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Background to the 2000 Spending Review

The 2000 Spending Review was launched in the autumn of 1999 and is due to be completed by July 2000. It will determine expenditure plans for the years 2001/02 to 2003/04 within the overall totals for public expenditure announced in the March 2000 Budget. The 2000 Spending Review will be the first to be conducted on a resource budgeting basis.

This Paper provides background material to the 2000 Spending Review including information on the review process, the overall expenditure limits for the review period and descriptions of resource budgeting and the Barnett formula.

Robert Twigger

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Summary of main points

- The 2000 Spending Review was launched in the autumn of 1999 and is due to be completed by July 2000.[1] Its purpose is revise existing public expenditure plans for 2001/02 and to set plans for 2002/03 and 2003/04.

- The overall level of public expenditure (defined as total managed expenditure - TME) for the period to be covered by the 2000 Spending Review was announced in the March 2000 Budget. TME is planned to increase from £371 billion in 2000/01 to £392 billion in 2001/02, £415 billion in 2002/03 and £440 billion in 2003/04. Overall TME is expected grow by 10.1% in real terms between 2000/01 and 2003/04 equivalent to an annual rate of 3.3%. TME is expected to rise from 39.2% of GDP in 2000/01 to 40.5% in 2003/04.

- As part of the introduction of Resource Accounting and Budgeting, the 2000 Spending Review will be the first to be conducted on a resource budgeting basis.

- The results of the 2000 Spending Review for the NHS in England (and the Barnett formula consequentials for Scotland, Wales and Northern Ireland) were announced at the time of the March 2000 Budget.

- During the course of a public expenditure round, the assigned budgets for Scotland, Wales and Northern Ireland are (for the most part) not negotiated separately, but are determined by the so-called ‘Barnett formula’.

- The Treasury Committee took oral evidence on the 2000 Spending Review from the Chief Secretary to the Treasury and Treasury officials on 10 May 2000.[2]

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[1] HC Deb 30 March 2000 c259W
[2] *Spending Review 2000*, HC 485-i 1999-2000

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I Introduction

A. Background

From the mid-1960s until 1996 it had been the usual practice for the government to undertake an annual public expenditure survey (PES) to set departmental expenditure limits for three to four years ahead. The results were generally published in the autumn prior to the first financial year to which the plans referred. The plans for the second and subsequent years were increasingly tentative and were often revised significantly in subsequent PES rounds.[3]

Following the 1997 General Election, the incoming Government cancelled the 1997 PES in favour of a Comprehensive Spending Review while adhering to the expenditure plans for 1997/98 and 1998/99 set by the previous administration. The review was intended to "…examine each department's objectives and look at every item of spending to ensure that it contributes to the Government's objectives as effectively and efficiently as possible."[4] The Comprehensive Spending Review reported in July 1998 and set public expenditure plans for the years 1999/00 to 2001/02.[5]

The 2000 Spending Review was launched in the autumn of 1999 and is due to be completed by July 2000.[6] Its purpose is revise existing public expenditure plans for 2001/02 and to set plans for 2002/03 and 2003/04. Thus, the last year of the first comprehensive spending review is also the first year in the second. The objectives for the 2000 Spending Review were set out in a written answer:

> **Mr. Matthew Taylor:** To ask the Chancellor of the Exchequer if he will make a statement on the objectives of the second comprehensive spending review.
>
> **Mr. Andrew Smith:** The aim of the 2000 spending review is to determine how best Departments' programmes can contribute to the achievement of the Government's objectives, in particular their aims of:
>
> - opportunity for everyone to fulfil their potential through education and employment;
> - a fair and inclusive society in which communities are healthy and secure;
> - higher productivity, sustainable growth; and
> - effective co-operation with our European and international partners.

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3 This paper does not attempt to provide a history of the public expenditure planning process. Readers interested in the recent past could consult C Thain and M Wright, *The Treasury & Whitehall: The Planning and Control of Public Expenditure, 1976-1993*.

4 HM Treasury, *Budget '97*, HC 85 1997-98 para 1.60

5 HM Treasury, *Modern Public Services for Britain: Investing in Reform*, Cm 4011. Available at: http://www.hm-treasury.gov.uk/pub/html/csr/4011.htm

6 HC Deb 30 March 2000 c259W

> The review will entail a rigorous scrutiny of Departments' performance in delivering effective and responsive services, improving efficiency and managing assets and other resources. It will also consider a range of issues which cross departmental boundaries.
>
> The review will set new departmental spending plans within the firm overall limits for public spending announced in the Budget.[7]

A major feature of all spending reviews is bilateral discussions between the Treasury and spending departments, initially between officials and then at ministerial level. The 2000 Spending Review, however, will also include 15 cross-departmental reviews aimed at identifying the best ways of improving inter-departmental co-operation and co-ordination. Details of the terms of reference of the cross-departmental reviews are given in Appendix 1.

The 2000 Spending Review will be overseen by the Cabinet's PSX Committee on Public Services and Public Expenditure, which is chaired by the Chancellor of the Exchequer. The Committee's terms of reference are: "To monitor progress against public service agreements, to review public expenditure allocations and make recommendations to the Cabinet".[8]

The results of the 2000 Spending Review for the NHS in England (and the Barnett formula consequentials for Scotland, Wales and Northern Ireland) were announced at the time of the March 2000 Budget. One of the reasons for this early announcement was to enable the report on NHS reform and modernisation (*The National Plan for the New NHS*) – to be published with the 2000 Spending Review in July – to be compiled on the basis of known levels of public funding.[9]

On 10 May 2000 the Treasury Committee took oral evidence about the 2000 Spending Review from the Chief Secretary to the Treasury and Treasury officials.[10]

B. Public expenditure trends

The overall level of public expenditure (defined as total managed expenditure - TME) for the period to be covered by the 2000 Spending Review was announced in the March 2000 Budget. (See Section III for details.) TME is planned to increase from £371 billion in 2000/01 to £392 billion in 2001/02, £415 billion in 2002/03 and £440 billion in 2003/04. TME is expected to represent around 39¼% of GDP in 2000/01. This is a relatively low

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7 HC Deb 20 April 2000 c633W

8 Cabinet Office, *Ministerial Committees of the Cabinet: Composition and terms of reference*, December 1999. Library location: deposited paper 99/2014

9 HC Deb 21 March 2000 c871

10 Treasury Committee, *Spending Review 2000*, HC 485-i 1999-2000

ratio by the standards of the last 30 to 40 years. The ratio is expected to increase to around 40½% of GDP by 2003/04. Details are contained in the following table and chart.

