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Cost Recovery Inquiry
Productivity Commission
Locked Bag 2
Collins Street East
Melbourne Vic 8003



11 December, 2000

Submission to Cost Recovery Inquiry – ABARE Pricing

The attached is more a case study than a full submission. But it illustrates a general point about how in the Commonwealth concern with cost recovery has tended to overcome any notion of the economics of public goods.

Besides being a part owner of a small cattle station, I also teach public sector economics, mainly to postgraduate students from Commonwealth agencies. Almost without exception these students, from senior third division ranks and upwards, have no notion of the theory of public goods. They have no notion of marginal cost, deadweight loss, externalities or non-rivalry. Nine out of ten times they will advocate, without thinking, that prices of government publications should be set at average cost. The beancounters at DOFA have done a pretty good job in knocking out of the public service any sense of public sector economics.

Should you want any of this material in a machine readable format, please let me know (iam@management.canberra.edu.au).

Sincerely,

I. A. McAuley

Ian A McAuley

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11 December, 2000

Kathy Walker
Publishing and Marketing
ABARE
Edmund Barton Building
Barton ACT 2600

Dear Kathy,

A couple of weeks ago I had a phone call from one of your staff, inquiring why I had ceased subscribing to ABARE bulletins. I had, for many years, subscribed to *Australian Commodities* and to *Australian Commodity Statistics*. I promised to write to ABARE to follow up.

The simple answer is the price. Five years ago, when we last had an economically competent government in Canberra, the price of *Australian Commodities* was \$126.00; it is now \$214.50 (\$323.40 for a web subscription). The price of *Australian Commodity Statistics* was \$75.00; it is now \$129.80 (\$237.60 for a web edition). Up to the time of the Howard Government the prices had stayed more or less constant in real terms.

I can see only two good outcomes from this pricing policy. It will intensify farmers' anger at the Howard Government, thus hastening its downfall, and it provides university teachers with case material in poor public pricing – not that there is any shortage of bad examples. Indeed, I have used ABARE's pricing as an example in an article I recently wrote in *Dissent* (copy attached).

As your agency's economists would know, any price greater than the marginal cost of production incurs waste – *deadweight loss* is the economic term. If your material is on the web, then the marginal cost of production is essentially zero. Yet, in disregard of economic principles, ABARE has put a very high price on this material. I have no doubt that this stems from the pressure your agency has come under from Finance and Treasury. DOFA has no notion of economic efficiency, and Treasury has a long hatred of small business. (Australian would be a much more orderly place if all those little farms could be sold off to agribusiness enterprises – it's their version of Soviet style collectivization.)

ABARE does excellent research, but it is being blocked to all but the largest players who can afford to pay ABARE's subscription prices. Perhaps your staff believe that farm lobby groups, like the NFF pass this information on, but the NFF and its state bodies do nothing of the sort. (They are little more than front organizations for the Liberal Party.)

One thing that is in ABARE's control is to unbundle the data. I am interested only in beef and in grains (because of the link between grains and beef). But your products come bundled – with mineral and other commodity data. (I am sure you are aware that bundling is against the spirit of the Trade Practices Act.)

But, more basically, ABARE should make all the data free on the Web – as is done by many government agencies. That would be the most economically responsible policy. Economic data is a non-rival public good with strong positive externalities; by depriving access to potential users there is waste. Farmers, deprived of market information, will make unwise decisions, with consequences throughout the industry and economy. Free provision would also be equitable, because farmers are paying for this data – through their taxes and through taking time to provide information to government agencies, such as the ABS.

I am copying this letter to the Productivity Commission, which currently has an inquiry on cost recovery in Commonwealth information agencies. I am also attaching a copy of a letter I sent to Warren Truss around this time last year.

If you would like to discuss any aspect of this letter I would be most happy to come and discuss the matter with you – in confidence of course, because I know how vindictive this government can be against public servants who do not rigidly toe the line from Party Headquarters.

Sincerely,

Ian A McAuley

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16 December, 1999

The Hon Warren Truss MP
Minister for Agriculture, Fisheries and Forestry
Parliament House
Canberra ACT 2600

Dear Minister,

Four years ago, before the election of your government, the publication *Australian Commodity Statistics* was priced at \$75.00. ABARE has now raised its price to \$120.00. I know enough about printing to know that the marginal cost per copy would be around \$10.00 at the outside.

