

David Heald: Improving the Quality of Public Expenditure

INTRODUCTION

The period 1998-2010 witnessed a remarkable growth in the quantity of public expenditure. There are measurement and data problems in specifying the actual growth, but the UK macroeconomic aggregate (Total Managed Expenditure) grew from 1999-2000 to 2007-08 by 69.9% in nominal terms and by 39.6% in real terms (Treasury 2009, p. 65). This planned surge, which increased the TME/GDP ratio from 36.3% to 41.0% before the global financial recession, was based on optimistic assumptions about the sustainable performance of the UK economy. In contrast, regardless of the extent of the coming fiscal consolidation, the decade of the 2010s will witness a heightened emphasis on the quality of public expenditure. This focus on quality, in terms of both efficiency and effectiveness, will permeate debates in the Scottish, UK and global arenas (IMF 2009). An important vulnerability is that few current decision-makers and top managers have personal experience of the exigencies of managing public expenditure in 'hard times' (Hood and Wright 1981).

Beyond its rhetorical appeal, the 'quality of public expenditure' is problematical. Judgements of quality must relate to the contribution of expenditure to public policy objectives that are contestable and contested. Accusations of 'waste' (ie deficient quality) often reflect disputes about policy objectives, rather than just about the delivery mechanisms for specified objectives. This is unsurprising when the policy domains raise fundamental issues: eg the role of foreign military intervention; the extent and coverage of public health care; and the extent to which governments modify the market-determined allocation of resources and life chances.

With quantity under serious threat, increasing the conversion rate from inputs to outputs to outcomes must be at the centre of efforts to improve the quality of public expenditure. Yet performance assessment mechanisms have complex effects on the delivery systems they measure. Notwithstanding the way the UK is perceived internationally to be a pioneer in Value-for-Money (VFM) audit, the full potential has not been reaped. VFM auditing is implicated in the social phenomena (eg the separation of watching from doing) that Michael Power (1999) calls the 'audit society' and Christopher Hood (Hood et al 1999) calls 'regulation inside government'.

RESEARCH OBJECTIVES

The impending fiscal consolidation presents a remarkable opportunity for the applicant not only to study the effects on the quality of public expenditure but also to contribute to improving quality. This would build upon his track record as an academic researcher but also on his extensive experience as participant observer (eg specialist adviser to House of Commons Select Committees; member (2004-09) of the Financial Reporting Advisory Board to HM Treasury; specialist adviser to The Public Accounts Commission (2002-08); and member of the Audit Commission's Technical Advisory Group).

There are three research objectives:

- (1) To conceptualise and to map the divergent yet interacting worlds of public expenditure and their effects upon its actual and perceived quality.** These consist of: the policy world (eg Spending Reviews conducted by ministers and civil servants); the world of delivery agencies (eg departments, 'quangos', NHS bodies, local authorities); the regulatory world (eg audit offices, specialist inspection agencies, some with precise remits about quality); and the world of media and political debate. Confusing messages have emerged from their interaction during the period of unprecedented peacetime public expenditure expansion: formal evaluation systems generally signal improvements and providers aim for world-class public services (Audit Commission 2005); the Office for National Statistics' 'Atkinson' measures indicate declining relative public sector productivity (eg Wild et al 2009); and the media portrayal of widespread public-service failure influences public attitudes towards paying the taxes that fund public expenditure. These mixed messages are damaging, not least because they generate a defensive posture by government and public authorities and breed resistance to effective transparency. Harder organisational shells have developed; 'corporate' projection stifles voices closer to the realities of service delivery and exposes those charged with governance to greater risks of unexpected failures (Heald 2006).
- (2) To understand and synthesise existing evidence on public expenditure quality, including those which have a cross-UK or international dimension.** Whereas comparability is often thwarted by structural differences and by data limitations, there is unquestionably scope for learning through comparisons provided that unreflective imitation is resisted. The project will concentrate on spending functions, such as education, health and justice, which are devolved within the United Kingdom. There has been a 'natural experiment' with policy in the Devolved Administrations diverging from that in England, in particular with the latter's emphasis on targets and market-type mechanisms (Keating 2005). A Nuffield Trust study of the NHS (Connolly et al 2010) rated England's efficiency and productivity as highest, though the criteria and evidence base have been disputed. These matters will acquire high policy salience, not least because the House of Lords Committee on the Barnett Formula has demanded a UK-wide needs assessment, without recognising the complexities of that task within the UK context. These developments point to the need for a more robust conceptualisation of what is meant by concepts such as VFM, as many so-called studies concentrate primarily on processes rather than on outcomes (Heald 2003, OECD 2008).

