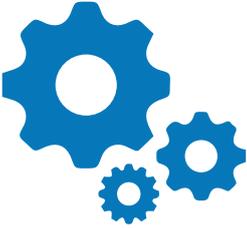


7

OPPORTUNITIES AND CHOICES



We can close the fiscal gap by strengthening our economy, delivering better services and infrastructure and building a more sustainable revenue base.

The analysis in this Report outlines how, if current policies and programs remain as they are, New South Wales is projected to have a fiscal gap in 40 years. The key question therefore is what can we do to prepare for the future?

This chapter outlines the opportunities and choices we face as a community to shape our future in a more sustainable way. These options are not policy prescriptions; rather they describe the choices available to us.

Our findings point to three broad areas for attention now and into the future:

- strengthening the NSW economy by focusing on population, participation and productivity;
- improving the way we deliver services and infrastructure; and
- improving the sustainability of our revenue base.

First, governments will need to consider how they regulate both the private and public sectors to enable more innovation and greater productivity particularly for new and emerging sectors of the economy. Investments in assets and in people will need to encourage migration, improve workforce participation and increase productivity.

Second, government services and infrastructure delivery will need to be as efficient and effective as possible. Improved services that are consumer-centric and outcomes focused, leveraging the digital age, innovative delivery models and dedicating resources to where they are needed most all offer great potential to improve services at lower cost.

Third, while we know that these opportunities can deliver benefits on the expenditure side of the budget, considering our revenue base and how we pay for services are options that governments can consider to place New South Wales on a more sustainable financial footing.

New South Wales is part of a federal system of government. Working on options with the Commonwealth can improve our fiscal sustainability and deliver the best outcomes for NSW citizens. For example, more cost-effective care for patients with chronic disease can be achieved through the Commonwealth Government's primary care programs and the State's hospital systems working better together.

In many cases, we have already begun the task of developing the opportunities and choices presented in this chapter, but it is likely that this development will need to be accelerated over the coming years if we are to change our projected fiscal path.

7.1 Strengthening the economy

Enabling and growing opportunity does not simply mean lifting economic growth. It also means lifting living standards by improving the environment, social outcomes and income distribution. A strong and flexible economy can support these objectives. It will also allow us to deal with global changes, such as technological change, the impact of climate change and the economic rise of Asia.

The NSW Government can strengthen the economy by regulating and investing with an eye to making New South Wales an attractive place to live and work by ensuring that:

- competition and innovation flourish across the economy;
- investments in our people improve productivity and workforce participation; and
- investments in infrastructure support a growing and ageing population and improve productivity.

Enabling competition and innovation

Sustaining a strong economy depends on a competitive and innovative private sector. In New South Wales, more than 85 per cent of employees work in the private sector.¹ In some cases, they are volunteers rather than paid employees.

With rapidly advancing technology and an ever changing external economic environment, governments will need to continually reassess how they regulate and interact with markets to support the innovation and productivity that delivers better goods and services to our community.

Regulating with a 'light touch' can encourage firms and non-government organisations to be more responsive to consumer needs. It can support the market to produce innovative goods and services and deliver better quality and more consumer choice. This also means reconsidering the regulation of existing markets and the government's role of market stewardship, so that innovative technologies and practices do not disadvantage new entrants in a given market.

A recent example of this is the legalisation of point-to-point ride sharing services. These changes involved the repeal of more than 50 regulations governing taxis and hire cars, and opened up the market to increased competition.

Governments will also need to be flexible in regulating to allow for new technologies and industries that may not yet exist. For example, Opal electronic ticketing is an 'open system,' which means it could be scaled up to allow customers to use it on their credit cards or mobile phones.

