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Australian Government

Australian Public Service Commission

Mr David Monk
Inquiry Secretary
Joint Committee of Public Accounts and Audit
PO BOX 6021
Parliament House
CANBERRA ACT 2601

Supplementary
Submission No: 54-1

Dear Mr Monk

Inquiry into the effect of the efficiency dividend on small agencies

The Public Service Commissioner, Ms Lynelle Briggs is scheduled to give evidence before the Inquiry on 19 September.

The Australian Public Service Commission lodged a submission to the Inquiry in July 2008. Staffing numbers are provided at Attachment A to the submission. To provide more clarity around those figures we have slightly revised our submission so that staffing levels for the Office of the Inspector-General Intelligence and Security (OIGIS) are separately identified. Staff numbers for OGIS were previously incorporated within the figures for the Department of the Prime Minister and Cabinet.

The Commission's revised submission is attached.

If you have any queries regarding this matter please contact me on telephone (02) 6202 3524.

Yours sincerely

Karin Fisher

Karin Fisher

Group Manager

Corporate

16 September 2008

AUSTRALIAN PUBLIC SERVICE COMMISSION SUBMISSION TO THE INQUIRY INTO THE EFFECTS OF THE ONGOING EFFICIENCY DIVIDEND ON SMALLER PUBLIC SECTOR AGENCIES

SEPTEMBER 2008

Introduction

The Australian Public Service Commission (the Commission) welcomes the opportunity to make a submission to the Joint Committee of Public Accounts and Audit (the Committee) inquiry into the effects of the ongoing efficiency dividend on smaller public sector agencies.

The Commission submission has two perspectives. The first is a broader APS perspective, utilising information gathered through the Public Service Commissioner's State of the Service Report and related research. The second is our own experience of the efficiency dividend as a small agency, and its impact on the Commission and its operations.

This submission is divided into three main parts:

- the general impact of the efficiency dividend;
- the potential impact on small agencies; and
- the impact on the Commission as a small agency.

Across the board, it is reasonable to expect agencies to pursue continuous improvement, obtain productivity gains and return a proportion of these to Government to enable it to consider priorities for reallocation. Productivity is not something that is ever totally exhausted: there are always new technologies and new skills and knowledge that allow greater efficiency, effectiveness and higher quality, some of which can be manifested as cost savings. The efficiency dividend has played an important role in driving reform and also maintaining budgetary and resource management rigour.

Current funding arrangements provide agencies with indexation supplementation to existing funding, and additional funding for new policy. Supplementation does not cover the full cost of non-discretionary increases and requires agencies to find substantial cost savings every year in order to fund wage rises and the efficiency dividend. Cost savings in the APS have been generated by governments by means of the efficiency dividend since 1987–88, previously 1% of operating costs, rising to 1.25% in 2005–06, with an additional 2 % dividend put in place for the period 1 March 2008 until 30 June 2009. (It should be noted that there are minor exemptions from the dividend for a few specific government agencies.)

It is clear that across the APS for the past decade, productivity growth has compared favourably with productivity improvements more broadly in the economy. Having to ensure wage increases can be fully covered, as well as servicing the efficiency dividend, has no doubt acted as a positive discipline overall in driving this productivity performance.

Small agencies, by necessity have had to be creative and innovative in managing their resources and sustaining staff commitment and engagement. The ability over an extended period to secure additional productivity increases may have become limited for some agencies, particularly where the range of outputs and services for which they are responsible is narrow and cannot be varied (eg where their functions are largely statutorily determined). They may have more limited scope to secure funding for new programmes and services, and a reduced capacity to garner efficiencies from economies of scale.

Further, there are thresholds for agency size, with respect to budgets and staffing, below which it is not easily possible to go without affecting functions. Small agencies have the same core operational functions as large agencies in meeting accountability, governance and workplace relations responsibilities.

These pressures are being acknowledged. Recently implemented government initiatives to explore scope for common purchasing arrangements across agencies, including in the areas of information technology, should result in more collaborative arrangements and greater efficiencies. The Review of the Australian Government's Use of Information and Communications Technology is also important in this regard.

