Office for National Statistics

Longer-term trends - Public Sector Finance

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Abstract

These articles examine the longer-term trends for a number of key economic statistics, providing context in which to view more recent movements in these series.

Introduction

The public sector finances offer a number of insights into how the UK economy has developed over time. Like any household, the Government is able to borrow and invest to support current and future activity, which can add to the country's debt level. However, the Government is also able to generate income from taxes which can then be used to provide public goods and services, such as schools, public roads and social support.

The public sector finance statistics show that government income and expenditure can vary considerably from month to month. Yet the longer-run picture demonstrates that since the 1970s central government income from taxation (current receipts) has remained broadly stable relative to the size of the economy. Changes in public spending have therefore had a greater influence on variations in the amount of borrowing. Public investment has also been on a downward trend since the 1960s, from a time when the economy was rebuilding after the effects of war to one where a number of public bodies have been nationalised.

This article will look in detail at the long-term trends within public sector income and expenditure, investment, borrowing and debt. This will provide the context against which the most recent movements in the public sector aggregates can be assessed.

Key Points

- The public sector current budget deficit and borrowing have fluctuated considerably over time as a share of GDP, in large part the result of the economic cycle.
- The current budget has been in deficit for most of the period since the mid-1970s, only returning to surplus for short periods around 1990 and 2000. The deficit peaked at more than 5% of GDP

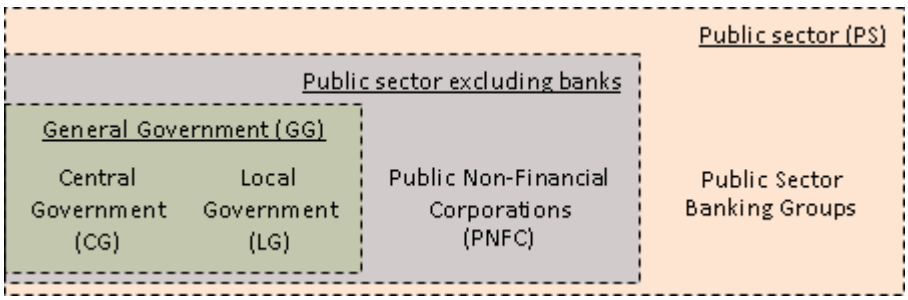
in the late 1980s and in 2009/10. The profile of borrowing is broadly similar, rising to a peak of just over 10% of GDP in 2009/10.
- Central government current receipts have varied mainly in the range of 32% to 35% of GDP since the mid-1970s, and remain within that range in the latest year.
- Current spending has varied a little more widely than receipts, and has risen outside its long-run range of variation relative to GDP since 2008/09.
- Public sector net investment has been on a long-run downward trend since the 1960s, but started to rise again from the late 1990s. Most recently, it has peaked as a share of GDP in 2009/10 but has fallen back again.
- Public sector net debt increased rapidly as a result of financial intervention since 2007. Net debt has now fallen below 100% of GDP in Q2 2014.

What is the public sector?

The public sector is the part of the economy controlled by the state and it comprises a number of sub-sectors. Each has different income and spending capabilities, and a range of statistics can be found for each of them. Figure 1 shows how these different sub-sectors fit together to make the public sector. Central government covers areas of government activity that are administered at a national level, whereas local government provides goods and services at a smaller local or regional level. Public non-financial corporations are government-owned trading businesses, and now include the Meteorological Office, the Driving Standards Agency and many housing associations for example. However in earlier periods, they also included many of the major energy, transport and communications companies that have since been privatised.

Public finance statistics in the UK focus on the public sector as a whole, whereas the sector for monitoring compliance with the EU's Excessive Deficit Procedure (EDP) is general government, i.e. central government and local authorities only.

Figure 1: The components of the public sector



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The majority of tax revenue is collected by central government, with some local taxes being collected by local authorities. There are also a number of public non-financial corporations that sell goods and services and therefore generate their own income. All sectors add to public spending,

and this is overseen by the Treasury and Parliament, often constrained within spending limits of the time.

Deficit and debt

There are two key concepts that attract the headline discussions of the public finances – the budget deficit and debt. In the UK these are measured by Public Sector Net Borrowing (PSNB) and Public Sector Net Debt (PSND) respectively, and are consistent with international reporting standards and legislation. PSNB is the difference between all public sector income and its expenditure, which results in either a deficit or surplus in each period. PSND is the stock of debt, which is the cumulative sum of these deficits or surpluses over time.

Public Sector Net Borrowing (PSNB)

Public Sector Net Borrowing (PSNB) is the difference between the income that government receives and its current plus net capital expenditure in a given period of time. PSNB is reported on an accrued basis – this means that transactions are recorded according to the period in which they are incurred, and not necessarily when the cash transaction takes place. This headline measure incorporates net borrowing across all of the public sector, including central and local government, as well as public corporations. PSNB has been the widely accepted measure of overall deficit/surplus since the late 1990s.

PSNB can be broken down into the excess of current expenditure over income, otherwise referred to as the Public Sector Current Budget Deficit (PSCBD), and Public Sector Net Investment (PSNI). The latter refers to the acquisition less disposal of capital assets and liabilities by government. For the former, when current government expenditure exceeds current government income, the current budget deficit is positive, which adds to net borrowing. Therefore PSNB is governed by the following equations:

$$PSNB=PSCBD+PSNI \quad (1)$$

where:

$$PSCBD=\text{current expenditure}-\text{current receipts} \quad (2)$$

In addition to PSNB, the Public Sector Net Cash Requirement (PSNCR) is another flow statistic that can provide useful information about the public finances. This was formerly referred to as the Public Sector Borrowing Requirement prior to the adoption of net borrowing measures for policy purposes in the late 1990s. The PSNCR is a measure of how much cash is required by the public sector to meet the difference between income and expenditure. This means PSNCR differs from PSNB as it is measured in cash terms rather than accruals, with transactions being recorded at the time that the cash changes hands.

Public Sector Net Debt (PSND)

Public Sector Net Debt (PSND) is the total outstanding amount that the government has borrowed, cumulated over the entire period of government borrowing. It is expressed as total public sector

liabilities net of liquid financial assets. A liquid asset is one that can be converted to cash at short notice and with little loss in its value – government-held foreign currency and cash balances are examples.

The PSNCR is the flow equivalent of Public Sector Net Debt (PSND) – so changes in PSND between two points in time will approximately equal the net cash requirement for the intervening period, as shown in equation (3).

$$PSND_t \approx PSND_{(t-1)} + PSNCR_t \quad (3)$$

Note that this relationship does not hold exactly. Differences can occur, for example, if government bonds (mainly gilts) are issued at discounts or premia. The level of PSND is deemed to have changed by the nominal value of the gilts issued, whereas the PSNCR is affected by the actual cash amounts received, i.e. the nominal value minus its discount or plus its premium. PSND can also be impacted by fluctuations in exchange rates affecting the value of official reserves and reclassifications in and out of the public sector, while PSNCR is not.

“Ex” measures of Public Sector Finances

The Government has made several direct interventions into the financial sector since 2007 in response to the global financial shock. The resulting reclassification of several recapitalised banking groups (including Royal Bank of Scotland and Lloyds Banking Group) as public financial corporations instead of private companies led to distortions to some of the aggregate public finance statistics. In order to be able to assess the underlying performance of the public finances free from such distortions, parallel measures of public sector deficit and debt were introduced which exclude these temporary effects.

The public sector net debt and net borrowing figures excluding these interventions are referred to as “PSND ex” and “PSNB ex”. These were initially measures that excluded the temporary effects of a number of financial interventions, such as the debt and borrowing of public sector banking groups as well as that related to schemes such as the Asset Purchase Facility, but included public sector banks’ transactions with government and interventions where the money spent was not expected to be recovered.

