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A Constructive Critique of the Treasury's Country and Regional Analysis of Public Expenditure

Jim Cuthbert and Margaret Cuthbert

Introduction

1. The accurate measurement and control of public expenditure is fundamental to successful government: it is essential at each of the stages of policy development, implementation, and monitoring. This paper is concerned with issues in the measurement of public expenditure in the post-devolution United Kingdom: in particular, we provide a constructive critique of the expenditure data currently published by the Treasury.

2. Our study is based on two regular exercises carried out by the Treasury:

a. the publication of the annual Public Expenditure Statistical Analyses (PESA), which contains an analysis of public expenditure attributable to the countries/regions of the UK. This attributable expenditure is known as identifiable: the remainder, (with minor exceptions), is known as non-identifiable.

b. the publication of the biennial Treasury Funding Statement for the Devolved Administrations (TFS), which sets out the procedures used in setting the budgets for the devolved administrations of the UK.

3. The starting point for this study was information obtained by the authors under the Freedom of Information (FOI) Act: namely, the fully detailed data base which underpins the PESA country/regional expenditure tables.

Access to this detailed data transforms the potential for analysing and understanding the published public expenditure figures, and also the operation of devolution. It is now possible to check, at individual sub-programme level, whether the classifications used in PESA are consistent with the split between devolved and reserved responsibilities in the TFS: in fact, in important respects, they are not consistent. Moreover, it is now possible to gain an understanding of exactly what expenditure is included in particular published PESA aggregates: the results of this are sometimes surprising.

4. The structure of the paper is as follows:

Section 1 gives background on PESA and TFS, and outlines the basic approach used in the current study.

Section 2 considers the treatment of expenditure which is on devolved functions and which is not identifiable in PESA. We show that there is a significant error in one of the key PESA statistics: at least £4.4 billion of expenditure on certain services in England is treated as non-identifiable, while expenditure on the corresponding services in Scotland is treated as identifiable: this affects the comparison of identifiable expenditure between the two countries.

Section 3 considers expenditure on devolved functions which is identifiable in PESA. One of our findings is that there is an asymmetry between Scotland and England in the way certain of these services are handled in PESA, which again affects the identifiable expenditure comparison between the two countries, though the effects of this error will be relatively small.

Section 4 considers reserved functions. It is shown that there are areas of ambiguity, and some apparent mistakes, in the way certain expenditure is classified in PESA.

Section 5 outlines the benefits of publishing considerably more of the detailed information underlying PESA than has been the practice to date.

Section 6 identifies the implications of our findings for the annual Government Expenditure and Revenues in Scotland (GERS) exercise carried out by the Scottish Executive.

Section 7 contains our conclusions and recommendations: these include detailed suggestions for improvements which are required in the conduct of the PESA and TFS exercises, and for the publication of data.

Section 1: Background on the Public Expenditure Statistical Analyses and the Treasury Funding Statement.

The Public Expenditure Statistical Analyses

1.1 PESA, (Treasury, 2005), is the primary source of outturn data on public expenditure in the UK. The country and regional analysis, (CRA), section shows public expenditure identifiable to Scotland, Wales, Northern Ireland and also the English regions. As the Treasury itself says of the CRA, "These National Statistics are widely used as the main source of regional spending data by analysts inside and outside Government." (ref: Treasury Guidance.)

1.2 The definition of identifiable expenditure is given in para 8.13 of PESA as

"that which can be recognised as having been incurred for the benefit of individuals, enterprises or communities within particular regions",

while non-identifiable expenditure is

“that which is deemed to be incurred on behalf of the UK as a whole: e.g., defence expenditure.”

The basic principle, therefore, is that expenditure should be allocated to a country/region on the basis of who benefits from the relevant service, rather than on the basis of the location where the relevant service is provided.

1.3 The CRA data is based on an annual Treasury exercise carried out with Whitehall Departments, in which departments split each of the identifiable sub-programmes by country/English region. The Treasury combines this data with those relating to the devolved administrations, and local authorities, to produce the CRA analysis.

