

Institute for
Fiscal Studies



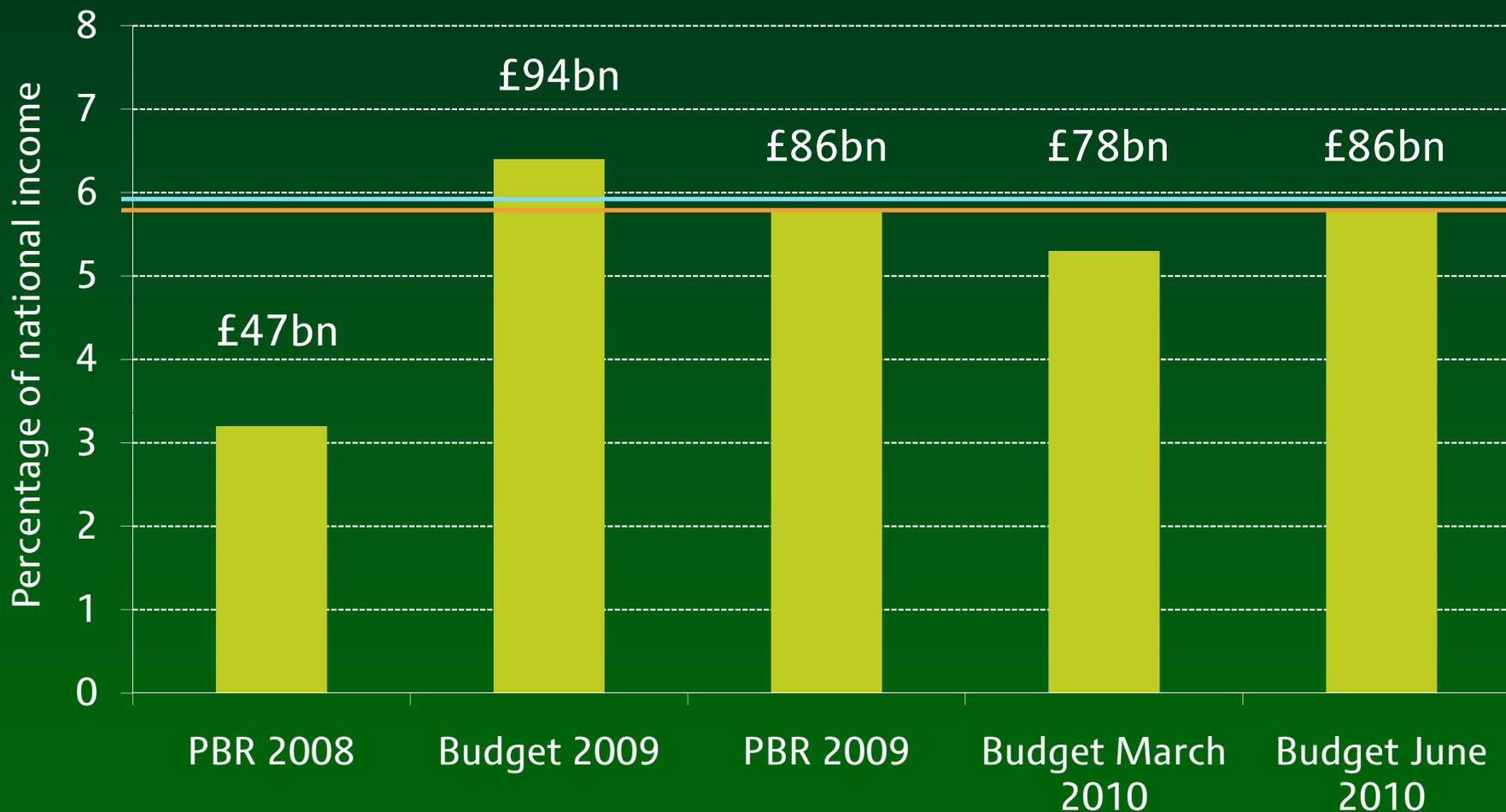
Public finances: more done, more quickly

