JCPAA Inquiry into the Efficiency Dividend

Submission from the Department of the House of Representatives

Introduction

The efficiency dividend (and the recent imposition of an additional special efficiency dividend of 2 per cent) is one important element of the current model for the funding of public sector agencies. In this submission, the Department will argue that the model generally, including the efficiency dividend, has had significant implications for the Department, which is a small agency. The Department will argue that a new approach to funding small agencies needs to be developed.

Of additional significance in relation to the funding of the Department is the apparent lack of awareness of the constitutional context in which the Department operates. The Department, together with the other parliamentary departments, supports the Parliament, a quite separate arm of the state from the executive government. It is completely unsatisfactory that the funding of the departments that support the Parliament is dictated by a model developed by the executive, with little capacity for the departments to negotiate additional funding. An important principle of the funding of Parliament as noted by a Study Group Report of the Commonwealth Parliamentary Association on the Administration and Financing of Parliament is that:

> Parliaments should have control over, and authority to set out and secure, their budgetary requirements unconstrained by the executive.[1]

A further constraint on the Department has been the approach of the Executive to treat the parliamentary departments as a 'portfolio', not recognising the important constitutional separation within the Parliament between the two Houses. It also does not recognise that the funding treatment of the parliamentary departments in the past has not been the same, resulting in disparities of funding that cannot be dealt with by treating the Parliament as a 'portfolio'.

The Department will propose that the Parliament needs to be treated differently to an agency of executive government and that the independence of the Parliament to be able to influence its budgetary outcomes should be recognised in any funding model.

In making a case for a different approach, the Department wishes to emphasise that the Parliament should be expected to achieve efficiencies, and that some of that improvement in efficiency should be returned as a dividend to the taxpayer. However, there also needs to be recognition that the parliamentary departments must have the capacity to support the core services of the Parliament to ensure that the Parliament is able to perform its key functions, one of which is to hold the Executive to account.

---

1 A Study Group Report published by the Commonwealth Parliamentary Association, *Administration and Financing of Parliament*, May 2005, p. 13.

Background to the efficiency dividend and the current funding model

The efficiency dividend was first imposed on public sector agencies in 1987-88 as part of a package of reforms known as the Financial Management Improvement Program (FMIP). The purpose of the policy was explained in the following terms:

> ..... each agency is expected to improve operating efficiency each year so as to reduce its total running costs expenditure by at least this percentage [1.25 per cent] with no diminution in output. The dividend is based on the notion that at least part of such productivity gains should accrue to the budget as a whole .... It represents the portion which it is the Government's prerogative to allocate; any gains above that can be used by the agency that achieved them.[2]

An ongoing efficiency dividend of 1.25 per cent has been in place since then, decreasing to 1.0 per cent from 1995-96, and back to 1.25 per cent in 2007-08. Since 1987-88, the efficiency dividend alone has meant a reduction of over 20 per cent in real funding to the Department. It should be noted that in the original funding model, productivity gains were expected to be achieved to at least meet the efficiency dividend. To the extent these exceeded the efficiency dividend, they were retained by agencies.

The efficiency dividend was reviewed by parliamentary committees on a number of occasions in the early 1990s.

The House of Representatives Standing Committee on Finance and Public Administration has reviewed the efficiency dividend twice. In 1990, as part of its review of the Financial Management Improvement Program, the Committee concluded that the efficiency dividend should remain, although it recommended the then Department of Finance should take careful account of the merits of exceptional cases in applying the dividend.[3]

In 1994, the Committee conducted an inquiry focussing exclusively on the efficiency dividend arrangements. While the Committee concluded the efficiency dividend should remain, it recommended, among other recommendations that:

- the efficiency dividend continue until 1996-97, but it be reviewed at the end of 1995-96; and
- the rate of the efficiency dividend be reduced from 1.25 per cent to 1 per cent at the end of 1995-96.[4]

The latter recommendation was implemented, with the reduction in the rate to 1 per cent.

---

[2] Task Force on Management Improvement, *The Australian Public Service Reformed: An evaluation of a decade of Management Reform*, Canberra, December 1992, p. 243.

[3] House of Representatives Standing Committee on Finance and Public Administration, *Not Dollars Alone: Review of the Financial Management Improvement Program*, September 1990, p. 37.

