

THE 2004 SPENDING REVIEW IN SCOTLAND

Ross Burnside and Arthur Midwinter

1. INTRODUCTION

The publication of the Executive's **Spending Plans for Scotland** in September 2004 marks the end of an intensive six month period in which budget strategy for the next three years is determined (Scottish Executive 2004a). Whilst the annual budget process continues into Stage 2 in October, and ends with the passage of the Budget Act in January the following year, it is concerned mainly with fine tuning and parliamentary scrutiny of the detailed spending proposals for individual programmes. The Spending Review process, however, is now recognised as the key stage in resource allocation (McKay and Fitzgerald 2002).

In this article, we seek to highlight the key strategic decisions and to discuss the main issues these raise. We do not provide a comprehensive analysis of the spending plans, as our interest is in the Spending Review as an exercise in budgetary choice, and therefore with the setting of priorities and their impact on allocations. It has long been recognised that the setting of priorities is a key task of politicians in the budgetary process. As long ago as 1949 Nye Bevan told the Labour Party Conference that 'the language of priorities is the religion of socialism' (Campbell 1997, pp. 206-7). Edmund Dell, a former Chief Secretary to the Treasury, took the view that 'there had to be priorities, as not every expenditure could be borne without cost to the country and its prospects for economic growth' (Dell 2000, p. 138). Determining priorities

Ross Burnside is a Senior Research Specialist in Finance and Economics at the Scottish Parliament and Arthur Midwinter is Budget Adviser to the Scottish Parliament Finance Committee. They write in a personal capacity.

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within and between programmes are in essence matters of political judgement, as there is no 'magic mechanism' for doing so (Lawson 1993).

Spending Reviews were introduced in the UK by the Labour Government in 1998, to assist in directing resources to agreed priorities. In the Whitehall context, Gordon Brown ensured priorities were clear cut, and health and education topped the list:

Our prudence has been for a purpose. It is because we have set tough efficiency targets, and reordered departmental budgets, that our top priorities, health and education, will receive more money than the other nineteen government departments combined.

(Keegan 2003, p. 287)

Financial systems, and strategic statements of priorities, help the process, but the outcomes are not automatic. Planning can be distorted by political pressures, unexpected circumstances, and ministerial advocacy over spending (Heclo and Wildavsky 1974). The nature of this process is well captured by Peter Self, who focused on the interaction between environmental pressures and budgetary politics, whereby:

The pressures for coping with social and demographic change, for example, in education, interact with the pressures of teachers and administrators for better staffing ratios, pay and conditions. Or again, the overall pressures for more expenditure on services like health, defence or agriculture interact with the relative skills and persuasiveness of specific pressure groups, with the electoral calculations of the parties and the activism and prestige of departments and ministers.

(Self 1980, p. 129)

In the conventions of budgetary politics in Britain, a minister who does not fight for cash will be on the receiving end of criticism. Whether Holyrood replicates this role for departmental ministers awaits further research.

Spending Reviews were also designed to provide a longer-term, cross-cutting perspective to the annual process which focused on incremental changes to departmental budgets, using the baseline as the benchmark for negotiations (Balls and O'Donnell 2002). The expenditure control framework distinguished between expenditure which is demand driven and required to be managed on an annual basis, and discretionary expenditure where choice is more meaningful. Demand driven expenditure is known as Annual Managed

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Expenditure (AME), and discretionary expenditure is known as the Departmental Expenditure Limit (DEL). The Spending Review focuses on the latter.

Within the Scottish Budget, the DEL is the main element, and it can be allocated according to the Executive's priorities, as can those elements of AME which are locally determined, such as the Non Domestic Rate Income (NDRI) and the Scottish Variable Rate of Income Tax. The Scottish Executive has the same right of access as Whitehall departments to the Treasury reserve for in-year spending pressures, and can carry forward underspending to the following year under End Year Flexibility (EYF) arrangements. In the first Scottish parliamentary term, the Scottish Budget grew from £16.3bn to £22.1bn (at 1999 prices).

