

## IFS analysis of today's public finance figures

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

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.

Carl Emmerson, deputy director of the IFS, said:

“Government borrowing over the first five months of the financial year was 70% up on last year, far bigger than the 19% increase implied by Alistair Darling’s forecast for the year as a whole in March’s Budget. VAT cash receipts fell in August, while receipts from Income Tax, National Insurance Contributions and Capital Gains Tax grew only weakly. Meanwhile, growth in public spending accelerated further above the increase forecast in the Budget.

Borrowing this year would come in at around £65 billion if the underlying increase seen so far this year persists, taking into account the £3.6 billion giveaways to income tax payers, motorists and house buyers that the Government has announced since the Budget. At a 13-year high of around 4.4 per cent of national income this would be the biggest deficit since before Labour came to power. Further increases in borrowing in 2009–10 are also possible given the Bank of England’s August forecast that economic growth will be as weak in 2009–10 as in 2008–09, and that the full effect of this on the public finances will only be felt with a lag.

The Bank’s growth forecasts alone suggest that borrowing might be almost £30 billion higher in 2010–11 than the Chancellor predicted in March. This suggests that public sector net debt, even excluding the impact of Northern Rock, is likely to break decisively through the Government’s ceiling of 40 per cent of national income. The big question for fiscal policy over the next few years is how much of the big increase in borrowing, and therefore debt, that now looks inevitable in the near term is temporary and how much will persist when economic output returns to a sustainable level. The more borrowing persists, the bigger the tax raising measures and cuts in public spending plans that would be required to get the public finances back into good shape.”

### Headline Comparisons

- **Central government current receipts** in August were 1.8% higher than in the same month last year. Receipts in the first five months of 2008–09 were 2.3% higher than in the same months of 2007. The 2008 Budget implied that central government current receipts for the whole of 2008–09 would be 5.0% above 2007–08 levels.

- **Central government current spending** in August was 7.8% higher than in the same month last year. Spending in the first five months of 2008–09 was 6.4% higher than in the same months of 2007. 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 August was £2.6bn, compared to £1.7bn in the same month last year. Together, public sector net investment during the first five months of 2008–09 has been £8.8bn, which is 38% higher than in the same months of 2007. The Budget predicted that net investment in 2008–09 would be £33.8bn, which is 17.9% above last year's level.

### **Assessing compliance with the fiscal rules**

Since coming to power, the Labour government has operated two fiscal rules – 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 little 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. Given that the impact of Northern Rock on measures of the public finances is expected to be temporary, the Treasury sensibly announced at the time of the Budget that it would operate a modified sustainable investment rule over this period – aiming to keep public sector net debt excluding Northern Rock's liabilities below 40% of national income.

Since 1998–99 public sector net debt has been kept below 40% of national income excluding Northern Rock. Mr Darling's May 13<sup>th</sup> mini-Budget announcement of a £2.7bn giveaway to basic-rate income tax payers this year<sup>1</sup>, his July 16<sup>th</sup> announcement of a postponement in the increase in fuel duties planned for 1<sup>st</sup> October 2008 costing £550m this year, and his September 2<sup>nd</sup> announcement of a twelve month postponement of stamp duty on purchases of residential property worth between £125,000 and £175,000 costing at £600 million of which around half will fall this year, would on their own leave him virtually no room left to manoeuvre against the sustainable investment rule over the next few years (even assuming that Mr Darling makes these giveaways purely one-off). But this effect is likely to be dwarfed by the impact of the economic slowdown, with the Bank of England and other forecasters predicting much weaker growth now than the Treasury did at the time of the Budget. Mr Darling may get some offsetting help from a change to the treatment of financial intermediation services in the national accounts, however. This will increase the level of measured 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 now in 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 either on whether there is a surplus over the years from 2006–07 to when the new economic cycle closes,

or on whether the cumulative current budget remains in surplus over the years from 1997–98 to when the current economic cycle ends.

## **Further Analysis**

We must be wary of assuming that the trends over the first five months of the financial year will persist over the remaining eight. Bearing this in mind, the figures for receipts and spending in August 2008 show:

### **Central government current receipts**

Cash receipts of Income Tax, Capital Gains Tax and National Insurance Contributions for August 2008 were 1.8% higher than in the same month last year. Together, receipts of these taxes during the first five months of 2008–09 were also 4.3% higher than those for the first five months of 2007–08. The Budget forecasts imply that receipts of these taxes will grow by 4.6% over the whole of 2008–09.

Cash receipts of VAT in August 2008 were 1.8% lower than the same month last year. Overall VAT receipts over the first five months of 2008–09 were 4.7% higher than those for the same months in 2007. The Budget forecast implies that VAT receipts will grow by 4.0% over the whole of 2008–09.

Corporation tax receipts for August 2008 were 30.7% higher than in the same month last year. Corporation tax receipts over the first five months of 2008–09 were 4.2% higher than those for the same months last year. The Budget forecast implies that corporation tax receipts will grow by 10.6% over the whole of 2008–09.

### **Central government current spending**

Expenditure on net social benefits was 4.3% higher in August 2008 than in the same month last year. Expenditure over the first five months of 2008–09 was 8.3% higher than in the same months of 2007. The Budget forecast implies that central government net social benefit expenditure will grow by 6.2% over 2008–09.

Spending on debt interest (which is relatively small as a share of spending overall) was £3.3bn in August 2008, which is 6.4% higher than in August 2007.

Other current spending by central government, including spending on the delivery of public services, was 9.5% higher in August 2008 than in the same month last year. Comparing the first five months of 2008–09 with the first five months of 2007–08, the figure is 5.1%. The Budget forecast implies that this component of spending will grow by 5.3% over the year as a whole.

In August 2008, **public sector net investment** was £2.5bn compared to £1.7bn in the same month in 2007. So far in 2008–09, a total of £8.8bn has been spent on public sector net investment, compared to the £6.3bn that had been spent by the same point in 2007–08. The Budget predicted that net investment in 2008–09 would be £33.8bn, which is 17.9% above last year's level.

### Further information and contacts

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The next *Public Sector Finances* is due to be published by the Office for National Statistics on 20<sup>th</sup> October 2008.

Relevant links:

This, and previous editions of this press release, can be downloaded from [http://www.ifs.org.uk/press/pub\\_fin.shtml](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, August 2008:  
<http://www.statistics.gov.uk/pdfdir/psf0908.pdf>

HM Treasury, Budget 2008:  
[http://www.hm-treasury.gov.uk/budget/budget\\_08/bud\\_bud08\\_index.cfm](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](http://www.hm-treasury.gov.uk/economic_data_and_tools/pubfinance/data_pubfinance_index.cfm)

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Notes to editors:

1. For discussion of the impact of this mini-Budget on individuals and the public finances see “The 10p tax rate: where next?”, by S. Adam, M. Brewer and R. Chote, IFS Briefing Note 77, <http://www.ifs.org.uk/bns/bn77.pdf> and “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.