Governments can also encourage competition and innovation through competition policy. In the 1990s, an in-depth review of competition policy (Hilmer Report) enabled Australian governments to collectively improve the economic performance of every state and territory. The Productivity Commission found that the productivity improvements and price reductions that followed raised Australia's GDP by 2.5 per cent.²

A recent review of national competition policy (the Harper Review) has called for acceleration in competition policy at all levels of government either collectively or individually. The changes to the point-to-point transport market and retail trading hours are NSW examples of first steps in this process. The Harper Review also identified human services, planning and transport as state government activities for future attention.

Investing in our skills

Training and education are investments in our individual and collective future. They improve our employment prospects, make us more productive and increase our earning capacity. They enhance our quality of life and help us take advantage of future work opportunities.

Our collective level of education is also vital to the prosperity of the economy. The Organisation for Economic Co-operation and Development (OECD) reports that the quality of schooling in a country is a powerful predictor of long-term national wealth.³

Over the next 40 years, while we may not know how we will work in the future, we do know that the jobs of the future will likely be very different from today. Continuous and flexible education and training will therefore give us the opportunity and ability to respond to the evolving NSW economy. Improving educational outcomes from preschool through all stages of a student's life (see Box 7.1) will be an important part of a long-term strategy to improve living standards.

Beyond school, the Vocational Education and Training (VET) sector builds human capital, drives productivity and encourages workforce participation. VET enhances occupational choices and increases the capacity for individuals to pursue a fulfilling career.

Regulating with a 'light touch' can encourage firms and non-government organisations to be more responsive to consumer needs.



Training and education will give us the opportunity and ability to respond to the evolving NSW economy.

¹ Australian Bureau of Statistics, 2016. Labour Force Australia Detailed (cat no. 6291.0). ABS, Canberra

² Productivity Commission, 2005. Review of National Competition Policy Reforms. Inq. Rep. PC, Canberra

³ Ludger, W., 2015. Universal Basic Skills What Countries Stand to Gain: What Countries Stand to Gain. OECD Publishing

OPPORTUNITIES AND CHOICES

The right infrastructure investments will ensure that New South Wales remains an attractive place to live and work.

Over the next 40 years, the challenge will be to ensure the VET sector is nimble, adaptable and responsive to the changing demands of business for skilled workers, particularly where skills shortages exist. At the same time, it needs to adapt to students' preferred training delivery modes. Reforms to the VET sector, such as the NSW Smart and Skilled reform, are opportunities to increase student choice and produce a more responsive training sector.

Lifting our skills and therefore participation and productivity go beyond just investing in our education system and includes creating workplaces that are family friendly and generationally diverse. While national workforce participation is largely influenced by Commonwealth policy, the NSW Government can encourage flexible and diverse workplaces and work arrangements. The State can also consider how the public health system supports people to get into, stay in and fully utilise their capabilities in the workforce throughout their longer lives.

Investing in the right infrastructure

In 2014-15 the public and private sectors invested \$109.5 billion of capital in New South Wales, which was 21 per cent of GSP.⁴ As discussed in Chapter Four, investing in infrastructure has a key role to play in making New South Wales an attractive place to live and work and improving productivity across the economy. Capital deepening, that is, the increase in capital per worker, contributed almost 60 per cent of the growth in national labour productivity in 2013-14.⁵ In New South Wales, the Government's Rebuilding NSW program is set to deliver a real increase of 3.6 per cent in GSP by 2035-36.⁶

Governments will need to respond to long-term demographic and economic conditions. While we may not know for certain what infrastructure projects are required in the next 40 years, the government can control the way the NSW planning system works and the investment projects it selects. It can make planning choices and investments that focus on improving living standards, workforce participation and productivity. It also means making choices and investments that encourage migration to boost the working age population and help offset the impacts of an ageing population.

According to the Productivity Commission, returns from investment in infrastructure are not guaranteed and depend on how successful investment decisions are and how efficiently infrastructure is used.⁷ As such, rigorous assessment and streamlined delivery processes will therefore be integral to a long-term strategic approach to capital investment.

