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Government Failure in Canada, 1997–2004 A Survey of Reports from the Auditor General

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Executive Summary

The discussion of the limitations of government and subsequent government failures is wholly absent from debate in Canada where, unfortunately, we still assume that governments act benevolently and without institutional constraints. That this is not true and that government failure does occur should now be plain to all: the reports of the Auditor General of Canada provide concrete evidence of the existence, and the extent, of government failure in Canada.¹ The Public Choice School of Economics, which applies traditional economic methods and techniques to explain the actions and decisions made by those who operate in the political marketplace, has striven to explain government failure empirically. This publication has been written to inform Canadians about the theories and insights of Public Choice Theory (§1), to document government failure from the reports of the Auditor General (§2), and, perhaps most importantly, to describe the mechanisms available to reduce government failure (§3).

Overview of Public Choice

The Public Choice approach to economics uses the traditional tools and methods of economics to analyze the political system. Scholars William Mitchell and Randy Simmons, whose book *Beyond Politics* is a modern-day application of Public Choice to a host of current problems, describe Public Choice as using “economic reasoning and analysis ... to uncover the institutions and processes that lead to government failure” (Mitchell and Simmons, 1994: 39).

Public Choice models the behaviour of four groups—voters, politicians, bureaucrats, and special interest groups—to explain actions within the government sector. Public Choice scholars have made a seemingly simple assumption regarding motivation that has led to major insights into how government operates. Specifically, each participant is assumed to act in his or her own self-

interest. For example, politicians are assumed to be vote-maximizers, interested in gaining election or re-election, while bureaucrats are assumed to prefer job security, larger budgets, and more power and influence.

This represented an enormous change from previous thinking into the motivations of government sector participants. Prior to the introduction of Public Choice, it was generally assumed that politicians, unlike private individuals, maximized “public interest” rather than “self-interest.” That is, politicians were thought to be primarily concerned with making decisions that provided the best outcome for society in general. While politicians were assumed to act out of self-interest in their private lives, they were thought to be guided by public interest in their political decisions. As Professor and Nobel Laureate James Buchanan has put it, the old way of thinking assumed that when people entered government they became economic eunuchs. Public Choice scholars changed this view of political behaviour by extending the assumption of self-interest to politicians and bureaucrats and, in doing so, explained why governments do not always act in the public interest despite benevolent personal intentions.

As in any marketplace, participants interact with one another in the political arena in an attempt to improve their situations. It is this interaction among participants and the institutional incentives that affect the decisions that are central to Public Choice.

Government Failure Documented in the Auditor General’s Reports

The reports issued by the Office of the Auditor General of Canada (hereafter Auditor General) are an excellent source of tangible examples of government failure that support Public Choice theory. This study describes 120 cases of government failure from the Auditor General’s reports over the last eight years (from 1997 to February

2004). The instances from the Auditor General's reports are classified by type of government failure: waste, misrepresentation, red tape, incompetence, program failure, self-service (creating a non-monetary benefit for the public service provider), and self-dealing (created a monetary benefit for the provider).

More than one quarter of the examples primarily involve incompetence, with waste accounting for one-fifth. Self-service, program failure, and misrepresentation each account for between 13% and 15% of the total. Instances of red tape and self-dealing are less common among these examples of government failure. The total number of government failures is also understated.

In reviewing the findings of the various Auditor General reports over the last eight years, it is quite easy to see that government failure is not simply a theoretical concept but rather all too often a common occurrence. Below are some of the more serious instances of government failure (see §2 of this study for a longer, chronological survey of government failure).

Credit Cards

Balances on public servant credit cards, issued to reduce reimbursement costs, were not paid on time and resulted in \$80,000 in unnecessary interest costs over four months.

Foreign Affairs

Foreign Affairs officials receive additional housing benefits based on hospitality expenses of which only 4 of 43 actually met the department's guidelines for such expenses. In one case, an official received over \$32,000 in benefits, even though the property was not used for hospitality over a four-year period.

Atlantic Fishery

Human Resources Development Canada (HRDC) initially estimated that 8,500 participants (28% of the eligible population) would rely on The Atlantic Groundfish Strategy (TAGS). By 1997, there were 21,722 participants, 54% of the eligible population. A follow-up review in 1999 found that:

- one-third of projects did not have a proposal on file;
- one-third of the files with a proposal did not meet stated funding criteria;

- nearly half of the files had not been closed-out upon completion, which made it impossible to determine whether funding had been used appropriately.

Social Insurance Numbers

A number of concerns regarding Social Insurance Numbers were raised in 1998:

- there were 3.8 million more SINs for Canadians 20 years and older than people in that age group;
- there were 100 times as many active SINs for those over the age of 100 as living Canadians over that age;
- over 50% of SINs had no supporting documentation;
- the Social Insurance Registry had almost 12 million uncertified accounts.

The Auditor General undertook a follow-up review of the SIN system in 2000 and found on-going problems:

- there were 5 million more SINs for people over the age of 20 than there are Canadians of those ages;
- more than half of these SINs were considered dormant;
- there were over 8.3 million usable SINs that have never been verified by personal identification;
- the majority of SINs issued since 1998 were not properly verified with the applicant's identity and citizenship status.

Hazardous Materials

The Department of National Defence (DND) estimated that one-quarter of its staff came into contact with hazardous chemicals on a daily basis.

Property Management

Public Works contracted out all 13 regional contracts for property maintenance to the same firm. The Auditor General discovered that the guiding principle was to provide employment to the department's existing staff rather than value for money.

Border Control

CANPASS was designed to expedite the movement of low-risk travellers while reducing administrative costs at the border. Anticipated savings have not yet materialized because user uptake has been limited. At Fort Erie and Windsor, for instance, CANPASS use was

frustrated as users had to wait in line-ups with regular traffic because no separate lanes were available. CANPASS lanes at two other border crossings have been abandoned for lack of use. In an attempt to encourage user uptake, the Whirlpool Bridge was restricted solely to CANPASS users. Use of the bridge subsequently dropped 63 percent. Despite the mixed results of past experiments, CANPASS was scheduled to be extended to other border crossings.

RCMP Services For Law Enforcers

A 1990 Auditor General's report noted that the FBI serves all of the United States with one central forensic facility while the Prairie provinces alone have three such facilities. A 1997 task force noted that the RCMP could reduce costs by reducing the number of laboratories and centralizing activities. Despite this apparent over-capacity, the RCMP opened a new \$12 million facility in Regina in 1995 and replaced a laboratory in Ottawa at a cost of \$21 million.

Grants and Contributions by Human Resources Development Canada (HRDC)

The Auditor General found a widespread lack of due regard and diligence in spending public funds and in achieving desired results in the Transitional Jobs Fund (TJF). Among a number of problems identified, the TJF required every funding application to include a written recommendation from a Member of Parliament. The Auditor General also raised concerns regarding documentation in the TJF. For example, the contribution agreements offered by HRDC stipulate that any recipient must indicate the number of jobs created through the program but only 14% of project sponsors responded to the job survey.

Similar problems were identified in the management control framework of the Youth Internship Canada program. Among the problems identified by the Auditor General were:

- only 5% of projects had been properly assessed for eligibility;
- only 18% of small projects could indicate any rationale as to why they received funding;
- nearly half of the small projects did not have proper approval; and

- there was no record of the number of jobs created for over 60% of the projects.

Atlantic Canada Opportunities

Agency Office Space

The Auditor General was critical of how the Atlantic Canada Opportunities Agency (ACOA) and Public Works tendered a contract for office space in Sydney, Nova Scotia. ACOA specified a contract for twice as much space as had been used at similar offices elsewhere in Atlantic Canada and with 10 times as many parking places. The contract also specified that the space had to be leased on a specific section of a specific street in Sydney. No rationale regarding the Sydney requirements was offered. Public Works surveyed downtown real estate and found the building acquired under the tender was 20% to 30% more expensive than buildings of superior quality in Sydney. The facility was never used for the purpose indicated and, at most, two federal employees were located at the site.

Governance of Crown Corporations

The Auditor General concluded that directors for Crown Corporations lacked key skills and capabilities that are needed to function effectively. The Auditor General noted comments by chairs and CEOs of Crown Corporations that roughly 25% of boards were out of their depth due to selection according to "political criteria." The Auditor General stressed the importance of audit committees but found at least half of such committees were operating below an effective level and demonstrated financial illiteracy in 3 of 15 audit committees examined.

Fleet Management

There is a lack of adequate and effective management of capital and human resources by the Department of Fisheries and Oceans (DFO). For example, the Maritimes Region mothballed a 14-year-old icebreaker for lack of funding, at the same time that the Newfoundland Region was using 41-year-old and 33-year-old icebreakers.

Income Support Tax Credits

The Auditor General raised concerns regarding a lack of fraud and abuse measures in the Child Tax Benefit (CTB) and GST Credit systems. For example, a prior 1996

Auditor General report concluded that there were more children enrolled in the CTB program than the eligible child population. Another study concluded that 30% of child deaths in Alberta and British Columbia went unreported to the program and that, in some cases, payments continued inappropriately until the child reached age 18. The 2001 report found that overpayments were still being made, reaching a quarter of a billion dollars, and that there were continuing delays in detecting errors.

Heating Expense Relief

The Auditor General concluded that the relief program was poorly targeted. The use of the GST Credit system expedited check issuance but was ineffective in allocating relief to intended recipients. Among other things, the Auditor General found that:

- roughly 90,000 Canadians in need of immediate assistance did not receive relief because their prior year income exceeded the GST Credit cut-off;
- less than one-quarter of the \$1.5 billion in payments went to low-income families facing emergency heating costs;
- between 25% and 35% of recipients received the check but had heating already included in their rent or heated with electricity;
- at least 40% of relief recipients were not low-income or did not face increases in heating costs;
- roughly 1 million of the 7.6 million households that received the relief could have received more than one cheque;
- at least 4,000 Canadian taxpayers who did not live in Canada received payments;
- up to 1,600 prisoners could have received cheques; and
- at least 7,500 deceased people received relief.