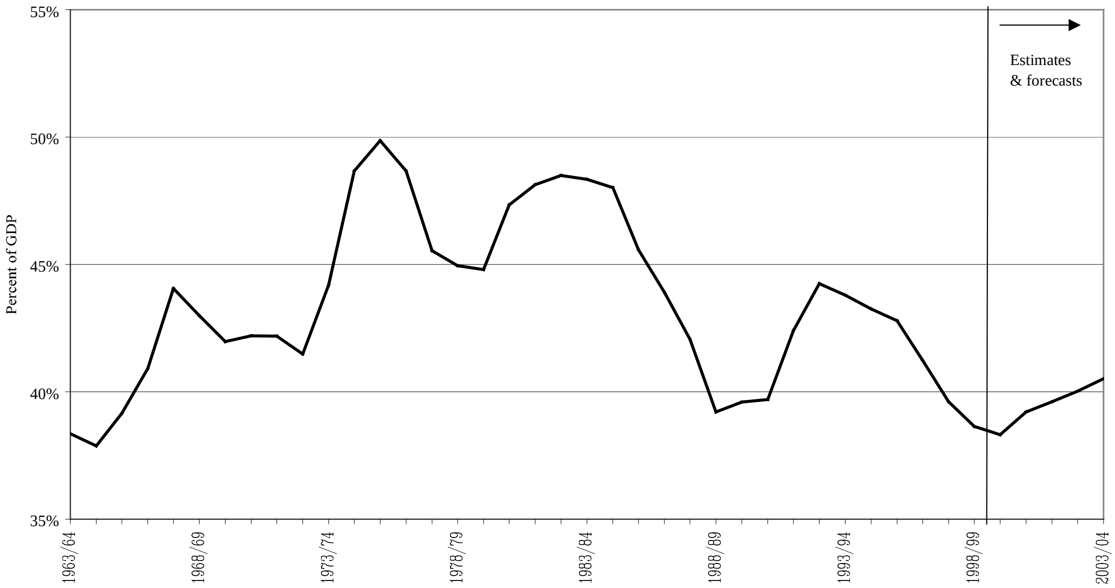
Total Managed Expenditure

Financial year	At cash prices (£ billion)	At 2000/01 prices (£ billion)	As percent of GDP
1963/64	12	154	38.4%
1964/65	13	159	37.9%
1965/66	14	167	39.2%
1966/67	16	178	40.9%
1967/68	18	198	44.1%
1968/69	19	199	43.0%
1969/70	20	199	42.0%
1970/71	22	205	42.2%
1971/72	25	209	42.2%
1972/73	28	217	41.5%
1973/74	33	240	44.2%
1974/75	43	263	48.7%
1975/76	55	267	49.9%
1976/77	63	269	48.7%
1977/78	68	258	45.5%
1978/79	77	263	44.9%
1979/80	93	269	44.8%
1980/81	112	274	47.3%
1981/82	124	279	48.1%
1982/83	137	288	48.5%
1983/84	148	297	48.3%
1984/85	158	301	48.0%
1985/86	165	298	45.6%
1986/87	171	299	43.9%
1987/88	181	301	42.1%
1988/89	188	293	39.2%
1989/90	207	301	39.6%
1990/91	223	302	39.7%
1991/92	250	318	42.4%
1992/93	271	334	44.2%
1993/94	283	340	43.8%
1994/95	297	351	43.3%
1995/96	309	355	42.8%
1996/97	316	352	41.2%
1997/98	323	349	39.6%
1998/99	331	347	38.6%
1999/00 (a)	345	353	38.3%
2000/01 (a)	371	371	39.2%
2001/02 (a)	392	383	39.6%
2002/03 (a)	415	395	40.0%
2003/04 (a)	440	409	40.5%

Note: (a) Consistent with *Budget 2000* .

Sources: HM Treasury, *Budget 2000* , HC 346 1999-2000
tables C3, C4 & C11
ONS - CSDB database series EBFT, YBHA & ABMI

Total Managed Expenditure



II Fiscal framework and Resource Budgeting

A. Fiscal framework

The Government's fiscal policy is based on two rules: the 'golden rule' (relating the public sector current balance) and the 'sustainable investment rule' (relating to net public sector debt). At the time of the March 2000 Budget, the objectives of fiscal policy and the two rules were summarised as follows:

> **2.14** The Government's key objectives for fiscal policy are:
>
> - ♦ over the medium term, ensuring sound public finances and that spending and taxation impact fairly both within and across generations. In practice, this requires that:
>   - the Government meets its key tax and spending priorities while avoiding an unsustainable and damaging rise in the burden of public debt; and
>   - as far as possible, those generations who benefit from public spending also meet the costs of the services they consume.
> - ♦ over the short term, supporting monetary policy where possible, by:
>   - allowing the automatic stabilisers to play their role in smoothing the path of the economy in the face of variations in demand; and
>   - where prudent and sensible, providing further support to monetary policy through changes in the structural (cyclically-adjusted) fiscal position.
>
> **2.15** These objectives are reflected in the Government's two strict fiscal rules, against which the performance of fiscal policy may be judged:

> - **the golden rule:** over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
> - **the sustainable investment rule:** public sector net debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level.
>
> **2.16** The golden rule is met if, on average over a complete economic cycle, the current budget is in balance or surplus. The Government has also said that, other things equal, a reduction in net public sector debt to below 40 per cent of GDP over the economic cycle is desirable.[11]

This Policy comes within the framework of the *Code for Fiscal Policy*[12] prepared under Section 155 of the *Finance Act 1998* and approved by the House of Commons on 9 December 1998.[13] This set five principles for the conduct of fiscal policy:

> The Government shall conduct its fiscal policy in accordance with the following principles:
>
> a. **transparency** in the setting of fiscal policy objectives, the implementation of fiscal policy and in the publication of the public accounts;
> b. **stability** in the fiscal policy-making process and in the way fiscal policy impacts on the economy;
> c. **responsibility** in the management of the public finances;
> d. **fairness**, including between generations; and
> e. **efficiency** in the design and implementation of fiscal policy and in managing both sides of the public sector balance sheet.

