Parliament of the Commonwealth of Australia

STAND AND DELIVER

Inquiry into the Efficiency Dividend Arrangements

Report from the House of Representatives Standing Committee on Banking, Finance and Public Administration

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Foreword

This report examines the efficiency dividend arrangements, a much criticised aspect of the management reforms of the last decade. The efficiency dividend is a levy of 1.25% on the running costs appropriations of budget funded departments and agencies. The purpose of the efficiency dividend being that the government is entitled to a share of the efficiencies being generated in the public sector, although the dividend also provides 'a bit of stick' to ensure that public sector managers remain focussed on the need to strive for efficiencies.

It is that need to continue to seek out efficiencies that has been the basic principle on which the inquiry has operated. The Committee is also supportive of the right of the Government to share in the gains that are achieved in order that those gains can be redirected to other Budget priorities.

The time available to the Committee has been short due to the change in the Budget timetable and other commitments which the Committee had last year. However I believe that this report provides a basis by which the debate can move forward. There can be no end to the process of improving performance in the public sector, what is obvious is that a range of more sophisticated approaches than the efficiency dividend needs to be developed to encourage and facilitate the continued improvements in public sector management in both a quantitative and a qualitative sense.

I thank my fellow subcommittee members, and those other members who have regularly attended the public hearings, for their strong support and valuable assistance in the conduct of the inquiry and the preparation of the subcommittee's report to the Committee.

I would also like to thank the former Chairman, the Hon Paul Elliott MP, for his work on the inquiry prior to his appointment as Parliamentary Secretary Assisting the Treasurer.

My appreciation goes to all who made submissions to the inquiry and who appeared at public hearings.

I especially thank Mr Steve Davis from the Department of Finance for all of the technical advice provided to the Committee.

DAVID SIMMONS MP
Chairman

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Members of the Committee

Chairman:	Hon D W Simmons, MP[1]
Deputy Chairman:	Mr P K Reith, MP
Members:	Mr J W Bradford, MP Mr R A Braithwaite, MP Mr B T Cunningham, MP Mr E Fitzgibbon, MP[2] Mr M Latham, MP[3] Hon L R S Price, MP Mr A C Rocher, MP Mr S Smith, MP Mr A M Somlyay, MP Mr H F Woods, MP
Secretary:	Mr Christopher Paterson

Members of the Subcommittee

The Subcommittee appointed to undertake the inquiry comprised:

Chairman:	Hon D W Simmons, MP[1]
Members:	Mr J W Bradford, MP (to 24 February 1994) Hon L R S Price, MP (to 24 February 1994) Mr P K Reith, MP Mr S Smith, MP
Subcommittee Secretariat:	Mr Christopher Paterson (Secretary) Mrs R Khanbhai
Technical Adviser:	Mr S Davis

1 Replaced the Hon R P Elliott, MP as Chairman from 10 February 1994.

2 Replaced the Hon J C Kerin, MP from 9 February 1994.

3 Replaced the Hon R P Elliott, MP as member of Committee from 9 February 1994.

Terms of Reference of the Committee

The Standing Committee on Banking, Finance and Public Administration is empowered to inquire into and report on any matters referred to it by either the House or a Minister including any pre-legislation proposal, bill, motion, petition, vote or expenditure, other financial matter, report or paper.

Terms of Reference of the Subcommittee

Inquire into and report on:

1. The structure and operation of the current ED arrangements, including:

    * method of application;
    * components included in its calculation;
    * variations in application between agencies; and
    * relationship between the ED and other measures of productivity, such as workplace bargaining.

2. The impact of the efficiency dividend:

    * identify the level of efficiency gains made in the APS since the introduction of the ED;
    * how has existence of ED contributed to those gains;
    * what type of efficiency measures have been implemented in order to meet the ED;
    * the impact of the ED on achievement of program objectives, APS employment patterns and on the capacity of Government to meet new policy priorities;
    * any adverse effects that the application of the ED may have had on the operation of agencies; and
    * the extent to which agencies with small budgets and staff have the capacity to achieve ongoing efficiency gains at least equivalent to the ED.

3. Adequacy of ED arrangements in achieving Government's goal of generating efficiencies and capturing the gains:

* has the ED become 'institutionalised', producing a saving to outlays on running costs but not making portfolios focus on increasing efficiencies; and
* is the broad application to virtually all agencies the best method of achieving the ED's goals.

4. Future methods of generating ongoing efficiency improvements and capturing the gains:

* continue application of the ED its present form, or in a revised form; and
* an alternative means of generating efficiencies and capturing the gains.

Acronyms and Abbreviations

ABC	Australian Broadcasting Commission
ABS	Australian Bureau of Statistics
ACIAR	Australian Centre for International Agricultural Research
AFP	Australian Federal Police
APS	Australian Public Service
ASL	Average Staffing Levels
ASO	Administrative Service Officer
ATO	Australian Taxation Office
CSIRO	Commonwealth Scientific and Industrial Research Organisation
DAAS	Department of the Arts and Administrative Services
DEST	Department of Environment Sport and Territories
DFAT	Department of Foreign Affairs and Trade
DIR	Department of Industrial Relations
DoF	Department of Finance
DSS	Department of Social Security
EEO	Equal Employment Opportunity
ED	Efficiency Dividend
EPAC	Economic Planning Advisory Council
HS&H	Department of Human Services and Health
ID	Industrial Democracy
IT	Information Technology
MAB	Management Advisory Board
OECD	*Organisation for Economic Cooperation and Development*
OH&S	Occupational Health and Safety
OOS	Office of the Official Secretary to the Governor-General
RCA	Running Costs Arrangements
POE	Property Operating Expenses
PSU	Public Sector Union
SBS	Special Broadcasting Service
SES	Senior Executive Service

List of Recommendations

1. The Department of Finance and the Department of Industrial Relations examine the options available to develop a process for measuring productivity which takes account of the quality of output in the Australian Public Service.

2. A resource agreement be developed between the Department of Finance and the Commonwealth Scientific and Industrial Research Organisation, and other similar research organisations, which will exempt direct research activities from the efficiency dividend, while central administrative activities should continue to be subject to the efficiency dividend.

3. The current budgetary arrangements applying to the Defence portfolio, the Australian Broadcasting Corporation and the Special Broadcasting Service continue to apply.

4. An efficiency dividend continue to be applied to running costs appropriations until 1996-97 and that it be reviewed immediately at the end of the 1995-96 financial year.

5. All section 35 receipts be exempt from the efficiency dividend.

6. The efficiency dividend be applied to Property Operating Expenses after appropriate Property Resource Agreements have been finalised.

7. The rate at which the efficiency dividend is levied be reduced from the current 1.25% to 1% and that this rate be reviewed at the end of the 1995-96 financial year.

CHAPTER 1
THE EFFICIENCY DIVIDEND

Introduction

1.1 This inquiry reviews the application of the efficiency dividend to the running costs budgets of Commonwealth departments and non-commercial agencies. The reference was received from the then Minister for Finance, the Hon R Willis MP, and followed a request by Cabinet in 1990 that the efficiency dividend be reviewed before the 1994-95 Budget.

1.2 As can be seen from the terms of reference, the Committee's brief included an examination of future methods for generating ongoing efficiency improvements. Bringing forward the Budget cycle this year placed significant constraints on the Committee's ability to consider a number of aspects of this inquiry in the detail usually considered appropriate. For this reason the Committee's report focuses narrowly on the efficiency dividend itself and a number of matters are identified in the report as requiring further study and consideration.

1.3 The terms of reference clearly stress two points: first the Government's goal of ensuring that efficiencies continue to be sought in the Australian Public Service (APS); and second that a portion of those efficiencies are captured and available for other Budget priorities.

1.4 In preparing this report the Committee has considered whether the application of the efficiency dividend is an appropriate means of ensuring that a portion of the efficiency gains being generated in the public sector are returned to the Budget.

Running Costs Arrangements and the Efficiency Dividend

1.5 Before considering the issues raised in the course of this inquiry it is worth setting out briefly the operation of the efficiency dividend and its relationship with running costs.

1.6 The efficiency dividend is an element of the Running Costs Arrangements (RCA) which are a major component of the continuing reform of Commonwealth public sector management which began during the early 1980s. Running costs represent the full current and minor capital costs of resources used by departments and agencies (hereinafter referred to as agencies) in providing government services. Running costs do not cover major capital expenditure, specific program budgets, transfer payments and accrued expenditures such as superannuation and depreciation.

1.7 The Running Costs Arrangements are intended to provide managers with the means to achieve efficiencies and there is virtually universal acknowledgment that the flexibilities offered to managers by the RCA have provided them with the means to manage their operations with increased efficiency and effectiveness. The efficiency dividend is intended to ensure that a portion of those efficiencies is available to the owner, the government, to redirect to emerging priorities in the public sector, regardless of the portfolio source.

1.8 Running costs appropriations include: salaries (further broken down into SES and non-SES); administrative expenses (including section 35 receipts); Property Operating Expenses; and Legal Services provided by the Attorney-Generals Department. Property Operating Expenses (POE) and Legal Services were introduced into running costs in 1992-93 under transitional arrangements.

1.9 The exemption from the efficiency dividend provided for POE under the transitional arrangements is specifically considered as part of this review. The exemption for funds appropriated to agencies for Legal Services provided by the

Attorney-General's Department will continue while agencies are tied to the Attorney-General's Department for the provision of legal services. This arrangement is due to expire at the end of 1994-95.

