

FISCAL SUSTAINABILITY & THE FUTURE OF PUBLIC SERVICES A SHIFTING GEARS PROGRESS REPORT

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PURPOSE

This report from the Mowat Centre and the School of Public Policy & Governance at the University of Toronto, supported by KPMG, is intended to help facilitate informed, strategic, long-term decision-making in Canada. This report is part of the *Shifting Gears* series.

The Mowat Centre and the School of Public Policy & Governance have undertaken this study because of our commitment to better understand how governments can improve their ability to deliver high-quality public services and 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 challenges.

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EXECUTIVE SUMMARY

This *Shifting Gears* progress report examines how well governments in Canada and across the OECD are doing in returning to fiscally sustainable positions. It points out that while Canadian governments are in better shape than many of their peers, complacency must be avoided.

Many governments have moved forward with short-term and transformative efforts to raise revenue and cut expenses. This follow-up to our 2010 report, *Shifting Gears: Paths to Fiscal Sustainability in Canada*, identifies which initiatives are working and which hold the most promise to facilitate a return to balanced budgets, both globally and in Canada.

Governments around the world are reducing their footprints and introducing measures to increase revenue. Short-term efforts are usually unsuccessful in putting public finances on fiscally sustainable paths. Even aggressive across-the-board cuts usually fail to change the basic structure of traditional administrative and policy processes. Without change to basic architecture, budgets are prone to rebound.

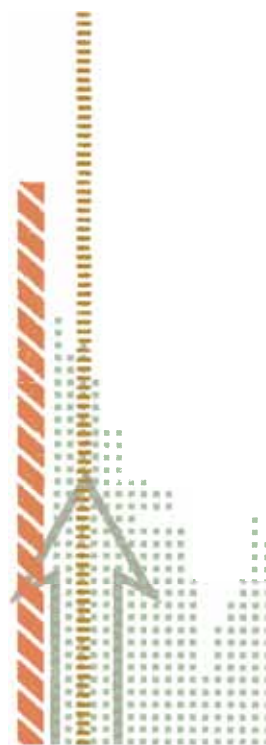
Instead, Canadian governments should begin to fundamentally revisit how they deliver public services. The models they rely on are creaking under the weight of public expectations, entrenched stakeholder interest, and shrinking fiscal capacity. Old business models should be questioned.

Supply chain management, back-office consolidation, and procurement are among the day-to-day processes that governments must continue to improve. This ongoing work constitutes business as usual. Governments need to consider how they can do more.

Governments must think carefully about incentives, governance, accountability, transparency, and measurement grounded in evidence. These are five lenses through which governments can assess potential reform initiatives.

Governments should approach their review exercises by clearly defining objectives and redefining how they deliver public services to meet those objectives from the perspective of the citizen.

In order to successfully deliver on a transformative agenda, governments require a clear understanding of what levers they possess to initiate change that will contribute to long-term sustainability.



Provincial governments no longer directly control most of their spending on a day-to-day basis. Their costs are driven by salaries and benefits structured through collective agreements, as well as direct transfers to other bodies (colleges, municipalities, school boards, hospitals, among others). These are two of the most important levers that provincial governments possess. But, they have too little control over them to effectively manage for long-term fiscal sustainability.

The key levers at the disposal of governments in Canada include: collective agreements, transfers to other bodies, data, hard assets like real estate, and consolidated legislative authority that facilitates the capacity to make changes quickly and coherently.

The transformative agenda is enormous and daunting, yet other jurisdictions are undertaking practical steps to move forward. Some worthy of consideration in the immediate future include:

1. Skills audits to ensure that the least expensive competent practitioner is delivering the necessary service.
2. Collective agreements that include more flexibility for management and labour to respond to rapid changes in technology and job requirements.
3. Client navigation services and program coordination focused on the small number of individuals who are the highest consumers of public services and who often cross back and forth between different service silos.
4. Clarifying governance and accountability relationships with recipients of transfer payments and service delivery partners.
5. Investment in new and better data collection that better facilitates public disclosure and secondary analysis.
6. Consolidation and differentiation in the health and other sectors to generate efficiencies and value for money.
7. Experimentation with payment for performance through the use of Social Impact Bonds and other instruments.
8. Advances in digitization, such as personal accounts so that individuals can manage their interaction with governments.
9. New approaches to collective bargaining and arbitration rules to ensure that governments have an ability to control the costs of labour.
10. Monetization of assets (where appropriate) such as data, real estate, crown corporations, and other holdings.

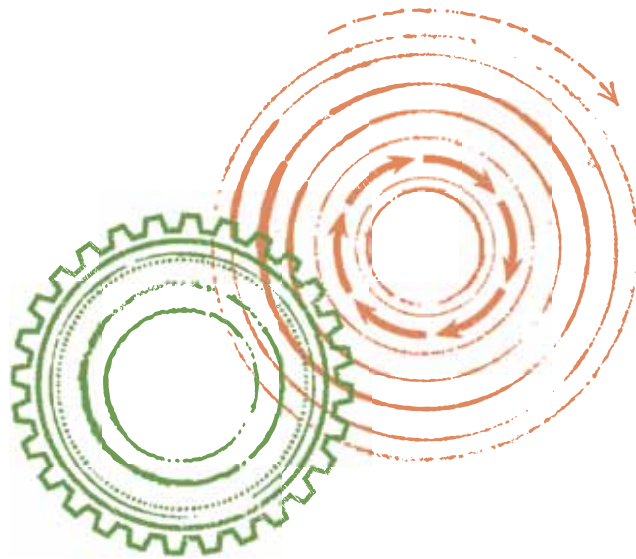
The program landscape in many areas is messy and cluttered. Processes must begin to consolidate programming across ministries and governments, with a focus on clarifying the objectives of programs and measuring whether these goals are being achieved. This should include vertical program reviews, which look across levels of government for savings. It should also include transparent policy audits that clarify program objectives and approaches to results measurement.

Governments do not have a good understanding of why so many of their efforts fail to deliver the desired change. Political or bureaucratic resistance is often responsible. The sense of urgency necessary to compel fundamental change is often absent.

Our bottom line is that Canadians must summon this sense of urgency. We face significant short-term challenges as well as long-term structural constraints driven by demographic factors and aging infrastructure.

Recent global experience demonstrates that governments have the ability to deploy breakthrough technologies and fundamentally change their delivery models. Recent global experience also demonstrates the consequences of failing to do so.

For those who believe in the future of public services, now is not the time for Canadians and their governments to hug the status quo.



SECTION ONE

CURRENT CONTEXT

Public finances have been under strain across Organization for Economic Co-operation and Development (OECD) member states since the financial crisis began in 2008. Governments have recorded significant budget deficits. Some of these deficits are cyclical, but many of them are structural.

In last year's *Shifting Gears: Paths to Fiscal Sustainability in Canada* we outlined the broad steps being taken by many OECD jurisdictions to restore fiscal balance (Mendelsohn et al. 2010a). These strategies included both short-term measures to increase revenues or decrease spending and measures targeted at the longer-term transformation of government operations.

Shifting Gears also considered the relevance of these measures for Canada. Our intention was to facilitate informed debate, strategic thinking, and long-term decision-making.

We accepted that simple cost cutting or tax raising solutions might be necessary to address short-term fiscal crises. We concluded, however, that these short-term solutions cannot ensure the long-term sustainability of government finances and public services.

We recommended that Canadian governments examine their budget decisions through a *transformative lens*. Governments should consider revenue generating mechanisms and operational models that promote long-term prosperity, equity, and fiscal sustainability. Canada's aging population, and the fact that many Canadian government budget deficits are structural in nature, underscore the need for this approach.

One year on, this *Shifting Gears* progress report compares how well governments in Canada and across the OECD are doing in returning to fiscal balance. We examine which strategies are delivering fiscal savings and improved delivery standards. We detail the transformative approaches governments are taking to raise funds and deliver higher quality services at lower cost. And we offer practical advice to governments on designing, delivering, and financing better public services in an age of fiscal restraint.

This report tracks four approaches governments are taking to respond to budget deficits:



1. **Short-term Measures to Increase Revenue** are measures meant to generate additional funds immediately. These include increasing consumption-based taxes such as Value Added Taxes and excise taxes, increasing the top rate of income tax, corporate taxes and bank levies, and more efficient tax enforcement.
2. **Transformative Approaches to Increase Revenue** are longer-term initiatives for raising revenues. These include carbon taxes, user fees, legalizing online gaming, and payment by result mechanisms such as Social Impact Bonds. Such mechanisms offer sustainable long-term sources of new revenue that can promote long-term economic growth, citizen protection, and intergenerational equity.
3. **Short-term Measures to Decrease Spending** are cuts to operating budgets designed to yield immediate savings. These measures include public sector headcount reductions, wage moderation, pension cuts, and cuts to program budgets.
4. **Transformative Approaches to Decrease Spending** are innovative government initiatives designed to deliver fiscally sustainable, high quality public services with fewer resources. These include the modernization of bureaucratic processes; reforms to healthcare, pensions, and other program operations; reforms to public sector pay mechanisms and staffing models; the co-production of services through collaboration with private and non-profit service providers; and digitization projects. These initiatives harness emerging technologies, changing political ideas, and growing international consensus on the need for medium- and long-term fiscal planning. Many of these initiatives require upfront investment, but are expected to yield significant long-term savings.



UPDATE OF FISCAL OVERVIEW IN THE OECD

Figure 1 provides a snapshot of the fiscal challenges faced by OECD member states in 2011. Some countries, such as Norway and Switzerland, have maintained healthy public finances. But most governments are still tackling sizeable budget deficits and remain vulnerable to persistent frailties in the global economy.

The majority of OECD jurisdictions have made some progress in reducing deficits since 2009, although their overall debt burdens continue to grow. Progress to date is due to a combination of consolidation measures, the withdrawal of stimulus spending, and more favourable macroeconomic conditions (IMF 2011a). A number of European countries facing large deficits, including Germany and the UK, have developed credible fiscal adjustment plans to pre-empt pressure from bond markets (OECD 2011a, 21).

The UK government, in particular, has undertaken a rapid consolidation program aimed at eliminating its structural deficit by 2014/15, although rising unemployment and slower than predicted economic growth in recent months may impede its progress. The UK government is also undertaking several transformative initiatives that are being closely monitored by other OECD governments. We have paid particular attention to these developments in our report.

Many eurozone governments have taken steps toward stabilizing debts as a result of market pressures. In particular, Ireland and Portugal are beginning to reduce their deficits under frontloaded consolidation programs supported by the European Union (EU) and the International Monetary Fund (IMF) (OECD 2011a).

Yet the prospects of eurozone members remain mixed. Some eurozone members, such as Germany and Finland, continue to benefit from market confidence and falling interest rates (IMF 2011b, 4-5). By contrast, Ireland, Greece, Portugal, Spain, and Italy have suffered sovereign credit rating downgrades which increased their borrowing costs. The risk of sovereign debt default, particularly in relation to Greece and Italy, still threatens to destabilize the economic recovery of eurozone members and OECD member states more broadly.

The US and Japan have particularly acute fiscal consolidation needs. Nonetheless, the national governments of both countries have delayed introducing serious fiscal adjustment measures until beyond 2011 (IMF 2011b; OECD 2011a; OECD 2011b).

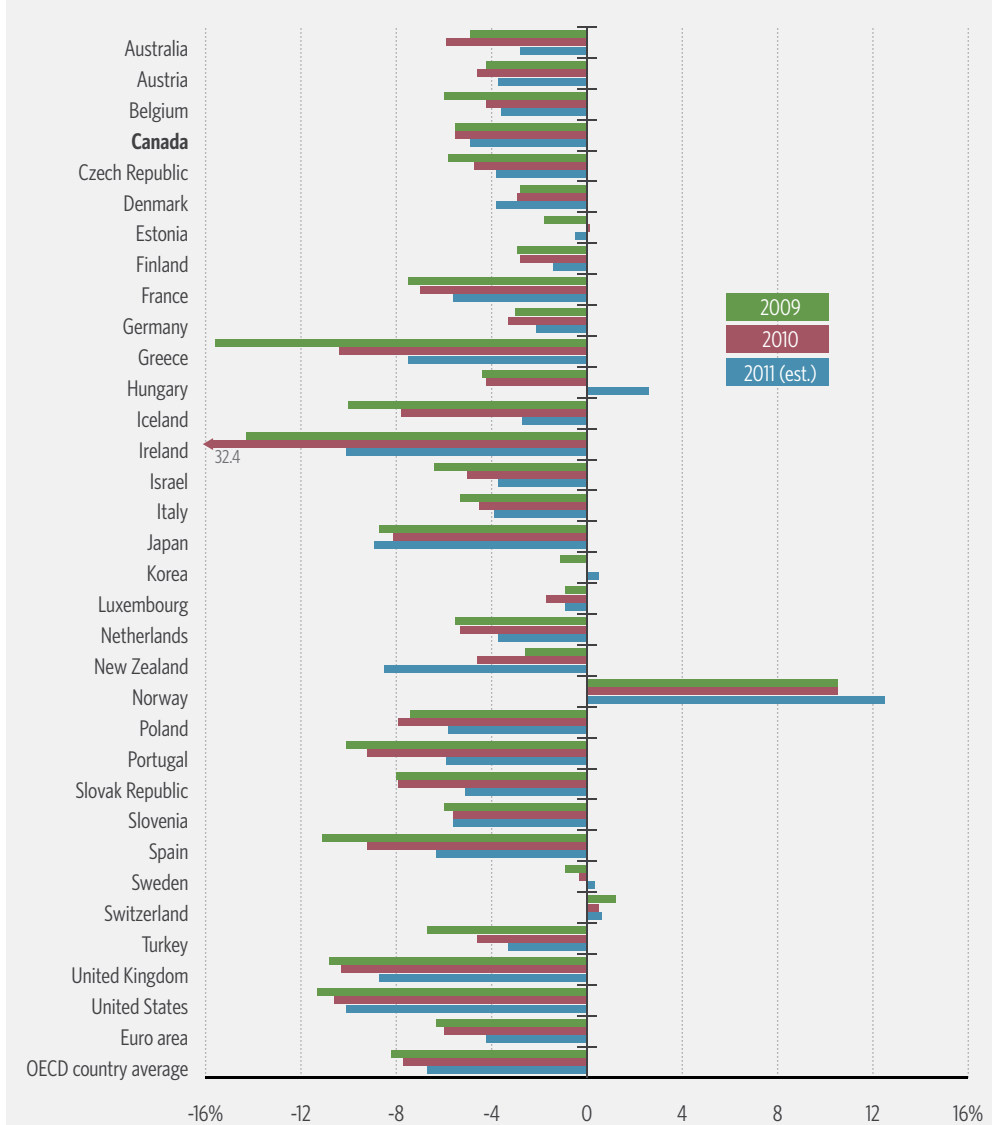
In Japan, reconstruction efforts following the earthquake and tsunami of March 2011 delayed efforts to address structural deficits predating the financial crisis (IMF 2011b, 17). In the US, deficit reduction programs are already being implemented at the state and municipal level with deficit reduction likely to become a central focus of the 2012 US federal budget and upcoming federal elections.

According to the IMF, both countries have managed to restrain borrowing costs, Standard & Poor’s recent downgrading of the US’s credit rating notwithstanding. However, while both countries “benefit from large stores of goodwill from investors [...] these favourable conditions could shift if needed policy changes are not forthcoming” (IMF 2011b, 1).

Ultimately, these and most other OECD governments will need to present credible plans in order to avoid paying higher premiums on their debts.

The majority of OECD countries also face long-term demographic and economic challenges that exacerbate structural deficits. According to IMF estimates, population aging and rising program costs will drive up pension and healthcare spending by an average of 1.2 and 2 percentage points of Gross Domestic Product (GDP) respectively by 2030 (see Figure 2).

FIGURE 1 OECD JURISDICTIONS: GENERAL GOVERNMENT DEFICIT/SURPLUS AS A PERCENTAGE OF NOMINAL GDP BETWEEN 2009 & 2011



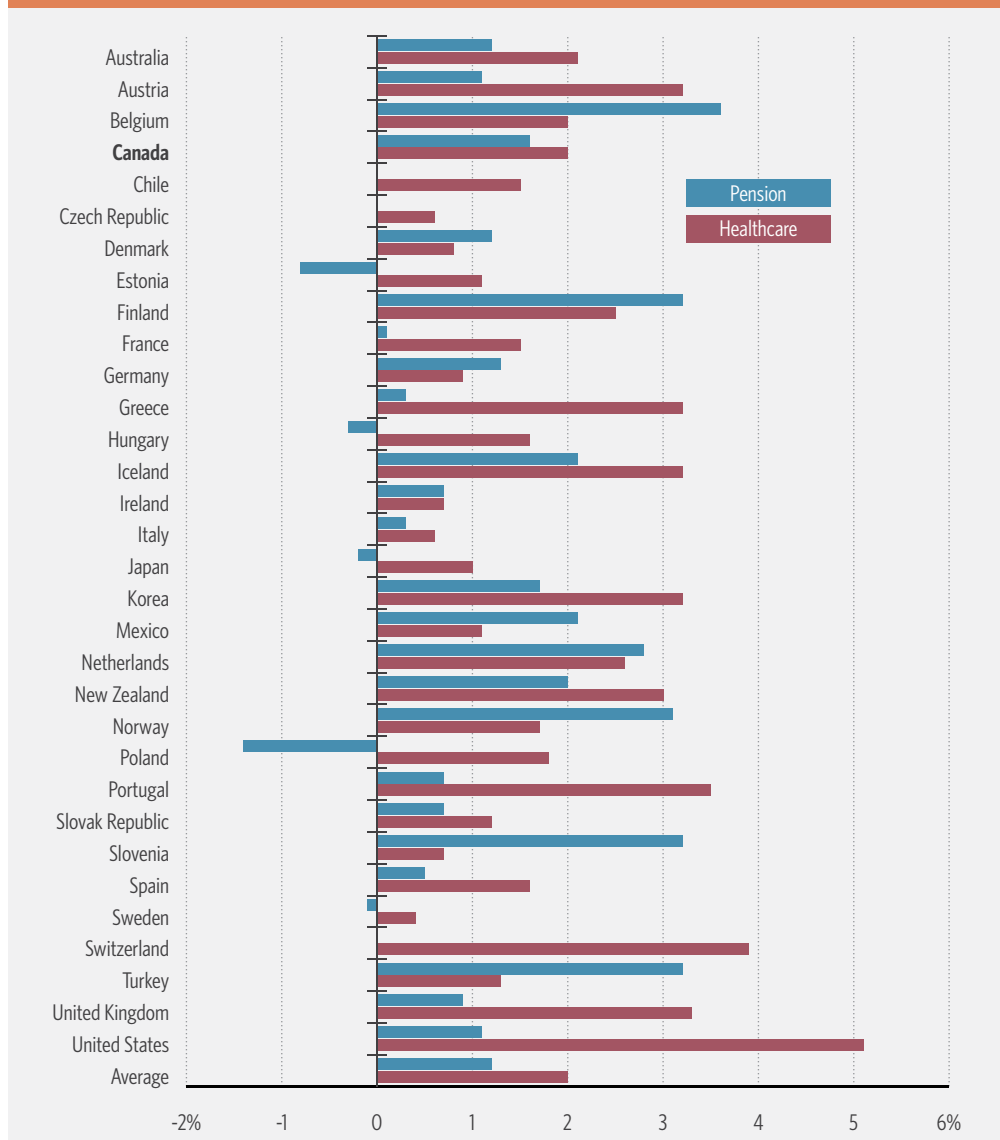
Source: OECD 2011b, 367.

A number of European states have made some progress toward pension reform. In stark contrast, political sensitivities have made most OECD governments reluctant to seriously address healthcare. Instead, many governments have either protected their health budgets or have limited healthcare reforms to areas such as pharmaceutical procurement.

