



The case for government reform now

The expanded role of governments means that taxpayers will pay more for public services—and will demand more in return. To meet these expectations, the public sector must transform itself.

François Bouvard, Thomas Dohrmann, and Nick Lovegrove

Long before governments around the world faced the current economic crisis, they wrestled with many difficult, complex challenges—health care, social security, education, national security, crime, and critical infrastructure. The demands on public services were growing, along with the burden on taxpayers, and there was no long-term certainty about how to pay the bill. Several countries ran large budget deficits, raising already high levels of public debt.

In recent months, the pressures on governments have multiplied further as a result of a potent cocktail of interlocking emergencies—the financial and economic crises, major shifts in energy prices, climate change, food supplies, and natural resources. The combined effects threaten economic and social breakdown as consumers suffer and unemployment and poverty rise. Even the viability of capitalism has been questioned.

François Bouvard is a director in McKinsey's Paris office; and

Thomas Dohrmann is a principal in the Washington, DC, office, where **Nick Lovegrove** is a director.

Whatever the public sector's role has been in creating these crises, few doubt that it has a critical role in resolving them. Governments are not only intervening to an unprecedented degree in private markets—to rescue or reinforce banks, insurance companies, and automobile manufacturers, among others—but also accumulating financial

covenants that threaten their long-term solvency in the process. Indeed, at a time when they have limited political, social, and financial room for maneuver, they are taking on a whole range of tasks beyond the scope of traditional policy and public services.

So now more than ever, governments must discharge their functions efficiently and effectively. But few of them have an established track record or reputation for managerial excellence. Indeed, their historical performance running departments and agencies often arouses skepticism. Many public officials, knowing this, seek to reform the way government works.

In our experience, these reforms typically fall short: with few exceptions, they skim the surface, cover too little ground, take too long, and leave much of the public sector relatively untouched. That's why we see a need for broader, deeper, and faster reform: what we call whole-government transformation. The current crisis provides both the necessity and the chance to improve the machinery of the state fundamentally—a challenge of vast scale and urgency.

There are relatively few instances of governments taking an integrated approach to reform, but those few illustrate the scale of the opportunity, especially for raising productivity. Under the prime ministership of Göran Persson, for instance, Sweden's government responded to its mid-1990s budget crisis by shaving 11 percent from operational budgets, with no apparent damage to performance, and then maintained tight control over future spending.¹ In 2004, Tony Blair announced the “Gershon targets”—led by Peter Gershon, then head of the Office of Government Commerce—which generated £26.5 billion a year in improved efficiencies. In November 2008, the UK government announced plans to save an additional £35 billion a year (see sidebar “Case study: Public-sector reform in the United Kingdom”). Similarly, the integrated transformation program of Nicolas Sarkozy's government in France aims to cut costs by €7.7 billion as of 2012 (see sidebar “Case study: Undertaking reform in France”). It's important to note that the adoption and implementation of these efficiency targets have gone hand in hand with reforms focused on significant improvements in outcomes, such as higher test scores in schools and reduced waiting times in hospitals.

The size of the prize from government reform is so large that it more than justifies the enormous effort required. If the US government could achieve the 15 percent or more productivity improvement we typically expect from a major private-sector change program, for instance, the savings to taxpayers would exceed \$134 billion annually (more than \$445 per citizen) on 2010 federal addressable spending of approximately \$900 billion.

¹ See Alastair Levy and Nick Lovegrove, “Reforming the public sector in a crisis: An interview with Sweden's former prime minister,” mckinseyquarterly.com, June 2009.

The right time for government reform

Some people argue that governments have more than enough to do addressing the current crisis and can't afford to divert time and attention to seemingly less pressing matters like a whole-government transformation.

Nor can such a transformation be undertaken lightly. Tony Blair famously said that "I bear the scars" from one particularly grueling round of reform. Change, never easy in any large institution, always seems harder in government, whose scale and complexity are daunting. So too is the challenge of initiating reform under the close scrutiny of the public, the press, and the legislature.

It's tempting to postpone the reform of government until the crisis is resolved. Yet that would be a mistake. The crisis is actually the right time to undertake far-reaching changes.

It's a necessity

Reform is now a necessity, not a choice. As governments assume a broader, more significant role in response to the crisis, it becomes ever more important that they should be efficient and effective—otherwise, they would compound the severity of the problems. This crisis is the public sector's ultimate test.

