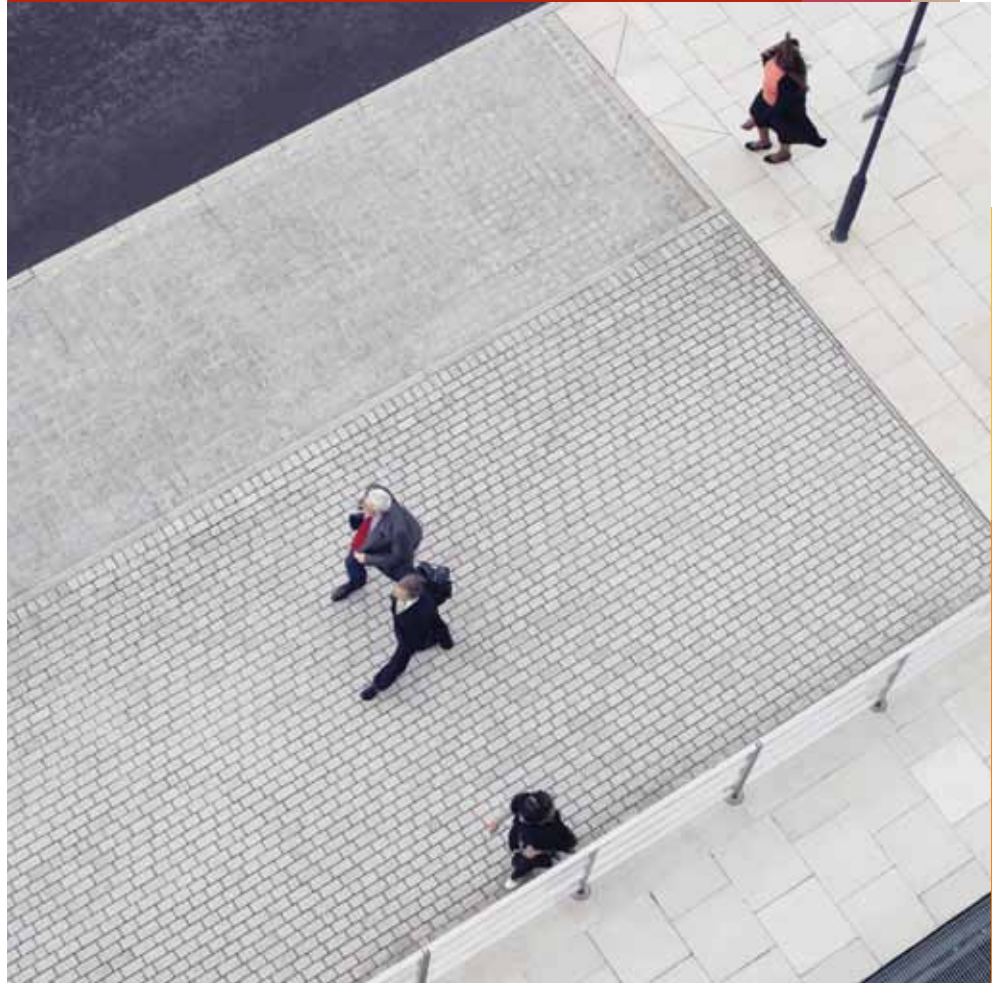


Rethinking government: doing things differently

*Government and the 14th
Annual Global CEO Survey*



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Foreword

Welcome to 'Rethinking government: doing things differently' in which we assess the changing relationship between government and business as the world emerges from the depths of global recession.

As in past years, we have extended and deepened the research for PwC's 14th Annual Global CEO Survey¹ by including a selection of interviews with senior decision-makers in governmental organisations across the world.

Our aim in doing this – and in publishing the findings here – is to understand better the implications for government policy of the views of CEOs and so contribute to mutual understanding and productive relationships between the public and private sectors.

Recovery for business – recession for government?

With global economic recovery taking shape, governments face a new set of challenges. Optimism is clearly returning to the private sector in those countries worst hit by global recession – businesses are growing steadily in many parts of the world and have stabilised operations in others. But in parallel, the public sectors in many countries are now entering recession, as governments particularly in the 'West' seek to tackle their fiscal deficits and control the spiral of public sector debt through spending cuts and tax rises.

This year's Survey suggests that there are some clear focal points for the strategic attention of private sector CEOs, particularly talent management and innovation as well as their relations with government. Many of these challenges are familiar to public sector managers who need to retain and motivate talent core to the delivery of public services and innovate their operations to deliver more for less, whatever the state of their country's public finances.

In this report, we set out the views of CEOs on the future, their priorities for government now and highlight the distinctive views of companies either with some form of government backing or with substantial sales to government.

We then go on to discuss the importance of governments and businesses working actively together to deal with a shared agenda of issues such as health and wellbeing, education and training and climate change through partnership and collaboration. We conclude with our views on how government and public sector organisations could do things differently to meet the needs of business and citizens.

We would like to thank not only 1,201 company leaders in 70 countries who shared their views with us for the CEO Survey, but also the government officials who took the time to share their thoughts with us. We are grateful to them for their cooperation and frank insights².

We look forward to a continuing and fruitful dialogue on how to create the society and government of the future for the citizens of tomorrow today, in a trusted, sustainable and more collaborative society.



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¹ 'Growth reimagined: Prospects in emerging markets drive CEO confidence' on www.pwc.com/ceosurvey

² Further details in 'Government and the Global CEO: Interviews with government' on www.psc.pwc.com

Summary

The key risk facing business – uncertain, volatile economic growth – is now integrally linked with the challenge to governments, mainly in the ‘West’, of stabilising their economies by dealing with fiscal deficits and scaling back government debt whilst avoiding punitive increases in tax.

Although the issue of uncertain growth and fiscal deficits does not apply equally to all countries, particularly in strongly growing economies such as China, India and Brazil, we were surprised by the degree of consensus internationally on the threat to business arising from the impact of fiscal deficits.

Nearly two thirds (61%) of CEOs surveyed were somewhat or extremely concerned about fiscal deficits, including CEOs in countries where governments are not undertaking major austerity measures in their domestic economies, the Middle East being the main exception. More positively, business will actively support new government policies which will promote growth that is economically, socially and environmentally sustainable – 72% agree or agree strongly with this.

How should governments respond? In our view, governments must rethink the role of the state in the 21st century, develop policies to achieve ‘good growth’ and tackle their deficits by doing things very differently, as well as doing fewer (and different) things. Governments subject to less immediate budgetary pressure will also benefit from taking a fresh look at future-proofing their activities in order to reduce the risk of facing these types of problems in years to come.

Business has clear views on the role and priorities for government. Governments have a key enabling role particularly in terms of developing infrastructure and ensuring stable capital markets and access to affordable capital. Business also recognises the role of government in reducing poverty and inequality arising from an unequal distribution of the proceeds of growth. But business is still frustrated by some of the consequences of this in terms of the burden of tax and regulation, although this is not as high up the order of priorities for CEOs’ own strategic action.

There is, however, a shared agenda where business sees a need for collaboration and joint responsibility with government on developing a skilled workforce, protecting intellectual property and dealing with the consequences of climate change. For instance, sustainable reduction of global poverty and combating climate change are amongst the most important challenges for governments. A dynamic, competitive and sustainable business sector working closely with governments is a prerequisite for successfully meeting these global challenges. Through its innovation and dynamism, business can play a key role in developing and implementing the new operating models and technologies necessary for the challenges which lie ahead.

Indeed, business is positive about the potential for collaboration, with 54% of the CEOs surveyed believing that government and business partnership will be more effective at mitigating global risks like climate change and financial crisis. This is a great starting point, but when it comes to words turning into action on key issues such as harmonisation of tax and regulation internationally business is less convinced of real progress being made by governments – less than half (40%) expect new regulations to be largely harmonised because of cooperation among governments or that tax policies and rates will increasingly converge among nations.

Collaboration needs persistent engagement – perspiration as much as inspiration. A long term view, investment in relationships and effective governance arrangements all need to be in place to realise desired outcomes. Otherwise businesses and governments risk retrenching to distrust and parochialism and investing sub-optimally in the assets they both seek to build – human, physical, social and other types of capital – which are necessary to promote growth which is economically, socially and environmentally sustainable ('good growth').

Critically, business needs governments to tackle fiscal deficits and future-proof their activities. As a consequence, governments must transform their activities and organisations and reshape their cost bases. As public sector recessions loom in many countries, governmental organisations must learn from the private sector's response to recession: cost-cutting and risk management are necessary but not sufficient. There is an equal need to maintain investments in innovation and talent management whilst being ready to enter collaborative vehicles which can deliver public services at lower cost such as joint ventures, alliances and public-private partnerships.

Of course doing things differently is not easy. It requires developing new service delivery models, innovative approaches to workforce reform, standardising, streamlining and sharing support services and seeking alternative ways to finance services including charging for activities previously delivered for free. It also requires a smarter approach to regulation and investment in real partnerships.

But all of this is necessary if governments are to emerge in better shape from the onset of public sector recession in many countries, and for all governments to be better placed to deal with the future stresses in a more integrated global economy.

Governments have a key enabling role particularly in terms of developing infrastructure and ensuring stable capital markets and access to affordable capital.

Section 1

The return to business growth

In this section, we set out the actions which businesses have taken to survive the recession and financial crisis, the views of CEOs on their state of confidence and the threats they still face.

We also highlight the differences in views of companies with a particular dependence on government, either through some form of government backing or as major suppliers to government.

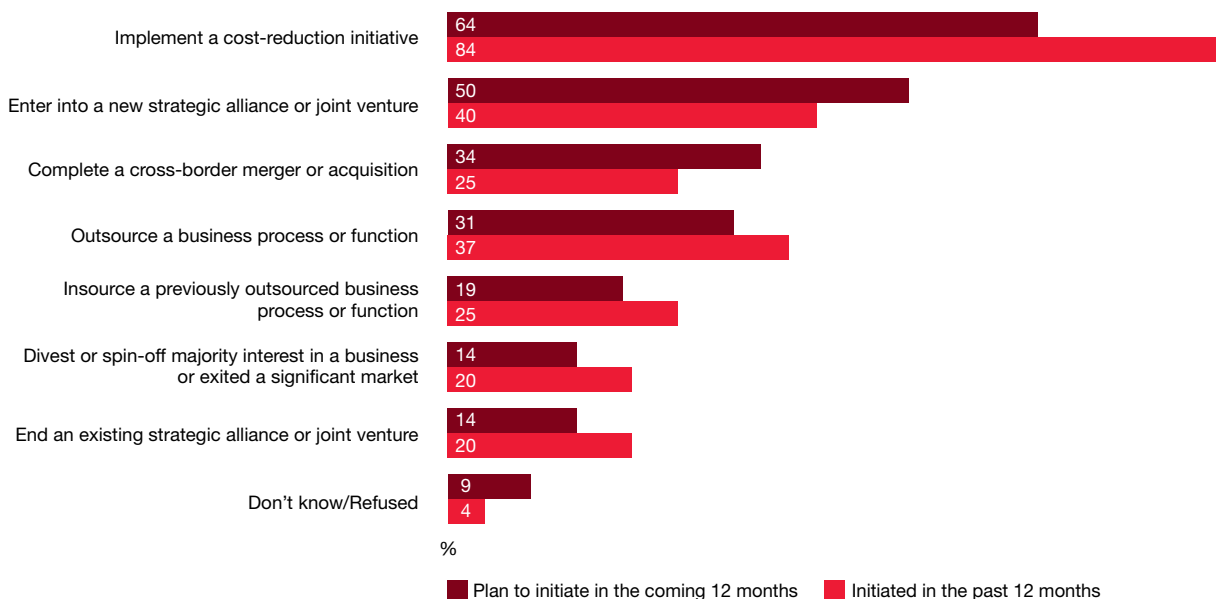
Lessons from recession

This year's CEO Survey reveals how the private sector survived recession, through:

- cost-cutting: as Figure 1 shows, 84% of CEOs responding to the Survey said that their companies had cut costs over the last year (with 35% reducing headcount) and 64% plan a cost reduction initiative in the next 12 months;
- innovating both to cut costs as well as increase revenues: this year 29% of CEOs surveyed see potential opportunities for growth through increasing market share and developing new products and services – this marks a major shift with the previous year where the number of CEOs looking to increase market share was double those looking to new product and service development for growth;
- keeping a focus on talent: 83% of CEOs have talent management strategy at the top of the management agenda for action;
- looking for opportunities to work with others more flexibly through joint ventures (JVs), alliances and outsourcing: for instance, half (50%) of CEOs interviewed plan to initiate a new strategic alliance or JV in the next year; as well as

Figure 1: Responses to recession

Which, if any, of the following restructuring activities have you initiated in the past 12 months, or plan to initiate in the coming 12 months



Base: All respondents (1,201)

- attending to risk management: 72% of CEOs are allocating more senior management attention to risk management.

