INSTITUTE FOR GOVERNMENT

Managing with less

The 2015 Spending Review

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Summary

It is not obvious that the 2015 Spending Review will allow the Government to, in the Chancellor's words, 'deliver more with less',[1] but it is certainly clear that it intends to manage with less. This report considers the changes that the Government must make if it is to keep its policy promises while also keeping to its commitment to reduce the deficit.

The reductions will take government spending relative to the size of the economy to levels that, in recent times, are below average but not unprecedented. However, the sustained period of cuts – a decade – will be unprecedented. The pattern will continue to be uneven, with spending on the NHS, pensions, schools, defence and overseas development protected, meaning that reductions will be concentrated on other areas of welfare, police and fire services, courts and prisons, childcare, higher and further education, and local services such as social care, children's services and local transport.

The Prime Minister has spoken of the **difficult decisions**[2] for unprotected areas. In the last Parliament, ministers were able to reduce spending on programmes inherited from the previous Labour Government that they no longer saw as a priority. In 2015, many of the current secretaries of state were in office before the election and have more ownership of their departments' programmes. While there are exceptions, such as at the Department of Energy & Climate Change (DECC) and the Department for Business, Innovation & Skills (BIS), where Conservative secretaries of state have replaced Liberal Democrats – or at the Ministry of Justice (MoJ), where Michael Gove has staked out an agenda of prison reform – this continuity is likely to mean that prioritising will be harder in 2015 than in 2010.

Each department is indeed now faced with tough decisions about how to best use resources to achieve the Government's ambitions. This process is harder because some government targets, such as doubling exports by 2020, look unachievable. Departments are juggling too many objectives. And there is insufficient recognition that, while efficiencies may be achievable in some areas, less money will often mean doing less. To drive effective prioritisation and implementation, we recommend that ***secretaries of state should publish their Single Departmental Plans by the end of the financial year, each with a short list of priorities and achievable targets, supported by implementation and workforce plans***.

Achieving the Government's spending targets will also require reassessing its major projects portfolio – which is worth half a trillion pounds – and exercising discipline about taking on new major projects. To reduce the risks of project failures and make room for the Government's new priorities, we recommend that ***the existing portfolio of major projects should be reduced and that any new projects should receive pre-announcement scrutiny from the Major Projects Authority***.

In a speech in September 2015, the Prime Minister indicated that the Government aims to do things differently, saying that reform, devolution and efficiency would underpin a **'smarter state'**.

Reform, through bringing in 'new providers', can introduce innovation and efficiencies into the public sector. However, there are complex challenges in developing and managing effective markets for public services, and there have been several recent failures, such as Olympic security and offender tagging.[3] Currently, there is no centrally co-ordinated oversight of public service markets. To reduce the risks of contracting out public services, we recommend that the

Government establishes a hub of expertise with responsibility for developing the capability to steward public service markets.

The 'new set of devolution deals' represents an opportunity to improve public services as well as to stimulate economic growth. Change in the public sector cannot, and should not, be designed and delivered exclusively by Whitehall. However, there are long-standing obstacles to a true transfer of power to cities or regions. To increase the likelihood that decentralisation in England will be successful, we recommend that ***Whitehall adopt a principled approach to decentralisation, laying out the criteria which will govern devolution deals, and that the Treasury remain involved in the implementation phase of these deals***.[4]

"The new set of devolution deals represents an opportunity to improve public services as well as to stimulate economic growth"

The Prime Minister also believes that **'making government digital'** has the potential to increase efficiency. The Government is right to have an ambitious agenda in this area, which could create services that are easier to use, at lower cost. It appears to be moving towards a more decentralised model of overseeing digital government. The risks are that too much will be attempted too quickly, without sufficient capability or support from the senior owners of business processes that must be changed. There are also dangers that the impetus for change will be lost; and that services will continue to be designed for organisations, rather than for users. To maintain momentum for reform and service improvement, we recommend that ***the Government continues to pursue an ambitious digital agenda with central oversight of the change process, including enforcing standards requiring services to be designed around users***.

Reorganising or abolishing **arm's-length bodies** (ALBs) is often viewed as another way to increase efficiency. For example, it has emerged that the Department for Business, Innovation & Skills is considering reducing the number of ALBs from 45 to around 20.[5] However, these sorts of reorganisations can be disruptive, time-consuming and expensive. To avoid costly and unnecessary institutional reform, we recommend that ***alternatives to reorganisation should be considered in the first instance and business cases which consider the rationale, the costs and how functions will be transferred or stopped should accompany any reorganisation***.

Finally, building a smarter state will depend on two key enablers: legislation, and capability and capacity in the Civil Service. **Legislation** is a necessary step to achieve certain spending reductions or enable new ways of working, such as digitising public services. The Government's small majority means that any reductions dependent on legislation are uncertain. Some controversial measures may be further delayed due to additional political scrutiny, such as the Chancellor's plan to cut tax credits which was blocked by the House of Lords in October 2015.[6] Following a period of sustained headcount reductions, there are also questions about the **Civil Service's capability and capacity** to take on the challenge that the Spending Review poses.

The Institute will continue to support leaders in government as they tackle the challenge of implementing the Spending Review.