Gemma Tetlow

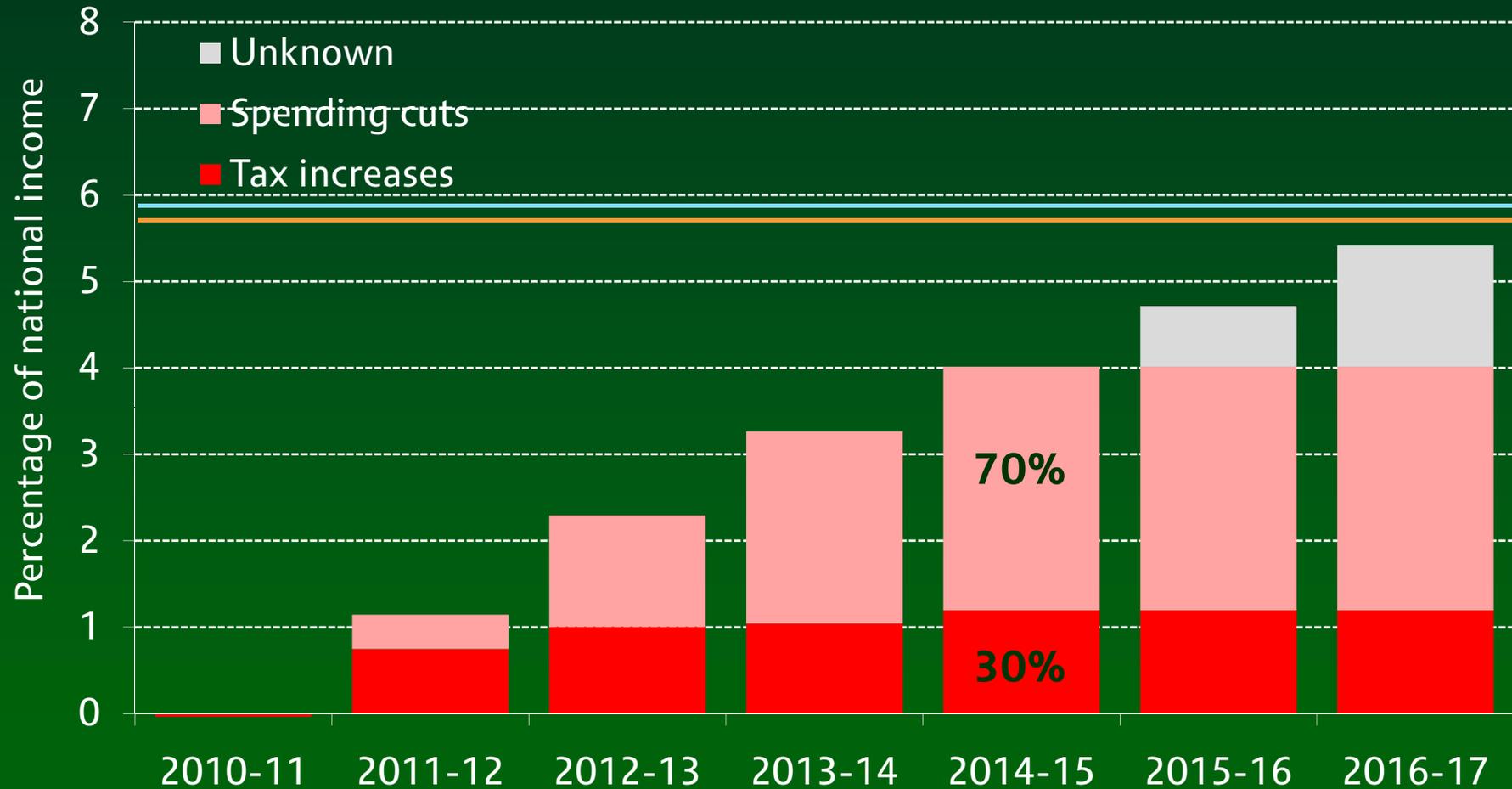
Summary

- OBR forecasts slightly increased the estimate of the size of the problem facing the new government
- Yesterday's Budget
 - accelerated tightening
 - increased total size of tightening
 - announced new fiscal mandate
- New measures amount to £52bn additional fiscal tightening by 2015–16
