

The Public Sector Squeeze



As public managers around the world seek ways to do more with less, the need is growing for a practical approach to define, measure and drive high performance in the public sector. Although public managers' budgets remain tight, taxpayers demand more, and better, service from public service organizations. Particularly in times of crisis, taxpayers question the value their governments are delivering to them. The increasing use of the Internet has further raised the bar on the level of service expected by the public. Some governments employ selective contracting out and privatization to raise productivity.

Elliott Hibbs must have felt as if he were caught in the jaws of a giant vise. During the first few months of 2003, the State of Arizona's newly appointed Director of the Department of Revenue found his agency had taken severe budget cuts for several years due to a state-wide austerity plan, in spite of its role as the major revenue producer for the State. Meanwhile, stakeholders ranging from legislators to taxpayers were demanding continued high levels of processing, enforcement and taxpayer assistance services without adequate resources to deliver those services. In

addition, the prior administration had taken resources from enforcement and moved them to the service delivery side of the agency to meet the demands for swift refund processing, adversely impacting the effectiveness of the department, particularly in collecting unpaid taxes. As part of the new administration and to combat what appeared to be a serious decline in agency function and capabilities, Hibbs presented a plan to the legislature to restore department resources to 2002 levels by improving processing while increasing aggressive collection of delinquent taxes.

Hibbs, an Arizona state government veteran of more than 20 years, was confident that the initial steps he took at the agency were improving the agency's performance and adding value for many stakeholders. He reassigned staff back to audit and enforcement activities and continued a major upgrade of the agency's computer systems, which had started prior to his arrival. Yet he was frustrated with the lack of good data and meaningful facts that could help sell his message to the legislature, that cutting the Revenue Department's budget was a short-sighted fiscal act. "We were accomplishing a lot in spite of getting budget reductions or not enough increases to even cover higher personnel and operations costs. We couldn't easily get the legislature to see the importance of the value we were adding for the people of Arizona," he said. Caught in this dilemma, Hibbs agreed to pilot the Public Service Value methodology as a way of allocating resources to areas that would create the most value for Arizona taxpayers. Along with other public managers around the world at that time, Hibbs was facing a public sector squeeze. He needed to find a way to create value with scarce resources.

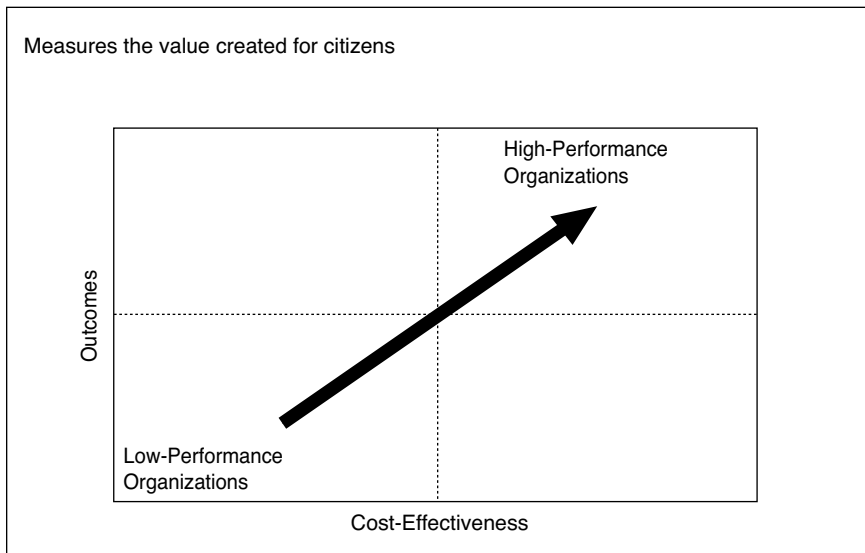
Public Service Value Approach

Like Director Hibbs, readers wrestling with the challenges of delivering value in the public sector may find Figure 1.1 helpful. It can be used to frame discussions with public managers about choices and trade-offs available to increase outcomes, or end results of

programs, as cost-effectively as possible. The Public Service Value Model is a framework that public managers can use to set priorities between several goals and objectives. By our definition, high-performance governments are those that increase public value—they are able to efficiently produce more or improved outcomes for the public monies spent.

The Public Service Value approach has been developed over the past few years with the help of dozens of government organizations and academic experts. Using the Public Service Value Model, a public manager can evaluate an organization's ability to achieve key social outcomes cost-effectively and aggregate these results to provide an indicative measure of relative public value creation.

