1. Public finances under the coalition

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Summary

- In March 2008, the official forecasts suggested structural borrowing was 2.7% of national income in 2007–08, which was slightly smaller than estimates produced by the IMF and the OECD at the time.
- When the last Labour government left office, the official forecasts implied that underlying structural borrowing had, since the March 2008 Budget, increased by around 5.7% of national income. The Labour government planned to eliminate this with new measures totalling 5.8% of national income to be fully implemented by 2016–17.
- In 2010, the coalition government announced further tax increases, cuts to social security benefits and further cuts to day-to-day spending on public services. The additional fiscal tightening it announced amounted to an extra 1.2% of national income on top of what Labour had planned. The government thought at the time that this would be sufficient to put it on course to eliminate the structural current deficit by 2014–15.
- Between 2010 and 2012, the outlook for economic growth and tax revenues deteriorated. The coalition government decided not to increase the fiscal tightening planned for this parliament but to extend the period of consolidation into the next. Consequently, the coalition government has borrowed more than planned over this parliament: over the five years from 2010–11 to 2014–15, borrowing is now estimated to have been around £100 billion higher than forecast in the November 2010 Autumn Statement.
- Between the end of 2012 and the end of 2014, the underlying outlook for the public finances was little changed. Despite this, the coalition government pencilled in further spending cuts for the second half of the next parliament in order to bring about a stronger fiscal position – an overall surplus of 1.0% of national income by 2019–20. The additional fiscal consolidation measures planned for between now and 2019–20 are 2% from net tax rises and 98% from spending cuts; this compares with an 18%/82% split between tax and spending among the measures implemented so far.
- IMF forecasts suggest that, out of 31 advanced economies, only Japan will have higher structural borrowing than the UK in 2015. This is despite the UK having done the seventh-largest fiscal consolidation since the crisis began. Plans set out for the next parliament imply that the UK is planning the largest fiscal consolidation between 2015 and 2019.
- Had the March 2010 Budget plan instead been retained, taxes would have been lower and spending higher than they have been. This would have offered greater support to household incomes and made it easier to deliver public services. But it would have resulted in significantly more borrowing and would only have deferred, rather than avoided, the need for greater fiscal consolidation.

1.1 Introduction

The period since the financial crisis and associated recession struck has seen a dramatic deterioration in the UK's public finances. This has led to the highest level of public sector net borrowing since the Second World War increasing public sector net debt to levels not seen since the late 1960s. While other advanced economies have also seen their public finances worsen, the UK has been relatively hard hit and has seen its international rank in terms of general government debt slip from its pre-crisis 'mid-table' position. This chapter documents how the underlying health of the public finances, and the government's fiscal response to this situation, have evolved since 2010. It does so using the National Accounts measures of the public finances – differences between these measures and the relatively new Whole of Government Accounts measures are discussed in Chapter 6.

The story is told by comparing five different vintages of forecasts and plans for fiscal policy. These are from Budget 2008, the March 2010 Budget, the November 2010 Autumn Statement, and the Autumn Statements of December 2012 and December 2014. Figure 1.1 sets out the forecasts at each of these points for the structural current budget deficit (the difference between non-investment spending and total receipts, after adjusting for the estimated impact of the ups-and-downs of the economic cycle, shown in panel a), total borrowing (the difference between total spending and total receipts, shown in panel b) and total public sector net debt (which, loosely speaking, is accumulated borrowing so far, shown in panel c). Each is measured as a share of national income. The series are shaded such that the more recent forecasts are in darker colours.

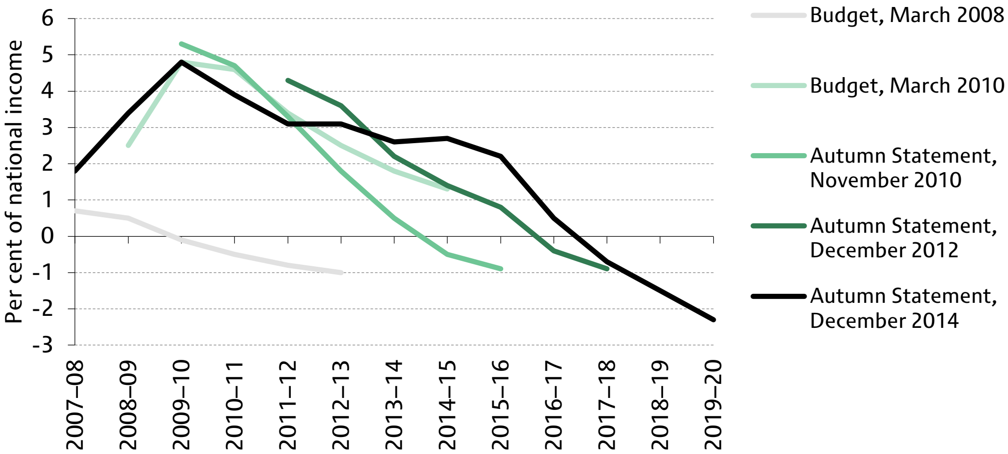
It should be noted that the forecasts are not quite like-for-like, with the classification changes that took place prior to the December 2014 forecast being particularly large. These led to more spending being classified as investment rather than current, thereby reducing the measured current budget deficit (and not affecting headline borrowing). They also increased the measured level of public sector net debt and the measured level of economic activity (and therefore reduced public sector net borrowing as a share of national income slightly).[1]

The story starts with the March 2008 Budget, which provides a pre-crisis baseline – setting out the last government's view on how the UK's economy and public finances would evolve before the worst of the financial crisis occurred. Two years later, the picture painted by the March 2010 Budget – of what the previous Labour government was bequeathing to the incoming coalition government – was much gloomier in terms of the outlook for the economy and public finances, even though these forecasts included plans for a significant fiscal policy tightening. The sharp deterioration in the outlook for the public finances between March 2008 and March 2010 can be seen in all three panels of Figure 1.1. In March 2008, the Treasury forecast that borrowing would decline from 2.9% in 2008–09 to 1.3% of national income in 2012–13, but instead it climbed to over 10% of national income (the highest level seen in the UK since the Second World War). This, coupled with the decline in national income, pushed up public sector net debt measured as a share of national income substantially.

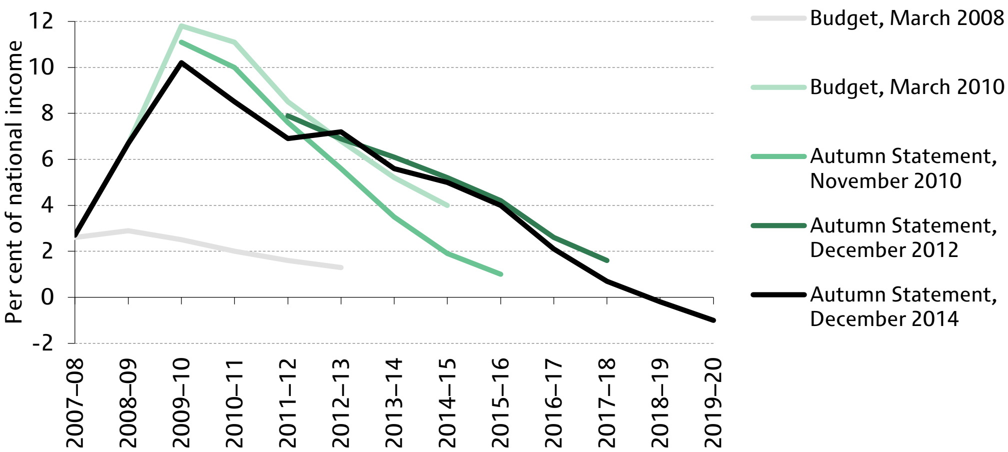
[1] Further details can be found in box 4.3, page 106, of Office for Budget Responsibility, *Economic and Fiscal Outlook, December 2014*, http://cdn.budgetresponsibility.independent.gov.uk/December_2014_EFO-web513.pdf.

Figure 1.1. Historic forecasts of:

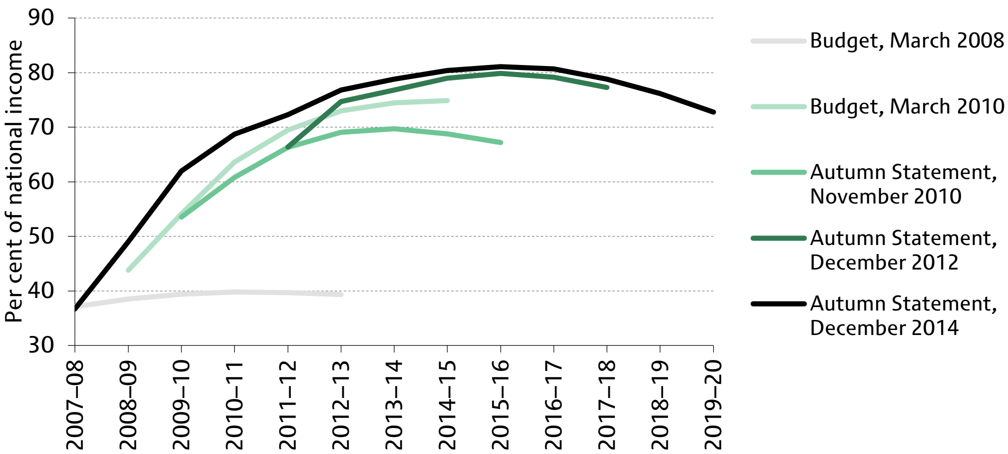
(a) Structural current budget deficit



(b) Public sector net borrowing



(c) Public sector net debt



Note: The transition from the 1995 European System of Accounts to the 2010 European System of Accounts (ESA95 to ESA10) between the March 2014 Budget and the December 2014 Autumn Statement affected measures of GDP and public sector net debt. Therefore note that some of the difference between the December forecast and the earlier forecasts reflects accounting changes, rather than a change in the underlying fiscal forecast. Figures exclude banks.
Source: HM Treasury, *Budget 2010*, http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/budget2010_documents.htm; OBR's Economic and Fiscal Outlook, various years.

