

IFS Green Budget 2017

In association with ICAEW and funded by the Nuffield Foundation.

With additional analysis from ICAEW and Oxford Economics.

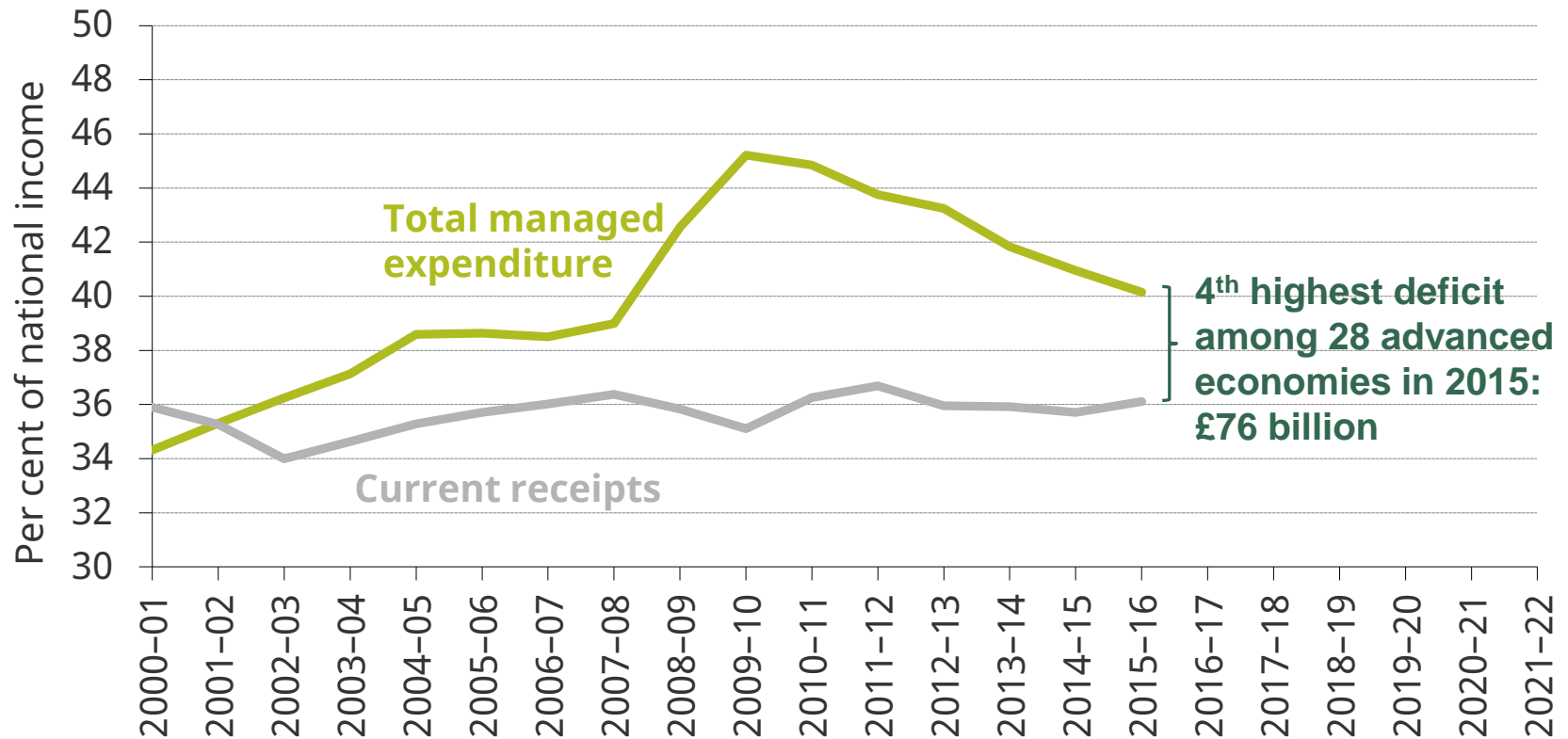
#IFSGreenBudget @TheIFS

Challenges facing the public finances

Thomas Pope

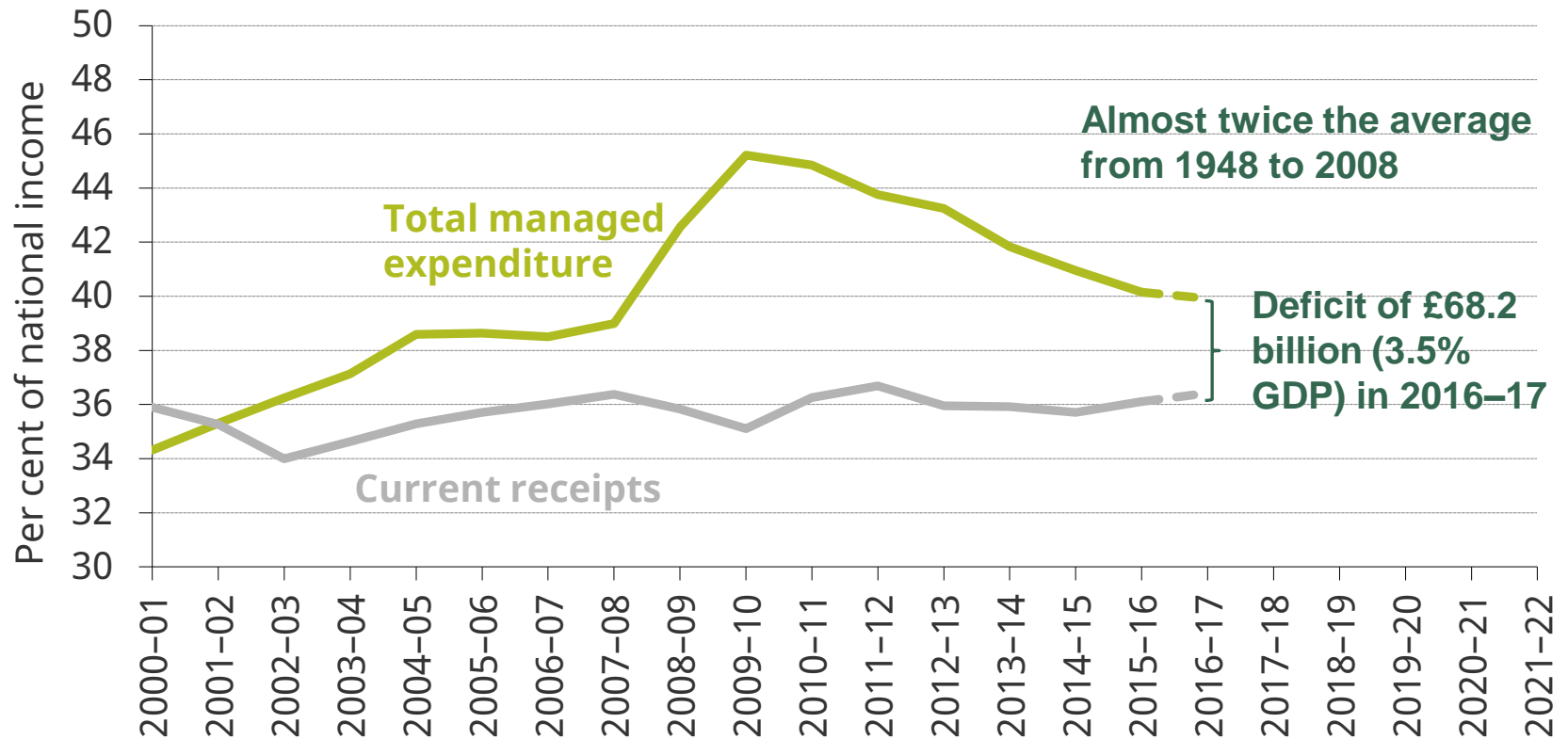
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Public sector spending and receipts since 2000–01