1.4 We note here two points from the guidance issued to departments on how to allocate identifiable expenditure, (ref: Treasury Guidance):

a. All transfer payments, (including current grants and subsidies to companies), are regarded as identifiable, on the basis of the residence or location of the grant recipient. (para 32 of guidance).

b. Spending on collective services by central government bodies is only regarded as identifiable where services are delivered at a regional or local level, and are mostly for the benefit of a regional or local community: (page 8 of guidance).

1.5 The data set used here, obtained under the FOI Act, is consistent with the aggregate figures published in the CRA of PESA 2005. It consists of data for 2003-04 expenditure by central government and public corporations, cross-classified by department (of which there are 49): expenditure function (18 categories): sub-function (59 categories): sub-programme (796 categories): whether capital or current: whether identifiable or non-identifiable: and, if identifiable, by country/region of England (13 categories).

Treasury Funding Statements (TFS)

1.6 Every two years, the Treasury produces a statement on the funding of the devolved administrations. “The purpose of this statement is to set out the policies and procedures which underpin the exercise of setting the budgets for the devolved administrations, and to inform those inside government and outside how the funding process operates.” (Treasury, 2004). The TFS is the only detailed source showing which sub-programmes are reserved and which devolved.

1.7 The TFS also sets out for each sub-programme within each relevant Whitehall Department, information on whether or not the function relating to that sub-programme is devolved to Scotland, Wales, or Northern Ireland, or is reserved.

Bringing the CRA and TFS data together

1.8 Technically, it should be possible to consider each item of expenditure as being cross classified by whether it is identifiable or non-identifiable in PESA: and whether the corresponding function has been classed as reserved or devolved in the TFS. Such an exercise would give a classification of expenditure, as set out in the following diagram:

		Non-Identifiable	Identifiable	Devolved
A				B Reserved
C	D			

In fact, it is not possible to carry out a complete reconciliation, because the sub-programme breakdowns used in the two Treasury sources are not wholly consistent. Nevertheless, much that is of considerable interest does emerge from even the partial reconciliation that is possible. The following three sections discuss expenditure falling in cell A, cell B, and cells C and D respectively.

Section 2: Expenditure on devolved functions which is non-identifiable in PESA: (Cell A above)

2.1 All Scottish Executive expenditure is regarded by the Treasury as identifiable. One might expect, therefore, that expenditure on the same services undertaken by Whitehall departments in England would be identifiable in the PESA database. However, comparison of the detailed PESA data with the TFS for 2002 and 2004 indicates that there are at least 82 expenditure cells, accounting for almost £4.4 billion of expenditure in England, where this expenditure is classed as non-identifiable in PESA, but where the corresponding functions in Scotland are devolved (and therefore identifiable).

2.2 The main departments where this occurs, and the corresponding amounts of expenditure falling into this category, are shown in the following table.

Expenditure on devolved functions which is non-identifiable in PESA: 2003-04

	£ million
Home Office	2,758
DEFRA	500
Constitutional Affairs	491
Office of Deputy Prime Minister	375
Other Departments	273
Total	4,397

For each department, the main functions contributing to the above table are:-

Home Office: operation of the prison system in England.
 DEFRA: functions such as English Nature and the Countryside Commission, along with a large number of environmental protection measures.

Department for Constitutional Affairs: the Court Service Agency and judicial salaries for England.

Office of the Deputy Prime Minister: the Valuation Office Agency, Central admin., and non-domestic rate collection for England.

2.3 Para 8.17 of PESA 2005 states that “figures for expenditure per head in the regions of England and the countries of the UK are therefore directly comparable.” This statement is contradicted by the fact that, as we have just seen, at least £4.4 billion of expenditure in England on functions which are devolved to Scotland is excluded from the basis of identifiable expenditure in England, while expenditure on the same functions in Scotland is included in identifiable expenditure in Scotland. This means that the comparison of identifiable expenditure between Scotland and England is not on a like for like basis, with identifiable expenditure in England being understated by at least 1.45% relative to the expenditure base used to describe identifiable expenditure in Scotland.

