

A BETTER WAY

Commission on the Reform of Public Services

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Minister of Finance, New Zealand 1990 - 93**

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At the beginning of 2002 the Reform Campaign recruited Sir Roger Douglas and myself from New Zealand to join Sir Steve Robson in conducting an audit of public services in Britain. The three of us share, and are proud of, a prominent track record for initiating and managing successful structural reform.

The first phase of our work involved a diagnosis of the current regime and a critical analysis of the policies advanced in the name of reform. What we discovered was not real reform, but a mish mash of confused targets, weak accountability and fuzzy thinking.

Our conclusions were unequivocal; the public service 'reforms' espoused by the government are programmed to fail. So long as the current structure of state monopolies is inviolate, no amount of exhortation or extra expenditure will change the reality of poor incentives to perform.

**The title of our Interim Report issued in June 2002 says it all;
SPENDING WITHOUT REFORM.**

Yesterday all Britons received the bill for that spending in the form of higher taxes.

Today all Britons are in double jeopardy. Tax increases are bound to cost the country its competitiveness, and bound to harm individual incentives. Worse still, citizens will continue to be cheated of services of a quality they are entitled to expect, despite all the new spending.

Later this week the Chancellor will present his budget which, it is safe to predict, will fail to break with the damaging pattern of spending without reform. So the vicious cycle of escalating taxes and declining public services is set to continue.

There is a better way. It involves regime change in the public sector. Success will not come from resorting to the application of yet more resources and yet more rules to the current structure. Only by addressing and changing the structural incentives for performance can consumer responsive services be assured.

**Today we present our Final Report entitled “A BETTER WAY”.
At the heart of our Report is a fundamental change to the way in which the government intervenes in the quest to secure better public services.**

The services tackled in this report are health, education, policing and crime. All three are dominated by state monopolies and in all three the state bundles together its roles as an owner/producer of the service, as a funder/purchaser of the service, and as a referee/regulator of the service. It is a recipe that compromises consumer interests, often fatally, produces inefficiency and inequity, and exposes the state to hopeless conflicts of interest and performance failures.

The Report advocates the unbundling of these roles and fundamentally changing the nature of the government interventions.

The starting point in each case is not so much with the public service per se, but with the quality of the patient service, the excellence of the pupil service, the surety that law and order services will ensure that citizens feel, and are, secure.

In the case of health and education, which are individual rather than public services, structural reform is about removing this conflict and injecting the proper incentives by changing the government’s role from being an owner/producer to being a purchaser/funder and regulator. Only when funding is switched from supply to demand can it be said that there is real choice; that the consumer is truly sovereign.

Freed from the conflict of being both player and referee in health and education, the state can discharge its regulatory role in a fashion that enhances contestable supply, secures standards and ensures transparency and accountability to consumers.

The absolute bottom lines of structural reform in health and education involve:

- the liberation of supply**

- the guarantee of consumer choice
- the radical change in incentives to perform

In the case of law and order, services which are genuinely public goods, structural reform involves disentangling the roles and responsibilities of the politicians and the law enforcement professionals. The politicians, whether at the central or local government level, are responsible for the public policy settings designed to promote citizen security, and accountable for the outcomes at the ballot box.

In turn those politicians must ensure that they purchase only those security services that most efficiently and effectively advance the outcomes sought. That will require precision in the purchase contract and specificity about the performance sought. The onus then shifts to the law and order professionals to deliver the specified outputs and to be accountable for performance.

This is precisely the formula of political leadership and professional accountability that has made New York no longer the violent city that it once was. This is the level of security denied Britons, but with regime change that need not be the case.

Regime change of the quality and kind advocated in our Report kills the two birds of rising taxes and declining public services with one stone.

Domestically the public policy agenda is dominated these very two issues; how the government taxes and spends (especially in this budget week), and how public services can be improved.

Let me reject outright the notion that there is a trade-off between the quality of public services and levels of taxation.

That is as false a proposition as the discredited trade-off claimed between inflation and growth.

In fact it is instructive to examine the monetary policy setting to see the promise and the power of structural reform to transform performance. Prior to central bank independence, politicians clung to control of the levers of monetary policy on the grounds that only they could make the so-called trade-off.

As the New Zealand experience first demonstrated, followed by Britain a decade later, structural reform to achieve Central Bank independence was the very thing that secured a credible commitment to price stability. In turn securing stable prices was the best contribution that monetary policy could make to growth.

While the domain is different, the issues are not dissimilar. The quest to secure better delivery of public services, like the quest to secure better conduct of

monetary policy, is an issue that has to be addressed in its own right. The answer for both patently does not lie in the application of more resources and more rules to a structurally flawed regime. Rather, a fundamental change in the incentives is what is productive of better performance.

