



Shifting Gears

Paths to Fiscal Sustainability in Canada



Purpose

THIS REPORT FROM the School of Public Policy and Governance and the Mowat Centre at the University of Toronto, supported by KPMG, is a first attempt to identify how well Canadian governments are doing in returning to fiscal balance, when compared to other OECD jurisdictions. It is intended to help facilitate informed, strategic, long-term decision-making.

The School of Public Policy and Governance and the Mowat Centre have undertaken this study because of their commitment to better understanding how governments can improve their ability to deliver high-quality public services and good quality public policy, even in times of fiscal constraint.

KPMG has supported this study financially because of its commitment to help its clients understand the challenges faced by governments and to contribute to the discussion of strategies that can be used to address these issues.

The top-line recommendation emerging from this study is that the financial crisis and the return of deficit spending provide all governments with an opportunity to examine their budget decisions through a *transformative lens*. Governments should work to return to fiscal sustainability over the medium-term by focusing on those strategies that modernize policy frameworks and service delivery models.

Simple budgetary measures—such as across the board freezes on departmental hiring or spending—may be necessary in providing some help in returning to balanced budgets in the short-term but are not strategic approaches that will transform governments or ensure fiscal sustainability over the long-term.

This report was prepared with contributions from faculty and staff at the School of Public Policy & Governance and the Mowat Centre at the University of Toronto.

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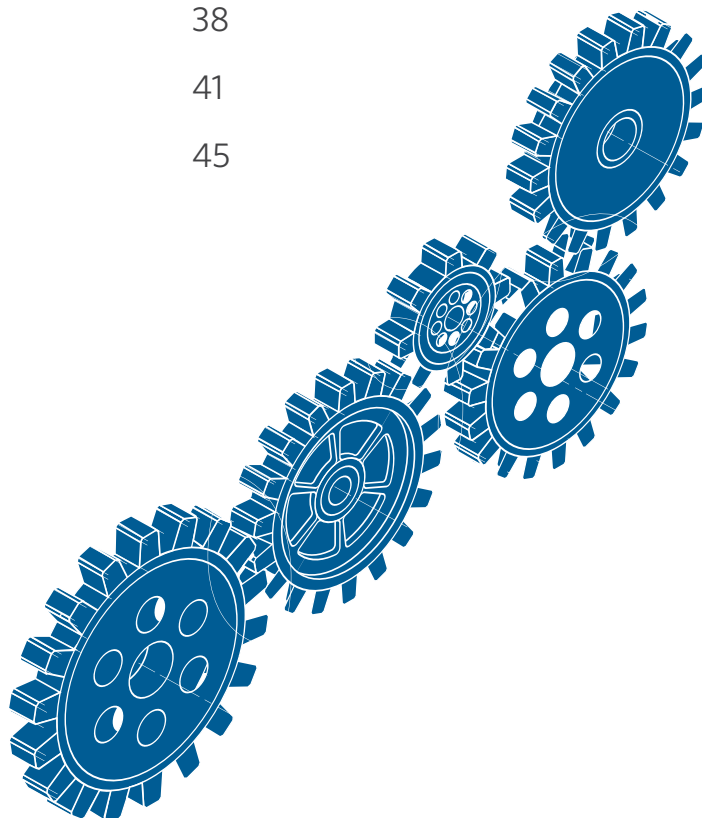
**Shifting Gears:
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Report produced by the Mowat Centre and the School of Public Policy & Governance at the University of Toronto, supported by KPMG.

ISBN 978-0-9867464-3-7

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Executive Summary

GOVERNMENTS AROUND THE WORLD face large budget deficits, some of which are structural. Addressing them will require significant fiscal and operational changes within governments.

Some countries are undertaking radical cuts to spending to return to a path of fiscal sustainability. These efforts are reducing the footprint of government and altering some of the basic social benefits that citizens have been receiving from their governments for decades.

Although Canadian governments are in the midst of stimulus spending and are posting high deficits, they do not face a short-term fiscal crisis on par with some European and US state governments.

However, the impending demographic challenges and the structural nature of deficits in most provinces will require Canadian governments to ensure that they can continue to meet public expectations with respect to programming and services while keeping these affordable.

The need to define fiscal sustainability strategies for the long-term provides Canadian governments with an opportunity to examine the choices they face through a “transformative lens,” choosing short-term investments that are likely to re-shape the way government works to ensure fiscal sustainability over the long-term.

Government actions to achieve fiscal sustainability fall into three broad categories. First, governments can increase revenue through higher taxation or user fees.

Second, governments can cut program spending, either through targeted initiatives or across-the-board restraint. Most OECD governments have embarked down the path of program cuts.

Third, governments can change how they operate and how they deliver public services. Efforts under this third umbrella include modernizing government operations through new governance relationships and new financing mechanisms, and by introducing breakthrough technologies and allowing individual citizens more control over how they access public services, with less intermediation by government institutions.

This report recommends that governments devote most of their energy to those strategies that have the greatest likelihood of contributing to long-term fiscal sustainability. Those with the greatest potential will be those where there are few institutional or administrative obstacles to change, where success can produce long-term transformation in how government works or the footprint of government, and where the fiscal pay-off is the largest. Political will and public acceptance will also be crucial.

Particularly promising initiatives include:

- **Transformative tax initiatives, such as harmonizing sales tax.**
- **Transformative policy changes, such as raising the retirement age or requiring more years of service before public sector pensions can be collected.**
- **Expanding current program reviews and undertaking “whole of system” reviews that include other levels of government and that harmonise functions across governments.**
- **Applying a more rigorous fiscal lens to ordinary policy decisions that in the past were not thought of as fiscal items.**
- **Embracing the digitisation revolution which promises to radically transform how individuals access public services.**
- **Modernizing bureaucratic processes through consolidation and delegating to others those functions which are not government’s core business of policy making, regulation and ensuring compliance.**
- **Adopting more service delivery models that rely less on direct delivery and more on new networks of government agencies, non-profit organizations, the private sector and individual citizens; improving governance, accountability and measurement of results in these areas will be crucial.**

Efforts must also include an intense focus on sectors where expenditures are large, growing rapidly and often include significant transfers to broader public sector institutions. In Canadian provinces, bringing down the rate of escalation in health budgets will be essential or it will be necessary to identify alternative funding methods, such as social insurance, to pay for them. Even within the context of Canada’s public health care model, efficiencies can be gained through changes to the incentive structures in the system, the delivery model and the use of information technologies (IT).

Efforts to ensure that Canadian governments are on a fiscally sustainable path will require from governments acknowledgement of the challenge; credible plans supported by research and fiscal analysis; sustained public communications and dialogue; experimentation, pilot projects and measurement; and the patience and follow-through to enable success, build momentum and facilitate transitions.

The path to sustainability is a societal project that necessitates dialogue across the political spectrum. This project is not an ideological attack on the state. It is about modernizing government so that it can perform its functions better and more efficiently.

The School of Public Policy & Governance and the Mowat Centre will follow progress and report back on the steps governments are taking to return to sustainability in order to facilitate policy learning and identify the most successful strategies.

- OCTOBER 15, 2010

Background

GOVERNMENTS ACROSS OECD COUNTRIES are facing deficits. For some, the deficits are cyclical, but for many, they are structural. These deficits will all be exacerbated by impending demographic challenges, including an aging population and labour shortages.

Awareness of these fiscal challenges was growing prior to the financial crisis that began in 2008, with many governments posting substantial structural deficits well before that time. The financial crisis produced further deterioration in governments' fiscal position.

Sharp cyclical decreases in tax revenue and increased expenditures in the form of automatic stabilizers—such as unemployment benefit programs—have been coupled with significant increases in discretionary fiscal stimulus spending. Government debt across OECD countries has ballooned over the past three years. Aggregated across the OECD, net financial liabilities (government debts) have grown from 38.8 percent of GDP in 2007 to 57.6 percent of GDP in 2010.

Much uncertainty remains. Both the prospects for the global economy and the appropriate policy response to economic challenges are uncertain. As Mohamed El-Erian has noted: “The world is on a journey to an unstable destination, through unfamiliar territory, on an uneven road and, critically, having already used its spare tire.”

While G-7 countries found much common ground in 2009 about how to combat the global financial crisis in its early days, there are strong disagreements in 2010 about how aggressively governments should attempt to balance their budgets.

OECD Chief Economist Pier Carlo Padoan argued in March of 2010 that governments should nurture nascent economic recovery by pulling back from stimulus spending (OECD 2010a), while others, such as Bank of Montreal Chief Economist Douglas Porter, argue that stimulus spending is still needed (CBC 2010). In reality, the urgency of returning to balanced budgets varies between jurisdictions depending on macroeconomic and fiscal conditions (IMF 2010a, p. 7).

What is clear is that the status quo is not sustainable over the long-term. At some point in the near future, governments will need to ramp down stimulus spending to address large cyclical deficits. More fundamentally, governments will need to undertake fiscal and program reforms to address the substantially larger and more troubling long-term structural deficits.



This report assesses the magnitude of the challenge confronting federal and provincial governments in Canada compared to other OECD countries. It then outlines an inventory of actions governments are taking to reduce their deficits.

This systematic description and categorization of the various approaches governments are using to return to balanced budgets allows Canadian decision-makers to better understand the range of options available to them, along with an appreciation of the costs and benefits associated with each. These actions fall into three broad categories: increasing revenues; cutting program spending; and changing how government operates, including its service delivery models. The success of these strategies will be monitored closely in coming years.

Strategies to reduce deficits are not merely accounting exercises. They play out against a backdrop of politics where governments must find a balance between the long-term need to identify fiscally sustainable spending approaches, the medium-term need to return to balanced budgets, and the short-term need to support citizens facing hardship, such as unemployment or a loss of retirement income.

CONDITIONS FOR A SUCCESSFUL RETURN TO BALANCE

Success depends on the existence of a number of pre-existing conditions, four of which are particularly important: political will, public support, institutional structures that enable governments to act, and mechanisms (such as administrative structures, fiscal levers and technological enablers) that permit changes to be driven through complex organizational, social and economic systems.





“To avoid prospects of continued high public debt accumulation in future years pushing up long-term interest rates or depressing private consumption, it is important to commit early to, and communicate, credible medium-term consolidation strategies.”

—OECD, 2009.

“What I currently find most ominous is the spread of a destructive idea: the view that now, less than a year into a weak recovery from the worst slump since World War II, is the time for policy makers to stop helping the jobless and start inflicting pain.”

—Nobel Laureate Economist Paul Krugman,
The New York Times, May 30, 2010.



Three Approaches in the Return to Balance

THE MEASURES ADOPTED across the OECD fall into three broad categories. The first includes measures to immediately raise revenues through increased taxation and traditional revenue-raising. In 2009 and 2010, many OECD governments raised taxes.

The second category encompasses spending reduction measures. These were more pervasive across the OECD, with most members introducing some form of austerity measures such as public sector wage freezes and targeted cuts in program spending. In many jurisdictions, comprehensive program reviews have been completed. In some countries, the extent of fiscal restraint is significant and is having—or will have—an enormous impact on the footprint of government and citizens' expectations.

The majority of measures undertaken to date falls into these two categories. Organizations and experts have described and assessed these efforts, and continue to do so. For example, the structural reform of government spending that was a precondition of International Monetary Fund (IMF) assistance to Greece is being closely monitored (IMF 2010b); similarly, the dramatic changes being introduced in the United Kingdom are being followed closely by the global community.

The third, alternative category targets how government operates, including how it raises funds and how it delivers public services. Efforts under this third umbrella converge around modernizing government operations through new governance relationships, new financing mechanisms, the application of breakthrough technologies, and allowing individual citizens more control over how they access public services, with less intermediation by government institutions.

