Re-inventing budgeting: the impact of third way modernisation on local government budgeting

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1. Overview
The focus of this project was on post-1997 policy innovations for the local government sector and their impact on traditional budgeting practices.

By studying the budgetary practices of two large but very contrasting English local authorities, the project was able to evaluate the ways in which each organization responded to different challenges and circumstances.

The main findings
• Both case study authorities abolished departmental structures and adopted small 'cabinets' with senior members holding portfolios that reflect a cross-cutting perspective. Budget scrutiny was greatly streamlined.
• Both authorities developed long and medium term plans intended to indicate the councils' priorities and guide long-term financial strategies.
• Both authorities developed new reporting systems that not only picked up the traditional budgetary variances but also monitored non-financial performance.
• Services (and their budgets) were subject to periodic fundamental reviews either as a result of the best value performance framework or as part of base budget review processes developed by the authorities themselves.
• Social services were pioneering cross-cutting initiatives with education and health that were beginning to influence traditional budgetary practices.
• At the time of the research, modernisation seems to be associated with outsourcing rather than on a rational appraisal of make or buy which might suggest bringing some services back in-house.
• In a period when council taxes had generally risen steeply, central government should have been less quick to scapegoat local government for problems caused by national policies. On its part, local government should have tried to improve its public image in the many areas where it had re-invented itself.

2. Objectives
The overall aim of the project was to undertake an empirical examination of budgetary practice in two large local authorities in England. These authorities were located in quite different regions of the country and face different economic, social and political pressures. One authority in the north of England had a declining traditional manufacturing base, high levels of unemployment and a relatively large proportion of population originating from the Indian sub-continent. The other authority was located in the south of England near to London and faced different challenges based around issues of congestion and labour shortages in the public services.
The project had five main objectives:

1. To ascertain the forms of budgeting employed by the authorities prior to the reforms introduced by the government after the 1997 election.
2. To trace the effects of changes in political and management systems such as Best Value performance frameworks and cabinet structures on the practice of budgeting.
3. To assess the impact of public/private partnerships on the practice of budgeting.
4. To examine the impact of cross-service programmes on budgeting practice.
5. To compare the two authorities and examine the emergence of innovations in council budgeting.

3. Findings

3.1 Introduction

With local expenditure 25% of total public expenditure and 10% of national income, UK local government is an economically important sector. It is also a major player in the delivery of public services, having responsibilities in areas such as education, social services, and environmental well-being. Yet local government is not just about service delivery as local authorities are democratically elected bodies and, as such, have an explicitly political dimension.

The Conservative approach to reform in the period 1979–1997 tended to downplay the political role of local government with an emphasis on changing the approach to service delivery through policies such as compulsory contractual tendering (CCT) and centrally imposed ‘caps’ on local expenditure. With the New Labour government (influenced by the concepts of the third way), the emphasis seemed to be much more on reforming local government rather than constraining it. Yet although New Labour has abolished the much disliked CCT and the capping of local government expenditure, it has still retained reserve powers to control local expenditure and required local authorities to deliver services based on the new principles of Best Value and Comprehensive Performance Assessment (CPA). Much of its modernisation policies have aimed to achieve integration, cross-cutting and joined-up government (DETR, 1998).

Many recent proposals for local government modernization in the UK seemed to have been informed by a widely held view that past efforts at reform have failed. Budgeting, in particular, was dominated by the practice of incrementalism. If global budget cuts or increases were required then there has been a tendency to decide on across-the-board percentage decreases/increases with little attempt to develop a system of priorities.

The various policies described through the umbrella term of the ‘New Public Management’ (NPM) between 1979–1997, did result in some changes in service delivery through innovations such as compulsory contractualisation, but they did not change long established budgetary practices at corporate level. With New Labour, modernisation initiatives were not always targeted at budgeting issues, but did attack the departmentalist mindset. A central question for this study, therefore, was to ascertain how far it was possible to reform or improve budgeting against a background of wider attempts to change traditional administrative cultures.

3.2 Local government reform since 1997

With the advent of Tony Blair’s first administration in 1997, the key plank of local government reform was Best Value. Under the Local Government Act (1999), councils had a duty ‘to deliver services to clear standards - covering both cost and quality - by the most effective, economic and efficient means available for local people’. Local authorities would set standards for those services for which they were responsible while for certain services, such as education and social services, the government would set national standards.

Best Value required the establishment of a performance management framework. The framework was to be composed of a performance plan, an agreed programme of performance reviews, the setting of targets for improved performance, an independent audit of the service reviews and performance targets. Best Value was accompanied by a system of audit and inspection in order to check on information and management systems. The Best Value regime also had a mechanism for intervention in the case of a failing local authority.

Although CCT had been abolished, the mandatory imposition of contractual governance via outside providers could still take place. Council services that are deemed to have failed by inspectors may be taken away from direct local authority provision via some form of public/private partnership. The implications for budgeting in this instance are quite radical.