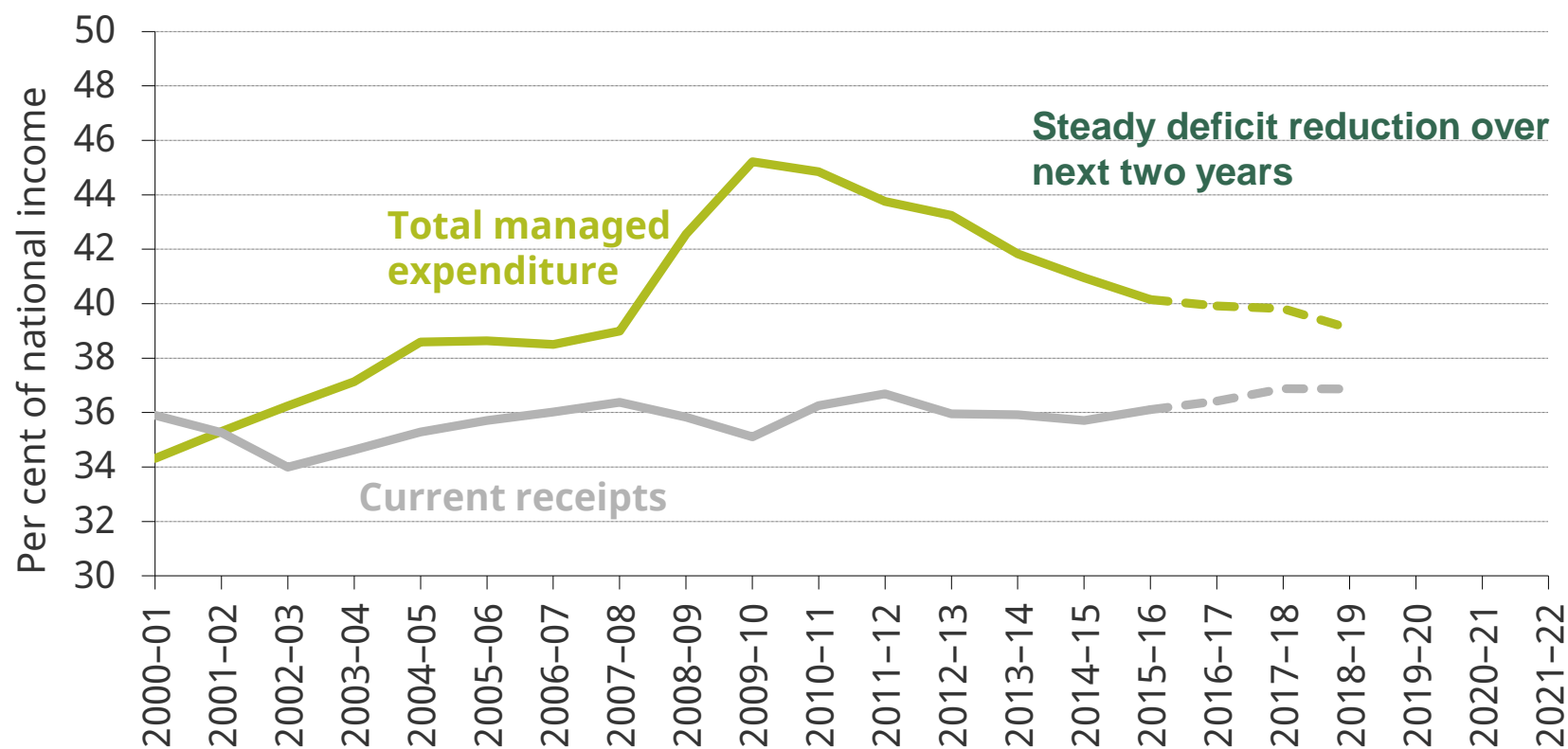
Source: Figure 3.2 of the Green Budget

Public sector spending and receipts since 2000–01



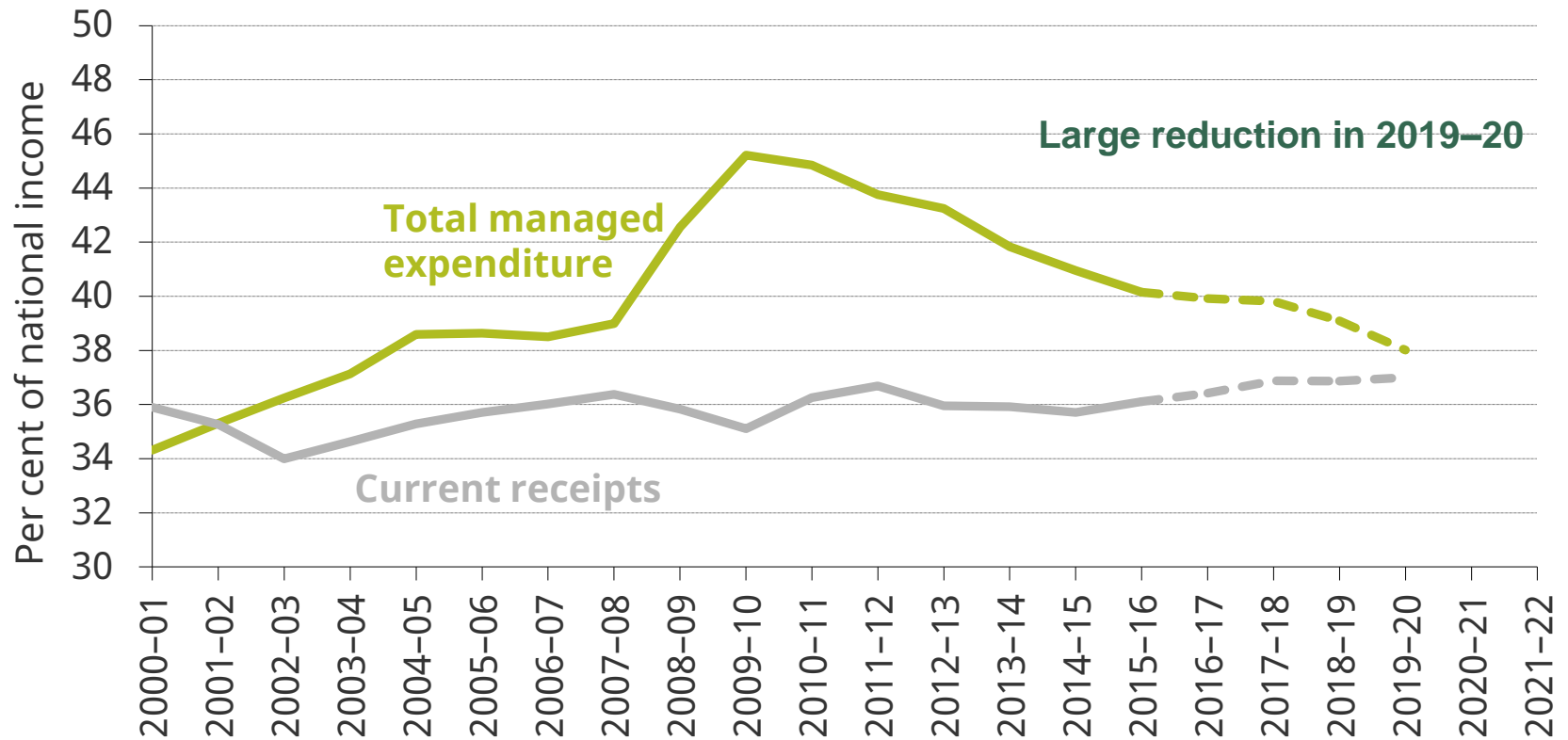
Source: Figure 3.2 of the Green Budget

Public sector spending and receipts since 2000–01



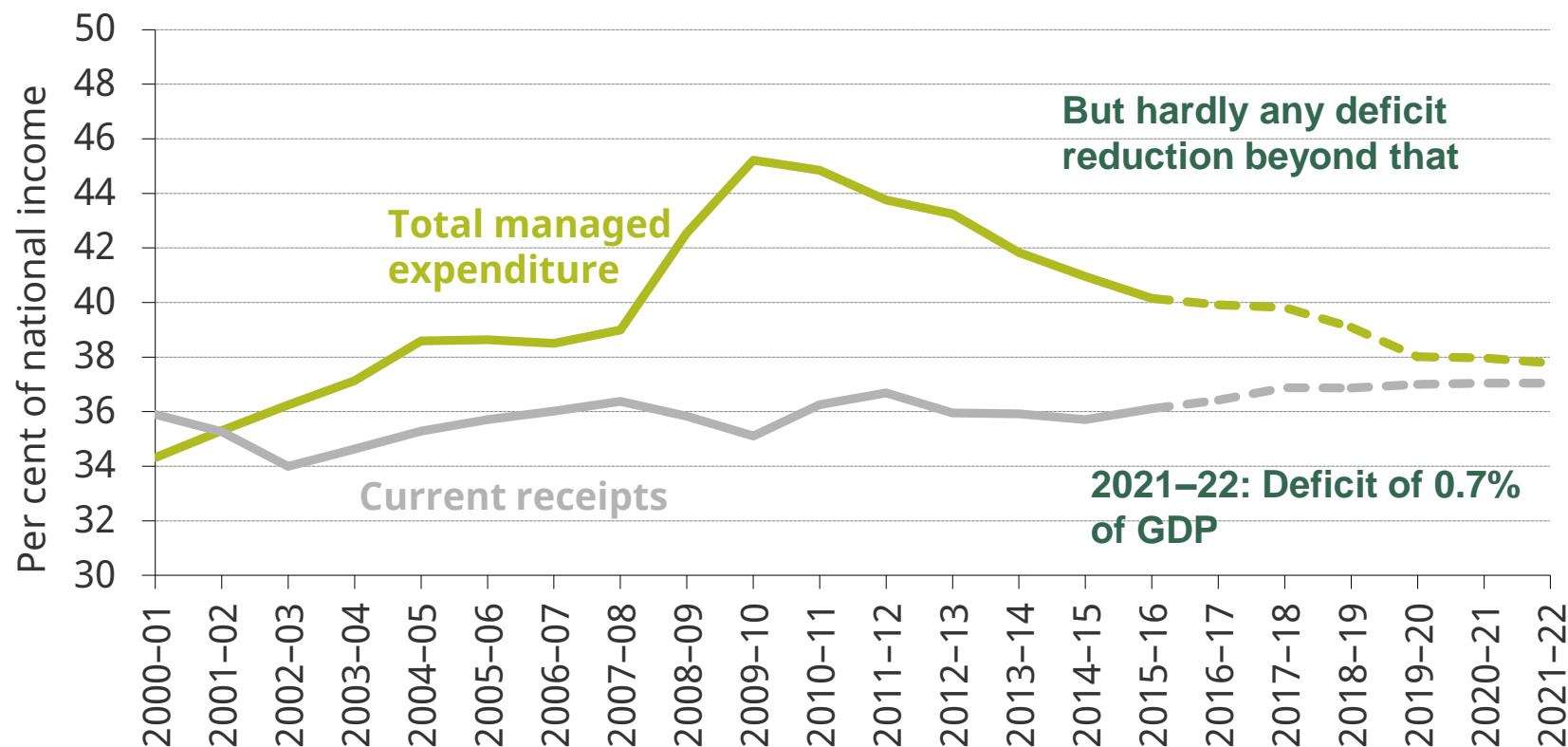
Source: Figure 3.2 of the Green Budget

Public sector spending and receipts since 2000–01



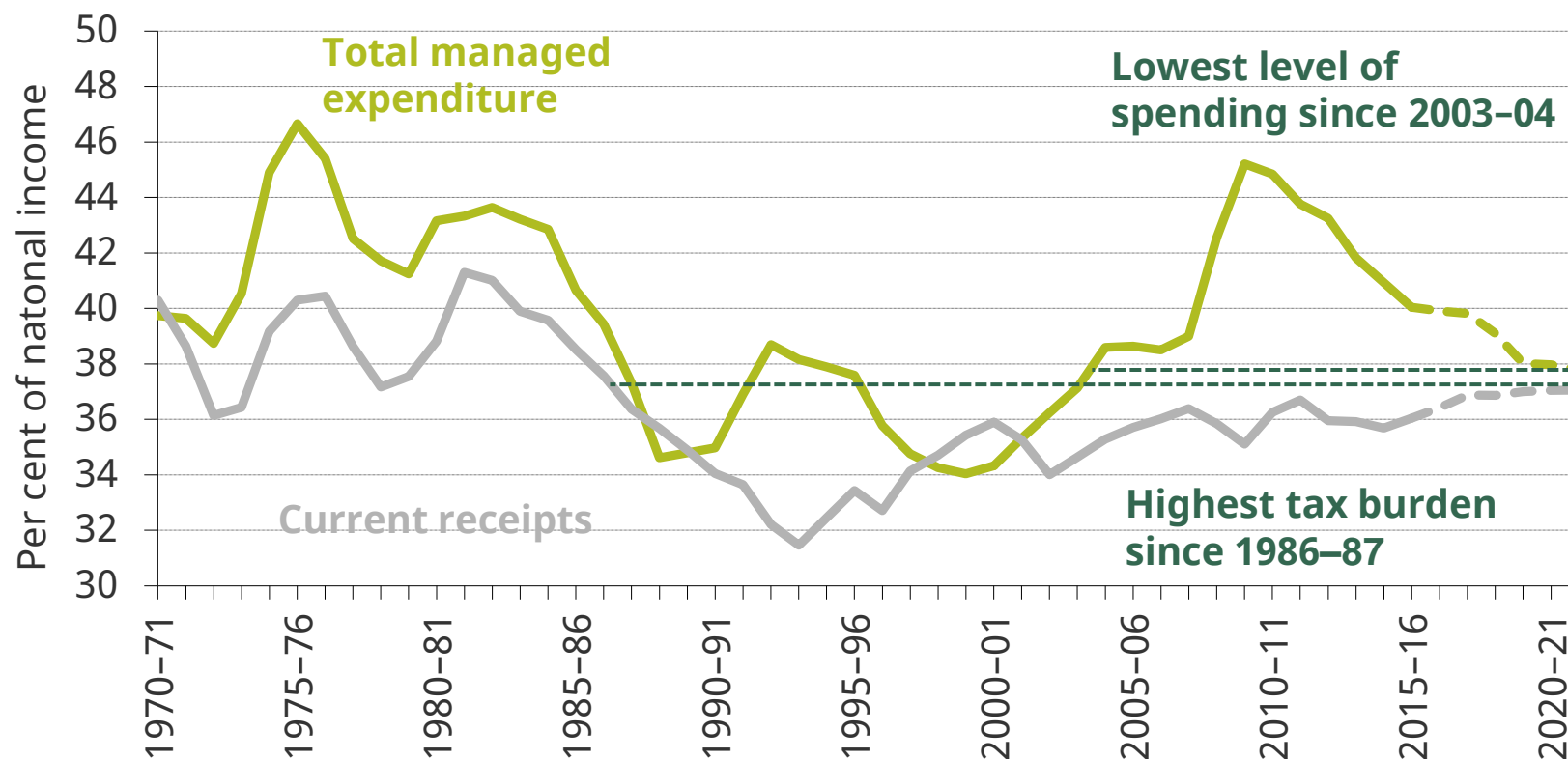
Source: Figure 3.2 of the Green Budget

Public sector spending and receipts since 2000–01



Source: Figure 3.2 of the Green Budget

Public sector spending and receipts since 1970



Source: Figure 3.1 of the Green Budget

The new fiscal targets

No targets that apply this Parliament

Fiscal mandate

- (Cyclically-adjusted) deficit below 2% national income in 2020–21
 - On current forecast: fiscal headroom of over £25 billion

