BEYOND THE BLUNT INSTRUMENT:
THE EFFICIENCY DIVIDEND AND ITS ALTERNATIVES

Jennifer Doggett

NOVEMBER 2010

CENTRE FOR POLICY DEVELOPMENT ISSN 1835-0135 OCCASIONAL PAPERS – NUMBER 11

About the Author:

Jennifer Doggett is a Centre for Policy Development research fellow. She is a policy analyst and consultant who has worked in a number of different areas of the health system, including the federal health department and the community sector, and as policy advisor. Jennifer is the author of 'A New Approach to Primary Care for Australia', published by the Centre for Policy Development in June 2007 and 'Out of Pocket: Rethinking Health Copayments' published by CPD in 2009, and is a contributing author to the CPD book 'More Than Luck: Ideas Australia needs now'.

About this paper:

This publication was subject to an informal peer review process. Thanks to Ian McAuley, Kristin van Barneveld, Miriam Lyons and Eva Cox for their feedback. All conclusions and any errors that remain are the author's own.

This publication was funded by the CPSU to contribute to the debate on public sector reform in Australia. Its conclusions do not necessarily reflect the views of the CPSU or its members. The CPD would like to thank the CPSU for making this publication possible, both through their financial assistance and also their practical help in accessing public servants for the roundtable and questionnaire. CPD would also like to thank the public sector employees who provided input into this paper through attending the roundtable and completing the questionnaire.

About the CPD:

The Centre for Policy Development is a progressive think tank dedicated to seeking out creative, viable ideas and innovative research to inject into Australia's policy debates. Find out more at http://cpd.org.au

About the public service research program:

Attempts to ensure that core public services can meet the needs of a changing society over the long term are being held back by our flawed policy processes. We need to move from top-down, short-term ad-hoc reforms to long-term, systemic renewal based on consistent principles, widespread participation and a realistic understanding of how we live now. The CPD's new public service research program will combine big-picture thinking on the role of government in the 21st Century with practical research on options for public sector reform.

Table of contents

Summary

Every year Australia allocates over $350 billion dollars, or almost 30% of our Gross Domestic Product, to our government sector[1]. This represents a substantial component of our collective resources, yet our current attempts to ensure that we get good value from this investment are deeply flawed.

The way in which we use public sector resources has a profound impact upon the sort of society we live in now and that which we leave behind for future generations. Using those resources more efficiently is one way to increase the capacity of government to improve the lives of individuals now, strengthen the foundation of the economy and contribute to a more cohesive and sustainable future for our country.

Research shows that Australia's public service is, on average, performing well by international standards[2]. However, given the changing demands of modern society, there are always potential areas of improvement and a need for all public services to implement effective mechanisms to review their performance.

Various governments have undertaken a number of processes to promote efficiency within the public service over the past three decades. The main mechanism used to drive performance improvements across the Australian Public Service (APS) as a whole is the Efficiency Dividend. The Efficiency Dividend has existed for 20 years and while it may have provided some initial budgetary savings, evidence now shows that it has had a number of unintended negative outcomes and is not effective in achieving efficiencies while maintaining the delivery of quality public services[3]. Therefore, alternative mechanisms need to be explored which would be more effective than the Efficiency Dividend in driving improvements in performance throughout the APS. This was a key recommendation of the Moran Review, which also identified some specific options for replacing the Efficiency Dividend, such as a reliance on discretionary savings and the implementation of review processes of individual public sector agencies[4].

Both Australian and international research in this area demonstrates that there is no agreed best practice process for promoting efficiency within public sector organisations. While different countries have tried a number of approaches to improve public sector performance, there is a lack of robust evidence on the outcomes and no clear consensus on the most effective mechanism for achieving maximum efficiency gains. Part of the reason for the lack of an objective assessment in this area is the difficulties involved in measuring performance of public sector organisations, in particular those with a central policy or advisory function. Another reason is that public sectors vary widely between countries in their composition, role and function making cross-nation comparisons extremely difficult.

This means that any assessment of public sector efficiency will necessarily involve a subjective component and will be influenced by the specific political, social and cultural environment in which the evaluation is occurring. It also highlights the importance of a transparent and accountable process for promoting a high performing public sector, involving input from all stakeholders, including public sector employees and their unions, in this process.

This report aims to provide a framework for the development of a new approach to supporting public sector agencies to be more efficient by drawing on the findings of Australian and international literature and the outcomes of a consultation process with APS employees. It identifies key principles which should underlie a new approach to measuring and promoting efficiency within the APS and makes specific recommendations on identified options for replacing the Efficiency Dividend. It also looks at the role of efficiency measures in the context of other worthwhile goals for improving the public service – such as transparency, accountability, the long-term quantity and quality of services and the equity of public access to and impact of services.

Summary of principles and recommendations

PRINCIPLES

» **Principle 1:** Efficiency should be seen as one of several measures of public service performance, and measures to improve efficiency should not compromise the effectiveness of policy development or implementation, such as the quality of service delivery.

» **Principle 2:** Efficiency measures should be based on a comprehensive assessment of outcomes, including longer-term impacts on individuals and communities.

» **Principle 3:** Efficiency measures should be evidence-based and reflect the actual potential for achieving efficiency gains.

» **Principle 4:** Stakeholders, including employees and their unions, should have the opportunity to provide input into efficiency measures.

» **Principle 5:** Efficiency measures should not be used by governments as a political tool to reallocate funding outside of normal budgetary processes.

» **Principle 6:** Efficiency measures should be regularly evaluated by an independent body, with employee representation included in this process. The timeframe of such evaluations should match the typical timeframe in which investments in efficiency gains achieve results.

» **Principle 7:** Agencies should be able to access funding from a specific budget allocation in order to identify potential efficiency gains and implement reforms.

RECOMMENDATIONS

» **Recommendation 1:** Undertake regular audits of agency and/or portfolio efficiency as a basis for developing efficiency measures, separately to the annual budget process.

» **Recommendation 2:** Reject discretionary savings processes as a means for achieving savings, as without a clear evidence base they are too easily politicised and subject to pressure from powerful interest groups.

» **Recommendation 3:** Reject the concept of an aggregate efficiency target, as it does not reflect the diversity of the APS.

» **Recommendation 4:** Consider funding a trial to assess and develop efficiency measures for common functions performed across multiple agencies, where there is evidence to support this approach.

» **Recommendation 5:** Undertake independent reviews involving input from stakeholders including employees and their union as the basis for developing efficiency targets.

» **Recommendation 6:** Trial a formal agreement between stakeholders on efficiency measures and targets.

» **Recommendation 7:** Trial a model which allows agencies to retain part of the savings they make by increasing efficiency.

» **Recommendation 8:** Undertake further consultation on putting efficiency measures into the context of a broader framework of measures of public service performance that includes environmental and social justice issues.

BACKGROUND

This paper was developed in response to the 'Moran Review' of the public service, instigated by then Prime Minister Kevin Rudd upon his election in 2008. The review focussed on the performance of Australia's public sector.

In early 2010 the Review released its report 'Ahead of the Game: Blueprint for Reform of Australian Government Administration' which identifies four broad areas where the Advisory Group believes performance of the APS could be improved and makes twenty-eight specific recommendations.

This paper focuses on Recommendation 9.1 of the Moran Review: **'Review the measures of agency efficiency.'**

Specifically, the 'Ahead of the Game' report recommended that a review of the Efficiency Dividend be undertaken by the Department of Finance with Treasury and Prime Minister and Cabinet, including consideration of alternative mechanisms to encourage agencies to be efficient, such as the following three specific measures:

» Retaining an Efficiency Dividend in a form similar to the current model, that is, one that does not discriminate between agencies;

» Removing the Efficiency Dividend entirely and relying on discretionary savings processes, driven by the government's budget priorities and offsets, to meet the government's fiscal objectives; and

» Introducing a mechanism that makes a qualitative and/or quantitative assessment of the level of efficiency between agencies and arrives at an aggregate savings target across the APS in accordance with these assessments.

The Moran Report states that this review should specifically consider whether alternative mechanisms to replace the Efficiency Dividend would generate at least an equivalent level of savings to the Government budget.

On 8 May 2010, Prime Minister Rudd announced that the Government had accepted all of the recommendations of the Moran Review. In response, a taskforce was established to implement the recommendation (above) to examine alternatives to the Efficiency Dividend.

This paper aims to provide input into this process by providing an overview of the key issues relevant to the Efficiency Dividend and recommendations on alternative mechanisms to support efficiency within the Australian public service.

Methodology

This paper was developed using the following process:

» A targeted literature review of current Australian and international research in the area of public sector efficiency and mechanisms to increase performance in public sector agencies;

» A questionnaire[5] seeking the views of APS employees on the principles that should underlie any approach to promoting efficiency and specific alternatives to the Efficiency Dividend; and

» A roundtable discussion of the principles and options for alternate efficiency mechanisms. The roundtable consisted of CPSU members who responded to an invitation in the organisation's newsletter. All attendees were current APS employees.

