



Pre Budget Draft (10 June 2010)

A JOB WORTH DOING

Cutting public sector costs while retaining outcomes, with examples from the education and skills sector

A report from London business to the Coalition Government

INTRODUCTION

With the UK facing a record fiscal deficit, it is imperative that the new Government both achieves efficiency savings in the delivery of all public services and adopts a rigorous approach to spending decisions, to ensure cuts target those programmes which add least value to the UK's future economic prospects.

Drawing on business expertise, this document provides some practical suggestions and examples to Government of how the task of deficit reduction could be tackled so as to eliminate wasteful public expenditure at the same time as improving returns on its investment. It builds on our November 2009 report, *Supporting UK growth while balancing the budget*.

As a specific illustration of how programme cuts might be approached, this document takes as an example the education and skills sector and suggests how savings of the order of magnitude required might be achieved while protecting outcomes. During a period of structural change in the UK economy, the sector has a critical role in ensuring Government savings genuinely offer a net financial benefit at the same time as providing effective training for jobs and minimising the impact on welfare costs. The document challenges Government to ensure that education and skills programmes offer genuine value for money for taxpayers, employers and learners.

A Job Worth Doing is being issued in draft ahead of the Government's emergency budget, with a view to producing a final document as London First's input for the Comprehensive Spending Review in the Autumn.

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THE SCALE OF THE CHALLENGE AND THE POLITICAL RESPONSE

The economic context

Over the financial year 2009-10, the UK public sector spent £674 billion but received only £508 billion in taxes and other income, resulting in an annual deficit of £166 billion¹. The national debt that has built up from this and previous years' deficits stands at £893 billion, amounting to 62% of our annual GDP². If the Private Finance Initiative and the funding required for currently unfunded public sector pensions are also taken into account, the Government's overall indebtedness can now be argued to amount to over £2,000 billion³.

The political context

The new Coalition Government has decided⁴ that

- Deficit reduction and ensuring economic recovery are the most important issues facing Britain
- The reduction in the deficit must be significantly accelerated, compared with the previous Government's plans
- The main burden of deficit reduction will be borne by reduced spending, rather than increased taxes

We understand that the overall public sector spending limits and deficit reduction targets for the next three years will be included in the new Government's first Budget on 22 June. We also understand that this will be followed by a detailed spending review to be completed in the Autumn, which will include department by department budgets across the whole of Government.

The scale of the challenge

The Coalition partners' election manifestos differed slightly over their preferred ratio of spending cuts to tax rises, with the Conservatives advocating 4:1 and the Liberal Democrats 5:2. Both manifestos asserted that the annual deficit must be cut by at least £71 billion over the five-year life of the current Parliament⁵. This implies that spending will need to be cut by the order of £60 billion, although this depends on growth forecasts from the Office for Budget Responsibility, and pace, ringfencing and tax/ spend incidence. For the purposes of this document, we assume that Government needs to make cuts to current annual expenditure of around 10%.

The Canadian example. The Canadian government engaged in a highly successful set of reforms in expenditure management between 1994 and 2000, in their programme to rebalance public finances. Their fiscal position was consolidated by 5% of GDP in the three years between 1994/95 and 1997/98, including a reduction in expenditure of 3% of GDP⁶.

A BUSINESS APPROACH

Businesses believe that the necessary spending reductions can best be achieved through a combination of efficiency gains across Government as a whole, together with targeted cuts to programmes and bodies that add the least value. Business experience, and that of some local authorities, suggests that it is possible to drive out efficiencies and achieve cuts while maintaining outcomes.

On the other hand, most central government budgets have increased continuously over the past fifteen years or more, so the majority of managers concerned have had little or no recent experience of implementing a significant cost-cutting regime. In this context, we welcome the creation of the new Efficiency and Reform Group, the joint Treasury-Cabinet group aiming to drive savings across Whitehall and arm's length bodies.

Experience of reducing operating costs significantly, while at the same time preserving an organisation as a growing concern, exists within both the private and public sectors. We recommend that the Government makes best use of the lessons learnt from these experiences wherever possible.

