Email from Chris Giles to Andrew Dilnot, 28 February 2013

Dear Andrew,

The statistical treatment of asset transfers from the Bank of England to the Treasury

I am writing to express my concern at the statistical treatment of transfers from the Bank of England to the Treasury as recorded by the important fiscal aggregates PSNB ex and PSND ex. I believe the classification recommendation of the Public Sector Finances Technical Advisory Group and the decision of the national statistician, outlined in a 21 February 2013 technical note*, is flawed and will lead to a serious distortion in the measurement of the underlying health of the public finances which runs counter to the national interest. I am sure you appreciate the need for consistent statistical series of the underlying health of the public finances, and that these series should be produced by the Office for National Statistics, not the Office for Budget Responsibility, the Institute for Fiscal Studies nor the Financial Times.

The guidance note** on the compilation of PSNB ex and PSND ex was published in March 2010 and I agree with PSFTAG and the national statistician that it should provide the basis of the classification decision for PSNB ex and PSND ex.

In its introduction, the guidance note states the purpose of the "ex measures" as "intended to show the underlying state of the public sector finances without temporary distortions caused by financial interventions, but including any permanent effects from these interventions".

I am sure you will agree with me that there is no possible world in which a material improvement in the underlying level of borrowing is achieved by the Treasury's decision to move billions of pounds from the one part of the public sector to another. Given the clear statement of principle in the guidance note, I was concerned that the ONS has decided that such transfers should be treated akin to tax revenue in the underlying measure of borrowing.

ONS justification for its decision

The ONS technical note justified its decision to treat the Treasury's transfer of cash as a legitimate means of lowering underlying measured borrowing with reference to the guidance note. It judged that the Bank of England's Asset Purchase Facility Fund was a temporary scheme, but transfers from the fund were permanent and should count in PSNB ex. It quoted from the guidance note saying that "“Bank of England run schemes indemnified by central government…are only regarded as having a permanent effect when there is an impact on the central government finances," adding that "the new cash flows between the BEAPFF and HMT clearly have an impact on the central government finances and as such these flows can be seen as permanent effects of financial interventions".

My reasons for concern

1. The ONS technical note ignored the initial principle outlined at the start of the guidance note that the purpose of the "ex measures" was to show the underlying state of the public finances without temporary distortions.
2. The ONS ignored a clear statement of the correct accounting treatment of the BEAPFF for the "ex measures" in the guidance note. In the section on financial interventions on page 7, the guidance note states clearly: "The assets acquired by the BEAPFF will, in time, be sold

back to the market. Any shortfall will be made up by central government while any profit on closure of the scheme will be retained in the public sector. It is at this point that the effect of the scheme will be regarded as permanent. The current effects are regarded as temporary and excluded from both PSND ex and PSNB ex". The clear guidance is that the "ex measures" should ignore potential losses or profits from the BEAPFF until closure of the scheme, yet the classification decision made no reference to this clear statement of principle. I was alarmed to find this paragraph was not deemed worthy even of discussion in the technical note.

3. The ONS technical note selectively quoted from the guidance note. The passage quoted related to the second principle in the calculation of the "ex measures". That principle states: "Permanent effects from financial interventions are those that will ultimately have an effect on central government's net debt or net borrowing. This includes transactions involving central government and central government run schemes, such as the asset protection scheme and credit guarantee schemes". The guidance note did not demonstrate the changes to cash management would ultimately have an effect on central government's net debt or net borrowing. Indeed, the Treasury and the Bank of England have been clear that this cash management exercise was not a demonstration of an expected eventual profit from quantitative easing. The Treasury press release of 9 November*** is explicit in stating "at some point in the future, as monetary conditions normalise, it is likely that the cash flows will need to be reversed". The expectation in government therefore that it is more likely than not for this to be a temporary flow of cash.

4. The ONS misinterpreted the word "only" in its guidance note. The reasoning for declaring the transfer of cash to be permanent and therefore counting for the "ex measures" appears to be a misinterpretation of the word "only" as "always". In the sentence, all common sense interpretations of the word "only" as "only able to be regarded as having a permanent effect when there is an impact on the central government finances". It is a necessary condition for the flows to be treated as permanent, not a sufficient condition.

I know the Financial Times among others does not feel able any longer to use the published PSNB ex measures as accurate guides to the underlying health of the public finances and will not use them, for example, in covering the Budget. We value the consistency of time series and the measures no longer provide the consistency that is required for scrutiny of government. As things stand, the OBR and Treasury are providing forecasts of underlying public borrowing excluding the effects of the cash management operations, but the ONS will not publish measures of the public finances on this basis. As such, I do not believe it is meeting users' needs.

While I would not wish to pre-judge your deliberations on the matter, I am sure you would agree that is a subject worthy of scrutiny by the UK Statistics Authority.

yours sincerely

Chris

* http://www.ons.gov.uk/ons/guide-method/classifications/na-classifications/classification-articles/changes-to-cash-management-arrangements/technical-article.pdf

** http://www.ons.gov.uk/ons/rel/psa/public-sector-finances/including-finance-lease-liabilities-in-public-sector-net-debt--pfi-and-other/public-sector-finances-excluding-financial-interventions.pdf

*** http://www.hm-treasury.gov.uk/press_109_12.htm

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