Financial resilience of English local government in the aftermath of COVID-19

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Abstract
Purpose – The financial resilience of local authorities has been a serious concern over the past decade due to austerity and its effects on local government budgets despite rising service demands. More recently, the scale and suddenness of the shock from COVID-19 has exacerbated problems of financial resilience. This paper explores the financial management responses required by a sudden, nationwide pandemic of such severity.
Design/methodology/approach – This paper applies the concept of financial resilience to English local government to analyse their situation in the aftermath of COVID-19. It is based on a close reading of official reports and the news media.
Findings – Local authority’s financial resilience could deal with normal levels of risk arising from austerity. However, the seriousness of COVID-19 alongside pressures still emanating from Brexit requires a significant level of central government support. This is critical as local government is expected to underpin future economic growth of the UK as well as deliver an important social response. Presently, the financial framework for funding individual local authorities through central government in terms of COVID-19 support is not on a reliable footing to answer specific demands. This can lead to gaming and perverse incentives.
Originality/value – This is the first paper to connect the financial resilience in the local government framework with the required central government funding procedures for sudden nationwide crises, such as the COVID-19 pandemic. It identifies the need to define what effect key variables, such as local government financial reserves, local deprivation indices and anticipatory financial management practices in local government should have on the determination of central government aid for individual local authorities.
Keywords COVID-19, England, Financial resilience, Local government
Paper type Research paper

1. Introduction
Since the financial crisis in 2008 and subsequent decade of the conservative-led central government’s austerity-localism policy, the financial resilience of local authorities in England has been a serious concern (Ahrens and Ferry, 2015; Jones, 2017). This has been further exacerbated due to uncertainties arising from Brexit and concerns over climate change (Travers, 2016). More recently, COVID-19 has shaken the foundations of government financial planning and intensified problems of financial resilience at all governmental levels, but in particular the local level where the capacity and capability to absorb and adapt is more limited (Marrs, 2020a). This paper explores financial resilience of English local government in the aftermath of COVID-19.

Whereas extant research into the financial resilience of local government has been conducted against the background of austerity, which focused on gradual adaptive processes and evolving financial management capabilities (Barbera et al., 2016, 2017; 2019; Papenfuß et al., 2017; Steccolini et al., 2017), this paper explores the concept of financial resilience in local government in the context of the sudden nationwide COVID-19 pandemic. The pandemic requires a significant level of central government support, at least as an interim measure. Otherwise a collapse in local government would not only weaken any social response in the
aftermath of COVID-19, but could also damage a central institution required for strengthening economic growth (Travers, 2012).

In the short term, local government support is coming from emergency budget allocations (Office for Budget Responsibility, 2020). However, as the true extent and implications of COVID-19 are better understood it becomes ever more critical that a formalised spending review is undertaken to provide a framework for political priorities, policies and funding mechanisms. In this way the spending review can take place as a framework for the annual budgets, with appropriate audit and accountability arrangements to look at not only the cost but the value for money and equity from decisions (Office for Budget Responsibility, 2020). Risk management practices can also take place against such a framework not only for local government itself, but the Ministry of Housing, Communities and Local Government (MHCLG) and more broadly across Whitehall departments that support local government activities (Davies, 2020).

The remainder of the paper is structured as follows. Section 2 outlines the literature around resilience, crisis and accounting and its implications for English local government in the aftermath of COVID-19. Section 3 sets out the methodology. Section 4 presents findings on the UK government response to COVID-19. Section 5 discusses the theoretical contribution and implications for policy, practice and future research.

2. Resilience, crisis and accounting

Local government financial resilience has been the subject of a growing body of academic research that has focused on financial conformance and overall financial sustainability of local government, but largely ignored service performance (Christian and Bush, 2018; Ferry and Eckersley, 2015; Sacco and Busheé, 2013). A series of comparative studies that drew on observations from Germany, Italy and the UK showed that local governments react differently to constraints and stimuli (Barbera et al., 2017, 2019, 2020). These differences were traced to inherent variations that were related to specific histories of resourcing and financial management. “Bouncing back” strategies, included for example taxes and fees increases, deferred investments, costs reductions, organisational resizing and asset sales. “Bouncing forward” strategies fed on—but also sought to improve—anticipatory capabilities. They emphasised self-sufficiency, innovation, entrepreneurship, redefinitions of core activities and service delivery modes, improved and new services and new clients. They required, for example, information exchange and sharing, monitoring systems, critical thinking approaches, organisational cultures of adaptation and rapidity of action, but also perceived control over sources of financial vulnerability in relation to financial autonomy, abundance of financial resources and low level of indebtedness and low volatility of own revenue resources. Thus, higher financial vulnerability was associated with bouncing back strategies, whereas bouncing forward strategies were associated with stronger anticipatory capacities.

