



UNITED KINGDOM

FISCAL TRANSPARENCY EVALUATION

November 2016

This Fiscal Transparency Evaluation for the United Kingdom was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in September 2016.

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Brian Olden, Jason Harris, Miguel Alves, Alpa Shah, Timothy Irwin, and Sami Yläoutinen

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GLOSSARY

AME	Annually Managed Expenditures
BEIS	Department for Business, Energy and Industrial Strategy
COFOG	Classification of the Functions of Government
CSR	Comprehensive Spending Review
DECC	Department of Energy and Climate Change
DEL	Departmental Expenditure Limits
DRD	Decommissioning Relief Deed
DUD	Departmental Unallocated Provisions
EITI	Extractive Industry Transparency Initiative
ESA95	European System of Accounts
ESA TP	ESA Transmission Programme
ESS	European Statistical Service
EFO	Economic and Fiscal Outlook
FAD	Fiscal Affairs Department
FSCS	Financial Services Compensation Scheme
FTC	Fiscal Transparency Code
FTE	Fiscal Transparency Evaluation
FSR	Fiscal Sustainability Report
FY	Financial Year
GFSM	Government Finance Statistics Manual
GSS	Government Statistical Service
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
IFRS	International Financial Reporting Standards
MGDD	Manual on Government Deficit and Debt
NAO	National Audit Office
OBR	Office for Budget Responsibility
OGA	Oil and Gas Authority
ONS	Office for National Statistics
PC	Public Corporations
PESA	Public Expenditure Statistical Analysis
PFI	Private Finance Initiative
PF2	Private Finance 2
PPP	Public-Private Partnership
PRT	Petroleum Revenue Tax
PSF	Public Sector Finances Report
PSNB	Public Sector Net Borrowing
RFCT	Ring-Fence Corporation Tax
SC	Supplementary Charge
UKCS	United Kingdom Continental Shelf
UKSA	United Kingdom Statistics Authority
WGA	Whole of Government Accounts

PREFACE

In response to a request from the then Prime Minister, Mr. Cameron, a technical assistance mission visited London, United Kingdom twice between July and September 2016 to carry out a Fiscal Transparency Evaluation. The mission included Brian Olden (Head), Miguel Alves, Jason Harris, Alpa Shah, and Peter Mullins of the Fiscal Affairs Department and Tim Irwin, Sami Yläoutinen and Mathew Brine (experts on FAD's fiscal expert roster). Mr. Phil Gerson (EUR Deputy Director) also joined the concluding visit in September 2016.

The mission met with senior officials of Her Majesty's Treasury including: Sir Dave Ramsden, Chief Economic Advisor to the Government; Julian Kelly, Director General, Public Spending and Finance; James Bowler, Director General Tax and Welfare; Richard Hughes, Director of Fiscal Policy; Jane Cunliffe, Director of Public Spending; and Mike Williams, Director of Business & International Tax.

The mission also met with officials from the Departments of Energy and Climate Change, Business, Innovation and Skills, Communities and Local Government and Environment, Food and Rural Affairs. The mission also benefitted from discussions with representatives of other public entities including the Bank of England, the Scottish Government's Department of Finance, the Greater London Authority, the House of Commons Treasury and Public Accounts Select Committee, Her Majesty's Revenue & Customs, the Infrastructure and Projects Authority, the National Audit Office, the Office of Budget Responsibility, the Office of National Statistics, the Oil and Gas Authority, the UK Debt Management Office, and UK Government Investments. In addition, the mission met with the Institute of Fiscal Studies, representatives of the petroleum industry, academia and the UK Extractive Industry Transparency Initiative.

This evaluation is based on information available at the time it was completed in September 2016. The findings and recommendations represent the views and advice of the IMF mission team and do not necessarily reflect those of the UK government. Unless otherwise specified, the data included in the text, figures, and tables in the report are estimates made by the IMF mission team and not official estimates of the UK government. The mission would like to thank the UK authorities and other participants for their excellent collaboration in the conduct of this evaluation and for the frank and open exchanges of views on all matters discussed. Particular thanks go to Richard Hughes, Vincent Tang, Harry Lee, and Lorraine Best for their support to the mission before, during, and after their visits to London.

EXECUTIVE SUMMARY

This report assesses fiscal transparency practices in the United Kingdom (UK) in relation to the requirements of the IMF's new Fiscal Transparency Code (FTC). Across all pillars evaluated in the code, the UK scores very highly when compared to other countries that have, to date, undergone an assessment.¹ Based on the evaluation set out in this report, of the 48 principles in the Code, the UK meets 9 principles at the basic level, 10 principles at the good level, and an unprecedented 23 principles at the advanced level. Fiscal transparency practices are strongest in the area of fiscal reporting and resource revenue management, while, on a relative basis, the UK also scores strongly on fiscal risks. In four principles, the UK's transparency practices do not currently meet basic practice. To further improve the level of transparency of government operations, key areas to be addressed include:

- Reducing the lag between the end of the financial year and the publications of Whole of Government Accounts (WGA) to improve the quality of information available for policymaking;
- Concentrating all major tax and spending decisions into a single fiscal event held at least three months prior to the start of the fiscal year to allow time for greater scrutiny by the legislature;
- Introducing a new and transparent fiscal objective to better shape fiscal policy over the medium term;
- Introducing a comprehensive and quantified fiscal risk statement that includes all major risks to the fiscal position; and
- Publish an asset and liability management report discussing developments, forecasts, and risks to the government's balance sheet.

More broadly, in evaluating the four separate pillars of the code the report found that:

- **Fiscal reporting** covers the entire public sector and includes details of all stocks and flows. This places the UK at the forefront of fiscal reporting practices worldwide, as relatively few countries include the broader public sector within their reporting universe let alone provide full coverage of the public sector balance sheet. The long delay in the publication of end of year financial statements is one area of weakness, but efforts are underway to address this.
- **Fiscal forecasting and budgeting** are of high quality, with the macro-fiscal forecasts, providing credible, comprehensive and relatively easily understood picture of how future policy and fiscal developments will develop. Equally, a credible medium-term budget framework is in place, supported by clearly understandable and comprehensive budget

¹ Of these 48 principles, two of the Natural Resource Revenue Management principles do not apply to the UK as it does not have a Sovereign Wealth Fund.

documentation. However, there are a number of areas that could be improved. In particular, the existing convention-based budget process is largely uncodified, allows the budget to be presented just before the start of the financial year, forces Parliament to approve the budget well into the fiscal year to which it refers, and has seen the Autumn Statement become, in effect, a mini-budget which sometimes dwarf the Budget itself in fiscal significance. Frequent changes in fiscal policy objectives make it difficult for the general public to fully grasp details of the design and implementation of fiscal policy through the budget.

- **Fiscal risk** practices score well, when compared to other countries that have undertaken the assessment. Examples of advanced practice include the Office of Budget Responsibility's (OBR) reporting of risks related to the macro-economy and the long-term sustainability of public finances and the Treasury's and the Bank of England's reporting of risks related to the financial sector. However, the absence of summary reporting of specific risks is a weakness that should be addressed. Other areas that could be improved include reporting of risks related to government assets, and the setting of limits on the stock or flow of government guarantees and commitments and contingent liabilities incurred in public-private partnerships (PPPs), and other forms of off-balance-sheet financing.
- **Resource revenue management** is an area of diminishing importance, as reserves of oil and gas near exhaustion. The UK's resource revenue management practices are strong by international standards. The last three years have seen a move towards clearer allocation of regulatory responsibilities, simplification of the taxation system and increased disclosure by petroleum companies. However, future tax refund obligations need to be clearly and effectively managed. Resource revenue transparency could be improved by publishing government forecasts of future decommissioning related liabilities, and broadening newly implemented corporate disclosure requirements for the extractive sectors.

Based on this evaluation, this report provides twelve recommendations aimed at further enhancing fiscal transparency. Specifically, these are:

1.1. Enhance consistency between the Whole of Government Accounts (WGA) and the Public Sector Finances (PSF) by disclosing a trial, simplified consolidation of the financial statements of WGA and RBS in the annual report section of the WGA, expanding the coverage of stocks and flows of the PSF report, as well as adding to the PSF summary statements produced under statistical standards that are closer to International Financial Reporting Standards (IFRS).

1.2. Control tax expenditures by subjecting them to numerical limits and enhance reporting through the addition of a sectoral and functional breakdown in cost publications.

1.3. Bring forward the publication of the WGA to nine months after the end of the reference period.

2.1. Include own source revenue and related expenditures into the fiscal aggregates to bring them to a gross basis.

2.2. Concentrate major tax and spending decisions into a single fiscal event held at least three months prior to the fiscal year, presenting the estimates simultaneously, allowing parliament to approve a unified budget at least one month before the beginning of the fiscal year.

2.3. Adopt new fiscal objectives as a matter of priority in order to frame decision making around the upcoming autumn statement.

2.4. Improve linkages between budget expenditure and intended policy outcomes.

3.1. Publish a comprehensive fiscal risk report combining the analysis of macroeconomic risks, the modelling of the fiscal impact of severe shocks, and a discussion of the magnitude and likelihood of specific fiscal risks.

3.2. Strengthen controls over off-balance-sheet commitments created by guarantees, public-private partnerships, and similar instruments.

3.3. Publish an annual report on the evolution and management of risks related to the government's financial assets and liabilities.

4.1. Publish signed Decommissioning Relief Deeds (DRDs), or at least a list of companies with whom DRDs have been signed, subject to obtaining each company's consent.

4.2. Continue with implementation of current corporate disclosure initiatives, and consider expanding reporting requirements to include payments to governments for the sale of commodities.

The remainder of this report provides a detailed evaluation of the UK's fiscal transparency practices against the standards of the FTC. It is organized as follows:

- Chapter I evaluates the coverage, timeliness, quality, and integrity of fiscal reporting;
- Chapter II evaluates the comprehensiveness, orderliness, policy orientation, and credibility of fiscal forecasting and budgeting;
- Chapter III evaluates arrangements for disclosure and management of fiscal risks; and
- Chapter IV evaluates arrangements for managing revenues from natural resources using a draft of the new Fourth Pillar of the FTC released in April 2016 for public consultation.

Table 0.1 represents a summary of the UK's performance against the FTC, while Table 0.2 presents a preliminary and partial estimate of the UK public sector financial overview for FY 2014/2015.

Table 0.1. United Kingdom: Summary Assessment Against Fiscal Transparency Code

I. Fiscal Reporting	II. Fiscal Forecasting & Budgeting	III. Fiscal Risk Analysis & Management	IV. Natural Resource Management
1.1. Coverage of Institutions	1.1. Budget Unity	1.1. Macroeconomic Risks	1.1. Legal Framework
1.2. Coverage of Stocks	1.2. Macroeconomic Forecasts	1.2. Specific Fiscal Risks	1.2. Fiscal Regime
1.3. Coverage of Flows	1.3. Medium-term Budget Framework	1.3. Long-term Fiscal Sustainability	2.1. Allocation of Rights
1.4. Coverage of Tax Expenditures	1.4. Investment Projects	2.1. Budgetary Contingencies	2.2. Disclosure of Holdings
2.1. Frequency of In-Year Reporting	2.1. Fiscal Legislation	2.2. Asset and Liability Management	2.3. Assessment & Collection of Revenue
2.2. Timeliness of Annual Accounts	2.2. Timeliness of Budget Documentation	2.3. Guarantees	2.4. Audit & Verification of Revenue
3.1. Classification	3.1. Fiscal Policy Objectives	2.4. Public-Private Partnerships	3.1 Reporting on Domestic Payments
3.2. Internal Consistency	3.2. Performance Information	2.5. Financial Sector	3.2. Reporting on Worldwide Payments
3.3. Historical Revisions	3.3. Public Participation	2.6. Natural Resources	3.3. Operational, Social & Env'tal Reporting
4.1. Statistical Integrity	4.1. Independent Evaluation	2.7. Environmental Risks	4.1. Budgeting of Resource Revenue
4.2. External Audit	4.2. Supplementary Budget	3.1. Subnational Governments	4.2. Resource Fund Operations & Oversight
4.3. Comparability of Fiscal Data	4.3 Forecast Reconciliation	3.2. Public Corporations	4.3. Resource Fund Investment Strategy

LEGEND	LEVEL OF PRACTICE				
	Not Met	Basic	Good	Advanced	Not Applicable

Table 0.2. United Kingdom: Public Sector Financial Overview, FY 2014/15
(Percent of GDP)

	General Government				Public corporations				Public Sector
	Central government	Local governments	Consolidation Gen. Govt.	Consolidated Gen. Govt.	Nonfinancial	Financial	Central bank	Consolidation Public Sector	
Transactions									
Revenue	35.2	10.9	-7.5	38.6	1.6	2.2	0.7	-2.0	41.1
Expenditure	42.7	11.5	-7.5	46.6	1.8	1.8	0.6	-2.0	48.8
Expense	42.0	11.2	-7.5	45.6	1.5	1.8	0.6	-2.0	47.5
Investment in NFA	0.7	0.3	0.0	1.0	0.3	0.0	0.0	0.0	1.3
Net operating balance	-6.7	-0.3	0.0	-7.0	0.2	0.5	0.1	0.0	-6.3
Net lending/borrowing	-7.4	-0.6	0.0	-8.0	-0.2	0.5	0.1	0.0	-7.7
Stocks									
Assets	54.4	28.6	-4.6	78.4	8.4	56.9	27.0	-30.3	140.5
Nonfinancial	27.8	18.2	0.0	46.1	7.2	0.3	0.0	0.0	53.6
Financial	26.5	10.4	-4.6	32.3	1.2	56.6	27.0	-30.3	86.9
Liabilities	176.6	24.0	-4.6	196.0	10.0	55.8	27.0	-30.3	258.6
Liabilities, other than equity	109.6	6.1	-4.6	111.1	5.8	54.1	26.8	-24.2	173.6
Pension entitlements (public employees)	66.9	17.9	0.0	84.8	0.1	0.0	0.0	0.0	84.9
Equity	0.0	0.0	0.0	0.0	4.2	1.7	0.2	-6.1	0.0
Net worth	-122.2	4.6	0.0	-117.5	-1.6	1.1	0.0	0.0	-118.1
Net financial worth	-150.0	-13.6	0.0	-163.6	-8.9	0.8	0.0	0.0	-171.7
Memorandum items:									
<i>NFW excl. Civil Servants' pension entitlements</i>	-83.1	4.3	0.0	-78.8	-8.8	0.8	0.0	0.0	-86.8
<i>Social Security pension entitlements</i>	209.8	0.0	0.0	209.8	0.0	0.0	0.0	0.0	209.8
<i>Net Worth Including All Pensions</i>	-332.0	4.6	0.0	-327.3	-1.6	1.1	0.0	0.0	-327.9

Source: IMF staff estimates, based on data publically available.

Note: Social Security pension entitlements refer to end-December 2010, the latest data point for which this information is available in the public domain (estimates included in the ONS article "[Pensions in the National Accounts – A fuller picture of the UK's funded and unfunded pension obligations.](#)")

I. FISCAL REPORTING

1. Fiscal reports should provide a comprehensive, timely, reliable, comparable, and accessible summary of the government's financial performance, financial position, and cash flows. This chapter assesses the quality of UK's fiscal reporting practices against the standards set by the IMF's Fiscal Transparency Code for the following dimensions:

- Coverage of public sector institutions, stocks, and flows;
- Frequency and timeliness of reporting;
- Quality, accessibility, and comparability of fiscal reports; and
- Reliability and integrity of reported fiscal data.

2. Over the last two decades, the United Kingdom has witnessed substantial improvements in government accounting and fiscal statistics compilation. Since 1998, Her Majesty's Treasury (HMT) has adopted national accounts standards, as established under the European System of Accounts (first ESA95, and currently ESA 2010) and its Manual on Government Deficit and Debt (MGDD), as the basis for the UK's fiscal framework, covering all public sector units. In addition, since commencement of publication of the WGA in financial year (FY) 2009/10, the financial statements of the consolidated public sector are now compiled in accordance with IFRS.

3. While the UK authorities publish a large number of fiscal reports, the standards under which they are compiled are largely consistent. As a result of the developments in fiscal statistics and public accounting, all fiscal reports are compliant with the international statistical standards, with the exception of financial statements, which are IFRS-based, but also follow national accounts standards in determining the consolidation boundary and for segmental reporting. As ESA and IFRS are not entirely consistent, the UK's Financial Reporting Manual requires all departmental groups (and HMT, for the WGA) to reconcile their fiscal reports and financial statements, on an annual basis. The UK's main summary fiscal reports, presented in Table 1.1. comprise:

- **Monthly fiscal statistics**, including the ESA-compliant PSF, jointly compiled by the Office for National Statistics (ONS) and HMT, containing detailed information on the accrued revenue, expenditure, financing, net borrowing, as well as on the net cash requirement, and net debt, for the public sector and its subsectors. The OBR issues a commentary on each PSF release, providing a brief analysis of the outturn data and comparing it to the most recent OBR fiscal forecast;
- **Quarterly and annual debt management reports**, comprising the UK Debt Management Office reports on its gilt and money markets operations over the given period, which contain also breakdowns of the gilt and T-bill portfolio by maturity, type of interest rate, holder, as well as movements in gilt yields;

- **Monthly revenue collection reports**, including information on receipts (and analysis of collection trends) of tax and social security contributions collected by Her Majesty's Revenue and Customs (HMRC), broken down by type of tax;
- **Quarterly and annual fiscal statistics**, compiled by the ONS to comply with the data requirements of the "ESA Transmission Programme"² (ESA TP) and the Excessive Deficit Procedure (EDP); the data are reported on an accrual basis, for the general government and its subsectors, although the sectoral accounts also include data on the nonfinancial public corporations;
- **Annual tax relief reports**, containing HMRC's estimates for the costs of the tax expenditures and structural reliefs. Separate reports are prepared for main (those with estimated cost of GBP 50 million or higher) and minor schemes. The report also discloses a list of relief schemes for which there is insufficient data for compiling any reasonable estimate;
- **Annual analysis of public expenditure**, containing information compiled by the HMT about public spending, using both the budgeting framework (aggregates used by the government to plan and control expenditure, covering central government departmental budgets) and the expenditure on services framework (aggregates based on National Accounts definitions and covering the public sector, excluding public banking groups); and
- **Annual financial statements**, comprising of the WGA, which consolidates the financial statements of all departmental groups and all other material public sector entities responsible to an executive arm of the government (with the exception of the Royal Bank of Scotland (RBS) Group, as there is an expectation that public ownership will be of a temporary nature).

² This document presents the requirements for national accounts data delivery within the framework of the implementation of ESA 2010. Its implementation started in September 2014.

Table 1.1. United Kingdom: List of Fiscal Reports

REPORT	Agency	COVERAGE			ACCOUNTING		PUBLICATION	
		Instit.	Flows	Stocks	Basis	Class.	Freq.	Lag
IN-YEAR REPORTS								
Public Sector Finances	ONS HMT	PS	R,E,Fin	Debt, Liq.FA	C,A	National	Mo.	20d
Commentary on the Public Sector Finances Release	OBR	PS	R,E,Fin	Debt, Liq.FA	A	National	Mo.	20d
Tax Receipts and National Insurance Contributions	HMRC	CG	Taxes	---	C	National	Mo.	20d
DMO Quarterly Review	DMO	CG	---	Gilts T-Bills	C,A	National	Quart.	6w
Quarterly Nonfinancial Accounts of General Government	ONS	GG	R,E	---	A	ESA	Quart.	3m
Quarterly Financial Accounts of General Government	ONS	GG	Fin	FA,L	A	ESA	Quart.	3m
Quarterly Maastricht Debt for General Government	ONS	GG	---	Debt	A	ESA(EDP)	Quart.	3m
Quarterly Sector Accounts	ONS	NFPS	R,E,Fin	FA,L	A	ESA	Quart	3m
YEAR-END REPORTS								
Whole of Government Accounts	HMT	PSex	R,E,Fin	NFA, FA,L	C,A	National	Annual	14m
Excessive Deficit Procedure Notification FY (CY)	ONS	GG	Balance	Debt	A	ESA(EDP)	2x/year	3m
Government Deficit and Debt Return	ONS	GG	Balance	Debt	A	ESA(EDP)	4x/year	3.5m
Main Aggregates of General Government	ONS	GG	R,E	---	A	ESA	2x/year	3m
Public Expenditure Statistical Analyses	HMT	PSex	E	---	A	National, ESA,COFOG	Annual	4m
General Government Expenditure by Function (CG) (LG)	ONS	GG	E	---	A	ESA,COFOG	Annual	15m
Detailed Tax and Social Contribution Receipts	ONS	GG	Taxes, S. Contr.	---	Mod. Cash	ESA	Annual	10m
National Tax List Questionnaire	ONS	GG	Taxes, S. Contr.	---	Mod. Cash	National, ESA	Annual	10m
Tax Expenditures and Structural Reliefs	HMRC	CG	Tax Expend.	---	C	National	Annual	9m
DMO Annual Review	DMO	CG	---	Gilts T-Bills	C,A	National	Annual	5m
UK National Sectoral Accounts (The Blue Book)	ONS	NFPS	R,E,Fin	NFA, FA,L	A	ESA	Annual	21m

Note: CG: Central Government; LG: Local Government; GG: General Government; NFPS: Nonfinancial Public Sector; PSex: Public Sector, excluding; PS: Public Sector; FY: Financial Year; CY: Calendar Year; R: Revenue; E: Expenditure; Fin: Financing; NFA: Nonfinancial Assets; FA: Financial Assets; L: Liabilities.

1.1. Coverage of Fiscal Reports

1.1.1. Coverage of Institutions (Advanced)

4. **In FY 2014/15 the UK's public sector comprised 38,241 separate institutional units with various legal forms.** As shown in Table 1.2, these can be broken-down into the following subsectors:

- **Central government**, which comprises of 7,858 units, including legislative, and executive bodies of the UK Government Departments, as well as the Monarchy, national insurance funds, non-departmental public bodies (such as national museums, devolved administrations in Scotland, Wales, and Northern Ireland, and Parliament); 469 National Health Service Institutions (including hospitals), 1,339 courts and 4,772 academies (central government controlled and funded schools) are also included;
- **Local governments**, which comprises 477 district councils, 10,500 parish councils in England, and 16,873 community schools, as well as another 821 bodies including, municipal departments, agencies, and nonprofit institutions which they control;
- **Public nonfinancial corporations**, which comprises 1,705 commercially-oriented corporations controlled by government units; of which, 1,634 are controlled by central government (most notably, the 1,577 registered providers of social housing in England, whose corporate policy is determined by government (through regulation) and 71 controlled by local government units; and
- **Public financial corporations**, which comprises the Bank of England (BoE, including the Asset Purchase Facility and Special Liquidity Scheme), RBS, a small municipal bank, and four financial auxiliaries.

Table 1.2. United Kingdom: Public Sector Institutions and Finances, FY 2014/15
(Percent of GDP, unless otherwise stated)

	Number of entities	Revenue	Expenditure	Balance	Intra-PS expenditure	Net expenditure	Net expenditure (Percent)
Public Sector	38,241	41.1	48.8	-7.7	0.0	48.8	100.0
General government	36,529	38.6	46.6	-8.0	1.3	45.3	92.8
Central government	7,858	35.2	42.7	-7.4	8.6	34.0	69.78
Local governments	28,671	10.9	11.5	-0.6	0.2	11.3	23.1
Nonfinancial public corporations	1,705	1.6	1.8	-0.2	0.0	1.8	3.7
Central Bank	1	0.7	0.6	0.1	0.6	0.0	0.0
Other financial public corporations	6	2.2	1.8	0.5	0.1	1.7	3.5

Source: UK Authorities and IMF Staff estimates.

5. **The UK's public sector accounted for around GBP 894.0 billion (48.8 percent of GDP) in expenditure in FY2014/15.** Table 1.2 also summarizes the distribution of public resources across the different subsectors of the public sector in FY 2014/15 and shows that:

- **General government** accounts for GBP 829.9 billion (45.3 percent of GDP), of which 75 percent flows through the central government, and 25 percent is spent through local governments;
- **Public corporations** account for a further GBP 64.0 billion (3.5 percent of GDP) of which 16 percent is spent by nonfinancial corporations, and 84 by financial corporations.

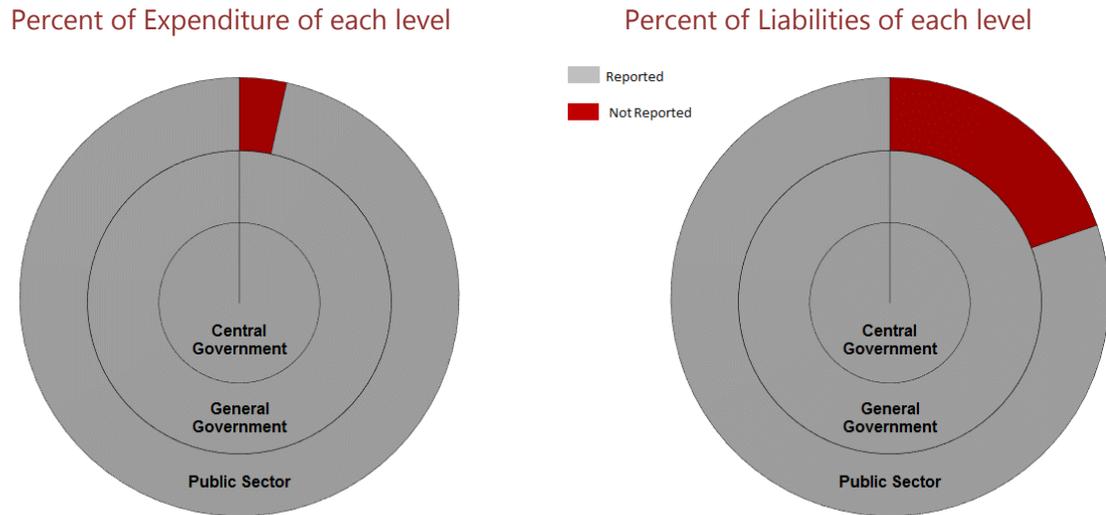
6. The PSF are the most comprehensive fiscal reports, covering the entire public sector, in accordance the latest international statistical standards. The institutional coverage of this report is determined by classification decisions of the ONS, which are taken on a regular basis, as classification assessments are concluded. The assessments can be instigated by the ONS, and HMT, the Devolved Administrations, Eurostat, or other UK government departments. However, decisions are taken solely by the ONS, strictly in accordance with the ESA 2010/MGDD sectorization rules. Updates in unit classifications are incorporated in fiscal statistics, and applied retroactively, as quickly as practical.³

7. The WGA, while also aiming to cover the full public sector, excludes some units for a variety of reasons. As discussed above, HMT bases the consolidation boundary of WGA on ESA/MGDD rules. The deviations to these standards, explained in the WGA publication, refer to: (i) small entities that are excluded from consolidation on the basis of materiality; and (ii) small sized entities that are not responsible to an executive arm of government, including parliamentary and audit bodies, and a few other units.⁴ In addition, HMT decided not to consolidate the RBS in the WGA, but instead record it as a financial investment, on the grounds that its consolidation would distort the accounts and make it difficult to determine trends. Cost considerations also weighed on this decision, given the practical difficulties (different year end, different asset valuation policies) in carrying out a fully accurate consolidation. Consolidating RBS with the rest of public sector has a material impact on gross revenue, expense, assets, and liabilities, but the impact on the net borrowing or net worth measures is relatively small, reflecting RBS's financial intermediation nature. From a fiscal transparency point of view, given the material impact of RBS in public sector aggregates, the disclosure of a presentational variant consolidating the WGA financial statements with those of RBS through a simplified/pragmatic approach, would somehow compensate for the deviation from standard accounting policies. Figure 1.1 shows the size of WGA departures from the full public sector coverage.

³ The ONS publishes monthly updates with the results of completed assessments, and a quarterly forward work plan of what organizations and transactions are scheduled for assessment over the coming 12 months. When deciding about the date of implementation of classification decisions, the ONS takes into account the complexity of the change (including the sourcing and quality assurance of data), the impact on the headline statistical measures and existing priorities.

