SOCIETY OF PROFESSIONAL ECONOMISTS' SEMINAR

Public Service Productivity and Reform

Thursday 22nd February 2024
8.30am for a 9am start

Institute for Government
2 Carlton Gardens
London SW1Y 5AA

SA REMARKS

Introduction

Thank you - and huge thanks to the Society of Professional Economists for organising this seminar and to the Institute for Government for hosting it and providing a fellow speaker.

Public sector and public service productivity are, in my view, a surprisingly neglected area of both academic enquiry and public policy focus – apart from a few notable exceptions.

The economist Tony Atkinson produced a landmark report on public sector productivity in 2005 (See: *Measurement of government output and productivity for the national accounts*) whilst Patrick Dunleavy at the London School of Economics has researched these issues for many years (See: https://www.lse.ac.uk/government/people/emeritus-academic-staff/patrick-dunleavy).

More recently, the Institute for Government through its excellent public services' *Performance Tracker* (See: *Performance Tracker 2023: Public services as the UK approaches a general election*) and Bark van Ark at the Productivity Institute (See: *Making public sector productivity practical*) have made invaluable contributions.

But these feel like exceptions rather than the norm. There aren't very many cross-cutting public sector and public service productivity research centres in British universities – though centres of expertise in particular services are more pervasive.

In some respects, it's perhaps not surprising this is a comparatively neglected area of research and analysis. Public sector and public service productivity raise tricky conceptual issues, are far from easy to measure, and the data we have are far from ideal (notwithstanding the first rate efforts of the Office for National Statistics and others).

Against this, the public sector and public services account for up to a quarter of national output and over two fifths of national spending. So, how well or badly the public sector and public services use the resources at their disposal matters for productivity performance more generally.

It particularly matters when economic growth is sluggish, and not generating additional tax revenues to pay for greater spending on public services, and the fiscal position is constrained as a result. In these circumstances improving public sector and public service outcomes will depend, crucially, on making better use of existing resources.

The evidence is clear, in any case, that public service performance depends on a great deal more than input funding including:

- Leadership, governance, and accountability.
- Innovation.
- A focus on prevention and early intervention.
- The empowerment of communities and service users.
- Data and evidence on what works and what does not.
- The capability and skills of the workforce; and
- Much more.

Consistent with this, the Chancellor said in last year's Autumn Statement that he wanted to increase public sector productivity growth by at least half a percent a year to maintain and improve public services whilst reducing the overall size of the state.

This followed his commissioning in June 2023 of a review led by the National Statistician into how public service productivity can be measured more effectively (See : https://www.ons.gov.uk/aboutus/whatwedo/programmesandprojects/publicserviceproductivityreview) and expected to start delivering improved measures from the spring of this year with a progress report published just this week (*Public Services Productivity Review progress report*, Office for National Statistics, February 2024).

So, this seminar is well timed. There's an opportunity for the economics profession generally to feed into this work.

It is also worth noting, by way of introduction, that there is some evidence – at least from Italy - that there is an inter-dependence between public sector productivity and private sector productivity. In other words, a more productive public sector is a contributor to a more productive private sector – though there aren't many studies on this.

In these remarks, I'm going to say a bit about:

- What we mean by public sector and public service productivity.
- What measures we have – and their limitations.
- What those measures show.
- What we know about the main drivers of public sector and public service productivity, and
- What actions might be taken to promote public service productivity, crucially perhaps as part of a more broadly based public service reform agenda.

<u>What is public sector and public service productivity?</u>

So, what is public sector and public service productivity?

In a way, it's quite straightforward. It's the relationship between public sector or public service outcomes and outputs - and the inputs needed to produce them.

The far from simple challenge is developing robust measures of those outcomes and outputs – particularly for non-marketed activities.

There is also a crucial distinction to make between technical and allocative efficiency as components of public sector and public service productivity.

Technical efficiency is about doing the things we currently do either at less cost or getting more outputs from what we currently do at the same cost or some combination of the two.

Allocative efficiency is about finding wholly different ways of achieving desired outcomes – at less or substantially less cost.

Technical efficiency, if you like, is about doing things right.

Allocative efficiency is about doing the right things – crucial for unlocking transformational improvements in productivity performance.

One thing I've learnt over the years as a civil servant is that the public sector and public services can be characterised by significant allocative inefficiencies. In the private sector what Schumpeter described as the forces of creative destruction have historically been important in reallocating resources to alternative uses driving improved outcomes through time.