The table overleaf summarises the main fiscal indicators as published in the March 2000 Budget. These incorporated the aggregate public expenditure totals on which the 2000 Spending Review is based.

The current budget – the basis for assessing the golden rule – is in surplus throughout the period. The surplus is lower when cyclically adjusted as output is assumed to be above trend during this period. The cyclically adjusted surplus falls over the period covered by the table from 1.8% of GDP in 1999/00 to 0.7% in 2003/04.

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11 HM Treasury, *Budget 2000*, HC 346 1999-2000. Available at: http://www.hm-treasury.gov.uk/budget2000/fsbr/contents.htm

12 Library Location UP2559 1997/98. Available at: http://www.hm-treasury.gov.uk/pub/html/prebudgetNov98/codefs.pdf

13 HC Deb 9 December 1998 cc430-583

Fiscal indicators

Percent of GDP

		1999/00	2000/01	2001/02	2002/03	2003/04
Surplus on current budget (a)	Actual	1.9%	1.5%	1.6%	1.2%	0.8%
	Cyclically adjusted	1.8%	1.3%	1.3%	1.0%	0.7%
Public sector net borrowing (a)	Actual	-1.3%	-0.7%	-0.5%	0.3%	1.0%
	Cyclically adjusted	-1.2%	-0.5%	-0.3%	0.5%	1.1%
Net public sector debt (b)	Actual	37.1%	35.1%	33.6%	32.7%	32.6%

Notes: (a) Excluding windfall tax and associated expenditure.
(b) At end year.

Source: HM Treasury, *Budget 2000*, HC 346 1999-2000 table C1

Public sector net borrowing (PSNB) is the Government's preferred measure of fiscal stance. On a cyclically adjusted basis it is expected increase from –0.5% of GDP (ie in surplus) in 2001/02 to 1.1% of GDP in 2003/04. This indicates that fiscal policy is expected to become less tight.

Net public sector debt – the basis for assessing the sustainable investment rule – is below the 'desirable' 40% level throughout the period. The ratio of net public sector debt falls from 37.1% in 1999/00 to 32.6% in 2003/04. These forecasts were compiled before the outcome of the auction of third generation mobile 'phone licences was known. (See Section IVC below.)

B. Expenditure aggregates

A new system of public expenditure control was introduced in the June 1998 *Economic and Fiscal Strategy Report*.[14] This incorporated a new public expenditure aggregate (TME), a greater distinction between current and capital expenditure, firm multi-year spending limits and increased end-year flexibility. In addition a number of existing concepts were renamed, partly as a consequence of the adoption by the UK in September 1998 of the 1995 European System of Accounts (ESA95). For example, the public sector borrowing requirement (PSBR) became the public sector net cash requirement (PSNCR) and the public sector financial deficit (PSFD) became public sector net borrowing (PSNB). The national accounting framework that reconciles the various concepts of spending and borrowing is set out in Appendix 2.

As mentioned above, the Government's preferred public expenditure aggregate is total managed expenditure (TME). This replaced the previous measure of general government expenditure (GGE). TME is defined as the sum of three elements consistent with national accounting concepts: public sector current expenditure, depreciation and public sector net investment. However, for public expenditure control purposes, TME consists of two

[14] HM Treasury, *Stability and investment for the long-term*, Cm 3978. Available at: http://www.hm-treasury.gov.uk/pub/html/efsr/3978.htm

components: departmental expenditure limits (DEL) and annually managed expenditure (AME).

- **Departmental Expenditure Limits**: are firm plans for three years for a specific part of a department's expenditure. In general the DEL covers all running costs and all programme expenditure except in certain cases where spending is included in departmental AME because it cannot reasonably be subject to close control over a three-year period. DELs are divided into current and capital budgets.

- **Annually Managed Expenditure**: is spending included in TME that does not fall within DELs. Expenditure in AME is generally less predictable and controllable than expenditure in DEL. Major items within AME include social security benefits, central government gross debt interest and local authority self-financed expenditure.

C. Resource budgeting

2001/02 will be the first year in which the traditional system of cash accounting for government departments will be replaced by resource accounting. The main differences between cash and resource accounting are:

- Current expenditure and income are on an accruals basis. This means that the income or expenditure is recorded in the period to which the transaction relates even if the cash is paid or received in a different period.

- The cost of a capital asset is spread over the life of the asset in the form of a depreciation charge rather than scoring as expenditure when the asset is purchased. In addition there will be an annual 6% cost of capital charge to reflect the opportunity cost of tying-up funds. These two items will be termed the 'capital charge'. Under cash accounting the cost of a capital asset is charged in full in the period when it is acquired.

To reflect the introduction of resource accounting the 2000 Spending Review will be the first to be conducted on a resource budgeting basis. This was confirmed in a written answer in December 1999:

> **Mrs. Lawrence:** To ask the Chancellor of the Exchequer when he plans to proceed with the introduction of resource budgeting.
>
> **Mr. Andrew Smith:** The next spending review, in 2000, will be conducted on a resource basis. This will fulfil the Government's commitment in the Code for Fiscal Stability to adopt, as soon as reasonably practicable, a resource accounting and budgeting approach for planning and accounting for the costs of resources consumed by government.
> The decision to proceed with resource budgeting follows a successful "dry run" of the new procedures carried out by all Departments during the course of 1999.

> This confirmed that the procedures were workable. However, it also highlighted a transitional issue in relation to Departments' ability to forecast the large new non-cash elements of resource budgets (depreciation, capital charges and provisions) for three years ahead.
> To allow time for a track record in forecasting, monitoring and controlling these items to be established, resource budgeting will therefore be introduced in two stages. In the first stage, in the plans drawn up in the 2000 spending review, the big non-cash elements of resource budgets will be part of Annually Managed Expenditure rather than Departmental Expenditure Limits. The intention is that, in the light of experience, these items will be moved into Departmental Expenditure Limits following the 2002 spending review.
> Details of the new arrangements are being placed in the Libraries of the House.[15]

The presentation of the results of the 2000 Spending Review will therefore be rather different from that in the Comprehensive Spending Review. Under resource budgeting each department will have a resource budget and a capital budget. Both the resource and capital budgets will contain elements that are within DEL and AME.

The flowchart overleaf illustrates how the system for resource budgeting is organised.

