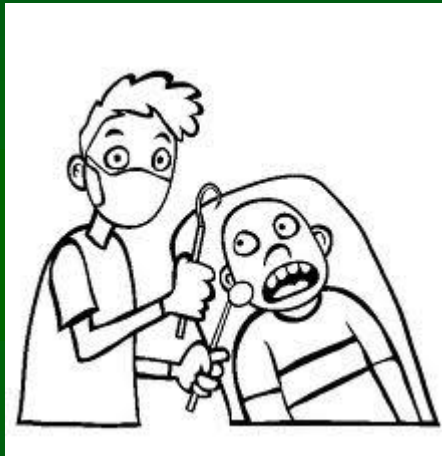


# Institute for Fiscal Studies

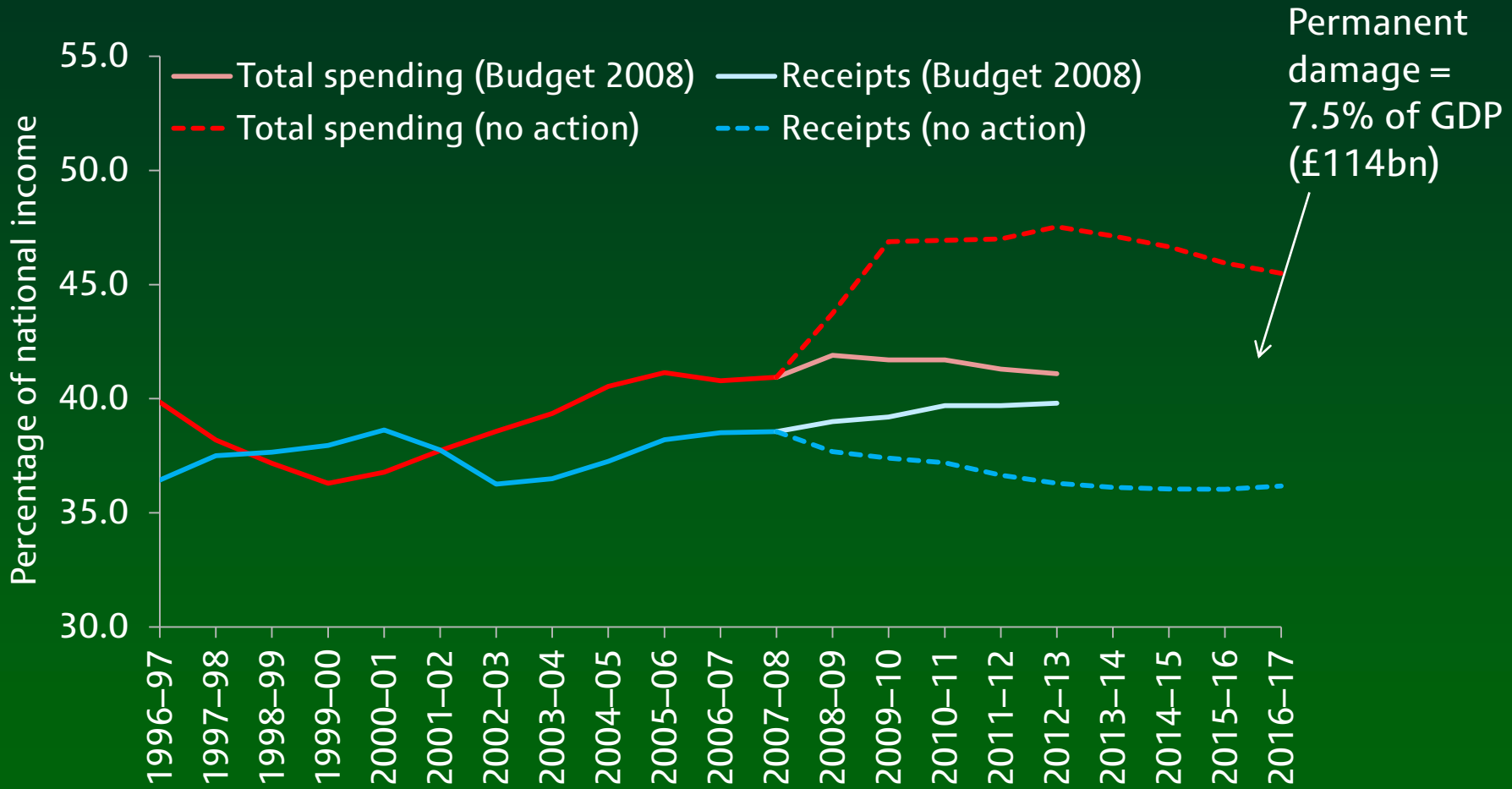


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## Fiscal repair

Rowena Crawford, Carl Emmerson and Gemma Tetlow

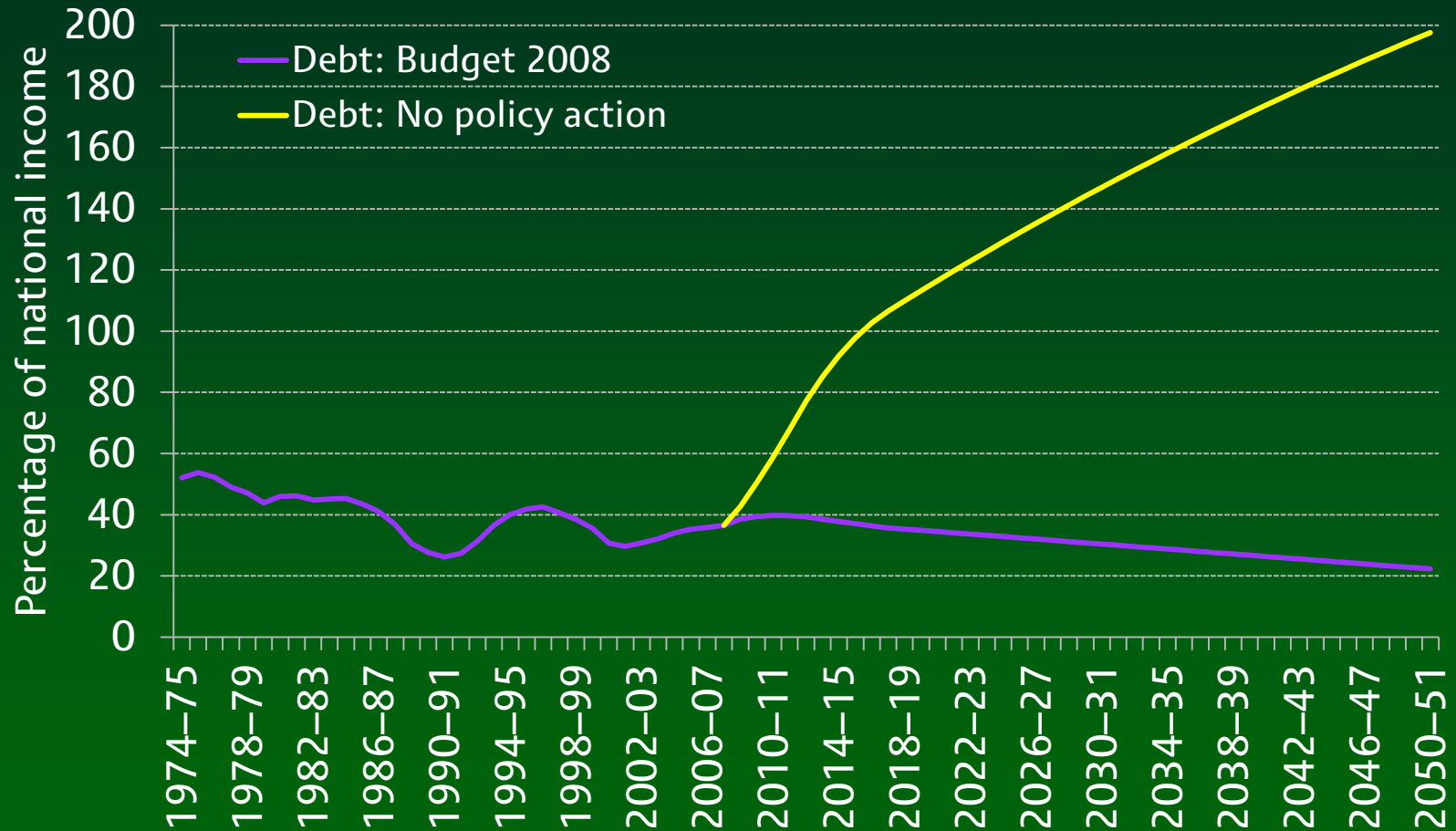
# The hole in the public finances



## Caused or revealed by the crisis?

- The £114bn hole primarily arose because national income is now forecast to be much lower in future than was forecast in 2007–08
- Why?
  - The crisis was a large negative shock to our productive potential?
