

PRE-ANNOUNCEMENT OF CHANGES TO THE PUBLIC EXPENDITURE BY COUNTRY AND REGION 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. This includes analyses of public spending by country and region, within a National Accounts framework.

2. In accordance with National Statistics protocol, this article gives prior notice of methodological changes to the analyses of public spending by country and region, to be published in Chapter 8 of PESA 2004 on 19th April 2004.

3. Most public expenditure in the UK is undertaken by UK government departments or by local authorities. A small proportion is undertaken by regional authorities, mainly the devolved administrations. Actual spending information is only routinely available on a regional basis for bodies organised on a regional basis, such as local authorities, the devolved administrations, health authorities and primary care trusts. In order to provide information on the split of expenditure by country and region, the Treasury asks the UK government departments to undertake an annual statistical exercise to apportion their historical outturn spending between countries and regions¹, for public spending that can be identified as benefiting the population of individual regions. The Treasury then collates departments' returns and combines these with the known spending of the regional bodies to produce the analyses of public expenditure by country and region that are then published in PESA each year.

4. These country and regional analyses are set within the framework of Total Expenditure on Services (TES), which is the spending aggregate that departments are asked to apportion between countries and regions. TES covers most expenditure by the public sector that is contained in Total Managed Expenditure (TME), which is the National Accounts based measure of total public spending.

5. This note follows an earlier note that was published on 17 March 2004, alongside the National Statistics update of the public spending by function series, which gave notice of methodological changes to the functional series, to be published in Chapter 3 of PESA 2004². That 17 March note provides relevant background information to this article in two key areas. First, it explained the concept of TES, which is used as the framework for both the functional series and the country and regional analyses. Second, it explained how TES and the functional series are going to change in PESA 2004, because of changes to base these analyses on definitions used in the international standard of Classifications of Functions of Government (COFOG). These changes to the functional series will carry through to the functional presentations of the analyses of public spending by country and region in Chapter 8 of PESA. The changes to TES will also affect the total size of the spending which is split by country and region. These changes are explained in the section later in this article on 'changes to identifiable and non-identifiable spending', which are terms explained below.

6. The country and regional analyses published in Chapter 8 of PESA 2004 will differ from those published in previous editions of PESA, because of the above changes to COFOG, and also because of further quality improvements following the McLean report.

¹ This country and regional analysis is based on the NUTS1 definitions of regions, where NUTS stands for 'Nomenclature of Units for Territorial Statistics,' which is the European classification of the regional breakdown of the EU's economic territory)

² 'Pre-announcement of changes to the public expenditure by function series to be published in Public Expenditure Statistical Analyses 2004', published on the HM Treasury public website at http://www.hm-treasury.gov.uk/economic_data_and_tools/national_statistics/natstat_index.cfm

QUALITY IMPROVEMENTS TO THE COUNTRY AND REGIONAL ANALYSES FOLLOWING THE McLEAN REPORT

7. The McLean report (entitled *'Identifying the flow of domestic and European expenditure into the English Regions'*) was published on the ODPM website³ in September 2003. This report presented the conclusions from a research project that had been commissioned by ODPM, with support from the Treasury and DEFRA, in which the research team, led by Professor McLean, had been asked to examine the quality of official data on government spending in the English regions and to identify methods that might be used to improve estimates of regional spending. This research was commissioned by ODPM, with support from HM Treasury and DEFRA, and represents an important contribution towards improving the evidence base for regional policy.

8. Professor McLean's research examined the methods and results of the regional spending statistics for 2000-01 published in PESA in 2002. The research identified various difficulties with departments' methods of apportioning historical outturn spending between regions and estimated that these difficulties affected some 12% of departments' returns underlying the statistics published in PESA 2002. It also found that the research had already directly contributed to producing better estimates in PESA 2003. The report made ten recommendations aimed at improving the recording of regional spending data.

9. Following the publication of Professor McLean's research report, the Treasury has reviewed methods and implemented changes, working with all the other government departments who supply these statistical breakdowns, in order to further improve the quality of the country and regional analyses published in PESA. This programme of change has implemented all the recommendations in the McLean report that referred to the PESA analyses, and introduced further reforms.

