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FROM: CHIEF SECRETARY

DATE: 30 January 1984

PRIME MINISTER

## PUBLIC EXPENDITURE REVIEWS : TERRITORIAL PROGRAMMES

Before deciding how best to approach the Secretaries of State, you asked to see a summary of the work the Treasury had undertaken, pointing to substantial over-provision of public expenditure in the block budgets for Scotland and Northern Ireland, though not Wales (your Private Secretary's letter of 3 January).

2. This summary is attached; a copy of the full report is being given to the Policy Unit. The three Secretaries of State so far know nothing of the work we have done.

3. I am of course ready to discuss this if you wish. If you decided to send a note on the basis of the attached to the Secretaries of State, calling for a review, I should be happy to provide a draft.

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SCOTLAND, WALES, AND NORTHERN IRELAND:  
PUBLIC EXPENDITURE BLOCK BUDGETS

The three territories receive a large part of their funds in the form of block budgets, together accounting for one-tenth of public expenditure, within which the Secretaries of State have wide discretion in relating resource allocation to local needs:

Block budgets (£m cash)

	1982-83	1983-84	1984-85
Scotland	5,937	6,058	6,240
Northern Ireland	3,568	3,806	4,020
Wales	2,228	2,370	2,440
Total	<u>11,733</u>	<u>12,234</u>	<u>12,700</u>

Public expenditure

planning total	<u>113,007</u>	<u>119,568</u>	<u>126,370</u>
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2. Per Capita spending in the territories, on the latest available (1981-82) figures, is high in relation to England. The picture is broadly similar whether one takes all programmes for which expenditure can be attributed to the territories (as below), or the blocks alone:

	Population (million)	Per capita expenditure (£)	Percentage above England
Northern Ireland	1.5	2,161	45%
Scotland	5.1	1,937	30%
Wales	2.8	1,756	18%
England	46.8	1,493	-

3. The relative generosity of the provision for the territories is of long standing and was reflected in the baselines for the budgets when they were introduced in the period of 1978-80. Baseline provision for the blocks as a whole is rolled forward each year under normal PES ground-rules - a flat percentage increase on the previous year's provision. The block system also entails the use of population-based formulae which, on principle of rough justice, allocate marginal changes (up and down) as a direct consequence of changes made in comparable English programmes during the annual Survey negotiations (see Annex A for details). Thus the system runs on from year to year, hitherto unchecked and largely automatic in operation.
4. What has happened is that the generous starting baselines, inherited from the 1970s and rolled over each year as described, have broadly maintained (even slightly improved) the territories' position relative to England; while the formulae for their part have had a more or less neutral effect over time (see Annex A). Under present arrangements, the territories' advantageous position seems set to continue.
5. The justification for the generosity of provision of course has been the special needs of the territories. But the study indicates that for many programmes, territorial expenditure

today is substantially above the UK average when assessed against objective measures of need. Examples are in Scotland health and personal social services, housing, and schools and in Northern Ireland health and housing.

6. These conclusions are reached by updating, in a broad-brush way, the results of an earlier needs assessment study, started in <sup>the</sup> devolution context and published in late 1979. The methodology used in this study is explained at Annex B.
7. For Scotland a literal reading of the results would point to excess expenditure currently of around £900m per annum in a block budget of £6b. In the imperfect nature of the methodology, this figure must be treated with caution. But it does show conclusively that substantial over-provision exists. The excess appears to have grown by around £275m since 1978-79, after inflation is allowed for; over half of this increase is due to a rise in Scottish expenditure provision relative to England much of which was implicit in the forward plans already in existence when the block was established (which looked forward to 1982-83); the remainder of the increase is due to reduced relative need in Scotland. Over-provision is thus likely to rise less rapidly in future. But it is there, and general economic circumstances do not provide much justification for it. Helped by oil as well as by high past levels of public spending, Scotland is rapidly closing the wealth gap with England: on both personal disposable income per capita and GDP per capita, it now scores 97-99% of the national average.
8. Wales, on the other hand, has expenditure not significantly above need overall, a situation expected to continue.

But with Northern Ireland we are back to a current excess approaching £200m per annum, a figure which leaves out of account the law and order programme where special considerations obviously arise. This excess has also grown since 1978-79; the growth is here almost entirely due to a rise in expenditure relative to England, for reasons similar to those applying to Scotland. Again, this figure must be treated with caution, and there are of course some strong arguments for special treatment (economic as well as political) in Northern Ireland's case; eg on the economic indicators cited for Scotland above, Northern Ireland scores only 72-81% of the national average. But here, too, over-provision undoubtedly exists.

