# FISCAL POLICY: CURRENT AND CAPITAL SPENDING


## Summary

This paper discusses the rationale for the Government's two fiscal rules in the light of trends in current and capital spending and their interaction with the fiscal policy framework. The main conclusions are:

In the past, fiscal policy outturns have been imprudent and not in the national economic interest:

current spending exceeded current receipts on average by more than 1½ per cent of GDP over the previous economic cycle, breaking the golden rule and imposing a burden on future generations;

the golden rule has not been met over any economic cycle since the early 1970s;

public investment has fallen to low levels by historical and international standards, even allowing for factors such as the effects of privatisation, and there are maintenance backlogs;

too often the actual fiscal stance was much looser than planned.

Previous approaches lacked transparency and attached insufficient importance to the distinction between current and capital spending. As a result:

decisions did not accurately reflect how future generations would have to pay for current public spending;

the arrangements were widely seen as biased against capital spending, and tended to encourage cutbacks in capital rather than current spending;

structural deficits were not identified sufficiently quickly to be tackled without significant costs.

A more sensible fiscal framework, while ensuring transparency and accountability, should focus on:

long-term planning rather than short-term bargaining;

outputs rather than inputs;

a clear distinction between current and capital spending, in both the overall control regime and the departmental spending plans; and

be based on prudence and stability, allowing for inevitable uncertainties.

The new fiscal framework has moved in this direction:

- the golden rule - borrowing only to invest - recognises the different economic nature of current and capital spending, and the public sector is being encouraged to make best use of its existing assets;

- the Government has set out clearly its two fiscal rules and is taking a prudent approach to managing the public finances - adjusting for the economic cycle and adopting cautious assumptions.

## Introduction - the need to distinguish between current and capital spending

Last autumn, the Treasury published a paper looking at the conduct of fiscal policy over the last economic cycle[1]. That paper drew two main lessons from the episode:

> take a prudent approach: adjust for the economic cycle and build in a margin for uncertainty; and
>
> be open and transparent: set stable fiscal rules and explain clearly fiscal policy decisions.

Since then, the Government has published the Code for Fiscal Stability which sets out the requirements for an open, transparent and accountable approach to managing the public finances, and which will ensure that fiscal policy is set in the UK's long-term interests.

The Code reaffirms the five key principles that lie at the heart of the Government's fiscal policy framework:

> **transparency** in the setting of fiscal policy objectives, the implementation of fiscal policy and in the publication of the public accounts;
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> **stability** in the fiscal policy-making process and in the way fiscal policy impacts on the economy;
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> **responsibility** in the management of the public finances;
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> **fairness**, including between generations; and
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> **efficiency** in the design and implementation of fiscal policy and in managing both sides of the public sector balance sheet.

The Code for Fiscal Stability is being given a statutory basis in the current Finance Bill. Separately, following a suggestion by Gordon Brown, the IMF published in April its Code of Good Practices on Fiscal Transparency - Declaration of Principles, which sets standards to which all countries should aspire. The annex to this paper reproduces a summary, prepared in April by the Treasury, of the UK's compliance with the IMF Code.

This paper explains why the Government has made a clear distinction between current and capital spending in setting the two strict fiscal rules that will govern fiscal policy over the course of this Parliament:

> the **golden rule**: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and

[1]. "Fiscal policy: lessons from the last economic cycle", HM Treasury, November 1997

**public debt** as a proportion of national income will be held over the economic cycle at a **stable and prudent level**.

The golden rule promotes fairness between generations: the bill for today's current spending, which mainly benefits today's taxpayers, will not be passed onto future generations. In contrast, investment today will benefit taxpayers in future years as well as now. This does not imply that capital spending is in any way automatically better than current spending: both have their role. Both have to be shown to be worthwhile and to offer good value for taxpayers' money. And both can have long-lasting effects on the economy.

The golden rule explicitly recognises the different economic nature of current and capital spending. The Government has a duty to maintain the level of investment required to meet the economy's needs and to ensure that the public capital stock is kept in good condition. Failure to do so hinders the effective delivery of public services, damages the efficiency of UK business and affects many aspects of our lives. In short, an inadequate level of public investment can damage the long-term performance of the UK economy.

At the same time, it is essential to take a responsible approach and to recognise the need for prudence in setting fiscal policy. The Government is determined to avoid policy mistakes, such as those of the late 1980s, that can quickly lead to unsustainable public finances and the need for painful corrective action. Fiscal policy is now based on a cautious approach, recognising the inherent uncertainties and adjusting for the effects of the economic cycle. And the prudent and stable debt ratio rule recognises that public debt cannot be allowed to stabilise at unaffordable levels.

The fiscal policy framework, including the processes of planning and controlling public expenditure, should support good decision-making that reflects the UK's long-term interests. It should not create incentives for policies or spending decisions that are poor value and guided by purely short-term considerations.

