Closing the financial gap: options in the public sector

Civica sponsored roundtable

July 2024

Introduction

On 17 July 2024, less than a fortnight after the UK general election, CIPFA, supported by our partners Civica, hosted a roundtable: *Closing the financial gap: options in the public sector*. Participants included service leaders and finance experts from local government and health.

In the run up to the election, the Institute for Fiscal Studies (IFS) criticised the two main parties for a lack of realism about the gap between their ambitions for the public sector and the resources available to realise them. Deep cuts in public services, new taxes or increased borrowing, the IFS argued, would be needed to achieve even a fiscal 'steady state'. These dynamics were evident shortly after the roundtable. In a statement on 29 July, the new Chancellor, Rachel Reeves, deploying revised Office for Budget Responsibility estimates, accused the previous government of leaving a £22bn fiscal gap, worse even than the IFS had predicted, comprising 'unfunded' spending commitments, a number of which she then cancelled.

Any further reductions in spending would doubtless impact the public sector as a whole. But the effect on 'unprotected' local services – those not singled out in budget cycles across recent decades as priorities for inflation or above inflation spending increments – would be especially acute. As early as the mid-2000s, protected services were already taking an ever-increasing share of public spend. Since the government had little politically acceptable room for manoeuvre on tax, local authorities were subject to a (modest) fiscal squeeze several years before the onset of austerity proper. Councils were targeted by efficiency initiatives, like the Gershon Review. After 2010, their predicament worsened radically. Severe spending retrenchment, designed to reduce the deficit brought on by the financial crisis, was followed by a series of further economic and geopolitical shocks – Brexit, COVID-19, Putin's war in Ukraine, energy price hikes, inflation, the cost-of-living crisis – each one exacting an eye-watering fiscal toll. Demand for local services, especially from vulnerable and disadvantaged people, has soared. But the resources to provide them have withered.

What was striking from the roundtable discussion, however, was the fortitude and resolution with which participants confronted these challenges. They all acknowledged that extra money would help, but the air wasn't thick with Oliver Twist-like pleading for 'more'. Instead, the focus was on pragmatic and achievable changes, which would help local service providers support their communities. Participants welcomed the improved 'mood music' in interactions between Whitehall and localities since the election. They hoped that the new government's commitment to listen would provide an opportunity for local leaders to air their ideas and suggest practical solutions to challenging problems.

The financial gap: its reality and implications

All roundtable participants active in local service delivery said they were facing revenue pressures – whatever sector they came from. The health service has been notionally protected during the austerity years, receiving at least inflationary increases in spend. But rising demand has outpaced new inputs, especially since COVID-19. One participant highlighted systemic problems in local health provision, which exacerbate the impact of resource scarcity. Structures such as integrated care boards, for instance, though intended to provide holistic solutions to care, need urgent review in the light of their poorly designed productivity metrics and bureaucratic governance burdens.

Council officers reported especially large budget gaps. One described an imminent revenue shortfall for their authority of well over 20%. Several councils represented at the session had been forced to seek exceptional financial support through capitalisation directions. As well as noting systemic causes, including the well-documented mix of pressures and scarcity, participants pointed to an array of exacting local conditions and cost drivers. Certain councils face inherent geographical or cultural challenges. Sites of historical interest or tourism assets may look like potential growth opportunities for communities, but where councils own or oversee them, the facilities generate substantial maintenance and upkeep costs. Similarly, representatives from councils in areas prone to flooding, or with coastal defences to sustain, argued that Whitehall did not recognise these pressures in full through dedicated funding. Participants unsurprisingly discussed the uneven geographic distribution of socioeconomic need and the consequently varied demands on councils. But they also explored subtleties and hidden issues. Certain types of community, such as seaside towns, attract vagrancy and homelessness – but not the extra taxpayer cash needed to deal with such problems.

The principal remedy mentioned in the session for managing these challenges was prioritisation, specifically restricting spending to cover only 'statutory' requirements. However, participants noted that this goal was made trickier by the lack of clarity about what constitutes statutory provision. Local government's remit includes a vast array of legislative mandates. Additionally, ministers frequently subcontract delivery responsibilities for national agendas to councils, often deploying ancient statutory powers to do so. Consequently, there is no stable consensus about the essential local service 'minima'.

