



HM Treasury

Resource Budgeting and the 2000 Spending Review

Explanatory note by HM Treasury

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1. The 2000 Spending Review introduces significant changes in the way the government plans and controls public spending with the move to resource budgeting. This note explains the changes and sets out how the new system affects the presentation of public expenditure numbers.

The basic idea of resource budgeting

2. Under the budgeting system that has been in operation until now, public spending is generally planned and controlled in cash terms. Cash payments and receipts score in the year they are made or received. It is not a pure cash system because we include some non-cash items in departmental controls like credit approvals for local authorities, and depreciation at an aggregate level. But generally, what counts is cash.
3. Under resource budgeting what counts is when the resources are consumed, not when they are paid for. Spending is scored as it is incurred, and income as it is earned. So resource budgets include costs such as stocks consumed (rather than bought and sold), provisions to meet future payments, and the cost of using capital assets (depreciation and a cost of capital charge). Where an advance payment is made to meet future consumption that does not score.

Benefits of Resource Budgeting

4. Budgeting in resource terms offers benefits at both the micro and the macro level. At a macro level it delivers:
 - C a clearer view of the real costs of providing individual services, which takes account of the full costs of holding assets;
 - C a more accurate figure for the cost of depreciation in central government;
 - C a more transparent split of capital and current spending, with public corporations' investment presented more clearly;
 - C a better measure of the total value of central government assets, building on what has already been achieved through the National Asset Register.
5. At the micro level, resource budgeting offers:

- C better incentives to manage assets and dispose of those no longer needed, and better incentives in planning investment, as this affects the cost of capital charge;
- C new incentives to manage working capital (debtors, creditors and stocks); and
- C a clearer distinction between loans and grants.

The background

6. The move to resource budgeting is part of a long planned reform to move the whole system of planning and accounting for central government expenditure onto an accruals basis. The introduction of Resource Accounting and Budgeting (RAB) was originally proposed by the previous government in a White Paper in 1995 and the present government endorsed this commitment.
7. In the 1999 Budget report, the Government outlined its intention to conduct the 2000 Spending Review on a resource basis. This autumn, Departmental accounts will be produced and published on a resource basis for the first time for the year 1999-2000. And, subject to the approval of the relevant Parliamentary Committees, Estimates will be presented to Parliament on a resource basis from 2001-02.
8. Other countries have undertaken similar reforms. New Zealand adopted a system of resource budgeting in the early 1990s and Australia did the same at Commonwealth level in 1999.

Resource budgeting in the 2000 Spending Review

9. Many features of the public spending system remain unchanged under resource budgeting. In particular, the framework established in the 1998 Comprehensive Spending Review remains in place. This centred around three year Departmental Expenditure Limits (DELs), which include most departmental programme and administrative expenditure. DELs are split into firm limits for current and capital spending. Expenditure which could not reasonably be controlled within a three year framework scores in Annually Managed Expenditure. AME is not published on a departmental basis but by category of expenditure. Examples of AME items include social security benefits, Common Agricultural Policy payments, and export credit guarantees.

10. This framework continues under resource budgeting. The 'current DEL' has been renamed the 'resource DEL', a title which better reflects the fact that we are measuring resources consumed separately from investment.
11. To prepare for the introduction of resource budgeting, the Treasury organised a dry run involving all departments between April and October 1999. This confirmed that converting cash plans into resource terms was feasible. But it also highlighted some concerns about whether potentially volatile non-cash items like depreciation - which departments have only a limited track record in forecasting - were compatible with budgeting three years ahead.
12. Ministers therefore decided to introduce resource budgeting in two stages:
 - C in Stage 1, in the 2000 Spending Review, the big non-cash items of resource budgets - depreciation, cost of capital charges and provisions - will be managed annually in AME rather than in three year DELs; and
 - C in Stage 2, in the 2002 Spending Review, we plan to move these items into DEL.
13. We believe this approach allows us to gain many of the benefits of resource budgeting while minimising the transitional risks associated with forecasting non-cash expenditure. Not all the benefits of resource budgeting will be realised fully in Stage 1 - in particular the micro incentives will not be fully delivered because the costs of holding capital assets will be outside the control limits applied to departments. But the improved flow of information on these assets will itself be a spur to better management. For example, in preparing plans for capital investment over the spending review period, departments are required to calculate the non-cash consequences (depreciation and cost of capital charge) of their asset acquisition and disposal strategies.

