

## **PRE-ANNOUNCEMENT OF CHANGES TO THE PUBLIC EXPENDITURE BY FUNCTION SERIES TO BE PUBLISHED IN PUBLIC EXPENDITURE STATISTICAL ANALYSES 2004**

### **INTRODUCTION**

Public Expenditure Statistical Analyses (PESA) is an annual compendium of public expenditure statistics that are presented in a variety of ways to provide a comprehensive source of data on public spending. Public expenditure aggregates can be examined in two ways. The first is a Treasury budgeting basis, where departments' budgets are made up of budgeting aggregates Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME), which are largely based on concepts in resource accounts produced in accordance with Generally Accepted Accounting Principles (GAAP). The second is the National Accounts basis of the Office for National Statistics, which conforms to international guidelines.

PESA presents public expenditure on budgeting basis to show the level and type of expenditure of different government departments; and it presents public expenditure on a National Accounts basis analysed by spending sector in chapters 4, 6 and 7 of PESA, and by function in chapters 3 and 8.

**In accordance with National Statistics protocol this note gives prior notice of methodological changes to the functional series in chapter 3 of PESA 2004, to be published on 19<sup>th</sup> April 2004.**

Chapter 3 of PESA gives a picture of changes in government expenditure over recent years. It uses a measure based on the National Accounts definition for public expenditure and focuses on showing the level of spending in the different functional areas of government. The public expenditure by function series differs from the departmental spending series in that it is not affected by transfers of responsibility between departments. The functional spending numbers are therefore consistent and comparable over time and for this reason often preferred to departmental numbers.

Updates to the PESA key functional series are also released as National Statistics updates at three other times of the year alongside the Public Expenditure Outturn White Paper (in June/July), Pre-Budget Report (usually in November, but the timing can vary) and the Budget as part of a National Statistics release. The functional series also forms the basis for the analysis of expenditure by country and region in chapter 8 of PESA. The methodological changes to the functional series in chapter 3 of PESA 2004 will also be carried through as changes to the functional presentations of the analyses of country and region in chapter 8 of PESA 2004.

### **REASON FOR CHANGE IN SERIES**

We have changed the presentation in order to improve quality. The method to derive the existing series for spending in different functional areas of government is UK specific and not based on a standard methodology. The new series reflects significant quality improvements through closer alignment to the UN Classification of the Functions of Government (COFOG). Using this internationally recognised methodology will give users increased understanding of how the statistics are compiled and allow greater confidence that their quality is assured against international standards.

The change to COFOG has had an impact in two areas.

- The categories have been changed to reflect COFOG
- The overall spending aggregate has been amended to accommodate some additional categories required under COFOG.

Alongside this change in methodology there has also been a quality improvement exercise. This involved a detailed audit of the allocation of departments' programme expenditure to the different functional categories. This exercise ensures that allocations that were made according to historical precedent are now based on knowledge of the programme expenditure and correct classification.

This note gives a detailed explanation of how the methodology change and quality audit have affected the series. It also aims to act as a source of information for anyone who may be interested in the relationship between the old and new series in the future.

## **PUBLIC EXPENDITURE BY FUNCTION**

### **Change to the basis of the series**

The key concept to understand in the derivation of the public expenditure by function series is **Total Expenditure on Services (TES)**. This is the spending aggregate that is allocated to function and covers most expenditure by the public sector that is included in Total Managed Expenditure (TME).

TME is a concept derived from National Accounts that covers current and capital expenditure of the whole of the public sector, that is, central government, local authorities and public corporations. Expenditure on Services includes central government spending but excludes the part of this that is finance to local authorities and public corporations. This central government expenditure is then combined with actual spending by local authorities and public corporations to give total public sector expenditure. Expenditure on Services is a near-cash measure of spending in that it excludes all non-cash items such as depreciation and cost of capital charges. Full details of the derivation of Expenditure on Services from departmental budgets will be available in an appendix of PESA 2004.

With the move to COFOG Total Expenditure on Services for the revised series will now additionally include expenditure in the following areas:

- Public sector debt interest
- Public sector occupational pensions

In addition, Total Expenditure on Services will change to include the effect of EU transactions on the same basis as TME. The existing definition of TES included net payments to the EC. This is being changed only to exclude the payments to the EC which, in the National Accounts, are considered as direct payments to the EC from UK citizens and enterprises. The UK's contribution to the EC will now be based on the GNI related contribution and the UK's.

The effect of these changes on TES for 2000-01 to 2002-03 can be seen in the following table.

