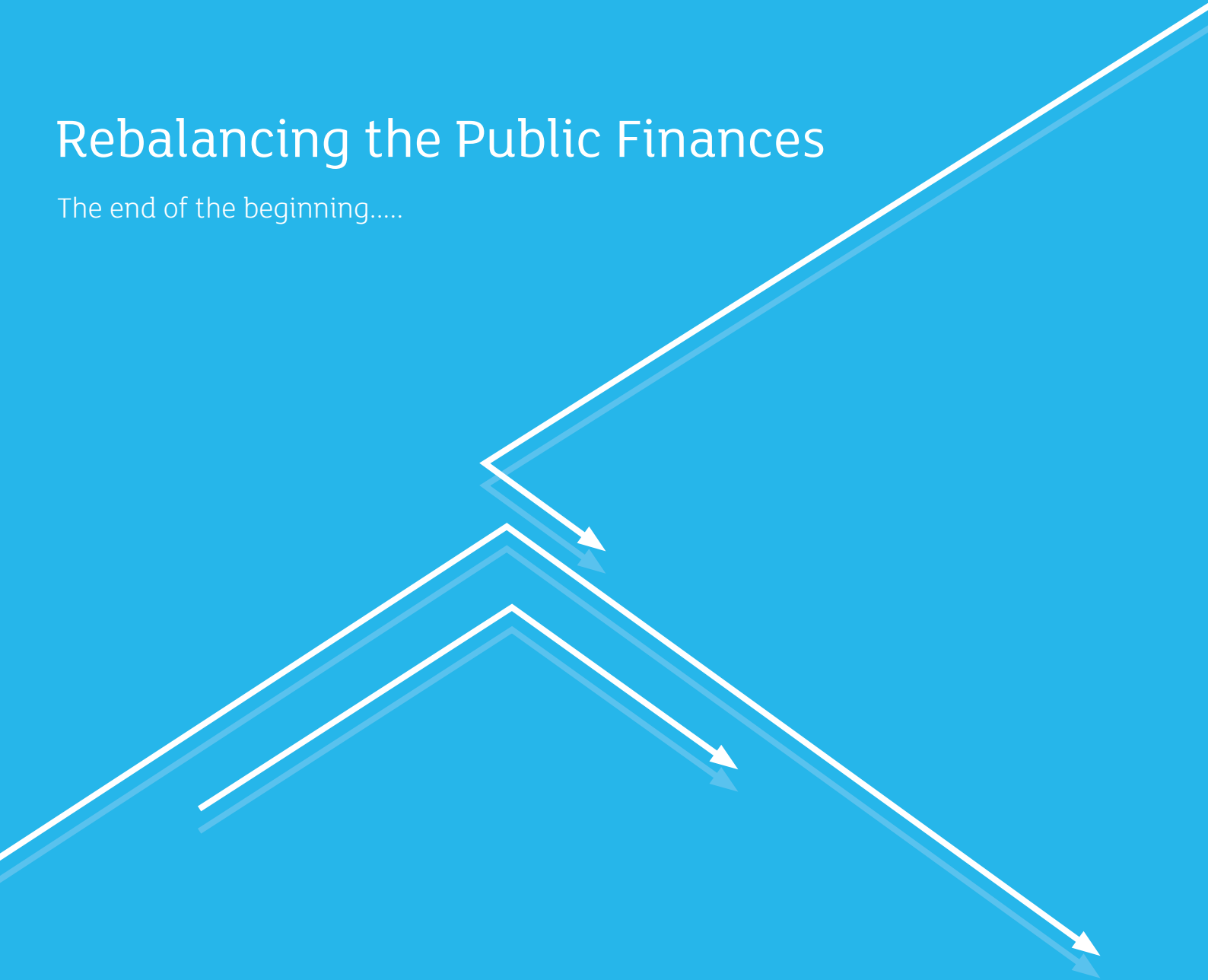


Rebalancing the Public Finances

The end of the beginning.....