The desire to “reinvent government” is nothing new. In the 1990s, David Osborne and Ted Gaebler documented the rise of entrepreneurial government. There is a vast literature on why the movement delivered less than promised by its proselytizers. However, it is expected that many governments will re-focus their efforts on identifying ways to deliver public services in a more cost-effective manner. These efforts will ideally learn from the successes and failures of the past two decades.

Chart 1 outlines the three approaches governments are taking to return toward balanced budgets and long-term fiscal sustainability. These approaches are not mutually exclusive and can be pursued simultaneously.

REINVENTING GOVERNMENT - TEN FOUNDATIONAL PRINCIPLES

In *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector*, David Osborne and Ted Gaebler identify 10 operating principles that they suggest should inform the reinvention of government. Governments should:

1. steer, not row (i.e., “it is not government’s obligation to provide services, but to see that they’re provided”)
2. empower communities to solve their own problems rather than simply deliver services
3. encourage competition rather than monopolies
4. be driven by missions, rather than rules
5. be results-oriented by funding outcomes rather than inputs
6. meet the needs of the customer, not the bureaucracy
7. concentrate on earning money rather than spending it
8. invest in preventing problems rather than curing crises
9. decentralize authority
10. solve problems by influencing market forces rather than creating public programs (London 1994)

CHART 1
LONG-TERM FISCAL SUSTAINABILITY STRATEGIES



Fiscal Overview in the OECD

DEBT IN MANY OECD countries has gone up significantly at both the national and sub-national level since 2005. Debt-to-GDP ratios are higher today than they were at other times during the previous decade in some of the world's most important economies, like the US and UK, and many smaller economies, including Portugal, Greece, and Ireland. Many smaller OECD economies have avoided this fate, including countries like Denmark, Switzerland and Sweden. Canada's debt-to-GDP ratio (which includes aggregated federal and provincial debt) remains well below 2000 levels (see Figure 1). Canada's deficits, while significant, remain on par or below its major competitors (Figure 2).

The estimates provided in Figure 2 offer a snapshot of the immediate challenges confronting industrial economies. However, they underestimate the scope of the fiscal challenge because they do not reflect future obligations associated with the modern welfare state—such as public pension obligations. According to the IMF, “On average, spending increases in health and pensions are projected at 4 to 5 percentage points of GDP in advanced economies over the next 20 years” (IMF 2010a, p. 36). The federal and provincial governments in Canada face these same challenges.

The OECD and others have highlighted the risks associated with this level of indebtedness (OECD 2010d). At the G-20 meeting in Toronto in June 2010, countries agreed to act in concert to cut their deficits in half by 2013 and to stabilize or reduce their debts as a percentage of GDP by 2016.

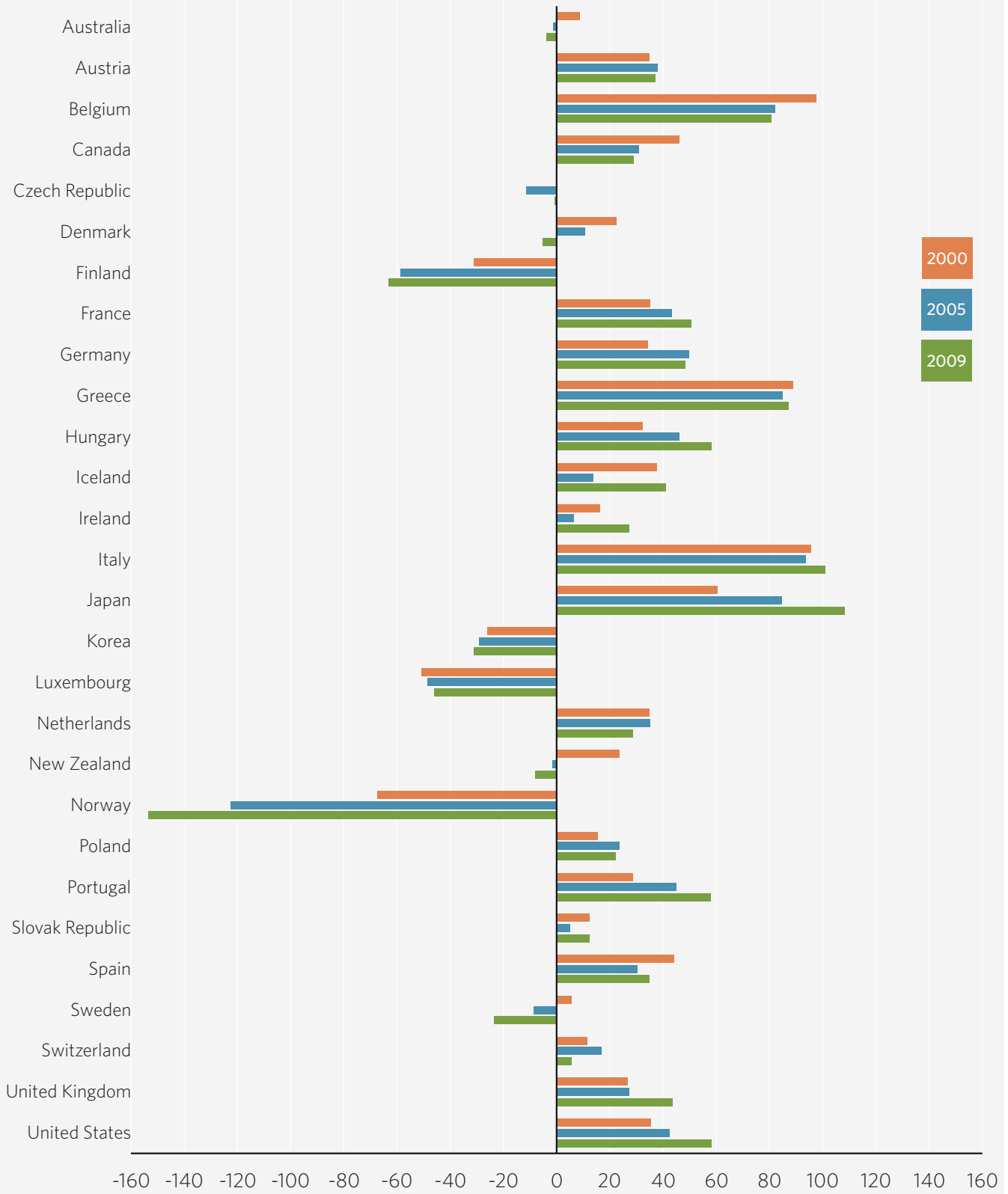
The prospect of continued high public debt could push up long-term interest rates and depress private consumption—both of which could threaten economic recovery. Risk of sovereign debt crisis in some countries would have ripple effects through the global economy and have an impact on all OECD countries. Governments must acknowledge the challenge, appreciate its severity, communicate a credible plan to return to fiscal balance and build momentum through achieving targets.

The size of fiscal adjustments varies significantly. Jurisdictions with deficits that are cyclical responses to economic downturns will have an easier time reducing debt levels than those with structural deficits (OECD 2010d). Likewise, those countries that experience more robust economic growth in coming years will be able to return to balanced budgets more quickly.

Governments must acknowledge the challenge, appreciate its severity, communicate a credible plan to return to fiscal balance and build momentum through achieving targets.

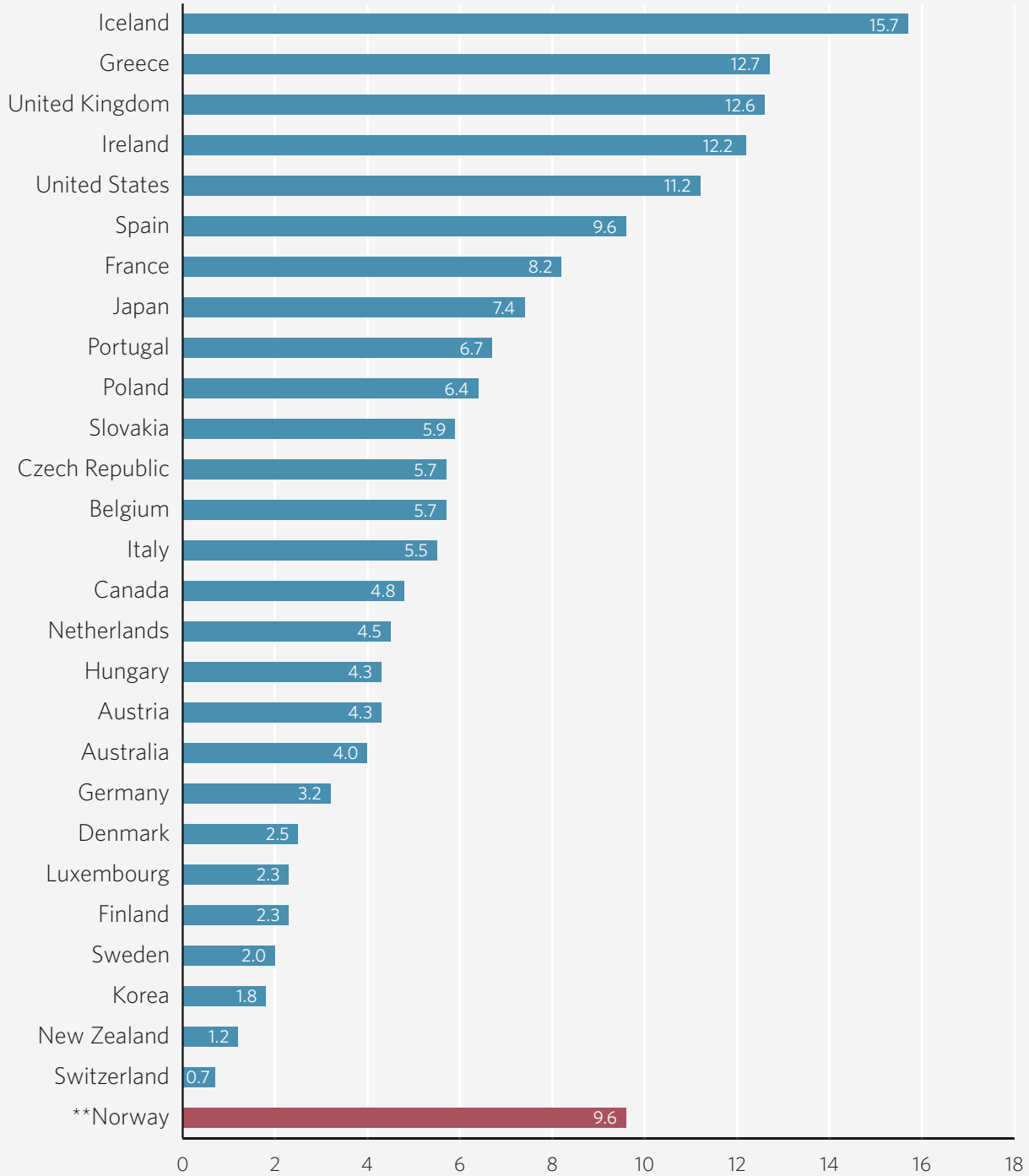


FIGURE 1
OECD JURISDICTIONS: NET DEBT AS A PER CENT OF NOMINAL GDP



Net debt includes central, state and/or local government debt as well as aggregate debt incurred by social security funds and non-market non-profit insitutions (NPI's) that are controlled and mainly financed by government. Source: OECD data.

FIGURE 2
OECD JURISDICTIONS: 2009 DEFICIT AS A PERCENTAGE OF GDP



**Norway is the only OECD jurisdiction to have a surplus as a per cent of GDP in 2009. Source: OECD data.



Where is Canada Headed?

UNLIKE SOME OF ITS OECD COUNTERPARTS, the federal government's deficit and debt situation do not require drastic measures over the short-term in the form of sharp increases in taxes or cuts to core programs. The federal government could return to balanced budgets without cutting transfers to provinces or individuals and without gutting core programs. Through a combination of spending restraint and cuts to non-core programs, the federal government could return to balance as early as 2014-2015. Markets remain confident that Canada's fiscal position is sustainable and secure.

