

**New Zealand Business Roundtable Guest Address**

**Making Government Smaller, Better, And Closer  
To Home**

**William Eggers  
DIRECTOR  
REASON FOUNDATION  
LOS ANGELES**

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## **MAKING GOVERNMENT SMALLER, BETTER, AND CLOSER TO HOME**

The Reason Foundation, for which I work, is a national public policy research organisation. It has a practical market-based approach, and is based in Los Angeles. Its areas of expertise include the environment, education, transportation and privatisation. My position at Reason is director of the Privatization Center. The deputy director of the Center, John O'Leary, and I spent over two years travelling around America, interviewing community leaders and over 400 public officials. We have also closely followed the recent experiences with government reform in other countries from Argentina to Britain and here in New Zealand. This experience has convinced us we are seeing today a radical shift in the ideas of citizens regarding what governments should do - and should not do.

For the first time in decades, ordinary citizens and their political leaders are asking the fundamental questions of a democracy:

- What should government do?
- At what level of government?
- How can government do necessary tasks better and more efficiently?

Not surprisingly, given that this is an election year both in New Zealand and the United States, the momentum has slowed a bit in moving forward on these issues. There is little doubt in our minds, however, that the long-term trend will continue.

The answers to these questions are the subject of a book we wrote called *Revolution at the Roots*. A preview to the answers is the book's subtitle: "Government needs to get smaller, better, and closer to home".

### **Making government smaller**

Working Americans now pay about 40 percent of their wages in taxes. Government spending in New Zealand also absorbs around 40 percent of national income when you include local government rates, ACC and fire service levies. It is an even larger percentage in most other industrialised countries. That means that at least every Monday and Tuesday we work for the government.

All over the world, as governments have grown, they have become involved in all kinds of activities far removed from their core missions, from classical radio stations and off-track betting parlours to selling liquor and operating resorts.

One of the most egregious examples we found of government over-reach was in Josephine County, Oregon. Spurred on by the exhortations of Osborne and Gaebler's bestseller *Reinventing Government* which told public sector workers to be 'enterprising', county officials, after thinking long and hard, came up with a really enterprising idea: the county would hold a rock concert.

This was the classic bad idea badly executed. County officials knew nothing about running rock concerts and the lineup proved it. Headliners included washed up 1960s 'stars' such as Country Joe MacDonald and Eric Burden of the Animals. The concert was called "Howlin' Through the Years", but when the howlin' was through the county had lost some \$75,000 - including \$22,000 on an audit to figure out how they lost so much money.

This notion of enterprising government is quite popular worldwide. In the context of your local government reforms and the creation of Local Authority Trading Enterprises (LATEs), I would urge you to consider carefully the perils of politicians playing at being business people. Ratepayers bear the potential risks and liabilities of these enterprises, and competition with the private sector is often not on fair and even terms.

When businesses restructure their operations, the first question they ask about everything they do is: "Should we even be doing this at all?" Or put another way: "If we weren't doing this already, would we consider doing it today?" Unfortunately, governments seldom ask this question.

While writing the book, I asked every department director, every government waste commission head and every reinventer the same question: "What have you ceased doing?" I always got the same response: the 'deer in the headlights' look followed by frantic shuffling through filing cabinets.

This failure to ask "Should we be doing this at all?" is, I believe, the central weakness of the 'reinventing government' movement. The idea of reinventing government was useful in prompting public officials to rethink the way government should operate. This said, *Reinventing Government*, by its own admission, ignored our first question: "What should government do?" In fact, co-author Ted Gaebler said:

In government we exist to do good. Doing good is a moral absolute. As long as one person is benefiting, we keep those programmes going.

This is a dangerous kind of morality because government can only give after it has taken. This is not a world of infinite resources. We must make trade-offs. We can't keep programmes going just because one person is benefiting, especially when many of these programmes do more harm than good.

