

Oral evidence



Taken before the Treasury Committee

Witnesses

# House of Commons

## Treasury Committee

# The 2005 Budget

## Oral and Written Evidence

### *Monday 21 March 2005*

Mr Robert Chote, Professor Peter Spencer,  
Mr David Walton, Mr Martin Weale and  
Mr John Whiting

HM Treasury officials

### *Tuesday 22 March 2005*

Rt Hon Gordon Brown, MP Chancellor of the  
Exchequer

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# Memorandum submitted by Professor David Heald, Sheffield University Management School

## BUDGET REPORT 2005: THE NEED TO REFORM FISCAL INSTITUTIONS

### INTRODUCTION

1. The public expenditure changes in Budget 2005 are minimal, as is clearly demonstrated by Tables C11 and C12 (Treasury, 2005, pp 257–58). A Budget delivered under the shadow of an imminent General Election can be expected to be even more political than usual, a feature accentuated on this occasion by the narrow margin by which the golden rule is now forecast to be met. Moreover, this is an odd-numbered year, so there is not the substantive content of, for example, Budget 2004 that set the spending envelope for Spending Review 2004. Accordingly, this memorandum reflects upon certain institutional issues that the Committee may wish to address, briefly now, but more substantively in the next Parliament. Therefore it considers:

- the general tone of the Budget process
- the independent audit of macroeconomic assumptions and
- the status of the Office for National Statistics

### THE GENERAL TONE OF THE BUDGET PROCESS

2. I regard myself as a sympathetic critic of the public expenditure policy of the Brown Chancellorship, but I have repeatedly criticised the pretentious titles and pre-written verbiage that have come to characterise the Budget Report. Sometimes it seems that the sheer volume is intended to obfuscate rather than render transparent the Government's fiscal position and plans. Moreover, the run-up to the Budget is characterised by plants in particular newspapers, some accurate and others not, in order to control the agenda. Except in the manipulative sense, Budget secrecy has become an insider joke. Although I understand the underlying partisan politics, and the implications of enormous Parliamentary majorities, these developments undermine the fiscal scrutiny functions of Parliament. This is undoubtedly part of a wider problem in which the Executive has little respect for Parliament, and thus not one for which there are institutional redesign remedies.

### INDEPENDENT AUDIT OF MACROECONOMIC ASSUMPTIONS

3. The Treasury always makes extensive reference to the fact that certain Budget assumptions are audited by the National Audit Office under the provisions of the Finance Act 1998. An external observer unfamiliar with the UK situation would be wholly deceived by the Budget Report (Treasury, 2005) as to the degree of assurance that can be derived from this arrangement. Unlike in its financial audit and VFM work, the National Audit Office cannot choose which assumptions to audit. It can only audit (a) those assumptions that are specifically referred to it by the Treasury, and (b) previously audited assumptions that come up for review on a three-year cycle. I have explained my objections to this arrangement in an academic publication:

The Treasury relied quite heavily on the assumptions having been independently audited by the National Audit Office (NAO), following the practice first established in 1997. The NAO does not audit the forecasts, its role being to ensure that these forecasts of the public finances are based on

assumptions that are transparent and widely regarded as reasonable. However, the NAO can only audit the assumptions that the Treasury puts to it, though since the March 2000 Budget there has been a rolling review of previously audited assumptions. Thus far, the assumptions embodied in earlier macro forecasts have not been seriously tested by events. In such an eventuality, the NAO could be seen to be implicated in forecasts that later came under challenge, thus deflecting some blame from the Treasury and potentially creating difficulties in its relationship to Parliament and its committees. Although the NAO only audits certain forecasting assumptions, and not forecasting systems or methodology, this distinction might be lost in practice (Heald and McLeod, 2002, para 505).

4. There are two further points to add to the above exposition. First, the arrangement clearly breaches one of the fundamental postulates of auditing, namely that independence implies investigatory as well as reporting freedom (Porter, Simon and Hatherly, 2003, Figure 3.1). The auditor must be clearly independent in terms of both specifying the work programme and in reporting findings. The former is breached. Although it might be objected that this postulate was developed with reference to audits that certify financial statements, the counter is that the use of the language of audit and the choice of the National Audit Office as auditor are clearly intended to confer legitimacy upon the exercise.<sup>1</sup> Second, the external observer might expect that the body responsible for auditing the Treasury's macroeconomic assumptions would devote substantial resources to this task, given its technical complexity and political salience. Instead, the National Audit Office has advised that the cost in 2002–03 was £65,000 (Tyrie, 2005, p 123). In part, this is due to the very short notice that the National Audit Office is given by the Treasury of new references of assumptions; though clearly those assumptions coming up for review on the three-year cycle are predictable. For Budget 2005, clearly a sensitive time in connection with both the electoral cycle and performance against the golden rule, there were no new references. The only assumption reviewed on the three-year cycle was the unemployment assumption, which does not seem likely to have been the first choice of an auditor with unrestricted rights of access and questioning. In my view, the Committee and other relevant Parliamentary bodies should urgently review the requirements of the Finance Act 1998. The National Audit Office needs to be dug out of the trap into which it has walked, in part out of a desire to be helpful.

#### THE STATUS OF THE OFFICE FOR NATIONAL STATISTICS

5. Shortly before the Budget, there was controversy in the media following the announcement that the Office for National Statistics would revise its public expenditure figures in a way that would make it easier for the Treasury to meet the golden rule in this economic cycle. The way in which this was originally reported, namely as a discretionary classification change regarding road maintenance, prompted cynicism that there had been political interference by the Treasury. Subsequent clarification (Office for National Statistics, 2005) indicates that the issue related instead to the correction of double counting rather than reclassification. This episode illustrates two important points. First, the position of the Office for National Statistics as an Executive Agency of the Treasury is perceived to undermine operational independence, even if that perception is unjustified. If the Treasury is going to place such reliance on compliance against fiscal rules, the scorekeeper of those rules must be seen to be independent. Accordingly, the Office for National Statistics should become an Executive Agency of Parliament, with suitable protective buffers established. Second, compliance with the golden rule, either way, should not be dependent upon chance reclassifications. When private sector firms take on debt covenants, these are often formulated in terms of constant (ie unchanged) Generally Accepted Accounting Practice, in order to protect both parties to the transaction from unexpected changes in accounting standards. Exactly the same point should apply here, so that classification changes are adjusted for.<sup>2</sup> As with cricket batsmen, it is better to have a lucky Chancellor of the Exchequer than an unlucky one, though it is unwise to let too much rest upon this. Although most expert observers do not believe that a minor infringement of the golden rule in this or another cycle is particularly important economically, the political stakes in terms of ministerial credibility have been made high by the amount of credit that has been claimed for past compliance. Similarly, the definition of the economic cycle should not be under the sole control of the Treasury.

#### CONCLUSION

6. A confident and competent Treasury is essential for effective economic performance, as those who remember when it was otherwise would certainly testify. However, these positive qualities, unless counter-balanced, can destabilise the relationships both between the Treasury and functional government departments and between the Government and Parliament. Therefore resistance to the proposals contained in this memorandum, on the grounds that the system has recently worked well, should be surmounted. Such an attitude is both complacent and under-estimates the institutional design problems that require urgent remedy.

18 March 2005

<sup>1</sup> See Power (1997) on the expansion of audit into non-traditional areas.

<sup>2</sup> In this specific case of the correction of data error, a case could be made either way, for adjustment or for non-adjustment.

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Supplementary memorandum