HOW BAD IS IT? WHAT DO WE DO ABOUT IT?

A STRAIGHTFORWARD GUIDE TO ONTARIO'S DEBT AND DEFICIT SITUATION

ontario chamber of commerce

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About the Ontario Chamber of Commerce

The Ontario Chamber of Commerce (OCC) is a business network of 160 local chambers of commerce and boards of trade in Ontario. Through this network, we are the voice of 60,000 members that range from small businesses to major corporations and industry associations. Together, our members employ over two million people and produce nearly 17 percent of Ontario's GDP.

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HOW BAD IS IT? WHAT DO WE DO ABOUT IT? A STRAIGHTFORWARD GUIDE TO ONTARIO'S DEBT AND DEFICIT SITUATION
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EXECUTIVE SUMMARY

Ontario's debt and deficit situation is a hot topic of discussion in the province. Some experts are calling it a crisis and think that the Government of Ontario should be taking every step possible to balance its books. Others believe that Ontarians should not be concerned, that the province's debt and deficit situation is sustainable, and that it will resolve itself as the economy returns to growth. Who is right and who is wrong?

The goal of this report is to provide a frank and straightforward account of Ontario's current fiscal situation. To do this, we analyze the province's fiscal history and examine the 'big picture' economic and demographic trends that are likely to impact the province's bottom line moving forward.

Based on this analysis, we find that Ontarians should be very concerned about the direction in which the province is heading. Ontario's fiscal situation is becoming increasingly dire, though we have not yet reached a crisis point. That said, we are likely to reach a state of crisis unless the province cuts spending and changes the ways it does business.

Over the past few decades, Ontario has been digging itself deeper into the red on a near-permanent basis. Governments of all political stripes have spent more than they have collected in revenues.

There is no ignoring the impact of recessions in the early 1990s and late 2000s. However, governments have failed to reduce their debt loads when the economy was performing well. By not doing so, our province has been set on an unsustainable path.

Ontario's precarious fiscal situation has negative consequences for all of us: it deters investment and reduces the government's capacity to make productive investments. Further, it compromises the government's capacity to respond to any future economic downturns.

Factor in aging population and a slow-growth economy, and the situation gets worse—both will put even more pressure on the provincial budget and make a large, persistent debt and deficit much more difficult to address. For instance, as the population ages, how will our shrinking workforce (i.e. tax base) afford to pay for necessary increases in health care spending?

We present six approaches in the second half of this paper that the government can take to reduce its spending and to begin paying down its accumulated debt. These include adopting alternative service delivery models, embracing asset recycling for some government assets, and introducing user-pay models for some services. These approaches also offer a means to improve the efficiency and effectiveness of government programs.

As noted in the 2014 provincial budget, "(t)he people of Ontario expect their government to be able to continue to provide high-quality public services and opportunities now and for generations to come" (Ontario Ministry of Finance, 2014a, 259). Unless government acts boldly and quickly, its capacity to achieve this goal will be severely compromised.

An Inconvenient Truth: Ontario's Debt and Deficit by the Numbers

- In 2013-2014, the Government of Ontario spent $10.5 billion more than it collected in revenue. This will increase to $12.5 billion in 2014-2015
- To achieve its deficit-elimination goal of 2017-2018, the government must reduce the deficit by over $4 billion per year for the next three years
- For 18 of the past 25 years, governments in Ontario have run a budget deficit
- Ninety-three percent of businesses in Ontario believe that eliminating the deficit is an important priority (OCC Quarterly Policy Survey, February 2014)
- Ontario's net debt in 2013-2014 was $267.2 billion. The cost of servicing this debt is $10.6 billion in interest per year, or $29 million per day

INTRODUCTION

For all but seven of the past 25 years, Ontario's governments have spent more than they have collected in revenues. As a result, the province's debt has grown significantly.

In the most recent provincial election, all political parties acknowledged Ontario's troubling fiscal situation but presented voters with starkly different approaches to address it. With the election now over, the time is right for a straightforward conversation about Ontario's finances and what to do to balance the province's books.

This report seeks to address a fundamental question: How concerned should Ontarians be with the province's fiscal situation?

> The people of Ontario expect their government to be able to continue to provide high-quality public services and opportunities now and for generations to come. Therefore, there is an obligation to ensure that the cost of these supports does not lead to unsustainable debt levels and high interest costs for future generations.
>
> - Ontario Ministry of Finance, 2014

This report is divided into two parts. In Part 1, we assess the status of Ontario's fiscal situation. To do this, we conduct a simple analysis of Ontario's fiscal history. We also examine the 'big picture' economic and demographic trends in the province that are likely to impact its bottom line going forward. We find that Ontarians should be very concerned with the province's fiscal situation.

In Part 2, we provide six approaches to reordering the way government does business that will go a long way in helping government to balance its books and to begin paying down its debt. We examine how other governments have succeeded in achieving fiscal sustainability while retaining their capacity to provide vital public services and make productive investments that will help foster economic growth.

Together with our members, we do not support slash and burn-style cuts to programs and services that Ontarians value. This approach compromises the quality and accessibility of public services, and fails to deliver savings in the long run. This said, government has a responsibility to improve the efficiency of its own operations before considering across the board tax increases to boost revenues.

The goal of this report is to increase public understanding about the critical fiscal issues facing Ontario and highlight how important it is to take action now. We hope that this report provokes a more informed conversation about the tough choices ahead.

PART 1: HOW BAD IS IT?

ONTARIO'S FISCAL SITUATION

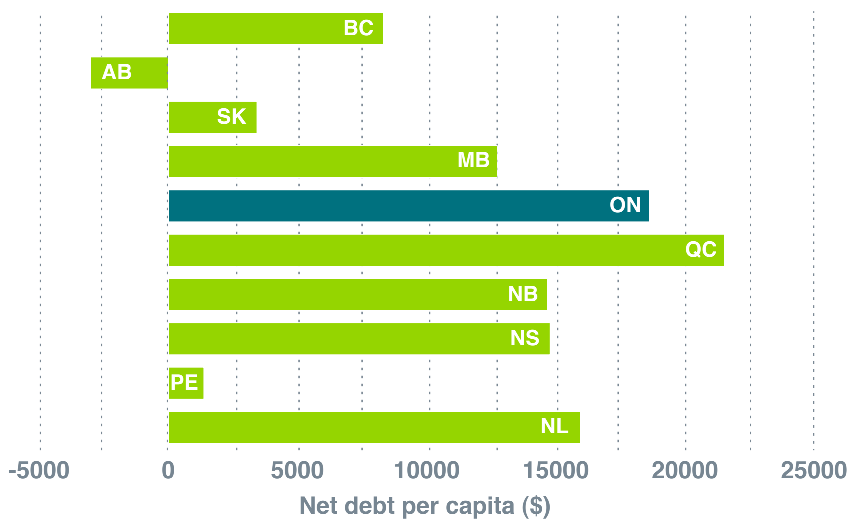
This section summarizes Ontario's current fiscal situation and asks: how did the province end up so deep into debt?

