House of Commons
Committee of Public Accounts

Managing Budgeting in Government

Thirty-fourth Report of Session 2012–13

Report, together with formal minutes and oral evidence

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Committee of Public Accounts

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The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume.
Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee is Adrian Jenner (Clerk), Sonia Draper (Senior Committee Assistant), Ian Blair and James McQuade (Committee Assistants) and Alex Paterson (Media Officer).

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Summary

The Government needs strong budgetary systems to be able to control and manage public spending and to provide high quality public services that offer value for money to the taxpayer. Departmental spending is approved by Parliament in the annual budget process based on the multi-year budgets set in the spending review. The 2010 Spending Review set a four-year spending total for each department. The Spending Review focused on reducing public spending and delivering the coalition Government's programme.

The Treasury managed the Spending Review by collating bids from departments and challenging submissions. The process built on the experience of previous CSRs and was better managed. However, we continue to have concerns about the capacity of the Treasury to effectively challenge departments, and Government continues to take some decisions which will not ensure best value for money.

Departments and the Treasury failed to take a longer term view on spending, making cuts in those budgets that were easiest to cut. For instance, whilst Treasury improved assessment processes to be able to rank capital projects, the overall level of capital investment was cut from (£57 billion in 2009/10 to a planned £41 billion in 2014/15. Resource expenditure as a whole will increase in nominal terms, albeit at a much slower rate. These decisions may not have been the best to meet the Government's growth objectives.

There were gaps in data which made it difficult to compare options or benchmark spending proposals. There were no incentives for departments to collaborate on cross-government issues. There was no evidence of clear thinking on how one decision to save money in one budget area might lead to an increase in expenditure elsewhere. There was also evidence of game-playing.

Decisions on where to spend or cut rest with Ministers and cannot be divorced from the political process. But these decisions need to be informed by rational analysis. Officials must do more to provide Ministers with reliable and comparable information to help them weigh up the effect of different spending options. The Committee welcomed the Treasury's commitment to follow up the National Audit Office's recommendations for improvement. The Treasury will need to implement the findings of this report in time for its next spending review.

On the basis of a report by the Comptroller and Auditor General,[1] we took evidence from the Treasury and the Head of the Civil Service, who also represents the Department of Communities and Local Government.

1 C&AG's Report, *Managing Budgeting in Government,* Session 2012-13, HC 597

Conclusions and recommendations

1. **Political and contractual commitments limit the ability to allocate resources to achieve best value.** In the 2010 Spending Review, political commitments to protect certain budgets such as health and international development meant that the brunt of departmental spending cuts had to be focused on just 40% of controllable expenditure. Inflexible programmes and existing contract commitments also limited the Government's ability to make changes. The Treasury and departments should identify, before each spending review, existing commitments and future funding pressures to make sure overall expenditure plans are realistic and sustainable in the longer term.

2. **The Government does not fully understand the impact of cuts as it focusses on short-term priorities rather than the longer term view.** The last spending review cut planned capital spending significantly, from £60 billion in 2009/10 to a planned £38 billion in 2014/15, a decision based partly on what could be cut quickly rather than an assessment of the likely impact of the cuts, for example, on economic growth. The Government subsequently reversed some of these capital cuts, increasing infrastructure spend by £6.3 billion. Other spending cuts were ill-thought through, for example, the UK Border Agency reduced staff too quickly and had to rehire staff to help with the resulting backlog of immigration case work. Departments should model the financial and operational implications of different spending options to support their bids for funding in the next spending review.

3. **The Treasury struggled to assess the cost effectiveness of proposed spending.** The Treasury's exercise ranking capital spending compared proposals on the basis of cost-benefit analyses, but these covered only 6% of total planned spending and some of the data was of poor quality. Departments often lack information on unit costs or benchmarks and struggle to compare spending options in terms of their value. Therefore, the Treasury could not make meaningful comparisons between spending options because the information required to do so was not available. Such information gaps cannot easily be closed in the brief period of a spending review. The Treasury needs to enforce requirements for departments to assess the cost-effectiveness of their spending; analyse in aggregate how well departmental proposals address key government objectives such as growth and fairness; and work with the Cabinet Office to make sure current information reforms reflect the need for informed budgeting.

4. **The Treasury does not promote cross-government budgeting.** The budgetary system still encourages departments to focus on their own interests and does not incentivise planning across departmental boundaries. This means that departments can make decisions without considering the cost implications for other departments, for example the higher rents proposed under the Affordable Homes Programme may well impact on the housing benefit bill. The Treasury, together with permanent secretaries, needs to address the technical and cultural barriers to joint working. This will include making sure that the budgetary system does not penalise departments bidding to increase budgets in order to lower overall government costs; and creating

incentives for departments to pursue novel proposals which cross departmental boundaries.

5. **High staff turnover and lack of commercial skills undermines the Treasury's ability to scrutinise departmental budgets effectively.** Staff turnover in the Treasury is too high: 44 of the 52 staff that worked in the Treasury's spending teams covering the five departments we examined had left within 20 months of the Spending Review. On the Department for Energy and Climate Change team only one of the thirteen team members remained. In past hearings on the Private Finance Initiative we have raised wider concerns over the lack of commercial skills in departments and the Treasury. The lack of corporate memory, relevant skills and sector knowledge means that the Treasury is not as effective as it could be in challenging departments - allowing some to engage in game-playing, for example, by deliberately withholding information from the Treasury. The Treasury should be clear about the skills it needs to be effective in challenging departments on their spending plans and subsequent performance, and put in a place a strategy to secure and retain staff with the appropriate skills and experience.

6. **The Treasury remains unable to demonstrate how it is enabling departments to learn from past experience to ensure better value for money.** There is little or no learning across departments and Treasury has yet to demonstrate leadership in this area. For instance, lessons learnt from PFI were not used to frame the contracts to transmit energy from off-shore wind farms. Treasury should consider how it will establish effective mechanisms to enable departments to use previous experience across Government in framing current and future programmes.

7. **There is too little external scrutiny in the budgetary process.** Parliament does not examine spending proposals, which would help to drive up their quality. Select committees could provide more challenge to departmental spending plans but lack the information to do so effectively. The Treasury should identify what information it could provide to select committees to enable them to scrutinise departmental spending plans and discuss with the Liaison Committee what might be done to encourage select committees to undertake this work.

1 Background

1. Since 1998 the Treasury has run spending reviews every two or three years to set the medium-term allocation of spending across government departments. Spending reviews set spending boundaries (envelopes) for departments based on their bids and negotiations with the Treasury. Departments' settlements contain some information on what their funding will be spent on, but in practice they have considerable freedom to decide how they allocate funding. Departments operate within the rules the Treasury sets and it monitors their adherence. The Treasury's aim is to keep overall spending under control, but also to ensure departments are incentivised to prioritise their spending to provide high quality public services and value for money to the taxpayer.[2]

2. Spending is split into two main types. Departmental Expenditure Limits (DEL) comprise: capital investment in assets such as buildings and equipment; and resource spending on programmes and administration, which is the main component accounting for nearly 90% of the total. The other main type of spend, Annually Managed Expenditure (AME), is on items such as welfare and benefits, where expenditure is outside the Department's direct control.[3]

3. The fiscal and political environment for Spending Review 2010 (SR10) was different to previous reviews as it focused on reducing spending. The Government committed itself to spending cuts totalling £203 billion over the four years. The Treasury ran the process for SR10 between June and October 2010 - treating the different types of spend in different ways. It asked departments to split their resource spending into up to five high level priority areas, and then negotiated these settlements, including proposed savings, bilaterally with each department. For capital spending, the Treasury ran a separate exercise in which it collated all proposed spending on individual projects and programmes from across government and compared them in terms of the value they were expected to deliver.[4]

2 C&AG's Report para 1.1, 1.6-1.7, 1.10 – 1.11

3 C&AG's Report para 1.7

4 C&AG's Report paras 1.12 – 1.16

2 Informed decision making across government

4. Commitments made by the Government, such as to increase overseas aid, maintain health spending and provide some form of protection to other budgets (for example education) meant that its scope to cut resource spending was limited. Departments accounting for approximately 40% of resource spending, including local government and the justice departments, therefore bore the brunt of spending cuts.[5] There were also other constraints which limited departments' flexibility when it came to cutting public spending. The Treasury told us that contractual rights of staff meant that their cost could not be cut out overnight. The Treasury also explained that to reduce wages the government would have to enact legislation and that successive governments had been reluctant to do this.[6]

5. Over the spending review period resource spending on programmes and administration is decreasing in real terms; however, in cash terms there is a small increase from £333 billion in 2009-10 (the year before the Spending Review) to £346 billion in 2014-15. This is in contrast to capital investment which was cut significantly in nominal terms—from £57 billion in 2009-10 to £41 billion in 2014-15. If these figures are adjusted for inflation they show a cut in departmental capital spending from £60 billion to just £38 billion—a real terms cut of over a third.[7]

