



UNLOCKING THE PUBLIC SERVICE  
ECONOMY IN ONTARIO:  
**A NEW APPROACH  
TO PUBLIC-PRIVATE  
PARTNERSHIP  
IN SERVICES**



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Unlocking the Public Service Economy in Ontario: A New Approach to  
Public-Private Partnership in Services  
By Josh Hjartarson, Liam McGuinty, and Alexandra Schwenger  
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# LETTER FROM THE CO-CHAIRS OF THE OCC'S ADVISORY PANEL ON ALTERNATIVE SERVICE DELIVERY

Ontario is facing extraordinary challenges. Its economy is projected to grow sluggishly for the next 20 years. Its debt-to-GDP ratio is rising to worrying levels. Its population is aging, placing increased pressure on public finances.

The province's fiscal and economic future is heavily contingent on the actions taken over the short-and medium-terms. Paramount among these actions must be a concerted effort to unleash the untapped dynamism of Ontario's public service economy—the mix of public, private, and not-for-profit providers who deliver public services.

As it stands, public sector spending makes up approximately 20 percent of Canada's GDP and the public sector comprises 25 percent of employment (OECD 2014). We believe that there is incredible scope for innovation, entrepreneurialism, and productivity improvements in the large portion of the economy over which the government has direct control.

By introducing greater competition and diversity into public services and creating more scope for partnerships (especially in the broader public sector) with the private and not-for-profit sectors in public service delivery, government can help spur economic growth while enhancing its capacity to meet the evolving and increasingly sophisticated demands of its population.

This report is not driven by ideological motives. It is motivated by the need to preserve the capacity of government in core public service areas in a context of rising debt, demand for services, and citizen expectations. Every political party in Ontario purports to be defenders of our public services. It is time for each of them to acknowledge the fiscal challenges we face and the need for innovation in the way government works.

Governments around the world are increasingly adopting new public-private service delivery partnerships. A primary objective of this report is to help spur innovation in Ontario—the kind of innovation that is already well under way in other industrial economies that are experiencing similar challenges.

While we may not replicate their every step, we can nonetheless learn from these jurisdictions' successes and mistakes. By doing so, we will be better prepared to meet the challenges that lay ahead of us and to ensure that our public services are sustainable and meet the needs of Ontarians for the foreseeable future.

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**Dwight Duncan and John Capobianco**  
Co-Chairs  
Ontario Chamber of Commerce Advisory Panel on  
Alternative Service Delivery

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## SECTION 1

# SUMMARY OF RECOMMENDATIONS TO THE GOVERNMENT OF ONTARIO

# RECOMMENDATIONS

## **IDENTIFY AND EVALUATE THE OPPORTUNITIES FOR ALTERNATIVE SERVICE DELIVERY (ASD)**

1. Government should undertake a services-audit to identify further ASD opportunities across the public and broader public sectors.

## **BUILD INTERNAL CAPACITY**

2. Government should establish an ASD Centre of Expertise.
3. The ASD Centre of Expertise should be equipped to incent and encourage the broader public sector to adopt ASD models.
4. The ASD Centre of Expertise should develop the capacity to help government assess the effectiveness of public services, conduct value-for-money analyses, and understand the cost-drivers in its existing service delivery models in order to facilitate decision-making on ASD.

## **MOVE FROM PROCUREMENT TO COMMISSIONING**

5. Government should collaborate with potential service providers on problem definition and solution design.
6. In order to commission effectively, government should make greater use of outcomes-based contracts.
7. Government should build the capacity to 'steward markets' in order to properly commission certain services.

## **MOVE FROM DEAL MONITORING AND OVERSIGHT TO GOVERNANCE**

8. Complex ASD requires new forms of deal management. Government should focus on deal governance and the objectives of risk management and value creation.
9. Government should ensure that the retained organizations in ASD arrangements are re-engineered so that they possess the skills and processes—and are subject to incentives—that enable government to fulfill its obligations to service providers.
10. Government should create more opportunities for external, public scrutiny of ASD arrangements through 'follow the dollar' provisions and transparency clauses in service provider contracts.

## **MOVE FROM RISK MITIGATION TO RISK MANAGEMENT**

11. Government should undertake an 'early wins' strategy that focuses on landing less complex ASD deals in the short-term in order to build competence and capacity and build risk tolerance among key stakeholders.
12. Government should develop tools and strategies to help policymakers systematically evaluate and manage risks. These tools and strategies should inform the development of risk management frameworks in each ASD partnership.

## **SPECIFY THE RIGHTS AND OBLIGATIONS OF GOVERNMENT, PROVIDERS, AND PUBLIC SECTOR WORKERS IN AN ALTERNATIVE SERVICE DELIVERY FRAMEWORK**

13. Government should negotiate a 'public sector employee transfer' framework with collective bargaining units that clarifies the rights and obligations of government, service providers, and public sector workers when government embarks on an ASD initiative.
14. Government should develop a pension framework that is based on best practices and allows transferred public sector employees to maintain access to their public sector pension plans.



## SECTION 2

# UNLOCKING ONTARIO'S PUBLIC SERVICE ECONOMY

# INTRODUCTION

One year ago, the Ontario Chamber of Commerce (OCC) partnered with the Certified General Accountants of Ontario to publish *Public Sector Problems, Private Sector Solutions*. The report made the case for the expanded use of alternative service delivery (ASD) models in Ontario. Its focus is on the *why* of ASD.

This report, written in collaboration with KPMG and MAXIMUS Canada, focuses on the *how*. It expands on the case for ASD through a *public service economy* lens. ASD can unlock growth and entrepreneurial opportunities in the huge portion of the economy under direct government control.

The report then provides advice to government on how to commission and partner with third-parties in the delivery of services in the public and broader public sectors. Successful ASD requires government to build new expertise and capacity and to adopt new approaches to procurement, risk management, and labour relations.

Some observers will see this report as ideologically motivated and an effort to push government to privatize, 'bust' unions, and reduce its overall wage bill. However, these are neither the objectives nor the consequences of the vast majority of ASD arrangements. ASD is a means by which governments can leverage the capital, technology, specialized skills, and expertise of its partners in order to meet specific public policy objectives, address complex social problems, and achieve better outcomes for their populations.



# GLOSSARY OF TERMS

**Alternative service delivery (ASD):** the process of public sector restructuring whereby governments partner with the private and/or not-for-profit sectors in the delivery of public services. In ASD arrangements, governments typically retain responsibility for strategy, policy, and compliance, while leveraging third-party know-how, processes, capital, and technology.

**Commissioning:** the process through which a government assesses the needs of service users and designs the services to meet those needs through the selection of an appropriate delivery mechanism and service provider (Gash et al. 2012, 20). Commissioning is to complex ASD what procurement is to outsourcing.

**Market stewardship:** government design and oversight of competition in public service delivery.

**Outsourcing:** an arrangement where the delivery of a public service is contracted out to an external provider. It is the least complex and transformative ASD arrangement on a continuum of complexity and transformation.

**Procurement:** the process of buying goods and services to maximize efficiency and value-for-money. It is often contrasted with commissioning, which puts a premium on identifying service users' needs and designing services to meet those needs through the introduction (or retention) of the most appropriate delivery mechanism (Gash et al. 2013).

**Public service economy:** the mix of public, private, and not-for-profit providers who deliver public services. It is also referred to as the mixed economy.

**Retained organization:** the personnel, processes, and systems that are not being transferred to the service provider in an ASD arrangement (EquaTerra 2009).

**Service provider:** the third-party that is contracted by government to deliver services on its behalf. This could be either a private or not-for-profit entity.

# WHAT IS THE PUBLIC SERVICE ECONOMY?

The term 'public service economy' refers to the mix of public, private, and not-for-profit providers who deliver public services (Sturgess 2012, 10).

The public service economy comprises a substantial component of the economy. By some measures, government is the single most important participant in the economy. In Canada, public sector spending accounts for 20 percent of Gross Domestic Product (GDP) and the public sector accounts for 25 percent of total employment (OECD 2014). This makes the public sector larger than Canada's manufacturing and financial services sectors combined.

In many areas, the provision of public services is shared between the public and private sectors. In the UK, up to one-third of what government spends is delivered through independent providers. In Ontario, the percentage of services being delivered by the private and not-for-profit sectors grew substantially in the 1990s. Private and not-for-profit service providers are visibly present in Ontario's public service economy.

We assert that in areas where the public service economy is prominent, government is inattentive to the market it creates, passive in market design and stewardship, and often fails to deliver value-for-money. An observation regarding Australia applies equally in the Ontario and Canadian contexts: "policymakers have given little thought to the appropriate mix of providers (public, private, and not-for-profit) in most sectors, and the extent to which they can or should be exposed to user choice, competitive tendering, and performance benchmarking" (Sturgess 2012, 7).

In the many public services where the private and not-for-profit sectors are largely absent and government is the sole provider, there are no clear benchmarks for productivity, cost, and value for taxpayer money. Outcomes are not

adequately measured and reported. The public is often poorly served as a result.

In a context of debt, deficit, and foreseeable low economic growth, Ontario needs to unlock the dynamism of the public sector by injecting diversity and contestability into the public service economy.

Not every aspect of government should be subject to market forces. However, a key goal of this report is to make the case for government to adopt an explicit *public service economy approach* in areas where competition, contestability, and diversity in service delivery can generate value, improve productivity, foster innovation, and enhance accountability to the consumers of public services and to taxpayers.

