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Controlling Public Expenditure

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Introduction

Control is a word carrying a powerful resonance; it clearly sounds preferable that something is 'under control' rather than 'out of control'. Evaluation of a particular control system can be hampered by ambiguity as to what that control system is designed to achieve and by the fact that objectives themselves shift as a result of experience. True political objectives are not necessarily rendered explicit (Hood, 1994): for example, it is genuinely difficult to determine whether the motivations for the adoption of public management reforms are to sustain the public sector by rendering it more efficient and legitimate or to erode political support for its services.

It is a central argument of this chapter that those more philosophically well-disposed to public expenditure need to pay the greatest attention to the efficacy of control systems. Not least, any future government without a fashionable and/or accumulated distaste for the public sector will confront intense pressures for higher expenditure. We begin by looking at the overall Conservative record on control, in the two different senses in which the word is used. Next, we look in some detail at how the reforms in the public sector have affected the nature of public expenditure control. We then look more widely at the lessons to be drawn from the last 17 years, before looking forward to prospective developments in this area.

The Conservative record

There are two distinct senses in which the word control is regularly applied in public expenditure contexts. First, control is used in the sense of 'conformity to plan', meaning that out-turns are 'in line with' the expenditure which has previously been planned by the relevant political decision makers. Such a characteristic is essential whatever views are held on the appropriate level of the General Government Expenditure/Gross Domestic Product (GGE/GDP) ratio. Second, control is often used as a euphemism for containment or reduction of spending. On this interpretation, evidence would be sought that public expenditure had fallen, in cash or in real terms, or perhaps relative to GGE or to the experience of other OECD countries.

Thain and Wright (1995) displayed evident pleasure in showing how the Conservative Government after 1979 failed to deliver on its successive public expenditure objectives (absolute reductions; reductions in real terms; and reductions as a proportion of GDP). However, the picture looks different if UK developments over this period are compared with those in other European Union (EU) and OECD countries. Figure 9.1 plots general government outlays as a percentage of GDP, separately for: the United Kingdom; the EU (with various memberships); and the OECD. In 1979, the United Kingdom starts well below all three EU averages and further detaches itself, briefly falling below the OECD weighted average (in which the United States and Japan have a combined weight of 58.66 per cent) in 1988 and 1989. Particularly striking is that the relative fall in the UK ratio, which took place during the Lawson boom, has subsequently been sustained. From 1990, the five series track each other very closely.

The United Kingdom is probably the most deregulated economy in the EU. This means that public functions can less readily be executed through regulatory instruments that do not affect the budget. In theory, a more deregulated economy may have either a higher GGE/GDP ratio (public functions can only be achieved through public expenditure) *or* a lower ratio (there is a more sceptical view of which public functions are desirable).

Some have argued that public expenditure should be curbed much more drastically than has so far been the case. Clarke (1995) and Patten (1995) have set 40 per cent as the desirable GGE/GDP ratio while Skidelsky (1995, p. 190) and Duncan and Hobson (1995, p. 435) outbid them at 30 per cent and 15–20 per cent respectively. Part of this agenda involves greater self-provision of public services, perhaps encouraged by tax incentives, while another part explicitly involves mandated private expenditures such as compulsory health insurance and pension provision. It is possible to take the view that the United Kingdom is pioneering the way to public expenditure retrenchment, just as it

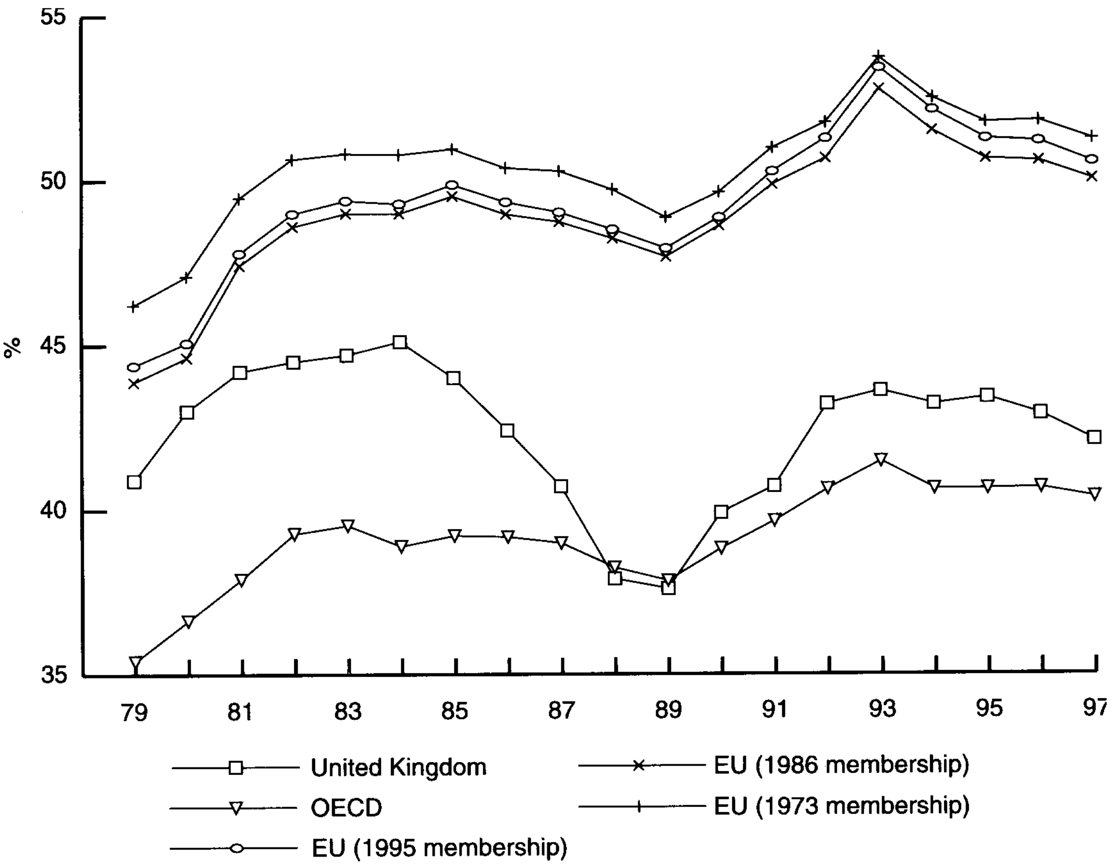

Figure 9.1. Comparative experience: general government outlays/GDP ratios (%).
Source: OECD (1996).
Notes: OECD and EU figures are weighted averages and exclude the UK. Data is missing for Luxembourg in the EU figures due to data non-availability. The following countries are excluded from the OECD figures for the same reasons: Iceland, Mexico, New Zealand and Turkey.

In order to calculate weighted figures for the EU and OECD, the GDP weights (based on 1991 Purchasing Power Parities, with the benchmark year being 1990) constructed by OECD (1996, p. 2) have been used.

did earlier on privatization. On this view, detachment from the EU constitutes an enormous policy success, some of the credit for which should be attributed to the control system. Indeed a somewhat smug attitude to the current fiscal problems of France and Germany can readily be detected.