6. We asked the Treasury about the decision to cut capital spending so significantly as it seemed to undermine the Government's objectives of securing jobs and economic growth. The Treasury explained that the decision to focus the biggest cuts on capital spending was in part driven by existing spending and political commitments. Decisions to defer or cancel new capital projects were easier to implement than cutting current spending which would often involve wage and benefit cuts. The Treasury acknowledged that, with hindsight, it would not have cut capital spending as significantly as it did and that the Chancellor's more recent injection of £6.3 billion for infrastructure represents a reversal of the some of the decisions taken during the Spending Review.[8]

7. The Treasury told us that cuts to public spending were difficult and could appear to be crude.[9] We recognise the difficulties in the prioritisation process but expect decisions to be made on a rational basis.[10] We have previously identified many examples where short term cuts have resulted in, often unanticipated, negative impacts over the longer term. For example, the Ministry of Defence's decision to delay projects, resulted in increased costs in the longer term; the UK Border Agency's decision to reduce staff quickly, despite progress on immigration case work being slower than expected, resulted in the Agency having to

5 Q 13

6 Q 1

7 Q 1; HM Treasury, Public Expenditure Statistical Analyses 2012, July 2012, Table 1.1 & 1.7

8 Qq 1 – 7, 9, 13, 38

9 Q 33

10 Q34

rehire staff to process the backlog; and cuts to spending on flood defences which may result in increased costs from flood damage in the future.[11]

8. A limited planning horizon, such as those for spending reviews, creates a risk that short-term priorities take precedence and that these decisions may have perverse impacts in the longer-term. The Treasury told us that the work of the Office for Budgetary Responsibility in producing long-term projections of fiscal sustainability and the introduction of the Whole of Government Accounts were helping to address this issue. The Treasury maintained that it was now better at considering the long-term costs of policy options, such as capital investment, and that a long-term view had informed pension reforms. However, it acknowledged that more could be done to encourage governments to focus beyond the current Parliament.[12]

9. The Treasury was proud of its innovative approach to rank capital spending on the basis of their economic returns and considered that it had resulted in a better allocation of scarce capital resources. However, it acknowledged that this exercise had only covered a small proportion of departments' spending (6% of all DEL). There had also been weaknesses in the availability and quality of the evidence used. Information on the value delivered by resource spending had been weaker still. In many cases, departments could not demonstrate what returns they were expecting or receiving from spending, and officials could not present Ministers with comparable information to enable them to compare options for spending, or the implications of cuts.[13]

10. Departments also lacked the sorts of management information vital to demonstrating what outcomes they expected to achieve for each pound of proposed spending. For SR10, none of the departments looked at by the National Audit Office initially supplied cost effectiveness or unit cost information and the Treasury admitted that compliance had been mixed. The Treasury did not initially request information on the value of spending or the impacts of cuts and subsequently found it difficult to gather this important evidence quickly. The short timescales may have hindered the collation of such information. However, information which could aid improved understanding of value for money such as data on unit costs, cost effectiveness and productivity is not commonly part of the key management information used in departments; and not routinely shared with the Treasury.[14]

11. The Treasury told us that, in some cases, it suspected that departments deliberately withheld information that may have proved inconvenient. It considered that in a number of cases departments had been gaming the system as they were unwilling to reveal that they had no evidence of any link between increased spending resulting in improved outcomes. The Treasury believed that in some spending areas, such as policing, skills and education, increased spending had resulted in poorer outcomes. For example, while teaching assistants were valued by teachers and parents alike, the Treasury considered they had a

11 Qq 39 – 40; C&AG's Report, *The UK Border Agency and Border Force: Progress in cutting costs and improving performance,* HC 497 (2012-13), para 2.14

12 Qq 11,15

13 Qq 3, 4, 37, 39, 45, 52, 54; C&AG's Report paras 2.14 – 2.15, 2.19 – 2.20

14 Qq 37, 39, 52 – 59; C&AG's Report paras 2.2 – 2.7, 2.28

negligible, if not negative, impact on outcomes. The Treasury maintained that it was now doing much more expert analytical work on public sector productivity, for example, in health care, so that it would be better prepared for the next spending review.[15]

12. There were also clear limits to the extent of cross-government working for SR10. The budgetary system does little to encourage or facilitate cross-government working. Engagement between departments and the Treasury spending teams are typically bilateral. While departments may be rewarded for good spending control, for instance by being given more flexibility to carry unspent money forward into the new financial year, they are not similarly incentivised to work together. The Treasury agreed that cross-government working on spending settlements was an area that needed to improve and told us that the demanding timetable for the Spending Review was one of the reasons that this had not happened as much as it might have. In addition, some departments felt that they could not work collaboratively unless given explicit permission. The Head of the Civil Service told us that it was the intention of civil service reforms to address cultural barriers to cross-government working through open policy making, the expansion of shared services, and recognition for staff that collaborate.[16]

13. The Treasury told us that the next spending review would need to be held by December 2014 at the latest and accepted that preparations should already be underway. The Treasury wanted departments to act now to identify how they can work together, but explained that uncertainty over the timing of the spending review meant that departments were reluctant to do this. Cross government working, like the use of management information, is not currently routine: incentives are needed so that departments feel empowered to identify opportunities outside of periodic spending reviews.[17]

15 Qq 53 – 54

16 Qq 20-24, 31– 32, 45

17 Qq 20 – 21, 24, 25 – 28

3 Challenge, scrutiny and learning

14. In total, 44 of the 52 staff that worked in the Treasury's spending teams for the five case study departments examined by the National Audit Office had left within 20 months of the Spending Review. We were particularly concerned that only one member of the thirteen-strong Department for Energy and Climate Change spending team for SR10 was still in place meaning that the Treasury is in a weaker position to support or challenge the department than it should be. The Treasury conceded that its staff turnover is "too high" although it did add that turnover was coming down. The Treasury explained that one of the reasons that so many spending team staff had moved on since SR10 was due to the fact that it had deliberately kept on experienced staff for the Spending Review who inevitably left once the work was complete.[18]

15. Of equal importance is the need to ensure the right staff are recruited and retained. We have previously expressed concern about the lack of commercial and contracting skills in departments and the failure to learn lessons from problems with the Private Finance Initiative. In response the Treasury agreed that it was important to have permanent staff members who have a good understanding of contracting rather than being reliant on consultants. It also conceded that it needed to be better at learning lessons from past experience rather than only focussing on things once they have gone seriously wrong. The Head of the Civil Service explained that it would always be a challenge to have enough highly paid experts to deal with all the contracts that the government has, and therefore it was incumbent on all civil servants to become more commercially aware.[19]

16. There is currently very little external scrutiny of the budgetary process. The National Audit Office report noted that legislative oversight of spending plans is not highly rated and highlighted OECD research which showed that legislatures in countries such as the USA, Germany, Switzerland and New Zealand have greater powers to amend budgets and longer to review them than the UK Parliament. In Scotland, budgets are published first in draft to enable public scrutiny and challenge, and in June 2011 the Scottish Finance Committee appointed a specialist budget adviser to scrutinise proposals. [20]

17. The Committee asked the Treasury if departmental select committees would be able to look at spending proposals to provide external challenge and accountability. The Treasury said that it would encourage such a move but noted that departmental select committees had generally not shown much interest in this area. It also noted that select committees had been consulted on PSAs (Public Service Agreements) in the past.[21]

18 Qq 42 – 44

19 Q 46 – 48, 51

20 C&AG's Report, para 2.30-2.32

21 Q 49 – 50

Formal Minutes

Wednesday 13 February 2013

Members present:

Mrs Margaret Hodge, in the Chair

Stephen Barclay
Guto Bebb
Jackie Doyle-Price
Chris Heaton-Harris
Meg Hillier
Fiona Mactaggart
Austin Mitchell
Nick Smith
Ian Swales
Justin Tomlinson

Draft Report (*Managing Budgeting in Government*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 17 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Thirty-fifth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 25 February at 3.00 pm

Witnesses

Monday 29 October 2012

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Sir Bob Kerslake, Head of Home Civil Service and Permanent Secretary, Department for Communities and Local Government**, Sir Nicholas Macpherson,** Permanent Secretary, HM Treasury, and **Sharon White,** Director General Public Services, HM Treasury Ev 1