Part 1
Spending reductions in context

The 2015 Spending Review is a landmark moment for government and the wider public sector. Ahead of the 2015 general election, David Cameron said that his plans meant overall spending reductions of just 1% per year: 'We don't think there's a family or a business that couldn't do that – and we don't think government, seeing as it's spending your money, should be any different.'[7] But the distribution of reductions means that, while some areas of spending will see an increase, some will face reductions of far more than 1%. The Chancellor's Spending Review launch signalled that achieving a budget surplus by 2020, at the same time as investing in 'our priorities, like the NHS and national security', would mean that other areas 'will have to find significant savings through efficiencies and by devolving power'.[8]

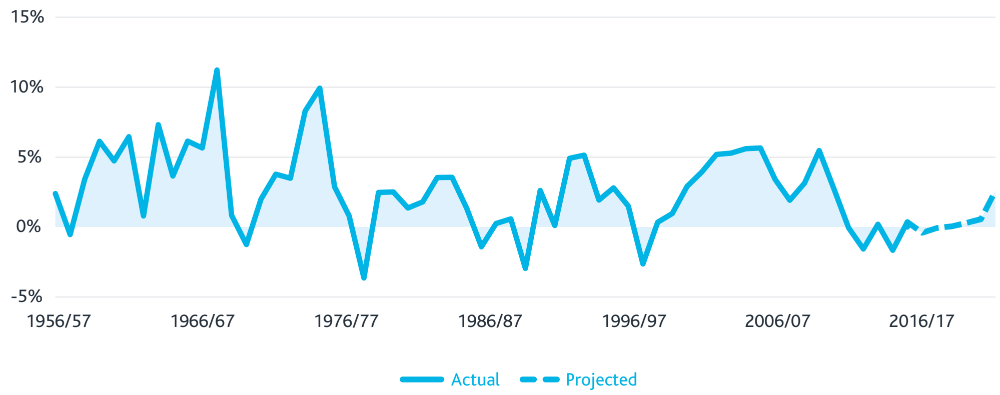
This report does not consider whether it is right to attempt to achieve a budget surplus, the correct balance between spending reductions and taxation, or where spending reductions should fall. Rather, we set the Spending Review in context and consider how, by managing the process well and investing in capabilities, the Government may be able to meet its ambitions. We consider this through the principles that the Prime Minister has identified as underpinning the Spending Review – reform, devolution and efficiency.[9]

In this first part of the report we make two main observations:

- If the 2020 spending target is met, there will have been an unprecedented decade of spending reductions. This will have followed a sustained period of increased spending in the previous decade (see Figure 1).

- The profile of spending reductions is such that unprotected areas of public spending will be exposed to a level of reductions that poses a significant challenge to public services in these areas. In addition, even protected areas of spending, such as the NHS, will come under pressure because of ambitious efficiency targets and dependence on areas of spending that are unprotected – such as, for the NHS, social care and prevention.

FIGURE 1 Annual percentage change in total managed expenditure, 1956/57 to 2020/21



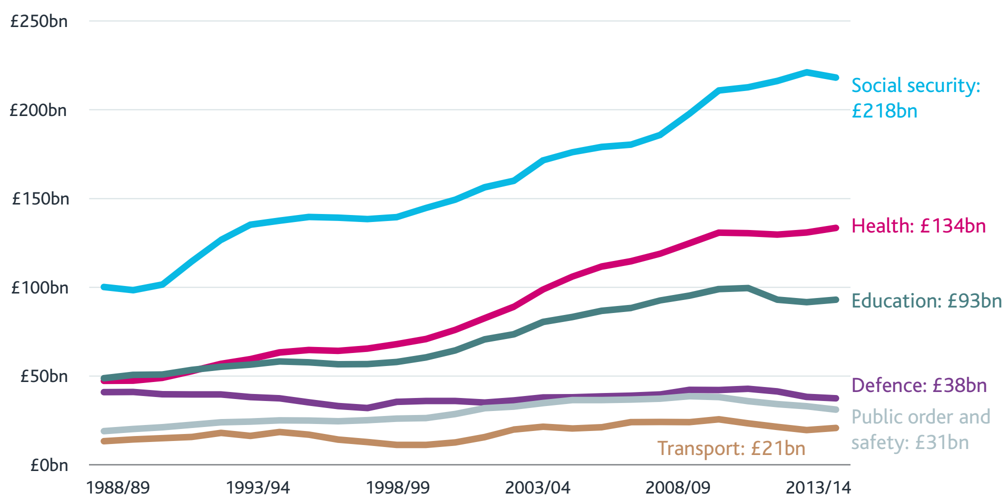
Source: Institute for Government analysis of Office for Budget Responsibility and Public Expenditure Statistical Analyses

While it is not obvious that the Government 'will deliver more with less',[10] as the Chancellor put it, it is certainly clear that the Government intends to manage with less. The Office for Budget Responsibility (OBR) projects that total managed expenditure (the sum of all government spending) will be at 36.3% of Gross Domestic Product (GDP) in 2020/21.[11] This is a significant reduction from the peak of 45.7% in 2010.[12] But 36.3% of GDP is not exceptional by historical standards – total managed expenditure was approximately 36% of GDP between 1998 and 2001.[13]

The distribution of spending reductions

The Government has committed to protect certain areas of public spending and there are also relevant manifesto or other commitments that must be met. As Figure 2 shows, the three largest areas of public spending are social security, health and education. All of these areas are partially protected.

