

Budgeting and Governing for Deficit Reduction in the UK Public Sector: Act Two ‘The Budget’

Abstract

At the time of the 2010 General Election in the UK, all of the major political parties agreed that tackling the deficit was a priority. However, the affectivity towards this objective and rules were not agreed upon in terms of the timing and depth of necessary spending cuts. Nonetheless, within a year of taking office after the election, the Coalition Government of Conservatives and Liberal Democrats set out a series of policies and initiatives at three junctures: the June 2010 “emergency” Budget, the October 2010 Spending Review and the March 2011 Budget.

The emergency Budget acted as a prologue for a more comprehensive programme of reductions in public spending. The Spending Review later that year set out the framework for further cuts over the medium term, and it can be considered as ‘Act One’ in Budgeting and Governing. ‘Act Two’ was the March 2011 Budget, which announced a further series of initiatives to reduce the public deficit and stimulate private sector growth.

The purpose of this paper is to briefly consider how the annual Budget process for resource allocation took place within the medium term planning framework of the Spending Review and the context of uncertain conditions. Therefore it considers ‘Act Two’ in the wider context of Act One, and finds that whilst the Spending Review provides a veneer of stability, changes to both departmental expenditure limits and annually managed expenditure within the Budget shift the underlying accounting measures of what is transparently being accomplished. The broader finding is therefore that annual Budgets are not constrained within the Spending Review framework, but are instead enablers of changing circumstances.

Key Words: Budget, Enabling Control, Governing, Public Sector; Government and Non-Profit; Financial Crisis; Deficit Reduction

50-word summary

This article shows how the UK Government was able to announce policies in its 2011 annual Budget and associated processes that sat outside the 2010 Spending Review framework. It therefore shows that the Budget process remains an enabler of changing circumstances and is not constrained by medium term financial planning.

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Introduction

This article analyses how the political theory of budgeting is being applied to the national budgeting process in the UK. It considers specifically how changes occur through the annual Budget within the Government's Spending Review framework, using a conceptual approach based on political theory of budgeting as a practice. As the context used is very current, an explanatory study methodology has been employed for this initial article.

For the purpose of this paper, Budgeting and Governing as practice in the UK public sector can be regarded as three acts:

- Act One is the Spending Review that sets out a framework for expenditure levels over the medium term as part of multi-year planning (Ferry and Eckersley, 2011).
- Act Two is the annual Budget that provides more detailed policy choices with resulting financial impacts and implications.
- Act Three is the Audit / Post-implementation Review.

In times of uncertainty, which may follow major changes in the wider political or financial environment, there may also be a prologue to these acts in the form of an "Emergency" Budget. This occurred in the UK after the Coalition Government took office in the spring of 2010.

Multi-year planning alongside annual Budgets has been theoretically considered (Wildavsky, 1964, 1975, 1988), proposed globally (Schick, 2009) and adopted in the UK since the mid-1990s (Hyndman *et al.* 2006). The Labour Government introduced the concept of the Comprehensive Spending Review to set the context for annual Budgets between 1997 and 2010 – a period of relative economic certainty until the financial crisis began in 2008. From 2010 onwards the Coalition Government also employed a Spending Review with annual Budgets, although this was during a period of economic uncertainty.

The Coalition's Spending Review, like its forerunners from the Labour Government, is considered to provide a stable framework within which Government can plan, construct and implement (in other words constrain) the annual Budget. However, it is the contention of this

paper that the Spending Review is an external legitimization of stability that can be decoupled from the annual Budget. In fact, the uses and processes within the Budget enable flexibility in policy implementation that does not break the veneer of certainty afforded by the Spending Review. This is because the Budget can make changes to policy, such as through the use of entitlements and transfer of roles to non-state actors, whilst remaining within the Spending Review's boundaries.

This article focuses on Act Two – in particular how the annual Budget takes place within the medium term planning framework of the Spending Review. In this case, it will be specifically considered within the context of uncertain conditions. To do so the paper will briefly review literature on public sector budgeting and governing, before considering the UK Government's 2010 Spending Review and its March 2011 Budget.

Public Sector Budgeting and Governing

This article draws on a theoretical framework that has been developed from the public administration aspects of political theory and from public sector accountancy (Wildavsky, 1964, 1975, 1988). It employs this as a conceptual frame of reference, together with practices (Schatzki, 2002, 2005, 2010; Ahrens and Chapman, 2007) that constitute rules, teleoaffective structures of objectives and affectivity towards them, and understandings to consider how political budget theory is being applied to the national budgeting process in the UK.

