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REFORM

The State of the State 2015-16
Recalibrating government

UK Public Sector | #stateofstate

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About Reform

Reform is a non-party think tank whose mission is to set out a better way to deliver public services and economic prosperity. Our aim is to produce research of outstanding quality on the core issues of the economy, health, education and law and order and on the right balance between government and individual. We are determinedly independent and strictly non-party in our approach.

Foreword

Welcome to *The State of the State 2015-16*.

Now in its fourth year, Deloitte LLP and Reform have once again collaborated to analyse material from a wide range of public sources, including the government's accounts, public spending data, departmental reports and official economic figures. We augment that data with insight from roundtable discussions and interviews with leaders from across the public services to produce a report that is grounded in the realities of our public finances and constructive in its thinking.

Ahead of the 2015 UK general election, debates raged over how many billions of pounds each political party was willing to commit to spending on public services. Yet virtually no discussion took place over how effectively that money was going to be managed and spent. By publishing *The State of the State*, we hope to put the spotlight on those issues.

This year's report finds the UK in the middle of a decade-long recalibration as the public sector aligns to a lower level of public spending. The fiscal consolidation programme that began in the wake of the 2008 global financial crisis is half-way through, and by 2020 its completion could see the UK's spending on public services at its lowest level for 50 years.

For many public bodies across the UK, the first half of this decade was dominated by cost reduction in the face of austerity. This report suggests that the next half of the decade could be more challenging than the last. Spending reductions will continue. But the UK's best civil servants, politicians and local public sector leaders are seizing the opportunity to shape a fitter and more focused state.

Amid this challenging recalibration, a sector that is built around the citizen, makes the most of its talent, takes the fullest advantage of technology, engages partners to best effect and maximises its value for the taxpayer is worth pursuing.



Mike Turley
UK and Global Public Sector
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The UK's best civil servants, politicians and local public sector leaders are seizing the opportunity to shape a fitter and more focused state

Executive summary

Recalibrating government

Over the course of this decade, UK Government spending is forecast to decline by a fifth as a proportion of GDP. Among advanced economies, the UK looks set to drop from the 16th biggest spender on its state to the 26th, requiring a profound adjustment in how the public sector operates. In other words, Government in the UK is recalibrating – and that recalibration aims to align lower public spending with a leaner public sector.

The State of the State finds that for those running the public sector, the first half of this decade has been characterised by austerity and cost reduction, but the second half needs to focus on aspiration and redesign. Because while adverse financial pressure may be continuing to force change, the circumstances exist to create a more cost-effective, citizen-centred and mission-focused public sector by 2020.

The state of the public finances

Seven years after the global financial crisis, the UK Government is still dealing with its consequences for the public purse. Our commentary observes that the deficit – the difference between what the Government earns and what it spends over a year – is expected to be £69.5 billion this financial year. That means the 2010-15 UK Coalition Government reduced the deficit by half since its post-crisis high in 2010. Under fiscal plans from the new Conservative Government, the deficit is now forecast to be eliminated by 2019-20.

The second half of the deficit elimination will see spending cuts continue at the same rate as the last UK Parliament, accumulating to a substantial shift, by global and historic comparisons, in the UK's level of public spending. While the G7 countries will see a reduction of 9.6 per cent in public spending this decade as a share of GDP, the UK's spending will drop by 19.5 per cent.

When governments run a deficit, they borrow to fund the shortfall in public spending. Since 2010-11, the Government has borrowed £403 billion. That took public sector net debt to £1.5 trillion which equals £23,428 for every UK resident. Every income tax payer would need to contribute £50,943 to pay off the full amount immediately. This year, debt interest will cost the Government more than it spends on the police and criminal justice system.

HM Treasury modelling for the Summer Budget implied a long-term approach to reducing debt, which might not return to pre-crisis levels until beyond 2035. Children born at the height of the financial crisis may still be able to see its debt legacy on the state's balance sheet in their adulthood.

For some organisations running local public services, continued austerity measures and demand pressures have begun to trigger signs of financial distress. Aggregating sector-wide warnings, more than 200 NHS bodies, councils, police forces and further education colleges could face serious financial difficulties in the course of this UK Parliament. Almost half of those are NHS trusts in deficit. In the next five years, the UK's central governments may need to intervene or co-ordinate support for local public bodies in financial difficulty.

Government through business lenses

Government is not a business, but applying business lenses to the public sector can provide fresh perspectives on its challenges. *The State of the State* explores the public sector's current challenges through the lenses of productivity, talent and the balance sheet.

Viewing government through a productivity lens, the report observes seven characteristics of highly productive public sector organisations:

1. Talented people with a licence to deliver
2. No repetition, hesitation or deviation
3. Citizen-centric forces shape services and attract resources
4. Insight informs deployment decisions and demand management
5. Technology helps people work smarter and cheaper
6. Form follows function
7. The journey never ends

The State of the State concludes that to pursue public sector productivity gains, the Government should accelerate progress towards digital transformation, support evidence-based reforms that may be disconnected from public opinion and ensure that continued local devolution seizes the opportunity for more joined-up services.

Viewing government through a talent lens, this report finds that spending cuts since 2010 have taken a toll on the public sector workforce. Headcount reductions have not always retained the skills most needed, morale has been affected and Civil Service pay may not be sufficient in some cases. The report recommends that Government departments and other public bodies rethink reward packages, ensure that further headcount reductions retain the right skills and that the state nurtures new abilities and behaviours in its future talent.

Through a balance sheet lens, *The State of the State* acknowledges that the Government faces a 'debt dilemma' as it seeks to balance debt reduction with spending on public services. The report concludes that the state's net liabilities need to be managed down and policies should be stringently assessed for their impact on the Government's financial position.

The view from local public sector chief executives

Exclusively for *The State of the State*, Ipsos MORI interviewed more than 40 local public sector leaders, who are collectively responsible for more than £16 billion of public spending. Asked to reflect on their challenges since 2010 and outlook to 2020, the leaders told us that:

- Their organisations have become more efficient and productive as a result of budget pressures. They expect a shift from cost reduction to redesign in the years ahead, and while they believe the coming five years will be challenging, many are optimistic about the future of their organisation and the services it delivers.
- Morale has suffered as a result of redundancies, pay freezes and reduced promotions. Some said that recruitment is difficult as salaries are not attractive enough, and others observed that the level of continuing transformation in their organisation makes the need to keep talented, skilled people greater than ever.
- Technology is seen as critical to a more productive, cost-effective and customer-centred public sector, but funding and cultural change are seen as the key barriers to harnessing it more effectively.
- By 2020, many expect their organisations to have retrenched into core, statutory activities. Many expect far greater levels of cross-sector working and a broader mix of providers. Most expect their organisation – and the system within which it operates – to have been redesigned to make it leaner and clearer on its mission.

Around the UK

The State of the State notes spending per head across the UK's four nations and disparities across the UK regions continue.

The report observes that in England, local devolution is progressing alongside constitutional changes to resolve the West Lothian question. In Northern Ireland, the challenge of finding political stability so that the Executive can seize its economic development and reform opportunities continues. In Scotland, with increased powers we see continuing devolved maturity, albeit with ongoing debate. In Wales, significant local government reorganisation and further devolved powers to include borrowing for capital investment have considerable potential as the Welsh Government continues to pursue its own devolution path.

Progress against indicators

Since the first *State of the State* in 2012, each report has assessed government progress against ten indicators that we felt would make a substantial difference to its effectiveness. This year, we find a range of achievement against those indicators, as shown in the table.

Achieved	Encourage corporate sector spending to achieve growth
	Drive significant public sector headcount reductions
	Manage cash effectively
Good progress	Meet efficiency targets of £20 billion per year
	Support social innovation and transfer one million public sector workers into mutuals
In progress	Save cash through payment by results
	Drive localism through council funding
	Support an economy-wide focus on productivity
Requires attention	Save cash lost through fraud
	Target net liabilities

Government in numbers

The UK state is a complex mosaic of organisations, democratically accountable to 46.8 million electors and supporting a population of 64.6 million people.^{1,2}

The Government's accounts identify 5,500 organisations across England, Northern Ireland, Scotland and Wales as the UK public sector. Together, they employ 5.4 million people, or 17 per cent of UK employment.

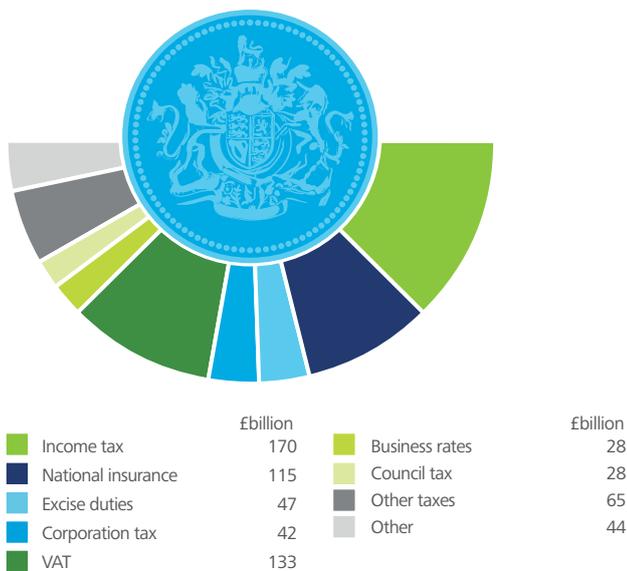
As well as national Government in Westminster and Whitehall, three distinctive administrations based in Belfast, Cardiff and Edinburgh run the state, each held to account by a unique elected assembly. Eight political parties are currently parties of UK national and devolved Government, with 149 ministers serving as political decision makers.

A total of 947 elected representatives currently legislate and scrutinise government in our elected assemblies, along with 775 members of the House of Lords acting as a second chamber of the UK Parliament. A further 73 UK members of the European Parliament scrutinise EU legislation that affects the UK and 18,100 councillors hold 418 councils to account.³

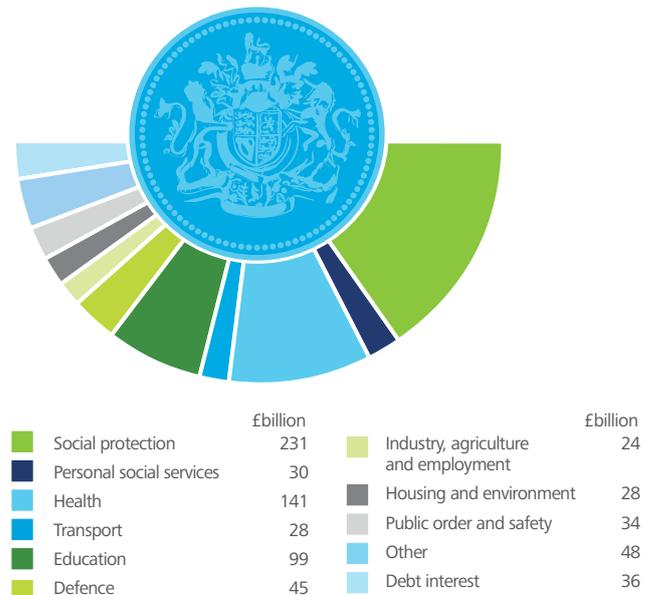
This financial year, the UK Government will raise £673 billion and spend £742 billion. The difference between what the state earns and what it spends – the deficit – is funded by borrowing, and this financial year the Government is expected to borrow £69.5 billion.⁴ The cumulative effect of that borrowing over time means that the Government's debts have risen almost threefold since the global financial crisis in 2008 to £1.5 trillion in 2015.⁵

The UK Government's latest balance sheet shows £1.337 trillion of assets including land, the road network and military equipment, and liabilities of £3.189 trillion including public sector pension schemes and borrowing. The state's net liability – the difference between what the Government owns and what it owes at an accounting year end – rose by £224 billion to reach £1.852 trillion at last count for the 2013-14 financial year.

Figure 1. Government income will be £673 billion in 2015-16



Government will spend £742 billion in 2015-16



Source: Budget 2015, HM Treasury

The state of the public finances

Introduction

Some seven years after the global financial crisis, the UK continues to deal with its consequences for the public purse. While economic recovery is well established, public sector austerity will remain throughout this UK Parliament as the Government strives to eliminate the deficit that the crisis created. Beyond 2020, once the deficit has been eliminated, the longer-term challenge of reducing public sector debt back to pre-crisis levels could take decades. In the meantime, signals of financial distress have started to emerge from some organisations in the local public services. This chapter explores the state of the public finances.

From recession to growth

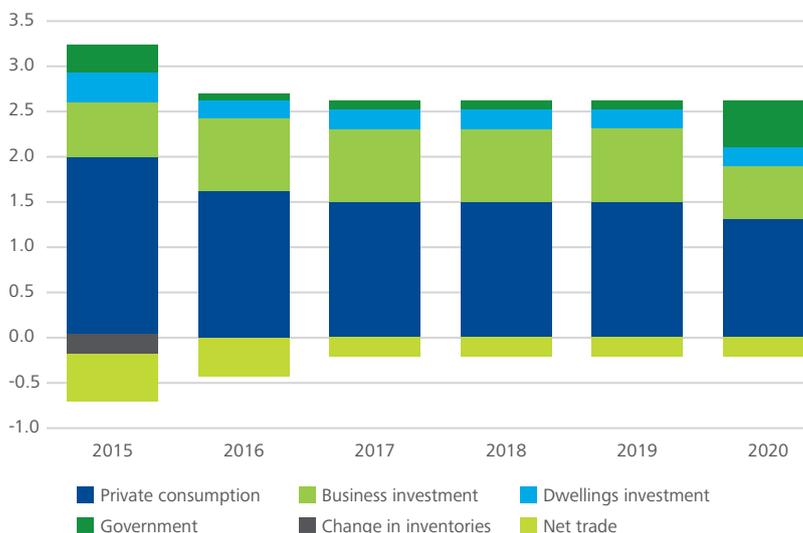
After the 2008 global financial crisis, the UK entered its deepest recession since quarterly data was first published in 1955.⁶ But after returning to its pre-crisis level last year, the economy looks set for continued, steady growth. The Office for Budget Responsibility (OBR) forecasts 2.4 per cent GDP growth this year and every year to 2020, with a slight dip to 2.3 per cent in 2016 to account for fiscal consolidation measures.⁷ That outlook is also reflected in Deloitte research that suggests chief financial officers in UK companies are among the most optimistic for revenue growth in Europe.⁸

Figure 2 shows elements of expenditure that the OBR expects to drive growth over the next five years. The resurgence of government spending as an element of growth is notable in 2020 when it is expected to grow again in line with national income.