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2012–13

First Report	The Government Procurement Card	HC 1915
Second Report	Mobile Technology in Policing	HC 1863
Third Report	Efficiency and reform in government corporate functions through shared service centres	HC 463
Fourth Report	The completion and sale of High Speed 1	HC 464
Fifth Report	The Regional Growth Fund	HC 104
Sixth Report	HM Revenue & Customs: Renewed Alcohol Strategy	HC 504
Seventh Report	Immigration: The Points Based System – Student Routes	HC 101
Eighth Report	Managing early departures in central government	HC 503
Ninth Report	Preparations for the London 2012 Olympic and Paralympic Games	HC 526
Tenth Report	Implementing the transparency agenda	HC 102
Eleventh Report	Improving the efficiency of central government office property	HC 288
Twelfth Report	Off-payroll arrangements in the public sector	HC 532
Thirteenth Report	Financial viability of the social housing sector: introducing the Affordable Homes Programme	HC 388
Fourteenth Report	Assurance for major projects	HC 384
Fifteenth Report	Preventing fraud in contracted employment programmes	HC 103
Sixteenth Report	Department of Health: Securing the future financial sustainability of the NHS	HC 389
Seventeenth Report	Department of Health: The management of adult diabetes services in the NHS	HC 289
Eighteenth Report	HM Treasury: The creation and sale of Northern Rock plc	HC 552
Nineteenth Report	HM Revenue & Customs: Annual Report and Accounts 2011-12	HC 716
Twentieth Report	Department for Energy and Climate Change: Offshore electricity transmission–a new model for infrastructure	HC 621
Twenty-first Report	The Ministry of Justice's language service contract	HC 620
Twenty-second Report	British Broadcasting Corporation: Off-payroll contracting and severance package for the Director General	HC 774

Twenty-Third Report	Department for Work and Pensions: Contract management of medical services	HC 744
Twenty-Fourth Report	Nuclear Decommissioning Authority: Managing risk at Sellafield	HC 746
Twenty-Fifth Report	Funding for local transport: an overview	HC 747
Twenty-Sixth Report	The Department for International Development: The multilateral aid review	HC 660
Twenty-Seventh Report	HM Treasury: Annual Report and Accounts 2011–12	HC 659
Twenty-Eighth Report	Department of Health: The Franchising of Hinchingbrooke Health Care NHS Trust and Peterborough and Stamford Hospitals NHS Foundation Trust	HC 789
Twenty-Ninth Report	Tax avoidance: tackling marketed avoidance schemes	HC 788
Thirtieth Report	Excess Votes 2011–12	HC 959
Thirty-first	Department for Transport: Lessons from cancelling the InterCity West Coast franchise competition	HC 813
Thirty-second	Ministry of Defence: Managing the defence inventory:	HC 745
Thirty-third	Department for Work and Pensions: Work Programme outcome statistics	HC 936

Oral evidence

Taken before the Committee of Public Accounts

on Monday 29 October 2012

Members present:

Margaret Hodge (Chair)

Meg Hillier
Fiona Mactaggart
Austin Mitchell
Nick Smith

Amyas Morse, Comptroller and Auditor General, National Audit Office**, Gabrielle Cohen,** Assistant Auditor General, NAO, **Nick Sloan,** Director, NAO, and **Paula Diggle,** Treasury Officer of Accounts, HM Treasury, were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Managing budgeting in government (HC 597)

Examination of Witnesses

Witnesses: **Sir Bob Kerslake**, Head of the Home Civil Service and Permanent Secretary, Department for Communities and Local Government, **Sir Nicholas Macpherson**, Permanent Secretary, HM Treasury, and **Sharon White**, Director General Public Services, HM Treasury, gave evidence.

Q1 Chair: May I start by proffering my apologies for keeping you waiting? It was difficult to get succinct answers out of previous witnesses. I am sorry, because I know that you are extremely busy.

This is a really interesting Report and I was trying to ground it in some sort of reality, rather than a theoretical analysis of where we are at. I happened to look, as one does, at the ONS figures, to give me some idea of how we are managing the budget. I am sorry that you have not got them, but I am sure they are familiar to you. If you look at the ONS figures on capital spend and revenue spend—the DEL spend—capital DEL declines over time from nearly £60 billion in 2009–10 to a planned £38 billion in 2014–15. If you look at revenue resource DEL—I am not looking at the AME—in 2009–10 it was £333 billion and it will go up to £346 billion in 2014–15. They are familiar figures; they are not a surprise to you.

The reason why I thought about them is that if we had a rational way in which we set our budgets, the last thing you would do, particularly in a period when you are trying to encourage growth in the economy, is cut capital investment and grow revenue investment, yet that is precisely what appears to be happening. Would you like to comment on why that is and how on earth it fits into the overarching strategy of Government to do things such as encouraging growth? How have you have allowed it to happen?

Sir Nicholas Macpherson: Why don't I start and Sharon, who is closer to the public spending strategy, may want to chip in if she disagrees with me or can think up some better arguments? I suppose that the most important factor in determining public spending at any point at time is the level of spending in the previous period. I know that in one sense that is irritating and it would nice to be able to start with a clean slate, but at any point in time any service will largely comprise the staff who are delivering that service. Even if you wanted to cut health spending or local authority spending overnight, you cannot, because of the contractual rights of the staff who work in those services. There is a broader point there in that, for a given level of staff, unless you are prepared to enact legislation to reduce their wages in nominal terms, you cannot actually reduce the wage bill overnight. Governments have cut wages—they did it in the 1930s—but it has been striking that successive recent Governments have been reluctant to do that. In one sense, you are a prisoner of the baseline.

At the margin, in seeking to set public spending, you can begin to turn the tanker round. This Government were elected on a programme of protecting large swathes of the public sector, so there was a commitment to ensure that health spending was maintained, at least in real terms, and there were commitments in relation to education, overseas aid and so on. Again, that constrains what you can do. You could say that you could change those commitments, but I am just an official and I have to work with the commitments that Governments give me.

Q2 Chair: I think I understand all that, but it seems that you took the easy cut. The easy cut was to cut capital, because that does not mean immediately sacking individuals, and it allowed you to meet the commitment around health, which I accept. However, the damage of that cut in terms of its impact on growth, particularly given what has happened with the economy, shows that it was a poor decision. It is trying to get underneath that. We think that you are clearly meeting the fiscal targets of cuts, but you are meeting them in a way that, because it has been done in the easy way, does not meet the Treasury's other objectives or the Government's objective of ensuring jobs and growth. You have actually damaged that with the capital cuts. Not you personally, rather the process.

Sir Nicholas Macpherson: Thank you. Ultimately, Governments decide how much they want to spend on current expenditure and how much they spend on capital spending.
Chair: But it was crazy. I understand that. It was crazy.
Sir Nicholas Macpherson: I would highlight one innovation, as picked up on by the NAO Report, which was the Treasury's attempt to inject more science into the allocation of capital spending. We literally drew up a long spreadsheet, which prioritised projects in terms of their economic return. As a result, I genuinely think that there was a better allocation of those scarce capital resources.

Q3 Chair: With respect, that was not the question that I was asking.
Sir Nicholas Macpherson: It is relevant.

Q4 Chair: It is not relevant, because it is a quantum.
Sir Nicholas Macpherson: It is relevant for the simple reason that the quality of public spending matters as much as the quantum of public spending.

Q5 Chair: What proportion of public spending was it that you actually did this in? What proportion of the one you analysed did the Government actually take notice of?
Sir Nicholas Macpherson: It was a relatively small proportion, but you have to start somewhere.

Q6 Meg Hillier: What was top of the list?
Sir Nicholas Macpherson: Can you remember, Sharon?
Sharon White: As Nick says—
Chair: Don't get us off this main topic.
Sharon White: Not all capital is created equally. One of the risks, particularly when you are trying to cut spending quickly—the Government in 2010 had an emergency Budget to cut in-year spending as well as spending in the coming financial year—is that you look first to capital, because you only have to build these things once and you can turn the tap off very quickly, which is the reason for doing the capital exercise. At the top of the list were infrastructure projects. Towards the bottom are those projects that are better for employment—on the construction side, for example—but with fewer economic returns.
I would also say that there is a point to what you say in that if we were looking back with hindsight, would we have cut capital as significantly as we did? The answer to that is probably not, as can be seen through the fact that—

Q7 Chair: You have brought money back in.
Sharon White: Exactly. Some of this we have reversed to some extent, trying to focus on the infrastructure investments as part of the series of growth announcements that the Government have had since then.
Sir Bob Kerslake: You referred to the easy option. If you take local government, which is a quarter of public spending, that saw a reduction in its formula grant by 27% over three years. I think that has been pretty challenging for local government, and I genuinely doubt whether it could have taken a further reduction on that scale.

Q8 Chair: We are looking at the financial viability of local authorities. It is one of the studies that the NAO is doing.
Sir Bob Kerslake: Taking Nick's point and taking the impact of having to deliver savings on the revenue side—certainly in the case of a very big part of public spending, local government—I think you took it as far as you could realistically have gone in the circumstances.

