



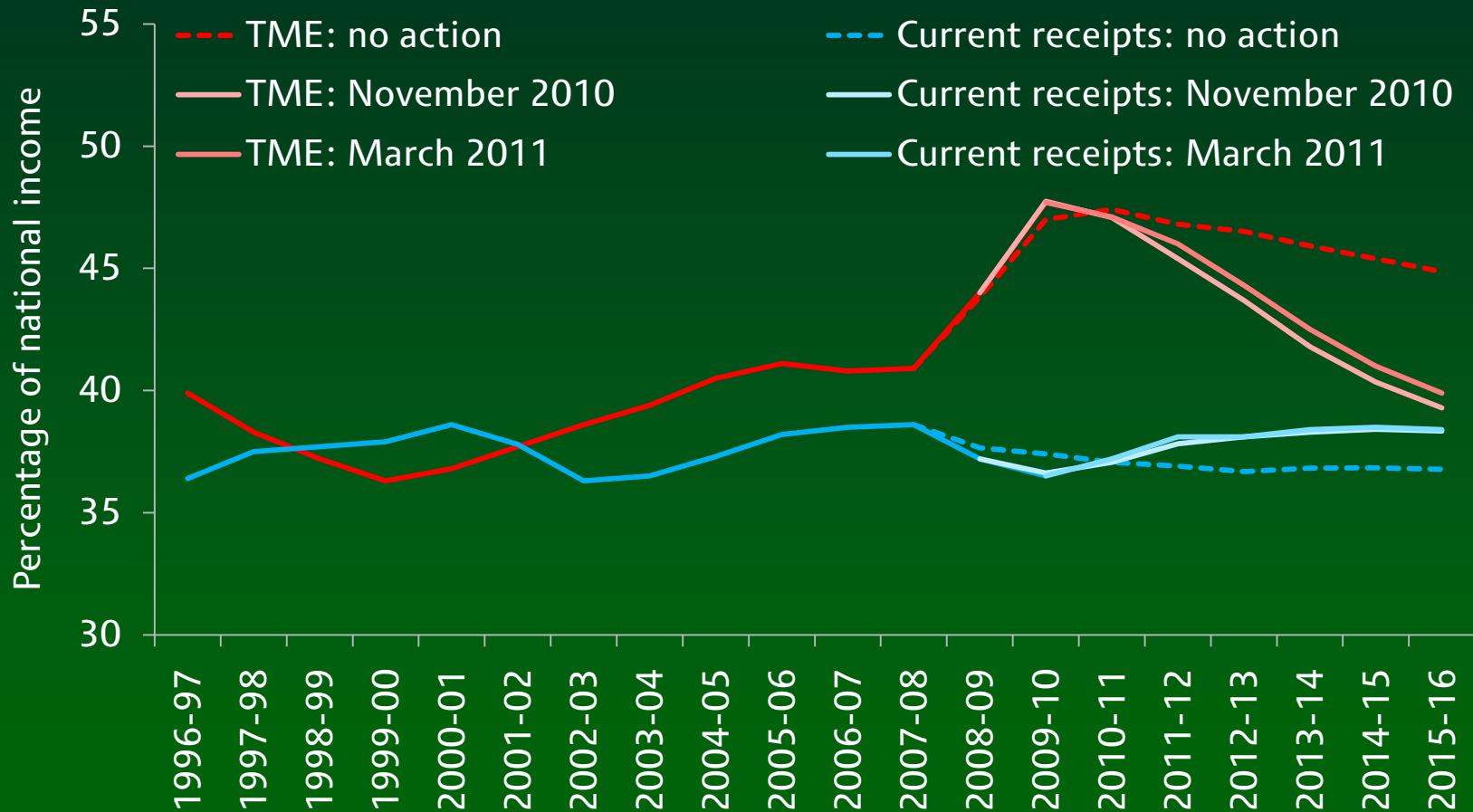
# Institute for Fiscal Studies



## Public finances: weaker outlook reduces room for manoeuvre

Gemma Tetlow

# The big picture



Note: TME = Total Managed Expenditure  
Sources: Office for Budget Responsibility; IFS calculations.