Following a public consultation and review of public sector finance statistics in 2014, the “ex” measures were simplified to exclude only the debt and borrowing of public banking groups. Therefore, all other interventions are now included in the “ex” measures. This article uses the new “ex” measures throughout.

Factors affecting the public finances

Trends in the public sector finances tend to be driven by three main groups of factors. The first is the economic environment: the state of the business cycle is an important determinant of government income and expenditure. When the economy is growing strongly, tax revenues are likely to be buoyant reflecting strong growth in incomes and spending, while low levels of unemployment should reduce expenditure on social benefits. This should reduce the need for the government to borrow to bridge the gap between income and expenditure. In contrast, during a period when the economy is

contracting, such as the 2008-09 economic downturn, tax revenues are likely to be more subdued, while rising unemployment will increase expenditure on social benefits, resulting in an increase in borrowing and therefore debt.

The second set of influences on the public finances arises as a result of Government policy actions. Government provides a range of goods and services that may not be readily supplied by the market in order to satisfy the individual and collective needs of the nation. The government also transfers resources between different parts of the population by levying taxes and re-distributing through social benefits. In the UK, government spending includes the provision of healthcare via the National Health Service and administering the welfare system, such as payment of the state pension. The main taxes are levied on consumption, wealth, profits and incomes. Changes in fiscal policy, such as tax rates and allowances, or changes in the level and composition of government spending will therefore have an effect on PSNB and PSND. However the public finances are also affected by other policies, such as the privatisation of nationalised industries or a programme of social housing sales. Annex A contains a timeline of some of the key policy changes that have had an impact on the UK's public finances.

Finally, long-term trends and societal changes can have an impact on the public finances through changes in demand for certain public goods and services. For example, improving health outcomes should lower the need for certain treatments while the ageing population may increase the demand for others. The birth rate will also have an impact on the demand for education in the future. More subtly, changing consumption patterns can influence tax receipts though changes in demand for taxed relative to less-taxed goods.

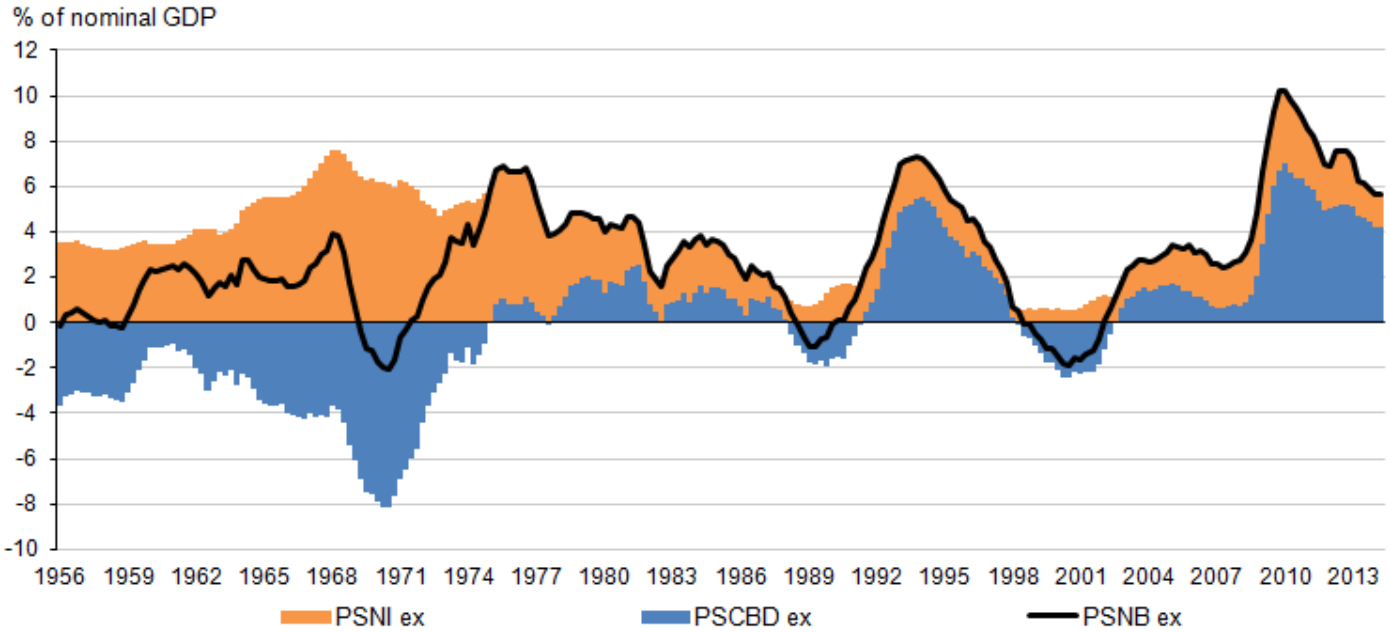
Trends in Public Sector Finances

Public Sector Finance (PSF) statistics are measured in current prices and therefore reflect the effects of both price and volume changes. To allow for inflation and growth in the economy over time, long-term trends in public finances are expressed as a proportion of nominal GDP. However it should be noted that changes in income, expenditure, deficits and debt on this basis may arise due to variations in nominal GDP, even if the cash figures themselves are unchanged.

Public Sector Net Borrowing (PSNB)

As discussed, ONS measures Public Sector Net Borrowing (PSNB) as the difference between government income and expenditure. This can be split into current expenditure on the day-to-day activities of the government and capital spending, where the government spends money in one period in order to generate benefits in future periods. Figure 2 shows trends in PSNB (black line), and its components – PSNI (orange bars) and the public sector current budget deficit (PSCBD, blue bars), as a percentage of GDP.

Figure 2: Public sector current budget deficit and public sector net borrowing, % of nominal GDP, four-quarter moving average, Q1 1956 to Q2 2014



Source: Office for National Statistics

Notes:

1. PSCBD ex refers to Public Sector Current Budget Deficit excluding banks.
2. PSNI ex refers to Public Sector Net Investment excluding banks.
3. PSNB ex refers to Public Sector Net Borrowing excluding banks.
4. A negative current budget deficit implies a budget surplus, likewise negative net borrowing implies public sector net lending.

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Having run a persistent current budget surplus between 1956 and the mid-1970s, the 1973-74 economic downturn saw a move into deficit which persisted through to the late 1980s. As net investment spending was reduced during the 1970s, the trend in net borrowing towards bigger deficits was less marked, and the average level of borrowing by the mid-1980s was similar as a share of GDP to its share in the 1960s.

For most of the period since the early 1980s the current budget has remained in deficit, with the exception of two periods from 1987 to 1991 and from 1998 to 2002. The deficit increased considerably during and following the 1990-91 and 2008-09 economic downturns – and reached 7% of GDP in Q1 2010, the highest since the Second World War. The effect of the 2008-09 economic downturn on the current budget was broadly similar in scale to the effect of the 1990s downturn. In both cases, expenditure exceeded income by more than 5% of GDP despite the fact that the fall in GDP was much larger in 2008-09. This may reflect changes in the composition of demand and activity between the two downturns. For instance the 2008-09 downturn experienced a

