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## The Macro-Fiscal Role of the U.K. Whole of Government Account

The U.K. Whole of Government Account (WGA) has been conceived by the Treasury as having a macro-fiscal role. This WGA is about fiscal transparency at the aggregate level, rather than at a more disaggregated level with regard to public sector decision makers at tiers of government, each with their own chain of accountability. This paper analyses the U.K. conception of the WGA, examining its theoretical background and evolution since the 1995 decision to convert central government accounting from cash to accruals. The definition of the area of consolidation is governed by statute, the declared intention being to align as far as possible with the national accounts definitions that provide the basis for fiscal aggregates, thereby overriding IAS 27. Net liabilities per WGA is mapped in this paper to macro-fiscal aggregates, including public sector net debt (the U.K. preferred measure), general government gross debt (the EU preferred measure) and public sector net worth (national accounts). Conceptually, the WGA measure is situated between net debt (against which only liquid assets are netted) and the long-term cash projections developed by the Treasury. Insights are provided into the damage inflicted on U.K. public finances by a period of over-optimism about fiscal performance and the economy's heavy exposure to the global financial crisis. Fiscal retrenchment in all countries can have a substantial illusory component, as proposals may reduce some measures of deficit and debt at the expense of the public sector balance sheet, to which the WGA draws attention. These measures may include: privatizing state assets; neglecting existing public sector assets; cutting public sector capital expenditure; substituting public-private partnerships for conventional procurement; and posting bills to the future. The U.K. WGA may also institutionalize some protection against accounting arbitrage that distorts policy choices and fiscal reporting. Well-documented reconciliations between figures derived from national accounts and from IFRS-based financial reporting are therefore imperative for fiscal transparency.

**Key words:** Accounting arbitrage; Accruals accounting in government; Area of consolidation; Fiscal sustainability; Fiscal transparency; Macro-fiscal; Public sector net worth; U.K. fiscal policy.

The Siena 2008 seminar on Whole of Government Accounts (WGA) and the resulting symposium in *Public Money and Management* (2009) demonstrated that there are different conceptions of the role that a WGA can perform. Australian WGAs are

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really consolidated accounts of particular political jurisdictions (i.e., Commonwealth and each state/territory), applying the principle of control and compliant with IAS 27 (IASB, 2008). The overriding concern is about political accountability, with transparency and yardstick competition being the key instruments. In contrast, the U.K. WGA was conceived in 1998 in macroeconomic terms, as shown by the emphasis that has been placed on close alignment with national accounts definitions. The U.K. WGA is about fiscal transparency at the aggregate level, rather than at a more disaggregated level with regard to multiple public sector decision makers, each with their own chain of accountability.

The purpose of this paper is to examine the potential uses of the U.K. WGA and—largely using proxy information—to discuss its policy relevance to the United Kingdom's future response to serious fiscal problems that, in part, originate in the near-meltdown of the global economy. The methodology of the research underpinning this paper has two dimensions. First, there has been a thorough examination of relevant published information, making connections between government accounting reform and long-term fiscal projections that stretch beyond expenditure planning horizons. Second, the authors have been participant observers throughout the WGA developmental process: this has included evaluation of U.K. plans and proposals for more extensive consolidation (Heald and Georgiou, 1995, 2000; Heald, 1998) and one author's 2004–09 term of membership of the Financial Reporting Advisory Board (FRAB). Interviews on a non-attributable basis have been conducted with governmental and regulatory actors. Sole responsibility for the views expressed remains with the authors.

It is not the purpose of this paper to discuss the issue of delays in producing the U.K. WGA, the topic having been covered in Chow *et al.* (2007) and Heald and Georgiou (2009). The project was announced in 1998 by the Treasury (1998b), with publication then scheduled for WGA 2005–06, yet there have been protracted delays. The difficulties encountered in bringing the WGA to publication were confirmed in June 2009 and June 2010 by the Treasury (2009c, 2010), notwithstanding first publication being scheduled for 2009–10. However, in March 2010, the Labour Government used statutory instruments (i.e., secondary legislation under the *Government Resources and Accounts Act 2000*)<sup>1</sup> to bring into force the requirement that the 2009–10 WGA be published not later than 31 December 2011.

The Conservative–Liberal Democrat Coalition Government, which took office in May 2010, transferred economic forecasting responsibilities from the Treasury to the independent Office for Budget Responsibility (OBR). This included long-term fiscal projections, with the OBR (2011b) publishing its first Fiscal Sustainability Report on 13 July 2011. On the same day, the Treasury (2011d) published unaudited 2009–10 WGA data, in the format shown in Tables 1 and 2, to which the Treasury's national

<sup>1</sup> *The Government Resources and Accounts Act 2000 (Commencement No. 2 and Transitional Provision) Order 2010* and *The Whole of Government Accounts (Specified Dates) Order 2010*. This timetable sets the following statutory deadlines: the Treasury to send the WGA to the Comptroller and Auditor General within 11 months of the end of the financial year; the Comptroller and Auditor General to certify the WGA within 19 months; and the Treasury to lay the WGA before the House of Commons within 21 months. Presumably this statutory timetable will be shortened at a future date.

ABACUS

TABLE 1

UNAUDITED SUMMARIZED WGA STATEMENT OF FINANCIAL POSITION, 2009–10

Revenue	£bn
Taxation revenue	(488.4)
Other revenue	(97.1)
Total operating revenue	(585.5)
Expenditure	
Social benefit payments	195.6
Staff costs	180.4
Other expenditure	292.7
Total operating expenditure	668.7
Net financing cost and gains and losses on assets	80.9
WGA net deficit for the year	164.1
Reconciliation to national accounts:	
WGA net deficit for the year	164
Public service pensions	(51)
Impairment of assets	(24)
Capital grants	(16)
Depreciation of assets	(6)
Provisions	27
Military expenditure not capitalized	5
Other	8
Current deficit (national accounts)	107

*Note:* This table follows the signing convention of the source, whereby summary totals omit negative signs.

*Source:* Treasury (2011d, pp. 3, 11).

accounts reconciliations have been added. The audited 2009–10 WGA is expected to be published before the statutory deadline of 31 December 2011. Discussion of these unaudited 2009–10 numbers is postponed until later in this paper.

## 1: THE U.K. CONCEPTION OF WGA

### *Theoretical Background*

Exactly what would be consolidated within U.K. government accruals accounts has been a recurring issue. In the mid-1990s, the Treasury imposed an area of consolidation for the resource accounts of government departments that breached FRS 2 (ASB, 1992), the U.K. GAAP standard on consolidation (Heald and Georgiou, 2000). In U.K. terminology, this is expressed as ‘setting the departmental boundary’. Executive agencies that were not trading funds would be consolidated but non-

MACRO-FISCAL ROLE OF THE U.K. WGA

TABLE 2

UNAUDITED SUMMARIZED WGA STATEMENT OF FINANCIAL POSITION, 2009–10

	£bn
Assets	
Property, plant and equipment	708.0
Equity investment in public sector banks	65.3
Other assets	432.0
Total assets	1,205.3
Liabilities	
Net public service pension liability	(1,133.3)
Gilt edged securities	(803.8)
Provisions	(105.0)
Other liabilities	(379.4)
Total liabilities	(2,421.5)
Net liabilities	(1,216.2)
Financed by future revenues	
General reserves	1,421.4
Revaluation reserves	(205.2)
Liabilities to be funded by future revenues	1,216.2
Reconciliation to national accounts:	
Net liabilities per WGA	1,216
Net public service pensions liability	(1,133)
Provisions	(105)
PFI contracts	(25)
Unamortised premium or discount on gilts	(16)
Tangible and intangible fixed assets	759
Payables and receivables	40
Investments	16
Other	8
Public sector net debt (national accounts)	760

*Note:* This table follows the signing convention of the source, whereby summary totals omit negative signs.

*Source:* Treasury (2011d, pp. 3, 11).

departmental public bodies (except those that were vote-financed), trading funds and public corporations would not be consolidated.<sup>2</sup>

<sup>2</sup> The structure of U.K. central government reflects historical evolution and political convenience rather than coherent design. There are two types of government department: ministerial (headed by a minister) and non-ministerial (headed by a civil servant). Within departments, routine operations are often conducted by Executive agencies, over which ministers/other heads of department retain policy responsibilities. (A small number of such agencies, namely those which generate extensive revenues, have trading fund status, which means that they are subject to a control system similar to that for public corporations.) More distanced from ministers, with some delegated policy responsibilities but account-

The Treasury refused to move on this issue, except marginally, but did respond to criticism (e.g., Heald and Georgiou, 1995) by promising to revisit the issue of the departmental boundary at a date later than the implementation of Resource Accounting and Budgeting (RAB) in 2001–02 (Treasury, 1995). Not until 2009–10, the first year of U.K. central government accounting on an IFRS basis, was there a significant extension of the departmental boundary along the lines proposed for many years by the FRAB.

In 1995, the Treasury also resisted proposals for a WGA consolidating the whole public sector. However, the Treasury changed its position in 1998, publishing the *Scoping Study* (Treasury, 1998b), in which it announced the WGA timetable. There would be a Whole of Central Government Account (WCGA), as well as a WGA which would consolidate the whole U.K. public sector, including local authorities and public corporations. This inclusion of local authorities was an essential part of the architecture of the WGA, designed to align with national accounts aggregates used for fiscal planning. There was never a debate as to whether local authorities would satisfy FRS 2's (ASB, 1992) control-based criteria for consolidation by central government.