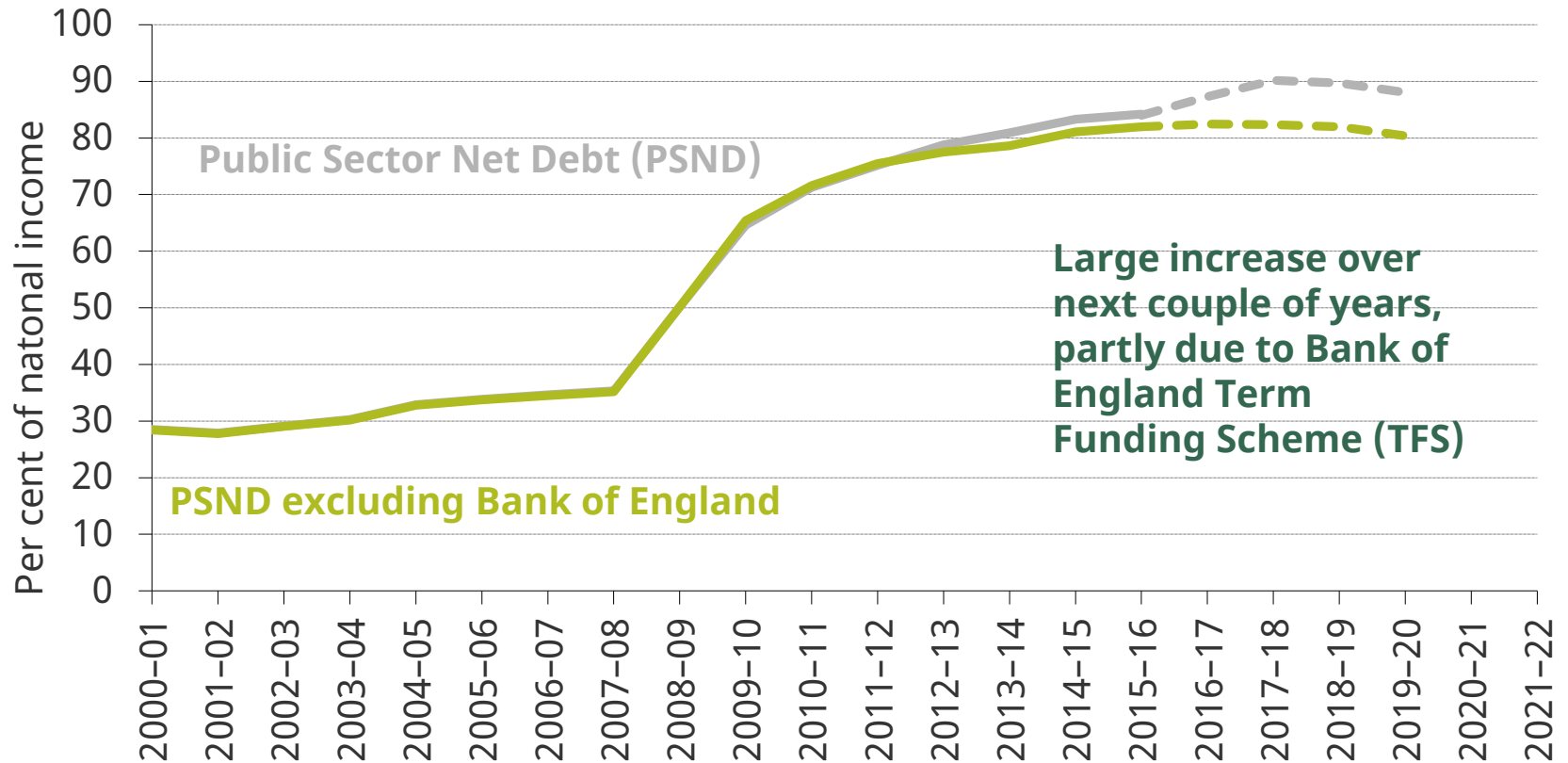
Welfare cap

- Includes most welfare spending, doesn't apply until 2021–22

Debt target

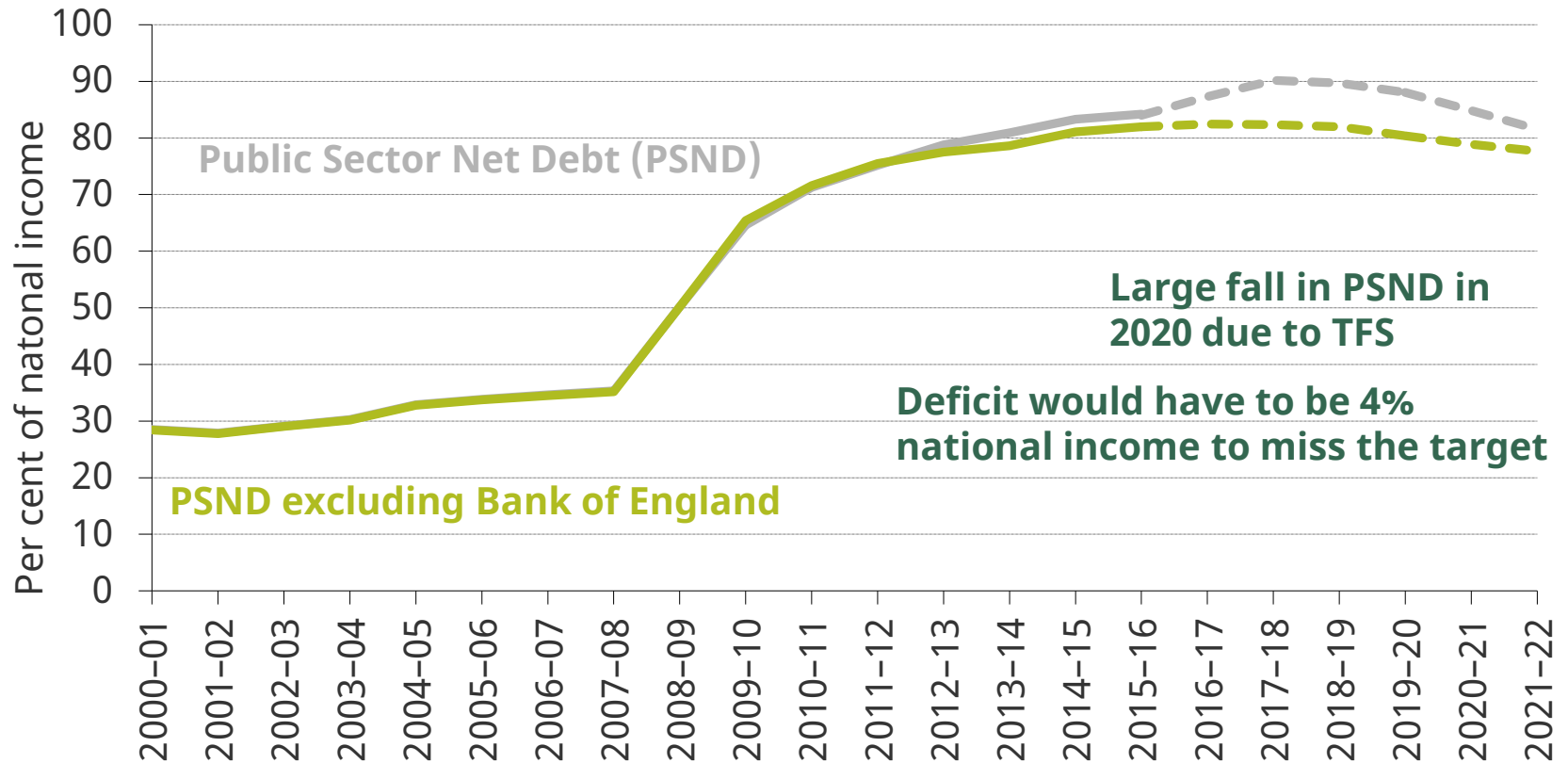
- Public Sector Net Debt to fall as % national income between 2019–20 and 2020–21

Public Sector Net Debt since 2000-01



Source: Figure 3.3 of the Green Budget

Public Sector Net Debt since 2000-01



Source: Figure 3.3 of the Green Budget

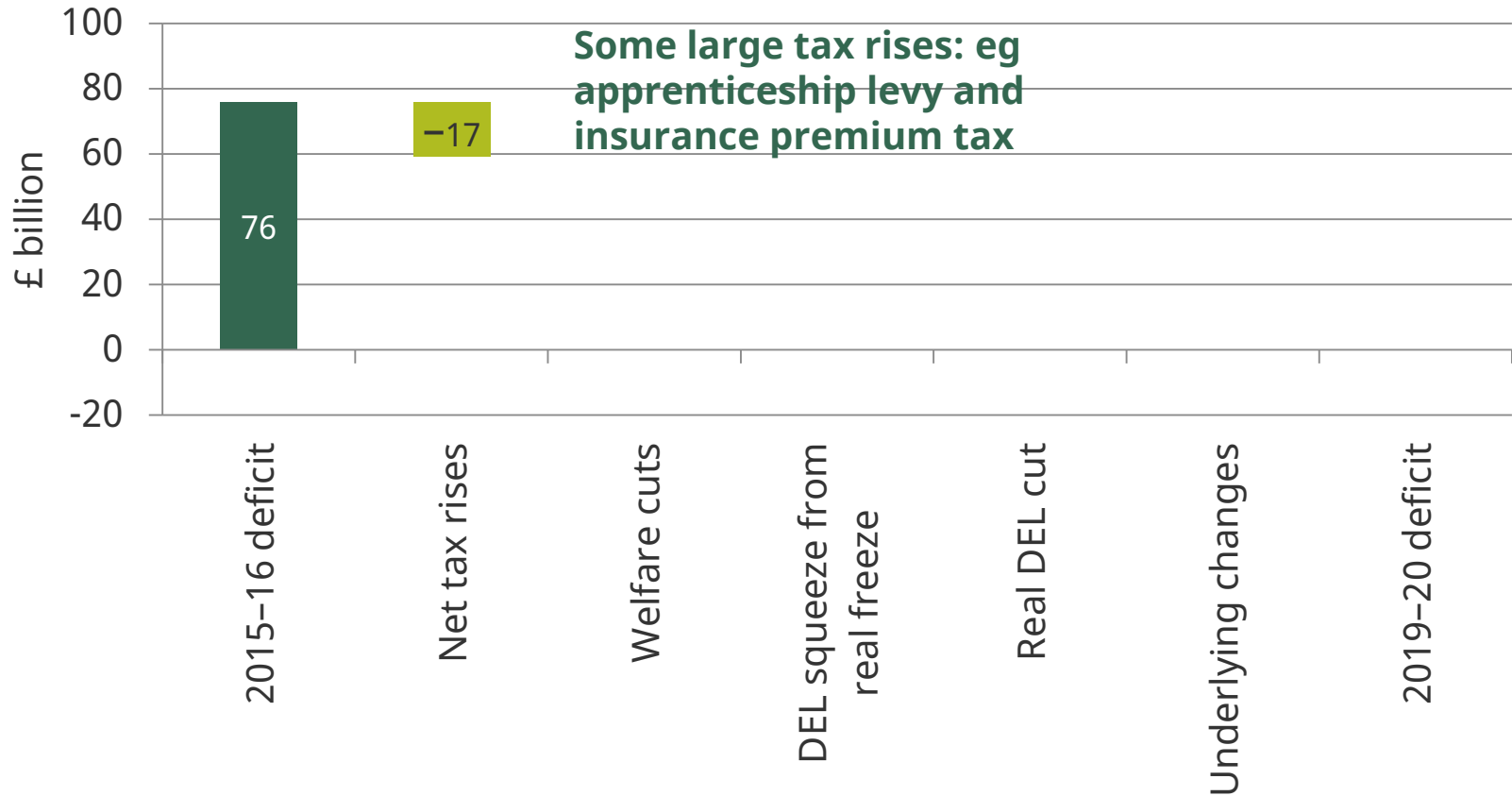
The new fiscal targets

The main objective of fiscal policy

- “Return the public finances to balance as soon as possible in the next Parliament”
 - I.e. 0.7% of national income deficit eliminated by 2024–25

