10. PUBLIC EXPENDITURE

The research on which this chapter is based has been funded by the Devolution and Constitutional Change Programme of the Economic and Social Research Council (under award L219252017) and the Nuffield Foundation (under award SGS/00629/G). The authors are greatly indebted to the persons who supplied information and especially to those who commented upon draft versions. Nevertheless, sole responsibility for the material and the interpretations placed upon it rests with the authors.

(1) INTRODUCTION

480. Overview of chapter on public expenditure. Any treatment of public expenditure must deal with both the technically complex questions of definitions and formal procedures and the highly politicised processes of government decision-making on resource allocation. In a democracy, it raises issues about the respective roles of the Executive and the Legislature. In the context of the newly devolved Scotland, it must also address decision-making at the United Kingdom and Scotland levels and the way in which the Scottish system is nested within the United Kingdom system. Of growing, though still modest, importance are the European Union (EU) dimensions of budgetary policy-making, notably the constraints imposed on deficits and debt.

The material in this chapter is ordered as follows. This introductory section provides some necessary background, including the provision of a guide to sources of public expenditure information and to the academic literature. Section 2[1] brings together technical material on definitions and measurements, as well as dealing with a number of special topics, such as the Private Finance Initiative (PFI). Sections 3 and 4[2] provide systematic coverage of the planning and control of public expenditure at the United Kingdom level and Scotland level, respectively. Some material in Section 4 can be abbreviated because of the coverage in Section 3, but a substantial amount of material is specific to Scotland. One obvious point is that there are two kinds of public expenditure in Scotland: that which is undertaken by United Kingdom departments in Scotland; and that which relates to the functions of the Scottish Parliament, and for which the Scottish Administration[3] is accountable. Section 5[4] provides coverage of organisations operating outside the core of both United Kingdom and Scotland governments. Section 6 contains a list of abbreviations[5].

Public expenditure is a very broad topic and this chapter does not attempt to provide comprehensive coverage of every aspect. The following principles have informed the chosen focus: all important issues are included; issues which are comprehensively covered elsewhere receive less attention, with the reader guided to other work; issues which are often misunderstood receive attention which may be slightly disproportionate to their substantive importance; and financial issues arising from the devolution settlement receive particularly close attention.

1 See paras 486 ff below.

2 See paras 504 ff and 526 ff below.
3 The term 'Scottish Administration' is clarified in para 527 below. See also paras 391–393 above.
4 See para 547 below.
5 See para 551 below.

481. Relationship of this chapter to other published work. This chapter is distinctive in the way in which it brings together analyses of the public expenditure planning and control system at the United Kingdom level and those at the newly devolved Scotland level; it also explores the links between these systems.

The authoritative 'official' account of United Kingdom Parliamentary financial procedures is that of Erskine May's *Parliamentary Practice*[1], which covers the Supply procedures in greater detail than this chapter. However, new editions of *Erskine May* appear relatively infrequently: the current edition was published in 1997 and the preceding one in 1989[2]. Consequently, this chapter (completed in November 2002) takes account of the important 1998 changes in the public expenditure planning system and of the Parliamentary implications of Resource Accounting and Budgeting (RAB)[3]. Another account of the United Kingdom level, again focusing on the formal Parliamentary processes, appears in Halsbury's *Laws of England*[4], the sister publication to the *Stair Memorial Encyclopaedia*. The United Kingdom level is also addressed in the academic literature, though changes to the system rapidly date the descriptive material. The authoritative book is by Thain and Wright[5], covering the period 1976 to 1993. Inevitably, its descriptive material is now dated, as it was published too early to assess the top-down reforms in 1992 and long preceded the 1998 reforms (new control aggregates) and the introduction of RAB in 2001–02. A more recent study is that of Parry and Deakin[6], whose coverage of Treasury policy-making on public expenditure is broader than its title might suggest. The United Kingdom system of accountability for public expenditure is comprehensively analysed by McEldowney[7] and by Daintith and Page[8].

In a different genre, there are the manuals on public expenditure, which have been published by international organisations, often targeted at either developing countries or transition economies in Central and Eastern Europe[9]. Although these have no direct coverage of the United Kingdom or Scotland systems, they provide material which highlights certain common problems and the contingent nature of solutions to those problems.

1 Erskine May *Parliamentary Practice* (22nd edn, 1997 by D W Limon and W R McKay).
2 Erskine May *Parliamentary Practice* (eds C J Boulton et al, 1989).
3 See para 496 below.
4 See 8(2) *Halsbury's Laws of England* (4th edn) (1996 reissue) CONSTITUTIONAL LAW AND HUMAN RIGHTS.
5 C Thain and M Wright *The Treasury and Whitehall: The Planning and Control of Public Expenditure, 1976–1993* (1995).
6 N Deakin and R Parry *The Treasury and Social Policy: The Contest for Control of Welfare Strategy* (2000).
7 J McEldowney 'The control of public expenditure' in J Jowell and D Oliver *The Changing Constitution* (Oxford University Press, 4th edn 2000) pp 190–228.
8 T Daintith and A Page *The Executive in the Constitution: Structure, Autonomy and Internal Control* (Oxford University Press, 1999).
9 S Schiavo-Campo and D Tommasi *Managing Government Expenditure* (Asian Development Bank, Manila, 1999); and R Allen and D Tommasi (eds) *Managing Public Expenditure: A Reference Book for Transition Countries* (OECD, 2001).

482. Understanding the concept of public expenditure. In broad terms, public expenditure is a simple concept: it denotes the dispensation by the state[1], on non-market criteria, of economic resources that it has acquired from firms and households. However, the detail is highly complex because the modern state is such a difficult concept to analyse. Consequently, care is always required in the interpretation of public expenditure figures, particularly when these become the subject of heated political debate.

Although much used in theoretical discussions in economics and political science, the term 'state' is infrequently used in political debate in the United Kingdom. Instead, the term 'government' is used, with distinctions made between central government and local authorities which, taken together, constitute the 'general government' sector in the national accounts[2]. This brings precision at one level: there is an operational list of organisations that fall within the national accounts' definition of general government. But there is a wide range of other organisations, including public enterprises (that is, commercial trading businesses)[3] and a host of *ad hoc* bodies[4] established by government to undertake certain kinds of activities and expenditure. The decisions as to whether and, if so, how such bodies are consolidated into public expenditure aggregates have major implications for the declared public expenditure totals. Bodies that are effectively controlled by central government and rely on it for most of their funding are generally classified as part of central government.

There can, however, be considerable argument about where the public sector (general government plus public corporations) ends and the private sector begins. The term 'quasi public sector' is used by academics, though not by official statisticians, as an umbrella term for organisations that are so 'close' to government (whether by virtue of financial dependency or effectively being under its control) that it becomes misleading to exclude them from consideration of the public finances. Universities and housing associations, both nominally private, are obvious examples. Nevertheless, following conventional practice, most of the material in this chapter relates to either general government or the public sector. In public expenditure statistics, sector classification decisions follow the advice of the Office for National Statistics and apply the rules of the European System of Accounts[5].

The reported size of public expenditure can also be affected by the treatment of fees and charges. Public expenditure can be expressed on a gross or net basis. Where charges are very small relative to total expenditure (for example, in the National Health Service (NHS)), the effect is minimal. However, where charges play a substantial role (for example, in public housing), there is a major difference between gross and net expenditure. In United Kingdom practice, fees and charges are in some cases treated as offsets to expenditure and immediately netted, whereas in other cases they are treated as Exchequer income and separately identified. The more that netting is the usual practice, the smaller will be the public expenditure totals revealed by the accounting system for any given level of public services. Generally speaking, income from fees and charges is treated as revenue (and not netted off) if there is little chance of avoiding the charge (for example, by declining to make use of the service for which it is levied); it is treated as negative public expenditure (and hence netted off) in other cases. A related issue is the treatment of the proceeds of asset sales. Usually, but not always, departments and other bodies are allowed to offset the proceeds of sales of assets, such as real property (that is, land and buildings). However, the proceeds of major privatisations of public corporations are treated as negative net acquisition of company securities, thereby reducing General Government Expenditure (GGE)[6] but not Total Managed Expenditure (TME)[7]. In the 1980s, this treatment as negative public expenditure significantly reduced the Public Sector Borrowing Requirement[8].

The interpretation of public expenditure data can be complicated by factors external to public expenditure definitions. A government might reduce the reported level of public expenditure by confiscating resources: for example, by means of military conscription, with pay set below market wages; or by seizing privately owned land for road building, with compensation set below market values. Such devices reduce reported levels of public expenditure, though most economists would question their efficiency and equity in peacetime conditions. In the United Kingdom, confiscation plays virtually no budgetary role, though some European Union countries are only now abolishing military conscription.

However, tax expenditures (that is, granting reliefs to taxpayers provided that they organise their consumption in a particular way) are extensive and can be sufficiently important in numerical terms to influence the interpretation of public expenditure trends and inter-country comparisons. Traditionally, the United Kingdom explicitly subsidised council tenants through subsidies to local authority Housing Revenue Accounts (which scored as public expenditure), whereas owner-occupiers benefited from mortgage tax relief (which was generally[9] not scored as public expenditure, but reduced total tax revenue). Both these forms of subsidy have now largely disappeared, though there remain the tax expenditures from the non-taxation of imputed income from owner occupation and the exemption from capital gains tax of the sale proceeds of the taxpayer's main residence. Another example is the tax deductibility of contributions to occupational pension schemes[10]. There have been controversies about the treatment of certain tax credit schemes, including that of the Working Families Tax Credit, when these appear as negative items on the revenue side of the budget.

Exhaustive public expenditure (that is, expenditure on goods and services) should be carefully distinguished from transfer payments. The key difference is that, in the former, the state takes decisions about the pattern of final output. Decisions have to be taken about both scale (that is, expenditure totals) and composition (for example, the relative priorities attached to defence and education). On the input side, the market is generally maintained, with the state bidding for factors of production in competition with firms and households. However, certain markets for public sector inputs may be distorted by the state's monopsony power and the monopoly power of unionised public employees.

In the case of transfer payments, the state redistributes purchasing power from the hands of one group of individuals (taxpayers) to those of another group (beneficiaries). The composition of final output depends upon the consumption decisions of individual recipients, thereby respecting consumer sovereignty. Decisions about the scale of such compulsory redistribution of purchasing power must be taken through political processes. It is difficult to map the resulting highly complex patterns in a welfare state: from the young to the old; from the more affluent to the less affluent; and the considerable amount of 'churning' that takes place (that is, the same individual simultaneously pays tax and receives benefits).

At any given level of public expenditure, there are important choices between policy instruments that lead to exhaustive public expenditure and those that involve transfers. Examples of this choice include: whether the over seventy-fives receive free television licences[11] or higher cash pensions; and subsidising housing by means of 'bricks and mortar subsidies' (for example, the traditional Housing Support Grant and general-fund contributions to Housing Revenue Accounts) versus subsidising tenants by means of housing benefit.

Public expenditure figures in an industrialised economy are huge in absolute terms, and comparisons between years are naturally affected by changes in price levels. For the purpose of analysis, public expenditure data are often either converted into constant price terms[12] or measured in relation to a macroeconomic aggregate such as Gross Domestic Product (GDP). As an indication of the scale of public expenditure in the United Kingdom, planned Total Managed Expenditure[13] on a resource basis[14] was £418.4 billion in 2001–02, 39.8 per cent of GDP. Over the period 1963–64 to 2001–02, the lowest recorded percentage on this definition of public expenditure was 38.3 per cent in 1964–65, with the highest being 49.9 per cent in 1975–76[15].

1 The term 'state' can be ambiguous. In some jurisdictions, eg the United States and Australia, it is used to describe a second-tier level of government. In the economic and political science literature, it is used both abstractly and as a synonym for government or public power. More generally, use of the term occurs in continental European countries, notably France, and in European Union discourse about 'state aids'. There used to be greater usage of the term in the United Kingdom, eg in relation to 'state industries'.

2 Explanations of the structured accounting framework underpinning the national accounts and the practicalities of their preparation can be found on the government statistics website (www.statistics.gov.uk). Comprehensive guidance is provided in Office for National Statistics *United Kingdom National Accounts: Concepts, Sources and Methods* (Stationery Office, 1998).

3 The large public enterprises in the United Kingdom were known as 'nationalised industries', but almost all the significant ones disappeared as a result of the 1979–97 Conservative government's privatisation programme.

4 A discussion of the different types of bodies involved is contained in paras 547–550 below.

5 Eurostat *European System of Accounts: ESA 1995* (Office for Publications of the European Communities, 1996). See para 524 below for a discussion of international comparability of public expenditure figures.

6 See para 487 below.

7 See para 490 below.

8 See para 488 below.

9 Mortgage tax relief was abolished from April 2000. The public expenditure treatment had previously depended upon the way in which the subsidy was delivered: Miras, under which there was a direct payment from the government to the lender, was scored as public expenditure, but, where mortgage interest was treated as a deduction from taxable income, this was scored as a tax expenditure.

10 In the annual *Financial Statement and Budget Report*, the Treasury publishes 'the estimated costs of the principal tax expenditures and structural reliefs': eg HM Treasury *Budget 2002: The strength to make long-term decisions: Investing in an enterprising, fairer Britain* (HC Paper 592 (2001–02)) (Stationery Office), Table A3.

11 The concession of free television licences for people aged seventy-five and above was introduced on 1 November 2000, and there were 3,208,717 beneficiaries at March 2002. Entitlement is at the person's main residence, and a licence currently in the name of a younger person can be transferred. The British Broadcasting Corporation is compensated by a payment from the Department of Work and Pensions (£366 million, in resources, in 2002–03 Main Estimate), set to cover the free licences and associated administrative costs.

12 See para 495 below.
13 See para 490 below.
14 See para 496 below.
15 *Public Expenditure: Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), Table 3.1.

483. Understanding the concept of public money. Whereas measures of public expenditure are rooted in national accounts definitions, the concept of 'public money' is much looser, albeit highly persuasive in political discourse. The Sharman Report[1], prepared by a committee established by the Treasury to review audit and accountability in central government, devoted considerable attention to developing an operational concept of public money. This matter has acquired importance because of controversies about 'following public money' in a context where service delivery organisations are not necessarily part of central government, or even of the public sector. Sharman developed the following definition[2]:

> '2.21 . . . the following principles are suggested . . .
>
> - all money received by a public body, from whatever source, is public money;
> - all money received from a public body by a non-public body is public money; and
> - additionally, public accountability may exist for private money where that money is either raised under statutory authority, or where the body in question is a local public spending body.
>
> 2.22 A definition of public money for accountability purposes is, therefore, proposed as follows:
>
> "All money that comes into the possession of, or is distributed by, a public body, and money raised by a private body where it is doing so under statutory authority"'.

Sharman highlighted several arguments which imply that a greater level of accountability should apply to public than to private money: that the money is usually raised under compulsion; that it should only be used for purposes for which it is intended; that standards of propriety should be higher; and that competition to drive down costs is largely absent. On such a basis can be constructed the argument that public accountability for resource use requires the demonstration of Value For Money (VFM)[3]. Accordingly, those using public money are open to questions that are not relevant to the use of private money. The lavish spending of celebrities may raise matters of taste, but that is clearly the legitimate domain of consumer sovereignty.

Understandably, legislatures wish to follow public money wherever it goes, especially in an environment where the Executive, rightly or wrongly, is suspected of locating transactions just outside accounting boundaries and outside the reach of Parliamentary scrutiny. Nevertheless, there are obvious dangers in the notion that what is public money always remains public money. This ceases to be the case when governments pay their employees or pay suppliers for services contracted in competitive markets. The fact that governments have bought stationery supplies from a company does not, and should not, give public auditors rights of access[4] to the books and accounts of that company. There is obviously a spectrum of relationships: demands for access by the public auditor have more credibility in the context of long-term contractual relationships, as, for example, under Private Finance Initiative (PFI) schemes[5] when the delivery of public services by departments or agencies critically depends upon particular services being supplied by a specific contractor. Examples include the provision of information technology services to the Inland Revenue and infrastructure management for the Ministry of Defence. Especially in connection with the activities of bodies outside the core of government[6], disputes about whether something is public money may have substantial ideological, as well as presentational, content[7].

In the United Kingdom, public money is connected with the actions of the Crown in Parliament[8], but not with the Crown as monarchy. Indeed, references to the Crown in United Kingdom discussions of public expenditure are rare, in comparison with Australia, Canada and New Zealand where references to Crown assets and corporations are commonplace. Such references are to the Crown as symbol of legitimate government and have nothing to do with the monarchy[9], whose finances are in the private domain.

1 Lord Sharman of Redlynch *Holding to Account: The Review of Audit and Accountability for Central Government* ('The Sharman Report') (HM Treasury, 2001).
2 Sharman Report, pp 9–15.
3 See paras 520 and 521 below.
4 See paras 520 and 543 below.
5 See para 502 below.
6 See paras 547–550 below.
7 In a letter to the *Sunday Telegraph*, which that newspaper titled 'BBC not borrowing from public purse', the British Broadcasting Corporation's Director of Finance, Property and Business Affairs corrected 'the impression that the BBC is to borrow money from the Government' and clarified that 'the Treasury has given approval for the BBC's commercial subsidiaries to borrow up to £350 million from external financial institutions — not from the Government itself' (J Smith, 8 September 2002). This was in response to a report the previous week, titled 'BBC wins £350m state funds' (D Reece, 1 September 2002). See para 488 below.
8 See para 214 above.
9 Public money would include the Civil List paid as a Consolidated Fund Standing Service (see para 508 below).

484. Sources of information: United Kingdom. The main source of detailed information on public expenditure in the United Kingdom is the series of departmental reports published around the end of the financial year[1] as command papers[2]. These give some detail of departments' expenditure, both the estimated outturn for the year just ending and the outturn for the previous five years, and the plans for the period covered by the latest Spending Review (SR)[3]. They also contain comment on policies, together with information on output and performance targets. Other sources of information are the Main Supply Estimates[4] and *Public Expenditure: Statistical Analyses* (*PESA*)[5]. The latter provides analyses of public expenditure by function and economic category of expenditure, and by country and region, as well as spending by department (at summary level) and grouped by budgetary control aggregates. It also contains an excellent 'Glossary of Terms'[6], which provides many of the formal definitions used in this chapter, and a search for contemporary data should begin with the latest issue.

The departmental report system, whose inauguration in 1991 was in part stimulated by research by Andrew Likierman and Peter Vass[7], has been somewhat running out of steam. There has always been considerable variation in the quality of departmental reports, partly reflecting different levels of departmental enthusiasm for them and partly the extent to which the relevant departmentally-related select committee[8] took a regular interest in their content. A Treasury review of departmental reports was completed in August 2001[9], and this may lead in time to fundamental changes. Exactly what will happen is more difficult to judge because of serious publication delays in 2002, attributable to the late Budget on 17 April.

One obvious change for 2002–03 was an entirely new document, *Supplementary Budget Information*, in some ways an Estimates' counterpart to *PESA*. Also, Estimates information was removed from departmental reports and restored to a Main Estimates document[10].

There is a general issue about which information is published centrally by the Treasury and which is published separately by departments. There is currently a period of flux regarding reporting on public expenditure to Parliament, partly (though not wholly) connected with the transition to full implementation of Resource Accounting and Budgeting (RAB)[11]. An enduring problem arises from the limited number of users of these reports, other than departmentally-related select committees[12], the House of Commons Library and a few academics. One factor is obviously cost: a full set of departmental reports in 2001–02 costs £335[13].

Departmental reports remain important vehicles for the scrutiny required in order to promote transparency and accountability. A good departmental report needs to combine a review of what the department did during the year, linking this clearly to expenditure, with a clear statement of future plans. A useful innovation from 1995 was the Treasury's practice of sending its 'core requirements' circular on the mandatory content of departmental reports to the Public Accounts Committee and the Treasury Committee, which in turn circulated this to departmentally-related select committees. Despite the limited audience, the preparation of a departmental report should encourage reflection within departments as to their aims, objectives and performance.

The Departmental Report of the Scottish Office, *Serving Scotland's Needs*, was always one of the best examples. In part, this was because it evolved naturally from the earlier publication, *Commentary on the Scotland Programme*, published from 1983 to 1990. The Principal Finance Officer from 1980 to 1985 was (now Sir) Russell Hillhouse (subsequently Permanent Secretary, 1988–98), who developed the *Commentary* out of material originally prepared for the Committee on Scottish Affairs[14] when it took evidence from the Secretary of State for Scotland on the Scotland chapter of the then annual Public Expenditure White Paper. This chapter had to be approved directly by the Treasury and was too brief to provide a comprehensive picture of the multi-functional Scottish Office. This sense of ownership of the departmental report did not occur in many other departments. The Departmental Report of the Scotland Office[15] is a much more limited document because of the transfer of expenditure responsibilities inherent in devolution.

PESA is an invaluable document, containing many informative analyses of totals, the focus of which is primarily upon Total Managed Expenditure (TME)[16]. *PESA* contains separate chapters on central government expenditure, local authority expenditure and public corporations. Most tables relate to the period covered by the last Spending Review to have been completed: for example, the 2002 edition (published in May 2002 when this was still SR 2000) contains three outturn years, one estimated outturn year, and two plan years[17]. A chapter in *PESA* provides certain data at a high level of aggregation for a longer period of time. For example, TME is provided in *PESA 2002–03* for the period 1963–64 to 2003–04, together with the TME/GDP (Gross Domestic Product) ratio. There is also a functional analysis of TME[18], covering the period 1984–85 to 2001–02 (estimated outturn); the Treasury publishes forward functional analyses of central government expenditure, including that by the devolved administrations, but it does not publish such forward analyses for local government on the grounds that these will depend on the individual decisions of local authorities[19].

Helpful tables reconcile the figures published in the previous *PESA* to those in the current volume. This analysis is necessary because these figures are affected by: (1) machinery of government changes, such as the creation and abolition of departments; (2) transfers (responsibility for particular expenditure moves department) and classification changes (where the basis of recording changes); and (3) allocations from the Reserve and other policy changes (that is, substantive differences)[20]. There is further discussion of the contents of *PESA* in later parts of this chapter, as the technical and statistical material is introduced.

Reports of departmentally-related select committees[21] will contain the results of such inquiries as they carry out on the activities of public sector bodies within their area of interest. Moreover, Executive agencies, Executive Non-Departmental Public Bodies and other public bodies produce their own annual reports[22], giving details of the bodies' operations, their plans and their accounts.

A large amount of contemporary material is available on government websites, such as those of the Treasury (www.hm-treasury.gov.uk) and the Office for National Statistics (www.statistics.gov.uk). Detailed web addresses for specific documents are not generally provided as experience suggests that these rapidly become dated[23]. The electronic publication of key documents on the web has made them much more accessible, without charge, than previously. However, there are concerns that, without efficient systems of archiving such material, it will become very difficult to locate[24] that which is published outside the official Parliamentary series[25]. Hardcopy versions of recent Treasury documents are contained in a book published by the Treasury to celebrate the achievements of policy after 1997[26].

1 Although the fiscal year for taxation purposes runs from 6 April to 5 April, the financial year for public expenditure purposes runs from 1 April to 31 March.

2 Throughout the 1990s, there were usually around twenty departmental reports, following the lines of departmental groupings. In 2002, this expanded to twenty-eight, reflecting the publication of separate reports for several small departments (eg Export Credits Guarantee Department and Office of Fair Trading, previously in the Departmental Reports of the Department of Trade and Industry).

3 This period is either two or three years depending on the location of that year within the Spending Review cycle.

4 The Central Government Supply Estimates 2002–03 were published on 9 May 2002 as HC Paper 795 (2001–02), untypically late owing to the delayed Budget on 17 April. This was supplemented by *Central Government Supply Estimates 2002–03: Supplementary Budgetary Information* (Cm 5510), a new publication bringing together Estimates material previously split between departmental reports.

5 Published as a Command Paper by the Treasury, Cm 5101 in 2001 and Cm 5401 in 2002: HM Treasury *Public Expenditure: Statistical Analyses 2002–03* (Stationery Office). In 2002, *PESA* was published before the departmental reports, though these timings were a consequence of the delayed Budget (delivered on 17 April, rather than in mid-March).

6 *Public Expenditure: Statistical Analyses 2002–03* (Cm 5401) (2002) Appendix G, pp 127–138. See Appendices E and F, which also provide definitions and explanations.

7 A Likierman and P Vass *Structure and Form of Government Expenditure Reports: Proposals for Reform* (Association of Certified Accountants Educational Trust, 1984).
8 See paras 162–166 above.
9 HM Treasury *Review of Departmental Reports* (General Expenditure Policy Team, HM Treasury, mimeo, August 2001).
10 The inclusion of Estimates (ie formal notification of requests to Parliament for funds) within the departmental report lasted only one year. Previously, the Treasury had published, as House of Commons Papers, detailed Estimates for each Department. See para 508 below.
11 See para 496 below.
12 See para 523 below.
13 However, it should be noted that current issues of departmental reports can be found on the relevant department website.
14 See para 530 below, in particular note 1.
15 See paras 527 and 528 below.
16 See para 490 below.
17 In contrast, *PESA 2001–02*, which came earlier in the SR 2000 period, showed: two outturn years; one estimated outturn year; and three plan years: HM Treasury *Public Expenditure: Statistical Analyses 2001–02* (Cm 5101) (2001).
18 Strictly, what is analysed in the functional tables is Total Expenditure on Services (see para 493 below), with a reconciliation provided to TME. See *PESA 2002–03,* Tables 3.5 and 3.6.
19 A research project currently being undertaken at Nuffield College, Oxford, with the assistance of the Treasury, is re-examining the functional data over a considerable time period. The preliminary results suggest that there are substantial data problems, and that the published data from before each Survey period should be treated with caution: S N Soroka and C Wlezien *Modeling Budgetary Policy Change: How Measures Matter*, Paper presented at the annual conference of the Political Studies Association, 5–7 April 2002, Aberdeen, mimeo.
20 See eg *PESA 2002–03*, pp 26 and 31, Tables 2.1 and 2.6.
21 See paras 162–166 below.
22 See paras 547–550 below.
23 A revamping of the Treasury website in November 2001 removed many documents. Clearly, for operational reasons, there have to be regular weedings to contain the size of official websites.
24 The potential difficulties in locating material published outside the official Parliamentary series have been acknowledged.
25 For the House of Commons, these series are Command Papers (Cm) (presented to Parliament by the government) and House of Commons Papers (HC), ordered to be printed by the House. For the Scottish Parliament, the series are known as Scottish Executive Papers (SE) and Scottish Parliament Papers (SP). An example of the former is SE/2001/294 where ‘2001’ denotes the year and ‘294’ the position in the series. An example of the latter is SP Paper 525 of Session 1 (2002). The Session number refers to the Parliament (ie the 1999–2003 Parliament is Session 1), with the term ‘Parliamentary year’ used in the sense that ‘Session’ is used at Westminster.
26 HM Treasury *Reforming Britain’s Economic and Financial Policy: Towards Greater Economic Stability* (eds E Balls and G O’Donnell) (Palgrave, Basingstoke, 2002).

485. Sources of information: Scotland. In Scotland, the Scottish Executive publishes an annual report giving information on planned spending for each of the Executive departments as well as, for the sake of completeness, that of the Scottish Parliamentary Corporate Body and of Audit Scotland[1]. More detailed information for the year ahead, or in progress, is published in Scotland’s Budget Documents, along with Budget Bills or draft revision orders[2].The Finance Committee of the Scottish Parliament conducts a regular annual cycle of scrutiny and information-gathering through the three stages of the budgetary process[3].

Important sources of material about the public finances of Scotland are the reports produced by Audit Scotland on behalf both of the Auditor General for Scotland (concerning the Scottish Executive, National Health Service and other public bodies) and of the Accounts Commission (concerning local authorities, and police and fire boards)[4]. The combined publication programme is substantially larger than before devolution, when there were reports published by the Accounts Commission and by the National Audit Office (NAO)[5] (as part of the United Kingdom series).

One of the significant features of the Scottish Parliament is that committees play a more proactive role in its operation than do select committees in the House of Commons. This has contributed to an intensification of committee scrutiny of government in Scotland, as committees of the Scottish Parliament now operate in areas previously left to the Scottish Affairs Committee[6]. Many of the investigations of Scottish Parliament committees effectively impinge on the management of the Scottish Budget, even in those cases where finance is not the principal concern.

A document of a different kind (statistical rather than budgetary) is the annual *Government Expenditure and Revenue in Scotland*, known as 'GERS'. Published on the authority of the Chief Economic Adviser, without ministerial intervention, this series began in 1992 and has greatly added to public knowledge about the public finances of Scotland. Usually appearing towards the end of the calendar year, it provides estimates, for a five-year period, of the fiscal deficit of Scotland, under present constitutional arrangements[7]. However, it also shows the effect of attributing to Scotland various percentages of North Sea oil tax revenues, which are scored by the Office for National Statistics in 'Extra Regio' (part of the United Kingdom but not of its constituent regions). This document is valuable in that it brings together the expenditures by and revenues of government in Scotland, thus stretching far beyond devolved expenditure. When interpreting these data, it should be remembered that many of these figures are driven by United Kingdom decision-making, not by decisions taken specifically with regard to Scotland. Consequently, GERS is a valuable starting point for discussion of Scotland's public finances under alternative governmental arrangements, but only that. For example, in the context of Scottish independence, any fiscal deficit would have to be covered, if not by borrowing then by expenditure reductions or tax increases.

1 The 2002 annual report (*The Scottish Budget: Annual Expenditure Report of the Scottish Executive*), issued on 2 April 2002 and available on the Scottish Executive's website or direct from the Finance department (in full detail or summary form), contains information from 2001–02 to the end of the then latest Spending Review (2003–04). Information regarding 2000–01, the first full financial year of the Parliament's operation, is not included in the 2002 annual report.
2 The main budget documents for 2001–02 were laid before the Parliament in January 2001 as document SE/2001/3, and a revision in November as SE/2001/253. A further (Spring) revision was laid before the Parliament in January 2002 as SE/2002/3. The main budget documents for 2002–03 were laid before Parliament in January 2002 as SE/2002/2.
3 See paras 539–541 below.
4 Examples of reports published after devolution include: Accounts Commission *Taking the Initiative: Using PFI Contracts to Renew Council Schools* (Edinburgh, 2002).
5 See para 520 below.
6 See para 530 below.
7 Successive annual issues of GERS are available on the Scottish Executive website (www.scotland.gov.uk). For an overview of the results which have been generated by the GERS series, see A Goudie 'GERS and fiscal autonomy' (2002) Scottish Affairs (Issue 41) 56.

(2) DEFINITIONS, MEASUREMENT AND SPECIAL TOPICS

486. Overview of section. This section brings together a considerable amount of the technical material relevant to the analysis of both the United Kingdom (section 3)[1] and Scotland (section 4)[2]. Definitions and measurement are partly a matter of internationally determined standards and partly a matter of Treasury discretion, a mixture that does not always combine well. An added ingredient is the indirect influence of the Accounting Standards Board (ASB)[3] over government accounting. This is mediated through the Financial Reporting Advisory Board to the Treasury (FRAB), an independent body though appointed and serviced by the Treasury[4].

Inevitably there are, on occasions, expositional problems in explaining the main technical and definitional terms in isolation from the exposition of the processes in the United Kingdom and in Scotland. Nevertheless, this grouping of material in one place has the undoubted advantage of conveying the sense of how embedded the financial system of the devolved Scotland is in the current United Kingdom public expenditure system.

The sequencing of material is as follows. The starting point is aggregate measures of public expenditure, including General Government Expenditure (GGE), which was the ultimate target of Treasury public expenditure control until 1998. Targets for the GGE/GDP (Gross Domestic Product) ratio were also set. Brief mention is made of political debates on the desirable size of the GGE/GDP (Gross Domestic Product) ratio. Attention then turns to the Treasury's use of control aggregates, which become the focal point of its public expenditure planning, management and control activities, followed by an extensive discussion of the current control aggregate, namely Total Managed Expenditure (TME). A narrower aggregate (Total Expenditure on Services (TES)) is examined, not least because several of the most important tables in *Public Expenditure: Statistical Analyses* (*PESA*) are on this basis. This is followed by an examination of the components of TME, namely Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME), on which basis the post-1998 system has been constructed. Important technical issues are then addressed: how to adjust public expenditure figures for inflation; and how to account on a 'resource' (that is, accruals) basis. This leads naturally on to Resource Accounting and Budgeting (RAB), a reform whose phased implementation will be complete in 2003–04, having been initially announced by Kenneth Clarke (then Chancellor of the Exchequer) on 30 November 1993. Finally, there is coverage of a number of special topics, including: issues connected with the European Union; and the role of the Private Finance Initiative (PFI), described under Labour as Public-Private Partnerships (PPPs).

1 See paras 504 ff below.
2 See paras 526 ff below.
3 Established in 1990, the ASB promulgates financial reporting standards for the United Kingdom private sector. It is a private sector body, though its standards have statutory recognition under the Companies Acts. Although it is not responsible for public sector accounting standards, the decision of the United Kingdom government, subsequently enshrined in the Government Resources and Accounts Act 2000 (c 20), s 5, to adopt Generally Accepted Accounting Practice (UK GAAP), modified where appropriate and then agreed by FRAB, has implicitly conferred a significant role upon the ASB in the regulation of public sector accounting. Its standards are published in a numbered series, eg Financial Reporting

Standard (FRS) 17 on the treatment of pension fund liabilities in company accounts (Accounting Standards Board *FRS 17: Retirement Benefits* (London)).

