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PUBLIC POLICY AND ADMINISTRATION IN AN ERA OF AUSTERITY

Rethinking local public services

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Introduction

There is increasing recognition of the need to make public services and welfare systems sustainable over the long term. International organisations such as the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the World Bank and the International Bank for Reconstruction and Development have recently advised many countries not only to cut their public spending but also to restructure their economies by investing in economic growth to increase the sustainability of public sector welfare programmes.

Chapters 2 and 3 deal with the second measure in their analyses of economic restructuring in OECD countries, including deregulation (Chapter 2) and privatisation of public sector activities, sometimes under the auspices of the World Bank and the IMF (Chapter 3). This chapter focuses on the first measure, detailing and analysing the ongoing public sector austerity. It considers both supply-side and demand-side initiatives to secure sustainable public finances, the latter having been largely ignored in the ongoing austerity-driven policy debates of most European Union (EU) countries. In fact, there is considerable scope to reduce the demand for public (and especially municipal) services to contribute to the increasing sustainability of public finances. The contribution of those measures is insufficiently recognised as policymakers focus on reducing the levels (i.e. supply) of local public services in order to reduce public spending.

The focus of this chapter is on local government austerity measures within the EU, where a ‘Fiscal Compact’ has been adopted by the Eurozone countries and those intending to adopt the euro single currency. The Compact defines budget rules whose aim is the containment of EU member states’ general government deficits (i.e. borrowing) and debts. It imposes a ‘debt brake’ on all 25 of the 27 EU countries’ governments that signed it in 2013. They are committed to progressively reducing their gross public sector debt by one-twentieth of the difference between the current level of debt as a proportion of national output measured by Gross Domestic Product (GDP) and the 60 per cent Maastricht limit. This debt brake requires their budgets to be reduced year after year for the foreseeable future, the more so if GDP growth remains low.
The rationale for austerity budgets

Levels of debt are indicative of a government’s ability to repay the money it has borrowed. Assuming, *ceteris paribus*, the higher that debt as a proportion of GDP the greater the risk of it not being repaid because, ultimately, tax revenues will not be sufficient to repay the original sum borrowed and the interest on it. This is especially the case where debt exceeds 100 per cent of GDP and is on a rising trend.

Official Eurostat data shows gross government debt for the euro group of countries rose from 66.2 per cent of GDP in 2008 to 90.9 per cent in 2014. Some countries’ public debt was below the 60 per cent limit but clearly, given the 90.9 average figure, most exceeded it, debt being particularly high in Ireland (117 per cent), Portugal (122 per cent), Italy (126 per cent) and Greece (158 per cent).

To avoid default, those governments must reduce their deficits and debts by imposing austerity budgets across the public sector. Governments will still have to reduce their spending even if they do default because they will almost certainly no longer be able to raise more loans from international and domestic financial markets to finance spending on public services and social security benefits. In this default scenario, they will become unable to control austerity as it becomes driven by financial markets, rather than by the Fiscal Compact programme.

Assuming, *ceteris paribus*, this will lead to a fall in the value of the euro against other currencies because the demand for euros falls as overseas investors stop buying EU governments’ bonds, in turn, this devaluation of the euro will drive up the rate of inflation as the prices of imports rise in terms of euros, thereby reducing the real purchasing power of incomes and so creating austerity.

It may, however, be thought that the crisis in the public finances will soon be over and that austerity is therefore not necessary. First, the global financial crisis (the ‘2007–2009 credit crunch’) led some governments to bail out their banks, rescuing them from bankruptcy by using public money to buy their shares (Bailey et al. 2009). Second, the economic crisis caused by the credit crunch led to rising expenditures on unemployment-related social security payments simultaneously with falling tax revenues as incomes, consumer spending and consequently profits fell during recession. Once the banks have returned to commercial viability, those governments may be able to repay the money they borrowed by selling at a profit the bank shares they bought to rescue the banks, and economic recession may soon turn to recovery. So is the Fiscal Compact’s programme of prolonged austerity really necessary?

