INSTITUTE FOR GOVERNMENT

The 2019 Spending Review

How to run it well

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About this report

This report, the first of a series by the Institute for Government on the role of the Treasury, is about the Whitehall process known as the spending review.

Spending reviews take place every two to five years. They set departmental budgets for three to five years ahead, and shape the scale and nature of public service programmes and public investment. More than that, they are a public, formal statement of the Government's aims – with the numbers that show how it intends to deliver these.

The next spending review is expected in 2019. Preparations for it are well under way.

The proposals in this report set out to tackle some of the recurrent failings of spending reviews. They lead governments to set unrealistic targets, and so undermine public trust. They do not encourage efficiency or better performance by departments. They end up as a contest between ministers for scraps of spare cash – often fought out in the media through leaks – rather than a systematic look at how government might do things better. They do not set priorities effectively, at a time when pressure on public finances should make that essential.

Some of the problems could be resolved quickly, we argue. Some go to the heart of the Treasury's current role; the people who work there; its relationship with other departments, the Cabinet Office and Number 10; and its understanding of the UK as a whole. These problems will take longer to address. We will address them thoroughly in future work.

Chapter 1 describes spending reviews, their history and why they matter.

Chapter 2 sets out what makes spending reviews work well and what can undermine their success.

Chapter 3 explains the context of the 2019 Spending Review and its particular challenges.

Chapter 4 contains our recommendations for running the 2019 Spending Review and beyond.

Chapter 5 raises some issues, wider than the Treasury, about the Whitehall organisation and the management of public services.

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Foreword

This report is the first output from a new programme of work at the Institute for Government on the Treasury and its role in government. The Treasury is the most powerful department in Whitehall because of its central role in government strategy and in allocating money for other departments to spend. The way it operates has an enormous impact on the success of the Government's programme, on economic growth and on people's views of government.

In this report we look at the Treasury's management of public spending, focusing on the Spending Review planned for 2019. Spending reviews provide plenty of fodder for political correspondents, who often use them as a proxy for which minister is doing well and whose influence is faltering. But they are not a Westminster game. They affect the Government's ability to achieve its aims for the country, determine the scope of public services and affect the lives of citizens across the UK.

Our proposals address the serious weaknesses in the way spending reviews have been carried out, drawing on themes which run through our wider work. These begin with the need for strategic planning and for the clear setting of priorities; and include the need for experienced, skilled professionals to make decisions, rather than bright but inexperienced generalists who are in a job for just a year or two. We also want to see governments acquire a better sense of what good performance is, and manage themselves to that end. That means more accountability for ministers and civil servants within government, and outside to Parliament and watchdogs such as the National Audit Office.

In researching this project, we talked to more than 60 people in interviews and at a private roundtable in June 2018. They included politicians and senior officials who are or have been at the heart of the conduct of spending reviews, those running public services, business leaders, charities and non-governmental organisations, as well as people affected by these decisions, in different parts of the country. All unreferenced quotes in the report come from these interviews. We appreciate the time these people have given and the frankness with which they have discussed these issues with us.

Bronwen Maddox

Bronwen Maddox
Director, Institute for Government

Summary

In 2019, the Government will announce new spending plans for public services and investment. These will need to cover, at least, the 2020/21 financial year, for which there are currently no plans in place. On the normal pattern of the past 20 years, the review should extend over at least the two following financial years as well.

Spending reviews serve the obvious function of ensuring there is a set of plans for departments which fit within the total amount of spending that the Government decides it can afford, which is a vital part of the Government's economic management. They are also a chance for the Government to set out its vision for the country and show how its policies support that. They shape investment which supports economic growth. They should be an opportunity to pursue efficiency and reform in public services.

Spending reviews are a necessarily political process. They represent choices between different priorities. When national finances are tight, as now, those can be tough choices. Recognising that is central to considering how spending reviews could work better.

Spending reviews: what works and what doesn't

The spending review process does some important things well. By international standards, the UK has a good track record of sticking to the spending allocated to each department. Past spending reviews have also been an effective way for politicians to bring about big change in spending and the shape of public services, for example the injection of significant additional resources into public services and investment after 1997, or the shift to retrenchment brought about by the 2010 Spending Review.

However, there are many concerns which are widely shared:

- Spending reviews too often consist of ministers jostling with the Treasury (and with each other, often through the media) about marginal increases or reductions in their department's budget. This gets in the way of any high-level strategy being fully reflected in decisions across government. It discourages departments from acting together, or the Treasury from using the review to solve problems that stretch across departments (such as health and social care, or police resources and mental health). It prevents the review process from being able to look at spending overall and find the best opportunities for greater efficiency or for reform.

- Departmental spending plans are not reliable. There is a tendency towards optimism bias, too little focus on risk, and there are incentives to shunt costs between programmes. There is now an unfortunate history of using accounting devices to flatter the numbers. There is not enough independent scrutiny or validation of the plans. There is too little focus on the long term and on the trends – and foreseeable problems – which may affect these plans.

- Discussions between the Treasury and departments over the money they will receive largely confine themselves to that spending allocation. They do not pay enough consideration to the results of spending, performance and efficiency. For a decade after 1998, there was a process that did consider performance explicitly, but since 2010, the Treasury has largely retreated from it. There are welcome signs of a revival of this approach – but very likely, it will flourish too late for the 2019 Spending Review.

- The Treasury's staff are widely characterised as bright, hard-working problem-solvers, but they also lack experience and key skills. Although they have access to Cabinet Office expertise in procurement, project management and digital, spending teams rely heavily on young generalist civil servants, who move between jobs frequently; a model that has some benefits but brings many risks. Turnover of staff means spending teams tend to lack deep insight into public services and projects, and lack the contacts who would help inform them.

- The Government has made significant efforts to strengthen professional finance skills across the civil service, including in the Treasury, and finance professionals now have more influence in Whitehall than before 2013, which is welcome. But the Treasury has abandoned a key element of its own 2013 Financial Management Review: the bringing together of the role of the lead official for spending with leadership of the 'finance function' – the group of officials who specialise in finance. This omission risks weakening the influence of finance professionals, and undermining the quality of financial management.

- Documents setting out spending and performance plans and reporting back on what has happened are confusing and omit essential data. That prevents Parliament and the public from using them.

- The Treasury is increasingly isolated from public services and their leaders. One public service leader said: "[The Treasury] reaches a view without engaging outside government, above all with leaders at the sharp end of public service delivery. Not only does this mean its view lacks grasp of the real world, it also insulates itself too much from politics."

Concern about these issues is longstanding. Some of these elements were captured vividly in the Fulton Report 50 years ago.[1] From time to time, the Treasury has acknowledged them and has made important changes for the better, but it has not gone far enough. Its current operating model has very deep roots, certainly back to William Gladstone's reforms as Chancellor in the 1860s, and it has proved remarkably impervious to attempts to force change on it, even from prime ministers.

Challenges of the 2019 Spending Review

To describe the context in which next year's review will take place as 'challenging' would be an understatement. The Government does not have a parliamentary majority. It will be taking decisions (most likely) in the immediate aftermath of the UK's exit from the European Union (EU). Brexit will continue to place huge calls on the attention of the Prime Minister and the Chancellor after 29 March 2019, whether or not there is a deal with the EU. Brexit throws a fog of uncertainty over the timetable for the next Spending Review; we understand the Government is still considering whether a one-year spending review is all that is reasonable to prepare. Meanwhile, some public services are under great strain after two previous rounds of spending reductions, even if they have achieved big improvements in efficiency (as our *Performance Tracker* report shows).[2] There is a widening gap between public expectations of public services and the money available to provide them.

The 2019 Spending Review: how to run it

Our proposals fall into five groups. Many of them could be implemented as part of the 2019 review, although there are also many changes that would have to be pursued over a longer period to have effect.

1. The Government should clearly set out its fiscal targets – how much money it intends to spend and to raise in tax (and is prepared to borrow). It needs to resolve the current ambiguity around how much it intends to reduce the deficit by, and by when. As part of this, it should set out its vision for the UK, including life after Brexit. That means explaining its priorities for public services (beyond the NHS), and for investment. The clearer it is about its agenda, the easier it will be to justify the difficult choices it needs to make.

2. The review needs to focus on performance, not just on allocating money to be spent. It needs to look at the results of that spending – what it does for citizens. A clear statement about the plans agreed by the Treasury and departments in the Spending Review in terms of performance and outcomes, as well as spending, should be published. The National Audit Office (NAO) should comment on whether the modelling and assumptions on which these statements are based are robust.

3. The Treasury should look beyond individual departments and use the review as a chance to solve problems that extend across departmental boundaries. Brexit is the most prominent. The future role played by local government and the funding needed to support it is another. Techniques of identifying and managing financial risk would benefit from consistency. Above all, the pursuit of value and efficiency is best co-ordinated from the centre of government.

4. The Government should publish more information about its intentions in terms of spending and performance, and once the review is implemented, what actually happened. It should present it in ways which interested, but non-expert, citizens can understand. The Institute for Government will contribute to the current Procedure Committee inquiry on the scrutiny of spending plans, and will look to work with government and Parliament to support improvements in documentation and processes.

5. The Treasury should set about strengthening the skills and expertise of its staff. Most immediately, it should make use of expert panels, and selected short-term external hires, to improve its insight into the most challenging issues facing the 2019 Spending Review. Beyond that, it needs a sustained push to raise the number

of its staff with financial skills. It needs to recruit more staff with experience in delivering public services and to reduce turnover of officials in their jobs. It needs to ensure that pay and benefits are enough to recruit and retain the necessary mix of professional backgrounds and ability.

Beyond the 2019 Spending Review

Many of these improvements will need to be strengthened further beyond 2019. They also raise important questions about the role of the Treasury (and the Cabinet Office and No. 10), as well as the management of public spending. One is whether the UK is right to combine its management of economics and of public spending in one ministry. The model has endured for more than 150 years, but there are alternatives, as those uneasy about the shortcomings of the present system point out.

The ideas that have inspired the past three decades of public management are also being challenged. Notions of how to pursue efficiency, the role of the private sector and competition, and a view of the public as consumers, not citizens – which have enjoyed a remarkable consensus through Labour, Coalition and Conservative Governments – are now being questioned. And as we approach the twentieth anniversary of devolution to Scotland, Wales and Northern Ireland, so too is the success of that project and the progress of decentralisation in England.

The centre of government – crucially, the Treasury in the current configuration – needs to take the lead in thinking about these questions. They are not a reason to be defensive; they reflect the shifting perspectives of our time – the sense of a need, at a time of some turmoil, to take stock of the record of recent decades. They also reflect public unease with the quality and responsiveness of government and with some of the reforms made in recent years.

These bigger questions are easily lost in the usual tussle of a spending review, with its point-scoring, media leaks and last-minute negotiations. But the leadership on this thinking can only come from the Prime Minister, the Chancellor and the officials who support them. Precisely because the 2019 Spending Review will take place in such uncertainty, it is a time to give thought to the answers.

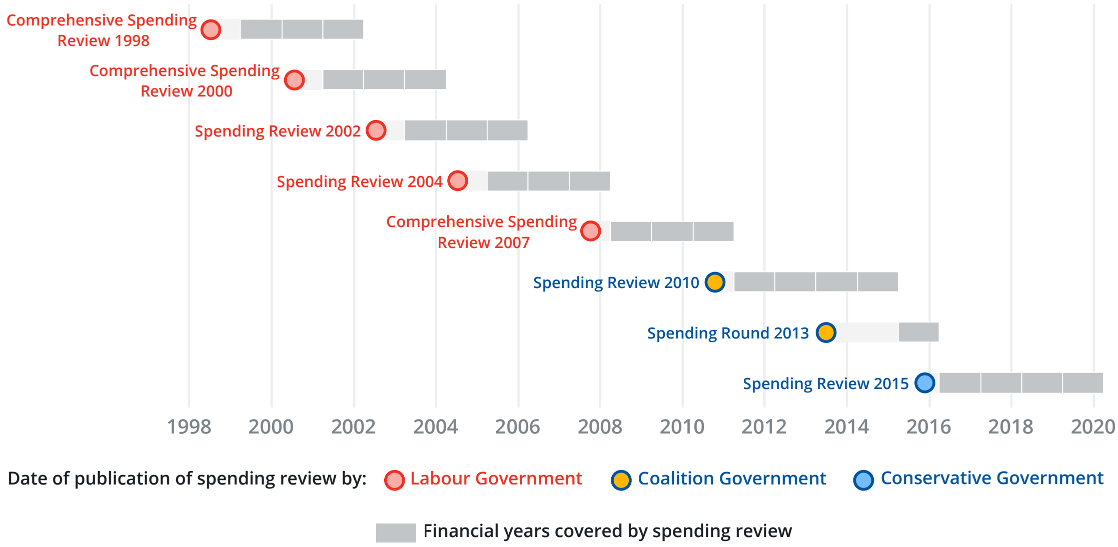
1. Setting the scene

What are spending reviews?

Since 1998, at intervals of two to five years, the Treasury has led a process across government for planning public spending over a number of years ahead,* known as the "Spending Review" (sometimes "Comprehensive Spending Review").**

The intervals between spending reviews and the periods for which they set spending are determined by the Chancellor (see Figure 1).

Figure 1: Spending reviews since 1998



Source: Institute for Government analysis

The important formal public output from spending reviews is a document setting out the Government's planned spending for departments and local government,*** for each financial year in the spending review period. The Treasury issues settlement letters for departments (which are not published) which lay out the allocation of money and the conditions attached to it in more detail.

