United Kingdom ONS

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Distinction between public and private sector and between market and non-market public bodies

1 The distinction between public and private sector bodies.

The UK bases its processes on the rules in the European System of Accounts (ESA95). On occasions reference may be made to SNA93, when the ESA does not provide the necessary precision but this is unusual.

Process

The UK operates a formal process for deciding on marginal, large or controversial classification cases. This is fully described on the ONS website. http://www.statistics.gov.uk/about/Methodology_by_theme/bec/downloads/About_NACC.pdf These decisions are taken by a National Accounts Classifications Committee (NACC), which is a committee of national accounts experts chaired by the Director of National Accounts Group. Decisions are authorised at an appropriate level and published on the ONS website with detailed explanations as necessary. Decisions follow the principles of ESA and when necessary are quality assured by Eurostat.

More straightforward cases are decided against a summary of the international rules by government departments, the UK Treasury or ONS officials. (See CLASS1 note attached separately.) They can still be referred to the NACC if any party wishes or the decision is challenged in any way.

Background

UK National Accounts classification decisions are consistent with the principles of the international statistical manuals, the *European System of Accounts 1995* (ESA95) and the *System of National Accounts 1993* (SNA93), and supporting manuals and case law.

Paragraph 2.18 of ESA95 defines how units acting in the economy are grouped into institutional sectors:

> *Each of the sectors and sub-sectors groups together the institutional units which have a similar type of economic behaviour.*
>
> *The institutional units are grouped into sectors on the basis of the type of producer they are and depending on of their principal activity and function, which are considered to be indicative of their economic behaviour. A sector is divided into sub-sectors according to the criteria relevant to that sector; this permits a more precise description of the economic behaviour of the units.*
>
> *The accounts for sectors and sub-sectors record all the activities, whether principal or secondary, of the institutional units covered.*
>
> *Each institutional unit belongs to only one sector or sub-sector.*

Chapter 2 of ESA95, which defines the institutional sectors in the National Accounting system, concentrates on control rather than ownership. For example, paragraph 2.28, which defines public non-financial corporations, states:

> *The sub-sector public non-financial corporations consists of all non-financial corporations and quasi-corporations that are subject to control (see paragraph 2.26) by government units.*

The key paragraph in ESA95 for determining control is 2.26. Although this refers to corporations, it sets out general standards to follow. It is reproduced below:

Control over a corporation is defined as the ability to determine general corporate policy by choosing appropriate directors, if necessary.

A single institutional unit (another corporation, a household or a government unit) secures control over a corporation by owning more than half the voting shares or otherwise controlling more than half the shareholders' voting power. In addition, government secures control over a corporation as a result of special legislation decree or regulation which empowers the government to determine corporate policy or to appoint the directors.

The approach to classification cases is to consider whether there:

(i) is control or influence over an entity's directors through the appointment process; or
(ii) any special factors that enable any part of the public sector to determine general corporate policy, either individually or collectively.

In addition to securing control through power of appointment, ESA95 recognises that control over a corporation can result from legislation, decree or regulation. We therefore examine the situation to see whether any of these apply. The following sections discuss the indicators of control more fully. They are not comprehensive – each case needs examining on its merits.

Detail

Indicator 1 – ownership of the majority of shares if decisions are made on a one share / one vote basis (there are cases where ownership is on a different basis to control). Need to look at ownership of the whole public sector as a number of public sector entities may hold shareholdings which need to be aggregated. This is not relevant in all of the public sector as many UK public corporations do not have shares. Examples of cases where it has been relevant temporarily is when the government has taken control of a private company in difficulty.

Indicator 2 – control of the board of directors through appointments. In many cases this is relatively easy to determine although again it is necessary to look at the total of public sector influence. There may be appointees of different levels of general government and of public corporations which need to be aggregated to assess the situation. Even when the public sector does not control the appointment of directors, they may have the right to veto proposed appointments. This can be seen as an indirect form of control if it influences the choices made. (This right of veto may also be relevant to indicators 3 and 4 below.) Another body, including a subset of the board itself, may be responsible for appointing the directors. In these cases it is necessary to look at the composition of these other bodies to see whether these are majority public sector or not. There may also be timing issues if the government (or the public sector more widely) appoints the first set of directors but does not control the appointment of replacement directors. The body would then be public sector until the initial appointments had expired, provided there was no control of the next set of appointments.

Indicator 3 – control of the appointment of key directors. In cases where control of the board is marginal look at the appointment of key executives, including the chief executive, chairman and finance director. Non-executive directors may also be relevant if they sit on key committees such as the remuneration committee determining the pay of senior staff.

Indicator 4 – control of key committees of the entity. Sometimes key policies of the entity are determined by sub-committees of the board. Examine whether any of these have a majority public sector membership. This can happen under the constitution if it specifies that some public sector members of the board must be on the committee.

Indicator 5 – "Golden Shares". In the UK the government owns a "golden share" in some companies, particularly those which have been privatised. This share gives the government some residual rights to protect the interests of the public and, for example, prevent the company selling off some categories of assets. The share may confer the right to appoint a special director who has strong powers in certain circumstances. The government has indicated that they do not expect to exercise the power of the "golden share" in normal circumstances and the companies' owners/shareholders have accepted the existence of the "golden share" voluntarily. Thus the powers covered by such "golden shares" are seen as contingent and not indicative of control. However if the powers were ever used then the entity would be immediately reclassified to the public sector from that date.