This decision in favour of a macro-fiscal WGA can be linked to the change of government (Conservative to Labour) in 1997, and the development by the new Chancellor of the Exchequer (Gordon Brown) of fiscal rules. Originally published the day before the March 1998 Budget, the *Code for Fiscal Stability* (Treasury, 1998a) was made statutory by the *Finance Act 1998*. The self-imposed domestic fiscal rules were (a) the golden rule (borrowing only to invest, meaning that the current surplus over the economic cycle would be zero or positive), and (b) the sustainable investment rule (public sector net debt would be kept below 40% of GDP, though there was some ambiguity about whether this rule applied in every year or over the economic cycle).<sup>3</sup> Gordon Brown made it clear that he viewed the U.K. fiscal rules as superior to those in the European Union (EU) Stability and Growth Pact, which requires the deficit to be less than 3% in each year and general government gross debt<sup>4</sup> to be less than 60%.

The effect on the RAB project was to emphasize its importance, beyond the original focus on financial reporting and financial management, to the generation of better data for macroeconomic policy making and for fiscal transparency (Heald, 2003). The role of WGA would go beyond better data for the national accounts-based aggregates used for macroeconomic policy, providing incremental information

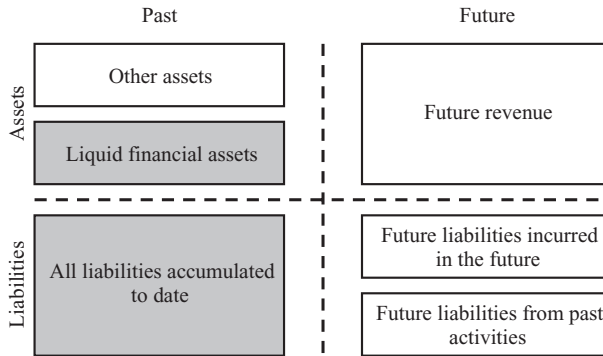
able through the minister to Parliament, are non-departmental public bodies (NDPB). Public corporations are trading and commercial organizations at some further distance from the department, but still accountable to Parliament through the minister. Privatization has dissolved many public corporations and some trading funds, but the model of using Executive agencies and Executive NDPBs has a strong hold.

<sup>3</sup> Over most of the first economic cycle, as identified by the Treasury, to which these domestic fiscal rules applied, only the golden rule had bite. The sustainable investment rule was easily met; at that time U.K. general government gross debt was well below the Maastricht ceiling of 60%. Moreover, some of the EU member states admitted to the eurozone had debt levels far in excess of the Maastricht ceiling.

<sup>4</sup> '[General Government Gross Debt] differs from the U.K. fiscal measure [Public Sector Net Debt] in two important respects. The first is the sectoral boundary, being defined as General Government; it excludes the net debt position of public corporations, which are included in the public sector. The second is that it measures gross liabilities and does not net off liquid assets' (ONS, undated, para. 26).

FIGURE 1

NATIONAL ACCOUNTS MEASURE OF NET DEBT



Source: Treasury (2003, p. 17).

about the public sector balance sheet. Although such a focus may seem exceptional internationally, the explicit notion that the U.K. government, particularly the Treasury, has responsibility for public expenditure as a whole, not just that of central government, dates back to the Plowden (1961) Report.

In a separate development, the Treasury established a long-term public finances team, whose work led to important conceptual and modelling developments. A pressing issue for the United Kingdom, as for many other EU countries, relates to the fiscal implications of an ageing population and to explicit and implicit pension debt. The first public manifestation of this Treasury work was the Long-term Public Finance Report (Treasury, 2002c), published for the first time alongside Pre-Budget Report 2002 (Treasury, 2002b). An expanded explanation of the thinking behind the projections appeared in the 2003 Report (Treasury, 2003) and is further elaborated by Eich (2008), who led these developments when working in the Treasury.

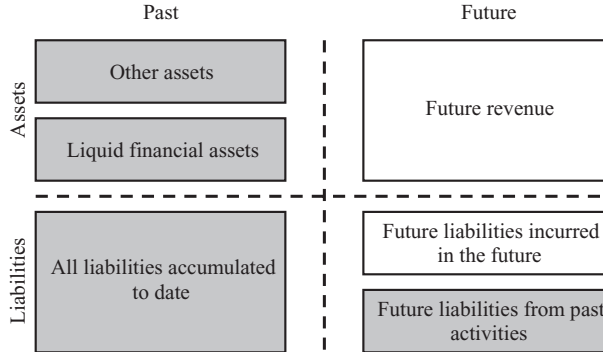
During apparently prosperous times, there is relatively little public debate about U.K. public finances. Since the onset of recession, that debate has focused almost entirely upon borrowing and net debt. If a metaphorical hurricane swept away all the United Kingdom’s physical infrastructure, net debt would not show any effect until reconstruction began. Net debt figures concentrate on the liabilities side of the public sector balance sheet, netting off only liquid financial assets.

Figures 1 to 3, reproduced from Treasury (2003), are quadrant diagrams which show assets and liabilities (rows) and past and future (columns).<sup>5</sup> In successive figures, there is more shading, indicating that a wider range of assets and/or liabilities is included in the coverage. For example, net debt (Figure 1) includes all liabilities

<sup>5</sup> This paper retains the diagram sequence of Treasury (2003, pp. 17, 20 and 23), even though a reformulation, which introduces contingent liabilities but not contingent assets, has now been published in OBR (2011b, pp. 19–20) and Treasury (2011d, p. 10—the counterpart of Figure 2 only).

FIGURE 2

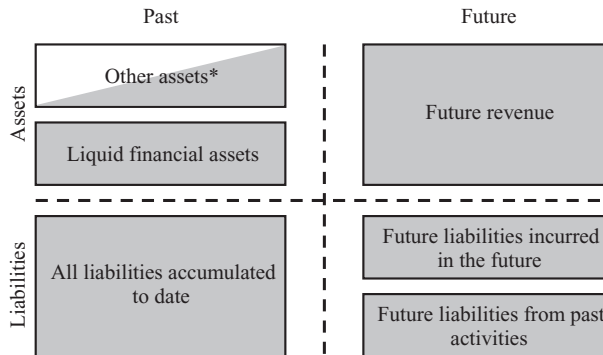
ACCRUALS-BASED BALANCE SHEET



Source: Treasury (2003, p. 20).

FIGURE 3

COMPREHENSIVE PROJECTIONS



\*Comprehensive projections usually only include financial assets.

Source: Treasury (2003, p. 23).

accumulated to date (bottom left quadrant), from which are deducted liquid financial assets (only a sub-set of the assets accumulated in the past).

The accruals-based balance sheet (i.e., WGA) is represented by the shading in Figure 2. This includes all assets and liabilities accumulated in the past, bringing in the ‘other assets’ excluded from net debt. The treatment of the future is more complicated. Future revenue fails the accounting recognition test. Also failing the recognition test is ‘future liabilities incurred in the future’: this sounds awkward but these should be thought of as commitments (e.g., state old age pensions).

The sequence is completed by Figure 3, which represents the long-term comprehensive projections developed by the Treasury and updated in the annual Long-term

Public Finance Reports.<sup>6</sup> Throughout U.K. budgetary documents, the Treasury has made a distinction between ‘forecasts’ (to which ministers are committed) and ‘projections’ (forward numbers that incorporate existing trends, but which do not embody ministerial policy). Projections for 45 years and for an infinite horizon sat on top of the platform of the five-year medium-term forecast prepared by a different section of the Treasury. The overall period was therefore 50 years, consisting of five from the medium-term forecast and 45 from the projections. Responsibility for both forecasts and projections now rests with the OBR.

As is emphasized in these reports, a large number of assumptions, principally about economic growth and demographic trends, are required to make long-term fiscal projections. The advantage of making these explicit includes the possibility of undertaking sensitivity analyses. Because these projections focus on future cash flows, it is possible to include future tax revenues and ‘future liabilities incurred in the future’.<sup>7</sup> The analytical tools used in the long-term fiscal projections are various formulations of fiscal gaps: for example, as a percentage of GDP, how large are the positive or negative changes in fiscal stance that are required to meet a specified measure of fiscal sustainability (Woods, 2006; Eich, 2008)?<sup>8</sup>

This conceptual development work at the Treasury located the GAAP-based WGA within the macro-fiscal framework, plotting its relationship to the narrow net debt measure and the broader comprehensive projections. There is a parallel development in a report on Sweden (Molander, 2009). However, it is important to note that Hills (1984, 1989) constructed an unofficial time series of the U.K. public sector balance sheet. One of the puzzles is why it has taken so long for this to move centre stage: perhaps the availability of better data, thanks to the spread of accruals accounting

<sup>6</sup> Long-term Public Finance Reports were published alongside the November/December Pre-Budget Reports from 2002 to 2006. No such report was published with Pre-Budget Report 2007 but one did appear accompanying Budget 2008. A report accompanied the Pre-Budget Report 2009 but did not contain the comprehensive long-term modelling of previous issues. There has been no official explanation of the reasons for departing from the original publication sequence. One might speculate that (a) the uncertainty attached to the near future makes credible projections far more difficult to do, and (b) there may have been reluctance to publish a report showing that U.K. public finances are unsustainable on existing policies.