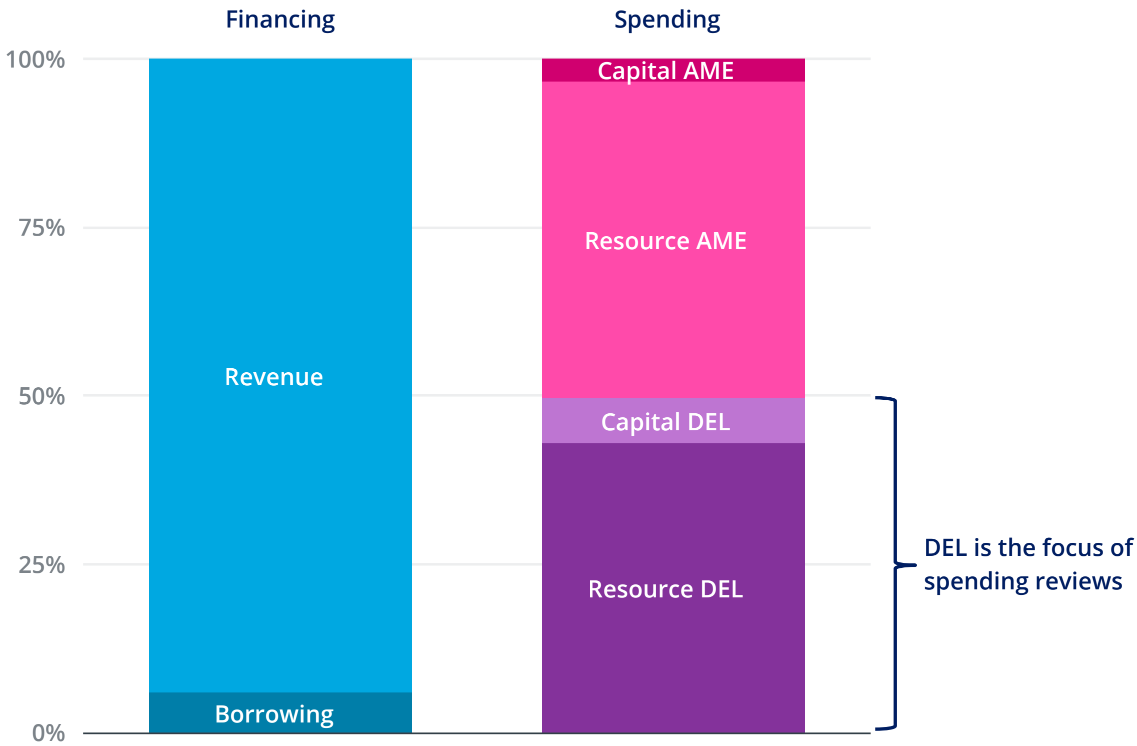
* Most spending reviews plan for three or four years, although in 2013 a 'mini' spending review planned spending for only one year, 2015/16. The two coalition parties knew they were not going to agree on a process extending well into the next Parliament, so agreed plans for the year covering the election period.

** The spending review system is the most recent version of a broadly similar process which has been operating in the UK since the early 1960s when the most direct predecessor, annual Public Expenditure Surveys, were first conducted.

*** Spending reviews set out the central government grant for local governments. However, central government grants now only account for 50% of local government financing, with the rest coming from council tax, business rate retention, and some other small sources of income including reserves. For more information see Ministry of Housing, Communities and Local Government (2018) *Local Authority Revenue Expenditure and Financing England: 2018 to 2019 budget*, GOV.UK, retrieved 22 August 2018, www.gov.uk/government/statistics/local-authority-revenue-expenditure-and-financing-england-2018-to-2019-budget

Spending reviews are focused on the part of public spending known as Departmental Expenditure Limits (DELs).[1] This is the spending allocated to and spent by departments; it might be spent on the running of schools or hospitals, for example, or everyday costs such as staff. More than half of public spending, notably pensions, welfare benefits and debt interest, known as Annually Managed Expenditure (AME), is not formally planned through the spending review process. It is spent on programmes led by demand and is hard for departments to control. However, changes to AME are often considered as part of the spending review process, if departments argue that savings from AME could be made to allow for more DEL spending. This means AME measures are sometimes announced in spending reviews. Figure 2 shows schematically how DEL fits into the wider fiscal picture.

Figure 2: The Departmental Expenditure Limit (DEL) in its wider fiscal context, 2016/17



Source: Freeguard G, Campbell L, Cheung A, Lilly A and Baker C (2018) *Whitehall Monitor 2018*, Institute for Government.

The spending plans set out in spending reviews must be consistent with the government's fiscal strategy. The Government therefore sets an envelope for DEL spending at the beginning of the spending review. Alongside decisions on the other main fiscal components – tax, borrowing and AME – this will enable the Government to achieve its targets. This fiscal framework has not yet been set for the 2019 Spending Review.

How the financial framework has been defined for previous spending reviews
1998: The Labour Government set out its financial framework for the 1998 comprehensive spending review saying that "current expenditure will grow by 2¼ per cent on average in real terms and public sector net investment will almost double to 1½ per cent of GDP over the next three years".[2]

2004: In light of projected economic growth, the framework for the 2004 Spending Review (set out in advance in the 2004 Budget) was for "current spending to increase by an average of 2.5 per cent in real terms in 2006-07 and 2007-08… [and] public sector net investment to rise from 2 per cent of GDP to 2¼ per cent of GDP by 2007-08".[3]

2010: The 2010 Budget gave fixed envelopes for resource and capital spending for the spending review later that year. The overall framework was for total managed expenditure (which includes AME) to fall by 4% in real terms over the period, current expenditure to fall by 1% in real terms and gross investment to fall by 31%.[4] It advised that departments (other than health and international development) would "see average real cuts to their budgets of around 25 per cent over the four years".[5] However, the eventual DEL envelope for the spending review was larger than suggested in advance, because the Government found additional AME cuts.

2015: The July 2015 Budget confirmed that the 2015 Spending Review would announce further reductions to departmental budgets, but did not give a specific envelope for DEL. It set out plans for total managed expenditure to fall by 2.4% of gross domestic product (GDP) over the period and for investment to grow in line with GDP from 2018/19.[6] The Spending Review itself set out plans for departmental resource spending (excluding depreciation) to fall by 3.3% in real terms and for departmental capital spending to grow by 5.3%.[7]

In both 2010 and 2015, the eventual DEL envelope for the spending review was larger than suggested in advance, because the Government found additional AME cuts and, in 2015, raised some taxes.

The spending review is a statement of intent by the Government. There is a separate annual process in which the Government seeks parliamentary approval for elements of central government spending, when Parliament votes on Supply Estimates presented by the Treasury. However, unlike in many other countries (notably the United States) this parliamentary control is a formality: Parliament can reject estimates in their entirety or propose reductions but it cannot propose increases to allocations. In practice it always approves them, with little substantive debate.

Like other Whitehall processes, the detailed work on spending reviews is done by officials. However, they are highly political processes. One former special adviser argued that ministers will always be working towards a political narrative and that it's "probably a bad process if they aren't".

Why do spending reviews matter?

Spending reviews serve several important purposes:

- They are one of the Government's main chances to set out its aims for the future of the country.

- Planning and controlling investment and public spending is a vital element in national macro-economic management. Governments take a view on the balance between tax, borrowing and spending, and they need to make sure that the sums add up: that public spending does not outstrip what they can finance through tax and borrowing.

- Much public spending (for example investment in infrastructure and staff) has micro-economic impact. It affects the growth of different parts of the country or different industries.

- Spending reviews are (or should be) an opportunity for ensuring value for money and performance, and driving transformation to achieve the best possible results from spending.

2. Spending reviews: what works and what doesn't

In this chapter, we review the strengths and shortcomings of the spending review process. Some important things are done well and compare very well internationally. However, there are important and persistent shortcomings. Key shortcomings are the way that a strategic allocation of resources can get lost in the political jostling for cash; and how more attention is given to how much money is allocated to each department than to the performance and results that follow. As one observer said: "the process tends to get to a set of numbers which add up, but are they the right ones?"

What works

A strong feature of the UK system has been that it has a good track record of achieving two important results. As one former senior Treasury and departmental official put it: "at the most basic level, the numbers need to add up and the settlement needs to stick".

The main (and very important) achievements of the current system are that it reliably reaches an allocation of money to each department in line with the total that government has decided that it can afford ('staying within the envelope'). Governments have also managed to stick (pretty closely) to these through the spending review period. A third positive feature of the current system is that it is able to bring about considerable change, sometimes turning the super-tanker of public services remarkably fast to suit economic and political objectives.

These successful elements are supported by positive features of the Treasury's staffing model, which many observers with experience inside and outside the Treasury noted: "lots of high-calibre young people, able to produce rapid, imaginative, clearly presented analysis and advice", as one former political adviser put it. Others point to the Treasury's staff's capacity for hard work, ability to think laterally about intractable problems, and very strong esprit de corps.

1. Staying within the envelope

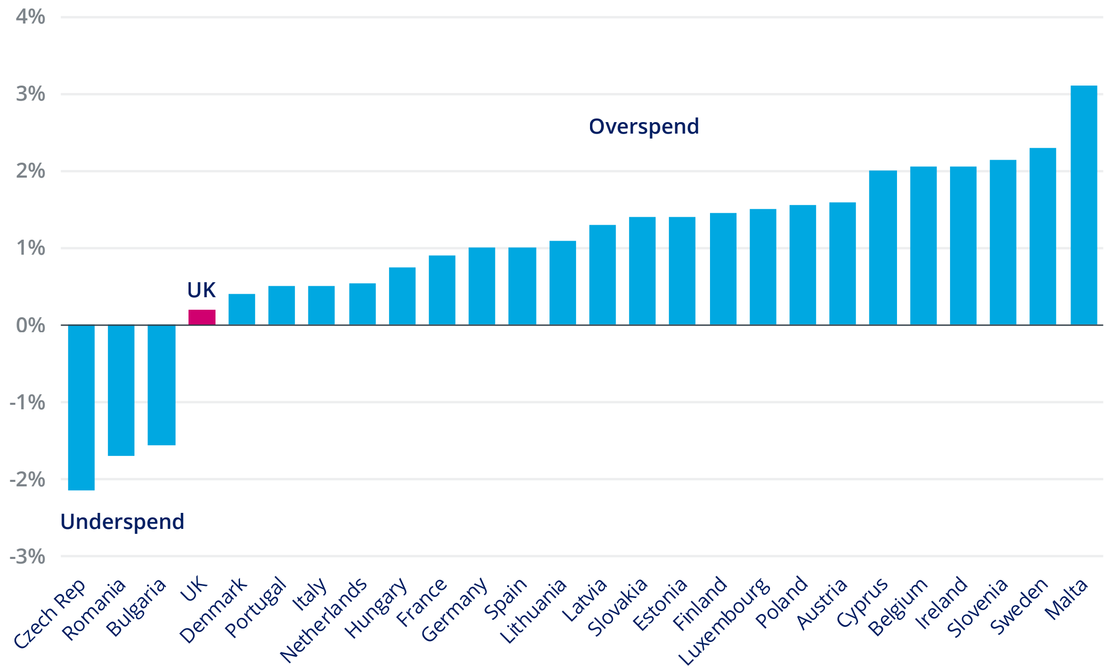
Effective planning of spending is a vital part of the Government's broader economic and fiscal management function. Reflecting economic circumstances in the UK and abroad, as well as political choice, different governments will reach different views on the level of borrowing, tax and spending that they want to have. Whatever the view, however, there must be a reliable and efficient way to ensure that total spending is in line. As a former senior Treasury official put it: "the Treasury has to do this, no-one else is going to". Since the current multi-year system for spending reviews started under Gordon Brown in 1998, for all the political changes of this period, governments have ended up with a set of spending plans in line with their stated intentions for public spending.

There is also widespread agreement that moving from annual to periodic spending reviews has been an improvement in the process. The same former Treasury official said: "Although the previous system agreed numbers three years ahead, there was less incentive to scrutinise years 2 and 3 when everyone knew they would be revisited. Multi-year settlements address this risk and give departments more certainty."

2. Sticking to the numbers

The UK's track record for outturn against published plans is good compared with other countries (Figure 3). Although changes are made to departments' plans between spending reviews, they are almost always the result of ministers, on advice, taking a conscious decision to provide additional funding for programmes. They are very seldom the result of programmes simply running out of control.

Figure 3: Extent of variance between spending and published plans in Europe as a percentage of gross domestic product, 2000 to 2015



Note: Figures indicate how much actual spending diverged from plans two years following publication, as a percentage of GDP. The chart shows that actual spending in the UK closely adheres to spending plans in contrast to most other countries in the sample.

Source: Institute for Government analysis of International Monetary Fund (2016) *United Kingdom: Fiscal transparency evaluation*, IMF Country Report No. 16/351, p. 37.

3. Turning the public services super-tanker

Since the 1980s, public spending has gone through phases of marked expansion and then contraction, reflecting economic circumstances and the political strategies of the government of the day. The Thatcher era brought an emphasis on efficiency and the theory that privatisation and the outsourcing of public services to the private sector would help deliver that. The Blair era brought its own emphasis on consumer choice and continued to embrace a role for the private sector; a philosophy that has enjoyed steady support since then across most of the political spectrum, even if now under explicit challenge from the Labour Opposition.

In 1998 and subsequent reviews in the Labour era, spending reviews put into effect an economic and political strategy to improve public services and increase public investment. According to one political participant, Gordon Brown and his team started with clear views, looking across government as a whole, about what they wanted to achieve (even if this did not translate into ownership of the strategy across government). Increases in resources did not always translate into results, and often not into strong improvements in productivity either.[1] All the same, these reviews showed that the Treasury could re-orient the public spending and services machine in line with political objectives.

By 2010, by contrast, the economic and political priority was to set about substantial reductions in public spending as a percentage of GDP, in the light of public spending growth in the Labour era, and the fiscal consequences of the financial crisis. Someone who was in a senior spending role in the Treasury at the time said this did not come easily: "It was challenging 'turning the super-tanker around' because departments and ministers didn't really believe consolidation would be enforced to the extent it was, or it could somehow bypass them."

However, he said, as the process went along, mindsets changed, aided by strong working between the Chancellor, the Chief Secretary and No. 10, and with Francis Maude in the Cabinet Office playing an important role in the efficiency drive. Political participants from both coalition parties, likewise commented on how one successful element in the 2010 review was that Danny Alexander was given space to handle much of the detailed negotiation. That enabled the Chancellor and the Prime Minister to keep clear of detail and focus on the most difficult substantive and political issues.

