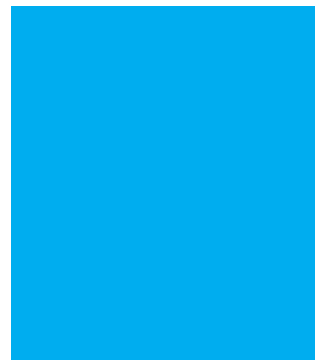
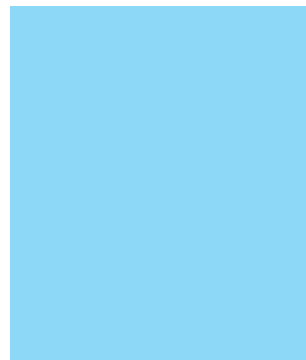
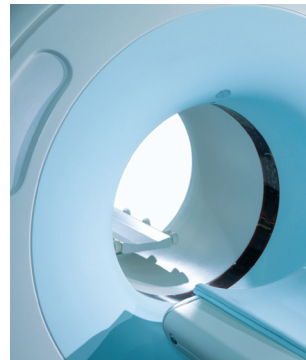
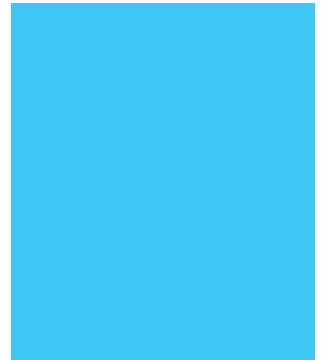
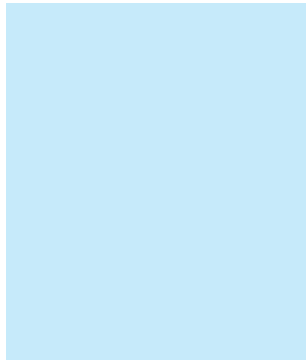


McKinsey Center for Government

Government Designed for New Times



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In a fraught world, policy makers cannot allow partisan divides to get in the way of crucial reforms. By drawing on successful strategies employed elsewhere and adapting to current needs, governments can—and must—do better.

Rarely has the need for effective government been greater than now—and rarely has the ability to produce it been more constrained. After the recent wave of storms and disasters—both natural and financial—the need for leadership and a concerted response from national capitals is acute. Adding to the pressure, many governments are managing the implications of an unprecedented degree of fiscal and monetary intervention. They are preoccupied with the urgent tasks of getting banks to lend again and demonstrating fiscal credentials to the bond markets. The crisis mode of the past few years endures in several countries, while in others there is no more than cautious optimism.

Leaders must confront long-term, fundamental questions too: from the size and role of the state to how best to stimulate growth; from profound and surging demographic imbalances to tackling growing unemployment and welfare bills; from deciding on the extent and nature of regulation necessary to protect the public to forging a new relationship between citizens and government services. Thus, many governments confront a daunting paradox: an expanded set of major

policy imperatives in a constrained and almost precarious fiscal position.

On these subjects, however, there is little agreement. The policy debate is becoming more polarized at arguably the worst possible time. There is a real risk that in the face of big choices and much disagreement, paralysis reigns. Leaders thus spend their energy on policy fights and battles for the hearts and minds of the public—at the expense of making progress.

It is in times like these that government matters most.

Our research shows it is possible to make huge strides in addressing critical challenges, even without resolution of the many ideological and policy dilemmas. From government spending to tax collection, education improvement to health outcomes, and welfare reform to job creation, we see the potential for meaningful improvement, to do more and better with less. What is needed is government management by design, built to fit these difficult times: government that identifies the most critical, solvable problems, reorganizes

where necessary to deliver the right solutions, and abandons the tools and approaches that no longer work.

In this effort, governments can draw heavily on the mission-driven mind-set of employees—a real comparative advantage for the public sector over the private sector. Too often leaders insufficiently tap into this valuable asset. And leaders can do far more to mine information on what is working elsewhere. International peers, often trying to solve exactly the same problems, provide invaluable road maps and lessons. Unlike the private sector, where companies spend millions of dollars trying to understand secret competitor strategies and replicate them, the public sector is an open environment, and thereby easier to mine for successful practices and lessons learned.

Government by design

Political leaders rarely campaign for office on a platform of government effectiveness. For some, it fails to capture their imagination or, they suspect, the imagination of voters. For others, tackling the bureaucracy is perceived as high risk and low reward compared with passing new laws in the legislature. Yet few succeed without achieving some reform. Many departing presidents, prime ministers, and cabinet secretaries reflect on how the engine of government itself was at the very heart of their successes or failures.

