

House of Commons
Treasury Committee

**THE 2002 PRE-BUDGET
REPORT**

Second Report of Session 2002–03

*Report, together with
Proceedings of the Committee,
Minutes of Evidence and Appendices*

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APPENDIX 8

Memorandum submitted by Professor David Heald, specialist adviser to the Committee

PARLIAMENT'S INFORMATION NEEDS ON PUBLIC EXPENDITURE

1. Public expenditure is currently growing very rapidly; the *End of Year Fiscal Report* (EYFR 2002) (Treasury, 2002d, para 4.56) reports overall growth as 7% in nominal terms between 2000-01 and 2001-02. The cumulative impacts of Spending Review 2000 (SR2000) and Spending Review 2002 (SR2002) mean that there is currently an unprecedented rate of planned public expenditure growth.² The successful translation of higher public expenditure inputs into service delivery outputs is clearly one of the most demanding challenges facing the Government.

2. From the perspective of Parliament, these are difficult times in which to monitor public expenditure trends. Whenever there is a change of public expenditure control system, there are inevitable discontinuities in the data. These have occurred as a result of the 1998 introduction of a control system based on Total Managed Expenditure (TME), Departmental Expenditure Limit (DEL) and Annually Managed Expenditure (AME). They have been compounded by the staged implementation of Resource Accounting and Budgeting (RAB), with SR2000 being conducted on a partial RAB basis and SR2002 being conducted on a full RAB basis. Cumulatively, it has become difficult to track public expenditure on a consistent basis over a number of years.³

3. This combination of rapid expenditure growth with low data comparability over time makes it appropriate for Parliament to rethink its information requirements on public expenditure. The extent and depth of the above changes, together with the inevitable complexity of public expenditure definitions and scoring, mean that Parliament must rely upon the Treasury to supply public expenditure data in a form that supports its scrutiny role. In recent years the Treasury has emphasised fiscal transparency as a key dimension of its fiscal framework: the annual *Public Expenditure: Statistical Analyses* (PESA) is a valuable document, which contributes towards this objective. Unfortunately, the usefulness of *PESA 2002-03* (Treasury, 2002a) is impaired by having been published in April 2002, before the completion of SR2002. Moreover, key tables in *PESA 2002-03* are not on a consistent basis across years, being expressed in terms of cash or resource, according to which basis the Treasury judges to be the most reliable in that particular year. Given the present public expenditure timetable, there is a strong argument for there being an Autumn Supplement to PESA, published at the time of the Pre-budget Report.

4. A welcome innovation in Pre-budget 2002 is the publication, of the EYFR. This document fills an obvious gap in the provision of outturn data, in that Parliament has previously had to wait until the following year's PESA, because the July Public Expenditure Outturn White Paper is a document of limited scope and is published too early to provide reliable outturn data for the year just finished. For the first time, Parliament has much earlier information on a comprehensive basis of estimated outturns for the most recent completed financial year and outturns on a comparable basis for the preceding financial year. Hopefully, the EYFR might in time develop into a document that produces comparable data for a longer run of years than two. EYFR 2002 (Treasury, 2002d, para 4.4) contains a helpful explanation of the present timetable for establishing final data for a particular financial year. Once the complex process of transition to RAB has been completed and experience gained, a shortening of these timescales would be desirable and should be feasible.

5. A reasonable speculation is that the present control system of DEL and AME will be subjected in the near future to much tougher testing than it has experienced since its introduction in 1998. For example, the economic conditions that have eased the pressure on certain kinds of AME have created space within TME for growth in DEL; this will probably not recur. Accordingly, it would be extremely helpful if the Treasury were to provide for the Committee:

- a time series for TME, DEL and AME at departmental level, as far as possible on Pre-budget 2002 definitions and measurement conventions, accompanied by an explanation of any data discontinuities; and
- a series of tables which establish the linkage between successively published figures for TME, DEL and AME, showing separately the effects of each of the occasions (eg Spending Reviews, Pre-budgets and Budgets) on which changes have been made, with the composition of those changes analysed into the categories used in PESA.⁴

So many changes have been going on that a user is unable to extract this kind of information from published sources. Moreover, there is a tendency for Treasury documents to show changes in relation to the previous published document, quite often six months rather than a year before the current document, thereby making it difficult to see a pattern of development over time. One of the issues of interest is the extent to which

² The magnitude of the changes is well illustrated by the following Treasury figures, provided after SR2002 but before Pre-budget 2002, on real terms changes in DEL: -2.2% (1995-96); -1.0% (1996-97); -2.3% (1997-98); +0.4% (1998-99); +2.1% (1999-2000); +4.3% (2000-01); +5.0% (2001-02); +5.4% (2002-03); +7.2% (2003-04); +3.6% (2004-05); and +5.0% (2005-06).