Rebalancing the Public Finances: The end of the beginning.....

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Executive summary

In December 2009, CIPFA and SOLACE published a joint report, *After the Downturn*, which explored three strategic options for the Government and public services in achieving the major and sustained spending cuts that would be necessary to rebalance the public finances. This further report assesses how those three options have been explored in the coalition Government's first months.

We conclude:

That the relationship between the state and the individual sits at the heart of the Government's 'Big Society' policy. It has resonance because, as is now widely accepted, the state can no longer afford to service its existing relationship with citizens.

The coalition Government has made several positive statements about a more localist approach to public services. Since our original report, it has taken radical action to abolish a number of agencies, placing significant emphasis on transparency and accountability as cornerstones of its approach to shaping decisions about 'delaying'. Importantly, the Government's definition of localism goes beyond devolution to local public institutions.

The current financial climate heralds the possibility of a dramatic increase in collaboration, leading perhaps to the emergence of a very different public services landscape over the next five years. However, maintaining continuity of service whilst simultaneously establishing new shared arrangements is likely to be a major challenge.

The next six months is likely to be the defining period for the project to rebalance the public finances, the end of the beginning and the so-called phoney war. This will be the period in which the project becomes real for citizens, families and communities and tough choices will be made nationally, in the spending review, and locally, in public bodies' budgets.

With such fast moving and far reaching changes to services, major new risks will appear. In particular, it is likely many, often vulnerable groups will become subject to multiple impacts, which government will find hard to foresee and manage.

The drive towards localism will require a much stronger commitment to engaging and involving the public in decision making.

In achieving greater collaborative working across public services, voluntary agreements will no longer suffice and new hard-wired, formal governance and management arrangements will have to be put in place to provide certainty.

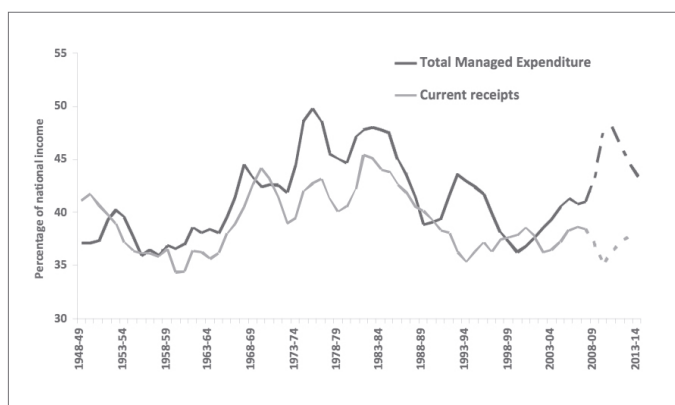
The skill - or otherwise - with which change is managed remains a critical variable in the system. Handled well, it has the potential to smooth and ease underlying tensions and disappointments. Handled poorly, it may exacerbate already inflamed situations.

Introduction

In the months leading up to the UK General Election of May 2010 it became clear that significant reductions in public spending were inevitable. In the election campaign itself all of the major political parties agreed that cuts would be necessary in order to rebalance the public finances after the serial impacts of the global financial crisis and the economic downturn.

As fig 1 illustrates, public spending was forecast to rise sharply to approximately 48% of gross national income in 2009/10 while tax receipts were expected to fall to levels last seen in the recession of the early 1990s.

Figure 1 Pre-election forecast of TME vs current receipts



Note: Excludes unrealised losses on financial interventions.
Source: HM Treasury.

Such a yawning gap between spending and receipts triggers a need for very high levels of public borrowing. All the major parties recognise that deficits of the order of £150bn per annum are unsustainable and that urgent action is required to curtail spending. The political debate, during the election and subsequently, has therefore been less about whether cuts are necessary and much more about how, where, and particularly when, they should be made.

