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CABINET

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**USING PRIVATE ENTERPRISE IN GOVERNMENT**

**Memorandum by the Chancellor of the Exchequer**

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

Why Contract Out?

2. Experience both in this country and in the United States has shown that the private sector, with the stimulus of the profit motive, can very often undertake operations on behalf of Government more cheaply than the Government itself. This in turn establishes private businesses with a potential for expansion including expansion overseas. It is true at national and at local level, in the Health Service and probably also in nationalised industries. But the present system was not designed to encourage contracting-out, and it needs a major push to achieve it. I am not, of course, urging wholesale contracting-out at any price: but in a large number of cases it will show a clear economic advantage.

Central Government

3. Under the stimulus of tight manpower targets, several functions have already been contracted out. There are a number of common services where the onus should be on

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departments to show why they should not be contracted out. It is within our own power to deal with any problems which may arise. In a parallel paper C(82)40, the Chief Secretary has made proposals for the control of Civil Service numbers after 1984. He suggests a major interdepartmental exercise in the New Year to identify the scope for further reductions. In the course of that operation we should identify the scope for further contracting-out of central government functions, and decide how to follow it up. The results are to be reported back to Cabinet in May 1983. This will also be a convenient opportunity to take stock on contracting-out generally.

## Local Authorities

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

## National Health Service

5. The Secretary of State for Social Services has already started a contracting-out campaign, beginning with a series of pilot experiments in each regional health authority, to demonstrate the scope for contracting-out initially of catering and cleaning, we should be ready to move on from these pilot schemes as soon as possible. One obstacle until now has been the VAT paid on bought-in services but not on in-house operations. I propose to remove this difficulty (see below).

## Nationalised Industries

6. The industries already have every economic incentive to contract-out operations where this is the most efficient solution. I recognise that operational or industrial relations objections will sometimes be valid; but very often they are only excuses for preserving the status quo. The case for contracting-out should, therefore, be pursued during 1983, industry by industry, probably in the course of the annual corporate planning discussions. I propose that Treasury and departmental officials collaborate in identifying the areas where the industries might be urged to contract out more of their operations, bearing in mind the industries' responsibility for day-to-day management decisions.

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## General

- a. The VAT anomaly applies only to the National Health service and central government departments. Local authorities already have VAT refunded to them. Nationalised industries recover it through their prices. I intend to legislate in the next Finance Bill to allow the Treasury to make an order refunding VAT to government departments and the National Health Services, where specific operations or groups of operations are contracted out. This will remove the present disincentive to such action.
- b. Industrial relations. There is no doubt that the unions, particularly in the NHS and the Civil Service, will resist any major extension of contracting-out. We already expect trouble in one or two government departments. Obviously the NHS exercise cannot be launched until the present pay dispute is resolved; but in general, I think we must face up to these difficulties as they arise.
- c. Managerial obstruction. There is understandable reluctance on the part of managers to give up any part of their functions. We must take every opportunity to counter this by pointing to the efficiency gains which have already been secured in some areas by greater use of the private sector. Some of these issues affect all four sectors, and the Departments concerned will need to remain in close touch and exchange experience as the operation proceeds. The Treasury can make suitable arrangements.
- (d) Civil Service and Related Bodies (Redundancy Compensation) Bill: Some of the work Cabinet commissioned on 25 November raises issues of importance in this context - particularly on the NHS and industrial relations. The Treasury will co-ordinate the two exercises.

## Conclusion

- a. I invite the Cabinet to agree:
  - a. that there should be a major and co-ordinated drive to secure further contracting-out in the public sector;
  - b. that the possibilities in the Civil Service should be pursued vigorously as part of the review of Civil Service manpower after 1984;
  - c. that the Health Service Ministers should implement the proposed pilot studies in regional health authorities;

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- d. that we should continue to urge local authorities to contract-out operations wherever possible,
- e. that opportunities for contracting-out in the nationalised industries should be pursued, either as part of the examination of the 1983 corporate plans for each industry, or separately.
- f. that I should, together with the Ministers concerned with the Health Service, local authorities and nationalised industries, report progress to Cabinet in May, at the same time that the Cabinet considers the outcome of the Civil Service manpower exercise.

and to note:

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

G.H.

H.M. Treasury  
10 December 1982

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