Feedback and ideas received through the questionnaire and roundtable have informed the development of the recommendations and principles in this paper, however the conclusions may not necessarily be endorsed by all participants. It is also important to acknowledge that the views of some important stakeholders were not sought as part of this project, including the general public, users of government services, senior public service managers and Government Ministers.

INTRODUCTION

From the day we are born to the day we die, every Australian is affected by our nation's public sector. Australia's public sector also has a significant impact on many people from other countries, such as refugees who come to our country seeking asylum, permanent residents who access public services and citizens of countries where the Australian defence force is engaged in a conflict or undertaking a peacekeeping role. The impact of the public service on our community is both profound and long term.

In Australia, as in many other countries, the influence of the public sector is partly due to the range of essential services it provides at all levels of government, in areas such as health, education and welfare. At a Commonwealth level, the public sector has a central role in areas that impact on the well-being of Australia's citizens and residents, such as taxation, international security, defence and justice.

The Australian Government also forms a major component of our economy with the sector contributing almost 30% of Australia's total gross domestic product (GDP). Public sector organisations are large employers, with almost 300 000 Australians working for the Federal Government, 160 000 of those in the APS[6].

The APS has also played a crucial role in key transition points in Australia's past. The Moran Review identifies several areas in which policy advice and implementation transformed Australia:

> *History demonstrates the impact of high quality policy advice and reliable public sector management on national wellbeing. For instance, the public service played an essential role in the microeconomic reforms of the 1980s and 1990s that are widely credited as having improved Australia's national competitiveness and standards of living. The floating of the Australian dollar, the deregulation of financial markets, and social policy reforms such as universal health care through Medicare, native title systems and the creation of Centrelink were also critical reforms developed in collaboration between government and the APS[7].*

Because the public sector has such a significant influence on the quality of life of individual Australians and our community as a whole, improving the efficiency of public sector agencies, where there is the capacity to do so, could provide direct and indirect benefits to all members of our community. In particular, efficiency gains could make additional resources available for increasing the quality, quantity or range of public services. A transparent and effective system for avoiding waste in the public sector could also be an important source of public confidence in government and in public services.

Section One – Public sector performance

Key points

- The performance of public sector agencies is a key issue for governments worldwide
- Efficiency is an important component of public sector performance
- Efficiency involves a relationship between inputs and outputs
- Measuring efficiency within public sector organisations is challenging, in particular in agencies with a central policy function.
- Efficiency needs to be distinguished from effectiveness when assessing the performance of public sector agencies
- Efficiency measures cannot be isolated from other performance measures
- Efficiency measures only achieve their aims when they reflect the broad and long-term goals of public sector agencies

The performance of public sector agencies is a key issue for Australia, along with many other governments worldwide. While the public sector has always played a central role in Australia, the recent focus on obtaining maximum value from our public service has been driven by a number of factors. These include: the ageing of our population and consequent increased demands on transfer payments and tax subsidies; citizens' greater expectations of government services; pressure on government budgets from the recent global economic crisis; and the greater availability of data with which to measure some of the outputs of public sector agencies. Other factors include the political advantage that opposition parties may gain by criticising incumbent governments as 'wasteful' and the relative political invisibility of aggregate budget cuts compared to cuts to specific services or payments or tax increases.

A large body of literature has evolved on the performance of public sector organisations over the past two decades[8]. This literature comes from a number of different disciplines, including public sector economics[9], management theory[10] and public administration[11] and provides a wealth of information on how countries worldwide are seeking to obtain the best value for their investment in public services[12].

EFFICIENCY AN IMPORTANT ISSUE

A key finding supported by this literature is that efficiency is a crucial factor in the management and promotion of performance within public services internationally and is also a driver of public sector reform.[13]

Efficiency is an important concept as it provides a measure of whether the public are receiving good value for the resources invested in public services. An inefficient public sector represents a waste of public resources and a loss to the community as these resources could be used elsewhere. For example, an inefficient health service will treat fewer people than is possible. This means that some people will miss out who could have been treated. The more efficient the public sector, the more value will be obtained by citizens from public sector programs and agencies. However, measuring efficiency in the public sector is complex and, if undertaken incorrectly, can result in outcomes which undermine the overall goals of the agency or program.

DEFINING AND MEASURING EFFICIENCY

Central to the concept of efficiency is that it encompasses a relationship between inputs and outputs. For example, the OECD defines efficiency as the relationship between the goods and services produced by government activity and the resources used to produce them[14]. Efficiency can only be understood with reference to both these factors and their relationship. There are, however, many ways in which the inputs and outputs of activities, such as the provision of public sector services, can be defined. It is important that the choices made about these definitions are transparent in any discussion of efficiency measures. It is also important to note that this definition (and the scope of this paper) relates to technical as opposed to economic efficiency.

NO BLUEPRINT FOR PUBLIC SECTOR EFFICIENCY

The formal definition of efficiency as a relationship between inputs and outputs is relatively straightforward. However, measuring efficiency within public sector organisations is difficult[15] for a range of reasons, including the fact that public sector agencies typically:

» do not operate in the free market;

» provide services free or at non-market price;

» often have little or no control over their inputs;

» usually have no competitors[16];

» provide services which are often not viable in commercial terms; and

» often produce outcomes that are the result of complex interplay of factors and occur only over the long-term, for example, education and health policies.

These factors are especially relevant to some outputs of public sector agencies, such as policy advice and analysis[17]. Assessing the efficiency of agencies whose primary function is to deliver a product or service (e.g. a line agency providing employment programs) can usually involve some form of objective measurement or quantitative analysis.

However, measuring the output of policy areas and agencies involves a far higher degree of subjective judgement. Generally, there is no single identifiable assessment mechanism that will provide a robust measurement of performance of these organisations. This does not mean that the efficiency of policy research, advice and development is unimportant but it does highlight the fact that judgements about efficiency in these areas are more likely to involve qualitative measures of performance, such as feedback from Ministers and Ministerial offices and user surveys[18]. These measures will always be inherently problematic, as those making the assessment will generally only have a partial understanding of the range of issues affecting the relevant agency and in some cases may themselves affect its performance. For example, a Ministerial Office may adversely impact upon an agency's efficiency through making excessive or ill-considered demands of it. It is important, therefore, that efficiency measures which rely on subjective assessments of output are clear about how these judgements are being made. It also needs to be accepted that there are limitations on the objectivity and comprehensiveness of assessments of efficiency in many areas of public sector activity.

The difficulties involved in measuring public sector efficiency are reflected in the Australian and international literature in this area and the wide range of ways in which performance of public sector agencies is promoted internationally.

An OECD document[19] states:

> *'There is no blueprint for enhancing public sector efficiency. OECD countries have thus adopted diverse approaches to reforming key institutional arrangements, which include: increasing devolution and decentralisation; strengthening competitive pressures; transforming workforce structure, size, and HRM arrangements; changing budget practices and procedures; and introducing results-oriented approaches to budgeting and management. Although the majority of OECD countries have engaged in some institutional reforms, the empirical evidence of their impact on efficiency is so far limited due to: the lack of resources to conduct evaluations; the lack of pre-reform measures of performance; the complexities in measuring efficiency in the public sector; and the problem of isolating the effects of specific institutional reforms on efficiency from other external influences.'*

As the quotation suggests, this approach to efficiency is based on the concept of a homogenous process producing quantities of similar units of production. This does not reflect the way in which public sector agencies operate or the types of goods and services they typically produce.

EFFICIENCY IN CONTEXT

This literature also reflects the fact that, while efficiency is important, it is not the only component of public sector performance. For example, Boyne's review of dimensions of performance included measures of output quantity, output quality, efficiency, effectiveness, accountability, equity, probity, democracy and impact[20].

Some commentators also criticise the central role efficiency plays in assessing public sector performance. For example, Stiglitz et al[21] see this approach as arising out of the inappropriate introduction of market-based approaches to the evaluation of public sector services.

> *'This modernising agenda introduced the market imperative to public services. Efficiency became a key objective, and a new regime of performance management was put in place. With efficiency defined primarily in terms of the relationship of costs to outputs ('unit costs'), performance came to be measured through quantitative output indicators.'*

THE LIMITATIONS OF EFFICIENCY

Criticism such as this highlights the need to understand the limitations of the concept of efficiency and the importance of contextualising efficiency measures within an overall understanding of the goals of public sector organisations.

In particular, it is important to understand that measures of efficiency do not, and cannot, evaluate the outputs of a program or organisation. For example, efficiency measures can assess whether or not a program to subsidise unemployed people to attend training courses is delivered with the minimum use of resources. However, they cannot tell us whether or not this program will assist in meeting the overall goal of promoting higher rates of employment.

Whether or not a program is effective in achieving its goals is important, but is a separate issue which needs to be measured independently of efficiency. Two programs may be equally effective but not equally efficient if they involve different levels of resource use.