What it takes

To truly transform government requires fresh thinking and a substantial investment of both resources and political capital: business-as-usual or modest or occasional improvement is inadequate. Those that have achieved sustainable and significantly higher levels of government performance did so by explicitly designing and executing multiyear reforms that push beyond everyday initiatives designed to improve management capability. In our research, we identify 40 such programs that have been enacted around the world in the past two decades. There

were a number of objectives these programs were designed to achieve: significant fiscal consolidation, better outcomes across multiple public services, and economic growth.

Analyzing these programs and interviewing the leaders involved reveals a valuable set of lessons for other government leaders facing major challenges. The first is being clear and ambitious about what the government is trying to achieve. Many transformations achieved what appeared to be impossible targets. Sweden, for example, moved from an 11 percent deficit to a fiscal surplus in the 1990s, having been close to default and an International Monetary Fund (IMF) bailout. A second lesson is the need to make big—not incremental—shifts in the amount of time, energy, and resources required. On average, the programs in our sample lasted for six years, with a staff of 1,300 involved in each.

Fit for purpose

Beyond this clear focus and investment of time and resources, government by design also means investing in those capabilities needed for success. Some of these are common and enduring across the public, private, and nonprofit sectors, such as employing best practices in technology and operations, organization and human resources, and budgeting and finance, as well as operating across geographic and stakeholder boundaries and making use of large data sets for better performance and policy. Other capabilities will be specific to the government sector, including risk management in regulation and client differentiation for welfare-to-work interventions.

Increasingly, the intense pressure for reform, combined with a new operating environment, makes innovation a critical capability. In many areas, government agencies around the world are reimagining how services are delivered (for example, through one-stop shops and e-portals) by providing greater data availability and through mobile services that allow citizens to get instant help and support. They are also migrating to a

new paradigm where nonstate actors—private companies, nonprofits, and citizens themselves—play an increasingly important role in designing and executing policies and services.

Finding answers to the solvable management questions

Governments that are willing to reform and build these crucial capabilities are better able to achieve major breakthroughs in the most fundamental policy areas, even in the absence of new policy or legislation.

Fiscal management

Take fiscal management, arguably the most daunting of all issues today. According to the IMF, most governments in countries that are members of the Organisation for Economic Co-operation and Development (OECD) need to improve their deficits by 4 percent or more of GDP to achieve long-term debt targets.¹ Of course much of this involves policy debate. Entitlement reform, public-spending reductions, and increased taxation are highly charged political issues. However, operational reforms designed to improve efficiency can make a meaningful difference now and set the stage for more successful policy implementation over time. In particular, spending reviews undertaken agency by agency—even if initially focused only on noncore functions such as technology, procurement, or travel—can yield meaningful savings that will increase credibility and flexibility as fiscal constraints increase. Similarly, improved tax collection, drawing on international best practices, can produce real revenue growth within the existing tax structure.

Spending reviews. A number of governments are taking a more strategic and evidence-based approach to achieving fiscal sustainability by launching multiyear spending reviews. These

reviews help to establish priorities and clear paths to deficit reduction. Almost without exception, the spending reviews uncover huge opportunities for improving effectiveness, decreasing costs, and increasing revenue by improving the efficiency of administrative, noncore activities. To size the prize, consider that our global benchmarking research indicates that operational expenditures represent 35 to 40 percent of total government expenditure; on average, 19 percent of GDP for OECD countries. Within that operational expenditure, roughly a third is spent on overhead functions, representing 6 to 7 percent of GDP in OECD countries.

To date, we have reviewed ten countries that have conducted such spending reviews during the past five years and discovered that there is currently little standardization in approach. Several governments have imposed top-down spending cuts, from the center to agencies, while others have developed a bottom-up understanding of the potential savings opportunities. Of those using a bottom-up approach, New Zealand and Denmark have used clear baselines and intragovernment or external benchmarks to estimate the savings potential—even though this is clearly an opportunity to drive success.

Drawing on benchmarks from different governments, we estimate a potential to save 5 to 10 percent of operational costs through overhead categories without compromising core programs. This represents a savings in the range of 0.3 to 0.7 percent of GDP—some 10 percent of the adjustment that countries are required to make in order to achieve their long-term debt targets. This is a significant contribution, given that it requires no compromise on core programs, no reduction in social programs, and no additional costs to taxpayers. And it ultimately sets the stage for better policy implementation in the future.