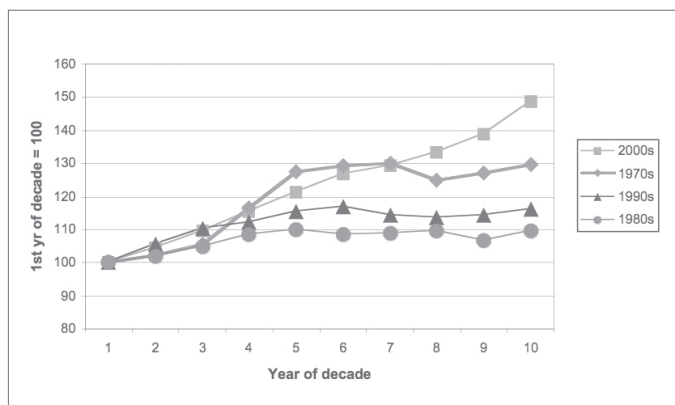
After the Downturn

In part by virtue of the roles played by their members, both CIPFA and SOLACE have been especially keen to encourage awareness and debate about these important developments and their implications for public services and the communities who rely upon them. In December 2009, six months ahead of the election, we therefore published a joint report, *After the Downturn*, outlining the national financial position, the scale of public spending cuts which might be attempted, and the key strategic policy options which were likely to play a part in any future Government's rebalancing strategy. The key messages were that:

- Two alternative speeds were likely to be considered: scenario A (slower speed) which might involve real terms headline spending reductions of around 2.5% per annum, and scenario B (faster speed) involving headline cuts of the order of 5% per annum.
- Decision makers at both national and local levels were likely to try to protect some services from cuts. Depending upon the scale of budgets prioritised in this way, other budgets would have to be cut more deeply. In scenario A headline cuts of 2.5% per annum were forecast to rise to as high as 7.5% per annum for some services, after both national and local determination of priorities. The parallel forecast for scenario B was cuts of up to 10% per annum for some services.
- Cuts of the order outlined would be necessary for a number of years and a major challenge would be to manage their cumulative medium and long term effects.
- Public service leaders were likely to explore policy options for achieving spending cuts in three broad areas:
 - 1 By redefining the relationship between the state and the individual
 - 2 By a significant layering of the public sector with many more decisions taken locally with minimal oversight
 - 3 By a major initiative to maximise economies by much more effective collaboration between public bodies

Compared to previous public spending adjustments the challenges facing Government and the country were and still are extremely severe. Figure 2 illustrates the relative buoyancy of public spending in previous decades despite policies, at various times, to reduce or contain it. It is safe to conclude therefore that few, if any, current public leaders or managers will have previously experienced funding reductions of the scale anticipated over the next few years.

Figure 2 Indexed total public spending



The March Budget

In March 2010 the Labour Government published what proved to be its last Budget outlining its plans to rebalance the public finances. In broad terms these were relatively close to scenario A, the slower speed option outlined in *After the Downturn*. They forecast that annual borrowing would reduce gradually from a peak of over £160bn to approximately £74bn in 2014/15 (see figure 3). The implication was that this trend would need to continue through a subsequent parliament/spending round to complete the rebalancing process – the so called ‘two parliaments of pain’ strategy.

The coalition Government

In the event, the May General Election produced a new Conservative/Liberal Democrat coalition Government. One of its first actions was the announcement of the creation of a new independent Office for Budget Responsibility (OBR) to bring greater transparency to and encourage greater public confidence in the public finance forecasts against which Government makes policy decisions.

In turn, one of the first actions of the new OBR was to produce its own initial assessment of the public finances and of the level of annual deficits and borrowing likely in current and future years (see figure 3).

From the outset, the new Government, concerned about the continuing instability of financial markets and the sovereign debt crisis emerging in a number of countries, resolved to take a significantly more aggressive approach to rebalancing the public finances than its predecessor. In its Emergency Budget of June 2010 it announced a strategy which is much closer to scenario B in the original *After the Downturn* report.