Canadian Health Network

The Auditor General concluded that Health Canada did not meet government contracting-out rules when it spent \$25 million on the Canadian Health Network. The program cost \$11 million more than was originally intended and had 25 contract amendments. The document management system alone cost over \$6 million and Health Canada, after four years of use, is considering using alternate software.

Satellite Communications

The Department of National Defence (DND) took eight years to develop a \$174 million satellite communications system. When the system was completed, DND determined that the commercial system it had been using was sufficient to meeting existing needs and required fewer staff to operate. In addition, the new military satellite communications system would require an additional \$15 million to meet current operational standards. The system remains in storage.

Pilot Training

The Department of National Defence (DND) contracted out a \$2.8 billion pilot-training program without including sufficient covenants in the event of insufficient demand and without fully contracting the support of NATO partners. In the first two years of a 20-year program, \$65 million was spent on training that was never used. Only 41% of the training paid for was actually used. Only 61 Canadian student pilots qualified for training, just 28% of the originally expected 216 student pilots. DND paid \$31 million for training for which the ministry did not have the necessary aircraft.

Acquisition of Office Space

The Auditor General found that Public Works had engaged in speculative land acquisitions. In one instance, a building was leased in the National Capital Region even though the file indicated that Public Works anticipated reluctance to move to that particular location. The client agency refused to move and a new tenant is being selected. In the intervening 16 months, Public Works has paid \$2.7 million in rent for an unoccupied building.

Firearms Registry

The Auditor General reviewed how information about the now controversial Firearms Registry was provided and disclosed by the Department of Justice (DOJ). DOJ assured Parliament that the Minister would be accountable for the full cost of the Firearms Registry. However, only the costs incurred by the Canadian Firearms Centre had been reported, not the full costs of the program. According to the Auditor General, DOJ provided insufficient financial information and explanations for the dramatic increase in the cost of the program. The cost

rose from an estimated \$119 million (\$2 million net cost after user fees) in 1995 to over \$1 billion in 2002.

The information system needed to run the Firearms Registry was well beyond any previous DOJ initiative. This inexperience led to cost overruns and frequent adjustments. By 1999, the system had received 1,000 orders for system changes. These changes typically took three to six months to implement and cost millions of dollars. In 2001, the Department conceded that the system was not working well, was expensive, obsolete, and inflexible. Construction and maintenance costs of the existing system were exceptionally high and were expected to represent 60% of future operating costs, significantly higher than the industry norm of 10% to 20%.

The Auditor General and law enforcers expressed serious concerns regarding the accuracy and completeness of this RCMP database. In 2001, an RCMP review revealed that people are in the database who should not be, while others should be included and are not. According to the Auditor General, the review concluded that a tragic incident could arise as a consequence of the poor data quality.

A 2000 report from the Auditor General had expressed concerns about the program's efficiency and noted that the Firearms Registry faced backlogs, even though the number of applications was lower than expected. Only 5,600 license applications were completed of the 41,500 received at the time of the audit.

Downsview Park

Downsview Park, an abandoned military base in Toronto, is being kept for use as an urban green space. It has received \$20 million in public funds, though the payment has not had approval from Parliament. This oversight was noted in 2000 but no action had been taken by 2002 to legitimize the transfer.

Immigration Control

In the last six years, there were 36,000 more people ordered removed from Canada than there were confirmed removals. The Auditor General estimated that Citizenship and Immigration Canada (CIC) will soon have to remove an additional 29,000 people now in Canada. In 1994, an evaluation of the border-point examination process found that the Department was only 50% effective at restricting inadmissible travellers. In 2000, 50% of the

applicants scheduled for removal did not appear for their removal hearing. The Auditor General remarked that CIC "has not analyzed how it will handle its growing backlog of investigations and removals."

Housing on Reserves

The Department of Indian and Northern Affairs (INAC) and Canada Mortgage and Housing Corporation have provided First Nations with \$3.8 billion for on-reserve housing over the last 10 years. INAC transferred \$34 million in 2001 and \$40 million in 2002 of unspent funds from other programs to address "urgent" housing needs on reserves. The Auditor General found inadequate information on how the funds were spent and noted that "the Department and First Nations were under pressure to spend the money before fiscal year end. This resulted in 'emergency spending' in the Department, with questionable results."

Sponsorship Program

The Sponsorship Program spent \$250 million between 1997 and 2003 to "increase the federal presence and visibility in communities across Canada by providing funds to support [1,987] cultural and community events." Over \$100 million was paid as fees and commissions to communication agencies. The Auditor General found that funds were transferred to Crown corporations in an attempt to hide the source and nature of the funding. The parliamentary appropriations process was circumvented and no discernible selection process was used.

Challenger Aircraft Purchase

The government decided to spend almost \$100 million on two new Challenger aircraft in the space of nine days in March 2002. The Auditor General noted that the Privy Council Office bypassed the government's own procurement policies and procedures with this decision, circumventing a proper review of requirements, how best to improve the air fleet, and a consideration of other alternatives.

Cultural Heritage

The government spent \$500 million on cultural heritage in 2000. The Auditor General looked at the areas most at risk: national historic sites and federal heritage

buildings, federal archives, and the collections of the National Library of Canada and federal agencies. More than two thirds of sites and buildings were found to be in poor or fair condition. Over 90% of the National Library collections are housed in buildings that “do not meet current standards for temperature and humidity.”

Reducing Government Failure

There are many methods available to governments interested in reducing government waste and overcoming institutional limitations.

Rationalization requires government to define its role clearly and eliminate or restructure any of the activities not supportive of its core functions.

Privatization entails the sale of state-owned assets to the private sector for private operation. Both of these approaches address government failure by changing the institutional structure of program delivery.

Public-Private Partnerships maintain a complementary role for government and maximize the comparative strengths of each partner in developing infrastructure.

Outsourcing uses the mechanism of competitive bidding for the provision of publicly financed goods or services.

Internal control and monitoring mechanisms can reduce future government failures. This would include more resources for the Auditor General, increasing the scope of available audits to include Crown Corporations and government foundations, and mandatory audit compliance.

Conclusion

The main lesson from the cases investigated by the Auditor General is that the limitations and institutional constraints of the government sector often lead to its failure. Given the number and magnitude of government failures that have occurred over the past eight years, little has been done to reduce the possibility of reoccurrence. The first step must be to prioritize the goals and objectives of governments. The next step must be to minimize the tasks that are undertaken in the public sector. The government does not need to undertake an activity in order to ensure that it is done. Public purposes, as we have shown, can be accomplished as well, or better, by contracting, privatizing, or ceding the activity to the private sector.

1 Public Choice

The discussion of the limitations of government and subsequent government failures is wholly absent from debate in Canada where, unfortunately, we still assume that governments act benevolently and without institutional constraints. That this is not true and that government failure does occur should now be plain to all: the reports of the Auditor General of Canada provide concrete evidence of the existence, and the extent, of government failure in Canada.¹ The Public Choice School of Economics, which applies traditional economic methods and techniques to explain the actions and decisions made by those who operate in the political marketplace, has striven to explain government failure empirically. This publication was written to inform Canadians about the theories and insights of Public Choice Theory (§1), to document government failure from the reports of the Auditor General (§2), and, perhaps most importantly, to describe the mechanisms available to reduce government failure (§3).

Overview of the Public Choice model

The Public Choice approach to economics grew out of the ground-breaking publication of *An Economic Theory of Democracy* by Anthony Downs in 1957. It has since developed into a mainstream branch of economics that uses economic tools and methods to analyze the political system.² Scholars William Mitchell and Randy Simmons, whose book *Beyond Politics* is a modern-day application of Public Choice to a host of current problems, describe it as using “economic reasoning and analysis . . . to uncover the institutions and processes that lead to government failure” (Mitchell and Simmons, 1994: 39).

This section explores some of the main findings of Public Choice economics that help us understand how government operates and provides an overview of the theory of government failure as developed by Public Choice. Most importantly, it describes the more signifi-

cant differences between a market economy and the government sector, differences that in large part explain why government failures occur.

Public Choice employs traditional economic methods and principles to analyze the political system. It models the behaviour of four groups—voters, politicians, bureaucrats, and special interest groups—to explain actions within the government sector.

Motivation

Public Choice scholars have made a seemingly simple assumption regarding motivation that has led to major insights into how government operates. Specifically, each participant is assumed to act in his or her own self-interest. For example, politicians are assumed to be vote-maximizers, interested in gaining election or re-election, while bureaucrats are assumed to prefer job security, larger budgets, and more power and influence.

This represented an enormous change from previous thinking into the motivations of those in the government sector. Unlike most classical or Keynesian economic models, which assume a benevolent, selfless government sector acting solely for some notion of the greater good, Public Choice has striven to include more useful and realistic assumptions about those in the government sector and their motivations.

Prior to the introduction of Public Choice, it was generally assumed that politicians, unlike private individuals, maximized “public interest” rather than “self-interest.” That is, politicians were thought to be primarily concerned with making decisions that provided the best outcome for society in general. While politicians were assumed to act out of self-interest in their private lives, they were thought to be guided by public interest in their political decisions. As Professor and Nobel Laureate James Buchanan has put it, the old way of thinking assumed that when people entered government they became economic eunuchs. Public Choice scholars changed this view of political behaviour by extending

the assumption of self-interest to politicians and bureaucrats and, in doing so, explained why governments do not always act in the public interest despite benevolent personal intentions.

