IFS analysis of today’s public finance figures

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

**Headline Comparisons**

- **Central government current receipts** in August were 7.6% higher than in the same month last year. Receipts in the first five months of 2005–06 were 7.2% 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 8.3% above 2004–05 levels.

- **Central government current spending** in August was 3.8% higher than in the same month last year. Spending in the first five months of 2005–06 was 5.9% 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 6.0% above 2004–05 levels.

- **Public sector net investment** in August was £0.3bn, or 18.4%, higher than in the same month last year. Together, public sector net investment during the first five months of 2005–06 has been £8.7bn, which is 75.3% higher than in the same months of 2004–05. The Budget predicted that net investment in 2005–06 would be £26.2bn, which is 38.0% above last year’s level.

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

“Today’s figures show an improvement on the public sector current budget – the measure used to assess compliance with the Golden Rule. This is in part due to slower growth in central government current spending, which was just 3.8% higher in August 2005 than in August 2004, compared with the 6.0% increase over the year as a whole implied by the Budget forecast. While this is good news in terms of keeping borrowing down, it should be noted that it comes alongside an increase in spending on net social benefits, suggesting that the decrease may be coming from spending on the delivery of public services. Spending on public sector net investment also slowed compared with previous months, but the cumulative total for the 5 months of this financial year is still running above the Budget forecast for the year as a whole. This should aid efforts to improve the delivery of public services, if the money is being spent effectively.

Tax revenues continue to grow more slowly than the Budget forecast for the year as a whole, with VAT receipts in particular remaining weak.
Overall, the public sector current budget showed an improvement this month and is now, cumulatively, stronger than in the same 5 months last financial year. If the trends seen so far this year continue, the Treasury can expect to meet the Golden Rule over a cycle running from 1997–98 to 2005–06. However, if the cycle does not close this year but continues into next financial year it may prove more difficult. In particular, it would require the significant improvement in the public sector current budget that the Treasury expected to occur this year to finally materialise in 2006–07."

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 £22.7bn 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 five months of the present financial year the current budget deficit was 10.8% lower than in the equivalent period last year – if the same were to be true over the next seven months, which it might not be, the deficit for 2005–06 would come in at £15.8bn. The average absolute forecasting error made one year ahead by the Treasury in the past is equivalent to £16bn in today’s terms.

For the cycle to close in 2005–06, based on the Treasury’s latest estimates, the economy would need to grow by 3½% between the first quarter of 2005 and the first quarter of 2006, more than most independent forecasters expect. This suggests that the Treasury may predict in this year’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 will be a small surplus.

Further Analysis

Little can be inferred or extrapolated with confidence about the public finances in 2005–06 from information on only the first five months of the financial year. Bearing this in mind, the figures for receipts and spending in August 2005 show:

Central government current receipts

Corporation tax receipts for August 2005 were 39.9% higher than in the same month last year. Corporation tax receipts for the first five months of 2005 were 16.2% 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.

Receipts of Income Tax, Capital Gains Tax and National Insurance Contributions for August were 12.2% higher than in the same month last year. Together, the receipts for these taxes during the first five months of 2005–06 were 9.3% 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.
Cash receipts of VAT in August 2005 were 0.8% higher than the same month last year. VAT receipts for the first five months of 2005 were 1.7% lower 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.

Central government current spending

Expenditure on net social benefits was 8.1% higher in August 2005 than in August 2004. Expenditure during the first five months of 2005 was 6.0% higher than in the same months of 2004. The Budget forecast implies that central government net social benefit expenditure will grow by 8.3% over 2005–06.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.5bn in August 2005 compared to £2.2bn in August 2004.

Other current spending by central government, including spending on the delivery of public services, was 1.1% higher in August 2005 than in August 2004. Comparing the first five months of 2005–06 with the same months in 2004–05, the figure is 5.2%. The Budget forecast implies that this component of spending will grow by 4.9% over the year as a whole.

In August 2005, public sector net investment was £1.7bn compared to £1.4bn in the same month in 2004. So far in 2005–06, a total amount of £8.7bn has been spent on public sector net investment, compared to the £5.0bn 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 38.0% above last year’s level.

Further information and contacts

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

Useful links and background information on the Budget can be found at http://www.ifs.org.uk/budgets/budget2005/index.php

Office for National Statistics & HM Treasury, Public Sector Finances, August 2005:

HM Treasury, Evidence on the UK economic cycle, 19th August 2005
http://www.hm-treasury.gov.uk/media/2E6/A5/economic_cycles190705.pdf

The IFS Green Budget, January 2005:

HM Treasury, Budget 2005:
http://www.hm-treasury.gov.uk/budget/budget_05/bud_bud05_index.cfm

HM Treasury, Public Finance Statistics Index:
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.