In managing their way through the recession, private sector cost cutting programmes, entailing redundancies for 10% or more of a company's workforce, have been commonplace across a wide range of industry sectors. Major UK-based companies affected recently range from Lloyds TSB to Axa, Rolls Royce to RBS, Northern Foods to GKN, Fujitsu to Cadbury, Shell to BT. Over 150,000 such company redundancies were announced in the last quarter of 2008 alone⁷.

A number of local and regional authorities have similarly brought down their costs in recent years.

In London, the London Development Agency (LDA) is charged with supporting economic development within the London region and is funded entirely by the public sector. Following the Mayoral elections in 2008, a new Chairman and Chief Executive were appointed. According to LDA Chief Executive, Peter Rogers, expenditure cuts were at least partially achieved through a clear articulation of the organisation's core purpose. The internal structure of the LDA, its size, culture and team objectives were redefined with this clarity. Workstreams which didn't serve the purpose or added marginal value were reduced or discontinued. The LDA's annual expenditure fell from £640 million to £462 million in 2009-10 (a reduction of 28% in two years) while maintaining and arguably improving desired outcomes. The LDA approach concentrated on a number of basic management principles, including:

- Be clear on the organisation's core mission, and then decide what activities to cancel or discontinue. The structure of the organisation should follow from its purpose, not vice versa.
- Concentrate on managing incremental improvements in performance year on year, rather than spending too much time trying to find comparable external bodies against which to benchmark. No two organisations are ever strictly comparable on their detailed measurements.

- Move towards an operating model that uses an element of payment by results.
- Decide on the percentage of administrative overhead that you are able to afford and stick to it. Re-engineer the organisation accordingly.
- Assume that there is no such thing as fixed costs - all costs, including premises, are variable (and can therefore be reduced) over the medium term.
- Ensure that the senior management bonus scheme directly supports the performance improvements that you are aiming for. In the LDA case, no bonuses or salary increases were paid last year. This year, the bonus structure is based on achieving measurable improvements in each of the following areas: 5% on bottom line cost/benefits, 5% on internal processes, 5% on staff satisfaction, 3.5% on external stakeholder (customer) satisfaction.

Overall, given that businesses and some public sector bodies have achieved spending reductions of 10% or more, with a disciplined approach to both efficiencies and cutting low value programmes, it should be possible for Government to achieve the further reduction of public sector expenditure per annum that is required to bring the deficit down to a more sustainable level during the current Parliament.

Securing savings in Whitehall

The Government faces similar challenges: how to increase productivity and take out costs while keeping the smaller workforce engaged and motivated. This requires a set of practical management skills and, in this regard, we would strongly urge Government to make use of successful private and public sector expertise, particularly in negotiating within heavily unionised workplaces.

A substantial part of any savings is likely to be achieved through the rigorous implementation of performance-related pay, restraints on salaries, headcounts and pensions, and through efficiency measures such as tougher procurement policies and back office productivity.

More savings will be available through reductions in non-core discretionary expenditure. Consultancy costs, for example, currently running in excess of £2 billion per annum across Government⁸, could be cut by 50%, in the view of the CBI⁹. Reducing budgets for travel, marketing, advertising and temporary staff, plus a detailed scrutiny of all “other” and “miscellaneous” budget lines, is likely to offer further substantial savings.

Obviously, it will be crucial for the Government to ensure that all the efficiency savings that are achieved actually flow through into genuine year-on-year reductions in total expenditure, and are not simply spent elsewhere within the public sector, as has happened in the past¹⁰.

For example, the outgoing Government’s proposed expenditure budget for 2010-11 shows an increase of 4.5% compared with 2009-10 (£704 billion over £674 billion)¹¹, despite claiming hundreds of millions of pounds in savings from ongoing “efficiency” programmes¹². Over the next five years, the previous Government’s Budget 2010 includes a plan to increase public sector expenditure continuously, reaching £748 billion in 2014-15. Since there are no year-on-year cost reductions within this expenditure plan, there are no contributions to reducing the national deficit¹³. We urge the new Government to adopt a radically different approach and ensure that the main burden of deficit reduction will be

delivered by reduced spending rather than increased taxes, as promised in the May 11 Coalition Agreement.

SECURING COST SAVINGS IN EDUCATION AND SKILLS

We have identified for further examination some specific examples of efficiencies and programmes from the areas of public sector expenditure on post-16 education and skills compulsory schooling, and suggest that this general approach might be replicated across other departments. The order of magnitude of saving required from this area to deliver a 10% saving is around £2 billion on a straight line basis.