There is a tendency for discussions about public sector and public service productivity to focus almost exclusively on technical efficiency. Technical efficiency is important, but the greater prize may be offered by allocative efficiency.

What measures do we have?

However, measuring public sector and public service productivity poses formidable challenges, including:

- Obtaining robust data on costs
- Turning cost and price data into volumes of inputs and outputs
- Adjusting outputs for quality, and
- Attributing changes in outcomes to changes in outputs.

Notwithstanding these challenges, the Office for National Statistics produces a remarkable regular annual publication on public service productivity for the UK – inspired by the Atkinson report of 2005 – with a review in hand at present aimed at further enhancing the data we have.

In most countries, public sector output is measured by public sector inputs.

In the UK, by contrast, approaching two thirds of public service spending is measured by quality adjusted outputs (details of the quality adjustments made can be found in: *Sources and methods for public service productivity estimates*, ONS, May 2022).

Thus, healthcare output is measured by appropriately weighted inpatient, outpatient and day care episodes and outputs of general practitioner services - adjusted for survival rates and health gain, waiting times and surveys of patient experience.

In the case of schools, the throughput of full-time equivalent students is adjusted for educational attainment at GCSE and equivalent grades.

In the case of adult social care, social care outputs are adjusted for changes in how well care needs are met using an adult social care survey.

There are also quality adjustments for public order and safety and children’s social care.

By these means improved measures of public service output and outcomes are obtained and these are used then related to measures of the input for each service to derive a series for public service productivity.

Because of their relative size, what happens in health and education is the key driver of overall public service productivity. The methods used here raise, of course, numerous issues and questions but I'd stress that the approach taken by the Office for National Statistics is amongst the most sophisticated in the world.

What do those measures show?

What do these measures show?

Based on the Office for National Statistics' latest experimental methods, total public service productivity growth averaged 0.2% per annum between 1997 and 2019 – ranging from -1.4% per annum for public order and safety (fire, courts, probation, and prisons but excluding the police) to +0.9% per annum for healthcare – with education, adult social care, and children's social care close to zero (source: *Public service productivity, UK* : 1997 to 2022, ONS, November 2023).

Historically, private sector productivity has gown faster than public service productivity. But, over the period from 2010 to the Covid crisis, the reverse was true. Public service productivity increased by an average of around 0.75% per annum – a marked improvement over the previous decade (See: *Making public sector productivity practical* by Bark van Ark).

It appears that austerity stimulated some improvement in public service productivity.

The data for 2020 (much distorted by Covid it should be stressed and not comparable to previous years) show a significant decline in public service productivity of over 15% – though that needs to be treated with caution given the National Health Service was holding significant unused capacity as part of preparations for a surge in Covid cases and the school system saw of course a surge in pupil absences not always made good by remote learning.

The Office for National Statistics estimate total public service productivity growth rebounded by 15.1% in 2021 and 2.2% in 2022.

Based on new experimental modelled nowcasts, the Office for National Statistics estimate public service productivity was around 0.3% lower than pre-Covid levels in 2022.

Ad hoc analyses also show significant post-Covid pandemic public service productivity challenges. For example, a recent piece by the Institute for Fiscal Studies (*Is there really an NHS productivity crisis?* - November 2023) notes the National Health Service has significantly higher funding and staffing levels (with FTE up around 15-20%) compared to 2019 (before the pandemic) yet is treating the same or fewer patients – not obviously made good by improvements in the quality of service such as reduced waiting times.

One specific measurement gap is capital: how productively public sector and public service assets are used and the productivity or otherwise of new capital investment for each public service. Do we get the returns – economic and social - we should? Whilst there are a few studies – such as Tony King and Ivor Crew's brilliant book, *The Blunders of Our Governments,* 2014 – they are comparatively few and far between.

<u>What are the main drivers of public sector and public service productivity?</u>

What do we know about the drivers of these trends?

Above all, that there is no magic bullet.

There are various drivers of public sector and public service productivity in the literature, most or all of which need to be acted on to bring about improvement.

Key ones include:

- Data - to enable us to understand the economic and social problems public services are there to help tackle, to target resources more efficiently (using tools such as data and predictive analytics), and to benchmark performance more effectively and transparently.

