Getting Back to Basics —
A Strategy for Effective Program Review

Revised Version

Submitted by the Atlantic Institute for Market Studies
to the Nova Scotia Fiscal Management Task Force

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Atlantic Institute for Market Studies

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Executive Summary

The Nova Scotia Government has run out of options. The reality of our fiscal situation can no longer be hidden or glossed over. Without serious structural changes to the way that programs are provided in this province, the government will progressively lose its ability to deliver programs that Nova Scotians truly need, as political decision making power slowly leaks away to the province's creditors.

There are only three direct levers available to government to bring public spending and revenues into line. The first is reducing debt service costs. These, however, are fixed in the short run, and can only be reduced in the medium to long term by a series of surplus budgets and careful management of existing debt. Second, the province can raise taxes. Governments throughout Canada, however, are moving in the opposite direction, especially as the public and policy makers become more aware of our uncompetitive tax burden relative to the United States, our chief market and competitor. Wide agreement is emerging that Canada's tax burden must be reduced, not increased.

That leaves spending reductions as the only direct action that the government can take today to safeguard the sustainability of vital public services and to avoid onerous tax increases in the future.

If the Nova Scotia Fiscal Management Task Force is to make a constructive contribution to effective change by the government of Nova Scotia, it should consider that:

- By international standards, Nova Scotia is delivering many programs through taxation and public provision that could easily be delivered by other means;
- Many of the government's core services are poorly organized and are therefore often ineffective and far more costly than they need to be;
- Program review will only succeed if the Task Force applies a series of consistent *tests* to existing programs to see whether they should be delivered publicly and, if so, whether they are now being delivered effectively and efficiently;

- The tests to apply are: neutrality, transparency, competition and separation;

- Governments should only provide those programs and services that cannot be provided any other way – the government’s core mission is to ensure needed programs are provided, not to provide those programs itself;

- Alternative Service Delivery models provide a more effective and efficient way of delivering goods and services to the tax-payer.

Introduction

Nova Scotia is in financial crisis. The provincial debt burden has reached levels such that even a modest shift in the foreign exchange markets, an economic downturn here or internationally, or further reductions in transfers to the provinces could be disastrous. The majority of this predicament can be laid at the feet of the decision makers of the past 25 years who have vastly overspent, allowed government to grow to excessive proportions and had to borrow massively in order to continue these programs. The situation calls for a solid financial plan, which begins with an evaluation of what services government should and should not be directly providing.

This is hardly news. The new Progressive Conservative Government under Premier John Hamm has already stated its intentions to address public spending through both internal and external program review. This being said, the current situation requires more than a statement of good intentions. The Liberal government under John Savage stated an intention to undertake a major program review but fell far short of achieving any real durable and effective change. This paper presents an effective way of thinking about public sector program review. An overview of why the review is necessary will be followed by the presentation of a powerful framework for thinking about the key issues surrounding program review. Finally, a short discussion of options for the future will be presented.

Why Program Review?

For the past twenty years successive Nova Scotia governments have overspent, misspent, borrowed excessively and badly misjudged the province's ability to pay for public sector programs. The financial problems of the Province have finally reached the point where they can no longer be hidden by creative accounting nor dismissed as a "disappointing year". Nova Scotia has a heavy debt burden, a huge deficit and continued high exposure to foreign exchange risk; all in a time of economic prosperity. Simply put, the status quo is not an option.

Since 1993-94 Nova Scotia's population has grown by 13,000 or a total seven-year growth of only 1.4%. Population growth is therefore flat, and demographics are shifting the age curve relentlessly older. While during the same period the Gross Domestic Product (GDP) of Nova Scotia grew 22.9%, better than the national average, the financial pressures actually increased.

Nova Scotia has been facing fundamental financial challenges since the early 1990's, primarily due to the rapid build up of public sector debt that began in the late 1970's and continued throughout most of the following two decades. This can be summarized as follows:

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- In the period 1993-1995 alone the cumulative deficits were $785 million and the total net debt burden[1] peaked at $11.0 billion or $11,900 for every person in Nova Scotia.

[1] Sum of net direct debt and unfunded pension liabilities. (DBRS)

- During the next five years, the reported cumulative deficits totaled $1.193 billion.

- Originally, the total reported debt declined by over $1.5 billion from 1994-95 to 1997-98, mostly due to favourable foreign currency rate movements. This reversed and increased by over $1.5 billion in 1998-99 to a total of $11.15 billion, again mostly due to adverse swings in conversion rates on the large portion of the provincial borrowing in foreign currencies.

The new provincial government earned its period of stewardship partially due to the rejection of the former Liberal government's Spring 1999-2000 Budget by the citizens of Nova Scotia. The financial highlights of this proposed budget were:

- A forecast expenditure growth for 1999-2000 of 3.1% and revenue growth of 1.7% resulting in a projected non-consolidated surplus, before crown corporation financial results, of $1.2 million.

