

Institute for  
Fiscal Studies



## Green Budget public finance forecasts

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## Green Budget baseline forecast

- Current budget deficit and public sector net borrowing
  - Higher in each of the next five years than forecast in the PBR
  - Additional 1.3% of national income borrowing in 2013–14
- Debt
  - Rises to 62.1% of national income by 2013–14, compared to 57.4% in PBR
- Budget judgement
  - Additional £20 billion of higher taxes or lower spending need to be implemented by end of next Parliament to expect to achieve the improvement in the public finances set out in the PBR
  - Outlook currently very uncertain
  - But better to announce measures that subsequently prove not to be needed than to risk a loss of investor confidence

## Forecasts for 2008–09

£ billion	PBR November 2008	Green Budget January 2009	Difference
Current receipts	545.5	538.9	–6.6
Current expenditure	586.7	586.7	0.0
Current budget surplus	–41.2	–47.8	–6.6
Net investment	36.5	36.5	0.0
PSNB	77.6	84.3	+6.6

## 2008–09: Explaining the difference in receipts

- Income tax (–£4.1bn)
- VAT (–£1.1bn)
- Stamp duty (–£0.6bn)
- Capital gains tax (–£1.0bn)

## 2008–09: Explaining the difference in receipts

- Income tax (–£4.1bn)
  - Assume particularly low income growth among the top 1%
- VAT (–£1.1bn)
- Stamp duty (–£0.6bn)
- Capital gains tax (–£1.0bn)

## 2008–09: Explaining the difference in receipts

- Income tax (–£4.1bn)
- VAT (–£1.1bn)
  - Fall in cash receipts since November has been even sharper than PBR forecast, and accelerating
- Stamp duty (–£0.6bn)
- Capital gains tax (–£1.0bn)

## 2008–09: Explaining the difference in receipts

- Income tax (–£4.1bn)
- VAT (–£1.1bn)
- Stamp duty (–£0.6bn)
  - Incorporate Treasury assumption that housing transactions in 2008–09 less than half 2007–08 level
  - 16% decline in house prices in 2008
  - 30% stock market fall during 2008
- Capital gains tax (–£1.0bn)

