



Note to readers:

I'm happy to say that this book is now about to have a proper publisher: Education Week Press. Initially I had printed copies myself and sent these to persons I thought would be interested. That original stock of copies is now exhausted. Education Week Press is reprinting the book. Copies should be available by the end of January 2005.

As soon as we know the ordering-arrangements and the price we will post here on the Education/Evolving website a link that will take you directly to Education Week Press. Meantime, if you would like to reach the publisher directly with an order, send an email to: "products@epe.org".

The Introduction and Chapter 1 of the book follow, here, for you to read; along with the Table of Contents. I hope these will interest you in buying and reading the full book.

Perhaps this is the best way to start, anyway. I have found . . . readers have told me they have found . . . that the book does not 'skim' well. I've said even to those who have the full book: "Don't try to skim it. If you have 10 minutes, read the Introduction."

Thanks for coming to the site to take a look. An author always appreciates the interest!

-- Ted Kolderie

CREATING

How and Why Governors and

the CAPACITY

Legislatures Are Opening a

for CHANGE

New-Schools Sector in Public Education



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Photo Credit: Cover photo courtesy of Tom Olmscheid,
Minnesota House of Representatives

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Preface

About 1980 I began to write occasional memos about what I then thought of as “public services redesign”. These grew out of work in Minnesota on general questions about the organization of the public sector; work that had its roots in the urban troubles of the 1960s and the dramatic loss of confidence in public institutions in the 1970s. I was involved in a project known as Public Service Options, trying along with others around the country to rethink some of the basic concepts of government’s role.

Into the early 1980s this work did not significantly involve public education. The schools had not at that point been caught up in the critical reappraisal being directed at urban renewal, public housing, welfare, health care and other social service programs. But with the release of *A Nation At Risk* in 1983 this changed, and education—the schools—joined the list of institutions under review as to their performance, responsiveness and cost.

So by the mid-‘80s the memos from my project—then located at the Humphrey Institute, the school of public affairs at the University of Minnesota—were beginning to explore questions about change and improvement in K-12 education. There was a rich discussion in Minnesota about this, resulting partly from Jim Kelly’s arrival as president of Spring Hill Center and his ability to bring into its conferences people from the network he had developed during his years with the education program of the Ford Foundation. Gov. Al Quie had commissioned work on education policy in 1982, Joe Nathan was stimulating a new discussion about student choice in public education, the Citizens League was working on these questions and by 1983 Berman/Weiler was under way with its study for the Minnesota Business Partnership.

Some of the memos were notes of discussions, some were interviews with national experts here for conferences at Spring Hill or for annual meetings of the National Education Association, the Association of Alternative Educators and other groups. Some were my own effort to think through the problems of this institution and what might be done about them. In these days before websites and email I printed and mailed the memos to a gradually-lengthening list of persons. I was encouraged to find they were being read. Twice, I think, someone called to ask me for a clean copy of one memo or another, saying “The one I have has been copied so many times it won’t copy any more”.

I mention all this, I suppose, because of the question whether a book written largely in the Minnesota context will prove useful—and interesting—to policymakers in other states and to others in the national discussion. This is a small state and—as people do quite often point out—not a typical state. We admire what Minnesota can do, they will say, but of course that has no meaning for us.

It does seem to make sense for the examples and the stories to be drawn from within a state, since the state is the critical arena for education policymaking. It seems to me, too, that Minnesota's policy discussion is a reasonable one from which to draw examples. The system-arrangements in public education and the institutional behaviors that result, and the issues these present, are broadly similar across the states. And for 30 years policy developments in Minnesota have been contributing significantly to the national discussion: the 1971 re-equalization of education finance, the tuition-tax-deduction which produced the *Mueller v. Allen* decision, the post-secondary option in 1985, inter-district open enrollment in 1988, the chartering law in 1991, the tax credit in 1996, the state's assumption of district operating cost in 2001 and most recently the idea of teacher professional ownership. A number of these have made their way through law and policy into the K-12 system-arrangements in other states and into national policy, and continue to be actively discussed.

