Exchequer and central government finance

In the Exchequer tables in the statistical annex to this *Bulletin*, and in official publications, it has not been easy to see how the U.K. balance of payments can affect Exchequer financing; nor has it been easy to relate the Exchequer's accounts to the statistics of national income and expenditure. Until now, the Government's total need for finance, whether met through changes in home or in overseas holdings of government debt, has been shown as one item—called the " cash deficit/surplus ". This item reflected, on the external side, changes in the foreign exchange holdings of the Exchange Equalisation Account, but not the net changes in overseas holdings of government stocks and of Treasury bills which are often closely related.

In co-operation with the Treasury, some changes have therefore been made in this issue of the *Bulletin* in the presentation of Exchequer statistics. The principal change is designed to gather together those " external transactions " which in total should give a better indication of the impact of the country's overseas transactions on the Exchequer's domestic financing. This is discussed on page 32.

A further change in presentation provides a link between the Exchequer's cash accounts and the statistics of national income and expenditure, so as to bring out more clearly the economic classification of the central government's transactions. This change is discussed first, because the article describes the alterations in the presentation of Exchequer statistics in the order in which they appear in the tables.

Changes in the statistics The first main alteration is that in Table 1 of the statistical annex net receipts from, and payments to, extra-Exchequer funds (which are defined later in this article) are now grouped with the Exchequer's revenue and expenditure, and with its Consolidated Fund loans, to form a " central government " group. As will be seen, the three items are closely associated; and the aggregate of the three is called the central government's " net balance ". An economic classification of transactions which make up the " net balance " is provided in a new Table 2; this table, which summarises and reproduces in a convenient form the classification already published by the Central Statistical Office, covers the same periods as Table 1 except that figures for the latest quarter (October-December 1965) are not yet available.

The second main alteration is that Table 1 now separates known overseas transactions in government debt from those of domestic holders. Changes in overseas holdings of all forms of government debt are grouped, under the heading " external transactions ", with the E.E.A.'s purchases and sales of gold and foreign currencies, because these items are interrelated. Thus the lower half of Table 1 now relates, as far as possible, to changes in the amount of government debt held by U.K. residents.

While Table 1 continues in principle to be a sterling cash account, derived mainly from statements of account, the division between domestic and overseas holdings of government stocks and of Treasury bills is not exact. As hitherto, some unidentified changes in overseas holdings may be included among the residual figures for domestic holdings, but the amounts involved are thought not to be very large. Exchequer borrowing from domestic sources also continues to include all holdings of U.K. banks, whether or not they represent the investment of deposits received from overseas.

Exchequer The word " Exchequer " is normally used to mean the Account of H.M. Exchequer, held mainly at the Bank of England. This is the central cash account of H.M. Government. By law all revenue, with a few exceptions, must be paid into this account and nothing may be paid out except as authorised by Parliament. A summary of all transactions over this account is provided annually in the *Financial Statement* issued on budget day and subsequently in the *Finance Accounts of the United Kingdom*, and also weekly in the *Exchequer Return* issued by the Treasury and published in *The London Gazette*.

Transactions over the Exchequer account can be divided into three broad categories:

(i) taxation and other revenue and expenditure (both current and capital), whether voted annually by Parliament (" supply services ") or for which there is a permanent authorisation (" Consolidated Fund standing services "). The net total of this item is called the Exchequer's surplus or deficit;

(ii) loans to, and repayments by, local authorities, nationalised industries and a few other bodies (known officially as " Consolidated Fund loans "); and

(iii) all other transactions, largely receipts and payments reflecting changes in the National Debt (grouped together, both in the *Financial Statement* and in the *Exchequer Return*, under the heading " Exchequer borrowing and special transactions ").

A study of the Exchequer account by itself cannot give any complete guide to the flow of central government spending. The Exchequer rarely deals direct with the general public, and most of its transactions are with other government departments. It is the transactions of these departments with the public which affect the economy. These departments effectively pool their cash resources with the Exchequer; so changes in the amount they lend to the Exchequer, mainly included in extra-Exchequer funds, reflect any difference between the Exchequer's net outlay and the net amount paid out to the public.