 - new measures comprise 85% spending cuts, 15% tax increases
 - overall fiscal tightening now 77% from spending cuts
- OBR forecasts for GDP assume no effect on supply side of policy measures
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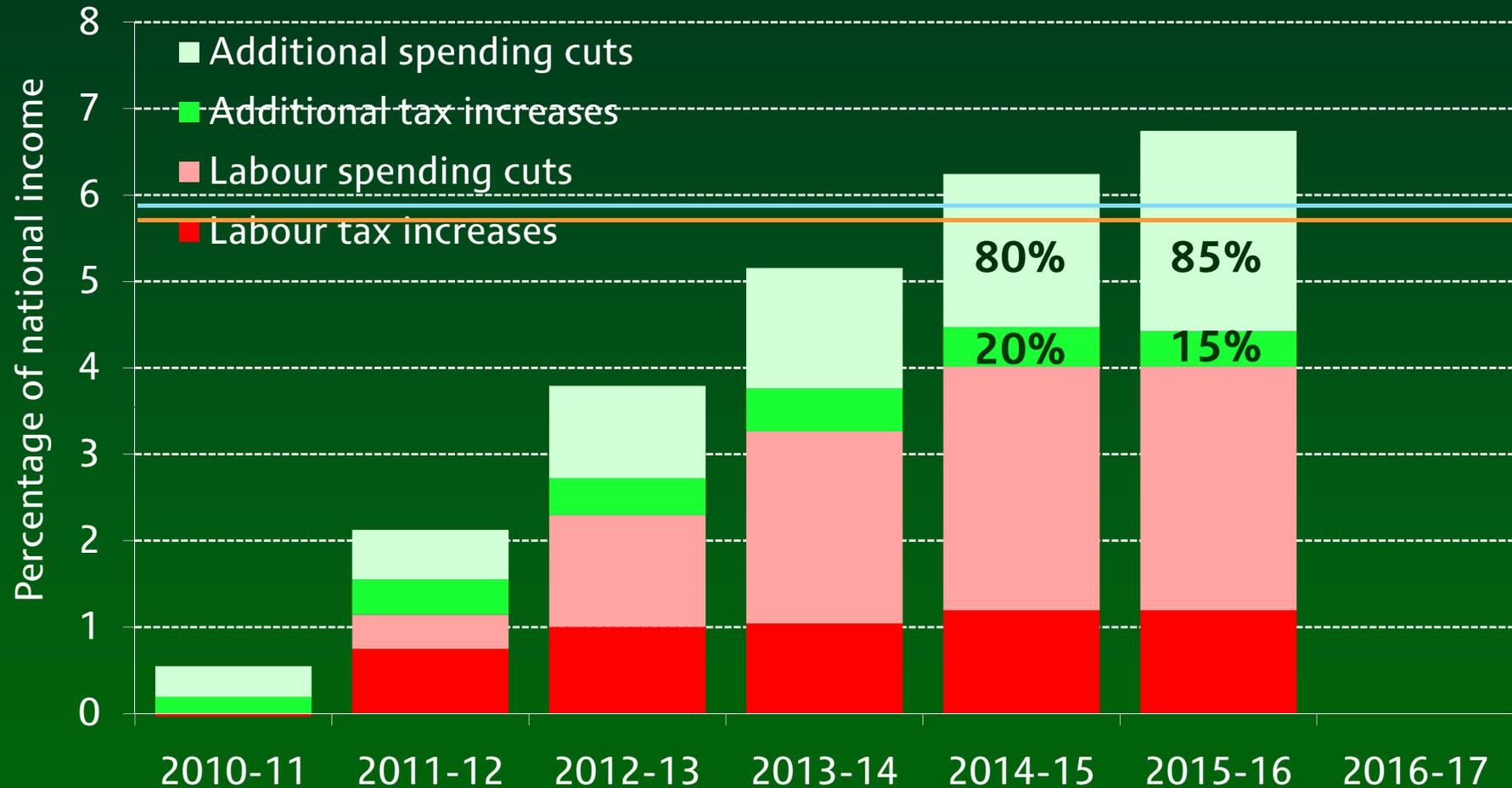
Size of the problem: change over time



