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Evolving to modernize
public services

The pursuit of fiscal sustainability

Clearing a path to fiscal sustainability in the public sector needs to start today. The public is relying on the government to cope with economic crises, climate change, social inequality, fast-moving advancement in technology, and more. And these are just a few of the major factors that are having direct impacts on public services for all Canadians. Rethinking government spending in the current context requires an understanding of national and global challenges, and calls for the operationalization and modernization of these services for a growing citizen base.

In the last five years, overall government spending has increased by **59.8%** and is set to increase by **5.7%** by 2025-26.

The public sector is no stranger to budget constraints, but not like this. With the Bank of Canada tightening monetary policy to lower inflation, organizations will need to find greater cost-efficiencies in the delivery of their services and products. The public sector also needs to strategize to meet citizen expectations for more and better services in ways that do not add to spending. Its reliance on borrowing to fund public services results in a higher total cost to deliver them, given the rising interest rates that determine the associated debt expenses.

Canada's federal per-person spending in 2023 continues to exceed that of the 2009 recession by 11.3% and the federal expenditures during World War II by an astonishing 28.8%.¹ As the Canadian population expands and ages, the growth trend of per-person spending will continue, along with the demand for public services. This trajectory will continue to put an increasing strain on the financial feasibility of the current systems.

In the last five years, overall government spending has increased by 59.8% and is set to increase by 5.7% by 2025-26.² Yet, as demand for government services increases, the financial pressures to deliver them are rising faster than the revenue streams needed to support them.

And not only are revenues constrained but borrowing costs to fund government operations and service delivery are rising as interest rates increase in an attempt to quell inflation. In 2023, the government will spend as much on debt interest as the Canada child benefit, Canada Health Transfer, and national daycare programs combined. This concerning trend is evident not only at the federal level but also across various provinces. In Ontario, for instance, debt interest currently accounts for a larger share of revenue than provincial post-secondary education. Meanwhile, British Columbia is expected to spend more on servicing debt interest than on public transportation and social assistance payments combined. These situations across the country underscore the call for sustainable fiscal management.

Excess spending is also demonstrated by the federal government's estimated allocation of \$60.7 billion to personnel expenses in fiscal year 2021-2022³, which accounts for more than half of its total annual operational spending. There's a noticeable trend toward increased investments and higher spending for hiring more people, as we saw in Service Canada's efforts to address passport application delays by expanding personnel, while leaving the infrastructure supporting this process limited. This trend stems from

factors such as inflation, inefficiency, and on-demand stimulation, which detract from efforts to innovate our insufficient and under-resourced critical public assets.

The prevailing response to fiscal challenges has been reactive in nature. While addressing them remains imperative, there's a significant opportunity for government departments to reconfigure their strategic directions and operations. Within government organizations, chief financial officers can adopt a client-centric approach as they prioritize efficiency. The delivery of programs during the pandemic demonstrated that, when pressured, government entities can devise innovative solutions to deliver services effectively.

When dealing with similar challenges in the past, the public sector would bank on economic growth to generate more revenue, but many think the country is heading toward an economic slowdown. According to the Organisation for Economic Co-operation and Development (OECD), any slowdown may persist for some time and aggravate an already poor outlook. In a recent forecast, the OECD predicted that Canada could be the worst-performing advanced economy for decades to come.

Faced with today's challenges, the public sector must focus on finding sustainable financing solutions and using the available staffing and financial resources effectively to maintain—and even enhance—the services already being offered.

Finding efficiencies

The government has a clear need to modernize. The initial phases of such a transformation require finding efficiencies within established programs.

Some of this work is already under way. In August 2023, federal cabinet ministers were asked to find a combined \$15 billion in savings within their departments and develop plans to realize those savings over five years.⁴ Provincial and municipal leaders will likely have to take similar measures to maintain essential services.

To identify and implement these efficiencies effectively, leaders can start by performing a co-ordinated, rapid diagnostic across departments and agencies. To be successful, this process must balance implementation speed with the impacts that full-time equivalent (FTE) cuts will have on service delivery and inter-agency coordination. The assessment also needs to ensure that any short-term tactical decisions don't impair the public sector's ability to execute bigger, medium-term savings in the future.



Working to cut costs and spend more productively can still lead to better outcomes

Setting the right approach and identifying opportunities in these early stages is critical and will determine the long-term success of finding efficiencies without eroding the public's trust.

Given the number of possible services that governmental agencies are interested in providing, it's imperative to examine them through a lens of efficiency-maximization and quality improvement in order to properly inform funding needs and operating model design. Prioritizing these aspects will be pivotal to delivering high-quality services and cost-effective value to the public. This process includes the following steps:



Start early

Everyone appreciates the urgency and need for leaders in the public service to act quickly, but that drive cannot come at the expense of detailed research and analysis to understand the longer-term effects of any potential change that would impact a service to citizens.



Define the goals

It's important to set expectations for sustainable improvements and desired outcomes from the outset. This starts with clearly defining the immediate and long-term risks and impacts of all options before choosing the best implementation plan to move forward with.



Ensure effective oversight

Once a plan has been formed and then put into action, government must ensure there are effective oversight and control mechanisms in place to help organizational units remain accountable.



See the big picture

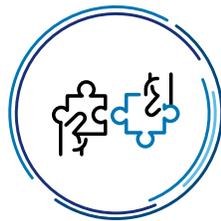
Organizational structure that seems streamlined within a department or agency may mask inefficiencies and duplication with other areas of government. To optimize budgets, teams must be empowered to work across departments and agencies, breaking down silos to find efficiencies and eliminate role duplication.