Extra-Exchequer funds Table 1 first shows the net amount paid out, or received, by the Exchequer in the first two categories mentioned above (that is its deficit, or surplus, and the net amount of Consolidated Fund loans); it then brings into the account Exchequer lending to, or borrowing from, extra-Exchequer funds. Changes in extra-Exchequer funds arise from a variety of causes. In the first place, as already noted, they reflect changes in the cash balances of government departments. These departments do not themselves maintain any significant deposits with the commercial banks; instead their balances are kept in an account with the Paymaster General—who holds only a small cash balance at the Bank of England and lends the rest to the Exchequer in the form of ways and means advances. In this way funds drawn by government departments from the Exchequer under parliamentary authorisation but not yet spent are automatically lent back to the Exchequer until actually required.

Secondly, changes in extra-Exchequer funds reflect alterations in the amount of government debt, whether short or long-term, held by certain funds which are statutorily independent of the Exchequer but which are administered by the central government. The main example is the National Insurance Funds. Contributions under the national insurance schemes from insured persons and employers are not, like tax revenue, paid direct to the Exchequer; instead they are credited to the National Insurance Funds administered by the Ministry of Pensions and National Insurance, which pass surplus money to the National Debt Commissioners for investment. These Funds also receive an annual grant from the Exchequer, as well as interest from their investments in government debt. Any excess of total receipts over expenditure, both on benefits and on administration, is immediately invested in government debt, and any shortfall is financed by selling government debt. In this way the operations of the National Insurance Funds, though separate from the Exchequer, are brought into its accounts—a surplus reducing the total amount the Exchequer has to borrow from other sources and a deficit increasing it.

Thirdly, receipts from extra-Exchequer funds include the net income of the Issue Department of the Bank of England. By statute the income of the Issue Department is paid over to the E.E.A. and goes to increase the Account's sterling resources (and hence its holdings of government debt). In this table, however, the income is kept separate from the E.E.A.'s other transactions.

A fuller description of transactions included under the heading extra-Exchequer funds is given in the notes at the end of this article.

Central government's net balance By combining the Exchequer surplus or deficit and Consolidated Fund loans with extra-Exchequer funds, the central government's net balance thus measures the finance needed to meet the net expenditure, including lending, of the central government as a whole—including, for example, the National Insurance Funds—rather than just that of the Exchequer. It reflects payments at the time they are made by the spending departments rather than when the funds are provided by the Exchequer; and it is not affected by Exchequer transactions with other government accounts.

Exchange Equalisation Account Table 1 now turns to external transactions. In the United Kingdom the official gold and foreign currency reserves are held by the Exchange Equalisation Account, a government account operated by the Bank of England. In addition to gold and foreign currencies, the Account holds sterling, which is all lent to the Exchequer against Treasury bills or, through the Paymaster General, in the form of ways and means advances. To pay for its purchases of foreign exchange day by day the E.E.A. withdraws sterling from the Exchequer, so increasing the Exchequer's need to borrow from other sources. Conversely, when the Account sells exchange it acquires sterling which it lends to the Exchequer, so reducing the Exchequer's need to borrow from elsewhere. The Account also carries gains or losses arising from the weekly revaluation of the assets of the Issue Department of the Bank of England, and receives the income earned on those assets.

Normally, the sterling resources available to the E.E.A. are adequate to ensure that frequent changes in the capital of the Account are not required. But substantial changes in the level of its foreign currency holdings will ultimately be reflected in an increase or a reduction of capital by means of a sterling transfer from or to the Exchequer. Such transfers are made periodically in round amounts and represent only a matter of book-keeping between two government accounts, because the increase or decrease in the Account's sterling assets immediately gives rise, other things being equal, to an increase or decrease of the same amount in its lending to the Exchequer. In other words, any change in the Account's capital merely ensures that it has an appropriate working capital in sterling immediately available to cover its needs; the change itself has no net effect on the Exchequer's borrowing from outside the central government. An increase, or decrease, in such borrowing occurs only as the E.E.A. uses the sterling to buy foreign exchange, or as it receives sterling from sales of foreign exchange. For these reasons, the item E.E.A. in the table merely records, in sterling, the change in the official reserves; an increase is shown as a payment of sterling by the Exchequer and a decrease as a receipt.(1)

