

“Reinventing Government at 20: A Q&A with David Osborne”

David Osborne is one of the most influential thinkers on public administration in the last 25 years. His best-known work, [Reinventing Government](#), came out about 20 years ago and was a New York Times best seller. In it, he argued for what he called a more “entrepreneurial” form of government. Many of his ideas about performance measurement, customer-oriented government, and managed competition in the public sector have now become commonplace. He had a significant impact on the Clinton administration and its attempt to reform the federal bureaucracy, as well as many other officials at all levels of government.

Public Sector Inc. editor Stephen Eide recently interviewed David about differences between the early 90s and 2008-9 recessions, privatization, pension and healthcare reform and K-12 public education. Below is an edited transcript.

Eide: Let’s start at the beginning to give our readers some context. How did things look in American government when *Reinventing Government* came out in the early 90s and what you were trying to accomplish with that book?

OSBORNE: It came out in February of 1992, and we were at the tail end of a double dip recession. We had a deficit that was about \$290 billion and Ross Perot was running for President as an Independent with the deficit as one of his biggest issues. People were very worried about the deficit and they were very worried about our economic future.

Our political leaders were just desperate for new ideas at that point. They were cutting left and right, and searching for new ways to approach these problems. So we were very lucky. The book took a long time, a lot of research, but it came out at precisely the right moment.

EIDE: One theme of that book was how governments could turn crisis into opportunity, something we’ve heard a lot about recently. How would you compare governments’ response to the recent 2008 recession to their response to the early 90s recession?

OSBORNE: The main theme of the book was more that we were operating with institutions built during the industrial era on a model called “bureaucracy.” We were operating with large, centralized bureaucracies, very hierarchical, that delivered standardized services to mass markets and they were monopolies. That model had worked very well in the industrial era, but in the information age, it was dysfunctional. Centralized bureaucracies, particularly when they were monopolies, were just too slow and too unresponsive and too expensive. The private sector had spent the last decade restructuring, trying to get more entrepreneurial, more nimble, and the public sector was beginning to do the same thing because they had no choice.

When you compare the two time periods, this past recession was much deeper, and much more frightening. State and local governments have shed 500,000 jobs in the past three or four years. In the early 90s, state and local governments’ fiscal straits were not nearly as bad because the pension costs were not as bad yet since the baby boomers weren’t starting to retire, and healthcare costs were not as

high yet as they are today. Those are the two things that are, besides the recession, bankrupting our governments today.

The years of 1993, 94, 95 were incredibly creative years, because people were still motivated by fear because of the recession, but they had some money to use to invest in change. We haven't really reached that point this time yet. There's always this cycle: during a recession's fiscal free fall, it's very hard to innovate because you're just cutting left and right and everybody's sort of in a bunker, psychologically. But once your revenues begin to rebound and you finally have some breathing room, and you've still got the urgency, that becomes the most innovative time. I hope we're getting close to that today.

EIDE: I wanted to ask you about privatization. This is an idea that you have always been associated with, but there have been some controversies recently, most notably Chicago's 2008 deal to sell its parking meters to Morgan Stanley for \$1 billion. Have your views on privatization changed at all since the early 90s?

OSBORNE: No, but I want to make clear what those views were. If you look at the introduction to *Reinventing Government*, you'll see a subheading that says "why government can't be run like a business." And if you read it you will find statements like "privatization is not the answer." It's one option, it's just a tool, and it can mean different things. One version of privatization is selling off an asset or a service. The more common form in this country, since, unlike Europe, our government didn't take over many industries, is contracting something out to a private company.

What we said in *Reinventing Government* is that private is not always better than public, but competition is almost always better than monopoly, at least in services. That's not true in compliance functions like police work and in regulatory functions: there you do need a monopoly. But in service functions, competition keeps everyone on their toes, and makes everyone try to innovate to get their costs down and their quality up. So we advocated, and still do, creating competition in all sorts of ways.

Sometimes the smartest way is just to contract out and have the private companies compete with each other. But there are a lot of dangers in that. There have been lots of examples of private companies being more astute than the government contracting officers they were dealing with, and rigging bids, sharing markets, or putting in a low-ball bid, getting the business, waiting until the public sector had killed off its capacity to perform the service, and then raising the price. You ought to keep some public capacity and you ought to have the public sector compete with the private sector. That tends to give you the best of both worlds and it tends to keep the private sector honest.

