

Tax and spend under Labour

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Outline

- Why do governments tax and spend?
- The public finance timetable
- Gordon's fiscal rules
- Tax and spend under Labour
- What to expect in next week's PBR

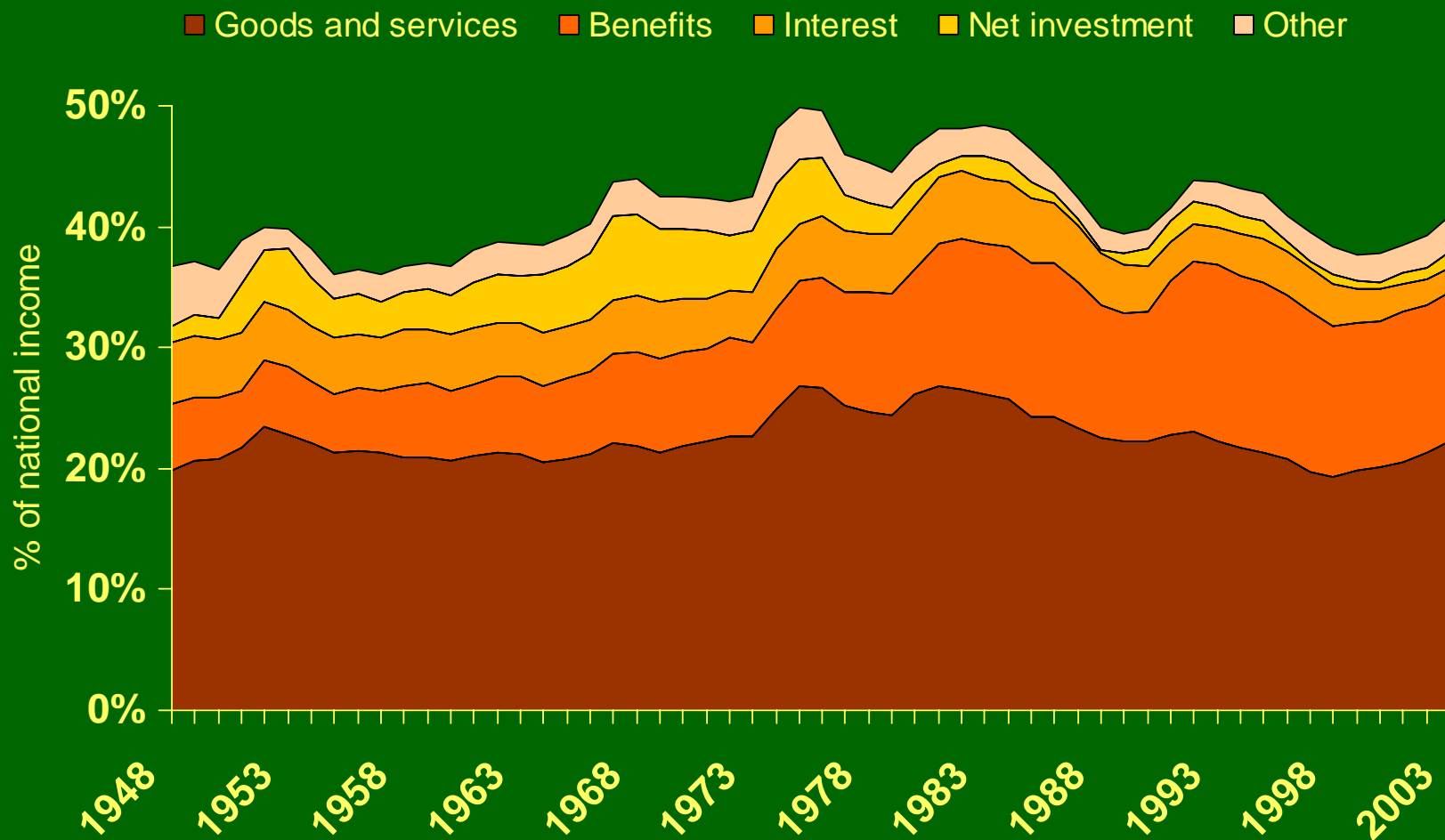
Why tax and spend?

- Providing public goods
 - Defence, criminal justice
- Replacing missing markets
 - Unemployment insurance, higher education
- Paternalism and spillovers
 - Schools, pensions, tobacco duties, green taxes
- Redistribution
 - Taxes, cash benefits, benefits-in-kind

Setting tax and spending

- Treasury plans spending totals and allocation between departments over three-year time horizons
- “Comprehensive spending review” next year will set spending plans for 2007/08, 2008/09 and 2009/10
- Taxes set and public finance forecast published in Budget each spring
- Another public finance forecast published in “pre-budget report” in late autumn. Due December 6.

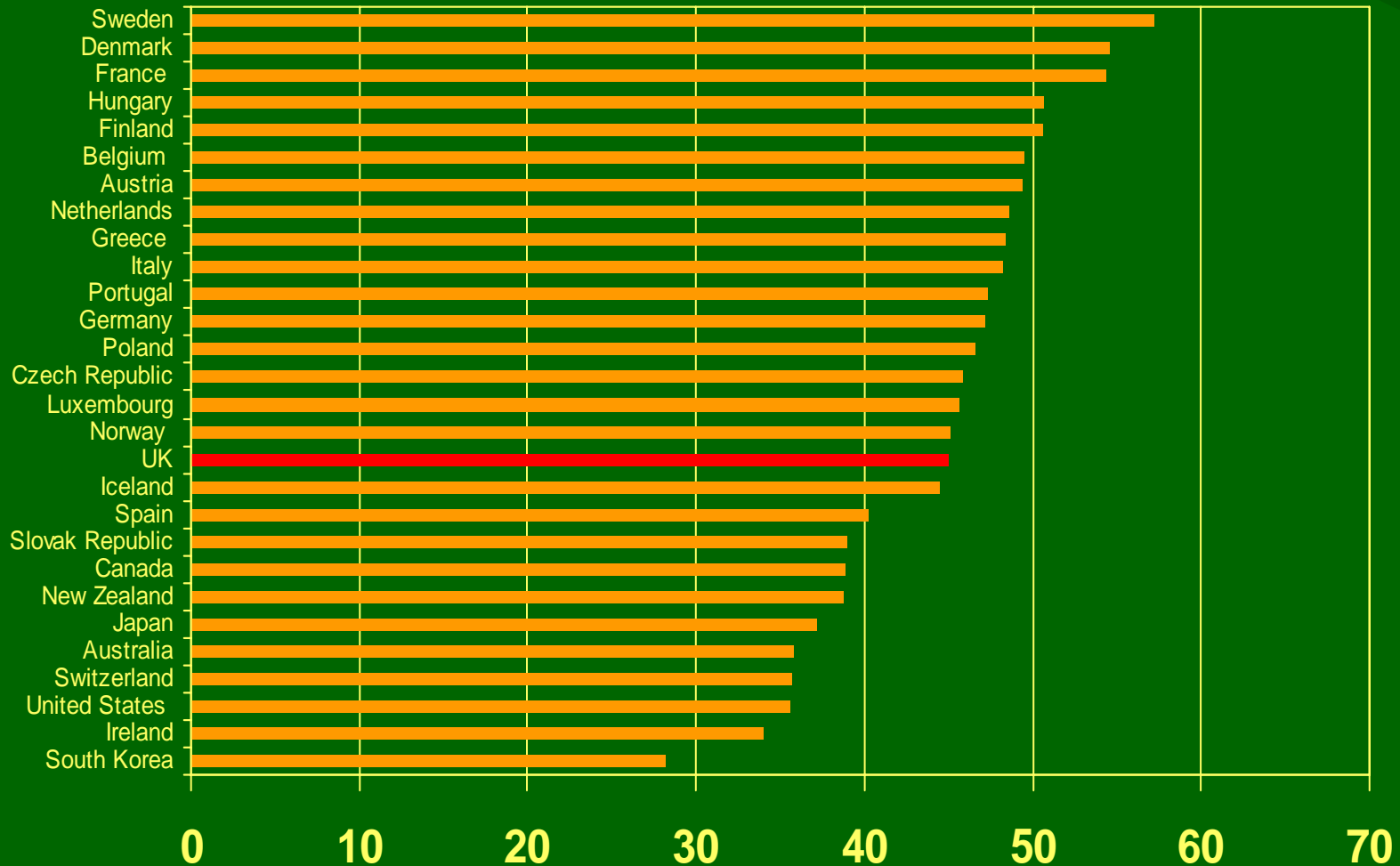
Public sector spending



Public spending by country

2005 (OECD definition)