  - The Treasury (and others) were unduly optimistic before the crisis?
- OBR revised estimates suggest the UK was in a slightly larger boom in 2007–08 than the Treasury thought
  - More of the borrowing in 2007–08 was permanent (not temporary)
- Based on this, we estimate £12 billion (0.8% of national income) of the hole existed in 2007–08
- Had the last government know about, and dealt with, this problem a large fiscal repair job would still have been needed post-crisis

# Fiscal repair necessary?



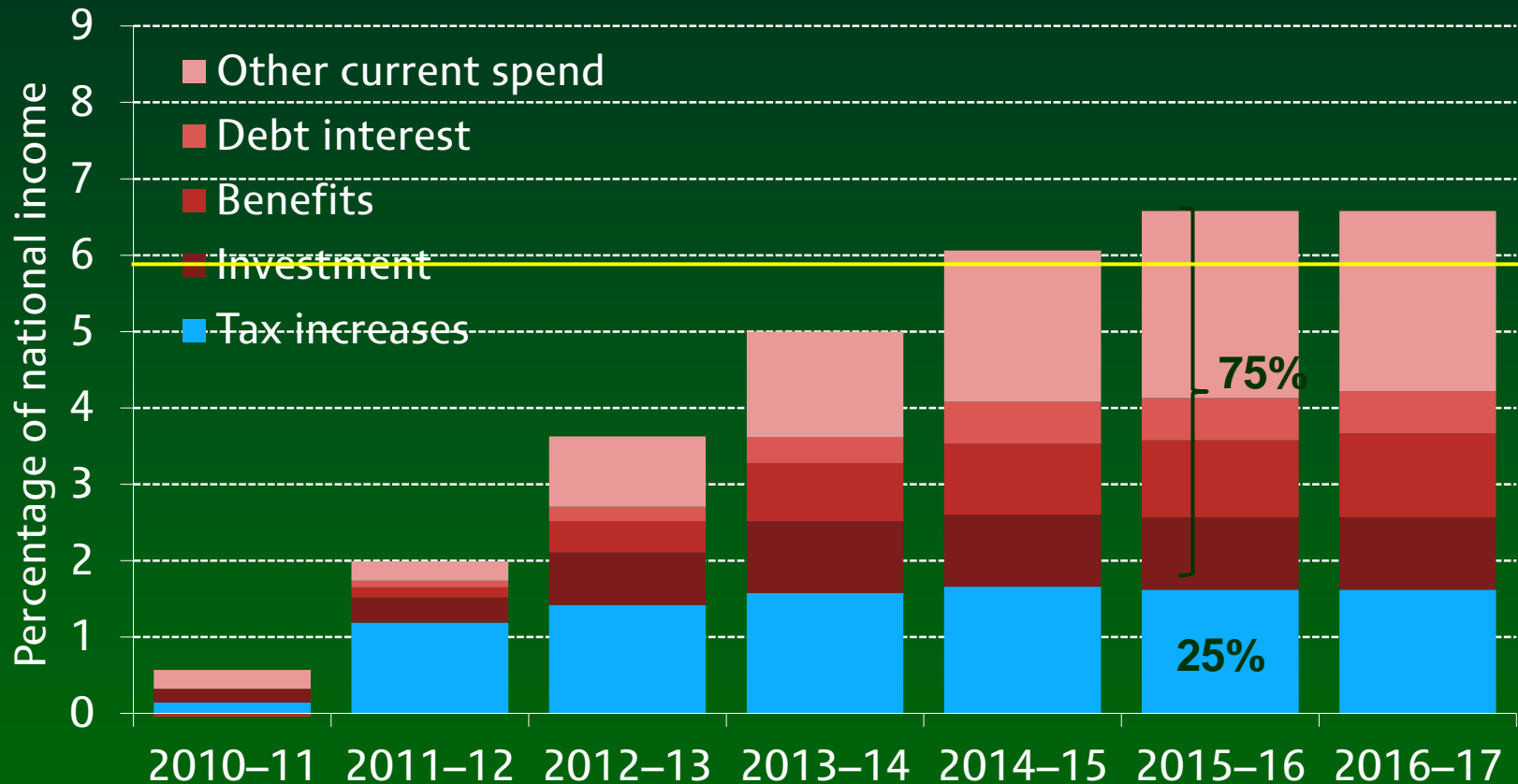
# The cure (March 2011):