Q9 Chair: The national statistics I was looking at were 09–10 out-turn against plans for 14–15. Local government has taken the brunt of the cuts; I accept that. But the figures on resource DEL show an increase, whereas the figures on capital budgets have come down. I have not looked at AME, but the impact of cutting the capital budgets on AME make it even worse, if you look at the total AME figure, because people are then out of work, they claim benefits and they do not pay tax. It just feels irrational. One had hoped that there would be a much more rational approach to the deficit reduction exercise than that which has taken place.
Sir Nicholas Macpherson: I know this will be no consolation to you, but all I can do is to compare and contrast this spending review with a spending review on which I worked with Sharon—we were both junior Treasury officials—in the early '90s, when there was a similar fiscal consolidation. I think one of the great reforms to public spending implemented by the previous Government was distinguishing the capital budget from the current budget. That at least means that we can have the conversation we are having at the moment. Back in the early '90s when we had to cut spending, there was no distinction between current and capital, so I can remember a complete axe being taken to capital programmes. I know it is never helpful to say, "You think it's bad now? It was a lot worse in the past." What I can tell you, however, is that I think the Treasury's framework has improved and no doubt when we come to the next spending review, following this very helpful Report, we can have an even better framework.

Q10 Chair: I have to tell you that one of the articles that I glanced at before this hearing said that the only time we ever did it properly was in 1922, or something.
Sharon White: The Geddes cuts.
Sir Nicholas Macpherson: The Geddes axe. That was a really serious cuts exercise.

Q11 Chair: Let me put another thing to you, which I think other countries do better than us, according to the Report. You don't look at the long-term implications of what you are doing, for example population increase—the impact that making a cut today will have on population and the intergenerational issues that we all bang on about, such as care. You haven't looked at that. There was a report last week or the week before about pensioner income going up at a faster rate than other incomes. Did you look at that when you decided?

Sir Nicholas Macpherson: This is, again, an area where we are incorporating that longer-term analysis far more in our preparations for spending reviews. A good example is the whole of Government accounts, and no doubt Sharon and I will be appearing in front of you in due course—

Chair: You will.

Sir Nicholas Macpherson: Sadly, it has been put off until the new year, even though Sharon is going to publish them two weeks earlier than last year.

Chair: Because we have got so much other stuff to get through.

Sir Nicholas Macpherson: My point about the whole of Government accounts is that that actually sets out long-term costs of public service pensions and so on. The other important reform is the work of the Office for Budget Responsibility, which produces sustainability reports. Partly because the Treasury has had its fingers burnt quite often in the past decades, we, the senior management of the Treasury, are putting a far higher weight when discussing policy options to set out the long-term cost. So, for example, only at the weekend I was reading a very impressive note by a Treasury official on our long-term capital strategy, which was very much picking up your challenge about how we improve the long-term quality of capital spending. I think this is important territory.

Q12 Meg Hillier: Can I just chip in? You were talking about politicians influencing decisions. If I am being really pessimistic, is it possible, however brilliant your budgeting is in the Treasury, to work when we politicians come in and say, "We don't want to do that. We want to do this"?

Sir Nicholas Macpherson: Taxing and spending is the most political activity there is. This is why Parliament exists. This is why this Committee exists. I would never want to put taxing and spending decisions in the hands of technocrats. Now that does not mean we cannot have a better system, and the Report makes some important suggestions. There are lots of areas of spending where I as an official will think, "Well this is a complete waste of time" and that on any criteria in terms of income, quality or better public services, "You shouldn't be doing this." But what is really striking is how politicians across parties can get completely hung up on input targets that constrain better spending choices. I know—I don't know because I am not a politician, but I can understand the pressures you are under, for example, to commit to a long-term overseas aid target or increase health spending year by year as a symbol of a commitment to improving services. But inevitably that makes the work of officials such as us more challenging.

Q13 Austin Mitchell: If the review is so smart, why does it always come back to the old formula that you cut local government more than you cut central Government because it is easy, and that you cut capital spending rather than other forms of spending? If you are cutting capital spending—you said you had a smarter system this year—why do you have to shove £6.3 billion back the year after because of problems with the infrastructure?

Sharon White: One of the issues about the coalition Government having been so clear about the areas it wanted to protect is that even while it brought AME into the equation, it meant that 40% of RDEL was basically bearing all the strain of the deficit reduction, in which you have two big areas of spending: Bob's area of local government, as well as the Justice Departments. One of the things that we tried to do to ameliorate the pinch points on local government last time round was to grant some additional flexibility. Yes, the strain is going to be tough, but all those ring-fenced pots of money that have prevented you from making local priorities with more flexibility, we did not get rid of all of them, but we made quite a lot of progress. The other thing we tried to do with the business rate reforms is to give local government more flexibility in terms of its revenue-raising powers. This is not perfect. But inevitably there was a sense that determining the priorities for where you are going to cut is better to do when you are closer to local communities than sitting centrally in Whitehall, even under the auspices of CLG.

Q14 Austin Mitchell: Why does £6.3 billion have to go back next year?

Sharon White: There are a couple of things. One of the things that has been interesting is that Departments as a whole have been under-spending. As a whole we have been overachieving the spending settlements for 2010. The issue about the additional injection is that where we thought the economy was going to be when forecasts were made in 2010 sadly is not where we are currently because of the eurozone overhang and so on. Ministers have been conscious to be flexible and to add back infrastructure spending, particularly locally and regionally specific through the RGF and so on.

Q15 Chair: To go back to what Nick Macpherson was saying, it is not the long-term impact of the spending, it is the demands on Government. Changing demography, increasing population and intergenerational demand will change the demand. It is not just the cost over time of doing something today that will have a cost tomorrow, but the changing demand. Other countries do it better than us or so it appears.

Sir Nicholas Macpherson: I am not wholly convinced that other countries do it better. In many ways Britain has led the world in terms of publishing long-term public spending projections. It started under Gordon Brown. It has been embedded further with the Office for Budgetary Responsibility. The demographic issues are really important. My challenge back to Parliament is to ensure that there is real focus on this. I think public service pensions have now been well dealt with, but the cost of pensions, in particular state pensions, and the growth of demands on social care are going to rise and something is going to have to give, if that is to be affordable.

In my experience as an official, for totally understandable reasons it is always very difficult to get Governments to focus much beyond the current

Parliament. Occasionally, under both major parties, difficult decisions have been taken, for example on SERPS and further pensions reforms under the previous Government, but I think there is more we could do on that.

Q16 Chair: Sharon, you gave evidence to us earlier on cost reduction in central Government. You said, "What we will begin to see in the second half of the Parliament has got to be policy redesign." So we do need to see radical strategic initiatives. Is there any evidence of them occurring?
Sir Nicholas Macpherson: Bob is reforming the civil service, structurally.

Q17 Chair: I said radical.
Sir Bob Kerslake: It is in the eye of the beholder, Chair. There are quite a lot of things going on. There are radical choices. To give you an illustration, we in CLG have been running an initiative called the whole place community budgets initiative, which is taking four areas across the country and how looking at all the different activities in that area you might deliver the service differently and save money. From the evidence so far—we are just awaiting the final report from those four areas—there are some very interesting and challenging ideas coming through, particularly in the agenda of health and care, which is after all the area where a very big spend goes on. There are some examples of quite radical thinking.

Q18 Chair: Where else? Trying to get health and social care better has been around ever since I was in local government. I accept the need to do it better but it is not a new idea.
Sir Bob Kerslake: It is not a new area, clearly, but some of the ideas coming through are quite radical and different in terms of what they are doing. I would argue that the work we are doing around troubled families is quite radical and, if we succeed, will significantly reduce some of the demands in terms of public expenditure. Those are two specific examples of radical change.

Q19 Chair: And in the rest of Government, Sharon?
Sharon White: There are a couple of things. Partly it is linked to community budgets, but I think the interface between health care and social care, which you will know from Islington days has been the great nirvana that we have not quite been able to touch, is inevitably going to be the big issue. We are looking at pretty small scale. The NHS has put £1.2 billion into social care community goals. We hope that you can somehow deal with the cultures—one that charges, one that doesn't. One that has a very professional service; the other that is basically a minimum wage, less professional area. That has to be the key to thinking about how we deal with the long-term demographic pressures.
There are single-tier pensions, where the Government have said they are going to come forward with some legislation. Can you get to a position where you have more certainty over what the state is going to provide, not just as a core minimum but as a top-up, in order to create the incentive for people to save more and take more care of themselves? Where the boundary of the state is going to be, assuming that our tax revenues are not going to budge much above 39% or 40% for the long term, is the big set of issues.
Sir Bob Kerslake: If I could just add a final one, we talked about the move to a new model on the funding of affordable housing, which was quite a radical change.
Chair: I'll come back to that later. Fiona wants to come in.

