



House of Commons
Education and Skills Committee

**Public Expenditure on
Education and Skills:
Government Response
to the Committee's
First Report of Session
2004–05**

**Third Special Report of Session
2004–05**

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The Education and Skills Committee

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Third Special Report

On 7 January 2005 the Education and Skills Committee published its First Report¹ of Session 2004–05, *Public Expenditure on Education and Skills*. On 8 March we received the Government's response to the Report. The response is reproduced as the Appendix to this Special Report.

Government response

The Select Committee's conclusions and recommendations are in bold text. The Government's response is in plain text.

Some of the conclusions and recommendations have been grouped for the purposes of the response

The effectiveness of increased expenditure on education and skills

1. The Government needs to take great care in making claims about the effectiveness of increased investment in education in increasing levels of achievement which the evidence cannot be proved to support.

The Government takes seriously the link between investment in education and higher achievement. Since 1997 there has been a much increased investment across the whole education sector. Expenditure in areas such as Sure Start and on new school buildings will not immediately impact on today's secondary school examination results, but will feed through into higher achievement in future years.

The difficulty in linking investment in education with examination results in a particular time period does not, however, undermine the case for that investment. The benefits to individuals and society of obtaining qualifications are substantial and are amongst the highest of those surveyed in the member countries of the Organisation for Economic Co-operation and Development (OECD).

For example the Department has calculated the financial return of obtaining A levels and degrees, balancing the costs of investment against the resulting flow of benefits over the working lifetime. The "social" rate of return for males, for example, which captures the costs and benefits of investment in education for the economy as a whole, is estimated at 6-8 per cent for a first degree and 15-21 per cent for 2+ A levels, well above HM Treasury's discount rate of 3.5 per cent, the threshold value for public sector investment.

The Government's *Five Year Strategy for Children and Learners*, published in July 2004 as Cm 6272, sets out a number of key reforms which will improve the performance of schools. In addition the Government's *14-19 Education and Skills White Paper*, published on 23 February 2005 as Cm 6476, sets out the future of curriculum and assessment for secondary

1 First Report from the Education and Skills Committee, Session 2003–04, *Public Expenditure: Schools' Funding* HC 112.

education. The proposed reforms will complement the Department's commitment to sustained investment in education and skills and help all individuals to improve and achieve higher levels of attainment.

2. Links between expenditure and outcome remain difficult to establish.

The Government accepts that the links between education expenditure and outcomes are difficult to establish. Providing evidence is made more complicated by:

- diminishing returns, meaning that it becomes progressively harder (and hence more expensive) to drive up attainment as the base level of attainment rises and
- time-lags associated with investment, which mean that benefits of today's investment in schools may take a number of years to be reflected in the attainment of 16 year olds.

The Final report of the Atkinson Review *The Measurement of Government Output and Productivity*, published on 31 January makes this clear. Talking about measuring government output it says in paragraph 2.15:

“It is important to recognise that there are lags between inputs and outputs, and that a marked increase in public spending, such as that which has taken place in recent years, may only show up in improved output indicators at a later date. This applies particularly to government output such as education and health.”

The Atkinson Review should be seen as the first step of a long-term process to improve the measures of government output and productivity. The Department has worked closely with the Atkinson Review team and is committed to furthering their aim of ensuring measures of the output of public services are as informative and robust as possible. But no single measure of output or productivity will ever fully capture the performance of complex public services such as education which produces multiple outputs and influences multiple outcomes. As paragraph 4.62 of the Atkinson Review says:

“The national accounts necessarily reduce productivity measurement to a single number, and this aggregate statistic may need to be supplemented by richer information.”

Schools' funding

3. The DfES reacted to perceptions of crisis rather than an actual widespread funding crisis, and in the solution that it has provided it has changed the nature of the funding allocation, the role of LEAs in education at the local level, and the role of the DfES.

4. Given the far reaching consequences of the changes introduced for 2004-05 and beyond, it concerns us that they were taken without the DfES having a full and accurate picture of the financial situation in schools across the country.