⁴ At the time of compilation of the WGA for FY 2014/15, the ONS had not yet taken the decision to classify housing associations in the public sector, so the WGA also exclude these units.

Figure 1.1. United Kingdom: Coverage of Public Sector Institutions in the WGA



Source: UK Authorities and IMF staff estimates.

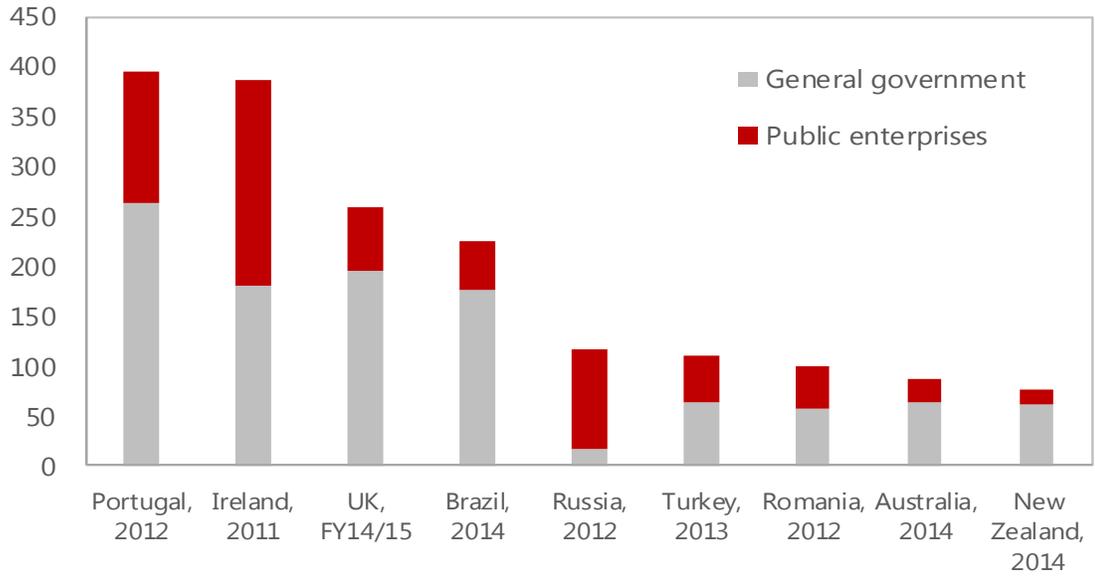
Note: "Not Reported" refers to expenditures of units not consolidated in summary fiscal reports.

1.1.2 Coverage of Stocks (Advanced)

8. The WGA includes a complete balance sheet. The coverage of this balance sheet is more complete than most advanced economies, as it includes the value of both financial and nonfinancial assets and liabilities (including liabilities arising from the defined benefit pension schemes of public employees). The public sector balance sheet presented in Table 0.2, which is primarily sourced from the FY 2014/15 WGA balance sheet, provides a detailed breakdown of the public sector assets and liabilities, amounting to:

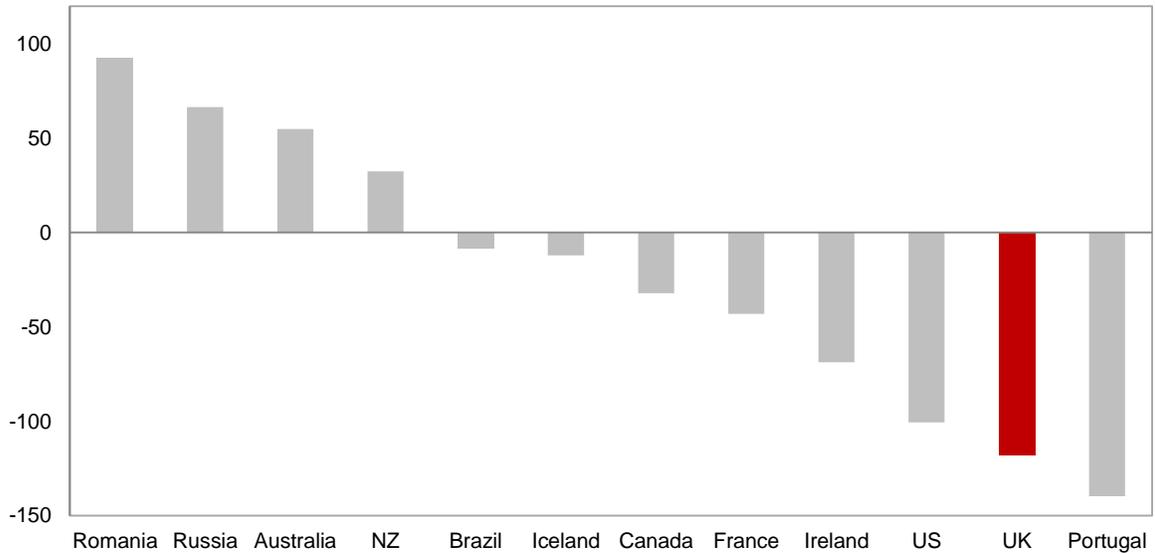
- GBP 982.6 billion (53.6 percent of GDP) in **nonfinancial assets** including 50.5 percent of GDP in fixed assets (buildings and structures, machinery and equipment, weapons systems, and other);
- GBP 1,591.4 billion (86.9 percent of GDP) in **financial assets** including 8.4 percent of GDP in currency and deposits, and 36.4 percent of GDP in loans granted to the private sector;
- GBP 4,736.6 billion (258.6 percent of GDP) in **liabilities** including 77.6 percent of GDP in debt securities, 84.9 percent of GDP in pension entitlements of civil servants, and 5.4 percent of GDP in accounts payable; and
- an **overall net worth and net financial worth** of -118.1 and -171.7 percent of GDP, respectively. (Figures 1.2 and 1.3 compare UK's public sector balance sheet data with other countries for which comparable estimates are available).

Figure 1.2. Public Sector Gross Liabilities in Selected Countries
(Percent of GDP)



Source: UK Authorities and IMF staff estimates.

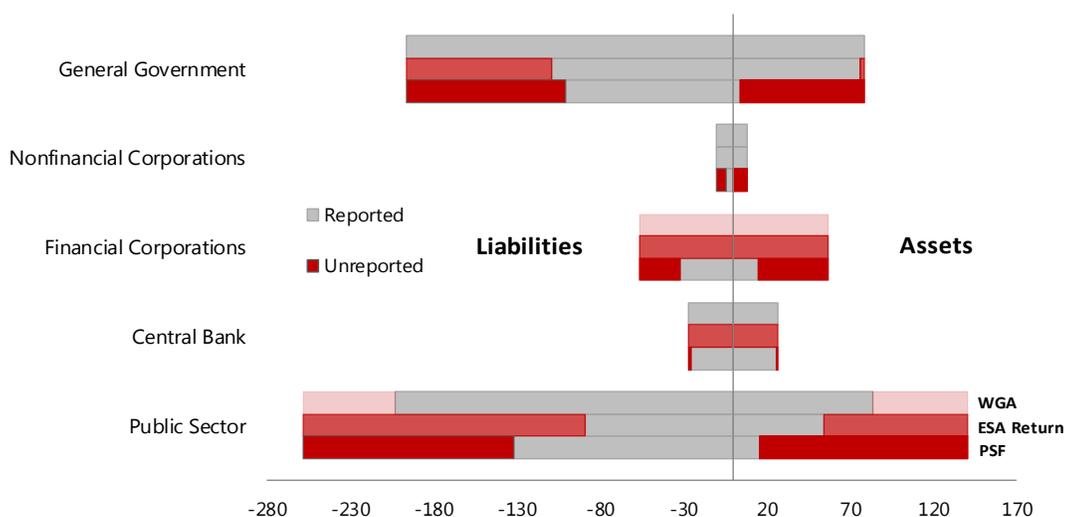
Figure 1.3. Public Sector Net Worth in Selected Countries
(Percent of GDP)



Source: UK Authorities and IMF staff estimates.

9. The PSF reports disclose information on a much more limited set of assets and liabilities, and do not include market valuations. By following the definitions of the ESA 2010/MGDD-based Excessive Deficit Procedure (EDP),⁵ the PSF fails to cover several material categories of stocks, such as nonfinancial assets, non-liquid financial assets, and liabilities arising from civil servants’ defined benefits pension schemes or other accounts payable. Furthermore, liabilities are disclosed at face value (labeled “nominal value” in EDP), which does not reflect unpaid accrued interest or the fluctuation in market prices). ESA sectoral national accounts returns fill some of these gaps by including stocks of missing financial instruments (with the notable exception of pension entitlements) and estimates of fixed capital, except the ones constructed via PPP arrangements. Figure 1.4 compares the coverage of stocks of both the WGA, PSF, and National Accounts.

Figure 1.4. United Kingdom: Coverage of Public Sector Balance Sheet in Fiscal Reports FY 2014/15 (Percent of GDP)



Source: UK authorities and IMF staff estimates.

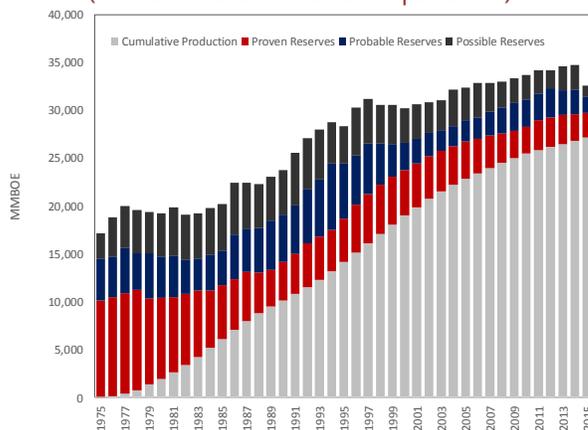
10. If the State Pension (Pay-As-You-Go) System’s pension entitlements for private sector employees were included in public sector liabilities, overall public sector net worth would decrease to around -328 percent of GDP. The treatment of pensions in the government’s accounts raises difficult issues in the UK, as in many countries. At present, any financial assets of the social security scheme, resulting from excess of contributions received over benefits paid, are included on the balance sheet of the public sector, while the system’s liabilities

⁵ Other major international statistical standards, such as the 2008 SNA or the GFSM 2014, are less prescriptive than the ESA/MGDD framework, and therefore leave room to the compiler to apply the general principles in a way that better reflects the true and fair financial position of the government. For example, these alternative standards recommend, the recognition of the stocks and flows associated with public employees’ pension schemes, or a more comprehensive application of the risks and rewards approach, which leads to the recognition of more PPP assets (and associated liabilities and transactions) in the accounts of public sector units. The more prescriptive rules of the ESA/MGDD are a consequence of it being the basis of the legal procedures of the Excessive Deficit Procedure framework, which requires equal treatment of all EU member states.

are not. Although this asymmetric treatment follows international statistical standards, it has the effect of presenting a more favorable picture of the government’s fiscal position than is actually the case.

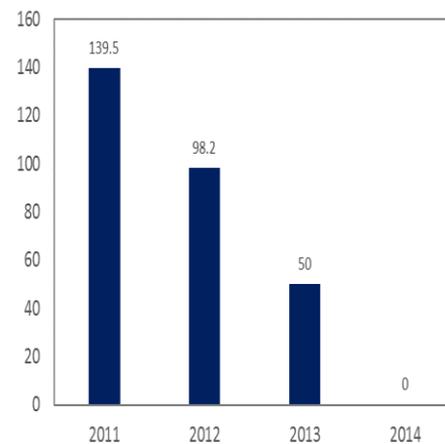
11. Reporting on oil and gas reserves is comprehensive and of high quality, and shows that the value of these assets is virtually null at present. The Oil and Gas Authority (OGA) publishes annual statements of cumulative production and the estimated remaining recoverable oil and gas reserves, along with an explanation of changes in reserve estimates (see Figure 1.5). The ONS publishes annual data on reserve volumes and provides a stock-flow reconciliation, attributing changes in reserve stocks over the year to either production or changes in reserve estimates. In addition, the ONS has recently started to estimate the monetary valuation for UK Continental Shelf (UKCS) oil and gas, in the context of the [Environmental Accounts](#) compiled in line with the System of Environmental-Economic Accounting. This exercise shows that the monetary value of oil and gas reserves has been reducing over time, reaching a zero value by end-2014 (see Figure 1.6).

Figure 1.5. UK: Cumulative Oil Production and Remaining Oil Reserves
(in million barrels of oil equivalent)



Source: OGA.

Figure 1.6. UK: Current Monetary Estimates of Oil and Gas
(in GBP billion)



Source: ONS.

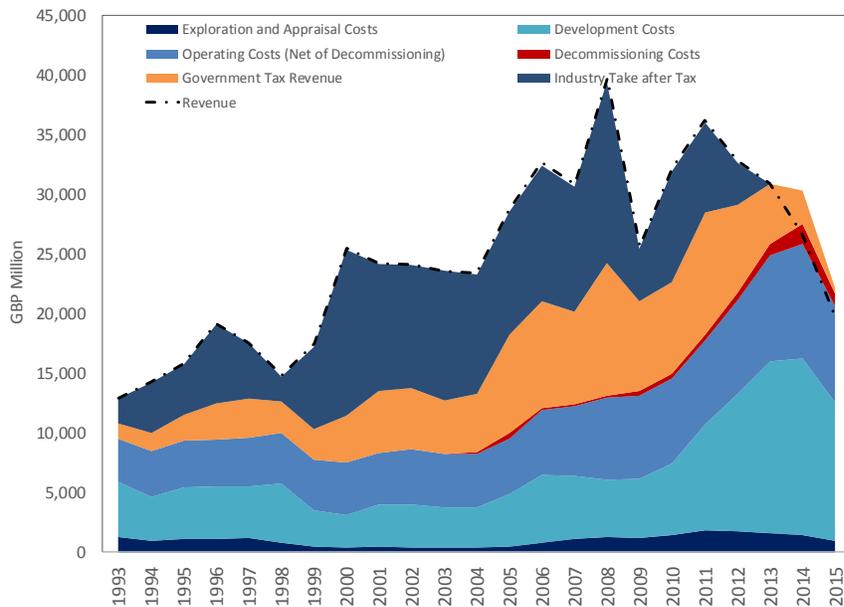
1.1.3 Coverage of Flows (Advanced)

12. The WGA covers all cash flows, accrued revenues, expenditures, and financing, and other economic flows. Following IFRS financial disclosure standards, the WGA includes: a statement of revenue and expenditure, with information on an accrual basis, including realized gains/losses in assets and liabilities; a cash-flow statement, with the cash flows from operating, financing, as well as from capital and financial investment; and a statement of comprehensive expenditure, with information on unrealized asset revaluation gains/losses and actuarial gains/losses associated with the pension liability.

13. Recognizing all accrued revenues and expenses would increase the public sector deficit (net borrowing) as currently reported in the PSF to 7.7 percent of GDP. The PSF does not disclose comprehensive information on cash flows and its coverage of accrual flows is substantially less comprehensive than that of WGA. Most of the missing flows are associated with the limitations in coverage of stocks discussed in the previous section, in particular, the unreported net accrual of pension entitlements of public employees, of GBP 56.0 billion (3.1 percent of GDP). With the exception of foreign exchange effects on gross debt (“Maastricht,” i.e., EDP, definition), no other economic flows are recorded in the PSF.

14. The government reports comprehensively on petroleum sector production, expenditure and tax revenue flows. The OGA produces monthly and annual reports on petroleum production at a field level, as well as an annual Income and Expenditure Statement for the UKCS, disaggregated by major revenue and cost category. With regard to tax collections, HMRC annually produces a detailed breakdown of government petroleum revenues, and the Department of Energy and Climate change (DECC – now BEIS, the Department for Business, Energy and Industrial Strategy) has reported on non-tax revenues collected (license fees and levies) in its annual report. Together, these publications allow a comprehensive sector-level understanding of the allocation of cash flows from the UKCS (see Figure 1.7).

Figure 1.7. United Kingdom: Cash Flows from UKCS Petroleum, 1993–2015
(in GBP million)



Source: OGA, HMRC and IMF Staff calculations.

Note: This figure considers the cash flows of the UKCS as a whole, using the OGAS’s Annual Income and Expenditure Statement. The figure illustrates the allocation of petroleum revenue between capital costs, operating costs and tax payments to government, and the resulting after-tax cash flow to industry. From 2013-15, revenue has been lower than the costs incurred and taxes paid, resulting in an overall negative after-tax cash flow to industry.

15. Analyses of the petroleum sector would benefit from a more detailed disclosure of government-related flows. The government does not currently disaggregate reporting on investment allowances granted to petroleum companies, or the sector's overall tax loss position (see Section 1.1.4 below). Doing so would facilitate analysis of the determinants of the current low and even negative levels of tax revenue from the sector. Furthermore, fiscal reports currently disclose petroleum revenue receipts only on an aggregate level, providing limited insight into the fiscal impact of UKCS decommissioning activity. Transparency would be enhanced if the government reported on decommissioning expenditure incurred each year, the associated tax losses generated, and any tax refunds paid to industry.

1.1.4 Coverage of Tax Expenditures (Good)

16. HMRC discloses a list of the main tax relief schemes and an estimate of their annual costs, identifying those schemes that are considered tax expenditures. The annual "Estimated cost of tax reliefs, expenditure and allowances" lists all active tax relief schemes (in December 2015, there were 401 active schemes), organized by type of tax scheme (tax expenditure, structural relief, or allowance) and by type of tax. For the tax schemes for which costs can be estimated, the publication shows the estimates of revenue loss for the previous fiscal year (t-1), the budget year (t), and two years following the budget year (t+1, and t+2), separating large schemes from minor cost schemes. The publication also contains a list of the schemes for which estimates were not produced,⁶ but these are relatively small in size. HMRC doesn't aggregate the costs of separate schemes because it overstates the amount of taxes that could be collected by government, due, for example, to interactions between the schemes.

17. There is no control on, or budgetary objectives for, the size of tax expenditures, which are relatively high by international standards. Tax expenditure analysis is integrated with tax law design but not with budgetary decision making. As a result, performance of tax expenditure schemes can't be assessed against quantitative measures in an analogous manner to spending programs. This may have contributed to the relatively high size of UK's revenue foregone from tax expenditures (increased in recent years to 6.3 percent of GDP in FY 14/15), when compared to other countries (see Figure 1.8). Transparency would be enhanced if tax expenditures were embedded in decision making on the overall spending envelope, making it

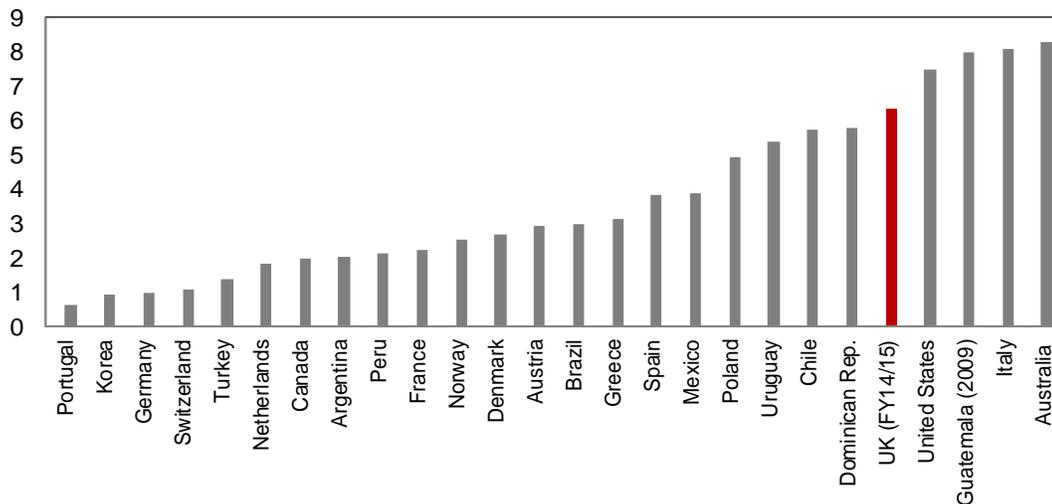
⁶ They are listed by area of the tax system and also categorized according to the reason why the cost information is not available: (i) information on the usage of the relief is not required in tax returns and cannot be reliably estimated from other data sources, and the cost of collection for statistical purposes is disproportionate; (ii) information on the usage of the relief is reported to HMRC, but the relevant data is not held in a centralized database, and the cost of gathering for statistical purposes is disproportionately large; (iii) information on the usage of this relief is available, but the cost is not quantifiable as it is dependent on other unknown factors; and (iv) the introduction of the relief is too recent for data to be available.

easier to assess whether the tax expenditure schemes can be justified on an ongoing basis as compared to other policy instruments.⁷

18. Understanding the impact of various tax incentive schemes on the UK economy could be improved by breaking down tax expenditures according to specific criteria.

Presently, the only available breakdown for tax expenditures is by type of tax, but the broad policy area can be inferred from the title of the tax relief scheme. The absence of a breakdown by criteria such as: function (COFOG); type of tax expenditure; industry sector of beneficiary; or geographical area hinders a more complete assessment of the redistribution of economic resources through the budget. For example, while the tax expenditure report shows data on the oil allowance, and other minor allowances granted under the Petroleum Revenue Tax (PRT), the more significant allowances granted to the petroleum sector companies for Supplementary Charge and Ring Fence Corporation Tax purposes are not separately disaggregated.

Figure 1.8. Revenue Loss from Tax Expenditures in Selected Countries
(Percent of GDP)



Source: UK authorities; IMF Fiscal Monitor 2011, for other countries.
Note: Estimates are for 2010, unless otherwise stated.

1.2. Frequency and Timeliness of Fiscal Reporting

1.2.1. Frequency of In-Year Fiscal Reporting (Advanced)

19. The PSF are published monthly within 15 working days of the reference month.

By compiling monthly data for the full public sector and its subsectors, the UK is at the forefront of in-year fiscal reporting practices. While the format of these reports follows national templates, they are compiled in accordance with ESA 2010 standards. In the context of the ESA TP, the ONS

⁷ This number includes only the tax expenditure schemes. If structural relief schemes and schemes with both tax expenditure and structural components were added, the total revenue foregone would increase to around 20 percent of GDP.

also releases quarterly general government data (nonfinancial and financial accounts, including a financial balance sheet) within 90 days of the reference quarter. These data are disseminated both domestically and in the databases of Eurostat and the IMF's Statistics Department.

1.2.2 Timeliness of Annual Financial Statements (Not Met)

20. The audited WGA have consistently been released more than a year after the end of the fiscal year. Since the first WGA release (fiscal year ending March 31, 2010), the time lag of publication has been reducing steadily. However, with the exception of WGA FY 2013/14, the report release dates continued to take place more than a year after the reference period (see Table 1.3). The reasons for this include the wide institutional coverage of the WGA,⁸ and is due primarily to two issues: first, local government units are required to publish their accounts only six months after the end of the fiscal year, which delays the process of public sector consolidation; and second, there is a persistently large number of material inconsistencies in the recording of intra-public sector transactions and holdings, that need to be dealt with before releasing the draft WGA for auditing.

Table 1.3. United Kingdom: Date of Publication of Whole of Government Accounts

Financial year	Date of submission to National Audit Office (NAO)	Date of publication	Time lag
2009/10	Dec 17, 2010	Nov 24, 2011	19m
2010/11	Feb 29, 2012	Oct 31, 2012	18m
2011/12	Feb 1, 2013	July 17, 2013	16m
2012/13	Jan 22, 2014	Jun 10, 2014	15m
2013/14	Dec 19, 2014	Mar 26, 2015	12m
2014/15	Jan 18, 2016	May 26, 2016*	14m

Source: UK authorities.

* Publication delayed due to late financial statements transmission by academies.

21. These delays limit the use of the WGA as an input to policy making. The UK authorities tend to base their policy decisions on the PSF, given its timeliness and wide institutional coverage. However, as described in Sections 1.1.2 and 1.1.3, the PSF coverage of stocks and flows falls short of WGA's on a number of material issues, that could be relevant for policy decisions (e.g., transactions, holdings and valuation of fixed and equity assets, cost of employment associated with pension entitlements, procurement of public assets via PPP arrangements). Furthermore, the PSF are not subject to the analysis of an external auditor, With the current time lag, WGA can only inform policy decisions two fiscal events after the fiscal year to which it refers.

⁸ There is a trade-off between institutional coverage and timeliness of fiscal reports. Countries with narrower institutional coverage of fiscal frameworks tend to experience less delays in publishing their annual financial statements. The UK has a particularly broad coverage by international standards and therefore the delays in publishing reports is understandable to a certain extent.

22. HMT is taking steps to improve WGA timeliness. Starting with fiscal year 2017/18, local government units will be required to release their audited financial statements by end-July (i.e., within four months of the end of the fiscal year). Furthermore, local authorities will be required to implement the latest accounting standards, which will contribute to the decrease of consolidation inconsistencies in both size and quantity. Finally, in response to the Public Accounts Committee's calls for making a better use of the WGA to inform policy decisions, HMT is increasing the level of accountancy skills in policy teams to facilitate a better understanding of information contained in financial statements.

1.3. Quality of Fiscal Reports

1.3.1. Classification (Good)

23. Fiscal reports include administrative, economic, and functional classifications, consistent with international standards. The sector classification adopted in all fiscal reports, including the WGA, follows the subsector breakdown of national accounts compiled according to ESA 2010. In addition, Public Expenditure Statistical Analyses (PESA) present central government expenditure data by departmental group, following the UK government's structure. The ONS releases to the European Commission, the IMF, and the OECD, include data classified by international standard economic and functional classifications. The common chart of accounts for central government units is based on IFRS standards, but is sufficiently detailed to allow its bridging to the economic classifications of international statistical standards, such as *GFSM 2014* or *ESA 2010*. The functional classification, employed by all public sector units, follows United Nations' Classification of Functions of Government (COFOG). For residency breakdowns, the ONS uses data available from external sector statistics, which are compiled in accordance with the *Balance of Payments and International Investment Position Manual (Sixth Edition)*, thus following the same residency criteria and classification as ESA 2010 and *GFSM 2014*.

24. The lack of a program classification is compensated by the widespread use of a COFOG-compliant functional classification. Departmental groups manage their expenditure and disclose information on it both by economic category and COFOG sub-function⁹ (in some cases, it goes even beyond the sub-function level). PESA uses this information to disclose a cross-classification of expenditure by administrative and functional classifications, which allows the analysis of the effectiveness of government policies in each area, as well as international comparisons in this regard. In compliance with the ESA TP, the ONS also compiles and discloses a cross-classification of expenditure by economic and functional classifications.

1.3.2 Internal Consistency (Advanced)

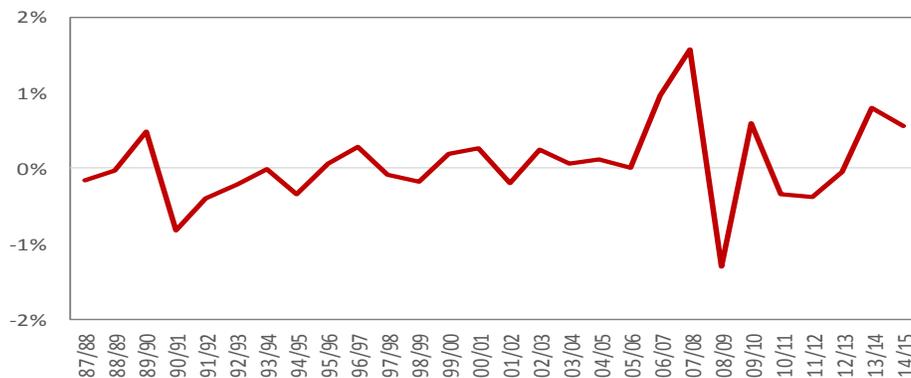
25. The internal consistency checks prescribed by the FTC are included in the monthly PSF statistical bulletin. The PSF include monthly data reconciling the net borrowing (fiscal

⁹ The only exception is the "Health" function for which England and Wales still can't disclose information with the level of detail required for COFOG level 2; instead, they use HMT's own sub-functional classification.

balance) and the net cash requirement (the cash borrowing measure). It also includes a reconciliation of the central government net cash requirement and the changes in net debt. These reconciliations are accompanied by a narrative and a diagram explaining how the main headline indicators of the bulletin fit together. The use of an integrated securities database for the compilation of data on the gilt portfolio ensures full consistency between debt issuances and debt holdings.