Yet few governments are equipped to meet it, either as a whole or at the level of individual departments and agencies. Too often, we find, the fragmented silos of governments work at cross purposes. Political appointees and civil servants have different goals and mind-sets. Confidence and tolerance for risk are low. There is little willingness to question historic practices and orthodoxies or to create a performance culture focusing on quality, costs, and access. Addressing these shortcomings in the middle of a crisis might seem like trying to fix an airplane in flight—but sometimes that's needed to land it safely.

The fiscal imperative

Before the crisis, many governments were already spending well beyond their means to meet current obligations (exhibit). Aging populations and the consequent pressures on health care, social security, and pension systems were sure to compound rising budget deficits and debt service burdens. Clearly, the crisis will reduce tax revenues for the foreseeable future and require most governments to invest extraordinary amounts of money to rescue failing institutions—even whole industries—restart the flow of credit, and stimulate demand.

How will governments restore something like a long-term equilibrium to their finances? They could do so by increasing taxes—which

would be unpopular with taxpayers and at least a short-term drag on economic growth—or by reducing transfer payments or other spending programs. Tax increases and budget cuts may be unavoidable in the coming years, but governments could minimize them by concentrating on raising efficiency and effectiveness, so that public spending yields the maximum benefit. In fact, improving the performance of government, though perhaps the most challenging of all available levers to implement, may be the most feasible politically. The improvement must take place across the board: uncoordinated, incremental initiatives couldn't possibly reduce the public sector's financial burden enough to meet the challenge.

The public's expectations and demands

Governments struggle to reconcile the desire for better public services with a reluctance to pay for them, and there was much dissatisfaction with their quality even in happier economic times. The increased role governments now play as a result of the crisis means that taxpayers

Case study: Public-sector reform in the United Kingdom

**Nina Bhatia and
Alastair Levy**

Public-sector reform has been at the heart of the UK government's agenda since 1997 as a concerted wave of reforms significantly changed the way the whole sector works. Governments around the world are seeking to learn from this experience.

The country's tradition of public-sector reform dates back to the 19th century, and such reforms have been a focus for successive governments over the past 30 years. The priority of the Conservatives, from 1979 to 1997, was privatization, refining the state's role, and introducing a more managerial culture to government. The focus on reform was renewed in 1997 with the electoral success of the Labour Party, which had put the quality of public services (in particular, schools and hospitals) at the heart of its campaign. This initial focus on the effectiveness of specific public services then expanded into a broader, more integrated reform strategy. Since 1997, the reform agenda—underpinned by an integrated approach to budgeting, targets, and performance management—has had five principal elements.

1. At the core of the agenda is a set of published Public Service Agreements (PSAs): performance contracts, between ministries and the center of government, following a review of each department's policy objectives and budgets.

2. The focus of the PSAs on the effectiveness of public services has been complemented by efficiency targets. In 2003–04, the government commissioned an independent efficiency review, chaired by Sir Peter Gershon, a former industry leader and head of the government procurement function. The review (like its successor, which reported in April 2009) gave each department well-publicized efficiency targets.

3. The United Kingdom's government is one of the most centralized among major developed countries. A number of reforms since 1997 have aimed to disperse power to regions and local areas. In health care, for example, 152 local payer functions across England now set local priorities and allocate funding. High-performing providers have won greater autonomy.

Nina Bhatia is a principal in McKinsey's London office, where **Alastair Levy** is a consultant.

will pay more for public services—now or later—and will expect and demand more in return.

Opportunity for reform

The idea that “a crisis is too good an opportunity to waste” is becoming commonplace. Businesses around the world are seizing this opportunity to rethink their operating assumptions and even reinvent themselves, often radically. Governments must do the same. The crisis may well mark what Professor Richard Rumelt calls a “structural break from the past—a moment when many of the critical assumptions that have driven our previous behavior and attitudes no longer seem correct or appropriate.”² It may also force the long-overdue clarification of the roles of the private and public sectors in a modern economy. For these and other reasons, we now have a once-in-a-generation opportunity to achieve a whole-government transformation.

²Richard P. Rumelt, “Strategy in a ‘structural break,’” *mckinseyquarterly.com*, December 2008.