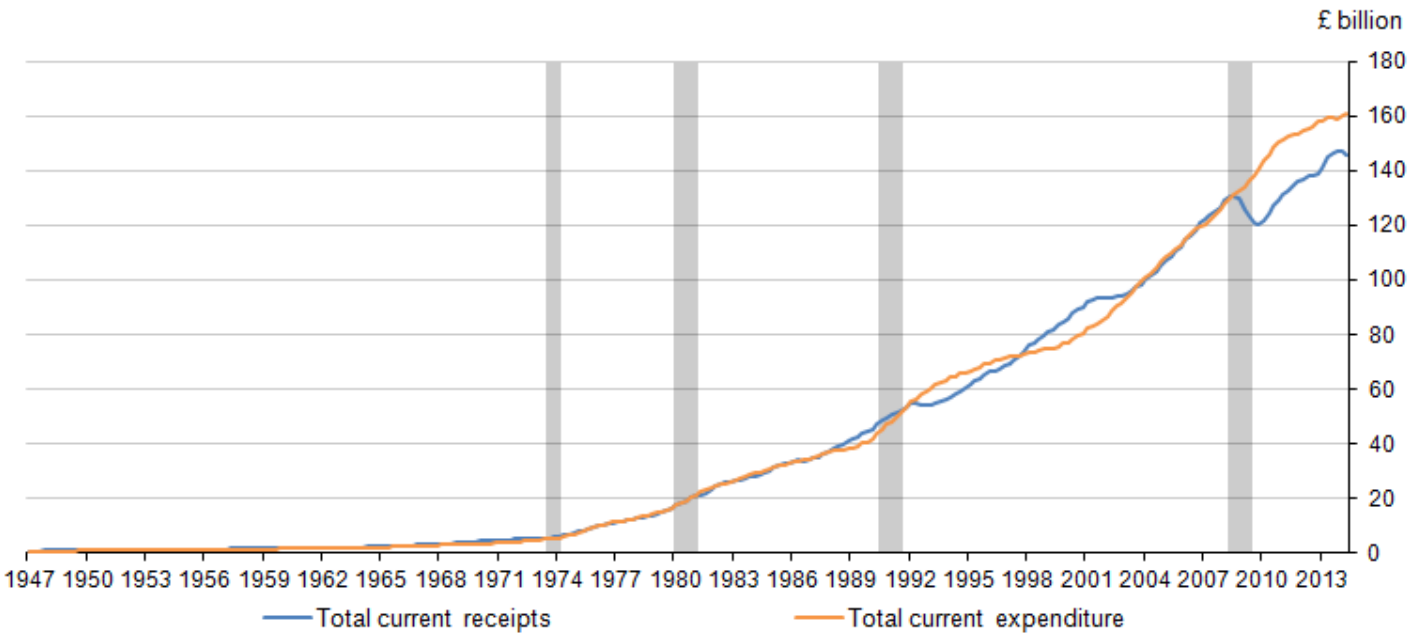
comparatively resilient labour market, which may have supported some tax receipts and moderated the extent of extra demand for unemployment-related spending.

Public Sector Net Investment (PSNI) as a percentage of GDP was noticeably higher in the 1950s, 1960s and 1970s compared with more recent decades. This can be partly attributed to the requirement to rebuild infrastructure and housing following the Second World War, where nearly 4 million houses were destroyed. Privatisations will have also had an effect over this period, as this moved capital expenditure (for example, aircraft for British Airways, and buildings and heavy machinery for British Gas) to the private sector, while public house-building has fallen sharply. Private finance initiatives may have also had an impact on reducing investment. This refers to a way of creating public-private partnerships, by funding public infrastructure projects with private capital. This would result in a lower level of investment, but a longer-term increase in current expenditure to meet the costs of paying for the services delivered by the projects.

Central Government Income and Expenditure

To understand the behaviour of net borrowing over the past 40 years, as well as in response to the 2008-09 economic downturn, it is important to understand the behaviour of different sources of public sector income and expenditure on both current and capital items. The nature of this income and expenditure has developed and changed since the 1950s. This section focuses specifically on central government, as it is this part of the public sector to which the majority of taxes and spending accrue.

Figure 3: Trends in central government current income and expenditure, £ billion, four-quarter moving average, Q1 1947 to Q2 2014



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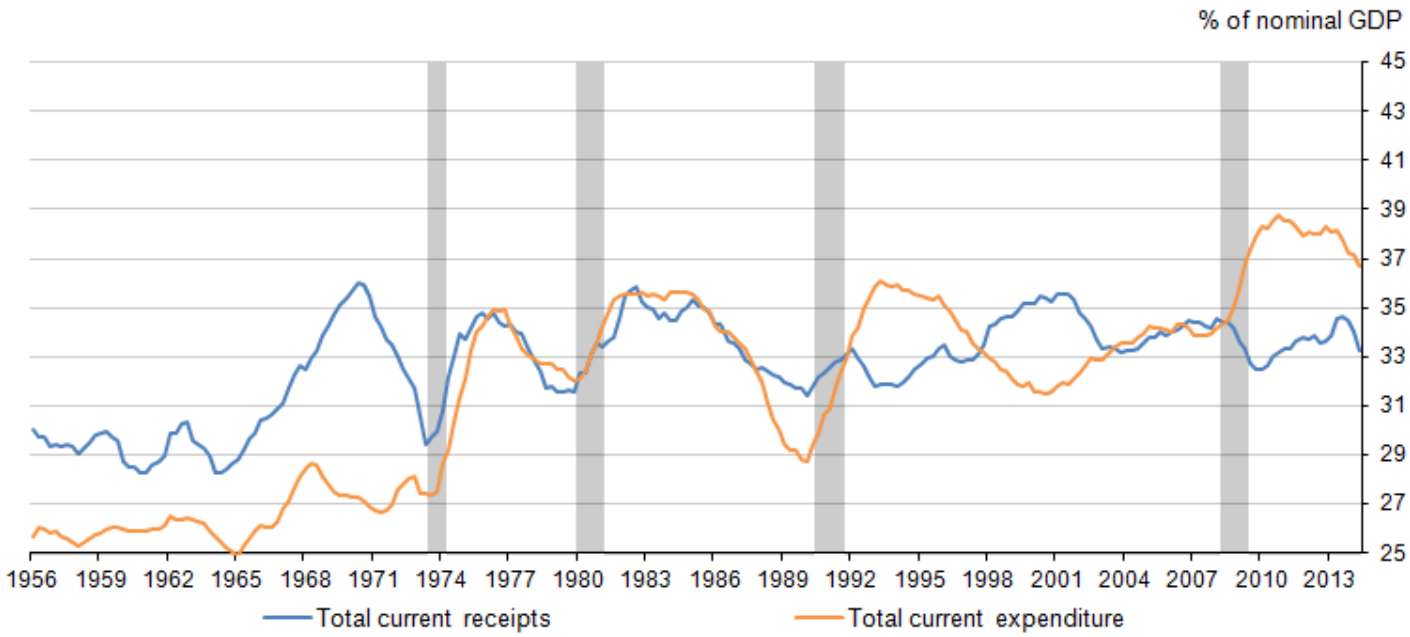
The value of central government income and expenditure increased at broadly similar rates in cash terms up until 2007 (Figure 3). However following the 2008-09 economic downturn, when GDP fell by 6.0% from peak to trough, current receipts fell sharply to levels previously seen in 2005. This fall in receipts reflects the weakening of the tax base due to falling spending, incomes and corporate profits which will have reduced revenues from VAT, income tax and corporation tax among others. In contrast, central government expenditure continued to grow: some components of expenditure, such as health and education, are relatively unaffected by the economic cycle. Instead trends in health spending, for example, are more dependent on population and demographic changes. Furthermore, spending on social protection programmes that are designed to offset the fluctuations in economic growth generally increases during economic downturns. Central government expenditure was 20% higher in Q4 2011 than its value in Q1 2008, whereas current receipts were 13.1% lower over the same period.

In order to allow for the effect of economic growth and inflation over the period, these data are presented as a proportion of GDP in Figure 4. The current budget surpluses that typified the 1950s and 1960s were the result of tax receipts being greater than expenditure, while in the 1960s and 1970s the levels of central government income and expenditure were broadly similar. From the late 1980s onwards the relationship is more volatile, but following the 2008-09 economic downturn there is a clear divergence between higher expenditure and lower receipts.

Figure 4: Central government current receipts and expenditure, % of nominal GDP, four-quarter moving average, Q1 1956 to Q2 2014



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Central government expenditure increased following economic downturns in the 1970s, 1990s and 2000s, although part of this increase will reflect the impact of weak GDP on the denominator. The latter will also hold up the ratio of receipts to GDP, although the decline during recent economic downturn is marked. Even though receipts fell substantially in nominal terms in 2009, these had returned to the same proportion of GDP by 2012.