26. Discrepancies have been contained in recent years. In the EU Excessive Deficit Procedure notifications, the ONS also discloses a detailed reconciliation between the net borrowing indicator and the gross debt (Maastricht definition) of general government and its subsectors. The discrepancy between above- and below-the-line calculations (one of the reconciliation items) of the net borrowing indicator has traditionally been small, the only exception being between FY 2007/08 and FY 2008/09, due to the volatility created by the eruption of the financial crisis (see Figure 1.9).

Figure 1.9. United Kingdom: Discrepancy Between Below- and Above-the-Line Net Borrowing of General Government
(Percent of Revenue)

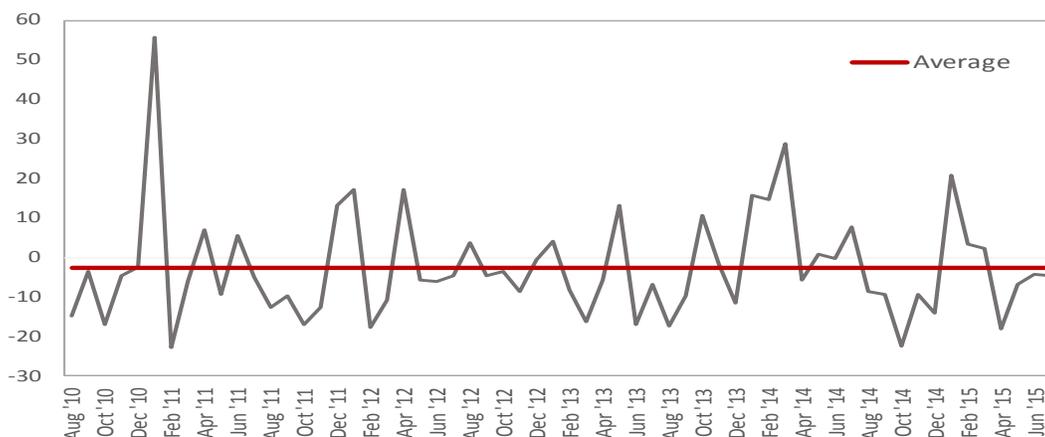


Source: UK Authorities (ESA Table 25 and Table 27 returns).

1.3.3 Historical Revisions (Good)

27. Revisions to fiscal statistics are transparently disclosed with an explanation for each major revision. The ONS has an open revision policy for the PSF, i.e., the historical series of these data can be revised every month for all time periods. Every monthly bulletin contains a section on revisions in headline indicators since the previous bulletin, and all major revisions are explained in detail. As a quality assurance procedure, every bulletin also contains a revisions analysis, based on a rolling 60-month series, which includes every vintage of a monthly observation and a statistical analysis of bias in the early estimates for each indicator. These analyses have demonstrated that the average revision between the first vintage and that of one year later has consistently been close to zero, although there have been high revision episodes in the past (mostly associated with classification decisions on government’s support to financial institutions in the context of the financial crisis) (Figure 1.10).

Figure 1.10. United Kingdom: Revisions Analysis for Central Government Net Borrowing
(Percent of first published value)



Source: UK authorities (ONS Public Sector Finances revisions analysis).

Note: Revisions are calculated by taking the change between the first estimate and the corresponding one-year revision, as a percentage of the first estimate. The outliers, episodes that fall above and below one standard deviation of the mean, are substituted with the five-year average from preceding years.

28. To date, only changes in methodological frameworks were accompanied by a bridge table between the old and new time series. The ONS ensures that whenever sources and methods are changed, the statistical databases are updated retroactively and the available time series are historically consistent. While this practice makes bridge tables less relevant to users, it prevents the quantification of the impact of specific changes, when multiple updates occur at the same time. The only instance where a bridge table was published, related to the change from ESA95 to ESA 2010. The ONS published two explanatory notes on this update, the first one explaining all major methodological changes qualitatively, and the second one quantifying the impact of each change in the past time series of headline indicators.

1.4. Integrity of Fiscal Reports

1.4.1. Statistical Integrity (Advanced)

29. Most fiscal statistics are compiled solely by the ONS, which is a professional independent body. The ONS is the executive body of the UK Statistics Authority (UKSA), an independent agency (non-ministerial department accountable to Parliament) at arms' length from the government, created in 2008, following the enactment of the 2007 Statistics and Registration Service Act. The ONS is bound by both the UK and the European Statistical System (ESS) Codes of Practice, and is frequently subject to reviews of the UKSA and Eurostat, regarding its central role as compiler of official fiscal statistics. The collaboration between government agencies in the compilation of official statistics is coordinated by the Government Statistical Service (GSS), a community of statisticians working throughout government, and led by the National Statistician. GSS members are all bound by the UK and ESS Codes of Practice.

30. The PSF are jointly produced by the ONS and HMT, but the responsibilities of the latter are essentially related to provision of good quality source data. This collaborative process was a consequence of HMT's decision in 1998, to base its fiscal framework on National Accounts principles. Under this arrangement, the ONS is responsible for the application of those principles, in particular regarding the sector classification of institutional units and how to record transactions and related stock positions. HMT staff who work with the ONS when jointly producing the Public Sector Finances are GSS members. The ONS also has final responsibility for compiling the statistical measures, and ensuring that they comply with international statistical standards and with the Code of Practice for Official Statistics. This involves, inter alia: the design of data collection systems; ensuring the existence of expertise and guidance to allow government bodies to supply data complying with national accounts principles; collection, aggregation and quality check of data supplied by government bodies; and review of the output of ONS calculations.

31. Fiscal statistics are disseminated according to international dissemination standards. The UK was among the first subscriber to the Special Data Dissemination Standards (SDDS), having formally subscribed on June 5, 1996. Currently, it meets all the SDDS requirements and reports comprehensive and consistent fiscal data to international organizations.

1.4.2. External Audit (Good)

32. The NAO, a parliamentary body, is the Supreme Audit Institution in charge of auditing the WGA. The Comptroller and Auditor General (C&AG) and the staff of the NAO are not civil servants and do not report to a minister. The NAO independently decides which examinations to carry out and how to report results to the Parliament. The Parliament's Public Accounts Commission oversees NAO's work, approves its budget, scrutinizes its costs and performance, appoints its external auditors, and commissions value-for-money studies of its work.

33. The C&AG's audit opinion on the WGA covers both the "true and fair view" and regularity approaches, consistent with international standards. The C&AG is required to form an opinion as to whether the WGA are free from material misstatement and comply with the relevant reporting requirements. It is also required to provide assurance that the transactions recorded in the financial statements are in accordance with Parliamentary or other authority. The audit is carried out in accordance with International Standards on Auditing (UK & Ireland), which are based on the International Standards on Auditing issued by the International Auditing and Assurance Standards Board.

34. Since their first release, the WGA have consistently been subject to major audit qualifications, but the number and size of these have been declining. The certificate and report of the C&AG includes specific recommendations for further action. Over time, the HMT has made progress in resolving the issues raised in qualifications. As a result, two major

qualifications were removed and the extension of limitation of scope was reduced on the audit of the WGA for financial year 2014/15. The qualifications that persist refer to: the definition and application of the accounting boundary, particularly the exclusion of RBS; inconsistent application of accounting policies (due to a number of the consolidated bodies following accounting standards that differ from IFRS); audit qualifications on the financial statements of consolidated bodies (specifically the Ministry of Defense and the Department of Education); and, to a lesser extent, incomplete elimination of intra-government transactions and balances.

1.4.3. Comparability of Fiscal Data (Advanced)

35. Budget estimates are comparable with outturn data. Following the adoption of national accounts as the basis for the UK's fiscal framework, departmental groups were required to prepare their budgets and track its execution following ESA2010 concepts and definitions. The institutional coverage of the consolidated public sector budget and the OBR's EFO is also based on national accounts (as determined by the ONS's classification decisions). The headline indicators of the Budget, Spending Estimates, and OBR's forecasts are therefore prepared on the same basis as the outturn data published in the monthly PSF.

36. The WGA are reconciled with fiscal statistics (which are also the outturn data). The publication of WGA includes a standard chapter on comparison to national accounts. Along with a detailed description of each major difference between accounting and statistical standards, the chapter includes two tables reconciling the main indicators of financial statements and fiscal statistics: (i) the WGA Net Liabilities vs. the PSF's Public Sector Net Debt; (ii) the WGA Net Expenditure vs. the PSF's Current Deficit. Furthermore, the explanatory notes to the financial statements provide additional details on every major reconciliation item. Following the requirements of the Financial Reporting Manual, departmental groups also reconcile their outturn on a budgeting basis to the outturn in their resource accounts on an IFRS basis.

1.5. Recommendations

37. The UK's fiscal reporting meets advanced practices in most areas. The assessment against the FTC, summarized in Table 1.5, shows that annual financial statements and monthly fiscal statistics, compiled in accordance with international statistical standards, cover the public sector and recognize the vast majority of its stocks and flows (both cash and accrual). This is a remarkable feature that places the UK to the forefront of fiscal reporting practices worldwide. It also shows that fiscal statistics are prepared by an independent agency, subject to strict Codes of Practice, thus contributing to credibility of fiscal data, and that annual financial statements are subject to an audit by an independent supreme audit institution, whose opinion has contributed to improvements in the government's accounting practices.

38. However, despite the cutting edge nature of many fiscal reporting standards, there remains scope to enhance fiscal reporting in some areas. The material impact of RBS on the public sector balance sheet (increase in gross liabilities by 50 percent of GDP) is not disclosed in any fiscal report. Furthermore, the WGA and PSF, essentially two presentational variants of the

same reality, could be made more consistent, to make them more relevant to users. The assessment also shows that tax expenditures (large by international standards) could be more effectively monitored and managed.

39. Based on the above assessment, the evaluation highlights the following priorities for improving the transparency of fiscal reporting:

- **Recommendation 1.1: Enhance consistency between the WGA and the PSF by:**
 - a. **Disclosing a trial, simplified consolidation of the financial statements of WGA and RBS in the annual report section of the WGA.** This would provide a more complete view of the public sector activity in the economy and would attenuate the effects of one of NAO's qualifications on the WGA financial statements.
 - b. **Expanding the coverage of data on stock positions of all public sector assets and liabilities in the PSF.** This would allow policy makers to more effectively manage the available assets and take into account long term implications of current policy decisions.
 - c. **Adding a set of tables to the PSF, compiled under alternative international statistical standards.** This would allow the PSF to include statistical data produced under a framework that is closer to IFRS, e.g., regarding the recognition of civil servant's pension entitlements and PPP arrangements, two of the largest reconciliation items between national accounts and WGA.
- **Recommendation 1.2: Control tax expenditures by subjecting them to numerical limits and enhance reporting through the addition of a sectoral and functional breakdown in cost publications.** This would encourage debate about the most efficient means of achieving policy objectives, facilitate a review (including for the purpose of budget setting) of tax expenditures alongside associated spending programs and an effective monitoring of fiscal rules.
- **Recommendation 1.3: Bring forward the publication of the WGA to target nine months following the reference period.** This would allow the WGA to be used more effectively for policy decision making and for government accountability purposes.

Table 1.4: Summary Assessment of Fiscal Reporting

	Principle	Assessment	Importance	Recs
1.1.1	Coverage of Institutions	Advanced: PSF consolidate all public sector institutional units and present data for each subsector. WGA consolidates all material public sector units, except the RBS.	High: PSF doesn't include full balance sheet information so RBS's material impact in the public sector balance sheet (increase in gross liabilities by 50 percent of GDP) is not disclosed in any fiscal report.	1.1
1.1.2	Coverage of Stocks	Advanced: WGA's balance sheet covers all assets and liabilities of the consolidated units, allowing the calculation of the public sector net worth.	Low: Reporting of stocks is comprehensive, including for nonfinancial assets (54 percent of GDP) and civil servant's pension entitlements (81 percent of GDP).	
1.1.3	Coverage of Flows	Advanced: WGA include statements for revenue and expenditure (accruals), comprehensive expenditure (other economic flows), and cash flows.	Low: The coverage of flows reported in each statement is in line with the relevant standards.	
1.1.4	Coverage of Tax Expenditures	Good: The estimated revenue loss from tax expenditures, broken down by policy area, is published at least annually. There is no control on, or budgetary objectives for, the size of tax expenditure.	Medium: The revenue foregone from tax expenditures and structural reliefs is large (20 percent of GDP). Tax expenditures of 6.3 percent of GDP are high by international standards.	1.2
1.2.1	Frequency of In-Year Reporting	Advanced: In-year fiscal reports are published 15 working days after the end of the reference month.	Low: Monthly fiscal reports cover the full public sector.	
1.2.2	Timeliness of Annual Financial Statements	Not Met: WGA have been published always more than a year after the end of the reference period.	Medium: The delay in the publication of the WGA (more comprehensive than PSF, in terms of stocks and flows) limits its relevance for decision makers.	1.3
1.3.1	Classification	Good: Fiscal reports include administrative, economic, and functional classifications consistent with international standards, where applicable.	Low: Expenditure is classified by function in a level that goes beyond COFOG's subfunction, in practice serving as a program classification.	
1.3.2	Internal Consistency	Advanced: Fiscal reports include all reconciliations prescribed by the code. The integrated securities database ensures full consistency between issuances and holdings of the gilt portfolio.	Low: Discrepancy between fiscal balance and financing of general government is very small (0.7 percent of total expenditure).	
1.3.3	Historical Revisions	Good: Revisions to historical statistics are reported with an explanation for each major revision, but there is no publication of bridge tables between the old and new time series.	Low: Changes in methodology or classification are applied to the entire time series, effectively making bridge tables less relevant. Revisions analysis are frequently undertaken.	
1.4.1	Statistical Integrity	Advanced: ONS is professionally independent and observes international statistical standards.	Low: Fiscal statistics are subject to the governance and code of practice of the UK Statistics Authority and Eurostat.	
1.4.2	External Audit	Good: WGA are audited by an independent institution and are subject to both a "true and fair view" and regularity opinions, in line with international auditing standards, with major qualifications.	Low: Effective collaboration between the HMT and NAO has allowed the removal or reduction in the size of qualifications over time.	
1.4.3	Comparability of Fiscal Data	Advanced: Budget estimates are comparable with outturn data (fiscal statistics). The WGA are reconciled with the latter.	Low: The notes to the WGA provide details on all items that explain the difference between major aggregates of WGA and Fiscal Statistics.	

II. FISCAL FORECASTING AND BUDGETING

40. Fiscal forecasts and budgets should provide a clear statement of the government's budgetary objectives and policy intentions, and comprehensive, timely, and credible projections of the evolution of the public finances. This chapter assesses the quality of UK's fiscal forecasting and budgeting practices against the standards set by the IMF's Fiscal Transparency Code. In doing so, it considers four key dimensions of fiscal forecasting and budget:

- The comprehensiveness of the budget and associated documentation;
- The orderliness and timeliness of the budget process;
- The policy orientation of budget documentation; and
- The credibility of the fiscal forecasts and budget proposals.

41. The UK's fiscal forecasts and budgeting documents are consistently of a high quality, and provide a credible, comprehensive, and relatively easily understood picture of how future policy and fiscal developments will play out. This is underpinned by:

- A rigorous, detailed, and highly transparent approach to macroeconomic and fiscal forecasts, which since 2010 has been the responsibility of the independent OBR.
- A long-standing and credible medium-term budget framework, that places binding multi-year limits on the spending of 25 central government ministries.
- Clear, easily understood primary budget documentation, which provides a link to past budget commitments, gives detailed information on new policy measures, and the impact of the budget on different income levels.

42. However, there are a number of characteristics that could be strengthened to both improve transparency and strengthen the budget process. These include:

- A convention-based budget system that is largely uncodified and difficult to understand from the outside, which allows the budget to be passed well into the fiscal year, provides multiple opportunities to change tax and spending policies throughout the year, and enables the government to change the rules of the game without consultation with other stakeholders.
- Budget documentation that can only be linked back to the estimates on which funds are appropriated with great difficulty, and that does not report on 4 percent of GDP worth of own-source revenues and their uses.
- A track record of frequently chopping and changing the guiding fiscal rules over the last seven years, to the point that at present there are none in place.

- No clear link in the budget documentation between the outputs and outcomes that budget expenditure is intended to achieve.

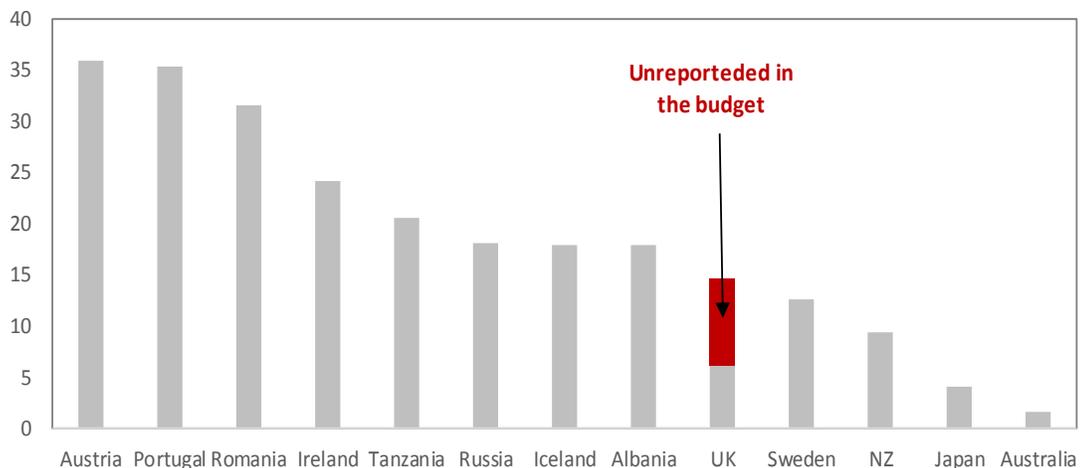
2.1. Comprehensiveness of Budget Documentation

2.1.1. Budget Unity (Basic)

43. Budget documentation includes revenues, expenditures, and financing of all public sector bodies. This includes all departments, public sector bodies that fall outside of the general government, and unusually by international standards, the Bank of England. The only exceptions to the coverage are the government owned banks.

44. However, the bulk of revenues and expenditures provided are on a net basis, with 3.7 percent of GDP (FY 2016/17) of own-source revenues and related expenditures largely ignored. The headline total managed expenditure (the main fiscal aggregate) figure used within the key budget documents, does not include expenditure associated with departmental income by each agency. Reporting both revenue and expenditure on a gross basis increases total managed expenditure from 39.7 percent of GDP in 2016–17 to 43.4 percent of GDP, and current receipts to 40.3 percent of GDP, with no net impact on borrowing—assuming that all departmental income is spent within the budget year.

Figure 2.1. Own Source Revenues
(Percent of Expenditure)



Source: IMF staff estimates.

45. Information on most departmental own source revenue is presented in supporting material, however this is presented well after the budget, in a way that is difficult to understand. The main estimates are presented a month after the main budget event, and after the beginning of the financial year, providing highly detailed, disaggregated information on budget funded spending as well as departmental income for each of the agencies. However, there is no reporting on how the departmental incomes is to be spent, or indeed whether they will be spent. The figures in the main estimates are presented on a different basis to the total

managed expenditure discussed in the main budget documents, and while a rough bridge between the two figures can be derived, it is technically very burdensome. This makes comparing budgeted expenditure to outturns by department very difficult.

2.1.2. Macroeconomic Forecasts (Advanced)

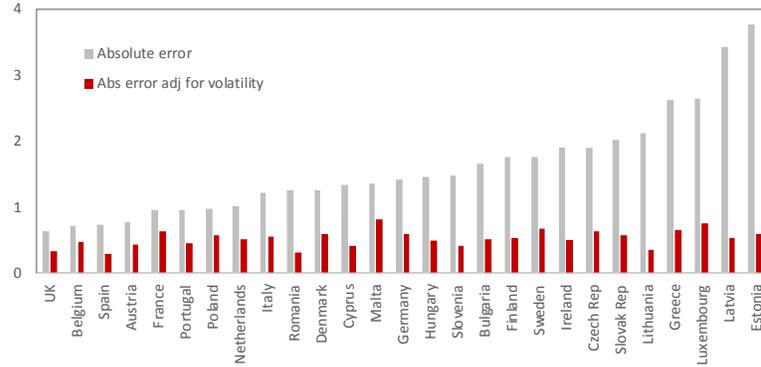
46. The Economic and Fiscal Outlook (EFO) includes detailed six-year forecasts for the main macroeconomic variables, their components and underlying assumptions. There is a detailed discussion of the economic outlook, including the developments since the last forecast, the main drivers behind the forecast of each component and the risks and uncertainties surrounding the forecast.

47. The depth and breadth of the economic and fiscal analyses presented in the economic outlook can be considered as best practice, and could be used as a benchmark by other advanced economies. Some of the highlights that could be picked up by other countries include:

- An explanation for the assumptions underlying the budget, such as oil price, equity prices, exchange and interest rates, as well as how those assumptions have evolved over previous forecasts.
- A detailed discussion of key sectoral outlooks, such as the household and corporate and external sectors, addressing their interactions with the labor market and balance of payments.
- An explanation of more fundamental drivers of the economic outlook, including detailed analyses of potential output, productivity and the output gap, including a hard-nosed assessment of past forecasts.
- The impact of policy measures on growth, covering fiscal, monetary and macro prudential policy.

48. GDP forecasts are relatively accurate and unbiased for the budget year, but do indicate some optimistic bias that increases over the forecasting horizon. The UK has the most accurate real GDP forecasting record in Europe, even after accounting for the relatively stability of the economy (Figure 2.2), and one of the lowest biases (Figure 2.3). However, one area where macro forecasting has struggled is around nominal GDP—which feeds most directly into the fiscal forecasts, where forecast errors have been consistently overoptimistic, particularly following the crisis (Figure 2.4). This has been recognized by the OBR in its own forecasting assessments, and recently steps have been taken to understand what is driving this.

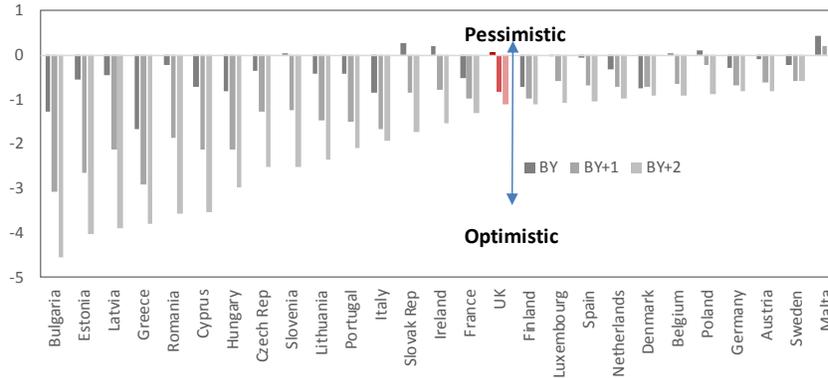
Figure 2.2. Real GDP Forecast Accuracy – Absolute Error for Budget Year (2000–15)^{1/}
(Percent)



Source: IMF staff estimates.

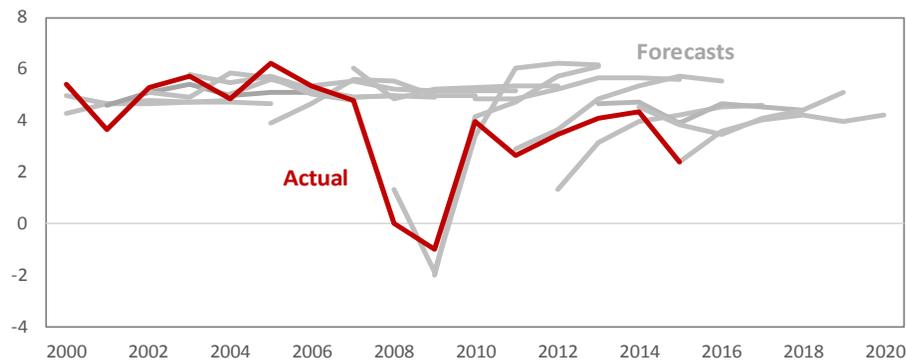
^{1/} Volatility adjustment is average absolute forecast error divided by standard deviation of growth over the period.

Figure 2.3. Real GDP Forecast Bias – Average Medium-Term Forecast Error (2000–15)
(Percent)



Source: IMF staff estimates.

Figure 2.4. United Kingdom: Nominal GDP Forecast History (2000–15)
(Percent)



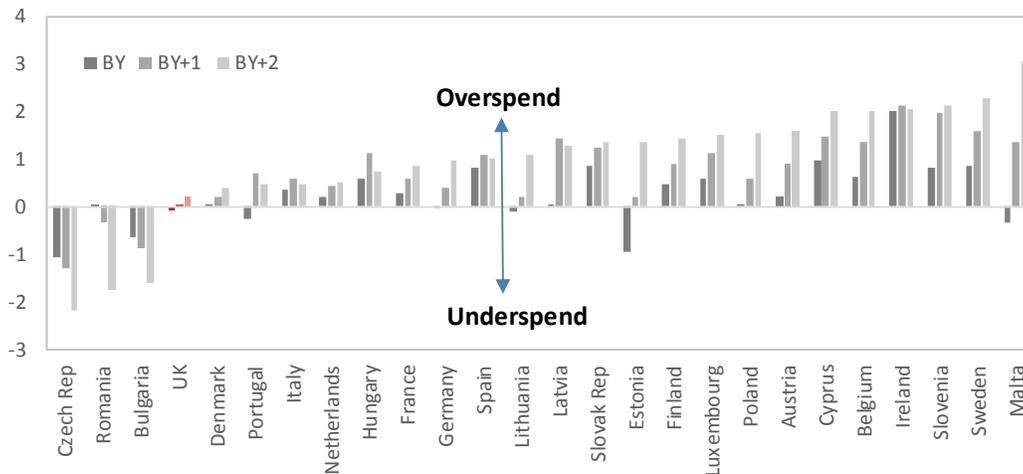
Source: IMF staff estimates.

2.1.3. Medium-Term Budget Framework (Advanced)

49. The UK has a long established medium-term budget framework based on multi-year spending agreements undertaken during comprehensive spending reviews. These spending agreements detail Departmental Expenditure Limits (DEL) that cover 25 central government ministries and around half of total managed expenditure, and are in place for fixed periods of (usually) three or four years. The remaining half of expenditure, known as Annually Managed Expenditure (AME) is largely made up of demand based programs, such as pensions and unemployment which is allowed to fluctuate according to needs.

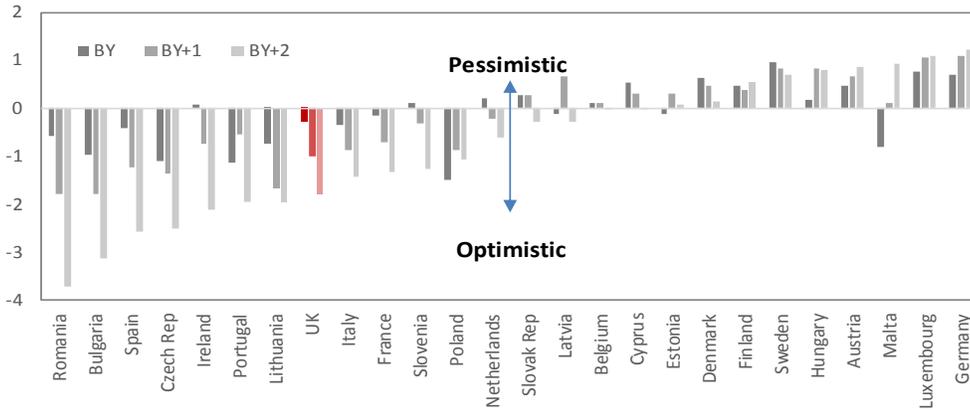
50. The UK has a strong record of delivering on its medium-term commitments on the expenditure side, though overoptimistic revenue forecasts have translated to worse fiscal balance outcomes than projected. The UK is almost unique in Europe, in that there is no bias—either upward or downward—in its expenditure forecasts (Figure 2.5), indicating that over both the short and medium term the government delivers on what it promises. This is underpinned by the DEL expenditure limits that are closely adhered to, and the practice of making further policy adjustments to offset unfavorable movements in AME to bring expenditure outturns in line with commitments. However, while this is true on expenditure, persistent revenue forecast downgrades (Figure 2.6), particularly, but certainly not limited to the financial crisis, have translated into consistent underperforming against the fiscal balance targets (Figures 2.7 and 2.8).

