

# **THE CODE FOR FISCAL STABILITY**

*The Code for Fiscal Stability is laid before Parliament under Section 155 of the Finance Act 1998.*

# 1. Introduction

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Under Section 155(7) of the Finance Act 1998, the Government is required to lay the Code for Fiscal Stability before Parliament before 31 December 1998. The Government's proposed Code for Fiscal Stability, on which the approval of the House of Commons will shortly be sought, is set out in part 2 of this document. The Code is virtually unchanged from the draft published alongside the Budget in March. Small changes have been made to reflect the new format of the public finances introduced in the Economic and Fiscal Strategy Report in June.

**Purpose** The Code sets out clearly the Government's commitment to a commonsense and honest approach to managing the public finances in the long-term interests of Britain. It is motivated by three key considerations:

- a stable economic environment is vital if growth and employment are to prosper;
- the conduct of fiscal policy is a critical influence on economic stability; and
- the framework for fiscal policy inherited by the Government had failed to deliver a stable economic environment. Indeed, fiscal policy had been an important source of instability in the economy.

The Code for Fiscal Stability is designed to address past weaknesses in the fiscal policy framework. In particular, it strengthens the openness, transparency and accountability of fiscal policy, features that also characterise the framework for monetary policy following the introduction of the Bank of England Act 1998. It improves the quality of information given to the public, the lack of which in the past was an important factor underlying policy mistakes.

**Key provisions** Under the Code, the Government undertakes a number of commitments. It will:

- conduct fiscal and debt management policy in accordance with a set of specific principles;
- state explicitly its fiscal policy objectives and operating rules, and justify any changes to them;
- operate debt management policy to achieve a specific primary objective;
- disclose, and quantify where possible, all decisions and circumstances which may have a material impact on the economic and fiscal outlook;
- ensure that best-practice accounting methods are used to construct the public accounts;

- publish a Pre-Budget Report to encourage debate on the proposals under consideration for the Budget;
- publish a Financial Statement and Budget Report to discuss the key Budget decisions and the short-term economic and fiscal outlook;
- publish an Economic and Fiscal Strategy Report outlining the Government's long-term goals, strategy for the future, and how it is progressing in meeting its fiscal policy objectives;
- publish a specific range of information from its economic and fiscal projections, including estimates of the cyclically-adjusted fiscal position;
- invite the National Audit Office to audit changes in the key assumptions and conventions underpinning the fiscal projections;
- produce a Debt Management Report outlining the Government's debt management plans;
- refer all reports issued under the Code to the House of Commons Treasury Select Committee; and
- ensure that the public have full access to the reports issued under the Code.

**Legislation** The Finance Act 1998 provides legal underpinning for the Code by:

- requiring the Government to lay before Parliament a Code for Fiscal Stability (this Code constitutes the first);
- allowing governments to issue an amended Code (but only with the approval of the House of Commons); and
- specifying the minimum provisions that a valid Code must contain. In essence, the Act requires the Government to issue a Code which applies the five key principles of fiscal management (transparency, stability, responsibility, fairness and efficiency) to the formulation and implementation of fiscal and debt management policy.

These statutory requirements make fiscal policy more transparent and governments readily answerable for any departure from the Code.

The Code for Fiscal Stability set out in Section 2 is that for which Government seeks the approval of Parliament under Section 155 of the Finance Act.

## 2. The Code for Fiscal Stability

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### Purpose of the Code

1. The purpose of the Code is to improve the conduct of fiscal policy by specifying the principles that shall guide the formulation and implementation of fiscal policy and by strengthening the reporting requirements incumbent on the Government.
2. In this Code, except where the contrary is stated, fiscal policy includes debt management policy.

### Principles of Fiscal Management

3. The Government shall conduct its fiscal policy in accordance with the following principles:
  - a. **transparency** in the setting of fiscal policy objectives, the implementation of fiscal policy and in the publication of the public accounts;
  - b. **stability** in the fiscal policy-making process and in the way fiscal policy impacts on the economy;
  - c. **responsibility** in the management of the public finances;
  - d. **fairness**, including between generations; and
  - e. **efficiency** in the design and implementation of fiscal policy and in managing both sides of the public sector balance sheet.
4. The principle of **transparency** means that the Government shall publish sufficient information to allow the public to scrutinise the conduct of fiscal policy and the state of the public finances, and shall not withhold information except where publication of that information would:
  - a. substantially harm:
    - i. the national security, defence or international relations of the United Kingdom;
    - ii. the investigation, prosecution, or prevention of crime, or the conduct of civil proceedings;
    - iii. the right to privacy;
    - iv. the right of other parties to undertake confidential communications with the Government;
    - v. the ability of the Government to undertake commercial activities; or
  - b. harm the integrity of the decision-making and policy advice processes in Government.

