HM Treasury

A strong fiscal framework

Explaining the government's new fiscal framework and rules

October 2024

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Introduction

Economic growth is the central mission of the government. Sustained growth is the route to increasing prosperity, repairing public services and improving living standards. Achieving long-term growth must be underpinned by economic stability and sustainable public finances.

The first legislation passed in this Parliament – the Budget Responsibility Act 2024 – will ensure that every fiscally significant change to tax and spending will be subject to scrutiny by the independent Office for Budget Responsibility (OBR). Alongside, the government committed to the principle of holding one major fiscal event a year and to reforms of the spending framework to support transparency and stability.

To underpin the government's commitment to fiscal responsibility, Autumn Budget 2024 announces a further set of reforms to the fiscal framework. These changes will support the long-term growth needed to rebuild Britain by repairing the public finances, providing certainty to families and business, and prioritising sustainable public investment.

The reformed fiscal framework, set out in an updated *Charter for Budget Responsibility,* will remain in place for the duration of this Parliament. The fiscal rules within the framework are:

- **The stability rule** – to move the current budget into balance so that day-to-day costs are met by revenues, meaning that the government will only borrow for investment.
- **The investment rule** – to reduce debt, defined as public sector net financial liabilities (PSNFL) or 'net financial debt', as a share of the economy.

The government recognises that public investment is a crucial driver of long-term growth. For the private sector to have the confidence to invest and innovate, public investment must play its part alongside. It is right that the fiscal rules align with this ambition.

This document explains the strengthened fiscal framework, which will help to unlock investment and deliver on the government's ambitions to grow the economy. The structure of the document is as follows:

- Chapter 1 provides an overview of the government's new fiscal framework;
- Chapter 2 explains different measures of public sector debt and the balance sheet;
- Chapter 3 sets out the policy rationale for targeting net financial debt in the fiscal rules; and
- Chapter 4 discusses the strengthened controls accompanying the investment rule.

Chapter 1
The government's reformed fiscal framework

Fiscal policy objectives that support sustainable growth

1.1 The Treasury's objective for fiscal policy, as set out in the *Charter for Budget Responsibility,* is to support sustainable economic growth and the provision of high-quality public services and investment across the UK, through the effective management of the public finances and sustainable taxes and borrowing.[1] This involves:

- taking decisions that support fiscal sustainability and safeguarding intergenerational fairness through a strong balance sheet;
- prioritising investment to support long-term growth and funding high-quality public services while delivering value for money for the taxpayer; and
- a clear commitment to fiscal transparency and strong institutions through affirming the independence of the OBR and ensuring that fiscal policy is supportive of monetary policy.

1.2 The Treasury's objective for fiscal policy is supported by new principles. The International Monetary Fund (IMF) has previously suggested that a principles-based approach to fiscal policy could provide greater stability.[2] The Treasury's principles for fiscal policy are:

- to move towards only borrowing for investment; and
- to keep debt on a sustainable path.

1.3 These principles will be delivered and monitored through the fiscal mandate and supplementary targets (the fiscal rules). In setting fiscal policy, the Treasury will consider a wide range of metrics to inform a full assessment of the sustainability of the public finances, and will seek to improve sustainability over time. At each medium-term forecast the OBR will independently analyse and comment on fiscal sustainability with reference to a set of metrics which will include (but is not limited to):

- Public sector net debt (PSND);
- Public sector net debt excluding the Bank of England (PSND ex BoE)
- Public sector net financial liabilities (PSNFL);
- Public sector net worth (PSNW);
- General government gross debt (GGGD);

[1] 'Charter for Budget Responsibility', HM Treasury, October 2024.
[2] 'United Kingdom: 2023 Article IV Consultation', International Monetary Fund, July 2023.

- Net debt interest costs as a percentage of gross domestic product and as a percentage of public sector receipts; and
- Central government net cash requirement (CGNCR).

Fiscal rules support sustainable public finances, laying the foundations for strong economic growth

1.4 Fiscal rules help to deliver the government's fiscal strategy. In the UK they have typically comprised a flow and a stock target. A flow rule constrains borrowing (the deficit, or amount of new debt acquired each year) while a stock rule constrains debt (the total amount the government owes from all previous borrowing). This aligns to IMF recommendations that fiscal rules "include a debt anchor establishing a medium-term objective, combined with a small number of operational rules, which guide annual fiscal policy".[3]

1.5 Autumn Budget 2024 confirms the government's fiscal rules, set out below.

Box 1.A Charter for Budget Responsibility fiscal rules

The stability rule: the current budget must be in surplus in 2029-30, until 2029-30 becomes the third year of the forecast period. From that point, the current budget must then remain in balance or in surplus from the third year of the rolling forecast period, where balance is defined as a range: in surplus, or in deficit of no more than 0.5% of GDP. This range will support the government's commitment to a single fiscal event every year by avoiding the need for policy adjustment at forecasts outside of fiscal events. If the range is used between fiscal events, the current budget must return to surplus from the third year at the following fiscal event.

The investment rule: a target to ensure debt, defined as Public Sector Net Financial Liabilities (PSNFL), is falling as a share of the economy by 2029-30, until 2029-30 becomes the third year of the forecast period. Debt should then fall by the third year of the rolling forecast period.

1.6 Beginning with a target to meet the fiscal rules in the fifth year of the OBR forecast and moving to target the third year represents a phased approach. It balances the initial need to manage the £22 billion of in-year spending pressures identified in the government's audit of public spending, published in July, with enhancing fiscal discipline by setting rules that bind sooner.[4]

1.7 Various external organisations have advocated for earlier year targets. The Organisation for Economic Co-operation and Development (OECD) recommended that the UK should "shorten the time horizon of fiscal rules", the Institute for Fiscal Studies (IFS) noted that a fiscal rule targeting debt falling in the fifth year of the forecast is "more arbitrary and gameable than

[3] 'Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability', International Monetary Fund, April 2018.
[4] 'Fixing the Foundations: public spending audit 2024-25', HM Treasury, August 2024.

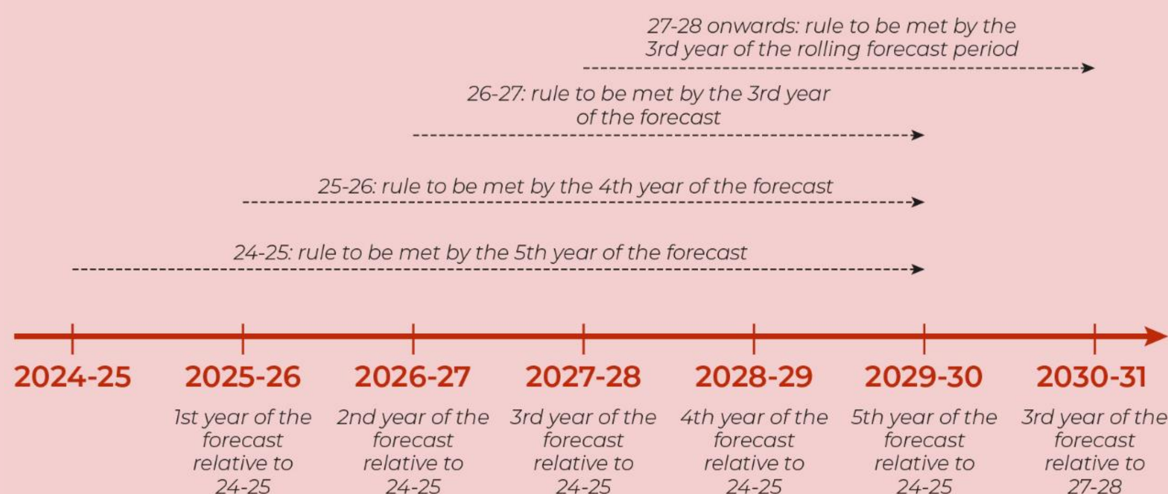
most", and the Institute for Government (IfG) proposed having a target that "is binding in the third, rather than fifth, year of the forecast."[5] Moving the fiscal rules to target the third year of the forecast binds near-term decisions while still providing space for macroeconomic adjustment and the operation of the automatic stabilisers in the first two years of the forecast.

