Memorandum from Professor David Heald

BUDGET 2009: THE FUTURE CONSIDERATION OF PUBLIC EXPENDITURE

INTRODUCTION

1. The key feature of Budget 2009 is the collapse of tax revenue projections (Treasury 2009b, Table C6 on p.231) between November 2008 and April 2009. This turns Table C3 on fiscal balances (p.224) into very grim reading. For example, the projected 2009–10 surplus on the current budget—the critical number for the golden rule during the last economic cycle—moved from a deficit of £4 billion (Pre-Budget 2008) to a deficit of £132 billion (Budget 2009).

2. The current Comprehensive Spending Review (CSR) period runs from 2008–09 to 2010–11, meaning that this is the beginning of the second year of three. Budget 2009 sets assumptions for aggregate spending for the three years 2011–12 to 2013–14: an average of 0.7% in real terms for current spending and public sector net investment falling to 1 1/2% of GDP by 2013–14 (Treasury 2009b, p.113). Given the foreseeable pressures on expenditure, a long period of public expenditure plenty will be followed by a much harsher environment, if not one of famine.

3. This context makes it very important to establish exactly what is happening to public expenditure. Table C10 (p.239) shows for 2009–10 a small upward revision (0.85%) in Resource Departmental Expenditure Limits (Resource DEL) in 2009–10 and a larger uplift (7.2%) in Capital DEL. A factor in the latter will be the pulling forward of some capital expenditure as an anti-recession measure. The position with regard to Annually Managed Expenditure (AME) is predictably different given that it includes social security benefits and central government debt interest: 2009–10 shows an increase of 7.45% and 2010–11 of 9.20%. Within Total Managed Expenditure (TME) there will be pressure from AME of a kind never experienced since the present public expenditure control system was established in 1998. To the extent that TME is regarded as a hard control total, the uncontrollable—at least in the short term—components of AME will put increasing pressure on total DEL.

4. In the context of growing pressure on DEL, Table C11 (Treasury 2009b, p.241) should be supplemented by tables showing (a) differences from figures in the previous publication, whether Pre-Budget Report or Budget Report, and (b) differences from one year previously (ie Budget Report 2009 compared with Budget 2008, and Pre-Budget Report 2009 compared with Pre-Budget Report 2008). The importance to Parliament and the public of such information is evident from the content of para C71 (Treasury 2009b, p.240), which summarises—in words, though not in numbers—factors leading to changes to DEL budgets since Pre-Budget Report 2008.

5. Faced with evaporating tax revenues, the Government has made limited changes to the public expenditure plans established in CSR 2007, which covers the years 2008–09 to 2010–11 (Treasury 2007). If there had been an annual public expenditure survey, as occurred until 1997, there would have been more debate about possible public expenditure reductions in 2009–10 and 2010–11 in light of the dramatic reductions in projected tax revenues. Given the depth of the current recession, there are in practice strong macroeconomic arguments for holding to the existing plans in order to support the economy, thus letting borrowing take the strain. Much will depend in future on:

— political choices about desirable expenditure levels; and
— the extent to which what is now happening to taxation revenues is reversed as the economy comes out of recession (ie cyclical) or turns out to be the consequences of a large structural hit on the productive capacity of the UK economy.

In terms of micro-level incentives for departments, there is the important issue of whether—and under what circumstances—the large amounts of accumulated End-Year Flexibility are allowed to be drawn down or are cancelled. Decisions about these matters should be made transparent to Parliament by means of clear reporting.

6. Alongside the Pre-Budget Reports of 2002 to 2006, the Treasury published an annual Long-Term Public Finance Report which explored the sustainability of UK public finances using a comprehensive projection methodology. Sitting on the platform of the five-year medium-term economic forecast, projections are made on both a 50-year and infinite time horizon. The benefits of this exercise probably arise more from highlighting future policy choices than from the calculated fiscal gaps, not least because of difficulties in specifying what is "current policy".

7. There was no Long-Term Public Finance Report accompanying the 2007 Pre-Budget Report but one was published alongside Budget 2008 (Treasury 2008a). Pre-Budget Report 2008 (Treasury 2008b, para

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Declaration of interest: the author is a member of the Financial Reporting Advisory Board, nominated as an independent economist by the Head of the Government Economic Service. The views expressed are entirely his own.
2.116) stated that “The next Long-term public finance report will be published in 2009”. This could have been interpreted to mean alongside Budget 2009, given that the previous issue accompanied Budget 2008. However, Budget 2009 (Treasury 2009b, para 2.107) states:

The next Long term public finance report will be published in 2009 and will be able to reflect the EU Economic Policy Committee’s latest, 2009, budgetary projections, which give 50-year projections of age-related expenditure across EU countries. Budget 2009 set out projections for net debt, cyclically-adjusted net borrowing and current balance until 2009–10, consistent with the requirement of the Code for fiscal stability.

