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Treasury Committee

The 2007 Comprehensive Spending Review

First Report of Session 2007–08

Report, together with formal minutes, oral and written evidence

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— External scrutiny of PSA/DSO data systems is not mentioned in CSR07 so it is unclear what, if anything, NAO is going to be asked to audit. If, for example, it was restricted to PSAs alone (the current policy) this would effectively take out three-quarters of the systems (or their equivalent) that are currently audited. NAO could use its Value for Money powers to audit DSOs, but this would clearly be unsatisfactory.

Efficiency and Value for Money

CSR07 confirms the government's intention to achieve £30bn in net cash terms annual savings by 2010–11.

This effectively more than doubles, in net cash terms, the efficiency target set by the Gershon Review for SR04.

CSR07 also published a very short report claiming that the Gershon targets have, in effect, been achieved. The report does not in any way address the serious criticisms of that data on which these claims are based made by the NAO and PAC. It says nothing about the lessons which can be drawn from the Gershon policy? It makes no analysis of the differential rates of success in the different work-streams of Gershon, or why some departments have exceeded their efficiency targets (notably the "not fit for purpose" Home Office)?

Indeed so short and flimsy is the report that we are reminded of the late Senator George Aiken who—as things went from bad to worse in Vietnam—advised President Johnson to "declare victory and leave."

This impression is compounded by the absence of the "Value for Money Delivery Plan" which is announced in CSR07 but not ıas promised—published alongside it. So at present we have a £30 billion target for savings—which is crucial to maintaining service levels in areas of public spending which are not keeping pace with growth in the economy, such as local government—entirely unsupported by evidence of how it is to be achieved. Given that CSR07 was three months (or one year and three months depending on your benchmark) later in appearing than originally planned this absence is remarkable.

Finally it is worth mentioning two further small details.

— HM Treasury insists on calling the new efficiency targets "value for money targets" in clear contradiction of their own agreed set of definitions (HM Treasury, 2001).

— HMT also insists that the new target is 3% but 3% of what is unclear. Three percent of Total Managed Expenditure (TME) in 2010–11, the time when Treasury claims £30 billion of net annual savings will be being made, is only around £20 billion (ie 3% of £678.3 billion).

16 October 2007

Reference

HM Treasury (2001) *Choosing the Right FABRIC—A Framework for Performance Information*, London, HM Treasury.

Memorandum by Professor David Heald, specialist adviser to the Committee

THE PRE-BUDGET REPORT 2007 AND COMPREHENSIVE SPENDING REVIEW: A CATALOGUE OF MISSED OPPORTUNITIES

Introduction

1. The Treasury has made great claims about the efficacy of the public expenditure framework established in 1998. Unsurprisingly it is difficult to establish whether the framework has made possible the maintenance of economic stability or whether the causation is the other way round. However, what can be confidently asserted is that the processes of CSR2007 have been unsatisfactory from the perspective of accountability to Parliament. Following the unexpected cancellation of SR2006, which would have reported in July 2006, the initial expectation was that CSR2007 would report in July 2007. A more satisfactory timing for the benefit of Parliamentary scrutiny would have been May 2007, allowing time for Select Committee hearings and reports before the summer recess. In the event, following the then Chief Secretary's evidence session on 30 January 2007 (Timms, 2007, Q10 on page Ev2), the CSR announcement seemed likely to be pushed back to October 2007. A written statement on 25 July announced the Chancellor of the Exchequer's intention to combine the PBR and CSR in a single statement in October (Darling 2007). It is widely believed that the actual date (9 October) was eventually chosen because of how that timing would fit into a late Autumn general election. This saga gives renewed weight to the Treasury Committee's recommendation that there should be a fixed timing or considerable advance notice of public expenditure announcements (Treasury Committee 2007a, page 64).

2. The merging of PBR2007 and CSR2007 into a combined statement had three implications. First, the cancellation of SR2006 meant that many departments received their CSR expenditure allocations much later than would otherwise have been the case. For example, 2008–09 would have been settled as the second year of SR2006 (announced July 2006) but became the first year of CSR2007 (announced October 2007). Second, it was predictable that the PBR2007 component of the 9 October statement would attract more attention than the CSR2007 component. Moreover, PBRs are not genuinely Pre-Budgets, in the draft as opposed to environmental sense of "green", but the first of an annual two-budget process. Third, Treasury (2007b para 2.45) stated that the "next Long-term public finance report will be published at a later date". This would normally be published alongside the PBR in late November/early December. However, the early PBR date and the ONS population projections being scheduled for 23 October mean that it could not be published at the same time. The Treasury should be asked for a commitment to publish the Long-term Public Finance Report before the end of 2007.