I don't want to know why this has happened – I know. Your government has to finance tax cuts for the privileged classes. ABARE has to share this burden, and publication prices are an easy target, justified under the dogma "user pays". The economists in ABARE are competent people; they know that the price is moving beyond what is affordable to all but the biggest farming enterprises. They also know that a well-informed farm sector makes better decisions about production and sales, and that therefore suppression of information has its economic costs – not just on the individual farmers, but more widely on our balance of payments, welfare budgets and general economic stability.

Economists know this waste as "deadweight loss"; they know that information such as this should be priced at no more than marginal cost – perhaps provided free on the Internet. (More colloquially, the practice which ABARE has been forced into is known as "monopoly rip-off".) But your government has allowed economic responsibility to take second place to an obsession with cutting government expenditure.

Little wonder farmers are angry. Every year they spend a great deal of unpaid time providing data for the ABS, which feeds into the ABARE. Then they are charged for the privilege of having access to the aggregated data.

Farmers, unfortunately, don't have a powerful voice in Canberra. (The NFF ceased being concerned with farmers' needs many years ago.) For you, as Minister, that's unfortunate, for you are not necessarily hearing how Howard's and Costello's economic incompetence is causing so much anger. I have observed Australian politics for a long time, and have seen many Ministers get quite nasty surprises on election night after they have spent years shielded from the truth by sycophantic lobbyists and public servants. I suggest you save yourself from that surprise.

Sincerely,

Ian A McAuley

Copy: (1) Mr Gavan O'Connor MP
(2) Australian Beef Association

DUMBBING DOWN IN CANBERRA

A guide to the Public Service reform industry

Ian McAuley explains the flawed premises underpinning public service reforms.

ON THE MENUS of some delicatessens and outdoor eateries can be found the 'ploughman's lunch' — a rich meal of cheese, bread and eggs, often topped off by sundried tomatoes or olives. It's a filling meal, generally inappropriate for people with a sedentary lifestyle. And, contrary to the bucolic notion that one is sharing in the simple fare of a ploughman, there is no evidence that it bears any relationship to what ploughmen ever had for lunch.

So too it is with public sector 'reforms'. The basis of many of these reforms is that the public sector should emulate the private sector, to the point of creating fictitious private sector models for emulation. By applying these fictitious models, public sector managers can inhabit the world of the make-believe private sector. Just as the urban middle class can pretend they are sharing in the world of the ploughmen, so too can public servants inhabit a fantasy private sector world. They can be transformed from bureaucrats to entrepreneurs.

Emulation of the private sector, or of an imaginary private sector, lies at the heart of recent

public sector 'reforms'. There are two assumptions; one is that the private sector is intrinsically more efficient than the public sector, and the other is that there is one, clear set of private practices.

But, as was shown in the first of these two articles, there are certain things that can be done only on the public sector, and certain other things that the private sector can do but not as well as the public sector — situations of market failure. And the notion of a private sector ideal is naive. There is no one 'private sector' model — covering operations from sandwich shops through to steel mills, from

operating call centres through to designing software systems. And similarly there should be no one 'public sector' model, covering operations from a pre-school through to a power utility, or from a local government aged care centre through to the Commonwealth Treasury. Yet, the path of 'reform' has tried to fit one normative model on the public sector — a model which, like the ploughman's lunch, has little connection to its claimed origins.

Many of the 'reforms' can be understood in this light — naive attempts to mimic what some believe to be 'private sector' practice.



P.S. REFORM

THE BOTTOM LINE

THE MOST pervasive of such developments is the primacy of the budget 'bottom line'. The most important measure of any program is the budgetary outcome. Producing impressive budgetary figures has become more important than the task of economic management. The macro aspects of this were covered in the first article (DISSENT No 2), but this budgetary obsession has implications at a micro level for the day-to-day management of public sector agencies. The guiding

notion is that because the private sector is driven by bottom line performance, then the public sector should also be so driven.