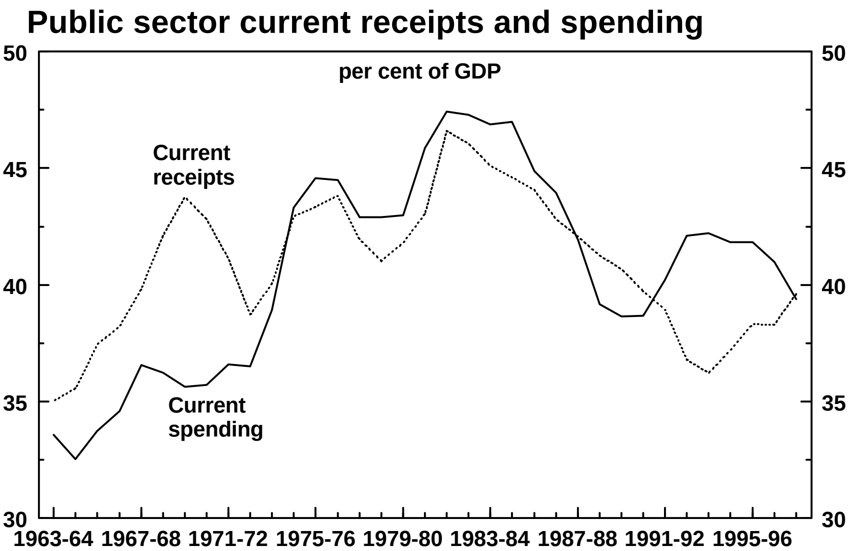
This paper looks first at the behaviour of current and capital spending in recent years. It then looks at whether the previous framework promoted good decision-making; finally it explains how the new fiscal policy framework will improve fiscal policy decision-making, and how a clear distinction between current and capital spending in the public finances will better reflect the fiscal rules and correspond more closely to the national accounts and internationally-agreed measures.

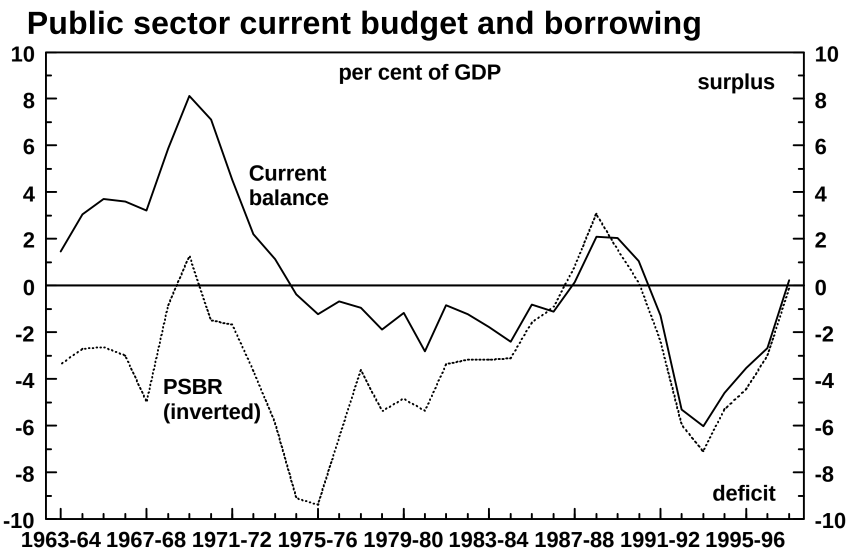
## What has happened to current and capital spending?

### *Trends in current spending and receipts*

The chart below shows the behaviour of current spending and receipts over time. Although current spending in the 1990s accounted for a lower share of national income than it did in the 1980s, this was accompanied by a deficit on the public sector's current account that was unprecedented in recent history. As the second chart shows, this in turn fed through into very significant public borrowing.

The golden rule was not met over the last economic cycle (1985-86 to 1996-97): current spending exceeded current receipts by over 1½ per cent of GDP a year on average. Moreover, the golden rule has not been met over any cycle since the early 1970s.