1.8 The rationale for moving to a rolling rule (targeting a year in the forecast, i.e. the third year, that continuously moves forward) rather than a fixed rule (targeting a specific financial year, e.g. 2029-30, that gets closer each year), is that it avoids the need to make sharp policy adjustments in response to small changes in the forecast or economic shocks. With a fixed rule, as the target grows nearer, adjustments like in-year savings or tax rises become more challenging and economically damaging. A rolling target instead provides a medium-term anchor to support stability and sustainable public finances.

Box 1.B Explanation of fiscal rule time horizons

The rules require the current budget to be in surplus and net financial debt to be falling as a share of the economy by 2029-30, until this becomes the third year of the forecast period. The current budget must then remain balanced or in surplus from, and net financial debt must be falling by, the third year of the rolling forecast period.

This means that both fiscal rules must be met in the fifth year of the forecast during financial year 2024-25, in the fourth year of the forecast in 2025-26, and the third year of the forecast from 2026-27 onwards and all subsequent years.



A stability rule so the government only borrows to invest

1.9 The government's stability rule requires the current budget to move into balance so day-to-day spending (e.g. on public services) is met by current revenues (e.g. tax). The current budget excludes spending on capital

[5] 'OECD Economic Surveys: United Kingdom 2024', Organisation for Economic Co-operation and Development, September 2024; 'How do the parties' policy proposals fit in with their fiscal rules?', Institute for Fiscal Studies, June 2024; 'Strengthening the UK's fiscal framework', Institute for Government, February 2024.

investment, measuring the difference between current receipts and all other expenditure. Balancing the current budget ensures that, over the medium-term, borrowing is only for investment. This means that future generations will not be burdened with the costs of public services today.

1.10 The boundary between current and capital spending is based on international statistical principles and applied by the independent Office for National Statistics (ONS), thus ensuring transparency and credibility.[6] Under alternative flow rules, such as public sector net borrowing (PSNB), capital spending could be cut to meet the rule. The stability rule removes this incentive, with cuts to capital spending no longer available as a means to meet the fiscal mandate.

1.11 The Institute for Fiscal Studies notes that "there are good reasons to target the current budget rather than overall borrowing, most obviously because we might think it is reasonable that the costs of financing investment spending are shared with future generations who, if the investments are done well, are likely to benefit from them."[7]

1.12 To support stable fiscal policy and the move to one major fiscal event a year, once the current budget rule targets the third year of the forecast it incorporates a range. The current budget must remain in balance or in surplus from the third year of the rolling forecast period, where balance is defined as a range: in surplus, or in deficit of no more than 0.5% of GDP. There is no upper limit on the surplus the government can hold, which will help to reduce policy asymmetry, but having the lower limit will help to avoid the need for policy adjustment at forecasts outside of fiscal events. The Institute for Government and Resolution Foundation have both previously recommended a range-based rule to prevent "disruptive fiscal fine-tuning".[8]

An investment rule that values government's financial assets

1.13 The government's investment rule supports a step change in investment in the economy to drive growth, while maintaining a strong fiscal anchor so that debt is on a sustainable trajectory.

1.14 Debt is defined as public sector net financial liabilities (PSNFL), or net financial debt, an official statistic published by the ONS and forecast by the OBR since 2016, based on international statistical guidance.[9]

1.15 Net financial debt includes all the debt and assets counted within PSND but is a broader and more comprehensive measure. In addition to the stock of debt captured in PSND, it includes all other financial liabilities, such as funded pensions obligations and standardised guarantees. In addition to liquid assets (like cash and deposits) captured in PSND, it also recognises illiquid financial assets, such as equity holdings and loans, which are netted off debt to calculate the measure of the balance sheet.

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6 European System of Accounts; The System of National Accounts

7 'How do the parties' policy proposals fit in with their fiscal rules?', Institute for Fiscal Studies, June 2024.

8 'Strengthening the UK's fiscal framework', Institute for Government, February 2024; 'Totally (net) worth it', Resolution Foundation, October 2019.

9 'Autumn Statement: Supplementary fiscal aggregates', Office for National Statistics, November 2016.

1.16 Net financial debt does not include non-financial assets owned by the public sector, such as school and hospital buildings.

1.17 There are three significant advantages to targeting net financial debt as a fiscal rule:

- **Strengthening fiscal management** – it provides a fuller account of what the government owes and owns, improving incentives to manage a broader set of liabilities and drive asset performance.
- **Recognising the value of financial assets** – net financial debt recognises that financial investments, such as loans, have a positive value and where they make a return above the government's cost of borrowing, they reduce (not increase) the debt burden.
- **Supporting growth enhancing investments** – financial investments, such as those made by the National Wealth Fund, are expected to help grow the economy while yielding a positive return for the taxpayer. Using a debt metric that does not recognise financial assets could create an incentive for the government to forgo profitable and growth enhancing investments.

1.18 The London School of Economics Grantham Research Institute noted that "it has long been recognised that public sector net debt is an incomplete metric for considering the health of the public finances. What matters is the assets the debt has been invested in." Its recommendation was to "reduce the emphasis on public sector net debt as the key 'stock' metric…. done by placing greater weight on broader metrics like public sector net financial liabilities."[10]

1.19 To support the move to the new investment rule, the government is introducing robust guardrails to ensure investments are consistent with fiscal sustainability and decisions represent good value for money, as set out in Chapter 4. These new controls include:

- **On delivery of capital spending**, the government will reform the way it plans, assures, delivers and evaluates capital spending and will underpin these reforms with new and strengthened institutions. This includes publishing a 10-year infrastructure strategy alongside Phase 2 of the Spending Review 2025, setting five-year capital budgets at spending reviews, publishing business cases for major projects and programmes, establishing the National Infrastructure and Service Transformation Authority (NISTA), and formally launching the Office for Value for Money.
- **On managing financial investments,** the government is publishing a *Financial Transaction Control Framework* alongside the Budget.[11] This re-confirms the established spending control framework for FTs in Managing Public Money and Consolidated Budgeting Guidance.[12] It also introduces new controls: that financial investments should by default target a return for the Exchequer that at least covers their cost of financing, that all large-scale financial transactions will be managed by expert bodies like the National Wealth Fund, and that the government will publish an annual report on the performance and value of its financial assets.

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10 'Designing a UK fiscal framework fit for the climate challenge', Andy King and Daisy Jameson, July 2024.

11 'Financial Transaction Control Framework: Managing government's financial investments', HM Treasury, October 2024.

12 Managing Public Money, HM Treasury, May 2023; Consolidated budgeting guidance 2024 to 2025, HM Treasury, February 2024

A fiscal framework that provides stability and transparency

1.20 The fiscal rules form part of a broader fiscal framework, set out in the *Charter for Budget Responsibility*[13] , which creates a more stable and predictable fiscal policy environment through:

- **A commitment to the principle of holding one major fiscal event per year** to give families and businesses stability and certainty on upcoming tax and spending changes.
- **Committing to hold a Spending Review every two calendar years**, setting Departmental Expenditure Limits (DEL) for a minimum of three years of the five-year forecast period. According to the IMF, this will "improve the credibility of the medium-term fiscal framework."[14]
- **Government reforming its approach to welfare, including setting a new welfare cap for 2029-30,** to support spending control and ensure that welfare spending is sustainable in the medium term.
- **An escape clause that provides a strengthened role for the OBR** when the government assesses there is a need to temporarily suspend the fiscal rules due to economic shocks.

