

‘Building a New Public Service Economy’

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1. The Proposition

Shortly after he was elevated to the office of Lord Protector, Oliver Cromwell is reported to have told Sir Peter Lely, the artist who had been commissioned to paint his portrait: ‘Paint me as I am. If you leave out the scars and wrinkles, I will not pay you a shilling.’

I am taking Cromwell’s instruction to Lely as my text today, since if the private sector is to be trusted with the delivery of public services, then there are some issues that will have to be addressed, and in my view, we must start by addressing them ‘warts and all’.

In bringing us together today, it seems to me that the IPA has put two propositions on the table:

They are saying to government: You must engage more deeply with the private sector for the delivery of public *services*, and not just for public *infrastructure*.

And they are saying to the private sector: You must be the kind of companies that politicians, public servants and the public at large would want to have involved in delivering public services.

These two propositions are deeply challenging.

They are challenging to government because they demand that it sees itself differently; that it joins the private sector in searching for ‘efficient boundaries’; that it develops new capabilities.

They are challenging to the private sector because they demand that we understand the complexities of public service provision; that we build new business models to address those complexities; that we develop new capabilities.

2. A Mixed Economy in Public Services

Let me start with the first of those propositions – that government should engage more deeply with the private sector in the delivery of public services.

For reasons that I don’t fully understand – and it is a subject I have given a great deal of attention – the notion that the government must deliver public services all by itself became a matter of political faith over the second half of the twentieth century.

This is not how most public services were originally developed. And, throughout much of the English-speaking world, it is not how they were delivered until the end of the Second World War.

In Britain, the Bank of England, the railways and the healthcare system were largely private concerns until 1946.

Australia was something of an exception, because it lacked a sophisticated market economy throughout the period when its public services were being built.

But even here, there is an old tradition of private roads and bridges, private electricity and gas companies, private fire brigades and ambulances.

Over the past couple of decades, there has been a reversal of this trend – not only in English-speaking countries, but right around the world.

Let me make it clear – I am not speaking about privatisation, which is largely about the state retreating from the provision of *private* services.

I'm speaking of a return of private and voluntary organisations to the delivery of *public* services – for the most part, under contract to the state.

As economists describe it, this involves a recognition that the public economy consists of a consumption function and a production function, and that these two roles are capable of being separated.

We are speaking of *public* services so, for the most part, the consumption function must remain with government.

But in many cases, the production function can be delivered by private, voluntary and independent providers under contract, as well as by public undertakings.

Among other things, this separation means that government can explore different economies of scale and scope in both production and consumption:

- a small local authority can contract to have its services delivered by a multinational public service company.

- and a large department at the centre of government can contract with a small voluntary provider to deliver services in the local community.

In the United Kingdom, this is often spoken of as a 'mixed economy' for public services.

In part, it is about the provision of infrastructure services – often referred to as 'public-private partnerships' or the 'private finance initiative'.

Typically, this market has started with largely construction-based PPPs – 'box PFI's' as the Japanese call them – and the service element has developed over time.

In Australia, PPPs have heavily concentrated on economic infrastructure, but in other countries, governments have placed much greater emphasis on social infrastructure, where the service element will typically be greater.

The success of PPP schools here in NSW – evident in comments by school principals, teaching unions and most recently the Auditor-General – confirms that Australian governments are now capable of proceeding down this same path.

There has also been a massive increase in IT-enabled change, with a growing emphasis over time on service provision. ‘Seat management’, ‘business process outsourcing’ and ‘shared services’ are all examples of this trend.

But the ‘mixed economy’ has always been about more than infrastructure and IT services, and in the UK we are now seeing the development of markets in a much wider variety of public services:

– health and education, children’s services and employment services, debt collection and regulatory services, policing support and probation services.

It is a trend that is by no means confined to the English-speaking world. Last week, I was in a meeting with JETRO – the Japan Export Trade Organisation – talking about the developments taking place in the Japanese market.

Acting on behalf of the Japanese government, JETRO has been meeting with a range of *public service* companies in the UK, trying to understand the range of business models and seeking to determine whether there are any barriers to entry into the Japanese market.

Japan – the second-largest economy in the world – has had PFI legislation since 1999 and has started developing sophisticated service-based models of PFI.

The Japanese parliament is currently debating legislation providing for the market-testing of public services.

A great deal of effort is being put into deliberately and actively building an internationally competitive public service economy.

3. Why Do This?

So why is the Japanese government going to all that trouble?

Why would the UK government expose itself to political pain to undertake such a major reform of public services?

Why should Australian governments go down this path?

a. Savings: The critics of competition and contracting sometimes question whether they deliver real savings.