<sup>7</sup> The comprehensive spending projections included capital as well as revenue spending. Treasury (2003, Annex) converted investment into a flow of service to deal with the intergenerational effects of capital spending in the generational accounts framework. The note to Figure 3 about the semi-shaded box (reproduced from Treasury, 2003, Chart 3) should be interpreted in the following way. When calculating the inter-temporal budget gap or fiscal gaps, the starting point is the existing gross or net debt stock. The existing public sector capital stock is not factored in; this could be done, but would lead to the calculation of different indicators. The inter-temporal budget or fiscal gaps are purely financial indicators in the sense that they do not take into account whether spending is current or capital as the focus is only on the future primary balance. The fact that capital spending creates lasting assets while current spending does not has no effect on the inter-temporal budget gap or fiscal gap. The concern of the models is exclusively with fiscal sustainability, not with inter-temporal equity.

<sup>8</sup> This U.K. approach is different from, but related to, the fiscal sustainability simulations conducted on a regular basis by the European Commission. A driving force behind the Commission’s work has been the costs of demographic ageing, especially in the context of the fixed exchange rate regime that applies to those EU member states which are members of the eurozone (European Commission, 2009).



across the whole U.K. public sector, is one factor behind the growing interest. Another factor is concern about the build-up of pension and other age-related liabilities.

The U.K. model of the WGA can be viewed as providing a supplementary fiscal indicator that goes beyond deficits and net debt. It builds upon, and could improve, the data behind the national accounts measure of net worth. The WGA can never be a self-sufficient fiscal indicator, not least because of the valuation problems that inevitably arise. Year-on-year changes will be difficult to interpret. Nevertheless, the WGA at a country's whole public sector level can provide insights into important fiscal questions. This broader view is particularly important during the current recession as it gives a clearer picture of government financial health or ill-health. While the concepts of 'fiscal sustainability' and 'intergenerational equity' are difficult to make operational, both clearly depend on what happens to the assets side and not just to the liabilities side. United Kingdom policy focus is upon borrowing, net debt and Maastricht indicators, in part because of international obligations and surveillance arrangements. However, that does not detract from the point that assets matter. Both the process of developing the WGA, and the resulting figures, will provide useful incremental information.

There is no obvious optimal level of public sector net worth. Those who favour a large economic and social role for the state would presumably wish to see strongly positive net worth, reflecting both the physical assets held by the state and financial assets held in part to smooth, for example, the budgetary costs of demographic ageing and the depletion of state-owned natural resources. However, those who favour greater focus on using the market rather than the state would presumably wish to see lower public sector net worth. In the context of industrialized market economies, there is no logic in maximizing public sector net worth. What is important is to understand changes, as this provides a different perspective on budgetary policies and long-term fiscal developments.

### *Regulation of the WGA*

United Kingdom developments have certain distinctive characteristics. The *Government Resources and Accounts Act 2000* determines the area of consolidation, not IAS 27 (IASB, 2008). The U.K. WGA is about the whole of the public sector, an interpretation re-enforced by the Treasury's refusal to publish the completed WCGA,<sup>9</sup> which should be seen as an entity for which the U.K. government is to be held accountable. A possible explanation for this refusal was fear that negative net assets—inevitable, given the asset and liability structure of the tiers of the U.K. public sector—would lead to 'government is bust' headlines. Such headlines subsequently arrived in abundance in the wake of the global financial crisis.

A jurisdiction-level WGA should be governed by best financial reporting practice, say, IFRS with limited public sector-specific adaptations and necessary interpreta-

<sup>9</sup> The Treasury wrote to one of the authors on 19 August 2008, after having conducted an internal review of its earlier decision not to release completed WCGAs and WGAs under the provisions of the *Freedom of Information Act 2000*. The grounds for this refusal were that premature release would risk damage to the 'financial interests of the U.K.'. Those interests might also be prejudiced by explaining the nature of the potential damage (Treasury, 2008b, paras 15 and 22).

tions. In contrast, macro-fiscal WGAs face an inherent tension between (a) financial reporting regulation (International Accounting Standards Board [IASB] and International Public Sector Accounting Standards Board [IPSASB]) and (b) national accounts regulation (UN System of National Accounts [SNA] and Eurostat's European System of Accounts [ESA]). The *Government Resources and Accounts Act 2000* contains powers of statutory override, intended for application in specific areas (e.g., exclusion of Parliament and the National Audit Office [NAO]) but potentially available to create wider divergence. Nevertheless, the working assumption is that, in most cases, IAS 27 will apply, except in terms of the WGA being defined to include local authorities and public corporations, in line with the national accounts' definition of the public sector.

Before July 2011, only one number (net liabilities per WGA in 2005–06) had been published from the U.K. WGA project. This appeared in the 2008 Long-term Public Finance Report (Treasury, 2008a, Chart 4.1 on p. 34), which showed net liabilities per WGA as 22% of GDP.<sup>10</sup> The preparation of the 2009–10 WGA has been further complicated by that being the first year for which central government and related bodies have accounted on an IFRS-basis, and by the later 2010–11 implementation of IFRS in local authorities.

The July 2011 publication (Treasury, 2011d, p. 5) of the unaudited summarized WGA records net liabilities per WGA as being 84.5% of GDP at 31 March 2010. There is no public domain analysis of this huge increase (62 percentage points) that would indicate the extent to which this reflects fiscal deterioration rather than improved data. Over the same period, public sector net debt (excluding financial sector interventions) increased by 16.9 percentage points and public sector net worth fell by 18.9. Despite these limitations, there is now something to work on, as the GAAP-based measure can be compared with data available for a much longer period from the national accounts.

## 2: THE SCALE OF FISCAL DAMAGE TO U.K. PUBLIC FINANCES

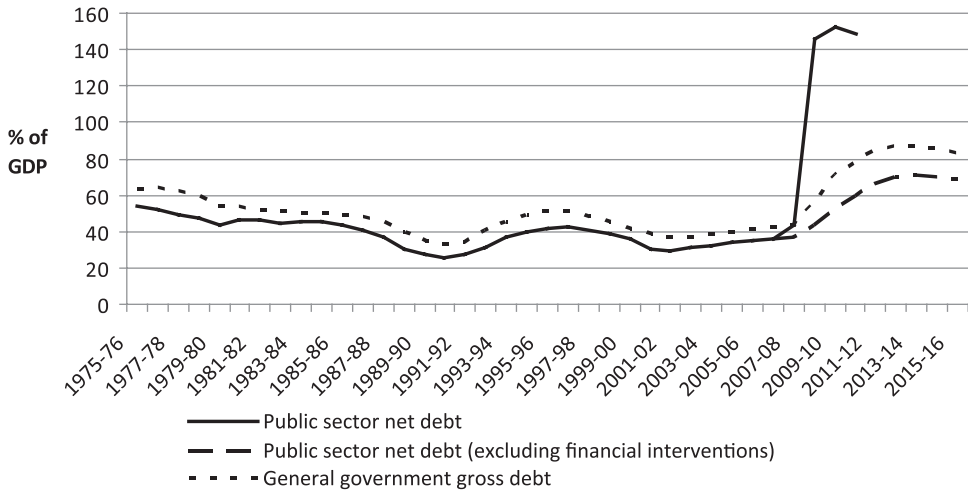
There are three issues to be addressed in this section, which presents balance sheet data for the U.K. public sector. First, if U.K. public finances really have been 'wrecked for a generation' (as Karel Williams has claimed; Parker *et al.*, 2009), should this damage be attributed solely to the U.K.'s financial sector? In contrast, Weale (2009, p. 7) portrays recent U.K. financial and fiscal history as 'A twenty-year binge: the profligate generation', portending a harsh period of redress for both public finances and private household finances. Second, the question arises as to what currently available evidence can be brought to bear on this issue. Third, what will be the incremental information content of the WGA, especially when there is a run of years of balance sheet data so that underlying patterns can be identified?

The first two questions can be taken together by looking at developments in net worth (national accounts) and indicative net liabilities (which can be thought of as

<sup>10</sup> There were no comparable data in the 2009 Report (Treasury, 2009e) but the OBR (2011b) published in July 2011 its first Fiscal Sustainability Report, following a comparable methodology.

FIGURE 4

MEASURES OF U.K. PUBLIC DEBT



Note: All data relate to the end of the financial year (31 March).  
 Sources: Treasury (2011a, Table A6); ONS (2011, p. 3).

a national accounts-based proxy for net liabilities per WGA). It will be useful to know whether these confirm or change the impression created by recent explosive increases in net debt. The data presented in the figures show problems that preceded the crisis in the global financial sector. This picture emerges notwithstanding that the Treasury’s (supposedly strict) self-imposed fiscal rules were met during the U.K. economic cycle running from the first half of 1996 to the second half of 2006 (Treasury, 2008c, para. 2.13 on p. 16). On the third question, the potential incremental information content of the WGA will also be demonstrated, but its decision-usefulness and transparency value will depend heavily on supplementary disclosures<sup>11</sup> and on having data for a run of years.

