

Cuts and Taxes? Improve Productivity First

The Mercury News
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March 08, 2004

While the passage of Propositions 57 and 58 is an important bipartisan victory, the hard work is just beginning, with a \$6 billion budget deficit still looming next year. Though the debate will now focus on where to cut programs or whether to raise taxes, there's an overlooked "third way" that can help close this gap: boosting government productivity, so that taxpayers get more for less.

The potential payoff from improving government performance is huge. Private sector productivity (the amount of goods or services produced per unit of input) has grown recently at roughly 3 percent per year. While government productivity is harder to measure, best estimates place its recent growth at less than 1 percent. Applied to California's budget, this productivity gap comes to at least \$2 billion a year.

How to close the gap? Productivity growth occurs when innovation (often enabled by technology) is applied by managers to the work their institution does. Competition fuels such innovation, and assures improvements across organizations.

The challenge in applying such insights to the public sector is the widespread view that much of what government does is by its nature insulated from the competition that drives productivity breakthroughs. Every business knows who their competition is, but who competes with the DMV or Caltrans?

But a deeper look shows that this view is mistaken. When you look at what government actually does, more than half of state activities turn out to have direct private sector analogs.

Take procurement. California buys over \$30 billion a year from outside vendors—everything from paper clips to gravel to drugs. Even the best-run private companies have been able to squeeze up to 10 percent out of their purchasing budget through more strategic and aggressive sourcing. California's Corrections Department spends roughly \$500 million a year on medical supplies and \$450 million a year on food.

Yet opportunities go far beyond procurement. Smarter use of information technology, for example, can both lower costs and improve the experience of citizens. In some areas such work has begun; paying your vehicle license fee on the DMV Web site is now as easy as a one-click book purchase on Amazon. But there's still vast untapped potential.

Health costs may present the largest long-term productivity opportunity, if state leaders set our collective sights high enough. Some promising experiments around the country suggest that part of the answer will involve re-jiggering regulatory incentives to give doctors, hospitals and other providers a stake in designing more cost-effective high quality care.

The new bipartisan spirit in Sacramento offers a chance to pursue these and other improvements as part of a new productivity agenda. The performance review established by Gov. Arnold Schwarzenegger is a good first step, but the effort needs teeth.

It would also help if State Controller Steve Westly were empowered to do performance audits of state departments, not just financial audits.

There will always be time for further program cuts and even tax increases to find their way into the debate. But to the extent that government productivity gains can ease the pain of the state's remaining fiscal adjustment, every Californian stands to win.

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