4. A series of initiatives have focused on improving skills in the public sector.

One program established the core competencies required of senior civil servants—including skills in general management and the operational delivery of services, in addition to traditional skills in formulating policy. Since 2005, the strengths of each government department have been assessed through a centrally led capability review.

5. In a number of areas of government, attempts have been made to give citizens greater influence over public services.

Parents and patients, for example, have greater choice over which schools their children attend and which hospitals they go to, respectively. In each case, more data are available online to support these decisions.

Since 1997, government reform has enjoyed visible leadership from senior politicians and civil servants. Prime ministers Tony Blair and Gordon Brown have invested significant political capital in the effort. Especially in the initial years, centrally set targets played a significant

role in prioritizing reform initiatives and shaping the debate on progress in delivering them. This approach was controversial; critics argued that it risked skewing resources to activities intended to meet targets rather than provide better outcomes. In response, a smaller number of outcome-focused targets now promote innovation by local agencies. Stronger resources for leading the reform effort were also created (in 2001) at the center of government: the Prime Minister’s Delivery Unit, 30 to 40 people who report to the prime minister on the most important reforms and play a hands-on role in helping to improve frontline delivery.

The United Kingdom’s public-sector reform still has far to go and faces new challenges as a result of the economic crisis. But the country’s experience so far highlights many choices that governments elsewhere will need to address.

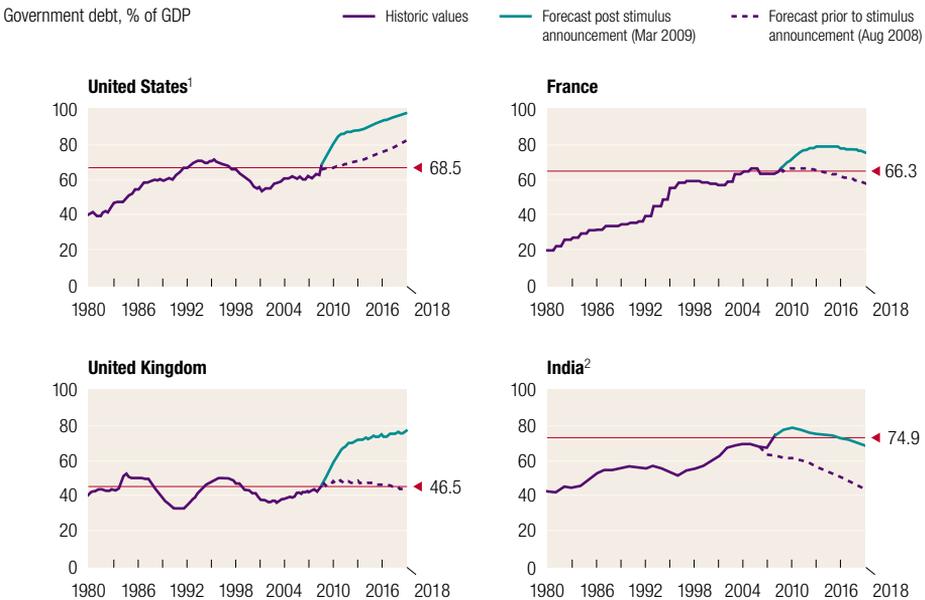
Raising the government's game

The reform agenda will differ from country to country, but there should be important points in common. First, most governments will need to broaden their approach to reform: a dispersed, sporadic one—a single department or agency at a time—can't achieve the level of change now required. Few governments have ever adopted an integrated reform program, but most will have no choice.

Such programs should reach most if not all departments and agencies. No doubt it makes sense to focus on the largest parts of the public sector—critical, high-cost services like health care, education, and defense. Nonetheless, small and little-known corners of government can yield significant breakthroughs and serve as pioneers or pilots. A broad approach to reform is also very useful to share the burdens and expectations it creates, to emphasize the shared pain and gain, to generate greater peer pressure, and to reveal the comparative performance of different parts of the public sector. A deeper approach to reform will also be needed. Most reform programs in the past didn't reach down into the inner core of governments, which will now have to make fundamental changes in the way thousands—in some cases, millions—of their employees work.

Exhibit

Government debt continues to rise



¹Represents total debt, including debt on government accounts that the United States owes to itself.

²Includes federal- and state-level public debt.

Source: Oxford Economics (Aug 2008 and Mar 2009 baselines)

Interaction and coordination among departments and agencies at the local, national, and international levels is important too. Since the silos characterizing government organizations make effective cooperation across their boundaries especially difficult, this must be a critical element of reform.