A department's resource budget will include administration costs and programme costs (both on an accruals basis) plus the cost of capital charge. The resource budgets of each department, together with items not allocated to specific departments (eg debt interest, National Lottery, EU contributions, local authority self-financed expenditure), comprise the overall resource budget. Various adjustments are then required in order to reconcile the resource budget to the national accounts total for public sector current spending and depreciation. These adjustments are many and various. They include technical adjustments to reflect differences between the treatment of transactions in the national accounts and resource budgeting (eg which transactions are accrued and how depreciation is calculated) and also differences in coverage (eg removing EU contributions and adding tax credits).

The capital budget will include new capital spending less receipts (eg from the sale of assets) plus net lending to the private sector or overseas.[16] The total capital budget includes the capital budget of each department plus items not attributed to departments such as local authority self-financed expenditure and the unallocated balances of the Capital Modernisation Fund and the Invest to Save Budget. Again various adjustments are then required in order to reconcile the capital budget to the national accounts total for net public sector investment. This will include deducting depreciation and net lending.

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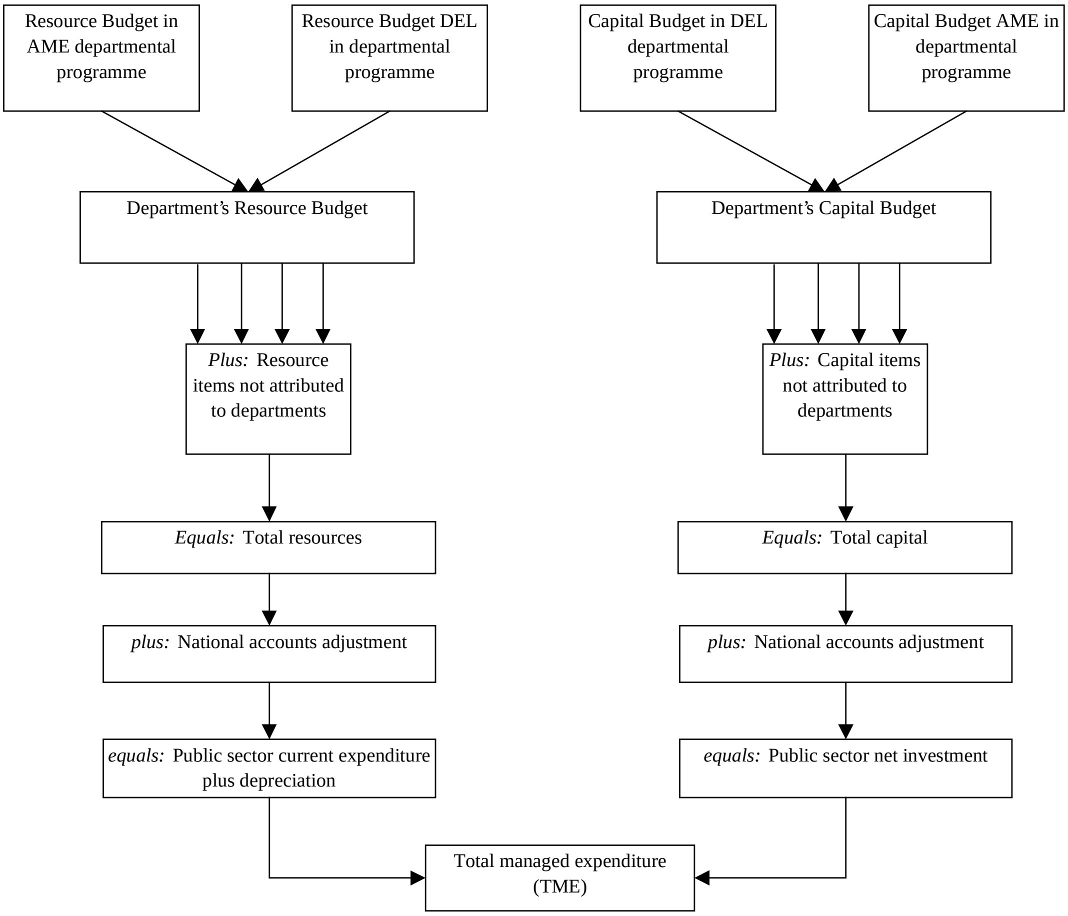
15 HC Deb 21 December 1999 c584W. Details were published in HM Treasury, *Resource Accounting and Budgeting: A short guide to the financial reforms*, December 1999. Library location: deposited paper 99/2004

16 Net lending is outside the scope of TME but is included in the departments' capital budgets to enable the Treasury to exercise control. It is later deducted in the national accounts adjustments in order to reach the correct total for TME.

Resource Budgeting Framework



III How much additional expenditure?

As noted in section IB above, the public spending 'envelope' for the 2000 Spending Review was announced as part of the March 2000 Budget. In particular:

- public sector net investment is assumed to rise to 1.8% of GDP by 2003/04 compared to 0.9% in 2000/01, and
- public sector current expenditure is planned to grow at 2½% in real terms from 2001/02 to 2003/04.

Overall TME is expected to grow by 10.1% in real terms between 2000/01 and 2003/04 equivalent to an annual rate of 3.3%. How does this translate into additional spending to be allocated to departments in the 2000 Spending Review? The following analysis is based on definitions of AME and DEL that applied prior to the introduction of resource budgeting.

One crucial factor is the proportion of TME that is allocated to demand-led programmes in AME such as social security and debt interest. Once this has been determined, AME can be deducted from TME to provide the aggregate level of DEL.

Press articles have suggested that, excluding the NHS, total DEL in 2003/04 will be at least £28 billion above the level so far announced for 2001/02.[17] This appears to be consistent with an assumption that AME grows at 1.5% per annum in real terms over the period 2000/01 to 2003/04. This is illustrated in the following table:

Possible increases in cash DELs
Assuming 1.5%pa real growth in AME

	2000/01 (£bn)	2001/02 (£bn)	2002/03 (£bn)	2003/04 (£bn)	Average real growth 00/01-03/04
Public sector current expenditure	348	366	384	404	2.5%
Depreciation	15	15	15	16	0.8%
Public sector net investment	8	11	16	20	31.3%
TME	371	392	415	440	3.3%
of which: AME (a)	177	184	191	200	1.5%
DEL (b)	194	209	224	240	4.8%
of which: NHS (c)	54	59	63	69	5.6%
Other announced to date (d)	140	144	144	144	n.app.
Residual		6	16	28	n.app.