Looking over the longer term, the ratio of current receipts to GDP has been largely stable, fluctuating around 33% of GDP since the 1970s, and has not risen much above 35%. There tends to be more variation in expenditure over the economic cycle. Expenditure rose to its highest share of GDP, nearly 39%, following the 2008-09 economic downturn. While it has fallen back somewhat since then, it remains at historically high levels relative to the size of the economy.

Income

Current receipts

Central government income is raised through taxes such as VAT, income and corporation taxes, and national insurance contributions. ONS measures these taxes in two categories: taxes on products & production and taxes on income & wealth.

- Taxes on products include VAT, stamp duty and excise duties, like those on alcohol and tobacco, and are levied per unit consumed.
- Taxes on production are those that are levied on production activities irrespective of the amount of output produced, and include taxes such as non-domestic (business) rates.
- Taxes on wealth are based on the market value of assets that are owned, for example bank deposits, shares and fixed assets.
- Taxes on income include income tax, capital gains tax and corporation tax.

The values of these tax receipts are shown in Table 1 at five-year intervals from 2003/04. In all cases the value of each tax receipt in 2013/14 is higher than that of 2003/04, which will partially reflect the effect of economic growth and inflation. While each component has been more stable as a proportion of total tax receipts in these years comparing 2003/04 and 2013/14, there have nevertheless been substantial moves within this period. Taxes on products & production and taxes on income & wealth together account for just over two-thirds of total receipts, with that of products & production being the slightly larger in 2013/14. Social security contributions (sometimes referred to as National Insurance Contributions, or NICs) account for just under one-fifth of total receipts. Interest & dividends received by central government had increased as a proportion of total receipts in 2013/14 from 2003/04.

Table 1: Components of central government current receipts in financial year 2003/04, 2008/09 and 2013/14

	£ billion			*% of total current receipts*		
	2003/04	**2008/09**	**2013/14**	**2003/04**	**2008/09**	**2013/14**
Taxes on production	151.8	169.8	223.5	37.7	33.6	37.9
Of which: VAT	79.2	87.8	120.2	19.7	17.4	20.4
Taxes on income & wealth	145.5	200.2	200.8	36.1	39.6	34.0
Of which: Income tax and capital gains tax	115.2	153.1	158.8	28.6	30.3	26.9
Other (mainly corporation tax)	30.3	47.1	42.0	7.5	9.3	7.1
Other taxes	10.3	12.7	17.4	2.6	2.5	2.9
Compulsory social contributions	75.1	96.6	107.3	18.7	19.1	18.2
Interest & dividends	7.7	9.7	20.3	1.9	1.9	3.4
Other receipts	12.2	16.1	21.1	3.0	3.2	3.6
Total current receipts	402.6	505.1	590.3	100.0	100.0	100.0

Table source: Office for National Statistics

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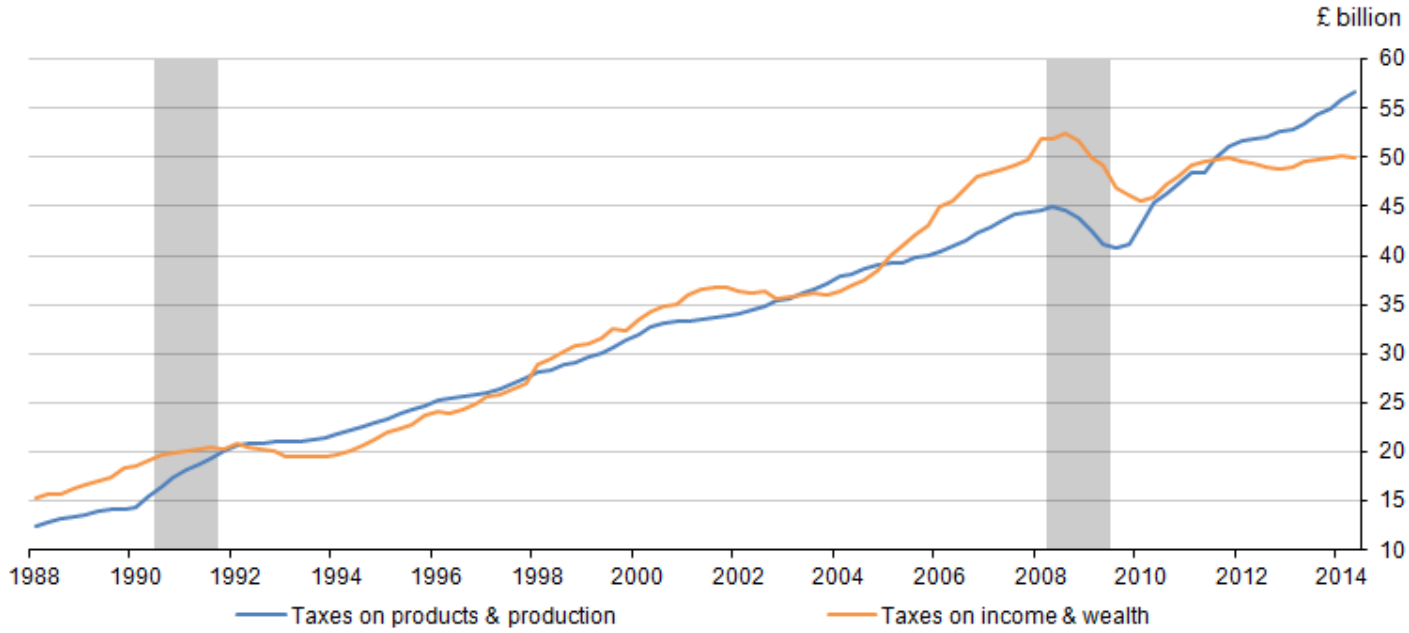
The most prominent story emerging from current price tax data is the differing performance of taxes on products & production and income & wealth following the 2008-09 economic downturn. Figure 5 presents the four-quarter moving averages for taxes on products & production and on income & wealth. Revenue from both fell sharply following the onset of the downturn, with a particularly marked fall in taxes on income & wealth. However, taxes on products & production rebounded much quicker from 2010 onwards, partly reflecting increases in the rate of Value Added Tax (VAT) in 2010 and 2011, initially from 15.0% to 17.5%, and then from 17.5% to 20.0%. Taxes on income & wealth also experienced a slight rebound in 2010 yet the value of these has been broadly constant since 2011.

Figure 5: Receipts from taxes on production & products and from taxes on income & wealth, £ billion, four-quarter moving average, Q1 1988 to Q2 2014