4 See para 514 below.

487. Aggregate public expenditure. General government expenditure is the concept on which most international statistics are based. It is the consolidated sum of the current and capital expenditure, and net lending, of central and local government. For many years, this was the conventional United Kingdom measure of aggregate public expenditure, though the Treasury's definition of General Government Expenditure (GGE) differed in some respects from the international definition. However, since 1998, it has been superseded by Total Managed Expenditure (TME)[1] as the Treasury's preferred measure of aggregate public expenditure.

Aggregate measures of public expenditure, such as GGE, are calculated at current prices, that is, those prices at which transactions take place. However, comparisons over time quickly become meaningless without some form of price-level adjustment. Accordingly, aggregate measures are often converted to constant prices, usually using the Gross Domestic Product (GDP) deflator. This is now known as, for example, GGE 'in real terms', though the older terminology of 'cost terms' would generate less confusion as to its meaning.

Both for comparisons within the same country over time and for comparisons among countries at the same time, it has become conventional to calculate the public expenditure/GDP ratio[2]. Although useful as a crude indicator of the relative size of public expenditure, this ratio is potentially misleading. The numerator includes transfer payments, but these are excluded from the denominator; the ratio is therefore not limited to 100 per cent, with values above this possible, if unlikely[3]. There is a problem of comparability if a country pays generous transfer payments but then treats them as part of taxable income, because GGE scores the gross amount. This is one, though by no means the only, reason why the public expenditure/GDP ratio in Sweden stands out internationally as being so high, making it an outlier[4]. Although retirement pensions are treated as part of taxable income in the United Kingdom, much benefit expenditure (for example, child benefit, incapacity benefit and income support) is not.

The public expenditure/GDP ratio gives a first indication as to the scale of government activity, though comparisons are only well-founded between countries that have broadly similar economic, social and political structures. However, much excitable commentary about the public expenditure/GDP ratio does not take these factors into account. In 1976, Roy Jenkins (then Labour Home Secretary) described a 60 per cent ratio as 'close to one of the frontiers of social democracy'[5]. In 2002, Sir John Egan (Chairman of the Confederation of British Industry) described anything above 40 per cent as entering 'bandit territory'[6]. In 1995, two writers linked to the Conservative Party advanced 'The long-term objective should be to reduce public expenditure to 15–20 per cent of Gross Domestic Product . . . over the next thirty years'[7].

Differences across countries and over time in the public expenditure/GDP ratio do reflect real differences in the role of government. However, interpretation should proceed with great caution. If the ratio attracts too much attention, there is considerable danger that policy will be distorted in order to manipulate the ratio. An artificial example illustrates the point. The government could legislate to compel individuals to take out private health insurance, with healthcare still provided by (National Health Service) NHS Trusts. In such circumstances, the only public expenditure on health would be (1) subsidies to those individuals without the income or assets with which to pay private insurance, and (2) external financing of NHS Trusts. This illustrates the use of coerced private expenditures as a substitute for public expenditure. There may be circumstances in which coerced private expenditure is an appropriate policy instrument: the statutory requirement not to drive a motor vehicle without insurance is a long-standing example. However, such cases should be considered on their merits, not on the basis of public expenditure scoring.

1 See para 490 below.
2 On the question of international comparability, see the discussion of government borrowing in para 488 below and of the definitions used in international surveillance in para 524 below.
3 A numerical example is provided by D A Heald *Public Expenditure: Its Defence and Reform*, (Martin Robertson, Oxford, 1983) p 13.
4 The Swedish GGE/GDP ratio is affected by the practice of having generous, though taxable, transfer payments, in circumstances where most other countries pay lower benefits on a non-taxable basis.
5 R Jenkins (now Lord Jenkins), Speech at Coleg Pencraig, Llangefni, to the Anglesey Constituency Labour Party, 23 January 1976.
6 C Denny 'CBI chief warns on NHS cash' (2002) *Guardian*, 20 May.
7 A Duncan and D Hobson *Saturn's Children: How the State Devours Liberty, Prosperity and Virtue* (Sinclair-Stephenson, London, 1995) p 435.

488. Measures of government borrowing. Public expenditure has to be financed either by taxation or by borrowing. There is a long history of debates about government borrowing, including the extent to which there can be a shift of burdens between generations and about the role of government borrowing in stabilising the economy over the economic cycle. The scale of public borrowing relative to Gross Domestic Product (GDP) receives a great deal of political and media attention, partly because of past economic difficulties experienced by the United Kingdom, and also because of the international obligations which have been accepted as part of membership of the European Union[1].

The measures of public borrowing that are reported by the Treasury in budget documents are strongly influenced by decisions that have been taken about how to measure and present the fiscal position. Consequently, this discussion distinguishes between the period up to 1998 and the period since.

General Government Expenditure (GGE)[2], as presented in United Kingdom budget documents up to 1998, included certain financial transactions that are not usually included in national accounts-based measures of total government expenditure. The rationale for including them was that they contributed to the public sector borrowing requirement (PSBR) that was then the key measure of fiscal stance. The presentation of the fiscal position was constructed around the identity 'PSBR = GGE – GGR + PCMOB', where GGR was 'general government receipts' and PCMOB was 'public corporations market and overseas borrowing'. The PSBR was a public sector measure, not a general government measure: it included certain transactions of public corporations. In national accounts terms, the PSBR was measured as current and capital expenditure less current and capital receipts plus net acquisition of financial assets (excluding some short-term liquid assets, for example, bank deposits). The general government borrowing requirement (GGBR) was customarily presented in terms of expenditure less receipts (that is, GGE – GGR). This involved splitting the net acquisition of financial assets into expenditure and receipts items: net lending and net acquisition of company securities were put on the expenditure side, and the rest on the receipts side. In national accounts terms, GGE was therefore defined as 'current expenditure + capital expenditure + net lending + net acquisition of company securities'. In practice, the last item was negative, as the government was disposing of financial assets through privatisations. There was controversy in the 1980s about this treatment of privatisation proceeds, because it lowered the PSBR rather than treating privatisation proceeds as a means of financing the PSBR.

In 1998, the government adopted a new fiscal framework[3]. The PSBR, now renamed the public sector net cash requirement (PSNCR), was replaced as the preferred measure of overall fiscal stance by public sector net borrowing (PSNB). Like the PSBR, the PSNB is a public sector, not a general government, measure. In national accounts terms, it consists of current and capital expenditure less current and capital receipts, financial transactions being excluded. This switch of focus from PSBR to PSNB removed the rationale for a measure of spending that included some financial transactions. Accordingly, GGE was replaced as the aggregate measure of public expenditure by Total Managed Expenditure (TME)[4], which, in national accounts terms, is the sum of public sector current and capital expenditure[5].

Compared with several other European Union countries, the underlying United Kingdom fiscal position is healthy: for example, core government debt as a percentage of GDP was 30 per cent in 2001–02, well within the constraints imposed by the Excessive Deficits Protocol[6]. This underlying fiscal strength, together with the fact that the United Kingdom is not subject to the Growth and Stability Pact in the same way as if it were a member of the euro, means that the automatic fiscal stabilisers[7] can be allowed to operate. The credibility now attached to its monetary and fiscal policy will increase the capacity of the United Kingdom government to borrow during an economic downturn.

Nevertheless, there are a number of grounds for concern about United Kingdom developments. First, one of the attractions of the Private Finance Initiative (PFI)[8] has undoubtedly been that the associated borrowing does not score as public borrowing. The amounts involved are becoming substantial[9], and require to be taken into account when interpreting the indebtedness of the United Kingdom government. The second is the growth of borrowing by bodies classified outside the public sector, but which are heavily influenced by government. Classification decisions about whether an organisation is in the public or private sector are taken by the Office for National Statistics (ONS)[10], in accordance with the European System of Accounts 1995[11]. A key dimension of this classification decision is whether a particular organisation is judged to be controlled by government. Establishing what government controls can be extremely difficult, as financial leverage and political pressure can be applied to notionally independent private bodies[12]. ONS has decided that Network Rail, the not-for-profit company established to buy the rail infrastructure from Railtrack plc (the privatised infrastructure operator which had gone into administration), belongs in the private sector. Accordingly, Network Rail will be able to borrow in capital markets without that borrowing counting as public borrowing. Concern about this treatment within the Statistics Commission[13], the watchdog over the ONS's independence, was reported in the media. However, after a meeting on 25 July 2002 with the ONS's classification experts, the Statistics Commission pronounced itself satisfied with the proposed national accounts treatment[14]. However, Sir John Bourn, the Comptroller and Auditor General[15], stated on 9 July 2002 that he would qualify the financial accounts of the Strategic Rail Authority, an executive Non-Departmental Public Body sponsored by the Department of Transport, if they did not consolidate Network Rail[16]. During the summer of 2002, there was extensive media reporting of arguments between the Department of Health and the Treasury concerning the status and borrowing powers of the proposed 'foundation hospitals'[17]. One of the attractions to the Department of Health of foundation hospitals was the intention that they would be able to borrow privately, outside the PSNB.

These developments prompt the concern that the government of the day has too much discretion. It is not just a question of whether the classification rules of ESA 95 have been correctly applied. More important is the sense that — denied officially by government but not discouraged by briefings given to the media — policy is being driven not by the merits of the case but by how such organisations will lie in relation to national accounts standards and financial reporting standards[18]. This creates the impression that governments apply the rules in a way which favours those policy initiatives they support but disadvantages those which they oppose. The consequences are to discredit control systems that have valid purposes and also to encourage organisations and opposition political parties to devise their own schemes to circumvent the formal rules[19]. Moreover, much of what passes for international comparisons is often special pleading to be allowed to do something that is allowed elsewhere, irrespective of the merits of that policy, either in its own context or in the United Kingdom context.

1 See para 524 below.
2 See para 487 above.
3 For a discussion of that macroeconomic framework, especially the Code for Fiscal Stability and the two fiscal rules (Golden Rule and Sustainable Investment Rule), see para 505 below.
4 See para 490 below.
5 For a discussion of international comparisons of public expenditure, see para 524 below. Focusing on a PSNB measure is more in line with international fiscal practice than was focusing on a PSBR measure. However, most countries focus on a general government measure rather than a total public sector measure, and the European Union uses general government net borrowing for measuring deficits for the Stability and Growth Pact. Such a concentration on general government creates substantial opportunities for manipulation, as evidenced by pensions-related transactions between the French government and France Telecom and dividend payments from the Bundesbank to the German government.
6 See para 524 below.
7 When the economy slows down or goes into recession, the structural features of the fiscal system lead to reduced tax revenues and higher public expenditure on transfer payments, such as social security and housing benefit. The converse applies when the economy is performing strongly. If a government responded in the first case above to reduced revenues by cutting public expenditure, that would aggravate the macroeconomic problem.
8 See para 502 below.
9 *PESA* does not contain information about PFI liabilities. However, the annual Financial Statement and Budget Report contains tables showing: departmental estimate of capital spending by the private sector (signed deals); estimated aggregate capital value of projects at preferred bidder stage; and estimated payments under PFI contracts (signed deals) (see

HM Treasury *Budget 2002 — The Strength to Make Long-Term Decisions: Investing in an Enterprising, Fairer Britain — Economic and Fiscal Strategy Report and Financial Statement and Budget Report* (HC Paper 592 (2001–02)).

10 ONS, created in 1996 through a merger between the Central Statistical Office and the Office of Population Censuses and Surveys, is a government department which is also an Executive agency (see paras 548–550 below). The National Statistician is the chief executive of ONS, and the minister responsible is the Chancellor of the Exchequer.

11 Eurostat *European System of Accounts: ESA 95* (Office for Publications of the European Communities, 1996).

12 David Davis MP, chairman of the Public Accounts Committee from 1997 to 2001 (see para 521 below), announced at the party conference in Bournemouth that a Conservative government would extend the right to buy, at discounts on market value, to housing association tenants. Housing associations are classified to the private sector, and have borrowed substantial sums from private sources (BBC News Online 'Plan to extend "right to buy"', 8 October 2002).

13 The Statistics Commission consists of a part-time chairman and seven other part-time commissioners. Independent of both ministers and the ONS, it has been established to advise on quality assurance, priority-setting and procedures designed to deliver statistical integrity.

14 'Once Network Rail meets specified criteria, it will be treated as a private sector company and the Strategic Rail Authority's guarantees treated as contingent liabilities and so not shown as government debt in the National Accounts. This decision is based on the European System of Accounts (ESA 95) which provides the basis for international comparisons' (Statistics Commission Press Release SC/PR/2002/07, 26 July 2002).

15 See para 519 below.

16 The minutes of the 9 July 2002 meeting of the Public Accounts Commission, at which he made this statement, are published in the *Eleventh Report of the Public Accounts Commission* (HC Paper 1251 (2001–02)) (Stationery Office, 2002).

17 There is an obvious parallel between foundation hospitals and the establishment of NHS Trusts from 1991 onwards. A considerable part of the appeal, to managers, of Trust status was the expectation, which never materialised, that there would be access to capital markets outside the PSBR. The agreement in 2002 between the Treasury and the Department of Health appears, at the time of writing (November 2002), to be that foundation hospitals will be allowed to borrow from private sources as well as from the Exchequer, but that all borrowing will be scored in the PSNB.

18 See the discussion on the Private Finance Initiative in para 23 below.

19 On proposals for local authority housing companies, see J Hawksworth and S Wilcox *Challenging the Conventions: Public Borrowing Rules and Housing Investment* (Chartered Institute of Housing, 1995). On proposals to facilitate public investment and thereby avoid the PFI route, see the Scottish National Party proposals for public service trusts: A Wilson 'The Scottish Trust for Public Investment: Equipping Scotland for the 21st Century' (Saltire Paper, 2001).

489. The rationale of control aggregates. The Treasury has a long tradition of establishing 'control aggregates' which become the principal focus of the public expenditure planning and control system. The post-1998 system concentrates on Total Managed Expenditure (TME)[1], which is composed of Departmental Expenditure Limit (DELs)[2] and Annually Managed Expenditure (AME)[3].

These control aggregates are, implicitly or explicitly, conceived of as a mechanism for controlling aggregate public expenditure: for a long time, this was taken to be General Government Expenditure (GGE), or one of its variants[4]. Some types of public expenditure are less conducive to direct planning and control over the survey period: for example, public sector debt interest will depend, *inter alia*, on market interest rates. Also, the level of social security expenditure will vary with the economic cycle, whose future course cannot be closely predicted. On a technical level, there are a number of accounting adjustments[5] that are outside policy control. Accordingly, there are attractions for the Treasury in defining a control aggregate that excludes these unpredictable elements. Such an approach means that it is easier, at least in principle, to prevent underspendings on the unpredictable elements leaking into higher expenditure on the controllable elements. Furthermore, it becomes clearer whether any overspendings should be attributed to failures in the control system or whether they are the product of external factors. This kind of distinction between unpredictable and controllable is far from being clear-cut at the margin, though there is substance in it. Traditionally, control aggregates have been considerably narrower than GGE, even when the policy target was explicitly on GGE or a variant[6]. The present system focuses on TME, which is numerically not very different from GGE though there are a considerable number of offsetting items in the reconciliation.

The specification of a control aggregate is a positive feature of the United Kingdom system. However, there are two grounds for concern. First, the main analyses of public expenditure, such as the tables in *Public Expenditure: Statistical Analyses* (*PESA)*, focus exclusively on TME (a Treasury construct) and fail to provide reconciliations between TME and the measures of expenditure used for international surveillance[7]. This deficiency is particularly unwelcome given that European Union integration means that there is now more comparative discussion of the public finances of member states. Second, the frequency of changes to the control aggregate can be viewed as excessive, in terms of damaging public understanding of the public expenditure system. Various explanations have been advanced: that the Treasury does this deliberately to reassert its own position within government and the dominance of the Executive; that successive changes are a Treasury 'coping strategy'[8] of periodic revision of the rules of the game in order to stay ahead, perhaps because the Treasury is considerably weaker than most observers believe; and that some changes have been a blame-deflection tactic (that is, blame the old system rather than the officials and ministers who operated it, a tactic likely to appeal if the same people remain in office). The habit of successive changes might well be damaging to the Treasury itself, not least by the way in which it damages data comparability. Moreover, it also generates a lack of experience among operators of the system, including Treasury officials themselves.

1 See para 490 below.
2 See para 491 below.
3 See para 492 below.
4 Two variants have been: (1) 'GGE less privatisation proceeds', which is higher than GGE; and (2) 'GGE-X', which differs from GGE in that privatisation proceeds and Lottery-financed expenditure are excluded; and debt interest is measured net of interest and dividends from public corporations and the private sector. The invention of GGE-X in June 1995 is said to have resulted from the annoyance of Kenneth Clarke (Conservative Chancellor of the Exchequer, 1992–97) that his public expenditure plans could be affected by the success of the National Lottery (expenditure financed from the Lottery is scored in GGE) (see para 501 below). 'GGE less privatisation proceeds' received considerable attention in the 1980s; and 'GGE-X' was the official public expenditure objective from 1995 until June 1998, when attention turned to the new control aggregate TME (HM Treasury *Stability and Investment for the Long Term: Economic and Fiscal Strategy Report 1998* (Cm 3978)).
5 See para 498 below.
6 Previous control aggregates are analysed in D A Heald 'Steering public expenditure with defective maps' (1995) 73 Public Administration 213. Changing the control aggregate is one of the ways by which the Treasury keeps control over the public expenditure process. One of the consequences of such changes is the creation of data discontinuities. A valuable guide to the historical development of the United Kingdom public expenditure planning and control

system can be found in H Mercer *Operational Selection Policy for the Control of Central Government Expenditure 1969 to 1997* (Operational Selection Policy 15, Kew, Public Record Office, 2001).

7 See para 524 below.

8 C Thain and M Wright 'Coping with difficulty: the Treasury and public expenditure, 1976–89' (1990) 18 Policy and Politics 1.

490. Total Managed Expenditure. An aggregate drawn from the national accounts, Total Managed Expenditure (TME) is the top-level control aggregate in the public expenditure control system established in 1998. *PESA 2002–03*[1] demonstrates that there are three different ways of expressing TME. First, TME consists of (1) expenditure of central and local government and (2) expenditure of public corporations[2], whilst excluding (3) grants and interest payments between parts of the public sector and (4) financial transactions. Second, TME consists of Departmental Expenditure Limit (DEL)[3] and Annually Managed Expenditure (AME)[4]. Third, TME consists of (a) public sector current expenditure; (b) public sector net investment; and (c) public sector depreciation. Also, TME is the expenditure aggregate that scores in Public Sector Net Borrowing[5], the Treasury's preferred measure of the government's fiscal stance.

When there are announcements of public expenditure increases or decreases, TME is the total that has to be monitored carefully. Press releases and newspaper reports often do not clearly distinguish increases in TME from changes to its composition. For example, the following changes do not affect TME: (i) switches from AME to DEL within the same TME total; (ii) releases from the DEL Reserve to departmental programmes, within the same DEL total; (iii) releases from AME Margin to departmental programmes, within the same AME total. Such compositional changes may cause confusion; this point is additional to long-standing concerns that governments sometimes announce the same increases on more than one occasion.

One of the most interesting annual tables in *Public Expenditure: Statistical Analyses* (*PESA)* is the analysis of TME by function; this table records, for example, all education expenditure, irrespective of whether it is incurred by central government or local authorities, or by Whitehall departments or devolved administrations. Though data for planning years are provided for central government expenditure (including that by the devolved administrations), this table always stops at the estimated outturn year (that is, the one just ending around the date of publication) for local government on the grounds that the actual pattern of expenditure will depend on the independent decisions of separately elected local authorities.

TME is a very broad public expenditure aggregate and, though not very different in size from General Government Expenditure (GGE), the reconciliation from TME to GGE is quite complicated. This has not been provided in *PESA* since the 1999 volume[6] (itself the first to operate on the basis of TME)[7].

1 HM Treasury *Public Expenditure Statistical Analyses 2002–03* (Cm 5401) (2002), p 124.

2 This is the expenditure of public corporations that falls within TME, whether as DEL (see para 491 below); AME (see para 492 below); or Accounting and other adjustments (see para 498 below).

3 See para 491 below.

4 See para 492 below.

5 See para 488 above.
6 HM Treasury *Public Expenditure: Statistical Analyses 1999–2000* (Cm 4201), Table B1.1. There are three sets of adjustments. The first relates to public corporations, necessary because TME is a public sector measure and GGE is a general government measure (ie excluding public corporations). The second relates to debt interest, again in relation to TME being a public sector measure. The third relates to a series of financial transactions, which have become known as 'Financial GGE'. Included here as negative expenditure are: privatisation proceeds; and the sale of loan books, including Housing Corporation debt and student loans (in this case, that part of the proceeds that is treated as negative net lending in GGE).
7 A reconciliation between TME and GGE, consistent with *PESA 2001–02*, is provided by D A Heald and J Short 'The regional dimension of public expenditure in England' (2002) 36 Regional Studies 743.

491. Departmental Expenditure Limit. Departmental Expenditure Limit (DEL) is the core of the 1998 public expenditure control system, intended to be set for three years ahead and re`viewed through the mechanism of the biennial Spending Review, held in 1998, 2000 and 2002. Brought together as DEL are those components of expenditure that are believed suitable for this kind of planning and control discipline. One of the undoubted benefits of DEL to departments has been the much more generous End-Year Flexibility (EYF) arrangements which apply[1]. On the other hand, there is a plausible link between generous EYF and the unprecedented levels of underspending which have characterised the system since 1999–2000. In 2000–01 outturn, in resources, DEL constituted 52.4 per cent of Total Managed Expenditure (TME). In turn, DEL was comprised of the Resource Budget[2] component (89.3 per cent of total DEL) and the Capital Budget[3] component (10.7 per cent).

DEL can be thought of as a spending envelope, set for each department, though sometimes published at departmental group level[4]. DEL is subdivided into Resource DEL and Capital DEL[5]. They are set for three years ahead during the biennial Spending Review (SR). For example, the SR 2000 announcement on 18 July 2000 set DELs for the years 2001–02, 2002–03 and 2003–04. Subsequently, the SR 2002 announcement on 9 July 2002 set DELs for the years 2003–04, 2004–05 and 2005–06. Consequently, the last year of one Spending Review becomes the first year of the next Spending Review. DELs are said to represent 'firm plans'[6] that can only be increased in exceptional circumstances, with the Treasury's agreement, through a claim on the DEL Reserve.

1 Departments are allowed to carry forward all of their unspent DEL, without any upper limit. The amount of EYF is calculated as unspent DEL in the previous year, less, where appropriate, (1) DEL Reserve claims agreed during that preceding year; and (2) EYF entitlements from previous years not taken up (HM Treasury *Public Expenditure 2001–02: Provisional Outturn* (Cm 5574) (2002), p 2). However, the EYF system is operated by the Treasury in a more discretionary way than this statement implies.
2 The Resource Budget, which also has an Annually Managed Expenditure (AME) component, is the budget for current expenditure on a resource basis.
3 The Capital Budget is that part of DEL that covers capital expenditure, including (1) gross capital formation; (2) net acquisition of land; (3) net acquisition of financial assets required for policy purposes (net lending); (4) capital grants (treated as resource expenditure in Estimates and in Departmental Resource Accounts); and (5) military equipment (treated as current expenditure in the national accounts). See HM Treasury *Public Expenditure Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), Glossary, p 128.
4 Departments falling within departmental groupings are listed in Appendix C of *PESA 2002–03*. Eg the departmental grouping 'Education and Skills' consists of the Department for Education and Skills and the Office for Standards in Education.

5 Full information on the precise coverage of Resource DEL and Capital DEL is provided in the annual issue of *PESA*.
6 *PESA 2002–03*, p 120, E.15.

492. Annually Managed Expenditure. The rationale for distinguishing Annually Managed Expenditure (AME) is that certain items, usually because they are less predictable and controllable, are unsuitable for planning over the three-year period used for Departmental Expenditure Limit (DEL). In 2000–01 outturn, in resources, AME constituted 47.6 per cent of Total Managed Expenditure (TME). AME consists of 'Departmental AME' and 'Other AME'. Departmental AME is outside DEL but within departmental budgets. The main categories include social security benefits, housing subsidies, Common Agricultural Policy (CAP) spending and self-financing public corporations. As an interim arrangement for 2001–02 and 2002–03, the non-cash accruals items (that is, depreciation, cost of capital and provisions) were included within Departmental AME. This was done because it was felt that there was not sufficient experience of these items for them to be then included in DEL, though they will switch to DEL in 2003–04 (that is, the first year covered by the Spending Review (SR) 2002 settlement).

The second component of AME is 'Other AME' which in turn breaks down into four main components. Two of these are 'Net payments to EC institutions[1]' and Central government gross debt interest. Another is 'Accounting and other adjustments' which receive separate treatment below[2].

The final component of AME is 'Locally Financed Expenditure', which is entirely different in character. This has three parts. The first is Local Authority Self-Financed Expenditure (LASFE)[3], which represents local authority expenditure financed from local resources such as council tax, borrowing, trading surpluses, investment income and the use of reserves. The second is expenditure financed by Non-Domestic Rates in Scotland and by Regional Rates in Northern Ireland. The third part would only arise if the Scottish variable rate of income tax[4] were to be levied. In the case of an upward variation, the additional expenditure would be treated as Other AME. In the case of a downward variation, the reduction in yield would be treated as negative Other AME, thereby reducing total spending authority.

AME is more actively reconsidered by the Treasury on a year-by-year basis than is DEL. There is no End-Year Flexibility (EYF) for AME[5]. The AME Margin is an unallocated margin on total AME included for prudential purposes, to be allocated by the Treasury to wherever it is needed. One of the arguments for the 1998 distinction between DEL and AME is that keeping the latter separate means that departmental programmes will neither be excessively pressured by increases in AME, nor allowed to benefit if AME is underspent (which should rather lead to a lower TME). In practice, however, underspendings on AME have sometimes been diverted into higher DELs.

1 This excludes the United Kingdom's contribution to the cost of EC aid to non-member states, this being attributed to the expenditure of the Department for International Development.
2 See para 498 below.
3 See para 544 below, and see LOCAL GOVERNMENT (Reissue) paras 445–504.
4 See para 538 below.
5 Except for the locally-financed expenditure component.

493. Total Expenditure on Services. To reach Total Expenditure on Services (TES), the following items are deducted from Total Managed Expenditure (TME): public sector debt interest; net public service pensions; allowance for shortfall (that is, expected underspending); and other accounting adjustments[1]. An indication of the magnitude of these deductions is that TME in 2000–01 (outturn, resource basis) was £367 billion whilst TES was £322 billion.

The statistical tables in *Public Expenditure: Statistical Analyses* (*PESA)* analyse TES along various dimensions. First, there is the functional analysis, breaking down expenditure into the following main functions: education; health and personal social services; transport; housing; other environmental services; law, order and protective services; defence; international development and other international services; trade, industry, energy, employment and training; agriculture, fisheries, food and forestry; culture, media and sport; social security; and central administration and associated expenditure. This table analyses TES, irrespective of the spending sector that incurs that expenditure. Each of these functions is broken down into sub-functions, for example, education into: under fives; schools; further education; higher education; student support; and miscellaneous educational services, research and administration. Unfortunately, at the sub-function level of analysis, there are grounds for doubting the reliability of coding.

Second, TES is also analysed by economic category, broken down according to the kinds of inputs that are acquired. The composition in 2000–01 (outturn, resource basis) was as follows: pay (21.65 per cent); other current expenditure on goods and services (30.73 per cent); subsidies (2.78 per cent); current grants to the private sector (37.10 per cent); current transfers abroad (2.57 per cent); net capital expenditure on assets (3.74 per cent); and capital grants (1.44 per cent).

Third, to the extent that this is feasible, TES is analysed by country and by region, and this analysis probably attracts more attention than any other. Given the political salience to devolved government in Scotland of the identifiable expenditure analysis, this topic is considered separately below[2].

Another dimension of analysis is by spending sector, classified as: central government own expenditure; local authority expenditure; and public corporation expenditure. *PESA 2002–03* analyses TME rather than TES. For 2001–02 estimated outturn, measured in resources, the respective contributions of the above spending sectors were 73.83 per cent, 24.84 per cent, and 1.33 per cent[3]. Within each spending sector, there is a disaggregation reflecting the budgeting treatment of that expenditure. For example, central government own expenditure consists of: Departmental Expenditure Limit (DEL); departmental Annually Managed Expenditure (AME); locally financed support in Northern Ireland; net payment to EC institutions; central government debt interest; and accounting and other adjustments. A surprising omission in current editions of *PESA* is an analysis of TES first by functional programme and then by spending sector. *PESA* contains separate chapters on central government own expenditure and on local authority expenditure.

There is some change of detail provided in successive annual issues of *PESA*, though the framework of analysis remains unchanged. Nevertheless, the manner in which data are presented is closely derived from the TME-based control system introduced in 1998, the replacement of which would fundamentally affect data presentation.

1 See para 498 below.
2 See para 494 below.
3 *Public Expenditure: Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), Table 1.14.

494. Identifiable public expenditure. A considerable amount of political attention is now given to the chapter in *Public Expenditure: Statistical Analyses* (*PESA*) that provides identifiable expenditure by main function (for example, health and education), both for the four countries (England, Scotland, Wales and Northern Ireland) and for the English regions. These data make it possible to calculate indexes (conventionally, United Kingdom = 100) of identifiable expenditure per head for each country and region for each main function. For example, the indexes for education in 2000–01 were: England (96); Scotland (124); Wales (98); and Northern Ireland (138). There are no published data below main function (for example, under fives, school education etc); access to unpublished data indicates that, at sub-function level, there are severe problems of comparability and data recording. In terms of identifiable expenditure per head, the indexes in 2000–01 were: England (96); Scotland (118); Wales (113); and Northern Ireland (136). Such figures are often, though misleadingly, used in discussions of whether the Barnett formula[1] is actually producing convergence in comparable expenditure per head[2]. Over time, the quality of these data has improved, though there are still grounds for concern, notably with regard to the attribution of identifiable expenditure in England to the nine English regions[3].

1 See para 536 below.
2 In brief, convergence would apply to devolved expenditure controlled by the Barnett formula (see paras 530 and 535–536 below), which is different across devolved administrations. Identifiable expenditure includes expenditure by United Kingdom departments in the countries and regions, and this is affected by the economic cycle and its differential impacts on countries and regions.
3 In *Public Expenditure: Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), the analyses are still presented on a cash basis. For total identifiable expenditure by country, the period covers 1985–86 to 2000–01. At main function level by country, the analysis covers 1996–97 to 2000–01. For total identifiable expenditure by English region, the period covers 1987–88 to 2000–01. At main function level by English region, the analysis covers 1999–2000 to 2000–01. In future, there will be data discontinuities arising from the switch to RAB.

495. Current versus constant prices. Even with modest levels of inflation, direct comparisons of the amounts of public expenditure in different years can be seriously misleading. Accordingly, public expenditure data are frequently converted from current prices (that is, prices ruling at the date of the actual transactions) to constant prices (that is, the prices ruling at a specified date, such as 2002–03 prices). The annually published *Public Expenditure: Statistical Analyses* (*PESA)* contains several tables published on a constant-price basis, referring to these as 'real terms'. The conversions are made using the Gross Domestic Product (GDP) deflators, updated every three months by the Treasury[1]. Applied to public expenditure, this series is intended to record the cost of public expenditure to the economy.

In the original Public Expenditure Survey Committee (PESC) system, established after the Plowden Report[2], this series was known as 'cost terms'. At that time, public expenditure was planned on a volume basis, with the inflation adjustment undertaken using specific price indexes: for example, health expenditure would be adjusted using specific price factors for health, and defence expenditure using those applicable to defence. During the mid-1970s, it became evident that volume planning[3] was extremely vulnerable to cost inflation, indeed sanctioning whatever price increases were recorded as having taken place. Almost all volume elements have now been purged from the United Kingdom public expenditure system, with health being the only functional area in which there are comprehensive specific price data still available, though these are not used for planning and control purposes. Although there would be little support for a return to volume planning, the point should be noted that a department facing rates of specific price inflation higher than general inflation, as measured by the GDP deflator, will be recording real terms increases, even though the real purchasing power of its budget is being eroded.

An indication of the importance of inflation adjustment is provided by the following example. In 1963–64, Total Managed Expenditure (TME) in current prices was £12.1 billion, rising to £418.4 billion in 2002–03. Expressed in cost terms at 2000–01 prices, this increase was from £155.5 billion to £397.3 billion[4]. In official public expenditure documents such as *PESA*, what is here labelled as 'current prices' is described as 'cash'[5].

1 The GDP deflator at market prices is calculated as GDP at current prices divided by GDP at constant prices, then re-expressed as base year = 100. Contemporary data are published on the Treasury website (www.hm-treasury.gov.uk). Eg for 1995–96, £729,001 million divided by £852,727 million (2001–02 prices), then re-expressed, gives a GDP deflator of 85.491. Public expenditure in 1995–96 can then be revalued to 2001–02 prices by multiplying by 100 and dividing by 85.491.
2 See para 506 below.
3 See para 506, note 4, below.
4 *Public Expenditure: Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), Table 3.1.
5 The term 'cash' has to be interpreted with care. Its precise meaning depends on the context. In ordinary usage it is used both to indicate the use of notes and coins as opposed to other forms of exchange (eg cheques), and as opposed to credit. Both these uses have their place in official use. But official papers also use the term in two more specialised cases: cash as opposed to real terms (as discussed in this para); and cash as opposed to resources (discussed in the next).

