IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published *Public Sector Finances June 2008*. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first three months of financial year 2008–09.

Gemma Tetlow, a senior research economist at the IFS, said:

“The Government has had to borrow 65% more during the first three months of the financial year than in the same period last year to meet the gap between what it spends and raises in tax revenue. This growth in borrowing is due to both weaker than expected receipts and higher than expected spending. This is a bigger deterioration than the Treasury was expecting at Budget time: Alistair Darling’s prediction then was that borrowing in 2008–09 as a whole would be only 24% higher than last year.

Today’s Financial Times suggests that the Treasury is set to change its self-imposed fiscal rules, which are intended to limit the extent to which the Government can finance public spending from borrowing, rather than tax revenues. Both fiscal rules could be improved but creating the impression that you would simply make them easier to meet whenever a breach seems likely undermines any credibility gained from having such rules.”

**Headline Comparisons**

- **Central government current receipts** in June were 2.5% higher than in the same month last year. Receipts in April, May and June 2008 were 2.5% higher than in the same months of 2007. The 2008 Budget implied that central government current receipts for the whole of 2008–09 would be 4.7% above 2007–08 levels.

- **Central government current spending** in June was 6.9% higher than in the same month last year. Spending in April, May and June 2008 was also 6.9% higher than in the same months of 2007. The 2008 Budget implied that central government current spending for the whole of 2008–09 would be 5.4% above 2007–08 levels.

- **Public sector net investment** in June was £1.5bn, compared to £1.0bn in the same month last year. Together, public sector net investment during April, May and June 2008 has been £4.0bn, which is 77.2% higher than in the same months of 2007. The Budget predicted that net investment in 2008–09 would be £33.8bn, which is 20.6% above last year’s level.
Oil prices and the public finances

On Wednesday the Chancellor announced that the 2p increase in road fuel duties planned for 1st October 2008 would be postponed. Doing this for six months, until 1st April 2009, would cost the exchequer approximately £550m in 2008–09. If they were to abandon the increase completely, it would cost them approximately £1.1bn a year forever more. For total tax receipts to come in as the Treasury forecast in its March Budget (less the £2.7bn giveaway announced in the Mini-Budget on May 13th), in spite of this cut in fuel duties, would therefore require a boost to revenues that was not expected at the time of the Budget. Higher oil prices increase receipts from petroleum revenue tax and North Sea corporation tax. The latest independent forecast of the oil price, combined with the most recent NAO audit of the oil price assumption suggest that these revenues could exceed the Budget forecast by as much as £7 billion this year. But higher oil prices will also depress receipts of other taxes such as fuel duties and non-North Sea corporation tax. This latter effect will be significant, not least because, as a net importer of oil, the UK’s national income is reduced by increases in the oil price. Furthermore, other economic developments since the Budget suggest that receipts of other taxes could also be disappointing. For example, the Budget forecast that revenues from stamp duties on share and property transactions would fall by 6% in 2008–09 but over the first two months of this financial year these revenues have fallen by 19%.

Assessing compliance with the fiscal rules

Since coming to power, the Labour government has operated two fiscal rules – the sustainable investment rule and the golden rule. The Treasury forecasts for the public finances published in March’s Budget implied that looking forwards there was virtually no room to manoeuvre against either fiscal 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 economic cycle that the Treasury believes began in 1997–98. Given that the impact of Northern Rock on measures of the public finances is expected to be temporary, the Treasury, sensibly, announced at the time of the Budget that it would operate a modified sustainable investment rule over this period – aiming to keep public sector net debt excluding Northern Rock’s liabilities below 40% of national income.

Since 1998–99 public sector net debt has been kept below 40% of national income. The forecasts from Budget 2008, combined with Mr Darling’s May 13th mini-Budget announcement of a £2.7bn giveaway to basic-rate income tax payers this year, suggest that he has virtually no room left to manoeuvre against the sustainable investment rule over the next few years (even assuming that Mr Darling succeeds in making this a purely one-off giveaway). Some assistance for Mr Darling may come from a change to how the ONS treats financial intermediation services in the national accounts. This change will increase the level of national income and so reduce the apparent level of public sector net debt when expressed as a share of national income.

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 during 1997–98 but is currently unsure whether this cycle ended (and a new
cycle began) in 2006–07, or whether we are now in the twelfth year of the same economic cycle. Over the years 1997–98 to 2006–07 there was a small cumulative current budget surplus. Looking forwards, meeting the golden rule will depend on either whether there is a surplus over the years from 2006–07 to when the new economic cycle closes, or whether the cumulative current budget remains in surplus over the years from 1997–98 to when the current economic cycle ends.

Further Analysis

Little can be inferred or extrapolated about the public finances in 2008–09 from information about only the first three months of the financial year. Bearing this in mind, the figures for receipts and spending in June 2008 show:

Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (cash) National Insurance Contributions for June 2008 were 2.8% lower than in the same month last year. Together, the receipts for these taxes during the first three months of 2008–09 were 2.9% higher than those for the first three months of 2007–08. The Budget forecasts imply that these taxes’ receipts will grow by 4.7% over the whole of 2008–09.

Cash receipts of VAT in June 2008 were 4.6% lower than the same month last year. Overall VAT receipts for April, May and June 2008 were 0.2% lower than those for the same months in 2007. The Budget forecast implies that VAT receipts will grow by 4.0% over the whole of 2008–09.

Corporation tax receipts for June 2008 were 0.3% higher than in the same month last year. Corporation tax receipts for April, May and June 2008 were 4.3% higher than those for the same months last year. The Budget forecast implies that Corporation tax receipts will grow by 9.9% over the whole of 2008–09.

Central government current spending

Expenditure on net social benefits was 5.0% higher in June 2008 than in the same month last year. Expenditure during April, May and June 2008 was 7.4% higher than in the same months of 2007. The Budget forecast implies that central government net social benefit expenditure will grow by 6.5% over 2008–09.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.4bn in June 2008, which is 2.0% higher than in June 2007.

Other current spending by central government, including spending on the delivery of public services, was 6.8% higher in June 2008 than in the same month last year. Comparing the first three months of 2008–09 with the first three months of 2007–08, the figure is 6.0%. The Budget forecast implies that this component of spending will grow by 5.3% over the year as a whole.

In June 2008, public sector net investment was £1.5bn compared to £1.0bn in the same month in 2007. So far in 2008–09, a total of £4.0bn has been spent on public sector net investment, compared to the £2.3bn that had been spent by the same point in 2007–08. The Budget predicted that net investment in 2008–09 would be £33.8bn, which is 20.6% above last year’s level.
Further information and contacts
For further information on today’s public finance release please contact: Robert Chote, Carl Emmerson or Gemma Tetlow on 020 7291 4800, or email rchote@ifs.org.uk, cemmerson@ifs.org.uk or gtetlow@ifs.org.uk.

The next Public Sector Finances is due to be published by the Office for National Statistics on 20th August 2008.

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

IFS Green Budget, January 2008, containing in-depth public finance analysis, can be found at:

Useful links and background information on Budget 2008 can be found at

Office for National Statistics & HM Treasury, Public Sector Finances, July 2008:

HM Treasury, Budget 2008:
http://www.hm-treasury.gov.uk/budget/budget_08/bud_bud08_index.cfm

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:

2. Central government current spending includes depreciation.

3. Where possible we compare figures on an accruals basis with the HM Treasury forecast.