Operationalizing a public service economy approach requires government to pursue and adopt new forms of public-private partnerships (P3s) and new approaches to procurement, oversight, and risk. These new forms of service P3s are discussed in Appendix 2. The new approaches to procurement, oversight, and risk are taken up at length throughout the rest of this report.

Total devolution of choice in services (through vouchers and other means) and asset monetization are other important tools that can help unlock the potential of the public service economy. However, they are beyond the immediate scope of this report.



## The Case for a Public Service Economy Approach in Ontario

Industrial economies around the world are facing the same three challenges—rising debts and persistent deficits, rising demand for core services, and lagging public sector productivity and innovation. The combination of these challenges is forcing governments to re-evaluate their role in the economy and the manner in which services are delivered. In Ontario, these challenges are particularly acute.

**Ontario faces a rising debt burden.** Ontario's deficit is \$11.3 billion and its debt is \$288 billion and rising. The province now pays more to finance its debt than it does on colleges and universities. Meanwhile, economic growth is expected to be sluggish for the foreseeable future, with a recent Ministry of Finance economic statement pegging yearly GDP growth at an average of 2.1 percent until 2035 (2014, 32). The Ontario Government can no longer bank on growth to improve its fiscal situation.

**Demand for services is growing.** By 2035, the number of Ontario seniors is projected to nearly double to 4.1 million with their share of the population reaching 23.8 percent, up from 15.2 percent in 2013 (Ibid, xiii). The Ontario Government projects that our aging demographic will add one percent annually to overall health spending beyond the usual cost drivers (Ibid, 27). Ontario's aging demography will lead to greater demand for other programs that benefit seniors, including income transfers, community and social services, and long-term care (Ibid, 27). Meanwhile, more retirees (as a percentage of the population) will translate into a smaller tax base available to fund public services.

**Public sector productivity is lagging.** The publicly available indicators suggest that public sector productivity lags behind that of the private sector (The Economist 2011; Deloitte 2013; McKinsey & Quarterly 2011). Irrespective, few governments have a clear understanding of the costs of delivering public services, and most make little effort to benchmark productivity or assess value-for-money. As the growth of Ontario's labour force slows, stronger productivity gains—within both the private and public sectors—are necessary to maintain the affordability of public services and will be an increasingly important source of economic growth.

Importantly, we reject the assumption that the public sector is always less innovative and less productive than the private sector. Where public services have been open to competition and open tendering, the public sector often wins.

The Government of Ontario has taken some steps to mitigate these challenges. In the wake of the 2008 recession, it froze public sector wages and reduced the budgets of some ministries. However, few efforts have been made to improve the measurement of outcomes, benchmark productivity, and assess value-for-money. Many other jurisdictions have taken bold steps in transforming public services. Ontario has been much more tentative, with two important caveats.

First, throughout the 1990s and early 2000s, Ontario experimented with public sector innovation and new forms of service delivery. It successfully reduced the overall footprint at Queen's Park from 90,000 plus public servants to 65,000, while maintaining overall service levels. Much of this reduction was delivered through partnerships with the private, not-for-profit, broader public sectors, and Delegated Administrative Authorities (DAAs). Tellingly, few of these partnerships have been reversed.

Second, Ontario began experimenting in infrastructure procurement and financing in the 1990s. Over the course of the last decade, Ontario has built world-leading expertise in P3 infrastructure financing and development. Infrastructure Ontario is a Crown corporation and a globally recognized P3 innovator.

Overall, however, the pace of experimentation and transformation in the province's public services has slowed, and now trails Australia, the UK, the US, and many other jurisdictions who have adopted new and innovative partnerships in service delivery. The provincial government needs to dedicate more resources and energy to learning from the efforts undertaken by those jurisdictions now recognized as global leaders in service transformation.





## SECTION 3

# INNOVATION IN PUBLIC-PRIVATE PARTNERSHIPS: ALTERNATIVE SERVICE DELIVERY

# INNOVATION IN PUBLIC-PRIVATE PARTNERSHIPS: ALTERNATIVE SERVICE DELIVERY

Governments around the world have experimented with a number of innovative forms of P3s in service delivery. These innovations fall under a single definitional umbrella of ‘alternative service delivery’ or ‘ASD’.

ASD is the process of public sector restructuring whereby governments partner with the private and/or not-for-profit sectors in the delivery of public services. In ASD arrangements, governments collaborate with external providers to achieve specific public policy objectives. In these arrangements, governments typically retain responsibility for strategy, policy, and compliance while leveraging third-party know-how, processes, capital, and technology. ASD enables the collaborating parties to ‘play from their strengths’ and focus on areas where they are best positioned to provide value.

Deficit and debt are primary drivers of service delivery transformation and ASD arrangements. However, deficit and debt alone are often insufficient conditions for transformation. ASD is often catalyzed by compelling (or a series of compelling) events such as service failures and resulting public outcry, the steady erosion of know-how on existing processes and procedures through retirement and attrition, or the need for substantial capital investment. More and more jurisdictions around the world are also turning to ASD as a means of addressing evolving consumer demands (see Appendix 1 for more).

Too often, both the proponents and opponents of ASD contribute to a polarized discourse based on hyperbolized archetypes, not evidence or best practice. On the left, ASD is often given the misnomer of ‘privatization’ or characterized as a way to drive down wages or bust unions. As the Ontario Public Service Employees Union (OPSEU) put it, “When it comes to value for money, no government policy of the last 20 years has a worse track record than privatization” (2014, 2). On the other side of the debate, libertarians see government monopoly in most areas as anathema to economic growth and individual freedom and choice. Some proponents espouse the extreme notion that areas including law, law enforcement, and dispute arbitration should be produced on the market (Friedman 2014).

## Alternative Service Delivery and Outsourcing are Different

While the terms ‘outsourcing’ and ‘ASD’ are commonly used interchangeably, they are not the same. Outsourcing is one type of ASD arrangement on a continuum of complexity and transformation that covers a range of service P3s, ranging from outsourcing to joint ventures, alliance contracting, social impact bonds, and so on. These arrangements are summarized in Appendix 2.

## Role of Government in Outsourcing versus Complex ASD Arrangements

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Monitoring and oversight  Partnership and market stewardship

Tendering and procuring  Commissioning

Achieving lowest cost  Driving outcomes

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We have to be really careful that we don't limit ASD opportunity to the lowest hanging fruit or focus on where we can generate lower labour costs. It's the complex areas that hold the greatest potential.

ASD Roundtable Participant

Governments across Canada are familiar with simple outsourcing arrangements. To cite a recent example, the City of Toronto has outsourced garbage collection in parts of the city. City staff monitor the performance of the private operator against easily measurable benchmarks and report back to City Council. These types of ASD arrangements are considered low-hanging fruit. Many (not all) are focused on lowering input costs, such as the cost of labour. Successful outsourcing requires much less skills and capacity on the government side of the equation than its more complex counterparts.

In complex ASD, government is typically focused less on driving down input costs and more on service delivery modernization and improving outcomes and service levels for the client. In complex ASD, government devolves transactional processes to third parties that possess the technology, know-how, and expertise best suited to deliver the desired outcomes. The role of government is to steer policy development, strategy, and to monitor outcomes against stated objectives. Relative to simple outsourcing, the relationship between the service provider and government is much more collaborative and partnership-driven.

### The Benefits of Alternative Service Delivery are Numerous

There is a global trend of increased usage of ASD models. The trend is visible at the municipal, subnational, and national levels and across government functions (front, back, and middle office). After a brief upswing in the 1990s, the pace of ASD innovation and uptake in Canada has slowed. Yet here in Ontario, very few of the services that have been shifted to an ASD model have been taken back by government (the operation of the Penetanguishene prison being the most prominent example of an Ontario ASD failure). The durability of these arrangements speaks to their success.

The appropriateness of ASD models is context-specific. Some areas of public service delivery are not suitable for private sector involvement. However, for many public services, the introduction of a new service delivery model can confer numerous benefits.

**ASD can foster innovation and improve productivity and service levels.** Research shows that competition in the public service economy creates a fertile climate for innovation and experimentation. Innovation in service delivery is enhanced through the introduction of new business models from which other government departments and units can draw. As Gary Sturgess puts it, "different kinds of service providers with different backgrounds, bring different perspectives to the challenge of delivering better and more cost effective services" (2012, 19).

While much of the public discussion on productivity dwells on Canada's poor private sector productivity compared to the US, little has been said about the gap between the Canadian private and public sectors.

Public sector productivity is difficult to measure. A simple 'output produced divided by hours worked' formula will not apply to a sector where outcomes are difficult to define, measure, and attribute (Ovsey 2012). However, such measures that do exist point to lagging public sector productivity (The Economist 2011; Deloitte 2013; McKinsey & Quarterly 2011).

Importing new business practices or leveraging private sector investment in technology and infrastructure can increase overall service levels and enable government to achieve more with equivalent or lower investment. In some areas, reducing overall expenditures may not be a goal. Instead, governments may want to increase service levels to reach more clients and address rising demand.

In Maine, for example, a private provider has been hired to improve the state's child immunization rate. By using third party market research data and regression analysis, the provider has successfully targeted its public health campaigns to specific population groups. As a result, child immunization rates have risen by 40 percent since the provider was hired with minimal impact on overall cost.