When the consumer of health or education services has choice and the provider is incentivised to be efficient, it costs less and the consumer gets more.

When the determination to lift levels of security starts with focusing on policies better designed to secure outcomes and the cost effectiveness of outputs, rather than being preoccupied with crude levels of inputs, citizens will be better assured about value for money from the law and order services.

Under the current regime the linkage between resources and results is at best tenuous or at worst non-existent. In the face of public pressure to “be seen to be doing something” about poor results, governments typically pump more public spending into the sector and in the name of bringing about necessary improvements reach into taxpayers pockets for just a penny or so more! Such an approach smacks not just of political bankruptcy, but ultimately leads to system bankruptcy as well. Staying on the up escalator of ever increasing levels of tax and spend is not the answer and all modern politicians who are honest with themselves know it.

It is regime change in the public sector that holds the key to better patient services, better pupil services and better law and order services.

The impact of the powerful new set of incentives at work leads to much better linkages between resources applied and results achieved.

The happy consequence of a radically different set of incentives that produce service performance on a value for money basis, is that politicians can exit the up escalator without prejudicing the service levels.

Real reform means that consumers will have cause to be more confident of being satisfied with service levels, and taxpayers will have cause to be more confident of being shielded from ever rising tax burdens.

The promise for the future is of more services from less tax.

Let me be quite unequivocal on this score. It is absolutely in the interests of every Briton, and particularly the less well off, to insist on a formula for change that has at its heart the commitment to better services and less tax.

As a politician who has been through the fire of structural reform in my own country, it is my contention that the architecture of reform is the easy part. The hard part is the politics of reform.

It is not that politicians don't know what to do when it comes to modernising the public sector. Take the state of the debate in Britain. Politicians of all persuasions are employing the language of consumer choice, the dynamism of properly functioning markets, and contestability of supply. There is a heightened consciousness of government failure and a willingness to examine on a first principles basis the role and limits of government and markets.

"No investment without reform" is the mantra right from the top. Just in the last two months the Chancellor of the Exchequer and his Conservative Party counterpart have given considered and heavy duty speeches on public service reform. The words are on every important politician's lips.

Yet all roads don't lead to Rome; or, should I say, that all roads don't lead to real reform.

Talk about the need for reform is one thing. The courage, the determination and the skill to press ahead is another. And coherence in reform design matters too.

This report is designed to make the politicians' task easier.

- We diagnose the systemic failures in the current regime.**
- We document the often catastrophic consequences of public service failure.**

In health, the scandal of over one million people on waiting lists, the worst cancer survival rates in Europe, the spectre of more bureaucrats than beds in the NHS.

In education, after eleven years of compulsory education, one in five children leaves school functionally illiterate and innumerate. We give the lie to universal public education. De facto a two-tier regime does indeed exist; too many children denied opportunity by being condemned to attend failed schools, while others have access to schools that survive despite the system.

In security, Britain has the highest rate of violent crime in Europe, and Londoners are six times more likely to be mugged than New Yorkers.

- **We advance coherent and concrete alternatives.**

Health reform that puts the patient first. This means liberalising the supply side and reforming the demand side to put purchasing power in the hands of the consumer.

Education reform that confers real school choice. This means that parents will have the responsibility, the means and the information to choose a school for their child, and schools will have the resources, the autonomy and the incentives to respond.

Law and order reform that makes people feel much more secure. This means a zero-tolerance approach to crime, innovative and accountable policing that enhances the chances of that criminals will be caught, efficient management of the judicial process and imprisonment regimes that deter and rehabilitate.

- **We reveal the results of our very recent deliberative polling exercises with focus groups that demonstrate a strong public appetite and demand for change.**
- **And, we address ways to best manage the politics of reform.**

Political failure occurs for many reasons.

History is littered with examples of reform where in the face of the predictable resistance from vested interests, politicians compromise, give and take, go halfway, which in turn invites new demands, leads to more compromises, spawns more demands and so a depressing race to the bottom ensues.

The worst feature of this half-way house reform is that the politician exhausts his or her scarce political capital for a 'reform' that won't and can't pay its full dividend, voters accordingly are not sold on the benefits of the reform, and the risk of roll-back is heightened. In the end 'reform' gets a bad name; the reform currency is de-based.

A variation on that depressing, yet familiar theme, is ad hoc or piecemeal reform. We can all think of pilots, opt-outs, one-offs; they are a worldwide phenomenon with governments who favour an incremental approach. The trouble with these approaches is that the 'experiment' is readily quarantined or cancelled. Not enough people get to taste success, and the vested interests have all the time and opportunity to mobilise against a comprehensive application of the structural change that so threatens their entrenched privileges and protections.

I have not come to condemn, but to encourage. Accordingly, let me move onto the front foot and spell out some of the golden rules of reform that we have distilled from our combined wisdom and experience.