There has been some field research evidence of good anticipatory capabilities in English local authorities (Barbera et al., 2019; Thomasson et al., 2020). Key to this are practices involving both central and local government, such as the spending review, budget, accountability and audit and risk management arrangements (Ferry et al., 2015; Ferry and Eckersley, 2019) as well as accountability relationships between local authorities and citizens (Ahrens et al., 2020; Ahrens and Ferry, 2015; Ferry et al., 2019). Maintaining such capacities over the long term would be important in light of expectations of enduring difficulties in funding public services, not least in the context of discontinued European infrastructure investment following Brexit (Travers, 2016). Some municipalities are attempting to become more entrepreneurial in response to budget cuts by focussing on the strategic domains of
boundary and belief systems (Ferry et al., 2017) and corporatisation of services (Andrews et al., 2020).

We would suggest, however, that the challenges arising from an urgent nationwide crisis such as COVID-19 put different strains on government than the “slow burn” of austerity. The academic discussion has frequently focused on the effects of austerity on sustainability in the public sector (Grossi and Cepiku, 2014). The roles of accounting in urgent crises of government has, thus far, been mainly explored in relation to natural and environmental disasters (Boin et al., 2016; Lai et al., 2014; Newberry, 2020; Sargiacomo, 2015). Moreover, the problems of governments’ risk policies and practices have attracted some interest in the public administration literature, for example in the UK context (Gerodimos, 2004; Rothstein and Downer, 2012).

The UK government had considered the risks of pandemics in planning documents from 2005 to 2018 (Lambert, 2020). They suggest that the UK had prepared to “mitigate” rather than “suppress” a virus outbreak, with deaths of between 210,000 and 315,000 people as a plausible planning outcome under a worst-case scenario. Strict social distancing enforced by the UK did not underpin any planning documents, nor did technological tracking, as employed in Singapore, or mass testing on the scale of South Korea. This was the playbook the UK government followed throughout February and into early March 2020, expecting that the outbreak would soon be over, albeit with significant deaths. This plan was reversed with the UK economy, government finances and freedom of movement sacrificed to avoid the potential mortality rate that the initial approach accepted. The crisis would seem illustrative of the notion of government as “congenitally failing” (Miller and Rose, 1990), both in terms of its planning and in the use of its plans when faced with the actual emergency.

The unprecedented nature of this global pandemic in contemporary times has led to greater interest in the specific problems that pandemics may pose for the uses of accounting by the state, by researchers or government finance practitioners. “[A]ccording to international finance expert Allen Schick, […] “no country has ever set aside sufficient fiscal reserves to finance major wars, economic depressions or biological pandemics […] In fact, few countries have sufficient reserves to cover shortfalls owing to cyclical recessions” (Marrs, 2020b). This includes even better-prepared countries, those that are likely to maintain fiscal balance during growth cycles, cover costs of pensions and healthcare and monitor sustainability of government budgets and policies. Public sector audit, too, fails to scrutinise government readiness for urgent crises concerning low probability, high impact events (Comptroller and Auditor General, 2019). Having said that, there is evidence some unconventional mechanisms to support governments through the Great Recessions have been employed in response to the pandemic, such as the reinstatement of swap lines from the USA Federal Reserve to major economies (Tooze, 2020).

A key difficulty lies in the unavailability of relevant statistics. Whilst the UK public sector is often credited with an ability to manage daily risks through effective scenario planning as well as medium term financial planning and risk management, during the decade of austerity the collection of much statistical information that would be required for mitigating risk during an urgent crisis has no longer been collected and analysed (Marrs, 2020b). Moreover, central government departments such as the MHCLG do not have clear oversight of what statistics are still available. Planning may well not be up to the challenge of managing key elements of financial and service resilience, such as reserves, insurance, or cash flow from debt covenants. At the national level, it is critical that there is an appropriate response from national institutions including government in terms of the planning, budgeting, audit and risk management mechanisms with informed central-local government relations (Ferry and Eckersley, 2015, 2019, 2020; Ferry et al., 2019).
3. Research approach and methods
The starting point for our paper was a concern over a potential neglect of key financial oversight practices during the fast-unfolding COVID-19 crisis. Clearly, the speed with which the UK population was infected and death rate surprised the government, as evidenced by quick changes of strategy and an overall lack of preparedness of the public health services to execute a coordinated response to the crisis.