Given its size and reach across the economy, enhancements to government productivity and service levels can induce productivity improvements elsewhere. As noted by *The Economist*, "even if government were to cost the same but produce more (better educated workers, decent health care, roads without holes, simpler regulation), the effect on private sector productivity would be electric" (2011).

Observers point out that the introduction of new service delivery models is not always required to achieve productivity improvements, innovation, and many of the other benefits of ASD. The concept of 'contestability' describes situations where public service managers behave as though they are facing actual competition (Sturgess 2012). To generate service productivity improvements, it is sometimes sufficient for government to signal that a service is a candidate for ASD.

Importantly, we reject the assumption that the public sector is always less innovative and less productive than the private sector. Where public services have been open to competition and open tendering, the public sector often wins. The City of Indianapolis opened its public works to competitive tendering, inviting the union and current employees to apply. Unionized staff won over 50 percent of the contracts (Goldsmith and Schneider 2003, 419).

**Contestability is always a good thing. Remember... the private sector won't win every contest.**

ASD Roundtable Participant

**ASD can strengthen accountability and provide customers with a greater voice.** A related and residual benefit from injecting competition and diversity into the supply of public services is the enhanced ability to benchmark across the public sector. ASD can enable citizens and government managers to contrast government departments with their private sector peers across a range of indicators including cost, outcomes, and overall service quality.

Further, greater diversity and competition in the public service economy affords citizens a greater say in the variety and quality of the services they receive (Sturgess 2012). By providing a greater basis of comparison, ASD also improves overall accountability across the public service economy.

**ASD transfers risk to the private sector.**

Ultimately, certain types of risk are not transferable. For example, the political risks associated with total service failure in social, health, and essential services will always be borne by government. The failure of water safety in Walkerton, Ontario is an illustrative example. However, other risks, such as financial and transactional risks, are more easily shared between government and third parties. Infrastructure P3 models, for example, have been very successful in transferring responsibility for cost overruns and delays in large capital projects (see Iacobacci 2010, i).

**ASD can reduce the costs of public service delivery.**

ASD is frequently looked to by governments as a way to achieve a cost-savings. The Serco Institute conducted the largest ASD study ever performed to determine whether the private delivery of public services results in cost-savings (Sturgess et al. 2007).

“The ASD portfolio of deals in BC relied on a pre-negotiated memorandum of understanding to the collective agreement covering the Government’s unionized workforce. The MOU allowed the government to outsource major components of government with employee transfers up to a negotiated cap. Employees maintained full successor rights, and were offered positions with the outsource provider that included same or better pay and benefit packages, continuation of union membership, and BC public pension. While unions continue to publicly oppose ASD agreements they have agreed to continuation of the ASD MOU in three subsequent collective agreements.”

John Bethel, former Assistant Deputy Minister, BC ASD Secretariat

The Institute examined 200 reports on ASD from 12 different countries, focusing on the areas of defense support, health services, prison management, refuse collection, and municipal services. It found that the average cost-savings totaled nearly 20 percent, though this varied by country and service area (Ibid, 4).

While some outsourcing arrangements rely on lower private sector labour costs to find cost-savings, complex ASD arrangements typically do not. In fact, cost considerations in complex ASD are often secondary to the goal of improving service levels and quality.

Take, for example, the success of BC’s ASD Secretariat. In 2003, the Government of BC

established the Secretariat with the mandate to identify opportunities for ASD and to assist with the procurement, negotiation, and oversight of ASD projects across government.

Over the first 10 years of its operation, the ASD Secretariat helped the BC government sign ten large-scale, long-term ASD contracts worth an approximate value of \$2.5 billion. These partnerships resulted in substantial process and technology improvements in health care billing, workplace support services, and revenue management, which translated into better service quality and service levels and \$550 million in savings. The savings were achieved without redundancies or salary reductions.

#### RESEARCH SUPPORTS THE MERITS OF ASD

**Defense Support:** Studies from Australia, New Zealand, and the US report savings in the range of 20 to 30 percent.

**Health Services:** Financial benefits in excess of 20 percent have been reported in the UK, Australia, and in Denmark.

**Prison Management:** Nine out of ten studies of US prison contracting found positive benefits associated with contract management, with savings mostly in the range of 5 to 15 percent. The financial savings in the UK appear to have been more than 20 percent, and perhaps as much as 30 percent.

**Municipal Services:** The range of cost-savings extends from 5 percent to as much as 25 percent in some studies. Results from the use of compulsory competitive tendering in UK local governments indicate that savings were toward the bottom end of this range.

From Sturges et al. 2007.

**ASD can enable government to focus its capacity and resources.** ASD models allow government to divest itself of transactional service delivery, freeing it to focus on its core competencies such as policy, strategy, and oversight. By generating efficiencies, government can also divert resources to improving service levels and reach.

This new delivery model allows the Region to put the savings toward subsidies for lower income families. It has also had the ancillary effect of heightening the public's level of trust and confidence in Peel as the system manager.

Janet Menard, Commissioner of Human Services, Peel Region, on the success of Peel Region's child care service delivery reforms

For example, in 2012 the Region of Peel reviewed its service delivery model for child care. The Region decided to step away from their role as providers of child care while maintaining their role as its system manager and funder. The Region of Peel has reached agreements with several external child care providers to take on direct delivery of child care services. As a result of its decision to use an external provider model, Peel Region has saved and re-profiled \$12 million annually to stabilize the system and expand the number of child care subsidies.

**ASD can drive commercial activity (including exports).** Public services constitute a large part of our economy. Because of the legislative and regulatory constraints placed on public providers, however, a significant amount of human capital is locked up within the public sector and public providers are unable to generate greater economic value through the commercialization of their innovations and intellectual property. Moving to ASD arrangements and thereby removing the constraints on providers allows them to more freely commercialize their services and expand to other jurisdictions.

For example, the private licensing of Ontario's land registry database resulted in the creation of Teranet, a successful corporation that provides

electronic land registration and writ services across the province. In 2012, Teranet announced their plan to expand after reaching an agreement in principle with the Province of Manitoba for a long-term license to operate Manitoba's Property Registry.

#### THE SHAREHOLDER EXECUTIVE: Lessons from the UK

There are assets that government, for public policy, revenue or other reasons, owns or partially owns. In Ontario, for example, government retains ownership of the primary wine and spirits distributor (LCBO) and a large portion of the province's electricity generation.

In the early 2000s, the UK Government was struggling with the difficulties inherent in balancing public policy and public ownership objectives. Many within government felt that the state was failing to maximize the value of government-owned businesses (National Audit Office 2007).

In response to this concern, the UK created a Shareholder Executive (SHeX), a body that centralizes expertise in corporate governance within government. The SHeX "oversees the government's shareholder relationships with businesses owned or part-owned by the government. It also offers a wide range of corporate finance expertise and advice to government departments in order to ensure the taxpayer gets good value-for-money" (Shareholder Executive 2013).

The SHeX led the profitable partial divestiture of the Royal Mail, the monetization of the publicly held student loan book, and the creation of the British Business Bank, a flagship institution mandated to boost access to finance for small and medium-sized enterprises (SMEs) (Shareholder Executive 2013).

The Government of Ontario should assess whether a similar structure or body would help it generate more value from its commercial assets.





## SECTION 4

# CREATING A PUBLIC SERVICE ECONOMY IN ONTARIO

# CREATING A PUBLIC SERVICE ECONOMY IN ONTARIO

The focus of this report now shifts to identifying how the Government of Ontario can create greater competition and diversity in the public service economy by adopting innovative ASD models. The recommendations are organized around three broad action themes:

- Identify and evaluate the opportunities for ASD;
- Build internal capacity to support increased usage of ASD models by adopting new approaches to service P3s in the areas of commissioning, retained organization re-engineering, and risk management; and
- Work with labour unions to specify the rights and obligations of government, providers, and public sector workers within an ASD framework.

## IDENTIFY AND EVALUATE THE OPPORTUNITIES FOR ALTERNATIVE SERVICE DELIVERY (ASD)

There are numerous opportunities for ASD across the public and broader public sectors in Ontario. However, these opportunities are obstructed by a limited understanding of ASD and a political culture that is resistant to change.

Some areas of service delivery face fewer barriers to transformation than others. Appendix 1 presents a rough picture of those areas where other jurisdictions have experienced success (or failure) by shifting service delivery to an external provider. Many of the successes from abroad could be replicated here in Ontario.

There are several challenges to conducting an effective and accurate services audit, even if it is preliminary. These challenges include (but are not limited to) determining the cost of a publicly delivered service, the absence of the right skills and incentives within government, and the fact that the bulk of the opportunities reside in the broader public sector. All these challenges can be overcome.

Outside of Ontario, governments of all political stripes and ideologies are using contracting innovations to transform the way services are delivered (see Appendix 2). The Nordic countries have spent the last several decades working with service providers to improve service quality and quantity.

Sweden, for example, uses a universal system of school vouchers, with private schools competing with public ones. Norway allows private firms to operate publicly funded hospitals. The bulk of Denmark's emergency services are provided by a private, for-profit company.

In Canada, governments from across the political spectrum are embracing partnerships with the private sector to drive innovation. Nova Scotia's NDP government has entered into a 10-year deal with IBM to provide SAP application management services for the province's Core Competency Centre and Health Administrative Services programs. A Liberal government in BC has contracted its health care claims processing to the private sector. Progressive Conservative and Liberal governments in Ontario have negotiated partnership agreements with the private sector to outsource Ontario's electronic land registration system (Teranet).