Further, focusing on basic provision while cutting back on other service areas comes at a cost. If planned maintenance budgets for council facilities become so spartan that only basic health and safety compliance can be assured, then this can prove a false economy, since costlier interventions may be needed later when buildings decay. Cutbacks in libraries, information services or youth provision can impair health, education and crime outcomes.

Changes in policy and spending patterns by other public service actors, including national government, can also have unintended downstream consequences, with reduced provision in one area potentially impacting another. One participant argued that the cost of homelessness in their area had been worsened by the removal of incentives and targets for housing development under the previous government. More generally, the fragmented nature of the public service delivery system and lack of institutional co-ordination were considered major barriers to optimising the use of limited resources and improving productivity.

Better productivity and a wider resource base

Contributors suggested that their organisations had already responded to years of lean resourcing by paring costs to the bone and streamlining processes. To get even more for less through productivity increases would thus require comprehensive service modernisation and/or collaboration between agencies. However, both transformational change and joined-up working face severe impediments. Service modernisation through digital technology entails substantial (and often unaffordable) upfront investment in kit and scarce human expertise. Collaboration between agencies is highly desirable. Integrated approaches to in-patient and outpatient care, for example, involving primary and acute health services on the one hand and local government on the other, are not just about improved resource husbandry, through the optimal management and even prevention of demand. They can also facilitate a seamless, personalised service experience for citizens. But to bring these approaches to life, participating bodies must free up resources for engagement, co-ordinated planning, and the staffing of combined operations. Furthermore, organisational incentives are often poorly aligned. One party to a collaboration may be subject to political, performance or governance controls that give it no reason to carry out activities from which another party will benefit. Why should council X spend money on a smoking cessation campaign whose beneficiary is hospital Z? Why should hospital Z support council X if a successful campaign leads to calls for Z's patient-care budget to be slashed?

Despite the challenges, participants mentioned numerous initiatives in which they are involved. In the digital arena, councils and other local service providers are exploring automation and AI. They are deploying technology to transform processing, invoicing and other back-office functions, as well as citizen-facing activities. Contributors argued that to make lasting improvements, technology should inspire comprehensive service reinvention. Existing 'analogue' ways of working should not be mapped onto new digital systems.

Participants also mentioned their experiences with a range of service delivery models. Some had been involved in the merger of council operations or shared services initiatives. They noted the effectiveness of these models in eradicating duplication in generic posts and processes or for pooling scarce skills. The use of third parties in service sharing was also hailed as a route to savings. Contributors certainly mentioned the recent spate of insourcing, often driven by specific contract issues or the pendulum swing of political fashion. Commercial providers and those who had used third-party models were nevertheless convinced that potential gains from this approach were substantial, demonstrable and still to be fully realised.

There was also a wider discussion about local governance and structures. Some contributors considered the proliferation of overlapping local functions and decision-making layers an obvious target for rationalisation, up to and including comprehensive normalisation of unitary government and the abolition of the two-tier system. Others argued against a 'one size fits all' approach, given the different challenges in areas with contrasting population densities, demographic characteristics and topographies. Nevertheless, there was broad agreement about the need for reform. The local service delivery model is defective. A new model, or perhaps suitably tailored models, should be explored.

Several participants had also experimented with income generation as a means of bridging the resource gap. Many had tested the price elasticity of fees and charges to the limits. Some were also familiar with an area of particular controversy – the commercialisation of property holdings. The discussion harked back to the 'Faustian pact' that ministers offered local authorities under the coalition government. Councils were told that there was no more money, and they would have to cut their cloth accordingly. However, to free them from direct performance oversight, the Audit Commission was abolished. Further, councils were invited to become more entrepreneurial in their use of assets and holdings, perhaps by purchasing commercial properties from which rental income could then be extracted to subsidise their revenue position. In the light of some newsworthy disasters and the acute indebtedness of several authorities, Whitehall's attitude to these matters has long-since become less laissez faire. Several participants indicated that their councils had moved away from ambitious commercial plans towards modest ones, including disposal of low-value assets to fund capital works or reduce revenue pressures. Some argued moreover that both the initial focus on commercial 'opportunities' and the subsequent controversy and reaction had undermined the consensus on what the priority focus for councils in general – and for finance functions in particular – should be.