After the 2003 election, however, the Labour and Liberal Democrat groups negotiated a new partnership agreement to form the basis of a new Programme for Government. This was reported to Parliament as adding £525m to the Budget plans under Spending Review 2002, and was mainly funded through EYF monies, and additional income of £196m from the Treasury accepting responsibility for funding more of the costs of Housing Stock Transfers (Parliamentary Statement, 11 September 2003). This included commitments to increase spending in higher and further education, public transport, health, and staffing levels in schools. Much of the additional expenditure was required to deliver commitments on pay and conditions for teachers (Midwinter 2003) and junior doctors and nurses (Audit Scotland 2004), which squeezed the resources available for service development. Finally, pressure from lobby groups such as the CBI on business rates, and pensioner groups on council tax, led to a review of local government finance, and to increasing political concern with these issues.

Spending Reviews take place every two years, but utilise a three year planning horizon, in which the last year of the current cycle overlaps with the first year of the new cycle and whose allocations are revisited as part of the new process. Spending Review 2004, therefore, covers financial years 2005-06 to 2007-08. Table 1 shows how the Scottish DEL has been modified over time, and how each previous Spending Review increased the resources available in the first year of the new cycle.

The **2004 UK Spending Review** (HM Treasury 2004a) was published on 12 July 2004. Its broad totals were consistent with **Budget 2004** (HM Treasury 2004b), planning overall increases of 2.5% per annum in real terms, but,

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within that total, the UK DEL was increased by 4.2%, and AME by 2.1% in real terms.

The Scottish DEL will grow by 21% over the new Spending Review period, from £21.3bn in 2004-05 to £25.5bn in 2007-08. This is equivalent to 3.5% per annum in real terms (Scottish Executive 2004a) and is only around 1% less than the previous Spending Review trend, which had been considered particularly generous.

Table 1
Scottish Departmental Expenditure Limits

		£m	% increase year on year
Spending Review 2000	2000-01	15,050	
	2001-02	16,230	7.8
	2002-03	17,370	7.0
	2003-04	18,470	6.3
Spending Review 2002	2002-03	18,210	
	2003-04	19,720	8.3
	2004-05	20,880	5.9
	2005-06	22,320	6.9
Spending Review 2004	2004-05	21,338	
	2005-06	22,757	6.7
	2006-07	24,202	6.3
	2007-08	25,549	5.6

Source: Scottish Executive 2000, 2002, 2004

2. STRATEGIC PRIORITIES

The 2004 Scottish Spending Review document, **Building a Better Scotland Spending Proposals 2005-2008: Enterprise, Opportunity, Fairness** (Scottish Executive 2004a), sets out four key priorities for the Spending Review cycle. These are 'growing the economy (which is the top Executive

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priority); delivering excellent public services; supporting stronger, safer communities and developing a confident, democratic Scotland.’

The first Scottish Spending Review (Scottish Executive 2000) identified infrastructure investment and social justice as the two strategic priorities, but contained no systematic exposition of how the package as a whole advanced them. In the 2002 Spending Review (Scottish Executive 2002), the Executive set itself five functional priorities and two cross-cutting themes. The five priorities were health, education, crime, transport, and jobs, with closing the opportunity gap and sustainable development as cross-cutting themes which departments were required to reflect in their spending proposals. This framework has been criticised for having too many priorities to be meaningful, with priority areas covering over 80% of the Scottish Budget (Midwinter 2005).

The 2004 spending priorities have been described in evidence to the Finance Committee as a largely presentational change (Scottish Parliament Finance Committee 2004b). The four strategic themes can also be found in the last Spending Review document, in which the First Minister said the Executive had to work on ‘growing our economy’, ‘increasing opportunities in our communities’, ‘improving public services’ and ‘safeguarding our environment’ (Scottish Executive 2002, foreword).