It is easy to understand the difficulties inherent in long-term projections when the present and near future are so uncertain. There will always be new generations of, for example, EU age-related expenditure projections; this stated reason for delay is less convincing than would be an acknowledgement of the unprecedented uncertainties about the platform on which the long-term projections sit. If there were slippage beyond Pre-Budget Report 2009, an important innovation in fiscal reporting might be lost. It would be helpful if the Treasury were to re-affirm its continuing commitment both to undertaking this work and to regular publication.

8. The UK public expenditure system is characterised by Executive domination, with a very limited role for Parliament. Illustrations of this reality are easy to find:

— The timing of the Budget is in the hands of the Government and the date chosen will affect the time available for the Treasury Committee to take evidence and report; this is exemplified by the 2009 Budget being as late as 22 April.

— Spending Reviews and Comprehensive Spending Reviews are usually published in July, which may be convenient for the Government but minimises the opportunity for Parliamentary scrutiny.

— The Government decides when Spending Reviews take place: after establishing a pattern of 1998, 2000, 2002 and 2004, what was expected to be SR2006 became CSR2007; and the two-year cycle was not restored in 2009.

— Notwithstanding its constitutional importance the Estimates procedure is almost entirely formal, affording no opportunity for Parliament to debate expenditure priorities; in fact, the Estimates simply convert the Government’s expenditure plans for that year into the required format.

— Parliament finds it difficult to obtain timely information that the Government does not wish to release; examples from recent years have included commitments under the Private Finance Initiative (PFI) and analyses of claimed efficiency savings—eventually such material becomes available but not when Parliament first requires it for scrutiny purposes.

— The Government controls costing information, therefore making it difficult for others (eg Opposition parties, Government backbenchers and select committees) to construct credible alternatives to existing policy.

9. My memorandum to the Treasury Committee at the time of the Pre-Budget Report in November 2008 drew attention to the Treasury’s Alignment Project:

Whereas the Treasury owns public expenditure aggregates and changes them at will, Parliament does own the Estimates system … The Treasury … is currently consulting Parliament and other stakeholders on the Alignment project, intended to simplify budgetary documents and—as far as possible—align Budgets with Estimates and Resource Accounts. Much of what the Treasury wants seems reasonable, though care is needed about the detail: for example, on the timing of information and on there being systematic overviews of departmental information. Implemented well, there are gains for Parliament as well as for the Government, but Parliament should exploit the leverage its ownership of Estimates potentially confers over the broader question of how financial information is reported to Parliament (Heald 2008, para 17).

The Treasury (2009a) subsequently published detailed proposals in March 2009 concerning a “clear line of sight” between Budgets, Estimates and Resource Accounts. This “Alignment project” is an important opportunity for Parliament to engage with the Treasury on issues that have two interconnecting dimensions:

— some of the detail is inevitably technical and requires careful consideration of the potential implications; and

— this proposed reform takes place in the context of the constitutional balance of power between the Executive and Parliament.

10. Important developments in financial reporting by government are in process. The anchor for central government financial reporting moves from UK Generally Accepted Accounting Practice to International Financial Reporting Standards in 2009–10, with impacts on, for example, the balance sheet treatment of PFI schemes. The first published UK Whole of Government Account (WGA) will relate to 2009–10. The
Alignment project can be seen as part of the process of improving central government financial reporting and accountability, bringing more clarity and reducing unnecessary complication. However, there are important issues that Parliament should address, including:

— the safeguards that should accompany a move to “net” voting;\(^1^1\)

— the safeguards that should accompany the alignment of Estimates to the Government’s expenditure control system;\(^1^2\)

— the timing of the financial planning cycle, both in terms of when decisions are taken and when Parliament becomes involved, whether in voting or in scrutiny; and

— the prompt provision of overview information so that the overall public finances are more transparent.

These issues are constitutionally and substantively important and their satisfactory resolution would enhance Parliament’s scrutiny capability.

\(^1^1\) Currently, Parliament votes “gross”, meaning that it approves both gross expenditure and the Appropriations in Aid (eg receipts from fees and charges) that departments are authorised to spend by the Estimate. Receipts beyond what has been authorised have to be surrendered to the Treasury as Consolidated Fund Extra Receipts. Under net voting, there must be clarity about (a) the type and level of charges that are to be imposed and (b) budgeted and actual amounts.

\(^1^2\) The present expenditure control system of TME, DEL and AME has been in place since 1998, an unusually long period in comparison with earlier years. If Estimates are aligned on the existing control system and then that control system is replaced by the Government, the Estimates would be stranded on the old system unless Parliament agreed to realign the Estimates on the new system. In practice, the long-established veto over changes to the Estimates that involve “questions of principle” (Limon and McKay, 1997, p.744), without the prior approval of the Public Accounts Committee and the Treasury Committee (and its predecessors), would have been rendered ineffective.