Figure 9.2 provides insights into trends in the composition of UK public expenditure between 1978–79 and 1995–96 (estimated out-turn). Summary graphics have obvious limitations: interpretation must proceed on the understanding that client group sizes may have changed markedly and that relative price effects may differ across spending areas. This plot of indexes of real expenditure by function (cash expenditure adjusted to 1994–95 prices by the adjusted GDP deflator, then converted to an index with 1978–79=100) shows just how pronounced compositional changes have been over 17 years. The 'winning' programmes are undoubtedly law, order and protective services (+109 per cent), social security (+68 per cent) and health (+69 per cent). These can be compared

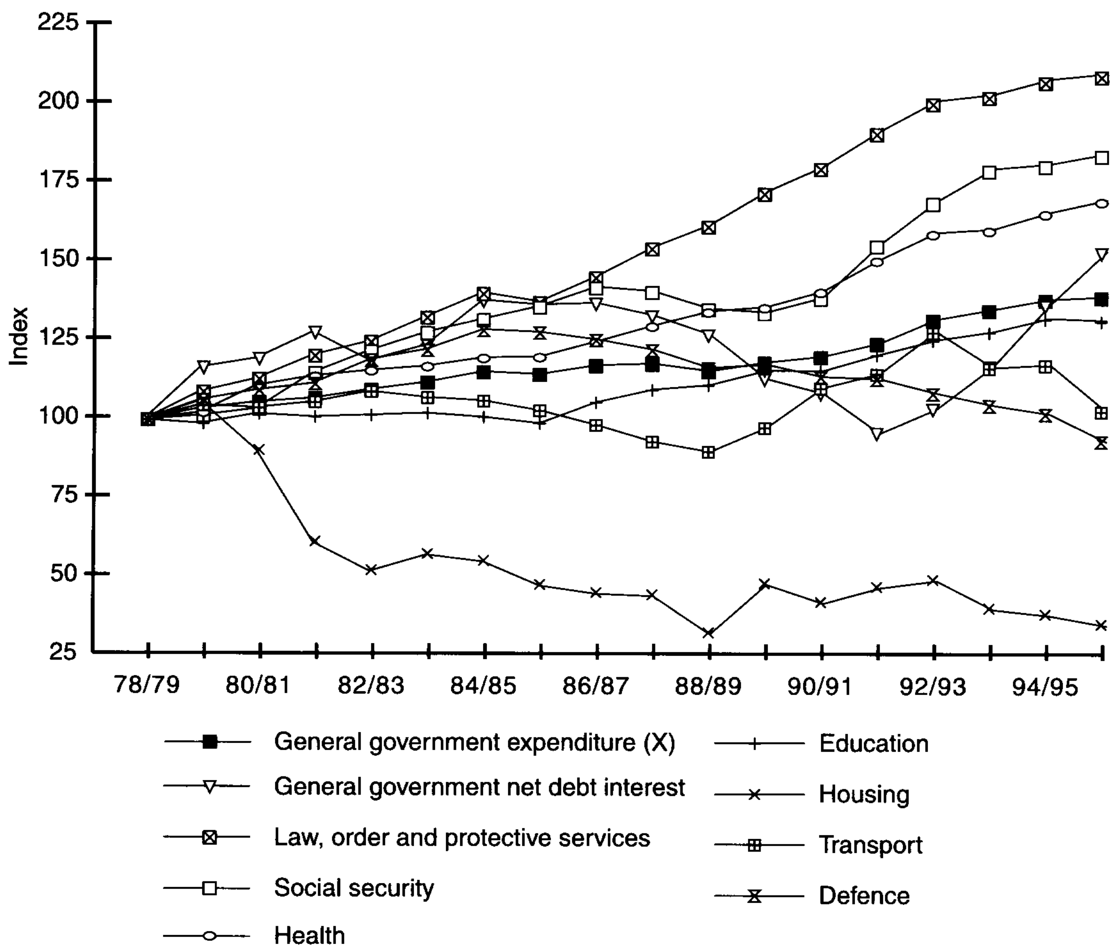

Figure 9.2. Real expenditure by function (1994–95 prices, indexed 1978–79 = 100). *Source*: Treasury (1996a), Table 1.3. The data for 1979–80 and 1980–81 were provided by the Treasury.

with the 39 per cent increase in GGE(X).[1] The 'losing' programmes shown in Figure 9.2 are housing (−65 per cent) and defence (−7 per cent). The profiles are also interesting. Defence peaked in 1984–85 (+28 per cent) before falling sharply, while education remained flat up to 1985–86 (−1 per cent) from which point it has grown quite steadily (+31 per cent by 1995–96). Transport shows an anti-cyclical path around an unchanged index. The strongly rising trend of general government net debt interest from 1991–92 carries a warning for the future. Further discussion of such trends has to take place at a more disaggregated level, for example, distinguishing between age groups within the education programme and with proper recognition of substitution effects (for example, housing's loss has been partially offset by the growth of housing benefit expenditure within social security). An obviously relevant question is whether or not such changes have reflected conscious political choices.

Figure 9.3 represents changes in functional composition in a different way, analysing programme contributions to changes in real GGE over the period 1978–79 to 1995–96 (estimated out-turn). This has the advantage over Figure

