



CANADA'S  
PUBLIC POLICY

# FORUM

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DU CANADA

The Public Policy Forum is an independent, not-for-profit organization dedicated to improving the quality of government in Canada through enhanced dialogue among the public, private and voluntary sectors. The Forum's members, drawn from business, federal, provincial and territorial governments, the voluntary sector and organized labour, share a belief that an efficient and effective public service is important in ensuring Canada's competitiveness abroad and quality of life at home.

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On behalf of Canada's Public Policy Forum and our project partners, I wish to thank the individuals and organizations who have contributed to our work considering productivity in Canada's public sector.

Over the past decade, Canadian leaders have delved into the productivity question in Canada. While much of the work has focused on our private sector, it is equally important that we consider this issue in the context of Canada's public sector.

Under the theme of **Public Service Next**, the Public Policy Forum has undertaken several research and engagement projects exploring the changing dynamics in government and emerging opportunities that are shaping our future public services. As part of this series of work, and in partnership with public and private sector stakeholders, we have convened a diverse and impressive group of leaders to consider public sector productivity in Canada.

We found that while no one has arrived at a precise definition and set of measurements, productivity in governments is at the forefront of many Canadian leaders' minds. And, there are a number of initiatives underway to improve the way we understand and apply productivity in a public sector context. These leaders believe that shifting the focus to consider the impact of government operations can be a game changer for Canadian productivity.

This report outlines some of the current best thinking on how we can advance an understanding of productivity in government in Canada. Clearly, this is an important area where further definition and application is required. We keenly look forward to advancing this work in the months ahead.

Thanks to our project team under the leadership of Paul Ledwell, Executive Vice President; Amanda Pickrell, Project Lead; and Julia Oliveira, Project Administrator.



David Mitchell  
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## OUR PARTNERS

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**Deloitte.**

**BMO** 



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# EXECUTIVE SUMMARY

Productivity has been a significant focus in Canada for several years, as we seek to keep pace with a much more dynamic global economy. Despite productivity and competitiveness being key to national prosperity, Canada has faced real challenges in driving its relative productivity level. In the early 1980s, Canada's productivity was comparable to the United States. In 2011, Canada's output per worker was only 78.3% that of the U.S. Compared to other countries, Canada also fares badly, with our labour productivity growth lower than that of top countries for many decades, hurting our international competitiveness.<sup>1</sup> In 2012, Canada's level of labour productivity achieved a ranking of 13<sup>th</sup> among 16 peer countries. Within these leading countries, only Finland, Switzerland, and Japan were lower.<sup>2</sup> Despite concerted efforts and focus, our productivity gap appears to be growing.

Efforts to improve productivity in Canada largely have been focused on our business sector. More recently, public sector productivity, and the need to improve it, has gained some traction globally<sup>3</sup>, and Canada is no exception. As a measure of spending, the broader public sector (incorporating all three levels of government) accounts for nearly 40% of Canadian GDP. At the federal level alone, the public sector has 262,000 employees, not including the RCMP and the military. By any account, the public sector has a massive impact on the productivity performance of the country.<sup>4</sup>

The current fiscal environment and ongoing demographic challenges makes the task of improving public sector productivity even more pressing. Austerity also provides the opportunity for governments to be creative and disruptive in their drive to change the way they do business, more so than in times of relative economic stability.

Throughout the course of discussions with Canadian leaders, we determined two lenses through which to view the productivity impact of government activity: the efficiency lens, with its heavy emphasis on cost inputs against delivery of services and programs; and a lens more focused on effectiveness and quality, where outcomes are more difficult to quantify.

Also in our discussions, it was repeatedly emphasized that the public sector is not the private sector, and it should not try to emulate the commercial and shareholder imperatives that businesses apply in their operations. As such, while the aforementioned lenses are useful for focusing the public sector productivity discussion, opportunities also exist for the public sector to change day-to-day activities. For example, challenging the ways that governments operate by examining culture at both the leadership and working level, striving for innovation and developing a new way of interacting with the public and elected officials. In the pursuit of public sector transformation, four key themes emerged:

- Relevance;
- Approach;
- Performance indicators; and,
- Enablers.

This paper provides a summary of research, interviews and roundtable discussions undertaken by the Public Policy Forum in 2014. It considers how efficiency and effectiveness can be applied, provides other jurisdiction examples of public sector productivity, and outlines contributors' views of where public sector should focus its efforts to transform government operations.

<b>EFFICIENCY</b>	<ul style="list-style-type: none"><li>• Applied where public sector activities most closely reflect private sector, e.g. data centres, financial management.</li><li>• Focus on cost savings and centralization of services.</li></ul>
<b>EFFECTIVENESS + QUALITY</b>	<ul style="list-style-type: none"><li>• Applied where the bottom line is not only about cost but includes more difficult-to-measure objectives, such as the quality of healthcare and education</li><li>• Focus on creating conditions that allow public servants to work effectively and provide value.</li></ul>

<sup>1</sup> Deloitte, *The Future of Productivity, a Wake-up call for Canadian companies*, Deloitte, 2013

<sup>2</sup> Conference Board of Canada, <http://www.conferenceboard.ca/hcp/details/economy/measuring-productivity-canada.aspx>, 2013

<sup>3</sup> Partnership Resource Centre (November 2006) *Partnership and Productivity in the Public Sector*, New Zealand Department of Labour

<sup>4</sup> Dan Ovsey (20 November 2012) *Ottawa wants better productivity, so why not measure its own?:* <http://business.financialpost.com/2012/11/20/ottawa-wants-better-productivity-so-why-not-measure-its-own/>

# INTRODUCTION: THE IMPORTANCE OF PUBLIC SECTOR PRODUCTIVITY

There are several reasons why public sector productivity is critical to broader economic outcomes:

1. In most countries, the public sector is the largest employer. This holds true in Canada, at the federal, provincial and municipal levels;
2. The public sector is a major service provider, particularly business services (which affect the cost of resource inputs, such as labour or technology) and social services (which affect labour quality); and,
3. The public sector consumes tax resources<sup>5</sup>

These factors mean that any changes in public sector productivity can have significant economic implications. The policy or program actions of governments can facilitate productivity gains, for example through the efficient and effective use of resources. Similarly, the opposite outcome could be achieved through waste or misallocation.