We consider the UK central government and English local government response to COVID-19 from March to July 2020 with regards to the impacts and implications for financial resilience. The 365 local authorities are a main conduit for public expenditure in England, with a net revenue budget of over £95bn for 2018/19, which is over 20% of total public service spend. The impact of local government is highly significant on other public services (such as education, NHS, police and fire services due to joint work) and on the private sector due to the effect on local communities and the extent of public service delivery and commissioning involving private sector partners. Therefore the accountability of local authority finances is of high significance for social value in terms of the social, economic and environmental well-being of citizens across England.

In terms of research methods, one of the authors attended the chancellor’s budget speech at the parliament on 11th March 2020 that considered responses towards prosperity to end austerity and to manage the threat posed by COVID-19. Since then additional allocations over and above the original budget for COVID-19 have increased exponentially, well beyond what was anticipated. To keep track of these budget changes the authors have reviewed subsequent documentation including official reports, online parliamentary committee sessions and news media during COVID-19 up to the 20th July 2020 and participated in expert conversations around the government response to COVID-19 and the financial situation.

4. Findings
4.1 Resilience during austerity
There have been concerns over the past decade around the funding resilience of English local government. For example, local authorities in England already had serious financial concerns after a decade of austerity combined with uncertainties around Brexit and additional costs to mitigate climate change issues. Indeed one of the researchers observed during his posting as a parliamentary fellow and then adviser from 2018 to 2020 that many social movement protests related to such issues.

From a revenue perspective, the finance system for local government has been subject to many calls for comprehensive reform (Governing England: Devolution and Funding, 2018). This has included grants from central government which have greatly reduced as part of austerity-localism policy (Sandford, 2016). The two main local sources of funding have also remained largely stagnant. This is despite a call to change the national non-domestic rates system so local authorities retain more of the business rates raised locally rather than having equalisation in distribution and recognition that council tax on domestic property is based on outdated property valuations and is not a strong link between funding raised locally and local democracy (Governing England: Devolution and Funding, 2018).

Various proposals for new sources of revenue funding have been suggested. They include more control of council tax, property valuations and a premium for empty homes and business rates, as well as a range of transport taxes, local income taxes and tourism tax. There have also been suggestions around capital and revenue funding through bid based grants. Other suggestions have included capital proposals such as asset sales and capital financing of borrowing, e.g. via the public works loans board. Overall, these do not make up for lost funds, however.
Regarding expenditure, demand and need have both increased from citizens but budget cutbacks to balance the books have led to staff reductions that have decreased available capacity to deliver. In particular, many discretionary services have been seriously depleted if not stopped and even mainstream statutory services such as child and adult social care have been particularly highlighted for concern (Oral Evidence Presented to the Housing, Communities and Local Government Select Committee of the House of Commons Relating to Local Government Finance and the Spending Review 2019, 2019).

4.2 COVID-19
The onset of COVID-19 since March 2020 has greatly exacerbated these concerns around financial resilience of English local government. COVID-19 is unlike the shock from austerity. Austerity came with a forewarning so local authorities could prepare and implement cuts over a period through consultation, prioritisation and exploration of alternative delivery options (Ahrens and Ferry, 2015). Yet these changes weakened the capacity and capability of local government and its ability to absorb future shocks and adapt. By contrast, COVID-19 is much more immediate in its impact and implications and gives local authorities little time to plan and take mitigation activities.

In March 2020, the UK government mobilised a wide ranging response to COVID-19 across five areas (Comptroller and Auditor General, 2020). They were health and social care responses (including service delivery, equipment, testing and vaccine development), various public services and emergency responses, support for individuals who were affected by the pandemic (including benefits and direct support to households), support for businesses and other support (including international aid). By mid-May 2020 the total commitment was £124.3bn, of which around £50bn went on payments to employees on furlough and around £30bn on other support for businesses (Comptroller and Auditor General, 2020, p. 6).