However, the fiscal challenges facing Canadian governments are real and, given impending demographic changes, will get worse without action. Sustained measures will be required to ensure structural deficits, particularly at the provincial level, are brought under control before the demographic challenges reach their peak.

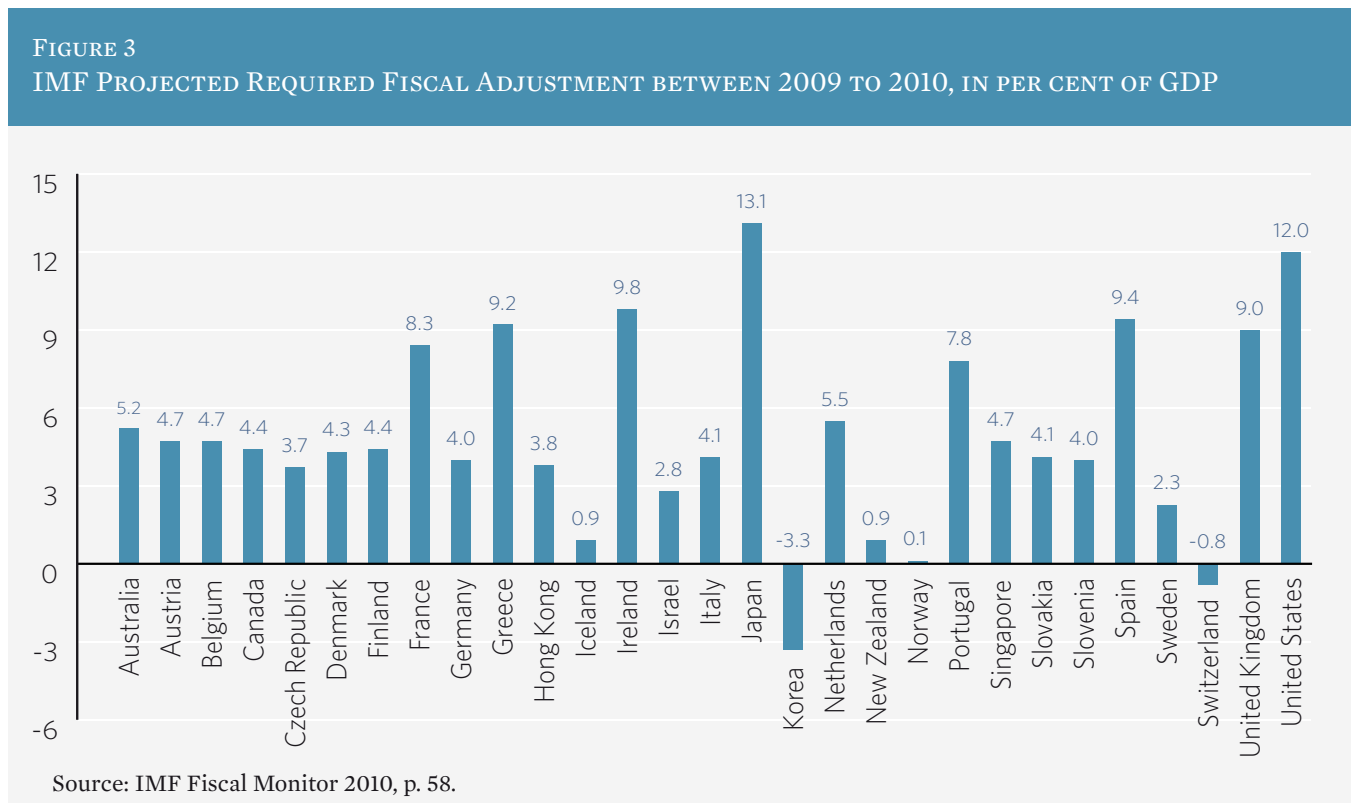
While some countries are taking drastic measures to get spiralling deficits under control, given that Canadian governments are not in a short-term crisis, they are able to make choices that advance policy objectives beyond simply reducing deficits in the short-term. Governments should apply a "transformative lens" to the choices they face, choosing those investments that are likely to transform the way government works so as to ensure fiscal sustainability over the medium-and long-term.

The IMF estimates that Canada will require a fiscal adjustment of 4.4% of GDP over the next decade to return to what the IMF describes as a prudent debt-to-GDP ratio. Although this is lower than many other OECD jurisdictions—and about half of what will be required in the UK and only one-third of what will be required in the US (see Figure 3)—it will be significant, particularly in some provinces. Although this is a somewhat smaller adjustment than Canada experienced in the mid-1990s, the growing pressure on health care budgets and lower expectations for global economic growth than in the 1990s might make the upcoming period of fiscal adjustment just as painful (Clark and Eisen 2010).

Governments should apply a "transformative lens" to the choices they face, choosing those short-term investments that are likely to transform the way government works so as to ensure fiscal sustainability over the medium and long term.

The fiscal position of the provinces varies. Canada's largest provinces, Quebec and Ontario, have larger deficits and debt-to-GDP ratios than most other provinces (see Figure 4). The extent of fiscal adjustment will be larger in these provinces. Even those provinces that find themselves in the strongest fiscal positions, such as Alberta, are now exploring how to raise more revenues and cut spending.

Cyclical deficits are tolerable. Deficits which recur on a yearly basis are not sustainable, as interest payments threaten to crowd out other public expenditures. Canada faced such a situation in the 20 years preceding the landmark 1995 federal budget—a budget which reversed two decades of deficits and set Canada on a path towards balanced budgets, debt repayment, reduced interest payments and, ultimately, a fiscal dividend which was applied to both increased program spending and tax reductions.



Canada's current debt-to-GDP ratio (which includes federal and provincial governments) is far below levels experienced during most of the past two decades (see Figure 5). The reasons for bringing down the debt in the mid-1990s included restoring international investor confidence in Canadian solvency and ensuring that Canada could withstand periodic recessions. These efforts were forward looking. Canada possessed the fiscal room over the past two years to both pursue stimulative spending and increase its debt-load in a manner viewed as relatively prudent in the context of a global economic downturn.

FIGURE 4
2009-2010 PROVINCIAL DEFICIT & DEBT LEVELS

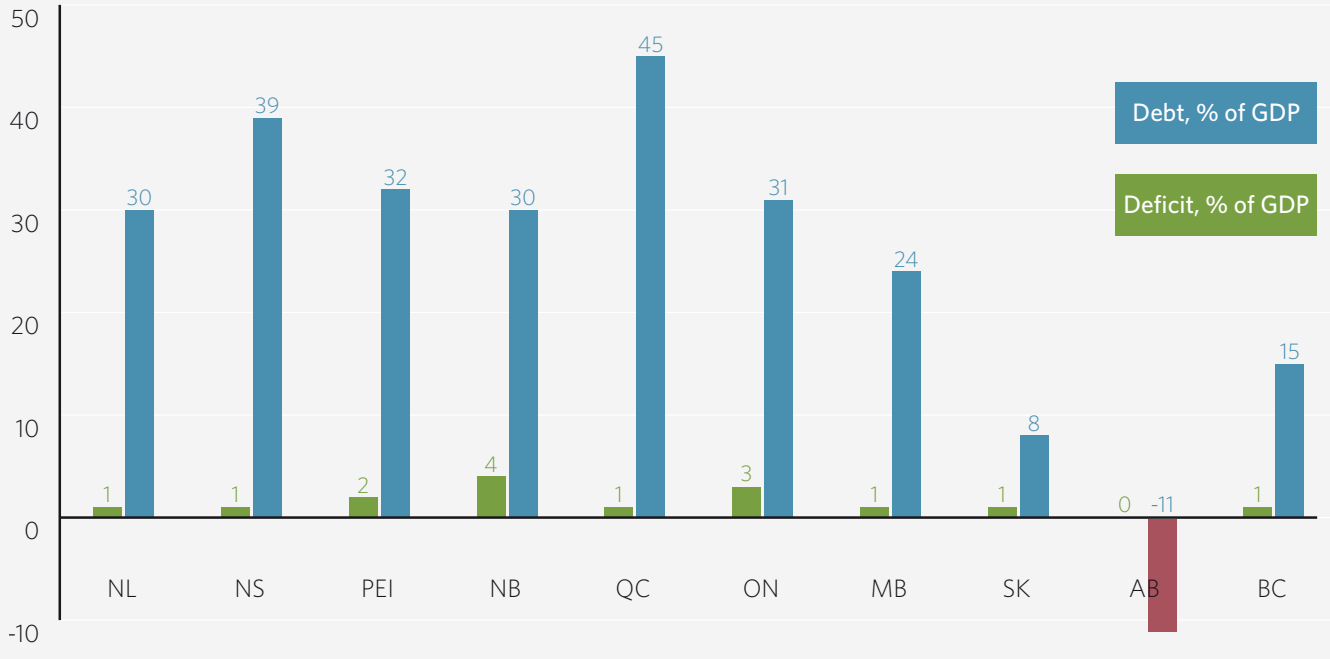
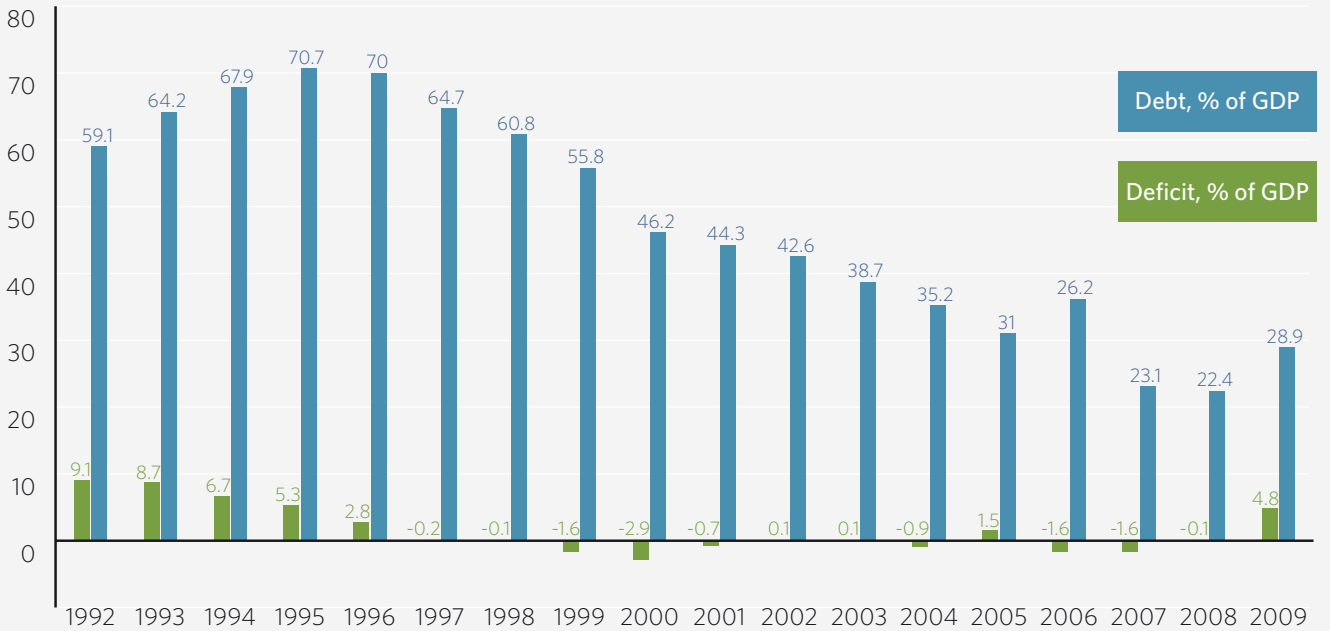
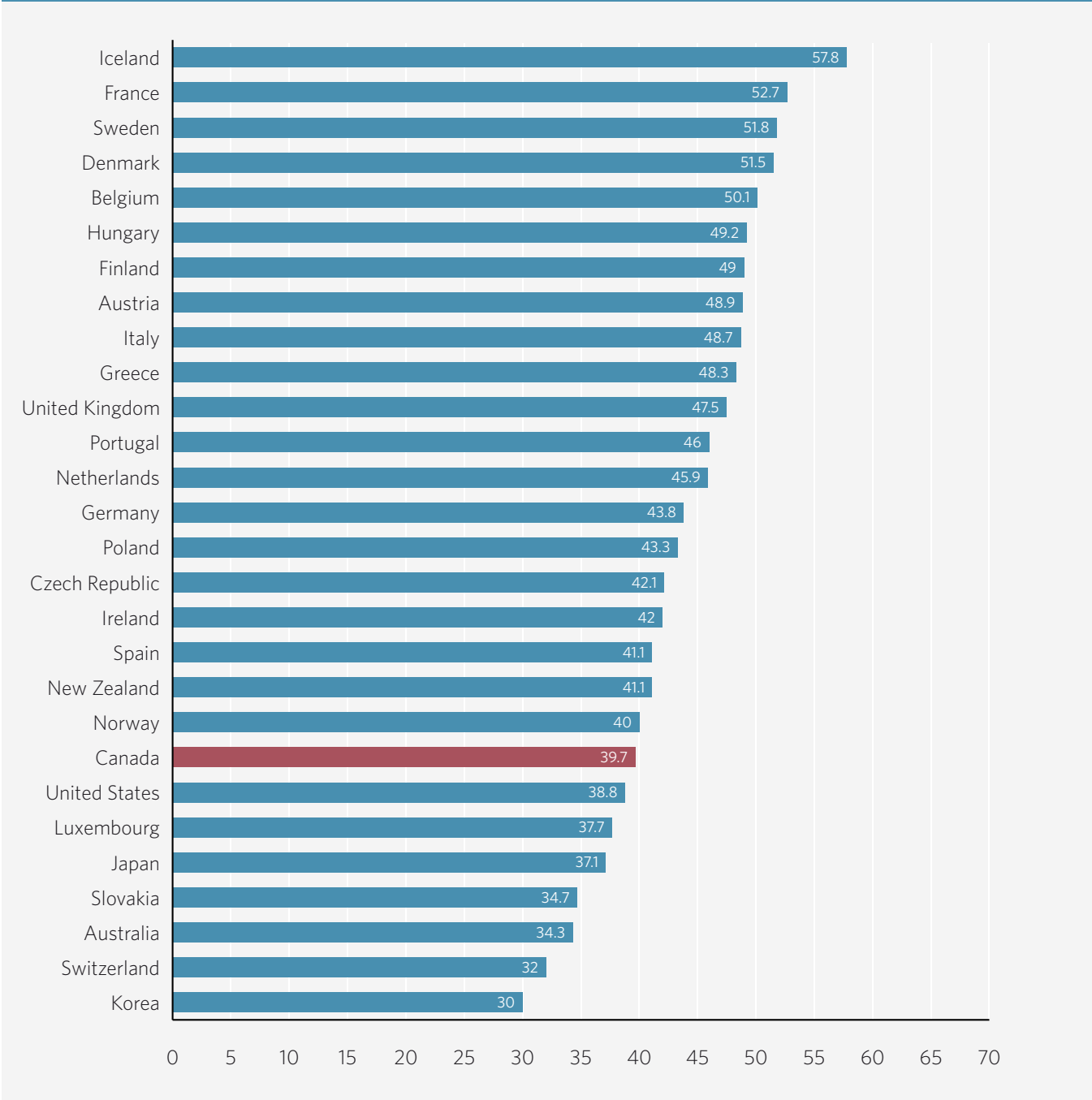


