

Setting the scene
2008



COMPTROLLER &
AUDITOR GENERAL

SECTION 1 ~ INTRODUCTION

1. In December 2007, I announced that I would be undertaking a review of expenditure by the States of Jersey. A copy of the announcement is attached as Appendix One. The purpose of this paper is to set the scene for that review.
2. The reasons for undertaking the review are related in part to what appear to be commonly held public beliefs about States expenditure. Many have said that:
 - the level of public expenditure has been badly controlled: that expenditure tends to rise to exhaust the income that is available.
 - money is wasted on administration: that administrative costs could be saved without affecting the services which are provided by the States.
 - there are too many public employees, they are paid too much and their pension arrangements are too generous.
3. Quite apart from establishing the facts on issues such as these, and establishing to what extent the States may reduce its expenditure (and the effect that this may have upon the States' services), the review is intended to assess the effectiveness of the States' arrangements for controlling expenditure. This will be important, not just for maximising efficiency and avoiding waste, but also for ensuring that the States is best able to meet the challenges that were recently described in the working papers that accompanied the States' consultation paper on population policy.
4. To set the scene for the review, this paper asks:
 - (1) what is States' expenditure: i.e. how is it defined.
 - (2) how has States' expenditure grown?
 - (3) what is it spent on?
 - (4) how should the success of States' spending be measured?
 - (5) can spending by the States be compared with spending in other places?

The paper concludes by describing the arrangements for the Spending Review.

WHAT IS STATES' EXPENDITURE?

Introduction

5. States' expenditure is defined in many different ways for different purposes. For some definitions income is deducted. For other definitions, income is excluded. For yet other definitions, certain categories of expenditure are excluded.
6. Thus before reviewing States' expenditure, it is important to identify precisely what it is that is to be reviewed; and that is the purpose of the following paragraphs. The principal terms which are used are:
 - (1) Net Revenue Expenditure (NRE);
 - (2) Gross Revenue Expenditure (GRE);
 - (3) Total Expenditure (TE); and
 - (4) General Government Expenditure (GGE).

Net Revenue Expenditure

7. The expenditure which is authorised annually by the States Assembly on the basis of the Annual Business Plan is called: 'Net Revenue Expenditure' (NRE).
8. It is 'Net' expenditure because it is stated after deducting income from charges made for services provided. It is 'Revenue' expenditure in so far as it excludes capital expenditure: ie expenditure on the acquisition of fixed assets.
9. Although this expenditure is approved by the States Assembly each year for the following year; in that year, States' Departments may be entitled to exceed the amounts approved if the Council of Ministers authorises Departments to carry forward an unspent approved budget from one year to another. To this extent, a Department may exceed its authorised NRE in a particular year, although there will not be an overspend against the total authorised by the States when the years are taken together.

Gross Revenue Expenditure

10. Gross Revenue Expenditure (GRE) is calculated by adding back the charges and income deducted in calculating NRE. Like NRE, GRE also excludes capital expenditure.

States Total Expenditure

11. The States' Total Expenditure (TE) is calculated by adding to GRE a number of categories of expenditure:
 - (1) expenditure incurred by 'separately constituted funds' such as the Criminal Offences Confiscation Fund;
 - (2) expenditure incurred by Trading Funds such as Harbours and the Airport; and
 - (3) capital expenditure.

12. Capital expenditure is expressly approved by the States Assembly when approving the Annual Business Plan. Otherwise, all of the heads of expenditure listed above fall outside the Assembly's formal approval.

General Government Expenditure

13. For the purpose of most international comparisons, the total of a government's expenditure (ie General Government Expenditure or GGE) would include not only TE as it is defined above but also Social Security expenditure and local authority expenditure. For the purpose of this paper, GGE is calculated by making the following adjustments to TE:

- (1) deducting capital expenditure and substituting an estimate of depreciation¹;
- (2) adding an estimate of parish expenditure²;
- (3) adding Social Security expenditure to TE; and
- (4) deducting the States' contribution to the Social Security funds.

How much is spent?

14. To demonstrate how these various definitions of States expenditure relate to each other, the totals of each for the past ten years are set out in Table One below. It should be noted however, that as calculation of GGE involves a degree of estimation, the figures for GGE in the table are subject to a greater margin of error than other figures in the table and may be subject to revision as the underlying data is better refined.

