Productivity in Government*

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I have the opportunity today to introduce you to the exciting topic of ‘Productivity of Government’.

I’m a little surprised to see you staying for such an apparently dry subject.

Perhaps you’re looking forward to lunch.

So to reward you for your persistence, I’m not actually going to address the topic.

Well, not for the whole of the next twenty minutes.

What I’d like to do instead is talk a little about:

- how we might improve productivity, including productivity in government;
- why it matters; and
- why the Productivity Commission is seemingly right out there in the front of so many of today’s debates.

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It is easy to mistake the role of the Commission, particularly when we appear to be such an active presence in the midst of all today’s controversial debates: automotive manufacturing, SPC, industrial relations. Not to mention disability and an ageing population.

We have in the last six months either published or been asked to look at those and a variety of other less exciting but possibly equally significant policy issues.

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Infrastructure for example, will be published as a draft report next month. A draft report on justice will arrive a month or so later; and early child education and childcare a bit later again.

It's a big agenda, quite a bit bigger than the Commission has had in the recent past.

Policy development in government goes through cycles.

I wish that it were not so, and at CEDA you might not wish it either.

But political cycles are generally short in Australia and expectations of government's ability to solve problems is generally higher than in much of the English-speaking world.

That leads to rises and falls in reform activity; although sometimes crisis intervenes.

And the level of controversy is increased because policy reform is hard enough if you planned for it, and even harder to get right in the midst of crisis.

Reform was hard twenty-five years ago, in the much-celebrated era of micro economic reform; and it is hard today.

Those who gain are often many, but not easily observed; those who lose are much easier to identify; and indeed easy to identify with.

In anticipation of this, past reform processes often planted the seeds of reform well in advance.

Tariff and quota reductions, and national competition policy reforms, which were much of the substance of that earlier reform era, were changes set to apply over long periods, quite often announced years in advance.

And structures can also be set up to house and maintain a commitment to updating policies through periods well in excess of a single electoral cycle.

These two factors – announcements of micro policy reform that extend over long periods and use of structures support the model – has allowed us 22 years of unbroken economic growth, something that also sets us apart from the rest of the English speaking world (and a fair element of the rest too).

The Productivity Commission itself is one of those structures.

Our heritage is that of the Industries Assistance Commission and the Industry Commission. Entities that advised of the damage that was done by poor resource allocation via industry assistance, regardless of whether governments welcomed the advice or not.

The current Commission model dates from the late 1990s, a time when the benefits from accepting advice of this kind were clear, and so governments chose to welcome the idea of reform-oriented critiques of policy.

Possibly clearer then than they are today, if recent debates over co-investment – such a curious term – are any guide.

We know from the experience of that earlier reform era that our economy can thrive despite – not just cope with – the effects of major reductions in assistance and the closure of significant employers.

A healthy economy is in fact one that does sort through and reallocate its resources on a continuous and rapid basis. Not one that attempts to preserve the industrial structure of previous generations regardless of changed circumstances.

The benchmark by which the governance of an economy should be judged is not whether a dogged fight was made against overwhelming global market trends with ever-increasing amounts of assistance, but whether that governance encouraged market structures of a sufficiently flexible kind to allow opportunities to emerge quickly to use the workers and the capital now unemployed.

This is not a popular view to express at a difficult time, and there is no doubt that for some locations the loss of these jobs is quite frightening.

But that is no excuse for quickly-assembled decisions on 'doing something'.

It is a time to look at what has worked in the past; what has worked recently internationally; and what the genuine capacities of communities are, to take advantage of that.

First do no harm. The rush to act is natural, but not necessarily wise.

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The Commission takes very seriously its almost unique ability to critique policy. We design our proposals for economy-wide benefit.

But the Commission does not claim omnipotence, nor do we seek to rule the world, despite suggestions to the contrary.

I should explain perhaps that when I came to the Commission, I suggested we start a Twitter account.

My reasoning was simple: we publish quite a lot. We see twitter as a heads-up notification service.

Moreover, since our product covers not just today's hot topic inquiry but also research matters that may get insufficient attention today but, if left unaddressed, will become tomorrow's hot topics, we see a need to gain a higher profile for them, too.

Twitter has in this way been quite good for us.

And if your role is to ensure attention to issues as apparently dull as productivity in government, the basic rule is 'No debate, no action'.

Our followers on Twitter are journalists and bloggers, a small band in total under a thousand – although in public policy circles, a thousand followers might be considered a throng.

And interestingly, the debate is not just the one you see in the mainstream news, where sensation may dominate.

As an example, it is possible that some of you will recall a research report we published last year on *Deep and Persistent Disadvantage*.