Source: Office for National Statistics

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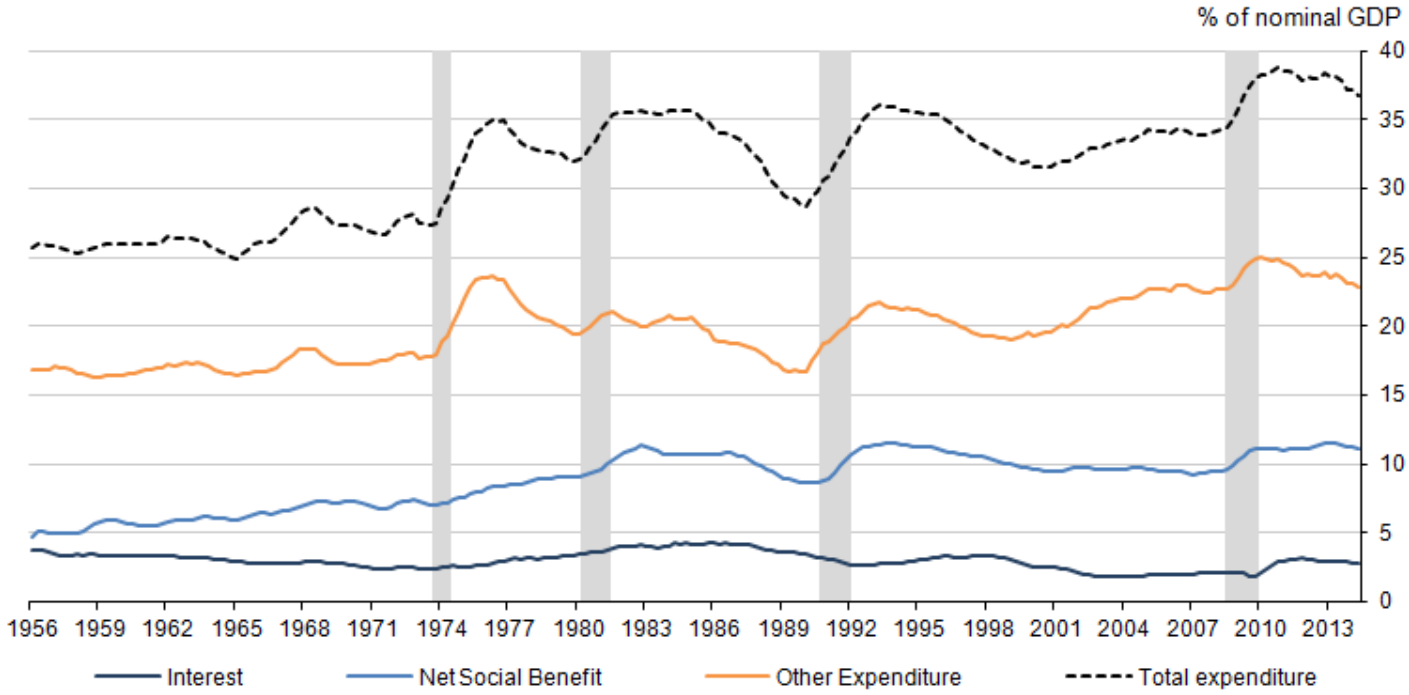
Expenditure

Current spending

Central government total expenditure fluctuated mostly between 30% and 35% of GDP between the mid-1970s and the mid-1990s, and has since increased as a proportion of GDP, as shown in Figure 6. It jumped to around 38% of GDP following the 2008-09 economic downturn, since when it has fallen back slightly but remains above 35%.

Figure 6: Composition of central government spending, % of nominal GDP, four-quarter moving average, Q1 1956 to Q2 2014



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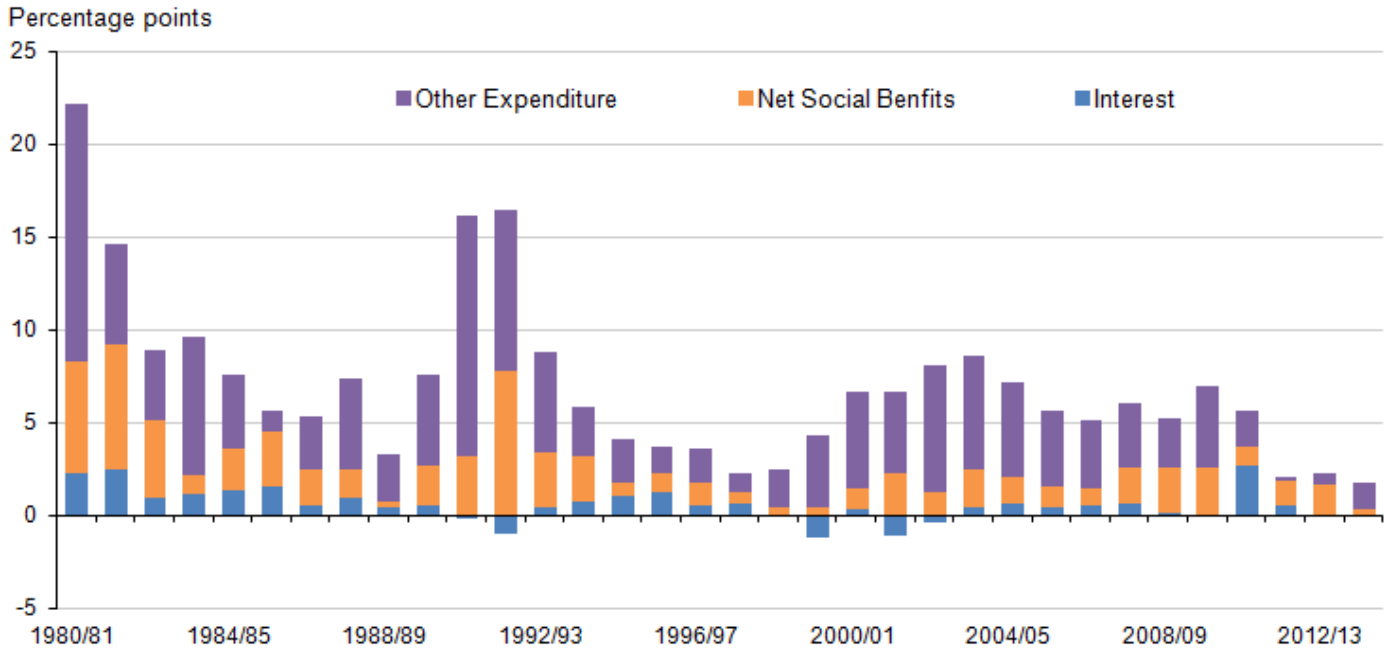
Central government expenditure can be divided into three broad categories: (i) net social benefits, for example pension and disability payments, family tax credits and unemployment benefit payments; (ii) 'other', which consists largely of expenditure - both labour costs and purchases of goods and services – for providing social goods and services, such as healthcare, education and defence; and (iii) interest payments on government debt. Other expenditure is the largest of these categories, and has been on an upward trend, increasing from around 17% of GDP in the mid-1960s towards 25% by 2010. Net social benefits have been relatively constant at around 10% of GDP since the early 1980s, with this proportion having increased by around 4 percentage points of GDP since 1956. Interest payments on the other hand have been on a downward trend since the 1980s. These payments were 4.2% of GDP in the four quarters to Q4 1985, and have fallen to 2.9% of GDP by Q4 2013.

Movements in other expenditure closely mirror those of total expenditure as a per cent of GDP. This is reflected in the annual contributions to expenditure growth presented in Figure 7. Other expenditure has made the largest percentage-point contribution to total current expenditure growth in most financial years since 1980/81, while the pattern in interest payments has tended to become smaller; net social benefits generally made a smaller contribution to expenditure growth in the 1990s and 2000s compared with the 1980s. However, from 2010/11 onwards, these trends have altered somewhat. In 2010/11, interest payments made a 2.6 percentage point contribution to expenditure growth, which is five times greater than the average annual contribution between 1980/81 and

2013/14. Net social benefits then made the biggest contribution in 2011/12 and 2012/13. Overall, growth in general government current expenditure during the last three financial years has been at its lowest rate since the late 1990s, growing by 1.7% in 2013/14 compared with annual growth rates above 5% in the 2000s.