Cost projections show this to be unsustainable. Governments need to adopt a transformative lens and rethink how they raise funds and deliver services at lower cost *without* adversely affecting service users.

This is no easy task. Long-term thinking is inevitably challenging when governments feel pressured to deliver tangible short-term results in order to win elections. Times of crisis offer governments rare opportunities to introduce transformative measures and service delivery models without alienating voters.

FIGURE 2 PROJECTED CHANGE IN PENSION & HEALTHCARE SPENDING AS A PERCENTAGE OF NOMINAL GDP BETWEEN 2010 & 2030



Source: IMF 2011b.

Notes: Pension data is missing for Chile and Switzerland. These projections are adjusted for recent pension reforms undertaken in France, Greece, Ireland, Italy and Spain, but not Estonia, Hungary and Poland. These projections do not account for the healthcare reform proposals being discussed in a number of European states.

WHERE IS CANADA HEADED?

Canada is not facing a short-term fiscal crisis. As of 2011, Canada's net general government debt-to-GDP ratio of 34.9 per cent is the lowest among G7 nations (IMF 2011b).¹ Still, Canada remains vulnerable in the short-term to economic weaknesses in other OECD jurisdictions, particularly the US and eurozone countries (TD Economics 2011a).

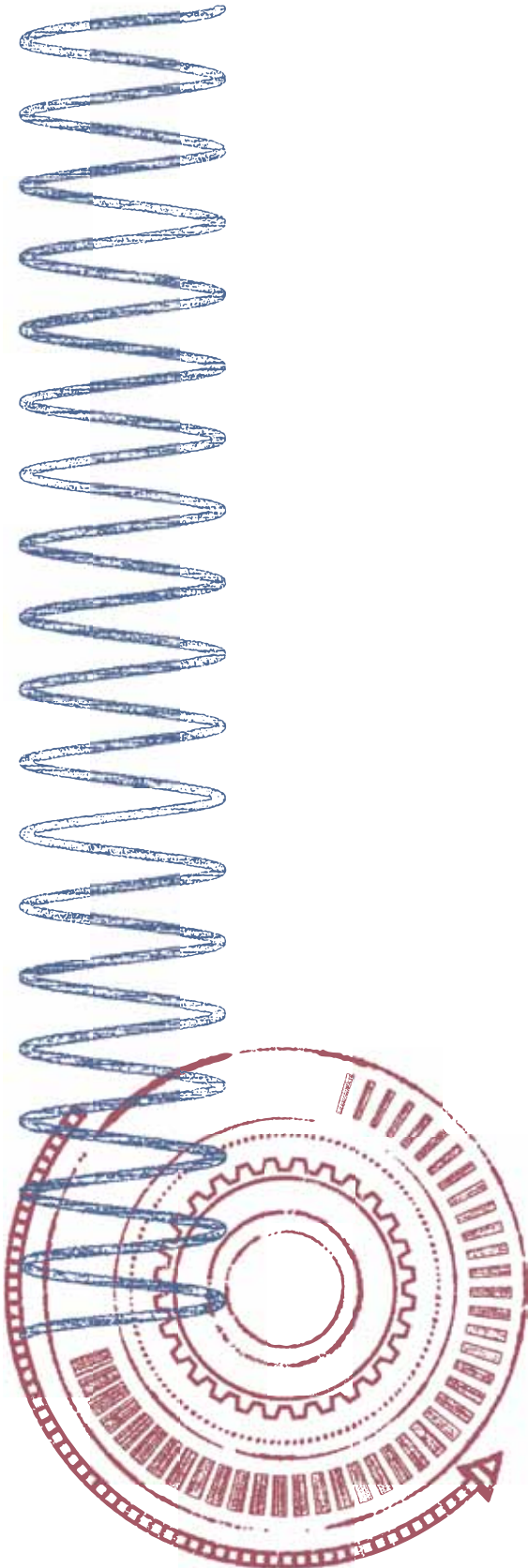
Canada has also been running a general government budget deficit since 2008/09. According to the IMF's 2011 estimates, Canada requires a fiscal adjustment of 4.3 per cent of GDP this decade to restore more prudent debt ratios (IMF 2011b, 30).

Moreover, the fiscal position of a number of provinces is a cause for concern. The debt burdens of Canada's largest provincial economies, Quebec and Ontario, are higher than most other provinces, and are projected to continue rising. Quebec's debt-to-GDP ratio is forecast to reach 50.4 per cent by the end of this fiscal year (Quebec Ministry of Finance 2011a, I.16). Ontario's debt-to-GDP ratio is projected to reach 40.6 per cent by 2014/15 (Ontario Ministry of Finance 2011, 290). And even financially strong provinces, such as resource-rich Alberta, are tackling deficits.

There is a need to sensitize the public to the fiscal challenges that Canadian governments face. In much of Europe, broad public awareness of the need to stabilize public finances has resulted in political support for transformative change. Such awareness is needed—and largely lacking—in Canada.

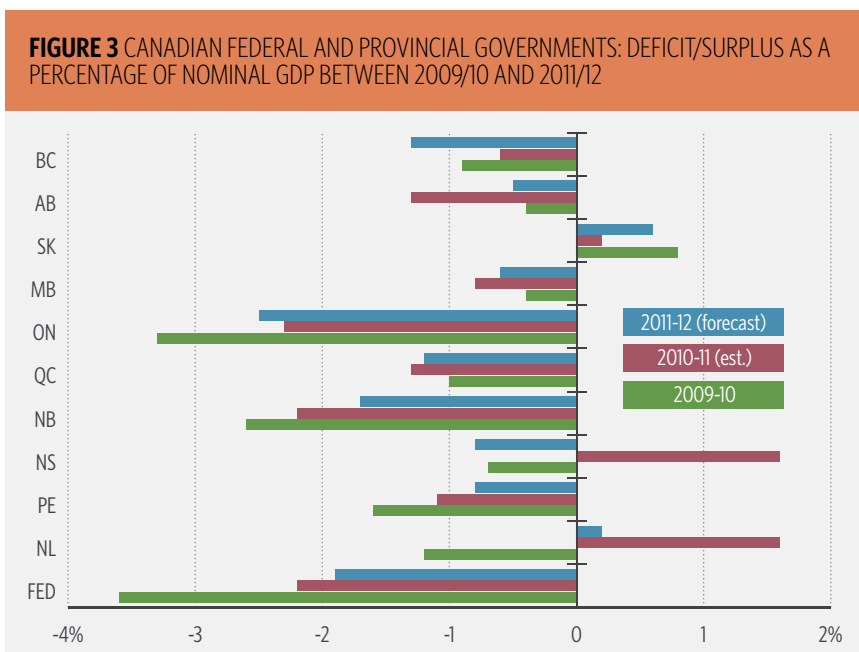
Canadian governments have generally made less headway in returning to balanced budgets than many European governments (see Figure 3). Most provinces have set medium-term deficit elimination targets of either 2013/14 (Alberta, British Columbia, Nova Scotia and Quebec) or 2014/15 (Manitoba and Prince Edward Island) (TD Economics 2011b, 4). The federal government has pushed back its own deadline of 2014/15 by one year (Curry and Howlett 2011).

Ontario faces a particularly sustained period of fiscal restraint. Its deficit elimination goal, established in the March 2011 budget, is 2017/18. It must now meet this target while also fulfilling recent election commitments (TD Economics 2011c).



British Columbia’s 2013/14 deficit elimination target also faces the challenge of absorbing an estimated CAD \$2.3 billion shortfall created by voters’ recent rejection of the harmonized sales tax (British Columbia Ministry of Finance 2011a).

Even as provinces scale back or eliminate their deficits, they continue to face growing overall debt burdens as well as rising interest payments. The governments of Nova Scotia, Ontario, and Quebec estimate their debt servicing costs will increase by 9.2, 20, and 24.7 per cent, respectively, between the fiscal years 2010/11 and 2012/13 (Nova Scotia Ministry of Finance 2011, 1.5; Ontario Ministry of Finance 2011, 195; Quebec Ministry of Finance 2011a, A.9).



Source: TD Economics 2011b.

As Table 1 shows, an increasingly sizeable portion of government spending will be diverted to servicing interest on debt over the next few years. This will further strain program budgets (TD Economics 2011d, 3). Putting public finances on a fiscally sustainable path will require Canadian governments to tackle their long-term debts.

TABLE 1 ONTARIO AND QUEBEC: PERCENTAGE OF TOTAL GOVERNMENT BUDGETARY EXPENDITURES DIVERTED TO SERVING DEBT INTEREST, 2009/10 TO 2013/14

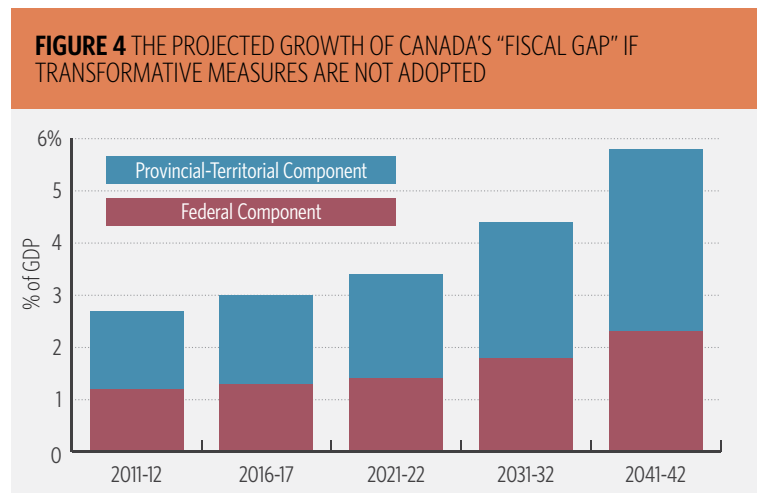
	ONTARIO	QUEBEC
2009/10	7.6	9.2
2010/11	7.7	10
2011/12	8.3	10.9
2012/13	9.1	11.8
2013/14	9.7	12.6

Source: Ontario Ministry of Finance 2011, 195; Quebec Ministry of Finance 2011a, A.9.

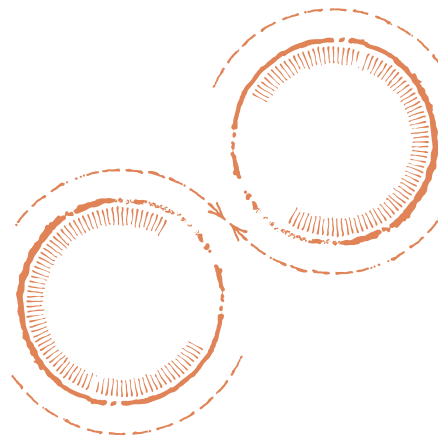
Canadian governments also cannot afford to ignore the long-term implications of current demographic trends. Canada's aging population will inevitably drive up government spending on healthcare and on age-related benefits such as pensions, while at the same time reducing labour force participation and tax revenues.

According to the Parliamentary Budget Officer (PBO), Canada's governments face a growing "fiscal gap" between revenues and expenditures. The PBO estimates the combined federal-provincial-territorial fiscal gap at 2.7 per cent of national GDP. Left unaddressed for a further 5, 10, 20, or even 30 years, the fiscal gap is expected to climb to 3, 3.4, 4.4, or 5.8 per cent of national GDP, respectively (see Figure 4).

Sustained long-term expenditure reductions or revenue increases are necessary. The longer this problem is ignored, the more drastic the policy response to it will have to be (PBO 2011a).



Source: PBO 2011a.

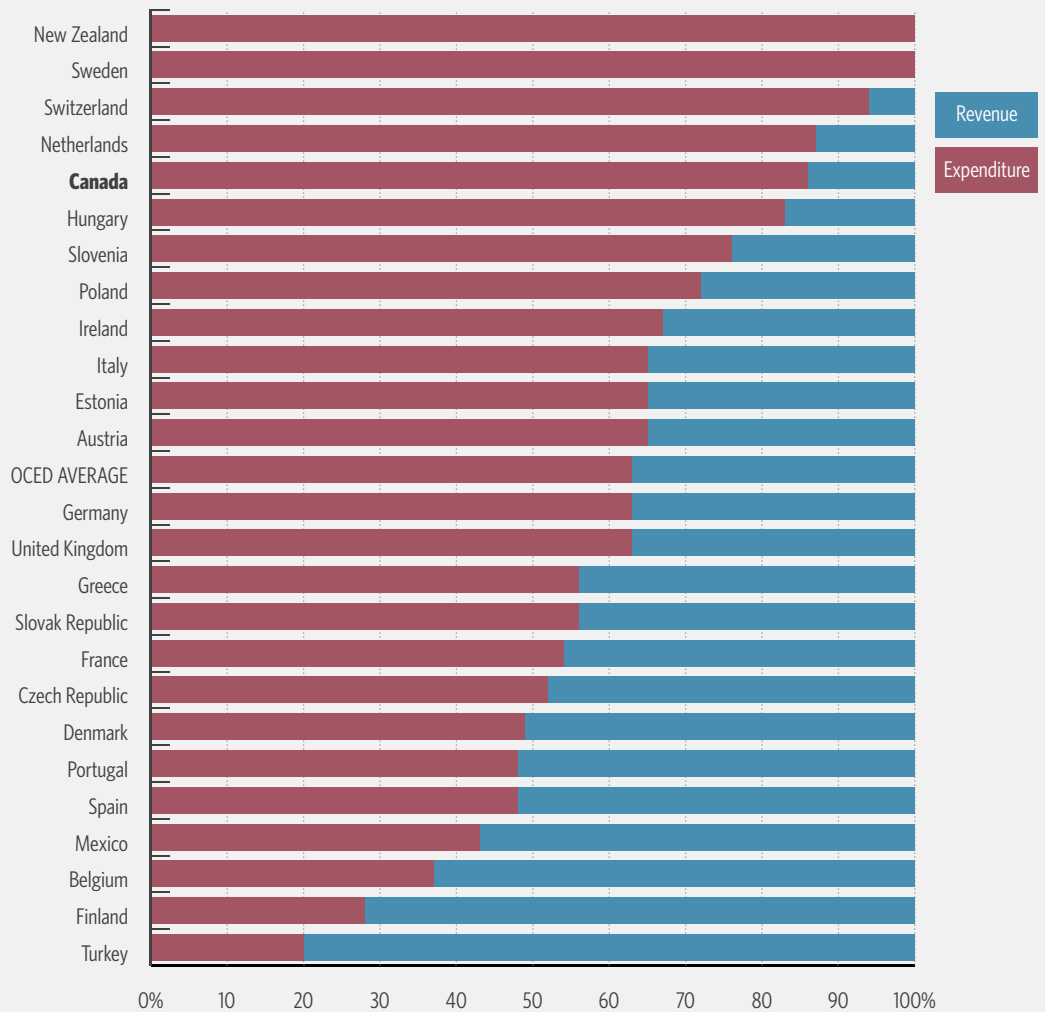


SECTION TWO

SHORT-TERM MEASURES TO INCREASE REVENUE

Continued market volatility, fluctuating economic growth, and rising unemployment have made OECD governments reluctant to reduce deficits by raising taxes. Revenue generating measures account for only 34 per cent of the fiscal consolidation efforts underway across the OECD. Nonetheless, tax increases have been employed by almost all OECD member states, particularly by those tackling substantial deficits (see Figure 5).

FIGURE 5 THE REVENUE/EXPENDITURE COMPOSITION OF FISCAL CONSOLIDATION PLANS AMONG OECD GOVERNMENTS



Source: OECD 2011c, 40.

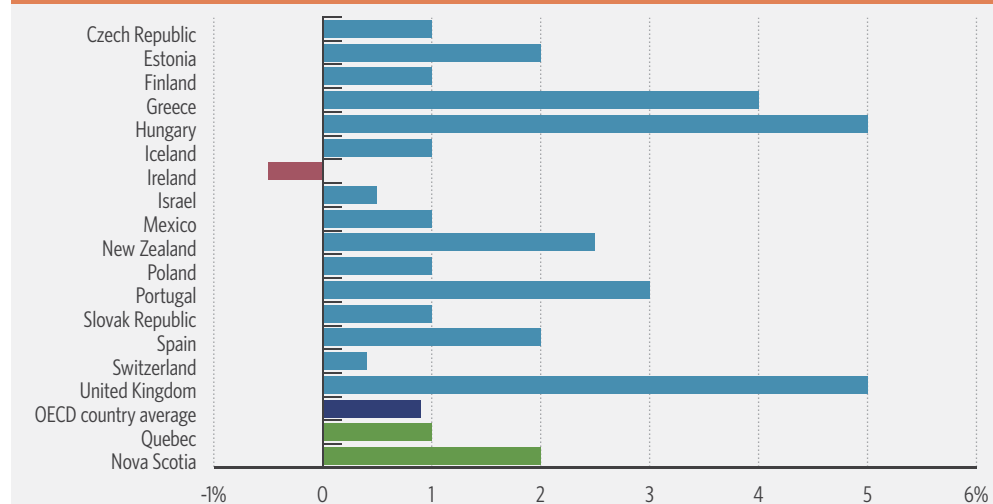
CONSUMPTION-BASED TAX INCREASES

The most popular short-term revenue generating strategy among OECD member states has been increasing consumption-based taxes, particularly Value Added Taxes (VAT) and excise taxes.

Since July 2009, fifteen OECD countries have raised their VAT rates on goods and services by between 0.4 and 5 percentage points (see Figure 6). Even in Ireland, where the VAT rate was lowered from 21.5 per cent to 21 per cent in January 2010, it is set to rise again to 22 per cent in 2013 and 23 per cent in 2014.

Canada's federal sales tax has remained constant since 2008. Nonetheless, rates have been raised at the subnational level. Nova Scotia and Quebec—the provinces with the highest provincial debt-to-GDP ratios in Canada²—have both raised their sales taxes in the past eighteen months (see Figure 6).

FIGURE 6 PERCENTAGE POINT CHANGES IN VAT RATES AMONG OECD MEMBER STATES BETWEEN JULY 2009 & SEPTEMBER 2011



Source: TMF Group 2011.

Notes: OECD member states in which there was no change in VAT rates between July 2009 and September 2011 are omitted. The rate of increase shown for the UK is distorted by the temporary reduction in VAT between December 2008 and January 2011 from 17.5 per cent to 15 per cent. The UK VAT rate rose from 17.5 per cent to 20 per cent in January 2011. Quebec is set to raise its sales tax by a further percentage point in January 2012.

The increase of excise taxes, particularly on tobacco and alcohol, has also been pervasive across the OECD. For some products, these taxes have been justified on health policy grounds, as in the UK government's targeting of budget cigarettes and high-strength beer (HM Treasury 2011a, 39). Countries such as Austria, Belgium, Slovenia, and Turkey have raised taxes on a range of items including fuel, plane tickets, company cars, and mobile phones (OECD 2011a).

Consumption-based taxes are advocated as the most "growth-friendly" of taxes, perhaps explaining why they have been so widely adopted

(OECD 2011a). It is for precisely this reason that Portugal's pro-growth tax strategy combines income tax cuts with VAT hikes (IMF 2011b, 6).

Early evidence suggests VAT increases have had a considerable impact on public finances. The UK's Office of National Statistics credits the UK's VAT increase with helping reduce expected central government net borrowing by £1.5 billion in March 2011 alone (ONS 2011a). The OECD acknowledges the role excise taxes are playing in Iceland's improved financial outlook (OECD 2011a, 29).

There are, however, tangible risks involved in raising consumption-based taxes. One is an expansion in the black market economy. Statistics Canada estimates that hikes in tobacco excise taxes in the early 1990s caused the market share of contraband tobacco to increase from 1 per cent in 1987 to approximately 31 per cent in 1993 (Gabler and Katz 2010).

There is also a danger of consumer flight to bordering jurisdictions. In 2009, for example, the Irish retail sector lost consumers to Northern Ireland when Ireland's temporary increase in VAT coincided with the UK's temporary reduction (TMF Group 2010).