Sustaining this economic growth is of course a significant preoccupation for the Government. The International Monetary Fund (IMF) has warned that the UK needs to contain financial stability risks from housing and mortgage markets to protect growth. But more fundamentally, for some years it has argued that improving productivity should be a policy priority.⁹ The UK's weak productivity is well documented: our economy has the second lowest in the G7 and for every hour of work, the US produces almost one third more output.¹⁰ This is such a complex and deep-rooted problem that even the Bank of England has acknowledged there is no single, credible explanation for the UK's 'productivity puzzle'.¹¹

Figure 2. Where wil the growth come from?

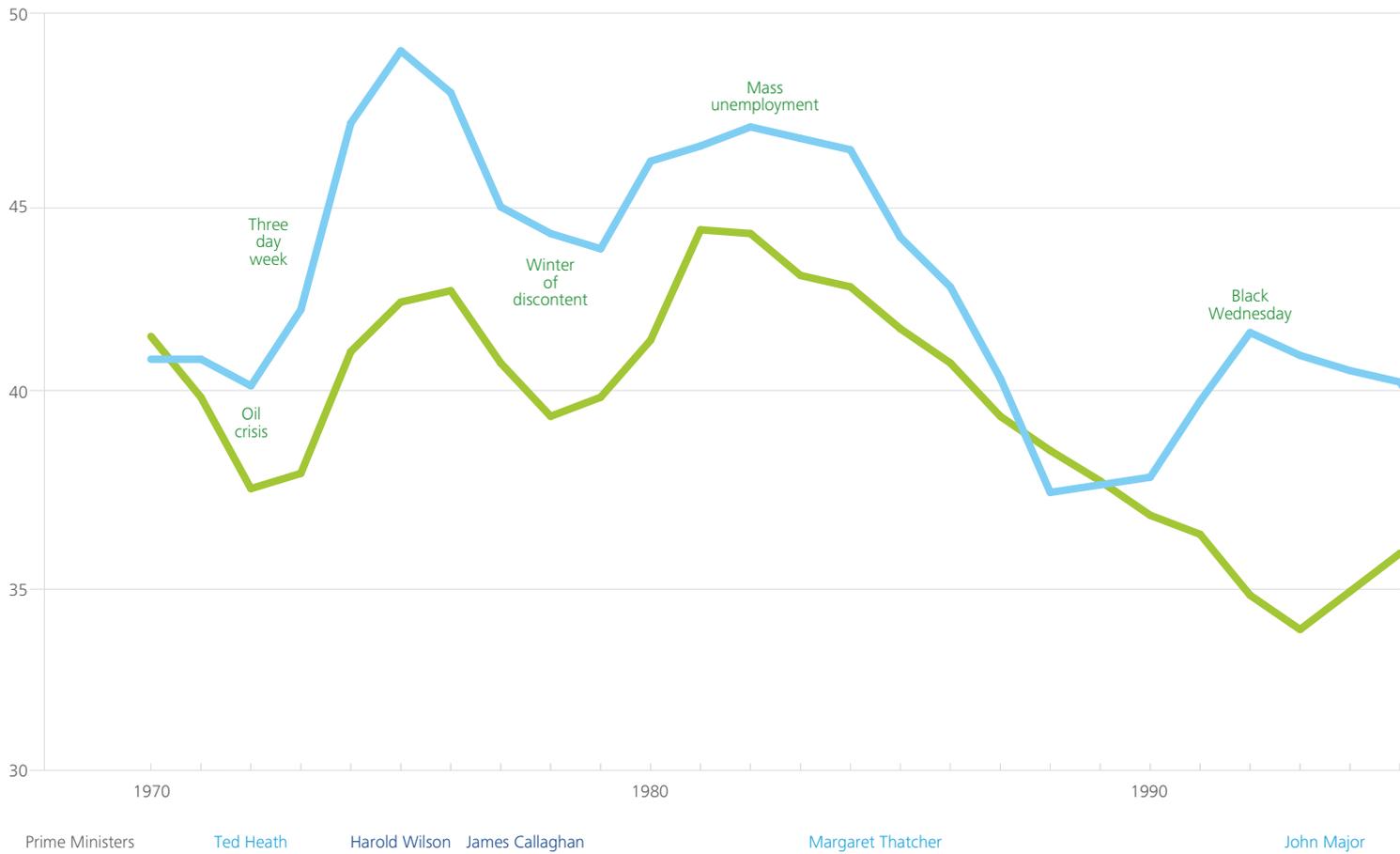
Percentage points



Source: Economic and Fiscal Outlook, Office for Budget Responsibility, July 2015

In July 2015, HM Treasury published a wide-ranging analysis of productivity's main drivers and set out an improvement programme that encompasses tax, workforce skills, transport, digital infrastructure, regulation and more. These interventions will require focus and energy over years to drive change, and the full impact of the Government's productivity plan may not be evident until beyond 2020.

Figure 3. Fifty years of UK public finances
Per cent of GDP



Sources: Office for Budget Responsibility, National Archives

Eliminating the deficit

The global financial crisis in 2008 hit the UK’s public finances hard. Figure 3 shows the relationship between tax and spending for the past 50 years, including the impact of key economic events.

The recession that came in the wake of the crisis pushed tax income down and public spending up. The gap between what the Government was earning and what it was spending – the deficit – grew to a post-war record in 2010, when the Government spent £154 billion more than it earned. Elected that year, the UK Coalition Government’s defining aim was to eliminate the deficit, closing the gap between its income and spending to make the public sector more affordable.

After a five-year programme of deficit reduction, broadly 80 per cent through public spending cuts, the deficit is expected to stand at £69.5 billion this financial year. The Coalition ultimately reduced it by half, leaving the remaining half to be reduced in this UK Parliament. Under the new Conservative Government, the target date for the deficit’s elimination and a shift to a surplus is now 2019-20.

Policy decisions continue to make a substantial difference to the deficit. The OBR reports that higher than expected receipts from income tax, VAT and stamp duty, along with in-year Whitehall cuts, plus decisions to increase the insurance premium tax rate and delay the introduction of tax-free childcare, have reduced the deficit by £5.8 billion.¹²

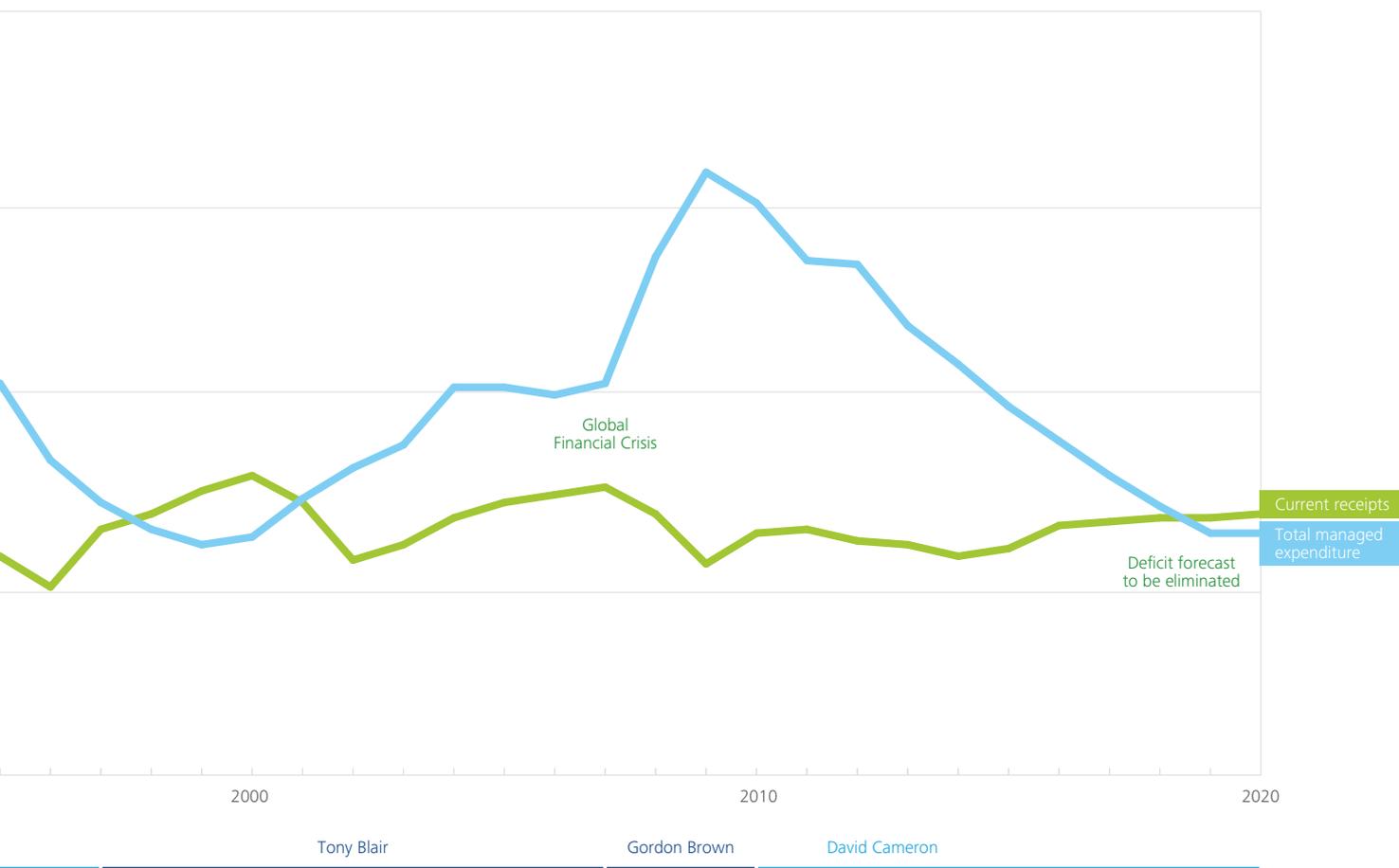
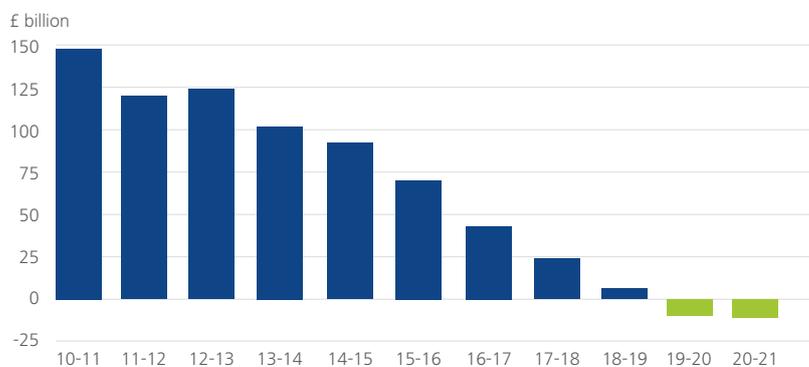


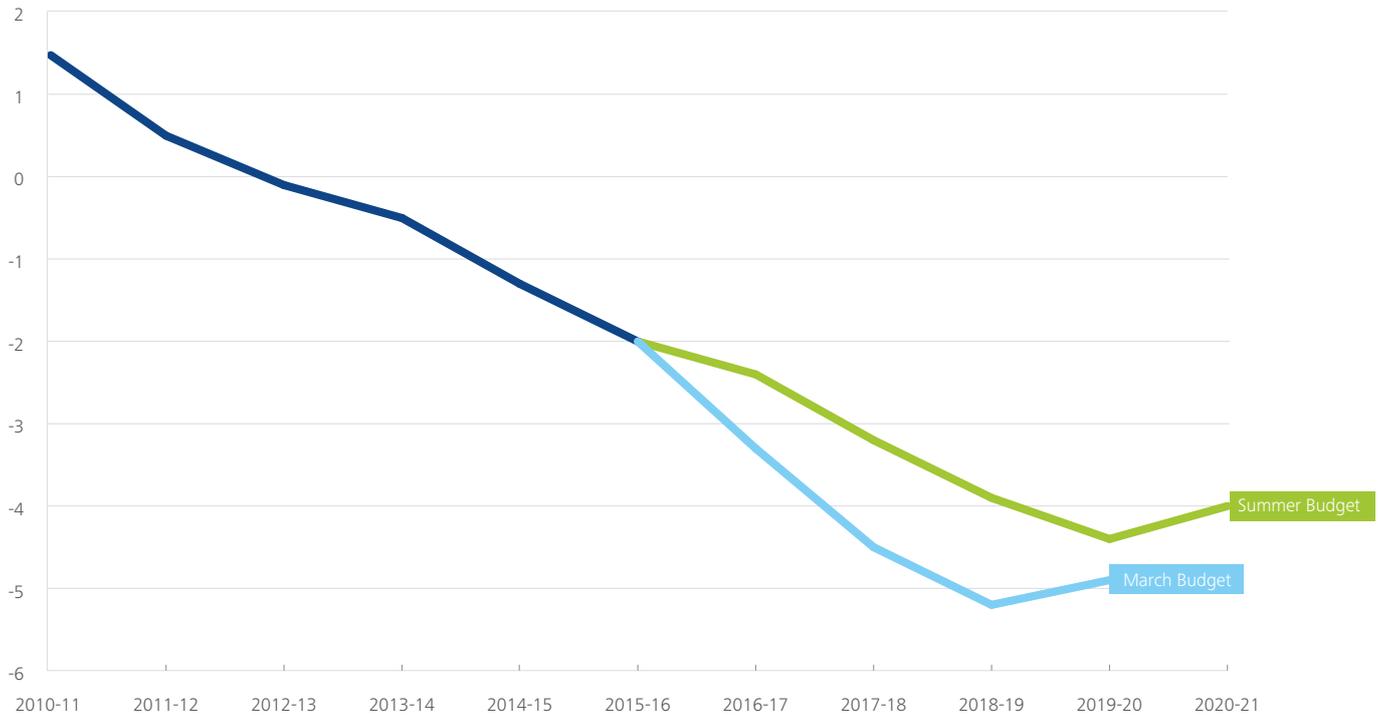
Figure 4 shows deficit reduction in the last UK Parliament and the forecast for its continued reduction to 2020-21. The remaining deficit amounts to 3.7 per cent of GDP, and official forecasts suggest that eliminating 2.4 per cent is likely to come from cuts to public spending and administration.

