IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published Public Sector Finances November 2007. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first eight months of financial year 2007–08.

Gemma Tetlow, a Senior Research Economist at the IFS, said:

“Today’s figures suggest that the Chancellor remains on course to meet his Pre-Budget Report forecast for a current budget deficit of £8.3bn this financial year. While spending is running ahead of his prediction – in particular current expenditure by central government on public services – tax receipts this month have also grown relatively strongly. However, this is not to say that the current budget projection will be met. Next month’s receipts will be particularly crucial. The recent problems in banks and financial markets could further depress already weak corporation tax receipts as well as reducing the income tax receipts the Treasury might get from City bonuses and salaries. The Treasury revised down its forecasts for corporation tax and income tax receipts last month, but in the past it has underestimated both the size and the duration of the hit to revenues from problems in the financial sector.”

Headline Comparisons

- **Central government current receipts** in November were 7.2% higher than in the same month last year. Last month’s Pre-Budget Report forecast for 2007–08 implies an increase over last year’s levels of 6.0% for the year as a whole and of 6.7% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 5.1% for the year to date, and a 5.4% increase between September and November 2007 over the same three months last year.

- **Central government current spending** in November was 7.2% higher than in the same month last year. Last month’s Pre-Budget Report forecast for 2007–08 implies an increase over last year’s levels of 6.5% for the year as a whole and of 6.4% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 6.7% for the year to date, and a 6.9% increase between September and November 2007 over the same three months last year.

- **Public sector net investment** in November was £2.1bn compared to £1.8bn in the same month in 2006. So far in 2007–08, a total amount of £13.1bn has been spent on public sector net investment, which is 14.1% higher than had been spent by the same point in 2006–07. Last month’s Pre-Budget Report predicted that net investment in 2007–08 as a whole would be £29.7bn, which is 15.5% above last year’s level and implies an increase of 28.4% for the period from September 2007 to March 2008.
What would happen if these trends continued?

Under the assumption that borrowing in the first eight months of 2007–08 as a proportion of the year’s total is the same as it was in 2006–07 then:

- **Public Sector Net Borrowing** would be around £42bn. This is compared to the £35.1bn forecast in the March 2007 Budget and the £38.0bn forecast in last month’s Pre-Budget Report.

- **Current Budget** would be in deficit by around £7bn. This is compared to the £5.7bn deficit forecast in the March 2007 Budget and the £8.3bn forecast in last month’s Pre-Budget Report.

It should be remembered that the average absolute error in forecasting one year ahead has been around £15bn. So an error of the magnitude implied by extrapolating from these trends would be small by historical standards.

Northern Rock

The Government’s guarantees to Northern Rock’s creditors, including the Bank of England, are counted as a contingent liability, so there is no impact yet on official measures of the public finances. Were these guarantees to be called upon, the resulting Government support would score as capital spending in the form of a grant. This would have no impact on the golden rule, but would increase public sector net debt. Were Northern Rock to be brought into public ownership the addition to public sector net debt from this grant would be offset by any addition to the Government’s short-term financial assets – notably the proceeds from the sale of any of Northern Rock’s physical or long-term financial assets (in particular Northern Rock’s mortgage book). It is hard to predict in advance what the net effect on the level of public sector net debt would be.

Assessing compliance with the fiscal rules

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”. Since July 2005 the Treasury has estimated that an economic cycle began in the first half of 1997 and the Pre-Budget Report stated that “the economy may currently be operating slightly above trend and that output may have moved up through trend towards the end of 2006”. If correct then the financial years 1997–98 to 2006–07 inclusive would cover the HM Treasury’s definition of an economic cycle. The government said that, over this economic cycle, “stable and prudent” would be defined as keeping public sector net debt 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, Alistair Darling is yet to announce whether he will continue to aim to keep net debt below 40% of national income in each year of the new economic cycle which may have begun late in 2006. 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.

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 cumulative surplus over the years 1997–98 to 2006–07 is estimated to have been £18.9bn in 2007–08 terms. This means that over this period the government met its golden rule. However, looking forward over the new economic cycle, some improvements to the golden rule may be desirable and the start of the new cycle would be a good time to consider these. In particular, as discussed in Chapter 3 of the January 2007 IFS Green Budget, 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.

Further Analysis

We should be cautious in inferring or extrapolating likely outcomes over the financial year as a whole from information on only the first eight months. Bearing this in mind, the figures for receipts and spending in November 2007 show:

Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (net cash) National Insurance Contributions in November 2007 were 6.4% higher than in the same month last year. Last month’s Pre-Budget Report forecast implies that the receipts from these taxes will be 7.0% up on last year’s levels over the whole year, and 7.2% up over the period from September 2007 to March 2008. Together, the receipts for these taxes during the first eight months of 2007–08 were 7.3% higher than those for the same months of 2006–07, while receipts for September, October and November 2007 were 9.1% higher than the same three months last year.

Cash receipts of VAT in November 2007 were 4.9% lower than the same month last year. Last month’s Pre-Budget Report forecast implies that these receipts will be 5.2% up on last year’s levels over the whole year, and 2.9% up over the period from September 2007 to March 2008. VAT receipts for the first eight months of 2007 were 6.3% higher than those for the same months in 2006, while receipts for September, October and November 2007 were 2.7% higher than the same three months last year.

Corporation Tax receipts in November 2007 were 2.6% higher than in the same month last year. Last month’s Pre-Budget Report forecast implies that these receipts will be 4.5% up on last year’s levels over the whole year, and 9.6% up over the period from September 2007 to March 2008. Corporation Tax receipts for the first eight months of 2007 were roughly the same as (0.1% higher than) those for the same months last year, while receipts for September, October and November 2007 were 3.7% higher than the same three months last year.

Central government current spending

Expenditure on net social benefits was 3.1% higher in November 2007 than in November 2006. Last month’s Pre-Budget Report forecast implies that this spending will be 5.9% up on last year’s levels over the whole year, and 4.9% up over the period from September 2007 to March 2008. Expenditure during the first eight months of 2007 was 6.5% higher than in the same months of 2006, while spending in September, October and November 2007 was 5.1% higher than the same three months last year.
Spending on debt interest (which is relatively small as a share of spending overall) was £3.0bn in November 2007 compared to £2.7bn in November 2006.

Other current spending by central government, including spending on the delivery of public services, was 8.7% higher in November 2007 than in November 2006. Last month’s Pre-Budget Report forecast implies that this spending will be 6.5% up on last year’s levels over the whole year, and 7.4% up over the period from September 2007 to March 2008. Comparing the first eight months of 2007–08 with the same months in 2006–07, the figure is 6.1% while spending in September, October and November 2007 was 7.6% higher than the same three months last year.

In November 2007 public sector net investment was £2.1bn compared to £1.8bn in the same month in 2006. So far in 2007–08, a total amount of £13.1bn has been spent on public sector net investment, which is 14.1% higher than had been spent by the same point in 2006–07. Last month’s Pre-Budget Report predicted that net investment in 2007–08 as a whole would be £29.7bn, which is 15.5% above last year’s level and implies an increase of 28.4% for the period from September 2007 to March 2008.

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


Office for National Statistics & HM Treasury, Public Sector Finances, November 2007:

HM Treasury, Pre-Budget Report / Comprehensive Spending Review 2007:
http://www.hm-treasury.gov.uk/pbr_csr/pbr_csr07_index.cfm

IFS Green Budget, January 2007, containing in-depth public finance analysis, can be found at:

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