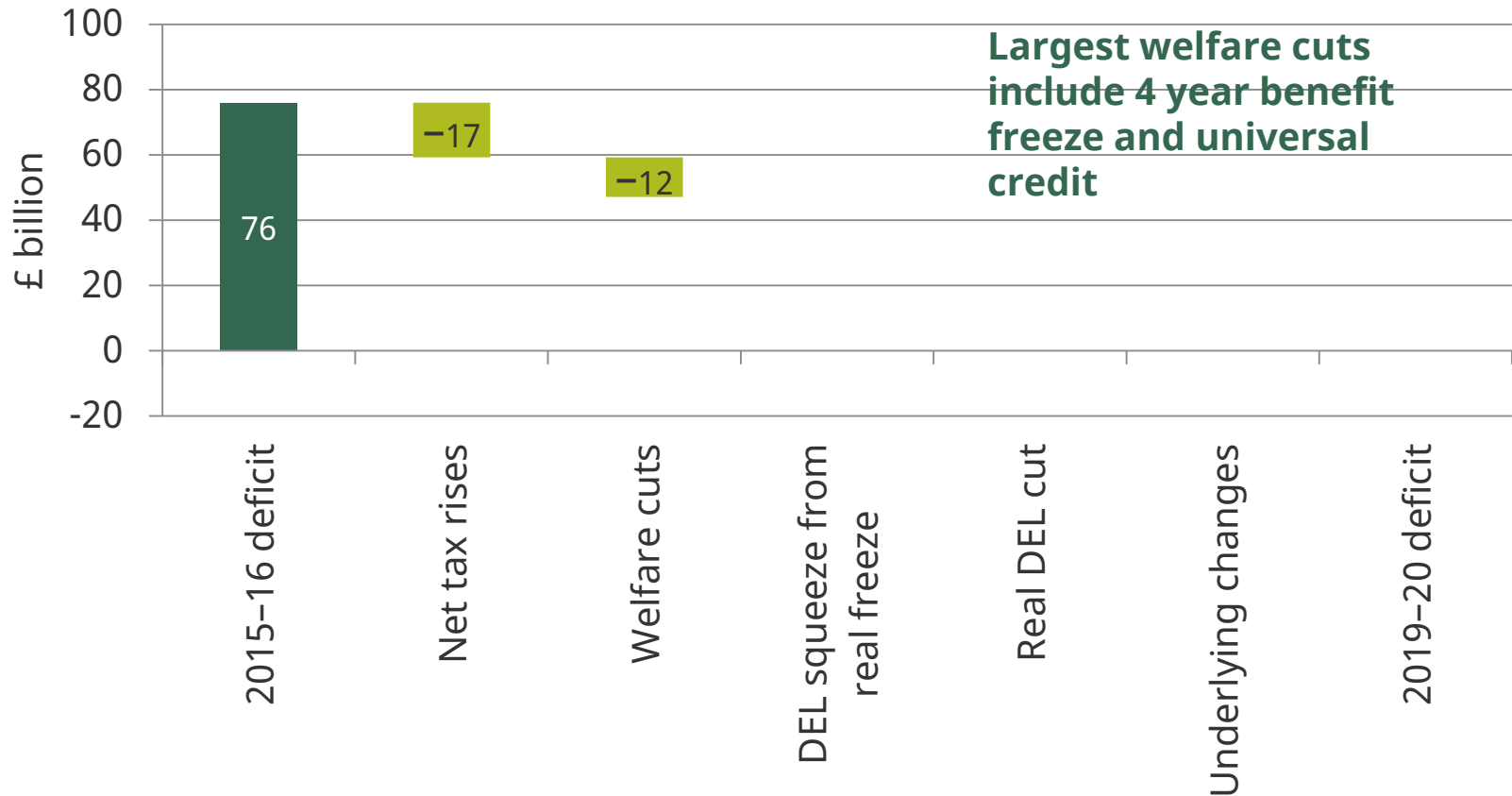
On current plans, further austerity required beyond 2021–22, more than a decade after consolidation began