FIGURE 2 Main areas of public spending (excluding debt interest), 1988/89 to 2013/14



Source: Institute for Government analysis of Institute for Fiscal Studies, *Spending by function*, April 2015

By far the largest area of public spending is social security, which includes the commitment to the state pension. Pensions spending now accounts for 51% of all benefit expenditure, and was 'triple-locked' in 2010, meaning that it increases every year by the highest of earnings growth, inflation or 2.5%.[14] The OBR notes that the triple lock is 'assumed to put further upward pressure on state pensions spending as a share of GDP'.[15] The £12 billion cuts linked to the Welfare Reform and Work Bill (currently before Parliament) are proving controversial, not least because – as with the 2012 welfare reforms that introduced reductions in housing benefit – some of these cuts will affect existing as well as future recipients. The House of Lords has already forced the Government to delay reforms to tax credits, which were expected to reduce spending by £4bn.[16] Constraining overall welfare spending will, therefore, be challenging.

Health is the second highest area of public spending. The Government has committed to increasing spending on the NHS, although serious challenges remain (see the box overleaf).

NHS EFFICIENCIES, SOCIAL CARE AND PREVENTION

According to the NHS *Five Year Forward View* (which relates to England), there will be a £30bn shortfall in the health service budget by 2020 if funding increases only in line with inflation.[17] The Government has committed to supplying £8bn of this shortfall, with the NHS meeting the rest by making £22bn in efficiency savings by 2020/21.[18] According to the *Forward View*, this implies making efficiencies far above the long-run rate observed in the NHS; The King's Fund describes these as 'heroic assumptions'.[19] Achieving greater efficiencies depends upon three factors: changing the way that the NHS works, 'action on prevention' – which reduces demand for NHS services, for example by discouraging smoking – and 'sustain[ing] social care services'[20], which reduces the number of people going into hospital and increases the number going out. As Figure 3 shows, 'other health and social work' (which includes all health and social work not covered by the NHS – and therefore includes staff employed in areas related to prevention and social care) is the category of employment that was most reduced by the Coalition Government. According to the Institute for Fiscal Studies (IFS), net spending per capita on social care was reduced by 16.7% between 2009/10 and 2014/15.[21] One impact of this was that councils tightened their eligibility criteria so that, by 2014, 150,000 older disabled people no longer qualified for assistance.[22]

The Health and Social Care Act 2012 created Public Health England in April 2013, to lead on prevention and gave responsibility for commissioning and designing local public health services to local authorities. There are two pressures on local authorities in this area:

- In the 2015 summer Budget, a £200 million reduction in the public health grant to local authorities was announced.[23]
- The public health 'ring fence' expires in 2016 and, given the general reductions in funding for local authorities, there will be pressure to use public health funding for other activities.

Because budgets for the Department of Health and Public Health England are unprotected, these pressures raise serious doubts about whether there will be sufficient 'action on prevention'. Clearly, legislation and administrative measures – such as smoking bans and school lunch regulations – also have an impact on prevention: it is not all about the money. Nonetheless, prevention and social care are both facing significant challenges which, in turn, affect the NHS's ability to manage within the projected budget. Continued restrictions on the growth in public sector wages (see below), combined with proposed changes to working practices, represent a further challenge.

Education is the third largest area of public spending. Here there is a commitment to protect resource spending per pupil.[24] This means that other school spending, childcare, sixth form education and under-19 further education within the Department for Education, and university budgets within BIS, will not be protected.

The next largest area of public spending is defence, which is protected through a pledge to maintain spending at 2% of GDP. There is also a commitment to spend 0.7% of GDP on international development. There are signs that the definition of these areas will be adjusted where possible to allow some funding of others that are under pressure. For example, the

Chancellor has indicated that portions of the foreign aid budget could be used within the UK to fund services such as housing for Syrian migrants in the first year of their arrival.[25]

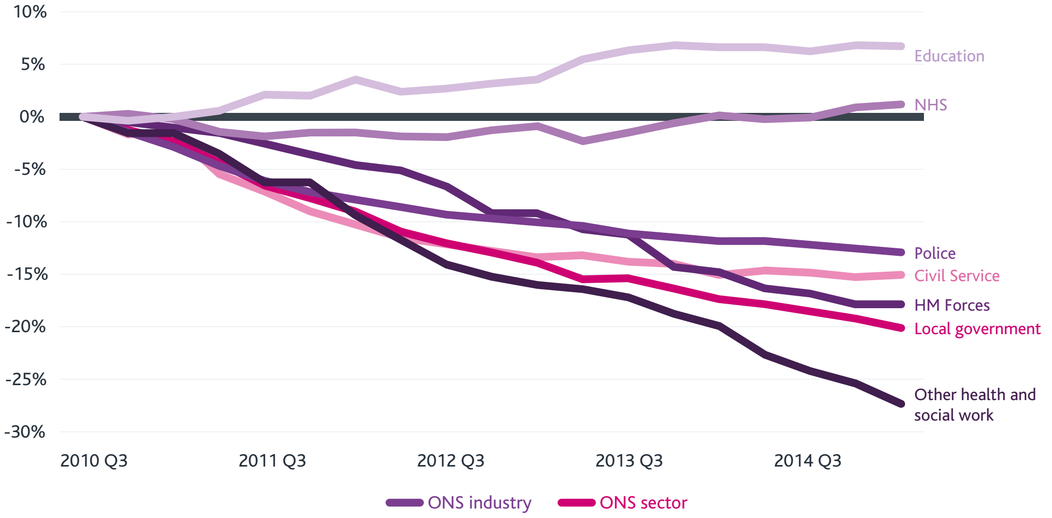
Other commitments from the Treasury include that: 'for the majority of spending, the Barnett formula (which allocates spending to Wales, Scotland and Northern Ireland) will apply in the normal way';[26] and that capital spending will be reviewed 'to identify the areas of spending that will achieve the best economic returns while delivering on the commitment to invest £100bn in infrastructure by the end of the Parliament'.[27] This appears to mean that capital spending will be largely protected.