The presentation of information on U.K. public finances is influenced by the United Kingdom’s position as a member of the European Union (27 countries), but not being part of the eurozone which now consists of seventeen countries. Figure 4 plots actual and forecast data for the period from 1975–76 to 2015–16:

<sup>11</sup> For example, a decomposition of provisions which will be the principal difference between net worth (national accounts) and net liabilities per WGA (IFRS). Other than capital consumption (the counterpart to depreciation in financial reporting), national accounts do not include provisions. The U.K. government currently has negative net assets, described as ‘net liabilities per WGA’. In this paper, however, statements are made about the increase/decrease in net assets, to avoid complicated sentence structures involving double negatives.

1. The dotted line plots general government gross debt on a Maastricht basis, which is the criterion used to assess the United Kingdom's performance against its EU obligations;
2. The bold line plots public sector net debt, which has been the Treasury's preferred measure, and was the criterion relevant to compliance with the U.K.'s domestic fiscal rules until their suspension; there are no official forecasts of this 'inclusive' measure, so 2010–11 outturn is the latest data entry; and
3. The dashed line plots public sector net debt excluding the direct cost of financial interventions (mostly in relation to public sector banking groups), departing from the full measure from 2007–08 onwards.

In November 2008, the Labour Government suspended the 1998 fiscal rules as part of its policy response to the global financial crisis, instituting instead a 'temporary operating rule' (Treasury, 2008c, p. 9). The Conservative–Liberal Democrat Government's fiscal policy mandate to the Treasury focuses on the immediate fiscal problem, containing two elements (Treasury, 2011c, p. 7): 'forward-looking target to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period' supplemented by 'a target for public sector net debt as a percentage of GDP to be falling at a fixed date of 2015–16, ensuring the public finances are restored to a sustainable path'.

Budgetary and reporting documents now emphasise (3), with (2) having very low profile, notwithstanding the declared attachment to national accounts aggregates. The Treasury's Budget presentation excludes 'liabilities and unrealized losses from financial sector interventions' (Treasury, 2009b, Table C2 on p. 222). The Treasury's (2011a, Table A6) monthly 'Public Sector Finances Databank' does not report (2). Another manifestation of Treasury control of data presentation is the disappearance of data for core debt. The principal difference from net debt is that 'the main variable element in the debt stock (the cycle) has been removed from core debt' (Treasury, 2002a, para. 1.4). The dropping of the core debt series after May 2010 was not announced, the change being made in response to (unspecified) Treasury policy needs without there being external consultation.

Four issues of major importance can be identified: whether the debt measure refers to general government or to the public sector; whether the debt measure is gross or net; whether there should be cyclical adjustment; and whether debt relating to 'temporary support' to the financial sector should be included. Independent forecasters, such as the National Institute of Economic and Social Research, also produce forecasts of the path of U.K. net debt.<sup>12</sup>

The increases in net debt from 2008–09 are breathtaking, when juxtaposed with what now look like modest cyclical swings over the previous 20 years. The Stability and Growth Pact's 60% rule on general government gross debt has not previously been

<sup>12</sup> The Treasury published forecasts twice a year: at the Pre-Budget in November/December and at the Budget in March/April; this responsibility has now passed to the OBR. Given the present uncertainty about the economy, one reason why external forecasts may differ from official ones relates to the dates at which they are made.

a constraint on the United Kingdom; the domestic ‘sustainable investment rule’ established a 40% ceiling on the net debt measure.

Some brief commentary on the current U.K. fiscal position is necessary:

1. This doubling of net debt—below 40% to over 90% on the Barrell and Weale (2009) projection—is a reflection of the support that the U.K. government has given to its domestic economy after the near-meltdown of the U.K. financial sector.
2. In addition to the direct and indirect effects of the global financial crisis on net debt and GDP, the Office for National Statistics (ONS) has reclassified some banks to the public sector on the basis of control by government; the liabilities of such banks are therefore included in the ‘broader’ measure of net debt, while the corresponding assets are disregarded unless they are liquid financial assets.
3. The United Kingdom has been particularly vulnerable given the large size of its financial sector which makes a much more than proportional contribution to tax revenues (Giles, 2011).<sup>13</sup>
4. The U.K. government was running a budget deficit<sup>14</sup> during the long boom, not having adopted the substantively prudent approach of certain other countries, including Australia.

With hindsight, the U.K. government mistook froth for a step-change in the performance of the U.K. economy; the froth was highly productive of tax revenues.

There are significant differences of view about the appropriate policy response. Samuel Brittan, an economic commentator on the *Financial Times*, has taken the view that increases in borrowing and debt should be accepted in order to support the fragile economy. An early withdrawal of government support—monetary as well as fiscal—might convert the recession into a depression (Brittan, 2009). Others warned that immediate fiscal action had become imperative, otherwise, the United Kingdom risked a debt downgrade. The latter view has been decisively taken by George Osborne, Chancellor of the Exchequer in the Conservative–Liberal Democrat Coalition Government which replaced the Labour Government in May 2010.

The United Kingdom has to make a large fiscal ‘consolidation’, a euphemistic way of saying lower expenditure and/or higher taxation than would otherwise have been the case. The Treasury’s view was that the United Kingdom had suffered a permanent loss of output of 4% of GDP (NAO, 2009, para. 109) and that, when recovery came, the economy would not return to its former growth path but would be on a

<sup>13</sup> There are no official statistics on the overall contribution of particular sectors to taxation revenue. In 2008, ‘financial intermediation’ contributed 9.0% of gross value added at current basic prices (ONS, 2010, Table 2.3). The pay-as-you-earn income tax revenue attributable to ‘financial and insurance services’ in 2007–08 was 14.9% (HMRC, 2010, Table 2.10) while the corporation tax revenue attributable to ‘banking, finance and insurance’ in 2007–08 was 25.1% (HMRC, 2010, Table T11.7). Notwithstanding the differences of coverage suggested by the labelling, the importance of the financial sector to U.K. tax revenues is clear.

<sup>14</sup> In part because of EU membership, the U.K. Treasury reports more than one deficit measure: surplus/deficit on current budget (an accruals measure); primary balance (an accruals measure); and Treaty deficit (actually, general government net borrowing on a Maastricht basis) (Treasury, 2009b, Table C2 on p. 222). Most measures are also presented on a cyclically adjusted basis.

lower one, even if the previous trend rate of growth were restored. The latest published estimate of the hit to trend output is in the June 2010 Pre-Budget Forecast (OBR, 2010, p. 73), which suggested an output loss of  $8\frac{3}{4}\%$  at the start of 2015 relative to the level implied by trend growth of  $2\frac{3}{4}\%$  from the end of 2006. However, these estimates are not comparable, as this later estimate did not reflect an OBR view of the historical output gap and the reference dates differ.

The peak of the economic damage came in 2009–10: excluding the financial interventions, the public sector current deficit was 7.63% of GDP; public sector net borrowing was 11.13%; and the year-on-year increase in the public sector net debt ratio at financial year end was 9.5 percentage points of GDP (ONS, 2011, p. 3). (The year-on-year increase in the public sector net debt ratio, including financial interventions, was 102.4 percentage points of GDP.) Given that these are not normal times, the separation between cyclical and structural factors is particularly problematic; the present world is not one of symmetric economic cycles.

If there had been a series of published WGAs from 2005–06 to 2008–09, it would have been possible to examine the impact of the late boom and current recession. The available data relate to the conceptualization of the accruals-based balance sheet in Figure 2 in the following ways:

- *Net worth* represents the difference between total assets (the sum of liquid financial and other assets, top left) and all liabilities accumulated to date (bottom left), reflecting the fact that debt incurred in the past has contributed to the financing of assets held today.
- *Indicative net liabilities* is net worth (as above) plus future liabilities from past activities (bottom right), using statistical estimates from the national accounts because full sets of entity financial reports are not available.<sup>15</sup>
- *Net liabilities per WGA* is conceptually the same as indicative net liabilities but is fully underpinned by financial accounts, U.K. GAAP-based until 2008–09 and then IFRS-based from 2009–10, adjusted for road infrastructure values in local government.

Two points to note are that (a) net worth is an intermediate step between net debt and indicative net liabilities, and (b) indicative net liabilities are a proxy measure of net liabilities per WGA.