496. Cash versus resources. Traditionally, public expenditure has been planned, controlled and measured on a cash basis, with transactions recorded when cash changes hands, rather than, for example, when goods are received or when services accrue from capital assets. This cash basis for government accounting, certainly in relation to core government, applied across the world until the move to accruals accounting was pioneered by certain countries in the early 1990s, most notably New Zealand. Although described as cash, the United Kingdom public expenditure control system included certain items which were 'permissions to spend', notably local authority credit approvals in England and the section 94[1] consents issued by the Scottish Executive to Scottish local authorities to incur capital expenditure.

On 30 November 1993, the then Chancellor of the Exchequer (Kenneth Clarke) wrote to the then Chairman of the Treasury Committee, announcing the government's intention to switch from cash to accruals for both accounting and budgeting. These proposals were developed in a Green Paper[2] in July 1994 and a White Paper[3] in July 1995, coining the term 'Resource Accounting and Budgeting'. In the context of United Kingdom central government accounting, the term 'resource' has become a term of art, indicating accruals accounting as applied in accordance with the Resource Accounting Manual[4].

In July 1993, the Treasury submitted proposals to the Public Accounts Committee and the Treasury Committee for what became known as 'Simplified Estimates'. These proposals, implemented in 1996–97, replaced the immensely detailed Estimates with a much more summarised format, organised in the form of a matrix[5]. The Treasury wanted to simplify the Estimates, and also recognised that such a change was a necessary prerequisite for any move from cash to accruals, though it did not make this link explicit at the time.

There was extensive consultation with Parliament about the implementation of Resource Accounting and Budgeting (RAB), largely in consequence of the link to the formal Parliamentary financial procedures. The Treasury Committee was consistently supportive of the RAB project, whereas periodic doubts were expressed by the National Audit Office and the Public Accounts Committee about the readiness of departments to achieve the transition. Indeed, the Comptroller and Auditor General suggested that there might need to be a further year of shadow running (2001–02), but sufficient progress was then made for the original timetable to stand[6].

The differences between measurement on a cash basis and on a resource basis can become complex. However, the essential differences are straightforward, as indeed are those items which give rise to significant differences between the two measurement bases. In principle, the cash basis is driven exclusively by *when* money changes hands: for example, goods paid for but not received are scored as expenditure whereas goods received but not paid for are not. By contrast, the accrual (or resource) basis recognises expenditure at the time it is incurred — when goods or services are received, or assets consumed — rather than when payment is made. Consequently, there is substantial scope for manipulation, at the end of a financial year, of the reported figures for cash expenditure. This problem is seen in extreme form in developing countries, and in transition economies in Central and Eastern Europe, where there are often large unpaid debts both between departments and to their private and public sector suppliers.

Whilst such debts are very unusual in the United Kingdom, the cash basis was often not strictly applied, with there being a huge effort to clear transactions just after the financial year end in order to include them in that year. Another example relates to the acquisition of capital assets. Under cash accounting, expenditure is recorded when the asset is paid for, not when use is made of it. There is no balance sheet containing the values of assets, and hence no depreciation during the years of use. Where a department makes substantial use of assets, the time series of its expenditure can be seriously distorted by peaks in capital expenditure. Moreover, the accounting for capital assets on a cash basis is often associated with a neglect of the existing asset base, for which asset registers are usually not kept. Public financial management reforms in the 1990s were much concerned with the inefficient utilisation of public assets, in part because managers viewed existing capital as a free good. These concerns contributed significantly to the establishment of capital charging as part of the NHS internal market reforms in 1991 and to their becoming a feature of RAB in central government[7]. Throughout the RAB project, HM Treasury has published a series of expository guides[8]. The most visible changes in budgets are the introduction of lines for depreciation and capital charges.

Although Resource Budgeting does not become fully operational until 2003–04, the first live year was 2001–02, when resource-based Supply Estimates replaced cash-based Supply Estimates[9] and resource-based Departmental Resource Accounts (DRAs)[10] replaced cash-based Appropriation Accounts. Whereas *PESA 2001–02* presented its tables on a cash basis, *PESA 2002–03* adopted a mixed basis of cash and resource. Without overlapping data, it is not possible to quantify the impact on particular departmental or functional programmes of this switch from cash to resource. However, it is clear that the impact will be much greater in the case of departments with heavy capital expenditure programmes and large asset bases within the departmental envelope, and relatively unimportant in those departments whose expenditure primarily consists of employment costs and other running costs.

PESA 2002–03 provides four outturn years on a cash basis, and then both 2001–02 (outturn) and 2002–03 (estimated outturn) on a resource basis. A discontinuity therefore occurs between 2000–01 (cash) and 2001–02 (resource), with there being, in the published figures, no distinction between changes in the measurement basis and changes in the level of expenditure. In the light of much speculation earlier in the development of RAB, that the move from cash to resource would significantly affect the reported functional composition of public expenditure, the apparent lack of impact is (at first sight) surprising. However, this is a direct consequence of the choice of Total Expenditure on Services (TES) as the expenditure aggregate to be analysed functionally[11].

1 See para 544 below and, for a comprehensive exposition, see LOCAL GOVERNMENT (Reissue) paras 425–426.
2 HM Treasury *Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government* (Cm 2626) (1994).
3 HM Treasury *Better Accounting for the Taxpayer's Money: The Government's Proposals: Resource Accounting and Budgeting in Government* (Cm 2929) (1995).
4 See para 514 below.
5 In the matrix format all numbers are arranged in rows and columns, whereas the traditional Estimates had been long listings of items, sometimes in minute detail (see paras 508 and 509 below).
6 See the oral evidence given to the Treasury Committee on 7 March 2000: Treasury Committee *Resource Accounting and Budgeting, Minutes of Evidence 7 March 2000* (HC Paper 308-i (1999–2000)) (Stationery Office), questions 60–108.
7 D A Heald and A Dowdall 'Capital charging as a VFM tool in public services' (1999) 15 Financial Accountability & Management 229.
8 See eg HM Treasury *Managing Resources — Full Implementation of Resource Accounting and Budgeting* (London, April 2001) ('blue guide'); HM Treasury *Managing Resources — Analysing Resource Accounts: User's Guide* (London, June 2001) ('red guide'); HM Treasury *Managing Resources — A Strategic Approach to Finance Training* (London, September 2001) ('pink guide'); HM Treasury *Managing Resources — Better Decision Taking in the Departments*, (London, 2nd edn July 2002) ('green guide').
9 See paras 508 and 509 below.
10 See para 514 below.
11 'Non-cash items, such as capital charges, depreciation, changes in provisions, are excluded from the definition of "expenditure on services" that drives most of the tables in this chapter' (*Public Expenditure: Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), p 35).

497. Shortfall and underspending. An important skill in public sector financial management is to spend the budget in the financial year to which it relates, without incurring wasteful or low-priority expenditure near the end of the financial year. Reports of departments, particularly the Ministry of Defence, sending out furniture vans to pick up goods so that the cash budget could be disbursed in-year did great damage to reputations. One of the claimed advantages of Resource Accounting and Budgeting (RAB) is that it would eliminate such year-end binges. However, there are at least two reasons for concern if budgets are not fully disbursed. The first is that the Treasury determines its macroeconomic plans on the basis of its expectations of the level of public expenditure, and these could be falsified by unexpectedly high levels of underspending. The second is that it is an important principle of public finance that there should not be taxation in advance of need.

Because the incoming Labour government in 1997 committed itself to holding to the public expenditure plans of the Conservative government, 1997–98 and 1998–99 were very tight years in public expenditure terms. The brakes came off under Comprehensive Spending Review (CSR) 1998 and Spending Review (SR) 2000, with substantial increases planned by both. Paradoxically, the subsequent years exhibited a new problem, that of significant underspending.

Every July, the Treasury publishes a White Paper under the title 'Public Expenditure Provisional Outturn'. The extent of underspending against Departmental Expenditure Limits (DELs), as recorded at this stage, has been as follows: 2.5 per cent (1999–2000)[1]; 3.2 per cent (2000–01)[2]; and 3.2 per cent (2001–02)[3]. Comparable figures cannot be provided for Annually Managed Expenditure (AME), as there are no 'limits', only estimated outturn in the preceding *PESA*. By definition, no direct comparison is available with the previous control regime, though the scale of underspending has unquestionably increased.

The reasons for underspending on such a scale are presumably diverse. First, the availability of End-Year Flexibility (EYF) on DEL means that departments no longer feel pressured to indulge in year-end binges. Second, the year-on-year increases in DELs have been unprecedented in recent years, and departments have sometimes found it difficult to disburse the additional funds, especially on services where there are labour market problems in connection with recruitment and retention. Third, in the context of capital expenditure where programmes had been run down, it has taken a considerable period of time for departments to re-equip themselves to manage such programmes. Fourth, the diversion of effort into Private Finance Initiative (PFI) schemes may also have contributed to underspendings on capital. Fifth, in certain areas, there has been an increasing amount of top-slicing of resources for particular purposes. The more fragmentation built into programmes, with a growing number of separate pots within the three-year programme, the more likely is overall underspending as the ability to move resources quickly is impeded.

1 HM Treasury *Public Expenditure 1999–2000: Provisional Outturn* (Cm 4812) (2000).
2 HM Treasury *Public Expenditure 2000–01: Provisional Outturn* (Cm 5243) (2001).
3 HM Treasury *Public Expenditure 2001–02: Provisional Outturn* (Cm 5574) (2002).

498. Accounting adjustments. Accounting adjustments are in principle simple, but a lot of care has to be taken, not least in relation to signs (that is, deducting a negative number is equivalent to adding a positive number). There are two levels of accounting adjustments within the present public expenditure planning and control system, and it is important not to confuse them. First, accounting adjustments are required to convert Departmental Expenditure Limit (DEL) (measured on a Resource Accounting and Budgeting (RAB) basis) to a national accounts basis. The largest component is the removal of non-cash costs, such as depreciation and capital charges. Second, accounting adjustments are required to align Annually Managed Expenditure (AME), where definitions are partly chosen for control purposes, to a national accounts basis. Significant items include: general government non-trading capital consumption (used in the national accounts rather than accounting depreciation); VAT refunds (their purpose is so that departments and local authorities do not have a tax incentive to favour in-house versus contracted-out provision); EC contributions[1]; intra-government debt interest; and non-cash spending in AME[2].

1 The accounting adjustments for EC contributions removes part of the EC net payments line included in Other AME, thereby converting from a Treasury definition to a national accounts definition.

2 HM Treasury *Public Expenditure Statistical Analyses 2002–03* (Cm 5401) (2002), Table 1.12 and Appendix B (pp 105–112); and HM Treasury *2002 Spending Review: New Public Spending Plans 2003–2006 — Opportunity and Security for All: Investing in an Enterprising, Fairer Britain* (Cm 5570) (2002), Table A.10.

499. Hypothecation. As a general rule, public revenues in the United Kingdom are not hypothecated to particular purposes. One historically important exception, the Road Fund, was raided by Chancellor of the Exchequer Winston Churchill in 1925 in the context of a budget crisis. A partial exception is the National Insurance Fund, though the link between national insurance contributions and benefits has long been attenuated by the grant in aid from general tax revenues. The 1 per cent increase in both employers' and employees' national insurance contributions in the 2002 Budget, stated to be for the purposes of increased National Health Service (NHS) spending, necessitated legislation to authorise this diversion[1]. In the 1990s, there was much more discussion of hypothecating, or earmarking, (increases in) particular taxes to particular purposes, most notably in the context of the NHS. There has been the example of the Treasury, on a non-statutory basis, committing to spend on the NHS the proceeds from above-inflation increases in tobacco duties[2]. Exactly the same kind of discussion has taken place in the context of congestion charging for motor vehicles.

It is necessary to draw a distinction between formal schemes of hypothecation, when there is a statutory obligation to spend revenues from particular sources on particular programmes, and commitments, to be taken on trust, by politicians to spend (additional) revenues in a particular way. The standard objection to formal hypothecation is that such a mechanism may lead to wasteful expenditure (a buoyant tax base) or to insufficient expenditure (a depressed tax base); there is no reason to believe that the 'optimal' amount of revenue will be forthcoming. The problem with hypothecation taken on trust is that there is no way of assessing the counterfactual: how much would expenditure have increased in the absence of hypothecation? Formal hypothecation is easier where there is some link between the tax and the service rendered (for example, television licence fees funding the British

Broadcasting Corporation). An undertaking to spend particular revenues in particular ways is most credible when the amounts are comparatively small or the impact localised: for example, congestion charges are used for transport improvements. Those who support hypothecation often believe that there has been a breakdown of trust between governments and citizens over taxation and expenditure; such hypothecation schemes are intended to be persuasive, usually in the direction of more expenditure.

1 The 'additional rate' is legislated in the National Insurance Contributions Act 2002 (c 19), s 1. NICA 2002, s 4, amends the Social Security Administration Act 1992 (c 5), s 162, with the effect that 100 per cent of this additional rate is allocated towards the cost of the NHS in England, Scotland and Wales. There is comparable provision for Northern Ireland in NICA 2002, s 5, with the amendment applying to the Social Security Administration (Northern Ireland) Act 1992 (c 8), s 142.

2 In the November 1999 Pre-Budget Report, the Chancellor of the Exchequer announced that any additional revenue raised from future real increases in tobacco duties would be spent on improving health care (HM Treasury *Stability and steady growth for Britain: Pre-Budget Report* (Cm 4479) (1999), para 5.113; HM Treasury *Additional money from tobacco duty increases to go to health spending*, Press Release HMT/Health, 9 November 1999). The proceeds from the 5 per cent real-terms increase in tobacco duties in Budget 2000 contributed to the additional £2 billion health funding for 2000–01 and to the increased allocations for the NHS up to 2003–04. In both Budget 2001 and Budget 2002, tobacco duty was increased in line with inflation, so there was no real-terms increase and hence no additional revenue to increase further the contribution from tobacco duty towards the funding settlements for health care. The government had committed itself to large real-terms increases in spending on the NHS and it is therefore not clear what difference in substantive, as opposed to presentational, terms was made by this linkage.

500. EC finance. Expenditure financed by grants from European Communities (EC) institutions[1] is included within departmental programmes, either in Departmental Expenditure Limit (DEL) or Annually Managed Expenditure (AME)[2]. Receipts from EC institutions are not netted off departmental programmes[3]. Departments have to find room for EC-financed expenditure within their overall allocations, both to provide expenditure cover for the EC receipts and the 'match funding' usually required because EC funds do not meet the whole cost of projects. The stated reason for this treatment is to ensure that programme managers exercise the same criteria in evaluating proposals for such expenditure as they would in the case of Exchequer-financed projects.

Expenditure under the structural funds, the European Social Fund (ESF) and the European Regional Development Fund (ERDF), is in DEL and therefore has to be accommodated by the devolved administrations within their Barnett-determined allocations. In practice, a separate budget line is shown within the published plans[4]. Expenditure on agricultural market support, under the Common Agricultural Policy, forms part of AME and is therefore outside the allocation determined by the Barnett formula[5].

EC policy requires that expenditure financed by EC grants is additional to, and not a substitute for, public expenditure by member states, the so-called 'doctrine of additionality'. While this is something that can never be either proved or disproved, the United Kingdom government can demonstrate that it plans public expenditure, at the United Kingdom level, net of EC receipts. There is separate identification of ESF and ERDF in Scotland, which is taken to show that there is additionality at the local (for example, Highlands and Islands) level[6]. In practice, EC funds are often used for activities that would otherwise receive a relatively low priority; there is inevitably a tension between wanting projects to be truly additional (that is, they would not otherwise have been done) and also to be high-priority.

In certain circumstances, the issue of additionality acquires high political profile. The minority Labour Administration in the National Assembly for Wales led by Alun Michael AM fell in February 2000 partly because it was judged to have failed to deliver more resources when West Wales (which covers 63 per cent of the area and 65 per cent of the population of Wales) acquired Objective 1 status for the 2000–06 period. Subsequently, Spending Review (SR) 2000 provided to Wales funding, additional to the Barnett formula consequences, to cover EC receipts, but not the match funding. This issue affected Scotland differently, as Scotland now faces a withdrawal of EC funding, rather than a step increase as in the case of Wales. With structural fund expenditure declining in Scotland, the cover for it within the published plans for the Assigned Budget was excessive, allowing redeployment, whereas in Wales additional cover would be at the expense of other programmes.

There is a separate system, known as EUROPES, which, though the expenditure numbers are very small, is important in principle. The European Commission makes direct payments to certain United Kingdom public and private organisations, which do not go through the United Kingdom Exchequer or the devolved administrations. Examples include grants to United Kingdom universities in connection with the Sixth Framework Programme for Research and Technological Development (2002–06). Whenever there is an increase above the baseline, this increase is allocated by the Treasury to departments. All United Kingdom departments and the devolved administrations will incur, on a pound for pound basis, the amount held to be attributable to them.

1 Strictly, membership is to the European Union, but it is the budget of the European Communities. References in the annual *Public Expenditure: Statistical Analyses* (see para 484 above) always refer to 'net contributions to the EC'. However, everyday language is much looser.
2 See paras 491 and 492 above.
3 The receipts are, however, netted off in determining the 'Net payments to EC institutions', a component of AME, and therefore of Total Managed Expenditure (TME). Consequently, high-level public expenditure aggregates therefore include only the net position. See para 498 above.
4 See, for instance, Scottish Executive *Building a Better Scotland: Spending Proposals 2003–2006: What the Money Buys* (Stationery Office, 2002), p 53.
5 See para 536 below. Expenditure on the Less Favoured Areas Support Scheme, formerly known as Hill Livestock Compensatory Allowances, though in DEL, is outside the operation of the Barnett formula.
6 This arrangement fulfils an agreement reached in 1992 between Sir John Kerr, then Permanent Representative at the European Commission, and Bruce Millan, then European Commissioner (and one-time Secretary of State for Scotland): European Commission, 'Bruce Millan releases 115 million pounds for United Kingdom coalmining areas after agreement on changes in UK public spending rules', Press Release IP/92/107, 17 February 1992. This does not guarantee that there is additionality at the Scotland level. See also EC Commission Regulation 1260/99, art 11.

501. National Lottery-financed expenditure. Lottery-financed expenditure is treated as public expenditure in the national accounts. It is included within Total Management Expenditure (TME)[1], not as Departmental Expenditure Limit (DEL)[2] but as departmental Annually Managed Expenditure (AME)[3] of the relevant department, currently the Department for Culture, Media and Sport[4].

Lotteries are reserved[5], but there is executive devolution[6] of some aspects of the National Lottery[7]. The Scottish Ministers have powers, with the agreement of the Secretary of State, to give directions relating to Scotland to distributing bodies; and they are entitled, as well as the Secretary of State, to receive reports, strategic plans and accounts[8], from such bodies in relation to Scotland. The Secretary of State is also obliged to consult the Scottish Ministers before giving certain directions and making certain appointments to the New Opportunities Fund[9].

The operation of the National Lottery is regulated by the National Lottery Commission[10] which publishes an annual report presented to the Westminster and Holyrood Parliaments[11].

Although Lottery-financed expenditure is small in relation to total public expenditure[12], what are significant amounts of money by any other standard are channelled to a large number of organisations in the public and private sectors. The proceeds for good causes[13] of the National Lottery are paid to the Secretary of State[14], who, in turn pays them into the National Lottery Distribution Fund, which is under his control and mangement[15]. The Fund allocates these to 'distributing bodies' in statutorily-determined percentages[16]. In the case of Sports and Arts Councils, the Lottery-financed funding channel can be much larger than the grant in aid which they receive from their parent departments. Monies not immediately required for distribution are invested by the National Debt Commissioners. Interest received on the investments made by the National Lottery Distribution Fund is attributed to the distributing bodies in proportion to their share of the balance on that Fund. A White Paper account is presented to both the House of Commons and the Scottish Parliament[17].

Each of the distributing bodies publishes a White Paper account[18] presented to both Parliaments[19] (even where the distributing body is exclusively concerned with Scotland[20]).

It is impossible to determine whether Lottery-financed expenditure is additional to public expenditure on a particular function, such as sport or the arts, or whether it displaces, to some degree, conventionally-financed expenditure. Nor is it possible to say whether the activities supported by the National Lottery: will be discontinued after this funding expires; will by then have become self-financing; or will add to pressure on the budgets of departments that — whatever the formal conditions of grant — may be expected to take over the commitments.

1 See para 490 above.
2 See para 491 above.
3 See para 492 above.
4 *Public Expenditure: Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), Table 1.1.
5 Scotland Act 1998 (c 46), Sch 5, Pt II, Section B9.
6 See para 391 above.
7 Scotland Act 1998 (Modification of Functions) Order 1999, SI 1999/1756, and Scotland Act 1998 (Transfer of Functions to the Scottish Ministers etc) Order 1999, SI 1999/1750.
8 Such reports and accounts will then be laid before the Scottish Parliament. Accounts relating solely to Scotland will be audited by the Auditor General for Scotland (see para 543 below) instead of the Comptroller and Auditor General (see para 514 below): SA 1998, ss 120,121, as read with SI 1999/1750, art 6.
9 Established under the National Lottery etc Act 1993 (c 39), s 43A (added by the National Lottery Act 1998 (c 22), s 7(2)).

10 NLA 1993, ss 3A–14, Sch 2A (amended by NLA 1998, ss 1, 2 and Sch 1).
11 NLA 1993, s 14(3), (4) (s 14(4) added by SI 1999/1750, Sch 5, para 12).
12 See paras 487 and 489 above, particularly para 489, note 4, above.
13 For data on the distribution of awards by good cause, constituency and region, see P Bolton and P Carling *The National Lottery* House of Commons Library Research Paper 01/66 (2001).
14 NLA 1993, s 5(6). In practice, this function is undertaken by the Secretary of State for Culture, Media and Sport.
15 NLA 1993, s 21.
16 These percentages are specified in NLA 1993, ss 22–23 (as extensively amended). The allocation process has two levels. At the first level in 2000–01, 16.67 per cent went to each of the Arts, Sports, National Heritage Memorial Fund and National Lottery Charities Board; 20 per cent went to the Millennium Commission (as of 21 August 2001, this was transferred to the New Opportunities Fund); and 13.33 per cent went to the New Opportunities Fund. At the second level, there were sub-divisions among Arts distributing bodies and Sports distributing bodies. The 16.67 per cent for the Arts was divided as follows: Arts Council of England (11.85 per cent); Scottish Arts Council (1.29 per cent); Arts Council for Wales (0.83 per cent); Arts Council of Northern Ireland (0.47 per cent); Film Council (2.03 per cent); and Scottish Screen (0.19 per cent). The 16.67 for Sports was divided as follows: English Sports Council (12.67 per cent); Scottish Sport Council (1.35 per cent); Sports Council for Wales (0.75 per cent); Sports Council of Northern Ireland (0.43 per cent); and UK Sports Council (1.53 per cent).
17 *National Lottery Distribution Fund Accounts 2000–2001* (HC Paper 753 (2000–01)) and SE/2002/87.
18 NLA 1993, s 35. See also para 518 below.
19 Eg *United Kingdom Sports Council Lottery Distribution Account 2000–01* (HC Paper 186 (2001–02)) and SE/2001/211.
20 Eg *sportscotland, National Lottery Fund: Statement of Account Prepared Pursuant to Section 35 of the National Lottery etc Act 1993* (HC Paper 1023 (2001–02)) and SE/2002/183. sportscotland is the trading name of the Scottish Sports Council, an Executive Non-Departmental Public Body (see paras 547–550 below).

502. Private finance. There is nothing new in governments borrowing money from the private sector to finance the provision of public services and, in particular, the acquisition of capital assets. Nor is there anything new in governments using the private sector to deliver public services. Indeed, all public services are delivered by private persons, who may, or may not, be public sector employees. There has always been a mixture of in-house and bought-in provision. What is new is that long-term contracts are being let, with the ownership and management of dedicated assets left with the private sector.

During the 1980s, the provision of private finance for public projects was governed by the Ryrie Rules[1]. These provided: that private finance could only be used if there were no favourable risk terms, such as a government guarantee; that projects must yield benefits in terms of improved efficiency and profit commensurate with the cost of raising risk capital from financial markets; and that use of private finance could not be additional to public finance. In other words, public expenditure would be reduced, pound for pound, in consequence of the use of private finance. The rationale for this provision was that there is little macroeconomic difference between the government borrowing on the market to finance public expenditure generally and the private sector borrowing for essentially public projects. The objective of the Ryrie Rules was to stop ministers from insulating private finance from risk so that it could be used to circumvent public expenditure constraints. The Ryrie Rules were formally retired in 1989. Subsequently, the Treasury promoted private finance as additional and not just substitutional; the Private Finance Initiative was launched in 1992 and revamped as Public-Private Partnerships (PPPs) by the Labour government in 1998[2].

That is not to say that the Private Finance Initiative (PFI) solely means substituting private finance for public borrowing. PFI projects typically consist of private businesses contracting to provide a service, including any necessary capital assets. In principle, PFI projects may only proceed if they provide better Value For Money (VFM) than public sector investment[3]. The idea is to harness private sector expertise in such areas as infrastructure provision and building construction and management, and to ensure that the various risks are borne by those best placed, and best equipped, to manage the risk. The theory is that the management and other benefits brought by the private sector can outweigh higher financing costs[4]. Nonetheless, there should be ways of harnessing private sector skills and allocating risk appropriately within a publicly funded project; the suspicion remains that a motivation of PFI projects is often to remove projects from the public sector balance sheet, thereby securing capital investment which cannot be fitted into existing capital budgets.

The public expenditure treatment of PFI projects depends on the view taken by the public sector body procuring the project and its auditors as to whether or not the related assets and the linked financing liability should be on its balance sheet. This depends, in turn, on the application of accounting principles designed to ensure that balance sheets reflect assets on the basis of control, not necessarily legal ownership[5]. The cost of assets appearing on departments' balance sheets[6] will count against their capital budgets. This means that the cost of a privately financed project where the provider is only effectively providing finance will count against the capital budget, the same position as under the Ryrie Rules.

Notwithstanding the amount of attention devoted to the PFI by the Conservative government after 1992, the number of projects and the amounts involved were slow to build up. This is no longer the case, as is shown by tables in the annual Financial Statement and Budget Report on the values of contracts signed or at preferred bidder stage, and on the estimated payments in future years under PFI contracts[7]. The absolute amounts are large, and these figures are becoming significant relative to total public sector investment[8].

1 After Sir William Ryrie, then Second Permanent Secretary to the Treasury. See D A Heald 'Privately Financed Capital in Public Services' (1997) 65 Manchester School 568.

2 The PFI is now regarded as only one form of PPP. Other possibilities include the introduction of private capital into public businesses, and sales of government services into wider markets. The possibilities are discussed in HM Treasury *Public Private Partnerships: The Government's Approach* (Stationery Office, 2000). On the Treasury-sponsored Partnership UK, see para 250 above.

3 *Public Private Partnerships: The Government's Approach* ch 1, para 19.

4 Governments in industrialised countries, such as the United Kingdom, can always borrow more cheaply than the private sector because of their ability to tax. In other words, their borrowing capacity does not depend on the quality of their projects.

5 For an analysis of both VFM and accounting aspects, see D A Heald 'PFI accounting treatment and Value For Money' (2003) 16 Accounting, Auditing and Accountability Journal (forthcoming); and M Spackman 'Public-Private Partnerships: lessons from the British approach' (2002) 27 Economic Systems (forthcoming).

6 With regard to prisons, there are now a mix of on-balance sheet and off-balance sheet PFI projects: *Home Office Consolidated Resource Accounts 2000–2001* (Cm 5444) (2002).

7 HM Treasury *Budget 2002: The strength to make long-term decisions: Investing in an enterprising, fairer Britain* (HC Paper 592 (2001–02)) (Stationery Office), Tables C17–C19.

8 On-balance sheet PFI counts as part of public sector net investment for the purpose of the government's fiscal policy rules, as set out in the Code for Fiscal Stability (HM Treasury *The*

Code for Fiscal Stability (HM Treasury, 1998): see para 505 below). The revenue charges arising from off-balance sheet PFI will become an increasingly important claim against future public spending. On-balance sheet PFI will bring lower revenue charges than its off-balance sheet counterpart, but there will also be capital charges and depreciation.

503. Financial resolutions. Bills[1] in both the Westminster and Holyrood Parliaments proposing new spending powers, taxes or other charges are subject to special procedures, which have the effect of requiring the agreement of the Executive to such proposals.

At Westminster, the right of initiative has long belonged to the Executive[2]. Any Bill that creates a charge upon the public revenue, including the remission of public debt, must be authorised by a resolution of the House of Commons, usually known as a 'Money Resolution' and the resolution itself must be recommended by the Crown[3]. Money Resolutions are usually moved immediately after Second Reading. Amendments to the Bill that are outside the scope of the Money Resolution are out of order and will not be considered. Similarly, a Bill that proposes 'a charge upon the people' requires a 'Ways and Means Resolution'[4], which can only be moved by a minister of the Crown. Indeed, if the primary purpose of the Bill is to raise money, then the Bill can only be brought in following one or more Ways and Means Resolutions.

At Holyrood, any Bill proposing a charge on the Scottish Consolidated Fund[5] or significant increases to expenditure payable out of the Fund or seeking to impose a significant charge or payment levied by a person whose receipts are payable into the Scottish Consolidated Fund[6] cannot proceed beyond stage 1 (the preliminary stage in the case of private Bills) unless the Parliament agrees to the expenditure or charge by resolution[7]. Such a financial resolution can only be moved by a member of the Scottish Executive or a Junior Scottish Minister. A Bill would fall if no such resolution has been proposed within six months of the completion of stage 1 (the preliminary stage in the case of private Bills), and it is passed.

1 See paras 123 ff above (United Kingdom Parliament) and paras 374 ff above (Scottish Parliament).
2 T Daintith and A Page *The Executive in the Constitution: Structure, Autonomy and Internal Control* (Oxford University Press, 1999), pp 108–109.
3 See Erskine May *Parliamentary Practice* (22nd edn, 1997 by D W Limon and W R McKay), ch 31. A short explanation is also contained in HM Treasury *Government Accounting 2000*, Amendment 1/01 (Stationery Office, 2001), Annex 2.2. See also HC Standing Orders (Public Business) (2002) nos 49 and 52.
4 See *Erskine May*, ch 32. See also HC Standing Orders (Public Business) (2002) nos 50–52.
5 See para 542 below.
6 Or would be but for alternative provision made under an Act of the Scottish Parliament (eg a Budget Act).
7 Standing Orders, r 9.12 in the case of public Bills and r 9A.14 in the case of private Bills.

(3) PLANNING AND CONTROL OF PUBLIC EXPENDITURE: UNITED KINGDOM

504. Overview of section. Using the framework and tools developed in section (2) above, this section provides an exposition of the planning and control system at the United Kingdom level. Accordingly, it covers both Executive processes of decision-making and procedures in the House of Commons (the control of 'money Bills' having been effectively removed from the House of Lords by the Parliament Act 1911 (c 13))[1]. The financial processes of the House of Commons in relation to public money are almost entirely formal, representing no threat to any government with a workable majority. Talk of 'Parliamentary control over public expenditure' is illusory[2]. The extent to which there is any financial scrutiny of the Executive depends almost entirely upon the work of the Public Accounts Committee[3] and the departmentally-related select committees[4]. The fact that a government with a majority controls the majority membership of such committees through the Whips' Office is one of the factors constraining the extent and quality of such scrutiny.

The section is ordered in the following way. It starts with the macroeconomic framework and the setting of spending envelopes for the plan years, and then turns to allocations among programmes. Once these Executive decisions have been taken, expenditure subject to Parliamentary vote is processed through the formal financial procedure. Issues of in-year management and control are then discussed. Government and its bodies are required to account to Parliament, and so the accounting and audit arrangements play an important role. The conduct of financial scrutiny is then considered.

1 Erskine May *Parliamentary Practice* (22nd edn, 1997 by D W Limon and W R McKay), pp 806–808.
2 See D A Heald 'The reform of Supply and financial reporting to Parliament' in the *Second Report of the Procedure Committee: Resource Accounting and Budgeting* (HC Paper 438 (1997–98)) (Stationery Office, 1998) pp 50–54.
3 See para 521 below.
4 See para 530 below.

505. The macroeconomic framework. Public expenditure constitutes such a significant part of the United Kingdom economy that it must be planned in relation to its macroeconomic context. This inevitably brings a top-down approach to aggregates, which sometimes comes into conflict with the needs of both political and managerial devolution. What seems rational and what seems irrational may crucially depend upon where you sit.

Notwithstanding the limitations of the public expenditure/GDP (Gross Domestic Product) ratio[1], governments are necessarily concerned about the level of public expenditure and its ratio to GDP. For a given level of public borrowing, higher levels of public expenditure require higher levels of taxation. Quite apart from political sensitivities in the United Kingdom about tax levels, most taxes have a damaging effect on the economy, by driving fiscal wedges between, in the case of income tax for example, what the employer pays as wages and what the employee receives. The United Kingdom has a considerably lower public expenditure/GDP ratio than its main European Union (EU) partners. Whilst it should be recognised that these countries, particularly France and Germany, plan to reduce their public expenditure/GDP ratios, the United Kingdom has considerable scope for political choice on levels.

A different concern relates to the macroeconomic instability of the United Kingdom economy through time. Although there is an element of the Treasury blaming its former ministers and officials, there is substance in its post-1997 concerns that earlier misreadings of the impact of the economic cycle on the public finances had been very costly[2]. Essentially cyclical fluctuations in the public finances had been interpreted as structural improvements, leading to much sharper readjustments having subsequently to be made. The policy response was to publish a Code for Fiscal Stability[3] and to enshrine this in legislation[4].