In the 2013-2014 fiscal year, the Government of Ontario spent $10.5 billion more than it collected in revenue. This deficit will increase the province's net debt to $267.2 billion. To service this debt, Ontario will pay $10.6 billion in interest payments, otherwise known as interest on the debt (IOD) (Ontario Ministry of Finance, 2014d).

Ontario has the highest net debt of any province in Canada and the second-highest debt on a per capita (i.e. per person) basis. In 2012-2013, Ontario's net debt exceeded that of Quebec (the second-most indebted province) by $75 billion and that of British Columbia (the third-most indebted province) by over $200 billion. In the same year, Ontario's per capita debt was approximately $18,600, second only to Quebec (Figure 1). On the whole, Ontario's fiscal situation appears poor relative to other provinces.

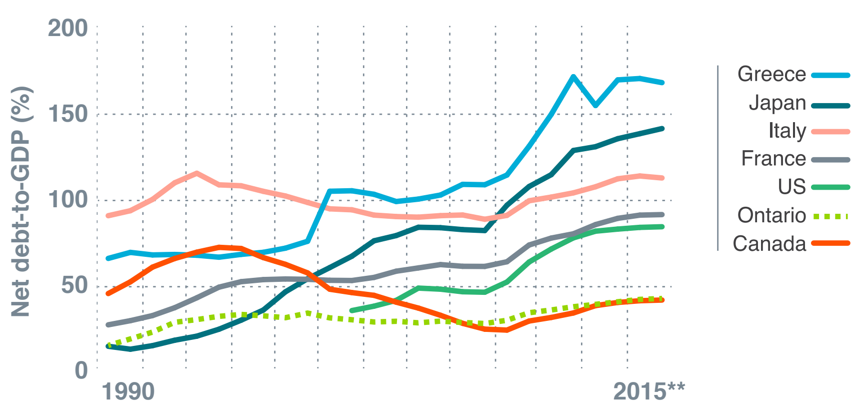
Figure 2 is merely illustrative. Ontario's fiscal situation, as a subnational jurisdiction, is not directly comparable to the situations in sovereign countries such as Greece. However, it does suggest that Ontario is doing better than many countries that have tipped over or face the prospect of a fiscal cliff. The Figure is also a useful reminder that a jurisdiction's fiscal health can worsen in a relatively short period of time.

Figure 1: In 2012-2013, Ontario's per capita debt was the second-highest among provinces



Source: TD Economics, 2014; Statistics Canada

Figure 2: Ontario is better off than other jurisdictions experiencing fiscal woes



Source: International Monetary Fund, 2014; Ontario Ministry of Finance, 2014a
*National figures aggregate data from all levels of government
**Estimated

HOW DID THE PROVINCE END UP SO DEEP INTO DEBT?

Figures 3 and 4 provide an overview of Ontario's fiscal situation over the past 25 years. In Figure 3, it is clear that the financial crisis of 2008 and subsequent government stimulus spending had a significant impact on Ontario's debt and deficit. From 2007-2008 to 2009-2010, the province's fiscal balance shifted from a small surplus to a $19 billion deficit.

While there is no doubt that the most recent recession had a large impact on our current fiscal balance, it does not tell the whole story.

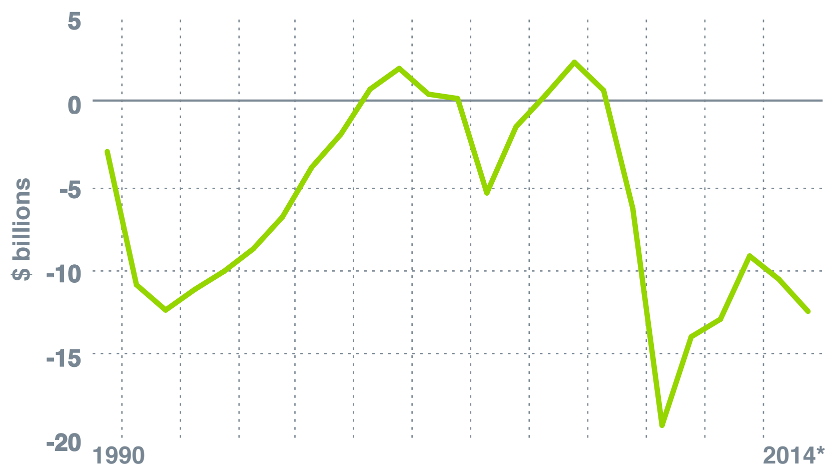
Since 1990, Ontario's debt has grown from $38.4 billion to an estimated $267.2 billion today (Figure 4). It has grown despite periods of strong economic growth and was driven by continuous government deficits. Government collected more revenue than it spent only seven times since 1990 (Figure 3).

From 1990-2014, Ontario's debt-to-GDP ratio grew from 13.4 percent to 38.9 percent.

Multiple recessions during this period contributed substantially to the cumulative debt; government chose not to pay down debt levels during periods of sustained economic growth. Instead, governments of all political stripes continued to run deficits and pile on more debt, including during the current five year recovery (Simpson, 2012).

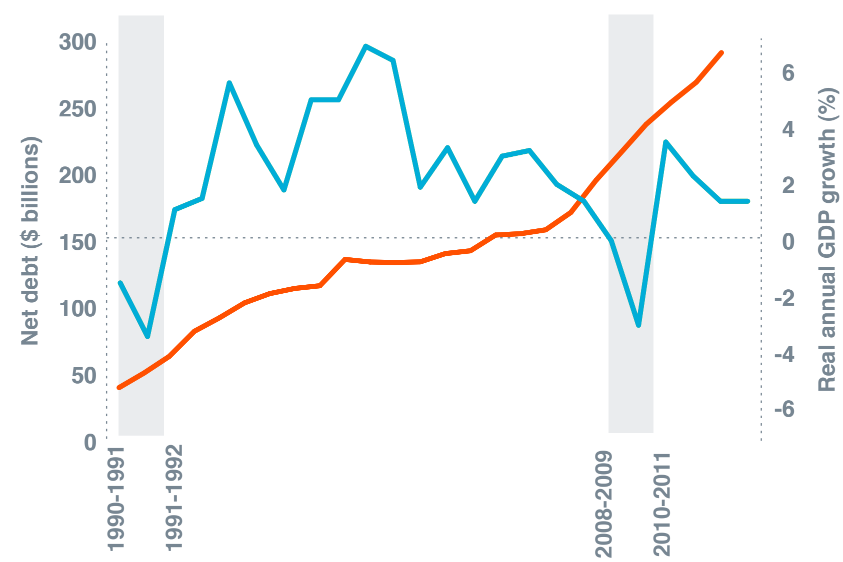
Indeed, there appears to be a fundamental and near-permanent imbalance between what the provincial government spends and what it collects in revenues. This imbalance, sometimes called a structural deficit, is becoming unsustainable and needs to be addressed for reasons we discuss later.

