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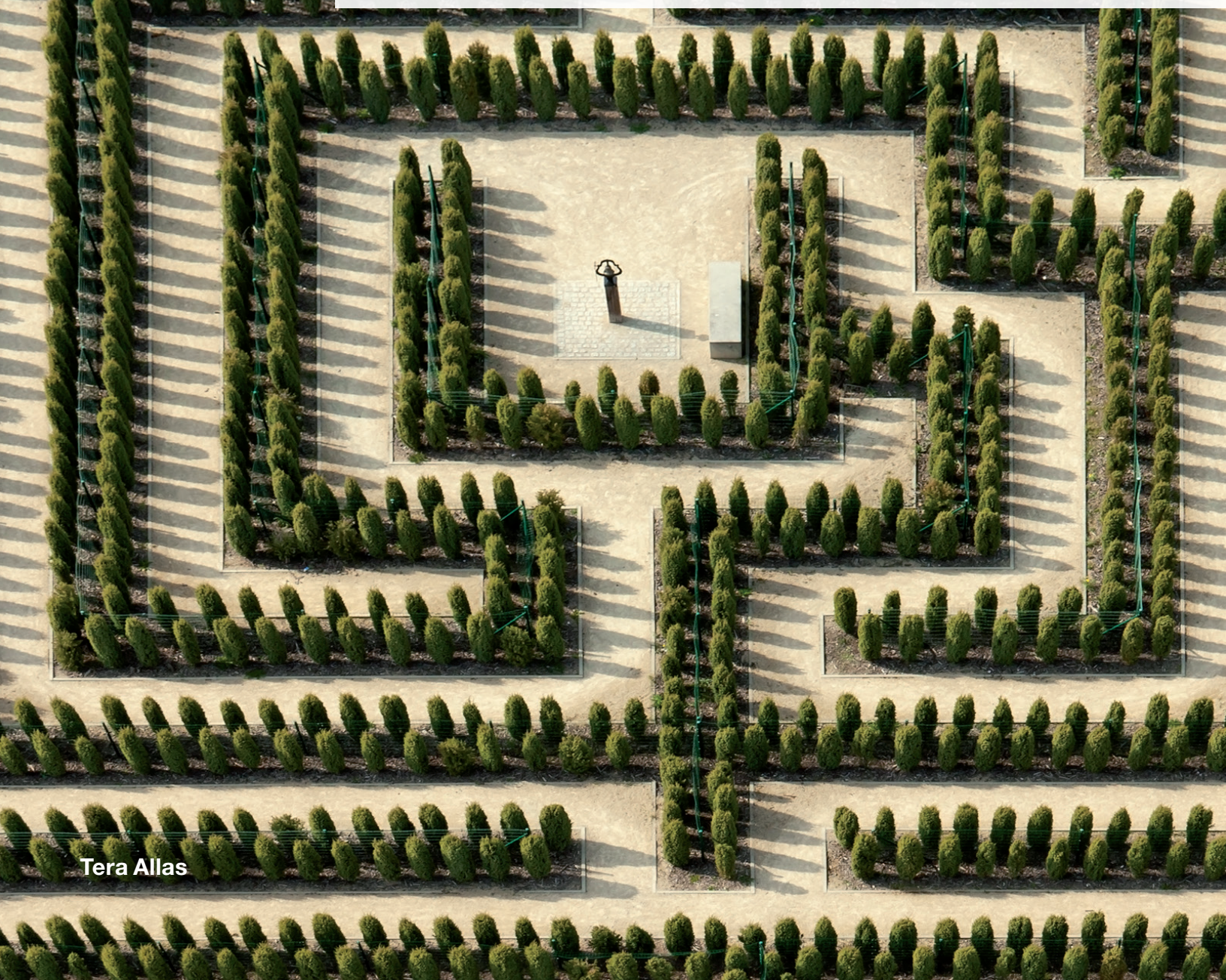


Tera Allas

# HOW THE PUBLIC SECTOR FITS IN THE PRODUCTIVITY PUZZLE

## A benchmarking study finds that governments could save $3.5 trillion a year by 2021 if they were to improve at the rate of their best peers.

Few topics in economics today generate as much debate as the productivity puzzle. In most advanced economies, productivity growth has declined sharply—from a rate of 2.1 percent per year between 1995 and 2004 to a rate of 0.8 percent per year between 2004 and 2016.

Economists have offered various explanations for this trend, including the mismeasurement of productivity in increasingly important sectors and a slowdown in technological innovation. But so far they have failed to reach a consensus.[1] It will be critical for them to do so: lower birthrates are slowing the expansion of the workforce, so about 80 percent of future economic growth will have to come from productivity improvements.[2]

As the debate continues, economists should take care not to overlook a critical piece of the puzzle: government productivity. Yes, it is challenging to accurately measure the inputs and outputs of government entities. But can we really afford to overlook a sector that accounts for 18 percent of global employment and 34 percent of global GDP? And one whose prominence has increased substantially over time?

The answer is a clear no.