I have to hope that those operating the institution will not put down a book from a non-educator; will not say, as insiders often do, that no one can understand an institution who has not been involved in running it. That might not be true. The problems of system design, especially, are sometimes understood more clearly and acted on more effectively by people outside. Those inside the institution may not be the most insightful, or the most candid, or the best positioned or most motivated to act. On this kind of system problem the knowledge of academic research about learning and the management experience of operators might not be essential. It might be better, actually, for the analysis and the proposals to come from someone whose experience has been largely with state policymakers in the redesign of large public systems.

To some readers this book will sound critical of 'public education'. So it is important to be clear at the start what—and who—is being criticized, and not, and why.

We all recognize the accomplishments of this institution. In a decentralized and democratic process people in local communities began more than 150 years ago to create public schools to educate and train their children. Over the years, with help from the state, the districts' administration was professionalized, the number of districts was cut by 80 per cent in the 1930s and '40s, new schools were built to handle the growth in enrollment after 1945. Even if with difficulty, the institution

adapted to children with handicaps, to racial integration and to collective bargaining.

Public education also has weaknesses: serious inequities and much difficulty with change. Like many things in life the institution is successful and unsuccessful, good and bad, at the same time. This book deals mainly with its inadequacies because these are now the issue; a serious problem for the country, complicating its effort to upgrade the knowledge and skills of its people. Praising the past would not help solve the present problem.

The people who work in K-12 are not to be criticized for the weaknesses of the institution. I remember saying this at a meeting at the Harvard Graduate School of Education in 1993; telling a group of state legislators “It’s your fault”, the state’s fault. The people in K-12 cannot change their institution; only the legislature can change it.¹ The people in the institution can be criticized, however, when they fail to point out its weaknesses and when they resist as the legislatures try to fix its problems. This is the ethical issue I raise in Chapter 12.

If this book proves useful it will be due to all I have learned from those who know education and education policy and from those who know politics and state policy-making. I remain a kind of journalist, who depends on his sources for his knowledge and his understanding of fields in which he is inexpert himself. Many people have been enormously helpful; especially my colleagues in Education/Evolving and especially Joe Graba, who saw clearly before the rest of us, from his experience both in public education and in politics, that the answers did not lie in trying to change the schools we have. I am responsible of course for the analysis and for the conclusions you see here.

The analysis and discussion is important: Ideas are important. But the changes now under way are due really to the efforts of the legislators and governors in so many states who have brought a new sector of public education into law against determined opposition at a time when practically no support for this idea was visible in public opinion. And to those teachers and parents and others who moved so quickly as the new laws appeared to do what so many would have said could not be done: to start and run new public schools for children failing—or being failed—in traditional schools.

We are only beginning to appreciate the remarkable success of both, in opening up this new and innovative sector of public education.

Ted Kolderie

September 2004

¹See Chapter 10.



THE CURRENT THEORY OF ACTION CONTAINS A CRITICAL FLAW

This country is trying hard to improve its public education but not thinking clearly enough about how, realistically, to get that done.

By introducing standards and measurement and consequences we have directed, commanded, the schools to improve. With its legislation in 2002 the national government is talking tough about accountability. But talking tough does not by itself make things happen: It is not usually productive to order people to do what in truth they cannot do. We need to think more clearly about the institution being able to do what it is being ordered to do.

The national discussion about improvement—so largely about standards and leadership and resources—tends to see as a problem of changing organizations what is in fact a problem of changing the institution. At bottom the problem is not one of organizational capacity. The problem is one of institutional capacity. The current arrangement of K-12 public education neither makes it possible to transform the existing districts and schools into something very different, nor significantly encourages the appearance of new organizations able to do better. We have a system problem.