It is also important that efficiency measures are seen as secondary to effectiveness measures and not as an end in themselves. A program that is effective but not efficient will deliver some benefits to the community, even if it involves some wasted resources. However, a program that is efficient but not effective may waste all the resources it uses if it delivers outcomes not desired by the community. This reflects the broader concept of economic (as opposed to technical) efficiency, which is not the target of the Efficiency Dividend or the alternatives proposed in this report.

Therefore, it is essential that efficiency measures are always seen as contingent upon the effectiveness of the programs/organisations to which they are applied. Efficiency should not be seen as a goal in itself and efficiency measures should not operate independently of other strategies to promote overall public sector performance.

This approach is implicit in the Moran Review, which places efficiency measures last in its list of nine recommended reform measures. In the Review, efficiency is seen as contingent upon other public sector goals, such as delivering better services to the community and increasing agency capability and effectiveness. The Review states that its vision for the future is that 'agencies have strong strategy, delivery, efficiency and organisational effectiveness…' and recommends a number of measures to increase the capability of agencies to deliver high quality and effective programs. It also recommends strengthening the governance framework of the APS to support organisations to become more efficient. These recommendations, along with others in the Review, provide the context within which efficiency measures need to be developed and implemented.

If efficiency measures are isolated from other performance measures, as can occur when governments cherry pick recommendations from reports such as the Moran Review, there is a danger that efficiency is seen as an end in itself rather than a means to achieve pre-determined outcomes with a minimum of resources. This would not support the overall goal of the public service, as expressed in the Moran Review, to 'meet the needs of citizens'.

CONFUSION BETWEEN EFFICIENCY AND EFFECTIVENESS GOALS

Confusion between effectiveness and efficiency often arises when there is a lack of clarity about the outputs of an organisation or program. Critics of programs often describe them as 'inefficient' when their actual point of disagreement is over the goals of the program rather than its delivery.

For example, the 'Building Education Revolution' has been criticised for not delivering value for money in the schools building program[22]. However, this criticism rests on an interpretation of the goals of the program which excludes the social benefit of reducing unemployment during a global economic downturn. If this is included as a goal of the program, the benefits of progressing the scheme rapidly can be balanced against those of developing a longer-term funding scheme. Or as economist Joseph Stiglitz argued during his recent visit to Australia – any waste of financial resources in the stimulus package must be compared with the waste of human resources during a recession[23].

This issue is particularly important in relation to public sector programs which often have multiple aims involving broad and abstract outcomes such as social justice and equity, as well as more tangible outputs. There can be a tendency in evaluating programs to focus on measuring the easiest output measures at the expense of other more complex outcomes. This can result in programs appearing to be inefficient for delivering outputs which are harder to measure, regardless of their importance.

For example, many providers in the old Job Network felt there was an incentive to take the 'efficient' approach of getting more highly qualified job seekers placed in employment quickly while 'parking' the hardest cases, regardless of the fact that greater social benefit would arguably have come from the opposite focus. However, this conflict only arises if the goal of the Job Network to deliver social benefits is ignored[24].

These examples highlight the need to include all outputs of public sector organisations and programs, even those which are long term and/or difficult to measure, when assessing their efficiency.

Key points

» The Efficiency Dividend is the main efficiency mechanism in the Australian public service.

» Reviews of the Efficiency Dividend have identified a number of problems with this mechanism.

» These problems include the failure to accurately target potential efficiency gains and the inconsistent impact of the mechanism across the APS.

» Reviews have found that small agencies and those with a service-delivery focus are especially adversely affected by the Efficiency Dividend.

» The Efficiency Dividend is based on a number of problematic assumptions about the nature of public sector organisations.

In practice, this often does not occur due to the pressures placed on Governments to provide simple and objective measures of outputs and the focus of the media and public debate on short term outcomes. This can create an environment in which it is easier to focus on short term easy-to-measure factors, such as the amount spent on a program or the number of services provided, over longer term less tangible outcomes, such as the broader social benefits delivered.

This can result in efficiency measures being developed which do not adequately reflect the goals of the public sector to provide goods and services that cannot be provided as well (or at all) by the private and community sectors and which aim to benefit the lives of individuals and the community as a whole, both in the short and longer term.

The problems that can result from this approach are discussed in more detail, in relation to the Efficiency Dividend, in the following section.

How does the Efficiency Dividend work?[26]

The Efficiency Dividend applies to the operational (running) costs of government departments. These include salaries, operational expenses and depreciation although some sources of funding are exempt (for example industry levies and funding for new policy proposals in their first year). Agencies calculate their own budget estimates for submission to the Department of Finance and Deregulation, based on instructions from Finance. In simple terms, an agency takes the figure that represents their departmental expenses from the previous budget and applies the Efficiency Dividend to this figure. After applying the dividend, the agency then indexes that funding for inflation using the relevant Wage Cost Index.

Which agencies does the Efficiency Dividend apply to?

All agencies are subject to the Efficiency Dividend unless they have been exempted by Government. Two agencies are currently exempt from the ongoing Efficiency Dividend: the Australian Broadcasting Corporation (ABC) and the Special Broadcasting Service Corporation (SBS). The Australian Nuclear Science and Technology Organisation (ANSTO) was previously exempted but this was removed in the 2010/11 Federal Budget. Three other agencies have the Efficiency Dividend applied to only a percentage of their departmental funding: the Australian Institute of Marine Science (12%); the Commonwealth Scientific and Industrial Research Organisation (30%); and the Department of Defence (11.2%). The following agencies were also exempted from the additional 2% Efficiency Dividend (applied from 2007 to 2010): the Australian Trade Commission; the Australian Fair Pay Commission Secretariat; the Workplace Authority; the Australian Prudential Regulation Authority; and the Australian Sports Commission. The reason given for these exemptions was that these agencies were significantly affected by other election commitments.[27]

What is the current rate of the dividend?

The rate of the dividend now stands at 1.25 per cent, with the Government imposing an additional one-off 2 per cent Efficiency Dividend for 2008-09 appropriations.

How much revenue is raised by the Efficiency Dividend?

As measured by short-term budgetary savings (see discussion below on why such a short-term approach is flawed) the Efficiency Dividend yielded savings of around $662 million in 2008–09.

What is the Government’s stated rationale for the Efficiency Dividend?

The Government has stated that the rationale for the Efficiency Dividend is to give agencies an incentive to find efficiencies; to redirect funds to higher priority activities and to publicly demonstrate efficiency improvements in the public service.

Section Two — the Efficiency Dividend

Currently, all federal public sector agencies are subject to an annual Efficiency Dividend that reduces administrative budgets each year on the assumption that 'efficiencies' will be found. This model has been used in Australia for over 20 years and is currently the main efficiency mechanism across the APS.

The Efficiency Dividend is a central factor impacting upon the way in which the Government uses public funds to provide services to the community. If it is effective in achieving its aims it could improve the efficiency of government departments and provide citizens with better value for the resources used. If it is ineffective, it could reduce the amount and the quality of services available to the community and waste resources.

In the past 16 years, the Efficiency Dividend has been reviewed twice – a House of Representatives Standing Committee on Banking, Finance and Public Administration report (1994) and a Joint Committee of Public Accounts and Audit report (2008). Both reviews concluded that the Efficiency Dividend had succeeded in driving efficiency in agencies, but the 1994 report did recommend that the Efficiency Dividend be reduced from 1.25 per cent to one per cent and that agencies' external receipts be exempt. The 2008 report found that the current Efficiency Dividend is placing significant stresses on agencies, particularly small agencies, and that the current mechanism was more than one per cent higher than what the private sector achieves.[25] The 2009 Moran Review of the public service also addressed the Efficiency Dividend and recommended that it be reviewed.

The reviews undertaken of the Efficiency Dividend and related issues of public sector performance[28] identified a number of problems associated with the implementation of the Efficiency Dividend, including the following.

It applies differently across different agencies

Because some expenses are exempt from the Efficiency Dividend (external receipts, special appropriations and funds for new policy proposals in their first year) agencies that are more reliant on these sources of funding are less affected. These include regulators and commercial research agencies that are funded from industry levies. The agencies that are more affected by the dividend include the courts, cultural agencies, oversight agencies and departments of state. For these agencies, eligible appropriations can comprise almost 100 per cent of their funding. Cultural institutions such as libraries and museums have been particularly affected by the Efficiency Dividend as they have large asset holdings, meaning that a high proportion of their expenses are tied up in depreciation, not subject to indexation. As a result, agencies have had to find additional efficiencies from their operating expenses to pay for efficiencies they cannot find in their depreciation.

