

NEW FORMAT FOR PUBLIC FINANCES

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This article describes the extra information the Office for National Statistics has begun publishing on public finances. The article also describes the further changes that occurred when national accounts moved to a European System of Accounts 1995 (ESA95) basis in September 1998. It also describes subsequent changes in January 1999, when monthly estimates of public sector net debt were first published; and November 1999, when monthly estimates of the public sector surplus on current budget, and net investment were first published.

The extra information is consistent with the new format for public finances outlined in the Economic and Fiscal Strategy Report (EFSR) presented to Parliament on 11 June 1998. The new format allows monitoring and assessment against the Government's fiscal rules.

A key aspect of the new format is the prominence it gives to two measures derived from national accounts - public sector current balance and net borrowing - rather than the public sector borrowing requirement (PSBR) which is a measure of government cash flows.

The PSBR has been renamed as the public sector net cash requirement to avoid confusion with public sector net borrowing which is on an accruals basis.

THE ECONOMIC AND FISCAL STRATEGY REPORT

The EFSR presented a new format for public finances which corresponded more closely to the Government's two fiscal rules, and emphasised the importance of distinguishing between current and capital spending.

These two fiscal rules are:

the *golden rule*: over the economic cycle, the Government will borrow only to invest and not to fund current spending;

the *sustainable investment rule*: net public sector debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level.

The Government believes that, all other things being equal, it is desirable that net public sector debt be reduced to below 40 per cent of GDP over the economic cycle.

The three key measures for monitoring public finances are:

public sector surplus on current budget - used to judge Golden Rule;

public sector net borrowing - the principal measure of the budget deficit

net public sector debt ratio - used to judge sustainable investment rule.

Table A shows the links between national accounts and the EFSR key measures.

THE NEW FIRST RELEASES

One of ONS's key objectives is to make information available against which government policies can be monitored and judged. ONS has begun publishing two new First Releases - *Public Sector Finances* which is monthly, and *Public Sector Accounts* which is quarterly. They make information available in the new format to help monitor fiscal policy effectively.

On 16 June 1998 ONS published the PSBR First Release under the new name *Public Sector Finances*. It showed the PSBR under its new name *public sector net cash requirement*.

On 16 July 1998 ONS expanded *Public Sector Finances* to include public sector net borrowing as well as all the information previously shown on the net cash requirement. This style continued until further enhancements in November 1999, when monthly data for the public sector surplus on current budget, and net investment, was first published.

On 23 June 1998 the new quarterly First Release *Public Sector Accounts* was published. It gave detailed quarterly information on the public sector derived from the quarterly national accounts published the same day. In particular it showed the public sector current balance, net investment, and net borrowing.

Public Sector Accounts was published again in September 1998 and December 1998 to coincide with the publication of national accounts. In 1999 the quarterly cycle was brought forward one month. The first *Provisional Public Sector Accounts* under the new timetable was published on 26th February 1999 to coincide with the UK's report on general government deficit and debt to the European Commission under the Maastricht Treaty.

Breakdowns of the public sector into central government, local government and public corporations are shown in both new First Releases.

Table A part 1

Existing UK national accounts	Treasury's new format for public finances
Current receipts	
- current expenditure	
= current surplus	
+ capital gains tax (CGT)	
+ other taxes on capital	
- depreciation	= surplus on current budget
+ capital grants received	*
- capital grants paid	*
- gross fixed capital expenditure	*
+ depreciation	*
+ fixed asset sales	*
- increase in stocks	*
= Financial surplus/deficit	= - net borrowing
- accruals adjustment	
- net lending	
- net acquisition of shares	
- transactions in notionally funded pensions	
- third party deposits in public accounts	
- other financial transactions ¹	
= - PSBR	= - Net cash requirement

* the components of "net investment" in Treasury's format

1. Includes the balancing item, trade credit, and some public corporation transactions.

Table A part 2

UK national accounts under ESA95	Treasury's new format for public finances post ESA95
Current receipts ² (includes CGT)	
- current expenditure ² (includes transactions in notionally funded pensions)	
- depreciation	
=	= surplus on current budget
+ net saving other taxes on capital	
+ capital grants received	*
- capital grants paid	*
= change in net worth due to saving and capital transfers	
- gross fixed capital expenditure	*
+ depreciation	*
+ fixed asset sales	*
- increase in stocks	*
= net lending(+)/borrowing(-)	= - net borrowing
- accruals adjustment	
- net lending	
- net acquisition of shares	
- other financial transactions ¹	
= - net cash requirement	= - net cash requirement

Note that under ESA95 there will be changes from different ways of measuring some components, for example, capital expenditure and accrued interest.