A political participant in the 2010 review noted how political and official players working together in the Treasury recognised that "there was public buy-in to reduce the deficit… there was plenty of fat to trim" and formulated a strategy in which a small number of "big hit" cross-government measures reduced spending numbers significantly. Another participant characterised this element of success: "Spending reviews won't work if they are overloaded with small reforms. The Government needs to do two or three big reforms well." In his view, the Government needs to "identify and prioritise programmes and issues where there is both political and substantive space to have a productive discussion".

As for the 2015 review, while problems (discussed below) have emerged in its aftermath, in terms of the immediate politics, it worked well. It took place soon after an election and the Conservative manifesto offered an obvious framework for the review. Senior ministers commended the role Sir Oliver Letwin, then Minister for Government Policy, played in translating the manifesto into this framework, and the fact that Chief Secretary to the Treasury Greg Hands, like Danny Alexander in 2010, was given space to handle the detail.

It therefore appears, particularly at political 'pivot points', that in important respects, the spending review process can be harnessed to ensure both the spending total and important individual programmes are in line with the Government's political and economic strategy.

What needs improving

Looking across the past 20 years, there are five main ways in which spending reviews have tended not to work well:

1. Politics trumps strategy.
2. Spending plans are not credible (and figures are fudged).
3. There is a lack of focus on performance, value and efficiency.
4. Treasury staff lack experience, and finance and accounting capability.
5. Transparency and communication beyond Whitehall are poor.

All of these problems contribute to a paradox noted by a number of former insiders and informed external observers: the Treasury has a reputation for being all-powerful, yet its actual ability to control and shape the translation of resources into public services and investment is questionable. As one observer with a mix of public sector executive and senior civil service experience put it: "The centre lacks the tools and capabilities to direct the Government strategically, with the result that its ability to steer what happens on the ground is patchy at best." An academic put it more bluntly: "[The Treasury] is very powerful but not powerful at all."

1. Politics trumps strategy

When the conditions are right, spending reviews produce a 'broadly accurate' expression of where the Chancellor and the Prime Minister want to take public spending and services. However, this does not happen all the time. Often, the review is highly adversarial. Ministers may go into battle with the Treasury by leaking their demands – and warnings of what will happen to public services if these are not met – to the media.

If there is a good side to this battle, it is that the Treasury is forced to take live political concerns into account. But the downside is obvious: the distortion of strategy by this many-sided tug of war, where the most heated political claims may triumph over those which might produce better long-term growth, for example, but are not high in public attention.

Former ministers and others described how they can 'play' negotiations in a way which produces a good outcome for them personally and for their departments. Even if they are not as nakedly manipulative as some accounts suggest, they agreed it is a discussion in which tactics consume their attention until it is all over.

Being able to make the process work in their interests and their departments' interests often seems to flow from experience in the Treasury. Nicky Morgan found it "incredibly useful to have that Treasury knowledge" when she went to the Department for Education[2] and John Healey felt he got a much better local government settlement in 2007 because he "understood how the spending review process worked and… was able to have those discussions early enough with Treasury in order to make that happen".[3] As Secretary of State for Children, Schools and Families (2007–10), Ed Balls felt that his department received a good settlement in the 2007 Spending Review because the Treasury knew he was "serious". His advice to other ministers reflects this: "When you establish your negotiating parameters, they have got to know that you mean what you say and it's robust."[4]

Former Transport Secretary Patrick McLoughlin emphasised the value of working out how to bring in support from No. 10: "Don't get veered off track. Providing you've got the support of the Prime Minister, you can do that."[5] On the substance, former ministers recommended being absolutely clear where the "red lines" are; and deciding, and sticking to, a negotiating strategy. That is sometimes to be "difficult". As Jack Straw put it: "you had to take it to the wire".[6] Another strategy is for ministers and departments to present their position in ways which align with the Treasury's view of the world. As Minister for Universities and Science, David Willetts, who had been a Treasury civil servant prior to becoming an MP, said he "re-presented and re-prioritised in accordance with what I knew their [the Treasury's] priorities were".[7]

Some ministers seem to think the right approach is to dig in and do a deal only at the very end, while others look to settle early. The Treasury sometimes tries to encourage ministers to settle early, for example by offering them a say on the settlements of other ministers who are still holding out. Yet taking part in a discussion about a colleague's programme, about which they are often not very well informed, does not seem a very powerful incentive for a minister to act against his or her own judgement and political interest.

At worst, negotiations with the Treasury are seen as adversarial, as are relations between departments who feel they are competing for the same pot of money. This leads to a lack of transparency in discussions and proposals. (One former Treasury minister felt that on capital spending in particular, "it [was] just a series of haggles".) It also limits the possibility of joint proposals across departments, which could offer more efficient projects and effective ways of pursuing government priorities.

As a joint minister in the former Department for Business, Innovation and Skills (BIS) and the Department of Health, George Freeman found himself at the centre of this rivalry: "Everybody went into their silos for a traditional comprehensive spending review [CSR]. It was weirdly dysfunctional: my BIS officials said they couldn't show me BIS CSR documents, because I was also a minister in the Department of Health. And vice versa… That's how tribal the CSR turf war and territorialism on funding is, and it makes it almost impossible to do the job, because the truth is that central to the strategy was the more efficient allocation of resource in pursuit of a national policy strategy set by the PM."[8]

Some former ministers say that the process consumes a great deal of their time, maybe too much for the benefit to their department. Chris Huhne recalled that the 2010 Spending Review "took up an awful lot of time" just as he had started as Energy Secretary.[9]

Ministerial experiences appear to range from feeling they can play the system to their advantage, through to viewing the process as not at all effective. They do not describe a process that allocates resources to departments in a way that is considered and strategic, and that takes into account what is best for the country.

2. Spending plans are not credible

Effective financial planning is not just about a set of numbers which work arithmetically, important though that is. The numbers need to be "right", as the observer quoted at the start of this chapter put it. We suggest that in several ways – vulnerability to optimism bias, 'cost shunting', the use of flattering accounting adjustments, identifying and managing risk, and insufficient focus on the long term – planning is nowhere near as robust as it needs to be. There is a lack of independent scrutiny and validation which would combat these tendencies.

Optimism bias

A process in which there is intense pressure to reconcile bids for money to the total funds available carries serious risks of optimism bias from departments. This comes in many forms, such as understating the likely cost; assuming change can be delivered on an unrealistic timescale; not allowing for the time and difficulty of changing behaviour among workforces or the public; and not recognising political risk, including how No. 10 or other departments may react when a measure 'surfaces' with the spending review announcement or subsequently.

Optimism bias is not a problem unique to government or spending reviews, but the lack of external scrutiny of plans and measurement of eventual performance means there is not much incentive to overcome it. As participants at our roundtable remarked, the spending review team in the Treasury, civil servants in the big spending departments and ministers all want to believe the best possible picture.

The 2015 review was too optimistic about the savings that could be achieved from the transformation of services and departments. For example, the Government made a 15% real-terms cut to the Ministry of Justice's budget, with no protections for prisons in 2015, despite early warning signs in the data on prison safety suggesting that any possible earlier efficiencies, if not illusory, were coming to an end (discussed further on page 24). The HM Courts and Tribunals Service was supposed to save £200 million a year for the Ministry of Justice from 2019/20, which committed in the 2015 Spending Review to reducing its spending by £500 million by 2019/20.[10] This was very optimistic. For instance, the level of savings was based on the assumption that 70% of users would switch to new online services within five years. But when HM Revenue and Customs shifted customers online, demand for 'offline' services did not reduce to the extent it anticipated and so savings were smaller than expected. The timetable for completing the programme was extended in November 2016 from four to six years, which is still shorter than the time taken to complete smaller programmes in other countries.[11] This extension also means it is unlikely that the full savings will be delivered within this spending review period. Both the NAO and Infrastructure and Projects Authority have raised doubts about whether it will be successfully delivered.[12,13]

It is often not clear how well decisions are grounded in evidence. For example, there is not yet enough data on the benefits and risks of outsourcing to fully assess its effectiveness in delivering different services. Yet outsourcing currently accounts for around a third of spending in the Department for Education and the Ministry of Justice, and 10% of spending in the Department for Work and Pensions (DWP).[14]

Cost shunting

A process which is strongly focused on negotiations between the Treasury and departments carries with it a significant risk of 'cost shunting' – savings in one programme resulting in costs being incurred elsewhere. That can easily mean that money is allocated between programmes in a much less useful way than if the whole picture were considered.

Meg Hillier, Chair of the Public Accounts Committee, has repeatedly raised cost shunting as a cause for major concern in her annual reports and highlighted that it is unsustainable.[15] Her committee has found evidence that reductions in spending on social care since 2010 have led to more hospital admissions and so increased costs to the NHS. Restrictions to housing benefits announced in the 2015 Spending Review and Autumn Statement made savings for the DWP, but have led to extra costs for local authorities in providing temporary accommodation.[16]

Separately, the Public Accounts Committee has expressed concerns that the savings expected from the Courts and Tribunals Service transformation are more likely to be realised by shunting costs to other parts of the justice system, such as the police, prisons or Crown Prosecution Service, than by genuinely reducing the costs of the service.[17]

Accounting treatment

Flattering accounting adjustments are one way of making the numbers add up for the settlement, without making difficult real adjustments to programmes – effectively 'putting it on the credit card'. For example, in 2012, higher education funding was reformed so that most funding would come from tuition fees, which would in turn be paid by student loans. These loans do not count towards either government's current spending or the deficit. Not all loans will be paid back, but the accounting system means that the cost will only hit the Government's spending numbers in future years (beyond those covered for several spending reviews) when they are written off. Education economist Gavan Conlon explained this to the Lords Economic Affairs Committee in 2016: "the taxpayer is essentially paying through loan write-offs instead of [government grants]... Instead of the government or the taxpayer paying for higher education now, it will be paid for over the next 30 years, also predominantly by the taxpayer."[18]

While the change to higher education funding helped the public spending numbers in the short term, the Office for Budget Responsibility (OBR) has now identified it as a source of long-term risk to the public finances. For one cohort of students receiving loans, it has estimated that the cost to government 30 years after graduation will be £9.7 billion, including the cost to government of financing the loans, and the loans that will be written off.[19] In the first three years of this period, the deficit will appear £3.2 billion smaller as a result, with this reduced to £0.4 billion per year after the students graduate. According to the OBR, the "fiscal illusion" from student loans in full is "roughly equal to the margin by which the Chancellor was meeting his fiscal target in

2020/21 in our most recent forecast". It does point out, though, that all the alternative ways of presenting the loans have disadvantages too.[20]

Flattering accounting adjustments have in the past also been used to continue to invest in infrastructure while meeting fiscal targets. Ninety per cent of private finance investment does not count towards public sector debt.[21] It has been favoured for this reason by politicians keen on keeping down headline measures of debt and meeting fiscal targets, and by officials under pressure to deliver this, as well as a belief that the private sector will conduct the work more efficiently. The Private Finance Initiative (PFI), historically the most common way to privately finance public assets, and its successor PF2, were used to deliver projects with a total capital value of almost £60bn, though their use declined significantly after 2010 due to both the financial crisis and controversy over the cost of the deals, with no new deals signed since 2016.[22]

But using private finance defers spending into the future – the Government will be making payments on the existing PFI and PF2 contracts until the 2040s.[23] This can limit budget flexibility down the line; and private finance is generally more expensive than public borrowing. Sometimes companies will run the services more efficiently (the original theory), resulting in an overall saving – but sometimes not. Keeping projects off the balance sheet may not even have the tactical benefits politicians perceive. Rating agencies can still account for off-balance sheet projects that are contingent liabilities, so they can still affect a country's credit-worthiness.[24] The people and organisations that are most concerned with the UK's level of debt are also those best equipped to see through such devices. If there are any gains at all in this kind of manipulation, they are likely to be transitory.

Planning for the long term

Spending reviews set plans for, at most, five years ahead, not the longer term. Some kinds of decision, notably on big infrastructure projects such as High Speed 2 (HS2), commit the Government to spending well beyond that time. This limited horizon is a problem for two reasons.

First, departments and the Treasury should clearly be planning spending over longer timescales where the character of the spending requires it. The National Infrastructure Commission's first National Infrastructure Assessment, published this year, should help the Government to do so for infrastructure investment, a large chunk of capital spending.[*] But longer-term planning is also needed for some resource spending (such as longer-term transformation programmes) and other capital spending (such as public buildings or defence equipment). As former Treasury Minister and Secretary of State Justine Greening, put it: "We won't know what the envelopes are for departments until 2019 when [the] Treasury does its spending review. You want long-term plans? I can't think of many organisations where you don't know what a departmental budget will be in two years' time."[25]

Second, long-term prospects for the public finances are extremely challenging. It is vital now more than ever that decisions about the short term recognise long-term

* For more on how this can be done, see Davies N, Atkins G and Slade D (2018) *How to Transform Infrastructure Decision Making in the UK*, Institute for Government, www.instituteforgovernment.org.uk/publications/how-transform-infrastructure-decision-making-uk

impacts, both positive and negative. On the one hand, planning should ensure, wherever possible, that short-term decisions do not worsen the long-term picture (as the decisions on student loans did for instance). On the other hand, there should be more incentives to make changes in the short term, which may not help the public finances over the spending review period but should improve the long-term position. This could be true of measures such as further changes to the state pension age, public service pensions, and measures to promote financial and personal independence in the increasing older population.

The OBR's 2018 *Fiscal Sustainability Report* warns of a worsening long-term outlook for the public finances.[26] The report increases projections of borrowing to 20.2% of GDP and public sector debt to 2.8 times GDP in 2067/68. These levels would clearly not be sustainable, although the OBR notes several key assumptions behind them, such as increased health and social care spending and the continued 'triple lock' on pension rises. Speaking at the report launch, OBR Chair Robert Chote, said: "In practice, policy would have to change to avert this."[27] Assuming there are no more big efficiencies to be made, that means more tax, much leaner spending commitments than in the OBR's assumptions, or most likely both.