Recent VAT and excise tax increases have also pushed up consumer price index inflation in the UK, France, and Spain in 2011, lowering real disposable incomes (European Commission 2011; King 2011). The regressive nature of these taxes means they have had a disproportionate affect on low income households.

INCREASE IN THE TOP RATE OF INCOME TAX

Many OECD governments have sought to increase their income tax revenues. Ireland and Greece have lowered their income tax thresholds so as to broaden their tax base. Other OECD governments have focused on more progressive revenue-raising strategies and increased the top rate of income tax.

In a survey of 86 countries conducted in 2010, KPMG calculated an average increase of 0.3 percentage points (pp) in the top rate of personal income tax between 2009/10 and 2010/11 (KPMG 2010a, 6). The average increase is 0.7 pp among OECD countries.

Several countries, including Denmark (-6.9 pp) and Hungary (-4 pp), remain committed to using top-rate cuts as stimulus measures. Others have introduced significant rate hikes, with the UK (10 pp), Iceland (9.1 pp), and Norway (7.8 pp) leading the way (see Figure 7).

This trend looks set to continue across the OECD. For example, Spain's 2011 budget introduced a rate increase from 43 per cent to 45 per cent on incomes over €175,000 (OECD 2011a, 188).

Additional pressure to increase taxes on high income earners has come in the form of high profile interventions by prominent business figures such as Warren Buffett and Liliane Bettencourt. Bettencourt prompted the French government to introduce a surtax of three per cent on incomes over €500,000 in August 2011. The US government has incorporated a proposed “Buffett Rule” (to ensure wage earners of over USD \$1 million face a higher rate of taxation) into its most recent tax reform plans.

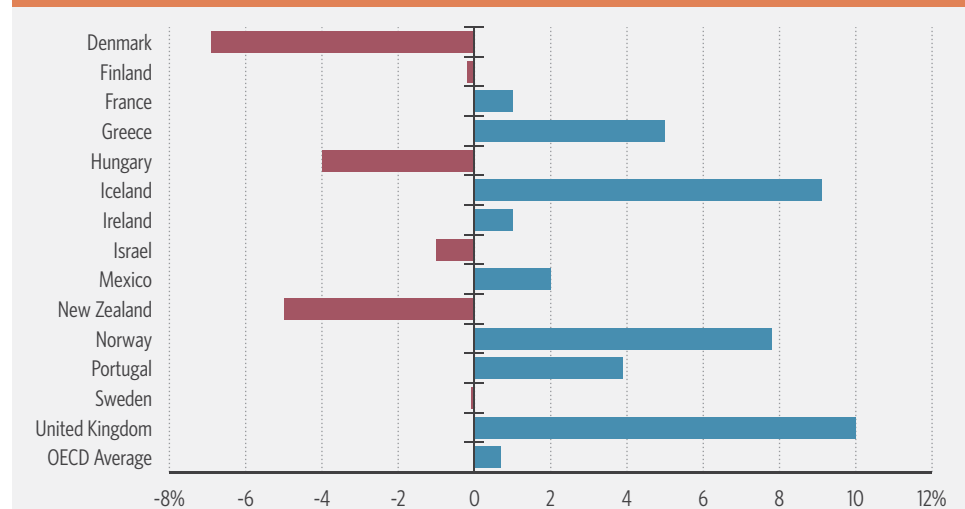
The long-term effectiveness of increasing the top rate of income tax is subject to a number of contingencies. First, these increases target a particularly internationally mobile demographic. This is the main reason that the Institute for Fiscal Studies has recently doubted whether the UK’s 10pp increase “will raise any revenue at all” (Mirrlees et al. 2011, 109).

Secondly, the popularity of such measures is shaped by the particular sensibilities of national political cultures. For example, while Bettencourt’s intervention helped tax increases pass through France’s legislature, it is doubtful whether Buffett’s advocacy will have a similar effect in the US.

Thirdly, in federal systems, separate income tax policies at both levels of government complicate the implementation of increases to the top rate of income tax. In Canada, for example, the top tax rate at the federal level is 29 per cent. Nonetheless, once provincial income taxes are accounted for, the total tax rate paid by wage earners of over CAD \$127,022 ranges between 39 per cent and 48.25 per cent (KPMG 2010a, 42).

Finally, the revenue potential of increases to the top rate of income tax depends on the structure of tax credits, reductions, and exemptions available in a particular jurisdiction.

FIGURE 7 PERCENTAGE POINT CHANGES IN THE TOP RATE OF INCOME TAX AMONG OECD MEMBER STATES BETWEEN 2009/10 & 2010/11



Source: KPMG 2010a.

Notes: OECD member states in which there was no change in the top rate of income tax between 2009/10 and 2010/11, including Canada, are omitted.

TAXES ON FINANCIAL INSTITUTIONS

Governments are generally shying away from managing deficits through corporate tax increases, with some governments even favouring growth-promoting tax cuts. Nonetheless, many governments have raised taxes or imposed levies on sectors that typically experience windfall profits. For instance, the UK government increased taxes on North Sea oil production profits in March 2011, to be reversed should oil prices drop to approximately USD \$75 a barrel (HM Treasury 2011a).

The most prominent trend to date has been levies on the financial sector. Many countries are introducing bank levies, even though international efforts to coordinate such levies have proved unsuccessful. Austria, France, Hungary, Iceland, Portugal, and the UK, are using these levies as revenue-raising mechanisms, with money being paid into national treasuries. Sweden, Germany, and Cyprus are taking a more transformative approach with revenues being transferred to permanent stabilization funds that can be drawn upon should future bank bailouts be necessary (KPMG 2011).

Bank levies can be lucrative in the short-term. In 2010, the UK's one-off bank payroll tax raised £3.5 billion (ONS 2011b). Its new bank balance sheet levy announced in the March 2011 budget is projected to bring in annual revenues of over £2.5 billion by 2012/13 (HM Treasury 2011a). In addition, bank levies offer governments a means of recouping recent bailout costs and often encourage better risk management by financial institutions through penalizing high-risk portfolios. Bank levies have also proved popular with electorates.

It is as yet unclear what impact bank levies will have on the competitiveness of national financial sectors. The current lack of international coordination on bank levies means that banks are at risk of double taxation if governments impose levies on foreign subsidiaries and the global activities of domestic banks. If financial institutions respond by shifting their operations or corporate headquarters to more tax-friendly jurisdictions, investment, jobs, and tax revenues would suffer.

Bank levies do, however, contribute to long-term financial stability if they are used to set up stabilization funds rather than being spent (Blakemore 2010; IMF 2010).

Both the G20 and the European Union are currently considering financial transaction tax (FTT) proposals as a means of raising significant revenues and discouraging speculation. Significant opposition from members within both organizations, however, will make these taxes difficult to introduce.

Neither bank levies nor FTTs are likely to be implemented in Canada with the federal government expressing strong opposition to any additional taxing of Canada's financial institutions.³

MORE EFFECTIVE TAX ENFORCEMENT

Our first *Shifting Gears* report highlighted the existing scope for boosting tax revenues through improved compliance (Mendelsohn et al. 2010a, 19). Governments are now pursuing a wide variety of strategies to tackle both domestic and offshore tax evasion.

High deficit countries such as Greece and Italy have made domestic tax compliance a central part of their consolidation programs (OECD 2011a). For instance, Greece's Medium-Term Fiscal Strategy seeks to recoup at least an additional 1.5 per cent of GDP through improved compliance between 2012 and 2015 (Ministry of Finance Greece 2011, 11).

Governments have also adopted a raft of measures to address offshore tax evasion. For example, the US Foreign Account Tax Compliance Act (2010) requires US citizens to report all foreign holdings to the Internal Revenue Service (IRS), with heavy penalties for noncompliance.

Governments are also negotiating agreements with traditional tax havens. In August 2011, for instance, the UK government reached an agreement with Switzerland to recoup taxes from the previously undisclosed Swiss holdings of UK residents. From 2013, the balance of undeclared bank accounts will be subject to a one-off levy (19-34 per cent) that covers outstanding tax liabilities. Going forward, Swiss banks will collect a "withholding tax" on undisclosed investment income (48 per cent) and capital gains (27 per cent) from these accounts on behalf of the British government (HM Treasury 2011b). Germany has concluded a similar agreement with Swiss authorities.

Such measures are politically uncontroversial and have the potential to improve the fairness and credibility of the tax system. Potential revenue gains are also substantial—Statistics Canada has estimated the value of Canada's domestic underground economy at up to CAD \$36 billion in 2008 (Statistics Canada 2011a).

On the other hand, revenue gains from tackling offshore evasion are difficult to predict because measures targeted at one tax haven could prompt capital flight to another.

SECTION THREE

TRANSFORMATIVE APPROACHES TO INCREASE REVENUE

Many OECD governments are embracing transformative tax initiatives to raise funds while at the same time promoting long-term prosperity, social well being, and fiscal sustainability. Some governments are also looking at alternative financing models that change both what government does and how it raises revenues. The UK, in particular, is experimenting with a number of new financing mechanisms that are being closely monitored by the international community.

CARBON TAXES

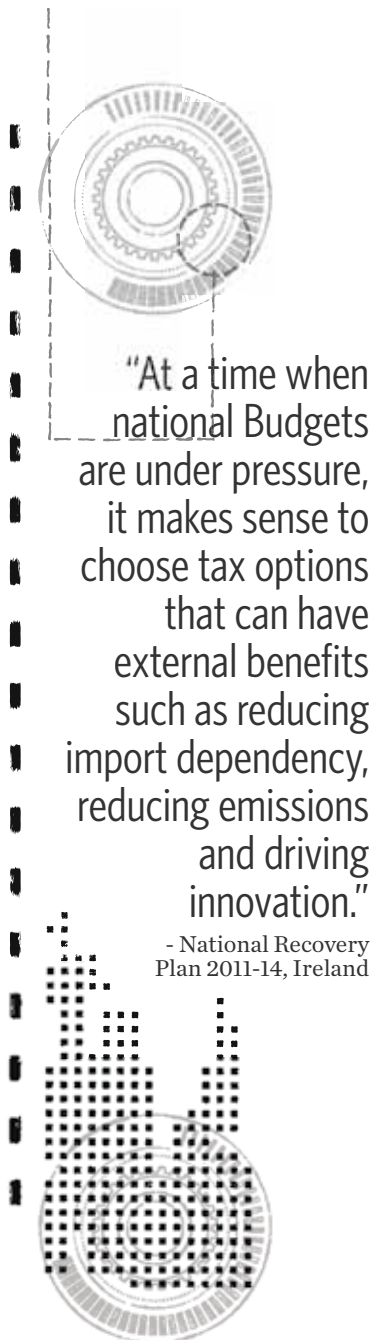
Some OECD jurisdictions are adopting taxes on carbon-based fuels as a transformative tax policy. Alongside generating revenue, these taxes seek to cut carbon emissions and strengthen the economy by stimulating technological innovation and reducing dependency on fossil fuel imports. Carbon taxes have recently been introduced in Quebec (2007), British Columbia (2008), and Ireland (2010), with Australia to follow in 2012.

Carbon taxes differ with respect to the rate of taxation; how the taxes are levied (at the point of production, distribution, or purchase); and how revenues are utilized (added to general revenue as in Ireland, earmarked for investment in specific programs as in Quebec, or returned to consumers through tax reductions as in British Columbia; see Box 1).

BOX #1: BRITISH COLUMBIA'S CARBON TAX

In 2008, British Columbia introduced a tax on the purchase of carbon-based fuels. This tax is structured to promote the growth of a low-carbon economy by encouraging a gradual change in British Columbians' consumption habits.

By 2012/13, the scheme is forecast to generate CAD \$1.1 billion in revenue. These proceeds will then be redistributed in tax reductions to lower-income households, small businesses, and corporations. This initiative shifts the focus of tax policy away from income sources and onto environmental well being, social equality, and the promotion of sustainable economic growth (Sumner et al. 2009, 5).



"At a time when national Budgets are under pressure, it makes sense to choose tax options that can have external benefits such as reducing import dependency, reducing emissions and driving innovation."

- National Recovery Plan 2011-14, Ireland

Carbon taxes have often proved politically difficult to introduce, as shown in the 2008 Canadian federal election campaign. In 2010, the French government abandoned plans for a carbon levy of €17 per tonne amid unfavourable court rulings and fierce public and business opposition.

In times of fiscal constraint, however, carbon taxes may be more politically palatable. The Irish government, for example, was forced to call off an unpopular carbon tax plan in 2004, but nonetheless introduced a €15 per tonne tax in 2010.

One criticism of carbon taxes is that they place a heavy strain on household budgets. Lower income taxpayers are particularly vulnerable to these taxes when not compensated through tax reductions or where energy producers simply pass costs on to consumers.

The direct environmental impact of carbon taxes is hard to measure accurately. In British Columbia, fuel consumption per capita has fallen by 4.5 per cent since its carbon tax was introduced in 2008 (Economist 2011). Greenhouse gas emissions have declined in four of the five European states that introduced carbon taxes in the early 1990s (Finland, the Netherlands, Sweden, and Denmark). Even in the fifth, Norway, where emissions increased, its carbon tax has been widely credited with stimulating emissions-reducing technological innovation in the offshore oil and gas industry (Sumner et al. 2009, 11; OECD 2011d, 126).

Where carbon tax revenues fund designated programs, the benefits of carbon taxes are more transparent (Sumner et al. 2009). Under Quebec's Climate Change Action Plan, for instance, carbon tax proceeds are financing public transit programs dedicated to the purchase of hybrid and electric buses and improving both rural provision and wheelchair accessibility on inter-city buses (Government of Quebec 2008).

ALTERNATIVE REVENUE SOURCES

User Fees

Many governments are attempting to raise funds for public services by introducing user fees. Under this model, part or all of service operating costs are met by the end user. For instance, Ireland's fiscal consolidation measures include user charges for domestic water

supply (which had been fully subsidized out of general tax revenues since 1997) (Government of Ireland 2010).

User fees are also emerging as a central part of Canada's deficit reduction strategy. Under the federal government's Strategic and Operating Review of 2011/12, departments and agencies are being encouraged to consider user fees to offset spending commitments (Clement 2011). Health Canada, Parks Canada, Canadian Heritage, and Natural Resources Canada are already conducting consultations on raising or introducing user fees. In December 2010, the Parole Board of Canada committed to preparing a new fee system where the full cost of a pardon request will be met by applicants (TBCS 2011). The City of Toronto is also undertaking a User Fees Review to inform its deficit reduction planning.

Governments often consider user fees a more politically palatable way of addressing budget deficits than tax increases or spending cuts. Still, the introduction of some fees has proved controversial, as evidenced by university tuition fee protests in the UK.

Advocates argue that user fees help regulate demand by encouraging the more efficient use of public services. For instance, the Irish Government has argued that water charges "will reduce demand to economically efficient levels over both the short- and long-term" (Government of Ireland 2010, 78). In the Canadian context, user fees are also regarded as less damaging to the competitiveness of provincial economies than tax increases (Guillemette 2010, 31).

Yet user fees are typically regressive taxes, limiting service access for those on lower incomes. They can also leave the user vulnerable to bearing the cost of poor service delivery. In the UK in 1999, for example, the cost of passport applications rose in response to the then Passport Agency's botched installation of a new computer system (NAO 1999; Public Accounts Committee 2000).

Legalizing Online Gaming

Online gaming is gaining a growing share of the commercial gambling market. Canadians are estimated to be spending approximately CAD \$1 billion a year on prohibited offshore gaming websites (KPMG 2010b, 10).

This trend has prompted many North American jurisdictions to consider legalizing and regulating online gaming. This is seen as a means of generating additional tax revenue while also protecting citizens.

Both British Columbia and Quebec launched regulated gaming websites in 2010, run by their respective lottery corporations, the British Columbia Lottery Corporation (BCLC) and Loto-Québec.

British Columbia's 2011 budget expects income from BCLC's *playnow.com* to help offset the fall in revenues from conventional lottery and casino-based gambling, which have declined during the economic downturn (British Columbia Ministry of Finance 2011b, 15). BCLC's

proceeds are distributed to municipal governments, charities and health services. Legalizing online gaming is therefore a way of sustaining this funding source at a time of declining revenues.

Proponents argue these online platforms also provide an alternative safe space for citizens who already participate in online gaming, with secure payment facilities, responsible marketing, transaction limits, and a fair playing field.

There remains considerable debate as to whether governments are simply keeping up with social and technological change and tapping into an existing revenue stream, or actively promoting gambling (KPMG 2010b). Critics argue that online gaming facilitates addiction, personal debt, and underage gambling.

Payment-by-Results and Social Impact Bonds

Payment-by-results schemes (PBRs) are increasingly popular with governments seeking new financing models for public services. Under PBR arrangements, external providers bear the cost of service delivery and are only paid by government if specified outcomes are achieved.

A particularly promising type of PBR initiative, Social Impact Bonds (SIBs), is planned or being piloted in a number of OECD jurisdictions (see Box 2).

The first SIB pilot project was launched by the UK's Ministry of Justice in September 2010. The scheme is a six-year project aimed at cutting the reoffending rates of short-term prisoners released from Peterborough Prison. It has inspired a range of similar initiatives including a further four SIB projects in the UK and proposed schemes in Australia and the US.

SIBs have the potential to deliver long-term fiscal savings by tackling the root causes of societal demands on high cost program areas such as criminal justice and healthcare. They are especially effective in helping vulnerable individuals that are intensive users of multiple government services and who collectively consume a substantial portion of service budgets.

The UK's 2010 pilot scheme raised £4.9 million of private funds for the rehabilitation of prisoners (Jagelewski 2011). The scheme's two non-profit providers offer individually tailored support including mentoring and re-housing. Early results from one provider reveal high uptake rates—in the region of 70 per cent—for the scheme (UK Ministry of Justice 2011, 51).



BOX 2: PAYMENT-BY-RESULTS SCHEMES (PBRs) & SOCIAL IMPACT BONDS (SIBs)

Payment-by-results schemes involve commissioning external providers to deliver specific outcomes rather than specific services. This emphasis on outcome rather than process is intended to promote innovation and save governments the cost of ineffective delivery.

Governments pay nothing upfront. Instead, providers underwrite the cost of service delivery and are only paid by governments if pre-agreed targets are met.

The viability of PBRs depends on a number of conditions (Social Finance 2011). It must be possible to:

- Attach a monetary value to potential outcomes
- Directly link potential outcomes to government budget savings
- Measure actual outcomes

Getting these conditions right requires both accessible, reliable data and independent measurement. First, data is necessary to price outcomes, develop performance indicators, and ensure the rewards offered by governments are attractive to providers while offering taxpayers value for money. Secondly, both providers and governments must feel wholly satisfied that the procedures for assessing PBR outcomes are reliable and impartial (Social Finance 2011). As a result, assessments are usually carried out by independent auditors.

A common concern with PBRs is that the delivery costs and financial risks faced by providers can prove too prohibitive for specialized but small non-profit organizations to enter the market. Such organizations may have the expertise and experience to deliver certain services but often lack the financial resources required.

Social Impact Bonds are a type of PBR focused on social outcomes. In these schemes the upfront capital required for social intervention projects is supplied by private investors, rather than the provider itself. If a program meets pre-agreed targets, the government then awards these investors (not the provider) a dividend—paid out of the savings it accrues by not having to tackle a particular social problem and its impacts. SIBs are often brokered by intermediary social investment organizations, with program outcomes monitored by independent assessors.

In contrast to other types of PBRs, this funding model allows greater numbers of non-profit sector organizations, with expertise in social services, to participate in service provision.

It is not entirely clear, however, whether SIBs actually promote innovation in social services delivery. Early evidence from the Peterborough pilot scheme suggests investors are more likely to be attracted to the tried and tested methods of well established providers (UK Ministry of Justice 2011, 52). Another risk is that, without careful monitoring, SIBs will simply cherry-pick participants that are comparatively easy to help, rather than prioritizing on the basis of need (Simpson 2009).