1.10 The RCA are intended to provide a medium term focus for financial management, encourage the devolution of control and responsibility and streamline the process of budget formulation by removing the Department of Finance (DoF) from the detailed examination of management decisions.

1.11 They are also intended to give greater flexibility to managers to manage their resources and thus encourage them to improve operational efficiency and effectiveness. The principle features of RCA that contribute to flexibility are:

- transfers between notional items;
- carryovers and borrowings (both single and multi-year);
- provision for the retention of receipts from specified activities;
- resource agreements; and
- certainty of funding from year to year.

1.12 When the RCA were first agreed by the Government the efficiency dividend was set to average 1% per annum over a period of three years. This rate was apparently chosen because it was within the range used by other governments at the time and it was less than the estimated long term labour productivity growth (2%) of the private sector in Australia.[1] A table setting out the efficiency dividend arrangements applying in Australian States and overseas can be found at Appendix 6 which identifies efficiency dividends levied over a range of rates from .5% to 2.5% per annum.

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1 Evidence, p. 9.

1.13 However before the implementation of the RCA in 1987-88 the rate was increased to 1.25% accumulating. It was reviewed and reconfirmed in 1990-91. The rate is arbitrary although there has been some retrospective justification of the rate through the calculation by the Department of Finance of labour productivity growth in the APS for the period 1987-88 to 1991-92 at 2.5% per annum.[2] The question of productivity will be addressed later in the report as will the rate of the dividend.

1.14 One point worth noting is that since 1990 the efficiency dividend has been included in the forward estimates. The significance of this is that the abolition of the efficiency dividend would result in a direct additional cost to the Budget of $81.7m in 1994-95 and a cumulative cost of $ 330m to 1997-98.[3]

Application of the efficiency dividend

1.15 As noted above, the efficiency dividend is applied to the gross running costs appropriation with a number of exceptions:

- specific agency exemptions may be sought by a portfolio minister (Appendix 7);
- Property Operating Expenses are exempt and a recommendation regarding the application of the efficiency dividend will be made in this report;
- new policy variations in the first year of funding and in some special transitional arrangements;
- other new funds such as those obtained through some resource agreements such as workload formulae; and
- section 35 receipts generated by cultural, sporting or recreational facilities.

2 Evidence, p. S152.

3 Appendix 7.

1.16 A detailed description of Running Costs Arrangements and the application of the efficiency dividend can be found in the *Running Costs Arrangements Handbook*[4] and in the submissions from the Department of Finance.[5]

Definition and Purpose

1.17 The Department of Finance (DoF) has identified three principle objectives for the efficiency dividend:

- to reduce the need for central intervention into the management of agencies and provide managers with the opportunity and incentive to continually seek new or more efficient means of undertaking ongoing government business;
- to allow Government (as owners of agency operations) to redirect a portion of efficiency gains to higher priority activities; and
- to clearly demonstrate Public Service efficiencies resulting from improvements in management and administrative practices.[6]

1.18 On the evidence taken by the Committee, the efficiency dividend is seen by some as an anomolous blunt administrative levy which is widely maligned, rarely endorsed, unsophisticated, unfair, unreasonable and an inefficient means of saving

4 *Running Costs Arrangements Handbook*. 1992. Canberra, Department of Finance, 32p.

5 Evidence, p. S161.

6 Evidence, p. S149.

money by cutting running costs regardless of its impact on the services delivered by government. For these reasons one witness described the efficiency dividend as *Stand and Deliver.*

1.19 The underlying propositions on which the objectives are based were outlined to the Committee by DoF. First that there is an obligation on public sector managers to seek ongoing efficiencies; second that the public sector reforms have provided the means by which these efficiencies can be generated; and third that, as owner, the Government has a right to share in the efficiencies and to redirect a portion of them to other areas of priority.[7]

1.20 The demonstration of efficiency gains was stressed by Finance. One of the objectives of the Running Costs Arrangements was to restrain costs growth and to make efficiency gains visible, the efficiency dividend is the means by which those efficiencies were to be made visible.[8]

1.21 It seems to the Committee that the purpose of the efficiency dividend depends on where you stand. A common agency view is that the efficiency dividend is simply an across-the-board cut to resources, a saving on inputs with little regard for outputs.[9] From the Government's perspective it is merely redirecting a portion of funds to higher priority areas for expenditure. This service wide perspective by government can be considered to be no more than what managers do within individual agencies. Good examples of which are the internal efficiency dividend applied by the CSIRO at a rate of 1.5%[10] and the corporate dividend in Finance at a rate of 3% in 1993-94.[11]

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7 Evidence, p. 5.

8 Evidence p. 19.

9 Evidence, pp. 130, 312 and S30.

10 Evidence, p. 44.

11 Evidence p. S156.

1.22 The view of a Finance official was put quite frankly at a public hearing:

> I do not see the efficiency dividend as being the way of achieving efficiencies ... the efficiency dividend does two things: by providing stick, it concentrates agencies' minds so that they utilise those various instruments to gain some efficiencies; and it ensures that the owners of the business, the government and the taxpayer, share in efficiency gains that it makes.[12]

1.23 This point was also supported by the view of the Attorney-General's Department that these gains 'should not be available to merely overcome natural inefficiencies or be in a sense socialised amongst those that work in the organisation'.[13]

1.24 There is no doubt that the efficiency dividend on its own does not produce productivity improvements or other savings, but there can be little doubt that it encourages managers to look for them. It is also difficult to dispute the logic that the efficiency dividend provides a simple means by which the government can access a portion of the efficiencies being generated in agencies.

1.25 This view is supported by the Management Advisory Board in *Building a Better Public Service* where the efficiency dividend is described as 'an important means of returning at least part of the benefit of productivity gains to the general Budget, although it would appear that the gains retained by agencies and passed on to users of government services have exceeded the return to the Budget through the Dividend'.[14]

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12 Evidence, p. 360.

13 Evidence, p. 187.

14 Management Advisory Board. 1993. *Buildinga Better Pubic Service.* Canberra, AGPS, p. 15.

CHAPTER 2
IMPACT OF THE EFFICIENCY DIVIDEND

Efficiency Gains in the Australian Public Service

Productivity

2.1 Productivity is an important aspect of the inquiry because many of the arguments both in favour of the efficiency dividend and opposed to the efficiency dividend are premised on this question of efficiency gains. What became obvious in the course of the inquiry is that the concepts of productivity and service quality in the public sector are not easily addressed and opinions vary considerably.

2.2 The measurement of productivity in the public sector, and in the service sector generally, is acknowledged as being difficult to achieve, however the Committee has examined a range of figures. The Department of Finance has developed a methodology to measure productivity and determined that there had been a 2.5% per annum improvement in labour productivity over the period 1987-88 to 1991-92. EPAC calculated that over the period 1967-1991, the average annual rate of growth in labour productivity for the business sector was 2%.[1] These figures exceed the level of the efficiency dividend. While the rate is not specifically linked to a productivity measure, it is clear that agencies have shared in the efficiency gains over that period.

2.3 The difficulty in measuring performance and productivity was noted in the submission from the Institute of Public Affairs:

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1 Evidence, p. S393.

> ... the standard statistical assumption has been that productivity in the general government sector remains constant over time and that increases in output are a function only of increases in employment.[2]

2.4 The efficiency dividend appears to contradict this statistical premise in assuming that there is scope for the general government sector to achieve productivity gains. The methodology developed by DoF to measure productivity has attempted to overcome the assumed link between employment levels and output.

2.5 The methodology uses data on average staffing levels (ASL) of agencies as the common variable. The input side of the equation is based on the change in utilised ASL. It is on the output side where Finance has attempted to overcome the assumption that output is linked to changes in the level of employment. DoF uses the alternative assumption that output variations come from externally agreed changes in function or workload (new policy), these are measured as ASL allocations. Thus productivity is a measure of the ratio of total output to the total input actually utilised. It is important to note that this approach does not measure change in the quality of output.[3] The measure of labour productivity growth as whole in the APS using this methodology was 2.5% per annum over the period 1987-88 to 1991-92.

2.6 The methodology has been criticised for using ASL to measure labour as it is claimed that this ignores the use of contractors and consultants and changes in the staff profile of the APS (there has been a steady decline in ASO 1-2s and an increase in other classifications, particularly Senior Officers). The assumption that quality has remained constant is also criticised.[4]

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2 Evidence, p. S326.

3 Evidence, p. S358.

4 Evidence, p. S208.

2.7 Finance noted that this criticism was considered by the Australian Bureau of Statistics (ABS) when the Bureau examined the Finance methodology, and that the ABS generally supported the methodology.[5]

2.8 The Department of Industrial Relations (DIR) pointed out that the conflicting views suggest that it is difficult to measure APS productivity trends with any reliability and that a methodology which is generally accepted is unlikely to be developed in the near future. The submission goes on to make an important point though:

> Nevertheless, the Government has a right to expect that the APS will pursue continuous improvements in productivity and efficiency and, in that context, referring to some community benchmark for productivity improvement is appropriate.[6]

2.9 However DIR notes that if the market sector is to be used as a benchmark, the current rate of the dividend may well be too high, by .25% if labour productivity is used and by .65% if total factor productivity is used. The efficiency dividend may now be extracting more than can be expected from the public sector which may impact on output. Although as has already been noted, there is no way of knowing the extent, if any, of that decline and whether it is output or quality that is suffering.