Agencies' capacity to make arbitrary savings has diminished over time

While there is some evidence that initially the Efficiency Dividend may have contributed to agencies becoming more efficient, the capacity to continue to find efficiency gains has diminished. This is resulting in agencies having to cut services and functions to meet targets. For example, the Australian

War Memorial (AWM) has reported having to cut back on successful functions, such as open days and carol singing, and reduce staff numbers as a result of the Efficiency Dividend. AWM Council Chairman General Peter Cosgrove has expressed concern that continuing efficiency measures may compromise the Memorial's capacity to commemorate the centenary of Gallipoli in 2015. The National Archives of Australia has also raised concerns that pressures from the Efficiency Dividend in conjunction with new freedom-of-information legislation could result in sensitive government documents being inadvertently released to the public due to inadequate staff numbers.

These examples reflect the findings of the Public Service Commission which in 2008[29] found that a significant number of agencies reported that the Efficiency Dividend had resulted in a reduction in services and increased pressure on staff, specifically:

> *'…a reduction in staffing levels and increased working hours for existing employees (each reported by around 50% of agencies). Almost one-third of relevant agencies indicated that the additional efficiency dividend had already had other impacts, including increased workloads and/or pressure on staff, increased customer service waiting times, reduced service standards for some customer activities due to fewer staff, training being postponed and a reduction in some programmes.'*

Smaller agencies and those with a service delivery focus suffer most from its adverse affects

While the Efficiency Dividend affects all agencies, small agencies and service delivery agencies (such as the Bureau of Meteorology and the Australian Bureau of Statistics) are particularly adversely affected. Small agencies have a reduced economy of scale and less capacity to shift funding internally to meet targets. They are also less likely than larger agencies to attract additional sources of funds, for example via new policy proposals. Agencies with a service delivery focus are also less likely to attract funding via new policy proposals which can be used to off-set the savings required via the Efficiency Dividend. However, over time larger agencies will begin to experience the same pressures imposed on smaller organizations as their capacity to accommodate the Efficiency Dividend internally diminishes.

One respondent to the survey commented:

> *'Smaller agencies have little or no capacity to achieve efficiency gains and are then forced to abolish positions to achieve short term efficiencies on paper but cause long-term costs to increase. e.g. abolishing OHS positions short-term will lead to increased accidents/injuries and higher workers' compensation premiums and costs long-term.'*

Measures are not well targeted

A common frustration raised during the consultation process was that the Efficiency Dividend was ineffective in targeting areas of inefficiency within their own workplaces and agencies.

For example, a number of participants identified that there was potential to save considerable resources by limiting unnecessary travel to meetings and other activities. They felt that there was scope in a number of cases for face-to-face meetings to be substituted by telephone, video and internet conferencing, which would save both time and travel expenses. It was also noted that a number of agencies had invested in expensive equipment to enable this to occur however the uptake was slow.

Other participants mentioned a need to be honest and up-front when programs are ineffective. They mentioned instances where failing or poorly performing programs were allowed to continue for too long because there was a cultural barrier within the APS to admitting that something had failed. This resulted in the ineffective use of resources and an unrealised source of efficiency gains. Some participants noted that in their agencies there appeared to be a preference for imposing across the board cuts to all programs, regardless of their performance, as opposed to identifying and cutting under-performing areas and allowing high performing programs to continue without budget cuts. Many participants felt that a more targeted approach to identifying areas of inefficiency would result in a more effective mechanism for making budget savings.

Actual efficiencies required are greater due to inadequate inflation adjustment

The Department of Finance and Deregulation (Finance) adjusts agencies' eligible appropriations for inflation using a variety of Wage Cost Indices (WCIs). Often these indices are insufficient as agencies' costs are increasing at a higher rate than the WCIs. This means that the actual savings required are greater than the Efficiency Dividend.

It doesn't reflect actual patterns of efficiency gains

Efficiency gains within organisations typically do not occur in equal increments over a long period of time. Major gains tend to occur occasionally, as the result of a new innovation (for example the introduction of a new technology) followed by a period of little or no gains while the changes are adopted. The imposition of a regular annual Efficiency Dividend does not match the actual pattern of efficiency gains within organisations.

It can create perverse incentives to limit efficiency gains

When managers know that they are required to meet an efficiency target every year they may anticipate the requirement for savings in the previous year. Therefore, if there is potential to achieve savings over and above the Efficiency Dividend one year, managers have an incentive to delay these savings in order to meet the target the following year.

It encourages inefficiencies in other areas

There is evidence that managers anticipate the need to achieve savings by 'building in' additional costs into other sources of revenue. For example, a department putting forward a new policy proposal may include additional expenses not required to implement the policy in order to have funds to hand back as efficiency savings. A few participants in the consultation process reported that it was common practice for managers within their organisation to look to new policy proposal funding as a source of revenue to off-set cuts made elsewhere. A consequence of this practice is that the Department of Finance then may anticipate this practice and unilaterally reduce funding for new policy proposals, thus risking under-funding proposals which have not had their budgets artificially inflated. It also wastes staff time and resources in diverting funding from one program to another in order to deliver program objectives in areas that have been cut due to the Efficiency Dividend.

It is not coordinated with other efficiency measures

In addition to the Efficiency Dividend, the government has occasionally introduced additional efficiency measures in specific areas, such as information management, central purchasing and property. This has led to a number of unintended impacts due to the interaction between the Efficiency Dividend and these additional measures, which compound the savings that agencies are required to identify.

It encourages politically-driven short-term savings

The Efficiency Dividend enables governments, under pressure from short electoral cycles, to quickly find short-term savings and ignore the longer-term impact of these on the capacity of APS agencies to fulfil their roles. It is easier for a government to impose an Efficiency Dividend than to take a longer-term and more complex approach to identifying potential savings throughout the APS which can be achieved without compromising performance.

Efficiency Dividend – underlying assumptions

The Efficiency Dividend is based on a number of flawed assumptions about the role of the public sector and the way in which it operates. This section identifies some of those assumptions and challenges their validity.

Assumption: Australia's public service is inefficient

Any discussion of performance and efficiency within the Australian public service needs to be seen within the context of research findings that the APS as a whole is already functioning at a high level of efficiency.

One recent example is an international benchmarking study commissioned by the Advisory Group to the Moran Review which compares the Australian Public Service with those in eight high performing countries: Canada, Denmark, France, New Zealand, Singapore, The Netherlands, United Kingdom and the United States of America.[30]

The report, written by KPMG, scored Australia in the top third of countries when it came to having a highly independent public service with a robust values-based culture. It also found that Australia's public service was highly responsive to changes in the economy. Specifically, the report found that:

> *'Overall, perceptions of the efficiency of Australia's bureaucracy and level of business regulation are perceived to be more favourable than the majority of the other comparator countries[31].*

One area identified by research in which Australia has the potential to improve performance in its public sector is in relation to the relatively high proportion of staff employed in support services as opposed to service delivery or other frontline operations.[32] However, the Advisory Group report notes that this may be partly a result of the devolution of management functions to smaller agencies as part of the public sector reforms of the 1980s-1990s and therefore out of individual agencies' control. There is also anecdotal evidence from individual agencies that reducing support staff can impact upon service delivery. For example, the Australian War Memorial reported that cuts to support staff forced by the Efficiency Dividend resulted in some previously successful functions and programs being terminated.[33]

Furthermore, there may be inefficiencies associated with reducing the numbers of support staff if this results in employees at higher levels having to undertake tasks which could be performed effectively by those at a lower level. Over the long term, there may also be broader societal benefits in creating more entry-level jobs in public sector agencies.

While there may be scope to increase efficiency in some individual agencies or across the APS in some functional areas, the evidence demonstrates that overall Australia's public sector is very efficient.[34]

Assumption: Cutting budgets delivers efficiency gains

While there are a number of different definitions of efficiency, at their core they are all based on a relationship between inputs and outputs. In general terms, efficiency is about delivering maximum performance for minimal input. Therefore, it can only be understood in relational terms, not by just looking at the inputs or outputs in isolation. However, the Efficiency Dividend focuses only on the inputs of an agency. It assumes that budgets can be cut without affecting outputs and that a budget reduction is an efficiency gain, regardless of its impact on the outputs of an agency. This is a fundamental misunderstanding of the concept of efficiency and is not supported by the experience of agencies which have had to cut valuable functions in order to meet efficiency targets.

Assumption: All agencies have the capacity to increase efficiency

The Efficiency Dividend imposes a uniform budget cut across the spectrum of the public service (with some specific exceptions, identified above). While this budget cut is termed an 'Efficiency Dividend' there is no mechanism within the Efficiency Dividend to identify areas of inefficiency (if indeed they exist) and reduce their budgets accordingly. It assumes that all agencies are operating at the same level of inefficiency and that this will be addressed through a uniform budget reduction each year. This does not reflect the evidence or the experience of those working in the APS.