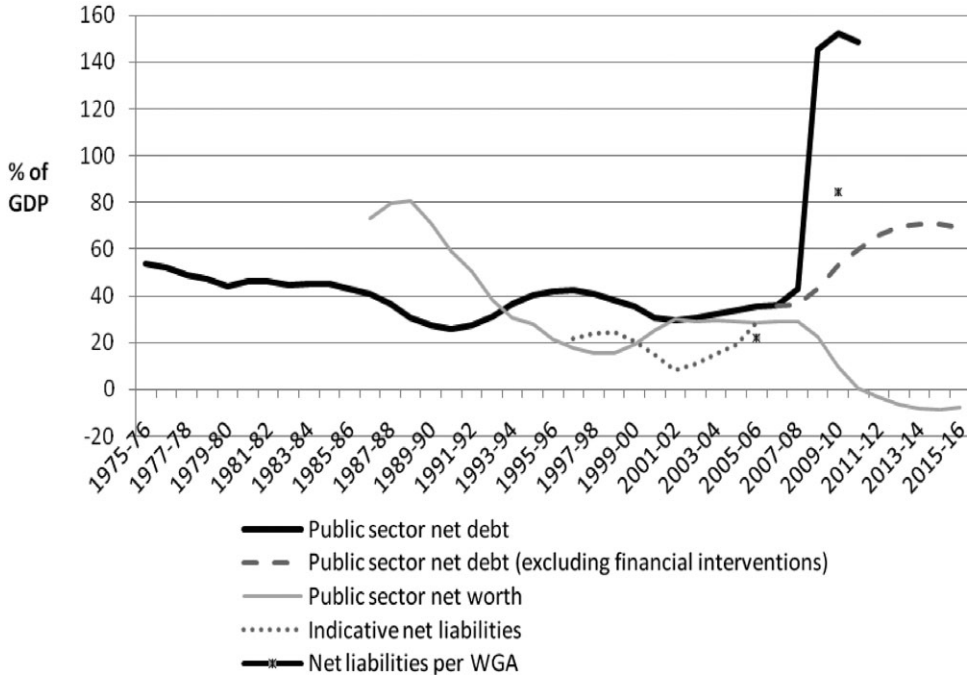
Some perspective about the U.K. public sector balance sheet can be gained from Figure 5, which uses national accounts data to get as close as possible to what the WGA might show. It extends the graph that appeared in the 2008 Long-term Public Finance Report (Treasury, 2008a, p. 34). Instead of starting at 1996–97, Figure 5 takes net debt back to 1975–76 and net worth to 1986–87.<sup>16</sup> All four series are plotted above the horizontal axis. However, only net worth is ‘positive’ in the sense that

<sup>15</sup> In practical terms, this involves starting with ONS public sector net worth, then—from GAAP-based balance sheets—adding single-use military equipment and subtracting provisions. If indicative net liabilities and net liabilities per WGA were using common data sources, there may be a data discontinuity in the former series at the year in which this began.

<sup>16</sup> It should be noted that ONS compiles public sector net worth on a calendar year basis, so these figures from OBR (2011b, Chart 2.1) involve pro-rating to convert into financial years.

FIGURE 5

FISCAL INDICATORS FROM THE U.K. PUBLIC SECTOR BALANCE SHEET



Note: All data relate to the end of the financial year (31 March).  
 Sources: Treasury (2008a, p. 34; 2011a, Table A6); ONS (2011, p. 3) and OBR (2011b, Chart 2.1).

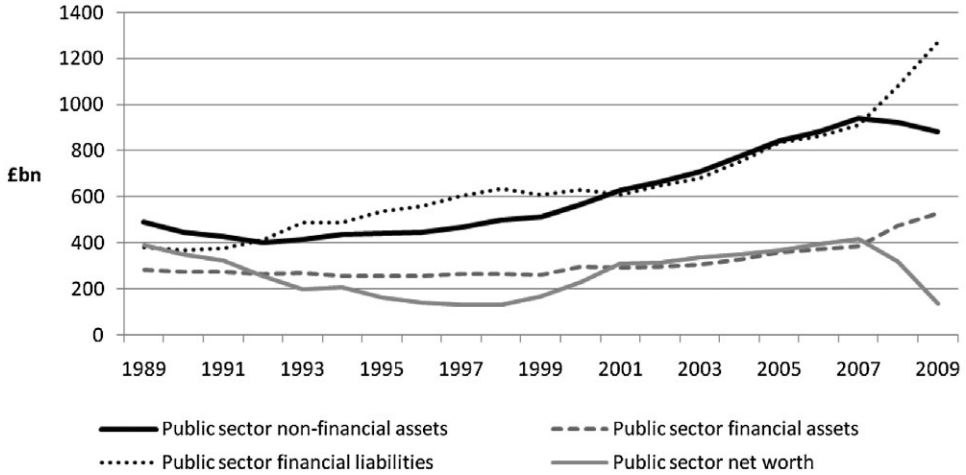
increases might normally be thought of as desirable and decreases as undesirable. In contrast, lower net debt, lower indicative net liabilities and lower net liabilities per WGA would generally be thought of as preferable to higher net debt, etc.

The reduction in net worth from 80.4% of GDP (1988–89) to 15.5% (1997–98) was dramatic, indicating that analysis of how the components of net worth changed will be useful. Significant factors will have been the Conservative Government’s privatization program and the early 1990s recession. After recovering from the 1997–98 low, net worth remained around 29% of GDP from 2001–02 until 2007–08, which was a period of remarkably fast growth in total public expenditure. It then fell sharply to 9.7% in 2009–10, 0.4% in 2010–11 and is projected to go negative in 2011–12. This will be driven by exceptional levels of borrowing and accumulating debt.

Figure 6 examines the components of net worth, on the original calendar-year basis. The coverage is from 1989 to 2009 and is expressed in nominal terms (i.e., no inflation-adjustment). There is strong growth in non-financial assets even before the post-1998 period of unprecedented public expenditure increases. The growth in

FIGURE 6

U.K. PUBLIC SECTOR NET WORTH, 1989–2009



Note: All data relate to 31 December.  
 Source: ONS (2010, various tables).

financial assets is more subdued. However, the growth in financial liabilities is even stronger than the growth in non-financial assets.

Figure 7 adjusts net worth and its components for inflation using the GDP deflator. Given the pattern of inflation in the period, the main effects are to show net worth as higher in 1989 and to emphasize the reduction in net worth over the period 1989 to 1999. The inflation-adjusted reduction is 80% of 1989 net worth, whereas the nominal reduction is 65%. When discussing net worth data, it must always be remembered that these are the difference between two extremely large numbers, both subject to measurement errors.

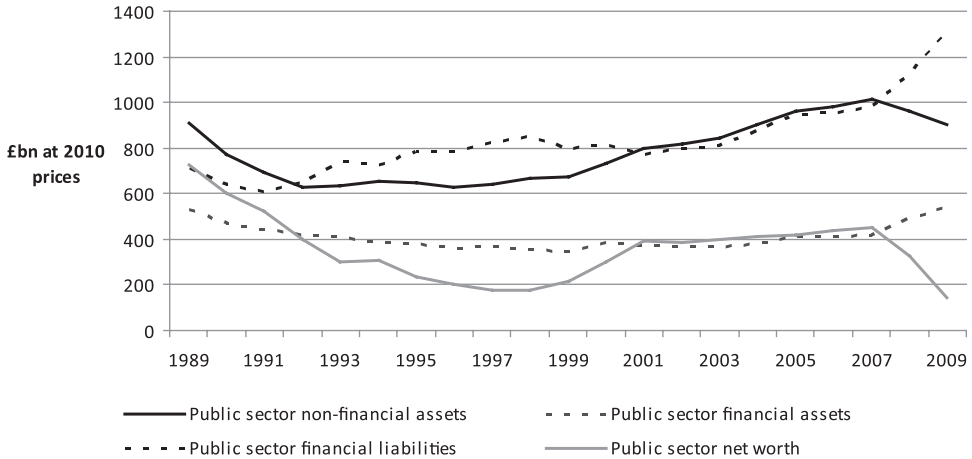
It is useful to sum up what is known about the U.K. public sector balance sheet. The Treasury refused to publish the WCGAs and WGAs which had been prepared, including denial of a Freedom of Information request (Treasury, 2008b). This refusal extended to data about indicative net liabilities and net liabilities per WGA, beyond what was published in the 2008 Long-term Public Finance Report (Treasury, 2008a). For 2005–06, indicative net liabilities and net liabilities per WGA were comparatively close (29% of GDP as against 22%), though this may in part reflect the use of common adjustments derived from unpublished U.K. GAAP balance sheets. The unaudited 84.5% of GDP figure for net liabilities per WGA in 2009–10 has no published counterpart in indicative net liabilities.

The post-1979 shift, especially early and pronounced in the United Kingdom, from the positive state to the regulatory state (Majone, 1997) makes it difficult to determine a desirable path for net worth. Privatizations will generally reduce reported



FIGURE 7

U.K. PUBLIC SECTOR NET WORTH AND ITS COMPONENTS, 1989–2009



Note: All data relate to 31 December.  
 Source: ONS (2010, various tables) and Treasury (2011b).

public sector net worth, as a result of transactions costs, disposals at discounts (or recognition of previously hidden losses) and capital distributions from government to taxpayer-citizens. Nevertheless, with mounting concern about the costs of population ageing, a prudent fiscal policy, *ceteris paribus*, would be to pre-fund some of these costs by an anticipatory build-up of net worth.

An important unknown is the quality of the data underlying this discussion. However, it would be reasonable to assume that data quality at the entity level improved after 2001–02 (RAB across central government) and should improve further after the WGA is published, particularly from 2010–11 when the whole U.K. public sector will be using a reasonably harmonized version of IFRS. In line with international practice, the ONS uses the perpetual inventory method (PIM) across all sectors of the economy to calculate capital consumption, the national accounts counterpart of depreciation. McLaren *et al.* (2011) announced ONS’s proposal to use WGA data for central government in place of PIM estimates for the 2012 Blue Book, while noting potential difficulties including the timing of WGA data availability.

Notwithstanding these caveats, the balance sheet data cast a different light on U.K. experience than would be gained from the ‘success’ in meeting the domestic fiscal rules in the previous economic cycle. ‘Success’ is enclosed within inverted commas as a reminder of the widespread criticism of the way that the Treasury re-interpreted the golden rule in mid-cycle and extended backwards the starting date of the cycle. Whether these changes, which made the golden rule easier to achieve, were justified is less important than the way in which the changes undermined confidence and trust in the domestic fiscal rules.