¹ It is necessary to use an estimate as the States' normal accounting system has not normally calculated charges for depreciation.

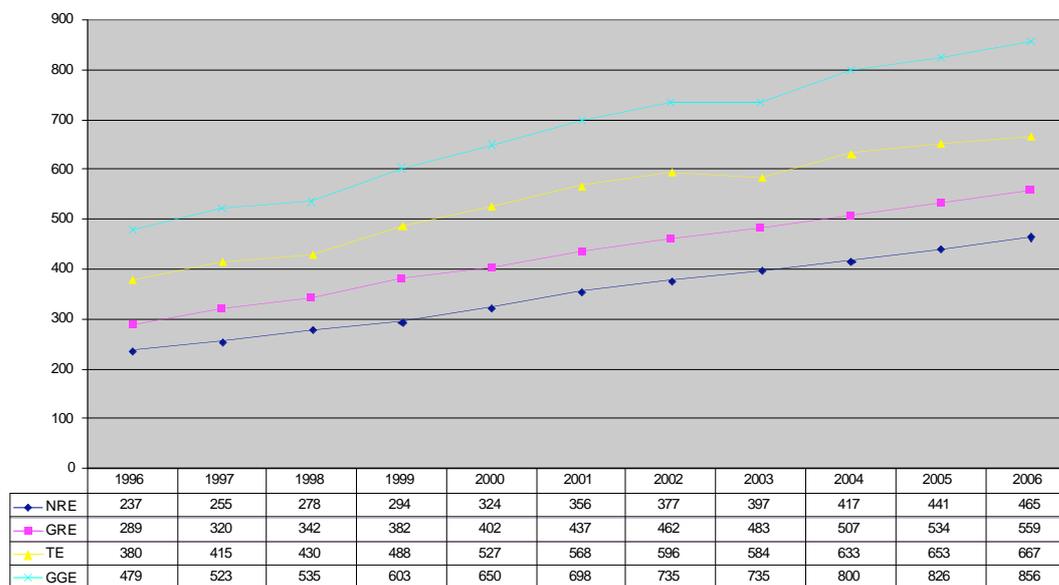
² It is necessary to use an estimate as records of the total amount of parish expenditure have not been collected routinely.

HOW HAS STATES' EXPENDITURE GROWN?

Introduction

15. In the following paragraphs, I will set out, as straightforwardly as possible, the available information concerning the rate of growth in States' expenditure taking each of the main definitions in turn. In each case, I will set out the information in the form of graphs and will then add observations on the patterns shown by each graph.

TABLE ONE: VARIOUS DEFINITIONS OF STATES' EXPENDITURE 1996-2006 (£ million)



Gross Revenue Expenditure

16. The actual GRE for the last ten years is shown in Table Two below. Table Three shows the percentage of GRE which was recovered by the States in the form of direct charges:

TABLE TWO: STATES' GROSS REVENUE EXPENDITURE 1996-2006 (£ million)