**March 2011: 5.8% national income (£91bn) hole in public finances**



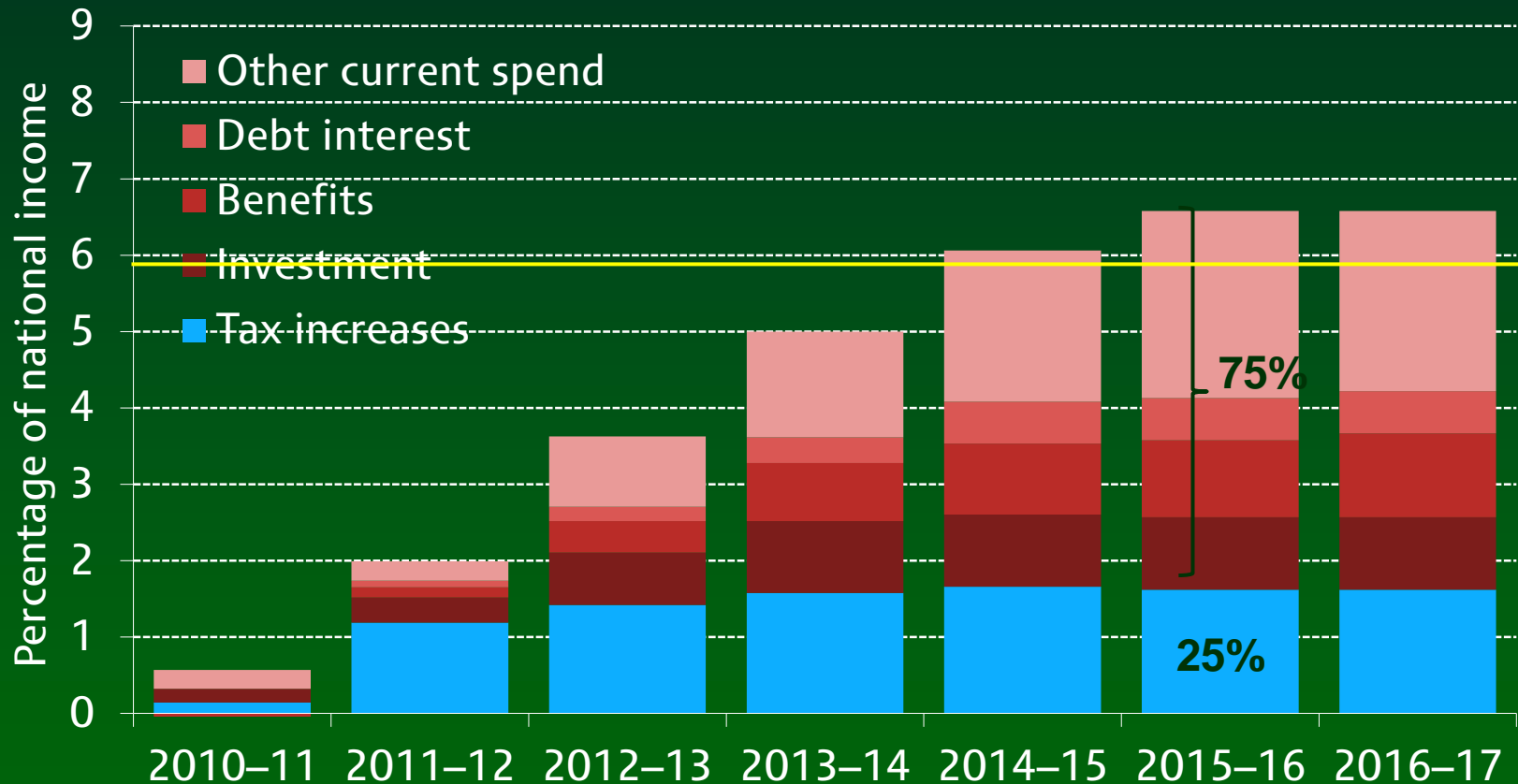
# The cure (March 2011): 6.6% national income consolidation over 6 years

**March 2011: 5.8% national income (£91bn) hole in public finances**



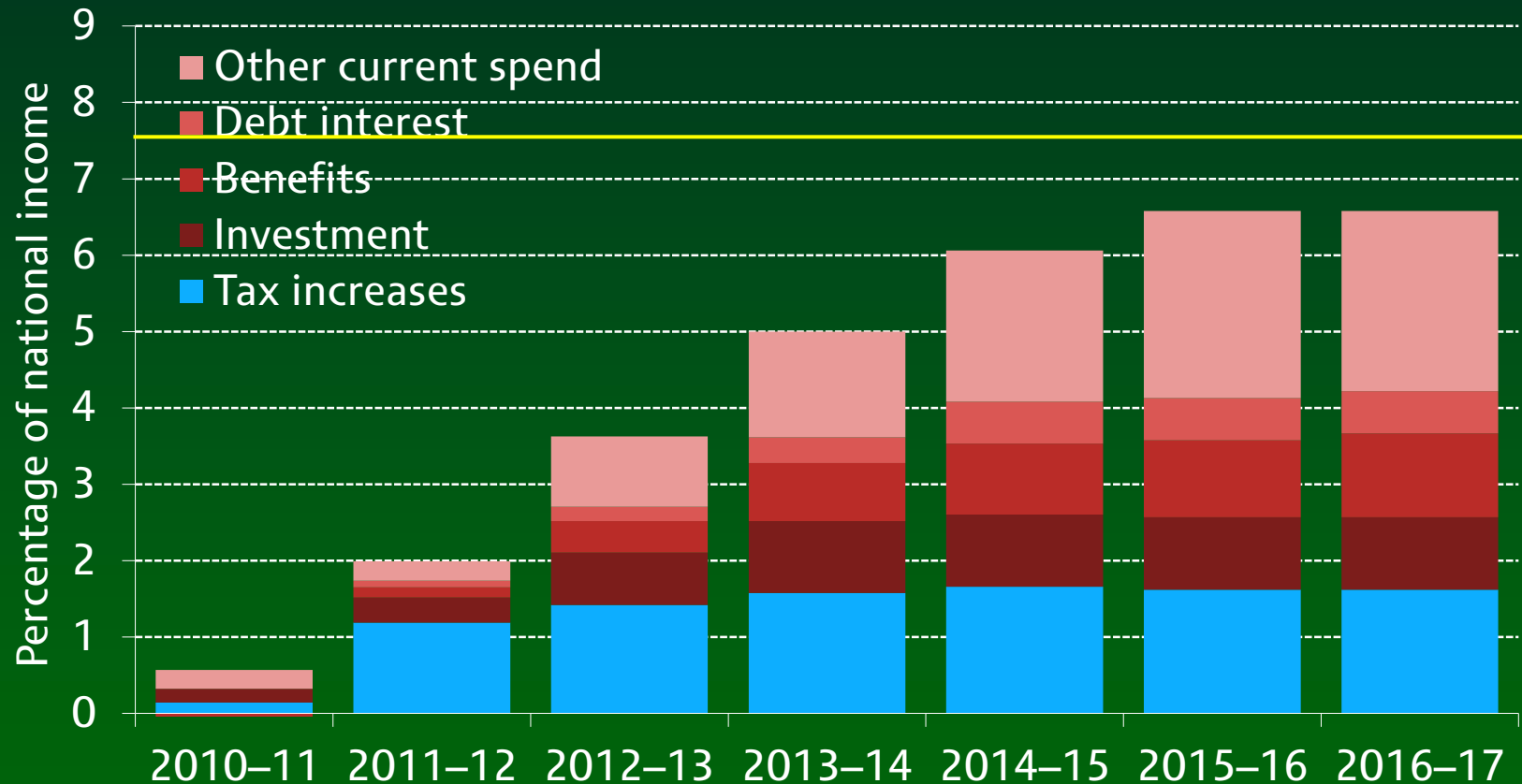
# The cure (March 2011): 6.6% national income consolidation over 6 years