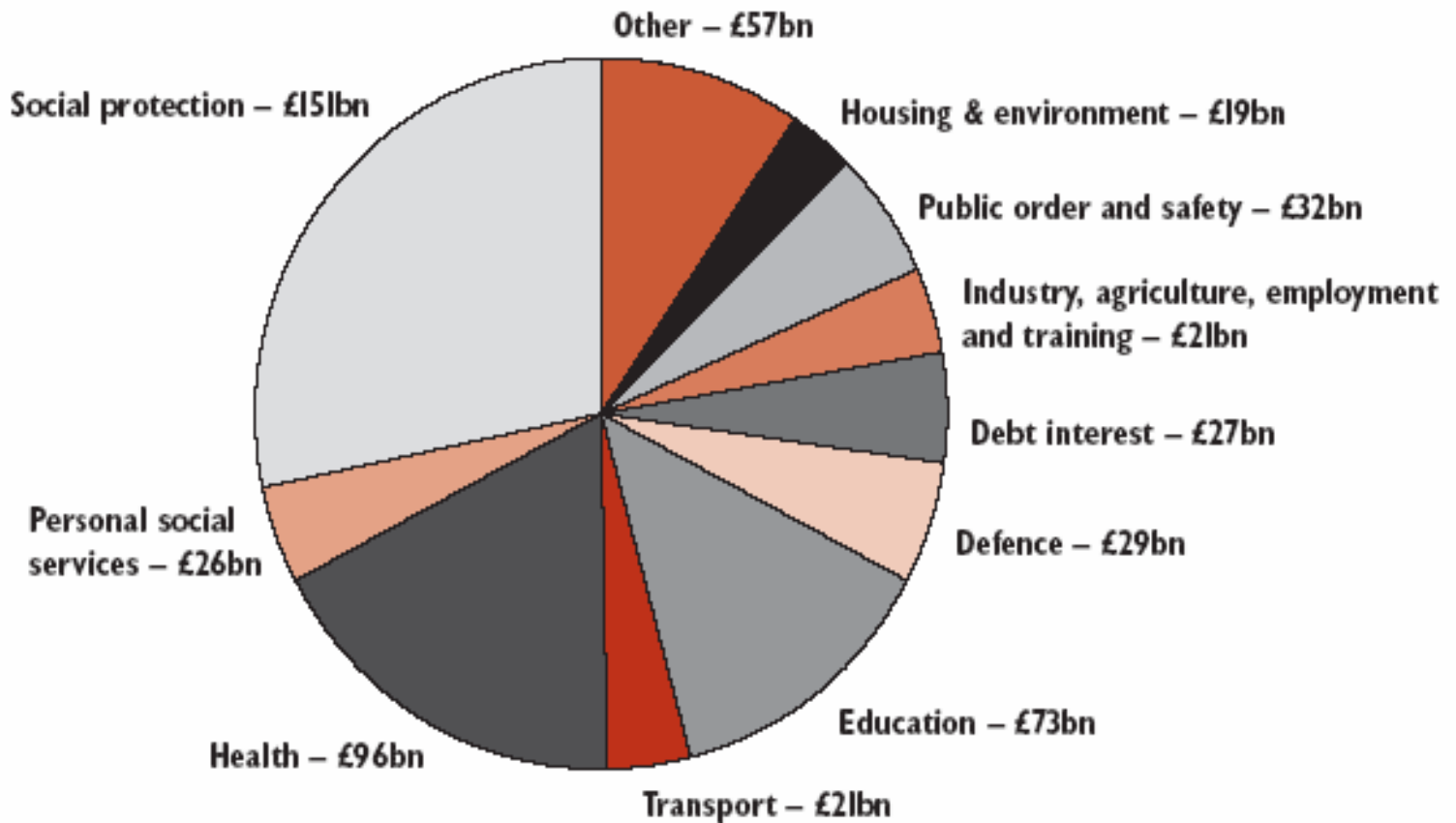
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Public sector spending

