Submission No: 25

Finance Submission to the Joint Committee of Public Accounts and Audit Inquiry into the Effects of the Ongoing Efficiency Dividend on Smaller Public Sector Agencies

Introduction

From the 1980s, successive Australian Governments implemented reforms to support a more devolved, principles-based financial management framework. Under this framework, Chief Executives are accountable and responsible to the Executive and the Parliament for managing the resources of their agencies. In turn, Chief Executives are provided with flexibility and autonomy to spend the funds appropriated directly to the agencies by the Parliament, within the policy parameters established by the Government.

The framework also imposes discipline on agencies by setting out detailed rules for handling various aspects of government resources. These include managing appropriations, spending public money, arrangements for banking and custody of public money, and for investing public money.

Recognising that productivity gains for agencies would result from this increased flexibility and autonomy and that government agencies had the capacity to seek ways to operate more efficiently, the Australian Government introduced the efficiency dividend, imposing an annual reduction in funding for the overall running costs of an agency.

The efficiency dividend operates as a mechanism by which the Australian Government is able to secure public service efficiencies arising from improvements in management and administrative practices. It also allows the Australian taxpayer to share in these gains by returning a portion to the budget for redirection to new or higher priority activities.

The efficiency dividend provides Chief Executives with a clear financial incentive to continually seek new or more efficient means of delivering services and managing their agencies' operations.

The efficiency dividend framework

The efficiency dividend was introduced in the 1986-87 Budget as an integral component of the running costs arrangements for departments and agencies. These arrangements involved a package of measures that provided greater flexibility to departments and agencies in the management of their staffing and administrative resources, combined with greater responsibility to use those resources efficiently. The arrangements also promoted a shift from inputs and compliance towards the achievement of outputs and outcomes. They included, for example, specific appropriations for salaries and administrative costs being consolidated into running costs and the introduction of carry over provisions that allowed certain unspent appropriations to be transferred between financial years.

The running costs arrangements also provided an incentive for departments and agencies to develop management systems focussing on results and encouraged managers to also consider the longer term changes required to implement results-oriented management.

Following an initial efficiency saving of 0.5 per cent in 1986-87, the efficiency dividend was applied at the rate of 1.25 per cent per annum from 1987-88 until it was decreased to 1.0 per cent per annum in the 1994-95 Budget following the inquiry into the efficiency dividend arrangements by the House of Representatives Standing Committee on Banking, Finance and Public Administration.

The efficiency dividend was then revised upward again to 1.25 per cent in the 2005-06 Budget following an election commitment by the previous Government in 2004. The increased efficiency dividend was to apply until 2007-08.

The previous Government further decided in the *2007-08 Mid-Year Economic and Financial Outlook* to maintain this higher rate of efficiency dividend (1.25 per cent per annum) from 2008-09 to 2010-11. The Government has continued this policy in the 2008-09 Budget.

As part of its election commitment *Savings for Labor's Better Priorities - Efficiency Dividend,* the Government has also applied an additional one-off 2 per cent efficiency dividend to the same base funding that has been used for the ongoing efficiency dividend of 1.25 per cent, with some exceptions that are outlined further below. A pro-rata adjustment was applied for the 2007-08 year, with the full year impact of 2 per cent occurring in 2008-09.

The benefits of the efficiency dividend

The efficiency dividend framework provides an incentive for agencies to continually seek efficiencies, delivering benefits to taxpayers and allowing the Government to re-direct efficiency gains to new or higher priority areas.

In the absence of the efficiency dividend, the identification and redirection of efficiency gains to other priorities would require a more interventionist approach by Finance to assess whether agencies were operating efficiently and to seek savings where this was not the case. Such an approach would be resource intensive, potentially more arbitrary, and would reduce the incentive for agencies to pursue efficiency gains themselves.

The efficiency dividend operates as a means of facilitating a change in priorities. It provides a return to the budget from ongoing gains in efficiency which can be redirected through the budget process to areas that the Government has identified for additional funding.

Application of the efficiency dividend

The efficiency dividend applies to departmental expenses (expenses controlled by agencies) that represent the ordinary operating costs of Government departments and agencies. They include salaries, operational expenses, including depreciation, and accruing employee entitlements.

The efficiency dividend applies to:

- all agencies in the general government sector, unless they are specifically exempted by Cabinet;
- total net departmental appropriations (that is, including depreciation but excluding receipts through section 31 of the *Financial Management and Accountability Act 1997* net annotated appropriations, such as interest income and receipts from other sources);
- other expenses of a departmental outputs type nature; and
- funding for all new policy initiatives following the year in which the new measures are introduced.

The efficiency dividend is applied before any price adjustments (i.e. indexation) are made to the estimates and is implemented through a corresponding reduction in appropriations revenue.