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# Changes in borrowing forecasts since Nov 2010

Public sector net borrowing, £ billion

	2010–11	2011–12	2012–13	2013–14	2014–15	2015–16
<b>Nov 2010 EFO</b>	<b>148.5</b>	<b>117</b>	<b>91</b>	<b>60</b>	<b>35</b>	<b>18</b>
Measures	0.0	0.0	0.3	0.0	0.1	-0.1
<b>Budget 2011</b>	<b>145.9</b>	<b>122</b>	<b>101</b>	<b>70</b>	<b>46</b>	<b>29</b>

# Measures: giveaway and takeaway

Budget 2011	£ billion				
	2011-12	2012-13	2013-14	2014-15	2015-16
Tax giveaway	2.9	4.3	5.1	6.0	6.4
Tax takeaway	3.5	4.4	5.4	6.1	6.7
Spending giveaway	0.7	0.4	0.3	0.3	0.3
Spending takeaway	0.0	0.0	0.0	0.0	0.0
Net tax increase	0.7	0.1	0.3	0.1	0.3
Net spending increase	0.7	0.4	0.3	0.2	0.2
<b>Net giveaway</b>	<b>0.0</b>	<b>0.3</b>	<b>0.0</b>	<b>0.1</b>	<b>-0.1</b>

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Measures	0.0	0.0	0.3	0.0	0.1	-0.1
Forecasting changes	-2.6	4.3	9.4	9.6	11.0	11.1
<b>Budget 2011</b>	<b>145.9</b>	<b>122</b>	<b>101</b>	<b>70</b>	<b>46</b>	<b>29</b>

## Forecasting changes by source

Effect on borrowing, £ billion	10–11	11–12	12–13	13–14	14–15	15–16
Wages & salaries	+1.6	+3.1	+4.4	+5.2	+5.3	+5.0
Inflation	+0.3	+2.7	+3.4	+5.0	+4.9	+5.6
Lower PAYE & NICs for given level of wages, salaries and bonuses	+1.4	+1.4	+1.5	+1.5	+1.6	+1.7
Lower 10–11 fin. sector bonuses	+1.0	+1.0	+1.0	+1.0	+1.0	+1.0
Higher debt interest payments due to higher borrowing	0.0	+0.3	+0.2	+0.8	+1.2	+1.6
Oil and gas prices (direct effect)	-0.1	-3.4	-2.7	-2.1	-1.9	-1.5
VAT gap	-1.0	-1.0	-1.0	-1.0	-1.1	-1.2
Inc. tax & NICs modelling changes	-0.3	-0.9	-1.7	-2.0	-2.0	-2.1
Other	-5.5	+1.1	+4.3	+1.2	+2.0	+1.0
<b>Total</b>	<b>-2.6</b>	<b>+4.3</b>	<b>+9.4</b>	<b>+9.6</b>	<b>+11.0</b>	<b>+11.1</b>



# Higher inflation but no increase in public service spending

## Planned Departmental Expenditure Limits (DELs)

% change	Annual real growth rate				4 year cumulative
	2011-12	2012-13	2013-14	2014-15	
SR2010	-4.0	-2.6	-2.2	-2.9	-11.2
Latest cash spending plans:					
Previous inflation forecast	-3.3	-2.6	-2.4	-2.9	-10.6
Latest inflation forecast	-4.2	-2.7	-2.5	-2.9	-11.7

- Additional real cut equivalent to £4bn
- But area-specific inflation experience is what matters



## Sailing perilously close to the wind?

- Coalition agreement: “We will guarantee that health spending increases in real terms in each year of the parliament”

<i>NHS spending</i>	Annual real growth rate				4 year cumulative
	2011-12	2012-13	2013-14	2014-15	
SR2010					
Previous inflation forecast	0.1	0.1	0.2	-0.0	0.3
Latest inflation forecast	-0.9	-0.1	0.1	-0.0	-0.9
Budget 2011	0.0	-0.1	-0.0	0.1	-0.1

- Just on course to spend no less in 2011–12 than 2010–11
  - pledge could be missed
- NHS faces 4-year real budget freeze: tightest since the 1950s