By late June, around 150 local authorities in the UK forecast a combined budget shortfall of £3.2bn as a consequence of various COVID-19 related effects, such as payments to families with reduced incomes, council tax holidays, lost business rates, lost leisure centre income and drop in tourism related income (BBC News, 2020). The impact on individual councils varied considerably (“Formal meeting (oral evidence session): Public services: lessons from coronavirus”, 2020). Local lockdowns, such as in Leicester, may make such differential impacts even greater as the crisis continues. At least five English councils warned that without more government support they may meet the criteria to issue a section 114 notice, declaring that they cannot achieve a balanced budget, i.e. spend exceeds resource. Ogden and Phillips (2020a) in a briefing note for the Institute of Fiscal Studies (IFS) likewise underlined local variations in the financial risk and resilience of English local authorities arising from the COVID-19 crisis [1].

Whilst the government provided £3.2bn of emergency grant funding and over £5bn of cash flow to support local authorities in March and April 2020, there were concerns over the basis on which allocations to different local authorities were made. The allocation of most of the first tranche of £1.6bn sought to address adult social care spending needs. The second £1.6bn tranche was allocated on a per-person basis, going mostly to lower-tier shire districts, even though upper-tier counties have responsibility for social care services. This was to address concerns that the crisis would affect income more than spending, especially in urban authorities in the Midlands and North England. Additional issues are that lower-tier shire district councils rely more on business rates and sales, fees and charges income, exposing them to more revenue risk. Local authorities with more deprived communities are expected to face less revenue risk than affluent ones, but their residents may be more susceptible to COVID-19, potentially increasing demands on services. The ability to cope with increased borrowing is also expected to vary considerably. Many local authorities relying on revenues
looking vulnerable in the short term have higher reserves, but not all of them. Overall, we
notice significant regional imbalances in funding and capital investment for the public sector,
creating vast differences in the ability of different local authorities to meet any crisis (Prowle
and Latham, 2020). A similar point is also made by the large discrepancies in the expected
funding shortfalls between different local authorities (BBC News, 2020).

The local authority with the largest deficit was Birmingham City council with a forecast
shortfall of £212m across 2020–21 and 2021–22, even after receiving £70m extra government
funding. The severity of the situation was signalled by a temporary amendment to section
114 suggested by CIPFA, whereby, in lieu of issuing a section 114 notice, “[a]t the earliest
possible stage a CFO should make informal confidential contact with MHCLG to advise of
financial concerns and a possible forthcoming S.114 requirement [, and] [t]he CFO should
communicate the potential unbalanced budget position due to COVID-19 to MHCLG at the
same time as providing a potential S.114 scenario report to the council executive (cabinet) and
the external auditor” (“CIPFA proposes amendments to S.114 guidelines”, 2020).

Marrs (2020a) on July 2nd estimated that local authorities overall had a £9.1bn total
pressure with estimated cost pressures of £3.6bn for the current year plus losses from fees
and commercial income and taxes of £5.5bn, with only £3.2bn having so far been offset by
government grants. Table 1 summarises the potential impact on council finances for financial
resilience arising from COVID-19.

A key question in the discussions over funding and funding gaps, however, is the
availability of reliable statistics and financial measurements. Notably, the full dataset of local
government financial information, on which the BBC reporting is based, does not disclose the
financial reserves of the local councils [2]. Recent reports suggest a heightened scrutiny of
local management of financial reserves (Rudgewick, 2020a). Whilst many councils will need
to draw on reserves, for some the management of the impact of COVID-19 will require that
they even reduce reserves that had been earmarked for specific purposes (Marrs, 2020a). Also,
whereas councils claim that the central government aid of £3.2bn was insufficient, England’s
Minister for Local Government said that this money was part of “a wider package of support
from across government for local communities and businesses – totalling over £27 billion”
(BBC News, 2020). It is in this context of fast-changing information that new funding
commitments, such as the 3rd tranche of emergency grant funding for local government of
£500m the MHCLG announced on 2 July 2020 [3] and the counter claims of local government
representatives that this amount was wholly insufficient, need to be understood (Rudgewick,
2020b): “Earlier this week, the Local Government Association predicted that additional costs
[as] a result of Covid-19 could reach £10.9bn this year” (Rudgewick, 2020b).