The efficiency dividend is not calculated to apply to agencies' capital acquisition programs.

Administered expenses are not usually subject to the efficiency dividend unless explicit decisions have been made by the Government. These expenses are those that are administered by the agency on behalf of the Government, and are normally related to activities governed by eligibility rules and conditions established by the Government or Parliament, such as grants, subsidies and benefit payments. A significant majority (around 83 per cent) of all general government sector expenses are classified as administered expenses.

There are six programs with administered expenses that are subject to the ongoing efficiency dividend. These are:

- the Commonwealth State Housing Agreement 2003-2008;
- the Reconnect Program;
- the Child Care Support Program;
- the Youth Links Program;
- the Job Placement, Employment and Training Program; and
- the Disability Employment Assistance and Other Services Program.

Exemptions from the ongoing efficiency dividend

The agencies that are currently exempt from the ongoing efficiency dividend are:

- the Australian Broadcasting Corporation;
- the Special Broadcasting Service Corporation; and
- the Australian Nuclear Science and Technology Organisation.

There are also several agencies where the efficiency dividend applies to only a proportion of their departmental funding. These are:

- the Australian Institute of Marine Science, which is subject to the efficiency dividend in relation to 12 per cent of its funding, in recognition of the cost of administering the organisation;
- the Commonwealth Scientific and Industrial Research Organisation (CSIRO), which is subject to the efficiency dividend in relation to 30 per cent of its funding broadly recognising its non-research activities; and
- the Department of Defence, in which case the efficiency dividend is applied to a range of civilian and non-operational areas. For the 2008-09 Budget, the efficiency dividend was applied to around 11.2 per cent of Defence's expenditure base.

In addition, the following agencies are exempt from the ongoing efficiency dividend in relation to specific funding:

- the Australian Customs Service in relation to its Coastwatch contractual arrangements for surveillance aircrafts and helicopters; and
- the Australia Council for the Arts in relation to grants to major performing arts organisations.

Agencies currently exempted from the ongoing efficiency dividend are also exempted from the one-off 2 per cent efficiency dividend.

In addition, the Government agreed to exempt the Australian Trade Commission, the Australian Fair Pay Commission Secretariat and the Workplace Authority from the one-off 2 per cent efficiency dividend because these agencies were significantly affected by other election savings commitments. The Government also agreed to exempt the Australian Prudential Regulation Authority and the Australian Sports Commission from the one-off 2 per cent efficiency dividend. The six administered programs that are subject to the ongoing efficiency dividend (and detailed above) are also exempt from the additional 2 per cent dividend.

Relationship to indexation arrangements

While the application of the efficiency dividend on agencies reduces the level of resources at their disposal, agencies receive additional resources through the indexation process. Indexation is the process by which the budget and forward estimates are updated to reflect forecast prices in the year to which they relate.

About $30 billion of Government departmental expenses are indexed by what are known as the wage cost indices (WCIs). The WCIs are a series of weighted averages of movements in non-wage costs (based on the Consumer Price Index) and a wage measure (based on movements in the Federal Minimum Wage determined by the Australian Fair Pay Commission).

Application of the efficiency dividend to smaller agencies

Although the Joint Committee of Public Accounts and Audit has defined small agencies as those with annual departmental appropriations of $150 million or less, this category incorporates a number of agencies that are more sizeable, including 5 of the 19 Departments of State and a number of significant agencies such as Comcare and the Australian Competition and Consumer Commission. In aggregate, these agencies make up around 9 per cent of 2008-09 total departmental expenses.

The imperative for smaller agencies to make efficiency and productivity gains is as important as it is for larger agencies. Consequently, the efficiency dividend is applied equivalently to large and small agencies, as a percentage of their expenses.

This recognises that the capacity for smaller agencies to make efficiencies need not be any less than the capacity of larger agencies.

In some cases, smaller agencies may face pressures in delivering increased services or outputs (for example, as a result of growing customer numbers or new requirements from the Government) or may face constraints on their capacity to achieve efficiencies in particular areas. However, many larger agencies also face similar pressures.

As an established part of the annual budget process, the Government may decide to provide increased funding to support new activities or higher demands, or to accommodate other pressures on agency budgets. Both small and large agencies may receive supplementary funding in this way, depending on the Government's assessment of relative priorities, and its overall fiscal objectives.

Equally, the Government may require further savings over and above those achieved through the efficiency dividend — again, this may apply to small and large agencies.

In summary, the efficiency dividend is intended to provide an incentive for agencies to operate efficiently and make further productivity gains, irrespective of their size. An exemption of small agencies from the efficiency dividend would remove the discipline on those agencies to pursue efficiencies and would treat them more favourably than other agencies.

Department of Finance and Deregulation
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