The Commission, through its coordinating role with the Small Agencies Forum, is providing opportunities for ongoing lessons to be learnt and shared amongst these agencies about the particular issues they face; while an approach in one agency may not necessarily be appropriate in another, there are best practice approaches to be explored. It is also providing assistance to agencies on more effective employment arrangements (eg recruitment processes) and better practice people management (eg with respect to unscheduled absences). In addition, moves have been made to reduce red tape and streamline the framework that agencies operate under, with a view to reducing unnecessary process and increase efficiency

The Commission would be happy to appear before the Committee to answer any questions which the members might have.

General Impact of the Efficiency Dividend

The overall productivity gains required to be made by APS agencies by the current funding arrangements are quite substantial. In addition to the 1.25%, (3.25% for 2008-09) per annum efficiency dividend, the wage cost indexes applied to departmental funding incorporate an assumption of productivity gains by agencies to finance remuneration increases. This approach has resulted in funding for increases in wage costs of around 2% per annum over the last 10 years. Given that wage increases have averaged around 3.75% to 4% per annum over recent years, agencies have needed to find ongoing cost savings of around 1.75% to 2% per annum to help meet wage increases.

The efficiency dividend (1.25%) must also be managed, with that amount being even higher in the final quarter of 2007-08 and for 2008-09 (3.25%) in light of the increase provided for under the Responsible Economic Management Package.

In effect this has resulted in a real reduction in funding since 2005-06 for agencies of 3-3.25% (being wage increases of 3.75-4% plus the efficiency dividend of 1.25% offset by funding supplementation of around 2%) which has risen since March 2008 to 5-5.25% (the additional 2% from the Responsible Economic Management Requirement).

Whilst a direct comparison between the level of cost savings in the APS and labour productivity growth in the rest of the Australian economy is not possible, productivity improvements in the APS do appear to compare favourably with annual labour productivity growth in the economy more broadly. Over the last decade average labour productivity has increased by 1.8% per annum in the Australian economy generally and by 2.2% per annum in the market sector.[1]

The transition to devolution of employment arrangements and agency control over employee pay and conditions in the APS has provided Agency Heads with a key management tool, enabling them to more easily identify and secure cost savings of this kind. These cost savings are beneficial, as long as the savings have not been made by reducing the quality or quantity of outputs produced by the agency, or by using short sighted responses such as a reduction in learning and development opportunities across the agency, which in turn, can diminish the agency's future capacity to secure further productivity gains.

The annual State of the Service Report prepared by the Commission has noted both the positive impact of the efficiency dividend on productivity, and the ongoing concerns of small agencies of securing higher productivity outcomes.

There are currently 19 portfolio departments and just under 100 agencies that employ staff under the *Public Service Act 1999* (the 'PS Act') framework. For the purposes of the data collected by the Commission on APS employees (based on actual numbers of employees) and current as at 30 June 2007, total APS employment was 155,500 (including non-ongoing employees). Small agencies are defined as those with 250 employees or less. Of these, there are more than 40 agencies, that employ around 4,700 persons. There are 21 micro agencies (with less than 100 staff), employing some 800 persons. It should be noted that 10 agencies accounted for over two-thirds (or 110,310 persons) of total APS employment as at June 2007. A list of departments and agencies by employee size is provided at Attachment A.

As noted above, the Government's Responsible Economic Management Package provided for an increase in the efficiency dividend of 2 per cent, effective from 1 March 2008 to 30 June 2009. The Budget papers also showed an overall reduction of 1200 in ASL for the general government sector, with the effects on APS agencies higher (with an overall net impact for APS agencies of 3,300). Agencies have employed a range of approaches to manage the increased efficiency dividend, and wherever possible, to ensure key staff are retained.

Overall, however, no service wide recruitment freeze was imposed and the Career Transition and Support Centre was established in the Commission to assist affected staff and agencies. As at 4 July, the Centre has had 81 registrations, and has successfully obtained alternative employment arrangements for 13 people.