The McKinsey Center for Government has developed a benchmarking tool to understand government productivity in 42 countries and seven sectors, over a period of 15 years. We've defined productivity as a measure of outcomes achieved relative to the underlying expenditure—looking, for instance, at the relationship between healthy life expectancy[3] and health expenditure per capita, or between level of skills and knowledge attained and spending per student. Given that it can be misleading to compare such metrics because of country-specific structural factors—such as demographics, geographies, and culture—we were particularly focused on understanding trajectories: Which countries improved their productivity most, and which got worse? What were the overall productivity trends?

We found that, with the exception of spending on public safety and tax collection, unit costs in government sectors have been rising faster than inflation—on average between 2 percent to 4 percent per year. In most sectors, this increase in expenditure has been associated with better outcomes, but there are exceptions. In primary and secondary education, for instance, average unit costs rose by about 2 percent and 4 percent, respectively, but average levels

[1] For more, see "New insights into the slowdown in US productivity growth," McKinsey Global Institute, March 2017, on McKinsey.com.

[2] For more, see "Can long-term global growth be saved?" McKinsey Global Institute, January 2015, on McKinsey.com.

[3] Life-expectancy figures are adjusted to factor in the quality of health throughout people's lifetimes.

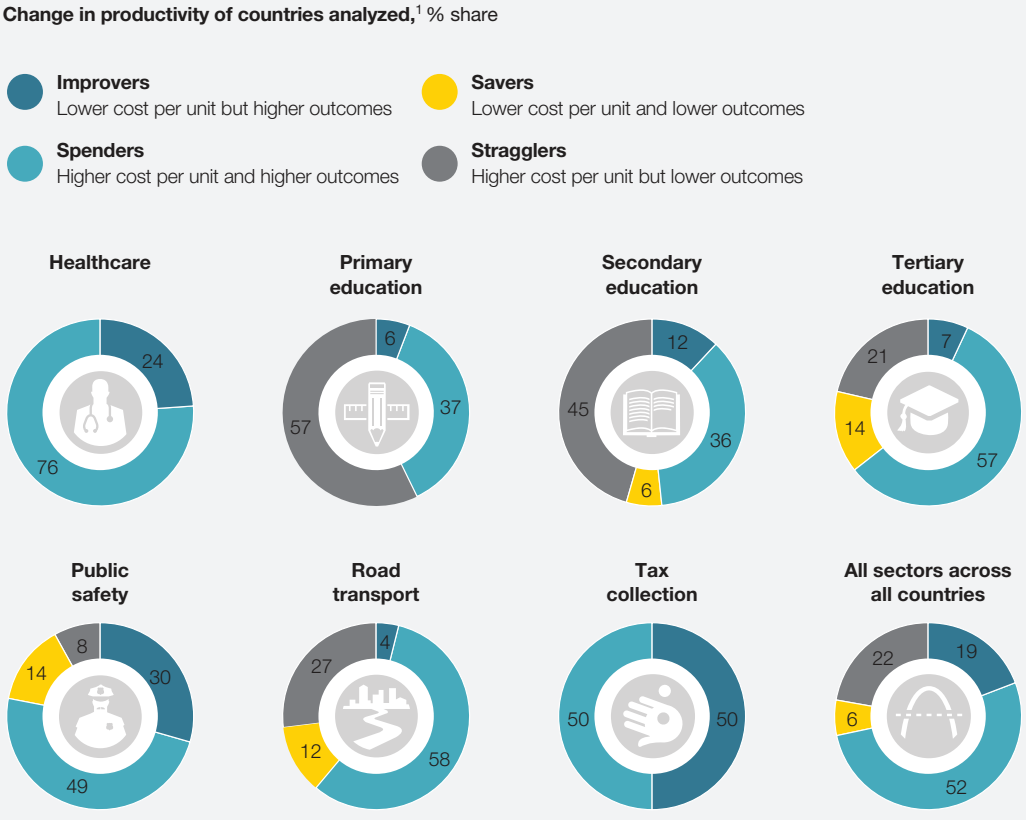
of skills and knowledge attained—as measured by the Program for International Student Assessment—fell by 0.7 percent and 0.4 percent, respectively. By any measure, this indicates deteriorating productivity.[4]

The good news is that every government sector also boasted its share of outperformers—countries that had improved outcomes while reducing expenditure or increasing it only slightly (exhibit). Our research indicates that if all countries were to increase their productivity at the rate of their most-improved peers, governments could save $3.5 trillion a year by 2021 with no negative impact on outcomes. This would be enough to close the global fiscal gap in 2021.

[4] For more on educational outcomes, see Mona Mourshed, Marc Krawitz, and Emma Dorn, "How to improve student educational outcomes: New insights from data analytics," September 2017, McKinsey.com.

Exhibit

**McKinsey Center for Government researchers identified pockets of productivity excellence in all government sectors.**




[1] Researchers looked at 42 countries and categorized them based on changes in cost per unit of output (efficiency) and outcomes (effectiveness) in each sector. Researchers looked at data for the most recent 5-year period available. When analyzing primary and secondary education, they used data within a 6-year period. Figures may not sum to 100%, because of rounding.

Source: McKinsey analysis

In many cases, aggregate figures can hide vast differences between organizations, sectors, and geographies. But our numbers reveal clear incentives for governments to share best practices and learn from others. ■

For detailed findings from the McKinsey Center for Government's productivity research, see "The opportunity in government productivity," on McKinsey.com.

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