Three actions to activate

All levels of government must seek to find sustainable solutions to their budgetary challenges that don't undercut the scope or quality of the services Canadians expect.

To achieve fiscal sustainability, government must undergo a significant shift in mindset. A modern approach requires a fundamental change from demand stimulation to productive assets that multiply economic benefits. Government must now trust that constraints can serve as catalysts for innovation and efficiency, moving away from operating with a surplus-oriented approach that focuses on hoarding resources and budget inflation toward a value-driven mindset that delivers value for money.

It's important that all changes are designed to minimize business disruption and achieve results rather than piecemeal attempts with meaningless impacts. While there are many actions governments can take to achieve budgetary and spending goals, much of the early work will focus on the following areas:



1. Design and implement new operating models

Embrace change

This may mean developing a fresh organizational structure and removing repetition of roles, duplication of work, and any additional organizational overhead.

Optimize existing processes

Cutting FTEs may be the quickest way to achieve budget targets, but it can be disruptive or even counterproductive at times, putting the public interest at risk. Improvements to the way organizations run can be made by refining core processes, fine-tuning organizational structure, refining governance, etc.

Smart tactic

To successfully design and implement new operating models, it is key to identify inefficiencies in the current model, prioritize strategic initiatives, and stabilize processes. Ministries (e.g., the Department of Defence) and Crown corporations have captured operational efficiencies by conducting operating model reviews across multiple programs and departments.



2. Review and reprioritize capital spending

Identify quick wins

Seek out early wins that will help optimize the allocation of funds and returns on investment. Reviewing project delivery to root out inefficiencies and identify operational improvements and cost efficiencies can be extremely effective.

Use test cases for major cuts

Cuts made without an eye to the future are bound to fail. Assess costs in a strategic context, factoring in portfolio optimization, strategic alliances, and outsourcing. Major cuts should be rolled out in select test cases so lessons from those experiences can be integrated to improve future outcomes.

Smart tactic

Recognizing the need to modernize their portfolios, public sector organizations with significant real estate portfolios have already started assessing scenarios for employees working from home, in-office, and through hybrid work to help optimize their asset allocation and with an eye to cutting future greenhouse gas emissions. This approach would allow government to achieve multiple positive outcomes too.



3. Perform ongoing evaluation

Embed detailed program reviews

Review business cases for both ongoing and planned programs, including assessing whether there is a clear line of sight on costs to deliver and the proposed benefits are properly identified and realistic.

Smart tactic

A public organization program review is a detailed examination of operating structures and delivery methods to assess opportunities to maximize outcomes for government through consolidation, digitalization, outsourcing capabilities, and pay-for-performance models. This type of review has been adapted by a variety of ministries in the past to assess cost-management proposals and identify more lean-based cost-reduction opportunities.

It's important for all levels of government to take immediate action, as the aging and growing population will continue to strain their ability to provide key services, including health care and education. They also share the same issue of taking on debt at a higher interest rate. The reality is that all public sector service providers across Canada need to prioritize the identification and implementation of sustainable financing solutions.

Additional actions to achieve fiscal sustainability include rethinking policies to develop new programs and services, making better use of technology to make sure government is future-ready and find new ways to collaborate, and establishing formal (e.g., public-private partnerships) and informal collaboration across all ecosystem players.

The path forward

The next step for the public sector is taking a long-term view to find sustainable savings that enhance service delivery rather than detract from it. This includes smarter use of technology and the modernization of processes across all government sub-sectors.

While most of the challenges the public sector faces have been building for some time, many have become acute in recent years. Coming through the global pandemic and dealing with a mixed economic outlook is a vulnerable position to be in—and there's limited time to act and incredible pressure to make the right decisions. Whether the next time the government is called on to help the country navigate a major challenge is around the corner or years

away, there's an impetus to move quickly to modernize the sector to ensure it's able to meet those needs. Adopting a multi-layered approach to fiscal sustainability protects service delivery, and prioritizing long-term financial well-being is critical.

Policymakers should act now, as headwinds are blowing; international trade issues, low growth, and changing population demographics are increasing the demand for public services, straining government's ability to meet citizen needs and expectations in a fiscally sustainable manner. This is an immediate concern—the most recent federal budget anticipates \$43 billion in net-new spending over the next six years.

At Deloitte, we want to help the government identify the areas of opportunity and challenges that may confront policymakers in the coming years. We want to offer forward-looking recommendations that will help the government prepare for the future. Ultimately, we want to help the government get past the near-term distractions to support the long-term planning needed to develop forward-thinking solutions that can usher in a fiscally sustainable future.

End notes

- 1 Tegan Hill et al., "Prime Ministers and Government Spending: 2020 Update," Fraser Research Bulletin, May 2020; Jake Fuss, "Prime Ministers and Government Spending: 2023 edition," Fraser Research Bulletin, February 2023.
- 2 Philip Cross, "Canada's Fiscal Policy Has Undermined Efforts to Tackle Inflation," Fraser Institute, 2023; Department of Finance Canada, "Details of Economic and Fiscal Projections," Government of Canada, March 28, 2023.
- 3 Alex Whalen and Steven Globerman, "Government getting bigger and bigger in Canada," Fraser Institute, September 2020; Treasury Board of Canada Secretariat, "Population of the Federal Public Service," Government of Canada, June 26, 2023; Mark Creighton, "Personnel Expenditure Analysis — Update," Office of the Parliamentary Budget Officer, April 4, 2023.
- 4 Bill Curry, "Cabinet ministers given Oct. 2 deadline to cut \$15-billion from spending plans" The Globe and Mail, August 2023.

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