

Summary

In recent decades great changes have taken place, both in the demarcation between public and private and in the governance of the activities carried out with some form of public involvement. A great number of these changes can be linked to the complex of ideas that go under the name of New Public Management (NPM). They have often been modelled on foreign examples, adapted more or less well to Swedish conditions. A general movement from public to private has taken place and has been implemented at all levels – calling into question the public involvement, introducing new forms of operation as companies and foundations, increasing private financing and private production of public services, establishing quasi-markets, and importing methods of governance, concepts and people in managerial positions from the private sector.

Motives behind the changes

The most important motives presented for a regime shift were a desire to increase *effectiveness* in public sector activities and to limit *expenditure increases*. In the longer perspective demographic changes were foreseen that would entail a growing dependency burden on the working population, and it was considered necessary both to limit total expenditure and increase the efficiency of resource use in the public sector. The means to be used for achieving these overall objectives were professional management methods, decentralisation of decision-making, results-based management, competition and generally strong expenditure discipline.

In the 1980s the core of the public sector – infrastructure, the welfare sectors, defence, justice and administration – was effective

and efficient in international comparison. At the same time, there were incentive problems in social insurance, and the pension system did not appear to be financially sustainable in the long term. From some quarters there were also more general calls for an overhaul of the public sector. Key phrases in that debate were improved service and choice in the public sector, the citizen in focus, participation and strengthened municipal democracy.

Purposes of the report

The purposes of this ESO study are the following:

- to establish a functional conceptual framework for analysing the interface between private and public
- to collect at an overall level some of the more important experiences from the past decades' changes in governance and draw conclusions from them
- to discuss, still at an overall level, how principles for governance of public administration can be developed. Both the central government and local government sectors are dealt with, partly because some of the fundamental questions concern division of responsibility between central and local government or the creation of legal persons separate from the state. Hence the two fundamental questions are: how to draw the line between public and private, and how the activities thus defined as public should be governed.
- to discuss more specifically how results-based management in central government administration can be developed and how it relates to the position of professional groups
- to discuss the role that evaluation and the “analysis agencies” should play in governance of public sector activities.

Interface between private and public

One element of the NPM doctrine is the idea that there is no difference between the private and public sectors and that importing solutions and recruitment from the private to the public

sector is therefore unproblematic. This is an error of judgment. The public sector differs from the private sector, above all in two important respects: the *fundamental logic* and the *degree of transparency*.

In a private operation the workaday decisions and actions are governed by the overall objective of maximising profit and responsibility to shareholders. A few decades of empirical research has shown that there are significant differences between the frames of reference of public sector and private sector employees – what can be summarised under the heading of a *public service mentality*. Even if there are common elements in the norms governing the public and private sectors, such as effectiveness and service, the differences between politically governed and market governed organisations are important. For example, the private sphere has no inherent requirement for equal treatment, though imposed non-discrimination requirements may entail some restrictions in this respect.

Also as regards *transparency*, there are important differences between the public and private sectors. Transparency, for example in the form of protection of sources, is an important element of quality assurance of an activity. Transparency also has positive side-effects on innovation in a sector. While collaboration between agencies is a natural part of operational development, commercial interests hinder dissemination of information in the private sphere.

In the public sector, transparency is the fundamental rule, and deviations from this are specified in the secrecy and personal data legislation. In the private sector commercial secrecy applies as a fundamental principle, and it is deviations from secrecy that are specified in the reporting requirements in the Companies Act, for example. Hence also in this respect society stands to lose, when an activity moves from public to private management.

Justifying public involvement

The situations that typically give rise to market failures are thoroughly analysed in economic theory. The most important examples of failures concern negative external effects (environmental impact, segregation), and their mirror images,

positive external effects or public goods (infrastructure, knock-on effects of education), long-term decisions (education, pension savings, natural resource management) and information deficiencies of various kinds (quality of services offered).

Taking this type of analysis as the starting point, the conditions necessary for various ways of implementing a policy can be discussed. Overall responsibility must be placed at the right level in the public sphere – central government, municipality or county council. Funding should be secured through a suitable combination of taxes and charges. As regards production, a decision must be made on what should be taken care of in house and what can be contracted out to external providers.

A general observation when applying this scheme of analysis is that the motives for public involvement that emerge in the analysis are often more numerous and more important than those indicated by a standard economic analysis. Omissions of this nature have contributed to poorer outcomes of policy changes than expected.