As the first state government to set up an independent statutory authority, Infrastructure NSW, to review and advise on infrastructure projects, New South Wales is in a good position to continue to improve the way we deliver high quality and efficient public infrastructure projects. For example, one of the recommendations in the Productivity Commission's *Inquiry into Public Infrastructure* is to improve the use of rigorous and transparent pre-evaluation and assessment tools (such as cost-benefit analysis) in project prioritisation and selection.⁸

4 Australian Bureau of Statistics, 2015. Australian National Accounts: State Accounts, 2014-15 (no. cat. no. 5220.0). ABS, Canberra.

5 Productivity Commission, 2015. PC Productivity Update, 2015. PC, Canberra, p. 33

6 Deloitte Access Economics, 2014. Economic Impact of State Infrastructure Strategy — Rebuilding NSW, p. i

7 Productivity Commission, 2015. PC Productivity Update. PC, Canberra, p. 10

8 Productivity Commission, 2014. Inquiry into Public Infrastructure. PC, Canberra

7.2 Delivering better services and infrastructure

In 2014-15, government services and infrastructure made up 13.1 per cent of the NSW economy. While this is smaller than the private sector, government services are central to our quality of life, especially where the services are addressing market failure.

The fiscal gap requires us to think strategically about how the government can prioritise and deliver high quality services more effectively and efficiently. International and Australian experience demonstrates that policies can help achieve this when they focus on:

- consumer-centric services that focus on long-term outcomes;
- leveraging the digital age;
- using innovative funding models; and
- improving efficiency across the public service.

Consumer-centric services that focus on long term outcomes

Placing the consumer at the centre when delivering services can improve outcomes for individuals in two ways. Consumers have more choice and control in what they receive, and services better meet their individual needs, which can place them on better life pathways.

First, the Productivity Commission's *Disability Care and Support Inquiry* and the *Competition Policy Review Panel* both recommended the adoption of greater choice in public service provision. This is based on important findings that:⁹

- there is rightfully a social expectation that people should be able to run most aspects of their lives and that they are a better judge of their own needs than policymakers;
- individuals have different and changing preferences about what matters in their lives; and
- a lack of choice can result in poorer quality, expensive services and less diversity and service innovation.

A key example of this approach is the National Disability Insurance Scheme (NDIS), which will enable people with disability to exercise choice and control, both in the pursuit of their goals and the planning and delivery of their supports.

It is important to be mindful that within a framework of greater user choice, governments retain an ongoing market stewardship function. This means that governments retain responsibility for overseeing the impact of policies on users and facilitating a well-functioning market.

Second, investing in consumer centric services that are targeted and outcomes focused can have profound positive impacts on satisfaction and long-term wellbeing. Such an approach to targeting investment can improve lifetime outcomes across the community and prevent longer term dependence on often costly services.

For example, Australian and international studies have found that good quality early childhood education and schooling can place at risk individuals on positive pathways (Box 7.1). Other opportunities include early and targeted services to reduce childhood obesity that can reduce the likelihood of infants and children developing chronic diseases in adulthood.¹⁰

Consumer-centric services provide more choice and control to the individual and can place people on better life pathways.

⁹ Productivity Commission, 2011. *Disability Care and Support Report Vol.1*. PC, Canberra, pp. 355-357

¹⁰ World Health Organization, 2016. *Report of the Commission on Ending Childhood Obesity*. WHO. p. 7



Home monitoring technology improves the detection of acute episodes, reduces the rate of hospital admissions and length of stay at hospital – ultimately improving outcomes for the individual and reducing costs to government.