Some of the reasons for the emergence of such large deficits were analysed and discussed in last November's Treasury paper. It is clear that:

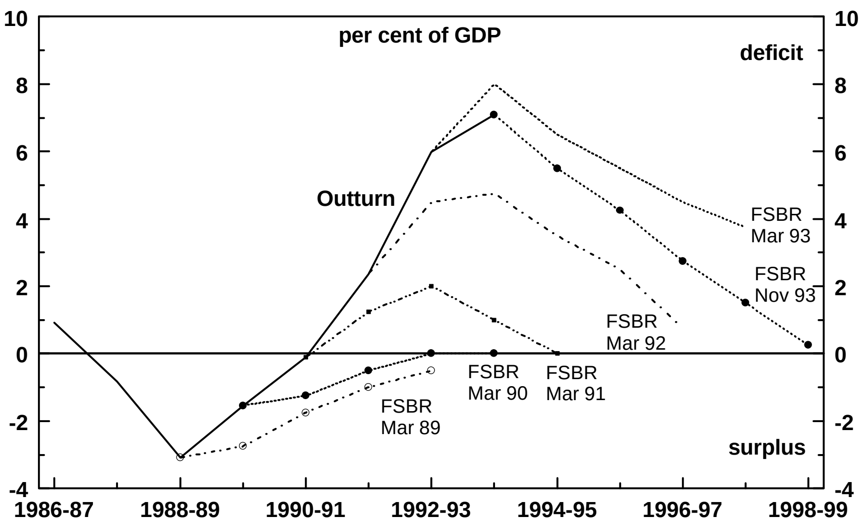
correcting this unsustainable position involved a long and painful period of fiscal consolidation;

the pressing need for this correction has not been conducive to a long-term approach to managing the public finances;

the public sector was acting as a drain on national saving at a time when there was a need for higher national saving, to facilitate the higher level of investment that is in the economy's long-term interests.

The chart below shows how often over the last economic cycle the actual fiscal stance turned out to be much looser than had been planned. There can be no escape from the fact that fiscal projections are uncertain, and it is important to recognise this in setting policy. However, the Government intends that the new fiscal framework should prevent a repeat of the late 1980s/early 1990s experience of worse than expected fiscal outturns year after year after year. An important lesson is the need to allow for the effects of the cycle on the public finances, so the Government now publishes cyclically-adjusted estimates of the main fiscal aggregates.

**Published PSBR medium term illustrative projections and outturn**




### *Trends in public sector investment*

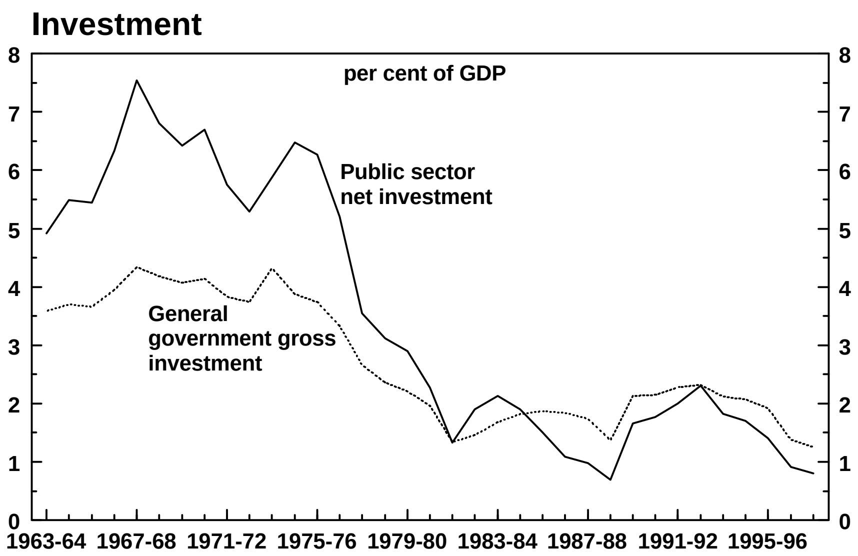
Drawing conclusions from movements in net investment over time is not straightforward. For instance:

privatisation has reduced the size of the public sector, with many firms that had been regarded as public utilities moving into the private sector;

other asset sales, for instance of council houses, have also depressed the figures;

increasing use of Public/Private Partnerships, especially as the Private Finance Initiative starts to make real progress, will mean that the public sector becomes a sponsor of investment projects rather than undertaking those projects itself.

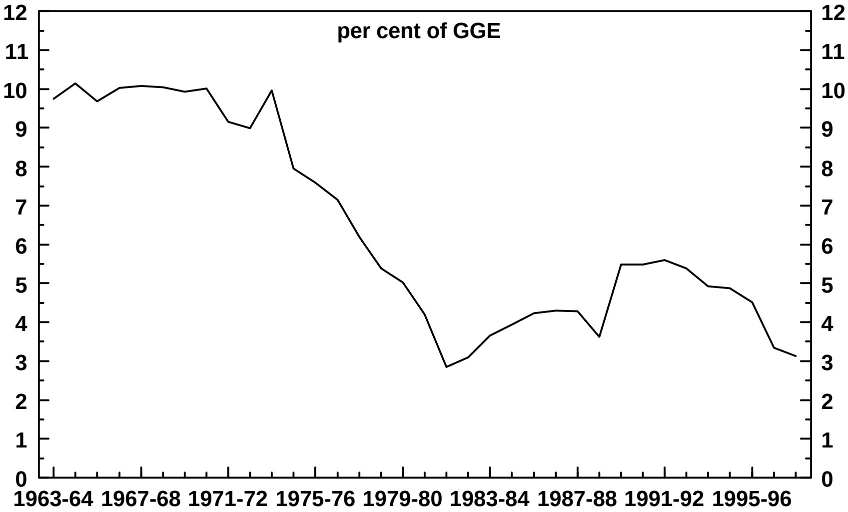
Nevertheless, it is clear from the chart below that public investment[2] has fallen by more than can be explained by the above factors. Of these, it is probably privatisation that has had the largest effect. One way of removing most of that distortion is to look just at general government physical investment. This series (gross of depreciation) still shows a significant fall in investment, though to a lesser extent than for the public sector as a whole. Both series, however, show a renewed fall in investment in the most recent years.




