IFS analysis of today’s public finance figures

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

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

“Today’s figures show that Alastair Darling will have to deliver his first Pre-Budget Report as Chancellor next month with government borrowing higher than last year, rather than falling as Gordon Brown had hoped and predicted in his final Budget in March. Over the first five months of this financial year, the public sector current budget deficit was £3bn larger than over the same period last year, whereas Budget 2007 had predicted that the deficit for the year as a whole would be smaller. The main reason that the current budget deficit is not yet shrinking as the Treasury hopes is a cash fall in corporation tax receipts. This has been more than enough to outweigh strong growth in cash VAT receipts. But as we are only five months into 2007–08, the figures for the year to date do not necessarily give an accurate guide to trends over the year as a whole. Over the longer term, the Treasury will doubtless be concerned that the recent problems in banks and financial markets will reduce the tax payments it receives from the financial sector, an unusually important source of revenue for the UK.

Next month’s combined Pre-Budget Report and Comprehensive Spending Review is a good opportunity for Mr Darling to announce improvements to the fiscal framework. 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. The Treasury should also consider what measures it can take to boost confidence that future forecasts of the public finances will not be made overoptimistic to delay painful tax and spending decisions. In relation to the sustainable investment rule, Mr Darling is yet to announce whether or not he will continue to aim to keep net debt below 40% of national income. The Treasury should consider 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 might be more appropriate. While estimates of conventional government debt rarely change significantly, the present value of expected public sector pension liabilities can change significantly with run-of-the-mill revisions to estimates of longevity and the rate used to discount future pension payments.”

Headline Comparisons

- **Central government current receipts** in August were 3.6% higher than in the same month last year. Receipts in the first five months of 2007–08 were 5.1% higher than in the same months of 2006–07. The
2007 Budget implied that central government current receipts for the whole of 2007–08 would be 6.7% above 2006–07 levels.

- **Central government current spending** in August was 7.4% higher than in the same month last year. Spending in the first five months of 2007–08 was 6.4% higher than in the same months of 2006–07. The 2007 Budget implied that central government current spending for the whole of 2007–08 would be 6.1% above 2006–07 levels.

- **Public sector net investment** in August was £0.8bn, or 67%, higher than in the same month last year. Together, public sector net investment during the first five months of 2007–08 has been £7.5bn, which is 0.5% higher than in the same months of 2006–07. The Budget predicted that net investment in 2007–08 would be £29.4bn, which is 11.8% above last year’s level.

Reclassification of Metronet and Tube Lines from the private sector to the public sector

In the light of new information the ONS has decided that the degree of control that the public sector has over these entities means that they should be classified as part of the public sector. The ONS has stated that the impact on the current budget, and therefore the golden rule, will be “relatively small”. The impact on public sector net debt is also estimated to be small. At March 2006 this reclassification is estimated to add just £0.3bn onto public sector net debt, which totals over £500bn. The reason why the revision is small is that Metronet and Tube Lines are estimated by the ONS to have net liabilities of £1.7bn and of this £1.4bn had already been included in public sector net debt.

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”. The Treasury estimates that an economic cycle began in the first half of 1997 and the Budget states that “the economy is expected to have returned to trend early in 2007”. This and other figures contained in the Budget imply that the Treasury now expects this cycle to include the fiscal years 1997–98 to 2006–07. 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. 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

Little can be inferred or extrapolated with confidence about the public finances in 2007–08 from information on only the first five months of the financial year. Bearing this in mind, the figures for receipts and spending in August 2007 show:

Central government current receipts

Receipts of Income Tax, Capital Gains Tax and (cash) National Insurance Contributions for August 2007 were 4.8% higher than in the same month last year. Together, the receipts for these taxes during the first five months of 2007–08 were 7.0% higher than those for the same months of 2006–07. The Budget forecasts imply that these taxes’ receipts will grow by 7.6% over the whole of 2007–08.

Cash receipts of VAT in August 2007 were 1.0% lower than the same month last year. VAT receipts for the first five months of 2007 were 8.4% higher than those for the same months in 2006. The Budget forecast implies that VAT receipts will grow by 3.4% over the whole of 2007–08.

Corporation Tax receipts for August 2007 were 44.9% lower than in the same month last year. Corporation Tax receipts for the first five months of 2007 were 3.1% lower than those for the same months last year. The Budget forecast implies that Corporation Tax receipts will grow by 11.7% over the whole of 2007–08.

Central government current spending

Expenditure on net social benefits was 5.5% higher in August 2007 than in August 2006. Expenditure during the first five months of 2007 was 5.7% higher than in the same months of 2006. The Budget forecast implies that central government net social benefit expenditure will grow by 5.6% over 2007–08.

Spending on debt interest (which is relatively small as a share of spending overall) was £3.1bn in August 2007 compared to £2.4bn in August 2006.

Other current spending by central government, including spending on the delivery of public services, was 6.2% higher in August 2007 than in August 2006. Comparing the first five months of 2007–08 with the same months in 2006–07, the figure is 5.7%. The Budget forecast implies that this component of spending will grow by 6.3% over the year as a whole.

In August 2007, public sector net investment was £2.1bn compared to £1.2bn in the same month in 2006. So far in 2007–08, a total amount of £7.5bn has been spent on public sector net investment, which is the same as had been spent by the same point in 2006–07. The Budget predicted that net investment in 2007–08 would be £29.4bn, which is 11.8% 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

IFS Green Budget, January 2007, containing in-depth public finance analysis, can be found at:

Useful links and background information on Budget 2007 can be found at

Office for National Statistics & HM Treasury, Public Sector Finances, August 2007:

HM Treasury, Budget 2007:
http://www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_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.