For a worthy but perhaps not hot-topic product, it generated more media attention than we – or I would guess most of you – would have expected.

On the day of release, News Limited plucked a story line from the report to the effect that the Commission supported the idea that genetics were to blame for disadvantage.

> Does a "rich gene" determine how successful children are at school? The Productivity Commission appears to think so.

Incorrect though the interpretation was, subsequent morning radio shock jock criticism was a bit of a surprise response for a peer-reviewed research paper.

But even more surprising was the twitter response to the story.

By a very large margin, the responses from the re-tweets and contributions from all over – in an area where the Commission has perhaps not been that prominent – was strongly supportive of the paper; and on research into disadvantage and its causes.

And dismissive of the idea that the Commission believed in the existence of a rich gene.

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Why is this relevant here today?

The Commission exists, as I noted earlier, in order to advise government on better public policy options for the future, analysed from the perspective of what will provide an improvement in productivity.

But more than just reporting to the Commonwealth on productivity, we are also required to promote public understanding of what productivity is all about.

And if your task is communication, be aware that an entire generation today now gets its primary information from social media.

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We have now extended our research program to look once a year at impending policy issues before they become crises.

The first example was work we published late last year on An Ageing Australia.

The subject is fascinating, and unlike a lot of policy, fundamentally unavoidable.

We can’t stop getting old. There are going to be more of us in the old category, lots more.

Today, we have one centenarian for every 100 babies. In 2060, we can expect to have 25 centenarians for every 100 babies.

If you were born in 1920, you spent about 13 years in retirement. If you were born in 1986, so are in your prime employment years today, statistically you will spend 30 years out of the labour force, mostly in retirement.

By so many of us living so much longer, we’re going to change patterns of resource use.

Aged care costs less than 1% of GDP today. By 2060, we expect it will be more than three times that.

Aged pensions, already around 10 per cent of the Commonwealth budget or 2.7 per cent of GDP, will increase significantly to 3.7 per cent of GDP (the percentage of the budget in 2060 is dependent on too many factors to calculate, but we cannot expect to do other than grow).

And much of what we're going to consume in those ageing years is currently supplied by government.

So productivity in government becomes very important.

Our report on ageing is accordingly relevant to today's discussion in two ways.

Firstly, since we're going to be consuming a lot more of what is supplied by governments, it will pay – both in terms of our funding as taxpayers and in the quality of services – to improve 'workplace' level productivity.

And we suggest some ways to do that.

But also because, at the broader level of the economy as a whole, the retirement system – a key focus of the report – in effect buys people out of the labour force. And may in future buy them out too early, affecting both the participation rate and the retention of valuable skills.

Let me repeat that earlier example: a 28 year old worker today can expect to spend a total of 30 years in retirement (plus any study above the basic high school level) compared with 13 years retired and out of the workforce when the aged pension was first introduced.

And the report suggests that if we are to address this effectively, we could adopt the approach of the previous reform era: lock-in reform early, allow the affected parties to anticipate the coming change, and act in advance of the biggest impacts arriving.

Put succinctly, there is merit in developing and planting the seeds of change now.

The most controversial option we examined was to index the age at which you accessed the age pension to the increase in longevity, effectively meaning that in the future – many years hence, perhaps around 2035 – the age of access to the pension might reach 70.

And we also looked at how the family home might be freed up as an asset, to support better quality of aged care, but not force people to sell up.

And we looked at costs and productivity in health.

Pithy, if inaccurate.

Better, maybe a touch of cynicism.

I should note that the Commonwealth Government has disavowed any plan to make changes in aged pensions.

Yet, as I mentioned earlier, the Commission's work is there for the long haul.

The policy implications of ageing will come upon us, sooner or later.

Two primary criticisms were made of the indexation of retirement income access to longevity: first, that manual or service industry workers were worn out well before such an age; and second, that employers weren't interested in older workers.

There are valid thoughts behind each of these views. Valid, but misplaced.

The first thought is one about physical disability, leading to an early exit from the workforce.

This problem exists today, and will exist tomorrow; and examination of the report will show that we incorporated an upward adjustment in access to disability support in our assessment of the nevertheless substantial fiscal benefit of such a move.

The second thought is actually part of the very problem that we would suggest can better be addressed by adopting this approach.

That problem is many of today's employers do indeed seem not to be focused on retention of aged workers; or structuring jobs to attract such workers.

But in less than a decade, in the same time period we suggest that such a policy may need to come into effect, employers will very much need to be focused on this.

The participation rate will fall with the ageing population. From the early 2020s, and on for decades, participation will decline from around 65 per cent of the working age population to below 60 per cent.