The education and skills sector provides all publicly funded education and skills development following compulsory schooling, and is vitally important both for the UK's future economic growth and for its social cohesion. The sector offers education and training that ranges from basic literacy to post-doctoral research. It provides many of the skills required by employers in both current and emerging industries, and helps individuals to play their part in society, fulfil their personal aspirations and develop their careers. During a period of high structural change in the economy, it also provides a crucially important cost effective service in enabling unemployed people to acquire new skills and make the transition to new jobs in new industries.

Education and training in this sector is delivered by universities, further education colleges, sixth forms and a wide range of private sector and charitable providers. Currently, the public sector funding responsibilities are divided principally between the Departments for Business, Innovation and Skills (BIS) and Education, together with their associated arm's length bodies or quangos. The Government currently spends about £23 billion per annum in this sector¹⁴.

The sector is unduly complex

Surveys¹⁵ show that businesses and other employers find the sector incomprehensibly complex and bureaucratic, with too many obscure, competing and overlapping public sector bodies. For example, a 2010 Experian survey of 2,000 London employers, commissioned by London First, asked London employers about their awareness and usage of five headline Government skills programmes/initiatives. Only 16% of respondents reported that any of these programmes had made a positive impact on their organisations.

Educational institutions¹⁶ also consistently complain about the sector's organisational complexity, and that they are overburdened with Government-imposed restrictions, controls and reporting requirements, particularly in the further education sector. (For a map of the skills landscape, see Appendix 1)

“The complexity of the public sector education and skills system was aptly summarised recently by the responsible minister in the last Government, Kevin Brennan¹⁷, during his evidence to a Parliamentary Select Committee in February 2010: “A huge number of bodies are involved in the skills world and it is incredibly complicated, so it is not surprising that you find it complicated. I do and people in business find it incredibly complicated. One of the things we are trying to do is to simplify it, but that in itself is complicated”

Principles for achieving proposed savings

Several recent independent studies¹⁸ argue that the current public sector approach to adult education and skills is over-reliant on a top-down, target-driven culture. This has inevitably resulted in heavy bureaucracy and high staffing levels in the departments and quangos concerned.

We therefore believe that the substantial public sector expenditure in the post-compulsory education and skills sector should be examined closely, and has the potential to be significantly reduced without jeopardising economic growth. The bureaucracy is too complex and many of the Government-funded skills programmes aimed at employers and employees over the last few years have had little impact and could potentially be cut back¹⁹. We take as our starting point two guiding principles in our recommendations, both to enhance outputs and drive down costs. These are:

- Substantially increase the role of demand – both employer and individual - as the driver for funding, and
- Deliver greater devolution of programme funding to elected regional and local authorities, including the Mayor of London so that services are provided as close as practical to those who consume them.

We encourage Government to consider channelling most public sector education and skills funding via learners rather than top-down against Government-set qualifications targets, while giving educational institutions far more management freedom and flexibility to meet local demands²⁰. At the same time, the Government should devolve more responsibility for decision-making on education and skills funding from national to regional level, particularly in London, with its mandate of a directly elected Mayor. This approach would ensure that the system is driven by the needs of individuals and organisations that are closest to the marketplace, while at the same time enabling bureaucracy costs to be cut. In parallel, Government might review the structure of relevant Whitehall departments to ensure that they support the delivery of this re-oriented system in the optimum manner.

The above approach would deliver significant efficiency savings. Combined with targeted cuts to low value programmes (together with some reinvestment in schemes which provide a better route to jobs, with the added benefit of removing people from welfare) the Government can deliver on its ambition to cut spending at the same time as preserving or even improving outcomes.

SPECIFIC RECOMMENDATIONS ON SAVING £2BN

With this overall rationale, we recommend that during its comprehensive spending review over the next few months the Government gives serious consideration to the following proposed cost-cutting measures, which have the potential to deliver annual savings of over £2 billion per annum between them.

Some of these proposals can be delivered immediately whereas others will take a few years. The deficit reduction programme will extend throughout the life of this Parliament, so the Government has sufficient time to introduce any primary legislation required, as well as take administrative measures, in order to achieve the substantial efficiencies in the education and skills system that we are proposing.