- Leadership, political will and a sense of urgency are a *sine qua non*.
- The Report makes the case to always strive for the gold standard when reforming. As in most things, there are always choices; the gold, the silver or the bronze etc standard.

Let me return to my example of the conduct of monetary policy that I referred to earlier in my speech to illustrate the power of my point. The previous Conservative administration knew that the monetary policy regime had to change. They resisted the gold standard of Central Bank independence, and opted instead for an embargoed disclosure of the minutes of the interest rate-setting meeting between the Chancellor and the Governor of the Bank of England. It looks absurd in hindsight, which it was at the time as well. In a defining moment of the first term of the current administration within 48 hours of taking office the Bank of England was made independent. Not only was the gold standard reform a resounding success, it is now a permanent feature of the economic policy landscape with no serious talk of rollback or reversion. Sustainability has been assured.

- Successful transformation requires a team of believers. Reform is not for solo voyagers. Key players in the government ranks must sing from the

same song sheet. But these days a coalition for reform must also reach out into the ranks of opinion leaders in the private sector and in civil society.

In this respect the campaign conducted by Reform and the opinion leaders they have assembled at this Conference is a model exercise.

- The existence of a constituency for change is essential. If the voters are not first persuaded that there is a problem, they are not going to be receptive to, let alone sold on, a solution that involves fundamental change.
- Showcase the benefits. Vested interests are typically well organized and shout louder and protest longer than the winners of reform. It is incumbent on the agents of change to crystallise the benefits. Concrete examples have a powerful demonstration effect. Seeing is believing.
- Finally, seek to institutionalise the reforms in a fashion that best ensures there can be no turning back.
The Bank of England reform, again, is a classic example.
Putting education purchasing power directly into the hands of parents would be another instance. Once vested with choice, parents will never surrender to politicians who want to rip it away.

In a rallying call to his troops in the cause of public sector reform in January of this year, the Prime Minister was characteristically forthright:

“We must not waste this precious period of power”

Two things need to be said about this rally cry.

Demonstrably opportunities to reform in a fundamental way have been wasted. Far from the PM’s declaration in 1998 “No investment without reform”, the spending agenda has been pursued with a vengeance, but the reform agenda is lamentably all show and no substance.

But more importantly the injunction that matters most is **“We must not waste...”**. The “we” applies to all political parties. The cause of reform is beyond partisanship; for all parties and in all seasons. This is not the exclusive preserve of one party, nor is it an issue that only commands attention at election time.

In my judgment , public sector reform is THE dominant issue on the home front in many and varied countries. Governments of all persuasions are having to grapple with these issues.

A generation ago, the domestic political agenda was likewise dominated by privatisation. While privatisation and public sector reform have their root in a similar question, the role of the state, the answers are inherently different. Worldwide the basic premise that drove privatisation was that the state had no proper role at all in the ownership and management of business enterprises. So the balance switched from the public to the private sector, and the state was left to discharge its regulatory role.

In the case of public sector reform, the balance is struck in a different fashion.

When it comes to the supply of health and education, Reform's Report advocates that the balance be struck in favour of contestable provision, a fundamental move away from state monopoly ownership and management. When it comes to demand, our Report champions consumer choice which means public funding is transformed into private entitlements vested in consumers.

In common with the current position the state would continue to discharge its regulatory role.

In short, public sector reform in health and education is not about the wholesale exit of the state, but about re-balancing the interventions of the state in favour of consumers.

When it comes to the supply of law and order, a classical public good, a re-balancing of another kind is advocated. Our Report argues for shifting the politicians away from input muddling and meddling, to policy and strategic leadership. At the execution level, the balance of management responsibility shifts to the law and order professionals, who in turn are accountable for their performance.

This Report rises to the Prime Minister's challenge of "money for modernisation". There is no more important a domestic cause, and no more critical a time to turn the slogan into a reality.

It is the public policy issue of the time, and the cause for politicians of all persuasions.

But the payoff for successful reform is not first and foremost political. As Reform's focus group exercises revealed, people are deeply cynical about the willingness or capacity of politicians to make a difference.

The real winners from reform are patients and pupils, consumers and citizens, and professionals such as doctors and nurses, teachers and those on the law and order frontlines.

There is another important group of stakeholders who have cause to urge regime change, and those are taxpayers. They know that national prosperity and individual living standards are harmed by the vicious cycle of rising taxes and declining services. They want a decisive break from this destructive pattern and are ready for change.

There is compelling demand for reform, that much is clear from not just our research. But before now the script for coherent and concrete reform has not really been written. That's why this is a Report whose time has come.

There is "A Better Way" and the Reform Report we are releasing today charts that course.

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<http://www.reformbritain.com/module.asp?module=3&page=home>