Box 7.1

Investing in education delivers long-term results

International and Australian experience shows that programs that channel education funding to students from disadvantaged backgrounds can improve students' education attainment and later-life outcomes. For example, Jackson, Johnson and Persico (2015) found that a 22.7 per cent increase in spending on appropriate school programs for low-income children can eliminate the education gap between children from low-income and wealthier families.¹¹

In New South Wales, the Department of Education's Schools Resource Allocation Model, explicitly directs funding to schools based on need. This includes socio-economic disadvantage, Aboriginality and student disability. In 2016, \$860 million was invested in NSW public schools to reduce the gap in outcomes between students from advantaged and disadvantaged backgrounds.¹² Economic modelling by the Department indicates that closing the performance gap between the most and least advantaged students may add \$406 billion to the NSW economy over the working life of those students.¹³

Short and long-term positive effects of early childhood education have been shown in Australia and internationally. For example, Victorian analysis using the Longitudinal Survey of Australian Children (LSAC) shows a significant positive association between pre-school attendance and Year 3 NAPLAN outcomes.¹⁴ Findings from international longitudinal studies, such as the US Perry Preschool Program study and UK EPPE/EPPSE study, show long-term benefits such as higher educational attainment, higher future earnings and reduced crime for specific student groups.^{15 16}

These examples show that the right investment in education, particularly for students from disadvantaged backgrounds can place them on improved socio-economic pathways.

Leveraging the digital age

Over the next 40 years there will be opportunities to make better use of data and technology in providing inclusive, customer centric and efficient services.

A good example of this is the use of technology enabled schooling that has given students, particularly in regional and remote New South Wales, access to a range of quality learning experiences regardless of their location. The virtual secondary school, Aurora College, has increased the opportunity for regional and remote schools to extend the learning of gifted and talented students, offer specialist courses with small enrolments and increase the collaboration between students across schools.

Telehealth is another example where technology has improved outcomes for citizens, particularly in the management of chronic disease. Australian and international trials have shown that home monitoring technology improves the detection of acute episodes, reduces the rate of hospital admissions and length of stay at hospital – ultimately improving outcomes for the individual and reducing costs to government.¹⁷

11 Jackson, C.K., Johnson, R.C., Persico, C., 2015. The effects of school spending on educational and economic outcomes: Evidence from school finance reforms. National Bureau of Economic Research

12 NSW Department of Education and Communities

13 Ibid; in 2014-15 dollars

14 Victorian Department of Education and Early Childhood Development, University of Melbourne, 2014. Early Bird Catches the Worm: The Causal impact of pre-school participation and teacher qualifications on year 3 NAPLAN outcomes. Victorian Government, Melbourne

15 Heckman, J.J., Moon, S.H., Pinto, R., Savelyev, P.A., Yavitz, A., 2010. The rate of return to the HighScope Perry Preschool Program, *Journal of Public Economics*, vol. 94, pp. 114-128

16 Cattani, S., Crawford, C., Dearden, L., 2014. The economic effects of pre-school education and quality. IFS Reports, Institute for Fiscal Studies

17 Celler, B.G., Sparks, R., Nepal, S., Alem, L., Varnfield, M., Li, J., Jang-Jaccard, J., McBride, S.J., Jayasena, R., 2014. Design of a multi-site multi-state clinical trial of home monitoring of chronic disease in the community in Australia. *BMC Public Health* 14, 1. Other examples include the UK's Whole System Demonstrator Program and the USA's Department of Veterans Affairs Telehealth Program

The digital age will also provide opportunities to use powerful data analytics (Box 7.2) to deliver more efficient and effective public services. For example, the NSW Data Analytics Centre (DAC) has been established to facilitate data sharing between agencies across the NSW Government to inform more strategic, efficient and whole-of-government based decision making. The DAC works within the NSW privacy and security landscape, and leverages world class data collection tools and applies best practice analytics, providing the opportunity to overcome silos and duplication across government agencies.

Another way we can leverage the digital age is to manage demand for services and the use of infrastructure. An efficient system that has the capacity to spread peak demand can delay the need for additional capital investments to increase capacity. For example, off-peak discounts are available on trains via the Opal electronic ticketing system to encourage trips outside commuter peaks and promote an efficient use of the public transport system.

Box 7.2

The future of government services

As governments embrace digital technology, citizens can expect to enjoy quicker, more convenient and better integrated services than ever before.