Efficiency savings

We propose savings in three areas: firstly, the central bureaucracy of skills where the Government has already indicated an appetite to cut quangos; secondly, from greater efficiency of individual institutions, partly as a result of reduced central bureaucracy, and; lastly, we highlight the apparent discrepancy between sixth form funding in schools and colleges.

Streamline the education and skills central bureaucracy. Merge the existing education and skills funding quangos (i.e. HEFCE, SFA, YPLA and NAS) into a single body, operating a more demand-driven and devolved regime²¹. Merge all qualifications quangos (QCA, QCDA, Ofqual, JACQA) into a single body. Reform all sectoral professional improvement bodies such as LSIS, so that they are only funded as needed by the institutions concerned, rather than top-down from central government. Significantly reduce the number of Sector Skills Councils, and retain only those who can secure at least 50% of their funding from employers within their sector. The estimated savings from these and the related measures recommended by Professor Alison Wolf in her study, *An Adult Approach to Further Education* for the Institute of Economic Affairs, would be in excess of £1 billion per annum. (Savings details from the IEA study. See Appendix 2)

Individual educational institutions become more efficient. From Professor Wolf's study and following our own discussions with a number of universities and further education colleges in London, we estimate that under the more devolved approach outlined above, a typical institution could save at least £300,000 per annum in staff and IT systems costs by relieving them of top-down reporting requirements. Since there are 166 universities and 425 colleges in the UK, total savings from this source could be up to £200 million per annum.

In addition, it may be possible to find additional efficiency savings by mergers between further education colleges in London - where there are currently 54 independent institutions - and in other metropolitan areas across the UK. Experience from Chicago suggests that London's further education needs could be met more efficiently from a much smaller number of significantly larger institutions, with extensive sharing of back office and administrative support.

Further Education college efficiency

"A stark illustration of the levels of bureaucracy and inefficiency in the current further education management system comes from one large institution in London. Newham College of Further Education, with an annual budget of £53m, manages 33 different public sector funding streams in the course of a year. Each has its own distinct, complex reporting regime, together with separate on-the-spot auditing requirements. As a result, the college typically has to manage on-site external auditors for 100 working days a year".

The 157 Group, which represents 28 of the largest colleges in the country with a combined budget of £1.6 billion and 700,000 learners, has called upon the new Government to permit greater management freedom for colleges, combined with more institutional mergers and acquisitions, as the best way to improve efficiencies and save costs across the sector.²²

Compare effectiveness of school sixth form funding with FE colleges

While public expenditure on school sixth forms is over £2 billion per year, it appears that they may be less efficient than the larger sixth forms in further education colleges, where the funding is 14% lower per student²³. Studies have also suggested that larger sixth forms can produce better A-level results per student, because they provide more staff and a wider choice of subjects^{24 25}. We therefore recommend that the Government investigates this funding discrepancy and considers the potential for bringing school sixth form funding per head into line with funding for further education sixth forms. At face value, this could save up to £300 million per annum.

Cutting programmes

Using the principles set out above of cutting low value programmes with little traction in the marketplace, there are many programmes which merit consideration,

Significantly reduce the Train to Gain programme. This government-funded employee training programme currently costs about £1 billion per annum²⁶. However, National Audit Office and Public Accounts Select Committee reports²⁷ point out that most of this expenditure simply funds training that employers would have carried out anyway, at their own expense. Employers across the UK currently spend about £37 billion per annum on staff training²⁸, so this £1 billion programme would have little overall impact, even if it were 100% efficient. The latest national UKCES Skills Audit²⁹ demonstrates that there are very few current skills gaps in the workforce and that employers are broadly content with the skill levels of their employees, subject to the ability to recruit globally for those with the rarest of talents, unlikely to be met by further education. Government employee training interventions might therefore concentrate on the small number of strategically important areas where there are genuine skills shortfalls in the economy, for example in engineering, technology and mathematics. The bulk of Train to Gain and most related Government subsidies for employee training could therefore be discontinued, saving up to about £800 million per annum. The Government has already indicated an ambition to make savings in this area³⁰.