Many participants in the consultation process expressed the view that some agencies – and areas within agencies – simply had no more potential for efficiency gains. As one respondent wrote:

> *'It would be very difficult to identify efficiency gains in DFAT as we have so few programs and so much of our operating budget is spent on fixed staff and property costs. Whole-of-government travel and IT reviews leading to savings have also eliminated potential areas for efficiencies.'*

This comment reflects the changing role of the Department of Finance from the previous to current government in switching its focus from selling public assets to seeking service-wide efficiency by proactively identifying whole-of-government savings. The result of this change in focus is that many of the potential savings that agencies may have been able to make to meet the Efficiency Dividend have already been provided through APS-wide measures, leaving reductions in staff and services as the only way to meet savings targets. This occurs because the Efficiency Dividend does not recognise that some agencies may already be operating at maximum efficiency and that no further gains may be achievable.

Assumption: Setting targets improves performance

The Efficiency Dividend involves setting targets for savings for specific agencies or for the public service as a whole. These targets are developed and imposed externally without input from the agencies themselves. There are a range of problems with this type of approach identified in the literature on public sector performance, including the fact that targets usually reflect a tendency to measure factors that are easy to measure, rather than those which accurately reflect performance.[35]

For example, Bevan and Hood[36] document three well-recognised problems that can arise from the setting of targets:

1. Ratchet effects (where targets are set based on previous years' performance). This creates an incentive for managers to reduce their output increases to a modest increment so that expectations and future targets will be set at a low level.
2. Threshold effects (where agencies focus attention on those outputs that are near to the required level of output). This leads to the concentration of effort on outputs that are just below the required level, ignoring the best (on the basis that these outputs will meet the test without effort) and the worst (on the basis that the effort required is outweighed by the cost of improving these to the minimum standard).
3. Distortion (where agencies focus on achieving output improvements in areas that are measured, at the expense of unmeasured aspects of performance).

These problems are all reflected in the experience of APS agencies in relation to the Efficiency Dividend. In particular, participants in the consultation process reported that managers tended to focus on meeting short-term budget targets at the expense of delivering longer term program objectives. For example, one participant reported that in her sub-agency evaluation processes for programs are frequently cut in order to reduce budgets despite the fact that these evaluations would provide valuable information for future program development in this area.

Section Three — principles and recommendations

This section draws on the research discussed above and consultation with Commonwealth public servants contacted via the Community and outlines specific principles which should underlie any approach to measuring and promoting efficiency within the APS.

Broader outcome measures

Principle 1: Efficiency should be seen as one of several measures of public service performance, and measures to improve efficiency should not compromise the effectiveness of policy development or implementation, such as the quality of service delivery.

Principle 2: Efficiency measures should be based on acomprehensive assessment of outcomes, including longer-term impacts on individuals and communities.

Efficiency measures should be put in the context of other factors which reflect the aims of the APS and its agencies. In most cases these aims relate to qualitative and long-term outcomes for individuals and communities. For example, the vision statement of the Department of Health and Ageing (DoHA) is Better health and active ageing for all Australians. The achievement of this vision can only be assessed over a lifetime – or even over multiple generations – of Australians. The policies and programs undertaken by DoHA therefore need to be assessed in terms of this timeframe and their potential to reflect this vision.

Often policies and programs involve investment of resources in the short-term to achieve gains in the longer term. For example, an anti-smoking program is unlikely to deliver short-term gains but will increase the health of the community and reduce spending on health care over the longer term.

Similarly, programs which support the recruitment and retention of Aboriginal and Torres Strait Islanders in the public service may result in short-term costs however, if successful, will deliver long-term benefits to the community through increasing the diversity of the APS and reducing inequalities between Indigenous and non-Indigenous Australians.

Measures, such as the Efficiency Dividend, which focus solely on short-term budget savings ignore the longer term benefits of programs such as this and do not reflect the core function of the APS to improve the lives of Australians, both now and into the future.

To ensure efficiency measures support the comprehensive aims of the APS it is essential that they are not allowed to interfere with the achievement of other aims which may be qualitative, long-term and include environmental and societal outcomes.

EVIDENCE AND EFFICIENCY MEASURES

Principle 2: Efficiency measures should be evidence-based and reflect the actual potential for achieving efficiency gains without compromising service delivery.

A major problem identified with the Efficiency Dividend in the literature and via the consultation process is that it is a uniform, arbitrary figure applied across the public service which does not reflect the actual potential for efficiency gains in individual portfolio areas/agencies.

Many participants in the consultation process felt strongly that the Efficiency Dividend was driven much more by the Government's need to find short-term savings than any evidence of existing inefficiencies within the APS. In many cases, they felt that this level of efficiency gain was not possible without making compromises to the outcomes of the program or policy area. In some cases participants felt that their work areas could achieve higher efficiency gains than those demanded by the Efficiency Dividend.

The evidence from the literature (and reflected by participants in the consultation process) is that there are some potential efficiency gains possible across the APS but that these differ widely from agency to agency and that there are some agencies where no further efficiencies are possible. There was strong support for the option suggested by the Moran review for efficiency targets to be based on an agency review. The Australian National Audit Office was suggested by a number of people as the appropriate body to undertake such as review.

The Gershon Report[37] approach to benchmarking and savings is one possible approach however its implementation was seen as flawed by many participants because targets were set for each agency without considering their genuine capacity to deliver these outcomes.

To achieve a sufficiently broad evidence base for developing efficiency measures, a specific analysis of the structure, processes and operating environment for each agency (or portfolio) would be required. This would need to take into account the diversity of public sector agencies and all factors relevant to the operating environment of the agency, including the following:

» size of the agency;

» function – particularly the primary or core roles of an agency;

» specific programs;

» the nature of the work undertaken by the agency – specifically whether it is increasing, decreasing or becoming more or less complex;

» the proportion of operating expenditure spent on non-discretionary costs, e.g. salaries and property;

» the proportion of fixed costs in total budget;

» portfolio, area of land managed to staff ratios; and

» stakeholder expectations.

This will reduce the potential for measures to discriminate against smaller agencies or those with a central policy function, which a number of stakeholders identified as occurring under the Efficiency Dividend.

In addition, there also needs to be acceptance that some agencies and sub-agencies may already be operating at maximum efficiency (as discussed below).

EMPLOYEE INPUT

Principle 4: Employees and their unions should have the opportunity to provide input into efficiency measures.

It is important that employees have the opportunity to provide input into the development, measurement and review of efficiency measures. This is because all employees have a role in improving efficiency within their agencies and also because they have specific knowledge of how efficiency can be maximised within their work areas. Unions can play a crucial role in representing members and coordinating their input in these kinds of processes. The process of reviewing agency efficiency and identifying efficiency measures needs to capture this knowledge and provide employees with the information and support they need to make a meaningful contribution to its outcome.

A continual frustration raised by participants consulted in the development of this paper was the lack of employee input into the Efficiency Dividend process. Many participants felt that they had a valuable knowledge of where efficiency gains could be achieved in their work areas but that they had little or no capacity to provide input into the Efficiency Dividend process. They felt that if there were greater employee input into efficiency measures that they would more accurately reflect the actual potential for efficiency gains and that also staff would be more engaged in the process and more motivated to achieve the targets set.

Genuine consultation processes with agency staff and unions require a long-term commitment and an investment of resources. For example, agencies may need to commit to an initial education/information provision process so employees are aware of government priorities in this area, options under consideration and relevant timeframes/constraints. A specific communication strategy may also be needed to support staff consultation processes to ensure they are effective.

Employee consultation must occur via a transparent process conducted by an independent body external to the organisation, so staff can have some trust in the outcome. It is also important that staff are aware of how feedback is being used to inform the development of efficiency targets and that any information provided is used to improve both agency and APS-wide performance, for example, by being returned to the agency in a de-identified format.

In terms of process, there are a number of mechanisms through which employee input could be obtained, including:

» staff surveys;
» built into planning processes at agency and sub-agency level;
» a dedicated email address to collate staff input;
» managers/team leaders regularly meeting with staff on this issue;
» the CPSU representing members in consultation processes;
» specific focus groups, forums and workshops;
» departmental or APS-wide wikis to which all employees could contribute; and
» an internal Gov 2.0 platform.

The above list represents options for consultation mechanisms, only some of which may be appropriate for individual agencies. It is important that any employee consultation process does not involve onerous reporting requirements or itself result in reduced efficiency.

Most participants felt strongly that input should be able to be provided anonymously. One suggestion was made that existing data collection measures, such as staff surveys, contain qualitative data that could be useful in identifying areas of potential efficiency gains and that this should be accessed before additional data collection measures were implemented. It was also noted that for employee input to be most useful, some initial education on efficiency measures might be required.

A number of people made the point that APS staff are becoming increasingly cynical about the commitment to staff input after having a number of negative experiences in this area. One participant described a 'consultation' process in her department in which staff was asked to provide feedback on an issue via an email address and it was found out later that the emails were never read.

A number of participants stressed that this must be a transparent process and occur external to the organisation so that staff can have some trust in the outcomes.

POLITICISATION

Principle 5: Efficiency measures should not be used by governments as a political tool to reallocate funding outside of normal budgetary processes.