Public service organizations can plot their performance on the Public Service Value Model diagram (see Figure 1.1). The direction

FIGURE 1.1**The Public Service Value Model**

that an organization moves from year to year reveals how performance is trending. For example, if an organization moves to the upper right-hand quadrant, it is succeeding in increasing outcomes and cost-effectiveness at the same time. On the other hand, if a public service organization increases outcomes but is not cost-effective, it will move toward the upper left-hand quadrant. An organization that manages its costs, but sees a reduction in outcomes, will move toward the lower right-hand quadrant. In these last two cases, when done deliberately, organizations are making explicit trade-offs between focusing on improved outcomes and increasing cost-efficiency in order to, in effect, maintain public value. Lastly, if an organization heads into the lower left-hand

Value Turnaround

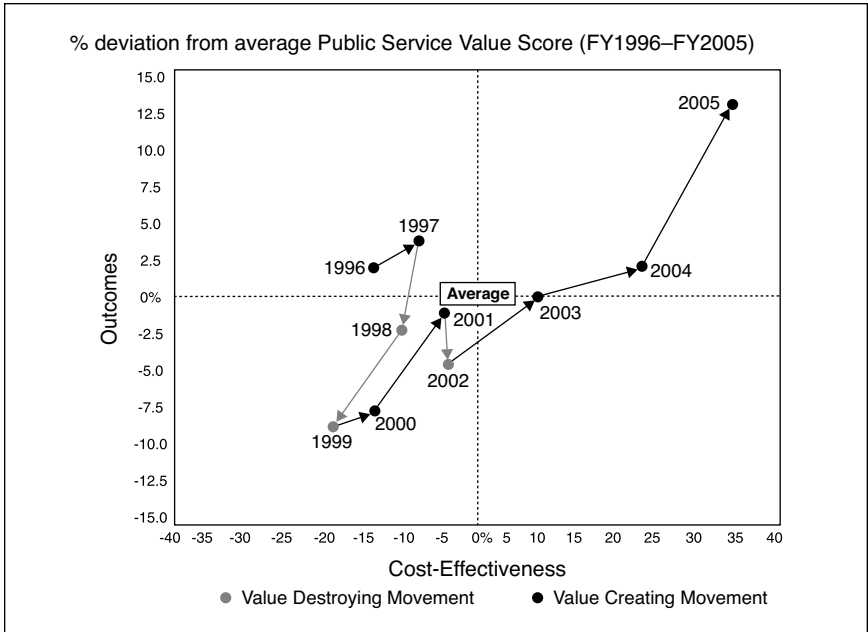
In 2003, Hibbs applied the Public Service Value Model to his agency to better determine whether, and how, his agency was adding value on a cost-effective basis. Using available revenue agency data, the model uncovered some eye-opening results.

The Public Service Value analysis demonstrated that the previous administration's policy of over-emphasizing customer service at the expense of tax compliance and collections had destroyed value compared with the Revenue Department's average performance. The model also graphically illustrated, using directional arrows to track annual department performance, that the steps taken beginning in early 2003 were creating value (see Figure 1.2).

While it still had a long way to go, the Department was achieving more of its strategic outcomes on a more cost-effective basis. How those outcomes were derived and tracked will be discussed in detail in Chapter Four.

FIGURE 1.2

Arizona Department of Revenue Public Service Value Performance Matrix



quadrant, it is experiencing a reduction of both outcomes and cost-effectiveness and is eroding public value and most likely taxpayers' confidence.

The Public Service Value approach to helping public managers define and increase value in the public sector was inspired by the principles of Shareholder Value Analysis, which is commonly used to understand the performance of companies. In the private sector, a company's shareholder generally sees the value of his or her investment increase with company earnings, which are ultimately reflected in the company's share price. For the Public Service Value

