



Measuring and improving state sector productivity

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The Productivity Commission was asked by the Government to provide guidance and recommendations on measuring and improving productivity in public services, especially education, health, justice and social welfare. These public services play an important role in promoting individual and community wellbeing.

In undertaking this inquiry, the Commission interviewed multiple current and former senior state sector leaders, carried out case studies to demonstrate how to measure productivity in public services, and commissioned research to better understand how innovation (which is the engine of productivity improvement) occurs and spreads in public services. It has also produced two final reports – one focused on *measuring* productivity, the other on *improving* public sector productivity.

High productivity matters for better, sustainable public services

State sector productivity is a measure of how well a government uses its available resources to deliver services to citizens. Higher state sector productivity allows a community to have more or better services or lower taxes. It also contributes to higher national productivity and through that, higher incomes and a larger tax base.

Higher state sector productivity will also enable the community to enjoy public services into the future. As New Zealand's people age, there will be more people needing assistance and a smaller share of the population working and available to provide services or pay taxes. New technologies may also lead to significant labour market disruption. Higher productivity in the state sector allows the Government to better manage these pressures.

There are many barriers to higher state sector productivity

Available evidence, while limited, suggests that recent state sector productivity growth has been poor. The Commission identified seven major barriers to achieving higher productivity.

Not enough demand for measures

It is difficult to understand and improve something that has not been measured. Yet measurement of public service productivity is relatively uncommon. Some agencies do not ask the right questions or do not make good use of available information, and politicians typically do not ask for productivity information.

Hostility to measurement

In addition, some who work in the state sector are hostile to the concept of 'productivity' or 'efficiency' in public services and resist its measurement. They argue that such measurement efforts would be a distraction from their core business, or would have perverse impacts.

Closed, risk-averse cultures in government agencies

Achieving productivity improvements in public services often means doing things differently – such as using technology better. In other words, it involves *innovation*. Yet many government agencies lack the culture needed to promote innovation. Far too often, agencies are risk-averse, closed to ideas from outside and poor at managing change.

Poor policy and commissioning practice

High-quality policy development supports productivity, by ensuring that the government is going the right things to achieve its goals. Effective commissioning ensures services are designed to best meet the needs and characteristics of users. But the quality of policy advice is mixed and government agencies often take very conservative approaches to commissioning services, leading to ineffective delivery and waste.

Restrictive rules and funding models

Innovation and productivity often depend on changing the mix of people, technologies, and other resources used to deliver services. In many cases, however, agencies or organisations delivering public services face rules or policies that limit their ability to make these changes.

Few budgetary rewards for productivity

The annual budget round is one of the most important tools for changing the behaviour and focus of government agencies. Yet the budget provides relatively little encouragement for productivity gains. The majority of existing spending on public services is not regularly reviewed and a large share of new funding allocated through annual budgets goes towards 'business as usual' activities rather than new and better approaches.

Patchy monitoring, evaluation and data use

Finally, government agencies often make poor or little use of available data and information. This means that public services may not fully meet the needs of users or officials may not know which services are ineffective, and need improvement.

How to move towards a more productive State

The Commission's recommendations are designed to lift productivity performance across the state sector, and will require efforts by ministers, agency leaders and central agencies.

There have been a number of promising developments in public policy and service development in recent years, such as the greater use of 'investment models' in

policy design and budget decisions. Some of the Commission's recommendations build on and extend these developments.

Set clearer expectations for productivity gain

Productivity goals for core public services have been largely absent from the state sector performance management system and should be put back on the agenda. Ministers can play an important role in lifting performance by setting clear expectations and standards for public services. Greater demand for information about productivity is important for building capability and changing agency practice. The State Services Commission should review the processes for setting and expressing ministerial expectations, to place more emphasis on productivity gains.

Build the capability to measure, and measure more

The state needs to better measure and understand its own productivity performance if it is to make improvements. The first step will be to build up measurement capability within government agencies, as this is currently weak. The Treasury and State Services Commission should establish and support a network of interested and capable officials to share experience and build expertise in state sector productivity measurement.

Report on core public service efficiency

Although the public sector produces a lot of information on spending, much of it is not very useful for measuring changes in public sector productivity. Regular collection and publication of information on expenditure on key public services (eg, annual per-client or unit costs for schooling, court trials, etc) would provide greater transparency and strengthen incentives on agencies and providers to seek ongoing improvements. Similar reporting in Australia has helped identify and spread good practice.

Use performance measures wisely

The Commission was asked to provide advice on the appropriate role of productivity measures in public sector performance frameworks. The Commission considers that there is a place for well-designed quantitative productivity measures in these frameworks, as they help provide a more balanced picture of performance. However, agency leaders should introduce such measures with care. Productivity measures should be designed with the input of stakeholders and staff, be supported by agency leaders and middle managers, have robust data sources in place, and be regularly reviewed to ensure they stay relevant. The conversations, questions and ongoing evolution of such measures, are where much of their value is to be found.

Raise the bar on new spending in the budget

The budget can be used to send stronger signals about the importance of productivity. The Commission recommends a set of reforms to increase the rewards for productivity and service improvements.

The first proposed reform is to set aside a share of each year's allocation of new funding for initiatives that have a high probability of making a significant impact on social wellbeing, and gradually increase this share over time. To qualify, these initiatives would need to have robust business cases, strong supporting evidence and clear evaluation plans.

The second reform is to tighten the link between past performance and future allocations from the budget. The annual budget round is supposed to test how well agencies have used their existing resources, but has lacked consequences for poor past performance. Under the Commission's proposals, agencies would only be able to access the 'high impact initiative' share of the budget allocation, if they could credibly demonstrate they had made productivity gains from their baselines.

The third recommendation is to retain and strengthen a separate avenue for organisations outside the public service to make budget bids. Non-government organisations and the private sector are important sources of innovative ideas and processes, but can face hostile or unreceptive public agencies. Allowing these organisations to make proposals directly, without the approval of departments, removes roadblocks and exposes ministers to a wider range of ideas and proposals. To help manage demand, the total amount of funding open to non-government proposals could be limited and could be focused towards priority themes. Non-government proposals would also have to meet the higher expectations regarding evidence, business cases and evaluation used for the 'high impact initiative' share.

Pay for results, not inputs

In many core public services, funding models encourage increases in inputs (eg, staff) or volumes (eg, student numbers). These models provide certainty for providers and can support access, but offer limited rewards for innovation, are often restrictive and can have perverse impacts. By comparison, results- or outcome-based funding models provide more flexibility and more incentive for productivity gains. Agencies responsible for the delivery or purchase of public services should review their existing funding models, and move as many as possible towards results- and outcome-based systems.

Improve agency performance

Developing greater openness to ideas, new technologies and change within government agencies is a necessary condition for more innovation and productivity in public services. Existing organisational review processes, such as the State Service Commission's Performance Improvement Framework, should be modified to test how well agency cultures, values and practices support innovation and productivity gain.

The two reports – *Improving state sector productivity* and *Measuring state sector productivity* - together with other inquiry material, are available at www.productivity.govt.nz/statesectorprod

The **New Zealand Productivity Commission** – an independent Crown Entity – conducts in-depth inquiries on topics selected by the Government, carries out productivity-related research, and promotes understanding of productivity issues.