These are key lessons for governmental organisations in countries entering their own public sector recessions, where public sector managers need to grasp the tough fiscal climate ahead as a lever to accelerate change. As Annette Trimbee, Deputy Minister of Alberta Advanced Education and Technology in Canada, said to us: ‘The biggest challenge that we face in this particular recession is the mood out there that this is a tiny blip and that we will white knuckle it through the next couple of years until it’s over. Our challenge is encouraging our stakeholders not to waste the crisis but to see it as an opportunity to do all the things they have wanted to do but there wasn’t the burning platform to do them.’

A recovery of confidence

Partly as a result of their actions, CEO confidence has now risen back to pre-recession levels with 48% of CEOs very confident in near term prospects

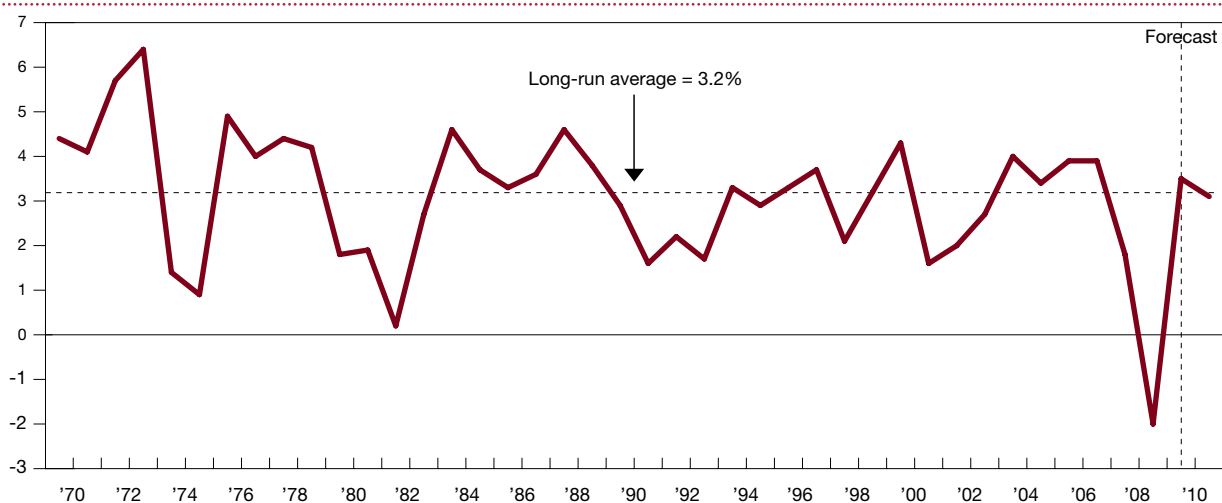
(next 12 months), close to the boom years of 2006 and 2007 (52% and 50% respectively).

This confidence is spread across all regions although Western European CEOs are the least confident (only 39% of CEOs are very confident), with their focus shifting to markets with higher growth potential outside Europe.

Growth (as measured by GDP) is also expected to have returned to its long run average in 2010 (see Figure 2). However, its composition has changed: only half the world is growing strongly. Although the IMF forecasts global growth at 4.2% for 2011, advanced economies, 52% of the world economy, are growing at only half that rate. In contrast, emerging markets are bustling, with Indonesia, India and China all forecast to grow faster than 6%³.

Figure 2: World GDP growth

% real growth



Source: IMF for 1970 - 2009 and PwC main scenario for 2010-11 (using market exchange rates to aggregate world GDP)

Threats on the horizon

But business still has many worries, as seen in Figures 3 and 4. There is anxiety about uncertain, volatile economic growth, fiscal deficits and government debt, over-regulation and increasing tax burdens as well as the availability of key skills.

Louis Camilleri, Chairman and CEO of Philip Morris International, pointed out some of the consequences: ‘When you have difficulty predicting the future, you clearly become somewhat risk-averse. So, I think if there was more predictability on tax, regulation, and currency, I think that would be an improvement. There’s just too much volatility and too many imbalances that, frankly, haven’t been addressed.’ Bob McDonald, Chairman of the Board, President and CEO, The Procter and Gamble Company, commented: ‘I know many governments think of the world economy as a zero-sum game. We don’t think of it that way. Our company, which has sales greater than the GDP of many countries, wants to do business and improve lives all over the world. The best way to do

that is to get governments around the world to work together to create economic growth.’

We will return to these issues for government attention later in this report.

The strategic response

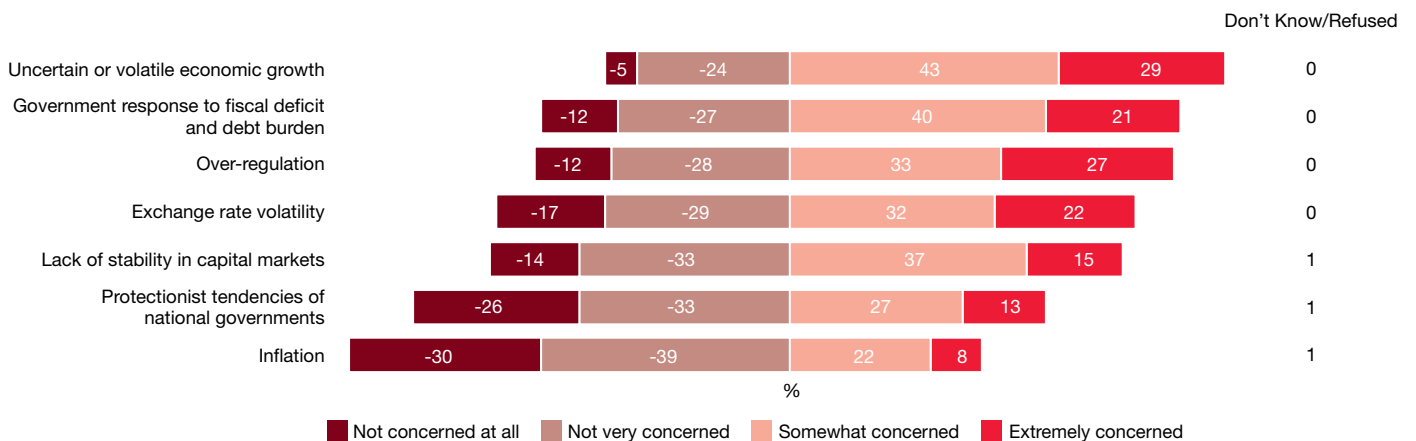
Against this background of economic uncertainty, business strategy is increasingly focusing on the twin requirements of talent management and innovation as the way to competitive advantage and growth.

Talent

The availability of key skills has risen in importance as an increasing concern in terms of its threat to business growth prospects (see Table 1). Looking in more detail at other results on talent, we found that two thirds (66%) of CEOs cited a limited supply of candidates with the right skills as the key talent challenge. The top response of CEOs to changes in the global business environment is to change their strategies for managing talent: 31% expect this to be a major change, with over half (52%) expecting some change.

Figure 3: Economic and policy threats

How concerned are you about the following potential economic and policy threats to your business growth prospects?



Base: All respondents (1,201)

Table 1: Changing concerns

How concerned are you about the following potential threats to your business growth prospects?

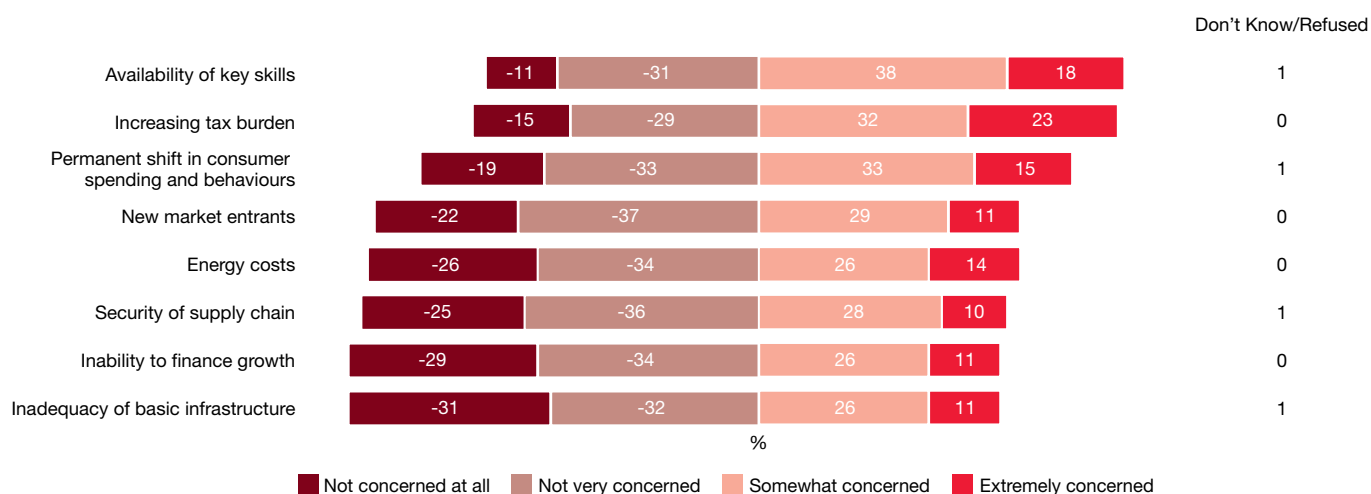
	2009% concerned	2010% concerned	Change 09/10
Uncertain or volatile economic growth (Previously protracted global recession)	65	72	+7
Over-regulation	60	60	-
Availability of key skills	51	56	+5
Exchange rate volatility	58	54	-4
Lack of stability in capital markets	59	52	-7
Permanent shift in consumer spending and behaviours	49	48	-1
Energy costs	54	40	-14
New market entrants (Previously low cost competition)	54	40	-14
Inability to finance growth	40	37	-3
Protectionist tendencies of national governments	49	40	-9
Security of the supply chain	35	38	+3
Inadequacy of basic infrastructure	33	37	+4
Inflation	40	30	-10

■ Increase of 10% or more ■ Increase of 1%-9% ■ No change or decrease

Note: Comparison of concerns only maps concerns that were asked in both 2009 and 2010

Figure 4: Potential business threats

How concerned are you about the following potential business threats to your growth prospects?



Base: All respondents (1,201)

‘43% of the CEOs interviewed expect to change significantly their strategy as consumers are expected increasingly to use mobile devices and social media to voice their needs and preferences.’