9. The results just described find some support in anecdotal evidence. It must also be borne in mind that Scotland and Wales, at least, have up to now been quite generously treated in some programmes falling outside their blocks such as agriculture, coal, rail, and shipbuilding. For example:
  - a. some 25% of the PSO grant to British Rail is for lines in Scotland and Wales - equivalent to about £200m a year;
  - b. the subsidy to Scottish mines is three times and to Welsh mines five times the UK average and equivalent to some £180m a year;
  - c. Scottish electricity prices are some 5% lower than in England and Wales on average, a larger differential than can be easily justified in economic terms.
10. Northern Ireland, too, has done well on agriculture. Further, our recent White Paper, embodying the results of the Review of Regional Economic Policy, implicitly recognises

that some shift is taking place in the relative economic fortunes of England and the territories, in favour of the latter; we are here addressing another manifestation of that same shift.

11. If a full review confirms the disparity, it could be put right by setting the baseline provision for the new final year in each annual Survey, not on the normal basis for public expenditure programmes - a flat percentage increase on the previous year's provision - but at a level related to need. There are various ways this might be achieved, as discussed in the report; and it is only realistic to assume that any adjustment will need to be phased over a good run of years. But a start could be made in the 1984 Survey, and it may be possible to secure some savings in the early years of that Survey too.

THE TERRITORIAL FORMULAE

The formulae apply only to marginal changes to the baselines made in the course of the annual Survey rounds. Any decision made in an annual Survey to increase, or reduce, a "comparable English programme" (as defined in the Treasury study) leads to an automatic adjustment, in the same direction, to the three territorial blocks, on the basis that Scotland gets 10:85 and Wales 5:85 of the change in the English programme, while Northern Ireland gets 2.75% of the consequential adjustment in GB public expenditure. These formulae are intended to reflect the relative population ratios : in fact Scotland's, due to its falling population, is now significantly too high (10:85 = 11.765% against an "entitlement" of 11.067%), Wales' is slightly too low (5:85 = 5.882% against an "entitlement" of 6.022%), while Northern Ireland's is about right (2.75% against an "entitlement" of 2.776%). The actual population figures on which these ratios are based are (1981 census): England 46.8m; Scotland 5.1m; Wales 2.8m; Northern Ireland 1.5m.

2. These formula discrepancies from "entitlement" matter little in practice, however, since the impact of the formulae is not only complex in itself in any given situation but - inasmuch as net increases to baseline public expenditure in one year tend to be offset by net decreases in another - is self-cancelling over time. That is to say: a net addition to public expenditure by way of a decision on a PES bid, being for the territories population-based, always erodes their baseline advantage over England, though does so differentially depending on the relationship between each territory's formula on the one hand, and, on the other, the proportion between block expenditure and comparable expenditure elsewhere. The formula discrepancies from "entitlement" have a much smaller impact - a partial offset where the formula is itself generous in relation to "entitlement" (Scotland), or an extra penalty where the formula is ungenerous (Wales). But a net reduction in public expenditure by way of a PES decision has precisely the opposite effect, in all respects.

3. The Treasury study shows that the formulae do in fact have a more or less neutral effect over time. The net formula cuts of 1979 and 1980 have been partially offset by the net formula additions of later years, and any residual effect has impacted only marginally on the ratio of territorial to English expenditure.



## THE NEEDS ASSESSMENT STUDY

The present internal Treasury study has involved a broad-brush update of work completed earlier under the title of the Needs Assessment Study.

2. The original Needs Assessment Study was an inter-departmental study, begun in 1976 and completed in 1979, of the relative needs of the four countries of the UK for public expenditure on the services that were to have been devolved under the Labour Government's devolution proposals. The study was actually completed after the collapse of those proposals, and was published by the Conservative Government in December 1979. A limited update was undertaken in 1980.

3. Here we describe the methodology used in the original interdepartmental studies, and repeated, with necessary limitations, in the present internal Treasury study.

Scope of the Needs Assessment Study

4. The purpose of the study was to provide information on relative public expenditure needs. It did not investigate absolute needs. It set out to answer the question: given £100 of public expenditure in England on providing the services studied, how many £'s of public expenditure would be required in the other three countries of the UK to achieve similar levels of provision?