Forecasts from the newly-formed Office for Budget Responsibility (OBR) – published in the November 2010 Autumn Statement – were slightly more pessimistic about the structural position in the near term (panel a) but not the headline position (panel b) than the March 2010 Budget forecast had been. The new coalition government decided to extend and accelerate the fiscal squeeze that had been announced by the Labour government, with a significant takeaway having been announced in the June 2010 Budget and the October 2010 Spending Review. The additional austerity announced by the coalition government meant that the November 2010 forecast was for borrowing to fall faster and further than had been forecast in March 2010.

Between Autumn 2010 and Autumn 2012, weak economic growth resulted in further downgrades to the outlook for the public finances. This was not matched by an announcement of further austerity for the current parliament on top of what the coalition government had already set in place during its first six months in office – instead the government responded by pencilling in more spending cuts for the first half of the forthcoming parliament. As a result, although borrowing continued to fall over this parliament, it did not fall as far as had been forecast in November 2010. Borrowing relative to national income in 2014–15 is expected to be slightly below half its peak level (i.e. as a share of national income, it is correct to say that the deficit has been halved), but this will still be more than twice as high as was forecast by the coalition government in Autumn 2010 (when the forecast was for borrowing this year of 1.9% of national income). In fact, it is more borrowing than had been forecast in Labour's March 2010 Budget for 2014–15 (4.0% of national income), despite the implementation of newly-announced net tax rises and spending cuts in the intervening period.

Between Autumn 2012 and Autumn 2014, the underlying health of the public finances was little changed, but the coalition decided to pencil in spending cuts for the second half of the next parliament. These mean that an overall budget surplus is forecast in the medium term (1.0% of national income in 2019–20, as shown in panel b). This would be a tighter fiscal position than the UK had (or was aiming to have) prior to the crisis, and a tighter one than has been achieved in all but four of the years since 1951.[2]

Public sector net debt is now projected to peak at over 80% of national income – double its pre-crisis level. While it is forecast to be on a downwards trajectory from 2016–17 onwards, it is forecast to remain considerably above pre-crisis levels in the medium term, although below the levels seen throughout the period from 1915 to 1968 (inclusive).[3]

This chapter goes through the changes in the assessed underlying health of the public finances and governments' responses to this situation in some detail. Section 1.2 starts by looking at Labour's bequest. Section 1.3 considers changes over the coalition's time in office – looking separately at its initial plan, its plan as of Autumn 2012 and its current plan. Section 1.4 describes how the UK's plans for reductions in structural borrowing compare with those for other countries. Section 1.5 concludes.

[2] These years were 1969–70, 1988–89, 1999–2000 and 2000–01.

[3] See figure 9 of A. Jowett and M. Hardie, 'Longer-term trends: public sector finance', November 2014, Office for National Statistics, http://www.ons.gov.uk/ons/rel/elmr/longer-term-trends/public-sector-fianaces/art-ltt-psf.html#tab-UK-Debt.

1.2 Labour's bequest

The position on the eve of the crisis

In the years leading up to the financial crisis, the UK economy experienced fairly strong, and extremely stable, growth. As Budget 2008 boasted, 'Over the past decade, the UK economy has proved strong and stable, with GDP growth averaging almost 3 per cent a year and inflation close to the Government's symmetric inflation target'.[4] But despite this, at the time of the March 2008 Budget, public sector net borrowing in 2007–08 was thought to have been £36.4 billion or 2.6% of national income.

This level of borrowing was slightly higher than the Labour government was comfortable with, not least because it required borrowing of no more than about 2% of national income in order to keep public sector net debt below the ceiling of 40% of national income that it had set for itself.[5] Therefore, the Labour government was planning a fiscal tightening to reduce borrowing to 1.3% of national income by 2012–13. It intended to bring this about by increasing public spending less quickly than growth in the economy (and much less quickly than it had been increased over the previous few years) and increasing tax receipts slightly as a share of national income (as a result of fiscal drag and some tax-raising measures, including increases in alcohol duties and vehicle excise duty).

On the face of it, these forecasts suggested that the public finances were in reasonable shape. At the time of the March 2008 Budget, the Treasury's estimate of structural borrowing – that is, the difference between total spending and total revenues after adjusting for the estimated impact of the ups-and-downs of the economic cycle – was only slightly more optimistic than that of the OECD or the IMF (see Box 1.1 for a further discussion). However, the UK's public finances could have been better prepared for a potential downturn.

One way of thinking about this is that – after more than a decade of strong growth – the deficit in the years prior to 2008 had been substantial and debt had grown as a proportion of national income in every year since it had dipped below 30% of national income in 2001–02. To believe this was genuinely cautious fiscal management really would require you to believe that boom and bust had been abolished – as Gordon Brown claimed on a number of occasions that it had been.

Box 1.1. How big was the UK's structural borrowing in 2007?

Policymakers often focus on structural borrowing – that is, the difference between total spending and total revenues after adjusting for the estimated impact of the ups-and-downs of the economic cycle – rather than headline borrowing. This is because the need for a fiscal tightening, or scope for a fiscal loosening, will depend not on the headline level of borrowing but rather on the amount of borrowing that is expected to be impervious to future economic growth and therefore is expected to persist.

[4] Paragraph B.30, page 148 of HM Treasury, *Budget 2008*, March 2008, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/250345/0388.pdf.

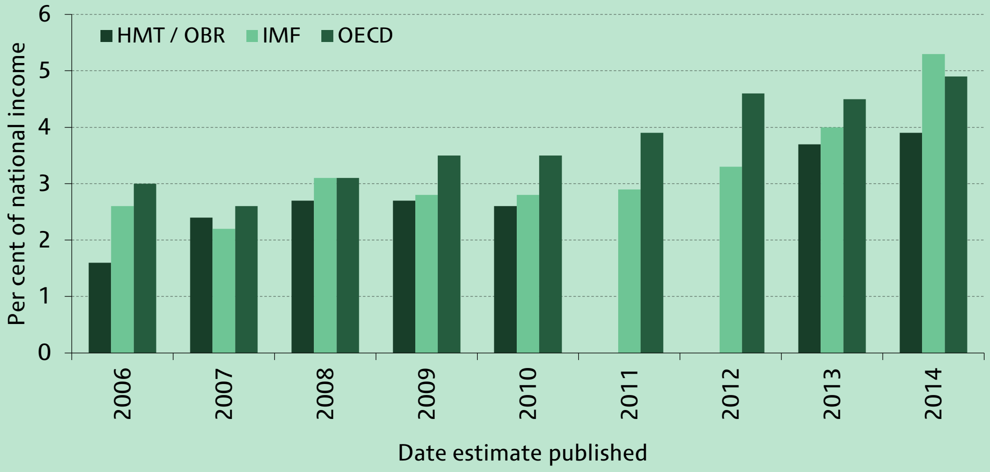
[5] This assumes that nominal economic growth averaged 5% a year, which was what the official forecasts assumed long-term economic growth would be prior to the crisis. Strictly, the 40% of national income ceiling on debt stated by Labour's sustainable investment rule only applied to the economic cycle at the time.

Unfortunately, estimating the structural level of borrowing is far from straightforward, and is particularly difficult to do in real time. It requires an estimate of the amount of spare capacity in the economy and an estimate of the relationship between this and the amount of cyclical borrowing. Neither is observed perfectly and estimates of spare capacity tend to vary substantially from forecaster to forecaster (see Chapter 5).

In the March 2008 Budget, the Treasury's judgement was that structural borrowing was 2.7% of national income in 2007–08 (£51 billion in 2015–16 terms). This is small relative to the size of the fiscal problem that we now face. However, the Treasury was not alone in taking this view. Figure 1.2 shows estimates from the Treasury, the IMF and the OECD for the size of structural borrowing in 2007, which were produced each spring between 2006 and 2014. The figure shows that in 2008 the Treasury's estimate of structural borrowing in 2007 was more optimistic than that of either the IMF or the OECD. But the differences were relatively small: the external estimates imply that additional fiscal tightening of about ½% of national income (or about £9 billion in 2015–16 terms) would have been needed to restore the public finances to the same position as the government intended.

