



Governments around the world on the Edge

Deloitte Consulting Global Financial Crisis Point of View

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There is no magic strategy that will turn the present global financial crisis into an unalloyed positive. However, governments around the world can find the seeds of long-term advantage in the decisions they make now. The world's governments are not all dealing with the crisis in the same way, although there are several common responses: Through innovation, reexamination of operational models, and thoughtfully directed support of key public- and private-sector institutions, they and the economies under their leadership can emerge as more efficient, competitive players in a post-crisis environment.

Expanded role for the public sector

Looking inward, governments will have to respond to this crisis the way many of them have responded to past crises – by discovering new ways to do more for less. These short-term efforts to save money can grow into long-term models for sustained efficiency. Looking outward, governments must be willing to expand certain commitments – on a deficit basis, if necessary – if they offer the promise of lasting value, not merely short-term stimulation. In fact, as in other historical periods of crisis, the role of the public sector is likely to expand. In this respect, governments are extending their reach on the financial and manufacturing sectors. But bigger is too simple an answer to the current challenge. Governments must be smarter.

Increased global interdependence

Two important forces are currently at work. One is increased global interdependence. The spread of credit difficulties from nation to nation, and the concerted effort in some quarters to erect firebreaks, finally puts to bed the idea that any nation is an island. Evidence of this is seen in recent efforts by the British and French governments to spur preemptive action by the International Monetary Fund (IMF) on behalf of threatened currencies and stocks in Eastern Europe. Commerce across borders may suffer as a result of the crisis, but international planning and cooperation will likely increase, not decrease.

The other is a renewed tendency toward devolution of state power from the center to the edge – from the national government to regional and local governments, and to key private-sector industries. What may appear at first glance to be a concentration of power is in fact a distribution of capital, putting resources on the ground in sectors and communities where it can be put to the greatest use.

Pressure sparks innovation

Pressure leads to innovation. It's as true in the public sector as it is in the private. In flush times, governments are like everyone else – fat around the edges and slow to tighten controls. Lean times demand new efficiency, while at the same instant, a public under pressure is demanding more from its government. Where innovation is able to reconcile these conflicting demands, the result can be new approaches that remain applicable long after the crowded hours of their inception.

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Consolidation and other effects

Solutions of this sort may lie in consolidation, shared services, or integration of service provision models into combined storefronts that make use of common needs and new delivery methods.

Contracts with private organizations that provide public services are under the same pressure as everyone else, and governments will find them more willing to consider not only cost concessions but more contract models that peg rewards to the quality of service delivery.

The relationship between public and private sector operations may also change as a result of the crisis. Public resources that currently return little value, such as abandoned land and buildings, may blossom into productivity under the contractual stewardship of private entrepreneurs. At the same time, an expanded public sector may be more attractive to investors, especially in comparison to faltering private equities, and better able to negotiate financing terms.

Spend, but wisely

Governments under pressure to inject value into their economies need to make strategic decisions and need to improve controls. Some short-term stimuli can evaporate without doing any lasting good. Others may have the effect of slowing an economy's adaptation to a more sustainable footing.

For example, pure cash stimulus packages coupled with appeals to increase consumer spending may exacerbate the reliance on consumption and credit that led to the current crisis. And subsidies that protect antiquated jobs don't do anyone any long-term good – they delay the inevitable and make it harder for industries to achieve lasting competitiveness. By this logic, a no-strings bailout to an existing domestic auto manufacturing industry may not have the benefit that could be realized from a public investment in new fuel-efficient technologies.

An economy in peril also calls for more investment in government's core function, the direct delivery of value-added services to the public. As with economic stimulus, however, there are right and wrong ways to proceed with service enhancements. Governments that expend scarce resources to mask problems and maintain the status quo will eventually face a reckoning. Governments that spend on ways to ease the pain of permanent economic transition

and clear barriers to innovation will most likely find their money well-spent.

Infrastructure and workforce development

In the United States in particular, infrastructure was already in need of significant investment even before the crisis added new impetus for public spending. The American Society of Civil Engineers estimated in 2005 that it would take \$1.6 trillion merely to bring the nation's overall infrastructure up to "good condition." Even when infrastructures don't suffer headline-making failures, they still have a braking effect on the economies they support. For example, America's most populated urban highways have become capacity-constrained chokepoints for millions of daily commuters.

Globally, the need to revamp infrastructure is just as keen as in the United States. Canada's local governments face a \$60 billion annual infrastructure deficit, according to the Federation of Canadian Municipalities. The European Commission estimated in 2006 that it needs to spend an estimated \$1.2 trillion on its energy sector alone. Deloitte reports that East Asia needs to spend \$165 billion a year on infrastructure. India, whose own Ministry of External Affairs reports that only 2 percent of roads are National Highways, spends only 6 percent of its GDP on infrastructure, compared to China's 20 percent. According to the World Bank, Latin American exporters are finding that poor transport facilities hamper their competitiveness abroad. Perhaps the only thing that the world's national and regional economies have in common when it comes to infrastructure is that no one appears to be allocating enough to it.