Figure 3: Since 1990, the government has achieved budget balance or surplus in only seven years



Source: Ontario Ministry of Finance, 2014d; TD Economics, 2014
*Estimated

Figure 4: Ontario's net debt has grown consistently over the past 25 years both within and outside of recessionary periods



Source: Ontario Ministry of Finance, 2014b, 2014d; TD Economics, 2014
*Note: Shaded area indicates recession

THE FISCAL OUTLOOK

In the near-term, the fiscal outlook is not positive. In 2014-2015, the deficit is expected to increase to $12.5 billion and the debt will grow to $289.3 billion (Ontario Ministry of Finance, 2014a).

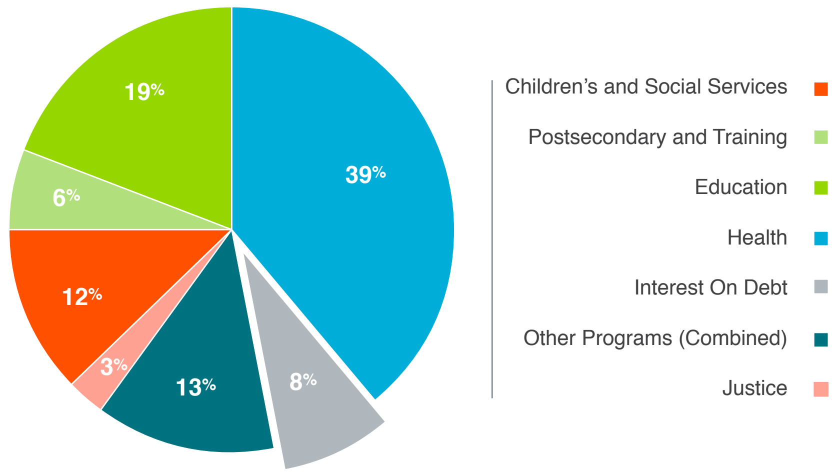
Interest payments will also grow as a component of spending. In 2014-2015, the province will pay $11 billion to service the debt, or 8.4 percent of its total spending. As Figure 5 shows, this is the fourth-highest expense in the province, and is more than what is spent on colleges, universities, and training programs for the unemployed, combined.

According to Ontario's Ministry of Finance, the accumulated debt will continue to consume more and more public dollars over the next few years (2014a). In fact, interest payments will be the fastest growing cost for the province until at least 2016-2017; they are expected to increase by 7.9 percent from 2013-2014 to 2016-2017, while total program spending is expected to increase by only 1.1 percent. During this time, interest payments will grow from 8.3 percent of government spending to 10 percent.

Within the next three years, Ontario's debt is set to rise by a total of $48 billion. At this point, interest spending will have increased to $14.2 billion per year (Stewart and Fields, 2014).

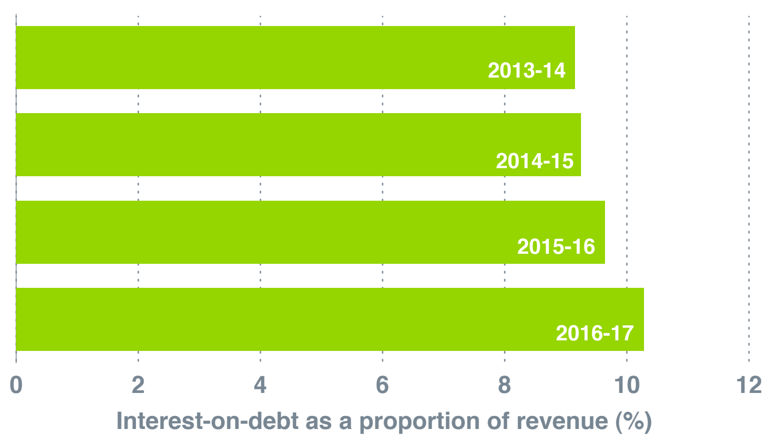
Examining interest from a revenue perspective is more telling. In 2013-2014, the cost of servicing the debt will be equal to approximately 9.1 percent of total revenue. By 2016-2017, this proportion is projected to grow to 10.3 percent (Figure 6). In other words, for the next few years, the growth in interest payments is expected to outpace the growth in the government's income.

Figure 5: In 2014-2015, interest payments will exceed spending on the postsecondary and training sector



Source: Ontario Ministry of Finance, 2014a.
*"Other Programs" groups together all other government program spending

Figure 6: Interest payments as a proportion of total government revenue will increase until at least 2016-2017



Source: Ontario Ministry of Finance, 2014a, 2014d.

Overall, this assessment of Ontario's fiscal situation reveals that Ontarians can expect to see sustained deficits, a growing debt, and increasing debt payment obligations. Why should we be concerned by these fiscal trends?

THE CASE FOR URGENCY

As this report demonstrates, Ontario's debt load has been steadily increasing since the 1990s and will continue to increase for the next several years unless bold steps are taken now to reduce it. This section details the reasons why Ontarians should be concerned about the province's fiscal situation and makes the case for urgency in addressing it.

PRESSURE ON GOVERNMENT SPENDING WILL INCREASE

For the next few decades, there will be considerable pressure on government to spend more. According to the Ontario Ministry of Finance, this pressure will be driven mainly by an aging population (2014c). Without a serious plan to tackle its deficit, the government will be hard pressed to meet its new spending obligations without going further into debt.

Ontario's population of seniors is expected to double by 2035 (from 1.9 million to 4.1 million). As a result, pressure on government spending will be driven by increased demand for certain government services. As stated by Ontario's Ministry of Finance, "the provincial government spends on average three times more per capita on health care for seniors than for the overall population" (2014c, pg. 26). The Ministry projects that an aging population will increase cost pressures on public health spending by over one percent annually.

The aging population will also increase spending pressure on other programs that serve seniors, such as community and social services (Ibid.).