The potential impact on small agencies

All agencies need to continually strive for greater efficiency and effectiveness and, as noted above, the efficiency dividend has acted as in important driver to this end. Pressures for agencies in managing their budgets will vary depending on a range of factors. Small agencies may, however, face some particular issues.

[1] Average calculated using data from ABS 2007, *Australian System of National Accounts, 2006 07*, Cat. No. 5204.0, ABS, Canberra.

Limited functional and financial flexibility

A relevant factor as well as agency size is agency function. Small agencies are often established to provide a focussed approach to a specific function or purpose, or to provide a degree of required independence. As such, the scope of the small agency's outcome is tightly defined, and may limit the capacity to reprioritise and/or make functional changes or to seek new funds for expanded activities. In addition, if such agencies are required to absorb new functions, the costs of doing so may appear small, especially when compared to larger agency proposals, but can represent a large proportion of the total agency budget.

Maintaining a competitive remuneration position to attract and retain skilled staff (especially in skill shortage areas)

Pay dispersion across the APS has increased significantly both within and among agencies since the introduction of more decentralised wage setting arrangements were introduced in the 1990s. Analysis by the Commission indicates that smaller agencies (those with below 250 employees and especially those with fewer than 100 employees) tend, on average, to be lower paying for most, but not all, classifications.

The Commission has examined the impact of remuneration on staff mobility. While there are a range of factors affecting mobility, such as geographical location and the specialist nature of some roles, the data does show some correlation between those agencies paying in the low to medium salary ranges and agencies experiencing higher rates of staff leaving to work in other agencies. However, it should be noted that results from the State of the Service Employee survey indicate that there are important reasons in addition to remuneration that underlie employees' intentions to leave their agency. The top five reasons for employees intending to leave their agency within the next two years as reported in 2007 were wanting a career change or a change of work, lack of career opportunities, wanting to gain additional experience, the quality of senior leaders and a lack of recognition. Remuneration ranked eighth.

The impacts on small agencies may be even more marked when consideration is given to how well they are able to attract staff with specific skill sets (eg ICT, financial management and accountancy). It is not unreasonable to assume that in a tighter labour market, small agencies may experience difficulties in matching the market rates for specialist skills they may need, given current funding arrangements. Anecdotal evidence, including from the Commission's own experience has shown this to be a serious consideration, with potential and adverse impacts on organisational efficiency.

Small agencies have, however, been less likely than medium or large agencies to self report through the Commission's annual agency survey that they have difficulty recruiting people with the required skills or that they have a higher than acceptable level of employee turnover. In 2006–07, 78% of small agencies reported that they had difficulty recruiting people with the required skills compared to over 90% of medium and large agencies.

Deferred investment in infrastructure and maintenance of existing systems and services

An ongoing call on productivity benefits can lead to a reduction in the availability of discretionary funds for investment in infrastructure development, and the funds available to maintain existing systems.

The impact can potentially be felt even more markedly in areas of high support costs. ICT is one such area. Agencies may well defer necessary but expensive investment, choosing instead to risk manage the existing systems with a range of 'patch' solutions that, over the longer term actually increase the transition costs to new platforms and infrastructure.

This approach has a number of potential difficulties. The obvious one is a failure of the system itself, or the lack of proper support for agency business through new and up-to-date systems and processes. Further, if not addressed, a cycle of declining support and services can bring about a reduction in staff morale, which in turn can affect retention and recruitment.

Finally, it is almost certainly only deferring the necessity for investment, meaning ultimately a large and probably more expensive (in current dollars) expenditure. This occurs as the gap between the existing systems (often unsupported as they use out of date coding and hardware) and the upgrades required to match industry standards become so large that the purchase of a completely new system is required.

Other investments may also come under pressure.

A key area is learning and development. Learning and development has an important role to play in organisational productivity, both in terms of its direct impact on capability, and its influence on employee engagement. Agencies may consider they can reduce expenditure in this area to meet increased budget demands, but risk agency health in doing so (eg governance and compliance capability).

Results from the 2004–05 State of the Service Report [2] show that small agencies invest less money in off-the-job learning and development activities compared to larger agencies—both in terms of actual expenditure and expenditure as a proportion of agency operating expenses. This may however be a feature of small agency approaches unrelated to the efficiency dividend. This year's results may provide further confirmation.