Figure 2.5. Expenditure Forecast Bias – Average Medium-Term Forecast Error (2000-15)
(Percent of GDP)



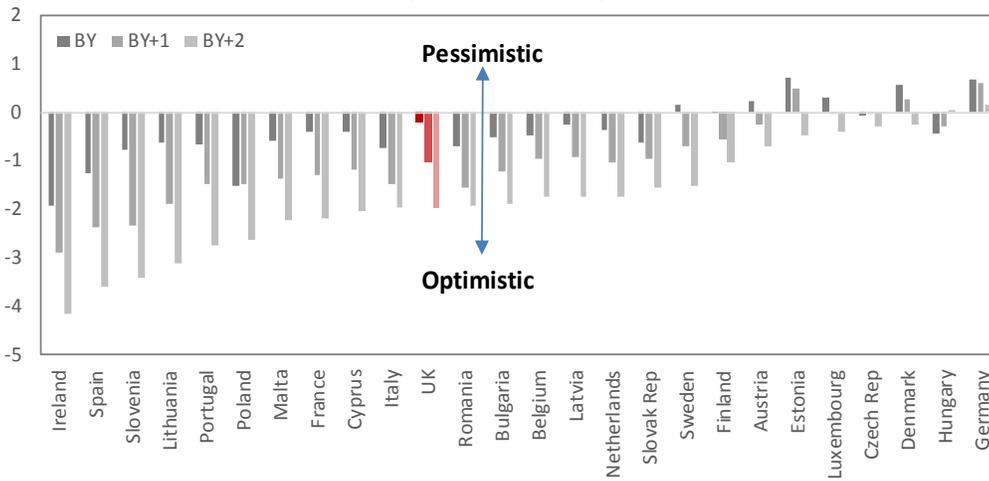
Source: IMF staff estimates.

Figure 2.6. Revenue Forecast Bias – Average Medium-Term Forecast Error (2000-15)
(Percent of GDP)



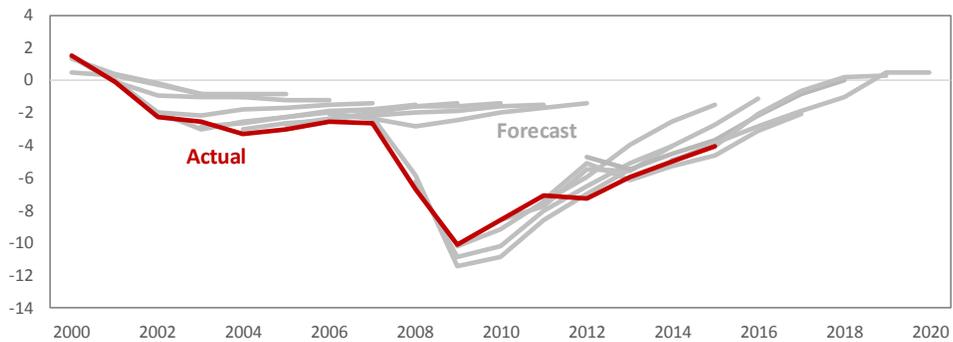
Source: IMF staff estimates.

Figure 2.7. Fiscal Balance Forecast Bias – Average Forecast Error (2000-15)
(Percent of GDP)



Source: IMF staff estimates.

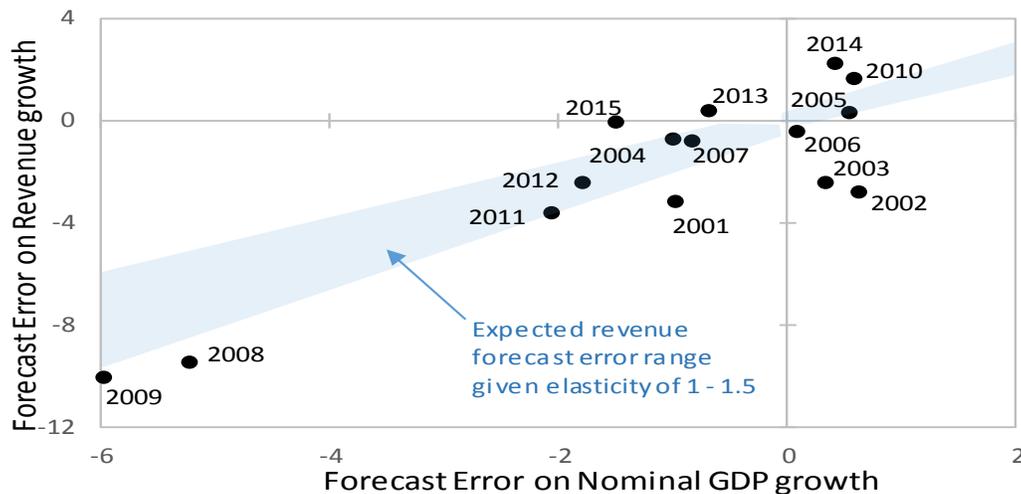
Figure 2.8. United Kingdom: Balance Budget Forecast History (2000-15)
(Percent of GDP)



Source: IMF staff estimates.

51. The revenue forecast errors are closely linked to the overoptimistic nominal GDP forecasts, rather than due to problems with the revenue forecasting models. There is a strong correlation between the accuracy of the forecasts for growth in nominal GDP and overall revenues (Figure 2.9), with errors largely falling within the expected range with an elasticity of revenue to growth of 1–1½. Paired errors consistently falling outside of that range would be indicative of microeconomic problems with the forecasting model relationships, rather than macroeconomic errors.

Figure 2.9. United Kingdom: Budget Forecast Errors on Nominal GDP and Revenue Growth (Percent forecast error for t+1)



Source: IMF staff estimates.

52. The fixed year nature of the framework means that as the end of the agreement period approaches, the framework horizon becomes shorter and shorter. For instance, by the last year of the 2010 Comprehensive Spending Review (CSR) period, by the time of the 2013 Budget, the spending limits by agency only applied for one year. In addition, the 2013 CSR was only for a one-year period. This meant that for 2014 and 2015 while aggregate expenditure figures continued to be provided over the medium term, ministries essentially reverted to an annual budget process.

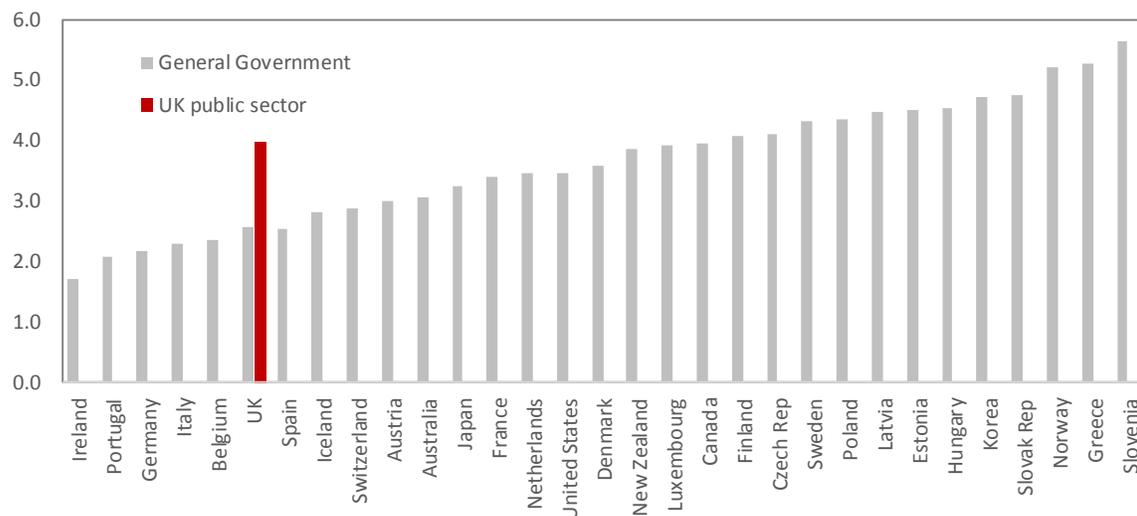
2.1.4. Investment Projects (Good)

53. Major government projects are now managed by the Infrastructure and Projects Authority (IPA). The IPA was formed in January 2016 through the merger of Infrastructure UK (IUK) and the Major Projects Authority (MPA), and it is responsible for project development, project financing, project assurance, and project support for major government projects.

54. General government investment in the UK is relatively low compared to many other countries (Figure 2.10). However, public sector investment in UK is much higher, around 4 percent of GDP in 2016. There are also a number of very large investment projects slated,

including the High Speed Rail project, an extension of airport capacity (decision pending) and the Hinkley Point nuclear power plant. Planned investment in UK economic infrastructure across different sectors has a combined value of GBP 425 billion (see Table 2.1).

Figure 2.10. Public Investment in Selected Countries
(Percent of GDP)



Source: IMF staff estimates.

Table 2.1. Planned Investment in UK Economic Infrastructure
(GBP billion in 2014/15 prices)

Sector	No. of projects & programmes	Total (£bn)	2016/17	2017/18	2018/19	2019/20	2020/21	Post 2020/21
Communications	6	6.0	2.8	2.2	0.4	0.3	0.2	0.0
Energy	167	255.7	24.8	26.7	26.0	20.1	19.9	138.3
Hinkley Point C	1	16.0	-	-	1.0	2.1	2.1	10.9
Flood	29	4.1	0.5	0.6	0.6	0.5	0.5	1.4
Science and Research	32	5.5	1.1	1.1	1.1	1.1	1.1	0.0
Transport	329	134.5	17.6	17.0	16.6	18.5	18.8	46.1
High speed rail	1	53.7	0.8	1.6	2.7	4.4	4.3	40.0
Waste	10	0.5	0.4	0.1	0.0	0.0	0.0	0.0
Water	29	19.3	5.0	5.0	4.7	4.0	0.5	0.1
Economic Infrastructure Investment Total	602	425.6	52.2	52.7	49.2	44.5	41.0	185.9
Social Infrastructure Investment Total		57.6						
Grand Total		483.2						

Source: National Infrastructure Pipeline.

55. Investment projects are transparently reported. The WGA, which provides information on all multi annual obligation, including investment projects, and budgets accompanying spending reviews provide details on planned investments. In addition, the new National Infrastructure Pipeline database includes information on the planned investment in all UK

economic infrastructure across both the public and private sectors. The IPA also produces detailed reports on major projects.¹⁰

56. All major investment projects go out for competitive tender and require cost-benefit analysis, though these are not necessarily published. These projects will either be developed and approved through a structured business case methodology using the Treasury five case model that includes cost benefit analysis, or a cost effectiveness analysis where more appropriate. The Green Book¹¹ presents the frameworks, processes and techniques that should be used. It covers different stages of the policy cycle, including setting objectives for a planned policy, project or program, appraising the options, implementing the solution and performing an ex post evaluation. All proposals are expected to use this methodology and are subject to appraisal including a cost-benefit analysis, and are required to go to a competitive tender. While some cost benefit analyses are released publicly due to Freedom of Information requests, they are not all published as a matter of course, bringing down the assessment to a good level.

2.2. Orderliness

2.2.1 Fiscal Legislation (Basic)

57. The bulk of the UK budget process is understood through convention, precedent and procedures that have been adopted over time, with relatively little provided in framework legislation. The budget timetable is governed by standing orders and conventions, as are the legislature's powers to amend the budget. The Charter of Budget Responsibility sets out the government's fiscal objectives, and provides the budget content requirements.¹²

58. Nevertheless, the system is well understood by budget actors, with the budget operating on stable timeframe, and the legislature makes almost no amendments—though this is more a reflection on the limits of parliamentary power. The Parliament is typically controlled by the government which has majority in the lower house. In general, the government maintains strict discipline on parliamentary votes, particularly on budget bills, where any failure to pass would represent a vote of no confidence, which could ultimately lead to the government resigning. Further, Parliamentary debate on the budget is relatively limited, with the initial oral debate on the budget starting immediately after the Chancellor gives his statement, leaving no time for anyone to scrutinize the budget before being required to give their opinion; while the

¹⁰ Major projects on the Government Major Projects Portfolio managed by the IPA are those where the project needs HM Treasury approval, either because the proposed budget exceeds a department's delegated authority level or because the project is novel, contentious, potentially sets a precedent or requires primary legislation.

¹¹ "The Green Book: Appraisal and Evaluation in Central Government" is a guidance, provided by HM Treasury for public sector bodies on how to appraise proposals before committing funds to a policy, program or project (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220541/green_book_complete.pdf).

¹² The Budget Responsibility and National Audit Act (2011) sets out the legislative requirements for the Treasury to produce the Charter, mandating that it include fiscal objectives, how they will be achieved and the content requirements of the budget.

(later) detailed debate within the parliament is limited to two votes (departments), with all the others rolled up into one omnibus vote. The House of Lords is even more restrained in terms of powers to amend supply bills, with no ability to amend, and can only delay passage by a month.

59. The convention-based system has a number of weaknesses. They system is very difficult for outsiders to understand. With few legislative requirements in place, the government has been able to change core budget features when convenient. For example, the medium-term budget framework was in effect abandoned in 2015 when the spending review was only done for a single year, instead of the usual four; performance targets as laid out in public sector agreements were dropped in 2010; and carryovers of unspent funds ceased in 2010, in response to savings needs.

2.2.2. Timeliness of Budget Documents (Not Met)

60. The UK's budget process is completed very late in the fiscal year, with the budget presented to parliament only two to three weeks prior to the beginning of the new financial year. This does not meet the basic practice in the FTC of presenting the budget one month prior to the beginning of the financial year, and is well short of the three-month requirement to meet the advanced level. Furthermore, the detailed spending estimates are provided a month after the budget is presented, and after the financial year has begun. This gives very little time for the Parliament or the public to scrutinize the budget before new policies are due to take effect.

61. The budget is not approved by Parliament until July, three months after the April 1 beginning of the financial year. This again does not meet the basic practice of approving the budget at least one month before the financial year begins. Spending authority for the new financial year is derived from the passage of the previous year's supplementary budget, that is introduced to Parliament a month prior to the budget (Table 2.2), but this does not account for policy changes announced in the budget. The Vote on Account that is passed alongside the supplementary estimates provide legal authority for spending equivalent to 45 percent of the previous year's budget. The authority to collect revenues for the first seven months of the financial year is provided through the Budget Resolution Bill, that is provided to parliament four days after the main budget event in mid-March.

62. The Autumn Statement is intended to operate as a mid-year update, but in recent years has taken on increasing importance, in some instances eclipsing the budget itself. There are typically large-scale policies announced in the autumn, such as the results of the 2015 spending review, and a major savings exercise in 2014, which are often taken to bring fiscal policy in line with announced targets following changes in the outlook (see Figure 2.15 below). Its role has increased in importance over time, where it started off as a pre-budget announcement, and evolved into an effective mini-budget.

Table 2.2. United Kingdom: Key Dates in the Current Budget Cycle

Timing	Event	Purpose
February	Supplementary Estimates Presented	Introduce changes from the previous autumn statement
Early March	Supplementary Estimates Passed	Pass policy changes from the previous Autumn Statement Provide legal appropriation for spending in the first months of the coming FY
Mid-March	Main Budget Event	Introduce aggregate budget information and new policy measures Present economic and fiscal forecasts
+ 4 days	Budget Resolution Bill Presented	Provide authority to raise taxes in the coming financial year
1-Apr	New Financial Year Begins	
April	Main Estimates Presented	Present detailed expenditure information by department
July	Main Estimates Voted Through Public Exp Statistics Analysis Presented	Provide authority to spend for the remainder of the financial year Presents detailed spending data in line with the main budget docs
Nov/Dec	Autumn Statement	Update economic and fiscal forecasts plus introduce new policy measures
February	Supplementary Estimates Presented	Introduce changes from the autumn statement

2.3. Policy Orientation

2.3.1. Fiscal Policy Objectives (Not Met)

63. The Government’s overall objectives for fiscal policy are set out in the Charter for Budget Responsibility. These are to:

- Ensure sustainable public finances that support confidence in the economy, promote intergenerational fairness, and ensure the effectiveness of wider government policy; and
- Support and improve the effectiveness of monetary policy in stabilizing economic fluctuations.

64. These broad objectives have been made operational by adopting specific fiscal objectives. The Charter for Budget Responsibility, approved by Parliament in October 2015, sets out the fiscal objectives as follows:

- The government’s fiscal mandate was described as a surplus on the headline measure of Public Sector Net Borrowing (PSNB) by 2019–20, maintaining a surplus in normal times thereafter (“fiscal mandate”);
- This was supplemented by a target for debt as a share of GDP to be falling in each year until 2019–20, after which it would continue to do so if the fiscal mandate is met (“supplementary target”);
- The fiscal mandate was further supplemented by a cap on a subset of welfare spending, at cash levels set out by the Treasury in the most recently published Budget report, over the rolling five-year forecast period, to ensure that expenditure on welfare is contained within a predetermined ceiling (“the welfare cap”).

65. If these fiscal policy objectives had been maintained, they would have been assessed at a good level of practice, albeit hindered by their frequent adjustments. While they are both precise and time bound, the frequent changes to the specific fiscal objectives reduces their credibility in guiding medium-term fiscal policy. For instance, the most recent budget surplus and net debt targets had only been in place for a year before being abandoned, with the previous targets introduced only seven months prior to that (Table 2.3).

66. However, while the targets remain formally in place, they have been publicly abandoned by both the current and previous Chancellors, leaving effectively no fiscal objectives in place during the assessment period.¹³ This results in an assessment of “not met” under the code, but this is in all likelihood a temporary aberration, as new objectives are anticipated to be adopted alongside the 2016 Autumn Statement.

Table 2.3. Recent UK Fiscal Rules

Introduced	Dropped	Target
May 1997	Dec 2008	Golden rule over the cycle
Dec 2009	May 2010	Annual reduction in Public Sector Net Borrowing to 2015-16, halving it from 2009-10 levels by 2013-14
June 2010	July 2015	Cyclically adj current budget balance by end of 5 year forecast period (target date continually pushed out) Public sector net debt falling by 2015-16
Dec 2014	July 2015	Achieve cyclically adjusted current balance by the end of the third year of the forecast period (amended) Public sector net debt as a percentage of GDP to be falling in 2016-17 (target year pushed out)
March 2014		A cap on welfare spending below limits set in the 2014 Budget Budget Surplus in 2019/20
July 2015	August 2016	Debt falls as percent of GDP each year Keep welfare spending below cash limits set in July 2015 (amended)

Source: UK Budget documents.

67. The OBR performs regular assessments on fiscal performance against the Government’s fiscal targets. The Charter for Budget Responsibility requires the OBR to judge whether the Government has a greater than 50 percent chance of hitting its fiscal targets under the current policy. These are assessed and published in each of the OBR’s EFOs.

2.3.2. Performance Information (Basic)

68. The budget provides information on the spending provided under each of the government’s main policy areas. The main supply estimates provide spending information by agency, what the agencies main objectives are, and provides a broad breakdown of where the overall funding will be directed, though this is more on an administrative basis.

69. However, the details provided on outputs and outcomes are less clear, and are not linked to the budget. In general, the UK’s policy objectives and related funding are decided on during the CSR agreements. However, these agreements only cover the funding under DEL,

¹³ See the Chancellor’s [speech](#) to the 2016 Conservative Party Conference, and reports on the previous Chancellor’s reported July 2016 [comments](#) in Manchester.

which makes up only half of total expenditure, and are not updated during subsequent budgets. The current incarnation of agreements is the “Single Departmental Plans (2015–20),” that lay out total DEL funding, high level objectives, and report on the indicators underlying them. However, there is no link within the plans as to what funding is available or what outputs will be produced, nor are there any targets for the indicators, though the plans do include specific commitments related to the government’s pre-election manifesto. Previous versions of departmental plans have taken different approaches to planning and performance. For example, the 2011–14 business plans laid out objectives and specific actions that would be taken to meet them, and the Public Service Agreements (1998–2010), provided objectives and targets.

70. Ex post reporting on how the government is performing against the objectives is included in each department’s annual report. These provide a description of the policy actions departments are taking to meet the objectives, and provide the results of a number of indicators. However, most have no targets against which these indicators are measured against, nor any link back to how the inputs were used to meet them.

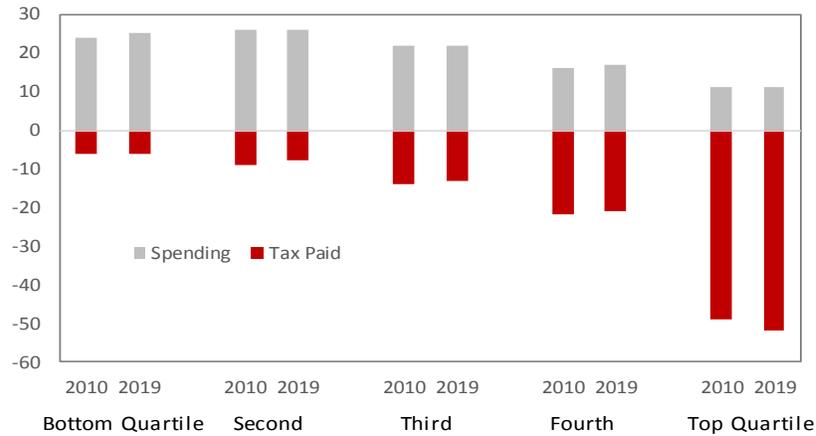
2.3.3. Public Participation (Basic)

71. In many ways, the UK meets advanced practice for public participation, particularly through the provision of clear, easily understood budget materials. There are easily understood descriptions of the budget, major policy measures and some information about the distributional impacts of spending and tax across different segments of the population—although the latter have been scaled back, are relatively high level, and difficult to link to particular policy decisions. Figure 2.11 presents an example of distributional analysis included in the budget documentation.¹⁴

72. However, citizens are given no formal voice in budget deliberations. A lively and well-informed media and public discussion of public and budget policy in some ways negates this, however in order to meet advanced practice, the government could introduce a formal call for budget submissions from the public (as in Australia), or public participation component in the estimates committee hearings (as in Canada).

¹⁴ The distribution of public spending that directly benefits households and the distribution of the taxes that they would have paid under the 2010–11 system, and how these distributions will have changed in 2019–20 as a result of policy changes.

Figure 2.11. Distributional Analysis –Tax and Spend Paid/Received by Income Quartile
(Percent of total expenditure/revenue)



Source: HM Treasury: "Impact on households: distributional analysis to accompany Budget 2016."

2.4. Credibility

2.4.1 Independent Evaluation (Advanced)

73. The independent OBR prepares all economic and fiscal forecasts for the UK Budget, and provides an assessment of whether the fiscal targets are being met (Figure 2.12). The OBR was set up in 2010 in an effort to increase the credibility of the government's fiscal forecasts, due to perceived political influence on government forecasts, as well as frequent tinkering with budget classifications made in order to meet fiscal targets.¹⁵

Figure 2.12. OBR's March 2016 Assessment of Performance Against the Fiscal Targets

Fiscal mandate:	budget surplus in 2019-20 and beyond	✓
Supplementary target:	debt falls as % GDP each year	✗
Welfare cap:	spending below cash limits set in July 2015	✗

74. The OBR is completely responsible for all economic forecasts, although the fiscal forecasts partly depend on Treasury DEL figures. While it is also responsible for fiscal forecasts, and prepares the revenue and AME forecasts, it accepts the DELs as determined by the Treasury, making some adjustments for over or under spending. This became an issue in the March 2015 budget, when the medium-term DEL projections (that had not been subject to a spending review, as this only applied for the first year of the forecasts period) implied a large

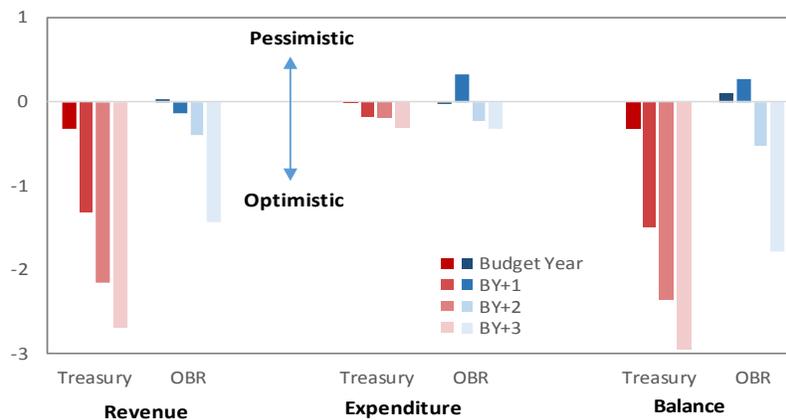
¹⁵ Examples include excluding network rail from public sector debt and reclassifying essentially current expenditures, such as road expenditures and payments for sexual discrimination, as capital to meet the golden rule.

decline in DEL spending. While OBR accepted those projections, it did demonstrate that Treasury's figures implied a sharp decline in real spending per capita.

75. While it is still relatively early in terms of its track record, the OBR's forecasting record indicates a lower degree of bias than under the Treasury forecasting regime.

Revenue forecasts have proven to be less optimistic than was the case when the Treasury was responsible, while the degree of expenditure overspends has been broadly similar, resulting in a lower bias on fiscal balance projections (Figure 2.13). While the Treasury's forecast period includes the global financial crisis, which worsens the errors, excluding the crisis years still yields a similar, albeit less dramatic pattern. In order to demonstrate its lack of bias ex ante, the OBR provides all of its models to the public, and performs rigorous ex post forecast evaluations.

Figure 2.13. Treasury (2000–09) versus OBR (2010–16) Average Forecast Errors ^{1/} (Percent of GDP)



Source: IMF staff estimates.

^{1/} Medium-term forecast errors assessed on Treasury's forecasts from the 2000–09 Budgets, and OBR's forecasts from the 2010–16 budgets.

76. The OBR also has a sign off responsibility for policy costings prepared by the Treasury. The OBR endorses (or not) these costings in each economic and fiscal update, and provides an uncertainty rating based on the data underpinning it, the complexity of the modelling and the possible behavioral impact of the policy. If the OBR disagreed with the Treasury's published costing, it would put its own referred costing in the forecast.

2.4.2. Supplementary budget (Advanced)

77. Any changes to the total or composition of the budget require a supplementary budget before funds can be spent. In exceptional circumstances, departments can be given access to the contingency fund, however this has very strict conditions and will need to be fully repaid. The supplementary budget is usually announced in the autumn statement, and appropriated through the supplementary estimates in February (one-and-a-half months prior to the end of the financial year). While it is possible for agencies to overspend relative to their

appropriations, this is then subject to an (embarrassing) excess vote procedure, and consequently these are relatively rare.

78. Over the past decade, the budget has been a credible guide to the actual fiscal outturn, with total managed expenditure averaging 0.2 percent lower than the announced figure. While year-on-year both supplementary budgets and execution errors have been significant (and sometimes in the same direction), the outturns have averaged out. The legal appropriations have seen considerably larger variability (Figure 2.14), though the largest of these, in 2015, related to adding in a provision for nuclear decommissioning that had no impact on the headline expenditure figures. There have only been two cases where spending has exceeded legal authority, in 2009 and 2013.