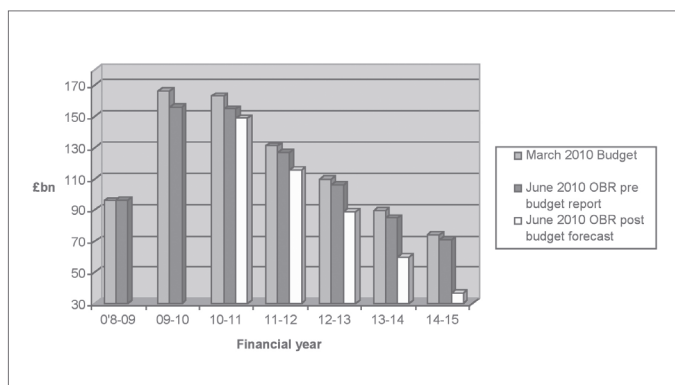
Some of the spending headlines of the Emergency Budget were:

- Prioritisation (ie protection of budgets) of spending in two key areas: the NHS and overseas aid
- Lower than average cuts in defence and education
- Average cuts in unprotected budgets of 25% over four years (equivalent to around 6.25% per annum)
- A two year public sector pay freeze with some protection for the low paid.

Further detail will be available when the results of the Government’s spending review are announced on 20 October. Subsequently it is also important to emphasise that a host of individual public bodies will make further budget decisions involving prioritisation/protection of some services. On this basis our original scenario B forecast of cuts of up to 10% per annum for some services remains entirely realistic.

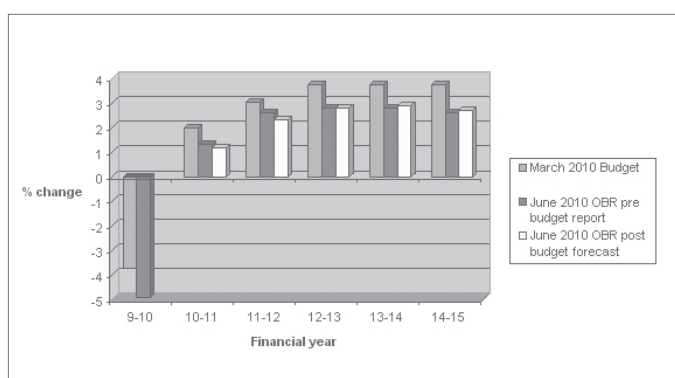
The OBR’s independent assessment of the Coalition’s Emergency Budget concludes that annual borrowing is likely to fall much more quickly than under the former Labour Government’s plans. By 2014-15 OBR forecast that annual borrowing will have fallen to £37bn, approximately 2% of GDP, as shown in figure 3.

Figure 3 Public Sector net borrowing



A great deal inevitably hinges upon the overall performance and growth of the UK economy. In that context it is important to outline the growth assumptions which relate to the various borrowing forecasts shown in figure 3 and in particular to highlight the OBR assumptions underpinning current forecasts. These are illustrated in figure 4.

Figure 4 GDP % change on previous year



Ongoing uncertainty

All of these issues remain hotly contested. Some of the key questions raised by commentators and analysts include:

- How will the public react when significant spending cuts are eventually implemented? Will they be resigned to the prospect after all of the media coverage anticipating the event? Or will they, despite the warnings, be alarmed when generalised predictions about cuts suddenly become real for their families and communities?
- How will Government and the political parties respond if public reaction is adverse and resistant? What impact, if any, will such a reaction have upon the unity of the coalition Government and future iterations of the Government's plans?
- What impact will public spending cuts have on economic growth, particularly in regional/local economies which are relatively more dependent upon public expenditure?
- How will international markets and global trends impact upon the UK's position? On balance will they be positive, creating a relatively supportive environment, or will they be turbulent, threatening significant new challenges and making the UK's recovery much more difficult?