Public investment has fallen, not just as a share of national income but also as a share of public spending. The chart below shows that general government physical investment in the early 1960s was close to 10 per cent of general government expenditure (GGE). However, this proportion fell through much of the 1970s and reached a low point in the early 1980s at less than 3 per cent. After rising through the 1980s, It has fallen back towards 3 per cent in recent years.

2. Public sector net investment is the measure used for the golden rule: it includes physical investment and grants in support of capital spending by the private sector. It is measured net of depreciation.

General government gross investment



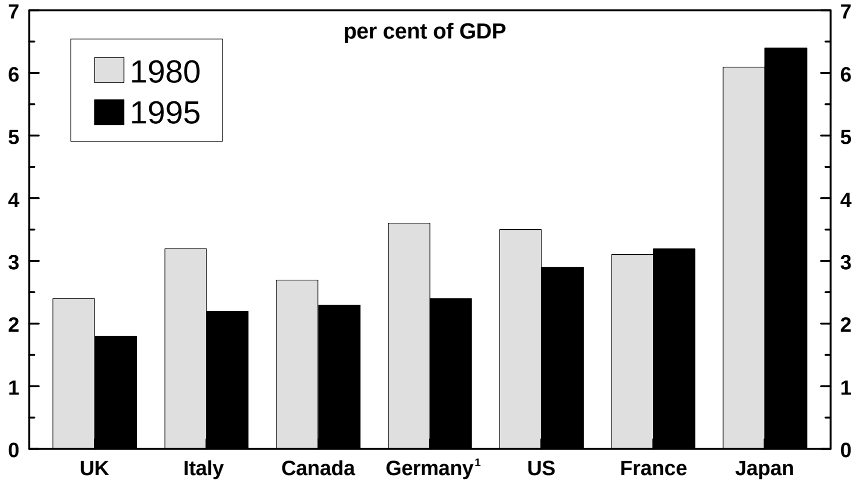

The concept of a maintenance backlog should be treated with some care, as there is no unique way of measuring backlogs. Nevertheless, the existence of maintenance and other backlogs in parts of the public sector is widely acknowledged, and shows up in the condition of many of the physical assets held by the public sector. They can be seen as an indicator of a need for higher investment, implying that past investment levels have been too low and resulting in a lower level of public service provision - in terms of both quality and quantity

There are particular pressure points. The main areas appear to be schools; hospitals; some parts of the transport system; and housing. The Government has already made available additional funding for capital spending in these areas.

International comparisons of public investment are prone to distortion by variations in coverage, especially in what is included in the public sector. For example, public investment in France is boosted by capital-intensive utilities which are still within the public sector. As with the effect of privatisations, one way of reducing these distortions is to look at investment just by general government.

The chart below shows OECD estimates of general government gross investment as a share of GDP. Some differences in coverage remain - for example the UK figures exclude investment by NHS Trust Hospitals (which are in the public corporations sector) but similar investment elsewhere is included. In addition, private finance has started to be used as an alternative to government investment in recent years.

## General government gross investment




*Source: OECD business sector database*

*1. Prior to 1991 West Germany, thereafter unified Germany*

The level of government investment varies considerably across countries. However, general government in the UK has invested a lower share of national income than in other G7 countries.

**The fiscal policy framework and its effects on decision-making**

The previous policy framework did not deliver fiscal policy outturns that were in the UK's long-term interests:

- the public finances deteriorated sharply at the end of the 1980s and the early 1990s, with an apparently sound position turning into clearly unsustainable levels of borrowing by 1993-94;

- over the last economic cycle - 1985-86 to 1996-97 - current spending exceeded current receipts by over 1½ per cent of GDP on average: failing to meet the golden rule and raising the burden of debt interest on future taxpayers;

- the previous framework was seen as biased against public investment, which created incentives to delay or cancel investment projects instead of cutting back current spending;

- but once investment had been undertaken, government departments were given little incentive to make good use of their assets.