COVID-19 has magnified the importance of local government. A longer term solution
would depend on investments in crisis prevention (Evaluating Preventative Investments in
Public Health in England, 2019), that considers virus suppression as well as mitigation
(Lambert, 2020) and also the ability to put local government financial planning and reporting
on a more reliable footing, such that it can quickly adapt to specific crises (Marrs, 2020b).

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<tr>
<th>Cost pressures</th>
<th>£3.6bn</th>
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<td>Lost tax income and non-tax income losses</td>
<td>£5.5bn</td>
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<td>Total financial challenges before grants</td>
<td>£9.1bn</td>
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<td>Total grants (emergency funding in 2 tranches)</td>
<td>£3.2bn</td>
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<td>Total shortfall</td>
<td>£5.9bn</td>
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5. Discussion
The paper considered the financial resilience of English local government during COVID-19. Whereas prior research has addressed financial resilience emanating from shocks such as financial crises and subsequent austerity policies at both the central and local government levels, we discuss financial resilience to shocks that have an immediate and significant nationwide impact that goes well beyond normal operational planning. As has been observed by commentators such as Schick it would be very difficult to plan reserves at a local level to deal with large-scale disasters and, as Ferry highlighted, while future-proofing is crucial the pandemic illustrated limitations and “Your planning is likely to go awry in the fact of events... Something will happen that you can\textquotesingle t predict” (Marrs, 2020b). Therefore, nationally and internationally coordinated government responses are called for. Financial resilience and contingency response planning therefore should be framed beyond the local level.

Crucial to such efforts are data analytics that underpin this financial resilience. Unfortunately, relevant capabilities have been depleted in English local government and MHCLG due to austerity. In addition, the institutional capacity and capability to be able to absorb the fallout from such a shock and adapt services accordingly has also been reduced during austerity with various layers of management and services stripped away from local government. It is therefore important that any financial resilience models consider service resilience in terms of crisis absorption and adaption. Presently, the financial framework for funding individual local authorities through central government in terms of COVID-19 support is not on a reliable footing to answer specific demands. Funds are distributed haphazardly. For example there is no framework to take account for need, deprivation, local authority financial reserves and local demographics among other things. The government’s accounting technologies have not yet caught up with the shock to its crisis response programme (Miller and Rose, 1990).

Policymakers need to consider how they can strengthen institutions and financial resilience ready for crises that need to be dealt with at a national level rather than just a local level; bearing in mind that national government must bail out local government during crisis-induced short-term underfunding—at the right amount for each local authority (Travers, 2020). According to the Permanent Secretary for the Department for Business, Energy and Industrial Strategy the scenario planning for pandemics focussed on health and was between Health and the Cabinet Office rather than focussing on the economy and local government issues (Public Accounts Committee, 2020). Policymakers also need to understand that the local government response will be crucial to the national effort to recover from COVID-19 as the local nature of a crisis requires local solutions (Johnson, 2020). Practitioners have to consider how funding can be employed in such responses towards financial resilience, especially regarding the different revenue and capital implications and how this feeds through to the income and expenditure account, cash flow statement and balance sheet for the future. In terms of future research, it is important that financial sustainability of governments at a local and national level is considered for England, the UK and comparative international studies. Studies should also research how local governments have actually responded in terms of tactics used as the crisis unfolded and their relationships with various central government departments.

Notes
1. The IFS report was published alongside a spreadsheet dashboard (Ogden and Phillips, 2020b) that collates for each local authority in England a series of indicators of COVID-19 risks. It looks at the extent these risks vary, focussing on revenues and financial resilience. It also shows extra funding central government has made available to help local authorities address these risks in the current financial year.
3. The extra £0.5bn was funded through a 3rd tranche bringing the total emergency grant funding for local government to £3.7bn. The summer statement by Her Majesty’s Treasury (HMT) “Plan for Jobs” https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/898422/A_Plan_for_Jobs__Print_.pdf highlights a higher figure of £4.7bn approved funding to local government. However, it is important to note, the extra £1bn is not emergency grant funding but specific ring-fenced funding to be passed direct to providers and includes £600m additional funding to support infection control in care homes and £221m to support rough sleepers through the pandemic.

References


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