The ageing of the UK's population is one of the main factors behind the pressure on public finances, because it will mean bigger spending commitments for social care, pensions and health.[28] The increased projections for borrowing and debt compared with 2017 are a consequence of the Government's announcement of increased spending for the NHS in June which, as the OBR puts it "can be interpreted as a crystallisation of medium- and long-term risks that we highlighted in our 2017 *Fiscal Risks Report*". NHS productivity is also not improving strongly, and technological developments in healthcare which improve outcomes but also increase costs continue to be adopted.

The long-term consequence of the accounting treatment of student loans (see page 18) is another cause of the increased projection for public sector net borrowing, and policy changes reducing the likely repayments on loans (mainly raising the income threshold for repayment) contributed to the increased projections for net debt.[29]

Risk

The identification, estimation and management of risk needs to be improved. The Treasury sets aside a reserve from which departmental plans can be topped up if risks materialise which require more spending and which departments cannot manage by re-allocating resources. The size of the reserve is set as a matter of judgement. It is not the result of a systematic examination of the scale of financial risks in individual departments, their likelihood and the triggers which would bring them about. Sometimes departments make agreement to their settlement conditional on access to the reserve, although, naturally, the Treasury tries to avoid this if possible.

The Treasury has shown an increased interest in public finance risk recently, including risks in public spending planning. It commissioned the OBR to produce a biennial *Fiscal Risks Report*, the first of which was published in 2017.[30] The Treasury's response document, published recently, sets out the detailed improvements in control and management which it and departments are taking to improve the management of public spending risk.[31] Together these reports represent a major step forward in risk management.[32] They do not, however, say anything about how strong, consistent, risk processes will be built into the 2019 Spending Review. It is important that they are. We discuss this further in Chapter 4.

Lack of external scrutiny and validation

The Treasury and departments largely 'mark their own homework' in terms of the reliability of the published numbers. The Treasury argues that it has recently strengthened its internal capacity for improving understanding of areas of spending which cut across departments by setting up a Costings Unit. However, it is still early days for this initiative, and it will not alter fundamentally this shortcoming.

The OBR validates the Treasury's costing of policy measures announced at each fiscal event. These are mainly tax and AME measures, but they do also include DEL decisions which increase or decrease DEL spending in aggregate (that is, policies which just shift spending between departments are not included). In 2015, for example, it assessed the Apprenticeship Levy, the Making Tax Digital programme and changes to the Universal Credit delivery schedule.[33]

But what is currently lacking is independent scrutiny of plans as a whole, and the assumptions about outcomes and performance which underpin them. The OBR "make no judgement as to whether particular policy objectives or programmes can be achieved for the sums of money allocated to them".[34] Parliamentary scrutiny and discussion of public spending plans is very limited.[*] Departments' initial proposals are not published, limiting scrutiny in advance of the settlements and meaning Parliament cannot meaningfully contribute to the spending review process. The published settlements include very little detail, and figures are often rounded. One parliamentary expert explained the impact of this: "What you do not get are hard numbers next to each policy over the spending review period, which would allow committees to scrutinise what a department's spending review settlement contains in its entirety, and how the department plans to spend its spending review settlement over the five years. Without the context of how various policy budgets change over time, it is very difficult for select committees to put into context how much money the Government is spending on its various policies, and how the focus is changing from one minister to the next."

The Institute for Government has argued that the lack of independent scrutiny of the plausibility of spending plans is a serious weakness.[35,36] As a former minister put it: "Parliament's currently very nominal role in relation to spending (voting on the Estimates) needs to be very significantly strengthened."

3. Lack of focus on performance, value and efficiency

The current approach focuses almost entirely on spending control and is much less clear in its treatment of performance and outcomes, and the relationship of these to spending (whether in terms of value or efficiency). As a local authority chief executive put it: "Accountability for managing inputs is important, but is not fully effective

* The Commons Procedure Committee is undertaking an inquiry into the establishment of a Commons Budget Committee.

without corresponding accountability for what is done with it, based on outcomes so far as possible."

Performance management

Many of our interviewees suggested that this aspect of the system had gone into reverse through the two most recent spending reviews. Before that, the system for planning performance and outcomes (Public Service Agreements; PSAs) had had some success (although former ministers and advisers of the 1997–2010 era rate their achievements more highly than their successors do).

The PSA regime started in the 1998 Comprehensive Spending Review and evolved through subsequent reviews. There had been growing attention on performance management in central government during the 1990s, following developments elsewhere under previous governments. Under the Thatcher Government's Next Steps Initiative, framework agreements setting out objectives, performance targets and resources had been drawn up for the new agencies.[37] Performance indicators and assessments were introduced for local government under John Major. By the late 1990s, the Treasury was developing a broader performance framework, Output Performance Analyses, in which departments would report their progress against departmental objectives, which would be signed off in advance of spending reviews. But days before the 1998 Comprehensive Spending Review, Ed Balls, then Chancellor Gordon Brown's special adviser, announced they would be replaced with PSAs, which were quickly drawn up after the spending review announcement. They were to be aligned with election pledges (unlike the Output Performance Analyses) and to include targets so the Government could report specific improvements in public services. This was meant to help demonstrate that New Labour were "responsible stewards of public money", during a period of increased spending.[38]

Politicians and officials involved in the process agree that initially (the 1998 and 2000 reviews) the system was not very effective. There were too many performance targets, and a lack of ways of holding departments to account.

Following the creation of the Prime Minister's Delivery Unit in 2001, however, and in the 2002 and subsequent reviews, the PSA system strengthened. A number of people who we spoke to told us that it resulted in a genuine dialogue between the Treasury, the Cabinet Office and departments about performance. One former senior official with experience in the centre of government and spending departments said: "By the mid-2000s, when the PSA system had matured, it helped both the Treasury and departments consider outcomes as well as financial inputs." Another person with experience in a big-spending department said the system "helped establish some markers which were the common property of No. 10 and the Treasury" and provided an "anchor" for decisions in the department.

It led to plans which were clear about the performance and outcomes expected from each department, as well as about spending. It laid the basis for a sense of accountability for departments – that they needed to perform in the way specified – and for the Treasury – that it needed to set reasonable targets.

A former senior Treasury official said that "more than previously, and since 2010, it enabled the centre to hold departments to account for what they were doing with public spending, as well as the amount they spent". He also added that lessons were effectively applied as the system matured: "The important learning from the evolutionary process is that targets should be small in number, based on outcomes so far as possible, and strategic." One political player in the era said: "By 2004 the system was mature and working. The UK became a world leader in putting accountability into the spending review process."

A former senior Treasury official commented on the importance of the Treasury and the Cabinet Office working well together on performance: "Things work best when the Cabinet Office and the Treasury's objectives and systems for performance management are aligned. This was the case for example when the Prime Minister's Delivery Unit under Michael Barber focused on delivery of objectives and targets in the Public Service Agreements agreed in the spending review." At other times in the Blair/Brown era, and after 2010, this had not been the case: "there was a desire to have parallel discussions with departments, using completely different systems". The personal and sustained involvement of the Prime Minister was also critical to the formal accountability arrangements in PSAs being taken seriously by both ministers and permanent secretaries.[39]

There are critics of the PSA model. A senior official in departmental finance roles at this time acknowledged that it indeed resulted in outcomes and performance being part of the process, but there was still not a deep enough understanding of the relationship between the two on the part of the Prime Minister's Delivery Unit or the Treasury. Others had experience of poorly framed targets leading to gaming and other perverse behaviours. For example, there were objectives to reduce waiting times in the NHS. By 2003 there was evidence of treating patients in an order that did not reflect their 'clinical priority', re-classifying patients between categories once an ambulance arrived depending on their waiting time, and re-classifying rooms in hospitals so waiting in them would count as an admission, all in efforts to meet targets.[*,40,41,42] Where PSAs were more focused on outcomes, there was not always good enough data to assess progress, which sometimes led to disputes about whether or not targets had been met.[43,44]

However, following the 2010 Spending Review, PSAs ceased. One of our interviewees, who was working in government at the time, argued that this was because "incoming ministers had a strong view based on the perceived downsides: too many targets, micro-management, and the associated risk of perverse incentives". Another said that in the aftermath of the financial crisis, the Prime Minister and the Chancellor felt that reducing the deficit was the obvious and urgent priority and it was doing this that would ensure good performance of services in the long run. For another, the Coalition's move to abolish the system "reflected a political choice to reduce the scope and performance of public services". In our view, however, something important has been lost: the use of reviews to monitor performance.

* Forms of these targets have remained in place after PSAs were abandoned, with reports of unintended outcomes and gaming continuing.

To some extent international comparisons suggest, in relative terms, a favourable and improving picture of the UK's approach to performance budgeting. In 2016, the OECD ranked the UK joint third on the existence of performance budgeting frameworks. This was a dramatic improvement on its 2011 ranking, following reforms to simplify annual reports and accounts and the introduction of Single Departmental Plans (SDPs) to set out planned performance in 2015-16. However, the OECD survey also reported that the UK performance framework does not "systematically set targets for all programmes" or involve "budgetary consequences if targets are not met." Further, it is based on whether frameworks exist, not their quality or how they work in practice.[45] In practice, the quality and transparency of performance information are still not strong, and departments are not held to account for results.[46] Even if attempts were made to measure performance and hold departments to account against SDPs or using annual reports, they currently lack the detail or specificity to do this properly.[47,48]

Value and efficiency

The energy and effort in spending reviews tends to be directed towards determining the figure for total spending and then on ensuring that what each departments gets fits within this envelope. That results in turn, as many have described to us, in a focus on the increments by which a department's budget is growing or shrinking. It does nothing to encourage a wider discussion about whether departments are spending their resources as a whole as effectively as they could be. Despite exhortations from officials right at the centre of government to use reviews to take stock in this way, under the pressure of time and the scramble for money, this wider evaluation generally proves elusive.

Some of our interviewees believe, however, that in contrast to the expansionary phase which preceded it, the phase since 2010 has stimulated departments and local government to improve efficiency. A senior local government leader said: "The first round of roles we made redundant, we didn't really notice that people weren't here anymore." (She added, however, "now, though, we do notice the effect of more recent cuts".)

There is much debate about whether, once the easy trims had been achieved, public spending management from 2010 really succeeded in improving value. Some of the ways the Treasury drove departments and public services to respond – for example pay and staffing cuts – may have resulted in a genuinely improved relationship between inputs and performance. But elsewhere they resulted in a deterioration in service, as we have argued in our annual *Performance Tracker.*[49] For instance, between 2010 and 2017, spending on courts fell by 19% in real terms and the number of staff fell by 29%, but the quality of the service largely held up, suggesting genuine improvements in efficiency. In prisons, spending was cut by 22% over the same period and core staff numbers by 26%. At first, it appeared that efficiencies had been made in prisons, with little change in the key indicators on violence and safety, but that soon proved illusory. Rates of assaults and self-harm have been increasing in prisons since 2013, particularly dramatically since 2015 and reaching record highs in 2018, suggesting a dramatic deterioration in the service. Reducing spending on services is a political choice, but it would be wrong to confuse it with improved efficiency.

Informed observers are sceptical about whether value and efficiency are really central Treasury concerns, and whether it is actually able to probe and challenge departments' spending as a whole. A former minister said: "The Treasury appears interested only in controlling financial inputs, not performance. Is this because they don't know how to do it, or because they don't want to? I suspect they don't want to. But why?" A former senior civil servant said: "As Accounting Officer, I felt very little real pressure on me to spend money as efficiently and effectively as I could… There is an underlying lack of seriousness, on both sides, about effectiveness and efficiency."

Good data is a necessary basis for probing value and efficiency. Interviewees agreed that financial data in government has improved over the past 10–20 years, albeit from a very low base. The creation of the Whole of Government Accounts (WGA) in 2010 was a step forward in allowing people to understand the balance sheet – the statement of the Government's assets and liabilities,* as well as its income and spending.

The WGA provide the basis for far enhanced management of assets and liabilities. However, some argued that it is not yet as good and timely as it should be, nor is it used to full effect. The WGA are published 18 months after the year-end they describe, when good commercial practice would be to publish within three months. One senior finance professional with government and commercial experience described Whitehall and the Treasury's use of WGA as "an extremely immature discipline. There is a pitiful understanding of balance sheet information" – that is, of assets and liabilities, how they come about and change. A former special adviser said: "WGA, while existing, has not been central to the spending review or other Treasury conversations with departments, so spending reviews are still too much about managing inputs, as opposed to the balance sheet conversations which corporate planning should be addressing too."

Interviewees outside central government were critical of what they saw as the failure of the 2010 and 2015 Spending Reviews to look for improved value and efficiency by devolving more responsibility to a local level. Leaders in local government, in particular, believe there is much untapped potential to secure better value through means such as rationalising public sector property holdings, sharing support services, designing services to meet specific local needs, and tackling the sources of demand on reactive public services at source.

Local government leaders think that their experience of managing the deepest cuts in the public sector since 2010 would enable them to search out value improvement in other local public services. Tom Riordan, Chief Executive of Leeds City Council, described its approach to value improvement: "Driving through the whole organisation is a set of values in which spending money wisely is core. Council staff now do not see efficiency as something imposed on them, or engage in the kind of gaming around budgets that can happen. They constantly look for ways to make better use of resources as part of normal behaviour. The council is actively shifting its relationship with families and citizens from a dependency model to one that works with and supports them to build stronger support networks around local community assets."[50]

* As examples, assets include infrastructure, land, buildings, military equipment and some financial assets, such as the Treasury's shares in the Royal Bank of Scotland. Liabilities include government borrowing, public sector workers' pensions, provision for nuclear decommissioning and clinical negligence in the NHS.

4. Staffing, capability and professionalism

The most common criticism of the Treasury we encountered – which is an old refrain – is that the staff, while bright and hard-working, are too young and inexperienced, and change jobs too often, to make good judgements about spending.