1.21 The framework also enhances the transparency of the public finances, improving the ability to scrutinise the government's policy by:

- **Confirming the detail of the fiscal lock** as legislated for in the Budget Responsibility Act 2024. This means that every fiscally significant change to tax and spending will be subject to scrutiny by the independent OBR.
- **Improving spending transparency.** The Treasury shall provide the OBR with regular information about spending pressures and formalise its power to forecast overspends against Department Expenditure Limits.
- **Requiring the OBR to analyse and report on long-term impacts of capital investments and other policies** at each forecast. This analysis will help demonstrate how the health of the public sector balance sheet is bolstered by good investment decisions.
- **Requiring annual reporting on government's contingent liabilities and financial investments**. Contingent liabilities are uncertain in timing or cost and don't appear on most measures of the balance sheet. The OECD recommends regular disclosure as "scrutiny that comes with disclosure" helps to "ensure that risks are identified, estimated, and managed".[15]

[13] 'Charter for Budget Responsibility', HM Treasury, October 2024.
[14] 'United Kingdom: 2024 Article IV Consultation', International Monetary Fund, July 2024.
[15] 'Managing disaster-related contingent liabilities in public finance frameworks', OECD, June 2017.

Chapter 2

Different measures of government debt explained

There are several measures of government debt

2.1 Ensuring government debt remains on a sustainable path is key to sound public finances and helps build buffers to economic shocks. This supports the stable macroeconomic environment needed for long-term growth.

2.2 A debt-to-GDP ratio is commonly used in fiscal rules to account for the burden of government debt relative to the size of the economy, but as the IFS notes "no single measure is a perfect indicator of the health of the public finances."[16] Internationally, there are various measures of debt used in fiscal rules.

2.3 Currently the ONS publishes and the OBR forecasts, among others:

- **Public sector net debt (PSND)** measures the debt liabilities of the public sector, less any 'liquid' assets (e.g. cash deposits and the foreign exchange reserves).[17] It excludes all illiquid assets and other financial liabilities.
- **PSND excluding the Bank of England (PSND ex. BoE)** was first published by the ONS in 2016 and was the metric most recently targeted in the fiscal rules.[18] It excludes the Bank of England from the definition of the public sector, so transactions between the Bank and the government add to debt, while transactions between the Bank and the private sector do not. With the '*Term Funding Scheme with additional incentives for SMEs*' closed to new drawings and outstanding loans due to be repaid by 2027, the main distortion from the Bank of England's balance sheet activities will be removed. Therefore, it is appropriate to return to targeting a measure of the public sector balance sheet that includes the Bank of England.[19]
- **Public sector net financial liabilities (PSNFL)** was first published in 2016 by the ONS and captures all financial assets (such as equity holdings and loans) and financial liabilities (such as funded pensions obligations) on the public sector balance sheet.[20] It is broadly the stock equivalent of Public Sector Net Borrowing (PSNB). It includes all the debt and assets counted within PSND but is a more comprehensive measure.

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[16] 'Fiscal rules and investment in the upcoming Budget', Institute for Fiscal Studies, September 2024.

[17] Assets are liquid if they can quickly be converted into cash with minimal impact on their value, e.g., cash deposits or other assets with a maturity of less than a year. For details see 'The Public sector balance sheet', Office for National Statistics, July 2009.

[18] 'Autumn Statement: Supplementary fiscal aggregates', Office for National Statistics, November 2016.

[19] Some loans are eligible for extension beyond 2027. For more information on the TFSME see 'Second Phase Extension of Term Funding Scheme with additional incentives for SMEs (TFSME)', Bank of England, May 2024.

[20] Definitions follow the National Accounts, set out in the 'System of National Accounts, 2008' and 'Eurostat'. Details can be found here: 'Autumn Statement: Supplementary fiscal aggregates', Office for National Statistics, November 2016.

- **Public sector net worth (PSNW)** was published in 2019 by the ONS and has been forecast by the OBR since 2021.[21] It builds on PSNFL by recognising the values of non-financial assets like schools and roads and by adding unfunded pensions liabilities and broader Public Private Partnership (PPP) liabilities.

Table 2.1: Balance sheet metrics used in the United Kingdom

	Public sector net debt	Public sector net financial liabilities	Public sector net worth*
Non-financial assets			Schools, roads and hospitals.
Illiquid financial assets		Equities, loans, student loans, accounts receivable.	
Liquid financial assets	Foreign exchange reserves and cash deposits.		
Debt securities, loans, currency and deposits	Gilts and money borrowed by public sector.		
Funded public sector pensions entitlements		Pension liabilities with corresponding assets.	
Other financial liabilities		Standardised guarantees, accounts payable etc.	
Unfunded public sector pension liabilities			Pension schemes with no corresponding asset.
PPP liabilities			Includes wider liabilities.

* Consistent with the IMF Government Finance Statistics Manual (GFSM).

Comparison of net financial debt to PSND

Components of net financial debt not in PSND

2.4 As shown in Chart 2.1, the liabilities captured in PSND make up the majority of those included in net financial debt. There are some additional assets and liabilities specific to net financial debt:

- Illiquid financial assets are a significant component of net financial debt not included in PSND, accounting for £1,058 billion (38% of GDP) in 2023-24.[22] These financial assets comprise mostly loans and equity holdings.
- Student loans and the Bank of England Term Funding Scheme account for almost 80% of public sector loan assets, worth £130.2 billion and £144.3

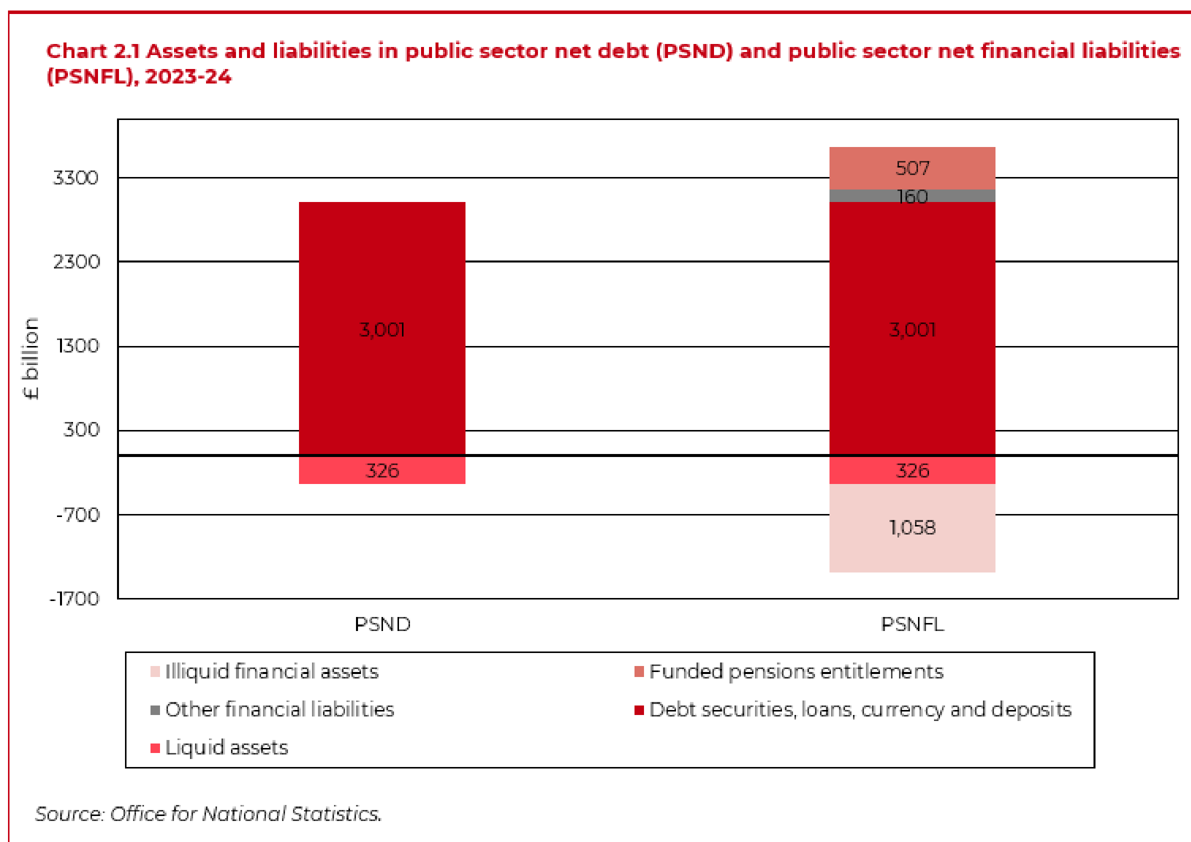
[21] In June 2019, the ONS introduced new supplementary tables that are compliant with the IMF's 'Government Finance Statistics (GFS) framework', as reported in the 'GFS Manual (2014)', IMF, 2014. This was the first time that the ONS had published PSNW on this basis.