- Innovation and the diffusion of innovation – including technological innovations such as digital transformation and artificial intelligence.

- Policy and programme evaluation – so we know what works and can allocate resources to activities that will make most difference – boosting efficiency and productivity - and can stop doing things that don't work.

- Organisational models that facilitate and encourage more joined up and efficient approaches across departmental boundaries and between different tiers of government; a better balance between prevention, early intervention, and the treatment of problems; and which open-up public services to new entrants better able to roll out more productive service innovations and challenge existing providers.

- Capability and capacity, including a workforce with the skills, adaptability, agility, and ability to learn from failure and to drive the application of data, evidence of what works, technology, and innovation.

- Empowered users who can co-produce outcomes for their communities, on the one hand, and to whom service providers are genuinely accountable and responsive, perhaps through quasi-markets on the other, and

- Leaders and managers, focused on outcomes, who understand the drivers and have the incentives and entrepreneurial freedom to seize opportunities at pace – whilst remaining accountable to users and taxpayers.

<u>What actions might be taken to promote public service productivity, perhaps as part of a more broadly based public service reform agenda?</u>

Given this, what exactly could - or should - we be doing across government further to promote public sector and public service productivity?

This is something on which the Chancellor is keen to gather ideas and it would be great to hear the thoughts of colleagues at this seminar.

I think the promotion of public service productivity is something that needs that to be approached with a broad frame and as part of a more broadly based approach to public sector and public service reform. That would cover issues such as: the overall public service reform strategy as well as the strategy for individual services; funding levels and multi-year funding; workforce strategy; and more – as discussed in successive Institute for Government *Performance Trackers*.

However, the fiscal position is going severely to constrain our ability to spend our way out of the challenges facing public services. So, my focus here is much more on practical yet I hope soundly based reforms and actions that could improve public sector and public service productivity and thus outcomes.

There are various dimensions to this in my view.

First, continuing to ensure the rigorous, objective appraisal of all public spending decisions, based on facts and evidence, including undertaking such appraisals early enough in the decision-making process so a decision can be reversed if that's what the appraisal suggests should be done. This in turn may require the building of a culture where it isn't seen as a failure not to proceed with a programme or project if its appraisal doesn't stack up. Robust appraisal offers a better chance of more effective and thus more productive interventions and associated spending.

The quality of public spending and investment matters as much or more than the quantity. The dangers of getting this wrong have been spelt out by, for example, Tony King and Ivor Crewe in their astonishing book, *The Blunders of Our Governments*, and by D R Myddelton in his book, *They Meant Well – Government Project Disasters* – everything from the R101 airship in the early 1920s, through Advanced Gas-Cooled Reactors to Concorde and more in more recent times.

Second, trialling or piloting interventions much more often before scale-up and roll out to see if they work and will offer good potential economic and social returns – and thus represent a productive use of public spending. Such trialling and piloting could help to provide greater confidence in what spending initiatives will deliver, support longer term planning and delivery, and thus support improved public sector and public service productivity. Consistent with this, I'm proud to say my own department has just launched a major test and learn initiative for homelessness interventions.

Third, devolution, decentralisation and the empowerment of communities and families open-up – at least in principle – scope for greater accountability; more experimentation; the breaking down of policy and delivery silos; culture change including continuous improvement; and the ability – at least in principle once again – of better tailoring services to the needs of local people and communities with consequent productivity benefits – within any given level of overall spending (this has been set out, for example, in a new paper by John Denham and Jessica Studdert for New Local on *Place-Based Public Service Budgets*).

Fourth, more generally empowering leaders and managers across the public sector and public services to exploit the opportunities offered by digital technologies and transformation. Such technologies offer the opportunity to reduce administrative and other costs of service provision and to develop wholly new services that better meet the needs of users than existing provision and at potentially much less cost.

Fifth, investing in policy or programme evaluation to provide a more comprehensive and more robust evidence base on what works or is likely to work. The National Audit Office has set out regularly Whitehall's poor track record in this respect. But it is a challenge being addressed with some vigour by the Evaluation Task Force and my own department has published and is taking forward an Evaluation Strategy that I'm proud to say covers key interventions across all our policy areas. Scaling up interventions that work – and stopping those that don't - will improve public sector and public service productivity.

Sixth, removing barriers to shifting resources to where the overall economic and social returns are greatest, and which would also improve public sector and public service productivity. For example, shifting resources over time from treating problems to preventing them or intervening earlier or, as the Institute for Government has argued, towards targeted capital investments that will deliver longer term productivity benefits such as investments in new technologies.

