IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published *Public Sector Finances July 2004*. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first four months of financial year 2004–05.

**Headline Comparisons**

- **Central government current receipts** in July were 6.5% higher than in the same month last year. Receipts in the first four months of this financial year were 6.1% higher than in the same months of 2003–04. The 2004 Budget implied that central government current receipts for the whole of 2004–05 would be 7.6% above 2003–04 levels.

- **Central government current spending** in July was 8.9% higher than in the same month last year. Spending in the first four months of this financial year was 6.4% higher than in the same months of 2003–04. The 2004 Budget implied that central government current spending for the whole of 2004–05 would be 5.2% above 2003–04 levels.

- **Public sector net investment** in July was £1.3bn, or 36.7% higher than in the same month last year. Together, public sector net investment during the first four months of this financial year has been £3.0bn, which is 9.8% lower than in the same four months of 2003–04. The Budget predicted that net investment in 2004–05 would be £22.4bn, which is 64.0% above last year’s level.

**Further Analysis**

Little can be inferred or extrapolated about the public finances in 2004–05 from information about only the first third of the financial year. Bearing this in mind, the figures for receipts and spending in July 2004 show:

**Central government current receipts**

Income tax and Capital Gains Tax receipts for July 2004 were 5.4% higher than in the same month last year. Together, the receipts for these taxes during the first four months of 2004–05 were 1.5% higher than those for the first four months of 2003–04. The Budget forecasts imply that these taxes’ receipts will grow by 7.2% over the whole of 2004–05.

Corporation tax receipts for July 2004 were 9.5% higher than in the same month last year. Corporation tax receipts for the first four months of this financial year were 15.0% higher than those for the same four months last year. The Budget forecast implies that corporation tax receipts will grow by 21.4% over the whole of 2004–05.

VAT receipts in July 2004 were 5.0% higher than the same month last year. VAT receipts for the first four months of this financial year were 8.0% higher than those for the same four months in 2003. The Budget forecast implies that VAT receipts will grow by 5.8% over the whole of 2004–05.
In July 2004, accrued receipts of social security contributions grew by 1.4% over last July’s level; for the first four months of this financial year they were 1.8% higher than in the same four months in 2003. The Budget forecast implies that social security contributions will grow by 3.2% over the whole of 2004–05.

Central government current spending

Expenditure on net social benefits was 3.4% higher in July 2004 than in July 2003. Expenditure during the first four months of this financial year was 6.5% higher than in the same months of 2003–04. The Budget forecast implies that central government net social benefit expenditure will grow by 6.5% over 2004–05.

Spending on debt interest (which is relatively small as a share of spending overall) was 6.2% higher in July 2004 than in July 2003.

Other current spending by central government, including spending on the delivery of public services, was 11.7% higher in July 2004 than in July 2003. Comparing the first four months of 2004–05 with the first four months of 2003–04, the figure is 7.0%. The Budget forecast implies that this component of spending will grow by 4.5% over the year as a whole.

In July 2004, public sector net investment was £1.3bn compared to £0.9bn in the same month in 2003. So far in 2004–05, a total amount of £3.0bn has been spent on public sector net investment, compared to the £3.3bn that had been spent by the same point in 2003–04. The total value of public sector net investment expected in 2004–05 according to Budget 2004 forecasts is £22.4bn, which is 64.0% higher than the total for 2003–04.

The effects of raised oil prices and relative weak stock market performance on the public finances

Higher oil prices affect tax revenues by raising the tax receipts from North Sea Oil taxes; they also have an indirect effect if they depress economic activity and reduce revenues from other taxes. The assumption made about oil prices in Budgets and Pre-Budget Reports is based on the lower of the price at the time of the forecast and the average of the latest independent forecasts. In March 2004, at the time of the Budget, the average of the independent forecasts was an oil price of $27.4/barrel in 2004 and $26.6/barrel in 2005. The assumption used by the Treasury was that oil prices would be $27.4/barrel this year and would remain the same in real terms thereafter. In August 2004, the average of the most recent independent forecasts is $33.9/barrel in 2004 and $31.4/barrel in 2005. According to the most recent NAO audit of the oil price assumption, the Treasury estimates that a 5% increase in the oil price would, other things being equal, increase revenues by about £220m in the first and £270m in the next year. The latest 2004 forecast is about 23.7% higher than the Budget one but half of the oil price increase is expected to be temporary. This suggests that, given the Treasury’s estimates of the revenue effects of oil prices, there may be about £1bn of extra revenue this year and £600m a year thereafter.

The stock market’s performance has an effect on stamp duty, corporation tax, Capital Gains Tax and inheritance tax revenues. The current assumption used to forecast equity prices is that the FTSE All-Share index rises from its value at the time of the forecast in line with money GDP. Between the December 2003 Pre-Budget Report and the March 2004 Budget, the FTSE All-Share index rose from 2154 to 2271, which put equity prices about 4.0% above what had been expected at the time of the Pre-Budget Report. According to the Budget, this increase was expected to add £½bn to current receipts in 2004–05 and £1bn a year thereafter. However, since March 2004, the FTSE All-Share
index has declined. The index’s value is currently about 2172, which is 6.5% below what was expected at the time of the Budget. If we apply the assumption of growth in line with money GDP to this lower level of equity prices, and assume that a 4% change in equity prices is associated with a £1bn-a-year long-run change in tax receipts, this suggests that tax receipts may be down by about £¾bn in 2004–05 and about £1½bn a year thereafter, relative to the Budget forecasts. This simple extrapolation suggests that the loss of tax revenues from the relatively weak performance of the stock market could easily offset the gains to the Exchequer from higher oil prices.

Carl Emmerson, deputy director of the IFS, said:

“Today’s figures reveal that central government receipts are continuing to grow less quickly than the Chancellor has forecast for the year as a whole. The Government always receives a large slice of corporation tax receipts in July, but while these grew by nearly 10% compared to last July’s figure the Treasury needs receipts to grow by more than twice this amount over the whole financial year if its forecast for corporation tax receipts is to be met. Weaker than expected receipts in the current financial year would strengthen doubts about the Treasury’s medium term forecast for historically high levels of corporation tax revenues.”

Further information and contacts
For further information on today’s public finance release please contact: Carl Emmerson or Sarah Love on 020 7291 4800, or email cemmerson@ifs.org.uk or slove@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/budgetindex.shtml

Office for National Statistics & HM Treasury, Public Sector Finances, July 2004:

The IFS Green Budget, January 2004:

HM Treasury, Budget 2004:
http://www.hm-treasury.gov.uk/budget/bud_bud04/bud_bud04_index.cfm

HM Treasury, Pre-Budget Report 2003 is available at:
http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr03/prebud_pbr03_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.