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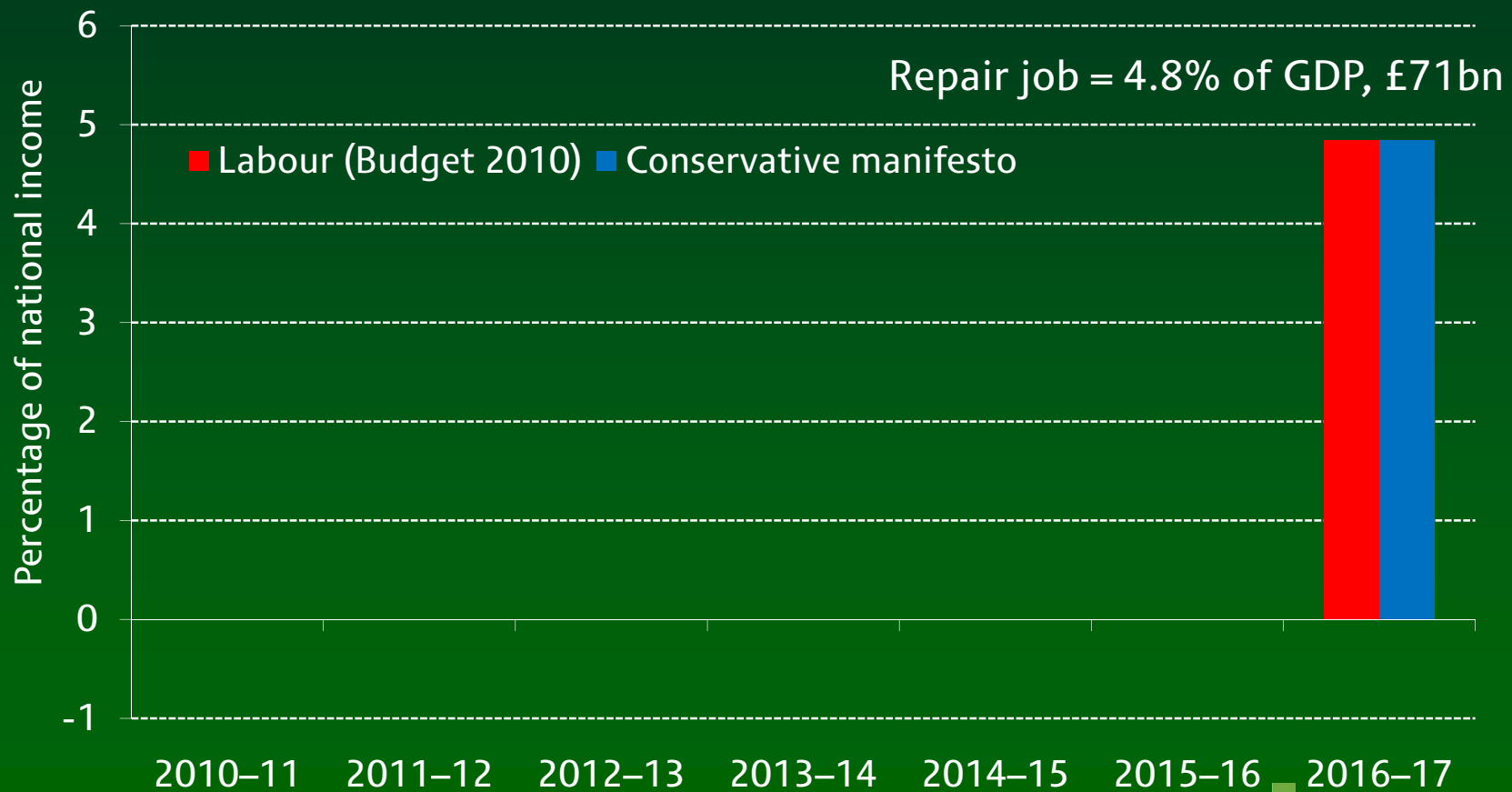
## UK public finances: fiscal repair needed