5. The Needs Assessment Study only took account of "objective" factors affecting expenditure need. Broadly, these were factors outside the direct control of the authority providing the service. It did not take account of what were termed "subjective" factors. These were factors flowing primarily from differences in policy in

the four countries and included, for example, bilingualism in Wales and denominational schooling in Northern Ireland. Nor did it take into account broad political considerations, for example, differences in overall economic positions which might be felt to justify differences in standards of public services.

#### Methodology

6. The approach adopted in the Needs Assessment Study was a pragmatic one. The assessments of need that were made were based heavily on Departments' experience and expert judgement, rather than on more formal statistical techniques.

7. Indicators of expenditure need were constructed in a number of stages.

8. First, the six main programmes that were covered by the study - Health and Personal Social Services; Education (excluding Universities); Housing; Other Environmental Services; Roads and Transport (excluding railways); and Law, Order and Protective Services (excluding the police) - were divided into expenditure blocks on the basis of the policy aims to which the expenditure was directed. For example, the Education programme was split into schools, further education, and libraries and museums.

9. Second, previous studies and Departments' knowledge and experience were drawn upon to identify the objective factors for each block, which would give rise to variations in the amount of expenditure needed in each of the territories to provide the same level of service as in England. These were mainly the number and characteristics of the individuals for which the service was provided, for example, the number and age of pupils for the schools block, plus factors influencing the cost of supplying the service,

for example, the sparsity of the population. A list of the factors that were most important for each block is provided as an Appendix.

10. Third, statistical indicators were derived to measure the relative incidence of the objective factors. Suitable statistics were readily available for many of the factors, for example, those based on population size and structure. In other cases, for example homelessness and road congestion, broad estimates or proxy measures had to be used.

11. Fourth, the statistical indicators were combined - weighted - together to give an index of expenditure need for each of the three territories relative to England. The weights used to combine the indicators were chosen to reflect the relative importance of the objective factors in causing variations in expenditure need. In some cases, this would be done on the basis of objective information. For example, the weight given to pupil age in determining expenditure need for schools was based on evidence of actual unit cost variations between different levels of schooling in the UK. In other cases, for example in deciding the relative weights to attach to homelessness and substandard dwellings in the need for housing investment, the assessment had to be based on judgement.

12. Finally, the indices of relative need for each of the blocks were aggregated together to provide an overall assessment of need. This was done on the assumption, basic to the study, that the overall assessment should be sufficient to provide in Scotland, Wales and Northern Ireland for the same range and level of service as in England, taking the objective factors into account. Accordingly, the indices for each expenditure block were combined in proportion to their share in English expenditure.

## MAJOR OBJECTIVE FACTORS

(i) Health and Personal Social ServicesHospitals and Community Health

## Current:

Size of population

Structure of population

Morbidity

Social deprivation

Teaching responsibilities

## Capital:

As on current plus shortfall in volume or quality,  
locational unsuitability, design unsuitability of  
existing capital stock.

Replacement of capital stock

Family Practitioner Services

Size of population

Structure of population

Morbidity

Deprivation

Personal Social Services

Size of population

65 and over: numbers living alone  
poverty

Under 18: density

18-64: poverty

(ii) Education

Schools

Current:

School population

Age distribution

Capital:

Lack of pupil places

Overcrowding

Substandard places

Deprivation

Further education

Current:

Number of students

Capital:

Lack of student places

Libraries and other

Total population

(iii) Housing

Capital:

Household/dwelling balance

Substandard dwellings

Overcrowding

Generalised Subsidies

Number of public sector dwellings

Loan Charges

Housing Assistance

Public and private tenants having low income

(iv) Other Environmental Services

Water services

Population growth and shift

Industrial growth and shift

Rate of deterioration of existing assets

Local Environmental Services

Size of population

Relative density of population

Relative sparsity of population

(v) Roads and Transport

Roads

Capital:

Congestion

Substandard roads

Current:

Road mileages and type

Heavy vehicle usage

Public Transport

Capital:

Replacement needs of existing stock

Current:

Fleet size and type

Elderly

(vi) Law, Order and Protective Services

Administration of Justice and Treatment of Offenders

Population

Number and types of crime

General Protective Services (other than Police)

Number of buildings and other installations  
in the various categories of high fire risk

(vii) Industrial and Economic Activities

Derelict Land Clearance

Areas of derelict land by type

Factory building

Areas of high unemployment

Industrial Development Activities

Areas of high unemployment

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