More recent estimates have suggested that structural borrowing in 2007 was in fact much larger. In March 2014, the OBR estimated that structural borrowing in 2007 was 3.9% of national income (i.e. 1.2% of national income, or £23 billion in 2015–16 terms, greater than was thought by the Treasury in the March 2008 Budget). The April 2014 IMF and June 2014 OECD estimates are that structural borrowing in 2007 was larger still, at 5.3% and 4.9% of national income respectively. These estimates are 2.2% and 1.8% of national income higher than those institutions thought back in 2008. These are significant upwards revisions, suggesting that a significant public finance problem could, perhaps, have been apparent in 2007. However, this still only accounts for a minority of the permanent increase in underlying structural borrowing that we estimate has taken place since March 2008 (8.4% of national income).

Figure 1.2. How big was structural borrowing in 2007?



Note: HMT estimates relate to those from the Spring Budget and are for the financial year 2007–08. The OBR did not produce revised estimates for structural borrowing in 2007–08 until March 2013; therefore data for 2011 and 2012 are missing. OECD forecasts are from the Economic Outlook from June of each year and are for the calendar year 2007. IMF forecasts are from the World Economic Outlook from April of each year and are also for the calendar year 2007.
Source: HM Treasury Budget, various years; IMF World Economic Outlook, various years; OECD Economic Outlook, various years.

As the OBR recently noted, between March 2003 and March 2008 independent forecasts for borrowing four years ahead were, on average, about £10 billion less optimistic than the official forecasts.[6] This was not solely because external forecasters took a different view of prospects for economic growth but also because they expected this growth to generate less additional tax revenue than the Treasury expected. For example, IFS Green Budgets in 2003, 2004 and 2005 – similar to other independent forecasters at that time – projected borrowing around £10 billion above the official forecast, even though these IFS forecasts assumed that the economy would evolve broadly in line with the official forecast. This suggests that part of the looser out-turn for fiscal policy over this period was predictable. However, £10 billion is only a small part of the deterioration in the public finances that ultimately manifested.

Furthermore, while the UK's public finances were not in a bad state on the eve of the crisis, they were not particularly strong compared with those of other advanced economies. As Chote, Emmerson and Tetlow (2008)[7] noted at the time:

> We are entering the current recession with one of the largest structural budget deficits in the industrial world and a debt level that may be among the smallest in the G7 but which is larger than that of most industrial countries. We have done less to reduce our structural budget deficit and less to reduce our debt than most other industrial countries since Labour came to office.

The position – and response – after the crisis struck

Later in 2008 and during the early part of 2009, it became apparent that the public finances were in a much weaker state than had been thought and that, at some point, policy action would be required to put them back onto a sustainable footing. Between the March 2008 Budget and the March 2010 Budget, we estimate that structural borrowing, stripping out the direct impact of fiscal policy measures announced in the interim period, was increased by 5.7% of national income (£107 billion in 2015–16 terms).[8]

The short-term response of the Labour government was to announce a package of temporary spending increases and tax cuts in an attempt to limit the length and depth of the recession. This short-term giveaway totalled 0.6% of national income in 2008–09 and 1.5% of national income in 2009–10. The largest single measure was a cut in the main rate of VAT from 17.5% to 15.0% for the 13 months from the start of December 2008 to the end of 2009.

The fiscal rules that the Labour government had attempted to adhere to between 1997 and 2007 were missed and, sensibly, ignored after the crisis hit. However, in order to help convince the public, and financial market actors, that it intended to reduce borrowing and return the public finances to a sustainable path, Labour replaced the existing fiscal rules

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[6] See chart 2.10 of J. Riley and R. Chote, 'Crisis and consolidation in the public finances', OBR Working Paper 7, http://budgetresponsibility.org.uk/wordpress/docs/WorkingPaper7a.pdf.

[7] Page 1 of R. Chote, C. Emmerson and G. Tetlow, 'The UK public finances: ready for recession?', IFS Briefing Note BN79, 2008, http://www.ifs.org.uk/bns/bn79.pdf.

[8] Figure 1.8 in the conclusion summarises the estimated increase in structural borrowing at the time of successive Budget statements, Pre-Budget Reports and Autumn Statements, along with the size of the medium-term policy response planned at that time.

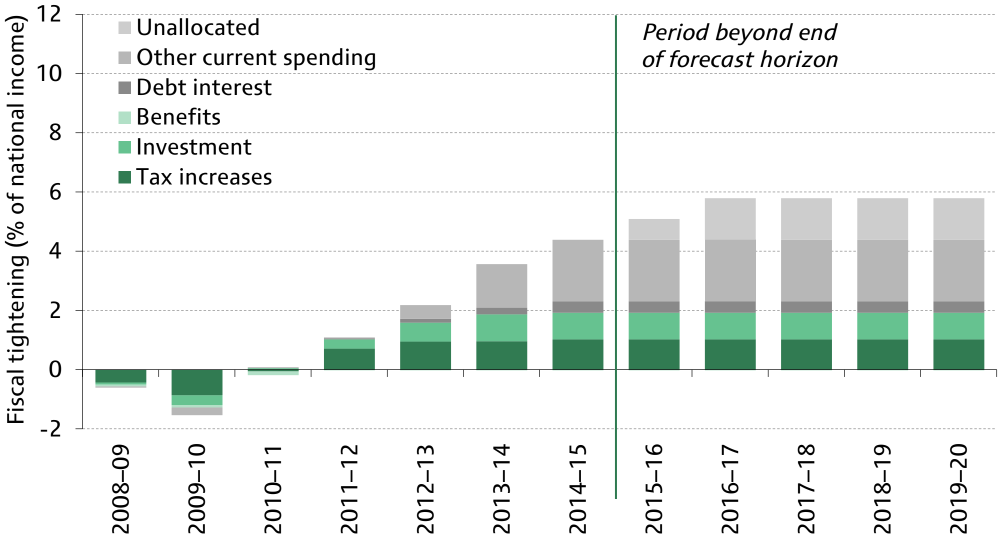
with three new targets, which were legislated as part of the Fiscal Responsibility Act 2010:[9]

- borrowing to fall as a share of national income in each year from 2010–11 to 2015–16;
- borrowing as a share of national income to be at least halved between 2009–10 and 2013–14;
- public sector net debt as a share of national income to fall between 2014–15 and 2015–16.

The Labour government then set in place a fiscal consolidation plan. Our estimates of its size, composition and timing are presented in Figure 1.3, with details of our methodology provided in Box 1.2. The fiscal consolidation began under Labour in April 2010, with the ending of the fiscal stimulus package (which represented a 1.5% of national income fiscal tightening between 2009–10 and 2010–11). A new 50p top rate of income tax (for those with an income over £150,000) also took effect from April 2010, although most of the revenue predicted to be raised from this was not expected to be received until after April 2011. Further tax rises were announced to come in April 2011 – in particular, increases in the rates of employee and employer National Insurance contributions (NICs) and a significant reduction in the generosity of tax relief on pension contributions for those on very high incomes. In total, these tax rises were forecast to boost receipts by 1.0% of national income by 2014–15.

The plans for public spending implied cuts to investment spending (0.9% of national income) alongside cuts to day-to-day government spending (2.1% of national income). The former was particularly deep given that the government had only previously been intending to spend 2¼% of national income on investment. But the Labour government

Figure 1.3. Size, timing and composition of the fiscal tightening: March 2010 plans



Source: Authors' calculations using all HM Treasury Budgets and Pre-Budget Reports between March 2008 and March 2010 (available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/budget_archive.htm).

[9] Available at http://services.parliament.uk/bills/2009-10/fiscalresponsibility.html.

did not announce any detailed departmental spending limits for the period beyond 2010–11 nor did it announce any significant net cuts to social security spending.

On top of this fiscal tightening allocated to tax and spending, the Labour government pencilled in a further tightening, worth 1.4% of national income (0.7% in 2015–16 and a further 0.7% in 2016–17), to come from an unspecified combination of further tax rises

Box 1.2. Measuring the size, composition and timing of the fiscal consolidation

There are a number of ways that one could define the size of the fiscal consolidation that has been announced since the crisis started. The method we follow essentially aims to quantify the difference between the levels that spending and revenues are now expected to be at and the levels they would have been at in the absence of any new policy announcements since March 2008. Three broad types of policy changes have been announced since March 2008: changes to taxes, changes to benefit spending and changes to public service spending.

The size of the fiscal consolidation arising from tax and benefit changes is taken to be the sum of the official estimates of the impact of tax and benefit policy changes (respectively). These costings are published alongside the policy announcements in Budgets, Pre-Budget Reports and Autumn Statements, and start from existing government policy – including the assumption that tax and benefit thresholds are increased each year using the normal uprating rules.

Measuring the size of the fiscal consolidation arising from changes to public service spending is more difficult, and requires us to define a *counterfactual* – what would have happened to levels of spending in the absence of policy change. The fiscal consolidation can then be calculated as the difference between actual (or the latest forecast for) spending and this counterfactual.