* the components of "net investment" in Treasury's format

1. Includes the balancing item, trade credit, and some public corporation transactions.

2. Current receipts and expenditure under ESA95 include capital gains tax and transactions in notionally funded pension schemes.

DEFINITIONS

Public sector

The public sector includes central government, local government, and public corporations. Public corporations include for example nationalised industries and national health service trusts. A list of bodies classified to the public sector can be found in *Sector Classification Guide for the National Accounts* - available from the ONS book shop and The Stationery Office. A new version based on ESA95 was published in September 1998.

Current balance

This is from national accounts. It is the surplus of the public sector's receipts over current expenditure on an accruals basis.

Receipts include: current taxes, national insurance and pension contributions, interest and dividends, rent, and trading surpluses.

Current expenditure includes spending on staff; goods and services; subsidies, pensions and social security benefits, and other current grants.

In the present system of national accounts an imputed charge for depreciation is recorded in both current expenditure, as part of final consumption, and as a receipt. Under ESA95 it remains in final consumption but the receipt is not shown in the current account - instead it is netted off in the *acquisition of non-financial assets account*.

The public sector surplus on current budget in the EFSR is equivalent to the current balance in existing national accounts, less depreciation (same as ESA95 treatment), plus all capital tax receipts. When national accounts move onto ESA95 in September, the surplus on current budget in the EFSR will be equivalent to net saving plus capital tax receipts. In ESA95 capital taxes include death duties and other taxes on capital transfers but does not include capital gains tax which is treated as a current receipt. In the EFSR, the surplus on current budget treats all taxes as current.

The current deficit is sometimes quoted: it is the current surplus with sign reversed.

Net borrowing and net cash requirement

Public sector net borrowing is a national accounts concept. It is the difference between the accrued income and expenditure of the public sector, and is equivalent to the public sector financial surplus/deficit in existing UK national accounts. In ESA95 it is called net lending/borrowing: a positive figure indicates lending, a negative figure is borrowing.

In the EFSR new format, net borrowing is the current deficit (surplus on current budget with sign reversed) plus expenditure on fixed capital formation net of depreciation and fixed asset sales; plus expenditure on capital grants less any received. The EFSR refers to the sum of these capital items as “net investment”. Note that net investment includes expenditure on investment grants to other sectors of the economy as well as expenditure on public sector fixed assets.

For the period between the introduction of the new format for public finances (11 June 1998) and the introduction of ESA95 (24 September 1998) the terminology could be a little confusing in that, within national accounts, presentations of the public sector will use “net borrowing” whereas other sectors will continue with “financial deficit”. After the introduction of ESA95 the new term “net borrowing” will be used throughout, and it will be equal to net borrowing in the EFSR new format.

The public sector net cash requirement (previously called the PSBR) is a measure of the public sector’s cash flow unique to the UK. It is the difference between the cash expenditure and cash income of the public sector. As well as current and capital spending, cash expenditure also includes net expenditure on financial assets acquired for policy reasons - such as lending to other sectors of the economy to help support the activities of those sectors - rather than acquired for liquidity management reasons. The financial assets acquired for policy reasons are known as determinants of the net cash requirement. Transactions in other financial assets and in financial liabilities are known as financing items since they help supply the cash required.

The net cash requirement is reduced by privatisation proceeds; net borrowing is not affected.

Negative net borrowing is called net lending. A negative cash requirement is known as a cash surplus.

In the EFSR capital consumption is called depreciation.

Net Debt in new format

The net debt of the public sector is the total of public sector financial liabilities, minus liquid financial assets, that count as financing items in the net cash requirement. Liquid financial assets include holdings of cash, bank and building society deposits, short term commercial bonds, and the official reserves which include gold, foreign currencies and overseas government bonds. Monthly data, from March 1993, have been published since the 19th January 1999 Public sector finances First Release.

This measure of net debt is at nominal prices rather than market prices. In particular it uses the prices at which government redeems gilts at maturity rather than their current market price. It is different from the net financial wealth of the public sector shown in national accounts. That measure is at market prices and includes a wider range of assets and liabilities - such as accruals adjustments.

Public sector net debt differs from general government gross debt reported under the Maastricht Treaty. The latter excludes public corporations and does not net-off liquid financial assets.

To a large extent net debt is the stock equivalent of the net cash requirement. The differences between the net cash requirement and changes in net debt are mainly from the difference between the issue price and nominal price of gilts; the uplift to index linked gilts; changes in the classification of public bodies; and changes in foreign currency exchange rates.

