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The draft Code for Fiscal Stability

January 2010

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Note to the reader:

This is a draft updated Code for Fiscal Stability, in the light of the provisions in the Fiscal Responsibility Bill. A formal revised draft will be laid before Parliament following Royal Assent of the Bill.

THE CODE FOR FISCAL STABILITY

The Code for Fiscal Stability is laid before Parliament under section 155(1) of the Finance Act 1998.

PURPOSE OF THE CODE

1. The purpose of the Code is to:
 - a. improve the conduct of fiscal policy by specifying the key principles and objectives that shall guide the formulation of fiscal policy;
 - b. improve the implementation of fiscal policy by strengthening the reporting requirements incumbent on the Government; and
 - c. provide such information on the Government's fiscal plans as is required by the Fiscal Responsibility Act.
2. In this Code, except where the contrary is stated, fiscal policy includes debt management policy.

THE FISCAL FRAMEWORK

3. The Government's fiscal framework is underpinned by:
 - a. the key principles, as set out in Finance Act 1998, and in accordance with which the Government must conduct its fiscal policy;

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- b. the Government's fiscal policy objectives, as set out in the Code; and
 - c. legislative fiscal plans, as provided for by the Fiscal Responsibility Act.
4. The Code for Fiscal Stability describes each of these aspects in turn.

KEY PRINCIPLES OF FISCAL MANAGEMENT

5. The Government shall conduct its fiscal policy in accordance with the following key principles:
 - a. **transparency** in the setting of fiscal policy objectives, the implementation of fiscal policy and in the publication of the public accounts;
 - b. **stability** in the fiscal policy-making process and in the way fiscal policy impacts on the economy;
 - c. **responsibility** in the management of the public finances;
 - d. **fairness**, including between generations; and
 - e. **efficiency** in the design and implementation of fiscal policy and in managing both sides of the public sector balance sheet.
6. The principle of transparency means that the Government shall publish sufficient information to allow the public to scrutinise the conduct of fiscal policy and the state of the public finances, and shall not withhold information other than information that is exempt from disclosure under the Freedom of Information Act 2000.
7. The principle of stability means that, so far as reasonably practicable, the Government shall operate fiscal policy in a way that is predictable and consistent with the central economic objective of high and stable levels of growth and employment.

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8. The principle of responsibility means that the Government shall operate fiscal policy in a prudent way, and manage public assets, liabilities and fiscal risks with a view to ensuring that the fiscal position is sustainable over the long term.
9. The principle of fairness means that, so far as reasonably practicable, the Government shall seek to operate fiscal policy in a way that takes into account the financial effects on future generations, as well as its distributional impact on the current population.
10. The principle of efficiency means that the Government shall seek to ensure that it uses resources in ways that give value for money, that public assets are put to the best possible use and that surplus assets are disposed of. The Government shall also have regard to economic efficiency and compliance costs when forming taxation policy.

FISCAL AND DEBT MANAGEMENT OBJECTIVES

11. The Government's fiscal objectives are:
 - a. over the medium-term, to ensure sound public finances and that spending and taxation impact fairly within and between generations; and
 - b. over the short-term, to support monetary policy and, in particular, to allow the automatic stabilisers to help smooth the path of the economy.
12. These objectives accord with the principles stated in paragraph 5.
13. The Government's debt management objective is to minimise, over the long term, the costs of meeting the Government's financing needs while:
 - a. taking account of risk; and

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- b. seeking, so far as possible, to avoid conflict with monetary policy.

FISCAL PLANS

14. The Fiscal Responsibility Act requires that the Government must always have a duty or duties to secure sustainable public finances – a “fiscal plan”. The Treasury will formulate and implement fiscal policy to meet its fiscal plan. Fiscal plans are set out in the Act and secondary legislation made under it.
15. The Government’s fiscal plans must be consistent with the key principles and fiscal objectives set out above in paragraphs 5 to 13.
16. Section 5 of the Act provides that the Code must explain the meaning of key terms used to describe the Government’s first legislative fiscal plan (the Fiscal Consolidation Plan):
 - a. public sector net borrowing;
 - b. public sector net debt; and
 - c. gross domestic product and gross domestic product (centred on a date).
17. These terms are explained below.

Public sector net borrowing

18. “Public sector net borrowing” (PSNB) means the National Statistic produced by the Office for National Statistics (ONS). PSNB is defined as item B.9 (net lending/net borrowing) in the European System of Accounts 1995 (ESA95). It represents the difference between public sector receipts and expenditure, on an accrued basis, and is a key measure of the fiscal stance.
19. PSNB covers the central government, local authority and public corporation sub-sectors of the economy. The

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independent ONS determine which institutions and transactions are in the public sector.

20. The Treasury will use the ONS measure of net borrowing (PSNB ex) that excludes the temporary effects of financial interventions but accounts for any permanent costs to the taxpayer.