In the current context, changing demographics, particularly the ageing population, is placing greater pressure on the public sector. A basic factor related to general productivity is the proportion of the population at retirement age versus the proportion at working age. Today, Canada's over-65 population relative to those 20-64 is 23%. By 2021 it will be 31%, and by 2050 it will be 47%. This growing ratio will necessitate an increase in labour productivity if Canada is to maintain its standard of living.<sup>6</sup> As baby boomers leave the workplace, Canada's overall employment rates and hours will decline<sup>7</sup>, while demand for government services will increase. The Organization for Economic Cooperation and Development (OECD) estimates that by 2050, public expenditures in OECD countries will have increased by an average of 6% of GDP to accommodate the needs of retirees.<sup>8</sup> A 2012 Government of Canada report found that the country must plan to prepare for this challenge or face drastic measures, including significant tax increases and/or service reductions.<sup>9</sup> Time is of the essence for governments to consider developing a framework to understand, measure, and advance internal productivity levels.

## *The challenge of defining public sector productivity*

When the private sector seeks to improve its productivity, it applies commercial imperatives to reduce the costs of producing outcomes. If this should mean, for example, job rationalization or reducing its bricks-and-mortar footprint, so be it. Governments don't necessarily have the same options available to them. For example, the federal government's recent decision to close eight regional Veterans' Affairs offices resulted in widespread protests, with veterans, the media, and the public accusing the government of "betraying" servicemen and women. When policy decisions are politically sensitive, the issues become far more complex and governments are sometimes faced with making decisions that do not necessarily advance productivity in the traditional sense.

The multifaceted nature of the public sector also provides a challenge to developing productivity strategies. Responsibilities and outcomes vary from back office functions to programs, service delivery and policy development. In this context, it is challenging to conceive of a single definition of public sector productivity.

While addressing public sector productivity is difficult, it is necessary if we consider the potential impact on the next generations.<sup>10</sup> Not attending to this question now will only cause more difficult issues down the road, particularly in view of future demographic challenges. The key is to identify where efficiencies can be realized and where governments' efforts can create the conditions for public servants to deliver effective, high-quality outputs.

## *The challenge of measuring public sector productivity*

In the private sector, measuring productivity is relatively straightforward. The different outputs produced by a given firm are weighted according to their price, added to calculate aggregated output, and then divided by total costs<sup>11</sup>. In comparison, difficulties arise in the public sector because outputs are often not priced and most public services are consumed collectively<sup>12</sup>. As a result, statisticians have tended to consider outputs too difficult to quantify and have adopted the solution that public

<sup>5</sup> D. Thornhill (April 2006) *Productivity attainment in a diverse public sector*, paper presented at the Institute of Public Administration Seminar on Promoting Productivity in a Diverse Public Sector, Dublin

<sup>6</sup> Deloitte 2013

<sup>7</sup> The sheer size of the baby boomer generation (about half of Canada's labour force), coupled with declining birth rates in recent years, means their retirement will have a significant impact on workforce productivity.

<sup>8</sup> Pablo Antolin, Thai-Thanh Dang, and Howard Oxley (2011) *Fiscal Implications of Ageing: Projections of Age-related Spending*, OECD Economics Department working paper number 305

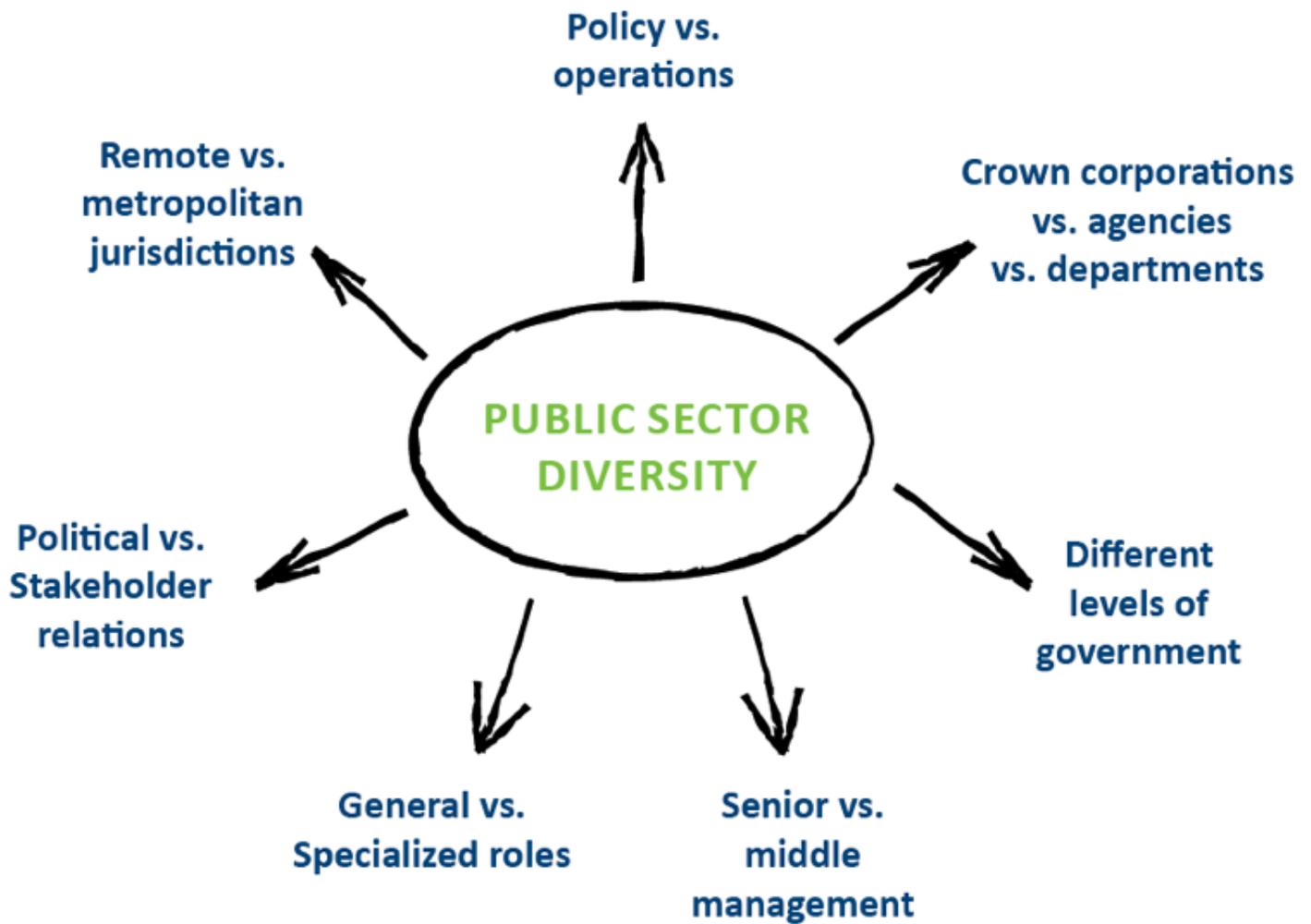
<sup>9</sup> Government of Canada (2012) *Economic and Fiscal Implications of Canada's Ageing Population*