The answer is that even if the financial and economic crises are fully reversed, it would be mistaken to believe that the public sector austerity will soon be over. This is because there have been five decades of increasingly unsustainable public finances, the remedy for which requires the multifaceted causes of ‘structural gaps’ in the public finances (spending persistently greater than revenues over many years) to be resolved, namely the financial, political, institutional, economic and cultural causes of ‘black holes’ in the public finances (Bailey et al. 2014a).

Five decades of increasingly unsustainable public finances

Even before the 2007–2009 credit crunch, time-series analysis of international public finance data made clear that ‘public finance appears to be becoming increasingly unsustainable’ (Bailey 2004: 204) in most developed countries and that ‘ultimately, corrective action will be required. This may involve radical cuts in public expenditures as well as sharp increases in taxation’ (ibid.: 180).

That analysis demonstrated the relatively high levels of public finance as proportions of national income in almost all developed countries within the OECD. Since the 1960s the average growth of spending on public services in those 34 or so countries only kept up with the
growth in GDP. However, from the 1980s, those countries’ relatively high percentages of public spending as percentages of GDP were increasingly due to current (rather than capital) expenditures and especially social security transfers, most notably in EU countries, as made clear in Figures 4.1 to 4.3.

Compared with the OECD averages, EU governments have long had relatively high levels of final consumption spending on goods and services (Figure 4.1), average levels of capital spending (Figure 4.2) and much higher welfare payments, especially the Eurozone (Figure 4.3). EU countries’ social security transfers (i.e. welfare payments) were below the OECD average before the mid-1970s but above it thereafter with a rising trend (Bailey et al. 2014a).

The rising proportions of the value of GDP accounted for by current expenditure, and especially on state pensions and other forms of income support in EU member states, were increasingly financed by public sector borrowing, tax revenues being increasingly and persistently less than current expenditures and so leading to increasing public sector debt as proportions of GDP (Bailey et al. 2014a).

In previous years, rapid economic growth yielded growing tax revenues as incomes, profits and expenditures on which taxes are levied increased. Moreover, moderate to high inflation reduced the real value of public sector debt (Bailey 2004). However, as both economic growth and inflation fell from the late 2000s, the warnings in the above quotations became much more prescient and prophetic.

There is now a huge legacy of public sector debt caused by governments increasingly spending more than they are able to fully finance with their tax revenues, and increasingly because of their relatively generous income-support programmes, this being especially the case in Eurozone countries. On average, those countries also spend relatively high percentages of GDP on health, education and other social services.

This long-term trend is the ultimate cause of the Eurozone sovereign debt crisis, not the financial and economic crises beginning in the late 2000s which, together, acted as triggers for

![Figure 4.1](attachment:image.png)

**Figure 4.1** Government final consumption as a percentage of GDP: OECD vs. EU and large economies

Source: Author’s depiction of data in OECD (2011a)
Figure 4.2 Government capital expenditure as a percentage of GDP: OECD vs. EU and large economies
Source: Author’s depiction of data in OECD (2011a)

Figure 4.3 Social benefits other than social transfers in kind as a percentage of GDP: OECD vs. EU and large economies
Source: Author’s depiction of data in OECD (2011a)
the inevitable public debt crisis. Those countries already had such excessive national debt levels and budget deficits that foreign lenders became increasingly reluctant to lend governments money to refinance public debt, at least not without unsustainably high and increasing interest rates on government bonds.

As a consequence of the high debt-to-GDP ratios noted above, it became virtually impossible for Portugal, Ireland, Greece and Spain (referred to as the PIGS countries) to borrow in order to refinance their debts and deficits in 2010 and thereafter. They were bailed out by the so-called Troika (meaning ‘group of three’) of the European Commission (EC), the IMF and the European Central Bank (ECB) so that they avoided defaulting on their debts.

The Troika only bailed out those countries whose public finance crisis was so severe as not to be capable of being resolved domestically. Those Troika-funded bailouts were made conditional upon the governments of the PIGS countries implementing stringent public sector austerity measures. Put simply, those countries lost control of how austerity is managed within their own public finances, a group of auditors from this triumvirate of international lenders carrying out regular checks to see if the bailed-out countries are fulfilling the conditions of their bailout agreements. These conditions typically include cuts in state pensions and in pay for, and employment of, public sector workers and structural reforms in their economies, including privatisation of state property and making it easier for firms to hire and fire employees. These measures are intended to make the PIGS countries more competitive on European and world markets.