The result was a serious deterioration in the main fiscal aggregates: public borrowing rose by 10 per cent of GDP between 1988-89 and 1993-94, and by 1996-97 the ratio of public sector net debt to GDP had risen by 18 percentage points from its trough in 1990-91. The effects on public spending are less obvious, but still apparent in the short-term focus engendered by the annual bargaining and search for spending cuts: a low level of investment relative to national income; relative to other components of public spending; and relative to other countries. More noticeably, the effects can be seen in the maintenance and other backlogs, and the extent to which many parts of the public sector have not been making good use of their capital assets.

***A framework that avoids the mistakes of the past***

The Government is determined to avoid repeating these sorts of mistakes. Last November's paper emphasised that a prudent and transparent approach is essential. One lesson from the past was the need for stable fiscal rules that do not change from year to year; to explain clearly fiscal policy decisions; and to make available the information needed to judge policy.

Another lesson was the need to take a prudent approach. From its first Budget onwards, the Government has adopted a deliberately cautious approach to forecasting the public finances. The National Audit Office was invited to audit key assumptions underlying the projections for the first time, to ensure that the forecasts were built upon a solid foundation. To illustrate the effects of the cycle and of uncertainty, estimates of the cyclically-adjusted fiscal position were thereafter published both on a central assessment of the cyclical position and also on a more pessimistic assessment.

***A framework that supports good decision-making***

A better policy framework would respect the principles of fiscal policy set out in the Code for Fiscal Stability. It would encourage long-term planning, make a clear distinction between current and capital spending and would focus on outputs rather than inputs.

The new fiscal framework, and in particular the new fiscal rules set out in the July 1997 Budget, aims to make a proper distinction between current and capital spending, recognising their different economic character. Following the golden rule over the cycle means that current receipts must meet the cost of current spending. So if spending cuts were required, these would need to be found from within current spending.

The golden rule is being implemented using a definition of the current balance that is very close to the concept used in the national accounts. The most important difference is that depreciation is counted as current rather than capital spending (though the national accounts treatment will come into line in September when national accounts are first published according to the definitions set out in the European System of Accounts 1995 - ESA95). This ensures that current taxpayers meet the cost of maintaining the capital stock, and actually makes the golden rule a more challenging target to meet.

There are other critical areas of public spending which have important effects on future prosperity, as well as yielding present benefits, for instance spending on education and health. The Government has accordingly given these areas priority.

Using the national accounts definition is transparent and avoids the temptation to count additional items as capital spending simply to make it easier to meet the golden rule. In this way, the definition of capital can be seen as based on a cautious approach, because using a wider definition of investment would reduce current spending and increase the surplus on the current budget.

Transparency, as indicated earlier, is of the essence for good policymaking. So it is important that in fiscal policy, as in other areas, information is readily at hand to enable policy to be judged and monitored. And that information has to be based on agreed and recognised definitions, such as the national accounts or other internationally-agreed standards. Performance against the golden rule cannot be judged unless the public sector accounts make a clear distinction between current and capital spending, in both the overall control regime and the spending plans for individual departments.

While the golden rule means that there is much more of a level playing field between current and capital spending, it is also important that public investment is set at a prudent and responsible level that does not threaten the sustainability of the public finances. So the Government is also committed to holding the public debt ratio over the economic cycle at a stable and prudent level.

As well as ending discrimination against investment, the Government has been taking steps to make better use of public assets. The National Asset Register, published last November, provided the clearest indication that any government has ever had of the extent and coverage of its assets. Departments are being given incentives to dispose of assets which are not contributing to meeting the Government's objectives, and to make better use of those assets they retain.

Further ahead, the introduction of Resource Accounting and Budgeting (RAB) will underpin the operation of the golden rule and the drive towards better stewardship of public assets. Based on accruals accounting and making a clear structural distinction between current and capital spending, RAB will capture the full cost of resources consumed in the production of outputs in each reporting period. And the introduction of capital charging for government departments will provide very real incentives to use capital productively.

As well as creating the right incentives for public investment and for making the best use of public sector assets, the Government is also addressing the question of whether private sector involvement can secure better value for taxpayers' money. With the increasing use of Public/Private Partnerships (PPPs), and especially the Private Finance Initiative (PFI), the public sector is moving more to being a sponsor of investment where this offers a more effective way of providing public services. In the new fiscal framework, the benefits of PFI, and other forms of PPP, are now seen in terms of securing the best value for money in delivering high quality public services, rather than producing a temporary reduction in the PSBR.

Although there have been suggestions that the focus of fiscal policy should be shifted to the general government financial deficit (the Maastricht measure), the Government has consistently made clear that it is right to look at the whole of the public sector, which is a wider measure than general government. It is ultimately the taxpayer who would foot the bill for the debts of a public corporation, and this should be recognised in the fiscal framework. Looking at the whole of the public sector means that the fiscal framework does not itself create artificial incentives to change behaviour simply in order to exploit differences in the control regime. The Government will, however, continue to publish the general government financial deficit and give it prominence in the Budget documentation.