The principles promulgated in the Code for Fiscal Stability have been set out as follows[5]:

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

These principles are stated at a high level of abstraction, leaving much scope for dispute about, for example, whether there is transparency in practice.

In operational terms, there are two fiscal rules: the Golden Rule and the Sustainable Investment Rule. The Golden Rule requires that, over the economic cycle, the government borrows only to invest and not to fund current spending. Implementation has to confront the point that it is not easy, certainly in advance, to demarcate the economic cycle. Moreover, there are policy questions as to whether, late in a particular cycle, fiscal policy would be adjusted in a direction not appropriate to the then contemporary economic situation in order to meet the Golden Rule.

The Sustainable Investment Rule requires that, over the economic cycle, public sector net debt is held at 'a stable and prudent level'. More specifically, the Treasury website states that: 'The Chancellor has stated that, other things equal, net debt will be maintained below 40 per cent of GDP over the economic cycle, in accordance with the sustainable investment rule'. Again, because of uncertainties over the length of the cycle, whether the 40 per cent ceiling has been adhered to can only be determined retrospectively.

Such ambiguities have led to criticism of the two fiscal rules, on the grounds that they are too manipulable by governments. Whether they are shown by particular Budget documents to be met depends crucially on the macroeconomic assumptions within which future expenditure plans are assessed. For example, the Treasury's upward revision of its trend growth assumption at the time of the 17 April 2002 Budget was portrayed by some as opportunistic. On the new assumption, of 2.5 per cent trend growth rather than the previous 2.25 per cent[6], it was much easier to show that the two fiscal rules would be met. Commentators have expressed surprise that this upgrading should have been done at a time of great uncertainty about macroeconomic performance. 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[7]. 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.

1 See para 487 above.
2 In particular, see HM Treasury *Fiscal Policy: Lessons from the Last Economic Cycle*, Pre-Budget Report Related Paper (HM Treasury, 1997).
3 The current version of this Code was published in November 1998: HM Treasury *The Code for Fiscal Stability* (HM Treasury, 1998).
4 Finance Act 1998 (c 36), s 155.
5 Material in this paragraph has been taken from the Treasury website's exposition of the Code for Fiscal Stability (see www.hm-treasury.gov.uk).
6 HM Treasury *Budget 2002: The strength to make long-term decisions: Investing in an enterprising, fairer Britain* (HC Paper 592 (2001–02)) (Stationery Office), Box C1.
7 On 20 May 1997, the incoming Chancellor of the Exchequer, Gordon Brown, asked the NAO to report on key assumptions; this report was released to the press on 19 June 1997, ahead of the Budget delivered on 2 July 1997: National Audit Office 'National Audit Office report on the audit of the Budget assumptions', Press Notice 33/97, 19 June 1997.

506. Determining total public expenditure. The evolution of modern public expenditure planning processes can be traced back to the Plowden Report[1]. This report recommended the institution of planning to replace annual *ad hoc* decisions in the context of the Supply Estimates[2]. This led to an annual system known as 'PESC'[3]. Planning was undertaken in volume terms[4] and covered the next five years. The results were announced in an annual series of Public Expenditure White Papers[5]. During the 1980s, major changes were made to the system: the forward period was reduced from five to three years; volume planning was abandoned; and the process was rebadged 'PES' (Public Expenditure Survey).

Setting the total available for distribution amongst the various public services is essentially a political decision. That decision will be informed by, amongst other things: the overall political background; the state of the economy; the government of the day's political philosophy with regard to taxing and spending; and the pressures arising from the services themselves. Conceptually, a distinction can be made between top-down and bottom-up approaches, though in practice most systems will combine elements of both. In a top-down system, a spending envelope is set at the very beginning of the process, so that allocation becomes a zero-sum game among departments. Great power is invested in a Chancellor of the Exchequer who has the political weight to impose such a spending envelope on his Cabinet colleagues; this is one of the reasons why the working relationship between Prime Minister and Chancellor of the Exchequer is of such importance to modern governments.

The opposite end of the spectrum is bottom-up, with bids being aggregated to produce a total which is certain to exceed available resources by a large margin. This is a sure route to a loss of public expenditure control, and is most likely to occur when the Chancellor of the Exchequer does not hold the support of the Prime Minister against spending ministers.

Although in principle the public expenditure system was then already top-down, the reforms of July 1992, with the introduction of the Control Total[6], led to a decisive strengthening of the top-down elements, in the wake of a period of lax expenditure control. In this respect, the June 1998 reforms, structured around Departmental Expenditure Limit (DEL) and Annually Managed Expenditure (AME), simply continued this process. However, the tight public expenditure control over the period 1993–94 to 1998–99, whilst beneficial in terms of facilitating macroeconomic adjustment, undoubtedly contributed to the 'underfunding' of public services, which it is now fashionable to decry[7]. From 1992 to 1997, more emphasis was given to containing the eventual total within that previously set by the Cabinet by setting up a Cabinet Committee (known as EDX) to settle the allocations to departments. This replaced an earlier arrangement whereby the Chief Secretary to the Treasury dealt with each department bilaterally, with differences settled, again individually, by a Cabinet Committee commonly known as the Star Chamber. The Chief Secretary still negotiated with departments, but under the oversight of EDX. At the same time, departments were given more freedom to decide on internal allocations. Up until then, the bilateral negotiations with the Chief Secretary had settled departments' programmes in some detail.

Following the 1997 general election, the annual process was replaced by a system of biennial Spending Reviews, covering three years ahead (therefore overlapping one year). The declared intention is that the plans for DEL will not be subject to future change, though this, in fact, has happened[8]. This change coincided with the redefinition of the public expenditure control aggregates, introducing Total Managed Expenditure (TME), DEL and AME. Under the previous system, the plans for all forward years could be reconsidered each year.

The plans do, however, contain provision for a DEL Reserve and an AME Margin. This is provision specifically set aside to cater for unplanned demands on public services, and forms part of the overall plans. It must not be confused with the Contingencies Fund[9].

1 *The Control of Public Expenditure* (Cmnd 1432) (1961). Analysis of the origins of the Plowden system can be found in R Lowe 'Milestone or millstone: the 1959–61 Plowden Committee and its impact on British welfare policy' (1997) 40 Historical Journal 463; and R Lowe 'The core executive, modernization and the creation of PESC, 1960–64' (1997) 75 Public Administration 601. The extensive literature on the subsequent evolution of the system includes: H Heclo and A Wildavsky *The Private Government of Public Money* (Macmillan, London, 1st edn 1974; 2nd edn 1981); R Clarke (ed A Cairncross) *Public Expenditure Management and Control: The Development of the Public Expenditure Survey Committee* (Macmillan, London, 1978); C Thain and M Wright *The Treasury and Whitehall: The Planning and Control of Public Expenditure, 1976–1993* (1995); and R A Chapman *The Treasury in Public Policy Making* (Routledge, London, 1997). This chapter concentrates upon the system as it was operating in 2002.

2 See paras 508 and 509 below.

3 Named after the Public Expenditure Survey Committee, a committee of officials overseeing the process. The committee did not take the decisions, but ran the information-gathering and other formal parts of the process.

4 This meant that the emphasis was on the volume of public services rather than their cost. The 'baseline' (ie the starting point for consideration in each year's plan) was the same volume of public services as set out in the previous plan. In practice, the baseline for each service was revalued on the basis of expected inflation for that particular service. See para 495 above.

5 The Public Expenditure White Paper was in 1991 replaced by departmental reports and *PESA* (see para 484 above).
6 See D A Heald 'Steering public expenditure with defective maps' (1995) 73 Public Administration 213.
7 It is not just interest groups which deplore past 'underfunding' of public services. The Treasury itself commissioned Derek Wanless to examine NHS spending, and published his final report alongside the Budget 2002 documents. Described on the Treasury website as 'the first ever evidence-based assessment of the long-term resource requirements for the NHS', it is a classic example of a work being commissioned to support prior political decisions: D Wanless *Securing Our Future Health: Taking A Long-Term View* (HM Treasury, 2002).
8 See para 511 below.
9 See para 510 below.

507. Determining the composition. The strengthening from 1992 of Treasury control over total expenditure may have been associated with some relaxation of its controls over the composition of departmental expenditure. There was a considerable amount of rhetoric about a lighter, more strategic approach to public expenditure control, not least in the context of the 1994 Fundamental Expenditure Review of the Treasury[1], which slimmed down its senior management. The Treasury needs to know enough about the detail of departmental programmes to be able to advise its ministers, notably the Chief Secretary, on the quality of departmental submissions to Spending Reviews (SRs) and on the allocation of expenditure among departments. However, there is a trade-off for the Treasury in that excessive involvement in departmental detail might distract it from its higher-level objectives: from a macroeconomic perspective, it is predominantly concerned with the 'big numbers'. Notwithstanding its prestige, the Treasury has always been a lightly-staffed department, with limited capacity to engage in long-term argument with departments. Following its 1994 Fundamental Expenditure Review, it appears that the Treasury swallowed too zealously its own running costs medicine, damaging its capability.

Under the system of annual Surveys up to 1997, there is some evidence of 'churning' (that is, the gains of particular departments in one year being offset by losses in subsequent years), thus leading to less coherence in expenditure planning than might have been achievable[2].

The 1998 introduction of Departmental Expenditure Limit (DEL), and particularly the availability of End-Year Flexibility (EYF), represented a significant devolution of budgetary responsibility to departments. There is, however, an important development which serves to undermine such budgetary devolution. There is at least some truth in the media characterisation of the Labour government as a duopoly, under which the Prime Minister (Tony Blair) has delegated much domestic policy-making to the Chancellor of the Exchequer (Gordon Brown). This control has been exercised through two main instruments, the first of which are the Spending Reviews conducted in 1998, 2000 and 2002, the second the set of Public Service Agreements (PSAs) between the Treasury and Departments, launched as part of the 2000 Spending Review settlement[3]. Under the PSA system, departments have had to agree a host of targets with the Treasury, a process that affords unprecedented leverage to the Treasury over departmental management and may also induce dysfunctional behaviour in the form of chasing targets even at the expense of policy objectives. These dangers were accentuated by the crude nature of many of the first-round targets, and by the sheer number of them.

'Shroud waving' by departments and interest groups has long been a feature of the United Kingdom public expenditure cycle. Under the present system, one of the consequences of tighter Treasury control over the formal machinery has been the increasingly hysterical tone of leaks and planted stories in the media. Public services, including those for which the official performance statistics show improvements over time, are regularly characterised as 'Third World' in their quality. The most striking cases in Spending Review 2002 related to the National Health Service (NHS) and the Home Office, with campaigns for more resources mobilising images of failure and doom. In the case of the NHS, this was successful, with the NHS settlement announced in the 17 April 2002 Budget, well in advance of the Spending Review 2002 announcement on 15 July. In both 2000 and 2002, the Prime Minister undermined the Treasury's position on health spending by commitments he gave in response to questions[4]. It is never clear whether such pre-emption of the formal decision-making process has been deliberate or unintentional.

1 HM Treasury *Improving the Treasury: Initial Decisions on the Fundamental Review of Treasury Running Costs* (HM Treasury, 1994).
2 See D A Heald 'Controlling public expenditure' in D Corry (ed) *Public Expenditure: Effective Management and Control* (Dryden Press for the Institute for Public Policy Research, 1996) pp 167–191.
3 PSAs set by the Treasury do not apply to the devolved administrations which are funded largely through an unhypothecated block grant, known as the Assigned Budget (see para 534 below for an exposition of the funding of the Scottish Parliament).
4 On 16 January 2000, the Prime Minister is reported to have said on the 'Breakfast With Frost' programme that 'his government would match the share of national wealth spent by other European countries on health at the end of five years' (BBC News Online, 'Blair pledges health cash boost', 16 January). However, the tape recording demonstrates that the actual replies to David Frost's questions were couched with multiple 'ifs'. On 28 November 2001, the Prime Minister confirmed, in answer to a supplementary question in Parliament from Charles Kennedy MP, leader of the Liberal Democrats, that it remained the policy of the government to raise health expenditure to the European Union average by 2005 (375 HC Official Report (6th series) col 964 (28 November 2001)).

508. Parliamentary authorisation of expenditure. The formal processes for the authorisation of certain kinds of, but not all, public expenditure by Parliament are linked with, though in practice subordinate to, the Executive processes for decision-making on levels and composition. In essence, what the Executive decides is reworked as a mechanical translation into the forms required for Parliamentary approval, though this should not be taken to mean that these Parliamentary forms are unimportant. It is this constitutional role in approving Supply which leads the Treasury to be respectful of the prerogatives of Parliament, most particularly the Public Accounts Committee and the Treasury Committee, when it proposes changes that impinge upon Parliamentary financial procedures. In the case of the redefinitions of public expenditure in 1988, 1992 and 1998, the Treasury did not consult Parliament in advance, and not even Principal Finance Officers in departments in the case of the 1998 redefinition. In telling contrast, the Treasury devoted considerable time and resources to persuading Parliament to accept Simplified Estimates[1] and to agree to the replacement in 2001–02 of cash Appropriation Accounts by Departmental Resource Accounts[2]. Moreover, Parliament's role in financial scrutiny of government expenditure plans, by means of its financial committees and departmentally-related select committees, effectively derives from its granting of Supply.

By convention, money[3] can only be spent with the approval of Parliament[4]. Moreover, again by convention, spending has to be as a result of specific statutory powers, not resting solely on the authority of the Appropriation Act[5]. Thus, spending has to be authorised both by Parliament granting the power to take the action giving rise to the expenditure, and, in the case of expenditure within the coverage of Supply, by Parliament granting the money. In practice, the relationship between the control aggregate (currently Total Managed Expenditure (TME)) and Supply expenditure is quite complex. The items included within Supply are: central government expenditure (Departmental Expenditure Limit (DEL) and Annually Managed Expenditure (AME)); central government grants to local authorities (DEL and AME); and devolved administration DELs. Excluded are, for example, credit approvals to local authorities in England; devolved administration AME; and the National Insurance Fund[6].

For most purposes, approval for resource expenditure and the associated cash requirement is granted in the annual Appropriation Act, the Bill for which, curiously titled the Consolidated Fund (Appropriation) Bill, normally receives royal assent in the days immediately before the Summer recess in late July[7]. Adjustments to spending authority are given force in Consolidated Fund Acts, of which there are normally two: before Christmas and before the end of the financial year (following, respectively, presentation of the Winter and Spring Supplementary Estimates). Spending in the period from the beginning of the financial year to the coming into force of the Appropriation Act in late July is authorised in a 'Vote on Account', given authority in the Consolidated Fund Act receiving royal assent just before the Christmas recess. The Appropriation Act and the Consolidated Fund Acts also give authority for the appropriation of income received by departments, to be used as Appropriations in Aid[8]. Without such authority, such income would have to be surrendered to the Treasury as Consolidated Fund Extra Receipts.

As the basis for the Consolidated Fund (Appropriation) Bill, the Treasury puts forward more detailed information in the form of Supply Estimates[9]. The main Estimates are published in April or May; the Summer Supplementary Estimates in June; the Winter Supplementary Estimates in November; and the Spring Supplementary Estimates in February. These Estimates may be, but are not always, considered by departmentally-related select committees. The proceedings on these Bills in the House of Commons[10] are purely formal.

For constitutional reasons, certain expenditure is kept outside the Supply procedure, usually in order to insulate it from political controversy. Given the absence of debate on Supply, this insulation is mostly symbolic[11]. In these cases, provided for in specific legislation, expenditure is paid directly from, or in the jargon 'charged on', the Consolidated Fund[12]. Since this effectively avoids normal Parliamentary control of expenditure, it only happens in exceptional cases where there are constitutional reasons. Examples include: the salaries of judges; the salary of the Speaker of the House of Commons and of the Comptroller and Auditor General[13]; and payments to the European Communities. These are known as 'Consolidated Fund Standing Services'.

1 See para 496 above.
2 See para 514 below.
3 'Money' is used here loosely, as from 2001–02 it is resource (see para 496 above) as well as cash which is voted. One of the reasons why the government needed to pass the Government Resources and Accounts Act 2000 (c 20) was that legal advice indicated that 'money' (voted under the provisions of the Exchequer and Audit Department Acts) should be interpreted as 'cash' and did not extend to 'resource'.
4 There is no general statutory provision to the effect that spending has to have specific approval. The settlements following the 1688 revolution constrain the right of the Executive to raise money. None the less the current system of appropriations grew up in the nineteenth century. Modern legislation, however, conferring spending powers on ministers, and indeed other bodies, virtually always provides that the sums required to use the power have to come from 'money (sometimes moneys) provided by Parliament'.
5 Erskine May *Parliamentary Practice* (22nd edn, 1997 by D W Limon and W R McKay) p 736 states: 'It is a general principle of constitutional propriety that new functions which are to be exercised on a continuing basis and which are to financed out of "money to be provided by Parliament" through the annual Appropriation Act should be authorised by specific Act, supported by a financial resolution, and not by the Appropriation Act alone. This general principle is subject to certain recognised exceptions in cases where the government incurs expenditure in the exercise of functions and powers derived from the royal prerogative, for example in relation to defence. From time to time, the government has sought to assert Parliament's legal power to authorise any expenditure or services by the Appropriation Act alone, and its own corresponding right to invite Parliament to exercise that power. The Public Accounts Committee, however, has upheld the general principle stated above, and the Treasury has agreed that practice should normally accord with the view of the Committee'. The Treasury has an understanding with the Public Accounts Committee, known in government circles as the 1932 Concordat, that the Treasury will aim at the observance of the principle that spending powers and duties should be defined by specific statute. In practice, the Treasury will only sanction spending whose sole statutory power is the Appropriation Act: on administration costs; where the amount is trivial (currently taken as less than £0.9 million a year); where the expenditure concerned is not recurring; or only pending the Executive seeking statutory powers at the earliest opportunity. HM Treasury Government Accounting 2000, Amendment 1/01 (Stationery Office, 2001), para 2.2 and Annex 2.1 explain this in more detail.
6 The relationship between Supply expenditure and TME is graphically represented in the Main Estimates: HM Treasury *Central Government Supply Estimates 2001–02 for the year ending 31 March 2002: Main Supply Estimates — Summary Request for Supply* (HC Paper 348 (2000–01)) (Stationery Office, 2001), p 12.
7 A different timetable is followed when Parliament is dissolved between the introduction of the Bill and the Summer recess, as was the case in both 1997 and 2001. In these instances, the Appropriation Act was passed before dissolution.
8 Typically, legislation authorising ministers to levy charges provides that the receipts are to be paid into the Consolidated Fund. Where this is not the case, eg because the receipts are obtained using prerogative powers, the Treasury's view is that receipts are payable into that Fund in any case, as part of the hereditary revenues of the Crown, under the Civil List Act 1952 (c 37). The Government Resources and Accounts Act 2000 (c 20), s 2, authorises the Treasury to direct that resources, subject to any limit in an Appropriation Act, may be appropriated in aid of resources authorised by Parliament. Such directions are contained in Treasury Minutes laid before Parliament.
9 Published as House of Commons Papers.
10 Consolidated Fund Bills require the assent of the House of Lords, though the proceedings are purely formal.
11 Indeed, neither judges nor the Comptroller and Auditor General could function without the Supply-financed expenditure on which their organisations depend.
12 See para 512 below.
13 See para 519 below.

509. The format of the Estimates. The Treasury publishes a single volume[1] of 'Central Government Main Estimates', generally organised as the basis of one Estimate for each department. Each Estimate is divided into Requests for Resources (RfR). Each RfR has an ambit in Part I of the Estimate, specifying its purpose and coverage; this is the wording reproduced in the Appropriation Act.

In Part II of the Estimate, the expenditure requests are organised in matrix format, with the lines (that is, rows) being functional 'sections' and the columns analysing resources and capital and also showing figures for prior years. The lines, or sections, are labelled alphabetically, and are arranged according to the main subdivisions of public expenditure control. First comes expenditure within Departmental Expenditure Limit (DEL), itself divided into 'Central government spending' and 'Support for local authorities'. Second comes expenditure within Annually Managed Expenditure (AME). Third comes 'Other spending outside DEL'. The columns, or 'subheads', distinguish: administration; other current; grants; gross total; Appropriation in Aid; net total resource; capital; and non-operating Appropriation in Aid. Finally, there are comparative figures for net total resource, relating to the preceding year's provision (the final figure, not the Main Estimates figure) and outturn for the preceding year but one[2]. Virement[3] (that is, reallocations of provision) operates on the basis of the above structure.

The advent of resource-based Supply has introduced some complicated issues of terminology, which have to be carefully disentangled to avoid confusion. 'Net Resource Outturn' (the Estimates total for resources) differs from Net Operating Cost (the accounts total for resources) because, for example, there is operating income surrendered as Consolidated Fund Extra Receipts. These have to be added back, so that Net Resource Outturn is higher than Net Operating Cost[4].

An important step is the 'Resource to cash reconciliation', which involves adding to the Net Resource Outturn the amounts for capital expenditure and the 'total accruals to cash adjustment' to reach 'Net cash required'[5]. The component items of the accruals to cash adjustment are: capital charges; depreciation; new provisions and adjustments; change in debtors; change in creditors; and use of provisions.

Part III of the Estimate tabulates Consolidated Fund Extra Receipts. Also included in the Estimate is a forecast operating cost statement, but neither a forecast balance sheet nor a forecast cash flow statement is presented.

Although most central government spending goes through the Supply process described above, there are other procedures. Ministers are given specific powers to lend money, from the National Loans Fund[6], to concerns such as certain Non-Departmental Public Bodies[7] and Trading Funds[8]. The legislation is specific to the concern, will set a limit on the total amount that can be lent, and is sufficient authority for the transactions. Spending out of this borrowing by such concerns, whether under these arrangements or on the market, scores as public expenditure. There is, however, no Parliamentary procedure to sanction the annual amounts[9].

Ministers may undertake spending not otherwise authorised by seeking, from the Treasury, an advance from the Contingencies Fund[10]. Advances from the Fund must be repaid as soon as the spending is authorised in an Appropriation Act or a Consolidated Fund Act. In the event of a department exceeding the expenditure authorised in the Appropriation Act and subsequent Consolidated Fund Acts, it must seek an advance from the Contingencies Fund, and an Excess Vote. Before an Excess Vote is granted, the Comptroller and Auditor General will investigate the circumstances, and the Public Accounts Committee will consider his report. Excess Votes are given authority in the next-but-one Appropriation Act.

1 In 2001–02, the first year of Supply on a resource basis, the Treasury published a Summary Request for Supply, showing departmental summaries, but with the detailed Estimate published in each departmental report. As from 2002–03, the former practice of publishing Main Estimates as a single volume has been restored: HM Treasury *Central Government Supply Estimates 2002–03 for the year ending 31 March 2003: Main Supply Estimates* (HC Paper 795 (2001–02)) (Stationery Office, 2002).
2 HM Treasury *Government Accounting 2000*, Amendment 1/01 (Stationery Office, 2001), para 11.3 explains this is more detail, and Annex 11.2 contains an annotated example.
3 See para 511 below.
4 Another example is where expenditure falling within Consolidated Fund Standing Services has been charged to the Operating Statement but must be deducted to arrive at Net Resource Outturn.
5 This terminology, though perhaps inevitable, is potentially misleading because some Estimates will contain consents.
6 See para 511 below.
7 See paras 548 and 549 below.
8 See paras 548 and 549 below. See also 8(2) *Halsbury's Laws of England* (4th edn) (1996 reissue) CONSTITUTIONAL LAW AND HUMAN RIGHTS para 743.
9 This contrasts with the position for bodies under the control of the Scottish Parliament, where such annual advances have to be authorised by Budget Act. The Public Finance and Accountability (Scotland) Act 2000 (asp 1), Sch 1, amends pre-existing legislation to provide for this, and legislation setting up new bodies provides for it. This new practice is adopted in the case of Scottish Water, following the merger of the three water authorities: Water Industry (Scotland) Act 2002 (asp 3), s 42(4), (5).
10 See para 510 below.

510. Contingencies Fund. The Contingencies Fund[1] allows the Treasury, in exceptional circumstances, to make repayable cash advances for the provision of services in advance of Parliament providing resources and cash for these services in the normal way. This might happen because: the cash provided in the Vote on Account[2] is insufficient; cash is required for a service for which there is specific enabling legislation but no provision in the Appropriation Act or a Consolidated Fund Act; cash is required for a new service in advance of the specific enabling legislation; provision already approved is exhausted; or there is a temporary shortfall in income or revenue.

Since this procedure avoids the normal Parliamentary control of expenditure, it is only used when the expenditure is so urgent that the public interest justifies such recourse. Parliament must be informed on each occasion[3]. Parliament must also be notified if a resource commitment will be, or has been, entered into before the approval of Supply, whether or not there is recourse to the Contingencies Fund in respect of associated cash[4]. In cases where specific enabling legislation is before Parliament, advances are only made after the Bill has received its Second Reading in the House of Commons[5]. Advances from the Fund must be repaid as soon as the spending is authorised in a subsequent Appropriation or Consolidated Fund Act. A White Paper account for the Contingencies Fund is presented to Parliament each year[6].

The Fund must not be confused with the Departmental Expenditure Limit (DEL) Reserve or Annually Managed Expenditure (AME) Margin[7], though this is frequently done in media reporting[8]. The latter represent unallocated provision within the government's public expenditure plans, whereas the Fund is a matter of Parliamentary authorisation through Supply.

1 Set up in 1862, this is now governed by the Contingencies Fund Act 1974 (c 18). The capital of the Fund is limited to 2 per cent of the total of authorised Supply expenditure for the preceding year. A fuller explanation of the operation of the Fund is provided in HM Treasury *Government Accounting 2000*, Amendment 1/01 (Stationery Office, 2001), section 11.6. See also Erskine May *Parliamentary Practice* (22nd edn, 1997 by D W Limon and W R McKay) p 753.
2 See para 508 above.
3 *Government Accounting* indicates that this would be by either an arranged Parliamentary question and answer or by a ministerial statement, unless the intention to use the Fund has already been announced in a footnote to a Main or Supplementary Estimate: *Government Accounting 2000* (2001), paras 11.6.13–11.6.15.
4 *Government Accounting 2000* (2001), paras 11.6.1.
5 In these circumstances ministers rely on their prerogative powers to undertake the action requiring the expenditure.
6 Eg HM Treasury *Contingencies Fund Accounts 2000–01* (HC Paper 618 (2001–02)) (Stationery Office, 2002).
7 See para 506 above.
8 An example of the terminological problem is the labelling by the Scottish Executive of the DEL Reserve as 'Contingency Fund' in its September 2002 spending plans; there is no Contingencies Fund in Scotland (but see para 540 below): Scottish Executive *Building a Better Scotland — Spending Proposals 2003–2006: What the Money Buys* (Stationery Office, 2002).

511. In-year control of public expenditure. Within the framework of Spending Reviews and the distinction between Departmental Expenditure Limit (DEL) and Annually Managed Expenditure (AME), the task of in-year control is to ensure that expenditure conforms to plan and that necessary Parliamentary authorisation is secured for amounts not covered by the Main Estimates. With regard to DEL, the possibility of making releases from the DEL Reserve confers vital powers on the Treasury and its ministers. Indeed, public commentary often misses the distinction between additional DEL and releases from the DEL Reserve to individual departments, leading to confusion about what is 'old' money and what is 'new' money. Moreover, contrary to the official rationale (by which underspendings in AME would lead to lower Total Managed Expenditure (TME))[1], in practice there have been some switches from AME to DEL in Pre-Budgets and Budgets during the four years in which the system has so far operated.

From the viewpoint of departments, expenditure blocks are now larger than was traditionally the case; in a sense, DEL can be seen as the culmination of the cash-limit system in operation since the mid-1970s[2]. In exchange for less Treasury control over expenditure detail[3], departments have to operate within harder ceilings. Moreover, there are unprecedented levels of End-Year Flexibility (EYF)[4], something else which can be seen as the culmination of earlier developments. There has been considerable surprise at the extent of underspending from 1999–2000 onwards[5], though this needs to be set in the context of the desire to avoid wasteful year-end binges and of the sharp change in trajectory of public expenditure growth. The Treasury's intention was to include in AME those items which are, for various reasons, more difficult to plan ahead, and these receive considerably more micro-management than does expenditure within DEL. Consequently, a department whose expenditure is predominantly DEL is, *ceteris paribus*, likely to enjoy more financial autonomy from the Treasury than a department with predominantly AME.

Because statutory authority is granted at a high level, there are opportunities for reallocating provision at lower levels, known as virement. Detailed rules are promulgated by the Treasury in *Government Accounting*[6]. With regard to the Resource Budget[7], the Treasury delegates to departments the power to vire, within sections (that is, along a line), between the other current and grants columns and out of the administration costs column[8]. Certain cases of virement will receive special Treasury scrutiny, namely: movement into discretionary[9] programmes from other programmes within DEL; opening of additional sections not in the Main Estimate or a Supplementary Estimate; movement in either direction between DEL and AME; and movement into administration costs. The following reallocations are beyond the power of virement and require a Supplementary Estimate and inclusion in a Consolidated Fund Act: transferring between one RfR and another; using savings to meet expenditure falling outside a reasonable interpretation of the ambit of the Estimate; or meeting additional expenditure through income beyond that authorised as Appropriations in Aid.

In terms of Supply, the in-year task is to ensure that necessary virement is acquired under these rules[10]. Inevitably, however, it may take some time before the implications for Supply of resource-based Estimates are fully digested. For example, it is possible that a department may have sufficient resource but not enough cash, for instance if customers have not settled invoices for services included within resource Appropriations in Aid.

1 Symmetrically, higher AME, eg during a recession, would lead to higher TME, rather than a reduction in DEL in order to hold TME constant.
2 On cash limits, see C Thain and M Wright *The Treasury and Whitehall: The Planning and Control of Public Expenditure, 1976–1993* (1995), ch 17.
3 Less control over expenditure detail does not necessarily imply less Treasury control over policy: see para 507 above.
4 See *Thain and Wright* ch 19, and para 491 above.
5 See para 497 above.
6 See HM Treasury *Government Accounting 2000* (Stationery Office, 2001), paras 11.7.8–11.7.10.
7 See paras 491 and 509 above.
8 See para 509 above.
9 'Discretionary' expenditure is that over which the department has some direct control. Most, but not all, expenditure in DEL (see para 491 above) is discretionary; all spending in AME (see para 492 above) is not. This distinction can be seen as a successor to an earlier distinction between cash-limited and non-cash limited expenditure. In the Estimates (see para 509 above), an asterisk denotes a section (ie line) containing discretionary expenditure.
10 *Government Accounting 2000*, Amendment 1/01 (2001), para 11.7, and para 509 above.

512. Consolidated Fund and National Loans Fund. The Consolidated Fund is effectively the government's current account. Unless specifically provided otherwise, all taxation and other receipts are paid into the Fund, and all government payments are made from it. In many respects, the term 'Consolidated Fund' is synonymous with that of the 'Exchequer'[1]. The Consolidated Fund is balanced daily with any surplus or deficit transferred to the National Loans Fund.

The National Loans Fund[2] is the government's main borrowing account and government borrowing is paid into it, though day-to-day operational transactions take place on the Debt Management Account and through

National Savings. It also has powers to lend to certain public bodies and, through the Public Works Loans Board, to local authorities. Repayments of these loans, together with interest payments thereon, are paid into the Fund. The National Debt is the gross liabilities of the National Loans Fund.

1 The Exchequer and Audit Departments Act 1866 (c 39), ss 10, 11 (as extensively amended), provides that most tax revenues and other monies payable to the Exchequer shall be paid into a single account and form one general fund. The account is kept by the Treasury at the Bank of England and the fund is known as the Consolidated Fund. See HM Treasury *Government Accounting 2000*, Amendment 1/01 (Stationery Office, 2001) para 27.2.
2 Set up under the National Loans Act 1968 (c 13). See 8(2) *Halsbury's Laws of England* (4th edn) (1996 reissue) CONSTITUTIONAL LAW AND HUMAN RIGHTS para 727.

513. Accounting Officer. The Treasury is required to appoint an Accounting Officer for each department that produces accounts, and also for each Trading Fund[1]. Customarily, this is the Permanent Secretary or Chief Executive; these are not accounting posts, but a designation of personal accountability. The Accounting Officer appointments for Next Steps agencies and Non-Departmental Public Bodies are made by the relevant departmental Accounting Officer. The formal duties of an Accounting Officer are to sign the accounts and send them to the Comptroller and Auditor General or other auditor[2]. However, the actual duties go far beyond that. Accounting Officers are personally responsible and answerable to Parliament for ensuring that all transactions conform to all relevant laws (*regularity*); meet standards of *propriety*; and represent *Value For Money* (*VFM*)[3]. They are also required, in the Memorandum of Appointment given to them by the Treasury[4], to seek written instructions from their minister before undertaking any action they believe does not meet these requirements. These written instructions are often known as Accounting Officer Directions. All such instructions have to be notified to the Treasury and the Comptroller and Auditor General[5], without undue delay. There is no mandatory requirement for information about them to be placed in the public domain, though some departments do arrange for a Parliamentary question to be answered. Some instructions may come into the public domain if there is a National Audit Office[6] report and Public Accounts Committee[7] hearing.