[4] House of Representatives Standing Committee on Finance and Public Administration, *Inquiry into the efficiency dividend arrangements*, March 1994.

Specifically in relation to small agencies, the Committee noted the difficulties experienced by them in realising the productivity gains to meet the efficiency dividend. It suggested the Department of Finance adopt a more flexible approach to considering applications from small agencies for exemptions from the efficiency dividend.[5]

The efficiency dividend was also reviewed by the then Joint Committee of Public Accounts (JCPA) in 1992 in the context of an inquiry into managing people in the public service. The Committee noted that it regarded 'the efficiency dividend as having been very damaging not only to the APS as a whole, but to smaller agencies in particular ....'.[6]

The Committee also noted that:

> The introduction of workplace bargaining is planned to result in work conditions based on productivity and may render the concept of efficiency dividends irrelevant, if not invalid. In view of productivity gains associated with the introduction of workplace bargaining the Committee regards it as timely to review the need for continuing the efficiency dividend, with a view to abandoning [it] altogether.[7]

The Committee recommended the efficiency dividend be abandoned.

As will be noted below, the Department achieved significant efficiencies during the course of the 1990s that enabled it to meet the efficiency dividend without a diminution of levels of service. The Department also met a base reduction of $300,000 in 1996-97, as part of a Budget savings measure for the parliamentary departments.

From the late 1990s, the funding model changed in important ways that had been flagged by the then JCPA. In the late 1990s, agencies were given responsibility for bargaining with their own staff for future pay increases. Initially, the pay increases negotiated under these agreements were funded (or at least partially funded). The Department developed its first agency agreement in 1998 on this basis. However, there has been no supplementation for pay increases since the early days of agency bargaining. The increases in pay rates to staff made under successive certified agreements have to be funded, under the policy parameters developed by successive governments, from productivity and efficiency gains within agencies.

5 ibid, pp. 28-30.

6 Joint Committee of Public Accounts, *Managing People in the Australian Public Service: Dilemmas of devolution and diversity*, Report 323, December 1992, p. 104.

7 Ibid, p. 15.

The combination of the efficiency dividend <u>and</u> the productivity and efficiency gains to be achieved to fund pay increases has, since the late 1990s, resulted in a double impact on agency budgets. Effectively the way the model works is that each year the Department receives an additional upwards price parameter adjustment (which has been around 2 per cent in the last few years). The efficiency dividend (1.25 per cent this year) is then discounted. The Department then has to fund pay increases (currently approximately 4 per cent per annum) and any price increases in supplier expenses from what is less than a one per cent increase in funding.

The former Public Service Commissioner, Mr Andrew Podger, has noted that this formula imposed by the Department of Finance and Deregulation:

> ..... implies productivity gains of well over 3 per cent per year every year, for every agency.
>
> That is clearly unsustainable and it doesn't happen. Moreover, the formula has no logic - it is a "nonsense on stilts".[8]

It is worth noting that productivity improvements in the economy generally have averaged just over 2.0 per cent over the last 20 years[9], well below three per cent per annum, indicating the unsustainable nature of productivity gains of three per cent over a lengthy period.

As Podger notes, the ways agencies have got around the constraint is by gaining new policy proposals and doing some padding of the costs involved in such proposals, or by dropping some outputs that few will notice. [10] Of course, agencies may also achieve some productivity gains, although as noted above, these are unlikely to be of the order necessary to sustain the agency over the longer term.

As the Department will indicate in the detail below, while it has been able to cope with this model for a number of years by achieving efficiency gains, it will not be possible to sustain this model into the future without reducing the provision of core services to the Chamber, committees or Members. In short, the model is not sustainable for the Department in the near and longer term.

With this introduction as background, the Department comments on the detailed terms of reference:

1. *whether the efficiency dividend has a disproportionate impact on smaller agencies, including whether or not smaller agencies are disadvantaged by poorer economies of scale or a relative inability to obtain funding for new policy proposals*

   The Department is a small agency, and the current funding model, including the efficiency dividend, as described above, has had a significant adverse effect. The reasons for this include:

8 Andrew Podger, 'Pay, performance and productivity', Public Sector Informant, July 2006, p. 23.
9 Perspectives on Australia's Productivity Prospects (Treasury Working Paper), September 2006, p.2.
10 Podger, ibid.

