Office for Budget Responsibility

PRESS NOTICE

The effect of oil price fluctuations on the public finances

Today the OBR publishes its report into the effect of changes in oil prices on the public finances. The report concludes that the overall effect of a temporary oil price rise would be close to zero. A permanent rise would create a loss to the public finances.

Higher oil prices would raise revenues of corporation tax, supplementary charge and petroleum revenue tax from UK oil and gas production. There are a number of offsetting effects on the public finances:

- higher pump prices would reduce the demand for fuel, lowering fuel duty receipts;
- temporarily higher inflation would push up the indexation of tax thresholds, benefits, public service pensions and index-linked gilts; and
- higher oil prices would be likely to reduce real household income and the supply potential of the economy, with detrimental effects on receipts from labour and capital income as well as from consumer spending.

The OBR Report looks at a temporary and permanent £10 a barrel rise in the oil price, an increase of around 20 per cent. While there are clear uncertainties around the estimates of the effect of oil prices on the public finances, using central estimates for a £10 a barrel higher oil price gives:

- a rise in pump prices of 7.4p a litre if fully passed through. Changing fuel duty by 1p a litre has an effect of around £500 million. To offset the whole rise in the pump price would cost around £3.7 billion;
- a boost to UK oil and gas revenues of around £2.4 billion. This could offset around two-thirds of the pump price rise, in the absence of any offsetting effects; and
- allowing for offsetting effects, particularly from the impact from a weaker economy means there is very little or no improvement in the public finances that could be used for stabilising the pump price.

Geoffrey Dicks, Member of the interim Budget Responsibility Committee, said:

“This Report marks the conclusion of our work as the interim OBR. It examines the effects of a change in the oil price both directly on the public finances and indirectly via its effects on the wider economy. Our analysis should provide the Treasury with useful evidence as it formulates its policy on the fair fuel stabiliser.”

Effect on the Public Finances of a temporary £10 rise in the oil price[1] (£ billion)

	Year 1	Year 2	Year 3	Year 4
UK Oil and Gas Revenues	2.4	0	0	0
Other Effects[2]	-0.6	0.4	0	0
Economy Effects	-1.7	-1.1	0	0
Overall Effect	0.1	-0.7	0	0

Effect on the Public Finances of a permanent £10 rise in the oil price[1] (£ billion)

	Year 1	Year 2	Year 3	Year 4
UK Oil and Gas Revenues	2.4	2.4	2.4	2.4
Other Effects[2]	-0.6	-0.2	-0.1	-0.1
Economy Effects	-1.7	-3.5	-4.1	-4.5
Overall Effect	0.1	-1.3	-1.7	-2.2
Potential Range	1.2 to –0.7	0.1 to –2.5	-0.9 to –3.1	-1.5 to –3.5

1. An improvement in the public finances is shown as positive.
2. Includes effect on fuel duty, VAT and from indexation effects

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Notes for Editors

1. The Report is available at :

http://budgetresponsibility.independent.gov.uk/publications.html

2. In the June Budget, 'the Chancellor asked the Office for Budget Responsibility (OBR) to undertake an assessment over the summer of the effect of oil price fluctuations on the public finances. Informed by this assessment, the Government will examine options for the design of a fair fuel stabiliser' (Budget 2010, paragraph 2.100).

3. A Fair Fuel Stabiliser would reduce fuel duty when oil prices rise (and vice versa). As the remit for this report notes, a key principle for such a stabiliser would be that it 'improves the long-term stability of the public finances. Therefore, understanding the size of any windfall accruing to Government as a result of high oil prices ... is key to designing a workable Stabiliser'.

4. This report was signed off by the interim Budget Responsibility Committee (Sir Alan Budd, Geoffrey Dicks and Graham Parker) on 13 August 2010.

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