<sup>10</sup> GDP is considered to be the most important factor in determining standard of living and productivity is critical to GDP. Given current productivity challenges and the additional challenge of an ageing population, the standard of living of future generations will decline unless productivity growth is improved.

<sup>11</sup> The London School of Economics and Political Science (2010) *LSE guide to understanding public sector productivity*: <http://blogs.lse.ac.uk/politicsandpolicy/archives/2661>

sector outputs are equal to the cost of producing them, meaning that there is a flat productivity assumption<sup>13</sup>. For a majority of countries, public sector productivity has therefore been assumed as zero in the national accounts.<sup>14</sup>

While measuring public sector productivity presents challenges, there are strong reasons to support further attention to the issue. Moreover, international examples demonstrate that it is possible to improve how public sector productivity is defined and measured; suggesting that Canada can learn from other jurisdiction, including within our own borders.



<sup>12</sup> Helen Simpson (2009). Productivity in the Public Sector. *Journal of Economic Surveys*. 23(2), p250-276.

<sup>13</sup> The London School of Economics and Political Science (2010) *LSE guide to understanding public sector productivity*: <http://blogs.lse.ac.uk/politicsandpolicy/archives/2661>

<sup>14</sup> S.Pekkola, P.Linna, J.Ukko, H.Melkas (2010) *Defining and measuring productivity in the public sector: managerial perceptions*, Emerald Group Publishing Limited

## OTHER JURISDICTION COMPARISONS

Like-minded nations and some governments in Canada are working to better understand and measure public sector productivity and are implementing workforce strategies. These leading examples can provide Canadian governments with some guidance on the issue.

### The United Kingdom

The UK Centre for the Measurement of Government Activity (UKCeMGA) was set up within the Office of National Statistics following the 2005 Atkinson Review, a yearlong study into the measurement of the UK's government's output and productivity. The review found that in the absence of final consumer prices for different types of non-market output, government has to find other ways to reflect quality. Work on public service productivity analysis in the UK is particularly focused on aspects of service quality that may change over time, and techniques for incorporating measures of quality.<sup>15</sup>

The UK uses multi-factor productivity to measure public service productivity, where the volume input measure is the aggregate of all inputs including labour, intermediate consumption and capital.<sup>16</sup> For outputs, the UK applies the principle that they should capture the 'value-add' of public services to the economy. This approach recognizes that outputs need to contribute to outcomes (for example, there would be little point in allocating public money to health treatments that do not have any impact on health).<sup>17</sup> This is a significant shift from traditional means of measuring public sector productivity, where outputs are considered to be equal to inputs. Instead, the UK accounts for quality change.

Key learning: Providing a central agency with responsibility for productivity can give focus and drive to the issue.

### The European Union

In 2001, the EU released the *Handbook on price and volume measures in national accounts*. This followed a directive from Eurostat, the EU statistics bureau, that member countries begin to produce direct volume measures on government outputs. The *Handbook* provides

directions for measuring non-market outputs (education, health, social security, defence and general public administration), using methods that are independent of expenditures on inputs.

The *Handbook* notes that although there are challenges in measuring non-market outputs (as no market prices exist), there are four criteria governments should use in creating indicators:

- They should cover all services produced provided to external users; only ancillary activities should not be counted;
- They should be weighted by the costs of each type of output in the base year;
- They should be defined in as much detail as possible; and
- They should be quality-adjusted.<sup>18</sup>

To determine quality adjustment, the *Handbook* provides three options:

- Direct measurement of the quality of the output itself: for example, a survey on the quality of public services or, for education, school inspection reports;
- Measuring input quality. This is not the preferred method, but, for example, employee compensation could be estimated such that quality changes in the workforce are included in the volume component (the sum of all inputs);
- Using outcomes: for example, if crime levels go down, this could in part be due to improved effectiveness of the police; or if the number of graduates from a university increases, while the number of students does not change, this could indicate that the university has improved its education standards.<sup>19</sup>

EU countries have had some success with these measures and have applied them most successfully to the health and education sector.<sup>20</sup> Table No. 1 outlines guidance

<sup>15</sup> Government of the UK (2006) Atkinson Review: Final Report, *Measurement of Government Output and Productivity for the National Accounts*, National Statistics, Government of the United Kingdom, Available at:

<sup>16</sup> Office for National Statistics (2007) *The ONS Public Productivity Handbook: Public Service Productivity*, Palgrave Macmillan Ltd, United Kingdom

<sup>17</sup> *ibid*

<sup>18</sup> Eurostat (2001) *Handbook on price and volume measures in national accounts* (2001 edition), Luxembourg: Office for Official Publications of the European Communities.

