IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published Public Sector Finances August 2006. 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 2006–07.

Headline Comparisons

- **Central government current receipts** in August were 6.1% higher than in the same month last year. Receipts in the first five months of 2006–07 were 6.9% 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 August was 6.7% higher than in the same month last year. Spending in the first five months of 2006–07 was 7.9% 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 4.8% above 2005–06 levels.

- **Public sector net investment** in August was £2.0bn, or 8.7% higher, than in the same month last year. Together, public sector net investment during the first five months of 2006–07 has been £10.6bn, which is 62.7% higher than in the same months of 2005–06. The Budget predicted that net investment in 2006–07 would be £28.8bn, which is 15.5% above last year’s level.

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

“Over the year to date, receipts have grown slightly faster than the Treasury forecast in the 2006 Budget for the year as a whole. As has been the case in recent months, today’s figures show that strong growth in receipts of Corporation, Income and Capital Gains taxes have offset weak growth in receipts of National Insurance Contributions and VAT. Less encouraging for the Chancellor is the stronger than expected growth in current spending by central government; spending on public services is running ahead of Treasury expectations, but at least part of this is due to a change in timing. Expenditure on benefits and tax credits is growing faster than the Budget 2006 forecast, at least partly due to the fact that claimant unemployment is rising more quickly than the Treasury had assumed.

In terms of the fiscal rules, today’s release had a potentially significant impact on the ease with which the Chancellor can expect to meet the sustainable investment rule in the coming years. Improvements to the way that elements of the Private Finance Initiative are scored in the public sector accounts have added 0.4% of national income to debt. Of
greater importance for the fiscal rules will be the implication of this change for debt going forwards, since the sustainable investment rule is likely to be more constraining in the coming years than it has been to date. The Autumn 2006 Pre-Budget Report should shed more light on this issue.”

**PFI accounting of finance lease liabilities**

Today’s ONS/HM Treasury press release gave the increases in public sector net debt due to changes in the treatment of finance lease liabilities, typically due to the Private Finance Initiative (PFI). The publication of these changes had been expected following a pre-announcement in *Public Sector Finances June 2006*, released on 20 July 2006.

The Public Sector Finances data will now include debt undertaken by the private sector under PFI, where accountants judge (and the National Audit Office agrees) that the public sector has taken on the risks and rewards of owning the asset concerned (e.g. a hospital), and where the new asset – or a phase of improvement work on an existing asset – is operational. This leads to public sector net debt being higher. Today’s release increased public sector net debt in March 2006 by £4.95bn. Figure 1, below, shows the effect that this accounting change would have had on the estimates of public sector net debt given in Budget 2006. The Chancellor’s self-imposed ‘sustainable investment rule’ commits him to keeping public sector net debt at or below 40% of national income. Over the current economic cycle this needs to be true every year. The Budget 2006 estimate for public sector net debt in 2005–06 was for 36.4% of national income and today’s revisions would increase that by 0.4% of national income to 36.8%.

**Figure 1. Changes to public sector net debt as a result of including estimates of the value of finance lease liabilities.**

The Treasury estimates that the capital value of assets on (or to be on) the public sector balance sheet is £23bn (1.9% of national income). Two-thirds is accounted for by the London Underground PPP. Today’s addition to public sector net debt is less than £23bn for two reasons: 1) the £23bn includes projects that are not yet operational and 2) the public sector has already paid the private sector money to cover some of the finance lease liability.
Going forwards, the adjustment to net debt will be further increased by the outstanding value of projects that become operational. However the upwards adjustment will also be reduced by payments made by the public sector to the private sector that cover part of the finance lease liability and which are already included in public sector debt. Therefore it is not straightforward to judge how today’s improvements to the measurement of debt will change debt going forwards; over the lifetime of a PFI deal, the effect on debt will initially be zero, before increasing to the outstanding capital value of the project and then slowly declining back to zero. A significant part of the revision to future public sector net debt could relate to the London Underground PPP since the capital value of these projects is £16bn but today’s adjustment for finance leases in March 2006 is just £0.9bn. The size of future adjustments will depend on when the components of the project become operational and the extent to which the finance lease liability has already been covered by intermediate payments already included in public sector net debt.