2.10 Some support for the Finance approach was forthcoming from Treasury. Having first suggested that the estimate of 2.5% relies on the 'perhaps heroic assumption that the quantity and quality of the output of the service remained unchanged over the period'.[7] Treasury went on to acknowledge that ' in

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5 Evidence, p. S151.

6 Evidence, p. S209.

7 Evidence, p. 86.

many areas of public administration the labour cost is the largest part. So using labour productivity as an approximation does not lead you too far astray'.[8]

2.11 Finance acknowledged the difficulties in measuring productivity in the public sector and that the figure of 2.5% is not a particularly accurate figure, although concluding that it is probably an underestimate. With regard to total factor productivity, a representative from Finance stated 'I am not aware of any measure of total productivity in the public sector and I am not ... sure how one would go about trying to measure it'.[9]

2.12 While there may be considerable debate over the level of productivity improvement in the APS over the period in which the efficiency dividend has applied, not one agency appeared before the Committee that did not claim substantial efficiency gains had been achieved in their respective organisations. What is lacking is any form of reliable measurement.

Quality of Service

2.13 The Committee accepts the difficulties associated with assessing the impact of the efficiency dividend on quality of service. However it is an issue that was raised repeatedly in submissions and by witnesses.

2.14 Treasury emphasised the difficulty confronting policy agencies:

> ... what distinguishes these (policy advising) activities is that they are not readily susceptible to the usual methods of productivity improvement such as utilisation of

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8 Evidence, p. 93.

9 Evidence, p. 8.

economies of scale, substitutions of capital for labour or improved work methods.[10]

2.15 Treasury further noted that they have little control over the volume of work and that economising necessarily involves reducing the thoroughness with which tasks are undertaken, consequently there is the danger that quality will be affected in the long run.[11]

2.16 The difficulty in identifying level of service was also raised by Human Services and Health (HS&H), a department with an obvious client focus. HS&H noted that they have some way to go to benchmark and identify the costs of the services that are being provided and that while client focus is increasing they are still to develop the methodology to enable measurement of the level of services being provided.[12]

2.17 On the other hand the Department of Social Security (DSS) has published performance standards for the majority of client interactions.[13] Social Security were able to provide the Committee with quite a lot of detail as to how they were focussing on client service and in so doing, ensuring that efficiency measures would not diminish the standards that had been determined. The impression gained from DSS was that the department had sought to maximise the benefits available to it under the RCA and that the effect on the organisation was positive, even with the efficiency dividend.

2.18 One of the few organisations to claim an instance of where quality had declined as a result of cuts arising from the efficiency dividend was the Family Court. The closure of the counselling service on the Gold Coast was identified as a

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10 Evidence, p. 87

11 Evidence, p. 95.

12 Evidence, p. 165.

13 Evidence, p. 295.

measure taken which resulted in a decline in service.[14] It was also stressed that to reduce counselling services is a very counterproductive measure, however, the primary responsibility of the organisation is to service the Courts and that activity has to have priority.

2.19 While it was a common complaint that the efficiency dividend was posing an imminent threat to service quality, DoF maintain that there is no convincing evidence that quality of service is being reduced as a result of the efficiency dividend. DoF also make reference to the fact that for agencies to be in that situation they would have had to be achieving efficiency gains of less than 1.25% which was not the case.[15]

2.20 The Management Advisory Board (MAB) of course takes a very careful interest in these matters and the Chairman of the MAB offered the following opinion:

> There is a vexed issue of whether the efficiency dividend has lead to a decline in the quality of service or the quantum of service. Measuring the quality and quantum of service is often a bit like beauty: it is in the eye of the beholder. I would have to say that I have never seen any hard evidence of loss of service, nor is there any hard evidence, as far as I am aware, of client complaints that the service has deteriorated.[16]

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14 Evidence, p. 235.

15 Evidence, p. 353.

16 Evidence, p. 394.

Conclusion

2.21 This question of productivity is one of the more problematic features of the inquiry. There have been numerous submissions and witnesses claiming that the efficiency dividend is having a serious impact on capacity to carry out their responsibilities. As a counter to that argument Finance have suggested that the productivity increase in the APS over the last several years has been at twice the level of the efficiency dividend and that agencies have had the opportunity to pocket the difference.

2.22 While there is a great deal of debate as to whether you can accurately measure productivity in the public sector, no agency was prepared to say that they had not been achieving efficiencies. Based on this evidence, the Committee has not found that the efficiency dividend has had a detrimental effect on the quality of services provided by public sector agencies.

2.23 A further point to be considered is the role of the efficiency dividend as a possible contributor to efficiency gains. The efficiency dividend does contribute to efficiency gains in a limited sense in that it serves to focus the minds of managers, particularly when the general outlook is for continued fiscal restraint.

2.24 The Committee is satisfied that there has been a continuing improvement in productivity in the APS over the period in which the efficiency dividend has been in force. This conclusion is based on the Finance study of productivity and the anecdotal evidence provided by witnesses and in submissions. It is also worth noting that a major contributor to those gains has been the flexibility offered to managers under the Running Costs Arrangements.

2.25 The concern the Committee has is that in the absence of any concerted effort to identify the level productivity improvement or to monitor and measure service quality, it may not be possible to identify when and if the efficiency dividend begins to have a negative impact on agencies.

2.26 From the point of view of the recipients of goods and services provided by the public sector, the Committee is of the view that further consideration should be given to Citizen's Charters. This would be in keeping with the reform agenda advocated by the MAB.[17]

The Committee recommends that:

1. **the Department of Finance and the Department of Industrial Relations examine the options available to develop a process for measuring productivity which takes account of the quality of output in the Australian Public Service.**

Measures Instituted to Meet the Efficiency Dividend Obligation

2.27 The nature of measures being implemented within the public service to enable agencies to generate efficiencies and to meet their efficiency dividend obligations were canvassed in the inquiry. The responses received can only be considered as indicative of the actions being taken.

2.28 Information technology (IT) is often cited as an area where investment has been made in order to achieve long term productivity enhancement. IT was nominated as the largest single contributor to productivity improvement in the Department of Finance.[18] The National Standards Commission also identified IT as the major source of efficiency improvement in the production of documentation and in the laboratory.[19] Major IT programs have been undertaken in a number of portfolios; Administrative Services, Attorney-Generals, Employment Education and

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17 *Building a Better Public Service*, op. cit., p. 11.

18 Evidence, p. 9 .

19 Evidence, p. 276.

Training, Foreign Affairs and Trade, Human Services and Health, Immigration and Ethnic Affairs, Industry Technology and Regional Development and Social Security.[20]

2.29 Perhaps one of the most ambitious is the 10 year program to upgrade technology in the Australian Taxation Office (ATO). This program involves a substantial investment of around $1.3 billion upfront in order to improve the performance of the Tax Office. In addition to new equipment, the modernisation process involves the development of new work practices and approaches to job design.

2.30 This program effectively operates as a resource agreement, with an upfront investment and a return on that investment. In this case a Modernisation Dividend, which over a period of eight years from 1990/91-1997/98 will remove the dollar equivalent of 3000 ASL from the ATO's funding base.[21]

2.31 It would be wrong to simply focus on IT as the sole or major source of efficiency improvement. A number of agencies were able to provide details of extensive programs of efficiency measures. The Office of the Official Secretary to the Governor-General (OOS) for instance provided details of measures including multi-skilling, reallocation of functions and jobs between programs, conversion of full-time to part-time positions and IT upgrade. What impressed the Committee was the comprehensive nature of the approach involving the entire operations of the Office and the strong focus on work practices and skills development. What is more this extensive program of productivity measures has been achieved with no apparent diminution in quality of service.[22]

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20 Evidence, pp. S352-354.

21 Evidence, p. S119.

22 Evidence, pp. S43-45.

2.32 One point worth noting here is the fact that the OOS would be generally regarded as a small agency, and while the matter of small agencies will be taken up again later in this report, the Office has applied to DoF for exemption from the efficiency dividend on a number of occasions.[23] What surprised the Committee is that the efficiency measures undertaken by the OOS are acknowledged as having been effective and comprehensive and at least one request for exemption was supported by the Department of Finance, but it was unsuccessful. There seems to be some inconsistency here with the stated position of Finance which is that agencies who are experiencing difficulty with the efficiency dividend are free to make a submission for exemption or assistance. This does not appear to have worked for the OOS and perhaps this should be re-examined.

2.33 The Family Court was another small agency that was able to identify a comprehensive program of efficiency measures covering a wide range of activities within the Court. Once again these focussed on work practices, contracting out particular services and a strong emphasis on best practice.[24]

2.34 The Federal Court also provided the Committee with an extensive list of measures taken to improve productivity, once again these measures cover a range of activities with particular emphasis on activities related to the operation of the Court.[25] One particular point worth noting is the devolution of some Judge related responsibilities to the Registrars, this has averted the need to appoint an extra three judges which represents a saving of between $500,000 and $1m per annum. The relevance is that the saving is not related to the efficiency dividend as it simply avoids the need for additional resources arising from increased jurisdictions. The

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23 Evidence, pp. S39 and 107.

