



serco  
INSTITUTE

# Government Business

When it comes to involving the private sector in public service delivery, opinion differs greatly. So is there such a thing as an inherently governmental function?

June 2010

Gary L Sturgess



## Government Business

Yet again, the US federal government is grappling with the question of what activities are ‘inherently governmental’ – which functions are so intimately connected to public interest that they can be trusted only to government employees? Among other contracting reforms initiated by the Obama Administration, the Office of Management and Budget has been asked to clarify ‘when governmental outsourcing for services is and is not appropriate’. Furthermore, the Department of Homeland Security has ruled that all professional service contracts exceeding \$1 million are to undergo additional review to ensure that they do not include functions that are inherently governmental.

To public officials and public service companies in North America, this is familiar ground. Some have traced the ‘core business’ debate back to the Federalist Papers, where the founding fathers argued what functions would be appropriate for the national government to deliver. The fact that this is still being debated two centuries later suggests that we might not be asking the right question. There are few governments anywhere in the world that do not involve external providers in the delivery of some public services, but how they are engaged differs markedly from one country to another.

The explanations for these differences are complex, but it is evident that cultural and historical influences play a significant part. This is apparent whenever public service companies cross from one country to another, bringing with them their traditional answers to the ‘inherently governmental’ question – such as happened in 2000, when the British security company Group 4 merged with the Danish emergency service provider Falck. Falck provides around sixty percent of Denmark’s fire services and eighty percent of its ambulance services, and has done since the 1920s. In the early 1990s, Group 4 was the first private company in nearly two hundred years to manage a prison in the UK. Sometime after the merger, a senior British executive from Group 4 Falck visited the Danish Ministry of Justice and suggested that they might consider contracting out the management of some of their prisons. He was informed that, in Denmark, prison management was considered the core business of government. He responded: “That’s interesting, because in Britain, we think that fire and emergency services are part of government’s core business.”

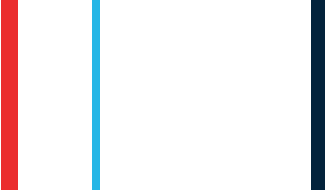
Public-private partnerships are often regarded as quintessentially Anglo-Saxon. However, as we look around the world, there are numerous examples of public service markets, which indicate that British and North American governments are in fact much less comfortable about engaging with the private sector than we might imagine. For example, the French nationalised very little of their water industry in the late 19th century, relying instead on concessionaires that developed over time into the corporate giants Lyonnaise des Eaux and Compagnie Générale des Eaux (the latter company, in turn, generating Canal+, Vivendi and Veolia). While the British did privatise their water industry in the 1990s, they have had to work hard to challenge the market leadership established by the French. To provide another example: years after the Dutch and the Germans have privatised their postal services, the British have recently abandoned a much less ambitious proposal to inject private capital into the Royal Mail. In the English-speaking world, some postal services are still regarded as core business of government. In part, German thinking is affected by the knowledge that, throughout much of the country, postal services were provided by a private company for hundreds of years.

---

*“It is evident that cultural and historical influences play a significant part”*

---

*“That’s interesting, because in Britain, we think that fire and emergency services are part of government’s core business”*



Public services today bear the imprint of past generations. In the US, the postal monopoly has been largely broken by the express companies – the same approach as was adopted in the late 19th century, when Wells Fargo operated a more comprehensive postal network than the US Mail throughout the western states. Political ideology goes some way towards explaining these differences. However, in studying the development of public service markets in different countries, the significance of social and economic factors is striking. Falck's involvement in emergency services arose out of the highly devolved structure of government in Denmark in the 1920s. It was actively assisted by the then socialist government, as it provided a way of modernising ambulance care in local government without provoking opposition to national intervention. While the US has had a protracted debate over the suitability of education vouchers, Australia has operated a partial voucher scheme for many decades. In their case, state funding was provided to the independent sector after the Catholics and Protestants were obliged to reach a compromise on the vexed issue of 'secular' education. That is the same reason why in the Netherlands – usually grouped with the social democratic states of northwest Europe – two-thirds of children attend (publicly-funded) private schools.