Basis of measurement of regional spending

10. One of the recommendations of the McLean report was that the Treasury and ONS should produce a joint memorandum on the rules for measuring regional expenditure under the alternative 'in' and 'for' methods (explained below), and publish it for consultation with users of National Statistics.

11. The Treasury and the ONS began work on this memorandum shortly after the McLean report was published, because the Treasury wanted to use this work to provide clearer guidance to departments on the methods that they should use to break down their spending by country and region, as part of the programme for improving the quality of these analyses for PESA 2004. Although this work was then used as the basis for improved guidance to departments, the need to start the country and regional analysis (CRA) data collection exercise in December 2003, for publication in PESA 2004, always meant that the consultation on this memorandum could not be completed in time to inform the CRA data collection exercise for PESA 2004. However responses from consultation on this memorandum can inform processes for PESA 2005 and beyond.

12. This joint Treasury and ONS memorandum has now been published as a National Statistics consultation document, at:

http://www.statistics.gov.uk/about/consultations/general_consultations/default.asp

The memorandum includes the actual guidance issued to departments for the PESA 2004 CRA data collection exercise, which is attached as an Annex to the memorandum. Users of National Statistics are invited to comment on the memorandum by the end of May 2004. Please see the contact details for comments at the end of this article.

³ Professor McLean's research report and the government's response to it are available on the ODPM website at: <http://www.local.odpm.gov.uk/research/expnder.htm>

13. As stated above, the memorandum aims to clarify the rules for measuring regional spending under the alternative 'in' and 'for' methods. The PESA analyses are based on the 'for' method, which measures which regions benefit for the spending, i.e. who the spending is for. Under this method, spending is analysed according to the regions where the primary recipients or beneficiaries of the spending are based. The alternative 'in' approach, in its most simple form, would analyse the spending according to the location of the region where the government departments that spend the money are based. Both methods have advantages and limitations. These are discussed in the memorandum. The memorandum also explains which approach has been used by the ONS and the Treasury in which context, and for what purpose.

Identifiable and non-identifiable spending

14. The limitation of the 'for' methodology, which is used to produce the country and regional analyses in Chapter 8 of PESA, is that, in PESA 2003, this only covered about 85 per cent of TES, and 80 per cent of TME. This is because only this amount of public spending can be identified as benefiting regions (this is termed 'identifiable' spending). The rest cannot be identified as benefiting individual regions because it is spent on services, such as defence, which benefit the UK as a whole. This residual spending that cannot be identified as benefiting individual regions is termed 'non-identifiable spending'. Non-identifiable spending can only be measured by region on an 'in' basis, and not on a 'for' basis.

Changes to identifiable spending (and the overall results of the country and regional analyses)

15. The overall amount of identifiable spending will change in the country and regional analyses presented in PESA 2004 for two reasons:

- i) the move to COFOG functions has increased spending included within the definition of TES, which in turn has increased both identifiable and non-identifiable spending;
- ii) the work done on the memorandum has clarified the definitions of identifiable and non-identifiable spending, so that the distinction between what is identifiable and what is not is now firmly rooted in National Accounts concepts. This has moved the boundary between identifiable and non-identifiable spending. Previously, the boundary was defined so that whole programmes of spending and in some cases all of the spending by some departments was treated as non-identifiable. Now, with these changes, spending is classified as identifiable or not according to its economic classification in National Accounts, its COFOG function, and any geographical boundaries within which it is delivered and consumed. This change has increased the number of departments that have some identifiable spending and expanded the scope of the CRA data collection, bringing several departments into the exercise for the first time. However, some whole functions are now classified as non-identifiable, and so there are switches in and out of identifiable spending.

The following paragraphs provide further details about each of these changes.

16. Under COFOG, the definition of TES has changed to include two new elements: net pension payments from unfunded public sector pensions schemes (which forms part of the Social Protection function), and public sector debt interest (which is distinguished as a separate function). Of these additions to TES, the net pension payments are classified as identifiable, because the spending benefits the regions where the recipients of the pension payments live. However the debt interest payments are classified as non-identifiable, because these payments benefit the UK as a whole, and cannot be identified as benefiting individual regions. So the COFOG changes increase both identifiable and non-identifiable spending.

