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FRUGAL INNOVATION: BEYOND THE CONCEPTS OF 'PUBLIC' AND 'PRIVATE'

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Mixing public and private provision

In Denmark, around 85 per cent of ambulance services and 60 per cent of fire services are delivered by a private company—Falck. This has been the case since the 1920s, when a socialist government allowed local councils to contract with external providers. Unlike its public sector counterparts in Denmark, and most other places in the world, Falck offers an integrated rescue capability that brings together all manner of emergency and non-emergency services. The company's slogan, 'Always There', captures rather neatly this vision of an integrated service.

In addition to the traditional emergency services, which are provided free of charge, Falck offers a wide range of subscription services: patient transportation, an ocean salvage corps, auto assistance at home and abroad, animal rescue, trauma counselling, chiropractic treatment, and even care of chronic illness through telemedicine. They have agreements with the police to tow illegally parked cars, provide divers for searches, and remove bodies from crime scenes. The Animal Protection Foundation contracted with them to transport sick and injured

animals. As a Chief Executive explained to me some years ago: ‘We’ve acquired this role. If you need help, call Falck, irrespective of the problem you might have.’ No one else provides such a broad service. If you were to contact your local municipality, you would not know which department to call. But if you needed help, you only needed to contact Falck. If a horse fell in a ditch, it was always Falck. If a storm removed the roof from your house or you needed to pump water from your basement, you phoned Falck.

The cartoon (see Figure 12.1) was published more than 100 years ago in Denmark, and neatly depicts this idea of an integrated rescue service. As you’ll see, Falck is everywhere, rescuing portly gentlemen who have fallen into fountains, recovering hats on the street corner, holding screens to provide some privacy for couples who are canoodling in the street.

Figure 12.1. Danish cartoon about Falck

Source: 'Blæksprutten' (Octopus), an annual Christmas cartoon about the year's events.

Among the Danes, Falck is seen as a public service. In local directories, the company is listed after the emergency services number 112 and ahead of the police. At Legoland, the fire engines bear Falck's name.

I first became aware of Falck in 1995, when the ABC interviewed British academic Norman Flynn about the denationalisation of public services in Europe. Flynn was clearly uncomfortable with the whole idea of privatisation and outsourcing, but he struggled to categorise Falck. He said:

Falck's an anomaly in Europe, it's a complete aberration. Everyone trusts Falck like they trust the state, it's a quasi-state thing. It just happens to be privately owned. But it is a national monopoly for these emergency services, but it's interesting because the Danes trust Falck as they trust the state (*ABC's Life Matters*).

To a much greater extent than those of us in the English-speaking world recognise, the social democratic countries of Western Europe rely on a mixed economy for the delivery of their public services.

I was reminded of this while facilitating a seminar on behalf of the Forum of Federations in Melbourne in mid-2013. There had been a series of front-page articles in the Melbourne press about some scandal in the state's hospitals, and a British academic, Clive Grace, held up a newspaper and observed that it could just as easily have been the headline of a paper in the UK. I could not find any of those exact headlines again, which probably indicates it was one of those passing crises that the media discovers and quickly moves on from. But here is a random list about crises in Australian public hospitals:

Nurses to strike at 160 public hospitals (*Sky News*, 21 July 2013).

Only one SA hospital meets emergency department patients target (*Advertiser* (Adelaide), 25 July 2013).

Hospital target waiting times down, fewer surgeries performed (*ABC News*, 6 June 2013).

The speaker after Grace was German academic Wolfgang Renzsch from the University of Magdeburg. He commented that such an issue would not make a headline in Germany, because with the exception of some veterans' facilities, German hospitals are owned and managed by private, not-for-profit, and municipal providers. The management of hospital services is not the responsibility of state and national governments, and therefore politicians would not be caught up in these stories. In examining, from here, the role of public services in the social democratic countries of northwest Europe, we overlook the extent to which they are mixed economies. In part this is because the Europeans do not draw the same crisp distinctions between public and private that we do in the English-speaking world, and as a result, the privatisation debate resonates in a different way.

My proposition is that we would have a better chance of pursuing innovative, new approaches to public service delivery if we were to bridge the deep and largely ideological gulf that we have constructed between public and private. If we were to reframe the debate, to move beyond simple concepts of public and private, we might be able to advance this discussion about new models and new approaches in an age of austerity. In fact, over the past decade there has been a discernible softening of this strict divide, particularly in the UK and Australia.