The most significant development since Spending Review 2002 is the identification by the Executive of a ‘top priority’. The former Finance Minister, Andy Kerr, refused to set a target for economic growth in the Spending Review on the grounds that ‘there is no point in my setting targets for things over which I have no control or influence’ (Scottish Parliament Finance Committee 2004b). This is a recognition from the Minister that whilst the Scottish Executive have a number of micro-economic policy levers it can use to promote economic growth, overall responsibility for the economy lies outwith aggregate spending decisions made by the Executive, and many external economic factors can also come into the equation.

This statement from Mr Kerr does raise the question of the appropriateness of setting economic growth as the Executive’s ‘top priority’ rather than, for example, economic development. This concern was raised by the Finance Committee in its Stage 1 report. In Draft Budget 2005-06, the Executive reaffirmed its reluctance to set such a target, as the economy ‘is heavily influenced by economic performance worldwide, and the global economic cycle. It would not be credible to claim specific changes in GDP were directly

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linked to specific Executive spending' (Scottish Executive 2004d, p. 181). The problem is that the answer does not sit easily with the rhetoric of budgeting for outcomes. However, for our purposes, it is helpful in that the setting of meaningful priorities provides strategic criteria for assessing departmental bids for resources in terms of their contribution to the wider objectives of the Executive as a whole.

The Finance Minister's introduction to Spending Review 2004 also highlights two further aspects of the budget as key issues. The first is the designation of capital expenditure as a priority for increased funding, and the second is the setting of efficiency targets to release resources to frontline services by 2007-08. We shall examine these developments in more detail below.

3. BUDGET ALLOCATIONS

In this section, we concentrate on the Departmental Expenditure Limits (DELs) as this is the block grant element of the assigned budget which provides discretion to the Executive to determine the spending mix, or allocation to ministerial portfolios and Level 2 programmes.

Firstly, we set out the increases in portfolio allocations over the period. Table 2 shows that five portfolios – Justice, Education and Young People, Health, Tourism and Transport – have received increases which are above the Scottish average, whilst the Finance portfolio – which is mainly concerned with the local government programme – has the lowest increase.

A number of Level 2 programmes within the other portfolios also received major increases, including Higher Education (HE) and Further Education (FE) (both receiving 31% increases within the Enterprise and Lifelong Learning (ELL) portfolio); Affordable Housing (receiving a 36% increase within the Communities portfolio); and Environmental Protection, Fisheries and Rural Development (increasing by 53%, 27% and 22% respectively within the Environment and Rural Development portfolio).

It is also worth considering whether the top Executive priority of 'growing the economy' has been treated as a priority in budgetary terms. The recently published refresh of the Framework for Economic Development (FEDS) (Scottish Executive 2004c) identifies investment in supporting business, infrastructure, technology, education and skills as being crucial for economic development. With the exception of the enterprise networks, all other relevant

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programmes have been prioritised in budgetary terms. No explanation is given for the standstill budget for the enterprise networks, but overall it is fair to say that programmes which have been identified as supportive of economic growth saw their budgets increase in relative terms. The other three priorities (delivering excellent public services, supporting stronger, safer communities and developing a confident, democratic Scotland) are of limited use as a guide to resource allocation, as almost any spending proposal in the Spending Review document could be regarded as contributing to one of them.