Post-1997, local government modernisation was also associated with increased local engagement. Local people could be consulted as individual consumers of council services or through neighbourhood and community based forums. Alongside these changes, local authorities began to establish new political and management structures that saw the abolition of the old departmental structure and replaced it with services areas being run as directorates.

The directorates were often placed in one organisational unit under a Chief Executive of Operations. Other measures designed to strengthen the corporate core included the establishment of local government cabinets and directly elected mayors.
3.3 The experience of ‘Eastmet’

The City of Eastmet Metropolitan District Council (an assumed name) is a large council in the north of England, serving a diverse and multi-cultural population of some 500,000 people, and managing an annual revenue budget in excess of £500m. The area has an ethnically diverse population with almost 20% of the population of Pakistani, Bangladeshi or Indian origin, while about 3% are of Afro-Caribbean or other non-white origin. Unemployment rates are relatively high at nearly 2% above the national average. The average wage is lower than the national average and 44% of children live in low-income households, compared to 27% nationally.

Eastmet’s response to the government’s modernisation programme varied in its application. In some areas it was a leader. For example, it was chosen to pilot a specific project in the early days of Best Value. However, the authority was relatively late in establishing new political structures.

In common with many local authorities, Eastmet eventually introduced a cabinet-style of executive. The main feature of the cabinet model was that the old committees based around services such as education, social services, and so on, were replaced by a small group of senior members each of whom hold a portfolio of responsibilities. The bulk of the members (who all formerly sat on the service committees) became ‘backbenchers’ sitting on newly formed scrutiny committees. The aim of the reform was to strengthen the corporate core of the authority, encourage cross-cutting and enable a more strategic perspective for councils. Management structures and processes were also re-aligned to support the new political structures.

Eastmet was a pioneer of Best Value with several of its senior officials helping to develop the policy after the 1997 election. At first, Best Value was not really integrated in to the budgeting system. For example, officers involved in implementing Best Value argued in the summer of 1999 that Best Value had not yet started to feed through to service deliverers and thus through to budgets.

The lack of linkage with budgeting did not stop the authority developing its performance indicators, a Performance management framework (by December 1999) and publish its first annual Best Value Performance Plan (BVPP) in 2000 (as required by local government Act 1999). Gradually Best Value began to develop its own routines with frequent (monthly) monitoring of performance. Elected members and top management began to receive regular reports of performance against targets.

The impact of Best Value on budgeting gradually increased as the new reporting systems and performance indicators bedded down. With spreadsheets of Performance Indicators (Pis) being submitted to the Chief Executive on an exception basis, a new system was being developed with monthly reports being fed into an emerging structure of executive and scrutiny committees. Although the newly created directorates still had their own budgets, there was now an expectation that resources would be moved around as guided by the performance-planning framework.

Although the council were pioneers in developing cross-service programmes, the study found little evidence for pooled budgets. There were, however, a number of cross-cutting projects that could have attracted special funding such as the Neighbourhood Renewal Fund.
As a way of improving an initial lack of linkage between Best Value and budgeting, the authority responded with a new financial strategy based on a long-term (20 year) vision of the authority and the area, and a consultation process with elected members, neighbourhood panels and speak out forums. This long term and strategic thinking led to ‘priority-led budgeting’. Both the corporate centre and service managers took a three-year budget view and the criteria for moving resources around were now more clearly linked to local consultation processes. Although shifting political fortunes meant that short-term political expediency might conflict with the longer term plans, the key change was that budgets could now more readily respond to priorities rather than simply roll over.

3.4 The experience of Southshire

Southshire (again, an assumed name) is generally very affluent, with a population of around 1 million and is located in the South of England. Although Southshire is the most urbanised shire county in England, 85% of its area is countryside. Ethnic communities comprise less than 3% of the population. Southshire has with virtually no unemployment contributing to significant labour and skills shortages in many areas. In all sectors there are shortages of labour in technical and support service areas. The annual revenue budget was about £900 million.

Southshire had been characterised by departmentalism (with departments described by one Executive Member as ‘huge silos...operating...to the detriment of the customer’), with a centralised approach to budgeting, supported by departmental finance functions which were established in the early 1990s. Members had traditionally relied on officer judgement to set out basic budget parameters and to put forward suggestions for Council Tax rises. The process has been incrementalist, with the Director of Finance providing a rolled-over budget comprising headline figures. Budget making had traditionally been carried out outside the corporate planning process, and was recognised as falling short of expectations. At the same time, the Council’s financial and information systems were generally perceived as falling to provide disaggregated service information as a basis for better budget-making linked to corporate priorities.

As in Eastmet, internal pressures to reform the budget process were building at Southshire in the run up to the post-1997 modernisation programme, and have worked in tandem with the modernization process ever since. In 1997 the Council instigated its own series of fundamental reviews (which pre-date Best Value, in spite of the overlapping terminology) carried out by around 40 task groups. The aim was to look for fundamental change in how services were provided and the resources committed to them. The fundamental reviews led to re-focussing and achieved a reduction in total spending of around 4-5% of the total Council revenue budget.

