



Public sector finances: 2014 revisions

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Accounting changes introduced to Public Sector Finance statistics from September 2014, are set to increase UK Public Sector Net Debt (PSND) and Public Sector Net Borrowing (PSNB) by around £130bn and £4bn respectively in 2013/14. The Public Sector Current Budget deficit and Public Sector Net Investment will also be affected.

The accounting changes being introduced by the Office for National Statistics (ONS) bring the UK's public finances in line with the 2010 European System of Accounts (ESA2010), and implement findings from a recent review of Public Sector Finance statistics.

A complete series of data will be published on 23 September 2014 in ONS' Public Sector Finances August 2014, including revisions of previous figures. Estimates of these revised figures have been published in recent editions of the Public Sector Finances release.

The ONS are also introducing a new way of measuring UK GDP, incorporating ESA2010 and other methodological changes. The upward revisions of nominal GDP, averaging to 4% per year would, all other things being equal, decrease debt/borrowing ratios expressed as a % of GDP. However, the revisions to PSND and PSNB mean that in some years revised ratios will actually be larger.

In March 2014 the OBR said they find it unlikely that revisions will have a significant impact on the Government's chances of meeting its fiscal mandate to balance the cyclically-adjusted current account budget (CACB) five years ahead.

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Contents

1	Introduction	2
1.1	What's changing?	2
	ESA2010	3
	Public sector finance statistics (PSF) review	3
1.2	The ex-measures	3
2	Debt: Public Sector Net Debt (PSND)	4
2.1	What's changing?	4
2.2	PSND as a % of GDP	5
3	Deficit: Public sector net borrowing (PSNB)	5
3.1	What's changing?	6
3.2	PSNB as a % of GDP	7
3.3	PSNB excluding APF and RMPP	7
4	Current budget deficit and net investment	8
5	The fiscal targets	9
6	Further information	9

1 Introduction

1.1 What's changing?

A new way of measuring public sector finances is being introduced in September 2014 by the Office for National Statistics (ONS). The new methodology brings the UK's public finances in line with the 2010 European System of Accounts (ESA2010), and implements findings from a recent review of public sector finance statistics.¹

The August 2014 edition of Public Sector Finances, released on 23 September 2014, will fully incorporate these changes. In advance, the ONS has published estimates of these revised figures in recent editions of Public Sector Finance Statistics.²

When considering these changes it is important to keep in mind the words of the Office for Budget Responsibility (OBR):

It is important to stress that these are changes to the way the public sector's finances are measured, not changes to the underlying activities being measured.³

Or as Paul Johnson, director of the Institute for Fiscal Studies puts it "It is important to remember that nothing has really changed in the health of the public finances, just the way the figures are counted."⁴

¹ See ONS. [Developments to Public Sector Finance Statistics – June 2014 update](#), for further details.

² <http://www.ons.gov.uk/ons/rel/psa/public-sector-finances/index.html>

³ OBR. [Economic and fiscal outlook, March 2014](#). Annex B

ESA2010

The ONS are implementing ESA2010, new national accounting standards to the UK. All EU countries are expected to move to the internationally comparable framework by October 2014, whilst other countries such as the US have already done so under the global equivalent UN System of National Accounts 2008 (SNA2008).

The common standards, definitions, classifications and accounting rules ensure comparability of national and regional accounts between countries. The introduction of ESA2010 impacts beyond the public sector finances: the ONS has produced a series of [articles](#)⁵ discussing ESA2010's impact on areas such as GDP.

The Library note [GDP and the national accounts: 2014 revisions](#) provides further discussion.

Public sector finance (PSF) statistics review

The ONS completed a review of public sector finance statistics in early 2014. The review which began in May 2013 focused on:

- improving public sector finance statistics to ensure they are well presented and easily understood; and,
- reviewing the methodology and guidance underpinning measures of Public Sector Net Debt (PSND) and Public Sector Net Borrowing (PSNB) that exclude financial interventions taken in response to the financial crisis (ex-measures).

The review led to the development of new ex-measures felt to be more robust and clearly defined. The new ex-measures only exclude public sector banks, whereas previous ex-measures also excluded some intervention schemes run by the Bank of England.⁶

A summary of all the improvements being introduced following the PSF statistics review is available in ONS' publication [2013 Review of Public Sector Finance Statistics: Consultation Response](#).⁷

1.2 The ex-measures

Generally commentators focus on measures which exclude temporary impacts of financial interventions when discussing the deficit or debt. The ONS introduced these so called 'ex-measures' to help users assess the state of the public finances without the distorting impacts of interventions taken in response to the financial crisis that began in 2007.