Adopting the indexation approach to accessing the age pension (and taking an equivalent approach to superannuation) will start to dissolve the idea of a retirement age.

It will take time for such an idea to affect workforce planning.

And provide a signal, but a necessary one, to employers to dissolve in their planning the idea that retirement occurs at 65.

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Which brings me, eventually, to the topic of today – the productivity of government.

Much as we would like to say that productivity is driven mainly by the decisions of firms and their employees – and it is – government has a number of quite strong effects on productivity.

Directly, it is the employer of a variety of services – health, education, taxation, Centrelink, defence, police, justice, social welfare.

This amounts to roughly 20 per cent of the economy by value add.

Indirectly, it funds some part of aged care services, child care services and disability services.

Since much of what government does is heavily labour-oriented, if thought of in terms of labour intensity, the government sector's influence on productivity will be higher than 20 per cent of the economy.

Measurement problems abound with government productivity.

I won't list them today but they can be summarised in the observation that officially an increase in inputs generates an equivalent improvement in outputs.

Notwithstanding measurement problems, it is essential we try.

And yet improving productivity in government is fundamentally different to the way we would normally achieve it in the market sector.

Incentives are absent or muted.

In some government areas we can use competition, as we have done in the market sector by removing licencing restrictions, privatisation and creating options for regulated access under the *Competition and Consumer Act*.

We can also apply user charges, but often these are imposed rather than influenced by consumers, such that their ability to improve resource allocation – the most powerful of productivity questions – is minimal.

Performance standards are said to be a useful tool, but the penalties for failure are small, if any, by comparison with markets. So again at the fundamental level, whether a government should be doing something or not is a question not often asked.

And of course expectations of government tend to go only in one direction, towards increasing quality or quantity of services, or both.

Just thinking about health for a moment will show all of these factors and more.

Purchasing arrangements are both driven by and divided between Commonwealth, State and private agents. So the degree to which consumers can affect supply is consequently minimal.

Demand, on the other hand, is generated by consumers but divorced from price by a combination of the essential nature of the service; and the complexity and lack of information about who to choose to supply and how much is reasonable to pay.

Quality of service continues to expand and expectations that all improvements will be supplied by a system are hard to resist.

Lifting productivity at the ‘firm’ level often requires alteration to purchasing decisions that are outside the scope of the hospital to determine. And the incentives are misaligned: facilities supply what the system pays them to supply, and will not stop supplying it until the purchaser (generally not the consumer) both ceases to purchase and yet the budget of the facility is somehow made whole. This can happen, but only with hard work. When it is hard work to improve productivity, it simply may not happen.

For those who disagree with this admittedly simple model, the Commission is considering running a roundtable on productivity enhancement pathways in health later this year. For those who agree with the model, we’d like you to attend too.

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Governments also affect productivity across the economy, beyond own-service provision. They do so via regulation.

Restricting hours of operation of retailing; or limiting the location or ability of businesses to offer services also restricts scope for productivity growth, aside from any social need it may meet.

Chemists are a classic example, long left off the reform agenda.

And thinking more broadly, governments of course establish the rules of entry and participation for many firms. Intellectual property rules, leasing and licencing, planning rules: all affect the utilisation of capital. We hope they do so for good social reasons. Sometimes it’s hard to see.

And finally, there is government as purchaser.

Aside from the more obvious cases of government as purchaser noted earlier – in aged care or disability – there is also the purchasing that occurs in programs such as defence.

If a product is going to be consumed for free – such as freedom from war – then the judgements on how much is invested and thus what is a productive level of supply are much harder to determine than in market circumstances.

Some countries choose not to invest much at all in major defence assets. This can be productive for their economies, as the investment capital freed up may earn higher returns than it would being tied up in AWDs or submarines. The truth is usually only found out in the long term.

And even when a community consensus may emerge around a certain level of armament, that does not seem to be the end of the matter.

There has been recent speculation that a solution to a year or so gap in the defence ship-building program should be to build another ship or ships, whether needed or not.

So the investment planned then becomes not solely an output of weaponry but becomes also about the preservation of a workforce.

The incentives for efficiency then may become quite perverse.

For example, a less costly alternative might be to build the same number of ships, but build them slower. Cheaper in capital terms, but poorer in productivity.

Productivity in the government sector is thus at times the victim of attempting to hit multiple targets at one time.

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Overall, it's a complex business and complexity invites us just to look away and hope.

But the coming increase in demand for services provided by government, driven by an ageing population – along with other factors, like constant expectation of improvement in services quality – makes it a vital one for serious policy consideration.