Fortunately the bottom line obsession is not universal in the private sector. But, from time to time, we see the entrepreneur who, in order to make an impression on the financial markets, goes all out to create an impressive set of financial ratios — a task easily achieved by letting maintenance expenditure slip, by reducing quality, by exploiting trust and goodwill with customers

and employees, by reducing 'soft' investments in marketing, research and human capital and by engaging in a little creative accounting. To show a good short term cash flow there are many clever options, such as selling assets and leasing them back. These devices can fool the financial markets for a year or two, but are ultimately at the expense of long term corporate health.

So too it is with the public sector. If producing impressive budgetary figures were an end in itself, then the task of public administration would be easy; spend less and find any way to raise revenue. But to make the 'bottom line' a policy objective in

its own right is absurd, for it glosses over the basic conflict between *financial management* and *economic management*, which can often be in conflict. In adopting a narrow financial focus such as the deficit or the 'size' of government, serious economic damage can result.

Financial management is about managing budgets. Financial accounting is no more than a pallid representation of a program's full costs and benefits. It is limited by what accountants call the 'money measurement' concept; that is, financial accounting data measures only what passes through an agency's ledger. Economic management, however, is far broader, particularly in the public sector. It is about creating wealth for the community, in ways which generally do not pass through any ledger. There is no ledger which captures the value of public health, safe roads, clean waterways or an educated population. These values can be partially captured in cost-benefit analysis, but not in financial accounting figures.

Despite these known limitations, financial accounting is in the ascendancy in the Commonwealth, displacing the more inclusive disciplines of cost-benefit analysis and considerations of public good theory. There is a process of false simplification, or dumbing down, in the accounting reforms being introduced in the name of accrual accounting and accrual budgeting. Accrual accounting is certainly an improvement on the old cash accounting system it replaces. But it is being vested with false expectations and magical powers. Public servants are told they can use accrual accounting to determine the full cost of their agencies' activities, with statements such as:

'Accrual information also enables the full costs of an organization's operations and activities to be measured.'¹

and

'Accrual accounting will provide ... a clear picture of the full cost of the goods and services our agencies provide'.²

Such statements are dangerously

simplistic. They reveal a fundamental ignorance in that they vest too much credibility into financial accounting.

No well-managed firm would make such an error. In the private sector there is a clear distinction between *financial accounting*, which is about external accountability, and *management accounting*, which is about costing and decision making. Costing and decision-making has to be undertaken using a variety of skills and judgement; there is no accounting system or computer program which can reveal a 'full cost'. This point is stressed by accounting professionals such as Harvard's Robert Kaplan, who has warned of the dangers of managerial accounting being supplanted by the mechanistic discipline of financial accounting.³ Yet the public service, in all its managerial reforms, is ignoring the discipline of management accounting, and its public policy equivalent, cost-benefit analysis, which brings to bear those costs which do not pass through the ledger.

Because of the money measurement convention, the costs revealed by financial accounting are very limited. They do not take into account non market costs. A decision not to spend public money on upgrading a road or railroad may look like a financial saving, but it will impose social costs in terms of travel time. Saving on public pharmaceutical expenditure by removing drugs from the Pharmaceutical Benefits Scheme will look good in the ledger of the health department, but it may result in a large shift in costs to the poorest members of society. A decision to charge a high price for a government publication may look good for the Bureau of Agricultural and Resource Economics but, if it results in farmers finding commodity and market information is unaffordable, it will have costly consequences for the farm sector, quite out of proportion to the small amount of revenue raised from charging for the publication.

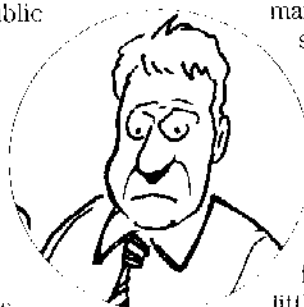
Market failure

As pointed out in the first article, many activities are in the public sector because of market failure. That is, because the private sector would not provide those services, or, if it did, would not provide them efficiently. For example, the private sector, left to its own devices, generally won't provide public health services, for there is no way in which the beneficiaries can pay a private provider for these services. The private sector will under-provide goods with high external benefits, such as research, and it tends to under-provide goods with long term returns, such as education and environmental protection. These (and many more instances) are cases of what economists call 'market failure',

and it is the economics of market failure which should form the prime guide to the public/private split of activities in a modern economy. If a public agency could be managed along purely private sector lines, in fact, there is probably little justification for it being in the public sector.