This note focuses on the ex-measures and their post September 2014 equivalents.

⁴ "ONS gives pre-election boost to UK politicians", FT [online], 28 February 2014, (accessed on 4 August 2014)

⁵ See: <http://www.ons.gov.uk/ons/guide-method/method-quality/specific/economy/national-accounts/methodology-and-articles/2011-present/index.html>

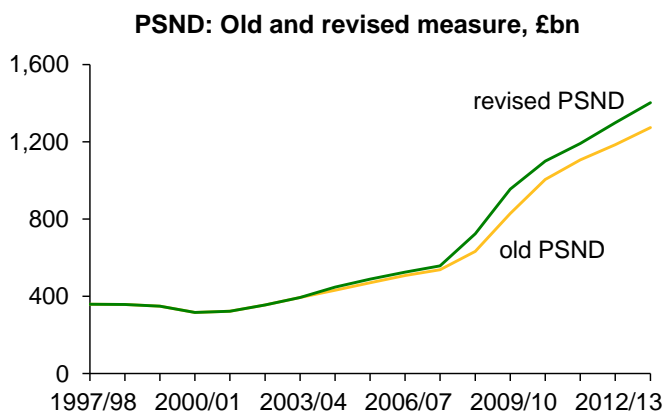
⁶ Further information is available in ONS' [Public sector finances: Public sector finances excluding financial interventions](#), 2010

⁷ ONS. [2013 Review of Public Sector Finance Statistics : Consultation Response](#), 2014

2 Debt: Public Sector Net Debt (PSND)⁸

From September 2014 PSND⁹ excluding banks will replace PSND excluding financial interventions. The revised measure will be applied retrospectively with higher debt expected in all years since 2004/05.

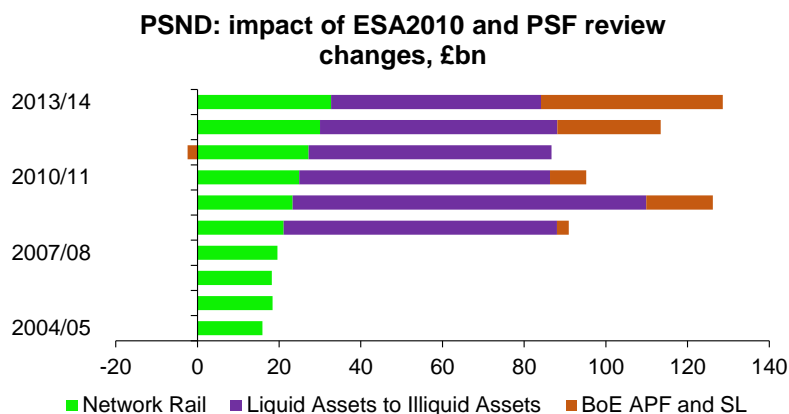
From 2008/09 to 2013/14 PSND is expected to be between £80bn - £130bn higher under the revised measure. The revised PSND is estimated at £1,402bn in 2013/14, £129bn higher than the £1,273bn recorded under the old measure.



2.1 What's changing?

The revised PSND measure is higher following: (i) the introduction of Network Rail to the public sector; (ii) a changed view as to how easily the government can turn their bank shares into cash; and, (iii) greater coherence in how financial interventions are treated.

Network Rail and its debt will be brought into the public sector from 2004/05. This is the only change affecting PSND prior to the financial crisis, and the only change to debt resulting from ESA2010.



PSF review changes bring improved coherence to how public sector finances are measured, and impact on PSND from 2008/09 for two reasons:

- shares held by the Government in RBS and Lloyds, previously classed as liquid or easily sellable and deductible from debt, will be classed as illiquid in line with other Government held shares. This means that they are no longer deductible from debt; and,
- the PSF review found an inconsistent treatment of financial interventions made during and after the financial crisis. To ensure equal treatment the net debt of both the Bank of England's Asset Purchase Facility (APF)¹⁰ and Special Liquidly (SL) schemes will be included in the revised measure.

⁸ Old and revised PSND are available from ONS' [Public Sector Finances July 2014](#). Revised figures are shown in the 'impacts' table. Data relating to individual changes affecting PSND are sourced from Annex A of ONS. [Developments to Public Sector Finance Statistics – June 2014 update](#)

⁹ Definitions of PSND and other Public Sector Finance terms are available in ONS' [Public Sector Finances Glossary](#).

¹⁰ This is more commonly known as quantitative easing. Further details is available in the Library note [Quantitative easing \(SN 4997\)](#), March 2012. For definitions see ONS' [Public Sector Finances Glossary](#).