Many senior Treasury officials have years of experience in the Treasury and in its management of government spending. But at the level of team leader – who have considerable freedom to set the way their teams work and their relationships with departments – and those in their teams, most will be younger officials. They will typically have only spent a brief time working on spending and have no experience of the particular subject (for instance, health or education). They are likely to be 'generalists', that is, not qualified in any relevant professional discipline and not having specialised in the subject – though they have access to the considerable resources of the Cabinet Office in the Infrastructure and Projects Authority and the commercial and digital functions.

Some of our interviewees argued the merits of this staffing model: that people may provide better challenges to arguments if unencumbered by prior assumptions; they are not 'captured' by the interests or perspective of a sector (such as defence or health); and it allows for a cadre of very bright analysts to take a consistent approach to Whitehall problems.

That said, the Treasury, like Whitehall overall, has come to recognise the value of professionalism and specialist expertise. Commercial capability in the civil service has been significantly strengthened since 2015 and professionals in the central Crown Commercial Service can now provide support on commercial issues to departments when needed. This expertise is vital for the Treasury to understand spending on contracts with providers outside government, whether for IT, road-building or prisons.[51] The Treasury has helped strengthen the 'finance profession' – those officials across Whitehall who are identified as specialists in finance. It is encouraging spending officials to become qualified in finance and accounting. However, the Institute for Government has argued strongly that these steps need to go further, and that the Treasury needs more of the people managing public spending to be qualified in finance, accountancy or both.[52]

In departments too, the strong involvement of competent finance professionals, economists and other professional specialists is necessary to ensure the department presents a credible picture to the Treasury. A senior official with experience in analysis and economic professions described a "long, slow, journey" towards data and analysis developed by professionals being understood and used properly in the process. A senior finance professional spoke of the value of applying widely used financial planning frameworks to the preparation and prioritisation of departmental positions. Finance professionals who understand such frameworks and, at least as important, how to make them work in organisations, can help build much more solid departmental positions. As we explore below, however, the extent to which the potential of professional input is being realised is still patchy.

Professional skills in finance

The Treasury gives a weaker role to professional skills in finance than might be expected in a finance ministry.

There is a view, although almost entirely confined to some current and recent Whitehall officials, that the importance of professional techniques in finance for planning and managing spending is overstated. They say that much of the experience and knowledge of commercial finance professionals is not relevant to government and that those people lack the understanding of politics and politicians which is essential for working on finance in Whitehall. Others recognise the importance of finance skills in properly recording and accounting for spending, but portray this as a 'book-keeping' role. They distinguish this from the roles in strategy and negotiation which are central to the spending review, and which they see as more the domain of the civil service's 'policy profession' (those officials who specialise in policy-making).

Others, including many with Whitehall experience, and business and local government leaders, challenge this strongly, and, in our view, correctly. Finance professionals outside government pointed out that the model of hiring people as generalists, and then putting them through on-the-job qualifications several years into their career, is different from that which prevails elsewhere in the public sector and in business. There, leaders in finance develop within specialist roles once they leave higher education. This long experience of using professional techniques is as important as the qualification. As one finance professional with public and private sector experience told us, "the right degree of professional rigour needs to be backed up with the experience which gives them judgement about how to apply it".

Justine Greening (a former accountant) decided in her time as a Treasury minister in 2010–11 that in creating its own model of generalists, government was "set[ting] itself apart from industry too much". She argued this year that government needs to accept the limits of the generalist model and introduce more trained accountants.[53] In our view, the Treasury also took a significant step backwards from the conclusions of its own 2013 Financial Management Review that the Director General, Public Spending and Head of the Government Finance Function roles should be combined. The roles are now separate again, with the head of profession role now undertaken by the Finance Director General in the Ministry of Justice (although he also sits on the Treasury Management Board).[54,55]

The combination of professional qualification and experience brings a number of essential attributes to the management of public spending and services:

- A thorough understanding of the complexity of public finances and the ability to communicate this complex information clearly and accurately to ministers and other decision-takers.

- Confidence in using financial expertise on leadership teams, especially in strategy discussions. Having more experienced finance professionals on departmental boards and other top-level groups will also help create consistency across departments on approaches to value, efficiency and risk.

- A thorough understanding of what makes good data and good reporting. This is necessary for high-quality financial and management information.

- The skills to interpret this data accurately to support business decisions. Consistent interpretation of data by finance professionals is vital to improving decision-making across organisational boundaries in government.

- A technical understanding of accounting and audit standards. This leads to more consistent and efficient reporting and auditing.

- The understanding and skills needed to manage risk. This is identified as a particular benefit of being a qualified accountant in the Government Finance Profession's Good Finance Director model.[56]

- Depending on the qualification, exposure to accounting practices in the private sector and wider public sector, which can be helpful for reassessing arrangements in central government and in building relationships outside Whitehall.

Treasury leaders say they recognise the importance of professional skills in finance. They point to the recent expansion of professional finance capability inside the Treasury, including two new director-level roles. These new directors support the Head of Government Finance Function. They also help the pursuit of 'transformation' – large scale reform – particularly those projects that extend across departments. They contribute to the analysis of risk and the testing of plans across the whole of government finance. There are also new teams responsible for talent management, recruitment and professional development in finance, and for promoting more consistent approaches in tax, technical accounting and grants.

Strengthening the finance function is important in itself. It should gradually strengthen the analysis which supports spending reviews. However, it is less clear whether there are steps to improve professional skills in finance professionalism within the Treasury teams that work on departmental spending.

Staff turnover

Frequent turnover undermines institutional memory. Staff have to re-learn the (considerable) complexities of the policy and institutional framework for spending in each programme. They are less likely to understand what policy options have been considered and ruled out in the past, and why. Each time someone moves on in a post, rapport has to be re-developed with key finance, analytical and policy contacts in departments. The development and maintenance of wider networks of public service and third sector leaders, think-tankers, academics and others who could help the Treasury in its challenge role is much more difficult when Treasury roles switch frequently.

Since 2011, the annual turnover rate in the Treasury has been 23% on average.[*,57] Despite plans to reduce turnover being frequently included in the Treasury's annual reports and referenced in its Single Departmental Plans, there is not much variation in

* The annual turnover rate is the proportion of staff leaving the department in a given year.

this rate over time. This also neglects moves within the department, which, if included, would increase the annual rate of turnover for individual positions substantially. In 2012, the National Audit Office highlighted that this was a specific problem for spending teams: "Out of the 52 staff in the spending teams for our case study departments, only eight were still in place 20 months after [the 2010 Spending Review]."[58] Chris Huhne, former Liberal Democrat minister, who worked in the City before entering Parliament, argued that "any professional organisation that has a staff turnover like the Treasury's should really be worried".[59]

One former Treasury spending team leader (something of an outlier in terms of deep prior experience on her programme) pointed out that to bring about real change, Treasury spending teams need a thorough understanding of the very different systems in which different public services operate. This includes the different ways in which public services are delivered (for example by a department itself, like the DWP, or via a public body, agency or local government), the supplier marketplace, the characteristics of service users, and the systems and cultures of the department and others in the delivery chain. Without this depth of understanding, it is very hard to put in place effective reforms, controls, or even personnel to manage these effectively.

Some interviewees praised the impact of past senior hires into the Treasury from outside Whitehall, and the expertise and relationships of government outside Whitehall they brought, and regret that this has not become institutionalised. Including this background in the professional mix of the Treasury's spending leadership team is important for a mature understanding of the management of operational public services.

Departmental culture

Many of our observers see the Treasury's culture as having significant weaknesses, despite the strengths mentioned at the beginning of this chapter. The Treasury is one of the five smallest departments with just over 1,300 staff in the core department and over 2,000 staff overall.[*,60] Its staff are on average younger than all other departments' (except the Department for Exiting the European Union) with a median age of 31, while 55% of its senior civil servants are under the age of 40.[61] The staff appear to enjoy the culture and prestige of working there; in surveys of civil service staff, the Treasury reports the highest morale of all departments, despite dissatisfaction with pay.[**,62]

As one former senior Treasury official put it: "[T]he Treasury has a more positive culture than Whitehall generally with its small size, varied work, giving young officials big responsibility early. But there is a 'Millwall factor' – 'Everyone hates us and we don't care'." That is part of a culture in which people work hard, collaborate well internally, and feel motivated. However, the culture brings significant risks. In conducting his 2017 review of the Treasury (commissioned by John McDonnell, Labour's Shadow Chancellor), Lord Kerslake, former Head of the Home Civil Service, found the Treasury was "described by many contributors as often arrogant, overbearing and negative towards other departments".[63] This was echoed in our conversations: officials in other departments (and some Treasury officials) acknowledge that the staffing model feeds

* Including staff working in the Treasury's executive agencies and non-ministerial departments.

** As measured by the engagement index in the Civil Service People Survey, which asks civil servants how satisfied they are with areas including organisational purpose, leadership, their teams, workload and pay.

perceptions that Treasury officials are not interested in others' perspectives, are rude, or unnecessarily aggressive.

Of course, as officials from other countries told us, relations between finance ministries and the rest of government always involve challenge, if not outright conflict. However, many think the Treasury would benefit from a change in style, with more of a respectful and constructive tone, for all the vigour of its challenges. The problem is not getting better, they think, and is an obstacle to good working relations.

Managing change

The Treasury's role in public spending and services, and the model and culture which it applies to delivery, has been remarkably enduring. Many of its foundations go back, at least, to the reforms of William Gladstone as Chancellor in the 1860s. This strongly entrenched role makes it difficult for anyone outside the Treasury to successfully apply pressure for change. Even prime ministers have been rebuffed – for example, neither of Harold Wilson's structural changes in the 1960s, the creation of separate economics and civil service management ministries, proved enduring.

The concerns we have described above have been put forward often, certainly over the last 50 years. In the Harold Wilson era in the 1960s, the Fulton Committee was critical of what it saw as an over-dependence on generalists, and of an over-reliance on detailed controls as opposed to what it saw as more modern management techniques. In the 1970s, American political scientists Hugh Heclo and Aaron Wildavsky described the high turnover and "able amateurs" of the Treasury, a department they found to be very close-knit internally but that remained "lofty and distant" to other departments. A minister told them that Treasury officials "often gave brilliant advice. But its characteristic was that it was coherent internally rather than necessarily fitting in with what went on outside".[64] The 1994 management review known as the Fundamental Expenditure Review commented again on high staff turnover, difficult relationships with some departments and the need for more training for staff.[65]

In 2007, the group of senior professionals from outside the Treasury commissioned to carry out its Capability Review identified risks arising from excessive staff turnover, lack of financial expertise and poor handling of external relationships.[*] It suggested these arose from weak management of skills, talent and career progression. In his remarks at the beginning of the report, the permanent secretary at the time set out plans to address these issues.[66]

Five years later, in 2012, the review by a senior Treasury official of the Treasury's response to the financial crisis found that there were still concerns about turnover of staff, career progression, and pay and incentives, which encouraged generalism rather than expertise.[67]

The next year, the Treasury's Financial Management Review was critical of the split in leadership between the Director General, Public Spending and the Head of the Government Finance Function.[68] As we have noted above, this led to the two roles

* Capability Reviews were a programme of reviews carried out in the 2000s to scrutinise the capability and leadership of the main departments.

being brought together, only to be split again in 2017. The themes we set out overlap with the assessment in Lord Kerslake's recent report for the Labour Party.[69]

Despite the frequency and weight of these concerns, which have been accepted by the Treasury's leadership (indeed often reflected in its own internal reviews), it has not been able fully to address them. While a tendency not to follow through fully on planned reforms is hardly unknown in Whitehall,[70] the persistence of this particular issue in the Treasury is unfortunate.

5. Transparency and communication

Our conversations have drawn out significant concerns about the presentation of public spending information to the wider world. Many feel the Treasury fails to communicate well with public services and with people beyond Whitehall.

Presentation of public spending information

There are four main sources of information on public spending plans and outturns: the published spending review settlement, Single Departmental Plans (SDPs), the Supply Estimates through which Parliament formally approves spending, and departmental annual reports and accounts.

- The published spending review settlement gives details of the settlement for each department, divided into resource and capital DEL, and gives examples of what this spending will be used for and some explanation of how it contributes to government targets and priorities.

- SDPs set out government priorities. Each department typically has between three and seven main objectives, with a list of lead ministers and lead officials responsible. There will be a layer of objectives below these and then related actions that should happen. In the May 2018 SDPs, departments mostly had between 25 and 60 priorities overall – far too many, in our view. SDPs were designed to link the money allocated to a department in a spending review with its output, and to help it to set its priorities. But most departments declare too many priorities and, although SDPs now include some data on the department's budget and staffing, those priorities, with a small number of exceptions, are not matched with spending. Departments do have more detailed internal plans, but the published ones do a poor job of enabling people to judge whether they are credible.

- Supply Estimates are presented by the Treasury to Parliament to gain formal approval for spending plans. There is an estimate for each department, which includes estimates for public bodies the department is responsible for. They cover expenditure, including AME and DEL (the focus of spending reviews), and also give details of departmental income and significant contingent liabilities.[*] They are published annually, soon after the Budget.

[*] Contingent liabilities are obligations to pay out money in the future if a certain event occurs (i.e. liabilities contingent on something in particular happening). Examples in the most recent Supply Estimates included the possibility of environmental clean-up costs, and injury and damage compensation. Only those that are valued at over £300,000 are included.

- Departmental annual reports and accounts review a department's activities and use of resources during the year. Each includes a report on performance, accountability and finance, but the format and content vary between departments, especially for the performance report. The performance report gives the department's objectives and its activity in trying to meet them. Some departments' objectives are the same as those in their SDPs (and so annual reports track progress against the SDPs), but some use a different set of objectives. The accountability report explains the department's staff composition, pay, governance structures and responses to events, audits and reports during the year. Financial statements detail expenditure, assets and liabilities, income and financial risks. They are usually published in June or July.

It is very difficult, and in some cases impossible, to compare a department's original spending plans with their eventual outturn. The quality of accounts published by departments varies widely. Annual reports might show changes in spending plans, but they do not necessarily give any explanation for these changes.[71] New ministers may have decided to change categories to highlight a new initiative, frustrating comparisons with previous years. SDPs do not link the priorities of each department (and now overarching government priorities) with the spending needed to deliver them. One expert parliamentary staffer says he can trace a story through these documents only with the utmost difficulty.