Overseas holdings of government debt "External transactions" include not only changes in the E.E.A.'s holdings of gold and foreign currency reserves but also any increase or decrease in overseas holdings of government stocks and of Treasury bills, and any change in other forms of debt to overseas. The last named category includes changes in the United Kingdom's net position with the International Monetary Fund, that is any increase in the U.K. subscription to the Fund less any change in the Fund's holdings of interest-free notes; other government borrowing (and repayment of borrowing) from overseas governments and institutions; and the sterling counterpart of central bank assistance in the form of currency deposits. It does not include other government transactions with overseas, such as lending to

(1) Even allowing for transfers of the net income of the Issue Department (referred to earlier), the net amount of sterling withdrawn from, or made available to, the Exchequer may in practice differ slightly from the change in the reserves, and the difference is included under "extra-Exchequer funds"; the reason for this difference is explained in the notes at the end of the article.

overseas governments or current expenditure abroad; these are taken into account in calculating the central government's net balance.

Total external transactions The total of external transactions is unaffected by transactions which result in both a change in the E.E.A.'s holdings of foreign currencies and also an equal change in overseas holdings of government debt. Thus an inflow of funds from abroad for investment in government debt appears in the table as a payment by the E.E.A., offset by an increase in one of the other items included in this group; in other words the increase in overseas lending to the Exchequer matches the additional Exchequer borrowing necessary to finance the E.E.A.'s purchase of the foreign currencies, and no extra finance is made available to the Exchequer. A fuller discussion of the effect on the economy of inflows and outflows of foreign funds will be found in the June 1962 *Bulletin*.

For similar reasons government borrowing from abroad does not normally affect the total of external transactions. If the Government borrow foreign currency from abroad, this is sold to the E.E.A. for sterling; but to provide the sterling the E.E.A. has to withdraw funds from the Exchequer, with the result that the Exchequer finishes up as it was. These transactions appear in Table 1 as a payment by the E.E.A. offset by a receipt under overseas holdings of " other debt ". A loan received from abroad in sterling usually has the same effect because the lender first needs to purchase sterling from the E.E.A.: if the lender already holds the sterling in, say, Treasury bills, a direct loan to the Government merely results in a switch from one form of government debt to another.(1)

The support for the reserves received in the last eighteen months or so from overseas central banks and the I.M.F. was a particular form of overseas official borrowing; and none of it, in itself, had any net effect upon the amount of sterling finance available to the Exchequer. The central bank assistance was partly in the form of swaps against sterling and partly in the form of foreign currency deposits. On the receipt of both types of aid the foreign currencies were sold to the E.E.A. for sterling. In the case of swaps the sterling was subsequently held on behalf of the central bank undertaking the swap and was usually employed for it in Treasury bills; the Exchequer tables thus record a payment by the E.E.A. matched by an increase in overseas holdings of Treasury bills. In the case of foreign currency deposits the sterling counterpart was also held in Treasury bills, but these bills were not directly owned by the central banks concerned and are recorded among " other debt ". The drawings from the I.M.F. had a similar effect—a payment of sterling by the E.E.A. offset by increased lending by the Fund to the Exchequer, which is included, like the sterling counterpart of foreign currency deposits, among " other debt ".

Thus the total of external transactions is unaffected by any inflow or outflow of overseas funds invested in government debt, or by almost all forms of government borrowing from abroad. Without there being any strict correspondence, there is, however, a broad relationship between this item and the balance of payments, a large balance of payments deficit being reflected by a surplus on external transactions and vice versa. This is because the balance of payments surplus or deficit during a particular period is normally matched, to a large extent, either by a change in the E.E.A.'s holdings of gold and foreign currencies, or by a change in overseas holdings of government debt. The total of external transactions will, however, fail to reflect a surplus or deficit to the extent that such an out-turn gives rise to a change in the net overseas liabilities of U.K. banks, local authorities or the private sector—for example, a change in overseas deposits with the banks, local authorities or hire-purchase finance companies.