Accounting Officers are assisted in their role by the Principal Finance Officers of departments (and counterparts in other bodies) and by their staff. These officials are specifically charged with ensuring proper standards of financial management, with their specific responsibilities being defined in *Government Accounting*[8]. The Accounting Officer is also responsible for ensuring there is an efficient system of internal audit, in accordance with the objectives, standards and practices set out in the Government Internal Audit Manual[9]. A potentially onerous aspect of being the Accounting Officer is the requirement to appear in front of the Public Accounts Committee[10], in order to answer questions arising either from the audit or from VFM investigations.

1 See paras 548 and 549 below. See also 8(2) *Halsbury's Laws of England* (4th edn) (1996 reissue) CONSTITUTIONAL LAW AND HUMAN RIGHTS para 743.
2 Government Resources and Accounts Act 2000 (c 20), s 5(6), (7).
3 HM Treasury *Government Accounting 2000*, Amendment 1/01 (Stationery Office, 2001), Box 4.1 offers definitions of regularity and propriety, though not of VFM: '"Regularity" is the requirement for all items of expenditure and all receipts to be dealt with in accordance with

the legislation authorising them, any applicable delegated authority and the rules of *Government Accounting*'; and '"Propriety" is the further requirement that expenditure and receipts should be dealt with in accordance with Parliament's intentions and the principles of Parliamentary control, including the conventions agreed with Parliament (and in particular with the Public Accounts Committee)'.

4 The full text of this Memorandum can be found in *Government Accounting 2000* (2001), Annex 4.1.

5 See para 519 below.

6 See para 520 below.

7 See para 521 below.

8 *Government Accounting 2000* (2001), Annex 4.2.

9 This is a two-part manual, now in its second impression, but somewhat out of date: HM Treasury *The Government Internal Audit Manual* (HMSO, 1996). There is an ongoing process of revision currently being undertaken. See also *Government Accounting 2000* (2001), Annex 4.4, para 6; HM Treasury *Government Internal Audit Standards: Good Practice Guide — Audit Strategy* (HM Treasury, 2002).

10 See para 521 below.

514. Departmental Resource Accounts. Departmental Resource Accounts (DRAs) for ministerial and non-ministerial departments are considered in this paragraph, with other DRAs — pension scheme statements[1];'voluntary' DRAs for Parliamentary bodies[2]; and DRAs for the Scottish Administration[3] — being treated separately. Departments which have an Estimate approved by the House of Commons must complete DRAs for each financial year by 30 November; the statutory deadline for these to be laid before the House of Commons is 31 January of the following year.

Machinery of government questions have traditionally been treated very casually in the United Kingdom, as evidenced by the lack of agreement on what constitutes a 'government department'. Curiously, there are different lists which do not coincide[4]. Given the central importance of the definition of the 'reporting entity' under accruals accounting, the implementation of Resource Accounting and Budgeting (RAB) brings with it the requirement for greater precision. The compromise actually reached is an untidy one. The departmental report system during the 1990s in practice related to 'departmental groupings', there being usually about twenty[5]. Estimates used to be grouped in 'classes', broadly coinciding with those groupings. However, Estimates are now presented at the level of departments, without there being the grouping into classes. The consequence is a large number of 'small' DRAs, which would not exist had the function been organised either as an Executive agency (whose separately published account would have been consolidated in the account of its parent department) or as an Executive Non-Departmental Public Body (in which case it would generally have been outside the departmental boundary)[6]. Another consequence is that most expenditure and assets are concentrated in a relatively small proportion of DRAs.

DRAs must be prepared in accordance with Treasury accounts directions, which themselves must ensure that the accounts present a true and fair view and conform to Generally Accepted Accounting Practice (UK GAAP)[7] and relevant guidance issued by the Accounting Standards Board (ASB), adapted as appropriate[8]. These accounts are all audited by the Comptroller and Auditor General. The Resource Accounting Manual (RAM)[9], developed by the Treasury and approved by Financial Reporting Advisory Board (FRAB), is described as UK GAAP modified, as appropriate, for central government[10].

Although the ASB regards government accounting as outside its remit, the potential for conflict has been illustrated by tension generated over Financial Reporting Standard (FRS) 5A[11], the Application Note developed by the ASB in relation to Private Finance Initiative (PFI) accounting[12]. The Treasury accepted FRS 5A[13] and developed complementary guidance[14], which is regarded as more favourable to off-balance sheet treatment of PFI schemes than FRS 5A.

After a year (1998–99) in which DRAs were audited but not published, there were two years (1999–2000 and 2000–01) of parallel running, in which audited DRAs were published on a shadow basis. In these years, the cash Appropriation Accounts remained the vehicle of accountability to Parliament. With the full implementation of Resource Accounting in 2001–02, Appropriation Accounts have ceased, and DRAs themselves have become the vehicle of accountability. In 2001–02, there were fifty-three DRAs (including pension scheme statements but excluding voluntary DRAs). There are DRAs for the Scotland Office, Wales Office, Northern Ireland Office and Northern Ireland Court Service, all of which are United Kingdom departments and whose funds are Voted in the Supply Estimates.

1 See para 515 below.
2 See para 516 below.
3 See para 543 below.
4 C Hood, A Dunsire and K S Thompson 'So you think you know what government departments are . . .?' (1978) 27 Public Administration Bulletin 20; I McLean, C Clifford and A McMillan 'The organisation of central government departments: a history, 1964–92' in R A W Rhodes *Transforming British Government — Volume 1: Changing Institutions* (Macmillan, Basingstoke, 2000), pp 135–155.
5 See para 484 above.
6 See paras 547–550 below.
7 There is no single definitive exposition of 'UK GAAP', though books produced by commercial publishers in association with Big Four accounting firms have acquired much influence: eg A Wilson, M Curtis, M Davis and G Wilkinson-Riddle (eds) *UK & International GAAP* (LexisNexis Butterworths Tolley for Ernst & Young, 7th edn 2002); C Richards, A Simmonds and P Barden (eds) *GAAP 2002: UK Financial Reporting and Accounting* (ABG, London, for Deloitte & Touche, 2nd edn 2002).
8 Government Resources and Accounts Act 2000 (c 20), s 5.
9 HM Treasury *Resource Accounting Manual: 2001–02 Edition* (Stationery Office, 2001).
10 Adapted as necessary to suit the circumstances of central government departments. The Treasury must consult FRAB before implementing any proposals in the accounting guidance for central government: see GRAA 2000, ss 5(3)(b), 24. FRAB was established in 1996 as a result of Parliamentary pressure from the Public Accounts Committee and the Treasury Committee, becoming a statutory body in 2001.
11 Accounting Standards Board *Amendment to FRS 5: Reporting the Substance of Transactions — Private Finance Initiative and Similar Contracts* (London).
12 See para 502 above.
13 HM Treasury 'Geoffrey Robinson welcomes accounting clarification of PFI', Press Notice 146/98 (1998).
14 Treasury Task Force *Technical Note no 1 (revised) — A recommended approach and mandatory presentation requirements* (1999).

515. Pension scheme statements. With regard to employee pensions, the United Kingdom government has large unfunded liabilities, though not on anything like the same scale as many continental European Union countries. These have been made much more transparent because they have been swept up within the Resource Accounting and Budgeting (RAB) programme. Included within the accounts published for the first time in 1999–2000 are seven pension scheme statements: Armed Forces Pension Scheme; Cabinet

Office: Civil Superannuation; Department for International Development Overseas Superannuation Pensions; Forestry Commission Pension Scheme; NHS Pension Scheme (England and Wales); Teachers' Pension Scheme (England and Wales); and United Kingdom Atomic Energy Authority Superannuation Scheme. The value of the liabilities at 1 April 2000 of the Principal Civil Service Pension Scheme was £58.6 billion[1]. It should be noted that these relate to the pensions of public employees in relation to their employment by government, and not to the much larger liabilities for citizen pensions, which are outside the scope of the RAB system.

1 *Cabinet Office: Civil Superannuation — Resource Accounts 2000–01* (HC Paper 554 (2001–02)) (Stationery Office) p 8. Pension scheme statements will be published annually as House of Commons Papers.

516. 'Voluntary' Departmental Resource Accounts. It is customary for the accounts of Parliamentary bodies to follow the procedures set by the Treasury for government departments; this is a matter of following best practice rather than a matter of statutory compliance. The voluntary Departmental Resource Accounts (DRAs) going live in 2001–02 are those for House of Commons Administration and the Electoral Commission[1]. The fact that a separate Estimate is presented to Parliament[2] for each of these bodies results in there being a separate DRA. In comparison with the DRAs of major spending departments, these accounts concern relatively simple activities[3]. These accounts are audited by the Comptroller and Auditor General.

1 The Electoral Commission was established on 30 November 2000, under the provisions of the Political Parties, Elections and Referendums Act 2000 (c 41). As to the Electoral Commission, see the forthcoming reissue title ELECTIONS.

2 By the chairman of the Public Accounts Commission in the case of the National Audit Office, and by the Speaker of the House of Commons in the other two.

3 A significant event was the construction of Portcullis House, the new Parliamentary building, which cost £234 million. This project was examined by the National Audit Office: 'the NAO found that the House obtained the high standard of architectural design, materials and workmanship that it had specified, and the building was completed broadly to time. While the 1993 forecast of costs was exceeded, the 1998 construction budget approved by the House of Commons Commission was not. In these terms, therefore, the House achieved value for money in the project to construct Portcullis House' (NAO Press Notice 35/02). The full report is National Audit Office *Construction of Portcullis House, the New Parliamentary Building* (HC Paper 750 (2001–02)) (Stationery Office). On the funding of the Westminster Parliament, see para 525 below; on the funding of the Scottish Parliamentary Corporate Body, see para 546 below; and, on the Holyrood Parliament cost overruns, see para 546 below.

517. Whole of Government Accounts. When the Treasury established the framework for the Resource Accounting and Budgeting (RAB) project in the July 1994 Green Paper[1], it ruled out both consolidations of Departmental Resource Accounts (DRAs)[2] and the preparation of Whole of Government Accounts. The Treasury position softened on Whole of Government Accounts in the July 1995 White Paper[3], partly in response to the views of Parliament[4]. At this White Paper stage, the Treasury agreed to commission long-term work jointly with the National Audit Office, whilst insisting on the primacy of 'successful implementation at a departmental level'[5]. A marked shift in the Treasury's position can be detected after the change of government in May 1997, from which time Treasury documents began to locate RAB much more firmly within the macrofiscal context[6]. The July 1998 scoping study report[7], published shortly after the 1998 Comprehensive Spending Review, was positive about the potential usefulness of Whole of Government Accounts, and announced a programme of work.

The Treasury is now working to a firm timetable for the progressive development of Whole of Government Accounts, as set out in a December 2000 memorandum to the Public Accounts Committee[8]. On present plans, the ultimate target is for an audited Whole of Government Account, covering the whole of the public sector and consistent with Generally Accepted Accounting Practice (UK GAAP), to be published for 2005–06. An important interim target is to publish a UK GAAP-based Central Government Account for 2003–04. In the meantime, the Treasury project team is developing Whole of Government Accounts on a national accounts basis as an input into fiscal management. When Whole of Government Accounts are available, they will have to be interpreted in the light of the boundary of the public sector as specified for this purpose by HM Treasury, which leaves quasi-public sector organisations outside[9].

1 HM Treasury *Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government* (Cm 2626) (1994).
2 For a discussion of this issue, see D A Heald and G Georgiou 'Resource accounting: valuation, consolidation and accounting regulation' (1995) 73 Public Administration 571–579. On the definition of the departmental boundary, see D A Heald and G Georgiou 'Consolidation principles and practices for the UK government sector' (2000) 30 Accounting and Business Research 153.
3 HM Treasury *Better Accounting for the Taxpayer's Money: The Government's Proposals — Resource Accounting and Budgeting* (Cm 2929) (1995).
4 National Audit Office *Resource Accounting and Budgeting in Government* (HC Paper 123 (1994–95) (HMSO, 1995); *Fifteenth Report of the Public Accounts Committee: Resource Accounting and Budgeting in Government* (HC Paper 407 (1994–95)) (HMSO, 1995); *Fourth Report of the Treasury and Civil Service Committee: Simplified Estimates and Resource Accounting* (HC Paper 212 (1994–95)) (HMSO, 1995).
5 *Better Accounting for the Taxpayer's Money*, para 3.10.
6 See para 505 above.
7 HM Treasury *Whole of Government Accounts* (HM Treasury, 1998).
8 HM Treasury 'Whole of Government Accounts: progress to December 2000 — Memorandum to the Committee of Public Accounts and the Treasury Select Committee'. This project has its own website and the memorandum is published there: www.wga.gov.uk. For an explanation of how information relevant to Scotland is supplied, see para 543 below.
9 On the quasi-public sector, see paras 488 and 502 above. In order to determine which bodies should be included in Whole of Government Accounts, the Treasury has applied to the public sector context the tests of control in FRS 2 (Accounting Standards Board *FRS 2: Accounting for Subsidiary Undertakings* (London)).

518. Other accounts relating to central government. This chapter has emphasised the reporting and accountability mechanisms embodied in the system of departmental reports[1] and of resource-based Departmental Resource Accounts (DRAs)[2], which replaced cash Appropriation Accounts in 2001–02.

Nevertheless, there are many other accounts prepared by central government and its various bodies, many of which are formally presented to Parliament. The following itemisation is illustrative rather than exhaustive. First, there are two annual publications in relation to the Consolidated Fund and the National Loans Fund: the main accounts[3]; and supplementary statements[4]. These reports will continue to be published on a cash basis, even with

Resource Accounting and Budgeting (RAB) fully operational. Second, the DRAs of large departments are typically consolidations of the parent department (whose own accounts are not published) and of on-Vote Executive agencies[5] (whose accounts are presented to Parliament as House of Commons Papers). Third, departments collectively sponsor many public bodies, some of which are classified as Executive Non-Departmental Public Bodies, which customarily fall outside the departmental boundary set for the DRA[5]. Although the reporting arrangements have traditionally been rather chaotic, a large proportion of these public bodies present their accounts to Parliament. Some of these reports and accounts take the form of glossy publications, mirroring the annual reports of quoted companies, whilst others are published in a bare format, known as 'White Paper accounts'[6]. Fourth, an examination of a complete collection of House of Commons Papers for a Parliamentary Session highlights just how many accounts are presented to Parliament in the White Paper accounts format, often in parallel to organisational self-reporting but not necessarily so. Large numbers of such accounts are presented to Parliament as a result of structures established specifically for England, such as Education Action Zones and Housing Action Trusts; a common feature being that central government has intervened on an area basis in delivering services that are traditionally the preserve of local authorities[7]. An annual publication of the National Audit Office provides a list of accounts audited by the Comptroller and Auditor General, though this is not a complete list of the accounts of public bodies because some are not audited by him[8].

1 See para 484 above.
2 See para 514 above.
3 HM Treasury *Consolidated Fund and National Loans Fund Accounts 2000–2001: Accounts, Prepared under Section 21 (1) of the National Loans Act 1968, Showing Payments into and out of the Consolidated Fund and the National Loans Fund in the Year Ended 31 March 2001* (HC Paper 380 (2001–02)) (Stationery Office, 2002).
4 HM Treasury *Consolidated Fund and National Loans Fund Accounts 2000–2001: Supplementary Statements, Prepared under Section 21 (3) of the National Loans Act 1968, Showing Details of the Transactions on the Consolidated Fund in the Year Ended 31 March 2001* (HC Paper 381 (2001–02)) (Stationery Office, 2002).
5 See para 548 below.
6 Using Scottish examples from the pre-devolution period, D A Heald and N Geaughan *Accounting and Control in Executive Agencies and Executive NDPBs in Scotland*, ACCA Research Report No 68 (Certified Accountants Educational Trust, 2001) (available on www.accaglobal.com) chart the complex patterns of financial reporting for such bodies. The term 'White Paper accounts' is used by those familiar with government financial reporting, though not recognised by House of Commons librarians.
7 It has been announced that Education Action Zones (set up in 1998) and Housing Action Trusts (set up in 1988) will be abolished.
8 National Audit Office *Accounts Audited by the Comptroller and Auditor General* (National Audit Office, London), annual publication. See the discussion of the Sharman Report in para 519 below.

519. Comptroller and Auditor General. The Comptroller and Auditor General is the Accounting Officer of the National Audit Office[1]. An important source of his influence derives from his role as adviser to the Public Accounts Committee[2].

The Comptroller and Auditor General is appointed by the Crown and is an Officer of the House of Commons[3]. His salary is one item among the small number of items treated as Consolidated Fund Standing Services[4], thus bypassing the annual Supply procedure. He can only be removed from office by petition to the Queen, following a resolution passed by both Houses of Parliament. There is no retirement age specified in statute or regulations. These arrangements are intended to protect the independence of the incumbent from the Executive and indeed from a simple majority of the House of Commons.

As Comptroller General, his duties are to authorise the issue of public funds from the Consolidated Fund by the Treasury to, for example, government departments. As Auditor General, he audits the accounts of government departments (including the accounts of Executive agencies) and those of many other public bodies, normally by statute but sometimes by agreement[5]. He also has powers to undertake examinations into the economy, efficiency and effectiveness with which bodies have used their resources (commonly called 'Value For Money (VFM) examinations')[6]. The bodies concerned are: those he audits, or over which he has inspection rights, either statutorily or by agreement; certain health service bodies; and any authority or body appointed by a minister of the Crown and which receives more than half its income from public funds. A potentially significant limitation on these powers is that he cannot audit companies established under Companies legislation, as he is not a qualified auditor under the Companies Act 1989[7].

Following the Sharman Report[8], the government has agreed to remove this limitation subject to that being possible within the constraints imposed by the Eighth Directive on European Company Law[9]. In no case is the Comptroller and Auditor General entitled to question the policy objectives of the department or body concerned. However, there is in practice substantial ambiguity as to what constitutes policy, and this provides substantial scope for VFM investigations that touch upon what would normally be described as policy.

During the passage of the Scotland Act 1998 (c 46), Tam Dalyell MP moved an amendment[10] to place upon the Comptroller and Auditor General a duty to audit the accounts of the Scottish Executive. David Davis MP, then Chairman of the Public Accounts Committee, tabled amendments to authorise the Comptroller and Auditor General to conduct VFM studies into the expenditure of the Scottish Executive. Both of these amendments were vigorously resisted by the government, as contrary to the spirit of the devolution legislation. Also unsuccessful were amendments tabled by David Davis to include in the Scotland Bill, *inter alia*, provisions for Accounting Officers, independent audit and a Scottish Public Accounts Committee. These were resisted by the government on the grounds that the Scottish Parliament should make its own provisions for these matters through Scottish legislation[11]. This insistence that accountability for devolved expenditure should be discharged by the devolved institutions represents an important constraint on the Comptroller and Auditor General, strongly encouraged by the Public Accounts Committee, in following public money[12] wherever it goes.

1 See para 520 below.
2 See para 521 below.
3 Exchequer and Audit Departments Act 1866 (c 39), s 3 (as amended) and National Audit Act 1983 (c 44), s 1. See also 8(2) *Halsbury's Laws of England* (4th edn) (1996 reissue) CONSTITUTIONAL LAW AND HUMAN RIGHTS paras 724–726.
4 See para 508 above.

5 Eg before devolution, the Comptroller and Auditor General audited the accounts of the Scottish Arts Council by agreement, since the royal charter setting up the body did not provide for audit. (It has since been amended.) For a discussion of the audit of public bodies, see para 550 below.
6 NAA 1983, ss 6, 7, Sch 4 lists a number of exempted bodies, which include the British Broadcasting Corporation.
7 Companies Act 1989 (c 40), s 25. This restricts eligibility for appointment as the statutory auditor of a company to those registered with a supervisory body recognised by the state for that purpose: *Audit and Accountability in Central Government: The Government's Response to Lord Sharman's report 'Holding to Account'* (Cm 5456) (2002). During the Parliamentary passage of the Government Resources and Accounts Act 2000 (c 20), the then Chairman of the Public Accounts Committee (David Davis MP) insisted that 'Company status must not be used as a way of avoiding public scrutiny or as a voluntary loophole built into accountability arrangements' (HC Official Report, SC A (Government Resources and Accounts Bill, Eighth Sitting), 20 January 2000, col 286).
8 Ie Lord Sharman of Redlynch *Holding to Account: The Review of Audit and Accountability for Central Government* ('The Sharman Report') (HM Treasury, 2001). See para 483 above.
9 EC Council Directive 84/253 (OJ L126, 12.5.84, p 20). The Directive permits member states to approve as company auditors only natural persons or firms of auditors meeting specified requirements.
10 Several amendments were discussed, though only one, a different amendment proposed by Tam Dalyell, was formally moved (and subsequently withdrawn). The Davis amendments, though discussed in debate, were never formally moved. See 306 HC Official Report (6th series) cols 610–642 (12 February 1998).
11 See paras 533 and 537 below.
12 See para 483 above.

520. National Audit Office. The National Audit Office (NAO)[1] is the modern incarnation of one pillar of William Gladstone's[2] system for the Parliamentary scrutiny of public money; the other pillar is the Public Accounts Committee[3]. Created in 1983 out of the Exchequer and Audit Department[4], the NAO is headed by the Comptroller and Auditor General[5]. It has its headquarters in London's Buckingham Palace Road, near Victoria Station, and also has offices in Cardiff, Newcastle and Blackpool.

There are several dimensions to the work of the NAO. First, there is its work on financial audit[6], extending beyond the certification of accounts to embrace both regularity and propriety[7]. Second, Value For Money (VFM) auditing has acquired major importance in the past twenty years, with the result that a significant proportion of NAO resources[8] are now committed to producing about fifty VFM reports each year. These explicitly link in to the meetings cycle of the Public Accounts Committee, whose own programme of work is framed around its link to the Comptroller and Auditor General and the NAO. Third, the NAO exercises substantial influence over United Kingdom developments in government accounting and audit, in terms of both its work directly for Parliament and its leadership role in relation to public audit, in the United Kingdom and internationally[9].

The Comptroller and Auditor General's statutory remit prevents the NAO from questioning 'the merits of the policy objectives'[10]. This constraint may divert VFM auditing away from the policy nexus towards managerial and implementation issues[11]. Another factor is the convention that 'facts' in NAO reports are agreed with departments ahead of publication, with the intention of avoiding disputes at Public Accounts Committee hearings between the Accounting Officer[12] and the Comptroller and Auditor General. A consequence is that published reports can be damaged by circumlocution and offsetting statements. As part of its own management review system, the NAO has established quality control mechanisms for VFM reports[13]. Most VFM reports lead to hearings in front of the Public Accounts Committee, which then issues its own report. This automatically generates a formal government reply in the form of a Treasury Minute usually covering a number of such reports. There is no such mechanism for reply in the case of the smaller number of reports, usually the less controversial ones, on which there is no hearing. The NAO believes that it significantly contributes to the achievement of VFM in the organisations covered by its work[14].

1 T Daintith and A Page *The Executive in the Constitution: Structure, Autonomy and Internal Control* (Oxford University Press, 1999), pp 190–199; J McEldowney 'The control of public expenditure' in J Jowell and D Oliver *The Changing Constitution* (Oxford University Press, 4th edn 2000), particularly pp 217–223.
2 Chancellor of the Exchequer, 1859–1866.
3 See para 521 below.
4 This had been established by the Exchequer and Audit Departments Act 1866 (c 39), which also created the post of Comptroller and Auditor General and placed an obligation on all government departments to produce annual Appropriation Accounts. A subsequent measure was the Exchequer and Audit Departments Act 1921 (c 52).
5 See para 519 above.
6 This now involves the audit of more than 600 accounts: National Audit Office *Corporate Plan 2003–2004 to 2005–2006* (National Audit Office, London, 2002), p 1. A full list of bodies audited by the NAO appears in the annual publication: National Audit Office *Accounts Audited by the Comptroller and Auditor General* (National Audit Office, London). There is also an annual report providing a valuable summary of each financial year's audit: National Audit Office *Financial Auditing and Reporting: 2000–2001 General Report of the Comptroller and Auditor General* (HC Paper 335-XIX (2001–02)) (Stationery Office, 2002).
7 See para 513 above.
8 Schedule 5 to the NAO's 2001–02 Departmental Resource Account (as to 'voluntary' DRAs, see para 516 above) provides the following breakdown of gross expenditure: 53 per cent certifying and reporting on accounts; 27 per cent VFM work; 6 per cent examining and reporting on risks to financial systems, regularity and propriety; 14 per cent on other work for Parliament and the public; and 0.2 per cent on the comptroller function: National Audit Office *National Audit Office Resource Accounts 2001–2002* (National Audit Office, London, 2002).
9 On a full cost recovery basis, the NAO bids for the audit of international public bodies; eg the Comptroller and Auditor General is currently the appointed external auditor of a number of United Nations specialist agencies, such as the International Atomic Energy Agency and the International Labour Organisation. The NAO provides auditing services to the Auditor General for Wales, on a full reimbursement basis. It plays a leading role in the Public Audit Forum (www.public-audit-forum.gov.uk), established by the public audit agencies (NAO, Northern Ireland Audit Office, the Audit Commission for Local Authorities and the National Health Service in England and Wales, and Audit Scotland) to perform a consultative and advisory role in relation to the development of public audit.
10 The power in the National Audit Act 1983 (c 44), s 6(1) ('may carry out examinations into the economy, efficiency and effectiveness with which any department, authority or other body to which this section applies has used its resources in discharging its functions') is qualified by s 6(2) ('[the power] shall not be construed as entitling the Comptroller and Auditor General to question the merits of the policy objectives of any department, authority or body in respect of which an examination is carried out').
11 However, see the discussion in para 519 above on the problem of delineating what is policy and what is not. See also J Keen 'On the nature of audit judgements: the case of value for money studies' (1999) 77 Public Administration 509.
12 See para 513 above.
13 'Independent reviews, currently undertaken by the London School of Economics, are completed for all published reports, focusing on technical content, presentation and quality of analysis. . . . The National Audit Office now share the London School of Economics quality assessments with audited bodies': National Audit Office *Corporate Plan 2003–2004 to 2005–2006* (National Audit Office, London, 2002), Table 4.

14 '[I]n the last three years savings resulting from the work of the Office have amounted to some £1.54 billion, an average of £512 million each year. The Office has thus met its target of achieving savings for the taxpayer of at least eight times its net costs': National Audit Office *Corporate Plan 2003–2004 to 2005–2006* (National Audit Office, London, 2002), para 1.2. These calculations are not in the public domain.

521. Public Accounts Committee. The second pillar of William Gladstone's system for the Parliamentary scrutiny of public money is the Public Accounts Committee[1], established in 1861; the first pillar being the National Audit Office (NAO)[2]. The Public Accounts Committee, whose official name is 'Committee of Public Accounts', consists of a maximum of sixteen members, including the Financial Secretary to the Treasury who, other than attending soon after appointment to be introduced to the committee, rarely, if ever, attends. By convention, the Public Accounts Committee is chaired by a senior opposition MP, usually with ministerial experience. Unlike other select committees[3], it is not empowered to meet when the House is adjourned and is not allowed to appoint specialist advisers, a consequence of which is that it relies heavily upon NAO support for briefings and report-writing. The committee's current practice is to meet on Mondays and Wednesdays at 4 pm, in public whenever possible as the generation of publicity is regarded as one of its most powerful weapons[4]. It conducts its business on a non-partisan basis to a much greater extent than other select committees. All meetings are attended by the Comptroller and Auditor General and/or his Deputy and appropriate staff. The Treasury Officer of Accounts[5] attends most evidence sessions, but is not present when the committee deliberates or when the Estimates of the National Audit Office are being considered. A specific role of the committee is that it must report that it sees no objection to sums being provided by Excess Vote before that Excess Vote can be considered by the House of Commons[6].

1 See para 167 above.
2 See para 520 above.
3 On the public expenditure role of other select committees, see para 523 below.
4 An unusual exchange in print between Brian Landers (a former Director of Finance of the Prison Service Agency) and Robert Sheldon (chairman of the Public Accounts Committee, 1983–97) reveals some undercurrents: B Landers 'Encounters with the Public Accounts Committee: a personal memoir' (1999) 77 Public Administration 195; R Sheldon 'Encounters with the Public Accounts Committee: a response to Brian Landers' (2000) 77 Public Administration 229; B Landers 'A reply' (2000) 77 Public Administration 231. See also J McEldowney 'The control of public expenditure' in J Jowell and D Oliver *The Changing Constitution* (Oxford University Press, 4th edn 2000), particularly pp 216–217.
5 The responsibilities of the Treasury Officer of Accounts, a post dating from 1872, are set out in HM Treasury *Government Accounting 2000*, Amendment 1/01 (Stationery Office, 2001), Annex 1.1. As well as responsibilities in relation to the Public Accounts Committee, the Treasury Officer of Accounts is responsible for the upkeep of *Government Accounting* and other guidance.
6 HC Standing Orders (Public Business) (2002) no 55(3)(c). See para 509 above.

522. Public Accounts Commission. The Public Accounts Commission is a statutory body, established by the National Audit Act 1983[1], as a consequence of the removal of Treasury power over the Comptroller and Auditor General and creation of the National Audit Office (NAO) out of the Exchequer and Audit Department. It is responsible for approving the Corporate Plan of the

NAO and approving its Estimate, with that being presented to Parliament in the name of the Chairman, not of the Financial Secretary to the Treasury. Following the recommendation of the Sharman report that the Commission should become more visible in holding the NAO to account[2], the meeting on 9 July 2002, at which the Comptroller and Auditor General sought approval of the NAO's Corporate Plan for the period 2003–04 to 2005–06, was conducted in public session. Its other duties are to appoint the Accounting Officer of the NAO (in practice, this will always be the Comptroller and Auditor General) and to appoint the auditor of the NAO (which will be a private firm of auditors).

The Commission, which should not be confused with the Public Accounts Committee[3], is not a select committee. It consists of nine members of the House of Commons: two are *ex officio* (Leader of the House of Commons and Chairman of the Public Accounts Committee) and seven are appointed by the House, none of whom may be ministers of the Crown. The Secretary of the Commission is a senior member of the Clerk's Department, undertaking this task amongst other duties. The Commission publishes a report, not annually but from time to time[4]. As a statutory body, not a Committee of the House, its proceedings enjoy qualified, not absolute, privilege.

1 National Audit Office Act 1983 (c 44), s 2(1). See also 8(2) *Halsbury's Laws of England* (4th edn) (1996 reissue) CONSTITUTIONAL LAW AND HUMAN RIGHTS para 721.
2 Lord Sharman of Redlynch *Holding to Account: The Review of Audit and Accountability for Central Government* ('The Sharman Report') (HM Treasury, 2001), para 21.
3 See para 521 above.
4 The minutes of the 9 July 2002 meeting are published in the *Eleventh Report of the Public Accounts Commission* (HC Paper 1251 (2001–02)) (Stationery Office, 2002).

523. The public expenditure role of select committees. Much of Parliament's detailed consideration of government policy and expenditure is now conducted through the inquiries and reports of departmentally-related select committees[1], whose programme of work receives some co-ordination by the Liaison Committee[2]. There is marked variation in the extent to which departmentally-related committees formally consider Supply and expenditure, though inquiries into policy invariably raise issues about expenditure. Much depends upon the subject area entrusted to a particular committee and also upon the enthusiasm of the chairman and clerk for expenditure issues. As well as considering macroeconomic policy, the Treasury Committee regularly takes evidence from Treasury officials and ministers on expenditure policy, more usually upon Pre-Budget, Budget and Spending Review documents than upon the formal Supply documents. Alongside the Public Accounts Committee, the Treasury Committee took evidence at regular intervals from Treasury officials during the development and implementation stages of Resource Accounting and Budgeting (RAB)[3]. The Procedure Committee also reported on the Parliamentary dimension[4], notably resource-based Supply.

It has long been recognised by senior Parliamentarians and Commons clerks that Parliament's monitoring of public expenditure matters is uneven and spasmodic. A significant problem has been the lack of expert assistance available to departmentally-related committees on government accounting and public expenditure matters, a deficiency highlighted by the transition to RAB. Following reports from the Liaison Committee[5] and the Modernisation

Committee[6], the House of Commons Commission decided in summer 2002 to establish a Central Scrutiny Unit within the Committee Office, with the dual remit of servicing pre-legislative scrutiny of Bills and supporting the financial work of departmentally-related committees[7]. The Liaison Committee is developing guidance[8] on the core tasks of departmentally-related select committees, particularly stressing the expenditure scrutiny role.

1 See para 163 above. On the role of the Public Accounts Committee, see para 521 above. On the Scottish Affairs Committee, see para 530 below.
2 See para 179 above.
3 See para 496 above.
4 *Second Report of the Procedure Committee: Resource Accounting and Budgeting* (HC Paper 438 (1997–98)) (Stationery Office, 1998).
5 *First Report of the Liaison Committee: Shifting the Balance: Select Committees and the Executive — Report and Proceedings* (HC Paper 300 (1999–2000)) (Stationery Office, 2000).
6 *First Report of the Select Committee on Modernisation of the House of Commons: Report, Together with the Proceedings of the Committee Relating to the Report* (HC Paper 224 (2001–02)) (Stationery Office, 2002), para 28.
7 For comparison with the position in the Scottish Parliament, see para 526 below.
8 Liaison Committee *Core Tasks for Select Committees: Draft Guidance from the Liaison Committee* (Session 2001–02) (mimeo, 2002).

524. International surveillance of United Kingdom public finances. As a result of both European Union membership and of the increasingly globalised economy, there is more international interest than before in the fiscal position of individual countries. In the European Union context, the concern has been that fiscal irresponsibility by some countries would damage the euro and impose higher borrowing costs upon all member governments[1]. More generally, international organisations such as the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) have become aware of how rapidly both fiscal and capital market crises anywhere in the world can be transmitted. These fears of contagion have encouraged the growth of international surveillance. To some extent, this is voluntary and intended to support country decision-makers, often facing difficult technical decisions in sensitive political contexts. However, there is a potentially coercive element as well.