Public Service

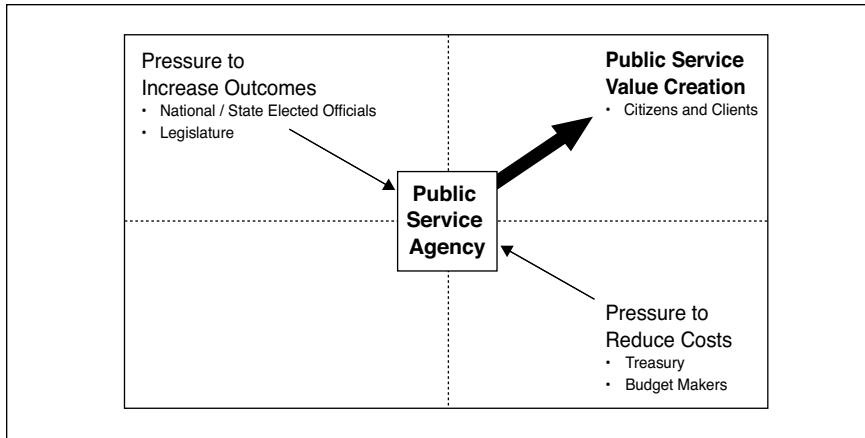
Our definition of public service is meant to be inclusive to encompass all organizations that are engaged in delivering services to the public that are, at least in part, paid for using taxpayer money. Public service organizations therefore include government agencies, nonprofit organizations and private sector companies that provide services that have traditionally been delivered primarily by governments. The determination of what is a public service is ultimately a political determination by governments.

Model, we substitute private sector shareholders with taxpayers, citizens, public service recipients and legislators.

Fiscal Crunch

The “value squeeze” experienced by Director Hibbs is an all-too-familiar challenge shared by public managers worldwide (see Figure 1.3). In the United Kingdom, for example, Ian Watmore, who in 2004 was appointed to the newly created position of Chief Information Officer and is now the head of the Prime Minister’s Delivery Unit, said, “It is difficult to balance the objectives of delivering social outcomes and services that consume more resources in an era when governments have less to spend on this rising demand.” Since public managers are continually asked to do more with less, the questions on everyone’s mind are:

- How does one determine if taxpayer money spent is actually improving government performance?
- How does one tell if public service programs are adding value?

FIGURE 1.3**The Public Sector Squeeze**

Politicians, like public managers, feel the squeeze when it comes to delivering value. Politicians feel pressure to deliver on voters' expectations for education, security, social services, pensions and health care. The pressure on budgets in most countries is unlikely to lessen significantly in the years ahead. One significant factor driving this fiscal crunch in most of Europe (particularly in France and Germany), Japan and the United States is the rapid aging of the population and the demands that population is putting on the social security and health care systems in these countries.

In the United States, for example, spending on Social Security, Medicare and Medicaid total roughly 8 percent of the gross domestic product (GDP). By 2030, according to the Congressional Budget Office, the cost of these programs is projected to consume about 15 percent of GDP, and by 2050 they could equal about 19 percent of GDP.¹ Brian Riedl, a budget analyst with the Heritage Foundation, noted, "The coming entitlement crunch is looking increasingly dire."

The budget outlook at the state and municipal level in the

United States is not more encouraging. States continue to shoulder heavy Medicaid-related health care costs. With few exceptions, many states also were unprepared for the fiscal downturn at the beginning of the new millennium. Some either borrowed heavily by issuing debt, engaged in budgetary maneuvering by underfunding pension or other long-term obligations to help cover short-term operating deficits, or both, to ride out the storm.

Great Expectations

It might seem logical for stakeholders to reduce their expectations of government when confronted with such obvious budget squeezes. However, quite the opposite reaction often seems to be the case. Interest in improving public sector performance comes from all angles, including taxpayers, public service recipients, the media, nongovernmental organizations and legislators. If anything, the prospect of a perennial budget crunch serves to increase calls from all stakeholders for a more efficient return on taxpayers' money. Public managers, already interested in finding new and improved ways to deliver public services, are reaffirmed in their efforts.

In 2004, twelve years after co-authoring the influential *Reinventing Government*, David Osborne published another important contribution to the debate on public value, *The Price of Government*, with co-author Peter Hutchinson. Osborne and Hutchinson have tracked spending at the federal level, as well as at state and local levels, in the United States for the past several decades. They demonstrated that since the early 1970s federal revenues (all taxes, fees and charges), as a percentage of aggregate personal income, trended within a fairly narrow range, averaging slightly more than 20 percent. At the state and local levels, the cost of government during this same period stayed within even narrower ranges of 7 to 8 percent for state, and 6 percent for local.²

Osborne and Hutchinson's findings suggest that, at least intuitively, Americans in the post-World War II era have had a fairly

consistent sense of an acceptable range of what they are prepared to pay for public services. If taxes trend too low, citizens complain about inadequate services and social inequities. If they trend too high, taxpayers and politicians start pounding the table for tax cuts.