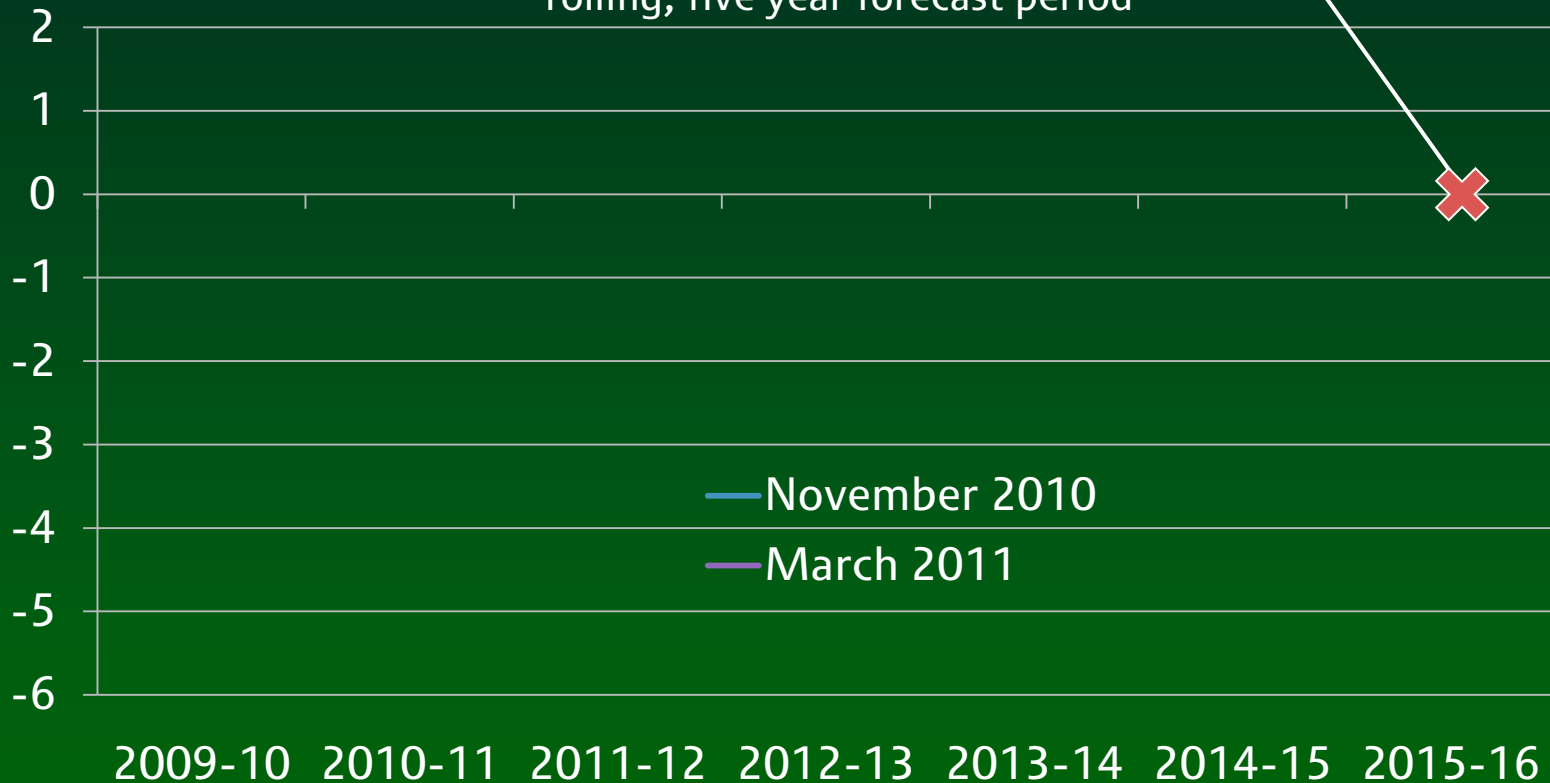
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<b>Nov 2010 EFO</b>	<b>148.5</b>	<b>117</b>	<b>91</b>	<b>60</b>	<b>35</b>	<b>18</b>
Measures	0.0	0.0	0.3	0.0	0.1	-0.1
Forecasting changes	-2.6	4.3	9.4	9.6	11.0	11.1
Cyclical	1.3	4.8	7.1	8.0	8.1	7.5
Structural	-3.9	-0.5	2.3	1.7	2.9	3.6
<b>Budget 2011</b>	<b>145.9</b>	<b>122</b>	<b>101</b>	<b>70</b>	<b>46</b>	<b>29</b>

