Jack Lang, former NSW Premier, gave Paul Keating this famous advice: ‘In any horse race, son, always back the one called Self Interest. At least you’ll know he’s trying.’ This is more than a great line about how politics really works; it is also a profound insight into one of the most common reasons why good policies and ambitious social programs come to grief.

Think about the home insulation catastrophe – the only people who can be relied on to care about whether the insulation is needed, and properly and safely installed at reasonable cost, are the ones who live in (or own) the house. But they were side-stepped in the way the scheme worked. The installer sent the bill direct to the government, in some cases for houses that didn’t exist, or that already had ceiling insulation. This can be seen as a principal-agent problem – the government effectively appointed itself as the householder’s agent, and they didn’t do a very good job at looking after their interests. The more general principle here is to align interests (and thus effort) with decision-making.

When it comes to re-designing the structure of the health system under the COAG-approved reforms, there is a lot to be gained from paying attention to this problem. Capital decisions are a good example. Under ‘business as usual’ rules in the public sector, the incentives for health services are to load up the costs of whatever project the government has decided to fund with everything they have ever wanted, because that’s your bite at the cherry and it can be a long time between bites. The government capital managers’ incentive is to build the cheapest project possible, regardless of impact on operating costs, because the operating budget is your problem.

A more virtuous alternative was used in Victoria under Kennett. Each Network was told how much money they would get for building projects over the following 5 years. The Networks then had to figure out what projects, at what cost, were most critical. You still had to go back to the government for release of the funds, so building the Taj for administration was not going to happen. But your incentives were firstly to design the thing for efficient operating; and then to find the best value option for each project, so that more of ‘your’ money was left for the rest of your agenda. This is what I would call correct alignment.

On any given day, those whose performance will be judged on the success of the local health services are going to be more focused on achieving that success than are those with broader and higher responsibilities. The idea of local health and hospital networks is based on this proposition. Now the challenge is to design the structures, the legislation and the delegations of authority so that the incentives are virtuous, and the horse is really trying.