Beyond these areas, which benefit from a significant commitment or protection, a relatively narrow base of unprotected public spending is to be reduced by £20bn. In addition to those noted above, the major unprotected budgets include: police and fire services, courts and prisons, childcare, and higher and further education. Another major unprotected budget is central government funding for local government, meaning that services such as social care, children's services and local transport will be affected, although the Chancellor's announcement on business rates will have an impact on local government funding (see below). Whitehall departments have been asked to model reductions of 25% and 40% in their Resource Departmental Expenditure Limit (DEL – spending which is not demand-led or for capital projects) as part of their Spending Review submissions.[28] Some have begun modelling reductions of up to 50%.[29]

Some (net) spending reductions may be achieved by charging users for services. For example, in higher education, tuition fees were raised in 2012 from £3,000 to either £6,000 or £9,000, depending on the university. During the last Parliament, charges were also introduced at criminal courts, with convicted criminals levied a fine relative to the costs of the case.[30]

In addition to raising income, some charges may reduce demand for services, thereby reducing costs. The Government has announced plans for further charges, such as the apprentice levy[31] and replacement of higher education bursary grants with loans.[32] However, from an administrative point of view, introducing charges may be no easier than reducing spending, and can be just as politically controversial, as demonstrated by the Government's decision to abandon plans for road pricing in 2007.[33] The Justice Secretary, Michael Gove, is also under pressure to change the policy on court charges.[34]

FIGURE 3 Change in public sector employment from Spending Review 2010 to March 2015 (selected sectors and industries)



Source: Institute for Government analysis of Office for National Statistics (ONS) Public Sector Employment Data, Q3 2010 to Q1 2015. 'Sector' and 'industry' defined by ONS

Note: The ONS classifies public sector employment in two ways: by sector (e.g. local government) and by industry (e.g the NHS)

In some areas, reductions may be made by reducing the number of public sector workers delivering services and changing pay and conditions for those who remain. The impact of changing patterns of spending on the public sector workforce is shown in Figure 3.

The Government has announced that it will 'fund public sector workforces for a pay award of 1% for four years from 2016/17 onwards'. It assesses that this will 'save approximately £5bn by 2019/20'.[35] The announcement and its implementation are, however, two different things: each employer needs to agree awards with staff. The Government also noted that it 'expects pay awards to be applied in a targeted manner within workforces to support the delivery of public services'.[36] One of the tasks that public sector leaders face is to plan workforces so that capabilities are in place for the Spending Review period and beyond – we explore this issue in Part 2 of this report.

As this section has demonstrated, the challenge facing the Government is both considerable and complex. It will not be enough to reduce spending: some services will have to be delivered differently, some may have to be stopped entirely, or commitments will have to be dropped or reinterpreted. By 2020, the public sector may look very different. In September 2015, the Prime Minister outlined his vision for how it might evolve. In the next section, we consider what this means for the Spending Review.

Part 2
A smarter state?

The first part of this report outlined the extent of the spending challenges faced as a result of the commitment to achieving a budget surplus by 2020 and other spending commitments. The 2015 Spending Review provides the framework for how the Government intends to meet these challenges. In a speech calling for a 'smarter state' delivered in September, the Prime Minister laid out the three principles that underpin this framework: reform, devolution and efficiency.[37] In this section, we consider each of these in turn:

- **reform**: bringing in 'new providers' of public services
- 'a new set of **devolution** deals' in England
- **efficiency**: 'making government digital' and reforming institutions.

We then consider two key enablers of the smarter state:

- **legislation** as a means to implementing the Spending Review
- **capability and capacity** in the Civil Service.

In his speech, the Prime Minister identified areas where spending will be protected, but spent less time addressing those that will not be protected, referring in passing to **'difficult decisions'**. We begin by considering these.

Difficult decisions

As outlined in Part 1, government commitments mean that cuts need to fall across a base of unprotected spending. Deciding which areas will receive less money – or, indeed, where the Government can stop activity – is much harder than deciding which areas will be protected.

These decisions should be driven by explicit prioritisation. At its core, the Spending Review is a prioritisation exercise that matches projected commitments to projected resources. In unprotected areas, this prioritisation will need to be especially rigorous (although, as the above example of the NHS shows, even where budgets are protected, tough decisions about priorities will still be necessary).

Prioritisation will need to take place at several levels – across government and within departments, ALBs and local government. Implementation planning is also needed to translate the identification of priorities into reality. The effectiveness of this planning is central to the Spending Review's credibility. If the Government has converted the rhetoric of difficult decisions into a credible plan for delivering its priorities with reduced resources, there should be clear evidence that some activities have been stopped. There are two areas in particular where the Institute would expect to see developments:

- Single Departmental Plans
- the major projects portfolio.

Single Departmental Plans

In July 2015 John Manzoni, chief executive of the Civil Service, announced that the Government would introduce Single Departmental Plans (SDPs) for all departments, which would serve as a 'single, clear roadmap … bringing together efficiency, spending round and activity plans'.[38]

A crucial test for the Spending Review will be whether the SDPs are a credible reflection of difficult decisions about prioritisation and, therefore, credible mechanisms for supporting spending reductions. If the SDPs are to be effective tools for ministers and officials, they must be focused on a short list of priorities, and cover important manifesto commitments relevant to a department and essential activities that did not receive attention in the manifesto. Previous mechanisms, such as the Departmental Improvement Plans, have had little impact, failing to become an integral part of the departmental planning process and becoming instead another feature in a crowded administrative landscape.[39] If the SDPs become cluttered lists used for compliance purposes, they will fail in their aim of focusing departmental leaders on the core task of ensuring that the Government's priorities are resourced and can be achieved.

