IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published Public Sector Finances July 2006. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first third of financial year 2006–07.

Headline Comparisons

- **Central government current receipts** in July were 11.4% higher than in the same month last year. Receipts in the first four months of 2006–07 were 7.1% higher than in the same months of 2005–06. The 2006 Budget implied that central government current receipts for the whole of 2006–07 would be 6.3% above 2005–06 levels.

- **Central government current spending** in July was 5.8% higher than in the same month last year. Spending in the first four months of 2006–07 was 8.4% higher than in the same months of 2005–06. The 2006 Budget implied that central government current spending for the whole of 2006–07 would be 4.8% above 2005–06 levels.

- **Public sector net investment** in July was £2.1bn, or 57.3% higher, than in the same month last year. Together, public sector net investment during the first four months of 2006–07 has been £5.6bn, which is 20.9% higher than in the same months of 2005–06. The Budget predicted that net investment in 2006–07 would be £28.8bn, which is 11.7% above last year’s level.

Gemma Tetlow, a research economist at the IFS said:

“The figures for government receipts in July will be encouraging for the Chancellor. In particular, Corporation Tax receipts have grown strongly, even after taking account of changes to the timing of payments from North Sea oil companies. Income Tax receipts also appear to have grown strongly although the extent to which this is explained by changes to the exact timing of receipt of self-assessment revenues due on 31 July will not be clear until next month.

Less encouraging for the Chancellor are this month’s figures for spending on social security and tax credit payments. These show that spending on these items continues to grow more strongly than was predicted in Budget 2006. In part this might be due to recent rises in claimant unemployment, which are greater than was assumed by the Treasury at the time of the Budget.

As a result, over the year to date, the deficit on the current budget is now 22% below the same four months last year. Over the whole year, the Treasury forecast requires a reduction on 49%. While the year to date has still been disappointing for the Chancellor, today’s figures bring us a step closer to meeting the Budget forecast.”
Assessing compliance with the golden rule

The Chancellor’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 can only borrow to finance capital spending.

In the 2006 Budget the Treasury estimated that the present economic cycle began in 1997–98 and would close in 2008–09, in line with its Pre-Budget Report 2005 judgement. As discussed in more detail in last month’s press release, revisions to national accounts data published on 30 June 2006 raised the possibility that the Treasury would once again have to revise its dating of the cycle. In particular, economic growth had been stronger in recent years than previously thought.

One possibility is that the Treasury could conclude that, rather than continuing to 2008–09, the cycle which began in 1997–98 ended in either 2003–04 or 2004–05, and that a fresh cycle started in the same year. Over a cycle running from 1997–98 to 2003–04 there would have been a cumulative surplus on the current budget of 3.8% of one year’s national income, corresponding to £49bn in today’s prices. So the golden rule would have been met. But over the first 3 years of the next cycle (2003–04 to 2005–06) there would already have been a cumulative deficit of 4.6% of one year’s national income, or £59bn in today’s prices. With the national accounts revisions implying that the economy would probably be back ‘on trend’ in 2008–09 or earlier, it seems highly unlikely that the golden rule would be met over this period.

It is far from a foregone conclusion that the Treasury will change the date of the cycle in this way. Even if it concedes that the economy moved above trend from late 2003 to late 2004, it may argue that that it did so by an insignificant amount and that this ‘mini-cycle’ should be considered as part of a longer cycle. This would be consistent with its decision last year to add 1997–98 and 1998–99 into its definition of the current cycle.

Further Analysis

Little can be inferred or extrapolated with confidence about the public finances in 2006–07 from information on only the first third of the financial year. Bearing this in mind, the figures for receipts and spending in July 2006 show:

Central government current receipts

Corporation Tax receipts for July 2006 were 35.8% higher than in the same month last year. Corporation Tax receipts for the first four months of 2006 were 18.1% higher than those for the same months last year. The Budget forecast implies that Corporation Tax receipts will grow by 15.3% over the whole of 2006–07. Changes to the timing of tax payments paid by North Sea oil companies introduced in Budget 2005 will subdue receipts in April 2006 and boost receipts in July and October 2006 and January 2007. This will explain some of the high growth in receipts seen in July but nonetheless receipts over the first four months of 2006–07 (i.e. including April 2006) are still running ahead of the Treasury projection for the whole of 2006–07.

Receipts of Income Tax and Capital Gains Tax for July were 14.0% higher than in the same month last year. Together, the receipts for these taxes during the first four months of 2006–07 were 8.2% higher than those for the same months in 2005–06. The Budget forecasts imply that these taxes’ receipts will grow by 7.0% over the whole of
The strong growth in July’s receipts is at least in part due to the timing of the part of self-assessment income tax payments that are due on 31 July each year. In 2006, 31 July fell on a Monday, enabling more cash payments to reach the government in July than in 2005 when 31 July fell on a Sunday.

Net cash receipts of National Insurance Contributions were 13.3% lower in July 2006 than in the same month last year and for the first four months of 2006–07 were 0.6% higher than in the same months in 2005–06. The Budget forecasts imply that these taxes’ receipts will grow by 4.8% over the whole of 2006–07. The fall in net cash receipts is explained by contracted-out rebates being paid to personal pension funds earlier in 2006–07 than in 2005–06. Accrued receipts of National Insurance Contributions were 2.4% higher in July 2006 than in the same month last year and for the first four months of 2006–07 were 3.4% higher than in the same months of 2005–06. These accrued figures are likely to give a better picture of the underlying pattern to date.

Cash receipts of VAT in July 2006 were 6.8% higher than the same month last year. VAT receipts for the first four months of 2006 were 4.8% higher than those for the same months in 2005. The Budget forecast implies that VAT receipts will grow by 5.0% over the whole of 2006–07.

**Central government current spending**

Expenditure on net social benefits was 5.4% higher in July 2006 than in July 2005. Expenditure during the first four months of 2006 was 5.3% higher than in the same months of 2005. The Budget forecast implies that central government net social benefit expenditure will grow by 2.7% over 2006–07. This was based on the assumption that the claimant unemployment would rise slowly from 0.91 million at the time of the Budget to 0.97 million in 2007–08. Figures published on Wednesday showed that the claimant unemployment count in July 2006 was already 0.96 million.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.2bn in July 2006 compared to £2.1bn in July 2005.

Other current spending by central government, including spending on the delivery of public services, was 6.0% higher in July 2006 than in July 2005. Comparing the first four months of 2006–07 with the same months in 2005–06, the figure is 10.2%. The Budget forecast implies that this component of spending will grow by 5.9% over the year as a whole.

In July 2006, **public sector net investment** was £2.1bn compared to £1.4bn in the same month in 2005. So far in 2006–07, a total amount of £5.6bn has been spent on public sector net investment, compared to the £4.6bn that had been spent by the same point in 2005–06. The Budget predicted that net investment in 2006–07 would be £28.8bn, which is 11.7% above last year’s level.

**Further information and contacts**

For further information on today’s public finance release please contact: Carl Emmerson or Gemma Tetlow on 020 7291 4800, or email cemmerson@ifs.org.uk or gtetlow@ifs.org.uk.

**Relevant links:**

Useful links and background information on the Budget can be found at

Office for National Statistics & HM Treasury, Public Sector Finances, July 2005:

The IFS Green Budget, January 2006:

HM Treasury, Budget 2006:
http://www.hm-treasury.gov.uk/budget/budget_06/bud_bud06_index.cfm

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

ENDS

Notes to editors:
1. Central government current spending includes depreciation.
2. Where possible we compare figures on an accruals basis with the HM Treasury forecast.