External communication and engagement

Poor-quality and confusing published documentation is part of a wider issue of poor external communication and engagement – which, to judge from our discussions with people outside central government, is becoming worse. There is a sense of exclusion and alienation from the process, and we suggest that the Treasury should be worried about this. A senior third sector professional lamented that, following changes in personnel, she was no longer seeing a senior Treasury official regularly to share views on the impact of public services on the societal group for whom she advocates.

A response might be that engagement on individual public services happens through departments. However, engaging directly in addition to this would enable the Treasury to draw on external insight on cross-system issues, for example the impact of mental health provision on policing, or of social care on health, or the way reduced spending on public services has affected particular places. A senior local government politician said: "[The Treasury] reaches a view without engaging outside government, above all with leaders at the sharp end of public service delivery. Not only does this mean its view lacks grasp of the real world, it also insulates itself too much from politics."

Interviewees argued that this limits the Treasury's understanding of how individual programmes and services interact in practice. A senior executive in a national non-governmental organisation gave an example: "The Treasury doesn't pay nearly enough attention to public services workforce issues. This is strange, because they are at the intersection of its public service funding and performance role, and its wider economy and productivity interests."

More direct engagement would also counter the perception that the Treasury is simply not interested in engagement.

Conclusion

The Treasury has a vitally important role in spending and public services, and on aspects of this it has performed consistently well. Addressing the shortcomings also described in this chapter would enable it to build on its strengths and become a more effective finance ministry for the 21st century. Our proposals for how to do this are in Chapter 4.

3. Particular challenges of the 2019 Spending Review

As we noted in Chapter 1, spending reviews are political exercises – an expression of priorities, formed after a jostling of competing claims. The review expected next year takes place in exceptionally challenging circumstances.

Spending control under a minority government

On current assumptions, the 2019 Spending Review will be the first to be conducted by a minority government since the current system started in 1998. One would have to go back to the Callaghan era (1976–79) for a time when the Government did not have a majority when making spending decisions. Now, not only does the Government not have a majority, but Brexit challenges the Prime Minister's authority in Cabinet.

Brexit, Brexit, Brexit…

The negotiations of the 2019 review will coincide with the UK's formal exit from the EU on 29 March 2019. It is going to be a real challenge for the Prime Minister and the Chancellor to carve out time to deal with the review. Yet as we have argued in the previous chapter, the success of the process depends on it having their serious attention. There is a risk that spending decisions become bargaining chips for the Prime Minister in securing Cabinet backing on Brexit issues. That reduces the chances of the strategic, evidence-based approach which is really needed.

Brexit creates even more uncertainty than usual about economic forecasts. Yet the Government depends on those in deciding its intentions for tax, borrowing and spending. The uncertainty will also affect spending more directly. AME on benefits is sensitive to assumptions about employment and inflation. Economic forecasts affect the future path of important elements of DEL planning and spending too. For instance, inflation and interest rates affect the costs of equipment and construction in capital spending, as well as the amounts raised from the sale of land and property agreed in departmental settlements (expected to total £4.5 billion (bn) in the 2015 Spending Review[1]). Rates of unemployment and average earnings will affect whether the Government realises the savings it assumed in two important areas in 2015 – in the Department for Work and Pensions (DWP) settlement from changes to employment programmes; and in the Department for Education settlement from freezing the repayment threshold for student loans. Brexit also affects other variables in departments' spending models, such as net migration.

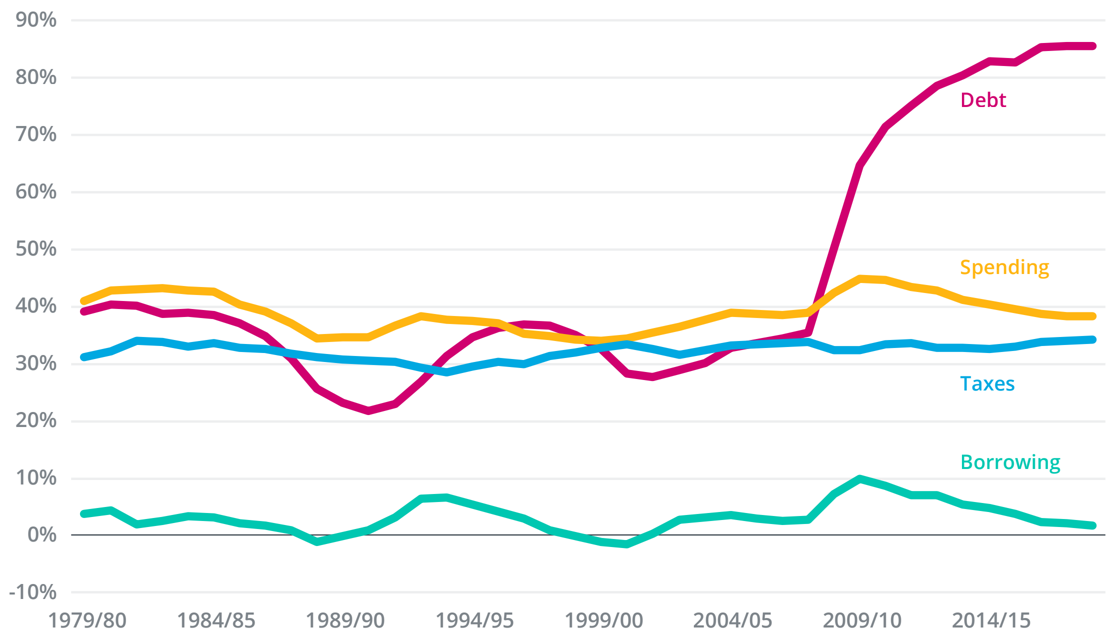
The competition for senior ministers' attention and the forecast uncertainty also create real difficulties in settling whether a normal review of three years or longer is achievable or whether a single-year settlement is the most that is deliverable. We explore that question further in our recommendations (see page 39).

National finances

The bald fact confronting this spending review is that there is not enough money for all the spending the Government (and the public) would like to do. In a sense, all spending reviews start like this. However, the Government has reinforced this constraint with its stated commitments to reducing the deficit further and to keeping taxes low. In making early pledges ahead of the Spending Review to increase spending on the NHS – which will amount to an additional £20bn by 2023/24[2] – the Government has reduced even further the money it can give to other services. It is also constrained by commitments it has made to schools and overseas aid.

We explained in Chapter 1 that the total available for spending on public services and investment (DEL) is the consequence of choices about tax, borrowing and AME spending (mainly welfare). Figure 4 shows the position on total spending, taxes (which make up the majority of government revenue), public sector net borrowing and total debt in the context of the past 40 years.

Figure 4: Spending, tax, debt and borrowing as a percentage of gross domestic product, 1979/80 to 2018/19



Note: Spending = total managed expenditure (TME). Taxes = national account taxes. Debt = public sector net debt (PSND). Borrowing = public sector net borrowing (PSNB).

Source: Office for Budget Responsibility, *Public Finances Databank*, July 2018

Taxes have risen as a percentage of GDP following the financial crisis to levels last seen in the early 1980s. For much of the preceding 30 years, they were lower. National account tax receipts are projected to reach 34.3% this year – a level that has not been seen since 1951. The Prime Minister recently said that "taxpayers will also need to contribute a bit more in a fair and balanced way".[3] However, fiscal hawks (naturally Conservative supporters) are constantly reminding the Government of its manifesto promise to "[keep] taxes as low as possible", arguing that "centre-Right parties don't get re-elected unless they deliver high growth and low taxes".[4,5]

Public sector net borrowing has been reduced from its peak financial crisis level of nearly 10% of GDP, to less than 2%. It is not at particularly high levels by the standards of the past 40 years. However, both the manifesto and more recent statements by the Chancellor commit to a balanced budget by the mid-2020s.

Public sector debt more than doubled as a percentage of GDP following the crisis and is now at its highest levels since the 1960s. The Government is committed to it falling as a percentage of GDP between 2019/20 and 2020/21, though it has no explicit target beyond that.

If there is no appetite to increase taxes significantly, how much the Government can spend will be determined by how much it is prepared to borrow. If it continues with the deficit reduction to which it is committed, and embodied in the Office for Budget Responsibility's (OBR's) forecast that it will fall to 0.9% by 2022/23, day-to-day spending by government departments on public services would need to fall by 0.6% in real terms between 2019/20 and 2022/23 to balance the books. That equates to a £5bn cut to annual departmental spending by 2022/23, but is less severe than the 0.9% a year cuts imposed in the 10 years to 2020. However, on top of this £5bn cut, the Government also needs to find an extra £16bn to meet its commitments to the NHS in 2022/23, and £20bn in 2023/24.

If, on the other hand, the Government were content to leave net borrowing at 1.8% of national income, instead of trying to make progress towards eliminating it, public service spending could be increased by around £20bn a year by 2022/23. This would provide enough money to fund the NHS announcement and avoid the need for real-terms cuts to spending across other departments.

But such spending would mean debt rising as a share of national income in 2022/23. If the Government wants to avoid that, without making any other changes to tax and spending plans, it would have only an extra £8–9bn for spending in 2022/23. That would mean a 3.9% real-terms cut to non-NHS departmental spending.

The only other options would be to increase taxes or cut welfare further, which is the main controllable component of AME. Both would be extremely challenging politically. The Government bears the scars of its forced retreat from increases for National Insurance contributions for the self-employed proposed in the 2017 Budget and the tax credit U-turn in 2015. With many benefits frozen for four years from 2016, in addition to significant reductions in entitlement, further reductions in welfare would be far from easy.

As we have argued, there are pressures for public spending to rise in the long term. That means that accounting changes and other options which solve short-term problems at long-term cost would be unwise.

The upshot is that the 2019 Spending Review will be another very lean one for public services, other than the NHS. There are choices about just how tight the allocations will be, and where cuts will fall, but they are on a spectrum from very difficult to really, really difficult.

Even though this will not be described as an austerity review (language the Government is no longer using), given these pressures and the savings that have already been made since 2010, it will be more difficult than the previous two. As we have shown, some public services are showing real signs of strain after the 2010 and

2015 reviews. Many interviewees involved in the 2010 review told us that there was a widespread expectation that it would be a one-off dose of austerity, to be followed by a return to the previous pattern in which there were at least some 'proceeds of growth' to be shared out. Continued austerity in 2015 was therefore a blow to expectations, and harder to deliver. Securing big additional savings from many programmes in 2019 will require departmental officials and ministers to adjust expectations even further.

4. How to run the 2019 Spending Review

We make five groups of recommendations for the 2019 Spending Review. We do not suggest that they will make the review easy; the process is always difficult and will be exceptionally so this time. But they would considerably strengthen the review. Reinforcing these changes after 2019 would bring about even stronger reviews beyond that.

They are:

1. Clarity of goals.

2. Focus on performance.

3. Strategic planning.

4. Use of data.

5. Professional skills.

1. Clarity of goals

We have argued that spending reviews work best when the Government makes clear what it is trying to achieve in public services and the economy. That needs to sit within a narrative of what kind of country it wants the UK to be (in this case, after Brexit too). The Government also needs to be clear and credible about its fiscal objectives. This is not the case at the moment. More clarity on the Government's intentions might discourage ministers from bidding for funds against each other quite so publicly. It would also help the Government to explain and defend in Parliament, and to the country, what will certainly be a difficult settlement.

Priorities

The Government has goals other than delivering Brexit. Some think the speech the Prime Minister gave on the steps of Downing Street immediately after the 2017 general election – including her pledge to tackle "burning injustices" – is the best expression of these wider objectives. But Brexit has overshadowed them. For the 2019 Spending Review, setting out clearly what the Government means for example by "investing in Britain's future" (a phrase Philip Hammond has used repeatedly as Chancellor) would help clarify priorities. It would also show that the Government has a clear view about public services and investment after Brexit. Defending tough choices and trade-offs is always easier if there is a narrative explaining where the Government intends to take the country and why people should buy into this vision. The Scottish Government, and governments elsewhere, have published policy frameworks of this kind.[1,2] It is clear that health is top of this list, but the Government needs to be clear about what else it considers important.

Timescale

Because of Brexit and other pressures, the Government has not yet decided whether the 2019 Spending Review will cover one year (the financial year 2020/21) or three years, to 2022/23. The case for a one-year review is that the current uncertainty about Brexit makes the economic forecasting which frames the spending review even more uncertain than usual. However, the consequence of a one-year review in 2019 is that there would be yet another one in 2020. If, as will inevitably be the case, public services need to cope with much more limited resources, they will plan much more effectively if they have a three-year settlement.

In our view, what works next year hangs crucially on whether or not there is a Brexit deal with a transitional period after March 2019. However desirable a three-year review appears to be in principle, political distraction and extreme forecast uncertainty in the immediate aftermath of a disorderly Brexit would make actually delivering it impossible. If, on the other hand, the UK is in a transitional state after March 2019, the argument for a three-year process is stronger.

Beyond next year's spending review, there is a case for looking at whether the Treasury could improve on the post-1998 model of holding reviews every few years which look three to five years ahead. Two other potential approaches were suggested by some people that we spoke to:

- If the Fixed-term Parliaments Act 2011 stands the test of time, beginning a review in the first six months after an election which puts into effect the programme of the Government for its five years in office. That would have the political advantage that difficult decisions would be taken at the point at which governments are normally strongest. The Government would be aligning financial resources at the outset, to stand behind its political programme.

- An annual process, looking ahead three years in terms of firm numbers and indicatively beyond that, where feasible and necessary for the effective management of resources (for example, in defence and transport where investment needs to be planned over a very long period). This would differ from the pre-1998 Public Expenditure Survey process in that planning for years 2 and 3 would be 'real' and adjusted only where there was a compelling need.

How to plan: departments, priorities or places?