As in any marketplace, participants in the political marketplace interact with one another in the political arena in an attempt to improve their situations. It is this interaction among participants and the institutional incentives that affect the decisions that are central to Public Choice. The following is a brief discussion of the major differences between the participants in a political marketplace and those operating in a competitive marketplace.

(1) Politicians

Politicians are the most recognizable participants in the political marketplace. They are characterized as being primarily concerned with getting elected and thus will advocate and subsequently support policies that maximize their chances of winning. Unfortunately, these policies are not necessarily those that maximize the interests of the general public, a result that stems from the diverse and often competing interests and preferences of voters. Since resources are scarce, politicians are forced to balance these competing interests by deciding how best to use available resources, primarily taxpayers' dollars, to maximize their chances of election.

Separating Cost and Benefits

One of the unique attributes of the political marketplace is the separation between the costs and benefits of goods and services provided by government. There is generally no direct link between taxes and the specific provision of goods and services.³ Individuals, families, and businesses that receive benefits from government programs may not be the same individuals, families, and businesses that are taxed to finance the provision of those programs. In addition, individuals, families, and businesses that are taxed may place very little value on the goods and services provided.

This fundamental separation of costs and benefits has enormous implications for the political system. It enables those seeking voter approval to provide specific, demonstrable benefits to those from whom they seek support. This relationship has become a fundamental tenet in political calculus: tax a large base a politically acceptable

amount to disperse the costs and deliver the proceeds to specific groups to concentrate the benefits. In reviewing most government programs, it is easy to identify the specific group for whom the resources are provided as benefits, while identifying the source of resources is typically much less transparent.

Decision-Making and "Log Rolling"

As a result of dispersed costs and concentrated benefits, the political decision-making process is substantially different from, and in many ways significantly more complicated than, that undertaken in the marketplace. An interesting phenomenon has arisen in the political system that is referred to as "log rolling," where politicians support specific measures in order to receive commensurate support for their own programs. For example, Politician A supports Bill X for the sole purpose of securing Politician B's support for his own special-interest Bill Y. This process of log rolling is generally seen as reducing societal welfare.⁴

The central tenet of Public Choice is that politicians maximize their own welfare or self-interest. When the overarching objective of politicians is simply to gain election or re-election, public welfare, long-term sustainability, and social improvement are largely secondary considerations.

(2) Bureaucrats

The other central government player in the political marketplace is the bureaucrat. It is increasingly acknowledged that the effectiveness of public-sector bureaucracies pales in comparison to their private-sector counterparts. While sometimes typecast as lazy and inefficient, the overwhelming majority of bureaucrats, especially those in senior positions, are honest, hardworking, and diligent. It is the nature of the institutional constraints and incentive systems in place within the public sector, rather than any particular deficiency of public-sector bureaucrats as individuals, that makes the government sector less efficient.⁵

Misaligned Incentives

The incentive system for effective management in government bureaucracies is generally weak. Bureaucrats are not typically compensated according to their productivity but rather according to the extent of their responsibili-

ties, as measured by the size of their budget or the number of civil servants they supervise. Instead of encouraging bureaucrats to save taxpayers' money, this compensation structure encourages them to increase spending.

The way in which budgets are allocated also creates perverse incentives: government departments are allocated resources based on their ability to spend all of the previous year's budget. The result is large spending increases at the end of each fiscal year in order to exhaust the current year's resources and justify the departments' forthcoming budget allotments.

Finally, it is in the best interest of the managers of any program, department, or ministry to exaggerate the extent of any problem or any purported market failure they are attempting to solve, since they are ultimately attempting to secure or increase their budgets. By making their area of responsibility a priority, bureaucrats have a far higher probability of receiving additional budgetary resources.

Operating as a Monopoly

This misaligned incentive structure is compounded by the fact that most government programs, departments, and ministries operate as monopolies. That is, there is no competition or choice available to citizens. As with any monopoly, there is a tendency towards higher prices, lower efficiency, service of lower quality, and a generally poorer product. In the absence of competition, there is little incentive for governments to provide the public with quality goods and services in a timely manner and at reasonable prices. Further, the inherently dynamic private sector is better equipped than the public sector to meet constant changes in demand.

Hard versus Soft Budget Constraints

Kornai (1979, 1992, 2003) identified budget constraints as one of the major and unchangeable differences between private-sector business enterprises and government. He argued that government budgets are soft, since it is impossible for government departments to go broke. Private-sector businesses, on the other hand, face hard budget constraints. If the latter incur sustained losses, the decline of their business capital will push them into bankruptcy. The private sector must, therefore, provide its customers with the quality goods and services they demand in a timely manner and at affordable prices.

The public sector simply does not face the same pressures. Consistent losses are not a problem; therefore, there is no incentive to react to consumer demands. The implication of Kornai's research is critical, as it indicates that the public sector can never perform at the level generated by a competitive private-sector market structure.

(3) Special Interest Groups

Special interest groups, which, like voters, operate outside government though they do act in the political marketplace. Interest groups, such as environmentalists, child advocates, business associations, unions, religious groups, and professional associations, normally coalesce around issues of importance to voters and to potential supporters. Their task is to represent their supporters and ultimately to provide to their members benefits that outweigh the costs of their acquisition.

The interest group is able to undertake analysis and public education, disseminate information, and lobby government for its particular position on issues better than any individual person or less organized association. It can reduce information and search costs for individuals and families by representing their preferences to government in exchange for financial support. These attributes are the basis for entire industries that attempt to affect government decision-making. Enormous amounts of human and capital resources are poured into these organizations on an annual basis in order to try to influence government.

Nobel Laureate Gary Becker did seminal work on the effect of interest groups and the competition between them for legislative success (Becker 1983). Strikingly, Becker concluded that the competition among interest groups was a mitigating factor in government failure because politicians and bureaucrats had to make decisions on which groups to placate. In other words, political actors could not satisfy all of the vested special interest groups and, therefore, had to calculate which to support.

Unfortunately, the main result of this type of special interest driven policy is that it leads to rent seeking,⁶ the expenditure of resources by individuals or groups to extract free public-policy benefits (or rents) from government. The cost of rent seeking ultimately comes at the expense of others through either the tax system or laws passed by government in favour of the interest group (preferential regulation).

Rents may take the form of protected markets, subsidies, beneficial tax treatment, or other specified benefits that are not generally available to everyone and are allocated without a price mechanism. This inevitably leads to a misallocation of scarce resources to the political process and lobbying rather than to direct public service production or research. Thus, the rent-seeking aspect of the political marketplace is seen as particularly damaging and counterproductive.

(4) Voters

Voters are perhaps the most interesting and least understood of the four participant groups. Voters represent both the beginning and the end of the political marketplace cycle. For our purposes, however, the critical insights from Public Choice relate to how voters make decisions. Unlike the economic marketplace, where the decision to purchase and consume can be made item by item, voters must make single decisions to acquire or not to acquire a whole set of policies offered by politicians. Consumers in the marketplace make purchasing decisions based on specific preferences for each individual item. Voters, on the other hand, must make one decision among candidates, based on a whole set of preferences regarding issues ranging from taxes, to health, to education, to defence, to the environment and so on. It is consequently very difficult for voters to reveal their complicated and varied preferences in a single vote.

Political and economic marketplaces also differ in terms of accountability. If consumers are displeased with the quality or pricing of a particular good or service, they have the opportunity to switch products. They can, therefore, directly punish the organization responsible. Lines of accountability from voters to politicians and bureaucrats are much less direct—if they exist at all. First, there are often several levels of government involved in the delivery or support of any particular programs. Second, problems present in current programs may be the result of poor decisions by previous governments that have only recently come to light. Third, as discussed above, a central characteristic of government programs is that those who bear the cost of programs in the form of taxes are usually not the same people who receive the benefits. Fourth, it is very difficult to hold to account those responsible for government failures since, in most cases,

bureaucrats dealing with the public have little or nothing to do with the actual underlying problem. Fifth, the large size of governments in most industrialized countries means that individuals deal with vast bureaucracies that typically pay little heed to customer experiences.

Why Public Choice Matters

Whether the free enterprise solution can be improved upon by the substitution of the government or other non-profit institution . . . cannot be ascertained solely by examining the free enterprise solution.

—Harold Demsetz, *Law and Economics*, 1969

When markets produce undesirable outcomes such as high unemployment, high inflation, pollution, or income disparities, there is a commonly held belief that politicians and bureaucrats, acting in the public interest, can best correct these effects. Further, many people believe that markets will not adequately or efficiently provide such goods as transportation infrastructure, health care, education, insurance, entertainment and culture, and so on, without government intervention.

In the past, little analysis was undertaken to assess the government's ability to correct these market results or to provide better goods and services; superior performance was simply assured by the proponents of government delivery. In the words of Harold Demsetz, this is the "nirvana approach" to public policy: when discrepancies arise between market results and ideal outcomes, many people deduced that the market outcome was inefficient and assumed that government intervention would improve the status quo (Demsetz 1969). This is not only a fallacy of logic but also inconsistent with real-world evidence that shows the superiority of competitive market structure over the misaligned incentives and structure of the government sector.

Public Choice has been a critical development in this debate since it has highlighted the government sector's peculiar limitations and institutional constraints, such that intervention by government often leads to poorer results than the status quo. The next section of this paper provides evidence from a Canadian context of exactly the sort of failures that arise from misguided and ineffective government activities.