Figures 4.1 to 4.3 make clear why these and other austerity measures are being introduced more generally across the EU, including reduced eligibility for state pensions and other welfare payments. The alternative is to close the ‘black holes’ in public finances by raising tax revenues (by increasing the rates and bases of existing taxes and introducing new taxes), but that would make EU member states’ exports less competitive on increasingly globalised markets at the very time it is necessary to promote economic growth in countries with weak economies.

Any further borrowing should be used to fund capital expenditures on economic infrastructure capable of promoting sustainable and self-reinforcing growth of GDP over the longer term rather than current expenditures on services and social security. This is what is required if countries are to restructure their economies.

This pro-growth strategy has also to accommodate the relentless growth in demand for public services at a time of heavily constrained government budgets that may not even keep up with inflation. Raising the retirement age, constraining the growth of other welfare payments, reform and merger of government departments and municipalities, and maybe reducing their responsibilities are options being implemented or considered in many countries.

However, it is questionable whether these changes will be sufficient to reverse public sector borrowing so that budgetary surpluses can be achieved with which to reduce public sector debt and/or finance supply-side measures to improve national productivity. In particular, the number of people of pensionable age will continue to grow in most countries and conventional municipal austerity measures will not be sufficient.

**Conventional municipal austerity measures**

The alternative austerity measures are depicted in Table 4.1. Short-term ‘quick wins’ are crude knee-jerk management approaches, relatively easy to justify pragmatically, but they only buy time to deal with austerity budgets. They take no account of organisational strategy, priorities and political sensitivities. They can cause essential services to fail to achieve key organisational objectives. They are temporary measures and are neither sufficient nor sustainable.
### Table 4.1 Categorizing austerity measures

<table>
<thead>
<tr>
<th>Short-term “quick wins”</th>
<th>Medium-term measures</th>
<th>Long-term measures</th>
</tr>
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<tbody>
<tr>
<td>• “salami slicing” cuts to all service budgets</td>
<td>• provide only statutory (not discretionary) services</td>
<td>• integrate front-line services (e.g. social and medical care of elderly people)</td>
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<tr>
<td>• freeze vacant posts and do not renew temporary posts</td>
<td>• voluntary and/or compulsory redundancies and early retirements</td>
<td>• merge municipalities to achieve economies of scale</td>
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<tr>
<td>• reduce opening hours (e.g. for libraries, museums and galleries)</td>
<td>• public sector pay limits</td>
<td>• reform public sector workers’ pensions to reduce their costs</td>
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<tr>
<td>• pay freezes for public sector workers</td>
<td>• bulk purchasing across the public sector to reduce input costs</td>
<td>• adopt new service technologies in health and social care, education, etc.</td>
</tr>
<tr>
<td>• postpone spending on repairs and maintenance</td>
<td>• contracting out public services</td>
<td>• develop self-service for digitised information and advisory/support services</td>
</tr>
<tr>
<td>• cut capital expenditures</td>
<td>• joining up top management structures to reduce manager numbers</td>
<td>• move from crisis management to prevention by early intervention for health, education and social care</td>
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</table>

**Source:** Author’s summary of the academic literature referenced herein

Medium-term measures are more considered approaches to manage austerity budgets but voluntary redundancy and early retirement compensation deals may result in imbalanced staffing structures (especially loss of key skills and service capabilities). Planned compulsory redundancies can help avoid such problems but still create additional compensation costs. Sharing managers and back office services can reduce costs at corporate level but economies of scale arising from the merger of municipalities are limited.

More strategic long-term measures include moving out of service silos to integrate services (such as social and medical care of elderly people) or otherwise promote better horizontal collaboration across services to eliminate duplication and work better together, pooling budgets for services and places (e.g. a neighbourhood). Such restructuring of services and service providers may achieve economies of scope as well as of scale.