In practice, the Efficiency Dividend has functioned less as a performance improvement measure and more as a redistributive mechanism that allows governments to be able to move funding to new priority areas without the political difficulty in shifting resources away from existing funding commitments. This reduces the capacity for agencies to deliver against their objectives and undermines the accountability and transparency of government. Efficiency measures should not be used as a de facto mechanism to change funding arrangements outside of normal budgetary processes but should focus on promoting optimum outcomes for resources already allocated.

REVIEW OF EFFICIENCY MEASURES

Principle 6: Efficiency measures should be regularly evaluated by an independent body, with employee representation included in this process. The timeframe of such evaluations should match the typical timeframe in which investments in efficiency gains achieve results.

A regular evaluation of efficiency measures is essential to ensure that progress towards agreed policy goals is being met within the legislative requirements.

Evaluations should be undertaken by a body external to the agency in order to be transparent and accountable to stakeholders. ANAO is one possibility, however, this would not be appropriate if it was also involved in an initial audit/review of agency efficiency, as discussed below. Other options include the Public Service Commission or a new body established for this purpose. This may require an initial investment of funds and training as it may take some time for the agency commissioned with this task to develop or obtain the necessary skills and experience. Therefore, there may need to be a 'training period' in which evaluations are undertaken but not used to affect funding purposes.

Evaluations should occur approximately every 24 months, as a shorter timeframe would not allow sufficient time for efficiency measures to deliver results.

Inquiries into the Efficiency Dividend (as discussed above) found that a 12 month timeframe for measuring efficiencies does not reflect the actual timeframe required to identify and implement changes within an organisation to improve efficiency. A two year timeframe should allow time for new systems to develop and to be fully implemented before assessing their impact. This may help to ensure that short-term issues don't skew the results, as some efficiencies may not be apparent or measurable within a shorter timeframe. As some participants noted, major changes such as new IT systems can take up to two years to deliver benefits and, if measured within a shorter timeframe, may not show any improvements.

A longer timeframe would also minimise the imposition of the evaluation on staff, helping to avoid the danger of efficiency measures that, perversely, increase inefficiency. This would be only one of a number of budget and performance review processes, both internal and external to the agency, which employees have to accommodate in addition to their usual work.

Principle 7: Agencies should be able to access funding from a specific budget allocation in order to identify potential efficiency gains and implement reforms.

Organisations improve their performance by changing the ways in which they operate, not simply by cutting costs and reducing expenditure. This can involve internal restructuring, changing organisational and management systems, creating new roles and implementing new operating processes, among other possibilities. To be effective, these changes usually require a substantial resource commitment from the organisation. Resources are required at all stages of the change process, including for consultation with staff, unions, clients and other stakeholders. Often reforms may require an initial investment of funding and do not deliver productivity gains until a later stage. For example, introducing a new information technology system may require the purchasing of new software and equipment, staff training and time for the organisation to adapt to the change.

Agencies in the APS do not typically have a budget allocation for funding to identify potential efficiency gains within their organisation and implement reforms. This restricts their capacity to implement ongoing performance management processes. All agencies should have access to funding from a central budget allocation to develop and implement organisational changes to improve performance. This funding should be provided to agencies on the basis of evidence of potential efficiency gains, for example from an ANAO review (as outlined above).

Alternative strategies

This section discusses specific alternative options for measuring and promoting efficiency within the APS to replace the Efficiency Dividend. These options include both those identified in the Moran Review (Options 1-4) and additional suggestions arising out of the consultation process for this project (Options 5-7).

OPTION 1 — ROLLING BUDGET AUDITS

Implement rolling budget audits (based on the approach taken in the Defence Budget Audit Report) which build a review into regular budget processes.

The implementation of regular reviews or audits would be an improvement on the Efficiency Dividend as it provides an evidence base for identifying potential inefficiencies and developing mechanisms to address them.

Another advantage of this approach over the Efficiency Dividend is that it may be less open to political influence and thus result in greater fiscal responsibility. It may also support a process of continuous monitoring and review and reinforce a continuous improvement culture, preferable to the current annual cycle of belt tightening followed by spending sprees at the end of the financial year.

However, while the concept of regular performance reviews or audits was supported, this should not be exclusively an internal process. There is a role for an external body as well, to give objectivity, independence and a broader perspective.

Some participants in the consultation process also felt that there was the potential for this option to lead to bullying of individual agencies, particularly those with less power and prestige than Defence.

It would also be important that the Budget review take account of all the reasons budgets may need to be increased, including emergency situations or unanticipated events. The involvement of all levels of agency staff, including executive management, mid level management and others, would be critical to ensuring the review's success.

One option for engaging all levels of staff in the review would be to establish a specific internal team assigned to this task, covering a cross section of staff from various areas (policy, front line delivery, finance, IT and strategy) and different levels (APS5 to SES). This could be combined with a role for an independent auditor or reviewer (e.g. Australian National Audit Office) to ensure some independence from the organisation.

As one participant commented:

'Line areas are best placed to advise on potential efficiencies in their program. External agencies may, however, be well positioned to provide advice on typical (or non-typical) efficiency opportunities.'

Recommendation 1: Undertake regular audits of agency and/or portfolio efficiency as a basis for developing efficiency measures, separately to the annual budget process.

OPTION 2 — DISCRETIONARY SAVINGS

Option 2: Remove the Efficiency Dividend entirely and rely on discretionary savings processes, driven by budget priorities and offsets, to meet the government's fiscal objectives.

This option has advantages over the current Efficiency Dividend in that it is more flexible in its implementation and could therefore be more responsive to government policy priorities. For example, some programs/functions could be quarantined from efficiency measures if they are already operating at maximum efficiency or if additional efficiency measures would have an adverse impact on service delivery.

However, this option is the most open to politicisation and, lobbying by powerful interest groups or short-term, sectional interests which could result in reduced performance overall. To a large extent this would depend upon how 'discretionary savings' were defined and who defined them. If they were based on appropriate evidence with staff, union and other stakeholder input the potential for this would be greatly reduced.

This option may also support the current practice of 'double dipping' whereby additional savings in specific areas, for example IT, are added to the Efficiency Dividend without it being reviewed so that agencies end up being required to deliver more than was initially intended.

The main challenge with this option would be to ensure that targets set reflect potential for efficiency gains in different agencies. Some participants felt that the current Efficiency Dividend process was highly distorted by the influential agencies and that this option would perpetuate this and discriminate against fringe and smaller agencies.

Recommendation 2: Reject discretionary savings processes as a means for achieving savings as without a clear evidence base they are too easily politicised and subject to pressure from powerful interest groups.

OPTION 3 — AN AGGREGATE TARGET BASED ON ASSESSMENTS

Introduce a mechanism that makes a qualitative and/or quantitative assessment of the level of efficiency between agencies, and arrives at an aggregate savings target across the APS, in accordance with these assessments.

This option also is an improvement on the Efficiency Dividend in that it uses evidence to develop savings targets. However, it is unlikely that a single aggregate target would reflect the diversity of APS agencies. Given that different agencies have very different roles, aims and operating environments, which require tailored staffing and resources, it is difficult to see how these could be accommodated within an aggregate target. This is likely to result in a target which has a disproportionate impact on different agencies and could result in agencies using resources to compete against each other rather than focusing on providing optimum levels of service to the Australian community.

This option may also reward bad management by allowing the inefficiencies of under-performing agencies to be offset against those from more productive departments. Therefore, it could result in the under-performance of some agencies being masked rather than identified and addressed.

This option may also make it more difficult to take the specific needs of agencies into account when evaluating efficiencies. This is because costs in some areas may be higher than average in specific agencies due to their role, and cannot be reduced without changing their function. For example, cultural agencies which store artwork or cultural artefacts have to maintain constant temperature controls which results in a higher electricity bill than other agencies without this function.

Another option suggested in the consultation processes was that efficiency could be measured across multiple agencies (or even the APS as a whole) by functional area rather than by organisation. Functional areas may be cross-agency, such as human resources, ICT, travel services, in a number of comparable agencies. This would provide opportunities for benchmarking across the APS and for identifying and adopting best practice. It would also reduce the potential for agencies to 'hide' under-performing areas within an overall agency review. Furthermore, it was suggested that this process might open up the possibility of sharing functions between agencies, i.e. for one agency to take on responsibility for a function needed by several other agencies.

Recommendation 3: Reject the concept of an aggregate efficiency target because it does not reflect the diversity of the APS.

Recommendation 4: Consider trialling the assessment and development of efficiency measures for common functions performed across multiple agencies, where there is evidence to support this approach.

OPTION 4 — SYSTEMATIC REVIEWS

Implement systematic agency reviews which assess the actual potential for savings in each department and use these as a basis for individual agency efficiency targets.

A major strength of this option is that it bases efficiency targets on an assessment of the actual potential for savings in individual agencies. This would enable those areas already operating at maximum efficiency to be exempt from savings targets and ensure efficiency measures are targeted at areas which have the potential to improve performance.