Experiences of NPM-inspired changes are mixed

The report presents an overall evaluation of NPM reforms in Sweden and abroad. There are both positive and negative effects. The positive effects recorded – increased supply, reduced costs – have, however, more to do with alternatives and competition than with form of ownership. Among the negative effects are increased budget strain, quality problems and increased risk of corruption.

In several cases, reforms implemented have had little to do with the actual problems identified in the respective areas of activity, and impact assessments before decisions have sometimes been insufficient. One example is that the pension reform was motivated by the fact that the previous pension system was not sustainable in the long-term, given expected demographic changes, but the premium pension system's NPM inspired component, the "funds marketplace", on average worsened the outcome for future pensioners.

Freedom of choice systems have meant increased supply and influence for users in some areas, but this increased influence is unevenly distributed in the population and, in addition, has

sometimes led to undesired effects. Freedom of choice systems based on school vouchers and other similar flat-rate compensation schemes also have the attribute that the entire gain from a productivity increase that may arise stays with the producer. Consequently, from the perspective of public finances they are of no interest.

The long-term effects of letting in private producers were also underestimated - effects not included in the decision support documents and naturally not included in the evaluations of the NPM reforms that have been carried out. Private actors seek various ways of increasing operating profit and may then contribute to increasing the burden on the public budget instead of reducing it. The repercussions may also be political, as in the case of private prisons in the USA, where producer organisations systematically work for extended sentence periods, contrary to criminological research recommendations.

The report analyses three sectors in detail – education, health and medical care and social insurance. *The education system* has undergone particularly large changes. Some of them are linked to the NPM doctrine – school vouchers, free right of establishment with low requirements on providers – while others, mainly the increase in municipal responsibility and pedagogical reforms, took place independently of it. However, it is interesting that the motives put forward for a strong increase in municipal responsibility in the years around 1990 – the alleged gains of decentralisation, results-based management, adjustment to local demand – to a great extent coincide with what was used as justification for the NPM changes.

Three facts predominate in the outcome of the changed education policy: poorer outcomes, increased spread of outcomes due to increased sorting of pupils, and grade inflation. *Performance* in Swedish schools has fallen steadily over a couple of decades. Several factors have contributed to this. The deterioration of the conditions for the teaching profession and the effects this has had on recruitment, unclear central directives concerning the curricula, discontinuation of central review of teaching materials, and general lack of clarity on the pedagogical core are some of the most important. *The fall in quality-adjusted teacher-pupil ratio* is very marked. Some of this can be explained by the increased municipal

responsibility, but private schools augment the effect by having both lower teacher-pupil ratios and more unqualified teachers than municipal schools.

Swedish experiences of the school choice system are in line with international experiences: the choice of school does not have any appreciable impact on the general level of performance, but sorting of pupils is reinforced. Besides the spontaneous sorting that arises as a result of pupils' and parents' choices, there is also evidence that the private schools sort among applicant pupils, in contravention of the current regulations. Competition for pupils has also led to grade inflation, since grades are a main instrument in marketing. There is a double gap; partly between national tests and grades, partly between local marking of national tests and control marking by external assessors. The consequence is that the information value of the grade system is undermined.

In *health and medical care*, the changes are as yet less far-reaching, since private care providers have existed for a long time in the system and the compulsory care choice scheme was implemented relatively recently. Some increase in supply has taken place, particularly in more densely populated areas, with consequent expenditure increases. There is a tendency towards concentration of less care-intensive patients to the private care providers, which may imply an incorrect allocation of resources under the current compensation system. The care choice scheme has also had negative effects in the form of increased prescription of antibiotics and to some extent has also led to more and longer sick leave periods.

Deregulation of the pharmacy market has led to increased supply, though concentrated to densely populated areas. Accessibility has increased through longer opening hours and sales of non-prescription medicines outside the pharmacies. At the same time, it is feared that this may lead to over-consumption of some medicines.

In *social insurance*, NPM-inspired changes have been implemented in the pension system through the premium pension system and assistance allowance to handicapped persons. Collective group insurance schemes have also added an increased private element in the system of social insurances. The *premium pension* choice engaged two thirds of future pensioners when it was

launched, but the level of activity of newcomers to the system subsequently fell drastically and is now below 1 per cent. Administration costs are high in the private funds, despite active negotiation by the Swedish Pensions Agency, and the spread in actual outcome among future pensioners is high. The state alternative, the Seventh Swedish National Pension Fund, has performed considerably better than the average private fund, while its administration fee is significantly lower.