2006-07 Treasury forecast from Budget 2006

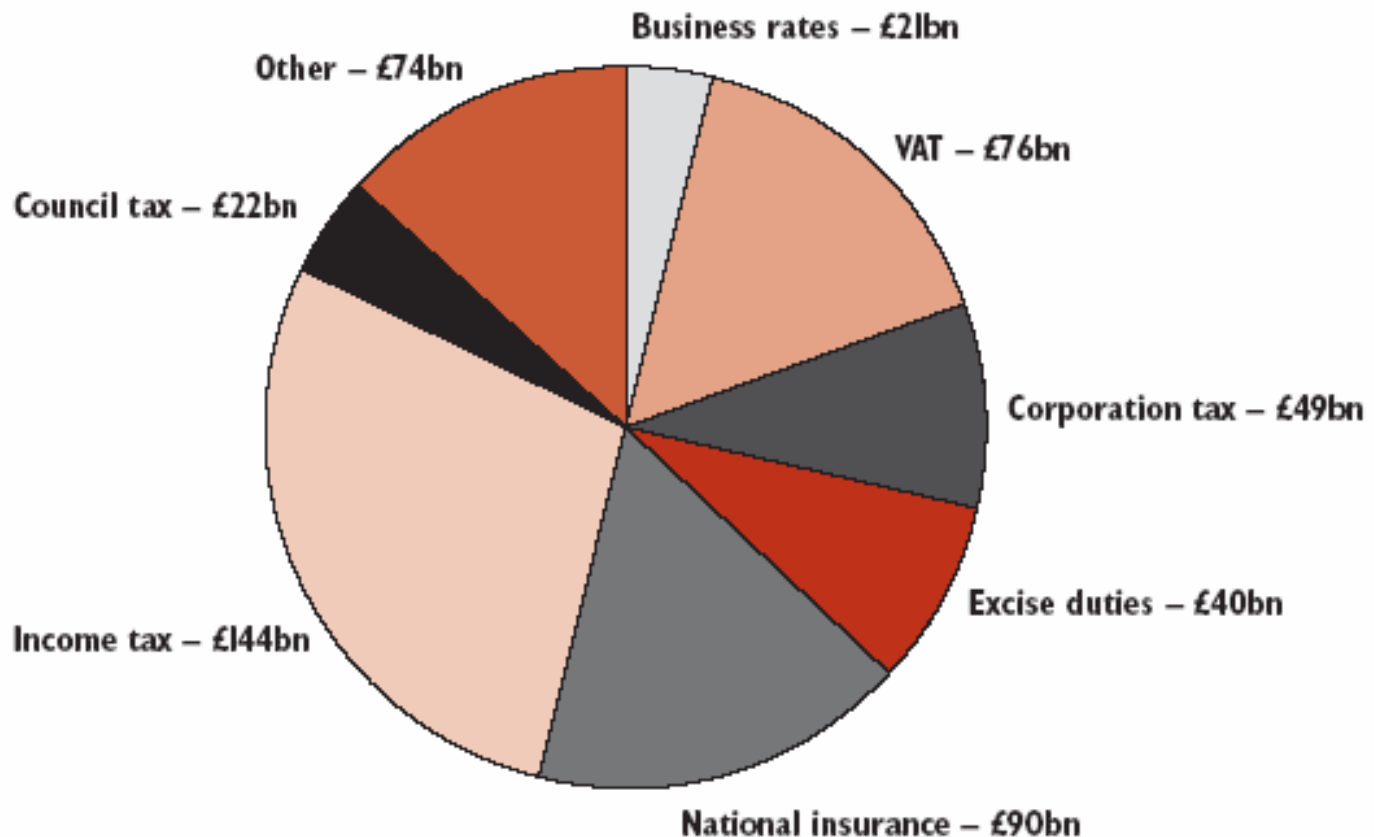
Total managed expenditure: £552 billion



Public sector revenues

2006-07 Treasury forecast from Budget 2006

Total receipts: £516 billion



Public sector net borrowing

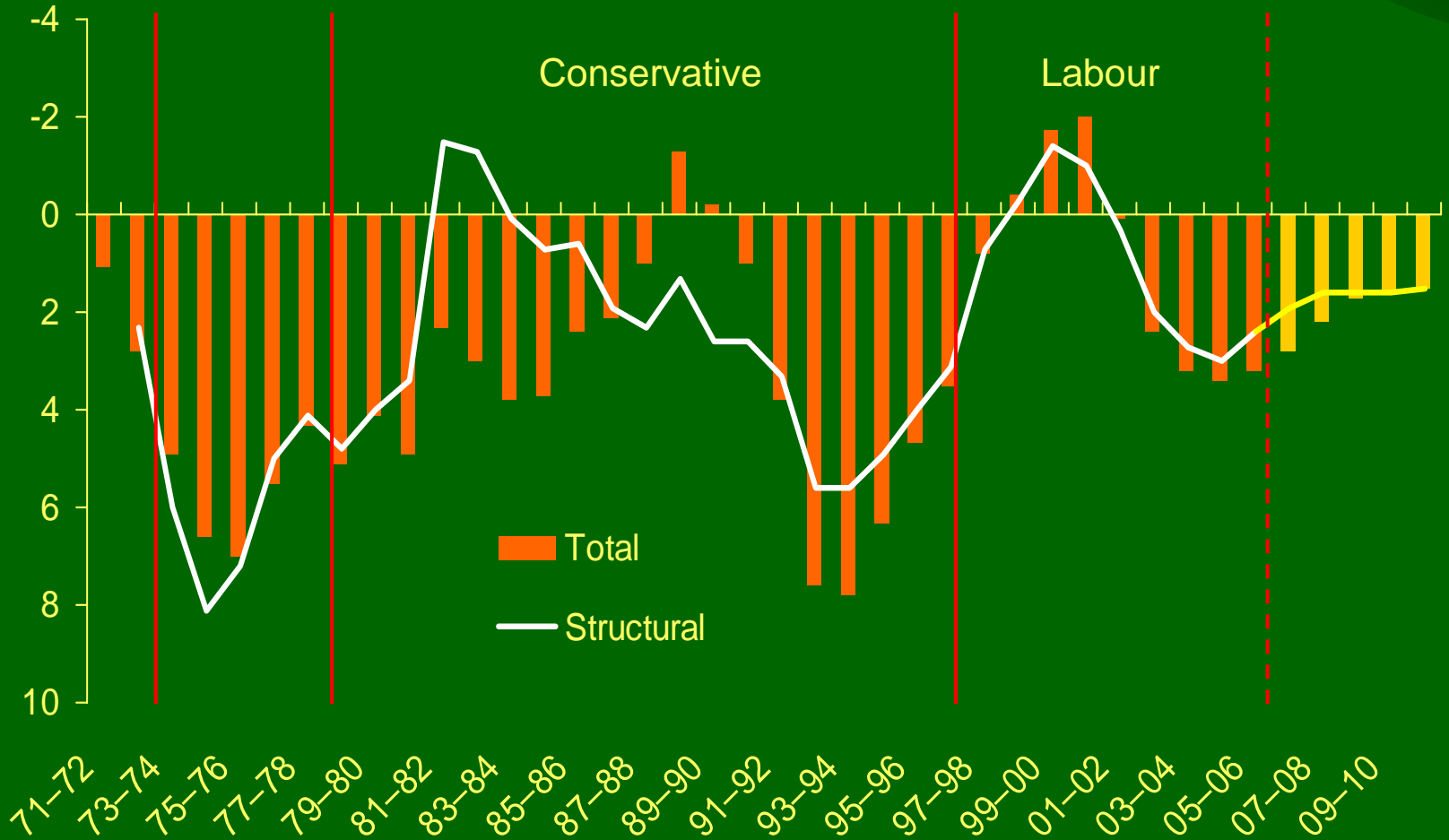
2006-07 Treasury forecast in 2006 Budget

- Spending 43.1% of GDP (£552bn)
 - Revenues 40.3% of GDP (£516bn)
-
- Borrowing 2.8% of GDP (£36bn)

Public sector net borrowing

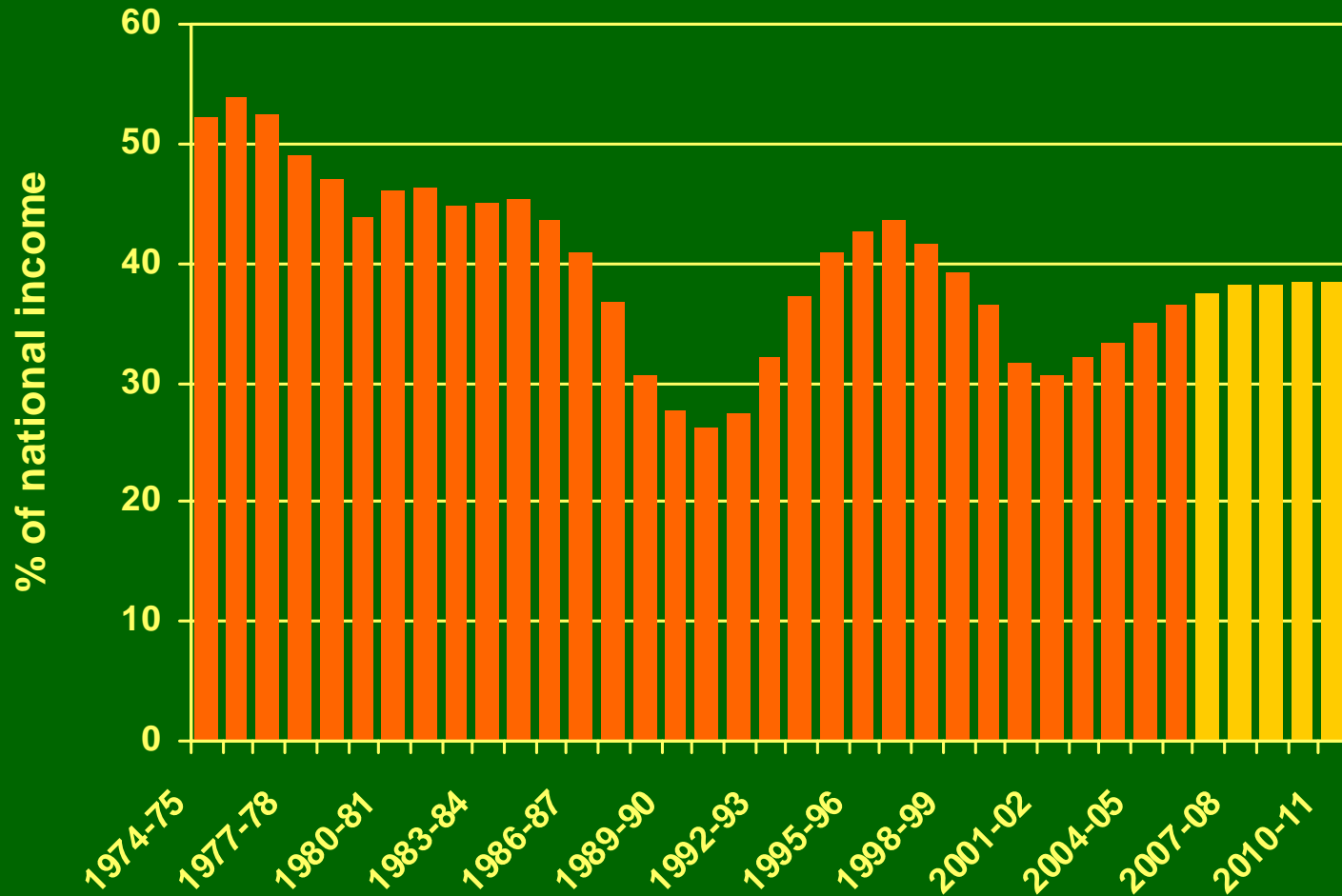
% of GDP

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Public sector net debt

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Why borrow?

- Inter-generational fairness
 - Capital spending, wars, training doctors?
- Stabilizing tax rates
- Macroeconomic management
- Political expedience

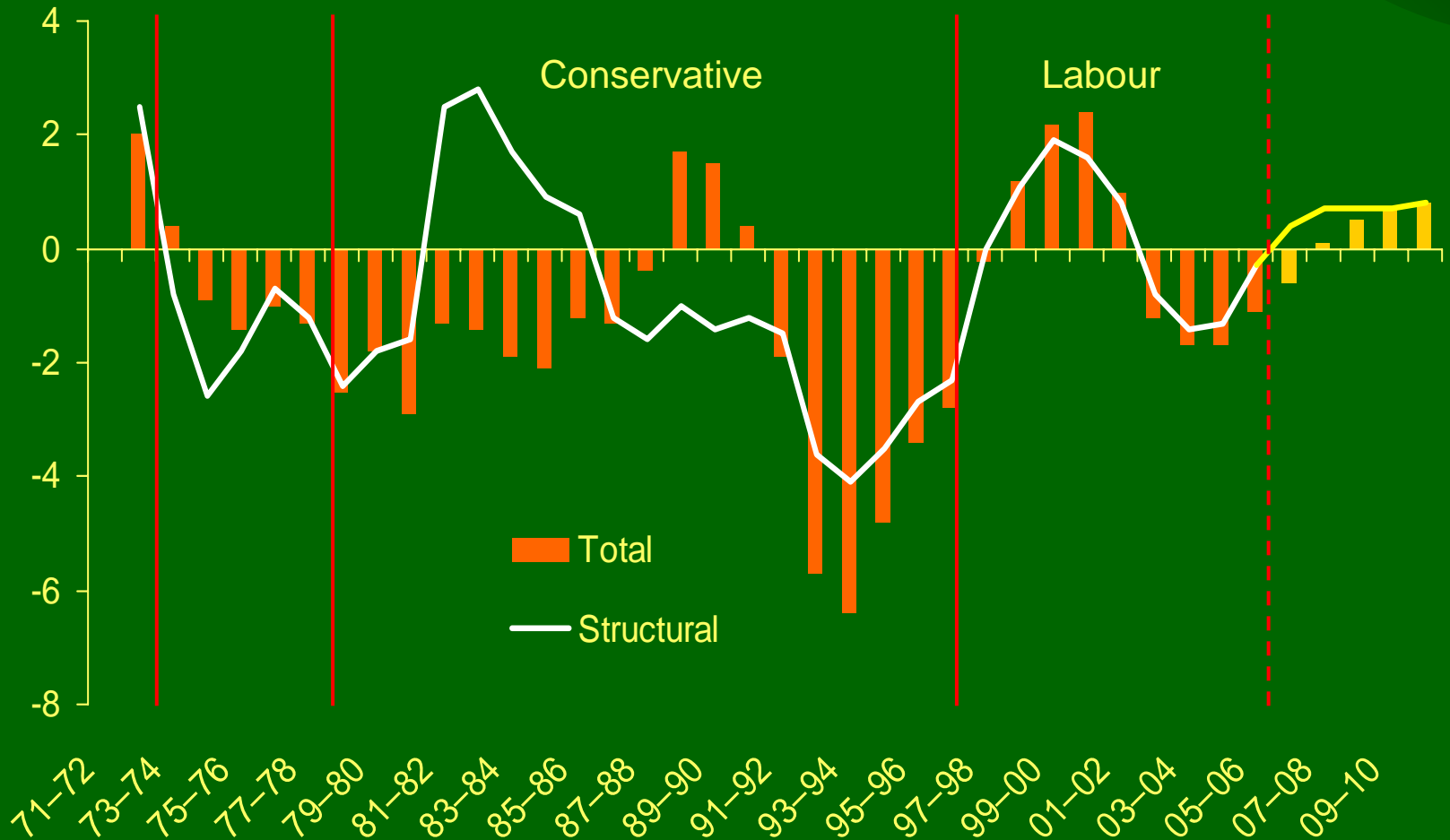
Gordon's fiscal rules

- Sustainable investment rule
 - keep debt at a “stable and prudent” level
 - defined as below 40% of national income
 - to be met every year in current economic cycle
- Golden rule
 - only borrow to invest
 - receipts must cover current spending
 - implies surplus or balance on current budget
 - on average over economic cycle, not every year