**March 2011: 5.8% national income (£91bn) hole in public finances**



# The cure (November 2011):

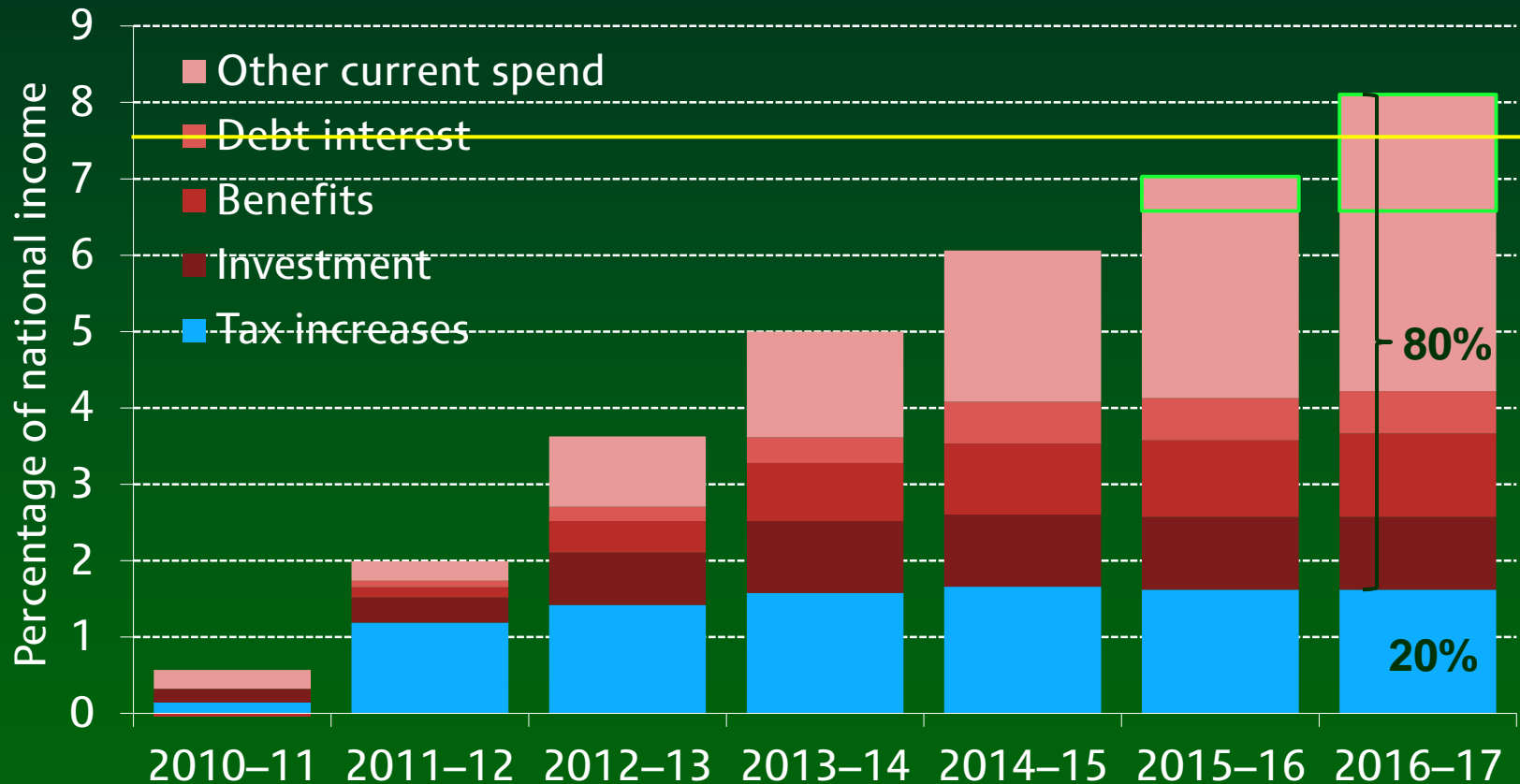
**Nov 2011: 7.5% national income (£114bn) hole in public finances**