PRODUCTIVE DEBT VS. UNPRODUCTIVE DEBT

While calling for fiscal restraint, the OCC and its members are also lobbying government to invest in critical infrastructure, such as public transit in the Greater Toronto and Hamilton Area and a road to the Ring of Fire. Is the OCC contradicting itself on the debt and deficit issue?

Taking on debt makes sense in certain situations, but is irresponsible in others. *Productive debt* is debt accumulated to underwrite spending that generates a high return on investment or to support countercyclical spending that keeps people employed during economic downturns. *Unproductive debt* is accumulated when government borrows continuously to finance its day-to-day operations.

Investing in critical infrastructure is an example of using debt productively. According to the Conference Board of Canada, every dollar that government invests in public infrastructure generates a $1.11 return in real GDP (Antunes et al., 2010). In the Greater Toronto and Hamilton Area, investments in transportation and transit infrastructure would help recoup the six billion dollars in lost productivity due to congestion each year (Metrolinx, 2008). Similarly, the OCC has calculated that a two billion dollar road to the Ring of Fire will unlock up to $30 billion in economic activity. Moreover, government would recoup its investment in approximately ten years (OCC, 2014).

The accumulation of unproductive debt over the past 25 years in Ontario is crowding out government's capacity to take on productive debt and make the investments necessary to spur growth.

From the mid-1970s to the end of the 1990s, Ontario persistently underinvested in its infrastructure capital stock (Figure 7). As a result, the province has both a serious infrastructure deficit, especially in transit and transportation, and an existing infrastructure stock that is deteriorating.

The current fiscal situation is a substantial barrier to addressing both the demographic and infrastructure challenges. Without bold and swift action to improve the fiscal situation, the government will be limited in its ability to respond to these growing spending pressures.

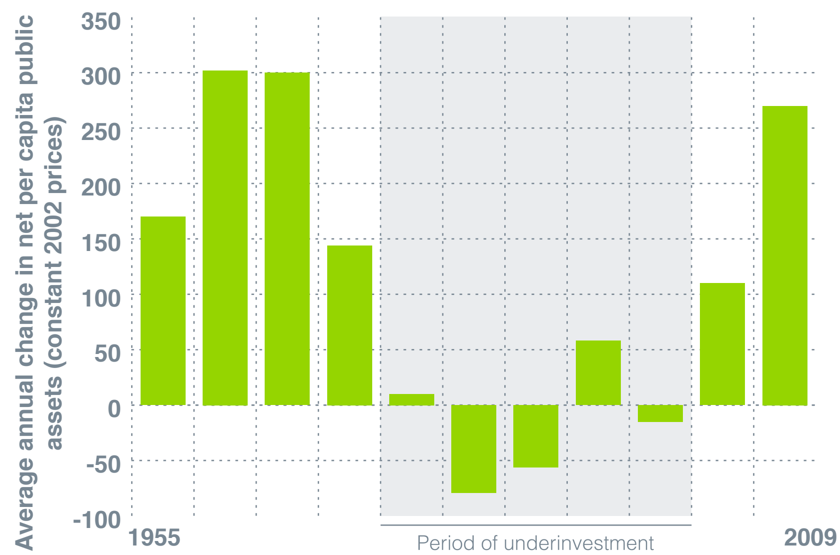
INTEREST RATES WILL RISE

The effective interest rate that Ontario pays to service its debt has declined from 10.9 percent in 1990 to 3.9 percent today (Figure 8). As a result, the cost of servicing that debt has become much cheaper, even as Ontario's total debt burden has increased. In 2011-2012, Ontario paid less interest than in 2000-2001, despite a 93 percent increase in net debt during that period (Ontario Ministry of Finance, 2013).

While interest rates are likely to remain low in the near- and medium-term, a future increase is inevitable (Canadian Press, 2014). When interest rates do eventually go up, the debt will be much more expensive to service. The Ontario Ministry of Finance estimates a one percent increase in interest rates would, based on its current debt, increase Ontario's interest payments by $400 million (2014a).

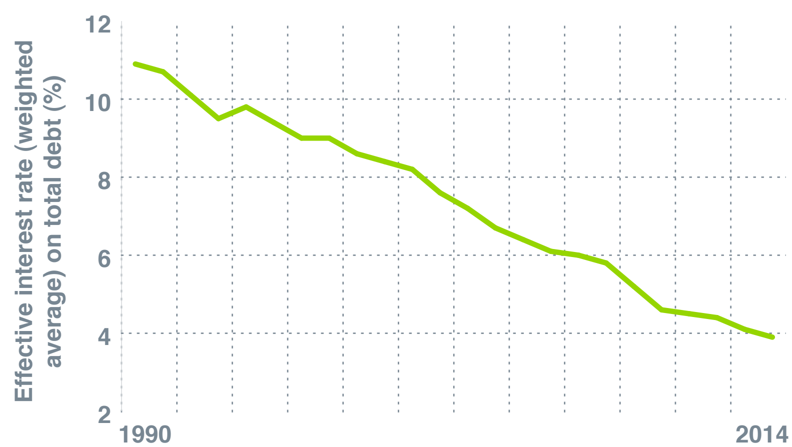
Increased interest payments on the debt will further crowd out government's capacity to spend on programs and services valued by Ontarians, such as education, health care, and transportation.

Figure 7: Significant underinvestment in infrastructure from 1975-2000 left Ontario with an aging capital stock that needs to be renewed



Source: Ontario Ministry of Infrastructure, 2011

Figure 8: Ontario has benefitted from declining interest rates since 1990



Source: Ontario Ministry of Finance, 2014a

ECONOMIC GROWTH WILL BE SLOWER IN THE FUTURE

Ontario will not grow its way out of debt. According to the Ontario Ministry of Finance (2014c), the province will experience slower economic growth for the next 20 years. From 1982-2013, Ontario's average annual real GDP growth was 2.6 percent. From 2014-2035, average growth in the economy is expected to be only 2.1 percent per year. This is because some of the key drivers of economic growth are expected to under-perform relative to historical trends.