## Conclusion

Current and future taxpayers will have to bear the cost of the current spending over the last economic cycle that was not covered by current receipts, ie they will pay the price for not meeting the golden rule. Many people and businesses are affected by the low levels of public investment and inadequate maintenance of existing assets.

The previous fiscal framework did little to prevent such failings: it hid the extent to which current spending was being financed by borrowing, and it is likely to have made a significant contribution to the decline in public investment over time.

Good principles of fiscal management require a framework that will support long-term planning; focus on outputs rather than inputs; recognise the essential difference between current and capital spending; and promote prudence and stability rather than short-termism.

## Summary of UK Compliance with IMF Draft Code of Good Practices on Fiscal Transparency

| I. CLARITY OF ROLES AND RESPONSIBILITIES | |
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| **1.1 The government sector should be clearly distinguished from the rest of the economy and policy and management roles within government should be well defined.** | |
| 1.1.1 The boundary between the government sector and the rest of the economy should be clearly defined and widely understood. The government sector should correspond to the general government, which comprises the central government and lower levels of government, including extrabudgetary accounts. | *The boundary between the government sector and the rest of the economy is defined consistent with European System of Accounts (ESA). This boundary is both clearly defined and widely understood.*<br>*The focus in the UK budget is on the total public sector, defined as general government plus public corporations. Public corporations are again defined according to the ESA (although the ESA does not define the public sector as such), and widely understood.* |
| 1.1.2 Government involvement in the rest of the economy (eg through regulation and equity ownership) should be conducted in an open and public manner on the basis of clear rules and procedures, which are applied in a nondiscriminatory manner. | *All the Government's activities are governed by a clear and transparent framework of law. Certain public utilities are subject to regulation by independent regulators who operate in a statutory framework. Government equity holdings outside the state sector are not significant.* |
| 1.1.3 The allocation of fiscal rights and responsibilities between different levels of government, and between the executive branch, the legislative branch and the judiciary, should be clearly defined. | *Local government operates within a clear legislative framework which defines authorities' ability to raise taxes and to borrow. The basis on which central Government provides financial support for local government functions is also defined in law.*<br>*There is a clear distinction between the roles of Parliament and the judiciary.* |
| 1.1.4 Clear mechanisms for the coordination and management of budgetary and extrabudgetary activities should be established, and well-defined arrangements vis-a-vis other government entities (eg the central bank and state controlled financial and nonfinancial enterprises) should be specified. | *The UK has both centralised co-ordination and management of the budget process and well-defined roles and financial arrangements vis-a-vis other government entities.* |

| **1.2 There should be a clear legal and administrative framework for fiscal management.** | |
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| 1.2.1 Fiscal management should be governed by comprehensive laws and administrative rules applying to budgetary and extrabudgetary activities. Any commitment or expenditure of government funds should have a legal authority. | *The UK Code for Fiscal Stability (which sets out the new fiscal reporting framework) is being given statutory underpinning in the Finance Bill.* *The expenditure of government funds is clearly established in law.* |
| 1.2.2 Taxes, duties, fees and charges should have an explicit legal basis. Tax laws should be easily accessible and understandable, and clear criteria should guide any administrative discretion in their application. | *All UK tax law is subject to Parliamentary scrutiny, and is supported by a range of explanatory material (such as leaflets and booklets). Fees and charges for State regulatory services are on a statutory basis.* *The current Tax Law Rewrite project aims to make tax law simpler and easier to understand.* *All extra-statutory concessions and statements of practice/interpretation issued by Inland Revenue/Customs are published, and are subject to scrutiny by the National Audit Office (NAO) and Public Accounts Committee.* *There are clear independent complaints and appeals procedures (including reference of complaints to the Adjudicator's Office or Parliamentary Ombudsman).* |
| 1.2.3 Ethical standards of behaviour for public servants should be clear and well publicised. | *Civil service behaviour is governed by the Civil Service Code. Ministerial behaviour is also governed by a Code for Ministers (formerly titled Questions of Procedure) that was issued in July 1997.* |

