TRL Insight

# Building Freedom

## Contents

# Executive Summary

Since the credit crunch of 2008, the Government has made clear its desire to work with local authorities to grow local economies and solve pressing social problems, such as the housing crisis. Reforms to the local government finance system have promised, and to some extent granted, greater financial autonomy for councils. These have begun to allow local authorities to invest in housing and supporting infrastructure and build the economies of their localities.

However, the public sector accounting regime has not reflected this change. Spending Review and Budget documents continue to present local authority borrowing as though it was the Government's own. The Treasury's preoccupation with the Public Sector Net Borrowing measure has led to irrational constraints being put on local authorities' capital expenditure activities.

Consequently, it has taken seven years and the shortage in housing to reach crisis proportions for the cap on Housing Revenue Account borrowing to be lifted fully – even assuming this to be implemented next year.

But to create sustainable communities, there also needs to be investment in local economies and infrastructure. Tax Increment Financing would help local authorities to achieve such investment, but England has only had one brief experiment with this. Again, this was held back because of the accounting regime. Reforms to this regime would allow Tax Increment Financing to reach its full potential. It would also allow councils to access borrowing to deal with emergencies (and perhaps for once-off service transformation, as they could from 2011-12 to 2013-14).

This report looks at the public sector accounting regime and compares it with those in other countries such as Denmark, Sweden and Canada. It highlights the diversity in fiscal documents and the measures they use. It shows the problems caused by the system in the UK, which reflects the centralised nature of late 20th-century political structures, and points out good practice in other countries. (Within the UK, we focus mainly on the circumstances faced by local authorities in England, but an appendix outlines the situation in other parts of the UK.)

The UK has proved it could weather the storm created by the credit crunch. Ten years on, with the cost of Government borrowing remaining extremely low, there is no significant reputational risk for the Government in making the proposed changes. But with the current uncertainty over the strength of the

British economy post-Brexit, the Government can ill afford to turn up its nose at tools which could promote growth in towns and cities across the country.

We therefore call upon the Chancellor to use the opportunity of next week's Budget to address these issues. Specifically, we recommend that:

- Spending Review and Budget documents should be reformed to reflect the financial autonomy of local government:
  - These documents should focus primarily on the finances of central government and bodies which are answerable to it (such as the NHS and Non-Departmental Public Bodies);
  - Corresponding statistics should be presented for expenditure, income, in-year balance and debt – excluding local government;
  - Financial and fiscal data estimates or projections relating to local government should only be included in these documents in a separate section providing a reconciliation for the whole public sector. These should be agreed through consultation with representatives of local government;
- The Government should immediately set up a panel of experts, as described in this report, to consult on the details of these changes. As part of their deliberations, they should consider the presentation of public finances in other countries. The details should be agreed in time to implement these changes in Spending Review 2019;
- In future, the Government should not impose any constraints on borrowing or investment on local government other than those contained within the prudential system. Neither should the Government reduce revenue funding for local government as a "cost" of greater borrowing or investment by local authorities.

# 1. Introduction

Next week, the Chancellor of the Exchequer, Rt Hon Philip Hammond MP, will present the Budget to the House of Commons. It will be a difficult Budget to present, as he still won't know whether the UK will reach a deal with the European Union (EU) in time for its departure. This makes it a difficult Budget to predict. However, we have already been told two things about it. Firstly, it will set out the details of the long-called for lifting of the cap on borrowing relating to the Housing Revenue Account (HRA). Secondly, it will look forward to the Spending Review next year.

The Spending Review could be an even tougher challenge for the Chancellor. He will want to pull out all the stops to boost growth across the whole country, in case of short-term (or even long-term) economic shocks caused by Brexit. He will also want to demonstrate that the UK is emerging from a decade of austerity. He will want to show that the Government is serious about tackling the housing crisis by making the lifting of the HRA cap permanent. And he will want to achieve all this without letting the deficit grow again.

As we show in this report, the HRA cap was put in place because of a rationale based on an anachronistic presentation of the public finances. This same problem was behind England's first experiment with Tax Increment Financing (TIF) being throttled right back before it had even commenced. (Nonetheless, considering its small scale, this brief experiment has resulted in some impressive developments.) The public finance regime has also caused other nasty surprises for local government down the years.

The report examines the public sector accounting regime in the UK and contrasts it with that in other EU countries and in Canada. It highlights some of the consequences of the UK's presentation of its finances and makes recommendations for reform.

As noted by pwc following a roundtable it jointly convened with Reform[1], the Spending Review should be placed-based and radical. It should allow investment which will bring benefits in the long term. It should put citizens and communities at the centre and build a country that works for everyone, ready for life after Brexit. The proposals in this report will help the Chancellor to achieve just that.

It is laid out as follows.

Section 2 provides the background and context for this analysis. It looks at trends in the UK economy and in central government's relations with local government. It provides overviews of the local government capital finance system and recent

Government policy on council investment in housing and supporting infrastructure.

Section 3 describes the public sector accounting regime in the UK, including the main measures of deficit and debt used in Spending Reviews and Budgets. It looks at the impact of these on local authority freedoms to build houses, infrastructure and vibrant local economies.

Section 4 looks at international comparisons, with subsections on Denmark, Sweden, Canada, France and the statistics collected by Eurostat. It highlights how diverse these are in the way they present the public finances and that it is possible to acknowledge and reflect the financial autonomy of local government in fiscal documents.

Section 5 draws out the lessons from these comparisons and presents our conclusions and recommendations.

There are three appendices. Appendix 1 gives a brief overview of capital finance in Scotland, Wales and Northern Ireland. Appendix 2 describes three emerging of potential sources of funding for investment. Appendix 3 provides further detail on public sector accounting in the UK.

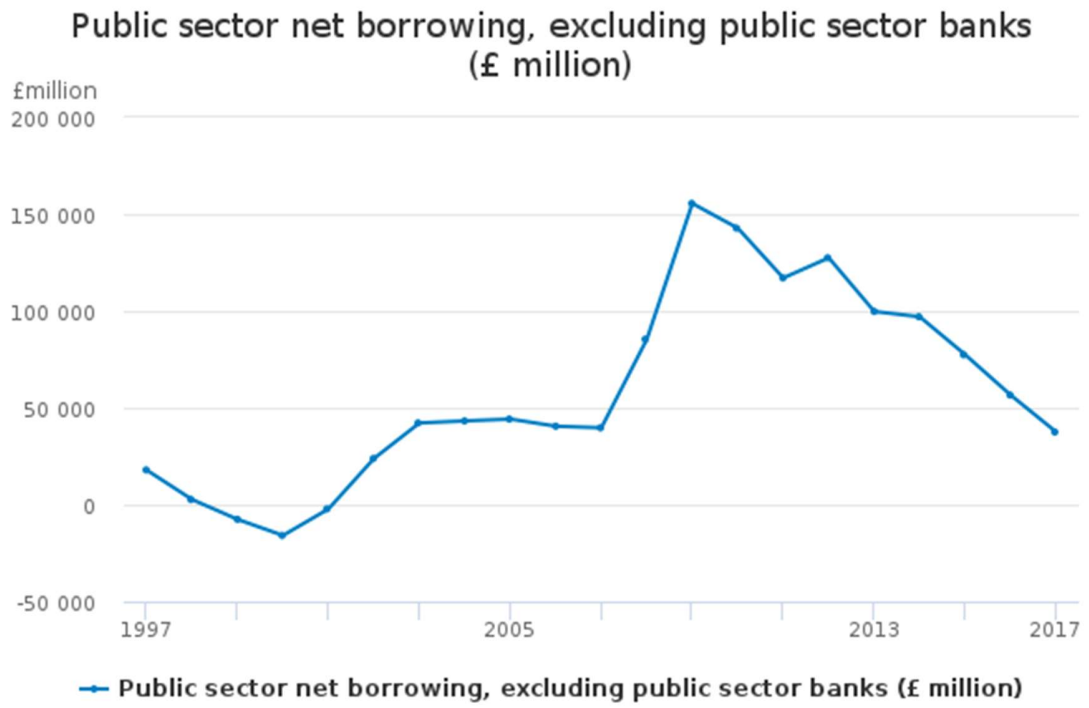
References and notes are provided at the end of the report, for those seeking further information on the topics in here.

# 2. Context

## 2.1 The UK economy

The UK economy is on a journey from a challenging and turbulent recent past to an uncertain future. In the credit crunch of 2008, lending by financial institutions to the private sector at large froze up. Businesses suffered and consequently tax revenues fell. To make up for this, the Government was forced to hike up its levels of borrowing – Public Sector Net Borrowing (PSNB) rose nearly fourfold between 2007 and 2009, even excluding the borrowing directly for bailing out the banks. It has taken a decade of "austerity" – tight constraints on public sector spending of all kinds – to get the deficit down to pre-credit crunch levels (see Figure 1).

**Figure 1: PSNB from 1997 to 2017**




*Source: Office for National Statistics. Contains public sector information licensed under the Open Government Licence v3.0.*

Over this decade, the UK economy has improved considerably according to many measures. Unemployment is at the lowest level in over 40 years[2], although research suggests that a significant proportion of the workforce may be "underemployed"[3,4]. Despite this, while inflation[5,6] and interest rates[7] are starting

to rise, they remain low by historic standards, as does the cost of government borrowing[8,9]. Nonetheless, long-standing problems with productivity and uneven growth across the UK remain.

Brexit is now the main preoccupation of the political world. Eurosceptics and the Chancellor alike predict a boost to the economy in the event of a good deal with the EU. On the other hand, preparations are being made for possible shocks to the economy in the event of no deal or a poor deal. Meanwhile, businesses are struggling to factor this political uncertainty into their decision-making.

While the main focus of the Government and the media is on Brexit, long-term trends are putting increasingly severe strains on public sector budgets. NHS and local authority budgets face rising pressures from the needs of a growing elderly population. And the housing crisis continues to bite, with waiting lists for social housing growing[10] and many workers finding they are unable to live in the more expensive parts of the country[11].

## 2.2 Devolution and local financial autonomy

Much of the post-war period in the UK has been characterised by growing central control over local government. This was particularly evident during the premiership of Margaret Thatcher, when, amongst other things, non-domestic rates were replaced by a uniform business rate for the whole of England.

Since around the turn of the century, we have started to see this reversed. The Greater London Authority (GLA) was created in 1999-2000, alongside the Scottish Government, Welsh Assembly and Northern Ireland Executive. The prudential system for capital finance in local government (see below) was introduced in 2003. 2007 saw the signing of the Central-Local Concordat[12] and the passing of the Sustainable Communities Act, although perhaps neither have lived up to their potential.