The Department does collect school level financial information twice a year: budget data at school level before the start of each financial year, and outturn data after the end of each financial year. Experience suggests that forecasts of expenditure between those two points are unlikely to be accurate: in 2003-04 we asked local authorities for forecasts of

expenditure which suggested that schools collectively were likely to use around two thirds of their balances during the course of the financial year, whereas outturn data show that in fact balances rose slightly. Requests for further in-year data would also be counter to the government's policy of reducing bureaucratic burdens on schools.

The Department agrees that the perceptions of schools and local authorities played an important role in the difficulties which arose in 2003-04. In light of that, as well as the genuine financial difficulties experienced by some schools, we believe it was right to take steps to restore confidence in the school funding system and give schools increased certainty and stability. The arrangements put in place for 2004-05 and 2005-06 have not involved radical reform but are designed to ensure that, within the existing architecture of the funding system, schools can have greater confidence that increases in funding intended for schools will reach them, and that every individual school will benefit from a minimum increase in their per pupil budget each year.

The new school funding arrangements which the government intends to introduce for 2006 and beyond are a key element in the Department's longer term strategy. The introduction of a ring-fenced grant to local authorities (the Dedicated Schools Grant) will enable three year budgets to be allocated to schools, based on the academic year, and will create a climate of stability and predictability. This in turn will open up greater opportunities for school leaders—heads and governors, supported by the local authority—to use funding more effectively and efficiently to achieve the best possible outcomes for all their pupils. Many headteachers have long argued the case for such a regime, and our proposals are strongly supported by both of the main headteacher associations. The introduction of the Dedicated Schools Grant is also a logical consequence of the government's policy that priority should be given to schools' funding, and in particular the "passporting" regime—under which authorities have been expected to pass the full increase in their Schools Formula Spending Share through to schools—which has been in place since 1999-2000. Consultation on these proposals began on 17 February and will run until 13 May.

The only change proposed in the roles of the Department and local authorities is that from 2006-07, the Department will be responsible for funding schools' core budgets through the Dedicated Schools Grant, paid to local authorities. Authorities will not be expected to add to this grant, but will remain free to do so if there is local support for such additional spending on schools. All that they will no longer be able to do is divert funding intended for schools to other services. Local authorities will remain responsible for the distribution of funding between schools in their areas using locally agreed funding formulae and subject to a minimum guaranteed per pupil increase each year for every school, as now.

Since these proposals will not directly affect the distribution of funds between schools, it is not necessary for the Department to know the financial position of every school. That is a matter for local authorities, who have freedom, for example, to target funding towards schools in financial difficulty outside their normal formulae and will remain responsible for supporting and promoting good financial management in their schools, including preventing excessive balances and deficits. The 51 authorities which received the lowest increases in resources for education between 2002-03 and 2004-05 are also receiving a two year package of transitional grant—worth £180 million in total—to help them to get

schools in financial difficulty back into balance. The introduction of three year budgets will also help all schools to plan ahead and avoid both deficits and unnecessarily large surpluses. Where schools do have existing deficits, three year budgets will help them to plan to eliminate those deficits over time.

5. The consequences of the problems with schools' funding in 2003-04 have been far-reaching. Given that the settlement for 2003-04 was distributed using a new funding formula, it is remarkable that within eighteen months the whole rationale for that original change, that the funding system needed to be fairer and more redistributive, has been abandoned in favour of a highly pragmatic near flat-rate system, with three year budgets being introduced in two years' time. This change has led to the loss of the LEAs' ability to make any executive decisions about schools' funding in their areas and will, we believe, inevitably lead to far greater involvement of the DfES in day-to-day management of the school system.

8. Given the school funding problems encountered in the spring of 2003, the risk to the Government of an ill-prepared or poorly-managed move to central funding could be profound.

The distribution formula introduced in 2003-04 is not being abandoned. The formula has been used for both the 2004-05 and 2005-06 settlements. The Department also intends to use the same formula—subject to some minor changes—to distribute the new Dedicated Schools Grant from 2006-07 (with transitional arrangements to ensure that schools in LEAs which have been spending above the Schools Formula Spending Share do not lose out). The proposals are to ring-fence that grant—to ensure that authorities cannot divert money intended for schools to other services—and require local authorities to give schools their budgets for up to three years ahead. Neither of those proposals requires a change in the distribution formula. Nor is there any reason why they should lead to greater involvement by the Department in the day to day management of the school system: local authorities will remain responsible for the distribution of funding between their schools according to local formulae and for the strategic management and quality assurance of the local school system.