[22] 'Public sector finances tables 1 to 10 : Appendix A', Office for National Statistics, October 2024.

billion in 2023-24. Over 90% of equity assets owned by the public sector are held by funded pension schemes, representing £506 billion in 2023-24.[23]

- Funded pension schemes' assets are offset by corresponding pensions liabilities, worth £507 billion in 2023-24.[24] This means the net impact of assets and liabilities of funded pensions schemes is small. There are also other financial liabilities captured in net financial debt worth £160 billion, like provisions for expected losses of standardised guarantees.[25]

Chart 2.1 Assets and liabilities in public sector net debt (PSND) and public sector net financial liabilities (PSNFL), 2023-24



Source: Office for National Statistics.

Changes over time

2.5 Because the assets and liabilities captured in PSND make up the majority of those in net financial debt, the metrics largely track each other over time. As noted by the OBR, the forecast for net financial debt as a share of GDP "is driven primarily by the forecasts for PSNB and GDP, and so shares many of the same sensitivities as PSND and other fiscal aggregates."[26] One simple way to think about net financial debt is that it is a stock measure that corresponds to the cumulative flows of PSNB over time.

2.6 Net financial debt and PSND also both include the Bank of England's balance sheet activities. They account for losses from the Asset Purchase Facility (APF)

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23 'Public sector net worth: Appendix O', Office for National Statistics, September 2024; 'Public sector finances tables 1 to 10 : Appendix A', Office for National Statistics, October 2024.

24 'Public sector net worth: Appendix O', Office for National Statistics, September 2024.

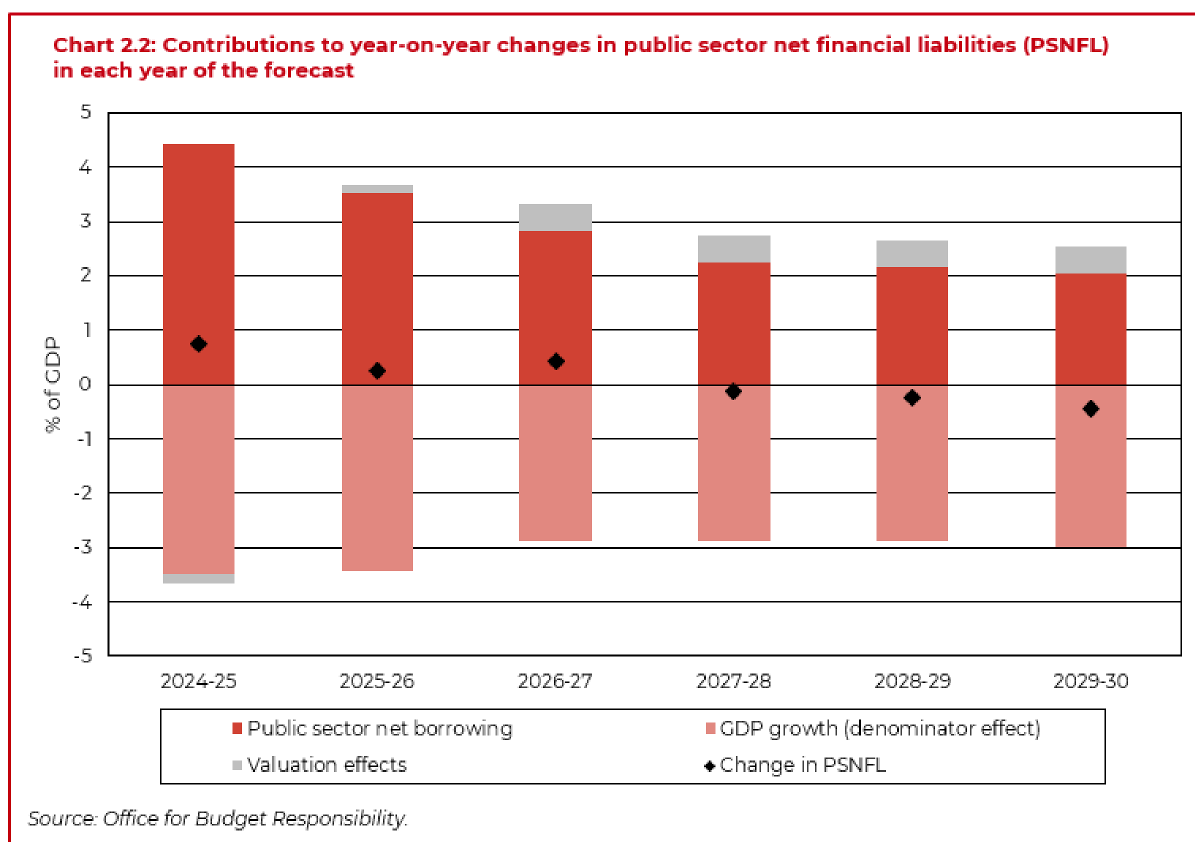
25 'Public sector finances tables 1 to 10 : Appendix A', Office for National Statistics, October 2024.

26 'Economic and Fiscal Outlook 2024', Office for Budget Responsibility, October 2024.

– a subsidiary of the Bank of England used to implement quantitative easing (the Bank of England's programme of bond purchases during the financial crisis) – in the same way.[27] APF losses comprise net interest costs and losses from bond sales and redemptions.

2.7 Net financial debt can diverge from PSND as a result of changes in assets and liabilities that only feature in net financial debt, like growth in financial assets and the net position of funded public sector pension schemes (i.e. whether schemes are in surplus or deficit). These elements have tended to have smaller effects on the trajectory for net financial debt. Chart 2.2 breaks down the contributions to year-on-year changes in the OBR's October 2024 forecast, showing PSNB and GDP growth as the main drivers.

Chart 2.2: Contributions to year-on-year changes in public sector net financial liabilities (PSNFL) in each year of the forecast



Source: Office for Budget Responsibility.