The Budget projects public sector net debt to increase to 38.4% of national income by 2009–10, i.e. just 1.6% of national income below the 40% ceiling. It is clear that today’s adjustments will erode at least part of this, increasing the chance that debt exceeds the 40% ceiling. Any breach as a result of today’s announcement would not be permanent since there is no impact of this improvement to the measure of public sector net debt in the long-run. In considering the effect of these changes on net debt, it is also important to remember that there is nothing special about the choice of 40% as a ceiling and it could be argued that a significant change in the definition of net debt should be accompanied by an equivalent change in the ceiling under the sustainable investment rule.

**Further Analysis**

Little can be inferred or extrapolated with confidence about the public finances in 2006–07 from information on only the first five months of the financial year. Bearing this in mind, the figures for receipts and spending in August 2006 show:

**Central government current receipts**

Receipts of Income Tax and Capital Gains Tax for August were 4.2% higher than in the same month last year. Together, the receipts for these taxes during the first five months of 2006–07 were 7.8% 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. The weak growth in August’s receipts is at least in part due to the timing of the part of self-assessment income tax payments which leads to lower receipts in August 2006 but higher receipts in July 2006. Income Tax and Capital Gains Tax receipts for both July and August 2006 together, were 9.8% higher than in the same two months last year.

Net cash receipts of National Insurance Contributions were 2.3% higher in August 2006 than in the same month last year and for the first five months of 2006–07 were 1.0% 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. Net cash receipts are partly subdued by contracted-out rebates being paid to personal pension funds earlier in 2006–07 than in 2005–06. Accrued receipts of National Insurance Contributions were 4.8% higher in August 2006 than in the same month last year and for the first five months of 2006–07 were 3.7% higher than in the same months of 2005–06. These accrued figures are likely to give a better picture of the underlying pattern to date.
Cash receipts of VAT in August 2006 were 2.0% higher than the same month last year. VAT receipts for the first five months of 2006 were 4.2% higher than those for the same months in 2005. The Budget forecast implies that VAT receipts will grow by 5.0% over the whole of 2006–07.

Corporation Tax receipts for August 2006 were 42.0% higher than in the same month last year. Corporation Tax receipts for the first five months of 2006 were 19.7% 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.

**Central government current spending**

Expenditure on net social benefits was 4.1% higher in August 2006 than in August 2005. Expenditure during the first five months of 2006 was 4.7% higher than in the same months of 2005. The Budget forecast implies that central government net social benefit expenditure will grow by 2.6% over 2006–07. This was based on the assumption that claimant unemployment would rise slowly from 0.91 million at the time of the Budget to 0.97 million in 2007–08. Figures published last week showed that the claimant unemployment count in August 2006 was 0.95 million.

Spending on debt interest (which is relatively small as a share of spending overall) was £2.2bn in August 2006 compared to £2.3bn in August 2005.

Other current spending by central government, including spending on the delivery of public services, was 8.8% higher in August 2006 than in August 2005. Comparing the first five months of 2006–07 with the same months in 2005–06, the figure is 10.0%. The Budget forecast implies that this component of spending will grow by 5.9% over the year as a whole.

In August 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 £10.6bn has been spent on public sector net investment, compared to the £6.5bn 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 15.5% 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 Christine Frayne on 020 7291 4800, or email rchote@ifs.org.uk, cemmerson@ifs.org.uk or efrayne@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](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](http://www.ifs.org.uk/budgets/budget2006/index.php)


Office for National Statistics, Including Finance Lease Liabilities in Public Sector Net Debt: PFI and Other

The IFS Green Budget, January 2006:

HM Treasury, Budget 2006:
http://www.hm-treasury.gov.uk/budget/budget_06/bud_bud06_index.cfm

HM Treasury, Public Finance Statistics Index:
http://www.hm-treasury.gov.uk/economic_data_and_tools/pubfinance/data_pubfinance_index.cfm

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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.
3. Please note that the Institute for Fiscal Studies is not related in any way to the ifs School of Finance (also known as ifs). For information about the ifs School of Finance, see http://www.ifslearning.com