To this end, the SDPs need to be supported by implementation plans outlining how they will be achieved. The Institute's work on implementation suggests that these must consider:

- the capability required for implementation, compared to what currently exists
- external factors that could influence implementation
- overlaps with other parts of the system
- the views of affected parties.[40]

Ministers must be bought into the plan as the means by which their priorities will be implemented, and understand the spending implications of deviating from them. They must also, as far as possible, be sure that the ways in which they intend to make spending reductions will be supported by the centre even when opposition emerges; the example of sentencing reform in 2010/11 is relevant here (see the box below).

SENTENCING REFORM

The failure to introduce sentencing 'discounts' under the Coalition Government provides an example of the risk of spending plans dependent on politically controversial changes. The 2010 Spending Review set a requirement for the MoJ – then led by Kenneth Clarke as Secretary of State – to make a 23% reduction in its resource budget.[41] The department's green paper proposed sentencing discounts for offenders who pleaded guilty 'at the earliest opportunity'.[42] Extending the maximum discount from 33% to 50% would, the department estimated, reduce spending by £130m by 2014/15.[43]

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Following controversy about the possibility that discounts could be applied to some categories of rape,[44] it was reported that the Prime Minister had ordered Clarke to drop the proposals,[45] and they were not included in the Bill. The Prime Minister said that the money would instead be saved through 'greater efficiency' in other parts of the MoJ budget.[46] And, indeed, by 2014/15, the department's resource budget was down 18% compared with 2010.[47] Legal aid reforms, including restrictions on eligibility, saw spending fall by £363m. Prison closures were expected to save £170m, and there were further spending reductions in the prison and probation services.[48] The MoJ has estimated that 60% of its savings have come from 'operational and back-office efficiencies'.[49]

However, the National Audit Office (NAO) has warned that these savings may end up costing money elsewhere in the system, or have a negative effect on performance.[50] According to the Prison Reform Trust, high-performing institutions have closed, more than 20% of prisoners are in crowded prisons, and 2014 saw the highest recorded level of deaths in custody,[51] as well as increases in 'serious assaults' in prisons.[52]

The current Secretary of State for Justice, Michael Gove, has said that 'on too many occasions, our prison system fails to rehabilitate, it fails to reform, it fails to ensure criminals are prevented from offending again – and again – and again' and committed to 'prison reform', although the implications of this are not yet clear.[53]

This implementation planning is made harder because some government commitments look unachievable. For example, in March 2012, the Chancellor set a target of doubling UK overseas exports to £1 trillion by 2020.[54] There has been very little progress: UK exports were £507bn in 2014.[55] The British Chambers of Commerce recently estimated that the UK will not hit the Chancellor's target until 2034.[56] Departments with targets of this sort must either disregard them or produce implementation plans that do not reflect reality.

In order to develop robust implementation plans and avoid failure departments must, as the NAO has pointed out, take a more strategic approach to staff reductions and workforce management.[57] Using the SDPs as a guide can help them to manage the process of downsizing, ensuring that they do not lose staff with essential capabilities. Often, it will make sense for specialist skills to be developed on a cross-departmental basis, rather than in many departments or ALBs. It will be an important part of the new chief people officer's remit to encourage and support departments to improve this aspect of their planning.[58]

To drive effective prioritisation and implementation, we recommend that ***secretaries of state should publish their Single Departmental Plans by the end of the financial year, each with a short list of priorities and achievable targets, supported by implementation and workforce plans***.

The major projects portfolio

The Major Projects Authority (MPA), part of the Cabinet Office, oversees the Government's major projects portfolio. This currently consists of 188 major projects which are projected to cost £489bn over their lifetimes.[59] The Ministry of Defence, DECC and Department for Transport are responsible for 80% of the whole-life cost of the portfolio, while some departments are responsible for only a single major project as defined by the MPA.[60]

Implementing these existing projects successfully will be a stretch for the Government. Adding to the portfolio will increase the risk of project failure. Making room for the Government's new priorities must mean reducing the number of existing projects and reallocating the resources. This will require co-ordinated action from the centre of government, with No. 10 and the Treasury supporting any reprioritisation of projects to avoid costly reversals.

“Evidence of effective prioritisation and planning to drive those decisions will be crucial to the Spending Review's credibility”

To reduce the risks of project failures and make room for the Government's new priorities, we recommend that ***the existing portfolio of major projects should be reduced and that any new projects should receive pre-announcement scrutiny from the Major Projects Authority***.

The Prime Minister is right that there will be difficult decisions ahead. Evidence of effective prioritisation and planning to drive those decisions will be crucial to the Spending Review's credibility as a framework for the next few years.