The Coalition Government of 2010-2015 made localism a key plank of its programme. Its philosophy was set out in the 2010 White Paper *Local growth: realising every place's potential*:

> *"Our approach recognises that places have specific geographic, historic, environmental and economic circumstances that help to determine the prospects for growth and the most suitable approach to support the private sector and residents' opportunities…*

> *"Policy should therefore recognise that the situation will be different for each place and is likely to be particularly affected by factors such as the inherent skills mix or entrepreneurial tradition of the population; business confidence; quality of infrastructure provision; and proximity to trading markets".*

Such local variation cannot effectively be managed from Whitehall. The White Paper outlined

> *"… a new approach to local growth, shifting power away from central government to local communities, citizens and independent providers. This means recognising that where drivers of growth are local, decisions should be made locally".*

During this period, the Sustainable Communities Act regime was enhanced with cross-party support and the reform of the HRA (see Section 2.4), worked up under the previous government, was implemented. The Localism Act 2011 contained, among other things, a suite of rights for communities and a General Power of Competence for local authorities.

### *Business Rate Retention and multiplier flexibilities*

Perhaps the most far-reaching reform was Business Rates Retention (BRR), which emerged from ideas set out in *Local Growth* and was introduced in 2013. Prior to this, billing authorities collected Business Rates (BR), but they were paid to central government, to be redistributed to councils in the form of grants. For much of this period, BR yield funded the bulk of the main revenue grant. This was distributed on the basis of an assessment of spending needs, net of ability to raise Council Tax.

Under BRR, a "local share" of Business Rates is retained within the local government sector. There is still an assessment of needs net of Council Tax, but instead of using fresh data for each year's settlement, it has simply been increased in line with the BR "multiplier" each year since 2013-14. There was also a projection of BR expected to be collected for each authority in 2013-14. The difference between these forms the basis for redistribution between local authorities: so-called "tariffs" and "top-ups".

This provides a financial link between local authorities and the businesses with premises in their area. If the net yield from business rates increases, the local authority receives more funding. Conversely, if the net yield falls, the authority's funding falls. (There are limits placed on possible losses and gains by the "levy and safety net system".) At the England level, the yield rises year on year, while

Government grants are being cut back. This means that at present, council funding overall is rising, with ever greater proportions being raised from local taxation. However, the main costs for local government are rising faster and the funding picture across England is very varied, with many councils facing unsustainable financial pressures.

The Government acknowledges that over time, the business rates yields and expenditure needs will diverge for many councils. It is therefore intended that there will from time to time be a fresh needs assessment and projection of business rates, to be used as a new set of baselines for the system, known as a "reset". The dates for these are set by central government.

Since the 2015 general election, further measures to enhance the financial autonomy of local government have been promised, and to a limited extent, delivered. In October 2015, the Chancellor announced that the "local share" of business rates retained by councils would be increased to 100% and that they would be granted greater flexibilities in the "multiplier" used to calculate business rate bills. A Bill was prepared to make 100% retention possible and to provide for the multiplier flexibilities, although the latter turned out to be fairly limited. Unfortunately, it did not make it onto the statute book, as it fell when the 2017 general election was called. Nonetheless, 150 authorities are now piloting higher local shares and planning is continuing for a higher local share, intended to be implemented as part of the first "reset".

Councils have also continued to see gradual increases in their financial autonomy in relation to their housing stock, culminating in the recent announcement that the HRA borrowing cap will be scrapped. This is described in Section 2.4.

The overall picture is one where local government has been repeatedly promised great strides forward in its financial autonomy, but the reality has rarely measured up to the grand announcements. Nevertheless, local financial autonomy is increasing and the mood music from the Government suggests this trend is set to continue. However, as we shall see, the advances are often subject to constraints which hold back investment for growth.

## 2.3 The local government capital finance system

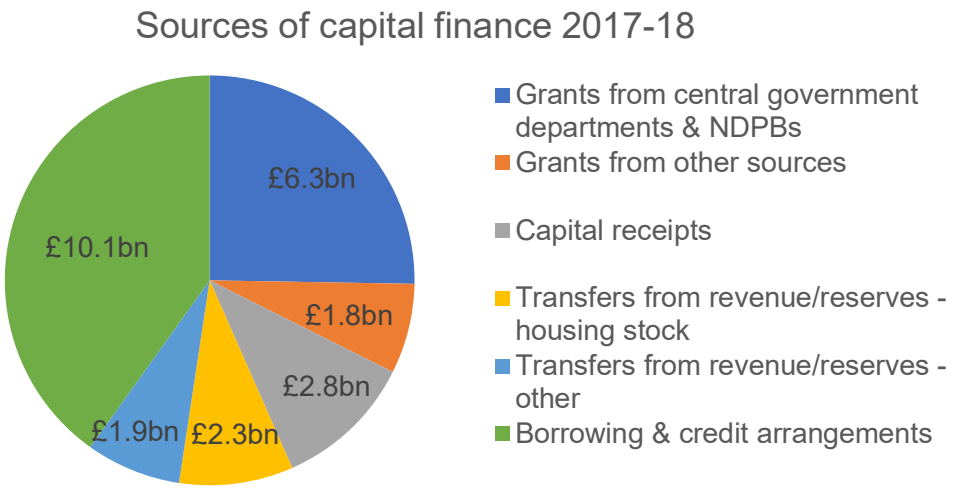
This section deals largely with the capital finance system in England. Appendix 1 contains further information on capital finance in Scotland, Wales and Northern

Ireland – both in relation to local authorities and the devolved governments themselves.

Local authority expenditure may be classified as either capital or revenue. Capital expenditure is, roughly speaking, expenditure that results in an asset or increases the value of an asset[13].

Figure 2 shows the sources from which capital expenditure by English local authorities was funded in 2017-18 (the last year for which we have outturn data).

**Figure 2: Local authority sources of capital finance 2017-18**




*Source: Capital Outturn Returns*

It should be noted that this only shows authorities' own capital expenditure. In practice, they are often involved in projects which lever in large amounts of investment from the private sector. This can result in revenue payments from the authority to the private sector – the most notorious example of this is the Private Finance initiative (PFI). (This is described in Section 3.3.) However, private sector partners can gain in other ways – for example, it is common to work with a construction company in regenerating an estate or neighbourhood, where the company ends up with its own assets such as homes which it can sell.

Note also that in Figure 2 we have kept transfers from revenue accounts/reserves for housing stock separate from that for other services. This is in accordance with local government accounting practice, as HRA funding can only be spent on the council's own housing stock. The HRA system assumes the use of a specific reserve, the Major Repairs Reserve. Of the £2.3bn shown here, 72% relates to transfers from the Major Repairs Reserve; the rest relates to

transfers directly from the HRA. Further information on the HRA system is given in the Section 2.4.

Transfers may only be made from revenue accounts into capital accounts and not vice versa. Capital receipts, capital grants and sums raised from borrowing are paid into capital accounts and may only fund capital expenditure, not revenue expenditure[14]. Until 2013-14, under exceptional circumstances, revenue expenditure could be treated as capital expenditure (and therefore be funded from any of these sources) with the approval of the Secretary of State, using a procedure called "capitalisation".

Most of the grant funding from central government shown in Figure 2 relates to schools and transport. Two thirds of the 'Grants from other sources' come from private developers, leaseholders and similar sources. The rest comes from a mix of Local Enterprise Partnerships (LEPs), the National Lottery, EU funds, GLA bodies and other councils.

Capital receipts are greatly affected by the state of the economy. When developers are struggling, there are likely to be fewer sales, both of land to developers and of properties constructed in mixed development schemes. When the property market is depressed, prices achieved by sales will slump. Capital receipts can also be used to meet the revenue costs of service transformation programmes which will generate on-going savings, with the approval of the Secretary of State[15]. This is described Section 3.6.

### *Credit Approvals and prudential borrowing*

The regulatory framework governing local authority borrowing in general fund assets (assets other than housing stock) was revolutionised in 2003.

During the 1980s and 1990s, there was a great deal of concern within Government about potential financial recklessness in some local authorities. Consequently, local authority borrowing was tightly controlled. Lending to local authorities would be overwhelmingly provided by central government through the Public Works Loan Board (PWLB); any credit raised from other sources would be marginal.

For investment in General Fund assets, prior to 2003 local authorities were allocated Credit Approvals each year. They could only borrow up to these amounts. As this applied to all credit arrangements which feature on council balance sheets, this greatly constrained investment.

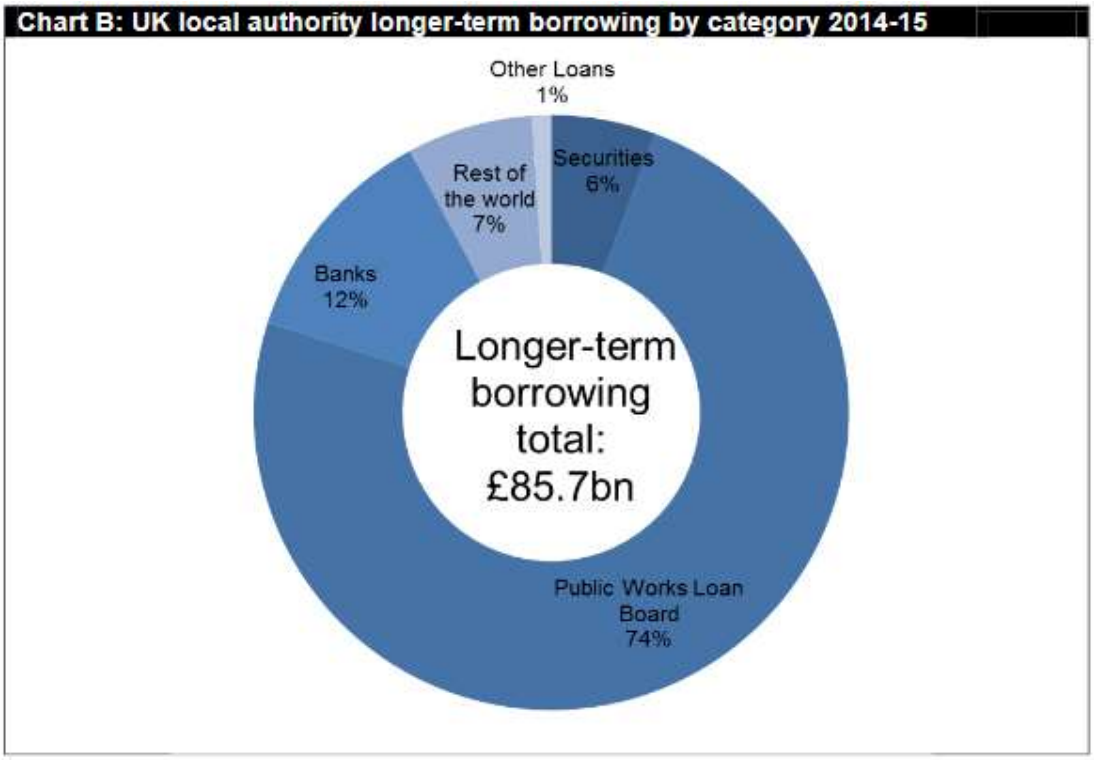
The Local Government Act 2003 scrapped Credit Approvals and replaced them with the Prudential System. This is very similar to the system that was already in use in France (see Section 4.4). Under this system, the constraints on a council's borrowing do not come from central government but from what is “prudent”. Councils must follow CIPFA's Prudential Code to ensure that their finances are sustainable and that credit is affordable. The introduction of this system initially led to a fast but not excessive increase in borrowing – the average annual increase in borrowing in England between 2004/05 and 2010/11 was 7.7% in real terms. Since then, the rate has slowed considerably – the average annual increase between 2010/11 and 2017/18 was 0.6% in real terms[16].