Indeed, companies are increasingly taking on a role in education. As Juha Rantanen, President and CEO of Outokumpu Oyj in Finland, points out: ‘If you think about it, many of the things one learns through formal schooling either at the vocational or university level, often become superseded by new knowledge and new technology within a matter of a few years. That’s why companies like ours have to provide their people with continuous training and education. And that’s a very valuable social benefit.’

Our government interviews revealed similar perspectives on talent. For instance, John Clarkson, Deputy Minister, Innovation, Energy and Mines in the Province of Manitoba, Canada, commented: ‘The key part about when you recover is having an adequate supply of skilled labour to be able to drive the business forward and be productive in doing so.’ Ferruccio Ferranti, CEO of Istituto Poligrafico e Zecca dello Stato S.p.A. in Italy, observed: ‘The main value is human resources, the people, those who make a business possible, who are geared towards continuous improvements, their availability to receive formative training to adapt their skills.’

Of note to governments, particularly those with ageing work forces, the main focus of CEO talent strategies is on motivating and deploying existing staff: only 11% expect significant change in their policies to attract and retain more women whilst only 10% expect increasingly to recruit and attempt to retain older workers. This seems to be at odds with the need to transform the nature of the work place, particularly in ageing societies, where there is greater need for a more flexible approach to be

taken to enable an extension of working lives⁴. It is worth observing in this context that over half of CEOs in Canada, Brazil, Middle East, India and Australia are proactive in their approach to older worker recruitment and retention.

Again, Juha Rantanen comments: ‘There’s been a lot of discussion in Finland and in Europe generally about extending careers so that people would have the option to work longer. And this is an area where companies can make a big difference because an ageing workforce requires that we keep our people healthy. So first of all that means doing all we can to avoid workplace injuries. But then we must go beyond that and try to get people to focus on keeping up their own wellbeing. Another way to extend careers is to increase job satisfaction by developing a working environment where people feel trust towards the company and their leaders. That is something we try to emphasise more and more: leaders take care of their people, so that our staff find their jobs fulfilling, and want to continue to work for us longer than they otherwise might.’

Innovation

New product and service development is cited by CEOs as equal in importance with market share as the main opportunity to grow their businesses, indicating a shift in priority towards innovation. Indeed, this is now a board level issue. Dr. Johannes Teyssen, Chairman and CEO, E.ON AG, commented: ‘For the first time in our corporate history, I’ve decided to task a specific E.ON board member with the responsibility for focusing exclusively on technology and innovation. We realise that our future success really hinges on our ability to innovate and mobilise new technology.’

⁴ See ‘The future of retirement in a transforming workplace’, PwC’s PSRC, December 2010

Customer demand and industry dynamics are accelerating the need to keep pace with technological change (see Figure 5). As an example, 43% of the CEOs interviewed expect to change significantly their strategy as consumers are expected increasingly to use mobile devices and social media to voice their needs and preferences.

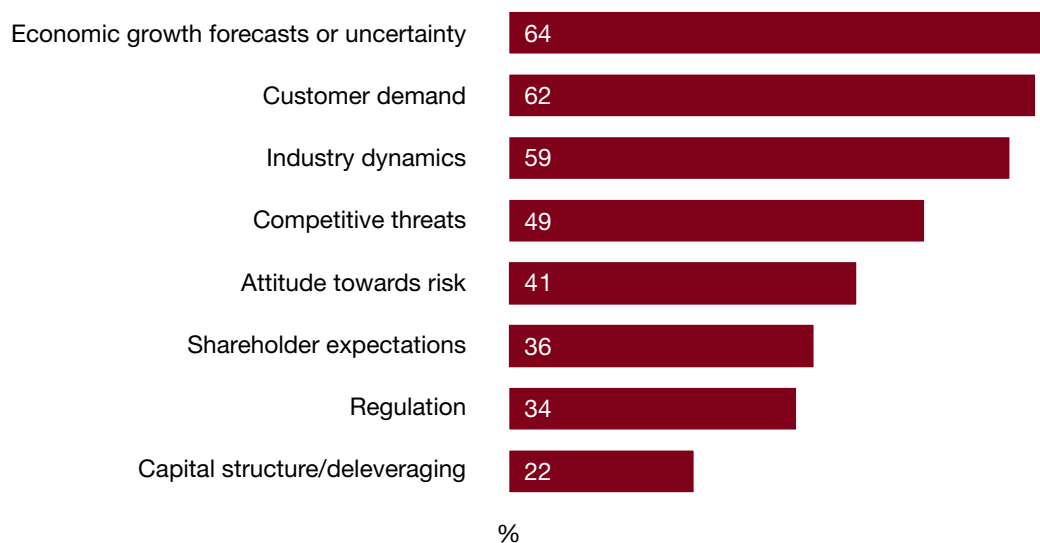
It is also of note that whilst economic growth forecasts and uncertainty, along with customer demand and industry dynamics, are significant influences on strategic action this year regulation is much less so. This is despite the fact that over-regulation is consistently an issue that is highlighted by business for government attention and was raised

again in the depth interviews with CEOs. Ed Breen, Chairman and CEO of Tyco International, stated: ‘In the US, the uncertainty generated by some of the regulation that’s been proposed or already passed has every CEO saying, ‘Why would I hire right now?’ So I think getting clarity around the application and consequences of regulation is important. Governments have to make the ground rules clear. I think regulatory uncertainty is the biggest hurdle businesses face right now.’

Perhaps this reveals that while the issue of over-regulation is always high on the CEO agenda, the current focus needed for government action is on a return to stable global economic growth.

Figure 5: Key drivers of strategic change

Of the following 8 factors that may be changing in your business, which have significantly influenced your need to change your strategy?



Base: All respondents who stated ‘changed in fundamental ways’ or ‘somewhat changed’ at Q2a (1,009)

‘For these companies where government is a significant customer, some key differences emerged from the typical responses in our Survey.’

Do businesses dependent on government have differing views?

Many of these worries, as well as the strategic responses, are shared by businesses with state backing and also those with a heavy dependence on government procurement. There are, however, some interesting and important differences which we set out below.

State-backed companies

This year, 13% of companies surveyed had some form of state backing (similar to last year at 14%). These companies include significantly⁵ more utilities, telecommunications and retail banks than the full sample of companies surveyed.

These companies tend to have a few significant differences from those completely privately owned, particularly that they are less likely either to be worried about government responses to fiscal deficits and debt or to expect the consequential spending cuts or tax rises to slow domestic economic growth. Indeed they tend to be more likely to expect to view rising debt as a growth opportunity whilst also not expecting their total tax contribution to rise. Some other significant differences are set out in Table 2.

Suppliers to government

In this year’s Survey, 15% of companies have sales to government comprising more than one third of their revenue. In our sample, these companies included significantly⁶ more companies in real estate, construction and civil engineering, medical devices and software and IT.

For these companies where government is a significant customer, some key differences emerged from the typical responses in our Survey. Perhaps of most obvious importance, these companies are more likely to expect a stronger impact from spending cuts/tax rises on growth in their export markets, are more likely to make strategic changes as a result and are more likely to expect sales to government to decline as well as less likely to expect a rise in their companies’ total tax contributions. Similarly to state-backed companies, these companies are also more likely to see these changes as a strategic opportunity (perhaps due to a better understanding of the government market where there continue to be opportunities e.g. for more outsourcing).

Other differences of views are set out in Table 3.

Conclusions

The key risk facing business – uncertain, volatile economic growth – is now integrally linked with the challenge to governments, mainly in the ‘West’, of stabilising their economies by dealing with fiscal deficits and scaling back government debt whilst avoiding punitive increases in tax.

This is similar for businesses with some form of government backing and with high sales to government, although the latter continue to see opportunities as well as threats arising from spending cuts.

We turn now to the implications of the views of businesses for the role of government.

⁵ If there is a difference of 7% or more between the results for state-backed companies compared with those for all companies in our Survey, this is statistically significant and the results are set out in this sub-section.

⁶ If there is a difference of 7% or more between the results for companies with one third of their revenues from government sales compared with those for all companies in our Survey, this is statistically significant and the results are set out in this sub-section.

Table 2: Some different views of state-backed companies

Topic	State-backed business views
Threats	Businesses with government backing tend to be more likely than our overall sample to be concerned about the inability to attract finance for growth and the availability of key skills (most significant concern). They are also more likely to be concerned about natural disasters and factoring them into plans. Over three years, they are more likely to be committed to securing access to affordable capital and critical natural resources, addressing climate change risks and improving infrastructure. Their strategies are more likely to have been influenced by their attitudes to risk, and they are more likely to have increased risk manager headcount and be re-examining their capital structure in response to risks.
Growth	These companies are more likely to expect the country in which they are based to offer low growth potential and are less likely than other companies to see China and Russia as important as growth markets, and in China's case as a source of supply as well. These businesses are less likely to have completed a merger or acquisition in the last year. They are also less likely to expect consumer focus on price and value for money to change their strategy in the next three years, although they do expect businesses' purchasing decisions to be driven primarily by price considerations.
Talent	CEOs in this category are more likely to expect scrutiny of their reward structures by regulators and/or investors but are more likely to be planning to work with government/education system to increase skills in the talent pool. They are also more likely to be planning some significant changes in setting compensation limits for executive talent and to increase the recruitment and retention of older workers as well as incentivising younger workers differently.
Innovation	There is more of an expectation that there will be government assistance to boost innovation outputs. These businesses are also more likely to see their strategies change in the next three years in response to a more active role of consumers in product and service development.
Stakeholders	These businesses are more likely to be changing their strategies in line with regulatory and stakeholder expectations, perhaps unsurprisingly as they have government as a part or full owner. They are also more likely to believe that government and business partnerships will be more effective in mitigating key global risks. Finally, they are also more likely to be expecting a major change in their focus on corporate reputation and re-building trust, perhaps to address some of the consequences of being taken into full or part state ownership.

Table 3: Some different views of major suppliers to government

Topic	Supplier views
Threats	These businesses are more likely to factor political instability into plans, presumably given the direct impact on company sales, and expect industry dynamics to be a more important factor in their strategies. They are also more likely to be allocating more board attention to risk management, increasing their commitment over the next three years to improve infrastructure and are more likely to be concerned about an inability to finance growth.
Growth	CEOs in major suppliers to government are more likely to see growth in the Middle East and are less likely to be concerned about energy costs and scarce natural resources. These businesses are more likely to have been driven to restructuring with more of them likely to have initiated outsourcing and joint ventures/alliances in the past 12 months and with more likelihood of alliances, JVs and mergers/acquisitions planned in next year (the last mentioned particularly in N America and Australasia). They also are more likely to be changing their strategy in response to consumers placing a higher priority on the country of origin for their products and to the growth of emerging market consumers.
Talent	These organisations are more likely to believe government's role in creating and fostering a skilled workforce as a priority and are more likely to increase their commitment over the next three years to create and foster a skilled workforce and work with the government/education system to increase skills in the talent pool. They are also more likely to expect key employees making career changes for personal reasons.
Innovation	These businesses are more likely to be increasing their commitment over the next three years to innovation and safeguarding intellectual property but are also more likely to expect innovations to be developed in overseas markets. They are more likely to expect government to give priority to generating innovation and protecting IP as well as more likely to expect government assistance to boost innovation. They are less likely to increase their commitment to protecting consumer interests.

Section 2

Rethinking the role of government

Two issues – tackling fiscal deficits whilst enabling growth – define the role of government from a business perspective at the current time.

All other issues, including views on tax and regulation, need to be seen from this perspective. In this section, we set out CEO views on the priorities for government action as well as areas where there is perceived to be a shared agenda.