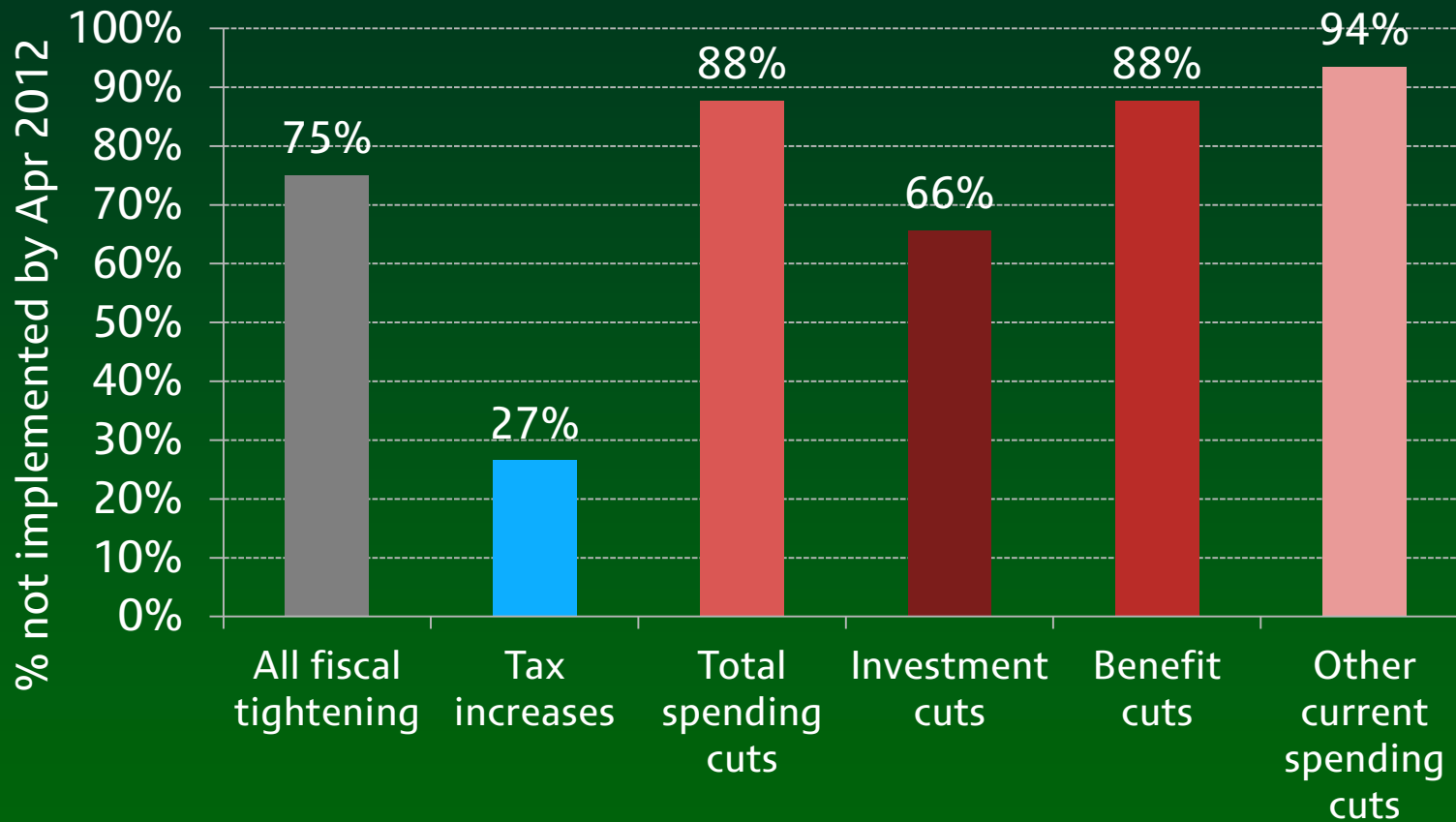


# The cure (November 2011): 8.1% national income consolidation over 7 years

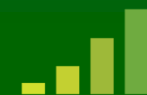
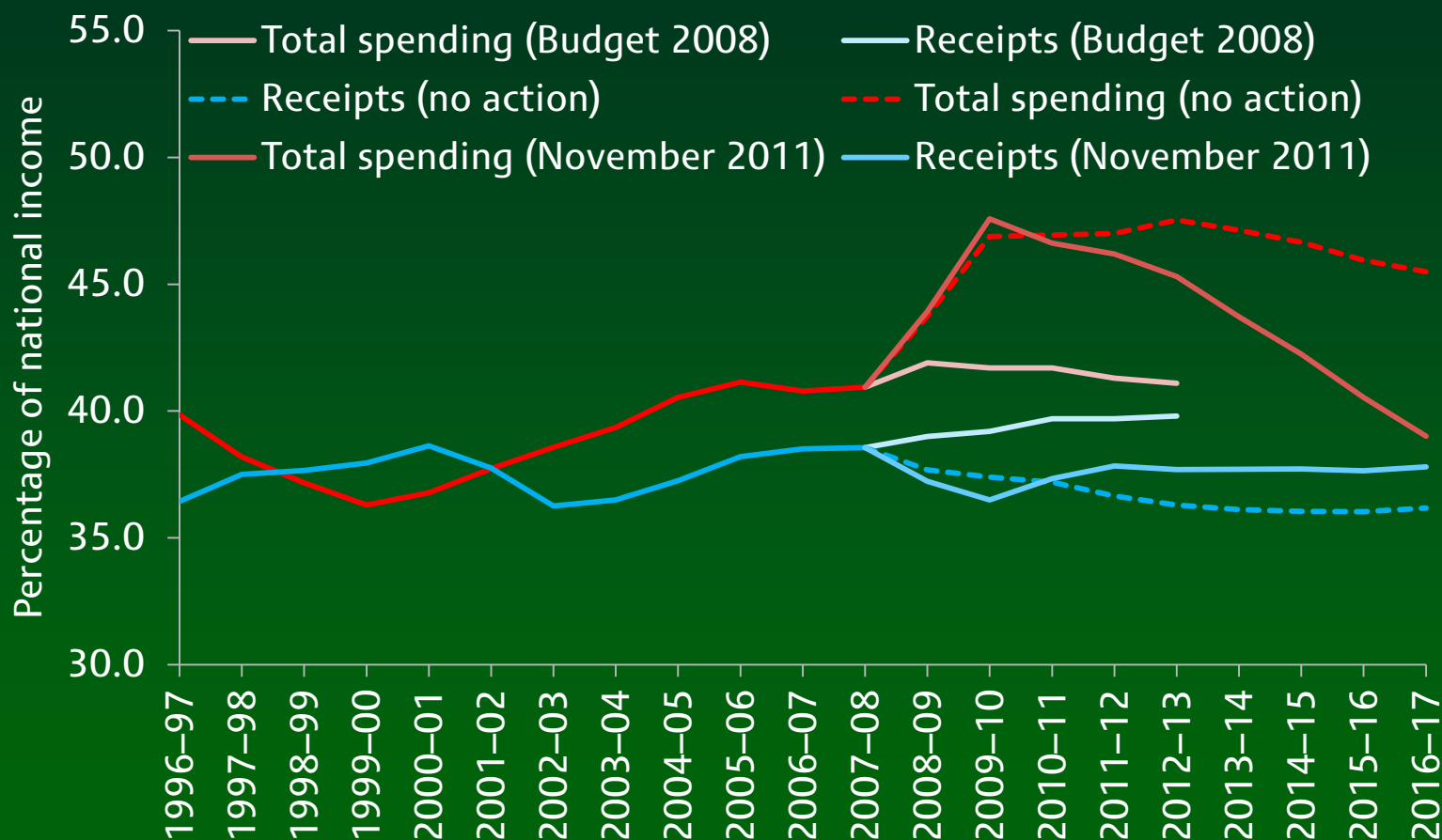
**Nov 2011: 7.5% national income (£114bn) hole in public finances**



# The pain to come

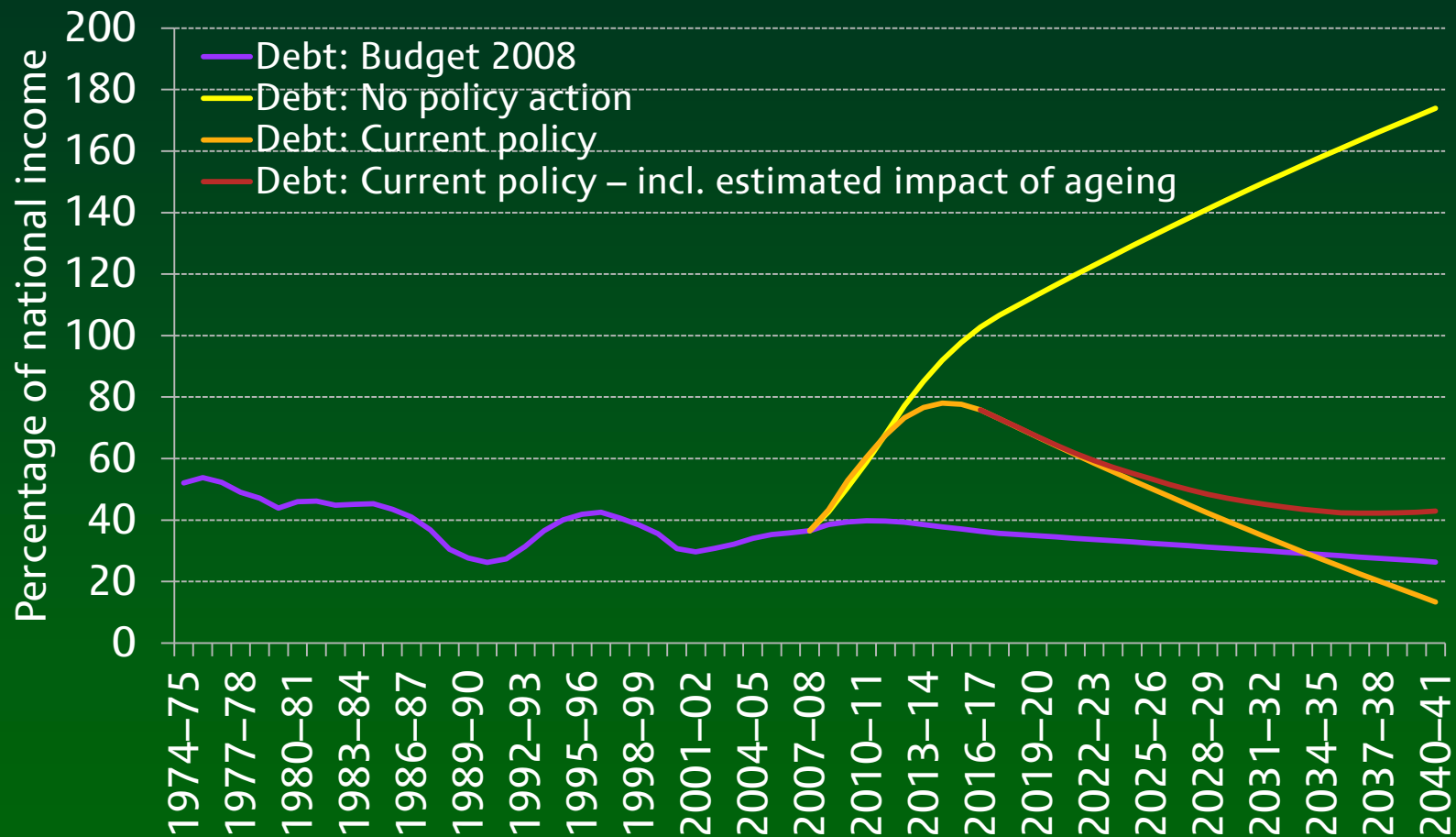


# Spending and revenues brought back to pre-crisis levels



# Debt back on a more sustainable path

- but to remain above pre-crisis levels for a generation



# Risks to the public finances

- Much uncertainty over borrowing forecasts for the next few years
- Macroeconomic forecasts might not prove accurate
  - Even if they did, revenues/spending might not turn out as forecast
- Government may yet be unable or unwilling to implement the planned spending cuts
  - Only 12% of the planned cut to public service spending (6% of the planned cut to *current* public service spending) implemented by the end of 2011–12