FIGURE 5
CANADA: DEFICIT & DEBT LEVELS



Canada continues to spend less of its GDP on public expenditures than most other OECD countries. This report is neutral on the appropriateness of that approach and recognizes that levels of taxation and public spending are political choices. There are very good reasons for keeping taxation and public spending low. However, the data reported in Figure 6 highlight that Canada retains the policy room to make choices about its public spending.

FIGURE 6
OECD JURISDICTIONS: GOVERNMENT EXPENDITURES AS PER CENT OF GDP (2008)



Provinces and territories are on the front lines of the demographic and fiscal challenges that Canada will face. Canada's Parliamentary Budget Officer has explicitly noted that returning to balanced budgets will be more challenging for provinces due to the pressures of health care spending than it will be for the federal government (Parliamentary Budget Officer 2010, p. 20). The structural deficits facing most provinces, combined with impending demographic pressures, will require action.

WHAT IS THE FEDERAL GOVERNMENT'S POSITION?

According to the Canadian Federal Budget tabled in 2010, "The actions taken by the Government over the last two years are working. Stimulus measures are maintaining and creating jobs and securing the economic recovery. As the economy improves, the Government will refocus its attention on its long-term economic plan. The cornerstone of this plan is a return to balanced budgets."

The federal government claims that by implementing such measures it can reduce the current deficit by almost half over the next two years to \$27.6 billion in 2011-12, and by two-thirds to \$17.5 billion in 2012-13. In 2014-15, the deficit is projected to be \$1.8 billion (Government of Canada 2010, pp. 11-12).

The Federal Government has stated that it will not raise taxes and will not cut major transfers to persons and other levels of government. However, the rate of growth in transfers to provinces could be slowed after 2014, when major federal fiscal transfers are up for renewal, and some targeted federal transfers to provinces, for example those dealing with immigrant settlement, have already been cut.



A Relentless Focus on Long-Term Transformation?

DURING THE PAST TWO YEARS governments consistently received the advice that their stimulus measures should, to the greatest extent possible, be investments in long-term prosperity. Some measures were necessary short-term steps to support people facing difficulty, such as the extension of benefits for the unemployed, but most governments tried to identify measures that represented long-term investments in future prosperity.

According to the OECD, governments have focused on improving infrastructure; supporting science, R&D, innovation and entrepreneurship; investing in human capital; and promoting transformation toward greener economies and technologies (OECD 2009, 24). These kinds of investments all make sense.

However, much as organizations recommended using the financial crisis to make transformative investments in the economy, the ongoing fiscal challenge represents an opportunity to make transformative changes to government.

Transformations to existing public service delivery, governance and funding models are being considered by those across the political spectrum. The approach is not about shrinking the role of the state but about finding ways to deliver public services of equal quality with fewer resources. The challenge for those on the left is “to be as zealous in reforming government...as in bringing new discipline to the operation of global markets” (Diamond and Liddle 2010). Putting governments on a fiscally sustainable path is a societal project that will need to be embraced by analysts across the political spectrum.

Investments that transform the economy inevitably have up-front costs. For example, countries that are investing in broadband strategies or tax credits to retrofit buildings expect that these short-term investments will pay off in the long-term in the form of economic growth or reduced energy consumption. The same is true of transforming government. Investing in the consolidation of IT across service delivery platforms adds new expenditure today but is crucial to help transform the way government delivers services so that they are more cost-effective in the long-term.

The current long-term fiscal challenges in many OECD countries demand that governments take a relentless and sustained approach to transforming the delivery of public services. Canadian provinces and Australian states are often cited as leaders in transforming the business model of service delivery, but even more progress must be made.

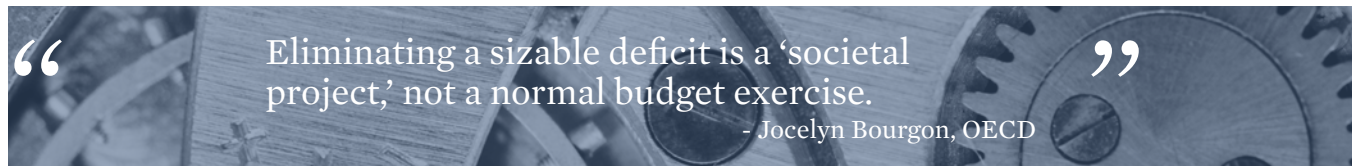
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The Path Toward Sustainability

RETURNING TO BALANCED BUDGETS requires significant budgetary adjustments in many countries. This section provides a summary of measures being undertaken or considered in OECD countries.

The majority of OECD jurisdictions are implementing tax increases, spending cuts or a combination of both. Fiscal adjustment strategies tend to be more focused on reducing expenditures, given the high pre-existing tax burdens in many countries (IMF 2010a).

In Canada, which is not facing a short-term crisis, a transformative lens should be applied to the major decisions being taken to achieve long-term fiscal sustainability. Returning to budgetary balance in the short-term is important, but should be only one consideration; long-term transformation in how government operates should be another.



Strategy One: Increase Taxes

MANY GOVERNMENTS HAVE BEEN cautious about raising taxes to narrow budgetary shortfalls in the midst of a severe economic downturn, although some have embarked on this path. This involves a range of measures including raising rates on income and sales taxes. The UK is raising its VAT to 20%. Many jurisdictions, including many US states, are making particular efforts on excise taxes, including higher and new rates on alcohol, soft drinks and tobacco (Rampell 2010). Others are looking to extract more revenue from natural resource royalties.

Canada is no different. For example, the Saskatchewan government has opted to raise taxes on cigarettes and alcohol, while Nova Scotia announced in its 2010 Budget that its HST rate will increase to 15%. But these are business-as-usual efforts to reduce deficits. Governments are also looking at other ways to increase their revenues.

Many governments are adding or increasing user fees. In Ontario, for example, the government has introduced time-of-use pricing to reflect the higher cost of electricity production during peak-use periods, which will likely generate increased government revenue. Some countries are adding fees that make the traditional offerings of the welfare state less accessible. Hungary and Sweden, for example, have introduced limited university tuition. In many jurisdictions, public services—from school books to visits to national parks to garbage collection—that were once free are now coming with a price-tag.

Governments are also using more full-cost-recovery models to fund public services. Unlike user fees, which charge a nominal fee for visiting a physician or picking up a bag of trash, full-cost-recovery models estimate the true cost of providing a public service—such as the disposal of hazardous waste—and re-coup those costs through fees. Some jurisdictions are moving away from subsidized electricity and introducing true-cost pricing in the sector, including Ontario, while others, like Manitoba and Quebec, continue to subsidize their rates.

Exploring improved ways of ensuring tax compliance is one way governments can increase tax revenues without major changes to taxation levels. Canada has pursued various compliance strategies in the past, including advertising campaigns to discourage tax avoidance, a 6-month amnesty to pay back taxes without fear of prosecution, and policy and legislative changes to make it more difficult for Canadians to hide money overseas.

Other countries are also moving on this front through improved investigations, legislation and investments in technology. President Obama launched a new initiative aimed at thwarting tax evasion, while the Nordic countries have continued their efforts to curb tax evasion through financial data sharing agreements with “tax haven” countries (Norden 2010).

A renewed effort by the international community concerning offshore accounts and tax avoidance will likely be politically attractive during a time of fiscal adjustment. These techniques need to be measured carefully to ensure that they are producing results, although there are good policy reasons—such as equity amongst citizens and the credibility of the tax system—to invest in better compliance even if these initiatives fail to produce huge savings.

Applying a transformative lens to tax policy asks how governments can efficiently and equitably raise revenue over the long-term. Governments in Canada have been pursuing some of these efforts. The purpose of this report is not to recommend any one of these strategies but to highlight that debates about how to raise revenues at a time of budgetary shortfalls should look beyond easy short-term increases in marginal tax rates or excise taxes on easy targets. Governments should look at their revenue raising

AUSTRALIA'S MINERALS RESOURCE RENT TAX (MRRT)

Beginning in July 2012, a new Minerals Resource Rent Tax (MRRT) will apply to the mining of iron ore and coal in Australia, and the current Petroleum Resource Rent Tax (PRRT) regime will be extended to all Australian onshore and offshore oil and gas projects.

tools and ask whether there are better ways to generate revenue while promoting prosperity, achieving social purposes and ensuring fiscal sustainability.

