The UK fiscal outlook: an age of austerity

Rowena Crawford
EBEA Bank of England conference, 27th June 2012
Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP

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

13% loss of trend output

Notes and sources: see Figure 3.2 of The IFS Green Budget: February 2012.
The “hole” in the public finances

Percentage of national income

Sources: Authors’ calculations using HM Treasury and Office for Budget Responsibility figures. (Updated version of Figure 3.6 of The IFS Green Budget: February 2012.)
The “hole” in the public finances

Permanent damage = 7.6% of GDP (£115bn)

Sources: Authors’ calculations using HM Treasury and Office for Budget Responsibility figures. (Updated version of Figure 3.6 of The IFS Green Budget: February 2012.)
No action would not have been sustainable

Notes and sources: see Figure 3.3 of The IFS Green Budget: February 2012.
The cure (March 2012): 8.1% national income (£123bn) consolidation over 7 years

Mar 2012: 7.6% national income (£115bn) hole in public finances
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.
The cure (March 2012): 8.1% national income (£123bn) consolidation over 7 years

**Mar 2012:** 7.6% national income (£115bn) hole in public finances
The cure (March 2012): 8.1% national income (£123bn) consolidation over 7 years

**Mar 2012:** 7.6% national income (£115bn) hole in public finances

The chart shows the percentage distribution of national income across various categories from 2010–11 to 2016–17, with a significant focus on tax increases and debt interest, indicating a major effort to balance the public finances.
Spending and revenues back to pre-crisis levels

Sources: Authors’ calculations using HM Treasury and Office for Budget Responsibility figures. (Updated version of Figure 3.6 of The IFS Green Budget: February 2012.)
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**: 37.8
- **Energy and climate change**: 6.5
- **NHS (England)**: 1.0
- **Defence**: -8.2
- **Average DEL cut**: -11.7

Real budget increase 2011–12 to 2014–15

DEL = Departmental Expenditure Limits
Notes and sources: see Figure 5 of “The changing composition of public spending”, IFS Briefing Note 119
### Whitehall departments: ‘losers’

<table>
<thead>
<tr>
<th>Department</th>
<th>Average DEL cut</th>
<th>Real budget increase 2011–12 to 2014–15</th>
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<tbody>
<tr>
<td>CLG: Communities</td>
<td>-71.3</td>
<td>-14.5</td>
</tr>
<tr>
<td>Transport</td>
<td></td>
<td>-27.2</td>
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<tr>
<td>Culture, Media and Sport</td>
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<td>Education</td>
<td>-80.0</td>
<td>-46.1</td>
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<tr>
<td>Justice</td>
<td>-60.0</td>
<td>-11.9</td>
</tr>
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<td>Home office</td>
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**Notes and sources:** see Figure 5 of “The changing composition of public spending”, IFS Briefing Note 119
Risks to the public finances
Risks to the public finances – short term

- Lots of macro economic uncertainty

- Government may yet prove unable or unwilling to implement the planned spending cuts
  - Just under half of the real cut to spending planned between 2009-10 and 2016-17 will have been implemented by the end of 2012-13
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?

Notes and sources: see Figure 3.12 of *The IFS Green Budget: February 2012.*
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- How tight will they feel?

Notes and sources: see Figure 3.12 of *The IFS Green Budget: February 2012.*
No change in trends of ‘priorities’

Notes and sources: see Figure 6 of “The changing composition of public spending”, IFS Briefing Note 119
Risks to the public finances
Risks to the public finances – longer term

- Demographic changes put upward pressure on spending
- OBR age-related spending projections:

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Sources: OBR Fiscal Sustainability Report 2011, Table 3.4
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<td>Pensioner benefits</td>
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<td><strong>Total age-related spending</strong></td>
<td><strong>22.0</strong></td>
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Sources: OBR Fiscal Sustainability Report 2011, Table 3.4
Projected effect of demographics on debt

Sources: OBR Fiscal Sustainability Report 2011, Chart 3.8
Risks to the public finances – longer term

- Demographic changes put upward pressure on spending

- Government faces 3 choices:
  - Increase taxes to pay for increased spending
  - Keep total spending fixed but reduce spending elsewhere
  - Reduce spending on age-related components to offset LR pressures
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  – Reduce spending on age-related components to offset LR pressures
    • Difficult

• Cannot postpone these choices indefinitely
Conclusions

• Permanent hit to public finances from financial crisis estimated at £115 billion a year (in today’s terms)
• Response is a £123 billion fiscal tightening by 2016–17
• Seven years from April 2010 imply the tightest seven-year squeeze on ‘public service’ spending since at least end of Second World War
• Borrowing forecasts are very uncertain
• Delivery of planned spending cuts is one of the main risks
  – Such cuts are unprecedented in the UK
  – Only half of the real reduction in spending planned between 2009-10 and 2016-17 will have been implemented by the end of 2012-13
• Even if plans to 2015-16 implemented, not out of the woods yet
  – Demographic pressures loom and will need to be addressed soon
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