## 2008–09: Explaining the difference in receipts

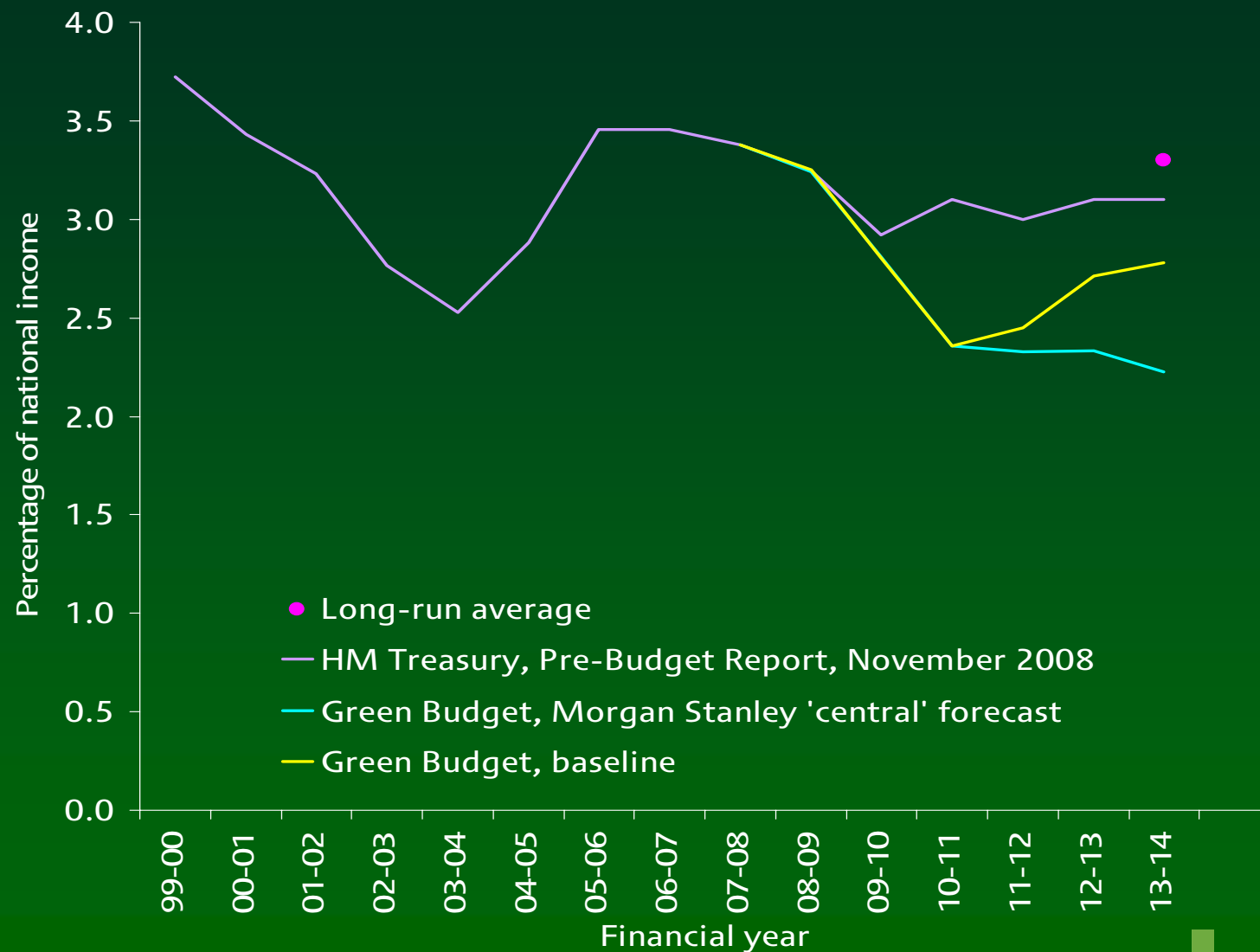
- Income tax (–£4.1bn)
- VAT (–£1.1bn)
- Stamp duty (–£0.6bn)
- Capital gains tax (–£1.0bn)
  - Assume hit to receipts from stock market fall, which Treasury forecast, happens earlier