For years up to 2012–13, we take as the counterfactual the plans set out in the March 2008 Budget. At that point, the then government had set out plans for overall spending for the two years beyond 2010–11 (the end of the then current spending review period) alongside some small medium-term tax increases. The spending plans were for a real-terms increase in current spending, with investment held constant as a share of national income; this implied that overall spending would fall as a share of national income. To the extent that real spending is less than this baseline, this is part of the consolidation.

Beyond 2012–13, we have no explicit pre-crisis spending plans. There are perhaps two obvious counterfactuals we could take. One would involve an assumption that, had the crisis not happened, real-terms spending would have stayed constant. This seems to us an entirely unrealistic scenario; it would have implied the size of the state shrinking and borrowing falling (and, ultimately, a surplus growing) indefinitely. Much more plausible is an assumption that spending would have risen in line with trend national income; certainly no period since the Second World War has seen a sustained cut to public spending as a share of national income. So, from 2012–13, we take as our counterfactual that total spending grows in line with GDP.

Using this methodology, counterfactual non-investment public service spending is assumed to grow more quickly beyond 2012–13 than before. Therefore the same real-terms cut to this spending between 2014–15 and 2015–16 as between 2011–12 and 2012–13, say, would imply a greater cut relative to the counterfactual and therefore a greater contribution to fiscal consolidation. That is one reason why, on this methodology, we find that a large proportion of cuts to non-investment spending are still to come.

and cuts to day-to-day government spending. It is perhaps not unreasonable that these cuts were unspecified, given that the size of the policy response required at the time was extremely uncertain and Labour was not planning to implement these measures until after the end of its five-year forecast horizon anyway. Overall, the planned tightening totalled 5.8% of national income – so was very slightly larger than our estimate of the increase in structural borrowing that had occurred since March 2008 (5.7% of national income). Therefore, the plan set out by the Labour government implied returning borrowing to roughly the path that it had been forecast to be on in March 2008. These forecasts also put the government on course to comply with its Fiscal Responsibility Act. Of the fiscal tightening, by 2014–15 (i.e. before the unallocated tightening was due to start) just under one-quarter (24%) was planned to be from tax rises and just over three-quarters (76%) from spending cuts.

1.3 The coalition's actions

On taking office, the new coalition set up an interim OBR – headed by Sir Alan Budd – to produce economic and fiscal forecasts in advance of an 'emergency' June 2010 Budget. The government announced a package of measures that would reduce borrowing by about £5 billion in 2010–11.[10]

The coalition repealed Labour's Fiscal Responsibility Act. The requirement to halve borrowing as a share of national income between 2009–10 and 2013–14 was – sensibly – replaced with a new fiscal mandate. This stated that the government would aim to balance the cyclically-adjusted current budget by the end of the (rolling) five-year forecast horizon. As we have discussed elsewhere, a forward-looking target for borrowing has many attractive features.[11] Less sensibly, the Chancellor decided to retain Labour's commitment that public sector net debt should be falling as a share of national income between 2014–15 and 2015–16. As we have argued elsewhere, this target has little to commend it.[12]

The interim OBR forecast that headline borrowing would be slightly lower than had been suggested in Labour's March 2010 Budget. However, the interim OBR judged that more of this borrowing was structural rather than cyclical and therefore would prove impervious to economic growth and require policy action to reduce. Our estimates suggest that, at the time of the November 2010 Autumn Statement (by which point the full OBR, headed by Robert Chote, was in place), the long-run increase in underlying structural borrowing that had emerged since March 2008 stood at 6.0% of national income – up from the 5.7% of national income estimate at the time of the March 2010 Budget.

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[10] A total of £6.2 billion of spending cuts were announced, although the impact on borrowing was offset by £500 million due to some spending increases and a small cut to business rates. In addition, £700 million was due to come from devolved administrations but did not apply until 2011–12. In 2010–11, a total of £5.0 billion came from cuts to spending by central government on public services and their administration, although the NHS, MoD, overseas aid, schools, Sure Start and 16- to 19-year-old education were protected from these cuts. The remaining savings came from the abolition of the child trust fund. For more details, see R. Chote and C. Emmerson, 'The first cut', IFS Observation, May 2010, http://www.ifs.org.uk/publications/4924.

[11] See C. Emmerson, S. Keynes and G. Tetlow, 'The fiscal targets', in C. Emmerson, P. Johnson and H. Miller (eds), *The IFS Green Budget: February 2013*, IFS Report R74, 2013, http://www.ifs.org.uk/publications/6562.

[12] See Emmerson et al. (2013) referred to in previous footnote.

The initial plan: fiscal repair complete in 2015–16

The coalition responded with a larger fiscal consolidation than had been planned by the Labour government. It announced additional measures worth 1.2% of national income on top of Labour's planned fiscal tightening, bringing the total fiscal consolidation to 7.0% of national income. This was deliberately more than sufficient to offset the additional

Table 1.1. Planned fiscal tightening by end of this and next parliament: March 2010 and November 2010 plans compared

	2014–15		*2019–20*	
	% GDP	**£bn**	**% GDP**	**£bn**
March 2010 Budget				
Estimated increase in structural borrowing since pre-crisis	–	–	*5.7*	*107.2*
Total fiscal tightening	4.4	82.7	5.8	109.1
Total specified net tax rises	1.0	19.4	1.0	19.4
Total specified net spending cuts	3.3	63.2	3.3	63.2
Investment cuts	0.9	17.0	0.9	17.0
Social security cuts	0.0	–0.3	0.0	–0.3
Current public service cuts	2.1	39.3	2.1	39.3
Debt interest cuts	0.4	7.2	0.4	7.2
Unspecified tax rise or non-investment cut	0.0	0.0	1.4	26.4
March 2010 to November 2010				
Change in estimated increase in structural borrowing since pre-crisis	–	–	*0.3*	*6.2*
Increase in total fiscal tightening	1.9	35.6	1.2	23.5
Increase in net tax rises	0.4	8.1	0.4	7.2
Increase in net spending cuts	1.5	27.4	2.3	42.7
Increase in investment cuts	0.0	–0.1	0.0	0.0
Increase in social security cuts	0.8	14.6	1.1	20.8
Increase in public service cuts	0.5	10.0	1.0	18.9
Increase in debt interest cuts	0.2	3.0	0.2	3.0
Increase in unspecified tightening	0.0	0.0	–1.4	–26.4
November 2010 Autumn Statement				
Estimated increase in structural borrowing since pre-crisis	–	–	*6.0*	*113.4*
Total fiscal tightening	6.3	118.2	7.0	132.6
Total net tax rises	1.5	27.6	1.4	26.6
Total net spending cuts	4.8	90.7	5.6	105.9
Investment cuts	0.9	16.9	0.9	17.0
Social security cuts	0.8	14.3	1.1	20.5
Current public service cuts	2.6	49.3	3.1	58.2
Debt interest cuts	0.5	10.2	0.5	10.2

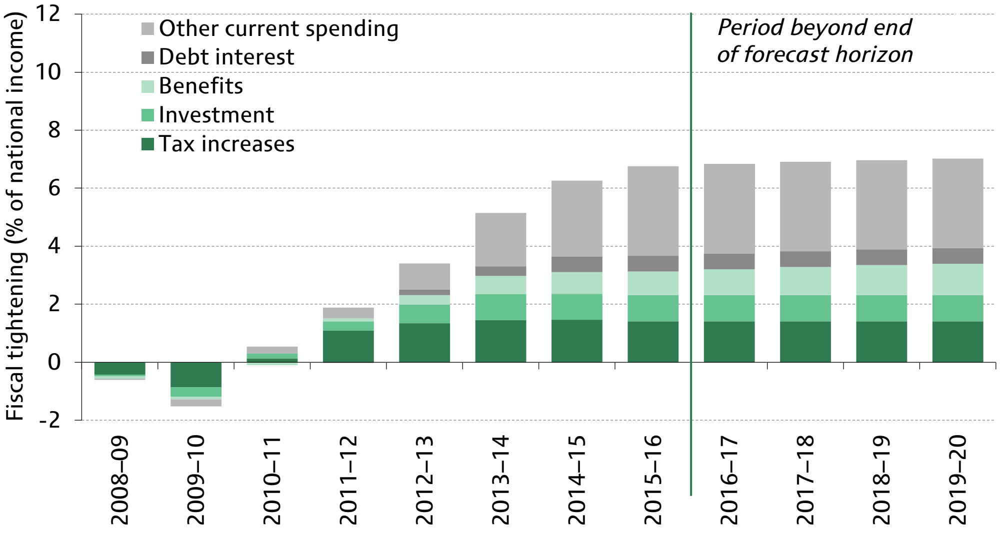
Note: Figures in £bn are in 2015–16 terms.
Source: Authors' calculations using all HM Treasury Budgets and Pre-Budgets between November 2008 and March 2010 (available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/budget_archive.htm) and the OBR Economic and Fiscal Outlooks of June 2010 and November 2010 (available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

borrowing that was thought to have materialised since the March 2008 Budget. Had things gone to plan, this would have left public sector net borrowing at a lower level than had been forecast in March 2008, though debt was still expected to rise from 53.5% of national income in 2009–10 to 69.7% in 2013–14. The coalition's fiscal repair job was also intended to be implemented more swiftly than Labour's, being fully implemented by 2015–16 rather than taking until 2016–17.

