IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published Public Sector Finances January 2008. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first ten months of financial year 2007–08.

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

“Strong receipts of corporation tax, income tax and capital gains tax in January have put the Chancellor back on course to meet his Pre-Budget Report forecasts for receipts for this financial year. Spending by central government has also grown slightly less quickly over the year so far than was forecast in the Pre-Budget Report. If these patterns over the first ten months continue during the remaining two months of this financial year, Alistair Darling would meet his forecast for a current budget deficit of £8.3 billion and total borrowing of £38 billion.

Reclassifications by the ONS at the beginning of February and the nationalisation of Northern Rock this week added about £100 billion to public sector net debt – although this is not yet reflected in the published figures. This will probably have pushed it to a 22-year high of around 45% of national income. This would shatter Gordon Brown’s pledge to keep debt below 40% of national income. But most, or conceivably all, of the effect is likely to be temporary. For the time being the Government should publish net debt figures with and without the impact of Northern Rock. Whether or not tax and spending plans will need to change in response to Northern Rock’s nationalisation should depend only on the long-term impact of Northern Rock on public sector net debt, which remains uncertain.”

Headline Comparisons

- **Central government current receipts** in January were 12.0% higher than in the same month last year. The Pre-Budget Report forecast for 2007–08 published in October implies an increase over last year’s levels of 6.0% for the year as a whole and of 6.6% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 5.8% for the year to date, and a 6.6% increase between September 2007 and January 2008 over the same five months last year.

- **Central government current spending** in January was 9.3% higher than in the same month last year. The Pre-Budget Report forecast for 2007–08 published in October implies an increase over last year’s levels of 6.5% for the year as a whole and of 6.6% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 6.3% for the year to date, and a 6.2% increase between September 2007 and January 2008 over the same five months last year.
• **Public sector net investment** in January was £2.8bn compared to £2.9bn in the same month in 2007. So far in 2007–08, a total amount of £18.0bn has been spent on public sector net investment, which is 7.0% higher than had been spent by the same point in 2006–07. The Pre-Budget Report forecast for 2007–08 published in October predicted that net investment in 2007–08 as a whole would be £29.7bn, which is 15.1% above last year’s level and implies an increase of 23.4% for the period from September 2007 to March 2008.

**What would happen if these trends continued?**

• Under the assumption that borrowing in the first ten 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 £38bn**. This is higher than the £35.1bn forecast in the March 2007 Budget but in line with the £38.0bn forecast in October’s Pre-Budget Report.

• Under the assumption that both receipts and current spending by central government in the first ten months of 2007–08 as a proportion of the year’s total is the same as it was in 2006–07, and that local authorities’ and public corporations run a current budget balance (which is what the Treasury forecasts and the latest data suggest) then the **current budget would be in deficit by around £8bn**. This is bigger than the £5.7bn deficit forecast in the March 2007 Budget and in line with the £8.3bn forecast in October’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**

On 17th February 2008, Alistair Darling announced that Northern Rock plc would be temporarily nationalised until such time as a suitable private sector buyer could be found. The immediate impact of this on the public finances was negligible as, for accounting purposes, the liabilities of Northern Rock had already (on 7th February 2008) been reclassified onto the public sector balance sheet. This had the immediate effect of increasing public sector net debt by about £100 billion (or around 7% of national income) – although the ONS has not yet had time to reflect this in the published figures.

The long-term effect of Northern Rock’s nationalisation on the public finances is still unclear. It is, however, likely that most if not all of the impact on net debt will be temporary. Indeed it is possible that the ultimate effect – once all of Northern Rock’s long-term financial assets have been sold – could be to reduce net debt.

**Assessing compliance with the fiscal rules**

Gordon Brown operated two fiscal rules during his period as Chancellor and Alistair Darling has continued to operate these since he took over. These are the sustainable investment rule and the golden 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 current economic cycle. But Mr Brown said earlier this
year that he believed that the economy was now beginning a new cycle. Therefore, strictly speaking, the sustainable investment rule is not currently defined – an omission that we have been urging the Treasury to rectify for some time.