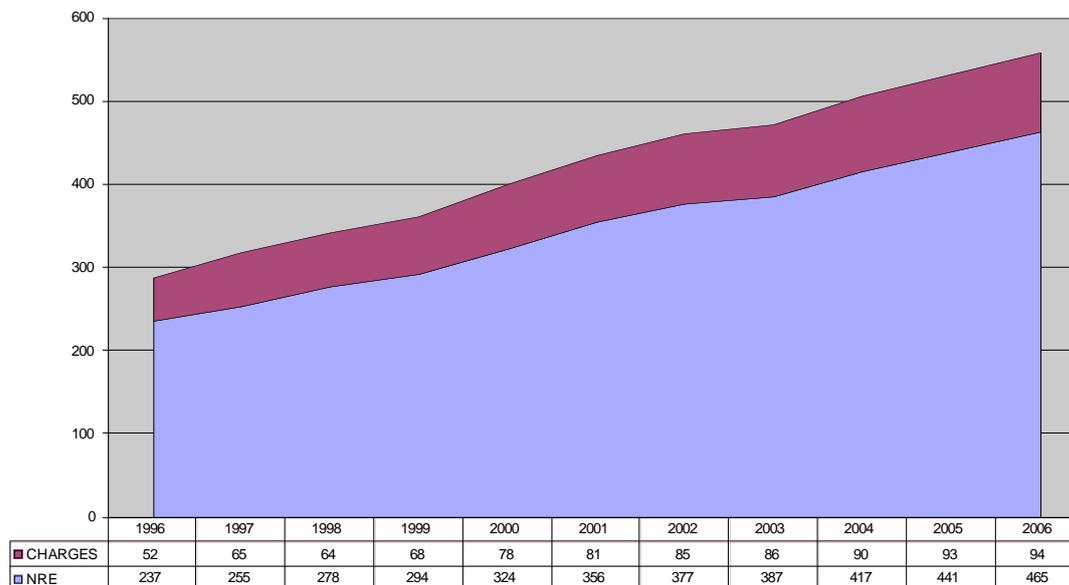
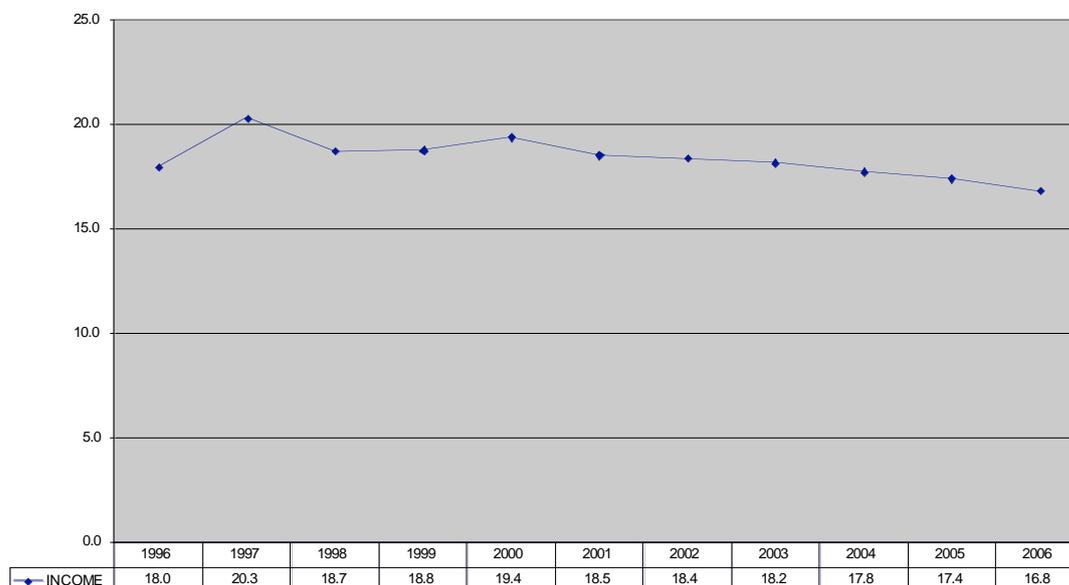


TABLE THREE: PERCENTAGE OF INCOME INCLUDING CHARGES SET AGAINST GRE (%)



Observations:

It is sometimes suggested that the States has attempted to conceal increases in expenditure by making direct charges for services. The patterns shown by these two graphs suggest that during the past ten years there has been no overall increase in the extent to which States expenditure is recovered by income including direct charges for the use of services.

17. As far as increases in expenditure are concerned, in all but one of the past ten years, GRE has increased by more than the annual increase in the Retail Prices Index (RPI). The annual increase in GRE by comparison with the annual increase in the RPI is shown in Table Four below:

TABLE FOUR: GRE AND RETAIL PRICES INDEX ~ ANNUAL %AGE INCREASE 1996-2006



Observations:

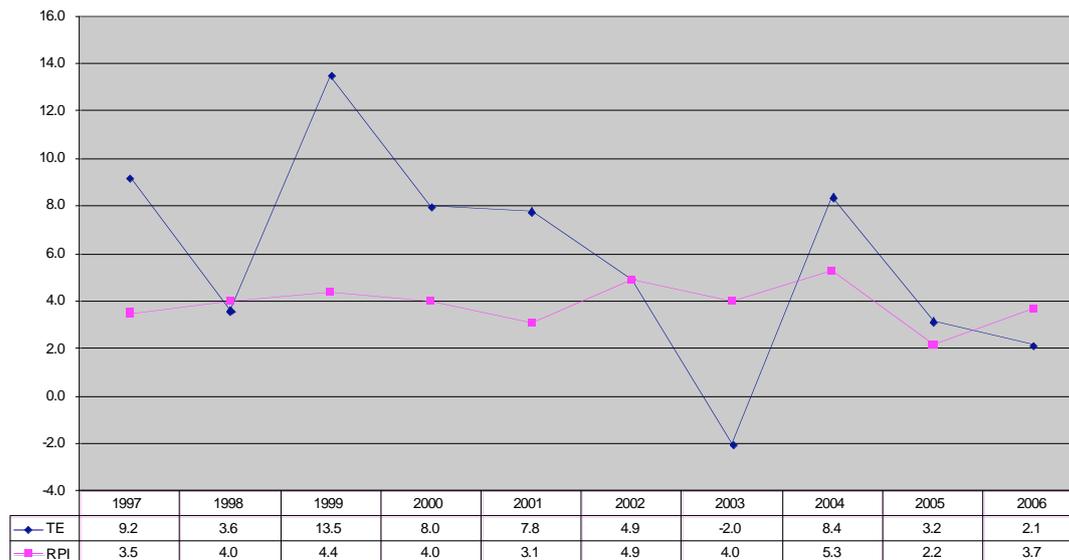
The pattern shown by this graph is consistent with increasing control of public expenditure having the effect of reducing the extent to which public expenditure increases faster than the RPI. The impression is reinforced by the fact that the cost of employing people represents the largest single category of cost incurred by the States. Since 2000, the annual increase in average earnings in the Island has often exceeded the increase in the RPI thus increasing the difficulty of restraining the growth in public expenditure to growth in the RPI.

	2000	2001	2002	2003	2004	2005	2006
RPI	4.0%	3.1%	4.9%	4.0%	5.3%	2.2%	3.7%
Earnings	5.5%	8.1%	4.2%	4.7%	3.3%	5.3%	3.3%

States' Total Expenditure

18. During the past decade, in most years the increase in TE has exceeded the annual increase in the RPI as shown in Table Five below:

**TABLE FIVE: ANNUAL %AGE INCREASES IN TOTAL EXPENDITURE AND RETAIL PRICES INDEX
1996-2006 (%)**



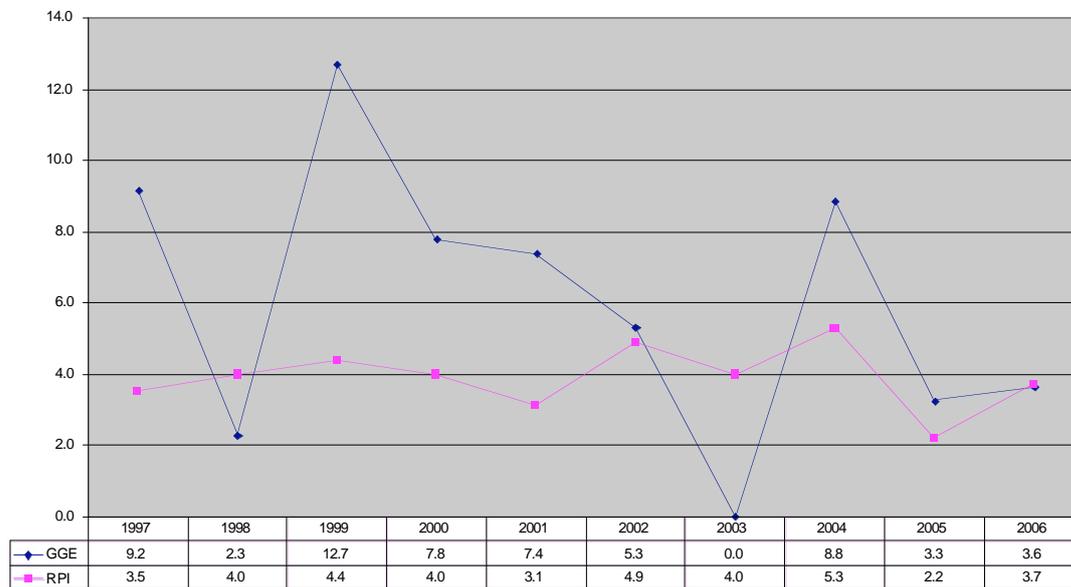
Observations:

As one might expect, the pattern of annual increases in TE matches the pattern of annual increases in GRE.