Q20 Fiona Mactaggart: It is interesting is that what you talk about as radical things go across traditional Government boundaries. One of the striking things about this NAO Report is the way in which it informs us that the process that went through in the spending review actually did not press for or generate rewards for cross-departmental working and so on. I am wondering what you are doing to make that more likely. There was an NAO Report in February this year saying that you should try to promote more benefits, and this Report points out that a lot of spending is not covered by the Cabinet ERG or whatever it is called. What are you going to do to get people to work together or to work out if someone else can do better what we have been doing and let them do it?
Sir Nicholas Macpherson: That is a fair challenge. It was in the nature of the 2010 spending review that this was a pretty demanding timetable—

Q21 Fiona Mactaggart: Absolutely. I am asking you what you are going to do next time, I am not asking you why you did not do it last time.
Sir Nicholas Macpherson: There are some good examples within it—local government, and Bob has been talking about the whole place community budget pilots, or the strategic defence review which covered not just defence but aid, the Foreign Office, the intelligence agencies and so on. There has been a slight tendency for enthusiasm for cross-Government working to ebb and flow. I remember working in the last spending review in 2007, when we actually abolished all public service agreements apart from those that were cross-cutting. I regarded that as in many ways the high-water mark of cross-Government working but, unfortunately, a few months after that spending review the financial crisis hit us. What was very striking was that as the then Government tried to respond to that financial crisis, they reduced focus on those cross-cutting PSAs and returned very much to classic centralist interventions; it was easier to get money out of the door by working through conventional Departments.
Part of the responsibility lies on the Treasury to set the right terms of engagement for the next spending review, but part of it also depends on Departments, and indeed agencies and organisations beyond central Government Departments, to form alliances and to build up a common evidence base, because even in a spending review where the Government are seeking to implement quite big spending reductions, organisations that can come up with really attractive bids and well argued submissions tend to make more progress than those who come up with really pretty

poor bits of analysis. So I would encourage Departments—right now, even before we have another spending review—to think through how they can better join up and form common cause. I hope—actually I know—that quite a lot of that sort of activity is currently going on, but we clearly need to do more.

Sir Bob Kerslake: To give two practical examples, we have had in CLG two joint board meetings, one with Health and one with Work and Pensions, because those are the two critical connecting areas that make most impact on what we are doing.

Q22 ***Amyas Morse:*** I want to ask about one of the central points in the Report. Given your reform agenda, Sir Bob, and the very powerful weapon that budgetary control provides for getting changes in management approach, do you actually feel that this is something we should use? We are clearly recommending that there be more use of this in driving change in Government, and while the Treasury does an excellent job of controlling spending, it should be sponsoring that approach towards more effective delivery through budgeting. Can I ask you to react to that?

Sir Bob Kerslake: My view is that the Treasury needs to enable and support that kind of cross-Government working to happen, but the barrier is much more cultural than the way that the financial rules work. That is what I have learned. Everybody is pre-programmed to have bilateral conversations with the Treasury, but it does not have to work that way. It is perfectly possible for the Home Office, the MOJ and for us and Health to have a bilateral conversation and then talk to Treasury. There is nothing in the rules that stops that sort of conversation happening.

Q23 Chair: But if it is cultural, something has to change the culture.

Sir Bob Kerslake: Indeed. That is a core part of what the reform plan seeks to do. The core part of the reform plan is to get a more unified civil service where there is much more sense of corporate leadership, cross-cutting work to deliver savings, and collaborative working on issues to do with policy. If you read through the plan, it is absolutely core that we deliver that kind of change in the way that things are done. Treasury has a role in the sense of allowing that to happen and supporting it happening, but it is much more about the wider reform agenda that will open it up.

Sir Nicholas Macpherson: There are two different models for doing this. You could revert to the system that existed until the 1970s where the Treasury was responsible for not only budgeting and the economy, but the civil service—up until the early '80s, the Treasury permanent secretary was also head of the civil service. Or you could have a different regime, which in practice is more sensible, where some of these functions are carried out outside the Treasury, often in a Cabinet Office, or, in the past, a civil service department. That inevitably means pooling a bit of Treasury sovereignty—the Treasury working closely with the head of the civil service, the Cabinet Office or No. 10. I felt that some of this Report was suggesting that the Treasury should be seeking to do all these things, but there are risks in having too dominant a Treasury.

Q24 Chair: I agree but you have to put incentives into the system, and money is the big one, to make sure that the things that are not happening start to happen. I am not clear how you will do that.

Sir Bob Kerslake: Let me give some practical examples. One is what we are doing around open policy making, where we are directly and deliberately encouraging different ways of developing policy, including bringing in external parties to look at how we develop policy. It is very possible that we can frame questions that go across the Departments that they look at.

A second example relates to the whole agenda around shared services. We have been very clear in the reform plan that we want to go beyond transactional services, such as pay roll and financial system stuff, and into expert services—legal, finance and so on. Indeed, we have said that we are willing to look at exploring policy as an area of shared services as well.

The third thing that we have said in the plan is that we want senior managers to have a range of experience by the time they get to director, so we will have more people, such as Sharon, who have done jobs in a range of different bits of Government and therefore have much more of a sense of the issues from different perspectives. Those are three practical ways in which we are going to develop a different culture that encourages people to work collaboratively across Departments on these issues.

Sharon White: I think there is also an issue about the confidence of Departments. One of the things that I and my spending teams have done for the last six months is to talk to Departments and say, "We don't know when the spending review is happening, but it will happen at some point and there is no money." Departments respond by saying that they cannot possibly work on whatever piece of cross-Government work, whether it is criminal justice reform or health and social care, until the Treasury gives them permission. I say that we will not necessarily give them permission because we do not necessarily know what the timetable is. There is almost a sense that unless the Treasury sets out a clear plan with a starting gun, Departments do not feel that they are empowered to do this work. Quite recently, Bob and I sponsored some work by the Institute for Government on different aspects of the civil service reform plan, including cross-Government working. The Treasury genuinely is in more open mode, and, while there are uncertainties about the time of the spending review, we genuinely want Departments to start doing the preparatory work now.

Q25 Chair: Do you know when the spending review will be? It has not been announced yet, has it?

Sharon White: No, the Chief Secretary has said there will be a spending review in this Parliament.

Q26 Chair: That is all that has been said?

Sharon White: That is all that has been said publicly.

Q27 Chair: But normally in the cycle you would be starting it now, wouldn't you?
Sharon White: The current spending review runs until 2014–15.

Q28 Chair: But you would start the work now.
Sharon White: Exactly. Ideally, you would be starting the work now, because the minimum that needs to happen in this Parliament is for the 2015–16 totals to be set, assuming that the fixed-term Parliament runs its course.
Sir Nicholas Macpherson: The key constraint, then, is Bob's local authority settlement for 2015–16, which has to be set by November 2014.
Sir Bob Kerslake: December at the latest.
Sir Nicholas Macpherson: So at the very least, assuming this Parliament runs its full five years, you have to have clarity on that by then.

Q29 Meg Hillier: It was interesting, Sir Bob, to hear you lay out the nirvana of how the civil service will work. My worry is that, at junior level—quite junior people are spending quite a lot of this money—the cross-cutting stuff just gets lost. People put their head down, get into their silo and desperately try to protect their bit of the budget. The NAO Report came up with some figures showing that, in some Departments, the capital analysis led to the submission of numbers that were obviously inflated. We know that a bit of game playing goes on in Departments, or it did. Is that still the case? How do you stop that? I suppose that is to the Treasury as well.
Sir Bob Kerslake: It is nirvana. Of course people protect their own budgets, and of course people will try to play games. The question is how you build in things that will break that down.

Q30 Meg Hillier: Aren't you talking about civil service reform, as well?
Sir Bob Kerslake: Yes.

Q31 Meg Hillier: What is the reward to a civil servant who plays the game of cross-cutting? If you are a Minister and your Department is not seen as strong, you are seen as a very weak Minister and your political career takes a nosedive, but if you are departmentally robust, except in a very few circumstances—there are exceptions—that is a sign of political success. Maybe, even if you have civil service reform, you might have that clash with the political culture.
Sir Bob Kerslake: I see your point. Let me give a couple of reasons why it makes sense for middle or junior civil servants to do things in the way I have described. First, most Departments—I suspect all of them—now have pretty rigorous investment control processes, so any decision on a programme or spend not only has to have been in the budget, but has to have been subject to a rigorous business case analysis. If their story is weak and, frankly, somehow or other this does not get picked up at the time the spending review is set, it will certainly be picked up by the investment sub-committees and in the business case analysis. There is a huge incentive for those who lead particular areas to get the story right, to make the case and not hang on to money, because if they do, they are not going to get through the rigorous processes that I suspect now exist in every Department.
Secondly, a lot of this depends on how you appraise civil servants. When you come to the year-end or mid-year appraisal, how do you judge their performance? The new regime that we are using—the new appraisal framework—very clearly acknowledges and recognises where people have worked collaboratively within Departments and across Departments. People are not going to be rewarded for very narrow actions that simply protect their own area. That is not likely to be the way they get rewarded. They are going to get recognised for working collaboratively with Departments to secure the best outcome for the Government.