# Can the tight spending plans be delivered?

## - Have such cuts been done before?

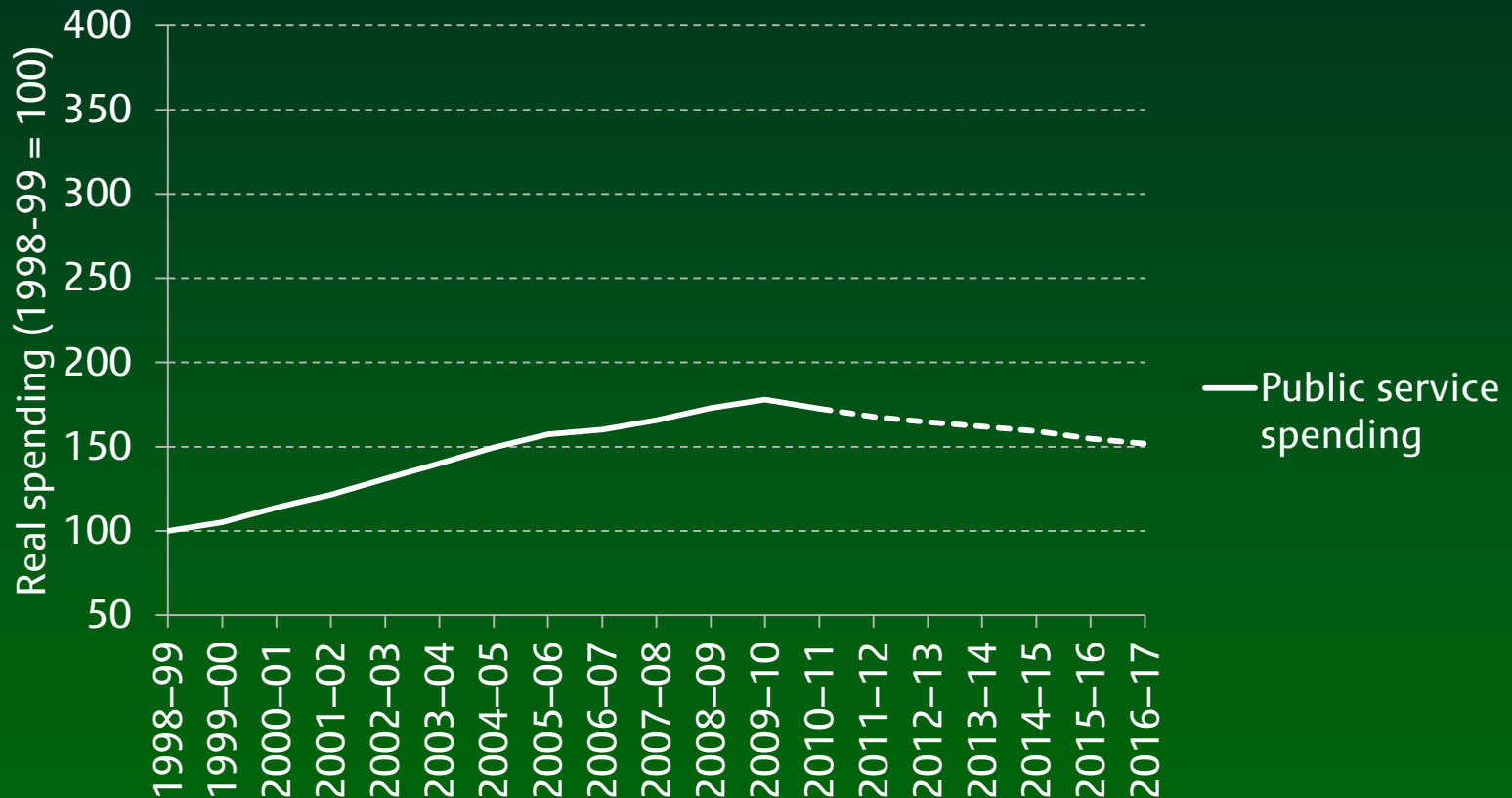
- Such cuts to public service spending not done in the UK before
  - Never more than 2 consecutive years of cuts previously
  - Spending plans imply April 2010 to March 2017 will be the tightest 7 years for public service spending since WWII
- What about elsewhere?
  - Consider 29 advanced economies since (generally) 1970s
  - Only example of comparable cuts is Ireland: over 1987 to 1989
  - Lack of examples could well be because comparable cuts have not been attempted rather than that they cannot be delivered
  - Other countries may do larger cuts post-crisis than the UK is planning

# Can the tight spending plans be delivered?

## - How tight will they feel?

- Cuts follow a period of big spending increases
  - 12 consecutive years of real increases (1998-99 to 2009-10)
  - by 2016–17 total public service spending will be the same as in 2004-05 in real terms (2000–01 as a % of national income)
- Does not imply not painful
  - Arguably more painful to experience 5 years of spending increases followed by 5 years of cuts than no spending increase for 10 years
- Not necessarily those areas that saw the largest increases that will see the largest cuts

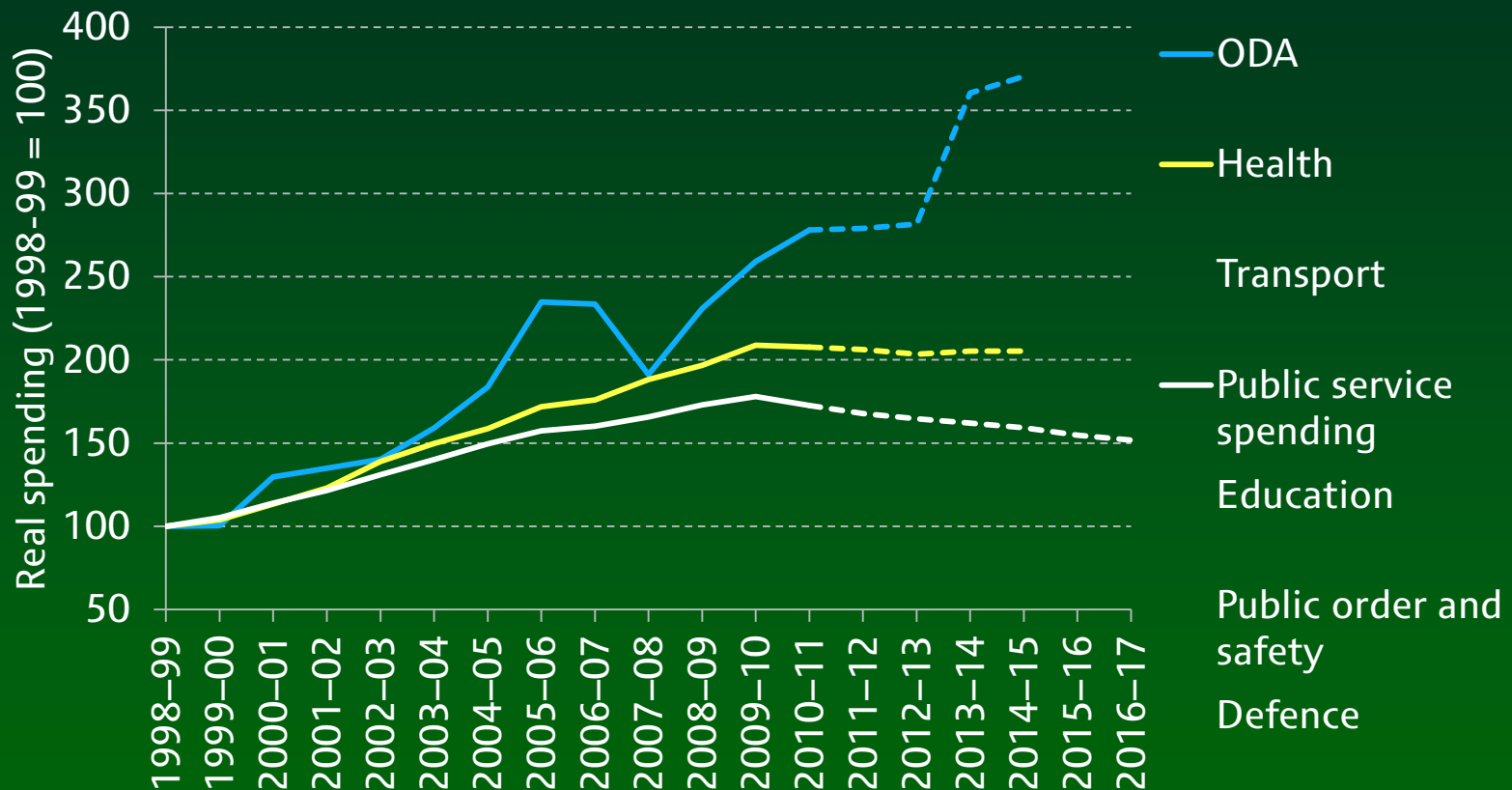
# Can the tight spending plans be delivered? - How tight will they feel?





