IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published *Public Sector Finances September 2006*. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first half of financial year 2006–07.

**Headline Comparisons**

- **Central government current receipts** in September were 4.1% higher than in the same month last year. Receipts in the first half of 2006–07 were 6.3% higher than in the same months of 2005–06. The 2006 Budget implied that central government current receipts for the whole of 2006–07 would be 6.4% above 2005–06 levels.

- **Central government current spending** in September was 7.7% higher than in the same month last year. Spending in the first half of 2006–07 was 7.6% higher than in the same months of 2005–06. The 2006 Budget implied that central government current spending for the whole of 2006–07 would be 4.7% above 2005–06 levels.

- **Public sector net investment** in September was £0.2bn higher (11.1%) than in the same month last year. Together, public sector net investment during the first half of 2006–07 has been £4.3bn higher (53.5%) than in the same months of 2005–06. The Budget predicted that net investment in 2006–07 would be 20.2% above last year’s level.

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

“Today’s figures show that over the first half of this year receipts have grown in line with the Budget projection whereas spending growth will need to slow for the Treasury’s forecast to be met. On the receipts side, strong growth in receipts of corporation tax, income tax and capital gains tax have been sufficient to outweigh weak growth in VAT, and other, receipts. On the spending side, spending on benefits and tax credits continues to grow faster than the Treasury’s forecast for growth over the whole year. The same is true of spending by central government on the delivery of public services.

As a result, the current budget is running at roughly the same level as it was this time last year. For the 2006 Budget forecast for this year to be met the current budget deficit would have to be half that seen last year. Therefore the pattern seen so far this year will no doubt be disappointing for the Chancellor.”
Assessing compliance with the golden rule

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 can only borrow to finance capital spending.

In the 2006 Budget the Treasury estimated that the present economic cycle began in 1997–98 and would close in 2008–09, in line with its Pre-Budget Report 2005 judgement. As was discussed in more detail in July’s press release, revisions to national accounts data published on 30 June 2006 raised the possibility that the Treasury would once again have to revise its dating of the cycle. In particular, economic growth had been stronger in recent years than previously thought.

One possibility is that the Treasury could conclude that, rather than continuing to 2008–09, the cycle which began in 1997–98 ended in either 2003–04 or 2004–05, and that a fresh cycle started in the same year. Over a cycle running from 1997–98 to 2003–04 there would have been a cumulative surplus on the current budget of 3.8% of one year’s national income, corresponding to £49bn in today’s prices. So the golden rule would have been met. But over the first 3 years of the next cycle (2003–04 to 2005–06) there would already have been a cumulative deficit of 4.6% of one year’s national income, or £59bn in today’s prices. With the national accounts revisions implying that the economy would probably be back ‘on trend’ in 2008–09 or earlier, it seems highly unlikely, if policies remain unchanged, that the golden rule would be met over this period.

It is far from a foregone conclusion that the Treasury will change the date of the cycle in this way. Even if it concedes that the economy moved above trend from late 2003 to late 2004, it may argue that it did so by an insignificant amount and that this ‘mini-cycle’ should be considered as part of a longer cycle. This would be consistent with its decision last year to add 1997–98 and 1998–99 into its definition of the current cycle. If the forecasts from Budget 2006 prove to be correct, the golden rule would be met over this period with £12.4bn to spare.

The Budget forecast implies that the current budget deficit this year would be 52.8% lower than the £14.8bn recorded last year. Over the first half of this year, the current budget is only 2.0% lower than the same period last year. Were this to continue for the next six months, which it might not, the Treasury’s margin of error would be reduced to just £4.8bn (less than 40% of what the Treasury expected just six months ago).

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 half. Bearing this in mind, the figures for receipts and spending in September 2006 show:

Central government current receipts

Receipts of Income Tax and Capital Gains Tax for September were 15.3% higher than in the same month last year. Together, the receipts for these taxes during the first six months of 2006–07 were 8.8% higher than those for the same months in 2005–06. The Budget forecasts imply that these taxes’ receipts will grow by 7.3% over the whole of 2006–07.
Net *cash* receipts of National Insurance Contributions were 3.3% lower in September 2006 than in the same month last year and for the first six months of 2006–07 were 0.3% higher than in the same months in 2005–06. The Budget forecasts imply that these taxes’ receipts will grow by 4.8% over the whole of 2006–07. *Accrued* receipts of National Insurance Contributions have grown by 4.7% over the first half of 2006–07 compared to the same months last year, which is in line with the Treasury forecast for *cash* receipts.

Cash receipts of VAT in September 2006 were 2.3% lower than the same month last year. VAT receipts for the first half of 2006–07 were 3.4% higher than those for the same months in 2005–06. The Budget forecast implies that VAT receipts will grow by 5.0% over the whole of 2006–07.

Corporation tax receipts for September 2006 were 12.5% higher than in the same month last year. Corporation tax receipts for the first half of 2006 were 19.0% higher than those for the same months last year. The Budget forecast implies that Corporation tax receipts will grow by 15.5% over the whole of 2006–07, well above the trend to date.

**Central government current spending**

Expenditure on net social benefits was 7.5% higher in September 2006 than in September 2005. Expenditure during the first half of 2006–07 was 5.3% higher than in the same months of 2005–06. The Budget forecast implies that central government net social benefit expenditure will grow by 2.6% over 2006–07.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.2bn in September 2006 compared to £2.1bn in September 2005.

Other current spending by central government, including spending on the delivery of public services, was 7.8% higher in September 2006 than in September 2005. Comparing the first half of 2006–07 with the same months in 2005–06, the figure is 9.0%. The Budget forecast implies that this component of spending will grow by 5.8% over the year as a whole.

In September 2006, **public sector net investment** was £2.0bn compared to £1.8bn in the same month in 2005. So far in 2006–07, a total amount of £12.3bn has been spent on public sector net investment, compared to the £8.0bn that had been spent by the same point in 2005–06. The Budget predicted that net investment in 2006–07 would be £28.8bn, which is 20.2% 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/budget2006/index.php
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.