Notes: (a) Assumes increases in 2002/03 and 2003/04 to achieve overall real increase of 1.5%pa.
(b) TME less AME
(c) Including Barnett formula consequentials of Budget announcement.
(d) Assuming non-NHS cash DEL for 2001/02 is maintained in 2002/03 and 2003/04.

This suggests that net additional DEL allocations (beyond the funds for the NHS already announced) could be some £6 billion in 2001/02, £16 billion in 2002/03 and £28 billion in 2003/04. After the Comprehensive Spending Review, increases in spending were expressed as cumulative cash totals for the three years. On this basis the total would be some £50 billion in addition to the £24 billion announced for the NHS in the March 2000 Budget. The cumulative cash increases in DEL announced in the Comprehensive Spending Review totalled some £63 billion including £21 billion for the NHS.

If AME were to grow less rapidly, say by 0.5% per annum in real terms, the amount of additional DEL would be higher, perhaps £6 billion in 2001/02, £19 billion in 2002/03 and £33 billion in 2003/04. On the other hand, if AME were to grow more rapidly, say by 2.5% per annum in real terms, the amount of additional DEL would be lower, perhaps £6 billion in 2001/02, £14 billion in 2002/03 and £22 billion in 2003/04. Both scenarios are illustrated in the following tables:

[17] See for example, “Brown to spend extra £40 billion”, *The Times*, 29 May 2000 p1

Possible increases in cash DELs
Assuming 0.5%pa real growth in AME

	2000/01 (£bn)	2001/02 (£bn)	2002/03 (£bn)	2003/04 (£bn)	Average real growth 00/01-03/04
Public sector current expenditure	348	366	384	404	2.5%
Depreciation	15	15	15	16	0.8%
Public sector net investment	8	11	16	20	31.3%
TME	371	392	415	440	3.3%
of which: AME (a)	177	184	189	194	0.5%
DEL (b)	194	209	227	246	5.7%
of which: NHS (c)	54	59	63	69	5.6%
Other announced to date (d)	140	144	144	144	n.app.
Residual		6	19	33	n.app.

Notes: (a) Assumes increases in 2002/03 and 2003/04 to achieve overall real increase of 0.5%pa.
(b) TME less AME
(c) Including Barnett formula consequentials of Budget announcement.
(d) Assuming non-NHS cash DEL for 2001/02 is maintained in 2002/03 and 2003/04.

Possible increases in cash DELs
Assuming 2.5%pa real growth in AME

	2000/01 (£bn)	2001/02 (£bn)	2002/03 (£bn)	2003/04 (£bn)	Average real growth 00/01-03/04
Public sector current expenditure	348	366	384	404	2.5%
Depreciation	15	15	15	16	0.8%
Public sector net investment	8	11	16	20	31.3%
TME	371	392	415	440	3.3%
of which: AME (a)	177	184	194	205	2.5%
DEL (b)	194	209	221	234	4.0%
of which: NHS (c)	54	59	63	69	5.6%
Other announced to date (d)	140	144	144	144	n.app.
Residual		6	14	22	n.app.

Notes: (a) Assumes increases in 2002/03 and 2003/04 to achieve overall real increase of 2.5%pa.
(b) TME less AME
(c) Including Barnett formula consequentials of Budget announcement.
(d) Assuming non-NHS cash DEL for 2001/02 is maintained in 2002/03 and 2003/04.

IV Other issues

A. Departmental planning

One of the purposes of both Resource Accounting & Budgeting and the 1998 Comprehensive Spending Review was to explicitly link expenditure to the Government's objectives. To this end, the 2000 Spending Review will be based around three documents for each review: Public Service Agreements (PSAs), Departmental Investment Strategies (DISs) and Service Delivery Agreements (SDAs).

1. Public Service Agreements (PSAs)

PSAs were a novel feature of the 1998 Comprehensive Spending Review. They brought together in one document information on departmental aims & objectives, resources, performance & efficiency targets and related policy initiatives. The PSAs were published in white papers in December 1998 and March 1999.[18]

For the 2000 Spending Review the aim is to have shorter PSAs that are more focused on key priorities. In a speech to the IPPR *New Economy* Launch Event on 4 April 2000 the Chief Secretary to the Treasury, Andrew Smith, stated:

> First we are focussing even harder on the things that really matter. PSAs are all about priorities. Openness and accountability about priorities should not be allowed to be fudged by too great a mass of targets.
>
> Second, we are making sure part of this focussing process involves separating out the key overall goals (the "what"), from targets for Departmental processes and operations (the "how").
>
> Third, we are working harder than ever before on ensuring we target the right measures of success. Determining what it is you want to achieve is the first crucial step. But picking the right measure to avoid unwanted distortions in the system, is as important.
>
> Finally, we are sharpening up our targets, making them as transparent as possible. We should be clear in every case about **what** the terms of the targets mean, **when** we are committing to deliver the target, and **how** it will be measured.[19]

2. Service Delivery Agreements (SDAs)

SDAs are a feature new to the 2000 Spending Review. They will support the PSAs by describing how the Government's priorities will be delivered, and the management and operational changes departments will be introducing to facilitate this.

3. Departmental Investment Strategies (DISs)

DISs were a novel feature of the 1998 Comprehensive Spending Review. For each department the DIS set out the broad strategy for managing capital and how this supported the department's wider objectives. Further details were provided in a white

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[18] HM Treasury, *Public Service Agreements 1999-2002*, Cm 4181; *PSA Supplement*, Cm 4315. Cm 4181 is available at: http://www.hm-treasury.gov.uk/pub/html/psa/csrpsa.pdf

[19] HM Treasury, *The future for public service agreements*, press release 48/00 4 April 2000. Available at: http://www.hm-treasury.gov.uk/press/2000/p48_00.html

paper in April 1999.[20] The DISs will be up-dated during the 2000 Spending Review and put on to a Resource Accounting and Budgeting basis.

4. Annual reporting

It is proposed that, under Resource Accounting and Budgeting departments will produce two main financial documents each year. A departmental plan, published in the spring, will replace the existing departmental report. It will include the department's expenditure plans on a resource basis and relate these to its objectives as set out in its PSA and SDA. The departmental plan will also set out the detailed resource estimate to be approved by Parliament. In the autumn there will be a departmental report that will include a copy of the audited accounts for the previous year and a report on performance against objectives as set out in its PSA and SDA.