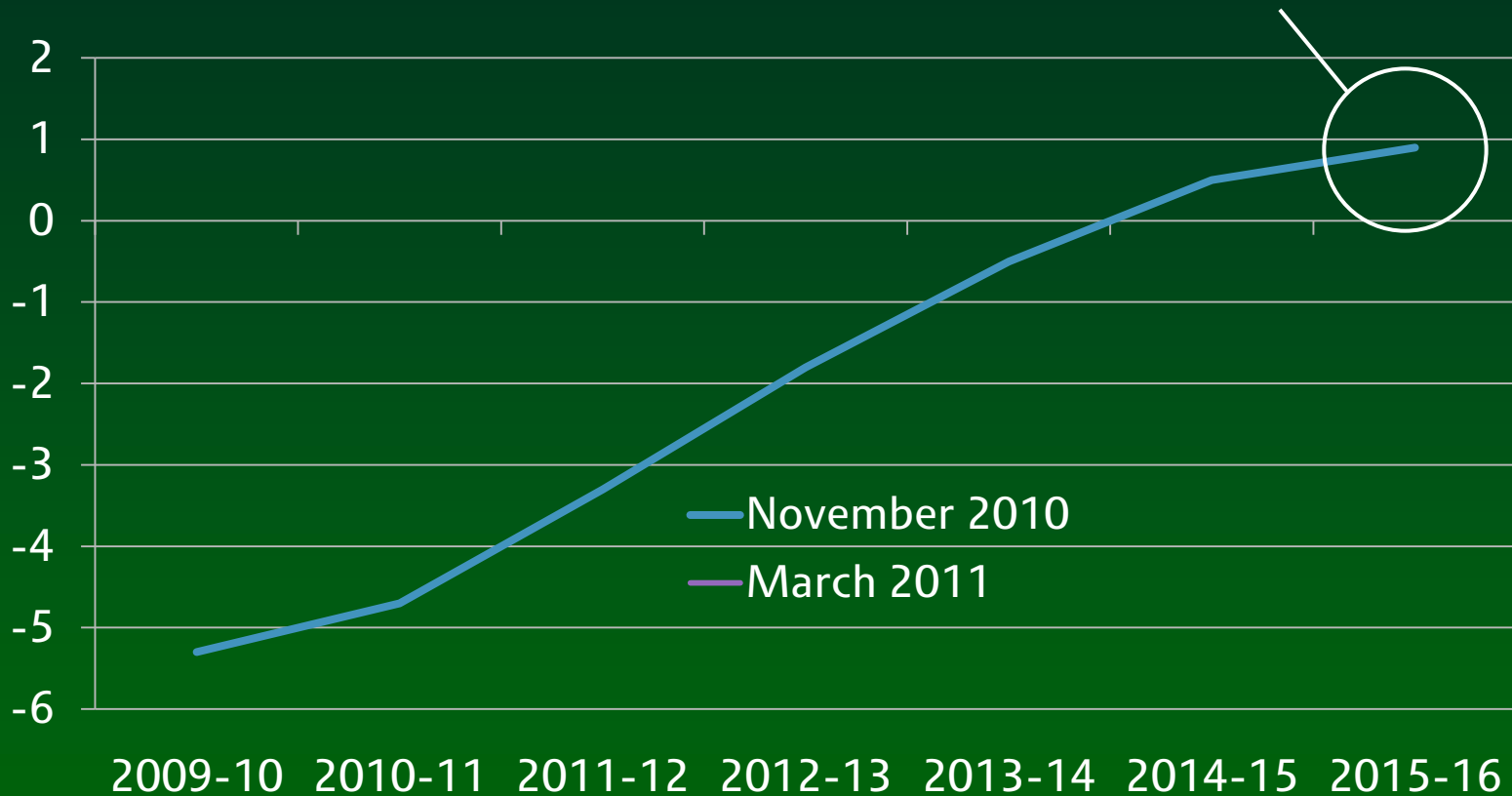
# Less headroom against the fiscal mandate