(3) On the basis of the results drawn from work on (1) and (2), to develop proposals on how public sector organisations can react to a harsher spending climate in ways that limit the damage to output and outcomes. The following appear to be promising avenues of investigation:

- The multiple objectives that underlie performance measurement systems may have dysfunctional effects: eg driving up provider performance by frequently “raising the bar” while creating an unjustified impression of failure. Those responsible for systems of audit, inspection and regulation have to be alert to the perverse as well as beneficial effects of their assessments on provider performance and on how league tables are interpreted in the divergent worlds of public expenditure. There are complex trade-offs between performance stimulation and inducing defensive behaviour such as membership of the ‘herd’ (eg conforming and not innovating).
- A lesson of the past decade is that the challenge function weakens when there is strong growth in public expenditure. In the context of ‘more for everyone’, there is less incentive for policy actors to scrutinise the programmes of others. For example, the Treasury Committee of the House of Commons has been less active on public expenditure during the plentiful 2000s than it was during the resource-constrained 1990s. This may also hold at different levels of government (eg Devolved Administrations and in local government) and within delivery agencies (eg NHS bodies and educational institutions). Fiscal retrenchment might facilitate tougher challenge and more effective scrutiny, both externally (eg by select committees) and internally (eg by Non-Executive Directors and audit committees).
- In the years of plenty there has been toleration of structural inadequacies (eg in local government), in part because reorganisations divert top management time, are expensive in front-loaded resources, and predictably generate damaging publicity. Such considerations will carry less sway in future but restructuring brings dangers of over-complicating public service delivery and risks combining units with divergent missions and accountabilities. The ‘shared services’ agenda offers potential savings, but only if effectively implemented in appropriate circumstances.
- Excess capacity (eg in primary schools) has been tolerated during the years of plenty. The removal of genuine excess capacity does not damage output quantity or quality. However, over and above the political difficulties usually encountered by facility rationalisation schemes, there are substantive obstacles. Hospital-associated infection has shown that too high utilisation of notional capacity can be dangerous, meaning that there is a difference between gross and net capacity. The extensive use of Private Finance Initiative (PFI) contracts complicates decisions about reconfiguration of facilities because of 30-year contractual commitments to take-or-pay. In some services considerations of access (eg time and travel costs) may constrain rationalisation when clients are ‘captive’ to local facilities (eg schools and out-patients) whereas in some cases (eg universities) there may be a high level of substitutability of supply. Moreover, ‘choice’ agendas require that there be some spare capacity. These considerations influence whether a declared policy of not bailing-out failing providers is viable.
- Certain problems confronting delivery organisations have become more difficult (and hence more expensive to resolve) through time. The National Equality Panel (Hills 2010, p. 9) has documented the higher levels of income inequality that differentiate the United Kingdom from northern Europe, particularly the Scandinavian countries. The Report also demonstrates that impediments to social mobility are quite resistant to policy intervention. These findings are relevant to the formula funding of particular delivery organisations and also to the assessment of their performance against key national objectives when they face markedly different social environments and operating conditions.

RESEARCH METHODOLOGY

Five methods will be used in the conduct of this research, with approximate time weights attached:

- (1) ***Reading the academic and policy literature***, which is voluminous in some areas but patchy in others, drawing out valuable ideas and firming up hypotheses that will inform the interviews and case studies. Previous experience of expenditure cuts suggests a range of organisational responses: eg increasing efficiency through cost reduction; strategic re-positioning; controlling demand; protecting the ‘core’; shedding functions; re-centralising control; cutting capital; proposing ‘sore thumb’ service withdrawals; passing costs to the future; and gaming accounting/statistical ‘boundaries’. **(20%)**
- (2) ***Undertaking systematic documentary analysis of primary sources***, which have multiplied in response to technological innovation and trends to pro-active disclosure, partly in response to the *Freedom of Information Act 2000*. The difficulty is no longer one of access but of devising investigatory strategies that avoid the researcher becoming overwhelmed. The huge volume of VFM studies (60 per annum by the National Audit Office alone) will be sampled to derive methodological and substantive lessons. **(30%)**
- (3) ***Conducting elite interviews*** with policy-makers, managers and financial management specialists in key organisations, such as: international surveillance organisations (eg OECD and the European Commission); government departments (eg Treasury, spending departments, and Office for National Statistics);

regulatory and assessment bodies (eg public audit bodies such as National Audit Office, Audit Commission and Audit Scotland; and private sector actors with regulatory roles, such as audit firms). The agenda for these interviews will be determined by the findings at (1) and (2). **(15%)**