- the inability to achieve economies of scale in a smaller organisation. For example, the Department has to fulfil all the reporting and compliance obligations of a larger agency. While the relative simplicity of the Department makes these obligations considerably less demanding than for larger agencies, they nevertheless result in a higher proportional level of compliance overhead costs than would be expected in a larger agency; and

- the Department has not been able to obtain funding through successful new policy proposals which, as Mr Podger has suggested, can be 'padded out' to assist agencies to fund either staff pay increases or the efficiency dividend. The Department's only recent successful new policy proposal (which ultimately was transferred to the Department of Parliamentary Services as part of the transfer of the security function) was for additional security measures at Parliament House following the events of 11 September 2001. The NPP had to be fully offset in all but the first year by savings measures.

To illustrate the effect on the Department over the last eight years of the impact of the funding model on an agency which has not received NPPs compared with agencies that have, the following table illustrates the Department's departmental funding budget and staffing numbers in 2000 and now compared to those of key central agencies - the Department of Finance and Deregulation and Department of Treasury (acknowledging changes of function, however a proportion of total funding is available to meet overhead costs).

Table 1 - Comparison of Departmental Budgets

	Budget 2000-2001	**Budget 2008-09**	**Percentage Increase**
House of Representatives*	$19.757m	$21.935m	11.0%
Finance and Deregulation	$120.237m	$225.045m	87.1%
Treasury	$71.913m	$146.446m	103.6%

* The 2000-01 budget has been adjusted downwards to enable comparability of figures by removing net funding for security services which the Department transferred to the Department of Parliamentary Services at the start of 2004-05.

Table 2 - Comparison of Departmental Staffing Numbers

Department	Staffing numbers June 2000		Staff numbers June 2007		Percentage change	
	SES	Staff	SES	Staff	SES	Staff
House of Representatives[1]	5	191 [2]	4	157	-20%	-17.8%
Finance and Deregulation[3]	43	918	85	1,525	+97.7%	+66.1%
Treasury[4]	46	548	80	921	+73.9%	+68.1%

1 Staffing numbers were based on information from the following annual reports. *Department of the House of Representatives Annual Report 1999-2000*, Commonwealth of Australia 2000, p 153. *Department of the House of Representatives Annual Report 2006-07*, Commonwealth of Australia 2007, p 94.

2 The staffing figures were derived by removing the figure for security staff (72), who were transferred to the then Joint House Department (now the Department of Parliamentary Services) in October 2003 from the total staff figure at June 2000 (263).

3 Staffing numbers were based on information from the following annual reports. *Department of Finance and Administration Annual Report 1999-2000*, Commonwealth of Australia 2000, p 88. Department of Finance and Administration Annual Report 2006-2007, Commonwealth of Australia 2007, p 127.

4 Staffing numbers were based on information from the following annual reports. *Department of the Treasury Annual Report 1999-2000*, Commonwealth of Australia 2000, p102. *Department of the Treasury Annual Report 2006-2007*, Commonwealth of Australia 2007, p 137.

Tables 1 and 2 demonstrate well the impact of the funding model on the Department over the last eight years. The Department's budget has grown only modestly in absolute terms (11 per cent) and has decreased in real terms (approximately 11 per cent at CPI inflation). The only way in which the Department has been able to sustain its budgetary situation is by cutting staff numbers (reduction of 17.8 per cent). By comparison, agencies such as Finance and Treasury have seen both their budgets and staffing numbers increase strongly, although it is acknowledged that they have had changing responsibilities and functions.

A particular feature for the Department, and probably of many small agencies, is the significant and increasing proportion of the budget devoted to staffing. In 2000, employee expenses as a proportion of the total Budget was 55 per cent. This financial year it will be 69 per cent. This very high proportion of employee expenses means pay rises have a significantly greater impact on the Department's budget and that savings measures inevitably will result in staff cuts. This situation is exacerbated when the Department has to compete with salary increases paid by other comparable agencies with more capacity to fund such increases. The Department's budget also is effected significantly by the parliamentary cycle, with expenses much less in election years as activity levels in the chamber and committees decrease.