2.4 This problem has arisen because PESA is intended to fulfil the functions of providing both (a) English regional comparisons and (b) country comparisons such as between England and Scotland. As it is impossible to identify English expenditure on some functions to the regions, the basis of comparison between English regions is different from that between England and Scotland. The present formulation of PESA, embodying a single concept of identifiable expenditure, is therefore too simplistic to enable both of these functions to be accomplished without error. In the next paragraph we outline the change which requires to be made in PESA to correct the problem.

2.5 The services listed at the end of para 2.2 would normally be regarded as general collective services for the whole of England: but since they have Scottish counterparts, they are not collective for the whole of the UK. As noted above in para 1.4b, the Treasury guidance on PESA classifies general collective services as non-identifiable. On this basis, the services in question would reasonably be classified as non-identifiable for regions within England, but identifiable between the countries of the UK. However, the CRA survey and database only have one category for non-identifiable, meaning non-identifiable for all countries/regions of the UK.

It would appear therefore, that what requires to be done to correct the error is to introduce a new “non-identifiable in England” category into PESA: and when making public expenditure comparisons comparing Scotland and England, to add the “non-identifiable in England” category to identifiable in England to put the comparison on the same basis as identifiable in Scotland.

3. Identifiable expenditure on devolved services (Cell B)

3.1 The Scottish Executive accounted for some £14,281m of identifiable expenditure in Scotland on devolved services in 2003-04. In addition, £168m of expenditure by Whitehall departments was identified to Scotland in 2003-04 on services which are devolved to Scotland. This expenditure is spread over some 7 departments and some 50 or so individual sub-programme cells of expenditure.

3.2 This £168 million comprises expenditure of three main types.

- a. where a Whitehall department is administering a devolved service for Scotland effectively as an agent of the Scottish Executive.
- b. where, in the course of administering a devolved service for England, nevertheless some of the resulting expenditure can be validly attributed as benefiting Scotland under the rules of PESA.
- c. where the attribution of expenditure to Scotland appears questionable.

3.3 Examples of the first category are:

- a. expenditure undertaken by the now defunct Strategic Rail Authority on the franchising of rail operators. Rail franchising is a devolved service to the Scottish Executive: but this function was administered by the SRA acting in consultation with Scottish Executive Ministers. In 2003-04, SRA expenditure attributed to Scotland under this head was just over £30 million.
- b. expenditure by the Criminal Injuries Compensation Agency: the CICA, which is listed in PESA under the Home Office, administers criminal injuries compensation for the whole of Great Britain, and is funded jointly by the Home Office and the Scottish Executive: the amount of expenditure identifiable to Scotland is £33m.

3.4 The second category of expenditure in para 3.2 arises where a Whitehall department is administering a devolved service in England, but where some of the beneficiaries can nevertheless be identified as being resident in Scotland. This could occur, for example, (a) where Scottish residents visit a national museum or gallery in England: (b) where recipients of certain public sector pension schemes such as for NHS (England) employees or for teachers in England, decide to retire to Scotland.

3.5 Given the “who benefits from the service” definition of identifiable expenditure in PESA, it appears quite reasonable that elements of English provision in cases like the above should be attributed to Scotland. However, there is a resulting asymmetry of treatment between Scotland and England. Scotland, from its devolved budget, funds national

museums and galleries and runs public sector pension schemes for teachers and NHS employees. Some of the beneficiaries of these Scottish services will be resident in England, but all Scottish expenditure on these services is attributable to Scotland in PESA. This asymmetry represents another distortion to the comparison of identifiable expenditure between Scotland and England. The effect will not be particularly large, given, for example, that expenditure by DCMS on Museums and Galleries attributable to Scotland amounts to just over £5million, and by DfES on teachers' pensions attributable to Scotland amounts to £19.8m. Nevertheless, it would be desirable if the anomaly were corrected in PESA.

