UK Budgeting System

The UK budgeting system has two main objectives:

- To support the achievement of macro-economic stability by ensuring that public expenditure is controlled in support of the Government's fiscal framework; and

- To provide good incentives for departments to manage spending well so as to provide high quality public services that offer value for money to the tax-payer.

Fiscal Framework

The UK Government has two fiscal rules:

- The **golden rule**: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
- The **sustainable investment rule**: public sector net debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level.

Achievement of the fiscal framework is measured using the National Accounts. These are prepared in accordance with the internationally agreed framework 'European System of Accounts' (ESA 95). The Office for National Statistics (ONS), acting as an independent agency, is responsible for the national accounts.

The national accounts aggregates used with respect to the fiscal rules, measured at the level of the public sector, are:

The **Surplus on the Current Budget** is used to measure achievement of the Golden Rule. It aims to measure current revenues and expenditure on an accruals basis. It includes a measure of depreciation and does not include provisions.

Public Sector Net Debt (PSND) is a measure of the stock of debt that includes the government's financial liabilities (such as government bonds and National Savings and pensions liabilities) less liquid assets. PSND is managed by limiting **Public Sector Net Borrowing,** which is essentially the flow equivalent of the PSND stock measure.

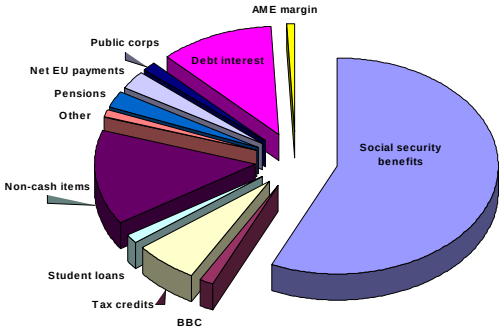
Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME)

Departmental Resource and Capital Budgets are divided into:

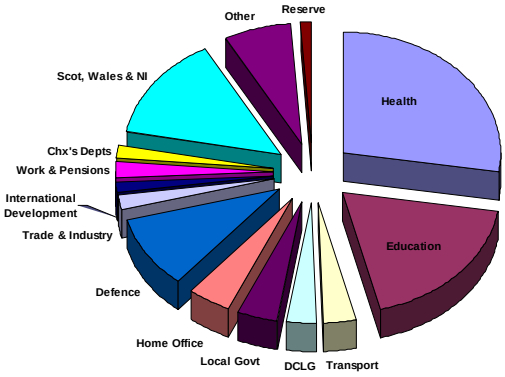
- **AME** – large and/or volatile demand led elements of expenditure the Treasury does not expect departments to control within budgetary limits. The Treasury reviews AME programmes twice a year with departments in the run-up to the two annual fiscal events, the Budget and the Pre-Budget Report, in which a revised AME forecast is published
- **DEL** – firm three-year departmental expenditure plans, set on a multi-annual basis in biennial or triennial Spending Reviews by administrative instruction from the Finance Minister (the Chancellor of the Exchequer), not by parliament. Departments may not exceed the limits that they have been set.

All programmes are in DEL unless the Treasury has determined that they should be in AME. The breakdown of DEL and AME is set out in the diagram below:

Annually Managed Expenditure



Departmental Expenditure Limits



Departmental budgets are set on an accruals basis, and cash is not controlled directly through the budgeting system. However, indirect control is exercised particularly through near-cash control totals for resource and capital DEL and the management of near cash in AME. In addition the Net Cash Requirement for Supply Expenditure is controlled through the Parliamentary Supply Estimates process, which provides Departments' legal authority to spend their budget allocations.

DEL control totals

Departments have separate DEL budgets for:

- **Resources** – current expenditure such as pay and including the current costs resulting from the ownership of assets, such as depreciation and a cost of capital charge. Within the Resource budget DEL there are separate budgets set in Spending Reviews for:

    - **Near-Cash** within Resource DEL – expenditure that impacts directly on the Golden Rule, for example pay and current procurement; and
    - **Administration Budgets** – expenditure on running central government departments but excluding their frontline activities. Note that while these two budgets overlap, they are separate control totals; they are not cumulative.
- **Capital** – for new investment and net policy lending.