Why has such bad practice come about? One can answer simply that it's the ideology of neoliberalism, but that's a superficial explanation. More likely, it's because Australia lacks a well-understood and agreed notion of the role of the public sector. Most people know that somehow the government has to be involved in defence and welfare, and that the government need not be involved in market activities like tourist accommodation and retailing. But even people with a degree in economics are not necessarily exposed to the economics of market failure.

One can do an entire major in economics without having to depart from the assumptions of a well-functioning, competitive market. When commentators like Michael Pusey criticise the dominance of economics in public policy, they are really criticising the paucity of economic thought and education in Australian universities, particularly in relation to the economics of the public sector.⁴



Australia has no institution like France's *Ecole Nationale D'Administration*, which can develop a set of professional public service skills and knowledge. Nor are university postgraduate courses in public administration well patronised. For most students, particularly those with numerical ability, the MBA (Master of Business Administration) is a much more attractive option than the MPA (Master of Public Administration), and the MPA is usually centred on 'soft' disciplines, such as the personnel management (under the neologism 'human resource management'). Most financial management training for the public sector is about financial accounting, rather than

management accounting, and cost-benefit analysis is relegated to obscurity as a highly specialised discipline. Tony Harris, former Auditor General in NSW, found that private firms were able to exploit the public sector, because public servants were not equipped with the financial training to analyse contracting out, BOOT (build, own, operate and transfer) and leaseback proposals.⁵ The capacity to do such analysis is standard fare in an MBA course, but not in MPA courses. Just as loan sharks target the naive and poorly educated consumers, so to do their corporate equivalents find public servants an easy target for schemes which exploit the public purse.

does to the front wheel bearing. But one cannot do the same to a frog, which is a complete, complex, interconnected organism. Mant provides several examples, mainly from the UK public sector, in which managers, looking after their own defined areas of responsibility, caused huge damage to wider systems. That is why there is merit in what is known as a 'career public service', in which people at all levels in all agencies have some knowledge of the broad context of public administration.

Tenure

There was a time when the public service was looked upon as a career service in its own right. Indeed, that was the philosophy behind the 1853 Northcote-Trevelyan Report, a manifesto for the UK and colonial bureaucracies, including Australia's. One of the key planks was that the service should be organised 'as a single service, and not as a disintegrated, fragmentary service'.⁹ Up to the 1990s there were vestiges of this philosophy in Australia, with practices such as graduate recruitment to the service as a whole, management training which relied on mobility between agencies (and the private sector) and standardised classifications across agencies. Now the service is truly fragmented. Mobility between agencies has fallen, and what mobility remains is mainly among technical service staff rather than policy staff.¹⁰ Staff are employed under enterprise agreements with individual agencies (a situation which resulted in confusion in the administrative rearrangements following the 1998 election). Tenure of service was one of the casualties of the reforms.

Contrary to the view that insecurity prods people to performance, there is a strong case for vesting the public service with a degree of stability, as a counter to an intrinsically unstable political set of institutions. No private company would survive for long if it were faced with a hostile takeover bid every three years, and possibly more often. The public service should provide a source of ongoing expert and dispassionate advice. (Elected government is under no obligation ►

MANAGERIALISM

LET THE managers manage' was the motto of the mid eighties reforms. If managers could be freed from constraints imposed by unnecessary regulations, such as control on inputs, line item budgets (which meticulously specified what was to be spent on salaries, overtime, travel, communications etc.), and staff ceilings, they would be able to exercise their creative talents to improve the efficiency of their operations.

The designers of the Financial Management Improvement Program in the mid eighties and subsequent reforms, without necessarily being aware of the source of their ideas, drew on a private sector management practice known as 'Management by Objectives' (MBO), first described by Peter Drucker in 1954.¹¹ A key aspect of MBO is that management exists in a hierarchy of objectives — higher level managers have general, high level objectives, which get broken down into simpler objectives down the line. Each manager is given specific objectives, and doesn't have to worry about the wider implications.