The emerging policy landscape

In terms of public announcements, the coalition Government is still in the relatively early stages of setting out the policy backcloth which will help to enable the planned spending cuts. More detail will be available after the spending review announcement on 20 October when individual Departments and organisations make public their plans for managing within the tight spending constraints which are anticipated. Nevertheless, even at this stage it is possible to detect the outworking of the three strategic options forecast in the original *After the Downturn* report. All three options appear to be actively in play in the Government's early policy actions and in the emerging responses of individual public bodies.

Option 1: Redefining the relationship between the citizen and the state

The relationship between the state and the individual citizen has been a recurring theme in the discourse about the financial challenges facing the country and the nature of the spending cuts under consideration. It also sits at the heart of the Government's 'Big Society' policy:

"The Big Society is about a huge culture change where people in their everyday lives, in their homes, in their neighbourhoods, in their workplace don't always turn to officials, local authorities or central government for answers to the problems they face but instead feel both free and powerful enough to help themselves and their own communities."

David Cameron, Prime Minister, 19 July 2010

The Big Society idea is still to be fully developed and articulated and has received some criticism for that reason. However, on some levels it has had resonance among practitioners and political commentators. That may be because it can follow from either of two related but nevertheless distinct premises, namely that:

- 1 The state can no longer afford to service its existing relationship with citizens, as manifested through welfare entitlements and public services. (This is a judgement about affordability rather than a judgement about the size or role of the state per se.)
- 2 The state has become too big and citizens have become too dependent. (This is a judgement that, irrespective of the financial context, the state's role needs to be reduced.)

All of the main political parties appear to subscribe to the first argument. None are arguing, for example, that current levels of spending should be defended and that the public finances should be rebalanced wholly by tax increases rather than spending cuts. There is a consensus that significant spending cuts are required, reducing current state provision, albeit that there are different views about where cuts should be made and at what speed.

The second argument is more controversial and certainly less universally accepted. But it clearly does feature in the Coalition's Big Society thinking and underpins much of the

public debate about welfare benefits, particularly in areas such as reducing dependency by creating stronger financial incentives for those who are able to work. We can also detect this theme in discussions about universal allowances such as child benefit. It is easy to justify taxation to fund benefits for the most needy members of society; it is much more difficult to justify a state which raises taxes to fund benefits for the very well off.

The fact that the relationship between the state and the citizen is being widely discussed does not in itself redefine the contract. There remains considerable uncertainty about how these discussions will conclude. Securing support for practical measures to reduce state provision is extremely difficult. Proposals to reduce or withdraw benefits are heavily scrutinised and tested through the lens of 'fairness'. Those who face the prospect of losing benefits which they have previously enjoyed almost inevitably feel that they are being harshly and unfairly treated. Similarly, those who have previously enjoyed and valued a public service are likely to protest unfairness if that service is taken away.

The position is made more difficult by considerable uncertainty surrounding how the Big Society and other policies will play out locally. A great deal of what local public bodies already do is built on Big Society principles, including enabling individuals and communities to take greater control of their own lives. However, the Government clearly wants to put much greater energy and drive behind this idea and develop it as a powerful reforming concept.

Against this backdrop, in local public services the Big Society is likely to focus much greater emphasis on listening and communicating with individuals and communities and encouraging deeper engagement with the public. In practice this may mean providing opportunities for whole communities to participate in and co-produce services through the design, commissioning and delivery stages. It may also include encouraging the establishment and development of new social enterprises, in some cases formed from predecessor organisations which have previously existed within the public sector.

Again, however, there is a worrying potential gap between theory and practice. Promoting and encouraging these changes to be adopted widely, amidst heavy cuts and other ambitious reforms, with very few resources available for pump priming new initiatives, is likely to be extremely

challenging. Progress may well be patchy at least in the short term. Success is more likely to occur in isolated pockets of good practice rather than on a universal, system-wide basis.