The State of the Service results also show that employees were most likely to indicate that increased knowledge and/or experience were important contributors to enhancing productivity. These results highlight the gains that can be made by investing in employees so they can become even more effective in their current roles. Failing to do so is a particularly short-sighted approach and has the potentially circular result whereby more productivity is needed to meet budget demands, yet reduced learning and development investment constrains productivity growth.

<u>Meeting minimum standards of governance requirements for accountability and reporting purposes</u>

Regardless of agency size, all bodies have legal responsibilities and reporting requirements including the creation of annual reports, financial statements and the implementation of diversity plans. These are complex tasks/issues, and a lack of sufficient skilled staff can effectively put such things beyond the capacity of small bodies to implement fully, or require the diversion of resources from other functional areas. Small agencies may also have less capacity to absorb or manage budget restrictions in these areas, without compromising

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[2] This is the most recent data the Commission has in regard to agencies investment in off-the-job learning and development. New data has been collected through the 2008 State of the Service agency survey.

compliance and/or the separation of appropriate delegations. Compliance failings can risk the long term capability of agencies, especially small agencies.

This also raises issues to be considered in the establishment of small (particularly micro) agencies, eg whether alternative centralised arrangements may be more effective, and/or whether shared or bureau type corporate services might be more appropriate.

Impact on the Commission as a small agency

The Commission is a central agency within the Prime Minister and Cabinet portfolio. The Commission supports two statutory office holders, the Public Service Commissioner—who is also the agency head—and the Merit Protection Commissioner.

Our mission is *to support a high performing Australian Public Service (APS)*. The statutory responsibilities that support our mission are outlined in the *Public Service Act 1999* (the Act) and include:

- evaluating the extent to which agencies incorporate and uphold the APS Values
- evaluating the adequacy of systems and procedures in agencies for ensuring compliance with the Code of Conduct
- promoting the APS Values and the Code of Conduct
- developing, promoting, reviewing and evaluating APS employment policies and practices
- facilitating continuous improvement in people management throughout the APS
- coordinating and supporting APS-wide learning and development as well as career development
- contributing to and fostering, leadership in the APS
- providing advice and assistance on public service matters to agencies on request
- providing external review of actions by the Merit Protection Commissioner.

The Commission works to achieve the outcome specified by the Government i.e. a confident, high quality, values based and sustainable APS.

The Commission employs around 180 staff, the majority located in our Canberra Office. The Commission has a small regional office in each capital city except Darwin and Hobart (serviced out of Adelaide and Melbourne respectively).

Issues for the Commission in managing its budgetary situation, including the efficiency dividend, include:

- finding efficiency measures (eg through streamlined internal procedures and procurement)
- deferral of ICT investment, meaning we are now faced with expensive upgrade requirements and an ICT environment that does not allow our employees to be as productive as they could be, and impacts on staff morale
- trimming the budgets of all operational areas, putting pressure on outcomes and services
- managing for the risks of a budgeted loss of earned revenue