Figure 4. The deficit
Public sector net borrowing



Source: Office for National Statistics

Figure 5. The austerity decade
Change since 2007-08 (per cent of GDP)



Source: Office for Budget Responsibility

Figure 5 shows the outlook for Resource Departmental Expenditure Limits, a good guide for spending on public services and running the state, for this UK Parliament.

As the figure also shows, that outlook changed substantially between the Coalition’s March Budget and the Conservative’s July Budget. In March, spending cuts scheduled for 2016-17 and 2017-18 were twice as deep as the deepest annual cuts in the previous parliament, which would have eliminated the deficit by 2018-19.

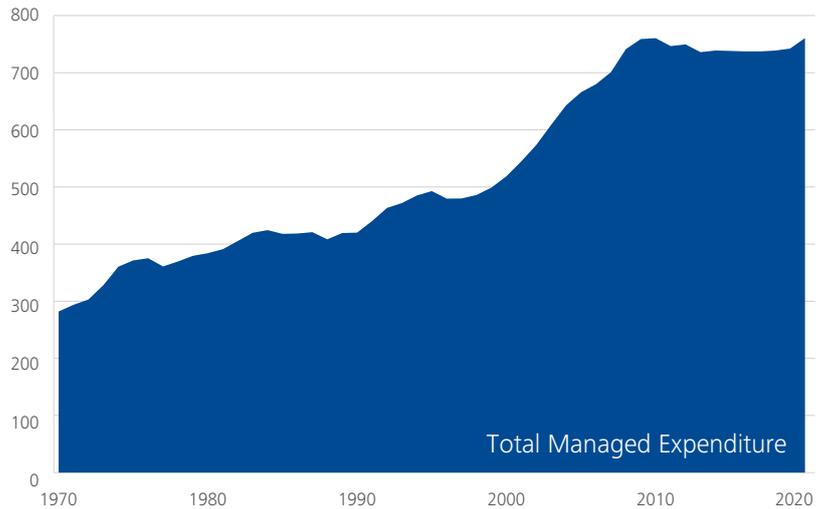
By July, with the election returning a Conservative majority government, the Chancellor delivered a new Budget that effectively cancelled £83.3 billion of spending cuts from the March Budget. But the Government is making that possible by running a deficit for one further year, eliminating it by 2019-20.

This smoother public spending profile does not mean that austerity has ended, but spending cuts will continue in this Parliament at the same rate as last. Figure 5 also shows how those cuts are accumulating to a substantial shift in the UK’s level of government spending. An even longer perspective in Figure 6 shows how all governments of the past 50 years increased public spending, but that trend was reversed by the last Government and public spending will not return to growth until 2019-20.

Figure 7 shows a global perspective of how the UK's public spending level changes in comparison to this peer group. While the G7 governments as a whole reduce their public spending by 9.6 per cent as a share of their GDP over this decade, the UK is set to reduce its spending by 19.5 per cent.

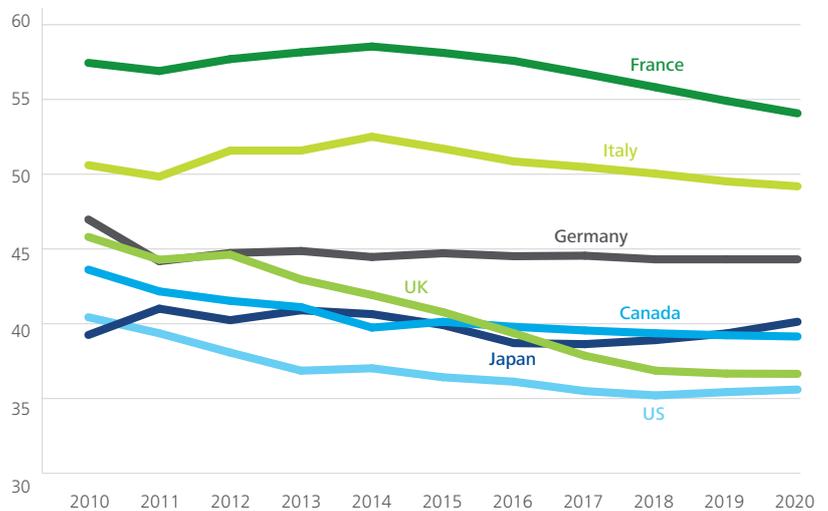
The figure shows that the UK is the only G7 government making such a fundamental shift of spending level through fiscal consolidation. Looking beyond the G7, IMF data shows that UK government spending was the 16th highest of the 37 most advanced economies in 2010, when measured as a percentage of GDP. The UK has since dropped to the 21st and is projected to be the 26th highest by 2020 – a drop of ten places in ten years that will see our closest public spending peers change from Norway and Spain to the US and Australia.¹³

Figure 6. Fifty years of public spending growth
£billion at 2013-14 prices



Source: Public Finances Databank, Office for Budget Responsibility

Figure 7. Public spending in the G7
Per cent of GDP



Source: World Economic Outlook database, IMF, April 2015

Paying down the debt

Reducing the deficit is the first and most pressing challenge for restoring the UK's public finances. Once that remedial action is taken, the next challenge is to reduce the substantial level of debt that the deficit has created. Just before the global financial crisis, UK government debt was £562 billion, or 37 per cent of GDP. But when governments run a deficit, they borrow to make up the shortfall by issuing gilts, so since 2010-11 public sector debt has increased by £403 billion. This financial year, UK public sector net debt reached £1,506 billion, or 81 per cent of GDP. By the EU's Maastricht Treaty definitions, UK debt was 89 per cent of GDP at the end of the financial year ending in March 2015. Either measurement places the UK well beyond the EU's 60 per cent limit for any country wishing to join the euro.¹⁴

Government debt currently equals £23,428 for every UK resident, and every income tax payer would hypothetically need to contribute £50,943 to pay off the full amount immediately. Such a high level of debt exposes the UK to risk in the event of further financial crises, vulnerability to fragile external forces such as interest rates and a burdensome level of debt service payments for the taxpayer. This financial year, the Government's net debt interest bill will be £36 billion, taking into account the effect of the Bank of England's Asset Purchase Facility. That is more than the police and criminal justice system's annual budget.

HM Treasury modelling published alongside the Summer Budget suggests that debt will remain higher than before the financial crisis for at least the next 20 years, even in a best case scenario where successive governments run a continued budget surplus and no adverse events harm the economy.¹⁵ Children born at the height of the financial crisis may still be able to see its debt legacy on the Government's balance sheet into their adulthood.

Further analysis of the Government's debt position follows in the next chapter.

Distress signals from the local public sector

In the past year, signals have emerged that some local public sector organisations – councils, NHS bodies, police forces and further education colleges – could be facing financial distress as a result of funding reductions and shifting patterns of demand for their services.

For local government in England, the past five years have seen a 37 per cent real terms reduction in funding according to the National Audit Office (NAO).¹⁶ While the Welsh Government shielded its councils from austerity for much of that period, councils in Wales have faced a three per cent reduction this financial year. In Scotland, the national audit body identifies a reduction in funding for councils of 8.5 per cent in real terms from 2010-11 to 2013-14. In Northern Ireland, the 11 newly-amalgamated councils have raised concerns with the Executive over funding levels.

At the same time, demand for services including social care, social housing and concessionary fares has risen and will continue to rise.^{17,18} Since 2005, the number of people aged over 85 – and most likely to need social care support – has gone up by a third, and two out of every five councils in England will have more children ready to start primary school in 2016 than they have places.^{19,20} The Welsh Local Government Association (WLGA) has noted that council spending on schools and social services continues to put pressure on budgets and Audit Scotland warns of increasing demand for social care and education, driven by changes in Scotland's population.^{21,22}

The NAO reported concerns in 2014 whether 52 per cent of single and upper tier local authorities would be able to deliver their medium-term financial plans.²³ There is no precedent for financial failure in local government, because councils are legally required to set balanced budgets and are therefore prevented from running deficits – in other words, they cannot become insolvent. That means financial difficulties in individual councils might only become evident when services fail, with potentially distressing consequences for the public.

A similar picture has emerged in Further Education (FE), which remains integral to local skills and employment strategies even if it is no longer technically part of the public sector. Between 2010-11 and 2013-14, the number of English colleges reporting a deficit doubled to 110, and the number deemed to have inadequate financial health doubled to 29, from a total of 244 institutions.²⁴ The Skills Funding Agency (SFA) believes that 70 colleges will face serious financial difficulties by the end of this current financial year.

Different commentators suggest a variety of forces at play in FE. The 157 group of colleges has pointed to a systemic problem caused by funding reductions and a legacy of debt from capital building projects.²⁵ Parliament's Public Accounts Committee has expressed concern that colleges are taking tough decisions on their finances without having the right financial management skills in place.²⁶ A letter from the Further Education Commissioner in March 2015 urged colleges to look for signs of financial inadequacy that include inaccurate financial forecasts, excessive staff costs and low class sizes.²⁷

Distress signals have also emerged from the police. Forces in England and Wales have faced a 25 per cent reduction in funding over the last UK parliament and cuts expected in the years ahead look set to increase financial pressure. Lincolnshire's police chief constable has warned that his force's budget will be unsustainable by 2018, causing it to "fall over".²⁸ Northumbria's chief constable has said that his force will need to "completely change our set up" in the years ahead.²⁹ That echoes the Chair of the National Police Chiefs' Council, who has described the need for a "re-imagining of policing" ahead.³⁰

In Scotland, the unified police force faces sustained budgetary pressure. While savings of £1.1 billion by 2026 that formed part of the original business case to merge eight forces look set to be realised, further cost pressures mean yet more savings need to be delivered.³¹ After this financial year, a reform fund of £70 million will no longer be available and the Scottish Police Federation has warned of a "stark financial challenge" ahead.³²

In Northern Ireland, the chief constable of the Police Service of Northern Ireland (PSNI) reported that balancing the service's budget for 2015-16 "has only been possible by making decisions that will have significant operational impacts, both this year and into the years ahead". He added that even a flat budget in subsequent years would mean "very significant gaps" in funding.³³

For police forces across the UK, rising demand pressures are particularly sensitive to provision in other areas of the public services. In an inquiry into police sustainability, the Public Accounts Committee heard that 78 per cent of police emergencies in 2013-14 were concerned with anti-social behaviour, or other incidents such as mental health-related issues, rather than crime. The Permanent Secretary of the Home Office told the committee that the police picked up a "disproportionate burden of mental health cases... particularly after hours".³⁴

In the NHS, continued ring-fencing has not kept it immune from funding and demand pressures. England's NHS trusts and foundation trusts ended the 2014-15 financial year with a record deficit, driven by a combination of high costs for agency staff, rising patient demand and financial plans that proved inaccurate. Some 40 trusts and 77 foundation trusts reported a combined deficit of £822 million compared with £115 million the previous year, and the situation is expected to get worse. Monitor, which regulates foundation trusts, has forecast a deficit of £989 million for 2015-16 which its chief executive has warned is unaffordable.³⁵ The King's Fund describes this financial year as the most challenging for NHS providers this century.³⁶

These financial distress signals suggest a turbulent period ahead for our local public service organisations

While NHS Scotland's finances are not as visibly distressed, health bodies are grappling with increasing demands and Audit Scotland has warned of increasing strain on services at a time of tightening budgets and the need for focused, long-term financial planning.³⁷

In Wales, an additional £225 million is being made available this year to address imminent spending pressures. Nuffield Trust modelling points to a shortfall of £2.5 billion in NHS Wales funding by 2025, with the same demand issues arising in Wales as throughout the rest of the UK.³⁸

In Northern Ireland, rising pressures triggered temporary measures that included recruitment restrictions, ward closures and the cancellation of some non-urgent surgeries last winter.

Aggregating these sector-wide warnings suggests that more than 200 frontline public sector organisations in the NHS, local government, police and further education could be at risk from financial distress and require intervention in the course of this UK Parliament. Around half of those are NHS trusts.

These financial distress signals suggest a turbulent period ahead for our local public service organisations and some may require performance intervention from within their sector or remedial financial support from central government. While mergers can be a workable solution in many cases, organisations with long-standing, multiple problems may not be attractive propositions for merger with high-performing peers unless central governments provide incentives and support. Each of the UK's administrations need to be clear on the risk of financial failure across the public services and plan for intervention.

