Analysis of ONS revision to accounting of some Government spending on the repair and maintenance of roads

The Office for National Statistics today detailed revisions to the accounting of some government spending on the repair and maintenance of roads. They improve Gordon Brown’s chances of meeting his “golden rule”, one of the key targets he has laid down for management of the public finances.¹

The revisions redress an inconsistency in the way in which some current spending, depreciation and gross investment spending were counted in the public finances. Prior to today’s changes, the spending required to maintain road quality was scored in both depreciation and current spending excluding depreciation. This double counting led to total current spending (including depreciation) being overstated and public sector net investment being understated by a similar amount.

These revisions improve Gordon Brown’s chances of meeting his “golden rule”. This states that on average over the economic cycle the government can borrow to pay for capital spending, because this is likely to benefit future taxpayers as well as today’s. But current spending (including depreciation) is assumed only to benefit today’s taxpayers, so it has to be covered on an ongoing basis by tax revenues and other government receipts. (The Treasury estimates that the current economic cycle covers the seven financial years from 1999–2000 to 2005–06).²

By reducing estimates of current spending (including depreciation) since 1998–99, the revisions increase the amount that the government can borrow over the remaining year of the economic cycle without breaking the golden rule. Specifically:

- The revisions reduce estimated cumulative current spending (including depreciation) since the beginning of 1999–2000 to the end of last year, 2003–04, by £2.1 billion to £1,921.5 billion. Public sector net investment (capital spending) between 1999–2000 and 2003–04 rises from an estimated £45.3 billion to £47.3 billion.

- If the revisions have effects of similar magnitude looking forward, there would be a £0.4 billion reduction in expected future annual current spending (including depreciation) and an equivalent increase in expected capital spending.

- The shift from current to capital spending is in the same direction as previous revisions. Initial Treasury estimates of the capital/current split in the first five years of the economic cycle showed current spending (including depreciation) averaging 97.9% of total public spending.³ Previous revisions reduced the proportion to 97.8% and today’s reduce it further to 97.7%.

- Under the assumption that the latest revisions persist in the future, the Chancellor could borrow an extra £3.4 billion over the remaining months of the economic cycle without breaking the golden rule (assuming that the economic cycle ends in 2005–06). This is not the same as the downward revision in the cash value of current spending between 1999–2000 and 2005–06, because the Chancellor assesses the golden rule by looking at the current budget balance in each year as a share of national income rather than in cash terms.

- The Treasury forecast in the December 2004 Pre-Budget Report that the Government would achieve the golden rule with £5 billion to spare over the current economic cycle. Today’s revisions increase its room for manoeuvre on the basis of the same forecasts (and the latest information on outturns for previous years) to £8.3 billion. This
assumes that the Chancellor will not need to spend the £3.5 billion reserve he has put aside for unexpected current spending needs. Assuming that this reserve is not spent, the revisions increase the amount by which the Treasury expects to overachieve the golden rule from £8.3 billion to £11.6 billion.

Commenting on today’s numbers Christine Frayne, a Senior Research Economist at the IFS, said:

“Today’s revisions allow the Chancellor to fund about an extra £3 billion more current spending through borrowing over the remaining months of the current economic cycle, without increasing the probability of the golden rule being missed. This increases the amount that the government can borrow for this purpose this year and next from around £25 billion to £28 billion, compared to the Treasury’s December forecast that it would actually borrow £20 billion.

Coming less than three weeks before what is likely to be a pre-election Budget, this increase in the Chancellor’s room for manoeuvre might seem conveniently timed. But there is no evidence that the ONS has acted improperly in making today’s revisions. However, the episode underlines the importance of ensuring not only that official statistics are free of undue political influence, but also that the public is confident that this is the case.

Over the medium term, the revisions suggest that the Chancellor will be able to borrow around £0.4 billion more each year to finance current spending without increasing the probability of breaking the golden rule in future economic cycles. This is a very modest sum compared to typical errors in forecasting the public finances.

It is important to remember that the distinction between current and capital spending is an imprecise one at the best of times. And it is not the case that capital spending always benefits future taxpayers and current spending only benefits today’s. This means that the golden rule is an imperfect way to ensure that the burden of paying for government spending is shared ‘fairly’ between different generations of taxpayers, and is a best a reasonable rule of thumb. Whether it is met or missed by a few billion pounds either way has much less direct economic significance than the importance placed upon it in the pronouncements of Treasury ministers might sometimes suggest.”

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Notes

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2 For further details of the Chancellor’s fiscal rules and progress towards them see, for example, chapters 2 and 4 of the January 2005 IFS Green Budget (http://www.ifs.org.uk/budgets/gb2005/index.php).

3 Initial estimates for each financial year come from the Pre-Budget Report, just over six months after the end of the financial year.