Table 2
Departmental Expenditure Limits over Spending Review Cycle

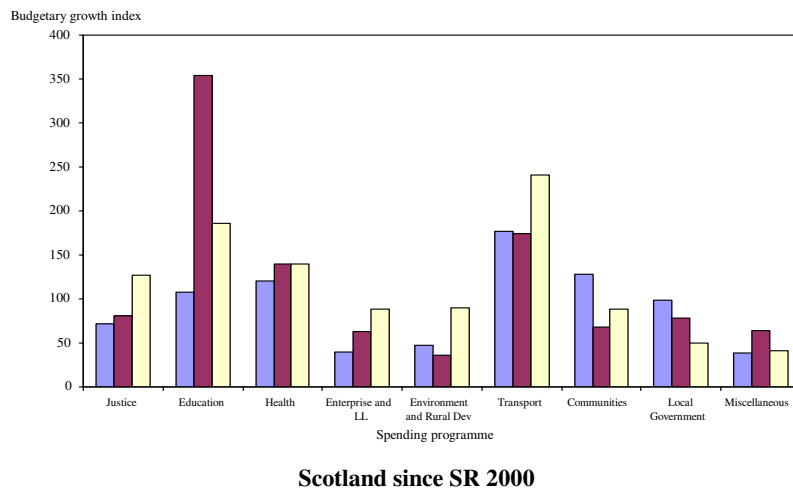
	2004-05	2007-08	change
	£m	£m	%
Justice	805	1012	25.7
Crown Office	89	102	14.6
Education	417	570	36.7
Tourism	233	292	25.3
Health	8048	10272	27.6
Food Standards	10	11	10.0
Enterprise & Lifelong Learning	2463	2893	17.5
Communities	826	970	17.4
Transport	935	1379	47.5
Environment	798	941	17.9
Finance	6312	7012	11.1
Administration	251	264	5.2
Scottish Parliament	87	106	21.8
Contingency Fund	58	41	-29.3
Total	21332	25865	21.2

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The issue of local government finance, which accounts for 34% of the DEL, has generated significant media attention since the Spending Review announcement by the Finance Minister on 29 September. Expenditure on local government is set to increase by 10% over the planning period, which is less than 1% per annum in real terms. It has been argued that this below average increase on local government is inconsistent with the Executive's strategy to prioritise investment in public services or strengthen communities given the importance of local government to both objectives.

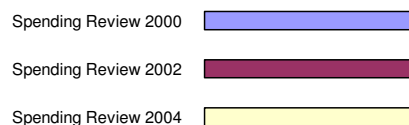
Finally we examined the patterns of expenditure over the three post-devolution Spending Reviews, and the results are set out in Figure 1.

Figure 1
Index of Budgetary growth for major discretionary spending programmes in



Key:

Figure 1 uses an index of spending growth, which compares the ratio of portfolio growth shares to baseline budget shares, with scores above 100 indicating portfolios with a higher proportion of growth monies – and



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therefore budgetary priority. In this paper, we wish to focus on the major (i.e. largest in financial terms) spending decisions, so we have grouped relatively small budgets into a miscellaneous category. In addition, as our interest is in the exercise of political choice over discretionary expenditure, we included Non-Domestic Rate Income in the local government DEL – as it is distributed to local authorities by the Executive. The index shows that Education, Health and Transport portfolios have consistently been treated as priorities since devolution, even though the stated priorities of the Executive have changed in each Spending Review.

4. CAPITAL SPENDING

A central element of the Executive's growth strategy is to tackle what the current Chancellor of the Exchequer has called the neglect of capital investment (Brown 1989). From 1999, the UK government planned a significant increase in capital spending, both in real terms and as a proportion of total expenditure. This would be reflected in the block grant to Scotland, but, under the devolution settlement, it would be for the devolved administration to determine the scale of the capital budget.

The UK government's commitment to targeting the 'long standing underinvestment in the public sector' (Emmerson, Frayne and Love 2003, p. 9) resulted in the reform of the expenditure planning and control in Whitehall. Capital expenditure had been regarded as an 'easy target' in the past (Dunsire and Hood 1989), with capital investment falling to around one-third of its ratio to GDP between 1968 and 1988, leading for example to years of neglect for investment in the water industry (Foster and Plowden 1996).