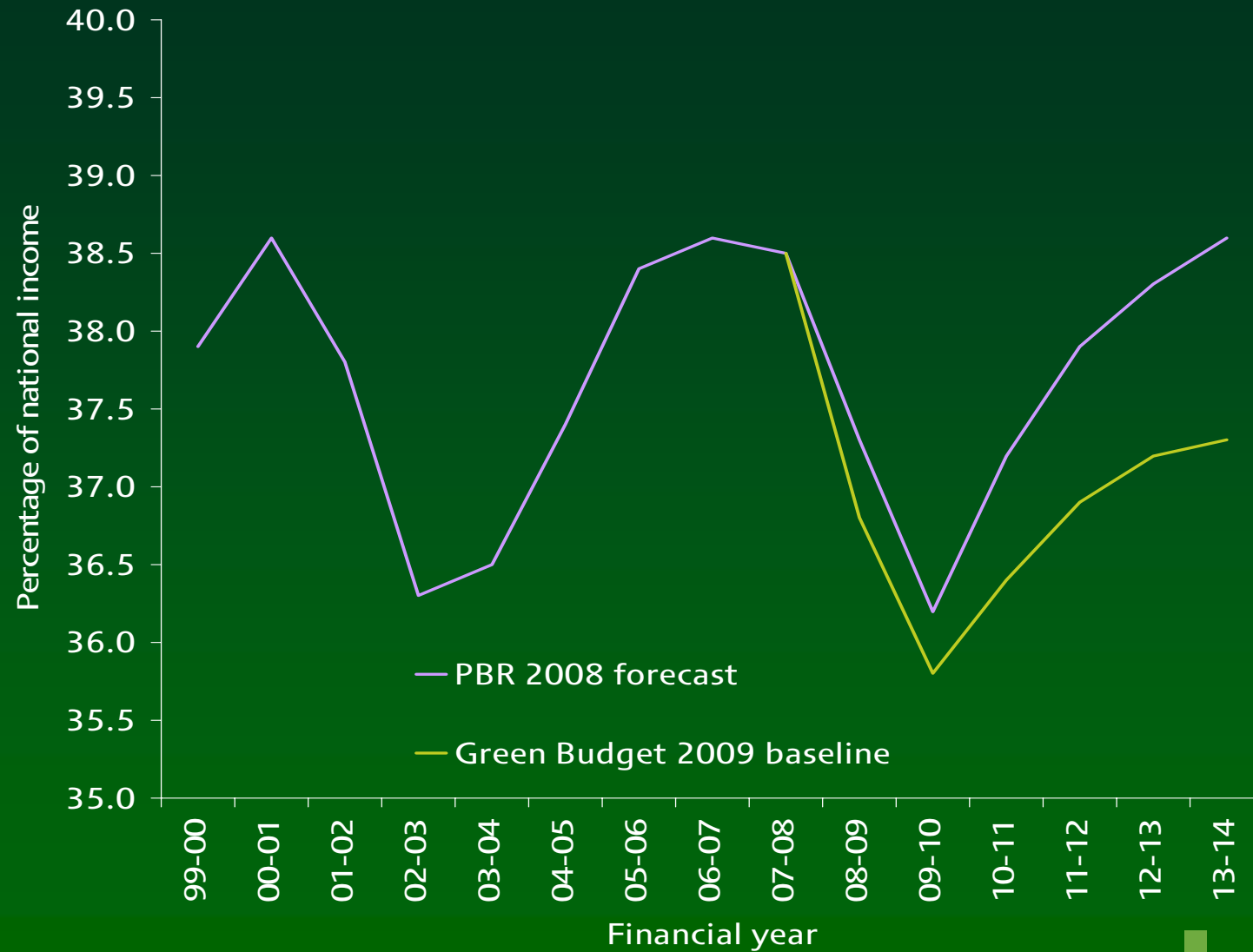
## Medium-term forecast: baseline assumptions

- Economy performs broadly as the Treasury expects
- Corporation tax
  - Morgan Stanley central forecast of negative corporate profits growth in 2008–09 and 2009–10
  - Lagged effect on tax receipts means cash fall until 2010–11
  - Receipts grow thereafter to return to long-run average