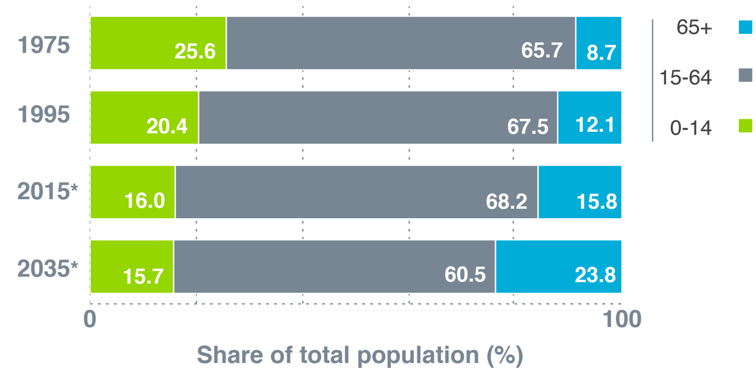
Ontario's aging population will be a significant drag on growth. Over the past few decades, the province's economy has benefitted significantly from a growing labour force. However, while our population will continue to grow, the graying of Ontario's population means that we can no longer rely on a growing labour force to drive economic growth (Figure 9).

From 1971-2013, the core working-age population in Ontario grew by an average of 1.5 percent per year. For the next 20 years, this figure will drop to 0.5 percent, as the number of workers that are retiring will drastically exceed the number of new entrants into the workforce. Ontario will be increasingly dependent on increased immigration to grow its labour force (Ontario Ministry of Finance, 2014c).

Worker productivity is another key driver of economic growth in the province. If Ontario is to keep up the pace of economic growth it experienced in the past, any decreases in labour force growth will need to be offset by making the smaller pool of workers more productive.

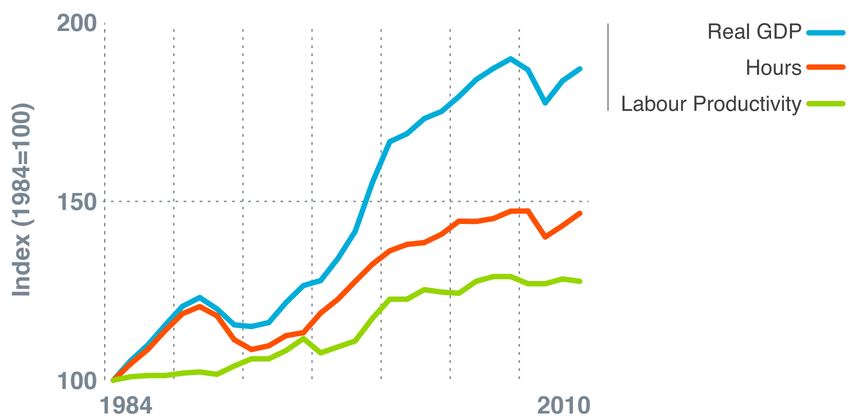
However, labour productivity in Ontario has stagnated over the past decade (Figure 10). Our labour market productivity growth has also lagged relative to the United States, where productivity has grown at 2.4 percent annually since 2001, compared with only 0.4 percent in Ontario (Ibid.).

Figure 9: By 2035, almost 1/4 of Ontarians will be over 65 years of age



Source: Ontario Ministry of Finance, 2014c
*Estimated

Figure 10: Labour productivity in Ontario's business sector has stagnated in recent years



Source: Ontario Ministry of Finance, 2014c

As the pressure to spend on programs to service Ontario's aging population grows, the relative tax burden on Ontario's shrinking workforce to pay for those programs will increase (Boivin, 2012). An increased tax burden will reduce the purchasing power among working-age Ontarians and be a further brake on growth.

In short, government will face two related pressures as a result of its aging population. First, demand for some services such as health care will increase. Second, a shrinking workforce will also reduce the overall tax base used to fund these services. Barring drastic improvements in overall productivity in the economy, Ontario is likely to experience slower growth for the foreseeable future. Government will need to take bold action to ensure that future generations of workers are not saddled with an unsustainable (and unfair) debt burden.

BUSINESS CONFIDENCE IS ERODING

According to a recent OCC survey, 93 percent of businesses in the province believe that eliminating the deficit should be a top priority for government (OCC Quarterly Policy Survey, February 2014).

Following the release of Ontario's 2014 Budget, Moody's Investors Service, as well as other credit agencies, revised their respective Ontario outlooks to 'negative'. When markets demonstrate waning confidence in the province's fiscal situation, businesses tend to become wary of investing. Rightly or wrongly, business tends to look at a government's fiscal situation as a proxy for the overall health of an economy. The perceived threat of higher taxes to pay down the debt may also depress investment (Scarth 2014).

The negative outlook for the provincial fiscal situation has not yet resulted in higher borrowing costs for the government. But investors will eventually demand a higher return on their investment in provincial debt, which will increase the cost of servicing the debt and cut into other program spending (Ontario Ministry of Finance, 2014a).

GOVERNMENT'S CAPACITY TO RESPOND TO FUTURE SHOCKS IS DIMINISHED

The current aggregate debt situation will constrain the government's capacity to respond to unpredictable external shocks, such as a global economic crisis. This is particularly worrying, as the provincial and federal governments invested heavily to help Ontarians get through the worst of the recent recession. For example, both governments invested over $13 billion to protect the auto sector. Given our current fiscal health, the provincial government may not be able to take similar steps in the future without significantly increasing the overall cost of borrowing and pushing the province to a fiscal precipice.

THERE IS A GROWING BURDEN ON FUTURE ONTARIANS

Arguably, the clearest case for bold action to address the high and increasing debt load is intergenerational fairness. The accumulation of debt means that future generations will face a wicked dilemma. They will have to either pay much more to maintain the diversity and quality of services that have benefitted current and previous generations, or enjoy less access to and lower quality public services.

The urgency of the situation is compounded by an aging population and lower projected growth. Both will greatly increase the percentage of income each individual worker will need to pay in the future to service the accumulated debt and maintain public service levels.

As noted in the 2014 provincial budget, the provincial government has made a commitment to provide high-quality services "for generations to come" (Ontario Ministry of Finance, 2014a, 259). Unless the government acts boldly and quickly to eliminate its deficit and begin paying down its debt, its capacity to achieve this goal will be severely compromised.

WE ARE NOT AT THE TIPPING POINT, BUT THERE IS A CLEAR CASE FOR URGENCY

If governments borrow too much, or borrow unsustainably, they may reach the so-called 'tipping point', when "the level of indebtedness could substantially increase borrowing costs and or/prevent access to capital markets" (Ontario Ministry of Finance, 2013).

In other words, a tipping point is the point at which government can no longer afford to simultaneously service its debt and also run day-to-day public services and programs. Most studies place the tipping-point at a net debt-to-GDP ratio of 80 to 90 percent (Ibid.). With a net-debt-to-GDP ratio of less than 40 percent, the province's fiscal situation appears far from crisis.

Based on the analysis above, there is a case for addressing the province's fiscal situation with urgency. Near- and medium-term trends like an aging population, slower economic growth, and declining business confidence will all make a large debt and deficit much more difficult to deal with in the future. To avoid a future crisis, the government needs to take bold actions today.

