Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP

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Actual GDP (March 2012)
Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP

- Actual GDP (March 2012)
- Potential ("trend") GDP – March 2012
Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP

- Actual GDP (March 2012)
- Potential ("trend") GDP – March 2012
- Potential ("trend") GDP – March 2008

13% loss of trend output

Weak short-term growth thought to reflect a permanent problem...
The big fiscal picture

Percentage of national income

- Total spending (no action)
- Receipts (no action)
The cure (March 2012): 8.1% national income consolidation over 7 years (£123bn)

Mar 2012: 7.6% national income (£115bn) hole in public finances
The pain to come

% not implemented by Apr 2012

- All fiscal tightening: 75%
- Tax increases: 27%
- Total spending cuts: 88%
- Investment cuts: 66%
- Benefit cuts: 88%
- Other current spending cuts: 94%

Source: Author’s calculations using Figure 3.5 of The IFS Green Budget: February 2012.
Spending and revenues back to pre-crisis levels

Percentage of national income

- Total spending (March 2012)
- Receipts (March 2012)
- Total spending (no action)
- Receipts (no action)

Year: 1996-97 to 2016-17
Economic developments since the Budget

• Outlook for growth has been revised down
  – OBR March 2012 forecast growth of 0.8% in 2012 and 2.0% in 2013
  – average of independent forecasters has moved from 0.5% and 1.7% in March 2012 to –0.3% and 1.1% in October 2012

• Public finances have performed weakly over first half of 2012–13
  – underlying borrowing is higher than in same months of 2011–12
  – if central government receipts continue to grow at the same rate for the rest of 2012–13, and all other receipts and spending come in as forecast, then borrowing would be £15bn higher than forecast

• Unless all additional borrowing temporary further tax rises or spending cuts would be required to reduce deficit as previously intended
Judging the health of the public finances: The Chancellor’s fiscal targets

• Fiscal mandate
  – Structural current budget must be forecast to be in balance or surplus at the end of the rolling five-year forecast horizon (currently 2016–17)
  – Imbalances between spending and revenues that purely reflect temporary economic weakness are alright
  – Can borrow for investment

• Supplementary target
  – Debt must be falling as a share of GDP in 2015–16
Meeting the fiscal mandate

Fiscal mandate: “cyclically adjusted current budget balance by the end of the rolling, five year forecast period”
Meeting the fiscal mandate

**Fiscal mandate:** “cyclically adjusted current budget balance by the end of the rolling, five year forecast period”
Fiscal mandate: “cyclically adjusted current budget balance by the end of the rolling, five year forecast period”
Debt back on a more sustainable path - but to remain above pre-crisis levels for a generation

Notes and sources: see Figure 3.3 of The IFS Green Budget: February 2012.
Can the tight spending plans be delivered?

- 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

- Only comparable international experience is Ireland in late 1980s

- On the other hand 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)
7-year squeeze on public service spending

Note: Figure shows total public spending less spending on welfare benefits and debt interest.
Whitehall departments: ‘winners’

International development 33.4
Energy and climate change 15.5
Work and pensions 0.9
NHS (England) -0.2
Defence -7.8
Education -11.4
Average DEL cut -11.7

Real budget increase 2011–12 to 2014–15

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DEL = Departmental Expenditure Limits
Notes and sources: see Figure 6.4 of The IFS Green Budget: February 2011.
Whitehall departments: ‘losers’

Average DEL cut
- Transport: -15.1
- Culture, media and sport: -21.6
- Home office: -25.6
- Justice: -25.8
- CLG: Local Government: -27.3
- Business, innovation and skills: -29.0
- Environment, food and rural affairs: -31.3

Real budget increase 2011–12 to 2014–15

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- Business, innovation and skills: -29.0%
- Environment, food and rural affairs: -31.3%
- CLG: Communities: -67.8%

Real budget increase 2011–12 to 2014–15

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DEL = Departmental Expenditure Limits
Notes and sources: see Figure 6.4 of The IFS Green Budget: February 2011.
How far have we gone so far? Whitehall departments: timing of cuts

Percentage of required cuts achieved

-25% 0% 25% 50% 75% 100% 125%

Defence
Transport
Total

CLG: Local Government
Education
CLG: Communities


Back-loaded

Notes and sources: see Figure 6.6 of *The IFS Green Budget: February 2011*. © Institute for Fiscal Studies
How far have we gone so far?
Whitehall departments: timing of cuts

Percentage of required cuts achieved

<table>
<thead>
<tr>
<th>Year</th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
<th>2014-15</th>
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<tbody>
<tr>
<td>Defence</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport</td>
<td></td>
<td></td>
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<td>CLG: Local Government</td>
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Notes and sources: see Figure 6.6 of The IFS Green Budget: February 2011.
Can the tight spending plans be delivered?
- How tight will they feel?