During our research we ran across a teenage pregnancy prevention programme in Illinois, the focus of which was on boosting self esteem. When the programme was evaluated it was discovered that single teenage women in the programme were having more babies than those in the control group. It turned out that the programme had boosted their self esteem so much that they believed they could raise more kids by themselves.

The National Performance Review (NPR), Vice President Gore's 'reinvention' of the federal government, by its own admission "focuses primarily on how government should work, not on what it should do". The result was that after looking at the entire federal government, which spends over \$1.5 trillion annually, the NPR only found three tiny programmes that it suggested should be eliminated. They were the Wool

and Mohair Subsidy programme, the Honey Subsidy programme, and the Essential Air Services programme.

One programme that escaped elimination was the Federal Helium Reserve, which was started in the 1920s to keep blimps afloat. This is an absurdity. Outside Amarillo, Texas, 214 federal employees are babysitting 30 billion cubic feet of helium - enough to last 100 years. This programme exists in spite of the fact that there is a large private market that sells helium for less than the government. So, what was the NPR's recommendation? "Improve the federal helium programme." This goes against the first law of common sense: never improve that which should be eliminated.

The inability to eliminate obsolete programmes produces a ratcheting effect, giving us a government that knows how to add but can't subtract. A government that is doing so many disparate things is unable to focus on its core functions.

We all know that government is too big. The \$64 million dollar question is: "How do we make it smaller?" To answer that question we have to understand first why government has grown so big in the first place. The answer in a word is 'politics'. Politics is the number one enemy of good, efficient public sector management. Spending other people's money is a time-honoured way for politicians to get elected and stay elected. As economist Thomas Sowell puts it:

- the first law of economics is scarcity; and
- the first law of politics is to ignore the first law of economics.

Politicians these days are getting a lesson in scarcity because across the globe voters and taxpayers are limiting the amount of money they can spend. The first thing you need to do if you want smaller government is to shut down the tax pump. Nearly every example of dramatic downsizing or innovation we saw was the result of cash shortage.

The next thing you do is look at government-supported activities and determine whether or not they could exist without government funding and operation. From sports stadiums to water systems to cultural institutions, there are countless things that the government undertakes that could be done more effectively and more efficiently by the private sector. In France, most of the water is supplied by private firms. In Britain, all the airports are privately owned. Even that great disciple of Milton Friedman, Muammar Gaddafi, has joined the trend, privatising Libya's camel industry a few years back.

One area where we have seen considerable progress is in getting government out of owning and operating cultural institutions. In January 1993, Norfolk, Virginia, turned its city-run botanical garden into a private non-profit operation. It received its first \$1 million donation the same day.

### **Making government better**

Making government better requires more than just ideological posturing: it takes hard work. To make government systems work better there is one key reform that stands out: replace government monopolies with competitive systems whenever possible.

This is pretty simple stuff. It even works in the former Soviet Union. When a private airline started flying in Russia in 1991 it challenged the long-time monopoly of the state-run Aeroflot, which was renowned for surly service. The new company had only one rule when hiring new flight attendants: applicants were rejected if they had any prior experience at Aeroflot.

Unfortunately, this idea hasn't yet completely sunk in. Guess what President Clinton did to improve public service in the federal government? He issued Executive Order #12862 which directs the federal government to "provide service to the public that matches or exceeds the best service available in the private sector". The order goes on to say, "The federal government must be customer driven".

The federal government must be kidding. No presidential or parliamentary decree will solve the problem of poor government service. No amount of presidential urging is going to make the Post Office truly focus on its customers - only competition will do that.

The good news is that the debate over competition has ended. The public sector is going through a competition revolution as monopolistic public services yield to competitive markets. Ten years ago the idea that private firms could manage everything from airports to public schools to prisons was unthinkable. Today, all these things are happening - in the United States and around the world.

The most comprehensive competition programme in America is in Indianapolis where mayor Stephen Goldsmith has shifted nearly 70 government services into the marketplace, saving taxpayers about \$230 million annually. The Indianapolis experience has demonstrated that the marketplace is the only way to truly test potential levels of efficiency - not against other governments, and not with a consulting study.