How resource budgeting affects the 2000 Spending Review numbers

14. To allow comparison between departmental spending in the Comprehensive Spending Review (CSR) period (1999-2000 to 2001-02) and the plans set out in the 2000 Spending Review for 2001-02 to 2003-04, we are restating the numbers for 1999-2000 to 2001-02 in resource terms.

15. The numbers we publish for public spending in resource terms will differ from those we have previously set out in cash. However, because the large non-cash items are in AME, the differences between the old and new expenditure limits (DELs) will generally be small.

Changes to DEL numbers

16. Resource budgeting can change the DEL numbers in several different ways.
- C **timing differences** - resource and capital DELs will not include prepayments for resources consumed beyond the financial year, but will include accruals where resources are consumed but paid for later. And **stock consumption** scores in the resource budget while spending on adding to stocks does not;
 - C **changes in the capital/current split** - some spending which scores as current spending under cash - such as defence fighting equipment and payments to health trusts to finance capital expenditure - will score as capital spending under resource budgeting;
 - C **capital charges on civil estate holdings** - unlike other capital charges, these are being applied in DEL as we already have experience in controlling them as part of running cost controls. So this will increase the resource DEL for many departments, to varying degrees;
 - C for larger **arms length bodies** (non-departmental public bodies or NDPBs) for example, the Legal Services Commission, we score full resource consumption and full capital investment, rather than grants paid to the body;
 - C for **public corporations and trading funds** (other than a small number of self financing public corporations such as the Post Office, which score in AME), we score profit or loss, subsidy, and capital investment rather than loans and grants as at present, thus better reflecting the full public spending consequences of these bodies.

Example - The Ministry of Defence

17. The Ministry of Defence is an example of a department where the numbers change significantly under resource budgeting. The table below shows the cash numbers for the Ministry of Defence

for 2001-02 - the baseline year for the review - as published in April's *Public Expenditure Statistical Analysis*, and compares these numbers with their treatment under resource budgeting:

Table 1 - Comparing cash and resource based DELs for MoD

£ million	2001-02 cash	2001-02 resource
Current/Resource DEL	21,441	18,072
Capital DEL	1,550	5,105
Total DEL	22,991	23,177

18. The conversion process from cash to resource for both current and capital expenditure is explained in the two tables below. On the current side:

Table 2 - Converting MoD's current spending into resource terms

Current DEL cash to Resource DEL		
Note	£ million	2001-02
	Current DEL - cash starting point	21,441
a	+/- timing adjustments	134
b	+/- changes in current/capital classification	-3,467
c	+ capital charges on the civil estate	0
d	+/- full resource consumption of arms length bodies (NDPBs)	0
e	+/- full resource consumption of public corporations	-35
	= Resource DEL	18,072

Notes

- a. This reflects overall movements in the level of debtors, creditors and stock consumption in the year in question.
- b. National accounts treat spending on fighting equipment as current spending, on the grounds that this spending does not represent an addition to the capital base. But under resource budgeting, we are treating this expenditure as capital expenditure, which is a better way of ensuring that what the Department spends on current

expenditure and what it spends on equipment are kept separate. The change represents a switch of some £3.5 billion from the resource to the capital budget in 2001-02.

- c. The MoD does not have civil estate holdings. However, for most departments this line will lead to a small increase in Resource DEL.
- d. As with many departments, the net effect of this line is zero. This can happen for one of two reasons. If an NDPB is entirely grant funded, measuring total resource consumption does not change the number. Or, as in the case of MoD NDPBs, the organisations are too small to affect the overall total. However, some NDPBs will fund consumption from cash reserves or from other sources - in this event, the Resource DEL will increase to reflect the full consumption of the body, not what has been paid to it in grants by the department.
- e. Profits of public corporations score as a credit in the resource budget, and losses as a cost. Previously, the interest and dividends paid by the body scored in the department's budget. So a higher profit than was due to be paid in dividends scores as a credit, as in this case, while a loss would hit the budget.