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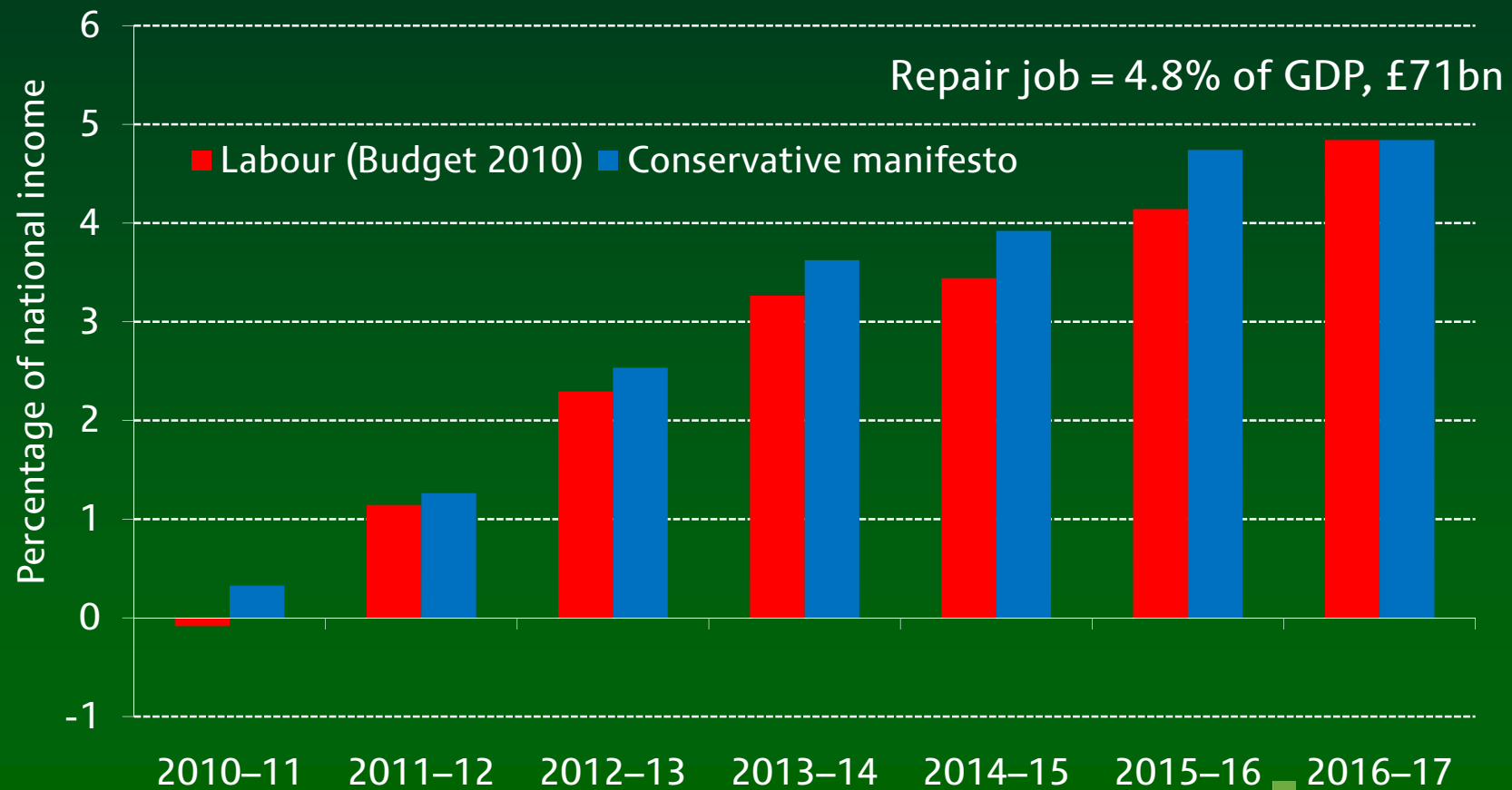
Carl Emmerson

