



HM TREASURY

The Spending Review framework



The Spending Review framework

Presented to Parliament by
The Chancellor of the
Exchequer
by Command of Her Majesty

June 2010



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1

Introduction

1.1 Reducing the budget deficit is the most urgent issue facing Britain. Last year, the latest Public Sector Net Borrowing forecast was the largest in Britain's peacetime history. The March Budget forecast the UK deficit to be 11 per cent of GDP this year. According to the International Monetary Fund (IMF), the UK has the highest budget deficit in the G7 and G20, and its latest forecasts project that public sector debt will double between 2007 and 2015, to around 90 per cent of GDP.

1.2 This high level of borrowing – a legacy of the previous Government – risks undermining fairness, growth and economic stability in the UK. The Government is committed to tackling the deficit and restoring debt to a sustainable path as:

- in general, the higher the level of debt, the higher the interest rate that markets will demand to compensate them for holding that debt. Failure to tackle Britain's deficit would therefore both push up the costs of debt service and risk higher long-term interest rates, not just for the Government, but also for families and businesses through the higher costs of loans and mortgages. Higher interest rates tend to reduce economic growth, through their adverse impact on investment and productivity;
- without urgent action, debt interest will take an increasing proportion of public expenditure, squeezing out spending on priorities. On the previous Government's plans debt interest was set to reach £70bn by 2014-15, around double the amount as a share of GDP as in 2006-07. It is unproductive and unfair to spend more on debt interest payments than, for example, on schools in England. All else being equal, action to reduce the level of debt reduces debt service costs and the level of tax required to deliver a given level of public services over the long term;
- as has been shown by recent developments, the level of debt can rise quickly when economic shocks hit. Higher levels of debt reduce the Government's capacity to respond to future economic shocks; and
- public borrowing is only taxation deferred, and it would be irresponsible to accumulate substantial debts that would have to be paid off by subsequent generations in the decades to come.

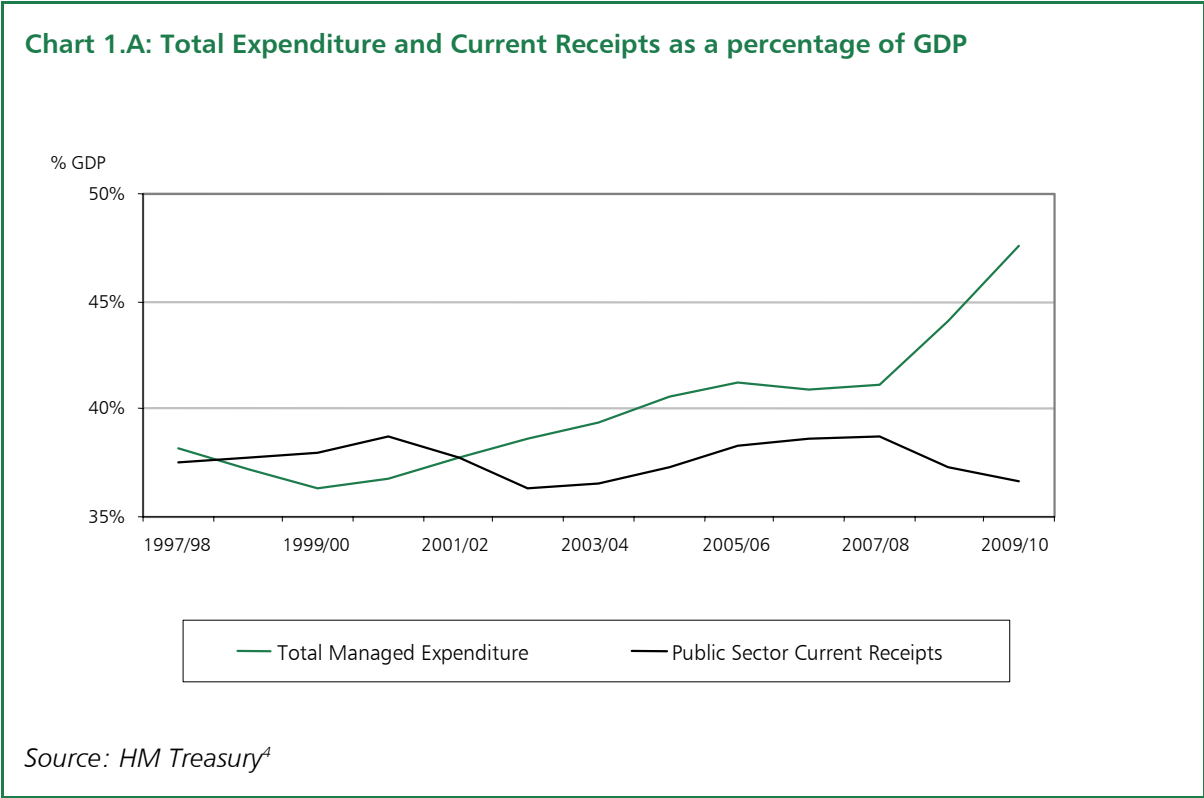
1.3 That is why the Government has committed to a significant acceleration in the reduction of the structural deficit over the course of the Parliament. This is necessary to show the world that Britain can live within its means, thereby rebuilding confidence in the economy and protecting jobs.