Q32 Meg Hillier: Do they all believe that yet?
Sir Bob Kerslake: Probably not, but over time a lot more will.

Q33 Chair: Let us come to the major criticism in the Report, which states—I have stopped doing the list—that you did the cuts without reference to business plans, structural reform, value for money, cross-departmental perspectives, service levels and external challenge. You did not measure the impact of cuts on economic growth. It all sounds like a very sorry state. It was too crude.
Sir Nicholas Macpherson: That is a point of view. Cutting public spending is often crude. There is no simple way to cut public spending. What I would say—this is important—is that you can get overly fixated on the spending review process, and you could, theoretically, as implied by those recommendations, seek to solve this grand set of simultaneous equations whereby on one day every single thing comes together: the spending totals, the business plan, the structural reform and the economic benefits. I guess if we could pull that off, it would be—

Q34 Chair: I don't think anybody is expecting that of you, Sir Nick—honestly. All we are expecting is a slightly more rational approach, which thinks a little bit about the priorities and the impact on economic growth.
Sir Nicholas Macpherson: Let me assure you that the Treasury does not recommend cuts according to the line of least resistance. All the Chancellors, Chief Secretaries and Prime Ministers I have worked with under a whole succession of regimes since I joined the Treasury in the 1980s are—and were—very focused on the implications of the settlement. They really wanted to know what it meant for prisons, the armed forces and the health service. In coming to a settlement, the Treasury, and indeed Departments, seek to advise Ministers of the implications. The reason you can do that is that spending reviews are not just one-offs. They reflect the extraordinary amount of work that goes on both before and after a spending review, which reflects quite a lot of detailed analysis of outputs, inputs and efficiency.

Q35 Chair: Then why can't the NAO see it? Their complaint to us—I have had this conversation with the NAO. Some of us who have been Ministers think we did sometimes do a more rational job than suggested. The NAO say they have absolutely no evidence or data that reaches them that enables them to say that in doing these cuts you looked at business plans, structural reform, value for money, or service levels. Why don't you let them see it?

Sir Nicholas Macpherson: Business plans were being prepared pretty much at the same time. If you look at what is in business plans, everything within them is affordable and consistent with the settlement. Indeed, many of the targets—they are probably not called targets now; they have probably got some new term of art. What is it? Impact indicators. All those impact indicators are consistent with the spending settlements.

Again, I would ask you to recall your time as a Minister. What tends to go on in a spending review is that, yes, there is a whole lot of information that informs the settlement, but once you get the settlement, there is a lot of work within the Department to spell out the detail. An example in the report is the Department for Communities and Local Government, which did a lot of work in the run-up to the spending review. One of the things about the spending review is that we all saw it coming. It did not really matter who won the last election. We all knew that there was going to be a pretty difficult spending review after it. The work had been going on for a couple of years, in some cases, before the review. Similarly, after the spending settlement, the DCLG did a lot of work in refining the proposals and in setting out a detailed plan. I think Bob can speak to that.

Sir Bob Kerslake: One thing struck me on this point. I see the general point, but if you look at how this process worked in practice—Government came in in May 2010; we had the emergency Budget due in June; we had the submissions into Treasury in July; and we had announcements of the spending review in October—much of the work that drove alternative options, challenge of existing spend, and ranking priorities happened through that process of spending review, and it happened in Departments.

Having then got the envelope of funding from the Treasury, a pretty rigorous process went on to test each of the propositions to see whether they were value for money, and then the business plan was produced effectively in May 2011 for the year ahead. I cannot see how else you could have done it. Given that you had a new coalition Government, with a new set of priorities and an imperative to cut spending, there was not in a sense a business plan in place that could have driven that process. It had to start from a political set of priorities and an imperative to reduce funding, and then you built the business plan from the outcome of the spending review process.

Q36 Meg Hillier: Can I take us back to my rather morose point earlier that, in the end, politicians decide it, but not necessarily very rationally? We cannot always be rational, because of the timetables of elections. How do you make sure that there is an underlying basis that is underpinning decisions, so that when that happens the decisions are made on the most rational basis possible?

Sir Bob Kerslake: I can only describe the DCLG experience, although I suspect it was similar to other Departments. We established a challenge process within the Department—the so-called red team and blue team approach of testing propositions.

Q37 Chair: That looked quite interesting.

Sir Bob Kerslake: It was meant to be a way of really rooting out whether the thinking was clear. In the case of capital, all the major pitches in for capital funding had net present value calculations. Once the Department met Ministers, they rigorously challenged each other on the ranking and priorities for funding. After all of that had happened, each one of the spending propositions was subject to a business case analysis and an investment committee, and they did not go ahead unless they represented value for money, as independently tested through the analysts. There are quite a lot of safeguards in the system. In the end, it is a political decision, but there was quite a lot of rigour in the system.

Nick Sloan: I just want to say that the point we were particularly making in the Report was that the process, when it started, did not explicitly ask for the impact of cuts or, indeed, of spend proposals on the level of services. Although some of that information built up through the process, there was never a time when that was brought together at any sort of common level. Indeed, it is not just our view; it was the view of the Treasury's own lessons learned review and of the capital ranking panel that the quality of information was patchy.

Q38 Nick Smith: Apologies for having to step out a bit earlier.

At our last session, Sir Nicholas, we had a really good discussion, I thought, about different tools for boosting the economy and the way that the Treasury was feeling its way through some of the macro-economic tools around QE—a very important discussion. But I am still troubled by this business about cutting spending without being mindful of the effect on economic growth. Returning to Sir Bob's point about capital spend, what do you think, Sir Nicholas, about the advice you would get from Departments around the cuts in capital spend? I would say that it has had a major impact and reduced growth in recent years. I just want to know what you thought about the advice you would get from Departments, particularly around capital cuts.

Chair: Nick, we did spend a lot of time discussing that, so just give a very quick answer.

Sir Nicholas Macpherson: A very quick answer is that it comes back to some of the discussion the other day. The Treasury is both an economics Ministry and a finance Ministry. In your finance Ministry function, at times like this you are very focused on getting public spending down, but it is a bit like Bob's blue challenge groups and red challenge groups, and so on. Actually, we have quite a strong economics Ministry function, whose role is to be very clear—"Look, hang on a second. You really don't want to do that, because of the effect on the economy."

To be fair, there was a high degree of prioritisation. For example, the science budget was protected to a large degree. Coming back to the quality of spending, there was a real attempt—certainly the most scientific attempt I have seen in my time at the Treasury—to prioritise against different capital projects. You are highlighting a trade-off. Left, I suspect, to many people's devices, you want to get current spending down and protect capital spending, but getting current spending down quickly involves really horrible choices, such as cutting benefits and cutting wages and, going back to the point I made earlier, no Government have done that since the 1930s.

Q39 Chair: May I bring you back? You say that some of these things happen in practice. Thinking about Reports we have had in this Committee, there has been a whole series of instances where you see a cut—this is in 2010—which then has an impact. Defence is absolutely chock-a-block full; we are going to come back to the aircraft carrier. There are just constant decisions being taken to give you a short-term cut, which has a fantastic—appalling—impact on long-term spending. You talked about the affordable homes programme, and we covered that when we did it. It was a capital cut, which will have an impact on housing benefit expenditure. We have a whole lot of examples—managing flood risk, DWP cutting the number of people, and not being able to implement the universal credit, transport cutting its budget for local authorities to mend potholes, leading to more expenditure later on. There are endless examples, and it all seems irrational. That is what I keep coming back to. It doesn't seem to be a sensible way forward.
Amyas Morse: We spend a lot of time in the Report saying that the Treasury's process of managing the budget at the centre works very well, but it is not linked to just what you are saying—it doesn't link sufficiently strongly into the way operational planning takes place in the Department, or beyond. We are not saying the Treasury should do all that itself. That is not what the Report says at all. What we are saying is that the Treasury should sponsor strong leads into just understanding the implications you were talking about, Margaret, so that we build up a culture of understanding the implications of decisions, not to say they don't have to be made, but just that people develop a more expert approach to understanding the implications of decisions that are made to implement central spending decisions. That is what we are really inviting you to sponsor.
Sir Nicholas Macpherson: I do accept that there are some really good points in the Report about how we can improve the budgeting process. I am not disagreeing with you. Indeed, only yesterday I was reading about when one of my predecessors said of the NAO in the 1890s that we—the Treasury—and the NAO are branches of the same police force.
Coming back to your point, Chair, I think we can do more to encourage Departments, working through the finance director community, to think these issues through. Most of the examples you used were of when the potential costs occurred within the same Department. If you are responsible for roads and you don't repair the potholes, that ultimately comes back and hits you in the Department because the road system will not work and so on.
Similarly, on aircraft carriers the decision was made in the Ministry of Defence, and one of the most important things the Treasury can do in relation to the MOD—we have discussed this in the past—is to ensure that it has a long-term programme that is affordable. Part of the problem, it is fair to say, that the MOD had in the last decade was extraordinary commitments and no plan whatever on the part of the accounting officer for how that programme would add up in the medium and longer terms.
I am happy to take the challenge that the Report has given, and in the next spending review to think through whether we can do better.
Sir Bob Kerslake: Briefly, on affordable housing, it is absolutely clear that we both knew what the consequential impact was of the new model on—

Q40 Chair: On housing benefit.
Sir Bob Kerslake: On housing benefit. Indeed, it was provided for in the overall sum.