3.6 The third category distinguished in para 3.2 is where the attribution of devolved expenditure to Scotland by a Whitehall department appears questionable. To give two examples:

a. The Department of Works and Pensions attributes £59.6 million of European expenditure to Scotland in 2003-04, comprising £7m payments under European Social Fund (ESF), £50.2m Payments in Advance under ESF, and £2.4m under ERDF. However, both ESF and ERDF are devolved to Scotland and the Scottish Executive PESA figures contain £47m for ESF and £98m for ERDF. The DWP attribution to Scotland appears highly questionable.

b. Again, under DWP, £4.2m is attributable to Scotland for administration of the Rent service - a purely English service. This too appears highly questionable.

We pointed out these questions to the Treasury: following the submission of the original text of this paper, they have come back to us confirming that the attribution of these payments to Scotland was incorrect.

3.7 Finally, it is worth concluding this section by noting another more intangible benefit of detailed scrutiny at sub-programme level: namely, an enhanced appreciation of the very concept of "identifiable expenditure". There is perhaps a tendency to think about identifiable expenditure in terms of the large programmes such as health and education. It is salutary to be reminded that tucked away in the figures are also elements like usage by Scottish residents of national galleries and museums in England, or the pensions paid to certain public sector pensioners who have relocated to Scotland.

Section 4: Reserved functions (Cells C and D)

4.1 The decision as to whether reserved expenditure should be regarded as identifiable or non-identifiable appears to be governed in most cases by the two principles which were outlined in para 1.4 above. However, for some categories of reserved expenditure, the decision is by no means clear cut. The specific example which probably best illustrates the problem is the grant payments made by the DTI to the United Kingdom Atomic Energy Authority,

(UKAEA): these payments are regarded in PESA as identifiable. In 2003/04, DTI provided £260.5m to the UKAEA for decommissioning, of which £111.8m (42.9%) was identifiable to Scotland: and £58.4m in grant-in-aid, of which £25m (42.8%) was identifiable to Scotland.

4.2 Presumably the UKAEA payments are regarded as identifiable in PESA because of the principle that grants to undertakings are identifiable. However, the service being provided by the UKAEA is a collective service for the UK as a whole: it is clearly in the interest of, and the responsibility of, the UK as a whole to see that its nuclear programme is safely tidied up. Scotland indeed benefits from the resulting multiplier effects, given that a substantial amount of the resulting expenditure is actually incurred here: but the fundamental principle in PESA is meant to be attribution on the basis of who benefits from the service, not who benefits from any multiplier effects of the cost of providing the service. On this basis, we argue that UKAEA expenditure should be treated as a collective service and hence regarded as non-identifiable in PESA.

4.3 The UKAEA represents only one, (if, admittedly, a fairly clear cut), example where there could be legitimate debate about the allocation of reserved services between identified and non-identified in PESA. In fact, there is a whole spectrum of transfer payments and grants, ranging from pure provision of services at one end, to provision of what is clearly a collective service at the other, with, in the middle, a considerable grey area which could be argued either way. Consider, for example, grants made by the research councils to fund scientific research. These are reserved, are identifiable in PESA, and are allocated by location of recipient research establishment. Clearly, they also serve a collective UK purpose- to develop the science base of the UK as a whole. But also, clearly, the receipt of a research council grant confers a tangible benefit on the recipient university- conferring prestige, and improving future prospects. The recipient universities are much more than mere agents spending the grant funding. On this basis, the decision to identify research council grants in PESA seems, on balance, entirely reasonable.

4.4 The substantive point we take away from this discussion is that some of the decisions as to whether reserved expenditure should be identified or not are genuinely difficult, and raise complications which go beyond the principles laid down in the current PESA guidance. There is potential ambiguity, particularly in relation to transfer payments and grants, between the "who benefits" and "location" principles for allocating expenditure to countries/regions. We recommend that the Treasury should improve the guidance it publishes in this area.

4.5 We now turn to another problem which arises with respect to reserved expenditure: this occurs where a Whitehall department has mixed responsibilities, covering provision of reserved services for the whole of the UK, while at the same time providing other services for England only.