Unique digital IDs and single 'gateways' to interact with government online mean that citizens will only have to enter information once to access a host of government services under one account. Streamlining these processes will also reduce opportunities for error and fraud, as well as lower the cost of delivering services.

Though New South Wales is already well down this path, some other countries are taking steps toward the future. Estonians, for example, can go online to register their business within seconds, e-sign documents, access their medical prescriptions, vote for parliament, and receive tax returns within two days of filing — all reflecting high quality and efficient government service delivery.

Greater use of technology for government services can also better cater for citizens varying needs and preferences. Those who want simple services such as basic registrations, renewals and payments will have more self-service and automated options. This means access to government services wherever and whenever they need them, including on their smart phones during their daily commute. Meanwhile, citizens with more complex needs such as disability or homelessness will increasingly benefit from a range of customized services which take into account individual needs and orchestrate the delivery of needed services from different areas of government and non-government providers.

A host of new technologies will allow the secure sharing of data, to enable seamless interactions within and across government agencies, and with non-government partners.

New South Wales is moving into the future with integrated government services through Service NSW for many transactional and information services. In the social services sector, the introduction of Patchwork, a smart, secure web application, provides front line family and community workers and other practitioners across agencies with contact information to connect with one another. This allows for a more comprehensive view of a person's care, more coordinated and earlier interventions, and better relationships between the different parts of a person's service network.



Leveraging the digital age will enable governments to provide more inclusive, consumer-centric and efficient services.

OPPORTUNITIES AND CHOICES



We will have more opportunities to use powerful data analytics to deliver more efficient and effective public services.

Innovative delivery models

There are other opportunities to improve the way we deliver services and infrastructure, by firstly determining who is best placed to deliver those services and secondly, developing innovative ways to fund them.

First, citizens are placing a higher value on the quality of service they receive and are becoming less concerned about the source of service. Increasingly governments have the opportunity to shift away from a 'one size fits all' approach to delivering services, and instead evaluate who is best placed to deliver services and then design the best system for accountably meeting those needs. This may be the government, the community sector or the private sector.

For example, the Auditor General has recently recognised that franchising services on the Sydney Ferries Network has resulted in cost savings, good service performance and effective risk transfer from the government to the private sector.¹⁸

Second, other ways we can improve how we deliver services and infrastructure is by reconsidering the way we fund them through partnerships with private and non-government sectors. For example, social impact investment brings together capital and expertise from the public, private and not-for-profit sectors to tackle a range of social issues. These partnerships can generate social impact and financial return (Box 7.3).

Another innovative example is the operator-led delivery model that will be used to deliver the Northern Beaches Hospital at Frenchs Forest in Sydney. The NSW Government is partnering with Healthscope to design, build, finance, operate and maintain the new hospital for 20 years. The integrated hospital will be a state-of-the-art facility for both public and private patients, delivering innovative and efficient services to the community.

Other innovative funding strategies like asset recycling are additional opportunities that governments can use to improve the way it delivers infrastructure. Asset recycling strategies release public capital locked up in physical assets. This capital can then be reinvested in the infrastructure needed to promote long-term growth. Asset recycling eliminates the need for government to underwrite the borrowing needs of divested businesses. The State's exposure to risky commercial revenue streams is also reduced, and consumers benefit from private sector led efficiency. Asset recycling has enabled the NSW Government to implement an ambitious infrastructure agenda. It has also helped New South Wales maintain its triple A credit rating.

Box 7.3

Examples of innovative financing for services

Managing expense growth into the future will require a long-term investment approach to services, or understanding how a dollar today can change customer outcomes in the future. Today, powerful data analytics tools are enabling a better understanding of consumer costs and how these change depending on which services they access, and when in their lifetime. These data can also be used to underpin innovative, incentive and results based financing arrangements.