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



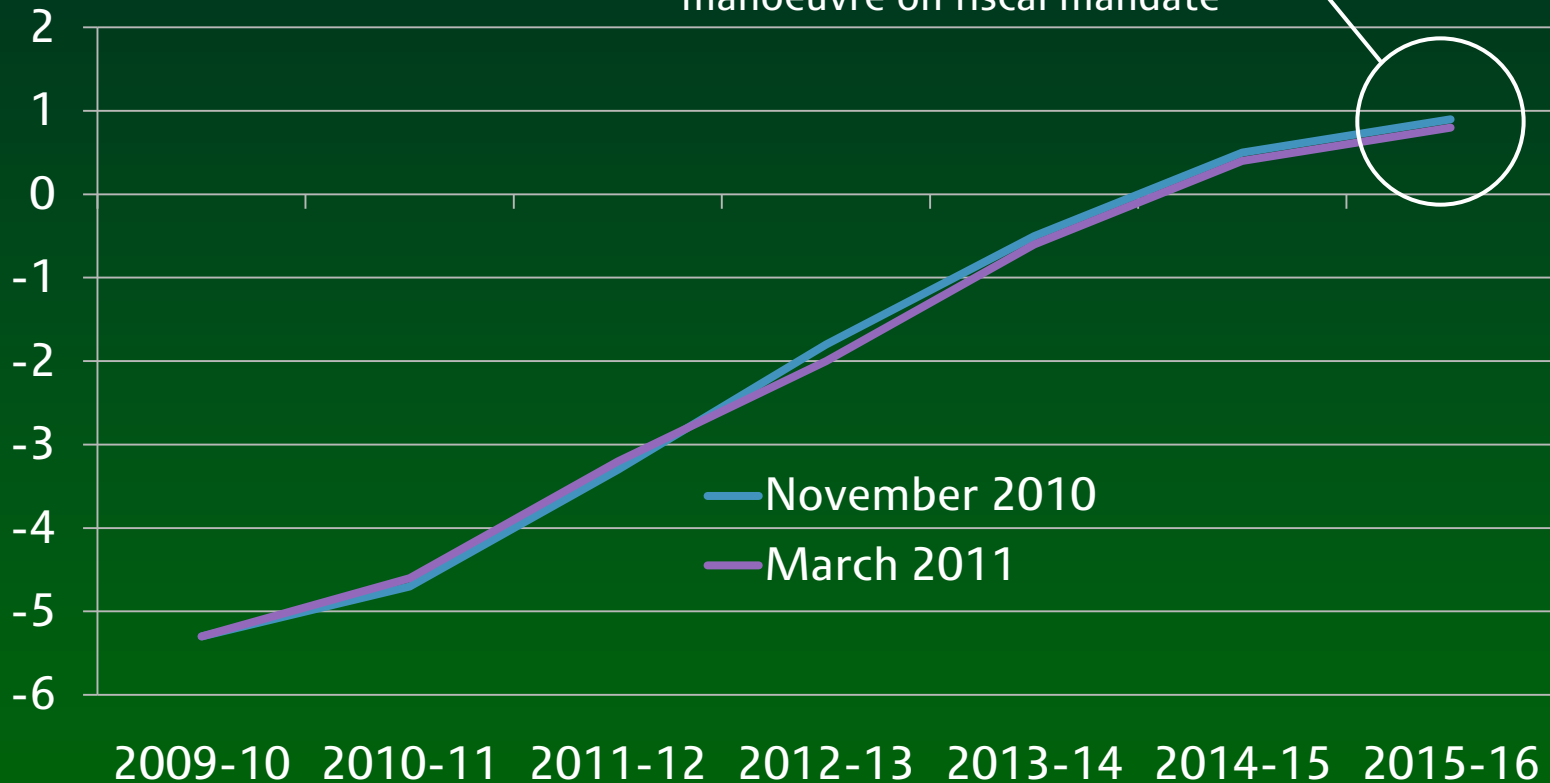
# Less headroom against the fiscal mandate

November 2010: 0.9% of national income cyclically-adjusted current budget surplus

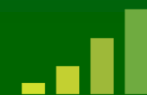


# Less headroom against the fiscal mandate

March 2011: forecast 0.2% of national income lower – reduces room for manoeuvre on fiscal mandate



But...room for manoeuvre already built in, meant Mr Osborne did not *have* to announce further tightening in order to remain on course to meet mandate



# Risks

- Output gap smaller than OBR currently thinks:
  - OBR forecasts output gap of  $-1.3\%$  in 2015–16
  - If 1.5ppt smaller, eradicates headroom against fiscal mandate
- Previous errors in official borrowing forecasts suggest 70% chance of cyclically adjusted current budget balance in 2015–16
  - in other words, 30% chance of further tax increases or deeper spending cuts needed to achieve cyclically adjusted balance in 2015–16
- Spending on public services
  - higher inflation could make cash spending plans harder to deliver
  - but at the first test government has not topped up the plans

# Summary

- £11bn increase in forecast for borrowing
  - OBR thinks 70% of additional borrowing is cyclical
  - additional structural borrowing means less room for manoeuvre on fiscal mandate
- New measures revenue neutral
  - tax cuts paid for by tax rises
- Significant uncertainties remain
  - macroeconomic outlook
  - difficulties in forecasting borrowing
  - pressures on public services



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# Lower short-term growth, offset by higher growth thereafter

Comparison of forecasts for real GDP growth and trend GDP

GDP does return to trend until 2017-18