It may seem surprising that we have failed so far to get to the heart of this question about the capacity to improve. Clearly anyone giving an order should want the other party to be able to comply. But the discussion has taken the traditional institutional arrangement as a given, and has gone directly to questions about ‘improving the capacity’ of districts and of schools and about enhancing the instructional skills of teachers. The assumption is that the clarity and coherence provided by new curricular frameworks, stronger leadership, better training, tougher accountability and richer financing will overcome whatever disincentives to change and performance are inherent in the present arrangement of K-12 education as essentially a regulated public utility. It is assumed these organizational improvements will be made, can be made.

This strategy began to emerge in the early '90s: national action to stimulate state action to stimulate district action to improve schooling. It was visible in national legislation in 1994. Then in the late '90s developments in national politics cleared the way for more dramatic steps. After 15 years of little progress, the public and its political leaders were in a mood to get tough with the organizations, to 'make 'em' improve.

In national politics education had long been understood to be "a Democratic issue": Money was the measure of commitment (and presumably the key to success) and Democrats would always top what Republicans were willing to spend. But by 2000, with education the public's number-one concern, the Republicans saw that to win the presidency they had to capture that 'issue'. The strategy was to try to make accountability trump money. And they did it. Once in office the new administration, using the national government's (seven per cent) contribution to K-12 finance as the lever, moved immediately to persuade Congress to enact the president's campaign slogan about "leaving no child behind". As it passed into law early in 2002 the idea was to require that all kids score well on standardized tests and to threaten either the kids or the schools with sanctions should they fail.

We do not know that this can be done. Pretty clearly it never has been done, in this country at least. No one demonstrated following *A Nation at Risk* in 1983 that it could be done. It was simply assumed that poor schools could and would be turned into good schools like caterpillars transformed into butterflies, with poor students turned into good students. There was no other concept in the policy thinking. The language of the discussion makes this clear: It is all about renewing, reforming, reinventing, restructuring, revitalizing, remodeling, reengineering, reconstituting; endlessly, 're-', 're-', 're-'. There has been little serious consideration that the absence of accountability and the ineffectiveness of leadership and the chronic demands for more revenue and the deficiencies in teacher practice are the result of a fundamental incapacity in the institutional arrangements.

This is the central issue now for policy: whether it is realistic to assume that law and regulation and exhortation can overcome the constraints of faulty system design. Even if conceivably they might, the uncertainty makes such an assumption clearly a risk. Remember: The bar is set very high. We are talking seriously about educating all students to high standards. This asks a lot of the organizations we have. It may be that within the present arrangements the job cannot be done.

In a conversation in the spring of 2003 I put the concern about this risk to a leading proponent of standards-based systemic reform. He thought a moment. "It is a one-bet strategy", he said.

A one-bet strategy is always a risk. It is a serious risk to be taking on something

as important to the nation and to its people as public education. And it is not a prudent risk to be taking since it is not a necessary risk to be taking: We do not have to limit ourselves to trying to get existing districts to improve existing schools. We can be moving at the same time to create the different and better schools new.

Because it is not a necessary risk it is not an acceptable risk for policy leadership to be taking, with other people's children. It is troubling that the public is being given so little sense of the risk that the current strategy might not succeed.

Success will require changing the old arrangements

Almost certainly it was necessary politically for those who shaped the current national strategy to accept the existing institutional arrangements. If 'systemic reform' had not been seen to accept this framework the major players in public education—the superintendents, boards and teacher unions—would not have listened. So proponents had to assume that districts, told what standards to meet and held accountable for results, could and would change and improve the schools they own and run; had to bet all the chips on the districts getting us the schools we need by changing the schools we have.

A theory is a statement that if we do X then Y will result. It is critical that the theory be valid; that Y in fact result when X is done. The concern rising from the experience so far is that—as now arranged—the institution will not produce the results we want, even when directed to do so.