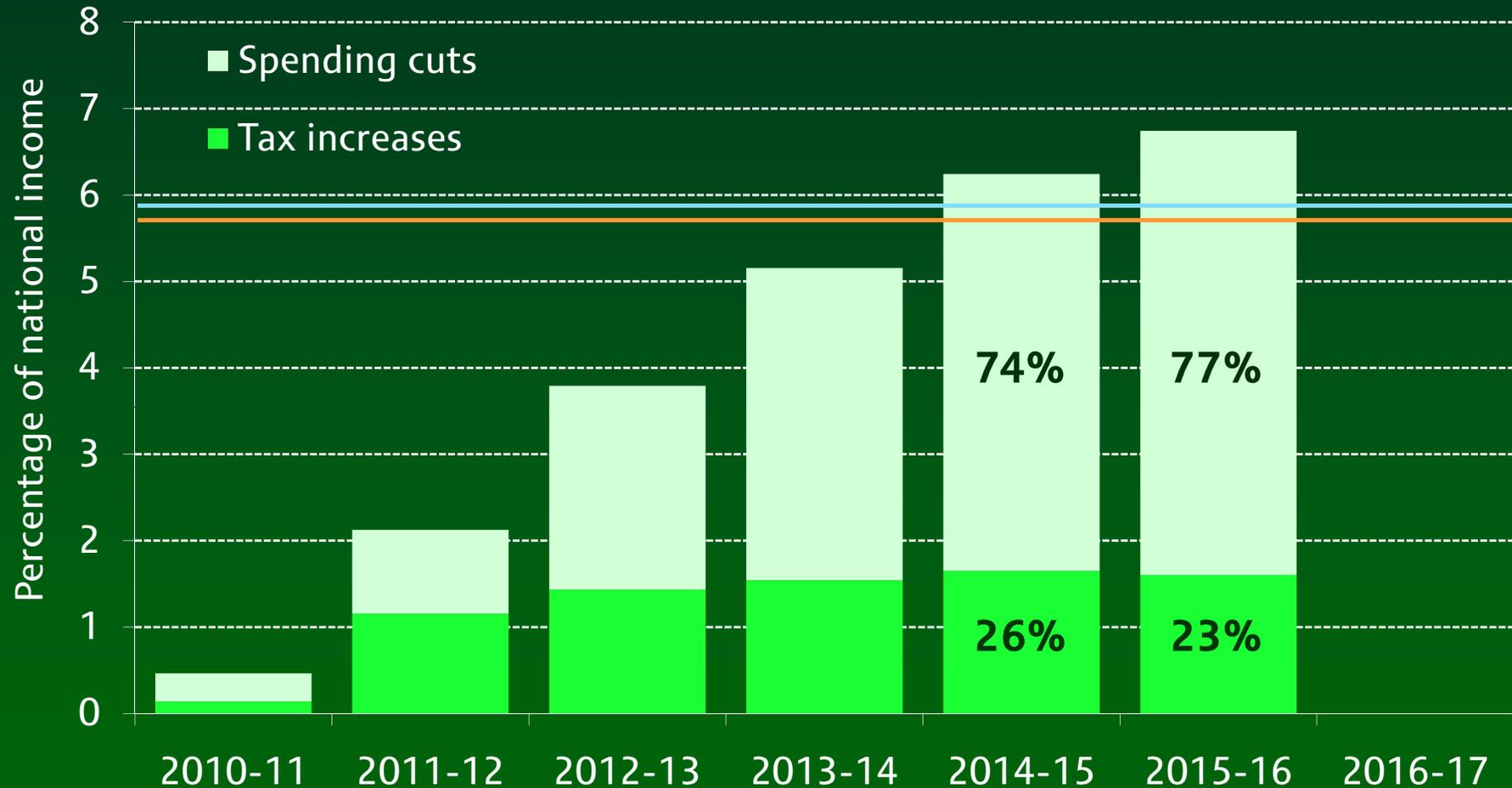
Fiscal tightening: Labour's plans



Fiscal tightening: additional measures



Fiscal tightening: final coalition plan



June 2010 Budget measures

	£ billion					
<i>Impact on PSNB</i>	2010–11	2011–12	2012–13	2013–14	2014–15	2015–16
Investment cut	–1.8	–2.0	–2.1	–2.1	–2.2	–2½
Current spending cut	–3.5	–7.7	–14.2	–19.9	–29.8	–42
Benefit spend	–0.4	–2.0	–4.7	–8.2	–11.0	–13
Debt interest	0.0	0.8	–1.0	–1.8	–3.0	–4½
Other current	–3.1	–5.6	–9.5	–11.7	–15.7	–24
Net tax takeaway	–2.8	–6.3	–7.0	–8.5	–8.2	–8
Tax takeaway	–3.0	–14.6	–17.2	–20.2	–20.8	–22
Tax giveaway	0.2	8.4	10.3	11.7	12.6	14
Total measures	–8.1	–15.1	–24.3	–32.3	–40.2	–52

Note: Figures do not sum due to rounding.
Sources: HM Treasury; IFS calculations.

June 2010 Budget measures: tax (1)

	£ billion					
<i>Impact on PSNB</i>	2010–11	2011–12	2012–13	2013–14	2014–15	2015–16
Tax takeaway	-3.0	-14.6	-17.2	-20.2	-20.8	-22
VAT increase	-2.9	-12.1	-12.5	-13.0	-13.5	-14
Bank levy	0	-1.2	-2.3	-2.5	-2.4	-2½
Reduce capital allowances	0	0	-1.0	-1.9	-1.8	-2