2. *whether the efficiency dividend is now affecting the capacity of smaller agencies to perform core functions or to innovate*

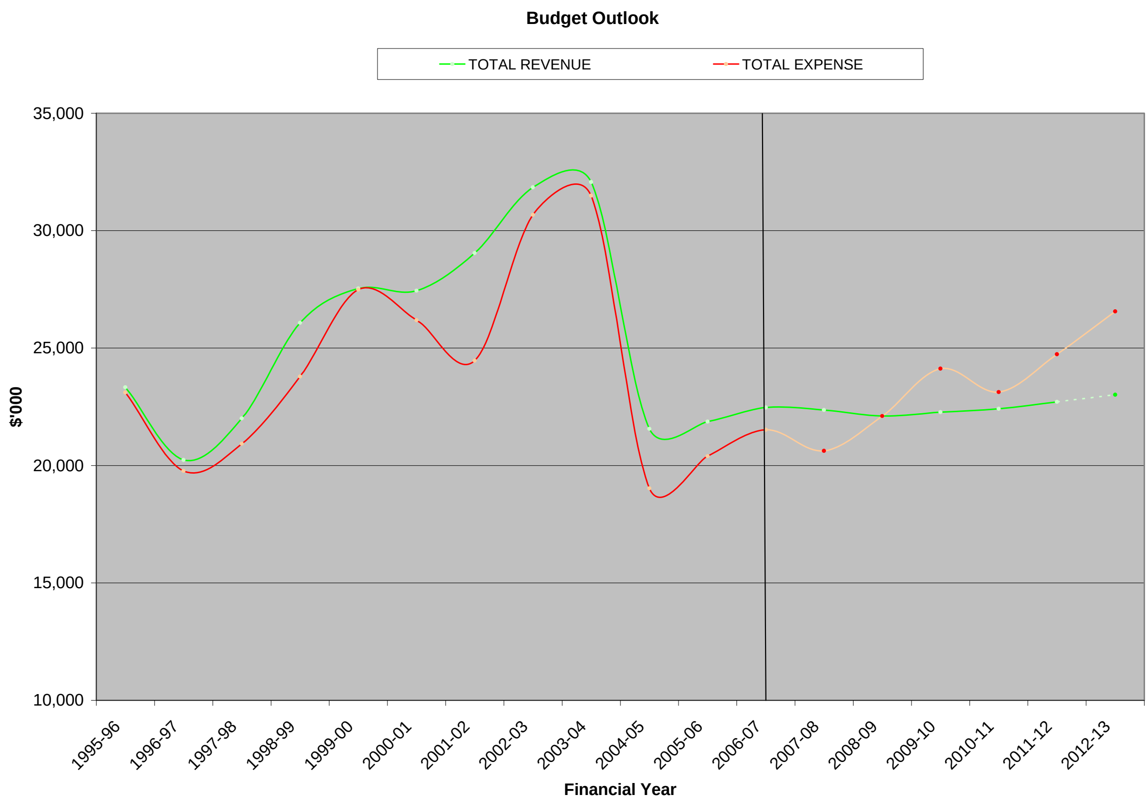
The following table demonstrates the impact of the current funding model on the Department's budget over the next four years. The table contains income figures which are locked in via the forward estimates process and expense estimates based on current activity levels, reflecting expected input price increases only.

<u>Table 3 - Department of the House of Representatives - Projected Budget Position</u>

	2008-09	**2009-10**	**2010-11**	**2011-12**
Income	$22.105m	$22.276m	$22.417m	$22.713m
Expenses	$22.105m	$24.123m	$23.125m	$24.737m
Profit/loss	$0m	($1.847m)	($0.708m)	($2.024m)

The following figure shows graphically the same information demonstrating how the Department's set income levels will increasingly fall short of likely expenses. Expense projections reflect the cyclical nature of departmental expenditures around the federal election cycle.

<u>Figure 1 - Department of the House of Representatives - Projected Budget Position</u>



There are a number of points to be made in relation to the table and figure. The additional efficiency dividend of 2.0 per cent from March 2008 has had an immediate and significant effect on the Department's budgetary situation. The Department has, as a result, moved from being in a satisfactory situation to being immediately in a marginal situation. It has brought forward for the Department the inevitable funding shortfall that would have arisen from the unsustainable nature of the current funding model. The budgetary outcomes in future years, driven by unfunded pay increases for staff and by the continuing 1.25 per cent efficiency dividend, will place the Department's budgetary position in a parlous state by 2009-10.