B. The Barnett formula

The arrangements for determining levels of public expenditure in Scotland, Wales and Northern Ireland were set out in a Treasury document published in March 1999.[21] Readers seeking a full exposition of the arrangements should consult this source.[22] The following notes look specifically at the way in which Barnett formula consequentials are determined in the public expenditure planning process.

During the course of a public expenditure round, DELs for Scotland, Wales and Northern Ireland are (for the most part) not negotiated separately, but are determined by the so-called 'Barnett formula'.

For each Whitehall department there is a comparability factor for Scotland, Wales and Northern Ireland. This reflects the proportion of the department's expenditure for which the devolved administration had responsibility in the base year. For example, the Scottish Executive and National Assembly for Wales (NAW) have no responsibility for social security and therefore have a comparability factor of zero with the DSS. On the other hand the Northern Ireland Executive has full responsibility for social security in the Province and therefore has a comparability factor of 100% with the DSS. Comparability factors for other departments can vary between these extremes.[23]

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[20] HM Treasury, *Departmental Investment Strategies: A summary*, Cm 4324. Available at: http://www.hm-treasury.gov.uk/pdf/1999/cm4324.pdf

[21] HM Treasury, *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland*, available at: http://www.hm-treasury.gov.uk/pub/html/docs/swni.html

[22] There may be some minor changes to the arrangements for the 2000 Comprehensive Spending Review to reflect the introduction of resource budgeting.

[23] Details of the comparability factors to be used in the 2000 Spending Review have not yet been published – HC Deb 17 May 2000 c186W

The other part of the formula is based on population shares. Usually these represent the population of Scotland, Wales and Northern Ireland expressed as a proportion of the population of England. However, where a Whitehall department generally has a wider geographical responsibility, a different share is used. For example, because law and order is largely planned on an England and Wales basis, the appropriate population share for Scotland is Scotland's population as a proportion of that of England and Wales. Similarly because social security is generally planned on a Great Britain basis, the appropriate population share for Northern Ireland is Northern Ireland's population as a proportion of that of Great Britain. The following table sets out these population shares on the basis of the latest mid-year population estimates.

Barnett formula population data

Country	Population mid-1998 (millions)	Percent of England	Percent of England and Wales	Percent of Great Britain
England	49.494	n.app.	n.app.	n.app.
Wales	2.934	5.93%	n.app.	n.app.
Scotland	5.120	10.34%	9.77%	n.app.
Northern Ireland	1.689	3.41%	3.22%	2.93%
United Kingdom	59.237	n.app.	n.app.	n.app.

Source: ONS, *Monthly Digest of Statistics*, April 2000 tables 2.1 & 2.2

Thus, for each change to the DEL of a Whitehall department, the Barnett formula consequential for Scotland, Wales and Northern Ireland is the change multiplied by the comparability factor multiplied by the relevant population share. For example, in the 1998 Comprehensive Spending Review the comparability factor for the Department of Health was 99.2% for each of Scotland, Wales and Northern Ireland. If £1 billion is added to the DEL of the Department of Health then the consequentials would be £102.6 million [£1,000m*99.2%*10.34%] for Scotland, £58.8 million [£1,000m*99.2%*5.93%] for Wales, and £33.8 million [£1,000m*99.2%*3.41%] for Northern Ireland.

The consequentials relating to each department are added to (or subtracted from) the existing DEL for Scotland, Wales and Northern Ireland. Most of the DEL is in the form of an assigned budget for which the devolved administration has responsibility. It is therefore not necessary for the devolved administration to use any additional resources for the same purposes as in England.

There has been particular concern in Wales that the Barnett formula will not reflect the special circumstances associated with the designation of West Wales and the Valleys as an Objective 1 area under the EU's structural funds. As funding from the structural funds will largely be channelled through the National Assembly of Wales these will score against its DEL. In addition the NAW (or its grant-funded bodies) will provide some of the 'matching' funds required for structural fund projects (ie the proportion of the project cost not met by the EU grant). The Treasury has agreed to consider the implications of obtaining Objective 1 status as part of the 2000 Spending Review:

> **Mr. Llwyd:** To ask the Chancellor of the Exchequer (1) what representations he has received from the National Assembly for Wales in relation to Objective 1 match funding and the Comprehensive Spending Review; (2) what representations he has received from the (a) First Secretary of the National Assembly for Wales and (b) Secretary of State for Wales with relation to (i) the Comprehensive Spending Review and (ii) this year's Comprehensive Spending Review and Objective 1 match funding.
>
> **Mr. Andrew Smith:** There have been a number of representations on the 2000 spending review and Objective 1 funding. The implications for the Welsh block arising from Objective 1 funding are currently being considered as part of the Government's Spending Review which is now under way.[24]

C. Proceeds from the auction of mobile phone licences

The auction of third generation mobile communication licences in April and May 2000 raised some £22½ billion. This is thought to be around £20 billion more than was assumed at the time of the Budget.[25] The DTI expects all the receipts to be received in the current financial year.[26] These receipts will score immediately against the public sector net cash requirement (PSNCR) but, in line with national accounting principles, will be spread over the 21-year life of the licences in determining the public sector surplus on current budget and public sector net borrowing.

The Government has announced that it intends to use the proceeds to reduce net public sector debt. For example:

> **Mr. Simon Hughes:** To ask the Chancellor of the Exchequer how he intends to use the (a) Budget surplus of 2000-01, (b) income from mobile phone licence sales and (c) Exchequer reserves.
>
> **Mr. Andrew Smith:** The Budget plans were set out in Budget 2000 (HC 346). Proceeds from mobile phone licence sales will be used to reduce public sector net debt. Reserves are used in line with the provisions of the Exchequer Equalisation Account Act 1979.[27]

Even if these receipts are initially used to repay government debt, additional resources could potentially be released for spending on services. Each £1 billion of national debt that is repaid this year will reduce the annual cost of debt interest by around £60-£70 million. Within the existing plans for total managed expenditure this could be re-deployed to other programmes.

