Press Release

Autumn Statement 2012: more fiscal pain to come?

In next week’s Autumn Statement the Chancellor may have to abandon one of his fiscal targets – that debt should be falling in 2015–16. He may also need to announce yet more spending cuts or tax increases for the next parliament in order to continue to meet his other fiscal target. This is the headline conclusion of a new report published today by researchers at the Institute for Fiscal Studies.

The analysis adjusts the Office for Budget Responsibility’s (OBR’s) March 2012 forecasts for the economy and the public finances in the light of new developments over the last few months. It takes account of the now weaker outlook for the UK economy (as implied by independent forecasters) and the disappointing trend in tax revenues seen over the last seven months.

Should the trend for borrowing so far this year persist for the remainder of the year borrowing in 2012–13 would total £133 billion (ignoring the one-off impact of the transfer of assets from the Royal Mail Pension Plan), which is £13 billion higher than forecast by the OBR. This would mean that underlying borrowing rose between 2011–12 and 2012–13 rather than fell as the Chancellor George Osborne had intended. This £13 billion overshoot in borrowing arises from an estimated undershoot in receipts of £17 billion, offset partially by a £4 billion underspend by Whitehall departments.

The report then sets out two scenarios for the public finances going forwards:

- A relatively optimistic scenario, under which all of this increase in borrowing, and all of the deterioration in the outlook for the UK economy, are temporary phenomena;
- A relatively pessimistic scenario, under which much of the undershoot in receipts, and all of the deterioration in the outlook for the UK economy, are permanent phenomena.

The figures in the report deliberately ignore the impact of the Government’s recent decision to change the way that it finances the interest payments on outstanding Government debt relating to the Bank of England’s purchase of gilts. This change, as the OBR has stated, does not directly materially change the long-term outlook for the public finances. In order to avoid any possible perception that the change was made in order to make his fiscal targets easier to meet, the Chancellor should instruct the OBR to exclude the impact of this change from all the figures when assessing compliance with the fiscal targets.

Under both our scenarios debt would be on course to rise as a share of national income between 2014–15 and 2015–16 (by the equivalent, in today’s terms, of £15 billion and £27 billion respectively). Therefore the Chancellor would be on course to miss his supplementary target for debt to fall between these two years. Since this supplementary target does not actually have much to commend it in terms of the economics of managing the public finances, the Chancellor would likely be best advised to abandon the rule and consult on replacing it with something that better ensures long-run sustainability rather
than engage in significant further fiscal tightening in order to remain on course to comply with this target.

Under the “optimistic” scenario the additional borrowing required over the next few years would be largely cyclical. Therefore, no further action above that already planned would be required to meet the Chancellor’s fiscal mandate, which states that the structural current budget should be forecast to be in balance or surplus by the end of the five-year forecast horizon. Even so he would still need face the painful options beyond March 2015 which he outlined in his Budget speech. There he mooted the possibility of welfare cuts of £8 billion (in today’s terms) and an average real terms cut to non-investment spending by Whitehall departments of 2.3% a year over the two years from 2015–16 to 2016–17.

Under the “pessimistic” scenario, the outlook would be even more difficult. Continuing to meet the fiscal mandate would require the Chancellor to, for example, extend to 2017–18 the same average squeeze on public service spending that is currently planned for the Spending Review 2010 period (so the squeeze would run for eight years rather than the five intended after the 2010 general election), implement the £8 billion of welfare cuts mooted in his March Budget speech, and implement a further £11 billion of tax increases or welfare cuts on top.

Commenting on the findings Carl Emmerson, Deputy Director of the Institute for Fiscal Studies, said:

“Since the Budget, the outlook for the UK economy has deteriorated and Government receipts have disappointed by even more than this year’s weak growth would normally suggest. As a result, the Chancellor might find himself having to abandon one of his fiscal targets. If much of the additional weakness this year feeds into a permanently higher outlook for borrowing, then in order to comply with his other fiscal target Mr Osborne would need to announce yet more tax rises or spending cuts for the next parliament in next week’s Autumn Statement. In that case the planned era of austerity could run for eight years – from 2010–11 to 2017–18.”

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Notes to Editors:
1. “Autumn Statement 2012: more fiscal pain to come?” by Carl Emmerson and Gemma Tetlow, IFS Briefing Note No. 136, is published on Monday 26 November 2012 and will be available from the IFS website www.ifs.org.uk

2. For embargoed copies of the report or other queries, please contact the IFS press office at: 020 7291 4800 / 07730 667013 or emma_h@ifs.org.uk

3. The authors are grateful for funding from the Economic and Social Research Council (ESRC).

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