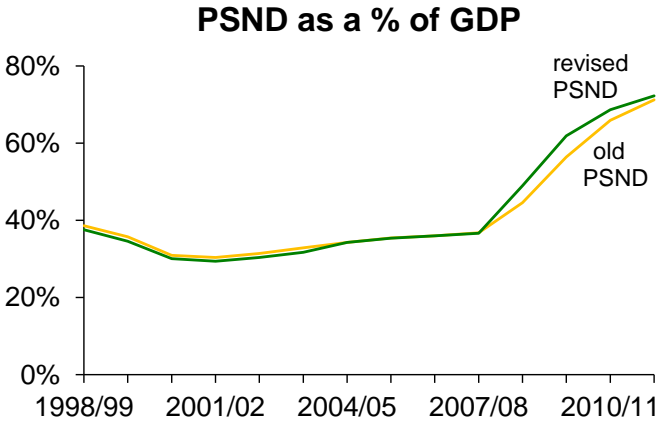
2.2 PSND as a % of GDP

The introduction of ESA2010 affects all areas of the National Accounts, including GDP. The Library note [GDP and the national accounts: 2014 revisions](#) provides further detail.

Revisions of around 4.0% per year¹¹ to nominal GDP will affect measures that bring context to the debt and deficit, such as PSND as a % of GDP.

Taking revisions to GDP and public sector finances together, PSND as a % of GDP:

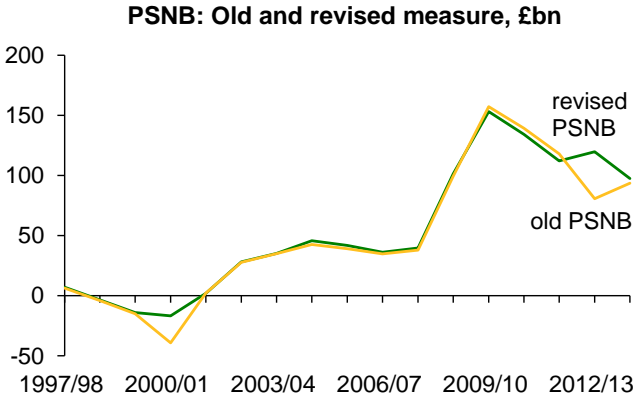
- between 1998/99 and 2003/04, is around 1% point lower annually under the revised measure, as larger levels of GDP are compared with unchanged PSND levels
- remains broadly similar between 2004/05 and 2007/08
- becomes larger under the revised measure from 2008/09: the gap between the revised and old measures reaches around 6% points in 2009/10, before falling down to 1% point in 2011/12



3 Deficit: Public sector net borrowing (PSNB)¹²

PSNB¹³ excluding banks replaces PSNB excluding financial interventions. The revised measure will be applied retrospectively and is set to lead to higher borrowing in the majority of the last 17 years.

The sum of the changes discussed below will add around £3.8bn to PSNB in 2013/14.