17. Following the work done in the memorandum which clarified the rules for measuring regional spending on an 'in' and 'for' basis, the distinction between 'identifiable' and 'non-identifiable' spending is now defined as follows:

- all transfer payments (subsidies and grants) are now classified as identifiable spending;
- some of these transfer payments are paid to people or organisations which are outside the UK, and so the presentation of these analyses in PESA will change to show a new additional 'region' of 'outside the UK';
- the remaining non-transfer payments (including the associated capital spending), are split between services to individuals (eg schools), which are classified as identifiable spending, and collective services – i.e. services provided collectively to whole communities (eg tax collection). This split between services to individuals and collective services is done using COFOG functions, following guidance set out in ESA 95. (Further details are set out in the memorandum);
- the collective services (including the associated capital spending) are then split between collective services which are delivered and consumed locally, within the NUTS1 regional boundaries used for the regional analysis, and other collective services which are delivered on a national basis, or which are consumed by communities that are spread across the NUTS1 regional boundaries. Collective services that are delivered and consumed locally are classified as identifiable spending – eg support for broadcasting by the Welsh Fourth Channel authority. Collective services that are delivered or consumed on a national basis are classified as non-identifiable spending – eg environmental research.

Figure 1. How identifiable and non-identifiable spending will be defined in the country and regional analyses in PESA 2004.

<u>Transfers</u> (subsidies and grants, as defined in National Accounts)	<u>Spending other than transfers</u>		
IDENTIFIABLE	Services to individuals (and associated capital spending) IDENTIFIABLE		} Split } between } services } to } individuals } and } collective } services } as defined } in } ESA' 95, } using } COFOG } functions
	Collective services (and associated capital spending): split between:	Collective services delivered and consumed on a regional basis IDENTIFIABLE	

18. For each function, the following tables shows how the split of identifiable and non-identifiable spending in 2001-02 will change in PESA 2004, compared to the previous analyses in PESA 2003.

19. Figure 2 shows that, although the proportion of TES that is identifiable is smaller in PESA 2004 than in PESA 2003, TES now covers a higher proportion of TME than before, and therefore identifiable spending has increased, both absolutely and as a percentage of TME.

Figure 2. Changes to identifiable and non-identifiable spending, in 2001-02.

	Identifiable spending	Non-identifiable spending	Total Expenditure on Services (TES)	Total Managed Expenditure (TME)
Last year's PESA, £ billion	306	47	353	391
as % of TME	79%	12%	91%	
This year's PESA, £ billion	317	57	374	391
as % of TME	81%	15%	96%	

Figure 3. Identifiable and non-identifiable spending, by function, in 2001-02, as % of total expenditure on services

As defined for country and regional analyses in Chapter 8 of PESA 2004			As defined for country and regional analyses in Chapter 8 of PESA 2003		
Function (COFOG) ⁽¹⁾	UK Identifiable	Non-identifiable	Function	UK Identifiable	Non-identifiable
General public services	43	57	Miscellaneous expenditure	33	67
EU Transactions	0	100	Overseas services	0	100
International services	0	100	Defence	0	100
Debt interest	0	100	Law, order and protective services	100	0
Defence	0	100	Trade, industry, energy and employment	74	26
Public order and safety	81	19	Agriculture, fisheries, food and forestry	95	5
Enterprise and economic development	92	8	Roads and transport	100	0
Science and technology	63	37	Other environmental services	100	0
Employment policies	100	0	Housing	100	0
Agriculture, fisheries and forestry	98	2	Health and personal social services	100	0
Transport	98	2	Culture, Media and Sport	100	0
Environment protection	92	8	Education	100	0
Housing and community amenities	100	0	Social Protection	93	7
Health	99	1	Total	87	13
Recreation, culture and religion	97	3			
Education and training	100	0			
Social protection	99	1			
Total	85	15			

⁽¹⁾ Previously, the order of categories in the function series in PESA reflected government priorities. 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.