3. Notwithstanding these timetabling issues, the Treasury Committee (2007a) published on 25 June 2007 a constructive report on the CSR process. That report discussed the "early" settlements and extracted from the Treasury the figure of 30% as being settlements to date in advance of the main CSR announcement (para 11 on page 9). The Government's response (Treasury Committee 2007b) to that report was disappointing in substance, with the honourable exception of an informative response on international development expenditure statistics (response to recommendation 8).

4. The years since the Spending Review system was introduced in 1998 have seen a remarkable increase in public expenditure measured in real terms. Much faster has been the cynicism-inducing inflation of language in Pre-Budget, Budget and Spending Review documents. Just to illustrate this point, the on-line.pdf of the combined CSR/PBR (Treasury 2007b) has been searched for key words:

— "world class" (with or without hyphen) appears 32 times;

— "excellent" appears 14 times and "excellence" 12 times;

— "success" itself appears 38 times and, in total, 78 times when including instances where this forms part of a longer word;

— "failure" appears twice and five times as part of a longer word;

— "improve" appears 120 times and 221 times including when part of a longer word;

— "deteriorated" and "deterioriation" each appear twice; and

— "investment" appears 327 times, often being misused as a synonym for public expenditure, without regard to its proper economic meaning.

One does not need to believe that public services are falling apart, or that much of recent public expenditure growth has been wasted, to find this one-sided language grating. The spin merely fuels the media barrage projecting failure and gloom. Wry amusement at such spin is no longer a sensible reaction to a linguistic compulsion that contributes towards the distortion of public perceptions and debate.

The Fiscal Rules

5. This is not the place to rehearse general arguments about the desirability or otherwise of fiscal rules. However, the informed reader is likely to smile on each of the seven occasions when the PBR/CSR makes reference to "strict fiscal rules". There is a serious danger that the Government will discredit the fiscal rules because of the widespread belief that these are manipulable. A crucial question is this: can one think of circumstances other than extraordinary international calamity in which a continuing government would admit to missing its fiscal rules? After the way in which the fiscal rules have been presented, even a minor breach could do immense reputational damage whilst not being, *per se*, of economic significance. This context puts huge pressure on classification decisions, as well as on presentation, thereby endangering the transparency that is the first of the five principles of UK fiscal policy management (Treasury 1998).

6. The Treasury had been expected to clarify whether the economic cycle had ended in the first half of 2007. Table 1.1 on "Meeting the fiscal rules" (Treasury 2007b) covers the years 2006–07 to 2012–2013. The Box on page 15 implies that the "current" economic cycle is continuing. The key statement on the economic cycle is the following:

> Since Budget 2007, upward revisions to estimates of non-oil GVA growth in 2006, combined with estimates of 0.8% growth in each of the first two quarters of 2007, show the UK economy to have been growing at slightly above-trend rates for seven consecutive quarters through to mid-2007. **Evidence from the broad range of cyclical indicators monitored by the Treasury, the latest National Accounts data and the Treasury's trend output assumptions imply output passed through trend towards the end of 2006 and that a small positive output gap, of around a 1/4%, has opened up. However, it is too soon to assess whether or not the economic cycle has ended** (Treasury 2007b, para 2.19, emphasis added).

7. This can usefully be read alongside another statement:

- the fiscal rules are set over the economic cycle, allowing the automatic stabilisers to operate fully to help dampen economic cycles. This flexibility in fiscal policy, along with a context of low and stable borrowing and debt, has enabled fiscal policy to contribute to macroeconomic stability. The IMF noted the "shallowness of the UK growth slowdown during the last global downturn", which they attributed in part to fiscal responsiveness (Treasury 2007b, Box 2.1 on page 18).

8. An optimistic interpretation would be that the 1998 fiscal framework has been so successful that economic cycles are no longer sufficiently pronounced for their dating to be robust to data revisions. If that were to be the case, the implications for the golden rule need to be openly discussed. Moreover, the longer the duration of economic cycles the more unacceptable it becomes that current fiscal policy depends on surpluses/deficits of perhaps ten years ago. Paradoxically, the claimed success of the fiscal rules is one of the factors that currently undermines the credibility of the 1998 formulations.

9. The other threat to the fiscal rules is the widely held suspicion that the Government would manipulate data. This might be unfair but that is partly a general reflection of declining trust in government and partly a specific reaction to past fudges. There are obvious dangers in targets that cannot be missed without dire political repercussions.