It's the economy, stupid!

As seen earlier, fiscal deficits and the public debt burden supersede all other policy threats to the growth of business. Yet, these concerns do not spill over to protectionist worries. Last year, half of CEOs expected protectionist tendencies would increasingly weigh on trade flows and acquisition strategies. This year, just over a third of CEOs shared the concern globally. This is the lowest Survey reading in five years (Latin America is an exception, where a half of CEOs surveyed continue to

view protectionism as a serious threat). Negotiations on the Doha round of global trade talks, started in 2001, failed to reach a breakthrough over the past year, but little has actually emerged to derail the pace of globalisation. Trade flows, in fact, increased more than expected: the World Trade Organisation in September 2010 raised projections for trade growth to 13.5% for the year, reversing a 12.2% plunge in world exports in 2009.

Still, signs of protectionist policies have not gone away. In emerging economies, global imbalances are reviving concerns over volatile capital inflows, for example. Currency volatility is a growth threat cited by at least half of CEOs in all regions excepting Western Europe⁷ and North America. Consider, for example, that Brazil's trade-weighted exchange rate has appreciated 17% since 2008.

The implications of fiscal deficits and debt

The actions by governments to tackle deficits – spending cuts and/or tax rises – are expected to slow domestic growth and lead to an increased tax burden (see Figure 6). Of particular interest to governments across the world, this expectation does not vary greatly by region, with CEOs almost uniformly concerned about the impact of fiscal deficits and debt. This appears to be the case even in countries where governments are not undertaking major austerity measures in their domestic economies, the Middle East being the main exception.

⁷ Survey undertaken prior to the Euro currency fluctuations in November/December 2010

In particular, CEOs surveyed in the US appear concerned: 41% agree strongly that public spending cuts or tax increases to address rising public debt will slow domestic economic growth – this strength of view is only higher in Africa (55%). By a distance, US CEOs expect a resulting rise in their total tax contribution (42% agree strongly). As a result, half (50%) of US CEOs will make changes to their strategies.

Doug Baker, Chairman and CEO, Ecolab, expresses the views of many in the ‘West’ when he says: ‘As for government debt, the uncertainty it creates erodes the willingness and ability of businesses like ours to invest and expand. What’s the exchange rate for the Euro going to

be in six months? How are European governments going to handle sovereign debt? A third of our volume is in Europe and we care a lot about those issues because they shape the underlying economic climate there.’ Louis Camilleri at Philip Morris International appears to concur: ‘In the Western world right now, companies face too much uncertainty about what steps governments are going to take. I think our leaders, certainly in the West, have not done a great job of communicating what it is they’re trying to achieve and most importantly how it will be achieved, which adds to the uncertainty for both companies and consumers. All that adds up to a built-in restraint on spending.’

Figure 6: Impact of fiscal deficits and debt

How strongly do you agree or disagree with the following statements regarding the economic impact of large fiscal deficits and rising government debt?

	North America (148)	Western Europe (420)	Asia Pacific (257)	Latin America (221)	CEE (98)	Middle East (27)	Africa (30)
Public spending cuts or tax increases to address rising public debt in the country in which I am based will slow domestic economic growth	67	63	69	51	55	37	70
My company’s total tax contribution will rise because of governments’ responses to rising public debt	67	53	55	46	48	30	47
Public spending cuts or tax increases to address rising public debt in other countries will slow economic growth in my company’s key overseas markets	49	47	47	38	31	44	53
My company is making strategic changes because of public spending cuts or tax increases faced at home or abroad	44	35	33	30	35	26	37
My company’s sales to government will decline because of governments’ response to rising public debt	15	24	19	19	18	15	27
Governments’ response to rising public debt represents a strategic growth opportunity for my company	14	13	27	22	14	19	20

Note: Respondents who stated ‘agree’ or ‘agree strongly’

However, only a minority of CEOs expect actions to cut deficits to impact directly on their sales to government, which is perhaps to be expected given that the majority of the companies we surveyed are not heavily dependent on government as a direct customer. Indeed, as our analysis of the UK Coalition Government's Spending Review revealed (See Box 1: 'Sectoral and regional impact of the fiscal squeeze'), the impact of fiscal squeeze on sectors and regions varies considerably according to the level of dependence on the public sector supply chain.

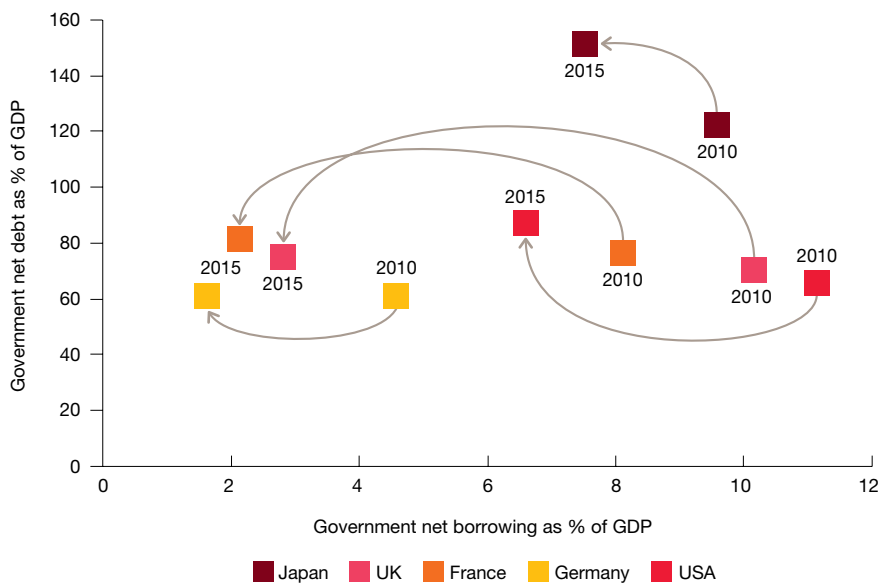
More positively, business will actively support new government policies which will promote 'good' growth that is economically, socially and environmentally sustainable at global, national and local levels – 72% agree or agree strongly with this. Indeed, as Paul Polman, CEO of Unilever, commented: 'We clearly need a business model that will help us return to growth – but growth that is equitable and sustainable for all of society. This will take political will.'

This view also seems to have resonance with those we spoke to in government. For instance, Greg Tweedly, Chief Executive, Victorian WorkCover Authority in Australia, stated: "No money, no mission" (Salvation Army). You can't do any social good without looking after the finances – similarly getting the finances right is necessary but not sufficient on its own either – the community has to benefit too. To me that encapsulates the issue: it's no good producing financially sustainable organisations if the community doesn't like what we provide...you need a balanced scorecard to ensure we serve the community at a level that they want and expect.'

Box 1: Sectoral and regional impact of the fiscal squeeze

Few of the major economies have so far matched the UK government's austerity plans (see Figure 7). PwC recently analysed the impact of UK spending cuts on sectors and regions⁸ and found that as well as the loss of jobs in the public sector (recently re-estimated by the UK's Office of Budget Responsibility to be 330,000 by 2014/15) there will be even larger losses for businesses supplying goods and services to government. We estimated a loss of 435,000 jobs in the UK by 2014/15, which would also fall more heavily on certain sectors (particularly construction and financial and business services) as well as regions with a higher dependence on the public sector in Northern Ireland, Scotland, Wales and the North of England.

Figure 7: Austerity Plans



Source: IMF

8 'Sectoral and regional impact of the fiscal squeeze', PwC's PSRC, October 2010

What are businesses' priorities for government?

It is clear that dealing with fiscal deficits and the uncertainty they cause is seen by business as their top priority for governments under budgetary pressure. But business has some other clear priorities for governments which impact directly on their competitiveness:

- Creating and fostering a skilled workforce (47% of CEOs, especially in North America, Western Europe and Central and Eastern Europe).
- Improving national infrastructure (51% of CEOs, especially in Latin America and the Middle East).
- Ensuring financial sector stability and access to affordable capital (45% of CEOs, especially in Western Europe and the Middle East).

Of these priorities, business expects government to play a lead role on financial stability, infrastructure and reducing poverty and inequality (see Figure 8).

Financial stability

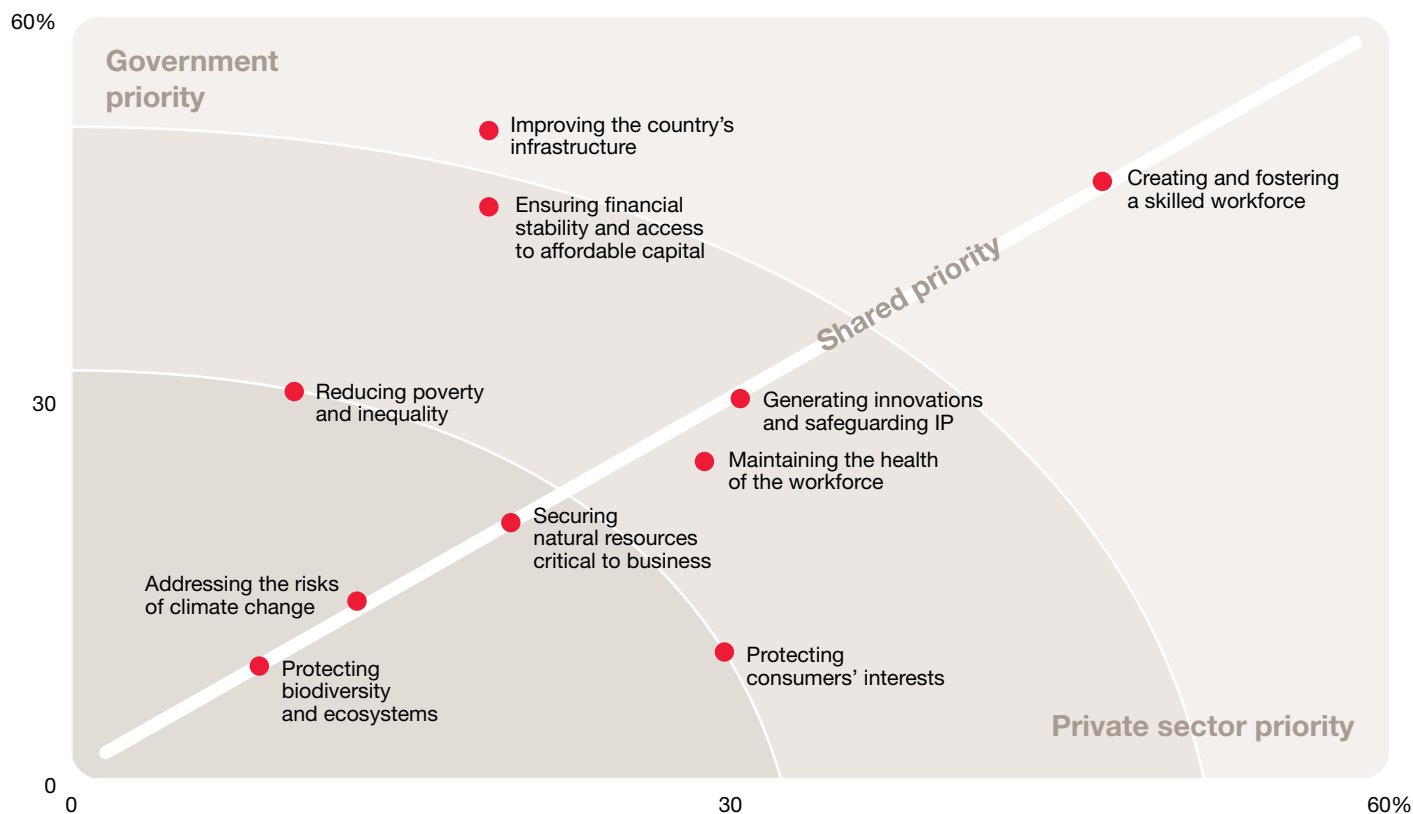
The lead role on financial stability is without question. Macroeconomic policy and regulation of capital markets are key at both supranational and national levels of government. Greg Tweedy in Australia neatly sums this up when he says: 'I see the government's role as being to stimulate when markets are failing and regulate when markets get over heated – those are the main functions of government – to give incentives to grow the market but with strong regulation where excess is a risk, whether that be in the financial institutions, the stock market etc – the policy setting is to figure out that

balance.' Nazir Alli, Chief Executive Officer, National Roads Agency in South Africa, also comments: 'Less government is not working. What we need to do is find a balance somewhere there between what one may want to term as "sufficient government".'