- On an adjusted basis using the Dominion Bond Rating Services (DBRS) fully consolidated numbers, the tiny 1999-2000 surplus is projected to be in fact a deficit of $43.0 million. The DBRS adjusted deficit for 1998-99 was $91.0 million compared to the government's announced $22.6 million surplus.

- To highlight the financial vise-grip the citizens of Nova Scotia find themselves in, the former government's four-year financial plan, defeated along with the June budget, projected total revenues from all sources during this period of $18.767 billion and cumulative surpluses of $11.2 million or .0006%!

- Following an increase in net debt of $649 million in fiscal 1998-1999, the four year forecast of net debt by the Province is projected to increase a further $531 million before beginning to decline slightly in the year 2003.

The Province's financial results have now been restated by the new Minister of Finance, and $1.1994 billion of adjustments made to the 1998-99 financial statements and prior years. The restated deficit for 1998-99 is $384.1 million and the "total net direct" increased from $8.369 billion at March 31, 1998 to $9.567 billion at March 31, 1999. The difference of $1.5 billion in the total debt burden number of $11.15 billion and the Minister's net direct debt of $9.567 billion is mostly attributable to the contingent and guaranteed debt outstanding for crown corporations and agencies such as Nova Scotia Municipal Finance Corporation, Sydney Steel Corporation, Nova Scotia Business Development Corporation and others.

Reality is that Nova Scotia's financial position is dangerously precarious, and the future ability of the province to provide essential services is silently being eaten away by the debt and its attendant burden of interest charges. Debt service charges are simply a given in the short term and Canada's tax burden is already too high relative to our own chief market (and competitor), the United States. That leaves public spending as the only lever by which Nova Scotians can take decisive action to bring public spending into line with their ability to pay.

Getting Back to Basics: Principles of High Performance Government

The review of public sector program spending can often be tainted by emotion. But such emotion cannot be allowed to determine the outcome of program review, whose very purpose is to ensure the long term health of basic public services by ensuring that Nova Scotia's public spending is in line with the province's means. Ultimately, it has to be determined what programs must remain in the public sector and what programs should be provided alternatively or have simply outlived their usefulness. In making this determination, government must concentrate on becoming more efficient and effective at delivering its core services, while handing the rest over to agencies and organizations better suited to the delivery of such programs and services. The result is referred to as high performance government.

It may be helpful to the Nova Scotia Fiscal Management Task Force to understand what high performance government is and the indicators thereof. There are four main indicators of high performance government programs:[2]

- Neutrality
- Transparency
- Competition
- Separation

[2] Peter Holle, Notes From The Frontier, The Frontier Institute for Public Policy, 1999.

Effective application of these principles means the difference between mere good intentions and a truly effective program review. In fact, our view is that program review will only succeed if the Task Force steps back from the looking at the details of each individual spending program and applies a series of consistent *tests* to all existing programs. Those tests should reveal whether a program should be delivered publicly and, if so, whether it is now being delivered effectively and efficiently. We believe that neutrality, transparency, competition and separation *are* those tests.

1. Neutrality

- Role of government organization shifts from producing to buying services.

- Customer needs for services are defined as specific "outputs" in measurable terms.

- As a purchasing agent, the organization "buys" services from the most effective supplier - either in-house or from alternative suppliers in the commercial or voluntary sector.

2. Transparency

- Full-cost accounting techniques (accrual accounting) are used to establish a level playing field and provide for objective comparisons between in-house and alternative service delivery.

- ♦ All costs associated with delivering a specific unit of service are allocated to calculate an internal cost of production.

- ♦ This process exposes the cost of overheads, internal inefficiencies and excessive bureaucratic layering. It usually leads to reductions in middle management and a streamlining of internal processes and regulations to make the in-house provider more competitive.

- ♦ The agency maximizes value by comparing the costs of alternatives and choosing the most cost-effective option.

3. Competition

- ♦ Neutrality and transparency create the foundation for a competitive framework within which choices between alternative delivery options can be made.

- ♦ Competition produces incentives for innovation and efficiency. Monopolies, whether public or private, lack these incentives.

4. Separation

- ♦ The roles of elected officials and management are separate and distinct to clarify responsibilities. The elected official represents the interests of the citizens, who are understood to be shareholders in the community. The management's role is to organize the use of resources to best fulfil the desires of the citizens.

- ♦ Elected officials are the board of directors and are not involved in directly administrative activities.

- ♦ Elected officials define the service levels (and commensurate tax levels) desired by their customers. Management is responsible for considering all alternatives and delivering the services in the most effective manner.

These straightforward principles enable us to rate the performance of government organisations and help us find out why so many public services cost too much:

- Too many operations are heavily biased towards in-house delivery, usually public monopolies:

e.g.: (a) liquor commission
(b) much transport infrastructure
(c) most hospital care
(d) public schools

- Service levels and costs are ill defined, so nothing can be measured.