1.4 The Government is committed to carrying out Britain's unavoidable deficit reduction plan in a way that strengthens and unites the country. The Spending Review will be guided by the principles of freedom, fairness and responsibility, in order to demonstrate that we are all in this together.

1.5 The Government has made clear that the bulk of the deficit reduction will be achieved through reductions in spending rather than increased taxes. Ensuring that taxpayers' money is

well spent is the fair and responsible way to reduce the deficit. This is consistent with international best practice: IMF research suggests that spending reductions are more likely to deliver a successful fiscal consolidation and better economic performance.

1.6 Under the previous Government, public expenditure was set to reach £704 billion this year, a historically high level of 48 per cent of GDP.¹ Government receipts have averaged around 38 per cent over the past 20 years, not exceeding 40 per cent in that time.² Chart 1.A shows a widening gap between government expenditure and receipts in recent years, reaching 11 per cent of GDP this year.³



1.7 Tackling a deficit of this scale requires urgent action. The Government has already set out how it will reduce spending this year by £6¼ billion by cutting waste. This involved taking some difficult decisions, but was essential to demonstrate the Government’s determination to get to grips with the deficit. The Government’s actions have already been endorsed by the conclusions of the G20 group of finance ministers in South Korea.

1.8 But reducing spending this year is only the first step on a long road towards restoring good management of Britain’s public finances. Even tougher decisions will be required at the Spending Review. The Government is determined to take those decisions in a way that is in line with its values of freedom, fairness and responsibility. The Government will:

- deliver its guarantee that health spending will increase in real terms in each year of the Parliament, and that 0.7 per cent of GNI will be spent on overseas aid by 2013;
- limit as far as possible the impact of reductions in spending on the most vulnerable in society, and on those regions heavily dependent on the public sector;

¹ Source: HM Treasury. March Budget 2010
² Source: HM Treasury. Data derived from National Statistics Public Finances statistical releases
³ Source: HM Treasury. March Budget 2010
⁴ Data derived from National Statistics Public Finances statistical releases

- protect as far as possible the spending that generates high economic returns; and
- make further savings to fund the priorities set out its programme.

1.9 The Government’s approach to public spending will not only be to live within its means but also to ensure that expenditure is focused on protecting the quality of the key frontline services that are important to the public and that provide support to the worst off in society. There can be no justification for spending public money on programmes and projects without considering the impact on the outcomes that people care about. This means putting in place structures that ensure accountability and transparency. All departments will publish business plans showing the structural reforms that they will implement to create more effective accountability and the measures they will take to ensure that effective results are delivered from the resources and inputs agreed in the Spending Review.