A further difficulty also arises from the fact that, in the short term, there are real fears that spending cuts will impact adversely on the capacity of the charitable/not-for-profit sector. Far from taking on more, and providing capacity to enable a shift away from the state, it may be able to do rather less.

We will not know the extent of any cuts to charitable/not-for-profit funding until public bodies have set their budgets post the 20 October spending review announcement. At that stage we will also begin to see exactly where other cuts which may affect the relationship between the state and the individual will occur. Cuts in funding are expected to trigger large numbers of redundancies. While it is too early to have a complete picture there are also already examples of local councils discussing withdrawal from non-statutory services, introducing higher eligibility criteria for services, raising levels of fees and charges and/or charging for services that have previously been free at the point of delivery.

A particular challenge for the state (in the shape of public bodies) will be to understand which citizens are affected by which cuts. There is a real risk that individual citizens/households/communities will suffer multiple impacts from a variety of cuts, perhaps made by a variety of different public bodies. These will be vivid for the individual but may be invisible to the state until they are highlighted by complaints, protests or media coverage.

In order to mitigate this risk, public bodies locally should endeavour to identify as precisely as possible who will be adversely affected by potential cuts, and should consider sharing this information openly with partner agencies. This will enable cumulative impacts to be modelled and understood before final decisions are taken. Not to do so risks unacceptable consequences for the citizens, families and communities concerned and a public reaction which may seriously undermine the broader policy aim of reshaping and resizing the state.

Option 2: A significant de-layering of the public sector with many more decisions taken locally with minimal oversight

The Government has made a number of positive statements about subscribing to a more localist approach in public services.

"If the best possible health outcomes are what we're looking for, that's what we must focus on; get rid of a tick-box target culture that gets in the way and give a focus at every point, through payment systems and commissioning and inspection, on delivering quality and outcomes... In order to deliver this, as in any walk of life and any public service, we must devolve decision making close to the front line".

Andrew Lansley, Secretary of State for Health, 9 October 2010

"Over the next 18 months we will deliver radical transparency and decentralising reforms through a step-by-step blueprint for handing over power to town halls. These will help local communities to take over the reins and deliver localism in practice - and in ways that they decide make sense to them."

Greg Clark, Minister for Decentralisation, 8 July 2010

In our original *After the Downturn* report, we argued that if deep cuts in public services are to be made, it is best to make many of those difficult decisions at local level where they can have regard to local needs and circumstances. However, for this option to have significant impact, local public bodies have to have the flexibility to make judgements about the public services which are right for their area. That means a shift away from the uniformity of national prescription and targets in favour of different service offers and standards in different communities.

We identified four key ways in which services and decision making might be localised:

1. Transferring additional responsibilities to local agencies e.g. local councils, police authorities and primary care trusts
2. Creating a more permissive legal framework for local agencies so that they have the flexibility to judge local needs, to act and to innovate
3. Reducing the number and cost of national agencies which are currently engaged in oversight, steering, guidance and inspection of local agencies and services

4. Challenging and reining back the instincts of the centre to try to ‘command and control’ services which are managed locally.

Since our report, the national picture has moved on rapidly. The Government has taken radical action to abolish a number of agencies including the Audit Commission, Regional Development Agencies, and Standards for England, and is undertaking a major review of hundreds of arm’s length bodies. There are also plans for major reforms of schools, paving the way for more Academies and Free Schools, and in the health service involving the abolition of Strategic Health Authorities and Primary Care Trusts and the devolution of commissioning to GP Consortia.

It is clear that while the Government’s concept of localism includes local public institutions, it also goes beyond them. Local authorities, for example, may receive new powers, including a power of general competence, and new freedoms such as tax increment funding, but the Government is also focused on localism beyond the town hall – with new local providers and civil groups enriching an increasingly diverse local public services economy.