2 Evidence of Government Failure in Canada

The reports issued by the Office of the Auditor General of Canada (hereafter Auditor General) are an excellent source of tangible examples of government failure that support Public Choice theory. This section provides highlights from the Auditor General's reports between 1997 and February 2004.

The Auditor General watches over government activities, auditing government operations and providing information to "Parliament to hold the government to account for its stewardship of public funds."⁷ The office is independent of the government of the day and reports directly to the House of Commons through the Speaker. It is important to note that the Auditor General is limited in an important respect: the office cannot comment on policy choices but only on the quality of their implementation.

Instances of government failure shown below have been classified by type. Each report from the Auditor General may show more than one type of government failure.

- Waste (W): inefficient allocation of public resources;
- Misrepresentation (M): inappropriate use of information;
- Red Tape (R): bureaucratic barriers to effective program delivery;
- Incompetence (I): inability to manage program delivery;
- Program Failure (F): inability to achieve stated objectives;
- Self-Service (S): program delivery that creates a non-monetary benefit for the provider;
- Self-Dealing (D): program delivery that creates a monetary benefit for the provider.

Table 1 summarizes, by type and number, the instances of government failure from 1997 to February 2004 discussed in detail below. The table shows that government failure is endemic to the provision of public services, as predicted by Public Choice theory. Every year for eight years, the Auditor General has documented multiple instances of most kinds of government failure. There are a total of 120 instances in the table. On a proportional basis, incompetence accounts for 28% of the total, waste for one-fifth, and each of self-service, program failure, and misrepresentation for between 13% and 15%. Instances of red tape and self-dealing are less common.

Table 1: Government Failures by Type— Number of Instances from Auditor General's Reports

	1997	1998	1999	2000	2001	2002	2003	2004*	Total
Waste	4	1	0	4	4	8	2	1	24
Misrepresentation	2	1	2	4	2	2	2	1	16
Red Tape	0	0	0	2	0	2	2	0	6
Incompetence	3	1	2	11	4	8	3	1	33
Program Failure	2	2	3	5	2	0	1	1	16
Self-Service	2	2	2	4	2	4	1	1	18
Self-Dealing	1	1	2	1	0	0	1	1	7
Total	14	8	11	31	14	24	12	6	120

* The reports listed in this column were among those prepared by the Auditor General in November 2003 but, because Parliament was prorogued, they were not released until February 2004.

It may be that the number of government failures is understated, as most of the problems highlighted in the Auditor General reports could be considered as wasting taxpayer funds and not effectively achieving program objectives. Only the key attributes of the government failure for each report are classified here. These examples, of course, only refer to audits undertaken by the Auditor General, published in the various Auditor General reports, and summarized here. There are many more possible examples in the \$140 billion that the federal government presently spends on its programs.

1997

Credit Cards

Balances on public servants' credit cards, issued to reduce reimbursement costs, were not paid on time and resulted in \$80,000 in unnecessary interest costs over four months. (W)

Foreign Affairs

Foreign Affairs overestimated the cost of embassy properties by \$2.4 billion, resulting in a 30% overcharge on passport fees since the cost of embassies is capitalized and passed on to users through passport fees. (I)

Foreign Affairs officials receive additional housing benefits based on hospitality expenses. Only 4 of 43 actually met the department's guidelines for such expenses. In one case, an official received over \$32,000 in benefits, even though the property was not used for hospitality over a four-year period. (D)

Foreign Affairs experienced internal resistance in its attempt to downsize ambassadorial residences. For example, one ambassadorial residence was sold for \$12 million and a new residence leased for \$350,000, on top of additional renovations of \$300,000. The ambassador refused to leave the previous residence and the project was cancelled, even though costs had already been incurred. (W, S)

First Nations Health

Reserve-provided health services were found to be inferior due to employee absences, improperly qualified

workers, and incompetence. In addition, some doctors may have been over-prescribing mood-altering drugs and drugs affecting the central nervous system. Health Canada was aware of the potential problem for nearly a decade and took no remedial action. (I)

Atlantic Fishery

The federal government and several provincial governments failed to deal with over-capacity in the Atlantic fishery. In fact, the federal government encouraged over-capacity by subsidizing the income of fishermen through Unemployment Insurance (UI) (now referred to as Employment Insurance). Unemployment Insurance payments for fishermen rose from \$20 million in 1972 to \$270 million in 1988. Self-employed Newfoundland fishermen received \$1.60 in UI benefits for every dollar earned in 1990. (I)

The Atlantic Groundfish Strategy (TAGS) did not achieve its goals of reducing over-capacity. Human Resources Development Canada (HRDC) initially estimated that 8,500 participants (28% of the eligible population) would rely on TAGS. By 1997, there were 21,722 participants (54% of the eligible population). The Auditor General also noted a 29% error rate in the calculation of program duration. (I, F)

Air Navigation System

The sale price of Canada's air navigation system was, in all likelihood, well below market value due to the exclusion of certain capitalization costs. The Auditor General characterized the reduced price as a subsidy to purchasers that could range up to \$1 billion. (M, W)

A series of contracts negotiated by Transportation Canada for financial advice were later amended, thereby substantially increasing their value. One contract began at \$165,000 and was amended twice to \$560,000, while another began at US\$375,000 and was amended to over US\$1 million. Both contracts provided no clear link between work done and the amounts paid. (M)

Moving Costs

Cost weighting schemes for relocating government employees are roughly twice the average weight of moves paid for by private individuals and so moves cost more. (W, S)

1998

Reductions in the Public Workforce

This initiative was hampered by

- Public servants not eligible for the program “swapping” jobs with those employees determined to be surplus. By 1995, some 2,600 swaps were reported.
- A requirement that public servants deemed surplus be given a reasonable job offer at equivalent salary in the same region before they could be laid off.

Termination benefits tended to exceed the private sector standard of 36 to 59 weeks of salary. Total restructuring costs exceeded the original estimate by \$900 million. The Auditor General also discovered double-dipping: some 600 individuals received buyouts and then returned to the public sector, mostly on contract, between 1992 and 1997. (S, D)

Equipment for the Canadian Forces

The Auditor General has issued warnings regarding capital spending by the military since 1984. In this review, they estimated five-year capital expenditure needs of \$11 billion, compared with only \$6.5 billion in available funds. Operations and maintenance costs exceeded 30% of departmental funding, further impairing equipment modernization. (F)

Health Laboratories

Resources were wasted within the integration of Health Canada and Agriculture Canada’s laboratory functions. For example, \$5.5 million was spent on planning for the Animal Virus Laboratory in Nepean before it was cancelled and \$10 million was lost when plans for a stand-alone Health Canada facility in Winnipeg were cancelled. Another laboratory in Winnipeg cost \$12 million to build but the containment laboratory was never used or evaluated and large portions of the facility remained empty. (W)

Agriculture Canada

Agriculture Canada’s Cash Advance Program provides loans up to 50% of the value of crops, with the federal government paying interest on the first \$50,000 advance. The Auditor General found no evidence that the pro-

gram contributed to orderly marketing. The incremental effect of the program was likely minimal and, rather than expanding credit, it actually displaced private credit financing. (F)

Social Insurance Numbers

The Auditor General raised a number of concerns regarding Social Insurance Numbers:

- there were 3.8 million more SINs for Canadians 20 years and older than people in that age group;
- there were 100 times as many active SINs for those over the age of 100 as living Canadians over that age;
- over 50% of SINs had no supporting documentation;
- the Social Insurance Registry had almost 12 million uncertified accounts. (I)

Highways

Transportation Canada provided Parliament with misinformation regarding road conditions relative to minimum national standards. Such information could have left the impression that improvements would require billions of dollars of expenditure. An internal study revealed that pavement surfaces were actually acceptably smooth and that the highways proposed for additional funding were well above the commonly accepted standard. (M)

Sole-source Professional Service Contracts

Contracts can be exempted from competitive bidding under specific circumstances. The Auditor General found that competitive bids were sought for only half of the \$3.7 billion in contracts that exceeded the minimum exemption level of \$25,000. None of the files met all of the Treasury Board Secretariat’s requirements regarding exemptions. (S)

1999

Underground Economy Initiative

Revenue Canada over-estimated the effectiveness of its Underground Economy Initiative, which focused on small and medium-sized businesses and involved 1,000 audit staff. The Auditor General concluded that the actual tax impact was “much less than the \$500 million

reported.” For example, Revenue Canada claimed \$100 million of detected income that was actually attributable to *Revenu du Québec*, the provincial ministry. (M)

Atlantic Fishery

The Auditor General found a contradiction between the Department of Fisheries and Oceans’ (DFO) stated objective of conservation and that of the decision-making process, which favoured social and economic factors. For example, both the snow crab fishery and the Bay of Fundy scallop fishery remained open to support equitable sharing of resources, despite strong conservation objections from DFO. Another example saw the issuance of offshore shrimp quotas to fishermen’s unions that did not have licenses. (F)

Another audit of TAGS followed up the Auditor General’s 1997 assessment. The Auditor General noted that:

- one-third of projects did not have a proposal on file;
- one-third of the files with a proposal did not meet stated funding criteria;
- it was impossible to determine how the selection criteria had been applied in most files;
- there was generally nothing in the file to indicate why a project had been recommended or selected;
- nearly half of the files had not been closed-out upon completion, which made it impossible to determine whether funding had been used appropriately. (I)

Hazardous Materials

The Department of National Defence (DND) estimated that one-quarter of its staff came into contact with hazardous chemicals on a daily basis. The Auditor General concluded that DND personnel were not meeting their legal and policy requirements governing hazardous materials. (F)