Methods of financing Unlike governments in some other countries, the U.K. Government have virtually no cash balances to draw on, nor do they build up temporary surpluses, seasonal or otherwise, on a bank account for use when required. Government deposits with the commercial

(1) However, in the rare case of sterling which has been invested by an overseas holder in local authority or private sector debt then being lent to the Government, there would be a single positive entry under " external transactions ".

banks are relatively small and stable: they are largely the working balances of those departments that need to maintain accounts throughout the country for local disbursements and receipts. Nor does the balance on the Exchequer account itself vary much. As was explained in the article " The management of money day by day " in March 1963, the authorities aim to maintain a daily balance of £2 million altogether on the accounts of the Exchequer and of the Paymaster General with the Bank of England. Any excess of government payments over receipts is matched by an increase in the amount of government debt held outside the central government; and any excess of receipts over payments by a reduction of such debt.

There are in effect five main instruments through which the central government borrow from the public—national savings in various forms, tax reserve certificates,[1] government stocks, Treasury bills, and (through the Issue Department of the Bank of England) bank notes. Only the last three forms call for some explanation here.

New issues of government stocks are made from time to time either by conversion of a maturing stock or for cash. Except where the terms include a cash payment, no money passes on a conversion issue and it therefore has no effect on Exchequer finance. Issues for cash are customarily made for amounts larger than could reasonably be taken up by the public on one day; they are therefore usually taken up mainly by the Issue Department and later on-sold to the market. Similarly, in order to avoid large disturbances in the market on the day a stock is redeemed, maturing issues are mostly bought from the market by the Issue Department during the preceding weeks or months. Apart from selling newly-issued stocks and buying maturing stocks, the monetary authorities in effect act as residual jobbers in the gilt-edged market, selling or buying other stocks largely in response to market demand. Such transactions with the public are usually made by the Issue Department, though occasionally by the National Debt Commissioners. Thus the net amount of stocks acquired, or disposed of, by the public depends not only on the amount of new issues and redemptions but also on the amount of net sales from, or purchases by, official accounts. Changes in the public's holdings of stocks are analysed by holder in Table 3 (i) of the annex.

Treasury bills are issued each week by tender, and also, at any time, direct to government departments and other official holders.[2] Bills issued initially to the public at the tender may subsequently be bought for official portfolios and those issued direct to official holders may be on-sold to the market. It is thus the changes in the total amount of bills held outside official hands (known as the total of market Treasury bills) which are significant in relation to Exchequer finance. These changes, which may be very different from changes in the total of tender bills outstanding, are also analysed by holder in Table 3 (i) of the annex.

Bank notes issued by the Issue Department of the Bank of England are backed almost entirely by government debt; and any change in the total amount of notes issued is directly matched by a similar change in the amount of government debt held. It is therefore convenient to regard the holders of Bank of England notes as the real source of the lending to the Exchequer represented by the Issue Department's holdings of government debt, and in the table changes in holdings of notes are classified according to the holder. Furthermore, Bank of England notes held by the Scottish and Northern Ireland banks as backing for their own note issues are classified according to the holders of the Scottish and Irish notes.

Domestic borrowing

Changes in overseas holdings of government debt have already been included under external transactions. The lower half of Table 1, under " domestic borrowing ", now shows the changes in the amount lent to the central government in various ways by all U.K. residents. Changes in the holdings of the banking sector are grouped separately from those of other holders because they have different consequences for monetary policy.

Borrowing from the banks

The banking sector, which includes the Banking Department of the Bank of England, provides such residual finance as the Government cannot

[1] For a description of tax reserve certificates see the September 1962 *Bulletin*.

[2] For a further description of U.K. Treasury bills and their method of issue see the September 1964 *Bulletin*.

immediately borrow from others. This is because any excess of payments from official accounts over receipts, not matched by an increase in borrowing from outside the banking sector (such as higher outside holdings of Bank of England notes, or of Treasury bills, or of government stocks), puts cash in the hands of the banks. In practice, this cash in the first instance takes the form of balances with the Banking Department of the Bank of England.

An individual bank can retain its surplus balance with the Banking Department; it can use it to buy government stocks or Treasury bills, or lend it to the discount houses, which may themselves buy stocks or Treasury bills; or it can use it to make advances, to buy commercial bills (direct or by lending to the discount houses, which may use it for this purpose), or to invest in other private sector debt.