When the conversation shifted to the overall shape of local services funding, participants' views were in line with the widespread consensus that the system is wholly inadequate.

Looking ahead: new opportunities to bridge the gap

The roundtable welcomed the 'reset' in central/local government relations following the general election. They hoped that Downing Street's engagement with the metro mayors would be the prelude to wider and more inclusive dialogue, exploring solutions to complex problems right across the local service landscape.

We asked participants to imagine they were involved in such discussions and share what they would call on the new government to do. There were many constructive ideas.

All participants wanted to see long-term (at least three-year) funding settlements for local services reintroduced. This approach, strongly advocated by CIPFA, would facilitate proper service planning. It would also prove especially beneficial if linked to greater clarity about the minimum range of local government responsibilities (the 'statutory' versus 'non-statutory' debate).

Alongside this collective understanding of service responsibilities and the long-term funding 'map', in-built policy and resourcing flexibility, allowing local variations and needs to be accommodated, would be essential. Part of this flexibility is about rational and equitable resource distribution. All participants called for the long-overdue Fair Funding Review to take place. But some contributors also aired the related question of bespoke resourcing. Going forward, government must ensure that any obligations it confers on local service providers are fully funded. (Significantly, participants demanded the right to say no to carrying out any that were not.) And service challenges inherent in location and geography, like flood defences or coastline management, must be recognised through suitable funding streams or opportunities to impose special levies on affected and interested parties.

Participants were keen to ensure that any engagement with government went far beyond conversations about minima or constraints and into more expansive terrain. Specifically, there was an appetite to discuss wholesale devolution. Noting that the prime minister and deputy prime minister had asked the metro mayors to spell out what they would do if granted greater power and delivery responsibility, participants hoped that the same question would be put to all local bodies. Radical devolution could catalyse new local business models, with integrated multiagency approaches, perhaps underpinned by 'place-based' budgets. Local and national partners could also work together to ensure that barriers to collective action on prevention or demand management, including misaligned incentives, were removed.

Throughout the session, participants complained that the localised consequences of shifts in central government funding or policy priorities were poorly understood by officials and politicians. An improved central/local conversation could promote better understanding and thus better policymaking. Conversely, deeper central/local engagement could provide local service leaders with a forum to advocate alternative approaches to delivering for citizens while saving money. New models for commercial partnerships and shared services could be proposed. More targeted and holistic uses of capital investment could also be explored, from resourcing digital transformation to reducing the revenue costs of repeated maintenance patch-ups on crumbling facilities. Further, the benefits of investment in areas such as housebuilding – and by implication, the costs of withholding it – could be considered in the round.

A better central/local conversation would also feed into a much-needed investigation of an essential component of effective, citizen-centric, technology-based services: data sharing across public bodies. Despite numerous recent initiatives in this area, for example on digital identity, the legal protections affecting citizen data can inhibit inter-agency collaboration. Several participants called on the government to place data at the top of its service reform agenda.

Other suggestions focused on funding mechanisms. A wholesale review of local fees and charges is overdue. Several participants suggested that it was time to consider radical options, such as tourist levies. The business rates regime, characterised by one participant as 'broken', also needs an overhaul. Some participants advocated full local revenue retention. Others pointed to unfair advantages and perverse incentives in both centralised and localised arrangements, as well as the various hybrids. But all agreed that the current approach is not fit for purpose.

There was a similar consensus about council tax. Participants advocated liberalisation of tax-setting, with the abolition of the referendum requirement. Further, there has been no revaluation of property bands since the early 1990s. Eleven million homes in the UK pay more council tax than Buckingham Palace. Most participants considered this situation to be absurd and egregious.

Finally, one participant suggested a funding approach for the health arena, which could have wider ramifications for other parts of the public sector: co-payments. There are already numerous private top-ups, as well as means-tested provision, in the health service. Extending elective payments to cover enhanced or urgent services has long been debated by policymakers across the political spectrum. By attracting private healthcare users into the mainstream NHS, co-payments could maximise the revenues going through the public system, thereby facilitating cross-subsidy and helping to leverage additional investment.