National Health Surveillance System

The National Health Surveillance system is intended to coordinate provincial health authorities in the detection and prevention of communicable diseases. There is no formal arrangement with the provinces and territories covering the common standards and procedures for collecting and exchanging data. In addition, Health Canada operates an office to track the incidence of disease and injury but has no formal system for collecting the information. (F)

Canada Infrastructure Works Program

The Auditor General expressed concerns about information published by the Canada Infrastructure Works Program regarding the source of estimates, the duration of employment, and whether job creation could be attributed to the program. The estimates were based on Statistics Canada’s assumptions regarding investment multiplier effects. These are not true performance measures since higher spending necessarily results in higher performance. Auditor General had previously raised this concern in 1996 but no adjustment in reporting was made. (M, S)

Property Management by Public Works

Public Works contracted out all 13 regional contracts for property maintenance to the same firm. The Auditor General discovered that the guiding principle was to provide employment to the department’s existing staff. The bidding process awarded 35% of total points for the quality and quantity of job offers to existing departmental employees and only 10% to the price quoted. (D)

National Defence

The Auditor General found widespread and systematic abuse from secret commissions and kickbacks from retail service stations providing diesel fuel for Canadian Forces and civilian Defence employees. DND personnel accepted cash rebates for 88% of 861 diesel purchases. (D)

Sole-source Professional Service Contracts

An Advanced Contract Award Notice (ACAN) can be issued—and the normal contracting process avoided—when government officials determine that there is only one competitive contractor. The Auditor General concluded that:

- over 30% of the cases had major differences between the statement of requirements and the terms of the contract;
- contractors’ work had not been critically assessed in three-quarters of the contracts reviewed;
- only half the files contained proof that the contract had even been delivered; and
- almost 90% of the 50 contracts examined did not fall under any of the exceptions or did not have adequate information to support the exception. (I, S)

2000

Human Resources Development Canada

Claims processing times by Human Resources Development Canada (HRDC) local offices improved slightly between 1996 and 1999 but at the expense of accuracy, which fell from 96% to 94%. Reduced accuracy increased underpayments of benefits by 60% and overpayments by a third. (I)

Canadian Immigration Program

Studies of the economic component of the Canadian Immigration Program indicated that selection criteria were no longer adequate and had raised false hopes among immigrants. For example, the list of occupations that receive additional consideration did not reflect Canada's current labour market, as they had not been updated since 1993. The selection of business-oriented immigrants left open the possibility of fraud, organized crime, and illegally obtained money. The Auditor General also raised concerns about the absence of any major penalties for submitting false statements and fraudulent documents. (I, F)

First Nations Education

Native education on reserves amounts to \$1 billion annually. The Auditor General found no process or mechanism to measure and assess whether or not student needs were being served. For example, there was no separate cost-per-student analysis for elementary and secondary schools. (R, F)

Border Control

This audit examined Canada Customs and Revenue Agency's (CCRA) border control system. Among several audit conclusions was that CCRA's look-out system for criminals was slow, could not read bar-coded documents, and relied on periodic updates rather than direct links to police databanks. The Auditor General noted that there were delays of two to five months in entering criminal records into the system and a previous study noted that the system was inaccessible over 10% of the time. (F)

CANPASS was designed to expedite the movement of low-risk travellers while reducing administrative costs at the border. Anticipated savings have not yet

materialized because user uptake has been limited. At Fort Erie and Windsor, for instance, CANPASS use was frustrated as users had to wait in line-ups with regular traffic because no separate lanes were available. CANPASS lanes at two other border crossings have been abandoned for lack of use. In an attempt to encourage user uptake, the Whirlpool Bridge was restricted solely to CANPASS users. Use of the bridge subsequently dropped 63%. Despite the mixed results of past experiments, CANPASS was scheduled to be extended to other border crossings. (I)

R&D Tax Credits

Unclear rules regarding the eligibility of software development for Canada Customs and Revenue Agency's (CCRA) tax credit program resulted in on-going court challenges and the expenditure of tens of thousands of staff hours and hundreds of thousands of dollars on multiple science reviews. The Auditor General found that science advisors and CCRA auditors rejected roughly \$1.3 billion of \$2.8 billion (46%) in claims requested under the program. (I)

RCMP Services for Law Enforcers

The estimated delay for DNA analysis by the RCMP was 82 days, even though the testing only took two days. The Auditor General attributed such delays to a lack of prioritization and unnecessary duplication of facilities. (I)

A 1990 report from the Auditor General noted that the Federal Bureau Investigation (FBI) serves all of the United States with one central forensic facility, while the Prairie provinces alone have three such facilities. A 1997 task force noted that the RCMP could reduce costs by reducing the number of laboratories and centralizing activities. Despite this apparent overcapacity, the RCMP opened a new \$12 million facility in Regina in 1995 and replaced a laboratory in Ottawa at a cost of \$21 million. The Auditor General concluded that the level of service does not meet the needs of the clients. (W, S)

The Auditor General also examined the backlog of applications in the RCMP's Firearms Registry. They noted that the Firearms Registry faced backlogs, even though the number of applications was lower than expected. Only 5,600 license applications were completed of the 41,500 received at the time of the audit. (I)

Airport Transfers

Transportation Canada did not determine the fair market value of airport assets and business opportunities when undertaking the transfer of ownership to airport authorities. Rather, it calculated Airport Authority rents based on the net book value of the airports. For example, the Auditor General noted that the book value of Pearson Airport would have been minimal due to the fact that Pearson's facilities had already largely been amortized. (W, M)

The Auditor General also expressed concern regarding the lack of transparency in these transfers. For instance, rent reductions of \$474 million had been granted to airport authorities but only \$97 million (20%) had been reported to Parliament. Three external studies concluded that the government incurred a financial loss with two of the four airport transfers but these results were not reported to decision-makers even one year later. (W, M)

Grants and Contributions by Human Resources Development Canada (HRDC)

The Auditor General found a widespread lack of due regard and diligence in spending public funds and to achieving desired results in the Transitional Jobs Fund (TJF). Among a number of problems identified, the TJF required every funding application to include a written recommendation from a Member of Parliament, which confused traditional accountability relationships. The Auditor General also concluded that fewer than 5% of TJF projects were adequately assessed. (I, S)

Officials at Human Resources Development Canada (HRDC) tried to spend their budget before year's end by advancing funds. HRDC recognized the advance as being spent, even though the funds were not expended on a cash-flow basis. (D)

The Auditor General also raised concerns regarding documentation in the TJF. For example, the contribution agreements offered by HRDC stipulate that any recipient must indicate the number of jobs created through the program. However, only 14% of project sponsors responded to the job survey. (I, F)

The *Auberge des Gouverneurs* project was sponsored by the Prime Minister's constituency office. The Minister announced \$600,000 of funding for the project before the project had been approved. HRDC determined that the project would create only two-thirds of the jobs orig-

inally expected. Departmental funding limits required that project funding should have been proportionally reduced but it was not. (M, S)

Similar problems were identified in the management control framework of the Youth Internship Canada program. Among the problems identified by the Auditor General were:

- only 5% of projects had been properly assessed for eligibility;
- only 18% of small projects could indicate any rationale as to why they received funding;
- nearly half of the small projects did not have proper approval; and
- there was no record of the number of jobs created for over 60% of the projects. (I, F)

Atlantic Canada Opportunities Agency Office Space

The Auditor General was critical of how the Atlantic Canada Opportunities Agency (ACOA) and Public Works tendered a contract for office space in Sydney, Nova Scotia. ACOA specified a contract for twice as much space as had been used at similar offices elsewhere in Atlantic Canada and with 10 times as many parking places. The contract also specified that the space had to be leased on a specific section of a specific street in Sydney though no rationale was offered for this. Public Works surveyed downtown real estate and found the building acquired under the tender was 20% to 30% more expensive than buildings of superior quality in Sydney. The Auditor General also discovered that the facility was never used for the purpose indicated and that at most two federal employees were located at the site. (W)

Governance of Crown Corporations

The Auditor General concluded that directors for Crown Corporations reflected Canada's diversity but lacked other key skills and capabilities that are needed to function effectively. The Auditor General noted comments by chairs and CEOs of Crown Corporations that roughly 25% of boards were out of their depth due to the selection according to "political criteria." The Auditor General stressed the importance of audit committees but found at least half of such committees were operating below an effective level and demonstrated financial illiteracy in 3 of 15 audit committees examined. (I, S)

Contracting Out

The Auditor General reviewed annual contracting-out statements by the government and concluded that contracting out was overstated. For example, standing orders were included in the inventory of activity, even though they are simply agreements with suppliers to supply when demanded. Public Works alone included \$1.3 billion in standing orders, and over \$300 million in credit-card payments were also reported as contracting activity. (M)

Management of the DFO's Fleet

There is a lack of adequate and effective management of capital and human resources by the Department of Fisheries and Oceans (DFO). For example, DFO's fleet is divided into five regional units, which results in missed opportunities for greater sharing of resources and for improved productivity. A case mentioned by the Auditor General involved the use of icebreakers in Atlantic Canada. The Maritimes Region mothballed a 14-year-old icebreaker for lack of funding at the same time that the Newfoundland Region was using 41-year-old and 33-year-old icebreakers. (R)

Employment Insurance

The Auditor General determined that there was abuse of the Employment Insurance (EI) program in British Columbia and that EI benefits were obtained through the use of false records. Human Resources Development Canada (HRDC) officials had been aware of the alleged fraud for over 20 years and Canada Customs and Revenue Agency had never prosecuted employers or claimants for making fraudulent claims. (I)

2001**Grants by Human Resources Development Canada (HRDC)**

The Auditor General noted that there is a lack of accountability related to Human Resources Development Canada (HRDC) grants and suggested that they be reserved for only particular cases. However, as of 2001, almost 70% of planned spending on funding was allocated to grants. (W)