**Table 1 Changes to Total Expenditure on Services**

£ billion

	2000-01	2001-02	2002-03
<b>Previous Total Expenditure on Services</b>	<b>324.8</b>	<b>351.6</b>	<b>377.5</b>
Include debt interest			
Public sector debt interest	26.4	22.5	21.3
Include pension payments			
Public service net pensions	4.9	4.9	3.9
Include effect of EU transactions on same basis as TME			
Adjustment to EC gross payments	-6.3	-6.1	-4.2
<b>New COFOG Total Expenditure on Services</b>	<b>349.7</b>	<b>373.0</b>	<b>398.5</b>

**Categories of the different functional areas of government**

COFOG describes the functions of government in ten categories. Within these ten categories there is a further breakdown of the function into sub-sets. The series is made up like a jigsaw with departmental programme expenditure allocated to sub-functions that then fit together to create overall function categories.

The functional categories that will be presented in the revised series are based on COFOG but include seventeen categories. These categories are firmly based on detailed COFOG sub-categories. We chose to split the main COFOG categories further as we believe the level of detail to be of interest to users. The following table shows how the categories in the revised series map to COFOG.

**Table 2 Map of COFOG categories to PESA 2004 categories**

COFOG category name	PESA 2004 category name
General Public Services	General Public Services
	EU transactions
	International services
	Debt interest
Defence	Defence
Public order and safety	Public order and safety
Economic affairs	Enterprise, and economic development
	Science and technology
	Employment policies
	Agriculture fisheries and forestry
	Transport
Environment protection	Environment protection
Housing and community amenities	Housing and community amenities
Health	Health
Recreation, culture and religion	Recreation, culture and religion
Education	Education and training
	<i>of which: education</i>
Social protection	Social protection

To change to the new categories from the existing series we have effectively changed the combination of sub-functions in the jigsaw that make up the functional categories.

The main change has been the break up of the old trade category as follows:

- Training is now part of education and training
- science and technology is a separate category
- employment policies is a separate category

The remainder of the trade function is combined with the following to give the new enterprise and economic development category

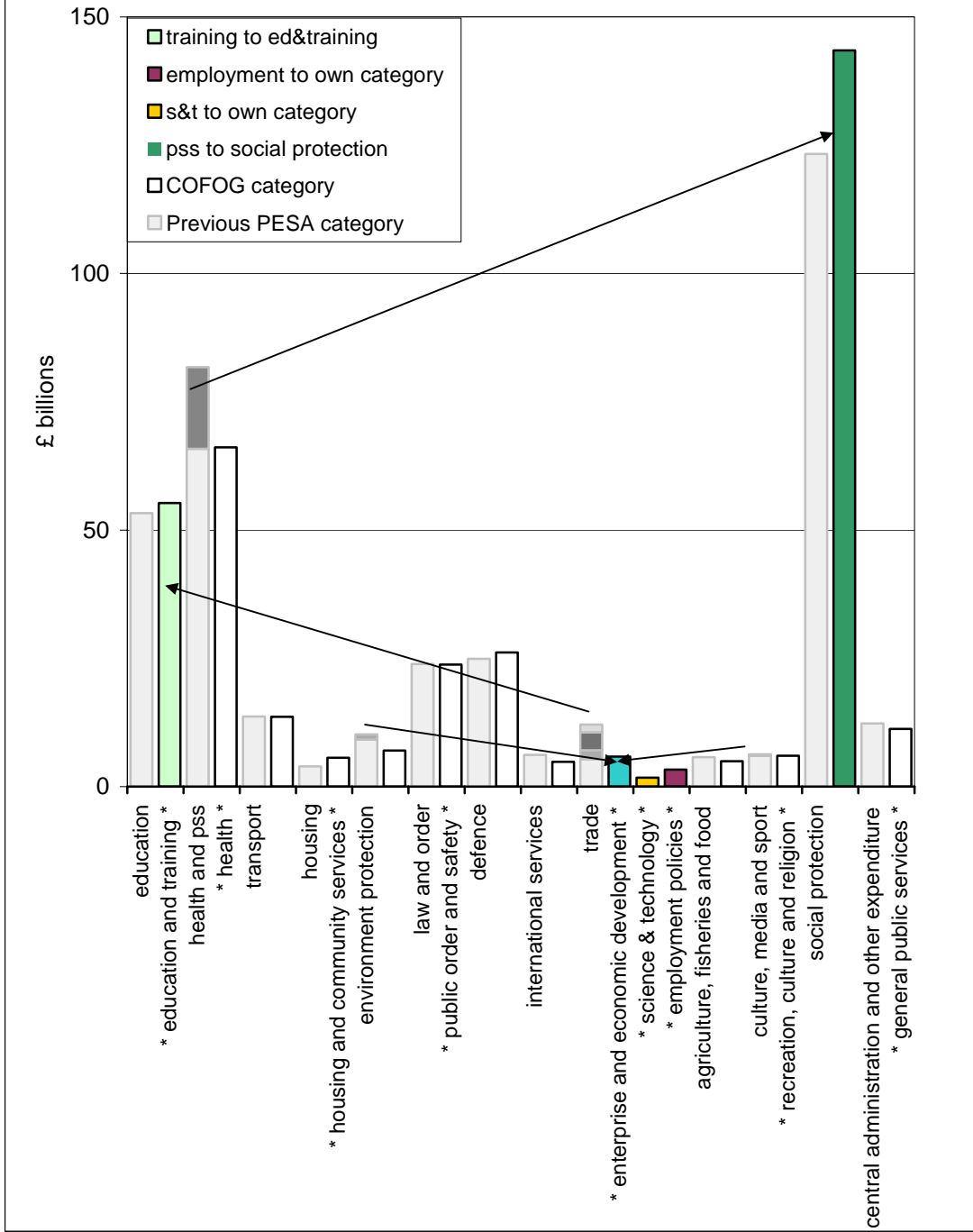
- urban policy from the existing environment function
- tourism from the existing culture function.