1.10 Successfully reducing the largest deficit in Britain’s peacetime history will mean approaching the Spending Review in a completely different way from how it has been approached in the past. It will mean:

- thinking innovatively about the role of government in society;
- taking the difficult decisions collectively as a Government to reduce the deficit; and
- consulting widely using all available talents to ensure that we deliver a stronger society as well as a smaller state.

1.11 This approach is at the heart of the coalition Government’s partnership, and draws on lessons learned from international examples of successful fiscal consolidations in the past, such as in Canada in the 1990s. They used a “Star Chamber” model of program review boards at Ministerial and senior official level to challenge departmental spending plans using a series of key questions to promote innovative thinking.

1.12 This document sets out the Government’s plans for the Spending Review, and the steps it will take from today to deliver this. In the June Budget, the Government will set the overall path for the public finances, including expenditure, over the rest of the Parliament.

2

Strategic approach to spending

2.1 The forthcoming Spending Review will involve more than the allocation of resources. While it will rightly focus on reducing Britain's record deficit and restoring sound public finances, it will also provide a platform to consider new and radical approaches to public service provision.

2.2 The scale of the challenge presents an opportunity to take a more fundamental look at the role of government in society and how it can fulfil that role. The Review will therefore consider how to deliver a step change in public sector productivity and value for money. The Government's values of freedom, fairness and responsibility will underpin its approach. The Government also recognises that how it spends money is often more important than how much it spends.

2.3 The Spending Review will set out a long-term vision for public services and a programme of key reforms to deliver that vision, including the specific actions being taken to implement reforms. The Government will:

- deliver a step change in the drive for efficiency and value for money in the public sector, including by driving down the cost of operational delivery as well as simply cutting out waste and lower priorities. The new Efficiency and Reform Group will support departments to deliver savings in specific areas, including renegotiating contracts, maximising collective buying power and using benchmarking to improve performance. Each Secretary of State will also appoint a Minister with specific responsibility for driving value for money across their department, identifying savings opportunities and playing a key role in challenging spending in all areas including spending on contracts and programmes;
- challenge departments, local government and delivery partners to consider fundamental changes to the way they provide vital services. This includes looking at how they can promote fairness by better targeting interventions; how they can promote freedom by encouraging a greater range of service providers, challenge state monopolies and exploit the synergies between delivery bodies; and how they can promote greater responsibility by shifting power, funding and accountability into the hands of individuals and frontline professionals who are often better placed to allocate limited resources;
- set out its plans to reform the welfare system, and to restrain the costs of public sector pay and pensions. The more that can be achieved in these areas, the more the Government will be able to do to protect jobs and spending on frontline public services; and
- look beyond near-term pressures to support reforms that better position the UK for meeting long-term demographic, economic, environmental and social challenges, any of which could imperil long-term fiscal stability if left unaddressed.

2.4 In light of its commitments to fairness and social mobility, the Government will look closely at the effects of its decisions on different groups in society, especially the least well off, and on different regions. Coupled with the radical reforms the Government has proposed for welfare, taxes and education, this Spending Review will make supporting those most in need a priority.

2.5 To ensure that all of these issues are considered, and that resources are prioritised within tighter budgets, departments will be asked to prioritise their main programmes against tough criteria on ensuring value for money of public spending:

- Is the activity essential to meet Government priorities?
- Does the Government need to fund this activity?
- Does the activity provide substantial economic value?
- Can the activity be targeted to those most in need?
- How can the activity be provided at lower cost?
- How can the activity be provided more effectively?
- Can the activity be provided by a non-state provider or by citizens, wholly or in partnership?
- Can non-state providers be paid to carry out the activity according to the results they achieve?
- Can local bodies as opposed to central government provide the activity?

2.6 In this era of substantially tighter spending, it is going to be more important than ever to demonstrate to the public that money is well spent. Setting out plans at the Spending Review is just the first step. The Government will then need to ensure that the reform programme is achieved and that there are robust mechanisms to ensure accountability to the public.