10. It is worth drawing attention to the wording of two paragraphs that appear under the section heading of "Improving transparency and accountability":

> As announced in The Governance of Britain Green Paper, the Government intends to strengthen Parliament's ability to hold Ministers to account for public spending by ensuring that it reports to Parliament in a more consistent fashion, in line with the fiscal rules, on departmental budgets set in Spending Reviews, in annual Estimates and in resource accounts. The Government will be consulting Parliament and others with an interest on how best to take forward this reform, with the aim of introducing changes before the end of the CSR07 period.
>
> Budget 2007 announced that from 2008–09 the annual accounts of government departments and other public sector bodies would be prepared using International Financial Reporting Standards (IFRS), **adapted as necessary for the public sector.** The Government is developing an IFRS-based Financial Reporting Manual for the public sector and considering how best to manage the transition. **Where necessary, IFRS standards may be adapted for the public sector to support the Government's wider aim of improving transparency from the fiscal rules through budgets, Estimates and accounts** (Treasury 2007b, paras 3.26 and 3.27, emphasis added).

The portent of this drafting, particularly the words emphasised, is unclear. The Treasury, in collaboration with the Financial Reporting Advisory Board,[2] has produced a draft IFRS-based version of the Financial Reporting Manual (I-FreM), though some important issues, including accounting for Private Finance Initiative assets, are not yet resolved. The first phrase in bold is a restatement of the well-understood existing position. However, the full sentence in bold, taken together with the section heading of "Improving transparency and accountability", might imply that some departures from IFRS would be driven by the budgeting system. The main purpose of adopting best private sector practice, UK GAAP from 2001–02 and IFRS from 2008–09, is to provide an anchor for UK government accounting and thus to enhance the credibility of accounts. Deviations from IFRS should only arise when there are accounting-relevant differences between government and the private sector, otherwise the credibility advantages will be lost. It would be alarming if para 3.27 were intended to signal a Treasury policy that budgeting considerations would drive adaptations to IFRS, especially if that were alleged to promote "transparency and accountability".

11. Table 1.1 projects that public sector net debt will peak at 38.9% of GDP in 2010–11. This is uncomfortably close to the sustainable investment rule's 40% limit, if that ceiling is interpreted to apply to every fiscal year rather than over the economic cycle. IFRS implementation may result in some PFI assets currently off balance sheet to the public sector client coming onto the public sector balance sheet, thus affecting the borrowing and debt numbers. A reasonable expectation was that the Treasury would clarify in this combined PBR/CSR how the fiscal rules would apply over the next economic cycle. This could have been done even without there being a final determination as to whether the "current" economic cycle has indeed ended. Without this clarity, fears will arise that accounting decisions on PFI and other "boundary" matters will be improperly influenced by how they affect performance according to the fiscal rules. The logical step was to announce now that the ceiling on the sustainable investment rule would be modified to accommodate changes in accounting treatment. Much reputational damage has been done in the past by defective PFI accounting under the existing FreM, based on UK GAAP. There are dangers, to be avoided, that PFI accounting under I-FreM will be distorted by public expenditure scoring and borrowing considerations.

[2] Declaration of interest: the author of this memorandum is a member of the Financial Reporting Advisory Board, nominated as an independent economist by the Head of the Government Economic Service.

The CSR Decisions on Public Expenditure

12. The CSR spending envelope was determined, as by convention, in the 2007 Budget Report (Treasury 2007a). Because the announcement was couched in growth rates rather than in totals, the Treasury Committee (2007a, Table 1 on page 12) estimated Total Managed Expenditure in 2008–09 (£615 billion), 2009–10 (£644 billion) and 2010–11 (£675 billion). The corresponding figures published on 9 October were, respectively, £617.4 billion, £646.6 billion and £678.3 billion (Treasury 2007b, Table B11 on page 173). Reference is made (Treasury 2007b, page 1) to "an addition of £2 billion to the plans set at Budget 2007 in order to take forward vital capital investment in public services", which Table B4 (page 164) indicates relates only to 2010–11.

13. Annex D of Treasury (2007b) reports the CSR2007 departmental allocations. This consists of a perfunctory summary (page 199) and 19 sections (labelled D1 to D19) reporting the settlements of departmental groupings. What it lacks are clear summary tables that should have appeared before the detailed sections. Those summary tables should have shown, for each departmental grouping and with column totals:

(a) 2007–08 Estimated Outturn.

(b) CSR2007 2007–08 baselines, which will be different from (a) because they were necessarily established at an earlier date.

(c) CSR2007 additions/reductions in the CSR years that were made in early settlements announced before 9 October 2007.

(d) CSR2007 additions/reductions in the CSR years that were announced on 9 October 2007 in the combined PBR/CSR.

(e) Final CSR2007 allocations.

Without such data it is difficult to track what has been happening, not least as early settlements up to March 2007 were about 30% of the final DEL increase. In the absence of such explicit chain-linking of data, the Treasury runs the risk of being accused of multiple announcements of the same expenditure additions.