The authors note that despite almost three decades of conservative politicians in the United States and elsewhere singing the praises of smaller government from the early 1970s to the late 1990s, "Citizens do not just want lower taxes and 'cheap government.' In reality, they constantly demand more from government, but at a relatively fixed price. They are in effect pressing for more value each year for the money they pay. In this respect, government is challenged by the same forces that constrain any other provider of goods and services."³

Acknowledging the projected spiraling health care and Social Security entitlement costs of the next few decades, Osborne and Hutchinson do not speculate as to whether, or to what extent, such pressures could force the "price" of government to ratchet sharply higher and become stable at an elevated plateau. They only point out that the sole precedent for such a dramatic repricing of government in the United States was triggered by a world war hard on the heels of a global depression. It occurred in the 1940s when federal taxes increased dramatically to pay for World War II. Once the U.S. economy had stabilized by the early 1950s, the price of government (which included significantly greater benefits and services than before the Depression) remained fairly constant, albeit significantly higher than prewar levels, for the next 50 years.⁴

Generally, governments do not follow a budget process that takes into account the price of government as described by Osborne and Hutchinson. Deal making at the eleventh hour typically results in a compromise budget, although as Osborne and Hutchinson point out, such deals do not always share voters' priorities or recognize that taxpayers in effect put limits on what they are willing to pay.

The Right Questions

In the wake of a fiscal crisis or natural disaster, citizens tend to hold their governments more accountable for delivering value than when politics as usual and competing special interests alone frame such discussions. As Mark Catlett, a former chief financial officer for the Department of Veterans' Affairs, noted, "Whenever there is a major catastrophe, people ask the right questions." Of course, the challenge for public managers and stakeholders is to find a means of asking the "right questions" about public value absent a crisis.

Nonetheless, national crises, whether terrorist attacks, severe economic downturns or natural disasters, do tend, at least temporarily, to throw the "price of government" off-kilter as spending spikes to help offset the impact of the crisis. The aftermath of a crisis is one of the periods during which citizen and legislative stakeholders stand back and reappraise the value they are receiving from public service organizations. Under such circumstances, stakeholders are more likely to look at how public service organizations performed, or failed to perform, in response to the crisis. A case in point is Hurricane Katrina, which devastated portions of the Gulf Coast of the United States, including New Orleans, in August 2005.

A good deal of public debate following the hurricane centered on the federal funding of levee maintenance and improvements in New Orleans. Questions were raised. If more money had been spent on the levee construction to make them able to withstand a more severe hurricane like Katrina, rather than a lesser storm as constructed, there may have been a different outcome. The consequences of resource allocation decisions are brought home to stakeholders at such times.

Another good example of how public value concepts can guide government decision-making is well illustrated by the U.K. government response to two major national crises concerning cattle over the past 20 years.

First, in the late 1980s, British cattle started to develop a degenerative brain disease. Bovine spongiform encephalopathy (BSE) is

a chronic disorder affecting the central nervous system of cattle, popularly known as mad cow disease. When it first appeared, the government's response, in light of the scientific knowledge available at the time, was one of public reassurance and playing down the magnitude of the problem. However, over several years, more cattle became infected and serious questions were asked about the possible transmission of BSE to humans. When in 1996 a potential link was made between a new variant of Creutzfeldt-Jakob disease in humans and BSE, the government had to take drastic action. A series of protective measures was introduced, including the purchase for destruction of cattle more than 30 months of age (which were believed to carry the greatest risk for BSE infection). The European Union imposed a ban on the export of beef from the United Kingdom, and the United Kingdom banned certain cuts of beef, such as T-bone steaks, from domestic consumption because they contained vertebral column, which was potentially infected.

The costs of the slaughter program and other measures ran into the hundreds of millions of pounds, and the effect on the British cattle industry was devastating. BSE eventually subsided and no epidemic of Creutzfeldt-Jakob disease has yet materialized. To date, there have been fewer than 200 cases. Many of the measures introduced by the United Kingdom have been included in the BSE eradication and prevention programs instituted by the European Union and other countries where BSE has occurred. The effectiveness of these controls can be seen in the rapid decline in the number of cases.

However, the BSE episode diminished public value. Public health outcomes declined as the public's confidence in food safety was eroded and the British beef industry was badly damaged. While the outcome of containing BSE was eventually achieved, with the benefit of hindsight, not all of the measures taken were either necessary or successful and some of the money spent had little or no effect on the outcome. However, beef consumption has been restored to previous levels and the beef industry is recovering.⁵

Then in early 2001, the U.K. government had to deal with a second major livestock crisis. Foot and mouth disease (FMD) was discovered in a herd of pigs in the north of England. FMD is an infectious disease affecting cloven-hoofed animals, in particular cattle, sheep, pigs, goats and deer. The disease is serious for animal health and for the economics of the livestock industry. While FMD is not normally fatal to adult animals, it is debilitating and causes significant loss of productivity. For example, milk yields may drop or the animals may become lame. In young animals it can be fatal.

