IFS analysis of today’s public finance figures

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

Headline Comparisons

- **Central government current receipts** in October were 9.6% higher than in the same month last year. Receipts in the first seven months of 2005–06 were 7.4% higher than in the same months of 2004–05. 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 October was 2.9% lower than in the same month last year. Spending in the first seven months of 2005–06 was 4.1% higher than in the same months of 2004–05. The 2005 Budget implied that central government current spending for the whole of 2005–06 would be 5.6% above 2004–05 levels.

- **Public sector net investment** in October was £0.6bn higher (43.1%) than in the same month last year. Together, public sector net investment during the first seven months of 2005–06 has been £2.9bn higher (39.7%) than in the same months of 2004–05. The Budget predicted that net investment in 2005–06 would be 38.3% above last year’s level.

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

“Today’s figures improve the chance that the Treasury will meet its golden rule, which will be good news for the Chancellor as he prepares for next month’s Pre-Budget Report. Despite this, looking over the year to date – which often gives a more informative comparison – the current budget deficit is 41% smaller than last year whereas to meet the Budget 2005 forecast it would need to shrink by 71% over the financial year as a whole. In part this is due to receipts of Corporation Tax continuing to come in short of the Treasury’s expectation, despite a strong performance in the latest month. To meet the Chancellor’s forecast for these receipts revenues from Corporation Tax would need to grow by almost 50% over the next five months compared to the same period last year. If instead they continue to grow at the rate seen so far this year then these receipts would be around £3½ billion below the Budget 2005 forecast.

The fact that the current budget deficit is running above the Treasury’s forecast for 2005–06 is despite the spending by central government on the delivery of public services only running 3.6% above that seen last year compared to the
Budget 2005 forecast for growth of 4.8% over the year as a whole. This will make it harder to deliver the improvements in public service quality that the Government aspires to, unless there has been an unexpected corresponding improvement in the efficiency with which the money is spent.”

**Assessing compliance with the golden rule**

The Chancellor is committed to running fiscal policy in line with two fiscal rules. The 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.

If the present economic cycle runs from 1997–98 to 2005–06, the golden rule will be met over this period as long as the current budget is not in deficit by more than £21.1bn in 2005–06. The Treasury forecast a current budget deficit of £5.7bn in Budget 2005, while the January 2005 IFS Green Budget predicted a deficit of £13.4bn. Over the first seven months of the present financial year the current budget deficit was 41.1% lower than in the equivalent period last year – if the same were to be true over the next five months, which it might not be, the deficit for 2005–06 would come in at £11.7bn. The average absolute forecasting error made one year ahead by the Treasury in the past is equivalent to £12bn in today’s terms.

For the cycle to close in 2005–06, based on the Treasury’s latest estimates, the (non-oil) economy would need to grow by nearly 4% between the first quarter of 2005 and the first quarter of 2006, considerably more than most independent forecasters expect. This suggests that the Treasury may predict in next month’s Pre-Budget Report that it will not close until 2006–07. Whether this would make the golden rule harder to achieve would depend on whether the current budget is likely to be in deficit next year; in Budget 2005 the Treasury predicted there would be a small surplus, while in the January 2005 Green Budget we predicted a deficit.

**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 seven months. Bearing this in mind, the figures for receipts and spending in October 2005 show:

**Central government current receipts**

Receipts of Income Tax, Capital Gains Tax and National Insurance Contributions for October were 12.9% higher than in the same month last year. Together, the receipts for these taxes during the first seven months of 2005–06 were 9.1% higher than those for the same months in 2004–05. The Budget forecasts imply that these taxes’ receipts will grow by 8.1% over the whole of 2005–06, so the last seven months have been encouraging for the Chancellor.

Cash receipts of VAT in October 2005 were 3.3% higher than the same month last year. VAT receipts for the first seven months of 2005 were 0.2% higher than those for the same 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 October 2005 were 23.4% higher than in the same month last year. Corporation tax receipts for the first seven months of 2005 were 18.3% higher than those for the same months last year. The Budget
forecast implies that Corporation tax receipts will grow by 28.4% over the whole of 2005–06, well above the trend to date.

**Central government current spending**

Expenditure on net social benefits was 0.1% lower in October 2005 than in October 2004. Expenditure during the first seven months of 2005 was 4.0% higher than in the same months of 2004. The Budget forecast implies that central government net social benefit expenditure will grow by 7.2% over 2005–06, faster than the first seven months of this year.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.3bn in October 2005 compared to £2.1bn in October 2004.

Other current spending by central government, including spending on the delivery of public services, was 5.2% lower in October 2005 than in October 2004. Comparing the first seven months of 2005–06 with the same months in 2004–05, the figure is 3.6%. The Budget forecast implies that this component of spending will grow by 4.8% over the year as a whole, faster than the first seven months of this year.

In October 2005, **public sector net investment** was £1.9bn compared to £1.3bn in the same month in 2004. So far in 2005–06, a total amount of £10.1bn has been spent on public sector net investment, compared to the £7.2bn 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 38.3% above last year’s level.

**Further information and contacts**

For further information on today’s public finance release please contact: Carl Emmerson or Christine Frayne on 020 7291 4800, or email cemmerson@ifs.org.uk or cfrayne@ifs.org.uk.

The Pre-Budget Report will be on Monday the 5th of December. An IFS briefing will be held at on Tuesday 6th December. The briefing is free of charge and will take place at 1 pm at our offices in Ridgmount Street. If you wish to attend please contact our conference organiser Bonnie Brimstone (bbrimstone@ifs.org.uk).

The IFS Green Budget, which will again be in collaboration with Morgan Stanley, will be on Wednesday 25th January 2006. For more details please email bbrimstone@ifs.org.uk

**Relevant links:**


HM Treasury, Pre-Budget Report 2005: [http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr05/prebud_pbr05_index.cfm](http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr05/prebud_pbr05_index.cfm)
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.