# Medium-term forecast: corporation tax receipts



# Medium-term forecast: total receipts



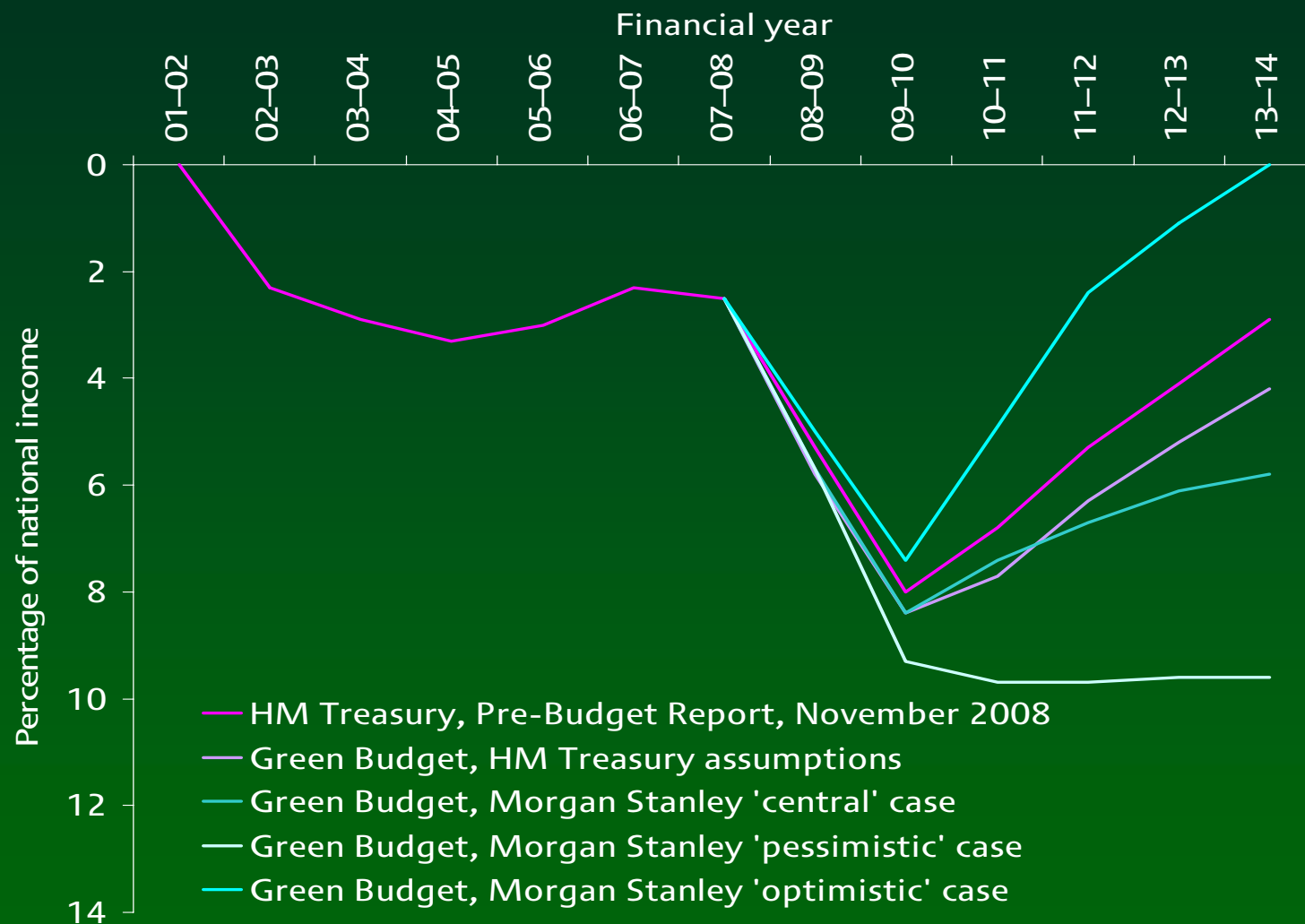
## Medium-term forecast: spending and borrowing

- Spending: assume PBR plans delivered from 2011–12 onwards
- Current budget deficit
  - 2008–09: £6.6bn larger than PBR 2008 forecast
  - 2009–10: £6.4bn larger than PBR 2008 forecast
  - Medium-term: falls from 5.7% of GDP in 2009–10 to 2.4% in 2013–14 (1.3% of GDP higher than PBR forecast)
- Public sector net borrowing
  - 2008–09: £84bn
  - 2009–10: £125bn
  - Medium-term: falls from 8.4% of GDP in 2009–10 to 4.2% in 2013–14 (1.3% of GDP higher than PBR forecast)
- Public sector net debt: rises to 62.1% of GDP in 2013–14
  - Higher than PBR forecast of 57.4%