Reduce annual invest. allow.	0	0	-0.1	-1.2	-1.0	-1
CGT	0	-0.7	-0.8	-0.9	-0.9	-1

Sources: HM Treasury; IFS calculations.

June 2010 Budget measures: tax (2)

	£ billion					
	2010–11	2011–12	2012–13	2013–14	2014–15	2015–16
Tax giveaway	0.2	8.4	10.3	11.7	12.6	14
Corporation tax	0	0.4	1.2	2.1	2.7	3½
Small companies' CT	0	0.1	1.0	1.3	1.4	1½
Employer NICs	0	3.1	3.2	3.5	3.7	4
Income tax Personal Allow.	0	3.5	3.7	3.8	3.9	4

Sources: HM Treasury; IFS calculations.

June 2010 Budget measures

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- New measures comprise: 26% benefit spending cuts, 4% investment cuts, 55% other spending cuts, by 2015–16

Note: Figures do not sum due to rounding.
Sources: HM Treasury; IFS calculations.

Changes to borrowing since the OBR report

	£ billion					
	2010–11	2011–12	2012–13	2013–14	2014–15	2015–16
PSNB: OBR 14 June	155	127	106	85	71	
Total measures	–8.1	–15.1	–24.3	–32.3	–40.2	–52
Other	2	4	7	7	7	
Change in PSNB	–6	–11	–17	–25	–34	
Budget: 22 June	149	116	89	60	37	20