In the next section, we highlight some encouraging actions taken by the current government to-date, but also underscore the need for government to go further.

GOVERNMENT: WHAT WILL YOU DO?

Ontario's debt has steadily increased over the past 25 years and will grow to unsustainable levels unless bold action is taken soon. Ontario needs a serious, detailed, and transparent plan to reduce the province's deficit and tackle its debt.

To date, the government has taken some encouraging steps to reduce its deficit. From 2009-2013, the government managed to reduce the deficit by $10 billion, or $2.5 billion per year. More recently, it has taken other key actions.

However, the situation remains worrisome. To reach its deficit elimination target, the government will have to reduce the deficit by over $4 billion per year, a pace that recent governments have never achieved. Further, achieving its target does not begin to address the overall debt. Clearly, there is still more to be done. This begs the key question for government: what will you do?

Despite the fiscal pressures, there is incredible scope for innovation, entrepreneurialism, and productivity improvements in the large portion of the economy over which the government has direct control. Government must fundamentally change the way it does business in many program areas.

By changing its business models, government can help grow our economy while enhancing its capacity to meet the evolving and increasingly sophisticated demands of the population. It can also maintain its ability to deliver core public services. In Part Two of this report, we propose six approaches to set the government on a more fiscally sustainable path.

> [W]ith a looming slowdown in the expansion of the labour force that is almost upon us and with the province's weak productivity growth of late, Ontario cannot count on a resumption of its historical strong growth rates... Spending simply cannot return to recent trends.
>
> - Commission on the Reform of Public Services, 2012

PROGRESS REPORT: KEY ACTIONS TAKEN BY THE GOVERNMENT OF ONTARIO

- Cut the annual growth in health care spending to below GDP growth
- Successfully negotiated no or minimal salary increases with key public sector unions, including a recent tentative agreement with AMAPCEO, Ontario's second largest public service union
- Appointed a single Minister, the new Treasury Board President, that is tasked with eliminating the province's deficit
- Introduced annual program review savings target of $250 million in 2014-2015, and $500 million in 2015-2016 and 2016-2017
- Established the Premier's Advisory Council on Government Assets, which is investigating how to generate the most value out of key public assets, such as the Liquor Control Board of Ontario (LCBO), Hydro One, and Ontario Power Generation (OPG)

PART 2: SIX APPROACHES TO ACHIEVING FISCAL SUSTAINABILITY

Despite the province's current fiscal challenges, government has the ability to secure a more fiscally sustainable future if it takes action now.

In this section, we outline six approaches that the Government of Ontario should consider adopting as it wrestles with how to eliminate its deficit and begin paying down its debt. These approaches are not simply cost-cutting measures. They also focus on making public services more responsive to changing citizen expectations and generating a greater return on the public's investment.

The approaches suggested in this section focus on government spending. The OCC and its membership feel that government must make a concerted effort to implement these approaches before considering tax increases. Government has a responsibility to improve the efficiency of its own operations before introducing across the board tax increases.

PARTNER WANTED: THE FEDERAL ROLE IN ONTARIO'S RETURN TO BALANCE

This report focuses on the Government of Ontario's fiscal situation and the steps it must take to return it to balance and sustainability. However, it is important to highlight that the federal government must play a key role in this effort.

The way that the federal government allocates $62.5 billion worth of transfers to other levels of government in Canada is a major disadvantage for Ontario (Government of Canada, 2014).

The gap between what Ontarians pay in federal taxes and what they receive in the form of program spending and transfers is $11 billion, or 1.9 percent of the province's GDP (Zon, 2013). The gap results from an unprincipled allocation formula in transfers directly to the provincial government, such as in the Equalization program, and unprincipled allocation in transfers directly to individual Ontarians, such as in the Employment Insurance (EI) program.

Where federal spending on programs in the province falls short, the province is forced to divert its own resources to bridge funding gaps. For example, an unprincipled EI system that disadvantages Ontarians means that the provincial government has to spend more on social assistance programs to support out-of-work Ontarians. This increases spending pressure on a government in an already troubling fiscal situation.

More principled federal transfers would make a substantial contribution to Ontario's efforts to return to fiscal balance and sustainability.

APPROACH #1: PROGRAM REVIEW

WHAT IS A PROGRAM REVIEW?

A program review is a government-wide effort to reduce its footprint by "ask[ing] questions not often posed in normal budgetary times" (Mowat Centre, 2010, 22). Among other questions, program reviews ask: "Should government be engaged in this activity? Is this policy accomplishing what we want? How do we know? Are there other programs across government that are duplicative?" (Ibid., 22).

WHAT DO PROGRAM REVIEWS ACCOMPLISH?

Periodic program reviews ensure that government funds are being used efficiently and effectively. By answering the questions posed above, governments can redirect public resources away from non-essential programs and services, and toward core ones. Undertaking program reviews can also reveal opportunities to improve efficiency in program and service delivery (KPMG, 2009). If undertaken seriously, periodic program reviews can effectively reduce unnecessary government spending and increase the government's capacity in priority areas.

Program reviews are not, however, simply fiscal exercises. Periodically re-examining the programs, services, and operations of government ensures that these are aligned with citizens' expectations of government. In this way, program reviews can make government more effective and responsive. They can also be used to "rejuvenate the public service by eliminating unsuccessful programs and strengthening effective ones" (Ibid., 23).

In Ontario, a government-wide program review to determine how programs and services align with government priorities would help reduce spending, where appropriate, and achieve savings by identifying redundancies and inefficiencies. The Government of Ontario has already begun this process, with expenditure reviews starting in 2013-2014 and program review savings targets to 2016-2017.

That being said, savings targets for the government have been set to a maximum of $500 million per year, which is less than one percent of the annual budget and far less than the $4 billion per year needed to meet its 2017-2018 balanced-budget target. The OCC and its members advocate more ambitious targets coupled with transformational changes in the way government does business, some of which are outlined in this section.

CASE STUDY: CANADA'S 1992-1997 PROGRAM REVIEW

A commonly cited example of a successful program review, leading to a smaller government footprint, is Canada's 1992-1997 program review (KPMG, 2009). During this review, the federal government eliminated a range of public services it had previously provided, cut all federal department budgets by 20 percent, on average, and reduced total government spending by 9 percent of GDP (Ibid.).

Many criticize the federal government's draconian cuts, particularly to federal transfers to provinces.

Further, the federal government failed a critical test of program review success. It did not sustain its spending reductions over the long-term. Indeed, spending quickly returned to pre-program review levels (Mowat Centre, 2010).