Public sector current balance

% of GDP

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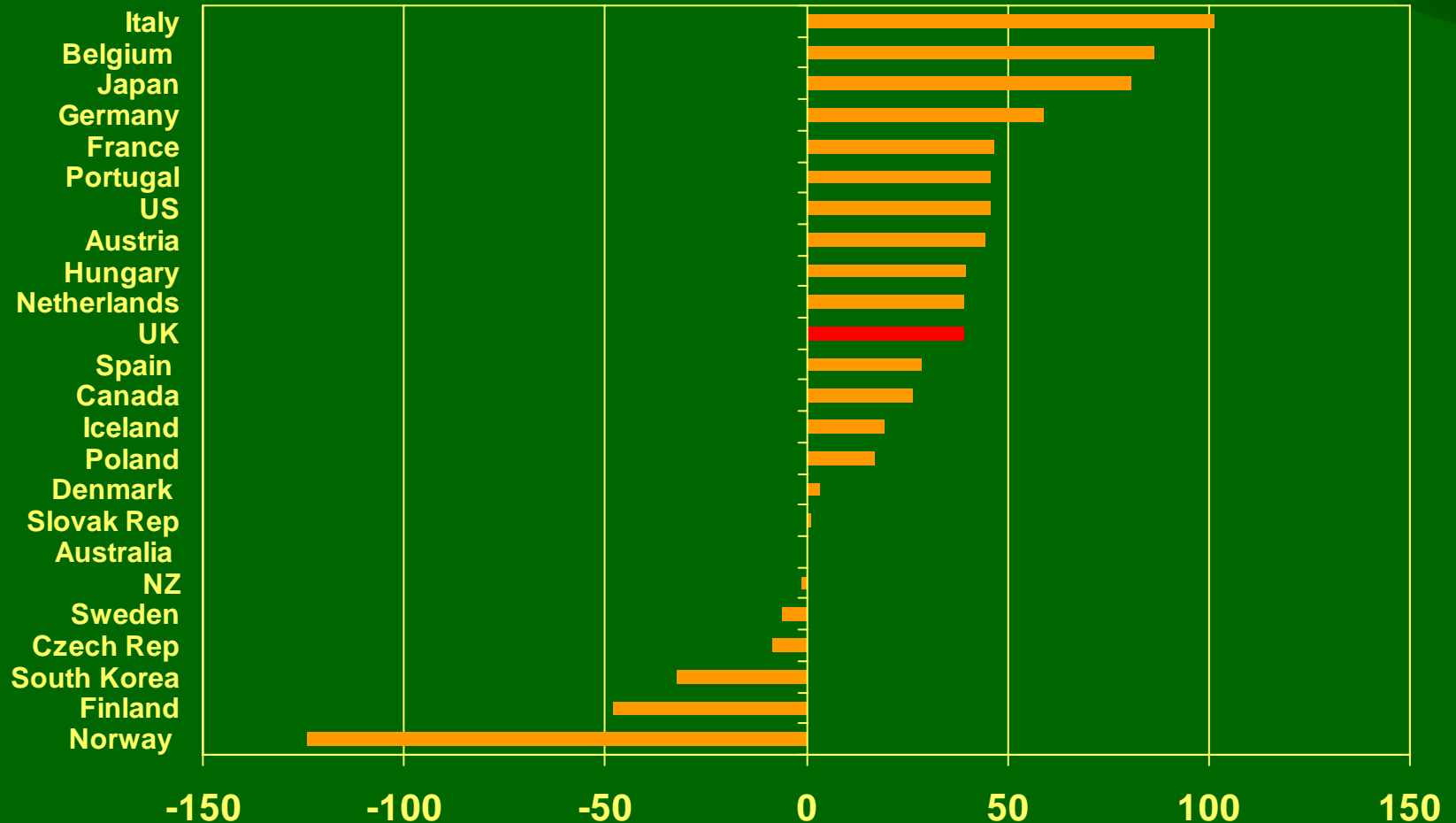
Are the fiscal rules sensible?

- Reasonable, but not optimal
- Golden rule
 - Time profile of costs/benefits
 - Definition of investment
 - Ability to pay
- Sustainable investment rule
 - Private finance initiative
 - Why 40%?

General government debt

% of national income

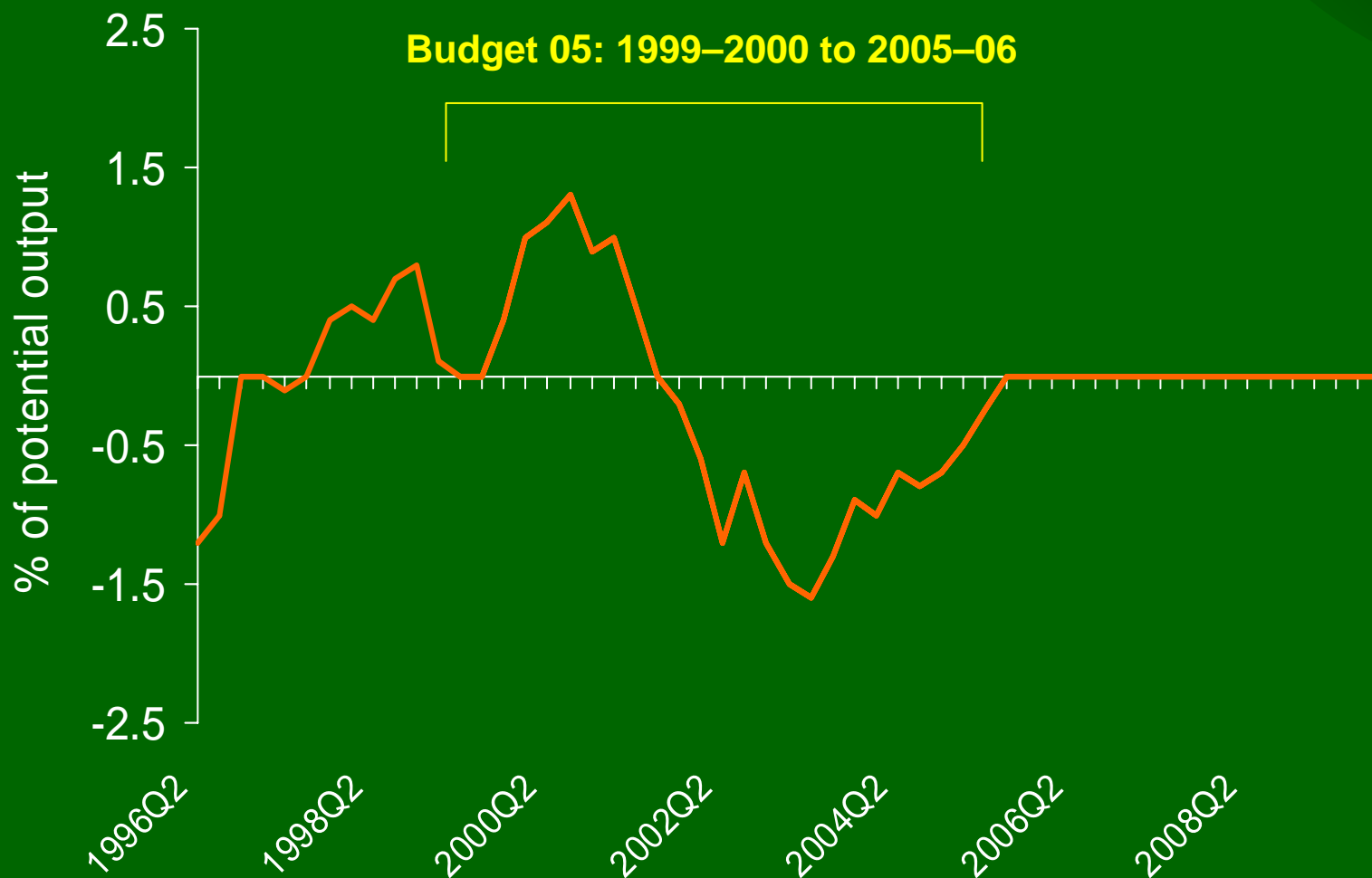
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Tax and spend under Labour