Many of these headline reforms mask underlying challenges. One of the major issues facing government is that relatively few public bodies carry out functions which can be simply discontinued without consequences. When abolishing existing organisations there are frequently significant responsibilities which need to be relocated and continued. In many cases the challenge of transferring and establishing these activities in new homes is complex and time-consuming. It is also potentially expensive.

Managing changes of this type on a huge scale – involving abolition of large numbers of existing bodies – involves significant risk especially in a climate of general uncertainty and instability. It therefore stands out as a critical challenge for government which may play an important part in shaping public opinion about the overall success or otherwise of its reforms. This is made more difficult by the timescale of a single parliament. That may be long enough to evidence a new trend in the public finances but it is unlikely to be a sufficiently long period in which to demonstrate real embedded change across hundreds of affected organisations.

In turn this creates other dilemmas for government. It creates a pressure to make rapid decisions and to implement them with urgency. But all too often decisions taken in this way are found to be flawed or incapable of standing up to very detailed scrutiny. Taking the right amount of time and care at the option appraisal, planning and testing stages

of policy development is critically important for downstream success.

The risks outlined have significant implications for the skills and capacity needs of the organisation in the short-medium term when major changes are being managed on several fronts. Organisations which ensure that they retain or if necessary recruit the right skills are much more likely to succeed than those which fail to do so.

The Government has placed significant emphasis on transparency and accountability as cornerstones of its philosophy and approach. These ideas are playing an important part in shaping some of the early decisions about ‘de-layering’. For example, rather than simply remove inspection and oversight functions, Government has tried to develop the notion of ‘armchair auditors’, informed citizens who can help to question and challenge public bodies. It remains to be seen whether this ‘army’ can be galvanised to make a significant contribution to holding public bodies to account.

In many ways this underscores the view in government – and more widely held – that merely passing more responsibilities to local public bodies does not equate to localism. Localism requires changes in approach and culture in many such bodies. It requires a much stronger commitment to engaging and involving the public in decision making, and the development of a mindset which puts citizens and service users right at the heart of the organisation’s thinking in every aspect of its business.

The best public bodies have already developed a host of innovative and imaginative ways to make these connections and to involve the public in difficult decisions about priorities, allocation of scarce resources, charging policies, cuts, etc – issues which are critical at the present time. Many others have much more to do to match these high standards. There will never be a better moment to make a bold move in this direction.

Finally, as well as ‘de-layering’ public services by abolishing organisations, this strategic option also recognises the opportunity to simplify organisational structures by removing layers of management *within* public bodies. Most public bodies are planning to make headcount reductions in order to manage anticipated funding reductions. In many cases this will involve developing new organisational structures. Intelligent organisations will take care to ensure that these structures are not only populated by fewer staff, but that they are engineered to be leaner and more streamlined.

Option 3: A major initiative to maximise economies by much more effective collaboration between public bodies

“Cameron Conservatism puts no faith in central direction and control. Instead, it seeks to identify externalities (social and environmental responsibilities) that participants in the free market are likely to neglect, and then seek to establish frameworks that will lead people and organisations to internalise those externalities – to act of their own volition in ways that will improve society by increasing general well being.” **Oliver Letwin, 8 May 2007**

At the time of the original *After the Downturn* report, the Total Place initiative was being piloted in 13 areas in England. Total Place was an ambitious collaborative approach to service re-design based on a whole area approach. HM Treasury published an evaluation of Total Place in March 2010 which concluded that:

“The pilots have demonstrated that there are real service improvements and savings to be made in all places from this way of working.... The examples in this report highlight a wide range of specific initiatives that demonstrate opportunities to make better use of public money.