The first example like this which we consider is activity by the Department of Culture, Media and Sport, (DCMS), in the field of tourism.

4.6 The DCMS is responsible, through VisitBritain, for promoting tourism overseas for Britain as a whole: it also has responsibility for promoting tourism locally within England, (the English Tourism Council (ETC) was subsumed into VisitBritain), and as part of this provides some of the funding for the English Regional Tourist Boards through grants. Surprisingly, despite this mix of British and specifically English responsibilities, all these DCMS functions are classed as reserved in the TFS.

From the detailed PESA database, it can be seen that of the total of £61.5 million expenditure in 2003/04, only £5.549 million is actually identified, a sum which is attributed to the English regions, and consists of the grants paid by VisitBritain to the English RTBs. This raises two important issues.

a) A significant part of DCMS activities on tourism relates to England, (namely, distribution of grant to RTBs in England, and the functions of the ETC subsumed in VisitBritain), with no parallel activities being undertaken by DCMS in Scotland. The classification of the DCMS expenditure on tourism in the TFS as reserved therefore looks wrong. This should be re-visited. Otherwise the effect is that Scotland is excluded from any Barnett consequences of the DCMS comparable activity of promoting tourism locally in England.

b) Whether or not the reserved/devolved status of DCMS tourism activity is revised, the identifiable/non-identifiable split of DCMS tourism expenditure is clearly wrong. The only expenditure which is identifiable to England is the £5.5m grant distribution to the RTBs. But for the remaining DCMS expenditure, there is evidence to suggest that a substantial component is expenditure purely or primarily for England. (For example in 2002/03, DCMS paid grants of £16.2m to the ETC and Greater London Authority - with no corresponding Scottish grant payments. Also relevant is the evidence quoted in Cuthbert and Cuthbert, (2002), to the effect that certain other key DCMS activities are slanted primarily towards England.) The identifiable/non-identifiable status of DCMS expenditure on tourism requires to be re-examined, taking into account a proper assessment of who actually benefits, and of the effort put in with respect to the different parts of Britain.

4.7 Exactly similar issues arise in our second example, with respect to support for export promotion and inward investment: these are reserved functions handled by UK Trade and Investment, and the PESA database records respectively £34.9m for DTI admin.: £21m for inward investment: and £75m for trade development.

The first of these categories is identifiable in PESA with £2.89m (8.3%) attributed to Scotland, which is close to Scotland's population share. However, according to the UK Trade and International finance department (see Cuthbert and Cuthbert, 2002), in 2002/03, £15.4m of expenditure under this head related purely to England, with no comparable spend for Scotland. So the wholly reserved classification of this category in TFS, and the identifiable to Scotland figure in PESA, both look suspect.

The other two categories, of inward investment and trade development, are not identifiable in PESA. However, in 2002/03, £12.9m of the inward investment spend was for grants to the English Regional Development Agencies, (RDAs), with no corresponding Scottish spend. So again, the wholly reserved classification of this category in PESA looks wrong, and at least the £12.9m should have been identified in PESA to England.

4.8 There is a general lesson to be learned from these two examples. If care had been taken to ensure that the PESA and TFS classifications were consistent, and if the reserved/devolved, and identifiable/non-identifiable status of each resulting cell of expenditure had been published, then it would have been obvious, (even at the stage of compiling the data), that the way in which the money was actually being spent was inconsistent with the TFS classification of all these functions as reserved. If so, not merely would better data have resulted, but it is probable that a better service for all parts of the UK would have resulted as well. Alternatively, if the Department continued to exercise some purely local English functions, then the relevant expenditure should be reclassified as devolved in the TFS.

Section 5 Further benefits of access to enhanced PESA data

5.1 This section considers two further potential benefits from the ability to access enhanced and detailed PESA information. First, is the opportunity to look below the main expenditure headings to see what is actually happening at micro level. Second, at a more aggregate level, there is the potential to fill an important gap in our understanding of the effects of devolution itself.

