

Government and public sector debt measures

Introduction

1. One measure of governments' performance in managing the public finances is the level of public sector debt. The definition and responsibilities for debt measurement have varied throughout time. This note sets out the history of them and explains the current arrangements.
2. Two measures of debt are used in the policy context. The main measure used domestically as part of the Government's fiscal policy framework is Public Sector Net Debt (PSND). The European Union's Excessive Deficit Procedure focuses on General Government Gross Debt.
3. Public Sector Net Debt records most¹ financial liabilities issued by the public sector less its holdings of liquid financial assets, such as bank deposits. The financial liabilities usually have an explicit monetary value but are measured using their nominal values i.e., not at market prices. The majority of debt financing is through central government issues of government securities (gilts) and treasury bills.
4. The UK Government has the Sustainable Investment Rule as one of its two main fiscal rules. *Budget 2006* states (page 18) that to meet this rule, "public sector net debt as a proportion of GDP [Gross Domestic Product] will be held over the economic cycle at a stable and prudent level". It also states that "other things being equal, net debt will be maintained below 40 per cent of GDP over the economic cycle."
5. With one exception the public sector is defined as in the National Accounts framework, consisting of central government, local government and public corporations. The exception is the Bank of England, which has traditionally been excluded (either in whole or in part) from public sector finance statistics.

The origins of public debt

6. Historically when the state had budgetary deficits, particularly those arising from wars, it funded them from taxation. The financing needed for the War of the League of Augsburg led to the creation of the Bank of England in 1694 and the first types of state public financing debt in England.
7. The early 1700s saw the emergence of banking and financial markets. The ability to raise money by creating debt through the issue of bills and bonds

¹ See paragraph 19

heralded the beginning of the National Debt. This rose from £12m in 1700 to £850m by the end of the Napoleonic Wars in 1815. The two world wars of the twentieth century caused debt levels to rise, from £650m in 1914 to £7.4bn by 1919 and from £7.1bn in 1939 to £24.7bn in 1946.

8. The period of relatively high inflation in the 1970s and 1980s saw debt rise from £33.1bn in 1970 to £197.4bn in 1988. Debt measures are usually presented as a percentage of GDP since comparisons over time need to allow for effects such as inflation. Dividing by GDP is the conventional way of doing this.

National Debt

9. The National Debt is the most well-known and oldest measure of public debt. The term 'national debt' is still commonly used today, often when reference should actually be made to the Public Sector Net Debt measure. This is because National Debt had a precise meaning, which is very different to PSND.
10. Data² for the National Debt extend back to 1691. For a large period of this time National Debt comprised the total gross liabilities of the Consolidated Fund. Since 1968 it comprises the gross liabilities of the National Loans Fund.
11. National Debt has quite a narrow coverage, missing the non- central government parts of the public sector and not even being a comprehensive measure of central government debt. It also includes liabilities to other parts of government (for example the National Insurance Fund holds gilts as investments) whereas it is standard for debt measures to consolidate out intra-sector holdings.
12. Reflecting these concerns estimates of the National Debt are no longer published. The final data relate to the level at 31 March 2004. The main information used in compiling National Debt continues to be available in the *Consolidated Fund and National Loans Fund Accounts*.

Net Public Sector Debt

13. In 1986 the Bank of England expanded the National Debt measure to produce Net Public Sector Debt (NPSD), producing the statistic back to 1975. End-financial year data were published annually in the *Bank of England Quarterly Bulletins*.
14. One anomaly with NPSD was that the definition of public sector excluded the Banking Department of the Bank of England (it included the Issue Department which until 1998 was classified as central government).

² Annual data from 1855 to 1998 are published in *Monthly Statistics on Public Sector Finances – A methodological Guide*. Data up to 2004 are available in sheet A10 of the spreadsheet available on the Treasury website http://www.hm-treasury.gov.uk/economic_data_and_tools/finance_spending_statistics/pubsec_finance/psf_statistics.cfm