Although the specific measures adopted have varied from country to country, the overall approach to managing austerity has been broadly similar throughout the EU, governments initially focusing on the short-term measures listed in Table 4.1 because they believed the crisis would soon be over (Kickert 2012; Kickert et al. 2013). The more radical medium-term austerity measures in Table 4.1 were not introduced until the severity and longevity of the problem was recognised. In general, the savings (‘fiscal consolidation’) pursued by austerity measures are greatest the greater the sizes of public sector deficits and debt, all measured as percentages of GDP (OECD 2011b, 2012).

The pragmatic supply-side approaches to austerity listed in Table 4.1 face many problems, particularly resistance from bureaucrats and service workers afraid of losing budgets and jobs, and from existing service users who wish to retain existing levels and methods of provision. Moreover, they do not address growing service demands, instead focusing on reducing budgetary costs. Increased social risks may arise because of the disproportionately negative effects of service cuts for young adults, people with disabilities and/or long-term illness, women,

These cost-cutting measures take place within the direct-provider model of service provision and so may not be an effective or sustainable solution to austerity budgets facing increasing demands. This model must increasingly ration availability of, and access to, services via longer waiting times (e.g. for health services) and stricter eligibility criteria (e.g. for social care of elderly) and so exacerbate the social risks just identified. There is already evidence that withdrawing services and social security from such vulnerable and disadvantaged groups may substantially increase social risks, for example as child protection services are withdrawn and as young adults face unemployment rates twice the average rate (McCormick and Harrop 2011; ONS 2012).

Municipalities must therefore seek to manage and mitigate those social risks by rethinking the way services are provided and used, the objective being to reduce their costs whilst increasing their outcome effectiveness. This means much more than ‘rolling back the frontiers of the state’ by adopting neoliberal policies promoting deregulation (see Chapter 2) and privatising state-owned enterprises (SOEs) and municipal assets and liberalising municipal service provision via contracting out to private sector firms (see Chapter 3). Receipts arising from the sale of SOEs are finite, and outsourcing the provision of public services to the private sector to secure potential cost savings is rather limited in utilising much the same service model and even those limited potential savings are not always achieved (Bailey et al. 2011). Transformative municipal austerity measures are also required.

**Transformative municipal austerity measures**

To put the public finances on a sustainable footing it is necessary to consider more collectivist alternatives to the traditional direct-provider municipal service model and to the enabling model under which public services can be provided not only directly but also by private and voluntary (charity) sector contractors.

Under both models municipalities are geared up to supply services rather than manage demand for them and are continually under pressure to achieve cost reductions via the cost-containment measures listed in Table 4.1. Depending on those measures means that they remain locked into their institutionally constrained mindsets and their departments remain locked into ‘service silos’. Instead, they need to seek transformative change by ‘thinking out of the box’ in terms of both supply-side and demand-side measures.

Very much bigger potential cost savings can be achieved by managing demand for services whereby municipalities encourage behavioural changes on the part of service users and citizens and their communities. This can be implemented by development of personal budgets for social care of elderly people and community budgets for street cleaning, parks maintenance, recycling and the other measures listed in Table 4.2.

In the UK, for example, municipalities should recognise that they face tough times (Audit Commission 2011), that the austerity era is here to stay (CIPFA 2012), that they cannot realistically ‘weather the storm’ (Wallace et al. 2013) or ‘game’ the cuts (Manning 2013). Instead, they will have to manage a significant and sustained adjustment in public sector funding (Solace 2009) by progressively transforming their model of service provision from direct provider, through enabling and empowering to a catalytic model in order to change behaviours of both service users and service providers (Keohane 2011).

This devolution of decision-making can make services more effective by incentivising individuals and communities to make best use of their municipally allocated budgets by changing...
Table 4.2 Alternatives to direct provider model