Tax collection. Meanwhile, as governments grapple with increasing social obligations and projected declines in the relative size of labor workforces, tax administrations are under even

¹ International Monetary Fund Fiscal Monitor, April 2011.

more pressure to collect every dollar of tax payable. They need to ensure that every dollar they spend collecting taxes yields the maximum benefit for citizens. Tax administrations also have broader significance: the interface and effectiveness of a tax administration often becomes a watermark of public confidence in a government.

In this quest, tax administrations can learn a great deal from one another. But our in-depth research at federal tax administrations in 15 OECD countries uncovered wide variability not only in the performance of tax authorities across countries but also within countries across different functions—submissions processing, examinations, collections, and taxpayer service.

We estimate that, in aggregate, the tax administrations in our study can collect an additional \$86 billion in direct tax revenues if they adopt the practices of the top third. Four major design elements stand out as avenues for achieving improvements: proactive demand management that smooths tax collection across the year and avoids the end-of-year bottleneck, sophisticated taxpayer segmentation to prioritize which taxpayers to target with which approaches, streamlined operations, and rigorous performance tracking. And these savings apply only to direct taxes.

Balance-sheet management. Beyond undertaking spending reviews and improving tax collection to manage the operating budget, governments have a major opportunity to take an end-to-end capital-management approach to their balance sheets at both the agency and government-wide level to improve fiscal health. This includes identifying and measuring material risks, incorporating the knowledge of risk into operations, and ensuring the integrity of the internal assessments over time. Even simple approaches to changing the inflow of accounts receivable or outflow of accounts payable can yield meaningful improvements.

Jobs

Along with fiscal management, unemployment dominates the landscape across most of the OECD. Here, too, exist fundamental differences in ideology and vision on how to solve rising unemployment risk stasis. Stimulus programs and other legislative actions to increase growth and create jobs may or may not get through legislatures, but other government interventions to improve demand, supply, and the matching of skills to jobs can significantly improve the jobs picture.

Many governments are now adapting vocational education to better fit employment prospects, for example, by involving employers more closely in both its design and delivery. Employment agencies are doing a better job of matching supply and demand by improving their market information and by producing more comprehensive, specific, and up-to-date data on vacancies, job seekers, and required qualifications. They are also segmenting the job-seeker population to better understand which segments can be processed in quick and automated ways and which merit deeper intervention and support.

Regulation and enforcement

After a series of catastrophic events, government bodies that protect the public—such as industry regulators, law enforcement, and disaster-preparedness agencies—are being more closely scrutinized with regard to their actions, their impact, and their overall effectiveness. But they are not necessarily receiving larger budgets. In stark terms, society is asking whether regulators are most effectively anticipating the next threat and protecting the public. As with unemployment, the policy debate on this issue can become quickly polarized around the trade-off between more protection for the public and consumers and the potentially negative impact of more aggressive regulation for economic growth.

Agencies can make great progress by focusing on optimal resource allocation and redesigning

how they organize and plan. They can place more emphasis on outcome-based regulation and on predicting, preparing for, and mitigating “tail risk.” The most significant assaults on the public’s sense of safety and security have come from events that previously seemed unlikely. Tail events are difficult to predict because they often require multiple things to go wrong. Examples include the attacks of September 11. Hurricane Katrina’s damage to the New Orleans levees, the financial crisis of 2008–09, and the recent earthquake and tsunami in Japan and the nuclear-power-plant meltdown that followed. But better risk-based systems can improve governments’ ability to prevent and respond to such events.

Core public services

In fact, across core public services—in areas such as infrastructure, education, health care, and policing—government by design can also enhance outcomes and manage costs. In these areas, the political discourse is often dominated by significant and legitimate ideological differences. Despite that, governments that focus on what really works operationally in driving outcomes can reap gains. Governments that systematically embrace the latest proven project-management approaches and tools can dramatically improve the value of infrastructure investments, at the same time reducing errors and time to completion.

In education, for example, school systems can learn from peers at a similar stage of evolution

or performance about the right levers to use for improvement—be it better use of pupil data, revision of standards and curricula, or a deeper professionalization of teaching careers. Likewise, the escalation of health care costs across all systems is provoking significant political debate. Yet the best systems are already beginning to make progress in health care productivity through a number of steps, such as the prediction of patients most at risk and the adoption of subsequent prevention strategies, delivery of care at home and in capital-light settings rather than in hospitals, and technology innovations to boost clinician effectiveness and efficiency. Government services can and should build on examples of success around the world.

There is a real prize for governments that can make progress even as the policy and fiscal environments threaten to thwart action. But to win, governments must adapt to fit the challenges of today, in part by applying best practices from around the world.

In challenging times, the government we need is rarely the government we inherit. Instead, government must be deliberately designed and managed to make progress on solvable problems.

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