Performance management

In recent years, a number of governments have strengthened the way individual departments and agencies deliver their services and manage performance. But as we often see in the private sector, it's necessary to go further by establishing a true performance-management regime and culture across every unit. The essential elements include goals focused on outcomes, an integrated way of allocating the right quantity and quality of resources for each objective, clear accountability across agencies, accurate and consistent measurements of progress, and benchmarking against best practice. Intervention to address emerging shortfalls and tangible consequences for success and failure are important as well. The UK government, with its Public Service Agreements for each department, supported by the Prime Minister's Delivery Unit at the center, has implemented many elements of that approach. The French government is taking a similarly tough-minded one.

Citizen-focused public services

Although some people take offense when governments adopt the language of business—for instance, by referring to citizens as customers—citizens in many countries clearly do want to be treated as valued customers of the public services they pay for through taxes. Pioneering governments have captured this idea's power by redesigning key public services around the people who use them, transforming their effectiveness and, sometimes, their efficiency. Service Canada, for instance, has merged more than 70 services from a number of agencies into a unified customer service organization that groups its offerings around the needs of citizens. In the process, it has saved more than CN \$400 million a year through increased efficiency and accuracy.

Talent management

Most government departments and agencies are people businesses that depend on the quality and capabilities of their talent. Yet many governments already have a talent deficit, notably for frontline roles such as doctors and teachers. They also face an impending demographic time bomb of retirements that threatens to widen the deficit and undermine their institutional memory.

Several governments are therefore rediscovering the lost art of managing talent, to attract the “best and the brightest” and give these future leaders the managerial tools and methodologies they need to

perform at the highest level. The United Kingdom's Professional Skills for Government program, for instance, has substantially upgraded the managerial training of senior civil servants. Niche enterprises such as Teach for America (in the United States) and Teach First (in the United Kingdom) have shown how the public sector can work with social entrepreneurs to attract distinctive talent.

The challenge is great: governments face an urgent need—but also a great opportunity—to modernize their approach to managing talent. For starters, they must rethink their employee value proposition—the reason a talented person would want to work for them—identify and implement incentives to encourage superior performance and penalize underperformance, and establish productive, collaborative relationships with public-sector unions. The forthcoming increased rates of retirement should be used as an opportunity to renew the

Case study: Undertaking reform in France

François Bouvard, Eric Labaye, and Karim Tadjeddine

In France, as in many European countries, controlling public-sector finances has become an imperative. The country's government debt ratio has reached 68 percent of GDP, and the trend in public spending is clearly upward.

Nicolas Sarkozy, who made this a key issue in his presidential campaign, offered a symbolic commitment not to replace one out of two retiring civil servants. After taking office, in 2007, President Sarkozy worked with Prime Minister François Fillon to develop and implement a global reform program, la Révision générale des politiques publiques (RGPP), to achieve structural reductions in public expenditures. The program has other goals too: modernizing the state's organization, improving services for citizens and companies, ensuring that civil servants receive greater recognition for their work, and promoting a culture of results. Overall, the objective, as the prime minister has said, is to "do better with less."

The program's expected €7.7 billion impact is to be captured by 2012—a target set before the world financial crisis began, so it

doesn't address the further increase in public debt required by government rescue plans. Nonetheless, the program, comprising 370 initiatives selected after a spending review in each government department identified money-saving and efficiency opportunities, is an example of what we mean by a whole-government transformation. All of the initiatives were launched simultaneously. A wide-ranging government reorganization is implied by some of them, such as the creation of cross-departmental shared services, including the management of real estate, human resources, and pensions. Other initiatives (for instance, the implementation of a new, performance-based university funding system) have critical goals and still others (such as the acceleration of the naturalization process) symbolic ones. The reform effort pulls varied improvement levers, including lean-operations techniques, information technology, and performance management.

Each ministry had to buy into the program—a key step early on. Empowered ministers, put in charge of developing action plans, set their own

François Bouvard and **Eric Labaye** are directors and **Karim Tadjeddine** is a consultant in McKinsey's Paris office.

talent pool and establish new working models with less built-in overstaffing and redundancy.