<table>
<thead>
<tr>
<th>Transform the model of service provision via direct-provider ⇔ enabling ⇔ empowering ⇔ catalytic role</th>
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<tbody>
<tr>
<td>Procure innovation and added value by making use of external skills available in:</td>
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<tr>
<td>• private sector and social enterprises via not-for-profit strategic alliances</td>
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<tr>
<td>• communities via community budgets for neighbourhoods</td>
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<tr>
<td>• households via proactive engagement in schooling, health, child and social care, etc.</td>
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<tr>
<td>Transfer assets to mutual and collective organisations and cooperatives</td>
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<tr>
<td>• to provide their own services (e.g. leisure and recreation)</td>
</tr>
<tr>
<td>Focus on ‘smart’ municipalities ‘leading from behind’ using networks and service platforms to create additionality</td>
</tr>
<tr>
<td>• by improving social productivity and social and public value creation – not just service output productivity</td>
</tr>
<tr>
<td>• by adopting the ‘learning organisation’ model to promote corporate and community learning for increasingly diverse populations</td>
</tr>
<tr>
<td>Evolve from statist to civic entities engaging proactively with all stakeholders</td>
</tr>
<tr>
<td>• more engaged citizens</td>
</tr>
<tr>
<td>• civic enterprise</td>
</tr>
<tr>
<td>• smarter working</td>
</tr>
<tr>
<td>• preventative and re-ablement services</td>
</tr>
<tr>
<td>• co-producing solutions with (not for/to) stakeholders</td>
</tr>
<tr>
<td>• recognising their assets and capabilities</td>
</tr>
</tbody>
</table>

Source: Author’s summary of the academic literature referenced herein

their behaviours and the ways in which they use services so as to reduce costs and be innovative in the co-design and co-production of services with municipalities and with other organisations such as micro-social enterprises and neighbourhood associations.

This approach within the public and voluntary (third) sectors is ‘the other side of the coin’ of regulatory capitalism in the private sector whereby development of a multifaceted web of governance aims to change (steer) not only the behaviour of profit-seeking companies in the private sector but also that of citizens interacting with their public, private and voluntary sector providers of public services in order to improve service outcomes.

Chapter 2 refers to this as the move away from a predominant focus on ‘command and control’ by governments and towards development of non-state, civil society and business organisations operating through overlapping non-hierarchical multiple sites of governance utilising incentives and moral suasion to steer (nudge) the behaviours of organisations and citizens.

If they do not change their model of service provision in such ways, municipalities will become increasingly preoccupied with cost savings, paying less attention to securing cost-effective outcomes and so becoming a tool of austerity, this being a particularly bleak outlook for local public services. Instead, it is better to manage and reduce service demand, not by rationing and cost shifting but instead by building resilience of communities by helping supportive social and community networks to stimulate community-led innovation.

This change in municipalities’ modus operandi empowers communities so that they can make provision of public services by themselves much more cheaply and effectively than their local governments. In this method of working, municipalities ‘lead from behind’ to act as catalysts to help communities improve their own wellbeing by building on their skills and
capabilities. Municipalities can help them by transferring ownership of their physical assets to
neighbourhoods (‘locked in’ to prevent their sale) so that such civic enterprise is not blocked by
high up-front costs, for example community houses, parks and other sports and leisure facilities
which communities then manage day-to-day, making use of volunteers where possible.

Unless there is transformative change, during the prolonged austerity, municipalities will
have to increasingly ration services, for example by imposing more restrictive eligibility criteria
for social care of frail elderly people. This may only shift costs to other parts of the public sector,
for example from social care of frail elderly people in their own homes to their care in hospital
accident and emergency units. Worse, it may lead to higher costs by disrupting services and so
reducing their effectiveness, and because crisis management is generally more expensive than
preventative action.

To avoid this scenario, municipalities need a change of mindset from supplying local public
services to reducing demand for them. They must foresee and reduce otherwise rising future
dependency by focusing on early intervention to reduce demand, working with the community
to build resilience and personal responsibility via strength-based approaches, for example for
social care (Fox 2013). This will also require public sector risk managers to recognise the social
risks created by austerity and become proactively engaged in the management of austerity
programmes (Asenova et al. 2014, 2015). This is referred to in Chapter 2 as being more
preoccupied with the future rather than the past.