## 3: THE WGA PERSPECTIVE ON FISCAL RETRENCHMENT

Discussion of U.K. public finances is currently phrased in apocalyptic language, with commentators competing to be the most gloom-laden. In part, this tone reflects the approach to, and aftermath of, the 2010 general election and a political climate which suddenly swung from celebrating a long period of planned public expenditure growth to one in which the wildest of proposals for service cutbacks and efficiency savings are reported at face value. What is most striking, however, is that most discussion of future public expenditure reductions to meet the twin problems of deficit and debt pay attention neither to the distinction between cash and accruals nor to the impact of 'savings' proposals on the public sector balance sheet.

The rapid growth of U.K. public expenditure from 1998 was in part intended to offset the effects of earlier fiscal retrenchments<sup>17</sup> which had disproportionately affected capital expenditure and contributed to long-term infrastructure deficiencies. Although there is disagreement about the timescale over which the huge deficit should be closed, there is none about the necessity of bringing that deficit down when the economy has recovered. The potential contribution of WGA to public policy debates about fiscal retrenchment is to be found in its transparency value. There is likely to be a substantial illusory component to fiscal retrenchment, as many proposals may reduce some measures of deficit and debt but inflict damage on the public sector balance sheet. A non-exhaustive set of examples will be briefly discussed, some of which echo the internationally recognizable practices of the past (Savage, 2005).

*Privatizing State Assets*

Generating revenue from privatizing state assets will reduce the deficit if the proceeds are treated as negative expenditure, rather than as a means of financing the deficit. Regardless of treatment, asset sales (e.g., enterprises, land and buildings, or spectrum) will, if so used, reduce net debt. What is usually ignored when such actions are proposed is that these represent a change in the public sector's portfolio of assets: cash increases whereas other assets decrease. Such sales will only increase net worth and net assets per WGA if the net-of-transactions-costs sales proceeds exceed the value to government of those assets.

As discussed in Section 1, there is no coherent rationale for maximizing public sector net worth/net assets per WGA. However, there is good reason to view with suspicion proposals to respond to a recurrent deficit with one-off transactions involving the public sector balance sheet. If the public sector holds assets which the private sector would use more efficiently and public policy goals would not be compromised, then there is a *prima facie* case for privatization. However, the expectation would be that a typical transaction would reduce net worth/net assets; expe-

<sup>17</sup> In public policy debates, fiscal retrenchment is usually described as 'fiscal consolidation', a euphemism that might lead to ambiguity when used in a paper concerned with consolidation in the accounting sense. The conventional wisdom of economists and policy makers is that a fiscal consolidation heavily weighted towards expenditure reductions rather than tax increases has more chance of success, in the sense of the effects 'sticking' and not being reversed at a later date.

rience suggests that transactions costs are considerable and disposals often take place at discounted prices. As an example, the Labour Government portrayed a proposed £16 billion asset sales program as a deficit-reduction measure (Wintour, 2009). It might be argued that governments and public bodies are often reluctant to dispose of assets except when under severe fiscal pressure. While this may be true, this does not affect the substantive proposition that privatizations will usually lead to reductions in net worth/net assets per WGA. The international salience of this point is emphasized by the external imposition of fire sales of public assets on eurozone countries such as Greece and Portugal, which suffer from problems of competitiveness and solvency.

#### *Neglecting Public Sector Assets*

A chronic problem in the U.K. public sector, replicated in many countries, has been the neglect of assets once acquired. Perrin (1984) associated this with the absence of capital accounting and the treatment of capital assets as free goods. Deferring the maintenance of capital assets reduces deficits and thus debt, and is seen as less painful than reductions in public services and employment. Under cash accounting at the entity level, and without a consolidated public sector balance sheet, this process is invisible until it manifests itself in backlog maintenance, often beyond the financial capacity of the entity. Under accruals accounting at the entity level, the resulting deterioration in assets should be indicated by impairment charges, which will feed through to net assets per WGA. Given the very large increases in U.K. public sector capital expenditure since 1998, a new round of neglect would be a depressing development. Better accounting cannot stop assets being neglected but the trend of impairments in the WGA can give signals that this is happening. However, Newberry's (2009) analysis of New Zealand's WGA indicated that asset deterioration might not be signalled because impairments were obscured by revaluations and depreciation. Clearly, the quality of disclosures will be an important factor in determining the usefulness in this regard of the U.K. WGA.

#### *Cutting Public Sector Capital Expenditure*

Cutting public sector capital expenditure is frequently a large component of fiscal retrenchment, in part because it can be done relatively quickly and in part because it transfers the pain outside core government. Such a policy reduces some measures of deficits and also net debt but builds up future efficiency problems as the capital stock cannot be sufficiently reconfigured in response to changing patterns of public service delivery. Capital starvation was a widely diagnosed problem of the U.K. public sector in the 1980s and 1990s, to which out-dated and failing infrastructure has been attributed. While invisible under cash accounting, and hidden without a WGA because there are thousands of entity accounts, in time infrastructure deterioration will be revealed by the WGA. Public sector net investment may become negative and the book value of property, plant and equipment would fall.

An early indication that reductions in capital expenditure will be a feature of the fiscal response to the U.K. deficit was found in the Labour Government's March 2009 Budget. Public sector gross investment was projected to fall from 4.5% of GDP

in 2009–10 (a year increased by projects brought forward as fiscal stimulus) to 2.6% in 2013–14 (Treasury, 2009b, Chart C5 on p. 226). This pattern continued in the June 2010 Budget and October 2010 Spending Review of the Conservative–Liberal Democrat Coalition Government. Alternating periods of capital starvation and gluttony will contribute to poor functionality of the public sector capital stock because they lead to weak implementation and strong vintage effects.

*Substituting Privately-Financed Capital Expenditure for Conventional Procurement*

One method of responding to capital starvation is to substitute capital expenditure by public–private partnerships (PPP) for publicly financed capital expenditure. This becomes attractive to decision makers if the accounting treatment of PPPs allows them to be treated as off the balance sheet of the public sector client. From 2001–02 to 2008–09 there was a large amount of arbitrage under U.K. GAAP between the ASB’s (1998) FRS 5A and the Treasury’s Technical Note 1 (Revised) (Treasury Taskforce, 1999). From 2009–10, with the move to IFRS, most PPP assets went on the public sector client’s balance sheet following the adoption by the Treasury of the IFRIC 12 (IASB, 2006) mirror-image treatment. The new arbitrage is between IFRIC 12 and the Eurostat (2004) national accounts guidance. The important point is less that the national accounts, prepared by the ONS, remain on the basis of risks and rewards than that the specific Eurostat rules are exceptionally lax (Heald and Georgiou, 2010, 2011).

Whereas accounting and reporting will be on an IFRS basis, budgeting and control, which is what decision makers really care about, will be on a national accounts basis. Most PPPs will be on entity balance sheets and on the WGA, but will be outside the national accounts fiscal indicators discussed in Section 2. This will recreate incentives for inefficient public investment decision making (approval will be more likely for PPPs that are ‘Off’ on the Eurostat rules) and obstruct transparency. The Treasury’s (2009d) June 2009 decision to adopt this treatment, at odds with its Alignment project (Treasury, 2009a) designed to give ‘a clearer line of sight’, illustrates just how tempting are such artifices. This was despite the prominence given by the Labour Government to ‘fiscal transparency’ in the Code for Fiscal Stability (Treasury, 1998a). This budgeting treatment has continued under the Conservative–Liberal Democrat Coalition Government, notwithstanding the Charter of Budget Responsibility (Treasury, 2011c).

*Posting Bills to the Future*

Under cash accounting, a recurrent device used in difficult budgetary periods was to find mechanisms by which reported expenditure could be reduced now, at the expense of higher expenditure later. One such device was to persuade employees to accept lower pay settlements accompanied by higher future pension entitlements. Such possibilities remain under accruals accounting, as certain commitments would not meet accounting recognition tests: for example, abolish certain payments to old-age pensioners (e.g., cash winter fuel allowances) while promising restoration of index-linking of pensions at a future date. There has been much comment about how PPPs facilitate the acquisition of new assets now, without reporting the capital expenditure.

Although some devices for posting bills to the future will escape detection in underlying accounts and thus in the WGA, these should be picked up by the Treasury's long-term fiscal projections. More generally, it is well known that accruals accounting provides opportunities for earnings management; the hierarchical systems of financial control over U.K. public sector service delivery organizations (e.g., National Health Service [NHS] Trusts and NHS Foundation Trusts) are settings likely to exhibit such behaviour. The WGA may act as a source of constraint as it gives the NAO leverage across the whole public sector. This will be more formal and structured than the leverage the NAO could have exercised, but did not, over PPP accounting in the NHS; the NAO audited the summarized accounts of NHS bodies of the same type, but did not override the entity-level off-balance sheet treatment allowed by the private and Audit Commission auditors (Heald and Georgiou, 2011).

#### 4: HANDLING THE MESSY PERIPHERY OF THE PUBLIC SECTOR

Exactly what is the boundary of the public sector, as defined for purposes of the WGA, is clearly of profound importance. Issues relating to the boundary are another source of gaming possibilities, but there are also genuine difficulties. Thirty years ago the United Kingdom had a relatively well-defined delineation of the public sector. The model of using public (i.e., statutory) corporations for state-owned trading activity differed from much of continental Europe, where there was extensive use of mixed public-private trading enterprises, incorporated under companies legislation. In the 1980s the U.K. Conservative Government made an unprecedented shift of the public-private boundary, starting a process that moved almost all public industrial and commercial activities into the private sector.