24 Evidence, p. 229.

25 Evidence, p. S295.

Registrar advised the Committee that the efficiencies generated in the Federal Court have probably been in the vicinity of 10% per annum over recent years; this has obviously helped curb the need for additional resources.[26]

2.35 These are further examples of small agencies seeking efficiency improvements across the full range of activities of their organisations. This approach is a common theme in the submissions received from small agencies and indicates that serious consideration should be given to the concerns being expressed by small agencies, particularly those that are able to demonstrate a track record in pursuing efficiency improvements.

2.36 The Department of Social Security offered another perspective. As a client oriented organisation, the quality of the service offered to clients is an important consideration. A recent review of client advices assessed the frequency, quality and need for advices and as a result there will be a substantial reduction in the number of advices being sent out. The savings potential is substantial with 70 million advices going out each year at a cost of 40 cents in postage plus associated computer resources.[27]

2.37 The Chairman of the Management Advisory Board offered the following comment in regard to efficiencies, 'My own view is that there are bigger gains to be made by stopping doing the wrong things than by doing the right things better'.[28] A number of agencies appear to be following this strategy, while others continue to go through a process of making the easy savings and moving through a process whereby eventually they have to consider eliminating low priority tasks.[29] What

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26 Evidence, p. 346.

27 Evidence, p. 299-300.

28 Evidence, p. 409.

29 Evidence, p. S109.

is apparent from the evidence taken by the Committee is that productivity improvements and service quality improvements are being made in all aspects of agency operations.

Staff Reductions and Staff Profiles

2.38 Staff reductions are a significant factor in the search for productivity improvements, which is to be expected given that labour costs are a major component of the running costs in public administration.

2.39 Many agencies claimed that the impact of the efficiency dividend directly resulted in staff reductions. The CSIRO said that the efficiency dividend was costing somewhere between 60 and 70 people per year; this represents slightly less than 1% of the 7,300 staff.[30] The Australian War Memorial on the other hand focuses on reducing administrative costs as opposed to reducing staff numbers.[31] The AFP has implemented 50 redundancies in 1993-94 in order to meet efficiency dividend requirements.[32] The Attorney-General's Department is paying out in the order of 100 staff each year as part of a restructuring process.[33]

2.40 A number of points have been made with regard to the impact of the efficiency dividend on staff levels and profiles. Many agencies have sought to reduce staff costs as a measure to increase productivity and to meet the efficiency dividend obligation, yet total staff numbers have risen by 7% over the period 1989-1993.[34] As was noted earlier there has been a change in the profile of staff with increases

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30 Evidence, p. 41.

31 Evidence, p. 70.

32 Evidence, p. 143.

33 Evidence, p. 195.

34 Department of Finance. 1993. *Australian Public Service Statistical Bulletin 1992-1993.* Canberra, AGPS, p. 62.

in the Senior Officer classifications and reductions in the ASO 1-2 classifications.[35] The Committee has seen no evidence that suggests that this realignment of staff classifications is more than the outcome of managers making decisions with regard to productivity. The Attorney-General's Department made a useful observation in this regard in that in looking for value for money, the relative cost of staff above and below the overtime cut off level has become pronounced, such that an ASO 6 on overtime very quickly costs more than a Senior Officer Grade C. Furthermore with the requirement for more highly skilled staff it is difficult to attract appropriate persons at the ASO 1 and 2 levels, the starting point now tends to be ASO 3.[36] While this comment is made with specific reference to the Attorney-General's Department, it is an indication of the fact that managers now have to consider all costs in the search for increased productivity.

Conclusion

2.41 There is a considerable amount of data collected and published on all aspects of employment in the APS and the Committee finds no evidence that the efficiency dividend is having an adverse effect on staff levels or the profile of staffing in the APS. It would appear that the most significant factor influencing variations in staff profiles is the increased responsibility devolved to managers under the RCA to manage resources in an optimal manner.

Freeing of Resources for New Policy

2.42 One aspect of the impact of the efficiency dividend that has to be considered is the role played by the dividend in making available resources for new policy. Payments made under the efficiency dividend arrangement are set out in the following table -

35 ibid, p. 5.

36 Evidence, pp. 199-200.

Efficiency Dividend Payments 1987-88 to 1993-94 (Est) (a)		
Financial Year	**ED Paid $m**	**Cumulative $m**
1987-88	53.9	53.9
1988-89	67.2	121.0
1989-90	70.7	191.7
1990-91(b)	74.5	266.3
1991-92	81.8	348.0
1992-93	78.3	426.4
1993-94	81.7	508.0

(a) Due to a review undertaken since budget-time, these figures differ from those reported in recent budget papers. For 1992-93 and 1993-94 they also include an adjustment for the ED payment from LSAG.

(b) No aggregate information is available on the payment of the efficiency dividend in 1990-91. The estimate in this table is based on the average affect on total running costs for all other years.

Source: Evidence, p. S152.

2.43 As can be seen the Budget has benefited to the tune of $508m since 1987-88. The funds made available through the efficiency dividend have met 38% (on average) of the net increase in running costs which resulted from new policy over the last three years. This demonstrates that the *efficiency dividend does provide a* significant capacity for the Government to fund new policy initiatives in high priority areas. Furthermore, while of little comfort to agencies that have had to surrender resources, there has been no overall reduction in resources, in fact running costs have increased over by an average of around 4% per annum over the last five years.[37]

Adverse Effects of the Efficiency Dividend

Threshold Absorption Costs

2.44 The Threshold is the limit under which supplementation to running costs budgets is not provided, and savings not pursued. Supplementation is only considered where non-recurring requirements exceed 1% or on-going changes exceed .5% of the running costs provision.

2.45 Agencies have made the point that a lot of these additional costs are mandated by Government, they are not discretionary. Such measures include work related expenses allowance for senior officers, fringe benefits tax, COMCARE occupational health and safety administration and technology upgrades to meet accrual reporting requirements. There is also the need to absorb additional functions such as equal employment opportunity, occupational health and safety and industrial democracy initiatives. The absorption of these costs, either direct or indirect, is considered by many agencies as effectively increasing the efficiency dividend.[38] This is a particular problem for small agencies who have a lesser ability to absorb some costs. The imposition of additional tasks does not take account of the capacity of a small agency to undertake the task effectively. For example the ability of what might be a very small personnel section to undertake initiatives such as EEO, OH&S, ID and workplace bargaining.

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37 Evidence, p. S331.

38 Evidence, p. S304.

2.46 The Committee was unable to assess the view put by Finance that the trade off for the threshold is that they do not pursue minor savings from agencies. This is a legitimate point although the Committee is not convinced that the two balance each other out.

Property Operating Expenses

2.47 The majority of submissions opposed the extension of the efficiency dividend to property operating expenses. Finance maintains that the current arrangements limit the flexibility of the RCA, in order to address this Finance is undertaking a property scrutiny process with a view to developing Property Resource Agreements with agencies which will specify what resources are to be provided for property in line with the purpose of those resources.[39]

2.48 Some agencies such as the War Memorial are effectively discriminated against by current arrangements in that their property expenses are already included in a single line appropriation and therefore already subject to the efficiency dividend.[40] Others supported the extension of the efficiency dividend to property with the qualification that separate arrangements might be required because of the longer term nature of the costs associated with property management.[41] Some agencies that are geographically dispersed such as the Courts, Bureau of Meteorology, the Australian Electoral Commission and Social Security to note a few, might be confronted with particular problems as property expenses would form a significant proportion of running costs.

2.49 What is apparent is that while the inclusion of POE in running costs for the purposes of the efficiency dividend would make the administration of running costs more efficient from Finance's view, there is significant scope for some

39 Evidence, p. 24.

40 Evidence, p. 70.

41 Evidence, p. 197.

agencies to be considerably worse off than at present. It is also true that the inclusion of POE gives agencies a larger pool from which to access savings, but this is only true if the overall burden is not increased. Probably the most important consideration is that property is not amenable to achieving short term cost reductions and a longer term perspective needs to be taken, possibly over five to seven years.[42] This long term perspective should be reflected in the resource agreements.

Workplace Bargaining

2.50 Workplace bargaining was raised in the majority of submissions and two issues dominated: that the efficiency dividend inhibits agencies in their ability to successfully conclude workplace bargains; and that workplace bargaining is an alternative to the efficiency dividend.

2.51 When workplace bargaining was introduced, the potential to double count in terms of efficiency gains was recognised and the efficiency dividend offset arrangement was devised to address this potential problem. One difficulty the Committee has with the offset arrangements is that the offset is limited to the sub-senior officer salary base, which seems to be rather restrictive. Finance is of the view that workplace bargaining is confined to labour related improvements and that improvements gained through IT and other such measures are unlikely to be captured in the workplace bargaining context.[43] Unfortunately, with very few bargains having been finalised, the Committee has not had an opportunity to test this view, however, anecdotal evidence would suggest that savings from administration are being sought just as eagerly as are savings from work practices. The Committee will be interested to see DoF's bargain when it is finalised.

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42 Evidence, p. 290.