Atlantic Canada Opportunities Agency

A principal criterion for grant approval by Atlantic Canada Opportunities Agency (ACOA) is commercial viability and, in order to ensure this, the agency's policy is to limit funding to three years. Despite this explicit rule, the Auditor General found that over 10% of projects reviewed had received funding in excess of three years. Worse still, over 20% of projects reviewed were deemed unlikely to be financially sustainable in the future without on-going government assistance. (W, M)

A significant measure of the agency's success is based on ACOA's partners reporting the number of jobs created. However, the Auditor General found that when a number of partners participate in a project, they all tend to claim responsibility for the jobs created. Such double counting made the actual numbers difficult to determine. The Auditor General further concluded that the methodology used in estimating job creation figures was flawed. ACOA continues to estimate that every \$25,000 spent creates or maintains a job for five years, despite past criticism of this method. (M)

Verification of Commercial Shipments

Canada Customs and Revenue Agency's (CCRA) response to the increase in trade has been a program of random verification of shipments. These spot-checks were intended to increase compliance and identify high-risk areas. In 1997, the Auditor General noted that CCRA had not made as much progress as it had expected. In 2001, the Auditor General concluded that periodic verification achieved little at great cost. After four years, the program had only completed 53 of 187 planned verifications. In determining reliability, 48 of the 53 companies verified had made classification errors. In some sectors, error rates were over 50%. (I)

Servicing National Defence Equipment

The Department of National Defence (DND) now operates equipment of a minimum serviceable level, which has meant reductions in the availability of equipment. The Auditor General identified a number of problem areas with respect to the availability of aircraft between 1998 and 2001, including a decline in the availability of the Aurora fleet from 55% to 42%

and of the Sea King helicopters from 42% to 29%. The Auditor General concluded that half of the decline in serviceable aircraft was attributable to repairs to keep the fleet airworthy. The Auditor General found similar problems in the Navy. (F)

The Auditor General also concluded that there were insufficient maintenance personnel to staff DND units and facilities fully. DND's maintenance units suffer overall vacancy rates of 13%, and 15% of the maintenance personnel that are available lack the qualifications their ranks require. (I)

Income Support Tax Credits

The Auditor General raised concerns regarding a lack of fraud and abuse measures in the Child Tax Benefit (CTB) and GST Credit systems. For example, a 1996 report from the Auditor General concluded that there were more children enrolled in the CTB program than the eligible child population. Another study concluded that 30% of child deaths in Alberta and British Columbia went unreported to the program and that, in some cases, payments continued inappropriately until the child reached age 18. The 2001 report found that overpayments were still being made, reaching a quarter of a billion dollars, and that there were continuing delays in detecting errors. (W, I)

Sole-Source Contracting

The Auditor General expressed concern that the rules for contracting out were still not being enforced. A sample of 26 sole-source professional service contracts was examined in 1998 and only eight satisfied even one of the stipulated conditions for sole-source contracts. In 1999, the Auditor General looked at a sample of 50 sole-source contracts and only 11% met the conditions stipulated by the government. (S)

Heating Expense Relief

In response to rising natural gas and heating fuel costs in the winter of 2000, the government granted relief checks to recipients of the GST Credit. The Auditor General was concerned that parliamentary scrutiny of the initiative was weakened because the government chose an approval process that did not involve Parliament. (S)

The Auditor General concluded that the relief program was poorly targeted. The use of the GST Credit system expedited check issuance but was ineffective in allocating relief to intended recipients. Among other things, the Auditor General found that:

- roughly 90,000 Canadians in need of immediate assistance did not receive relief because their income in the year prior exceeded the GST Credit cut-off;
 - less than one-quarter of the \$1.5 billion in payments went to low-income families facing emergency heating costs;
 - between 25% and 35% of recipients received the check but had heating already included in their rent or heated with electricity;
 - at least 40% of relief recipients were not low-income or did not face heating cost increases;
 - roughly 1 million of the 7.6 million households that received the relief could have received more than one cheque;
 - at least 4,000 Canadian taxpayers who did not live in Canada received payments;
 - up to 1,600 prisoners could have received cheques; and
 - at least 7,500 deceased people received relief.
- (I, W, F)

2002

Government Foundations

The Auditor General noted that foundations distort the accurate portrayal of government financial performance. The government accounts for lump-sum transfers to foundations as expenditures, even though they represent future spending, and this minimizes the apparent size of the fiscal surplus. Foundations have also been placed beyond the reach of effective ministerial oversight and parliamentary scrutiny. (M, S)

Tax Administration

The Auditor General found that Canadian Custom and Revenue Agency's (CCRA) registry for tracking tax forgiveness requests does not record the reasons given for rulings. The original intention of the registry was to pro-

vide consistent rulings but this is impossible when the reasons are not given. In one case, a nation-wide service provider received three different rulings from seven regional tax authorities for the same tax issue. (R)

Canadian Health Network

The Auditor General concluded that Health Canada did not meet government contracting-out rules when it spent \$25 million on the Canadian Health Network. The program cost \$11 million more than was originally intended and experienced 25 contract amendments. The document-management system alone cost over \$6 million and Health Canada, after four years of use, is considering using alternate software. (W)

Under government procurement rules, a contract valued at less than \$25,000 can be tendered without public bidding. The Auditor General found that the Canadian Health Network used contract splitting on a series of contracts to award contracts under \$25,000 and subvert the competitive bidding process. In one instance, a multimedia call centre was posted for bidding on March 10, 1998 with a closing date of March 20, and a completion date of March 31. (S)

Satellite Communications

The Department of National Defence (DND) took eight years to develop a \$174 million satellite communications system. When the system was completed, DND determined that the commercial system it had been using was sufficient to meeting existing needs and required fewer staff to operate. In addition, the new military satellite communications system would require an additional \$15 million to meet current operational standards. The system remains in storage. (W)

Social Insurance Numbers

The Auditor General undertook a follow-up review of the Social Insurance Number (SIN) system. Continuing problems:

- there were 5 million more SINs for people over the age of 20 than there are Canadians of those ages;
- more than half of these SINs were considered dormant;
- there were over 8.3 million usable SINs that have never been verified by personal identification; and

- the majority of SINs issued since 1998 were not properly verified with the applicant's identity and citizenship status. (I, M)

Pilot Training

The Department of National Defence (DND) contracted out a \$2.8 billion pilot-training program without including sufficient covenants in the event of insufficient demand and without fully contracting the support of NATO partners. In the first two years of a twenty-year program, \$65 million was spent on training that was never used. Only 41% of the training paid for was actually used. Only 61 Canadian student pilots qualified for training, just 28% of the originally expected 216 student pilots. DND paid \$31 million for training for which the ministry did not have the necessary aircraft. (W, I)

Small Business Loan Guarantees

One of the stated goals of the Canada Small Business Financing Program is that loans should be incremental. A recent internal report suggested that 46% of the loans could have been obtained without the program. An additional program goal is that loans should be issued on a cost recovery basis. This is only possible if loan defaults do not exceed 6.25% of the value of guaranteed loans. The Department expects 9% of loans issued between 1995 and 1999 to default. This is expected to lead to losses in excess of \$200 million. (W)

First Nations Reporting

In reviewing concerns of First Nations over reporting requirements, the Auditor General determined that populations on reserves are unknown because the "Indian Registry System . . . was not designed to collect information about the number of residents." Therefore, the exact proportional impact of spending is unknown. (I)

Marine Navigation

The Department of Fisheries and Oceans (DFO) staffs 50 of 51 lighthouses in Canada, largely for heritage reasons. Between 1998 and 2003, Treasury Board committed \$85 million to maintain staffing at lighthouses. The Auditor General concluded that staffed lighthouses are unnecessary. Since 1990, the United States has removed

staff from 474 of 475 lighthouses. The Auditor General concluded that it is unclear how staffed light stations serve a heritage objective. (W, S)

Canadian Space Program

The Canadian Space Agency (CSA) is currently experiencing difficulty because of program commitments that are often beyond its control. Some of the CSA's cost overruns are attributable to decisions made by Canada's international partners. In one instance, delays at NASA in launching a Canadian component for the international space station cost the Canadian government an additional \$13 million in maintenance costs. When NASA withdrew its support for launching the RADARSAT-2 satellite, the project was delayed two years at an additional cost to taxpayers of \$167 million. In 2008, Canada is committed to pay 2.3% of the costs of operating the International Space Station but the ultimate cost of this commitment is unknown. (I)

Acquisition of Office Space

Public Works has a \$1.7 billion annual budget for housing some 187,000 civil servants. According to an internal assessment, key planning documents are outdated or missing. The Branch knows the renewal dates of leases but it does not use that information as a basis to plan ahead. More than half of all cases reviewed were examined with insufficient time to consider all options. This led to vacant buildings and poor client service. (I)

The Auditor General found that Public Works had engaged in speculative land acquisitions. In one instance, a building was leased in the National Capital Region even though the file indicated that Public Works anticipated reluctance to move to that particular location. The client agency refused to move and a new tenant is being selected. In the intervening 16 months, Public Works has paid \$2.7 million in rent for an unoccupied building. (W)

Audits concluded that Public Works undertook decisions to buy or lease with insufficient information. The files reviewed showed that 14% of purchases and leases were missing investment analysis reports and 21% lacked market analysis reports. The Auditor General concluded that management does not systematically monitor key items of business, such as the prices paid for leases and the timeliness of project completion. (I)