2.8 Before the measures announced in Autumn Budget 2024, the OBR forecast that the margin against net financial debt falling as a share of GDP in 2029-30 would be £8.7 billion higher than for PSND, and £20.9 billion higher than PSND excluding the Bank of England (PSND ex BoE). This gap has narrowed relative to the OBR's March 2024 forecast, when it had been £37.1 billion and £53.0 billion in the fifth year respectively. This reflects changes by the OBR to the forecast methodology for net financial debt to capture the effects of asset purchase facility (APF) sales and redemption losses, as well as other changes

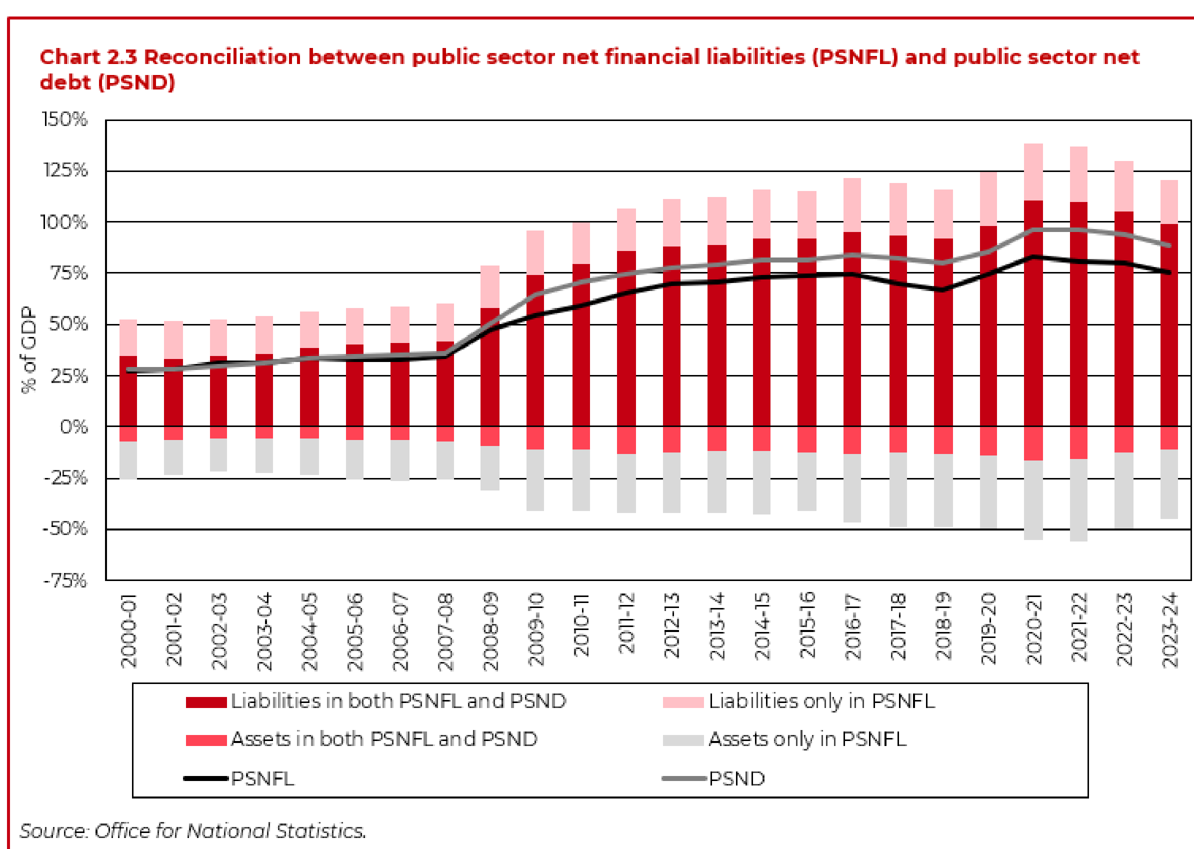
[27] The APF began in 2009 and was expanded during the Covid-19 pandemic. The APF is indemnified by HM Treasury, so all profits and losses accrue to HM Treasury. Since October 2022, HM Treasury has been making cash transfers to the Bank of England to cover losses, as gilts are sold back to the market as quantitative easing is unwound.

to the underlying pre-measures forecast for both metrics. The change is detailed in the OBR's October 2024 Economic and Fiscal Outlook.[28]

2.9 In the past, there have been specific moments when the path of net financial debt and PSND diverged, primarily when government increased its stock of financial assets that offset a rise in liabilities:

- During the global financial crisis, net financial debt and PSND diverged when the government purchased shares in banks like Royal Bank of Scotland and Lloyds, as net financial debt recognised the value of their assets as well as the cash spent on them.[29]
- During COVID-19, the metrics diverged as the Bank of England expanded the Term Funding Scheme.[30] This increased PSND but net financial debt scored both the loan assets and corresponding deposit liabilities.

Chart 2.3 Reconciliation between public sector net financial liabilities (PSNFL) and public sector net debt (PSND)



Source: Office for National Statistics.

Volatility and revisions to net financial debt

2.10 As with all fiscal metrics, net financial debt is subject to data revisions or changes in the valuation of assets and liabilities, which can shift the level of debt up or down. Notably, a change was made in 2021 to the discount rate

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28 'Economic and Fiscal Outlook 2024', Office for Budget Responsibility, October 2024.

29 Both Royal Bank of Scotland (now NatWest group) and Lloyds were reclassified to the public sector during the financial crisis. All headline measures of borrowing and debt (including PSND and PSNFL) excluded these public sector banks due to their distortive effects on the public finances.

30 The Bank of England's Term Funding Scheme (TFS) is a programme designed to provide funding to banks and building societies at interest rates close to the Bank Rate, in order to increase lending to businesses and households.

applied to funded public pensions liabilities from 2016-17, which affected the value of these liabilities.[31] The design of the investment rule, which requires net financial debt to fall, targets a trajectory which means that level shifts from revaluations or data revisions should not force offsetting fiscal policy changes. Revisions primarily affect the starting level of debt and so will have a smaller effect on a trajectory-based fiscal rule.

2.11 Over time, changes in net financial debt appear to have been less volatile than PSND. Table 2.2 shows that over 1998-2023 – the full ONS time series for net financial debt – the standard deviation of the year-on-year change in net financial debt as a share of GDP is lower than that for PSND, at 4.6% relative to 5.5%. As set out above, this is driven by PSND rising more than net financial debt in crisis periods, as it does not recognise where the government acquires financial assets through economic interventions that offset rising liabilities. Looking at non-crisis periods only (taking 1998-2007 and 2010-2019 together), this difference narrows and PSND and net financial debt are broadly similar in year-on-year volatility, with net financial debt remaining less volatile.

Table 2.2 Year-on-year changes in public sector net debt (PSND) and public sector net financial liabilities (PSNFL)

	1998-2023		1998-2007 & 2010-19	
	PSND	PSNFL	PSND	PSNFL
Mean	2.5%	2.0%	1.2%	0.9%
Standard deviation	5.5%	4.6%	2.9%	2.6%

Source: Office for National Statistics.

2.12 The Treasury, OBR and ONS established a net financial debt working group with an agreed joint work programme, taking forward statistical and forecast development relevant for this measure. This group aims to drive data quality improvements for both the forecast and outturn statistics, such as improving the timeliness of updates to funded pensions data in the public finances, and as part of ONS's continuous statistical development programme.

[31] 'Recent and upcoming changes to public sector finance statistics', Office for National Statistics, August 2021.

Chapter 3
Rationale for targeting net financial debt

3.1 As set out in Chapter 1, there are three significant advantages to targeting net financial debt as a fiscal rule:

- **Strengthening fiscal management**, as it improves incentives to manage financial asset performance and the costs of a broader set of liabilities.
- **Recognising the value of financial assets**, such as loans and equity that are expected to yield a financial return that pays their debt interest costs.
- **Supporting growth-enhancing investments** by recognising assets created by financial investments, government can step up support for its growth mission in a fiscally sustainable way.