Traditionally in the UK, planning is done by department, as is Treasury control of spending, and parliamentary authorisation for it. This is deeply rooted in conventions about the accountability of ministers for their departments, and the accountability of permanent secretaries as Accounting Officers for the propriety, regularity and value for money of spending. However, departmental boundaries obstruct effective financial management. The focus on what happens within one department can lead to cost shunting between departments (as discussed in Chapter 2), opportunities for departments to work together or share resources being neglected, and a lack of strategic planning on issues that do not fall neatly within departmental boundaries. Regional disparities in spending can also result from a lack of co-ordination across departments; whether over investment in infrastructure in one area, or reduced spending repeatedly falling on services concentrated in another area.

It is right then to consider the merits of other approaches, such as planning that extends across departments. The creation of the National Infrastructure Commission in 2015, and the publication of its first National Infrastructure Assessment this year, signal that the Treasury understands the need in some areas for long-term planning that extends across departmental boundaries. This is needed in other areas too (and, as we have argued elsewhere, the Government needs to now develop and implement a National Infrastructure Strategy to reap the rewards of this approach[3]). Brexit is just one of the priorities that demand a new approach. Ageing might be another; so might the forthcoming changes in local government finance. Planning geographically would be another approach (as George Osborne's Treasury began to do through devolution deals when he was Chancellor).

At the very least, it would be useful for the Government to make transparent in its planning how it is taking account of trends that clearly affect different departments, and what it thinks the impact of its policies will be on different parts of the country.

Fiscal objectives

The Government's current fiscal intentions are ambiguous. Its stated commitment is to continue to aim for a balanced budget by the mid-2020s.[4] However, it has not yet announced new fiscal targets to succeed those which expire in the mid-2020s. The Chancellor also said in the 2018 Spring Statement that "I do not agree with those who argue that every available penny must be used to reduce the deficit" and "debt reduction [should be balanced] against the need for investment in Britain's future".[5] Ahead of the spending review, the Government has gone on to make major commitments to the NHS and to relax control on public sector pay.

This leaves it in an uncomfortable place. As one Conservative parliamentarian put it, speaking for many fiscal hawks: "There are widespread unrealistic expectations among the public and MPs about the scope for increasing spending." At the same time, the Government is beset by 'me too' demands from secretaries of state (some of these pursued in the media), including for social care – bearing in mind the warnings of health and care commentators that if this demand is not met, much of the money the Government has allocated to health will be soaked up by the needs of the elderly for care. The Chancellor made a start by telling the Cabinet on 18 June that "he has no more money", and the Chief Secretary reinforced that message in a recent Cabinet meeting.[6,7]

But the Government has a long road ahead of it before the review is complete. It will be under pressure from Cabinet colleagues and the public to tolerate a higher level of public borrowing than before in order to improve services – but it might feel that would distinguish it too little from Labour. It should choose a clear position, which may disappoint people, but at least ends the uncertainty of ministers and the public alike.

We suggest that the financial framework for the review should also include two other disciplines:

- It should protect capital spending, which boosts the productive potential of the economy, and hence future tax revenues to finance public services.

- It should set itself the discipline of at least ensuring the long-term pressures on public finances are not worsened by spending review decisions. This would be a new part of the framework, but it needs to be more than aspirational. It requires a clear measure against which achievement can be benchmarked. One approach would be to adopt an explicit target of reducing the OBR's 2067/68 projections of public spending and debt by defined percentages of GDP.

2. Focus on performance

In Chapter 2, we argued that spending reviews fail to consider the performance of departments. They fail to encourage improvements in performance and fail to hold departments accountable for outcomes. We suggest the process could be strengthened in a number of ways.

Decisions on the spending allocated to departments or projects need to be taken with full understanding, by the Treasury and departments, of what that means for performance and results. This requires departments to have agreed ways of measuring performance and monitoring results (which should tally with the goals in the Single Departmental Plans for each department). The Treasury should scrutinise these carefully and, in publishing the results of the Spending Review, include clear information about the outcomes and performance that it expects. If it is not possible to do that comprehensively in the settlement document, it should follow quickly in a new series of Single Departmental Plans.

What exactly the performance measures should be will depend on the characteristics of different programmes and the availability of data. However, from experience in the UK and elsewhere, we can suggest a few principles.[8,9] The discussion between the Treasury and departments should be based on a small number of performance measures, taking into account ministers' priorities. Having too many objectives can demotivate workforces and leaders, and, as we have argued before, "too many priorities mean no priorities".[10,11]

As far as possible, performance should be expressed in terms of outcomes. For example, one of the Ministry of Justice's objectives in its Single Departmental Plan is to "provide a prison and probation service that reforms offenders". This is a sensible high-level result on which to focus, but importantly, it is then also backed up by a number of performance indicators to assess it: on prison violence, self-harm and prison officer numbers.[12] In his 2017 report on public value, Sir Michael Barber explained the importance of maintaining focus on outcomes: "A hospital might deliver a large number of medical appointments with the funding allocated to it, but if those appointments do not translate into improved health outcomes for patients then the service is not improving the lives of those it serves."[13] The Treasury should also scrutinise departments' proposals for achieving these outcomes, and indicators for assessing progress towards them.

Proposed measures should be carefully tested with leaders of public services, non-executive members of Whitehall boards and professional experts to ensure they are realistic, appropriate and well designed. Targets are most effective where those responsible for delivering them are engaged in the process of creating them, so consultation at this level should help to build support.[14]

The Government should make sure the relationship between spending and performance is as clear as possible by publishing a statement at the end of the process, setting out the changes which have been made to planned spending, and how these are going to be achieved practically (policy changes, service standards, efficiency and transformation). This document would be the basis for Commons committees' scrutiny.

The statement published should include indicative longer-term numbers and a discussion of the implications. How far forward it is sensible to look will vary from programme to programme. For programmes with a large capital element, like defence and transport, this should be far enough ahead that the full impact of current plans can be seen. For social programmes, notably health, there is a case for looking even further ahead, to the OBR's Fiscal Sustainability Report's 2067/68, to shed light on the extent to which the review is or is not addressing long-term pressures. As a senior parliamentarian put it: "There is a lack of interest in long-term pressures, and too often an emphasis securing short-term savings which come with long-term costs and liabilities."

We recommend that the NAO should be invited to comment formally on these statements, specifically on the extent that:

- the financial models used to produce them are sound
- the Treasury and departmental teams have followed a sensible and rigorous process in putting together their models
- key assumptions are evidenced, and consistent across Whitehall
- the Treasury and departments have an understanding of the practical means by which spending will lead to the intended level of performance and outcomes.

We note of course that under its remit, the NAO does not comment on policy or political goals.

In the coming years, it will be important to continue to strengthen financial and performance planning, through the skills of Treasury staff, agreement on how to measure and pursue performance, and more independent scrutiny.

3. Strategic planning

There are strategic issues stretching across the whole of government which the Spending Review needs to address. These begin with Brexit, but include the future funding of local government, and the need for the consistent treatment of value and of financial risk.

Spending consequences of Brexit

As well as the exceptional uncertainties it creates for the economic background to the review, Brexit will give rise to pressure for extra spending in many departments. The Treasury will need to look at them across the whole of government. In addition to the direct payments to the EU to which the UK will be committed in a withdrawal deal, the extra spending falls into three categories:

- Domestic programmes to replace current EU spending, such as for farmers, universities and economically underperforming areas. The Government has made a number of short-term guarantees that such funding will continue after exit.

- Costs of Brexit preparation and implementation: for example on new permanent regimes for customs and migration, and maybe adjustment grants for severely affected businesses.

- Mitigating knock-on effects from leaving the EU, for example if there are labour shortages in key public services which add to wage pressures, or if government bodies lose income from EU sources which reduce their net spending.

Local government

Local government has been treated as a 'programme', funded through what is now the Ministry for Housing, Communities and Local Government (MHCLG). In 2019, a number of converging changes and pressures mean that local government will need to be treated as an important whole-of-government issue.

Over the past eight years, the Government has subjected local government to two very important sets of changes:

- Funding for councils has been reduced, and service pressures have increased.[15] Central government has also passed on costs to local government without compensating funding (see page 18). In the face of rising demand for adult and children's care services, councils have tightened their criteria for support and reduced preventive services, but have nevertheless had to reduce other services by a third in real terms to maintain care funding (although councils have increasingly been forced to constrain even those services).[16] As one commentator put it to us, "we are getting close to the point where funding for anything other than care crosses the X axis" – meaning that there will be literally nothing left for anything other than care services.[17] The financial collapse of Northamptonshire County Council, while widely viewed as at least in part a consequence of mismanagement there, shows that there is a growing level of risk in the sector.

- Taking away the central grant but letting councils keep more locally raised revenue. This started in 2013, with the Government assigning 50% of business rates revenue to councils (with corresponding reductions in their grant). In 2015, the Government committed to assigning 100% of business rates to councils by 2020.[18] However, after two consultations, and with only 18 months to go, it has not settled important elements of how this will work.

The particularly fierce application of austerity to council spending, and the shift in funding from national grant to local property taxes, mean that a broad base of citizens and businesses are paying for highly focused social care services. In 2016/17, 80% of local authority social care spending in England went on 2% of the population.[19] Yet universal local services like libraries, leisure centres and children's centres, used by many people, are increasingly cut back. The potential for rising resentment is clear. Yet the issues about which part of the population and economy should support which services demand highly technical thinking. It would be best if the Treasury addressed this carefully as a central strategic element in the spending review process.

The Treasury needs to make sure that the spending review settlement matches a set of clear decisions on what local government should be delivering. Part of the answer may lie in the pursuit of better value across local government, and nationally funded and directed local services (see below).

Value

In Chapter 2, we highlighted the concern that past spending reviews have not focused enough on value and efficiency, and that to the extent improvements were secured in 2010 and 2015, they may have been easy wins. The Treasury demonstrated its interest in pursuing value across government by commissioning Sir Michael Barber to provide advice. His report, published in 2017, urged government to "implement a tool for measuring, tracking and delivering [productivity] improvements while permanently embedding a new dialogue around public expenditure".[20] It proposed a 'Public Value Framework' as a means for doing so, and called for the framework to be "integrated into the ongoing conversations and processes around public expenditure" and the basis of reviews of large programmes.

A Public Value Unit has since been set up in the Treasury with the task of implementing this framework. It is running pilots to test how the framework works in practice and to refine it (amid some concerns that while Barber's analysis was shrewd, the framework might be too complex to be practical). The unit plans to publish an updated framework after it has finished these discussions – although that may not be in time for the 2019 review.

The difficulty of reconciling a desire to shrink the deficit with public expectations, at a point when some services are struggling, means that it is vital that the 2019 review takes the pursuit of value seriously. The Treasury therefore needs to find practical ways to seek out efficiency and reform. We suggest below using panels of Whitehall non-executives and other people with relevant experience to provide challenge and scrutiny. Efficiency improvements which produce big savings during the review would obviously be particularly welcome, but this element of the review should also take seriously potential efficiency and transformation initiatives which will help reduce longer-term pressure on public spending (beyond the period of this review).

One dimension should be to test the argument that value might sometimes be improved by devolving responsibility and authority for funding to a local level. One former minister argued: "The only way to drive further value out of public services is to push responsibility down to local level and let local leaders innovate within a tough financial envelope." The Spending Review should include working with selected councils to see what savings are possible. If the case seems made, the Treasury could test this approach in a small number of council areas after the 2019 review, to provide evidence on whether to pursue more decentralisation.

Financial risk

The Spending Review should ensure there is a careful and transparent identification of the financial risks affecting major programmes building on the approach outlined in its response to the OBR's financial risks report.[21] The money allocated for each programme will inevitably be based on the 'central case' projections. But the review should also consider when that funding might no longer be enough, how likely is that departure from plan, and what could then be done. These steps include:

- whether preventive action can be taken to stop risks arising
- what steps could be taken if a risk does arise, to eliminate or minimise its consequences
- where money could be clawed back if one part of a programme overspends
- risks which would need a response from central government, whether through access to the Reserve, or (in the case, for example, of risks related to economic performance) increased borrowing.

4. Use of data

In this report and other Institute for Government work, we have set out major concerns about the quality of published information on spending and performance.[22,23,24]

The Treasury says it is taking steps to improve the consistency and quality of data inside government. That includes the plan to produce a 'Common Chart of Accounts' – a single set of codes to be used across central government for financial reporting.[25] If the Government does not have good internal data, it cannot publish useful data. It would be desirable to see progress on these areas:

- Whether it is possible to publish plans, reports and accounts from which businesses, politicians, analysts and interested lay readers can see how actual spending and performance compares with original intentions, and the reasons for any changes between the plans and later reports.
- How to ensure proper scrutiny of government's off-balance sheet spending, such as funding infrastructure via private finance, and 'quasi-spending', including some kinds of tax reliefs which reduce revenue and lending to homebuyers (Help to Buy).[26] Public spending commitments, as currently defined, exclude these, but as they result in foregone revenue or financial liabilities, it seems right that they should score in comparable ways in public sector plans and accounts. This may require changes to the accounting treatment to make sure all financing choices are transparently included in government accounts.
- The role of Parliament in scrutinising plans and outturns. What are the roles of the different players – the Public Accounts Committee, Treasury Committee and departmental committees – in the current committee structure? Is there a need for a further Budget Committee, what would its terms of reference be, and what would be its relationship with the Treasury and departmental committees? What is the role of the Lords, among whose members will be many subject experts who could add value to scrutiny?

- The role of the Commons in approving spending. What could be done to improve the engagement of Members in approving spending? Should Parliament have the genuine option to change the Government's spending plans? What could be done about the risk such powers would lead to poor decision-making, for example Members using their power to make objectively poor decisions which suit narrow constituency and other interests?

These questions about data, transparency and scrutiny need to be taken seriously across the whole of government. They are part of its wider challenge: to secure and improve the data which it needs to run itself and the country.

We welcome the decision of the House of Commons Procedure Committee to hold an inquiry on the case for a Commons Committee which would strengthen parliamentary scrutiny of spending plans.[27] We will be offering evidence to the Committee and will be considering further ways in which we can support government and Parliament in improving documentation and systems.

5. Professional skills

As we said in Chapter 2, weaknesses in the Treasury's staffing capability are longstanding. The Treasury has acknowledged them, but has not succeeded fully in addressing them. It has recently taken steps that should lead to a stronger 'finance function', or group of people across government specialising in that role. Its leadership now needs to set about building its strength in public services and spending that is fit for modern government.

