IFS analysis of today’s public finance figures

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

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

“The Pre-Budget Report forecast that growth in central government receipts would accelerate over the remainder of this financial year. Today’s figures show that this was not the case in September, despite relatively strong growth in cash receipts of Income Tax, National Insurance Contributions and Capital Gains Tax. Cash receipts of VAT were particularly weak this month with these being lower in cash terms in September 2007 than in September 2006. However much of these data may already have been available to the Treasury when they made their projection for last week’s Pre-Budget Report.

Looking forwards Alistair Darling expects net debt to remain just below 40% of national income throughout the forecast period, but the current budget not to return to surplus until 2009–10. Despite the PBR statement last week the Chancellor is yet to announce how the sustainable investment rule will be judged over the new economic cycle which may have begun one year ago. If he defines compliance as ensuring that ‘net debt will be maintained below 40% of GDP in each and every year’, as Mr Brown defined it over the period of his Chancellorship, then the sustainable investment rule would be expected to be met, albeit with very little, and declining, room to manoeuvre. If Mr Darling’s forecast for the current budget proves to be correct, the golden rule would also be met over an economic cycle beginning in 2006–07, provided the cycle runs for at least five years. Risks to these forecasts include revenues lost due to the recent problems in banks and financial markets failing to bounce back as the Chancellor expects, a larger detrimental impact of this instability on the UK economy in 2008, and the Government’s spending plans failing to be compatible with its aspirations for improving public services and challenging target for reducing child poverty”.

**Headline Comparisons**

- **Central government current receipts** in September were 4.6% higher than in the same month last year. Last week’s Pre-Budget Report forecast for 2007–08 implies an increase over last year’s levels of 6.1% for the year as a whole and of 6.8% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 4.9% for the year to date.

- **Central government current spending** in September was 5.4% higher than in the same month last year. Last week’s Pre-Budget Report forecast for 2007–08 implies an increase over last year’s levels of 6.1% for
the year as a whole and of 6.8% for the period from September 2007 to March 2008. The latest figures show an increase over last year’s levels of 6.3% for the year to date.

- **Public sector net investment** in September was £1.2bn, or 68%, higher than in the same month last year. Last week’s Pre-Budget Report forecast for 2007–08 implies an increase of 13.1% for the year as a whole and an increase of 19.5% for the period from September 2007 to March 2008. Together, public sector net investment during the first six months of 2007–08 has been £10.3bn, which is 10.8% higher than in the same months of 2006–07.

**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 £18.7bn 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 half. Bearing this in mind, the figures for receipts and spending in September 2007 show:
Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (net cash) National Insurance Contributions for September 2007 were 7.8% higher than in the same month last year. Last week’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 six months of 2007–08 were 7.0% higher than those for the same months of 2006–07.

Cash receipts of VAT in September 2007 were 1.3% lower than the same month last year. Last week’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 six months of 2007 were 7.3% higher than those for the same months in 2006.

Corporation Tax receipts for September 2007 were 15.0% higher than in the same month last year, although due the pattern of these receipts over the year, September is not usually a significant month. Last week’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 six months of 2007 were 0.8% lower than those for the same months last year.

Central government current spending

Expenditure on net social benefits was 6.3% higher in September 2007 than in September 2006. Last week’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 six months of 2007 was 5.8% higher than in the same months of 2006.

Spending on debt interest (which is relatively small as a share of spending overall) was £1.0bn in September 2007 compared to £1.4bn in September 2006.

Other current spending by central government, including spending on the delivery of public services, was 6.5% higher in September 2007 than in September 2006. Last week’s Pre-Budget Report forecast implies that this spending will be 6.6% up on last year’s levels over the whole year, and 7.2% up over the period from September 2007 to March 2008. Comparing the first six months of 2007–08 with the same months in 2006–07, the figure is 5.8%.

In September 2007, public sector net investment was £3.0bn compared to £1.8bn in the same month in 2006. So far in 2007–08, a total amount of £10.3bn has been spent on public sector net investment, which is the same as had been spent by the same point in 2006–07. Last week’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.

Further information and contacts

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


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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.