The Act also specifies that borrowing shall be “charged indifferently on all the revenues of the authority”. Given that the revenues include council tax and other fees levied on local residents, this means that creditors will always receive repayment in full. Should the local authority find a loan difficult to repay, it can always re-finance the investment with a PWLB loan, as the Government remains the lender of last resort.

### *Sources of loans, credit and related capital*

Most of the lending to English local authorities, and indeed UK local authorities, is undertaken by the PWLB. Until 2014-15, the Department of Communities and Local Government (DCLG – now the Ministry of Housing, Communities and Local Government or MHCLG) collected statistics on this. Figure 3 below comes from the 2014-15 publication[17] and relates to all loans for over a year – that is, those that are for capital expenditure rather than in-year cash flow purposes.

**Figure 3: Local authority sources of borrowing 2014-15**




*Source: Local authority borrowing and investments, UK 2014-15, DCLG. Contains public sector information licensed under the Open Government Licence v3.0.*

The PWLB has been in existence for around two hundred years. It is now part of the Treasury's Debt Management Office (DMO), set up in 1998 when the Bank of England was granted independence. It on-lends money raised by the Treasury through issuing gilts (government bonds). Until 2010, it on-lent at the rate at which it borrowed (see Section 3.4 for more on this). These low rates, the ease of taking out loans and the terms and conditions have in practice made the PWLB the default option for borrowing – the "lender of first resort". As Figure 3 shows, in 2014-15 the PWLB lent six times more to local authorities than their next largest creditor, the banks.

Two categories in Figure 3 require further explanation. "Other loans" includes building societies, central government and a host of public sector, financial sector and other private sector sources – the largest source in this category, according to the source document is "other financial institutions".

The largest source in the "Securities" categories is negotiable bonds. Local authorities can issue bonds themselves. This happens in many countries and is widespread in the United States.

It is often stated that municipal bonds were issued frequently in the UK in the 19th Century. In the latter half of the 20th Century, however, issuance dwindled away to nothing. In recent years, the UK has seen a few local authorities start to issue bonds again[18]. When the GLA issued bonds for Crossrail in 2011, they were the first to be issued by a local authority for over 17 years[19]. Four years later, Warrington issued a £150m bond deal to help finance its town centre regeneration plans[20,21]. Aberdeen followed suit the following year[22] and Birmingham issued its "Brummie Bond" last year[23,24].

Local authorities may also collectively issue bonds. Municipal bonds are regularly issued by institutions set up for this purpose in Denmark, Sweden, Canada and France as we shall see in Section 4. New Zealand, Finland and Japan, amongst others, also have established institutions or structures for issuing municipal bonds.

Here in the UK, such an institution has been created in the last few years. The first steps towards what is now the UK Municipal Bonds Agency (UKMBA) were taken by Local Government Association (LGA) in 2014. The agency, founded in 2015, is now a public limited company. It issued a "framework agreement" to authorities wishing to issue bonds through it – the first authority to sign this agreement was Cambridgeshire County Council in February 2016[25]. It has an Aa3 rating from Moody's[26], but has yet to issue bonds.

Councils also have the power to set up companies. Local authority companies operate at arm's length from the authority and are usually used for projects that are semi-commercial in nature. A capital base for the project can be raised through a stock issue. This may be appropriate where a scheme creates a variable or uncertain income stream which can be paid as a dividend. Until recently, few councils were using this power. However, in recent years, there has been a rapid increase in the creation of Local Housing Companies (LHCs). A study published last October estimated that "there are probably as many as 150 LHCs in England, most formed in the past few years"[27]. Many of them "have been established by stock holding councils as a reaction to government constraints on the Housing Revenue Account" (for example, the borrowing caps described in Sections 2.4 and 3.4, rent controls and the Right to Buy), "as well as to cuts in housing budgets".

Other ways of raising capital for investment in local authority assets have been considered in recent years. Appendix 2 provides an overview of some of these:

- Community shares and bonds;
- Pension fund investment;

- Real Estate Investment Trusts.

## 2.4 Housing finance

Not all local authorities own housing stock. Those that do are required to keep a ringfenced account, the Housing Revenue Account, to manage the finances of the stock. Investment in council housing remained tightly constrained until the end of 2011-12. Until this point, HRA financing revolved around a complicated calculation of Housing Subsidy. The subsidy calculation contained a deduction for assumed rent levels, and so could be positive or negative.

Under the HRA restructuring process, introduced in April 2012, local government effectively "bought out" of the subsidy system. Councils then took on extra debt or had debt paid off by the government until their estimated surplus rental income over the next 30 years was precisely enough to pay the financing costs of the total debt plus their estimated investment needs[28].

If this were the full extent of the government's involvement in debt and borrowing levels, any authority whose surplus income exceeded the government's estimate could borrow against future surpluses for investment. In particular, were a council to increase its plans for housebuilding over the next few years, it would expect to receive greater rental income than the government's estimate.

Unfortunately, local authorities could not borrow on the basis of receiving this income, because the government set a borrowing cap – authorities could only borrow up to the level of the government's valuation of investment needs (if this is higher than their actual debt on 1 April 2012). We shall look into the reasons for this cap in Section 3.4.

Since HRA restructuring, there has been concerted lobbying by the sector to remove this cap. It has in fact been extended – councils have been granted "flexibilities" to it – several times since it was introduced.

In both 2015-16 and 2016-17, HRA borrowing limits were raised by just £150m. This extra headroom was allocated by competition, with 74 awards in 2015-16 made to 21 authorities.

West Lancashire BC, for example, was allowed to borrow an extra £2.5m for the Firbeck Revival Scheme. This project was part of a wider regeneration of Skelmersdale town centre, which had wide support from residents and other stakeholders. The extra borrowing unlocked further funding, allowing a total investment of £8m on the scheme, with £5.5m provided from the council's HRA and general fund budgets. Three years on, there are 42 new dwellings at the site.

They are all equipped with smart meters and a home office with appropriate telephone, internet and power sockets. The constructors successfully ensured that construction waste was kept to a minimum, and ecology surrounding the dwellings was left undisturbed. The construction uses energy efficient fabrics and provides plenty of daylight for residents. Furthermore, the development has included street scene improvements and the enhancement to the area means that adjacent land will be more attractive for development. This should help with the delivery of the wider town centre regeneration.

*Firbeck Revival Scheme, courtesy of Mainer Associates*

In the Autumn Budget 2017, the Chancellor announced that the HRA cap would be lifted for areas of high affordability pressure from 2019-20, up to a total of £1bn by 2021-22. The Budget stated that "the government will monitor how authorities respond to this opportunity, and consider whether any further action is needed"[29]. Bids were invited from authorities in these areas in a prospectus issued on 26 June this year, with a closing date of 30 September[30].

The following week, on 3 October, the Prime Minister announced in her party conference speech that the cap would be ended completely[31]. An accompanying press release stated that "The cap will be lifted as soon as possible, with further details confirmed in the Budget"[32]. On the 18 October, the Secretary of State wrote to local authorities explaining the legal route through which the Government intended to remove these caps, inviting comments[33]. The letter recognises and appreciates the high number of bids in response to the 26 June

prospectus and the positive reaction from councils to the Prime Minister's announcement.

This change in policy has indeed been widely welcomed by the sector. Sixty local authorities have stated in an open letter that they will borrow more for building homes as a result[34]. Cheltenham BC has written publicly about its plans in more detail[35].

Besides borrowing powers, the Government has at times provided local authorities with direct grant funding for housing investment. One particular funding stream worth noting here is the Housing Infrastructure Fund. This was announced in July 2017. In launching it, the Secretary of State for Communities and Local Government wrote[36]

> *"We hear time and again that putting infrastructure in early could make all the difference in making new land available and getting homes built. Without the right infrastructure, no new community will thrive – and no existing community will welcome new housing if it places further strain on already stretched local resources."*

The fund is therefore to "help ensure the right infrastructure is in place at the right time to unlock the high quality new homes that this country so badly needs". A total of £2.3bn is available, which is awarded on a "highly competitive basis". Bids are put to the Government for funding relating to two types of proposal: Marginal Viability Funding and Forward Funding. Announcements have been made about projects receiving both types of funding. Further information on this fund can be found on the Housing Infrastructure Fund page on the Government's website[37].

# 3. The UK public sector accounting regime and its consequences

## 3.1 Measures used in Budgets and Spending Reviews

The British government compiles public expenditure statistics in various different documents. We will focus on those used in Budgets and Spending Reviews. (Other documents include National Accounts, Supply Estimates and Whole of Government Accounts – see Appendix 3 for more on this.)

Public expenditure, as set out in Budgets and Spending Reviews, is usually broken down two ways: into current and capital spending, and into Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME). While DEL and AME sound like they relate purely to central government, this is not the case. Actually, all public sector spending – central government, local government and public corporations – is included in these figures. Details are given in Appendix 3. (A summary of the situation for Scotland, Wales and Northern Ireland is given in Appendix 1.) Note that this means that even if a council borrows from a third party, such as a building society, when this money is spent it contributes to these expenditure figures.

Spending Reviews and Budgets (and formerly Autumn Statements and Pre-Budget Reports) therefore set the basic parameters of public spending and allocate spending within these parameters. In addition, they set out projections of income, borrowing and debt. There have also been several measures of borrowing and debt used over the years. Appendix 3 provides information on the history of these changes.

The main measure of debt used in these documents is currently Public Sector Net Debt (PSND). The definition of PSND is the joint responsibility of ONS and HM Treasury (ONS produce guidelines and have been known to consult with European counterparts on areas of uncertainty)[38].

The main measure of borrowing is currently Public Sector Net Borrowing (PSNB). (The former measure of PSBR is also still reported – see Appendix 3 – under the new name Public Sector Net Cash Requirement (PSNCR).)

The following table shows how Public Sector Net Borrowing is composed.

**Figure 4: Calculation of PSNB – forecast % of GDP, March 2018**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 |
|---|---|---|---|---|---|
| Public sector current expenditure | 34.7 | 34.6 | 34.2 | 33.7 | 33.5 |
| Public sector net investment | 2.1 | 1.8 | 2.1 | 2.4 | 2.3 |
| Depreciation | 2.0 | 1.9 | 1.9 | 1.9 | 1.9 |
| **Total managed expenditure** | **38.8** | **38.4** | **38.3** | **38.1** | **37.8** |
| *minus* | | | | | |
| **Public sector current receipts** | **36.6** | **36.7** | **36.8** | **36.8** | **36.7** |
| **Public sector net borrowing** | **2.2** | **1.8** | **1.6** | **1.3** | **1.1** |

*Source: Table 4.40 of Economic and fiscal outlook – March 2018, Office for Budget Responsibility*

## 3.2 Fiscal rules

During his tenure as Chancellor, Gordon Brown repeatedly stressed that the Treasury was managing the public finances in accordance with two "fiscal rules", the "golden rule" and the "sustainable investment rule". Since then, the Government has always adopted fiscal rules. The fiscal rules since 1997 are summarised in Table 2 of a publication by the House of Commons Treasury Committee, *Autumn Budget 2017 - Fifth Report of Session 2017–19*[39].

