



Witnesses

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## House of Commons Treasury Committee

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# Spending Review 2004

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## Oral and Written Evidence

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Mr David Walton

HM Treasury: Mr Nicholas Macpherson, Mr  
Jonathan Stephens, Mr Michael Ellam and  
Mr Chris Martin

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Rt Hon Gordon Brown, Chancellor of the  
Exchequer and officials

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## Memorandum submitted by Professor David Heald (13 July 2004)

## SPENDING REVIEW 2004: MORE DIFFICULT TIMES AHEAD

## THE SPENDING ENVELOPE FOR SR 2004

1. Under the post-1998 public expenditure framework, the Budget in an even-numbered year sets the spending envelope for the two "new years" (eg 2006–07 and 2007–08) of that year's July Spending Review. There was sufficient material in the 2004 Red Book (Treasury 2004a) to indicate that the Treasury had set the envelope for Total Managed Expenditure (TME) for 2006–07 and 2007–08, the two "new years" coming into Spending Review 2004 (SR 2004), and also for the year beyond. The following table was implicit in Table C4 of the 2004 Red Book (Treasury 2004a, page 252):<sup>1</sup>

Table 1: Derivation of Total Managed Expenditure from Budget 2004

£ billion	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09
Current expenditure	394.0	428.0	450	479	504	530	554
Depreciation	14.4	14.8	16	16	17	18	19
Net investment	10.6	16.2	22	25	27	31	32
Total Managed Expenditure (TME)	419.0	459.0	488	520	548	579	605

Note: 2002–03 is outturn; 2003–04 is estimate; and 2004–05 to 2008–09 are projections.

TME was projected to 2008–09, the second year of SR 2006 and the fourth year in office of a Government elected in 2005. As a result, the public expenditure plans of Opposition parties can be portrayed as involving public expenditure cuts, even when they incorporate year-on-year real growth.

2. SR 2004 (Treasury, 2004b, para 1.10) provides the more conventional presentation of TME, demonstrating that there have been no shifts in aggregates in the period between Budget 2004 and SR 2004.<sup>2</sup>

Table 2: Components of Total Managed Expenditure from SR 2004

£ billion	2004–05	2005–06	2006–07	2007–08
Departmental Expenditure Limits (DEL)	279.3	301.9	321.4	340.5
Annually Managed Expenditure (AME)	208.3	218.9	227.8	239.5
Total Managed Expenditure (TME)	487.6	520.8	549.2	580.0

Note: DEL is measured net of depreciation.

## THE COMPOSITION OF SPENDING

3. Significantly, programme totals had by Budget 2004 already been set for the SR 2004 period for education and health, programmes which, taking the United Kingdom as a whole, constitute a significant proportion of total public expenditure on services. The Treasury website explains this in the following way:

The Chancellor's Budget on 17 March 2004 announced early spending decisions in a number of key areas including Health and Education. To reflect the high priority the Government attaches to education, the Budget announces that spending will grow by 4.4% a year, on average, from 2004–05 to 2007–08. UK education spending will be £8.5 billion higher in 2007–08 than in 2005–06. This will ensure that recent progress in raising educational standards and achievement is sustained and that new challenges can be addressed over the coming years. In Budget 2002, the Government also announced a record increase in NHS funding of 7.2% a year in real terms over five years to improve health outcomes so that people live longer, healthier lives.<sup>3</sup>

4. The main programme numbers contained in SR 2004 appear in the analysis of total DEL by department (Table 1.2) and in the analysis of Total Managed Expenditure (Table A1). A fundamentally important point is noted in paragraph A6. How much is available for distribution as DEL depends on the forecasts for AME. At the time of a Spending Review, the claims made by AME on the TME totals set at the previous Budget determine how much room there is for DEL. Of particular importance in this regard

<sup>1</sup> Table 1 was constructed using the alternative definition of TME as current expenditure + depreciation + net investment.

<sup>2</sup> The minor differences between the TME figures in Table 1 and Table 2 for 2006–07 and 2007–08 are presumed to be technical in origin, rather than involving policy changes.

<sup>3</sup> [http://www.hm-treasury.gov.uk/spending\\_review/spend\\_sr04/spend\\_sr04\\_index.cfm](http://www.hm-treasury.gov.uk/spending_review/spend_sr04/spend_sr04_index.cfm)



are the paths of debt interest and benefit expenditure. One of the characteristics of a Spending Review is that it only provides programme totals, with most of the detail appearing in ministerial/departmental announcements in the days after the formal announcement.