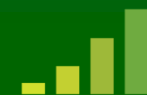
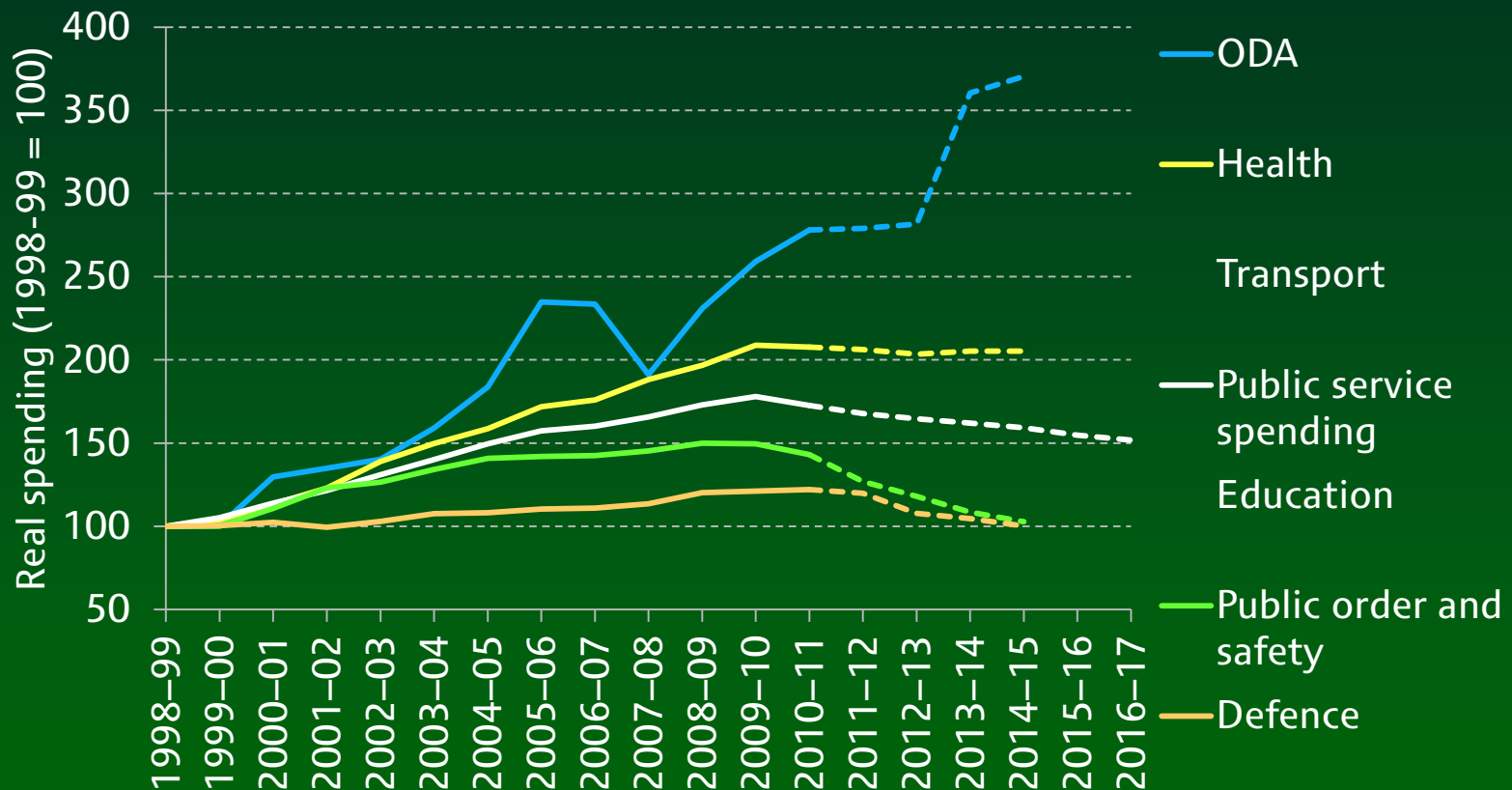
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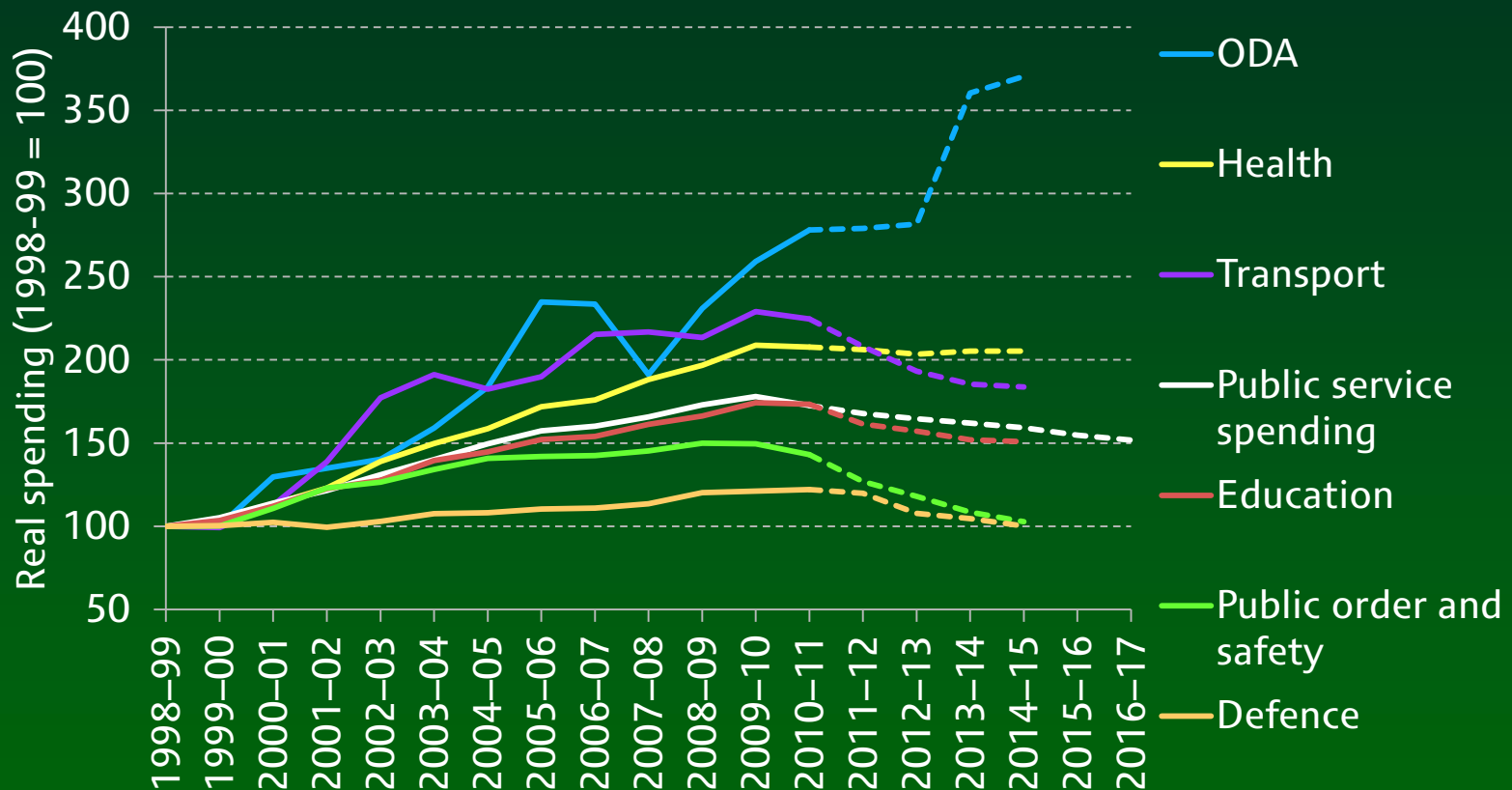
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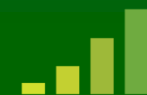
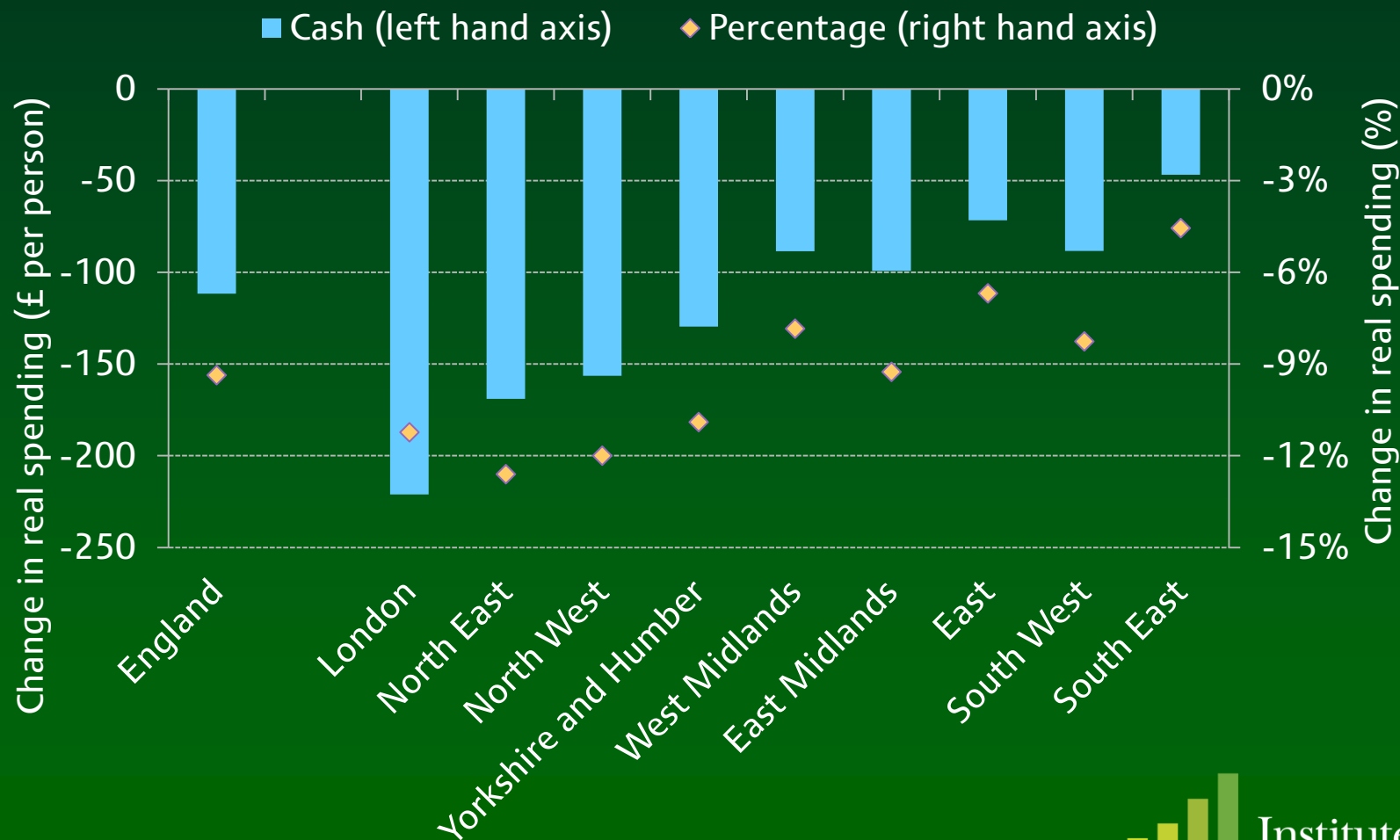