In practice, the surplus cash is unlikely to be retained in the form of a balance with the Banking Department, because the banks and discount houses avoid holding higher, non-earning, balances than they need. But even if it were, it would be invested in government debt at one remove—since it would give rise to an increase in the Exchequer's net indebtedness to the Banking Department.

The choice for an individual bank, therefore, is usually either to use surplus cash to buy government debt or to use it to lend to the private sector, direct or through on-lending by a discount house. But lending to the private sector—though it may reduce the surplus cash of an *individual* institution—will do nothing, in itself, to reduce the cash of the banks as a whole.[1] (The banks' total private sector assets, and deposits, might rise enough to make the cash they hold no longer surplus; but in that case it would remain in the form of banks' balances with the Banking Department and would be invested by the Banking Department in government debt) The surplus cash of the banks *as a whole*, however, can be reduced through their purchases of government debt, usually stocks or Treasury bills—the latter either through the authorities' day-to-day operations in the money market, or through the weekly tender.

Thus the Government's residual finance is initially provided, one way or another, by the banking sector—although in the long run a considerable increase in the banking sector's holdings of government debt, and in their deposits, normally leads to more government debt being taken up by holders outside the banking system. Since, as noted earlier, the banks and discount houses avoid holding more cash (in the form of balances with the Banking Department) than they need, fluctuations in government borrowing from the banking sector are normally reflected in the amount of government debt held by the banks and discount houses rather than by the Banking Department. From time to time there are substantial movements in the Exchequer's net indebtedness to the Banking Department; but these rarely reflect the provision of much extra finance for the Exchequer;[2] they normally result from transactions within the banking sector. These, for example, could include changes in bankers' balances consequent on seasonal or other movements in the banks' total deposits, or in their holdings of bank notes; or changes in Special Deposits; or changes in Bank of England advances to the discount market.

Summary To sum up, Table 1 now classifies Exchequer transactions in three main categories: those making up the central government's "net balance"; "external transactions"; and "domestic borrowing". The central government's net balance is a measure of net government expenditure (including lending) resulting broadly from decisions of a budgetary nature; while the total of external transactions largely corresponds to the U.K. balance of payments position (both on government and on private account)—though only so far as that position is reflected in changes in the

(1) The banks' cash would however be subsequently reduced if, for example, the increase in bank lending to the private sector led to a larger take-up of government debt by the private sector or to greater expenditure overseas.

(2) There is normally little movement either in the Banking Department's investments in private or overseas debt or in its liabilities to private or overseas customers. Its largest customers in these groups are overseas central banks, and any surplus funds on their accounts are usually automatically employed on their behalf in government debt (and included among overseas holdings under "external transactions").

reserves or in overseas holdings of government debt. The balancing total of domestic borrowing represents the consequent domestic financing requirement. The three sub-totals are not wholly independent (for example, government expenditure overseas is included both as a debit within the central government's net balance and if it is spent in foreign currency, which has to be purchased from the E.E.A., as a positive entry within " external transactions "); nevertheless the table illustrates that the amount the central government need to borrow from domestic sources depends not only on their own revenue and expenditure but is also related to the country's balance of payments position.

The total of the Exchequer's domestic borrowing is then analysed to show the impact on the banking system. To the extent that the central government's requirements are not met from sources outside the banking system the banks' total lending to the Government will rise alongside a similar increase in their deposits. Conversely an increase in non-bank holdings of government debt will, other things being equal, be accompanied by a decrease both in bank lending to the Government and in bank deposits.

Notes to Table 1 of the statistical annex

Exchequer

Revenue and expenditure (net): the difference between expenditure and revenue as shown in the weekly *Exchequer Return*, a positive figure representing a surplus and a negative figure a deficit. There is normally a deficit in the first three quarters of the financial year followed by a very large surplus in the last quarter, when tax revenue is at its greatest.

Consolidated Fund loans (net): the net amount disbursed by the Exchequer as loans (mostly to finance capital expenditure) to nationalised industries, to the Local Loans Fund for on-lending to local authorities, and to some other bodies. To the extent that these loans are not financed by a surplus of revenue over expenditure, the Exchequer is in effect fulfilling the function of a financial intermediary, *i.e.*, it is borrowing in the market in its own name and on-lending the funds mostly to other members of the public sector.

Extra-Exchequer funds, etc.: these comprise the following items.