15. The calculation of NPSD started with the principle that this debt measure was the approximate stock equivalent of the PSBR.
16. It differed from the National Accounts financial balance sheet concept of financial liabilities in that debt was measured at nominal value rather than their value in the market. This was because it is the value that government will have to pay on maturity. The market value is only important to the asset holder as a price at which they can sell the asset at that time. As the redemption date approaches the market value should converge towards the nominal value.
17. Liquid assets, such as bank deposits and foreign exchange reserves, were subtracted from the consolidated gross liabilities to give 'net debt'.
18. However, minor changes moved NPSD away from being precisely the stock equivalent of the PSBR. There were three main reasons for this:
 - (i) revaluation of foreign currency reserves due to exchange rate movements affect the sterling value of the official reserves but have no effect on the cash requirement;
 - (ii) the capital uplift on index-linked gilts was only recorded in the cash requirement when it was paid out but accrued in the debt measure over the life of the stock to reflect the most recent relevant value of the Retail Prices Index;
 - (iii) when gilts are issued at discounts from or premia to the nominal value, the level of debt is deemed to have changed by the nominal value of gilts issued, whereas the cash requirement is financed by the actual cash amount received.
19. Excluded from the list of financial liabilities here are those that were not financing items of the PSBR. These were the share and other equity values of public sector entities (the nominal value of which will be close to zero anyway and would largely be consolidated out since the public sector is more often than not the sole equity holder), financial derivatives (where the liability would have a matching asset which would be deemed liquid and is also excluded) and accounts payable. The last occurs when there is a timing difference between a non-financial transaction and the corresponding cash payment.
20. Also excluded were provisions and contingent liabilities. It is standard practice in the international standards defining National Accounts for these items to be excluded.
21. The PSBR was a cash concept unique to the UK, although it had similarities to an International Monetary Fund measure. With the introduction of the new Public Finances framework in 1998, the PSBR played a less important role as the Government's preferred measure moved away from the cash accounting basis and onto the accruals basis consistent with National Accounts framework. The PSBR continued to be produced but was renamed the Public Sector Net Cash Requirement (PSNCR) to avoid confusion with the Public Sector Net

Borrowing measure. The PSNCR definition and measurement are the joint responsibility of ONS and HM Treasury.

Public Sector Net debt

22. In January 1999 ONS began reporting the information monthly in the *Public Sector Finances First Release*. It was renamed Public Sector Net Debt (PSND), but kept the same definition as NPSD.
23. Responsibility for the definition and measurement of PSND is now the joint responsibility of ONS and HM Treasury. The Bank of England was previously also part of the technical group which had this responsibility but as they withdrew from compilation and publication of the measure their involvement declined.

Maastricht EDP Debt

24. The 1992 Maastricht Treaty on European Union obliged EU member states to avoid excessive government debt levels. The Protocol on Excessive Deficit Procedure (EDP), an annex to the Treaty, defines this as 60 per cent of GDP.
25. The protocol defines the debt measure with reference to the European System of Accounts, which is since 1998 is the basis upon which the UK National Accounts are compiled on.
26. The debt measure used is General Government Gross Debt (GGGD). This differs from the UK fiscal measure, PSND, in two important respects. The first is the sectoral boundary, being defined as General Government it excludes the net debt position of public corporations, which are included in the public sector. The second is that it measures gross liabilities and does not net off liquid assets.
27. The definition excludes accounts payable, which is consistent with how PSND is defined.
28. ONS is responsible for compiling and sending the UK's EDP data biannually to the European Commission. HM Treasury is responsible for producing and sending forecasts for future years.
29. ONS produces a first release to accompany the distribution of the EDP data, which gives further information. The releases are available on the National Statistics website at www.statistics.gov.uk
30. GGGD can be reconciled with PSND. The first reported data for GGGD had reconciliation items as it used the 1979 version of the European System of Accounts. With the adoption of reporting EDP data under the updated 1995 version these discrepancies disappeared as the new practice used definitions already used in PSND.

Imputed debt

31. As noted earlier, PSND includes some imputed debt. This usually occurs when government is considered the true economic owner of an asset or liability, even though it is not the legal owner of it, and an imputation is made to route the transaction via government.
32. In 2001 it was decided that PSND should be updated to include imputed debt, in particular those liabilities associated with finance leasing that were part of the GGGD definition. This moved the definition of PSND further away from being the stock equivalent of the PSNCR. However, problems with deriving estimates for the level of the imputed debt has delayed the inclusion of finance lease liabilities in PSND until September 2006. In August 2005 imputed debt associated with securitised bonds issued by London & Continental Railways was included in PSND.

Core debt

33. From *Budget 2002* HM Treasury has also published a version of Public Sector Net Debt excluding the effects of cyclical fluctuations. This is referred to as 'core debt'. It is not a National Statistic.