Rising demand from an ageing population

Pressure continues to increase on the public finances as a result of the UK's ageing population. Official population projections suggest that the number of people in the UK aged over 85 will increase from 2.4 per cent to 7.4 per cent of the population in the next 50 years.³⁹ As the King's Fund observes, people born in the post-war baby boom will reach their 80s by 2035, and are more likely to reach that age than their parents.⁴⁰

The ageing population is a very welcome trend, but it comes at a cost for the public purse. A House of Commons report found that the costs of hospital and community services for people over 85 are three times greater than for a person aged 65 to 74.⁴¹ Over the next 50 years, the OBR projects that spending on health will increase by ten per cent, spending on long-term care will double and spending on state pensions will increase by a third in relation to GDP as a result of age-related pressures.⁴²

A 2015 study by the European Commission found considerable variety in levels of age-related spending predictions across Europe. It forecast that France, Italy and Greece would see less pressure on public spending by 2060 than the UK, while countries including the Netherlands, Germany and Norway would experience greater pressure. However, the Commission warned against complacency, noting that the impact of ageing on public spending is expected to be high across the EU, with effects becoming increasingly apparent in the next decade.⁴³

Government through business lenses

Introduction

Government is not a business. But applying 'business lenses' to the public sector can allow for distinctive perspectives and fresh thinking. Our analysis suggests that as the Government continues to recalibrate the public sector to a lower level of spending, it should consider reform through three such lenses: a productivity lens, a talent lens and a balance sheet lens. This chapter outlines the view through each.

The productivity lens

In 2010, Office for National Statistics (ONS) figures suggested that public sector productivity had been flat for 13 years. The amount of activity the public sector delivered, according to the ONS data, seemed inextricably bound to the amount of funding it received.

As austerity began, the ONS observed nascent improvement in the figures, with growth rates of 2.5 per cent in 2011 and 1.2 per cent in 2012.⁴⁴

The private sector tends to experience productivity gains during recessions, not least because workers in a declining workforce have to produce more, and the same could have been true of the UK public sector in austerity.⁴⁵

Productivity gains can help the public sector maximise its efforts, focus on the impact it delivers and make the most of its funding. We suggest that every hour of public sector staff time saved in a year through better productivity is worth £57.7 million to the public sector in England, £2.9 million in Northern Ireland, £7.2 million in Scotland and £4.3 million in Wales – a total of £72 million to the UK's public purse.

As well as the importance of better productivity for the public sector itself, Cabinet Office Minister Matthew Hancock used a *Reform* platform to underline its importance in driving up the UK's overall productivity as well.⁴⁶

The State of the State suggests that the UK's central governments can lead the pursuit of public sector productivity gains in five ways.

First, digital technology has a particularly significant role to play in more productive, cost-efficient working and its use should be accelerated. Bold projects, such as the move away from paper tax discs last year, illustrate the scale of potential. In their final year, 42.4 million paper discs were issued and their decommissioning is expected to save £10 million a year.⁴⁷

For public sector organisations thinking through the potential of technology, Deloitte observes that successful digital transformation requires a fundamental change of mindset. Public sector leaders need to re-imagine their processes for a digital age, rather than recreate analogue activities in digital form. As well as rethinking what they will deliver, they need to rethink how they will deliver as traditional project management models may not work where technology and the organisation's needs are changing rapidly. Agile working and in-flight testing are often more appropriate for digital change.

Digital transformation often requires investment, and our interviews with public sector leaders in the following chapter suggest that this is a barrier to progress that the UK's central administrations could help overcome through 'invest to save' funding. Such investment should be led by the organisations themselves to support their own digital transformation, as the bodies with public accountability. The World Bank's chief information officer recently observed, "IT is not a cost to be constrained" but is a means of delivering solutions and more effective ways of working.⁴⁸

Government could also act to make procurement processes better-suited to digital transformation. Reforms could allow for more digital-friendly procurement, reflecting programmes which often evolve during their delivery.

The second way that government needs to lead in productivity is to make it less abstract and more meaningful for the public sector. A framework and guidance for measuring productivity, best practice examples and shared definitions would demystify productivity and help accelerate change. The UK Government has committed to launching initiatives to boost productivity alongside this November's Spending Review, which should help put productivity in a real-life, public sector context.

The third way that the UK's governments can support productivity is by stimulating connections between interdependent and overlapping parts of the public sector. Over four years in the US, the Government Accountability Office identified 188 areas in which public bodies overlapped, duplicated each other's activities or missed opportunities to join up because they were too fragmented.⁴⁹ The UK's emerging local devolution deals have considerable potential to deliver productivity gains by making cross-sector connections. Beyond those areas, coordination across government departments and local public bodies has exceptional potential for system-wide gains.

Fourth, the Government needs to back the public sector in evidence-based reforms that may seem counter-intuitive and challenge widely-held beliefs. For example, there is a citizen view that police 'on the beat' help deter crime, but research suggests that officers have greater impact when deployed in more targeted ways.⁵⁰ Similarly, a 2012 study for the Department for Education suggested that extra funding in itself does not improve school performance.⁵¹ And this year, a Deloitte report for the Ministry of Justice questioned the correlation between funding and performance, as currently defined, in youth offending teams.⁵² These evidence-based insights each challenge popular thinking and question whether extra funding improves public services. They suggest a disconnection between citizen views and operational evidence that would require bold political leadership – local and national – to resolve.

The fifth way in which the UK's central governments can support better productivity is by supporting a move towards more customer-centred services. User-feedback is a critical part of that, especially in designing digital services, and social media could have a role to play. In the US, federal agencies are now encouraged to use Yelp – a review site similar to TripAdvisor – to gather actionable feedback on their services and engagement with the public.⁵³ Clearly, gathering feedback in a public forum would need to be managed appropriately, but it is worth noting that 43 per cent of Yelp reviews have given five out of five stars while just 14 per cent have given one star. In other words, citizens are not exclusively moved to offer complaints but also wish to comment on favourable experiences.⁵⁴

A survey for Collaborate, a social business supporting cross-sector collaboration, found that less than a quarter of people – 24 per cent – feel that the public services always or often understand their needs and just 16 per cent feel that the public sector listens to their preferences. When asked to rank desirable characteristics for organisations delivering public services, respondents to the survey suggested that understanding people's needs is the most important.⁵⁵

Seven characteristics of public sector productivity

Research for *The State of the State* assessed public sector reform programmes and high-performing organisations around the world to identify common themes and behaviours. That analysis points to seven characteristics of highly productive public sector organisations.

These seven characteristics may not be applicable to all organisations but are intended as simple reference points to help guide the pursuit of better productivity. They are:

1. Talented people with a licence to deliver

Highly productive organisations attract talented people because they offer a salary that corresponds with the market rate for their skills and experience. Those rewards are enhanced by an engaging culture, flexible working choices and the opportunity to make a difference.

People in productive organisations enjoy a high performance culture, underpinned by authentic performance management. An active approach to talent management means that the organisation pre-emptively ensures that the right people are in the right posts when needed.

Talented people in highly productive organisations are given a licence to deliver because they are deployed according to their skills. Their organisation makes best use of their talent and maximises their working time by deploying them across multiple responsibilities.

2. No repetition, hesitation or deviation

Productive organisations have designed repetition out of their processes. Those that deal with the public make sure transactions are right first time to avoid unnecessary duplication of effort.

Hesitation is reduced in productive organisations because managers have enough autonomy to make decisions. While decision-makers recognise risks, they know they have the permission and authority to make a call.

Highly productive organisations are focused on the core of their mission – the public value that they create – and do not get sidetracked. So just like in the classic Radio 4 game, ‘repetition, hesitation or deviation’ are rarely found in the most productive public sector organisations.



3. Citizen-centric forces shape services and attract resources

The best public sector organisations put the citizen at the centre of their thinking. That means services are designed around the user experience and developed with their input.

Continued and transparent citizen interaction keeps the organisation connected to their needs. By understanding what the customer wants, productive organisations do not waste resources on initiatives that do not add value. They are active in seeking continuous, constructive feedback and they act on it.

The force of ‘citizen-centricity’ does not stop at agency boundaries. It pulls public sector teams and resources together from different organisations to work around service users in ways that generate cross-sector productivity gains.

4. Insight informs deployment and demand management

Highly productive organisations understand their environment and act on that insight. For public bodies, that means a working knowledge of where demand comes from for their services, the factors that affect it and how their resources are deployed to meet it. The principle applies as much to public service delivery organisations as it does to administrative teams with internal clients.

If an organisation understands how demands on its services operate, it can maximise its productivity in two ways. First, it can align its resources to demand. Frontline staff, for example, can be deployed when and where they are needed the most. Second, the organisation can shape citizen demand through preventative measures including behaviour change.

5. Technology helps people work smarter and cheaper

Public sector organisations can suffer from under-investment in IT. But technology is key to more productive working practices – whether the employee is in an office or in the field.

Highly productive organisations deploy technology that helps employees maximise their time. For office staff, that could mean better software, tools to help them collaborate with colleagues or new hardware that simply works faster. For field workers, mobile technology reduces their latent time and the need to return to an office.

Technology is also exploited to good effect in interactions with citizens. Many people in the UK have become accustomed to personalised, online self-service and are open to that kind of interaction with the public sector too.

6. Form follows function

Many UK public sector organisations have evolved over decades – even centuries – and sometimes in ways that have weighed down their productivity. Overlapping and duplication have often been introduced into the system. Opportunities for joined-up working have been missed as organisations grew in silos.

Highly productive organisations have been redesigned for today's needs. Where appropriate, back-office functions have been shared. Management has been delayed. In some cases, organisations have merged. While these activities have become commonplace across the UK public sector, considerable opportunities still exist.

New business models provide public sector leaders with varied options to recast their organisations. But whether internal change or more profound transformation is the most effective option, highly productive organisations tend to be structured around the principle that 'form follows function'.

7. The journey never ends

Debates around public sector reform can inadvertently perpetuate a myth: that change requires a brief period of activity to reach an end-point at which reform is permanently complete. But society, people and technology never stop changing. At the same time, every government will seek to shape the public sector in line with its agenda through a reform programme.

For these reasons, the pursuit of better productivity needs to be a continuous process rather than a one-off project. The most high-performing organisations never stop seeking efficiencies and new ways of working. In the private sector, competition drives that persistent search. For the public sector, a continual productivity journey is best achieved by fostering a culture of innovation and never-ending dialogue with service users.

Recommendations: through a productivity lens

The State of the State concludes that looking through a productivity lens, the UK Government and devolved administrations need to:

- accelerate the use of digital technology across the public services through 'invest to save' funding for public services as well as procurement reforms
- establish a meaningful framework through which organisations can agree definitions on productivity, pursue gains and share best practice
- generate productivity gains through departmental co-ordination, and through continued local devolution that integrates services and organisations
- back evidence-based reforms that may challenge widely-held beliefs on funding priorities, giving leaders across the public services license to make bold decisions that will improve productivity
- encourage the use of user reviews, social media and other research to access continuous user feedback on public services.

The talent lens

Advanced governments around the world are increasingly alive to the importance of talent, but unfortunately austerity has taken its toll on the UK's public sector workforce. As our interviews with public sector leaders in the next chapter show, redundancies, pay freezes and reduced promotion opportunities have affected morale. But as public sector organisations continue to reduce their headcount, redesign their operations and seek productivity gains, public sector leaders know that they need skilled and motivated employees more than ever.

Since 2010, the UK public sector headcount has gone down by 409,000, taking into account the effect of reclassifying employees in further education, the Royal Mail and banks acquired after the financial crisis.⁵⁶ That equates to a seven per cent drop in the total public sector workforce over the first half of this decade. Estimates suggest that the public sector headcount may fall by 800,000 from 2010 to 2020.

A survey for TotalJobs asked public sector staff how headcount reductions had been handled in their organisation. One-third of respondents felt that retaining highly skilled talent during the cuts was handled poorly, and a third thought that the opportunity to let underperformers go was badly utilised. The research concluded that talent had often left the organisation while employees with inconsistent performance had stayed.⁵⁷ That is also observed in the private sector during cost reduction. Public sector leaders need to view further losses in their organisations through a talent lens to make sure they do not lose capabilities that they will require in the medium term, after cuts have been made.

In Whitehall, as well as the Scottish and Welsh Government, the Civil Service People Survey provides a candid view of attitudes. The latest results show that civil servants have a clear view of their organisation's objectives and their contribution towards them. Encouragingly, they show that civil servants are interested in their work and enjoy a strong sense of accomplishment. Those attributes will be increasingly important to attract future talent: the Deloitte Millennial Survey shows that six in ten millennials choose to work for employers that provide them with a sense of purpose.⁵⁸

Less encouraging is the view of pay and benefits that emerges from the survey. Against an engagement benchmark of 59 per cent, the Civil Service-wide score for satisfaction with pay and benefits is just 28 per cent. The lowest level of satisfaction in the entire survey comes when civil servants are asked to compare their pay to people doing similar jobs in other organisations. That benchmark score now stands at 24 per cent and has gone down every year since the survey began in 2009.⁵⁹

These issues have serious implications for talent and capability in government. Europe-wide research by Deloitte found that lower public sector pay limits the pool of talent available for government finance positions and an NAO study of government procurement experts concluded that salaries for their roles are insufficient.⁶⁰ Those procurement professionals collectively administer £40 billion of contracts, so taxpayers might reasonably expect the Civil Service to employ people at market rates to manage their money, even if those rates are out of kilter with standard pay grades. Other examples of roles that require highly-marketable skills – not least for digital transformation – are common across government.