19. On the capital budget side, the reconciliation works as follows:

Table 3 - Converting MoD's capital spending into resource terms

Capital DEL cash to Capital DEL resource		
Note	£ million	2001-02
	Capital DEL - cash starting point	1,550
f	+/- changes in current/capital classification	3,467
g	+/- full capital expenditure of public corporations	98
	= Capital DEL in resource terms	5,105

- f. This line represents the switch from the resource to the current budget of fighting equipment - i.e. the reverse of note b.
- g. This reflects the addition to the MoD budget of capital expenditure by their public corporations financed from trading or other sources of income, rather than simply loans and grants from the department. Previously, this expenditure scored in the

accounting adjustments in AME.

Other changes to DEL numbers

20. For most departments, the numbers will not change as substantially as they do for the MoD. For example, the Department for Education and Employment's resource DEL increases by around £35m. This is accounted for by small timing adjustments, capital charges on the civil estate, and better scoring of the consumption of its subsidiary bodies like Remploy and the Student Loans Company. The capital DEL for the department is unchanged.
21. Some other significant changes to DEL numbers include:
 - C the Department of Health's capital DEL increases by around £1bn and the resource DEL decreases by the same amount, as a result of scoring NHS trusts' capital expenditure in the capital DEL. The old cash based system scored this expenditure as current spending when health care purchasers paid the money over to trusts;
 - C the Lord Chancellor's Department shows an increase of around £100m each year, reflecting the cost of capital charges on its substantial civil estate holdings;
 - C a number of departments show higher capital DEL numbers, because of the inclusion of the total capital expenditure of public corporations in the capital DEL. Previously, these had scored in the accounting adjustments in AME.
22. In the 2000 Spending Review, we will be publishing both cash and resource numbers for the years covered by the Comprehensive Spending Review (1999-2000 to 2001-02, the last year showing pre-2000 Spending Review additions totals). This will allow a direct comparison between the cash and resource totals for individual departments, and allow growth rates for the period covered by the two reviews to be calculated on a consistent basis.

New lines in Annually Managed Expenditure

23. part of the move to producing resource accounts, all departments have now produced balance sheets. This allow departments to calculate their asset base and use this to apply charges for depreciation and the cost of holding capital assets. And, when a department recognises a provision to meet future expenditure under agreed accounting policies, this is also recorded in the accounts. In the 2000 Spending Review, these non-cash costs score in resource budgets

in AME. The AME table in the Spending Review White Paper will set out these costs at an aggregate level.

The Fiscal Aggregates

24. The changes to the DEL numbers outlined above mean that the total DEL number published in Budget 2000 increases. For 2000-1, for example, total current spending in DEL decreases by some £4.3bn, whilst capital expenditure increases by £5.3 billion. This is because of classification switches from current to capital, timing effects, and the switch from AME to DEL of capital spending of public corporations.
25. So other things being equal, the increase in DEL since the budget as a result of the move to resource budgeting would be £1.0 billion. However, the change to resource budgeting does not mean any change to the fiscal aggregates. For the purpose of measuring compliance with the fiscal rules, Total Managed Expenditure will continue to be measured on a basis consistent with the internationally recognised national accounts. The fiscal rules already incorporate some resource concepts such as the inclusion of depreciation in measuring adherence to the golden rule. The consolidation of the RAB data - including both the increases in DEL and the new non-cash lines in AME - and the fiscal aggregates is made through balancing adjustments in AME. So Total Managed Expenditure remains unchanged.
26. A full reconciliation from DEL totals set out in cash in Budget 2000 and DEL totals under resource budgeting will be set out in a table in the statistical annex accompanying the 2000 Spending Review White Paper.