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[24] HC Deb 16 May 2000 c103W
[25] "Mobile phone licence winners to get tax relief", *Financial Times*, 10 April 2000
[26] HC Deb 12 May 2000 c503W
[27] HC Deb 18 May 2000 c255W

Appendix 1: Terms of reference of cross-departmental reviews

The 2000 Spending Review includes 15 cross-departmental reviews. These will involve the Treasury, the Cabinet Office and outside experts. The first 13 reviews were announced in December 1999 and will cover the following areas:

> The review of **Welfare to Work and ONE** will consider how the Government can move further towards its aim of employment opportunity for all. The review will look at all expenditure devoted to moving people from welfare to work, including expenditure on the Employment Service, the New Deals and the cost of providing benefits, training and advice for those not in work. This work is being led by members of the Cabinet sub-committee on Welfare to Work. Departments involved include Education and Employment, Social Security, Health, Inland Revenue and others.
>
> The review of **Sure Start and Services for the Under Fives** will consider the Sure Start programme in the light of developments since its launch in 1998. It will review evidence which has emerged since the last spending review, and will aim to take a complete view of what current needs are and what different government programmes are delivering. Minister for Public Health Yvette Cooper will report on this review with Secretary of State for Employment David Blunkett. Involved are the Departments of Health, Education and Employment, Environment, Transport and Regions, Social Security and the Home Office.
>
> The review of **Young People at Risk** will report on the most cost effective policies and means of service delivery for helping young people at risk aged 13 - 19 to make the transition safely from childhood to adulthood. It will make recommendations on adjustment to existing programmes as well as on co-ordination and accountability arrangements. The work is being led by Minister for Employment, Welfare to Work and Equal Opportunities Tessa Jowell and involves Departments across Whitehall.
>
> The review of **Support for Older People** will look at the scope for improving the "gateway" to ongoing care and support for older people and some disabled people who cannot work. It will review existing arrangements for information provision and needs assessments, exploring the possibility of a single point of access to services. It will consider the scope for more rational, effective and efficient systems of service delivery across the boundaries of social services, social security, the NHS, other government bodies, and the private and voluntary sectors. The work is being led by Minister of State for the Cabinet Office Ian McCartney and involves Departments across Whitehall.
>
> The **Criminal Justice System** review will build on initial work in the Comprehensive Spending Review. The CSR proposed setting clear objectives and targets for the criminal justice system as a whole and introducing new arrangements for joint strategic planning and performance management at national and local level. The new study will take stock of what has been achieved and what more remains to be done, and help underpin effective crime reduction.

The Home Secretary Jack Straw will lead this review. All departments involved in the criminal justice system will participate.

The review of **Drugs** will build on the work undertaken in the previous spending review to make a fundamental and rigorous assessment of the effectiveness of the use of existing anti-drugs resources. As well as considering the outputs and resources required to underpin the strategy, it will also consider mechanisms for co-ordination and delivery of the strategy, both at national and local level. A particular concern will be to focus efforts on pro-actively tackling the root causes, rather than reactively subsidising failure. The review is being led by Minister for the Cabinet Office Mo Mowlam, working with the UK Anti-Drugs Co-ordinator Keith Hellawell and Departments across Whitehall.

The review of **Crime Reduction** will build on the Crime Reduction Strategy established in the last spending review. It will consider the scope for crime-reducing activities across the whole of Government, tackling the full range of factors associated with criminality and offending. The review team will ensure that its findings are reflected in resource allocation and target setting in the 2000 Spending Review. The review is being led by Home Office Minister of State Charles Clarke and Departments across Whitehall are involved.

The review of **Local Government Finance** will provide an overview of the spending needs and objectives of English local government to inform decisions in the 2000 Spending Review. The key outputs of the review will be the local authority revenue settlement and investment strategy. The review will also consider how targets can best be delivered on the ground. The review is being led by Minister for Local Government and the Regions Hilary Armstrong. All Departments with an interest in local government are involved.

The review of **Government Intervention in Deprived Areas** will consider the impact of main programmes in deprived areas as well as regeneration funds and area-based initiatives. Building on recent work by the Social Exclusion Unit, it will seek to ensure that the 2000 Spending Review supports the Government's aim of narrowing the gap between the most deprived neighbourhoods and the rest of the country. The Chief Secretary has asked Treasury Permanent Secretary Sir Andrew Turnbull to lead this review, reporting to all interested ministers.

The review of **Rural and Countryside Programmes** will build on the recent recommendations to Government by the Performance and Innovation Unit and ongoing work on the Rural White Paper. It will consider rural development, environmental issues and the provision of public services in rural areas. Minister for the Cabinet Office Mo Mowlam will lead this review. Other departments involved include the Ministry of Agriculture, Fisheries and Food, the Department of Environment Transport and the Regions and the Department of Trade and Industry.

The review of **Science and Research** aims to ensure that science which is supported from public funds in England is being properly conducted and exploited to the benefit of the economy at large. This work will take full account of work being carried out for a Science and Innovation strategy led by the DTI. It will be led by Minister for Science Lord Sainsbury, and will involve the Department of Trade and Industry, the Department for Education and Employment, and the other Departments that play a significant role in this area.

The review of **Conflict Prevention in Sub-Saharan Africa** will consider how the UK's objectives for conflict prevention in this region can best be defined and delivered. The review will also consider the scope for applying the conclusions of the review to conflict prevention worldwide. The review will be led by Secretary of State for International Development Clare Short. Other departments involved include the Foreign Office and the Ministry of Defence.

The review of **Nuclear Safety in the Former Soviet Union** will identify the UK's key priorities, taking into account G7, EU and other international efforts to address nuclear safety, security and mitigation of the nuclear legacy in the FSU. It will examine how both UK bilateral assistance and UK contributions to multilateral programmes contribute towards achieving these objectives. The review is being led by Foreign Office Minister of State John Battle. Other Departments involved include Trade and Industry, Defence, International Development and Environment, Transport and the Regions.[28]

Two further reviews have subsequently been added covering the following areas:

Knowledge Economy

This review will consider best how to develop the **Knowledge Economy** and how best to move towards the Government's aims of making Britain the best country for e-commerce by 2002; putting all government services on-line by 2005; and having universal access the Internet by 2005. A key focus of the review will be electronic government – ensuring that these plans are co-ordinated to maximise efficiency through electronic service delivery. The review is being chaired by the Chief Secretary and the Minister for E-commerce.

