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GOVERNMENTAL FINANCIAL RESILIENCE UNDER AUSTERITY: THE CASE OF ENGLISH LOCAL AUTHORITIES

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KEY CONCLUSIONS

The recent global financial crisis represents yet another reminder of the importance of governmental financial resilience, i.e. governments' capacity to cope with financial shocks and difficulties. The research conducted on four English local authorities shows that:

- Financial resilience approaches have gained increased momentum in the aftermath of the 2008 crisis
- Financial resilience generally requires a combination of capacities and reactions, i.e. management of slack resources, income generation, learning how to see things coming, developing anticipatory capacity, organisational restructuring and development of new skills, ensuring continuity in leadership, adopting a holistic view and rethinking services
- Two main approaches to financial resilience emerge: local self-sufficiency and internal financial management.

ABSTRACT

The increased uncertainty, volatility and complexity arising from the economic crisis and the context of austerity require governments to put greater emphasis on flexibility, adaptability and a long-term perspective in their financial management.

Through a multiple case study analysis of 4 local authorities, this report adopts the conceptual lens of financial resilience to explore the main shocks undergone by local authorities over the last 10 years and the related responses and capacities, with a specific focus on the recent 2008 crisis and current context of austerity. The analysis suggests relevant implications for policy makers and managers.

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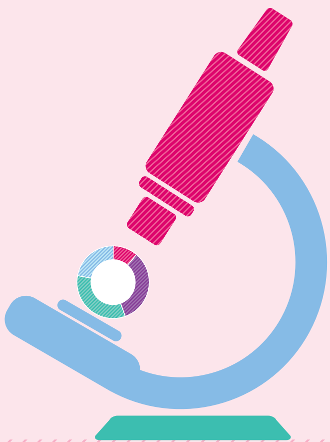


INTRODUCTION

For more than thirty years public management theories and practice have been strongly influenced by the search for efficiency heralded by New Public Management[1] and similar public sector modernisation movements.

Public administrations have focussed their attention on economy, efficiency and effectiveness, looking for cost containment, matching resources and goals, output maximisation or input minimisation. The present context of austerity and crisis calls for alternative solutions and new conceptual lenses to cope with the related challenges.

One of these possible alternative views is resilience. Resilience is a term that has gained increasing usage in recent years (National Audit Office, 2013; CIPFA, 2014) as a capacity for reaction to crises, either as bouncing back to an original state (passive resilience), or as the capacity to anticipate and cope with the unexpected, bouncing forward through the development of new capabilities and the creation of new opportunities (active resilience).

However, so far, little attention has been given to the financial aspects of resilience and how an understanding of resilient financial management approaches can help organisations plan for and cope with an uncertain future. Given this premise, financial resilience represents the main focus of this report. By exploring this concept in four English local authorities, our analysis shows that preoccupation with (financial) resilience is a recent phenomenon, whose importance has been made more evident after the crisis.

Indeed, a greater emphasis has recently emerged on the relevance of a rethinking of public services, in line with a more cohesive and dialogue-based approach to balancing budgets, which seems to require a strengthening of both financial and non-financial considerations.

Old approaches to financial resilience, mainly based on continuous monitoring, incremental and across-the-board-savings and the use of reserves for keeping services as they are (capacity for bouncing back) may thus require to be replaced, in future, by a greater focus on governmental bouncing forward capacity.

As identified in this report, cohesion, dialogue, prioritisation and consideration of the interdependence of financial and non-financial performance may ensure this capacity for learning. However, different ways of being resilient emerge; resilience as bouncing back, independence and efficiency, capacity for investing and facing the unexpected, self-sufficiency and innovation capacity.

What is more, it would appear that there is a need for these to be developed and adapted further following the UK national elections in May 2015, with respondents seeing no let-up in the pressure on financial resources going forward.