43 Evidence, p. 28.

2.52 The view that workplace bargaining offered an alternative to the efficiency dividend was strongly supported. The difficulty with existing arrangements is that the outcome of any bargain provides no benefit to the Budget, the benefits flow to employees only. The Department of Industrial Relations took up this point in its evidence to the inquiry:

> The need for a separate efficiency dividend would be obviated if the efficiency dividend was subsumed fully and more simply within the future workplace bargaining gainsharing arrangements ... There is a need to ensure that future framework arrangements provide an incentive for all APS agencies to participate in agency bargaining processes where benefits are shared between staff, the agency and the government on behalf of the taxpayer.[44]

2.53 The Department of Finance actually regard the efficiency dividend as operating in tandem with the workplace bargaining process, the dividend being the means by which the government continues to share in productivity gains.[45]

2.54 The Committee is not satisfied that the current workplace bargaining arrangements offer an alternative to the efficiency dividend arrangements. This is because there has been such little progress on workplace bargaining to date that it is not possible to form a judgement as to the nature of the productivity gains that will be included in an agreement. The most significant factor is that under current arrangements there is no benefit to government from workplace agreements.

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44 Evidence, p. 173.

45 Evidence, p. 366.

Conclusion

2.55 Employee relations is a significant topic in itself. In the context of the pursuit of efficiencies, it is particularly important because the cost of labour is a major cost in the administration of the public service. There is a lot of room for improvement in people management. A more flexible system is needed. We are fortunate that the APS is manned by people of the highest calibre. Labour market flexibility, if introduced, could offer many advantages both to employees and the public service.

2.56 Resource agreements and workplace bargaining have been touted as possible alternatives to the efficiency dividend. This prospect was raised by the Joint Parliamentary Committee of Public Accounts.[46] The Public Sector Union's submission pursued this theme with the statement that:

> The expectation is that the agency bargaining process will yield significant improvements in productivity and the parties, including the Government, will benefit through gainsharing arrangements.[47]

2.57 The Committee was provided with quite a lot of evidence on this subject. One official from the Tax Office, who for 18 months has been a member of the ATO's workplace bargaining team, said, 'I would say that the totality of the rules and the framework that we have to work within could hardly be more complicated.'[48]

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46 Joint Committee on Public Accounts. 1992. *Report 323: Managing People in the Australian Public Service.* Canberra, AGPS, p. 105.

47 Evidence, p. S72

48 Evidence, p. 136.

2.58 We were also informed at this early stage of instances where workplace bargaining, rather than encouraging good employee relationships, was actually responsible for less co-operative attitudes. However, as it develops, workplace bargaining could supplant the efficiency dividend but, at this point in time, this alternative approach is not a practical option.

2.59 Given that workplace bargaining is only now being implemented in the public service, a full analysis of its import is not yet possible. The Committee envisages that a later review of the efficiency dividend would encompass a further examination of workplace bargaining.

Small Agencies

2.60 The matter of the impact of the efficiency dividend on small agencies has been raised already (paragraphs 2.31-2.34), it is an example of the uneven capacity of agencies to deliver efficiency gains. The Public Sector Union (PSU) took up the case of small agencies and cited the Australian Film Commission where staff are working unpaid overtime and the Film and Television School where staff are taking leave in lieu instead of overtime.[49] The position of the PSU is that small agencies do not have the capacity to absorb resource reductions indefinitely.

2.61 The issue of thresholds is a particular concern for small agencies and has been raised in a number of submissions. The Senate for instance views the requirement to self fund new government initiatives as the most critical factor impacting on small agencies.[50] The Australian National Parks and Wildlife Service maintains that even in areas like IT there is only limited scope for small agencies to achieve efficiency gains when compared to large agencies.[51] The Australian Centre for International Agricultural Research was particularly pessimistic:

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49 Evidence, p. S66.

50 Evidence, p. S14.

51 Evidence, p. S31.

> The efficiency dividend has reduced the ability of a small agency to react quickly to external influences or unpredictable increases in workload. ACIAR in particular, does not have the capacity to achieve ongoing efficiency gains as it is near its optimal efficiency limit given current technology standards. Further efficiency dividend cuts may result in efficiency and productivity levels actually declining in the future.[52]

2.62 A consistent picture emerged from the submissions received from small agencies; the submissions consistently claim that the imposition of the efficiency dividend has dysfunctional aspects and that workplace bargaining is a more appropriate solution for these types of institutions.

2.63 The Department of Finance acknowledges that small agencies have less flexibility than large agencies and maintains that the exemption provisions are available if they are genuinely in a position where efficiency gains cannot be delivered.[53] There is good reason to be sceptical about this statement. The case of the Office of the Official Secretary to the Governor-General has already been cited, several applications for exemption were all rejected. Finance have provided a list of organisations where application for exemption have been rejected,[54] it would appear that an organisation has to be minuscule or very short term if the list of exemptions is any indication of the likelihood of success. That is with the notable exceptions of Defence, ABC and SBS which have their own arrangements.

2.64 Finance have suggested that one possible solution to the difficulties experienced by small agencies would be to move to a portfolio based arrangement and in this way the differing capacities of agencies could be dealt with by the

52 Evidence, p. S53.

53 Evidence, p. 6.

54 Evidence, p. S355.

Minister. Perhaps the views of the Chairman of the MAB are worth heeding in this respect, *'it might encourage the minister to move resources between different* agencies within a portfolio and some of those small agencies might find that they did even worse'.[55] As far as small agencies are concerned this proposal is really just shifting the responsibility for examining the issues raised by small agencies.

2.65 The Committee urges the Department of Finance to adopt a more flexible approach to the problems being experienced by small agencies when considering future applications for exemptions.

55 Evidence, p. 399.

CHAPTER 3

ADEQUACY OF THE EFFICIENCY DIVIDEND

Has the efficiency dividend become institutionalised?

3.1 It is important to consider whether the efficiency dividend has become institutionalised through agencies simply looking for savings to outlays rather than focussing on increasing efficiencies. The two main objectives of the efficiency dividend are to ensure that a portion of the efficiencies being generated in the public sector are returned to government, and to provide some incentive to managers to focus on achieving efficiencies. It is also one of the few concrete demonstrations that efficiencies are being sought out and achieved in the public sector.

3.2 Finance maintain that the dividend should be set at a rate that ensures that there is an incentive for managers to continue to seek efficiencies,[1] this argument relies on the premise that there has been productivity growth greater than 1.25% in the public sector over recent years. It also assumes that the extra costs imposed on agencies through the operation of the threshold has not effectively raised the rate of the dividend to the point where the incentive is lost. Both propositions are debatable.

3.3 Some agencies still appear to be adopting the approach noted by the MAB Task Force of eliminating activities that they can do without as opposed to looking for improvements in the productivity of the core business of agencies.[2] One of the significant problems in this regard is the lack of any systematic information

1 Evidence, p. S154.

2 The Task Force on Management Improvement. 1992. *The Australian Public Service Reformed: An evaluation of a decade of management reform*. Canberra, AGPS, p. 249.

on the type of efficiency measures that are being developed and implemented. The Department of Industrial Relations notes that this may have contributed to the common perception that the efficiency dividend obligations are in fact being met through arbitrary cuts and that the efficiency dividend is indeed becoming institutionalised.[3] Evidence given by the Australian Taxation Office suggests that this is a common perception among staff there and that it is causing morale problems.[4] This is probably a mistaken impression in most instances, from the evidence received by the inquiry, it appears that most managers are taking full advantage of the flexibilities offered under the Running Costs Arrangements to ensure that the efficiency dividend obligations are being met through genuine efficiencies. Although there was some indication that the full range of flexibilities offered under the RCA are not fully appreciated in all instances.

3.4 The submission from the Department of Environment, Sport and Territories maintains that it is becoming institutionalised, 'DEST believes that departments and agencies need a break from the ED which has been in operation for six years and which now threatens effective program delivery ... It has become a standard budget adjustment ... As such the ED in itself provides neither incentive nor ability to attain improved efficiency'.[5]

3.5 The then Department of the Arts and Administrative Services makes an interesting comment, DAAS points out that the simplicity of the dividend is attractive, however, it can lead to an arithmetically institutionalising process. This can happen if the dividend is administered centrally instead of devolving authority and administration. *A centralised approach tends to result in a mechanical process*, focussing operational concerns on internal management decisions about resources, rather than on measures to improve efficiency.[6] This reflects a view expressed in

3 Evidence, p. S199.

4 Evidence, p. S122.

5 Evidence, p. S81.

6 Evidence, p. S 216.

Building a Better Public Service which stresses the need to continue to devolve authority within line agencies if efficiency and effectiveness are to continue to be enhanced.[7]

3.6 There are a number of shortcomings associated with the efficiency dividend which may ensure that it becomes institutionalised and simply a means of producing savings on outlays. The rate of the efficiency dividend needs to be established at a level which has some logical relationship with the level of productivity in the public sector. This means that a lot of work is going to have to be done to devise an acceptable methodology for measuring productivity and service quality. In this way the fact that gains are being shared can be demonstrated, at the moment it involves a degree of faith and an acceptance of anecdotal evidence. All that can be said with any degree of certainty is that $508m has been extracted from running costs budgets without any major dislocation in agencies thus far.

3.7 This point was highlighted in *Building a Better Public Service* where one of the reform strategies for the future was identified as the better definition of results and better specification of quantitative and qualitative performance information and a greater use of evaluation.[8] A number of other future reform strategies are also identified which will contribute to improved productivity among other objectives, but there is little point in pursuing these reforms unless there is an acceptable means of quantifying outputs and outcomes.

Method of Application of the Efficiency Dividend

3.8 The application of the efficiency dividend at a uniform rate across all agencies received a lot of adverse comment. The across-the-board approach is reminiscent of the ad hoc cuts that occurred prior to the introduction of running

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7 Management Advisory Board. 1993. Building a *Better Public Service*. Canberra, AGPS, p. 11.