The most important body of political theory was the seminal work of Wildavsky (1964, 1975, and 1988) on the practice and politics of comparative budgeting in public sector organisations and the associated concepts of political and budgetary incrementalism (Wildavsky and Hammond, 1965; Wildavsky, 1978), as well as the private government of public money (Heclo and Wildavsky, 1974). Wildavsky (1978) initially defended annual incremental budgeting as a way to govern in both times of growth and austerity, but later abandoned this position in light of the changing political environment (Wildavsky, 1988). He observed in the USA that much government expenditure now escaped annual review, because 46% of the Federal Budget was spent on entitlements, 28% on defence and 14% on debt interest. Consequently, much of the annual Budget fights were about the small proportion (12%) that remained. More rational budget approaches were therefore considered, including zero-based budgeting, planned programme budgeting systems and priority-based budgeting, each of

which have their own advantages and disadvantages. The UK has experienced a similar movement in the make-up of public spending all be it to different levels, and employed a number of these budget methods at different times and to various extents (see Coombs and Jenkins, 2001; Jones and Pendlebury, 2010; Prowle, 2009; Seal and Ball, 2006 for a discussion).

Nonetheless, all of these variations keep to the basic principle of annual Budgets. In their exploratory study of annuality in public budgeting, Hyndman *et al.* (2006) found it to be a widespread phenomenon. 'Annuity' refers to the way in which Budget allocations have to be spent by the end of a financial year or be surrendered to a central authority or budget-holder. Whilst there are certain benefits of annuality for those at the centre of an organisation who wish to impose traditional central control, it is argued that it can lead to dysfunctional spending behaviour that is uneconomical, inefficient and ineffective and can therefore fail to provide value for money.

To try and overcome these problems, medium term financial plans have become common accounting practice, and they normally sit alongside the annual Budget in public administration (Schick, 2009). This has the advantage of allowing longer term planning than is possible under a system of annual authorisations and gives greater flexibility at the centralised control level of government departments. In the UK central government context, the Spending Review provides the medium term framework to manage the strategic reform of public expenditure control, usually over a three or four year-period. It also sets the context for policy development through associated performance management arrangements such as the Public Service Agreements that were introduced by the Labour Government in 1997 (Rhodes, 2011). The annual Budget process deals with politics and resource allocations within the overall Spending Review framework, but at a more nuanced level (Hyndman *et al.* 2006).

These concepts of political theory have often been linked in accounting research to other research ideas and in particular neo-institutional theory. For example, Hopwood (1984) suggested accounting's role in the public sector reflected Foucauldian ideas of discipline and visibility but also made an explicit link to institutional theory (Meyer and Rowan, 1977; Meyer, 1979). Covalleski *et al.* (1993), calling on institutional theory (Meyer and Rowan, 1977; Di Maggio and Powell, 1983), highlight the importance of organisations conforming to societal standards and norms of expected practice in order to derive legitimacy. To do so,

institutions tend to decouple external image systems from the more complex and ambiguous practices and processes through which organisational members carry out their tasks. Public sector organisations must therefore create, maintain and manage legitimacy in order to receive continued support and maintain their funding (Bealing, 1994), even if the accounting systems operate as a “myth”, legitimating the actions of the service to the major elements of its external controlling environment (Lapsley, 1994).

Drawing from neo-institutional, organisational and political theory, Brunsson (1995), Edwards *et al.* (1995) and Pettersen (1995) highlight the functionalism of budgets, but also their role in generating legitimacy and the importance of following rules, values and rationalised myth. Covalski and Dirsmith (1995) emphasise the need to understand the power and self-interest that reside within the various exemplars of formal organisations. From this Johnsen (1999) argued that decoupled or loosely coupled implementation processes may serve instrumental purposes rather than merely symbolic purposes, fashion or legitimisation. Central themes of neo-institutionalism remain isomorphism and legitimacy (Gomes *et al.* 2008; Kasperskaya, 2008). However, some authors have sought to expand the engagement with broader neo-institutional theory literature (Tolbert, 1995; Oliver, 1997; Modell *et al.* 2007). There has also been some effort to supplement the macro focus of neo-institutionalism with micro levels of analysis (Ezzamel *et al.* 2007; Modell, 2006). The trend of blending a neo-institutional approach with other theoretical perspectives also continues (Nor-Aziah and Scapens, 2007; Hopper and Major, 2007).