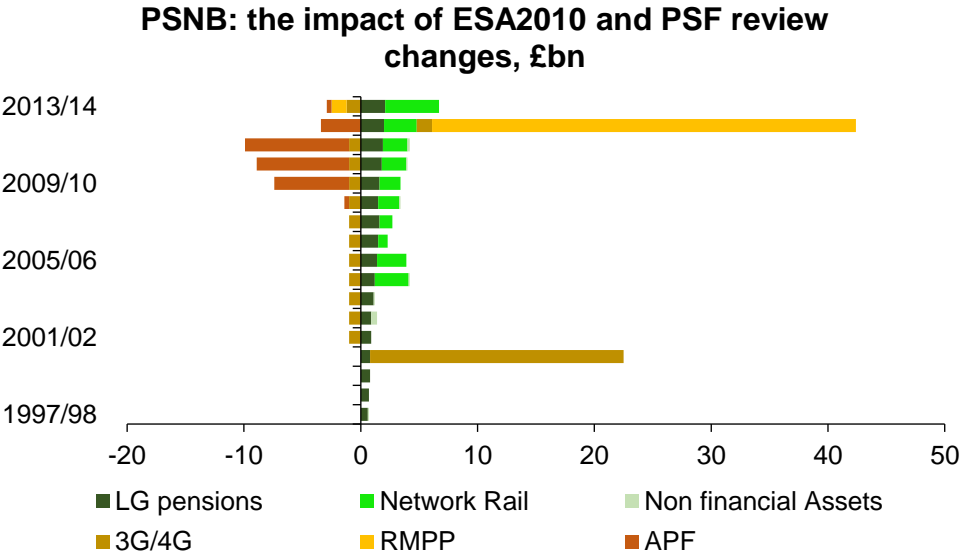


¹¹ Between 1997 and 2012
¹² Old and revised PSNB are available from ONS' [Public Sector Finances July 2014](#). Revised figures are shown in the 'impacts' table. Data relating to individual changes affecting PSND are sourced from Annex C of ONS. [Developments to Public Sector Finance Statistics – June 2014 update](#)
¹³ Definitions of PSNB and other Public Sector Finance terms are available in ONS' [Public Sector Finances Glossary](#).

3.1 What's changing?

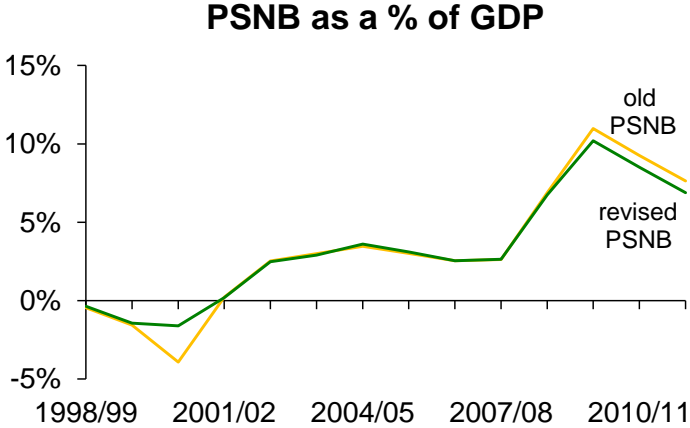
- Network Rail's move to the public sector increases borrowing, as does the requirement that the Local Government Pensions Scheme includes annual social contributions to cover contribution shortfalls (the difference between entitlements and contribution).
- Transactions between the Bank of England's APF and the private sector will be included, decreasing borrowing.
- Phone licence sales will be treated as a rent rather than one off sales. The one off sales which currently decrease borrowing in 2000/01 (£23bn for 3G) and 2012/13 (£2.3bn for 4G) are removed and replaced with annual receipts which decrease borrowing by around £1bn per year.
- In April 2012 historic liabilities and some assets of the Royal Mail Pension Plan (RMPP) transferred to the government. ESA2010 changes the treatment of this transfer resulting in a substantial increase in borrowing in 2012/13 (£36.3bn) but lower borrowing in future years.

ESA2010 introduces the majority of these changes, only the APF transactions are introduced as a result of the PSF review.



3.2 PSNB as a % of GDP

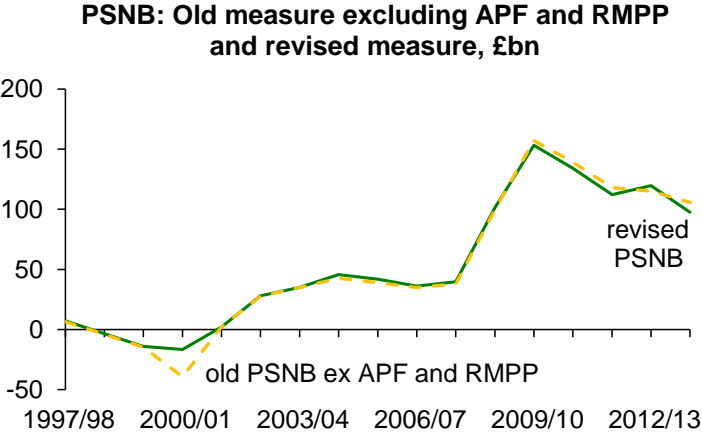
From 2008/09 onwards revision of GPD and decreased PSNB under the revised measure combine to move PSNB as a % of GDP below the old measured valued. In 2011/12 PSNB as a % of GDP is set to be 6.9% under the revised measure, roughly 0.7% points lower than under the old measure (7.6% of GDP)



3.3 PSNB excluding APF and RMPP

Many commentators currently focus on a measure of PSNB which also excludes the transfer of the RMPP and transfers from the APF, generally called the ‘underlying’ measure. The change in treatment of the RMPP and flows between the APF and government result in there being no equivalent measure of the ‘underlying’ deficit from September 2014.

The revised PSNB excluding public banks is set to be around £8bn lower in 2013/14 than PSNB excluding financial transaction, APF and RMPP.