8 ibid., p. 11.

costs budgets. There was, however, considerable support for the guaranteed funding over the Budget and forward estimates period, which is the other side of the equation.

3.9 Treasury suggested that a variable (lower) rate could be applied to pure policy advising agencies or other activities that have intrinsically low potential for productivity improvement and of course many small agencies would like to see a zero rate.[9]

3.10 There are a number of possible approaches to variable rates. A sliding scale could be devised which, using an exponential curve, would allow for a gradual progression of rates based on the size of agencies running costs budgets and still maintain the overall level of return to the Budget. This approach would have the advantage of distinguishing between small, medium and large agencies without having to determine threshold points. It would however make the system much more complex, with greater involvement by Finance in oversighting the system and regular recalculation of the bases. It also assumes that all agencies with low running costs budgets have a reduced capacity to achieve efficiencies and this is not the case. There would also be some disquiet among larger agencies over the question of whether they are subsidising small agencies.

3.11 A number of submissions suggest that agency specific rates be negotiated. The Department of Foreign Affairs and Trade (DFAT) recommended such an approach, whereby a notional levy could be applied each year but that the actual quantum be negotiated according to the ability of each agency to generate savings. DFAT acknowledges that it would be awkward in practice to institute a variable levy.[10] A variable levy would run counter to the RCA objectives as it would involve Finance in detailed examination of agency budgets. It would also have the potential to reduce the incentive to seek efficiencies in their operations if a

9 Evidence, p. 87.

10 Evidence, p. S137.

comfortable rate were agreed. The suggestion by DFAT that an incentive could be provided by allowing the levy to be offset against new policy proposals, would reduce the flexibility available to the government to redirect resources to areas of greatest priority, and would restrict gains to individual portfolios.

3.12 Another alternative would be to have step rates such that small, medium and large agencies would pay different rates. There would be considerable debate over definition of category size and the appropriate rates to apply in each category. The cut off points would have to be arbitrary.

3.13 The benefits of a common rate are; predicability, simplicity in administration and the fact that Finance does not have to become involved in the detail of agency management. It could also be argued that a common rate is fair in that all agencies contribute equally.

3.14 The Committee's view is that a common rate is simple to administer and is in accordance with the running costs principles which are generally strongly supported by managers. The downside, which is essentially the differing capacity of agencies to meet the efficiency dividend obligation, would be better dealt with by developing alternatives to the dividend in the medium term and by modifying the dividend in the short term.

CHAPTER 4

CONCLUSION - MODIFICATIONS AND ALTERNATIVES

4.1 The terms of reference require the Committee to consider the future of the efficiency dividend, whether it should continue in a modified form or whether an alternative approach should be adopted. There is little doubt that the application of the dividend to agencies' budgets is a matter of great debate, with a number of the central agencies supporting its continued application while the remainder support either modification or abolition. This is similar to the responses noted in the report on the evaluation of the management reforms of the last decade, *The Australian Public Service Reformed*, and to the arguments put forward when this Committee reviewed the Financial Management Improvement Program in 1990.

4.2 In considering the issues raised in the course of the inquiry, the Committee has borne in mind two principles. First that there is a duty on managers in the Australian Public Service to continue to seek out more efficient means of managing departments and agencies and to ensure that standards of service are maintained or improved. The second point is that government has a right to share in those efficiency gains as the government is accountable for the expenditure of public monies and it is up to the government to determine Budget priorities. As stated in the Introduction to this report, the Committee has focussed on whether the application of the efficiency dividend is the most appropriate means for ensuring that a portion of the efficiency gains being generated in the public sector are returned to the Budget.

4.3 There is no doubt that the flexibilities available under the Running Costs Arrangements provided managers with the means to achieve ongoing efficiencies and that managers have an obligation to do so. The devolution of *responsibility for resource decisions to agencies and the guarantee of funding* requires that there be a mechanism to ensure that managers focus on achieving efficiencies and to enable a share of those gains to be returned to government. The efficiency dividend performs this role in a simple cost effective manner.

Productivity

4.4 One fundamental difficulty associated with the efficiency dividend, and any alterative approach, is the *measurement of productivity*. This was discussed at length in Chapter 2 and a recommendation was made that a method be developed to measure productivity and service quality. Unless an acceptable process is developed to identify the level of productivity increases in the public sector and the impact that changes in management and resource levels are having on quality of service, it will be very difficult to develop more sophisticated approaches to generating efficiencies and capturing the gains than the efficiency dividend. The alternative is to continue to rely on the methodology developed by DoF and anecdotal evidence of efficiency measures.

4.5 The recommendation is entirely consistent with the approach advocated in *Building a Better Public Service* (paragraph 3.7) which identifies the need for better definition of results and better specification of quantitative and qualitative performance information. It is also consistent with developments in performance reporting and evaluation programs which are all increasingly output oriented.

Alternatives to the Efficiency Dividend

4.6 Two main approaches have been taken in suggesting alternatives to the efficiency dividend; workplace bargaining and resource agreements. Market type mechanisms were also suggested as a means of improving public sector efficiency and effectiveness.

4.7 Workplace bargaining was suggested by numerous agencies as an alternative to the efficiency dividend. The Committee was not persuaded that the current workplace bargaining arrangements offer a viable alternative to the efficiency dividend for two reasons: the existing arrangements do not allow for a return to the Budget of any portion of the identified productivity gains; and that there has been insufficient progress in the bargaining process to make any judgement as to the outcomes. The Committee believes that when the workplace bargaining arrangements are renegotiated the government should examine those arrangements as an alternative to the efficiency dividend, by including a return to the Budget.

4.8 Resource agreements have also been suggested as an alternative to the efficiency dividend. A number of examples of quite sophisticated agreements are in operation at present such as the Regional Staffing Model in the Department of Social Security and the Modernisation Program in the Australian Taxation Office. Small agencies have also taken advantage of resource agreements to assist with staffing requirements where workloads fluctuate such as in the Federal Court.[1]

4.9 The *Running Costs Handbook*[2] identifies resource agreements as providing flexibility in the use of resources to enhance outcomes and notes that there are no hard and fast rules for sharing financial benefits from resource

1 Evidence, p. 335.

2 *Running Costs Handbook*, op. cit., p. 7.

agreements. The only principle is that there should be a financial incentive for agencies to improve efficiency and effectiveness, and an appropriate share for the Budget.

4.10 Finance have acknowledged that resource agreements can incorporate *special alternative arrangements to the efficiency dividend for sharing productivity* gains with the Budget. Currently alternative arrangements have been developed for the Department of Defence, the Australian Broadcasting Commission and the Special Broadcasting Service. Finance cite each of these as being in the nature of a resource agreement.[3] This provides an avenue for other agencies who believe their circumstances to be exceptional to seek alternative arrangements. One area that is suitable for a resource agreement arrangement is the Commonwealth's research organisations where there are considerable difficulties in discriminating between programs and running costs. The case of the CSIRO is a particular example where it is suggested that it is inappropriate to apply an efficiency dividend to research activities.

4.11 The CSIRO has good reason to highlight the anomalies of the efficiency dividend. About 70% of its activities are in research and development and are subject to the efficiency dividend. But the Australian Research Council and the Research and Development Co-operative Programs are exempt from the efficiency dividend. As a consequence, research on cane toads is exempt, but research on dragon flies is not.[4]

The Committee recommends that:

2. a resource agreement be developed between the Department of Finance and the Commonwealth Scientific and Industrial Research Organisation, and other similar research

3 Evidence, p. S376.

4 Evidence, pp. S 8-9, pp. 56 and 61.

organisations, which will exempt direct research activities from the efficiency dividend, while central administrative activities should continue to be subject to the efficiency dividend.

4.12 The Committee is of the view that the arrangements for Defence, the ABC and SBS should continue as the long as there are demonstrable benefits to the Budget.

The Committee recommends that:

3. the current budgetary arrangements applying to the Defence portfolio, the Australian Broadcasting Corporation and the Special Broadcasting Service continue to apply.

4.13 The difficulty with resource agreements is that they have to be tailored to suit individual agencies and are not a universal alternative to the efficiency dividend. They will probably continue to be the exception rather than the rule for the immediate future. The Committee also considers that the workplace bargaining arrangements do not provide a viable alternative to the efficiency dividend. It is therefore appropriate that an efficiency dividend continue to be applied to running costs budgets where alternative arrangements do not exist. The Committee will also recommend a number of modifications.

The Committee recommends that:

4. an efficiency dividend continue to be applied to running costs appropriations until 1996-97 and that it be reviewed immediately at the end of the 1995-96 financial year.

Modifications to the Application of the Efficiency Dividend

4.14 There are a number of specific matters which arose in the course of the inquiry which involve modification to the efficiency dividend arrangements.

Small Agencies

4.15 The problems confronting small agencies have already been covered in Chapter 2. The main concerns were that small agencies have limited flexibility with regard to their resources, that a large proportion of their expenditure is non-discretionary and that their staff are often specialised which limits opportunities for redeployment and changed work practices. Small agencies, which are often single purpose agencies, also claim that they do not have the access to additional funding through new policy that is available to large agencies.

4.16 The Committee is not convinced that small agencies should be exempt from the efficiency dividend. The evidence taken demonstrates that small agencies can be very innovative. The Committee is of the view that the modifications suggested to the efficiency dividend arrangements contained in this report will go some way to assisting small agencies. The Committee also recommends that the next review of the efficiency dividend focus particularly on the situation of small agencies.