The Best Value review process at Southshire (which arguably simply extended the Council’s own ‘fundamental review’ programme) was mobilised in support of arguments for improving the customer focus of the traditional service departments and for improving awareness of the consequences of resource shortages. Officials and members frequently claimed that much of the modernisation programme was simply a codification of some good practices, which they, in Southshire, had already adopted.

More recently, Southshire had implemented a major corporate change programme, ‘People First’, to develop stronger links between finance and performance in recognition that the corporate planning process had been decoupled from the budget-making process. People First aimed to deliver enhanced budgetary performance reporting, leading to a focus on service outcome targets alongside traditional measures of accounting budget against expenditure. More fundamentally, People First was underpinned by significant restructuring of the old Southshire Departments. Schools support services became a unified service that operated on the basis of functionally mixed teams within different areas of Southshire. Traditional boundaries between the two major service blocs (and traditional political power bases), Education and Social Services were eroded. The old ‘Special Educational Needs’ section was married more closely with Social Services to create a unified Children’s Service. The eventual outcome (around 2004) was merged budgets.

Alongside this, Southshire Council introduced a new political structure that delegated the management of its business to a single party Executive of ten Members, each with responsibility for a specific area of work or ‘portfolio’. Budget scrutiny became the responsibility of a very small number of Executive portfolio holders.

Southshire also made significant investments in its budgetary and performance system. Further significant investment in an ERP (Enterprise Resource Planning) system provided information at service level which had been previously unavailable.
4. Conclusion

Although both the case authorities were subject to the same regulatory regimes, the geographical, economic, demographic and structural differences between them meant that they faced different challenges and circumstances and responded in different ways.

First, although national government has raised aggregate levels of funding to local government, the distribution of the increases has varied with a general favouring of the metropolitan authorities in the north and midlands over the southern shire counties. Second, national government also raised its expectations for performance from local authorities so that although resources were increased, demands were also increased.

In addition, the Audit Commission (2003) noted a number of external pressures on councils that push up spending:

• Public expectations that services will improve.
• Pressure from central government to spend more to meet government priorities.
• The role of inspectorates and other regulators in requiring councils to meet more demanding standards.

The most important driver of diversity was the immense difference in the economic circumstances between Eastmet and Southshire. Whilst Eastmet faced challenges of de-industrialisation, unemployment and general economic decline, Southshire’s problems were outcomes of affluence with issues of congestion and labour shortages.

There were, however, a number of commonalities between the authorities in the way that budgeting practices were developing:

1. New political and management structures - the old management structures were almost inevitably incrementalist with big departments that were in alliance with specialised committees. Both case study authorities have abolished departmental structures and have adopted small ‘cabinets’ with senior members holding portfolios that reflect a cross-cutting perspective. In Southshire, for example, there is a single organisational structure and budgets for children’s services replacing the old education and social service departments.

2. An increased use of policy-led budgeting - both authorities had developed long and medium term plans that were intended to indicate the councils’ priorities and guide long-term financial strategies. In Eastmet, finance officers aided the different political groupings to formulate their own budgets. The overall aim in both authorities was to embed corporate priorities into the budgetary process.
3. An increased use of non-financial performance indicators in conjunction with financial measures - both authorities had developed new reporting systems that not only picked up the traditional budgetary variances but also monitored non-financial performance. Both authorities had also developed three year financial strategies with special mechanisms to allow investment in services and promote changes in service provision.

4. Services (and their budget) were subject to periodic fundamental reviews - incrementalism is associated with a tendency to just roll over existing budgets without asking whether the underlying activities that are being financed are still necessary or the most effective way of providing local government services.

Best Value has institutionalised a programme of periodic reviews. Southshire had a member-led approach to fundamental review that had actually anticipated the Best Value philosophy. In Eastmet, finance managers were introducing a system of Base budget review, which followed the principle of reviewing service budgets to see whether it was possible to take lines out.

In addition to these findings, the report makes a number of recommendations for improved budgetary performance:

- There needs to be a more even handed approach to outsourcing. At present, modernisation seems to be associated with outsourcing rather than on a rational appraisal of make or buy - which might suggest bringing some services back in-house.

- In connection with the above point, the authorities were developing necessary skills in contract negotiation and monitoring on a rather ad hoc basis. Since these areas seemed to be seen as the responsibility of finance staff, professional accounting bodies should perhaps place more explicit emphasis on training their members in these skills.

- The government should practice more of what it preaches. Policy at central government level is not joined up, resulting in damaging rivalry between ministries such as the ODPM and the DFES.

- In a period when council taxes have generally risen so quickly, central government should be less quick to scapegoat local government for problems that government has caused. On its part, local government should try to improve its public image and demonstrate that in many areas it is doing a very good job. Local government has re-invented itself but the knowledge and nature of the improvements are not as widely appreciated, as they should be.

- In connection with the last point, it is important to recognise the many benefits that accrue from the decentralisation of political power to locally elected bodies and resist the centralising pressures that emerge when central/local relations become strained.

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1. This study was conducted just before the proposed changes in the role of schools and local authorities set out in the recent Educations Bill (HMSO, 2006)
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