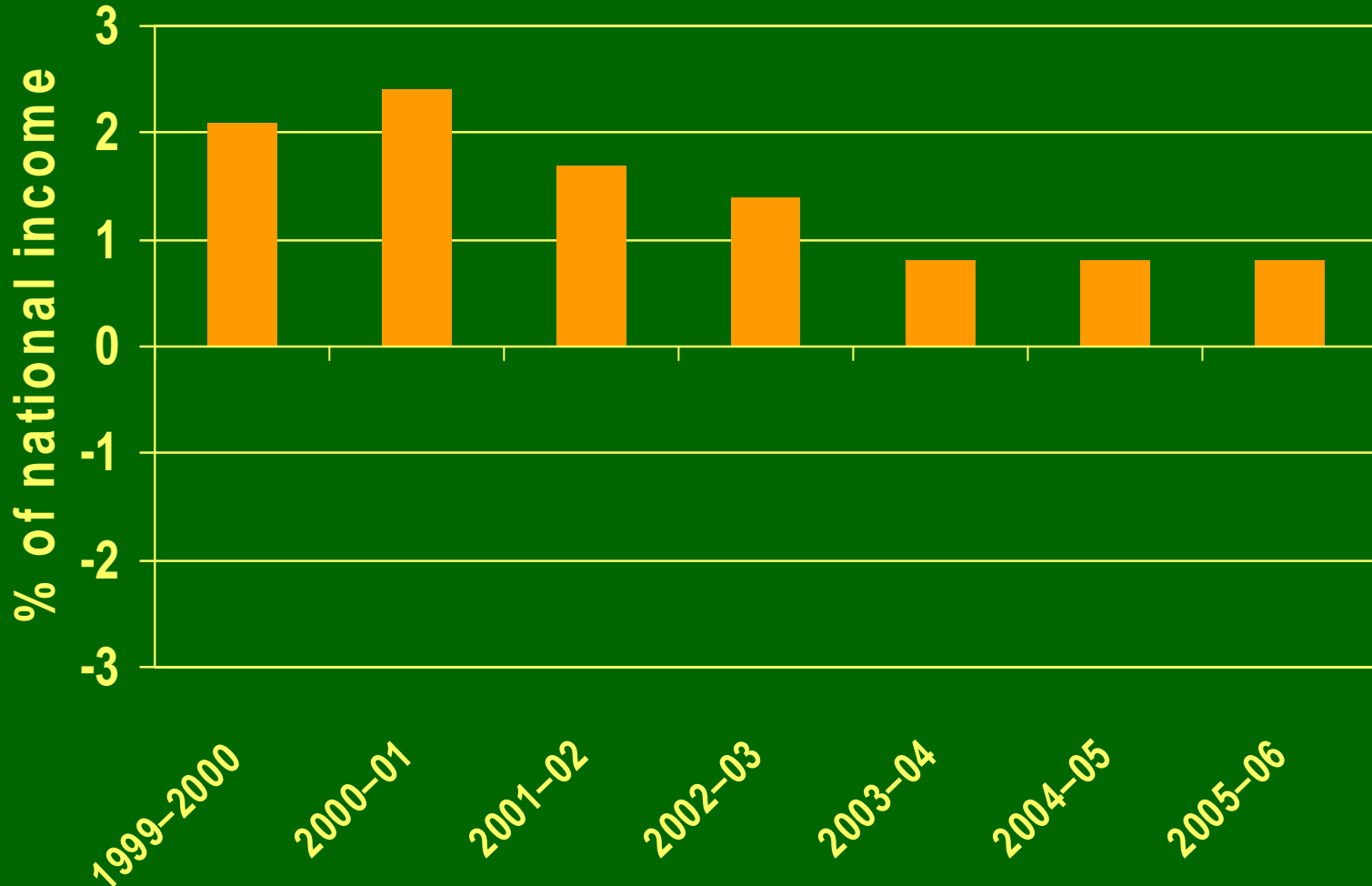


A seven year cycle



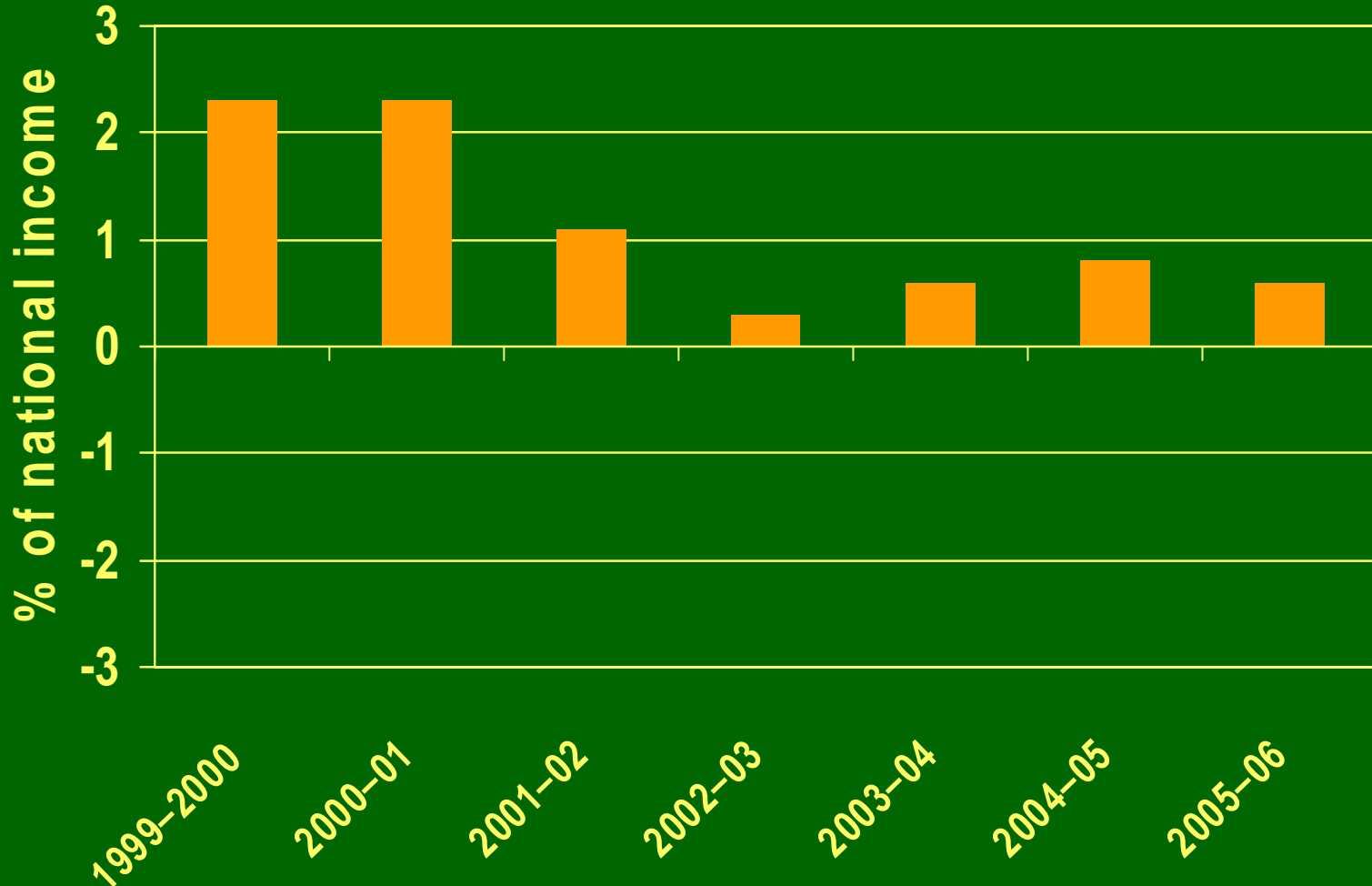
Fiscal position weakens

Current budget balance (Budget 2001)



