IFS analysis of today’s public finance figures

Today the Office for National Statistics and HM Treasury published Public Sector Finances April 2005. We now have details of central government receipts, central government spending, public sector net investment, borrowing and debt for the first month of financial year 2005–06 and revised details for the whole of financial year 2004–05.

Headline Comparisons

- **Public sector surplus on current budget** in 2004–05 is now estimated to have been minus £17.4bn (i.e. in deficit), compared to the March 2005 Budget estimate of minus £16.1bn.

- **Public sector net borrowing** in 2004–05 is now estimated to have been £35.4bn, compared to the £34.4bn estimate in the Budget.

- **Central government current receipts** in April were 9.0% higher than in the same month last year. The 2005 Budget implied that central government current receipts for the whole of 2005–06 would be 8.4% above 2004–05 levels.

- **Central government current spending** in April was 1.6% higher than in the same month last year. 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 April was £1.1bn compared to just £0.4bn in the same month last year. The Budget predicted that net investment in 2005–06 would be £26.2bn, which is 45.9% above last year’s level.

The 2004–05 outturns and the golden rule

The Chancellor is committed to planning fiscal policy in line with his two fiscal rules. The first of these, the golden rule, requires that public sector current spending be met entirely out of public sector receipts over the course of an economic cycle – in other words, that the public sector current budget is at least in balance. The present economic cycle, which began in 1999–2000, is expected by the Treasury to end during 2005–06.

If, as Morgan Stanley argued in the January 2005 IFS Green Budget, the economic cycle came to a close in 2004–05, then the golden rule was met with £8.2bn to spare. However, this would mean that the economy would be broadly on trend during 2005–06 and yet the Treasury is expecting a deficit of £5.7bn on the current budget. This could pose problems for the ability of the golden rule to be met over the new economic cycle without further tax raising measures.
If the Treasury is correct, and the economic cycle ran from 1999–2000 to 2005–06, then the golden rule will be met over the current economic cycle as long as the current budget is not in deficit by more than £8.7bn in 2005–06. The March 2005 Budget forecast is for a current budget deficit of £5.7bn, while the January 2005 IFS Green Budget forecast is for a £13.4bn deficit. The average absolute forecasting error made one year ahead by the Treasury in the past is equivalent to £15bn in today’s terms. On the basis of previous Treasury forecasting errors we estimate that if the March 2005 Budget forecast is the best available forecast then the probability that the golden rule will be met over the economic cycle ending in 2005–06 would be 57.6%, while if the January 2005 IFS Green Budget is the best available forecast then the corresponding figure would be 38.2%.

Carl Emmerson, deputy director of the IFS said:

“Today’s figures show a current budget deficit in April 2005 of £0.2bn compared to a deficit of £2.3bn in April 2004. This reduced deficit is due to low growth in spending by central government departments, including a fall in spending on social security benefits. While this improvement will no doubt be pleasing for the Chancellor, particularly given the small margin of error within which he expects to meet his golden rule, it remains touch-and-go whether or not the rule will be met over the current economic cycle. In the short term the recent increases in the oil prices should also boost revenues. If, as is expected, this increase in oil prices is not sustained then it will not reduce any need for further tax raising measures in order to comply with the golden rule in future.”

**Further Analysis**

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

**Central government current receipts**

Income tax and Capital Gains Tax receipts for April 2005 were 14.3% higher than in the same month last year. The Budget forecasts imply that these taxes’ receipts will grow by 9.6% over the whole of 2005–06.

Receipts of National Insurance Contributions in April 2005 were 4.4% higher than the same month last year. The Budget forecast implies that receipts of National Insurance Contributions will grow by 5.8% over the whole of 2005–06.

VAT receipts in April 2005 were 8.1% lower than the same month last year. The Budget forecast implies that VAT receipts will grow by 4.5% over the whole of 2005–06.

Corporation tax receipts for April 2005 were 9.7% higher than in the same month last year. The Budget forecast implies that Corporation tax receipts will grow by 28.8% over the whole of 2005–06.

**Central government current spending**

Expenditure on net social benefits was 1.4% lower in April 2005 than in April 2004. The Budget forecast implies that central government net social benefit expenditure will grow by 4.5% over 2005–06.
Spending on debt interest (which is relatively small as a share of spending overall) was £2.2bn in April 2005 compared to £1.9bn in April 2004.

Other current spending by central government, including spending on the delivery of public services, was 1.7% higher in April 2005 than in April 2004. The Budget forecast implies that this component of spending will grow by 6.5% over the year as a whole.

In April 2004, public sector net investment in April was £1.1bn compared to just £0.4bn in the same month last year. The Budget predicted that net investment in 2005–06 would be £26.2bn, which is 45.9% above last year’s level.

The effects of raised oil prices on the public finances

Higher oil prices affect tax revenues by raising the tax receipts from North Sea Oil taxes. The assumption made about oil prices in Budgets and Pre-Budget Reports depends on how the price at the time of the forecast compares to the average of the latest independent forecasts. If the former exceeds the latter, the independent forecast is used and projected to remain constant in real terms. If the actual price is below the forecast, the actual price is used instead. In March 2005, at the time of the Budget, the average of the independent forecasts was an oil price of $40.6/barrel in 2005 and $37.8/barrel in 2006. The assumption used by the Treasury was that oil prices would be $40.6/barrel this year and would remain the same in real terms thereafter. In May 2005, the most recent independent forecasts have an average of $46.3/barrel in 2005 and $41.9/barrel in 2006. 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 year and £270m in the next. The latest 2005 forecast is about 14% higher than the Budget one but the majority 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 £620m of extra revenue this year, £170m the next and negligible gains thereafter. The gains are of short duration because prices are expected to fall by 2006 almost the whole way back to previously expected levels. Moreover past experience suggests that the higher than expected current oil price could lead to the Chancellor choosing to delay the inflation increase in road fuel duties planned for 1st September 2005 – deferring this for a further 6 months would cost the exchequer £235m in 2005–06.

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


HM Treasury, Budget 2005: http://www.hm-treasury.gov.uk/budget/budget_05/bud_bud05_index.cfm
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. Estimates for the likelihood of meeting the golden rule over the current economic cycle take the Budget 2005 forecast for GDP in 2005-06 of £1,242bn.