On both sides of the political fence, governments have increasingly turned to external providers for the delivery of public services, and we have begun to see the emergence of public–private hybrids that defy simple classification.

In truth, the boundaries between public and private were never as severe as the ideologues would have us believe. There was certainly a preference for large, industrial institutions over the first half of the twentieth century, but the public sector was always a mixed economy with hybrids that did not easily fit in any camp. Private and not-for-profit schools have always been part of the education sector in Australia, and the debate over state aid that has raged since the 1960s is not about whether we will proscribe non-government schooling, but whether taxpayers will subsidise them with partial vouchers. Britain had grant-maintained schools as early as 1902.

Much the same applied when it came to the health sector; in NSW we have a number of privately owned and operated public hospitals, established in the early twentieth century, and known in the relevant part of the *Health Services Act 1997* as ‘affiliated health organisations’ or ‘Schedule 3 hospitals’. The most prominent of those is St Vincent’s Hospital in Darlinghurst, Sydney. It is an iconic part of the public hospital system, but is in fact a not-for-profit private hospital operating as a public hospital. The vast majority of what we now call community services were conceived and created—and to this day are still operated—by the not-for-profit sector. I grew up in a little country town in southeast Queensland, and I can remember watching the cars from the ‘Blue Nurses’ come and go in the street as we played cricket in the front yard. It was just one of those community services that were a continual presence in the background as one grew up.

The voluntary sector has always been the great innovator when it comes to the development of new public services. Indeed, it is difficult to think of a public service—apart from those which required some element of coercion—which was not invented by the voluntary sector. These include hospitals, schools, fire brigades, ambulances, ocean rescue, social insurance, home care for the sick and disabled, the concept of a probation service, and even professionally designed and maintained highways.

I have often challenged audiences to name a non-coercive public service that was developed by government, and over three to four years of putting that challenge to my audiences, nobody’s been able to identify one. Somebody once suggested urban planning (which is a regulatory service, but could also be regarded as a public service), but in fact the garden city was conceived by a private individual, Ebenezer Howard, and the first garden cities in England—Letchworth and Welwyn—were constructed by not-for-profit organisations that he created (Parsons and Schuyler 2002). Indeed, England has a history of

privately developed towns which date back to the Middle Ages. In the UK, someone suggested the National Health Service (NHS). But the principles of integrated healthcare, which was supposed to be one of the unique offerings of the NHS, were drawn from the Great Western Railway (GWR) Medical Fund. This was established by the GWR at Swindon in 1847—a very innovative model that influenced the early design of the NHS a century later.

The Australian Public Service sector is, and always has been, a mixed economy with a diverse range of public, private and not-for-profit providers. My rough calculations indicate that approximately one third of public sector services in this country are provided by independent proprietors. In some community services, it is as high as 90 to 95 per cent: in health and education it is around one in three; whereas an average of one in five prisoners are held in privately managed prisons. In some other public services such as policing, of course, the role of external providers is negligible.

There is bipartisan agreement in this country on the desirability of having a mixed economy—nobody is suggesting that the aforementioned ratios should be wound back. Indeed in the last few years, we've seen Labor governments as well as Coalition governments substantially expand the role of private and not-for-profit provision. In arguing that in its search for solutions to the austerity challenge, the Australian government should move beyond simple notions of public and private, I maintain that it needs to look at the *full* range of public service providers, not merely those that are directly controlled by public officials. Among the 30 per cent of public services that is provided by public and not-for-profit organisations, there are monopolies that need to be opened up to contestability. There are services delivered under programs that are decades out of date, and are in urgent need of being recommissioned. If we reframe the debate so that we are scrutinising the performance of, and drawing upon the capabilities of, the full range of public service providers, we substantially expand the scope for reform.

Benefits from contestability

Let me suggest another way in which we can reframe the debate about reform. Many of those who advocate privatisation or outsourcing as a means of transforming public services base their argument on an assumption that the private and not-for-profit sectors are inherently superior to the public sector—'private good, public bad'. With limited exceptions, that proposition is not borne out by the evidence, and to maintain such a proposition is offensive to the hundreds of thousands of men and women who have dedicated themselves to a career in the public service.