Lean operations

Governments are starting to recognize that much of what they do is configured around large, complex service operations, often labor intensive and essentially static. Lean-operations techniques are improving the efficiency and effectiveness of some parts of the public sector—defense logistics, hospital waiting times, tax and immigration assessment processes, and even policy development, for example. The results frequently exceed expectations: one tax authority, for instance, processed 75 percent more returns while cutting assessment errors by 40 percent and processing lead times by 80 percent. As the pressures to deliver more with less grow, governments will need to deepen and intensify their use of lean techniques to transform service operations.

efficiency and service-level targets, and every minister's budget incorporated financial and productivity gains. To ensure strong, consistent, and high-visibility governance, a supervisory committee is led by the budget minister and the chiefs of staff of the president and prime minister. The committee has a formal progress meeting with each minister every three months. To encourage transparency, the government put measurement at the heart of its approach. The budget minister reports on each department's progress every quarter. (Citizens can stay up-to-date by visiting rgpp.modernisation.gouv.fr.) This kind of communication raises the odds that all ministries will focus on the reforms until they are implemented.

The French transformation journey has just begun and it will probably take until 2012 to capture the full benefit. Several big challenges remain. For one, the reforms focus on administrative structures and processes and have yet to achieve visible improvements for citizens and civil servants. Demonstrating the reality of change—even on a small scale, such as reducing wait times for emergency treatment

in hospitals—is critical to the success of reform programs.

Second, human-resources practices should get particular attention. Civil servants must be helped to acquire new operational skills that will allow them to implement the reform program successfully. Departments must make sure they have the right people in the right positions. That means more coordination between ministries and greater flexibility to move people from one position to another, depending on needs.

Third, the first round of reforms successfully addressed the ministries' running costs, but the effort must be expanded to cover all public spending. The government has already decided to broaden the modernization effort to 650 other state agencies. Covering the entire public-sector spending base is probably a five- to ten-year challenge.

Spending on external goods and services will have to be managed more carefully as well. These expenditures are rising significantly, yet few governments have modernized and professionalized their procurement and contracting. For many of them, now forced to stanch the outflow of funds, this is an immediate priority. Addressing it will not only ensure that governments get better value for money but also make their suppliers more productive.

Information systems

Most governments recognize information technology's increasingly prominent role and are committed to large, ambitious IT-development programs. Several tax authorities and social-security administrations that conduct much of their business online, for instance, have dramatically improved their efficiency and service quality. But large-scale public-sector IT programs have run into costly and embarrassing difficulties—notably in important areas, such as electronic medical records.

Perhaps that's why governments tend to adopt new technology more slowly than the private sector does—indeed, more slowly than citizens in their homes do. It's hard to believe that the public sector can meet its current and future challenges if the technology gap persists. But to address it, governments must learn to manage large IT programs in a timely and cost-effective way.

Why government reform is hard

Alastair Levy

Despite good intentions, many government reform programs are too slow, take too long, and achieve too little. Some of the barriers to success result from the inherent differences between the public and private sectors. Government's sheer scale and the need to integrate reform across several tiers of agencies and departments, for example, create a unique level of complexity. Effective decision making is complicated by the need to balance political and managerial priorities and to operate under the gaze of the public, the legislature, and the media.

Other barriers, arguably more of the public sector's own making, could be ameliorated if successful reform leaders focused on them by building capabilities and challenging inherited ways of working. There are five such barriers.

Alastair Levy is a consultant in McKinsey's London office.

1. The slow pace of reform often results directly from an ineffective approach to change management.

The leadership may not be sufficiently urgent and intense. Frequently, the objectives of reform and accountability for making it happen are unclear, and the management of reform programs is weak. What's more, governments tend to ignore the possibility of building momentum through early wins and lack a developed performance culture. McKinsey's private-sector experience shows the importance of these dimensions of change.

2. Reform programs often lack the stretching, sustained ambition that transformational change requires.

Typically, governments must raise their efficiency and effectiveness by 15 to 20 percent rather than the 2 to 3 percent they often aim for. Organizations can achieve a real break from the past only by challenging existing parameters—structure, size, capabilities, or processes.

Leading reform in a crisis

Government reform can and should be seen as a direct response to the economic crisis, not a distraction from it. In fact, it provides a powerful context for accelerating the pace.