For example, until recently, there has been little data on the life pathways of young people leaving Out-Of-Home-Care (OOHC). To better understand the pathways of these children, the NSW Government's Office of Social Impact Investment commissioned a model of the financial and social benefits of interventions to assist young people who are or have been in OOHC. Preliminary results show that young people who leave OOHC risk poor social outcomes later in life and likely require costly government interventions later in life.

¹⁸ NSW Auditor General, 2016. Franchising of Sydney Ferries Network Services

Chart 7.1 Average cost each year for Aboriginal and Torres Strait Islander males since OOHC exit

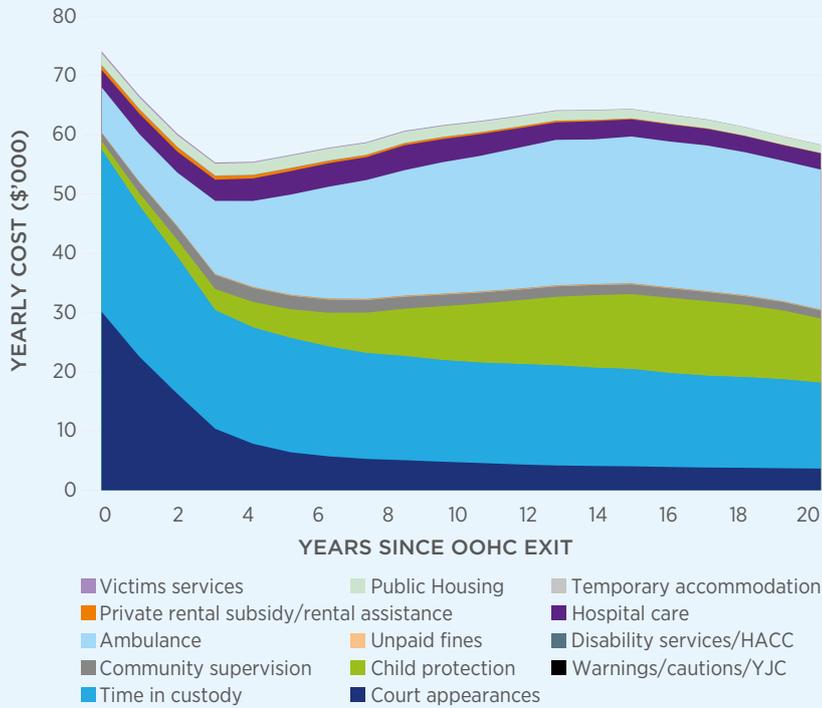
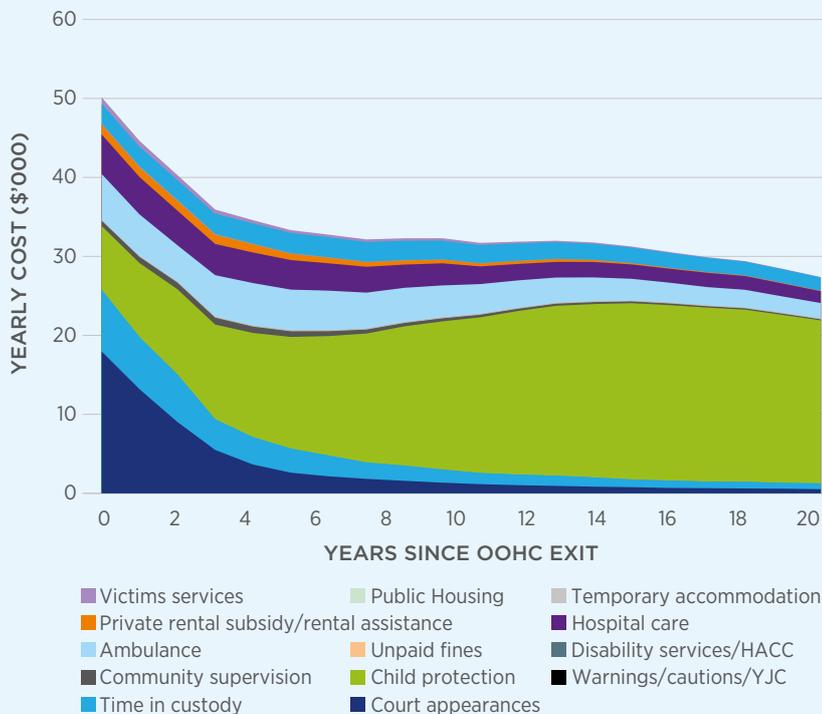