The problem, the critical flaw in the current theory, is the acceptance of those existing arrangements. The prevailing theory sets the question incorrectly. It asks whether changing structure improves 'instruction', and to that question answers, No. So far, fair enough. Clearly what will improve learning will be improvements in what teachers and students do, and in the methods and materials they use. Still, structure matters. The correct question, the important question, the practical question for policymakers, is: Within what structure, under what arrangements, is this effort to 'improve instruction' likely to be more successful?

The prevailing theory does not really defend the existing arrangement; simply accepts it. But this regulated-public-utility arrangement has made public education an inert institution, lacking the capacity to do what we now need it to do. As a result the process of improvement has become largely an effort to push improvement into the inert institution. We have been treating public education like a patient in intensive care, supported by casts and pulleys, hooked up with tubes and wires flowing in nourishment and stimulus from the outside. We have been trying to do for the organizations the good things they did not do for themselves.

This is basically ridiculous as a strategy. Why, if we want the districts to change, would we leave in place the constraints that make it so difficult for them to change?

Normally we arrange our institutions to be self-improving institutions, so the organizations within them become self-improving organizations. This means structuring the institutions so their organizations will do, themselves, the good things that need to be done: set standards, measure performance, impose consequences, control costs, improve practices, prepare leadership and innovate with new technology. And will do these things on their own initiative, in their own interest and from their own resources.

About 1984 William Andres, then just retired as CEO of Dayton-Hudson Corporation, was asked by the governor to head a task force on productivity in Minnesota state government. Andres asked others more familiar with the public sector: “Is productivity something you do, or something that happens if you do the fundamentals right?” If you paused to think he would explain: “I was in retailing. In retailing turnover is very important: Stores that turn over their inventory rapidly are more profitable. Every so often a store manager tries to ‘do’ turnover, and quickly that store isn’t profitable any more. So in our company we decided a long time ago that turnover is something that happens, and we concentrate on doing the fundamentals right.”

That puts much in perspective about the strategy for education. We are trying to ‘do improvement’ when we should be working to get the fundamentals right. We should be arranging this institution so its organizations make and are able to make, themselves, the changes and improvements needed. We should be restructuring the K-12 institution so it too becomes a self-improving institution. This means we cannot take present arrangements as given. The flaw in the theory of action, that confines policy to efforts within present arrangements, will have to be fixed.

We need to think about this now very soon—broadly, and carefully and sensibly and above all with realism about the way organizations and institutions behave.

This book is an attempt to do that. The solution will be difficult to implement but is essentially simple. It is to restructure the K-12 institution to make it possible for new schools to appear; for different and better schools gradually to take the place of low-performing schools—while at the same helping the districts to do what they can to improve the schools they run. This ‘two-bet’ strategy will hedge against the likelihood that an effort confined to paying, exhorting and commanding the districts to improve will not succeed.

In the 1990s governors and legislatures, following the old rule about always changing a losing game, began to enact laws creating a new ‘open sector’ in public education, partly inside but substantially outside the district framework. Moving beyond the district required them to withdraw the exclusive franchise that the old public-utility arrangement gave the local board to offer public education. It required being open to the idea that more than one organization can offer public education in the community.

This book describes that new state effort. It will say something about the need for the new schools to be different from the schools that exist today, to have any real chance of educating the students now not learning well in traditional schooling. But as the photo on the cover should suggest, this is not really another book about better schools and better learning. It will not go into questions about learning as an educator would. It is about strategy, about method; is mainly about how to arrange the K-12 institution so it will provide reasons and opportunities for those who are educators to develop and sustain a diversity of quality schools.

Part One explains what it is about the traditional arrangement that makes the K-12 institution inert, that constrains change. Part Two explains what changes will be required in the system for K-12 to become a self-improving institution. Part Three explains what specifically state policy leadership will need to do, and how it can deal with the arguments thrown up against system change. Part Four then asks how quickly the changes can get made and explains who specifically will need to do what specifically.

Change will not be easy. The interests within K-12 will not want to see their institution re-arranged. For understandable reasons they will try as they usually do to hold policy to incremental changes within existing arrangements. But others, outside the institution, have a different interest. It is their children that are at risk, their nation that is still very much at risk.