The move away from a sales tax to a value added tax in most provinces is an important step forward in strengthening the Canadian economy and contributing to long-term fiscal sustainability. The recent decisions by Ontario and BC were undertaken in part to ensure long-term economic prosperity and the fiscal sustainability that comes with it.

Other issues are now being debated in many jurisdictions. A carbon tax would be a major initiative that, if done properly, could strengthen the Canadian economy and transform how the government raises revenues. Most countries have inheritance taxes, while Canada does not, which could arise as an issue for public consideration given the impending unprecedented inter-generational wealth transfer that is beginning to occur. In addition, the IMF has noted that raising the tax rate on the very highest of earners should be considered (in Canada, the top marginal federal rate begins at \$127,022), particularly if coordinated internationally to reduce the incentive to change country of residence.

The more widespread adoption in Canada of a social insurance approach for funding some social benefits could be considered. Under these regimes, citizens, and often employers, are obliged to make contributions to fund specific benefits. Some social benefits are primarily paid for through these targeted accounts funded by individual contributions, rather than through general revenues. Examples include health insurance in Germany and the Canada Pension Plan and US Social Security system.

There tends to be greater public support for social insurance than taxes because of the closer link between the financing mechanisms and the benefits received (Mossialos and Dixon 2002). Canada's Employment Insurance system could be re-designed as a true social insurance program to protect people from employment related loss of income; the federal government or provinces could use a social insurance model to fund prescription drugs or long-term care benefits.

Consideration could be given to tax swaps, whereby the federal and provincial governments agree to vacate some tax areas in return for others. The most promising would be for provinces to vacate the area of corporate taxation and cede it entirely to the federal government in exchange for a greater share of income tax or GST. The volatility of the corporate tax base, coupled with the greater diversification of the national compared to the provincial economies, suggests that the federal government may be better situated to occupy the corporate tax field, leaving a more stable and less mobile tax base—such as the GST—to the provinces, given the greater fiscal pressure they are expected to be under in coming years.



Strategy Two: Decrease Spending

IN ADDITION TO FINDING new revenues, most OECD jurisdictions have developed plans to reduce their spending. The extent and magnitude of these reductions varies between countries based on capacity and need, but in some jurisdictions the impacts are enormous. The UK has undertaken a significant cost-cutting exercise, while Greece has had significant austerity measures forced upon it by the international community. In many US states, budgets are severely strained and public servants are being forced to take unpaid leaves of absence.

Some jurisdictions have undertaken immediate across-the-board cuts, applied to all or virtually all government departments. These can be an important signal to the public, the international community and to the public service itself that the government is serious in its intention to reduce spending. This course can be a relatively simple short-term response, forcing executives across departments to find savings from within their own budgets. The approach is a blunt one and does not strategically assess what government does or how. Germany, Ireland and others have been following this path.

Before a government determines which of the approaches outlined in Chart 1 to pursue, a threshold question must be addressed: is the government trying to find savings in order to do the same with less—or is it prepared to stop doing certain things? If the government is not prepared to reduce its footprint in the short-term, there is no way to get around the need to reduce the cost of wages and benefits. In the UK, the government has announced its intention both to stop doing some things, while also finding ways to spend less on those things that it continues to do.

There are real political and labour relations challenges to delivering the same services with fewer people who are paid less money, but it is a credible strategy for reducing government expenditures without significantly affecting public services. Whether in the form of salary freezes or shrinking the size of the public service through attrition and vacancy management, public sector expenses can be brought down significantly over time through constraints on salaries, wages and the number of employees. For example, Spain has announced pay cuts of about 5 percent for civil servants. In Canada, Ontario is attempting to freeze wages in the public and broader public sector, while Saskatchewan is targeting a reduction in the size of its government by 15% over 4 years.

Any serious effort to bring down the cost curve of government over the long-term must confront the costs of labour in the broad public sector.

Bringing down the cost of wages and benefits in the broad public sector may be good public policy because it furthers equity objectives. Employment in the public sector was historically more secure but less well-remunerated than the private sector. Today, while it remains more secure, it now tends to be better remunerated as well, with better benefits. Any serious effort to bring down the cost curve of government over the long-term must confront the costs of labour in the broad public sector and the associated equity issues.

If government chooses to reduce its footprint, program review and policy audits can be undertaken. These processes ask questions not often posed in normal budgetary times: Should government be engaged in this activity? Is this policy accomplishing what we want? How do we know? Are there other programs across government that are duplicative? To answer these questions requires significant resources and focus, above and beyond ordinary cost-reduction efforts.

Program reviews that identify programs where government may no longer have a legitimate interest can deliver real savings without affecting core public services. Governments are much better at beginning new programs than assessing them and eliminating those that are not delivering results. Periodic program reviews are healthy for governments; current deficit levels make such reviews a matter of urgency.

Program reviews look to reduce the footprint of government by identifying those programs that are not fulfilling a vital public purpose; more detailed policy audits examine whether existing programs are the best approach to address a given problem. Policy audits accept that a given program is directed toward a public good in which government has a legitimate interest, but they assess whether the policy instrument being used is the most effective one and whether there are alternatives that could be as effective at lower cost.

Some jurisdictions, most notably the UK, have undertaken program reviews based on the 1994 Canadian experience, which is held up as a model. In Canada, the success of program review remains contested.

While the federal government did eliminate its structural deficit, critics point to the fact that this elimination occurred largely due to surging revenues from the GST, substantial corporate tax revenues during a period of economic growth, and significant cuts in fis-

Program reviews and policy audits require significant resources and focus, above and beyond ordinary cost-reduction efforts.

cal transfers to provinces, which increased provincial debt loads. Despite a reduction in the size of the federal public service by approximately 45,000 employees, this reduction was soon erased and the size of the federal government quickly returned to pre-program review levels. A program review, to be judged a true success, must sustain reductions in program spending over the long-term, without unilaterally cutting transfers to sub-national governments.

If undertaken properly, these activities are more than cost-cutting exercises: they are opportunities to experiment with less expensive ways of achieving desired policy outcomes by aligning societal values, policy instruments and objectives. When properly conducted, they can rejuvenate the public service by eliminating unsuccessful programs and strengthening effective ones.

Broad policy reviews and audits can be coupled with targeted efforts that pay particular attention to spending in major, sprawling departments. In Germany and the UK, these reviews are taking place in departments of education. In the US, they would have to include military spending, where almost \$700 billion is expected to be spent in 2014-2015.

For Canadian provinces, concerted effort to reduce the escalation of the cost curve in health care spending will be imperative. Given the many realistic administrative, policy and technological reforms that have been proposed in the health sector, significant savings are possible. Governments need only to summon the political will.

Governments are likely to explore transformative policy changes to reduce their spending. This could include a serious discussion in Canada about raising the retirement age and requiring more years of service before collecting pensions in the public sector.

Many of Canada's programs have incentive structures that encourage Canadians to retire early rather than work longer. These rules may have been appropriate in the 1960s when life expectancy was lower and there was a surplus of labour, but they are not appropriate as life expectancy rises and Canada experiences labour shortages. The US and many EU countries have been moving in this direction, increasing the size of one's retirement benefit if one delays retirement. The move to raise the retirement age in France is provoking significant social unrest.

Jurisdictions are re-considering old policy debates through the lens of long-term fiscal sustainability. From California's renewed debate over the legalization of some recreational drugs—which could then be subject to taxation—to the legalization of on-line gambling in some Canadian provinces, public policy issues are being reframed in the context of fiscal challenges.



In the decision-making process, governments may be forced to consider more seriously the fiscal implications of non-fiscal policy changes. For example, in Canada, the Parliamentary Budget Officer has estimated that the federal government's crime bill will add approximately \$618 million annually in operational costs—and another \$1.8 billion over five years in construction costs—to federal and provincial budgets. That is not a reason to withdraw the bill but it is likely that many governments across the OECD will place increased fiscal scrutiny on policy decisions that may have been assessed in the past without serious attention to their fiscal implications. This will require the application of more rigorous fiscal analysis in some policy areas.

Missouri has taken these considerations even further by becoming the first US state to systematically provide sentencing judges with cost estimates of what various incarcerations will cost the State in a bid to encourage judges to think about costs among their sentencing considerations.

A FOCUS ON HEALTH CARE IS ESSENTIAL

According to IMF projections, health care spending in advanced economies is projected to rise by 3.5 percent of GDP in 2010–30 due to population aging and technology-induced cost pressures (IMF 2010a, 44). Reducing expenditures and stabilizing costs in this category will be one of the key challenges in implementing a fiscal adjustment strategy.

Reducing health care expenditures may require a combination of supply-side incentives (including global budgeting), financial incentives for reaching targets, case-based compensation rather than fee for service, and the evaluation of the cost-effectiveness of new treatments, drugs and technologies. It may also require demand-side measures, including user fees in many countries. In Canada, it will require a re-examination of how health care is delivered, with a view to changing the incentive and compensation structure so that the same quality service can be provided less expensively.

Containing costs in the health care sector should include the relentless introduction of technologies to change how care is delivered. For example, many countries allow patients to book appointments with physicians via e-mail or re-fill prescriptions online. There is no reason why many health care services cannot be provided remotely and virtually, except opposition from some stakeholders. Canadian provinces are laggards in terms of pursuing and implementing such initiatives.

A Complementary Path: Changing How Government Operates & Delivers its Services

THE TWO STRATEGIES DISCUSSED above can be thought of as traditional approaches to fiscal adjustment. In some countries, they are being undertaken in ambitious ways and have had a real impact on the public service and the social benefits that citizens will receive. Program review and policy changes are being undertaken in many jurisdictions with an eye toward shrinking the footprint of government.

But governments are also exploring more innovative ways to decrease public spending and achieve fiscal balance without citizens experiencing a decline in the quality of core public services.

It would be unfortunate if governments emerged from this period of fiscal adjustment unchanged—except that they do a little bit less, with slightly fewer staff. Governments should look at their need to reduce spending as an opportunity to capitalize on new technologies, governance models and financing mechanisms that can help re-shape government.

These approaches can be grouped into five categories: *modernizing bureaucratic processes, reassigning roles and responsibilities between governments, moving toward the digitisation of governance, devolution, and alternative financing models* (see Chart 2). All focus on enabling the capabilities of others to deliver services or perform functions traditionally performed by government. In the process, all look to change the business model of how government delivers public services.

This third strategy, when combined with the first two, could foreshadow a different relationship between government and citizens. Government's footprint would likely shrink and government programs could be delivered less expensively, but advocates of this approach contend that citizens will not experience a decline in the quality of their

public services and might acquire greater capacity to shape their interactions with government, with fewer institutional intermediaries.

Governments have experimented with these strategies over the past two decades. Some of these approaches fell under the umbrella of New Public Management, a movement which most observers acknowledge has had only a marginal impact on the overall effectiveness of government. A full review of these earlier experiments can be found elsewhere (see, for example, Dunleavy et al 2005).

The efforts underway today are different. There is new fiscal urgency, better understanding based on learning from earlier projects, more sophisticated appreciation of networked governance models, increased citizen capacity and expectations, an appreciation of the benefits of less intermediation between citizens and institutions, a readiness to experiment and measure the success of demonstration projects, and new technologies that can facilitate change. These new initiatives in public service reform represent different tools for different fiscal realities.

Table 1 highlights the major obstacles and conditions for success for modernizing public service delivery models. Table 2 synthesizes where governments have experimented in the past and where they are trying to get to. The descriptions are not intended to be exhaustive. They sketch out emerging attempts to design new public service delivery and financing models.