General Government Expenditure

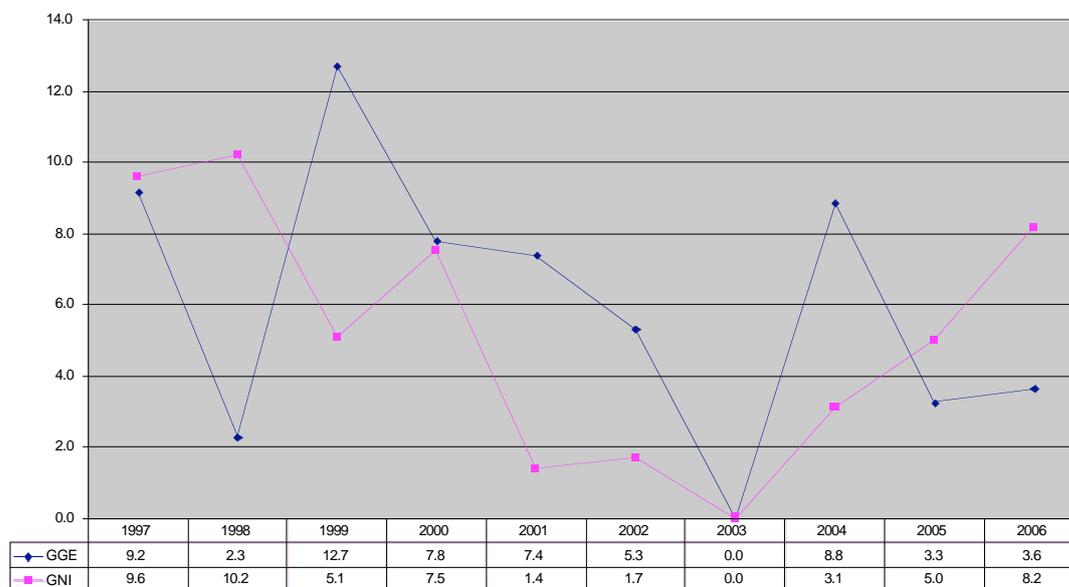
19. As I have explained, GGE is calculated by making a number of adjustments to TE including adjustments to include the net cost of social security payments, the cost of using capital assets and parish expenditure. The purpose of calculating GGE is to produce a measure of public spending that is consistent with OECD definitions and which can then be used for making international comparisons.
20. The annual increase in GGE can also be compared with the annual increase in the retail Prices Index. This comparison is shown in Table Six below:

TABLE SIX: ANNUAL PERCENTAGE INCREASES IN GGE AND RPI



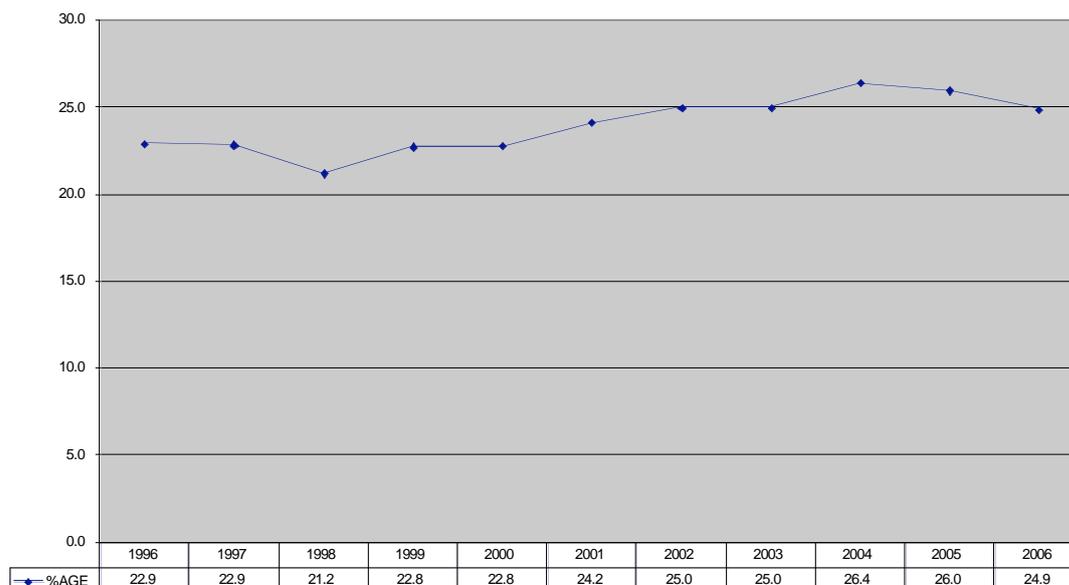
21. Changes in GGE and the Island's Gross National Income (GNI) are shown in Table Seven below:

TABLE SEVEN: ANNUAL PERCENTAGE CHANGES IN GGE AND GNI 1996-1006



22. Expressed as a percentage of the Island's Gross National Income, the movements in GGE during the past decade are shown in Table Eight below:

TABLE EIGHT: GGE AS A PERCENTAGE OF GNI



Observations:

The pattern shown by Table Six comparing changes in GGE and RPI are similar to those shown in earlier comparisons of GRE and TE with RPI.