Critical to the success of this measure would be to ensure that the reviews involve all stakeholders, including staff, unions and users via a transparent consultation mechanism. As discussed (above) in reviews of agency efficiency there are roles for both internal and external review processes. To ensure objectivity and consistency in reviews across agencies, an independent group such as the Australian National Audit Office could conduct the reivews, or a new statutory authority could be set up specifically for this purpose. This would require additional resources to ensure that review teams are appropriately equipped for their role, in terms of their skills and experience, with expertise relevant to the particular portfolio or agency being examined.

The timeframe for reviews is also an important issue that would need to be addressed. This involves balancing the resources required for a comprehensive review with the need for review to maintain relevance as agencies develop and evolve. One option put forward in the consultation process was a rolling program running over each agency every 3-5 years.

Another suggestion was that reviews should occur every time a major work or expenditure is proposed that is outside the nominal operations of the agency. This would ensure that the expenditure is transparent and in the interests of the public service rather than the careers of those in executive positions within the public service.

There would be no need to establish an APS-wide timeframe for reviews as that this could vary depending on agency and results of earlier reviews. For example, a high-performing agency (as determined by an earlier review) would be unlikely to suddenly yield significant new savings so a review period of 3-5 years would be appropriate. However, an under-performing agency would have greater potential for achieving quick efficiency gains and therefore should be on a 12 month review cycle. It should also be noted that targets are not necessarily needed to deliver savings and that a similar process could be put in place without setting efficiency targets.

As discussed above, agencies should be able to nominate to opt out of efficiency measures if there is evidence that they are already operating at optimum efficiency and that this would be determined on the basis of an audit/review.

Recommendation 5: Undertake independent reviews (involving input from employees and their unions) as the basis for developing efficiency targets.

The following options were identified during the consultation process as additional strategies for promoting efficiency in public sector agencies.

OPTION 5 — FORMAL AGREEMENTS

Develop a 'formal agreement' between senior managers, relevant Ministers, employees, unions and stakeholders for each agency, on efficiency targets and measures to achieve them.

This option would involve a similar process to enterprise bargaining with all key stakeholders involved in developing efficiency targets. Once an agreement was reached it would be signed off (e.g. by the Minister, Department Secretary/CEO, relevant Union Secretary or the Auditor General).

This option would ensure all stakeholders have input into the setting of efficiency targets. It would lock-in stakeholder agreement on the level of the targets and how best they could be achieved. It would aim to ensure employees are part of the process, rather than having an external mechanism imposed upon them. It also provides the opportunity for a consensus agreement between all stakeholders which is likely to result in more realistic targets than one which excludes key players.

A key strength of this option is that it would allow input from all relevant stakeholders and involve employees at different levels within an organisation who will have differing views and knowledge about where efficiency gains can be made. This is likely to reduce the potential for negative unintended consequences of targets set by management without input from staff at lower levels.

A disadvantage of this option raised by some participants was that it might be too time-consuming to negotiate and therefore not be cost-effective. An additional point was that the proposed process may be open to undue influence by poor management if other stakeholders were not effectively represented. In particular, the success of this process was seen as depending upon a strong role for employees and their unions where they have real influence and are not just tokenistic inclusions.

One participant noted that this approach would represent a significant change and therefore would require culture shifts and take some time (and generational change) to fully implement. While this form of workplace democracy is not uncommon in Scandinavia and Germany, it is relatively unusual in Australia.

Recommendation 6: Trial a formal agreement between stakeholders on efficiency measures and targets.

OPTION 6 — INCENTIVES FOR MEETING TARGETS

Provide incentives for agencies to develop and meet their own efficiency targets, such as allowing agencies to retain a proportion of saved funding.

Currently, the Efficiency Dividend delivers savings to consolidated revenue and individual agencies do not keep savings achieved. This option involves providing incentives for agencies to develop and meet their own efficiency targets, such as allowing agencies to retain a proportion of saved funding to be used for internal purposes.

This would recognise the contribution of employees and provide recognition and incentives for efforts made to improve performance. It also reflects the current approach to performance management within the APS where staff are rewarded for performance improvements through annual performance evaluation.

The percentage of efficiency gains that should be retained by agencies could be varied. Participants in the consultation process ranged from 50 per cent to 100 per cent with one person suggesting that it should start at 50 per cent 'with a sliding scale when certain amounts are reached (for example, 50 per cent up to $10m then 40 per cent for the next $10m etc)'. Another suggested that it should be based on what is considered a 'reasonable profit level', for example, whatever level at which we impose additional tax on mining companies.

The saved resources could be used for a range of functions, including funding:

» trials of new and innovative programs;

» support services for agency staff;

» support for the redeployment of staff where efficiency goals result in a restructuring of the workforce;

» staff development programs, such as conference attendance;

» staff facilities; and

» staff retention initiatives.

However, concerns were also expressed in the consultation process that this option could be open to misuse and may not result in any benefits to employees. Specifically, concerns were raised that any bonuses could go to managers who may have overworked staff to get their performance bonuses and therefore give managers an incentive to exploit staff.

Some participants also expressed the view that funding for public services does not belong to departments or public servants but to the community as a whole, to be allocated according to the priorities of the government. Therefore, allowing agencies to retain resources for use at their discretion may undermine the role of the APS.

In addition to this, some participants were sceptical about the execution (rather than the principle) of this option, in particular the potential for agencies to manipulate the data to deliver false efficiency gains.

Recommendation 7: Trial a model which allows agencies to retain part of the savings they make by increasing efficiency.

OPTION 7 — INCLUSION OF BROADER MEASURES OF PERFORMANCE

Include environmental and social justice measures along with efficiency measures as a performance target.

The Efficiency Dividend and other savings measures implemented across the APS have generally relied on a narrow definition of efficiency. However, participants in the consultation process raised the concept of including environmental and social justice measures in an overall efficiency/performance target. This would involve introducing a mechanism to measure performance in this area, for example, CO_2 (or equivalent) emissions, and including this in the setting of efficiency targets.

Participants commented that this would provide a broader view of performance than just a narrow output measure and would set an example for the private sector.

Some participants made the point that some agencies would, by the nature of their work, find it harder to meet targets based on environmental or social justice outcomes. For example, an agency which is required to operate seven days a week (such as a museum or art gallery) will necessarily require more power for heating/cooling/ lighting and other functions than one which only operates Monday-Friday. Therefore, it would be important that any mechanism introduced to measure performance in this area would be able to distinguish between an agency which is legitimately using power at the weekend to provide a service to the public and one which is closed but has simply left lights/heating/cooling running.

Given these issues and the fact that this option was not considered in the Moran Report (or associated documents), there is scope for further consultation with stakeholders on the implications of including environmental and social justice measures into performance measures.

Recommendation 8: Undertake further consultation on putting efficiency measures into the context of a broader framework of measures of public service performance that includes environmental and social justice issues.

COMBINING OPTIONS

The options described above are not mutually exclusive in most cases. For example, Options 5-7 could be combined with any of the other recommendations.

Conclusion

Improving the performance of Australia's public service can deliver long-term benefits to individual Australians and the community as a whole. There is widespread evidence that the Efficiency Dividend is not working effectively to promote a high level of performance across APS agencies and, in some cases, may be reducing their capacity to provide high quality services to the community.

Continuing to impose an Efficiency Dividend on public sector agencies, in the absence of any evidence of the potential for efficiency gains, will result in a public sector that is focussed more on delivering short-term budget savings than on high quality services and longer term outcomes. This is not in the interests of the Australian community and does not represent good value for our collective investment in our public sector.

There are better ways to promote a more efficient public service for Australia's future. Australian and international research, along with consultation with public servants through the CPSU, has revealed a number of areas of agreement on some of the next steps needed to achieve this aim. These include strongly supported principles for guiding the development of efficiency measures as well as a high level of concurrence around the crucial features required by any alternative to the Efficiency Dividend. Features identified as central to the development of a more effective mechanism for driving efficiency gains within the APS were: an evidence-based process for identifying potential efficiency gains, an independent review of current processes at portfolio, agency, and/or functional level; a transparent and accountable process for developing and implementing efficiency measures; a central role for employee and union input; and regular independent reviews of any new measures to assess whether or not they are achieving their aims.

Additional options, such as allowing agencies to retain some of the savings made when meeting efficiency targets and the inclusion of broader environmental and social justice measures to complement efficiency targets could be combined with any of the options identified by the Moran Review. Further consultation with stakeholders needs to be undertaken on these options, along with consideration of a trial within selected agencies to assess their potential to deliver an effective and comprehensive mechanism for promoting public sector efficiency in Australia.

To accept the stated conclusion of the Moran Review – that 'a world-class public service must meet the needs of citizens', the performance of Australia's public sector must be measured against its capacity to improve the quality of life and well-being of all individuals in our community. The Efficiency Dividend's narrow approach to measuring performance is restricting, rather than enhancing, the capacity of our public sector agencies to provide high quality services and meet their longer-term objectives. It is time to move towards a new approach to public sector performance which reflects the central role of the public sector in our society and its capacity to improve our quality of life and well-being.