As a report for the cross-party think tank GovernUp concluded in 2014, the role of reward in public sector capability needs to be acknowledged, and pay levels for people with specific, high-value skills need to be reconsidered to recruit and retain talent.⁶¹

The Civil Service has seen considerable developments in its approach to talent in recent years. The Major Projects Leadership Academy (MPLA) has supported 350 civil servants in developing their skills and confidence since its launch in 2012. The MPLA, managed by Deloitte with the Oxford Saïd Business School, aims to address self-observed leadership capability gaps.

Encompassing other roles, the Civil Service launched a plan in 2013 to improve skills across four, self-diagnosed areas in need of development: leading and managing change; commercial skills and behaviours; delivering successful projects and programmes; and redesigning services and delivering them digitally. While those skills are all vital, our analysis of the future of government suggests that they need to be developed as part of a wider shift in expectations on Civil Service and public sector leaders of the future.

Deloitte research suggests that the best government leaders of the future will demonstrate a series of new abilities and behaviours that encompass multiple skill sets. They will be adept at connecting people, information and resources to deliver through complex networks. They will operate with a default level of transparency towards their colleagues and citizens, and use social media to engage both continually. Their decisions will be informed by evidence and they will test out their thinking by iterative processes as part of innovation.⁶² These kinds of future behaviours and abilities – rather than individual skills – need to be nurtured by governments that want to shape their future talent.

Beyond leadership roles, if the public sector continues to shape around citizen expectations, some technical professions may need to become more customer-orientated or organisations will need to decide where customer care is centred within their workforce.

The impact of automation on employment has attracted considerable public attention this year, informed by a study for Deloitte by Oxford academics Carl Frey and Michael Osborne. Looking at the public sector roles within their data suggests that certain jobs have a high probability of being automated over the next ten to twenty years. The roles with the highest probability are set out in the table below.

Occupation	Probability of automation
Library assistants	0.97
Local government administrators	0.96
Inspectors of standards and regulations	0.94
Health care practice managers	0.82
School crossing patrol officers	0.80
Traffic and parking wardens	0.80
Street cleaners	0.66

Various technological advances are automating elements of these occupations. Digital and online technology is making a significant impact on how information is managed, how appointments are made and how data is processed. Sensors and digital imaging technologies are bringing that same impact into the physical environment, automating elements of traffic enforcement for example, through the Internet of Things. For some roles, technology is simply improving the speed and efficiency at which tasks are completed, and headcount can be reduced accordingly. For others such as school crossing patrols, recruitment difficulties could be contributing to the ongoing decline in numbers, in addition to technological advances.

In contrast, many roles found predominantly within the public sector are among the least at risk from automation in the next 20 years. Given the nature of their tasks, frontline roles including healthcare professionals, social workers, teaching staff, police and fire officers are all at low risk from automation, according to the research, because they require high levels of perception, creativity and social intelligence as well as varying degrees of physical manipulation.⁶³

Recommendations: Through a talent lens

The State of the State concludes that looking through a talent lens, the public sector needs to:

- ensure that further headcount reductions are considered in relation to medium-term plans so that public sector organisations retain the talent and skills that they need
- recognise the role of reward in attracting and retaining talent, especially where specific and highly-marketable skills are needed
- develop leading-edge skills in future talent, recognising that the public sector needs new abilities and behaviours as well as specific skills.

Figure 8. The state's income statement

	2009-10 £billion	2010-11 £billion	2011-12 £billion	2012-13 £billion	2013-14 £billion	Notes
Revenue	583.4	614.0	616.6	620.7	648.5	The main source of revenue – what the state receives – is taxation. The state raised £559 billion in taxes in 2013-14. The major source of non-tax revenue is from the sale of goods and services including £24 billion earned by local authorities.
Direct expenditure	(619.5)	(663.3)	(647.8)	(665.8)	(663.8)	Government's direct expenditure covers all of its costs, including £213 billion of staff costs and £190 billion to purchase goods and services.
Other operating expenditure	(47.7)	(38.4)	(67.3)	(51.5)	(54.2)	Other operating expenditure includes £15 billion of impairment of assets and £39 billion of pension scheme costs and actuarial revaluations.
Net financing cost	(78.6)	(83.2)	(88.1)	(79.4)	(78.8)	Net financing cost includes £49 billion of interest on pension scheme liabilities and £32 billion interest for government borrowing.
Other	(0.3)	(0.3)	1.3	(2.7)	(0.3)	Revaluation of financial assets and liabilities as well as net loss on disposal of assets.
Net expenditure for the year	(162.7)	(94.4)	(185.3)	(178.7)	(148.6)	Net expenditure describes the shortfall between the government's income and its expenditure in accounting terms.

Figure 9. The state's balance sheet

	2009-10 £billion	2010-11 £billion	2011-12 £billion	2012-13 £billion	2013-14 £billion	Notes
Assets	1,249.5	1,234.3	1,270.6	1,297.5	1,337.3	Assets – what the state owns – include £358 billion of land and property.
Liabilities	(2,477.4)	(2,420.0)	(2,617.5)	(2,925.4)	(3,189.1)	Liabilities – what the state owes – include £1,302 billion of public sector pension liability, £1,096 billion of government borrowing and £142 billion of provisions for events that are likely to happen in future.
Net liability	(1,227.9)	(1,185.7)	(1,346.9)	(1,627.9)	(1,851.8)	Net liability – the difference between assets and liabilities – has risen by £624 billion since the first set of accounts.

The balance sheet lens

Reading the UK state's income statement and balance sheet* allows for analysis of its underlying financial health and sustainability. This accountancy view has been made possible by HM Treasury's production of Whole of Government Accounts (WGA). Produced annually since 2009-10, WGA are the largest consolidated public sector accounts in the world and represent a major achievement in public financial management. Along with HM Treasury and Deloitte's 'Simplifying and Streamlining' project to improve the usability of public sector financial reporting, WGA continues to establish the UK as an international leader in public financial reporting and accountability.

A shortform of the most recent WGA report, for the 2013-14 financial year, is shown in figures 8 and 9.

Now that five sets of WGA have been published, clearer trends are beginning to emerge: the effect of the Government's austerity measures on its income statement is becoming apparent in the latest accounts

as net expenditure has decreased by £14 billion since 2009-10. Since the previous fiscal year, the income statement shows a reduction of direct expenditure of £2 billion, which includes a reduction of £1.2 billion in public sector wages.

Offset against this expenditure, the Government has seen an increase in revenue of 4.5 per cent overall, with a 6 per cent increase in tax income.

Two significant issues arise from reading the past five years of WGA balance sheet. First, the Government's net liabilities have increased by £624 billion or 51 per cent since 2009-10. That includes £314 billion of borrowing to fund the deficit and £167 billion of rising public sector pension liability.

The substantial liability increases are clear cause for concern and the Government is addressing them by reducing expenditure with an aim to eliminate the deficit, reduce debt and reform public sector pensions. However, the impact of those reforms will not be evident in WGA for some years.

*The term 'income statement' and 'Balance sheet' is used in the interests of broad understanding though for the public sector 'Statement of Comprehensive Net Expenditure' and 'Statement of Financial Position' are technically more accurate under the public sector financial reporting and International Financial Reporting Standards.

An increase in Government liabilities may be driven by the classification of new entities as public sector by the ONS, resulting in the consolidation of these bodies into the WGA. In structuring arrangements, for example, outsourcing or PFI arrangements, the Government should give early consideration to whether the ONS will classify any new entity or arrangement as part of the public sector, thereby bringing the assets and liabilities of these entities within the Government balance sheet.

Second, provisions for costs that the state expects to incur have increased by £40 billion since 2009-10. That increase is mainly due to a 37 per cent rise in provisions for nuclear decommissioning and a 69 per cent rise in provisions for NHS negligence. The UK Government is acting to stem these rises, which could otherwise put pressure on the public finances in years to come. The Government has moved to a new model which shifts decommissioning responsibilities for future power stations onto private sector partners. That should share risks between the public and private sectors and provide for greater value for money over time. However, ultimately the decommissioning provision is likely to continue to be held by the public sector as the only body able to undertake the activity. Similarly, to reduce the pace at which the NHS negligence provision continues to grow, the Government legislated to stop lawyers charging 100 per cent success fees on their costs. However, this was counter-productive in the short term as it is thought to have driven 1,000 new claims per month for six months before it came into force, representing an 18 per cent rise.

The debt reduction dilemma

Viewed through a financial statement lens, the Government faces a debt reduction dilemma. Paying down its £1.5 trillion debts as quickly as possible would reduce exposure to risk and debt servicing costs, but could require a continuation or acceleration of austerity measures. Conversely, with interest rates low there is an argument to let high debt levels continue and pay debts down over decades, allowing for greater public spending and investment. Of course, the reality is complex, and it is far from a binary choice; for example continuing or increasing borrowing while interest rates are currently low is likely to have a longer run effect on underlying interest rates, thereby increasing repayment costs overall.

Analysis by the OECD suggests that governments should consider their 'fiscal space' when making this judgement, which is essentially their room for manoeuvre on debt levels before they cause an immediate concern to markets. The analysis suggests that 22 advanced economies have enough 'fiscal space' to consider such a long-term solution, along with high employment and normal interest rate levels.⁶⁴ The UK is in that group – but only just. In the OECD's ranked order of 22 states, the UK is second from the bottom.

The Chancellor's Summer Budget implies that the Government favours a longer-term, organic approach and is planning to reduce its debt over decades by running an ongoing budget surplus. While that provides more scope for investment, the Treasury's modelling suggests that debt might not return to its pre-financial crisis level until beyond 2035, assuming optimistic economic conditions.

Of course, a long-term fiscal strategy requires future administrations to comply. For that reason, the Government is introducing a Charter for Budget Responsibility as a governance mechanism. The Charter commits the UK to staying in surplus – therefore spending within the limits of how much it is prepared to tax its citizens – in order to maintain financial discipline and reduce debt over time. While future governments would be able to amend the Charter or can set their own fiscal targets, they will be subject to parliamentary scrutiny and assessment from the independent OBR.

As the IMF pointed out this year, legislative devices like the Charter can anchor government policy and act as a guide towards medium-term objectives. Such mechanisms are particularly vital, in the IMF's view, for governments with high debt levels and an ageing population that will put pressure on public spending in the decades ahead – just like the UK.⁶⁵

While the Charter is a significant development with far-reaching implications, the Government still needs to pay close attention to its balance sheet in policymaking. Student loans illustrate why this is so important: they are expected to add more than nine per cent of GDP to public sector debt within the next fifteen years. However, of the £64 billion that has been lent to students, just £42 billion is expected to be recovered. Assessing the real cost/benefit to the financial position of the country is complex, as increased access to higher education also drives increased higher-skilled job creation and gross domestic product, giving rise to additional tax revenues over the longer term. Student loans are, therefore, one major example of the complexities of policy-making's impact on the state's financial position.

Recommendations: through a balance sheet lens

The State of the State concludes that looking through a financial statements lens, the government needs to:

- evaluate new ventures to assess whether they are likely to be classified as part of the public sector and would therefore add to the public sector balance sheet
- ensure that policy decisions are assessed for implications on liabilities, and act to drive down the state's net liabilities over time to manage the UK's exposure to risk and unsustainable trends
- continue development of Whole of Government Accounts in line with National Audit office (NAO) guidance so that they become a single view of the state's financial position, used across government to inform policymaking.

Local voices: In the words of public sector chief executives

If you had asked local government in 2010 to become as productive as we've become, we probably couldn't have done it. We wouldn't have known how to do it, but by forcing us to become more productive, we have.

We're a million times more efficient and productive than we were just a few years ago and one of the positives of the financial pressure we have been placed under is that we have had to look very hard at rationalising our processes and systems. We have delivered enormous savings to the public purse while maintaining the vast majority of the services we provide.

We are having to manage with fewer resources and that is bringing difficult decisions about what to prioritise.

I think we have made the best of it. It has meant that we have had to go through an enormous amount of change.

There's no doubt, back in 2010, things were pretty inefficient.

Don't let the crisis go to waste. It's an opportunity to do great things.

Things are better than they were in 2012 and 2013. We have been through the restructuring and budget cuts and fairly major downsizing of our services.

● Local Government ● Police ● NHS ● Education ● Fire ● Civil Service

Introduction

The UK's local public service leaders – including council and NHS chief executives, chief constables, chief fire officers, and directors of children's services – are uniquely placed to comment on the state of the state. As in previous years, Deloitte and Reform have commissioned Ipsos MORI to capture their attitudes and outlook through in-depth interviews. This summer, they interviewed more than 40 public sector leaders from across England, Northern Ireland, Scotland and Wales who are collectively responsible for £16 billion of public spending. Consensus views emerged on seven areas in those interviews: austerity, risk, people, technology, devolution, politics and the future. This chapter shares insight, along with quotes, from the research.

What public sector leaders told us about austerity

The majority of public sector leaders interviewed for *The State of the State* were confident in how they had changed their organisations in response to budget reductions. Most spoke with a sense of pride about what their people had achieved since 2010, and while none suggested that change was easy, many described their organisations as fitter and more focused as a consequence of austerity measures.

One local government director told us that "we're a million times more efficient and productive than we were just a few years ago", adding that financial pressure had forced the council to "look very hard at rationalising processes and systems". Another council interviewee said that "things are better than they were. We have been through the restructuring and budget cuts". Similarly, an NHS chair shared a candid view that "there's no doubt, back in 2010, things were pretty inefficient".

When telling us about the last five years of austerity, most of our interviewees described challenging processes of cost reduction, internal reorganisation and prioritisation. A police chief constable told us that "we are having to manage with fewer resources and that is bringing difficult decisions about what to prioritise". Another said, "I think we have made the best of it. It has meant that we have had to go through an enormous amount of change...identifying lots of ways to work differently, reducing hierarchy...reducing the size of headquarters and cutting back on support services". A council chief executive recognised that austerity pressure has driven change, reflecting that "by forcing us to become more productive, we have".