Public sector net debt

21. “Public sector net debt” (PSND) means the National Statistic produced by the Office for National Statistics. PSND is a measure of indebtedness defined as gross debt less liquid financial assets. It is a key indicator of fiscal sustainability.
22. Like PSNB, PSND covers the central government, local authority and public corporation sub-sectors of the economy. The independent ONS determine which institutions and transactions are in the public sector.
23. In addition, as for PSNB, the Treasury will use the ONS measure of net debt (PSND ex) that excludes the temporary effects of financial interventions but accounts for any permanent costs to the taxpayer.

Gross domestic product

24. UK Gross domestic product (GDP) is a measure of the total economic activity in the United Kingdom. It is a National Statistic produced quarterly by the Office for National Statistics.
25. Gross domestic product for the financial year is the measure used for assessing borrowing as a share of the economy (because borrowing is a flow concept, measured over the course of a period).
26. Gross domestic product centred at the end of the financial year is the measure used for assessing debt as a share of the economy (because debt is a stock concept, measured as at a particular point in time)

REPORTING ON FISCAL PLANS

27. Consistent with the principle of transparency, the Fiscal Responsibility Act requires the Treasury to report on:
 - a. the progress which has been made towards complying with its fiscal plan (“progress reports”); and
 - b. whether or not its fiscal plan has been complied with and, if not, why not (“compliance reports”).
28. The Fiscal Responsibility Act also permits the Code to make provision about the content and form of reports on progress and compliance in relation to fiscal plans.
29. The Act provides that reporting on fiscal plans shall be alongside Economic and Fiscal Strategy Reports and Pre-Budget Reports.
30. In making a progress report, the Treasury shall set out its assessment of whether the fiscal plan is due to be complied with. This assessment should be based on the Treasury’s fiscal projections, as described below.
31. In making a compliance report, the Treasury shall set out whether it appears to them at the time of the compliance report, that the fiscal plan has been complied with. This assessment shall be based on the outturn data available at the time.
32. If it appears to the Treasury that the plan has not been complied with, the Treasury shall:
 - a. provide an account of why compliance was not achieved; and
 - b. set out what it intends to do to remedy the situation.

ACCOUNTING PRACTICE

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33. The Government shall ensure that accounts are to be produced for the whole public sector (as provided for by the Government Resources and Accounts Act 2000). These accounts shall also be produced on a consolidated basis, consistent with the ONS definition of the public sector.
34. The Government shall, to the extent reasonably practicable, apply best practice accounting methods - as represented by Generally Accepted Accounting Practice in the United Kingdom, adapted as necessary for the public sector - in the production of its accounts. The Government shall continue to make use of Resource Accounting and Budgeting for planning and accounting for the costs of resources consumed by Government.

THE PRE-BUDGET REPORT

35. If, as is usual, there is only one Budget in a financial year, the Treasury shall publish a Pre-Budget Report (PBR) at least three months prior to it, unless this is the first Budget of the Parliament, in which case a PBR shall not be required. In addition, if there is more than one Budget in any financial year, only one PBR shall be required.
36. The PBR shall be consultative in nature, and shall include, so far as reasonably practicable, proposals for any significant changes in fiscal policy under consideration for introduction in the Budget. However, the PBR shall not be taken as an indication of all tax policy areas where the Government may choose to act. In particular, consultation may not be possible in areas which:
 - a. carry the risk of significant forestalling activity by existing or prospective taxpayers; or
 - b. could lead to significant temporary distortions in taxpayer and market behaviour, including disruption in financial markets.

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37. The PBR shall also include, either in the main document, or in a subsidiary document:
- a. a report on progress on and compliance with the Government's legislative fiscal plan (as required) in line with paragraphs 27 to 32;
 - b. An Economic and Fiscal Projection (as defined in paragraphs 42 to 47); and
 - c. An analysis of the impact of the economic cycle on the key fiscal aggregates, including estimates of the cyclically-adjusted position.

THE FINANCIAL STATEMENT AND BUDGET REPORT

38. The Treasury shall publish a Financial Statement and Budget Report (FSBR) at the time of the Budget. The FSBR shall provide, either in the main document or in a subsidiary document, as a minimum:
- a. an Economic and Fiscal Projection (as defined in paragraphs 42 to 47);
 - b. an explanation of significant fiscal policy measures introduced in the Budget; and
 - c. an explanation, where necessary, of how these policy measures restore the path of the public finances to a position consistent with:
 - i. the fiscal policy objectives (specified in paragraphs 11 to 13) and legislative fiscal plan in force at the time ; and
 - ii. the Government's European commitments, in particular the terms of the Stability and Growth Pact.