The current Government has as its primary fiscal objective to "return the public finances to balance at the earliest possible date in the next Parliament" [40]. (Though, as the Treasury Committee has noted, this was set before the last general election, so it is unclear which Parliament this now refers to.)

In order to achieve this objective, the Treasury's "fiscal mandate in this Parliament is a target to reduce cyclically-adjusted public sector net borrowing to below 2 per cent of GDP by 2020–21".

It has also set a target "for public sector net debt as a percentage of GDP to be falling in 2020–21".

All three of these objectives are based on measures which increase when local authorities spend money on capital projects. Keeping local government capital expenditure low therefore helps the Treasury to achieve its targets. While the precise fiscal rules have changed over the years, there has always been a Treasury concern to keep public sector borrowing down, including investment by councils in their assets. This can be to the detriment of local communities and their economies, as we shall see below.

## 3.3 Credit Approvals and the Private Finance Initiative

As described above, before 2003, central government kept local authority borrowing very tightly constrained, through the credit approval regime. This prevented councils increasing public sector borrowing beyond limits imposed by the Government, but meant that the quality of some assets worsened considerably over time and became in sore need of replacement. Indeed, this became a problem for many parts of the public sector.

When Labour came to power in 1997, a solution they used was to expand the use of PFI. As the capital works were carried out by the private sector, the capital outlay did not contribute to public sector borrowing figures. Once the asset was built, the council or other public sector body would repay the private sector, with interest, out of its revenue budgets. These payments would often be bundled up with other payments for items such as management fees and maintenance costs into a single regular "unitary charge". The Government considered this so beneficial to public sector balances that they subsidised local authorities for using PFI, through a revenue grant. Consequently, it often became the most cost-effective option for local government and for many types of project, it was commonly considered "the only game in town"[41].

Subsidies for new PFI projects were ended by the Coalition Government, but for many projects the unitary charges are still being paid.

## 3.4 The Prudential System and the HRA Cap

Local authority capital investment was considerably freed up with the introduction of the Prudential System in 2003. It is striking that this policy was introduced at precisely the time that the national finances were entering an unusually healthy period.

The government did, however, include a power to set a national cap on borrowing in the Prudential System, which it could use if it feared total borrowing across the country may rise too high. This cap has never been used, but there was great concern in local government that it might be used in 2010.

Instead, in Spending Review 2010, the interest rate on PWLB loans was raised by 1% above gilts and a sentence was removed from DMO guidance on issuing loans. HMT stated that these moves were to encourage a wider market of vehicles that local authorities could invest through and discourage authorities automatically approaching PWLB every time. The 1% margin would also protect the NLF against intra-day volatility and effectively contribute to deficit reduction. (Discounts on this

rate are now available for councils providing particular information of use to HMT or investing in certain classes of infrastructure[42].)

Despite the introduction of prudential borrowing, investment in council housing was constrained by the subsidy system. By the time this system was overhauled in 2012, the credit crunch had happened and the public finances were again subject to tight restraint. Consequently, borrowing under the new system was capped. The Government explicitly stated that the reason for the cap was that borrowing for such investment formed part of PSNB and "reforms must not jeopardise the Government's first priority, which is to reduce the national deficit"[43].

Campaigning for this cap to be lifted started immediately. However, as explained in Section 2.4, borrowing limits were not raised until 2015, and then only by £150m across the country, allocated by competition. Limits are now being raised by £1m with a promise to remove them entirely.

Once again, it is striking that major changes to this policy have started to occur now that the public finances are in better shape. Indeed, the announcement that the cap will be lifted has occurred precisely at the time the Government is talking about "ending austerity". There are indications that the Government wishes to remove the cap completely from the start of the next municipal year – this is the tenor of the current consultation – but there is no firm commitment to this date so far. Even if this is the case, local government will have had to wait seven years for this cap to be removed.

The scale of what local authorities could achieve is immense, if their response to the announcement and what West Lancashire and other authorities achieved with the £150m flexibility are anything to go by.

Nonetheless, while this borrowing remains within the figures the Government presents as its own spending in fiscal documents, there must be a concern that another cap could be imposed were the economy to deteriorate in future.

## 3.5 Tax Increment Financing

The interplay between the Prudential System and BRR could have been an opportunity for a significant increase in investment by councils in the economies of their neighbourhoods. In theory, they could take into account retained BR when determining how much it was prudent to borrow. This would have meant that if a project were to boost business growth, it could be funded up front from borrowing and the loans repaid by the increase BR yield. This is an example of a

mechanism known as Tax Increment Financing (TIF) – borrowing for projects against consequent uplifts in tax yields.

The problem with this was that repaying the loans could require decades' worth of increased yield. That would be fine if the increase yield were predictable over this period. But the facts that the Government could change the parameters of the business rate system over this period (such as the "levy ratio") and that there would be "resets" of the system, made such prediction impossible.

It was therefore argued that where a TIF scheme was proposed, it should be exempt from changes to the system for a sufficient period to be financially viable. However, once again, the fact that the capital expenditure contributed to PSNB led the Treasury to impose constraints on this. Despite a high-profile announcement by the Deputy Prime Minister that TIF would be made a reality, a national limit of £150m was imposed on TIF borrowing. (That is, outside Enterprise Zones, which are led by Local Enterprise Partnerships and have a unique tax and regulatory environment, including BR reliefs of up to 100%[44].) The Government explained that this is because such schemes "come at a cost to government since we have to count the cost of the additional capital expenditure the new borrowing supports"[45].

In the end, only three urban areas were involved – Newcastle-Gateshead, Sheffield and Nottingham – as part of the "City Deals" they were agreeing with the Government. These TIF projects were known as "New Development Deals" (NDDs). These were followed in 2015 by a single TIF project (again, outside Enterprise Zones) in Brent Cross in North London[46].

The boost to a local economy even from such a small investment can be impressive though, particularly where TIF can help lever in funding from the private sector and expand existing projects.

One only has to look at the Stephenson Quarter in Newcastle to see the potential of using retained BR in this way. Under the NewcastleGateshead NDD, the two local authorities agreed with the Government in 2012 that all business rates would be ring fenced and retained for 25 years. On this basis, they were able to invest £92m across four sites in an Accelerated Development Zone (ADZ), including the Stephenson Quarter. On this site, the following have been completed: a Crowne Plaza hotel, a 35,000 sq ft Grade A office building (fully occupied since 2016), a multi-storey car park, a University Technical College (UTC) and a 1,000 capacity, Grade II* listed cultural venue. Further new builds, conversions and redevelopments are planned[47].


*Stephenson Quarter, Newcastle, courtesy of Clouston Group*

Impressive progress is being made on other sites too, with, for example, the award-winning Urban Sciences Building opening on the Newcastle Helix site last year, to be followed next month by a lab facility for life sciences[48].

Were TIF to be rolled out on a larger scale, it would be important to ensure that the resulting borrowing would be undertaken prudently. The tried-and-tested prudential regime should ensure this. It is unlikely that there would be a surge to make use of new freedoms, but they could be very useful in unblocking small numbers of important projects which would not otherwise be viable.

To provide a sense of scale, back in 2011 Centre for Cities projected that even if England's 56 cities were to launch a TIF project the size of that undertaken by Edinburgh – an "unrealistic prospect" – the total annual revenue commitment of to service the resulting debt would be just £440m[49]. They stated that

> *"This would increase public sector debt by less than 0.5 percent and represent just two percent of England's current annual business rates revenues…"*

TIF can also be used to unlock investment in transport and similar infrastructure. For example, in the Nottingham NDD, £8m of transport schemes in the Creative

Quarter were funded by TIF[50]. Similarly, the TIF deal for Brent Cross involves the delivery of a new Thameslink station[51].

## 3.6 Capitalisation

Borrowing and capital receipts may normally only be used for capital expenditure. However, the Local Government Act provides a procedure for special exemptions to this. For some one-off, unavoidable and otherwise unaffordable revenue costs, permission could be granted by the Secretary of State to treat them as though they were capital costs. An annual procedure was to apply for such permission, with strict guidance notes. This guidance made it clear that the direction would only be granted if all of the following applied:

- the cost was otherwise unaffordable to the authority,
- the cost was incurred for a reason beyond the authority's control,
- it was not a cost which will occur on an ongoing basis, and
- it was affordable to the government.

There was one procedure for equal pay compensation awards and one procedure for all other applications[52].

In 2011-12 this was extended to included exceptions for councils wishing "to deliver efficiency savings early through organisational restructuring"[53].

This "capitalisation" as it was known was merely a permission to treat revenue costs as though they were capital costs and involved no funding for local government. Nonetheless, the national total was constrained, again because the capital expenditure added to PSNB. Furthermore, an equivalent sum was docked from revenue funding for local government – in the first year of BRR, this was an explicit top-slice from grant funding.

The system changed fundamentally the following year. The capitalisation pot was run down to zero. There was to be "no formal capitalisation fund or bid process in 2015/16". In its place, councils could use apply to use their capital receipts to meet service transformation costs. (There was also a bid-based fund for this purpose.) This meant that borrowing could no longer be used to cover service transformation and that no capital resources could be used to cover other large one-off costs[54]. Thus a council facing a large, unexpected one-off cost will now have to meet it by cutting already stretched revenue budgets. If it wishes to undertake a one-off service transformation, then it also has the option of selling assets, when it may not be prudent to do so.

## 3.7 Summary

In summary, the picture is one of increasing autonomy for local government at the individual, operational level. The greatest advances have been at times when the public finances as a whole have been healthy – notably in 2003. At other times, reforms have been more grudging. But many changes have included either an explicit cap or a reserve power for the government to impose limits on the total investment by local authorities. These generally result in reduced investment, increased uncertainty in budgeting and/or increased cost for local government. These limits reflect concerns of the government about public expenditure, debt and deficit under the current accounting regime.

Since 2010, the Government has been keen for local government to explore new credit arrangements with third parties. This is clear from the changes to the terms of PWLB loans and from various regulatory changes and government announcements. In such an environment, the inclusion of local government expenditure within departmental and governmental totals makes increasingly less sense.

All of the problems listed in this section stem from the public sector accounting regime used by central government, which is peculiar to the UK. Other ways of presenting the public finances are possible, which respect the financial autonomy of local government, as we shall see in the next section.

# 4. International comparisons

We now want to look at how these matters are dealt with in other countries.

In 1995, the Chartered Institute for Housing (CIH) commissioned John Hawksworth of Coopers & Lybrand and Steve Wilcox of University of Cardiff and the social housing consultancy HACAS to carry out a report on public borrowing rules and housing investment. The report, *Challenging the Conventions*, contained a table of showing the coverage of the key budget deficit measure of many European countries. This is reproduced below.