(4) *Surveying relevant actors in front-line delivery agencies*, using a web-based questionnaire to generate evidence on how organisations seek to protect quality when resource-constrained. The questions will be framed in relation to the hypotheses emerging from methods (1) to (3). The large number of similar organisations means that views can be anonymised, without fear of accidental identification. **(10%)**

(5) *Conducting desk-based case studies* on emergent issues such as: the response of delivery organisations to being labelled top performers or failing; options analysis; capacity-reduction in PFI and non-PFI contexts; and variations in operating conditions that affect funding needs and performance assessment. **(25%)**

OUTPUTS, OUTCOMES AND DISSEMINATION

The planned outputs of the research are:

- Evidence on how the four postulated worlds interact and affect actual and perceived expenditure quality
- Evidence about the beneficial and dysfunctional effects on performance and quality of the conjunction of pressures to be ‘like a business’ (Gray 1998) while being made subject to prescriptive external systems of surveillance, performance assessment and quality appraisal
- Evidence about how public sector organisations cope with reductions in input growth but increased demand, more complex supply chains and greater ‘client’ heterogeneity
- Proposals on how the generation of, and choice between, spending options might be more effectively structured and on how cost reduction might improve or protect expenditure quality

The project should therefore make a significant contribution to the Scottish Government’s National Outcomes, particularly “Our public services are high quality, continually improving, efficient and responsive to local people’s needs”. The most relevant national indicators are “Improve public sector efficiency through the generation of 2% cash releasing efficiency savings per annum” and “Improve people’s perception of the quality of public services delivered”. In addition, it should be stressed that higher public expenditure quality is also supportive of the other 14 National Outcomes.

The project will lead to a number of publications in top-level refereed journals. Other channels of dissemination will deliver short- and medium-term impacts, not least because of publication lags with refereed journals. These would include: Working Papers from the project; written and/or oral evidence presented to inquiries (recent examples are the Treasury Committee, the Lords Committees on the Barnett Formula and on the PFI, and the Calman and Holtham Commissions); and responses to public consultations (eg the International Public Sector Accounting Standards Board on service concession accounting). Earlier research has been used by the IMF, OECD, the Scottish Government and HM Treasury. There will be dissemination through the media (as recently in the *Economist*, *File on Four*, *Financial Times* and *Newsnight Scotland*).

PROJECT RESOURCING

This application is for bought-out time for research in academic year 2010-11. The nature of the work means that it could not be delegated to a research assistant and I could not undertake this ambitious project while fulfilling my normal university responsibilities. I have applied for the £2,000 maximum allowance for research expenses, for travel within the United Kingdom and to Brussels (European Commission) and Paris (OECD).

REFERENCES

- Audit Commission (2005) *World Class Financial Management: A Discussion Paper*, Audit Commission.
- Connolly, S., G. Bevan and N. Mays (2010) *Funding and Performance of Healthcare Systems in the Four Countries of the UK Before and After Devolution*, Nuffield Trust.
- Gray, A. (1998) *Business-like but Not like a Business: The Challenge for Public Management*, CIPFA.
- Heald, D. (2003) ‘Value for money tests and accounting treatment in PFI schemes’, *Accounting, Auditing and Accountability Journal*, Vol. 16(3), pp. 342-71.
- Heald, D. (2006) ‘Transparency as an instrumental value’, in C. Hood and D.A. Heald (eds) *Transparency: The Key to Better Governance?*, Proceedings of the British Academy 135, Oxford University Press, pp. 59-73.
- Hills, J. (chair) (2010) *An Anatomy of Social Inequality in the UK – Summary: Report of the National Equality Panel*, Stationery Office.
- Hood, C. and M. Wright (1981) *Big Government in Hard Times*, Oxford, Martin Robertson.
- Hood, C., C. Scott, O. James, G. Jones and T. Travers (1999) *Regulation inside Government*, Oxford University Press.
- IMF (2009) *United Kingdom: Staff Report for the 2009 Article IV Consultation*, International Monetary Fund.
- Keating, M. (2005) *The Government of Scotland: Public Policy Making after Devolution*, Edinburgh University Press.
- Power, M. (1999) *The Audit Society: Rituals of Verification*, Oxford University Press.
- OECD (2008) *Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money*, OECD.
- Treasury (2009) *Public Expenditure: Statistical Analyses 2009*, Cm 7630, Stationery Office.
- Wild, R., F. Munro and D. Ayoubkhani (2009) *Public Service Output, Input and Productivity: Education*, ONS.