



PRESS RELEASE

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Pre-Budget Report 2004

Gordon Brown shrugged off the uncertainties that surround any forecast for the public finances and insisted in his Pre-Budget Report that he would meet his self-imposed constraints on borrowing without having to cut spending or announce new tax increases.

The Chancellor predicted in March that he would need to borrow £10.5bn this financial year to bridge the gap between tax revenues and non-investment spending. But over the first seven months spending has been stronger and tax revenues weaker than projected for the year as a whole. He would need around £23bn if these trends persist.

This would not be a particularly big error by past standards and neither would it have much direct economic impact. But the risks to the Chancellor's cherished reputation for prudence may be greater – it would put him on course to miss his much-trumpeted “golden rule”, which states he should only borrow on average over the ups and downs of the economic cycle to pay for investment rather than day-to-day spending.

Mr Brown dismissed the possibility that he would suffer this embarrassment. He said spending growth would slow and tax revenues would pick up – buoyed by the lagged impact of higher oil prices. He predicted that the current budget deficit would come in at £12.5bn, only £2.0bn higher than his Budget forecast.

In judging whether the golden rule is being met, the Treasury focuses on the economic cycle it assumes to have begun in 1999–2000. Despite speculation that it might argue that the cycle is already in its last year – a view backed by many independent commentators – the Treasury still maintains that the cycle will end next year in 2005–06.

Indeed, it believes that economic activity is still running 0.8 percent below the level consistent with stable inflation. The remaining slack gave the Treasury scope to stick with its Budget economic growth forecast of 3-3½% in 2005, higher than the 2.5% average of other forecasters.

By increasing its current budget deficit forecast by £2.0bn for this year and £1.4bn next, the Treasury further reduced the amount by which it expects to overachieve the golden rule over the seven-year cycle from £11bn at Budget time (and in excess of £120bn in Budget 2001) to £8bn, including £3.9bn in the reserve for unforeseen spending needs.

This is calculated by summing the surpluses and deficits over the cycle as shares of national income. If the rule were judged by adding the cash values, it would be on course to be missed by £1.0bn.

Whether or not the trends in revenues and spending so far this year turn around quickly enough to meet the golden rule in the short term, attention at election time will also focus on whether the rule can be met over the next cycle without the Chancellor having to trim his spending plans or announce fresh tax increases.

Again the Chancellor had no doubts in his speech to the Commons. He predicted that the deterioration in the current budget deficit this year and next would correct itself and that the position from 2006–07 onwards would be in line with what he expected at Budget time.

The Chancellor expects the current budget to move steadily back into the black. Even excluding any improvement arising automatically from the Treasury's expectations of a stronger economy, the underlying current budget balance is forecast to move from a deficit of 0.4% of national income this year to a surplus of 0.8% of national income in 2009–10.

The concrete measures announced in the Pre-Budget Report have only a modest net effect on the public finances. By 2007–08 Mr Brown is planning to spend £600m more on childcare measures, tax vehicle users £720m less, provide other giveaways worth a net £255m, all paid for in part by anti-tax avoidance measures that he hopes will raise £1,230m.

Whether the improvement in the current budget balance materialises on the desired scale depends in large part on whether tax revenues rebound as strongly in the medium term as the Chancellor continues to hope. This relies mainly on a substantial pick-up in corporation tax receipts, which the Chancellor conceded will once again be lower than expected this year.

If tax revenues do not rebound of their own accord, then Mr Brown – or his successor – would need to announce fresh tax raising measures to bring in the revenue needed to finance the government's spending plans and meet the golden rule with the comfort he has always sought.

Whether or not fresh measures have to be announced, the Chancellor is predicting that the tax burden will rise by 2.2% of national income over what is likely to be the next parliamentary term. This represents an increase in taxation equivalent to £26bn in today's money, compared to the £16bn seen since Labour came to office. The view of the voters may depend on whether they think it has been well spent.

ENDS

Notes to editors:

1. This article can be used in its entirety or quoted in part. Please credit the authors as Robert Chote and Carl Emmerson, Institute for Fiscal Studies.
2. A briefing outlining our analysis of the Chancellor's PBR statement will be held at IFS on Friday 3rd December at 1pm. If you would like to attend or have any queries, contact the IFS press office on 020 7291 4800.
3. Our 2005 Green Budget, which will examine the Chancellor's options for the 2005 Budget, will be published in January next year. We are pleased to announce that, for the first time, it will be produced in collaboration with Morgan Stanley. The launch will take place on the morning of Wednesday 26th January. Further details will be circulated nearer the time, but please contact Emma Hyman or Bonnie Brimstone in the IFS press office if you would like to attend.