Table Seven shows the relationship between growth in GNI and GGE. The graph is consistent with:

- (1) growth in public expenditure having been constrained when growth in GNI was slowing or non-existent although public expenditure declined later or more slowly than GNI; and*
- (2) growth in public expenditure being less constrained when GNI began to grow again.*

WHAT IS IT SPENT ON?

Introduction

23. If knowing how much is spent by the States is not straightforward, knowing what money is spent on is also challenging. It ought to be possible to answer two questions:

- (1) what is purchased by the expenditure?
- (2) what is the purpose of each unit of expenditure?

What is purchased?

24. The annual accounts of the States report what is purchased by the States' expenditure. However, separate analyses are published for each of the definitions of overall expenditure and the resulting information is difficult to combine.

25. The following table sets out an analysis of what was purchased by Gross Revenue Expenditure. The table below sets out only the largest items of expenditure. This analysis is taken from the annual accounts of the States for the four years 2003 to 2006.

26. I have not been able to prepare a similar analysis for earlier years because the States' accounts did not set out the equivalent information in an accessible form.

TABLE NINE: ANALYSIS OF GROSS REVENUE EXPENDITURE

	<i>2006</i>	<i>2005</i>	<i>2004</i>	<i>2003</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
States' staff costs: salaries and wages	218.5	210.4		
States' staff costs: pension	24.6	25.8		
States' staff costs: social security	11.7	11.2		
	254.8	247.4	234.3	225.3
Supplies and services	70.7	65.5	63.0	59.1
Administrative costs	19.6	18.0	15.0	13.6
Premises and maintenance	44.6	41.9	43.1	39.5
Contribution to social security funds	57.8	51.9	52.0	51.0
Community benefits	35.0	25.8	24.0	22.8
Other grants	24.0	18.7	20.4	19.7
Housing rent abatements	15.2	16.1	16.2	16.3
Student grants	10.0	10.0	9.1	7.5
PECRS pre-1987 debt	5.2	-	-	-
Other	22.7	36.2	28.0	27.5
TOTALS	559.6	531.5	505.1	482.3

Observations:

This analysis shows in 2006 £84 million of the States' expenditure was paid as direct support for people (eg housing rent abatements or student grants) or other organisations (eg other grants or community benefits) and £57.8 million was paid to the Social Security funds to support future direct payments to individuals. The balance of £417.6 million was spent on providing services (eg schools, hospital, roads etc), administration and the other functions of government. It was spent on:

- *staff costs;*
- *premises and maintenance;*
- *administrative costs; and*
- *supplies and services.*

These categories can be misleading however since they are broad but not all-encompassing:

- *Staff costs include the costs of hospital staff and teachers as well as administrators.*
- *Premises include the hospital and schools as well as Cyril Le Marquand House.*
- *The benefits shown in the above table do not include the Social Security benefits which are paid from the separate Social Security Funds.*

The effect is that this published analysis is not a good basis on which to analyse the States' costs.

However, subject to this warning, if reductions in costs are to be achieved it is inevitable that these principal categories of cost must be re-examined.

What is the purpose of States' expenditure?

27. The States' annual accounts do not provide an overall analysis of expenditure by reference to the purpose for which expenditure was incurred. However, the accounts are accompanied by departmental reports each of which analyses the department's expenditure by reference to individual services. For example, the service analysis provided by the Department for Education Sport & Culture sets out the costs of the following principal services:

- Non fee-paying provided schools.
- Fee-paying schools.
- Further vocational and tertiary education.
- Special education needs and special schools.
- Public libraries.
- Youth service.
- Higher education (student finance).
- Instrumental music services.
- Child care support.
- Heritage (grant to the JHT).
- Arts (including grant to the JAT).
- Sports centres.
- Playing fields and schools sports.
- Sport development and advisory council.
- Community fund.
- Play schemes and outdoor education.