The measures of total public expenditure used by international organisations, though national accounts-based, do not coincide with those used by the Treasury[2]. Eurostat[3] and the OECD use the same measure of general government expenditures[4], which is not the same definition as the General Government Expenditure (GGE)[5] on which the Treasury focused before 1998. The most systematic comparisons are provided in *Government Finance Statistics Yearbook*, an annual publication of the IMF. Data are obtained primarily through a detailed questionnaire to government finance statistics ‘correspondents’, usually located in the ministry of finance or central bank of the reporting country. In this publication, government is differentiated in the following way: central government; state, provincial or regional governments; local governments; social security funds; and supranational authorities (that is, institutions of the European Union)[6].

For many years, the OECD has published regular Economic Surveys of its member countries[7], on a cycle which is broadly annual, though no Survey is published in a period immediately before an election in that country. Fiscal position and budgetary management are among the topics that are regularly reviewed. Draft reports are discussed with the relevant government, some of which are very edgy about drafting, in part because OECD criticisms or policy suggestions may be taken up in the domestic media. These Surveys are an invaluable starting point for learning about public expenditure in an OECD member country.

'Surveillance' is identified by the IMF as one of its three main tasks; the others are lending and technical assistance. According to the IMF, 'Surveillance involves the monitoring of economic and financial developments, and the provision of policy advice, aimed especially at crisis-prevention'[8]. The monitoring of fiscal positions proceeds in parallel with monitoring of capital market conditions. There are two main strands affecting the fiscal side. First, 'Article IV' consultations are conducted bilaterally every year between a team of IMF officials and the finance ministry of each member country. A recent development is that the results of these consultations, both the report of the officials and the country response, are published on the IMF web page, provided that the country government agrees[9]. These provide a useful point of entry into fiscal developments in particular countries. Second, a response to the 1997–99 Asian crisis has been the development of a set of codes, including one on fiscal transparency[10], which act as benchmarks against which the institutions and performance of particular countries can be judged. These reviews are organised as a programme known as Reports on the Observance of Standards and Codes (ROSCs)[11].

Although OECD Economic Surveys and IMF assessments may cause some embarrassment when they are perceived to be critical, the potential impact of the obligations entered into under the Stability and Growth Pact[12] is much greater. The Excessive Deficits Protocol, attached to the Maastricht Treaty, was subsequently incorporated into the Stability and Growth Pact[13]. This sets ceilings on the ratios of new government borrowing to GDP (3 per cent) and on public debt to GDP (60 per cent). Monitoring is conducted by European Commission officials, with ECOFIN[14] being the decision-making body. With the agreement of ECOFIN, individual countries can be cautioned about their budgetary position, requested to make policy changes so as to avoid breaching these ceilings, and, ultimately, fined[15].

These ceilings do not depend on the state of the economic cycle, and it is possible to envisage circumstances in which complying with these ceilings would involve suppressing the automatic stabilisers[16]. In addition, the process in practice has become intensely politicised. When Ireland and Portugal were in danger of breaching the ceilings, they received cautions. However, when Germany and France were in danger of doing likewise, political bargaining among governments spared their blushes. Smaller members of the European Union have complained that the rules seem to apply only to the politically less influential. The credibility of the Stability and Growth Pact has been damaged by these developments, and also by the way in which Romano Prodi, President of the European Commission, has described it as the 'Stupidity Pact'[17], because of its rigidity and its failure to take account of cyclical conditions.

Great care must be taken when making international comparisons of public expenditure. It is necessary to understand the institutions and policy processes in the countries that are being compared. For example, the traditional reliance in Japan on company welfare reduced the need for government welfare; and variations across countries in the extent of compulsion to join private pension or health schemes are relevant to the interpretation of public expenditure/GDP ratios[18].

1 It has been widely reported that the Stability and Growth Pact was desired by the large countries, such as France and Germany, who suspected that southern European countries (notably Greece and Italy) would not be fiscally responsible. Ironically, the 3 per cent ceiling on government borrowing in any year is now causing serious difficulties for France and Germany.
2 See paras 487, 488 and 490 above.
3 Eurostat, based in Luxembourg, is the statistical agency of the European Commission.
4 OECD *National Accounts of OECD Countries — Volume II: Detailed Tables* (2002).
5 See para 487 above.
6 *Government Finance Statistics Yearbook 2001* (International Monetary Fund, 2001), p ix.
7 The latest OECD report on the United Kingdom contains a chapter on managing public expenditure: *OECD Economic Surveys: United Kingdom*, Volume 2002/1.
8 'IMF at work', IMF website (www.imf.org).
9 See eg IMF *United Kingdom: 2001 Article IV Consultation — Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the United Kingdom*, IMF Country Report No 02/39 (March 2002).
10 IMF *Revised Code of Good Practices on Fiscal Transparency* (Updated on 28 February 2001).
11 Out of eleven areas for which standards have been developed, those on (1) data, (2) fiscal transparency, and (3) monetary and financial policy transparency have been developed by the IMF. The ROSC report on the United Kingdom, prepared when the programme was at an experimental stage and covering all three IMF areas, is dated 15 March 1999: International Monetary Fund *Experimental Report on Transparency Practices: United Kingdom*.
12 Resolution of the European Council on the Stability and Growth Pact (Amsterdam, 17 June 1997), OJ C 236, 2.8.1997, pp 1–2. 'The agreement, which has become known as the Stability & Growth Pact, was finalised at the Amsterdam Council (17 June 1997). It was based upon articles 99 and 104 of the Amsterdam Treaty which had been the basis for the surveillance procedure and the excessive deficits procedure in stage 2 of EMU under the Maastricht Treaty. Thus there was no need for negotiations on a new Treaty. The German/French plan was that member governments should have a continuing duty to present budget plans to other member states who, by a system of qualified majority voting, would decide whether an excessive deficit situation existed' (T Edmonds 'The Stability & Growth Pact: the difficult years', in G Allen (ed) *Economic Indicators*, Research Paper 02/59 (House of Commons Library, 2002), p ii).
13 'In stage three of EMU, Member States shall avoid excessive general government deficits: this is a clear Treaty obligation .... Under Article 5 of Protocol 11, this obligation does not apply to the United Kingdom unless it moves to the third stage; the obligation under Article 109e (4) of the Treaty establishing the European Community to endeavour to avoid excessive deficits shall continue to apply to the United Kingdom' (Resolution of the European Council on the Stability and Growth Pact, para I).
14 ECOFIN consists of the finance ministers of European Union member countries, meeting as the European Council, with the chair being taken by the minister of finance of the country then holding the European Union presidency. On the margin of the ECOFIN meeting is held the meeting of the Eurogroup, which only finance ministers of countries within the euro may attend.
15 The United Kingdom cannot be fined unless it proceeds to stage 3 of the EMU, ie joins the euro.
16 See para 488 above.
17 BBC News Online, 'Row over "stupid" EU budget rules' (17 October 2002). A contribution to present difficulties came from the extent to which fiscal data were manipulated in order to allow countries to qualify for membership of the euro when it was launched in January 1999. See F Forte 'The Maastricht "Excessive Deficit" rules and creative accounting', in R Mudambi, P Navarra and G Sobbrio (eds) *Rules and Reason: Perspectives on Constitutional Political Economy* (Cambridge University Press, 2001) pp 258–288. The vulnerability of general government figures to manipulation (eg transactions between general government and public organisations outside general government) is discussed in para 488 above. The rationale for the rigidity in these rules probably stemmed from concern that flexibility in interpretation would lead to laxity.
18 See para 487 above.

525. Funding of Parliament as an institution. There are three Parliamentary Estimates. The first covers peers' expenses, the general administration of the House of Lords, capital works, building maintenance and utilities. The second covers the salaries and allowances of members of the House of Commons, central information technology and related centrally-provided services for members. The third is for House of Commons administration, covering general administrative costs, capital works, building maintenance and utilities.

The first two are included in the main Supply volume[1], laid by the Financial Secretary to the Treasury, but prepared by officials in both Houses of Parliament. Responsibility for the preparation of the Estimates for House of Commons administration rests with the Finance and Services Select Committee, appointed in 1991[2], with the assistance of the Board of Management[3]. The Speaker of the House of Commons, not the Financial Secretary to the Treasury, presents this Estimate to Parliament, at the same time as the Main Estimates and those for the National Audit Office and the Electoral Commission are presented. This third estimate is prepared by officials and approved in sequence by the Finance and Services Select Committee and by the House of Commons Commission, in accordance with a high-level strategic plan within which individual decisions are fitted. The Parliamentary procedure is exactly parallel to that for Supply in general, with a voluntary Departmental Resource Account (DRA)[4] replacing the Appropriation Account from 2001–02. The determination of the House of Commons budget is a matter for the House of Commons, with no formal role for the Treasury, though this expenditure scores within both Supply totals and Total Managed Expenditure (TME)[5]. The Clerk of the House of Commons is the Accounting Officer[6] for the second and third estimates, with the Clerk of the Parliaments being the Accounting Officer for the first.

1 See paras 508 and 509 above.
2 See para 177 above; and Erskine May *Parliamentary Practice* (22nd edn, 1997 by D W Limon and W R McKay).
3 The Board of Management comprises the heads of all House departments, chaired by the Clerk of the House of Commons as Chief Executive.
4 See para 516 above.
5 See para 490 above.
6 See para 513 above.

(4) PLANNING AND CONTROL OF PUBLIC EXPENDITURE: SCOTLAND

(a) Introduction

526. Overview of section. Attention now turns to the specifically Scottish aspects of public expenditure, both non-devolved and devolved.

The United Kingdom government figures prominently in three of the five topics covered in this section: (1) the continued operation in Scotland of the United Kingdom government, important in public expenditure terms particularly in connection with social security expenditure; (2) the operation of the Scotland Office, a United Kingdom department headed by a Cabinet minister (Secretary of State for Scotland) and created when most of the Scottish Office became the Scottish Executive; and (3) financial relationships between the United Kingdom government and the devolved Scottish Executive[1]. The fourth and fifth topics relate exclusively to Scotland, namely (4) the internal budgetary and financial processes of the Scottish Executive, and (5) the handling of financial matters by the Scottish Parliament.

The Scottish Parliament is potentially more powerful in relation to the Executive over public money than is the House of Commons in relation to the United Kingdom government. With proportional representation for the devolved tier, but not for the United Kingdom Parliament, this different relationship is likely to endure. It is perhaps not proportional representation itself which is important, but the fact that it is likely to result in coalition or minority government. In such a context, the administration becomes more anxious to keep its backbenchers content in the exercise of their scrutiny roles.

However, the lack of real power of the House of Commons stems from a number of factors, including: the complexities of modern government; the perceived difficulties of handling a complicated set of numbers; the lack of newsworthiness in clinical numerical analysis; the temptation to pursue relatively minor issues in an expenditure context, especially if they can attract media attention; and the realities of the political party system. Each of these factors is also present in the Scottish Parliament, and it will take a conscious and sustained effort not to allow it to slip into the same ways. For example, the opposition will have to mount a credible questioning of the Scottish Executive's expenditure allocations, rather than focus on the Barnett formula system, and the committees will have to avoid becoming lost in the detail.

It is convenient to discuss the United Kingdom government in Scotland before addressing the newly established devolved arrangements. The sequencing of the devolved material is explained below[2]. However, the first step is to clarify terminology in relation to the Scottish Administration, as this impinges on the treatment of public expenditure.

1 The United Kingdom terminology for the Executives in Scotland, Wales and Northern Ireland is 'devolved administrations'.
2 See para 529 below.

527. Scottish Administration. Winetrobe's chapter[1] within this title contains a discussion of the terms 'Scottish Executive' and 'Scottish Administration'. He regrets the lack of a nickname for the Executive[2] as opposed to the Parliament, thus adding to the general confusion about the role of each. A further problem is the lack of a convenient term to describe the whole community funded by the Parliament. Briefly, the Scottish Administration is a wider community than the Scottish Executive since it includes junior Scottish Ministers and the holders of certain non-ministerial offices, and their respective staffs.

The Scottish Parliament grants money directly[3] to the Scottish Ministers, other parts of the Scottish Administration and an even wider group of persons, including the Scottish Parliamentary Corporate Body, Audit Scotland, the Forestry Commissioners and the Food Standards Agency.

Unless a function is reserved or is a concurrent function[4], then the prerogative and statutory powers have transferred to the Scottish Ministers. If the United Kingdom government wishes to spend money on devolved functions, it could not do so under the prerogative, but would have to acquire statutory authority[5]. There is a question as to whether the United Kingdom government would be able to rely on an Appropriation Act, given that the prerogative has transferred, or would have to seek specific statutory authority.

1 See paras 391–393 above.
2 See para 391 above.
3 There is an important distinction between persons and bodies granted money directly by the Scottish Parliament, and directly accountable to them, and those funded by the Scottish Ministers out of money granted to ministers by the Parliament. In the latter case, ministers are accountable for the use of the money.
4 A 'concurrent function' is one exercised jointly by the Scottish Ministers and a minister of the Crown as provided in the Scotland Act 1998 (c 46), s 56 and orders made thereunder (Scotland Act 1998 (Concurrent Functions) Order 1999, SI 1999/1592). See also the Scotland Act 1998 (Transfer of Functions to the Scottish Ministers etc) Order 1999, SI 1999/1750.
5 SA 1998, s 53 provides that functions, whether arising from the prerogative or statute, exercisable within devolved competence, are to be exercisable by the Scottish Ministers instead of by a minister of the Crown. Thus the ministers of the Crown no longer possess powers.

(b) The United Kingdom Government in Scotland

528. United Kingdom departments in Scotland. The arrangements for determining the expenditure of United Kingdom government departments operating in Scotland[1] are precisely the same as those for United Kingdom departments generally. The allocations will normally be to departments at the United Kingdom level, with the allocation to services in Scotland a matter for the internal operation of the department[2].

1 Eg: the Department of Work and Pensions, the revenue departments, the Ministry of Defence, the Department for International Development, the Home Office (immigration, passport, and gaming regulation services), the Department of Transport (driver and vehicle licensing, Marine and Coastguard Agency, civil aviation services, and health and safety) and the utility regulators.
2 Generally speaking, there will not be such a thing as an allocation to Scotland, with the amount spent in Scotland being a by-product of departmental decision-making conducted on functional lines. There is, however, evidence in the past that a territorial formula can occasionally be used in contexts beyond that for which it was developed. Eg Sir Alan Peacock's (chair of the Scottish Arts Council, 1986–92) introduction to the 1989–90 report of the Scottish Arts Council, then part of the Arts Council of Great Britain, makes reference to the use of the Goschen formula (see para 535 below) for determining the allocation to the Scottish Arts Council.

529. Scotland Office. The arrangements for the Scotland Office reflect the devolution financial settlement, as do those for the Wales Office. Although the mechanics of authorising Supply at Westminster are the same, provision for the administrative expenses of the Scotland Office[1] counts against the allocation determined under the Barnett formula[2]. In effect, it is the first call on the Assigned Budget[3].

Because of the limited expenditure responsibilities of the Scotland Office, its departmental report is a slim document. However, Annexes to the report provide certain analyses that are difficult to find elsewhere. For example, Annex 1 of the 2002 Report distinguishes separately for the Scotland Office and the Scottish Executive (1) consumption of resources (that is, Resource Budget) and (2) capital budget. Another analysis distinguishes current and capital expenditure for both the Scottish Office and the Scottish Executive, and divides Annually Managed Expenditure (AME). Most interestingly, Annex 6 reconciles Total Managed Expenditure (TME) by the Scottish Executive with the grant payable to the Scottish Consolidated Fund[4]. TME consists of the Departmental Expenditure Limit (DEL), AME and Non-Domestic Rate Income. Various adjustments are required to reach the grant payable to the Scottish Consolidated Fund. A non-exhaustive list of deductions is as follows: Net capital allocation to local authorities; Non-Domestic Rate Income; Expenditure Finance by EC receipts; and Intervention Board receipts supporting expenditure in AME or DEL. There are also cash to accruals adjustments, for example in relation to depreciation and cost of capital.

1 Including the Office of the Advocate General for Scotland. See also para 265 above.
2 See para 536 below, and see also the table at HM Treasury *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly* (3rd edn, 2002) p 32.
3 The voted expenditure of the Scotland Office comprises its administrative expenditure and the payments made by the Secretary of State into the Scottish Consolidated Fund (see para 542 below) under the Scotland Act 1998 (c 46), s 64(2), ie that part of Scottish expenditure requiring Exchequer funding. It would also include any direct expenditure by the Secretary of State for Scotland on reserved matters, should any ever be incurred; the extent to which such provision would count against the Assigned Budget (see para 536 below) is not clear.
4 See paras 542–544 below.

530. Role of the Scottish Affairs Committee. The Scottish Affairs Committee[1] is a departmentally-related select committee of the House of Commons, initially established in 1979 under the St John Stevas reforms[2]. Set up to shadow the Scottish Office, it was not appointed in the 1987 Parliament because the Committee of Selection was unable to nominate; some Conservative MPs had declined membership and all select committees must reflect the political balance of the House of Commons.

Early knowledge of the Barnett formula stems from a public session on 7 July 1980, at which George Younger MP, then Secretary of State for Scotland, gave evidence to the committee chaired by Donald Dewar MP[3]. Some of the durability of the Barnett formula may be attributable to information about its existence having reached the public domain in this way. This knowledge allowed the Scottish Affairs Committee to regularly ask the Secretary of State for Scotland whether that year's public expenditure changes had been settled by means of the Barnett formula. Defence of the formula, against what was suspected to be the Treasury's desire to change it, became one of the key tasks of the Secretary of State for Scotland[4]. Although reliable information about the formula's operation was slow to reach the public domain, there was clearly a substantial amount of newspaper briefing.

Since 1 July 1999, the Scottish Affairs Committee has shadowed the Scotland Office. The committee has no formal remit with regard to other United Kingdom departments in Scotland, though (as with its predecessor) this does not, in practice, prevent it from initiating wide-ranging inquiries on matters affecting Scotland. The committee has taken public evidence from the Secretary of State for Scotland on the Departmental Report of the Scotland Office, which contains statistical tables on the funding flows from the United Kingdom government to the Scottish Consolidated Fund. Following evidence taken on 7 November 2001, the Scotland Office provided supplementary data, which allowed the calculation of the Barnett formula consequences from Spending Review 2000 to be replicated[5]. This was the first time on which this could be done from information in the public domain. The committee has exercised restraint in not seeking to examine the uses to which the Scottish Parliament puts the funds it receives from the Scotland Office Supply Estimate, part of the United Kingdom Supply Estimates. Such restraint is a matter of constitutional convention, rather than of law.

1 When established on 31 October 1979, its name was the 'Committee on Scottish Affairs'; the name change took place on 30 March 1983. There had briefly been a predecessor committee, the 'Select Committee on Scottish Affairs', established on 25 February 1969; this fell into abeyance after the 1970 dissolution of Parliament. Nevertheless, sessional select committees on Scottish Affairs were appointed for the 1970–71 and 1971–72 Parliamentary sessions. The existence of such committees ceased after the latter reported in October 1972. See also para 523 above.

2 Erskine May *Parliamentary Practice* (22nd edn, 1997 by D W Limon and W R McKay) pp 672–676.

3 Committee on Scottish Affairs *Scottish Aspects of the 1980–84 Public Expenditure White Paper: Minutes of Evidence* (HC Paper 689 (1979–80)) (HMSO, 1980). On 15 April 1980, there had been an arranged Parliamentary question. The Secretary of State for Scotland (1) announced the establishment of a Scotland public expenditure programme and a separate 'class' of Estimates for Scotland (expenditure had previously been spread over several programmes and classes); and (2) explained that this would formalise existing 'arrangements under which, where there are comparable English and Welsh programmes, the Secretary of State has discretion in the allocation of expenditure in Scotland within a total determined by reference to those programmes' (952 HC Official Report (5th series), cols 458–459W (15 April 1980)). At this juncture, the formula had no name (see para 535, note 8, below).

4 Ian Lang (Secretary of State for Scotland, 1990–95) notes in his memoirs that part of his role was to 'keep the Treasury at bay'. 'The real scope for protecting Scottish interests lay in the side deals and the special *ad hoc* negotiations that stood outside the corral of the "block and formula". I calculated after two years as Secretary of State that the Barnett formula had reduced the Scottish Office budget by £17 million, whilst separate deals with the Treasury had increased it by £340 million. The very existence of the Barnett formula, far from inhibiting me, enabled me to concentrate on special deals to augment our resources': I Lang *Blue Years Remembered: A Political Memoir* (Politicos, London, 2002) p 194.

5 Scotland Office 'Supplementary Memorandum submitted by the Scotland Office' in *Scotland Office Departmental Report 2001: Minutes of Evidence Wednesday 7 November 2001* (HC Paper 345-i (2001–02)), Evidence 19–22; and D A Heald and A McLeod 'Beyond Barnett? Funding Devolution' in J Adams and P Robinson (eds) *Devolution in Practice* (IPPR, 2002), pp 147–175.

(c) Scottish Parliament

531. Introduction. At least twenty-five years of intensive debate on devolution preceded the establishment of the Scottish Parliament in 1999, not least in connection with financing[1]. It is therefore appropriate to start with some historical background on the evolution of the determination of the Scottish Office budget, from the Goschen formula of 1888 to the adoption in 1978 of the Barnett formula, initially as a temporary measure, and on how the enacted provisions evolved from proposals advanced in the recent past.

1 D Heald *Financing Devolution within the United Kingdom: A Study of the Lessons from Failure* (Research Monograph No 32, Centre for Research on Federal Financial Relations, Australian National University Press, 1980); and D Heald *Financing a Scottish Parliament: Options for Debate* (Scottish Foundation for Economic Research, 1990).

532. Financing the Scottish Assembly under the Scotland Act 1978. The Scotland Act 1978 (c 51), which never came into force, provided for transfers from the United Kingdom government to a Scottish Consolidated Fund, together with lending to a Scottish Loans Fund. That Fund would, in turn, lend to various Scottish institutions, such as the nationalised industries and the new town development corporations. The amount of funding was not determined under the Act, but a system was to be put in place whereby the Scottish Assembly would receive as 'block funds' a set proportion of English expenditure on the services devolved to the Assembly, with the freedom to determine the distribution amongst those services. The proportion, along with that for Wales, was to be determined in consultation with the Assemblies and would take into account relative need[1].

In preparation for this system, the Treasury conducted a needs assessment[2]. The Scottish and Welsh Offices contributed to the conduct of the assessment, but it is thought that they did not agree with all the conclusions.

'Need' in this context is a convenient term, but not a very accurate one. No technical process can determine the absolute need for public services; that is a matter for political judgement[3]. All that a needs assessment can seek to do is to estimate the differing costs of providing a particular basket of public services in different areas. Whether or not that particular basket adequately meets perceptions of need depends on the perspective of those making the judgement. The expenditure needs index will depend not only on unit cost information (for example, cost per school child) but also upon the number of service recipients, which depends on demographic structure and on participation rates in publicly provided services, such as health and education.

1 *Devolution: Financing the Devolved Services* (Cmnd 6890) (HMSO, 1977).
2 HM Treasury *Needs Assessment Study: The Report of an Interdepartmental Study Co-ordinated by the Treasury on the Relative Public Expenditure Needs in England, Scotland, Wales and Northern Ireland* (HMSO, 1979).
3 A Midwinter 'The politics of needs assessment: the Treasury Select Committee and the Barnett formula' (1999) 19(2) Public Money & Management 51.

533. The financial provisions of the Scotland Act 1998. The Scotland Act 1998 provides for three main sources of funding for the Scottish Parliament and the Scottish Executive. These are: payments made by the Secretary of State at his discretion[1]; the proceeds, positive or negative, of varying the basic rate of income tax[2]; and the proceeds of other receipts of the Scottish Administration[3] (unless the Treasury determines otherwise by order[4]). The proceeds of all of these are to be paid into[5] (or charged on[6]) the Scottish Consolidated Fund[7] unless, in the case of receipts, the Scottish Parliament determines otherwise[8].

The Act also provides for the Secretary of State to lend the Scottish Ministers up to £500 million[9] out of the National Loans Fund, for the limited purposes of meeting a temporary shortfall or providing a working balance on the Scottish Consolidated Fund[10]. The Scottish Ministers have, however, no power to borrow for general purposes and, indeed, are specifically prohibited from borrowing except under this provision or a power in any other Act of Parliament[11]. Certain other bodies[12] may borrow either from the Scottish Ministers or, sometimes, on the market, and there is nothing to stop the Scottish Parliament from granting further powers either to existing bodies (other than the Scottish Ministers) or to new bodies. Such borrowing, even from external sources, would not, however, add to the budget available to the Scottish Parliament[13].

Taxation is a reserved matter[14], but there is an exception for local taxes to fund local authority expenditure. Thus, in addition to the income tax-varying power, the Scottish Parliament can legislate to change the local taxation system, including the imposition of new taxes, as long as the proceeds are used to fund local authority expenditure. Given the high levels of central support for local authorities, there is scope for the Scottish Parliament to substitute higher local taxation for that support, allowing the use of the resources released for other purposes. However, that opportunity is constrained since the United Kingdom government may reduce the Assigned Budget if levels of self-financed expenditure grow significantly more rapidly than in England, or growth is such as to threaten United Kingdom public finance targets[15].

The Scottish Parliament may also legislate for charges to be levied for public services, including those provided free at present. It could not, however, set charges that would in effect be a tax, for example because they were not directly related to the provision of a service or bore no relation to the cost of providing that service. Apart from the possibility of litigation if this were done, the Treasury could require the Scottish Ministers to pay to the Secretary of State (and in turn to the United Kingdom Consolidated Fund) receipts considered by the Office for National Statistics to be a fine or a tax[16].

1 Scotland Act 1998 (c 46), s 64(2).
2 See para 538 below.
3 SA 1998, s 64(3).
4 SA 1998, s 64(5), (6).
5 SA 1998, ss 64(1), (2), 77(1).
6 The term 'charged on' means that the liability is inescapable and requires no further authorisation from the Scottish Parliament (SA 1998, s 65(1)(a)).
7 See para 542 below.
8 SA 1998, s 64(4).
9 The Secretary of State may, with the consent of the Treasury, vary this amount by order, a draft of which must be approved by the House of Commons (SA 1998, s 67(3), Sch 7, para 2).
10 SA 1998, ss 66, 67.
11 SA 1998, s 67(4). There is currently no known power for the Scottish Ministers to borrow under any other Act of Parliament.
12 Eg Scottish Enterprise. A fuller list is effectively given in the Public Finance and Accountability (Scotland) Act 2000 (asp 1), Sch 1 (as amended).
13 See para 534 below.
14 SA 1998, Sch 5, Pt II, Section A1.
15 HM Treasury *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly* (3rd edn, 2002), para 5.2.
16 *HM Treasury*, section 7; SA 1998, s 64(5),(6). The receipts to be surrendered are listed in the Scotland Act 1998 (Designation of Receipts) Order 2000, SI 2000/687.

534. Determining the total budget of the Scottish Parliament. The legal framework outlined above is complemented by non-statutory arrangements. Essentially there are three elements in the funding of the Scottish Parliament: the 'Assigned Budget' or 'Block Grant' (which is Departmental Expenditure

Limit (DEL))[1]; the 'Non-assigned Budget' (which is DEL); and expenditure within Annually Managed Expenditure (AME)[2]; and the variation in the basic rate of income tax determined by the Scottish Parliament. These are supplemented by income of the Scottish Ministers and other public bodies.

The so-called 'Block Grant' should not be confused with the payments into the Scottish Consolidated Fund made by the Secretary of State. Effectively, the Block Grant is an expenditure consent granted by the United Kingdom government for the services over which the Scottish Parliament has full responsibility over the allocation of expenditure. It is that part of the budget that is determined by the Barnett formula. It is funded, as is the Non-assigned Budget, partly by the cash payments from the Secretary of State, but also by borrowing, local taxation, and other receipts, including those from the European Union (EU)[3].

The Non-assigned Budget has comprised certain items, within DEL, for which the allocation of expenditure was determined either in accordance with United Kingdom policy or EU regulations. The Scottish Parliament was not able to divert this allocation to other purposes though it would not have been expected to make good any expenditure overrun. Examples have been Welfare to Work and Less Favoured Area Support Schemes (formerly Hill Livestock Compensation Allowances) in the first and second editions of the Statement of Funding Policy document[4]. There are currently no examples of expenditure within DEL but outside the Assigned Budget.

This lack of discretion to reallocate provision, coupled with protection from the consequences of overspend, also applies to expenditure within AME. The amount of both the Non-assigned Budget and AME are determined in bilateral negotiations with the Treasury.

Two different kinds of expenditure are scored as AME[5]. Spending on the Common Agricultural Policy (CAP) is included here because of the influence of EU and United Kingdom policy-making. Also within this first group, where there is little policy discretion and expenditure ring-fencing, is Housing Support Grant and National Health Service (NHS) and teachers' pensions. Also here, for technical reasons, are certain accrual items such as capital charges for roads. A second group of items is treated as AME in order to facilitate the albeit limited discretion enjoyed by the Scottish Parliament over its total budget: Local Authority Self-Financed Expenditure (also in Other AME in England); Scottish Non-Domestic Rate Income (in DEL in England); and the Scottish Variable Rate of Income Tax[6].

The funding received by the Scottish Parliament through the Scotland Office is based upon the operation of Resource Accounting and Budgeting (RAB)[7], as are all Spending Review allocations to United Kingdom departments and the other devolved administrations. This embeds the Scottish Parliament in the United Kingdom public expenditure control and government accounting system, as information has to be provided to the Treasury on a RAB basis. There is no United Kingdom obligation upon the Scottish Parliament to account on a RAB basis, though the Scottish Parliament has imposed a system of authorising expenditure on a RAB basis[8].

For United Kingdom departments, the distinction between Resource DEL and Capital DEL is important in terms of Treasury control over their expenditure. In the case of the Scottish Parliament, however, this distinction has no control significance (that is, the provision can be reallocated either way), though the distinction is maintained for statistical purposes.

1 See para 491 above.
2 See HM Treasury *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly* (3rd edn, 2002).
3 In 2002–03, the funding of the Scottish budget took the following estimated proportions: 77 per cent central government transfers; 3 per cent assigned revenues; 3 per cent borrowing; 2 per cent EC funds; and 15 per cent own taxes. Of the 'own taxes', council tax gross of council tax benefit represented 50 per cent (40 per cent net) and Non-Domestic Rate Income represented 50 per cent. The Scottish variable rate of income tax (tartan tax) (see para 538 below) was not used (D A Heald and A McLeod 'Fiscal autonomy under devolution: introduction to symposium' (2002) Scottish Affairs (Issue 41) 5).
4 In the second edition (HM Treasury *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly* (2nd edn, 2000), p 27), Welfare to Work and Less Favoured Area Support Schemes (formerly Hill Livestock Compensation Allowances) were recorded as the Non-assigned Budget (ie within DEL but outside the scope of the formula).
5 See para 492 above.
6 See para 538 below.
7 See para 496 above.
8 Public Finance and Accountability (Scotland) Act 2000 (asp 1), s 1. See also paras 540 and 541 below.

535. From the Goschen formula to the Barnett formula. In 1888, the then Chancellor of the Exchequer, Mr George Goschen MP[1], announced in his Budget Statement the distribution of a predecessor of revenue support grant to local authorities on the basis of a formula giving 80 per cent to England and Wales, 11 per cent to Scotland, and 9 per cent to Ireland[2]. Thereafter, Scotland received 11/80ths of the support given to England and Wales over a wide range of expenditure. It was even enshrined in statute for certain education expenditure from 1918[3] to 1959[4]. The use of that formula was formally discontinued in 1959, in parallel with the introduction of the Plowden reforms[5].

From 1959 until 1978, the budget of the Scottish Office was determined in the same way as that of other government departments under the Public Expenditure Survey arrangements[6], basically by negotiation between the Secretary of State and the Treasury on a service-by-service basis. The negotiations may have been affected by the Goschen legacy, in that 11/80ths of England and Wales provision may have been seen as a minimum.

During the protracted proceedings on devolution in the 1970s, the then government proposed that the funding of the devolved Assemblies in Scotland and Wales should be determined by a new formula giving the Assemblies a set proportion of English expenditure on the same services as those which were to be devolved[7], though with freedom to vary the composition of expenditure. That formula was to be determined, in consultation with the Assemblies, on the basis of a needs assessment, and would be reviewed, again taking account of changing relative need, from time to time (perhaps every four years) to coincide with the term of the Assemblies. Since these arrangements were only to be finalised in consultation with the Assemblies, they clearly could not be put in place initially; however, neither the White Paper nor the Parliamentary proceedings during the passage of the Bill that became the Scotland Act 1978 (c 51) addressed the initial position.

The Barnett formula[8] seems to have been originally an interim arrangement for use until the needs-based arrangements could be negotiated and implemented. It was used, for the first time, in the determination of the Scottish Office budget in the 1978 Public Expenditure Survey; that would have, in turn, determined the initial budget of the Scottish Assembly, had it been set up. The incoming Conservative government in 1979 continued with the use of the formula, perhaps because of the benefit of an automatic process compared to negotiation for what was a relatively small part of total public expenditure. At the same time, the Conservative government introduced the 'Scottish block': that part of the Scottish Office budget primarily determined by the Barnett formula. This meant that the Secretary of State was able to determine the distribution of expenditure within the block, without having to agree this, service by service, with the Treasury[9].

