Written evidence submitted by The Fraser of Allander Institute (FAI)

Who we are and why we are responding to this inquiry

The Fraser of Allander Institute (FAI) is a leading independent economic research institute based at the University of Strathclyde, focussing on the Scottish and UK economies.

The FAI combines internationally renowned researchers with knowledge exchange specialists who have significant experience from the public and private sectors. This ensures that the Institute's analysis is not only cutting edge, but delivered in a way which is accessible and relevant. Institute staff are regularly called upon to provide independent briefing and advice to government, parliament and industry.

João Sousa is one of the Deputy Directors of the FAI, leading the institute's work on macroeconomic and fiscal issues. João also has significant experience in the public sector using and producing data and analysis based on the public finances. João was previously the lead analyst on the Office for Budget Responsibility's long-term projections (which include use of the Whole of Government Accounts metrics), and so has first-hand experience of using these metrics and data releases, as well as their relevance for the OBR's outputs and broader interested parties in the state of the public finances.

Response

1. This evidence is based on my use of the Whole of Government Accounts (WGA) during my work at the OBR and since joining the Fraser of Allander Institute, as well as on the latest publication of the WGA, especially given the Comptroller and Auditor General's (C&AG) assessment of the progress of improvements to timeliness and quality by HM Treasury.

2. The principle behind the WGA is laudable, and the fact that this such a comprehensive set of accounts is prepared on an ongoing basis in the UK is not to be taken for granted. In broad terms, the UK has some of the most comprehensive metrics and targets for assessment of the public sector's liabilities in the world. The fact that the 'deficit' and the 'national debt' are taken to mean <u>public sector</u> net borrowing and net debt – as opposed to general government, for example, which is used in the Euro Area – is a credit to the UK's commitment to fiscal transparency to a greater extent than many of its peers. This has served to discourage many of the off-balance sheet tricks used across other countries through the use of public corporations to hide away liabilities.

3. This is not to say that no 'fiscal illusions' have ever been used by the UK Government – take the sale of the student loan book at a discount during the 2010s for example, as a way to bring down debt in the short run. This is where the WGA has shown its worth. The OBR's use of it in its long-term projections and consistent highlighting of some of these fiscal illusions was instrumental in bringing them to the fore. The Office for National Statistics (ONS) has now changed its treatment of student loans by imposing an immediate charge on government borrowing when loans are issued, discouraging the Government from pulling tricks in the same form.

4. This principle has been applied more broadly since then, with remarkable success in highlighting the expected future costs of financial transactions in the form of non-performing loans or called-upon guarantees. The Covid loans schemes are the best example of this, and the OBR and ONS were again at the forefront of showing this by including best estimates for the cost of these loan guarantees as soon as they were issued in both the public finances and in fiscal forecasts. This is an important part of holding the government to account, and one which should be celebrated.

5. This is part of the WGA-type principles that have become embedded in the thinking about the public finances that has become part of the public sector's attitude towards financial management. Paragraph 2.17 of the OBR's 2011 *Fiscal sustainability report* (FSR) highlighted a number of areas in which the national accounts fell short of comprehensively capturing the costs of government policies, meaning that the OBR's baseline for long-term projections needed to be augmented by information from the WGA.

6. The improvement to the National Accounts since then in the form of capturing these future liabilities means that many more of these liabilities now for part of the net borrowing and net financial liabilities baseline that the OBR use. To some extent, the WGA has become almost a victim of its own success in embedding this thinking in reporting organisations, and therefore it is less needed than it used to be for long-term projection work.

7. There are still some areas where further information must be sought to provide an accurate picture of future financial flows, defined benefit public sector pensions being the most obvious one. Despite employee and employer contributions, they are on net paid out of the general purse, as there is an annually managed expenditure (AME) top-up grant that is required to fund them, and this is expected to continue to be the case in perpetuity.

8. But looking at the OBR's latest sets of long-term projections highlights just how downgraded the use of the WGA as a data source has become. The OBR used to devote a large part of its FSR (now part of the *Fiscal risks and sustainability report*, or FRS) to discussing the changes from the latest WGA, but it has little bearing on the new projections as the national accounts more comprehensively include future liabilities. Specialist reports are commissioned from the Government Actuary's Department to provide a regular revaluation update to public sector pension schemes.[1]

9. And with that being the case, some of the usefulness of each new edition of the WGA for institutions such as the OBR and users of their publications such as our institute is diminished.

10. Does that mean that the WGA is no longer useful? Not necessarily – the principles in which it is based continue to be worthwhile. But it is probably at a crossroads. Its comprehensiveness makes it costly and difficult to compile in a timely fashion. This Committee's previous reports and the C&AG's updates point out the fact that the Treasury has been working to produce the accounts more quickly, which was a difficult task, and yet it is still nearly 2 years after the date of reporting for the balance sheet.

11. The lack of timeliness means that when the WGA comes out, it is well out of date relative to decision-makers' thoughts – quite correctly, because we want politicians and senior civil servants to be focused on the here and now as well as the future, not relitigating what

[1] Some of the other areas not covered in the public finances, such as contingent liabilities, are not included by the OBR either in their long-term projections, but rather covered as long-term risks in the FRS (and previously in the *Fiscal risks report*). These generally do not move significantly in short periods of time, even if they can be significant. Clinical negligence and nuclear decommissioning are some of the largest of these.

happened 24 to 36 months ago. And in the absence of more timely data on a WGA-basis, decision-makers prefer to turn to less comprehensive but more regularly updated data such as the Public Sector Finances (PSF) release.

12. This is particularly problematic for the sector for which the WGA's coverage has been dropping off most acutely, which is local government. Eight section 114 notices have issued by English local authorities since the pandemic and the Institute for Government expect more in 2024-25,[2] while equivalent declarations are a potential concern in Scotland. Local authorities in England in particular increased their risk-taking in the 2010s, and some are likely to be severely exposed to interest rate risk.

13. Their financial position and that of the local government sector as a whole is a concern, and one that requires more data. But the data used in compiling the PSF release on the local government side is based on much less data than the central government equivalent, over which the Treasury has much more control and oversight. This makes the compilation of accurate and timely accounts all the more pressing, and is probably one of the areas where the Government should focus efforts in the WGA.

14. In my view, there are four stepts that the WGA production process should take:

    a. Become more timely and report on a more frequent than annual basis, in the same way that private sector entities do when listed. Quarterly reports could be issued without a full audit, but they would provide a more timely indication of the latest data, and would certainly be more timely.

    b. A full set of accounts should be produced within months of the end of the financial year, and certainly before the following fiscal event, so that any issues uncovered could be addressed by politicians and senior civil servants in a timely manner. Of course the Government is a large organisation to co-ordinate this, but building reporting timelines across departments to feed into this is necessary for the accounts to be meaningful.

    c. For large but not very time-sensitive aspects of the accounts, which are unlikely to change significantly year to year (e.g. contingent liabilities from nuclear decommissioning), take a rotating approach to different areas so that they are fully calculated and audited every few years, without requiring a full deep dive every year.

    d. Create a structure that allows the reporting of local authorities to be both incentivised and punished if not fulfilled in a way, but in a way that is also used for timely monitoring of spending across authorities by the Treasury and the Department for Levelling Up, Housing and Communities. With the financial problems faced by the sector, having a structure that is proactive in identifying potential issues and that can flag up risks in real time could be combined with reporting requirements so as to provide both transparency and resilience.

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[2] https://www.instituteforgovernment.org.uk/explainer/local-authority-section-114-notices (Accessed 3 April 2024).