



House of Commons
Treasury Committee

The 2006 Budget

Fourth Report of Session 2005–06

Volume II



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Oral and written evidence

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9. CONCLUDING COMMENT: UK COMPETITIVENESS

It is pleasing to see that the Chancellor has listened to calls that we and many others have been making for action to be taken to ensure that the UK's tax system remains competitive. Our perception is that the UK has been slipping down the tax competitiveness league and, while this Budget does not contain any major steps to change things, the establishment of the panel of advisers is an important signal that we are going to move in the right direction, as is the Chancellor's statement that he intends to continue his dialogue with business.

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26 March 2006

Memorandum submitted by Professor David Heald

BUDGET 2006: THE PUBLIC EXPENDITURE DIMENSION

INTRODUCTION

1. The weight of Budget and associated documents has become disconnected from the significance and relevance of their contents. Notwithstanding the Parliamentary theatre and media attention, the *Pre-Budget Report 2005* (Treasury 2005) was more important than *Budget 2006* (Treasury 2006a). The pre-written verbiage of parts of the current Red Book, which overwhelms in volume but not in informativeness, stands in contrast with both older Red Books that were thin technical documents and the excellence of the annual *Public Expenditure: Statistical Analyses*. The weight of Budget documents is used as a technique of Executive dominance, as the shortness of media attention means that most coverage focuses on what the Treasury puts out on Budget day. By the time clarification is secured regarding missing information, attention has moved on. This effect is certainly not accidental.
2. Reading the Budget documents creates an odd sensation. Some of the content (eg in Chapters 2 and 6) is detached from reality:
 - The rhetoric of “transformation”, “reform”, “investment”, “transparency”, “devolution”, “prudent”, “cautious”, “audited” and “world class” is so indulgent and self-congratulatory that one wonders if some drafters inside the Treasury are parodying ministers.
 - Changes that are presented as devolving and decentralising are in reality concentrating power at the core of central government, weakening departments and other public organisations and creating system fragility.
 - Notwithstanding political and media debate focusing on pensions' sustainability, wage pressures in the public sector and the financial implosion of parts of the National Health Service in England, there is no discussion of how these pressures will be handled during the step decrease in public expenditure growth rates. This reduces the credibility of fiscal forecasts and projections which show the two fiscal rules just being met.
 - Whatever the considerable merits of the fiscal rules, their credibility is stretched to breaking point if one poses the question: “How would the Treasury present a breach in the fiscal rules?”. The fact that this could not happen without a change in political control, whether party or personal, should be a cause of great concern to Parliament. This indicates dangerous territory, in which classification and financial reporting may be distorted both by control systems and by presentational imperatives.
3. There is nothing new or wrong about “advocacy”, and one should expect all governments to engage in this. However, there need to be limits. I do not subscribe to the view that the large increases in public expenditure in recent years have been wasted, but I am very alarmed by the propagandizing nature of current Budget documents. I am also reminded of Michael Power's observation about potential differences between presentation and reality in the “audit society”: [the person in a public organisation being audited] “hears the rhetoric of excellence in official documents but lives a reality of decline” (Power, 2003, pp 199–200).
4. This memorandum illustrates these concerns by concentrating on two issues:
 - The lead-up to Comprehensive Spending Review 2007.
 - Failures against the Treasury's own test of transparency, which is one of the five principles of the statutory Code for Fiscal Stability.

PRE-VIEWING COMPREHENSIVE SPENDING REVIEW 2007

5. Under the post-1998 public expenditure framework, the Budget in an even-numbered year normally sets the spending envelope for the two "new years" of that year's July Spending Review. Departing from this practice, Spending Review 2006 has been cancelled, replaced by Comprehensive Spending Review 2007 and a review of long-term issues in 2006. More details of how this will work have been provided in Budget 2006, but these in turn raise a new set of questions.

6. If there is going to be in 2006 "a national debate on the future priorities for public spending and public services, to inform the CSR" (Treasury, 2006a, Box 6.1 on page 131), then a number of questions arise:

- Will the 2006 report on long-term issues be published in July 2006, just before Parliament's summer recess? (This would seriously inhibit timely work by select committees.)
- Will a public consultation at a time of slowing public expenditure growth not lead to clamours for more expenditure? (If so, it would have been better to set the spending envelope for 2008–09 to 2010–11 before the consultation started.)
- What is the logic of the early CSR2007 settlements (Treasury, 2006a, p 127)? (Public priorities might be for more effective, less fraud-prone but more costly DWP administration and/or more Home Office²⁷ expenditure on police and prisons.)