**Figure 5: Key budget measures in EU and accession states in 1994-1995**

| Country | Key budget deficit measure (sectoral coverage) |
|---|---|
| UK | Whole of public sector |
| Germany | General government (sometimes including railways) |
| France | Central government |
| Italy | State sector |
| Spain | General government |
| Netherlands | Central/general government |
| Belgium | General government |
| Denmark | Central government (sometimes general government) |
| Greece | General government |
| Ireland | Exchequer borrowing requirement (includes some state enterprises) |
| Portugal | Public administration sector (close to general government) |
| Luxembourg | General government |
| Austria* | Federal government |
| Sweden* | Central or general government |
| Finland* | General government |

* Not yet EU members when source reports were written

*Source: Coopers & Lybrand research based on various OECD and EIU country reports (mostly for 1994)*

*Source: Challenging the Conventions, John Hawksworth and Steve Wilcox (CIH), 1995*

However, we have conducted desk-based research and looked into some of these in more detail. From the above list, we have examined the information available on the web in English relating to Denmark and Sweden. We have drawn also from a publication by the Audit Commission on local government in France in 1997. We have supplemented this with up-to-date information on France's new municipal bonds agency.

We have also looked at one case outside the EU. We examined local government finance in British Columbia and the way it relates to the public finances of that province and of the Canadian federal government.

For each of these, we have looked at the capital finance system for local authorities, focusing particularly on borrowing and debt. This has included any aspects of the constitutional structure and the responsibilities of councils that affect their finance system. We have also looked at the central government's budgetary and financial documents and tried to identify their relationship with the borrowing and debt of local authorities.

Finally, we have looked at the statistical data collected by the European statistical agency, Eurostat.

## 4.1 Denmark

*Nyhavn, Copenhagen*

There was a major reform of Danish local government in 2007 which affected both its structure and funding. It replaced 14 counties with five regions and cut the number of municipalities from 271 to 98.

The Danish system of public finances appears to be based on a high degree of collaboration between central government, the regions and local authorities to find solutions to central government's macroeconomic concerns and financing issues for each level of government. In 2012, the Danish parliament passed the Budget Act, which came into force in 2014. This now sets constraints on budgets for all levels of government and forms a framework for the "budget cooperation" process.

Nearly all public services for individuals and families are devolved to local authorities (the councils governing the municipalities). A distinction is made between services which are funded by service users (public utilities and housing for the elderly) and those which are fully or partly funded from general taxation. A high proportion of the funding for these services comes directly from taxes for which the authorities set their own rates[55,56]. (However, central government can

impose temporary tax freezes and these powers have been used in recent decades[57,58].)

The total expenditure for local government is agreed between central government and the Danish local government association. Equalisation amounts are determined by central government. These are not net neutral – central government contributes to equalisation. The local government association then works with individual local authorities to agree their budgets. These must be in balance or in surplus. Expenditure against these budgets is monitored by central government: authorities submit all budgets and accounts to the Ministry of Interior and Health. (Overruns will be deducted from the block grant from central government for the following year.)

Borrowing is only allowed for capital construction in relation to services which are funded by user charges. At the end of 2017, total local government debt amounted to only to 4.5% of GDP. Much of the lending, together with financial leasing, derivatives and advisory services, is provided by KommuneKredit. This is an association of which all local authorities are (voluntarily) members. It was established in 1898 by an act of parliament[59] and is a "non-profit organisation". Loans are secured against members' total tax base and carry a 100% local government guarantee[60]. It has an Aaa/AA+ credit rating.

In the 2007 reform, the separation between public utilities and their local authority owners, which had become blurred, was strictly enforced. KommuneKredit's role was bolstered with a new act of parliament.

Denmark's finance ministry appears to publish relatively few documents in English and these are not consistent from year to year. Those with the most detail on Danish budgetary policy and statistics are probably the *Budget Outlook* series, which were published by the ministry in English until December 2014.

*Budget Outlook, August 2011*[61], for example, shows the general government budget deficit for the 2011 and 2012, together with historical data, broken into three sectors: central government, local government and social funds:

**Figure 6: Composition of Denmark's general government budget balance**

**Table 5.1**
**General government budget balance, 2005-2012**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|
| **DKK bn, current prices** | | | | | | | | |
| May | 77.6 | 82.3 | 81.4 | 56.9 | -46.5 | -50.8 | -74.3 | -80.0 |
| **August 2011** | **77.6** | **82.3** | **81.4** | **56.9** | **-46.5** | **-48.3** | **-68.2** | **-84.5** |
| - Central government | 82.7 | 89.7 | 85.8 | 64.6 | -32.5 | -44.0 | - | - |
| - Local governments | -5.5 | -7.8 | -4.5 | -7.4 | -12.6 | -4.1 | - | - |
| - Social funds | 0.4 | 0.3 | 0.0 | -0.3 | -1.5 | -0.2 | - | - |
| **August 2011 (per cent of GDP)** | **5.0** | **5.0** | **4.8** | **3.3** | **-2.8** | **-2.8** | **-3.8** | **-4.6** |

Note: The specification of the central and local government budget balances does not fully reflect that the central government, through transfers to the local governments, bears the risk of fluctuations in expenditure and revenues due to the business cycle.

*Source: Budget Outlook, August 2011, Danish Ministry of Finance*

The text of this document explains that:

- estimates for the current year have been compiled using the central government budget, the government spending reports and the local government budgets for the year;
- estimates for the following year have been compiled using the central government budget proposal, "the Reform Agenda 2020" and the agreement with local government on their budgets;
- the general government budget balance figures (showing a surplus until 2008) were compiled by Statistics Denmark.

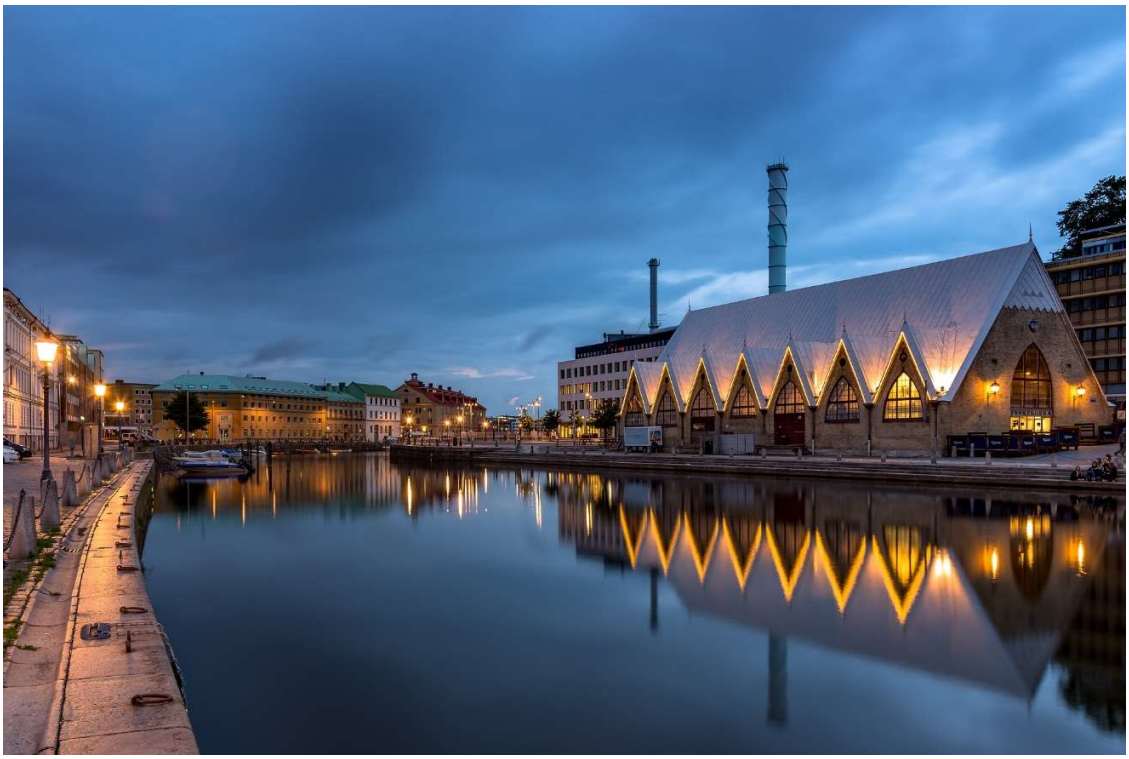
("Reform Agenda 2020" is a series of reforms to improve Denmark's structural deficit[62].)

More recent issues of *Budget Outlook*, such as the last one[63], while presenting different tables and surrounding information, nonetheless continued to state explicitly whether data related to central government or general government.

In recent years, the finance ministry has published several documents in English on the central government financing requirement[64]. Central government debt is managed by the Government Debt Management Office at Danmarks Nationalbank[65]. It borrows from financial markets to cover the government's

financing requirement. It also administers the social funds, as well as re-lending and loan guarantees to government-owned companies.

## 4.2 Sweden



*Feskekôrka (fish market), Gothenburg*

Like Denmark, Sweden makes a clear distinction between financial statistics relating to general government and those relating to central government. Unlike the United Kingdom, it does not draw a clear distinction between investment and current spending (or capital and revenue) in its budget documents.

The parameters within which the Swedish government sets its budget are determined in quite a procedural way. The principles are set out in *The Swedish Fiscal Policy Framework*, part of which is enshrined in law[66]. This appears to be agreed by political consensus, following an economic crisis in the early 1990s and updated in the last few years. The framework consists of a strange mix of principles relating to central government, principles relating to local government and principles relating to general government.

The main principle for central government is the expenditure ceiling. Each year, the government sets a cash ceiling, which covers almost all central government expenditure other than debt interest, for the third year ahead. By convention, this is then fixed – it is not amended.

For local authorities, the framework (and the law) sets out that except in exceptional circumstances, they must budget for revenues to exceed expenditure[67]. They are not required to stick to these budgets come what may, but if they end a year with a deficit, they must balance their budgets within three years. (Again, there is an exception for special circumstances.)

The most prominent principle in the framework, required by the Budget Act, is that of setting a surplus target for the public sector as a whole. The Swedish parliament set the current target of 1% of GDP as an average over a business cycle in 2007. In 2019, this will reduce to one third of one percent. The framework sets out indicators for monitoring compliance with the target (this has been strengthened in the revised framework). It appears to be implicitly assumed that the balanced budget requirements described above are sufficient to ensure a surplus in the local government sector, so that central government only has to generate a sufficient surplus on its own budget. Presumably, then, the local government annual budgets include both sums borrowed and the costs of financing debt, although it is difficult to find confirmation of this.