Figure 7: Contributions to growth of central government current expenditure, 1980/81 to 2013/14



Source: Office for National Statistics

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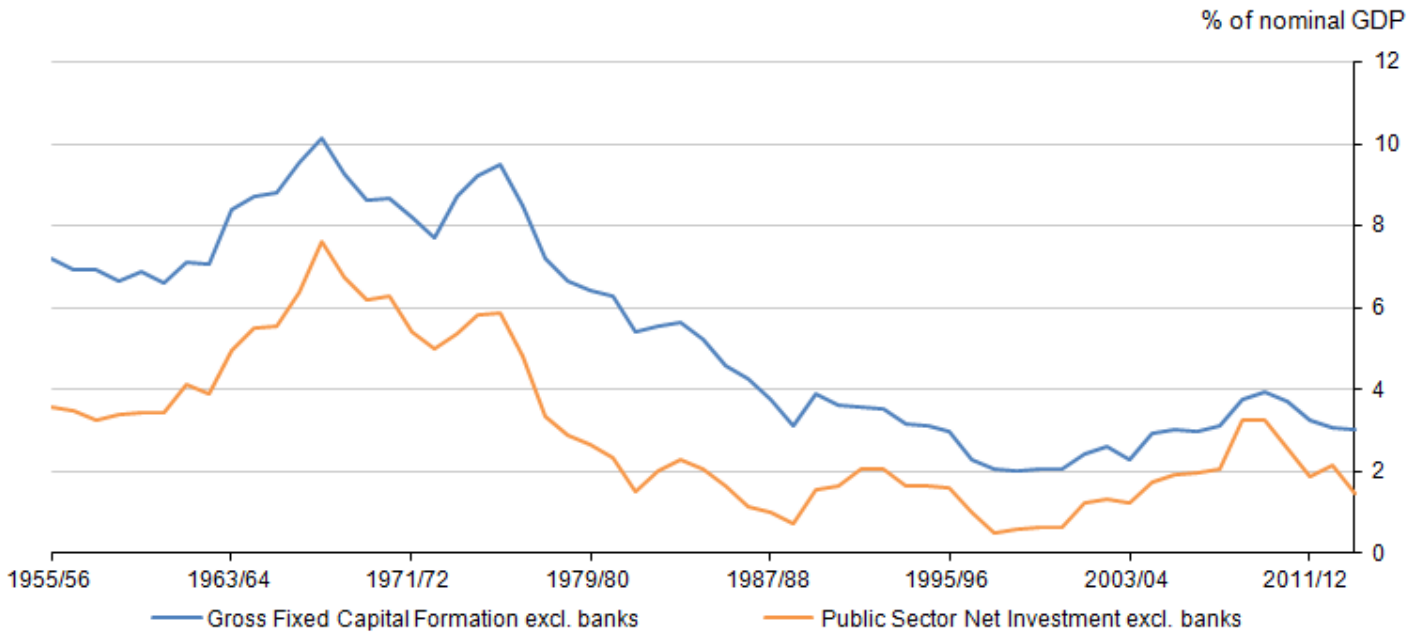
Capital expenditure

The previous section analysed central government current expenditure. This section focuses on capital expenditure for the public sector as a whole. Capital expenditure is spending in one period that generates a stream of benefits in future periods, for example, buildings, roads and infrastructure projects. Capital expenditure is referred to as net investment in the public sector finances. This includes both investments in Gross Fixed Capital Formation (GFCF), which creates a fixed asset that will last longer than a calendar year (like buildings), and also on capital transfers to the private sector and overseas. This investment is then measured net of depreciation and capital grants from the private sector.

Figure 8 compares public sector GFCF excluding public banks in current prices with the PSNI ex measure shown in the public finances. The value of GFCF is usually higher than public sector net investment, which subtracts depreciation and capital grants from the private sector. Both series show broadly similar trends, with GFCF declining from around 8% of GDP in the early 1970s to around 2% in the late 1990s. PSNI fell from around 6% of GDP to 0.6% over this period. The value

of public sector gross fixed capital formation had been on an upward trend prior to the 2008-09 economic downturn.

Figure 8: Public sector gross fixed capital formation and net investment, % of nominal GDP, 1955/56 to 2013/14



Source: Office for National Statistics

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The relatively high level of investment in the late 1950s and 1960s reflected the need to rebuild infrastructure and housing following the Second World War. Social housing new building work declined sharply from the early 1980s onwards and a large proportion of ownership of social housing was transferred to the private sector. Privatisations in the 1980s and 1990s also had an effect on PSNI, by shifting capital expenditure from the public to the private sector.

UK Debt

What is debt?

The level of borrowing in each period is a flow which accumulates to generate the stock of outstanding debt owed by government to its creditors at the end of the period. Public sector net debt is therefore a ‘stock’ concept, to which the activities of government in spending and raising money contribute. PSND was 126.6% of GDP in 2013, or 79.1% of GDP excluding public sector banks (PSND ex). The level of UK debt excluding public banks passed £1 trillion in 2010.

The main determinants of the net debt are the accumulation of all historic differences between income and spending. However, there are also revaluation effects from changes in the value of

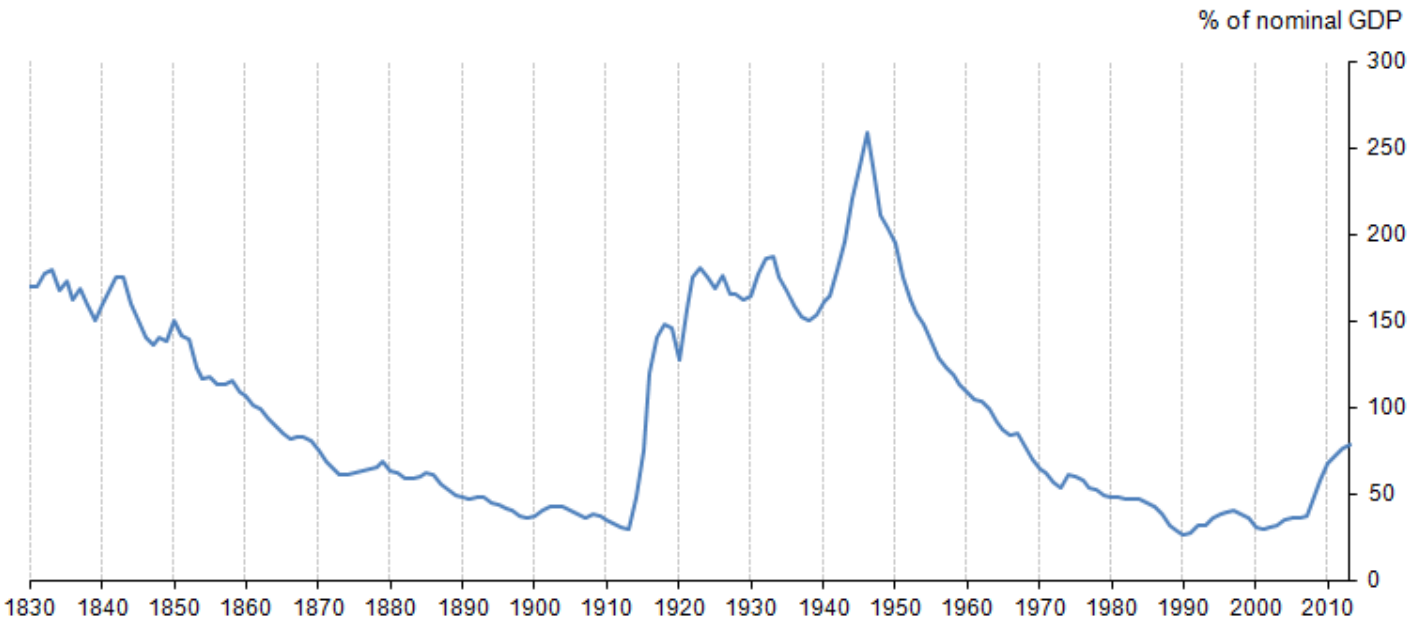
assets and liabilities, for instance due to movements in exchange rates or share prices, and in write-offs.

Why is debt important?

The level of government debt is important because investors have to be persuaded to finance it, for instance through the purchases of government bonds. The debt burden is not sustainable if this cannot be done without investors requiring a sharply higher rate of interest in order to offset the perceived riskiness of such purchases. The level of debt that is sustainable varies from country to country and is affected by the political and economic conditions for each country.

ONS does not produce a single consistent measure of net debt for periods prior to the mid-1970s. However, the Bank of England has estimated debt and GDP figures back to 1830 to give the series shown in Figure 9. Even though these estimates are not fully consistent over time, they show the large accumulation of debt during the First and Second World Wars. This makes periods where PSND is less than 50% of GDP more unusual than periods when debt is above that rate. However the current level of net debt, measured by PSND ex, of around 80% of GDP is the highest since the late 1960s.