2.7 To achieve this, the Government has ended the previous government's complex system of Public Service Agreements, which relied on top-down performance management and too many politically motivated targets. Over the Spending Review, the government will consider the best structures for ensuring departmental accountability for achieving more for less. This will include the publication of departmental business plans showing the resources, structural reforms and efficiency measures that they will need to put in place to protect and improve the quality of key frontline services while spending less. These plans will also include the key statistics and data that the public can use to hold departments to account for spending money efficiently and effectively.

2.8 The Coalition Programme for Government¹ also made a commitment to create strong financial discipline at all levels of government and place an obligation on public servants to manage taxpayers' money wisely. In accordance with this, the Government will:

- strengthen and re-position the role of the departmental finance director (FD) as an enabler of informed decision making at Board level, mandating FD approval of new investments and consultation on material business decisions;
- provide an aligned, long term strategy for financial management across central government, and ensure that FDs and their finance teams have the skills and experience to drive it;
- introduce financial performance measures such as improved balance sheet and cash management, and improve risk management including by departmental self-assessment; and

¹ Source: HM Government: The Coalition - our programme for government

- increase the quality, transparency and accountability of financial information through the action it has already taken in publishing the Treasury's COINS database, through the Clear Line of Sight project and in publishing Whole of Government Accounts.

3

Scope of the Spending Review

3.1 The Spending Review, to be published in the autumn, will set out spending plans for the whole Parliament. It will show how the Government will reduce the deficit whilst building a free, fair and responsible society.

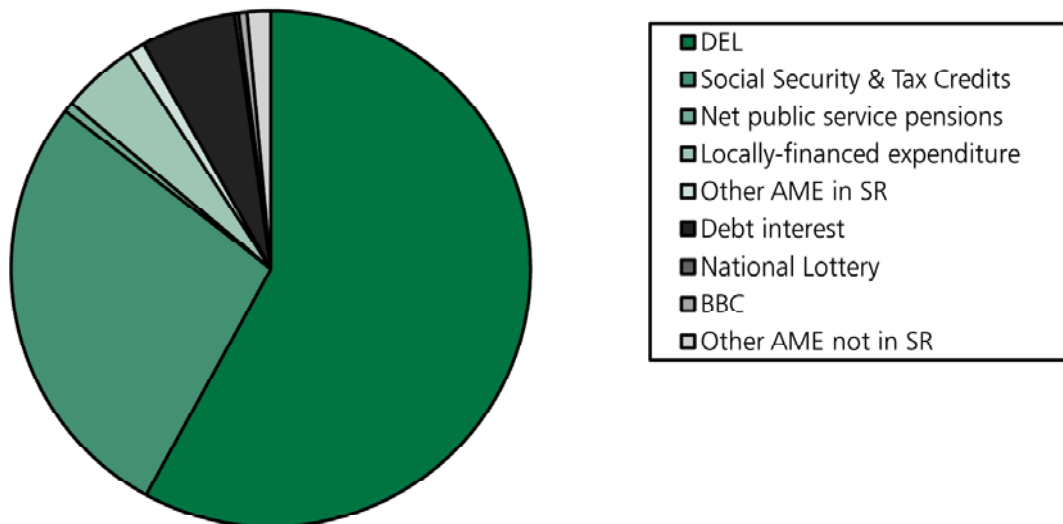
3.2 Ahead of the June Budget, the newly established Office for Budget Responsibility (OBR) will make independent forecasts for the economy and the public finances. They will produce the fiscal projections that will underpin Government policy in the Budget.

3.3 In the June Budget, the Government will set out the mandate that it will pursue for the public finances, against which the OBR will judge its fiscal policy. This will include setting the path for expenditure in the next Spending Review period which will give a clear sense of the scale of the challenge.

