

IFS analysis of today's public finance figures

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

IFS public finance bulletins are generously supported by the Economic and Social Research Council.



The analysis is based on IFS calculations and does not reflect the views of the ESRC.

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

“Today’s figures for central government tax and spending show that receipts have grown less quickly, and current spending more quickly, than was forecast for the year as a whole in last week’s Budget. To the extent that these figures were taken into account by the Treasury in drawing up its Budget forecasts, today’s figures do not cast doubt on the Treasury’s forecasts for this year. Of greater importance is the future outlook for the public finances. This is especially true in the context of the Treasury’s own Budget forecasts, which reveal that it is planning on the basis of having virtually no room to manoeuvre against either of its two self-imposed fiscal rules. Treasury forecasts for borrowing have been repeatedly over-optimistic in recent years and the Chancellor must hope that he is luckier this time. Further stock market falls certainly would not help. If the 4% fall in share prices over the last week had taken place before the Budget, the Treasury would probably have had to cut its revenue forecasts by at least a further £½ billion a year.”

Headline Comparisons

- **Central government current receipts** in February were 2.5% higher than in the same month last year. Receipts in the first eleven months of 2007–08 were 5.4% higher than in the same months of 2006–07. The 2008 Budget, published last week, implied that central government current receipts for the whole of 2007–08 would be 5.8% above 2006–07 levels.
- **Central government current spending** in February was 6.9% higher than in the same month last year. Spending in the first eleven months of 2007–08 was 6.4% higher than in the same months of 2006–07. The 2008 Budget implied that central government current spending for the whole of 2007–08 would be 6.2% above 2006–07 levels.
- **Public sector net investment** in February was £1.6bn, or 50%, higher than in the same month last year. Together, public sector net investment during the first eleven months of 2007–08 has been £22.1bn, which is 10.5% higher than in the same months of 2006–07. The Budget predicted that net investment in 2007–08 would be £28.5bn, which is 10.6% above last year’s level.

The impact of equity prices on the public finances

In last week's Budget, the Chancellor revised down his forecasts for tax receipts from 2009–10 onwards by £2¼bn per year due to equity prices being 14% lower than assumed in the Pre-Budget Report. This figure includes only the direct effect of equity prices on receipts of stamp duty on shares, corporation tax, capital gains tax and inheritance tax.

In making the forecasts for receipts over the next five years, the Budget assumed that equity prices would grow in line with the economy from the level which the FTSE All-share index was at on 6th March 2008 (2959). This is not an unreasonable assumption to make. However, had the Budget been this week and taken the value of the FTSE All-share index at the close of play on 19th March (2841), then its forecasts would have been based on equity prices being a further 4% lower for evermore. The direct impact would be a reduction in forecast capital tax receipts of around £½–£¾bn a year. There may also be detrimental indirect effects on tax receipts via lower earnings, bonuses or employment in the financial services sector and any negative effects of the fall in equity prices on the wider economy.

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. Today's release announces that the ONS plans to publish figures for the level of public sector net debt including the liabilities of Northern Rock in its May public finance press release.

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 economic cycle that the Treasury believes began in 1997–98. On the reasonable assumption that the 40% ceiling continues to apply, the reclassification of Northern Rock's liabilities onto the public sector balance sheet on 7th February 2008 (and its subsequent nationalisation) meant that the sustainable investment rule, as judged at that time, would have been broken by a significant margin. However, sensibly the Code for Fiscal Stability allows the Government to depart from its stated fiscal rules temporarily and indeed the Treasury confirmed in last week's Budget that they would operate a modified sustainable investment rule for the period over which Northern Rock has an impact on measures of the public finances. They stated that during

this period compliance with the sustainable investment rule would be judged as keeping public sector net debt excluding Northern Rock's liabilities below 40% of national income. This redefinition of the rule is sensible as it retains the spirit of the sustainable investment rule without requiring structural changes to the public finances in response to the material but temporary impact of Northern Rock on the public finances.

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 about to enter 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.

The latest Treasury forecasts for the public finances published in last week's Budget imply that looking forwards there is virtually no room to manoeuvre against either fiscal rule, regardless of the end date of the cycle that began in 1997–98.

Further Analysis

Information is now available for eleven months of the current financial year. The figures for receipts and spending in February 2008 show:

Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (cash) National Insurance Contributions for February 2008 were 4.1% higher than in the same month last year. Together, the receipts for these taxes during the first eleven months of 2007–08 were 7.9% higher than those for the same months of 2006–07. The Budget forecasts imply that these taxes' receipts will grow by 8.0% over the whole of 2007–08.

Cash receipts of VAT in February 2008 were 3.0% lower than the same month last year. VAT receipts for the first eleven months of 2007–08 were 4.3% higher than those for the same months in 2006–07. The Budget forecast implies that VAT receipts will grow by 4.1% over the whole of 2007–08.

Corporation Tax receipts for February 2008 were 6.8% lower than in the same month last year. Corporation Tax receipts for the first eleven months of 2007–08 were 3.6% higher than those for the same months last year. The Budget forecast implies that Corporation Tax receipts will grow by 4.7% over the whole of 2007–08.

Central government current spending

Expenditure on net social benefits was 9.4% higher in February 2008 than in February 2007. Expenditure during the first eleven months of 2007–08 was 6.9% higher than in the same months of 2006–07. The Budget forecast implies that central government net social benefit expenditure will grow by 6.5% over 2007–08.

Spending on debt interest (which is a relatively small part of overall spending) was £3.0bn in February 2008 compared to £2.7bn in February 2007.

Other current spending by central government, including spending on the delivery of public services, was 5.7% higher in February 2008 than in February 2007. Comparing the first eleven months of 2007–08 with the same months in 2006–07, the figure is also 5.7%. The Budget forecast implies that this component of spending will grow by 5.9% over the year as a whole.

In February 2008, **public sector net investment** was £4.7bn compared to £3.2bn in the same month in 2007. So far in 2007–08, a total amount of £22.1bn has been spent on public sector net investment, which is the same as had been spent by the same point in 2006–07. The Budget predicted that net investment in 2007–08 would be £28.5bn, which is 10.6% above last year's level.

Further information and contacts

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Next month's release will be published on 18th April 2008. This will include provisional outturns for the whole of 2007–08.

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: <http://www.ifs.org.uk/budgets/gb2008/index.php>

Useful links and background information on Budget 2008 can be found at <http://www.ifs.org.uk/budgets/budget2008/index.php>

Office for National Statistics & HM Treasury, Public Sector Finances, February 2008: <http://www.statistics.gov.uk/pdfdir/psf0308.pdf>

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:

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