Figure 9: Net debt as a % of nominal GDP, 1830 to 2013



Notes:

1. Source: ONS & Bank of England Calculations
2. Due to data scarcity, the historic data are the nominal, or 'face', value of net debt while more recent data (from the 1970s) are PSND. The historical GDP and debt data are taken from the Bank of England's "The UK recession in context – what do three centuries of data tell us?" article from the Quarterly Bulletin Q4 2010. ONS calculations are used to remove the effects of public banking groups from 2007 onwards.

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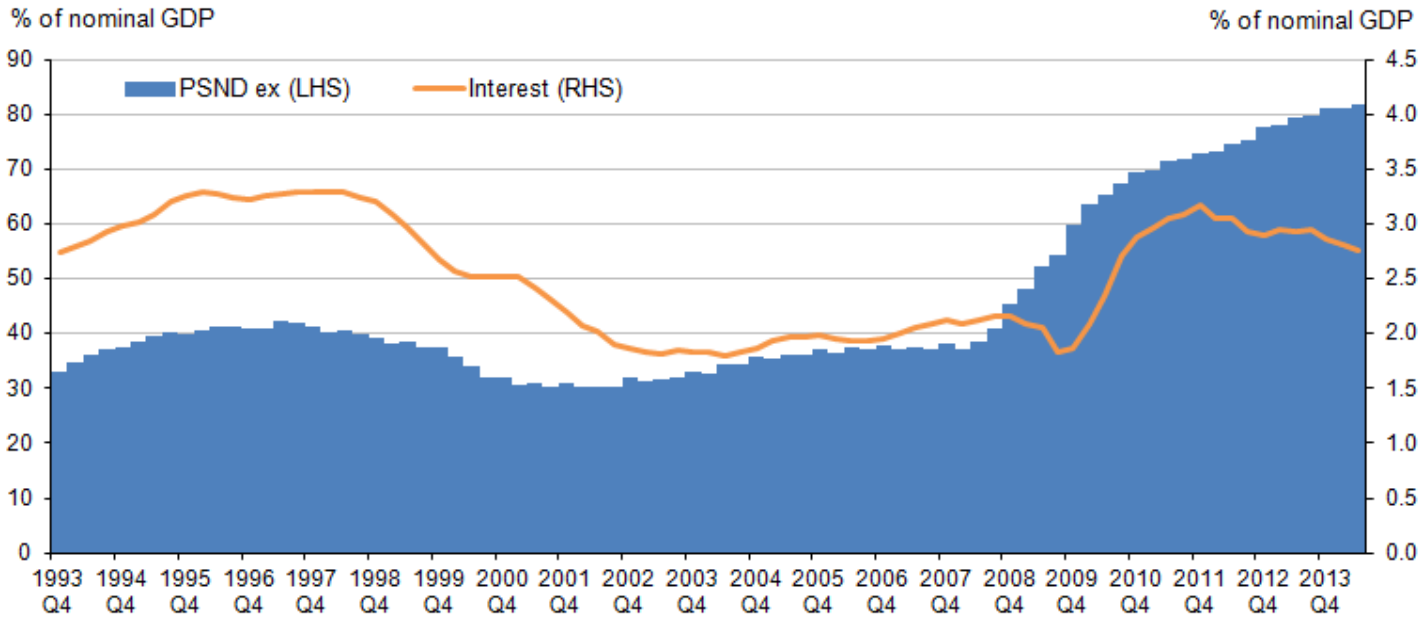
If the interest rate on government debt stays the same, then the larger the stock of public debt, the higher the interest payments will be. Figure 10 shows PSND ex and interest payments each as a proportion of GDP. From the mid-1990s to early-2000s, the debt-to-GDP ratio fell, and so too did the level of interest payments. PSND ex then rose, increasing quickly during and after the 2008-09 economic downturn to the current level of around 80% of GDP.

Figure 10: Public Sector Net Debt excl. banks and the four-quarter moving average of interest paid on debt, % of nominal GDP, Q4 1993 to Q2 2014



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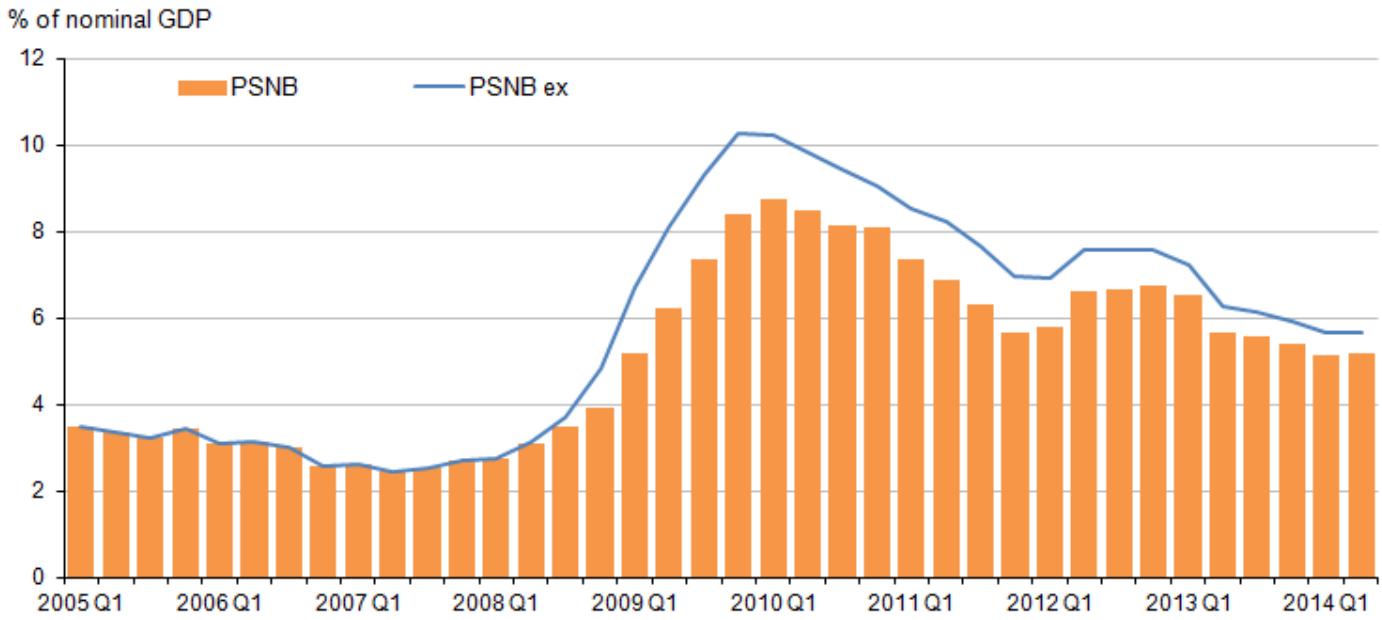
However, interest payments initially fell in early-2009 as economic conditions deteriorated, before increasing rapidly between Q4 2009 and Q4 2011. Although PSND ex has continued to increase as a proportion of GDP in 2012 and 2013, interest payments have fallen as a proportion of GDP, which partly reflects lower interest rates on government debt in addition to quickening economic growth. Comparing the mid-1990s peak in interest payments with the post-downturn peak shows that the debt-to-GDP ratio increased much quicker in the most recent period and yet interest payments have been falling from this peak. This indicates that interest rates were maintained at lower levels post-downturn than in the mid-1990s.