³ This is not to be taken as a criticism of these changes, the RAB component of which I have consistently supported.

⁴ Tables of differences in *PESA 2002-03* (Treasury, 2002a) analyse changes into: machinery of government; transfers and classification; and reserve allocation and other policy changes.

there have been transfers of provision from DEL to AME during these early years of operation of the TME system.

6. Thus far under the TME system, an unexpected problem has been the level of underspending against public expenditure plans. Several factors seem to have been important: the need to become familiar with a new control framework; the availability of End-Year Flexibility (EYF); and the practical problems associated with managing a step increase in the rate of growth of public spending. EYFR 2002 (Treasury, 2002d, para 4.21) makes reference to the "stock of EYF" reported in the July Public Expenditure Outturn White Paper (Treasury, 2002b, Table 6).

7. The critical issue for the future is the extent to which the large increases in both nominal and real terms public expenditure translate into higher outputs. It is well-known that the measurement of the quantity and quality of public services is a difficult issue, and that proxy measures of performance may divert attention from non-measured dimensions of performance. Notwithstanding that caveat, the task for the Treasury and departments is to ensure that an excessive proportion of this higher expenditure is not absorbed into cost increases, particularly into public sector wages. Parliament should be looking to the Treasury and departments to provide the best possible information on what is happening to the various indicators of service levels and outputs. A strong Relative Price Effect (ie public sector costs go up faster than the GDP deflator) would imperil the achievement of the Government's public expenditure objectives.

8. At several points in the Pre-budget Report (Treasury, 2002c) and associated documents, there is reference to the Treasury's assumptions having been audited by the National Audit Office (NAO).⁵ The implication is drawn that this audit process provides assurance that the assumptions that enter the Treasury forecasts should be regarded as "cautious". Moreover, "assumptions audited by the NAO" appears as one of four categories into which Budget 2000 forecasting differences for 2000-01 and 2001-02 public expenditure are analysed in Tables 4.2-4.5 of EYFR 2002 (Treasury, 2002d). The other categories are: "economic determinants"; "fiscal forecasting differences"; and "other factors". The NAO is statutorily entitled to review only those conventions and assumptions submitted to it by the Treasury (Finance Act 1998, s 156(5)); the only such request relating to the April 2002 Budget was to examine the proposed quarter-point percentage increase in the underlying trend growth rate used in making the fiscal projections, as no previously examined assumptions were to be altered. Given the emphasis which the Treasury places upon the NAO's role in auditing assumptions, it would be useful to ask Treasury officials to carefully delineate the division of responsibility between the NAO and itself.

9. The clear message conveyed by the Pre-budget Report (Treasury, 2002c) and associated documents is that the United Kingdom's public finances are sustainable, and considerably more healthy than those of certain other European countries. One dimension relates to the level of public debt. However, concerns have been expressed about the way in which certain UK transactions are recorded; the merits of structuring those transactions in particular ways are not the issue under consideration here. Two examples illustrate these concerns. If projects are funded through the Private Finance Initiative (PFI) and are judged to be off-balance sheet to the public sector, the associated borrowings are not classified as public debt. Given that this form of public procurement is now quantitatively significant, it is important for public debate that the size and nature of future PFI commitments is fully and regularly documented. The second example relates to the treatment of particular organisations as outside the public sector. The most cited contemporary example refers to Network Rail, which the Office for National Statistics (ONS) has determined should be classified to the private sector in the national accounts (following European System of Accounts 1995). In contrast, and operating on the basis of financial accounting principles, the Comptroller and Auditor General has stated that Network Rail should be on the balance sheet of the Strategic Rail Authority. Irrespective of the merits of these decisions, it is important that Parliament is kept fully informed of the size of these items, so that the numbers on public debt can be interpreted in the light of these additional disclosures.

5 December 2002

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⁵ See, for example, Box 1.1 on p. 2 of EYFR 2002.