The key changes which the Chancellor's reforms created were in distinguishing between capital and resource budgets – in effect ring-fencing capital – the introduction of Resource Accounting and Budgeting (RAB) – which required economic costs such as depreciation and capital charges that reflect the consumption of assets to be accounted for in budgetary decisions – and End Year Flexibility (EYF) which allows unspent monies to be carried forward into the next financial year. This would be consistent with the Chancellor's 'golden rule' of 'borrowing only to invest' (Balls and O'Donnell 2002, p. 160), as the emphasis now is on net capital investment (i.e. after accounting for depreciation).

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The current position was set out clearly in the Treasury's **Statement of Funding Policy** (HM Treasury 2004c) for the devolved administrations, which acknowledges the need to treat capital and current expenditure differently, and to include the consumption of fixed assets and the costs of holding them within current expenditure to reflect long-term investment rather than cash spent in the year of acquisition. The result was:

separating spending into a capital budget and a resource budget with limited flexibility for transferring from capital to resource spending, together with the continuation of separate administrative cost controls, ensures that essential capital investment is not squeezed out by short-term pressures.

(HM Treasury 2000, p. 13).

The Finance Committee report into the Scottish Water industry expressed concern that there were high levels of slippage in the water capital investment programme, which had some £500m of unused borrowing capacity, much of which was transferred to other programmes by the Executive for non-capital purposes (such as pay costs in the NHS) a move, which although within the current HM Treasury rules, is not consistent with the principle of increasing capital investment. However, the Executive has reported that the unspent money will still be available to Scottish Water which has 100% EYF, as necessary, and Scottish Water have indicated it is not required for 2004-05 (Scottish Executive 2004e).

Analysing capital spending trends between 1999 and 2002 is problematic because the phased introduction of Resource Accounting and Budgeting disrupted the cost basis of the data, whilst the change in definition of capital to expenditure which creates a public asset effectively excludes grants to the private and voluntary sector from the figures. Nevertheless, whilst the data under the previous definition showed a modest growth from 11.3% to 11.8% in the share of capital expenditure from 1999-2000 to 2001-02, the trend since 2002-03 is of a modest decline from 9.4% to 9.1%, reflecting the revised definition (Midwinter 2004). The Finance Committee, therefore, recommended the Executive provide clear evidence of capital expenditure being treated as a priority in SR 2004 (Scottish Parliament Finance Committee 2004a)

The Finance Minister set a target of increasing net capital investment by at least 5% per annum over the Spending Review period, to deliver over the

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longer term the infrastructure required to 'grow the economy'. These figures now include capital grants to the private sector (which are treated as resource expenditure in the accounts) but exclude the capital elements of public private partnerships (PPP) which do not count as public expenditure in the accounts. The total level of capital investment in government services, therefore, is somewhat higher than the official figures show. The global figures for capital are set out in Table 3. This shows that capital spending plans are set to increase in cash terms by around 10% per annum.

Table 3
Capital Spending Plans over the Spending Review cycle

	£ million	% increase
2004-05	2,282.68	N/A
2005-06	2,685.24	17.6
2006-07	2,986.09	11.2
2007-08	3,187.59	6.7

Source: Scottish Executive (2004, p. 10)

5. LOCAL GOVERNMENT FINANCE

Local Government finance has been characterised by a high level of dependency on central grants since the abolition of domestic rates, with over 80% of funding coming from central government. The expectation that this balance of funding problem would be solved by returning non-domestic rates to local government was not met as the Executive decided to retain this power in Edinburgh. Whilst the capping constraints of the past have been reduced, central-local financial relations remain a potential source of difficulty.

Writing in **Scottish Affairs** in 1997, Arthur Midwinter observed that

with the council tax, I would expect some reconsideration of the mode of intergovernmental fiscal relations between London, Edinburgh and local government. Governments find it easier to transfer painful decisions to other institutions rather than face them themselves. Grant reductions from the Treasury to Edinburgh and onwards to local government must be

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possible.
(Midwinter 1997, p. 33).