For any given level of public spending, the evidence suggests that we would get better outcomes from our budgets over time if we invested more in prevention and early intervention. There is good evidence for this across a broad range of policy areas, including health, criminal justice, helping those experiencing multiple disadvantage, support for families and parenting, homelessness and rough sleeping, and many others.

But that is - perhaps surprisingly - difficult to do – with only 5% of NHS spending, for example, devoted to prevention.

We need innovations that would make increased levels of preventative investment easier to achieve, including overcoming the double funding problem of maintaining treatment whilst shifting to prevention. This might include exploring the scope for genuinely innovative social investment, partnerships with the private sector, or other approaches that would enable a shift of resources from the reactive treatment of problems to pro-active prevention and early intervention.

Not easy but there is good evidence (for example, from my department's work on supporting families and homelessness and rough sleeping) that this can significantly improve outcomes for any given level spend – reducing numbers of children going into care or people sleeping rough.

Seventh, making better use of data:

- To better understand economic and social problems and their drivers.

- To target resources more effectively at tackling those drivers, including deploying technologies and methods better able to predict who may need help, and thus intervene earlier and more cost-effectively to head off more expensive calls on public services – at any given level of public spending, and

- To identify where or how performance can be improved.

In relation to the last of these, my team has for some years analysed the technical efficiency of local government. For each local service for which local government is responsible, we seek calculate the unit cost of delivering that service (generally service expenditure divided by population but it can be the number of households or traffic flow or other specific measures depending on the service) – with an adjustment made for differences in area costs such as labour and office accommodation.

We then use the Chartered Institute for Public Finance and Accountancy's nearest statistical neighbours' model only to compare authorities with other authorities like them both in terms of population characteristics and service outcomes achieved.

This provides estimates of the potential scope for technical efficiency improvements in local government if all authorities performed at – say - the median level for their nearest statistical neighbours (assuming no problems of deliverability or any need for upfront investment to unlock the savings etc).

The newly established Office for Local Government (https://www.gov.uk/government/organisations/office-for-local-government/about) provides a great opportunity to gather data and undertake ongoing analyses of the opportunity for improvements in productivity performance. Indeed, this could be a model on which to build in other public services.

The potential improvements identified by such work relate, it should be stressed, solely to technical efficiency – what could theoretically be realised if all local authorities did what they do now at the median or some other level of efficiency of their nearest statistical neighbours.

So, they do not capture the scope for potential improvements in allocative efficiency if local authorities adopted different ways of achieving their desired outcomes. But such comparisons of the productivity of different service providers, within a given service, could in principle be extended to other public services and help drive improved productivity performance across the piece.

Eighth, and finally, continuing action is needed to remove the barriers to joined up solutions across Whitehall and between central and local government which would more effectively – for example - meet the needs of vulnerable people.

The homelessness systems evaluation my department has recently commissioned provides a pointer to the opportunities that could be realised through systems approaches that mobilise different Whitehall departments and bring together central and local government more efficiently, effectively, and thus productively to achieve desired outcomes.

My department can't on its own end homelessness and rough sleeping but needs the Ministry of Justice and the Prison Service; the Department for Health and Social Care, including drug and alcohol abuse services; the Department for Work and Pensions; and others top play their part. We will be both more effective and more productive if we work together - a perennial aspiration perhaps but no less true for that.

The need to think and act systemically pervades of course many public services – health and social care is another compelling example. The report issued by Public First and the Institute for Government last summer on *The NHS Productivity Puzzle* pointed to various key drivers of NHS productivity at present, including: the right capital investment; avoiding high levels of staff turnover and the loss of experience; effective hospital management empowered to drive efficient and effective outcomes; minimising delayed discharges; and the right incentives (amongst other things). The important thing is to deliver these in combination – any one is not enough. A strategic and system-wide approach is key.

There are other reforms and actions that could no doubt be added to this list, but I think these are the main ones. It would be great to hear the views of colleagues on what their top priorities for improving public sector and public service productivity should be.

What have I missed? What have I got wrong?

Is what I've reviewed totally fanciful?

But I hope this is helpful in framing our conversation.

Stephen Aldridge
Analysis and Data Directorate
Department for Levelling Up, Housing and Communities