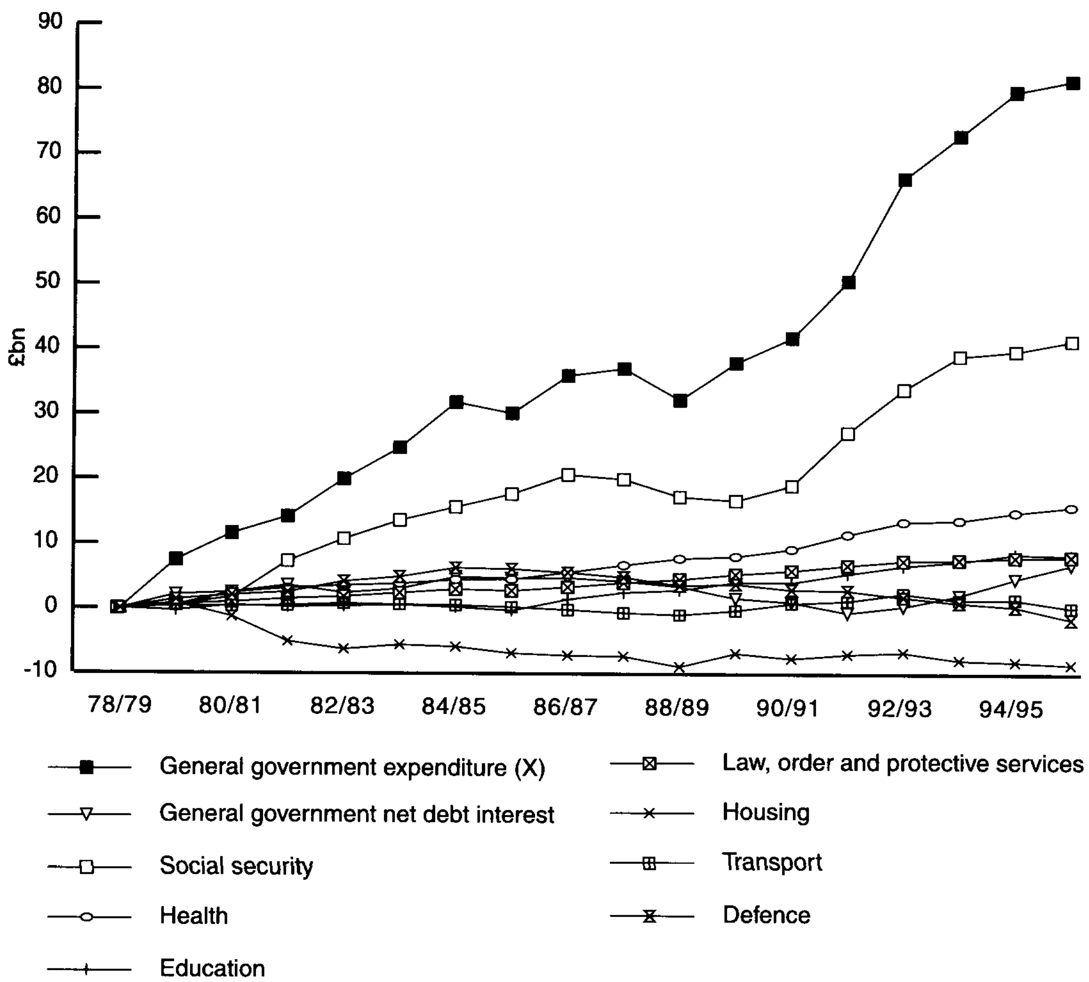

Figure 9.3. Real increase in programme expenditure since 1978–79 (change in expenditure £bn, 1994–95 prices).
Source: Treasury (1996a), Table 1.3. The data for 1979–80 and 1980–81 were provided by the Treasury.

9.2 of incorporating information about the relative size of different programmes. In terms of such contributions, social security has been a dominant force. Out of gross increases to real GGE totalling £96 billion between 1978–79 and 1995–96, social security accounted for 43.2 per cent.

Control in the 'new' public sector

Control is essentially an executive process, in which Parliament has little role. Within a parliamentary system such as that of the United Kingdom, the role of Parliament is best understood in terms of authorization. For example, the Treasury mechanically converts the first year of the Public Expenditure Survey plans into the necessary form for Estimates. These have traditionally differed in both coverage and measurement convention, though the introduction of the matrix-style simplified Estimates in 1996–97 (Treasury and Civil Service Committee, 1995; Treasury, 1996b) was intended to bring about some convergence. The Supply procedure has huge constitutional symbolism, being described by Elliott (1985) as the 'dignified element', in contrast to the Survey as the executive process (the 'efficient element'). In practice, however, Members of Parliament take remarkably little interest in the formal financial procedures of the House of Commons, and the limited discussion of public expenditure which does occur is conducted *ex ante* through the Treasury Committee and the departmental select committees and *ex post* by the Public Accounts Committee. This reality is unlikely to be changed either by procedural reforms or by injunctions from outsiders that Parliament should take these matters more seriously. This context, in which control is seen as an executive matter, has important implications for the flow of information about government finances into the public domain.

Those parts of the public sector which have not been privatized since 1979 have seen dramatic changes in organizational shape, external relationships and managerial culture (Flynn, 1993; Lovell, 1994; Russell and Sherer, 1994; Walsh, 1995; and Farnham and Horton, 1996). Cumulatively, the influence of the New Public Management (NPM) (Hood, 1991) has been pervasive.

This transformation is exceptionally difficult to characterize, particularly because of the tension between decentralization (devolving budgets and decision making) and centralization (establishing clearer lines of vertical accountability, often disrupting older collegiate or consensus models). Despite the rhetoric of decentralization, there have been successive waves of central initiatives. These include the Financial Management Initiative, the creation of agencies, market testing, management plans and running costs controls, the Private Finance Initiative (PFI) and Resource Accounting and Budgeting (RAB) (Treasury, 1995). This complex brew generates its own ambiguity about ultimate management responsibility and about where the line between political and managerial decision making lies. The greater recourse which is now made by ministers to the claim that 'operational matters' are for managers and not for them has led many outside government to suspect that this formula is being developed into a potent instrument for blame deflection.

The architects of NPM reforms believed that restructuring the public sector with smaller, more focused organizations, relating to each other via formula funding and quasi-markets, would deliver efficiency savings. There would be more output from the same input or, alternatively, the same output for less input. Although the pace has varied, the direction of reform in most OECD countries is similar (OECD, 1993; 1995a, b). Two questions therefore arise: whether the NPM reform programme has genuinely delivered efficiency savings; and what effect it has had on the controllability of public expenditure. The first question is discussed in Chapter 12 by Peter Jackson. The second is addressed here.

Is control now easier or harder?

Two distinct stories can be told. First, the package of reforms makes public service delivery units compete against each other, giving them incentives to secure cost reductions and quality improvements. Much greater attention is paid to service delivery, and to strengthening institutional management against both trade unions and professional groupings such as doctors. Such managers face the rigours of market and quasi-market mechanisms set in place by the central decision makers. Albeit in a garbled form, public choice ideas have certainly influenced the NPM reform agenda (Kraan, 1996).

This appears to be an optimistic story. Nevertheless, this optimism has to be qualified because of the huge gulf between the rhetoric about 'buying outputs to secure outcomes' (which ministers and civil servants have increasingly mastered) and the reality of output and outcome measurement where serious work within government seems to have been squeezed by a combination of lower running costs and a fundamental lack of interest in evaluation.

The second story is less optimistic. In the new structure, the public sector can be conceptualized as a set of planets (government departments), many with a set of moons, some of which have their own satellites. What is distinctive about this constellation is that the planets are often dwarfed in size by the moons and satellites. Such fragmentation may complicate the control of public expenditure aggregates in a number of ways, most notably if delivery units are able to mobilize political resources against the centre. One manifestation may be a refusal to surrender efficiency gains in the form of budget reductions and an insistence upon using them to expand output or quality in that particular programme area. In other words, the inter-programme flexibility enjoyed by central decision makers may be impaired. The system may become arthritic in the sense that public money can less readily be switched around as new priorities unfold.

Quasi-autonomous units may pursue their own narrowly focused agendas (where only specified outputs and their own costs matter) and may be able to sustain greater resistance to reductions (one obvious mechanism involves independent public relations activity which can be used to mobilize opposition). An interesting example relates to housing associations and their 'peak' organizations which operate with a measure of lobbying independence from the non-departmental public bodies (NDPBs) which fund them out of departmental programmes. During the 1980s and early 1990s they were able to exploit the hostility of Conservative ministers towards local authority housing to their own advantage.