<sup>19</sup> *ibid*

<sup>20</sup> Peter C Smith and Andrew Street (2007) "The measurement of non-market output in education and health", *Economic & Labour Market Review*, Volume 1, No. 6, Office for National Statistics, United Kingdom

	Health	Education
Input	What the health system uses in order to provide its output.	What the education sector uses in order to provide its output.
Activities	The individual actions carried out by the health sector in delivering a completed treatment.	N/A
Output	The quantity of healthcare received by patients, in terms of complete treatments, adjusted to allow for the qualities of the services provided.	The quantity of teaching received by students, adjusted to allow for the qualities of the services provided.
Outcome	The change in health status due to health sector interventions.	Lack of consensus over what constitutes educational outcomes.

**Table 1**

provided for these sectors in the *Handbook*. However, this demonstrates some of the challenges in applying concepts across different sectors. For example, there is no consensus on what constitutes outcomes, which also makes it difficult to compare performance across EU countries.

Key learning: well developed principles are important and necessary, but application across different jurisdictions can be a challenge.

### Australia

Public sector productivity has been on the agenda in Australia since the late 1980s with governments, both conservative and liberal, focused on government reform. The question of productivity has raised many challenges, most notably how to develop a measure. Following various initiatives including those emphasizing program management and budgeting, outputs and accountability and technical outcomes with performance indicators, current efforts at the federal level are focused on initiatives which are considered to be more achievable, including:

- Reform of management frameworks – better aligning public management expectations and processes;
- Undertaking shared outcomes projects – encouraging the public sector to work across siloes to achieve outcomes; and,
- Standardization of process to get the benefits of scale – for example, ICT procurement and alignment of human resource systems.

At the state level, productivity efforts have been more successful due to the more direct link to service

delivery. For example hospital funding is based on a mix of performance indicators so quality adjustments are made, and schools funding is attached to prospective improvements for students.

In light of the many initiatives which the Australian government has already undertaken to improve public sector productivity, there are learnings which could be useful to Canada’s future efforts:

1. Productivity Commission Report on Government Services: Since 1998, the federal government has conducted a yearly assessment to provide information on the equity, efficiency and effectiveness of government services in Australia. The Review is intended to be used for strategic budget and policy planning, for policy evaluation, and to demonstrate accountability. The intention is that the Review’s data will provide incentives to improve government services by promoting transparency and informed debate about comparative performance. The services assessed in 2012 accounted for approximately \$164.7 billion, around 68.6% of total government recurrent expenditure.

While Australian officials believe that this collection of information is at the forefront of government reporting, there is some frustration in how the information is used. Through the Council of Australian Governments process<sup>21</sup>, comparisons are made of state performance however these conclusions are not always accepted by states. Moreover, states believe that the federal government should better recognize the link between performance measures and service delivery and future funding decisions should be focused on driving change in those sectors. Senior officials believe that this approach to assessing performance is one of the key things that a national government can and should have in place but in

<sup>21</sup> COAG – definition

the Australian context the feedback loop from data collection to future decision-making needs to be improved. The potential of the exercise is not currently being maximized and outside of government the Review is considered more an exercise in frugality.

2. Australian Government Efficiency Dividend: Since 1987, the government has been applying an efficiency dividend to federal government departments and agencies. The dividend is an annual reduction in funding for the overall running costs of government organizations. The justification for the dividend – which is applied at an average of 1.0-1.5% – is that ongoing increases in productivity make it possible to reduce funding and realize savings without compromising outputs. The savings are applied only to departmental funding (i.e. the costs of running a government department), not to administered funding (for government programs). The Dividend seeks to apply private sector discipline to the public sector and to encourage managers to continually seek new or more efficient ways to carry out government business.

A 2011 assessment of the efficiency dividend found that in essence that the measure is not superior to a more targeted approach to achieving productivity and in many ways it has become a part of the budget management process. Managers factor in the funding impact of the dividend at the beginning of the fiscal year and plan accordingly, so the impact on efficiency is questionable. As such, as a cost savings measure the dividend is effective but it has minimal impact on transforming Australian public sector productivity practices.

3. Persistence and engagement: Senior officials note that the public sector has spent a lot of time on techniques and methodologies to progress the productivity agenda, but with time have realized that persistence and engagement is the most important element for success. Over time, the underlying thinking about productivity has changed little but the emphasis has varied dependent on leadership views. Australian leaders therefore consider that maintaining

engagement with the government and opposition and working on how parliament holds the public service to account should be prioritized over fixations on definitions and methodologies.

Key learning: public sector productivity is challenging and requires concerted effort, attention and re-assessment over many years to make progress.

## Alberta

In December 2013, the Alberta Government released the second report of its results-based budgeting program reviews. The initiative was established in November 2012 for a three year period to review Alberta government programs to ensure that activities are aligned with outcomes, and to measure the overall effectiveness of expenditure. The Alberta Government does not intend the reviews to be cost-cutting exercises. Rather it is about finding out what works and what doesn't and adjusting business processes accordingly.

Senior government officials' note that the public service has done a particularly bad job of understanding the effectiveness of its activities and results based budgeting is trying to get a handle on this. What distinguishes Alberta from other jurisdictions is that it is not dealing with the same austerity pressures, which has led to a certain degree of complacency. At the same time the population is growing dramatically which means that there will be significant future pressures on the system with increased demands on services and infrastructure.

Reviews are not organized by traditional ministries but rather across lines of business, of which 15 lines were identified. This approach captured the connections that are required across ministries for delivery of government policies and programs, for example health care, and better identified the significant issues that arise when you are managing across multiple interfaces. Each review is driven by a team of public service officials and overseen by a challenge panel, led by a member of the legislative



assembly, which ensures that reviews are comprehensive and take a multi-sector perspective to learnings and outcomes.

