

Date: 3 June 2011

To: Minister of Finance

Annotated Agenda: Meeting on Contestability, Tuesday 7 June 11.30am to 12pm.

Purpose of the Session:

- 1. To answer your questions on what Ministers can do now**
- 2. To outline how we are planning to drive things forward**
- 3. To gauge just how far we should push in this space**

1. Your Questions: legislative barriers, risk and capture

a. There are no overarching legislative barriers

- ***There is nothing in the Public Finance Act that stops Ministers from contracting with parties other than departments*** – although chief executives are accountable for how their departments are run. (There are already examples where Ministers have sought contestable policy advice, e.g. various working groups like the 2025 taskforce, independent advice from Doug Kidd on fisheries).
- ***But there may be sometimes legislative barriers*** from legislation other than the Public Finance Act, and these would need to be addressed as part of the process.
- ***And there are some conventions that limit Ministers' choices***
The State Sector Act makes chief executives responsible for the provision of advice to their Minister and to other Ministers of the Crown. However, the convention is that each department reports only to their own Minister – another Minister can only seek advice from them with the agreement of the responsible Minister (e.g. other Ministers can't just ask Treasury for advice).

We think the real constraints on contestability are ones of readiness and willingness

- The regulatory environment may not be ready (e.g. there may not be a process for protecting the consumer from poor service because quality has been controlled by the government as provider).
- The public service may not have the expertise to manage third party suppliers or may not know what suppliers could offer (e.g. they may look for companies which will do it the old way rather than look for any way it can be done).
- There may be upfront costs that are difficult to fund and/or difficult decisions that make the choice uncomfortable (e.g. redundancies).
- There may not be (or may not be enough) alternative suppliers.
- The public service may be conflicted when assessing the options, or when approached by a supplier, because the new supplier competes with their own operation.

This suggests that some form of central support would be helpful – both expertise to guide and alternative advice to challenge. There may also be ways to help Ministers with purchasing choices. Developing these ideas is part of our work programme.

b. The best way to manage risk is in the design of the outsourcing ... but sometimes risk is inherent and options are limited

The level of risk around contestability depends on:

- ***The structure of the market*** – having many small players gives government choices when things go wrong; one supplier increases the risk – but often looks more efficient.

- **The nature of the service** – critical and high profile services inherently mean the government bears the risk (though SCF demonstrates that “too big to fail” is a not product of outsourcing).
- **The options (and how easy they are to implement)** – if the government is trapped (e.g. by IP or unique IT systems) then it effectively bears the final risk. This may make non-specific systems attractive even if they are more expensive.
- **Having the right skills to manage the risks** – which may mean using specific skills when the risks are large (as has happened with Crown Fibre Holdings).

The level of residual risk should be one consideration when considering a contestable arrangement – and sometimes it will be a reason not to move – or not to choose the option that looks the cheapest (like one single supplier).

c. What options do Ministers have now?

- Any Minister can seek advice from their department on how things could be done differently.
- Cabinet could require departments to identify the options for their current operations – who else could do it, what would it cost, and what would it take?

2. Taking this work forward:

We are working on bringing proposals to you on:

- **Expanding the vision of managers** – we are working on advice (like the Criteria for the Regulatory Framework) to get best practice. We are also thinking about how to enable greater use of expertise including private sector expertise.
- **Expectations** – we are looking at where we can build in greater pressure and the incentives for innovation. (e.g. in Ontario, departments have to expose about one-third of their own work each year to the challenge that it cannot be done better by others).
- **Examples** – finding places to show the value that can be achieved through some flagship proposals. We are actively seeking places where contestability has been successfully used overseas that could be adapted here (e.g. the moves to make legal aid contestable in the UK).
- **Contractual arrangements and models that might help provide the right incentives.** PPPs are already in use, but overseas there are other models such as staff collectives, social bonds and different types of contracts where risk and rewards are shared.
- **External challenge** – developing a way of testing decisions on using contestability. We are working on the options around:

Withheld under s9(2)(f)(iv)

3. Testing your level of ambition – what kind of changes are you looking for?

This table provides examples of the range of options that could potentially be available. We have provided them as a way for us to understand your level of ambition in this area.

Area	A little	Moderate	Lots
Withheld under s9(2)(g)(i). Page 4 also withheld under s9(2)(g)(i).			