| II. PUBLIC AVAILABILITY OF INFORMATION | |
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| **2.1 The public should be provided with full information on the past, current and projected fiscal activity of government.** | |
| 2.1.1 The annual budget should cover all central government operations in detail and should also provide information on central government extrabudgetary operations. In addition, sufficient information should be provided on the revenue and expenditure of lower levels of government to allow a consolidated financial position for the general government to be presented. | *The annual budget covers all central operations in detail, although much of the more detailed information on public expenditure is published later in the Public Expenditure and Statistical Analysis Report (PESA) and departmental reports. Sufficient information is published on lower levels of government to allow a consolidated financial position to be determined for both general government and public sector.* |
| 2.1.2 Information comparable to that for the annual budget should be provided for the outturns of the preceding two fiscal years together will forecasts of key budget aggregates for the two years following the budget. | *The UK Code requires figures for key fiscal aggregates to be produced for the two years preceding the budget year and projections to be produced for two following years. Additional historical fiscal data is published by the Office of National Statistics.* |
| 2.1.3 Statements should be published with the annual budget giving a description of the nature and fiscal significance of contingent liabilities, tax expenditures and quasi-fiscal activities. | *An annual statement of the contingent liabilities of the Consolidated Fund is published in the Supplementary Statements to the Consolidated Fund and National Loans Fund Accounts.*<br>*The UK Code also requires analysis of risks surrounding the fiscal outlook including contingent liabilities as well as risks from unquantified government decisions and past forecast errors.*<br>*Information on tax expenditures is also published.* |
| 2.1.4 The central government should regularly publish information on the level and composition of its debt and financial assets. | *The UK Code requires the publication of information on the overall debt portfolio used to finance past deficits in the Debt Management Report each March. In addition there is a legal requirement to publish the liabilities and assets of the National Loans Fund. The annual statement of the Exchange Equilisation Account, which holds the Government's foreign currency reserves, will be published from 1997-98 onwards.* |

| **2.2 A public commitment should be made to the timely publication of fiscal information.** | |
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| 2.2.1 Specific commitments should be made to the publication of fiscal information (eg in a budget law). | *The UK Code will require the publication of fiscal information twice each financial year.* |
| 2.2.2 Advance release date calendars for fiscal reporting to the public should be announced. | *The release dates for the budget and pre-budget report are announced publicly in advance.* |

| III. OPEN BUDGET PREPARATION, EXECUTION AND REPORTING | |
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| **3.1 Budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget and identifiable major fiscal risks.** | |
| 3.1.1 A statement of fiscal policy objectives and an assessment of sustainable fiscal policy should provide the framework for the annual budget. | *Under the UK Code, governments are required to publish an Economic and Fiscal Strategy Report (normally with their budget). This report will set out their long-term economic and fiscal strategy, (including fiscal policy objectives), assess short-term outcomes against this strategy, present illustrative long-run fiscal projections (for at least 10 years) and analyse the impact of the economic cycle on key fiscal aggregates.* |
| 3.1.2 Any fiscal rules that have been adopted (eg a balanced budget requirement and borrowing limits for lower levels of government) should be clearly specified. | *The UK Code will require a government to state, no later than its first budget, the fiscal objectives and rules by which it intends to operate fiscal policy over the life of the Parliament. Deviations from these rules will need to be explained.*<br>*The Government has set out its fiscal rules, for example in the November Pre-Budget Report and March PSBR.* |
| 3.1.3 The annual budget should be presented within a comprehensive and consistent quantitative macroeconomic framework and the economic assumptions and key parameters (eg effective tax rates) underlying budget estimates should be provided. | *The UK Code will require the Government to report the key assumptions, forecasts and conventions underpinning its economic and fiscal projections.* |
| 3.1.4 Existing commitments should be distinguished from new policies included in the annual budget. | *The UK Code requires the Financial Statement and Budget Report to include an explanation of any new policy measures introduced in the Budget.* |
| 3.1.5 Major risks to the annual budget should be identified and quantified where possible, including variations in economic assumptions and the uncertain costs of specific expenditure commitments (eg financial restructuring). | *The UK Code will require the Government to publish an analysis of the key risks surrounding the economic and fiscal outlooks. This will include Government decisions that have still to be quantified with certainty, other material contingent liabilities and past forecast errors.* |

| **3.2 Budget estimates should be classified and presented in a way that facilitates policy analysis and promotes accountability.** | |
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| 3.2.1 Government transactions should be on a gross basis, distinguishing revenue, expenditure and financing, and classifying expenditures on an economic and functional basis. In addition, expenditure should be classified by administrative category. Data on extrabudgetary operations should be similarly classified. Budget data should be presented in a way that allows international comparisons. | *Transactions are shown on a gross basis, distinguishing revenue, expenditure and financing, and expenditure is also classified by both economic and administrative category (ie departmental programmes). An analysis of spending on a functional basis is produced in PESA.*<br>*Once Resource Accounting and Budgeting is implemented budget data will be classified according to UK GAAP, adapted as necessary for the public sector. This will affect the measurement but not the classification of transactions. Information consistent with ESA will continue to be produced.*<br>*The UK budget covers the total public sector (defined as general government plus public corporations).* |
| 3.2.2 A statement of objectives to be achieved by major budget programs (eg improvement of relevant social indicators) should be provided. | *Formal objectives are required for all individual spending programmes. Although each spending programme may contribute to more than one objective (a training programme, for example, may contribute to both skilling the labour force and reducing unemployment), collectively the objectives will cover all programme objectives.*<br>*In addition, the Government is producing statements of objectives (based on the social/economic improvements it wishes to see) for each Department. However, they will not require formal objectives in the same way as for individual programmes.*<br>*Once resource accounting and budgeting is implemented, statements of departmental spending on each objective will be subject to formal audit.* |