Indicator 6 – regulation. The borderline between regulation and control can be difficult to judge. There are many examples of government involvement through regulation, particularly in areas such as monopolies and privatised utilities, but regulatory involvement itself is not necessarily control. Therefore, it is possible for there to be regulatory involvement in important areas, such as setting prices, without the entity ceding control of general corporate policy. Where regulations are accepted by the entity (ie the entity chooses to operate in a highly regulated environment) this suggests that they are not equivalent to control. However, when the regulation is so tight as to effectively dictate how the entity performs its business, then this is recognised as a form of control.

Indicator 7 – control by a dominant customer. If 100% of sales are to one public sector customer there is clear scope for dominant influence. This can also apply when slightly less than 100% of sales are to one customer, although the presence of a minority customer usually implies an element of independent decision making.

Indicator 8 – controls attached to borrowing from the government. Lenders often impose controls as conditions of making loans. If they are more than would be typical when a healthy private sector entity borrows from a bank, they indicate control.

Indicator 9 – other controls associated with the entities constitution and other rules. There are often a number of formal legal documents underpinning an entity. These need to be examined for indications of control although it is difficult to cover all eventualities. The following list suggests points to watch for to check whether government can:

- determine aspects of how the body delivers its outputs
- have a final say in sale/acquisition of fixed assets
- be entitled to share of proceeds of asset disposals that goes beyond the repayment of previous government support for capital formation
- close the body
- prevent the body from ending its relationship with government
- change the constitution of the body
- decide what sort of financial transactions the body can undertake, or limit them
- prevent the body from receiving certain types of income from other sources
- exert numerous minor controls over how the body is run
- exert financial control (n.b. this is different from funding) as part of a general system of controlling public expenditure
- control dividend policy
- set pay rates
- (for non-regulatary reasons) approve acquisitions.

Indicator 10 – look at the totality of the case to check whether the total impact of all indicators implies control, even when none of them does on its own.

2 Economically significant prices – market or non-market.

The UK uses the standard test for distinguishing between market and non-market entities as set out in ESA95, and reproduced below:

3.32. In order to determine the type of producer and the sector for the private NPIs, a 50% criterion should be applied:

a) if more than 50% of the production costs are covered by sales, the institutional unit is a market producer and classified to the non-financial and financial corporations sectors;

b) if less than 50% of the production costs are covered by sales, the institutional unit is an other non-market producer and classified to the sector NPISH. But other non-market NPIs that are controlled and mainly financed by general government are classified to the general government sector.

3.33. In distinguishing market and other non-market producers by means of the 50% criterion, sales and production costs are defined as follows:

a) sales cover the sales excluding taxes on products but including all payments made by general government or the Institutions of the European Union and granted to any kind of producer in this type of activity, i.e. all payments linked to the volume or value of output are included, but payments to cover an overall deficit are excluded.

This definition of sales corresponds to that of output at basic prices except that:

(1) output at basic prices is only defined after it has been decided on whether the output is market or other non-market: sales are only used in valuing market output; other non-market output is valued at costs;

(2) the payments made by general government to cover on overall deficit of public corporations and quasi-corporations are part or other subsidies on products as defined in paragraph 4.35. c. As a consequence, market output at basic prices includes also the payments made by general government to cover an overall deficit;

b) production costs are the sum of intermediate consumption, compensation of employees, consumption of fixed capital and other taxes on production. For this criterion other subsidies on production are not deducted. To ensure consistency of the concepts sales and production costs when applying the 50% criterion, the production costs should exclude all costs made for own-account capital formation.

The 50% criterion should be applied by looking over a range of years: only if the criterion holds for several years or holds for the present year and is expected to hold for the near future, it should be applied strictly. Minor fluctuations in the size of sales from one year to another do not necessitate a reclassification of institutional units (and their local KAUs and output).

3.34. Sales may consist of various elements. For example, in case of the health care services provided by a hospital sales may correspond to:

a) purchases by employers to be recorded as income in kind paid to their employees and final consumption expenditure by these employees;

b) purchases by private insurance companies;

c) purchases by social security funds and general government to be classified as social benefits in kind;

d) purchases by households without reimbursement (final consumption expenditure).

Only other subsidies on production and gifts (e.g. from charities) received are not treated as sales.

Similarly, the sale of transport services by an enterprise may correspond to intermediate consumption by producers, income in kind provided by employers, social benefits in kind provided by the government and purchases by households without reimbursement.

Publicly-controlled entities considered non-market as a result of this test are classified as general government. Publicly-controlled entities considered market as a result of this test are classified as public corporations.

Sales or subsidies?

The key difficulty here is defining in 3.33a what is a genuine sale and what is a subsidy. In many contracts between government and "public corporations", if we considered the amounts paid as sales then the market test result would be about 100%. If we considered them as subsidies to cover a deficit, then the market test result would be close to 0%.

The following extract from the Class(2000)1 paper agreed with HM Treasury also gives our case law position on "sales".

> Sales are defined as payments for goods and services at economically significant prices. Such prices are economically significant in the sense that they influence the amounts demanded and supplied. A difficult issue is determining whether payments made by a government unit to another public unit in respect of work done should be classified as sales or as grants. In general the payments would be classified as sales if they are related to specific volumes or values of output under arms-length contracts and are not paid if that output is not delivered.

Assessment on economically significant prices

The ESA rules do work and have been generally accepted across government as a classification criterion. The "50%" in the rule has sometimes been challenged but in the majority of cases it seems to give sensible answers by correctly identifying bodies which are acting in a market way. It should perhaps be higher, say 70% or 80%, but any chosen figure will be arbitary.

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