Public finance forecasts and Budget judgement

Rowena Crawford, Carl Emmerson and Gemma Tetlow
Context: deficit needs to fall from post WW2 peak

Percentage of national income


PSNB
Cyclically-adjusted PSNB

Source: IFS calculations; HM Treasury; Office for Budget Responsibility.
Summary

• Green Budget baseline forecast
  – current budget deficit and public sector net borrowing in 2010–11 to be £2.9 billion lower than the OBR’s autumn forecast
  – over next five years: this small gap reduces and then returns
  – public sector net debt peaks at a slightly lower level

• Barclays central forecast
  – worse outlook for the macro economy than the OBR forecasts
  – borrowing falls by less over the next five years, cyclically-adjusted current budget in deficit in 2015–16

• Barclays alternative cases
  – ‘optimistic’ case: better outlook for the macro economy but still only leads to public finances evolving broadly as the OBR expects
  – ‘pessimistic’ case: worse outlook for the macro economy leads to smaller fall in borrowing and debt still rising in 2015–16
## Forecasts for 2010–11

<table>
<thead>
<tr>
<th>£ billion</th>
<th>OBR November 2010</th>
<th>Green Budget February 2011</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current receipts</td>
<td>549.7</td>
<td>552.6</td>
<td>+2.9</td>
</tr>
<tr>
<td>Current spending</td>
<td>655.9</td>
<td>655.9</td>
<td>0.0</td>
</tr>
<tr>
<td>Current budget surplus</td>
<td>−106.2</td>
<td>−103.3</td>
<td>+2.9</td>
</tr>
</tbody>
</table>

Notes and sources: see Table 5.2 of *The IFS Green Budget: February 2011.*
Forecasts for 2010–11

<table>
<thead>
<tr>
<th>£ billion</th>
<th>OBR November 2010</th>
<th>Green Budget February 2011</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current receipts</td>
<td>549.7</td>
<td>552.6</td>
<td>+2.9</td>
</tr>
<tr>
<td>Current spending</td>
<td>655.9</td>
<td>655.9</td>
<td>0.0</td>
</tr>
<tr>
<td>Current budget surplus</td>
<td>−106.2</td>
<td>−103.3</td>
<td>+2.9</td>
</tr>
<tr>
<td>Net investment</td>
<td>42.3</td>
<td>42.3</td>
<td>0.0</td>
</tr>
<tr>
<td>Borrowing</td>
<td>148.5</td>
<td>145.6</td>
<td>−2.9</td>
</tr>
</tbody>
</table>

Notes and sources: see Table 5.2 of *The IFS Green Budget: February 2011*. 
Differences in 2010–11 forecast

• Receipts (+£2.9 billion)
  – income tax (+£1.5 billion)
  – National Insurance contributions (+£1.5 billion)
  – corporation tax (+£0.4 billion)
  – fuel duties (–£0.4 billion)
  – VAT (–£0.5 billion)
  – other taxes (net +£0.4 billion)

• Spending (£0.0 billion)
  – we assume OBR forecasts for current spending and public sector net investment are correct
Medium-term forecasts: baseline assumptions

- Economy performs as the OBR expects
  - far greater information provided by OBR means fewer gaps need to be filled in
- Total departmental spending totals for 2011–12 to 2014–15 kept to in cash terms
- Current spending and investment spending frozen in real terms in 2015–16
- Only new policies are those committed to in Budgets/PBRs/Spending Reviews
Possible new policies?

• NHS spending
• Income tax personal allowance
Possible new policies?

• NHS spending
  – coalition agreement commits to year-on-year real increases
  – OBR’s November forecast revised up expected inflation, so that planned small real increase in England now a planned small real cut
  – we assume funds are reallocated from the DEL reserve

• Income tax personal allowance
Possible new policies?

