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Improving estimates of public sector debt

The Office for National Statistics today announces improvements to the measurement of public net sector debt to account for finance lease liabilities, which mainly arise from Private Finance Initiative (PFI) and Public Private Partnership (PPP) projects.

In an article published today, ONS explains that the public sector has finance leases for certain capital assets. ONS estimates that the total liability under these finance leases was £4.95bn at the end of March 2006, and has added this to its estimate of Public Sector Net Debt (PSND). About 85 per cent of this figure relates to PFI and PPP projects. These are termed "on balance sheet" deals. Estimates of PSND have been revised up in all years from 1987 to 2006.

For a public sector finance lease liability to exist for an asset, under a PFI or PPP project or any other leasing arrangement:

- The public sector must be the economic owner of the asset. That means that it has taken on the risks of ownership, such as the obligation to make repairs.
- The asset must be operational.

The decision on whether a capital asset is economically owned by the public sector is made by government accountants and their independent auditors. The resulting estimates of finance lease liability are recorded in the resource accounts of government departments, the financial statements of public corporations or the accounts of local authorities as appropriate. ONS has used these data as the main source for the estimates of imputed finance lease liabilities for the PSND, published today.

The addition of £4.95 billion to PSND would, on its own, increase PSND as a proportion of GDP by 0.4 percentage points. However, the revision to PSND as a proportion of GDP in March 2006 in today's Public Sector Finances First Release is 0.1 percentage points due to the inclusion of the latest published GDP estimates.

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HM Treasury estimates that the total capital value of all PFI and PPP projects is over £46 billion, of which about £23 billion relates to projects where the public sector is, or is expected to become, the economic owner, i.e. the deals that are on, or potentially on the public sector balance sheet.

However, many of these projects are at the design stage or under construction when the asset is not operational, so the capital assets are economically, as well as legally, in private sector ownership. There will be no public sector finance lease liability for these projects until the assets are operational and economically owned by the public sector. Consequently, the estimates of imputed finance lease liability for such projects are much smaller than the total capital value of the assets.

Also, over the life of a contract, the finance lease liability (debt) is reduced through repayments from the public to the private sector so that once repayments have started, the capital value will nearly always be larger than the outstanding debt.

Some projects, such as road and rail networks, involve an existing asset being developed or improved, while remaining in use. In such cases, the asset moves from being under construction to being operational in phases, so public sector finance lease liabilities are recorded in phases when economic ownership transfers. The London Underground Ltd. (LUL) PPP projects are the biggest examples of projects with ongoing development work for an operational asset, for which there is an imputed public sector finance lease liability.

ONS is continuing a programme of work on accounting for PFI and PPP projects in general. In particular, it is working to improve identification of Single or Special Purpose Vehicles (SPVs), the companies set up by private sector contractors to carry out and account for PFI and PPP work. ONS is also continuing work to discover whether any PFI or PPP related capital assets appear on the balance sheets of both the private and public sector, or on neither.

BACKGROUND NOTES

1. The revised levels of Public Sector Net Debt are published today by in the ONS/HM Treasury Public Sector Finances First Release at

   http://www.statistics.gov.uk/pdfdir/psf0906.pdf

2. The ONS article *Including Finance Lease Liabilities in Public Sector Net Debt: PFI and Other* is published today on the National Statistics website at http://www.statistics.gov.uk/cci/article.asp?id=1638.

3. Some aspects of PFI and PPP schemes – capital expenditure, service charge payments and interest payments – are already included in the national accounts and in public sector finances.

4. Some departmental resource accounts were not available at the time of publication, so the imputed finance lease liabilities have been estimated.

5. The national accounting treatment of finance leases is covered in detail in the System of National Accounts (SNA93) and the European System of Accounts (ESA95).

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