Program reviews must be accompanied by transformative actions in order to generate fiscal sustainability over the long-term.

APPROACH #2: ALTERNATIVE SERVICE DELIVERY (ASD)

WHAT IS ASD?

Alternative Service Delivery (ASD) refers to the process of public sector restructuring that transfers responsibility for the delivery of public services from government to outside organizations.

ASD and privatization are not the same. Privatization implies the transfer of ownership to the private sector, whereas ASD merely separates policy direction from the delivery of services and programs. Governments are still required to retain oversight, set policy, and define the desired outcomes and monitor progress.

ASD fails when government abdicates its oversight role. ASD succeeds when government builds up the capacity to oversee and monitor the arrangement.

Further, ASD fails when its sole goal is to tear up collective agreements and/or suppress wages.Partnership with public sector unions is critical for success.

WHAT DOES ASD ACCOMPLISH?

Many governments around the world have used alternative models of service delivery as a mechanism for finding cost-savings, while either sustaining or improving service quality and service levels. A study by the Serco Institute identifies average cost savings of around 20-30 percent in ASD efforts undertaken elsewhere (2007).

By opening up service delivery to the private and not-for-profit sectors, ASD models take advantage of market incentives to enhance productivity, achieve greater efficiencies, and harness new technology.

Beyond its fiscal benefits, ASD accomplishes many other public policy objectives:

- ASD enables government to leverage private sector investment to modernize the delivery of public services.
- ASD enables government to access new and innovative business models.
- ASD facilitates the commercialization of government intellectual property and business processes.

Utilizing ASD in specific services, such as the back-office reconciliation of Ontario Health Insurance Plan transactions and frontline services like ServiceOntario, can help the government save money while preserving (or even enhancing) its capacity to deliver valuable services.

CASE STUDY: ONTARIO'S DRIVETEST

In 1994, the provincial government implemented graduated licensing in Ontario, which effectively doubled the number of road tests that the Ministry of Transportation (MTO) needed to deliver. MTO lacked the capacity to handle the volume of tests—the Auditor General reported that wait times for road tests were greater than nine months. The government decided to seek an outside provider, who could deliver the service more efficiently.

In 2003, Serco, a large multinational service provider, won the contract in which it paid $114 million upfront for the exclusive right to deliver Driver Examination Services for 10 years.

Under the agreement, Serco staff perform all driver examination operations. The 2003 contract included nearly 100 measured performance standards that Serco is required to meet, including an 85 percent customer satisfaction, a 20 minute maximum wait-time inside the DriveTest Centre, a six-week maximum wait to get a road test, and penalties of over $3,000 for every error that MTO auditors find. Under this agreement, MTO provided most of the IT required to run the business.

In 2013, Serco was awarded another 10-year agreement to deliver these services. This second agreement included some changes, such as a smaller set of performance standards that were more focused on key outcomes rather than inputs. The new contract also allowed Serco to take responsibility for all of the customer and employee-facing technology, which will yield greater efficiency, service quality, and customer satisfaction. This contract model is currently yielding customer satisfaction rates above 90 percent.

More information on ASD, and its applicability and potential benefits for Ontario, can be found in the OCC's recent publications: *Public Sector Problems, Private Sector Solutions* and *Unlocking the Public Service Economy in Ontario.*

APPROACH #3: ASSET RECYCLING

WHAT IS ASSET RECYCLING?

Asset recycling is a principle for public asset management that "requires governments to dispose of legacy assets to generate capital to invest in new assets or to refurbish existing infrastructure" (Fenn, 2014, 1). This approach to asset management uses the value of past public investments to fund new investment needs. By definition, asset recycling is not used to fund a government's day-to-day operations, or to temporarily reduce budget deficits.

Asset recycling has two primary stages. First, a government identifies and sells a public asset. The asset is sold because it "no longer need[s] hands-on government attention or no longer achieve[s] a priority public purpose" (Ibid., 21). Government may also decide that it is redundant to both regulate and own the asset. Second, the government uses those funds to invest in new or refurbished assets that "should be in the hands of government entities" or that require substantive public investment (Ibid.).

WHAT DOES ASSET RECYCLING ACCOMPLISH?

Asset recycling forces governments to evaluate their portfolio of assets and understand the rationale for public ownership of those assets.

In Ontario, asset recycling could be one method of reducing the province's large infrastructure deficit, in the context of a reduced fiscal capacity. The value of the province's public assets was an estimated $165 billion in 2013 (Ibid.). These include crown corporations like the Liquor Control Board of Ontario (LCBO), Ontario Lottery and Gaming Corporation (OLG), and Ontario Power Generation (OPG). Unlocking the value of some of these legacy assets, which may no longer have a clear rationale for direct government ownership, would be a significant financial resource for the province.

Asset recycling also accomplishes some other objectives. First, the province can leverage the value of its aging assets to make productivity-enhancing investments with a higher return on investment (as discussed earlier in this report). Second, asset recycling could provide a consistent stream of new investment opportunities for Ontario's pension funds, which have been active in investing in infrastructure assets abroad but not in Ontario (Ibid.).

CASE STUDY: INFRASTRUCTURE AUSTRALIA

Similar to Ontario and Canada, Australia is facing a significant infrastructure deficit in a context of tight fiscal constraints. As one solution to this problem, Infrastructure Australia (IA) supports the adoption of asset recycling in their asset management plans. Asset recycling was incorporated into IA's 2013 National Infrastructure Plan, and a $5 billion Asset Recycling Initiative was included in the country's 2014-2015 budget, which provides financial incentives to states and territories that sell public assets to fund new infrastructure development.

Supporting these broad policy shifts have been local examples of successful asset recycling initiatives in the country. For example, in 2012, the New South Wales Government refinanced the Sydney Desalination Plant (Infrastructure Australia, 2012). Sydney Water signed a 50 year water supply agreement with the plant, with third-party independent regulation of prices.

This refinancing endeavour raised $2.3 billion for the government, which exceeded the cost of building the plant by $300 million (Ibid.). The New South Wales Government used this money to pay off the debt it incurred when building the plant, while investing the rest in new infrastructure projects, including roads, hospitals, and schools (Ibid.).

APPROACH #4: OUTCOMES-BASED INCENTIVES AND ACCOUNTABILITY IN THE PUBLIC SERVICE

WHAT IS IT?

Closely linking incentives and accountability for public servants to specific outcomes can increase the efficiency of government, improve program and service quality, and help the government do more with less (Panchamia and Thomas, 2014).

WHAT DOES IT ACCOMPLISH?

