Withholding Dividends: Better Ways to Make the Public Sector Efficient

TARGET30
REDUCING THE BURDEN FOR FUTURE GENERATIONS

Alexander Philipatos

SNAPSHOT

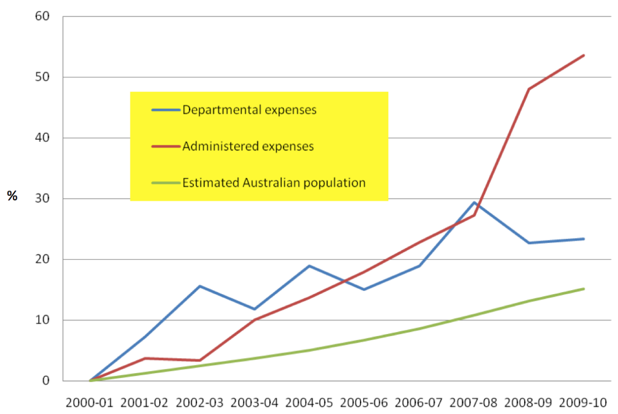
During the 2000s, federal government running costs (departmental expenses) grew from $32 billion to $52 billion, or 23% in real terms. This occurred despite an efficiency dividend of at least 1% applied to funding for agency running costs for the entire period. In the battle to reduce the size and cost of government, public sector reform requires going beyond the efficiency dividend to achieve significant, lasting savings for taxpayers.

What is the efficiency dividend?

The efficiency dividend has been one of the go-to policies for increasing efficiency in the public service. The dividend is an across-the-board cut to funding that government agencies receive to pay for running costs (such as wages and office expenses).

Growing public sector costs

Figure 2: Cumulative real growth in nominal expenses (departmental and administered) compared to population growth (2000–01 to 2009–10)



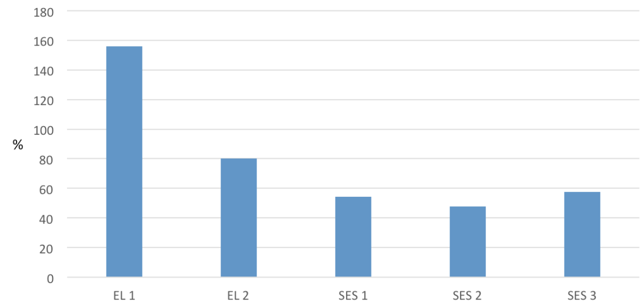
Source: DoFD (Department of Finance and Deregulation), *Report of the Review of the Measures of Agency Efficiency* (Canberra: March 2011), 14.

A top heavy public sector

Going back further, Australian public service has grown top heavy since the early 1990s. Top-level management (Senior Executive Service, or SES) has grown over 50% since 1991, while the number of middle management public servants (Executive Level, or EL) has more than doubled. In 1991, managerial employees (EL and SES) constituted 15% of the public service; today they represent 30%.

Growth of managerial public servants

Figure 5: Growth of ongoing EL and SES employees (1991–2013)



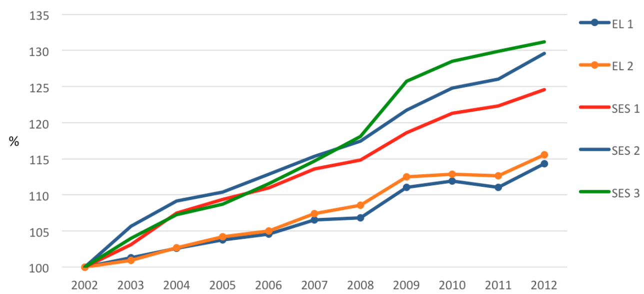
Source: APS (Australian Public Service), *Statistical Bulletins* (Canberra: 1991 to 2013).

The changes in composition make for larger costs to the federal budget. There are more managers at the top drawing hefty salaries.

The salaries at the top too have grown considerably. Base remuneration for the SES has grown between 25% and 35% in real terms since 2004. By contrast, salaries for lower level public servants have grown between 8% and 20%.

High-level public sector salaries are rising

Figure 7: Cumulative real growth in median base salary (2002–12)



Source: APS (Australian Public Service), *Remuneration Report 2012*; ABS (Australian Bureau of Statistics), Consumer Price Index (various years).

Distinguishing between efficient and inefficient agencies

The efficiency dividend has failed to stem the growth in agency costs, with little impact on composition changes in the public service and salary growth. But the dividend has further problems.

Because the dividend is applied across the board, it applies equally to efficient and inefficient agencies. Different funding ought to apply depending on which agencies are most efficient.

- The efficiency dividend fails to distinguish between efficient and inefficient agencies. Some agencies should be subject to larger cuts, while other more efficient agencies ought to receive smaller cuts.
- Smaller agencies are often less able to create efficiencies than larger agencies. They cannot easily achieve economies of scale and have fewer resources to apply for additional funding.
- Some agencies have been able to game the system by submitting applications for new policy proposals to attract the additional funding that comes with it. This can lead to a growth in unnecessary and ineffective programs – and cost taxpayers more.

Tackling public sector growth

Perhaps the most important problem with the dividend is that it fails to tackle the growth in the public sector at its source. New policies and programs are driving the growth of government. New policies require new resources – and a bureaucracy to administer it.

Getting greater efficiency out of the public sector depends on getting better value for money out of essential services, but it also requires decommissioning inefficient or ineffective programs and agencies. The efficiency dividend does not address this significant problem. In fact, it allows ministers to sidestep the important decisions about which programs and agencies the government needs, and which should be cut.

How do we increase efficiency in the public sector?

There are two solutions to increase efficiency in the public sector:

1. The government should increase competitive pressures in providing public services, with the type of competition depending on the service, in three ways:
   a. greater private sector involvement through the use of vouchers for public services
   b. competitive tender, where private companies compete for the right to provide public services for a designated period
   c. greater contestability, where the performance and efficiency of public sector agencies are benchmarked against the private sector so that if agencies do not deliver on outcomes, or are too inefficient, government can contract with the private sector.
2. Conduct regular review of agency functions and programs through an independent body (such as the Productivity Commission's Review of Government Services) to determine which agencies/programs are meeting objectives and how to make them more efficient. These reviews should also be used to cull programs and agencies that are continually failing their objectives, are operating at too high a cost, or are more appropriately provided for by the private market. This process will require greater measurement of outputs and outcomes, so the build-up of performance indicators will aid in benchmarking across government services.

Note: Table and figure numbers correspond to the same in the report.

AUTHOR www.cis.org.au

Alexander Philipatos is a Policy Analyst in the Economics Program. His research has included analysis of public transport infrastructure, but focuses predominantly on industrial relations and labour market policy.

Alexander has a Bachelor of Economics (Hons) from La Trobe University; before joining the CIS in 2011, he was a tutor at La Trobe teaching Introduction to Quantitative Analysis.

THE CENTRE FOR INDEPENDENT STUDIES