The current system does not give schools flat rate increases in their budget shares, and nor will the new arrangements from 2006. Local authorities will remain responsible for determining a local formula for the distribution of funds to schools, in consultation with their Schools Forums. Budgets will not be fixed in cash terms for three years ahead but will be responsive to changes in pupil numbers; and we are currently consulting on the extent to which other changes in schools' circumstances should be taken into account in finalising budgets each year. The aim is to strike the right balance between giving schools greater certainty and stability on the one hand, and ensuring that budgets accurately reflect the circumstances of the year in question on the other.

It is true that the Minimum Funding Guarantee (MFG) ensures that schools receive a minimum per pupil increase each year: this means that any distributional change will happen gradually, rather than suddenly as happened in 2003. The number of schools which will need an additional allocation to bring them up to the level of the MFG, and the number which will receive increases above this minimum level as a result of the local formula, will vary according to the level at which the MFG is set: two thirds of schools

received increases above the level of the MFG in 2004-05. The consultation document seeks views on the level at which the MFG should be set in future: again, the aim is to strike the right balance between certainty and predictability for schools on the one hand and responsiveness to changing circumstances on the other.

The Government's proposal to introduce a new Dedicated Schools Grant to local authorities and three-year budgets for schools from April 2006 will not centralise school funding. Local authorities will continue to be responsible for the distribution of funding between the schools in their area.

6. It cannot be right to make far-reaching changes to the funding system for schools because of reported problems without quantifying those problems to see if change is merited, nor without understanding fully the nature of any failings so that the changes can be demonstrated to address them.

7. The DfES seems content to say that the formula spending share system failed, but that it does not matter to what extent and for what reasons it did not deliver the desired result. This is incredibly short sighted. There is not proper evidential basis for saying that change is merited, and no way of being confident that the changed system will address any problems that exist. For a Department that believes in evidence-based policy the DfES has remarkably little evidence to support the changes it is making.

The Department believes that it has a good understanding of the reasons why some schools encountered funding difficulties in 2003-04, following detailed consultation with our national partners. One of the key factors was that the introduction of a number of changes at once led to significant distributional change, and that schools did not have sufficient warning to be able to plan effectively on the basis of the new information. The fact that, as the Committee has found, the funding problems turned out to be less widespread than originally suggested supports this explanation: it was the suddenness of the changes that caused the difficulties for many schools, rather than the changes themselves.

The Department's proposals for 2006 and beyond will directly address this problem by giving greater stability and predictability to schools—building on the changes that have already been put in place for 2004-05 and 2005-06. They are based on feedback from schools themselves and their representatives and have received strong support from the headteacher, teacher and governor associations. The introduction of three year budgets is also consistent with the proposals of the Office of the Deputy Prime Minister to introduce three year settlements for local authorities, which again are intended to enhance the ability to plan ahead effectively and make the best use of resources. The Department believes that it is right that schools, as well as the rest of local government services, should benefit from this longer planning horizon.

Staff reductions

9. We accept the principle of the Gershon review's proposals to increase efficiency in public services and to redistribute resources to the front line.

The Department is fully committed to the Efficiency Review's objectives of freeing up resources for redeployment to the front line, and have a strong record of success in this

area; for example, our work on value for money, reforming the workforce and reducing bureaucracy in schools. The Department is managing an increasingly demanding delivery agenda while reducing its overhead costs in real terms. The Department plans to achieve £4.3 billion in efficiency gains by 2007-08, contributing towards the Government's overall efficiency target of over £20 billion. These efficiency gains are not about cutting spending on front line services, and overall DfES spending will continue to rise year on year. The key aim is to help front line organisations make better use of their funds, increasing value for money.