4.17 Another solution proposed by the Department of Finance is the application of the efficiency dividend on a portfolio basis.[5] DoF suggest that this would allow the portfolio minister to reallocate resources to assist small agencies. As noted already (paragraph 2.64), the Committee is not convinced that such an approach would have a positive benefit for small agencies and may in fact be to their detriment. The Committee does not support the development of a portfolio based arrangement for the application of the efficiency dividend.

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5 Evidence, p. S374.

Section 35 Receipts

4.18 This was a point that was not canvassed extensively in submissions. However the Committee did pursue the exemption provisions related to s.35 receipts in public hearings and with the Department of Finance. The indications are that current exemptions granted for s.35 receipts are inconsistent and lack any rational basis, they appear to have been ad hoc decisions which were probably right for those specific cases at the time the decisions were made.

4.19 There has been a considerable emphasis over recent years on agencies developing user charging arrangements and also in seeking out external sources of funds. User charging and external funding are both measures which encourage efficiency and the receipts benefit the budget.

4.20 The encouragement of agencies to apply user charging and seek alternative sources of funds would be facilitated by the exemption of all s.35 receipts. This would provide significant relief from the efficiency dividend for a number of small agencies and reduce the need for direct funding from the Budget.

4.21 DoF took up this point in its final submission and suggested that an exemption be granted to receipts under $1 million per annum[6]. The basis for this was that some agencies operate substantial commercial operations, although it is unclear whether the suggested cut off is related to these commercial operations or to a financial target. If agencies are generating income then the Budget benefits, the Committee sees no reason why an additional impost should be applied to user charging arrangements. Strictly commercial operations could be subject to a resource agreement.

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6 Evidence, p. S376.

The Committee recommends that:

5. **all section 35 receipts be exempt from the efficiency dividend.**

Rate of the Efficiency Dividend

4.22 There has been a focus by agencies on whether the efficiency dividend should be abolished and one of the supporting arguments is that it is becoming progressively more difficult to find efficiencies as the easy options have been exhausted. The report has already indicated that the dividend should continue to be levied at a uniform rate.

4.23 The Department of Industrial Relations have indicated that the rate of the efficiency dividend is probably too high when compared to the market sector (paragraph 2.9) which indicates that a rate between .6% and 1% is more appropriate than the current rate. As the Committee noted in paragraph 2.2, productivity in the public sector in particular, and the service sector more generally , is difficult to measure.

4.24 The Committee is of the view that the rate at which the efficiency dividend is levied should be related to the rate of labour productivity growth in the Australian Public Service. At present there are a range of rates of growth cited for labour productivity and total factor productivity in the private and public sectors. If the efficiency dividend is to operate on a rational basis it is important that the recommendation on measurement of productivity be accepted and implemented forthwith. The rate at which the dividend is levied is essentially a Budget consideration and a range of options are set out in Appendix 8.

Property Operating Expenses

4.25 The problems associated with including property in running costs have already been covered (paragraphs 2.47 to 2.49). The inclusion of POE in the running costs for the purposes of the efficiency dividend would make the whole arrangement much simpler to administer and it would increase the pool from which agencies could seek efficiencies. It will also remove an anomaly that applies to a number of small agencies with single line appropriations who already effectively have the dividend applied to their POE.

The Committee recommends that:

6. **the efficiency dividend be applied to Property Operating Expenses after appropriate Property Resource Agreements have been finalised.**

4.26 In order to ensure that the extension of the application of the efficiency dividend to POE does not have an adverse effect on agencies, the rate at which the efficiency dividend is levied should be reduced to a level which ensures that there is no nett increase in dividend received by the Budget.

The Committee recommends that:

7. **the rate at which the efficiency dividend is levied be reduced from the current 1.25% to 1% and that this rate be reviewed at the end of the 1995-96 financial year.**

Future of the Efficiency Dividend

4.27 The efficiency dividend meets the objectives set by government in that it stimulates the search for efficiencies, ensures a portion of those efficiencies are returned to the Budget and demonstrates (in a crude manner) that efficiencies are being generated in the Australian Public Service.

4.28 The Committee does not see a long term future for the efficiency dividend in its present form. The variable capacity of organisations to meet the efficiency dividend obligations will ensure that some agencies will begin to lose their capacity to maintain the quality of the services that they are meant to provide. It is imperative that alternative approaches be developed to ensure that managers have an incentive to continue search for efficiencies and to ensure that the government is able to access a portion of those gains for other Budget priorities.

4.29 The first and most important step to changing the current approach will be to put more effort into developing a means to enable realistic assessments to be made of the output of the public sector in both a qualitative and a quantitative sense.

Further Reform

4.30 The Commonwealth public sector accounts for a significant proportion of the Gross Domestic Product. A more efficient public sector will release resources for other purposes. This can give the Government the discretion to increase or improve the public sector's provision of goods and services or to fund tax cuts to allow taxpayers the choice to redirect their income to either investment or consumption.

4.31 The quest for greater efficiency is widespread in the free enterprise democracies. Expert evidence to the Committee made it clear that much remains to be done.

4.32 The secretary of the Attorney-General's Department, with his extensive experience in the APS, was able to give the Committee the benefit of his considered views. He supported the efficiency dividend. Examples were given where the APS has either been slow to introduce obvious reforms or has yet to adopt standards that would be considered mandatory in the private sector, such as:

> The overwhelming majority of departments could not at this stage produce their accounts in an accrual form, and they could not comply with the standard accounting requirements of what is normal throughout all of the private sector, the GBE's, and, as I say, the majority-if not all-of the state public services. Until you can do that, you do not have, as a manager, the fundamental data from which you can decide whether or not you have got the right number of people, the right number of dollars, the right technology, and so forth-and in the right places.[7]

4.33 Not surprisingly the rationale for further reform in the APS was not disputed in evidence before the Committee. A comprehensive framework for public sector reform is necessary. As noted in paragraph 4.6 this framework would include market type mechanisms.

4.34 According to the OECD Public Management Service, market type mechanisms show:

> ... significant potential to economise resources and generate reliable indicators of performance. But they are quite sensitive to the manner of their implementation: the benefits can quickly disappear if they are inadequately designed or under-funded. At the risk of over-simplifying, the bigger the number of market features incorporated, the higher the gains, the fewer the surprises and the easier the control.[8]

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7 Evidence, p. 192.

8 Evidence, p. S329

4.35 Clearly, blind adherence to market solutions would be inappropriate. Government may be big business but all government is not business. There are *functions of government which should not be commercialised, eg in the Defence* Forces there are many functions which can never be contemplated for commercialisation. Where functions can be commercialised they should be done so in a manner sensitive to the circumstances.

4.36 It is this potential that should now be examined by this Committee.

THE HON DAVID SIMMONS MP
Chairman
24 March 1994

Appendix 1

Conduct of the inquiry

On the 27 August 1993 the then Minister for Finance, the Hon R Willis MP, wrote the Committee with a request that the Committee undertake an inquiry into the efficiency dividend arrangements. The Committee accepted the reference and as is its practice, appointed a Subcommittee to undertake the inquiry.

In conducting this inquiry it was important to give all Commonwealth departments and agencies that are subject to the efficiency dividend an opportunity to make a submission to the inquiry. The inquiry was advertised in the major metropolitan newspapers on 24 and 25 September 1993. The Chairman also wrote to all portfolio secretaries inviting submissions and the Department of Finance advised all agencies of the inquiry terms of reference through Estimates Memorandum No. 1993/41, released on 8 October 1993.

As the Report has significant ramifications for the Budget, the changed Budget arrangements presented a particular difficulty for the Committee as it effectively shortened the period available to take evidence. Nevertheless, the Committee is satisfied that it was able to address the major issues raised by departments and agencies.

The Committee received 40 submissions; a list of the submissions and their authors is at Appendix 2 and exhibits received are at Appendix 3.

In developing the public hearings program the Committee was conscious of the time constraints and sought to take evidence from a representative cross section of departments and agencies. In total the Committee took evidence from 44 witnesses representing 17 departments and agencies as well as the Public Sector Union at 11 public hearings between 25 November 1993 and 1 March 1994. Details of the public hearings program are provided at Appendix 4.

The submissions and public hearings transcripts have been incorporated into volumes which are available for inspection at the National Library of Australia, Commonwealth Parliamentary Library and the Committee Secretariat. References to the evidence in the text of this report refer to the page numbers in the submissions volumes and the public hearings transcripts.

Appendix 2

List of submissions

No.	Name of person/organisation
1	National Standards Commission
2	Commonwealth Scientific and Industrial Research Organisation
3	Department of the Senate
4	Human Rights and Equal Opportunity Commission
5	Australian Institute of Criminology
6	Insurance and Superannuation Commission
7	National Crime Authority
8	Department of the House of Representatives
9	The Treasury
10	Australian National Parks and Wildlife Service
11	Department of Defence
12	Office of the Official Secretary to the Governor-General
13	Australian Centre for International Agricultural Research
14	Australian Electoral Commission

15	Affirmative Action Agency
16	Public Sector Union
17	Attorney-General's Department
18	Department of the Environment, Sport and Territories
19	Australian Federal Police
20	Australian Taxation Office
21	The Law Reform Commission Australia
22	Department of Foreign Affairs and Trade
23	Ms J A Keir
24	Family Court of Australia
25	Department of Finance
26	Australian War Memorial
27	Department of Industry, Technology and Regional Development
28	Department of Industrial Relations
29	Department of the Arts and Administrative Services
30	Office of National Assessments
31	Department of Health, Housing, Local Government and Community Services
32	Federal Court of Australia
33	Department of Social Security
34	Australian Broadcasting Corporation
35	Institute of Public Affairs
36	Centre for Australian Public Sector Management

37	Department of Finance
38	Department of Finance
39	Public Sector Union
40	Department of Finance

Appendix 3

List of Exhibits

Exhibit No 1: Staffing Profile as at 30 November 1993 - presented by the Attorney-General's Department.