These others outside K-12—and the state policy leadership that is their agent—are the primary audience for this book. I do hope, though, there will be some educators, and more than a few, who will read it and who will say: Yes, this is what has to happen; it is time.



PART ONE

HOW EXISTING ARRANGEMENTS OBSTRUCT IMPROVEMENT





INCENTIVES SHAPE ORGANIZATIONS' BEHAVIOR

The old agenda has not given much attention to incentives as they affect the organizations in K-12. Essentially in trying to fix the schools the effort has been to push districts to do things they have neither reasons to do nor opportunities to do, confusing what they 'ought to do' with what they have a reason to do.

The strategy of systemic reform reflects a deep conviction that structure, governance, system 'arrangements', do not provide the significant levers for policy. Changing the system, as its advocates often say, does not change teacher practice or improve student learning.

That is true, but not the point. The arrangements in any institution shape what must be done and what can be done. Set well they can work powerfully to help organizations succeed. Set badly they can present a huge obstacle to success. They create the incentives that shape organizations' behavior.

Suppose a nation wanted to increase the revenue available to charities. Someone might suggest that gifts to charity be exempt from tax. Suppose the response was that, no, we don't want to spend time adjusting the structure of the tax laws. We want to work directly to increase giving. Surely most of us would think such an objection passing strange. It is true of course that exempting gifts from taxation does not directly increase the charities' bank balances: The army of 'development officers' working for charities attests to that. But relatively few charities do not value the incentive for giving created by the tax exemption.

So it is not good to diminish the central importance of structure, in any field. And not in K-12 public education. Incentives matter.

Institutions and organizations tend to behave the way they are structured and rewarded to behave, as Walter McClure of the Center for Policy Studies likes to say. If we do not like the way they are behaving it may not make much difference to tell

them to do better or to change the way they are led. We will probably do better to change the way they are structured and rewarded. It makes a difference what an organization has a reason to do, or has no reason to do. It makes a difference what an organization has an opportunity to do, or has no opportunity to do.

Those thinking about incentives do often think about incentives for individuals. It may matter more how incentives are structured for organizations: what reasons they have, to act, and what opportunities they have, to act. Organizations have interests. They want to survive and they want to grow. They protect their turf, their jurisdiction. Organizations have personalities; develop their own culture. They can be jealous, proud, stubborn. Organizations like to be well-regarded. There is a strong drive for self-justification. For-profit or non-profit, they want to maximize and protect their revenues. Many, like many individuals, find change stressful; prefer a quiet life. These interests influence the way they respond as situations change and as policy changes. And the organization's incentives shape its members' behavior.

At the first anniversary of the Saturn School in Saint Paul in May 1991 Albert Shanker, then president of the American Federation of Teachers, talked candidly about the importance of incentives.

He'd stressed first the importance of motivating students, of giving students a reason to work hard. Then he turned to the question of motivating educators, of giving educators a reason to change.

"Something has to be at stake," he said. "There is, in other fields: Your organization could fail. People in these fields dislike change too. But they have to do it. We in education don't, because for us nothing is at stake. If our kids do brilliantly nothing particularly good happens. And if we don't push we can count on remaining popular with our colleagues. . . . "We have got to deal with this question of consequences for adults", he said. "Educators simply are not going to take the risks of change, against the pressures of everyday popular feelings, unless they have to."



Changing incentives changes behavior

State policy leadership does not have to be frustrated by an institution's low performance and by the resistance from its organizations when the state exhorts it to do better. Or by its sometimes straight-out refusal to comply with legislative intent.

Over the years, as Dan Loritz says, Minnesota tried most everything: tried exhorting districts to improve, tried research to show them how to improve, tried giving them money to improve. Nothing much worked. "So we decided we'd try giving 'em a reason". Loritz was effectively education adviser to Gov. Rudy Perpich in the 1980s. It was in the '80s that Minnesota's effort at system-change began to develop.

