House of Commons
Treasury Committee

The 2004 Budget

Sixth Report of Session 2003-04

Volume II

Oral and written evidence

Ordered by The House of Commons to be printed 31 March 2004

HC 479-II
Published on 16 April 2004
by authority of the House of Commons
London: The Stationery Office Limited
£13.00

Written evidence

Memorandum submitted by Professor David Heald, Sheffield University Management School

BUDGET 2004: A LIMITED WINDOW ON SR 2004

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" (ie 2006–07 and 2007–08) of that year's July Spending Review. From the perspective of the user looking for systematic information about the overall shape of SR 2004—the programme detail will come in July—the 2004 Red Book is disappointing. There is an announcement about total education expenditure up to 2007–08, health having been settled earlier. There are several piecemeal announcements, whose timing now rather than in July seems to be motivated by media management, but there are not the comprehensive tables needed for analysis. One example is "additional funding for Sure Start, early years and childcare of £669 million in 2007–08 compared with 2004–05, an average annual real growth rate of 17.3%" (para 1.28).

(2) There is sufficient material in the Red Book to indicate that the Treasury has now set the envelope for TME for 2006–07 and 2007–08, the two "new years" coming into SR 2004. Some information is given in the Red Book (para 1.15), but not the TME numbers:

Budget 2004 sets firm overall spending limits for the 2004 Spending Review period, allowing:

- current spending to increase by an average of 2.5% in real terms in 2006–07 and 2007–08, in line with the cautious assumption for trend economic growth and consistent with the nominal growth rates set out in Budget 2003 and the 2003 Pre-Budget Report. Final plans for Departmental Expenditure Limits and Annually Managed Expenditure will be set in the Spending Review; and
- public sector net investment to rise from 2% of GDP to 2.25% of GDP by 2007–08 to continue to address historic under-investment in Britain's infrastructure while remaining consistent with the sustainable investment rule.

Up to 2005–06, the TME numbers appear in Table C11 (page 266), providing a 2005–06 "baseline" of £520.4 billion. The Chancellor's speech (*Hansard*, 17 March, col 332) announced 2006–07 as £549 billion and 2007–08 as £579 billion. Accordingly, the SR 2004 increases over 2005–06 baseline are £29 billion (2006–07) and £59 billion (2007–08).

(3) Fortunately Table C4 (page 252) allows the construction of a table showing TME, using the alternative definition of TME as current expenditure + depreciation + net investment:

£ 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
TME	419.0	459	488	520	548	579	605

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

TME is therefore "projected" to 2008–09, the second year of SR 2006 and the fourth year in office of a Government elected in 2005.

(4) Also relevant is the target of £20 billion for efficiency savings: presumably these will be allocated to departments and the forecast savings then allocated to departments according to Government priorities. The Committee may wish to explore with the Treasury:

(a) how much of the TME increases in 2006–07 and 2007–08 over 2005–06 baseline have already been committed in those expenditure decisions which have been announced ahead of the SR 2004 announcement in July?;

(b) the dangers inherent in booking £20 billion of efficency savings in advance of detailed implementation plans; whatever the long-term merits of what is proposed by the Gershon and O'Donnell reviews, there are grounds for scepticism about net savings in the SR 2004 period; and

(c) ways to ensure that the Government does not announce expenditure increases equal to the sum of expenditure increases *plus* efficiency savings, without at the same time making explicit any reductions that have been imposed on departmental baselines.

(5) Although I recognise that there is little chance of remedy, I again deplore the descent into spin and propaganda of sections of the Red Book under the present Government. Chapter 6 ("Delivering high quality public services") is just appalling. The Government has, rightly in my view, committed increasing resources to public services. There is scope in the Red Book for an evidence-based discussion of progress to date. That could usefully address concerns about, *inter alia*:

- whether inputs are being fully translated into outputs and outcomes;
- the extent of the Relative Price Effect (ie public sector costs going up faster than the GDP deflator); and
- the extent to which changes in performance indicators are measuring genuine service improvements or grading drift, and the extent to which service quality may be improving even when output volume indicators are lagging input growth.

Instead, the tone of Chapter 6 is breathless and unreflective, and several of the claims tendentious. I began to wonder whether there is an internal Treasury game to see how many buzz words (eg world-class, vision, empowerment, devolution etc) per page could make it through to publication. Some sentences seem like parody. Governments can reasonably indulge in advocacy but some of what now appears in the Red Book is more likely to alienate than persuade.

INDEPENDENT AUDIT OF MACROECONOMIC ASSUMPTIONS

(6) The Treasury always makes reference to the fact that certain Budget assumptions are audited by the National Audit Office under the provisions of the 1998 Finance Act. The level of assurance provided is much less than what is portrayed in Budget documents. Unlike in its financial audit and VFM work, the National Audit Office cannot choose which assumptions to audit. It can only audit (a) those assumptions that are specifically referred to it by the Treasury, and (b) previously audited assumptions that come up for review on a three-year cycle. Box C1 (page 251 of the Red Book) lists the key assumptions audited by the National Audit Office in the context of Pre-Budget Report 2003 and Budget Report 2004.

(7) Although experience-to-date of the 1998 macro-fiscal framework allows reflected credit to be claimed, I have always had reservations about this unusual role—the "client" determines what can be looked at—for the National Audit Office. As there is no present prospect of the statutory duties imposed by the 1998 Finance Act being revisited, the Committee may wish to ask the Treasury to clarify:

- the process through which they decide which macroeconomic assumptions, apart from those automatically revisited, should be referred to the National Audit Office; and
- the amount of notice that the National Audit Office was given of the assumptions that had to be audited before Pre-Budget Report 2003 and Budget Report 2004.

(8) It is important to distinguish between (a) accounting numbers, and (b) fiscal numbers. The accounting numbers are now on a Resource Accounting & Budgeting (RAB) basis, and the fiscal numbers are on an ESA95 (ie national accounts) basis. The treatment of Network Rail has been much discussed; the Red Book (page 284) indicates that Network Rail is now classified as having been in the private sector since 1 April 2003. The Comptroller & Auditor General threatened to qualify the financial accounts of the Strategic Rail Authority unless Network Rail was consolidated on the basis of control; consolidation now occurs. Crucially, however, this financial accounting treatment does not affect the fiscal numbers, as a result of the ONS decision that Network Rail should be classified to the private sector in the national accounts.

(9) Table C14 (page 270) on "Accounting adjustments" is interesting. The Treasury deserves credit for insisting on implementation of FRS 17, the Accounting Standards Board's pensions accounting standard. However, Table C14 shows a very large negative accounting adjustment (ie public expenditure-reducing) for pensions (£23.3 billion in 2005–06), when the financial accounting treatment is replaced by the national accounts treatment for the purposes of calculating TME. The Treasury can therefore claim credit for implementing rigorous accounting standards (FRS 2 on control, FRS 17 on pensions) in resource accounts, but they do not affect the fiscal numbers. Table 1.1 (page 4) of the Red Book shows that the two fiscal rules will be met, but the golden-rule numbers would look quite different on a RAB basis. Given the rationale that the Government has advanced for the golden rule, the Committee might wish to question the Treasury as to the logic of ignoring the new evidence, based on the private sector accounting standard FRS 17, of the real cost of public sector pensions.

19 March 2004