Bibliography

Advisory Group on Reform of Australian Government Administration (2010)
'*Ahead of the game: blueprint for reform of Australian Government Administration*'
Available online: http://www.dpmc.gov.au/publications/aga_reform/aga_reform_blueprint/index.cfm

Advisory Group on Reform of Australian Government Administration (2009)
'*Reform of Australian Government Administration: Building the world's best public service*'

Australian Bureau of Statistics
'*Measures of Australia's Progress*'
www.abs.gov.au

Bevan, G. and Hood, C. (2005)
'*What's Measured is What Matters: Targets and Gaming in the English Public Health Care System*'
The Public Services Program Discussion Paper Series No. 0501

Bouckaert, G., Verhoest, K. and De Corte, J. (1999)
'*Public sector performance contracting in Belgium and Flanders*'
Public Management Centre, Katholieke Universiteit Leuven.

Boyne, G. (2003)
'*Sources of Public Service Improvement: A Critical Review and Research Agenda Journal of Public Administration, Research and Theory*'
Vol 13 (3): 367-394

Boyne, G., Meier, K., O'Toole Jr, L., Walker, R. (2005)
'*Where Next? Research Directions on Performance in Public Organizations*'
Journal of Public Administration, Research and Theory
Vol 15 (4): 633-639

Cole, M. and Parston, G. (2006)
'Unlocking public value: a new model for achieving high performance in public service organizations'
John Wiley and Sons

Department of the Treasury (2006)
'Policy advice and Treasury's wellbeing framework'
Available online: http://www.treasury.gov.au/documents/876/PDF/Policy_advice_Treasury_wellbeing_framework.pdf

Gershon, P.
'Review of the Australian Government's Use of Information and Communication Technology'
http://www.finance.gov.au/publications/ict-review/index.html

Giovannini, E., Hall, J., Morrone, A., Ranuzzi, G. (2009)
'A framework to measure the progress of societies'
Draft OECD working paper

Heinrich, C. (2002)
'Outcomes-Based Performance Management in the Public Sector: Implications for government accountability and effectiveness'
Public Administration Review, 62, 6 (November-December 2002):712-25

Hoque, Z. and Adams, C. (2008)
'Measuring public sector performance: A study of government departments in Australia'
CPA Australia

Hyland, P., Ferrer, M., Santa, R., Bretherton, P., (2009)
'Performance measurement and feedback in a public sector program'
School of Management, Queensland University of Technology

Irwin, T. (1996)
'An Analysis of New Zealand's New System of Public Sector Reform'
Performance Management in Government
Organisation for Economic Co-operation and Development

Institute of Wellbeing (2009)
*How are Canadians **Really** Doing?*
Available online: http://www.ciw.ca/en/ResourcesAndDiscussion/Reports.aspx

KPMG (2009)
'*Benchmarking Australian Government Administration Performance*'

Mayne, J and Eduardo Z (eds). (1997)
'*Monitoring Performance in the Public Sector: Future directions from international experience*'
Transaction, New Brunswick, NJ

Organisation for Economic Co-operation and Development (2007)
'*Performance Budgeting in OECD Countries*'
OECD 2007 (1)

Organisation for Economic Co-operation and Development (2007)
'*Performance-based Arrangements for Senior Civil Servants OECD and other Country Experiences*'
OECD 2007 (2)

Organisation for Economic Co-operation and Development (2007)
Journal on Budgeting – volume 7 – No. 1
OECD 2007 (3)

New Economics Foundation (2009)
'*Seven principles for measuring what matters: A guide to effective public policy-making*'

Organisation for Economic Co-operation and Development (2009)
'*Focus on Citizens: Public Engagement for Better Policy and Services*'
OECD 2009 (1)

Organisation for Economic Co-operation and Development (2009)
'*Government at a Glance 2009*'
OECD 2009 (2)

Organisation for Economic Co-operation and Development
'*Government Capacity to Assure High-Quality Regulation in Australia*'
OECD 2009

Scales, B. (1997)
'*Performance Monitoring of Public Service in Australia*'
Australian Journal of Public Administration, 56, 1: 100-109

Shah, A. (2005)
'*Public Service Delivery*'
World Bank 2005 (1)

Shah, A. (2005)
'*Public Expenditure Analysis for Citizen-Centered Governance*'
World Bank 2005 (2)

Shaw, T. (2010)
'*What does progress mean to you?*' in
More Than luck: Ideas Australia needs now
Centre for Policy Development 2010

Smith, P. (ed.) (1996)
'*Measuring Outcomes in the Public Sector*'
Frances & Taylor, London

Stiglitz, J., Sen, A. & Fitoussi, J. (2009)
'*Report by the Commission on the Measurement of Economic Performance and Social Progress*'

Victorian Community Indicators Project
'*Measuring wellbeing: engaging communities The final report of the Victorian Community Indicators Project*'
http://www.communityindicators.net.au/files/civ/20060817_VCIP_Final_Report.pdf
2006

Wikiprogress
'*The Global Project on "Measuring the Progress of Societies"*'
http://www.wikiprogress.org/index.php/Global_Project

Endnotes (see bibliography for full citations)

1. Advisory Group on Reform of Australian Government Administration (2010)

2. KPMG (2009)

3. For example see the House of Representatives Standing Committee on Banking, Finance and Public Administration report (1994). This was followed by a Joint Committee of Public Accounts and Audit report (2008) and associated submissions.

4. Advisory Group on Reform of Australian Government Administration (2010), Recommendation 9.1

5. This was promoted internally by the CPSU via email lists and received 21 responses.

6. Advisory Group on Reform of Australian Government Administration (2010)

7. ibid, p. 12

8. For an overview of this field see Hoque, Z. and Adams, C. (2008, Australian research) and Cole M and Parston G (2006, international research).

9. For example, Hoque, Z. and Adams, C. (2008)

10. For example, Hyland et al (2009)

11. For example Heinrich, C. (2002)

12. OECD 2007 (1)

13. KPMG (2009)

14. OECD 2007 (2)

15. Shah 2005 (1)

16. Exceptions to this include government services which compete with private providers, such as Centrelink, Australian Hearing Services and the Commonwealth Rehabilitation Service.

17. For a detailed discussion of this issue see Cole, M. and Parston, G. (2006), Chapter 3.

18. OECD 2009 (2)

19. OECD 2007 (3)

20. Boyne et al (2005)

21. Stiglitz et al (2009)

22. 'Building the Education Revolution Implementation Taskforce: Interim Report', Commonwealth of Australia (2010), p. 24

23. Metherell, L. 'Stimulus "served Australia well" despite waste', ABC News, Aug 6 2010

24. Hetherington, D, 'The Value of a Job', Per Capita (2008)

25. Page xxiii

26. This section is drawn from Joint Committee of Public Accounts and Audit (2008), Chapter 1.

27. Ibid, p. 3

28. House of Representatives Standing Committee on Banking, Finance and Public Administration (1994). This was followed bya report from the Joint Committee of Public Accounts and Audit (2008) and the Advisory Group on Reform of Australian Government Administration (2009, the 'Moran Review').

29. Australian Public Service Commission (2008), Chapter 6

30. KPMG 2009

31. Ibid

32. Advisory Group on Reform of Australian Government Administration (2009)

33. Australian War Memorial (2010), Page 1

34. See Advisory Group on Reform of Australian Government Administration (2010), Hoque, Z. and Adams, C. (2008), and KPMG (2009)

35. Boyne et al (2005)

36. Bevan, G. and Hood, C. (2005)

37. Gershon, P. (2008)

Add your voice to ours: join the CPD Supporters

CPD makes its work available online at no charge. You can access our papers at http://cpd.org.au where you can also sign up to receive updates on our latest research and commentary.

Publishing and promoting fresh new policy ideas does cost money. For individuals, a small regular contribution is a great way to support the work of the Centre. For organisations who wish to receive and share printed copies of CPD publications, we offer library subscriptions. Subscribers receive two copies of each CPD policy paper by mail.

CPD is endorsed as an approved research institute so all donations over $2 are tax-deductible. If you would like to join the CPD Supporters, you can donate online at at http://cpd.org.au/donate or fill in the form below.

Sign me up to the CPD

Name: ____

Email: __________________________ Phone: _____________

Postal address: ____

____

Contribution amount

$100.00 monthly Supporter

$50.00 monthly Supporter

$20.00 monthly Supporter

Other monthly amount: _____

One-off contribution: ______

Payment details

Cheque: *Please make payable to the Centre for Policy Development and mail to us at PO Box K3, Haymarket 1240*

Direct Deposit: *Centre for Policy Development Ltd, BSB 032006, Account 392 494*

Credit card: *Visa* *MasterCard*

Card holder name: ______________________________________

Card number: ____ /____ / ____ / ____ Expiry date : ___ / ___

Signature: ___________________________ **Security code:** _____