20. These changes to the definition of identifiable spending will increase the total of identifiable spending in all years, across the whole UK, and for some individual countries and regions. Measured identifiable spending may not increase equally for all countries and regions: this will depend on the regional distribution of the new elements, and the elements removed.

Quality improvements in central guidance and format and coverage of data collection

21. As explained above in paragraphs 11-12, the Treasury have improved the central guidance issued to departments, so that the guidance gives departments clearer instructions, and the methods are firmly based on National Accounts/ ESA definitions, and are consistent with ONS methods. The Treasury have also supplemented the guidance with examples of best practice in completing the CRA data collection returns.

22. Other central improvements in the data collection exercise are that:

- the Treasury has combined the previously separate data collection returns, so that departments are asked to provide the country and regional splits in one exercise, rather than two as before, and departments have been given more time to complete their returns. The presentation of the results will also be joined up: data for both the country and regional splits now covers 5 outturn years, and the data will be presented as one analysis of spending across the whole UK, split by NUTS1 regions;
- the Treasury has asked departments to provide more information on their sources of data for their regional splits, and their quality assurance processes.

23. The Treasury has also expanded the scope of the CRA data collection exercise to cover the employment (pay) costs component of non-identifiable spending. To the extent that departments have managed to provide these data, these will be presented in a new additional table in Chapter 8 of PESA 2004, separately from the main analyses of identifiable spending. This new information on the regional employment costs of departments' non-identifiable spending will differ from the main analyses in that it will be on an 'in' basis. These data have been collected as an important first step to try to improve the overall extent of the coverage of the country and regional analyses. Employment costs account for about 30 per cent of non-identifiable spending, and are the type of spending on which departments should most easily be able to provide additional regional information, reflecting the location where their staff are based.

Quality improvements in departments' methods of apportioning spending to regions

24. The Treasury has conducted a large campaign, working with departments, to improve departments' statistical methods of apportioning outturn data to regions, particularly in those areas where the McLean report had found problems with methods that departments had used in the 2002 regional data collection exercise. This campaign has implemented further recommendations from the McLean report, including:

- a series of seminars for departments, tailored to their requirements, to explain how these regional data are needed as an evidence base for regional policy, and to explain the methods which departments should use to achieve the required quality assurance;
- high level contacts with senior officials to raise the profile of this exercise in departments; to ask departments to provide quality assurance, and to ensure that departments make best use of the specialist expertise and information which is available across their department in making their inputs to this exercise. Departments were advised to appoint a senior manager to be in charge of the data compilation process, and advised in particular to involve statisticians to provide quality assurance on these statistical returns, which are part of National Statistics;
- departments have been told that they should use the NUTS1 definitions of regions;
- the Treasury statistics Head of Profession also wrote to other statistics Heads of Professions in the main departments, urging them to become involved and recommending Professor McLean's idea that Heads of Profession for Statistics should draw up a protocol for the collection and return of territorial and regional expenditure data for their department. However it is for individual departments as to whether or not they implement this idea.

25. As a result of this quality improvement campaign, several departments have reviewed their methods and made considerable improvements to the quality of their returns. Departments

such as the Departments for Education and Skills, and the Department for Food, Environment and Rural Affairs, who the McLean researchers criticised for using population statistics to estimate their regional spending in the 2002 regional analysis exercise, have now used specific data or relevant indicators which give far better estimates of which regions benefit. Departments have in some cases also made direct use of the specific suggestions for improving their regional splits that were contained in the detailed sections of the McLean report.

26. Where departments have changed their methods either to improve the quality of their returns, or as a result of the clearer Treasury central guidance on methods, then these changes may also change the overall results of the shares of regional spending. The results will be of better quality, and will reflect more accurately which countries and regions benefit from the spending for each of the last five years. However the results will not be directly comparable with results published in previous editions of PESA, because of these quality improvements.

Comments

27. If any users of National Statistics would like to comment on this article or on the associated memorandum or the revised presentations of regional statistics in PESA 2004, then they are invited to write to the PESA branch of the Public Service Delivery Analysis team in HM Treasury, at the address below.

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