The evidence suggests that it is *contestability*, rather than privatisation, that delivers the benefits. While the concept of contestability is deeply challenging to policymakers engaged in frontline delivery, and while there are some public services where an uncontested government monopoly is unavoidable (and indeed desirable), there is nothing inherently offensive in the slogan ‘competition good, monopoly bad’. The public at large is generally sceptical about privatisation or outsourcing of public services, but it has little sympathy with monopolists in either sector. The public likes the idea of user choice—just witness the overnight popularity of Australia’s National Disability Insurance Scheme (NDIS)—and it warms to the idea of competitive tendering, as long as it can be reassured that the tender is conducted openly and fairly.

One of the significant breakthroughs over the past decade in thinking about public service reform has been the discovery of contestability. Contestability is not just outsourcing, and it does not necessarily involve competition—it is the credible *threat* of competition, or ‘benchmarking with teeth’. Where there is already a monopoly in the private sector, simple outsourcing will result in a less contestable outcome than robust benchmarking or other innovative models that involve public sector provision. Contestability is limited by contracts that have a longer term than is necessary or justified by the nature of the contract. Traditional outsourcing is often inappropriate where public services are inherently monopolistic, where the services in question are unique or so closely integrated that they can’t be broken down into parts, or where there is a problem with physical or human asset specificity.

To my knowledge, the first person to explore the application of contestability to public services was Chris Ham, then Professor of Health Policy and Management at the University of Birmingham, who published a brief note on the matter in the *British Medical Journal* in 1996. Ham was seconded to the Department of Health from 2000 to 2004, where he served as Director of the Strategy Unit. He is now CEO of the King’s Fund, which is probably the most influential think tank in the UK health sector. In that 1996 note, following the collapse of the first experiment with the NHS internal market, Ham wrote:

While competition as a reforming strategy may have had its day, there are nevertheless elements of this strategy that are worth preserving, not least the stimulus to improve performance which arises from the threat that contracts may be moved to an alternative provider should not be lost. The middle way between planning and competition is a path called contestability. This recognises that healthcare requires collaboration between purchasers and providers and the capacity to plan developments on a long-term basis. At the same time, it’s based on the premise that the performance may stagnate unless there are sufficient incentives to bring about continuous improvement. Some of these incentives may be achieved through management action or professional pressure, and some may derive from political imperatives.

In addition, there is the stimulus to improve performance that exists when providers know that purchasers have alternative options. The essence of contestability is that planning and competition should be used together, with contracts moving only when other means of improving performance have failed. Put another way, in a contestable health service, it is the possibility that contracts may move that creates an incentive within the system, rather than the actual movement of contracts. Of course for this to be a real incentive, it must be said, contracts must shift from time to time (Ham 1996, 71).

In some situations, outsourcing is still the most appropriate course of action. There is now a well-developed market in this country for warehousing and logistics, and the onus of proof must now rest on those who would argue that warehousing and logistics should be done in-house. This is the so-called '*Yellow Pages* test', which was described by California Governor Pete Wilson as follows: 'If a service provided by government is advertised by private companies in the *Yellow Pages*, it's a good candidate for privatization' (Wilson 1996, 29). Put another way, if you can find somebody in the *Yellow Pages* that's doing this, you really ought to be asking the question: Why are you doing it in-house? Note that he uses the term 'privatisation' here rather than 'contracting'.

In some cases, the technological capabilities of private sector firms have outstripped those of the public sector, and in those cases governments might decide outsourcing is the most suitable course. The innovative new road maintenance contracts tendered by the NSW Road and Maritime Services (RMS) are an example of this. Each of the shortlisted consortia has one or more international companies involved in their bid, because the RMS is drawing heavily on models that have been developed in New Zealand and the UK. The NSW government has elected *not* to develop its capabilities in-house or form joint ventures with international corporations, and this is an understandable decision.

There are also situations where, in order to create a credible threat of competition in the rest of the system, governments may elect to outsource a proportion of their services. It was for this reason that the NSW Labor government did not permit an in-house bid when it conducted a competitive tender for the management of Parklea Prison in 2009. Throughout the rest of its term in office, Labor employed a policy of contestability in the reform of its prisons. Contestability drives robust benchmarking, and it motivates public service managers to undertake serious reform. It recognises that private sector monopolies are no better than public sector monopolies and, in many cases, worse. It is a good example of an approach to public sector reform that goes beyond the traditional debate of public versus private.