Consider the story of the city's wastewater treatment plants. Though Indianapolis was widely considered to have one of the best-run, most advanced wastewater systems in the country, Goldsmith thought it could do better. An accounting firm was hired which produced a study that said the operation was highly efficient but could save perhaps 5 percent if it was managed better. The mayor said "thanks but no thanks" - what's relevant is what the marketplace will do with the management of the plants, not what a consulting company says can be done.

The business was put out to tender and four of the largest firms in the country put in bids. The winner brought down costs by 44 percent (about \$11 million a year) - not 5 percent, but 44 percent, for one of the most efficient plants in the country. The private firm had technologies, research and economies of scale that the city doesn't have. It's not that the city employees are bad, but that technology, research and scale are limited. The decision to compete created value in unexpected ways.

The notion of bringing market forces into government and testing government operations against the best in the private sector can be applied to many different things governments do, from fire protection to child care to education.

With the tremendous problems in public education in the United States, the purchaser/provider distinction is finally beginning to enter the education arena - though far more slowly than we would like. Districts in four states currently have private companies running public schools. One of these is the Boston Renaissance Charter School in Massachusetts run by the Edison Project under the state's charter school legislation. Rather than being run by government officials, these schools are managed by parents, teacher groups, private companies, or non-profit organisations. Charter schools have to compete with existing government-run schools by attracting students and the funding that goes with them.

For the same amount of funding the district spends per student, the Edison Project offers an education programme that is an hour longer each day and two months longer annually. Parental satisfaction is high. The waiting list is long - even for teachers. The school had over 1,000 applications for fewer than 50 teaching positions.

Some schools contract for the educational needs of particular children. Many states, for example, competitively contract to provide education for at-risk students. Ombudsman Educational Services, a private firm with contracts in half a dozen states, has an 85 percent retention rate. The cost is usually between one third and one half lower per student than in the public schools. A limited number of public schools have been established at business worksites. Known as satellite schools, such schools currently operate at an airport, a Hewlett Packard plant, a hospital, and a nuclear power plant.

Until recently, these kinds of reforms were unheard of. School contracting, public school choice, charter schools and private practice teaching are all commendable efforts to bring market forces to the public education system.

But we need to be sober about their potential impact. All these efforts face strong political opposition, and all are limited in certain critical respects. If competition is the best way to supply education, why not go all the way? Why not let parents choose any school they want?

We now have one - soon to be two - publicly-financed education choice systems. Both are fairly small and are targeted at low-income students. There is also a limited scheme which allows some lower income families to send their children to the school of their choice, public or private. This scheme, the Milwaukee Parental Choice Program (MPCP), was championed by Polly Williams, an African-American legislator. Williams, a Democrat and former welfare recipient, represents one of Milwaukee's poorest neighbourhoods, and the programme is limited to low-income families. As of the 1994-95 school year, the MPCP had grown to 830 children attending 12 private schools at public expense.

What do parents think of choice? They like it. According to an evaluation conducted at the University of Wisconsin:

... [parental] attitudes toward choice schools and the education of their children were much more positive than their evaluations of their prior public schools.

The lack of major progress in enacting publicly-funded school choice programmes has prompted business leaders and philanthropists to create privately funded choice programmes in 21 American cities.

In August 1991, Pat Rooney, the chief executive of the Golden Rule Insurance Company in Indianapolis, took matters into his own hands. Wanting to help disadvantaged children in Indianapolis and demonstrate the effectiveness of school choice, Rooney started the CHOICE Charitable Trust. Funded entirely by private donations, the programme gives low-income parents half the tuition at the private school of their choosing, up to a maximum of \$800 per child per year.

The response was overwhelming. Within three days of announcing the programme, 621 families requested applications. By the 1993-94 school year, over 1,000 low-income families were receiving scholarships. So if this concept is only common sense, why hasn't it happened on a broader scale?

The answer: political resistance from teacher unions and other public employee unions, which is the major barrier to replacing government monopolies with competition.