When telling us about their predictions for further cuts to come, interviewees expected harder challenges ahead.

After five years of cost reduction, many expect to redesign their operations and rethink their services in the five years ahead. An NHS finance director said that he “can’t physically cut anymore” and a chief fire officer said that he thought “there is worse to come”.

However, many were confident and optimistic for the future. A council chief executive said that “we know what we’ve got to do, which doesn’t mean to say at all that we don’t have difficult choices to make – we do”. An NHS chair told us that “it’s doable but we’ve really got to start reshaping the way things happen”.

In the light of Whitehall’s increasing emphasis on public sector productivity gains, we asked our interviewees for their perspectives on productivity. One local government chief executive thought that thinking in terms of productivity “gets to the nub of some of our issues” but added that measuring it presented some difficulties. Another said that his authority needed to benchmark its productivity and compare it to others in order to inform change.

What public sector leaders told us about risk

Some of the public sector leaders we interviewed told us that austerity measures had increased their organisation’s exposure to risk and the prospect of adverse events – and they warned that those risks could rise as cuts continue.

An NHS finance director warned that “I don’t think the public will notice changes in services until you get something that happens in the community. There will be a tragedy and then people will ask how this happened”. Another senior NHS leader told us that the trust was “taking more risks than we should” through increasing use of health care assistants rather than nurses.

A director of children’s services said that “we have got to the point where the flesh that was on the bone in 2010 has been taken off... it will be extremely challenging to provide the level and quality of services expected and required”. Similarly, a chief constable told us that police in his force would be unlikely to attend a burglary “unless they absolutely need to” in years to come.

While risks to the public are of primary concern to our interviewees, they also spoke about risks within their organisations as a result of change. A senior civil servant said that “managing a smaller budget and delivering with a smaller workforce is possible, but we will need to manage that within a very short timeframe which brings many risks as you don’t have time to plan things”.

I don’t think the public will notice until you get something that happens in the community. There will be a tragedy and then people will ask how this happened.

We have got to the point where the flesh that was on the bone in 2010 has been taken off. Local authorities have a good track record of making savings and central government keeps coming back for more. It will be extremely challenging to provide the level and quality of services expected and required.

There is an understanding that you could get away with some processes which might increase risk, because you have got to save money, but there is no public appetite for that at all.

The Government is ‘salami slicing’ but this will affect the safety of the public.

A process of seeking efficiencies, managing a smaller budget and delivering with a smaller workforce is possible but we will need to manage that within a very short timeframe which brings many risks as you don’t have time to plan things, you just have to do the best you can.

Financial constraints are clearly compromising patient quality. We are taking more risks than we should. We cannot fill staffing template for wards with our own staff so we have to use temporary staff, and we will have to use more health care assistants and not nurses.

● Local Government ● Police ● NHS ● Education ● Fire ● Civil Service

When you've got a horizon which is just more and more cuts, it gets more challenging at a personal level to maintain morale and help staff to think positively, particularly those suffering pay freezes and a big drop in promotions.

We've got a legal responsibility to provide primary medical services to the population but it may not be GPs in the future. It may be hospital consultants working more in the community. So there's a whole mind shift needed in the NHS. I don't think the NHS will survive if it tries to carry on being the way it is for the next five years.

Policing is now more difficult than ever before and the workforce has lost motivation.

The key issue about driving efficiency is that you try and make sure on a day-to-day basis that your staff are tasked against the greatest need and that you've got a problem solving philosophy, which is you are trying to solve a problem rather than just react to it.

We need to be much more closely attuned to thinking about what will attract and keep staff who are capable of doing great things with limited resources.

Most of the people in the organisation now work flat out as the organisation has shrunk.

One challenge is going to be retaining and motivating top quality directors and senior management because it's a fairly thankless job being a director of a hospital trust, and with no money being put in to the system it's going to get increasingly tough.

I think that it has worsened. I think that the motivation of staff has significantly deteriorated. They see the NHS as completely focused on finance, and that wasn't what they signed up for. It really gets to them and annoys them. They see every decision that we make as detrimental.

What public sector leaders told us about their people

Our interviews suggest that people issues are a significant preoccupation for public sector leaders. Some said that their staff were demoralised after years of cuts, including a police chief constable who told us that he struggles to maintain morale among staff experiencing pay freezes and a drop in promotions. Another simply said, "the workforce has lost motivation". Some interviewees told us that headcount reductions in recent years had increased the workload for remaining staff. A chief fire officer put it bluntly: "most of the people in the organisation now work flat out as the organisation has shrunk".

Others told us that recruitment was a problem because salaries were not attractive enough and public sector responsibilities can be daunting. An NHS non-executive told us that retaining and motivating senior management is a challenge because "it's a fairly thankless job... and with no money being put into the system, it's going to get increasingly tough".

Many recognised the importance of talent in securing better productivity. A local government chief executive said that "we need to be much more closely attuned to thinking about what will attract and keep staff who are capable of doing great things with limited resources". Another perspective came from a senior official in the Northern Ireland Civil Service. Aware that they are earlier in their austerity years than other parts of the UK, the official noted that "we could benefit from experience and expertise, the human capital which exists to deliver these projects". He added that transformation hinges on people, saying that change "will depend on how we engage with staff so that they are given power to influence".

Some NHS interviewees spoke about the importance of alternative people deployment models as budgets tighten and demand continues to rise. An NHS strategic director believes that "we need to look at the efficiency of how we deploy the workforce. Rather than asking nurses to work harder, we have to train them to work in a different way". The chair of another NHS body suggested that staff may need to be deployed more flexibly, using the example that hospital consultants may need to work as GPs in the future. He concluded that "there's a whole mind shift needed in the NHS. I don't think the NHS will survive if it tries to carry on being the way it is for the next five years".

What public sector leaders told us about technology

Many of our interviewees spoke about the importance of technology in making savings, working more productively and meeting citizen expectations.

Harnessing digital technology is seen as particularly critical. One local government director summed up the consensus view that digital is “cheaper, quicker and it’s what the public want from us.” Mobile technology is also seen as vital to the future of public services. Many interviewees told us that their frontline staff in the field were increasingly equipped with mobile devices to help maximise their productivity and reduce downtime.

However, many of the leaders saw funding and culture as significant barriers to making the most of technology. A chief fire officer acknowledged that restrictions in the amount of funding available to invest in digital meant he was “less ambitious than he would like to be”. An NHS official said that “if I had a magic wand, technology is what I’d throw all the money at”. In Scotland, a chief executive told us that his local authority had been accumulating a surplus to invest in technology but ongoing cuts meant that it would no longer be possible.

Culture was seen as an even bigger barrier to change. A chief constable told us that he struggles “to get officers to understand they can use their devices to stay out in the community and don’t need to come back to the station”. An NHS chief financial officer described the main barrier to change as “the will and commitment of the people”. A civil servant said that people in his organisation were the main constraint to better use of technology, suggesting that “we are not an organisation made of the digital generation that see technology as an intrinsic part of day to day life”.

Interviewees also shared their experiences of change. One pointed out the danger of narrow thinking in digital transformation, which can lead organisations to replicate existing systems with new technology rather than rethinking processes end-to-end. Another noted that the sector no longer needs to rely on expensive adaptations of off-the-shelf software but can think through what they need, “because someone will come up with a system to do it”.

The individuals within the organisation are a constraint. While many are perfectly able to use technology, we are not an organisation made of the digital generation that see technology as an intrinsic part of day to day life. So that represents a barrier for us.

You can end up replicating the old system with new technology.

We have restricted funding so are therefore less ambitious than we would like to be. It would be better to be more mobile and tech based.

It is hard to get officers to understand that they can use their devices to stay out in the community and that they don’t need to come back to the station.

We want to put as much transactional activity through digital services as possible as it’s cheaper, quicker and it’s what the public want from us.

If I had a magic wand, technology is what I’d throw all the money at.

Face to face engagement costs us between £10 and £14. Telephone costs between £3 and £5. Online costs between 8p and 17p. It’s a no brainer.

Our Achilles heel is the manual input of data.

We have an archaic IT system. Clinicians and non-clinicians all feel disempowered by this.

It’s the worst place I have ever worked for IT. Even if money was removed as a barrier, there would still probably be an attachment to where things are now.

In the past there has been an expectation to deliver services with local councillors as the point of contact, but this new way with less funding will place tensions on those relationships. We need more real leadership.

One of the notable things about austerity since 2010 is the complete failure of politicians to address for themselves, at every level, the impact of austerity. I think that the savings have largely been, almost totally been delivered by management in the public sector.

There is a question mark about whether the political system can deliver the degree of change and the pace of change that is actually required.

I don't think we've seen enough political leadership on this subject, there's not enough telling the public that they actually get a far poorer service every day because agencies don't do enough to exchange the most basic information.

It's a difficult conversation but it's a public one we need, which is: what is the healthcare people really expect us to do for them at different stages in their life?

What you have got is a government that is not as committed to the NHS as it likes to make out it is. I think they make a lot of decisions that are not very well thought through. There is a lot going on that they aren't thinking about the impact further down the line.

The Government needs to tell the public that there won't be Police and Community Support Officers in the neighbourhood. Do they want patrolling on the street or the net, because they can't have both.

What public sector leaders told us about politics

Politics matters to the local public services. Nationally, decisions taken in Holyrood, the Senned, Westminster and Stormont have far-reaching implications for people managing the public sector. Locally, democratically-accountable organisations are led by politicians who make a profound difference to their success and their connection to citizens.

Many of our interviewees talked about politics in the context of austerity. A strong consensus emerged that they wanted local and national politicians to engage the public in reconfiguring the citizen-state relationship. They believe that public debate is needed on what people should expect from the public services and how they could take greater personal responsibility for issues such as their own healthcare.

One council chief executive told us that the relationship between local people and services will change over time as funding reduces. He told us that "there has been an expectation to deliver services with local councillors as the point of contact but this new way with less funding will place tensions on those relationships. We need more real leadership". An NHS chair told us that the UK needs a difficult but public conversation on the health care that they expect.

In Scotland, a local authority chief executive told us that "people and communities will need to build a greater understanding of what they can do themselves" as services are further prioritised. He went on to add that national politicians – in Holyrood and Westminster – should better understand the rationale behind the difficult decisions that councils are taking.

An alternative view came from a chief constable who suggested that politicians should shine a light on public sector reform issues to influence change. He told us that "I don't think we've seen enough political leadership on this subject. There's not enough telling the public that they get a far poorer service every day because agencies don't do enough to exchange the most basic information".

● Local Government ● Police ● NHS ● Education ● Fire ● Civil Service

What public sector leaders told us about local devolution

Unsurprisingly, most local public sector leaders were supportive of the UK Government's move towards greater devolution to local areas. Most saw the main benefit as more joined-up, redesigned public services.

A chief constable suggested that local devolution could help public services "break out of the silos". A senior local government officer described collaboration across public sector borders as a key benefit, and a council chief executive argued that devolved decision-making would deliver "better decisions and... a better bang for our buck".

However, many interviewees acknowledged barriers. Some local government leaders suggested that the starting point for devolution programmes should be their potential to improve services – and not on more inward-looking issues. One council director said that "most people want services to be good quality – they're not bothered about how. I think the public sector spends too much time on the 'how' rather than the 'what'". Another warned that policy debates should not dwell on governance issues such as mayoral arrangements.

Interviewees also suggested that local politicians could become defensive where organisations began to work across borders, and that areas without a strong regional identity might be less inclined to seek devolution deals.

In many parts of the country, there is no real identification with the region. In Manchester and the North East, people do identify strongly but in this part of the world, people do not identify with the region. That's a challenge.

Do I think that we, with our partners, could probably make better decisions and get a better bang for our buck, for money that is just currently spent nationally, at a local level? My answer would be yes, I do. So I'm up for devolution. What I don't want to do is to start this with a debate about governance...you know, there needs to be a mayor before you do this, etc.

The benefits would be in collaboration across our borders – why would we all need our own admissions teams when we could share our resources in that capacity? You would lose political sovereignty, which is a concern. I guess you know members in some authorities – and this is one of them – are very jealous and partisan in supporting the area.

The main benefit is the opportunity to redesign public services at local level. To break out of the silos. I think the drawback is that it's such a huge and complex thing to get your head around in terms of being able to deliver that degree of change. If anything, you scratch your head as to why we have still got so much of the public service designed on what feels like very much a Victorian model.

There are two elements to it: there's a political element – to use the example of the Northern powerhouse, it's about making the North feel valued by Westminster in political terms. But there's also a finance and efficiency aspect of it because there is something, I think, to be said for making sure that local people get the local decisions that they need.

● Local Government ● Police ● NHS ● Education ● Fire ● Civil Service

All of the 'nice to haves' will have gone. It will be harder to get complex families into work. The threshold for support for vulnerable people will rise.

It will be harder in 2020 than in 2010. For example police cannot go to a burglary straight away unless they absolutely need to.

We would need to merge with other forces and work more closely. Close police stations to keep officers out and about in the community. Increase the number of mobile data devices.

It will be leaner, fitter, more agile and happier. We talk to our colleagues in GB who have dealt with really significant reductions which we haven't faced yet here and they were saying that their jobs are more enjoyable, they have greater clarity, flexibility and satisfaction from the responsibilities they have.

We're going to see expectations changing. People will not want to be in hospital, they'll want to be at home as long as they can be. And I think we're going to get more customer driven services as opposed to provider driven.