The scale and composition of the fiscal consolidation plans as of March 2010 and Autumn 2010 are compared in Table 1.1. The June 2010 Budget announced a net tax rise worth 0.4% of national income. The most significant tax increase was the increase in the main rate of VAT from 17.5% to 20% in January 2011.[13] This brought the total post-crisis net tax rise up to an estimated 1.4% of national income. The June 2010 Budget and the October 2010 Spending Review announced net cuts to social security benefits and tax credits that were expected to raise 1.1% of national income. The largest single policy was to change the measure of inflation used to uprate most social security benefits (and also public service pensions). There were also significant cuts planned to benefits such as disability living allowance for those aged under 65 and housing benefit for both private and social sector tenants.[14]

The remainder of the planned additional consolidation came from further cuts to public service spending. These fell on day-to-day spending as the coalition chose largely to keep to (rather than add to) the planned deep cuts to investment spending that had been set out in the March 2010 Budget. Of the additional fiscal tightening measures announced by the coalition government during its first six months in office, 14% was from a net tax rise and 86% from net cuts to spending. Taken together, this meant that the overall post-crisis fiscal tightening planned in November 2010 comprised 20% tax rises and 80% spending cuts, as shown in Figure 1.4.

Figure 1.4. Size, timing and composition of the fiscal tightening: November 2010 plans



Source: As Table 1.1.

[13] For a discussion of tax changes implemented by the coalition government, see http://election2015.ifs.org.uk/taxes.

[14] See A. Hood and D. Phillips, 'Benefit spending and reforms: the coalition government's record', IFS Briefing Note BN160, 2015, http://www.ifs.org.uk/publications/7535.

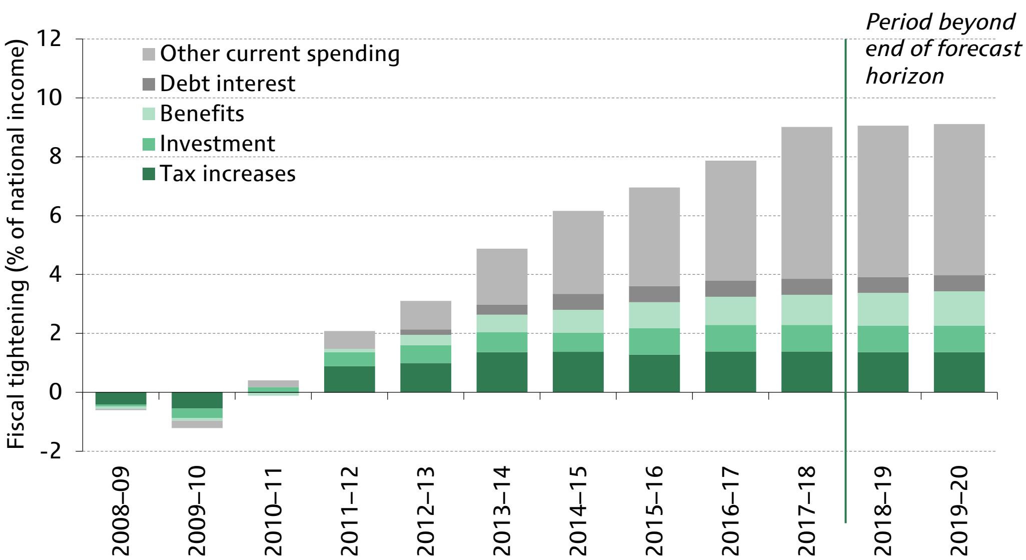
The 2012 plan: fiscal repair complete in 2017–18

The economy – and therefore the public finances – did not, however, remain on the course forecast by the November 2010 Autumn Statement. Unfortunately, over the following two years, the OBR made sizeable downwards revisions to its forecasts for growth and therefore tax revenues. The OBR judged that these in large part reflected weaker potential output of the UK economy – in other words, were indicative of a larger structural problem in the UK's public finances. We estimate that the increase in the estimate for structural borrowing between March 2008 and December 2012 was 8.3% of national income; this compares with an increase of 6.0% of national income up to November 2010.

The coalition government's response to this increase in forecast borrowing came in two parts:

- For this parliament, the coalition government chose not to implement any additional net tax rises or net spending cuts. Instead borrowing was simply allowed to fall more slowly than previously planned. As a result, the December 2012 Autumn Statement forecast that borrowing would fall by 46% by 2013–14 from its 2009–10 level. This was less than the 50% fall that Labour's Fiscal Responsibility Act would have required. Borrowing was expected to still be running at 5.2% of national income by 2014–15, almost three times the 1.9% of national income that had been forecast in the November 2010 Autumn Statement (as shown in panel b of Figure 1.1).
- For the next parliament, the coalition government chose to offset almost exactly the increase in forecast structural borrowing by pencilling in two more years of planned

Figure 1.5. Size, timing and composition of the fiscal tightening: December 2012 plans



Source: Authors' calculations using all HM Treasury Budgets and Pre-Budgets between November 2008 and March 2010 (available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/budget_archive.htm) and all OBR Economic and Fiscal Outlooks between June 2010 and December 2012 (available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

spending cuts.[15] This extended the planned period of fiscal consolidation to 2017–18. Since all of the additional tightening was through net spending cuts (rather than through any net tax rises), this meant that, by 2017–18, the planned fiscal tightening was now intended to comprise 85% spending cuts and 15% tax rises, as shown in Figure 1.5.

Despite the increase in borrowing over this parliament – and associated upwards revision to the cyclically-adjusted current budget deficit – the coalition government was still judged to be complying with its fiscal mandate. This is because the mandate applied to the forecast deficit at the end of the forecast horizon, by which point the additional planned spending cuts were forecast to be sufficient to offset the underlying deterioration in the public finances. In December 2012, the OBR was forecasting that the current budget (cyclically-adjusted) would be in surplus by 0.9% of national income in the last year of the forecast horizon (2017–18), just as it had done in November 2010 (when the last year of the forecast horizon was 2015–16). This is shown in panel a of Figure 1.1.

In contrast, the (lack of) fiscal action in the current parliament in response to the increase in borrowing left the supplementary target – that public sector net debt should be lower in 2015–16 than in 2014–15 – on course to be breached. In November 2010, the OBR had forecast that debt would fall from 68.8% of national income in 2014–15 to 67.2% one year later, but the December 2012 forecast was that it would instead increase from 79.0% to 79.9% (as shown in panel c of Figure 1.1). However, this target had little to commend it, so the fact that it was on course to be breached should not, in itself, be of concern. Indeed, it would have been unwelcome for the government to implement new fiscal policy measures purely to comply with that misguided objective.

The 2014 plan: further cuts to achieve surplus in 2019–20

Over the period between December 2012 and the current set of forecasts, the underlying public finance picture has not changed significantly. Our estimates suggest that the increase in underlying structural borrowing since the crisis began is now estimated to be 8.4% of national income, which is slightly higher than the 8.3% of national income estimated in December 2012. Essentially, all of this upwards revision occurred in the March 2013 Budget. Over the five-year period from 2010–11 to 2014–15, borrowing is now estimated to have been around £100 billion higher than forecast in the November 2010 Autumn Statement.[16]

Even though the estimated size of the problem did not increase very much between December 2012 and December 2014, the coalition government chose to extend the planned duration and depth of the spending squeeze. In November 2013 the spending squeeze was extended from 2017–18 to 2018–19 and in November 2014 it was extended further to 2019–20. This increased the overall size of the post-crisis fiscal consolidation package to 10.7% of national income (£202 billion in 2015–16 terms). As a result, the OBR now forecasts that the cyclically-adjusted current budget will be in surplus by 2.3% of national income in 2019–20 (shown in panel a of Figure 1.1) and that the overall

[15] We estimate that the increase in underlying structural borrowing between the November 2010 and December 2012 forecasts was 2.3% of national income, while the fiscal response – in the form of further spending cuts – was increased by 2.1% of national income.