MBO works very well where the work of a number of units comes together to form a unified whole. It is a good way to organise an

automobile factory or a hamburger chain. In public administration, however, its uses are limited, for it tends to encourage parochialism and cost-shifting. The manager in a strict MBO environment has a confined, narrow focus. (Drucker himself was later to warn of the dangers of unthinking applications of management techniques in the public sector.¹²)

Most public sector agencies are not stand-alone. A key characteristic of the public sector is interactive complexity and interconnectivity. What happens in one part will affect other parts. For example, although employment programs, superannuation policy and tax collection are handled in separate agencies, decisions made in one of these agencies will have effects in the other agencies. Trade and agricultural policies are inextricably woven together, but for administrative convenience they are handled in separate agencies. The public sector needs a large amount of coordination, and people, at all levels, who understand system complexity and who can see the big picture. Alistair Mant describes system complexity using the colourful metaphor of the frog and the bicycle.⁸ One can bring a bicycle to optimum performance by attending to its parts; what one does to the chain sprocket is largely independent of what one

to heed such advice, however.) Prime Minister Menzies considered a professional, politically detached public service as an administrative asset.¹¹

Notions of professionalism, stability and tenure, however, are now seen as part of an old order. The new public servant is an entrepreneur, not an analyst. He or she is responsive to two prime demands — the political demands of executive government, and the budgetary demands of the Department of Finance and Administration. While elder statesmen like Robert Menzies and respected academics like Alan Blinder and Robert Reich may defend the notion of a professional bureaucracy, the fashion is in the opposite direction.¹² Admittedly, tenure in the public service was abused in the old system — it was used to support featherbedding, and the public service carried many unproductive staff. But such abuse establishes a case for reforming tenure, not abolishing it.

A Political Secretariat

The other trend has been the politicisation of the public service. Public servants have always had a close interface with executive government, but the public would be shocked if ever they knew how much work of public servants is spent on providing political services to executive government — drafting replies to constituents, writing speeches, and writing briefs to protect ministers from Opposition criticism. As the experiences with the Coalition's pre-election tax proposals demonstrated in 1998, the public service can easily become a political secretariat for the governing party.

In losing a professional and disinterested public service we lose our only long term, stable source of disinterested advice on public policy. Governments have many sources of advice — lobbyists, backbenchers, and party apparatchiks, but all come with a strong vested interest and, in general, they represent the voices of concentrated interests rather

than the community as a whole — investors and workers in particular industries, electors in marginal seats. As Mancur Olson points out, reliance on such sources of advice can stultify governments into a role limited to intermediation between specific interest groups, at the expense of the wider public purpose.¹³ A professional public

service can act as a counter to this concentration of influence, by representing, dispassionately, the interests of the many and the weak, and to bring those voices to the political table.¹⁴ From such processes can come more inclusive and economically responsible public policy.

PERFORMANCE MEASURES AND INCENTIVES

A LONG WITH MBO has come a plethora of performance measures. While the management texts warn about the risk of MBO producing its own paperwork burden, the public service seems to be deaf to such warnings. The 'reform' industry has become in itself a large, unaccounted, bureaucratic overhead. One public servant describes the process as akin to 'pulling up a sapling every month to see how it's growing'. John Micklethwait and Adrian Wooldridge, writers for *The Economist*, describe the performance obsession:

Mention Management theory to Oxford professors who spend half their time reporting back to Whitehall or to doctors who are judged by how many 'illness episodes' they have treated and you are greeted by a tirade. Everybody in the upper reaches of the public sector seems to agree on the awfulness of managers: on the hideousness of their language, the harmfulness of their methods, and the sheer second rateness of their intellects. The only question is why governments have allowed themselves to be hoodwinked by this bunch of failed businessmen into wasting so much money.¹⁵

One of the genuine reforms in the public sector has been a relaxation of the focus on inputs (line item budgeting) to a focus on outputs and outcomes. But the culture of close, quantified control has remained; it has simply been transferred to output and outcome reporting. The implicit assumption behind such a reporting burden is that it is only through a set of

explicit controls that performance can be guaranteed. If there had been some general failure by governments to deliver better outcomes in education, health or road safety, then such attention would be warranted. But there is no such evidence. Evidence from the US, in fact, suggests that with the possible exception of crime there has been consistent and long established improvement in outcomes which are influenced by government policy — road safety, health, literacy and many other areas.¹⁶ Improvement didn't wait until Al Gore decided to read Osborne and Gaebler's cult epistle on 'reinventing government'.¹⁷ Outcome improvement was going on long before the peddlers of prophetic hype and managementspeak were born.