In the past 35 years, public sector unions have grown into a formidable force in politics around the world. In the United States, while union membership in the private sector has been declining for the last four decades, public sector unions have been booming. Public sector union membership has increased sevenfold since the 1950s. During this time, government has expanded dramatically, so that public sector unions have a larger share of a larger pie.

This represents an extremely powerful political force - just ask the Chirac government in France which was forced to scuttle many of its reform plans when the public sector unions shut down the country in protest at the government's austerity plan.

Public employee unions look out for the interests of their members - wages, benefits, and job security. As Al Shanker, president of the American Federation of Teachers (AFT), once put it: "When the kids start paying union dues, that's when we'll start looking out for their interest". This sounds harsh but the AFT and other unions are just doing their job: protecting the jobs and interests of their members. That's okay - it's what unions are supposed to do. But we need to remember that government basically exists to serve citizens and taxpayers, not government employees.

The problem is not the public school teachers, not the public road workers and not even the dreaded 'bureaucrats'. Public sector managers arguably work in a much more difficult environment than their peers in a competitive firm. The system is the problem.

Partly as a result of union opposition and partly as a result of our democratic systems, an important area of state sector reform in which the United States is noticeably behind New Zealand is in reforming the organisational structures, management systems, and personnel systems of the core public sector.

Our present systems are archaic. Working for the US federal government is frustrating because rewards and punishments are not linked to performance. When

the time comes for your raise, it isn't determined by your supervisor two offices away but by the 535 members of the US Congress who have no idea what a stellar job you might be doing.

The other side of the coin is that civil service protections and union agreements ensure that you can't easily be fired, no matter how bad a job you do. There is no way to exaggerate enough how difficult it is to fire a public employee.

I was recently in Hawaii advising state officials on streamlining government. That week there were front page headlines of a series of prison scandals, including guards selling drugs to prisoners, guards being convicted of sexual assaults, and an investigation of guards selling guns to felons. Sex, drugs, and guns - that sounds more like an American public high school than a prison. But a powerful union made changing things difficult. Virtually no one got fired. In one case, a union guard was working five days a week and then serving time at the weekend. While this cut down on his commuting time, the taxpayers of Hawaii aren't too happy that the inmates are running the prisons.

There is no way to make government operate efficiently under such a system. I hope to take back with me some ideas on how to implement the reforms you have accomplished in these areas. The main obstacle is political. To realise fundamental changes in these areas, a politician must expend considerable political capital with little potential for much political payoff - after all, no one was ever re-elected for doing a great job reforming the civil service system.

### **Making government closer to home**

We call the process of moving government closer to home 'devolution'. In our context, devolution has come to mean two things. First, it means decentralising government, moving authority from central governments to local levels of government and thus involving individuals more in their own governance.

This summer the US Congress passed an historic welfare reform bill that will remove the federal welfare entitlement and transfer welfare to states. But this is only the first step.

The second meaning of devolution is transferring responsibility for programmes like welfare from government to individuals, families and voluntary associations. Each is appropriate in certain cases. Both are crucial.

Most applicable to your situation is the second meaning of devolution.

The 'Index of Leading Cultural Indicators' put together by former US Secretary of Education Bill Bennett documents the dramatic rise in social pathologies in the United States over the past 30 years.

A lot of people say these are the nation's biggest problems. We see them more as a symptom. The problem is the collapse of community - especially in our urban centres. The growth of government has contributed to this collapse by crowding out civil society. An example is Our Lady of Victory's homeless shelter in Brooklyn. This was a casualty of government aid. For 13 years, Our Lady of Victory had operated its

church shelter for homeless men, many of them alcoholics. It had helped 1,400 men put their lives back together. Soon after the city opened two shelters within walking distance, the church shelter didn't have enough demand and closed its doors.

Why did so many homeless men choose the city shelter over Our Lady of Victory? Because church counsellors demanded that those seeking aid change their behaviour. They had to avoid alcohol and receive counselling as a prerequisite to receiving assistance. The city shelters applied few, if any, conditions for giving handouts. Clients didn't have to put up with such 'hassles'.