---

*“The shape of public service markets will always be strongly influenced by the nature of the service itself”*

The shape of public service markets will always be strongly influenced by the nature of the service itself, so that, even within the same country, we encounter different models being used for different services. In the UK, for example, the prisons market is characterised by a single purchaser and a handful of large private sector providers. The business model is characterised by the management of purpose-built facilities under long-term contracts. The municipal services market, on the other hand, is characterised by multiple buyers and sellers operating within a broad national framework, with suppliers offering a wide variety of different business models. In waste management, for example, there is competition between two delivery models, one based around vertical integration and heavy investment in treatment technologies, the other characterised by horizontal integration, bringing together waste collection and neighbourhood environmental services. In the emerging market for homecare, where beneficiaries are being empowered to select their own providers, a highly fragmented market is emerging, dominated by third sector providers and, to a much greater extent, by individual carers. And yet when we look at the same public services across a number of different countries, we find remarkable differences – further evidence that historical and cultural factors have a major part to play.

---

*“What works well in one country, sector or time period may not work well in another”*

While some market designs and some business models are more effective than others, there is no simple way of evaluating them from a purely theoretical point of view. What works well in one country, sector or time period may not work well in another. In some cases, public-private joint ventures are being driven by political considerations – not always the best of drivers. Conversely, at the same time, the very same vehicles are being employed for good commercial reasons.

Models based on competitive tendering and contracting may be well suited to a time when centrally-planned, monopolistic delivery models are first being broken up and private sector capacity is still being developed. However, they may not have a long-term future, as citizens demand that services are responsible to them directly. On the other hand, for services that are more public in nature – defence and prisons being the obvious examples – procurement models will prevail indefinitely.



---

*“The globalisation of public service markets will challenge traditional concepts of what is ‘inherently governmental’”*

We can be reasonably confident that the globalisation of the public services sector will continue, and one of the inevitable consequences of this will be the importation of market and service models across national borders. European countries are unlikely to adopt ‘health maintenance organisations’ (HMOs) after the North American experience in the 1980s where patients complained that cost control was too restrictive. However, as coordinated care is introduced for the chronically ill, it is likely that Americans will play a major role in developing new business models, influenced by the HMOs. For the same reason, the first round of contracts for purpose-built elective care treatment centres in the UK in 2003 went to American and South African firms. It was not until the second round, when British providers had shifted from their historical spot-contracting model, that they captured market share. This is also why, in exploring new models for the hospitals sector, the UK is looking to Sweden, and in developing PPP toll roads, the United States is looking to Australia.

The globalisation of public service markets will challenge traditional concepts of what is ‘inherently governmental’. There is no simple solution as to what rule-of-thumb should guide us in its place. As Peter Drucker pointed out in his 1994 paper on the ‘theory of the business’ the ability to adapt and change is vital. “The theory of the business has to be tested constantly. It is not graven on tablets of stone. It is a hypothesis. And it is a hypothesis about things that are in constant flux – society, markets, customers, technology. Some theories of the business are so powerful that they last for a long time. But ... eventually every theory of the business becomes obsolete and then invalid.”

## Primary healthcare

In thinking about the differences in market models for public services, consider how different countries handle choice of General Practitioner. In the United Kingdom, choice is now theoretically available, but the fact that the vast majority of doctors are contracted to the NHS, combined with the legacy of a cumbersome zoning system, means that there is actually very little choice – except for those who are prepared to pay for private healthcare.

In principle, Canadians have unlimited choice; in practice, a shortage of doctors has led to them operating closed lists, and even deselecting excess patients. Service is free at the point of delivery.

Australians benefit from a national health insurance system, but they have choice of doctor by virtue of a voucher which covers most of the basic medical costs. In France there was, until recently, unlimited choice; since 2004 they have been required to nominate a primary care physician, although they can go elsewhere if they are prepared to pay more.

Perhaps unsurprisingly, the less regulated market in North America has resulted in greater diversity. While patients retain ultimate freedom of choice, in practice, health insurance funds may restrict the choice of provider to a pool of approved physicians.