These efforts have all proven highly successful. Ontario should learn from these approaches (and its past successes) and seek more opportunities for service delivery partnerships.

### **Recommendation 1: Government should undertake a services-audit to identify further ASD opportunities across the public and broader public sectors.**

There are many variables that support the case for a shift to an ASD model. We outline some of them on pages 16-17. Not all conditions must be met in order to justify adopting an ASD solution. Further, some conditions will have different weight depending on the context. Where service delivery transformation is the primary driver of ASD, cost considerations will be secondary to harnessing a service provider's business models, technology, and expertise.



**The service is not ‘inherently governmental’.**

While this report makes the case for greater use of innovative service delivery models across numerous public services, there are some functions that are too close to the core business of government to make ASD models appropriate. Gash and Panchamia (2013) pose three questions to test whether a service is inherently governmental:

- Does the service involve making key policy decisions?
- Does the service constitute the government’s law and order capability?
- Is the service intimately related to the government’s duty to protect the public?

As the authors note, if a service has any one of these characteristics, contracting it out “will substantially limit the government’s control and authority over core functions. Therefore, it might generally be prudent to retain these types of services in-house” (Gash and Panchamia 2013, 8-9).

However, there have been advances in contract design that have enabled governments to devolve services to service providers in some areas once thought too sensitive or too core to the government’s mandate. The UK, for example, now outsources some of its cold-case murder investigations to external partners on a pay-for-performance basis. The state of Florida uses a private provider to help families adopt children with special needs. Adoptions have increased by more than one-third following the introduction of an ASD model.

Where service delivery transformation is the primary driver of ASD, cost considerations will be secondary to harnessing a service provider’s business models, technology, and expertise.

**ASD could be easily implemented.** Government should consider the barriers (including attitudinal) that it would face when shifting the delivery of a service to an external provider and the likelihood of whether barriers could be overcome.

Attitudinal barriers are perhaps highest in the health services. In a 2013 OCC survey, close to 45 percent of businesses were opposed to greater private sector involvement in the delivery of publicly funded health services (Hjartarson et al. 2013, 9). However, surveys in other jurisdictions reveal that people tend to care more about the quality of the service rather than who provides it (Gash et al. 2013, 21).

Other barriers include high levels of policy and demand uncertainty. While both make it difficult to attract private sector providers, they can be addressed through contract design.

**The private sector is active in the space and a marketplace for the service already exists.**

The potential for ASD is higher where there are numerous high quality providers already active in the space. Outsourcing garbage collection has made sense for many municipalities because of the private sector’s active presence in the space.

The absence of providers is not an insurmountable challenge as there are ways that government can encourage markets in delivery areas where none currently exist. For example, a sole provider might be broken up into a number of competing firms with diversified ownership and management, competition can be invited from international providers, or capacity can be developed over time by contracting support services for which a market already exists and then expanding the scope over time (Sturgess 2012, 30).

However, it is certainly easier to devolve services in areas where the private sector is already active and where there is ‘market depth’.

**ASD provides a high potential for cost-savings.**

Government should consider whether or not its fiscal situation would improve as a result of moving a given service to an ASD model. Any calculation should include the transaction costs associated with tendering, contracting, and performance monitoring. Capital avoidance or total cost of ownership should be factored into the cost-benefit calculation.

**The private sector is well-suited to provide additional value.**

Government should consider whether or not the private sector has the ability to contribute additional value to the service in question through capital injection, access to technology, and new business models (Gash et al. 2012, 2).

**ASD provides a high potential for improvements in service quality and/or service levels.**

Government should consider whether the quality and/or quantity of a service would be improved by transforming its delivery. An improvement in the quality and/or quantity of a given service should be sufficient reason to encourage a government to transform its delivery mechanism, given the opportunity cost associated with continuing to deliver a service inefficiently or at a lower standard of quality.

**Service outcomes are measurable and attributable.**

A precondition for determining cost-savings or service quality improvements is government's ability to quantify service costs and service outcomes. As one expert notes, "if service outcomes are difficult to measure or attribute, the government may find it difficult to decide what it wants from providers, the value they add, and the price it should pay for the service" (Gash et al. 2012, 2).

**The service has successfully been moved to an ASD model in other jurisdictions.**

Government should consider whether other jurisdictions have been able to successfully shift a particular service to a service provider. Government should also consider whether the contextual factors present in Ontario will result in a service's successful implementation.

**There is a high potential for commercialization of the service in question.**

Government should consider the potential benefits of moving activity from the non-commercial to the commercial sphere. Will ASD expand the scope for entrepreneurialism and innovation in the economy?

**Teranet, A Made-in-Ontario Success Story**

Ontario was the first jurisdiction in the world to provide electronic registration of land related documents. In 1991, the government partnered with the private sector to convert and automate Ontario's land registration system.

Under the terms of their contract with Teranet, the private operator of the land registration system, the government received an initial payment of \$1 billion and a 50-year stream of royalty payments in exchange for exclusive electronic land registration and writ services. The government maintains control over fee increases (Teranet 2014).

Today, Teranet provides electronic solutions to 80,000 end users, 38 real estate boards, and over 250 municipalities and institutions in the legal, real estate, government, and financial markets.

In 2012, Teranet announced a plan to grow their business, after reaching an agreement in principle with the Province of Manitoba for a long-term license to operate Manitoba's Property Registry.

## BUILD INTERNAL CAPACITY

Successful ASD requires government to have the capacity to conduct an audit for service transformation opportunities, commission for services, and properly evaluate outcomes and govern deals. Some of these skills are highly specialized and should be housed in a centralized unit, to be accessed by ministries when needed. For example, it makes sense to centralize costing and complex commissioning know-how.

Other skills, such as those needed to govern service delivery partnerships, should be present across relevant ministries and government bodies. For these skills, a centralized body should be responsible for capacity building across government departments. Most jurisdictions that utilize successful ASD models have some form of a Centre of Expertise.

### **Recommendation 2: Government should establish an ASD Centre of Expertise.**

The ASD Centre of Expertise should have a mandate to identify suitable candidates for ASD within the public and broader public sectors. It should be a resource for the public and broader public sectors on the design and management of ASD contracts. The Centre should also house the necessary skills needed to commission and manage ASD contracts, including skills in finance, law, negotiations, economic modeling, and specialized procurement.

Infrastructure Ontario is a close equivalent. It is a Government of Ontario Crown corporation that is responsible for delivering and overseeing P3s in infrastructure development across the province. Infrastructure Ontario is recognized as a world leader in alternative financing and procurement for major capital projects and now exports its expertise to other jurisdictions. Infrastructure Ontario's *Risk Template* helps Ministries and the broader public sector assess whether their projects are suitable candidates for P3 ventures.

## SUCCESS WITH CENTRES OF EXPERTISE: TWO EXAMPLES

### **The ASD Secretariat (BC)**

The ASD Secretariat was established in 2003 by the Government of BC with the mandate to identify key ASD opportunities and act as an empowered, nimble central body and results management team to oversee, monitor, and support ASD projects across government.

The Secretariat provided specialized expertise, cross-ministry issue resolution, and knowledge management, leadership, and oversight. After the first 10 years of its operation, the Secretariat helped the BC government sign ten large-scale, long-term ASD contracts with an approximate value of \$2.5 billion, while the financial benefits accrued to government over this same period totalling \$550 million.

### **Queensland Public Service Commission (QPSC) (Australia)**

The QPSC is a central agency in the Queensland Government whose mandate is to deliver better economic and social outcomes for Queensland residents. The QPSC sits on the budget review committee and has an independent voice in advising government on the potential options around service delivery transformation.

The QPSC has a mandate to promote the contestability and commissioning of public service delivery. All Queensland departments of the Crown are obligated to evaluate their services through a lens of cost-effectiveness and service reach and quality.

The QPSC applies a consistent framework for rigorous assessment of performance and suitability for ASD models. This has helped to depoliticize the QPSC's recommendations to government.

**Recommendation 3: The ASD Centre of Expertise should be equipped to incent and encourage the broader public sector to adopt ASD models.**

Roughly 87 percent of Ontario government spending occurs in the broader public sector. Nearly \$98 billion of Ontario's \$112.2 billion in program spending goes toward transfer payments to individuals and organizations such as school boards, universities, colleges, and hospitals (Ontario Budget 2013).

However, beyond very blunt financial incentives, few levers exist in Ontario that allow government to compel the broader public sector to transform their service delivery models. Further, the decentralization of public service delivery to the broader public sector compounds the challenge of diffusing best practice and know-how.

The ASD Centre of Expertise could offer financial incentives to encourage broader public sector bodies to look for ways to improve service quality or find a cost-savings in the services they deliver. The government could return a portion of the present value of projected savings to the retained organization in question. To work, these financial incentives would need to be backed by strong and consistent signals from the government around future budgetary allocations and the need to maintain service standards and service levels.

The Centre should be tasked with helping the broader public and the municipal sectors identify opportunities for ASD and disseminating best practices in procuring and managing ASD arrangements. It could also help purchasers in the broader public sector generate scale for the procurement of commonly used and less context-specific services (such as back office payroll and Information Technology, etc.).