3.4 The Spending Review will set departmental expenditure limits (DEL) for every Government department. To ensure that the Spending Review looks comprehensively across the whole of Government expenditure, it will also cover significant elements of Annually Managed Expenditure (AME) where the risk is taken by the Exchequer as a whole, setting out plans for savings and reform in these areas. These include:

- social security;
- tax credits; and
- public service pensions.

Chart 3.A: Coverage of the Spending Review



Source: HM Treasury¹

3.5 As Chart 3.A shows, this approach means that the vast majority of public spending (those elements shaded in green) will be incorporated within the Spending Review.

3.6 For capital spending, the Government will undertake a fundamental review of spending plans to identify the areas of spending that will achieve the greatest economic returns. Departments will also be asked to examine their assets and consider how they can be managed more effectively, including considering the role of privatisation and contracting out where assets do not need to be held in the public sector.

3.7 The Government will also consider whether there are areas of spending for which funding allocations should be set on a longer-term basis than the life of the Parliament to provide greater certainty to service providers, users and investors. The benefits will need to be weighed against the need to retain flexibility to adapt spending plans to emerging economic and fiscal circumstances.

3.8 For other areas of spending, departments will be asked to provide a full assessment of the unit costs of key public service outputs. This analysis will show how the unit costs have changed over the years, how they compare with other countries and the private sector and how the unit costs will be reduced in future as public spending becomes more efficient. On the administrative spending of central Whitehall and its Arms Length Bodies, departments will be asked to reduce their spending by at least one third.

3.9 The Government has set out its intention to promote the radical devolution of power and greater financial autonomy to local government. It will use the Spending Review to progress this, in particular through simplifying the funding to local government and reducing the burden of centrally driven reporting requirements. The Government will ensure that the Spending Review process considers the needs of local government holistically, and takes account of the opportunities for frontline bodies to work together across traditional boundaries. As set out in Box 4.A, the Government will also ensure that it consults with all tiers of government during the Spending Review.

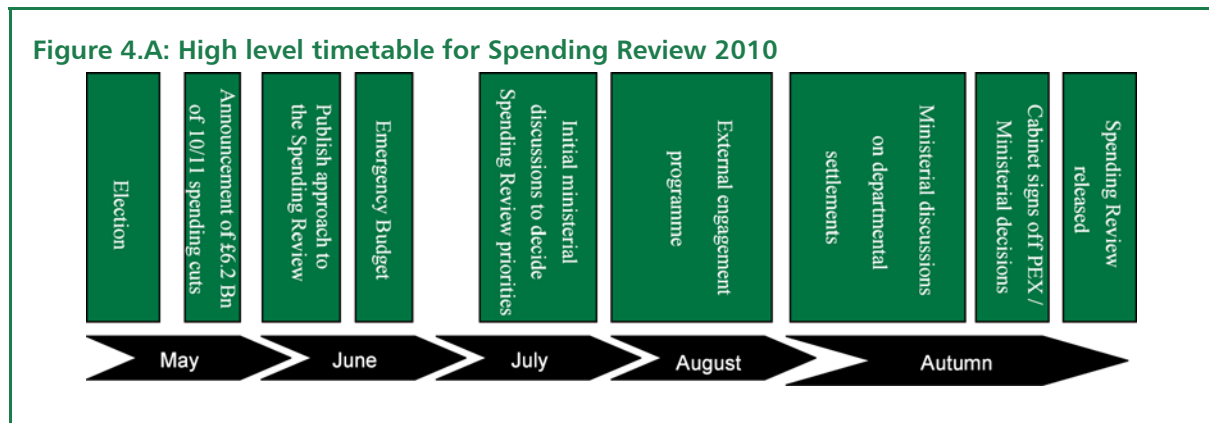
¹ Data derived from March Budget 2010

3.10 The Spending Review will also determine the level of funding to the devolved administrations of Scotland, Wales and Northern Ireland. The Government is committed to working closely with the devolved administrations to tackle the UK's budget deficit, and build the foundations for strong and sustained economic growth. The Finance Ministers' quadrilateral meetings will discuss the Spending Review and ensure that the devolved administrations are fully consulted.