Strengthening fiscal management

3.2 Net financial debt broadens the scope of fiscal management, providing a fuller account of what government owes and owns. It does this by capturing all financial assets and liabilities on the public sector balance sheet, as defined by the ONS in line with international guidance.[32] The Institute for Fiscal Studies notes that the metric offers a "more complete picture of the government's financial position, while removing some of the perverse incentives associated with a narrow focus on PSND."[33]

3.3 Targeting a broader measure reduces incentives to take decisions where the full fiscal costs are not accounted for. For example, the historic sales of tranches of the Student Loan Book in 2017 and 2018 were conducted with an explicit objective of reducing PSND.[34] Future sales were ceased in 2020 following an ONS change in the accounting treatment that better reflected their effect on the public finances. As noted by the OBR, as net financial debt "includes all financial assets, the perverse incentive to sell these assets for less than their value is removed in this metric."[35] Under net financial debt, the sale of financial assets recognises both the loss of future income (the value of the asset), as well as cash received from the sale.

3.4 As of 2023-24, net financial debt captures £668 billion of financial liabilities in addition to those included in PSND.[36] This includes the liabilities of funded public sector pension schemes, worth £507 billion, as well as these schemes'

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[32] Definitions follow the National Accounts, set out in the 'System of National Accounts, 2008' and 'Eurostat'.
[33] 'Fiscal rules and investment in the upcoming Budget', Institute for Fiscal Studies, September 2024.
[34] 'The sale of student loans', National Audit Office, July 2018.
[35] 'Economic and Fiscal Outlook 2024', Office for Budget Responsibility, October 2024.
[36] 'ONS Public Sector Finances, Appendix A', Office for National Statistics, October 2024.

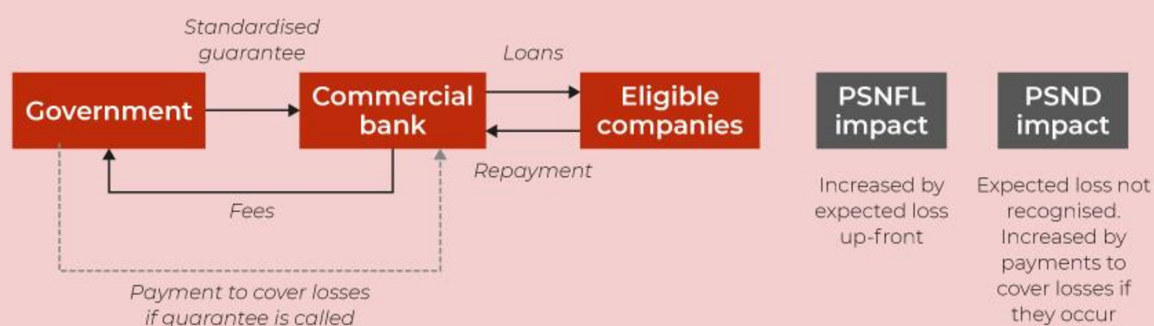
assets, which are some of the larger values on the public sector balance sheet. Having a wider set of assets and liabilities included in the target debt metric helps to shine a light on their fiscal consequences and strengthens incentives for government to control costs effectively, improving fiscal management.

3.5 As an example, net financial debt recognises the expected losses of issuing standardised guarantees like the COVID-19 loan guarantee schemes, which are not recognised as an upfront cost in PSND. As of March 2023, these schemes are forecast to have a lifetime expected cost, gross of fee income, of £17.5 billion (N.B. the costs net of fee income, recorded in net financial debt, will be slightly smaller).[37]

Box 3.A Fiscal impact of standardised guarantees

A standardised guarantee is where multiple guarantees are offered on the same terms to multiple lenders.

The **Coronavirus Business Interruption Loan Scheme** (CBILS) provided financial support to smaller businesses affected by COVID-19. The government guaranteed 80% of the finance to the lender and paid interest and any fees on behalf of the small business for the first 12 months.[38]



When CBILS was introduced, public sector debt, measured by:
- Net financial debt increased by the estimated expected losses of the guarantee when issued;
- PSND did not include this liability. The guarantees appeared to be 'free' when issued. This measure only increased as a cash payment was made.

3.6 Public Sector Net Worth (PSNW) is an even broader measure of the public sector balance sheet than net financial debt, covering both non-financial and financial assets and liabilities. Using PSNW as a fiscal target would present practical challenges: valuing non-financial assets, such as schools and hospitals, can be complex, and these assets often do not generate direct financial returns. The government will, however, consider PSNW alongside other metrics to inform a full assessment of the public finances.

37 The schemes included are BBLS, CBILS and CLBILS, and figures are presented gross of fee income as of March 2023. Source: 'COVID-19 loan guarantee schemes performance data' as at 31 March 2023, 'BEIS annual report and accounts 2022 to 2023'.

38 Apply for the Coronavirus Business Interruption Loan Scheme, Government Guidance (withdrawn 1st April 2021).

Recognising the value of financial assets

3.7 Net financial debt captures not just debt that the public sector owes, but also assets that are expected to generate future returns. The National Institute for Economic and Social Research has set out the benefit of valuing "assets that may yield an immediate financial return or indirectly so via their implied impact on the economy" when assessing government debt.[39]

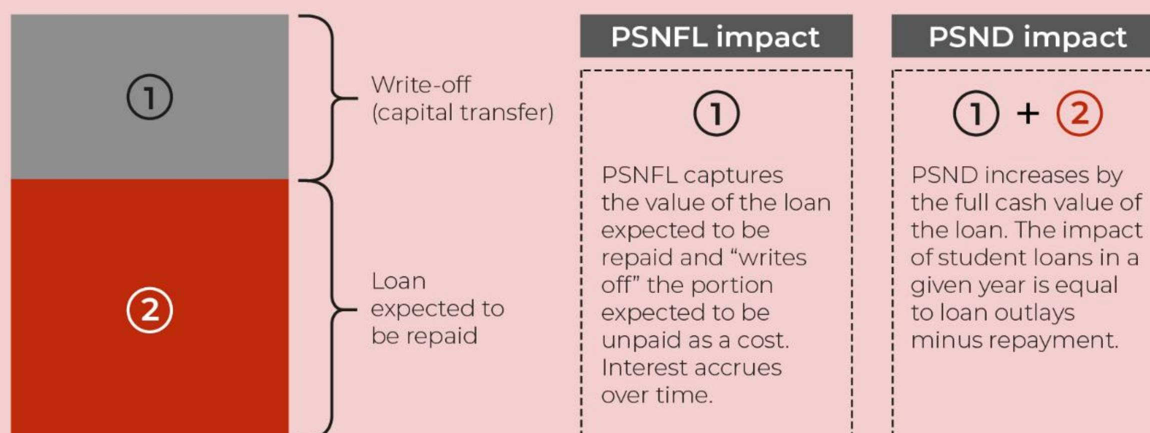
3.8 A debt target ensures that the servicing and repayment of debt is sustainable. Net financial debt captures assets that will generate a positive return for the Exchequer. This is important for a full assessment of fiscal sustainability, as it reflects that financial assets generate income that covers (or even exceeds) the debt interest cost incurred to finance them.

3.9 Using a debt metric that does not recognise the value of financial assets can create an incentive to forgo investment that offers long-term fiscal benefits. PSND initially treats a loan the same as a grant by only capturing upfront spending on the loan and not recognising the loan asset (i.e. that a loan issued today will likely be repaid with interest in the future), as illustrated in Box 3.B.

Box 3.B Fiscal impacts of student loans

When the government borrows to issue student loans, it does so in expectation that many student loans will be repaid over time with interest.

PSND only captures upfront spending on the government loan and worsens by the full value of the loan on issuance. Net financial debt recognises the value of the loan expected to be repaid, which offsets the liability incurred, while treating the balance expected to remain unpaid as a cost (a 'write-off').



Supporting investment to boost growth

3.10 Growth is the government's central mission. The move to net financial debt supports the growth mission by creating a framework to deliver the step change in investment the economy needs, in a fiscally sustainable way.