79. While changes to the budget year have been small, the Autumn Statement has focused on announcing medium-term policy changes in order to meet the fiscal targets. Indeed, the quantum of policy decisions announced in the Autumn Statement exceed those announced in the Budget by a considerable margin, particularly on the tax side (Figure 2.15). This poses a challenge to the universality of the budget, with decisions not being taken at a single point in time, preventing comparison on trade-offs and comparisons across decisions. This has also led to complaints from business and commentators on the frequency of changes to the tax system, and a call from commentators to move to a single fiscal event to provide greater certainty and stability, to release resources for better consultation, and to produce higher quality legislation.

Figure 2.14. UK: Budget versus Outturn
(Percent of Total Managed Expenditure)

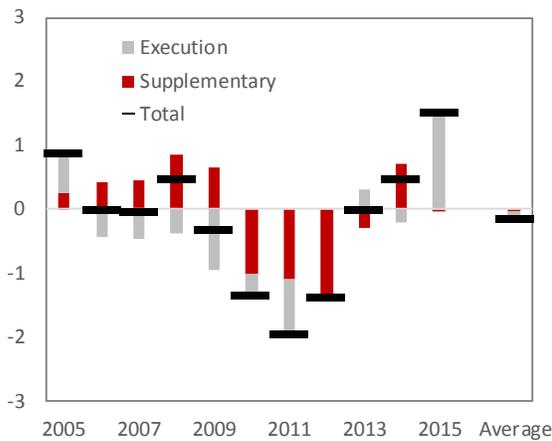
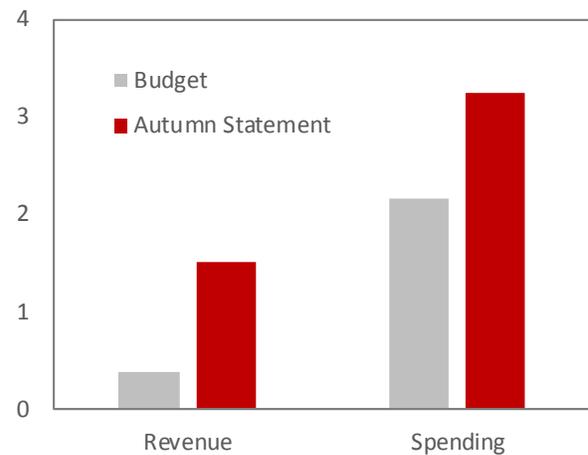


Figure 2.15. UK: MT Policy Decisions (2010-16)
(Percent of Expenditure)



Source: IMF staff estimates.

2.4.3. Forecast Reconciliation (Advanced)

80. The OBR produces an ex post evaluation of its forecast performance on an annual basis. This evaluation analyses in detail the differences between outturn and fiscal forecast.

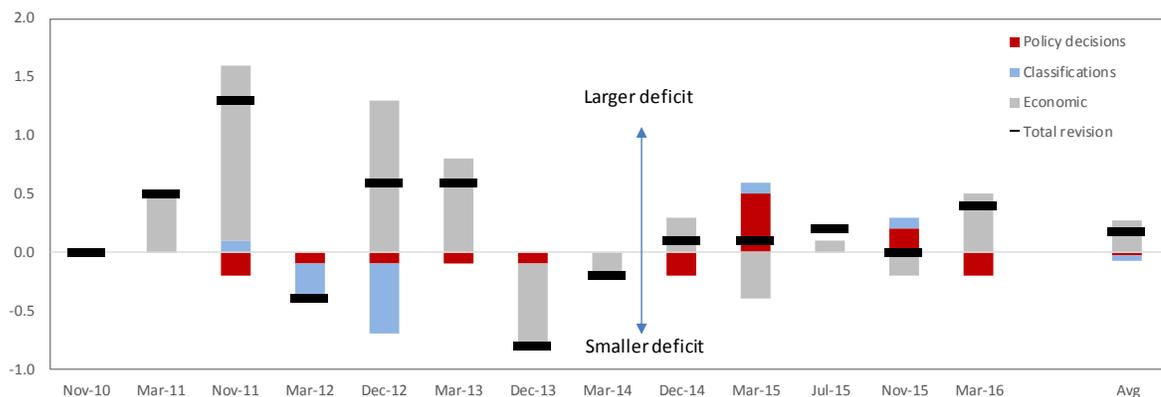
Furthermore, each OBR forecast report includes a detailed breakdown of changes since the previous forecast.

81. The OBR provides a reconciliation of changes to the fiscal forecast in each of the budget updates. It classifies the forecast revisions into three categories:

- Classification changes: these are typically the result of decisions taken by the ONS since the previous forecast;
- Underlying forecast changes: these are the result of OBR’s judgements about how forecasts—primarily economic—should change in light of new information since the previous forecast; and
- Policy changes: the results of Government decisions that are announced in each Budget and Autumn Statement, or in the period since the previous fiscal event.

82. On average, since 2010 the forecast deficit has been revised up by 0.2 percent of GDP over the medium term in each of the updates (Figure 2.16). This has been driven by continual downward revisions to economic parameters, which have led to a deterioration of 0.3 percentage points to the deficit, while policy decisions have tended to offset this, with the exception of 2015, when policy decisions cost the budget. Finally, there have been two large instances of accounting and classification changes, which reduced the forecast deficit in March and December 2012.

Figure 2.16. United Kingdom: Average Revision to Headline Public Sector Net Borrowing Forecasts Over the Next Five Years (Percent of GDP)



Source: IMF staff estimates.

2.5. Recommendations

83. Table 2.3 summarizes the assessment of the UK’s practices against those of the Code. It shows that UK meets advanced practice in four of the Code’s 12 dimensions and good practice in a further two. While the UK is at the forefront of many good practices in fiscal forecasting and budgeting, it is also true that only basic practice is met in three dimensions and does not meet the criteria are regarded as not met in a further two. Lifting the UK’s practices to

an advanced level would require relatively little effort and should be considered by the government going forward. Addressing areas of particular concern such as the non-inclusion of all own source revenue in budget documentation, the lack of time available to allow budgets to be scrutinized before they are officially announced and the absence of a comprehensive and stable fiscal objectives would all help in this regard.

- **Recommendation 2.1:** Include own source revenue and related expenditures into the fiscal aggregates to bring them to a gross basis.
- **Recommendation 2.2:** Concentrate all major tax and spending decisions into a single fiscal event held at least three months prior to the fiscal year, presenting the estimates simultaneously, allowing parliament to approve a unified budget at least one month before the beginning of the fiscal year.
- **Recommendation 2.3:** Adopt new fiscal objectives as a matter of priority in order to frame decision making around the upcoming autumn statement.
- **Recommendation 2.4:** Improve linkages between budget expenditure and intended policy outputs and outcomes.

Table 2.4. Summary Evaluation: Fiscal Forecasting and Budgeting

	Principle	Assessment	Importance	Rec
2.1.1	Budget Unity	Basic: While budget covers the full public sector, and taxes are reported on a gross basis, non-tax revenue and related expenditure are reported on a net basis	High: Own source revenues are 15 percent of expenditure, 8 percentage points of which is unreported	2.1
2.1.2	Macro Forecasts	Advanced: Detailed 5-year forecasts for all macro variables are presented and explained.	Low: While real and nominal GDP forecasts are upwardly biased (0.8 percent for T+2), this is low internationally.	
2.1.3	Medium-Term Budget Framework	Advanced: Budget includes MT projections for departments (DEL) and AME programs. Spending reviews determine lower level expenditure into the MT.	Low: Deficit outturns are frequently moderately larger than projected (1 percent of GDP in T+2)	
2.1.4	Investment Projects	Good: Total obligations are provided in the WGA, all major projects require CBA analysis in line with the greenbook, and all projects go through competitive tender.	Medium: Public investment is high at 4 percent of GDP, with a number of large projects in the pipeline.	
2.2.1	Fiscal Legislation	Basic: Content requirements are in the Budget Responsibility Act. There is no legislation laying out the budget process or the legislative's power to amend.	Medium: Largely a convention based system, well understood internally. Amendments are rare.	2.2
2.2.2	Timeliness of Budget Documents	Not Met: Budget is submitted less than a month before the financial year, with estimates provided into the new year, and passed 3-4 months after it begins.	High: Policy changes worth ½ percent of expenditure made within the budget year.	2.2
2.3.1	Fiscal Policy Objectives	Not met: There are effectively no fiscal objectives in place, following the abandonment of previous target of surplus in 2019/20 in the fallout of the Brexit decision.	High: Elevated uncertainty, large prospective fiscal activity and debt and deficit of 83 and 3 percent of GDP.	2.3
2.3.2	Performance	Basic: The budget includes information on inputs for each major policy area but not on outputs or expected outcomes.	Medium: Spending Review process provides guidance but lack of comprehensive performance framework.	
2.3.3	Public Participation	Basic: Budget provides accessible information, but little public participation in budget process.	Low: Well informed public and media lead to robust policy discussion.	
2.4.1	Independent Evaluation	Advanced: Independent OBR produces forecasts and assesses government against fiscal objectives.	Low: Prior to OBR, government forecasts were consistently optimistic	
2.4.2	Supplementary Budget	Advanced: Increases above individual voted spending limits require an ex ante change in estimates, except for the use of contingency fund, or leads to excess votes.	Medium: Large in year budget changes through the autumn statement, but in-year changes average out over time.	
2.4.3	Forecast Reconciliation	Advanced: OBR provides a forecast reconciliation in every budget update.	Medium: Forecast revisions lead to frequent policy adjustments to hit targets.	

III. FISCAL RISKS

84. This section assesses the government’s analysis, reporting, and management of fiscal risks against the practices of the FTC. It looks at three dimensions of the issue:

- General arrangements for the disclosure and analysis of fiscal risks;
- The reporting and management of risks arising from specific sources, such as government guarantees, public-private partnerships, and the financial sector; and
- Coordination of fiscal decision-making between central government, local governments, and public corporations.

Table 3.1 lists some government reports that provide information on fiscal risks.

Table 3.1. United Kingdom: Selected Government Reports Relevant to Fiscal Risks

Report	Related Risks and Issues	Author
<i>Economic and Fiscal Outlook</i> , March 2016	Macroeconomic risks, budgetary contingencies	OBR
<i>Fiscal Sustainability Report</i> , June 2015	Long-term risks	OBR
<i>Budget 2016</i>	Budgetary contingencies	HM Treasury
<i>Whole of Government Accounts</i> , 2014–15	Guarantees and other contingent liabilities, PPPs	HM Treasury
<i>Public Sector Finances</i> , report and Appendix tables 1-10, June 2016	Debt, subnational government, public corporations	ONS
<i>Debt Management Report 2016–17</i>	Debt	HM Treasury
<i>Contingent Liabilities and Other Potential Liabilities</i> (spreadsheet)	Off-balance-sheet PPPs, guarantees	ONS
<i>Private Finance Initiative and Private Finance Projects</i> , 2015, summary and spreadsheets	PPPs	HM Treasury
<i>Financial Stability Review</i> , July 2016	Financial sector	Bank of England
<i>National Risk Register of Civil Emergencies</i> , 2015 edition	Environmental risks	Cabinet Office
<i>Local Government Finance Statistics England</i> , July 2015	Subnational governments	Department for Communities and Local Government
<i>Annual Review of the Shareholder Executive</i> , 2014–15	Public corporations	Shareholder Executive
<i>UK Financial Investments Annual Report and Accounts 2015/16</i>	Public corporations	UK Financial Investments

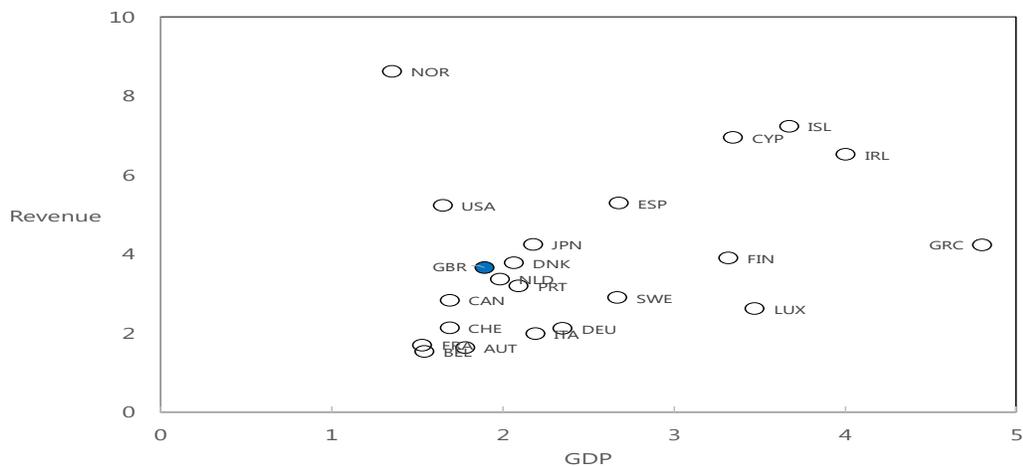
3.1. Disclosure and Analysis

3.1.1. Macroeconomic risks (Advanced)

85. Macroeconomic risks are among the most important. Even a modest shortfall in the growth of the economy relative to forecasts can lead to losses for the government much larger than those caused by the realization of many other risks, like flooding or a call on a typical government guarantees. Changes in growth mostly affect the government’s tax revenue, though spending on unemployment benefits is also sensitive to the state of the economy.

86. The UK economy and tax revenue are more stable than those of many countries. Despite the financial crisis of 2008–09, the UK’s large and diversified economy is relatively stable and, largely as a result, the government’s revenue is also relatively stable (Figure 3.1). This relative stability, combined with the government’s policy of borrowing in local currency at long maturities, puts the government in a good position to manage fiscal risks.

Figure 3.1. Volatility of GDP and Government Revenue, 2000–15, Selected Advanced Economies
(Percent)



Source: IMF World Economic Outlook database, April 2016

Note: Volatility is measured as the standard deviation of the annual growth rate. Revenue is for general government and is deflated by the consumer-price index. The sample is the G7 plus Western Europe.

87. The OBR’s Economic and Fiscal Outlooks analyze macro risks in three ways. Fan charts indicate the extent of uncertainty about future deficits and debts, on the assumption that current forecasts are no more accurate than past forecasts. Sensitivity analyses show how forecast outcomes could change with small changes in important forecast assumptions, taken one by one. And scenario analyses show how outcomes could change if several assumptions were varied simultaneously in plausible ways. These analyses are used to assess whether the government is likely to meet its fiscal targets. Taking a broader perspective, the OBR could also

investigate the likely effects of a very steep recession on public finances (a fiscal stress test),¹⁶ while the Treasury could consider how it would respond to such a shock.

3.1.2. Specific fiscal risks (Not Met)

88. Specific fiscal risks are those not easily analyzed in typical macroeconomic models.

They include the risks that explicit and implicit guarantees will be called and the risk that the government's assets will lose value. Many are discussed in the following sections.

89. No report summarizes specific risks, though relevant information is disclosed. The OBR's medium- and long-term fiscal projections discuss some specific fiscal risks, and the notes to the WGA disclose a lot of information on an overlapping set of risks. But some important sources of risk, including the possible direct and indirect fiscal costs of another financial crisis, are not discussed. And no report offers a comprehensive summary of specific fiscal risks and their possible implications for public finances. (This is likely to change when the OBR publishes its planned report on fiscal risks in 2017.)

3.1.3. Long-term sustainability of public finances (Advanced)

90. The aging of the population is expected to create large, uncertain fiscal costs. The OBR estimated in 2015 that bringing net public-sector debt back to 40 percent of GDP would require a permanent fiscal consolidation beyond that already planned of 1.9 percent of GDP. In the absence of policy changes, it forecast that the government would start to run a primary deficit (that is, a deficit excluding interest payments) in 2033–34, and that public debt would start to rise inexorably (Figure 3.2). These estimates are, as the OBR stresses, highly uncertain. If productivity growth were slower than forecast, for instance, debt would rise more quickly. The apparent unsustainability of the government's policies mirrors problems faced by most advanced economies. The European Commission's Fiscal Sustainability Report 2015 judged that the UK was one of 14 European countries facing a "medium sustainability risk in the long-term" (p. 8) and that sustainability would require consolidation of 3.2 percent of GDP (p. 156).

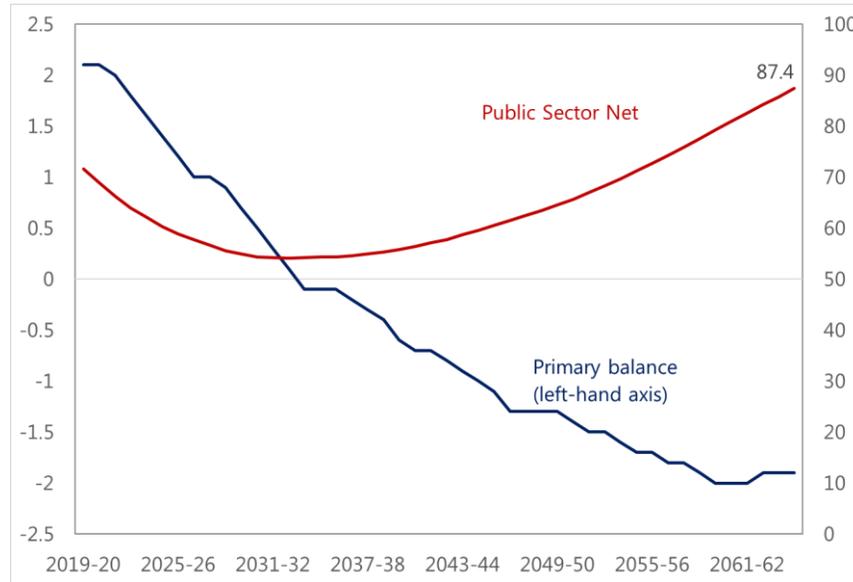
91. The OBR regularly publishes long-term projections under different assumptions.

The projections, which have a term of about 40 years, consider all spending, not just its age-related components, and show how the debt and deficit will evolve under a baseline scenario and under other scenarios based on different assumptions about pension rules, interest rates, demography, and so on. The *Fiscal Sustainability Reports* containing the projections were published every year until 2015, along with several background papers, but with the new work created by the referendum on the EU and the introduction of the planned biannual report on fiscal risks, the OBR plans to publish the *Fiscal Sustainability Report* only in the years in which the

¹⁶ See IMF, *Analyzing and Managing Fiscal Risks—Best Practices*, June 2016.

risk report is not published. This make sense, but it would also be useful to publish short, updated summaries of each report in the “off” years.

Figure 3.2. OBR’s Projections of the Deficit and Debt, 2019–20 to 2064–65
(Percent of GDP)



Source: OBR, *Fiscal Sustainability Report*, June 2015, Chart 1.

3.2. Risk Management

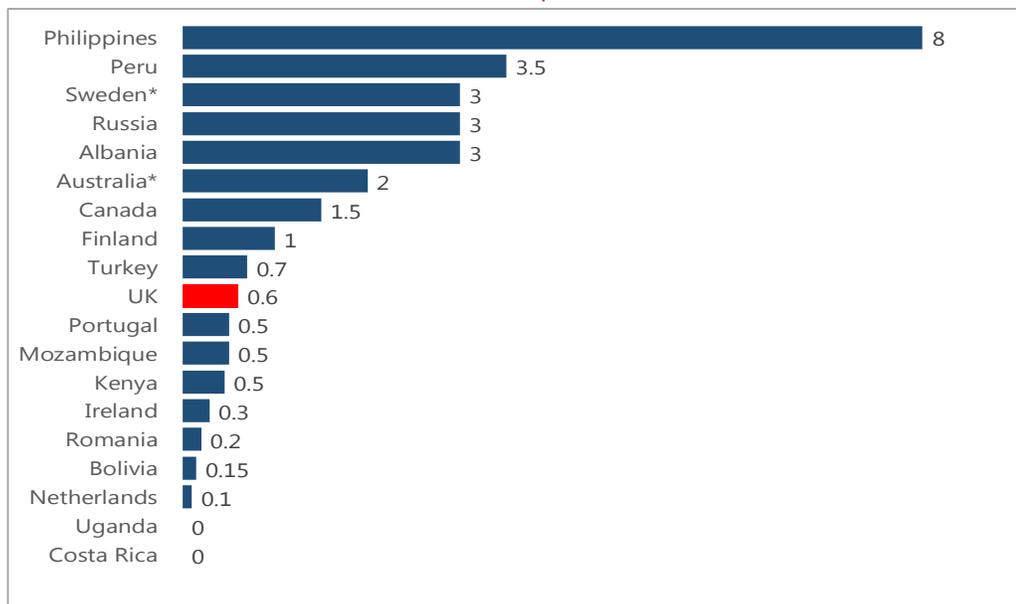
3.2.1. Budgetary contingencies (Good)

92. The budget contains reserves to deal with unexpected spending. In *Budget 2016*, the budget-year reserve for expenses (resource DEL) was GBP 3.6 billion and the budget-year reserve for capital expenditure (capital DEL) was GBP 1 billion. In total, the two reserves equal 0.6 percent of budgeted spending. This puts the United Kingdom about in the middle of the range observed in other countries for which data are readily available (Figure 3.3). Each department has its own departmental unallocated provisions (DUP), and the two reserves are intended to meet only those needs that are both unforeseen and unmanageable within departmental budgets. There are no restrictions on the types of spending that may be funded from the reserves, but before calling on the reserves departments are expected to respond by “managing the pressures down; using their DUP; re-prioritizing and making offsetting savings elsewhere in the budget; deferring spending elsewhere in the budget; and transferring provision from Resource DEL to Capital DEL (if the pressure is in Capital DEL).”¹⁷ Transfers from the reserve to the relevant appropriations are typically made in the supplementary budget. If the unforeseen spending needs are urgent,

¹⁷ HM Treasury, *Consolidated Budgeting Guidance 2016 to 2017*, February 2016, pp. 9–10.

spending can temporarily be funded from a contingencies fund if certain criteria are met and the Treasury's approval is given.¹⁸ There is no in-year reporting of the use of reserves.

Figure 3.3. Size of Contingency Reserves in Selected Countries
(Percent of Expenditure)



Source: IMF *Fiscal Transparency Evaluations* and other IMF Staff estimates.

Notes: * Reserve at end of forward-estimates period.

3.2.2. Management of assets and liabilities (Basic)

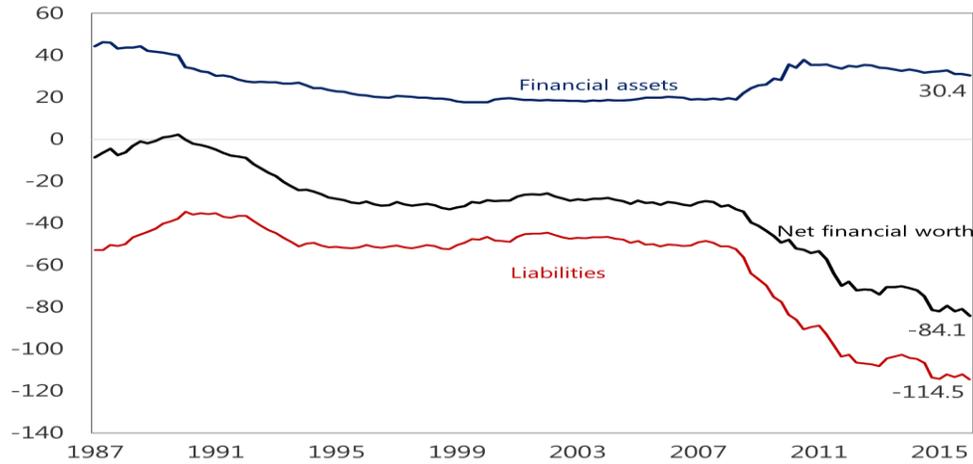
93. The government has large liabilities and also valuable financial assets. Its holdings of financial assets rose during the financial crisis, as it rescued failing banks, while its debt grew even more. At the end of March 2016, the financial assets of general government amounted to 30.4 percent of GDP, while its liabilities were worth 114.5 percent (Figure 3.4). The value of the liabilities was higher than headline measures of debt, including the Maastricht estimate of the debt of general government (87.7 percent of GDP),¹⁹ partly because the headline measures of debt exclude certain kinds of liabilities including derivatives and accounts payable amounting to about 7 percent of GDP. The rest of the difference arises because Maastricht debt is recorded at its face value, which, with the fall in interest rates, is now less than its market value.²⁰

¹⁸ HM Treasury, *Managing Public Money*, August 2015, including paragraph 2.6.2 and Annex 2.4.

¹⁹ Eurostat, General Government Gross Debt—Quarterly Data, available at <http://ec.europa.eu/eurostat/web/government-finance-statistics/data/main-tables> (accessed October 20, 2016).

²⁰ Since the introduction of quantitative easing, differences in valuation bases have also complicated judgements about the evolution of the main domestic measure of debt: Net Public Sector Debt is recorded at face value, but the Bank of England buy gilts at their market value. Because market values are now generally higher than face values, the Bank's actions have caused reported debt to increase, even though the purchase by one public body of debt issued by another public body does not fundamentally alter public finances.

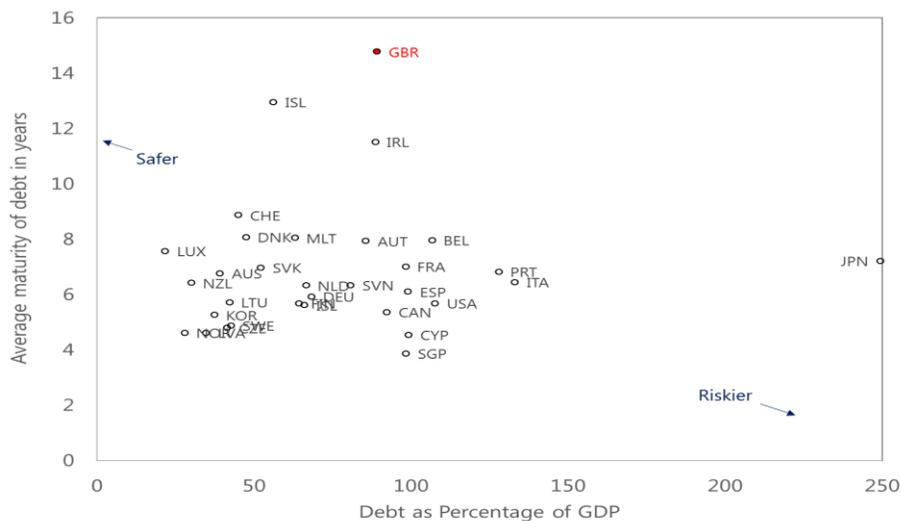
Figure 3.4. United Kingdom: Financial Balance Sheet of General Government 1987 Q1–2016 Q1
(Market value in percent of GDP)



Source: Eurostat Government Finance Statistics, Quarterly Financial Accounts for General Government, July 2016.
Notes: The negative of liabilities is shown. Pension liabilities to public servants are not included in these data or headline measures of debt.

94. The risks related to debt are disclosed. The Treasury's annual *Debt Management Report* describes debt-related risks and shows a probabilistic forecast of debt-service costs. There is also a clearly disclosed debt-management policy, which is to borrow in pounds, mostly at fixed rates, for long-average maturities (Figure 3.5), without use of derivatives. There is relatively little discussion in public documents of the risks surrounding the government's other liabilities, such as pensions, or of the risks surrounding its assets.

Figure 3.5. Level and Average Maturity of Debt in Advanced Economies, 2015

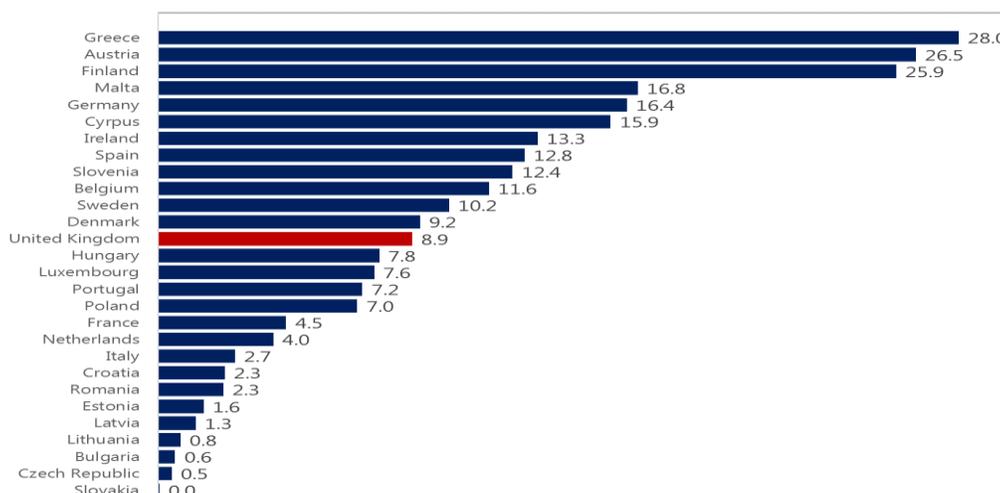


Source: IMF, *Fiscal Monitor*, April 2016, Table A23.