The other main category change is that personal social services (PSS) is now included in the social protection category (it was previously part of the health and PSS category).

The presentation of the EU line has also changed. It is no longer part of the central administration category and is shown explicitly in the EU transactions category.

The following chart attempts to show the relationship between the existing and revised categories using latest National Statistics for 2002-03. The chart shows the previous PESA categories (bars with grey shading) alongside the most comparable COFOG category (clear bars). Where the combination of sub-functions has changed the relevant part of the previous PESA categories is shaded in a corresponding colour to the new COFOG category. COFOG category names are denoted with an asterix where they differ from the previous PESA category name.

**Chart 1 Changes to the categories in the functional analysis**



The manner in which the series has been revised means that it will be possible to generate the structure of the existing function series by taking a different combination of sub-functions in the revised series. The following table provides this underlying data to facilitate this.

**Table 3 New COFOG presentation: adjustments to reach structure of old series**

New COFOG presentation		1998 -99	1999 -00	2000 -01	2001 -02	2002 -03	Previous PESA	
Function	Sub-function						Function	Sub-function
Defence	Civil Defence	6	6	6	2	4	Law, order and Protective services	Civil Defence
Enterprise and economic development	Support for business	493	689	762	992	1,117	Trade	Support for aerospace shipbuilding coal and steel
	Support for business	150	176	204	254	270	Culture, media and sport	Tourism
	Support for business	1,882	1,688	2,211	2,049	2,265	Trade	Regional and other industrial support
	Regional policy							
	Regional policy	1,902	1,179	1,043	871	1,015	Environment protection	Urban
	Economic development and trade	273	296	365	480	433	Trade	Department Admin
	Economic development and trade	2,481	2,400	2,570	2,939	3,258	Trade	Trade, scientific and industrial support
Science and technology								
Science and technology	Science and technology							
Employment policies	Employment policies	2,460	2,768	3,305	3,533	3,504	Trade	Employment policies
Education and training	Training	1,512	1,626	1,475	1,225	1,524	Trade	Training
Social protection	PSS	10,979	12,102	12,877	13,857	15,907	Health and PSS	PSS

### Presentation of the different functional areas of government

Previously, the order of categories in the function series in PESA reflected government priorities with functions shown in descending order. The key government priorities of education and health are given first in that order. The revised series will now be presented in the order outlined by COFOG. This order is the agreed international standard for the presentation of the functions of government and will provide consistency of the statistics with the COFOG classification.

There is one area of COFOG where we will supplement the standard presentation. Under COFOG, the education and training category is made up of a number of education sub-sets and one for training. We will continue to show the education part of this category separately below the education and training series.

## IMPACT OF THE CHANGES ON THE SERIES

The existing series has been published for the last time today, alongside the Budget, and is shown below for the years 1998-99 to 2002-03.