5.2 To illustrate the first advantage we consider two particular areas: employment, and enterprise.

5.3 PESA (Table 8.11) implies that expenditure per head on employment policies in 2003-04 was £148 per head in Scotland relative to £55 in the UK. This difference appears to suggest a much greater focus in Scotland on improving employment opportunities. The detail of employment expenditure for Scotland taken from the PESA database is shown below.

Spending Agency	£m
Scottish Executive:	
Scottish Enterprise	461.4
ESF	47.3
Careers Service	0.2
DWP	394.9
Other	9.1
Total	912.9

5.4 When we examined this breakdown, the following errors in the data became apparent.

a. The figure for Scottish Enterprise (SE) represents all of SE expenditure including spend on enterprise as well as employment.

b. The figures exclude Highlands and Islands Enterprise (HIE) spend on employment, which is included under enterprise.

Correcting these errors would mean replacing the figure of £461.4m in the above table by £176m, (which is the SE and HIE combined spend on skills and employment). Note that these errors, which are readily detectable once the detailed data is available, are virtually undetectable from the published aggregate figures alone. The effect is to reduce the spend on employment in Scotland to £628m, or £102 per head.

We informed the Treasury of the misallocation of SE and HIE expenditure in PESA: their response was that they would include both Scottish Enterprise and HIE under Enterprise as from PESA 2006. Since, as we have seen, these bodies have responsibility for both employment and enterprise functions, this is not a satisfactory response.

5.5 In addition, the detailed information in the PESA database also tells us much that is interesting about the nature of expenditure on employment. No less than £190m of the £394.9 million DWP spend on employment is DWP administration. In fact, it appears from the DWP Annual Report, (2005), that almost all the administration costs for those of working age have wrongly been attributed to the employment function, so the £190m figure should be significantly reduced. (This mistake occurs for all parts of the UK so it does not affect country/region comparisons.) In addition, note that £98.3m of the DWP spend is on restructuring: that is, internal DWP spend on improving their service. While this is validly included under employment, the implication of the large administration and restructuring component is that the amount spent on frontline employment policies in Scotland is quite small and probably only £55 per head. This is just over a third of the headline PESA figure of £148 per head.

5.6 Our second example is the PESA data on Enterprise and Economic Development. Identifiable expenditure on this function in Scotland is £550m, comprising Scottish Executive £307m, UK Departments (mainly DTI) £154m, and Local Authorities £89m, (Table 8.17 of PESA 2005). The PESA database, however, reveals the following features:

a. the composition of the Scottish Executive figure is as follows

HIE	£95.5m
ERDF	£98m
RSA	£40.3m
Promotion of Tourism	£36.2m
Central and misc.	£19.5m
Electricity	£12.3m
Other	£ 5.2m
Total	£307m

This table mistakenly includes all HIE expenditure but omits all that of Scottish Enterprise: this is the other side of the error we noted in para 5.4 above. To correct this, the figure of £307m should increase by £284.5m.

b. Under DTI are items like £69.4m for ring fenced coal health liabilities, and £34.8m for the Post Office. While no doubt correctly attributable to Enterprise and Economic Development in a technical sense, these nevertheless do not spring obviously to mind as mainstream constituents of this function. The same can also be said of Electricity and Central and Misc. in the Scottish Executive table above. Overall, the message is that without examining the detail, there is no indication in the PESA aggregate figures either as to the serious error in the overall total figure for Enterprise and Economic Development, or of the actual nature of significant elements of the expenditure being undertaken. Without this detail, wrong conclusions could easily be made as to the effectiveness and value for money of spend on employment and enterprise policies.

5.7 Our findings in the previous two examples are relevant to the study carried out by Wood, (2005), for the Scottish Parliament Finance Committee. Wood's study concluded that there was a lack of evidence that spending on public services had been influenced by economic development priorities. This conclusion was based on examination of Scottish Executive budget figures: the Wood study used the published PESA aggregate figures for spend on enterprise and employment in Scotland by Whitehall departments. Had it been able to examine the detail in the PESA database underlying the figures on Whitehall spend in Scotland on

enterprise and employment, it would have been able to draw even stronger conclusions.