Governments trying to keep pace with growth may find that innovative financing strategies, such as public-private partnerships (PPPs), provide a useful alternative. And in the particular case of roads, strategies like user charging, variable tolling, and other demand management policies, implemented with new technology, can be effective in reducing congestion and getting the most value from existing capacity. When the need is for innovative management and technology, the answer often lies in a PPP.

PPPs often encounter grassroots resistance. This was a factor, for example, in the recent failure of a deal that would

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have brought private management to the Pennsylvania Turnpike [If this is a client, make sure you have LCSP permission to print. Despite this resistance, however, PPPs remain an attractive upgrade and repair funding option for many types of infrastructure, because they provide immediate revenue without new taxes or debt and shift costs to the private sector. PPPs are also being used to fund infrastructure utilization technology implementations under which private entities manage the use of infrastructure, or sell data derived from managing it, and pay government for the opportunity.

Directing a government's crisis-era spending on projects of lasting infrastructural value seems to be an easy decision. But it's not that simple. That spending leaves behind not one legacy, but two: the projects, and the workforce that creates them. The kind of workforce that builds roads and schools is not necessarily the highly skilled workforce upon which a nation can sustain a 21st-century economy over the long term. In the example of the New Deal, the United States side-stepped this problem by moving from a government-subsidized recovery footing to a government-subsidized war footing. Today, spending on steel and concrete, while necessary, must be balanced with investments in more advanced endeavors that stimulate the creation of an educated, globally competitive cadre of knowledge workers.

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Globalism, if not unanimity

The effects of the financial crisis don't respect national borders, and so the response to the crisis has been international in scope. However, a new

age of interconnectedness does not mean a new age of unbroken harmony. Governments have already begun to show differences in the way they approach the new reality, including some outright disagreements.

For example, according to the *New Zealand Herald*, both parties in New Zealand's recent national elections voiced support for direct government assistance to individuals who lose their jobs as a result of the crisis, a path few other nations appear willing to follow as of this writing. In Europe, French President Nicolas Sarkozy is leading the call for greater government intervention in key private industries, but he has faced resistance from German leaders who consider the plan too "interventionist." Germany, for its part, has proposed relaxing European Union (EU) emissions taxes in order to help the transportation industry weather the storm, which has not been a popular stance among the continent's green advocates.

The value in these disagreements is educational. Over time, observers will be able to see how the competing approaches work out, identify best practices, and draw lessons they can put to use at home.

Something has got to give

If government spending is likely to increase in response to the financial crisis, the obvious question is who – or what – pays for it. The answer appears to be long-term aspirational goals, even ones that would promise lasting benefits if funded in full.

Corporate responsibility, education and environmental protection are some examples. Canada, a signatory to the Kyoto agreement on greenhouse gas reduction, unilaterally suspended its observance of the treaty's limits in 2006 under the new government of Conservative Prime Minister Stephen Harper because the new ruling party felt the restrictions were too great a drag on the economy. This decision has recently withstood a court challenge. Germany's position on emissions controls can be seen in a similar light.

Projects that don't offer economic value, and making a distinction between those that do versus those that are aspirational in nature may be more blurry than in the past.

Governments across the globe may emerge from this shift with a new generation of public servants at the helm.

Transforming public service and attracting talent

If the nature of government investment is changing as a result of the financial crisis, the nature of government service is also evolving. As part of an overall commitment to cost efficiency, public sector organizations need to be careful about their pension commitments and the other benefits that government workers in many countries have taken for granted over many generations.

Put simply, public service will offer more challenges with fewer guaranteed comforts. Which makes public service recruitment and management another example of the do-more-with-less challenge that characterizes most elements of the global financial crisis – and also makes it a transformative opportunity. The emphasis should be on value – getting the best work and thinking from public servants from the most efficient investment in their talent – rather than on absolute savings realized over the short term. After all, these are the people working hard on solutions to the crisis.

Governments across the globe may emerge from this shift with a new generation of public servants at the helm, people who come to the profession with plans and expectations that differ from those of their predecessors. Their approach to playing a part in government will change: Instead of looking for stability and long term benefits, they will be entering the government with the desire to make an impact on things that matter to them, such as energy issues. Their influence will be felt for years to come.

The special non-cyclical nature of government

The present situation illuminates that the public sector is neither cyclical nor counter-cyclical. It is non-cyclical. The demands placed, the resources it commands to meet those demands, and the managerial methods with which it makes key decisions follow their own rhythms.

Government, unlike private enterprise, has both the opportunity and the responsibility to look past the problems of the moment to focus on the distant horizon. Heads of state don't file quarterly earnings reports, and their actions are ratified (when at all) by a public whose demands are more complex than debits and credits.

The actions taken now by farsighted governments will come with a cost. It isn't easy deciding to expand spending when everything else is contracting. However, with intelligent planning, governments can make investments today that not only ease the immediate burden of the economic crisis, but lay the foundations for stronger economic performance once it's over.

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