To move the Department's budget back into balance, savings or productivity gains of approximately $1m per year or 5.0 per cent of the Department's budget will need to be achieved over the forward estimates period. Such savings could only be achieved by reductions in core services - productivity gains of this order without service reductions, particularly after the gains that have been achieved over 20 years now, could not achieve this level of savings. Alternatively, the Department could run its budgets at a significant loss, but that would not be sustainable.

There is no capacity for the Department to consider either new initiatives or innovation, given the lack of discretionary expenditure allowed within the current budget position. For example, the Department had been considering funding a position for an additional person to assist the Department to identify and develop its historical records and resources, which it saw as an important step in supporting and maintaining parliamentary thinking and culture. It will not be possible to fund this position. The Department, together with the other parliamentary departments, recently organised celebrations for the 20th anniversary of Parliament House. It is unlikely that such special events will be able to be staged in the future. There will be no capacity to fund information technology developments, to improve the operation of the Chamber or committees or to assist individual Members. Similarly, the Department wishes to proceed to implement electronic document management as a significant way to boost work effectiveness in the longer term, but it will struggle to fund the resources for implementation in the short term.

A range of strategies was proposed to improve the ability of the Standing Committee on Aboriginal and Torres Strait Islander Affairs to attract input to its inquiries from Indigenous groups, to enhance the committee's relationship and credibility with Indigenous people and to improve the quality of its recommendations. These proposals included the purchase of specialised training for staff, the use of experts as consultants to develop communication strategies for inquiries, and for committee staff to travel to remote communities to build networks and understanding of issues. Under current budgetary restraints these initiatives have not been pursued.

3. *what measures small agencies are taking to implement the efficiency dividend, and the effect on their functions, performance and staffing arrangements*

As has been noted, the efficiency dividend has been in place for 20 years and the current funding model which necessitates the achievement of additional productivity gains to fund pay increases since the late 1990s. In that time the Department has implemented significant efficiency measures which have enabled it to live within its budget without a significant impact on the provision of core services. It has also taken on additional services with no additional resources.

Some examples of efficiency measures that have been implemented include:

- the Department reducing its SES staffing from seven in 1995 to four, resulting in a saving in current dollars of approximately $650,000 in the Department's budget;

- from 1996-97, a reduction by approximately 25% in the number of staff in the Table Office, the office directly supporting the operations of the Chamber and Main Committee of the House of Representatives, through innovative use of information technology;

- over the past decade, realisation of significant savings in the costs of printing parliamentary documents and reports by providing access to such material electronically. It is also noted that in recent years the Table Office has also progressively reduced the number of copies that government agencies must provide of legislation and documents presented to the Parliament, resulting in significant savings in printing costs for these agencies;

- in 1996-97 the Committee Office moved to an arrangement whereby most secretariats became responsible for managing two committees. Previously each committee had a dedicated secretariat. Further changes, dating from 1999, have resulted in most secretariats now supporting three committees. Between 1996 and 2000 the number of people performing the duties of committee secretary was reduced from 17 to nine. The number of secretaries has since been reduced to eight. As well as a reduction in the number of committee secretaries, efficiencies were achieved through greater flexibility in deployment of staff to different committees within a secretariat and the development of more versatile staff;

- two major offices (the Liaison and Projects Office and the Parliamentary Relations Office) being brought under one Director instead of the previous two Executive Band 2 staff;

- significant changes have been made to the arrangements for messengerial and attendant services over a number of years with greater centralisation of mail delivery and improvement in processes. This has resulted in substantial savings over time realised through changing the fundamental character of the attendant workforce from full time to sessional. In 1995-96 there were 23 full time and 12 sessional staff, today there are 3 full time and 25 sessional staff;

- the implementation of new technology has enabled the Department to streamline its processes resulting in opportunities to reduce staffing time and enhance service provision. For example, the recent development of a secure online document distribution system for committee papers has reduced direct costs for copying and mailing papers as well as savings in staff time; and

- no growth in corporate services staff in the past ten years, despite a definite growth in compliance requirements and increased focus on accountability.

The Department also has absorbed additional functions and responsibilities without any additional funding being received.