But a reason to do something is not enough. Giving people a reason to act, without the opportunity to act, produces only frustration. Nor is it effective just to give people the opportunity: Without the reason nothing will happen either. The two go together.

Incentives exist, intended or not. There are always things an institution and its organizations may do and may not do; there are always reasons for them to act or not to act. These incentives become the ‘rules of the game’ that shape the way the organizations behave. All of us, all the time, see organizations responding—and rationally—to the incentives created by the system in which they exist. And we see policymakers arranging and rearranging the incentives, sometimes purposefully and sometimes inadvertently; sometimes with good results and sometimes with unfortunate results.

Bad things happen where the incentive-structure is badly designed. Where it is well designed, on the other hand, it can work powerfully for the public interest. It is especially important for policymakers to ensure that the incentive-structure is aligned with the objectives they want the institution to accomplish.

In business

Over the years Congress had reshaped the program of insurance intended to protect funds deposited in savings and loan associations. With deposits insured the S&Ls were able to attract funds because their depositors were secure in the knowledge that any losses would be repaid by federal deposit insurance. In the early 1980s the limits on deposit-insurance were raised from \$40,000 to \$100,000 per account. “Confident that the government would stand behind even the shakiest institutions, savvy investors deposited \$100,000—not a penny more—in S&Ls that offered high interest rates. Thus shielded from the discipline of the market, S&Ls made high-risk loans.”¹ Many such loans could not be repaid. Ultimately the defaults cost the taxpayers billions. Some of what happened was criminal behavior, and some people did go to jail. But the real culprit was the incentive created by the deposit insurance.

More recently executives in fast-growing electronics industries began to take their compensation in the form of options to buy company stock at a defined price. This gave them a reason to increase the market price of the stock so they could sell high what they had bought low. This in turn gave them a reason to influence the company’s accounting to show ‘results’ that would drive the share price higher; gave them “a perverse incentive to inflate earnings”, as the chairman of the Federal Reserve put it. An effort by the Securities and Exchange Commission to make

¹Wall Street Journal March 14, 2002

options chargeable as an expense had been blocked in Congress, leaving in place the opportunities that in time drew executives, accountants and auditors from deception into fraud. Prosecutions are still under way and the country is still working its way out of the problem. Now the regulators are trying again to require options to be reported as compensation expense.

In health insurance

Until the 1930s families paid the hospital and doctor as they paid anyone else who did them a service. But in the depression too many families could not pay. Hospitals were in financial trouble. So the payment system began to be restructured.

First came prepayment: the beginning of what we now call 'health insurance'. This provided a way for families to pay something regularly toward the cost of hospital and doctor bills when they needed care. After 1945 came the idea that some third party ought to make those prepayments for you. Labor unions bargained this into contracts. It was a benefit, not taxable, so unions had a reason to take compensation increases in this form. Employers' willingness gave them the opportunity. So the practice spread rapidly. In 1967, with Medicare, the federal government became a third-party payor for persons over 65.

This restructuring of health-care finance had dramatic effects. Powerful incentives were at work; old reasons combined with new opportunities. Patients wanted the best care, doctors wanted to provide the best treatment (and to earn fees), hospitals wanted to have the best facilities, technology companies wanted to sell the best equipment. And neither the patient nor the doctor or hospital had to pay directly. The bill was sent to the insurers. The law let insurers recover their costs. So they raised premiums accordingly. Employers then built the higher premium costs into the price of their products. Essentially this cost-pass-through arrangement simply sent doctor and hospital bills to the American economy for payment. By the mid-1970s health-care costs were rising by more than 10 per cent a year and were consuming almost 14 per cent of gross domestic product.