1 Ironically, Goschen was the Liberal MP for Edinburgh East, including Holyrood, from November 1885 to July 1886, elections in which Home Rule for Ireland figured prominently; Goschen was firmly against and became a Liberal Unionist aligned with the Conservatives. When Lord Randolph Churchill suddenly resigned on 20 December 1886, Goschen became Chancellor of the Exchequer in Lord Salisbury's Conservative government and required a seat in the House of Commons; he won the London constituency of St George's, Hanover Square in February 1887: A R D Elliott, 'George Joachim Goschen, first Viscount Goschen (1831–1907)' in S Lee (ed) *Dictionary of National Biography: Twentieth Century — 1901 to 1911* (Spottiswoode, London, 1912) (reprinted Oxford University Press, 1976), pp 135–140.

2 A description of the origins of the Goschen formula appeared in para 524 of the previous edition of the Constitutional Law title in 5 *Stair Memorial Encyclopaedia* (1987). The passage is attributed to Mr (now Sir) Malcolm Rifkind, who, by the date of publication, had become Secretary of State for Scotland (1986–90). The Goschen formula is not well documented: '. . . the orthodox account of the Goschen formula, usually derived from Boyle (1966), attributes its proportions to relative population shares. Using census population data reported by the Royal Commission on Local Taxation (Balfour of Burleigh, 1902), Mitchell [1991] demonstrates that this cannot have been the case. Instead, the Goschen formula of Scotland (11 per cent), Ireland (9 per cent) and England and Wales (80 per cent) represented the assignment of probate duties in the (rounded) percentages of their overall contributions to the Exchequer. Initially, it was less favourable to Scotland than population shares, and latterly more favourable as Scotland's population continued its seemingly inexorable decline . . . Goschen later refused a request by Sir George Campbell (Liberal Kirkcaldy) to publish "in a return" the relevant figures on which the Goschen formula was based (Goschen, 1888b) . . . Goschen had decided to introduce Local Taxation Accounts for Scotland, Ireland, England and Wales which would be fed by certained assigned revenues, as part of an attempt to separate "Imperial" from "Local" taxation (Watson Grice, 1910)' (D A Heald *Formula-Based Territorial Public Expenditure in the United Kingdom*, Aberdeen Papers in Accountancy, Finance and Management W7 (1992), pp 54–55).

3 Education (Scotland) Act 1918 (c 48), s 21 (repealed).

4 Local Government and Miscellaneous Provisions (Scotland) Act 1958 (c 64), s 5(1) (repealed).

5 On the 1957 announcement of the impending demise of the Goschen formula, see *Heald* (1992, p 55). It is, of course, entirely possible that the Goschen formula, or something quite like it, was used informally for some allocations even after its formal use was discontinued: see para 528 above.

6 See para 506 above.

7 *Devolution: Financing the Devolved Services* (Cmnd 6890) (HMSO, 1977).

8 The term 'Barnett formula' was coined in 1980, after Joel (now Lord) Barnett, Chief Secretary to the Treasury at the time the formula was first used: D A Heald *Territorial Equity and Public Finances: Concepts and Confusion* (Studies in Public Policy No 75, Centre for the Study of Public Policy, University of Strathclyde, 1980), p 12.

9 For a discussion of how information about the Barnett formula and the Scottish block reached the public domain, see para 530 above.

536. The operation of the Barnett formula. Originally, the Barnett formula[1] allocated 10/85ths[2] of the increases in comparable[3] English provision to the Scotland programme. This was based on rounded percentages of the Great Britain population (85 per cent England, 10 per cent Scotland and 5 per cent

Wales)[4]. The formula applied, and still applies, not to the total provision, but only to the increases (or decreases) in allocations made in successive Public Expenditure Surveys, now Spending Reviews (SRs). The greater expenditure in Scotland per head of population comes not from the formula, but from the existing expenditure levels when the block and formula arrangements were established.

The formula itself was adjusted in 1992 to reflect the actual relative populations, though there is in practice a lag[5], and it is now updated annually on the basis of mid-year population estimates[6]. At the time of Spending Review 2002, the Barnett formula percentages, now expressed relative to England, were: Scotland 10.23 per cent; Wales 5.89 per cent; and Northern Ireland 3.40 per cent[7].

At devolution, the use of the Barnett formula was continued[8] with a number of adjustments made to the composition of the Scottish block, now renamed the Assigned Budget.

The Barnett formula has aroused much controversy, both in that it is perceived to guarantee Scotland an advantageous position and, conversely, in that it results in a diminishing share of United Kingdom expenditure for Scotland. There is, undoubtedly, higher expenditure per head in Scotland on devolved services than there is on comparable services in England, though systematic figures are not published.

One of the effects of the formula is to converge, albeit over a long period, expenditure per head in Scotland towards that in England. There has been considerable discussion as to why it is difficult to find empirical evidence of such convergence[9]. The most important factors appear to be: bypass of the formula, particularly in the 1980s; relatively low growth in nominal public expenditure in the 1990s; and continuing falls in Scotland's relative population, thus offsetting the convergence effect. More evidence of convergence is now to be expected, owing to: fewer opportunities for formula bypass; unprecedentedly high rates of growth of comparable public expenditure in England; annual updating of the formula to reflect changes in relative population[10]; and the fact that the formula now applies to a greater proportion of expenditure increases[11].

Two specific provisions in the Statement of Funding Policy document deserve attention. First, the Treasury has the right to claw back from the Assigned Budget amounts it determines if there is excessive growth in Local Authority Self-Financed Expenditure[12]. Second, the Treasury has the right to impose across-the-board reductions in public expenditure[13], a mechanism that would be disadvantageous to the devolved administrations relative to the same amount of public expenditure reductions being channelled through the formula[14].

1 For expositions of the Barnett formula, see D A Heald 'Territorial public expenditure in the United Kingdom' (1994) 72 Public Administration 147; D Bell, S Dow, D King and N Massie 'Financing devolution', *Hume Papers on Public Policy* 4.2 (Edinburgh University Press, 1996); and D A Heald and A McLeod 'Beyond Barnett? Funding Devolution' in J Adams and P Robinson (eds) *Devolution in Practice* (IPPR, 2002), pp 147–175.

2 When comparability related to England and Wales rather than just England, 10/90ths was used.

3 Expenditure in England comparable to devolved services in Scotland has never been published in a satisfactory form. However, for the data which are available, see HM Treasury *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly* (3rd edn, 2002) pp 45–66.

4 The actual proportions at the time were England 85.31 per cent, Scotland 9.57 per cent, Wales 5.12 per cent.
5 Eg the increments in the 2000 Spending Review used the population figures for 1999. That Review determined initial spending allocations for 2001–02, 2002–03, and 2003–04. Thus the 2003–04 allocation was based on 1999 population and was not updated on account of later population information. The allocation was subsequently changed because of further allocations to England, in Budget Statements (such as substantial additional expenditure for the National Health Service in the 2002 Budget) and the 2002 Spending Review. In each case, the Barnett formula would be applied to the additions, using the latest population data available at the time the allocation is made; existing allocations would not be revised on account of relative population changes subsequent to the allocation being made.
6 The 'Statement of Principles' enunciated on 9 December 1997 by Alistair Darling MP, then Chief Secretary to the Treasury, is reprinted in each edition of the Statement of Funding Policy: *HM Treasury* (3rd edn, 2002), Annex A, pp 39–43.
7 *HM Treasury* (3rd edn, 2002), p 44.
8 The Barnett formula has no legislative backing. The intention to use the formula as the basis for funding devolution was announced in the July 1997 White Paper: Scottish Office *Scotland's Parliament* (Cm 3614) (1997), para 7.1.
9 Deficiencies in the data do not allow precise estimates of actual convergence. Attempts, however, to quantify the so-called 'Barnett squeeze' are at best misconceived and, at worst, political mischief-making; they assume that Scotland has an entitlement to the same rate of increase as in England, irrespective of existing levels of expenditure per capita.
10 Nevertheless, the rapid growth of population in England, whilst the Scottish population is static or falling, will continue to dampen convergence. Indexes of per capita expenditure are much affected by the population denominator.
11 Previously, new expenditure baselines for horizon years (ie the first time a year comes into the Survey) were based on provision for the previous final year, adjusted broadly in line with inflation. The increment on which the formula operated did not therefore include this adjustment. This practice stopped, with effect from the 1993 Public Expenditure Survey, though this change was not announced until 1997: HM Treasury 'Supplementary memorandum submitted by HM Treasury on Tuesday 16 December 1997', in *Second Report of the Treasury Committee: Barnett Formula* (HC Paper 341 (1997–98)) (1997), particularly Annex 2, pp 38–39.
12 *HM Treasury* (3rd edn, 2002), Annex A, para 8(e). See para 544 below.
13 *HM Treasury* (3rd edn, 2002), Annex A, para 8(a).
14 The Treasury has on at least one occasion implemented an across-the-board percentage reduction in departmental baselines, at the initial stage of a Survey, before then applying the formula. Whether by accident or design, this procedure allows ministers to state that the Barnett formula has been implemented, even though it erodes the protection afforded by the formula to inherited expenditure. Money 'saved' by applying a constant percentage cut to the territorial blocks and to comparable expenditure can then be passed through the Barnett formula, generating formula consequences supplementary to those generated by year-on-year increases in comparable expenditure. Naturally, the arithmetical effect is disadvantageous to the devolved administrations because the constant percentage cut generates more 'savings' from their blocks than they subsequently receive back in these 'artificial' formula consequences. There have been no across-the-board reductions to the Assigned Budgets of the devolved administrations.

537. The Report of the Financial Issues Advisory Group. Attention now turns to the procedures for allocating the expenditure amongst the different services, for Parliamentary consideration and approval of that allocation, and the arrangements for accounting for the expenditure and for its audit. These matters were considered by the Financial Issues Advisory Group, an independent group set up the Secretary of State to advise on these questions.

The Group's recommendations[1] were substantially accepted and given force in the Public Finance and Accountability (Scotland) Act 2000[2], the second Act passed by the Scottish Parliament (the first being an emergency measure), and the various written procedures are described in the paragraphs that follow.

1 The report of the Group was published by the Scottish Office; and, at the time of writing was still available on the Scottish Executive website (www.scotland.gov.uk). A summary of the recommendations is also available in the report of the Consultative Steering Group.
2 Public Finance and Accountability (Scotland) Act 2000 (asp 1).

538. Scottish variable rate of income tax. One of the most controversial aspects of the devolution financing system is the Scottish variable rate of income tax, dubbed the 'tartan tax'[1] (initially by Michael Forsyth, Secretary of State for Scotland, 1995–97). Thus far, the tartan tax has not been used, either upwards or downwards.

The legislation[2] authorises the Scottish Parliament to pass a resolution providing that the percentage determined for the basic rate of income tax by the United Kingdom Parliament for a particular tax year will be increased or decreased by up to 3 percentage points, but only in multiples of half a point. Such a resolution may only be moved by a member of the Scottish Executive and it may not be amended. A motion for a resolution, which may only be for a single tax year, may only be moved within a year of the start of the tax year to which it relates. It may be moved after the start of the tax year to which it relates but only at Stage 3 of a Budget Bill (or a Bill to amend a Budget Act)[3].

If there is a change in the income tax structure (such as in the width of the various bands), the Treasury has to assess its effect on the Parliament's tax-varying powers. If the Treasury believes this effect to be significant, it must lay before the House of Commons a statement of whether an amendment to the tax-varying powers is required and, if so, their proposals for so doing[4].

The amended rate would be applied by the Inland Revenue: in the case of an increase the proceeds would be paid by the Revenue into the Scottish Consolidated Fund[5]; in the case of a reduction a charge would be made on the Scottish Consolidated Fund by way of a payment to the Revenue of the shortfall in its income[6]. The Scottish Ministers may reimburse the United Kingdom government for any administrative expenses incurred[7].

1 D A Heald and N Geaughan 'The tartan tax: devolved variation in income tax rates' (1997) British Tax Review (Issue 5) 337.
2 Scotland Act 1998 (c 46), Pt IV (ss 73–80).
3 SA 1998, s 74(1), (2), (5) and Standing Orders, r 8.10.
4 SA 1998, s 76. An excellent example of the implications for devolved finance of United Kingdom tax policy is provided by the changes to the income tax structure made in the March 1999 Budget. This restructured tax bands, replacing the existing 20 per cent band (£0–£4,300 of taxable income) with a starting band of 10 per cent (£0–£1,500), with the net effect that the basic rate (23 per cent in 1999–2000) started at a taxable income of £1,500. The Treasury stated: 'Effects on the Scottish Parliament's tax varying powers — statement regarding Section 76 of the Scotland Act 1998: After the changes. . ., a one penny change in the Scottish variable rate in 2000–01 could then be worth approximately plus or minus £230 million, compared with plus or minus £180 million prior to these changes. In the Treasury's view, an amendment of the Scottish Parliament's tax-varying powers is not required as a result of these changes' (HM Treasury *Building a stronger economic future for Britain: Economic and fiscal strategy report and financial statement and budget report* (HC Paper 298 (1998–99)) (Stationery Office), p 99). These United Kingdom changes increased the potential yield of the tartan tax, yet arguably made it more difficult to levy because its starting point is now lower down the income scale. The Treasury estimate that a 1p change in 2002–03 would still be worth approximately £230 million, giving a potential variation of £690 million in either direction (HM Treasury *Budget 2002: The strength to make long-term decisions: Investing in an enterprising, fairer Britain* (HC Paper 592 (2001–02)) (Stationery Office), p 159).
5 SA 1998, s 77.

6 SA 1998, s 78.
7 SA 1998, s 80. Although this does not require the reimbursement of such expense, it must be assumed that a charge would be made. The financial memorandum for the Scotland Bill stated that the cost of establishing the administrative machinery would be £10 million, with annual running costs of £8 million, plus set up costs of £6 million (and running costs of £1 million a year) for the (then) Department of Social Security.

539. Allocating expenditure. In the United Kingdom, public expenditure allocation[1] is essentially an Executive-controlled process. In Scotland, while the process is Executive-led, there is more of a role for the Parliament in the early stages. There appears, however, to be an emerging consensus that this system, though preferable to that at Westminster, has not worked as well as expected and will be reviewed.

There are essentially three stages, which are set out in a written agreement between the Scottish Ministers and the Finance Committee of the Parliament[2]. At stage 1, the Scottish Executive is obliged to let the Parliament have, by 31 March each year (or the first day thereafter on which Parliament sits), a provisional expenditure plan for those years[3] for which expenditure figures are available[4]. The Parliament is then able to undertake public consultation if it wishes, though in practice the Executive has carried out its own consultation. Should it undertake public consultation, the Executive must report the responses to the Parliament[5].

At stage 2, the Executive must publish, by 20 September each year[6], its detailed spending proposals for the year ahead in draft[7]. Before it does so it must give an indication of whether it intends bringing forward a motion in due course to vary the basic rate of income tax[8]. The Finance Committee will then prepare, in consultation with other committees, a report on the Executive's proposals, which may put forward an alternative set of proposals, but which may not propose varying the total. This is followed by a plenary debate. Again, neither the motion for the debate nor any amendment may propose a different total, but it may, of course, propose alternative allocation of the total proposed by the Executive[9]. The Standing Orders of the Parliament require the Bureau[10] to set aside sufficient time for these procedures during October and November each year[11].

Stage 3 of the agreed process is the Parliamentary consideration of the annual Budget Bill, a topic examined in the following paragraph.

As well as dealing with the expenditure of the Executive and its satellites, the procedures have to make provision for the expenditure of the Parliament itself[12] and for the audit service[13].

Little has been published, as yet, about the internal procedures within the Executive for determining the allocations at the draft stage or the final proposals following the Finance Committee's recommendations. The Executive has, so far, sought public comment before producing a draft budget and presumably takes some account of the results. But the details of the weight given to this factor and of the internal negotiations have not been made public. No doubt there is considerable horse-trading between individual ministers and departments and the central finance function, and some ministerial means of resolving disputes.

The practice, thus far, has been for subject committees to scrutinise the spending plans for the relevant department at both stage 1 and stage 2. The extent to which they do so varies by committee, reflecting in part other demands on the committees' time.

1 See paras 507 and 508 above.
2 Finance Committee *Agreement on the Budgeting Process* (SP Paper 155) (Session 1, 2000), Pt I.
3 This will depend on the number of forward years still covered by the latest Spending Review carried out at United Kingdom level, since it is the results of these reviews that determine the additional amount available under the Barnett formula.
4 In practice this is set out in the Scottish Executive's Annual Expenditure Report.
5 SP Paper 155, Pt I, para 4.
6 This date may be varied by agreement if it clashes with the completion of a United Kingdom Spending Review: SP Paper 155, Pt I, para 7; this happened in 2002.
7 In 2001 this was done in a document entitled *Finance Committee 13th Report 2001: Report on Stage 2 of the 2002/03 Budget Process* vols 1 and 2 (SP Paper 468). The document also contained preliminary spending plans for 2003–04.
8 See para 538 above.
9 SP Paper 155, Pt I, paras 9–10.
10 The Bureau is the body set up by the Standing Orders, r 5.1 to, *inter alia*, propose the business programme of the Parliament.
11 Standing Orders, r 5.8, para 1(b).
12 See para 546 below.
13 See para 543 below.

540. Authorisation of expenditure. Except for that expenditure statutorily 'charged' on the Scottish Consolidated Fund by any enactment, expenditure can only take place if it is authorised by the Scottish Parliament. The use of resources by any body whose expenditure is payable out of the Fund must be authorised in a Budget Act[1].

There is an annual Budget Act, with the Bill proposing it (the Budget Bill)[2] presented by 20 January each year[3], and the Bureau must set aside sufficient time in January and February for its consideration[4]. Budget Bills are subject to special procedures: only the Executive may submit them; only the Executive may propose amendments; the Bill goes straight to the plenary stage of Stage 1; and Stage 3 must begin between twenty and thirty days from introduction[5].

When presenting a Budget Bill the Executive must provide a report setting out its response to the proposals made by the Parliament at the second stage of the budgeting process, as well as changes since the draft budget necessitated by changes in the overall allocation from the United Kingdom government[6]. The Executive will have to exercise fine judgment as to the extent to which it can ignore the Parliament's own proposals. While the Bill is unamendable (except on an Executive motion)[7], the Parliament could, however, decline to pass it. That would clearly be a serious, perhaps even a confidence, matter. Should a Budget Act not be in place at the beginning of a financial year for any reason, expenditure can continue for previously approved purposes up to the same rate as in the previous year[8].

To date, each Budget Act has contained provision for the amendment of some of the detail by statutory instrument, subject to affirmative approval of the Parliament[9]. This allows amendments to be made during the year without the need for a further Budget Bill. In addition, the Scottish Ministers have a limited power to authorise urgent expenditure in the public interest in circumstances where it is impracticable to promote an amendment to the Budget Act[10]. If they do so, they must report the matter to the Parliament[11]. This procedure is the Scottish Parliament's counterpart to the use of the Contingencies Fund[12] in the Westminster Parliament.

1 Public Finance and Accountability (Scotland) Act 2000 (asp 1), s 1(1).
2 See also para 376 above.

3 Finance Committee *Agreement on the Budgeting Process* (SP Paper 155) (Session 1, 2000), Pt I, para 11.
4 Standing Orders, r 5.8.1(c).
5 Standing Orders, rr 9.16.2 to 9.16.6.
6 SP Paper 155, Pt I, para 12.
7 'Amendments to a Budget Bill may be moved, and notice of amendments to such a Bill may be given, only by a member of the Scottish Executive or a junior Scottish Minister': Standing Orders, r 9.16.6.
8 PFA(S)A 2000, s 2.
9 See eg the Budget (Scotland) Act 2001 (asp 4), s 7.
10 PFA(S)A 2000, s 3.
11 PFA(S)A 2000, s 3(5) requires the report to be made as soon as possible after authorisation. SP Paper 155, Pt III, para 8 suggests that, if possible, a report be made fourteen days before any expenditure actually takes place.
12 See para 510 above.

541. Control of public expenditure. No sums may be paid out of the Scottish Consolidated Fund without the prior granting of a 'credit' by the Auditor General for Scotland[1]. This is a fairly light form of prior audit, in that the Auditor General does not vet individual payments by the Scottish Ministers and other persons receiving money from the Fund. Instead he grants block credits from time to time to the Scottish Ministers who then make issues out of the Fund to the various recipients, including themselves.

The main responsibility for ensuring adequate control is given to Accountable Officers. The Permanent Secretary of the Scottish Executive is statutorily appointed Principal Accountable Officer for the Scottish Administration[2]. He, in turn, appoints Accountable Officers for other parts of the Scottish Administration and for other bodies whose accounts are under the control of the Auditor General for Scotland[3]. Typically, these will be the heads of the departments of the Administration[4] and the chief executives of Executive agencies, health service bodies and non-Executive Non-Departmental Public Bodies. These officials are directly responsible to the Parliament in respect of their duties as Accountable Officers[5].

The Principal Accountable Officer determines their duties, and in practice Accountable Officers are put under a duty to ensure both propriety and regularity, and also economy, efficiency and effectiveness in the use of the resources under their control. If an Accountable Officer considers that any action, which is required by the minister (or other person or persons in charge of the department or body), is inconsistent with these duties he must seek a written instruction to take the action and report the matter to the Auditor General for Scotland[6].

Accountable Officers within the Executive are assisted by the Principal Finance Officer and his staff. That official is given, by the Permanent Secretary, a specific role to ensure that there are adequate systems for handling public money, including the prior examination of spending proposals to ensure propriety, regularity and Value For Money, budgetary controls, approval procedures, monitoring and the evaluation of results. The Executive also has an internal audit capability.

1 Public Finance and Accountability (Scotland) Act 2000 (asp 1), s 5.
2 PFA(S)A 2000, s 14(1). PFA(S)A 2000, s 16(1) appoints the Clerk of the Parliament as the Principal Accountable Officer for the Scottish Parliamentary Corporate Body; and s 17(1) requires the Scottish Commission for Public Audit to appoint an Accountable Officer (who may, but need not, be the Auditor General for Scotland) for Audit Scotland.

3 PFA(S)A 2000, s 15(1)–(4).
4 In Scotland, non-ministerial office-holders, such as the Registrar General for Scotland, are not appointed as Accountable Officers, even though they are effectively the heads of their departments. Instead, other officials, such as the director of finance, will be appointed. This differs from United Kingdom practice: eg the Director General of Water Services is Accounting Officer for the Office of Water Services. Before devolution, the non-ministerial office-holders were their own Accounting Officers.
5 PFA(S)A 2000, s 15(6).
6 PFA(S)A 2000, s 15(6) and (8).

542. Scottish Consolidated Fund. The Scottish Consolidated Fund was established under the Scotland Act 1998[1] and is, in practice, simply a bank account that must be held with the Office of HM Paymaster General[2].

It has legislative significance in that the financial provisions for devolved government are built on its existence. The Scotland Act 1998[3] sets out the circumstances under which sums may be paid out of the Scottish Consolidated Fund. Apart from statutory charges[4], and other expenditure payable out of the Fund under that Act[5], sums cannot be paid except in accordance with rules made by or under an Act of the Scottish Parliament[6]. Such rules are contained in the Public Finance and Accountability (Scotland) Act 2000[7].

The significance of sums being statutorily charged on the Fund is that no further approval is necessary for the expenditure, and the Parliament cannot veto it. This procedure is only authorised in special circumstances, such as the salaries of the judiciary and certain payments to be made to the Secretary of State and the Board of Inland Revenue[8].

1 Scotland Act 1998 (c 46), s 64(1).
2 SA 1998, s 64(8). The Office of HM Paymaster General is a part of the Treasury which is responsible for holding the working balances of government departments and other public bodies in accounts at the Bank of England, with these balances being made available overnight to the National Loans Fund (see para 512 above) in order to minimise government borrowing costs.
3 SA 1998, s 65(1).
4 SA 1998, s 65(1)(a).
5 SA 1998, s 65(1)(b). See also s 119(6), (7).
6 SA 1998, s 65(1)(c).
7 Public Finance and Accountability (Scotland) Act 2000 (asp 1), ss 4–6.
8 These charges are imposed by SA 1998, eg ss 64(7), 66(2), 71(7), 78(1), 119(3). The Scottish Parliament has not legislated to authorise any further charges.

543. Accounts and audit. The Scottish Parliament has complete freedom to establish its own accounting and budgeting procedures. In practice, however, there are powerful forces towards uniformity with the United Kingdom government. First, there is the matter of external credibility, which urges compliance with generally accepted standards. Second, the expenditure consents received from the United Kingdom government in Spending Reviews[1] is on a Resource Accounting and Budgeting basis[2], and the Scottish Executive must be able to account to the Treasury on this basis.

With the agreement of the Audit and Finance Committees of the Scottish Parliament, Scottish Ministers have agreed to look to the Financial Reporting Advisory Board[3] as the source of independent advice on the technical rules of accounting (that is, application of all reporting standards and principles) and on minimum disclosure requirements. FRAB delivers this advice via its review of the Resource Accounting Manual[4], which is accepted as best practice. FRAB's advice will not extend to the format of accounts or to disclosures beyond the minimum requirements. Scottish representation on FRAB is one member nominated by the Scottish Ministers and one member nominated by the Auditor General for Scotland.

The Scottish Ministers, the Lord Advocate and every other person to whom sums are paid out of the Scottish Consolidated Fund must prepare accounts for each financial year[5]. The Scottish Ministers also have to prepare accounts for the Fund itself[6]. The form of the accounts, the content and layout must be as directed by the Scottish Ministers[7]. Their power of direction is not statutorily constrained; but they have agreed that, before they issue a direction, the substance will be agreed with the Parliament[8].

The arrangements for Departmental Resource Accounts (DRAs) in Scotland are quite complex[9]. There are two DRAs under the title 'Scottish Executive', the 'core accounts' and the 'consolidated accounts'. As from 2001–02, the core accounts include all departments within the departmental boundary of the Scottish Executive, treated as a stand-alone reporting entity. The consolidated accounts include the core departments of the Scottish Executive, as defined above, and the ten Executive agencies within the departmental boundary[10].

These accounts are to be sent to the Auditor General for Scotland for auditing[11]. The Auditor General for Scotland is an independent official, not subject to direction by either the Parliament or the Executive, appointed by Her Majesty on the nomination of the Parliament. He can only be removed from office following a division in the Scottish Parliament in which two-thirds of the members vote for dismissal[12]. The Auditor General may either audit the account himself or direct that it be audited by a suitably qualified person[13]. Audit services are provided by Audit Scotland[14] to the Auditor General for Scotland, as well as to the Accounts Commission for Scotland[15]. Audit Scotland both undertakes audits using its own staff and procures audit work from private sector concerns[16].

The auditor must report in some detail the extent to which expenditure has been properly incurred in accordance with the relevant statutes, and whether the accounts conform to any appropriate direction. The auditor sends his report to the Auditor General for Scotland[17] who may prepare a report of his own. The Auditor General must then send the account, the auditor's report and his own report to the Scottish Ministers in time for them both to lay these documents before the Scottish Parliament and to publish them within nine months of the end of the financial year[18].

The Auditor General for Scotland may also initiate examinations into the economy, efficiency and effectiveness with which bodies and office-holders have used their resources in discharging their functions[19]. These are commonly known as Value For Money (VFM) studies or performance audits. Again, he may undertake the study himself or direct that another person do so[20]. In practice, studies are undertaken by Audit Scotland, or contracted out by them. Studies may be into: departments of the Executive; other bodies whose accounts are audited under the control of the Auditor General for Scotland; bodies which agree; and bodies specified by the Scottish Ministers by order. They may specify bodies that receive from public funds more than a quarter of their income or £0.5 million a year, whichever is the lesser[21]. The examiner[22] must report the results to the Auditor General who may, but need not, report the results to the Parliament.

The Auditor General for Scotland, and any persons appointed by him for either audit or VFM studies, must be given access to all documents under the control of the body concerned, and be given such information and explanation as he may reasonably require. He may also require access to documents and information, and explanation from other persons, provided that such persons have been specified in an order made by the Scottish Ministers[23].

Audit Scotland is a direct recipient of spending authority and cash under Budget Acts. The audit of the accounts of the Scottish Ministers must always be funded in this way[24], thus ensuring that Audit Scotland is not dependent on the Executive for audit fees.

The Scottish Commission for Public Audit (SCPA)[25] examines proposals from Audit Scotland on its budget[26]. It also appoints an auditor for Audit Scotland (in practice a private firm) and may initiate VFM studies into that organisation[27].

Any account laid before the Parliament and any report of the Auditor General for Scotland will be considered by the Audit Committee. This is one of the 'mandatory' committees[28] and is always chaired by a member who does not belong to any political party taking part in a coalition forming the Executive[29]. The committee takes evidence from the relevant officials[30] before making reports to the Parliament. The Executive must respond to reports within two months.

In respect of Whole of Government Accounts[31], the Government Resources and Accounts Act 2000[32] provides that the Treasury may not designate a body as one for which information must be provided, if its activities relate entirely to Scotland. However, information for such purposes will be provided through the provisions in section 96 of the Scotland Act 1998[33]. This procedure channels such information through the Scottish Executive, rather than the Treasury dealing directly with Scottish bodies.

1 See paras 506 and 507 above.
2 See para 496 above.
3 See para 514 above.
4 HM Treasury *Resource Accounting Manual: 2001–02 Edition* (Stationery Office, 2001).
5 Public Finance and Accountability (Scotland) Act 2000 (asp 1), s 19(1). PFA(S)A 2000, s 19(3) also requires each holder of a non-ministerial office to prepare accounts if the Scottish Ministers so decide. Although some holders, eg the Registrar General, receive money directly from the Fund, and are therefore covered by s 19(1) (see s 19(6)), the Keeper of the Registers of Scotland does not, but operates more or less as a Trading Fund (see s 9).
6 PFA(S)A 2000, s 19(2).
7 PFA(S)A 2000, s 19(4).
8 Audit Committee *Agreement on the Form of Accounts and Powers of Direction* (SP Paper 158) (Session 1, 2000) sets out the agreement between the Parliament and the Executive on the format of accounts and the use of the powers of direction.
9 See para 496 above for an exposition of Resource Accounting and Budgeting, and para 514 above for an explanation of the arrangements for DRAs for United Kingdom departments.
10 See para 548 below for a listing. Registers of Scotland, as the equivalent of a trading fund (see para 549 below) is not consolidated.
11 PFA(S)A 2000, s 19(7). Other accounts, eg those of health service bodies and certain Executive Non-Departmental Public Bodies, are also sent to the Auditor General for auditing. This is provided for in the legislation setting up or controlling the individual bodies. PFA(S)A 2000, Sch 4 amends pre-existing legislation to provide for this.
12 Scotland Act 1998 (c 46), s 69. Standing Orders, r 3.11 sets out the procedures to be followed on appointment; and r 3.12 those for dismissal.
13 PFA(S)A 2000, s 21(3).
14 PFA(S)A 2000, ss 10, 11, Sch 2.
15 See para 545 below.

16 In cases where the Auditor General for Scotland audits the account himself, the work will in practice be carried out by Audit Scotland either directly or through contracting out. The essential difference is that it is the Auditor General for Scotland who, personally, signs the audit certificate.
17 Unless, of course, the auditor is the Auditor General himself.
18 PFA(S)A 2000, s 22.
19 PFA(S)A 2000 s 23.
20 In this case there are no conditions on the qualifications of the person undertaking the study.
21 PFA(S)A 2000, s 24(2). At the time of writing no bodies had been specified. Before initiating VFM studies into Scottish Water, the Auditor General for Scotland must consult the Water Industry Commissioner (PFA(S)A 2000, s 23(7)).
22 This term is explicitly used in PFA(S)A 2000, ss 23, 24.
23 PFA(S)A 2000, s 23. At the time of writing there were no orders under s 23(5).
24 PFA(S)A 2000, s 11(1) allows Audit Scotland to levy charges for some of its activities. But these do not include the audit of accounts completed under s 19(1)–(3).
25 Established by PFA(S)A 2000, s 12(1). The Commission consists of five Parliamentarians, including the convener of the Audit Committee. Standing Orders, rr 3.13–3.15 provide for the appointment (by the Scottish Parliamentary Corporate Body with the approval of the Parliament), resignation and removal of the members.
26 Finance Committee *The Budgeting Process — Agreement between the Scottish Commission for Public Audit and the Finance Committee* (SP Paper 157) (Session 1, 2000) sets out the arrangements for the submission of the budget and its examination by the Finance Committee.
27 PFA(S)A 2000, s 25.
28 Standing Orders, r 6.1.5.
29 Standing Orders, r 6.7.
30 So far the officials examined have tended to include the relevant Accountable Officer even though the Financial Issues Advisory Group (see para 537 above) suggested that the committee should see the officials most directly concerned.
31 See para 517 above.
32 Government Resources and Accounts Act 2000 (c 20), s 10.
33 SA 1998, s 96.

544. Relationship of local government to the devolved financial system. The expenditure and financing of Scottish local government is outside the scope of this chapter, being covered by the Finance chapter of the Local Government title[1]. Nevertheless, a brief discussion of the relationship between the funding of the Scottish Parliament and the local government finance system is essential.