Some examples include:

- the establishment of the Main Committee in 1994 as a second business Chamber of the House of Representatives. In recent years the Main Committee has regularly dealt with between 35 and 40 per cent of bills, as well as performing other functions and has met for 25 per cent of the time the House is meeting, creating a significant additional workload. No additional funding has been provided to the Department to support the Main Committee;

- in 2002 the House increased the number of committees it established by four bringing the total number of committees supported by the Committee Office from 17 to 21.[11] The increased cost for committee support was absorbed by the department without supplementation. Supplementation of $250,000 per year for each additional committee supported by the Department had been routine in the early 1990s; and

[11] In 2008 there was net reduction of two in the number of committees supported by the department - one general purpose standing committee and one domestic committee. Potential savings from this will be limited however because the Selection Committee has been replaced by a Whips' meeting which receives a similar amount of department support as did the committee and the new Petitions Committee appears likely to need support levels approaching those of a general purpose standing committee.

- select committees, which are established to inquire into specific matters for a limited term, have also been supported in recent years without supplementation (for example, in 1999, 2001 and 2003).

The Department has sought to ensure its efficiency measures deliver savings with minimal impact on services and it has also, as noted above, been able to take on additional services. However, the Department's capacity to continue to make the savings required without looking at reductions in core services is now very limited.

4. *any impact of the efficiency dividend on the use by smaller agencies of "section 31"agreements to secure non-appropriation receipts (eg through user charges and cost recovery) - noting that these receipts are not subject to the efficiency dividend*

The Department currently is using its capacity to earn section 31 revenue to the extent that is possible recognising the Department's roles and functions. Given the Department's functions and its community service obligations, raising additional revenue to meet the funding shortfall is <u>not</u> an option.

5. *how application of the efficiency dividend is affected by factors such as the nature of an agency's work (for example, cultural, scrutiny or regulatory functions) or the degree of discretion in the functions performed by smaller agencies*

The Department referred early in its submission to the special place of the parliamentary departments in Australia's constitutional arrangements and it reiterates the implications that status should have in relation to the funding of the Department.

In addition to this fundamental point, the Department also notes that it has little discretion in the functions which it performs. The core services of the Department are to support the House of Representatives Chamber and Main Committee, House of Representatives and some joint committees and Members within Parliament House. The activity levels of the Chambers and committees are not driven by the Department but by the House itself—Government, Opposition and Members—offering little capacity for discretion in service levels. In fact all the trends for the provision of such services involve the Department meeting increasing demands. Similarly, there is little discretion in the provision of services to Members in the building as there are basic requirements which must be met.

6. *if appropriate, alternatives to an across-the-board efficiency dividend to encourage efficiency in the Commonwealth public sector, including consideration of whether certain agencies should be exempted from the efficiency dividend, or whether the rate of the dividend should vary according to agency size or function*