CHART 2
NEW PUBLIC SERVICE DELIVERY MODELS



TABLE 1
OBSTACLES AND CONDITIONS FOR SUCCESS FOR NEW PUBLIC SERVICE DELIVERY MODELS

OBSTACLES	CONDITIONS FOR SUCCESS
Stakeholder opposition	Early stakeholder buy-in and recognition of benefits
Public misunderstanding	Political will, citizen engagement processes, invisible nature of changes and demonstration pilot projects
Bureaucratic resistance and risk avoidance	Bureaucratic licence and empowerment
Bureaucratic values such as stability Inertia and policy legacies	Disruptive technologies or circumstances, particularly those that empower individuals and their ability to make choices
Lack of ability to undertake detailed business cases	Technical, financial and expert advice and support
Administrative, legal, intergovernmental complexity	Eliminating pre-existing regulatory and legislative hurdles
Long-term nature of benefits	Short-term interim initiatives to build momentum and public/political understanding
Government concern about fiduciary responsibilities	Workable governance structures and enforceable agreements to protect the public interest
Government concern about loss of control	Government appreciation of capacity to structure processes and the new power this delivers

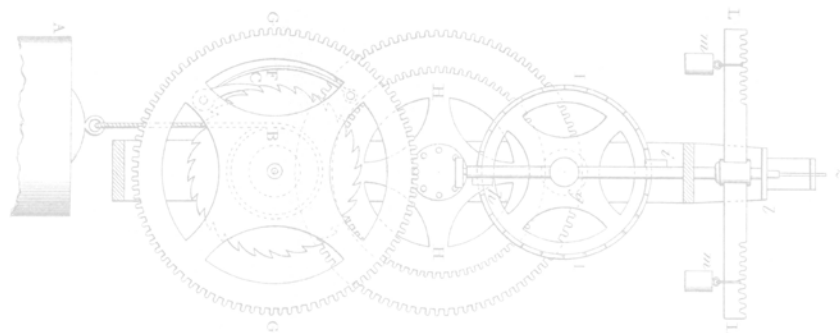
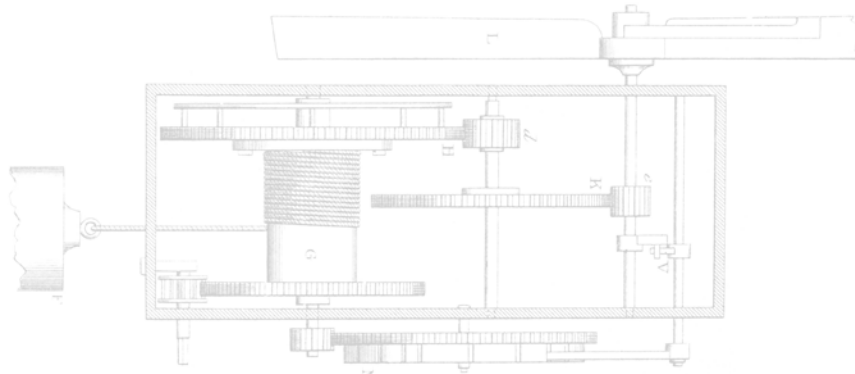


TABLE 2
OLD VERSUS NEW APPROACHES

1990s	2010
New Public Management	Incentives, consolidation, some competition, specialization
Ad hoc look at who does what	Whole-of-system program review
Large IT projects, behind firewalls	Enabling better use of collaboration technologies and open-book government to facilitate digital era governance and individual choices with fewer institutional intermediaries
Downloading and outsourcing	Using social innovators, communities, citizens and private sector—enabled by technology—to deliver public goods more responsively, but with more effective accountability relationships, governance models and performance measurement
First wave of Public Private Partnerships	Second wave—risk transfer to private sector along with cost certainty
Privatization	Monetizing assets while keeping them in public hands



Modernizing Bureaucratic Processes

PUBLIC SECTOR BUREAUCRACIES are hierarchical organizations guided by values such as stability, accountability and risk management. Governments will need to find ways to preserve these values while integrating new technologies, responding to evolving societal expectations of public institutions and offering services in terms defined by users rather than institutions.

The adoption of a single-window approach to some services has been a successful step in the modernization process. Consolidating departmental services holds the promise of realizing economies of scale, while also simplifying the relationship between the provider of services and the user. This is happening horizontally across government departments, where citizens are accessing service at “one-stop shops”, in person and virtually. Service Ontario is viewed as a world leader and the UK has proposed a similar vision of integrated services (Varney 2006).

These consolidations are also happening vertically, across governments. Service Ontario and Service Canada have a collaboration agreement in place to co-locate some service providers. Likewise, Employment Ontario, which has now consolidated a variety of disparate federal and provincial programs into one coherent offering of training services for the unemployed, has continued the trend in Ontario toward client-facing consolidation.

A more recent development has been experimentation with consolidated approaches to the delivery of human services such as health and social services. Australia’s CentreLink works to help people in need become financially self-sufficient through the consolidation of many existing programs delivered by a range of departments. These approaches look at government services from the perspective of the end-user and make a commitment to seamlessness in moving between services offered by different departments and different governments (The Kennedy School, <http://www.innovations.harvard.edu>).

These client-facing consolidations improve the experience for those who use public services. Back-office consolidations, on the other hand, improve operational performance by eliminating fragmentation and duplication among processes invisible to the citizen, such as human resources, IT, procurement, information sharing and the use of physical infrastructure. Significant reforms are underway in many jurisdictions to radically squeeze the cost of these functions (see, for example, Gershon 2004). This includes

Consolidating departmental services holds the promise of realizing economies of scale, while also simplifying the relationship between the provider of services and the user.

better supply chain management and improved real estate management. These efforts will need to be deepened, given, for example, the number of government real estate holdings in Canada that continue to sit vacant or under-used.

Some governments are centralizing some functions that are highly specialized, such as IT procurement, as a response to duplicative processes in different departments. New Zealand has outsourced some of its contract-drafting to private sector lawyers rather than having lawyers in dozens of ministries responsible for occasional contract drafting. Focusing on core business in departments, along with identifying the best places for specialized tasks to be performed, will be part of strategies designed to ensure long-term fiscal sustainability.

Successful reform efforts from the last two decades can be deepened. These include those initiatives that alter incentive structures, including the use of outcomes-based performance data to drive results, with the use of computerized crime mapping in New York being a forerunner of this practice. The UK has been a leader in providing budgetary incentives to higher performing organizations or delivery units. Many organizations have had success with more rigorous approaches to HR, including better assessment of individual and cross-departmental performance management (Dean 2009).



Reassignment of Roles & Responsibilities Between Governments

CANADA'S DIVISION OF POWERS between the federal and provincial/territorial governments—and municipalities—does not maximize efficiency or effectiveness. Its 19th Constitution was not designed for the realities of 21st century technology and citizens' expectations. Reassigning some roles and responsibilities between governments—and encouraging governments to get out of each other's policy space—may produce fiscal savings (Mendelsohn et al, 2010).

Eliminating entanglement can deliver administrative efficiencies and cost savings. It can also enhance democracy by ensuring that one government is accountable to the electorate for particular policy domains. When one government is accountable, it can make the necessary hard trade-offs, as well as seek out and implement innovative policy approaches without needing the consent of other governments. As federations prepare to deal with medium-term fiscal challenges, a new distribution of responsibilities between central and sub-national governments may be required.

In some instances, uploading responsibilities to national governments can help eliminate policy and program fragmentation and enable the realization of significant economies of scale. In other cases, devolution will produce savings because program delivery can be handled more efficiently by sub-national and local governments that can better tailor services to local conditions.

WHOLE-OF-SYSTEM REVIEW

Many governments in federations have undertaken program reviews to seek out administrative efficiencies. These have been restricted to analyzing the programs offered by one government. None, to our knowledge, have applied a more ambitious, transformative lens to their program reviews by including more than one government. Current program reviews are not looking at the wide range of activities where more than one order of government is active and policy space is shared. The potential savings, improved service delivery and enhanced accountability from clarifying who does what in Canada are considerable.

CORPORATE TAX COLLECTION

In 2006 the Governments of Canada and Ontario signed an agreement that established one set of rules and one point of contact for corporate income tax collection. Under the agreement, the federal government collects and administers Ontario's corporate income tax, and businesses file a single tax return.

The agreement reduces compliance costs for businesses—with projected savings of up to \$100 million in annual compliance costs for Ontario businesses—and enables the Canada Revenue Agency (CRA) to streamline service and reduce administrative costs (Department of Finance Canada, 2006).

PHARMACEUTICAL PROCUREMENT

Canada's Premiers recently announced that they have agreed to establish a pan-Canadian purchasing alliance to consolidate public procurement of common drugs and medical supplies and equipment, where appropriate. By capitalizing on their combined buying power, provinces and territories will achieve economies of scale and cost. This is just the tip of the iceberg. Similar savings could be realized in procurement in other areas.

A *vertical* program review examines those areas where federal and sub-national governments both occupy the same policy space. Both would collaborate to find fiscal savings through the elimination of unnecessary duplication. An *interprovincial* program review would bring sub-national governments together in a systematic way to see whether there are activities that they currently undertake separately that could be just as effectively undertaken collaboratively or by one or several provinces acting on behalf of all.

For example, provinces are responsible for rating movies, but some smaller provinces have stopped the practice and simply accept the ratings offered by another province. In a more ambitious recent interprovincial example, provinces are in the process of pooling their pharmaceutical purchasing strate-

gies. There is nothing preventing governments from shrinking their footprint by simply accepting decisions made in other provinces on routine matters (like movie ratings) or pooling their activities to take advantage of economies of scale.

IMMIGRANT SETTLEMENT SERVICES - BRITISH COLUMBIA

In 1998 the federal government and British Columbia (BC) signed an agreement that devolved most immigrant settlement and integration services to BC. The agreement was renewed in 2004 for five years, then extended for a year and renewed again in April 2010. The devolution has eliminated duplication between federal and provincial programs, provided for better integration with other settlement services, allowed for greater flexibility and responsiveness in programming, and produced better outcomes. It has led to a number of innovations, including expanded language training (some of which has a labour market component), the placement of settlement workers in schools, and programs targeted at particular groups, including seniors (Hiebert 2009, 12-13).

FEDERAL-PROVINCIAL ENVIRONMENTAL ASSESSMENT COORDINATION

Environmental assessment (EA) is an area where the public has not wanted either government to abdicate its authority. Historically, efforts to devolve or upload responsibility for conducting EAs have met with stiff resistance from environmental groups.

In order to balance the tension between retaining oversight and streamlining processes for businesses, Ontario and the federal government entered into an agreement on EA cooperation. The 2004 Canada-Ontario Agreement created an administrative mechanism to coordinate the EA process whenever projects are subject to simultaneous review by both jurisdictions.

Under the Agreement, both orders retain their legislative and decision-making responsibility. Projects still require separate approvals. However, decisions are based on the same body of information. The timing of approvals and announcements are coordinated.

The federal-provincial cooperation on EA is viewed positively both by businesses and environmental groups. It is considered a potential model for coordinating inspections, investigations and enforcement activities in other sectors.

Digitisation

GOVERNMENTS ARE GOING THROUGH an assumption-shattering transition. A decade ago, governments approached IT in the same way they approached other technology investments: as investments in tools to allow them to perform their job more easily. Today, it is understood that IT will not simply supplement conventional administrative processes and business practices, but that digitisation will transform what these processes and practices are (Dunleavy et al 2005).

Information technology is an enabler of the strategic business objectives of the public sector, much like in the private sector. It offers the opportunity for both savings and service quality improvements. Governments have in the past sometimes undertaken large IT investments that have not lived up to their promise, often because the service provider underestimated the complexity of government operations or because governments felt they had to build new IT from scratch. These things have changed.