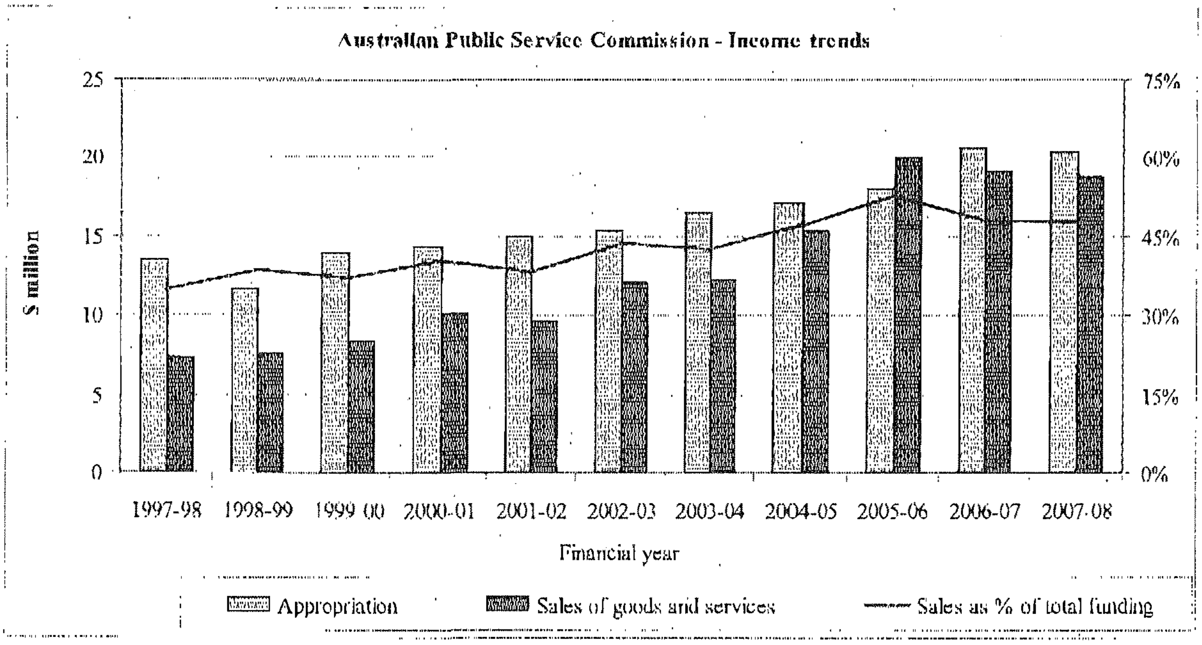
- having little room to absorb higher than expected increases in certain costs (eg significant increases in lease and associated fitout costs in the overheated Perth office rental market).

The Commission's budget

The nature of these management issues requires an understanding of the composition of the Commission's budget, and how it is applied to its staff and functions.

The Commission is unique in some respects in that a number of its core statutory responsibilities are not budget-funded and are performed on a cost recovery basis. For example the Commission's statutory responsibility to co-ordinate and support APS-wide training and career development is performed on a fully cost recovered basis.

Over the last 10 years there has generally been a steady increase in the proportion of the Commission's budget that comes from earned revenue compared to that which is received through appropriation. This is shown in the figure below.



The appropriation provided by the Government to the Commission in 2008-09 is $22.8m which is directed primarily towards the performance of non-discretionary activities. These include the preparation of the annual State of the Service Report, processing Machinery of Government changes, merit review functions and the on-line gazette. The additional costs of $18.5m to perform the full range of activities the Commission is responsible for is derived from income earned from such things as training and development programmes and employment services.

As the figure indicates, almost 50% of the Commission's funding therefore comes through earned revenue, compared to 35% in 1997-98.

About 80 people or 39% of the Commission's staff will be funded off-budget in 2008-09 from revenue raising activities. The Commission employs approximately 180 staff across five areas of focus and a corporate support group.

Recovered revenue

The figure on the previous page shows that revenue declined from a high in 2005-06 of just over $20 million, to $19.1 million in the following year and $18.8 million in 2007-08. As already stated, the budget target for this year is slightly lower again, at $18.5 million.

The reliance on revenue for budget outcomes has a number of limitations. The Commission's budgetary base is at risk if we fail to meet revenue targets.

The Commission's revenue is earned in an open market where agencies have a choice about where they source their services, as well as the level of services they require. Demand can vary, and income can fluctuate accordingly. Commission fees are also determined on a cost recovery basis only, so a downturn in demand is not offset by an increase in fees.

A broader concern for the Commission in this respect is if budgetary pressures on agencies leads to a reduction in learning and development demand, with a potential impact on the recovered revenue of the Commission, and a potential to compromise the statutory function of the Commission to co-ordinate and support APS wide learning and career development.

Future directions and conclusion

The Commission has been concerned about the effects of funding arrangements and the application of the efficiency dividend, including on smaller agencies, for a number of years, canvassing those issues in the Public Service Commissioner's State of the Service Report.