● Local Government ● Police ● NHS ● Education ● Fire ● Civil Service

What public sector leaders told us about the future

When we asked our interviewees to tell us how they saw their organisation in 2020, three common expectations emerged.

First, they expect their organisations to retrench into core activities. Local government interviewees were clear that discretionary services will be increasingly scaled back as authorities focus on their statutory duties. One council chief executive said that "all the 'nice to haves' will have gone" by 2020, adding that the threshold for support in other areas is likely to rise. A director of children's services told us about a "constant emphasis on statutory services and slimming down everything else".

Second, public sector leaders expect greater cross-sector collaboration and a greater variety of providers over the next five years. One council chief executive suggested that the authority will be "far more integrated" and expected his future leadership team to be formed of cross-sector professionals. Another said that he expected to see "a real mixed bag of service delivery entities, which are increasingly jointly managed between ourselves and other government organisations". Yet another local government chief executive sees the sector's future as a "very, very mixed market".

A number of interviewees stressed the importance of cross-sector working for the future of social care, but raised concerns. One local government chief executive told us that NHS reorganisation had hampered their joint working in recent years. Another questioned why local government would invest in social care to alleviate pressure on the NHS.

Third, our interviewees expect their organisation to be designed differently by 2020, with a renewed sense of mission – and most see a very positive vision of 2020. A Northern Ireland official expects to see a "leaner, fitter, more agile and happier" public sector by the end of this decade. A council director expects his authority to be "much more efficient, more effective, much clearer on priorities".

One council chief executive provided a compelling prediction of change in local government over the next five years, worth quoting at length:

“2010 to 2020 is about moving councils away from a subservience to national government and towards a point of independence from national government... moving us towards a default position which is about change rather than about continuity and stability... about outcomes and a much more steely assessment of the return for the spend that we make... more commercial, more business-like, if you like, almost less concerned with the public good unless there is evidence to support it... the need to re-evaluate our relationship with vulnerable people and what we can do to support effectively the lives of vulnerable people, which is where the majority of our spend lies.”

Some interviewees suggested that central government and the devolved administrations should each create a vision for public services that would act as guides for change within public sector organisations. They argued that national debates on public services continued to focus on austerity and efficiency rather than the potential for better, more citizen-centred services. A strong sense of direction would also help organisations coordinate around a set of core principles. One chief constable warned that localism without a shared vision is creating a “random hotchpotch” of policing models that “doesn’t feel well planned out”.

The Prime Minister’s speech on public service reform in September has gone some way to setting clearer priorities. He cited the experience in Hampshire, where Deloitte has supported the county council and emergency services to establish shared support functions. The Prime Minister concluded that “we need to see that sort of thinking in other places.”⁶⁶

By 2020 we will be much more efficient, more effective, much clearer on our priorities. Our services will be leaner, better and more productive than ever.

There will be unintended consequences. Reducing the amount of times the streets are cleaned could backfire. London has millions of visitors a year – if we are degrading it then what does that do?

We will move towards bins being collected less frequently. Youth services which were free will be provided by volunteers and libraries will be charged for.

We know what we’ve got to do, which doesn’t mean to say at all that we don’t have difficult choices to make – we do.

● Local Government ● Police ● NHS ● Education ● Fire ● Civil Service

Around the UK

Introduction

The devolved government arrangements as we know them today began in the late 1990s with the Good Friday Agreement of 1998, Scotland Act of 1998 and Wales Act of 1998. The most significant steps towards greater devolution since then are now underway, triggered by 2015's close-run independence referendum for Scotland. However, those steps are not restricted to Scotland's relationship with Westminster as the referendum has stimulated devolution debates in each of the administrations.

This chapter explores how the public sectors in Northern Ireland, Scotland and Wales are continuing to diverge, as well as differences across England's regions.

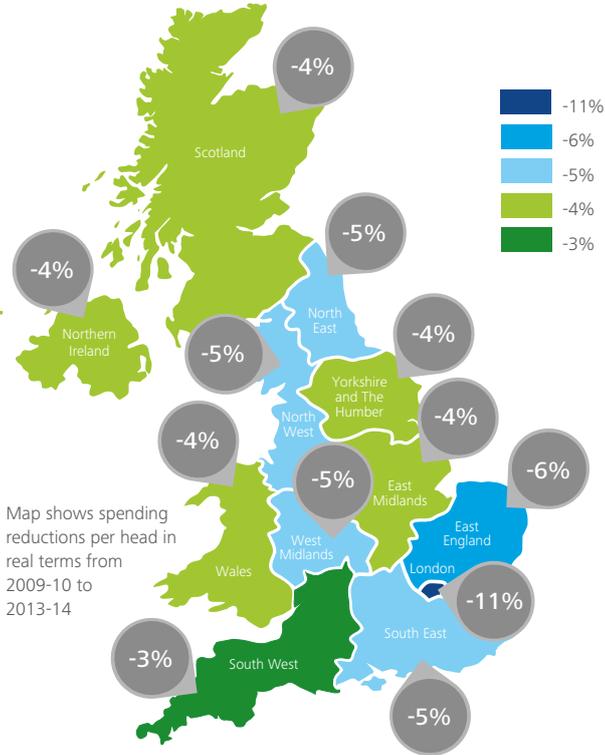
Figure 10. Across the UK
Public sector spending per head



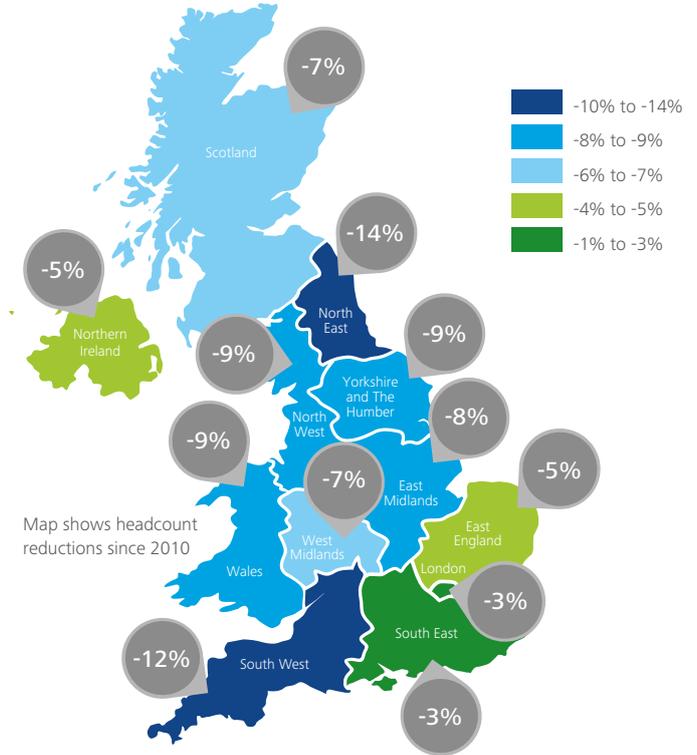
Public sector as a percentage of total employment



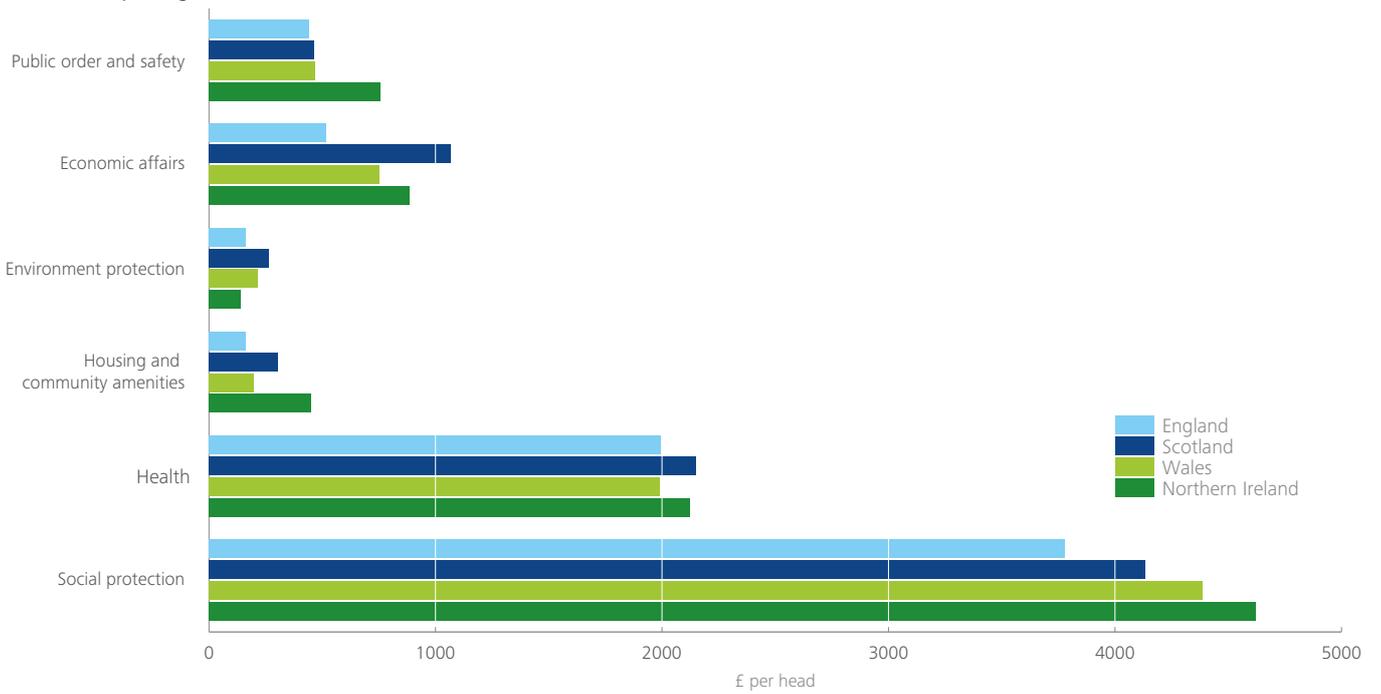
Spending reductions per head across the UK



Public Sector employment



Areas of main spending difference



Source: Office for National Statistics, HM Treasury

England

The state of the state

England's governance looks set to change significantly in this UK Parliament, in part because the Scottish Independence Referendum threw a spotlight on the effects of devolution on England, and in part because new devolution deals could change the way the public sector is managed in large parts of the country.

Legislation announced in the Queen's Speech will introduce new procedures in the UK Parliament so that decisions only affecting England, or England and Wales, must be taken with the consent of the majority of MPs representing constituencies in England and Wales – thus resolving the 'West Lothian question'.

Public sector consortiums have put forward 34 proposals for devolution deals in England to the Department for Communities and Local Government (DCLG) which are under consideration as part of the Spending Review. The most ambitious could see greater local control of healthcare, housing, transport and skills among other parts of the public sector under the leadership of an elected mayor.

Reserved matters

England is governed by the UK Government, currently led by a Conservative majority. Matters reserved by the UK Government that are currently not devolved include:

- the constitution
- foreign affairs
- defence
- international development
- the Civil Service
- financial and economic matters
- immigration and nationality
- misuse of drugs
- trade and industry
- aspects of energy regulation
- aspects of transport including regulation of air services
- employment
- social security
- abortion, genetics, surrogacy, medicines
- broadcasting
- equal opportunities.

Public spending

Figure 10 shows annual public spending per head is lower in England than in the other UK administrations. At £8,678 per head, citizens in England receive around three-quarters of the amount spent on citizens in Northern Ireland.

From 2009-10 to 2013-14, which are the most recent figures available, annual spending per head in England went down by six per cent compared to four per cent in the other administrations.

Figure 10 also shows the most significant spending differences across the UK.

Public sector employment

England has the lowest proportion of public sector employees in the UK as a proportion of the total workforce. Some 16 per cent of the workforce is employed by the state, equalling 4,204,000 people. Since 2010, public sector headcount in England has reduced by seven per cent, or 320,000 people.

Northern Ireland

The state of the state

Northern Ireland appears to be pausing at a junction. While it has experienced a surge in investment, ongoing political instability threatens to hamper its economic potential.

The last financial year saw a record £1.4 billion of investment in Northern Ireland, with Invest NI supporting 37,000 jobs from 2011 to 2015, exceeding its target. A young, educated workforce, strong infrastructure and relatively low costs all make Northern Ireland a compelling prospect for global companies and its potential over the next decade is extraordinary. This investment has positioned Northern Ireland as a fast-growing hub for financial and professional services, creative and digital industries.

The growth of private sector market and employment opportunities in Northern Ireland marks important progress in coordinated efforts by the Executive to rebalance the economy. Against this backdrop, the Executive is now progressing a Voluntary Exit Scheme (VES) with the aim of reducing the public sector workforce by 20,000 in the next four years. Such a move could not have been delivered in the absence of a stronger private sector.

The Stormont House Agreement of December 2014 provided the foundation for progressing public sector reform in Northern Ireland but its implementation has stalled and renewed political agreement is needed to push forward. Legislation is also in place to allow Stormont to reduce its corporation tax rate to an expected 12.5 per cent rate. This would match the Republic of Ireland rate and further boost Northern Ireland's global appeal to investors. Like welfare reform implementation however, political consensus is required to secure its delivery and provide the expected economic benefits.

The next Assembly term will be critical in executing the next phase of public sector reform. This reform will be essential to ensure the immediate and longer term financial sustainability of public services. In the medium term, Northern Ireland's public sector will need to innovate and develop new and improved service delivery models to generate the necessary savings and modernise.

Moving forward significant cross-cutting reforms requires, for example: the optimisation of shared services, transformation of debt management across government, dealing with increasing levels of financial distress in delivery organisations, further digital transformation and better use of analytics tools to inform policy development and delivery. Delivering this reform agenda and creating a culture of innovation and continuous improvement will require investment in people and a different approach to managing talent.