Reform: bringing new providers into public services

One of the biggest changes to UK public services over the past 30 years has been the increasing role that non-state providers play in the provision of those services. Supporters of this approach argue that creating a market for public services can encourage innovation and efficiency – as the Prime Minister put it: 'What energises many markets are new insurgent companies, who break monopolies and bring in new ways of doing things. We should apply this thinking to government'.[61]

However, while introducing new providers and building new markets for public services may present opportunities to improve services and reduce costs, the Institute's previous work on public sector markets indicates that the Government should be under no illusions about the challenges that building effective markets presents.[62]

Delivering services through private providers requires the Government to be confident that contractors are both working in the public interest and making effective use of public money. In this regard, the Government's recent record is mixed. Following several high-profile failures in recent years – for example, Olympic security and offender tagging – the Public Accounts Committee noted that 'problems with contracting are widespread, long-standing and rooted in the culture of the Civil Service'.[63] The NAO has also expressed concerns about the Government's ability to establish a 'true and fair view of financial activity' in academy schools and issued an adverse opinion on the DfE's accounts as a result.[64]

Managing the contracting out of public services that have complex objectives is not straightforward. The challenge for government is not only to outsource services to external providers, but also to design, build and act as a 'steward' of public sector markets, so that these provide long-term value for money for the taxpayer and have positive policy outcomes.[65] Achieving this will require the Government to take informed decisions about what services are amenable to contracting out and to embark on the process only after carrying out a systematic risk analysis.[66]

> “The challenge for government is... to design, build and act as a ‘steward’ of public sector markets, so that these provide long-term value for money”

Building an effective market requires a comprehensive understanding of the wider system’s ability to respond to the newly created market (where there are existing providers, the transition will be far easier); and an accurate assessment of the skills and capabilities required by government to manage it. Many of the problems observed by the Institute with existing public sector markets are fuelled by a lack of commercial skills and contract management. The latter will make it difficult to implement the Prime Minister’s expectation that ‘providers should be paid by the results they achieve’,[67] particularly where those results are hard to measure. The Government has, however, established several mechanisms for improving commercial capabilities across Whitehall – the Commissioning Academy and Crown Commercial Service, to name two. With the Civil Service set to get smaller, departments will need to ensure that they do not degrade their capability to oversee contracts and markets.

To reduce the risks of contracting out public services, we recommend that the ***Government establishes a hub of expertise with responsibility for developing the capability to steward public service markets***.

New devolution deals in England

Change in the public sector cannot be designed and delivered exclusively by Whitehall. Giving local areas more control over how money is spent and altering the balance of power between Whitehall and towns and cities around the country is one of the stated aims of the Government. The Prime Minister has pledged that: ‘This government will sign a new set of devolution deals, giving the opportunity for every part of our country – and everyone in it – to drive a better future for themselves and their neighbours.’[68]

The Institute has previously addressed devolution to Scotland, Wales and Northern Ireland.[69] In England, under the Coalition Government, as noted above, local government gained new functions and also had to make spending reductions; it was given more freedom on how spending could be allocated and more control over revenue. The new government is continuing this trend. At the 2015 Conservative Party conference, the Chancellor unveiled plans to allow local authorities to keep more revenue from business rates, in exchange for taking on more responsibilities.[70]

As part of the 2015 Spending Review, local areas were invited to submit proposals for these devolution deals directly to the Government. Sustainable decentralisation in the UK will require long-term financial planning, so the involvement of local areas in the Spending Review negotiations was a welcome move, and one for which the Institute has previously argued.[71] However, there are challenges.[72]

The desire to accelerate the timetable for devolution raises the possibility that the submissions from cities and local areas will have been completed in a hurry, without the serious planning or negotiation that would ideally accompany designing and submitting a bid. The process and criteria for assessing these bids are also opaque. The Treasury's role must extend beyond brokering deals. It must involve itself in the implementation phase, checking and driving progress, to ensure that the full range of potential benefits are realised and that the deals do not become watered down before they are put into action.

Reversing patterns of centralisation with the aim of building better public services and achieving local growth will be complex for both politicians and civil servants. Whitehall departments will have to adapt to working in a landscape with significantly altered responsibilities, funding arrangements and power structures. Decentralisation will not work unless it is seen by all parties as a genuine transfer of power, not simply a financial transaction. Effective relationships between city regions and other areas and the centre of government will be essential.[73]

To increase the likelihood that decentralisation in England will be successful, we recommend that ***Whitehall adopt a principled approach to decentralisation, laying out the criteria which will govern devolution deals, and that the Treasury remain involved in the implementation phase of these deals***.

Efficiency: making government digital and reforming institutions

The Prime Minister indicated in his 'smarter state' speech that he wanted 'to go much further in making government **digital** – saving money and improving services at the same time'.[74] The Cabinet Secretary, Sir Jeremy Heywood, reinforced this in an October 2015 interview, citing 'tech innovation' as one route to making 'the big savings that are needed without damaging public services'.[75] It is clear that digital government will be an important feature of the Spending Review.

In 2011, the Institute identified two priorities for digital government:

- first, the creation of a stronger 'platform' for government – a government-wide approach to driving down costs, reducing duplication and establishing standards to support interoperability
- second, the introduction of 'agile' methods, to embed a more modular and iterative approach to IT-enabled change.[76]

The creation of the Government Digital Service (GDS) in 2012 marked a significant step towards achieving these. In 2010, there was a small digital team in the Cabinet Office, with co-ordination across Whitehall being driven by a Chief Information Officer Council; by 2015, the GDS claimed to employ 500 staff, and there has been substantial growth in the number of staff with digital roles in departments.[77]

The most visible impact has been on government websites. The establishment of GOV.UK has created a clearer, more accessible service for the public. According to one study that involved 10,000 mystery shoppers across the European Union (EU), testing services around 'life events' – such as moving house or starting a business – the UK is ahead of other member states on mobile access, but 'around the average' overall.[78] However, problems remain. The redesigned websites have led to some losses of previously available information and greater navigation problems for specialist users.[79]