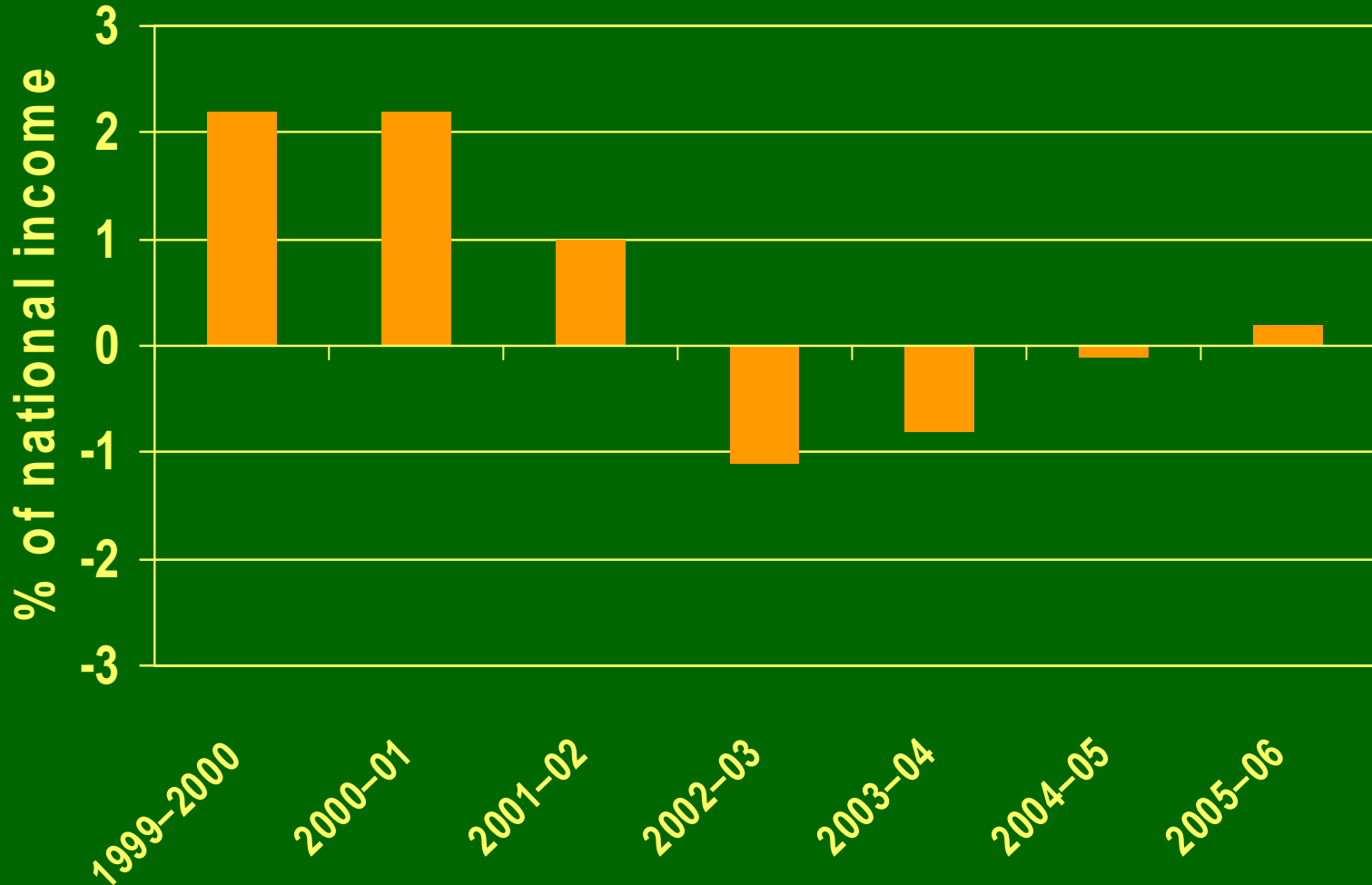
Fiscal position weakens

Current budget balance (Budget 2002)



Fiscal position weakens

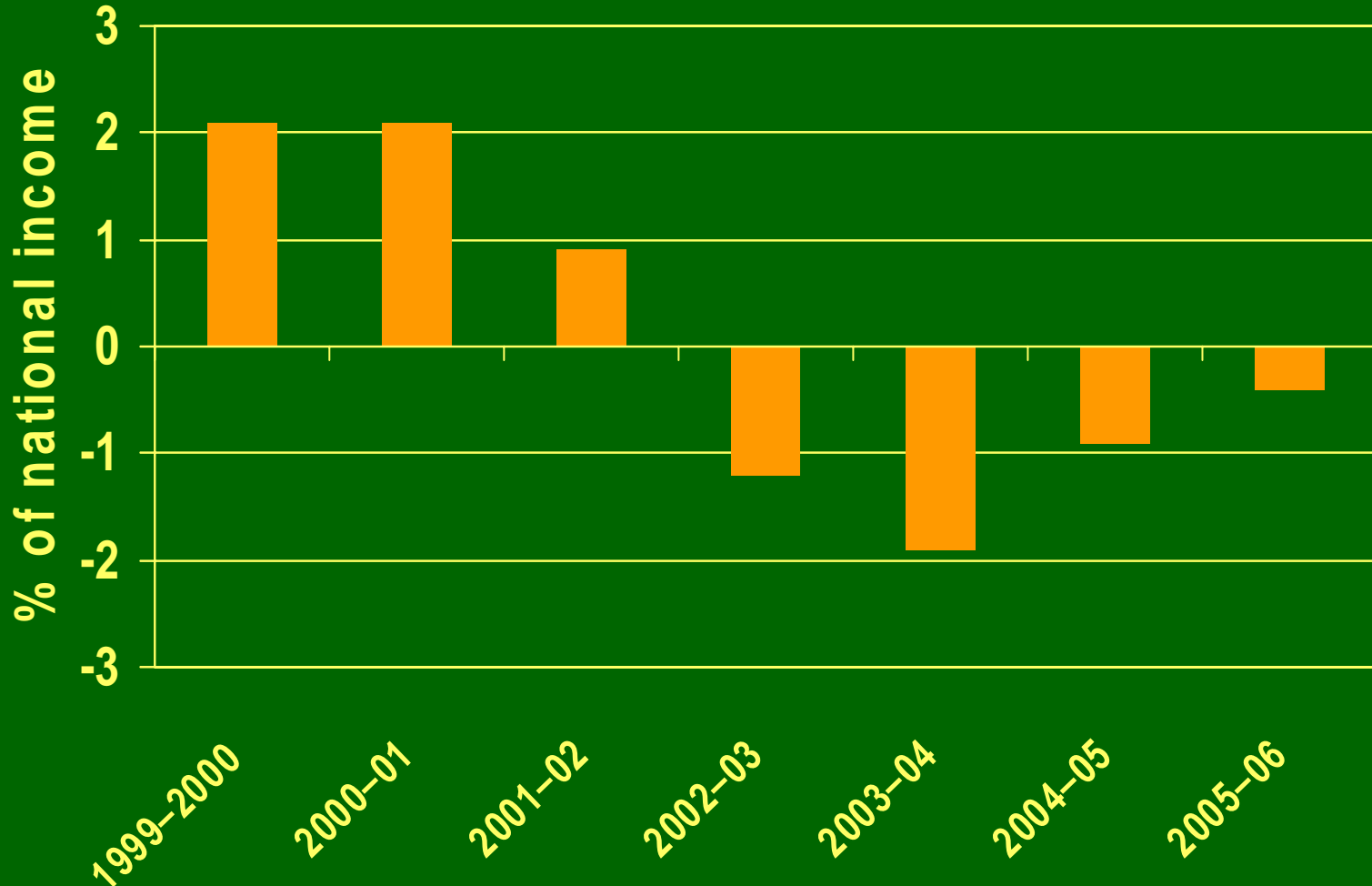
Current budget balance (Budget 2003)



Fiscal position weakens

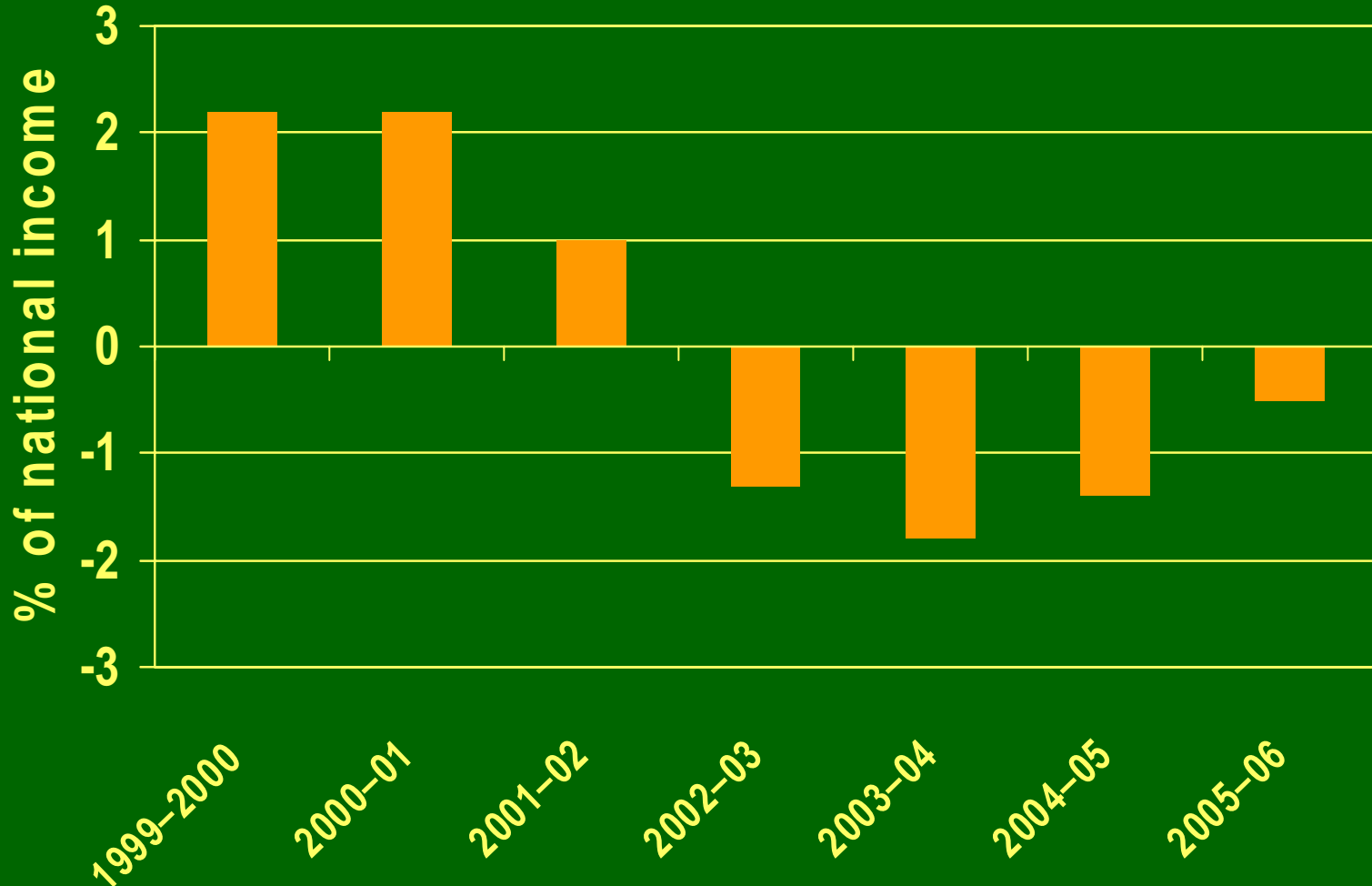
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Current budget balance (Budget 2004)