If Canadian governments decide to introduce SIBs, the underdeveloped nature of the social investment market in Canada could also prove an obstacle. In the Peterborough pilot scheme, a social finance organization played a crucial intermediary role in brokering the SIB agreement. Canada has relatively few organizations of this type (Jagelewski 2011).

Canadian governments may look to follow recent initiatives launched by the US and UK governments to stimulate the growth of their social investment markets. The 2012 US federal budget allocates up to USD \$100 million to kick-start SIBs (termed “Pay for Success Bonds”) (OMB 2011). The UK has launched Big Society Capital—a £600 million social investment fund derived from the assets of unclaimed bank accounts and contributions from the financial sector (Big Society Capital 2011).

There are also a range of other potential applications for this type of financing model. For example, the UK government is experimenting with the use of this funding mechanism to assist the country’s transition to a low carbon economy. Its flagship “Green Deal” initiative will see private investors meeting the cost of energy efficiency retrofits to public, residential and commercial buildings, and being reimbursed by bill-payers through the savings generated (UK DECC 2011).

On all of these initiatives, the crucial success factors for government to get right include reliable data in designing program delivery, a process for independent measurement and reporting, and sufficient capital.

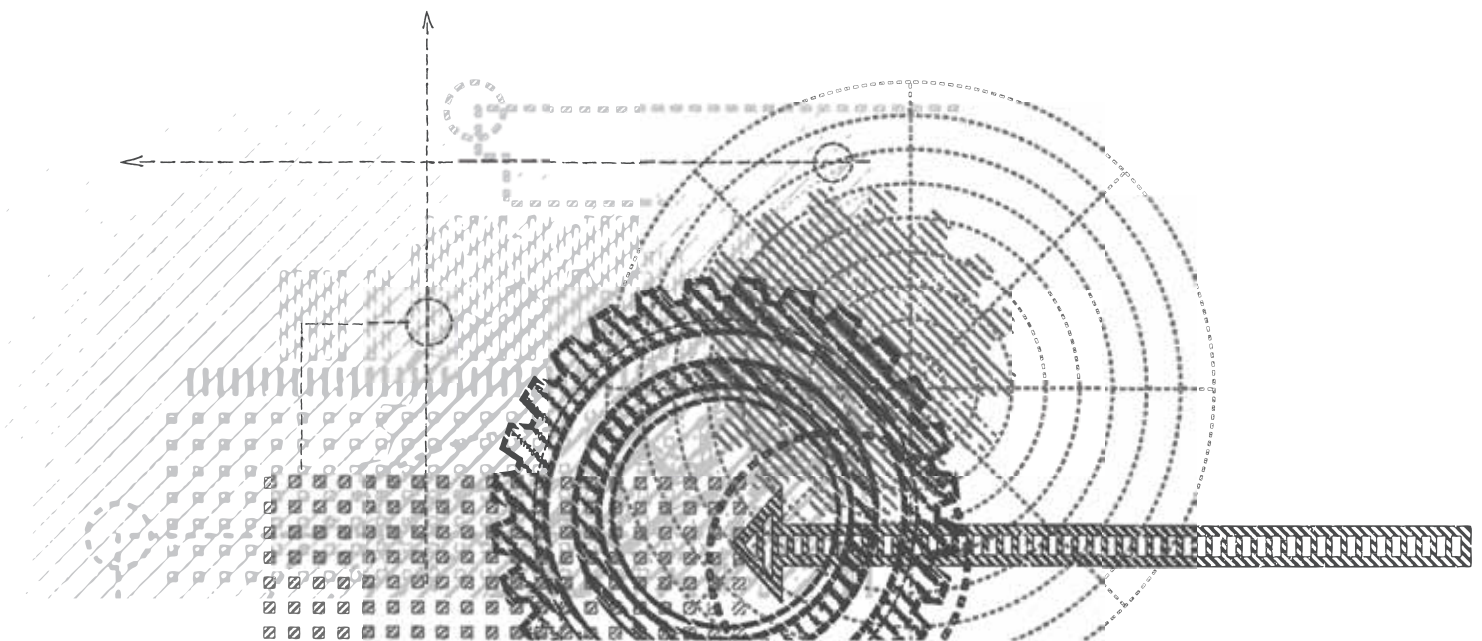


TABLE 2A: SUMMARY OF SHORT-TERM REVENUE-RAISING MEASURES

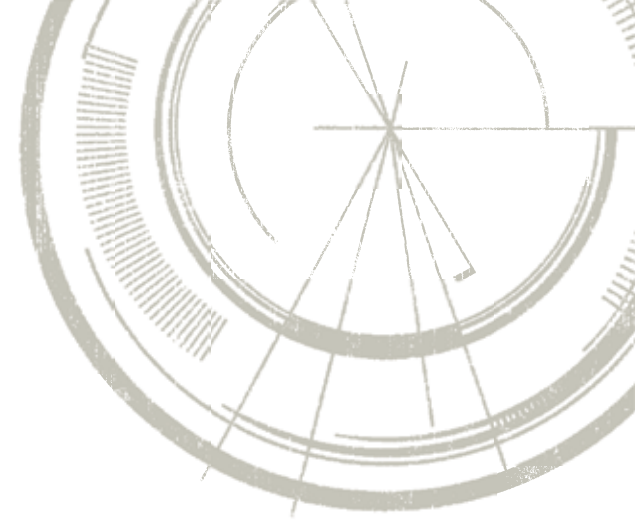
INITIATIVE	JURISDICTIONS INVOLVED	RISKS	BENEFITS	RESULTS TO DATE
Increase Value Added Tax rates	Czech Republic, Estonia, Finland, Greece, Hungary, Iceland, Ireland (2013), Israel, Mexico, New Zealand, Poland, Portugal, Slovakia, Spain, Switzerland, UK Nova Scotia and Quebec	<ul style="list-style-type: none"> Consumer flight to bordering jurisdictions Regressive tax Increase in consumer price index inflation and corresponding reduction in real disposable incomes 	<ul style="list-style-type: none"> Comparatively “growth-friendly” Easy to implement/administer 	<ul style="list-style-type: none"> Increase in consumer price index inflation and corresponding reduction in real household disposable income (Spain, UK) Increase in tax revenue has driven down net government borrowing (UK) Consumer flight to neighbouring jurisdictions (Ireland)
Increase excise taxes	Australia, Austria, Belgium, Czech Republic, Estonia, France, Greece, Hungary, Iceland, Israel, Mexico, Poland, Slovakia, Slovenia, Spain, Switzerland, Turkey, UK	<ul style="list-style-type: none"> Expansion of the black market economy Consumer flight to bordering jurisdictions Regressive tax 	<ul style="list-style-type: none"> Comparatively “growth-friendly” Supports health policy objectives in relation to the effects of tobacco and alcohol Easy to implement/administer 	<ul style="list-style-type: none"> Increase in tax revenue has improved Iceland’s economic outlook Increase in consumer price index inflation and reduction of real household disposable income (France, Spain)
Increase the top rate of income tax	France, Greece, Iceland, Ireland, Mexico, Norway, Portugal, Spain, UK	<ul style="list-style-type: none"> High wage earners vacating one tax domicile for another 	<ul style="list-style-type: none"> Progressive tax Popular with the majority of the electorate Easy to implement/administer 	
Bank levies	Austria, Cyprus, France, Germany, Hungary, Iceland, Portugal, Sweden, UK	<ul style="list-style-type: none"> Banks risk double taxation if levies are imposed on foreign subsidiaries and the global activities of domestic banks Banks may relocate their operations to more “tax-friendly” jurisdictions Reduction in the competitiveness of national financial sectors Significant administrative setup costs for tax authorities 	<ul style="list-style-type: none"> Popular with electorate Encourages better risk management by penalizing high-risk portfolios Offers a means of recouping banking sector bailout money Reduces prospect/impact of future financial crises (if levies are paid into stabilization funds) 	
More effective tax enforcement	Canada, Germany, Greece, Slovenia, Italy, UK, USA	<ul style="list-style-type: none"> Risk of capital flight from one tax haven to another Payoffs are uncertain as the extent of compliance is difficult to predict 	<ul style="list-style-type: none"> Boosts credibility of tax system Boosts perceived fairness of tax system Politically uncontroversial 	<ul style="list-style-type: none"> Anecdotal evidence suggests increased compliance/ revenues

TABLE 2B: SUMMARY OF TRANSFORMATIVE REVENUE-RAISING MEASURES

INITIATIVE	JURISDICTIONS INVOLVED	RISKS	BENEFITS	RESULTS TO DATE
Carbon tax	Australia (2012) and Ireland British Columbia and Quebec	<ul style="list-style-type: none"> • Opposition from the public and business community • Regressive tax • Significant administrative setup costs 	<ul style="list-style-type: none"> • Reduction in carbon emissions • Promotes green energy innovation needed for a low-carbon economy • Potential to reduce long-term dependency on fossil fuel imports by encouraging the use of non-carbon based energy sources 	<ul style="list-style-type: none"> • Reduction in carbon-based fuel consumption (British Columbia) • Tax revenues invested in public transit (Quebec) • Encouraged innovation in carbon capture and storage techniques (Norway) • Strong stakeholder opposition (Australia, Canada, France) • Tax reductions for low income households have helped offset the regressive impact of British Columbia's carbon tax • Tuition fee protest (UK)
User fees	Canada, Hungary, Ireland, Sweden, UK	<ul style="list-style-type: none"> • Strong opposition from user groups • Regressive tax • Leaves user vulnerable to bearing the costs of poor or inefficient service delivery 	<ul style="list-style-type: none"> • Less damaging to economic competitiveness than increasing taxes • Encourages the more efficient use of public services 	<ul style="list-style-type: none"> • The revenues from British Columbia's playnow.com have helped offset declining tax revenue from conventional lottery and casino-based gambling • Municipal governments, charities, and health services have already benefited from online gaming revenues in British Columbia
Legalizing online gaming	British Columbia, Quebec (since 2010)	<ul style="list-style-type: none"> • Greater ease of access to gambling may exacerbate addiction and associated financial hardship • Problematic online identity verification may facilitate underage gambling 	<ul style="list-style-type: none"> • Taps into an already established revenue stream • Greater citizen protection through regulation and licensing 	<ul style="list-style-type: none"> • Startup funds to kick start social investment market (UK, US) • High participation rates from target population (UK) • Careful monitoring of service delivery (UK) • Investors have been attracted to the tried and tested methods of well established providers rather than innovative approaches of new service delivery partners (UK)
Social Impact Bonds	Australia, UK, USA	<ul style="list-style-type: none"> • May incentivize investors to cherry-pick scheme participants that are easy to help, rather than prioritize on the basis of need 	<ul style="list-style-type: none"> • New funds to tackle the root causes of societal demands on program budgets • Inefficiencies and failures borne by private investors alone rather than taxpayer • Harnesses the expertise and innovative capacity of the non-profit sector • Additional assistance for vulnerable or disadvantaged populations 	

SECTION FOUR

SHORT-TERM MEASURES TO DECREASE SPENDING



Cuts in public expenditure account for almost two-thirds of fiscal consolidation efforts underway in OECD member states (see Figure 5; OECD 2011a). Countries receiving international bailouts, in particular, have had substantial spending cuts demanded of them. These cuts have had a significant impact on the footprint of government as well as on citizens' expectations of public services across OECD jurisdictions.

The deficit reduction plans of most OECD governments have some provisions for cutting operating costs. Several have even made this a high priority and imposed across-the-board spending cuts.

Canada's federal government has frozen departmental operating budgets for two years at their 2010/11 level (Ministry of Finance Canada 2011, 179). The UK government has targeted savings averaging 34 per cent in the administration budgets of central departments and arm's length bodies between 2010/11 and 2014/15 (HM Treasury 2010, 9). France, the Netherlands, and Estonia have also sought widespread cutbacks in public administration costs (OECD 2011a).

OECD governments are realizing operational savings in multiple areas including advertising, marketing, procurement, IT, and hospitality. However, the majority of measures have been directed at reducing the public sector wage bill.

On average, the public sector wage bill accounts for 24 per cent of general government expenditure, and the majority of operating budgets, across the OECD (OECD 2011c, 48). In the 2009/10 Public Accounts of Canada, for instance, personnel costs made up 67 per cent of departmental operating budgets, and this percentage has been growing over the past five years (PBO 2011b, 2).

Over half of OECD member states are looking to cut back on this outlay, principally through a combination of headcount reductions and wage moderations. Canadian governments are primarily relying on attrition and wage freezes to reduce payroll costs (see Table 3).

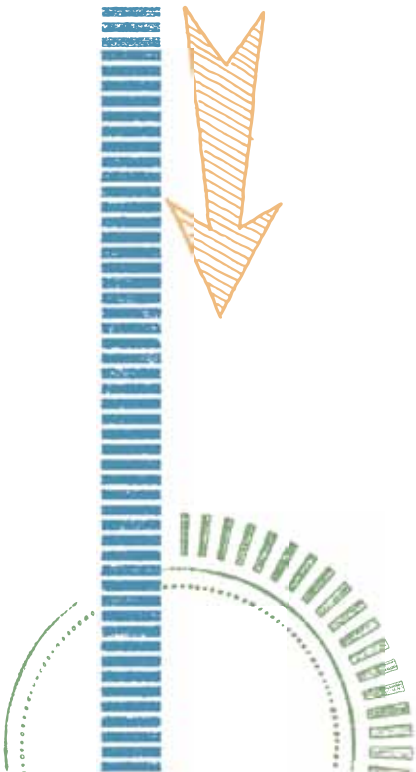


TABLE 3 SHORT-TERM MEASURES USED BY OECD MEMBER STATES TO REDUCE THEIR PUBLIC SECTOR WAGE BILLS

PUBLIC SECTOR PAYROLL REDUCTION MEASURES	OECD GOVERNMENTS (EXCLUDING CANADA)	CANADIAN GOVERNMENTS (FEDERAL & PROVINCIAL)
HEADCOUNT REDUCTION		
Incentivized departure schemes (early retirement and voluntary severance)	Ireland, UK	British Columbia, Federal government
Career breaks/unpaid leave	Ireland	New Brunswick
Recruitment freezes	Ireland, Portugal, UK	New Brunswick
Lowering replacement ratios	Austria, Czech Republic, France, Greece, Italy, Portugal, Spain, Turkey	British Columbia, Federal government, Ontario, Saskatchewan
WAGE MODERATION		
Wage cuts	Czech Republic, Denmark (ministerial level), Greece, Ireland, Italy (high earners), Portugal (high earners), Slovakia, Slovenia, Spain	
Salary caps	Greece, Ireland	
Wage freezes	Greece, France, Italy, Netherlands, Portugal, Spain, USA, UK	British Columbia, Manitoba, New Brunswick, Ontario
Limits on promotions	Ireland, Portugal	
Bonus cuts or freezes	Germany, Greece, Hungary, USA	
Restrictions on overtime pay	Greece, Ireland	

Sources: Holmes and Lilico 2010; OECD 2011a; OECD 2011c; provincial budgets (2009-2011).

Note: A number of countries have announced plans to reduce headcounts (Germany and Slovenia) or moderate wages (Belgium, Estonia, and the Slovak Republic) without providing policy details.

PUBLIC SECTOR HEADCOUNT REDUCTIONS

Most governments wishing to reduce the size of their public sector workforce are relying on natural attrition to minimize labour unrest and the upfront financial costs of severance packages. Governments have lowered replacement ratios to anywhere between 10 per cent (Spain) and 50 per cent (Austria, France, and Portugal) (OECD 2011c, 49; see Table 3).

The UK and Ireland have sought more rapid wage bill reductions through introducing recruitment freezes alongside incentivized career breaks and voluntary exit schemes. As a result, the UK's civil service headcount fell by 5.4 per cent (25,820 full-time equivalents) between September 2010 and September 2011 (IFG 2011). The Irish public sector workforce fell by 1.7 per cent (5,349 full-time equivalents) between April 2010 and March 2011, resulting in sustainable wage bill savings of approximately €289 million (Implementation Body 2011a).

As well as the disruption to services that necessarily comes with any large-scale restructuring, this policy has also resulted in a disproportionate number of senior civil servants exiting the public service in both Ireland and the UK. Whether the consequent redistribution of responsibilities to less experienced civil servants constitutes an increase in efficiency or a critical loss of institutional memory and expertise remains to be seen.

Early retirement schemes have also pushed up the cost of pensions—contributing in part to a 14.3 per cent increase in the Irish Exchequer’s pension bill (Implementation Body 2011a, 7).

PUBLIC SECTOR WAGE MODERATION

Public sector payrolls are also being reduced through a range of wage moderation strategies. These include the UK’s efforts to save £3.3 billion through a two year pay freeze introduced in June 2010, Portugal’s targeted public sector pay cut of five per cent, and Germany’s suspension of civil servant bonuses in 2011—the equivalent of a 2.5 per cent salary cut (Ernst & Young 2010).

Unlike headcount reductions, which involve upfront costs, wage moderation measures offer direct and immediate savings. These measures can also reduce inflation. Spain’s 5 per cent cut in public sector wages in 2010 and public sector wage freeze in 2011 have been credited by the European Union with helping ease inflation (European Commission Economic and Financial Affairs 2011).

Advocates of wage moderation measures point to the need to close the gap between public and private sector pay—a gap that has grown during the recession. This gap increases significantly if other employment benefits are taken into account (Tiagi 2010, 471).

Risks associated with these measures include a national reduction in real disposable income (given that on average, 15 per cent of OECD country workforces are employed in the public sector), and labour unrest (as recently occurred in Greece, Ireland, Spain, and the UK) (OECD 2011c, 48).

PUBLIC SECTOR PENSION CUTS

Public sector pensions have been one of the primary drivers of rising labour costs during the financial crisis. Reducing pension costs has become a focus of expenditure reduction efforts in many OECD jurisdictions, even though complex legal frameworks leave governments with little maneuvering room in making adjustments to existing pension plans (see Box 3).



France, the UK, and Ireland are increasing average employee contributions by 2.7 per cent, 3 per cent, and 7.5 per cent, respectively. The UK is set to derive further savings from tying pensions to consumer price index inflation (which stood at 2.8 per cent in 2010/11) rather than retail price index inflation (which stood at 4.8 per cent in 2010/11) (IFS 2011). Other OECD governments, such as Hungary, are freezing government pension contributions.

In the US, pension cuts are largely being made at the state and municipal levels. Colorado and Minnesota have cut cost-of-living adjustments on existing public sector pensions. Detroit has reduced police pension benefits for 2011/12. Many US jurisdictions have temporarily suspended their pension fund contributions, with the expectation of catching up with these payments as the economic outlook improves (Baker 2011).

As with wage moderation, advocates of cuts to public sector pensions point to a growing disparity between the public and private sector. In the UK, for instance, the average value of public sector pensions (adjusted for education, age, and gender) in 2005 was 16.1 percentage points higher than that of private sector pensions. This was an increase of two percentage points from 2001 (IFS 2010, 17; IFS 2011b). Rising public sector wages over the past decade mean that higher public sector pensions may not be needed to compensate for lower public sector pay as much as they did in the past.

However, the current public-private pension disparity is partly the result of the declining terms of private sector pensions (Hutton 2010, 4). In particular, defined benefit schemes have gradually been replaced by defined contribution schemes where recipients share the risk of pension fund investment. Calls for public sector pensions to be reduced to private sector levels may therefore be a misplaced “race to the bottom” argument (Hutton 2010, 4)

There are also legal implications to altering the pension payments of existing workers in defined benefit schemes. Jurisdictions such as Colorado and Minnesota have faced lawsuits over proposed changes.

Moreover, in 2011, plans to alter public pension payments in both the UK and Greece resulted in both labour unrest and disruptions in services.