THE ECONOMIC AND FISCAL STRATEGY REPORT

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39. The Treasury shall publish an Economic and Fiscal Strategy Report (EFSR), usually at the time of the Budget. But if there is more than one Budget in any financial year, only one EFSR shall be required.
40. The EFSR shall include reports in relation to progress on and compliance with the Government's legislative fiscal plan in force at the time (as required). The reports shall be in line with paragraphs 27 to 32.
41. In addition, and within the context of the specified key principles of fiscal management, the EFSR, either in the main document or in a subsidiary document, shall:
- a. set out the Government's long-term economic and fiscal strategy, including any long-term objectives for the key fiscal aggregates;
 - b. assess both recent outcomes and the short-term economic and fiscal outlook contained in the FSBR against this longer-term strategy;
 - c. assess whether the short-term outlook and long-term strategy is consistent with the Government's European commitments, in particular, the terms of the Stability and Growth Pact;
 - d. present illustrative projections of the outlook for the key fiscal aggregates for a period not less than 10 years into the future, based on a range of plausible assumptions, so as to shed light on the inter generational impact and sustainability of fiscal policy; and
 - e. present an analysis of the impact of the economic cycle on the key fiscal aggregates, including estimates of the cyclically-adjusted position

ECONOMIC AND FISCAL PROJECTIONS

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42. Where a report published under this Code contains an Economic and Fiscal Projection, that report shall contain, as a minimum:
- a. the key assumptions, forecasts and conventions underpinning the projection, including those relating to world economic growth, the terms of trade, and trend output;
 - b. projections of:
 - i. GDP and its components;
 - ii. retail prices (including any measure of prices that is the formal inflation target of the Government); and
 - iii. the current account position of the balance of payments.
 - c. a statement of cash flows, reflecting projected cash flows for each financial year;
 - d. a statement outlining proceeds received from the sale of public assets;
 - e. any other such statements as are necessary to reflect fairly the projected financial performance of the Government; and
 - f. an analysis of the risks surrounding the economic and fiscal outlook, including Government decisions and other circumstances that have still to be quantified with certainty, other material contingent liabilities and an indication of past forecast errors for aggregates noted in paragraph 42(b) and for Public Sector Net Borrowing (PSNB).
43. The financial statements issued under paragraph 42 shall include projections of key fiscal aggregates, including: current spending and current revenue, the current balance, public sector net borrowing, the central government net cash requirement, general government net borrowing, general government gross debt, public sector net debt a measure of net

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wealth and public sector net investment. Where possible, the statements shall provide a breakdown of expenditure and revenue by sector and economic and/or functional category.

44. The financial statements shall also include any other such indicator as is required to judge achievement against the Government's fiscal policy objectives and rules and against the Government's European commitments, in particular the Stability and Growth Pact.
45. Every economic and fiscal projection contained in a report published under this Code shall be based, so far as reasonably practicable, on all announced Government decisions and all other circumstances that may have a material impact on the fiscal outlook. In particular:
 - a. where the fiscal impact of these decisions and circumstances can be quantified with reasonable accuracy by the day the projections are finalised, the impact should be included in the published projections; and
 - b. where the fiscal impact of these decisions and circumstances cannot be quantified with reasonable accuracy by the day the projections are finalised, these impacts should be noted as specific fiscal risks.
46. The projection horizon is to be a period of not less than two full financial years following the date of publication. For each of the statements, comparative figures for the key fiscal aggregates covering the previous two financial years are to be published.
47. The Treasury shall also provide an explanation of all significant accounting policies, including any changes from previous practice.

ROLE OF THE NATIONAL AUDIT OFFICE

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48. The Treasury shall invite the National Audit Office (NAO) to audit any changes to the key assumptions and conventions underlying the fiscal projections. The Comptroller and Auditor General shall ensure that any advice is communicated to the Treasury and laid before Parliament.

CONDUCT OF DEBT MANAGEMENT AND THE DEBT MANAGEMENT REPORT

49. The Government shall report, in a Debt Management Report, published alongside the Budget, on the structure of its borrowing, structure of the debt portfolio and the cost of the government debt, giving sufficient information to allow the public to scrutinise the conduct of its debt management policy. The Government's agents for implementing debt management policy, the Debt Management Office and National Savings & Investments, shall publish more detailed information in their own annual reports and accounts and / or other regular publications.
50. The Government shall set remits for its agents in the annual Debt Management Report. This report will include:
- a. forecast of the net funding through National Savings;
 - b. the overall size of the gilts issuance programme for the coming financial year;
 - c. the planned structure for debt issuance including the proportions of index-linked and conventional gilt issuance; and
 - d. a planned gilt auction calendar.
51. The remits shall be subject to revision or confirmation as the Government publishes subsequent fiscal projections.

REFERRAL TO TREASURY COMMITTEE

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52. The Treasury shall refer to the House of Commons Treasury Committee every report published as a requirement of both the Code and the Fiscal Responsibility Act.

DISCLOSURE OF OTHER INFORMATION

53. The Treasury shall publish, from time to time, other information that it determines would better enable the public to scrutinise fiscal policy and the state of the public finances.

PUBLICATION AND INSPECTION OF REPORTS

54. The Treasury shall, in respect of every report published as a requirement of the Code and the Fiscal Responsibility Act, arrange for the publication of a notice indicating:
- a. where copies of the report are available for inspection free of charge; and
 - b. where copies of the report are available for purchase.
55. The Treasury shall make available copies of each report for inspection or purchase for at least 6 months following publication. Copies of all reports shall also be made available on the Treasury's internet website.