10. In order for us to understand fully what is being proposed, the Department should make public both the detailed reasoning behind the headline 31% staff reduction and a comprehensive assessment of the risks in making that reduction, and the ways in which they are to be managed. In particular, the Committee needs to have evidence that schools' funding will in future be overseen effectively without a large new bureaucracy.

The *Five Year Strategy for Children and Learners*, published in July 2004, and in particular Chapter nine: 'Managing the Transformation', sets out the reasoning behind the major reform that is underway in the Department. We are using programme and project management disciplines to manage the delivery of the reform programme, including the key risks involved and we will provide the Committee with a note of how we are doing this before Easter. The changes in role will enable the Department to reduce its staffing by 1,460 by 2008—a reduction of 31 per cent on October 2003 levels. This will be achieved by less direct management of the system and less direct service delivery; by removing overlap between the responsibilities of the DfES and its agents and partners; and by continuing efficiencies. A smaller Department will also help to reduce burdens at the front line.

The Department has set out in greater detail for its staff in April and May 2004 the impact of the proposed reductions on different areas of the Department's work, on different locations and on different grades. Copies of the key messages to staff will be placed in the House of Commons library along with a new booklet, *The DfES of the Future*, published in February 2005 which provides more detail of the rationale behind the changes. The core role of the Department will be to: support Ministers in providing strategic leadership to the system; develop policy by drawing on high quality analysis and real knowledge of how the system works; involve, and build support among, partners and stakeholders; and communicate the vision powerfully.

The Department itself will do less direct management and direct service delivery. It will increasingly be designing systems which can deliver the Government's policy objectives without over-prescription and bureaucracy. It will use the guiding principles of the Five Year Strategy—personalisation and choice, diversity, freedom and autonomy and stronger partnerships—to underpin its work.

The Department will continue to fulfill the normal day to day responsibilities of a Government Department. This means supporting Ministers in carrying out their public and Parliamentary duties, managing taxpayers' money well, and making a success of the Freedom of Information Act by providing high quality information to Parliament and the public. We will strive constantly to improve the standard and efficiency of these services.

There is no intention, or need, to create a large new bureaucracy for schools' funding.

Financial management capabilities of the DfES

11. In the case of ILAs, the objective of expanding training was given such a high priority that the caution normally associated with Government policy implementation was completely overlooked. With schools' funding, although we may never have a clear picture of the extent of the problems, one difficulty was the way in which the settlement for 2003-04 was presented by Ministers, leading all schools to expect large sums of extra disposable income which in many cases did not materialise. The lessons here are clear: always have a rigorous risk assessment, and do not oversell a particular policy where, as with school's funding, accurate forecasts of the outcome are not available.

12. Virtually the whole of the public sector will be in transition over the next five years as the Gershon proposals are implemented, and the Government will no doubt argue that the DfES along with other organisations has to contribute to the success of those changes. At the same time the DfES will be implementing the wide-ranging policy changes that we have discussed in this report across all schools and across all children's services. We have identified financial management and project management problems that have occurred within the Department, and it clearly needs to address its methods of working in order to limit the possibility of similar problems in the future.

Since the Committee's hearings in 2002 on the failure of the Department's Individual Learning Accounts programme the Department has continued building on the lessons learnt to develop financial, risk management and programme and project management skills across the Department, using professional specialist expertise where it is needed.

More recently the Department has developed and is currently implementing a Departmental Risk Improvement Plan to further develop and foster a management culture which supports well thought-through risk taking and innovation. This plan focuses on the areas where we need to raise our risk management capability including the effective management (not just identification and assessment) of risk; improving the management of risk with delivery partners; and improving the clarity of risk management strategy and policies. The plan is backed up by a robust evaluation strategy which will allow us to monitor and review progress and its effectiveness, and provide us with evidence upon which to base decisions about future improvement actions.

Government purchasing policies specify that contracts are let through competitive tendering, and the EU Procurement Directives further specify that large projects are tendered across the EU member states. Tender responses to each procurement exercise are assessed on their own merits against clearly defined criteria. It is not at all improper that one supplier may be successful in more than one procurement exercise.