BOX 3: THE GROWING PRESSURE OF PUBLIC SECTOR PENSION LIABILITIES

The recession has placed considerable strain on underfunded public pension liabilities. Low interest rates and stock market volatility have eroded the value of pension funds across the public sector. Canada's Via Rail fund, which recorded a surplus in 2007 and then a deficit of CAD \$150 million in 2011, is typical of this trend (De Souza 2011; Via Rail 2011).

For many US states and municipalities, this cyclical deficit, coupled with a temporary freeze in pension contributions, has resulted in considerable pension plan shortfalls (Baker 2011). Aggregated across the major US state pension plans, unfunded liabilities reached USD \$765.6 billion in June 2010 (Baker 2011; NASRA 2010). With defined benefit schemes still the norm in public sector pension plans, the cost of cyclical deficits cannot be shared with pension recipients and must be covered by cuts or transfers from general revenues.

Unfunded public pension schemes—where recipients are paid out of current employee contributions and general revenue transfers—represent a significant long-term risk. In the UK, where all central government pension schemes are unfunded, accumulated liabilities (valued at market interest rates) stood at 85 per cent of GDP in 2007, according to British North-American Committee estimates (BNAC 2009).

By contrast, in the US and Canada, where the vast majority of schemes are funded, unfunded liabilities stood at 28 per cent and 27 per cent of GDP respectively (BNAC 2009). Greater longevity and an aging workforce in all of these countries will only increase these liabilities (OECD 2011b).

CUTS TO PROGRAM BUDGETS

Fiscal consolidation plans across OECD jurisdictions also involve significant cuts to program budgets. There is considerable variation in the program areas that governments have targeted. According to the OECD's 2010 survey of the fiscal consolidation plans of 30 member states, the most common areas earmarked for cuts are: welfare/social security (18 countries), healthcare (15), pensions (14), infrastructure (13), defence (8), education (5), international aid (5), energy/environment (5), agriculture (4), culture (3), and justice/police (3) (OECD 2011a).

Welfare and social security payments are commonly selected in part because cuts to these programs are considered less detrimental to economic growth than other program cuts (OECD 2011a). While healthcare has also been a frequent target for cuts, these have mostly been limited to marginal areas such as pharmaceutical procurement.

A number of OECD jurisdictions, including France, Greece, Italy, and the UK, are also reducing fiscal transfers to subnational authorities. While such measures may improve central government finances, they often result in debt burdens being passed on to the subnational level, as occurred in Canada's fiscal consolidation of the mid-1990s (Bourgon 2009).

Even though program spending cuts appear inevitable across most OECD jurisdictions, they carry a number of risks.

First, there can be negative spillover effects on the private sector. For instance, reduced capital spending by British Columbia and Nova Scotia is affecting private sector companies that depend on government contracts. In the long-term, the lack of infrastructure investment may also slow economic growth.

Secondly, not only do program cuts affect service quality and accessibility, they also tend to disproportionately affect low income households.

Finally, these short-term measures do little to address the long-term fiscal sustainability of program budgets. Past recessions have shown that savings from such cuts often have little lasting effect. As the OECD observes, "it is even possible that measures taken to restrict costs in the short run can increase long-run spending—if necessary investments are delayed and desirable prevention policies are not implemented" (OECD 2010a, 15).

Impending demographic challenges and rising delivery costs demand a transformative lens that recognizes the need to deliver high quality services with fewer resources.

SECTION FIVE

TRANSFORMATIVE APPROACHES TO DECREASE SPENDING

Ongoing budgetary challenges present opportunities to change what government does and how it does it. While most OECD governments have introduced austerity measures, some have also embraced more transformative reform agendas. These longer-term reforms are taking advantage of technological developments, adopting new approaches to fiscal planning, and employing innovative service delivery models. Such innovative reforms are having a measurable impact on public finances, government operations, and the quality of service delivery.

MODERNIZING BUREAUCRATIC PROCESSES

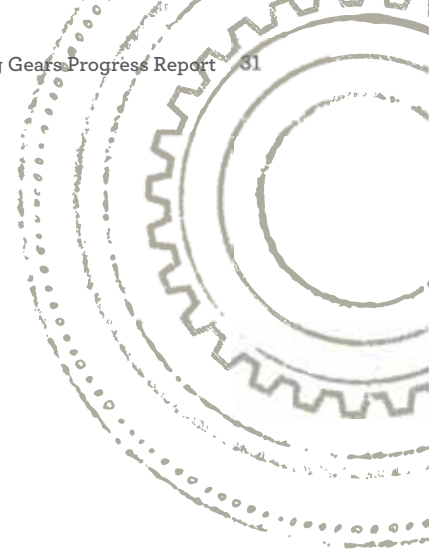
Governments have the ability to deploy breakthrough technologies and fundamentally change administrative processes and delivery models. Obstacles mostly stem from inertia and comfort with the current order. For those who believe in the future of public services, now is not the time to hug the status quo.

Effective Fiscal Planning

What has become clear to public decision-makers during the past two years—if it had not been clear already—is that creditors matter. Governments need to have credible fiscal plans, communicate them, and live by them. Financial mismanagement has contributed to the scale of current budget deficits and has put a premium on governments demonstrating fiscal responsibility.

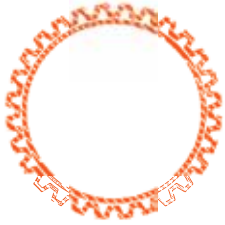
Many OECD jurisdictions are radically transforming their strategic planning, budgeting, and forecasting procedures in an effort to set their economies on fiscally sustainable paths. This includes conducting comprehensive spending reviews, establishing independent fiscal bodies, and incorporating long-term fiscal projections into budgetary decision-making.

First, governments are introducing comprehensive spending reviews to assist in medium-term fiscal planning. As we pointed out in our first *Shifting Gears* report, in times of fiscal restraint such a review allows governments to pose important questions that are seldom asked during normal budgetary times.





If conducted properly, spending reviews provide governments with the opportunity to scrutinize the value for money of existing programs, establish spending priorities, identify alternate efficiency and productivity models, and experiment with less expensive ways of delivering high quality services. Spending reviews are most effective when they are collaborative exercises: engaging departments, agencies, and the public.



Ireland launched its first Comprehensive Review of Expenditure in 2011. A separate Capital Expenditure Review is also being conducted to prioritize infrastructure needs and to protect long-term growth by ensuring that austerity measures do not impact critical investments (Government of Ireland 2011).



Canada has introduced a one-off comprehensive Strategic and Operating Review to examine program spending across the federal government in 2011/12. This review interrupts Canada's ordinary four year strategic review cycle. Variations on this federal exercise are also being conducted at the provincial and municipal level. Ontario, for instance, has appointed a commission to review expenditure in time for the 2012 budget. The City of Toronto has launched a series of reviews into service provision, efficiency, and user fees.



Secondly, several governments have recently established independent fiscal bodies to assess domestic public finances, issue economic forecasts, and monitor government adherence to fiscal rules. These bodies include Canada's Parliamentary Budget Office (2008), the UK's Office for Budget Responsibility (2010), Australia's Parliamentary Budget Office (2011), Ireland's Fiscal Advisory Council (2011), and Portugal's forthcoming fiscal policy council.

The constitutional powers of these bodies vary across jurisdictions. Nonetheless, some of these new bodies have been credited with improving the quality of government fiscal planning, especially by challenging the use of overly optimistic forecasts (IFS 2011).

These bodies face the challenge of establishing themselves as independent and indispensable (von Trapp 2011). The impartiality of the UK's Office for Budget Responsibility was widely questioned, for instance, until it moved out of the UK Treasury and ceased relying on seconded Treasury officials. Since then it has been praised for improving the transparency and quality of economic forecasts used by government (IFS 2011, 2). In contrast, Hungary's Fiscal Council, established in 2008, fell victim to budget cuts and was all but abolished after publically challenging government forecasts (Calmfors et al. 2010).



Finally, there is a growing international consensus on the need to incorporate long-term fiscal projections into budgetary planning. In 2010, Canada joined 18 other OECD member states in annually publishing long-term fiscal sustainability reports—assessments that combine judgments on current public finances and spending commitments with long-term demographic and cost projections (Anderson and Sheppard 2009).

These exercises have little value, however, unless they actively inform budget decisions. For a number of European OECD countries, these forecasts constitute little more than a compliance exercise under the European Union's Stability and Growth Pact. Other OECD countries, such as Australia, carefully consider these long-term projections during the budget planning process (OECD 2009). Given the impending demographic challenges facing OECD jurisdictions, governments need to make, and be seen to make, full use of fiscal sustainability reports in their financial planning.

CONSOLIDATING STRUCTURES AND SERVICES

Many OECD jurisdictions have sought to deliver cost savings and administrative efficiencies through large scale consolidations in bureaucratic structures and operations. Relationships between service providers and users are being streamlined through the vertical and hierarchical consolidation of services across government.

The UK's welfare reforms, for instance, include the consolidation of working-age tax credits and benefit payments into a single "Universal Credit." The Department for Work and Pensions, which will administer the program from 2013, will become the single point of contact for recipients. This system will replace the multiple central and local government bodies with which claimants must currently engage.

Despite startup costs of approximately £2 billion, this new arrangement promises a more agile and transparent service that better meets user needs while delivering long-term savings. Fraud should be easier to detect, applications will be faster to process, and payments will be structured so as to provide both incentives to work and ongoing support once in work (UK DWP 2010).

Governments are also seeking efficiency savings through consolidation of their IT operations and back-office functions. In Canada, Ontario achieved sustainable annual savings of CAD \$100 million as a result of its 1998 IT consolidation initiative, while British Columbia substantially reduced energy costs by scaling back its data centres in 2011 from one hundred to just two (PWGSC 2011).

These successes have spurred efforts to streamline IT infrastructure at the federal level. A new agency, Shared Services Canada, is working to improve security and achieve economies of scale by rationalizing government e-mail systems, electronic networks, and data centres (PWGSC 2011).

The opportunity to take advantage of shared corporate services such as IT and human resources has also been a motivating factor behind the reorganization of government agencies. Following a review of its arm's length agencies in October 2010, the UK government merged or abolished over 300 bodies, uploading many functions to central departments (Gay 2011, 3). On a smaller scale, the Ontario government is seeking annual efficiency savings of CAD \$5 million from the

merger of Infrastructure Ontario and the Ontario Realty Corporation (Infrastructure Ontario 2011).

Such reorganizations involve considerable upfront costs. The ability to realize long-term savings depends on having a detailed business case. The UK National Audit Office has been critical of the frequent failure of governments to identify precisely where savings will be made (NAO 2010). Similar concerns have been voiced over the absence of a business plan to accompany the launch of Shared Services Canada in August 2011 (Minsky 2011).

In Canada, there is also considerable room for vertical consolidation. Innovation policy is but one example. In the agricultural sector in Ontario, there are seven federal and provincial departments administering 45 policies and programs that impact either value-added agriculture directly or innovation more generally (Creutzberg 2011).

For companies on the ground, the policy landscape can be confusing. As Mendelsohn et al. (2010b) argue, there are a number of policy areas in Canada where overlap and duplication across governments should be rationalized to not only yield savings but also improved policy outcomes.

PROGRAM REFORM

Many governments across the OECD are introducing reforms to ensure the long-term sustainability of program budgets. Within Canada, subnational governments face the added challenge of operating within tightly committed budgets over which they have little day-to-day control.

Well over 80 per cent of all provincial government expenditures represent transfers to others. This includes transfers to institutions, like municipalities, colleges, school boards and hospitals, as well as to individuals, such as to doctors, for each procedure they perform. On a day-to-day basis, these are not controlled by governments. They are governed by earlier negotiations and legacy understandings which have resulted in formulae for allocating and distributing funds (such as the formulae that control how much each university or hospital will receive) or fee schedules which determine how much doctors will be paid per procedure.

Governments must identify better ways to ensure these funds are being spent in a manner that achieves results. This may require new ways of ensuring accountability, through different forms of performance agreements with institutions and different approaches to fee schedules. It may include new forms of incentives and payment for better outcomes. In our report, *Fiscal Sustainability and the Transformation of Canada's Healthcare System*, we describe the various pricing reforms that could unleash change in the healthcare sector (Falk et al. 2011). Similar approaches are possible in other areas of the broader public sector, including K-12 and post-secondary education.

Efficiency Savings in Program Operations

OECD governments looking for long-term efficiency savings from public services are increasingly turning to methods imported from the private sector. The use of “Lean” management techniques is proving particularly popular.

Lean methods involve the systematic analysis of each component in a manufacturing process. Elements that add value for the end user are optimized while those that detract value are designed out (Mott MacDonald 2011). Applied to government operations and public services, this approach can help improve coordination, rebalance workloads, eliminate waste, and enhance user experience.

Saskatchewan’s Ministry of Health has been implementing Lean techniques in healthcare provision since November 2008. The Ministry’s Vaccine Team, for instance, realized savings of CAD \$1.2 million in 2009/10 by streamlining the transportation of vaccines to clinics and improving inventory and stock management procedures (Lean Advisors 2011; Saskatchewan Ministry of Health 2011, 18). In 2010, the Saskatchewan government extended the application of Lean methods to all ministries.

Lean techniques have also been applied successfully in UK law enforcement. Beginning in 2006, the Home Office and KPMG launched Operation QUEST to improve performance and reduce costs across 17 police forces and government agencies.

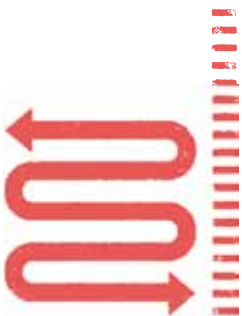
Police forces benefited from new incident prioritization procedures and resolution frameworks (Bassett et al. 2011). Tangible results included faster incident response times, increased rates of arrest and a fall in repeat calls to police control centres (KPMG 2010c).

By 2010, efficiency savings from Lean methods had led to an average rate of return on upfront investment in QUEST of 10:1 (KPMG 2010c, 2). These savings were both reinvested in services and used to offset budget cuts.

The transformative capacity of Lean techniques depends on public services being able to deliver continuous improvement (KPMG 2010c). The development of in-house capabilities is crucial. While both Operation QUEST and Saskatchewan’s health service scheme initially relied on external expertise, both initiatives heavily engaged practitioners in the process and trained staff in Lean methods.

Pension Reform

OECD governments are beginning to take transformative action to address increasing pension liabilities in light of aging populations. Some governments have modified terms for new entrants in public sector occupational pension schemes. In the US, for instance, California, Georgia, and Michigan have moved to hybrid defined benefit and defined



contribution schemes. Ireland has moved from a final salary to an average career earning scheme (Government of Ireland 2010).

Many other countries have taken broader steps toward pension reform, seeking to reduce future strains on the state pension system in general. Strategies to put state pensions on a fiscally sustainable path *without* reducing future pension payments fall into two broad categories: measures directed at extending working lives and measures aimed at increasing the share of the working population covered by occupational pensions (OECD 2011e).

The biggest trend to date has seen governments extend working lives by raising the eligibility age for state pensions. Since 2007, eleven governments have enacted such increases. In some cases these increases took immediate effect, but more commonly they have been spread over the next two decades (see Table 4).

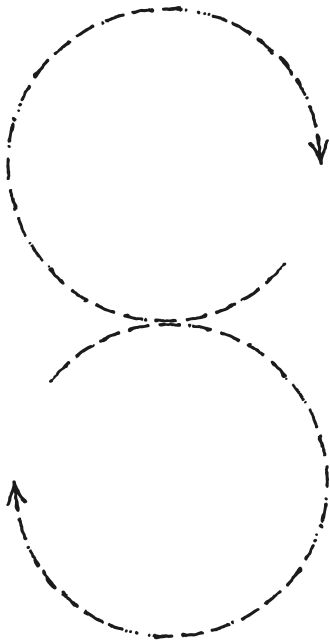
Other measures being adopted to extend working lives include abolishing mandatory retirement ages (Canada, UK), increasing the number of contributory years required to receive full pensions (France, Spain), and introducing both incentives for late retirement and penalties for early retirement (France).

Governments stand to benefit both from reducing the proportion of the population claiming pensions and from the additional tax revenues and pension contributions that come with citizens working longer. Moreover, while rates of youth unemployment in many OECD countries are high at the present time, there is little evidence to suggest this problem will be exacerbated by delaying the retirement of older workers (Kalwij et al. 2009).

The likelihood of these initiatives securing the long-term sustainability of state pension systems is mixed. According to OECD estimates, only five member states (Hungary, Italy, Korea, Turkey, and the UK) are raising pension ages enough to combat projected increases in life expectancy over the next 40 years (OECD 2011e, 34).

Moreover, in setting rigid timetables for pension age increases, most member states are missing an opportunity to make pension systems more responsive to future demographic change. The UK government is already introducing legislation to accelerate a timetable set out a mere four years ago, largely because “life expectancy is increasing faster than projected” (UK DWP 2011, 1; see Table 4). As the OECD advocates, a more sustainable and dynamic approach would involve establishing an “automatic link” between life expectancy and pension age. To date, only three countries (Italy as of 2015, Greece as of 2020, and Denmark as of 2027) are adopting this strategy (OECD 2011e, 86).

Finally, there has been greater unrest in countries such as France and Greece where the notice period given for pension age rises has been relatively short. This underscores the need for governments to take a long-term lens now in order to avoid sudden policy changes later. Governments offering longer timescales, or gradually phasing in changes over the course of a longer implementation period, have given



citizens more time to accept and adapt to change, and have encountered less protest as a result.

Some OECD governments have also sought to boost pension coverage and thereby diversify sources of retirement income as part of their pension reform strategies. This approach has two foundational principles: universal access and automatic enrolment. So far it has been implemented in New Zealand, the UK, and Ireland, with other OECD governments monitoring its success.

TABLE 4 INCREASES IN STATE PENSION ELIGIBILITY AGES AMONG OECD MEMBERS SINCE 2007

OECD MEMBER	REFORM INTRODUCTION DATE	RISE IN STATE PENSION ELIGIBILITY AGE	IMPLEMENTATION PERIOD
Australia	2009	65 to 67	2017-23
Estonia	2010	63 to 65	2017-26
France	2010	65 to 67 (full pension eligibility) 60 to 62 (minimum pension eligibility)	2011-18
Germany	2007	65 to 67	2012-29
Greece	2010	60 to 65 (women) Link to life expectancy	2010 2020
Ireland	2011	65 to 66 66 to 67 67 to 68	2014 2021 2028
Italy	2010	Link to life expectancy	2015
Korea	2007	60 to 65	2013-33
Spain	2011	65 to 67	2013-25
Turkey	2008	60 to 65 (men) 58 to 65 (women)	2036-46 2036-48
UK	2007 2007 2007 2007 Planned (2012)	60 to 65 (women) 65 to 66 66 to 67 67 to 68 65 to 66	2010-20 2024-26 2034-36 2044-46 2018-20

Source: OECD 2011a; OECD 2011e; Pensions Board Ireland 2011.

Notes: Eligibility ages apply to both men and women unless indicated. A further five OECD countries (Czech Republic, Denmark, Hungary, the Slovak Republic, and the US) introduced legislation to increase pension eligibility ages prior to 2007 in measures that are yet to take full effect.

From 2007, the New Zealand government has required all new employees to be automatically enrolled in the government-backed KiwiSaver retirement scheme. In the UK, it will gradually become mandatory between 2012 and 2016 for all employers to enrol their staff in a company pension scheme or the National Employment Savings Trust (NEST) pension plan. Similar proposals are being developed by the Irish government.

In all three cases, workers are required to opt out once enrolled rather than opt in, under the assumption that few will opt out. Governments are thereby positively harnessing the very inertia that in the past led too few workers to sign up for voluntary pension plans (OECD 2007, 7).

