

SUBMISSION TO THE DEPARTMENT OF TREASURY & FINANCE

REVIEW OF STATE'S PUBLIC FINANCE LEGISLATION

1. Looking Backwards

1.1 Your Review terms of reference

I would like to list a number of extracts from the October 2008 DTF discussion paper to indicate the frame of reference I intend to comment within. These extracts with page numbers are as follows;

- *This review will play an important role ... in ensuring that government in Victoria is even more accountable, accessible and transparent. (foreword)*
- *What represents best contemporary management practice for the key elements of financial management, including planning, governance, resource allocation, resource management, and accountability? (page 2)*
- *Under this (output management) model, resource allocation decisions about the nature and mix of outputs should be based on each output's expected contribution to government outcomes. (page 7)*
- *Growing Victoria Together sets out long term goals (or outcomes) including performance measures for social, environmental and economic progress. (page 8)*
- *Meaningful performance information should tell parliament and the public what government is planning to do and what it has achieved.(page 17).*

1.2 A brief statement of my experience

I spent some 8 years studying and teaching economics at Melbourne University, followed with 10 years with Shell in the corporate and strategic planning and marketing functions, then 18 years as a senior Victorian public servant, with the last 4 years a mix of corporate and advisory work. Over a lifetime of work I have been keenly interested in resource allocation decisions and the tools and information systems which underpin them.

I have been a player in an excellent resource allocation system at work – with Shell. I have long experience of the intricacies of the public service system – and I have equally seen some very poor private sector systems. What marked out Shell as outstanding in this field was its integrated package of strategic planning (using the scenario planning tool) and annual business plans (down to divisional level), its competitive internal resource allocation processes, and its information systems – to enable effective decisions to be made at the coalface, to signpost progress, and to enable speedy reporting against agreed targets.

This set of experiences provides me with a particular vantage point from which to comment on public finance in Victoria. Given this experience I intend to focus my submission on the limitations of the existing output management framework, the benefits of moving to an outcomes based strategic planning system, and the requirements for its effective implementation and operation. In my view there is a compelling case for change.

1.3 Deficiencies of the present system

The DTF discussion paper identifies many of the deficiencies of the present system and makes a strong case for change to a strategically-driven system focused on outcomes. However I would like to state these deficiencies in my words and add a few. My list of deficiencies is a long and overlapping one;

- It does not allow parliament and the community to gain any sense of what has been achieved
- Most agencies report on many measures but it is impossible to form a view of what the aggregate activity level has been, let alone the aggregate *impact*
- Opportunity costs of resources used are not recognized
- Too many things are measured and often not the right things
- Performance measures are often based on association rather than causation but are intended to give the appearance of causation.
- There is no indication in the GVT documentation what contribution the government's actions are intended to make to the achievement of the stated goals
- There are no formal linkages between the goals of GVT and agency performance measures
- Meaningless targets are often set which can be easily "achieved"
- Agencies focus on DTF's requirement for input and output-based performance measures and are thereby dissuaded from focusing on the collection of data on impacts and outcomes
- Agencies focus on meeting DTF's reporting requirements to the detriment of the development of useful management information systems which would contribute to more effective resource allocation.
- Performance data does not enable any cost- benefit assessment of the use of resources, nor indeed any rate of return calculations
- Politicians are not committed to effective performance reporting

It is difficult to estimate how what impact these individual deficiencies have on the effectiveness of the existing system but they should not be underestimated. Take for example the focus on performance reporting at the expense of development of information management systems. The benefit of the latter would both be better day to day management decisions but also the generation of the non-financial information to enable regular rate of return calculations to be made at the department level.

This is important because at the departmental level there are often many policy instruments to choose from to achieve any particular goal. The collection of non-financial performance data on a regular basis *when used in conjunction with suitably tailored financial information* provides a solid foundation for choice between policy instruments which current performance reporting does not aim to do.

1.4 There are 3 classes of weaknesses

There are 3 levels of deficiencies in the present output budgeting management system inherent in the above list. Some of the weaknesses are native to the tool. These include a focus on input and output measures and the absence of cost benefit based information.

This is a structural weakness.

Others, such as the focus on performance reporting to the detriment of management information occur directly or indirectly because of the way in which the tool has been implemented. These are implementation weaknesses.