The Education Maintenance Allowance (EMA) national assessment and payment service project is a recent example of programme development where good risk management and contract management procedures were used to successfully launch the scheme. Procurement of the service was carried out under negotiated procedures, commencing with publication of a notice in the Official Journal of the European Community on 1 December 2002.

The initial six selected contractors were reduced to three at the evaluation process with the assistance of specialist external advisors. Detailed negotiations followed and Capita was appointed as the supplier. Although the procurement process was protracted the Department successfully launched the EMA service. Time spent on developing the business model and statement of service requirement, recognising and securing an appropriate level of expert advice and resource to support the tendering process and the production of highly detailed and specialised material before best and final offers proved highly valuable.

There has long been a recognition that market capacity and capability are issues across Government. Sir Christopher Kelly led an Office of Government Commerce (OGC) team which produced the December 2003 report *Increasing Competition and Improving Long-Term Capacity Planning in the Government Market Place*.

Competition and the level of market maturity, capacity and capability varies between different market segments and some markets appear relatively immature. It is true that in some market segments, it appears that certain suppliers seem better prepared to bid and have the infrastructures, capacity, and understanding of the system to provide better delivery assurance during tendering.

The Department has successfully supported the creation and development of new markets through a range of activities including dialogue with prospective suppliers; carrying out soft market testing discussing the likely procurement strategy, using open specifications that focus on outcomes, appropriate contracts, risk transfer arrangements and by minimising supplier “lock-in” through developing exit provisions into contracts.

Following on from the Kelly report the Department is also participating in the markets initiative led by the OGC. The Department assisted in producing the November 2004 best practice guidance *Market Creation for the Public Sector* and will continue to assist OGC in taking forward the Kelly Action Plan.

Further education

13. It makes no sense that a student undertaking a course at a Further Education college should, other things being equal, be less well funded than a student taking the same course at a local school. The Secretary of State appears to recognise that truth, but progress towards equal funding is painfully slow. Greater urgency is needed. Further Education colleges should not be seen as a means of providing education on the cheap.

The Government recognises that there is a funding gap between school sixth forms and further education (FE) colleges in the resources provided for students aged 16 to 18 following similar programmes. Our policy has been to raise the level of funding for colleges, as and when we are able to secure the resources to do so. FE colleges are not providing education 'on the cheap'.

Funding comparisons between schools and further education are far from straight forward, and there are different ways of looking at it. Given that funding per learning aim is at the heart of the Learning and Skills Council's funding system for schools and colleges, the main

measure used is the difference in funding rates for an AS/A2 qualification. In 2002/03 the difference between the AS/A2 base rates for school sixth forms and further education colleges was 10.5 per cent.

At the 2002 Spending Review a record funding increase for the FE sector was delivered. The increased funding enabled the Learning and Skills Council to deliver a 4.5 per cent increase in funding rates in 2003/04 for all colleges that agreed development plans. In the same year, school sixth form funding rates increased by 3 per cent—resulting in a narrowing of the funding gap to 9 per cent. FE colleges that delivered against their plans receive a further 5 per cent increase in funding rates for 2004/05 compared with a 4 per cent increase for schools—a further narrowing of the gap to 8 per cent. We expect a similar step in funding rates in 2005/06, further reducing the gap to 7 per cent.

The Government also recognises that funding cannot be divorced from issues of quality. As a result of the recent additional investment in the sector and the introduction of our Success for All strategy, we have seen overall improvements to the further education sector. Overall, learners are achieving more and the vast majority (90 per cent) are satisfied with their learning experience. College success rates are up from 65 per cent in 2001/02 to 68 per cent in 2002/03. This latter figure means that more than 80 per cent of learners stay to the end of their course; and, of those, just over 80 per cent pass it successfully. The introduction of national floor targets is making an impact on quality and standards. The number of colleges above their floor targets has risen from 84 per cent in 2001/02 to 86 per cent in 2002/03. Work-based learning success rates are also rising and poor provision is being closed. The majority of employers (80 per cent) are also satisfied or very satisfied with the training they receive from colleges.

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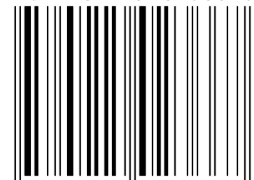
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