OBJECTIVES

This project explores and conceptualises financial resilience by looking at:

- How English local authorities react to, anticipate and absorb shocks that affect their financial condition and whether different approaches emerge
- How reactions and capacities for response have evolved over time, particularly in the aftermath of the global financial crisis
- The lessons to be learnt for ensuring that the financial resilience of local government is seen in a longer term perspective.

RESEARCH METHODOLOGY

The project uses multiple case study analysis of four English local authorities, selected from the 152 single-tier and county councils (STCCs) to represent different combinations of financial performance[2] and related volatility over a ten-year period.

The four councils are Wigan Council, Manchester City Council (both metropolitan boroughs), Derbyshire County Council (an upper-tier authority) and Warrington Council (a unitary authority and a former "new town"). In each council, up to three interviews were conducted with key informants, namely, the CEO or Deputy CEO, the Director of Finance and section 151 officer and a service department director. The interviews focused on three main topics:

- The financial health of the councils and their main financial and non-financial goals
- The main risks and shocks that the councils had faced over a ten-year period and how they had identified and responded to these
- The understandings, meanings and possible dimensions of financial resilience in each council.

Not surprisingly, respondents tended to focus on the financial impact of the economic crisis, pointing generally to a delay between the onset of the financial crisis in 2008 and the full impact of the austerity measures and other policy changes introduced by the Coalition government, which can be referred back to 2010.

FINANCIAL RESILIENCE: SHOCKS, RESPONSES AND APPROACHES

THE PERCEIVED SHOCKS

Prior to 2008, the main shocks identified by respondents related to:

- Specific policy issues (e.g. waste disposal due to increases in landfill tax)
- Problems with the management of specific budgets (e.g. Adult Services and Children's Services)
- One-off events (e.g. uninsured losses arising from claims on the council)
- The requirement to achieve Gershon[3] efficiency savings.

After 2008, and especially from 2010 onwards, local authorities have increasingly been coping with:

- The impact of central government funding reductions, a real-terms reduction in central government funding of 37% between 2010/11 and 2015/16 (National Audit Office, 2014)
- The local impacts of the economic crisis, in terms of increased pressures on some services (e.g. social services and benefits payments) and reduced tax collection due to a shrinking tax base
- The impact of changes to business rate retention and related appeal[4] rules
- The new responsibility of locally funding council tax benefit payments[5], previously paid by central government.

HOW LOCAL AUTHORITIES FACE AUSTERITY AND FINANCIAL CHALLENGES: CAPACITIES AND RESPONSES

A number of key messages emerged from this research as being important to the application and development of resilient behaviours in a financial setting.

1. Managing slack resources: financial flexibility

Flexibility through the management of slack resources was seen as an essential component of financial resilience, both before and after 2008.

Prior to the age of austerity, financial flexibility was ensured through:

- Management of reserves
- "Salami slicing" budget reductions, i.e. across-the-board proportionate cuts
- Budget transfers and virements, both in-year and to base budgets.

Reserve management was used to help absorb some specific shocks, e.g. for the impact of single status job evaluation, alongside maintaining reserves at a prudent level over a period of time. Salami slicing was used extensively prior to 2008 as a means of absorbing financial shocks over the whole organisation.

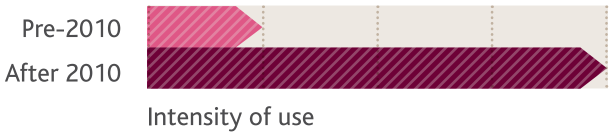
Budget transfer and virements were generally used to smooth the effect of departmental overspends, and this was a routine part of year-end budget management, e.g. in the case of adult services where due to its demand-led nature there was a tacit acceptance, in most cases that it would likely overspend against its budget each year and need to be "bailed out". In the initial build up to the cuts experienced in 2010 there was some evidence of such approaches remaining to provide flexibility, but not after this point.