[16] This is the change in cumulative public sector net borrowing over the five years and therefore includes changes that have occurred purely due to classification changes such as those in Autumn 2014.

budget will be in surplus by 1.0% of national income (panel b of Figure 1.1). Keeping to this plan would comply with Chancellor George Osborne's desire, as stated in his Autumn 2013 Conservative Party conference speech, to deliver a budget surplus in the next parliament.[17]

Table 1.2. Planned fiscal tightening by end of this and next parliament: March 2010 and December 2014 plans compared

	2014–15		*2019–20*	
	% GDP	**£bn**	**% GDP**	**£bn**
March 2010 Budget				
Estimated increase in structural borrowing since pre-crisis	–	–	*5.7*	*107.2*
Total fiscal tightening	4.4	82.7	5.8	109.1
Total specified net tax rises	1.0	19.4	1.0	19.4
Total specified net spending cuts	3.3	63.2	3.3	63.2
Investment cuts	0.9	17.0	0.9	17.0
Social security cuts	0.0	–0.3	0.0	–0.3
Current public service cuts	2.1	39.3	2.1	39.3
Debt interest cuts	0.4	7.2	0.4	7.2
Unspecified tax rise or non-investment cut	0.0	0.0	1.4	26.4
March 2010 to December 2014				
Change in estimated increase in structural borrowing since pre-crisis	–	–	*2.7*	*52.9*
Increase in total fiscal tightening	1.5	27.5	4.9	92.7
Increase in net tax rises	0.0	0.3	0.1	2.4
Increase in net spending cuts	1.4	27.2	6.2	116.7
Increase in investment cuts	–0.3	–5.5	–0.1	–2.8
Increase in social security cuts	0.8	15.2	1.1	21.3
Increase in public service cuts	1.0	18.9	4.1	77.1
Increase in debt interest cuts	–0.1	–1.3	1.1	21.1
Increase in unspecified tightening	0.0	0.0	–1.4	–26.4
December 2014 Autumn Statement				
Estimated increase in structural borrowing since pre-crisis	–	–	*8.4*	*160.1*
Total fiscal tightening	5.8	110.1	10.7	201.8
Total net tax rises	1.0	19.7	1.2	21.9
Total net spending cuts	4.8	90.4	9.5	179.9
Investment cuts	0.6	11.5	0.8	14.2
Social security cuts	0.8	14.9	1.1	21.0
Current public service cuts	3.1	58.1	6.2	116.4
Debt interest cuts	0.3	5.9	1.5	28.3

Note: Figures in £bn are in 2015–16 terms.
Source: Authors' calculations using all HM Treasury Budgets and Pre-Budgets between November 2008 and March 2010 (available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/budget_archive.htm) and all OBR Economic and Fiscal Outlooks between June 2010 and December 2014 (available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

[17] See, for example, http://www.politics.co.uk/comment-analysis/2013/09/30/george-osborne-s-conference-speech-in-full.

The scale and composition of the fiscal consolidation plans as of March 2010 and December 2014 are compared in Table 1.2. Between November 2010 and December 2014, the coalition announced significant additional spending cuts – in particular, the choice to extend the spending squeeze to cover 2017–18, 2018–19 and 2019–20. This increased the total spending cut by 6.2% of national income compared with what had been planned in March 2010. The entire additional squeeze on spending was on current spending. In fact, over the current parliament, the government has actually increased planned investment spending. The initial plan (shown in Table 1.1) had been to keep to the cuts set out in Labour's last Budget, but subsequent decisions have reallocated some spending from current to capital, meaning that in 2014–15 the government has actually increased investment spending relative to the plan it inherited from the last Labour government. The overall squeeze on day-to-day spending on public services over this parliament has also turned out greater than planned due to central government departments not spending all of their allocations. Fuller details of how spending cuts were allocated between current and capital spending and between different government departments – and how these allocations changed over time – can be found in Chapter 7.

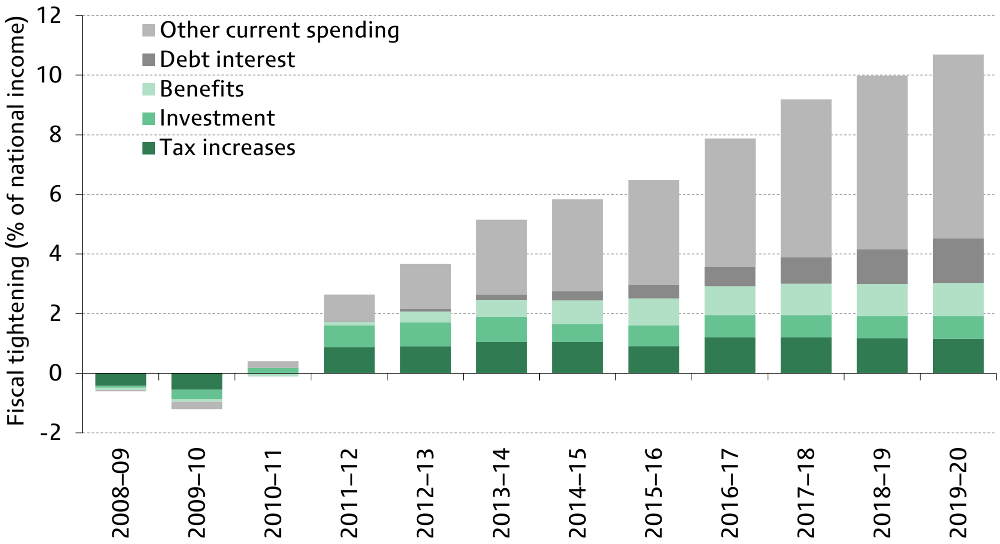
On the tax side, since the coalition government came to office, the net effect of new tax measures plus changes to estimates of how much previously-announced measures would actually raise has been to increase the overall net tax increase by just 0.1% of national income (£2.4 billion in 2015–16 terms) on top of the planned tax rise that the coalition inherited from the previous Labour government. However, even this may overstate the long-run tax rise coming from the measures announced by the coalition. Some of the measures that have been implemented are forecast to boost revenues over this parliament but to have either no effect or actually weaken revenues over the longer-term.[18] This issue is discussed in more detail in Section 5.5 of Chapter 5.

Overall – taking all the measures announced since the crisis began – the UK's fiscal consolidation plan involves (by 2019–20) a net tax increase of 1.2% of national income (£22 billion in 2015–16 terms) and a net spending cut of 9.5% of national income (£180 billion in 2015–16 terms), relative to our pre-crisis counterfactual (see Box 1.2). In other words, overall the plan now comprises 89% spending cuts and 11% tax rises, as shown in Figure 1.6. However, because the net tax increase has been relatively front-loaded, by the end of 2014–15 net tax rises will represent 18%, and net spending cuts 82%, of the consolidation actually implemented. Looking forwards over the period from 2014–15 to 2019–20, the plans imply a small net tax rise (0.1% of national income) and a significant spending cut (4.7% of national income). Therefore, of the consolidation to come, an estimated 2% is from net tax rises and 98% is from spending cuts.

The change in the height of the bars from year to year in Figure 1.6 provides an indication of the pace of austerity over time. It accelerated in 2010–11 and 2011–12 (when the additional tightening was 1.5% of national income and 2.3% of national income, respectively) and has since slowed (reaching 0.7% of national income in 2014–15 and 0.6% of national income in 2015–16), but is projected to accelerate again in 2016–17 (1.4% of national income). For example, there is actually a smaller net tax rise in 2015–16 than in either the previous or the subsequent year.

[18] In particular: the reduction in tax for those drawing funds from a defined contribution pension after age 55; the introduction of a new class of voluntary NICs for two years; accelerating payments for tax avoidance schemes; and capping the proportion of banks' profits that can be offset with prior losses.

Figure 1.6. Size, timing and composition of the fiscal tightening: December 2014 plans



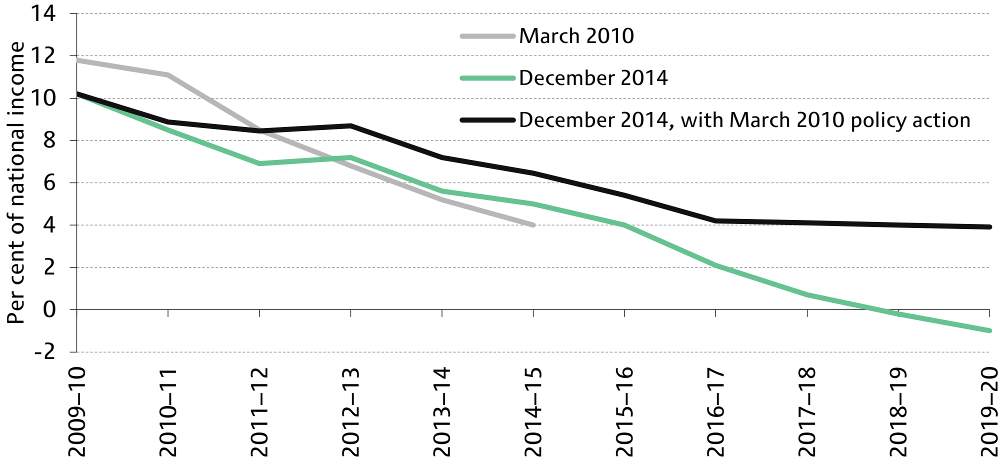
Source: As Table 1.2.