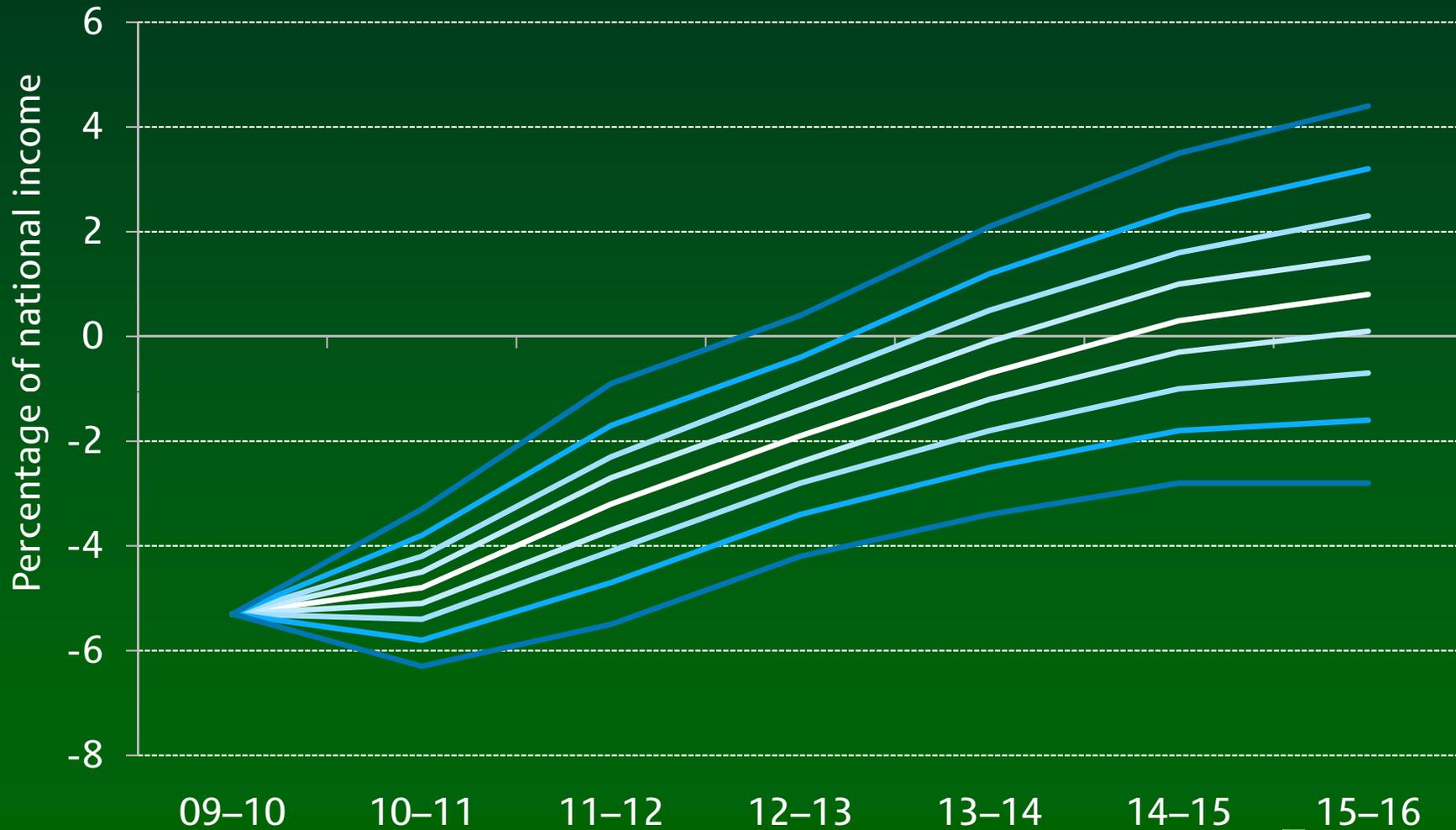
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The Chancellor's new fiscal targets (1)

- Rule 1: balanced structural current budget by end of forecast horizon
 - Forecast horizon runs to 2015–16 at the moment
 - Requires total fiscal tightening of 5.9% of GDP
 - OBR forecasts suggest on course to over-achieve the target by 0.8% of GDP
 - Approximately 60% chance that meet target

Meeting the fiscal mandate?

60% chance of a surplus on the structural current budget under current policies



Source: Office for Budget Responsibility
(http://budgetresponsibility.independent.gov.uk/d/fan_charts_intervals.xls)

The Chancellor's new fiscal targets (2)

- Rule 1: balanced structural current budget by end of forecast horizon
 - Forecast horizon runs to 2015–16 at the moment
 - Requires total fiscal tightening of 5.9% of GDP
 - OBR forecasts suggest on course to over-achieve the target by 0.8% of GDP
 - Approximately 60% chance that meet target
- Rule 2: debt as a share of GDP falling by end of forecast horizon
 - OBR forecasts show debt falling as % GDP from 2014–15
 - If meet first rule, likely to meet second as well