Even more seriously, the complex network of quasi-contracts (purchaser/provider contracts in the NHS are not legally enforceable) and real contracts (emerging from market testing, contracting out and the PFI) may accentuate the difficulties of securing reasonably rational expenditure cuts if these are suddenly required for macroeconomic reasons. The capacity to implement top-down reductions may be seriously impaired. Moreover, through contracts, present decision makers may have greater ability to 'lock in' future decision makers. Some of the former might even relish the thought that engineering a fiscal crisis in which existing public provision becomes unaffordable is a tactical route to desirable but otherwise infeasible welfare state privatization.

The experience of the community charge shows just how difficult it can be to predict the long-term consequences when financial systems interact with political systems. The advocates of the community charge believed that local authorities would cut expenditure in response to high marginal tax costs. In fact local authorities increased expenditure, successfully transferring the blame to central government which then delivered more grant (Gibson, 1990).

It is difficult to make a judgement between the two stories: namely, competition between providers leads to efficiency enhancement and strengthens expenditure control *versus* fragmentation leads to a loss of control and flexibility. A possible synthesis of the two stories is that the new structure may produce genuine efficiency gains but at the cost of greater system instability and at more risk to aggregate public expenditure control.

Is central control illusory?

Jenkins's (1995) critique of quangocracy emphasized the illusory nature of the central control which appears to have been established. There are concerns relating to the organizations which supervise quasi-markets and to those that contract with them. Of immediate relevance is the current fashion for downsizing the centre of departments, most notably the Treasury itself. The idea seems to be that the adoption of NPM techniques renders the task of the centre easier.

Yet the counter-argument can readily be mobilized. Fundamental Expenditure Reviews (FERs) may be accentuating an inherent problem, by delayering, demanning and deskilling the Treasury and core departments, just as their workload changes but expands. The Treasury FER documents are eloquent about the need for the Treasury to adopt a more 'strategic' approach to public expenditure control (Southgate *et al.*, 1994; Treasury, 1994). Paradoxically, an authoritative study of the Treasury over the period 1976–93 casts the Treasury's 'expenditure controllers' (those Treasury officials who shadow spending departments) as the heroes of the control system, notably in the way in which they exploit knowledge and contacts in developing a relationship of constructive tension with 'their departments' (Thain and Wright, 1995). It is not yet clear what a strategic approach means in practice (Wright, 1995), especially when the 'devil' frequently resides in the 'detail'.

Heald and Scott (1996) drew attention to the weakness of the centre of the NHS financial system, characterizing the finance directorates of the four management executives (i.e. one for each country) as understaffed and overstretched. The fragmentation of delivery organizations which themselves had weak accounting and finance functions accentuated the vulnerability of financial control. Below Director of Finance level (where the 1990–92 recession rebounded to the NHS's advantage by making it more appealing to professional accounting staff), many NHS providers are thinly staffed. Quasi-markets naturally involve higher transactions costs than more hierarchical systems. The relevant test is whether the total costs of given output levels are reduced. Populist attacks on NHS managers and accountants may lead to the implementation of half-baked proposals to control management costs through central command, leaving financial control vulnerable and preventing savings in total costs from being reaped. The tone of a recent House of Commons debate on NHS bureaucracy (*Hansard*, 26 June 1996) vividly highlighted these risks.

What should worry the Treasury is that the Thain and Wright (1995) analysis seems to support the view that effective defence of global totals from political and other threats may require a high level of detailed intelligence about programmes. Without that, it is difficult to judge whether departments and subordinate provider units are engaging in shroud waving or whether there are real difficulties. Misjudgements may backfire in the form of higher expenditure, either because the shroud-waving story is believed or because a genuine case is resisted and later explodes. The final public expenditure cost of bovine spongiform encephalopathy (BSE), or 'mad cow disease', is as yet incalculable, but it seems at least possible that much of this cost could have been avoided had proper inspection and regulatory systems been in operation during the 1980s. Weak regulation has led to large unexpected public expenditure costs.

An aggressively tough attitude to expenditure reduction may lead to significant falls in real output, a particularly serious issue where output measurement is inherently difficult. Moreover, a rapid deterioration in the finances of public and quasi-public providers not only obscures public understanding but could also seriously undermine aggregate control. Alarms have recently been sounding about NHS trusts and about higher education institutions (HEIs). Although some of this is undoubtedly part of the bargaining game, there is the genuine point that reductions in the control aggregate may be achieved in ways which reduce the net worth of the public sector. They may also weaken the financial viability of the providers that actually deliver public services.

Incentives

The formula funding systems upon which central government increasingly relies can have unexpected and dysfunctional consequences (Heald and Geaughan, 1994). For example, the way in which the 1996 Research Assessment Exercise in the higher education sector stimulated the growth of a transfer market for researchers may have bid up unit costs just at the time when the HEIs needed to reduce unit costs to safeguard financial viability. Trends which are widely recognized as unsustainable at system level may be irresistible at institutional level: unilateral non-participation in such a transfer market might have led to serious reductions in research grant.

Because of risk pooling, the level of aggregation at which funding takes place may be vitally important. Excessive fragmentation may render the funding recipient vulnerable to random variation in, for example, patient needs. This will lead to a 'false' uniformity in expenditure levels where both under-provision and over-provision relative to need become prevalent. In turn, the exploitation of horror stories about service failures in the under-provided areas may lead to an upward drift in real funding or to a serious loss of public confidence.

Systems which involve more high-powered incentives may lead to the aggressive exploitation of micro-level incentives, without regard to system stability. Even when formula funding and quasi-markets lead to genuine cost reductions, the new arrangements will alter the balance between programme and running costs. Moreover, an admirable concern to secure cost reductions may lead to attempts to shift costs on to third parties; lower levels of cost internalization within organizations subject to unified management control accentuate this tendency. Naturally, the alignment of financial and opportunity costs becomes much more important in a system exhibiting managerial decentralization. In such a context, it is necessary to establish who is responsible for the broader range of costs and benefits which do not necessarily accrue to the decision makers, who are themselves under pressure to pay greater attention to financial variables. Transport is an excellent example (Maddison *et al.*, 1996).

Tougher questioning of the value-for-money of public expenditure programmes is undeniably a feature of NPM, notwithstanding doubts about the reliability of performance indicators and measurement systems. This insistence upon performance is taking place against a backcloth of profound social change whose implications for public expenditure growth reverberate upon control systems. It is useful to force a distinction between those factors which would generally be viewed as incidental to 'good news' and those incidental to 'bad news'.

For example, many public expenditure pressures in the health and welfare fields can be traced to a substantial lengthening of life expectancy, reflecting the benefits of improved living standards and public services. In such cases, policy makers ought to be pleased about the cause of the expenditure pressure. The expenditure consequences of 'success' do not disappear but present different problems, relating, for example, to the renegotiation of earlier commitments like care for the elderly, or to the response to new circumstances (e.g. student finance in the context of a mass higher education system).

In contrast, some expenditure pressures can be linked to policy failure. Higher rates of imprisonment because of rising crime and higher social security benefits because of long-term unemployment are good examples. Moreover, the 1980s and 1990s have witnessed a sharp increase in economic inequality in the United Kingdom, to a much more dramatic extent than has been seen in other EU countries (Atkinson *et al.*, 1995). There is considerable controversy as to the underlying causes (e.g. tax/benefit policy, deregulated labour markets and increasing returns to human capital as a result of economic globalization) and as to whether the UK experience represents the future for other EU countries.