It is clear from Table 1.2 that the coalition's response to the public finance challenge has been to implement a larger fiscal consolidation over this parliament, and to plan for a larger fiscal consolidation over the next parliament, than was envisaged by the last Labour government in its March 2010 Budget. It is not possible to know how Labour would have reacted to the worse public finance situation that has developed over this parliament. One option might have been to keep to the March 2010 Budget plan, i.e. to implement a smaller package of net tax rises and spending cuts than the coalition has done. This would have made it easier for the government to support household incomes and to deliver public services over this period. But it would have meant more borrowing, thereby missing the targets that Labour legislated in its own Fiscal Responsibility Act (and by a greater margin than the coalition did), and would only have deferred rather than avoided much of the need for greater fiscal consolidation.

An estimate of how much greater government borrowing (and therefore how much greater household incomes and/or spending on public services) would have been had the March 2010 Budget plan been left in place is provided in Figure 1.7. This shows the OBR's latest forecast for public sector net borrowing (in green) alongside the March 2010 Budget forecast (in grey), plus an estimate of what borrowing might now be projected to be had the March 2010 plan been left in place (in black). This third line is calculated by taking the December 2014 forecasts for borrowing and adding to these the difference between the estimated direct impact of the fiscal consolidation being implemented now and that which was planned back in March 2010. An important caveat is that this line does not allow for any significant indirect impact of the consolidation on the path of the economy or the interest rate payable on government debt; these are strong assumptions.

Borrowing is now forecast to be slightly larger as a share of national income in 2012–13, 2013–14 and 2014–15 than was forecast at the time of the March 2010 Budget before any of the coalition's additional fiscal tightening had been planned. Had only the policies as of March 2010 (i.e. the announced fiscal position of the then Labour government) been implemented, and had the economy followed broadly the same path, then borrowing would have been an estimated 6.5% of national income in 2014–15 rather than its actual

Figure 1.7. Plans to reduce borrowing compared: March 2010, December 2014, and December 2014 with March 2010 policy action



Source: Authors' calculations using the HM Treasury March 2010 Budget (available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/budget_archive.htm) and all OBR Economic and Fiscal Outlooks between June 2010 and December 2014 (available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

5.0% of national income. The difference between borrowing under each plan increases after 2015–16 due to the additional austerity that is now implied by the coalition government's forecasts.

1.4 How does the UK compare internationally?

The UK has already done significant fiscal tightening in response to the global financial crisis and recession and is planning significant further tightening. It was not the only country whose public finances were substantially affected by the crisis and so it is interesting to look at how the UK's plans for reducing borrowing compare with other countries' plans. (A cross-country comparison of general government net debt is provided in Chapter 5.)

Unfortunately, comparable detailed data on the magnitude of fiscal consolidation measures on a consistent basis across countries are not (to the best of our knowledge) currently available. However, an indication of the size of fiscal consolidation being carried out can be produced by looking at estimates of structural borrowing in different countries and how this is projected to change over time. This is done in Table 1.3 using estimates from the International Monetary Fund (IMF), produced on a consistent basis, for general government structural borrowing across 32 advanced economies. This measure of borrowing differs from the standard UK measure, which we have focused on throughout the rest of this chapter, for a number of reasons. Importantly, the measure shown in Table 1.3 excludes the financial position of public corporations and, for the UK, are based on policies as of the March 2014 Budget.

The left-hand set of columns in Table 1.3 show the peak level of general government structural borrowing over the period from 2008 to 2010 (inclusive) for each country, as well as the forecast level of borrowing in 2015 and 2019. The right-hand columns show the change between the peak level of borrowing and 2015, the change between 2015 and 2019, and the change between the peak and 2019. Countries are ranked from the weakest to the strongest fiscal position at the start of this period, with Greece having the highest level of structural borrowing initially (19.1% of national income) and Singapore the lowest (−0.9%, i.e. a surplus).

The data show that the UK had the fourth-highest level of borrowing at the peak (which for the UK was 10.3% of national income in 2009), behind only Greece (19.1% in 2009), Iceland (17.9% in 2008) and Ireland (12.1% in 2008). Those three countries were all

Table 1.3. Austerity in the UK compared with other advanced economies (IMF forecasts of general government structural borrowing, and change in structural borrowing, from recent peak to 2015 and 2019)

	Level of structural borrowing (% of national income)			*Change in structural borrowing (% of national income)*		
	Recent peak	**2015**	**2019**	**Peak to 2015**	**2015 to 2019**	**Peak to 2019**
Greece	19.1	–1.2	0.9	–20.3	2.0	–18.3
Iceland	17.9	0.8	0.3	–17.0	–0.5	–17.5
Ireland	12.1	2.2	–0.7	–9.9	–2.9	–12.8
United Kingdom	10.3	3.6	0.2	–6.6	–3.5	–10.1
Portugal	9.6	1.5	1.8	–8.1	0.3	–7.8
Spain	9.5	2.9	1.6	–6.7	–1.2	–7.9
United States	9.1	3.3	4.0	–5.8	0.6	–5.2
Latvia	8.9	0.7	0.6	–8.2	–0.1	–8.3
Japan	7.8	5.5	4.7	–2.3	–0.8	–3.1
Slovak Republic	7.6	1.5	0.7	–6.1	–0.8	–6.9
Malta	6.1	2.5	1.8	–3.6	–0.7	–4.3
Norway	5.9	6.5	6.7	0.6	0.3	0.8
Israel	5.9	2.5	1.6	–3.4	–0.9	–4.3
France	5.6	2.8	0.5	–2.9	–2.3	–5.1
Australia	4.9	1.8	–0.2	–3.2	–2.0	–5.1
Belgium	4.8	1.5	–0.5	–3.4	–1.9	–5.3
Czech Republic	4.8	1.3	0.0	–3.6	–1.3	–4.8
Netherlands	4.5	0.0	0.1	–4.5	0.1	–4.4
Slovenia	4.5	2.7	3.0	–1.7	0.3	–1.5
New Zealand	4.5	0.6	–1.3	–3.9	–1.8	–5.7
Canada	4.0	1.8	0.9	–2.1	–1.0	–3.1
Austria	3.8	1.0	0.5	–2.8	–0.5	–3.3
Italy	3.7	0.5	0.0	–3.3	–0.5	–3.8
Germany	3.5	–0.4	–0.4	–4.0	0.0	–4.0
Denmark	1.9	2.3	0.9	0.3	–1.3	–1.0
Finland	1.3	–0.3	–0.3	–1.6	0.0	–1.7
Hong Kong SAR	0.9	1.0	–0.9	0.1	–1.9	–1.8
Luxembourg	0.4	1.3	2.0	1.0	0.7	1.7
Switzerland	–0.2	–1.1	–1.1	–0.9	0.0	–0.9
Sweden	–0.3	0.6	–1.4	0.9	–2.0	–1.2
Korea	–0.5	–0.7	–1.7	–0.2	–1.0	–1.3
Singapore	–0.9	–4.1	–3.3	–3.1	0.8	–2.3

Source: Statistical table 3 of IMF, *Back to Work: How Fiscal Policy Can Help*, Fiscal Monitor, October 2014, http://www.imf.org/external/pubs/ft/fm/2014/02/fmindex.htm.

forced into implementing larger, swifter fiscal consolidations than the UK. As a result, by 2012, all are judged to have reduced their structural borrowing to below that of the UK.[19]

Out of all 32 advanced economies, up to 2015 the UK is forecast to have seen the seventh-largest reduction in structural borrowing since the crisis peak. This leaves the UK with the third-highest estimated level of structural borrowing (at 3.6% of national income), behind just Japan (5.5%) and Norway (6.5%). The latter is a very special case because the IMF excludes oil revenues in its estimates of structural borrowing for Norway. The IMF forecasts that Norway's overall structural budget position will be a surplus of 9.9% of national income in 2015. Therefore the UK's fiscal position in 2015 is, in effect, forecast by the IMF to be stronger than only that of Japan.

Between 2015 and 2019, the IMF is forecasting that the UK's structural borrowing will fall by 3.5% of national income (from 3.6% to 0.2%). This is larger than the reduction in structural borrowing forecast by the IMF for any of the other 31 advanced economies shown in Table 1.3, suggesting that the UK is planning the largest fiscal consolidation over this period. The only two countries that appear to be planning fiscal tightening on a comparable scale are Ireland (2.9%) and France (2.3%). As a result, the UK is forecast to have the fifteenth-smallest (or eighteenth-largest) level of borrowing by 2019.

It is possible that the UK's planned fiscal consolidation between 2015 and 2019 appears so much larger than that in most other economies because other countries have not yet developed or published full plans for this period. For example, the IMF forecasts that in the United States structural borrowing will be 3.3% of national income in 2015 but will rise to 4.0% of national income by 2019. On the other hand, the IMF forecasts actually miss out some of the austerity now planned in the UK: the IMF forecasts were produced in October 2014 and therefore do not include the announcement in December 2014 that the government has pencilled in a further squeeze on public spending in 2019–20.

1.5 Conclusion

Public sector borrowing has not fallen as quickly over this parliament as was expected in 2010. This is not because the coalition government has failed to implement the tax increases or spending cuts that it announced, nor primarily because those measures have raised less or cut spending by less than expected, but rather because economic growth has been lower than forecast, depressing tax revenues.