Business, however, does have its role to play and is in general positive about the potential for collaboration with government to mitigate global risks like climate change and financial crisis, with 54% expecting government-business partnership will be effective. But business is less convinced when it comes to harmonising tax and regulations globally – less than half (40%) of CEOs surveyed expect new regulations to be largely harmonised because of cooperation among governments or that tax policies and rates will increasingly converge among nations.

Figure 8: Who's responsible?

How much does your company plan to increase its commitment in the following areas, to improve national competitiveness and social well-being over the next three years? Which three areas should be the Government's priority today?



Base: All respondents (1,201)

Note: CEOs were asked how much their companies plan to increase commitments to achieve these outcomes; and what should be the government's priority.

The plot shows percentages of CEOs who chose each of these areas. Multiple choices were allowed

Source: PwC 14th Annual Global CEO Survey

‘The key issue remains how to best involve the private sector in funding infrastructure development.’

Infrastructure

Business clearly sees government in the driving seat for infrastructure. As noted by Gregory R. Page, Chairman and CEO, Cargill. Incorporated: ‘the role of government in creating reliable infrastructure – a power grid, transportation, an educational system – is obviously critical to establishing an environment in which commercial activity can flourish. In the absence of infrastructure, economic opportunity declines for everyone. No one company is big enough to compensate for a substandard electrical grid. You can’t run a big business on the back of a 300 horsepower diesel engine.’

However, government is also looking for a more active involvement of business. As Bertholt Leeftink, Deputy Secretary General of the Ministry of Economics, Agriculture and Innovation in The Netherlands, comments: ‘At least for The Netherlands, and I think for many other countries, planning and building infrastructure is very much in the hands of the governments. But it’s obvious that the private sector has a lot of knowledge in terms of building cheaply and efficiently or in a more environmentally friendly way. This is therefore really a topic where public and private sector partnerships can be very interesting because the different stakeholders have different knowledge and skills and different expertise to bring to the table.’

Similar views come from Guilherme Mattar, Secretary for International Relations, Sao Paulo City Hall in Brazil: ‘The challenges are undoubtedly significant. However within the context of fiscal responsibility that permeates the administration of the Municipality of

São Paulo there are opportunities to leverage partnerships with the private sector, to ensure investments and provision of services which the government might not be able undertake by itself. Those initiatives rely on the creation of opportunities to be publicised to the private sector – domestic and foreign – as well as to ensure appropriate conditions for the participation of private capitals in such projects.’ Jon Rouse, Chief Executive of Croydon Council in the UK, concludes: ‘Joint investment in infrastructure is a clear example of a potential win/win situation as businesses get fees/charges and involvement in projects can also open up wider opportunities.’

Consumer surveys in some countries also support the case for private sector involvement. For instance, in Australia a survey released by Sydney University’s Institute of Transport and Logistics (ITLS)⁹ found that transport and infrastructure remain high priority issues for Australians, and that the majority of residents think the private sector has a major role to play in infrastructure delivery. For instance, 44% of Australians said the private sector should be involved more in the provision of public transport, while 32% said the private sector should be involved less.

The key issue remains how to best involve the private sector in funding infrastructure development (see Box 2: ‘Funding infrastructure’).

⁹ The ITLS-Interfleet Transport Opinion Survey (TOPS) is a quarterly survey of Australians’ confidence about transport.

Box 2: Funding infrastructure

Given the dramatic need for investments in infrastructure, occurring at a time when many government budgets are under severe pressure, the role of private capital in financing infrastructure seems more critical than ever. Vast segments of existing infrastructure in the developed world are becoming deficient and the demand for new infrastructure in developing economies is growing. According to the World Economic Forum (WEF) report ‘Paving the way’¹⁰, it is estimated that anything up to US\$3 trillion per annum needs to be spent on infrastructure across the globe.

The scale of this infrastructure funding requirement means it is unlikely to be met solely through public finance – there is a need for governments to collaborate with the private sector and reinvigorate capital markets as a source of funding. Now is the time for governments both to re-evaluate the public-private relationship whilst also working harder to understand and manage public perceptions, which is integral to the success of any transaction as well as the broader relationship between public services and the private and voluntary sectors.

If government’s objective is to reach a sustainable investment level, then structures that lock in this cost and encourage efficient delivery are important such as PPPs and the Regulated Asset Base. Indeed, these mechanisms continue to have potential in regions with a stable regulatory structure as a method of sharing risk or financial burden as well as locking in the funding for necessary maintenance of infrastructure, which is particularly important at a time of public spending cuts.

Given the dramatic need for investments in infrastructure, occurring at a time when many government budgets are under severe pressure, the role of private capital in financing infrastructure seems more critical than ever.

Poverty and inequality

A similar point can also be made with respect to reducing poverty and inequality, where government leads but business has the key role in terms of creating jobs and wealth. As John Clarkson in Canada puts it: ‘I think if you went to industry and said to them we want you to be part of our poverty reduction strategy most of them would glaze over and roll their eyes around but if you go to industry and say...how do we engage together to ensure that population is a good source of future labour for you then you are coming at it from a different perspective. From that perspective you can start to engage employers in the components that are appropriate for them to contribute on.’

This appears to be reinforced by Paul Polman at Unilever: ‘Governments have come to their own realisation that they need a thriving and successful private sector because only business can create wealth. Government can re-distribute wealth. NGOs can advocate for specific allocations of wealth. But at the end of the day, only business can create wealth.’

¹⁰ ‘Paving the way: Maximising the value of private investment in infrastructure’, World Economic Forum, 2010

In each of these three areas – financial stability, infrastructure and poverty and equity – government has a key enabling role. This involves creating the right framework of incentives and sanctions, as set out in Box 3.

Where does business see a lead role?

There are also some areas where business believes it should lead – on consumer interests and the health of its workforce. It is a positive development to see business taking its role in both areas so seriously, particularly the health and wellbeing of employees. However, many in government might expect a shared role although this will vary according to the nature of state involvement. Tim Wiles, Deputy Minister, Alberta Finance and Enterprise, Canada, comments: ‘Going forward, probably where industry could contribute most is on wellness and occupational health and safety – as work-life balance and healthy workplaces are one of the tools organisations have to compete for labour.’

Box 3: Government as an enabler

Government’s role is increasingly seen, even in developing economies, not as one of widespread and pervasive intervention in all aspects of market activity, but as an enabling and facilitating one helping to put in place a set of incentives and sanctions to promote ‘good’ behaviours and curb market excesses.

According to Jon Rouse in the UK: ‘The government’s role is an enabling one – it can’t produce growth on its own but it can produce an environment of fiscal and financial stability. It does this by using its resources in a highly targeted way, particularly by focusing on two areas – infrastructure and skills (from early education onwards).’ Annette Trimbee in Canada has similar views: ‘Government has three roles: an assurance role (a protective role); a facilitator role; and an infrastructure role (people and buildings) and government’s role in sustainable economic growth is about looking longer term. It is about backstopping some of the risks so that businesses are encouraged to pay more attention to longer term issues.’

Our interviews with government officials revealed support for this view of an enabling role which had a number of components:

- Creating an environment of fiscal and financial sustainability with access to capital for the private sector but where finance is seen as a means to growth rather than an end in itself.
- Creating the conditions conducive to growth and the creation of jobs in the private sector, seen as a key requirement for the role of government in reducing poverty and inequality. This includes investing in infrastructure, ensuring level playing fields and fair competition and protecting intellectual capital to assist innovation.
- Establishing a regulatory environment which makes it easier to do business, with rules set at the appropriate level (internationally, nationally and locally) where compliance costs are minimised through better engagement with business on implementation.
- Taking a long term view and providing appropriate incentives for business growth in terms of tax, royalty regimes, grants and guarantees.

‘It is a positive development to see business taking its role in both areas so seriously, particularly the health and wellbeing of employees.’

A shared agenda?

In a number of other key areas, business itself sees a joint role – developing a skilled workforce, along with generating innovation and safeguarding intellectual property, securing access to natural resources and dealing with climate change and threats to biodiversity. As Agah Uğur, CEO of the Borusan Holding Group in Turkey, says: ‘High-level strategic coordination with long term competitiveness should be the focus for the government and the private sector. Let’s come up with ideas together and work together to advance.’

We discuss in more detail below the most important of these joint roles from a business perspective – education and innovation.

The role of business in education

Education is a cornerstone of any modern economy. As such, both government and business have a vested interest in ensuring the best systems possible in their countries. The opportunity for a shared role on education was revealed in our interviews with government. For instance, Dube Tshidi, CEO of the Financial Services Board, South Africa, states: ‘We need partnership on education, because the level of education in South Africa, as you know, is not where it is supposed to be. There’s a lot of people who are not so well educated. Again, you need partnership between government and business.’

The role for business is particularly well recognised when it comes to continuing development and on-the-job training. As Dr. Johannes Beermann, Minister of State, Chief of the State Chancellery of Saxony, Germany, states: ‘Improving the skill base in the workforce is crucial for a society... Modern educationalists often emphasise the need for more continuing education and this in particular is a responsibility of businesses: to provide more further education for their staff. Businesses have a responsibility with regard to education and training as well, but further education in particular is an area that needs to grow.’

The new development is that the skills and education system is becoming much more of a market with companies looking for their own education systems to best meet their workforce requirements. For instance, Tan Sri Azman Mokhtar, Managing Director, Khazanah Nasional Berhad based in Malaysia, described to us the investments being made by business directly in the education system (see Box 4: ‘Education and business in Malaysia’). Similar trends of wider participation in the educational system can be seen in other countries ranging from the charter schools in the US and free schools in Sweden to academies in the UK.

The issue becomes how to integrate private business in education and define an agreed role for the private sector. In many countries, the private sector is a new player in education and its role has grown with perceptions of a decrease in the performance of government in dealing with the issue in some areas. Government, however, has to take responsibility for creating the framework for private/public collaboration in this area.

Box 4: Education and business in Malaysia

‘Education, as we know, is a very important enabler of economic development and social mobility. There is a very strong correlation between access to education and national development. In Malaysia, we’ve been blessed with strong educational institutions over many years. However, over the past few decades there’s been a gradual decline in public education. In response, Khazanah is undertaking educational reforms in what are now known as ‘trust schools’. These schools are in the public sphere, but are nonetheless adopted and run by the corporate sector. In our case, Khazanah will be taking control of ten schools – gradually ramping up to 50 – that will be funded through public-private partnerships. Public education is a big issue and one where the private sector can fill the gaps that government often has a difficult time addressing. And it’s an issue that links back to how do we define business success, because if we don’t solve the education issue then the problem will eventually degrade the private sector’s ability to recruit a capable workforce. So this is a good example of how the state can use the strength of the private sector – which, as I said, is not just based on money, but more importantly on organisational skills and the ability to execute – to promote national competitiveness.’ Tan Sri Azman Mokhtar, Managing Director, Khazanah Nasional Berhad, Malaysia.