As government has grown, community has been weakened. At the same time, the growth of the secular has squeezed out religious institutions. Churches, community groups, families and other private mediating institutions - when they're working right - give individuals what individuals need, not what government rules say they're entitled to.

Consider Sister Connie Driscoll's group home in Chicago which offers refuge to single women and their children. Sister Connie is a tough nun, but she embodies tough love.

On the day we called, the shelter had conducted random drug testing at 6 a.m. There is no swearing, no visits from boyfriends, and women need a pass to leave the shelter. Sister Connie doesn't have these rules because she's mean. She has them because she knows that to be truly compassionate she also has to be tough. Tough love works - the home has a 95 percent success rate.

Sister Connie has nothing but scorn for government programmes that simply send out a cheque. She points out that poverty is not the real issue - lack of responsibility is the issue. If you're on welfare you can get a cheque of \$260 a month. But, if the welfare agency finds out you're on drugs you can go into a programme for disabilities and instead of getting \$260 a month you can get \$536 a month, because drug dependency is considered a disability. So now you can spend twice as much on drugs.

However, in addition to the tough rules, the St Martin de Porres shelter offers something else: love. When someone at the shelter is talking about leaving and looks to be heading for a relapse, the whole group will surround that person with support, saying "Don't do it. Wait". No one wants anyone there to fall, because they care - they're like family.

Government programmes cannot operate this way. It's not that people in government are uncaring. It's just the nature of public assistance. Public officials can't simply give to those they think need help and withhold from those they don't. With government programmes, it's not the people receiving aid who have to follow the rules, it's the people giving the aid who have to do so - they are tied up in red tape and bureaucracy.

The big question is how do we build - or rebuild - the capacity to transfer more responsibility to the community?

One approach being suggested in New Zealand and Australia is to introduce more contestability into social services. While this is likely to lead to some improvement, the experience in the United States has not been entirely positive. For over 30 years

we have spent hundreds of billions of dollars on contracts with non-profit providers to deliver social services. In the process we have turned many once proud, independent charities into little more than an arm of the human services bureaucracy. Most of the contracts are let without competition, and performance specifications and outcome measurements are virtually non-existent.

An idea now being advanced in the United States would get the government entirely out of the business of middleman in transferring funds from taxpayers to non-profit organisations through the creation of a charitable tax credit. Every American could take a credit ranging from \$100 to \$3000 for donations given to groups that are singularly engaged in the alleviation of poverty and are largely unsupported by the government. Think about it: if you had a financial windfall and wanted to help the poor, would you even consider giving time or a cheque to the government?

Though it comes with no guarantees, the idea of allowing individuals to select charities based on their effectiveness has enormous appeal. Money would tend to flow to charities that are perceived to be effective.

### **Conclusion**

We asked the same question of almost every major public official and every policy expert we spoke to: "What will government look like in the twenty-first century?". Most said it would be more decentralised, more flexible, have self-managed work teams, be re-engineered, customer focused, better, cheaper, faster and so on.

But UCLA social scientist Jim Wilson, probably one of the smartest people we talked to, had a very different answer - and it was scary.

It's going to be bigger, more complicated, more burdensome, and more costly. No matter what point in human history you ask that question, the answer is always the same. Government gets larger.

One government official compared government to a gas - no, not because it stinks but because like a gas, governments always expand to fill the container. But what is its container? If government cannot restrain its own growth, who can prevent it from growing without bounds?

The answer is people like you, acting in your capacity as stewards of your governments. That was the spirit of the original revolution we had in the United States. It was about self-governance.

One critic called this message anti-government. I disagree. After all, George Washington, the first president of the United States, didn't hate government, but he knew how an overbearing government could diminish human happiness. Washington said:

Government is not reason, it is not eloquence, it is force: like fire, it is a dangerous servant and a fearsome master.

It's time to make government people's servant once again. That means making government smaller, better and closer to home.