Trust and Transaction Costs

Trying to achieve efficiency improvement through explicit controls is ultimately self-defeating, for the costs of those controls (what economists refer to as 'transaction costs') soon outweigh any improvements resulting from their imposition. There are other possible paths to reform, such as building trust in institutions. The alternative of developing and encouraging higher trust and a sense of responsibility, however, seems to be quaintly old-fashioned. As Francis Fukuyama points out, trust is an asset which reduces the transaction costs (or 'paperwork' in everyday language) of control.¹⁸ Specifically referring to the public sector Micklethwait and Wooldridge, citing the ideas of

Henry Mintzberg, point out that 'civil service professions have traditionally exercised control through shared values, inculcated through long training; now it is assumed that their only values are financial'.¹⁹

Trust in institutions is one of the casualties of the 'reforms'. The Australian Taxation Office, for example, in selling ABN records to private banks and accounting firms, has eroded trust. Yet trust is one of the essential ingredients of a well-functioning taxation system. For the sake of a small amount of revenue, which would make its performance bottom line look more pleasing to the beancounters, the Tax Office has eroded one of its prime assets.

Performance measurement is intrinsically complex, but such complexity is brushed aside in the push for governments to develop indicators of efficiency, effectiveness, outputs and outcomes. Such terms are bandied about by people with little knowledge of the complexity inherent in such measures. Eminent economists, such as George Stigler, have warned that even the seemingly simple concept of technical efficiency may be meaningless.²⁰ If 'efficiency dividends' are produced through extra unpaid overtime, or a deferral of annual leave, this is hardly an improvement in efficiency; rather it's a case of working harder, not smarter. Substituting capital for labour may increase labour productivity, but in the public service it has necessarily increased efficiency, as measured by more complex (but still partial) measures such as total factor productivity.²¹

Performance-based Pay

One of the most inappropriate institutions in the public service has been individual performance-based pay. In a survey of senior public servants, performance based pay was found to be one of the least well accepted 'reforms'.²²

Well accepted management

research suggests that performance-based pay is not a guaranteed motivator. For people who are intrinsically motivated, perhaps through loyalty to a professional set of standards, extrinsic rewards such as performance based pay will generally be seen as patronising and devaluing, thus decreasing their motivation.²³ It is not only wasteful; it is also de-motivating to some of the most enthusiastic and professional staff.

But perhaps professional standards are incompatible with the new managerialism. Self-starters and enthusiastic staff are

less malleable than myrmidons who will respond, in true Pavlovian style, to the caprices of political opportunism. At the time of writing, the head of the Department and Cabinet was proposing to increase senior executive salaries to the half million dollar range.²⁴ Such a proposal begs one to question what has changed in the public service that it can no longer attract trusted, competent and dedicated people as it has in the past; perhaps it has become a very unattractive place for such people to work.

CONTRACTING OUT

FINALLY, there is the 'reform' of competitive tendering and contracting out. The justifications are in terms of opening up services to competitive contestability, allowing agencies to retreat to specialise in their core competencies, and obtaining the benefits to be found in best private sector practice.

Evidence on the success of contracting out, however, is mixed. When it comes to simply specified services, such as trash collection and cleaning, contracting out seems to result in cost savings; for more complex activities, however, there is no firm evidence of cost saving and some evidence of reduction in quality.²⁵

Certainly the Commonwealth has bent over backwards to help potential private sector contractors.

In the Commercial Support Program of the

Defence Department, for example, the government actually publishes its cost estimates for standard components, such as hourly labour rates, using costing methods which tend to overstate the government's costs because they include full overhead absorption. All the private competitors have to do is to come in below the inflated internal estimates.

Similarly the Commonwealth is divesting itself of property ownership. It has signalled that it will sell buildings to the private sector, and lease them back, unless the return required by the private owners is too high — 'too high' in this case being an annual return of 20 percent.²⁶ It has sold custom built buildings, just for the sake of reducing reported debt. To take a domestic analogy, imagine selling your house and renting it back, just so you could say you had paid off your mortgage. If your mortgage had been at, say, 8 percent and the new owner was getting a 19 percent return, this would hardly be an intelligent move. But that is just what is advocated, and practised, by the Commonwealth, in the name of reducing debt.