The effect of financial interventions and the ‘ex measures’

The PSNB ex and PSND ex measures were introduced to show the underlying position of the public sector finances without the temporary distortions caused by financial interventions, while including the permanent effects from them. These interventions included the nationalisation of a number of UK banks following the global financial shock in 2007. ONS reclassified some of these organisations as public financial corporations in the National Accounts. This means those banks’ gross liabilities would add to public sector net debt from the point of public ownership. The main public sector banks included Northern Rock[1], Bradford and Bingley, Lloyds Banking Group[2] and Royal Bank of Scotland. Following a public consultation and review of public sector finance statistics in 2014, the “ex” measures were simplified to exclude only the debt and borrowing of public banking groups.

Figure 11: The effect of financial intervention on PSNB, % of nominal GDP, Q1 2005 to Q2 2014



Source: Office for National Statistics

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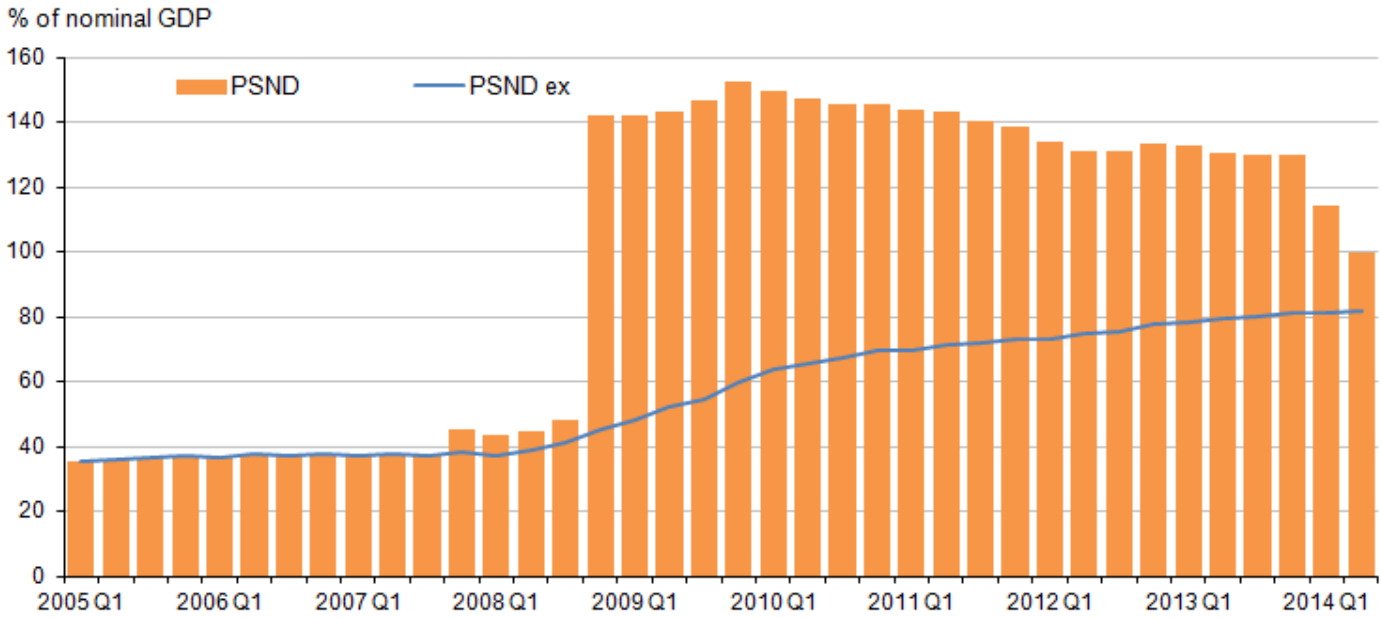
Figure 11 shows that the effect of the public sector banking groups on PSNB is relatively small. PSNB ex is higher relative to PSNB, averaging 1.1 percentage points of GDP per quarter between Q3 2008 and Q2 2014. However, this gap has narrowed in more recent quarters, averaging 0.5 percentage points of GDP per quarter since Q2 2013. The ex measure is higher relative to PSNB owing to the public sector banking groups having negative net borrowing. Nevertheless, PSNB and PSNB ex have been on a downward trend since Q1 2010, making both about twice as large as a share of GDP than in Q1 2007.

However there is a much bigger change to the debt-to-GDP ratio if the public sector banks are included, as shown in Figure 13. PSND ex was around 38% of GDP at the end of 2007, subsequently rising to more than 80% in 2014. But PSND jumped to 141.8% of GDP in Q4 2008, although falling back somewhat in later years. The fall in PSND seen over the first half of 2014 reflects the sale of publicly-held shares in Lloyds Banking Group, which were sufficient to reclassify Lloyds back to the private sector. The Government still holds around one-quarter of the shares in the banking group. Overall, PSND as a proportion of GDP has been on a downward trend since 2009, and fell below 100% of GDP in Q2 2014.

Figure 12: The effect of financial intervention on PSND, % of nominal GDP, Q1 2005 to Q2 2014



Source: Office for National Statistics

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The big uplift in PSND from the inclusion of public sector banks stems from the definition of PSND itself, and from the composition of the nationalised banks' balance sheets. Banks typically have a large amount of liabilities offset by a large amount of assets; however, a sizeable proportion of these assets tend to be 'illiquid', so that they are difficult to convert into cash in a short period of time. PSND ex is therefore higher because it includes the stock of all liabilities but only nets off the stock of liquid assets, i.e. liabilities increase substantially but assets rise by much less.

Notes

1. Since January 2012, part of Northern Rock returned to the private sector and is no longer counted in public sector statistics from that month onward. Northern Rock Asset Management remains under public control.

2. The Government sold a 6% share in Lloyds Banking Group in September 2013, and a further 7.5% share in March 2014, where after it was reclassified as a private financial corporation.

Annex A: A selection of fiscal policy events

Some of the main fiscal policy decisions include:

- The first introduction of income tax in the Budget of 1799.
- First old-age pensions provided by the state from the 1908 Budget.
- The 1941 Budget was the first to outline the Government's plan to run a budget deficit.
- The post-war nationalisation of a number of industries – for example coal in 1946; rail, inland water transport and some road haulage and passenger transport in 1948.
- Creation of the NHS in 1948.
- Capital Gains Tax and Corporation Tax introduced in the 1965 Budget.
- Value Added Tax (VAT) introduced in the 1971 Budget to be levied from April 1973.
- IMF financial programme for the UK in 1976 of up to $3.9bn following speculation around the value of sterling. Pre-conditions to the agreement included cuts in public expenditure and tax increases to reduce the budget deficit.
- The sale of some shares in British Petroleum (BP) was announced in the mini-Budget of December 1976, putting it among the first privatisations in the UK.
- The second Budget of 1979 saw a change in economic policy towards using interest rates and monetary policy to control inflation and shifted the tax base towards taxes on consumptionrather than taxes on income.
- The 1981 Budget announced sizeable tax increases equivalent to 4% of GDP to lower the budget deficit at a time of high inflation and falling output. The Budget prompted a letter from 364 economists against the economic rationale for these decisions.
- Privatisations of public services in the 1980s, including British Aerospace from 1981; British Gas, 1986; British Steel, 1988; and water services in England and Wales, 1989.
- In the 1991 Budget, VAT was increased by 2.5 percentage points to 17.5%, with the proceeds used to lower council tax.
- Large tax increases and cuts in public spending were announced in the second Budget of 1993 as the Government announced its intention to eliminate the budget deficit by the end of the 1990s.
- Fiscal rules announced in the 1997 Budget to balance the budget over the economic cycle and maintain public debt at a sustainable level.
- Nationalisation of a number of financial institutions from the second half of 2007 following the global financial market shock of that year.
- A post-downturn fiscal policy framework was introduced in 2010 to lower the budget deficit sustainably and put debt on a downward profile.

Background notes

1. Details of the policy governing the release of new data are available by visiting www.statisticsauthority.gov.uk/assessment/code-of-practice/index.html or from the Media Relations Office email: media.relations@ons.gsi.gov.uk

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