Public finances: outlook and risks

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Disease and cure (December 2012)

Dec 2012: 8.2% national income (£129bn) hole in public finances, offset by 9.2% national income (£144bn) consolidation over 8 years

Notes and sources: see Figure 5.8 of The IFS Green Budget: February 2013.
Returning spending and revenues to pre-crisis levels

Notes and sources: see Figure 5.9 of The IFS Green Budget: February 2013.
How much fiscal consolidation is needed in the medium-term?

• Estimating how much medium-term fiscal consolidation is needed is difficult
  – Official estimates of the size of the hole in the public finances have changed over time
  – View about medium-term public finance position is sensitive to view taken on how much scope there is for economic recovery
  – Also depends on how tax revenues and spending respond as economy recovers
Size of the problem and the planned solution: changes over time

Notes and sources: see Figures 5.5 and 5.6 of *The IFS Green Budget: February 2013*. Additional calculations using Budgets, Pre-Budget Reports and Economic and Fiscal Outlooks since March 2008.
Forecast for borrowing deteriorated between November 2010 and December 2012

Change in official borrowing forecasts between Nov 2010 and Dec 2012

- Increase in borrowing (without policy action)

Notes and sources: see Table 5.2 of The IFS Green Budget: February 2013.

Additional author calculations.
George Osborne has allowed the automatic stabilisers to operate during this parliament...

Change in official borrowing forecasts between Nov 2010 and Dec 2012

Notes and sources: see Table 5.2 of The IFS Green Budget: February 2013. Additional author calculations.
...but has announced measures to offset structural borrowing increase by 2017–18

Change in official borrowing forecasts between Nov 2010 and Dec 2012

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase in borrowing (without policy action)</th>
<th>Increase in borrowing (with policy action)</th>
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</tr>
<tr>
<td>2017–18</td>
<td>60</td>
<td>60</td>
</tr>
</tbody>
</table>

- Increase in cyclical borrowing in 2017–18 has not been offset

Notes and sources: see Table 5.2 of The IFS Green Budget: February 2013. Additional author calculations.
Wide range of views among forecasters about amount of spare capacity in UK economy

Structural borrowing could be 1.6% of national income larger

Structural borrowing could be 2.0% of national income smaller

Output gap (% of trend GDP)

Average of independent forecasters (excl. OBR): −3.0%

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Notes and sources: see Figure 5.14 of The IFS Green Budget: February 2013.
How will tax revenues and spending respond as the economy recovers?

• Full public finance forecasts are presented in Appendix A, using four different macro scenarios
  – OBR
  – Oxford Economics central
  – Oxford Economics ‘corporate reawakening’
  – Oxford Economics ‘Eurozone break-up’
• Focus here on main areas where forecasts differ from the OBR’s
Borrowing could be higher than the OBR forecasts

• Borrowing could be higher in 2012–13 than 2011–12 (on like-for-like basis)
  – IFS baseline forecast is for borrowing this year of £125.4bn
  – This is £4.9bn higher than the OBR’s December 2012 forecast: due to lower expected tax receipts (–£3.1bn) and higher spending by central government departments (+£1.6bn)
  – Implies greater than 50/50 chance that borrowing will be higher this year than last (when it was £121.4bn)

• But, economically, medium & long-run are what matters – these risks include:
  – Tax revenues could grow less quickly than OBR expects
  – Future adverse shocks (e.g. Eurozone break-up)
  – Government may prove unable/unwilling to implement the large planned cuts to public spending
Borrowing could be lower than the OBR forecasts

• Tax revenues could grow more quickly than OBR expects
  – Baseline forecast is for higher growth in VAT and corporation tax
• Trend output could be higher: implying lower structural borrowing
  – As in Oxford Economic central scenario
• Future positive shocks
  – If corporate confidence and investment picks up more quickly, economy and tax revenues could grow more rapidly
• Post-election tax rises
  – Incoming governments have raised taxes by an average of £7.5bn a year in the 12 months following the last six general elections
Summary of alternative public finance forecasts:
Cyclically-adjusted current budget surplus

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

Notes and sources: see Figure 5.15 of The IFS Green Budget: February 2013.
Summary of alternative public finance forecasts: Public sector net debt

Supplementary target: public sector net debt as a share of national income should be falling at a fixed date of 2015–16

Notes and sources: see Figure 5.16 of The IFS Green Budget: February 2013.
Key points

• IFS baseline forecast is that borrowing will be £4.9 billion higher in 2012–13 than 2011–12 on a like-for-like basis

• Fiscal policy in this parliament is set to be more expansionary than suggested by forecasts from November 2010
  – Chancellor has allowed automatic stabilisers to operate, offsetting just £1 billion of the £65 billion rise in forecast borrowing for 2014–15

• But borrowing increase has been offset in the next parliament by further planned squeeze on public spending

• Exact size of problem and medium-term action required is uncertain – both upside and downside risks exist

• Debt has increased significantly over last 4 years; further adverse shocks could easily drive it above 100% of national income