3.2.3. Guarantees (Basic)

95. Government guarantees have fallen in recent years, but remain significant. During the financial crisis, the government used guarantees to support banks and encourage them to lend to households and businesses. By 2010, guarantees issued by general government to others amounted to 28 percent of GDP. Since then, they have fallen to 8.9 percent, about average in Europe (Figure 3.6). These figures exclude guarantees given by the Treasury to other units in general government, such as Network Rail, and include guarantees given to public corporations, such as the Bank of England. Government guarantees given to private entities amount to 5.6 percent of GDP.²¹ The government's plans to contain reported spending while encouraging investment may encourage greater use of guarantees that have no immediate effect on the headline measures of the debt and deficit.

Figure 3.6. Government Guarantees in Europe, 2014
(Percent of GDP)



Source: Eurostat Government Finance Statistics, Contingent Liabilities and Potential Liabilities
Notes: The number for Cyprus is from 2013.

96. Guarantees are disclosed, but there is no legal limit on their issuance. Information on the total level of guarantees (of the kind shown in Figure 3.6) is available from the ONS. The WGA and the Treasury's departmental accounts also disclose and explain guarantees. Some guarantees are recognized on the face of the WGA balance sheet and a smaller range are recognized on the statistical balance sheet. Most, however, remain off-balance-sheet in the statistics and thus not subject to spending targets based on the headline measure of the deficit. Moreover, no guarantee liabilities are counted in the key measure Public Sector Net Debt.

²¹ This is the total guarantees given by units of general government less one-off guarantees given to public corporations, as reported by ONS, Contingent Liabilities and Other Potential Liabilities (spreadsheet), Table 1. GDP is the April 2016 *World Economic Outlook* estimate for 2014.

3.2.4. Public-private partnerships (Good)

97. Public-private partnerships (PPPs) also create off-balance-sheet liabilities. Although concession-type PPPs are very old, the UK pioneered the use of a kind of PPP in which the government pays for the service provided by the PPP company. Although such projects, referred to in the UK under the rubrics Private Finance Initiative (PFI) and Private Finance 2 (PF2), may sometimes be more efficient than traditional public investments, they are widely perceived to have been used to keep government spending and liabilities out of headline measures of the deficit and debt,²² which creates problems for the management of fiscal risks. The capital value of off-balance-sheet PPPs (as defined by Eurostat) remains greater in the UK than in most of Europe, at 1.7 percent of GDP (Figure 3.7), but has declined slightly in recent years as the use of these projects has slowed. The commitments associated with these PPPs is much larger than their capital value because the government is obliged to pay the expected costs of not only the construction of the assets but also their maintenance and associated services. The simple sum of all projected payments to PFI companies from 2016–17 to 2043–44, when the last projected payment will be made, is GBP 210 billion (10.9 percent of GDP), of which GBP 177 billion (9.2 percent of GDP) is off-balance-sheet in fiscal statistics.²³ The present values of these amounts, at the government's borrowing costs, are equivalent to 9.8 and 8.3 percent of GDP, respectively.²⁴

98. Recent years have seen the development of new kinds of PPP. The government has encouraged the private financing of infrastructure projects by guaranteeing the associated borrowing (see Section 3.2.3) and, in the case of electricity projects, by entering into contracts for difference with generators. These contracts effectively fix the price the generators receive: the government receives money from the generators if the market price of electricity exceeds the strike price, and it pays money to the generators if the market price is below that price. The liability created by contracts for differences on March 31, 2016 was GBP 31 billion (1.6 percent of GDP), none of which counts as debt in the headline measure published by the ONS.²⁵ The cost of

²² See House of Lords, Select Committee on Economic Affairs, *Private Finance Projects and Off-Balance-Sheet Debt*, Vol. 1, March 17, 2010, pp. 16–17, as well as Eduardo Engel, Ronald D. Fischer, and Alejandro Galetovic, *The Economics of Public-Private Partnerships*, Cambridge University Press, 2014, p. 30; David Heald and George Gergiou, "The Substance of Accounting for Public-Private Partnerships," *Financial Accountability and Management*, Vol. 27, No. 2, 2011, p. 29; and John Kay, *Other People's Money: The Real Business of Finance*, 2015, Chap. 5.

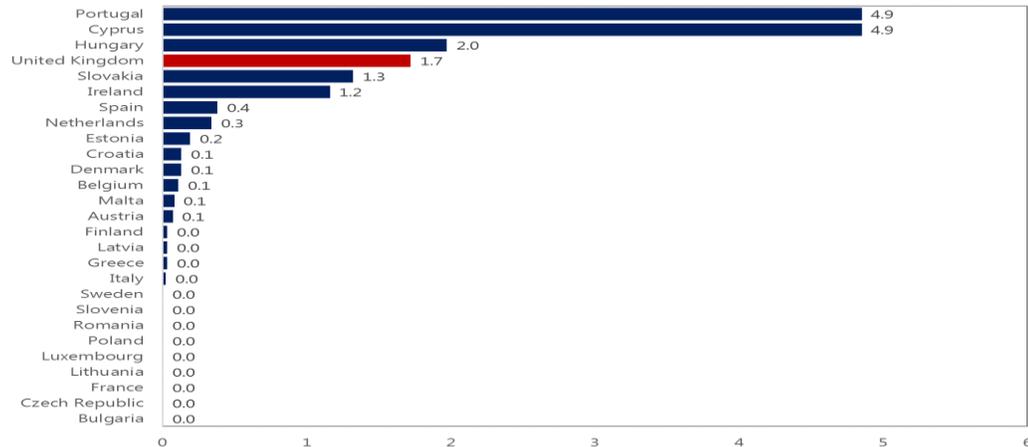
²³ These are the sum of the projected payments from 2016–17 to 2049–50 in the spreadsheet "Current projects as at 31 March 2015." Projects not reported on-balance-sheet according to ESA are assumed to be off-balance-sheet. The estimate of GDP is for calendar year 2016 and is from the IMF's April 2016 *World Economic Outlook* database.

²⁴ These estimates use the nominal spot yield curve for government borrowing on August 11, 2016, published by the Bank of England at <http://www.bankofengland.co.uk/statistics/pages/yieldcurve/default.aspx>. Very similar estimates are obtained if a constant discount rate of 1 percent is used.

²⁵ This is the estimate of the fair value of the liability reported by the Department of Energy and Climate Change in its *Annual Report and Accounts 2015–16*, p. 153. Of this amount, some GBP 13 billion is recognized on the department's accounting balance sheet (see notes 1.32 and 13). None of the liability counts as debt in the

the proposed contract for difference for the Hinckley Point C project has been estimated at GBP 30 billion (1.5 percent of GDP).²⁶

Figure 3.7. Off-Balance-Sheet PPPs in Europe, 2014
(Percent of GDP)



Source: Eurostat Government Finance Statistics, Contingent Liabilities and Potential Liabilities.

Notes: The number for Cyprus is for 2013.

99. The implications of PPPs for public finances are disclosed. Although most PPPs are off-balance-sheet in the statistics used for setting fiscal targets, most are on-balance-sheet in the WGA. Following new Eurostat rules, the ONS also publishes an estimate of the value of PPPs that are off-balance-sheet in the statistics (shown in Figure 3.6). Finally, the Treasury publishes projected government payments in PFI and PF2 projects by project for every year of each project’s life. There is no limit on the total financial obligations the government can incur over the life of PPP contracts, but aggregate spending on PFI and PF2 projects over the five years beginning in 2015–16 has been subject to a limit of GBP 70 billion.²⁷

3.2.5. Financial sector (Advanced)

100. The fiscal risks created by banks are among the most important. Some of the risks are direct: the government may be required, or may choose (subject to legal restrictions), to bail out a failing bank. One of the government’s main legal obligations is to support the Financial Services Compensation Scheme (FSCS), which guarantees deposits up to certain limits.²⁸

statistical estimates published by the ONS. The government expects to receive the money from a levy on electricity users; the associated tax asset is off-balance-sheet in both the accounts and the statistics.

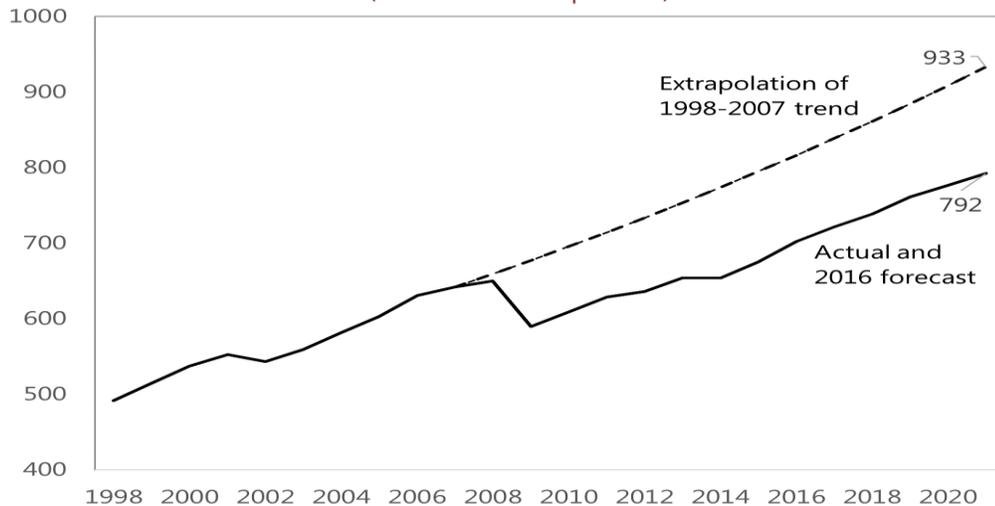
²⁶ National Audit Office, *Nuclear Power in the UK*, July 13, 2016, p. 9. GDP is the IMF’s April 2016 estimate.

²⁷ HM Treasury, *Investing in Britain’s Future*, 2013, p. 9.

²⁸ From a legal perspective, the FSCS is not part of the government: it is a company limited by guarantee with no ultimate controlling entity; see its *Annual Report and Accounts, 2015/16*, p. 95, borrows from the Treasury when its own, relatively modest resources are insufficient to meet claims (*Annual Report and Accounts*, p. 111), and it is treated as part of the public sector for the purpose of statistics and accounts (see WGA 2014–15, p. 183).

In addition, there is the effect that financial crises have on the wider economy and thus the government’s revenues. Figure 3.8 compares the government’s actual and currently forecast revenues with those that could have been forecast before the global financial crisis by extrapolating historical rates of growth. The loss of revenue relative to the pre-crisis forecast between 2008 and 2015 was about GBP 700 billion (38 percent of 2015 GDP)—an enormous amount compared to the losses likely to be caused by most other risks considered here.

Figure 3.8. United Kingdom: Revenue Loss Relative to Pre-Crisis Extrapolation
(Billions of 2016 pounds)



Source: IMF, *World Economic Outlook* database, April 2016

Note: The extrapolation assumes that revenue grows after 2007 at the rate that it grew between 1998 and 2007.

101. Much has been done since the financial crisis to reduce fiscal risks from the financial sector. There are new rules designed to increase banks’ capital, reduce their vulnerability to temporary funding problems, isolate their basic deposit-taking and payment functions from their speculative activities, and otherwise ensure that private creditors bear losses before taxpayers. Overall, the reforms have aimed to ensure that problems in financial institutions, no matter how large or complex, can be resolved without jeopardizing financial stability or imposing costs on taxpayers. There is some evidence that the value of implicit government guarantees has declined since the crisis.²⁹ More generally, the IMF’s most recent assessment of the stability of the sector concluded that the reforms had greatly increased the sector’s resilience.³⁰

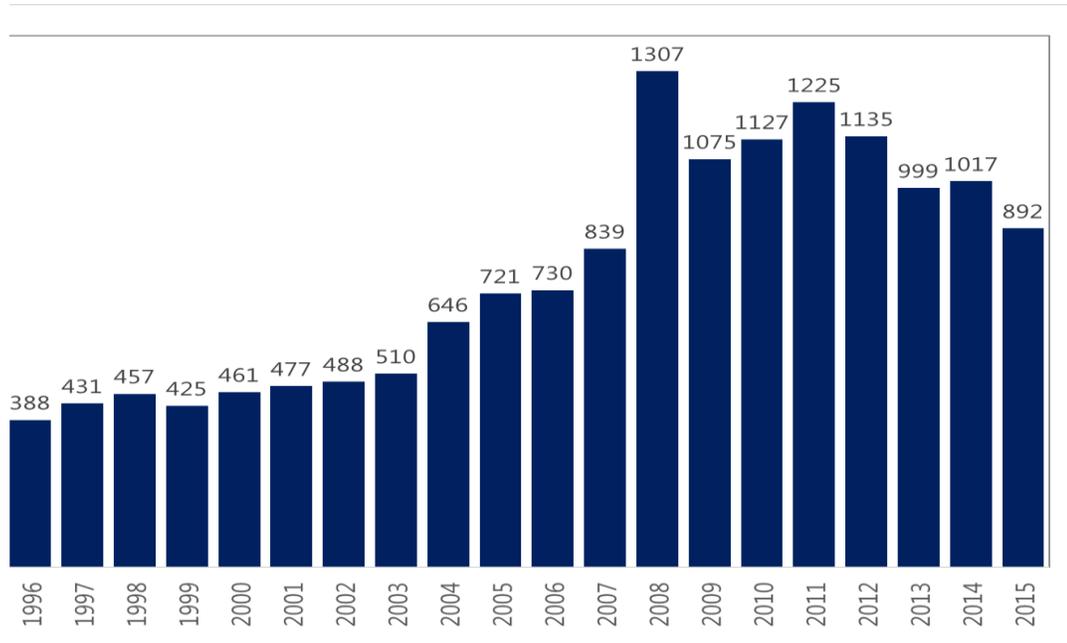
102. Yet the sector remains extremely large and highly leveraged. Figure 3.9 shows that the sector’s non-equity liabilities (which are what creates risk) have fallen since the peak of the crisis, but were still larger as a percentage of GDP in 2015 than they were in 2007. Figure 3.10

²⁹ IMF, *Global Financial Stability Report*, April 2014, Fig. 3.10.

³⁰ IMF, *Financial System Stability Assessment*, June 2016.

shows that the sector's liabilities in 2014 were greater in the UK than in any other large European country. Table 3.2 breaks the UK sector's liabilities into categories, including some that are explicitly government guaranteed and some that may benefit from some remaining implicit guarantees. The sector is also complex. (The data discussed here include the Bank of England and other public financial corporations; see Section 3.2.2 for more on publicly owned banks.)

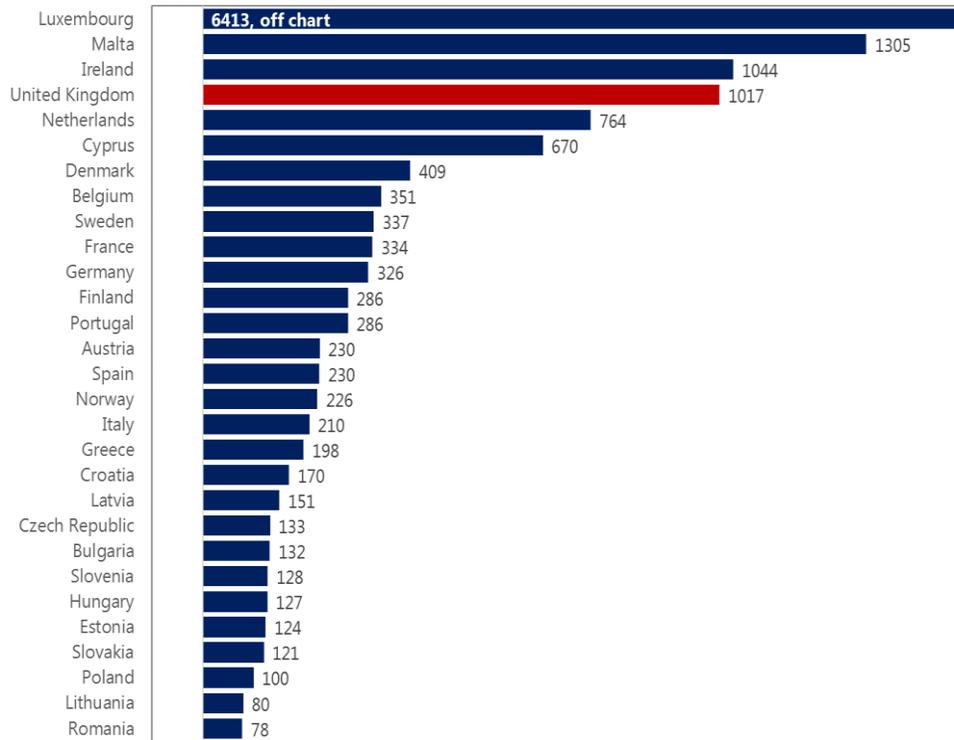
Figure 3.9. United Kingdom: Liabilities of Financial Corporations, 1995–2015
(Percent of GDP)



Source: Eurostat, Financial Balance Sheets, updated September 5, 2016.

Note: The figure shows total consolidated claims (also called liabilities) less equity claims.

Figure 3.10. Liabilities of Financial Corporations in Europe, 2014
(Percent of GDP)



Source: Eurostat, Financial Balance Sheets, update of September 5, 2016.

Note: The figure shows total consolidated claims (also called liabilities) less equity claims. Some countries are excluded for lack of data.

Table 3.2. United Kingdom: Liabilities of Financial Corporations, 2015

Liabilities	Amount in percent of GDP
Deposits	265
Debt securities and loans	166
Insurance, pensions, etc.	207
Derivatives	243
Other	8
Total	892

Sources: Eurostat, Financial Balance Sheets, updated September 5, 2016.

Notes: The Eurostat data are those described as consolidated. Deposits include transferable and other.

103. Explicit support for the sector is disclosed and financial stability analyzed. The WGA and the Treasury's departmental accounts report the government's explicit support for the sector. The Bank of England's twice-yearly *Financial Stability Reviews* discuss the soundness of the financial sector and report the results of stress tests. The OBR also reports on the net fiscal effects of the government's interventions in the financial sector. There is, however, no reporting on the broader risks that another financial crisis could cause for public finances, either because of

possible implicit guarantees or, most important, the effect of another financial crisis on economic activity and thus government revenues. Nor does the total exposure of the FSCS appear to be reported.

3.2.6. Natural resources (Advanced)

104. North Sea oil and gas is no longer an important source of revenue. Low sector profitability, a reduction in tax rates, high levels of investment, increasing decommissioning activity and the payment of refund liabilities resulting from the carryback of trading losses have led to a decline in tax revenue over the last three years, culminating in negative overall revenues in 2015/16.

105. The government analyses the risks associated with commodity price, production, and cost movements. Analysis by the OBR shows that economic factors have been the biggest source of forecasting error over the last five years, in large part due to the difficulty in predicting oil and gas prices. The 2015 FSR provided a comparison of price, production and revenue forecasts and outturns since 2010, and price and production sensitivity analysis on its long term forecasts. Reflecting the considerable price uncertainty, the March 2016 forecast assumed a conservative \$35.5/barrel price for 2016/7, increasing to \$44/barrel over the period 2018–21, generating negative overall revenue projections until 2021 (Figure 4.1 (f)).

106. A key fiscal risk arises from the loss carryback treatment for decommissioning costs. These tax losses will be absorbed by the general budget, either through reduced tax revenues or refunds to industry, since there has been no historical saving of revenues in anticipation of these liabilities. In 2015, total decommissioning costs for the UKCS over the next 25 years were estimated at approximately GBP 43.7 billion: GBP23.7 billion for PRT-paying fields and GBP20 billion for non-PRT paying fields.³¹ However, there is considerable uncertainty around these figures and how they are likely to be distributed over time.³²

107. The PRT is the principal source of near-term tax refund liabilities. Following cessation of production, losses can be carried back almost indefinitely.³³ The amount of the repayment due will depend on the company's tax history and the tax rate that applied in the year that the loss is carried back to, as well as any interest due on the repayment. The principal portion of the repayment is then taxable for ring-fence corporation tax (RCFT) and the supplementary charge (SC). Losses can also be carried back against payments of RCFT and SC to 2002, at rates of 30 and up to 20 percent respectively. However, since these payments are subject to the company level petroleum ring-fence (see Chapter IV) rather than being paid at a field

³¹ HMRC Annual Report 2014/15.

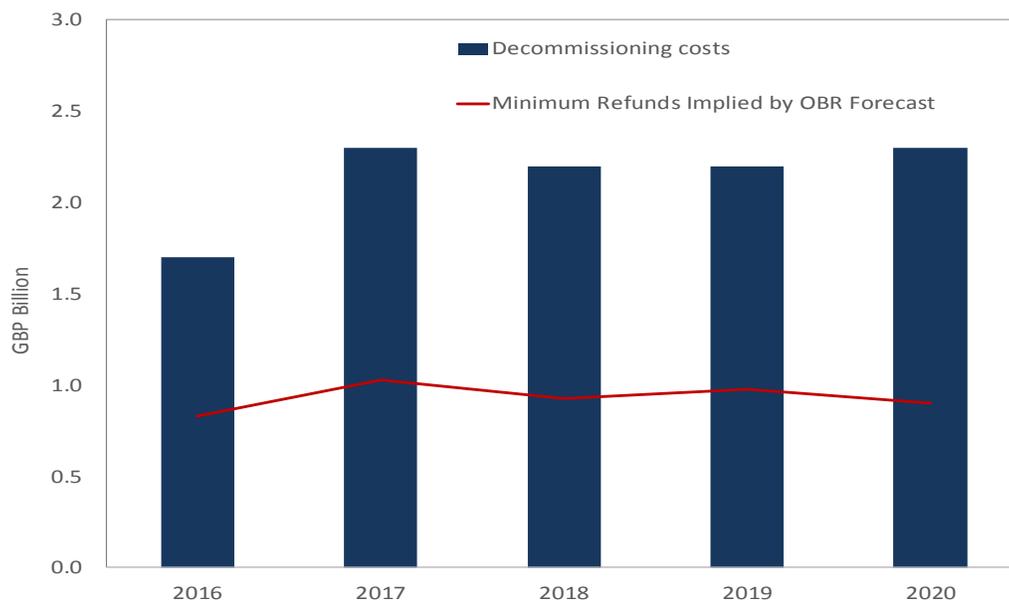
³² Estimates of total decommissioning costs have increased significantly from GBP23bn in 2009 to GBP43bn in 2015. Such estimates are also subject to the volatility of capital costs in the upstream oil and gas industry, which usually follow price trends with a short time lag.

³³ Certain exceptions apply when carrying back to previous participators before 2004.

level, HMRC estimates that such losses will be offset against a company's taxable income resulting in reduced tax payments, rather than a refund.

108. Detailed analysis on the potential timing and impact of decommissioning-related tax losses is not published. Figure 3.11 shows OBR's medium-term estimate of decommissioning expenditure, as well as the minimum tax refunds implied by its negative medium-term petroleum revenue forecast.³⁴ These figures suggest a net refund liability of approximately GBP 1bn per year over the next five years, which amounts to between 40 and 65 percent of decommissioning costs incurred annually. In its 2015/16 accounts, HMRC estimated a net GBP 6.9 billion contingent liability provision for anticipated refunds for PRT fields over the 2016–42 period, of which only GBP 1.7 billion is anticipated in the 2016–21 period. Publication of greater detail of the assumptions underlying these figures would increase transparency surrounding the government's anticipated refund liabilities.

Figure 3.11. Medium-Term Decommissioning Costs and Net Tax Refunds



Source: OBR and IMF staff estimates.

3.2.7. Environmental risks (Basic)

109. Natural disasters and other environmental problems create some fiscal risk. Floods are common and create spending needs that cannot always be met in departments' existing budgets. In recent years, at least, the necessary spending has not been very large as a proportion of total public spending. For example, floods in the winter of 2013–14 led to "exceptional

³⁴ Figures from March 2016 EFO, with calendar year adjustment. Of course, the total refunds will be larger, since the OBR forecast reports petroleum revenue on a net basis, offsetting repayments against receipts.

additional” funding of GBP 180 million (0.01 percent of GDP) in 2014–15, as well as smaller amounts in other years.³⁵ Of course, more costly floods are possible, as are other disasters such as an influenza pandemic or an accident at a nuclear power plant. In the long term, climate change creates major risks.

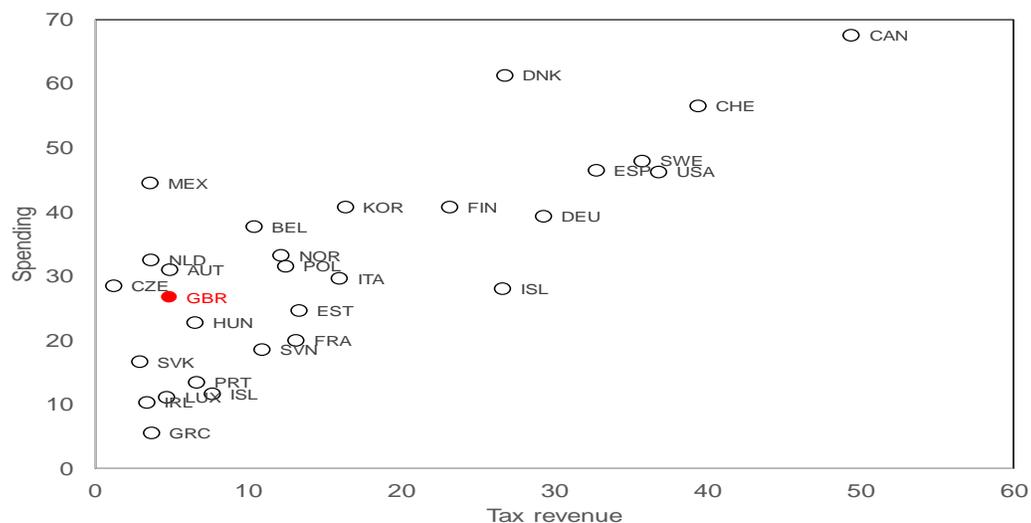
110. The government reports on a wide range of risks in the *National Risk Register*. The 2015 edition of this biennial report discusses risks related not only to floods, pandemics, and other natural hazards but also the risks of various kinds of terrorist attacks. It is based on a more comprehensive analysis that for reasons of national security is not published. Though valuable, the *National Risk Register* does not estimate the possible budgetary consequences of the emergencies it discusses.

3.3. Fiscal Coordination

3.3.1. Subnational governments (Basic)

111. Public finances have traditionally been highly centralized. In 2011, local governments collected only 5 percent of all taxes (Figure 3.12), compared to an OECD average of 15 percent. Their share of spending was higher, at 27 percent, compared to an OECD average of 32 percent.