Frankly, it isn’t much of a debate. It is beyond dispute that competition is a powerful tool for driving down cost.

b. Productivity Improvements: The more difficult question is whether competition and contracting are capable of delivering improvements in *productivity* – delivering more outputs for a given supply of inputs.

And there the evidence is mixed. . .

There are some markets where competition and contracting have delivered real value for money.

But there are other markets where cost savings have been delivered at the expense of employees and end-users.

Compulsory competitive tendering in UK local government (in the 1980s) was one such market.

It takes no great skill to deliver cost savings by cutting back on service to customers.

Nor is it a *productivity* gain if workers bear the brunt of savings through reduced terms and conditions.

The challenge – for governments and for public service companies – lies in demonstrating that they can manage services *smarter*.

Good management demands that the private sector contribute something *extra* to the delivery of public services.

We need to *explain* that in the public debate.

We need to *demonstrate* it through good service design.

And government needs to challenge us to *bring about real innovation* in service delivery.

The outstanding example in the UK is the prisons sector, where private companies are not only delivering services that are 10-15% cheaper, but also delivering services that are recognised as being more decent.

The NSW Public Accounts Committee recently produced a report on contestability in prisons, and found that it had delivered significant reductions in sick leave and overtime.

Sick leave and overtime are productivity issues. Better management has delivered greater outputs for a constant level of inputs.

Competition and the mere *prospect* of competition in NSW have motivated prison managers to deliver more for less.

I know that there are those who argue that competition *should* be used to drive down terms and conditions.

I would counsel against such an approach.

While it may deliver more business in the short term, it will narrow the scope of what governments are prepared to do over the medium to long term.

If the private sector is to be trusted to deliver complex public services – if we want a politically sustainable market – we have to prove that we value our employees;

- that we understand the importance of a public service ethos;
- that we are bringing something more to public services than the steel to cut workers' pay and conditions.

c. Service Improvements: Competition and contracting is also capable of being used to drive through service improvements.

Sadly, there are too few examples of this around the world. Traditionally, governments have used the private sector more often to drive down costs.

But in the UK, the government invited private companies to take over failing Local Education Authorities to turn around educational performance.

In Ontario, the provincial government asked the private sector to take over the management of the Driver Examination Service, initially to solve a waiting list problem.

And in Japan, the Ministry of Justice is using the establishment of the first PPP prisons to lift standards and impose greater accountability in the prison system.

Where governments are serious about driving up standards, and holding public and private providers to account, then contestability has a great deal to recommend it.

d. Diversity and Innovation: Competition and contracting also increases the diversity of the public economy and provides greater scope for innovation.

Diversity increases choice. Choice drives responsiveness. Where government agencies have choice, where end-users have choice, public services will be better tailored to need.

Diversity allows government to explore alternative solutions in parallel rather than in serial (one after the other).

Diversity improves government's ability to solve complex problems. Indeed, there is research which suggests that an organisation composed of experts and amateurs is better at solving problems than one made up entirely of experts.

We find some evidence of this in the public service economy.

None of the 'experts' had appreciated that employing female prison officers in a male prison would bring down testosterone levels and make these prisons safer – until prison contractors adopted a gender-neutral recruitment policy.

e. Capability: In some areas, the private sector is being engaged because it has capabilities that government generally does not (and doesn't need to).

The most obvious example of this is in information and communications technology.

This is partly due to the huge investments in research and development. It is partly because of the complexity of the services in question. And it is partly driven by the pace of change.

f. International Best Practice: Finally, competition and contracting is creating an international public services economy, with private providers playing a role in the transfer of best practice from one country to another.

Australia can benefit from this:

- On the one hand, state and local governments can have access to the best and brightest in the design and management of public services from around the world.
- On the other hand, by being more proactive in public service reform, Australian governments can provide local public service companies with a platform to expand into the international marketplace.

4. The Possibility of Leadership

There is no reason why Australia cannot play a significant part in the development of the international public service economy.

A decade ago, Australia was one of the leaders.

(i) In the late 1980s and early 1990s, NSW led the world with a whole new generation of PPP toll roads.

And off the back of that experience, Macquarie developed infrastructure funding models that it has exported to Europe and North America.

Ten years later, Australia is still recognised as one of the leaders in this field – although our competitive advantage (as a country) is now waning.

(ii) In the mid-1990s, the federal government created a mixed economy for employment services, a model that has influenced policymakers in UK, France and Japan.

And off the back of that experience, Ingeus, a small Queensland firm has been able to win significant welfare-to-work contracts in Britain and in France.

Australia used to be one of the world leaders. But ten years on, it has surrendered that role.