28. In other words, it is possible to find in the States' annual financial accounts, analyses of the purposes for which each Department's expenditure was incurred.

HOW SHOULD THE SUCCESS OF STATES' SPENDING BE MEASURED?

Introduction

29. Many people seem to think the answer to this question is obvious: governments spend money to provide services. Front-line services should have users. To measure their success in providing services, one should ask the users of the services. The difficulty with this answer is that it can be misleading because of the variety of services which governments exist to provide.

What governments exist to provide

30. The traditional 'services' of a state arise from the traditional definition of a state. They relate to the creation, defence and maintenance of the state: foreign relations, defence, the maintenance of order and the raising of taxes.
31. As time passed, states became involved in establishing the framework for a community by providing the infrastructure which it needs: roads, ports, canals, railways, power grids and so on.
32. More recently, states have tended to provide social services which do not arise from the definition of the state or the creation of an infrastructure: such as education and health care.
33. As the range of state activities increases, there is bound to be controversy at the boundaries over the addition of new activities.

Differences between types of service

34. The newer, social services are likely to be directed towards improving the position of individual 'users'. Often the purpose of these services can be defined in terms of a measurable improvement in the user's circumstances. The success of these services can be judged partly by measuring the improvement in users' circumstances and partly by consulting the views of users.
35. But even these services have a 'public' element. Some services may be provided as a demonstration of a community's social conscience. Others may be intended to increase economic advantage or to create a sustainable environment. Assessing a state's success in achieving this purpose is much more difficult.
36. The older 'services' may not be so easily judged.
37. For example, a state's function of managing foreign relations is not directed to any single user. It is even less obvious that success can be assessed objectively in the short term. How can one tell whether a state has managed its foreign affairs effectively?
38. Similarly, it is not clear how a state could measure with objectivity or conviction, its success or failure in providing a satisfactory network of roads. One can measure the spending on providing new roads or maintaining existing roads: it is more difficult to measure the success of that spending in providing a network of roads that enables a community to function successfully. Certainly there is no single user or group of users who can be consulted.

39. Another example is provided by the maintenance of law and order. It can become obvious that a state has failed to keep law and order: the community may become exercised because of egregious failures. But it is not so clear how one knows that law and order have been maintained. Would this amount to nothing more than an absence of public disquiet over failures?

Misconceptions

40. These difficulties cause problems: because they can lead to misconceptions about what a government does and how to assess its success in doing it.
41. The fact that some 'services' have measurable outcomes may lead people to undervalue 'services' for which there are no easily measurable outcomes. The fact that some people who provide 'front-line services' can see direct effects for what they do may lead others to undervalue the work of bureaucrats whose work has not such effects.
42. Yet the people who manage (for example) a state's foreign relations will be doing work without which it might not have been possible for the 'front-line' services to be provided. Disparaging these bureaucrats because the outcome of their work is difficult to assess would seem counter-productive.

Performance measurement

43. The difficulty of assessing success can be an excuse for a government not to try to measure its success consistently and to avoid publishing data that others can use as a basis for their assessment of its success. Yet measurement and the provision of information are necessary if a community is to form a balanced view of its government's activities
44. One of the purposes of the Spending Review will be to assess the States' effectiveness in measuring its performance.

CAN JERSEY'S SPENDING BE COMPARED WITH OTHER PLACES?

Introduction

45. The Island is not alone in needing to assess whether its public spending is well controlled and achieves the outcomes that are desired or planned. In many places, the process of assessment would be assisted by comparisons with financial and performance data about other authorities facing similar challenges and demands for service and, within the United Kingdom, with performance targets set by central government. The States' expenditure can also be assessed in this way, but the process is more complicated than at first it may seem.