Early results from New Zealand appear promising. As of August 2011, only 37.8 per cent of the 663,912 workers automatically enrolled in the KiwiSaver scheme had opted out. Over 1 million existing workers voluntarily joined the scheme (Government of New Zealand 2011). KiwiSaver has proved particularly successful in extending occupational pension coverage to employees of small- and medium-sized businesses, many of whom previously had little access to retirement benefits.

Such state sponsored schemes, however, face a difficult balancing act between attracting savers and protecting public finances. In the 2010/11 fiscal year alone, KiwiSaver cost the New Zealand government close to NZ \$1.2 billion in tax exemptions, startup incentives, and top-up payments (New Zealand Treasury 2011). The government is now scaling back these incentives in an effort to put the scheme on a fiscally sustainable path (Marier 2010; New Zealand Treasury 2011).

At the other end of the spectrum, analysts have warned that the UK government's decision to make NEST entirely self-financing may limit participation in the scheme. A prohibitive fee of 1.8 per cent is due to be levied on pension contributions until startup costs are recouped (Johnson 2011).

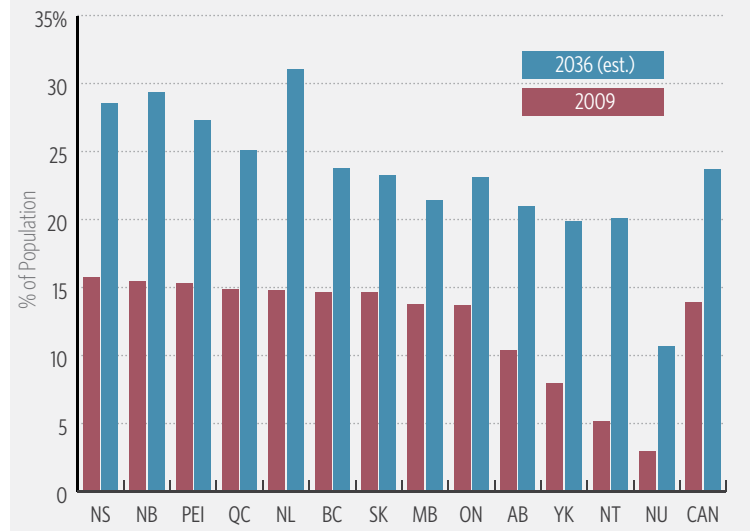
Canada's public pension system is in a comparatively stronger financial position than most pension systems in the OECD, but it still has its weak points. The 1997 reforms to Canada's mandatory earnings-related state retirement plans, the Canada Pension Plan (CPP) and the Quebec Pension Plan (QPP), stabilized the finances of the former. However, the QPP continues to face an actuarial deficit—caused by an aging population, high incidence of early retirement, sluggish wage growth, and low investment returns (OECD 2010b, 15; Marier 2010, 7).

The demographic pressures on the QPP are especially acute. Quebec already has one of the largest proportions of pensioners in Canada, and this proportion is expected to rise by over 10 percentage points by 2036 according to Statistics Canada (see Figure 8). According to the Quebec Ministry of Finance's 2011 estimates, QPP's reserves will be exhausted by 2039 if reforms are not undertaken (Quebec Ministry of Finance 2011b).

New QPP reforms were announced in Quebec's March 2011 budget. Over a six-year period starting in January 2012, QPP contributions will be raised by 0.9 per cent. Additional financial incentives to encourage later retirement and penalize early retirement will be introduced in 2013 and 2014 respectively (Quebec Ministry of Finance 2011b).



FIGURE 8 PROJECTED INCREASE IN THE PROPORTION OF THE POPULATION AGED 65 OR OVER AT THE NATIONAL AND PROVINCIAL-TERRITORIAL LEVEL, 2009-2036



Source: Statistics Canada 2010a, 58, medium-growth scenario 1.

Another weak point in Canada's pension system is the downward trend in private sector pension coverage (Marier 2010). In 2009, just 39.2 per cent of the workforce was enrolled in a voluntary Registered Pension Plan (Statistics Canada 2010c). This trend coincides with record levels of household debt (reaching 149 per cent of disposable income in the second quarter of 2011)—a situation far from conducive to proactive saving for retirement (OECD 2011b, 117).

This situation implies a future that will see much greater reliance on the state pension system at a time when the population is aging. It also portends an overall future decline in standards of living among retirees, exacerbated by the fact that Canada's state pension system offers a comparatively low income replacement rate. According to OECD estimates, this replacement rate currently stands at 44.4 per cent for the average earner—12.9 per cent below the OECD mean (OECD 2011e, 177).

There is little political support in Canada for an increase in the maximum replacement rate. Instead, Canadian governments, like other OECD governments, have focused recent reform initiatives on increasing coverage and extending the working life.

In the 2011 budget, the Federal Government announced the abolition of mandatory retirement in sectors that are federally regulated, following similar earlier moves by Ontario (2006), Newfoundland and Labrador (2007), Saskatchewan (2007), British Columbia (2008), and Nova Scotia (2009).

In 2010, provincial finance ministers agreed to establish Pooled Registered Pension Plans (PRPP) so as to increase occupational pension coverage among the self-employed and workers within small- and medium-sized businesses (Ministry of Finance Canada 2011). In March 2011, Quebec was the first province to introduce a PRPP in its budget.



Like the New Zealand and UK schemes, this initiative is likely to use automatic enrolment (Quebec Ministry of Finance 2011b, 7).

Healthcare Reform

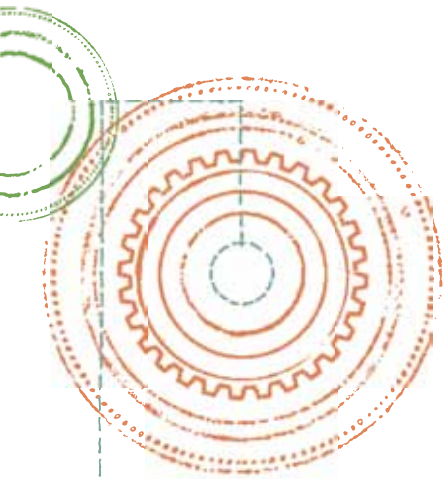
Citizens aged 65 and over account for a disproportionate share of healthcare spending. In Canada, for example, this demographic comprises 14 per cent of the population but accounts for 44 per cent of provincial-territorial healthcare expenditure (CIHI 2010). Aging populations will therefore put significant upward pressure on healthcare costs in Canada and across the OECD.

This development will seriously undermine the capacity of many OECD jurisdictions to reduce long-term public debt. Averaged across OECD countries, healthcare already accounts for 14.7 per cent of general government expenditures, having risen 1.7 percentage points since 2000. These figures are even starker for Canada, where 18.7 per cent of expenditure is dedicated to healthcare—a rise of 4.3 percentage points since 2000 (OECD 2011d, 67).

Despite this outlook, healthcare remains marginal to the fiscal consolidation plans of many OECD jurisdictions, due primarily to political sensitivities. In general, OECD governments either confine measures to adjustments in pharmaceutical procurement or avoid addressing healthcare altogether (Ernst & Young 2010 ; OECD 2011a).

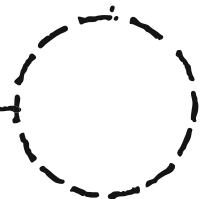
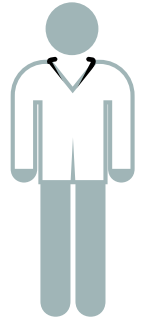
It is commendable that governments have avoided the type of short-term budget cuts that in past recessions reduced health service quality and accessibility while failing to deliver lasting savings. However, there is a growing need to make healthcare systems fiscally sustainable. In our recent *Shifting Gears* healthcare report, we identified a number of areas where transformative action could be taken (Falk et al. 2011; see Box 4).

Crucially, our proposed reforms steer clear of user fees, higher taxes, and privatization. Instead, we recommend that healthcare be reconceptualized as a high-tech industry where real-time adjustments in delivery models, pricing mechanisms, regulations, and administrative systems enable productivity gains to be harnessed. All too often in the past, government investment has lowered unit costs through technological innovation and system improvements without processes being put in place to allow the public purse to profit from these savings.



BOX 4: FISCAL SUSTAINABILITY & THE TRANSFORMATION OF CANADA'S HEALTHCARE SYSTEM - RECOMMENDATIONS FOR TRANSFORMATIVE ACTION (FALK ET AL. 2011)

1. **Modernize the organization of hospitals by modifying clinical business models:** The current system, where many procedures are done either in general hospitals or in a doctor's office, does not allow efficiency gains to be realized. Much that goes on today in a general hospital could be provided more efficiently elsewhere: academic centres could focus on excellent diagnostic work-ups, specialty clinics could provide routine procedures efficiently and accessibly, and networks of care could monitor patient well being.
2. **Use virtualization to develop new roles for providers and patients:** Virtualization can allow health professionals to use the telephone and email for patient interaction as well as encourage more breakthrough technologies. It will also mean that healthcare access will no longer be contingent on geography and region, thereby allowing more savings without adverse effects on care.
3. **Exploit the gains from digitization:** Policy makers can support the process of IT modernization by reforming agencies so that they can respond to technological change more quickly, and also by providing more of the available IT funding directly to care providers. This may begin by supporting grassroots innovation in healthcare, including the use of smartphones and tablets to enable doctors to communicate more effectively and deliver treatment more quickly.
4. **Devolve decision making selectively and where appropriate:** Rather than beginning reform efforts with structural changes to regional bodies, policy makers should focus on devolving some decision making to institutions that can respond innovatively to local needs. This may include expanding the accountability functions of regional bodies, strengthening specialty care networks, supporting organic mergers and acquisitions, and encouraging physicians to take on a larger role in regional bodies.
5. **Reform the way health services are purchased:** The current system, based on fee-for-service payments to physicians and global budgets for hospitals, has allowed the benefits of productivity gains to accrue largely to providers. At least some of those benefits should be returned to funders (i.e. governments) in the form of lower prices. By moving to a more sophisticated payment system for physicians, pharmacies, acute care, and chronic care, spending can be reduced, particularly in those areas where real costs are falling fastest.



Virtualization—that is, the remote delivery of healthcare through the use of information and communications technology—offers particular scope for reducing long-term spending on health services while improving accessibility and quality.

In Ontario, telemedicine is already enabling improvements in outpatient management. The installation of monitoring equipment in the homes of patients with chronic health conditions has allowed medical practitioners to keep track of patient progress in order to prevent relapses.

In a trial of 800 patients conducted by the Ontario Telemedicine Network, average hospital readmissions fell by 65 per cent while visits to Emergency Rooms and walk-in clinics dropped by 72 per cent and 95 per cent respectively (OTN n.d.). Such projects bring down the cost of the “1 per cent of patients who account for 49 per cent of costs” in Ontario (Falk et al. 2011).

Virtual consultations offer other potential benefits. Remote communities can access high quality healthcare without patients or health workers having to travel and keeping patients apart can reduce the spread of infections. Reimbursement rules currently reward only face-to-face contact between patients and practitioners, so the potential cost savings of virtual contact would depend on restructuring fee schedules.

Virtualization will facilitate healthcare providers’ access to expertise and specialist services beyond their immediate locality. Ontario, Manitoba, and Newfoundland and Labrador are in the process of establishing a telepathology network which will improve the quality and speed of diagnostics by allowing hospitals to share computer images of samples.

Virtualization could also open up new sources of revenue for healthcare providers, with innovative technologies enabling services such as diagnostics to be exported. Such developments could promote the continued growth of high-tech clusters in cities such as Toronto.

These potential gains could be harnessed in other program areas such as education. Virtual classrooms would offer children in remote areas access to education without long commutes, while school boards derive savings from lower transportation and physical infrastructure costs (Hammer 2011).

Virtual initiatives such as the Ontario E-learning Consortium also allow education providers to share expertise and resources remotely. Course materials, curricula, course delivery, and teacher training. Revenues could again be generated by exporting e-learning resources overseas.

However, as with healthcare, the various benefits of these initiatives must be carefully weighed against risks, such as social isolation, and obstacles, most obviously the lack of internet accessibility in some locales (Hammer 2011).

LABOUR

In the face of rising public sector wage bills, OECD governments are testing a range of measures aimed at transforming both pay mechanisms and staffing models. These initiatives are primarily designed either to harness public servants' expertise in locating sustainable cost savings or to transition to a more integrated and agile public service.

Changing Incentive Structures for Public Servants

Canada's governments are experimenting with new mechanisms to encourage the public sector workforce to locate sustainable savings. In June 2010, for instance, the federal government launched the Employee Innovation Program, a two-year pilot scheme that offers federal workers financial rewards for developing innovative ways of improving core services while lowering running costs. In July 2011, the federal government also reconfigured its performance-related pay system by linking the bonuses of senior public servants to achievements in meeting federal savings targets.

These new incentive structures are designed to counteract the budget-maximizing tendencies of bureaucrats, who often optimize department/agency resources rather than seek productivity gains (Niskanen 1971). These initiatives seek to harness the invaluable knowledge and innovative capacity of those most familiar with government operations and public services.

Such schemes recast public servants as active partners in reform rather than passive and potentially unwilling implementers of prescribed change (Bourgon 2009; McCrae et al. 2009; Wilks 2010). In so doing, they can potentially reduce the demoralizing effects of budget cuts such as those seen in the Canadian public service in the 1980s and early 1990s.

The challenge for voluntary schemes such as the Employee Innovation Program will be to deliver lasting cultural change. Two similar public service schemes in Ontario—the Innovation Fund (2004) and the Ideas Program (2006)—enjoyed an initially enthusiastic response from staff. However, both the quantity and the quality of submissions gradually declined over time. At the end of the day, the schemes gave rise to localized “pockets of innovation” but failed to generate the hoped-for wider cultural transformation (Shah and Prokopec 2011).

Mandatory performance-based pay initiatives may be more successful in engendering behavioural change. However, the pressure to deliver quick cashable savings could be counterproductive to achieving either long-term fiscal sustainability or continuous improvement.

Staff and Professional Mix

It is also possible to arrive at long-term efficiency savings by reallocating staffing responsibilities, identifying the least expensive person who is competent to deliver a particular service while maintaining service quality. For instance, our *Shifting Gears* healthcare report highlights the significant but unrealized efficiencies that could accrue from such a reallocation of responsibilities among healthcare practitioners, thanks to both technological innovations and advances in medical practice (Falk et al. 2011).

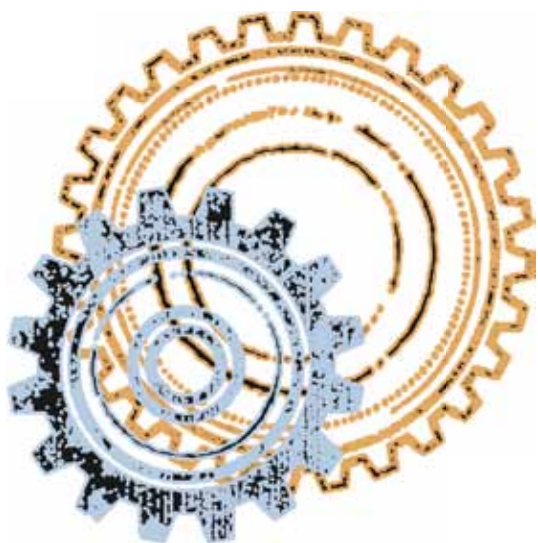
Technological innovation frequently enables lower-cost skilled practitioners to deliver a particular service. However, the rigidity of current healthcare delivery models prevents such savings from being realized.

For instance, in many Toronto area hospitals electrocardiograms (ECGs) can now be read by computers with almost 100 per cent accuracy. While the task of communicating the results to patients could easily be devolved to other medical staff, physicians are still paid to interpret ECGs, often doing little more than reading out a computer's interpretation.

Medical practice tends to advance along a continuum from “intuitive” to “precision” medicine. Intuitive medicine requires experienced clinicians both to understand the causes of medical conditions and engage in experimental treatment. In precision medicine, effective treatments have already been developed and procedures become repeatable and routine (Christensen et al. 2009). There is thus considerable scope to devolve these procedures from experienced physicians to other healthcare professionals.

In the US, for instance, there is a growing trend toward allowing certified registered nurse anaesthetists to deliver anaesthesia without physician supervision. Sixteen US states use this delivery model, with California (2009) and Colorado (2010) adopting it most recently. This practice is particularly cost effective since the average hourly wage for nurse anaesthetists is \$76.08 as opposed to the average \$127.98 wage for (physician) anaesthesiologists (Daugherty et al. 2010, 26).

This transition to nurse-administered anaesthesia has not been uncontroversial, including a failed lawsuit in California. Nonetheless, state governors cite a mounting body of evidence that identifies no difference in the quality of care received by patients as a result of this transition.



As we suggest in our *Shifting Gears* health report, there is a need to allow ‘disruptive innovation’ to break up rigid healthcare delivery models. We should seek a more dynamic approach to public services where real-time adjustments can be made to ensure the most efficient “mix of professionals” carries out various functions (Falk et al. 2011).

This approach could also be extended to other sectors. In law enforcement, for instance, there is growing recognition that police resources can be freed up to tackle crime by transferring certain duties—such as neighbourhood patrols, guarding crime scenes, and controlling crowds at public events—to community support officers. In the UK, where Police Community Support Officers (PCSOs) were first introduced in 2002, the average starting salary of a PCSO is around £16,000, as compared to the £23,000 average starting salary of police officers (UK Home Office 2011). The Royal Canadian Mounted Police piloted a similar Community Safety Officer scheme in 2008.

Collective Bargaining and Agreements

In 11 OECD countries, including Canada, public sector pay is determined by collective agreements between governments and unions. In a further 13 member states, governments are required by law to consult unions when setting pay (OECD 2011c, 131). In the wake of the financial crisis of 2008, however, “wages in the public sector are increasingly the outcome of unilateral state decisions rather than collective bargaining” (Glassner and Watt 2010).

In jurisdictions where collective agreements are not legally binding, some governments have imposed wage restrictions that supersede existing agreements. The Irish government took this course of action in 2009, for instance, sparking widespread labour unrest (Glassner and Watt 2010).

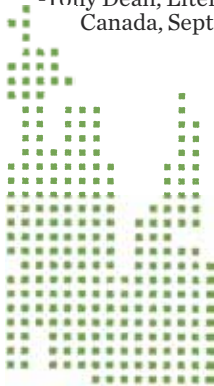
In other jurisdictions, such as Michigan, New Jersey, and Wisconsin, the restrictions of legally binding collective agreements have been circumvented by new legislation that limits the bargaining power of unions.

By contrast, Canada’s provincial governments, including British Columbia and New Brunswick, have avoided legislative change by making wage freezes a non-negotiable premise of new collective agreements (New Brunswick Ministry of Finance 2009, 25; Statistics Canada 2011b).

However, attempts to replicate this approach in Manitoba and Ontario have had rather mixed outcomes. In a March 2011 agreement with the General Employees’ Union, the Manitoba government only secured a civil servant wage freeze in the first two years of a four-year deal. The government of Ontario has also struggled to contain wages in recent collective agreements despite announcing their intention to do so in the 2010 budget (Globe and Mail 2011; Government of Ontario 2010, 13; NUPGE 2011).

"...the focus on privatization and contracting out is diverting attention from an entirely new frontier in service delivery... a collaborative mix of public, not-for-profit, private and community-based, voluntary organizations as well as emerging 'social enterprises'."

-Tony Dean, Literary Review
Canada, September 2011



Collective bargaining is not necessarily an impediment to fiscal sustainability. Rather, it can be harnessed to facilitate public sector transformation plans in times of fiscal restraint. In a four-year Public Services Agreement concluded in 2010, the Irish government retreated from unilateral action and agreed to halt further compulsory redundancies and wage cuts. In exchange, unions agreed to cooperate in delivering a more flexible, productive, and integrated public service.