Investments that will be most successful at delivering long-term fiscal savings and improved program delivery will be those that break-down silos, capitalize on pre-existing applications available to the wider public, build networks, facilitate collaboration, permit individuals to control how they receive public services with few institutional intermediaries, and exist in never-ending beta (i.e. they can continuously be improved, preferably by very large groups of users not restricted to government).

Five streams of activity are most promising. First, governments will continue to improve their ability to use technology to deliver transactional services. In some cases, the cost of a transactional service went from dollars to pennies, while customer satisfaction increased. This is what happened when Ontario transitioned to delivering birth certificates online.

More challenging, but still with great potential, will be the use of IT to provide a more integrated and personalized approach to human services. This will include such things as electronic health records, which will provide both patients and providers with critical information on diagnostic tests, previous providers, treatments and prescriptions.

GCPEDIA

Government departments around the world continue to set up internal intranets and build their own IT projects for networking and information sharing. In most instances, this no longer makes any sense—it is not cost-effective and it is not an efficient way to use information, collaborate and create knowledge.

GCPEDIA is the Government of Canada's internal wiki for collaboration and knowledge sharing. GCPEDIA is accessible only via the Government of Canada network. GCPEDIA provides a stable, open environment with a limited number of rules in which communities can form, develop, and share knowledge, without management by a large formal organization. GCPEDIA is part of the larger Open Collaborative Workplace initiative and although it does exist "behind the firewall" for security reasons, it is successfully breaking down silos and is continuously improving.

According to users, GCPEDIA can make the world of work for federal public servants larger (by allowing almost real-time networking with all federal employees) and smaller (reducing the cost and impacts of geographical distance in work teams).

DATA.GOV.UK

Launched in January 2010, Data.gov.uk is home to national & local data for free re-use. The site offers a portal into government data, making that data easy to find, easy to license, and easy to re-use. The site is open source. One of the potential pay-offs is more efficient, effective, cost-effective service delivery.

Moving from paper to digital records saves both time and costs and results in better quality services. Purpose-built digital client records can streamline patients' transition from hospital to community care and reduce emergency room wait times. Because more publicly funded services will be provided in an increasingly networked way, digitisation will be necessary to link large numbers of otherwise disconnected providers with one another and their clients.

Third, governments will increasingly use digitised information, continually updated and made available in real time, to inform risk analysis, policy making, regulation, delivery and performance measurement. The information will not only be used by governments, but citizens will be able to make informed choices about service options, from childcare services in Stockholm to wait times in various Ontario hospitals.

Many jurisdictions are experimenting with these breakthrough technologies to improve their residents' experience with public services. In Edinburgh, for example, buses all have GPS devices and residents can download a simple app for their mobile device to find out how far away their bus is from the stop. These new service delivery models will enhance users' experiences by focusing on providing individuals with more control over how they use a public service, with greater information and less intermediation.

"Open book" government could be the fourth frontier. Previously closed files will be opened to citizens to allow them to more actively manage their own interactions with public institutions. This might include access to their medical files to allow them to monitor their own treatments. More services will be defined from the perspective of the user rather than the institution.

It is no longer far-fetched to imagine citizens having personalized, secure access to their own public accounts where they can conduct all of their public business. Just as banking customers manage their mortgage, retirement investments and chequing account from one site, citizens may soon expect the same of government. Progress will require legislative changes to allow those institutions with separate authorities to come together and to enable cooperation across governments.

THE NEW WORLD OF HEALTH INFORMATION TECHNOLOGY

SUNDHED.DK

Sundhed.dk is a Danish internet portal which brings together health information and online health services in one place, with personalised features for citizens.

The options available include prescription renewal, ordering prescriptions online, online consultation with health professionals, access to individual medical histories since 1977, access to the Electronic Health Record kept by hospitals, access to personal medicine profiles, personalised information, and the opportunity to make a living will or register as an organ donor. In essence, the site enables the creation of personalized patient information platforms.

The portal has an annual budget of €5 million, but produced significantly more in savings to the healthcare system. Evaluation has shown that one-third of citizens seeking information on their health through Sundhed.dk are reassured and choose to delay or not book a visit to their GP, leading to a net saving of approximately 900,000 consultations with GPs per year. The move to electronic prescriptions has also led to annual savings of more than €12 million for this one initiative alone (<http://www.socialinnovationexchange.org/node/4782>).

E-PRESCRIPTIONS IN SWEDEN

Currently 42% of all prescriptions in Sweden are transferred from the doctor to the pharmacy electronically via Sjunet, the Swedish ICT network for healthcare, or by using web-based prescribing. The use of e-prescriptions has resulted in lower rates of user error, stronger security and privacy as well as time savings for healthcare provider organizations. In 2005, five years after the beginning of planning and development, there was already a net benefit of approximately \$27 million (European Commission 2006).

It will not be easy, but some jurisdictions will no doubt succeed in figuring out how to allow citizens to renew their driver's licence and apply for a child tax credit from their own personalized whole-of-government account. Canadian federalism and its divided authority represent obstacles that must be overcome if Canadian governments are to enjoy the downstream administrative savings and if Canadians are to enjoy more modern service delivery.

Finally, governments will more aggressively explore how to undertake open data initiatives, which refer to processes aimed at sharing government information with the public in open ways that promote analysis and reuse. These initiatives could offer real improvements in policy development and service delivery by capitalizing on the knowledge and abilities of large numbers of people and organizations putting public data to new uses.

Governments are just beginning to scratch the surface of the digitisation revolution that is upon them. Some of these changes will require early up-front investments. It is unclear which of various applications will be most cost-effective and deliver the greatest capacity for improvements in service delivery.

What is clear is that governments will have to apply the lessons from previous reform initiatives if investments are to have their transformative effect and provide users with more seamless experiences with government. This could include using publicly available technologies rather than building and procuring new IT from scratch. It will require improvements to data security and managing privacy. Monitoring these efforts, both in terms of their success and their fiscal impact, will be essential for governments.



Devolution

PUBLIC SERVICES AROUND THE WORLD now have almost thirty years experience with devolution of some functions to other actors. This devolution has gone hand-in-hand with an evolving understanding that government's core roles are policy maker, regulator and setter of standards. Other actors are sometimes better placed to deliver services or ensure compliance.

Examples are well-known, from the initial contracting out of municipal services such as garbage collection in the 1980s in the US, the privatization and creation of special purpose delivery agencies incubated during the Thatcher era in the UK and, more recently, the growth of more widely dispersed and networked modes of delivery spanning many sectors of the economy, including the charitable sector and informal networks of citizens. The Howard Government in Australia in the late 1990s sold off most of the commercial enterprises housed in the Department of Administrative Services, which included services such as property maintenance and car fleet management. Few observers would suggest returning these non-core services to the public sector.

These changes have not always been paralleled by effective approaches to accountability, governance and performance measurement. Governments will need to develop better tools to ensure that services are being provided to acceptable standards. Accountability and reporting will need to be improved—not to add new paper burdens but to ensure that substantive outcomes are being achieved.

Citizens are increasingly self-organizing—sometimes with the help of non-profits, sometimes with the help of the private sector—to deliver public goods. Collaborative and social networking technologies are likely to accelerate devolution to social entrepreneurs and others who may participate in the “co-production” of public services. Attempts to improve upon current gaps in accountability and performance measurement must acknowledge that more services will be delivered through looser networks.

DELIVERY OF PUBLIC GOODS BY NOT-FOR-PROFIT ASSOCIATIONS

FREE SCHOOLS

The UK has established a process for enabling not-for-profit businesses, charities, faith groups, and/or parents to establish and operate “free schools.” These schools will be able to set pay and conditions for staff, deviate from the national curriculum, decide the length of school days and terms, and often key operational matters. The government will pay for premises and provide funding per pupil. Sixteen schools are expected to be operating by 2011.

DELIVERY OF PUBLIC GOODS BY SELF-ORGANIZING CITIZENS

WWW.PATIENTSLIKEME.COM

Through this website, citizens have self-organized to be a part of a community of similarly situated individuals who share the same disease but who are dispersed over wide areas. They provide to each other a source of information and understanding and make unnecessary some routine trips to physicians.

CO-CREATION OF PROGRAMS

ADDRESSING CRIME

In the UK, local governments have sought to involve citizens as co-creators in devising local crime reduction partnerships. Police forces and local councils set priorities and targets together and create operational strategies for achieving them. Councils and police must share operational responsibility and public accountability (Quirk 2003, 107).

While outsourcing has in some instances been reversed in dramatic ways (such as the re-integration of 28,000 airport security workers in the US and the re-nationalization of Railtrack in Britain), there are a number of areas in social policy where devolution and partnerships with third parties have dramatically reduced program costs, including social housing and immigrant settlement services in Canada. Governments continue to learn both from successes and failures.

More ambitious contracting out may be the next frontier. In the private sector, many firms work to focus on their core business and partner with other firms to deliver ancillary services. Governments are starting to consider doing the same because they recognize they do things that they don't need to do. Some tasks currently performed by public servants can be more efficiently performed by others. There may be large cost-savings for jurisdictions that are willing to think differently about collaborating with specialists who can more efficiently and knowledgeably manage functions such as human resources or IT.

Governments may also choose to divest their authority over certain programs and activities to other actors. For example, during the 1980s, a number of governments divested their direct authority over interest rates to independent central banks. Continued delegation or devolution of some government functions could depoliticize certain crucial public activities. Moving toward more independent agencies would reduce some of the transaction costs associated with decision-making in large, complex bureaucracies.



GETTING OUT OF NON-CORE BUSINESS

PEOPLE FIRST AND ACCESSHR

Florida's People First project is a statewide human resource outsourcing initiative designed to contract out staffing administration, human resource administration, payroll, and benefits. People First's implementation includes all 33 state agencies, over 400,000 current and past state employees, and involves a nine-year contract with Convergys Corporation worth \$350 million. Between 2003 and 2008 the project saved the government of Florida an estimated \$92 million.

The Texas AccessHR project from the Texas Health and Human Services Commission includes payroll, benefits processing, time and leave processing, and compensation and classification administration. As of 2008 the project had saved the government of Texas an estimated \$22 million (Bacon and Wilson 2008, p.7).

OFFICE FOR BUDGET RESPONSIBILITY

In 2010, the UK government announced plans to establish the Office for Budget Responsibility (OBR), which will provide the economic and fiscal forecasts on which the government's budgets will be based. The principal task of the OBR is to provide an independent assessment of whether the government is likely to meet the deficit reduction objectives established by the Chancellor of the Exchequer. The OBR is modeled after the Swedish Fiscal Policy Council which provides an independent review of budgetary plans and performance.

The Chancellor of the Exchequer has stated that this places UK fiscal policy "at the cutting edge of international best practice" and will provide greater credibility and confidence in forecasts about the UK economy and public finances.

Alternative Financing

GOVERNMENTS ARE EXPLORING new ways to raise the funds necessary to deliver public goods. Three approaches are considered here: public-private partnerships for infrastructure (P3s), better monetization of public assets and the use of bonds.

The use of private capital to fund some portion of public infrastructure projects is now commonplace. Governments have become much more sophisticated at negotiating with private firms to procure, finance, deliver, manage or maintain public sector assets than they were during the first wave of projects in the 1990s. Governments now secure better agreements than they did during the first wave of P3s.

Seventeen OECD countries now have dedicated P3 agencies. These agencies have the skills to focus on obtaining value and the ability to ensure that liabilities are properly evaluated (OECD 2010b). These agencies have been successful at transferring risk to the private sector and securing more certainty around schedule projections (Conference Board of Canada 2010, 5).

Of active P3 projects in Canada, fully 70% include design-build-finance and some combination of operation and/or maintenance (The Canadian Council for Public-Private Partnerships, updated May 2010).

In the 1980s, governments looking for new ways to extract value from existing assets often turned to privatization and one-time sales. Although such sell-offs continue to occur, governments are increasingly looking to more sophisticated forms of asset monetization.