4

Timetable and process

4.1 The Government will move promptly to complete a Spending Review that meets its commitments to both deficit reduction and public service reform.



4.2 The June Budget will set out the mandate the Government will pursue for the public finances, including the path for expenditure in the next Spending Review period. This will enable the Government to start intensive discussions about how to deliver the required spending reductions.

4.3 Ahead of the summer recess, departments will, working with HM Treasury, submit initial plans for delivering their objectives within reduced budgets. The Treasury will provide guidance to departments so that preparatory and technical work can begin now.

4.4 Departments' submissions will include plans to deliver continuous value for money improvements, as well as proposals to make savings through more fundamental public service reform on the major blocks of spending. In determining their objectives and considering reforms to these key blocks of spending, departments will test their programmes against the key questions on value for money in public spending discussed in Chapter 2, prioritising the programmes and activities which are most effective at achieving the Government's goals.

4.5 Where the achievement of a Government objective depends on more than one department, it will be important that those departments work closely to deliver it in the most cost effective manner. In some cases this may involve additional spending by one department to realise savings in another department's budget. To support closer collaboration between departments the Treasury is encouraging departments to submit joint Spending Review submissions on cross-cutting issues.

Shared responsibility

4.6 The Spending Review will shape the role of the state in the future, and the Government's reform agenda for this Parliament. It is not for the Treasury to impose these decisions on departments. Nor is it the sole responsibility of the Treasury to deliver fiscal consolidation. The Government is committed to working collectively to make the decisions about how to reduce spending in a way that is in line with its values.

4.7 To lead this collective approach in Government, the Prime Minister has appointed a Committee of senior Cabinet Ministers – the Public Expenditure (PEX) Committee. Chaired by the Chancellor of the Exchequer and supported by the Chief Secretary, the PEX Committee will advise the Cabinet on the high level decisions that will need to be taken in the Spending Review. The initial membership of the Committee will be:

- Chancellor of the Exchequer (Chair) – The Rt Hon George Osborne MP
- Chief Secretary to the Treasury (Deputy Chair) – The Rt Hon Danny Alexander MP
- Foreign Secretary – The Rt Hon William Hague MP
- Minister for the Cabinet Office and Paymaster General – The Rt Hon Francis Maude MP
- Minister of State at the Cabinet Office – The Rt Hon Oliver Letwin MP

Other Cabinet Ministers will be eligible to be considered as members of the Committee once they have settled their departmental allocation.

4.8 The membership will ensure that, as with the coalition programme, the Government draws on the best ideas from across the coalition parties, and that the Committee represents the range of views in taking the difficult decisions that will be needed.

4.9 Alongside this, the Cabinet Secretary and Permanent Secretary to the Treasury will chair an officials committee at Permanent Secretary level to build the Government's collective understanding of the issues, ensuring support for the overall principles and approach and discussing cross-cutting issues.

4.10 The PEX Committee will ensure the Government takes the time to consider collectively the effect of different options on its agreed priorities, and on different groups of society. Over the summer, the PEX Committee will test and challenge departments' plans, and ensure that they respond to external engagement. These deliberations will be informed and supplemented by the detailed conversations that will take place between the Treasury and departments.

4.11 In particular, the PEX Committee will consider:

- the Government's approach to cross-cutting issues, including public sector pay and pensions and local government expenditure;
- the key objectives for each department to ensure that sufficient prioritisation has been taken in line with spending challenges and that the quality of key frontline services will be protected; and
- the strategic issues, for example, reform of the welfare state.

4.12 The Committee will also take into account the findings of the various independent reviews that have spending implications. Some reviews will conclude in time for the Spending Review, others will be ongoing and the Spending Review will take into account any initial conclusions. These include:

- Commission to review the long-term affordability of public sector pensions;
- Strategic Defence and Security Review;
- Local Government finance Review;
- Commission on long-term care;
- Review of Legal Aid;

- Review of sentencing policy;
- Review of the Housing Revenue Account;
- Review of the terms and conditions for police officer employment;
- Review to set the date at which the state pension age starts to rise to 66;
- Lord Browne's Higher Education Review; and
- Review of support for part-time students.