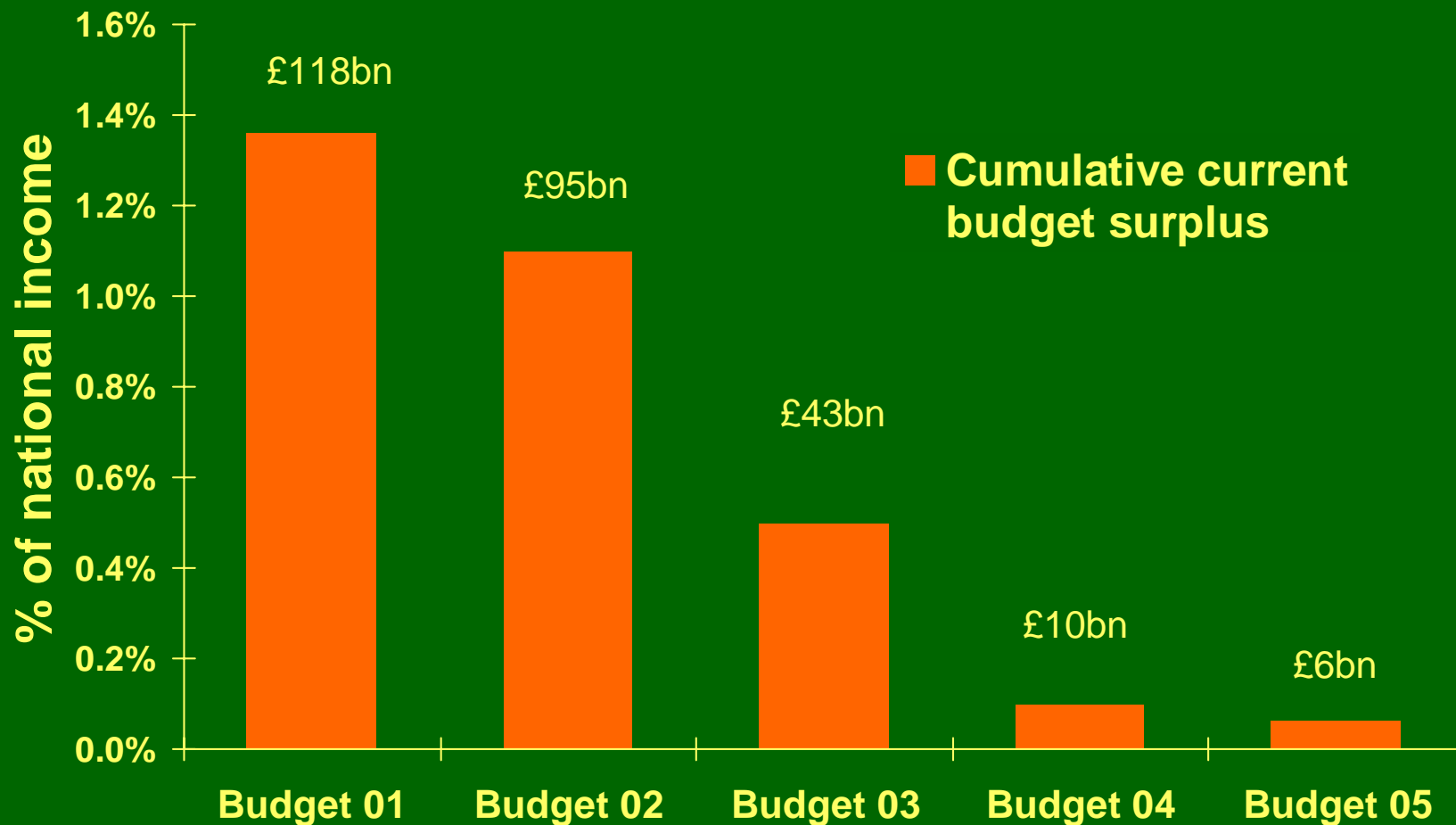


Fiscal position weakens

Current budget balance (Budget 2005)



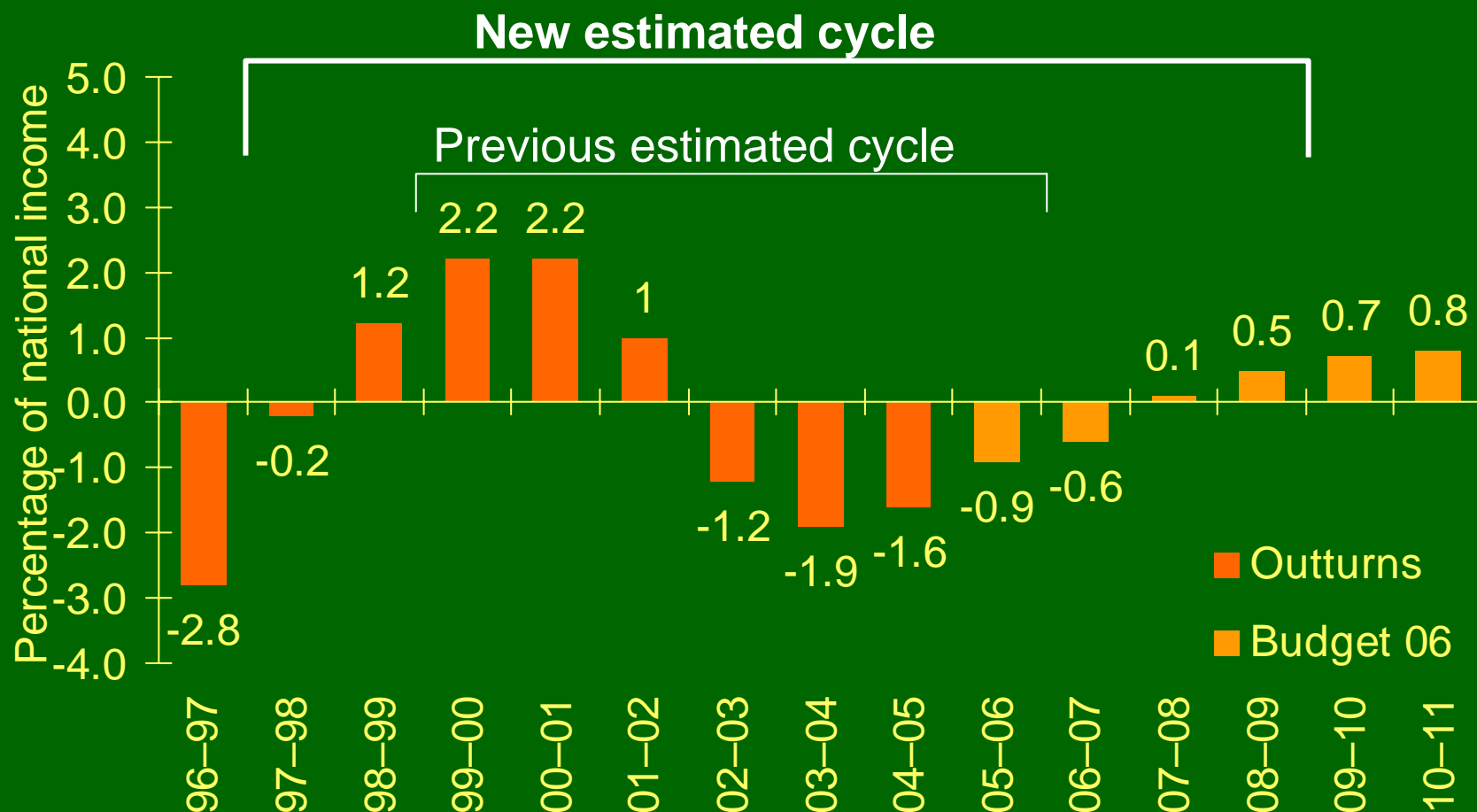
Overachieving the golden rule



Action follows election

- Treasury consistently overoptimistic since '01
- IFS and others suggested need for tax increases and/or cuts in spending plans of £10bn+
- Post election PBR:
 - Raises taxes by £3bn
 - Pencils in £7-8bn spending cut
 - Elongates economic cycle from 7 to 12 years