Only a few years into the results-based budgeting program reviews, the public sector has identified a number of learnings, which will influence future work in the province:

1. **Efficiency versus effectiveness:** The initiative was focused on three key things – relevance, effectiveness and efficiency. One of the early wins was from an efficiency perspective. By looking at integrated lines of business, the review quickly identified tools to improve engagement across ministries, including ICT investments and communication strategies. It was much more difficult to get a handle on effectiveness. The greatest benefit to date in terms of effectiveness has been the critical awareness that has been raised across senior levels of public service and with elected officials about some of the huge gaps in information and knowledge to assess and report effectiveness. It also became evident that leaders well understood their programs and the direction of their ministry, but not long term trends fiscally and socially.
2. **Political will:** The role of the MLAs in the process has greatly improved information sharing between the public service and elected officials and underscored the importance of political will to progressing productivity efforts. Public service leaders have realized that they were not doing a good enough job in engaging with the Government and that they have a role in ensuring that all stakeholders understand the medium and long-term pressures that the province

is facing. The Alberta public sector is also considering how to unlock ways the Government can hold it accountable in a way that is sustainable in the long term.

3. **Role of central agencies:** As the initiative enters its third phase, public sector leaders have noted that the central agencies have importantly contributed to the process by challenging departments' review work. As a result, they believe that the role of central agencies should be reinvigorated to strongly lead productivity efforts and provide an integrated view of government activities.
4. **Acting on learnings:** One of the challenges that the Alberta public sector is still grappling with is how to integrate learning and results into practices so that they don't overload the system and in a way that is integrated into business as usual. Ideally, it is not about new rules and processes, nor about creating more bureaucracy, but creating a new way of working. One early proposal that is being considered is to tie findings into human capital strategies so that future public servants are better equipped.

**Key learning: a strong shared understanding of productivity objectives between elected officials and public service leaders will realise success more quickly and effectively.**



# SEEING PUBLIC SECTOR PRODUCTIVITY IN CANADA THROUGH DIFFERENT LENSES

Throughout the project, leaders emphasized that there is no single lens through which to consider public sector productivity. While there has been some criticism of the public sector's tendency to prioritize spending reductions to increase productivity, project contributors noted that sometimes efficiency needs to be the focus. At the same time, other cases suggest the focus should be more on the effectiveness or quality of outcomes. It can be difficult to measure the bottom line in the public sector because even if governments are as efficient as possible, there are often competing objectives unrelated to cost savings. The public sector has an obligation to serve the greater good, and in these instances, a different, more balanced kind of productivity lens should be applied. The main challenge therefore in the public service is in using both lenses, and not prioritizing one or the other to achieve unbalanced outcomes.

## Efficiency

There is a strong reason why governments have used efficiency to drive more productivity in the public sector: controlling spending is the most direct way to save costs. Governments have also taken this approach due to the difficulties of applying basic formulas to measuring productivity, and because service outcomes are hard to define and apply when delivery is so diverse. However, in areas such as information technology, transactional human resources, procurement, and data entry, private sector measures can be applied, and the sector should work more closely with non-government partners to apply business methodologies to improve productivity.

Service Ontario was one of the early initiatives to provide Canadian citizens with an easy, more cost-effective way to access government services. In 2004, the Government of Ontario established service centres, a website, call centres and kiosks to consolidate several previously-siloed services, including health care registration, driver and vehicle licensing, business registration and birth, marriage and death certificates. The establishment of the federal Shared Services Canada in 2011 was equally an efficiency initiative. Moving from over 60 financial systems across 100 organizations to just six was a significant achievement, and has been lauded by international partners (including Australia)<sup>22</sup> as a key indicator of productivity in practice.

In some cases, efficiency can be driven too far and is not necessarily the best outcome for government services. Some initiatives can turn out to be short-term fixes that have the contrary result of reducing long-term productivity. For example, hiring freezes create staff shortages and overwork, which can result in the most talented staff (who are the most mobile) seeking opportunities elsewhere. Governments “hollow out” and the short-term productivity boosts don't last.<sup>23</sup> Governments therefore need additional lenses through which to consider productivity.

## Effectiveness and quality

There are several areas where governments naturally want to ensure the quality and strength of their outputs, such as education, health, and national defence. When it comes to the intangible outcomes associated with these sectors, such as a good education, better hospital care, or safe air travel—things that are difficult to measure with perfect, quantitative accuracy—governments are considering how they can improve the quality and effectiveness of outcomes within existing resources.<sup>24</sup>

Many provinces are leading the way in trying to improve the quality of government services. In Ontario, two organizations are developing better data around good practice to drive better education and health outcomes. Health Quality Ontario is funded by the Government of Ontario to promote best practices that health care providers can adopt to improve the system. The organization also provides indicators and targets, and other success stories, specifically contextualized to Ontario health care. The Higher Education Quality Council of Ontario (HEQCO) is also developing measurable elements that higher education institutions can adopt as indicators of quality, with a view to improving attendance, academic records and graduation rates.

Justice on Target (JOT) is another initiative to improve the effectiveness of government services, in this case the criminal justice system. Initially, JOT was focused on reducing the provincial average number of appearances and days required to complete a criminal charge. After achieving this goal in 2011, JOT began to refine its objectives from across-the-board reduction targets to develop benchmarks that account for the complexity of individual cases, thus taking a broader effectiveness lens of justice activities in the province.

<sup>22</sup> Dr Ian Watt (September 2012) Productivity, public value and leadership, speech to the Global Access Partners Economic Review Summit

<sup>23</sup> LSE guide to understanding public sector productivity

<sup>24</sup> M.N.Baily, K.Croxson, T.Dohrmann, L.Mendonca (March 2011) The public sector productivity imperative, McKinsey and Company

### Combining efficiency and effectiveness

Any definition or measurement of public sector productivity should involve both effectiveness (in terms of the achievement and quality of outcomes) and efficiency (in terms of ratio of outputs to inputs).<sup>25</sup> In simpler terms:

- Are citizens satisfied with the type and quality of the services that they are being provided?
- Are the public dollars being invested having the desired impact?
- How could these services be provided more cost-effectively?