Interestingly, whereas constitutionally council tax is a matter for local government, some regard it as a source of potential fiscal discretion to the devolved administration, providing a significant proportion of the revenue to the Scotland programme (14.4%) prior to devolution. Combined with the 5.5% from sales, fees and charges, and 15.6% from Non-Domestic Rate Income, this was interpreted as indicating 'that there is a considerable amount of revenue generation ... and hence discretion' (Heald, Geaghan and Robb 1998, p. 38) within Scotland. In practice, this would require grant manipulation to deliver increased revenues via council tax.

In practice, the financial context of devolution turned out to be much more benign than expected. Spending Review 2004, however, delivered a very low increase in comparison with other services. This continues a trend of local government receiving a declining share of the Scottish Budget since devolution (Midwinter and Burnside 2004). In Spending Review 2004, Aggregate External Finance (AEF) is planned to grow by 9.9% from £7.7bn to £8.5bn, compared with an average increase from £21.4bn to £25.9bn, or 21%. This gap is much greater than in the past two Spending Reviews, of 19.6% compared with 23.3% on average in Spending Review 2002; and 17.2% compared with 21.2% in Spending Review 2000 (Scottish Executive 2000, 2002, 2004). With inflation estimated at 7.5% over this period this would add £580m to current costs, which leaves nearly £220m to cover new developments. A further 2% has been built into Executive assumptions for efficiency savings, which in our estimation will have reduced the total level of grant by around £160m. The local government budget will increase by 3.7% in 2005-06 compared with a total Scottish budget growth of 6.7%. To provide a 6.7% increase for local government would require a budget of £8257m, an additional £230m.

Looking at past experience of such exercises suggests that some of the savings might be met through higher council taxes. This certainly happened between 1992-93 and 1996-97, when the government assumed all pay increases would be funded from efficiency gains, with a resultant fall in spending and big increases in council tax. As a result, band D council tax increased from a level of £558 in 1993-94 to £784 in 1996-97, an increase of around 11% p.a. in real terms (Midwinter 1998, pp60-61).

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The spending plans contain specific commitments to increase police grants by £80m over the cycle whilst roads maintenance Grant Aided Expenditure will be increased by £60m per annum. The document does not cost the commitments on education, social work and waste disposal set out in the Draft Budget, although COSLA costed the proposal for additional teachers at £110m in its submission to the Spending Review (COSLA 2004), and these three items alone would exceed the resources available. This appears inconsistent with the statement to Parliament by former Finance Minister, Andy Kerr, that the Executive has covered these costs:

They asked us to ensure that we fully fund any new commitments that we want them to deliver in this budget, and I can confirm that we have done so. They asked us to make an allowance in their budgets for pay and price inflation, and I can confirm that we have made such an allowance. They asked us to confirm that all our existing initiatives are fully funded in their baseline budgets and, again, I can confirm that we have done so. (Official Report, 29 September 2004, col. 10669).

For 2005-06, local authorities have set indicative plans for an average increase of 4.4%. The Finance Minister had already indicated that he did not expect the increases to be out of line with recent trends.

However, the following day, the First Minister told Parliament he saw no need for increases of more than 2.5% per annum for the next three years. A 2.5% increase would be out of line with the indicative plans outlined by Local Authorities, and trends in council tax increases in recent years, on top of a below average increases in grants to Local Authorities. A few days later, however, a spokesman implied the First Minister had not been referring to 2005-06, but only the two subsequent years in the new spending review cycle (Gordon 2004).

Council tax is an inelastic form of tax, meaning its yield does not rise automatically with inflation, and so it is not surprising that when expenditure is growing in real terms, council tax will rise also. However, if central government wishes to restrict council tax increases in line with inflation, then it should fund all real growth in spending from increased grant. Reliance on efficiency gains on past evidence will not suffice. A review by the Audit Commission (2003) of reasons for council tax increases in 2003-04 of 12.9% on average found two principal factors – councils increasing spending more than provided for in the grant settlement, and the effect of the grant regime

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itself through gearing – the ratio of grant to council tax in funding – whereby a 1% increase in spending (or reduction in grant) increased council tax by 4%. In Scotland, since devolution, council tax has risen on average by around 4.8% per annum, much lower than the English average of 9.2% per annum since 1997.