The consolidation plan in detail



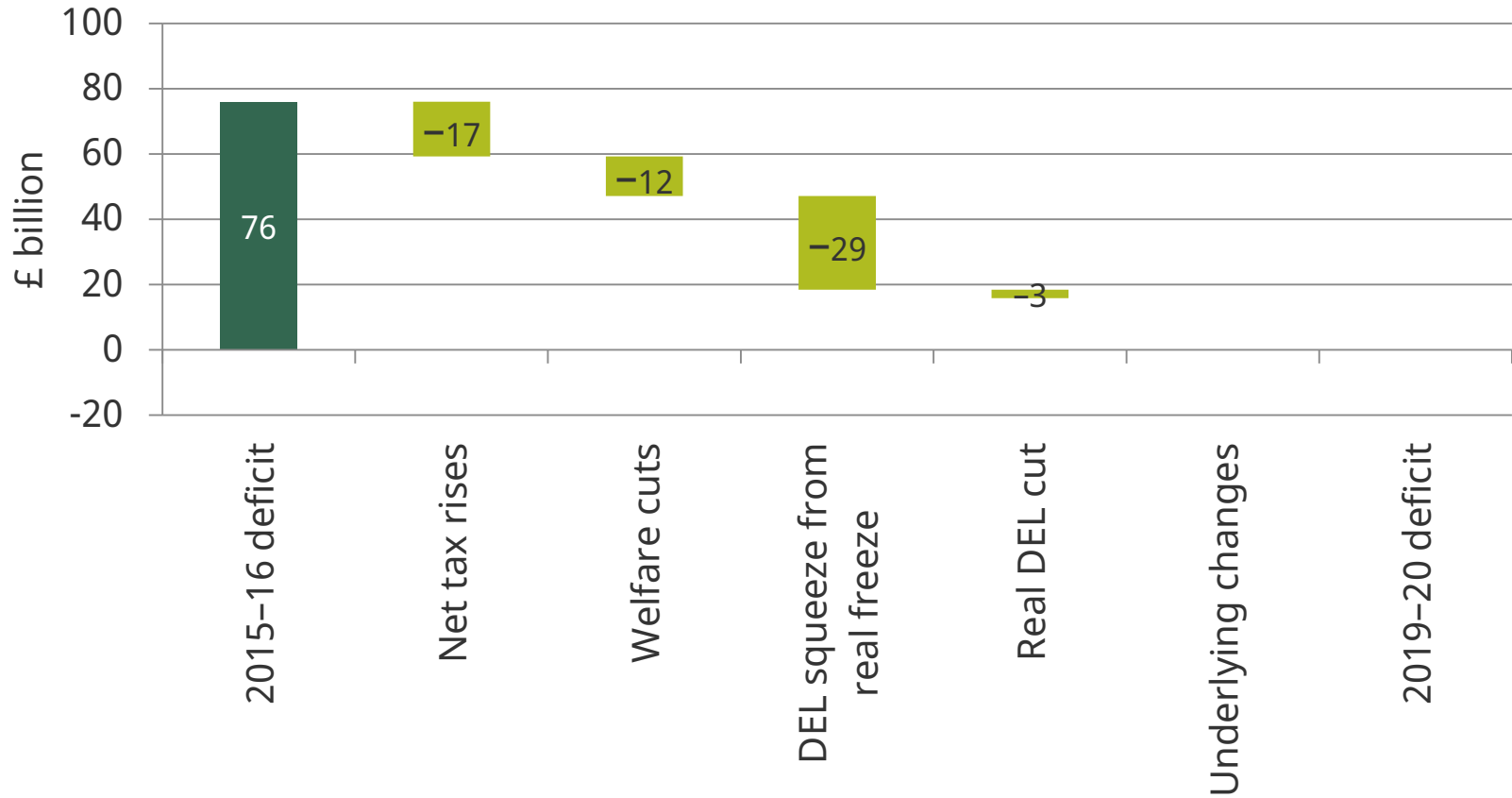
Source: Figure 3.5 of the Green Budget

The consolidation plan in detail



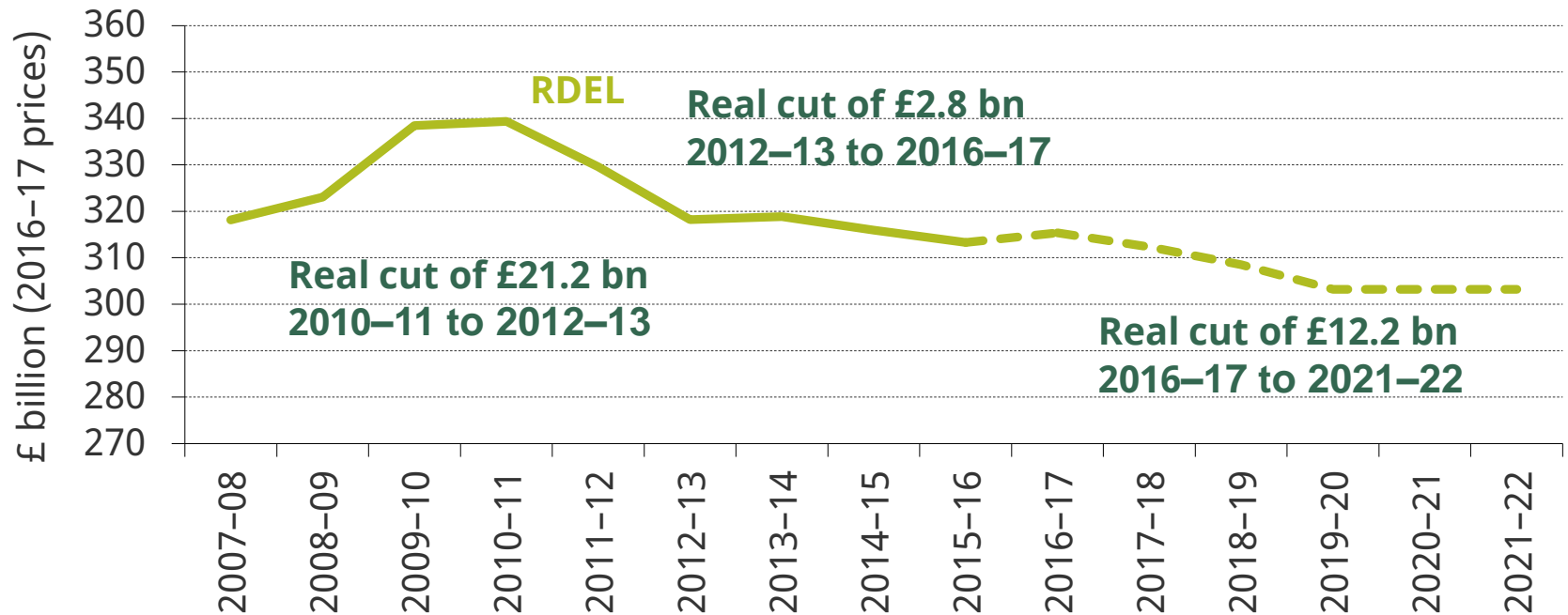
Source: Figure 3.5 of the Green Budget

The consolidation plan in detail



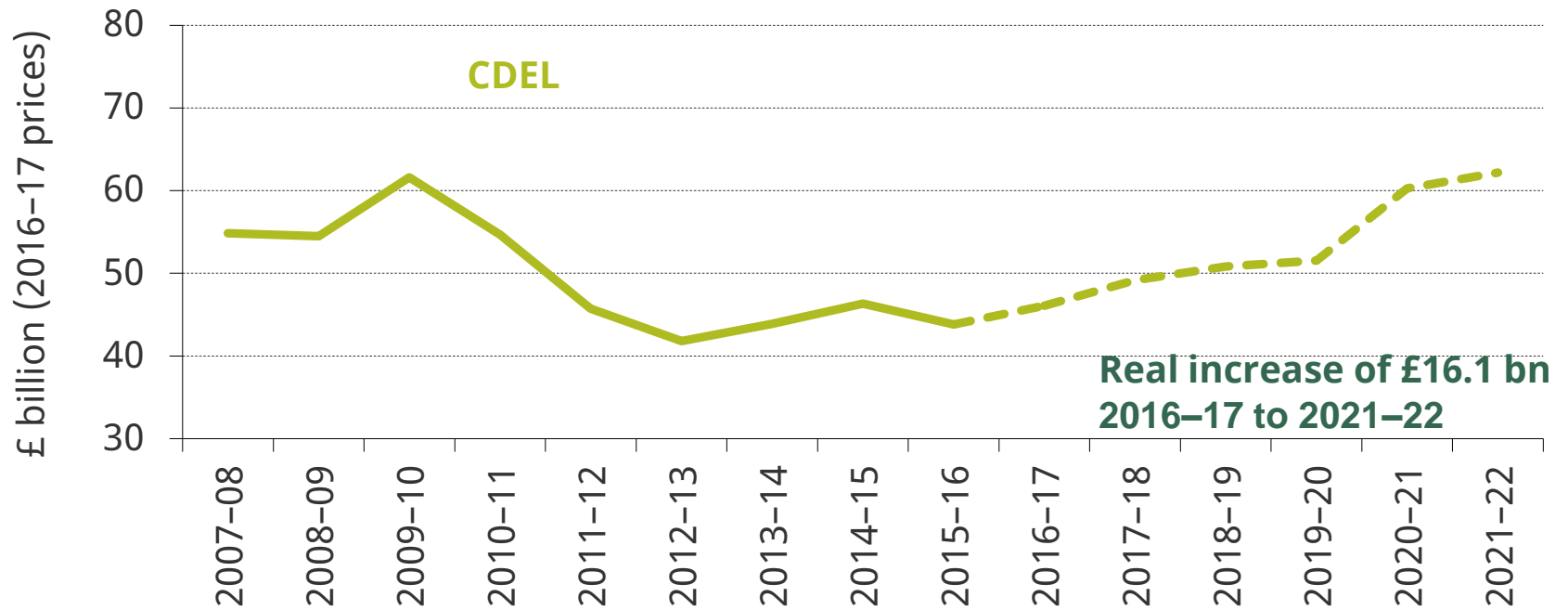
Source: Figure 3.5 of the Green Budget

Day-to-day spending set to face deep cuts



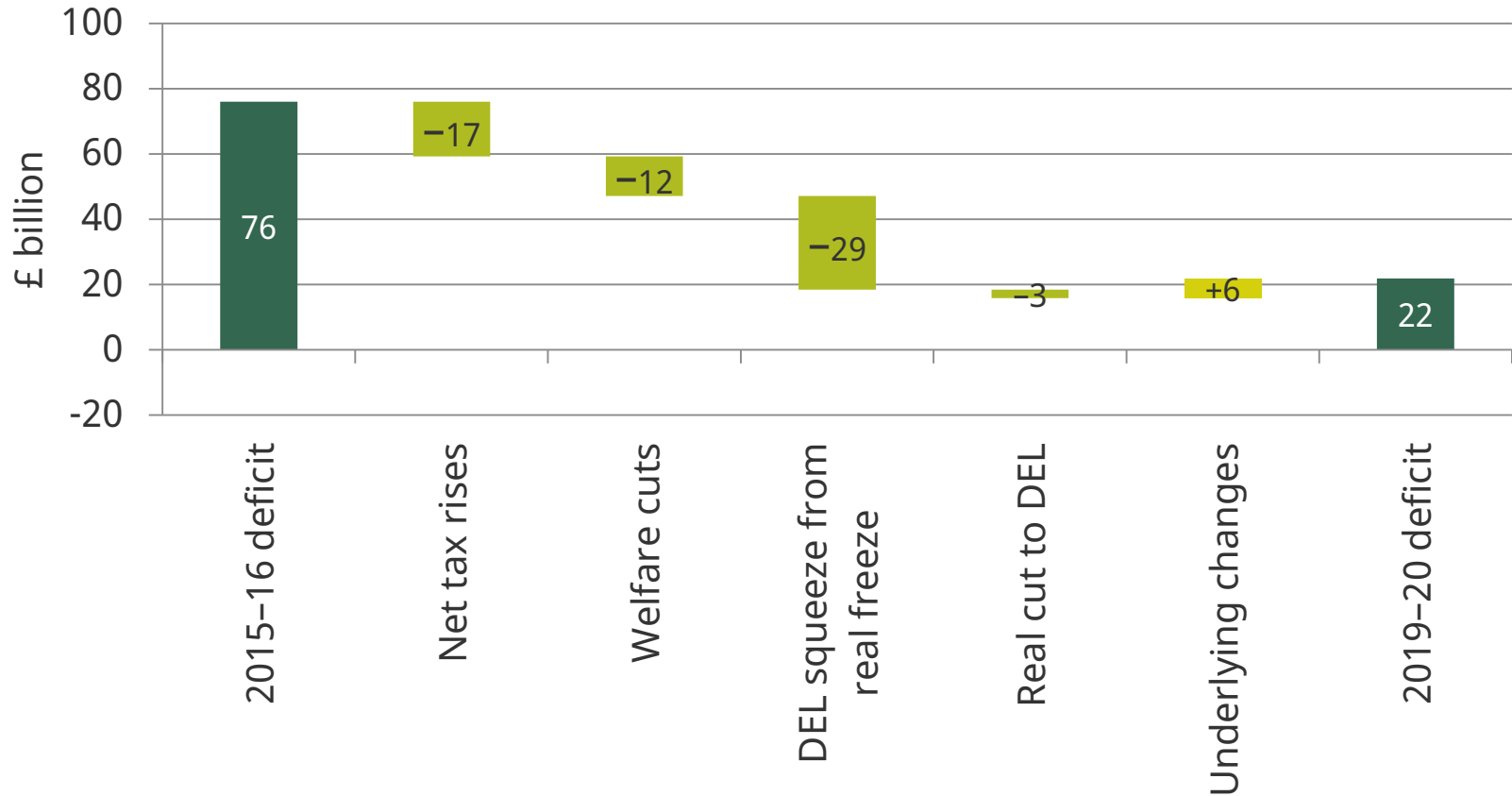
Source: Figure 3.9 of the Green Budget

But capital spending to grow



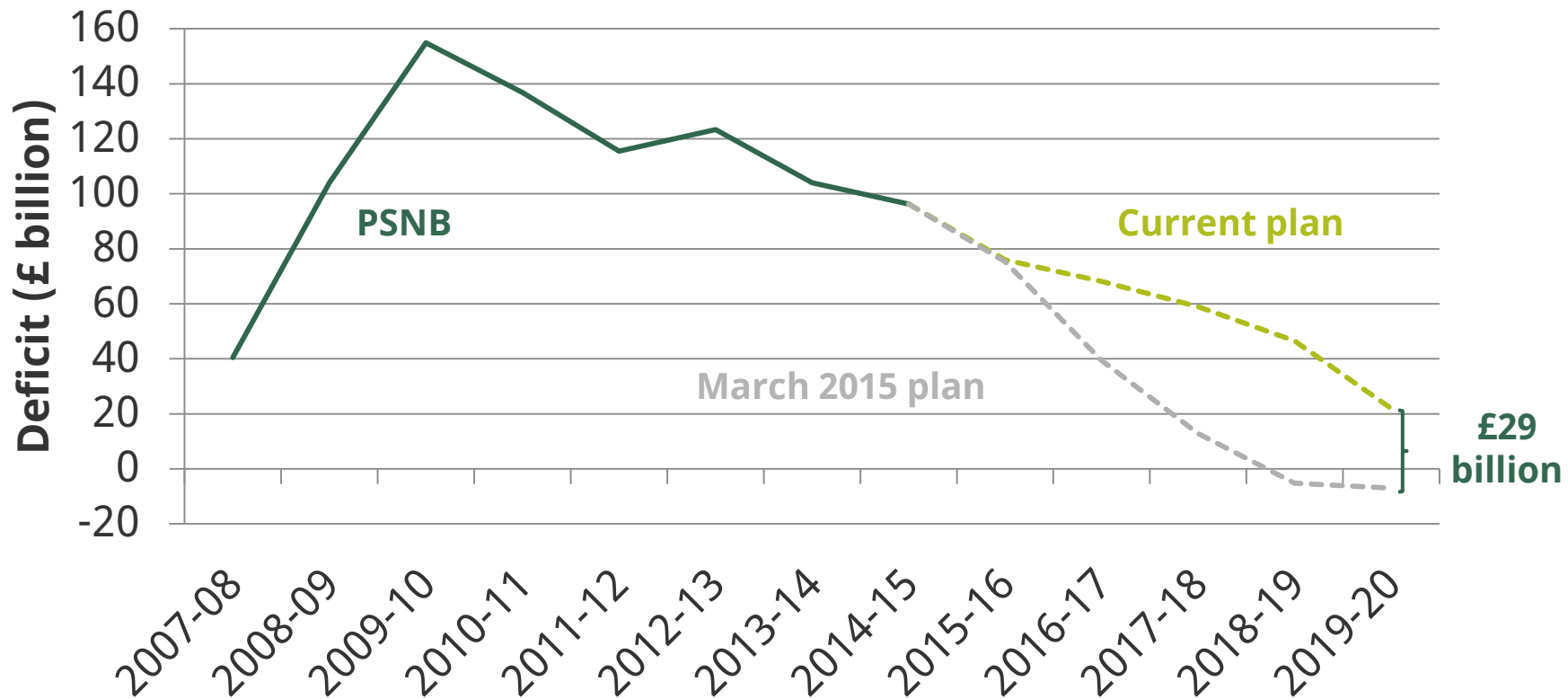
Source: Figure 3.10 of the Green Budget

The consolidation plan in detail

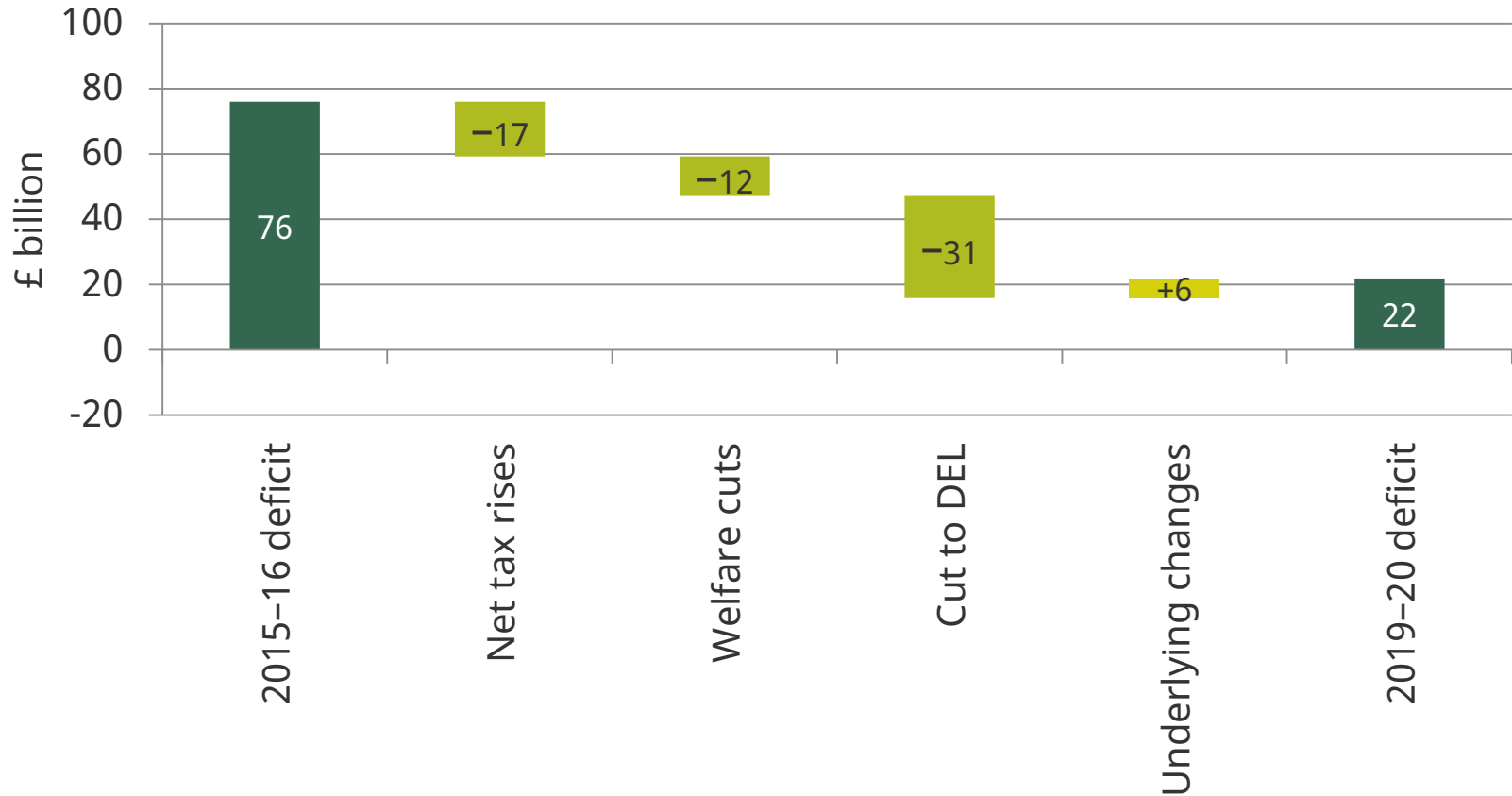


Source: Figure 3.5 of the Green Budget