From 2019, there will also be a benchmark for the size of consolidated gross debt for general government (Maastricht debt – see Section 4.5), known as the "debt anchor". This is set at 35% of GDP. If the debt deviates by more than 5% of GDP from this benchmark, the government must explain to the parliament why this has happened and how it will be managed. Unlike the last Labour government's Sustainable Investment Rule in the UK, this appears to be a deviation *either way* from the benchmark. The framework provides reasons for this rule. The English version seems a little unclear on why this explanation needs to be given if the debt falls too far *below* the benchmark, but implies that it is because debt can be used to create wealth:

> *"The general government net debt of around 30 per cent of GDP at the end of the 1990s has since become net financial wealth of just over 20 per cent of GDP in 2016."*

This mix of using figures relating to central government and figures relating to general government seems to continue in budget documents. For example, one page on the Swedish government's website relating to the 2018 budget is titled "Central government budget in figures"[68]. It states that

> *"An important part of the Government's work in realising its policies is to draw up proposals on the central government budget. The proposals are submitted to the Riksdag in the spring and autumn. The Government's budget proposals for 2018, presented to the Riksdag in September, were adopted by the Riksdag in December 2017. The Government's Spring*

*Fiscal Policy Bill and the Government Bill 'Spring Amending Budget' for 2018 were presented to the Riksdag on 16 April 2018."*

It then provides

*"…a compilation of the Government's calculations and proposals for the central government budget for the years 2017–2021 as presented in the 2018 Spring Fiscal Policy Bill."*

The first table shown is reproduced below.

**Figure 7: Table on central government balance from *Central government budget in figures*, Government Offices of Sweden website**

Central government balance 2017-2021

SEK billion

| | 2017 (Outcome) | 2018 (Forecast) | 2019 (Forecast) | 2020 (Forecast) | 2021 (Forecast) |
|---|---|---|---|---|---|
| Revenue | 1 001 | 1 063 | 1 082 | 1 086 | 1 164 |
| Expenditure excl. interest on the Central government debt[1] | 930 | 974 | 993 | 1 015 | 1 024 |
| Interest on the Central government debt etc.[2] | 11 | 14 | 28 | 18 | 9 |
| Net lending by National Debt Office | -3 | 2 | -6 | 5 | 5 |
| Cash adjustment | 2 | 0 | 0 | 0 | 0 |
| **Central government balance** | **62** | 74 | **67** | **50** | **126** |

Note: The amounts may not sum to totals because of rounding.
[1]Including change in appropriation balances.
[2]Refers to expenditure under expenditure area 26 Interest on central government debt etc.
Sources: Statistics Sweden and own calculations.

*Source: Government Offices of Sweden website*

This is followed by breakdowns of the revenue line and of central government expenditure.

On the other hand, there is a page titled “From the Budget Bill for 2018: Budget statement”[69] which provides a link to “a summary of the Budget Statement”. The first table in this document is “Reforms and financing in the Budget Bill for 2018”. The figures in this table show the “impact on general government net lending” in SEK billion of the various policies in the Budget. The only other table in the document does the same for total tax increases and total tax cuts.

Much of the borrowing by Swedish local government is from Kommuninvest[70]. It was founded by a county council and its nine municipalities in 1986 (although with a different name – the current name was adopted in 1992). 287 local authorities and regions are members (90% of the local authority sector) and it only lends to members. It is very proud of its Aaa/AAA credit rating. According to its website, it “accounts for more than 40 percent of the Swedish local government sector’s borrowing”.

## 4.3 Canada

*Science World, Vancouver*

The history and geography of Canada has resulted in it having a federal system of government. It has ten Provinces and three Territories. The Canadian Constitution recognises the central “federal” government and the Provinces as

separate governments with their own legislative authorities and sets out the powers of each. A change to the division of these powers requires a constitutional amendment. The three territories, on the other hand, have powers delegated to them by the Canadian parliament; these powers can be changed unilaterally by the parliament or federal government.

The responsibility for local government lies with the Provinces, according to the Constitution. The Provinces assigns powers to a local authority through provincial legislation – the powers of a local authority are limited to what is granted to it by the Province. It appears that when a local authority exercises a power, including raising revenue or a loan, it does so by issuing a "bylaw".

We have looked most closely at the Province of British Columbia (BC). It has a Ministry of Municipal Affairs and Housing which supports local authorities in much the way that the Ministry for Housing, Communities and Local Government (MHCLG) does in England[71]. As explained on its website[72]:

> *"The Ministry of Municipal Affairs and Housing supports local governments with their legislated financial responsibilities in order to promote the long-term sustainability of the local government system, this includes:*
>
> - *Providing advice on all aspects of local government finance*
> - *Promoting sound financial management in local government*
> - *Providing a complete, reliable and consistent source of data on local governments in B.C.*
> - *Promoting good financial and reporting practices*
> - *Reviewing and approving long-term borrowing and development cost charge bylaws"*

According to the website, "Property taxation is the main source of revenue for local governments", but local authorities may also levy fees and charges for services. They may also receive grants and monetary transfers from the provincial government and/or the federal government, which may be conditional or unconditional.

Some local authority bylaws in BC require provincial approval[73] and some may require a local referendum ("assent voting")[74] or "alternative approval" (or "counter-petition" – effectively inviting a citizen-led initiative)[75].

There are a range of purposes for which local authorities can borrow or enter other credit arrangements. The authorities' fiscal year starts in January but taxes are not collected until July. To bridge this gap, they may borrow up to 75% of the year's tax levy, plus any money remaining due from "other governments" (such as the provincial government).

They may also borrow for capital expenditure. These loans are categorised into short-term (under five years) and long-term capital borrowing. Both require approval from the "Inspector of Municipalities" (a provincial government post). Short-term borrowing is subject to a limit based on population, while long-term borrowing is usually subject to approval by the electorate through assent voting or alternative approval. (Other long-term credit arrangements are always subject to elector approval.)

Municipalities (the main type of local authority) may also borrow or enter credit arrangements to fund services, subject to a limit. This limit is that the total annual financing cost of all such loans and agreements is no more than 25% of the municipality's revenues which are controllable by the municipality and sustainable for long periods of time[76].

Like Denmark and Sweden and now England, BC has a collective borrowing agency for local authorities, the Municipal Finance Authority of British Columbia (MFA). It "provides long-term, short-term, and equipment financing, investment management, and other financial services to communities and public institutions in BC"[77]. It was created in 1970 by provincial legislation but is proudly independent of the provincial government. All borrowing is joint and several. Its website states that

> *"To this day, the MFA remains unique in Canada. In all other Provinces where a municipal borrowing entity exists, they bear the guarantee of their governments. In fact, many of these agencies are themselves de facto "creatures" of their provincial governments which retain the control and resultant benefit of their consolidated borrowing efforts. The continued AAA credit rating, the highest possible, is shared by few other municipal borrowing agencies or even other provinces in our country, and has not required such a provincial debt guarantee to achieve it."*[78]

The Province of British Columbia also has credit ratings, with Moody's, Standard & Poor's, Dominion Bond Rating Service and Fitch Ratings: Aaa/AAA/AA (high)/ AAA[79]. This allows it to borrow directly from capital markets. It does this for crown corporations and agencies[80]:

> *"Most Crown corporation and agency borrowing is done through the Fiscal Agency Loan Program of the Province. Under this program, the provincial government borrows directly in the capital markets and off-lends the bond proceeds to government or government bodies under the same terms as the bond issuance. The bond financing costs and future payment obligations (interest and principal) for the loan made under the Fiscal Agency Loan Program remain the responsibility of the respective government or government body that borrowed the funds."*

However, a footnote in the province's *Public Accounts 2017/18*[81] makes it explicit that the Program also lends to local authorities.

The only debt figures presented in BC's *Budget and Fiscal Plan 2018/19 – 2020/21*[82] and *Public Accounts 2017/18* are for provincial debt. These are presented in a consistent basis in both documents. A footnote in the *Public Accounts* states that these figures include fiscal agency loans to local authorities. This – and indeed the rest of both of these documents – implies that the figures do not include any other local authority borrowing or credit.

In the federal budget, the debt and deficit measures concentrated on are federal debt and deficit.

In Budget 2018[83], Table 1 shows the effect of new policies and changes since the 2017 Fall Economic Statement (FES 2017) on the budgetary balance. It starts with the balance shown in FES 2017, then carries out the adjustments to get the "final budgetary balance". Below this is "Federal Debt", implying that all the budgetary balance figures are federal ones.

On the next page, there are two charts side-by-side, one showing "Federal Debt-to-GDP Ratio" and the other showing "IMF Forecast for General Government Net Debt-to-GDP Ratios, 2017". A note under the latter explains that it includes the federal, provincial/territorial and local government sectors. Further charts on federal budgetary balance and federal debt appear later in the document.

## 4.4 France

*Hotel de Ville (town hall), Roussillon*

An Audit Commission report, *Capital Gains: Improving the Local Government Capital Expenditure System*, provides a fairly detailed picture of the capital finance regime in 1997[84]. *Capital Gains* makes it clear that in the early 1980s, there was a major programme of decentralisation in France. This covered both responsibilities and tax-raising powers. Partly as a result, investment by local government rose rapidly over the following four years.

Local authority capital investment was described as being "subject to a centrally imposed framework of controls". This consisted "almost entirely of statutory rules intended to ensure that capital budgets are prudently managed, at any given level of spending – especially by making debt-servicing costs an automatic and visible charge on revenue budgets". At the time, this contrasted dramatically with the UK system of credit approvals. The report also quoted the Interior Ministry: "Since decentralisation, the state is no longer the guarantor of last resort for local authorities' undertakings towards banks"[85]. It stated that this was a key part of the logic behind the hands-off approach of the state. (As mentioned in Section

2.3, such a change has not accompanied the introduction of the prudential system in the UK.) It is notable that a decade on from the devolution reforms, concern about rising public sector debt related mainly to central government.

One major difference between the situation in France then and the prudential regime in the UK now, is the extent of local authority local guarantees to other bodies. Many devolved bodies were set up as joint ventures between local authorities, or between local authorities and partners in other sectors. One common form with a large capital budget was the Société d'Économie Mixte (SEM), often used for regeneration programmes. Such joint ventures, despite local authorities contributing capital to them, are treated as private sector for national accounts purposes. Local authorities regularly also guarantee up to 50% of any loan taken out by the joint venture. There are further caps on the amounts local authorities can guarantee. Nonetheless, by the time of the report, serious problems were emerging with lenders calling in guarantees, particularly in relation to social housing associations and SEMs for economic development.

France also has a municipal bond agency, Agence France Locale (AFL). It was launched in 2013 and received a banking licence and rating from Moody's (Aa3) in 2015. It made bonds eligible for purchase in June 2016[86]. Local authorities can become shareholders in the AFL Group. During the 2017 calendar year, it granted €556m in credit and 50 new local authorities joined the AFL Group. As at 31 December, it had 223 shareholders, €1.6bn in outstanding loans and a positive gross operating income of €156k[87].

## 4.5 Eurostat

The Maastricht Treaty of 1992 set out convergence criteria for joining the Euro. This involved a particular measure of government debt. The measure goes under various names, often called General Government Gross Debt (GGGD) or simply Maastricht debt or Treaty debt. This measure is defined according to ESA95 conventions[88].