Governments have done considerable work assessing the effectiveness and efficiency of their activities after they have been established or undertaken. The Auditor Generals at both the federal and provincial levels regularly review government operations and provide information and advice on the stewardship of public funds, including whether government programs are being managed with due regard to economy, efficiency, and environmental impact. These reports also include recommendations for addressing deficiencies when they occur. While this process is important for assessing whether public funds are being well spent, governments could do more at the outset of initiatives to look at the productivity of activities before they start. In education and health, for example, there is potential for significant improvements. Governments could develop better analysis around the potential of future policies and programs, and “leap frog” advancements by seeking to fundamentally change outcomes with a single policy or program initiative, rather than taking incremental steps to improvement.

<sup>25</sup> Partnership Resource Centre (November 2006) Partnership and Productivity in the Public Sector, New Zealand Department of Labour



# TRANSFORMING THE PUBLIC SERVICE TO ACHIEVE PRODUCTIVITY OBJECTIVES

While the lenses of efficiency and effectiveness are very useful when considering some of the transactional activities that governments undertake, and can provide a focus for benchmarking good practices, contributors also stressed that the public sector needs to be considering ways to change the way it operates so that it can be more consistently oriented to productivity goals. To do this, four key themes emerged: relevance, approach, performance indicators and, enablers.

## Relevance

In today's constantly evolving environment, governments are under pressure to maintain their relevance by delivering good quality services and achieving difficult outcomes. Contributors agreed that productivity is important to government relevance and that there are two main strategies that can be employed – better engagement with key stakeholders and improved use of data for accountability and decision making.

## Engagement

A move towards citizen focused outcomes is a useful way through which to engage the public in productivity efforts. The popular view of governments is that they can be fixated on red tape and obstacles but if the public sector is to remain relevant and dynamic, the debate needs to shift to what works and what doesn't and putting emphasis on the front end and on user experience. Contributors agreed that the public sector should consider how to design use and usefulness into programs and processes.

Parliament is a key stakeholder that should be engaged and leveraged to provide sustained attention to reform and on improving productivity. Elected officials have a myriad of issues capturing their attention on any given day, and only a select few may have a particular interest in government reform and productivity. By designing accountability processes and productivity strategies in partnership with members of parliament, the public sector may have more success in developing initiatives that aren't dependent on election cycles.

Unions are another group which could be better engaged in productivity efforts. Unfortunately, many unions consider productivity as a means to cut jobs which makes cooperation challenging. However, there may be opportunities for the public sector to engage on a more regular basis to share information and thinking, so that productivity is not seen as the strategy of last resort when the government is in a weak fiscal position.

## Data use

Governments spend a lot of time collecting information and outcomes of government policies and programs for accountability measures. However, contributors noted that the feedback loop on using these findings to influence future decision making is not as strong as it could be. By linking reporting on expenditure to future decision making, and by learning from past experiences, both good and bad, governments can make better use of performance measures.

## Approach

Contributors agreed that it is important to move the conversation about public sector productivity from "why and why not" to "how". The time for debating the merits of a public sector that operates as effectively as possible has past, so the focus should be on approaches to improving operations.

## Leadership

The role of leaders is critical to realizing progress on productivity efforts and more than ever, the public sector is looking to its leadership cohort to work as a team. Many productivity initiatives, whether they are focused on achieving more with less or on simply working better across government to realize outcomes, rely as much on behavior as they do on process. Project contributors agreed that Deputy Minister groups can and should work differently to provide good governance and better stewardship. For example, breaking down siloes (further discussed below), depends in large part on the behavior and attitudes of organization leadership. Leaders can also shape organizational attitude towards productivity endeavors.

Another area where Deputy Ministers can be most effective is in engaging with elected officials. The public sector can sometimes be too reactive and focused on day-to-day government issues, and not spend enough time engaging and leading the conversation on public sector reform. Public sector leaders have a role to play in working with elected officials to debrief on productivity initiatives to develop understanding of why the activities are undertaken. Some contributors noted that they have seen success in tying productivity initiatives to existing government processes, such as the budget, to underscore their importance.

## Identifying lines of business

It is well understood that the public sector needs to break down siloes to operate effectively. However, in a fiscally constrained environment, departments tend more often than not to hoard resources for their own policy and program priorities. In a recent exercise to improve the effectiveness of government operations, the Alberta Government organized its assessments according to lines of business. By working across ministries it became immediately clear where information sharing could be improved, but also where efforts were being duplicated. One of the key outcomes of the exercise was identifying that departments were ostensibly in competition with each other for resources, which was contrary to realizing objectives.

## Key Performance Indicators

Canada's private sector has fallen behind many countries in significant productivity indicators such as investment in research and development, ICT and risk taking. Because of this Canada is losing talent; exports and growth are suffering. To tackle this challenge, the private sector has developed a series of key performance indicators. While the private sector is clearly different, the context is relevant and the challenges interrelated, providing a useful comparison and benchmark for the public sector. And contributors agreed that while the type of KPIs that are used in the private sector cannot be directly translated to the public service, having measures and targets for performance could positively contribute to improving productivity.

Although it will be important to acknowledge the difference between blanket indicators which can apply to all of government, and targeted indicators for specific parts of government, KPIs could have a role to play in assisting government to develop common standards. Contributors identified three areas that they considered should be a priority for performance indicators, which could be applied to many areas of government:

- Innovation with, and procurement of, ICT;
- More effective use of machinery and equipment, including through P3 procurement; and,
- Public sector use of private sector research and development.

There could be a role for the Auditor Generals or the ombudsman in developing and reporting on KPIs.

## Investment and enablers

### Attitudes to risk and innovation

Aversion to risk is a recurring theme throughout any discussions about public sector productivity. High levels of accountability and public scrutiny mean that many public servants rely on business as usual processes and are reluctant to engage in innovation. Austerity measures and recent cost-cutting exercises further influence attitudes because tolerance for failure and possible waste of public funds is low.