Firearms Registry

The Auditor General reviewed information provision and disclosure by the Department of Justice (DOJ) regarding the now controversial Firearms Registry. DOJ assured Parliament that the Minister would be accountable for the full cost of the Firearms Registry. However, only the costs incurred by the Canadian Firearms Centre had been reported, not the full costs of the program. According to the Auditor General, DOJ provided insufficient financial information and explanations for the dramatic increase in the cost of the program. The cost rose from an estimated \$119 million (\$2 million net cost after user fees) in 1995 to over \$1 billion in 2002. (M, W)

The information system needed to run the Firearms Registry was well beyond any previous DOJ initiative. This inexperience led to cost overruns and frequent adjustments. By 1999, the system had received 1,000 orders for system changes. These changes typically took three to six months to implement and cost millions of dollars. In 2001, the Department conceded that the system was not working well, was expensive, obsolete, and inflexible. Construction and maintenance costs of the existing system were exceptionally high and were expected to represent 60% of future operating costs, significantly higher than the industry norm of 10% to 20%. (I, W)

Canadian Firearms Program

The Auditor General and law enforcers expressed serious concerns regarding the accuracy and completeness of this RCMP database. In 2001, an RCMP review revealed that people are in the database who should not be, while others should be included and are not. According to the Auditor General, the review concluded that a tragic incident could arise as a consequence of the poor data quality. (R)

Mail Food Program

The Government subsidizes the shipment of perishable food to northern aboriginal communities. No review has ever been conducted on the rationale behind the food entry points selected. Food is currently shipped out from Val D'Or, Churchill, Iqaluit, and other remote communities. The Auditor General suggested that program administrators consider shipping food from other Canadian cities where the prices, quality, and variety of fresh food are better. (I)

Downsview Park

Downsview Park, an abandoned military base in Toronto, is being kept for use as an urban green space. It has received \$20 million in public funds, without ever receiving approval from Parliament. This oversight was noted in 2000 but no action had been taken by 2002 to legitimize the transfer. (S)

2003**Financial Information Strategy**

The government has invested over \$600 million in its Financial Information Strategy (FIS), intended to integrate all costing and decision-making information into one database. The shortcomings of the FIS infrastructure means that 90% of the managers interviewed do not rely directly on the FIS system but rather use internal accounts. As well, nearly 90% of the 44 entities with multiple business lines account for their administrative costs on a separate business line. This led the Auditor General to conclude that “the full cost of departmental activities is not being presented to Parliament and the public.” (M)

Immigration Control

In the last six years, there were 36,000 more people ordered removed from Canada than there were confirmed removals. The Auditor General estimated that Citizenship and Immigration Canada (CIC) will soon have to remove an additional 29,000 people now in Canada. In 1994, an evaluation of the border-point examination process found that the Department was only 50% effective at restricting inadmissible travellers. In 2000, 50% of the applicants scheduled for removal did not appear for their removal hearing. The Auditor General remarked that CIC “has not analyzed how it will handle its growing backlog of investigations and removals.” (I, F)

Canada Customs and Revenue Agency (CCRA), which administers most ports of entry into Canada, does not receive effective immigration intelligence from CIC. In part, this is because the CCRA’s administrative system is based on license plates and is not compatible with the CIC system based on personal identification. (R)

Minister’s permits may be issued to immigrants who are otherwise inadmissible to Canada for technical,

medical, or criminal reasons. In 2001, nearly 4,000 such permits were issued. The Auditor General examined a representative sample of permits and found that the applicants’ files did not support the issuance of permits in 40% of the cases. In cases involving applicants with a criminal background, nearly half of the files did not provide justification for the permit. (I)

Housing on Reserves

The Department of Indian and Northern Affairs (INAC) and Canada Mortgage and Housing Corporation have provided First Nations with \$3.8 billion for on-reserve housing over the last 10 years. INAC transferred \$34 million in 2001 and \$40 million in 2002 of unspent funds from other programs to address “urgent” housing needs on reserves. The Auditor General found inadequate information on how the funds were spent and noted that “the Department and First Nations were under pressure to spend the money before fiscal year end. This resulted in ‘emergency spending’ in the Department, with questionable results.” (W, S)

Citizenship and Immigration Canada

Visa issuance is the primary form of control on immigration. The Auditor General was concerned that the Immigration Visa and Record of Landing document “was outdated and easy to falsify.” Furthermore, departmental records indicate that visas had been stolen. Theft was in part possible because certain offices did not reconcile document inventories on a daily basis and other appropriate controls were not in place. (I, D)

The departmental performance report claims that Citizenship and Immigration Canada attracted 137,119 skilled workers to Canada in 2001. In fact, the number of skilled workers that came to Canada was 58,860, with 78,259 dependants. The Auditor General stated that “the information presented to Parliament on the number of skilled workers entering Canada may be misunderstood.” (M)

Job classification in the Public Service

The government has planned to reform the existing job classification system that had 840 pay rates and 70,000 rules governing pay and allowances since 1990. The Treasury Board Secretariat was constrained in its efforts

because total conversion costs could not exceed \$400 million, no salary was to be lowered as a result of conversion, and a majority of civil servants had to see an appreciation in their classification levels. For 12 years, “tens of thousands of employees from some 60 departments and agencies devoted significant amounts of time and energy to writing, evaluating, and revising work descriptions for some 150,000 employees—more than once,” with estimated incremental expenditures at \$200 million. On the structure of the current pay system, the Auditor General says that “these classification standards support values no longer relevant to achieving efficient delivery of services and programs.” (W, R)

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Sponsorship Program

The Sponsorship Program spent \$250 million between 1997 and 2003 to “increase the federal presence and visibility in communities across Canada by providing funds to support [1,987] cultural and community events.” Over \$100 million was paid as fees and commissions to communication agencies. The Auditor General found that funds were transferred to Crown corporations in an attempt to hide the source and nature of the funding. The parliamentary appropriations process was circumvented and no discernible selection process was used. (M, D)

Purchase of Challenger Aircraft

The government decided to spend almost \$100 million on two new Challenger aircraft in the space of nine days in March 2002. The Auditor General noted that the Privy Council Office bypassed the government’s own procurement policies and procedures with this decision, circumventing a proper review of requirements, how best to improve the air fleet, and a consideration of other alternatives. (W, S)

Land Claim Agreements

The Auditor General examined two land-claim settlements with the Gwich’in in the Northwest Territories and the Inuit in Nunavut. In both cases, the agreements set out government obligations that have not been measured or assessed over the past 10 years. (I)

Cultural Heritage

The government spent \$500 million on the cultural heritage in 2000. The Auditor General looked at the areas most at risk: national historic sites and federal heritage buildings, federal archives, and the collections of the National Library of Canada and federal agencies. More than two-thirds of sites and buildings were found to be in poor or fair condition. Over 90% of the National Library collections are housed in buildings that “do not meet current standards for temperature and humidity.” (F)

3 Reducing Government Failure

Given the inherent weakness of government identified by Public Choice analysis and the examples of government failure documented by the Office of the Auditor General of Canada, we must ask if there are mechanisms through which government failure can be reduced. The methods available for reducing government failure range from simple bureaucratic and administrative changes, such as increasing oversight and improving public sector incentives, to the outright elimination of government activities.

Perhaps the most important step in reducing government failures is setting priorities. By prioritizing its objectives, government would be better able to ensure that critical services are provided to citizens in a timely and cost-effective manner. A failure to prioritize goals and objectives leads to misallocation of limited resources, spreading resources too thinly, and ultimately to an inability to achieve the desired goals and objectives. More disconcerting is the potential for the government to fail to provide vital services in which it has a central role, such as public safety and national defence. Below is a list of some of the other mechanisms for reducing government failure.

(1) Rationalization

This requires government to clearly define its role and eliminate, or at the very least reduce, any of the activities not supportive of its core functions. It represents one end of the spectrum of alternatives available to government to curb waste and reduce government failure.

For instance, a government may decide that it is not necessary or appropriate for government to allocate investment capital, as the federal government does at present through various regional development and tax subsidy programs. The ideal response would be to eliminate such activities.

There are a number of obvious examples where it is difficult to articulate a clear mandate or even need for

government involvement, given the presence of a functioning market. In the addition to capital allocation, other examples of questionable government involvement include support for broadcasting, agricultural subsidies, industrial strategies, and job promotion schemes. Eliminating these activities of government would not only provide additional resources for other programs or tax relief but would also sharpen the oversight capacity of parliament and the attention of the public sector.

Rationalization also embodies the recognition that there is a range of proper government involvement, from simple oversight and regulation to direct program financing and provision. Understanding the range between these two extremes can assist government not only in rationalizing the areas in which it should be involved but, equally as important, in determining the methods by which it should structure its involvement.

(2) Privatization

Government privatization initiatives also require a prioritization of responsibilities and activities by government. Unlike rationalization, however, privatization entails the sale of state-owned assets to the private sector for private operation.

For example, the government may decide that it is not necessary or productive for the state to own, operate, finance, and regulate gas stations. It could, therefore, sell its stake in a state-owned oil and gas company to the private sector, as the Canadian federal government did with Petro-Canada.

The benefits of privatization are well established and result from the key differences between how the private and public sector behave and the incentives each faces.⁸ Economists William Megginson and Jeffrey Netter, for example, provided a comprehensive, worldwide review of privatization in an article published in the *Journal of Economic Literature* (Megginson and Netter, 2001). They

found, among other things, that the public sector uses less capital and is more labour intensive than the private sector. Less capital in the hands of public-sector workers leads to their having lower productivity than their private-sector counterparts, even though research indicates that public sector employees receive a wage premium.

Another essential difference is that governments are preoccupied with fulfilling social goals rather than pursuing economic or business objectives. This often leads to a significant misallocation of resources. Instead of allocating capital where it garners the highest economic rate of return, governments typically allocate capital to areas that maximize political returns, i.e. the governing party's chances for re-election.