(i) Changes in the total amount lent to the Exchequer, whether against stocks, Treasury bills, ways and means advances or other forms of government debt, by:

(*a*) the National Insurance Funds and various other government funds;

(*b*) the Local Loans Fund, representing funds in transit to, or repayments by, local authorities; and

(*c*) the Iron and Steel Realisation Account, representing broadly the proceeds of the resale to the private sector of the nationalised part of the industry, less any funds used to finance capital development in that part of the industry still nationalised, and also less any transfers to the Exchequer.

(ii) Changes in the balances of government departments, mainly with the Paymaster General.

(iii) The net income of the Issue Department of the Bank of England.

(iv) The difference between changes in the official gold and currency reserves and the actual net amount of sterling made available to, or withdrawn from, the Exchequer by the E.E.A. (see below). This difference arises mainly from the E.E.A.'s earnings—including interest received on the Government's holdings of foreign currency securities, which has no sterling counterpart.

(v) The difference between net investment in national savings by the public and the net amounts made available to the Exchequer, either direct or through the National Debt Commissioners (see below).

(vi) The increase in the face value of coin outstanding. The proceeds of sales of coin by the Royal Mint, less costs of production, are in effect included as a receipt under revenue and expenditure (net). However, to achieve consistency with other financial statistics, it is convenient to regard the increase in the public's holdings as a loan to the Government like their holdings of notes; and, to offset this, the increase is also included in extra-Exchequer funds as a government payment.

(vii) Payments to international lending bodies (other than the I.M.F.) in the form of increased subscriptions less withdrawals of interest-free notes (see below).

Exchange Equalisation Account: the figures recorded here are the changes in the official gold and currency reserves. Hitherto the figures shown against this item were the actual amounts of sterling made available to, or withdrawn from, the Exchequer by the E.E.A. (apart from that arising from the transfer to the E.E.A. of the net income of the Issue Department of the Bank of England). The change has been made in order to obtain a common entry —the central government's net balance—in both the Exchequer accounts and the central government capital account. The difference between the two series of figures is small and is now included in extra-Exchequer funds.

Overseas holdings:

Stocks: these figures comprise changes in:

(i) government and government guaranteed stocks registered in the name of a bank or bank nominee company but held for overseas customers, as reported by banks in the United Kingdom; and

(ii) other overseas holdings of government stocks to the extent that they can be identified from the stock registers.

The figures are not complete because the analysis of the stock registers does not yet cover all stocks, and also because it is not possible to identify all overseas holdings held through U.K. agents or nominees other than banks. Any unidentified overseas holdings are included among the residual figures for other domestic holders.

Treasury bills: the figures are taken from Table 20 of the annex. It is assumed that other overseas holdings (that is bills held other than through a U.K. bank) are negligible.

Other debt: these figures are identical with those shown against " other external items " in earlier tables except that they exclude, while the earlier tables included, U.K. subscriptions to the International Bank for Reconstruction and Development and the International Development Agency, less the change in these institutions' holdings of interest-free notes. The change has been made, as with the entries for the E.E.A., to achieve consistency with the central government capital account. The net amount of these transactions, which is now included in extra-Exchequer funds, represents lending by the U.K. Government to third countries through these organisations; and because other government lending overseas is included within the central government's net balance, it is not unreasonable that this should be too.

Banking sector: the figures for changes in the banking sector's holdings of government debt and cash are taken from Table 8 of the annex. No allowance is made for any holdings of tax reserve certificates by the banks, as these are not separately identifiable.

Other holders: the figures for government borrowing from " other holders " are residuals, arrived at by deducting changes in the amounts of government debt held by overseas holders and by the banking sector from the total amount in each category borrowed by the Exchequer from outside the central government.

The figures for national savings record changes in savings at the time when payments and withdrawals are made by the public and include, as an increase in savings, the accrued interest on national savings certificates. An analysis by type of savings is given in Table 3 (ii) of the annex. The amount actually made available to the Exchequer, through the National Debt Commissioners in the case of savings bank deposits, is slightly different, mainly because the Exchequer does not pay out accrued interest on national savings certificates until they are encashed but partly also because of differences in timing. In consequence, an adjustment is included in extra-Exchequer funds.