5.8 Our final example in this section deals with an aggregate-level advantage of enhancing the basic PESA data set. One of the most interesting features of devolution should be to observe how patterns of expenditure in the different countries diverge, reflecting differing and changing priorities in the constituent countries of the UK. It is a remarkable gap in current data sources that there is no published analysis that adequately illustrates this. The published PESA data for the Scottish Executive and Welsh Assembly do indeed show (with some very minor exceptions) how spending on devolved services is split by function in these two countries. The problem is that, for England, the PESA database contains only information on whether expenditure is identifiable or not: it does not show devolved/ reserved status. So all that can be produced from PESA are analyses of identifiable expenditure for England: which is quite different from an analysis of expenditure on services which are devolved.

This gap could easily be filled if, as we recommend, the Treasury aligned the sub-programme classifications used in PESA and TFS: and recorded in each annual PESA database both the identifiability and reserved/devolved status of each cell of expenditure.

5.9 In practice, the procedure would be slightly more complicated than this, since:

a. There might be a need for a small increase in the number of expenditure cells, since some PESA cells would need to be split if they currently contain a mix of devolved and reserved responsibilities.

b. There are some differences in the mix of services devolved to Scotland, Wales and Northern Ireland: so a slightly more complicated coding structure would be required to describe devolution status, rather than a simple binary distinction between devolved and reserved. These, however, are relatively minor complications compared to the potential benefits from the proposed change. Together they could result in a more accurate TFS, improved data quality in PESA, and analyses showing a proper comparison of the patterns of spend on devolved services in Scotland, (or Wales, or Northern Ireland), in comparison with the same services in England.

6. Implications for GERS

6.1 The Government Expenditure and Revenue in Scotland (GERS), (Scottish Executive, 2004), has been produced annually by the Scottish Executive (previously the Scottish Office) since 1992. GERS is intended “to enhance public understanding of fiscal issues in Scotland”, and gives an estimate of the balance between government revenues and expenditures in Scotland. Note that for the purposes of GERS, Scotland is defined to exclude the North Sea, so

North Sea revenues are excluded. On the expenditure side, the intention is to capture all of the general expenditures of government attributable to Scotland: this is a much broader concept than PESA identifiable expenditure. We published in 1998 a critique of technical and philosophical aspects of GERS, (Cuthbert and Cuthbert, 1998): much of that paper is still relevant.

6.2 On the expenditure side, GERS is fundamentally based on PESA. To the PESA estimate of identifiable expenditure for Scotland is added a share of non-identifiable UK expenditure and also a share of any government expenditure which has been identified in PESA to “outside UK”. Non-identifiable and outside-UK expenditure are apportioned to Scotland using factors like Scotland’s population share of the total UK population.

6.3 Our findings in the earlier sections of this paper have immediate implications for GERS. Some of these findings mean that there are clear or likely errors in GERS: for example,

a. In section 2, we identified at least £4.4 billion of expenditure in England which was non-identifiable within England but was classed in PESA as generally non-identifiable within the UK. The attribution in the GERS methodology of Scotland’s population share (8.5%) of non-identifiable expenditure to Scotland would mean that at least £370 million of English expenditure would be wrongly attributed to Scotland.

b. In section 3, we identified over £63m on ESF and the Rent Agency whose attribution to Scotland in PESA is incorrect.

c. In section 4, we questioned the attribution to Scotland of £136.8m of UKAEA expenditure.

d. In section 3, we identified an asymmetry in the way certain services were identified between Scotland and England, which results in identifiable expenditure in Scotland being somewhat overstated relative to England. The net effect of these items alone is that the GERS methodology, if applied to the 2003-04 data, would overstate general government expenditure in Scotland by over £500m.

Note that the last published GERS relates to 2002-03, while we have the detailed PESA data only for 2003-04. However, it is clear from comparison of the published PESA figures for 2002-03 and 2003-04 that the same mistakes were made in PESA in these two years. So the published GERS figures for 2002-03 are in error because of the above points by about the same order of magnitude.