Seal (1999), through an institutionalist interpretation of the new public management in UK local government, illustrated the role of accounting in compulsory competitive tendering that created a form of contract governance. He also illustrated the modernity, modernisation and deinstitutionalisation of incremental budgeting in local government through the introduction and use of the Best Value performance management framework (Seal 2003). Seal and Ball (2005) considered regulating corporate performance and the managerialisation of local politics and illustrated the impact of policy innovations on traditional budgeting practices (Seal and Ball 2006). They showed local authorities developed long and medium term plans intended to indicate the councils’ priorities and guide long-term financial strategies, and developed new reporting systems that not only picked up the traditional budgetary variances but also monitored non-financial performance.

More recently, Seal and Ball (2011) developed a dialectic of control theoretical framework to explain turbulence in public sector budgeting. This was applied to fieldwork from two large UK local authorities with a crisis in education funding to explore the knowledge and intentionality of actors engaged in budgeting. They found that cognitive issues based around unreliability of cost and planning data were significant in tactical success for local budgeting. Central government, however, was able to exert power through its ability to change the rules, leading to new structures for public education provision. The dialectical framework avoids the reductionism and functionalism that characterises some of the budget gaming literature.

The issues of political budget theory are now considered in the context of recent announcements on National Budgeting and Governing in the UK, in relation to the three specific developments identified earlier.

Prologue: The Emergency Budget (June 2010)

As a prelude for what was to come, in June 2010 Chancellor of the Exchequer George Osborne gave an “emergency” Budget speech only six weeks after the Coalition Government came to power. This concentrated on highlighting the nature and level of public debt, the need for deficit reduction and set out a range of initial spending cuts that would total an additional £32bn per year by 2014-15. It also proposed how an extra £8bn would be raised by tax increases during this period – most notably by increasing the rate of Value Added Tax from 17.5% to 20% (HM Treasury 2010a).

Act One: The Spending Review (October 2010)

Following on from the Emergency Budget, the October 2010 Spending Review provided a framework for reducing public expenditure levels between 2011/12 and 2014/15. For example, an announcement of the grant funding that central government provides to English local authorities will be cut in real terms by an average of 7.25% over each of the next four years (HM Treasury, 2010b). Indeed, in terms of austerity measures, the Spending Review sets out the largest prolonged reductions in public spending since the 1920s, dwarfing Thatcherite attempts to hollow out the state nearly thirty years ago. After months of negotiations behind the scenes, some parts of Whitehall agreed to Budget cuts of approaching 30% between 2011 and 2015 (HM Treasury, 2010b; Ferry and Eckersley, 2011).

The previous Labour Government had made the first attempt at multi-year financial planning through its Comprehensive Spending Reviews. However, these took place during a period of economic growth and relative stability, when revenues were comparatively predictable and it was therefore reasonably straightforward to propose how public money should be spent in the forthcoming years. The Coalition Government's 2010 Spending Review was the UK's first attempt at multi-year financial planning in a time of austerity. This is a much more difficult undertaking, since revenue streams from taxation are uncertain and spending plans therefore need to be flexible – and there is an overriding requirement to reduce the public deficit (Hood, 2010; Pollitt, 2010).

Act Two: The Budget (March 2011)

It is within this context that the March 2011 Budget has to be considered (HM Treasury, 2011). At first glance it appears that no significant changes were made to the Coalition Government's fiscal and spending plans in the Budget, because they were constrained by the framework of rules set out in the Spending Review. Following this line of argument, annual Budget speeches are now essentially tinkering exercises that try to keep the economy on track so that the Government can keep its commitments for the remainder of the Spending Review period. In that sense, Budget speeches are reminiscent of the old 'autumn statements' that Chancellors used to make: there might be the odd nugget of new policy amongst the rhetoric, but the important information is mostly about how the economy is performing and whether the levels of public revenues and spending are on target. In March 2011 significant announcements were unlikely for another reason: the Government was reluctant to further upset the financial markets by announcing major changes to its spending or fiscal policy.

This scenario may well have held true when the UK Government was able to bask in the stability provided by the long period of economic growth up to the 2008 financial crisis. However, closer analysis of the 2011 Budget suggests that the Government was not unduly constrained by the Spending Review: instead, it was able to use the Budget to react to emerging developments. One such development was the fact that the Office of Budget Responsibility downgraded its growth forecasts for the UK economy, meaning that the Government would need to borrow an additional £45bn over the next four years to make up

for lost revenues and fund additional benefits payments. The following examples illustrate how the Chancellor was able to make a number of significant announcements to try and address this issue. As a result, they show how the Spending Review framework gave Ministers a large degree of flexibility to make changes on an annual basis through the Budget.

A ‘Budget for Growth’?

A key objective of the Coalition Government has been to change the nature of the UK economy so that it relies more on exports and manufacturing, and less on the public sector, financial services and debt-fuelled spending. Aware that much of the public was becoming concerned about the Government’s focus on cutting public spending and that a sluggish economy growth would make it more difficult to reduce the deficit, Ministers promised a ‘Budget for Growth’ in the spring of 2011. As such, Mr Osborne announced various initiatives to try and stimulate private enterprise.