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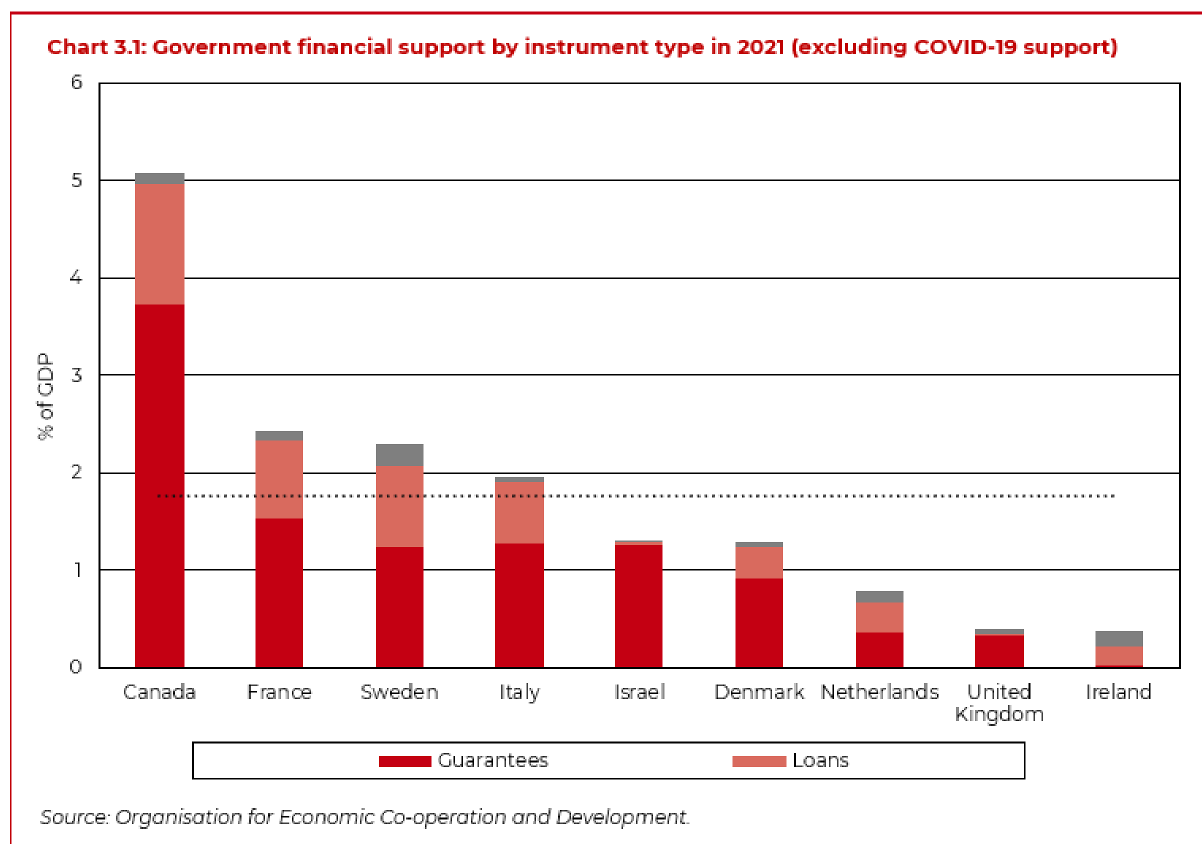
[39] 'A Consideration of Fiscal Targetry', National Institute for Economic and Social Research, October 2024.

3.11 Public investment is a crucial driver of growth, contributing to the stock of capital in the economy and increasing productivity. Because net financial debt recognises the value of assets created by financial investments in the capital budget, it allows for higher capital spending than a rule targeting PSND. At Autumn Budget 2024, the government sets out its plans to fix the foundations of the economy, including by increasing public capital spending by an additional £100 billion over the next five years.[40]

3.12 Alongside, the government will look to catalyse private investment. A key lever for this is using financial instruments like loans, equity and guarantees to invest alongside businesses in the UK's growth sectors. As shown in Chart 3.1, the UK has historically made less use of financial instruments in industrial policy compared to many advanced economies.

Chart 3.1: Government financial support by instrument type in 2021 (excluding COVID-19 support)



Source: Organisation for Economic Co-operation and Development.

3.13 Many of the UK's international peers treat financial instruments, or institutions that provide them, differently in their fiscal frameworks:

- the EU and many OECD members target general government debt as their debt measure, which excludes the effect of public corporations like policy banks that make financial investments; and

[40] This is based on a comparison with Spring Budget 2024 capital spending plans to 2028-29 and the OBR's pre-measures assumption that capital spending rises with nominal GDP in 2029-30.

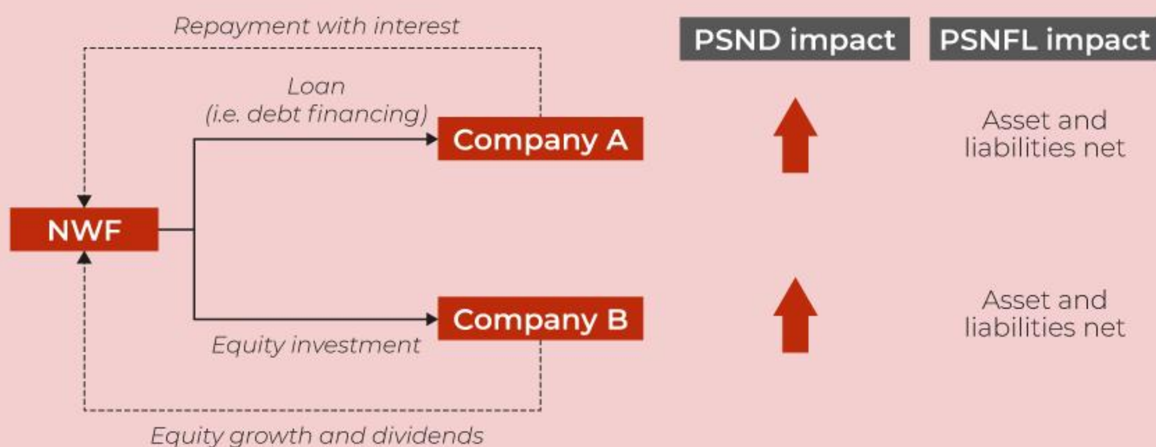
- some countries, for example Australia, monitor measures of net debt that subtract the government's financial assets (including loans) from gross debt, to support assessments of fiscal sustainability in the medium term.[41]

3.14 Policy banks like the National Wealth Fund (NWF), British Business Bank (BBB) and UK Export Finance (UKEF) were set up to use financial instruments to drive private investment and business growth, while generating a financial return. For example, UKEF has returned over £2 billion to the Exchequer from its main account since 1991.[42] A move to net financial debt allows the government to recognise the value of the assets held by UK policy banks in its debt rule, while capturing the liabilities required to fund these investments.

Box 3.C Fiscal impacts of National Wealth Fund (NWF) financial investments

NWF issues a loan it expects to be repaid to Company A: increases PSND the same as a grant, but in net financial debt an offsetting loan asset is scored.

NWF acquires a minority equity stake in Company B: increases PSND the same as a grant, but in net financial debt an offsetting equity asset is scored.



Under government budgeting rules, **NWF accounts for future expected losses** from potential loan defaults. It charges appropriate risk-based interest rates across all its loans to **target portfolio-level returns**. NWF also **holds sufficient economic capital** to manage the downside risk of its investments.

For these investments, **net financial debt improves over time** as the NWF receives interest and dividend payments and registers gains in equity values.

Net financial debt will also reflect costs – interest paid on government borrowing to make investments, loan write-offs and losses in equity values.

41 'Australian Government Debt', Parliament of Australia, May 2023.
42 'UK Export Finance Annual Report and Accounts 2022-23', UK Export Finance, June 2023.