GOV.UK was the first GDS-supported platform; others are being rolled out (for example Verify, which checks the identity of users) or planned (such as a single platform for payments in and out of government). The GDS has also been central to a new 'agile' approach to project management, although wider government practice and guidance on project management have not changed.[80]

The next phase of digital transformation will require a strong focus on end-to-end business processes rather than simply concentrating on the customer interface. The departure of much of the founding leadership of the GDS in September 2015 indicates that there may be a change in strategy, with departments once again taking greater leadership of the cross-government digital agenda.[81] There are risks in this approach, because departments and agencies often find it difficult to create seamless services for users when more than one department or agency is involved. There is also the risk that too much will be attempted too quickly, without sufficient capability or support from the senior owners of business processes that must change.

To maintain momentum for reform and service improvement, we recommend that **the Government continues to pursue an ambitious digital agenda with central oversight of the change process, including enforcing standards requiring services to be designed around users**.

“Measures intended to improve the efficiency of ALBs, such as Cabinet Office spending controls on recruitment and staff compensation, have largely ignored issues of effectiveness”

The Government may also try to create efficiencies by **reforming institutions**. Making changes to the machinery of government, such as the transfer of functions between departments, is often viewed as an effective means of addressing long-standing institutional weaknesses in the Civil Service.[82] While there may be good reasons for institutional reform, as the Institute has noted elsewhere, such changes can be disruptive, time-consuming and, in the short term, costly. The Institute has estimated that establishing a new department can cost at least £15m within the first year.[83]

During the 2010–15 Parliament there was a limited amount of institutional change in Whitehall, but some functions were transferred between departments: for example, the Cabinet Office assumed responsibility for constitutional affairs from the MoJ, and responsibility for youth strategy and policy also moved into the Cabinet Office, from the Department for Education.

In contrast, there were significant changes in the ALB landscape. The number of ALBs fell considerably, but this was not accompanied by a corresponding reduction in the number of functions performed by government, as the example of the abolition of the Audit Commission showed.[84] Measures intended to improve the efficiency of ALBs, such as Cabinet Office spending controls on recruitment and staff compensation, have largely ignored issues of effectiveness. The focus has instead been on reducing running costs and consolidating back-office functions.[85] As with efficiency targets, spending controls do not on their own make organisations more effective.[86]

In addition, these controls may be incentivising changes to organisational form that may not be appropriate. One of these forms is a 'government-owned company' (GovCo), a type of public corporation.[87] These bodies are not all subject to the spending restrictions imposed on other government organisations and can be granted enhanced freedoms over their business model and day-to-day operations.

Several high-profile GovCos have come into existence this year. In April 2015, the Highways Agency was replaced by the government-owned Highways England, while Ordnance Survey – formerly a trading fund – also became a GovCo.[88] In the case of Highways England, legislation was required to make the change.[89] In May 2015, the Chancellor announced the creation of UK Government Investments (UKGI), a GovCo created by merging two existing bodies – the Shareholder Executive and UK Financial Investments.[90] UKGI is wholly owned by the Treasury.

Achieving real spending reductions from ALBs will require decisions about which functions can be stopped or transferred, or in which areas services provided by ALBs can be reduced. As the Government considers a new round of ALB consolidation – BIS is apparently considering reducing the number of ALBs from 45 to around 20[91] – it is important that the experience of the past five years is taken into account. Setting up and closing bodies creates significant challenges and there is currently limited capability at the centre of government for providing assistance or advice, leading to frequent reinventions of the wheel.[92]

To avoid costly and unnecessary institutional reform, we recommend that ***alternatives to reorganisation should be considered in the first instance and business cases that consider the rationale, the costs and how functions will be transferred or stopped should accompany any reorganisation***.

Enabling the 'smarter state'

Two enablers will be central to building a smarter state: legislation, and capability and capacity in the Civil Service. We consider these in turn.

Legislation

Legislation both enables and constrains the process of achieving spending reductions. The Government can use legislation to reduce demand-led spending – for example, by uprating benefits at less than inflation, as it did during the last Parliament, or altering eligibility for certain types of benefit, as the Chancellor is attempting to do with tax credits.[93] System-wide reforms, such as reducing public sector pensions or transferring regulatory costs to industry, can reduce the Government's expenditure.[94]

The Government can also use legislation to reduce the workload of individual departments by cancelling discrete programmes of work. The Coalition Government did this with the Identity Documents Act 2010, which reversed the introduction of identity cards and the national identity register.[95] Digitising services – for example, the removal of tax discs from cars, which now saves the Driving and Vehicle Licensing Agency (DVLA) £7m per year – often requires legislation.[96] However, statutory duties can impede departments' freedom to act. Those with a greater part of their business enshrined in legislation will have fewer places to search for reductions but potentially greater leverage with the Treasury to avoid them – or a greater requirement for legislation.

The Government also has a manifesto that it wishes to see implemented, some elements of which will require new legislation. The 2015 Queen's Speech set out plans for 25 Bills that the

Government intended to lay before Parliament, including an EU Referendum Bill, a Bill to extend the right-to-buy policy, legislation on the High Speed 2 Rail Link and immigration.[97] These have significant implications for government expenditure (and revenue in some cases).