Additionally, the Centre should be charged with aggregating and disseminating the price signals and the outcomes from ASD initiatives to encourage public and broader public sector-wide benchmarking and to facilitate greater

understanding of the costs of public services. More numerous and accurate benchmarks alone might encourage increased uptake of ASD across the broader public sector.

**Recommendation 4: The ASD Centre of Expertise should develop the capacity to help government assess the effectiveness of public services, conduct value-for-money analyses, and understand the cost-drivers in its existing service delivery models in order to facilitate decision-making on ASD.**

No topic elicited more heated debate during our consultative roundtables than that of the applicability of costing models to public services. Some public sector experts maintain that the underlying complexities of public services prohibit them from being accurately costed, particularly in the human services and those areas where back, middle, or front office functions are shared.

Private sector practitioners, meanwhile, point to the many jurisdictions that have developed successful costing methodologies. The Government of Canada, for example, has a clear understanding of the cost of producing a single passport (ASD Roundtable Participant 2014). SAP technology has helped governments and corporations alike undertake activity-based costing analyses with high degrees of accuracy.

Both public and private sector experts agree, however, that simple calculations of pre- and post-ASD input costs are too narrow in evaluating the suitability of ASD models for several reasons. First, there is basic agreement that services in more complex areas, such as those with complex value chains and multiple and shared back and front office functions, are more difficult to cost accurately.

Second, lowering input costs is often a secondary goal to transformation and service delivery modernization. Before and after costing is an apples-oranges comparison where new business processes have been put in place, new technology installed, and new skills leveraged. ASD could generate far better outcomes for the

same or cheaper input costs. Further, the desired outcomes themselves are often redefined as part of the ASD commissioning process.

Therefore, the government could mandate the ASD Centre of Expertise to conduct complex value-for-money analyses that attempt to disentangle the relationship between input costs and downstream outcomes across a range of public services, focusing first on those areas that are obvious candidates for modernization and/or that could be good candidates for leveraging private sector capital.

Value-for-money analyses require a clearer understanding of cost-drivers in the provision of existing services. For example, demand variability can artificially inflate the costs of delivering a service. Governments will typically staff to (or close to) peak demand in a service area. Service providers that apply innovations to smooth demand variability stand to reap large windfalls, potentially eroding public acceptance for ASD models and attracting the ire of the Auditor General.

Value-for-money analyses also require substantial capacity to monitor outcomes and performance. Governments everywhere struggle to evaluate the downstream impact of their activities. However, Ontario's international peers have redoubled their investments in program and outcomes analysis. Ontario should mandate the ASD Centre of Expertise to do the same. This is particularly important given that outcomes-based contracts are the new norm in ASD arrangements.

Building the necessary capacity within government is a necessary but insufficient condition for successful ASD arrangements. Governments need to modify their approaches to service partnerships across three dimensions: transitioning from procuring to commissioning for services; from monitoring to governance; and from risk mitigation to risk management.

## WHEN TO TRANSFORM

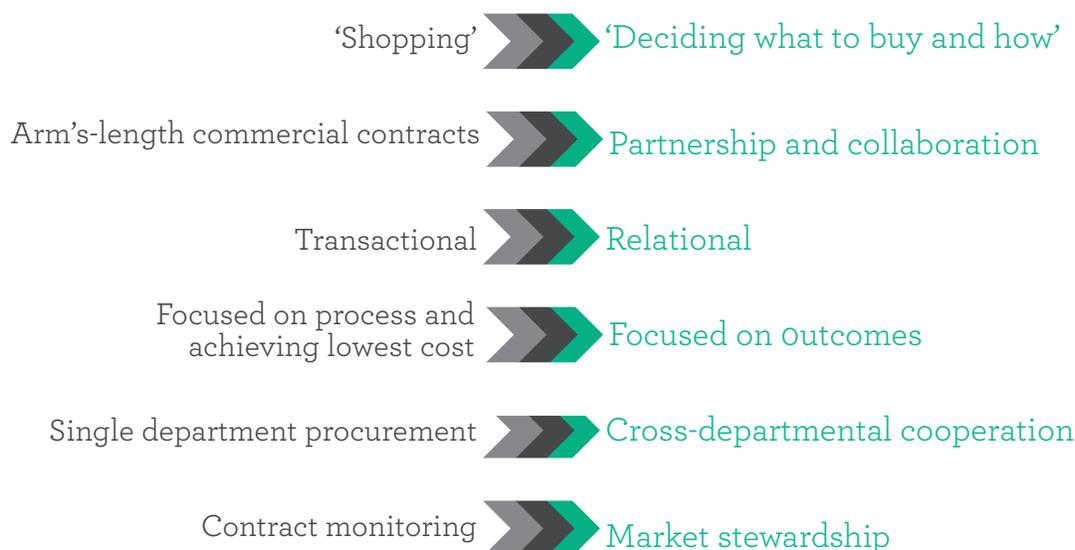
One of the first questions governments contemplating complex ASD will ask themselves is whether to transform a service first, harvest the savings, then look to ASD models; or to instead find a partner at the outset and share the risk of transformation with them.

Experts, however, point out that there are numerous instances of success under both scenarios. The presence or absence of other factors, such as political will, is much more important in determining success than the sequence of transformation.

Further, innovations in contract design and procurement enable governments to harvest the financial benefits from service improvements and efficiency gains (see Appendix 2). Contracts can include limits, for example, on windfalls for service providers. Governments can also reap the monetary gains when licenses expire and services are re-procured.

## MOVE FROM PROCUREMENT TO COMMISSIONING

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Ontario has built an international reputation in P3 infrastructure projects. However, government has little recent experience commissioning for ASD. It is time to build this capacity across the range of government departments in Ontario.

Just as 'outsourcing' fails to accurately capture the service delivery partnership innovations that have evolved across the OECD, the term 'procurement' does not adequately capture the nuances required to successfully undertake ASD.

Procurement refers to the process of buying goods and services to maximize efficiency and value-for-money. Commissioning refers to "the process of assessing the needs of people or users in an area, designing and specifying the services to meet those needs, and choosing the delivery mechanism to secure an appropriate service while making the best use of total available resources" (Gash et al. 2012, 20).

There are several important distinctions. In a procurement approach, the parameters are clear: all things being equal, government should purchase those goods that cost the least. In the case of complex services, however, parameters are often undefined, solutions are sometimes not readily apparent, and desired outcomes are frequently unclear. Landing on a mutually agreeable price, therefore, is more art than science.

It follows then that contracting for complex public services leverages a broader range of business models, focuses on outcomes rather than process or inputs, relies on partnership and collaboration between government and provider, and "demands a great deal more of government procurement officers than in the past" (Sturgess 2012, 9). The transition from procuring to commissioning requires three primary actions on government's part (see recommendations 5, 6, and 7).

**Recommendation 5: Government should collaborate with potential service providers on problem definition and solution design.**

In a traditional procurement scenario, the relationship between government and service providers is arm's length. In contrast, commissioning for ASD typically involves heavy engagement and collaboration with the provider community during all stages of the contracting process.

When a government knows exactly what they want, they will get exactly what they want and be exactly wrong. There's no person or group, government or private sector, on the planet that will know exactly what they want out of a deal before that deal is negotiated.

ASD Advisory Panel Member

In a collaborative procurement model, potential service providers are invited to participate from the very earliest stages of Request for Proposal design. This approach allows service providers to help define the problem that government wants to solve and design the solutions to address the problem. Collaboration allows for outside the box solutions that government may not have on their radar.

**Recommendation 6: In order to commission effectively, government should make greater use of outcomes-based contracts.**

Successful commissioning requires a shift away from process and input-based contracts to outcomes-based contracts, often with payment-by-results provisions. The shift in focus away from process to outcomes incents providers to innovate and encourages governments to be flexible with respect to (and care less about) the provider's processes and business models.

For example, the most recent prison operation contracts in the UK have placed a premium on rehabilitation, with a significant part of the performance fee based on a reduction in recidivism rates (Sturgess 2012, 22). At HMP Doncaster, a UK prison that has been contracted on this basis, the prison's operators have adopted a new approach to prisoner interventions: upon entry to the facility, new prisoners are assessed and assigned a case manager, and all subsequent interventions are tailored to meet that prisoner's needs (Sturgess 2012, 22). The nature and frequency of interventions are highly diverse and are dependent on the prisoner's particular circumstances and their progress across a number of indicators.

**THE COMMISSIONING ACADEMY (UK)**

The UK's Commissioning Academy is a virtual development program for senior commissioners from all parts of the UK public sector. The program consists of workshops, guest speakers, site visits, and peer challenges (Commissioning Academy 2014).

The Academy keeps public sector commissioners abreast of the latest developments in outcomes-based commissioning; alternative funding models, including social impact bonds; joint commissioning across organizational boundaries; and new models of delivery, such as mutual and joint venture companies.

Each participating organization is tasked to implement a '100-day plan' to improve their organization's commissioning practice and to ultimately improve outcomes. The academy is funded by the UK's Cabinet Office.

"In order to transform public services in a climate of fewer resources and increasing demand, we need capable, confident, and courageous people in the public sector who are responsible for designing and delivering services offering value for money."

UK Commissioning Academy, 2014.