Current budget balance



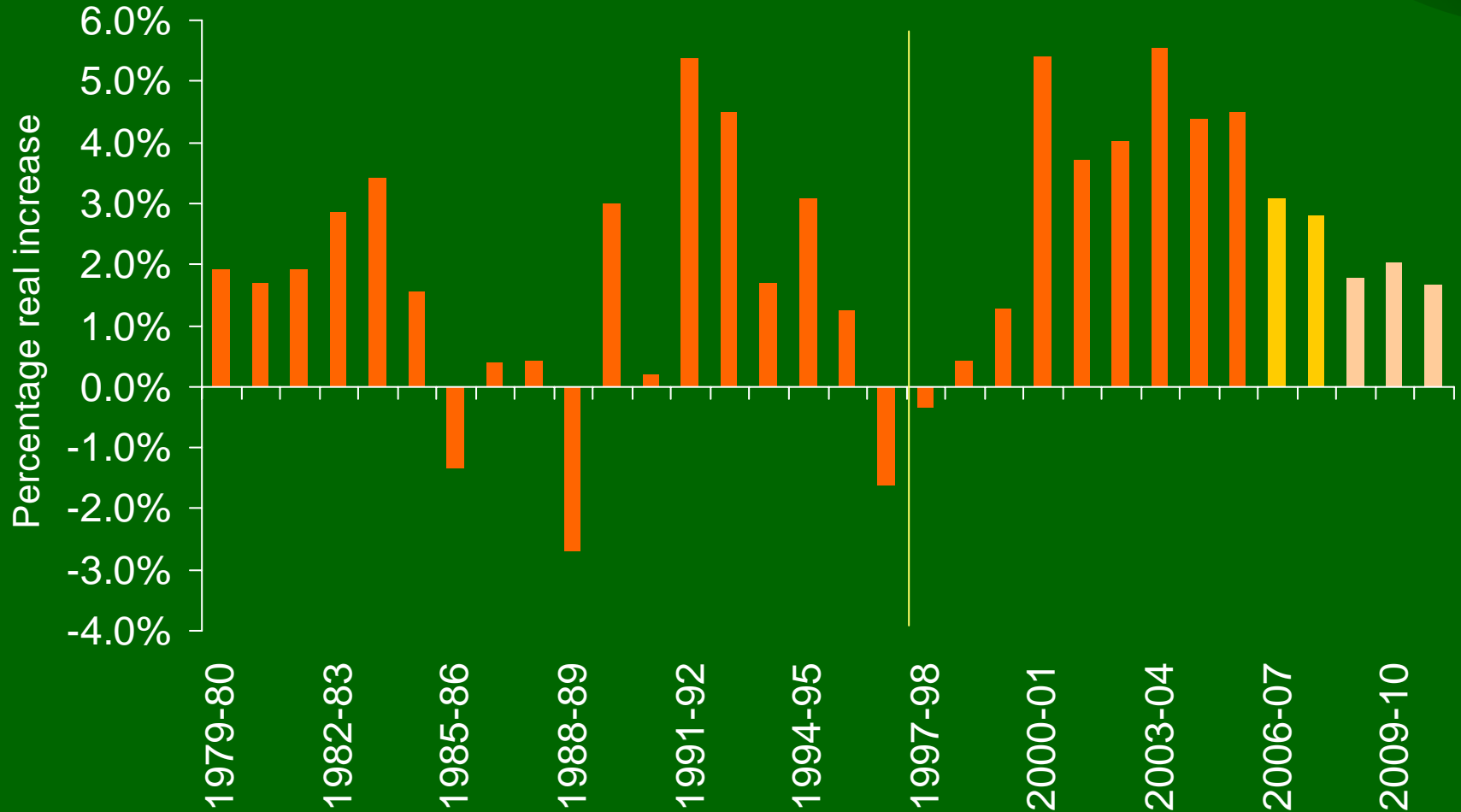
Expected net debt after 5 years

	% of national income	<i>Headroom under debt ceiling</i>
Budget 2001	31.0%	9.0%
Budget 2002	30.0%	10.0%
Budget 2003	33.8%	6.2%
Budget 2004	36.4%	3.6%
Budget 2005	37.1%	2.9%
Budget 2006	38.4%	1.6%

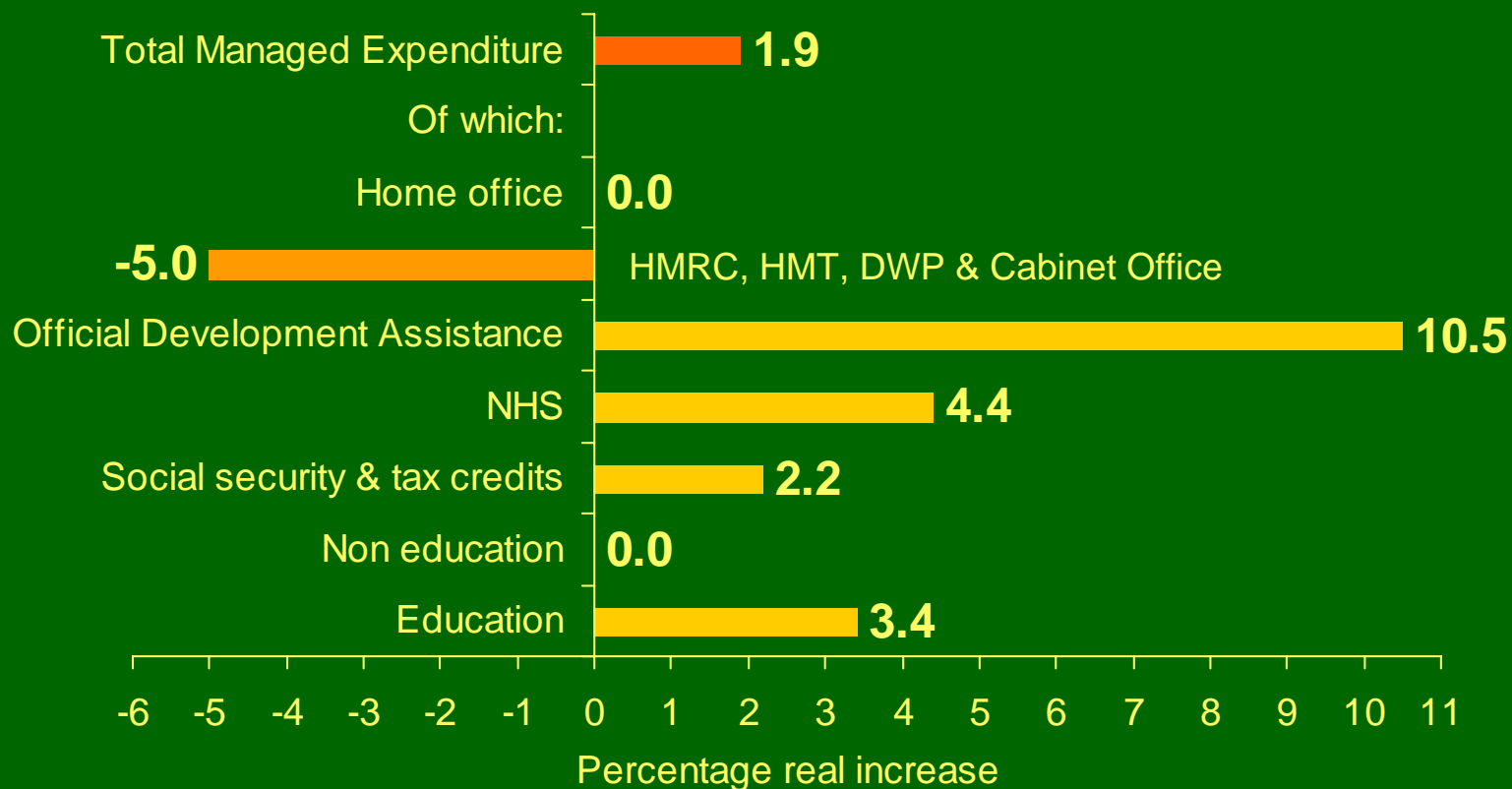
What can we expect in PBR?

- Upward revision to GDP growth forecast
- Little change to public finance forecasts
- Will Treasury change cycle dates again?
- Green taxation
- Child poverty
- More pieces of the spending jigsaw?

Increases in spending



Sharing the pain



Health versus education?

	I	II	III
Health	4.4% (Wanless minimum)	3.1% (Tories 1979-97)	2.8%
Education	3.4%	5.2%	5.6% (Labour to date)