The sheer scale of the financial pressure brought to bear after 2008 required an increase in sophistication in the use of such tools. For example, in recent times there has been a recognition that the use of financial reserves could only realistically put-off the inevitable in terms of the baseline cuts required, rather than solve the problem outright or allow the council to ride the storm before returning to normal. In this way there has been a shift away from "bouncing back" approaches to resilience to ones more akin to adaptation and improvement. Maintaining a healthy reserve balance is still seen as important and shows recognition of a need to maintain at least some slack resources. It could be argued that this is even more relevant as inefficiencies are driven out of baseline organisational budgets, giving less scope for budget transfers to solve financial shocks. Alongside this, more fundamental budget reviews were undertaken with, as one chief executive described it, a "humble and honest" approach to savings being required based on changes to the way services were delivered, an approach that replaced the use of salami slicing and reduced the need for in-year virements. (See also points 7 and 8).

Moreover, reserve management now entails:

- A closer relationship with risk management to make provision for shocks in advance and reduce their impact on service provision
- The devolution of responsibility to departments in managing their own reserves (in addition to the central management of strategic reserves), placing greater accountability on departmental heads for managing the redesigning services within available funds
- Use of reserves to:
  – Soften the impact of cuts over a longer period of time
  – Create capacity for invest-to-save initiatives that enable future base-budget reductions
  – Take "one-off hits" corporately without the need to further reduce service budgets (e.g. changes to national insurance contributions or local tax regimes)
  – Provide capacity to absorb any non-achievement of planned budget reductions in a given year.

2. Income generation



Another mechanism used by local authorities to offset and absorb the impact of reductions in central funding was to turn to other forms of income generation. Such measures included:

- Council tax rate increases, where there was scope to do so
- Increases in the rates of fees and charges
- Increases in the scope of fees and charges (i.e. charging for services not previously charged for)
- Economic development measures to increase the incidence of tax collected (council tax and business rates) or provide additional external income (e.g. dividends), including, for example:
  – Policies aimed at getting citizens into work
  – Granting loans to businesses
  – Supporting major commercial development projects.

Whereas such approaches had been used prior to 2008, their use was ad-hoc, limited and politically framed. After 2008, they were viewed collectively in a much more integral and acceptable (although not always palatable) part of financial planning.

Increasing self-sufficiency in Warrington

In Warrington, forecasts show that in three years' time general grants will be down to £9m (excluding specific grants and education grants). This drop off in government funding will require greater self-sufficiency in terms of local income streams (council tax, business rates and income generation), while at the same time reducing costs to become more efficient, especially in terms of statutory services, prompting a change in budget setting approach to one that is more outcome-based. The "new town" status granted in 1968 gave Warrington a greater capacity to quickly adapt to new developments (it is currently developing the biggest new commercial development in western Europe). This may be considered as a facilitator aspect to resilience, even if economic growth (and so new residents and new businesses) bring associated costs in terms of services required.

In general terms there is a view that having greater reliance on own resources may make it easier to remain resilient. However, confidence levels are dipping, given the sustained and continuous pressure on services and resources allied to the council's already low unit cost base, with 2016/17 being seen as a critical year.

3. Learning how to "see things coming"

Having systems in place to identify and quantify the financial implications of major shocks was seen to be an important element of being financially resilient. "Seeing things coming" and "reading the tea leaves" appears to have been developed and learnt over time. This is about ensuring that risk management and other monitoring tools are embedded within the organisation and thus are interpreted as means to an end, not simply "box-ticking" exercises. Interviewees pointed to the necessity to avoid the reliance on comprehensive analyses and lists in the absence of directions or indications of possible reactions.