The role of government in innovation

Another area ripe for collaboration between business and government is innovation and the protection of intellectual capital. Governments need to foster innovation. The private sector is also asking for that kind of support even though it is not necessarily expecting government help to be forthcoming. Only 25% of the CEOs we surveyed expect government assistance (including financing, tax credits and/or technology transfer) to boost their innovation outputs.

There is huge competition internationally for investments in R&D, with China, Europe and other major regions seeking to recreate their own Silicon Valleys. The last thirty years have witnessed enormous growth in knowledge-intensive services in many countries such as green technology, financial and business services, telecommunications, health and education services.

Fostering innovation – a keystone in the foundations of a knowledge economy – is vital to creating competition and promoting growth. Yet governments face important tax, legal and fiscal considerations when deciding on their policies. Successful innovation requires, amongst other things, a focus on well functioning markets, low corporate taxes, appropriate R&D incentives, links between funding and performance and support for higher education and foreign direct investment – all areas which are priorities for government attention.¹¹

Conclusions

There is a strong degree of consensus on the threat to business arising from the impact of fiscal deficits, including CEOs in countries where governments are not undertaking major austerity measures in their domestic economies, the Middle East being the main exception.

More positively, business will actively support new government policies which will promote ‘good’ growth that is economically, socially and environmentally sustainable.

‘Only 25% of the CEOs we surveyed expect government assistance...to boost their innovation outputs.’

Beyond cutting their deficits, business also has clear views on the role and priorities for government. Governments have a key enabling role particularly in terms of developing infrastructure and ensuring stable capital markets and access to affordable capital. Business also recognises the role of government in reducing poverty and inequality arising from an unequal distribution of the proceeds of growth. But business is still frustrated by some of the consequences of this in terms of the burden of tax and regulation, although this is not as high up the order of priorities for CEOs’ own strategic action.

There is, however, a shared agenda where business sees a need for collaboration and joint responsibility with government on developing a skilled workforce, protecting intellectual property and dealing with the consequences of climate change.

For instance, sustainable reduction of global poverty and combating climate change are amongst the most important challenges for governments. A dynamic, competitive and sustainable business sector working closely with governments is a prerequisite for successfully meeting these global challenges. Through its innovation and dynamism, the business sector can play a key role in developing and implementing new operating models and technologies necessary for the challenges which lie ahead.

Indeed, business is positive about the potential for collaboration, but when it comes to words turning into action on key issues such as harmonisation of tax and regulation internationally business is still less convinced of real progress being made.

¹¹ ‘Innovation – Government’s Many Roles in Fostering Innovation’, PwC, 2010, assembles PwC’s research on a dozen countries (as well as several US states) known for their large concentrations of high-tech organisations, and reviews and analyses the specific tax, legal and other fiscal policies that governments are employing to foster innovation in their territories.

Section 3

Doing things differently

Whether responding to the need to cut deficits, or acting now to future-proof public sector activities, a combination of actions is needed by governmental organisations to reshape their cost bases.

This section sets out a framework for assessing the drivers of cost in the public sector and our views, supported as appropriate by our government interviewees, on the necessary agenda on where and how government and public sector organisations must do things very differently.

So how can government respond?

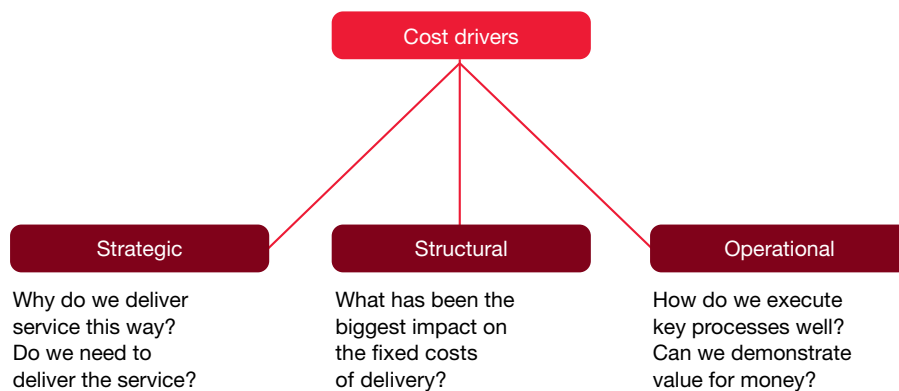
Public services, in any country, must be put on a sustainable footing for the long term. Lars Martin Klieve, City Treasurer of Essen in Germany, sees this need quite clearly: ‘Tasks that may have outlived their usefulness will come under scrutiny and we will no longer provide them. This examination must be all-inclusive and not just selective. A consolidation of public finances must affect the whole range of public responsibilities.’

All taxpayers want and expect public money to be spent more effectively and efficiently, to deliver services to as high a standard as possible within the budgets available. This often means doing things differently, as well as doing fewer (and different) things.

For those with the greatest risks from debt and fiscal deficits, the objective must be to find ways of doing things which realise cashable savings, are sustainable over the medium and long term and which put the citizen and service user front and centre in the debate. Even those not facing immediate pressure of budget cuts can benefit, however, from careful ongoing scrutiny of their cost base.

Figure 9 shows the three major cost drivers of public services and provides a framework for any public body seeking to reduce its costs, whilst Box 5: ‘A diagnostic for governments’ (overleaf) provides a simple checklist of the key questions any public service leader needs to ask about their organisation.

Figure 9: Cost drivers in the public sector



‘There is a range of ways in which governments can do things differently and meet the needs of citizens and businesses alike.’

Box 5: A diagnostic for governments

Strategic questions

- Is the activity essential to meet government priorities?
- Does the government need to fund this activity?
- Does the activity provide substantial economic value?

This might include looking at options for the public doing more for themselves as well as government stopping doing things completely.

Structural questions

- Can the activity be targeted to those most in need?
- Can local bodies as opposed to central or federal government provide the activity?
- Can the activity be provided by a non-state provider or by citizens, wholly or in partnership?
- Can non-state providers be paid to carry out the activity according to the results they achieve – payment by results?

This might also include looking to provide many more services online or through other cheaper delivery channels shared across public agencies.

Operational questions

- How can the activity be provided at lower cost?
- How can the activity be provided more effectively?

This might include reducing spending through outsourcing, standardising, simplifying and sharing routine services and boosting staff productivity.

In last year’s report, we stated ‘Efficiency improvements will be necessary, but not sufficient on their own to fill the fiscal gap. It will also mean revisiting the role of government, stopping some activities, prioritising some areas over others and re-designing service delivery.’¹² Bertholt Leeftink in The Netherlands expresses the sentiment of prioritisation this year when he says: ‘What we in The Netherlands have tried to do, I would say rather successfully, is to rule out spending cuts on public investment as much as possible. Indeed, we have even spent more money on certain areas such as innovation and green projects because we think it’s crucial for the future strength of the Dutch economy.’

There is a range of ways in which governments can do things differently and meet the needs of citizens and businesses alike. We believe there are six key actions for any government and public sector organisation:

- Develop new approaches to workforce reform and managing talent.
- Innovate service delivery.
- Standardise, streamline and share support services including deciding whether to make or buy.
- Fund services in different ways.
- Partner and collaborate more effectively
- Regulate in a smarter way.

We set out our views for each of these action areas overleaf.

¹² ‘Rethinking and reshaping the business environment: Government and the Global CEO’, PwC’s PSRC, January 2010

Develop new approaches to workforce reform and managing talent

When budgets come under pressure, it is inevitable that the costs of the public sector workforce must be reduced, as labour costs are usually the largest part of the cost base. However, expensive redundancy programmes are not the only way to achieve this.

The reflex approach of public sector bodies to efficiency drives and spending cuts has traditionally been to start by getting rid of secondees and contractors, then relying on recruitment freezes and natural wastage to reduce numbers as far as possible and introducing redundancy schemes to deal with the bulk of the problem.

This approach reduces headcount, but it:

- costs a lot of money in the form of redundancy payments and consequently intensifies pressure on other spending in the relevant year;
- means that the remaining staff members are not necessarily those needed for the future; and
- has potentially significant negative social and economic knock-on effects, by making people unemployed without equipping them to find new employment.

In this context, Sir Robert Naylor, Chief Executive of University College London Hospitals NHS Foundation Trust in the UK, warns that talent management is too important an issue to get wrong: ‘No matter what fantastic buildings and equipment and facilities we have, we are fundamentally a people business. The organisations that will succeed most in the future will be those that really focus on their people, how they get the best out of their people, how they invest in them, how they communicate well and how they inspire their people to do the best they can.’

In our view, governments need to be more active in planning their workforce strategies and retaining key talent. Where workforce reduction is necessary, it needs to be managed in a way which minimises the impact on unemployment by reskilling and redeploying displaced public sector employees. Governments need to develop innovative workforce reforms such as:

- Developing partnerships with private sector manpower providers to performance manage and retrain staff, to find new employment for them where possible, and to manage redundancies where it is not.
- Redesigning national public sector pay structures so that they relate to the skills and experience needed to deliver services at local/regional level rather than reflecting organisational hierarchies. More flexibility in terms and conditions locally may also enable businesses (such as outsourcers) to relocate activities to areas where there are people with public service skills looking for work.

Quick wins on pay costs can also be delivered through arrangements for voluntary reduced working hours (as introduced by many private sector employers over the past two years) and holding back increment-induced pay inflation.

Innovate service delivery

Public sector leaders must challenge their existing service delivery models to ensure that they are really delivering value for money at all times. There are numerous examples of services being rethought, from personal budgets being given to the elderly to buy their own care to the police working with local communities to make their local streets safer. Indeed, radical devolution of power and responsibility can produce better outcomes for much less money.

We believe that it is critical for public services to be designed around the needs of users, not based on traditional professional boundaries and ways of working. Redesigning services can both cut costs and improve outcomes. Box 6: 'New approaches to service delivery' sets out a framework for redesigning services.

In addition, whether resources come from the public, private or third sectors is a secondary issue; what matters is the service delivered to citizens. As Ken Smith, Director-General, Department of the Premier and Cabinet in Queensland, Australia, observes: 'There are many opportunities for the private sector to participate in a range of human services.'

Business has participated very strongly in those service areas which can be commercially oriented e.g. airports can be owned and operated by the private sector and function really well. The issue for governments, particularly in an era of controlling government debt, is why you'd have capital tied up in facilities that will still be provided irrespective of whether you own them or not – and whether the role of government is then more about quality assurance than direct provision.'

Box 6: New approaches to service delivery

A framework for redesigning service delivery models through greater citizen involvement is shown in Figure 10. This sets out the different types of roles the state and the citizen might play in both designing services, on the one hand, and directly delivering them on the other¹³. Within the box, there are three extreme positions, running diagonally from the top-left to the bottom right hand corner:

- In the top left hand corner is the classic professional public service model, where the professional monopolises design and delivery.
- At the centre is a 'pure coproduction' approach, in which users and professionals take more or less an equal role in both the design and delivery of the service.
- In the bottom right hand corner is 'pure community self-provision', where the state plays no role and the community or citizen (or business) does things for themselves.

Figure 10: Different roles for the user and the professional in the design and delivery services.

		Responsibility for service design		
		Professionals are sole service planner	Professionals and users/community as co-planners	No professional role in planning
Responsibility for delivery of service	Professionals as sole service deliverer	Traditional professional service provision	Professional provision but with communities/users involved in design	Professionals as sole deliverers
	Professionals and users/communities as co-deliverers	User co-delivery of professionally designed services	Full co-production	User/community delivery with little professional
	User/communities as sole deliverers	User/community delivery of professionally planned services	User/community delivery of co-planned services	Self-organised community provision

Source: Boyle and Harris 2009, p.16.