Again, it's just one tool among many, though it's one that has been becoming more common since the 1970s. If you look at all the studies, we're contracting more and more things out every decade and we're learning how to do it more intelligently. Sometimes we get burned, but you look at academic studies, you'll find that, when you contract out a public function for the first time, savings tend to be in the 20-30% range.

EIDE: You mentioned the pension and healthcare issues, a main focus of ours at Public Sector Inc. How should governments address their problems with pensions and healthcare benefits?

OSBORNE: My last book was called [*The Price of Government*](#) and the subtitle was “Getting the Results We Need in an Age of Permanent Fiscal Crisis.” My co-author and I chose that phrase “permanent fiscal crisis” because if you look at the demographics, we really are going to be in fiscal crisis for the rest of our adult lifetimes. And it’s for two reasons, one, our healthcare system is so dysfunctional that it consumes 18% of our economy. That’s way above the rest of the world, almost double what the rest of the developed world spends on healthcare. And it has become a huge, huge cost for governments because almost all of them pay for health insurance for their employees and many of them pay for health insurance for their retirees. The second big factor is that the baby boomers are starting to retire. Over the next 30 years, we’re going to massively expand, almost double, the number of people who are 65 or older. So we’re going to spend a lot more on pensions than we bargained for 20, 30, 40 years ago. We’ve got systems that we can’t afford, basically, and there’s lots of ways to reform both pensions and healthcare, and many governments are pursuing them.

With pensions, the knee jerk thing is to give people a 401k rather than a defined benefit pension, so that you minimize the risk. But if you look at the data, defined benefit plans, because they’re big and they’re managed well, get a return of about 1% higher per year than 401ks. That adds up to a whole lot over a career. So they’re a lot better for public employees.

But we need to gradually scale back the benefits by charging employees more, changing the ratios, and we also may need to trim back the age when you can collect the pensions. We have public employees retiring after 30 years with very good pensions, and living another 40 years beyond that. And we end up paying them more in retirement than we did while they were actively working. We just can’t afford that any longer. People live too long today.

EIDE: And healthcare?

OSBORNE: Two big changes are needed. One, in a lot of markets, hospitals in the 1990s were under tremendous cost pressure, and so they began to band together. I live in the Boston area, and we have two dominant healthcare provider systems centered around the big hospitals. They’ve bought up a lot of the community hospitals out in the suburbs, and they now have so much bargaining power that when they face the insurance companies, they’ve been able to charge really high prices. These hospitals that have market power typically charge 50% to 100% more for the same procedure than the smaller hospitals. So, we basically need anti-trust for healthcare. We need to deal with this concentration of market power.

Even more importantly, we have to shift the way we pay for healthcare. Right now, the dominant model is fee-for-service, so that a provider charges you for every procedure, and when their income gets squeezed, they do more procedures. In regions that have more doctors and hospital beds per capita, in other words, where there’s more competition between the doctors for income, they do way more procedures, sometimes double per capita, than other regions. And the outcomes are *worse*.

In Massachusetts, where I live, we’re in the midst of a shift, led by both the private and the public sectors, from fee for service to what are now called global payments, or what used to be called “capitation.” The idea is that my primary care physician would negotiate an agreement with my insurer

for a certain dollar fee to take care of me all year. And if I end up needing specialist care or hospital care, it comes out of that fee. Now if it gets too expensive, there's a cut off, because we don't want to bankrupt our primary care physicians. Blue Cross Blue Shield pioneered this in Massachusetts and now other insurers are following and the state government is trying to do it with Medicaid and state employees. So in five years we should have a health care market dominated by global payments, and in that market, if I'm a provider, my incentive is to do fewer procedures and keep people healthy.

Now, you have to do avoid incentivizing denial of care, because a provider could also make more money by doing fewer procedures. You've got to measure quality and reward quality, so that if you hit certain quality targets, you get extra money at the end of the year.

I'm sure we'll be tinkering with this for years to get it right, but it's a fundamental reform that we need to make as a nation.