Other potential savings. From the employer perspective and given the level of savings needed, the Coalition may also wish to investigate value for money of other programmes, including:

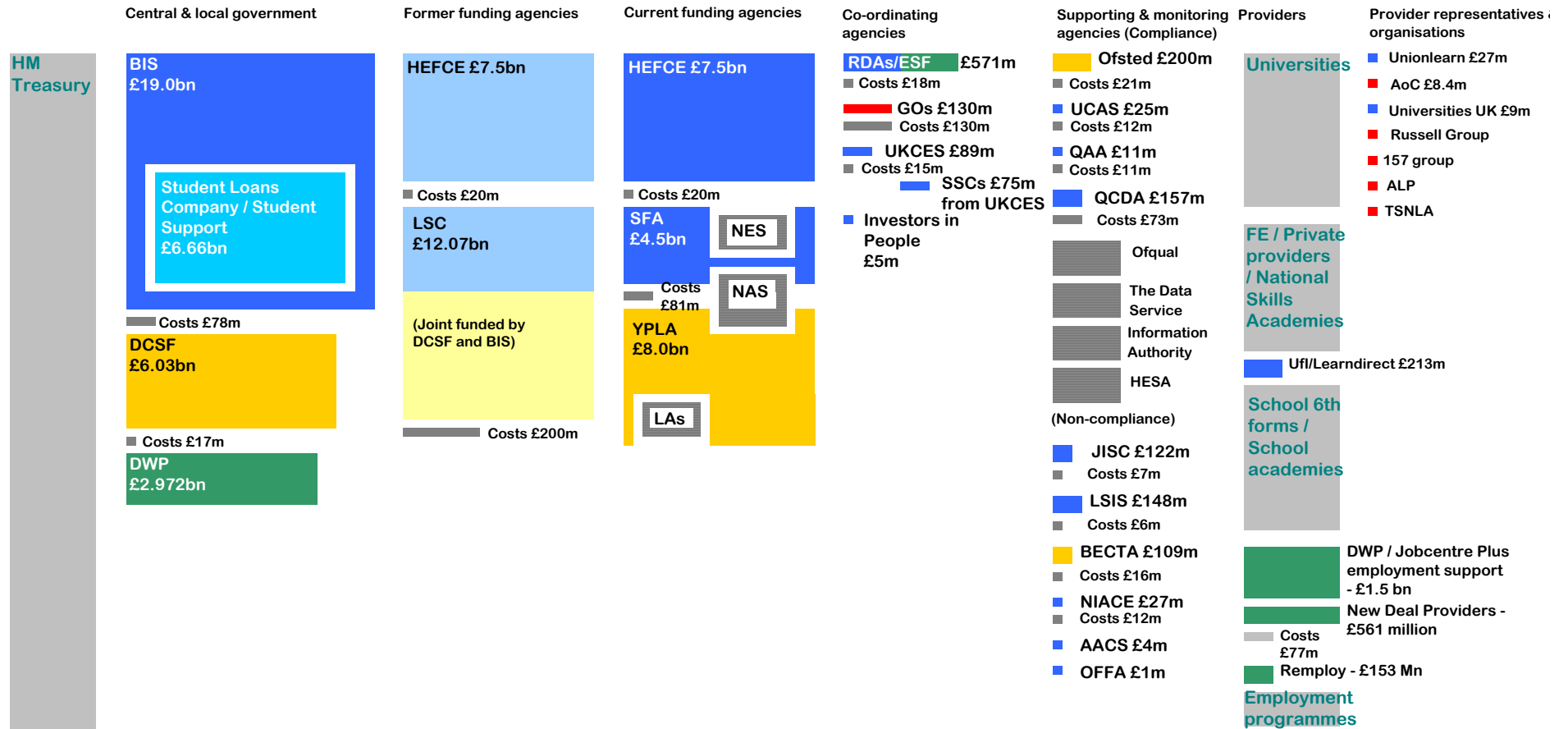
- Reviewing subsidies to employers for degree level training and education schemes (£50m p.a.)
- Exploring whether a reduction can be achieved in UK Government expenditure on grants and loans for EU students (£400m p.a.)
- Deferring the increase of the school leaving age to 18 (£100m p.a.)
- Converting all student grants to loans and/or charging a real rate of interest on all student loans (£1.5bn p.a.)