5. The principle of **stability** means that, so far as reasonably practicable, the Government shall operate fiscal policy in a way that is predictable and consistent with the central economic objective of high and stable levels of growth and employment.
6. The principle of **responsibility** means that the Government shall operate fiscal policy in a prudent way, and manage public assets, liabilities and fiscal risks with a view to ensuring that the fiscal position is sustainable over the long term.
7. The principle of **fairness** means that, so far as reasonably practicable, the Government shall seek to operate fiscal policy in a way that takes into account the financial effects on future generations, as well as its distributional impact on the current population.
8. The principle of **efficiency** means that the Government shall seek to ensure that it uses resources in ways that give value for money, that public assets are put to the best possible use and that surplus assets are disposed of. The Government shall also have regard to economic efficiency and compliance costs when forming taxation policy.

## Fiscal and Debt Management Objectives and Operation of Fiscal Policy

9. Subject to paragraph 12, the Government shall state and explain its fiscal policy objectives and the rules by which it intends to operate fiscal policy over the life of the Parliament. These objectives and operating rules shall accord with the principles stated in paragraph 3, and shall be restated in each Budget.
10. The Government may change its fiscal policy objectives and operating rules, provided that:
  - a. any new fiscal policy objectives and operating rules also accord with the principles stated in paragraph 3; and
  - b. the reasons for departing from the previous objectives and operating rules are stated.
11. The Government may depart from its fiscal objectives and operating rules temporarily, provided that it specifies:
  - a. the reasons for departing from the previous fiscal policy objectives and operating rules;
  - b. the approach and period of time that the Government intends to take to return to the previous fiscal policy objectives and operating rules; and
  - c. the fiscal policy objectives and operating rules that shall apply over this period.

12. The primary objective of debt management policy shall be to minimise, over the long term, the costs of meeting the Government's financing needs whilst:
  - a. taking account of risk; and
  - b. seeking, so far as possible, to avoid conflict with monetary policy.

## Accounting Practice

13. The Government shall ensure that accounts are to be produced for the whole public sector. Where reasonably practicable, these accounts also shall be produced on a consolidated basis.
14. The Government shall, as soon as reasonably practicable, adopt a Resource Accounting and Budgeting approach for planning and accounting for the costs of resources consumed by Government, based on Generally Accepted Accounting Practice in the United Kingdom, adapted as necessary for the public sector.

## The Pre-Budget Report

15. If, as is usual, there is only one Budget in a financial year, the Treasury shall publish a Pre-Budget Report (PBR) at least three months prior to it, unless this is the first Budget of the Parliament, in which case a PBR shall not be required. In addition, if there is more than one Budget in any financial year, only one PBR shall be required.
16. The PBR shall be consultative in nature, and shall include, so far as reasonably practicable, proposals for any significant changes in fiscal policy under consideration for introduction in the Budget. However, the PBR shall not be taken as an indication of all tax policy areas where the Government may choose to act. In particular, consultation may not be possible in areas which:
  - a. carry the risk of significant forestalling activity by existing or prospective taxpayers; or
  - b. could lead to significant temporary distortions in taxpayer and market behaviour, including disruption in financial markets.
17. The PBR shall also include, either in the main document, or in a subsidiary document:
  - a. an Economic and Fiscal Projection (as defined in paragraphs 20-25); and
  - b. an analysis of the impact of the economic cycle on the key fiscal aggregates, including estimates of the cyclically-adjusted position, so as to shed light on progress against the fiscal objectives stated under paragraphs 9-11.

## The Financial Statement and Budget Report

18. The Treasury shall publish a Financial Statement and Budget Report (FSBR) at the time of the Budget. The FSBR shall provide, at a minimum:
  - a. an Economic and Fiscal Projection (as defined in paragraphs 20-25); and
  - b. an explanation of significant fiscal policy measures introduced in the Budget.
  - c. an explanation, where necessary, of how these policy measures restore the path of the public finances to a position consistent with:
    - i. the fiscal policy objectives and operating rules specified in paragraphs 9-11; and
    - ii. the Government's European commitments, in particular the terms of the Stability and Growth Pact.

## The Economic and Fiscal Strategy Report

19. The Treasury shall publish an Economic and Fiscal Strategy Report (EFSR), usually at the time of the Budget. But if there is more than one Budget in any financial year, only one EFSR shall be required. Within the context of the specified principles of fiscal management, the EFSR shall:
  - a. set out the Government's long-term economic and fiscal strategy, including any long-term objectives for the key fiscal aggregates;
  - b. assess both recent outcomes and the short-term economic and fiscal outlook contained in the Financial Statement and Budget Report against this longer-term strategy;
  - c. assess whether the short-term outlook and long-term strategy is consistent with the Government's European commitments, in particular, the terms of the Stability and Growth Pact;
  - d. present illustrative projections of the outlook for the key fiscal aggregates for a period not less than 10 years into the future, based on a range of plausible assumptions, so as to shed light on the inter-generational impact and sustainability of fiscal policy; and
  - e. present an analysis of the impact of the economic cycle on the key fiscal aggregates, including estimates of the cyclically-adjusted position.