Given the recent experience of BSE, the U.K. government response focused on four key outcomes:

1. Rapid reassurance to the public that the problem was being addressed
2. Limiting the impact on the British farming industry
3. Containing the cost
4. Bringing the disease under control

Usual practice with FMD is to slaughter the immediately infected stock, to slaughter stock known to have had contact with infected stock, to limit the movement of stock and to control all access to infected areas. Vaccination of animals that might be exposed to infection is now recommended as the final measure to limit the spread of the disease. However, having vaccinated animals would limit the ability of the European Union and United Kingdom to trade freely on the world market. In addition, this would have yet again brought into question the quality of British livestock, which had only recently begun to be reestablished after BSE.

The U.K. government, conscious of the outcome of minimizing impact on the farming industry, decided against vaccination for a multitude of reasons. Instead, it implemented a policy of culling all animals within a given geographic range of a known outbreak, whether they were known to have had contact or not. This policy led to the cull of over 4.2 million animals before the outbreak was contained.⁶

On this occasion, focus on two particular outcomes—the need to

contain the spread of the disease without risking the status of the herd by using vaccination—proved to be expensive while, given the high-level of media attention, still not effectively providing reassurance that the disease was being effectively managed. Public value was again called into question as commentators in the press and Parliament asked whether the cost of the measures taken was proportionate to the outcomes delivered. E.U. and U.K. government guidelines for managing future outbreaks of FMD have now been changed to put a greater emphasis on vaccination.⁷

As both examples illustrate, natural disasters present a number of public value challenges:

- Governments must react quickly, often with less than complete information.
- The desired outcomes could be unclear and might well conflict.
- It is easy to spend money ineffectually where the desired outcomes have not been established as government seeks to respond rapidly to an emerging crisis.

In this context, a Public Service Value analysis could bring new rigor to contingency planning for natural disasters. Conducting such an analysis could help public managers think through, in a structured manner and without the pressure attending an actual crisis, what the desired outcomes would be in response to a given disaster. A Public Service Value analysis would help public officials examine the trade-offs that they would need to consider when dealing with such an emergency. In addition, Public Service Value analysis can be used to evaluate responses to disasters so that future disaster planning can be improved.

The Public Performance Gap

There is increased pressure on public service organizations to open additional channels of communication for servicing and informing the public. One early initiative that New York City Mayor Michael

Bloomberg took on when elected in 2001 was to improve the level of service that city agencies provided New Yorkers. For example, simply listing phone numbers for the sprawling city government, which provided more than 900 different services through more than 50 agencies, consumed 14 pages of the New York City phone book. The Bloomberg Administration wanted a single contact number, with live operators handling callers' queries, to improve government responsiveness. The operators would access a constantly updated knowledge base to quickly provide directory assistance, information or services to citizens, businesses and visitors. In 2003 the city launched its widely acclaimed "311" service, providing a simple number to call for all nonemergency services and information. The program, which has recently been handling over 40,000 calls a day and received over 240,000 calls on the first day of the December 2005 transit strike, has increased government responsiveness and citizen satisfaction while at the same time significantly reducing the city's call center costs.

The pressure exerted on public sector performance is happening around the world from the citizens of Indiana (who want electronic service from the Indiana Department of Revenue to match what they receive from the private sector), to the people of Spain (who are pressing for greater access to information about retirement and other benefits from their Instituto Nacional de la Seguridad Social [INSS]). At the INSS, public managers have answered this demand through technological modernization and a citizen-based approach. Among the measures adopted by the agency is a new web site that offers citizens electronic access to administrative forms and other information, as well as new in-person citizen centers and a toll-free telephone information system.