4.13 In the autumn, the PEX Committee will advise the Cabinet on allocations for departments based on bilateral discussions between departments and the Treasury. It will supplement regular discussions at Cabinet at key points in the process, including ahead of the June Budget, and as decisions are being taken ahead of the conclusion of the Spending Review in the autumn.

4.14 To deliver this, the Government knows that it will require the input of the brightest and best individuals to achieve the optimal outcome in this Spending Review. Therefore, it will form a Spending Review Challenge Group of experts – both from within government and outside – to act as independent challengers and champions for departments throughout the process. Their remit will be to think innovatively about the options for reducing public expenditure and balancing priorities to minimise the impact on public services. The Government is also committed to engaging more widely during the Spending Review, and its plans are set out in more detail in Box 4.A.

Box 4.A: Delivering a fully consultative process

We're all in this together

The Government is committed to carrying out Britain's unavoidable deficit reduction plan in a way that strengthens and unites the country.

The Government is determined that this Spending Review process will be open, responsible and fair and conducted in a way that protects the poorest and most vulnerable in our society; in a way that unites our country rather than divides it; in a way that demonstrates that we're all in this together.

Over the next few weeks, the Government will begin a process to engage and involve the whole country in the difficult decisions that will have to be taken. Doing so will demonstrate that this Government believes there is a more open, transparent and collaborative approach to solving problems than has been the case in the past.

Transparency

As the Government has said, greater transparency across Government is at the heart of our shared commitment to enable the public to hold politicians and public bodies to account; to reduce the deficit and deliver better value for money in public spending. The Government will build on the actions it has already taken to publish raw public spending data from the Combined Online Information System (COINS) which the Treasury uses for fiscal management. In addition, the Government will publish more user-friendly subsets of COINS data by August 2010, and has committed to publishing online all new items of central government spending over £25,000 from November 2010.

Engaging with experts

As part of its public engagement process, the Government will gather talented individuals from within the public sector and beyond, harnessing their expertise to think creatively about the big questions it faces.

The Government will organise a series of events over the summer to discuss and debate various aspects of public spending. The line-up of events will incorporate many of the key areas that need to be considered as part of the overall Spending Review process, including the following themes:

- cross-cutting issues such as the role of localism, including how this can meet the Government's vision to distribute power and opportunity more widely;
- major areas of departmental Government expenditure; and
- the broader welfare reform strategy, which will be considered in this Spending Review alongside other AME spending to ensure a comprehensive process.

A range of people will be invited to these events, to make sure that they represent a wide spectrum of expertise and viewpoints. Invitees will include members of think tanks and interested groups, academics, representatives of local government, business and trade unions, and public sector experts and watchdogs such as the Audit Commission.

The Government also wants to consult more broadly at the sectoral level, to ensure that all issues are properly considered and priorities balanced against each other. Departments will be asked to do this over the summer to inform their discussions with the Treasury.

Immediate steps

4.15 The Treasury has asked departments to re-examine spending approvals given between the start of the year and the election. Departments and the Treasury have been working together to determine whether these approvals are affordable and consistent with the Government's priorities, stopping those that are not. In some cases, the outcome may be to suspend the project until the Spending Review, when a final decision on affordability will be taken.

Conclusion

4.16 There is no doubt that the forthcoming Spending Review will be challenging. But it also presents a unique opportunity to deliver the programme that the coalition Government has set out to achieve: to deliver radical, reforming government, a stronger society, and power and responsibility for every citizen. By doing things differently – thinking innovatively about the Government's role in society, taking the decisions about Britain's future collectively, ensuring that fairness is at the heart of those decisions and that everyone has their say – the Government can deliver the real change that Britain needs.



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