13 'Capable Communities: Citizen-Powered Public Services', PwC's PSRC, November 2010

Ken continues: ‘What we are seeing is governments re-assessing their role in terms of what they can and can’t do in the current environment and going back to first principles to resolve difficult problems they haven’t had to face before.’

There is therefore a need to challenge the traditional boundaries between the public sector and other sectors of the economy in service provision. Whilst there has been much debate about this, it has in the main been limited to two specific areas: greater involvement of the private sector in providing back office services; and the potential involvement of a third sector in providing services which touch individual citizens e.g. the unemployed, vulnerable or offenders.

But new technology also opens up new avenues for innovation. For example, could many more government services be provided online? As the public gets used to shopping and banking online, barriers to moving radically in this direction are reduced and the efficiency dividend could be substantial. For instance, the combination of telecommunications and healthcare has opened up the space for telecare solutions which in turn enables a potential transformation in patient care. The key point is that such possibilities will not even be considered unless traditional boundaries are challenged.

The result is a need for a new type of capability in government – one described by Danilo Broggi, Chief Executive Officer of Consip S.p.A., in Italy as ‘strategic flexibility’. ‘Innovation is not an aim but an instrument. It is a cultural process; it takes time, requires effort, perseverance and determination... We need to be very innovative, must be all-rounded, in search of constant modernisation for processes and activities. Today flexibility is really a strategic flexibility. We must be able to evolve or quickly develop a strategic framework to direct our strategies even in case of abrupt changes. And then you have to be flexible on the whole, so to be somehow able to even break the paradigms of the past. I believe that innovation and flexibility are two important components of today’s reality if we still want to be competitive.’

Innovation should also not only be seen in the context of the need for transformation but also for continuous improvement. As Paul Polman of Unilever states: ‘People tend to see innovation strictly in terms of revolutionary, breakthrough products – technologies to sequester carbon emissions or microchips that can process data 600 times faster. That’s fine. But most innovations are the result of steady, continuous improvement.’

Importantly, innovation can be assisted by unlocking the potential of commissioning models across government. In particular, by providing business with the right incentives and aligning profit with the needs of society, it is possible to achieve a wide range of policy goals. A simple example from our interviews was to design in requirements for energy efficiency into new buildings when commissioning new construction projects.

‘...by providing business with the right incentives and aligning profit with the needs of society, it is possible to achieve a wide range of policy goals.’

Standardise, streamline and share support services

The scope for potential savings in the back office is well known, but often little progress has been made because:

- The subject has rarely commanded the attention of senior managers in the public sector.
- No real attempt has been made to standardise and simplify many repeated processes (such as benefit payments) across the public sector – the essential precursor to making them more efficient.
- Most organisations have only looked at the issues within their own boundaries – whilst there are some shared service organisations in operation, they cover only a fraction of the whole territory.

In our view, there should be a clear expectation on all public sector organisations that they will drive down their back office costs through mandating more standardised and simplified processes across the public sector, creating a contestable market for support services (with a range of private and public sector suppliers) and separating existing public sector shared service operations from their customer organisations.

This also applies across organisations within the public sector. For instance, Lars Martin Klieve in Germany points out: ‘Governments in my area of responsibility are municipal governments and for these I can see a wide range of possibilities. Almost all of the tasks we have to perform need to be performed by other cities and municipalities as well. Tasks in areas where there’s less and less personal involvement and which will become more and more paperless, such as accounting, and where it doesn’t matter where the server is located and where scanned documents are processed, can be performed by shared service centres for several municipalities.’

More also needs to be done to increase the inter-operability of standards, systems integration and enable single points of contact to be established within and across public services. Our interviews with two state-owned companies in Italy provided some examples.

- Ferruccio Ferranti pointed out how their approach to identity management is yielding benefits by providing individuals not only with a mechanism for crossing borders but is also allowing access to local services such as children’s canteen services, libraries and registry offices, with the potential in future for electronic payment services: ‘It’s a matter of creating a net that, through a reliable identification of people, will open the doors to the services to which you are entitled.’
- Marco Cuccagna, General Manager of Equitalia S.p.A. explained to us the opportunity of a development which will ‘bring all our information system on the open source platform, so to allow companies to have interconnectivity, switching application with the minimum cost and full reusability for all the users who come into contact with our company.’

Finally, the strategic decision needs to be made as to whether to provide services in-house (‘in-sourcing’) or outsource them in areas like IT, HR and financial management. But the decision to make or buy is also moving beyond the back office. An example of a hospital in the UK’s National Health Service demonstrates the point: ‘The reality is that we now only run part of what was traditionally seen as the hospital business, that is the direct patient care side. Virtually everything else, all the support services which used to be run directly by the public sector are now run by private sector organisations. That’s pretty unusual and you won’t find many other hospitals in the country that have gone to the extent that we have’, commented Sir Robert Naylor.

‘More also needs to be done to increase the inter-operability of standards, systems integration and enable single points of contact to be established within and across public services.’

Fund services in different ways

There is a need to take a fresh look at how services are funded. One key area to consider is that of charging. Public sector organisations in most countries already charge for some of the services they provide. Whilst there may well have been (and continue to be) good reasons of public policy for providing services free of charge, charging for public services may be a way to 'share the pain' when cuts in spending need to be made.

Canada had to face the challenge of fiscal consolidation in the 1990s, and this year's interviews demonstrated a continuing willingness to be radical. 'As we continue to face fiscal challenges those things [charging for services] will come onto the table for consideration. How far we go with them is hard to say but I look at some of the municipal services and there is clearly a trend there in terms of charging for services' says Tim Wiles. John Clarkson adds: 'I think every government will look at mechanisms for how they recover the direct costs of what they are doing and demonstrate the value for that in some sort of fee category and we will do that too.'

It will make a different accountability structure around those services – we will have to demonstrate value before they are willing to pay for those services.'

We believe it is time for public authorities to ask whether there any services currently provided for free where charging would be appropriate, whether charging could be introduced e.g. to manage overall demand for a service, or differentiated e.g. charging for 'premium' elements of a service like fast turnaround. In all cases, there is a need to ensure that charges are set at the right level to cover fully absorbed, rather than simply incremental, costs. Box 7: 'Charging ahead' sets out the key questions to be asked.

As well as charging, there are other ways being developed to fund services, ranging from Tax Increment Financing to bond finance, such as Social Impact Bonds. Each of these mechanisms is seeking in different ways to bring forward funds from the private sector in return for payments in future, increasingly linked to the successful delivery of outcomes.

Partner and collaborate more effectively

Independent of the fiscal context, businesses and governments need to improve their relationships and invest in collaboration and partnerships. As Bob McDonald of The Procter & Gamble Company comments: 'To the degree that governments around the world can work together and provide greater certainty, I think that would really provide more hope and more willingness to spend and invest.' Our interviews with government this year show there are many opportunities to collaborate, across areas from education and housing to health and wellbeing to climate change. Yet there is a need to overcome the distrust that has often manifested the relationships between business and government.

Our private sector interviews are also anticipating a new relationship: 'In response to the economic crisis, we can expect to see more re-regulation and an increased role of government in business over the next few years. At the same time, governments now understand more than ever that business is their partner in finding solutions to economic and social problems. Governments have seen that business can bring important capabilities to the table,' says Paul Polman of Unilever.

Box 7: Charging ahead?

- Are there any services currently provided free of charge where charging would be appropriate?
- Should charging be introduced to manage overall demand for a service, or to shift it in time, or to make users bear the costs of expensive methods of accessing the service (e.g. face to face rather than online)?
- Is there scope for charging for 'premium' elements of a service (e.g. faster turnaround; face-to-face delivery) whilst the 'basic' service is provided free, or for a modest charge?
- Where charges are made, are they set at the right level?
- How do they compare with the charges made by other bodies for similar services?
- Do they cover fully absorbed costs rather than simply incremental costs?

Business, however, needs not only to hear the rhetoric of collaboration but to see action including through a more active role by government as a customer in product and service development. As Mark Frequin, Director-General, Housing, Communities and Integration at the Ministry of Housing, Spatial Planning and Environment in The Netherlands puts it: ‘The main track is, ‘Let’s find new balance between market activities on the one hand and government activities on the other hand,’ knowing that we need the cooperation of the two. We have found out that you can gain both and then the market parties can tell that they are fulfilling a very essential role in terms of society. We now define very precisely what is the objective, what is the role of every partner, and then you get real partnership.’

We believe a new deal is therefore needed between business and government achieved by:

- Identifying win/win propositions which are good for both business and the community, and are sustainable over time.
- Establishing the common ground between the public and private sectors and sharing risks in a proportionate and equitable way.

- Creating effective governance, clear accountability for design and delivery of services and clarity on the respective responsibilities of the public and private sector.
- Investing in relationships and taking a long term view, working more as partners than as transactional purchaser/supplier.
- Recognising that each party brings different skills and expertise to any deal, which need to be complementary if collaboration is to succeed and requires willingness to compromise and recognise the strengths, and weaknesses, on both sides.

This also applies to procurement where a more collaborative approach is needed both within government (to achieve better deals for public spending with the private sector) and through the commissioning process (to achieve policy outcomes e.g. by building sustainability into investments in new infrastructure).

Finally, it is important to note that the need for collaboration applies not only to the relationship between business and government but also within government itself.

Regulate in a smarter way

Given the frustration shown by business for the way in which it is regulated, there is also a specific real need to deliver on better collaboration and partnership with respect to regulation. Part of this is an ongoing need for more policy stability and transparency. As Greg R. Page of Cargill. Incorporated states: ‘Greater transparency, even-handedness and consistency in the direction of policy would be very helpful. When the direction of government policy is consistent and predictable, business can adapt its behavior as required. What’s troublesome are these zig-zags in government policy that can leave a company like Cargill at the risk of being caught out in a totally unexpected – and unfair – way.’

Evgeny Dod, CEO of RusHydro, made a similar point: ‘The relations with investors, legislation and rulemaking procedures should be predictable and long-term, in order to avoid any changes during the timeframes of any of our projects. As renewables, and primarily the hydropower industry, have a long-term investment cycle it may take decades to build a large station. It is obvious that, with changing conditions, investment risks increase, and the probability of joining this or that project decreases.’

In last year’s report, we set out some of the principles which need to be addressed if regulation is to become smarter (Box 8: ‘Smarter regulation’).

Box 8: Smarter regulation

Many of the principles of better regulation are well known: regulation needs to be proportionate, accountable, consistent, transparent and targeted. In our view, the key principles underpinning a smarter approach to regulation are as follows:

- ‘Think global, act local’ – define the right rules to underpin success in a modern global economy, tailored to the national and local context.
- Fair reciprocity – it is not enough to define a transparent set of rules, but to implement them in a fair and reciprocal way.
- Outcome-based – focus on outcomes, not purely process, and make judgements on results, not just box-ticking.
- Clarity and stability – ensure that the rules for regulation are clear and not subject to constant tinkering and change for change’s sake.

This approach is still needed – the challenge is for government to change its way of working to make this a reality. John Clarkson illustrates the point from his experience in Canada: ‘Why does a company have to go through three layers of government to get all their regulatory issues dealt with, why can’t they go to a one stop shop that can deal with it all? We’ve designed ourselves based in silos and now we’re getting a much different view of government – it’s not about how services are delivered but about how people want to access the services. That’s going to drive the change that needs to take place to get governments into a more collaborative mode that requires better understanding and sharing and more common practices across governments – it’s a cultural change.’