They will have to utilise a ‘Nudge Agenda’ to encourage people to reduce smoking,
consumption of alcohol and junk foods and to take more exercise to improve their physical and
mental wellbeing and so reduce future demand on public services. Such catalytic municipal
services can strengthen supportive social and community networks. Additionally, municipalities
can seek to promote strategic change in their areas through ‘place-shaping’ for community
wellbeing and by developing the ‘Big Society’ for social/societal wellbeing. This requires
municipalities to formulate public policies with all stakeholders in the voluntary, community
and faith sectors, many of which already provide preventative services independently of local
governments. Municipalities will also have to engage with the public about spending reductions
required by the austerity measures and to make clear the cost and value of services to stimulate
new thinking and formulation of new policies for community-led innovation in local services

Instead of ‘doing more with less’ it is a question of ‘doing things differently’ because although
there is scope to improve service productivity to do so is difficult and slow (Bailey et al. 2014b).
Otherwise municipalities are likely to become residualised providers of increasingly rationed
services, sharing out the misery of austerity as more and more growing demand remains unmet.
Instead, ‘doing things differently’ has much more potential to improve social productivity via
multi-stakeholder partnerships (strategic alliances) and networks for service co-production and
coop-governance to help communities help themselves by changing the modus operandi of
municipalities.

A more optimistic vision is that municipalities have to be more proactive ‘place shapers’,
abandoning the traditional ‘one-size-fits-all’ model of public services which leads to a mismatch
between service provision and what citizens ultimately want and need and which, in turn, leads
to service costs being unnecessarily high. Instead, municipalities must rethink new whole-
systems approaches, focusing on improving outcomes, reforming their delivery through service
integration, collaboration, partnerships, strategic alliances and commissioning. Clearly, merging
small municipalities into larger ones is only a very small part of the much more holistic reform
to structure, functions, financing and especially methods of working that is required for the
municipal sector.
Transformational rethinking is also required, ‘Smart Cities’ not only utilising inter-organisational collaboration and outsourcing but also developing public–third sector partnerships (non-profit models), mutual organisations, etc. to promote community and individual wellbeing. This method of working is distinct from being a direct provider of services and seeks to improve productivity in terms of outcomes as distinct from outputs. This modus operandi has potential to secure more public value co-creation than cost reduction but can save costs nonetheless.

**Conclusions**

Many countries face prolonged public sector austerity due to weak or negative economic growth and the need to deal with persistent public sector deficits and debt. They cannot afford to wait for spontaneous economic recovery and the ensuing extra tax revenues, tempting though that may be for politicians reluctant to take unpopular decisions. Other countries must begin to act now in order to mitigate financial and social risks so as to protect the wellbeing of their citizens. The bailed out EU member states left it much too late and so much more drastic action is required by the Troika’s austerity programme than might otherwise have been necessary. This has severely reduced the wellbeing of their populations and condemned them to years if not decades of cuts in their welfare states.

It has been made clear that municipalities need to develop a new multi-stakeholder governance model of service provision (strategic alliances) with or without austerity so that they develop non-statist service models as social needs and solutions evolve. Austerity is therefore an opportunity to rethink services, their objectives and service models, moving from top-down municipal models to bottom-up deinstitutionalised structures giving up control to communities by changing municipal functions, financing and modus operandi.

This is not neoliberal governments ‘getting out of the way’ through service withdrawal and privatisation. Instead, it is based on developing new non-statist community service models made innovative, catalytic, resilient, and fit for the 21st century within increasingly pluralistic social needs and solutions. Municipalities will increasingly have to procure innovation and add social and public value by engaging a wider range of stakeholders involved in co-design, co-production and co-governance of public services.

Much more strategically, municipalities will ultimately have to redefine the relationship between the citizen and state, so that individuals, families and communities begin to do more for themselves while the state does less as they learn by doing and become more confident in their own abilities and capacities to promote their wellbeing and resilience.

Reducing public spending requires strategic thinking about both economic and societal restructuring. Local governments must become learning organisations as they pilot-test new models of service provision, using whichever model is appropriate for a specific service at that point in time but recognising that societies, institutions and local economies evolve as new capabilities are developed.

Clearly, there is no ‘magic bullet’ solution or quick fix to the inevitably prolonged austerity and the real difficulty is in escaping the prevailing municipal culture of the paternalistic technocratic direct-provider supply-oriented model of local government in most countries, not least those in the EU.
References