The implications of increased inequality

The focus on value-for-money has also led to tougher questioning of the distributional consequences of public expenditure (van de Walle, 1995). This new scepticism about who the beneficiaries are should be welcomed. Nevertheless, it is essential that such evaluations focus upon long-term and system effects, not just first-round effects. For example, affluent-worker exit from council housing or middle-class exit from state education may temporarily improve distributional targeting but later diminish political support for continued expenditure. Whereas greater inequality emphasizes the importance to economic and social functioning of good public services, it also makes them more difficult to sustain politically.

When growing economic prosperity was broadly based and hence socially inclusive, it was possible for some authors such as Alan Peacock to envisage a future in which society 'grew out' of the welfare state and where individuals would make private provision for educational, health and welfare services in a way unforeseen when the welfare state was established (Wilson, 1985). Now that growing economic prosperity is much less inclusive, some authors have argued that the welfare state can no longer be afforded: the aspirations of the affluent for public services far outstrips what governments, nervous of taxpayer reaction and fearful for international competitiveness, are willing or able to provide. The key political judgement, of course, relates to whether those who have opted out of public services would remain willing to finance public services for those still dependent upon the state. The political dynamics of such a situation are difficult to predict: for example, a substantial minority of the population self-providing for health might set new benchmarks for service availability which governments would later find difficult to deny to NHS patients. Unexpected or unintended consequences can be pervasive in their effects. For example, the US healthcare system has become more aggressively competitive in the 1990s, a development which is helping to control costs but which is also exposing the extent to which the problem of the uninsured population had hitherto been dealt with through (no longer viable) cross-subsidies out of charges made to insured patients.

The problem is further aggravated by the probability that increasing inequality may damage the productive efficiency of some public services. It may be exceptionally expensive, or even impossible, to produce high-quality educational services in a crime-ridden, drug-affected inner city area or peripheral housing estate. This deterioration in production conditions is taking place in the context of moves from needs-based funding, where central government grants for health and local authority services delivered more money to under-performing areas, to more performance-based models. Fragmented structures may lead to coordination problems in terms of their impact on particular geographical areas, arising from the narrow aims of each body and the dysfunctional incentives of multiple funding systems. This echoes the argument frequently made by John Stewart (e.g. Jones and Stewart, 1983) in favour of multi-purpose local authorities, though the coordination problems existing within such organizations should not themselves be underestimated.

In a proper cybernetic sense, a system is under control when it is capable of being steered to a desired state. However, this discussion has thrown serious doubt upon such a claim for the current UK public expenditure control system. What lessons then can be derived from the experiences of 1979–96, and what modifications of the present system are suggested?

Lessons from the period of Conservative Government

Several lessons can be drawn from the period of the Conservative Government after 1979, a period remarkable in post-war terms for the sustained commitment to curtailing the resource demands of the public sector.

First, medium-term control over public expenditure aggregates is difficult. There have been powerful external pressures generating higher claims for expenditure: for example, notwithstanding the strong desire of Conservative ministers to curtail such expenditure, real GGE(X) grew by 38.8 per cent between 1978–79 and 1995–96, and the proportion of GGE(X) accounted for by social security increased from 23.5 to 31.2 per cent (Treasury, 1996a).[2] Indeed, public expenditures on goods and services have been crowded out by such growth of transfer payments: without such growth, real expenditure on, say, health and education would probably now be higher. The unexpected severity of both the 1979–81 recession, where seasonally adjusted real GDP at market prices fell by 6.0 per cent between 1979(Q2) and 1981(Q2) and the 1990–92 recession, with a fall of 3.6 per cent between 1990(Q2) and 1992(Q1), threatened medium-term public expenditure control. Moreover, even in retrospect, there has been considerable difficulty in disentangling cyclical from trend factors in expenditure growth (Virley and Hurst, 1995).

Complicating matters further, the political presentation of fiscal objectives has taken precedence over consistency. The meaning which Treasury ministers attach to the policy commitment of 'balancing the budget over the economic cycle' has changed markedly: from the sum of surpluses and deficits being zero over the cycle (November 1991) to the Public Sector Borrowing Requirement (PSBR) returning to zero at some point during the cycle (November 1992) (Heald, 1995). The projected PSBR for 1996–97 (revised upwards in July 1996 to 3.6 per cent of GDP) – a deeply disturbing figure for the fifth year of continuous real GDP growth – is attributable to revenue shortfalls rather than to expenditure overruns (Mowl, 1995).

The lesson here is that any specific commitment about the level of the PSBR might well be compromised by the apparent increase in fiscal instability – in part arising from more pronounced economic cycles – and by the fact that the economy seems to have become more resistant to generating tax revenue.

Second, there has been less constancy in the Conservative Government's approach to public expenditure than is typically projected or assumed (Thain and Wright, 1995). Periods of repressed growth store up future problems. An example is the pre-1988 controls over public sector pay. The effects of the political cycle can also be detected, most notably in the 1991–92 loss of control. There was ample contemporary evidence about the likely path of expenditure aggregates after the 1991 Autumn Statement (Heald, 1991b), but the issues were postponed until after the 1992 general election.

In their account of his premiership, two of John Major's then closest advisers have written:

> As one seasoned Treasury mandarin puts it, a five-year Parliament tends to be more expensive than a four-year, because two spending rounds take place under the pressure of an election. And if you have two Prime Ministers in this period, you double the pressure, since they will inevitably have different priorities. Margaret Thatcher had agreed to an enormous roads programme. John Major was to give more money to health.
>
> (Hogg and Hill, 1995, p. 119).

In contrast, surprisingly tough public expenditure control has been exercised in the run-up to the 1997 general election, undoubtedly assisted by sustained economic growth and low inflation. The lesson is that the public expenditure process is an intensely political one, rendering elusive medium-term stability in the pursuit of defined objectives.

Third, since 1988 much Treasury effort has been wasted on redefinitions of the control aggregate. The real motivation for the 1990 redefinition, by which the old planning total was replaced by the new planning total which excluded local authority self-financed expenditure, still remains obscure (Heald, 1991a). The 1992 switch to the Control Total, which mainly excluded cyclical social security spending, was essentially diversionary: 'There are circumstances when it appears easier to change systems than to admit to the real nature of problems . . . ' (Heald, 1995, p. 231). Such redefinitions, characterized by Thain and Wright (1990) as 'coping strategies', are resorted to by the Treasury in the face of failure to achieve public expenditure objectives. It is far from obvious what this process of successive redefinitions has achieved for the Treasury. The serious consequence is that the loss of data comparability renders public expenditure figures increasingly impenetrable to anyone other than technical specialists, further aggravating the 'switch-off' effect so evident in the parliamentary neglect of financial matters. In consequence:

> There has been a loss of information from the public domain, and of transparency about public expenditure. This conclusion is robust, whether this outcome is interpreted as deliberate obfuscation (an abuse of executive power by a government continuously in office for a long period of time and expecting to remain there) or as unintended (cumulative definitional change surpasses the Treasury's information processing capacities).
>
> (Heald, 1995, p. 234).