Performance contracting

I spent 10 years in the UK running a corporate think tank for a large public service company. The first research project we undertook after my arrival was to interview contract managers who had previously managed the same service in the public sector—the same people who were doing the same job, but in a different model. It was a very insightful piece of work, and we found that many of the benefits of competitive tendering come not from competition but from contracting.

Competition is by no means unimportant; the process of winning a competitive tender bestows on management a powerful mandate for reform, which enables them to renegotiate custom and practice. But a great deal of work is done by the contract itself. A performance contract provides much greater clarity to frontline managers about the government's priorities. When they are written into a contract, performance targets provide predictability, so that management and staff know how they will be judged and are able to adapt their behaviour accordingly. A term contract provides frontline managers with stability so that over a period of five to seven years, for example, they are isolated to some extent from the policy churn that has become a feature of modern politics.

It is unsurprising, then, that contract managers who used to work in the public sector reported that the contractual shield provided them with a great deal more authority and autonomy in managing their team. However, they also reported feeling personally much more accountable. Since the boundaries of the organisation were more clearly defined, and since performance targets were more predictable and stable, they knew that they would not be able to shift responsibility to someone else. Service level agreements between the commissioners of public services and public sector agencies have made little impact because they have failed to comprehend the essence of what makes a contract work. Again, if we reframe the question so that we focus on the contract rather than just competition or contestability, we can open up a whole new range of tools to use in addressing the challenge of austerity.

Recognising diversity

The concept of diversity offers us another way of doing this. Some of the examples and themes that I am about to refer to have been woven into the fabric of this book. Traditionally, public service commissioners have drawn on a very limited range of tools in the design of solutions to policy problems. That has begun to change, but there are still not enough tools in the policymaker's

toolkit. As psychologist Abraham Maslow observed: ‘I suppose it is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail’ (Maslow 1996, 15).

Our capacity to understand the problem in front of us is constrained by the range of possible solutions at our command. If the only tools you have available to you are a hammer and a monkey wrench and someone gives you a watch and asks, ‘What’s the problem and can you fix it?’, you are going to struggle because you have got two tools that are not particularly appropriate for the task at hand. Privatisation and outsourcing have certainly introduced diversity into the range of models from which policymakers can draw—but not very much. There are many public services where privatisation and outsourcing would be decidedly inappropriate. Much the same applies to ‘digital government’. It is a useful addition to the toolkit, but it is only one instrument in a range of alternatives we should be exploring.

Over the past few years, we have seen the emergence of new models that are not easily slotted into the old categories of public, private and not-for-profit. Simone Walker’s chapter in this book relates to social impact bonds. While we have not really moved beyond the pilot phase even in the UK, and certainly not in the US or in NSW (where the first two pilots are underway), there is significant interest in this radical new approach. What is interesting, given the subject of this chapter, is that in the UK some of the providers in these consortia of social impact bonds are public entities, local governments and similar institutions.

We are also seeking public–private hybrids that provide scope for contestability where traditional outsourcing would not. In the UK, one of the most interesting is GSTS Pathology—a public–private joint venture between two leading NHS hospital trusts and a large public service company. The NHS trusts bring to the joint venture their expertise in pathology, while the private company brings its expertise in management. NHS staff are seconded rather than transferred, so that the trusts have retained their negotiating power within the joint venture. This is not soft and woolly—rather, it is a grown-up, very commercial joint venture. Now we have seen the emergence of some hybrids here in Australia, for example the Chris O’Brien Lifehouse, a new oncology facility at the Royal Prince Alfred Hospital (RPA) in Sydney.

In the UK’s welfare to work and rehabilitation sectors—the probation sectors—we have seen the emergence of a new service model, generally referred to by public officials as the ‘integrator model’. Table 12.1 shows Serco’s model; G4S have adopted this approach as well. In this particular case, the company assumed significant financial and operational risk for delivering service outcomes, but the integrators deliver none of the actual services themselves. Rather, they assemble and then closely manage a diverse supply chain on behalf of

government. There is then an interesting argument that the integrator is acting as manager of the government's supply chain, rather than being the head of a virtual organisation selling into government.