The key, as ever, is persistence and a willingness to engage in a proactive way with business, particularly on the implementation issues associated with any regulatory change. ‘Local level style of engagement with the private sector is important,’ according to Greg Tweedy in Australia. ‘That’s been the nature of the political environment in Australia for the last few years: change led by government but with levels of engagement with business increasing such that if change is contemplated, engagement is significant and constant to ensure that the private sector point of view is taken into account.’

Governments also still need to tackle competing regulations at different levels – national, state and local. As Tim Wiles in Canada puts it: ‘Regulatory reform is a big plank of competitiveness. We are trying to streamline regulatory processes as much as possible, without getting in industry’s way too much but at the same time keeping an eye on the stewardship of our public lands [...] regulations are getting layered on top of each other [...] To the extent we can, we work with our partners in other levels of government to reduce complexity but it is hard work to undo the past and there are areas where the jurisdictions are fuzzy between federal and provincial, and between provincial and municipal.’

Conclusions

Critically, business needs governments to tackle fiscal deficits and future-proof their activities. As a consequence, governments must transform their activities and organisations and reshape their cost bases. As public sector recessions loom in many countries, governmental organisations must learn from the private sector’s response to recession: cost-cutting and risk management is necessary but not sufficient. There is an equal need to maintain investments in innovation and talent management whilst being ready to enter collaborative vehicles which can deliver public services at lower cost such as joint ventures, alliances and public-private partnerships.

Of course doing things differently is not easy. It requires developing new service delivery models, innovative approaches to workforce reform, standardising, streamlining and sharing support services and seeking alternative ways to finance services including charging for activities previously delivered for free. It also requires a smarter approach to regulation and investment in real partnerships.

Collaboration needs persistent engagement – perspiration as much as inspiration. A long term view, investment in relationships and effective governance arrangements all need to be in place to realise desired outcomes. Otherwise businesses and governments risk retrenching to distrust and parochialism and investing sub-optimally in the assets they both seek to build – human, physical, social and other types of capital – which are necessary to promote growth which is economically, socially and environmentally sustainable.

‘A long term view, investment in relationships and effective governance arrangements all need to be in place to realise desired outcomes.’

Section 4

Growth at any cost?

As well as doing things differently, governments need to continue to support wealth creation. This section sets out some views emerging from our interviews in the public and private sectors on the type of growth needed and some implications for governments.

Is all growth good?

Businesses look to governments to create the conditions for growth through effective macroeconomic policies. ‘It is very important both in Europe but also in the US and in other parts of the world that we return to the well-known, sound principles of macro-economic policy,’ says Bertholt Leefink in The Netherlands, and continues: ‘Deficits which are not too high, debt ratios which are not exploding, interest rates that are not too low, exchange rates that are in line with underlying competitiveness, a wage policy where wages develop in line with underlying

productivity and so on.’ Lars Martin Klieve in Germany also sees this need quite clearly: ‘The first step of fostering financially sustainable growth is budget consolidation, i.e. to restore to normality excessive national deficits that are only justified during a financial crisis, so that in future crises or recessions the government can be actively contributing to growth. This is the central task required of the government.’

The call from our interviews in both the public and private sectors is increasingly for this growth to be sustainable economically, socially and environmentally. John Clarkson in Canada is clear: ‘You can’t approach any one of these things [financial, social and environmental sustainability] independently... developing people, developing the community, delivering in an efficient manner and protecting the environment have to be considered together to be considered to be sustainable. There is a lot more consciousness today of those things working together.’

Over time, however, growth and value seem to have become de-coupled. Lars Martin Klieve in Germany has a further interesting perspective on this. ‘I have learned that profits need to be validated in the long run first before they can be called profits. Profits need to be sustainable too.’ Nazir Alli in South Africa asserts: ‘We’ve got to become a bit harsher and hold people accountable for their actions...It will become more responsible in the sense that we will take the larger interests of society into account as well, as opposed to just what one may call our shareholder value. Through that, I think we will end up with a sustainable growth.’

‘Our GNP...measures everything, in short, except that which makes makes life worthwhile’.

John F. Kennedy

In our view, there is a need to develop policies promoting ‘good growth’ - growth that is economically, socially and environmentally sustainable at global, national and regional levels.

An asset-based approach to growth

A starting point for such an approach is to consider the framework for investment in the assets or ‘capitals’ needed for any economy to prosper in the long run, adopting a similar approach to that which we advocate for city managers (see Box 9: ‘An asset-based approach to economic management: lessons from cities’).

Greg Tweedly in Australia summarises as follows: ‘Sustainable growth is essential but growth getting ahead of itself created excesses that led to downfall.’

Box 9: An asset-based approach to economic management: lessons from cities

‘The more well-balanced a city is for both businesses and residents, the better it will fare’.¹⁴

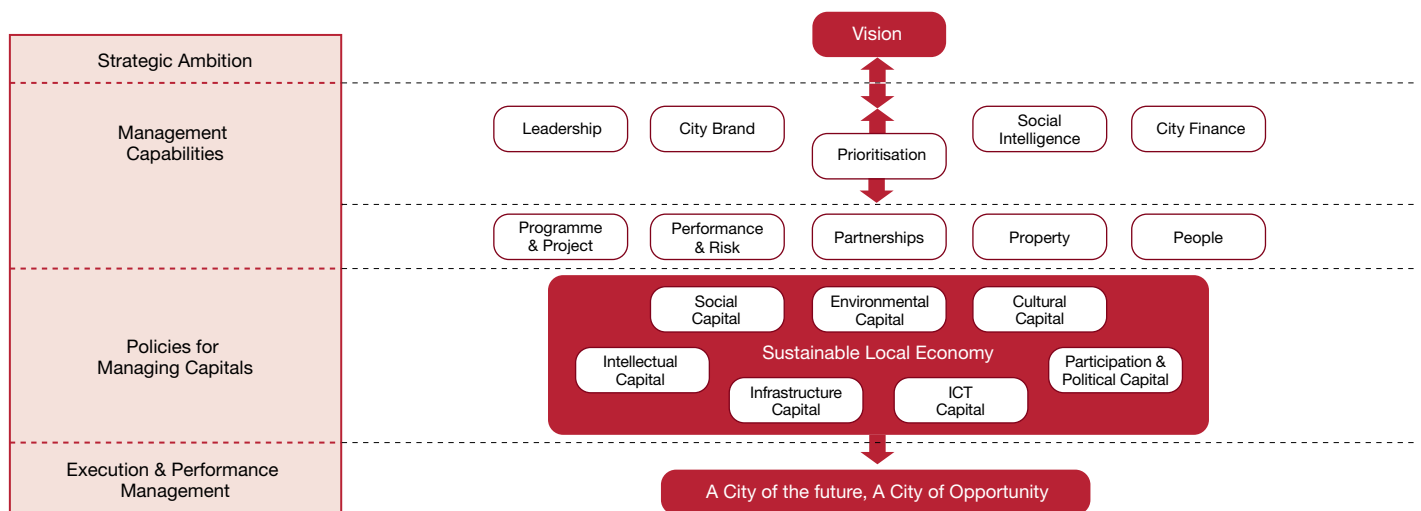
Cities facing multiple challenges, which were intensified by the financial crisis, have urgently to implement strategies that allow them to compete for business investment, retain talent and attract visitors. As set out in Figure 11, the management of cities of the future is a complex affair.

We recommend adopting a holistic approach that will take a city forward. The starting point for a city is formulating a clear vision which captures its strategic ambition. In order to channel all resources towards accomplishing the vision, the city’s management has to develop multiple internal capabilities: an inspirational leadership, a resilient city brand and an ability to learn from other cities through social intelligence. Under the current circumstances, managing finances effectively is becoming an extremely essential enabler, together with managing the city’s projects, performance risks, partnerships, assets and human capital.

Developing a clear vision and internal management capabilities allows a city to prioritise, invest in and strategically manage the building blocks or ‘capitals’ needed by any city for long-term prosperity – social, environmental, cultural, intellectual, infrastructural, ICT and political participation capitals. By putting in place and implementing the appropriate policies, a successful city will maximise its investment in those capitals which are most relevant to its strategic vision, while optimising its investment in those capitals which are less relevant.

Of course, all of this must also be done in a way that is sustainable and through collaboration and partnering with citizens, the private sector, academia and NGOs.

Figure 11: A holistic approach



14 ‘Cities of Opportunity’ Partnership for New York City/PricewaterhouseCoopers, March 2009

‘Promoting prudent and sustainable growth is critical to securing the long term recovery of the global economy.’

To avoid market failure we need to govern in a strong sense but not with excessive strength. Governments of any persuasion want strong growth but one that can survive crises, so it’s our role to read ahead and set up an environment that ensures that growth continues. When you look at the interface between government and private sector, the government is the enabler of development but if it can’t get out of the way, it can start to flounder. That’s the challenge.’

Part of this debate is now focusing on how we define and measure growth. Traditional approaches and measures do not appear to be sufficient to provide a useful guide to policy-makers. For example, as Ferruccio Ferranti in Italy comments: ‘GNP can be used as an index for growth, albeit not 100% representative of growth, and we need to introduce concepts of sustainable developments...adopted at an international level... Obviously, this may end up having an impact on growth, and this is the reason why we need to take into consideration indicators other than the ‘simple’ turnover.’

In our view, there is a need to develop new ways of demonstrating economic progress, that balances the concept of GDP with other measures of economic life in order to obtain a better overall view of the success or otherwise of economic policy.

Conclusions

Promoting prudent and sustainable growth is critical to securing the long term recovery of the global economy. However, whereas the fallout from the financial crisis brought economic issues to the centre of public debate, notably less attention has been paid to the pressing question of how to achieve robust and durable growth in the future, that is, growth which is financially, socially and environmentally sustainable.

The evidence base is building on the need for not just growth, but for ‘good growth’¹⁵ but more needs to be done to generate indicators which are useful in a policy setting. We will be undertaking further research to capture what it is that the public, and business, think is important in the way that wealth is created and how this can be used to inform future public policy decision making.

¹⁵ See The Commission on the measurement of economic performance and social progress (also known as the Stiglitz Commission) http://www.stiglitz-sen-fitoussi.fr/documents/rapport_anglais.pdf

Final thoughts

Rethinking government

Whilst complaints about tax and regulation will always feature high on CEO agendas, as shown by past Surveys, the overwhelming current priority is for governments to focus on achieving stable, balanced and sustainable growth globally.

With the change in the economic climate, and the onset of public sector recessions in many countries, governments are now being called on to rethink their roles and reshape their activities in relation to business:

- Business sees government as having a critical role as an enabler, creating the environment for business to grow and for citizens to enjoy the proceeds of growth.
- Although there is reticence in many countries for the state to be too involved in markets, there is a shared view that the risk of unfettered competition can also be too great. As a result, government, at national and supranational levels, needs to be vigilant and willing to use a combination of incentives and sanctions to encourage ('nudge') the right behaviours in both businesses and citizens.
- Business wants to collaborate actively on issues such as skills, safeguarding intellectual capital and dealing with climate change.

- But business is also vocal in its enduring frustrations with government – primarily over-regulation and rising tax burdens. Although of a lesser importance than dealing with fiscal and economic uncertainty, the call from business continues to be for more effective efforts to be made to harmonise regulations and tax across, and within, nation states and to invest in the fundamentals of any modern economy – infrastructure, stable capital markets and education.

As such, the challenges for government are clear:

- Where appropriate, deal with deficits by doing things differently.
- Tackle regulation by doing less but smarter.
- Invest in collaboration and partnerships.
- Develop policies promoting 'good growth' which focus on long run sustainability in its widest sense, not just short term fixes.

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