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| 3.2.3 The overall balance of the general government should be a standard summary indicator of the government's financial position. It should be supplemented by other fiscal indicators (eg operating balance, structural balance and primary balance) when economic circumstances make it inappropriate to base judgements about fiscal policy stance on the overall deficit alone. | *The UK Code will require the Government to publish information on a variety of fiscal indicators including the public sector borrowing requirement and the general government financial deficit. However, emphasis will be placed on indicators that best assess a government's performance against its fiscal objectives and rules.* |
| 3.2.4 The annual budget and final accounts should include a statement of the accounting basis (ie cash or accrual) and standards used in the preparation and presentation of budget data. | *The UK Code requires the Treasury to provide an explanation of all significant accounting policies, including any changes from past practice.* |
| **3.3 Procedures for the execution and monitoring of approved expenditures should be clearly specified.** | |
| 3.3.1 A comprehensive, integrated accounting system should be established. It should provide a reliable basis for assessing payments arrears. | *The UK Code requires the Government to endeavour to apply best-practice accounting methods (ie adapted UK GAAP) and move to a resource accounting and budgeting approach. Data consistent with ESA will also be produced.* |
| 3.3.2 Procedures for procurement and employment should be standardised and accessible to all interested parties. | *UK procurement policy is based on value for money, with competition for all purchases unless there are justified reasons to the contrary. Larger contracts are subject to EC and WTO competition requirements.* |
| 3.3.3 Budget execution should be internally audited, and audit procedures should be open to review. | *The facility exists to audit internally the implementation of budget programmes.* |
| **3.4 Fiscal reporting should be timely, comprehensive, reliable and identify deviations from the budget.** | |
| 3.4.1 During the year, there should be regular, timely reporting, of budget and extrabudgetary outturns, which should be compared with original estimates. In the absence of detailed information on lower levels of government, available indicators of the financial position of (eg bank borrowing or bond issues) should be provided. | *There is regular reporting of budget outturns in the form of the monthly PSBR press releases, although detail is somewhat limited.*<br>*Full reconciliation of (emerging) outturns with budget estimates are normally only published for the next Budget.* |

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| 3.4.2 Timely, comprehensive, audited final accounts of budget operations, together with full information on extrabudgetary accounts, should be presented to the legislature. | *The UK prepares cash accounts to a statutory timetable, subject to audit by the NAO and laid before Parliament by the Treasury. There are also various white paper accounts laid before Parliament.*<br>*It is not clear if these current accounts would be classed as final accounts of "budget operations".* |
| 3.4.3 Results achieved relative to the objectives of major government programs should be reported to the legislature. | *The UK will publish performance results for programmes. However, formal policy on the publication of both outcome and output measures is yet to be finalised, although the most likely outcome is publication alongside (rather than as part of) the audited accounts.* |

| IV. INDEPENDENT ASSURANCES OF INTEGRITY | |
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| **4.1 The integrity of fiscal information should be subject to public and independent scrutiny.** | |
| 4.1.1 A national audit body, or equivalent organisation, should be appointed by the legislature, with the responsibility to provide timely reports to the legislature and public on the financial integrity of government accounts. | *The NAO was set up by statute in 1983, and is headed by the Comptroller and Auditor General who is an Officer of the House of Commons. The C&AG has security of tenure, and can only be removed from office by the Queen on an address from both Houses of Parliament.*<br>*The NAO has a statutory duty to certify most categories of government accounts, notably the annual appropriation accounts. As well as certifying individual accounts the C&AG also prepares an annual general report for the House of Commons which summarises the results of financial audit work undertaken in the past year.* |
| 4.1.2 Macroeconomic forecasts (including underlying models) should be available for scrutiny by independent experts. | *Macroeconomic forecasts are published in the Budget and Pre-Budget Reports. The Industry Act requires an updated version of the macroeconomic model underlying these forecast to be made publicly available.*<br>*The Code requires Treasury to invite the NAO to audit changes to the key assumptions and conventions underlying the fiscal projections. Any NAO advice received will be published.* |
| 4.1.3 The integrity of fiscal statistics should be enhanced by providing the national statistics office with institutional independence. | *The Government is currently consulting publicly on ways to strengthen the accountability and governance arrangements for official statistics to enhance their integrity, ensuring that they are of the highest quality and produced and disseminated in a way which is free from political interference.* |

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