**Recommendation 7: Government should build the capacity to ‘steward markets’ in order to properly commission certain services.**

Successful implementation of ASD often requires opening new markets where they previously did not exist. In some areas, markets are deep and there are a plethora of potential providers (e.g. IT services, human resources, call centres). In others, commissioners must become the stewards of markets, deciding what steps are necessary to ensure that the market has sufficient depth and diversity (Sturgess 2012, 79).

According to Gash et al., the stewardship of public service markets requires policymakers to:

- engage closely with users and providers to understand their needs and objectives;
- set the ‘rules of the game’ and allow providers and users to respond to the incentives governments create;

- constantly monitor the ways the market is developing and how providers are responding to the rules; and
- adjust the rules of the game in an effort to steer the system to achieve their public policy goals (2013, 35).

Beyond identifying opportunities, herein lies a *raison d’être* for the ASD Centre of Expertise. At present, government lacks the capabilities needed to commission for services, to design performance incentives, and to disseminate best practices across government (Sturgess 2012, 25-26). The ASD Centre of Expertise should devote considerable capacity in the early stages to build up and then disseminate this knowledge across departments.

## MOVE FROM DEAL MONITORING AND OVERSIGHT TO GOVERNANCE

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Arm’s length  Partnership

Risk mitigation  Risk management

Contract fulfillment  Value creation

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Complex ASD requires a new approach to deal management and a shift from contract monitoring and oversight toward deal governance and partnership. After the signing of a typical procurement contract, there is little impact on the consumer experience. The desired outcomes are clearly defined and relatively easy to measure. The service or functional area to be impacted is contained within one or two departments. The risks associated with the deal are relatively minimal.

Therefore, the relationship between government and the service provider is arm’s length, with government playing oversight and monitoring roles focused on contract fulfillment. Little re-engineering of the retained organization is required, beyond the creation of a transition team and oversight capacity. Government

typically is already equipped to effectively govern these types of transactions. Ontario has extensive experience in these types of deals, in areas like logistical support services—in both the health and education sectors—and correctional facility support services.

However, more complex ASD arrangements typically involve significant transfers of assets and employees (EquaTerra 2009). In these instances, there are usually significant impacts on the customer experience. Meanwhile, outcomes are less discernible and attributable and government has less experience and less capacity to govern these types of deals. All of these factors contribute to increased risk and require new forms of deal governance.

**Recommendation 8: Complex ASD requires new forms of deal management. Government should focus on deal governance and the objectives of risk management and value creation.**

Governance in complex ASD models must account for two sets of objectives: risk management and value creation (EquaTerra 2009). Risk management focuses on meeting contractual obligations, resolving issues rapidly, and managing the relationship between the client and the provider. Value creation focuses on ensuring the delivery of expected savings, managing demand, and institutionalizing process improvements.

There are two steps to meeting these objectives, the first of which is designing governance as part of a service contract. The second is re-engineering the retained organization to meet its obligations to the service provider and to partner effectively in the governance process. Both objectives are critical components of successful complex ASD arrangements, and both must be crafted in ways that reflect the desired outcomes from the ASD process.

There are three steps to designing effective governance (EquaTerra 2009). First, governance should be contemplated prior to entering into an agreement.

Second, governance design should accommodate both the transition phases of an ASD arrangement and the steady state (the operating phase that follows the transition phase and runs until the end of the contract). The skills and capacity required in the transition and steady state phases of a deal are different, with the former often requiring more capacity and specialization. According to EquaTerra, “more than 50 percent of outsourcing efforts ‘fail’ due to transition” (2009, 9). The Centre of Expertise can be particularly helpful during transition phases.

Third, effective governance design should also accommodate the reporting and evaluation of outcomes and allow for flexibility and accountability. Each agreement should include an accountability map with clear direction on the conditions and actors to which issues are elevated. Agreements should also provide opportunities for public scrutiny (a point we take up further on in this report).

**Recommendation 9: Government should ensure that the retained organizations in ASD arrangements are re-engineered so that they possess the skills and processes—and are subject to incentives—that enable government to fulfill its obligations to service providers.**

Getting the retained organization right is half the battle in any ASD project (Deloitte 2010, 4). The retained organization consists of three major components: the employees and management remaining with government, the retained processes and systems not being transferred to the service provider, and the new processes that are needed to govern the deal and fulfill the obligations on the government side (EquaTerra 2009, 60). At a minimum, the retained organization is typically responsible for contract management and evaluation, though its responsibilities in complex ASD arrangements extend much further.

A common reason to pursue ASD is to enable government to focus more on delivering its core competencies—such as policy development, strategy, and oversight—and less on transactional processes. This shift, however, also requires the building of new capacity to govern and effectively partner with service providers (EquaTerra 2009).

According to Blatchford and Gash (2012), those skills most needed within the retained organization are commercial and market design and stewarding skills. Civil servants with direct responsibility for commissioning services will need experience in contract negotiation, while those civil servants charged with contract management and evaluation will need to be able to design systems and metrics to assess whether providers are achieving policy objectives (Blatchford and Gash 2012, 13-19).

In addition to building processes, government should ensure that the incentives for the employees of the retained organization are aligned to the contract's objectives. Incentives should be put in place at the organization-wide and individual levels through pay-for-performance mandates (Gold et al. 2013; Deloitte 2010). Experts consulted concur that defining specific metrics and milestones for the retained organization and its employees is critical for following through on the government's obligations in an ASD relationship.

**Recommendation 10: Government should create more opportunities for external, public scrutiny of ASD arrangements through 'follow the dollar' provisions and transparency clauses in service provider contracts.**

Our own survey data confirms public reticence to ASD, with only half of surveyed businesses expressing support for greater private sector involvement in the delivery of services (Hjartarson et al. 2013, 9).

Opening up contracts to greater public scrutiny is crucial for generating public acceptance of ASD and for maximizing the chances that deals will generate value-for-money and meet their stated objectives. Despite the misgivings of some interviewees for this study, we endorse a number of solutions.

First, 'follow the dollar' provisions should be included in ASD contracts. These provisions should enable the Auditor General to scrutinize and report out on contract outcomes and value-for-money. These provisions should be applicable to subcontractors as well.

It is difficult to understand why the auditor should not have the authority to scrutinize public service contracts... Parliament is entitled to be reassured that business and accounting processes are in place to justify performance payments under the contract.

Sturgess 2012, 86

Importantly, the Auditor General may not currently have the capacity—or the right competencies—to review some of the more complex ASD deals. The Auditor should assess its capacity in this respect and address any shortcomings.

Second, all providers of public services should be obligated by government to publish the non-commercially sensitive details of their contract, their performance against contractual objectives and performance metrics, and, where applicable, user satisfaction levels (Gash et al. 2012, 9). These details should be made publicly available on a single website.



## MOVE FROM RISK MITIGATION TO RISK MANAGEMENT

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All ASD initiatives have a level of risk associated with them. Typically, the more complex the ASD deal, the higher the risk. Undertaking complex ASD requires a culture shift in government, within the bureaucracy, and among elected officials. It also requires a good deal more acceptance for experimentation among stakeholders and citizens. As noted by one expert we consulted, "officials don't get fired for presiding over steady declines of their departments. They do get fired when they take risks and those risks do not work out."

There are conditions that support greater risk tolerance. In the UK, the national government's dire fiscal situation (in a context of deep recession) generated greater government willingness and public tolerance regarding experimentation in service delivery. In BC, service failures in health transaction operations enabled government to pursue partnerships with the private sector. Ontario's deteriorating fiscal situation and lagging capital investment in some public service areas may eventually create similar conditions.

**We have to find a way to help government try things, experiment, innovate, learn by failing.**

Mark Zuckerberg, CEO, Facebook

**Recommendation 11: Government should undertake an 'early wins' strategy that focuses on landing less complex ASD deals in the short-term in order to build competence and capacity and build risk tolerance among key stakeholders.**

There are steps that government can take to foster a culture of risk-taking. In addition to building capacity and competence, achieving early wins identified in an ASD services audit will provide officials and citizens a better understanding of the potential benefits of ASD.

Government should do more to alert the public to the results from ASD arrangements previously undertaken (such as Teranet). Organizations like the OCC have an important role to play here as well.

**Recommendation 12: Government should develop tools and strategies to help policymakers systematically evaluate and manage risks. These tools and strategies should inform the development of risk management frameworks in each ASD partnership.**

Government should also task the ASD Centre of Expertise to develop risk management frameworks that can be used by ministries and agencies entering or considering entering into ASD arrangements. While service delivery risks cannot be eliminated, they can be identified and managed. Infrastructure Ontario has already developed a world leading risk management framework that the ASD Centre of Expertise can look to for guidance.

Finally, partners in ASD arrangements should be compelled to share their assessments of project risks with each other. Joint risk registers are prescribed practice for complex procurement in the UK. Risk registers outline the nature of the risk, its probability, its consequences, and the actions that can be taken to mitigate the risk. They also include accountability ladders to ensure that senior officials are alerted when problems arise.

### **SPECIFY THE RIGHTS AND OBLIGATIONS OF GOVERNMENT, PROVIDERS, AND PUBLIC SECTOR WORKERS IN AN ALTERNATIVE SERVICE DELIVERY FRAMEWORK**

A major obstacle for governments seeking to transform service delivery in Ontario is the perception that ASD will circumvent public sector employees' collective bargaining agreements (CBAs).

