Public finances: Osborne sails close to the wind

Gemma Tetlow
Public Finances: Overview

- Borrowing increased throughout medium-term horizon
- Largely due to lower than previously forecast level of “potential” output in UK economy: permanent problem
- A policy response of two halves
  - 2011–12 to 2014–15: reshuffling of existing tax and spend
  - 2015–16 and 2016–17: significant additional spending cuts
- Policy action sufficient to ensure still forecast to meet fiscal targets
Forecasting changes

- Borrowing increased in medium-term by about £30 billion a year
- Revenues lower by £40 billion a year
  - Lower receipts from...
    - Wages and salaries
    - Corporate profits and bonuses
    - Household consumption
    - Lower asset and commodity prices
  - Higher receipts from...
    - Investment
- Spending lower by £10 billion a year
  - Lower interest rates reduce debt interest spending
  - Higher unemployment increases welfare spending
Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP

Lower growth this year and forecast for next year
Weak short-term growth thought to reflect a permanent problem.

The chart compares actual GDP growth with potential ("trend") GDP growth from 2009-10 to 2016-17. The data indicates a 3½% loss of trend output, with GDP returning to trend in 2017-18. Most of this is expected to be a permanent loss of output.
Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP

Actual GDP (Mar 2011)
Potential ("trend") GDP - March 2011
Actual GDP (Nov 2011)
Potential ("trend") GDP - November 2011
Potential ("trend") GDP - March 2008

9½% loss of trend output
3½% loss of trend output
Size of the problem: change over time

Percentage of national income

Sources: HM Treasury; OBR; Author’s calculations.
Size of the problem: change over time

Percentage of national income

- HMT PBR 2008
- HMT Budget 2009
- HMT PBR 2009
- HMT Budget March 2010
- OBR Budget June 2010
- OBR
- OBR November 2010
- OBR Budget 2011
- OBR November 2011

Sources: HM Treasury; OBR; Author’s calculations.
Problems meeting the fiscal mandate

Fiscal mandate: “cyclically adjusted current budget balance by the end of the rolling, five year forecast period”
## A response of two halves

<table>
<thead>
<tr>
<th>Autumn statement 2011</th>
<th>£ billion</th>
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<tbody>
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<td>Tax giveaway</td>
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Note: Figures may not sum due to rounding. Sources: HM Treasury; IFS calculations.
# A response of two halves

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## A response of two halves

### Autumn statement 2011

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<td>0.3</td>
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Sources: HM Treasury; IFS calculations.
Fiscal tightening, March 2011

March 2011: £91bn hole in public finances

Sources: HM Treasury; Author’s calculations.
Nov 2011: £114bn hole in public finances

Sources: HM Treasury; Author’s calculations.
Fiscal tightening, November 2011: more to do, some more done

Nov 2011: £114bn hole in public finances

Percentage of national income


- Extra spend
- Other current spend
- Debt interest
- Benefits
- Investment
- Tax increases

Sources: HM Treasury; Author’s calculations.
Less headroom against the fiscal mandate

**Fiscal mandate:** “cyclically adjusted current budget balance by the end of the rolling, five year forecast period”
Perilously close on the supplementary target

Supplementary target: “public sector net debt as a percentage of GDP to be falling at a fixed date of 2015–16”
6-year squeeze on public service spending

Note: Figure shows total public spending less spending on welfare benefits and debt interest.
DELs: The grand old Duke of York?

Note: Figure shows Departmental Expenditure Limits (DELs) as a share of national income under current policies, assuming no further changes to Annually Managed Expenditure policies.
Public Finances: Summary

• Reduced outlook for potential output of the UK economy
• Fed through into permanently higher borrowing, without policy action
• A policy response of two halves
  – 2011–12 to 2014–15: reshuffling of existing tax and spend
  – 2015–16 and 2016–17: significant additional spending cuts
• Policy action sufficient to ensure still forecast to meet fiscal rules
  – Less room for manoeuvre against fiscal mandate than had in March
  – Substantially less room for manoeuvre against the supplementary target