7. Chart 2.4 of the Budget Report (Treasury, 2006a, p 34), headed "Meeting the golden rule", shows that the margins for this economic cycle are very tight: "... there is a margin against the golden rule of £16 billion in this cycle, including the AME margin, the same as at the 2005 Pre-Budget Report" (Treasury, 2006a, para 2.58 on page 34).²⁸ Notwithstanding the frequent use of "cautious" in relation to the fiscal forecasts, Chart 2.8 of the Budget Report (Treasury, 2006a, p 39) shows that the golden rule would be breached in the present cycle on the 'cautious case' (which assumes trend output one percentage point lower in relation to actual output than the central case):

The Government is, on the basis of cautious, independently-audited assumptions, meeting the golden rule in the central case. In the cautious case, Chart 2.8 shows that the cyclically adjusted surplus will be in balance at the end of the projection period (Treasury, 2006a, para 2.74 on page 39).

It is necessary to go back to the Budget Report 2003 (Treasury 2003, para 2.69 on page 41) to find reference to the "stress test" of the golden rule, namely that the golden rule is also met on the cautious case. The adjective "cautious" now effectively relates to the claimed caution of "independently-audited assumptions". I have warned elsewhere (Heald and McLeod, 2002, para 505; Heald 2004, Ev 69) that auditing the Treasury's macroeconomic assumptions is a task that the National Audit Office should never have taken on. This relationship breaches a fundamental principle of auditing, namely that an auditor must have "investigatory freedom" (ie audit what it wants when it wants) as well as reporting freedom (Porter, Simon and Hatherly 2003, p 43). The former does not exist in this case and the expertise and resources available to the National Audit Office for this task do not match those of the Treasury.

FAILURES AGAINST THE FISCAL PRINCIPLE OF "TRANSPARENCY"

8. Transparency is not achieved by incantation, as in countless claims of "openness and transparency". Its achievement depends fundamentally on the structuring of communication in ways that help the user of government financial information. However highly the United Kingdom may score on IMF check lists of good fiscal transparency practices, defects in budgetary documents and the budgetary process heavily qualify those results. The key problems are overload (there is too much for users to absorb on short, sometimes artificially constructed, deadlines) and bias (uncomfortable facts are just disregarded and presentation is selective). There is not space in this memorandum to fully develop these points, but three substantive issues are now used as illustrations.

INFORMATION ON EFFICIENCY GAINS

9. There is a Government commitment "to continuing to report on progress against efficiency targets openly and transparently, including through Departments' Autumn Performance Reports and annual Departmental Reports" (Treasury, 2006a, para 6.14 on page 132). What is lacking in Chapter 6 is a summary table of efficiency gains to date, analysed by department and nature. Parliament, and the Treasury Committee in particular, need to be able to see the broad picture and how that evolves through time.

10. There is also the question of the validation of efficiency gains, an issue addressed in part by a recent report from the National Audit Office (2006). Given the lack of public trust in government information, this is an area requiring careful monitoring. Conceptually, it is difficult to measure efficiency gains, not least because the inherent difficulties in measuring public service output mean that it is difficult to hold the quantity and quality of that output constant. This is necessary in order to distinguish between genuine efficiency gains and expenditure savings that lead to reductions in public output. There is an obvious danger that the political imperative to meet targets becomes the dominant objective, even at risk to service levels and quality. Moreover, the National Audit Office is itself in a difficult position. Given that its self-imposed performance target is to achieve £8 for the taxpayer for every £1 it spends,²⁹ the National Audit Office itself has an incentive to report savings and have these signed off by its audit clients.

ACCOUNTING FOR THE PRIVATE FINANCE INITIATIVE

11. There are two distinct issues concerning the Private Finance Initiative (PFI), namely: (a) whether PFI projects are value for money, and (b) whether they are accounted for on or off the public sector balance sheet. On Budget Day 2006, the Treasury published a new document on the PFI, entitled *PFI: Strengthening Long-Term Partnerships* (Treasury 2006b). This 121-page document concentrates on the value-for-money issue, but makes some misleading statements about accounting:

- decision to use PFI is taken on value for money grounds alone, but not at the expense of employees' terms and conditions. The accounting treatment of a PFI project is not relevant to this decision. Around half of PFI projects by value are reported on departmental balance sheets (Treasury, 2006b, p. 13, emphasis in original).