Chapter 4

A strong set of supporting controls

Managing financial investments effectively

How net financial debt ensures sound financial investments

4.1 Financial transactions (FTs) take place when the public sector acquires or sells financial assets like equities or loans via transactions with the private sector. A move to net financial debt recognises that equity investments or loans create corresponding financial assets to the liability incurred to finance them.

4.2 There are strict requirements on what counts as a financial asset and how different transactions are treated. Net financial debt, defined as PSNFL, is an official statistic produced by the independent ONS based on international statistical guidance.[43] This means, for example, that:

- For lending to result in a recognised loan asset, the loan must be expected to be repaid with interest, which means interest-free lending or lending to firms in distress would be treated as a grant and worsen net financial debt.
- Loan and equity assets aren't recognised in net financial debt if they are transactions between two parts of the public sector.
- Lending routed by government through off-balance sheet vehicles to public sector entities would also count as public sector borrowing and worsen net financial debt.
- Loan write-offs or reductions in equity values worsen net financial debt when they occur, with equities measured at market value, meaning that poor asset performance will be reflected in the metric over time.

4.3 Alongside, the government applies International Financial Reporting Standards (IFRS) in its established budgeting system. This adjusts budgets upfront for expected credit losses (the risk of borrowers defaulting on loans) and the expected costs of loss-making loans or investments (i.e. where expected returns are below the government's cost of borrowing). This ensures that government organisations reduce spending to account for these losses and trade-off expected losses with other spending.[44]

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[43] Definitions follow the National Accounts, set out in the 'System of National Accounts, 2008' and 'European System of Accounts 2010'.

[44] 'Consolidated budgeting guidance 2024 to 2025', HM Treasury, February 2024.

Pre-existing spending control of financial transactions

4.4 The government already has a well-established spending control framework for managing FTs set out in Managing Public Money and Consolidated Budgeting Guidance (Chapter 8)[45] and this system will remain in full.

4.5 Departments require Treasury consent and budget cover for spending on FTs, with budget cover allocated through spending review and budget processes. This means no department or public financial institution will be allowed to expand their use of FTs without Treasury approval. FTs are also ringfenced in department budgets to recognise their distinct fiscal impact.

4.6 FTs are scored in budgets in line with IFRS. They affect the capital budget as they are made (e.g. purchase of shares or net lending) or settled (e.g. sale of shares). They affect the resource budget via returns received on assets (e.g. interest on loans), changes in asset values, and recognition of losses.

4.7 Under net financial debt, to strengthen spending controls and ensure that investment in FTs is fiscally prudent and value for money, the government is introducing a series of further controls for FTs, set out below.

New controls for financial transactions

4.8 The government is publishing a *Financial Transaction Control Framework* alongside the Budget.[46] This sets out the following new requirements:

- All new, large-scale FTs and guarantees must be provided by public financial institutions like the NWF, UKEF, and BBB, who will make operationally independent investment decisions, employ expert fund managers, have a mandate to make a positive return for the Exchequer, and manage risk using economic capital models. Initially, while it is established, the government expects that Great British Energy's investment activity will be undertaken by the NWF.
- All new FTs should, by default, target a risk-adjusted return above the government's cost of borrowing (the relevant gilt rate) and overhead costs. Where the government, in limited cases, undertakes FTs that it expects to be loss-making to support a specific policy need (e.g. crisis interventions), these costs will be taken from departmental budgets directly and thus need to be traded off with spending.
- Standardised risk controls will be put in place for all FT and guarantee programmes, by drawing on the economic capital approach applied by commercial banks.
- All approved FTs must meet stringent value for money criteria, including addressing a clear market failure and not crowding out private sector investment.

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[45] 'Managing Public Money', HM Treasury, May 2023; 'Consolidated budgeting guidance 2024 to 2025',HM Treasury, February 2024.

[46] 'Financial Transaction Control Framework: Managing government's financial investments', HM Treasury, October 2024.

4.9 In addition, the government will publish an annual *Government Financial Investment Report*, to provide transparency to the public, Parliament and markets on its financial asset portfolio. This report will:

- Set out the financial assets that the government owns, their latest valuations, their financial performance, and policy benefits achieved.
- Over time, assess risk in downside economic stress scenarios and be used by the Treasury to consider government's risk at an aggregate level.
- Be produced by UK Government Investments (UKGI), an arm's length body of the Treasury who are the government experts in corporate finance.
- Be robust and independently verified, in particular on the valuation of government's assets, using asset valuations drawn from accounts already audited by the National Audit Office (NAO).

4.10 The Treasury is working with the Comptroller and Auditor General to ensure the *Government Financial Investment Report* builds appropriately on the existing audits of asset valuations.

A measured approach to the future use of financial transactions

4.11 As set out in Table 4.1, the fiscal rules announced at Autumn Budget 2024 are not accompanied by a significant increase in the planned use of FTs. The October 2024 forecast for the level of spending on FTs over 2024-25 to 2028-29 is lower than in the March 2024 forecast.

Table 4.1: Changes in financial transactions forecast since March 2024*

	£ billion					
	Forecast					
	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
March 2024	12.6	13.5	17.4	17.8	18.3	
October 2024	10.5	13.1	18.6	17.7	17.7	18.0
Difference	**-2.1**	**-0.4**	**1.2**	**-0.1**	**-0.6**	

Source: Office for Budget Responsibility.

*FTs as presented in the OBR EFO as net acquisitions of financial assets, less term funding scheme, and equivalent in Spring 24.

4.12 The government intends to consider its future approach to use of FTs in a measured and phased way, using FTs in a prudent manner that prioritises maintaining economic stability and fiscal sustainability.

4.13 At every fiscal event, the Treasury will publish total planned FTs together with details on the fiscal controls put in place for public financial institutions, which will be the government's main vehicles for providing FTs. This will include setting out public financial institutions' total investment capacity, annual investment limits and risk controls (such as economic capital models).

Ensuring capital budgets are spent well

4.14 Supported by the new fiscal framework, Autumn Budget 2024 announces a plan to rebuild Britain by increasing public investment and unlocking private investment. The government is increasing public capital investment by £100 billion over the next five years. This increased capital investment, if maintained, will increase the size of the UK economy over the long term and support the delivery and reform of public services.

4.15 Alongside this, the government is taking steps to ensure an even greater focus on high-quality investment and delivering value for money for the taxpayer. The government is reforming the way it plans, assures, delivers, and evaluates capital spending. These changes will provide greater certainty for departments, investors and supply chains, and greater assurance that the investment is high-quality and well delivered. These reforms include:

- Publishing a 10-year infrastructure strategy alongside Phase 2 of the Spending Review, outlining the government's long-term approach.
- Setting five-year capital budgets and extending them every two years at regular spending reviews, which will avoid funding cliff edges and give more certainty.
- Increasing the transparency of investment decisions by publishing business cases for major projects and programmes.

4.16 The government will underpin these reforms with new and strengthened institutions, including:

- Establishing the National Infrastructure and Service Transformation Authority (NISTA) to drive more effective delivery of infrastructure across the country. NISTA will combine the functions of the National Infrastructure Commission and the Infrastructure and Projects Authority. NISTA will be operational by spring 2025 and will implement the government's infrastructure strategy, in conjunction with industry. Alongside existing assurance mechanisms, NISTA will have an enhanced role in supporting major projects, including validating business cases prior to HM Treasury funding approval.
- Formally launching the Office for Value for Money, with the appointment of an independent Chair. As a first step, the Chair will advise the Chancellor and Chief Secretary to the Treasury on decisions for the multi-year Spending Review. This will include an assessment of where and how to root out waste and inefficiency, value for money studies in high-risk areas of cross-departmental spending, and scrutiny of investment proposals to ensure they offer value for money.
- Working with the NAO to benefit from their scrutiny of capital projects and learn lessons which can be applied to future projects.

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