Contributors suggested that the public sector needs to be ambitious if it is going to break down barriers to innovation. For example, organizations could consider cordoning off a small portion of their budgets specifically for innovation activities. Importantly, the public sector would need to communicate the objectives of these funds – to make calculated risks – very clearly to the public and elected officials. Government could also consider creating an ombudsman to monitor, report and encourage public sector innovation.

More easily achievable actions to stimulate creativity include promoting interchanges between the public and private sectors to encourage exchange of ideas and practices, and doing more to develop linkages and share excellence between governments. Federal Provincial/Territorial mechanisms are a means through which jurisdictions could take advantage of experiences and lessons learnt from other governments.

### ICT

ICT is widely recognized as a leading driver of innovation and productivity. According to the Organization for Economic Co-operation and Development (OECD), ICT investments accounted for over 50% of the labour productivity growth in Canada between 2000 and 2009. In creating a smarter and more risk tolerant public service, it is important to get the ICT aspect right. Technology drives analytics and better use of business data. Canadian governments are traditionally slow adopters of ICT, due both to risk aversion and a lack of appetite to make the level of financial investment required to upgrade ICT infrastructure and skills. Unfortunately there have also been a number of celebrated failures in ICT acquisition and use, so elected officials are wary of supporting large scale and potentially transformational investment. The public sector needs to move beyond past failures, because ICT can be one of the most important contributors to productivity. Moreover, government is falling behind its partners with a slower and lower pace of investment which undermines efforts to remain relevant.

### *Political will*

In discussing case studies, contributors noted that initiatives were most successful when elected officials were engaged and supportive of public sector productivity objectives. In the Australian context, senior officials believe that they benefited from the fact that governments of different persuasions had reformist agendas. This motivated, but also supported, productivity initiatives. In contrast, while Alberta was considered to be a jurisdiction at the forefront of the productivity agenda in the early 1990s with its work on accountability reporting and measures, long term economic and political stability has led to some complacency and made it more challenging to deal with fundamental productivity issues within its system.

### *Competition*

In the private sector, competition drives productivity but contributors agreed that it was more challenging in the public sector, where governments often enjoy a monopoly on service delivery or policy and program development. However, they also emphasized that there are ways, through leadership and funding strategies, to break public sector inertia. Consider the experience of the Ontario Government, who significantly improved hospital wait times by introducing accountability agreements with hospitals that tied funding to achieving wait time targets. Where funding levers do not exist, the role of leadership is critical to providing motivation and creating a culture that is focused on achieving productive outcomes. Although the public and private contexts are very different, it doesn't mean that objectives need to be so.

### *Culture and talent*

Given the investment that governments make in services, and the importance of human capital to the productive delivery of these services, more investment can and should be made in developing the right culture to enable high performance in the public sector. For example, governments could support talented staff to pursue opportunities outside of the public sector to develop different skills and an appreciation of other sectors that can then be transferred back into the public service. The current people management structure and labour issues make it difficult to deploy human capital resources flexibly.

More significantly than commercially-oriented organizations, the key input to government productivity is human capital. In Canada, the public service represents a well-educated, professional labour force that is key to our overall productivity. Governments need to recognize that part of the productivity puzzle is how well this expensive and skilled input is applied to productive work.

### **Partnerships**

Given productivity is a challenge facing all sectors, there are lessons that the public sector can learn from private and other initiatives. All sectors could also benefit from working together more closely to advance broader Canadian productivity discussions. Governments are no longer in the business of delivering services alone. Some private and non-profit organizations now exist primarily because they can deliver government services more quickly and less expensively. Public-private partnerships (P3s) are becoming more common, whether for large

### **Economic impact of P3s**

In March 2014, the Canadian Centre for Public Private Partnerships released a 10-year study that found that P3s are significant contributors to Canada's economy, generating \$51.2 billion in direct economic output and 290,680 direct full-time equivalent jobs between 2003 and 2012.

Based on a review of public-private partnerships in operation or under construction from 2003-2012, the following cumulative economic impacts were realized over the 10 years:

- 517,430 total full-time equivalent (FTE) jobs, including 290,680 direct FTE jobs
- \$32.2 billion in total income/wages and benefits, including \$19 billion in direct income/wages and benefits
- \$48.2 billion in total gross domestic product (GDP), including \$25.1 billion in direct GDP
- \$92.1 billion in total economic output, including \$51.2 billion in direct economic output
- \$9.9 billion in cost savings
- \$7.5 billion in tax revenue to government

scale infrastructure investments or smaller social services programs. P3s can be challenging and contractually complicated, and they carry their own set of risks. But governments need to consider how they can work more closely with partners to realize better value for government investments.

Impact investing is another tool that governments could better leverage to realize social outcomes for individuals and communities more efficiently. Across Canada, governments have taken steps to support impact investment and social innovation, including:

- Social Innovation Endowment Fund (Alberta);
- Social Enterprise Strategy (Ontario);
- The introduction of hybrid corporate forms for social enterprises (British Columbia and Nova Scotia);
- Social Economy Act (Quebec); and,
- The federal Call for Concepts for Social Finance in 2012.

However, given that social investment is growing in Canada – as of May 2011, the Canadian impact investing market was estimated at \$4.45 billion and is projected to grow to \$30 billion within 10 years<sup>26</sup> – leadership from the government could realize even more significant partnership outcomes.

<sup>26</sup> Andrew Sharpe & Eric Thomson, (2010) "[New Estimates of Labour, Capital and Multifactor Productivity Growth and Levels for Canadian Provinces at the Three-digit NAICS Level, 1997-2007](#)," *CSLS Research Reports 2010-06*, Centre for the Study of Living Standards

## CONCLUSION AND NEXT STEPS

A 2013 report on productivity found that a majority of Canadian companies are significantly underinvesting in their business in comparison to competitors in the US. Canadian executives perceived themselves to have the same risk tolerance as their American counterparts, but in practice, their actions show that they are less willing to take risks. Canadian businesses are seen as being overly reliant on government support to pursue innovation, rather than taking the initiative themselves.<sup>27</sup> Recent studies have found that governments at all levels are also risk-averse when it comes to supporting or adopting innovation. Our careful and cautious approach presents significant challenges to improving Canadian productivity in both the public and private sectors.<sup>28</sup>

However, in both sectors, there is some concerted effort to address and improve productivity. Whether by adopting widespread organizational changes, such as Service Canada, or specific targeted initiatives, such as performance management reforms, the public sector is aware and focused on the need to increase productivity.