Finally, Megginson and Netter found both short-term and long-term gains for economies undertaking privatizations. In the short term, taxpayers gained through one-time revenues from the sale of government assets; in the longer term, privatizations increased economic growth. Megginson and Netter note: "Divested firms almost always become more efficient, more profitable, financially healthier, and increase their capital investment spending."¹⁰

This survey buttresses earlier work completed by the World Bank that examined over 60 privatized companies in 18 countries. It found that, after privatization, companies increased profitability by 45%, efficiency by 11%, output by 27%, investment in plant and equipment by 44%, and employment by 6%; an overwhelming endorsement of the benefits of privatization.¹¹

Finally, and perhaps most insightful, were the conclusions of Harvard Professor Janos Kornai in his analysis of soft and hard budget constraints discussed above.¹²

(3) Public-Private Partnerships (P3s)

Unlike the previous two options, Public-Private Partnerships (P3s) maintain a central and active role for government. An ideal P3 includes an accurate matching of costs and benefits for participating partners and maximizes the comparative strengths of each.¹³

A common example of P3s is infrastructure construction and maintenance. Most often, private firms are contracted to design, construct, and maintain the infrastructure while the government provides assistance with

financing and land assembly. Harnessing the competitive advantages of the private sector can reduce the overall costs of the project while maximizing the potential benefits.¹⁴ It is important to acknowledge the importance of P3 contracting and the fact that many P3 initiatives go awry because of poor planning or poor contractual agreements.¹⁵

(4) Outsourcing

This option retains an even larger role for government than the P3 option discussed previously. Outsourcing is simply the use of competitive bidding for the provision of specified goods or services for government. For instance, the government may decide that it has no particular expertise in the provision of food services or janitorial services and opts to use private firms. The government opens the provision of the services to competitive bidding, within the context of certain contractual stipulations. Governments across Canada currently use outsourcing to reduce costs and maximize efficiency.

The benefits of outsourcing are well documented in academic literature. Domberger and Rimmer (1994), in a review of international empirical studies on contracting out in public sectors in North America, Europe, Asia, and Oceania, concluded that competitive tendering and contracting usually leads to substantial cost savings, in the order of 20%.

Savas (1982) examined the available international evidence on the effects of contracting out in a host of services formerly provided by governments, including solid-waste collection, electric power, fire protection, transportation, postal services, health care, education, and social services. Savas found that, at the very least, the evidence indicates that public provision of services is not superior to private provision and that the argument for private provision can find considerable support. Other studies support the finding that private services are superior to their public counterparts.

For example, in two cross-Canada surveys of municipalities, McDavid (1988) found clear evidence of cost savings due to outsourcing based on productivity differences between the public and private sectors. Finally, Domberg *et al.* (1995) evaluated 61 cleaning contracts

in an attempt to determine the effects of outsourcing on costs and quality. They found that competitive tendering significantly lowered prices and maintained or enhanced the quality of service.

It is also important to note that simply introducing competitive bidding can improve public-sector performance.¹⁶ An example of this occurred in Indianapolis under Mayor Stephen Goldsmith, where public-sector productivity was improved by simply opening up the provision of government services to competitive bidding. Such improvements in the public sector provide support that, at a minimum, the public sector should be exposed to competition from the private for-profit and non-profit sectors for the delivery of government services.

Like P3s, outsourcing can be abused by both private providers and government. The critical component in an outsourcing initiative is the tendering process. Unfortunately, as we saw in section 2 of this study, there were a number of instances identified by the Auditor General where outsourcing was severely abused and resulted in losses to the government (taxpayers). It is, therefore, critical that incentives for undertaking outsourcing be such that departments find it in their best interest that outsourcing be successful. In addition, outsourcing contracts should include clear measurable targets for service delivery. Finally, on-going review of contracts and results should be undertaken by the outsourcing department as well as by an oversight department such as the Office of the Auditor General.

(5) Internal Control and Monitoring Mechanisms

Internal government mechanisms are yet another option available to reduce government failure. For instance, the resources of the Auditor General, the Ethics Counsellor, the Public Accounts Committee, the Treasury Board, and other governmental departments could be expanded so as to allow for a greater number of reviews and greater depth of review. In addition, a position equivalent to a Corporate Comptroller could be introduced within Treasury to monitor and control spending by government more closely.

(6) Strengthening the Auditor General's Office

A specific recommendation, based on the previous section, would be to expand the resources of the Auditor General's Office¹⁷ and broaden the scope of available audits to include Crown Corporations and government foundations. In addition, any program, department, or ministry that undergoes an audit review should be required to publish its response within a set period of time, including measurable plans to overcome difficulties identified by the Auditor General.

Finally, follow-up audits to determine compliance should also be made mandatory and all communications should be made public. This process could be improved further if a dedicated parliamentary committee, similar to the Public Accounts Committee, were given the oversight of the Auditor General and, more importantly, the follow-up process with audited programs, departments, and ministries.

Conclusion

There are many mechanisms that can be used by governments interested in reducing waste and overcoming institutional limitations. The most important changes are to focus resources on areas of priority and to establish rules and regulations that create an environment within which productive and effective decision-making can be undertaken. In addition, it is critical to acknowledge the range of government involvement available and determine the most effective means by which a government can involve itself in a particular activity.

The main lesson from the facts as assembled by the Auditor General is that governments are not very effective vehicles for accomplishing outcomes. Therefore, the objective must be to minimize the tasks that are undertaken in the public sector. The government does not need to undertake an activity in order to ensure that it is done. Public purposes, as we have shown, can be accomplished as well, or better, by contracting, privatizing, or ceding the activity to the private sector.

Notes

- 1 Given the heightened interest in the area of government waste and failure and, in particular, the recent attention paid to the Auditor General's Office, the authors feel it important to state that this project has been underway for nearly a year and was started well before the latest report from the Auditor General began to attract public attention. This study is the first of a new series from The Fraser Institute that will document government waste and failure.
- 2 Public Choice received widespread attention when one of its founders, James Buchanan, won the Nobel Prize in 1986. Buchanan and his colleague Gordon Tullock were instrumental in establishing the Center for the Study of Public Choice at George Mason University <<http://www.gmu.edu/jbc/>> and the Public Choice Society <<http://www.pubchoicesoc.org>>. There are a large number of publications listed in the reference section for those who wish to further their understanding of this important branch of economics.
- 3 Some programs, like Employment Insurance and the Canada Pension Plan, have a much closer link between taxes assessed and the direct benefits provided to recipients than most programs.
- 4 For a through discussion of "log rolling," see Tullock et al., 2002: 29–41.
- 5 See Gunning, 2003: 271–330; Niskanen, 1971; Tullock, 1987; Tullock et al., 2002: 53–62; and Mitchell and Simons, 1994: 58–62.
- 6 See Gunning, 2003: 347–72 and Tullock et al., 2002: 43–52 for a through analysis of rent seeking.
- 7 See Office of the Auditor General, <<http://www.oag-bvg.gc.ca/domino/other.nsf/html/bodye.html>>.
- 8 For further information on privatization, please see the Reason Foundation's Privatization Initiative's website at <<http://www.privatization.org>>. The Fraser Institute has also published a number of studies, ranging from full-length books to shorter journal articles on various privatization initiatives and opportunities: Jones, 2003; Jones and Walker, 1997; Hepburn, 2001; Easton, 1998; Schafer, Emes, and Clemens, 2001; Walker, 1988; Lofgren, 2002b; West, 1997; Clemens and Esmail, 2002a, 2002b; Clemens and Miljan, 2001; Chittick, 2003. See also the important work, Butler, 1992.
- 9 The reports discussed below were among those prepared by the Auditor General in November 2003 but, because Parliament was prorogued, they were not released until February 2004.
- 10 See Megginson and Netter, 2001: 381.
- 11 See Ewing et al., 1997; Guislain, 1997; Pohl et al., 1997; and Sader and Megyery, 1997.
- 12 In Kornai, 1992, 2003. For a broad overview of budget constraints and their affects, please see Kornai et al., 2003.
- 13 For further information on P3s, please see the National Council for Public-Private Partnerships <<http://ncppp.org/>>; The Institute for Public-Private Partnerships <<http://www.ip3.org/>>; Canadian Council on Public-Private Partnerships <<http://www.pppcouncil.ca/>>; we also recommend reading Finn Poschmann's excellent overview of P3s in Poschmann 2003, available at <http://www.cdhowe.org/pdf/commentary_183.pdf>.
- 14 Hanss (2001), in an extensive analysis of Germany's municipal local transport utilities, argues that public-private partnership would overcome competitive disadvantages of public enterprises and produce benefits for both the private company and the government. Specifically, the financial burden on the government is minimized, freeing up funds for other purposes.
- 15 Nijkamp, Van der Burch, and Vindigni (2002), in analyzing nine Dutch case studies of public-private partnerships in urban land-use projects, conclude that the success of public-private partnership depends on several factors. First, a P3 is more likely to succeed if it is designed on the basis of a joint-venture model. Next, a detailed outline

of the scope of the project, the planning, and the level of party involvement is an essential element of success. Finally, clear insight into the expected costs, revenues, and profitability is critical.

- 16 For more information on civic reform, see Goldsmith, 1998, McMahon et al., 2003, and the website of the Manhattan Institute's Center for Civic Innovation, <<http://www.manhattan-institute.org/html/cci.htm>>.
- 17 For an interesting discussion of the Office of the Auditor General and its increasing importance, see Gibbins, Berdahl, and Harmsworth, 2000.

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