5. Two features of the run-up to the SR 2004 announcement on 12 July 2004 are worthy of comment. First, there has been the familiar pattern of media briefing. Concerns about how governments present information about public expenditure are certainly not new. What is significantly different is the atmosphere of distrust surrounding many government statistics, including financial ones. The reasons why this has occurred are partly rooted in contemporary British political culture, particularly the antagonistic relationship between governments and media. Paradoxically trust in government numbers has diminished as rhetoric about transparency has exploded and there have been genuine improvements in practice. Examples of bad practice include the release of SR 2004 details ahead of the Parliamentary statement and the introduction of changes to the methodology for calculating certain public sector outputs on a timing that would inevitably be interpreted as beneficial to the Government.<sup>4</sup>

6. Second, the launching of five-year plans for education and health, within the totals set in Budget 2004 or before, has been widely taken to indicate conflict within Government. Some spending departments seem to have used the protection of 10 Downing Street as a tool against Treasury intervention in their programmes. Whilst there are grounds for concern that an over-intrusive Treasury has damaged the policy-making and implementation capabilities of line departments, there are also doubts as to whether well-thought out policy is likely to emerge from secretive and isolated arrangements. Moreover, particular announcements about DEL beyond the current SR period pre-empt other DEL, a feature that would be intensified if AME developments ceased to be favourable.

#### DEVOLUTION OR CENTRALISATION?

7. The debate between centralisation and decentralisation has a long history in both political science and management theory. An obvious distinction is between political decentralisation to bodies with their own legitimacy and managerial decentralisation within structured hierarchies that impose strong obligations of vertical accountability. Government rhetoric now stresses devolution, both managerial and the so-called "new localism". Yet there is widespread criticism of the present Government as being unprecedently centralist, with claims about devolution often being greeted by disbelief. As on the topic of the Private Finance Initiative (see below), what managers and professionals in the public sector will say privately differs enormously from what they will say on the public record. There is much sensible managerial advice in recent guidance (Cabinet Office and Treasury, 2004a), but recognition of the above tensions and dilemmas is missing.

8. This matters fundamentally for two reasons. First, it is difficult to square greater managerial devolution with the barrage of central initiatives, including Lyons (2004) on public employment relocation and Gershon (2004) on efficiency savings. Whatever the long-term merits of the recommendations emerging from central reviews, they can undermine devolution and impose significant transactional costs. Second, increased fragmentation of public service delivery raises concerns about regularity and also about the capacity of bodies with supervisory and regulatory roles. For example, if there is to be more direct central government funding of schools, the demands upon departmental capacity will increase rather than reduce.

#### EFFICIENCY SAVINGS

9. The search for continuous improvement in the efficiency of public services is an immensely important task, for which the Treasury naturally has the lead role. Technological change and learning from developments in the private sector should facilitate cost reduction, a process that needs to be systematic and cumulative. Disbelief is the initial response to the Government and Opposition competing to claim dramatic cost reductions, achievable quickly and with no impact on service quality. It becomes more serious when these are factored into forward expenditure plans and are partly based on a hypothesised reduction in regulation. There is much support for a reduction in regulation in general, but also much clamour for increases in specific regulations. When it becomes so politicised, "releasing resources to the frontline" becomes a dangerous slogan. Fighting forces depend on military logistics, with the latter risking being viewed as "waste". A proper definition of efficiency savings would emphasise reducing resource inputs for given outputs, without recourse to dangerous labelling. Whilst there is much that is constructive in the Gershon Review (Gershon, 2004), the labelling of only one of six work-streams as "productive time" will feed populist caricatures of the other five as "unproductive".<sup>5</sup>

<sup>4</sup> The issue here is not the merits of particular changes, rather the effects of unexpectedly introducing them ahead of public discussion, especially when, as in the recent case of National Health Service output data, these are beneficial to the Government. The Statistics Commission (2004) has indicated its concern at the changes introduced by the Office for National Statistics (2004), in advance of both the publication of the Atkinson Review on the measurement of public sector output and of consultation on proposed changes.

<sup>5</sup> Witness media graphics of civil servants wearing bowler hats.



## MEETING THE FISCAL RULES

10. Chart 1.1 (Treasury 2004b, page 4) indicates that the margins on the golden rule are likely to be very narrow in the next economic cycle. Much clearly depends on the performance of the economy and on good performance limiting pressures on AME. There is a danger that meeting the golden rule becomes such a matter of credibility for the Treasury that the integrity of the forward fiscal projections comes into question. There are already concerns about the way in which certain assets and liabilities are kept off the public sector balance sheet. The National Audit Office (2004) has calculated that 57% of PFI assets are on-balance sheet for the public sector client and 43% are off-balance sheet. However, if the London Underground is excluded, the percentages are 20% on-balance sheet and 80% off-balance sheet. Whereas a substantial proportion of central government PFI assets are on-balance sheet, very little is on-balance sheet in the local government and health sectors. Moreover, 24 out of 27 local authority and health PFI projects examined by the National Audit Office were on the balance sheet of neither the public sector client nor the Special Purpose Vehicle.

11. Chart 1.5 (Treasury 2004b, page 8) shows that PFI and asset sales make a considerable contribution to total investment plans. The Chancellor's SR 2004 statement indicated that asset sales would generate £30 billion in the period to 2010. More information is certainly required as to the composition of these asset sales because of their importance to the fiscal arithmetic.

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