Today the Australian market is thin. The range of models is narrow. There is little scope for innovation in scale or scope.

There is no one to champion a public service economy;

- no one voice capable of speaking to the international public service companies, to explain the advantages of investing in the Australian public services market, to explore and eliminate the barriers to entry.

And, until now, there has been no one in the business community who was prepared to explain the benefits of a public services sector to the Australian public.

These are the challenges that the IPA is putting to government and industry today.

5. Building Public Service Markets

In the early stages of building a public service economy, governments are often inclined to see themselves as just conducting a series of unrelated procurements.

What they are doing in reality, is creating markets.

They may be poorly designed markets that fail to attract participants.

They may be badly managed markets that deliver poor outcomes.

But, like it or not, they *are* creating markets.

Many politicians and public officials seem to find that a startling proposition.

They seem to view markets as overgrown jungles full of dangerous beasts, capable of being tamed only at the margins.

They have trouble thinking of public service markets as plantations, capable of being deliberately managed so as to serve public ends.

These are not 'free' markets. They are artificial markets created by government to deliver public outcomes.

This demands that politicians and public officials understand what purposes they want these markets to achieve.

They are entitled to insist that service providers address key public policy objectives.

They are right to be selective about the kind of providers that are allowed to participate in these markets.

But of course, they must also understand how to attract a sufficient number of quality providers with a diversity of business models to ensure that there is a truly competitive market.

In short, governments are entitled to build politically-sustainable markets.

They are entitled to ensure that the quality of service to end-users is addressed up front.

It is right that they should seek to ensure good employment practices, particularly where core public services are involved.

6. Building a New Industry

Of course, this raises significant challenges for private sector providers, who must respond to these demands.

Indeed, in proposing a Services Taskforce, the IPA is saying to industry that it must anticipate the public's concerns.

Industry has an obligation not just to follow the lead set by government, but to make a positive contribution to the development of politically sustainable markets.

We need to be the kind of companies that politicians, public servants and the public at large would *want* to have involved in delivering public services.

And it is here that some plain speaking is required.

To be perfectly frank, we in the private sector have not done enough to convince the public that we can be trusted in this space.

We have not done enough to encourage good employment practice in this sector.

We have not demanded that government use competition and contracting to improve the quality of public services.

We have not championed the cause of increased public accountability.

I recognise that these are issues that individual companies cannot pursue on their own.

And until now, we have not come together as public service providers, under the umbrella of an industry association, to campaign for better markets.

The Services Taskforce proposed by the IPA would provide us with an opportunity to do just that.

However, if we want to progress this agenda, then I would suggest that there are some brute facts that we need to confront:

1. Fact: Engaging the private sector in the provision of public services generates disquiet on the part of the general public.

We *need* a public debate.

We need a debate to encourage the public to take an interest in these issues.

We need a *mature* debate if we are to explain where we stand on these issues.

And it follows that we must be active participants in that debate.

Both government and the private sector need to document and explain our successes. (And, indeed, the IPA is about to start that work with its national database on PPPs.)

We need to be frank about the failures; and to demonstrate that we are capable of learning the lessons.

But we also need to be asked to deliver better services. And we must ensure that we do.

The evidence from here and overseas indicates that public concerns about private provision decline dramatically once they have seen it work in practice.

2. Fact: The public has trouble understanding why private companies should make a profit from the provision of public services.

They understand that the profit motive is an extraordinarily powerful motivator.

But they need to be convinced that such a powerful incentive is capable of being harnessed to serve the public interest.

We need to explain the role that profits perform in rewarding innovation.

We need to make it clear that profits pay taxes (where publicly-provided services often pay none).

We need to explain what PPP profits are doing for pension funds.

And the public needs to be reassured that profits are capable of being regulated by the government customer and by competitive forces, so that they are kept to a reasonable level.

3. Fact: The public is concerned about the impact of competition on the quality of public services.

The public are not convinced that competition and contracting results in better value-for-money.

Government and the private sector have to do the work to document case studies where this has happened – to show that it is possible –

- and to generate a more mature debate about the policy conditions that are necessary for such a market.

4. Fact: The public expects a high level of accountability and transparency.

And they are entitled to do so.

These projects are funded by the taxpayer, or they are funded by the end-user because of an exclusive licence granted by government.

Of course government must ensure that legitimate commercial-in-confidence is protected.

But commercial-in-confidence must not be used as a screen to avoid appropriate public scrutiny.

In the UK, by far the best source of information on the great successes of PFI and PPP is the National Audit Office. There is no reason why the Auditors-General should not perform a similar role here in Australia.

They will sometimes identify practices and procedures that need to be done better.