# Local government spending cuts (England)

- Net current service expenditure (excluding education, police and fire) set to face real cut of 10.4% between 2009–10 and 2011–12
- Cuts differ by local authority due to different cuts to grant income and different reliance on grants versus council tax and other income
  - 1/4 of LAs planning cuts of over 15%, 1/10 planning increases
  - Cuts are larger in areas with initially high spending levels (urban and poorer areas)

# Local government spending cuts (England)

Average change in spending (excl. education): 2009-10 to 2011-12



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  - 1/4 of LAs planning cuts of over 15%, 1/10 planning increases
  - Cuts are larger in areas with initially high spending levels (urban and poorer areas)
- Relatively protected spending areas:
  - environment and refuse services: average 1.7% real increase
  - social care: average 4% real cut
- Worst hit spending area:
  - planning and development: average 43% real cut

# Summary

- Apparent hole in the public finances has increased by £114 billion (7.5% of national income) since the start of the financial crisis
- We estimate that £12 billion of this (0.8% of national income) existed pre-crisis
- Planned fiscal consolidation: 8.1% of national income (£123 billion) over the 7 years to 2016–17
- Borrowing forecasts very uncertain
- Delivery of the planned spending cuts is one of the main risks
  - Only 12% of the cuts to public service spending will have been implemented by the end of this financial year
  - Such deep cuts to public service spending have not been delivered in the UK before – the only comparable international example is Ireland in the late 1980s