6. EFFICIENCY TARGETS

A new development in Spending Review 2004 was the setting of an efficiency target for the Scottish Budget. It was first announced in a parliamentary statement in June 2004, developed in the Spending Plans document, and then published at departmental level in October. Although the Scottish target of £500m savings in administrative costs for deployment in frontline services was set prior to the UK government's Spending Review announcement in July, the approach adopted is very similar.

Sir Peter Gershon was appointed by the Prime Minister and the Chancellor of the Exchequer to undertake a Review of Public Sector Efficiency to inform Spending Review 2004, with the objective of releasing resources for use in front-line services. His work was focused on Department Expenditure Limits, and, whilst it did not apply to the devolved administrations, the review team shared its proposals and process with them. The Gershon Report also notes that both the Scottish and Welsh administrations have set targets for efficiency gains 'as ambitious as those in England' (Gershon 2004, p. 33).

The key aspects of administration identified as sources of potential savings were:

- Rationalisation of back-office functions, such as finance, human resources and IT, through sharing between institutions;
- Professionalisation of procurement to improve efficiency of purchasing;
- Greater use of electronic processing of benefits, pensions, tax collection, etc;
- Rationalisation of policy, funding and regulatory functions, in central departments and their agencies;

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- Improving productivity through technology, and use of paraprofessionals, to increase time spent on delivery by front-line staff

Gershon's assessment was that around £20bn of savings were possible, at least 60% of which would be cash-releasing, whilst the remainder would improve productive time within services. However, the UK Spending Review (HM Treasury 2004) shows that around 69% of the efficiency gains identified by UK departments would be cash-releasing, saving around £14.8bn, although for comparable programmes to areas devolved to the Scottish Parliament the cash saving element was around 50%.

In Scotland, the Executive's public presentation of the issue led to conflicting interpretations as to whether the Scottish targets were driven by and tougher than the UK government's review. In response to Parliamentary questions, it stated that 'no targets for efficiency savings have been set for the budget as a result of the UK Spending Review. The Executive has set its own targets and details of the efficiency gains we aim to secure will be published in our forthcoming Efficient Government plan' (S2W-10482).

This is a clear statement of the constitutional position. Nevertheless, the Executive did initially identify the same areas for saving as Gershon: namely procurement, back office reform, transactional services and policy, funding and regulatory regimes, with some £200m savings projected from procurement gains. The feasibility of savings from the other areas is not clear cut, as the initial announcement did not set out the financial assumptions underpinning the efficiency targets, and much of the public discussion consisted of vague generalisations about spending more on delivery and less on administration.

However, in an interview with the **Financial Times**, the First Minister was reported as stating that 'I want us to go not just as far as Gershon, but I think in Scotland we can go further' (**Financial Times** 2 September 2004). The following day in the **Herald** he was reported as saying 'nationally the government has produced targets of 1.25% each year cash savings in government spending across departments. We in Scotland will go further than that, and in three years time we will have targeted a minimum of 2% cash savings in government spending' (Fraser 2004).

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This does not seem to go further than 1.25% per annum, or 3.75% over three years. Attempting to get a clear explanation of the Executive's efficiency savings, another parliamentary question received the following response:

The Scottish Executive is undertaking an efficiency initiative that is as ambitious as the Gershon Review in its scope and will seek to secure comparable or greater gains in efficiency. The Executive was engaged in securing efficiencies in the public sector before the Gershon Review. Its efficient government initiative will go on until 2010 – longer than the activity outlined in the Gershon Report.

(S2W-10531)

In a further question, the Minister was asked how the £500m savings exceeds the planned cash savings at UK level, and replied that

The Scottish Executive has never claimed that the £500m saving in its budget by 2007-08 exceeds planned UK cash savings.