**Table 4 Existing public expenditure by function series**

	cash, £ billion		accruals £ billion		
	1998-99 outturn	1999-00 outturn	2000-01 outturn	2001-02 outturn	2002-03 outturn
Education	38.8	40.9	44.2	49.2	53.3
Health and PSS	57.3	62.3	66.6	73.2	81.7
<i>of which: Health</i>	<i>46.4</i>	<i>50.2</i>	<i>53.8</i>	<i>59.4</i>	<i>65.8</i>
Transport	8.7	8.6	9.1	11.3	13.7
Housing	3.7	2.9	3.0	4.4	3.9
Environment	8.0	9.5	9.3	10.0	10.2
Law, order and protection	17.5	18.8	20.3	23.0	23.9
Defence	22.6	22.7	24.9	24.1	24.9
International	3.2	3.4	4.1	5.1	6.2
Trade, employment etc	9.1	9.5	10.7	11.2	12.1
Agriculture	4.8	4.6	5.4	7.1	5.8
Culture, Media and Sport	5.3	5.0	5.9	5.8	6.3
Social protection	99.4	104.1	109.4	116.8	123.3
Central Administration etc	10.6	10.2	11.8	10.3	12.3
<b>Total expenditure on services</b>	<b>288.9</b>	<b>302.4</b>	<b>324.8</b>	<b>351.6</b>	<b>377.5</b>
Public sector debt interest	29.4	25.3	26.4	22.5	21.3
Other accounting adjustments	14.4	15.9	15.9	16.6	20.3
Allowance for shortfall	0.0	0.0	0.0	0.0	0.0
<b>Total Managed Expenditure</b>	<b>332.7</b>	<b>343.6</b>	<b>367.1</b>	<b>390.7</b>	<b>419.0</b>

The same data is shown below on the new basis to give the revised public expenditure by function series. This now includes the revised Total Expenditure on Services aggregate and presentation of the revised functions as follows, including the additional education line.

**Table 5 Revised public expenditure by function series (COFOG)**

	accruals, £ billions				
	1998-99 outturn	1999-00 outturn	2000-01 outturn	2001-02 outturn	2002-03 outturn
General public services	8.8	9.4	9.3	10.7	11.3
EU transactions	-2.0	-2.7	-2.5	-5.1	-1.9
International services	3.0	3.6	4.0	4.6	4.9
Debt interest	29.3	25.3	26.4	22.5	21.3
Defence	23.7	24.1	24.9	24.6	26.1
Public order and safety	17.9	18.4	20.4	23.0	23.8
Enterprise and economic development	3.7	4.7	4.9	5.2	5.9
Science and technology	1.3	1.3	1.3	1.5	1.8
Employment policies	2.8	3.1	3.4	3.3	3.3
Agriculture, fisheries and forestry	4.6	4.5	4.8	6.5	4.9
Transport	8.5	9.0	9.1	11.3	13.6
Environment protection	5.0	5.9	6.4	6.8	7.0
Housing and community amenities	4.2	3.6	4.5	6.1	5.6
Health	47.0	49.4	54.0	59.7	66.1
Recreation, culture and religion	5.5	5.6	5.6	5.5	6.0
Education and training	39.8	42.1	45.7	50.8	55.3
of which: education	38.8	40.7	44.2	49.4	53.6
Social protection	114.4	122.1	127.5	136.0	143.5
<b>Total expenditure on services</b>	<b>317.4</b>	<b>329.4</b>	<b>349.7</b>	<b>373.0</b>	<b>398.5</b>
Accounting adjustments	13.9	12.6	15.9	16.4	19.2
<b>Total Managed Expenditure</b>	<b>332.7</b>	<b>343.6</b>	<b>367.1</b>	<b>390.7</b>	<b>419.0</b>

Due to the change in the structure of the functional categories not all of the series are comparable. However the differences between those categories that are easily comparable are shown below.

It is worth noting that the existing series has a slight break in series between 1999 and 2000. This is due to the change from a cash accounting system to one of accruals. However, all the data in the revised series and the data post 2000 in the existing series are on an accruals basis. In practical terms this change has only a small effect on the data and that is due to timing differences. All other differences between cash and accruals data (ie. depreciation and other non-cash items) are removed for the analysis.

The following table compares the series for the years 2000-01 to 2002-03 where any changes in series will reflect the move to COFOG and not include any timing differences with the move to accruals data.