Active Community

The review of the **Active Community** is considering how we might encourage an increase in volunteering in statutory services and in communities. The review is being chaired by Lord Falconer.[29]

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28 HM Treasury, *Public services reform: making a real difference: details of cross-cutting reviews in 2000 spending review*, press notice 214/99 21 December 1999. Available at: http://www.hm-treasury.gov.uk/press/1999/p214_99.html

29 HM Treasury. Library location deposited paper 00/900

Appendix 2: Concepts of borrowing and spending

The table on page 27 summarises the national accounts framework that enables the various borrowing and spending aggregates to be reconciled. The table includes eight lettered boxes indicating the main aggregates:

- **Box A – Public Sector Current Expenditure**: includes the main items of public expenditure other than investment and includes most general government pay and procurement and social security benefits. (Operating revenues and expenses of public corporations are netted-out.)

- **Box B – Public Sector Surplus on Current Balance**: is the difference between current receipts and current expenditure. This differs from the usual national account concept of current account gross saving due to the different treatment of depreciation and capital taxes. This is the measure used to assess performance against the 'golden rule'.

- **Box C – Public Sector Net Investment**: is defined as follows:

	Public sector gross fixed capital formation (net of asset sales)
plus	Increases in inventories and valuables
plus	Capital grants to the private sector
less	Depreciation of fixed assets
less	Capital grants received from the private sector

- **Box D – General Government Net Borrowing**: was previously known as the general government financial deficit. This represents the balance on current and capital accounts. It is the measure of government deficit used under the excessive budgets procedure contained in the original Maastricht treaty.

- **Box E – Public Sector Net Borrowing**: was previously known as the public sector financial deficit. This represents the balance on current and capital accounts. It also represents general government net borrowing (box D) plus public corporations' net borrowing.

- **Box F – Public Sector Net Cash Requirement**: was formerly known as the public sector borrowing requirement. This represents public sector net borrowing (box E) plus the financial transactions in lines 25 to 29 which add to or reduce the need for the public sector to borrow.

Public Sector Accounts: 1998/99

£ billion

Line	Transaction	General government			Public corp's	Public sector
		Central government	Local authorities	Total		
	Current receipts (a)					
1	Taxes & social security contributions (b)	301.0	12.1	313.1	-0.0	313.1
2	Gross operating surplus	4.0	8.5	12.5	4.5	17.1
3	Interest & dividends from private sector & abroad	3.0	0.8	3.8	0.3	4.0
4	Interest & dividends (net) from public sector	6.3	-3.9	2.4	-2.4	
5	Rent & other current transfers	0.7	0.0	0.7	0.6	1.3
6	**Total current receipts**	**315.0**	**17.5**	**332.5**	**2.9**	**335.5**
	Current expenditure					
7	Current spending on goods & services	96.1	60.0	156.1		156.1
8	Subsidies	3.6	0.8	4.4		4.4
9	Net social benefits	93.5	13.6	107.1		107.1
10	Net current grants abroad	-1.0		-1.0		-1.0
11	Current grants (net) within public sector	61.3	-61.3			
12	Other current grants	16.7		16.7		16.7
13	Interest paid to private sector & abroad	29.2	0.3	29.5	-0.5	29.1
14	**Total current expenditure**	**299.4**	**13.4**	**312.8**	**-0.5**	**312.3 A**
15	**Depreciation**	**3.8**	**6.0**	**9.8**	**3.8**	**13.6**
16	**Surplus on current budget (6)-(14)-(15)**	**11.8**	**-1.8**	**10.0**	**-0.4**	**9.6 B**
	Net investment					
17	Gross fixed capital formation (c)	4.5	5.7	10.2	4.3	14.6
18	*less*: Depreciation	-3.8	-6.0	-9.8	-3.8	-13.6
19	Increases in inventories & valuables	0.0		0.0	0.1	0.1
20	Capital grants (net) within public sector	4.0	-2.8	1.2	-1.2	
21	Capital grants to private sector	3.8	1.0	4.8		4.8
22	*less*: Capital grants from private sector		-0.4	-0.4	-0.0	-0.4
23	**Net Investment**	**8.6**	**-2.6**	**6.0**	**-0.6**	**5.4 C**
24	**Net borrowing (23)-(16)**	**-3.2**	**-0.8**	**-3.9 D**	**-0.2**	**-4.1 E**
	Financial transactions					
25	Net lending to private sector & abroad	0.3	-0.1	0.2	0.1	0.3
26	Net acquisition of UK company securities	0.2	0.1	0.3	0.2	0.6
27	Amounts receivable/payable	0.1	0.2	0.3	-0.3	0.0
28	Adjustments for interest on gilts	-2.4	0.0	-2.4	0.0	-2.4
29	Other financial transactions	-1.2	0.1	-1.1	-0.2	-1.3
30	**Net cash requirement (24)+(25) to (29)**	**-6.2**	**-0.4**	**-6.6**	**-0.4**	**-7.0 F**
31	Net lending within public sector	1.6	-1.9	-0.2	0.2	
	Public expenditure aggregates					
32	**General government expenditure (14)+(15)+(23)-(22)+(25)+(26)+(31)**	**314.0**	**14.9**	**328.9 G**		
33	**Total managed expenditure (14)+(15)+(23)**	**311.8**	**16.8**	**328.6**	**2.7**	**331.3 H**

Notes: (a) On an accruals basis.
(b) Includes capital taxes and council tax. Excludes oil royalties.
(c) Net of sales of fixed assets.

Source: ONS, Financial Statistics, May 2000 tables 1.1A & 2.3C

- **Box G – General Government Expenditure**: prior to 1998 GGE was the main public expenditure aggregate. It represents total current and capital expenditure of general government plus financial transactions in lines 25, 26 & 31. Net acquisition of company securities (line 26) has been negative in most recent years reflecting the privatisation programme.[30]

- **Box H – Total Managed Expenditure**: is the new public expenditure aggregate and is the sum of current expenditure (box A) depreciation (line 15) and net investment (box C).[30]

Thus to move from TME to GGE one deducts public corporations self-financed TME (line 33) and adds financial transactions within GGE (lines 25, 26 & 31).

[30] In this presentation the local government contribution to GGE and TME only represents self-financed spending. The total contribution can be calculated by adding in current grants (line 11), capital grants (line 20) and, for GGE, net lending (line 31) from central government.

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