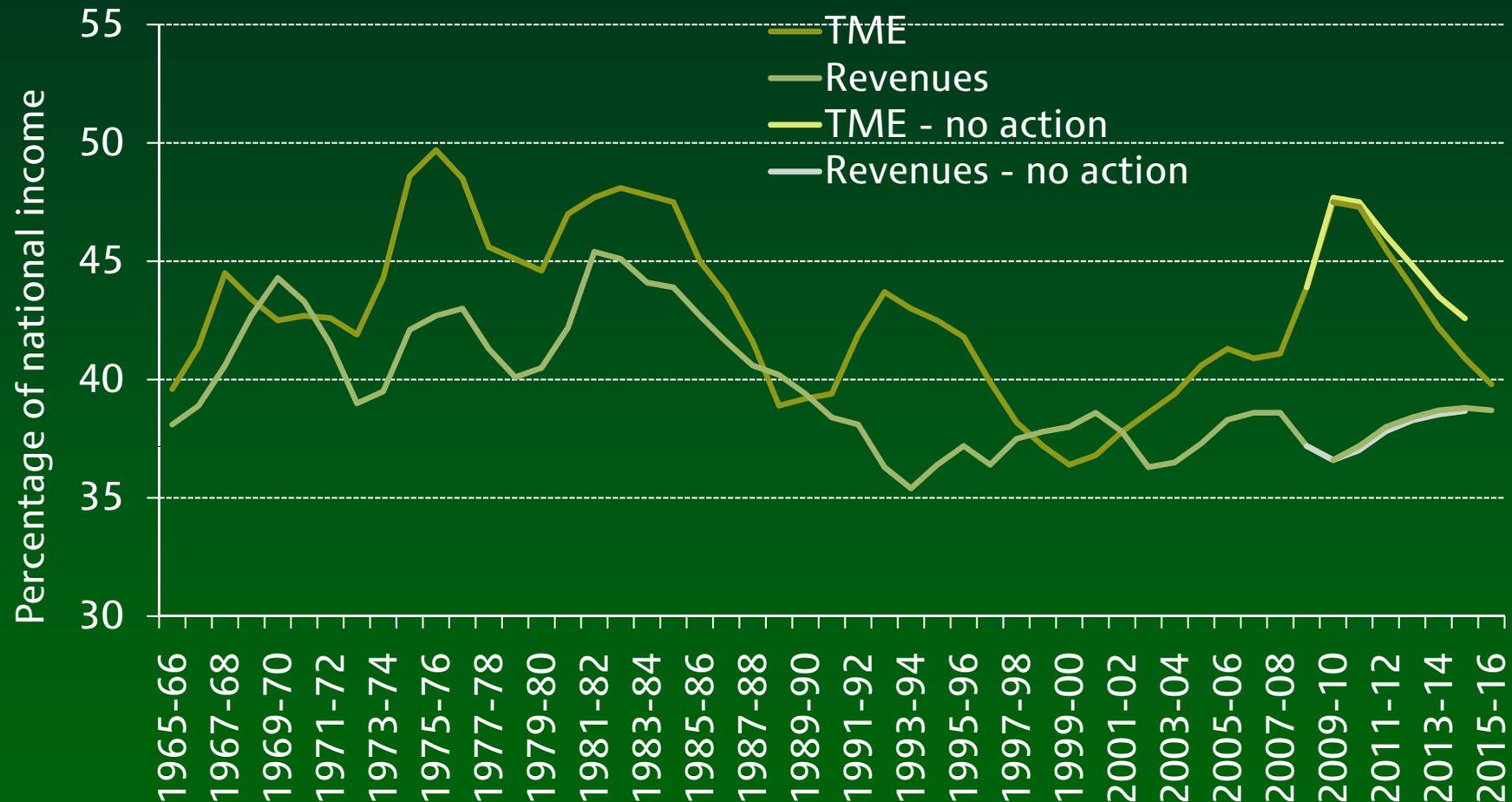
The Chancellor's new fiscal targets: critique (1)

- Advantages of the first rule
 - Forward-looking not inappropriately constrained by past borrowing performance
- Disadvantages of the first rule
 - Easy continually to add an extra year of fiscal squeeze in last year of forecast horizon
- Budget stated that end of forecast horizon will shorten in future
 - Advantage: reduces the scope for pencilling additional future tightening in every statement
 - Disadvantage: if the horizon becomes too short, it becomes incredible that target will be sensibly met (e.g. Maastricht criteria)

The Chancellor's new fiscal targets: critique (2)

- Second rule is not a sufficiently constraining fiscal target in the longer term
 - If first rule met, second rule unlikely to be binding under plausible scenarios for future investment spending
 - Sensibly, Chancellor plans to announce a debt target “once the exceptional rise in debt has been addressed”
 - OBR to provide assessment of outlook for overall indebtedness

Revenues and spending: impact of the Budget



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