Enhancing financial planning in Manchester

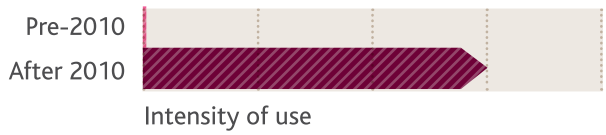
In Manchester, post austerity has seen the focus shifting from a year-on-year approach to financial management to a three-year planning process, more oriented towards the delivery of outputs. Departments have increasingly been required to manage their own bottom-line wherever they can, working in a constructive way with centralised finance support teams. Financial planning is now a more inclusive process, rather than centrally set budget targets to work within as in the past. A business planning sub-group of directors establishes the general budget principles and generates ideas about things they can do, including reductions in services where appropriate. Elected members are involved and engaged in the process through their own executive group. There has been a systematic review of "big ticket items" which has included for example a phased withdrawal from the provision of day-care facilities. Taking a prudent and long-term view of risk management identifies major shocks in advance, enabling appropriate responses to be taken, whether through sensible reserve management or redesigning services to take money out of the base-budget.

4. Making an early start: anticipatory capacity

Risk management must also be about taking action quickly to respond to potential shocks before they arrive, especially if they have significant financial consequences. A common approach to responding to the initial round of cuts in 2010 was to take action in advance of their announcement. Getting an early start was seen by the councils as a valuable way of maintaining resilience, even though initial estimates of the cuts were understated. Typical approaches consisted of:

- Planning against an anticipated level of reductions, which helped to prepare the ground for when the scale of the cuts was known
- Bringing forward the baseline savings (within three years instead of four)
- Over-programming the reductions.

5. Organisational restructuring and developing new skills within the organisation



Organisational restructuring was also seen as way of reducing costs in all of the local authorities. Such activity ranged from a traditional focus on streamlining back office services to minimise the impact on the front line, to a fundamental change in the way front line services were delivered (see also point 8).

In parallel, there was a focus on developing skills and competencies of staff, for example entrepreneurial skills and new competencies associated with new ways of working such as commissioning, collaboration and the co-production of services.

6. The role of political leadership and continuity

The responses to the crisis were considered to have been facilitated through a consistency of political leadership approach, irrespective of changes in local political control. In some councils, where political control had not changed for many years, this was a natural process. In others, where there had been a swing in control during the period, it needed to be actively managed. Interestingly, it was not the political party that mattered, there being different parties in control at a local and national level during the period. This aspect was not ideologically driven, but rather a pragmatic acceptance that action needed to be taken given the scale of the problem.

7. Adopting a holistic view

Developing corporately and transversally focused and collegiate senior management teams appears to have played an important role in coping with the shocks associated with the age of austerity. This required:

- Intensive communication across the organisation
- A transversal and integrated view of the issues at stake
- An openness to dialogue (i.e. avoiding silo protectionism)
- A stronger integration of strategic, financial and operational management.

Integration between financial and operational management appears differently looking at the pre-crisis period and after 2008. Prior to 2008 and within the overall need to balance the budget:

- Non-financial goals were more likely to take precedence politically
- Operationally, there was also a tacit acceptance that some services, by their very nature, were more likely to overspend (e.g. children's services, adult social care) and would be bailed out at year-end by savings in other areas
- These internal in-year "shocks" were able to be absorbed through the presence of slack resources.

Since 2008 (and even more since 2010) interdependence between financial and operational management has been considered as a critical aspect for success and it has been developed differently in the councils, for example by:

- Spending reductions through re-prioritising the balance of service provision across all departments
- Greater value placed by operational departments on the support offered by the finance team
- A reorganisation of support functions (in one case the performance management team was brought into the central finance function to assist in better understanding the link between financial and non-financial management).

8. Re-thinking services

Especially after 2010, the severity of funding reductions, as well as the increasing awareness of structural changes, encouraged a re-thinking of services in terms of:

- Adoption of priority-based approaches, with a focus on expected outcomes. This required:
  - Systematic reviews of the affordability of non-statutory services
  - Withdrawing from the provision of some non-statutory services (e.g. day-care facilities)
  - Challenging the quality of remaining services
- Resorting to partnering solutions, often by encouraging third and private sector actors to take on the responsibility for service provision (e.g. creation of community interest companies to provide leisure and cultural services)
- Joined-up-services, through collaboration with other public sector entities (e.g. NHS and Parish Councils) as well as an increasing emphasis on pooled budgets and strategic alignment
- Co-production.