6.4 We argued in section 4, there needs to be a more general exercise conducted in PESA, examining in much greater detail the identifiable / non-identifiable status of expenditure on reserved functions. Further, we have not

been able to completely reconcile the inconsistent sub-programme classifications used in PESA and the TFS: hence we are not confident that we have identified all of the significant errors in PESA.

The implication, therefore, is that our work in this paper has established that there are significant errors and question marks in PESA which impact on GERS: that the effect of the errors identified so far on GERS is that Scottish expenditure is overstated by around £500m. There is, however, further work to be done, and PESA will not provide an adequate platform upon which to build a GERS exercise until the reforms which we are advocating for PESA have been undertaken.

The fact that past GERS exercises have been conducted without detecting the kind of problems with the underlying PESA data which have been identified here, points to a failure in the Scottish Executive to adequately check the source data.

6.5 In addition, we recommend that the Scottish Executive should publish much more detailed information as part of any future GERS exercise. Specifically, for each non-identifiable or outwith-UK cell of expenditure, the Scottish Executive should publish reserved/devolved status, exactly what factors they have used in apportioning the expenditure to Scotland in GERS, and how much expenditure has been apportioned as a result. This detail would greatly add to general understanding of exactly what is being attributed to Scotland by GERS.

To give one example, consider the Channel Tunnel Rail Link. This Department of Transport function is reserved, and is identifiable expenditure in PESA. In 2003-04, of the £223.6m expenditure within the UK, less than 0.5% is identifiable to Scotland, equivalent to just over £1m. However, a substantial amount of the expenditure on the channel tunnel rail link is classed in PESA as outwith-UK (£166m). Given the GERS methodology, 8.5% of this outwith-UK expenditure would be attributed to Scotland – amounting to £14.1m. Clearly, there is, to say the least, room for debate as to whether Scotland should be attributed with 8.5% of outside UK expenditure, but less than 0.5% of within UK expenditure on this function.

This is the type of issue which would immediately become apparent if the detailed data we are recommending was published each year with any future GERS.

Section 7 Conclusions and Recommendations

7.1 In this article we have uncovered significant weaknesses in the country and regional analysis as currently conducted: (given that our study has not been comprehensive, there may well be others). We list below detailed recommendations which would remedy these weaknesses. The effect of implementing these recommendations would, however, go further than improving the utility and quality of the data in PESA, and the accuracy of the TFS. As we have seen, (from the tourism

and enterprise examples discussed in section 4), a degree of mismatch can occur between the description in TFS of what the devolved/reserved responsibilities of a department ought to be, and what the department actually does. In these circumstances, the actual quality of service delivery is likely to be compromised. Hence implementing the recommendations outlined below is likely to lead to an actual improvement in the quality of service itself.

7.2 Our detailed recommendations are:

- i. the Treasury should align the sub-programmes used in the PESA and TFS exercises, and the reserved/devolved status of each expenditure cell should be recorded in the PESA database.
- ii. The lack of a “non-identifiable within England” category of expenditure in PESA should be rectified.
- iii. The asymmetry for certain functions in the attribution of devolved identified expenditure as between England and the devolved administrations should be corrected.
- iv. Improved guidance should be issued on the attribution of identifiable expenditure in PESA.
- v. The Treasury should produce and publish detailed expenditure data at department/sub-programme level, showing for each item of expenditure whether the function is reserved or devolved, as in the Treasury Funding Statement: whether it is identifiable or non-identifiable in PESA terms, and, if identifiable, the country/regional split of the expenditure.
- vi. The Treasury should use the devolved/reserved code included in the enhanced PESA database to produce and publish analyses of expenditure on devolved services, split down by function, on a comparable basis for all countries of the UK.
- vii. As regards the Scottish Executive, it should pay greater attention to checking the quality of source data for any GERS type exercise: if it continues with the annual GERS exercise, it should publish for each non-identifiable sub-programme, (as published at (v)), the basis of apportionment to Scotland used in GERS.

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