IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published Public Sector Finances May 2005. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first two months of financial year 2005–06.

Headline Comparisons

- **Central government current receipts** in May were 4.2% higher than in the same month last year. Receipts in April and May 2005 were 6.6% higher than in the same months of 2004. The 2005 Budget implied that central government current receipts for the whole of 2005–06 would be 8.5% above 2004–05 levels.

- **Central government current spending** in May was 7.4% higher than in the same month last year. Spending in April and May 2005 was 4.9% higher than in the same months of 2004. The 2005 Budget implied that central government current spending for the whole of 2005–06 would be 6.0% above 2004–05 levels.

- **Public sector net investment** in May was £1.6bn, or 65.0% higher, than in the same month last year. Together, public sector net investment during April and May 2005 has been £2.7bn, which is 94.5% higher than in the same two months of 2004. The Budget predicted that net investment in 2005–06 would be £26.2bn, which is 45.9% above last year’s level.

Assessing compliance with the golden rule

The Chancellor has set himself two fiscal rules that constrain how much the government can borrow and to what purpose. The golden rule requires that public sector current spending be met entirely out of public sector receipts over the course of an economic cycle – in other words, that the public sector current budget is at least in balance. The present economic cycle, which began in 1999–2000, is expected by the Treasury to end during 2005–06.

If, as Morgan Stanley argued in the January 2005 IFS Green Budget (and as a number of other independent forecasters have suggested), the economic cycle in fact came to a close in 2004–05, then the golden rule was met with £7.9bn to spare. However, this would mean that the economy would be broadly on trend during 2005–06 and yet the Treasury is expecting a deficit of £5.7bn on the current budget. Deficits early in the economic cycle will require offsetting surpluses later if the rule is to be met again.

If the Treasury is correct, and the economic cycle runs from 1999–2000 to 2005–06, then the golden rule will be met over the current economic cycle as long as the current budget is not in deficit by more than £8.3bn in 2005–06. The March 2005 Budget forecast is for a current budget deficit of £5.7bn, while the January 2005 IFS Green Budget
forecast was for a £13.4bn deficit. The average absolute forecasting error made one year ahead by the Treasury in the past is equivalent to £15bn in today’s terms. On the basis of previous Treasury forecasting errors we estimate that if the March 2005 Budget forecast is the best available forecast then the probability that the golden rule will be met over the economic cycle ending in 2005–06 would be 56.6%, while if the January 2005 IFS Green Budget is the best available forecast then the corresponding figure would be 37.2%.

Christine Frayne, a senior research economist at the IFS said:

“There is very little we can say with confidence on the basis of just two months’ data, but so far the current budget deficit is only about 10% smaller than in the same period last year. If that were to remain the case throughout the year the government would record a current budget deficit in excess of £15 billion, significantly more than it can afford to do if it wishes to meet the golden rule over a cycle ending in 2005-06. But it is far too early to predict that this will be the outcome and, even if it were, the direct economic consequences of breaking the golden rule by this margin would be negligible - although it would doubtless be embarrassing for the Chancellor. The disappointing performance to date relative to the Budget predictions for the year as a whole reflects weaker increases in revenues from VAT, national insurance contributions and corporation tax than the Treasury is looking for over the full year, offset by stronger income tax and capital gains tax receipts.”

Further Analysis

Little can be inferred or extrapolated about the public finances in 2005–06 from information about only the first two months of the financial year. Bearing this in mind, the figures for receipts and spending in May 2005 show:

Central government current receipts

Income Tax and Capital Gains Tax receipts for May 2005 were 17.5% higher than in the same month last year. Together, the receipts for these taxes during the first two months of 2005–06 were 15.6% higher than those for the first two months of 2004–05. The Budget forecasts imply that these taxes’ receipts will grow by 9.6% over the whole of 2005–06.

In May 2005, receipts of National Insurance Contributions grew by 0.1% over last May’s level. Receipts of National Insurance Contributions for April and May 2005 were 2.3% higher than those for the same two months last year. The Budget forecast implies that National Insurance Contributions will grow by 5.8% over the whole of 2005–06.

Cash receipts of VAT in May 2005 were 1.8% lower than the same month last year. VAT receipts for April and May 2005 were 5.5% lower than those for the same two months in 2004. The Budget forecast implies that VAT receipts will grow by 4.5% over the whole of 2005–06.

Corporation tax receipts for May 2005 were 17.8% higher than in the same month last year. Corporation tax receipts for April and May 2005 were 10.5% higher than those for the same two months last year. The Budget forecast implies that Corporation tax receipts will grow by 28.8% over the whole of 2005–06.
Central government current spending

Expenditure on net social benefits was 7.8% higher in May 2005 than in May 2004. Expenditure during April and May 2005 was 2.6% higher than in the same months of 2004. The Budget forecast implies that central government net social benefit expenditure will grow by 4.5% over 2005–06.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.2bn in May 2005 compared to £2.1bn in May 2004.

Other current spending by central government, including spending on the delivery of public services, was 7.5% higher in May 2005 than in May 2004. Comparing the first two months of 2005–06 with the first two months of 2004–05, the figure is 5.4%. The Budget forecast implies that this component of spending will grow by 6.5% over the year as a whole.

In May 2005, public sector net investment was £1.6bn compared to £1.0bn in the same month in 2004. So far in 2005–06, a total amount of £2.7bn has been spent on public sector net investment, compared to the £1.4bn that had been spent by the same point in 2004–05. The Budget predicted that net investment in 2005–06 would be £26.2bn, which is 45.9% above last year’s level.

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

Useful links and background information on the Budget can be found at http://www.ifs.org.uk/budgets/budget2005/index.php

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

The IFS Green Budget, January 2005:

HM Treasury, Budget 2005:
http://www.hm-treasury.gov.uk/budget/budget_05/bud_bud05_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:
1. Central government current spending includes depreciation.
2. Where possible we compare figures on an accruals basis with the HM Treasury forecast.