IFS analysis of today’s public finance figures

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

Carl Emmerson, a deputy director at the IFS, said:

“If the trends seen so far this year continue, public sector net borrowing could reach £42bn this year. This is £4bn more than the Chancellor’s predicted in last month’s Pre-Budget Report, although this would not be a particularly big error by historical standards. The overshoot in borrowing to date reflects the fact that capital spending is growing twice as quickly as the Treasury forecast in the Pre-Budget Report, rather than particularly weak tax revenues.

Of course, these trends could change. Growth in public sector capital spending might slow over the rest of the year, not least because it is very lumpy from month to month. Perhaps more worryingly for the Chancellor, the recent problems in banks and financial markets could further depress already weak corporation tax receipts as well as reducing the income tax receipts the Treasury might get from City bonuses and salaries. The Treasury revised down its forecasts for corporation tax and income tax receipts last month, but in the past it has underestimated both the size and the duration of the hit to revenues from problems in the financial sector.”

**Headline Comparisons**

- **Central government current receipts** in October were 4.4% higher than in the same month last year. Last month’s Pre-Budget Report forecast for 2007–08 implies an increase over last year’s levels of 6.0% for the year as a whole and of 6.7% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 5.0% for the year to date, and a 5.2% increase in September and October 2007 over the same two months last year.

- **Central government current spending** in October was 8.7% higher than in the same month last year. Last month’s Pre-Budget Report forecast for 2007–08 implies an increase over last year’s levels of 6.0% for the year as a whole and of 6.7% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 6.7% for the year to date, and an 8.0% increase in September and October 2007 over the same two months last year.

- **Public sector net investment** in October was £2.6bn compared to just £0.9bn in the same month in 2006. So far in 2007–08, a total amount of £12.7bn has been spent on public sector net investment, which is 24.6% higher than had been spent by the same point in 2006–07. Last month’s Pre-Budget Report predicted that net
investment in 2007–08 as a whole would be £29.7bn, which is 13.1% above last year’s level and implies an increase of 18.8% for the period from September 2007 to March 2008.

What would happen if these trends continued?

Under the assumption that borrowing in the first seven months of 2007–08 as a proportion of the year’s total is the same as it was in 2006–07 then:

- **Public Sector Net Borrowing** would be around £42bn. This is compared to the £35.1bn forecast in the March 2007 Budget and the £38.0bn forecast in last month’s Pre-Budget Report.

- **Current Budget** would be in deficit by around £7bn. This is compared to a the £5.7bn deficit forecast in the March 2007 Budget and the £8.3bn forecast in last month’s Pre-Budget Report.

It should be remembered that the average absolute error in forecasting one year ahead has been around £15bn. So an error of the magnitude implied by extrapolating from these trends would be small by historical standards.

Northern Rock

The Government’s guarantee for the liquidity support provided by the Bank of England to Northern Rock is counted as a contingent liability. There is no current impact on official measures of the public finances. Were the guarantee to be exercised then the resulting Government support would score as a capital grant. This would have no impact on the golden rule, but would increase public sector net debt. Were Northern Rock to be brought into public ownership public sector net debt would be increased to the extent to which the Government’s financial liabilities were increased by more than the Government’s financial assets.

Assessing compliance with the fiscal rules

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”. Since July 2005 the Treasury has estimated that an economic cycle began in the first half of 1997 and the Pre-Budget Report stated that “the economy may currently be operating slightly above trend and that output may have moved up through trend towards the end of 2006”. If correct then the financial years 1997–98 to 2006–07 inclusive would cover the HM Treasury’s definition of an economic cycle. The government said that, over this economic cycle, “stable and prudent” would be defined as keeping public sector net debt below 40% of GDP in each and every year. Apart from in 1997–98, when debt was at 41.3% of GDP, public sector net debt was indeed kept below this level in each year. However, Alistair Darling is yet to announce whether he will continue to aim to keep net debt below 40% of national income in each year of the new economic cycle which may have begun late in 2006. When considering how this rule is to be applied, 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. However some difficulties exist with, in particular, measuring public sector pension liabilities accurately since their magnitude is heavily dependent on the assumptions underpinning them, which is not the case with conventional government debt.
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 cumulative surplus over the years 1997–98 to 2006–07 is estimated to have been £19.4bn in 2007–08 terms. This means that over this period the government met its golden rule. However, looking forward over the new economic cycle, some improvements to the golden rule may be desirable and the start of the new cycle would be a good time to consider these. In particular, as discussed in Chapter 3 of the January 2007 IFS Green Budget, 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.

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 2007 show:

Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (net cash) National Insurance Contributions for October 2007 were 10.4% higher than in the same month last year. Last month’s Pre-Budget Report forecast implies that the receipts from these taxes will be 7.0% up on last year’s levels over the whole year, and 7.2% up over the period from September 2007 to March 2008. Together, the receipts for these taxes during the first seven months of 2007–08 were 7.4% higher than those for the same months of 2006–07, while receipts for September and October 2007 were 9.1% higher than the same two months last year.

Corporation Tax receipts for October 2007 were 1.6% higher than in the same month last year. Last month’s Pre-Budget Report forecast implies that these receipts will be 4.5% up on last year’s levels over the whole year, and 9.6% up over the period from September 2007 to March 2008. Corporation Tax receipts for the first seven months of 2007 were the same as those for the same months last year, while receipts for September and October 2007 were 3.8% higher than the same two months last year.

Cash receipts of VAT in October 2007 were 10.7% higher than the same month last year. Last month’s Pre-Budget Report forecast implies that these receipts will be 5.2% up on last year’s levels over the whole year, and 2.9% up over the period from September 2007 to March 2008. VAT receipts for the first seven months of 2007 were 7.9% higher than those for the same months in 2006, while receipts for September and October 2007 were 6.6% higher than the same two months last year.

Central government current spending

Expenditure on net social benefits was 8.0% higher in October 2007 than in October 2006. Last month’s Pre-Budget Report forecast implies that this spending will be 5.8% up on last year’s levels over the whole year, and 5.9% up over the period from September 2007 to March 2008. Expenditure during the first seven months of 2007 was 6.6%
higher than in the same months of 2006, while spending in September and October 2007 was 8.6% higher than the same two months last year.

Spending on debt interest (which is relatively small as a share of spending overall) was £3.1bn in October 2007 compared to £2.5bn in October 2006.

Other current spending by central government, including spending on the delivery of public services, was 7.7% higher in October 2007 than in October 2006. Last month’s Pre-Budget Report forecast implies that this spending will be 6.5% up on last year’s levels over the whole year, and 7.4% up over the period from September 2007 to March 2008. Comparing the first seven months of 2007–08 with the same months in 2006–07, the figure is 6.0% while spending in September and October 2007 was 7.8% higher than the same two months last year.

In October 2007 public sector net investment £2.6bn compared to just £0.9bn in the same month in 2006. So far in 2007–08, a total amount of £12.7bn has been spent on public sector net investment, which is 24.6% higher than had been spent by the same point in 2006–07. Last month’s Pre-Budget Report predicted that net investment in 2007–08 as a whole would be £29.7bn, which is 13.1% above last year’s level and implies an increase of 18.8% for the period from September 2007 to March 2008.

Further information and contacts
For further information on today’s public finance release please contact: Robert Chote or Carl Emmerson on 020 7291 4800, or email rchote@ifs.org.uk or cemmerson@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

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.