Consolidation plans: now and pre-election

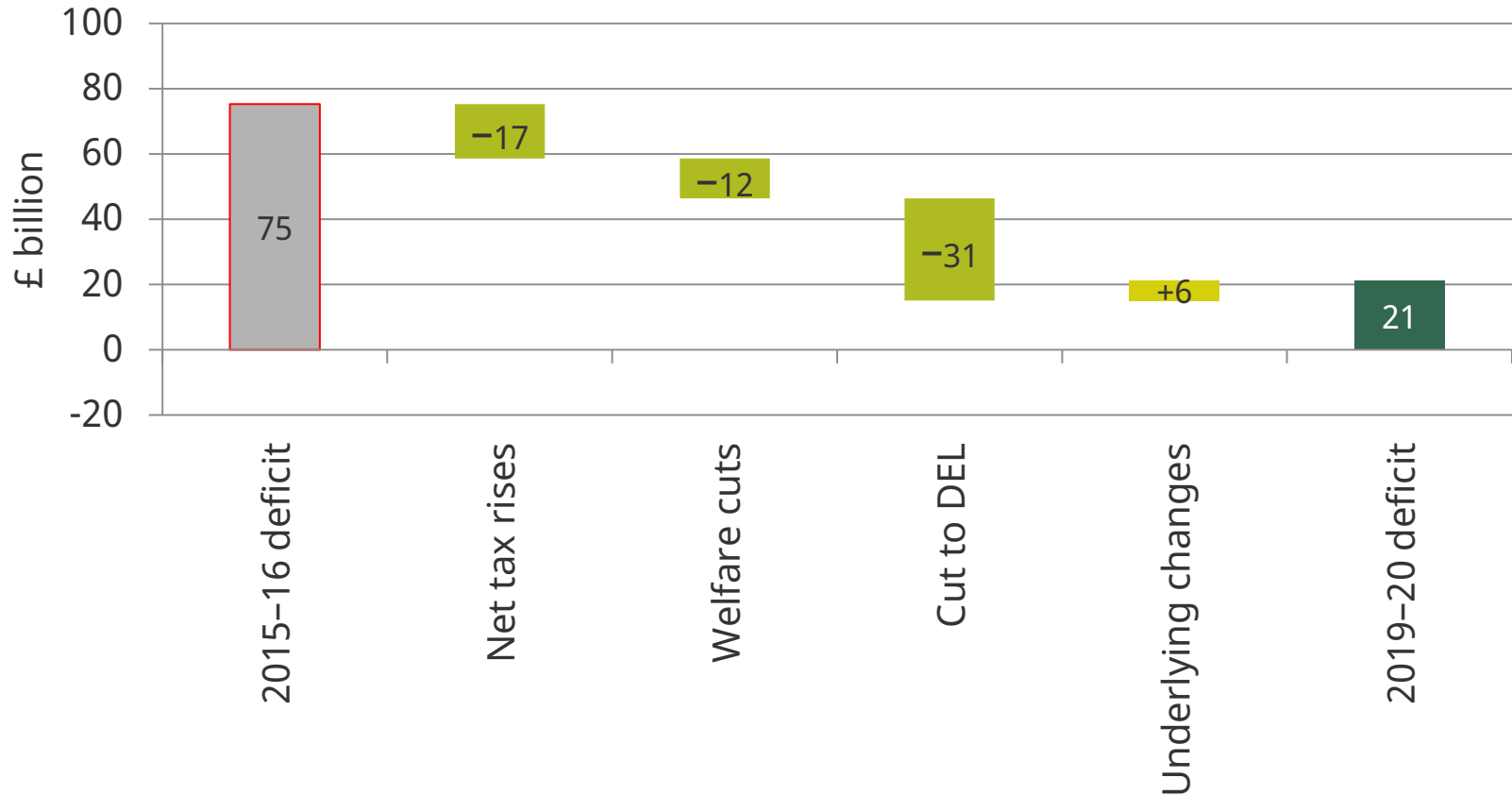


Consolidation plans: now and pre-election



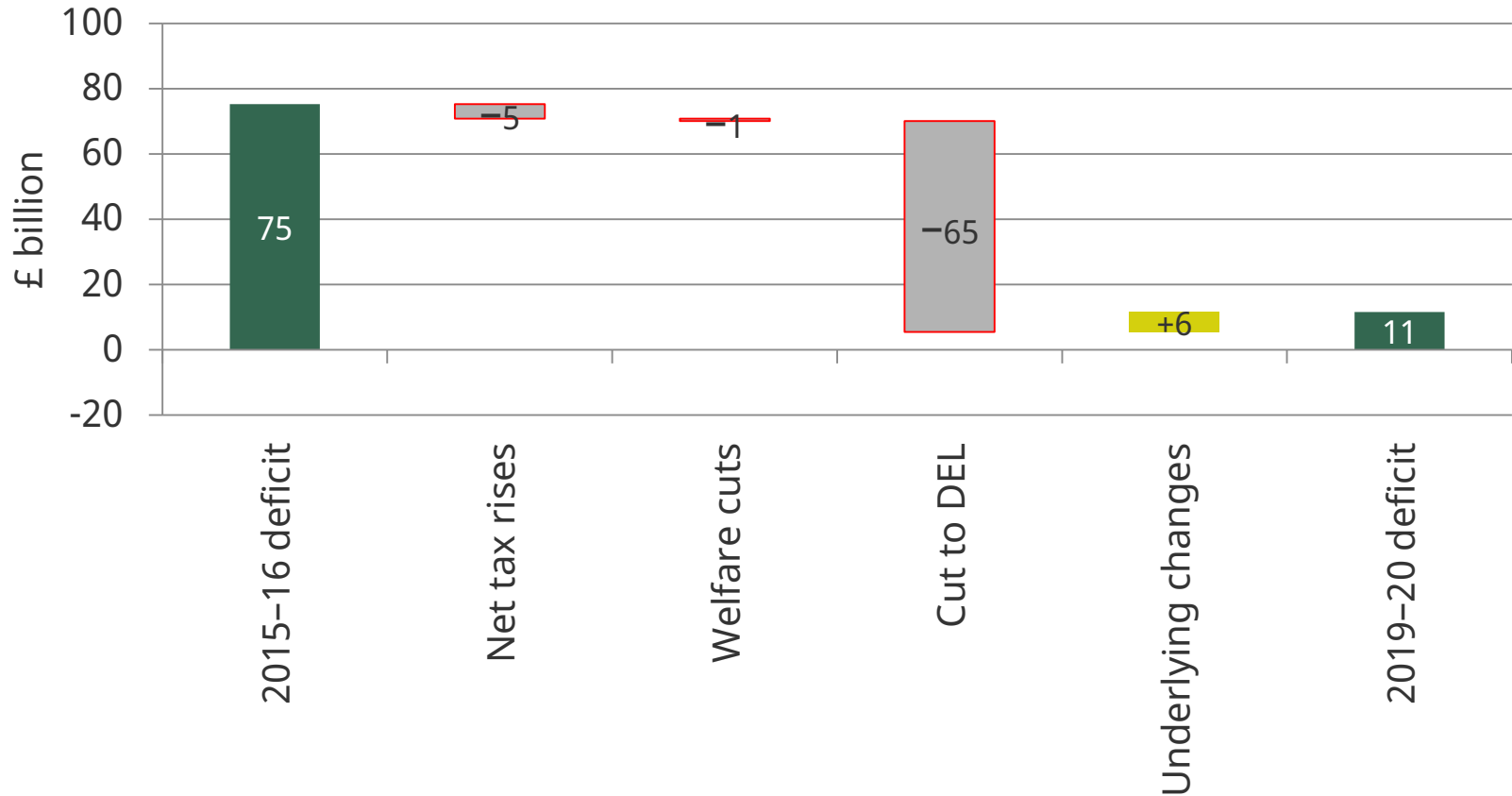
Source: Figure 3.5 of the Green Budget

Consolidation plans: now and pre-election



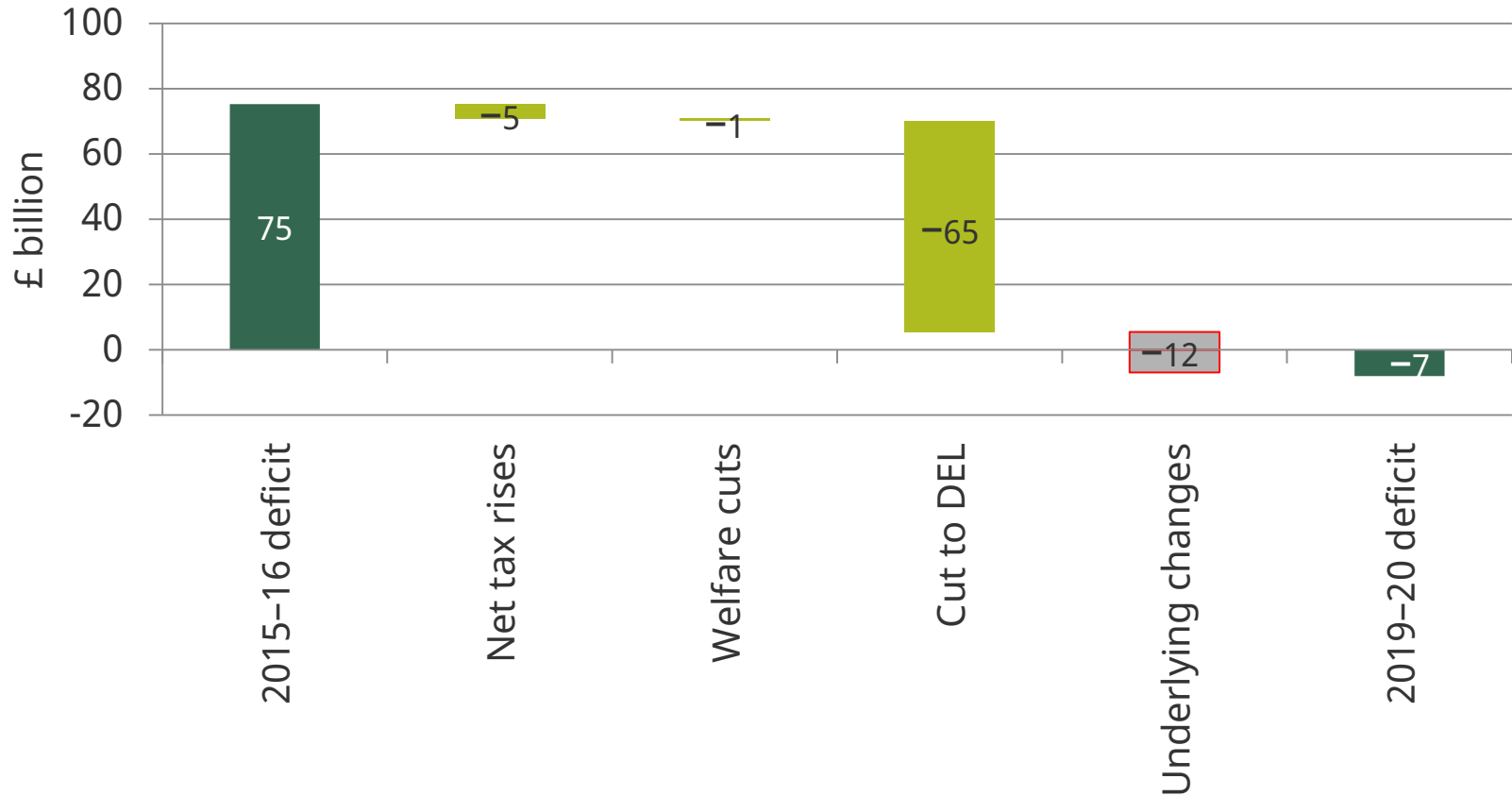
Source: Figure 3.5 of the Green Budget

Consolidation plans: now and pre-election



Source: Figure 3.5 of the Green Budget

Consolidation plans: now and pre-election



Source: Figure 3.5 of the Green Budget

Risks to the forecast: tax policy

Most of the tax rises planned for this parliament have already happened

But some promised tax cuts are not currently on the books