Indeed, a multicountry report published in 2005 by Accenture, "Leadership in Customer Service: New Expectations, New Experiences," concluded that among the 22 nations surveyed, "Citizens' willingness to embrace a new generation of services outpaces governments' ability to deliver them."⁸ Canada, which

ranked number one in three of the four facets of leadership in customer service measured by the study, endeavors to provide superior citizen service. The Canadian government's experience with its Government On-Line program has led the country to the recognition that taking the next step to service transformation implies a radical change in the way government as a whole is managed. As a result, Canada has recently articulated a service vision to redesign services, service delivery and public service itself to achieve dramatic improvements in client satisfaction, cost savings and efficiencies, policy outcomes and accountability and transparency. The vision specifies achievement of outcomes within a framework defined by citizens' needs and a whole-of-government approach to service delivery.⁹

If anything, the pressure on public service organizations to create more technology-driven service options, driven largely by citizens' increased use of the Internet, is only likely to expand in the coming years. Alan Webber, an analyst with Forrester Research, and formerly an analyst with the U.S. Department of the Interior, has observed "As technology pushes us forward and networking on the Internet or elsewhere becomes more ubiquitous, people are looking for government to perform the same way. Or at least they want it to trend a lot more in that direction."

Fostering Competition in Government

In the private sector, competition for customers and capital typically forces performance improvements. High-performance businesses offering innovative products or services tend to attract new customers and outperform industry laggards, expanding and adding employees in the process. Also, they attract capital as investors bid up their share price, or purchase newly issued shares, in anticipation that the company's high growth rate will produce a high return on investors' capital. Competitors are forced to improve their performance or risk withering away or being

acquired by another market player. Investors tend to pull their money out of such companies by selling their shares and buying shares of higher-performing businesses.

However, in the public sector, competition has played a less direct role in improving performance. Until recently, the closest thing to competition in the public sector was competition among political parties or officials for votes. A newly elected candidate could declare a citizen mandate and bring in new governing policies. However, a new and growing form of competition in government is the contracting out of certain services. In select cases, where government used to be the sole provider, some nations, states and municipalities have decided to contract services out to be more efficient. Refuse collection is a common example, in many countries, of the private sector performing a tax-supported public sector job relatively efficiently. In the United States, for example, private companies today manage about 70 percent of the waste generated by local municipalities.¹⁰ Private sector haulers typically bid against each other for a municipality's multiyear garbage hauling contract. While there have been some scandals in the garbage collection industry, the private sector competition generally has proved to be an efficient means to raise the large amounts of capital needed to fund the purchase of fleets of garbage trucks and other equipment. A key part of the price haulers charge the city is determined by how efficiently they can raise capital in the private markets to fund purchases of trucks and other capital equipment. The hauler proposing the most efficient and effective economic model usually wins the contract, helping to boost the cost-efficiency and possibly service levels of local governments and thus helping make taxpayers' money go farther.

Privatization and the contracting out of public services have tested the degree to which private sector competition in the public sector can help improve government performance. Privatization (where a service previously provided by the government moves into the private sector) and contracting out (where services are provided by a private sector company, but still paid for by govern-

ment) has been gaining ground at all levels of government for at least the past two decades. These practices have been especially widespread in New Zealand, the United States and the United Kingdom, and the moves to introduce competition into public services have provided added impetus to the trend toward fostering high performance in the rest of the public sphere.

New Zealand Success

Nationalization of major industries in New Zealand in the wake of World War II followed a path similar to that set by post-war government in the United Kingdom. And like the United Kingdom, New Zealand by the late 1970s and early 1980s was eyeing privatization as a means of improving economic efficiency, creating more jobs and, in essence, adding public value.¹¹ Beginning in the mid-1980s, New Zealand started the task of privatizing many of its state-owned industries, including railroads, rural banks, telecommunications and public works. "They had become a vehicle for soaking up unemployment, they were massively overstaffed," said Maurice McTigue, a former New Zealand cabinet officer who led much of the privatization, and who currently serves as director of the Government Accountability Project at the Mercatus Center, George Mason University. To ease the pain of layoffs, the national government took significant up-front buy-out costs, noted McTigue, although the scope of the layoffs did trigger initial public resentment. In the railroad sector, for instance, employment plunged from 28,000 to 5,000, while in the telecom sector payrolls were slashed by 50 percent. The government operated the enterprises as profit-making companies for a few years, and converted them to full accrual-based accounting, before offering shares in the companies to the public.

Public opinion reversed itself within a few years as sharp improvements in public services and efficiency drove customer satisfaction, and it became clear that privatization was adding public value. The waiting time for a new phone line, for example, fell from around 6 weeks to just 24 hours in most of the country. The cost of residential and business service fell by 58 percent and 69 percent, respectively, in just three years. Competition in the telecom sector increased to such an extent following deregulation that within three years total employment actually exceeded preprivatization levels by 30 percent. In the railroad sector, shipping rates fell by 55 percent, and the railroads by the late 1980s were posting annual profits for the first time in three decades.