In assistance allowance to handicapped persons, the recipients of the benefit have total freedom of choice of provider, and private companies now dominate supply. Along with unclear legislation and the flat-rate compensation, this has contributed to a severe increase in expenditure.

As public social insurance has distanced itself from the income-loss principle, the *collective group insurance schemes* have gained in importance. Employees not covered by collective agreements do not have this insurance, and there is also some underutilisation, because not everyone knows about the supplementary insurance schemes. The collective group insurance schemes also lead to higher administration costs, since double systems are needed for one insurance policy.

In summary, the NPM inspired reforms do not appear to be adequate responses to the problems identified for the Swedish public sector. Consequently, there are strong reasons to reconsider a number of reforms.

How can governance be developed?

For a principal-agent relationship between public and private providers to function as intended, three conditions must be met: a carefully specified *contract*, *information* about what has actually been provided and *sanctions* in case the contract has not been fulfilled by the contractor. These relationships also exist when a service is produced in house, but outsourcing solutions complicate matters in all three respects. Conditions are changed when the public sector principal that is ultimately responsible no longer is the employer of the person performing the actual work. Further, there is no direct equivalent to the public sector ethos.

There is extensive criticism against increasing requirements for documentation, verifications, supervision, audit and evaluation that are summarised under the heading of *the audit society*. Some of this criticism is warranted, but has often been aimed at the wrong target. It is NPM inspired reforms and their associated elements of private actors, fragmentation into principals and agents and similar changes that have been the driving force behind this growth.

At the same time as the extent of supervision has increased, it is perceived to be insufficient in many quarters. As new problems are discovered, new demands are made for increased and stricter supervision. Unfortunately, effective supervision is hindered in some cases by lack of resources and sometimes also by an inadequate legal basis. Sanctions also sometimes appear to be inadequate, when errors are discovered.

Key principles for policy changes

Before reconsidering governance of public sector activities, some fundamental principles should be established. They apply to the interface between public and private, results orientation, freedom of choice and the conditions necessary for market solutions.

The *special nature of the public sector* must be respected. The interface between private and public must be distinct, and attention must be given to the values that society may lose when changing regimes. If the secrecy requirements of the commercial sphere in a particular area are strong, it should be questioned whether private providers should be engaged at all.

Every activity should be assessed in accordance with the results achieved. *Results orientation* is therefore central, regardless of whether the operations are under public or private management. Results and effects must be analysed, which is often a demanding task, akin to research. Evaluation is, however, crucial for the learning capacity of the public sector.

In pace with the failure of NPM changes to deliver the promised effects, the arguments have shifted towards *freedom of choice*. For most people, freedom of choice is probably instrumental, that is, a means to achieve higher efficiency and effectiveness, better adaptation and suchlike, but for some people freedom of choice has

an inherent value. However, regardless of how it is seen, it must be weighed against other values when formulating policy.

The conditions for market solutions are generally less favourable in the areas that by tradition are dealt with by the public sector. Under certain conditions of governance they can nevertheless be made to work; public procurement regulations are an example of this. The problem with many of the changes implemented in recent decades is that these conditions were not created, but despite this the de-regulation or re-regulation was carried out anyway. A prerequisite for success is that the fundamental conditions are met as regards competition, transparency etc.

Alternative paths to better governance

The mixed experiences of the NPM regime at different levels make it important to seek other ways of developing the public sector, both in central government and in municipalities and county councils. When reconsidering NPM related changes in the light of experience, it is important at the same time to retain the elements that are valuable; mainly the focus on results and evaluation.

There is criticism of deprofessionalisation and loss of authority over performance of the work, which is well-founded, and thus there are also sound arguments for *restoring lost authority to the professions*. In this area as well, some of the problems can be linked to new methods of governance. Occupational groups with a weaker educated professional identity have been damaged most by the reforms. Classical professions such as lawyers and doctors seem to have maintained their traditional occupationally linked identity. Increasing the individual scope of action for the occupational groups concerned without reflection is not, however, the solution. The interests of the professions do not entirely coincide with the public interest. In all areas of activity there is a need for autonomous analytical capacity without direct responsibility for management, which can conduct a qualified dialogue with the profession on results, potential for improvement and strategies in the longer term.

The development of in-house production has been applied successfully by agencies such as the Swedish Tax Agency, the

Swedish Social Insurance Agency and the Swedish Customs Service, without any radical administrative reforms. In all cases efforts have been made to make it easier for citizens and companies to comply with applicable legislation and access the benefits they are entitled to. Enhanced rule of law through increased uniformity is also an objective that has been formulated and partly achieved.

