

IFS analysis of today's public finance figures

Today the Office for National Statistics and HM Treasury published *Public Sector Finances April 2008*. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first month of financial year 2008–09 and revised details for the whole of financial year 2007–08.

IFS public finance bulletins are generously supported by the Economic and Social Research Council.



The analysis is based on IFS calculations and does not reflect the views of the ESRC.

Gemma Tetlow, a senior research economist at the IFS, said:

“Today’s figures show that the Government borrowed slightly less last month than in April 2007, but this is only the first month of the financial year so it gives little clue to the outlook over the year as a whole. The Chancellor will have been pleased to see that the current budget deficit last year was almost £2 billion smaller than it appeared last month. However, a weakening economy is expected to spill more red ink in the months to come. Last week’s mini-Budget will also add about £2.7 billion to the Treasury’s borrowing this year.

The Office for National Statistics also published estimates suggesting that around £92 billion will be added to public sector net debt by the nationalisation of Northern Rock and the associated decision to bring the Bank of England onto the public sector balance sheet. This brings the level of net debt at the end of March 2008 to around 43.1% of national income. In principle this breaches the Government’s pledge to keep public sector net debt below 40% of national income, but it has sensibly said that the rule should be assessed excluding the impact of Northern Rock, much if not all of which can be expected to unwind when it returns to the private sector.”

Headline Comparisons

- **Public sector surplus on the current budget** in 2007–08 is now estimated to have been minus £5.7bn (i.e. in deficit) compared to last month’s estimates which suggested a deficit of £7.6bn, the March 2008 Budget projection of minus £7.9bn (and the March 2007 Budget projection of minus £4.3bn).
- **Public sector net borrowing** in 2007–08 is now estimated to have been £34.3bn compared to last month’s estimates which suggested borrowing of £35.6bn, the March 2008 Budget projection of £36.4bn (and the March 2007 Budget projection of £33.7bn).
- **Public sector net debt** at the end of 2007–08 is now estimated to have been £527.7bn, or 36.7% of national income, the same as last month’s estimates and lower than the March 2008 Budget projection of 37.1% (and the March 2007 Budget projection of 38.2%). This figure excludes the impact of the reclassification of Northern Rock plc and the Bank of England onto the public sector balance sheet. Figures in today’s press release from the ONS show that including the net liabilities of these organisations would increase public sector net debt at the end of March 2008 from £527.7bn to £620.1bn (or 43.1% of national income).

- **Central government current receipts** in April were 3.7% higher than in the same month last year. The 2008 Budget implied that central government current receipts for the whole of 2008–09 would be 4.7% above 2007–08 levels.
- **Central government current spending** in April was 3.6% higher than in the same month last year. The 2008 Budget implied that central government current spending for the whole of 2008–09 would be 5.3% above 2007–08 levels.
- **Public sector net investment** in April was £0.05bn compared to £0.1bn in the same month last year. The Budget predicted that net investment in 2008–09 would be £33.8bn, which is 18.0% above last year's level.

Assessing compliance with the fiscal rules

Gordon Brown operated two fiscal rules during his period as Chancellor and Alistair Darling has continued to operate these since he took over. These are the sustainable investment rule and the golden rule. The Treasury forecasts for the public finances published in March's Budget implied that looking forwards there was virtually no room to manoeuvre against either fiscal rule.

Gordon Brown said in 1998 that in order to stick to his "Sustainable Investment Rule" public sector net debt should be kept below 40% of national income in each year of the economic cycle that the Treasury believes began in 1997–98. The reclassification of Northern Rock's liabilities onto the public sector balance sheet on 7th February 2008 (and its subsequent nationalisation) posed a potential problem for Alistair Darling in meeting the sustainable investment rule as Northern Rock's net liabilities are sufficiently large to push public sector net debt well above the 40% ceiling - the figures published today by the ONS suggest that public sector net debt, including Northern Rock and the Bank of England, stood at 44.5% at the end of December 2007. However, sensibly, the Government have invoked the clause of the Code for Fiscal Stability which allows them to depart from the stated fiscal rule temporarily. So for the period over which Northern Rock has an impact on measures of the public finances they will be operating a modified sustainable investment rule – aiming to keep public sector net debt excluding Northern Rock's liabilities below 40% of national income.