New ways of services delivery and services prioritisation in Derbyshire

After 2008, reductions in Derbyshire's budget were initially made on a "salami slicing" basis, with each department shouldering the same proportion of pain, encouraging directors to work collegiately and act corporately. A change of political control in 2013 saw the adoption of a more prioritised basis of budget reduction, although this resulted in a hiatus with too many priorities and a resulting lack of focus immediately after the election. The council still operates a prioritised approach, but paradoxically this produced similar results to those had salami slicing been adopted, the only difference being that central support departments have had to make proportionately greater savings than service departments. Going forward, managing demand for service, more than becoming more efficient, will be essential for obtaining savings. It has now become firmly embedded that decisions need to be made within the resources available. There is, inevitably, some disagreement as to where cuts should fall but an acceptance that over all they need to be made.

New ways of services delivery and services prioritisation in Wigan

In Wigan after 2008, spending reductions and reserves (allocated and unallocated) were used to both help smooth the under/over achievement of spending plans at the corporate level. However, using reserves was not sufficient to manage the scale of the budget reductions. Indeed, using up reserves would not have resulted in the change programmes the council was able to introduce, as these required a fundamental rethink to the way services were delivered. The Chief Executive, thus, required directors to be "humble and honest" about service priorities and required a greater level of corporate understanding across the management team. This was aligned with a strengthened approach to risk management, with a more open dialogue of risks and their impact between and across service directors and the Director of Finance, giving a better understanding of the wider implications. For example, within Adult Social Care a new director was tasked with removing £8m from the adult social care budget which was already in the lowest quartile of authorities in terms of spending. Resetting the budget required not only operational changes in service delivery, but also a new recognition at the corporate level of the challenges facing the service, allowing the budget to be set at a realistic level, something that had not occurred in the past and was part of the reason for successive overspending on this service.

DIFFERENT APPROACHES TO FINANCIAL RESILIENCE

Historically, patterns of resilient behaviour have been seen to be present within the English local authority sector and as such resilient behaviour is nothing new. What has changed in the present context is a greater awareness, recognition and use of the term resilience as well as a more sophisticated and probably explicit approach to its application. More specifically, the above analysis shows that the 2008 crisis can be considered as the most important shock occurring in recent years, as well as the turning point where past ways of delivering services and deciding on budgets were swept away and explorations for new approaches started.

The analysis suggests that not only do approaches to facing crises and shocks evolve over time, but that it is possible to identify different combinations of approaches to and capacities for financial resilience. This different mix of combinations leads to different foci of financial resilience, which can be seen to have been affected by the onset of the financial crisis. Table 1 shows the different approaches and foci to financial resilience emerging across the four cases.