- Raising the personal allowance (to £12,500) and higher-rate threshold (to £50,000) by 2020–21 to cost £1¾ billion

And it's likely that fuel duties continue to be frozen in cash terms

- Freezing until 2020 would cost a further £2½ billion

So these policies combined would reduce receipts by £4¼ billion (in 2016–17 terms)

Risks to the forecast: spending policy

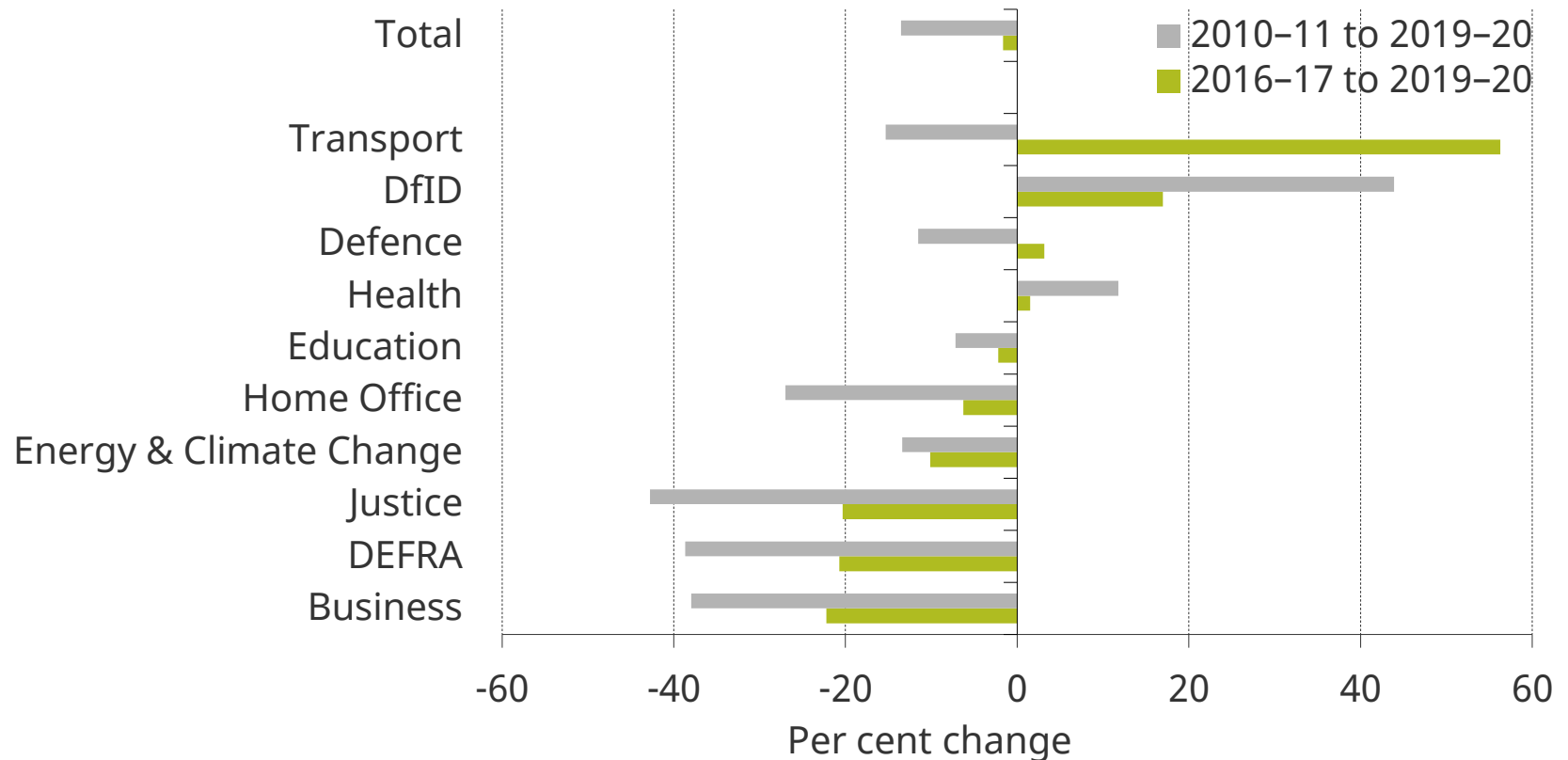
Our (net) EU contribution is a positive risk for the spending forecast

- Currently assuming the money is all spent elsewhere
- But could cover EU spending in UK and still bank around £8 billion

But there are still spending cuts to deliver

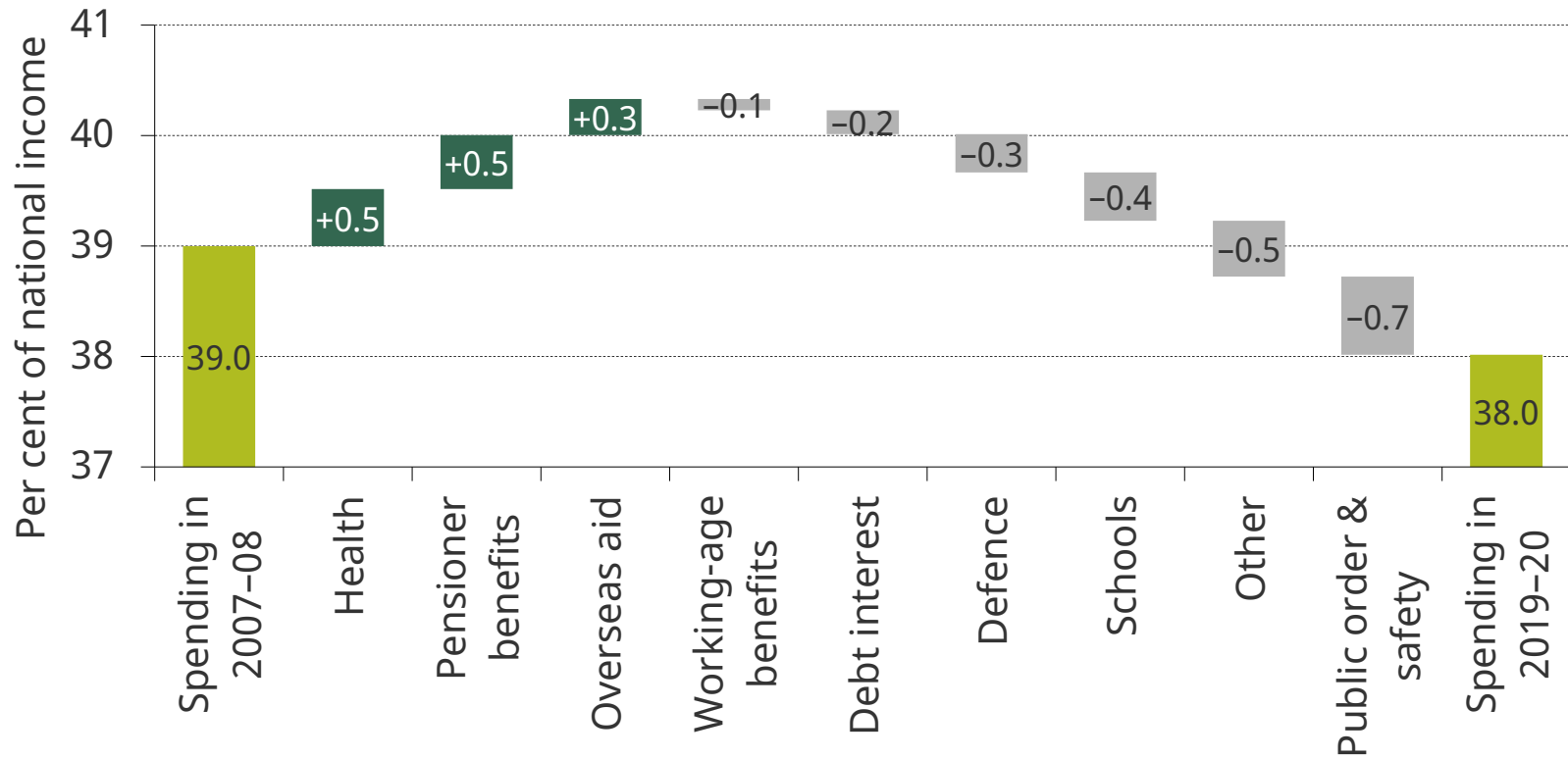
Departmental spending plans: 2010–11 to 2019–20