In both central government and county councils and municipalities the question should be asked whether support functions such as IT and cleaning are best dealt with by outsourcing or in-house production; they should not be defined routinely as peripheral to the core activities. Experiences from healthcare show that low quality of cleaning may threaten the core objectives.

Management of large *workflows* is a universal problem in public sector activities and may apply to such differing activities as public transport, patients in healthcare, cases at case-handling authorities and detainees in prisons. There are methods for improving effectiveness of workflow management that are now used regularly in parts of the private sector (logistics companies etc.) but that have not yet gained ground in the public sector to any great extent. It is important that this is done through knowledge transfer to government agencies. Privatisation is a slow detour that is difficult to justify in order to achieve the efficiency improvements that may be made in this way, and in many areas this is not even an option.

A more *consistent use of public procurement* can also lead to substantial savings. In the PPM system, joint procurement of a limited range of fund solutions that satisfy the requirement of a varied supply would reduce the system's administration costs substantially. This solution has been applied to occupational pensions and also abroad. A similar solution could be applied in the area of assistance services to handicapped persons in order to overcome the increase in expenditure.

Competition can be achieved in various ways. Using generally available information sources, such as the National Agency for Education's database Salsa or open performance reports on health and medical care it is possible to create pressure for change without any organisational changes in other respects. If an element of freedom of choice is desired – which in both education and healthcare has proved to entail problems – a first step is to open up

for competition within the public sector, in the way illustrated by the university system, where applicants to restricted admission programmes in higher education express their preferences. A second step is to increase the circle of producers with non-profit actors, if such a need is identified.

Results-based management has been called into question repeatedly, but also in this area it is important to specify the criticism. The form of results-based management that above all has attracted criticism is that which builds on performance indicators at a low level in the organisations – in extreme cases at individual level – and where allocation of resources or pay setting is more or less automatically linked to the outcome.

Results-based management needs to be constantly developed and adapted to the local conditions. This is a difficult analytical problem, which up to now to a large extent has been left to administrative agencies to manage. Well-considered standardisation combined with specific sectoral knowledge is required. The main questions concern in which types of activity and for what purpose results-based management is to be used – as a basis for discussion or more directly in decisions on allocation of resources.

Operations development requires performance analyses and *evaluation*. Evaluation in the sense of causal evaluation has become more important. At the same time, methodological development in the area of causal analysis implies that more qualified evaluations can now be made. As in all reform processes, it is important that the results of such analysis are anchored in the organisations concerned before measures are taken.

Analysis agencies have a central role to play in governance of public sector activities. By creating a qualified agent in each sector that is independent of the administration, the Government and the general public are supplied with analysis of the sector that contributes to transparency, accountability and development. There are still no analysis agencies for important sectors such as defence and environmental policy. Further areas of activity may be relevant.

Specific policy conclusions

The following policy conclusions have been drawn for the three policy areas studied specifically in the report.

Concerning education policy:

- Public sector responsibility for the education system must be set at the right level if national interests linked to education are to be secured. Central government must therefore resume full responsibility for schools from municipalities and private authorities.
- Private schools do not perform better than municipal schools, when performance is adjusted for differences in background factors. They have not contributed to the rate of innovation, but achieve results by sorting pupils, thus enabling them to reduce teacher-pupil ratios. If municipalities are considered inadequate as providers of basic education, this logically holds also for private providers.
- The school choice system leads to grade inflation and increased sorting of pupils without having significant effects on the general performance level. It should be abolished and replaced with possibilities to express preferences for schools, preferences that should then be confronted with public objectives concerning equality of opportunity and integration.

Concerning health and medical care:

- County councils should be free themselves to determine the extent to which freedom of choice and freedom of establishment are to be applied, so that the care choice scheme can be evaluated.
- Compensation systems should be designed so that they reflect as far as possible care providers' actual costs.

Concerning social insurance:

- The ceiling in public insurance should be raised, so that the principle of income loss is also respected in practice. Funding should be secured through cost shifting vis-à-vis collective

group insurance schemes, which will become correspondingly unnecessary.

- The premium pension system should be abolished. If freedom of choice is considered desirable, a limited number of funds should be procured and managed by the public sector.
- Assistance services to the handicapped should be procured regionally and locally, so that the recipients of such services can choose between a number of providers. Resources freed up can be used to raise the level of ambition or be saved.