It is always hazardous making comparative judgments about the degree of financial autonomy enjoyed by sub-national governments in different countries. It is currently fashionable in Scotland to compare the financial autonomy of the Scottish Parliament adversely with that of the Autonomous Community of Catalonia in Spain. What such comparisons often ignore is that the Scottish Parliament has full legislative control over local government structure and the local authority financial system. Notwithstanding the obvious political constraints, the Scottish Parliament has the legislative power to abolish or reform either the council tax or the Non-Domestic Rate[2]. Importantly, it would be difficult for the United Kingdom government to bypass the Scottish Parliament by dealing directly with local authorities, as the Spanish government regularly does in Catalonia.

The Barnett formula system[3] relates to all devolved expenditure in Scotland, whether undertaken by the Scottish Executive itself, by its boards and agencies, or by separately elected local authorities. Central government support to local authorities counts as part of the Scottish budget. Aggregate External Finance (AEF)[4] consists of: Revenue Support Grant to local authorities, Police Grant and Other Specific Grants (all scored as Departmental

Expenditure Limit (DEL) within the Assigned Budget); and Non-Domestic Rate Income[5] (scored as Other Annually Managed Expenditure (AME)). These are large amounts, the total in 2000–01 (outturn cash) being £5,867 million. Local Authority Self-Financed Expenditure (LASFE)[6] in Scotland is classified as 'locally financed expenditure', and scored as Other AME[7].

Also scored as DEL within the Assigned Budget are net capital allocations, including those issued to local authorities under section 94 of the Local Government (Scotland) Act 1975[8]. The amount in 2000–01 (outturn cash) was £511 million. The alleged shortage of section 94 consents has been an important factor behind local authorities having recourse to the Private Finance Initiative[9] as a means of acquiring new capital assets, such as schools. The Scottish Executive has announced proposals, mirroring those for England, which would relax capital controls and substitute a system of prudential constraints. Presumably, a practical consequence would be that local authority capital expenditure would be removed from DEL and would become part of AME. Also, presumably, the Treasury would be able to make deductions from the Assigned Budget should there be excessive growth in local authority capital expenditure, in parallel with the existing provision with respect to excessive growth in Scottish LASFE[10].

There are three main elements: Revenue Support Grants; redistribution of Non-Domestic Rates; and specific grants. Revenue Support Grants are simply that — grants in support of local revenue. They are not hypothecated to specific services. Their amount is determined by the Scottish Ministers in orders[11] approved by the Scottish Parliament[12]. An innovation in 2000 was that indicative settlements for three years ahead are now announced after each Spending Review, though the formal orders are still taken one year at a time.

Non-Domestic Rates are effectively a national (at the Scottish level) tax[13]. Although these are collected by local authorities, the rate (which is the same for all local authority areas) is determined by the Scottish Ministers, to whom the proceeds are paid over[14]. Accordingly, the uniform rate in Scotland need not be the same as that in England[15]. The revenue is redistributed to local authorities on a basis determined by the Scottish Ministers: in practice that of population[16]. The distribution to individual authorities is set out in the Local Government Finance Orders[17].

Specific grants are for specific purposes authorised in legislation applicable to each grant. The most important is that for police.

The sum of Revenue Support Grant, Non-Domestic Rates and current specific grants is known as AEF[18]. The distribution mechanism works on AEF, not the individual elements. Thus estimates are made of the Non-Domestic Rate redistribution and specific grants for each authority, and the balance paid as Revenue Support Grant. The system of distribution of AEF[19] attempts to take account of the varying relative need of each authority by taking into account differing levels of 'client groups', for example school pupils and the elderly.

1 See LOCAL GOVERNMENT (Reissue) paras 421 ff.
2 See LOCAL GOVERNMENT (Reissue) paras 483–494 (on council tax) and 454–459 (Non-Domestic Rate Income).
3 See para 536 above.
4 See LOCAL GOVERNMENT (Reissue) para 448.
5 See LOCAL GOVERNMENT (Reissue) paras 454–459.

6 LASFE represents local government expenditure financed from local resources such as council tax, borrowing, trading surpluses, investment income and use of reserves (*Public Expenditure: Statistical Analyses (PESA) 2002–03* (Cm 5401) (2002), p 133).
7 This treatment would also apply to the proceeds, positive or negative, of the Scottish variable rate of income tax (see para 538 above).
8 See LOCAL GOVERNMENT (Reissue) paras 425–426.
9 See para 502 above.
10 See para 536 above.
11 See eg the Local Government Finance (Scotland) Order 2002, SSI 2002/70.
12 These Orders have to be specifically approved by the Parliament (affirmative resolution) in contrast with the more usual procedure whereby statutory instruments have effect unless the Parliament resolves otherwise (negative resolution).
13 However, the Scotland Act 1998 (c 46), Sch 5, Section A1 describes Non-Domestic Rates as a local tax. Presumably, this is to make it clear that they are exempted from the general reservation of taxation.
14 In practice, the tax is collected centrally by reducing the regular payments of Revenue Support Grant and Non-Domestic Rate redistribution by an estimate of the rates collected. There are arrangements to correct for actual collection experience.
15 The Scottish Non-Domestic Rate poundage was the same as that in England from 1995–96 until 1999–2000. Following the 2000 revaluations, the Scottish poundage was set above the English level in order to maintain the real-terms yield. Valuations in Scotland had increased by less than those in England (see D A Heald and A McLeod 'Fiscal autonomy under devolution: introduction to symposium' (2002) Scottish Affairs (Issue 41) 5).
16 Since the grant distribution system acts on AEF (see later in paragraph), the actual determinant of redistribution is largely immaterial.
17 See LOCAL GOVERNMENT (Reissue) para 521.
18 There are some minor current specific grants outside AEF. Generally these are where authorities receive grants, eg historic buildings grant, on the same basis as any other applicant.
19 See LOCAL GOVERNMENT (Reissue) para 448.

545. Local government finance. Individual local authorities[1] are responsible for setting their own budgets for current, sometimes called revenue, spending, both the totality of expenditure and the allocation amongst services. But they do so under a number of constraints. The most obvious of these is the availability of central government grant[2] and the effect of the planned expenditure on the council tax. Council tax is the only tax over which local authorities have any control, and they set the rate for their own particular area. They have some discretion in granting exemptions for charities, sports clubs and the like, but the other details of the tax regime (such as valuation, property affected and other exemptions and discounts) are determined statutorily.

In setting budgets, authorities must take into account not only taxpayer pressure on the level of council tax but also the guidance given by central government on tax increases. The Scottish Ministers have powers to reduce the level of council tax, and to reduce grant, in respect of individual authorities.

Local authorities can only undertake capital expenditure with the consent of the Scottish Ministers[3]. In practice, consents are generally issued in blocks rather than for individual projects. Local authorities may borrow to fund such expenditure. They may also borrow to fund emerging deficits on current expenditure[4] and to alleviate cash flow difficulties.

Local authority accounts are audited by auditors appointed by the Accounts Commission for Scotland[5]. These auditors may either be members of the staff of Audit Scotland or come from private firms of auditors. Audit Scotland provides other support for the Commission as well as direct audit services[6]. Audits are conducted under the direction of the Controller of

Audit, an official appointed by the Commission who, on appointment, becomes a member of the staff of Audit Scotland (unless he is the Auditor General for Scotland)[7].

1 An up-to-date exposition can be found in *CIPFA's Guide to Local Government Finance in Scotland* (CIPFA, Edinburgh, 2002).
2 See below.
3 Local Government (Scotland) Act 1973 (c 65), s 94. This section has been amended on numerous occasions by subsequent legislation. See LOCAL GOVERNMENT (Reissue) paras 506–519.
4 Although local authorities should not plan to incur either a surplus or a deficit on current expenditure, it is inevitable that one or the other will happen in practice.
5 LG(S)A 1973, s 97 (as amended, latterly by the Public Finance and Accountability (Scotland) Act 2000 (asp 1), Sch 4, para 3(3)); see LOCAL GOVERNMENT (Reissue) paras 506–519.
6 PFA(S)A 2000, s 10.
7 LG(S)A 1973, s 97(4AA) (added by PFA(S)A 2000, Sch 4, para 3(3)).

546. Funding of the Scottish Parliamentary Corporate Body. The budget procedures have to make provision for the expenditure of the Parliament itself[1] and for the audit service. While not particularly significant in total, these are a potential source of friction between the Parliament and the Executive since all expenditure on these items reduces, by a like amount, the total available for Executive expenditure. The Executive has agreed to put forward the allocations proposed by the Scottish Parliamentary Corporate Body (SPCB)[2] and by the Scottish Commission for Public Audit (SCPA). The Finance Committee has concluded agreements with both the SPCB[3] and the SCPA[4] for it to examine these proposals. Although the Executive is obliged to accept these figures for the purpose of putting detailed proposals to the Parliament, it could promote an amendment to the Budget Bill[5] to vary them. Similar to Westminster[6], where the Parliamentary institutions are included in the Appropriation Act, the Budget Act includes provision for the Parliament. In contrast to Westminster, the accompanying documents to the Budget Bill include provision for the Parliament and for Audit Scotland.

1 On such as members' salaries and allowances, the staff of the Parliament, and the provision and maintenance of premises, including the construction of the new Parliament building at Holyrood. On the subject of the latter, see Auditor General *The New Scottish Parliament Building: An examination of the management of the Holyrood project* (2000).
2 Finance Committee *Agreement on the Budgeting Process* (SP Paper 155) (Session 1, 2000), Pt I, para 14. The SPCB is a counterpart to the House of Commons Commission, and the SCPA is a counterpart to the Public Accounts Commission (see para 522 above). For a discussion of SPCB, see paras 333 and 352 above.
3 Finance Committee *The Budgeting Process — Agreement between the SPCB and the Finance Committee* (SP Paper 156) (Session 1, 2000).
4 Finance Committee *The Budgeting Process — Agreement between the Scottish Commission for Public Audit and the Finance Committee* (SP Paper 157) (Session 1, 2000).
5 See para 359 above.
6 See paras 508 and 509 above.

(5) ORGANISATIONS OUTSIDE CORE GOVERNMENT

547. Overview of section. This is organised as a separate section because the situations in the United Kingdom and in Scotland are broadly comparable. Moreover, there is a great deal of misunderstanding about the nature of organisations outside core government, and how they relate to public expenditure and to accounting and accountability requirements.

For example, the term 'quango' (Quasi Autonomous Non-Governmental Organisation)[1] is a label applied, often with pejorative overtones, to various units outside the core of ministerial departments, but which are, to varying extents, dependent upon public money. There is no generally accepted definition of what constitutes a quango. The term is not used officially[2], but commentators apply the term, with varying degrees of discrimination, to a wide range of organisations, both in the public and private sectors.

1 Their reports are usually laid before Parliament and published by the Stationery Office.
2 The term was used for a while by the Cabinet Office (www.cabinet-office.gov.uk), which maintained what it described as the 'Quango website'. This has now been changed to the 'Public Bodies' website.

548. General. In truth, there is a bewildering variety of organisations operating outside the core of ministerial departments. These have been established over a long period of time for a variety of purposes, the principal ones being: to carry out executive and certain regulatory functions at arm's length from ministers; to carry out judicial functions; and to provide expert advice to ministers. Given their diverse ages and purposes, the organisations vary widely in their forms of constitution.

The main such organisations are as follows: Executive agencies; Executive Non-Departmental Public Bodies (NDPBs); advisory NDPBs and tribunals; health service bodies; non-ministerial departments; public corporations; nationalised industries; and local public spending bodies. These organisations exhibit complex and varied relationships to public expenditure aggregates, sometimes provoking political argument about which expenditure is scored and which is not.

Executive agencies[1] are simply parts of government departments (or, confusingly, sometimes entire departments)[2]. They normally undertake executive functions where there is a strong argument for ministers being directly accountable to a Parliament, leaving the policy to the parent department (although some do have some responsibility for policy)[3]. Agencies are given a greater degree of operational freedom, agreeing a number of operational targets with the responsible minister annually. Chief executives have a right of access to ministers.

They derive their powers from those of the minister (or in some cases the official) in charge of the department. In the case of agencies of ministerial departments, their actions are those of the minister[4]. Although they have some of the appearance of independence, they have no real separate identity from that of their parent department.

Executive NDPBs[5] carry out executive and regulatory functions separately from ministers, usually either because they bring specialist expertise not available within government or because there is reason to distance ministers from the decision-making process. Constitutions vary widely: the most important tend to be incorporated by statute (and thus derive their powers from statute); but there are also companies, royal commissions, and bodies established by royal charter or warrant. These latter bodies derive their powers from their document of incorporation.

Advisory NDPBs do not have executive functions and exist to tender expert advice to ministers on a wide range of subjects; tribunals undertake quasi-judicial functions[6]. Advisory NDPBs may be established by statute, or they may simply be set up by ministers under the prerogative. Such bodies do not generally spend any money on their own account: their administrative requirements are often provided by the Scottish Ministers. They are not therefore considered further in this section.

National Health Service bodies are all statutory bodies. They are considered in greater depth elsewhere[7].

Non-ministerial departments[8] are departments of state[9]. They are not headed by ministers, but by a single official or Commission of some sort. Nowadays, their main rationale is that they carry out functions which are essentially governmental, but which should be undertaken independently of ministers. The privatisation of public utilities has led to the adoption of this form for the offices of utility regulators, for example the Office of Gas and Electricity Markets (OFGEM). However, some non-ministerial departments seem more of a leftover from former times[10].

Public corporations and nationalised industries are industrial or commercial enterprises under direct government control[11]. Most nationalised industries were privatised in the 1980s and 1990s, but some remnants remain[12].

'Local Public Spending Body' (LPSB) is a term invented in 1996 by the Committee on Standards in Public Life[13]. It defined LPSBs as 'not for profit bodies which are rarely elected and whose members are not appointed by ministers. They provide public services, often delivered at a local level, and are largely or wholly publicly funded'. These bodies are outside the definition of the Cabinet Office publication *Public Bodies*[14], but they are dependent on public money and often closely regulated by government. Examples are higher and further education institutions, local enterprise companies and registered social landlords (that is, housing associations). Certain LPSBs borrow money from the private sector on the security of their publicly funded assets[15].

Universities, further education colleges and local enterprise companies are not public bodies; they are part of the private sector. However, given their heavy dependence on public funds, they are sometimes treated as public bodies by some commentators.

In addition to these fairly formal arrangements, there are other advisory groups, task forces and similar organisations established by ministers, using prerogative powers, often for short periods. There are also many organisations, in the private and voluntary sectors, which depend to a great degree on funding from government or on government contracts.

Bodies may operate solely devolved functions, solely reserved functions or a mixture of both. They may operate only in Scotland, or across a wider area. Clearly, bodies with only devolved functions and operating only in Scotland will be the responsibility of the Scottish Parliament; and those with only reserved functions, no matter the geographical spread of their operations, will be the responsibility of the United Kingdom government.

Other bodies may, but need not necessarily, be designated 'cross-border public authorities'[16]. In that case, general responsibility remains with the United Kingdom government, but: the Scottish Ministers must be consulted on the appointment and removal of members and the exercise of ministerial functions relating to devolved matters; and any report laid before the United Kingdom Parliament must also be laid before the Scottish Parliament[17]. Further specific provisions, including the modification of those just mentioned, may be made for specific bodies[18].

Bodies operating only in Scotland with both devolved and reserved functions, and which have not been designated cross-border public authorities, are not reserved[19]. This means that the Scottish Parliament may legislate on the constitution of the bodies concerned, and may add or remove functions which are themselves devolved; but it may not make provision relating to reserved functions.

1 Executive agencies operating only in Scotland in 2002 were: Scottish Prison Service; Communities Scotland; Historic Scotland; National Archives of Scotland; Scottish Fisheries Protection Agency; Student Awards Agency for Scotland; Scottish Agricultural Science Agency; Registers of Scotland; Scottish Courts Service; Fisheries Research Service; Scottish Public Pensions Agency; and HM Inspectorate of Education. Ten of these are included in the consolidated account of the Scottish Executive (see para 543 above). The two exceptions are: Registers of Scotland, which operates on a similar basis to a Trading Fund (see para 549 below); and National Archives of Scotland, a non-ministerial department headed by the Keeper of the Records of Scotland. In addition, various United Kingdom Executive agencies, such as the Benefits Agency and Forest Enterprise, were also active in Scotland. Confusingly, the Scottish Environment Protection Agency (SEPA) is not an Executive agency, but an Executive NDPB.

2 Eg the Department of the Keeper of the Registers of Scotland operates as the Registers of Scotland Executive Agency.

3 Eg Historic Scotland remains responsible for advising ministers on aspects of policy on historic buildings and ancient monuments.

4 *Carltona Ltd v Comrs of Works* [1943] 2 All ER 560, CA. See para 230 above.

5 A full list of Executive NDPBs can be found in the annual Cabinet Office publication *Public Bodies*, available on the website (www.cabinet-office.gov.uk). The 2001 version was published in 2002 by the Stationery Office. The Scottish Executive has also published (1 July 2002) A *Guide to Public Bodies in Scotland*, on NDPBs, tribunals, public corporations, nationalised industries and National Health Service bodies operating in devolved areas, available on its website (www.scotland.gov.uk).

6 A full list of Advisory NDPBs and Tribunals can also be found in *Public Bodies* and *A Guide to Public Bodies in Scotland*.

7 As to health service bodies, see HEALTH SERVICES, vol 11, and the Updating Service.

8 Leaving aside the revenue departments, the main non-ministerial departments operating in Scotland in 2002 were: the Forestry Commissioners; the Food Standards Agency; the General Register Office (Scotland) (the department of the Registrar General of Births, Deaths and Marriages for Scotland); the National Archives for Scotland (the department of the Keeper of the Records of Scotland); and the Registers of Scotland Executive Agency. The utility regulators also headed non-ministerial departments. There were other non-ministerial officials (such as the Queen's and Lord Treasurer's Remembrancer) but none that had a readily identifiable separate department. See also para 232 above.

9 As departments of state and therefore firmly part of government, they clearly cannot be described as non-government organisations. That has not stopped commentators referring to them as quangos.

10 Dating from the aftermath of the 1914–18 war, the Forestry Commissioners appear to be an anomaly of this type. If such an activity were begun now, the policy functions would be undertaken by ministers and the executive functions would, if not privatised, be vested in a public corporation or an Executive NDPB, or perhaps undertaken by an Executive agency. The existence of two Executive agencies of the Commissioners (Forest Enterprise and Forest Research) lends force to this point. On the Forestry Commissioners, see also para 550 below.

11 The distinction between nationalised industries and public corporations is not clear; but it is maintained in *Public Bodies* and *A Guide to Public Bodies in Scotland*. Public corporations listed include the British Broadcasting Corporation, the Independent Television Commission, the Channel Four Television Corporation, Scottish Water, established by the Water Industry (Scotland) Act 2002 (asp 3), and Consignia Holdings plc, the former Post Office converted into a 100 per cent government-owned company on 26 March 2001, under the Postal Services

Act 2000 (c 26). In the 2001 edition, *Public Bodies* listed no Scottish nationalised industries. Previous editions had listed Caledonian MacBrayne Ltd (CalMac), Highlands and Islands Airports Ltd (HIAL), and Scottish Transport Group (STG). Curiously, the 2002 edition of *A Guide to Public Bodies in Scotland* listed CalMac, HIAL and STG as nationalised industries. Most nationalised industries were statutory corporations, established under specific Acts of Parliament, and treated as public corporations for public expenditure purposes. However, CalMac and HIAL are both companies whose entire share capital is owned by the Scottish Ministers.

12 Remaining nationalised industries include the British Waterways Board and various bodies (such as STG) still in the process of being wound up.

13 *Second Report of the Committee on Standards in Public Life* vol 1 ('The Nolan Committee') (Cm 3270-I) (1996).

14 Summary information on LPSBs is, however, given in the 2001 edition of *Public Bodies*.

15 Lord Sharman of Redlynch *Holding to Account: The Review of Audit and Accountability for Central Government* ('The Sharman Report') (HM Treasury, 2001), p 13.

16 By Order in Council under the Scotland Act 1998 (c 46), s 88.

17 SA 1998, s 88(1)–(3).

18 By Order in Council under SA 1998, s 89. The Scotland Act 1998 (Cross-Border Public Authorities) (Adaptation of Functions etc) Order 1999, SI 1999/1747, makes specific provision for each of thirty bodies.

19 SA 1998, Sch 5, Pt III, para 1. As well as various NDPBs, local authorities are, in fact, Scottish public authorities with mixed functions.

549. Funding. These non-core organisations are funded in a variety of ways depending on the type of body, its constitution and its own particular circumstances. It is difficult to generalise.

Non-ministerial departments normally receive their funding directly from the appropriate Parliament or Parliaments[1]. These funds are granted under the normal Supply arrangements of the appropriate Parliament and not channelled through ministers.

Such departments are normally subject to the usual arrangement whereby their receipts are to be paid into the Consolidated Fund (or Scottish Consolidated Fund) unless the respective Parliament agrees otherwise[2].

Sometimes they operate as Trading Funds[3] and are thus able to utilise their receipts without further authorisation[4]. Trading Funds are given a capital structure by the issue of Public Dividend Capital (PDC)[5], borrowing from the appropriate minister or the National Loans Fund[6], or both. They are expected to manage their affairs so that, taking one year with another, their expenditure is met by their income, and they may be given further financial targets[7]. In practice, they are expected to earn a standard rate of return on their net assets and to pay this into the Consolidated Fund through a combination of interest on loans and dividends on PDC.

Executive agencies receiving government funding do so through the normal Supply arrangements. This may be as part of the Parliamentary grant to their parent department or as a separate grant to the department for the specific purposes of the agency. Agencies will require Parliamentary authority, through the Supply procedure, for the use of any receipts, whether from trading, statutory fees or other sources, unless a particular agency is also operating as a Trading Fund[8].

Executive Non-Departmental Public Bodies (NDPBs) operate under a variety of funding arrangements[9]: their expenditure may be borne on the Parliamentary grant to ministers; they may receive a grant, or grant in aid[10], from ministers; they may have a more formal contractual arrangement providing specific services to ministers for payment; they may have authority to borrow money, either from ministers or on the market; they may have income from statutory fees or levies; they may trade more generally; or they may operate under a combination of two or more of these arrangements. The precise package for any particular body will be a function of the statutory provisions under which it operates and the less formal detailed management agreement it has with ministers.

Generally speaking, Advisory NDPBs do not spend any money. As a rule, the department to whom they give advice meets their administrative needs.

Health authorities (England and Wales) and health boards (Scotland) are funded directly by ministers. Trusts receive funding for current expenditure from boards, and they may also receive loans and issues of PDC from ministers.

Universities and other higher education institutions receive their main public funding[11] from the Scottish Higher Education Funding Council, and further education colleges from the Scottish Further Education Funding Council, themselves both Executive NDPBs. They may also, of course, have independent income from fees, endowments, research contracts and the like. Local enterprise companies operate under contract with Scottish Enterprise or Highlands and Islands Enterprise, again both Executive NDPBs.

1 The Forestry Commissioners, whose remit is restricted to Great Britain, receive funds from the United Kingdom and Scottish Parliaments, as well as from the National Assembly for Wales. The Food Standards Agency, established by the Food Standards Act 1999 (c 28) and with a remit including Northern Ireland, receives funds from both Parliaments and from both Assemblies.

2 This is normally achieved in the legislation setting up the department. Typically the United Kingdom legislation will contain a provision that sums received by the body are to be paid into the consolidated fund. Such provisions have no effect in the cases of departments set up before devolution and operating purely in devolved areas (Scotland Act 1998 (c 46), s 119). Similar arrangements are imposed in Scotland by making the relevant office-holder a member of the Scottish Administration (SA 1998, s 126(7), (8)), thus attracting the provisions of SA 1998, s 64(3), (4). It will be open to the Scottish Parliament to impose similar conditions (or not), should it ever legislate to set up more such bodies. There are specific provisions for the payment of appropriate receipts of the Forestry Commissioners and the Food Standards Agency into the Scottish Consolidated Fund (Forestry Act 1967 (c 10), s 27(4A) (added by the Scotland Act 1998 (Cross-Border Public Authorities) (Adaptation of Functions etc) Order 1999, SI 1999/1747, Sch 12) and Food Standards Act 1999 (c 28), s 39(5)).

3 Trading Funds are set up under the Government Trading Funds Act 1973 (c 63) (amended by the Government Trading Act 1990 (c 30)).

4 Before devolution, the department of the Keeper of the Registers of Scotland had operated since 1 April 1996 as a Trading Fund. The Government Trading Acts do not apply to devolved bodies and it no longer does so. The Public Finance and Accountability (Scotland) Act 2000 (asp 1), s 9 provides for substantially similar arrangements for the Keeper. There is no Scottish legislation allowing for the establishment of such arrangements in other cases by statutory instrument (as there is in the United Kingdom).

5 PDC can be likened to equity capital, though there are no shares. PDC is paid over by ministers to organisations (not all of which are non-ministerial departments or Trading Funds) authorised by statute to receive it. Ministers receive the necessary funds under normal Supply procedures. In the case of Trading Funds, some or all of the PDC in issue may have been deemed, rather than paid over in cash, in consideration of all or part of the pre-existing capital assets utilised by the Fund. Recipients of PDC are not normally expected to repay it while they remain in business, but they are expected to pay dividends.

6 The National Loans Fund was set up by the National Loans Act 1968 (c 13). See also para 512 above.

7 See GTFA 1973, s 4 (1)(a), (b) (amended by the Government Trading Act 1990, s 2(2), (5), Sch 2, Pt II).

8 As explained in note 4 above, the Keeper of the Registers of Scotland (whose department is also an Executive agency) operates under statutory arrangements substantially similar to that of a Trading Fund.

9 These funding arrangements, prior to devolution, are extensively discussed in D A Heald and N Geaughan *Accounting and Control in Executive Agencies and Executive NDPBs in Scotland*, ACCA Research Report No 68 (Certified Accountants Educational Trust, 2001) (available on www.accaglobal.com).

10 The technical difference between a grant and a grant in aid is that a grant in aid need not be refunded if it is not utilised. More generally, a grant is for a specific purpose, while a grant in aid is a more general subsidy (although the detailed management arrangements may allocate the grant in aid for different purposes and constrain the extent to which NDPBs may reallocate expenditure).

11 Scottish universities also compete with other United Kingdom higher education institutions and independent research organisations for project and programme funding from the United Kingdom Research Councils (such as the Economic and Social Research Council), which are funded from the United Kingdom Science Budget.

550. Accounts and audit. Generally speaking, the arrangements for the accounting of non-core organisations, and for the audit of these accounts, conform to the normal arrangements for bodies having a similar constitution. Thus, non-ministerial departments are subject to the same arrangements as ministerial departments[1]; and Executive Non-Departmental Public Bodies (NDPBs) that are companies have to account, and have these accounts audited, in accordance with the Companies Acts.

The Forestry Commissioners and the Food Standards Agency are special cases. They are granted money from the United Kingdom Parliament and the Scottish Parliament, as well as the National Assembly for Wales and, in the case of the Food Standards Agency, the Northern Ireland Assembly. They are both, in effect, departments of more than one government. Each must prepare separate accounts in relation to Scotland[2]. The 'Scottish' accounts of the Forestry Commissioners are audited by the Auditor General for Scotland or by persons appointed by him[3], and those of the Food Standards Agency by the Comptroller and Auditor General[4].

The accounting and audit arrangements[5] for bodies established by statute are set out in the statutes setting up the bodies. In the case of United Kingdom bodies there tend to be differences in the detail, partly due to changing drafting fashions over the years. However, there are major differences in the audit arrangements, with some bodies having their accounts audited by the Comptroller and Auditor General, and some by auditors appointed by the Secretary of State[6]. There are, however, standard auditing arrangements for devolved bodies in Scotland[7]. Under these arrangements, such bodies have their accounts audited under the control of the Auditor General for Scotland, including those that, prior to devolution, had Secretary of State audit appointments.

Caledonian MacBrayne Ltd and Highlands and Islands Airports Ltd are companies and as such their accounts are audited in accordance with the Companies Acts. The auditors are appointed by the members of the companies who happen to be, for the time being, the Scottish Ministers.

1 United Kingdom non-ministerial departments for which an Estimate is approved by the House of Commons must complete resource accounts under the Government Resources and Accounts Act 2000 (c 20), s 5. Others must prepare accounts, if required by the Treasury to do so, under GRAA 2000, s 7. The Accounting Officers of Trading Funds must prepare accounts under the Government Trading Funds Act 1973 (c 63), s 4(6A) (added by the Government Trading Act 1990 (c 30), s 2(2)(e)). All of these accounts must be audited by the Comptroller and Auditor General. Officials in charge of Scottish non-ministerial departments to whom sums are paid out of the Scottish Consolidated Fund must prepare accounts under the Public Finance and Accountability (Scotland) Act 2000 (asp 1), s 19(1); and holders of offices in the

Scottish Administration which are not ministerial offices must do under PFA(S)A 2000, s 19(3). These accounts must be sent to the Auditor General for Scotland for auditing: PFA(S)A 2000, s 19(7).

2 The Forestry Act 1967 (c 10), s 45(1) (substituted by the Scotland Act 1998 (Cross-Border Public Authorities) (Adaptation of Functions etc) Order 1999, SI 1999/1747, Sch 12, para 4(1), (36)) requires: the Commissioners to submit to the Scottish Ministers an annual report and accounts as to their proceedings as regards Scotland; and the Scottish Ministers to lay the report and accounts before the Scottish Parliament. The Food Standards Act 1999 (c 28), Sch 4, para 3(1) requires the Food Standards Agency to prepare separate accounts of its expenditure of sums paid out of the Scottish Consolidated Fund.

3 FoA 1967, s 45(2) (as so substituted).

4 FSA 1999, Sch 4, para 3(4)–(6).

5 The arrangements for accounting and audit, prior to devolution, are extensively discussed in D A Heald and N Geaughan *Accounting and Control in Executive Agencies and Executive NDPBs in Scotland* ACCA Research Report No 68 (Certified Accountants Educational Trust, 2001) (available electronically on www.accaglobal.com).

6 During the Parliamentary passage of the Government and Resources and Accounts Act 2000 (c 20), the then Chairman of the Public Accounts Committee (David Davis MP) stated: 'The audit arrangements for arm's length public bodies are currently arbitrary and illogical' (HC Official Report, SC A (Government Resources and Accounts Bill, Eighth Sitting), 20 January 2000, col 286). Some statutes establishing public bodies preclude the appointment of the Comptroller and Auditor General by imposing qualifications for auditors analogous to those in the Companies Act. In some other cases, the Secretary of State has the power to appoint auditors to bodies for which the Comptroller and Auditor General would be eligible, but in relation to which audit contracts have been let to private firms.

7 Scotland Act 1998 (c 46), s 120 changes references to the Comptroller and Auditor General in relation to Scottish functions to references to the Auditor General for Scotland. In addition, the Public Finance and Accountability (Scotland) Act 2000 (asp 1), Sch 4, amends individually the statutory provisions for devolved public bodies, including health service bodies but excluding the Scottish Transport Group and the Scottish Tourist Board, to the effect that their accounts have to be 'sent to the Auditor General for auditing', thus attracting the standard provisions (see para 543 above) set out in PFA(S)A 2000, ss 21, 22. The intention must be that any future bodies set up by legislation of the Scottish Parliament will be treated in like manner. The omission of the Scottish Tourist Board (now styled visitscotland) is believed to be due to an oversight. Since, however, prior to devolution, the Board had its accounts audited by the Comptroller and Auditor General, the provisions of SA 1998, s 120, together with PFA(S)A 2000, s 21(1) ensure that the standard provisions apply.

(6) LIST OF ABBREVIATIONS

551. Abbreviations. The following is a list of abbreviations used in this chapter.

AEF	Aggregate External Finance
AME	Annually Managed Expenditure
ASB	Accounting Standards Board
CAP	Common Agricultural Policy
CSR	Comprehensive Spending Review
DEL	Departmental Expenditure Limit
DRA	Departmental Resource Account
EC	European Communities
ERDF	European Regional Development Fund
ESA	European System of Accounts
ESF	European Social Fund
EU	European Union

EYF	End-Year Flexibility
FRAB	Financial Reporting Advisory Board
FRS	Financial Reporting Standard
GAAP	Generally Accepted Accounting Practice
GDP	Gross Domestic Product
GERS	Government Expenditure and Revenue in Scotland
GGBR	General Government Borrowing Requirement
GGE	General Government Expenditure
GGR	General Government Receipts
IMF	International Monetary Fund
LASFE	Local Authority Self-Financed Expenditure
LPSB	Local Public Spending Body
NAO	National Audit Office
NDPB	Non-Departmental Public Body
NHS	National Health Service
OECD	Organisation for Economic Cooperation and Development
ONS	Office for National Statistics
PCMOB	Public Corporations' Market and Overseas Borrowing
PDC	Public Dividend Capital
PES	Public Expenditure Survey
PESA	Public Expenditure: Statistical Analyses
PESC	Public Expenditure Survey Committee
PFI	Private Finance Initiative
PPP	Public-Private Partnership
PSA	Public Service Agreement
PSBR	Public Sector Borrowing Requirement
PSNB	Public Sector Net Borrowing
PSNCR	Public Sector Net Cash Requirement
RAB	Resource Accounting and Budgeting
RAM	Resource Accounting Manual
RfR	Request for Resources
ROSCs	Reports on the Observance of Standards and Codes
SCPA	Scottish Commission for Public Audit
SPCB	Scottish Parliamentary Corporate Body
SR	Spending Review
TES	Total Expenditure on Services
TME	Total Managed Expenditure
VFM	Value For Money