IFS analysis of today’s public finance figures

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

Gemma Tetlow, a research economist at the IFS said:

“Over the first two months of this financial year, the public sector current budget deficit was £0.3bn larger than in the same two months in 2006–07 at £6.6bn. The Treasury forecast in the Budget that the deficit would shrink this financial year, so on the face of it this is disappointing. But as we are only two months into 2007–08 very little can be it inferred from what we know so far about the trajectory of the public finances over the whole year.

Revisions this month to estimates of current budget surpluses in the years since 1997–98 now suggest that Gordon Brown’s golden rule was met with around £13bn to spare over the 10-year economic cycle that the Treasury currently estimates to have run from 1997–98 to 2006–07. While further revisions to estimates of spending and revenues may change the estimated size of the cumulative current budget surplus over this period, they are unlikely to eliminate it entirely. This suggests that we can be fairly confident that the rule will ‘stay met’ unless new national accounts data force the Treasury to re-date the economic cycle.

The latest revisions mean that had the Chancellor not made the debateable decision in summer 2005 to move the start date of the economic cycle two years earlier, he would now have broken the golden rule by only £0.4bn, the narrowest of margins, over the eight-year cycle that would have begun in 1999–2000. Though such a breach would have had no direct economic significance in an economy now generating £1,300 billion a year in national income, the re-dating of the cycle may already have undermined the credibility of the fiscal framework.

The beginning of a new economic cycle, and the arrival of a new Chancellor at Number 11, would seem a sensible time to tweak the fiscal framework for the better and to try to help restore credibility. In particular, 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.”
Headline Comparisons

- **Central government current receipts** in May were 6.3% higher than in the same month last year. Receipts in April and May 2007 were 5.7% higher than in the same months of 2006. The 2007 Budget implied that central government current receipts for the whole of 2007–08 would be 6.6% above 2006–07 levels.

- **Central government current spending** in May was 7.2% higher than in the same month last year. Spending in April and May 2007 was 6.3% higher than in the same months of 2006. The 2007 Budget implied that central government current spending for the whole of 2007–08 would be 5.6% above 2006–07 levels.

- **Public sector net investment** in May was £1.3bn, or 8.2% lower, than in the same month last year. Together, public sector net investment during April and May 2007 has been £2.8bn, which is 15.8% lower than in the same two months of 2006. The Budget predicted that net investment in 2007–08 would be £29.4bn, which is 18.5% above last year’s level.

Assessing compliance with the fiscal rules

The Chancellor’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 £12.3bn in 2006–07 terms (or £12.9bn in 2007–08 terms). This is higher than the £10.6bn (in 2007–08 terms) implied by last month’s data, which is mainly due to upwards revisions to previous estimates of the current budget surplus in the years from 1999–2000 to 2002–03. These outturns suggest that the golden rule was 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 41.6% of GDP, public sector net debt was indeed kept below this level in each year. However, the Treasury is yet to announce whether they will continue to aim to keep net debt below 40% of national income over the next economic cycle. Indeed, this is a decision that it appears may well be left until Mr Brown’s successor takes over at the Treasury. When considering how this rule will be applied over the next economic cycle, 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.

Further Analysis

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

Receipts of Income Tax, Capital Gains Tax and (cash) National Insurance Contributions for May 2007 were 9.1% higher than in the same month last year. Together, the receipts for these taxes during the first two months of 2007–08 were 7.6% higher than those for the first two months of 2006–07. The Budget forecasts imply that these taxes’ receipts will grow by 7.6% over the whole of 2007–08.

Cash receipts of VAT in May 2007 were 16.2% higher than the same month last year. VAT receipts for April and May 2007 were 13.0% higher than those for the same two months in 2006. The Budget forecast implies that VAT receipts will grow by 3.4% over the whole of 2007–08.

Corporation tax receipts for May 2007 were 20.7% lower than in the same month last year. Corporation tax receipts for April and May 2007 were 0.9% lower than those for the same two months last year. The Budget forecast implies that Corporation tax receipts will grow by 11.7% over the whole of 2007–08.

Central government current spending

Expenditure on net social benefits was 4.8% higher in May 2007 than in May 2006. Expenditure during April and May 2007 was 4.8% higher than in the same months of 2006. The Budget forecast implies that central government net social benefit expenditure will grow by 5.4% over 2007–08.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.8bn in May 2007, £0.5bn higher than in May 2006.

Other current spending by central government, including spending on the delivery of public services, was 6.7% higher in May 2007 than in May 2006. Comparing the first two months of 2007–08 with the first two months of 2006–07, the figure is 5.8%. The Budget forecast implies that this component of spending will grow by 5.7% over the year as a whole.

In May 2007, public sector net investment was £1.3bn compared to £1.4bn in the same month in 2006. So far in 2007–08, a total of £2.8bn has been spent on public sector net investment, compared to the £3.4bn 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 18.5% above last year’s level.

Further information and contacts

For further information on today’s public finance release please contact Gemma Tetlow on 020 7291 4800, or email 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

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


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.