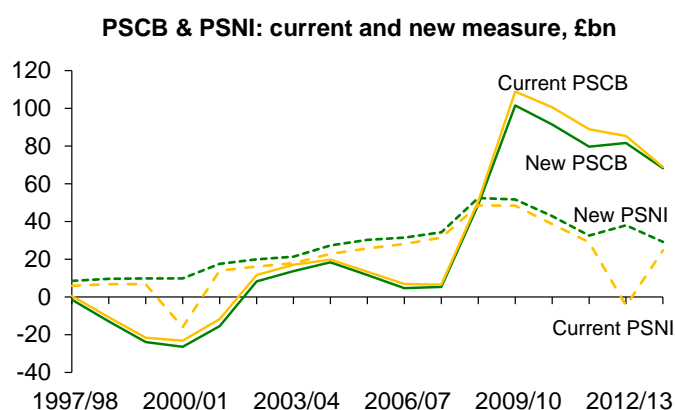
4 Current budget deficit and net investment

Each change affecting PSNB (as discussed in Section 3) will affect one or both of Public Sector Current Budget (PSCB) deficit and Public Sector Net Investment (PSNI).¹⁴ These two measures, when summed together, equal PSNB.¹⁵

In addition, new rules on the capitalisation of spending on research & development (R&D) and government spending on military weapons¹⁶ will switch spending from PSCB to PSNI, without affecting PSNB.

Under ESA2010 the non-financial assets of R&D spending and government spending on military weapons will no longer be treated as intermediate consumption,¹⁷ but as capital spending. Capitalisation of these items will result in a reduction to the PSCB deficit and an increase in PSNI.¹⁸

In 2013/14, PSCB deficit excluding banks is set to be £0.6bn lower under the revised measure and PSNI excluding banks £4.5bn higher.



Box 1. Definitions.

PSCB deficit: The difference between spending on items that are ‘consumed’ in the year of purchase (public sector current expenditure) and revenue raised from activities in the current year (public sector current receipts).

PSNI: The balance of acquisition less disposals of capital assets and liabilities.

Public sector net borrowing = PSCB deficit + PSNI

ONS’ [Public Sector Finances Glossary](#) provides further definitions of terms included in this note.

¹⁴ See Annex C of ONS’ article [Developments to Public Sector Finance Statistics – June 2014](#) update for full details of how changes affect each measure

¹⁵ Public Sector Current Budget deficit + Public Sector Net Investment = Public Sector Net Borrowing.

¹⁶ Specifically Single Use Military Equipment

¹⁷ Goods and services used up in production

¹⁸ Further details are available from ONS’ [Changes to National Accounts: Measuring and Capitalising Research and Development](#), 10 June 2014 and ONS’ [Transition to ESA10: Capitalising Government Spending on Military Weapons](#), 10 June 2014

5 The fiscal targets

The 'fiscal mandate'¹⁹ requires the Government to balance the cyclically-adjusted current account budget (CACB) five years ahead. The supplementary target is for PSND to be falling as a share of GDP in 2015/16. Currently these are assessed on measures which exclude financial interventions. If the targets shift to the measure excluding banks, then the OBR will report progress against these new measures.

The OBR believe that the revisions are unlikely to affect the Government's chance of meeting the mandate, but changes to measurement of PSND may increase the chance of PSND falling as a share of GDP in 2015/16:

The forthcoming changes to the public finances data are unlikely to have a significant impact on the measured CACB at the end of the forecast horizon, and thus on the Government's chances of meeting the fiscal mandate. But even though the measured level of net debt will be significantly higher after the revisions, the chances of it falling in 2015-16 are likely to be greater if the APF starts selling gilts before the end of 2015-16, as assumed in our central forecast – although still not greater than 50 per cent. Debt would also fall more steeply if the Government was to sell more of the shares that it purchased as a result of financial interventions.²⁰

6 Further information

ONS. [Developments to Public Sector Finance Statistics – June 2014](#), June 2014

ONS. [Transition to ESA10: Update to Impact on Public Sector Finances](#), February 2014

ONS. [2013 Review of Public Sector Finance Statistics: Consultation Response](#), February 2014

Office for Budget Responsibility. [Economic and Fiscal Outlook: March 2014](#), March 2014, Annex B.

[GDP and the national accounts: 2014 revisions](#), House of Commons Standard Note SN6982, 12 September 2014

ONS. [Public Sector Finances – Glossary](#) [online]

¹⁹ HM Treasury. [Charter for Budget Responsibility](#), March 2014 update, March 2014

²⁰ OBR, [Economic and Fiscal Outlook: March 2014](#), March 2014, para B.24-B.25