Central to this was a ‘Plan for Growth’ that was published alongside the Budget. This set out four aims for the economy:

- To create the most competitive tax system in the G20
- To make the UK the best place in Europe to start, finance and grow a business
- To encourage investment and exports as a route to a more balanced economy
- To create a more educated workforce that is the most flexible in Europe.

A number of reforms to rules were proposed to try and achieve these objectives. One area of significant change was in the planning system. Of particular interest was placing a new ‘duty to co-operate’ on Councils to work together to address planning issues that impact beyond local boundaries, such as transport, housing or infrastructure. In addition, there was relaxing of rules and reforms to stimulate the building of new homes that attempted to enable builders to construct new homes and initiatives to get more young people into work through ensuring provision of additional apprenticeship places, creating extra new university technical colleges, and introducing a new work experience scheme.

More importantly, although the Chancellor described the Budget as being ‘fiscally neutral’, he made a number of changes to the tax system that will continue into future years. These included increasing the personal allowance by a further £630 in April 2012, and indexing future increases in personal tax thresholds to the consumer price index rather than the retail price index. The latter is expected to reap more than £1bn a year in extra revenue for the Exchequer by 2015-16. There was also a drive to simplify the tax system, including consulting on merging income tax with national insurance and scrapping 43 different tax reliefs. Together with other reforms, such as the introduction of a carbon tax on the power sector, and proposing changes to the way in which poverty is measured, these examples demonstrate how the Spending Review framework provides the Chancellor with significant room for manoeuvre in annual Budgets.

Indeed, the Budget set out various proposals that would reform the budgeting process itself. These included changing rules for how the Spending Review is reported upon, which will have implications for the practical understanding of those involved in setting, steering and delivering public policy. Most noticeably, the Chancellor announced several changes to the Government’s own budgetary procedures – demonstrable proof that the annual Budget is not constrained by the Spending Review framework. For example, the End Year Flexibility system will be abolished and replaced by a new “Budget Exchange” scheme, which allows departments to surrender an under-spend in advance of the end of the financial year in return for a corresponding increase in their Budget in the following year. The accounting system that governs activity would therefore affect practice. He also reiterated his desire to strengthen control over Annually Managed Expenditure, by transferring some of it into Departmental Expenditure Limits. The Budget is therefore acting as a catalyst for revisiting the Spending Review, enabling policy change that will affect levels of spend across Departmental Expenditure Limits and Annually Managed Expenditure boundaries.

Conclusions

This paper has investigated whether the Spending Review provides a definitive framework that constrains the annual Budget, or whether the annual Budget provides a means for enabling and adaptability. It illustrated that the annuality of the Budget took place within the medium term planning framework of the Spending Review, but whilst the Spending Review provided a veneer of stability, the changes to rules through the annual Budget shift the

underlying accounting measures of what is transparently being accomplished. Annuality of the Budget therefore remains not constrained within the Spending Review, but is an enabler of changing circumstances.

Taken together, annual Budgets and multi-year Spending Reviews can therefore provide a balancing of stability and change during periods of deficit reduction. Indeed the annual Budget is not merely about Departmental Expenditure Limits but also Annually Managed Expenditure. Policy change initiated through the annual Budget can therefore use both classifications of expenditure for enabling an affordable, balanced and sustainable position to emerge that is reconcilable with the plans of the Spending Review. Far from the annuality of the Budget being constrained by the Spending Review, it actually has an effect on the rules, objectives and affectivity toward them that determine the practical intelligibility of what makes sense to do, enables practical understanding on how to do what makes sense to do to be made more common and shared, and has functionality through situated accounting mechanisms. As a result, the Budget enables change whilst maintaining the perceived stability of the Spending Review that affords it legitimacy. This does not just apply in the accounting sense of financial numbers, but also for citizens whose organisational, institutional and social lives are shaped by it.

Whether the 'Budget for Growth' will accomplish what it sets out to deliver remains uncertain. A number of other factors will also play an important role in any economic recovery, not least the Eurozone crisis, the level of interest rates and the price of oil. Various scenarios could occur, and so the Chancellor may at some point have to reveal a pre-existing Plan B or come up with an alternative strategy very quickly. However, as the paper has shown, he may be able to do this within the current Spending Review framework, as this does not necessarily constrain the annual Budget. In other words, a new Spending Review may not be required – even if the Government continues to struggle to reduce the deficit and economic growth remains sluggish.

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