Two speculations are worth airing. One is that it might be necessary to distinguish between the 'official' and 'ministerial' Treasury. Chief Secretaries now come and go – there have been 10 in 17 years – and may have career agendas which rank higher in their priorities than a coherent public expenditure system. A Chief Secretary who is expected to and does run the term of a parliament has more to gain from a secure control system. The use of this post as a stepping stone at the bottom of the Cabinet promotion ladder has undoubted costs: greater longevity of office for John Biffen (Chief Secretary 1979–81), in the manner of Jack Diamond (1964–70) and Joel Barnett (1974–79), might have substantially affected how systems and expenditure developed. The other speculation is that, the rapid succession of incumbents in key posts in the Treasury (notably, the Grade 3 in charge of the Survey) may have encouraged new incumbents to seek kudos and hence further promotion in taking credit for new systems rather than in making existing systems work. The lesson here is that careful attention is required to staffing matters, both ministerial and official, to ensure that the correct signals are transmitted.

Fourth, systems of control which are geared to severe input restrictions must be supported by subtle and sophisticated monitoring on the output side. Gray and Jenkins (1990, 1993) have regretted the lack of integration in the United Kingdom between budgeting, auditing and evaluation. The quality of available output information has been thrust to the centre of the debate on RAB by the National Audit Office (1996), which has implied that audited performance information should be viewed by Parliament as a pre-condition for resource budgeting (RB). Extending the argument much further, Laughlin and Broadbent (1996) have remarked upon:

> . . . the growing call for the accountability of the Conservative Government of the UK for the range of far-reaching managerial changes which have been implemented in the public sector over the last fifteen years . . . the Government should be accountable for this investment of taxpayers' money but not in a way which simply justifies its actions to the body politic but rather in a way which goes beyond this to a complete critical evaluation of the merit and worth of the Reforms.

A lack of systematic evaluation is emerging as a characteristic of NPM reforms, the agenda often being moved on – perhaps, deliberately – too quickly for evaluation to secure adequate attention. Despite OECD rhetoric about New Zealand and the United Kingdom as model pupils, that organization has itself shown more interest in proselytizing than in careful evaluation. It is essential to recognize that outputs and outcomes are themselves problematic:

> . . . researchers have generally taken an uncritical view of what constitutes outcome. That is, they have taken the favoured concept of outcome as given. So – for example – in health care the received wisdom is that outcome relates to the enhancement of the quality and quantity of life. Yet it may well be that citizens value many other features of the health care *system*, such as the reduction of risk, the promotion of equity, and the reassurance of a culture of care.
>
> (Smith, 1996b, p. 3, italics in original).

The burst of enthusiasm for evaluation within the Treasury in the mid-1980s appears to have faded, with no published successors to Lewis (1986) and Durham (1987). Smith (1996a) noted the unevenness of work across public services in output measurement and the links to outcome. The United Kingdom is not represented in Pollock *et al.* (1994), the prestigious handbook on operational research in the public sector. Given the growth of academic work on Data Envelopment Analysis (Ganley and Cubbin, 1991), there has been a notable lack of published work from the Government Economic Service which enjoys privileged data access. Viewed from outside, it seems that the analytical capacity of the Treasury, notably in terms of microeconomics and operational research, has been allowed to degrade. Some of the work traditionally conducted in-house may now be subcontracted, though its nature may be affected by the renowned tendency of consultants to produce managerially or politically desired results.

The lesson here is not to be optimistic about the development of evaluation capacity within UK government. Leaving aside issues of cost and technical difficulty, evaluation is potentially threatening because of its uncontrollability. For example, it *might* generate unwelcome evidence of underfunding (e.g. in health) or conclusions which contradict ministerial policy beliefs (e.g. 'prison works'). The most effective way to secure better analysis conducted in and published by central government is to concentrate upon structuring external challenges.

Fifth, the published documents which derive from the Survey, the departmental reports and the Statistical Supplement, have become much less effective at communicating the Government's forward expenditure priorities. The Treasury cannot necessarily deliver a particular forward functional pattern, primarily because of to the multi-functional expenditure responsibilities of local authorities. However, messages about priorities are important, even if these are to be understood as indicative of central government wishes. Certainly, the claim that the figures traditionally published in earlier public expenditure White Papers were 'worthless' is unconvincing.

The disappearance of such forward figures has led to much greater public confusion about which functional expenditure areas are really receiving priority. Even public expenditure specialists cannot disentangle this. Moreover, there arises a considerable likelihood that the gains and losses of successive Surveys to some extent cancel each other out.

There are no publicly articulated medium- or long-term priorities. Though there have been internal updates, the Treasury has never published a sequel to its 1984 Green Paper on public expenditure prospects on a 10-year horizon (Treasury, 1984). The forward projections which have been published for particular programmes (e.g. Department of Social Security (1993)) have been viewed externally as softening-up exercises for entitlement reductions rather than as genuine attempts to stimulate public debate. In practice, the composition of expenditure appears to have been driven by a mixture of external factors (like continued social security growth, concerns about law and order and policy disasters such as BSE) and by the accretion of *ad hoc* commitments, the implications of which are not thought through. An example of the latter is the 1992 election commitment to maintain health expenditure in real terms, which has been interpreted to involve no adjustment for the transfer out of the health programme of certain responsibilities under community care.

This is not a complaint about the balance of programmes being determined politically rather than through a technocratic cost–benefit analysis. Rather, it is a complaint about the structuring of the agenda for political decisions. Those journalistic accounts which have benefited from access to insiders dwell excitedly but depressingly upon the role of personalities and of ephemeral political clout, with little sense of medium-term political priorities. For example, some ministers have refrained from fighting their corner and making bids in the expected way while other ministers have been ambushed by the presence of senior ministers whose experience and knowledge of departmental programmes has exceeded their own. Rapid ministerial turnover has been an aggravating factor (Bogdanor, 1996). Some of the compositional shifts in expenditure highlighted in Figure 9.2 may have their origins in such chance events: the lack of growth of education spending in the early 1980s seems to be such an example.

The lesson here is that reliance upon crude mechanisms of aggregate control can eliminate effective political choice. Where there are genuine ceilings on aggregates, trends in particular areas, like rising social security expenditure in the past and perhaps 'PFI costs' in the future, can severely constrain options. After any change of government, the new Chief Secretary would be well advised to expect to be told by the Treasury official running the Survey that binding commitments have more than exhausted the automatic release from the Reserve.

Sixth, media coverage of public expenditure has become dominated by leaks of various provenance, and there is no longer much serious coverage of the official documents. There are some technical reasons for this. The advent of the Autumn Statement in 1982, which gave the aggregate decisions on public expenditure down to departmental level, reduced the news value of the main documents published in February. The unified Budget has predictably further displaced coverage of public expenditure.