In last year's report, the Commissioner said:

> "Although some agencies may achieve the required efficiencies through genuine efficiency gains or sensible re-prioritising, others may have no choice but to fund pay increases by cutting worthwhile activities and/or reducing numbers of employees. This in turn could lead to a reduced capacity to absorb new initiatives and to deliver on core responsibilities.
>
> To meet increased wage and conditions pressures without cutting activities and/or employees, new approaches to meeting these budgetary challenges may need to be considered. The current arrangements are likely to hinder APS agencies, particularly small agencies, competing for high quality staff in an ever-tightening labour market. Consideration of a 'safety valve' for agencies in stress may be warranted."

In the development of such a 'safety valve', relevant considerations could include the quality of an agency's service management; its organisational capability; and its record in pursuing performance improvement. In the latter regard, it is interesting to note the findings of the 1994 Inquiry into the efficiency dividend arrangements by the House of Representatives Standing Committee on Banking, Finance and Public Administration. It concluded that consideration should be given to small agency concerns "where there was a track record of efficiency improvements.[3]

The Commission has also encouraged agencies to focus on the issue. Its booklet on Agency Health notes:

> "The performance of agencies is also fundamentally dependent on the sustainability of the funding base provided by government. A high-performing agency will put a strong emphasis on managing its operations in an efficient and cost-effective way, and in pursuing continuous improvements in productivity. Nevertheless, where funding for the agency is not sustainable, whether for front line policy development, regulation and service delivery, or for support services, such as information management, a high-performing agency will be proactive about raising such issues with central agencies and with government. This is not a sign of failure, but a sign of an agency that puts a high priority on maintaining its corporate health."

The Commission has included some specific questions in this year's State of the Service employee and agency surveys:

- agencies have been asked to identify the actions they have taken to manage the increased efficiency dividend, to identify employee impacts, and whether agencies are managing excessive workloads and what measures they have in place to manage employee's annual leave levels.
- employees have been asked about the hours they have worked, their overall satisfaction with work life balance and whether their workplace supports them in achieving a good work-life balance.

These questions will be reported on in the State of the Service Report, which will be tabled at the end of November.

The Commission will also continue to look for ways to further support small agencies through its statutory role. As noted earlier, the Commission coordinates a small agency network forum that shares information and provides some support to small agencies and has recently facilitated access to a consultancy service specifically focussed on small agency issues. A course on IT specific issues for small agencies is also being investigated, and through our research on the needs of new statutory office holders we are also considering a range of options on how to further support small agencies and their unique issues and concerns.

[3] Report of the Inquiry, para 2.35, p.19

Attachment A

All staff by agency as at 30 June 2007

Agency	*Total*
- ACLEI	6
- Inspector-General Intelligence & Security	7
- National Competition Council	9
- ORER	11
- Future Fund Management Agency	12
- Professional Services Review	16
- EOWA	21
- Cancer Australia	26
- Australian Fair Pay Commission	28
- National Water Commission	32
- AOFM	33
- Commonwealth Grants Commission	41
- NOPSA	42
- Office of the Parl. Counsel	48
- National Blood Authority	50
- ACIAR	52
- ASADA	55
- Federal Privacy Commissioner	58
- Aust. Institute of Family Studies	59
- Australian Research Council	73
- Torres Strait Regional Authority	76
- CrimTrac Agency	81
- National Capital Authority	106
- Aust. National Maritime Museum	109
- AIATSIS	114
- HREOC	116
- ABCC	128
- FSANZ	131
- Office of National Assessments	133
- ARPANSA	134
- Commonwealth Ombudsman	153
- Federal Magistrates Court	160
- Administrative Appeals Tribunal	162
- GBRMPA	171
- Australian Industrial Registry	175
- Royal Australian Mint	181
- Productivity Commission	207
- Aust. Institute of Health & Welfare	211
- NHMRC	221
- Questacon	231
- National Native Title Tribunal	244
- Australian Film Commission	244
- AUSTRAC	247
- Australian Public Service Commission	250
- National Museum of Australia	282
- ITSA	285
- Australian War Memorial	293
- Office of Workplace Services	303