2019–20



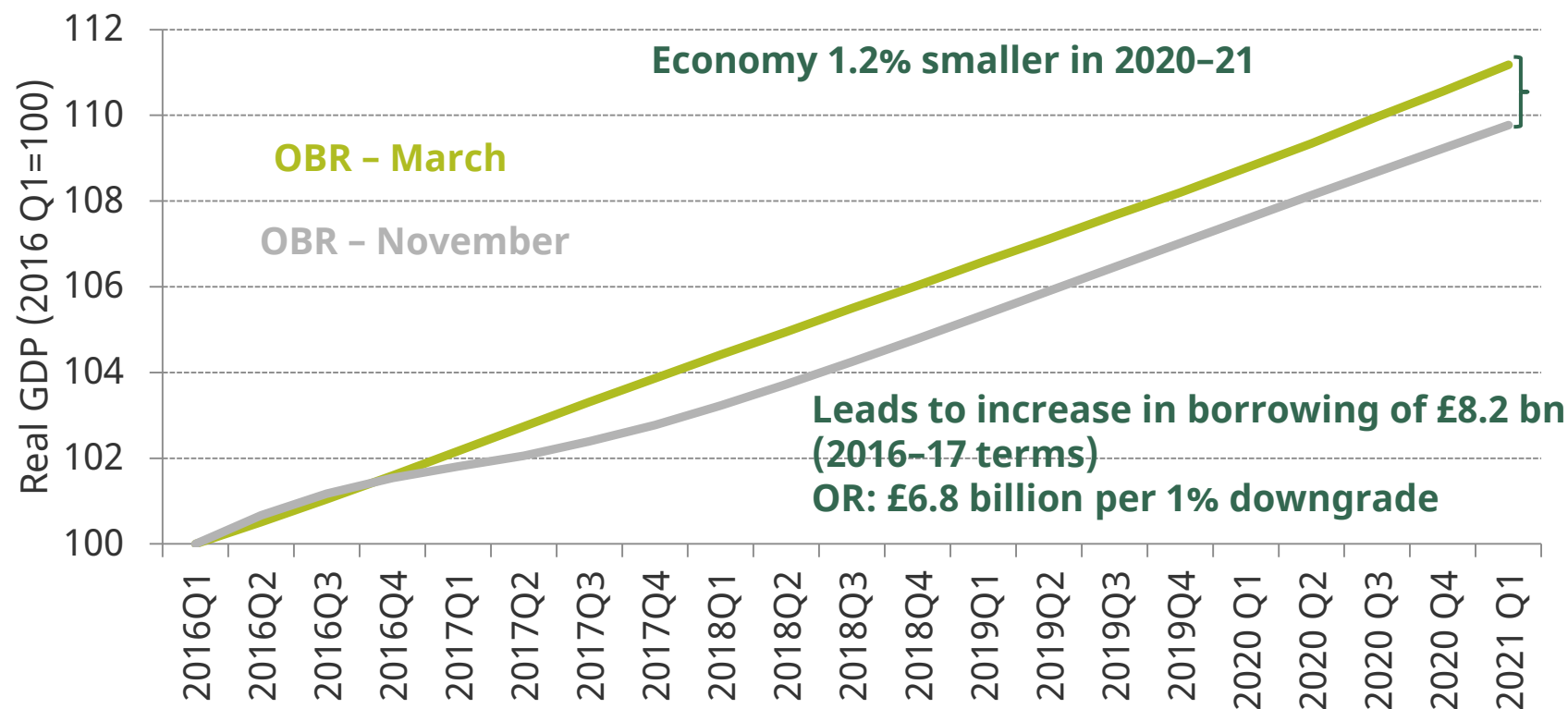
Source: Figure 3.11 of the Green Budget

The changing make-up of the state



Source: Figure 3.14 of the Green Budget

Economic growth uncertain: downgraded since March



Source: Figure 3.15 of the Green Budget

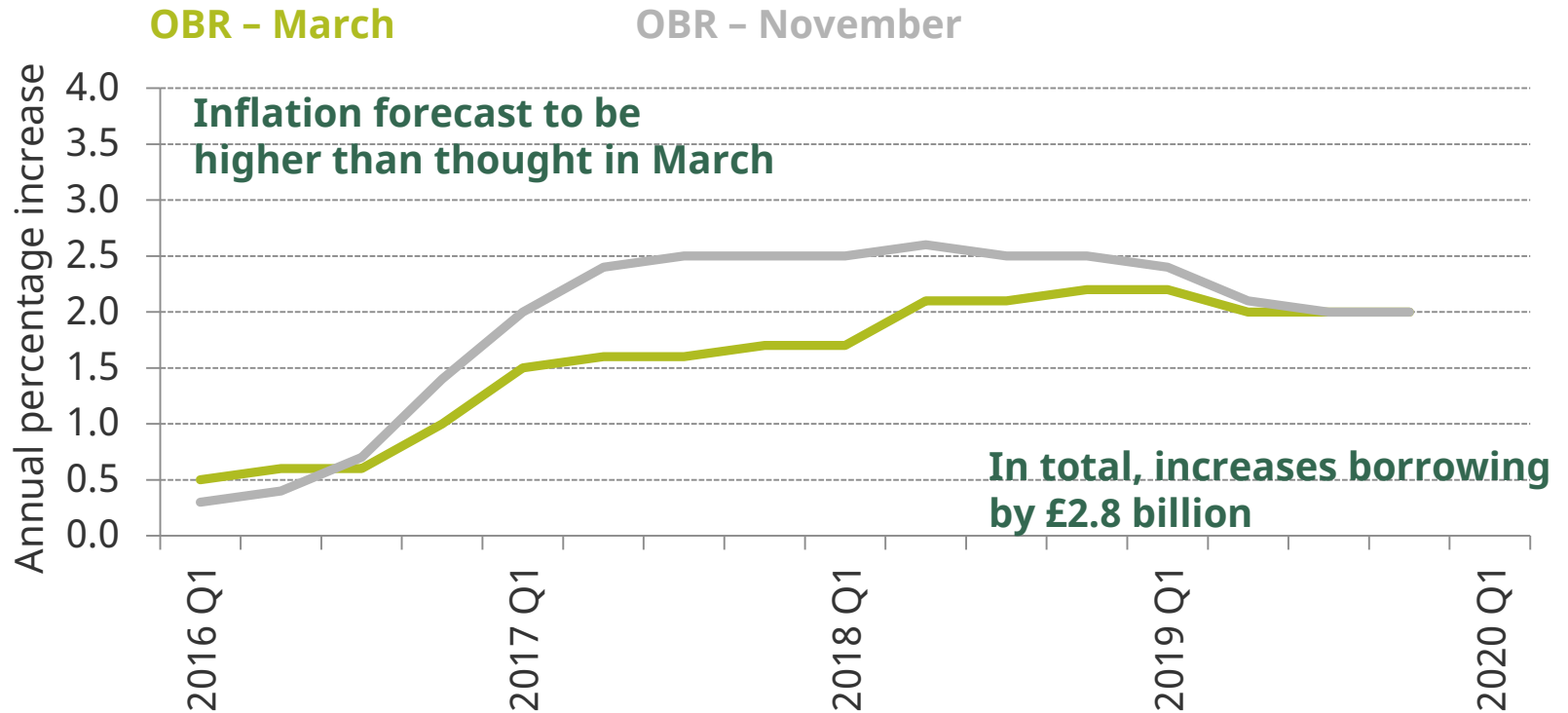
Effect of smaller economy on borrowing

In November forecast, 1% smaller economy increases borrowing by £6.8 billion (0.35% of national income)

The true effect might be worse in the long-run

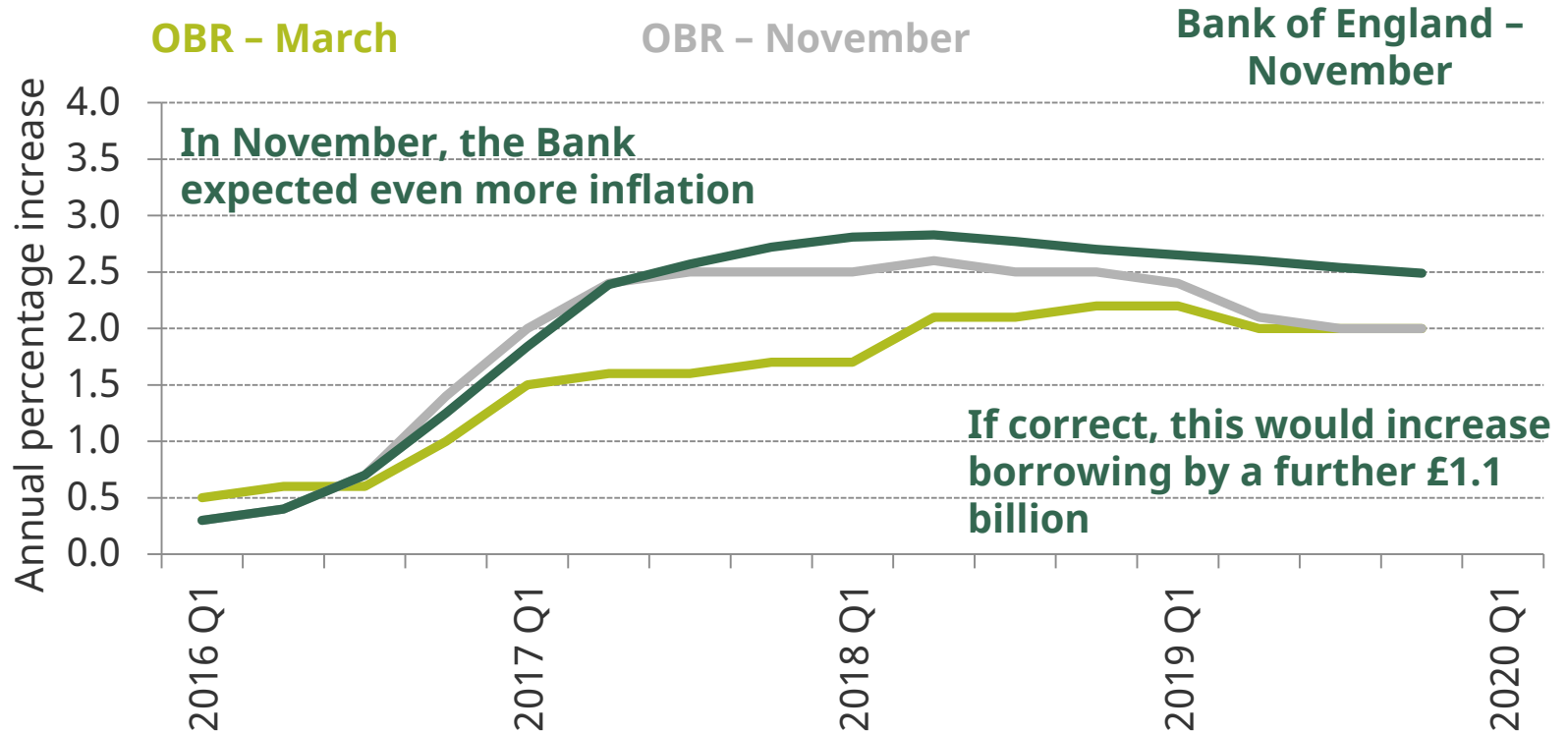
- OBR expects 1% downgrade to economy to increase borrowing by 0.5% national income
- Would add extra £3½ billion to borrowing

Forecasts for household inflation: CPI



Source: Figure 3.16 of the Green Budget

Forecasts for household inflation: CPI



Source: Figure 3.16 of the Green Budget

Interest rate risk

Since 2007–08, debt has doubled (as % national income) but debt interest has fallen

Due to a combination of low interest rates and QE

If gilt rates rise, or the bank rate rises, faster than forecast, debt interest spending will increase

1 ppt rise in bank rate equals £4.4 bn extra debt interest spending

1 ppt rise in gilt rates leads to £5.2 bn extra by 2021

The longer-term challenge

The main objective of fiscal policy requires elimination of the deficit by 2024–25 at the latest

But this is not likely to be easy

- The OBR expects growth to remain sluggish until 2025
- And there are significant upward spending pressures
 - The effects of ageing (and other pressures) projected to increase spending in 2025 by 1.0% of national income

The longer-term challenge

The OBR forecasts a deficit of £14¼ billion (2016–17 terms) in 2021–22

And there is set to be spending pressures equalling 1% of national income (£19½ billion in today's terms)

So we may need a consolidation of around £34 billion in the next parliament

Summary

More deficit reduction planned over this parliament

- Large cuts to day-to-day spending after three years of little change
- Forecast to reach a deficit of £22 billion in 2019–20

Even this may not be achieved

- Some promised tax cuts not currently on the books
- The main risk concerns the path of the economy

No further consolidation on the books beyond 2019–20

Eliminating the deficit in the next parliament will not be easy

- Consolidation worth £34 billion may be required