Nevertheless, the political reasons are much more important. Politicians increasingly respond to a tabloid agenda, a response which is believed necessary for political survival. Regarding the Survey itself, very little is known about its conduct and substance, though documentary accounts such as that of Thain and Wright (1995) afford valuable insights about earlier periods. While spin-doctoring and leaking are now pervasive, intelligent discussion of priorities between programmes is minimal. Insiders have formidable advantages over outsiders in terms of access to data and expertise, a situation becoming more pronounced in a political climate in which opposition parties hardly dare talk about expenditure options. More consistent data and greater openness are preconditions for higher quality debate.

One difficulty is that the United Kingdom lacks institutions with bite, such as the US Congressional Budget Office whose analysis fatally damaged the Clinton Administration's health reform package (Congressional Budget Office, 1994). Another is that the prevailing politically directed managerial culture forces civil servants to 'sell' existing policies rather than to 'speculate' about alternatives.

Those with political power derived from control over information flows will never willingly relinquish this. The Treasury's success in excluding the scrutiny of 'policy objectives' from the remit of the National Audit Office when it was established in 1983 (Jenkins, 1995) has reduced the effectiveness of its value-for-money work. The lesson here is that regular and systematic evaluation requires institutional innovation.

Improving control

Machinery of government

The 1990s have seen a crisis of confidence in British public life whose implications are far-reaching. The combined effect of the report *The Proper Conduct of Public Business* (Public Accounts Committee, 1994) and of the Nolan Committee (Nolan, 1995) has been to demonstrate both how standards of public behaviour have declined and how behavioural norms, previously thought to be deeply internalized, need to be rendered explicit. These events have undoubtedly generated a cynicism about elements of 'quango government', with potentially long-term consequences. However, reform is not straightforward. Any superimposing of decentralized political control over the managerial model of centre/purchaser-funder/provider may further complicate control over aggregates. For example, proposals to 'democratize' mono-functional quangos may accentuate the problem as they may acquire greater legitimacy and hence become more effective as spending lobbies.

The fundamental question is about where in the system political choices can be and are made. This question is wider than the control of public expenditure but its resolution is profoundly important for the design of control systems. Devolution, of the kind proposed for Scotland, will require new fiscal institutions, relating to data gathering for purposes of fiscal equalization and of fiscal coordination (Heald and Geaughan, 1996).

More generally, there are direct consequences from the diminution of the effective power of local authorities whose expenditure in 1995–96 still accounted for 24.7 per cent of GGE(X). A consequence of 'opting out' (for instance of schools) from local authority funding and control is that the expenditure-switching discretion of democratically elected local authorities is lost. A corrective mechanism is removed.

Once unleashed, the centralist potential of the UK system resists restraint. Paradoxically, greater centralism has been accompanied by greater pretence about local authority discretion, perhaps in recognition of how useful this fiction is in terms of blame transfer. A specific problem has been that, while immensely successful at winning national elections, the Conservative Party's defeats in local elections have provoked both a retreat from participation and a deeply ingrained contempt for local authorities. Stripped of functions and disabled by reorganization, local authorities have faced intensifying pressures to conform to central government expenditure assessments, not just on levels but also on the composition of spending. More intense political interest in the pattern of local authority expenditure (e.g. statements about schools expenditure in the November 1995 Budget) renders it more difficult to resist expectations of 'pass-through'.

The problem is that such centralism breeds more centralism, not only through the actions (legislative and financial) of central government but also through party control exerted by the Opposition front bench over Labour Groups on local authorities. Over time, the information content of variations in per capita expenditure is eroded, as these variations begin to reflect earlier formula allocations rather than local political choices in varying contexts.

Public expenditure management

Public expenditure is undoubtedly a technical area, though not as inaccessible as many politicians and opinion formers profess to believe. A number of technical changes, notably concerning definition and coverage, would make the nature of the available policy options more transparent, and that is healthy for political debate. However, an enthusiasm for transparency may not be universally shared.

First, a new government would be under pressure from spending lobbies to exploit perceived loopholes in control systems in order to achieve desired policy goals. Resisting such temptations would undoubtedly be difficult for a government more ideologically sympathetic to public expenditure.[3] There will be pressures to redefine particular items out of the totals that government seeks to control. Current examples include Hawksworth and Wilcox (1995) and Radcliffe *et al.* (1996) concerning local authority housing. A strong line should be taken against 'playing with the rules'.

In addition to these 'wheezes' at the margin, there will be proposals to quasi-privatize expenditure functions, by substituting mandated private expenditures for public expenditure (e.g. Field (1995) on social security, and Minford and Ashton (1995) on health). Such proposals ought to be evaluated on their specific merits in relation to public policy objectives and not in relation to their effect on the GGE/GDP ratio.

The efficiency of the economy is not synonymous with the containment of public expenditure. Some of the proposed methods would reduce overall efficiency. Tanzi (1995) described a number of ways in which developing country governments have reacted to public expenditure reductions by substituting inferior instruments. For example, they have used quasi-fiscal regulations such as rent controls in place of housing subsidies and quasi-fiscal activities such as differential exchange rates and interest rates.

This warning about fiscal gains being illusory if quasi-fiscal mechanisms are substituted for public expenditure is also relevant to OECD countries. For example, the United Kingdom has shifted some of the costs of statutory sick pay and statutory maternity pay from public expenditure to employers. This search for substitute mechanisms is one of the dysfunctional consequences of control. Alternatives are not necessarily inferior but inferior ones may be adopted in order to circumvent scoring systems. As with tax expenditures, such instruments tend not to be properly costed, for both opportunistic and technical reasons. Well before the advent of NPM it was recognized that definitional issues concerning the boundary of the public sector were both technically difficult and vulnerable to gaming (Gretschman, 1985).

Second, the Treasury should reinstate the pre-1990 practice of publishing forward projections of the functional and economic category compositions of public expenditure. Undoubtedly, these need to have health warnings attached, specifically relating to the considerations that out-turns will be affected by the decisions of separately elected local authorities and devolved Parliaments. The importance of understanding how the Treasury expects functional composition to evolve is even more important because of the growth in lottery-financed expenditure (where issues of additionality will figure prominently) and of the growth in PFI activity and costs. Quite apart from the value of such material to those outside the Survey process, Cabinet ministers themselves must be able to set one year's decisions within the proper context.

Third, there is a strong case for maintaining the present Control Total. This is not because it is entirely suitable but because the increasing instability of public finances makes it important to have a control aggregate whose behaviour can become reasonably well understood. Changes in the definition of the control aggregate both damage data continuity and hinder data interpretation. Provided that the Treasury is willing to devote the staff resources, it can provide a consistent series for a particular control aggregate for an earlier period and the Treasury have done this for the Control Total back to 1984–85 (Treasury, 1996a, Table 1.1). However, because a different control aggregate was in use until 1993–94, the earlier cyclical behaviour of the current definition is not necessarily a good guide to future cyclical behaviour. One advantage of the current Control Total from a Treasury perspective is that reductions in cyclical social security are not available for transfer to other programmes.

Fourth, several important changes coming on stream will affect the capital component of public expenditure and will have important consequences for control. The Treasury's RAB initiative will profoundly affect the treatment of capital. Assets will be valued and included in commercial-style balance sheets. Capital charging will be instituted across central government. Resource budgeting will involve the Survey being conducted, and Supply voted, on a resource accounting (RA) basis, which means that capital expenditure will be excluded from the Estimates unless there is dual voting of accruals and cash.