Q41 Chair: Basically it was a political decision.
Sir Bob Kerslake: Well, it was a judgment, as your Report identified, that overall there was a fairly small difference in value-for-money terms, and the benefit of securing housing now justified going with the new model. That was clearly laid out in the NAO Report.
Sharon White: Briefly, David Pitchford and I gave evidence to the Committee a few months ago. Something on which the Treasury spends a lot of time is considering whether, once the allocations have happened, the money is going to the right place, and whether the great big shiny thing you thought you were going to deliver is going to be delivered on time. Although we are not there to do a Department's job for them, on the big issues of risk, the Treasury is very closely engaged, but in partnership principally with the Cabinet Office.

Q42 Chair: That brings us neatly to your people. It rather took me aback in the Report that eight out of 52 of the people working in the Treasury spending teams are still in place: a tiny proportion. If you take the risk issue and look at DECC which is one of your biggest risk Departments on all its programmes, you only have one of the 13 with any institutional memory of what went before.
Sharon White: I don't know whether Nick will have views.
Sir Nicholas Macpherson: Sharon's will be far more interesting.
Sharon White: There are issues of Treasury turnover. The Treasury's turnover is too high.

Q43 Chair: You also encourage people to move. My experience of these people who worked on the Treasury spending teams is that it was a thing you did for a couple of years and then you got promoted out of it if you were good at it. It is one of these things about keeping people so that they know something.
Sir Nicholas Macpherson: Or they are poached. We had this brilliant guy who ran our local authority team and then our education team and now he is director in

Bob's Department, where at least his knowledge is of some use.

Q44 Chair: That is of some use. But eight out of 52? It was the DECC thing that hit me because DECC is on everybody's red list for so many projects.
Sharon White: As you will have seen from the review I did of the financial crisis, Treasury's turnover is too high. We have set a target and it is coming down. On the spending side, those figures are in a sense worse than usual because one of the things we deliberately did for the 2010 spending review was to keep people on. People who had been involved in preparing for the spending review 2008–2009 did the spending review with institutional knowledge, being experts on health, education or CLG. Then, inevitably, we had lots of people leaving in quite a short space of time. Most of them have gone to other parts of the Treasury. As you say, one of the attractions of a Treasury career is that you can work on a number of different areas within the building. Some have left but quite a lot of the churn has been internal. One thing I am keen to do, thinking about the next spending review, is to make sure that we build back our capability and our expertise. People are staying on longer. Turnover is coming down, not by enough, but it is coming down. I don't want to pretend that it is a rosy picture, but those figures are partly a reflection of planned moves after the spending review.

Q45 Chair: In your document in April 2012 you said you would reward good spending control. How are you defining that and what are you going to do to incentivise it?
Sharon White: Departments who are successful in forecasting reasonably accurately, which is not a universal virtue, are more likely to be looked at favourably on things like budget exchange, flexibility at the end-year point and also in terms of access to the reserve. One thing the Treasury has also been keen to do is to strengthen our own financial capability. We have a big project at the moment within the Treasury to make sure that our accountants and our policy people are working more closely together and in a more integrated way than in the past.
Sir Bob Kerslake: May I add a point on that? That innovation is a really valuable one as it brings the accounting and spending functions closely together. My personal view across Departments is that in terms of the impact of the reductions on staff—typically, we are a third, as you know, Chair—by and large the finance functions have held together pretty well. In some cases they are now stronger than in the past. Where I think the worry is justified is around the continuity on leading major projects. I worry much more about that than I do about the finance function where I think we have held some pretty strong teams over this period.

Q46 Chair: One more question which we raised with you, Sir Nick, last week was this issue of the learning process. It drove us slightly mad. I don't know whether you have had a chance to reflect on the issue last week. We have endlessly revisited PFI and expressed concerns as a Committee about the failure to get value for money in all sorts of ways. We then see these offshore transmission contracts being signed and there being absolutely no reference to any sharing of profits anywhere or particularly around refinancing. I know you keep saying it is going to happen, but that is the sort of thing in a deficit-reduction environment that drives you really mad, because it is such a waste. Your Treasury official said, "I think it was a new type of contract and a new type of business, and…the aim was to get this up and running, and not to introduce restrictions or limitations on getting the project off the ground—or off the water, so to speak." That is not good enough from Treasury.
Sir Nicholas Macpherson: I have taken the Committee's interest in PFI very seriously. I think we are learning lessons on implementation, on tax and creative tax solutions, continuing to remind Departments that they need to take into account the costs for the whole of the public sector, in particular HMRC, which is really important. It is ultimately a question for Ministers whether we persist with the PFI framework. Successive Governments have tended to talk quite tough in opposition and then perhaps seen the benefits of PFI when they enter government. I think, Sharon, we are due—

Q47 Chair: This isn't the issue of PFI. I know you are coming back. We will keep coming back to PFI. It is the learning from PFI. We have just had another. The more private sector involvement you get in public services, it is really important that we get smart at contracting, and we are not very smart at it.
Sir Nicholas Macpherson: It picks up on Bob's point about projects. It is a matter of not only keeping people in place who can run major projects, but people who really understand contracting. You really don't want to be too dependent on consultants when you are negotiating these deals.
We are quite good in Whitehall at learning lessons when things go really wrong. Only this afternoon we are getting an interim report on the Department of Transport's problems. I think we are less good at learning where things go okayish to mildly badly, which too often in Whitehall is seen as probably a good outcome.

Q48 Chair: I would even challenge the Department. We had the east coast and we then muck it up for the west coast.
Sir Nicholas Macpherson: It is incumbent on the Treasury and the Cabinet Office to ensure that we are learning the lessons. There are some positive things going on in terms of training—the Major Projects Academy and so on. The issue of contract negotiation is critical, and having good people with a good commercial sense negotiating those contracts is really important. That comes back to a whole lot of issues around pay and so on.
Sir Bob Kerslake: In the reform plan we propose to make that the priority for improving skills and capacity. We will have at least one and probably more centres of excellence on commercial skills, because it is a big gap.

Q49 Chair: You should have had them to do the MOJ interpretation contract, I can tell you. They have lost only £2,000 they told us. That is all that they have lost on an absolutely abysmal failure to deliver.
The final thing is that you talked about external challenge—the Report talks about external challenge. I thought the stuff that you did in CLG looked very interesting. Why can't departmental Select Committees—not us—have a chance to look at and comment on CSR proposals? That might bring a little bit of interesting external challenge and accountability.
Sir Nicholas Macpherson: I would really encourage that. I am always surprised how little interest departmental Select Committees take.

Q50 Chair: It's all so secret. Would you be prepared to recommend to your Ministers that that should happen?
Sir Nicholas Macpherson: We have in the past done a degree of consultation. I remember when we had PSAs, we consulted our Committees on the nature of the PSAs, the measurements and so on. I value parliamentary interest, not least because you are far more in touch with ordinary citizens than I can be working in the Treasury. You can partly blame the Executive, but I think Select Committees just do not find this sexy enough.
Sir Bob Kerslake: Earlier, I mentioned the business plans that are needed for each spending decision. In a sense, what the spending review does is give you the spending capacity in the Departments, but the individual projects and programmes do not go ahead until they have been assessed in the Departments. It seems to me that Select Committees can and should ask questions about the business plans that have been put together.
Chair: We might recommend it and see what happens to the recommendation.