Every member of the EU, whether they wish to join the Eurozone or not, is required to provide Eurostat with various statistical data. This includes deficit and debt data used to compile GGGD and its deficit equivalent, General Government Financial Deficit (GGFD). Maastricht debt as a proportion of GDP is published by the OBR and in the Budget. It includes borrowing by each level of government - central, state and local - and also includes social security funds. It does not include borrowing by public corporations. The ONS publishes the raw data provided to Eurostat[89]. Eurostat itself publishes the deficit and debt figures for each country, and various breakdowns of them[90,91]. These include a breakdown

into the four subsectors (the three levels of government plus social security funds).

## Summary

This study has revealed the variety within fiscal documents across the world – even within the few countries we have looked at. The excerpt from *Challenging the Conventions* shows that in the EU in the mid-1990s, the most popular scope for the primary deficit measure was "general government". But this is far from universal. It is not simply a case of the UK using one system and the rest of the EU using another.

Furthermore, the definition of the main measure of deficit should not be seen as the start and end of the public sector accounting regime. Countries can have outwardly similar deficit measures and still have different fiscal control regimes and ways of funding local authority capital expenditure.

Our study has shown the importance of appreciating that each country has a different political culture when considering the national accounting regime in different countries. This culture may include the attitude to investment and the roles of, and relations between, different levels of government. In addition, this culture changes over time, often in response to economic events and pressures. (Indeed, within the UK, there has not simply been one accounting system – different systems have been used by the UK government for different purposes at different times.)

For example, one way in which England differs from the countries we focused most on is that there is no level of government between local authorities and the national government. (That is, if you exclude the GLA in London, which is treated like a local authority for most local government finance purposes.) Denmark and Sweden both have regional governments, while Canada has the provinces and territories. This must be borne in mind when considering the systems used in those countries – although of course, there is a comparable level of government in Scotland, Wales and Northern Ireland.

Nonetheless, even taking this into account, the UK seems to stand out on the list from *Challenging the Conventions*. It also appears distinctly different from the countries we looked at in the way that local government finances are entangled within expenditure and income statistics in the fiscal documents. It appears that these countries' fiscal documents acknowledge, at least to some extent, that local authorities are separate institutions, and this promotes a more mature

partnership between levels of government. (And this is achieved without any breach of the countries' international obligations in statistical reporting.)

# 5. Conclusions and recommendations

In Section 3 we looked at the way that DEL and AME included local government capital expenditure in UK fiscal documents and consequently such expenditure is included in PSNB and PSND. The fiscal rules then motivate the Government to impose constraints on capital expenditure by local authorities. This happens particularly when the UK economy is struggling. So just when the Government is most keen to promote growth, it is imposing conditions which restrain councils' investment for growth. In the case of TIF, the application of these rules partially scuppered one of the Government's own policies.

In Section 4 we saw that it doesn't have to be this way. The UK appears to be unusual in the way it rolls local government into the figures used in fiscal documents. Denmark, Sweden and Canada all explicitly and prominently feature central government-only measures in their fiscal documents. In Canada, the federal government focuses mainly on federal deficit and debt in its budgets, but also presents some charts showing general government debt for international comparison purposes. Similarly in Denmark, central government budgets for its own expenditure and local government does likewise; documents then explicitly show how the budget balances for these are added (together with social funds) to get a total deficit for all levels of government.

We therefore come to the conclusion that it would be possible and highly beneficial to reform the public sector accounting system in the UK. This conclusion has been reached before, notably in the report *Challenging the Conventions* and its follow-up, *Consensus for Change*[92].

However, we differ from those authors in our assessment of the nature of that reform. We reject the notion of simply replacing one measure of deficit with another. What is needed is an overhaul of the presentation of public expenditure within fiscal documents, including the various measures reported in them. The new presentation should be based on the desired relationships between the component parts of the public sector. In particular, it should recognise that local authorities have their own democratic mandate. They are responsible for their own spending decisions to their own electorates. They want to work in a mature partnership with central government. This can be reflected in the central government's fiscal documents, while still allowing central government to fulfil its role of overseeing and reporting on the UK economy as a whole.

Replacing PSNB and PSND in the fiscal rules with GGFD and GGGD, thus excluding housing corporations while continuing to include local government, would do nothing to promote investment in infrastructure and local economic

growth. It must, though, be remembered that it was over 20 years ago that this idea was promoted by CIH. This was during the Major Government. The policy landscape at that time was very different – for example, it was still about six years before Arm's Length Management Organisations (ALMOs) came into existence. We had not seen the growth in PFI, Housing Associations or Local Housing Companies that we have since. We are now in a world where the ending of the HRA cap has been promised and the UK has committed to leaving the EU. In these circumstances, the arguments for taking Eurostat's chosen measure of deficit as our primary one no longer stack up.

Furthermore, there are risks with such an approach. We have seen with PFI that simply taking spending off balance sheets encourages the Government to divert spending through these routes. In this case, there would be an incentive for the Government to channel increasing amounts of its spending through public corporations. This could easily reduce democratic accountability for public spending. This strongly suggests that any reform to the public finances should be based on principles of democratic accountability, not just a desire to build more.

In seeking to reform the public finances, it would be prudent to draw on as wide a range of expertise as possible. For example, there is considerable knowledge and expertise in HM Treasury, MHCLG, local government, the housing, regeneration and financial sectors, the European institutions, ONS, CIPFA and in main political parties. Each has its own specific concerns which are worth exploring.

If this is done, then past experience suggests that collaborative working can become very positive and potential pitfalls avoided.

At the level of officials, this positive collaborative approach was evident, for example, on Capital Programmes Working Party. This body met to look at issues relating to the local government capital finance system. It was chaired by DCLG and its members included representatives of HMT, DMO/PWLB, CIPFA, local authorities, the Audit Commission, the Scottish and Welsh Governments and the Northern Ireland Audit Office.

Another example of good practice worth considering is the London Finance Commission. This was chaired by Tony Travers and had elected politicians from across the political spectrum as well as senior local government officers.

Both were able to tap into the wide-ranging expertise of their members, take a "helicopter view" of the issues and come up with innovative and coherent proposals for change.

A similar body to develop proposals for reforming the public finances could examine the following:

- How to address all the current problems experienced by councils and agencies trying to increase local investment – including borrowing on the basis of future uplifts in BR yield, meeting large unforeseen costs and paying for one-off service transformation;
- Avoiding future unwelcome constraints on local authority investment;
- Avoiding possible unintended consequences of the reforms (including avoiding perverse incentives to take transactions "off balance sheet");
- Ensuring the reforms still allow the Government and bodies such as the OBR and ONS to fulfil obligations on the robustness and international comparability of statistics;
- Ensuring that any additional borrowing resulting from these changes does not adversely impact on any institution's financing or lead to any part of the public sector taking on significant additional risk (bearing in mind that such borrowing would be undertaken in accordance with the Prudential Code).

**We therefore recommend that:**

- **Spending Review and Budget documents should be reformed to reflect the financial autonomy of local government:**
  - **These documents should focus primarily on the finances of central government and bodies which are answerable to it (such as the NHS and Non-Departmental Public Bodies);**
  - **Corresponding statistics should be presented for expenditure, income, in-year balance and debt – excluding local government;**
  - **Financial and fiscal data estimates or projections relating to local government should only be included in these documents in a separate section providing a reconciliation for the whole public sector. These should be agreed through consultation with representatives of local government;**

- **The Government should immediately set up a panel of experts, as described in this report, to consult on the details of this change. The details should be agreed in time to implement this change in Spending Review 2019;**

- **In future, the Government should not impose any constraints on borrowing or investment on local government other than those contained within the prudential system. Neither should the Government reduce revenue funding for local government as a "cost" of greater borrowing or investment by local authorities.**

In summary, to grow local economies and help them thrive in the long run, investment is needed in local authority assets. With the current accounting system, these will have to be on the public sector balance sheet if a re-run of the misuse of PFI is to be avoided. Any mechanisms developed to increase investment during times of difficulty for the UK economy will be hampered by limits put in to prevent the public sector deficit increasing. Therefore reforms to the public sector accounting system itself are necessary to grow sustainable communities.

# Appendix 1 – capital finance in Scotland, Wales and Northern Ireland

The Scottish Government, Welsh Government (formerly the Welsh Assembly Government) and the current incarnation of the Northern Ireland Executive are all relatively young institutions. They were all established in 1998-1999, after the creation of PSND and roughly concurrent with the creation of PSNB described in Section 3 and Appendix 3.

All three receive funding from the UK Government, from both DEL and AME budgets, in relation to both revenue and capital expenditure. They also have tax raising powers, such as landfill tax in Scotland and Wales and Air Passenger Duty in Northern Ireland. Some funding also comes directly from the EU.

Borrowing powers are similar for the three administrations. The Scottish Government may borrow for both capital and revenue expenditure, subject to separate limits. Capital borrowing is limited to 10% of the capital DEL grant in any one year and a cumulative maximum of £2.2bn. It may be from the National Loans Fund (NLF), from commercial loans or by the Scottish Government issuing its own bonds. Revenue borrowing is to cover fluctuations in tax receipts and related purposes. It is limited to £200m in any one year and a cumulative maximum of £500m. Loans are from the NLF and must be repaid within four years. (The in-year limits for both capital and revenue borrowing cited here are the amounts currently set by Treasury ministers; the cumulative maxima are fixed in legislation.)

In Wales, capital borrowing is limited to £125m in any one year and a cumulative maximum of £125m. It may be raised through the NLF, through commercial loans or by issuing bonds. The Welsh Government may also borrow to cover in-year fluctuations in the main fund and (from 2018) in tax receipts. This is limited to cumulative maximum of £500m, and in the latter case, £200m in any one year. This kind of borrowing is from the NLF.

The Northern Ireland Executive may usually borrow up to £200m annually for capital purposes (although this limit has on some occasions been increased) and £3bn cumulatively. This is through the NLF. It may also take out short-term loans from the NLF for cash management purposes, up to a maximum outstanding principle of £250m.

Local government is a matter devolved to all three institutions. Local authorities raise local taxes – business rates and council tax (or domestic rates in Northern

Ireland) – and receive funding from other sources, including the devolved governments.

Further information on all of this can be found in two publications by HM Treasury:

- *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*[93], October 2010; and
- *Statement of funding policy: funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly*[94], November 2015.

The first of these sets out the implications of borrowing by local government for the public finances of the UK:

> *"7.1 The devolved administrations have the reserve power to set maximum capital expenditure for capital investment by local authorities (District Councils in Northern Ireland) and other public bodies. Borrowing counts towards the Public Sector Net Cash Requirement (PSNCR) and hence, is included within the devolved administrations' total budgets each year as a control mechanism, so that any increases in borrowing must be offset by reductions in other spending. The effect is to reduce the level of grant from the United Kingdom Government and hence to restore the United Kingdom borrowing position.*
>
> *7.2 Generally the financing costs of higher borrowing are met locally - either from the assigned budget itself, from local taxation or through higher charges for services. Local authority capital is funded through a balance of borrowing, where financing costs must be met by local authorities, and capital grants, where financing costs are met by the United Kingdom Exchequer. In cases of a significant shift in the balance between borrowing and capital grants, the Treasury reserves the right to adjust the assigned budget for the financing costs of this shift."*

# Appendix 2 – potential sources of investment

In future there may be scope for greater institutional investment, for example by pension and insurance funds. There may also be considerable opportunities for neighbourhood-level investment. This appendix gives an overview of some mechanisms that have been suggested in recent years.