Figure 3.12. Subnational Tax and Spending, OECD, 2011
(Percentages of totals)

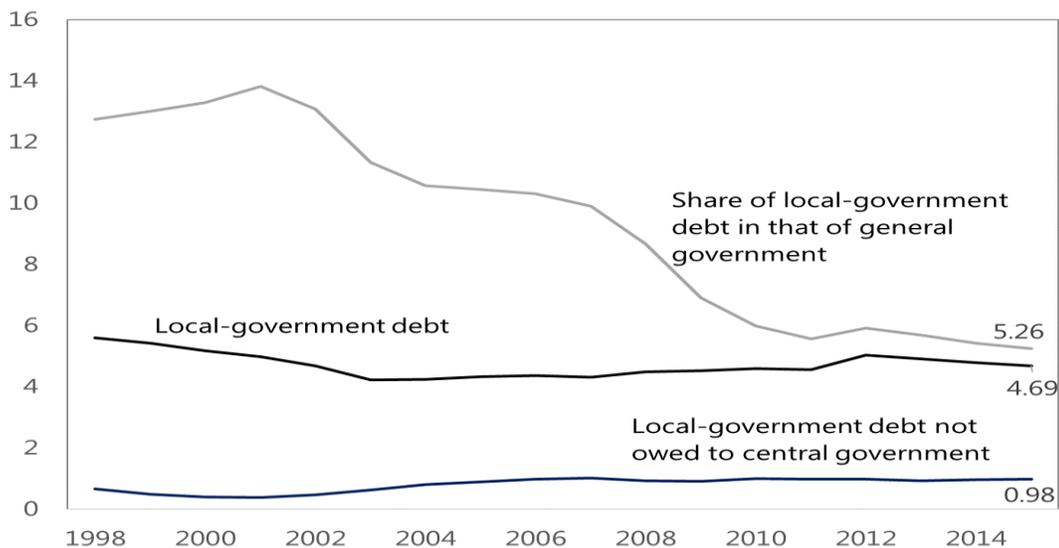


Sources: OECD, *Fiscal Decentralization Database*, Tax Autonomy Indicators and Consolidated Expenditure.

³⁵ Department for Environment, Food and Rural Affairs, *Central Government Funding for Flood and Coastal Erosion Risk Management in England*, December 2015, p. 7. GDP is the IMF’s April 2016 *World Economic Outlook* estimate for calendar year 2014.

112. Local governments' borrowing is modest, at 5 percent of GDP. Moreover, most of their debt is owed to central government.³⁶ Local governments can borrow from the central government's Public Works Loan Board, usually for less than they can borrow from others. The share of local governments' debt in the total debt of general government has also fallen sharply since 2001 (Figure 3.13). Local governments' borrowing from third parties is not generally guaranteed by the government, but it may benefit from implicit government guarantees. Standard and Poor's says in its rating of the Greater London Authority that it believes that central government "would be willing to provide timely extraordinary support to the GLA, if required."³⁷

Figure 3.13. Debt of Local Government, 1998–2015
(Percent of GDP, except for share of total)



Sources: ONS, Public Sector Finance, Appendix Table PSA8A2.

Notes: Debt not owed to the central government is assumed to be equal to total local-government debt less "LG/CG cross holdings of debt" and thus it is assumed that the central government does not have any debt to local government.

113. Devolution may create some fiscal risks, at least in the transition. Local governments in England are being given somewhat greater revenue-raising powers, and their grants from the central government are declining. Authority for some government functions has also been transferred to the devolved administrations of Northern Ireland, Scotland, and Wales, and the Scottish Government is getting further fiscal powers—though its borrowing will be limited to GBP 4.7 billion (0.2 percent of 2016 GDP).³⁸ The move to a new regime brings with it the risk of fiscal problems, at least in the transition. Some local governments may initially lack the skills to

³⁶ See also *Local Government Finance Statistics England 2016*.

³⁷ Standard & Poor's, *Greater London Authority Rating Affirmed at "AA+" on Exceptional Liquidity and Government Support; Outlook Stable*, November 13, 2015, p. 3.

³⁸ HM Government and the Scottish Government, *The Agreement Between the Scottish Government and the United Kingdom Government on the Scottish Government's Fiscal Framework*, 2016, pp. 8–9.

manage their new responsibilities and lenders' may exploit perceived implicit guarantees. Transferred revenue streams could also turn out in some cases to be too small or too uncertain to allow local governments to carry out their responsibilities.

114. Good information is available on subnational finances. The ONS includes data on the local-government sector's spending and revenue and debt in its monthly *Public Sector Finances*. (For the purposes of these statistics, the Northern Ireland Executive, the Scottish Government, and Welsh Government are treated as parts of central government.) There are also annual data on local governments in England, Scotland, and Wales.³⁹ English local governments are required to run a balanced current budget and, in aggregate, local governments in the UK have run a current surplus in nine of the last ten years.⁴⁰ There is no numerical limit on the amount that they can borrow to finance investment, although the chief financial officers of English local governments are required to ensure that any borrowing is prudent, and all local governments are required to comply with the Prudential Code produced by the Chartered Institute of Public Finance and Accountancy.⁴¹

3.3.2. Public corporations (Basic)

115. Before the financial crisis, the public-corporations sector was remarkably small. In the mid-2007, its debt (as defined by the ONS) was just GBP 18 billion (1.2 percent of that year's GDP) (Figure 3.14).⁴² This was the result of the privatizations of the 1980s and 1990s, and probably also the application of debt and deficit targets to the entire public sector, instead of to general government as, for instance, in the Euro Area. The broad coverage of the targets gives the government no incentive to carry out public policies using government-controlled entities that are just commercial enough not to count as part of government, but does encourage it to use quasi-public entities that are classified by ONS as part of the private sector (e.g., Network Rail and PFI companies, at least when they were created).

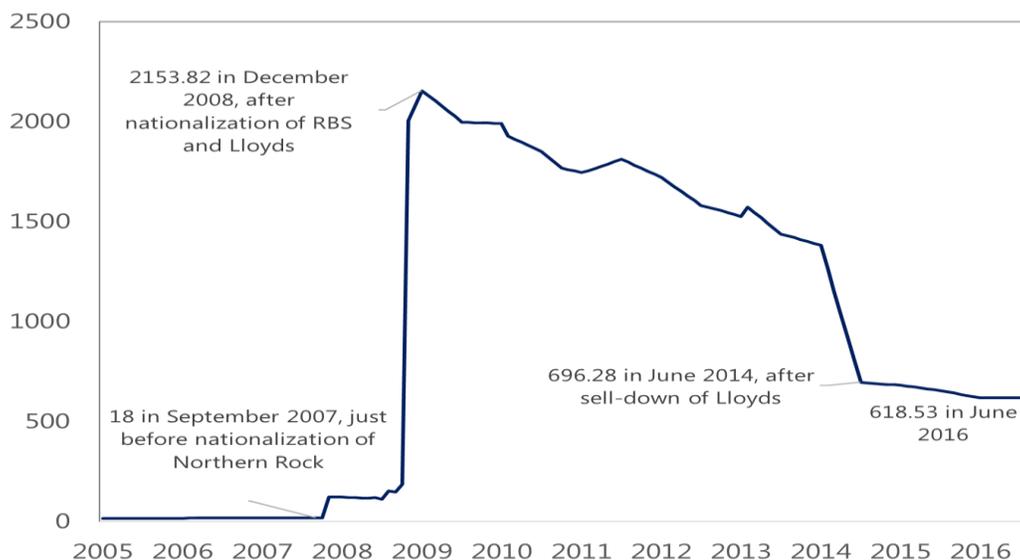
³⁹ For England, see Department for Communities and Local Government, *Local Government Financial Statistics England*, No. 26, 2016; for Scotland, *Scottish Local Government Financial Statistics 2014–15*; for Wales, StatsWales's webpage <https://statswales.gov.wales/Catalogue/Local-Government/Finance>.

⁴⁰ ONS, Public Sector Finances, July 2016, Appendix Table PSA6G, total current receipts and total current expenditure.

⁴¹ CIPFA, Prudential Code, p. vii.

⁴² The ONS definition excludes liabilities such as pensions and accounts payable, as well as the debt of the Bank of England.

Figure 3.14. United Kingdom: Public Corporations' Gross Debt, 2005–16
(billion pounds)



Sources: ONS Table PSA8B for June 2016, columns 16 and 20, for data, and ONS, *Treatment of Public Sector Banks in Public Sector Finances*, November 21, 2014, for classification of banks.

116. The public-corporations sector is now dominated by RBS. With the nationalizations of the crisis, the sector's gross debt peaked, at the end of 2008, at an extraordinary GBP 2,154 billion (141.7 percent of that year's GDP).⁴³ With the restructuring and sales of the other nationalized banks, RBS is now the only commercial bank still classified as a public corporation. Even though its balance sheet has shrunk considerably since nationalization,⁴⁴ its liabilities still dwarf those of other public corporations (Figure 3.15). On June 30, 2016, they amounted to GBP 848 billion (45.5 percent of 2015 GDP).⁴⁵ Next most important were the housing associations that were reclassified in 2015 as public corporations, and then London Underground and London Buses.⁴⁶ There are also many government-owned companies that are classified as part of general government. One of the most indebted is Network Rail, which at the end of June 2016 owed GBP 30 billion (1.6 percent of 2015 GDP).⁴⁷

⁴³ ONS, *Treatment of Public Sector Banks in Public Sector Finances*, November 21, 2014.

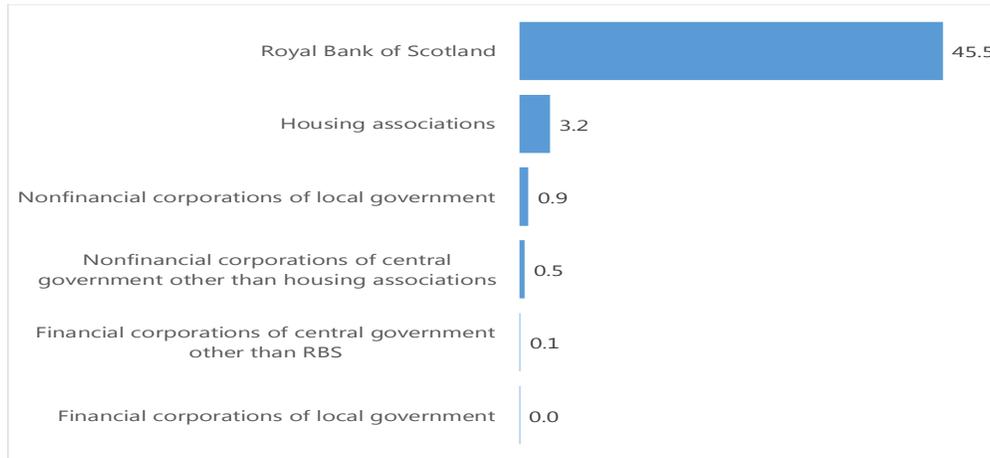
⁴⁴ RBS, *Annual Report*, 2015, p. 375.

⁴⁵ RBS, *Interim Results*, 2016, p. 14. This amount is larger than the RBS debt reported in the ONS's statistics because, in contrast to those statistics, it includes (i) pensions, accounts payable, and derivative liabilities and (ii) the liabilities of units of RBS that are located outside the UK.

⁴⁶ ONS, *Contingent Liabilities and Other Potential Liabilities* (spreadsheet), Table 2.

⁴⁷ ONS, *Public Sector Finances*, Appendix table PSA8A2.

Figure 3.15. United Kingdom: Public Corporations' Liabilities, 2015–16
(Percent of GDP)



Sources: RBS, *Interim Results, 2016*, p. 24, for RBS; ONS, *Classification Announcement: "Private Registered Providers" of Social Housing in England*, p. 2, for housing associations; ONS, *Contingent Liabilities and Other Potential Liabilities, 2015* (spreadsheet), Table 2, for others. IMF, April 2016 *World Economic Outlook* database, for GDP.

Notes: The data are for June 2016 (RBS), October 2015 (housing associations), and March 2015 (others). GDP is for 2015. The estimate for housing associations is the ONS's provisional estimate of the effect of the reclassification on its measure of the net debt of the public sector.

117. Eight years after its nationalization, RBS is still a fiscal problem. Despite the efforts to improve its finances, it has lost money every year since nationalization, the size of its losses ranging from GBP 8 billion in 2013 (0.5 percent of GDP) to GBP 1 billion in 2015.⁴⁸ The share price of the 73-percent-government-owned bank has fallen from over 400p at the end of 2014 to 193p at the time of writing (August 11, 2016). As with many banks, its leverage is very high. At the August 11 share price, its June 2016 assets of GBP 902 billion are supported by common equity worth only GBP 23 billion. (Its leverage and Common Equity Tier 1 ratios, as defined by banking regulations, are 5.2 and 14.5 percent, respectively.⁴⁹) Although RBS does not benefit from explicit government guarantees, it may benefit from some implicit guarantees, though probably less than before the financial-sector reforms mentioned in Section 3.2.5. Among RBS's "credit strengths," Moody's mentions a "moderate probability of government support" for its "junior deposits" and "operating company senior unsecured debt."⁵⁰

⁴⁸ RBS, annual reports for 2015 (p. 375) and 2012 (p. 488).

⁴⁹ RBS, *Interim Results, 2016*, p. 24.

⁵⁰ Moody's, *Credit Opinion*, July 5, 2016, p. 8. Moody's is more cautious about assuming government support for RBS than it is in some other countries, in relation to publicly (or privately) owned banks. It also says, for instance, "For RBSG's senior unsecured debt, we consider the probability of government support to be low and therefore we no longer include uplift for systemic support. This is because government support would only be likely to be provided to the operating entity, to be able to maintain its critical functions and mitigate risks to financial stability, from its failure" (p. 8).

118. Public banks are also excluded from headline measures of public finances. Although the ONS publishes an estimate of gross public debt that includes the debt of RBS, and previously other public banks, Net Public Sector Debt—the measure used for setting debt targets—excludes it. As is evident from Figure 3.10, the exclusion has greatly reduced the headline measure of debt. Similarly, although some transfers between public banks and the government affect the headline measure of the deficit—Public Sector Net Borrowing Excluding Public Sector Banks—their profits and losses do not.⁵¹ There may of course be good reasons for setting targets for the finances of only a subset of the public sector, but the exclusion of RBS from the headline debt measure could cause its finances to be less carefully scrutinized than those of other government entities—especially if it continues to remain in government ownership for some time.

119. The Bank of England is also a public corporation, albeit of a different kind. It is not classified as such in ONS statistics (it is *sui generis*), and is therefore excluded from the data examined above. It is consolidated in the WGA and treated as a public financial corporation for the purpose of segment reporting. However, its operations are in general included in headline measures of the debt and deficit. Exceptions have occurred because of the creation of statistical measures that exclude the “temporary” effects of the government’s interventions to solve the financial crisis, which among other things led to the abovementioned exclusion of public banks’ debt from the headline measure. Another consequence was that a transfer of accumulated dividends from the Bank of England to the Treasury reduced the reported deficit, even though it had no effect on the finances of the public sector.⁵²

120. Transfers between the government and public corporations are disclosed, but there is no annual report on the finances of the sector. The annual reports published by the Shareholder Executive and UK Financial Investments (which have now been combined in UK Government Investments) included relevant information on public corporations and other government-owned companies, but not enough to assess the risks created by the sector. Another problem is the antiquated nature of the Bank of England’s accounts. Although the Bank of England operates in practice as “one bank,” it presents separate financial statements for its

⁵¹ Nor is RBS consolidated in the WGA, although, unlike ONS’s statistics, the WGA reflect changes in the fair value of the government’s shareholding in the bank. The WGA for 2014–15 includes several arguments for not consolidating RBS. Some are not persuasive. “The scale of RBS,” it is said, “would dwarf other aspects of WGA, distorting the accounts and making it difficult to determine trends” (Note. 1.22.1). There is value in presenting information that makes it easy to see trends in the non-RBS part of the public sector, but this could be achieved, as in the ONS statistics, by presenting two sets of information (either by using segment reporting or by showing two entities on the face of the main financial statements as in the case of parent and group accounts). This aside, the scale of RBS is a reason for including it, not excluding it. Note 1.3, on the scope of the accounts, however, states that “some entities have not been included in WGA at this time largely for pragmatic and materiality reasons” and then mentions RBS and a set of minor entities.

⁵² See UK Statistics Authority, *Statistics Relating to Transfers from the Asset Purchase Facility Fund*, June 12, 2013.

banking and issue departments and does not consolidate its subsidiaries including the one that carries out quantitative easing.⁵³

3.4. Recommendations

121. Table 3.3 summarizes the assessment of the UK's practices in the area of fiscal risks.

As it shows, the UK's practices are frequently good or advanced when judged by the standards of the Fiscal Transparency Code. Examples of advanced practice include the OBR's reporting of risks related to the macro-economy and the long-term sustainability of public finances and the Treasury's and the Bank of England's reporting of risks related to the financial sector. The disclosure of information about risks falls short of the standard of basic practice in the Code only in summary reporting of specific fiscal risks. An area where the disclosure falls short of the standard of good practice is the reporting of the risks related to the government's assets. In many cases, the government's *control* of risks also falls short of the Code's standards of good or advanced practice. Although the disclosure of information about government guarantees public-private partnerships and subnational governments is good, there are no limits on the total financial obligations incurred in these areas.

- **Recommendation 3.1:** In the planned report on fiscal risks by the OBR, combine the analysis of macroeconomic risks already presented in the OBR's *Economic and Fiscal Outlooks* with (i) an analysis of the effects of severe shocks (a fiscal stress test); and (ii) a discussion of the implications for forecasts of a set of specific risks, including those created by guarantees, PPPs, civil emergencies, and the financial sector.
- **Recommendation 3.2:** Develop a policy for constraining the growth of off-balance-sheet commitments created by guarantees, public-private partnerships, and the like, for example by having the government set a limit on these obligations when it sets its fiscal-policy framework under the Charter for Budget Responsibility.
- **Recommendation 3.3:** Publish an annual report on the evolution and management of the risks to the government's financial assets and liabilities, taking account where appropriate of the ways in which the values of these assets and liabilities are likely to vary with the government's revenue and spending.

⁵³ Bank of England, *Annual Report, 2015*, pp. 54, 56 (n. 33).

Table 3.3. Summary Evaluation: Fiscal Risks				
	Principle	Assessment	Importance	Rec
3.1.1	Macroeconomic Risks	Advanced: The OBR's <i>EFOs</i> report sensitivity, scenario, and stochastic analyses, though with a rather narrow focus on the likelihood of meeting fiscal goals.	High: Although the economy is big and diversified, fluctuations in GDP still create very large uncertainty about tax revenue.	
3.1.2	Specific Fiscal Risks	Not met: Several specific risks are disclosed in the <i>WGA</i> and other reports, but there is no comprehensive summary report on specific risks.	Medium: Several specific risks are important, especially those from the financial sector (see below).	3.1
3.1.3	Long-Term Fiscal Sustainability	Advanced: The OBR's <i>Fiscal Sustainability Reports</i> present 40-year projections of the debt and deficit, and show sensitivity of outcomes to key assumptions.	High: Cutting net public debt to 40 percent of GDP is estimated to require a permanent fiscal consolidation of about 2 percent of GDP.	
3.2.1	Budgetary Contingencies	Good: The budget contains a reserve to meet unforeseeable, unmanageable spending needs, though there is no in-year reporting on its use	Low: Variations in spending are moderate.	
3.2.2	Asset-and-Liability Management	Basic: Borrowing is authorized by law and risks surrounding debt are analyzed in the <i>Debt Management Report</i> , but risks surrounding assets are not reported.	High: The market values of general government's assets liabilities, excluding pensions, are 30 and 115 percent of GDP, respectively.	3.3
3.2.3	Guarantees	Basic: Guarantees are disclosed each year, but there are no legal limits on the total stock or issuance of guarantees.	Medium: Explicit guarantees for entities outside general government amount to 9 percent of GDP.	3.2
3.2.4	Public-Private Partnerships	Good: The government reports on PPPs, including planned payments over the lives of the contracts, but there is no limit on off-balance-sheet PPP obligations.	Medium: Present value of commitments in off-balance-sheet PPPs is 9 percent of GDP.	3.2
3.2.5	Financial Sector	Advanced: The Treasury reports explicit obligations, and the Bank of England assesses the stability of the sector and publishes the results of stress tests	High: Banks are less fragile than before the crisis, but their liabilities remain very large, at nearly 900 percent of GDP.	3.1
3.2.6	Natural Resources	Advanced: Historical oil volumes, values, and tax revenue are disclosed, and different forecasts of revenue are published.	Low: North Sea oil now generates little net revenue, and sometimes even losses.	
3.2.7	Environmental Risks	Basic: The National Risk Register identifies and discusses natural disasters and other environmental risks, though without quantifying possible fiscal costs.	Low: Floods create uncertain spending. Nuclear decommissioning creates future costs over the very long-term estimated at 5 percent of GDP in nominal terms.	
3.3.1	Subnational Governments	Basic. Information on the aggregate finances of local governments is published, by region, but there are no limits on borrowing by local governments.	Medium: Local-government debt is moderate, at 5 percent of GDP, but devolution creates additional risks.	
3.3.2	Public Corporations	Basic: Transfers between the government and public corporations are disclosed, but little summary information on the finances of the corporations is published.	Medium: The liabilities of public corporations (mainly RBS) are 50 percent of GDP.	

IV. RESOURCE REVENUE MANAGEMENT

122. This section assesses the government’s management of resource revenues based on based on a draft of the Natural Resource Revenue Management Pillar of the FTC released for public consultation in April 2016. It focuses on sector-specific dimensions including:

- Openness and transparency of the legal and fiscal regime;
- Allocation and disclosure of resource rights;
- Collection of resource revenues; and
- Reporting by resource companies.

123. The petroleum sector has played a significant role in the UK economy to date.

Offshore gas production started in 1967 and total hydrocarbon production peaked in 1999 at 4.6 million barrels of oil equivalent (MMBOE) per day (Figure 4.1a), at which point the UK was able to meet all of its oil and gas demand domestically. Since the late 1990s, production levels have been generally declining, and with 70–80 percent of the estimated ultimate resource having been extracted (Figure 4.1c), the government has placed a renewed focus on encouraging new exploration and maximizing the economic recovery of remaining petroleum resources.

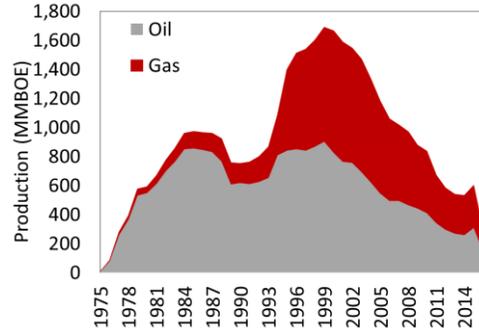
Production now comes from over 300 mainly small and increasingly mature fields, with increasing decommissioning activity, as fields reach the ends of their productive lives. The UK Continental Shelf (UKCS) is a high cost basin by international standards and, while the quality of North Sea crude has historically generated substantial profits for the sector, recent price trends have driven down the sector’s profitability (Figure 4.1d). Low sector profitability, a reduction in tax rates, high levels of investment, increasing decommissioning activity and the payment of refund liabilities resulting from the carryback of trading losses have led to a decline in tax revenue over the last three years, culminating in negative overall revenues in 2015/16.

Figure 4.1. United Kingdom: Petroleum Sector Snapshot

The UK has produced 43 billion barrels of petroleum over the last five decades...

...contributing a sizeable, although volatile share of government revenue.

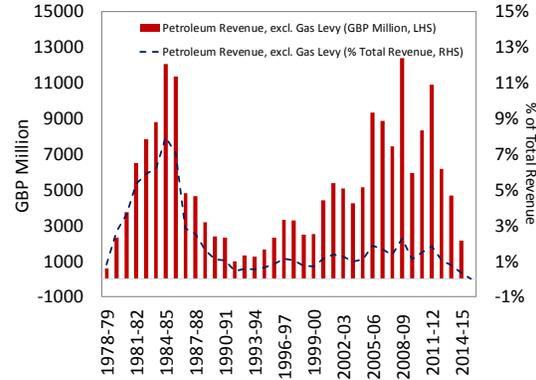
Figure 4.1 (a): Petroleum Production (1975-2015)



Source: OGA

Between 70 and 80 per cent of estimated reserves have now been extracted ...

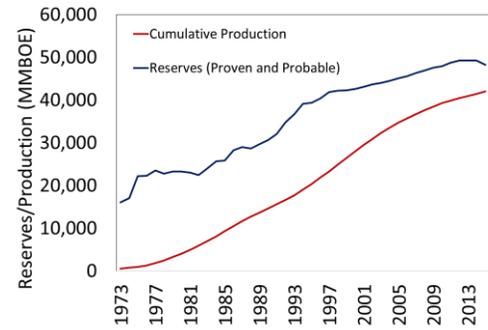
Figure 4.1 (b): Petroleum Tax Revenue (1975-2015)



Source: HMRC

...with recent price movements putting industry profitability on a further downward trend.

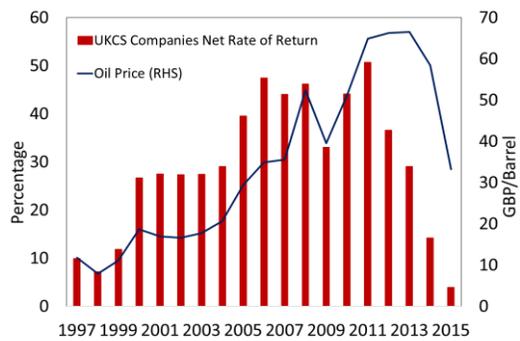
Figure 4.1 (c): Petroleum Reserve Depletion (1975-2015)



Source: OGA

In this context, the revenue significance of the sector is low.....

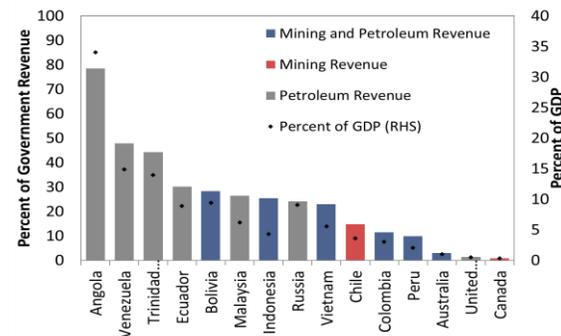
Figure 4.1 (d): Sector Profitability (1997-2015)



Source: ONS, WEO

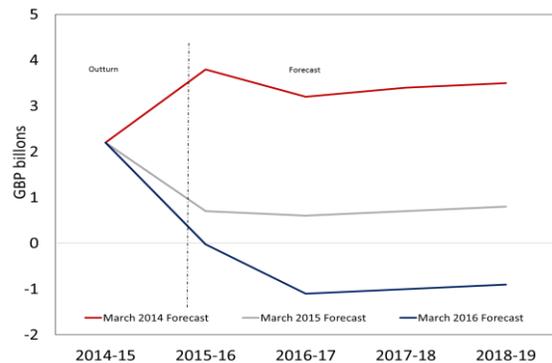
.... with projections of a net cost to government in the form of tax refunds as decommissioning activity commences

Figure 4.1 (e): Resource Revenue Dependence (2000-13)



Source: IMF staff estimates.

Figure 4.1 (f): Petroleum Revenue Forecasts (2016-19)



Source: OBR

4.1. Legal and Fiscal Regime

4.1.1. Legal Framework for Resource Rights (Advanced)

124. The UK has a clear, accessible, and comprehensive legal framework for the petroleum sector covering each stage of the resource development process.⁵⁴ Under the consolidated Petroleum Act 1998, the right to extract petroleum resources within Great Britain and its territorial waters is vested in the “Crown” or the State.⁵⁵ A framework of laws, regulations and licenses determine the conditions for granting rights to the private sector for the exploration and extraction of petroleum, which differ for onshore and offshore areas, and the rules governing pipeline and decommissioning activity.⁵⁶ Licenses cover the exploration, appraisal, development and production for a specified time period in a given area, with transition between phases being subject to fulfilment of the agreed work program or development plan and relinquishment of acreage. Hydraulic fracturing in the onshore sector is subject to additional conditions specified in the Infrastructure Act 2015, as well as local planning approvals.

125. The creation of an independent regulator represents a move to strengthen and clarify institutional responsibilities. In 2015, following the recommendations of the Wood Review,⁵⁷ the government created the OGA as regulator of petroleum operations, initially as an Executive Agency of DECC (latterly BEIS). In October 2016 the OGA became a government company under the provisions of the Energy Act 2016. The creation of the OGA represents a move towards better governance and stewardship of the UK’s remaining petroleum resources and infrastructure. The OGA conducts licensing rounds and monitors activity in the sector, and with its new autonomy it will gain the power to impose penalties for non-compliance.