EIDE: What you say about the need for a more intelligently designed healthcare system make sense, but to go back to pensions, isn't that ultimately a political issue?

OSBORNE: Yes, I agree completely. It's just a math problem. Solving it is not hard, it's just the politics of it. You're taking things away from people, and the other complication is that, in many states, it's unconstitutional to change somebody's pension after you've hired them. It's a legal problem and a political problem.

EIDE: The last thing I wanted to ask you about is K-12 public education. The data and accountability approach has had, in the case of policing, a very significant impact on crime. Public education also adopted a similar data and accountability approach in the early 90s, but I don't think we've seen quite the same truly amazing gain.

OSBORNE: Public education is a big, bureaucratic sector. It tends to change very slowly. The big push for standards and measurement came with No Child Left Behind in 2001, but No Child Left Behind was designed very poorly by people in Congress who don't have a clue how public education really works. The measurements are all absolute measurements, not measures of growth. Here in Massachusetts, we can tell you how this year's sixth grade class did compared to last year's sixth grade class, but that information doesn't help you improve the school because those are two different groups of students. What you really need to know is how much growth did the average student get, and which teachers produced the most growth.

Measuring growth and value added is spreading, but it's not enough. Having information about performance is good, but you need consequences for performance. One of the reasons that CompStat worked so well is that it really affected promotions within police departments. Police officers *live* for promotions. When Bill Bratton did CompStat in New York City, the precinct captains who took it seriously and did a good job got promoted, and the ones who didn't got sent to Staten Island, which was sort of like being sent to the basement.

That's what we're missing in education, except for charter schools. Charter schools, in states that do them right, are really working. Now many states don't do them right, and their failure is that they don't

create consequences. Part of the charter school idea was that you get a charter, which is just a performance contract, to operate your school, for let's say five years. And if your students are not making progress, and your results are not sufficient, then you won't get another charter, and your school will be closed. That is done in some states and not in others. Some states have really fallen down on that challenge. And those states have charter results that are roughly the same as other public schools. But in Massachusetts, in New York, in Louisiana, and in a few other states, they do close failing charters. Every teacher, every staff member at a charter school knows that if their kids are not learning, their jobs are at risk and it makes all the difference. And the results in some of these places are just almost staggering.

The most dramatic example is New Orleans. Because of Katrina, New Orleans has been able to reinvent its system. 85% of the kids last year were in charter schools, next year it'll probably be 90% and pretty soon it'll be 95%. They may keep a few traditional schools, but it's going to be 5 or fewer out of close to 100 schools. After Katrina, the state took over every school that was below average on the state performance scores. That was all but 17 schools in the city. And they gradually reopened them as the population came back, trying to open as many as charter schools as they could. In their first year back, 2006-2007, that spring, 23% of those kids were testing at grade level or above. Last spring, this year, 2013, 57% of those kids tested at grade level or above.

New Orleans is the fastest improving district in Louisiana for sure, and I'm willing to bet it's the fastest improving district in the country. And it's because their schools have autonomy, the principals can hire and fire, and there is accountability. There's full choice for the parents. The parents can pick any public school for their child, and the money follows the child. So if you're not attracting students, you're not attracting money and your school might close. And the state authorizing body, the Board of Elementary and Secondary Education, and its recovery school district, which created these charters, are both very serious about closing charters if they're not working. And they not only close them, they replace them in the same building with a new school run by an operator that has had outstanding results. So every year they're eliminating their worst five or six schools and replacing them with new schools run by their best charter operators. Now that's a formula for success.

In *Reinventing Government*, we said, at the end of the book, let's take these ten emerging principles and apply them to several things. One was health, one was public education, and one was public safety. And in public education, if you apply them, what you get is essentially a system of charter schools, where the district steers but doesn't run schools. It contracts with operators to run schools, and that's what's emerged in New Orleans. Other big cities are moving in that direction such as Detroit, Cleveland, Washington, DC. Many, many are watching New Orleans closely, and I think that's probably the future of public education, at least urban public education in this country. So there is a lot of change in that sector, and that's where we're getting the best results.

EIDE: This has all been fascinating. Thanks for talking with Public Sector Inc.