As a result, the Irish government now has greater capacity to redeploy staff and change working arrangements at short notice, making real-time adjustments in response to workload imbalances or changing circumstances. Over the past year, for instance, 500 public servants were redeployed to the Department of Social Protection and the Department of Enterprise, Trade and Innovation to tackle a backlog of unemployment-related work (Implementation Body 2011b). The collective agreement was also used to encourage staff to make efficiency savings by leaving open the prospect of a rise in wages should sufficient savings be generated (Ministry of Finance Ireland 2010).

CO-PRODUCTION

The outsourcing of public services to the private sector has been a traditional response to fiscal constraints over the past three decades. Some OECD countries, such as Greece and Portugal, continue to pursue this approach. However, many others are now introducing a range of new partners into the service delivery process.

Initiatives are underway across the OECD to involve users, the non-profit sector, and small- and medium-sized businesses in the co-production of public services. This entails engaging these actors in the design and evaluation of services as well as, increasingly, affording them an active role in service delivery. In so doing, governments are reconfiguring the roles and responsibilities of state and society in the delivery of public services (OECD 2011f).

One of the more high profile interventions in this policy arena has come from the UK. The *Open Public Services White Paper* of July 2011 set out a reform agenda in which services across the entire public sector are to be systematically opened up to new delivery partners—including social enterprises, voluntary organizations, and private sector firms (UK

Government 2011).

In this case, deregulation is being used to allow local groups and businesses greater control over, and the freedom to innovate within, local services. A number of such schemes have already been launched in areas including education (free schools) and social security (Work Programme).

This overall approach builds on experiments by the previous UK government in the education and health-care sectors: namely, the introduction of plural providers in the former, and of social enterprises in the latter. While it is far too early to second-guess the outcomes of the white paper, results are already emerging from these earlier experiments (see Box 5).

The OECD identifies 22 member states with co-produced public services in specific sectors—the most common being education, public order, social protection, economic affairs, and general services (OECD 2011f, 48-9; see Table 5b).

Governments face a number of challenges in opening public services to multiple providers. First, co-production redistributes risk that many non-profit organizations and small- and medium-sized businesses may struggle to absorb. Frameworks need to be put in place to assist non-traditional providers in undertaking such risk.

Secondly, allowing providers the freedom to innovate should not come at the cost of a robust accountability and monitoring framework (Dean 2011). Should providers fail—as one UK community healthcare enterprise did in 2009—the state, as the provider of last resort, is forced to resume delivery at significant cost to taxpayers.

Finally, while there is considerable scope for public services to be co-produced in Canada, prohibitive taxation and regulatory regimes hinder the ability of charities and other non-profit organizations to partake in such initiatives. Steps need to be taken to liberalize rules on social enterprise within a coherent regulatory framework (Mulholland et al 2011).

BOX 5: OUTCOMES FROM EARLY OPEN PUBLIC SERVICE INITIATIVES IN THE UK

Academy Schools

First established in 2002, academies are public schools set up in collaboration with external sponsors such as faith groups, charities, universities, businesses, and non-profit organizations.

Between September 2002 and May 2010, 203 academy schools were set up, with sponsors required to contribute up to £2 million in capital investments or endowment funds. A review by the National Audit Office in 2010 commended the academy model for both raising academic standards and utilizing the support that many sponsors provided in the form of financial resources, business acumen, and professional expertise.

However, a number of sponsors had defaulted on their funding commitments, leaving some academy schools in financial difficulty (NAO 2010b). The UK government has now expanded the program and dropped the requirement that sponsors make financial contributions.

Community Healthcare

Under the Right to Request program (2008-2010), community healthcare practitioners within the National Health Service could apply to establish their own social enterprises to deliver services on contract that they once provided in-house. By the end of 2011 there will be over 50 such enterprises. Early evidence of cost savings and improved services on contract from these enterprises includes dramatic reductions in staff sick leave, the proliferation of additional services, and better cross-sector coordination to suit patients' needs (NAO 2011b).

Digitization

Co-production is also driving current developments in online government. In recent years, citizens—once regarded as passive recipients of web-based services and information—have come to be viewed as active participants in the online design, delivery, and evaluation of government services and activities. OECD governments are now using a variety of e-tools to engage with citizens online.

Crowdsourcing

Experiments in crowdsourcing (the open online outsourcing of particular government problems or tasks to interested individuals and groups) are growing rapidly. Since 2007, for instance, the US Patent and Trademark Office has run a series of trials engaging the public as ‘peer reviewers’ of patent applications. Volunteers have assisted patent examiners in conducting background research on the originality of submissions (USPTO 2011).

In September 2010, the US General Services Administration launched challenge.gov, a central website where departments and agencies can post particular problems or challenges and offer cash prizes for innovative solutions. In its first 12 months of operation, challenge.gov has been used by 36 departments and agencies and has proved to be a cost-effective payment-by-results scheme in areas such as public safety, technology, and preventative healthcare (Challenge.gov 2011).

Online collaboration in the form of internal wikis is being used to break down information silos across government departments. One such initiative, GCPEDIA, was launched by the Canadian federal government in 2008. It allows public servants to share information and ideas online and has been used by senior administrators to canvass opinion (Cochrane 2011). Similar projects have since been launched in Australia and the US.

Paperless Government

OECD jurisdictions are also continuing to develop more ‘traditional’ e-government operations, digitizing services that are better tailored to citizens’ needs and taking advantage of the lower transactional costs offered by moving services from paper-based to digital delivery. The UK’s Electronic Vehicle Licensing scheme, for instance, not only cut processing costs by 30 per cent but demonstrated the sustainability of these savings with a 98 per cent customer return rate. With half of all transactions occurring out of working hours, the public have also benefited from greater accessibility (UK Cabinet Office 2009, 16).



E-billing and digital communications are increasingly utilized by national and local governments across the OECD. These initiatives deliver the type of resource and efficiency savings long enjoyed by the private sector.

Open Government

A new wave of open government initiatives has shifted responsibility for public sector transparency from citizens (who needed to request information under freedom of information legislation) to government bureaucracies, who now have a duty to disclose information (NAO 2011a, 24).

Open data web portals that provide datasets for public use have emerged at multiple levels of government across the OECD. Since 2009, 19 OECD countries have launched such portals, as have 31 US states, 13 US cities, the province of British Columbia, and 10 Canadian cities including Calgary, Edmonton, London, Ottawa, Toronto, and Vancouver (DataGov 2011). The policy objectives driving these initiatives vary across jurisdictions, but most centre on increasing accountability, empowering citizens, and stimulating economic growth and innovation.

As yet there is no strong evidence regarding the impact of these initiatives. Nonetheless, open data projects have been linked to sustainable cost savings through discouraging the waste and misuse of public funds. In the UK in 2009, for instance, Windsor and Maidenhead Council began publishing online the automated meter readings for energy and gas use in their buildings. The move encouraged behavioural change that immediately cut energy use by 15 per cent (UK DCLG 2010).

Open data portals can also facilitate “work shifting” from the public to the private sector (Cochrane 2011). In releasing high-value datasets, governments are allowing the private sector to absorb the cost of processing information and building applications. In Canada and the US, for instance, Google has used transit agency data to provide services that assist commuters in planning their routes (Curry 2011).

Open data portals can also boost private sector productivity. In New Zealand, forestry companies have used data released from the government’s Land Use and Carbon Analysis System to inform plantation planning (Randow and Carver 2011).

However, there have been a number of problems with the quality of datasets that have been released so far under open data programs. These include a lack of standardized measures and heavy redaction due to strong privacy laws in many countries (Huijboom and Van den Broek 2011).

Overcoming entrenched organizational resistance to disclosing official information has also been a challenge. In December 2009, President Obama resorted to setting quotas for the number of datasets government agencies should release after a slow response to the launch of the data.gov portal (Hogge 2010, 5-6).



Open data policies could also jeopardize public sector financing models. For instance, the UK's national mapping agency, Ordnance Survey, is being required to release selected datasets for free while also relying on selling and licensing mapping data to cover running costs (Hogge 2010; Huijboom and Van den Broek 2011).

Digital Consolidation

The UK government is streamlining its online services by consolidating an unwieldy portfolio of websites into just a few central web hubs, eliminating 687 of the 1,020 central government websites that were active in July 2010 (UK COI 2011). Web content is being rationalized and transferred to two main portals (Directgov and Businesslink), while a new website, *Alphagov*, is being developed to serve as a 'single UK government website' (Alpha.gov 2011).

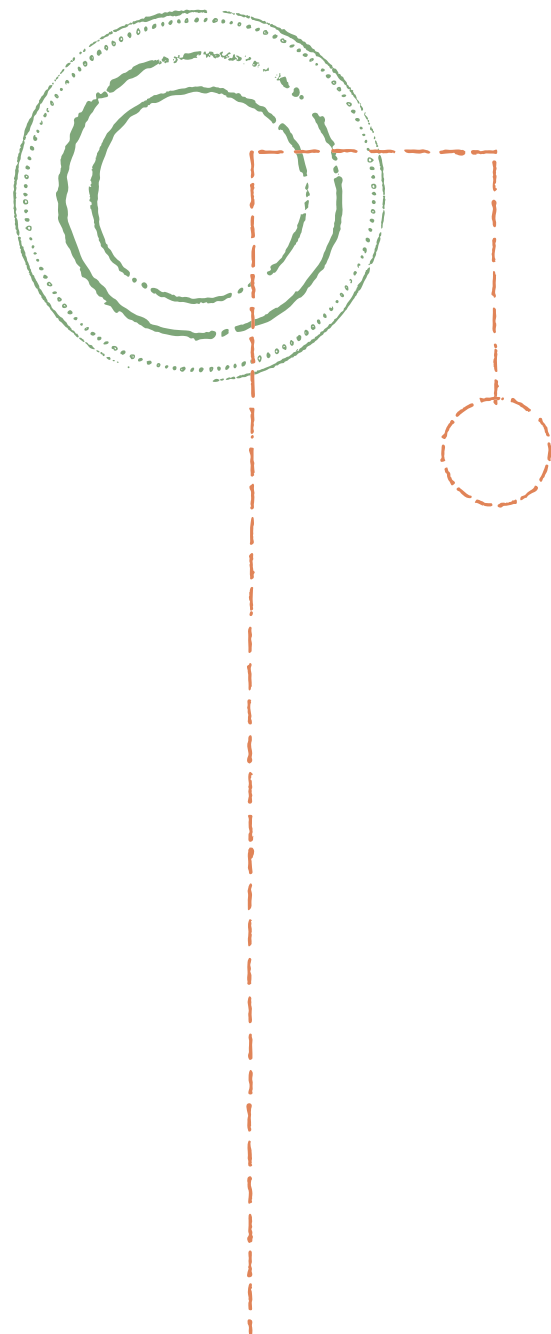
These efforts will provide users with a recognizable brand and ensure that access to online services and information no longer entails negotiating complex government structure, while also delivering £360 million in annual savings (Lane Fox 2010).

Digital consolidation exercises are being employed to offer a more personalized approach to public service delivery. In 2009, the French government launched *mon.service-public.fr*, a secure portal where citizens can access e-government services through their own personal online accounts. Individual users are also able to inform multiple government agencies of changes in personal circumstances through this single domain.

The initiative has been extremely popular. In its first year, 1.5 million accounts were opened and one-third of French citizens notifying government organizations of a change of address did so through *mon.service-public.fr* (OECD 2011g, 103-4).

Such an initiative is, of course, easier to implement in states where government services are highly centralized. Canada's complex inter-governmental arrangements mean that an equivalent initiative would face both legislative and regulatory hurdles. As a result Canada is falling behind other OECD member states in meeting citizen expectations and realizing the sustainable efficiency savings inherent in consolidating services. In his annual report to the Prime Minister in 2011, Wayne G. Wouters, Clerk of the Privy Council and Secretary to the Cabinet pointed out that:

A decade ago, Canada was seen as an international leader in service delivery through initiatives such as Government On-Line. But we have lost momentum. In this digital world, our "vertical," department-by-department approach to service delivery is more than just inefficient—it is failing to meet Canadians' expectations for one-stop, single-window services (Wouters 2011, 10).



To make up this ground, Canadian governments need to work toward both the vertical and horizontal consolidation of online services. This will require both intergovernmental collaboration and the breaking down of silos across each government.

There are also a number of broader challenges associated with the digitization of public service delivery. First, it can involve considerable upfront costs before savings are realized. Secondly, it can exacerbate social exclusion. Digital literacy and internet access vary across populations. In the UK, for instance, 17.4 per cent of the adult population report never having used the internet (ONS 2011c, 1).

Governments have a regulatory and infrastructural role to play in ensuring that web connectivity is accessible, affordable and dependable (Cochrane 2011). The UK, for instance, is developing a network of certified online assistance centres and mobile phone applications for citizens with access to internet through phones as opposed to home computers (UK Cabinet Office 2011).

The US federal government has offered tax breaks to telecommunication companies extending high-speed internet into new areas. More could also be done in Canada, where rural broadband coverage remains uneven. In many locations broadband is simply not economically viable without government intervention (Marlow and McNish 2010).

Finally, the effectiveness of digital service delivery depends on internet security. High profile cyber-attacks, such as those committed against Canadian federal government websites in 2011, as well as incidences of identity theft, lower public confidence and increase delivery costs (Curry and Freeze 2011). Canadian governments need to develop comprehensive cyber-security and identity management strategies to protect information and assets as well as to assure providers and users alike that they are dealing with legitimate entities.

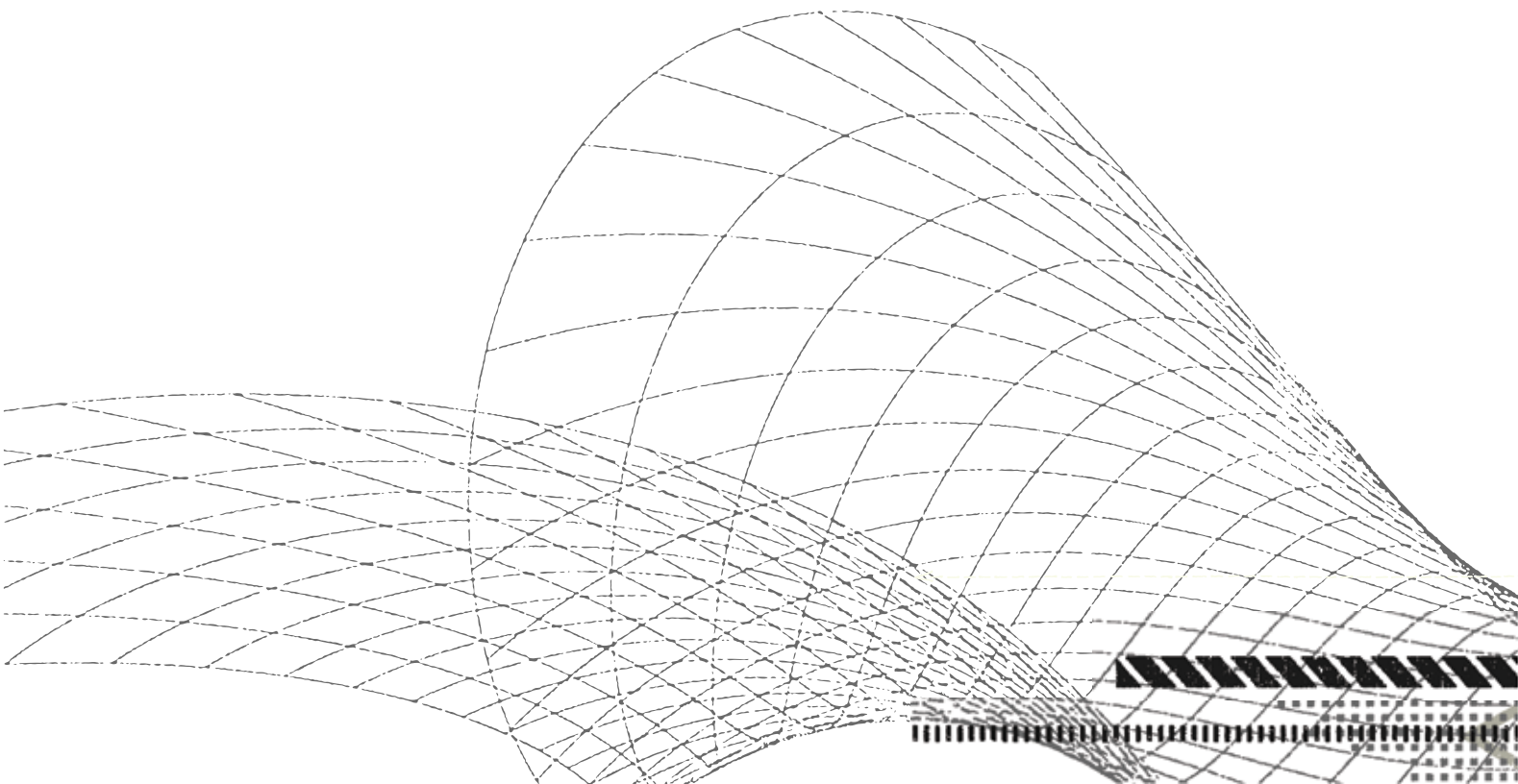


TABLE 5A: SUMMARY OF SHORT-TERM EXPENDITURE REDUCTION MEASURES

INITIATIVE	JURISDICTIONS INVOLVED	RISKS	BENEFITS	RESULTS TO DATE
Public sector head-count reduction	Austria, Canada, Czech Republic, France, Greece, Ireland, Italy, Spain, Portugal, Turkey, UK British Columbia, New Brunswick, Ontario, Saskatchewan	<ul style="list-style-type: none"> Loss of experience and expertise Incentivized departure schemes involve substantial upfront costs and administration Labour unrest and service disruption Increase in unemployment rates 	<ul style="list-style-type: none"> Smaller public services offer sustainable wage bill savings 	<ul style="list-style-type: none"> Sizeable reduction in public sector headcount and associated wage bill (Ireland, UK) With the departure of a disproportionate number of senior civil servants, staffing pyramids have been distorted (Ireland, UK) Widespread industrial action and service disruption Early retirement schemes have increased the public sector pension bill in Ireland
Public sector wage moderation	Czech Republic, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Netherlands, Portugal, Slovakia, Spain, UK, USA British Columbia, New Brunswick, Manitoba, Ontario	<ul style="list-style-type: none"> Industrial action and service disruption Lower staff morale Reduction in real household disposable income 	<ul style="list-style-type: none"> Immediate savings Greater parity with the private sector Easy to implement/administer 	<ul style="list-style-type: none"> Industrial action and service disruption Credited with having eased inflation in Spain
Public sector pension cuts	France, Hungary, Ireland, the UK, several US states and municipalities	<ul style="list-style-type: none"> Adjustments to existing pension plans leave governments open to legal challenges Potential race to the bottom with the private sector 	<ul style="list-style-type: none"> Immediate savings Greater parity with private sector Achieving sustainable savings will help address underfunded pension liabilities 	<ul style="list-style-type: none"> Industrial action and service disruption (France, Greece, UK) Cuts have been subject to legal challenges (UK, USA)
Cuts to program budgets	Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Mexico, Netherlands, New Zealand, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, UK Nova Scotia, Ontario, Quebec	<ul style="list-style-type: none"> Private sector suffers due to loss of public sector contracts Regressive impact Public protests Reductions in subnational transfers shift rather than reduce debt burden Cuts to program budgets may increase spending in the long-term if needed investments are neglected 	<ul style="list-style-type: none"> Substantial savings in high-spend program budgets 	<ul style="list-style-type: none"> Widespread public protests Construction industry affected by reduction in public sector infrastructure projects (UK)