This is not our view alone. Lord Kerslake's 2017 report on the Treasury, produced for the Labour Party, said: "An urgent review should be carried out to ensure the department has the resources and skills commensurate in terms of both quality and quantity with the demands of its responsibilities."[28]

The key elements should be:

- **Professional finance skills**. While these are not the only professional skills required, they should be properly dominant in a way they are not now. In line with the Treasury's own conclusions in the 2013 Financial Management Review,[29] the Director General, Public Spending should be an experienced finance professional recruited from inside or outside government, and should also be the Head of the Government Finance Function. Financial skills in other senior civil service roles in the Public Spending Directorate should be strengthened, with a target by 2022 for two thirds of roles to be occupied by finance professionals (with significant finance professional experience as well as a high-level qualifications).

- **Understanding of programmes**. Each spending team should include at least one person with significant experience in the area of public service with which it deals. Each team should set up, and engage frequently with, a team of experts drawn from public services, business, the third sector and academia, which can advise it on the issues it should be prioritising and how to go about addressing them.

- **Staff turnover**. The target of no more than 20% turnover in professional roles in the Public Spending Directorate proposed in 2012 should be reasserted and firm plans put in place to ensure it is met by 2022.

- **Pay**. The Treasury's capability should be determined by what is needed to do the job well. While it needs to apply the same degree of rigour to the scrutiny of its own arrangements as it applies to departments, that should not preclude paying what is demonstrably needed to create and maintain a fully effective central finance function for government. Having defined the types of capability it needs to attract and retain, the Treasury should develop a corresponding compensation strategy.

- **Level of resources**. Planning and managing public spending and services is a vital function. The level of resources allocated to it should enable it to employ the right number of people and pay them what is required.

This programme needs to be sustained and developed over several years to achieve the full results needed. But next year's spending review could be most easily strengthened by two steps that would be quick to take.

First, the Treasury should hire some people on short-term contracts to boost its understanding of the most challenging issues in the Spending Review, for example prisons and rehabilitation, adult and children's social services, and schools' efficiency. These could include finance and business analysts to scrutinise departments' plans, or secondees from public services or the third sector with a deep understanding of how programmes work and of previous reforms.

Second, Whitehall's non-executive directors (on the boards of departments), as well as senior leaders in public services and business leaders, should be involved. They could challenge the planning for programmes as it stands now and sense-check emerging settlements on spending. The Government should set up panels to provide it with advice on key programmes, and on trends and problems that extend across departments. This would also combat perceptions that the spending review is a closed process which does not draw enough on external understanding. Panels could add value by:

- ensuring the narrative and priorities are clear (see page 38)

- advising on the pursuit of value and efficiency (see pages 24 and 44)

- looking at the potential for improving value by devolving responsibility and budgets, in conjunction with senior local government professionals (see pages 25 and 44)

- commenting on the assessment of risk (see pages 20 and 44–5), building on previous work led by Ian Barlow, former lead non-executive director of HM Revenue and Customs.

We have argued that the Treasury's management of its reputation is weak. The Treasury should view effective communication not just as announcing the Spending Review and its conclusions, but as a vital element of the whole process. As a senior local government politician put it, "the process should include conversations about the big, difficult, issues, involving all the players whose involvement is needed to move forward". It should aim to draw in the insight and ideas of public service leaders and others with relevant expertise, and promote understanding of the challenges it is trying to solve and the approach it proposes.

It is important that the Treasury's Public Spending Directorate improves its performance in engaging with Parliament, public service leaders and citizens, and managing its reputation positively. More recruitment from wider public services, and working with expert networks, as we suggest above, would help with this. A greater proportion of Treasury staff would have established networks and reputations, which can be used to spread understanding of the Treasury's role and performance. In addition, effective external engagement and communication needs to be seen as intrinsic to the roles of all officials from the Director General downwards. It needs to be seen as a key capability in recruitment and development, and there should be a core team leading and shaping the corporate approach.

The emphasis on strong communication needs to extend beyond public service leaders to the public. The Treasury should ensure that it finds ways to level with the public on its fiscal and spending choices, for example encouraging more reflection on the relationship between ambition for public services and how they should be paid for through taxation.

Summary: what the Government needs to do to run a successful 2019 Spending Review

1. Clarity of goals

The Government should:

- Outline a narrative of what kind of country it wants the UK to be and its priorities within this.
- Decide the period the spending review will cover. Review the timescale for spending reviews in future.
- Make transparent how it is taking account of trends that affect more than one department, and how its policies impact different parts of the country. Review whether planning by department is the best approach, rather than planning by priorities or places.
- Set clear and credible fiscal objectives ahead of the review.

2. Focus on performance

The Treasury, with departments, should:

- Link spending decisions to performance by agreeing with departments on the performance that they are expected to achieve, scrutinising departments' plans for this, and taking spending decisions on that basis.
- Publish clear information about expected outcomes and performance in the spending review settlement, or shortly after in updated Single Departmental Plans.
- For each programme, publish a statement of changes to planned spending, and indicative longer-term spending estimates. The National Audit Office should formally comment on these statements.

3. Strategic planning

The review should:

- address the impact of Brexit on spending.
- address the spending pressures and impact of financing changes on local government, reflecting clear decisions about what local government should be delivering
- focus on the value and efficiency of spending, building the evidence on whether to pursue more decentralisation after the 2019 review
- identify the financial risks affecting major programmes thoroughly and transparently.

4. Use of data

The Government should consider how to:

- improve the quality of plans, reports and accounts so it is possible to assess changes between actual spending and the settlement
- ensure scrutiny of 'off-balance sheet' spending, tax reliefs and other measures which do not officially fall into public spending commitments but directly affect revenue, spending and borrowing
- strengthen Parliament's scrutiny of spending plans and outturns
- develop the role of the Commons in approving spending.

5. Professional skills

The Treasury should:

- Make some short-term hires to boost the Treasury's understanding of the most difficult issues in this spending review.
- Involve Whitehall's non-executive directors and public service and business leaders in the process.
- Strengthen financial skills in senior civil service roles in the Public Spending Directorate, with a target by 2022 for the proportion of roles to be occupied by finance professionals. The Director General, Public Spending should also be Head of the Government Finance Function.
- Increase understanding of programmes in spending teams. Each spending team should include at least one person with significant experience in the area of public service with which it deals.
- Reduce staff turnover in the Treasury to meet the target of no more than 20% turnover in professional roles in the Public Spending Directorate by 2022.
- Develop a compensation strategy based on a review of what the Treasury must pay to attract and retain the staff it needs.
- Review the level of resources in the Treasury that is needed to manage public spending.
- Improve engagement with Parliament, public service leaders and citizens, by making effective external engagement and communication a key capability in recruitment and development.

5. Beyond the 2019 Spending Review

In Chapter 4, we set out how we think spending reviews can be improved in 2019 and beyond. The thrust of our argument is to make the Treasury more responsible for the performance of departments, not just for their compliance with budgets. It is also to use spending reviews as a chance to fix problems that stretch across government (such as the way that failings in social care become a burden on the NHS).

As we have argued in Chapter 4, the practical changes which will need to be pursued over more than one year in order to take root are:

- Building performance into discussions with departments.
- Setting up independent scrutiny of plans (for instance by Parliament or the National Audit Office).
- Improving the reliability, consistency, transparency and accessibility of data and accounts.
- The Treasury solving problems that extend across departments.
- Exploring the scope for devolving funding to local areas.
- Improving finance and accountancy skills, and knowledge of programmes in the Treasury, particularly in the Public Spending Directorate.
- Reducing turnover among Treasury staff.

However, our recommendations about spending reviews raise much wider questions about the Treasury's role and about the management of public spending. We will consider these in future work, but acknowledge them here. These include:

- The Treasury's role.
- Performance and accountability.
- New Public Management and the role of the private sector in delivering public services.
- Shortcomings of the tax system.
- Centralisation of UK government and devolution.

The Treasury's role

The role of the Treasury today has roots that go back centuries, as we have acknowledged. As one academic put it, "the Treasury, as an institution, and its operating model, are deeply rooted in a set of strongly enduring characteristics of the UK political economy". All the same, there are persistent questions about whether the allocation of responsibilities at the centre of government is the best one. There is no single, simple solution but the questions are not going away.

Responsibility for the planning and management of public services is now divided between the Treasury and the Cabinet Office, a model that dates from 1968, although the boundary moved around in the 1980s and 1990s. Responsibility for pay passed from the Treasury to the Cabinet Office in 1995, for example, while the Prime Minister's Delivery Unit was created as part of the Cabinet Office in 2001, transferred to the Treasury in 2007, and abolished in 2010.[1]

Some argue that the division of responsibility for public services between the Treasury and Cabinet Office results in a lack of clarity and accountability. Others argue there is benefit in a degree of internal tension between spending control (the Treasury) and organisational effectiveness (the Cabinet Office).

The current model is not the only option. Other countries, including those with a Westminster model of government, assign responsibilities in different ways.[2,3]

In Australia, the Department of Finance is responsible for financial analysis, management and reporting, spending control, and the efficiency of the public service and performance reports. It supports the budget process, including ensuring estimates are reliable. (This explicitly gives the department the kind of focus on performance and the responsibility for producing credible estimates that we have recommended.) The Treasury is responsible for economic and fiscal policy, and co-ordinates the budget.

Some countries split the management of public spending from fiscal and economic planning. In Canada, the Department of Finance is responsible for running the budget process and economic and fiscal policy, but the Treasury board, a Cabinet committee, is responsible for decisions on spending, performance and financial management. In Ireland, the Department of Finance is responsible for economic and fiscal policy but the Department of Public Expenditure and Reform (although led by the same team of ministers) is responsible for the management of public spending. The division may allow one department to focus more cleanly on public spending, but risks detaching it too much from economic policy.

There is a continuing debate (subdued, although it sometimes flickers to the surface, as in Lord Kerslake's report for the Labour Party) about whether the UK should change the model.[4] How to organise the centre of government will always be heavily affected by politics – by how powerful a prime minister is willing to allow the chancellor to be, for example. Any significant changes would cause disruption and risk, whatever their merits in principle.[5] Changing departmental boundaries at the centre of government, by itself, is also unlikely to improve the management of spending and public services. But the enduring nature of this debate, even if at a low volume, shows the frustrations many feel with the current model.

Performance and accountability

One of the main themes of this report is the need for the Treasury not just to produce plans which add up on a spreadsheet and resolve political dilemmas, but also to devise plans to make public services and investment work better, and to manage their performance better in its dialogue with them.

That needs to go hand in hand with stronger and clearer accountability for decisions in Whitehall, to Parliament, to existing watchdogs such as the National Audit Office, and possibly to new bodies (such as one to scrutinise spending plans). We have addressed this in a separate project, *Accountability in Modern Government*.[6]

It also needs a better sense of strategic planning. As one of our interviewees pointed out, for all the emphasis on the Treasury's 'power' (because of its control of departments' funding), the centre of government is actually weak in its capacity for strategic planning. Its plans can be bent out of shape by a determined minister and department. There needs to be a place in government for thinking about the fundamental relationship with citizens and the design of public services, and that is best done at the centre of government.

New Public Management and the role of the private sector

The management of public spending today is steeped in the thinking of the past three decades. Some of this comes under the label of New Public Management, as it came to be known, and closely associated theories about the role of the private sector in delivering government services. These ideas have produced undoubted improvements, especially in some transactional services. But they are under challenge, because of some equally evident shortcomings.

The characteristic of New Public Management was its emphasis on setting targets (with a lot of emphasis on digital technology), using data to see if they were met, planning delivery of policies at the centre of government, and generally drawing on the management techniques of the private sector. There was also enthusiasm for using competition to drive down costs (for example in tenders for contracts) and on outsourcing government work (services and construction) to private companies.

To some extent, the UK has been a trend-setter. Sir Michael Barber developed his theories of 'deliverology' during the Blair administration, working closely with the Treasury. These have since spread elsewhere (for instance, to New Zealand, Sierra Leone and Malaysia).[7]

There are now questions about whether this approach has reached its limits. As we have argued in our work on outsourcing, it works well with highly transactional services where performance can be measured, where there is competition to provide the service or construction, and where the activity is not integral to the nature of government.[8] Catering is one good example. However, it struggles in areas where those conditions are not met (such as probation, where none of the conditions are met).

It is important to distinguish where these techniques have worked – as they often have – from where they now appear inappropriate. The Institute for Government is running a new project on the record of outsourcing and the best approach. Inevitably, any shift in the philosophy of public management of the past three decades would have an impact on the way the Treasury approached the funding of public services.

Shortcomings of the tax system

There is also growing debate about whether the patchwork of taxes in the UK gives a modern government the tools it needs to raise revenue in a systematic and predictable way, from a wide enough base of people and organisations, without perverse consequences. The distortions caused by property taxes to the housing market are one example; the difficulties of collecting corporation tax from international companies are another.

Any systematic attempt to tackle these problems will have an impact on the Treasury's role and on its approach to the funding of public services.

Centralisation and devolution

The UK remains extraordinarily centralised in its government compared with many democracies. The devolution to Scotland, Wales and Northern Ireland nearly 20 years ago was an important step in correcting this. The few city deals agreed during George Osborne's time as Chancellor were a move in a similar direction in England, though were limited in scope. But many wonder if more should be done.

It is true, as critics point out, that decentralisation can lead to duplication of services and a lack of national standards. But at its best, it leads to innovation, closer accountability, responsiveness to local needs, and a drive towards the most efficient and imaginative use of resources. It would, of course, remove a degree of control from the centre of government. But that is no reason for not exploring it.

Conclusion

These are all broader questions about the Treasury and about public services in the UK. That they are a matter of live debate now should not be a surprise. That reflects the pressures of the time – not least Brexit and national finances, and a sense of public distrust of government. It also stems from the sense that a lot of improvements have been made, some quite recent. As we have argued in this report, that opens up the chance to make further improvements now.

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