Q51 Nick Smith: I feel a bit reluctant about raising this issue, but a few years ago I had some involvement with PFI negotiations as a local councillor. Going back to your earlier point, Sir Nicholas, about there being a gap in having really good negotiators on commercial contracts, you talked in passing about the tricky issue of pay for people in the public sector who do big ticket, sophisticated negotiation. Help us out. Do you have any further ideas? That is something I saw as a real gap in the public service then.
Sir Nicholas Macpherson: I am slightly conflicted on that, because the Treasury clearly has an interest in keeping pay down across the board, but I think we also have to face up to why we underperform in specialist areas. The fact is that people who are very commercially minded are not going to have the same sort of public service motivations as people such as Sharon, myself and Bob. Bob took a big wage cut to join the civil service. I am not against paying more to specialists in such areas, and I am not against bonuses, big bonuses potentially, provided there are very clear success measures and those people are employed on reasonably short-term contracts. Once you sign up to being a permanent civil servant, there is a trade-off and I would be reluctant to pay people large sums of money to do—although we don't have jobs for life any more—on the face of it, a long-term job. That is something we need to look at. I know the Chief Secretary is quite interested in this area, and I know Bob is interested in it, too.
Sir Bob Kerslake: For certain types of job, particularly those that are very market facing, you have to look at what the market is paying and reflect that in what you are trying to do. On this issue of commercial skills, we need a relatively small number of highly expert people, and we need a larger number of civil servants who are more commercially competent. In my view, you need both in the civil service, not just the high-paid experts. Our challenge is that we are never going to have enough high-paid experts to deal with every commercial contract we negotiate, because there are hundreds, if not thousands, of them. We have to get more commercially aware and more commercially savvy as part of the deal of being a good civil servant.
Sharon White: I would also pick up the point about civil service reform plans, because one of the issues we have is that we expect every Department with big projects to have its own commercial capability. DECC is a very interesting case in point. Actually, we need to think about how we pool the small number of highly expert, well paid commercial experts, and then find a way in which we can have more of a call-down contract, with the resource being more centralised than it is currently.
Sir Nicholas Macpherson: It is also about retaining expertise. I always use the example of Northern Rock. We were criticised by this Committee for the amount of money Goldman Sachs took off us for dealing with Northern Rock, and we really learned the lesson in the following year. The contracts we negotiated with the investment banks when it came to sorting out RBS and the other banks were infinitely better value for money. So, taking the Chair's point, if we can just learn and embed the knowledge and experience, we do not necessarily need some super-duper, whizzo commercial expert, but we have to do it properly.

Q52 Fiona Mactaggart: One of the things the Report says is that the design of the process in SR10 "supports the Treasury's objectives for spending control better than those for value for money." How are you going to change that?
Sir Nicholas Macpherson: Sharon, you are going to lead the next spending review, if we can retain you for that long. How are we going to do this?
Chair: She's only just arrived.
Sharon White: A big issue for us is how we use the next two years. It partly comes back to this issue about taking the spending review as a concertinaed two to three-month period and what happens in the run-up. One of the things that I would like to do is to think about some of the big blocks of spending where we know—coming back to your demography point, Chair—we are going to have to take out, or at least revisit, the amount of spending. We need to think about whether that supports the elderly; whether there is efficiency in the health care system; or whether even a real-terms freeze means that we are probably going to have big efficiency changes for the next five

or 10 years. We need to use the next two years, or however long we have until the next spending review, to do some more forensic work.

As a particular example on health care, we are sponsoring working with Nuffield. It is doing much more expert analytical work on public sector productivity: how you boost public sector productivity and what the comparisons are across health systems. I would like to see whether we can do that for the two or three other big blocks of spending. Some of it the Treasury will be able to do internally, but a lot will have to work with Nuffield or the IFS, looking a bit more internationally than we have done in the past.

It is slightly controversial, but there will be areas where affordability and value for money just conflict. I would not understate the importance that at the end of the day the money is adding up, and we are seeing spending and the path of it beginning to slow in the way in which in 2010 we had Greek-style worries with the markets. So there is a lot more we can learn in trying to improve value for money, but that is not going to be our only metric in terms of making sure the next SR delivers financially, but also delivers economically for growth and for public service reform.

Q53 Fiona Mactaggart: Taking it down to something smaller and more fiddly: figure 5. What does that tell you? Have we learnt anything from that figure?

Sharon White: The Treasury always sends out guidance notes to Departments, as we did on 11 June 2010. Compliance was mixed. It got a bit better over the summer as we chased up Departments. The issue here is where we have data gaps, and for me the question about public sector productivity is the big one. Do we know, for health or for schools, what £1 of spend is delivering in terms of outcomes? There were some areas—skills is a good example, and although this is not very popular, policing is a good example—where there is almost an inverse correlation between what we spend and the outcomes that we deliver. This is partly about the numbers, but it is partly about having a better understanding of how you reorient your spend—

Q54 Chair: Say that again? There is an inverse relationship?

Sharon White: Skills and the FE sector, which you will know a lot about, is an area where we have put in substantial new sums of money with no return; it is not even a small positive. That is partly because it is captured by the suppliers—by FE colleges—with not enough responsiveness by employers and students. There are still many areas—schools are another example—where you have a lot of analysis that the big increase in work force, principally teaching assistants who are loved by teachers and loved by parents, has neutral if not negative impacts on school outcomes, because you tend to get the weaker ability children taught by the less well qualified professionals. There are a lot of areas where we have some evidence, but we need to get more complete evidence before the next spending review.

Amyas Morse: You were not surprised, then, when you went through this earlier. Did it not surprise you that people did not have the information available to deal with it? What that really tells me is that they had to prepare it especially for you, rather than using it for running their own Departments.

Sharon White: I think it is partly that, and I think it also partly reflects Bob's point about preparation before 2010. Some Departments really got the message that 2010, after the election, was going to be a serious constraint on spending, and others either had not quite internalised it or—apologies—did not have the political space to be able to do some really serious planning on spending before 2010. Some of it, to be frank, is also gaming—"I'm not going to explain to the Treasury, but actually if I spend more money on policing, I can't see where the outcomes are."

Amyas Morse: Forgive me just for one second, Chair. The thing is, if one looks at the campaign that Lord Browne has run on management information and at what we are saying about people not having management information, people do not understand their cost. Almost universally, the knowledge of the effect on costing is very—

Sharon White: Yes, that is true.

Amyas Morse: This may sound as though it is quite basic stuff, but if you cannot cost and understand the options that you are assessing, how do you make them? It is just impressionistic. I think we are way short of the competence we need in these Departments. I know that I am generalising—it is different in different Departments—but if you want to be able to make decisions that say "This not that", do not prepare it by hand or by estimating on the back of a bit of paper, but actually have it come off the systems. You make decisions that way normally, and they should be able to tell you this stuff pretty much as soon as you ask them, because it is as easy as taking it off the systems and sending it to you, and that is so rarely the case.

Sharon White: I think the picture is variable. As you know, we are doing work with DCLG on management information to try to make this more systematic, but for some Departments this is a real up-hill struggle.

Q55 Chair: This is down to you, Sir Bob, in the reform of the civil service.

Sir Bob Kerslake: Again, you are right to say we need to improve it, but we must not over-read it. If I take my own Department, we got 27 of the 35 requests in by July, and the balance came in in August and September. The principal gap was that there was a change in the way in which the arm's length bodies were covered, and additional information was required from them, in fact. It was lack of information about the arm's length bodies, so there are some gaps—

Chair: Actually, if you look at it—

Sir Bob Kerslake: May I just finish the point, Chair? Yes, there clearly were some gaps, but we should not go away with the impression that there was a complete information desert here, because there was not.

Q56 Chair: Yes, but you went 27 to 35. The reason I interrupted you is that, if you look at the right-hand side, there are all the things that tell you about VFM etc.

Sir Bob Kerslake: The things that were mandatory requests was what I was specifically referring to there, not the discretionary requests.

Q57 Fiona Mactaggart: I was quite interested in whether one of the lessons of figure 5 is that too much is being asked and not the right stuff—and it is asked as part of the spending review at the last minute rather than being part of a culture.

Sir Nicholas Macpherson: Having seen a lot of different information regimes come and go at the centre of Government, by which I mean the Treasury and the Cabinet Office, I think you need real discipline. There are two things. There is Amyas's point that any Department which really knows what it is doing must have a clear idea of where the extra tax pound—to use an American expression—is going. I have this conversation with HMRC from time to time, about: "Just tell me the cost to tax in ratio."

It is also incumbent on the centre not to have advocates of Mickey Mouse measures. Amyas's other point is that there are some measures which Departments do not use because they have not got their act together, but there are other ones which they do not use because they know that they are gobbledegook. I think real discipline is required on the part of the Treasury and the Efficiency and Reform Group, because if we do not maintain discipline, Departments just switch off and ignore it.

Q58 Fiona Mactaggart: Exactly. Is that going to happen next time?

Sir Bob Kerslake: I think it is just worth saying on the reform plan that we have now agreed a set of quarterly management information that every Department will do—it has been done by agreement with Departments, so it is not being imposed by the Treasury—and that will form a standardised set of measurements for each Department.

Q59 Fiona Mactaggart: But will it provide you with the stuff that you need to do the next spending review?

Sir Bob Kerslake: I think it will provide you with a lot of information but, truthfully, I do not think anybody will ever invent a system where every bit of what is needed for the spending review is instantly at hand. That is back to nirvana again, frankly.

Chair: Good. Thank you. It was a shorter session, because we had to deal with Capita before it, so apologies for that and apologies again for keeping you waiting.

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