In November 2010, the coalition government thought that a large part of the borrowing in that year was purely cyclical and would disappear as the economy recovered. However, the economy has not bounced back as strongly as initially expected and the OBR now judges that it never will. As a result, headline borrowing has declined less quickly than originally expected and the government has announced additional spending cuts for the forthcoming parliament with the aim of achieving a budget surplus. But virtually no net additional measures have been announced since November 2010 for implementation in this parliament. Instead the coalition government chose largely to stick to its originally-planned pace of fiscal tightening and leave the additional cuts for after 2015. Consequently, borrowing has been higher over this parliament than was originally expected. As a result, public sector net debt is higher than was intended by the coalition government at the start of the parliament and is at a relatively high level both compared

[19] The structural deficit in Iceland is judged to have been lower than the UK's since 2009.

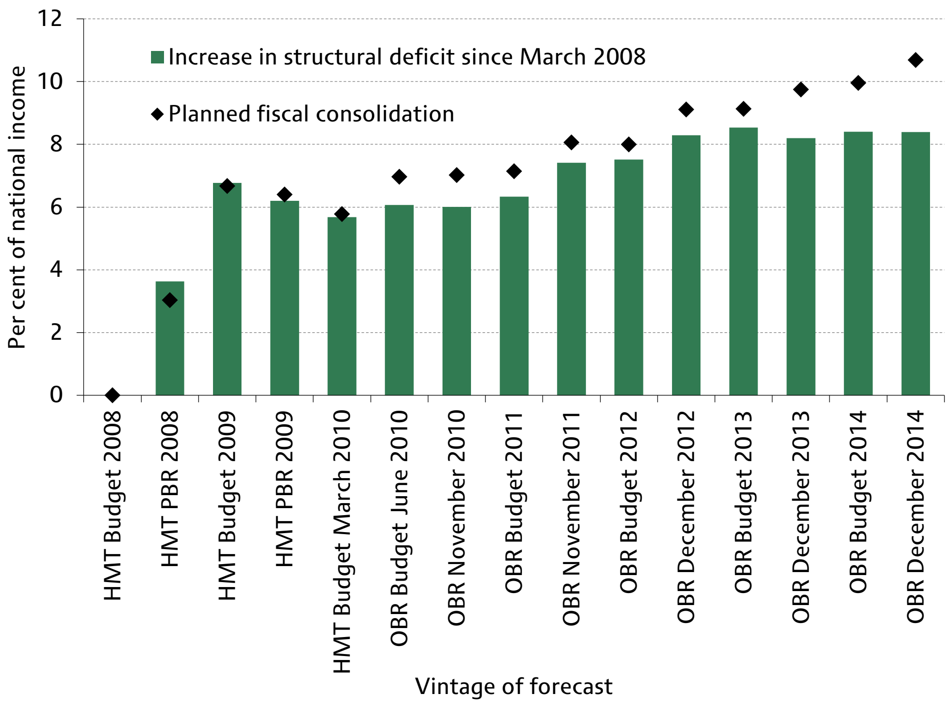
with recent UK history and relative to many other advanced economies. This is discussed further in Chapter 5.

There have been three notable broad trends in fiscal policy during this parliament. First, economic news has caused the OBR successively to revise down its forecasts for economic growth and to revise up its forecasts for both headline and structural borrowing. This has caused the government to respond by pencilling in further fiscal tightening. We calculate that the OBR's December 2014 forecasts imply an increase in underlying structural borrowing since the March 2008 Budget (i.e. that which was caused, or at least revealed, by the financial crisis and recession) of 8.4% of national income; this compares with an increase of 6.0% of national income implied by its November 2010 forecasts.

The second notable trend is that the government has chosen to announce new consolidation measures that more than offset the effects of these forecast revisions on medium-term borrowing. The government's plan is now to achieve an overall budget surplus of 1.0% of national income by the end of the five-year forecast horizon, compared with borrowing of 1.0% that was planned in November 2010.

The third notable trend has been to shift the balance of fiscal consolidation increasingly towards spending cuts and away from tax increases. The net effect of new measures announced during this parliament has been, at most, to increase future tax revenues very slightly and to reduce future public spending substantially.

Figure 1.8. Estimated increase in medium-term cyclically-adjusted borrowing (excluding policy response) and the size of the policy response since March 2008



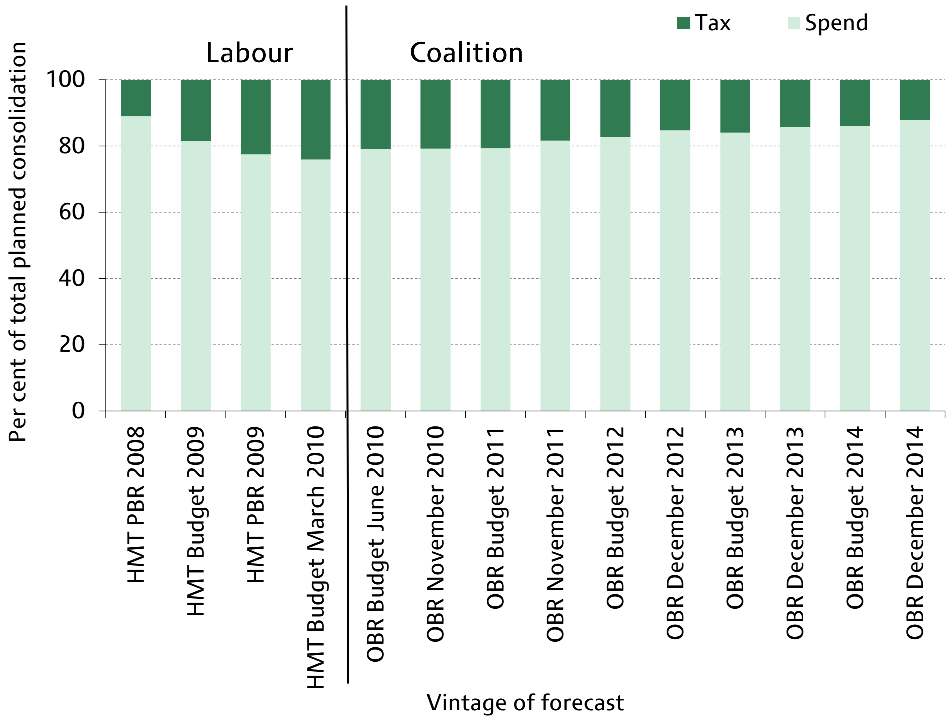
Source: Authors' calculations using all HM Treasury Budgets and Pre-Budgets between March 2008 and March 2010 (available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/budget_archive.htm) and all OBR Economic and Fiscal Outlooks between June 2010 and December 2014 (available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

These three stories are summarised in Figures 1.8 and 1.9. Figure 1.8 shows – for different points in time – the estimated underlying increase in structural borrowing since the March 2008 Budget (green bars) and the planned fiscal response at that point in time (black diamonds). Particularly large increases in the size of the estimated fiscal challenge were seen in the Pre-Budget Report of 2008, the Budget of 2009, the Autumn Statement of 2011 and (to a lesser extent) the Autumn Statement of 2012. These fiscal events also saw particularly large increases in the size of the fiscal response, but so too did June 2010 (in the coalition government's first Budget) and December 2013 and December 2014 (when the coalition decided to extend the planned public spending squeeze in order to reduce structural borrowing further).

Not only has the planned size of the overall fiscal consolidation changed over time but the share that is from net tax rises, as opposed to net spending cuts, has also changed. Figure 1.9 shows the share of the planned eventual fiscal consolidation that was forecast to come from net tax rises and net spending cuts from each fiscal event since the March 2008 Budget. Under the Labour government, the share forecast to come from net tax rises, while still a minority of the overall planned consolidation, was increased at each fiscal event. In contrast, under the coalition government, the share of the planned consolidation coming from net tax rises has fallen over time (it fell in every fiscal event except Budget 2013).

The coalition government will have implemented tax increases and spending cuts worth around 5.8% of national income by the end of the current financial year (2014–15). This goes some, but far from all, of the way to offsetting the increase in underlying structural

Figure 1.9. Share of the planned fiscal consolidation from net tax rises or spending cuts



Source: Authors' calculations using all HM Treasury Budgets and Pre-Budgets between November 2008 and March 2010 (available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/budget_archive.htm) and all OBR Economic and Fiscal Outlooks between June 2010 and December 2014 (available at http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

borrowing that we estimate was caused (or revealed) by the financial crisis and recession (8.4% of national income). The current government will bequeath to its successor a plan for further deep cuts to spending in the next parliament, in order to achieve an overall budget surplus of 1.0% of national income. This will not be easy to achieve. Chapter 7 discusses what the government's plans imply for spending on public services. Alternative options include cutting social security spending (discussed in Chapter 9) and/or increasing taxes (discussed in Chapter 10) further than currently planned. But, of course, the exact scale of measures that will be required remains uncertain, as developments over this parliament have demonstrated. Chapter 5 discusses some of the upside and downside risks to the official forecasts and plans that have been the focus of discussion here.