruit fly free status at risk.

If public confidence in SA's fruit fly program is to be restored PIRSA and the government need to rethink the current approach to the program's management. This includes the very basic issue of whether PIRSA should continue to rely on labor hire firms for the provision of its casual workers or whether it might be more prudent to adopt a less risky approach and once again engage its own casual workforce.

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