These controls support the achievement of the fiscal framework and provide management incentives for departments.

Near-Cash within Resource Budget DEL is a control aggregate close to the measure of current spending that impacts on the current balance used to assess the Golden Rule. It excludes non-cash items such as depreciation (although depreciation impacts on the current balance, it is measured on a different basis), cost of capital charges (not in the current balance) and movements in provisions (not in the current balance, but expenditure that in GAAP terms is financed by release of provisions is in the current balance and is in near-cash).

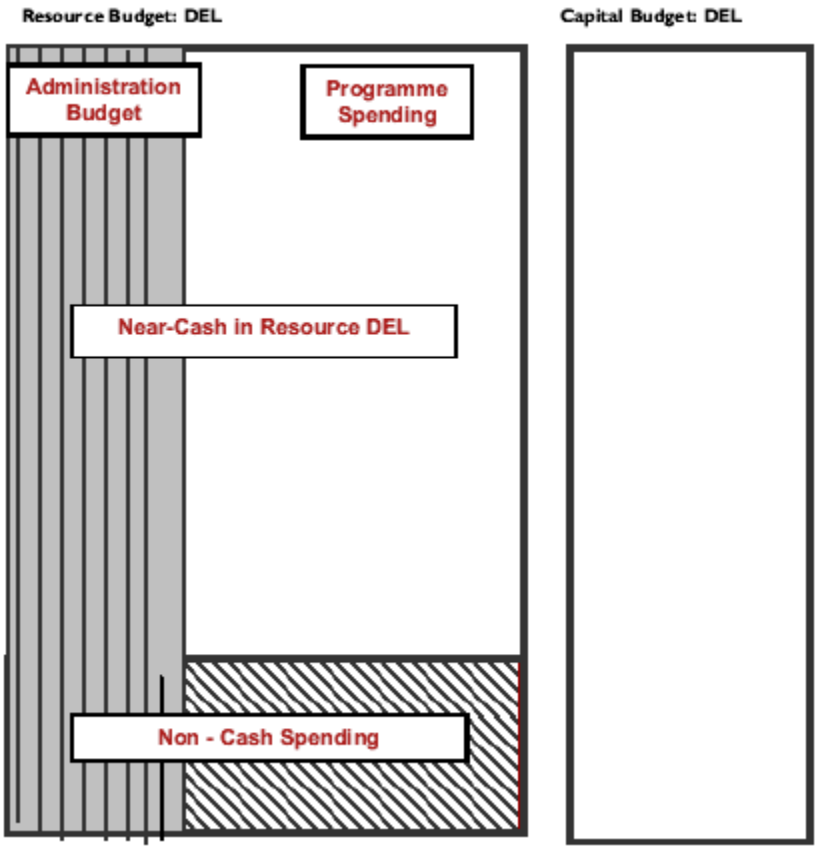
Resource Budget includes both near-cash and non-cash current spending. Departments are expected to manage non-cash costs like other costs, because this reflects their management of department's assets and liabilities, and changes in depreciation and provisions convey useful information to managers. So if necessary departments have to make offsetting savings in any part of their resource budget if non cash items rise. Similarly, where material savings on non-cash reflect management action, the Treasury will consider allowing switches of provision to near-cash in order to maintain incentives to manage non-cash costs.

Administration Budgets are controlled to ensure that as much money as practicable is available for front line services and programmes. Provision in the Resource Budget that is not in Administration Budgets is termed programme spending.

Capital budget spending is controlled because net investment increases Net Borrowing and hence the level of debt.

Departments are able to vire spending from near-cash Resource DEL to non-cash Resource DEL, and from Resource DEL to Capital DEL , but not vice versa.

These control totals are set out diagrammatically below:



Within each of these control totals, departments have broad autonomy to pursue efficiencies and prioritise expenditure in order to optimise the value for money of spending. Where departments experience spending pressures in an area of their budget they are expected to re-prioritise and make offsetting savings elsewhere. Exceptionally, a department may make a claim on the Reserve, a small contingency set aside a part of the Spending Review process.

The budgeting system also contains a mechanism, end year flexibility (EYF), whereby departments may carry forward unspent DEL provision into later financial years. Entitlements to EYF are calculated each year and published in the Public Expenditure Outturn White Paper.