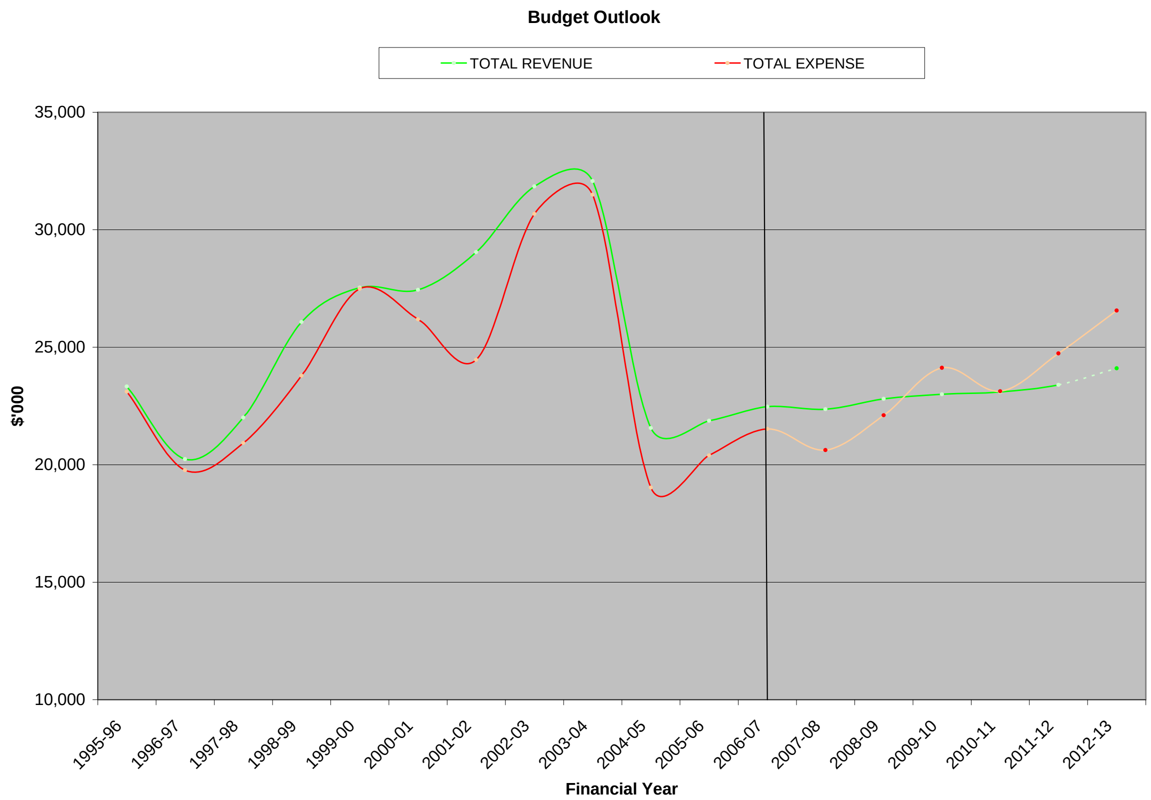
The Department has argued that it is the current funding model as a whole that has created difficulties for small agencies. The continuing efficiency dividend has been part of the model that is now creating funding difficulties for the Department. However, it is the combination of the efficiency dividend and the productivity gains to be achieved to fund pay increases that is proving to be unsustainable. The special additional dividend from March 2008 has contributed in bringing forward the crunch time for the Department's funding. This point can be illustrated by looking at the Department's forward budget for 2008-09 if there is no continuing efficiency dividend and without the special additional dividend.

The following table and figure reproduce table 3 and figure 1, but with both the continuing efficiency dividend and the special additional efficiency dividend removed from 2008-09 (projected income is approximate).

Table 4 - Department of the House of Representatives Budgetary position without the continuing efficiency dividend and special additional efficiency dividend

	2008-09	**2009-10**	**2010-11**	**2011-12**
Income	$22.800m	$23.000m	$23.100m	$23.400m
Expenses	$22.105m	$24.123m	$23.125m	$24.737m
Profit/loss	$0.695m	($1.123m)	($0.025m)	($1.337m)

Figure 2 - Department of the House of Representatives Budgetary position without the continuing efficiency dividend and special additional efficiency dividend