A further risk to Mr Darling's ability to comply with the sustainable investment rule was posed by his announcement on May 13th of changes to the income tax system for 2008–09, which are projected to cost £2.7bn to be funded through additional borrowing. Given the Treasury's Budget 2008 estimate for the size of the UK economy in 2008–09 (£1,405bn), this would represent further borrowing amounting to 0.2% of national income. This would effectively remove what little room for manoeuvre in the future the Chancellor appeared to have against the sustainable investment rule at the time of the Budget, even if he did succeed in making this a purely 'one-off' giveaway. However, Mr Darling may be saved from a potentially embarrassing breach of this fiscal rule by the change to how the ONS treats financial intermediation services in the national accounts. This change will increase the level of national income and so reduce the apparent level of public sector net debt when expressed as a share of national income.

The Treasury's 'golden rule' requires public sector current spending to be met entirely out of public sector receipts over the course of an economic cycle – in other words, that the public sector current budget should be in balance or surplus on average over the cycle. The government should only borrow to finance capital spending. The Treasury estimates that an economic cycle began during 1997–98 but is currently unsure whether this cycle ended (and a new cycle began) in 2006–07, or whether we are about to enter the twelfth year of the same economic cycle. Over the years 1997–98 to 2006–07 there was a small cumulative current budget surplus. Looking forwards, meeting the golden rule will depend on either whether there is a surplus over the years from 2006–07 to when the new economic cycle closes, or whether the cumulative current budget remains in surplus over the years from 1997–98 to when the current economic cycle ends.

The effect of the May 13th 'mini-Budget' on the Chancellor's prospects for meeting the fiscal rules are discussed in more detail in a briefing note also published today by IFS.¹

Further Analysis

Little can be inferred or extrapolated about the public finances in 2008–09 from information about only the first month of the financial year. Bearing this in mind, the figures for receipts and spending in April 2008 show:

Central government current receipts

Receipts from Income tax, Capital Gains Tax and National Insurance Contributions for April 2008 were 8.8% higher than in the same month last year. The Budget forecasts imply that these taxes' receipts will grow by 4.6% over the whole of 2008–09.

VAT receipts in April 2008 were 6.8% higher than the same month last year. The Budget forecast implies that VAT receipts will grow by 4.0% over the whole of 2008–09.

Corporation tax receipts for April 2008 were 7.4% higher than the same month last year. The Budget forecast implies that Corporation tax receipts will grow by 9.9% over the whole of 2008–09 .

Central government current spending

Expenditure on net social benefits was 8.3% higher in April 2008 than in April 2007. The Budget forecast implies that central government net social benefit expenditure will grow by 6.7% over 2008–09.

Spending on debt interest (which is relatively small as a share of spending overall) was £3.2bn in April 2008 compared to £2.6bn in April 2007.

Other current spending by central government, including spending on the delivery of public services, was 0.1% higher in April 2008 than in April 2007. The Budget forecast implies that this component of spending will grow by 5.2% over the year as a whole.

Further information and contacts

For further information on today's public finance release please contact: Robert Chote or Gemma Tetlow on 020 7291 4800, or email rchote@ifs.org.uk or gtetlow@ifs.org.uk.

Relevant links:

This, and previous editions of this press release, can be downloaded from http://www.ifs.org.uk/press/pub_fin.shtml

IFS Green Budget, January 2008, containing in-depth public finance analysis, can be found at:
<http://www.ifs.org.uk/budgets/gb2008/index.php>

Useful links and background information on Budget 2008 can be found at
<http://www.ifs.org.uk/budgets/budget2008/index.php>

Office for National Statistics & HM Treasury, Public Sector Finances, April 2008:
<http://www.statistics.gov.uk/pdfdir/psf0508.pdf>

HM Treasury, Budget 2008:
http://www.hm-treasury.gov.uk/budget/budget_08/bud_bud08_index.cfm

HM Treasury, Public Finance Statistics Index:
http://www.hm-treasury.gov.uk/economic_data_and_tools/pubfinance/data_pubfinance_index.cfm

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Notes to editors:

1. "Alistair Darling's mini-Budget: can he afford it?", by R Chote and C Emmerson, IFS Briefing Note 78,
<http://www.ifs.org.uk/bns/bn78press.pdf>
2. Central government current spending includes depreciation.
3. Where possible we compare figures on an accruals basis with the HM Treasury forecast.