Looking at the situation, Anne and Herman Somers went to the heart of this system-design: "In no other realm of economic life is repayment guaranteed for costs that are neither controlled by competition nor regulated by public authority and in which no incentive for economy can be discerned".²

Telling hospitals and doctors that they would be reimbursed for whatever they did was in effect giving them an incentive to do everything; was like a baseball owner telling his players he would pay them by the number of times they swung the bat. It had to be changed. Soon capitation appeared; the idea of giving hospitals and

²Herman M. and Anne R. Somers, *Medicare and the Hospitals*, Brookings Institution, 1967.

doctors a reason both to constrain use and to keep people healthy. Give them a fixed amount, let them pay the patients' bills, let them keep what they did not need to spend. Provide a choice of plans and the information about hospital and physician 'batting averages' that patients need to make good decisions.

Health-maintenance organizations and other forms of 'managed care' appeared. Much was accomplished. The rate of increase in health-care costs slowed dramatically. But policy probably went too far in reversing the incentives. By the 1980s there were charges that the health plans were scanting care in favor of profits. For 20 years the country has been struggling to find the right balance of incentives, in an intricately complex system. Only recently are policy thinkers coming back to getting the incentives right: identify the high-quality, low-cost clinics and hospitals and arrange the benefits program to flow them patients; essentially what Walter McClure and Paul Ellwood were arguing in the early 1980s.³

In education

In the early '80s Florida enacted a program of school-based management for districts. One district gave its schools their money in a lump. The schools paid their own bills—as, for energy. And they could keep for school activities money they did not need to spend. District officials quickly noticed the electric bills beginning to drop. Students and teachers were turning off the lights and the air-conditioning when they left the classroom. This generated money to pay for field trips and other activities. The site-management program had been structured, even if unintentionally, to give the kids and teachers a reason and an opportunity to behave differently. And they responded to the incentive created.⁴

While superintendent in Milwaukee Howard Fuller saw teachers absent too often. The cost of the substitutes at that time fell on the district budget. Fuller restructured the 'substitutes' program to give each school its share of the budget for substitutes, and to make each school pay for its own substitutes (i.e., pay for teacher-absences). Each school could keep what it did not need to spend. As with the energy costs in that Florida school, teacher-absences went down.

Michael Kirst, Stanford University professor and former chair of the California State Board of Education, has long been concerned about students' preparation for college. To him it is a matter of the incentives not being set right. If colleges admit students based partly on grade-point-average (as they do), if students want to get admitted to college (as they do) and if students may choose the courses they take in

³See Professor Michael Porter's article in the *Harvard Business Review*, June 2004. Also the column by Jeff Madrick in the *New York Times* July 8, 2004.

⁴Related by Larry Pierce, then at the University of Oregon, to a meeting convened by the Northwest Area Foundation in Saint Paul, August 1982.

high school (as they may), then an incentive exists for students in high school to take less-demanding courses in which they can get higher grades.

In county government

Through the 1950s there was growing conflict between Minneapolis and its suburbs. The city and suburban officials were fighting over taxes, roads, parks, welfare; all advocating, not surprisingly, for their own jurisdictional interests. Everyone knew the 1960 census—reflecting the growth of the suburbs – would require a redistricting of the Hennepin County board.

At the time four of the five commissioners came from the city of Minneapolis, one from the suburbs (then still called “rural Hennepin”). There was a strong desire not to recreate in the restructured county board the city/suburban warfare raging at the municipal level. The Citizens League proposed that five new commissioner districts be laid out with one entirely Minneapolis, one entirely suburban and three overlapping the city/suburban boundary. The idea was to give a majority of commissioners a reason to focus on the problems of the county as a whole; to deny these three an opportunity to represent the interest of either Minneapolis or the suburbs. It worked.