If departments need to pass Bills to make the reductions required by the Spending Review, it will be difficult to achieve this quickly. To be included in the 2016 Queen's Speech (assuming the current session finishes in 2016 and is not extended, as happened at the start of the last Parliament), such legislation would need to be well developed already. If new Bills are not introduced until the start of the 2017 session, they would be unlikely to become law before 2018.

Even once a Bill has been introduced, the scrutiny process often takes some time and its progress may be subject to delays or alterations. For example, the Public Service Pensions Act 2013, which introduced a single-tier pension scheme for the public sector, took eight months from first reading to Royal Assent, following a delay in the House of Lords.[98] The Welfare Reform Act 2012 took more than a year to pass and was significantly amended. Bills may also be subject to costly revisions and fail to deliver the expected reductions. During the passage of the Public Bodies Act 2011, a government defeat meant that two public bodies due for abolition were saved, and ministerial powers to abolish or modify certain public bodies were removed.[99] These risks are greater for the current government than the Coalition Government, given its small majority in the Commons (which is likely to decay through the Parliament as a result of by-elections) and weaker position in the House of Lords.

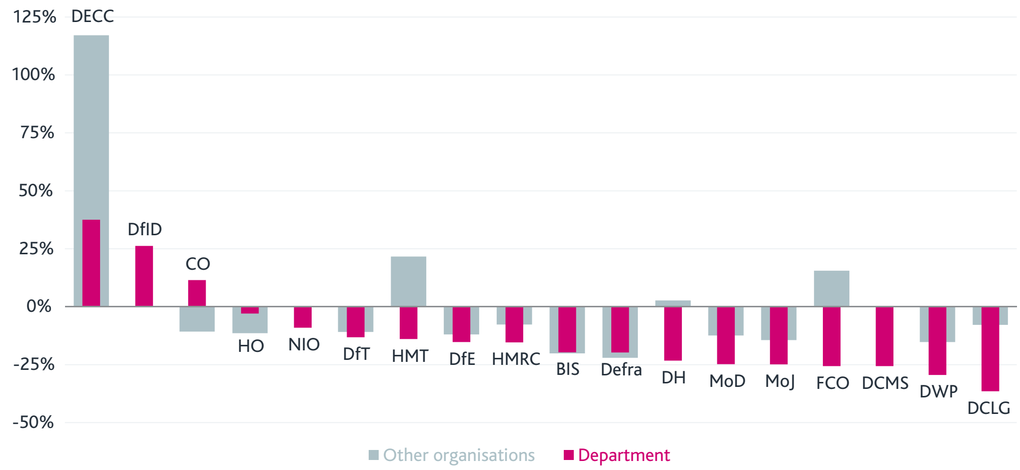
Capability and capacity in the Civil Service

The Civil Service has shrunk considerably since 2010. The aspiration in the 2012 Civil Service Reform Plan was to reduce the number of civil servants to 380,000 by 2015, a reduction of 23% from the 2010 baseline. By mid-2015, the headcount stood at 397,850 full-time equivalents.[100] As Figure 4 shows, there has been significant variation in the depth of reductions in individual departments.

At one end of the spectrum, some departments have lost nearly a third of their staff, while at the other, a small group of departments has expanded. It has been widely reported – although not confirmed – that there are plans to reduce the workforce by a further 100,000 by 2020.[101]

The impact of these reductions is hard to quantify, not least because the effectiveness of Whitehall departments is hard to measure. What can be said is that they have resulted in a Civil Service that is older and more senior than in 2010.[102]

FIGURE 4 **Change in civil service staff numbers (full-time equivalent), Spending Review 2010 to March 2015**



Source: Institute for Government analysis of Office for National Statistics (ONS) Public Sector Employment Data, Table 9, Q3 2010 to Q1 2015

Notes: 'Other organisations' refers to organisations that are part of the Civil Service but not directly managed department by the department.
A list of abbreviations of Government departments can be found at **www.instituteforgovernment.org.uk/sites/default/files/WM2014_Annex.pdf#page=12**

A main driver of Whitehall's headcount reduction was pressure on departmental administrative budgets. The 2010 Spending Review outlined plans to reduce these by about 33% between 2011 and 2015 – this target was increased to 40% in the 2013 Spending Review. While the overall amounts are relatively small, changes in administration budgets are important because they can impact on the ability of individual departments to deal with spending reductions in areas for which they are responsible. If administrative budgets are again a focus for reductions, it poses a serious risk to Whitehall's capacity to deliver on the Government's priorities.

As indicated above, there are also questions about how headcount reductions have impacted the mix of skills and capabilities inside departments. Implementing the Spending Review and achieving the Prime Minister's ambition to see a 'smarter state' will require the right people with the right skills, working on the right projects.

As we have highlighted, there are many initiatives that the Government could build on to enhance its capability.[103] For instance, implementation of the Treasury's Financial Management Review has been strengthening financial capacity across Whitehall. As departments seek to realise the Spending Review, they need financial information that links costs, outputs and outcomes in order to identify how the last of these can be maintained while budgets are falling. The next step would be to institutionalise these improvements, creating a centre of excellence that could help departments to create financial information that cuts across operational boundaries.

Next steps

If the Government is to successfully manage with less, it must overcome some significant challenges, as highlighted in this report. The Institute will continue to support leaders in government as they tackle these.

In the coming months, the Institute will examine further some of the key issues raised here, including:

- the future of digital transformation in government and the development of a credible strategy for sustaining the changes already implemented
- overcoming the obstacles to a true transfer of power from Whitehall to cities and regions
- managing change in Whitehall departments.

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