TABLE 1: DIFFERENT APPROACHES TO FINANCIAL RESILIENCE

APPROACH TO FINANCIAL RESILIENCE	COUNCIL	OVERVIEW	SPECIFIC RESPONSES
Focus: Local self-sufficiency. Financial resilience as a component of managed local economic growth and development.	MANCHESTER	Strategic approaches to combine resilience with efficiency over the last decade including rebalancing local economic sectors and investing in assets outside and inside the city to create alternative income streams, enabling investment while not compromising services.	• Linking financial and non-financial goals • Prioritising services based on outcomes • Engaging managers and elected officials • Careful and targeted handling of reserves • Strengthening risk management • Continuous monitoring and validation • Improving efficiencies • Joining up • Income generation through investment
	WARRINGTON	New town status helps to some extent to overcome reduced levels of government funding due to its relative affluence and ease of development. The council has taken a proactive approach to dealing with its financial challenges with a view of being in control of its own destiny.	• Improved forecasting/predicting capability • "Rainy day" and specific reserves • Outcome based budgeting (link between financial and non-financial measures and goals) • Focussed risk management • Joining up services • Income generation
Focus: Internal financial management. Financial resilience as anticipating and adjusting to changing environmental conditions and contexts.	WIGAN	Faces challenges linked to deprivation. Taking action in advance of the cuts, linked to an imaginative use of reserves, was used to create capacity to absorb funding reductions while services were reconfigured.	• Efficiency savings while not affecting service provision • Use of slack resources to help mitigate and manage financial shocks • Starting early and "over-programming" to give flexibility • Moving away from "salami slicing" to a more corporate and collegiate approach to spending cuts • Over-programming of savings used in order to give year-on-year flexibility • Reconfiguring of services • "Dialogue" approach to savings and risk management
	DERBYSHIRE	Focus on driving out inefficiencies, increasing or introducing fees and charges and building up and using allocated and unallocated reserves to alleviate pressure on services while they are reconfigured.	• Scanning forward and planning ahead • Active use of slack resources/reserves to avoid making changes to service delivery • Early recognition of crises/problems • Increasing the incidence of fees and charges • Initial "salami slicing" reductions replaced by a "corporate approach" to savings with more collegiate decision-making • For the future, more focus on reconfiguration of services and increasing incomes

CONCLUSIONS

The recent financial crisis represents yet another reminder of the enduring importance of governmental financial resilience, i.e. governments' capacity to cope with financial shocks and difficulties.

The research conducted on four English local authorities shows that:

- Financial resilience generally requires a combination of capacities and reactions, including the management of slack resources, income generation, learning how to see things coming, developing anticipatory capacity, organisational restructuring and development of new skills, ensuring continuity in leadership, adopting a holistic view and rethinking services
- These capacities and reactions have gained increased momentum in the aftermath of the 2008 crisis, with local authorities intensifying or re-orienting their use, or starting to adopt them, in response to the related financial shocks
- Capacities and reactions appear to vary across organisations, being influenced by the contexts where they operate and their history and path of development. From the analysis, two main approaches emerge from the combination of capacities and reactions, i.e. local self-sufficiency and internal financial management.

The analysis suggests that the approaches identified have been essential in meeting current challenges, but that governments need to continuously strengthen and adapt them to the changing environment.

Looking forward, the councils appeared to be less optimistic about their ability to respond to the next wave of cuts, and future years are seen as potentially difficult. Each council recognised the need to further rethink its approach to financial management yet again in the coming years. Such alternative approaches may include the further development of tools and skills for:

- Consolidating the link between risk management, anticipatory capacities and reactions
- Strengthening financial self-sufficiency
- Ensuring a stronger integration of strategic, operational and financial management
- Improving accountability and decision making in partnerships, joining up and multi-agency working
- Supporting strategic decision making geared towards ensuring the government's role in economic growth, as well as income generation.

ENDNOTES

1. The New Public Management has been generally described as a movement responsible for introducing market-like and managerial principles in the public sector.

2. As a measure of financial performance we took the ten-year average contribution to unallocated reserves as a proportion of net expenditures (National Audit Office, 2013). Volatility is the standard deviation of this measure.

3. Following the report of Sir Peter Gershon, the Government's spending review of 2004 required local authorities to make year-on-year base-line efficiency savings of 2.5% per annum between 2004/05 and 2006/07.

4. From April 2013, local authorities that are collection authorities were allowed to retain up to 50% of business rate growth as an incentive to grow their local economies. The changes increased the level of financial uncertainty for local authorities by transferring the risk of business rate appeals and business rate avoidance to local authorities (Local Government Association, 2013(1)).

5. From April 2013, the national Council Tax Benefit system was replaced by local Council Tax Support schemes in tandem with a 10% reduction in central government funding. This increased financial risk for local authorities that are billing authorities in terms of both the additional financial burden of a demand led benefit and the uncertain impact on collection rates. (Local Government Association, 2013(2))

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