In industry

In the early 1900s there were terrible accidents in the steel mills. The companies took the view that accidents were the workers’ problem, not the company’s problem. Companies spent their money not for safety but to hire lawyers whose job was to deny liability. Then, beginning in 1911 in Washington, states created a new kind of insurance program. Rather than having injured workers sue in the courts the idea was to accept that accidents happen and to create a workers’ compensation fund to pay for the medical care and for the lost income of those injured. The money was raised by an assessment on the employers. Companies, knowing they would pay the costs, quickly saw a reason to introduce safety programs in order to reduce their costs—which of course they had always had the opportunity to do. Over the succeeding 20 years the injury rate in the iron and steel industry fell by 90 per cent.⁵

Among nations

Three times between 1870 and 1940 Germany attacked France. In 1950, as Cold War tensions made the United States want to rearm Germany, the fears of Germany recurred in France. Thinking about the problem it seemed to Jean Monnet that the answer was to change the context; to merge the interests of the two nations so that war was unthinkable, impossible. He began by persuading the Schuman government in France to propose the merger of the coal and steel industries of Germany

⁵The story is told in Mark Aldrich, *Safety First*, Johns Hopkins Press, 1997.

and France, in an arrangement open to the participation of others. What became the Coal and Steel Community evolved into the Common Market, then into the broader (and still-expanding) European Community. By 2003 it was possible to drive from Lisbon to Vienna without showing a passport or changing your money.

'The system' creates the incentives

Incentives do powerfully shape behavior. They can have good effects or bad effects. So they need to be structured with care. However virtuous the intentions, all efforts to change the way business or health care or education is built need to consider what incentives are being created. It will not do to ask, later, questions like, "Who foresaw that health insurance, which was supposed to help people stay healthy, also would create a disastrous inflation in health-care costs?" Consequences can be foreseen.

An effort to change behavior through incentives rather than through commands, by altering the structure of opportunity and reward for organizations, needs to be added now to the strategy for the improvement of public education. Changing the incentives needs to be our concept of 'changing the system'.

This requires some explanation, because 'system' has quite different meanings for different people.

I once asked an analyst at RAND Corporation what people there mean when they say 'system'. He answered: "A collection of interacting parts". And that is a common notion of 'system'. The aviation system in this sense is United, American, Delta and the other airline companies, the airport authorities, the FAA air traffic control, etc. The communications system is the telephone companies, the radio and television broadcasters, the FCC, the internet and the world wide web and all the companies involved in electronics, the carriers of hard-copy messages like the Postal Service and Federal Express, etc. The financial system is the banks, the investment houses, the mutual funds, their regulators; on and on. In the public sector we talk about the transportation system, meaning the highways and local streets and the organizations that build them, the transit buses and rail lines and the organizations that run them, the private cars and their owner-drivers, etc. All these are collections of interacting parts.

But there's a second definition. 'System' can also mean the principles on which the interacting parts are organized. We're using this second definition when we talk about a socialist system and a market system, or about the difference between a consumer market and a social market. When we talk about the public sector we talk about authoritarian systems and democratic systems; or, on the operating side, about a bureau system and a contract system. These terms describe the principles that govern the collections of interacting parts. The principles differ radically, the varia-

tions creating different incentive-structures, different combinations of opportunities and reward.

This book will reserve the term ‘system’ for the principles on which things are organized, for the rules of the game. When it means the interacting parts themselves it will talk about ‘the institution’ and the organizations that make it up.⁶

In this definition the incentives exist initially for organizations. It is well to assume that these incentives will then exist for the individuals in the organization. It is dangerous to assume the reverse: that the imperatives felt by the organization will not also be felt by its members. Or to assume that an organization will be able to impose on its members requirements for performance that do not exist for the organization itself.

The incentives created need to be aligned with the mission the institution and the organizations in it have been given to perform. In the K-12 institution at the moment, unfortunately, they are not. This is a critical flaw in the current effort to get the districts to change existing schools.

⁶Sports offer a wonderful opportunity to see the system shaping the behavior of the coaches and the teams; to watch the game change as those in charge adjust its rules in response to changing expectations and changing conditions. See for example *From Six-on-Six to Full Court Press; a Century of Iowa Girls' Basketball*, Janice Beran, Iowa State University Press, 1993.