- Elected officials are involved deeply in administrative activities where they have little experience or skill.

The result is low-performance government and high-cost services. In turn we pay higher-than-necessary taxes that are eroding our relative living standards. It is possible to create excellent public services, lower taxes, and rising prosperity at the same time. We can do all this by reorganising our public sector according to these principles of high-performance government.

The Nova Scotia Fiscal Management Task Force must put every effort into attaining high performance government. This will require certain programs be reduced, provided alternatively or eliminated. Reduction of a program's scale is very straightforward, as is elimination. However, alternative program service delivery is often misunderstood and therefore not given the consideration it deserves.

Doing Things Differently

It must be made clear that Alternative Service Delivery of public sector programs does not necessarily mean privatization, although privatization will often be an option with powerful benefits that deserves careful evaluation. There exists a myriad of compromises between line department delivery in the public sector and private sector ownership.

> "The current environment of fiscal restraint, downsizing and the increasing use of technology has created a number of opportunities for public sector reform and renewal. Governments now find there is the political will and public support to implement significant, and in some cases radical policy and program changes. It is clear that governments must change in order to effectively address fiscal realities and the limitations they place on policy and program

funding, and in order to respond to public expectations and low public confidence in public servants and institutions. Our research finds that governments have three options:

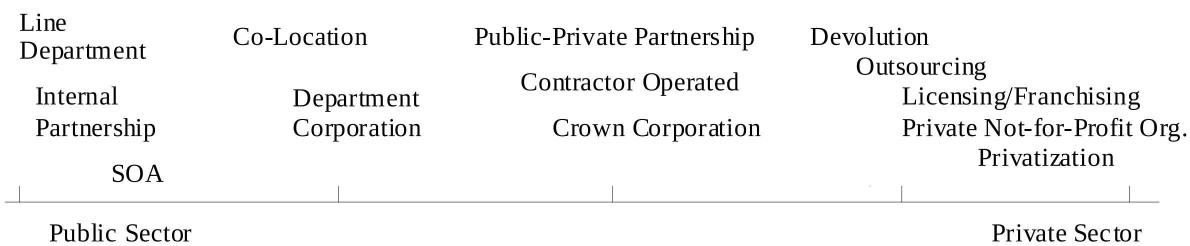
1. Getting out of public policy obligations through abandonment, devolution of responsibilities to others or privatization.

2. Doing more with less- the continued maintenance of the status quo by contracting out, by using existing silo structures found within the bureaucracy, or by continuing to demand more output from the current workforce.

3. Seeking out new, non-traditional ways of conducting business within the public service. For the lack of a better or more comprehensive term "alternative service delivery" (ASD). ASD is an approach to restructuring that concentrates on innovative and critical questions concerning programs and service delivery and finds creative ways of developing better solutions."[3]

[3] Robin Ford and David Zussman, Alternative Service Delivery: Transcending Boundaries from *Alternative Service Delivery: Sharing Governance in Canada*, KPMG Centre for Government Foundation, 1997, pg 8

There are a number of delivery options which government can move towards in order to increase neutrality, transparency, competition, and separation of purchasing and provision. These options can be represented in the following diagram:



At the far right end of the spectrum, methods of service delivery remove the ultimate responsibility for delivery away from government to external management and/or ownership. Along the continuum, a hybrid of alternatives exists. A solid business case should be developed to demonstrate efficiency and effectiveness in the delivery option that is chosen. Clearly, the farther right one moves along the spectrum, the greater is the likelihood that qualities of neutrality, transparency, competition, and separation of purchasing and provision will be maximized.

High performance government is about efficient and effective provision of goods and services to taxpayers. The Nova Scotia external program review will fall short of achieving high performance government if it does not recognize and recommend the application of appropriate Alternative Service Delivery models.

Conclusion

The current fiscal situation in Nova Scotia is critical. Unless serious steps are taken to ensure a reduction in overall spending, the future viability of core government functions will be in question. The size of the public sector in Nova Scotia has grown to excessive proportions in the past twenty years and with this growth has come excessive spending. A high performance government would provide directly only those services government is good at and leave the rest to the private sector or an appropriate variation thereof. It is absolutely essential that the Nova Scotia Fiscal Management Task Force recognize the need for neutrality, transparency, competition and separation in public sector programs. To do otherwise is to simply repackage the previous program review failures.

What AIMS has attempted to do in this paper is to lay out a framework for grappling with the vital public policy issues raised by program review. We have not attempted to apply these principles to any particular government programs, in large part because of the constraints of time and length imposed by the program review process itself. The Institute wishes, however, to make clear that its staff are more than willing to sit down with the members of the Nova Scotia Fiscal Management Task Force to discuss in detail how to apply the latest innovative thinking in public sector reform to Nova Scotia's current difficulties.

We wish you well in your difficult task.