The goal of asset monetization approaches is to decrease the financial burden associated with providing or operating an asset, without losing access to the product of that asset. Models of asset monetization include the use of tolls, user-fees, other non-tax revenue, the creation of public corporations, more sophisticated management of real estate holdings, identification of commercialization possibilities

THE TEXAS MODEL

In 2009, a private group, NTE Mobility Partners, was conditionally awarded the initial work on a multistage project for the 36-mile North Tarrant Express in the Dallas region. Under the 52-year agreement, \$2 billion in mostly-private funding will be used to design, build, operate and maintain a new highway system by using toll and non-toll roads that will double capacity by 2015.

BC & ONTARIO LEADERSHIP

British Columbia and Ontario have undertaken the greatest number of P3 projects. Both provinces have very strong records with respect to cost certainty and timing. In BC, of the 11 projects that have reached substantial completion, six were delivered ahead of schedule while five were delivered on time. In Ontario, 30 Alternative Financing and Procurement projects are underway through Infrastructure Ontario, mostly build-finance hospital projects. Of the six projects that have reached substantial completion as of the end of November 2009, all were completed within the approved public-sector budgets (Conference Board of Canada 2010).

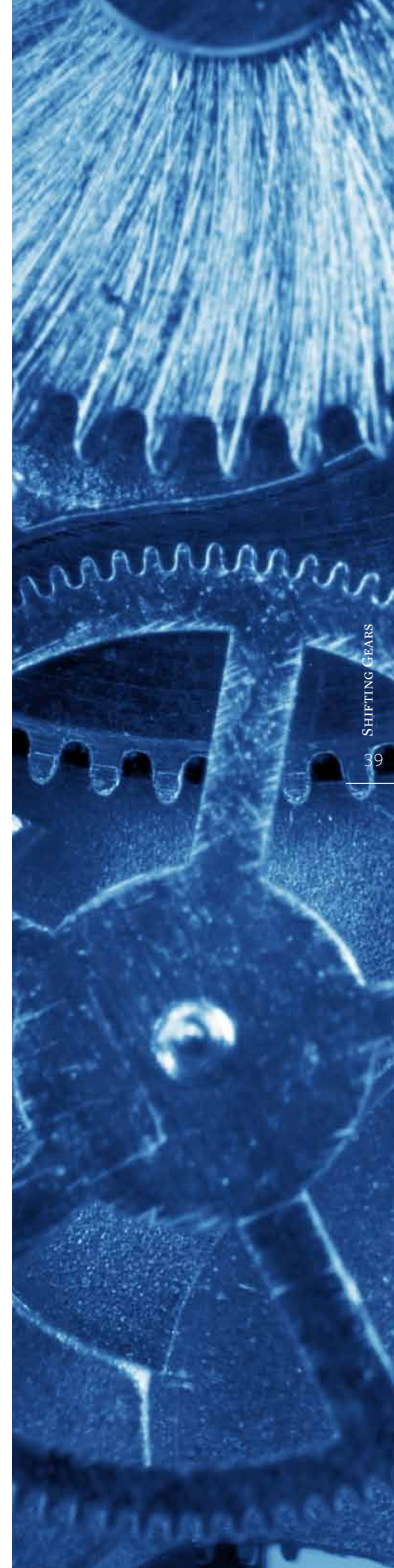
from existing assets and partial divestment. For example, some US states are looking to using the private sector to manage some revenue generating public assets in exchange for an upfront payment and yearly payments that represent a portion of savings from more efficient delivery or management. Ensuring standards of performance becomes the key role of government in these cases.

In some jurisdictions, public transit is being financed through the anticipated increase in property values along transit routes. In another model, developers are being compelled to invest in trust funds for public transit in order to be able to develop properties that will generate significant profits for developers so long as new public transit is installed. In both cases, the private sector offsets some of the cost of new public infrastructure through their own increased profits.

Governments at all levels have used bonds to generate income to finance public services. Typically, bonds involve a purchaser providing an upfront investment of capital to the bond issuer, in return for which the purchaser receives payments over time. Governments are now looking at more creative ways of using bonds to fund public projects or to generate revenues from existing assets.

The UK is experimenting with social impact bonds, which are tied to the performance of a non-profit organisation tackling a difficult social problem. Private investors invest in a charitable organization, which then has the long-term capital to initiate its project. Depending on the success of the project in achieving its objectives, the government will pay investors a return—or nothing if results have not been achieved. Social impact bonds provide long-term funds for promising ideas, transfer risk to private capital markets and cost public money only if there are measurable social benefits.

The US is experimenting with both casino bonds and Property Assessed Clean Energy (PACE) bonds. With casino bonds, states obtain an immediate infusion of cash by creating a securitization of future gambling cash flows by transferring the right to a portion of these cash flows to a newly created trust co-owned by the state and new investors. PACE bonds allow property owners to finance energy efficiency improvements using bonds issued by municipal financing districts or finance companies. Interested property owners receive financing (up to 20 years) for these improvements, which is repaid through an assessment on their property taxes. This arrangement spreads the cost of clean energy improvements over the expected life of the measure (PACENow 2010).



BRITISH WATERWAYS

British Waterways (BW) is a public corporation accountable to the Department for the Environment, Food and Rural Affairs (Defra) and the Scottish Government. BW owns and is responsible for over 2,000 miles of canals, rivers and supporting infrastructure for which it is the navigation authority. It has a duty to maintain these assets so that they deliver public benefits. It also owns a significant portfolio of nonoperational properties throughout Great Britain. This portfolio comprises properties and land within its asset base that are not directly involved in the operation of the waterways.

The portfolio generates income from rents (2008-09: £26.5 million) and profits from sales of properties and development sites (2008-09: £4.7 million); rental income supports maintenance of the waterways network while profits from sales are reinvested in the waterways and the portfolio.

In its 2009 Budget, the UK government announced that BW would transfer its property activities (including joint ventures) into a wholly-owned property subsidiary—"in order to ensure clear separation of, and focus on, both maximising gains from its property and best management of the waterways" (HM Treasury 2009, p. 5).

SUCCESSFUL P3S: UK & AUSTRALIA

The public-finance initiative (PFI) model has been present in the UK since the early 1990s. The model includes private-sector involvement in all forms of public infrastructure. Since 1992, 790 PFI projects have been initiated and nearly 500 completed. As of 2007, PFI projects represented 10 to 13 per cent of all UK investment in public infrastructure. A study by the UK National Audit Office indicated that 29 of 37 P3 projects surveyed did not experience any increase in construction budgets after the start of the contract and that the cost increases in the remaining eight projects were due mainly to additional work requested by the public sector owners.

In Australia, the National PPP Forum analyzed 67 Australian infrastructure projects of which 25 were P3 projects and 42 were conventionally procured. It determined that P3 projects demonstrated greater cost certainty overall, with average cost increases of only 4.3 per cent after the contract was awarded, compared with 18 per cent for conventionally financed projects (Conference Board of Canada 2010, 22).

Where to Go From Here?

GOVERNMENTS AROUND THE WORLD are being told that they will need to raise taxes or cut programs and services in order to balance their budgets. This will no doubt be true in many countries. It will certainly be true in most Canadian provinces.

But Canadian governments have an opportunity to also pursue a variety of transformative initiatives. Program cuts will be necessary. The medium-term fiscal pressures are real, in part due to under-funded pension liabilities. Some provincial governments face significant structural deficits. Even for those that do not currently face structural deficits, these will emerge in the next decade due to demographic changes unless reforms are made to public programs. It is incumbent on governments to see if new modern service delivery models, reforms to program operations and transformative tax and policy changes can ensure fiscal sustainability.

The footprint of government has changed over the past 25 years and will continue to do so. It is today clearer than before that governments are capable of delivering current program offerings with fewer resources and fewer public servants. This requires both political will to confront some stakeholders and the readiness to reinvent how government serves the public. It requires governments to embrace new service delivery models, new governance models and breakthrough IT applications. It requires governments to use these methods in a manner that empowers individuals to access government benefits with less direct intermediation by institutions and public sector organizations. It requires governments to understand that their core function is to make policy and regulate; others may ensure compliance or deliver services, so long as governments improve their governance and accountability models.

Few students of public administration believe that the footprint of government, how government is organized or its relationship with the public will look the same ten years from now as it does today. Governments are having change forced upon them by fiscal challenges on the one hand and technological and social evolutions on the other.

Governments should look at these pressures not as separate phenomena to be managed independently. Social, fiscal and technological changes are mutually reinforcing opportunities to introduce transformative policies and new models of service delivery, without sacrificing the public interest.

Few students of public administration believe that the footprint of government, how government is organized or its relationship with the public will look the same ten years from now as it does today.

The extent of the savings to be found, the ability of governments to drive the most ambitious changes, and the time that will be required for these changes to occur remain uncertain. Measurement and reporting will be necessary and these efforts are already underway in some other countries (Podesta and Rushing 2010). Table 3 depicts the various approaches to long-term fiscal sustainability. Four criteria are highlighted: public appetite, institutional capacity, overall effectiveness (i.e. fiscal pay-off) and transformative capacity.

Those areas where public appetite exists are most likely to be the first places government looks to act upon. However, some of them will encounter institutional or administrative obstacles, including the need to secure the consent of some actors before progress can be made. Others will be ineffective in bringing down spending significantly over the long-term.

Governments should focus on those strategies likely to have the largest fiscal pay-off. If they happen to be areas where the institutional obstacles are few and the public may be receptive, governments will almost certainly pursue them. This report also suggests that if these areas have a transformative capacity to improve how government delivers services, they should be at the top of a government's fiscal sustainability agenda.

These four criteria lead to conclusions about where governments will devote their efforts: transforming the practices in their largest spending departments, such as Health; bringing down the cost of wages and benefits in the broad public sector; introducing transformative policy changes that affect retirement and pensions; modernizing bureaucratic processes; and digitisation that allows individuals to access their own services in ways of their own choosing, with less intermediation by public sector bureaucracies.



This report has outlined the emerging transformative approaches taking place in Canada and abroad. These changes include transformative tax initiatives, like the move toward a harmonized sales tax, as well as transformative policies that will reduce government expenditures, like movement across Europe and the US to raise the retirement age.

These changes also include transforming how government delivers public services to citizens through modernizing delivery models, financing mechanisms, new governance models, and the use of breakthrough—and often relatively inexpensive—information technology and digitisation.

None of the choices outlined in this report are value-free. They are political choices and will best be undertaken by governments that understand their own values on issues like equity, rights, entitlements and the public interest. The choices will all require research, fiscal analysis, sustained public communications and dialogue, and time for transitions to occur.

This research represents a foundational piece intended to promote basic literacy regarding available and emerging fiscal, policy and delivery strategies. Future reports will document how well these initiatives are working and with what effect—both politically and fiscally.



TABLE 3
WHERE WILL GOVERNMENTS FIND THE MOST SUCCESS?

STRATEGY	PUBLIC APPETITE	INSTITUTIONAL CAPACITY & ADMIN. LEVERS	EFFECTIVENESS	TRANSFORMATIVE CAPACITY
TAXES				
Increasing tax rates (income, corporate, VAT/sales, property, excise)				
Increase compliance				
Reduce tax credits/expenditures				
Resource royalties				
Add new taxes (excise, carbon, inheritance)				
Non-tax revenue/user fees				
Transformative tax policy changes				
PROGRAM SPENDING				
Across-the-board cuts				
Program reviews				
Policy audits				
Targeted efforts on high spending departments				
Wage & benefits across the broad public sector				
Transformative policy changes on program spending				
ALTERNATIVE MEASURES				
Modernizing bureaucratic processes				
Reassignment of roles & responsibilities				
Digitisation				
Devolution				
Alternative financing				

Yes To some extent No

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