14. Table 1.3 (Treasury 2007b, page 12) shows £344.6 billion as Total DEL, and also provides 2007–08 baseline and plans for 2008–09, 2009–10 and 2010–11 for departmental groupings. The final column shows average annual real growth rates off a 2007–08 baseline; for example, NHS England is given as 4.0%. Note 1 to Table 1.3 notes that "baselines exclude one-off and time limited expenditure". A tabulation prepared for the Treasury Committee by the House of Commons Scrutiny Unit, using the data in Annex D, resulted in a baseline total of £341 billion, less than the £344.6 billion in Table 1.3. Post publication, the Treasury has explained to the Committee that note 5 to Table 1.3 had been accidentally omitted at printing. That note would have stated: "Figure for total DEL in 2007–08 represents latest estimate of spending. Departmental baselines will not sum to total because of one-off and time limited items". In fact, 2007–08 baseline components in Table 1.3 add to £341.4 billion, less than Total DEL that is shown as £344.6 billion. In contrast, 2010–11 components add to £397.0 billion, the difference from £396.9 billion Total DEL likely to be a rounding error. One-off and time-limited items may be legitimately excluded by the Treasury in negotiations with departments, but their omission in the published data is seriously misleading. The average annual real growth rates of departments affected by one-off and time-limited items will be overstated and are on a different basis from the 2.1% growth rate of Total DEL.

15. There are two possible reactions to the data problems described above. First, the Treasury is engaging in sleight of hand, relying on the fact that by the time the problems are discovered, the newsworthiness will have gone. Second, in part due to chronic timetabling, the problems reflect not only the inherent difficulty of getting tables correct and aligned but also a lack of understanding on the part of the Treasury as to what data are valued by Parliament and other users. I am personally inclined to believe the second explanation, though the Treasury's reputation for spinning numbers will provoke suspicion of the first.

A Catalogue of Missed Opportunities

16. There has been a catalogue of missed opportunities, accentuated by the disintegration of the normal Spending Review cycle. For example:

(a) No decision on whether the "current" economic cycle has ended or proposed modification of the 1998 fiscal rules.

(b) Inadequate clarity of the CSR settlement, as evidenced by the presentation of baselines, calculations of annual average growth rates and the absence of summarised tables showing the "stages" that generated the CSR2007 allocations.

(c) Little public debate about the trade-off between expenditure functions (eg defence versus education versus health) in the context of lower real growth rates, something which the cancellation of SR2006 might have made possible.

(d) Too much verbiage in the combined PBR/CSR document, without adequate attention to user needs for well-designed and comprehensive tabular information.

(e) Lack of evidence that the Treasury will engage with Parliament and other users in order to make budgetary numbers more transparent and comprehensible.

This is disappointing given that there is much to commend certain aspects of UK public expenditure documentation, such as End-Year Fiscal Report and Public Expenditure: Statistical Analyses, about which the Treasury has regularly engaged in dialogue with users. It is probably not accidental that these beacons of good practice are retrospective in coverage and not forward-looking.

17. There are two issues that should seriously worry Parliament:

(a) The fiscal deficit being so high given the record of 60 consecutive quarters of economic growth. There should now be the cushion of a large safety margin on deficits and debt, in case of seriously adverse international or financial markets developments.

(b) The political salience of the fiscal rules having risen to the point when the credibility of a government would be at stake if these rules were broken. The worry is that there would be enormous pressure to distort or obfuscate the fiscal position were the rules likely to be broken, except in the circumstances of an internationally-generated calamity or when a new government wished to rubbish its fiscal inheritance.

October 2007

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Memorandum by Barnardo's

Introduction

1. Barnardo's works directly with more than 110,000 children, young people and their families in over 350 services across the UK. These services are located in some of the most disadvantaged neighbourhoods where child poverty and social exclusion are common features. We work with children affected by today's most urgent issues: poverty, homelessness, disability and abuse. Our projects work with children aged 0 to 18 (or 24 in the case of young care leavers).

2. Barnardo's welcomes this opportunity to submit evidence to the select committee's enquiry into the 2007 pre-budget report. As an organisation we welcomed the Government's 1999 pledge to end child poverty in a generation. We believe this to be a bold, exciting and potentially far-reaching social goal which will benefit many of the most disadvantaged children in the UK. However, despite initial progress we are concerned that progress has slowed and even reversed, with 100,000 more children living in poverty before housing costs in 2005–06 compared to 2004–05. We believe the pre-budget report 2007 offered the Government an important opportunity to bring forward additional proposals to put the government back on track in achieving its target.

Executive Summary

3. Barnardo's is extremely disappointed with the measures contained in the pre-budget report aimed at tackling child poverty, and believe these are woefully inadequate if we are to achieve the goal of halving child poverty by 2010. In particular we believe:

— proposed increases in tax credits are less than 10% of the level of investment we believe is required if the Government is to meet the 2010 target; and