Efforts to consider public sector productivity, or Canadian productivity more broadly, understandably need to account for the Canadian economic context and the nature of our public and private sectors, including the differences in experience at the municipal, provincial, and federal levels. However, our project has demonstrated that there are valuable lessons to be learned from other jurisdictions, including within our own borders, such as:

1. The importance of providing focus and drive to this issue, perhaps through central agencies; and,
2. Developing a strong shared understanding between elected officials and public service leaders of what public sector productivity means.

Further work is clearly needed to explore the issue in greater depth, including considering where efficiency or effectiveness may be over-emphasized to the detriment of other metrics and more work must be done to advance definition and measurement. To further this important dialogue, the Public Policy Forum will be working with diverse partners to undertake a series of case studies comparing and contrasting Canadian approaches to public sector productivity. These cases will:

- Include examples from different levels of, or agencies of, government and different types of activity, i.e. policy, programs, administration, and service delivery.
- Define key factors for success that governments can apply to future activities.
- Begin to identify where governments should focus their productivity efforts.

<sup>27</sup> Deloitte (2013) *The Future of Productivity, A wake up call for Canadian companies*, Deloitte LLP, Canada

<sup>28</sup> Public Policy Forum (2012) *Leading Innovation: Insights from Canadian Regions*, Public Policy Forum, Ottawa

# APPENDIX A – PRODUCTIVITY DEFINITIONS

## Business sector productivity

Statistics Canada develops annual productivity measurements of the Canadian economy called the Canadian Productivity Accounts (CPA). To measure productivity for the business sector, broad economic sub-sectors and industries at the national and provincial levels, Statistics Canada uses two measures – labour productivity and multi-factor productivity.<sup>29</sup>

## Labour productivity

Labour productivity measures the amount of goods and services produced by one hour of labour. More specifically, it measures the amount of real GDP produced by an hour of labour. Labour productivity, or output per hour, differs from multifactor productivity in its treatment of capital and labour inputs. Labour productivity-output per hour worked-does not explicitly account for the effects of capital or of changes in labour composition on output growth. As a result, changes in capital intensity (the amount of capital per hour worked) and labour composition (percentage of the growth that comes from higher skilled workers and investment in human capital) can influence labour productivity growth.<sup>30</sup>

## Multifactor productivity

Multifactor productivity (MFP) relates a change in output to several types of inputs. It is a more comprehensive indicator than labour productivity because it incorporates all the factors that contribute to growth – capital, energy, materials, and services as well as labour. Improvements in multifactor productivity are also often associated with technological and organizational changes.<sup>31</sup>

The most common formula for calculating multifactor productivity ratio is output divided by KLEMS, or output/KLEMS. In this equation, K represents capital services, L represents labour services, E represents energy, M represents materials and S represents purchases services. For example, a car manufacturer may use the annual number of cars produced as its output and the total cost of capital, the total cost of labour, and so on, to calculate the change in output in relation to the change of the combined inputs.<sup>32</sup>

<sup>29</sup> Statistics Canada (2013) *Productivity Measures and Related Variables - National and Provincial (Annual)*: <http://www23.statcan.gc.ca>

<sup>30</sup> OECD (2013) OECD Glossary of Statistical Terms: <http://stats.oecd.org/glossary/detail.asp?ID=4819>

<sup>31</sup> Andrew Sharpe & Eric Thomson, (2010) “[New Estimates of Labour, Capital and Multifactor Productivity Growth and Levels for Canadian Provinces at the Three-digit NAICS Level, 1997-2007](#),” *CSLS Research Reports 2010-06*, Centre for the Study of Living Standards

<sup>32</sup> Tanya Robertson (2013) *Multifactor Productivity Ratio*: <http://smallbusiness.chron.com/multifactor-productivity-ratio-31922.html>



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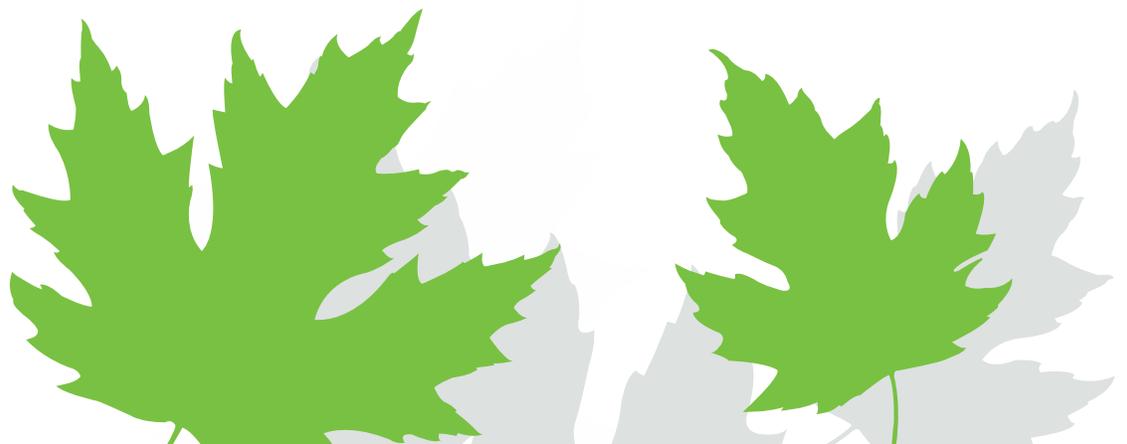
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# NOTES

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