**Table 6 Difference for comparable categories and years**

	accruals, £ billion		
	2000-01	2001-02	2002-03
	outturn	outturn	outturn
Education	0.0	0.2	0.3
Health	0.3	0.4	0.3
Transport	0.0	0.0	-0.1
Housing	1.5	1.7	1.7
Environment	-2.9	-3.2	-3.2
Law and order	0.1	0.0	-0.1
Defence	0.0	0.5	1.2
International	-0.1	-0.5	-1.3
Agriculture	-0.6	-0.6	-0.9
Culture	-0.3	-0.3	-0.3
Social protection	18.0	19.2	20.2
Administration	-2.5	0.4	-1.0
<i>Non-comparable functions</i>	<i>11.4</i>	<i>3.7</i>	<i>4.1</i>
<b>Total Expenditure on Services</b>	<b>24.9</b>	<b>21.3</b>	<b>21.0</b>

As can be seen in the above table the biggest differences from the change in series are for social protection and environment. The exact differences for these and some other categories are examined in the following section.

## DIFFERENCES BETWEEN THE FUNCTIONAL SERIES

### Social protection

The social protection function is affected by the changes in the functional categories. The revised social protection function now includes spending on personal social services, which was previously included with health in the health and personal social services category. The public service pensions spending that is now included in Expenditure on Services is also allocated to social protection. The effects of these changes and the quality improvement exercise are shown below.

**Table 7 Social protection**

	accruals, £ billion		
	2000-01	2001-02	2002-03
	outturn	outturn	outturn
<b>Previous social protection series</b>	<b>109.4</b>	<b>116.8</b>	<b>123.3</b>
Data quality improvements	0.2	0.2	0.2
Include spending on PSS and pensions			
PSS	13.0	14.0	16.1
Public sector pensions	4.9	4.9	3.9
<b>New COFOG social protection series</b>	<b>127.5</b>	<b>136.0</b>	<b>143.5</b>

## Environment protection

The size of the environment protection function has reduced by approximately 30%. This is a considerable change in size and is only partly attributable to the change in categories due to COFOG. The majority of the difference is due to data quality improvement. It was found that a lot of data had been incorrectly allocated perhaps during some Machinery of Government (MoG) changes affecting these areas. Some spending on the regions, local government and planning policy was included in the environment function.

The effect of these changes is shown below.

**Table 8 Environment protection**

	accruals, £ billion		
	2000-01 outturn	2001-02 outturn	2002-03 outturn
<b>Previous environment protection series</b>	<b>9.3</b>	<b>10.0</b>	<b>10.2</b>
Exclude spending on urban policy			
Urban	-1.0	-0.9	-1.0
Include spending on environmental research	0.2	0.2	0.2
Remove spending mis-allocated to environment in previous series	-3.5	-4.0	-4.1
<i>of which:</i>			
Local government services	-1.3	-1.3	-1.1
Regional policy	-0.7	-0.9	-1.2
Agriculture	-0.1	-0.1	-0.2
Planning	-1.5	-1.6	-1.7
Include spending not previously allocated to environment	1.4	1.4	1.7
<i>of which:</i>			
Decommisioning of nuclear sites	0.2	0.3	0.3
Environment agency	0.9	0.9	1.1
Other data quality improvements	0.3	0.2	0.3
<b>New COFOG environment protection series</b>	<b>6.4</b>	<b>6.8</b>	<b>7.0</b>

## Housing

The housing series has also been affected by the above changes. Spending on town and country planning has been removed from environment protection function and re-allocated to the housing series. The effects of this re-allocation can be seen in the table below.

**Table 9 Housing**

accruals, £ billion

	<b>2000-01 outturn</b>	<b>2001-02 outturn</b>	<b>2002-03 outturn</b>
<b>Previous housing series</b>	3.0	4.4	3.9
Include spending on planning services			
Planning	1.5	1.6	1.7
Other small quality improvements		0.1	
<b>New COFOG housing series</b>	<b>4.5</b>	<b>6.1</b>	<b>5.6</b>

**Defence and International Services**

The data quality improvement exercise and classification guidance from COFOG has resulted in a re-classification of peace keeping expenditure. The military side of peace keeping (ie. deployment of troops) is now allocated to defence with only the diplomatic part of peace keeping now allocated to international services. The changes in these two series reflect this classification.

**Government priorities of health, education and transport**

The definition of the health, education (the sub-set of education and training) and transport series are left unchanged with the move to COFOG. Any change in the series is due to quality improvement and is of a small scale. The overall effect is negligible and allows increased confidence in the numbers produced. Any government target in these areas that measures achievement by reference to the previous functional series can be measured equally well by reference to the new COFOG series.

**PUBLICATION OF EXISTING SERIES**

The existing public expenditure by function series will cease to be published from today. Requests for the series in the future will be met only if there is a substantial business need. Users of the statistics that predict a future need for the old series are asked to contact PESA branch of the Public Service Delivery Analysis team.

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