#### **Recommendation 13: Government should negotiate a 'public sector employee transfer' framework with collective bargaining units that clarifies the rights and obligations of government, service providers, and public sector workers when government embarks on an ASD initiative.**

Some governments have found tremendous success developing successor frameworks for ASD deals. For example, in BC, the ASD Secretariat developed a framework that includes extensive guarantees to transferred public sector employees beyond those conferred by law. This framework has formed the foundation of almost all of BC's ASD deals struck over the last 11 years. Key components of the framework include:

- All workers are guaranteed an offer of employment.
- All transferred employees are provided with a guarantee of same or better pay and benefits—including pension.
- All transferred employees retain membership in their public sector union.
- Every transferred employee has the option to return to government within two years.
- If the service is re-procured after the initial ASD contract expires, existing employees' pay and benefits are protected (Roundtable Participant, 2014).

Australia, New Zealand, and the UK have also developed employee transfer frameworks, and in some cases developed legislation and regulations that place certain obligations on employers where a service is transferred from one employer to another. These obligations protect employment and place a premium on employee morale.

The UK Government has developed a set of regulations that provides employment rights to employees when their employer changes. These regulations are commonly referred to as 'TUPE' (Transfer of Undertakings - Protection of Employment). TUPE applies equally to public or private sector undertakings and provides transferred public sector employees with broad protections relating to their CBA and union membership (Treasury Board 2014). Additionally, in cases where a public sector employee objects to a change of employer, they have the right to remain within the public sector. TUPE also provides transferred employees with the option to request that their new employer vary their contract of employment to take into account economic, technical, or organizational reasons.

Here in Ontario, the Ontario Public Service Employees Union (OPSEU) has established a five-point 'Quality Public Service Protection Plan' to help guide government in making decisions around employee transfers (Thomas, 2014). OPSEU represents more than 130,000 public sector workers across Ontario, in areas including health care, social services, and education.

**ASD works best when there is trust between the service provider and the bargaining agent. A precondition to trust is a well-defined and thoughtful change management process.**

ASD Roundtable Participant



Encouragingly, OPSEU's requirements and those frameworks that have been implemented elsewhere are mostly aligned. Some provisions, such as the requirement to table reports in the legislature, may be too onerous, particularly for smaller deals. However, OPSEU's framework provides a good basis for further discussion and negotiation.

Given the transformative nature of complex ASD, employee transfer frameworks should also provide space for employee role redefinitions and enable new performance management regimes to be implemented (these will differ between government and the private sector). Without clarity around the scope for change management, service providers will add additional risk premiums to any transaction. ASD arrangements are also much more likely to fail in the absence of change management frameworks.

**Recommendation 14: Government should develop a pension framework that is based on best practices and allows transferred public sector employees to maintain access to their public sector pension plans.**

To some private providers, public sector pensions are a deterrent to their participation in ASD arrangements. However, the expansion of ASD in some jurisdictions demonstrates that defined-benefit public sector pensions, while expensive, can be maintained in an ASD arrangement. Several jurisdictions have rules in place that protect pension coverage for those employees transferred to the private sector in an ASD arrangement.

In the UK, public sector employees who are members of a public sector pension plan, and who are compulsorily transferred from the public sector are covered in the government's 2013 Fair Deal guidance *Staff Pensions: Staff Transfer from Central Government*.

Under the Fair Deal guidance, service providers must contribute to their employees' pensions. In the event of re-procurement, employees must be provided with continued access to the relevant public service pension plan. The UK's staff transfer guidance replaces an older version that had called on private providers to

**KEY COMPONENTS OF OPSEU'S QUALITY PUBLIC SERVICE PROTECTION PLAN**

(Thomas, 2014)

1. Any public service will not be privatized or contracted out without public consultation and clear evidence that privatization will lead to improved services.
2. Any decision to privatize or contract out a service will not be made without a full and open review by an independent body or individual, who will ensure full cost/benefit analysis and comprehensive social and economic impact studies are conducted.
3. Public sector workers, their representatives and other interested parties shall have standing in the review process.
4. The reviewing body or individual will issue and table with the Ontario legislature a final report with recommendations along with all studies and analysis.
5. In the event that a specific privatization is recommended, employees will have the ability to move to the new employer with existing rights, benefits and entitlements.

provide "comparable" pension arrangements to transferred public sector employees.

Similarly, in BC, private providers contribute to transferred employees' pension plans through a trust, whereby the government maintains liability for the overall performance of the pension plan.

While the UK and BC models have gone a long way to assuaging labour union concerns, in some cases, ASD arrangements created deep tensions between non-transferred employees and transferred employees of the same external provider. Often, non-transferred employees will not have access to the same type of pension benefits as their transferred counterparts.

Here in Ontario, there is no existing framework that sets out employer and employee obligations and rights in the event that a service is transferred to an external provider. The government should clarify the rules for transferred employee pensions. The BC trust model appears to be particularly promising.

# CONCLUSION

Ontario was once a leader in service delivery innovation. In the past, governments of all political stripes partnered with the private, not-for-profit, and broader public sectors as a means of meeting fiscal challenges while maintaining overall service levels. Since then, the pace of innovation has slowed.

Meanwhile, Ontario's population is aging. Its infrastructure deficit is growing. Its economic growth will lag behind its Canadian and international peers for the foreseeable future. These factors represent a pending and significant drain on a government that already faces unsustainable deficit and debt levels. A new wave of transformation and experimentation in the way public services are delivered in Ontario is urgently required.

A number of governments facing similar challenges are experimenting with new forms of ASD. The results have been largely positive. Governments are doing more with less while improving service levels and overall responsiveness to the evolving and increasingly complex needs of their populations.

Ontario can learn much from these experiences. For example, they teach us that ASD does not lead to wage suppression and union busting, is not a vehicle for privatization, and does not erode the state's capacity to meet the needs of its population. On the contrary, the primary reason to pursue ASD is to protect and enhance the capacity of the state to meet its public policy objectives by leveraging the capital, technology, expertise, and business models of the private and not-for-profit sectors.

Another important reason to pursue ASD is to unlock the commercial and entrepreneurial potential of the huge portion of the economy that the government controls. By injecting competition, diversity, and contestability in public services, government can deliver new sources of economic growth and a new dynamism in the economy.

Successful ASD, however, requires government to adopt a *public service economy approach*. A public service economy approach compels government to build the capacity to create and steward the marketplace for public services. It also requires government to adopt new approaches to procurement, oversight, and risk.

All of this will take courage on behalf of our politicians, bureaucrats, and citizens. If we are able to muster this courage, we will meet the challenges that lie ahead of us and ensure that government is positioned to meet the needs of its citizens well into the future.



# APPENDIX 1: EXAMPLES OF ALTERNATIVE SERVICE DELIVERY

Past studies have found that suitable areas for ASD range from back office services (including finance, IT, and HR services) to front office services (including delivery agents, field staff, and enforcement). The table below presents various government functions that are currently being delivered by outside agents in other jurisdictions. Many of these examples are taken from Gary Sturgess' 2012 report *Diversity and Contestability in the Public Service Economy*.

Government function	Jurisdiction	Description of the service	Results (where possible)
<b>Back Office</b>			
Audit services	Australia	In the state of Victoria, the Auditor-General contracts out some of their audit functions to private providers. In New South Wales, around 30 percent of the auditing is done by external providers.	
Back office processing (OHIP equivalent)	British Columbia	MAXIMUS, a private operator, operates British Columbia's health and benefits processing functions.	Since 2005, MAXIMUS has met all 27 new service level requirements for Health Insurance BC. For example, all calls from citizens and providers are answered within specified time frames whereas prior to handover to MAXIMUS, more than 50 percent of calls encountered a busy signal. Furthermore, the contract requires MAXIMUS to make significant capital investments to replace aging technology supporting the two programs, investments that the province retains ownership of at the conclusion of the contract.
Electronic Land Registration Services	Ontario	Ontario's Electronic Land and Registration System (ELRS) is operated and maintained by a private company, Teranet. In 2010, the Government of Ontario agreed to a 50 year extension of Teranet's license to provide electronic land registration and writ services to Ontarians.	Under the terms of their contract with Teranet, the government received an initial payment of \$1 billion and a 50 year stream of royalty payments in exchange for exclusive electronic land registration and writ services. The government maintains control over fee increases. As a result of their success in Ontario, Teranet has been contracted to operate Manitoba's land registration system.
Email hosting	United States	Washington D.C. has moved to an enterprise version of Google Apps, a software suite that includes e-mail (Gmail), calendar, documents and spreadsheets, and wikis (known as Google Sites).	Since the move to Google Apps, Washington D.C. cut its email costs in half.