The post-1980 changes that became known as new public management (NPM) have blurred the boundary between the U.K.'s public and private sectors. For core government there are no difficulties. However, in important areas of public policy, there are organizations sitting on the public-private boundary. Universities, for example, are classified by the ONS to the private sector but they are subject to public law, receive large amounts of public funding, and are covered by the Freedom of Information Acts. University borrowing and debt do not score, respectively, as part of public borrowing and net debt, and universities are outside the WGA. As a matter of long-standing public policy, local authorities have been marginalized as providers of social housing, whereas housing associations (not-for-profit private bodies, mostly established as charities) have been promoted by central government. They have been encouraged to borrow from private capital markets, their borrowing not counting as public borrowing, nor their debt as public debt.

The blurring of the public-private boundary inevitably means that difficult judgments about accounting treatments have to be made in relation to both financial reporting (IAS 27) (IASB, 2008) and national accounts (ESA 95) (Eurostat, 1995).<sup>18</sup>

<sup>18</sup> For EU member states, national accounts are currently regulated by ESA 95 (Eurostat, 1995). This makes some modifications to the System of National Accounts (SNA 93) (United Nations Statistics Division, 1993). ESA 95 is the only 'regional' version of SNA 93. Successor versions of each will soon be implemented.

Whereas both systems of accounting use ‘control’ as the criterion for consolidation, the different traditions and disciplines of these two epistemic communities—financial reporting and audit versus economics and statistics—may lead to different judgments with respect to particular entities. Given the explicit links between the U.K. WGA and macro-fiscal policy, this creates tension between financial reporting and national accounts. This means that disclosure of reconciliations between financial reporting and national accounts figures is of profound importance for fiscal transparency. An impressive feature of the unaudited summarized WGA 2009–10 is the clarity of the reconciliations in Tables 1 and 2.

The privatization of rail infrastructure unwound when Railtrack plc went into administration. It was reincarnated as Network Rail Ltd, a not-for-profit company nominally controlled by its members but financially dependent upon central government. In a rebuff to substance over form, the form and structure of Network Rail was design-engineered by the Treasury to be classified by ONS to the private sector, via an iterative process in which the ONS was ill-advised to engage. Whereas Network Rail is outside net debt, the NAO has indicated that, in its view, it meets the control criteria of IAS 27 and therefore should be consolidated in the WGA. However, as discussed earlier, the WGA is not governed by IAS 27 but by the statutory provisions of the *Government Resources and Accounts Act 2000*, which contain a statutory override. Where the Treasury has not included entities within the consolidation process, the lack of data means that consolidation in 2009–10 is impractical, whatever the resolution of discussions between the Treasury and the NAO on the proper boundary for the WGA. Although there is nothing in the public domain, a reasonable presumption would be that this issue is one factor behind there not yet being an audited WGA 2009–10 account.

Accept, for this discussion, that NPM claims that more private-like entities will be more efficient and effective than traditional government organizations, in part because they are less directly affected by budgetary politics and face harder budget constraints. It therefore seems possible that concerns about reducing operational autonomy would make the NAO reluctant to determine that, for example, universities and housing associations fall within IAS 27.<sup>19</sup> Moreover, as occurred in the case of Network Rail Ltd, organizations on the fringe of the public sector can be design-engineered around the control indicators. Enthusiasm can be expected in the search for ‘innovative’ funding mechanisms: U.K. debates genuinely become interested in foreign experience when in search of lessons on how to circumvent accounting and budgetary rules (Barrell and Hubert, 1999).

The financial crisis has raised a totally unexpected issue; no one would have anticipated that any U.K. government would either nationalize banks or become majority shareholders in them. If the WGA had been published on its original

<sup>19</sup> An example of when the NAO has used audit qualifications to insist on consolidation, in accordance with FRS 2, concerned Scottish Enterprise and Highlands & Islands Enterprise. These Scottish public sector regional development agencies were not consolidating the (since abolished) local enterprise companies, which had been established as their service delivery organizations. In contrast to universities and housing associations, this case was low profile and consolidation, when enforced, did not increase public borrowing and net debt.

schedule, there would have been two years (2005–06 and 2006–07) before these developments. The first year of publication (2009–10) might be the year most affected by bank ownership, as the government has rejected continued ownership and wishes to dispose of its holdings to the private sector as soon as market conditions permit.

A pragmatic solution in 2009–10 would be to consolidate where the IAS 27 control tests are satisfied, but also to publish the WGA excluding the state-controlled banks. The size of bank assets and liabilities, relative to those held by general government, would swamp the WGA. However, Treasury (2010, para. 19) has stated that ‘we will not be incorporating the public sector banks into WGA in the short term given the intended temporary nature of ownership and the significant costs of consolidation to the taxpayer’. Given logistical issues still outstanding as late as June 2010, the capacity to consolidate the banks did not exist. This means that the Treasury will use its statutory override power to exclude these banks from the 2009–10 WGA, raising the question as to whether this will lead the NAO to qualify the account for this reason. Although exclusion might be thought reasonable in the present exceptional context, this will create a precedent of having used the statutory override, making it more likely that this would be used in future for questionable purposes.

## 5: REFLECTIONS

Walker (2009) examined the identity of users of public sector consolidated statements and also addressed the uses to which those potential or actual users might put them. He compiled a list of eighteen judgments, categorized as ‘routine’, ‘conditional’ and ‘exceptional’, which, in theory, prospective classes of users can make on the basis of consolidated statements. He concluded that the financial information relevant to the majority of these judgments is already available for Australia in sources such as budget documents and the Australian adaptation of the International Monetary Fund’s (IMF) Government Financial Statistics (GFS) system.<sup>20</sup> He also indicated that a number of routine judgments can be based on information presented in the form of consolidated statements. Importantly, however, he suggested that ‘these would not necessarily be consolidated statements encompassing the whole of government (or, to be more specific, statements encompassing the whole of a specific tier of government)’ (p. 173) and proposed alternative criteria (to that of control) for determining their scope.

In the different context of the United Kingdom, the Treasury has taken a distinctive view about the role of the WGA. Starting with the *Scoping Study* (Treasury, 1998b), there has been an evolving rationale for the U.K. WGA, albeit in the years before publication. This has occurred through the Long-term Public Finance Report’s (Treasury, 2003) schematic diagrams (reproduced here as Figures 1 to 3)

<sup>20</sup> The United Kingdom makes GFS returns to the International Monetary Fund. However, these receive negligible attention in U.K. debates, possibly because of the strong tradition of focusing on the public sector as whole, not on general government.

and in the restatement of the case for accruals accounting across the whole U.K. public sector (Treasury, 2005). It is important not to exaggerate the potential usefulness of the U.K. WGA, especially at this stage of its development. To the extent that it will be used, this is likely to be by 'intermediate users' (Rutherford, 1992), such as academics and specialist journalists acting as information brokers (Heald, 2003).

The U.K. WGA is a consolidation of consolidations as the entities included within the WGA will often themselves have produced consolidated accounts on the basis of IAS 27. The process of preparing the WGA involves sub-consolidations, some functional (e.g., departmental groupings) and some that relate to sectors of government (e.g., English local authorities). Notwithstanding the U.K. government's refusal to publish or release the WCGA in advance of the WGA, as in the original timetable, some potential users of the WGA may be most interested in the sub-consolidations. If this is the case, the Treasury is likely to face pressure to publish the sub-consolidations, thus going further than the planned segmental analysis of the WGA—central government, local government, NHS, and public corporations.

In relation to the U.K. WGA, this paper has highlighted a number of reasons for a modest degree of optimism about potential usefulness. First, even before publication, the WGA project promoted discipline in terms of entity financial reporting (challenging the attitude that 'no-one reads accounts', which had contributed to past neglect of timeliness) and of addressing inconsistent accounting across the component parts of the public sector (Ellwood, 2003).

Second, it has provided a context in which the regulatory arbitrage that was such a feature of PPP accounting from 2001–02 to 2008–09 (Heald and Georgiou, 2011) could be addressed: the publicly stated concerns of the NAO about PPP accounting in relation to the WGA contributed to ending this arbitrage. There is a parallel to the uses of consolidated financial statements in the private sector, whose purpose is to report on the economic entity and to act as a disincentive against financial 'innovations' designed to disguise or obscure the economic substance of transactions. The fact that this objective is not always met in the private sector does not invalidate it there; neither do the problems that may be encountered with WGA consolidations.

Third, the WGA will provide incrementally useful information in relation to the public finances. There is potential to correct the narrow focus on the net debt measure, which disregards all assets other than liquid financial assets. It should be useful in policy debates about fiscal sustainability and intergenerational equity, the substantive content of each being controversial. Given the dramatic projected increase in net debt, the appropriate policy response is not clear. For example, eliminate the deficit but accept net debt at a much higher level, as might be done after a major war. Or, eliminate the deficit and quickly bring net debt down to the 1998 sustainable investment rule's 40%. Or, eliminate the deficit and bring net debt down to 40% over a longer period, itself contingent upon the state of the world economy. The effect of such policies should be monitored, not least because some methods of containing or reducing net debt would significantly reduce net worth and net assets per WGA. The WGA will never tell policy makers what to do, but can



contribute to greater fiscal transparency by generating and putting into the public domain information relevant to policy debates.