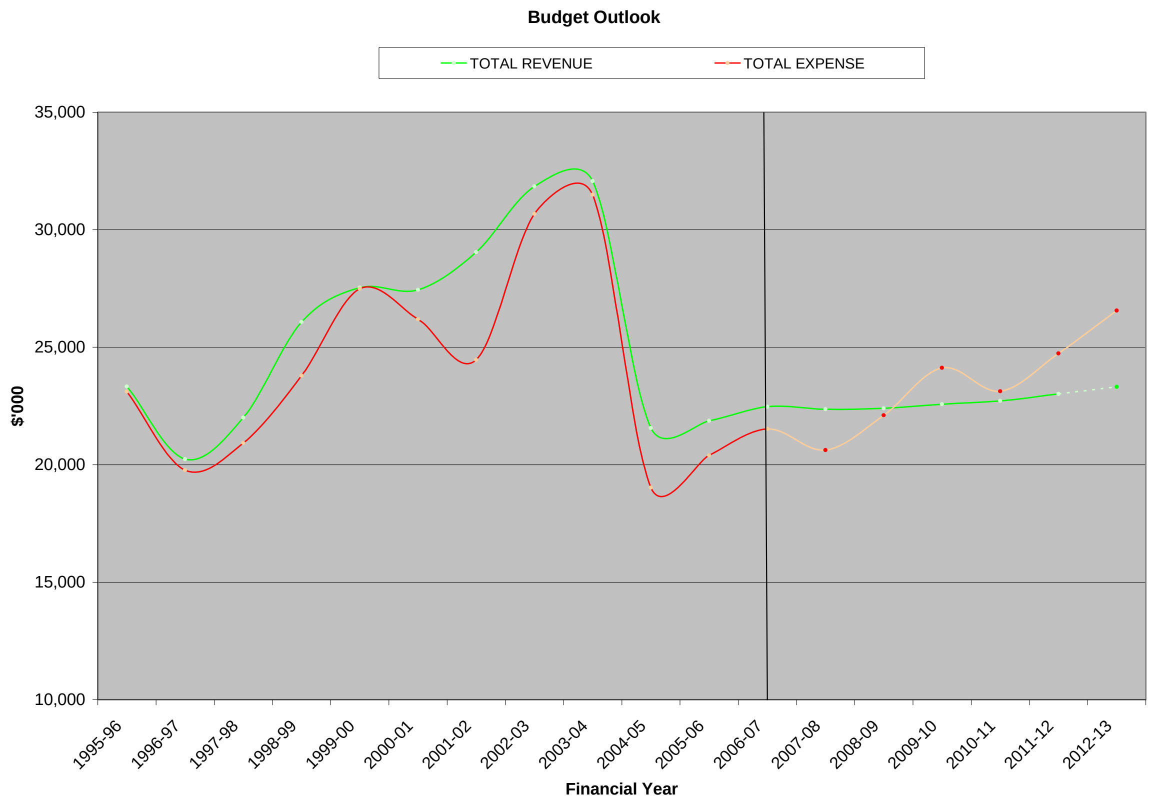


The following table and figure reproduce table 4 and figure 2, but with only the continuing efficiency dividend removed from 2009-10 onwards (the one-off 2% reduction to the baseline remains - projected income is approximate).

Table 5 - Department of the House of Representatives Budgetary Position without the efficiency dividend from 2009-10

	2008-09	**2009-10**	**2010-11**	**2011-12**
Income	$22.405m	$22.576m	$22.717m	$23.013m
Expenses	$22.105m	$24.123m	$23.125m	$24.737m
Profit/loss	$0.300m	($1.547m)	($0.408m)	($1.724m)

Figure 3 - Department of the House of Representatives Budgetary Position without the efficiency dividend from 2009-10



Tables 4 and 5 and Figures 2 and 3 demonstrate that the removal of the continuing efficiency dividend and even the removal also of the special additional efficiency dividend will do no more than delay an inevitable budgetary squeeze for the Department. As has been noted earlier in the submission, the problem for the Department lies in the funding model overall, of which the efficiency dividend is but one important component.

Conclusions and recommendations

The Department concludes that:

- the current model for funding smaller agencies such as the Department, of which the efficiency dividend is one important component, is not sustainable for the Department, even in the short term;

- the Department is faced with:
  - making significant reductions in services to remain viable; and/or
  - operating at a substantial loss—such operation is not sustainable;

- abandoning the efficiency dividend, of itself, will not solve the Department's funding position;

- a modest productivity return from agencies should continue to be a feature of the funding model in recognition that agencies should be able to become more productive and some of that gain should be returned to government; and;

- the independence of the Parliament should be recognised by having the Minister for Finance and Deregulation meet, and agree with, the Presiding Officers, the proposed budget of the parliamentary departments prior to finalisation of the Budget bills and papers.

Recommendations

The Department recommends that:

1. An alternative funding model be adopted for small agencies. The specific features of the model should include:

    - the ability to submit proposals for additional funding that are not necessarily new policy proposals. The proposals for additional funding would have to be either new initiatives or policies or be based on capacity to continue to deliver core outputs of the agencies by recognising their need to remain competitive with other public sector agencies in the labour market;

    - the continuation of the requirement for a modest productivity return from small agencies to the central budget; and

    - policy parameters for agency bargaining for small agencies which recognise that they may not be able to achieve productivity earnings to offset all pay increases and that some resort may be had to proposals for additional funding to meet competitive pay increases.

2. In recognition of the independence of the Parliament, the Minister for Finance and Deregulation meet with the relevant Presiding Officer/s and agree the proposed budgets of the parliamentary departments prior to the finalisation of the Budget bills and papers.

July 2008