In Ontario, employee compensation accounts for over half of all program spending in the provincial government (program spending was $116 billion in 2013-2014; Ontario Ministry of Finance, 2014a).

The Government of Ontario has already taken three steps to achieve real reductions in the growing cost of labour. First, since 2012, wage agreements for the Ontario Public Sector have been below the average of those of collective agreements in the private sector, Ontario municipalities, and the federal government (Ibid.). Second, the government has also negotiated contribution agreements with four pension plans, which will result in considerable reductions in future pension expenses to 2017-2018 (Ibid.). Third, the government has repeatedly cancelled or scaled back pay-for-performance increases for middle and senior management.

While these measures will reduce short-term labour costs for government, they will not necessarily translate into long-term cost savings, or a greater return on investment (Commission on the Reform of Ontario's Public Services, 2012). These actions are not intended to make the public service run better, they are only intended to make it cheaper.

If the government is to move toward fiscal sustainability, it will need to take steps to enhance its return on investment and ensure that desired outcomes are being achieved at the desired cost.

Public sector compensation is the most accessible tool to achieve this outcome. For example, instead of cancelling pay-for-performance incentives, government should reinvigorate them for all levels of the public service and tie them to specific and measurable outcomes.

CASE STUDY: NEW ZEALAND'S "CHIEF EXECUTIVES"

Since the 1980s, New Zealand has taken significant steps to reform the structure of its civil service. Most notably, the national government has recast the bureaucratic leaders of its departments as "Chief Executives", who sign five-year contracts to achieve specific operational outcomes.

Chief Executives are held to account on meeting the objectives set out in the contract, and their contract may not be renewed if those objectives are not reached. A Chief Executive who meets their targets has the option of renewing their contract for a shorter, three-year term. This allows for new talent to fill senior management roles in the public service on a regular basis (Lodge et al., 2013). Through the use of fixed-term and outcomes-based contracts, New Zealand has increased accountability within its government (Ibid.).

APPROACH #5: USER-PAY MODELS

WHAT IS USER-PAY?

Adopting a user-pay model for government services means that "part or all of service operating costs are met by the end user" (Gold et al., 2011, 19). In other words, the government puts a price on a program or service. Depending on the price, user-pay can be used to partially or fully cover the cost to government of providing the service.

WHAT DOES USER-PAY ACCOMPLISH?

In Ontario, adopting user-pay models for specific government services could be a method of maintaining current service levels and quality in the context of a reduced fiscal capacity and increased demand for services.

Currently, many government services in Ontario are funded entirely out of general revenue. This means that all citizens pay for these services, regardless of whether or not they use them. By appropriately applying user-pay to some of these services, government could continue to provide them, while reducing the amount of money it contributes. Proponents also argue that user fees help regulate and mitigate unnecessary or spurious demand and encourage more efficient use of public services (Ibid., 20).

However, putting a direct user cost onto a service will also create accessibility issues that would need to be incorporated into the design of such a scheme (see the subsequent discussion on means testing). Further, user pay models may not be appropriate for services where the public puts a high value on universal access.

CASE STUDY: TRANSPORT FOR LONDON'S 'CONGESTION CHARGE'

In 2003, Transport for London (TfL), London's public transit agency, introduced a congestion charge in central London. The congestion charge acts as a user fee for roads in downtown London: during working hours, motorists are charged a tariff for bringing their vehicle into a designated area of the city (TfL, 2014). In 2003, the congestion charge was £3, and it has since increased to £11.50 today.

As a user pay scheme, the congestion charge has successfully acted to regulate the demand for road infrastructure (i.e. reduced congestion and encouraged other modes of transportation) and raise revenues for TfL to spend on other transit infrastructure improvements (TfL, 2008; KPMG, 2009). For example, in 2007-2008, net revenues from the congestion charge scheme were £137 million. TfL used the majority of these funds for transit improvements in Greater London, specifically bus operations (TfL, 2008).

APPROACH #6: MEANS TESTING

WHAT IS MEANS TESTING?

Adding a means-testing provision to a service means that "recipients with greater means will be asked to make a greater contribution to the cost [of that service]..." (Department of Health and Ageing, 2012).

Many services and benefits in Ontario are currently available to all Ontarians at the same upfront cost (often at no charge), despite significant variation in people's financial means. Adding a means-testing provision to the price of a service takes into account an individual's 'ability to pay'.

WHAT DOES MEANS TESTING ACCOMPLISH?

From a fiscal perspective, means testing can be a method by which government secures additional funds by reducing access for those with higher incomes. Individuals with greater means will pay more for a means-tested benefit or service. In this way, means-testing could be a method of maintaining a quality or level of service in the context of a large deficit.

By varying the cost of or access to a service based on means, it can also increase the efficiency and effectiveness of government spending. Means testing reduces spurious demand, thereby increasing access to those that require the service. Further, it is a lesser evil than reducing overall acess through broad service cuts.

CASE STUDY: AUSTRALIA – LIVING LONGER. LIVING BETTER.

Many governments using means-testing schemes in their health care services. For example, in July 2014, the Australian Government integrated means-testing arrangements into residential aged care as part of its *Living Longer. Living Better.* reform package.

As part of this reform package, the government will reduce the amount it contributes toward the care and accommodation of individuals with greater financial means (Commonwealth of Australia, 2012; Department of Health and Aging, 2012) This is one strategy that Australia is taking to increase the sustainability of aged care, in the context of an aging population (Commonwealth of Australia, 2012).

CONCLUSION

Ontario's current fiscal situation is not yet a crisis. However, Ontarians should be concerned about the direction in which the province is heading. Our large debt and deficit is creating a less-than-favourable business climate and reducing the government's ability to spend on key priorities.

In addition, increasing demand for some services, rising interest rates, and sluggish economic growth will squeeze our future budgets and make a large debt and deficit much more difficult to deal with. As a result, the fiscal choices that the government makes today will have a profound impact on the debt and deficit situation in the future.

We hope that his report sheds some light on the province's recent fiscal history and the potential consequences of a high debt load. We also hope that this report successfully demonstrates a need for urgency in dealing with the province's debt.

The approaches to reduce government spending, set out in this report, are drawn from successful examples both in Ontario and internationally. They offer an opportunity to reduce government spending and to reshape government programs and services to increase the public's return on investment.

Government has already taken some positive steps in this direction. By adopting these six approaches, the Government of Ontario can set the province on a path toward fiscal sustainability.

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Ontario's fiscal situation is becoming increasingly dire, though we have not yet reached a crisis point. That said, we are likely to reach a state of crisis unless the province cuts spending and changes the ways it does business.

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