## Economic and Fiscal Projections

20. Where a report published under this Code contains an Economic and Fiscal Projection, that report shall contain, as a minimum:
  - a. the key assumptions, forecasts and conventions underpinning the projection;
  - b. projections of:
    - i. GDP and its components;
    - ii. retail prices (including any measure of prices that is the formal inflation target of the Government); and
    - iii. the current account position of the balance of payments.
  - c. upon the implementation of Resource Accounting and Budgeting, an operating statement, reflecting the Government's projected current revenue and current expenses for each financial year;
  - d. a statement of cash flows, reflecting projected cash flows for each financial year;
  - e. a statement outlining proceeds received from the sale of public assets;
  - f. any other such statements as are necessary to reflect fairly the projected financial performance of the Government; and
  - g. an analysis of the risks surrounding the economic and fiscal outlook, including Government decisions and other circumstances that have still to be quantified with certainty, other material contingent liabilities and an indication of past forecast errors for aggregates noted in paragraph 20(b) and for Public Sector Net Borrowing.
  
21. The financial statements issued under paragraph 20 shall include projections of key fiscal aggregates, including: current spending and current revenue, the Surplus on Current Budget, Public Sector Net Borrowing, the Public Sector Net Cash Requirement, the General Government Financial Deficit, General Government Gross Debt, Public Sector Net Debt and a measure of net wealth. Where possible, the statements shall provide a breakdown of expenditure and revenue by sector and economic and/or functional category.
  
22. The financial statements shall also include any other such indicator as is required to judge achievement against the Government's fiscal policy objectives and rules and against the Government's European commitments, in particular the Stability and Growth Pact.

23. Every economic and fiscal projection contained in a report published under this Code shall be based, so far as reasonably practicable, on all Government decisions and all other circumstances that may have a material impact on the fiscal outlook:
  - a. where the fiscal impact of these decisions and circumstances can be quantified with reasonable accuracy by the day the projections are finalised, the impact should be included in the published projections.
  - b. where the fiscal impact of these decisions and circumstances cannot be quantified with reasonable accuracy by the day the projections are finalised, these impacts should be noted as specific fiscal risks.
24. The projection horizon is to be a period of not less than two full financial years following the date of publication. For each of the statements, comparative figures for the key fiscal aggregates covering the previous two financial years are to be published.
25. The Treasury shall also provide an explanation of all significant accounting policies, including any changes from previous practice.

## Role of the National Audit Office

26. The Treasury shall invite the National Audit Office (NAO) to audit any changes to the key assumptions and conventions underlying the Fiscal Projections. The Comptroller and Auditor General shall ensure that any advice is communicated to the Treasury and laid before Parliament.

## Conduct of Debt Management and the Debt Management Report

27. The Government shall report annually on the structure of its borrowing and the cost of the government debt, giving sufficient information to allow the public to scrutinise the conduct of its debt management policy. The overall debt portfolio used to finance past fiscal deficits will be presented in the Debt Management Report, to be issued within each financial year. The Government's agents for implementing debt management policy, the Debt Management Office and National Savings, shall publish more detailed information in their own annual reports and accounts.
28. The Government shall set remits for its agents in the annual Debt Management Report. This report will include:
  - a. a forecast of the net funding through National Savings;
  - b. the overall size of the gilts issuance programme for the coming financial year;
  - c. the planned debt maturity structure and the proportions of index-linked and conventional gilts; and
  - d. the gilt auction calendar.

29. The remits shall be subject to revision or confirmation as the Government publishes more subsequent fiscal projections.

## Referral to Select Committee

30. The Treasury shall refer to the House of Commons Treasury Select Committee every report published as a requirement of the Code.

## Disclosure of Other Information

31. The Treasury shall publish, from time to time, other information that it determines would better enable the public to scrutinise fiscal policy and the state of the public finances.

## Publication and Inspection of Reports

32. The Treasury shall, in respect of every report published as a requirement of the Code, arrange for the publication of a notice indicating:
- a. where copies of the report are available for inspection free of charge; and
  - b. where copies of the report are available for purchase.
33. The Treasury shall make available copies of each report for inspection or purchase for at least 6 months following publication. Copies of all reports shall also be made available on the Treasury's internet website.