Even so, there are complications. Government reform programs have a mixed track record, partly reflecting the fact that the public sector is larger and more complex than even the biggest commercial businesses. The ambiguous results also reflect the specific challenges facing governments—relatively limited capabilities and an ossified organizational culture, as well as strong political pressures that make it harder for government leaders to focus on the long-term transformation and make the tough choices it requires (see sidebar “Why government reform is hard”).

Government reform faces another challenge too: this may not be the best time to raise productivity by cutting public employment substantially. With rising joblessness in many countries, there will be a natural desire to keep government payrolls high, even at the risk of delaying efficiency improvements.

3. Public-sector leaders often lack the strong centers that their most successful business counterparts use to drive change through the organization. The scale of government and the legal separation of powers (for instance, among national, state, and local governments) mean that centrally controlled approaches to change can go only so far. This complexity, though, increases the need for sophisticated functions at the center of government and of major departments in order to set strategic priorities, allocate resources, manage performance, assess risk, and instill momentum for change across departments and agencies.

4. Governments are often awash with data but ill-equipped to use them in decision making. That makes it much harder for reform leaders to exercise the core functions of making and communicating effective decisions, whether about alternative models of service delivery or the allocation of scarce financial or human resources. The results of these shortcomings often include misspent resources, the loss of valuable time, and an inability to justify proposed reforms.

5. Not enough is done to engage public-sector employees. Transformational change requires a sustained and systematic effort to solicit the support, harness the expertise, and stimulate the creativity of the frontline administrative staff and of professionals such as doctors, nurses, teachers, and police officers. Government leaders—political or executive—can’t delegate this responsibility or allow it to become diluted as change gets under way.

Leading from the front

Especially in a crisis, it's essential that government reformers lead from the front. Transformational-change efforts are short of leadership capacity, money, and management talent. Only leaders can ensure that among the myriad demands the economic crisis has spawned, government reform gets its due.

Equally, only leaders can inspire the public sector's workforce to undertake difficult, sometimes painful reforms. These employees are typically motivated much less by financial incentives than by a sense of mission and peer pressure. To create the required momentum and support for change, government leaders must relentlessly engage with agency managers, civil servants, frontline staff, and professionals. And that's not all—the leaders must also educate consumers of public-sector services and the citizen body as a whole about the need for reform and for tough decisions on priorities. A well-informed public that demands better services will create pressure for change.

Not least important, change will happen only if government leaders develop and communicate reform strategies that identify the public sector's shape in ten or more years and show how to get there. These strategies will have to reflect trade-offs between what must be done to address urgent short-term needs, on the one hand, and to lay the foundations for a long-term transformation, on the other. A sustained drive to bring about rapid, tangible change must then follow.

Embedding successful reform

All too often, public- and private-sector reform programs alike make early progress but lose their initial energy and sense of purpose—often, when external conditions change. To make reforms endure, it will be necessary to weave them into the warp and weft of government.

Political leaders alone can't provide the intense focus and unyielding persistence required to drive a reform program. They typically need help from the kind of small, high-caliber team that business leaders appoint to steer key initiatives. Both France and the United Kingdom, for example, have relied heavily on high-quality “delivery units,” which can be indispensable in propelling large-scale, far-reaching, and enduring transformations.

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What’s more, the momentum of change is more likely to be sustained if it’s reinforced in tangible ways—in meaningful commitments to the public and the public-sector workforce and by the hard-wiring of reform objectives into budgets. Clear quantitative performance metrics and milestones are important too, so several governments (including those of New Zealand, the United Kingdom, and the US state of Virginia) have developed and applied detailed ones, which have helped them assess and communicate their progress in areas such as reducing crime and hospital waiting times and improving educational test scores.

Such actions at the center aren’t enough, however. Government’s scale and complexity make it essential to encourage departments and agencies to assume ownership of the reform effort. It will therefore be necessary to invest in developing change agents—leaders who act as role models for new and better ways to work—and to place them in key government units so that reforms reflecting the public’s needs come down to the front line.

Finally, pilot projects provide a “proof of concept” and enable pioneers to demonstrate the possibilities of reform. If these efforts succeed—especially if they make an early impression on the public—they establish the case for broader, deeper reform.



Undertaking comprehensive, deep government reforms at a time of national and international crisis may seem daunting—perhaps even a distraction from the essential tasks of restoring sound finances and long-term prosperity. In fact, however, a purposeful, concerted, and determined transformation of government is essential for both of those purposes as well. ○

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