(S2W-10439)

These apparent contradictions have yet to be clarified. The Executive has created a small Efficient Government Fund of £60m – which will work on an 'invest to save' basis, to 'stimulate a sustainably more efficient public sector and to demonstrate the reallocation of resources for better front line use' (Scottish Executive Circular, 2 September 2004), and applications can be made from Departments, Agency Non-Departmental Public Bodies, Health Boards, Universities and Colleges, Local Authorities, Fire Authorities and Police Authorities, with an emphasis on joined-up delivery, through procurement, support services, and transactional processing, productive time, improvements in policy, funding and regulation, internal efficiency, and other efficiency savings.

The technical note on targets produced as a supplement to the Spending Review defines an 'efficiency improvement' as an activity which improves the ratio of outputs to resource inputs, either by producing the same outputs with fewer inputs, or better outputs for the same inputs. Whilst the Efficient Government Initiative addresses both, the value of increased outputs is difficult to describe objectively, and therefore the £500m target relates only to the second category which results in identifiable cash releasing savings.

When the Efficient Government Plan was published on 29 November, the target had been increased to £745m of cash-releasing savings, supplemented

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by £300m of time-releasing savings, which had not been identified in the June statement by Mr Kerr. As the £745m includes £95m from Scottish Water, this needs to be excluded from comparisons with the UK, as it is outwith the Department Expenditure Limit. This makes total savings (cash and time-releasing) of £950m by 2007-08, equivalent to 3.7% of the Scottish DEL. The comparable figure for Whitehall is 7.3%. The new Finance Minister, Tom McCabe, is refusing to comment on comparisons with Whitehall, on the grounds that he will set targets which are 'appropriate for Scotland'.

7. CONCLUSIONS

Spending Review 2004 delivered continuing real growth in the Scottish Budget to 2007-08. This has allowed the Scottish Executive to continue to provide significantly above average increases for education, health and transport. In addition, the Executive has been able to fund a major expansion in capital spending.

Our article, however, raises issues around the adequacy of the allocation for local government and the realism of the efficiency targets set for the next three years. The local government share of the Scottish Budget has been in relative decline since devolution, raising concerns about a centralising trend over the mix and total of local spending, and the adverse impact this might have, both in terms of higher council taxes, and on the Executive's strategy to improve public services and strengthen communities.

The concern over efficiency targets is that the Scottish figures appear less stringent than the Whitehall figures, reinforcing the political concerns that the Barnett formula overly benefits Scotland, and that this encourages a less robust approach in Scotland to managing public finances (Treasury Committee 1997). This is an aspect of devolution finance where perceptions of overfunding remain, although the Scottish excess over its 'needs' in the Treasury study would release around £1.4bn, a small amount for reallocation on a UK basis, but a significant shortfall for Scotland (Midwinter 1999). This requires a rigorous and transparent approach to the public finances, in which efficiency savings are realistic, transparent, and auditable, and in which allocations effectively meet priorities and Scotland's expenditure needs. The Spending Review process facilitates the exercising of political choice, but it doesn't guarantee it. That requires the rigorous determination of priorities, and whilst there is evidence of progress in this direction, there is still scope for improving performance in targeting priorities.

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Devolution provides the scope for a degree of political autonomy for Scotland within the UK. Considerable attention has been paid to specific policy differences, over free personal care for the elderly, student fees, and choice in health and education (Hazell 2003). There is no doubt that the Scottish Executive had no constitutional requirement to pursue similar approaches to financial management as its Westminster counterpart. Political networks, however, work across institutional boundaries. With the Chancellor's influence in Scottish Labour politics, it is not surprising that similar approaches to the public finances and budget priorities are to be found in Spending Review 2004. The argument that the approach to efficiency targets in Holyrood is more ambitious than Westminster is not borne out by the material in the public domain thus far, and this may add to the pressure to review the financial arrangements for devolution, despite the fact that any Scottish 'overfunding' is minimal in a UK context.

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