There is widespread criticism of 'public service mutuals' in the UK. Private corporations dismiss them as nostalgia for the cooperative movement of the nineteenth century. Union leaders insist they are just another form of privatisation. In fact, employee-owned enterprises are relatively common in one part of the private economy—the professional services sector. Lawyers, accountants, consultants, and some healthcare professionals usually operate under a partnership model, which is essentially employee-owned. Structural features explain why employee ownership is common in professional services, and in my view, those features occur in many parts of the public service economy. Other than lack of imagination, I find it difficult to understand why public service mutuals could not succeed as an alternative business model (see the later chapter by Hems in this volume for greater discussion on mutuals).

Table 12.1. Serco Welfare to Work model

	Coventry	Staffordshire	Herefordshire	Shropshire
Engage	Sarina Russo	Shaw Trust	Beacon Employment	Shropshire County Council
Enable	Trainbrains	Stoke on Trent Council	Beacon Employment	Shrewsbury College
Empower	Shaw Trust	Inspire 2 Independence	JHP Group Ltd	Shaw Trust
Specialists	Birmingham Chamber Training; Royal National College for the Blind			

Note: Each provider listed in the table above is indicative of each of those elements of the model; in the full model, there are two to three providers in each category.

Source: From Serco Group plc, 'Work Programme West Midlands & South Yorkshire', presentation to the author, 20 April 2012.

Some of the greatest innovation is taking place in India, where social entrepreneurs are developing profoundly different models of public service delivery in circumstances where governments, because of inadequate tax revenues, cannot hope to meet the needs of a population demanding basic services such as health and education. In fact, the term 'frugal innovation' comes out of these social entrepreneurs developing these new models in India ('First break all the rules: The charms of frugal innovation'). Examples include high volume, high quality heart surgery performed at a fraction of the cost of comparable services in the West. In large part this is possible because these industries are lightly regulated in India; the professional guilds do not have the same capacity to prevent experimentation with innovative new approaches.

While the Australian public will not want their governments to directly adopt those models, I think it is highly likely that they will be deeply influenced by the lessons that have been learned out of the ‘frugal innovation’ period in India.

In the exploration of alternative service models, it is vital that government ensures appropriate transparency and accountability; issues of competitive neutrality inevitably arise, but these issues are by no means insuperable. I was intimately involved in the development of the competitive neutrality principles in this country, when we were designing a framework for the corporatisation of government business enterprises in the late 1980s. Contrary to what some analysts now maintain, corporatisation was not developed as a staging post on the way to privatisation, but as a means of enabling government business enterprises to behave in a more commercial way and to compete fairly in the wider economy. Corporatisation was intended as a reform to carry the debate beyond public and private, and a succession of reports by the Productivity Commission and the NSW Independent Pricing and Regulatory Tribunal bear witness to the massive productivity gains produced by that process.

Stopping budgetary elephants in a time of austerity

Surveying the recent debates over the parlous state of the Commonwealth budget, there is little doubt that Australian governments are in for a period of sustained austerity. Scope for further tax increases will be limited, and both state and federal governments must look to the effectiveness with which they deliver public services. The fiscal gap is now so large that it cannot be closed just through staff freezes, efficiency dividends and waste-watch committees.

In looking at plausible reform tools, I have been deeply influenced by Aaron Wildavsky’s assessment of zero-based budgeting in the US government in the 1960s. In his writings on the matter, he quoted a public servant he interviewed: ‘Some butterflies were caught, no elephants stopped’ (Wildavsky and Hammond 1965, 336). Governments have to start looking for the elephant-stoppers and, done well, contracting and contestability offer that potential. But governments must also offer solutions that are capable of commanding bipartisan support. They must find a framework that unleashes the energy of the *change vanguard* (see Kelman, in this volume). They must find a narrative that will generate a broadly based reform coalition within government, well beyond that vanguard.

To use a metaphor taken from Steve Kelman’s book, having made the effort to get the flywheels spinning, they must find a way of maintaining the momentum of reform over time, through successive changes of government (Kelman 2005).

It must outlast any electoral cycle. There are a variety of ways in which this might be done, but none of them will be possible, in my view, if we do not find a way of moving beyond traditional concepts of public and private.

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