Government and the private sector should welcome such advice; because it is through such analysis and debate that we will learn and improve.

7. Some Lessons from the UK on a Strategy

Confronting these brute facts (and dealing with them) will create the political space within which a public service economy can be built.

It is not for me to tell you how you should do that. I have been living in another country for six years now.

And the way that you address these issues here will differ in some respects from how we have done it in the UK.

But let me speak for a moment about some of the strategies that we have pursued in the UK, in the hope that there might be some lessons from which you can draw.

Following the 2001 election, several of the leading public service companies started talking about the need to create some political headroom around the concept of a public services sector.

We decided that we needed to speak to government as an industry about issues of common concern.

We needed to speak to the unions, to make it clear that we did understand the value of motivated employees.

We needed to speak to the public, to explain our successes, to explain our desire to deliver quality services, to explain how we were delivering value-for-money.

In late 2002, we formed the Public Services Strategy Board within the Confederation of British Industry – the peak industry association in the UK.

We began by bringing together around a dozen leading public service companies – leaders in their field – that were clearly committed to high quality, sustainable markets.

Our starting point was to draft a ‘statement of intent’, a charter of values that has made it clear to government, unions, and the media what we stand for.

This ‘statement of intent’ has also served as our agenda for reform, bringing the various companies together in a common cause. Companies who have joined the PSSB since have clearly understood what we are trying to achieve.

Over the three and a half years since that time:

We have opened up a dialogue with government – with the Prime Minister and his Secretaries of State, with permanent secretaries and agency heads, with procurement officials and with trade union officials.

We have documented the scale of our industry – the wide range of services we deliver, the hundreds of thousands of people that we employ, the success we have had in taking British know-how abroad and bringing home export income.

We have worked with government and the unions to develop a code of conduct to address poor employment practice in the industry. We have documented good practice and developed standards.

We have worked with the unions to ensure that major changes in public sector employment conditions flow across to contracted staff, with the costs being shared by government and industry.

We have worked with UK Trade & Investment, to ensure that they promote the public services sector when they speak to governments overseas. We have participated in training programmes for commercial officers in British embassies abroad.

We have engaged with the Office of Fair Trading about the application of competition law and economics to public service markets.

We have just published a major report on ‘competitive neutrality’ – the level playing field – in public service markets. This is becoming a significant issue because of the growing complexity of the mixed economy.

We have not attacked government in this report; rather, we have acknowledged the complexity of this issue and sought to find ways of working with government on better market design.

We have partnered with the voluntary sector in the launch of the competitive neutrality report. The level playing field is a major issue of concern to voluntary providers, and we are working closely with them to put this issue on the agenda.

We have formed a strategic partnership with ACEVO – the Association of Chief Executives of Volunteering Organisations – and the National Consumer Council, to promote the reform of public services from the consumers’ perspective.

Early on we discovered that the debate over public service reform was being conducted without reference to the end-users of those services.

Too often it wound up being an argument between two producer interests –the unions and ourselves.

We decided that we needed to get together with other stakeholders to better understand and better communicate how public services look from the consumers’ perspective.

We have also begun to document best practice:

We started with a report on prison contracting – it turned out there was already a wealth of material published by government and academics demonstrating that contracting had been extraordinarily successful in this sector.

We were able to do the same with Local Education Authorities, where there was a significant amount of data on the performance of students and schools that had never been properly analysed.

Over the three and a half years since the PSSB was established, union criticism of private provision has significantly declined.

There is widespread agreement that competition and contracting has worked well in some sectors.

And believing that it has more political headroom, the government has pressed forward with a new generation of public service reform.

9. Conclusion

Each country has its own political history, a different governmental structure, a unique set of public concerns.

But there are lessons to be learned, and the IPA has chosen to adopt the CBI concept of a ‘statement of intent’ and adapt it to Australian conditions.

A draft has been prepared and as we proceed into the formal meeting, there will be an opportunity to discuss the concept of a charter of values, and the content of an agenda for reform.

The private sector has a long and honourable history in the provision of public services.

The concept of the fire brigade was invented by the insurance companies of London.

The Rainhill Trials – that great moment in history when Stephenson's 'Rocket' was tested – were conducted by a private railway company.

And the term 'civil service' and the concept of merit promotion were taken from a public service corporation, the East India Company.

The private sector has contributed a great deal to the public service economy over the years.

But we must not leave out the scars and the wrinkles.

If we do so, we will fail to appreciate the complexities of this market,

- we will not understand the challenges that government faces in delivering better public services to an ever more demanding public;

- and we will deny the private sector the opportunity to make a contribution to the ongoing reform of these services.