Notes and sources: see Figure 3.12 of *The IFS Green Budget: February 2012.*
Can the tight spending plans be delivered?  
- How tight will they feel?

Real spending (1998-99 = 100)


- ODA
- Health
- Transport
- Public service spending
- Education
- Public order and safety
- Defence

Notes and sources: see Figure 3.12 of *The IFS Green Budget: February 2012.*
Can the tight spending plans be delivered? - How tight will they feel?

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

Notes and sources: see Figure 3.12 of The IFS Green Budget: February 2012.
Trade-off between cuts to public service spending and welfare cuts: 2015–16 and 2016–17

Note: HM Treasury and IFS calculations. Resource Departmental Expenditure Limits (RDEL) is the non-investment component of the spending by central government on the delivery and administration of public services.
Conclusions

• Financial crisis and recession opened up large hole in the UK’s public finances

• Government has a fiscal consolidation plan that lasts to 2016–17
  – Four-fifths coming from spending cuts

• Risks to the fiscal consolidation plan
  – Can cuts to public service spending be delivered?
    • UK has not achieved such a sustained period of cuts to public service spending since World War II
    • Also few comparable examples internationally
    • Areas facing biggest cuts are largely not those that saw big spending increases under Labour
  – What if the economy weakens further?
    • Temporary economic weakness is alright but additional permanent weakness is not

• More difficult decisions to be made in the next Spending Review
The UK public finances

Carl Emmerson

Growth is under performing

<table>
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<tr>
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<th>Outturn</th>
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<tr>
<td>2012 Q1</td>
<td>0.3</td>
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<td>2012 Q2</td>
<td>0.0</td>
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<td>2012 Q3</td>
<td>0.6</td>
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<td>2012 Q4</td>
<td>0.3</td>
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<td><strong>2012-13</strong></td>
<td><strong>1.0</strong></td>
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- Borrowing looks likely to overshoot in 2012-13
- Pressure on government to stimulate
  - Timely, targeted and temporary
Longer term public spending issues

• Demographic pressures (ageing population) put upward pressure on spending
## OBR age-related spending projections

<table>
<thead>
<tr>
<th>% of national income</th>
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<th>2021-22</th>
<th>2041-42</th>
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<tr>
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Sources: OBR Fiscal Sustainability Report 2012, Table 3.6
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</tr>
<tr>
<td>Public service pensions</td>
<td>2.2</td>
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<td>1.5</td>
<td>1.3</td>
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<tr>
<td>Education</td>
<td>4.5</td>
<td>4.6</td>
<td>4.4</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>Total age-related spending</strong></td>
<td><strong>21.3</strong></td>
<td><strong>21.3</strong></td>
<td><strong>24.2</strong></td>
<td><strong>26.3</strong></td>
</tr>
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Sources: OBR Fiscal Sustainability Report 2012, Table 3.6
International comparisons

• Cyclically-adjusted borrowing compared to 28 other advanced economies

<table>
<thead>
<tr>
<th>Year</th>
<th>UK rank</th>
<th>Compared to</th>
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<tr>
<td>2007 (pre-crisis)</td>
<td>4th highest</td>
<td>Greece, Ireland, Portugal higher</td>
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<td>Crisis peak</td>
<td>5th highest</td>
<td>Greece, Ireland, Iceland, Spain higher</td>
</tr>
<tr>
<td>2016</td>
<td>15th highest</td>
<td></td>
</tr>
<tr>
<td>Increase: 2007-peak</td>
<td>9th largest</td>
<td></td>
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<tr>
<td>Decrease: peak-2016</td>
<td>5th largest</td>
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Sources: IFS calculations using data from IMF, Fiscal Monitor, September 2011.
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