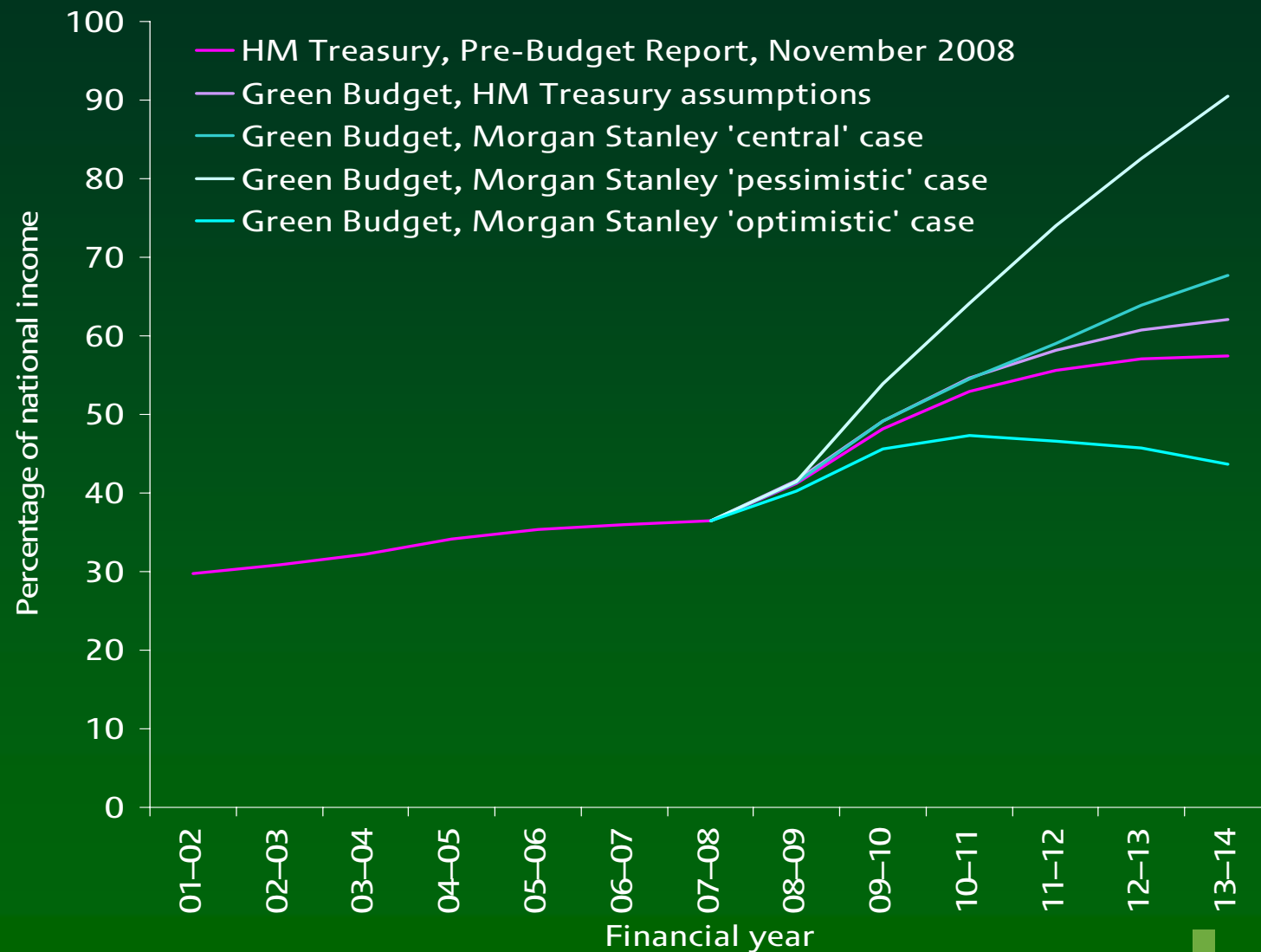
## But the outlook is uncertain...

- What if trend growth rate is somewhat lower?
  - Morgan Stanley ‘central’ case: similar economic growth to 2011–12, thereafter economy back at trend and so less scope for further bounce-back
- Downside risks
  - Morgan Stanley ‘pessimistic’ case: deeper recession and trend growth rate considerably lower
- A more favourable outlook
  - Morgan Stanley ‘optimistic’ case: no permanent loss of potential output, activity bounces back strongly in 2010 and beyond

# Public sector net borrowing: alternative scenarios



## Implications for public sector net debt



# Budget judgement

- The outlook for the next few years is uncertain
- Short-term: should there be a further stimulus?
  - Raises issues beyond the scope of the Green Budget
  - If fiscal stimulus desired, should be targeted and temporary
- Medium-term:
  - Additional £20 billion of spending cuts or tax increases need to be implemented by the end of the next Parliament to expect to achieve the strengthening that PBR 2008 was looking for
  - The cost of inaction should action be required higher than the cost of announcing a tightening that is later found not to be needed