The third perhaps can best be described as the weaknesses added by the political system. This is a behavioural weakness. Consider for example the challenge of producing a scorecard on the contribution of the state government to the state's economic performance .

Any attempt will inevitably prove unsatisfying because politicians (a) typically shy away from measurable big picture *commitments*; (b) tend to talk in aspirational goals rather than real targets; (c) only attempt what they believe they can comfortably achieve; (d) shift the goalposts when the going becomes uncomfortable; and, (e) rarely provide performance data which allows an assessment even of their (gross) contribution; and (f) never provide data which enables an assessment of their net contribution.

This ambivalence to accountability and transparency is a key issue. Whilst by and large the level of commitment to the financial dimensions, cannot be questioned in principle, given the role of the Auditor-General, in practice attempts by the community to find out what governments have achieved can be easily frustrated by a defensive government. And are typically frustrated by most governments. So whilst observance of the principles of transparency and accountability for non-financial as well as financial outcomes is desirable there would be little point in implementing a system which not be permitted to deliver.

An outcomes-focussed strategic planning system is a double-edged sword for politicians sensitive about public perceptions. On the one hand such a system properly implemented would permit indeed demand better resource allocation and better decisions, it would also require the generation of data to demonstrate progress towards goals and the contribution of the government to the achievement of these goals. If there is currently an incentive to be less than transparent and accountable, then the incentive would be multiplied with the prospective release of more focused performance-based information.

1.5 An example

Perhaps the best way to make some of the above points is to take a recent government policy statement, illustrate its shortcomings, and point to the ways it could be improved. The example I propose to use is the statement “**Building Our Industries For The Future**” released by the Premier and Acting Minister for Industry and Trade during November 2008. This is a \$245 million industry assistance package.

Its major deficiencies from a public policy standpoint are as follows;

- It is impossible to work out what contribution it will make to the state’s highest level economic goals
- It deliberately mixes existing commitments with new activities to make it impossible to determine what *new* funds are being committed
- It provides no indication of how Victorian industry will develop (a) without the package and (b) with it, and therefore what difference it will make
- It provides no indication of what measures and against what targets its impact should be judged, either at the individual initiative level, or whole package level
- It provides no indication of whether the government expects it to make a net contribution to industry development in the state.
- It provides no real argument for the choice of these particular interventions.

It is a plan without a clear goal, without a clear statement of what it will cost, without justification, without performance measures or any indication of whether it might be beneficial. It fails nearly every test of sound public policy one might measure it against – including the government’s own goals of transparency and accountability.

2. Looking Forward

2.1 Introduction of whole of government level strategic plans

The discussion paper asks at what level strategic plans should be prepared. This should clearly be at the whole of government level. At this level goals and high level strategies should be determined and comprise the strategic plan. These goals should be disaggregated and together with the high level strategies, passed down to the departments to develop their own complementary strategic plans.

2.2 Responsibility should lie with Department of Premier & Cabinet

The organizational form and positioning of the strategic planning function within government is a key consideration. Here there are two issues. The first is the location of the strategic planning function within the structure of government, and the second is the functions with which it is co-located.

The logical place for this function is with the Department of Premier & Cabinet. The responsibility for the determination of the government's goals, the form these take, and the target levels should be the primary responsibility of DPC, along with the determination of the high level strategies to achieve them.

The strategic planning function is of a different nature to the financial planning and management function. At the end of the day finance, and resources, are the means to the ends but the ends themselves are the government's own goals and strategies. Whilst there may well be one or more high level goals which relates to finance – eg. *sound financial management* – clearly the majority of government goals will be stated in non-financial terms.

A further argument for primary responsibility to lie with DPC is the need to introduce effective matrix management to recognize that there is an imperfect match between government goals and organizational structures.

At the same time the DTF role should not be understated. Determination of the state's financial capacity to deliver any particular package of goals, and the associated financial management strategies, should be the primary responsibility of DTF. Description of the future operating environment should also be a DTF responsibility. Rolling out an integrated financial and strategic planning system should be a joint responsibility of DPC and DTF.