Despite the lack of attention that they have received, two other developments are likely to have significant impacts. Lottery-financed capital has implications for priority setting, not least because such grants can effectively commit future revenue expenditure (e.g. by making it too politically costly to resist requests for money to meet operating costs). The PFI raises a number of issues concerning expenditure control (see Chapters 2 and 14 by Sheila Watson and John

Flemming respectively) particularly because it 'posts' bills to the future and because information on future commitments may be denied to Parliament on the grounds of commercial confidentiality. Some progress has been made but this is limited. The departmental report of the Department of Transport, for instance, now separately identifies a PFI costs line as part of its future current expenditure, but without revealing information about the present value of future commitments.

The question of the guarantees extended by government to the moons and satellites has been highlighted by the application of the PFI to the NHS, leading to an untypical explicitness on the question of guarantees. If an NHS trust went bankrupt, its liabilities would be transferred either to another NHS body or to the Secretary of State (*National Health Service (Residual Liabilities) Act 1996*). This is exactly the kind of contingent liability which the Estimates will describe as 'unquantifiable'. Such arrangements have implications for the extent of risk transfer to the private sector and render the centre vulnerable to long-term contracts signed either carelessly or with regard to self-preservation.

Traditionally, the Survey has been criticized for treating capital as the 'swing' item, which could be turned on and off at will. If PFI commitments were to acquire considerable magnitude, the situation would change drastically. Moreover, the present emphasis on the PFI runs counter to one of the central motivations of capital charging, namely to bring home to decision makers the full opportunity costs of capital. Ministers greatly enjoy announcing and later opening new facilities. The enjoyment may be even greater when, if PFI-financed, new prisons and new roads do not score against budgets at that juncture (Heald, 1996).

In all these areas, the clear need is for the accounts to be transparent in terms of what commitments have been entered into and what they imply for public expenditure in the future.

Fifth, new machinery for the evaluation of public expenditure programmes should be introduced. It needs to have a medium-term agenda as well as a capacity to provide authoritative costings of policy proposals for select committees and for Members of Parliament. The existence of such a facility would significantly undermine the information monopoly which currently protects departments and disables opposition parties. As well as a remit to evaluate departmental performance and output and outcome indicators, the new machinery should address two troubling issues. One is whether the concern to cut running costs ('wasteful bureaucracy') may in practice diminish the effectiveness of much larger programme expenditure. The other is the examination of trade-offs between expenditures which fall on different programmes (e.g. social security versus employment; social security versus housing), and the analysis of spillovers between programmes. If an unsatisfactory mix of expenditures is currently leading to waste, that creates the possibility of releasing resources. It seems likely that external consultants would play a considerable role in such machinery, though recent experience of their extended use in government has emphasized that the location of control over the commissioning budget for such work must be carefully considered.

Sixth, there are several outstanding issues on the road to full RAB. Resource budgeting entails conducting the Survey on an accruals basis and Estimates being voted on an accruals basis. There needs to be clarification about the relationship between the proposed Resource Control Total and cash totals. There is also the question of how accounting policies will be determined, especially as choices between alternative treatments may impact sharply on 'key' numbers. Accruals accounting is more judgmental than cash accounting and there will be issues which are both technically difficult and politically sensitive. In New Zealand, which has pioneered government accounting reforms, an unspoken motive on the part of reformers has been to restrict the opportunities for politicians to manipulate the numbers. If, in the United Kingdom, the Treasury were to dominate standard-setting, such reforms might on the contrary confer greater discretion on politicians (Jones, 1996). The work of the (independent) Financial Reporting Advisory Board, established by the Treasury in response to parliamentary pressure, will be important as a safeguard.

Finally, there is the question of how to express a new government's medium-term public expenditure objective, and the level at which this would be set (e.g. a target GGE/GDP ratio or one relative to some EU average). There are genuine dilemmas here. If an aggregate target is set but there is no clear forward view of the desired composition of expenditure, it is likely that the control system, heavily concentrating on aggregates, will by default deliver a composition far removed from that which would consciously have been chosen.

The binding constraint is likely to be externally imposed, namely conformity to the obligations entered into under the Maastricht Treaty. It should never be forgotten, however, that control systems are more sustainable if there is comprehension of their relevance to policy objectives and acceptance of their legitimacy. When they are considered to be arbitrary and irrational, they become viewed as legitimate targets for circumvention.

Conclusion

We have seen that public expenditure control is inherently difficult and that it shapes decision making at all levels. Yet the Survey, as the core system, is conducted in a private world, with many of the glimpses offered to others being fragmented or simply manipulative. The message of this chapter is that control of public expenditure, in its proper sense of steering towards chosen objectives, is essential if wider policy objectives are to be achieved. A failure of control in terms of aggregates will lead to deep and ill-directed retrenchment. During the past 17 years, in which containing aggregates has received great priority, there has been a drift in composition towards one which is favoured neither by advocates of high or low public expenditure.

The best way to contain aggregate pressures is to build greater transparency into the process, a task which will require both technical ingenuity (e.g. providing documentation which is intelligible) and political resolve (e.g. those within the private world will resist intrusion). There is no reason for panic about affordability because the UK's position in terms of aggregates is superior to that of many other EU countries (e.g. in terms of the public debt/GDP ratio and of unfunded public sector pension liabilities). Nevertheless, it is sensible to have a somewhat crude aggregate target to act as a hard budget constraint but this must be accompanied at programme level by sophistication about objectives, outputs and outcomes. Clearly, the aggregate target should itself be subject to periodic review. What must be resisted are attempts to circumvent that target by means of wheezes such as reclassifying items outside the control aggregate and adopting substitute instruments such as mandated private expenditures. When there is much talk about the desirable size of government, it needs to be remembered that a GGE/GDP ratio of 40 per cent may be too low if health and education are entirely public but too high if both are fully private.

Notes

1. In June 1995, the Chancellor of the Exchequer substituted GGE(X) for GGE excluding privatization proceeds as the Government's public expenditure objective, the aggregate which is judged relevant to the Government's medium-term objective that public expenditure should take a declining share of GDP. GGE(X) differs from GGE in (a) excluding privatization proceeds; (b) excluding lottery-financed spending; and (c) measuring debt interest net of interest and dividends from public corporations and the private sector.
2. Such comparisons through time are not exact because of the changing form of programmes: for example, housing benefit expenditure (part of social security) has been substituted for housing expenditure.
3. Barnett (1982, pp. 124–5) explains Harold Lever's 'ripping wheeze' for financing the Housing Corporation outside the PSBR, using a private limited company as the vehicle. There is a sting in the tale: 'Unfortunately the company later lost money, mainly because the variable interest rates it had to pay were higher than the fixed interest on its long-term loans to Housing Associations. So this particular "ripping wheeze" ended with a private company becoming a wholly owned subsidiary of the Housing Corporation, eventually to be wound up' (p. 125).

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