Chart 7.2 Average cost each year for Aboriginal and Torres Strait Islander females since OOHC exit



Source: NSW Treasury model commissioned from Taylor Fry based on service data received from NSW Government agencies including the Department of Family and Community Services, Bureau of Crime Statistics and Research, Ministry of Health and the Department of Finance, Services and Innovation.

OPPORTUNITIES AND CHOICES

Promoting an efficient public service means that resources are dedicated to where they are needed most.

Actuarial analysis as demonstrated above can be used to underpin innovative, 'payment by results' arrangements such as social benefit bonds (SBBs). SBBs are financial instruments that pay a return based on achieving agreed social outcomes and private investors provide up-front funding to service providers to deliver improved social outcomes. These innovative funding models are not about the government agency or service. Rather, they incentivise consumer-driven services that deliver the outcome.

An example of a recent SBB is the Newpin pilot, which funds an intensive support service delivered by UnitingCare Burnside to safely reunite children in OOHC with their families. Encouragingly, the scope to expand innovative pay-by-results funding models is large and can be applied across many government portfolios.

Improving efficiency in the public service

Promoting an efficient public service means that resources are dedicated to where they are needed most. Improving efficiency in the public service not only means that 'less can be more', but it can improve outcomes for NSW citizens and close the fiscal gap as discussed in Chapter Six.

Initiatives to streamline government agencies, like the Government's eliminating duplication project, are ways to improve efficiency across the public service.

An independent panel has been tasked to review all public sector departments and agencies, boards and committees. The intention of this reform is to streamline administration and governance arrangements and consolidate government agencies, bodies, boards and committees.

7.3 Building a sustainable revenue base

The two main revenue sources for the NSW Government are payments from the Commonwealth Government (including the GST) and state taxation. A third, currently smaller, revenue source is charges for services and property rights like mineral royalties.

The revenue New South Wales receives from the Commonwealth is our largest source of revenue comprising of the GST and funding for state managed services, the most significant of which is for hospitals.

These payments are necessary given the mismatch between the Commonwealth Government's stronger capacity to raise revenue and states and territories' responsibility for services and infrastructure. As highlighted in Chapter Five, this mismatch totalled \$89 billion for all states and territories in 2014-15. Funding decisions by the Commonwealth can significantly impact on NSW services and its long-term fiscal position.

In the absence of nationally agreed reforms like those in disability, state and territory governments are likely to remain best-placed to identify and manage the service and infrastructure needs of their citizens. Modernising Australia's federation arrangements by aligning accountability for service spending with authority for revenue raising would allow states and territories to ensure they have the funds to deliver the services and infrastructure taxpayers expect. A collective agreement on tax policy reform and expenditure responsibilities will ensure states are able to address the fiscal gap directly.

There are opportunities to consider reforms to state revenues that can enhance efficiency, fairness and financial sustainability. For example, the government has announced plans to abolish the Emergency Services Levy. The introduction of a property-based levy will provide a more fair and simple way to fund fire and emergency services, as well as improving the affordability of property insurance in New South Wales.

As a state, we have opportunities to place ourselves in a more sustainable position to manage whatever unfolds in the future. This will mean making choices about how we strengthen the economy, choices about how we deliver services and infrastructure, and choices about our revenue base.

By thinking about these choices now, we place ourselves in a strong position to ensure that for New South Wales, the future is bright.



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