While some contracting out results in a private sector windfall, some benefits no-one, other than lawyers and accountants. There is little, if any, accountability for the transaction costs associated with contracting out through competitive tender. These costs include preparing specifications, selecting tenderers, handling legal complaints of unsuccessful tenderers, and supervising contracts (ironically, such costs are often counted as 'corporate overheads', and have to be absorbed by internal business units competing for government work.) Nor is there any public accountability for the costs



borne by unsuccessful tenderers, which are usually passed on in terms of higher prices when they do eventually win government contracts.

"Core activities"

Contracting out is often justified on a 'core business' argument. The notion that organisations should retreat to a set of core activities, however, is based on a misunderstanding of management theory. Organisations with many activities exist precisely because the control systems within organisations minimize transaction costs and allow for a high degree of flexibility. To take another domestic analogy, most people own a car, even though they are not specialised drivers. The alternative of using taxis for all travel is unacceptable, because of the loss of flexibility and the cost of booking cabs and handling the monetary transactions.

In the public service, in fact, the whole notion of core business is, in fact, somewhat elusive. Market failure does not follow neat, compartmentalised forms. Many disparate activities end up in the public sector — as Herbert Leonard of Harvard's Kennedy School says 'the hard jobs are left to the public sector'. Government departments are therefore grab-bags of loosely connected activities. Some large activities, such as Medicare claims processing, can be separately identified, but there are many small, residual functions. That is the nature of government. McDonalds may be able to decide it will restrict itself to fast food and stay out of the gourmet end of the market, but Customs cannot decide it is going to stick to import processing and give up drug interception because it's too difficult and costly. (That is one reason why techniques such as continuous improvement, which apply to mass production functions, are not particularly suited to most government functions.)

Loss of competencies

Contracting out leads to a long term loss of competencies in the public service. Once functions are contracted out all that remains is a group of contract managers, who have no more than low level generic managerial skills, and who are incapable of assessing the technical aspects of tenders and contracts. The Institution of Engineers has commented on the 'de-engineering' of the public service — engineering and technical jobs have been stripped out of public sector agencies. When they have been replaced they have been replaced by 'managers', lacking in technical skills.²¹ Similarly, many competent policy analysts have been lost to the public sector, and have been taken on by consulting firms which contract to the government. This imposes high transaction costs, for the fees charged by the consulting firm have to cover tendering costs, and the consultants are generally on a learning curve for each new job — working on sports administration last month, foreign policy this month, and aged care next month. The assets of specialisation, continuity and personal experience have been lost.

CONCLUSION

A PROFESSIONAL public service is a valuable asset. We come to appreciate it, perhaps, only when we observe the effects of its demise.

In the name of 'reform' there has been a large amount of damage done to Australia's public service. While some of the reforms have had grounding in good management practice, many have not. Many have become intertwined with the barren ideology of reducing the size of government. Some have tried to emulate private sector practices, without appreciating the context within which those practices apply.

Australia needs to build a normative model of public service. For a long time that model was implicit in an unwritten contract

Internal Reform

In all the rhetoric on contracting out there has been a good deal of faith put into the benefits of competitive contestability.²⁸ There has been virtually no discussion on the alternative, and that is internal reform. The implication seems to be that public service managers are too incompetent to improve the performance of their own work units. No one who has managed in the public sector would deny that reform is difficult, but is this because of some intrinsic incompetence? More likely, it is because of government imposed costs and restrictions — heavy paperwork in the name of 'accountability', the provision of political support for executive government, requirements to use private sector services rather than developing in-house expertise, and financial regulations which sacrifice performance to the achievement of impressive short-term financial reports. These encumber the manager who wants to bring about genuine reform, and there is no shortage of private sector competitors who have a vested interest in seeing that the public sector remains encumbered.

between executive government and the public service, but there is nothing left of that contract, and, apart from some vague and inappropriate notion of competitive contestability, nothing has replaced it. There is a sound, rational, set of economic theory that defines a role for the public sector in a market economy, but that theory is not within the guiding principles of the new public service. That omission is costly, for the result is ultimately impoverished economic and social policy. ■

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References and footnotes for this paper are available on request from DISSENT.