Government function	Jurisdiction	Description of the service	Results (where possible)
<b>Back Office   continued</b>			
Information Technology	Nova Scotia	Nova Scotia has entered into a 10-year deal with IBM who provides SAP application management services for the province's Core Competency Centre and Health Administrative Services programs.	IBM has extended job offers to all 75 government employees who were managed under those services.
Valuation	Australia	Many of the valuations undertaken by the New South Wales Valuer General are undertaken by external providers.	
<b>Middle Office</b>			
Court support: facilities management, security, IT support	Australia	Melbourne's County Court building, opened in 2002, was designed, built and operated as a public-private partnership. P3s are standard nowadays, but what set this apart is the fact that many of the court's services are now delivered by the private provider, including court recording and transcription, custodial services, court security and management, and courtroom booking services.	
<b>Front Office</b>			
Correctional services	United Kingdom	Beginning in 1988, the UK began contracting out prison management to private operators.	Around 15 percent of prisons in the UK and Wales are managed by private sector providers under contract. In some cases cost savings are as high as 20-30 percent.
Correctional services	Ontario	In 2001, the government outsourced the operation of the correctional facility in Penetanguishene to a private operator for five years.	In 2006, the facility was returned to public control after an internal review by the Ministry of Correctional Services found a publicly run facility in Lindsay performed better across a variety of indicators.
Community care	Australia	Federal, state, and private providers all play a role in delivering community care.	In Queensland, Blue Care (a not-for-profit nursing services organization) operates 260 centres in 80 communities, and employs 10,000 staff and volunteers.
Health services	Australia	Australian health services are delivered by a mix of public and private providers.	In 2007-2008 the general hospital cost per case was about 30 percent higher in public hospitals compared to private hospitals.  A 2010 study by the Australian Productivity Commission of 368 public hospitals and 122 private hospitals found that private hospitals were less costly than public hospitals when medical costs were excluded.

Government function	Jurisdiction	Description of the service	Results (where possible)
<b>Front Office   continued</b>			
Health services	Maine	In the state of Maine, a private provider has been hired to improve the state's child immunization rate.	By using third party market research data and regression analysis, the provider is able to target their public health campaigns to segmented population groups. As a result, child immunization rates have risen by 40 percent since the provider was hired with minimal impact on overall cost.
Public transportation	Australia	State and city private providers deliver rail, bus, and ferry services.	Multiple independent reviews have found that private providers are more efficient.
Adoptions	Florida	The state of Florida uses a private provider to help families adopt children with special needs.	Completed adoptions for children with special needs in Florida have increased by more than one-third following the introduction of an ASD model.
Education	Sweden	Since 1992, Sweden has allowed private operators to manage publicly funded schools. School operators are given greater flexibility in shaping curriculum.	Roughly one-quarter of Sweden's secondary school students attend a privately operated school.
Non-emergency patient transport.	Australia	Beginning in the early 1990s, the state of Victoria liberalized the market for non-emergency patient transportation.	Over the last 20 years, most Australian states have moved to mixed patient transportation markets.
Fire and emergency services	Denmark	Most of Denmark's emergency services are provided by a private, for-profit company, Falck.	Research has concluded that Denmark's emergency services are more cost-effective than those in other similar countries and within Denmark, Falck's fire services are more efficient than those provided by most municipalities. A study of 275 local governments reported that Falck was as much as 65 percent less costly in areas where they provided fully professional fire services.
Road services/ maintenance (toll roads)	Canada	Leased to a private consortium in 1999, Highway 407 has been the subject of heated debate over the last decade.	The government was not given a say in setting user rates, which has created controversy among users.
Prison management	United States	Private companies operate around 25 percent of correctional facilities in the US.	The majority of studies on US prison contracting found financial savings in the range of 5 to 15 percent.

# APPENDIX 2: INNOVATIONS IN ALTERNATIVE SERVICE DELIVERY MODELS

There has been considerable innovation in ASD and contracting models over the past 20 years. Each model has its own advantages and liabilities which make them suited to different sets of objectives and risks. Where a market is non-existent, questions of market design will need to be answered well before a model is selected. The models below, many of which have been identified in Gary Sturgess' 2012 *Diversity and Contestability in the Public Service Economy*, demonstrate that governments have moved well beyond outsourcing.

**Alliance Contracting:** involves open book accounting and risk-sharing among all project members. Project members set an initial target cost and any under-or over-runs are shared by all participants. This method rewards strong performance because participants win or lose depending on the overall project performance. It is best suited for situations where timely completion of the project is of paramount concern but has also been found to improve non-cost outcomes and prevent disputes.

**Availability Contracts:** a form of output contracting where governments pay for access to facilities and equipment rather than acquiring ownership. This is a common ASD model in the United States, Australia, and New Zealand. It is also a fairly common concept in the private sector, especially in the energy, railway, and civil aviation sectors.

**Delegated Administrative Authorities (DAAs):** are not-for-profit entities that administer legislation on behalf of the government. DAAs have delivered regulatory services in Ontario for nearly 20 years, in areas like motor vehicle inspection station oversight, commercial vehicle safety enforcement, and private career colleges. According to the Commission on the Reform of Ontario's Public Services, DAAs reduce costs to taxpayers, improve regulatory outcomes and efficiency, and retain government oversight (2012, 56).

**Framework Contracting:** lays out broad terms and conditions under which agreements can be called off. They are used to narrow the field of potential bidders or in instances when the commissioning agency cannot determine the quantities of goods or services required in advance. Framework contracting reduces costs and expedites procurement.

**Government-Owned, Contractor-Operated (GOCO):** GOCO models have been around since the Second World War, when government used private sector research capability in publicly owned facilities. Here in Canada, the federal government is moving to a GOCO model for the management and operation of the Atomic Energy of Canada Limited's nuclear laboratories.

**Public-Private Joint Ventures:** aim to bring together the complementary strengths of the public and private sectors, in an effort to complete a project or operate a service. This model works best where government agencies have high levels of technical expertise but lack the commercial skills to translate that expertise into an efficient and effective service. In the UK, the Prison Service has established a joint venture with a facilities management company and a large not-for-profit provider to compete for prison management contracts.

**Public Service Mutuals:** are organizations that have left the public sector but continue delivering public services. Typically, the employees of the mutual control the organization. In the UK, 65 public service mutuals are currently in operation and are delivering around \$1.8 billion of public services.

**Social Impact Bonds:** are issued by government to a third party, typically a private or not-for-profit service provider, indicating that a payment will be made if a predetermined target is reached. It is the prospective income of said bond that will hopefully attract a third party investor. Social Impact Bonds reduce risk for government, as government is not obliged to pay if results are not met. Social Impact Bonds also allow greater flexibility and independence to the investor/provider to deliver the service on their own terms. Both the US and the UK are experimenting with Social Impact Bonds.

# APPENDIX 3: RISK ASSESSMENT CHECKLIST FOR THE RETAINED ORGANIZATION

Risk	Applicable to this service? (Yes/No)	Who assumes the risk? (private or public sector)	Why are they best positioned to assume the risk?	Probability of the risk (low, medium, high)	Ramifications of the risk	Possible mitigating actions
<b>Policy Risks</b>						
Change in government policy						
Change in legislation						
<b>Liability Risks</b>						
Default of private provider						
<b>Service Quality Risks</b>						
Service quality falters						
Service fails						
Service no longer meets the government's public policy objectives						
<b>Operations Risks</b>						
Higher than anticipated cost of delivering the service						
The service is not adopted at a high enough rate						

Risk	Applicable to this service? (Yes/No)	Who assumes the risk? (private or public sector)	Why are they best positioned to assume the risk?	Probability of the risk (low, medium, high)	Ramifications of the risk	Possible mitigating actions
<b>Financial Risks</b>						
There are cost overruns						
<b>Other Risks</b>						
Service is no longer required						
IT system fails						
Procurement risks: the wrong process was used and/or the wrong winner was selected						
Privacy is compromised by the service						

## APPENDIX 4: GENERAL CONTRACTING RISKS\*

Contracting risks	Mitigating action
It is difficult to measure the value-add of providers?	Use individual choice as proxy for quality
	Retain a public sector comparator
	Collect data to generate reliable performance and counterfactual models
Are service outcomes highly dependent on the performance of others?	Identify functions that facilitate coordination and keep in-house
	Bundle function together in one aggregate contract
	Specify and reward desirable collaborative behaviour
Does delivering the service require investment in highly specific assets?	Own the asset and only contract out operation
	Negotiate long term contracts
	Minimize risk of policy and demand uncertainty
Is the service characterized by high demand uncertainty?	Negotiate payment caps and minimum income guarantees
	Make capital investments and only contract out service operation
Is the service characterized by high policy uncertainty?	Achieve a broad and cross party consensus
	Design short, flexible contracts
	Keep contracted functions at arm's length from political influence
Is the service essential for government's ultimate decision-making or coercive authority?	Retain service in-house

\* This table is from Gash and Panchamia (2013, 2).

# APPENDIX 5: TYPICAL COSTING COMPONENTS

## Costing a Public Service

The following should serve as a rough guide for governments seeking to identify the costs of a public service. The costing components identified below are based on the costing model identified in Bean and Hussey's *Costing and Pricing Public Sector Services* (Essential Skills for the Public Sector, 2011).

### COMPONENT A: SALARIES AND WAGES

- Wages
- Benefits (includes health and pensions)
- Overtime
- Temporary/Agency fees
- Travel and subsistence

### COMPONENT B: PROPERTY RELATED COSTS

- Rent and Rates
- Services (cleaning, security, etc.)
- Utilities (electricity, telephone and gas)

### COMPONENT C: GOODS AND SERVICES COSTS

- Materials
- Printing and stationery
- Postage
- Training
- Professional fees
- Insurance
- Support service costs (e.g. central cost of personnel, legal, finance, etc.)
- Interest charges (reflecting the cost of any borrowing the service incurs)

### COMPONENT D: FIXTURES, FITTINGS AND EQUIPMENT COSTS

- Office furniture
- Computer hardware and software
- Repairs and renewals

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