IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published *Public Sector Finances July 2007*. 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 2007–08.

Carl Emmerson, a deputy director of the IFS, said:

“Over the first third of this financial year, the public sector current budget deficit was £4.5bn which is £1.3bn larger than in the same period last year. This is due to lower receipts from North Sea oil companies, and slightly higher-than-expected spending by central government, outweighing the effect of strong growth in VAT receipts. The Treasury forecast in the Budget that the deficit would shrink modestly this financial year so, on the face of it, this is disappointing. But as we are only four months into 2007–08 very little can be inferred from what we know so far about the trajectory of the public finances over the whole year.

The beginning of a new economic cycle, and the arrival of Mr Darling as Chancellor, would seem a sensible time to tweak the fiscal framework for the better and to try to help restore credibility. October’s combined Pre-Budget Report and Comprehensive Spending Review would be a good opportunity for the new Chancellor to announce improvements to the fiscal framework. The golden rule should be made more forward-looking, less reliant on our ability to date the economic cycle, and should take explicit account of the significant uncertainty around any fiscal forecast. The Treasury should also consider what measures it can take to boost confidence that future forecasts of the public finances will not be made overoptimistic to delay painful tax and spending decisions. In relation to the sustainable investment rule, Mr Darling is yet to announce whether or not he will continue to aim to keep net debt below 40% of national income. The Treasury should consider whether a broader measure of the public sector’s indebtedness, for example to include more PFI or public sector pension liabilities, and a suitably higher debt ceiling might be more appropriate. While estimates of conventional government debt rarely change significantly, the present value of expected public sector pension liabilities can change significantly with run-of-the-mill revisions to estimates of longevity and the rate used to discount future pension payments.”

**Headline Comparisons**

- **Central government current receipts** in July were 5.5% higher than in the same month last year. Receipts in the first four months of 2007–08 were 5.7% higher than in the same months of 2006–07. The 2007 Budget implied that central government current receipts for the whole of 2007–08 would be 6.8% above 2006–07 levels.
• **Central government current spending** in July was 6.4% higher than in the same month last year. Spending in the first four months of 2007–08 was also 6.4% higher than in the same months of 2006–07. The 2007 Budget implied that central government current spending for the whole of 2007–08 would be 6.0% above 2006–07 levels.

• **Public sector net investment** in July was £0.5bn, or 29.5%, higher than in the same month last year. Public sector net investment has totalled £5.6bn during the first four months of 2007–08, down 8.6% on the same months of 2006–07. The Budget predicted that net investment in 2007–08 would be £29.4bn, which is 14.7% above last year’s level.

**Assessing compliance with the fiscal rules**

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 in the first half of 1997 and the Budget states that “the economy is expected to have returned to trend early in 2007”. This and other figures contained in the Budget imply that the Treasury now expects this cycle to include the fiscal years 1997–98 to 2006–07. The cumulative surplus over the years 1997–98 to 2006–07 is estimated to have been £18.9bn in 2007–08 terms. This is higher than the £16.2bn implied by last month’s data, which is mainly due to downwards revisions to previous estimates of depreciation over the period from 1997–98 to 2006–07. These outturns suggest that the golden rule would have been met over a ten year economic cycle beginning in 1997–98.

The sustainable investment rule states that “net public debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level”. The government said that, over the economic cycle that is thought to have ended earlier in 2007, public sector net debt was to be kept below 40% of GDP in each and every year. Apart from in 1997–98, when debt was at 41.3% of GDP, public sector net debt was indeed kept below this level in each year. However, the new Chancellor is yet to announce whether he will continue to aim to keep net debt below 40% of national income over the economic cycle that is thought by the Treasury to have begun earlier this year. When considering how this rule is to be applied, the Treasury should assess whether a broader measure of the public sector’s indebtedness (for example, to include more PFI or public sector pension liabilities) and a suitably higher debt ceiling would be more appropriate. However some difficulties exist with, in particular, measuring public sector pension liabilities accurately since their magnitude is heavily dependent on the assumptions underpinning them, which is not the case with conventional government debt.
Further Analysis

Little can be inferred or extrapolated about the public finances in 2007–08 from information about only the first third of the financial year. Bearing this in mind, the figures for receipts and spending in July 2007 show:

Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (cash) National Insurance Contributions for July 2007 were 13.9% higher than in the same month last year. Together, the receipts for these taxes during the first four months of 2007–08 were 7.6% higher than those for the same months of 2006–07. The Budget forecasts imply that these taxes’ receipts will also grow by 7.6% over the whole of 2007–08.

Corporation tax receipts for July 2007 were 0.9% lower than in the same month last year. Corporation tax receipts for the first four months of 2007–08 were 0.3% lower than those for the same four months of 2006–07. The Budget forecast implies that Corporation tax receipts will grow by 11.7% over the whole of 2007–08. This weakness in receipts in the latest month is, at least in part, explained by low receipts from North Sea oil companies in July 2007 compared to July 2006 which is believed will not continue for the rest of the financial year.

Cash receipts of VAT in July 2007 were 9.2% higher than the same month last year. VAT receipts for the first four months of 2007–08 were 10.9% higher than those for the same four months in 2006–07. The Budget forecast implies that VAT receipts will grow by 3.4% over the whole of 2007–08. However, accrued receipts of VAT over the first four months of 2007–08 were 5.9% higher than over the same four months last year, which is more in line with the Budget 2007 forecast for cash receipts over the whole year.

Central government current spending

Expenditure on net social benefits was 5.1% higher in July 2007 than in July 2006. Expenditure during the first four months of 2007–08 was 5.9% higher than in the same months of 2006–07. The Budget forecast implies that central government net social benefit expenditure will grow by 5.6% over 2007–08.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.9bn in July 2007, 0.3bn higher than in July 2006.

Other current spending by central government, including spending on the delivery of public services, was 6.5% higher in July 2007 than in July 2006. Comparing the first four months of 2007–08 with the first four months of 2006–07, the figure is 6.0%. The Budget forecast implies that this component of spending will grow by 6.2% over the year as a whole.

In July 2007, public sector net investment was £2.2bn compared to £1.7bn in the same month in 2006. So far in 2007–08, a total of £5.6bn has been spent on public sector net investment, compared to the £6.1bn that had been spent by the same point in 2006–07. The Budget predicted that net investment in 2007–08 would be £29.4bn, which is 14.7% above last year’s level.
Further information and contacts
For further information on today’s public finance release please contact Robert Chote or Carl Emmerson on 020 7291 4800, or email rchote@ifs.org.uk or cemmerson@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


Useful links and background information on the Budget can be found at http://www.ifs.org.uk/budgets/budget2007/index.php


The HM Treasury Budget 2007 is available at: http://www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_index.cfm


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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.