Exhibit No 2: Family Court of Australia, Expenditure 1992-93 - presented by Mr Glare.

Appendix 4

Program of activities undertaken by the Subcommittee

Public hearings

Canberra	25 November 1993
Canberra	15 December 1993
Canberra	16 December 1993
Canberra	2 February 1994
Canberra	3 February 1994
Canberra	7 February 1994
Sydney	14 February 1994
Canberra	21 February 1994
Canberra	24 February 1994
Canberra	28 February 1994
Canberra	1 March 1994

Appendix 5

List of witnesses appearing at public hearings

Witness/organisation	Date(s) of appearance
Australian Broadcasting Corporation	**14 February 1994**
Mr Peter Lidbetter Deputy Managing Director	
Mr Eugene Remedios Corporate Treasurer	
Australian Federal Police	**2 February 1994**
Mr Arnold Hoitink Assistant Secretary Resources and Services Division	
Mr Alan Mills Assistant Commissioner Investigation Department	
Mr Gregory Thompson Acting Executive Officer Resources and Services Division	
Australian Taxation Office	**2 February 1994**
Mr Richard Highfield Second Commissioner	
Mr Christopher Mobbs Acting First Assistant Commissioner Corporate Services	
Mr John Body Director Corporate Budgeting	

Attorney-General's Department **7 Febraury 1994**

Mr Terrance Gallagher
General Manager
Resources

Mr Alan Rose
Secretary

Australian War Memorial **15 December 1993**

Mr Brendon Kelson
Director

Ms Linda Atkinson
Assistant Secretary
Corporate Services

Ms Rhonda Lewis
Finance Manager

Commonwealth Scientific and Industrial Research Organisation

Mr Arthur Blewitt **15 December 1993**
Director
Corporate Services

Mr Robert Garrett
General Manager
Corporate Finance

Dr Thelma Heyde
Principal Secretary
Government Business and Policy

Dr Maxwell Whitten
Chief
Division of Entomology

Department of Defence **7 February 1994**

Mr Robert Tonkin
Acting First Assistant Secretary
Resources and Financial Programs

Department of Finance	**25 November 1993** **28 February 1994**

Mr Malcolm Crompton
Principal Adviser
General Expenditure Division

Mr Leonard Early
First Assistant Secretary
General Expenditure Division

Mr Stephen Bartos
Assitant Secretary
Resource Management Improvement Branch

Mr Steve Davis
Chief Finance Officer
Resources and Running Costs Policy Section

Mr Mark Wiggins
Research Officer
Resource Management Improvement Branch

Federal Court of Australia	**28 February 1994**

Mr James Howard
Registrar

Mr Ian Mackinlay
Manager
Court Resources

Family Court of Australia	**14 February 1994**

Mr Bruce Fankland
Principal Director of Administration

Mr Leonard Glare
Chief Executive Officer

Department of Human Services and Health	**3 February 1994**

Mr Nicholas Mersiades
Branch Head
Budget Management Branch

Mr Michael Roche
Deputy Secretary

Department of Industrial Relations	**3 February 1994**

Mr Peter Core
Secretary

Mr Ralph Yates
First Assistant Secretary
Australian Public Service Division

Ms Stephanie Bennett
Acting Assistant Secretary
Workplace Policy and Advisory Branch

Management Advisory Board	**1 March 1994**

Dr Michael Keating, AO
Chairman

National Standards Commission	**14 February 1994**

Dr Grahame Harvey
Deputy Director

Office of the Official Secretary to the Governor-General	**16 December 1993**

Mr Robert Sturkey
Official Secretary

Mr Christopher Bell
Director
Corporate Services

Mr Anian Don

Budgets and Finance Officer

Mr Brian Edwards
Director
Honours Secretariat

Public Sector Union **24 February 1994**

Ms Patricia Ranald
National Industrial Officer

Mr John Stapleton
National Industrial Officer

Department of Social Security **21 February 1994**

Mr Brendan Godfrey
Deputy Secretary
Corporate

Mr Michael Goldstein
First Assistant Secretary
Resource Management

Mr Andrew Phelan
Assistant Secretary
Resources

Department of the Treasury **16 December 1993**

Mr Neil Hyden
Acting Deputy Secretary (Economic)

Appendix 6

Efficiency Dividend Equivalents

Government	Current Efficiency Dividend or Equivalent
Commonwealth	1.25% pa
New South Wales	1.5% pa (plus 1.0% "deficit contribution" loading in 93-94 to 94-95)
Australian Capital Territory	2.0% pa savings requirement over 92-93 to 94-95
Queensland	1.0% pa
Victoria	1.5% pa
South Australia	No indexation for inflation or wage increases
Western Australia	No specific dividend at present
Tasmania	0.5% pa
Northern Territory	1.0% pa
New Zealand	No automatic indexation for inflation; ad hoc cuts
United Kingdom	No automatic indexation for inflation
United States	Indexation for inflation; ad hoc cuts
Canada	No indexation for inflation (salaries excepted); ad hoc cuts

Source: Evidence, p. S 351.

Appendix 7

Current Exemptions to the Efficiency Dividend

Specific exemptions

Companies and Securities Advisory Committee (Attorney-General's): small size (two staff) limits the scope for efficiency improvement.

Australia-Japan Foundation (Foreign Affairs and Trade): because of its small size (four staff, $0.9m running costs), in the last Budget the AJF's running costs were agreed on the basis of costing of actual activities planned for 1993-94, rather than formal application of running costs guidelines. As no running costs base was brought forward from 1992-93, it was not possible to apply the efficiency dividend.

Refugee Review Tribunal and Immigration Review Tribunal (Immigration & Ethnic Affairs): 1993-94 was the first year in which appropriations for these agencies were separately identified. As such the efficiency dividend for 1993-94 was calculated on the whole of the Portfolio and applied against the Department, not separated out for these two agencies. In the forward years the efficiency dividend has been applied to both agencies.

Defence Portfolio: the efficiency dividend is assumed to be comprehended in the annual real growth global determinations for Defence. The Minister for Defence has the freedom to decide the internal distribution of Defence resources (including efficiency gains), subject only to the Government's Defence policy guidance.

Construction Industry Development Agency (Industrial Relations): under the Building and Construction Industry Reform Strategy, this agency has a limited life (to June 1995) with agreed funding levels for the agency being apportioned between the Commonwealth (70%) and Private Sector employers in the industry (30%).

Australian Broadcasting Corporation and Special Broadcasting Service (Transport & Communications): subject to global funding agreements (which run until June 1994), which exempt them from the efficiency dividend.

Shipping Industry Reform Authority (Transport & Communications): Small authority, established for a limited term (95-96); exemption was granted in exchange for waiving carryover entitlements.

Source: Evidence, p. S 165.

Appendix 8

Potential Cost of Changes to the Efficiency Dividend Arrangements (a)

	1993-94 $m	1994-95 $m	1995-96 $m	1996-97 $m	1997-98 $m	Effective Rate(b)
Salaries	6 366	5 856	5 821	5 795	6 009	
Admin	4 195	4 203	4 196	4 289	4 448	
POE	1 047	990	957	964	999	
Total RC	11 609	11 049	10 974	11 048	11 457	
Current Arrangements (1.25% of Salary and Admin)						
Efficiency Dividend	85.8	81.7	81.4	81.9	85.0	0.96%
Cost of varying from current arrangements						
% of Salary and Admin						
0.80%	-29.4	-29.3	-29.5	-30.6		0.61%
1.00%	-16.3	-16.3	-16.4	-17.0		0.77%
2.00%	49.0	48.8	49.2	51.0		1.53%
% of Total Running Costs (incl POE)						
0.80%	-21.5	-21.6	-21.8	-22.6		0.70%
1.00%	- 6.4	- 6.7	- 6.7	- 7.0		0.88%
1.25%	12.4	12.0	12.0	12.5		1.10%
2.00%	68.8	68.0	68.4	71.0		1.76%
Cumulative impact on forward estimates						
% of Salary and Admin						
0.80%	-29.4	-58.7	-88.2	-118.8		
1.00%	-16.3	-32.6	-49.0	-66.0		
2.00%	49.0	97.9	147.0	198.0		
% of Total Running Costs (incl POE)						
0.80%	-21.5	-43.1	-64.9	-87.5		
1.00%	- 6.4	-13.2	-19.9	-26.9		
1.25%	12.4	24.3	36.4	48.9		
2.00%	68.8	136.8	205.2	276.2		

(a) Based on 1993-94 Budget data. Salary/admin/POE splits based on information from departments and major agencies only.

(b) Excluding effects from Defence, ABC and SBS.

Source: Correspondence from Department of Finance dated 23 March 1994.