CONCLUSION

We welcome the Government's commitment to cutting the deficit. The challenge is in implementation at least as much as in aspiration. Business is keen to help Government with the tough challenges ahead and will support deficit reduction programmes of the type described in this document; namely a combination of efficiencies and the removal of low value programmes. We have used education and skills as an example herein but believe that equivalent opportunities lie in other areas of Government expenditure.

Experience in the private and public sectors suggests that savings of the required orders of magnitude are achievable. We hope that the Government will give serious consideration to both the general and the specific cost-cutting proposals in this document and would be delighted to discuss them in more detail as appropriate.

The skills landscape 2009/10



- Organisation responsible to or primarily funded by BIS
- Organisation responsible to or primarily funded by DCSF
- Organisation responsible to or primarily funded by DWP
- Not clearly answerable to a department
- Size of budget unclear

- Number of squares is approximately equal to the size of gross expenditure, with a square equal to between £0 and £25 million

An adult approach to Further Education. Institute of Economic Affairs. Professor Alison Wolf. November 2009

In her monograph, Professor Wolf argues that:

- The administrative overhead costs incurred by further education quangos are about ten times the equivalent overheads for university education. A total of 21 different quangos have had responsibility for the funding and content of post-compulsory education and training since 2006. Approximately 75% of the Learning and Skills Council's costs are a direct result of misconceived and micro-managed programmes.
- The previous Government's policy of seeking to increase economic productivity through improving the skills of adults in the workplace failed to deliver gains in overall productivity. The evidence suggests that the most heavily promoted programmes do nothing to enhance an individual's earnings power.
- There is no evidence that employers are under-investing in training. On the other hand, a number of major companies now have substantial parts of their employee training paid for by the taxpayer.
- Adult education should be treated along the same lines as university undergraduate education, with all of it except apprenticeships being funded by directly subsidising the learner, rather than through central planning through a huge network of quangos. This reduces overall spending, ensures that money is spent effectively and would enable adult learners to equip themselves with the skills and education that are relevant to them.

Professor Wolf recommends cutting out the Training to Gain programme and in addition making the following savings, amounting to a further £900 million or so per annum:

- UK Commission on Employment and Skills, Sector Skills Councils. £83 million
- FE "improvement" programmes including LSIS. £154 million
- Quality reform within the LSC (now SFA/YPLA/NAS) budget. £83 million
- QCA/QDA/Ofqual savings from vocational qualifications. £40 million
- Align LSC (now SFA/YPLA/NAS) administration costs with HEFCE. £150 million
- Exam fee savings of 50% in FE Colleges. £100 million
- Remove funding for 45,000 NVQs which provide negative returns. £146 million
- Remove other listed BIS projects. £132 million

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 - ¹¹ Budget 2010. Her Majesty's Treasury. March 2010.
 - ¹² eg Putting the Frontline First. Her Majesty's Government. December 2009; Reforming Arm's Length Bodies. Her Majesty's Treasury. March 2010
 - ¹³ Budget 2010 p 189. Her Majesty's Treasury. March 2010.
 - ¹⁴ Departmental annual reports. May 2009.
 - ¹⁵ eg Voice of London Employers. Experian for London First. October 2008 and May 2010; Training in the Recession. Institute of Directors May 2009; Towards Ambition 2020. UK Commission for Employment and Skills. October 2009. London Chamber of Commerce International Survey. March 2010.
 - ¹⁶ eg Protect services to students by targeting cuts and embracing efficiency. 157 Group. November 2009
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 - ¹⁹ eg Train to Gain; developing the skills of the workforce. National Audit Office. July 2009; Train to Gain. Public Accounts Committee January 2010
 - ²⁰ eg Sink or Swim – Facing up to failing universities. Policy Exchange. April 2009
 - ²¹ e.g. A Re-Vision of the Skills Landscape. Experian for London First. May 2010
 - ²² 157 Group Letter to Ministers. May 2010
 - ²³ Protect services to students by targeting cuts and embracing efficiency. 157 Group. November 2009
 - ²⁴ Select Committee on Education and Skills. Fifth report, 2005
 - ²⁵ Size matters: economies of scale in schools and colleges. Owen et al for the LSDA. 2005
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