But, on the reasonable assumption that the rule is to be interpreted as defined to date, the reclassification of Northern Rock’s liabilities onto the public sector balance sheet on 7th February 2008 (and its subsequent nationalisation) mean that the sustainable investment rule will now have been broken by a significant margin. Indeed, the addition to net debt is so large that this would have been true had the Northern Rock saga taken place at any time in the last four years.

Sensibly the Code for Fiscal Stability allows the Government to depart from its stated fiscal rules temporarily so long as it specifies:

- the reasons for departing from the previous fiscal policy objectives and operating rules;
- the approach and period of time that the Government intends to take to return to the previous fiscal policy objectives and operating rules; and
- the fiscal policy objectives and operating rules that shall apply over this period.

This means that the Treasury can, and should, modify the sustainable investment rule for the period over which Northern Rock has a material but temporary impact on measures of the public finances. It should state clearly what arrangements will be in place during this period. One way to retain the spirit of the sustainable investment rule would be to continue to aim to keep public sector net debt below 40% of national income, excluding the impact of Northern Rock. To measure outturns and plans against this objective the Treasury should publish measures of debt that exclude the impact of commitments made to Northern Rock, while it remains classified as a public corporation.

In January’s 2008 IFS Green Budget, we argued than on current policies it is more likely than not that the Government would breach the 40% ceiling anyway in the next few years, even in the absence of any Northern Rock effect.

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 £18.8bn 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 2008 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 ten months. Bearing this in mind, the figures for receipts and spending in January 2007 show:

Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (net cash) National Insurance Contributions in January 2007 were 11.8% higher than in the same month last year. The Pre-Budget Report forecast published in October 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 ten months of 2007–08 were 8.4% higher than those for the same months of 2006–07, while receipts for September 2007 to January 2008 were 10.4% higher than the same five months last year.

Cash receipts of VAT in January 2008 were 4.8% higher than the same month last year. The Pre-Budget Report forecast published in October 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 ten months of 2007 were 5.0% higher than those for the same months in 2006, while receipts for September 2007 to January 2008 were just 1.8% higher than the same five months last year.

Corporation Tax receipts in January 2007 were 22.0% higher than in the same month last year. The Pre-Budget Report forecast published in October 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 ten months of 2007 were 3.9% higher than those for the same months last year, while receipts for September 2007 to January 2008 were 9.0% higher than the same five months last year.

Central government current spending

Expenditure on net social benefits was 6.0% higher in January 2008 than in January 2007. The Pre-Budget Report forecast published in October 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 ten months of 2007 was 5.7% higher than in the same months of 2006, while spending in September 2007 to January 2008 was 4.1% higher than the same five months last year.

Spending on debt interest (which is relatively small as a share of spending overall) was £3.1bn in January 2008, which is the same as it was in January 2007.

Other current spending by central government, including spending on the delivery of public services, was 11.8% higher in January 2008 than in January 2007. The Pre-Budget Report forecast published in October implies that this spending will be 6.6% up on last year’s levels over the whole year, and 7.7% up over the period from September 2007 to March 2008. Comparing the first ten months of 2007–08 with the same months in 2006–07, the figure is 6.0% while spending in September 2007 to January 2008 was 7.1% higher than the same five months last year.
In January 2007 public sector net investment was £2.8bn compared to £2.9bn in the same month in 2007. So far in 2007–08, a total amount of £18.0bn has been spent on public sector net investment, which is 7.0% higher than had been spent by the same point in 2006–07. The Pre-Budget Report forecast published in October predicted that net investment in 2007–08 as a whole would be £29.7bn, which is 15.1% above last year’s level and implies an increase of 23.4% for the period from September 2007 to March 2008.

Further information and contacts
For further information on today’s public finance release please contact: Robert Chote or Gemma Tetlow on 020 7291 4800, or email rchote@ifs.org.uk or gtetlow@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

Statements by HM Treasury, the Bank of England and the Financial Services Authority relating to Northern Rock can be found at http://www.bankofengland.co.uk/publications/northernrock/index.htm


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.