TABLE 5B: SUMMARY OF TRANSFORMATIVE EXPENDITURE REDUCTION MEASURES

INITIATIVE	JURISDICTIONS INVOLVED	RISKS	BENEFITS	RESULTS TO DATE
<p>Effective fiscal planning (spending reviews, fiscal councils, long-term fiscal projections)</p>	<p>Australia, Canada, Greece, Hungary, Ireland, Portugal, Slovenia, UK Ontario Toronto</p>	<ul style="list-style-type: none"> As publicly funded entities, independent fiscal bodies may struggle to establish themselves as viable and impartial authorities Governments may treat fiscal planning as a compliance exercise 	<ul style="list-style-type: none"> Governments can demonstrate fiscal responsibility to creditors, markets, and consumers Spending reviews provide an opportunity to scrutinize the value for money of existing programs and identify alternative service delivery models The use of long-term projections in budget planning ensures resources are allocated in accordance with longer-term demographic and fiscal pressures 	<ul style="list-style-type: none"> Independent fiscal bodies have improved the quality of government forecasts and fiscal planning Hungary's Fiscal Council was abolished under budget cuts
<p>Consolidating structures and services</p>	<p>Canada, UK British Columbia, Ontario</p>	<ul style="list-style-type: none"> Significant upfront administrative costs Disruption to services as bureaucratic structures are reorganized 	<ul style="list-style-type: none"> Sustainable cost savings from administrative efficiencies Single-window approaches to service delivery ensure citizens no longer need to negotiate complex government structures Service consolidation offers improved transparency and better fraud detection Mergers provide an opportunity to take advantage of shared services such as IT and human resources 	<ul style="list-style-type: none"> Significant upfront administrative costs The UK has undertaken a major consolidation of arm's length organizations IT infrastructure consolidations in British Columbia and Ontario have led to lower energy costs and sustainable efficiency savings Concerns have been raised over the lack of detailed business cases to accompany planned reorganizations
<p>Efficiency savings in program operations (via the application of Lean methods)</p>	<p>Canada, UK Saskatchewan</p>	<ul style="list-style-type: none"> Implementation of Lean methods requires upfront investment Cost savings will only be sustainable if staff are trained in Lean techniques 	<ul style="list-style-type: none"> Lean initiatives can help rebalance workloads, improve system coordination, eliminate waste and enhance the end user experience Improved public sector morale 	<ul style="list-style-type: none"> Saskatchewan's Ministry of Health has derived substantial savings from improvements in areas such as vaccine distribution and inventory UK law enforcement agencies have improved incident prioritization and handling procedures, with a 10:1 average rate of return on Lean investment Sustainable efficiency savings have been made possible by training public servants in Lean techniques (Canada, UK)

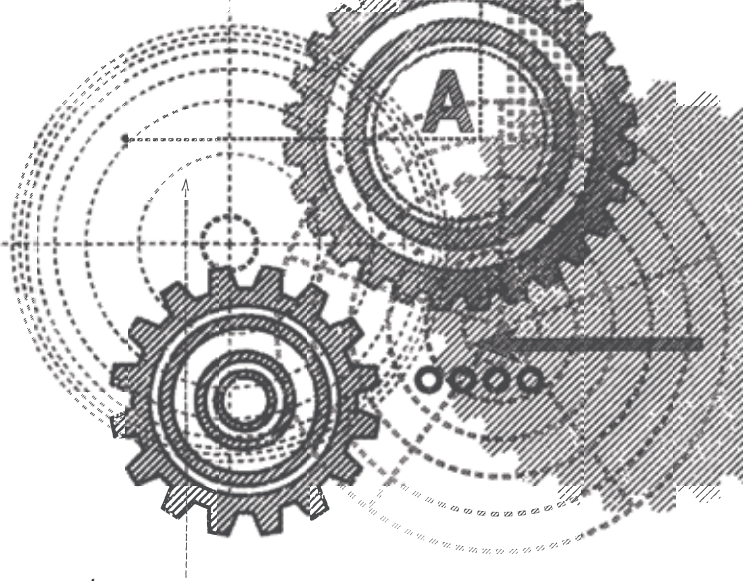
TABLE 5B CONTINUED: SUMMARY OF TRANSFORMATIVE EXPENDITURE REDUCTION MEASURES

INITIATIVE	JURISDICTIONS INVOLVED	RISKS	BENEFITS	RESULTS TO DATE
Pension reform	Australia, Estonia, France, Germany, Greece, Ireland, Italy, Korea, Spain, Turkey, UK British Columbia, Newfoundland, Nova Scotia, Ontario, Quebec, Saskatchewan	<ul style="list-style-type: none"> Public protests State-sponsored occupational pension schemes face a difficult balancing act between the need to attract savers and the need to protect public finances 	<ul style="list-style-type: none"> Improves the fiscal sustainability of pension systems in light of aging populations Increases in pension eligibility ages extend working lives, reduce claimant numbers and boost both tax revenues and pension contributions Increases in occupational pension coverage reduce reliance on state for retirement income and encourage saving at a time of rising household debt 	<ul style="list-style-type: none"> According to OECD estimates, only five member states (Hungary, Italy, Korea, Turkey and the UK) have raised pension ages enough to combat projected increases in life expectancy over the next 40 years Overly rigid timetables for pension age increases have required revision (UK) Public protests particularly in countries that only offered short notice periods for pension age changes (France, Greece) New Zealand's KiwiSaver scheme has increased occupational pension coverage at considerable cost to public finances
Healthcare reform	Canada, UK, USA	<ul style="list-style-type: none"> Limited public appetite for healthcare reform Investment in new technology involves substantial upfront costs Current fee schedules obstruct cross-provincial delivery initiatives Virtualization could socially isolate patients 	<ul style="list-style-type: none"> Addresses the cost implications of aging populations Enables productivity gains from past investments in healthcare to be realized Virtualization can improve the accessibility of healthcare Virtualization allows remote communities better access to healthcare 	<ul style="list-style-type: none"> The use of telemedicine in outpatient management has improved the general health of patients with chronic conditions and brought down the cost of their treatment Cross-provincial telepathology networks have improved the quality and speed of diagnostics
Reformed incentive structures	Canada Ontario	<ul style="list-style-type: none"> Savings-related performance pay prioritizes quick cashable savings at the expense of long-term fiscal sustainability Voluntary schemes may fail to fully engage staff 	<ul style="list-style-type: none"> Harnesses the knowledge base and innovative capacity of those most familiar with government operations and public services Recasts public sector employees as active partners in reform rather than potentially unwilling implementers of prescribed change 	<ul style="list-style-type: none"> Voluntary project-based schemes in Ontario produced localized innovation rather than wider cultural change
Staff and professional mix	Canada, UK, USA	<ul style="list-style-type: none"> Industrial action and service disruption Legal challenges from unions 	<ul style="list-style-type: none"> Allows for the efficient allocation of staff resources in response to technological innovation and changes in service demand 	<ul style="list-style-type: none"> Use of nurse anaesthetists to deliver anaesthesia without physician supervision has lowered staffing costs in many US states without altering quality of care Use of community support officers to free up police resources (Canada, UK) Legal challenges (USA)
Collective bargaining and agreements	Canada, Ireland British Columbia, Manitoba, New Brunswick, Ontario	<ul style="list-style-type: none"> Public sector wage bill may rise 	<ul style="list-style-type: none"> Collective agreements can be used to incentivize staff to find efficiency savings Collective bargaining can be harnessed to facilitate public service transformation Stabilizes industrial relations 	<ul style="list-style-type: none"> Ireland has used a collective agreement concluded in 2010 to achieve a more flexible and integrated public sector

TABLE 5B CONTINUED: SUMMARY OF TRANSFORMATIVE EXPENDITURE REDUCTION MEASURES

INITIATIVE	JURISDICTIONS INVOLVED	RISKS	BENEFITS	RESULTS TO DATE
<p>Co-produced services</p>	<p>Austria, Canada, Chile, Czech Republic, Estonia, Finland, France, Hungary, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, Norway, Poland, Portugal, Slovak Republic, Slovenia, Sweden, Turkey, UK</p>	<ul style="list-style-type: none"> • Non-profit organizations and small- and medium-sized businesses may struggle to absorb the financial risks involved in service delivery • If delivery partners fail, the government (as the provider of last resort) must step in and resume delivery at considerable cost to the taxpayer • Service disruptions • May impact a government's downstream capacity to implement or change policies • The freedom to innovate may conflict with a robust accountability and monitoring framework 	<ul style="list-style-type: none"> • Harnesses the expertise and innovative capacity of community organizations, the non-profit sector and small- and medium-sized businesses • Reduction in footprint of government offers savings in operating budgets • Community empowerment 	<ul style="list-style-type: none"> • The introduction of external sponsors into the UK schools system has helped raise academic standards and granted schools access to sponsors' financial resources and expertise • Employee mutuals have reduced costs and improved service quality in UK community healthcare • Some external providers have defaulted on spending commitments and become insolvent • The involvement of non-profit organizations in service delivery has been hindered by a prohibitory tax and regulatory regime in Canada
<p>Digitization</p>	<p>Australia, Austria, Belgium, Canada, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Korea, Netherlands, New Zealand, Norway, Spain, UK, USA</p> <p>British Columbia</p> <p>Calgary, Edmonton, London, Medicine Hat, Mississauga, Nanaimo, Ottawa, Toronto, Vancouver, Windsor</p>	<ul style="list-style-type: none"> • Significant upfront IT development and infrastructure costs • Bureaucratic resistance to the disclosure of official information • The free release of government datasets could jeopardize the funding models of agencies reliant on the sale or license of data • Differences in digital literacy and internet access across populations may exacerbate social exclusion • Cyber-attacks and identity fraud may lower public confidence and increase delivery costs • Complex interface with privacy legislation 	<ul style="list-style-type: none"> • Online collaboration can be used to break down information silos across government • Crowdsourcing harnesses the expertise of interested individuals and groups online • In contrast to paper-based delivery, digitizing services offers governments lower transactional costs and citizens greater accessibility and convenience • Greater transparency discourages the misuse and waste of public funds • Facilitates work shifting as the private sector absorbs the cost of processing government data • Open access to government datasets can help promote innovation and improve planning and productivity in the private and non-profit sectors 	<ul style="list-style-type: none"> • Canada's internal public service wiki, GCPEDIA, has allowed ideas to be shared and opinion to be canvassed across government • Rapid take up of opportunities for online transactions and interactions with government (France, UK) • Significant upfront costs • Resource and efficiency savings from e-billing, paperless administration and online transactions • Cyber-attacks on government websites (Canada, Estonia, UK) • Canada's complex intergovernmental arrangements have proved an obstacle to digital consolidation exercises • The UK has eliminated duplicated web content and lowered service provider costs through a major consolidation of government websites • Open data portals have sprung up at multiple levels of government • Datasets have often been heavily redacted due to privacy laws • The lack of standardized measures across datasets has hampered attempts to use government data • Mandatory quotas for the release of datasets have been necessary to overcome organizational resistance (USA) • The private sector has used government datasets to provide services for consumers and facilitate business planning

WHERE TO NEXT? CONCLUSION



Governments across the OECD face both short-term pressures to balance budgets and long-term structural constraints driven by demographic factors, aging infrastructure, and rising service delivery costs.

Current short-term measures to cut spending or increase revenues should go some way toward eliminating existing budget deficits. However, they are unlikely to put public finances on a fiscally sustainable path.

Canada's governments face a range of fiscal challenges that are both cyclical and structural. The debt burdens of Canada's largest provincial economies, Quebec and Ontario, are higher than most other provinces, and are projected to continue rising.

An aging population also poses a range of challenges for the future delivery of public services.

Long-term thinking is inevitably challenging when governments are under pressure to deliver tangible short-term results. Yet we may have a rare opportunity to introduce transformative measures without alienating voters.

In much of Europe, broad public awareness of the need to stabilize public finances has helped build political momentum for transformative change. Such awareness is needed in Canada.

Transformative efforts will be easier if governments remain conscious of their primary role as policy-makers. Governments should remain agnostic on the question of who delivers services. Setting policy, defining the public interest, outlining objectives, measuring outcomes, and ensuring that services are delivered efficiently and effectively are crucial roles of government moving forward. Other actors, however, are often better placed to deliver services.

The transformative agenda is enormous and daunting. In this report, we have outlined a number of promising initiatives that OECD jurisdictions are taking. Each comes with their own risks and benefits. The specific approaches Canadian governments decide to adopt are ultimately political choices.

It is time for governments to move into high gear. Some of the most important early actions to consider include:

Implement measures to stimulate the growth of the Canadian social investment market

Social Impact Bonds have emerged as a promising new financing mechanism in a period of fiscal restraint. These collaborative arrangements harness the expertise of the non-profit sector and the financial resources of private investors. SIBs offer the possibility of considerable long-term savings. Moreover as a type of payment-by-result scheme, governments pay investors nothing if specified outcomes are not achieved. So long as SIBs are carefully set up and the risks involved are properly calculated, the potential gains to private investors, the non-profit sector, and taxpayers alike are considerable.

Assure greater control of labour costs in the public sector

If governments are unable to manage growth in overall compensation in the broader public sector, there is little chance that governments can return to fiscally sustainable positions. Governments will need to assess whether the current approach to collective bargaining is appropriate and how arbitration-driven salary increases can be controlled. This is likely to include undertaking skills audits to ensure the most efficient mix of professionals is assigned to particular tasks, and to include more flexibility within collective agreements and job descriptions so that workforce management can keep pace with rapid technological change.

Use new forms of performance agreements, accountability arrangements, and allocation formulae to broader public sector actors

Transfers to hospitals, school boards, colleges, municipalities, and other actors represent another key lever that drives government expenditures without sufficient control. In high expenditure areas like health and education, new funding models are being proposed. These should be considered.

Undertake new and more ambitious forms of program review with an eye toward vertical and horizontal consolidation

Too many programs with overlapping goals have evolved over time, delivered by different governments and different departments with insufficient coordination. As we suggested in our first *Shifting Gears* report, program reviews should be expanded to include more than one level of government. Comprehensive policy audits that seek clarity on the objectives of programs and on how success is to be measured should be conducted, with an eye toward overlap and consolidation. The innovation and R&D space, for example, is exceptionally crowded—clarity is required. There are other policy spaces where vertical program reviews should find considerable savings (Mendelsohn et al. 2010).

Consolidate online services

A growing number of OECD governments are undertaking web consolidation exercises that allow citizens to access multiple government services through a single portal. These initiatives may take the form of a single web domain or personal online account. In either case these initiatives offer citizens a recognizable brand they can trust. They also ensure users are not required to negotiate complex government structures when accessing online services and information. Online consolidation also offers sustainable long-term savings through the elimination of duplicate content as well as lower web maintenance and service provider costs. Managing online interactions with the government should be as easy as online banking.

Re-examine and reconstruct old organizational and administrative models


Governments should simultaneously pursue consolidation and differentiation where appropriate. Governments should identify areas where greater differentiation and specialization will create cost savings and better outcomes (e.g. new universities focused on undergraduate teaching; specialized medical clinics that perform routine procedures), as well as areas where greater consolidation will save money and improve quality (e.g. much easier credit sharing and joint offerings between universities; management of acute care by facilitated networks of health providers who support patient navigation through complex systems).

Explore improved ways of monetizing assets

Governments have been too quick to sell off assets or leave them abandoned. This should change. Governments should undertake reviews of their assets—including data, real estate, and crown corporations—and consider how best to retain and monetize them. In some cases this may involve repurposing. For example, post-secondary institutions are in need of new facilities while many school boards have an excess of buildings. Someone must be accountable for ensuring that these connections are made.

Take a team-based approach across silos to target high consumers of public services

A very small but challenging percentage of the population consumes health and human services to a disproportionate degree, often with relatively mediocre returns. Public service delivery should be integrated and team-based. Silos must be broken down. Programs must be citizen-centred. Results must be measured. The aim of these efforts must not simply be to save money through coordinating a variety of discrete services; the goal must be to deliver measurable improvements in outcomes for some of the most challenging cases.



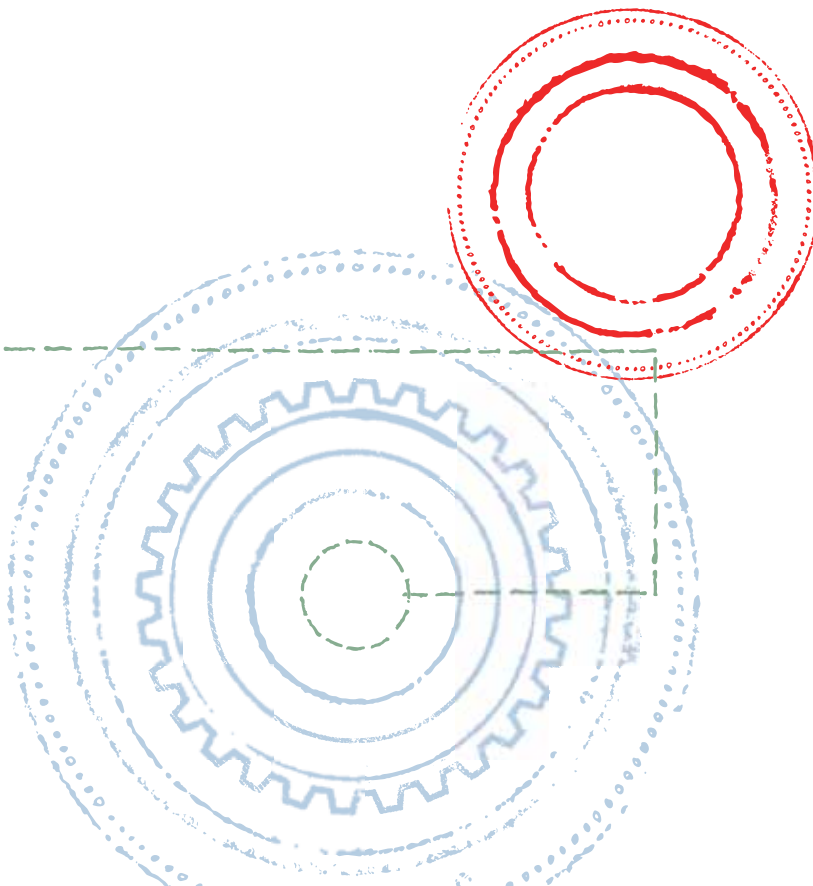
Implement regular, ongoing reviews of programs, expenditures, and outcomes being achieved

Governments should define ongoing regular review processes that are deployed in a sustained manner as part of the annual budget cycle. The results of reviews should inform budget deliberations. They should not be reserved for extraordinary periods or moments of fiscal crisis. The focus should be on ensuring that clearly defined program objectives are still relevant and are being achieved. During these processes, consideration would also be given to whether there are better program options for achieving objectives and whether new delivery methods are appropriate. These are some of the most important early steps that governments can take. We have a problem, but recognizing available solutions is a necessary first step.

To be successful, governments will need to clearly define and articulate the values that motivate their actions. Returning to balanced budgets is important, but it is far more likely to be successful—and strategic—if governments have a sense of purpose beyond balancing the books.

Rebuilding trust in government is at the core of this transformative agenda. By ensuring that citizens' daily experience with public services is exceptional, trust in the ability of government to deliver on its promise can be restored.

Governments should summon the political will and help lead the public to a better appreciation of the magnitude of the issues we face, while challenging stakeholders and public servants to redefine how public services are delivered.



ENDNOTES

1. Following IMF and OECD practice, the term “general government” is used in this report to denote central, state/provincial, and local governments (see IMF 2011b, 74; OECD 2011b, 365).
2. Authors’ calculation based on statistics in Department of Finance Canada 2010 and Statistics Canada 2010b.
3. See evidence given by Jim Flaherty, Finance Minister, to the House of Commons Standing Committee on Finance, 19 August 2011. Accessed at <http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=5119513&Language=E&Mode=1&Parl=41&Ses=1>.

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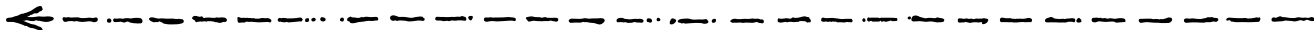
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FISCAL SUSTAINABILITY & THE FUTURE OF PUBLIC SERVICES

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