Problems in benchmarking

46. There are several features of the Island's position that make comparisons difficult and potentially misleading:

- (1) there are few, if any, truly comparable authorities. The States of Jersey acts both as a central and local government authority. As such, its range of activities is much broader than those which would be attempted, for example, by a local authority on the mainland of the United Kingdom.
- (2) the Island's population is relatively small. As such, for many services the population is smaller than would be considered necessary elsewhere to maximise the efficiency of services or justify the creation of separate infrastructure and administrative structures.
- (3) the small population have to bear the overhead cost of creating a government structure which in many developed countries would be borne by a much larger population.
- (4) the Island is more remote than a mainland authority. As such, the Island is not able to depend upon the provision of timely support from neighbouring authorities. The result of this is that the Island has to consider maintaining reserves of equipment and material in order to deal with exceptional emergencies. In turn, this will have the effect of increasing the cost of the service involved.
- (5) although the Island uses the same currency as the mainland of the United Kingdom, there is evidence that the purchasing power of sterling on the Island is lower than on the mainland. The result of this is that unless allowance is made for the difference in purchasing power, the Island's services will appear more expensive than similar services provided by a mainland authority in the same manner.
- (6) the geographical separation of the Island makes recruitment of staff more problematic and potentially more expensive than for a mainland authority; especially for posts which require some experience of other authorities or qualifications for which no training course exists in the Island.
- (7) the limited recruitment market in the Island tends to lead to rapid inflation in earnings so that remuneration levels in the Island exceed those on the mainland of the UK.

47. Thus the mere fact that a comparison suggests that one of States' services is more expensive than the equivalent service provided by a mainland authority is not conclusive evidence that the States' management of its services is inefficient.

ORGANISATION OF THE SPENDING REVIEW

Terms of reference

48. The terms of reference for the overall review are set out in Appendix One.

Organisation of the review

49. The review will consist of a number of projects which will lead to an overall assessment of the review's outcome. Three types of project will be commissioned:

- (1) *reviews of the expenditure planning process for the States overall.*

The first of these reviews will examine the claims that in recent years the States has made cost reductions of the order of £35 million per year. A further review will examine the States' performance measuring and reporting processes.

- (2) *reviews of departmental expenditure planning and management.*

Projects will examine a small number of Departments responsible for the largest budgets: e.g. Health & Social Services, Education Sport & Culture and Home Affairs. A number of smaller Departments will also be examined.

- (3) *reviews of cross-cutting issues.*

Among other subjects, projects will examine: staff remuneration, the costs of pension arrangements for the States' staff, and the possibility of achieving cost reductions through out-sourcing.

Timetable

50. It is intended that, in accordance with my normal practice, the reports of individual projects will be published as they are completed. This should lead in due course to the publication of an overall report on the findings and recommendations of the review followed by a report on the process by which the States manages expenditure.

51. I expect that the first reports will be published by the end of January and will at least include reports on:

- (1) the States' claimed achievement of annual reductions of the order of £35 million.
- (2) the States' performance reporting practices.

52. It is anticipated that the review will be substantially complete by the late spring of 2008 although the planned report on the process by which the States manages expenditure may not be available until the summer of 2008.

APPENDIX ONE ~ TERMS OF REFERENCE FOR THE SPENDING REVIEW

1. The purpose of this paper is to set out the terms of reference for an overall review of States' spending.

Background

2. This review is commissioned in accordance with the powers of the Comptroller & Auditor General as set out in the Public Finances (Jersey) Law 2005 in the light of:
 - (1) the debate on the 2008 Business Plan in the States Assembly and the withdrawn amendment to reduce voted expenditure for 2008;
 - (2) public debate on the level of States' expenditure in the light of the introduction of a Goods and Services Tax and proposed deficits in future years; and
 - (3) work to identify potential savings which was undertaken by the Chief Minister's Department with the agreement of the Chief Minister and the Council of Ministers.

Review

3. The purpose of the review is to examine:
 - (1) the process by which the States manages its overall expenditure;
 - (2) whether the States consistently and rigorously identify and prioritise potential expenditure savings;
 - (3) whether all reasonable savings have been identified together with the issues that have to be confronted in achieving those savings;
 - (3) all issues relating to the possibility of restraining the growth of States expenditure, not subject to any limit or restriction;
 - (4) whether there is evidence that the States' financial management systems are insufficiently robust to permit proper control of expenditure and to permit identification of opportunities for expenditure reductions;
 - (6) whether, in appropriate circumstances, the States have considered alternative means of service provision and whether a decision has been reached on the basis of sound principles; and
 - (7) any other detailed matters that appear relevant to items (1) to (6) above.

The Report

3. The outcome of the review will be a report prepared and published in accordance with the provisions of the Public Finances (Jersey) Law 2005 and including such recommendations as appear appropriate.
4. The factual content of the report of the review will be confirmed with those officials whose advice and information has contributed to the review.



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