3. Introducing strategic planning

3.1 The process steps in developing a whole of government strategic plan

To be effective the planning process needs to have a number of steps to it. The first step must be to describe the government's goals. This must be done in a way which is operationally useful for its delivery arms (departments and other entities). Measures must be clear along with targets, timelines, and assignment of responsibilities to departments (and other entities), and whole-of-goal matrix management teams.

Achievement of the established government goals needs to be set against the expected operating environment for the government and its agencies. Alternative futures need to be considered at the whole of government level and robust whole of government strategies developed to respond to these alternative futures. The language of these goals and strategies needs to be in terms of targets, gaps, and the broad measures that government will take to fill these gaps and meet their targets.

The second step then needs to be to devolve the scenarios and strategies and disaggregated goals to the delivery arms – the departments – to determine their resourcing requirements to deliver their respective parts of the government's goals. In turn the departments would disaggregate their parts of the government's goals and allocate to their business units and related entities. This process should go on down the organizational chain as far as practicable.

At each stage of this process responsibility for government goals would be allocated, bids for resources to deliver these goals lodged, and budgets matched to the governments goals developed with DTF. Within reasonable boundaries this would need to be an iterative process up and down each organization with goals allocated, budget bids lodged, goals reassessed and reallocated and budget bids adjusted.

The bidding process – of resources to deliver budget outcomes related to government goals – must require rate of return evaluations at each step in the process. In addition benchmarking efficient and effective resource use against best in class should be a standard requirement of such resource bids. In this way competitive bidding for resources within government could be encouraged in response to the need to meet particular targets related to government's goals. But it should also encourage the government to consider the various rates of return on its different interventions, and rebalance some of its goals.

3.3 The form of the strategic plan(s)

The discussion paper seeks input on the form of the strategic plans and points to *Growing Victoria Together* as the government's present statement. Quite rightly this statement is described as a vision rather than strategic *plan*, but provides little in the way of government strategies and no indication at all of the contribution that the government will make to the achievement of these aspirational goals. Clearly this framework would require substantial overhaul if it were to serve the purpose of be the basis of a whole of government strategic plan for the state.

At the whole of government level in my view the critical content is;

- a statement of the government's goals
- the projected (long term) operating environment (described in terms of multiple futures)
- the government's strategies to deliver change
- the projected difference (ie the contributions) that the government's strategies would make in the targeted areas
- the allocation of these contributions across departments;
- the resources required to deliver on the interventions
- indicative rate of return information at the level of individual goals.

3.4 New skills and market intelligence required

The challenge of introducing such a system should not be underestimated. In particular the systematic analysis of the future, the level and quality of market intelligence acquired and assessed, and the analytical skills required to manage a planning system with multiple futures built into it are substantial. At the lower level, skills across the agencies would have to be considerably enhanced to develop the quantitative foundations for more effective resource allocation decisions within and across agencies.

4. Conclusions

There are many advantages to the community in the adoption of an outcomes-based strategic planning system. These are largely set out in the DTF discussion paper. Many of these advantages are of a systemic nature arising from the deficiencies of the existing output management framework. A number of the potential benefits arise from correcting the imperfect manner in which the existing system has been implemented.

As noted there are further deficiencies because of the incentives which presently exist to inhibit full government accountability, transparency and as a result, effective resource allocation. These will not change simply with a change of system. A better system with the same (dis)incentives built into it may be no better at all. "Government failure" would be highly likely to occur and defeat the prospective benefits of a changed system. A careful analysis of the reward systems inherent in both systems, and their impact on the effectiveness of both is required.

It could be expected that there would be substantial efficiency gains accruing from the establishment of an integrated strategic and financial planning system within the Victorian public sector. Clarity of goals associated with greater transparency of purpose and achievement levels with supporting rewards systems for the implementers would reduce misdirected and wasted effort across the political, bureaucratic and community levels. Whilst

difficult to measure, these gains should not be underestimated and are likely to be substantial.

Finally it needs to be acknowledged that political judgements will underpin resource allocation decisions, and that quantitative data will often be treated as an input rather than “the answer” The establishment of an effective outcomes-based strategic planning system need not compete with this reality. However the community should demand that the best quantitative analysis possible is provided to assist in the ultimate decision. The strategic planning model developed and adopted by Shell and other international companies back in the 1970's, and as practised today, would be a good model for government to implement.