PRODUCING THE FIGURES

The figures are compiled using existing methods for the monthly net cash requirement and quarterly national accounts. A new method was developed for calculating monthly net borrowing since these figures had not been produced before.

The monthly net cash requirement is calculated from monthly data on:

- central government cash flows recorded by Treasury
- public sector bank and building society deposits and borrowing collected by BoE
- the financial transactions of local authorities from DETR
- some public corporations' financial transactions collected by ONS

Monthly net borrowing is estimated by producing figures for each of the components that reconcile the difference between net borrowing and the net cash requirement. These are shown in table B.

For some of these components monthly data are available: such as central government transactions in notionally funded pension schemes and third party deposits in public accounts. For others, there are monthly data that provide an accurate approximation: such as central government transactions in company securities (estimated from privatisation proceeds) and lending to the private sector (estimated from data on student loans and launch aid loans to the aerospace industry). The national accounts balancing item is estimated to be zero.

The most difficult component to estimate is that for accruals adjustments. These represent the differences between accrued and cash measures of the various flows which are accrued in national accounts. For example, most excise duties accrue when goods are sold but the cash does not appear in government bank accounts until the following month.

For calculating monthly net borrowing, accruals adjustments are estimated separately using a variety of methods that depend mainly on how the accrued figures are produced. The majority of the accrued figures are only available quarterly and so are not ready in time for the monthly net borrowing calculation, whereas cash figures are available. For most of these cases, the technique is to estimate the accrued figure for the latest period by taking the accrued figure for the same period in the previous year and updating it by a moving average annual percentage change in the cash.

The monthly net borrowing figures, and reconciliation components, will be revised quarterly to bring them into line with the actual quarterly national accounts data.

DEVELOPMENT WORK

Precise figures for some of the components in the calculation of public sector net borrowing are not available in time for the monthly First Release and so have to be estimated. This means that the monthly net borrowing figures will be subject to larger revisions than those for the net cash requirement. ONS is working on methods to improve the initial estimates.

Development work was undertaken to produce monthly measures of the current balance. These data were first published on 19th November 1999.

Methods to produce figures for the net debt of the public sector more quickly and frequently will be examined. These data were first published on 19th January 1999.

A separate project is underway to improve the ONS estimates of non-financial balance sheets; this will improve estimates of the net financial wealth of the public sector.

THE INTRODUCTION OF ESA95

The new format for public finances will be consistent with the European System of Accounts 1995 (ESA95). ESA95 provides a robust set of definitions of government expenditure, income, and financial transactions to ensure public finances are presented fairly and consistently. It also makes international comparisons of public finances possible - such as the statistics needed for monitoring the European Union's excessive deficit procedure.

On 24 September 1998, ONS published national accounts for the first time according to the rules of ESA95. The treatment of some transactions in ESA95 is different to that in existing national accounts. The main changes affecting the public sector balances are:

- a) Some expenditure on computer software and on military assets with a civilian use will be treated as capital expenditure. At present it is current expenditure.
- b) The current account will include a charge for the depreciation of capital infrastructure such as roads and bridges. At present this is excluded from the capital consumption figures.
- c) Interest on gilts will be recorded as it accrues rather than when it is paid, and the difference between the issue price and redemption price of gilts will be recorded as interest spread over the life of the gilt.

- d) Transactions in government notional funded pension schemes will be recorded as current income and expenditure. At present these unfunded pension schemes, such as for teachers and NHS staff, are treated as if they were funded (in the sense of there being a stock of financial assets to pay the pensions) and the difference between contributions and pensions paid is treated as a financial transaction.

- e) Debt write-offs are treated as capital transfers and loan repayments, instead of just being a balance sheet change.

- f) Certain third party deposits in public accounts (at the Office of HM Paymaster General and the National Investment and Loans Office) that are government liabilities will be treated as financing the net cash requirement rather than determining it.

- g) Receipts of capital gains tax will be treated as current receipts rather than as capital receipts.

TABLE B

Reconciliation of net cash requirement and net borrowing.

The table shows the financial transactions that are estimated to derive monthly net borrowing from the monthly net cash requirement.

Net Cash Requirement

- net¹ acquisition of company securities
- net² lending to private sector and abroad
- transactions in unfunded pension schemes³
- accruals adjustments
- miscellaneous financial transactions⁴

= Net Borrowing

1. net of sales (privatisations)
2. net of repayments
3. the surplus of pensions paid over pension contributions
4. includes third party deposits in public accounts, the national accounts balancing item, trade credit, and some other minor financial transactions.