- NHS spending
- Income tax personal allowance
  - coalition agreement says “We will further increase the personal allowance to £10,000, making real terms steps each year towards meeting this as a longer-term policy objective. We will prioritise this over other tax cuts, including cuts to Inheritance Tax.”
  - increasing personal allowance to £10,000 in 2015–16 while clawing gains back from higher-rate taxpayers would cost £4.3 billion
  - we do not allow for this policy in our forecasts

© Institute for Fiscal Studies
Cyclically-adjusted current budget balance

Notes and sources: see Figure 5.3 of The IFS Green Budget: February 2011.
Public sector net debt

Notes and sources: see Figure 5.4 of The IFS Green Budget: February 2011.
The weak Q4 growth figures

- Economy estimated to have shrunk by 0.5% in last quarter of 2010
  - OBR November forecast was for growth of 0.5%
- Unless view of potential output lowered, higher growth expected in future as economy has further to bounce back
  - this should be true of output lost due to bad weather
- Central government receipts holding up despite this weaker growth
  - weak VAT receipts in December, but we still expect overall receipts to be greater than the OBR forecast for 2010–11
- Should not change fiscal policy with every piece of new information
Uncertainties around macroeconomic outlook (1)

- Alternative scenarios highlight downside risk to public finances
  - Also incorporate new information since OBR report
- Barclays central scenario
  - Future potential output lower than OBR expects, and national income takes longer to return to this level
- Barclays ‘optimistic’ case
  - Future potential output closer to OBR assessment
  - But composition of growth less favourable to public finances
- Barclays ‘pessimistic’ case
  - Financial crisis and associated recession assumed to have an even greater detrimental impact on potential output
  - More persistent gap between national income and potential output
Cyclically-adjusted current budget balance

Notes and sources: see Figure 5.3 of The IFS Green Budget: February 2011.
Public sector net debt

Notes and sources: see Figure 5.4 of The IFS Green Budget: February 2011.
Uncertainties around macroeconomic outlook (2)

- Should not change fiscal policy with every piece of new information
- Fiscal plan should acknowledge inherent uncertainty
  - state up-front what broad course of action would be pursued under different possible scenarios
  - more credible than a supposedly fixed plan
  - avoids need for “u-turns”
Budget judgement

• Near term: should the Budget contain a significant net fiscal giveaway to help economy?

• Medium term: should the Budget use any improvement in the fiscal outlook to reduce size of fiscal tightening?
Budget judgement

• Near term: should the Budget contain a significant net fiscal giveaway to help economy?
  – no boost to demand if looser fiscal policy led to tighter monetary policy
  – risk that investors may start to question the credibility of fiscal consolidation plan if government doesn’t implement the first part

• Medium term: should the Budget use any improvement in the fiscal outlook to reduce size of fiscal tightening?
Budget judgement

• Near term: should the Budget contain a significant net fiscal giveaway to help economy?
  – no boost to demand if looser fiscal policy led to tighter monetary policy
  – risk that investors may start to question the credibility of fiscal consolidation plan if government doesn’t implement the first part

• Medium term: should the Budget use any improvement in the fiscal outlook to reduce size of fiscal tightening?
  – economy might not grow as quickly as OBR expects
  – even if it does, receipts might not bounce back as strongly
  – possible need to top-up public service spending plans
Budget judgement

• Near term: should the Budget contain a significant net fiscal giveaway to help economy?
  – no boost to demand if looser fiscal policy led to tighter monetary policy
  – risk that investors may start to question the credibility of fiscal consolidation plan if government doesn’t implement the first part

• Medium term: should the Budget use any improvement in the fiscal outlook to reduce size of fiscal tightening?
  – economy might not grow as quickly as OBR expects
  – even if it does, receipts might not bounce back as strongly
  – possible need to top-up public service spending plans

➢ Better to bank any forecast improvement in the public finances to give greater headroom against these risks
Budget judgement

• Near term: should the Budget contain a significant net fiscal giveaway to help economy?
  – no boost to demand if looser fiscal policy led to tighter monetary policy
  – risk that investors may start to question the credibility of fiscal consolidation plan if government doesn’t implement the first part

• Medium term: should the Budget use any improvement in the fiscal outlook to reduce size of fiscal tightening?
  – economy might not grow as quickly as OBR expects
  – even if it does, receipts might not bounce back as strongly
  – possible need to top-up public service spending plans

➢ Better to bank any forecast improvement in the public finances to give greater headroom against these risks

➢ May be no need to implement alternative policies at this stage, but having alternatives to hand could prove useful