The accounting treatment of a PFI project on a departmental balance sheet, and its reflection as an asset in the national accounts, plays no part in the Government's decision about when to use PFI. That decision is based on value for money. Around 50% of PFI projects by capital value are reported on departmental balance sheets. The accounting treatment follows rules set and audited by a series of independent national and international organisations (Treasury, 2006b, para 2.27 on page 23).³⁰

2. There have been long disputes about PFI accounting, particularly about the criteria on which it should be decided whether a PFI-financed asset should be on or off the balance sheet of the public sector (for the history, see Heald 2003). Some of the present difficulties stem from tension between (a) *FRSSA* (published by the Accounting Standards Board) and (b) *Technical Note 1 (Revised)* published by the Treasury. Assets are more likely to be on the public sector balance sheet using *FRSSA*. In its annual reports, the Financial Reporting Advisory Board has repeatedly stressed its concerns about PFI accounting.

3. The current problems relate to:

- The widespread perception in public organisations that off-balance sheet PFI is often "the only show in town", with there being no public money for conventional procurement and no public expenditure cover for on-balance sheet PFI.³¹
- There is inconsistent treatment across the public sector, both across territorial jurisdictions and across functions.³²
- There is evidence that some assets are not on the balance sheet of either the public sector client or of the private sector operator, to an extent that goes beyond what might be expected from disagreements on marginal cases.
- There is a dangerous interplay between the market for advice on the accounting treatment of prospective PFI schemes (leading to shopping for advice) and the provision of auditing services.

It is disappointing that the Treasury has the resources to produce a long report on other aspects of PFI, but so neglects these fundamental accounting issues. This contrast is bound to fuel suspicion that the Treasury is content to let matters drift on, rather than take necessary steps that would be likely to reduce the reported level of government debt.

²⁹ Statement of National Audit Office Financial Impacts for 2004" in the 2005 Annual Report of the National Audit Office, pp 73-75). My personal view is that this target of £8 for £1 is undesirable and that the numbers are not credible as a result of savings.

³⁰ Although a breakdown by departments is not given, it seems likely that this percentage is heavily affected by the accounting treatment of the London Underground PPP.

NON-PUBLICATION OF THE 2004-05 WHOLE OF CENTRAL GOVERNMENT ACCOUNT

15. The Whole of Government Accounts project is a welcome Treasury initiative, first announced in 1998. The published timetable was for there to have been a published Whole of Central Government Account 2004-05, followed by a complete Whole of Government Account for 2006-07 (to be published in Spring 2008). Without public announcement, the Treasury decided not to publish the Whole of Central Government Account 2004-05, either on an audited or unaudited basis. The following exchange took place at the Public Accounts Commission (2006, p 28) meeting on 28 February 2006:

RICHARD BACON: Don't you think it damages public confidence when there is a series of delays? The complete Whole of Government Accounts . . . is scheduled to be prepared and audited for 2006-2007, which means that it will be ready at a politically sensitive time, in Spring 2008. Would you agree that not publishing the Whole of Central Government account for 2004-2005 gives a bad signal when fiscal transparency is a fundamental tenet of the Statutory Code for Fiscal Stability?

SIR JOHN BOURN: Having said that they would do it and then deciding not to do it certainly has the result that you say.

16. Strong support has been given by Parliament to the Treasury's Whole of Government Accounts project. It is important that, if the Treasury departs from the public timetable, there is a clear public statement of the reasons for delay. Otherwise, the suspicion will arise that the reason for non-publication is that the results make uncomfortable reading.

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27 March 2006

Memorandum submitted by the HCI Alliance

This response is on behalf of the HCI Alliance, an alliance of BT, Intel and Microsoft, which has been working with the government since mid 2003 on Home Computing Initiatives. The HCI Alliance is a representative body providing the neutral voice of the HCI industry, promoting the benefits of HCI in a non-partisan way and continuing to work with Government to iron out issues and challenges relating to HCI (for example salary sacrifice). It is not a regulatory or controlling body.