The data in Figures 5 to 7 suggest that the Treasury and external commentators should have paid greater attention over the last economic cycle to what was happening to net worth. Instead, with there being no apparent danger of breaching the sustainable investment rule's 40% limit on net debt, attention focused on compliance with the golden rule, long after the issue of numerical compliance over an extended cycle had lost its economic, as opposed to political, salience. In Figure 5, the period 1998–99 to 2001–02 shows the expected relationship between net worth (rising) and net debt and indicative net liabilities (both falling). In contrast, in the period 2001–02 to 2005–06, the threefold increase in indicative net liabilities as percentages of GDP did not follow the expected relationship with net debt (rising modestly) and net worth (staying flat). There is no explanation of this development in the public domain.

Newspapers, and indeed international organizations with economic surveillance responsibilities, regularly compare deficits and debt across many countries. The availability of macro-level WGAs for a range of countries, for a run of years, would facilitate more constructive international comparisons. As such availability seems unlikely, more attention might be paid to the existing net worth data in the national accounts. However, the quality of those national accounts data will in turn depend on the quality of entity reporting and on whether entity data are actually being used for the national accounts. The issue of net worth is attracting attention in other countries. The Swedish Fiscal Policy Council has been established as a public body to monitor Sweden's public finances. It has complained that, in the 2010 budget, 'There is only a snapshot (the situation at the end of 2008) but no picture of developments [of public sector net worth] over a number of years' (Swedish Fiscal Policy Council, 2009, para. 15). Those countries which have pioneered the move from cash to accruals accounting should be in a position to have better data for the national accounts measure of net worth, as well as to develop IFRS-based measures comparable to U.K. net liabilities per WGA. However, in federal countries there may be constitutional inhibitions on whole-of-public-sector consolidation.

Two views might be held about the consequences of a unilateral increase in fiscal transparency by a small number of countries. On the one hand, greater transparency of a country's public finances might lead to greater understanding and public confidence, thus facilitating improved fiscal decisions and market assessment of sovereign risk. This is the implicit model behind many programs of public financial management reform. On the other hand, there might be nervousness about the reception by, *inter alia*, financial markets and rating agencies to more extensive liability information than is published by other countries, which prefer either not to know or not to tell. Negative net assets for a government, which has the power to tax, do not have the same implications as for a corporate entity. This fundamental difference might be lost in media reporting, public debate and market reaction. The political context of publication might also be important: for example, if a deliberately negative slant were put on the U.K. WGA 'results', in support of a policy to

reduce the size and scope of the public sector.<sup>21</sup> A precedent would be the condemnatory report on past fiscal policy that was published after the change of government in 1997 (Treasury, 1997). Put more formally, this is a case of asymmetric information where government knows more about the public finances than do outsiders. Will revealing a government's private information to citizens and market participants, in the absence of comparable revelation by other countries, improve or damage the standing of that government and/or country?

The unexpected decision of the Treasury to publish the unaudited summarized WGA 2009–10 was linked to the OBR's wish to use WGA data in its first Fiscal Sustainability Report (OBR, 2011b). It is an open question as to how different the audited figures will look, though the pattern of data availability has been set. Highlights from Table 1's income statement include the following:

- Operating revenue in 2009–10 covered only 78% of the sum of operating expenditure, net financing cost, and net gains/losses on assets;
- The WGA net deficit for 2009–10 was 53% higher than the national accounts measure of the current deficit; and
- The reconciliation brings into focus key methodological and measurement differences between financial reporting and national accounts.

However, most attention is likely to be paid to Table 2's statement of financial position:

- Total liabilities are 101% larger than total assets;
- The net public service pension liability represents 47% of total liabilities and, in the notes, is shown to be extremely sensitive to the choice of discount rate;
- The reconciliation draws attention to the difference between financial reporting and national accounts treatment of Private Finance Initiative liabilities; and
- WGA liabilities to be funded by future revenues are 60% higher than the national accounts measure of public sector net debt.

As emphasized in Section 1, the information value of WGA will heavily depend on there being a run of years, but it is already possible to formulate questions that previously could not be articulated or answered. The analysis of differences between financial reporting and national accounting (Daffin and Hobbs, 2011) is likely to be a productive activity, both in terms of new insights and of identification of areas where data and methodologies might be improved while retaining the integrity of the distinct reporting systems.

Fourth, there are policy questions about the design of fiscal institutions, including which body is responsible for particular tasks, including long-term comprehensive

<sup>21</sup> The Treasury (2011e) press release, accompanying the unaudited 2009–10 WGA (Treasury, 2011d), quoted the Chancellor of the Exchequer, George Osborne: 'The information published today by the Treasury and the OBR represents a step change in transparency, lifting the lid on liabilities built up in the past and the pressures we face in the future. They show that our deficit and reform plans are not just right for the economy now, but also right for the economy and fair for the country in the future.' By past standards, this spinning was mild. In the event, media attention in July 2011 was diverted from public finance matters by the phone hacking scandal engulfing the *News of the World* and the Metropolitan Police.

fiscal projections. The Treasury is to be commended for the development of the Long-term Public Finance Report, published at each (November/December) Pre-Budget from 2002 to 2006 and then at the March 2008 Budget. The 2009 Report (Treasury, 2009e), published in December 2009, did not contain the comprehensive modelling that had previously shown the U.K. public finances to be sustainable. With the Treasury as the author, there was an inevitable credibility problem. The Treasury would find it difficult to publish projections showing fiscal unsustainability at a time when its ministers were proclaiming sustainability, and vice versa. This raises the question of whether ‘official’ projections should be prepared by some independent body; this has been resolved for the time being by the creation of the OBR. The OBR has taken over economic forecasting responsibilities from the Treasury, including the Long-term Public Finance Report, about which it undertook a public consultation (OBR, 2011a) and published the Fiscal Sustainability Report in July 2011 (OBR, 2011b). However, such a division of responsibility may contain dangers, including a dispersal of expertise and/or a stand-off between the ministerial department and the independent agency.

Fifth, there is the possibility of arbitrage between financial reporting (IFRS) and national accounts; Eurostat (2004) provided supplementary guidance that interpreted ESA 95 regarding PPP assets and liabilities. The Treasury’s June 2009 decision to follow Eurostat in its spending reviews and budget allocations (Treasury, 2009d) has no direct effect on the WGA: the Estimates and resource accounts will be on an IFRS basis, thus following the mirror-image treatment of IFRIC 12. The relevance is indirect: it is a reminder that devices that obfuscate the public finances will be used when these are available, particularly in stressful budgetary circumstances. It is also a reminder that the WGA, prepared on an IFRS basis but intended to be aligned as far as possible with the national accounts, is actually controlled by the provisions of the *Government Resources and Accounts Act 2000*.

Sixth, the messy periphery of the U.K. public sector means that the WGA, as the product of accounting consolidation, cannot be expected to provide a self-sufficient picture of the public finances. Consolidations assume quite clean structures with clean boundaries whereas some public–private hybrid arrangements are extremely complicated (Newberry, 2009), reflecting the influence of NPM ideas and of various innovations designed to arbitrage statistical and accounting boundaries. Accordingly, the quality of disclosures that accompany the U.K. WGA will affect its usefulness and might also constrain arbitrage by making such devices more transparent. Less important for the United Kingdom, which traditionally reports domestically on the public sector, is that most reporting to international/supranational organizations for purposes of fiscal surveillance relates to general government. Those countries which report domestically on general government, not on the public sector, might respond to fiscal austerity by arbitraging across the general government boundary. Such a development would be damaging to fiscal transparency and international comparability.

Finally, there are implications for the research agendas of academic accountants, especially those with public sector interests. They might be among the prominent users of WGA. As well as the much-remarked globalization of private sector

accounting regulation, a similar pattern is emerging for the public sector, evidenced by the growing influence of IPSASB. International agencies, particularly the IMF and the World Bank, are taking close interest in its work, thereby adding to IPSASB's credibility and legitimacy. Moreover, there is now a greater interface between GAAP-based government financial reporting and System of National Accounts/ESA-based national accounts. This greater linkage between financial reporting and national accounts might also encourage governmental overrides of standards developed for the private sector by IASB and challenge the legitimacy of IPSASB.

There is undoubted scope for comparative research on consolidation practices in general and on WGA in particular. New Zealand is the country whose experience is closest to that of the United Kingdom, but an important difference is that the former uses IAS 27 to determine that local authorities are not controlled by government whereas universities are. Using the national accounts definition of sectors, the U.K. WGA consolidates local authorities but not universities. The unexplained decision not to publish the WCGA, despite this being in the original program, is indicative of the different weight placed on accountability and macro-fiscal considerations. The focus of this paper has been almost exclusively on the balance sheet; this focus might continue once the U.K. WGA is live, perhaps because national accounts measures of current period performance are so well-established.

There will be many technical issues to resolve but there are also bigger issues regarding legitimacy, capacity and authority. This is a public policy domain in which academic accountants can contribute their expertise. By their very nature, debates about fiscal policy, particularly questions of fiscal sustainability and intergenerational equity, involve difficult judgments, as well as expertise. Those judgments can be informed by the multiple fiscal indicators examined in this paper. It is therefore imperative that there are well-documented reconciliations between figures derived from national accounts and those derived from IFRS-based financial reporting.

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