The new ways of working pioneered by leading local areas can be replicated everywhere by:

- *starting from the citizen viewpoint to break down the organisational and service silos which cause confusion to citizens, create wasteful burdens of data collection and management on the frontline and which contribute to poor alignment of services; and*
- *providing strong local, collective and focused leadership which supports joined up working and shared solutions to problems with citizens at the heart of service design.”*

Some Ministers have signalled that they are in favour of continuing the essence of the Total Place approach (albeit almost certainly under a new banner) and the Spending Review is expected to announce a further series of pilots to trial the pooling of public spending budgets at the local level. The Local Government Association has led the argument for place-based or community budgets:

“Public services will have to become more transparent, more effective, and cheaper. This simply will not happen without a significant change to the way funding is allocated and decisions are made.”

The Government has also expressed support for shared management structures between local public bodies and for the development of shared services on a much wider basis than has been the case hitherto.

The case for collaboration and sharing between public bodies is not new. It has existed for a long time and there are many examples of its benefits being realised in practice, albeit sometimes on a very modest scale. The breakthrough to collaboration as the rule rather than the exception has been elusive, however. Faced with a choice, public bodies have usually preferred to maintain independent arrangements rather than negotiate shared models.

The current financial climate challenges these priorities. Possibilities are made more interesting by the existence of new organisations in the local economy. For example, GP Consortia and Free Schools will require efficient and economical support services. Buying into a local shared service may well be an attractive option.

These unique conditions therefore herald the possibility of a dramatic increase in collaboration, leading perhaps to the emergence of a very different public services landscape over say, the next five years.

Negotiating and managing the transition to a large number of shared arrangements will present major management challenges, however. These will be given extra edge and urgency by the imperative to save money in the short, medium and long term.

One of the significant questions posed by a much higher level of collaboration activity will be to what extent can shared models be sustained through voluntary/relatively informal partnerships? Whilst such arrangements may be appropriate in the short term to encourage action, experimentation and innovation, it is debatable whether they are sustainable and right for the medium and longer term.

Ultimately, new arrangements must be hard-wired into more formal governance and management structures to provide greater clarity and certainty. This is a critical point in the change process because it is the stage at which partners have to cede absolute control in exchange for influence. It is also the stage at which initiatives become much more difficult to disentangle and reverse.

Maintaining continuity of service whilst simultaneously establishing new shared arrangements is likely to be a major challenge. Partners will need to exercise real caution about how quickly significant savings can be delivered in the life cycle of a new shared service. New arrangements are likely to be less than successful if, during their implementation, managers are constantly striving to accelerate the delivery of unrealistic savings targets.

Looking ahead: the end of the beginning

There is a distinct possibility that the next six months will be the defining period for the project to rebalance the public finances. This will be the period in which the project becomes real. Tough choices will be made nationally, in the Spending Review, and locally, in public bodies' budgets. Citizens, families and communities will be affected by cuts and changes in service arrangements. Their reactions and responses will create new pressures and tensions in the political parties and potentially impact on policy making going forward. Risks will be tested in real time. The skill or otherwise with which change is managed remains a critical variable in the system. Handled well, it has the potential to smooth and ease underlying tensions and disappointments. Handled poorly, it may exacerbate already inflamed situations. Multiple impacts – a variety of different cuts impacting on the same citizen/family/community – stand out as a possible lightning rod for concerns, and as a problem which is potentially very difficult for government or any of its agencies to manage.

Faced with these challenges it is important that government works with and listens to public service bodies who are facing significant financial change. With that support, CIPFA and SOLACE are confident that the experience and expertise of public service leaders will enable their organisations to continue to serve and support their communities through these turbulent times.



CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services and wherever public money needs to be effectively and efficiently managed. As the world's only professional accountancy body to specialise in public services, CIPFA's qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance.

SOLACE (Society of Local Authority Chief Executives and Senior Managers) is the representative body for senior strategic managers working in the public sector. Through its policy and professional development activities, the Society promotes excellence in public service. Its commercial arm, SOLACE Enterprises, provides high quality, customer-focused and practical support to local government and the public and voluntary sectors, both in the UK and internationally. The SOLACE Foundation carries out educational and other work which falls within the charitable aspects of the Society's objectives.