The challenge for Northern Ireland now is to secure short and longer term political stability which will provide a basis on which the Executive can function effectively and deliver against its priorities.

About the Northern Ireland Executive

The Northern Ireland Executive is a five-party, power-sharing executive formed of the Democratic Unionist Party (DUP), Sinn Féin, Ulster Unionist Party (UUP), Social Democratic Labour Party (SDLP) and the Alliance Party.

Matters devolved to the Executive are:

- health and social services
- education
- employment and skills
- agriculture
- social security
- pensions and child support
- housing
- economic development
- local government
- environmental issues, including planning
- transport
- culture and sport
- Northern Ireland Civil Service
- equal opportunities
- justice and policing.

In addition, the Northern Ireland Assembly can legislate on certain other matters with the Secretary of State's consent.

Public spending

Annual public spending per head is higher in Northern Ireland than anywhere else in the UK. At £10,961 per person, Northern Ireland residents each receive £2,283 more in public spending than those in England. Northern Ireland's spending is notably higher than the rest of the UK on public order – policing, prisons and courts – due to its security needs. While public order and safety costs £443 per head in England, it costs £755 per head in Northern Ireland. At £4,622 per person, it also has the highest social protection costs, which comprise state pensions, welfare benefits, social services and other forms of support.

However, Northern Ireland spends less per head than anywhere else in the UK on environmental protection. At £141 per head, spending in this area is almost half the amount spent in Scotland.

Since 2009-10, annual spending per head has gone down by £472 in real terms, or four per cent. That is the same level of austerity reduction seen in Scotland and Wales when measured as spending per head, but slightly less than the six per cent in England.

Public sector employment

Northern Ireland has the highest proportion of public sector employees in the UK. Some 26 per cent of the workforce is employed by the state, equalling 208,000 people and since 2010, headcount has reduced by less than five per cent, or around 10,000 people.

Scotland

The state of the state

The independence referendum may have kept Scotland within the UK, but the close result ensured further devolution and a surge of Scottish influence in Westminster. This year is seeing a flurry of activity in both regards.

The Scotland Bill that will provide further devolved powers has been progressing through Parliament since its introduction in May. Discussions are also underway on a new fiscal framework, which is expected to be agreed in autumn 2015. New institutions are being created to manage and govern Scotland's new powers, including a new tax authority, and the fiscal commission will be placed on a statutory footing.

Against that backdrop, Scotland's public sector continues to diverge from those in England, Wales and Northern Ireland. A new programme for government promises a raft of reforms that include a data-driven focus on educational attainment, intervention to widen access to higher education, a 'custody in the community approach' to prisons, and an ambitious 20-year strategy to transform acute services. The latter has committed the Scottish Government to eliminating the use of the private sector in planned care and delivering world-leading performance on waiting times and driving productivity improvements.

Central and local government in Scotland will inevitably be watching the council reorganisations in Northern Ireland and Wales with interest. Similarly, Scotland's bold move to merge its police forces and its fire services is being watched closely from south of the border. Successful integration of eight organisations into one will always take time and for Police Scotland, the appointment of a new chief constable, as well as a new chair of the police authority, will be important milestones.

About the Scottish Government

The Scottish Government is a working majority government, led by the Scottish National Party (SNP), with 25 ministers acting as political decision makers. Some 129 legislators serve as Members of the Scottish Parliament, who next face an election on 5 May 2016.

Matters devolved to the Scottish Government are:

- health and social work
- education and training
- local government and housing
- justice and policing
- agriculture, forestry and fisheries
- environment
- tourism, sport and heritage
- economic development and internal transport.

Public spending

At £10,275 per head, annual public spending in Scotland is the second highest across the four UK countries. However, that has reduced by £453 per head since 2009-10.

Scotland has the highest spending per person on health in the UK at £2,151, some £157 more than is spent in England. It also spends substantially more than any other country in the Union on economic affairs, including economic development and transport, at £1,069 per head compared to £516 in England.

Spending on environmental protection is also highest in Scotland at £265 per head. While the Scottish Government places significant emphasis on protecting the country's natural environment, geographic differences play a role in levels of environmental spending – and Scotland's population is relatively sparse at 68 people per square kilometre compared to 134 people in Northern Ireland.⁶⁷

Public sector employment

Scotland has the second lowest level of public sector employment in the UK. Some 21 per cent of the country's workforce are employed by the public sector, amounting to 532,000 people.

Since 2010, Scotland's public sector headcount has gone down by seven per cent, or 42,000 people.

The Scotland Bill 2015-16, currently progressing through the UK Parliament, looks set to devolve powers including:

- the ability to set thresholds and rates on income tax, and keep the money raised in Scotland
- the provision of the first ten per cent of VAT revenue raised in Scotland
- devolved Air Passenger Duty
- new welfare powers worth around £2.5 billion.

The state of the state

In the run-up to the 2014 Scottish independence referendum, implications for further devolution in Wales became increasingly apparent. As a result, a Wales Bill is expected to be published this autumn to pass through Parliament in early 2016 that should provide the Welsh Government with a new 'reserved powers' model. In other words, all matters other than those reserved by Westminster will be considered devolved.

More specifically, the Wales Bill is expected to see devolved powers over borrowing for capital investment, some elements of taxation, energy projects including fracking, election and assembly affairs, and some transport responsibilities. The Welsh Government is currently consulting on the creation of a Welsh Revenue Authority to collect devolved taxes from 2018.

Significant differences already exist in terms of the delivery of healthcare which is mainly through integrated Health Boards providing acute, mental health, community and primary care services. For citizens, those differences become manifest in concessions that include free prescriptions and hospital parking.

Local government in Wales looks set for significant reorganisation. Options are currently under discussion for either eight or nine councils to be created from the existing 22 as the Welsh Government believes that some are too small, which increases duplication and harms service quality. Such significant structural change does come with budget implications, as successful reorganisation could require investment in order to achieve savings in the medium and longer term.

About the Welsh Government

The Welsh Government is a minority government formed by the Labour Party, with 13 ministers and deputy ministers acting as political decision makers. Based in Cardiff's Senedd building, 60 Welsh Assembly Members (AMs) legislate and hold the Welsh Government to account. They next face an election on 5 May 2016.

Matters devolved to the Welsh Government are:

- agriculture, fisheries, forestry and rural development
- ancient monuments and historic buildings
- culture
- economic development
- education and training
- environment
- fire and rescue services and promotion of fire safety
- food
- health and health services
- highways and transport
- housing
- local government
- National Assembly for Wales
- public administration
- social welfare
- sport and recreation
- tourism
- town and country planning
- water and flood defence
- Welsh language

Public spending

At £9,924 per head, public spending in Wales is the second lowest in the UK. Since 2009-10, it has gone down by £415 per person in real terms.

Wales is the only UK country without any outlying public spending levels. The only area of public services in which Wales spends more than the other UK countries is education, where spending per head is £1,520 compared to £1,410 in England, £1,428 in Scotland and £1,503 in Northern Ireland.

Public sector employment

Wales has the second highest proportion of public sector employment in the UK. Some 21 per cent of the total workforce is employed by the state, amounting to 293,000 people.

Since 2010, headcount has reduced by nine per cent or 32,000 people.

Government progress against indicators

Introduction

Since our first report was published in 2012, *The State of the State* has assessed government progress against ten indicators. Analysis of those three years suggests that the public sector has shown considerable progress in some areas, but success in others has proved more elusive. This section of the report sets out our observations on progress to date and puts forward new indicators for the years ahead. With a new Government working to fulfil its manifesto commitments over the next five years, the time is right to identify a new set of measures that we will revisit annually.

Progress review

In 2012, our first *State of the State* identified ten indicators against which we have been assessing government activity in each subsequent report. Our original indicators combined the government's own commitments with areas that should – in our view – have been targeted with focused reform efforts. The table below summarises our latest assessment of those ten indicators.

Our assessment	Indicator	Evidence
Achieved	Encourage corporate sector spending to support growth	Post-crisis recovery is now established in the UK economy. Continued initiatives to maintain growth include cutting corporation tax and raising the employment allowance to encourage job creation.
	Drive significant public sector headcount reductions	Between 2010 and 2014, the Civil Service salary bill went down by £2.49 billion, or 18 per cent, and total public sector employment has fallen by 59,000 in the last year. ^{68, 69}
	Manage cash effectively	Government's cash management operation aims to make best use of cash surpluses, managed through the Debt Management Office (DMO). In 2014-15, the DMO met the Government's net cash requirements and has set cost-effectiveness of its cash management function as a key theme for this financial year. ⁷⁰
Good progress	Meet efficiency targets of £20 billion per year	The Cabinet Office achieved an impressive £18.6 billion of savings in 2014-15. However, this falls short of its ambitious £20 billion target for the year. ⁷¹
	Support social innovation and transfer one million public sector workers into mutuals by 2015	The number of mutuals that have 'spun-out' of the public sector has exceeded 100. The latest available Cabinet Office figures suggest that they are delivering £1.5 billion of public services and employing 35,000 people. ⁷² Government remains committed to this reform and is expected to roll out a 'right to mutualise'.
In progress	Save cash through payment by results	Managed effectively, outcome-based commissioning could help focus public spending and stimulate innovation. Government needs to help such commissioning mature through support for contract management, advice and incentives.
	Drive localism through council funding	Devolution deals are a long-overdue step towards a more decentralised public sector. Crucially, funding and accountability are central to their design. However, Government needs to address financial distress in some councils in the shorter term.
	Support an economy-wide focus on productivity	UK productivity remains second lowest in the G7, but the Government has established an improvement framework based on long-term investment as well as reforms to policy areas including planning, skills, and regulation.
Requires attention	Save cash lost through fraud	Changes underway to the public sector counter-fraud landscape mean that pan-sector fraud rates are not currently available. However, the Government acknowledges that losses in the benefits and tax credits system are 'unacceptably high'. ⁷³ Councils in England have detected a record £188 million of fraud. ⁷⁴
	Target net liabilities	The UK state's liabilities rose by £264 billion in the year to 2013-14, driven by increased borrowing and pension liabilities. Government reforms to public sector pensions and plans for debt reduction should reduce liabilities over time. But, as the Public Accounts Committee warned, the Government needs to recognise the impact of policy and spending decisions on its balance sheet. ⁷⁵

Indicators for the new parliament

This year's *State of the State* identifies a new set of indicators for the new UK Parliament. Over the years to 2020, we will comment on the Government's progress by viewing its reform programme through three strategic lenses. They are:

- a **productivity** lens to help government improve public sector productivity as a central part of an economy-wide plan

- a **talent** lens to help government attract, manage and deploy its best people to best effect across the public sector
- a **balance sheet** lens to help government focus on reducing public sector debt and ensure that spending decisions are assessed for their implications on long-term liabilities.

Our indicators are set out in the table below.

Lens	Indicators	Evidence
Productivity	Economy-wide productivity improvements	Reporting against the Government's productivity plan as well as public sector productivity gains that reflect our seven characteristics of highly productive organisations.
	Continued progress from analogue to digital government	Cost savings or narrative evidence to show continued development of the public sector's use of technology, and in particular, data to show that digital technology is being used end-to-end as well as to improve the user-experience.
	Greater value for taxpayer money through new ways of working across the public sector	Increasing numbers of public service mutuals, greater use of outcome-based commissioning and evidence of a widening provider mix.
Talent	Ongoing capability improvements in the Civil Service	Continued progress against the Whitehall Capability Plan and assessment of Civil Service people surveys.
	Shift towards talent management approaches across the public sector	Greater flexibility in reward as well as working arrangements, increased diversity and evidence of other measures to attract and retain talent.
Balance sheet	Target net liabilities to improve the Government's balance sheet	Restraint in public spending growth, reduction in net liabilities and evidence of policymaking that is informed by Whole of Government Accounts.
	Data-driven policymaking	Alleviation of demand on public services and spending through evidenced-based decisions, including those to address the needs of an ageing population.

Conclusion

The State of the State finds Government in the UK half-way through a process of recalibration. Financial pressure born out of the global financial crisis will see UK public spending drop by one-fifth this decade, and the public sector is recalibrating itself to align with that new financial reality.

That recalibration is not easy. Headcount reductions and pay freezes have taken their toll on morale across the public sector. But our interviews with chief executives suggest that they have been able to turn the budgetary pressure of the past five years into positive change within their organisations. They did not, understandably, welcome public spending cuts. But it is a testament to the grit, resilience and professionalism of senior leaders across public services that they have been able to use austerity pressure to shape more efficient organisations and services.

This report considered the next five years for the UK's governments and public sectors through the lenses of productivity, talent and the balance sheet. In doing so, we recommend that the UK's central governments should:

- accelerate the use of digital technology across the public services through 'invest to save' funding and more digital-friendly procurement
- establish a meaningful framework for public sector productivity improvement
- generate productivity gains through departmental coordination and continued local devolution
- back evidence-based reforms that may challenge widely-held beliefs on funding priorities

- encourage the use of user reviews of the public services to generate continuous customer feedback, as part of customer-centred public service reforms
- ensure that headcount reductions are managed in ways that retain the skills needed in the sector
- recognise the role of reward in attracting and retaining talent, and adjust packages accordingly
- develop the abilities and behaviours needed for the future of the public sector – not just individual skills
- evaluate new ventures to assess whether they are likely to be classified as part of the public sector and would therefore add to the balance sheet
- ensure that policy decisions are assessed for their implications on the state's liabilities
- continue to develop Whole of Government Accounts to become a single view of the state's financial position.

This report finds that the current reshaping of government will be challenging – but has the potential to create a more cost-effective, citizen-centred and mission-focused public sector by 2020.

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