⁵⁴ All relevant laws and regulations are publicly available and easily accessible. Between them, the government-wide website and the new OGA website house all legislation, regulations and guidance documents published by the relevant sector departments and agencies. There are no legal impediments to the disclosure of non-commercially sensitive information, and the Freedom of Information Act of 2000 and the Environmental Information Regulations provide for a public right to access information held by public authorities, subject to certain exemptions.

⁵⁵ The Petroleum Act does not vest ownership of resources in the Crown, only the right to extract, which is then transferred under licenses. Ownership of resources is established through licenses, upon extraction, at the well-head.

⁵⁶ Northern Ireland holds ownership of onshore oil and gas under the Petroleum (Production) Act (Northern Ireland 1964, as well as responsibility for issuance of its onshore licenses. The legal and fiscal framework applicable in Northern Ireland is not assessed in this chapter.

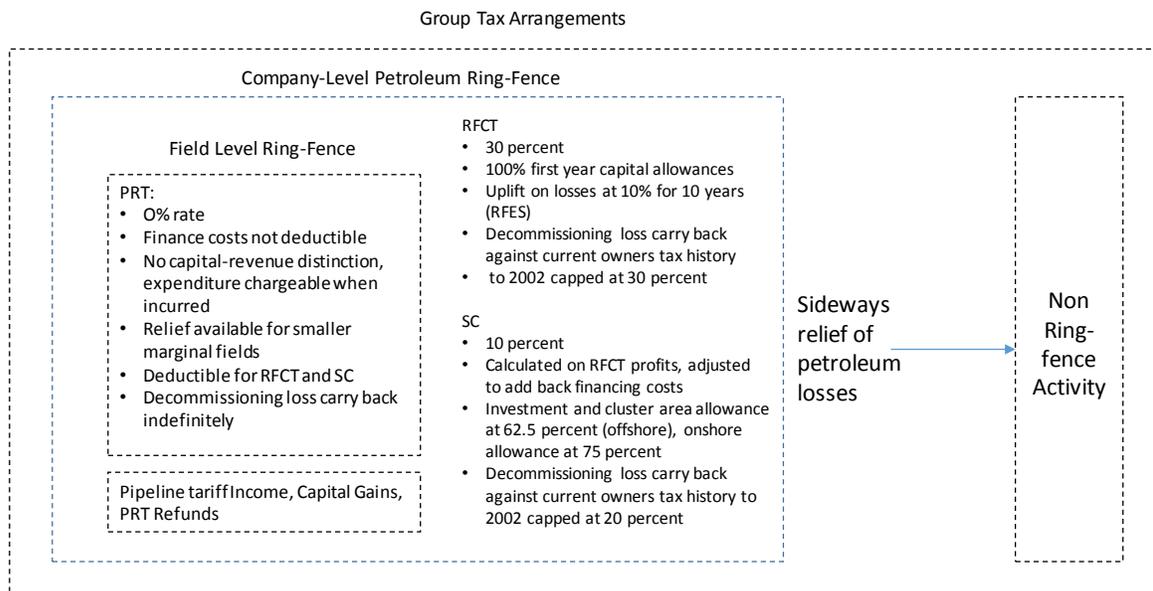
⁵⁷ The Wood Review refers to an independent review of UK offshore oil and gas recovery and its regulation commissioned by DECC in 2013, led by Sir Ian Wood.

4.1.2. Fiscal Regime for Natural Resources (Advanced)

126. The upstream petroleum sector fiscal regime is clearly set out in legislation in terms of the rates and base, and the scope for variation in fiscal terms between fields. The regime is made up of three tax instruments: the RFCT, the supplementary charge (SC) and the now zero-rated petroleum revenue tax (PRT) which applies to fields which received development consent before March 16, 1993 (Figure 4.2). The variation of ring-fencing⁵⁸ treatment between tax instruments, along with the carryback scheme for the recoupment of trading losses and for losses incurred when decommissioning petroleum fields, adds complexity to the system. A decommissioning relief deed (DRD) is available to all companies, providing an assurance of stability of the tax relief available with respect to decommissioning costs. Companies are also subject to statutory indirect taxes and business rates, as well as several sector-specific non-tax payments including license fees and the new oil and gas levy introduced under the Energy Act 2016.

127. The principal source of variation in terms between fields has been a system of investment allowances under the SC. The March 2015 budget repealed a set of allowances differentiated by field characteristics such as water depth and pressure level, moving to a single basin-wide investment allowance, and cluster area allowance, which simplifies the system and levels the playing field among license-holders. For onshore oil and gas, the regime remains the same as for the offshore sector, albeit with a higher 75 percent investment allowance.

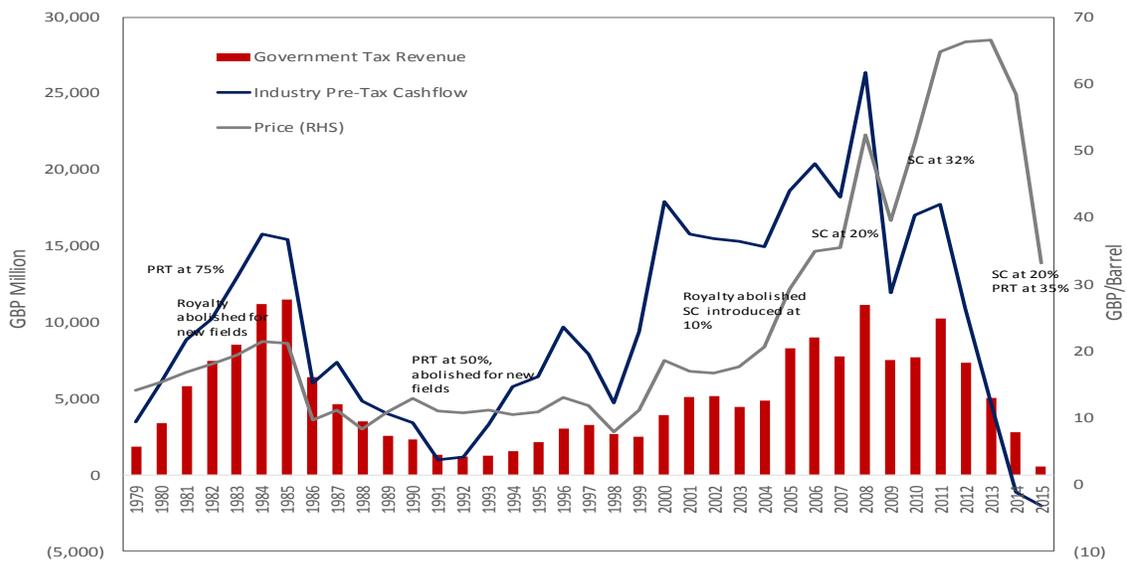
Figure 4.2. United Kingdom: Petroleum Sector Fiscal Regime



⁵⁸ A ring-fence places a limit on the consolidation of income and deductions for tax purposes across different activities, or different projects, undertaken by the same taxpayer. For the UK's PRT, consolidation of income and expenses is restricted to the field level, generating a PRT liability for each field operated by a particular company. RFCT and SC are subject to the petroleum ring-fence (see Figure 4.1), which prevents losses from a company's other activities from reducing taxable profits generated through its upstream petroleum activity.

128. The petroleum sector fiscal regime has been historically variable and complex, constructed through incremental policy changes over time. HMT has been the principal policymaking agent and petroleum sector tax policy has been driven by the overall fiscal position of the government, with incremental modifications in the regime over the last 30 years often based on movements in the oil price (Figure 4.3), a pattern which industry has learned to expect over the commodity cycle. The figure suggests that with such a reactive approach to policy-making, overall tax revenue collections have not followed the pre-tax cash flow of the industry in any systematic way. Following the 2013/14 “Driving Investment” review of petroleum sector tax policy, HMT has begun to take a more systematic and transparent approach to tax policy. Upon conclusion of the review, HMT clearly stated its goals to simplify and reduce the tax burden in light of the maturity of the basin in order to support the efforts to maximize economic recovery of remaining United Kingdom Continental Shelf (UKCS) resources.

Figure 4.3. United Kingdom: Government Revenue and Pre-Tax Cash Flow (1979–2015)



Source: OGA, HMRC and IMF staff calculations.

129. The carry back treatment of tax losses related to decommissioning has generated a number of complications for the sector. The UKCS has seen a large number of transactions and associated changes in license ownership over the last 30 years. In the case of field-level PRT, following cessation of production, losses can be carried back to the tax history of previous owners of the field and can be factored into a transaction price, whereas for the RFCT and SC the losses can be carried back only against taxes paid by the company. Thus, the need to have a tax history in order to carry back losses complicates matters for new entrants specializing in late-life assets and decommissioning. This element of the fiscal regime has led to transactions being structured to ensure that the anticipated tax refunds are not impacted, for example through shared liability of decommissioning expenses between the buyer and seller. HMT is currently consulting with industry to gather evidence to establish to what extent, if any, this is preventing commercial transactions.

4.2. Allocation of Rights and Collection of Revenue

4.2.1. Allocation of Resource Rights (Advanced)

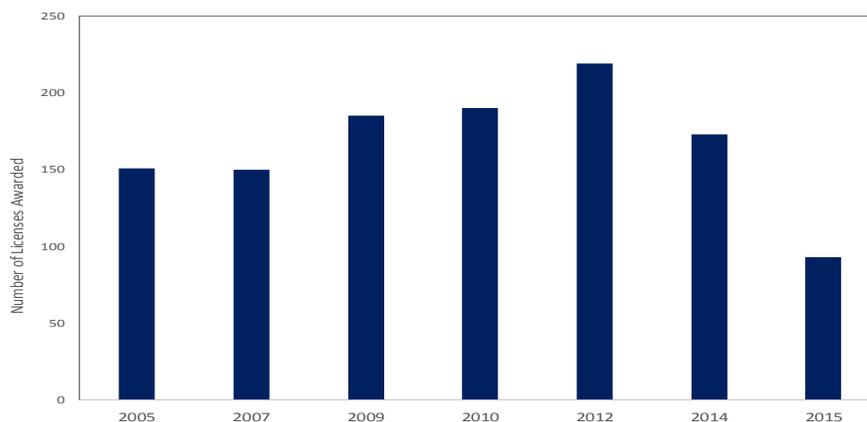
130. In accordance with the UK Petroleum Act, the UK's process for granting natural resource rights is open and competitive. The EU's Hydrocarbon Licensing Directive, which has been transposed into UK law, requires the tender to be announced and advertised in the EU's Official Journal, 90 days prior to the application deadline. Even in the case of special out-of-round allocations, for example, for blocks adjacent to existing licensed blocks, the areas to be licensed must still be opened up to public tender and advertised as per EU legislation.

131. The rights allocation system involves clearly defined and published pre-qualification criteria and disclosure of final awards. When the licensing round is announced, the pre-qualification criteria are published, along with the bid evaluation criteria in the form of a mark scheme. There have been no fiscal biddable variables in recent licensing rounds, and the mark scheme is based on qualitative and quantitative aspects of the proposed work program. At the conclusion of the licensing round, a list of winners and their overall mark is published by the OGA.⁵⁹ Licenses typically follow the model clauses, although the non-commercially sensitive parts of the winner's work program are published as part of their license. Any transfer of licenses following the initial award is also subject to OGA approval procedures.

132. The level of transparency of the process appears to be appropriate, although there is room for further disclosure, given the large number of licenses awarded each year (Figure 4.4). The design of the system, through its use of scores assigned on the basis of features of the proposed work program, involves some inevitable element of discretion. Public disclosure of the mark schemes for all or at least the winning bidders would increase the transparency of the system. However, given the general absence of any challenges to the outcomes of licensing rounds, strong administrative capacity and anti-corruption/anti-bribery rules, the system appears to be appropriate in the UK context.

⁵⁹ Following discussions with the authorities, it is understood that in line with suggestions from the mission, OGA plans to publish a complete list of applicants to licensing rounds for the next licensing round (the 30th round) and onwards.

Figure 4.4. United Kingdom: Number of Petroleum Licenses Awarded (2005–15)



Source: OGA.

4.2.2 Disclosure of Resource Rights Holdings (Good)

133. The government maintains and publishes an interactive database and map of petroleum licenses. The interactive map allows a user to easily see all blocks licensed or offered, along with key details such as the start date of the license, its status, coordinates and the names of the operator and its partners. The OGA also publishes the license documents themselves, searchable by license number, along with a list of license relinquishments, updated annually. For enhanced transparency and record-keeping, the database could include a history of the changes of ownership, together with regular reporting on licenses transferred during a given year.

134. Recently signed DRDs have not been published. The Finance Act 2013 grants HMT the ability to enter into these stabilization contracts with license-holders, a model version of which is available online. As of June 2015, the government had entered into 72 DRDs. While HMT reports to Parliament each year on the number of DRDs that have been signed, the actual contracts have not been published, nor the names of the companies with which these contracts have been signed, due to the inclusion of a confidentiality clause in each of the contracts. It is understood that each of the contracts follows the model document. Consistent with good practice under the FTC, the government should consider publishing these contracts, or at least the parties to them, after obtaining each company's consent.

135. The government's "person with significant control" database allows knowledge of the ultimate beneficiary of the license. The newly implemented legislation requires all UK incorporated companies, in all sectors, to provide the name, country of residence, and the nature of their control, with five tests to determine whether a beneficiary is significant enough to warrant disclosure in the register. The EITI process also encourages disclosure of beneficial owners, although only one company reported this information in the 2014 report. For additional transparency and accountability, the government could require public disclosure of the chain of any intermediaries between the license-holder and the ultimate beneficiary.

4.2.3. Assessment and Collection of Revenues (Advanced)

136. HMRC produces an annual report on its audit and compliance activities. HMRC publishes an annual report containing its consolidated accounts and detailed reporting on the tax gap. In this publication, the HMRC reports against its targets, and provides details of compliance activity undertaken during the year. The annual report does not disaggregate this information by sector. However, relevant sector-specific details are noted. For example, the 2015-16 report explains a revised approach to estimating the provision for decommissioning costs.

137. HMRC also provides a large amount of guidance on the petroleum sector fiscal regime, with clear mechanisms for consultation between government and industry. The web-based Oil Taxation Manual provides a detailed guide to each of the tax instruments and the intricacies of calculating the tax base. HMRC has a dedicated tax team for the sector with specialist knowledge in this area, and meets regularly with the UK Oil Industry Taxation Committee. HMRC's Oil and Gas working group is also working with its stakeholders to identify areas where the administrative burden can be reduced, for example by simplifying the filing of returns for the now zero-rated PRT.

138. There is a clear process for dispute resolution with regular reporting on disputes resolved. As for all sectors, there is a Tax Dispute Resolution Board to which cases are referred in the first instance, with an appointed commissioner responsible to ensure that tax disputes are resolved in an appropriate manner. The process is clearly set out in the Litigation and Settlement Strategy, and the Code of Governance for resolving tax disputes. Aggregate information regarding the nature and status of referrals is published in the Tax Assurance Commissioner's Annual Report. If disputes are not resolved at this level, they are referred to HM Courts and Tribunals Service. However, the regular consultation and cooperation in the petroleum sector have meant that most disputes are resolved by mutual agreement between industry and HMRC, with very few cases proceeding to litigation.

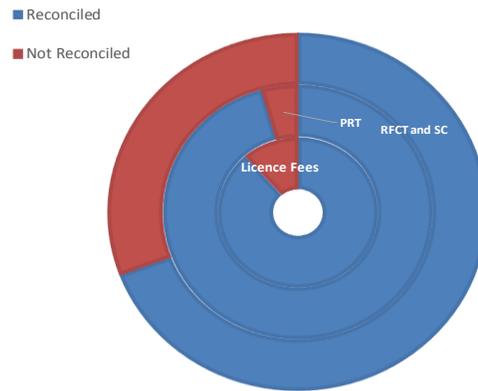
4.2.4. Resource Revenue Audit and Verification (Good)

139. The UK published its first EITI report in April 2016, reconciling tax revenue data for 2014. Project-level payments were reported where possible, for example in the case of the PRT and the license fees, while the RFCT and SC which are determined within the petroleum sector ring-fence were combined and reported at the company level. The publication of this report forms part of the process to reach EITI compliance, which the UK hopes to achieve upon completion of its next report in 2017.

140. Non-disclosure by several companies meant that not all tax revenues were reconciled. Information on tax payments made by individual companies are subject to taxpayer confidentiality provisions under UK law, and therefore HMRC required waivers from reporting companies in order to be able to provide this information for the EITI exercise. With six petroleum companies neither reporting nor providing the waiver, 25 percent of total petroleum

tax payments and license fees were left unreconciled. This reconciliation gap was most significant for the SC and RFCT category (Figure 4.5). Continued non-disclosure by significant petroleum companies will prevent the UK from achieving EITI compliance, and is now a priority issue for the UK EITI multi-stakeholder group.

Figure 4.5. United Kingdom: Coverage of EITI Reconciliation



Source: UK EITI Report (April 2016).

4.3. Company Reporting

4.3.1. Reporting on Domestic Payments (Advanced)

141. Most resource companies operating in the UK publicly report material company-level tax payments on a voluntary basis under the EITI. Fifty-nine petroleum companies reported on their 2014 payments. As mentioned in 4.2.3, six companies which were within the scope of the report did not participate, leaving a significant amount of unreconciled tax revenue. Increased company participation in the exercise is now a priority for the UK EITI multi-stakeholder group. While the scope of the report is limited to resource extraction companies, this is sufficient since there are no sales of UK petroleum by the government to commodity trading companies.

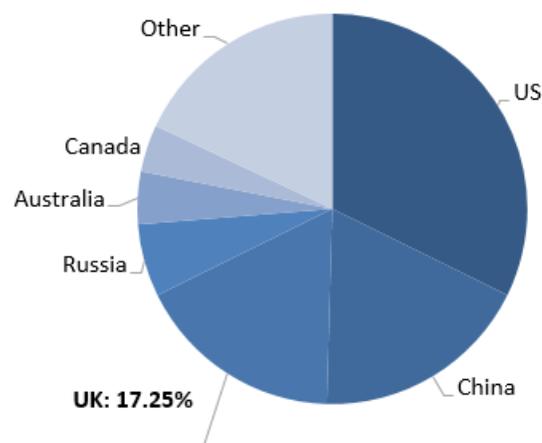
142. As EITI reporting is further established, the UK might consider publishing the underlying company submissions and to reduce the time lag in publication. While the first report contains an example of the template completed by companies during the process, each company's report was not published, something that is common practice in a number of EITI compliant countries. In addition, the disaggregation of payments and repayments of PRT, SC, and RFCT would provide additional information on the tax revenue flows to and from the sector, particularly as refund payments become more significant. Consideration should be given to the feasibility of separate reporting of RFCT and SC since they are calculated on different tax bases due to variations in deductions and investment allowances. Furthermore, given the high institutional and human capacity of the institutions involved in the process, the UK should aim to publish the report more promptly after the end of a financial year, demonstrating the possibility for reducing the typical two-year time lag in the EITI process.

4.3.2. Reporting on Worldwide Payments (Good)

143. The UK has made significant progress on reporting of worldwide payments to governments by resource companies. The relevant provisions of the EU Accounting Directive and the Transparency Directive were transposed into UK legislation in 2014. The Accounting Directive applies to UK-registered large or public interest companies that are active in the extractive sectors or logging industries, while the Transparency Directive applies to companies active in these sectors who are issuers with securities admitted to trading on an EU regulated market. UK legislation requires companies to report annually on project-level payments made to governments worldwide for financial years beginning on or after January 1, 2015, including by their overseas subsidiaries. The materiality threshold for payments reported is GBP 86,000 for a single payment or series of related payments. Reporting under the Accounting Directive by UK-registered firms are filed with Companies House, while submissions under the Transparency Directive by UK-listed companies are filed with the Financial Conduct Authority and published by the Morningstar investment research platform.

144. Implementation of this legislation is an important step given the significance of the UK in facilitating and financing extractive industry activity (Figure 4.6). The government estimates that 177 companies will fall under the scope of the Accounting Directive, and 80 extractive companies will be subject to Transparency Directive, of which 37 are UK registered. Under both directives, reports are required to be filed in an electronic and machine readable format in accordance with the UK's Open Data Charter.

Figure 4.6. Regional Distribution of Extractive Sector Public Capital (in percent of Market Cap) 1/



Source: FT Global 500 (2015)

1/ Includes 36 oil, gas, and mining companies with a total market capitalization of USD 2.8 trillion.

145. Consistent with the EU directives, payments to governments for the sale of commodities are not included within the scope of the legislation. The legislation currently applies to companies engaged in resource extraction activity in the mining, petroleum, and

logging sectors. Increasing global awareness of transparency surrounding the purchase of commodities from governments by trading houses suggests the need to also require such payments to be disclosed. This is not only significant given the presence of large commodity traders such as Glencore on the London Stock Exchange, but also to set an example for other countries to follow suit in expanding the scope of their reporting requirements.

4.3.3. Operational, Social, and Environmental Reporting (Advanced)

146. There is adequate disclosure of environmental and social impacts of petroleum sector activity. In the offshore sector, EU legislation requires that an environmental impact assessment is submitted for approval by BEIS before any activity can commence. BEIS publishes a list of applications received and a summary document for each of the consents granted. The assessments themselves are not published online, but are available on request. Submission of an environmental impact assessment is also a requirement for approval of decommissioning work programs. In the onshore sector, there is significantly more public reporting on environmental impact. Any onshore oil and gas activity requires an environmental permit, as well as fulfilment of any additional requirements of the regional environmental agency. Onshore activity is also subject to planning approval by the relevant local authority, which requires submission and publication of an environmental impact assessment for consultation with local communities.

147. There is regular disclosure of information related to project operations. The initial work program is published as part of the license document. Field level production data, supplied by companies, is updated by the OGA on a monthly basis. The UKCS field information portal reports key data about each petroleum field, its partners, discovery wells, production history and location, as well as gas flaring activity.

4.4. Resource Revenue Management

4.4.1. Budgeting of Resource Revenue (Advanced)

148. Petroleum revenues are remitted to the national budget, with no specific fiscal objectives for utilization of revenue. Trading loss and decommissioning-related refund payments are also financed by general government revenue. There is limited earmarking of non-tax revenues including a small population based share of license fees which is transferred to Northern Ireland by BEIS (GBP 1.9 million in 2014/15), the oil and gas levy which has recently been introduced to finance the newly created OGA (GBP 8.2 million in 2015/16), as well as with some smaller fees and charges also retained by the OGA (GBP 1.1 million in 2015/16). In the case of shale gas, GBP 100,000 is to be paid to the local communities by operating companies for each well drilled and 1 percent of future revenue from shale gas activity will be allocated to the local communities by operating companies. Business rates paid by petroleum companies undertaking shale gas exploration or extraction will also be retained by the relevant local authority.

4.5. Recommendations

149. Table 4 summarizes the assessment against those of the Code. It shows that the UK meets advanced practices in seven dimensions and good in the remaining three applicable dimensions of the draft code. It has a clear and comprehensive legal and fiscal framework, follows open and competitive rights allocation processes. As noted in Chapters I–III, the UK also performs effective fiscal reporting, forecasting, and budgeting of petroleum revenues. In recent years, the government has also taken a clearer, more systematic approach to fiscal policy formulation and institutional oversight of the sector.

150. However, declining production and price levels, and increasing tax refund obligations have raised new transparency considerations. Refunds due to the sector exceeded revenue collections in 2015/16, and the OBR now forecasts negative revenues from the petroleum sector over the next five years. Significant uncertainty around decommissioning cost estimates and the likely fiscal cost implications raises the need to monitor, forecast, and manage these liabilities over the medium term. As explained in Chapters I–III, HMRC’s petroleum revenue outturn should provide an annual disaggregation of receipts and refunds from and to the sector. In a climate of economic uncertainty and fiscal austerity, government payments to the petroleum sector are also likely to require clear explanation and public communication. Better reporting on the tax loss position of the sector and the size of investment allowances will further increase transparency, and allow a more complete understanding of the sector’s current and projected tax contribution.

151. The UK should continue its implementation of emerging international standards with respect to corporate disclosures. The first EITI report demonstrated significant progress in establishing the necessary infrastructure and reporting frameworks, resulting in voluntary reporting by 59 petroleum companies. Similarly, publication of the first company reports under the EU Accounting and Transparency Directives and submissions to the beneficial ownership register are significant steps forward in generating a culture of corporate transparency. Over time, there is scope to play a further pioneering role in the area of corporate disclosure, expanding reporting requirements to include payments to governments for the sale commodities, and to require UK-registered companies to report not only the ultimate beneficiaries, but any chain of intermediaries connecting the local rights holder with the ultimate owner.

- **Recommendation 4.1:** Publish signed Decommissioning Relief Deeds (DRDs), or at least a list of companies with whom DRDs have been signed, subject to obtaining each company’s consent.
- **Recommendation 4.2:** Continue with implementation of current corporate disclosure initiatives, and consider expanding reporting requirements to include payments to governments for the sale of commodities.

Table 4.1. Summary Evaluation: Resource Revenue Management

	Principle	Assessment	Importance	Rec
4.1.1	Legal Framework for Resource Rights	Advanced: Legal framework is clearly established in published laws and model licenses. Freedom of Information Act facilitates legal access to all non-commercially sensitive information held by government.	Medium: Recent pressures facing the North Sea petroleum sector, and large upcoming decommissioning investment require a clear and certain policy and regulatory environment.	
4.1.2	Fiscal Regime	Advanced: Tax rates and bases are clearly specified in laws and regulations.	Medium: With frequent changes of regime increases need for clear and comprehensive fiscal regime specification.	
4.2.1	Allocation of Resource Rights	Advanced: Licensing rounds are conducted in an open manner involving public calls for tender, pre-specified qualification criteria and mark scheme and publication of winning bidders and scores.	Medium: Declining production from mature producing fields gives added importance to attracting new investment in exploration and enhanced recovery.	
4.2.2	Disclosure of Resource Rights Holdings	Good: All licenses are published. DRDs are not published. No disclosure of chain of intermediaries between local rights holder and beneficial owner.	Low: All signed DRDs follow the model template.	4.1
4.2.2	Assessment and Collection of Revenues	Advanced: HMRC produces guidance notes, reports annually on compliance and audit activities, and has a clear dispute resolution process.	Medium: Complexity and variability of fiscal regime requires good administrative capacity and processes.	
4.2.3	Resource Revenue Audit and Verification	Good: EITI report on 2014 payments represented project-level, independently validated but incomplete reconciliation.	Medium: 25 percent of petroleum revenues were unreconciled. Full reconciliation required for EITI compliance.	
4.3.1	Reporting on Domestic Payments	Advanced: Reporting by 59 petroleum companies on project-level payments in 2016 UK EITI report.	Medium; 100 percent of activity undertaken by the private sector.	
4.3.2	Reporting on Worldwide Payments	Good: Implementation of 2014 Payments to Government Regulations for UK listed/domiciled companies is in progress with first reports due in 2016/17. Legislation does not apply to trading companies.	Medium: Large proportion of worldwide resource extraction and trading activity conducted by UK-listed or incorporated companies.	4.2
4.3.3.	Operational, Social and Environmental Reporting	Advanced: Environmental impact assessments are publicly available, and OGA publishes regular drilling and production activity reports. Continued engagement with local communities required for onshore activity.	Low: No history of environmental or social issues, although shale gas activity has raised new concerns	
4.4.1	Budgeting of Resource Revenue	Advanced: Petroleum revenues are remitted to the national budget, with no specific fiscal objectives for utilization of revenue. Monitoring and management of tax refunds now an emerging issue.	Low: Significance of petroleum revenues has been low in recent years (0.4 percent of total tax revenue in 2014/15). However, tax refunds resulted in negative revenue of -24m in 2015/16) raising new liability management issues.	
4.4.2	Resource Fund Operations and Oversight	N/A	N/A	
4.4.3	Resource Fund Investment Strategy	N/A	N/A.	

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