## Community shares and bonds

If local residents, businesses and community groups feel ownership of a project, they may be willing to invest in it. This could be share capital, through a local authority company or community-based company, or debt investment, such as through an off-market bond.

Many community groups have set up their own ventures to invest share capital in local amenities. This route is often used for renewable energy schemes, but has also been used for community shops, pubs, and business training[95]. The ventures are often set up as Industrial and Provident Societies. Such community investment could be expanded if local authorities were to play a leading role. Given their contacts with the key players across all sectors in their communities, they are ideally placed to bring together the necessary partnerships to make such projects work.

As described in Section 2.3, a few UK authorities have started to issue bonds in recent years. However, the costs of accessing established capital markets are usually too high to make financial sense for most authorities acting individually. These costs include securing a credit rating from a rating agency, as well as brokers' and consultants' fees. Once these are added in, the total cost of borrowing in this way is higher than that from the PWLB, unless the issue is very large.

Other options are to make a private placement or to issue off-market ("non-negotiable") bonds. It has been suggested that off-market bonds could potentially be suitable for issuing in small quantities to individuals[96], for example for investment in neighbourhood amenities. Community bonds are used by non-profit organisations for investing in local amenities in Canada[97,98].

## Pension funds

Pension funds need a good rate of return over the long term for their fundholders, consistent with their policies on risk and social responsibility. In the past, UK pension funds have tended to focus on investments listed on financial markets, such as shares and bonds. Pension funds are rarely invested in British local authority projects. Where they are, it is usually through an intermediary fund.

However, this is starting to change. In 2012, the Pensions Infrastructure Platform (PIP) was launched. It was "set up by pension schemes, for pension schemes, to ensure better alignment, better value and better governance". It boasts that "we are open to all UK pension schemes, and any pension scheme that decides to invest through us will enjoy the same better value as our founding investors". It investments include social housing in Leeds and energy from waste facilities in Cornwall, North Yorkshire and South Gloucestershire[99].

There are also examples of foreign pension funds investing in UK assets – for example, the Crown Estate owns some of the most prestigious commercial property in London, such as Regent Street shops. It has received investment in some of its London property from the Norwegian government's pension fund, from the Ontario Municipal Employee Retirement System (OMERS) and the Healthcare of Ontario Pension Plan (HOOPP).

English local authority pension schemes have in recent years been preoccupied with a major restructuring exercise, which has only recently concluded[100]. This was started under the Chancellorship of George Osborne. He believed that this reform would boost investment in infrastructure[101], but most are not yet close to a point where they can handle infrastructure investments[102]. However, there are examples of local government pension funds investing in infrastructure and in business support, from both before and after the reform:

- Cambridge and Counties Bank[103] is a partnership between Cambridgeshire Local Government Pension Fund and Trinity Hall, a College of the University of Cambridge. It provides banking services, including deposit accounts and loans, to small to medium sized enterprises (SMEs). While it initially concentrated on Cambridgeshire, Northamptonshire, and Leicestershire, it soon spread out into other regions of England.

- Matrix Homes was a joint venture between Manchester City Council and the Greater Manchester Pension Fund (GMPF) which built 240 new homes on five sites across the city between 2014 and 2016, for sale and market rent[104].

- GMPF and the London Pensions Fund Authority (LPFA) set up a £500m infrastructure joint venture, which made its first investment in October 2015. This was a commitment of £60m towards funding the construction and operation of British renewable energy assets, starting with an investment of £9m in a biogas plant in Yorkshire[105].

- Suffolk Pension Fund invested cash in two infrastructure funds in 2012 and last year announced a further investment of £110m in alternatives, to be managed by M&G Investments. £60m of this will be invested in a greenfield infrastructure fund[106].

## Real Estate Investment Trusts (REITs)

REITs are companies that invest directly in a portfolio of properties. The gains made from this investment are exempted from corporation tax, in exchange for paying at least 90% of property income to shareholders[107]. The REIT regime came into force in January 2007. Existing property companies have converted to REIT status and new REITs have been created[108]. There are now more than 70 UK REITs. They include some well-known brands, such as Big Yellow Storage and Intu Properties, which owns shopping centres in many towns and cities in the UK and Spain.

Initially, the portfolios consist of commercial properties spread around the country. However, in recent years, REITs have become involved in providing housing and healthcare properties, including social housing, care homes and assisted living.

Much of the pressure to establish and expand the REITs regime in the UK has come from the British Property Federation. BPF has looked at the possibility of setting up local REITs and believes these could be popular – shareholders would see for themselves the impact of the investment[109].

# Appendix 3 – further detail on public sector accounting in the UK

### *Public expenditure documents*

The British government compiles different financial statistics for different purposes. This is particularly true for public expenditure statistics. For example:

- Budgets – allocated by the Treasury in Spending Reviews. Reported on to Parliament, and amended as necessary, at successive Budgets and Autumn Statements.
- Supply Estimates – these seek annual parliamentary authority for the individual departments' spending.
- Resource Accounts – these report departments' actual spend for the year.
- National Accounts – an integrated set of accounts covering the whole of the economy.
- Whole of Government Accounts – a consolidated set of financial statements for the UK public sector, first published in November 2011 for the year 2009-10.

The Treasury ran a project to align the basis for compiling the first three of these from 2008 to 2010. In consequence, the Supply Estimates for 2011-12 onwards were compiled on precisely the same basis as budgets, but a small discrepancy with the basis of the resource accounts remained[110].

National accounts are compiled according to the European System of Accounts (ESA)[111]. Whole of Government Accounts are compiled according to International Financial Reporting Standards (IFRS)[112].

### *Measures of debt and borrowing*

These are summarised in Figures 8 and 9 below.

National Debt was the main measure of public sector debt from the early 18th century until 1986. It comprises the gross liabilities of the National Loans Fund. (Or prior to 1968, the Consolidated Fund.) It thus relates to all gilts issued, whether the sum raised is ultimately used by central government or not. PWLB loans are therefore indirectly included. Gilts purchased by other parts of Government (for example, the National Insurance Fund) are included, but not all central government debt is.

The main measure of borrowing until 1998 was the Public Sector Borrowing Requirement (PSBR). The ONS say of it that it "was a cash concept unique to the

UK, although it had similarities to an International Monetary Fund measure"[113]. It covered the whole public sector and was equal to the excess of total public sector expenditure (current expenditure plus capital expenditure) over current receipts.

In 1986, the Bank of England expanded the National Debt measure to create a new measure, Net Public Sector Debt (NPSD). When ONS started providing a monthly report on such matters, it was renamed Public Sector Net Debt (PSND). This measure was meant to represent the stock equivalent of the PSBR, although this relationship was only approximate and became less accurate over the years. PSND is still the main measure of public sector debt presented in Spending Reviews etc. The old National Debt measure continued to be reported until 2004.

In the late 1990s there were a number of changes to public sector accounting[114]. In 1995, a new version of the European System of Accounts, known as ESA95, was produced. Also, the Labour Government, on taking power in 1997, introduced two fiscal rules:

- 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.

Alongside this, ministers wanted a clearer distinction between current and capital spending in the presentation of the public finances. To accommodate all of these changes, in 1998 a new presentation of the public finances was brought in. Under ESA95, the National Accounts contained a deficit measure called Public Sector Net Borrowing (PSNB), which was calculated on an accruals basis. This became the government's main measure of borrowing, which it remains today. (Although there have been changes to it, including the reclassification of housing associations in November 2017[115] and the reclassification of Bradford & Bingley and Northern Rock in December 2012[116].)

At the same time, PSBR was renamed the Public Sector Net Cash Requirement (PSNCR) and it is still reported.

The Office of Budget Responsibility provides a reconciliation between PSNB and PSNCR. The definition of PSCNR is the joint responsibility of ONS and HM Treasury.

Finally, as explained in Section 4.5, since 1992 every EU state has been required to collect data using the GGGD and GGFD measures and report it to Eurostat. This requirement will cease when the UK leaves the EU.

### Figure 8: Summary of debt measures used by the UK

| Debt measures | Period used as main measure | Basis of measure | Includes local government? | Includes public corporations? |
|---|---|---|---|---|
| National Debt | until 1986 | Gross liabilities of the National Loans Fund | ✓ | ✓ |
| Net Public Sector Debt (NPSD)/Public Sector Net Debt (PSND) | 1986 onwards | Stock equivalent of the PSBR | ✓ | ✓ |
| General Government Gross Debt (GGGD or Maastricht debt or Treaty debt) | (collected for EU since 1992) | Nominal value of gross debt in loans, currency and deposits, and securities other than shares and derivatives | ✓ | X |

### Figure 9: Summary of deficit measures used by the UK

| Deficit measures | Period used as main measure | Cash or accruals basis? | Includes local government? | Includes public corporations? |
|---|---|---|---|---|
| Public Sector Borrowing Requirement (PSBR) (now called Public Sector Net Cash Requirement (PSNCR)) | until 1998 | Cash | ✓ | ✓ |
| Public Sector Net Borrowing (PSNB) | 1998 onwards | Accruals | ✓ | ✓ |
| Public Sector Net Borrowing excluding interventions in financial sector (PSNBex) | 2008 onwards | Accruals | ✓ | ✓ |
| General Government Financial Deficit (GGFD) | (collected for EU since 1992) | Accruals | ✓ | X |

*How local government capital expenditure contributes to DEL and AME*

Local government capital expenditure is included in DEL and AME in the following way:

- Capital grants and revenue support for borrowing contribute to the CDEL of the sponsoring department

- Where capital expenditure by English local authorities is financed from any other sources - prudential borrowing, receipts, CERA etc - this is included in AME.

- Assets are netted off AME.

Expenditure which is included in AME is counted at the time of expenditure. For example, if a local authority borrows money and puts it in a bank account, the net value of the loan and the bank deposit is zero until the money is actually spent. If a local authority sells an asset, it gains a receipt which has a positive value for the public sector accounts until it's actually spent.

This is all valid regardless of whether the expenditure relates to the General Fund (GF) or the HRA. This includes HRA restructuring debt.

The only distinction between HRA and GF is seen in the National Accounts, where borrowing/capital expenditure is split into sectors. In these, the local authority's housing function is included within public corporations, so HRA borrowing/capital expenditure falls in the public corporations sector rather than the local authority sector[117].

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Where the text around a reference is clear about the source of the reference, we sometimes simply give a web link below. Otherwise, a full reference is given, in case of future unavailability of the web link.

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