Presentation at Institute for Government, May 17<sup>th</sup> 2010

# Size and timing of the fiscal tightening (1/2)

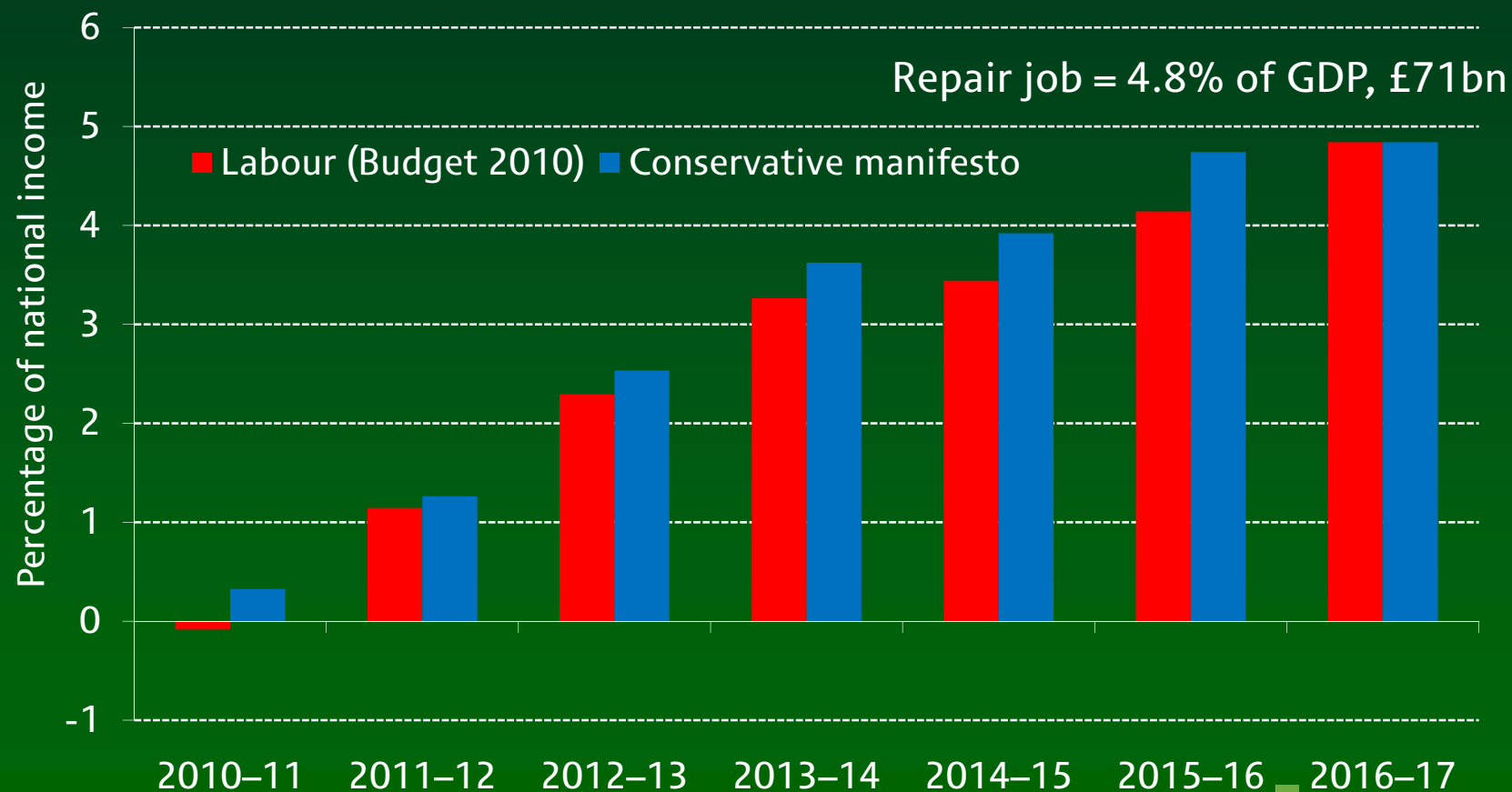


## Size and timing of the fiscal tightening (1/2)



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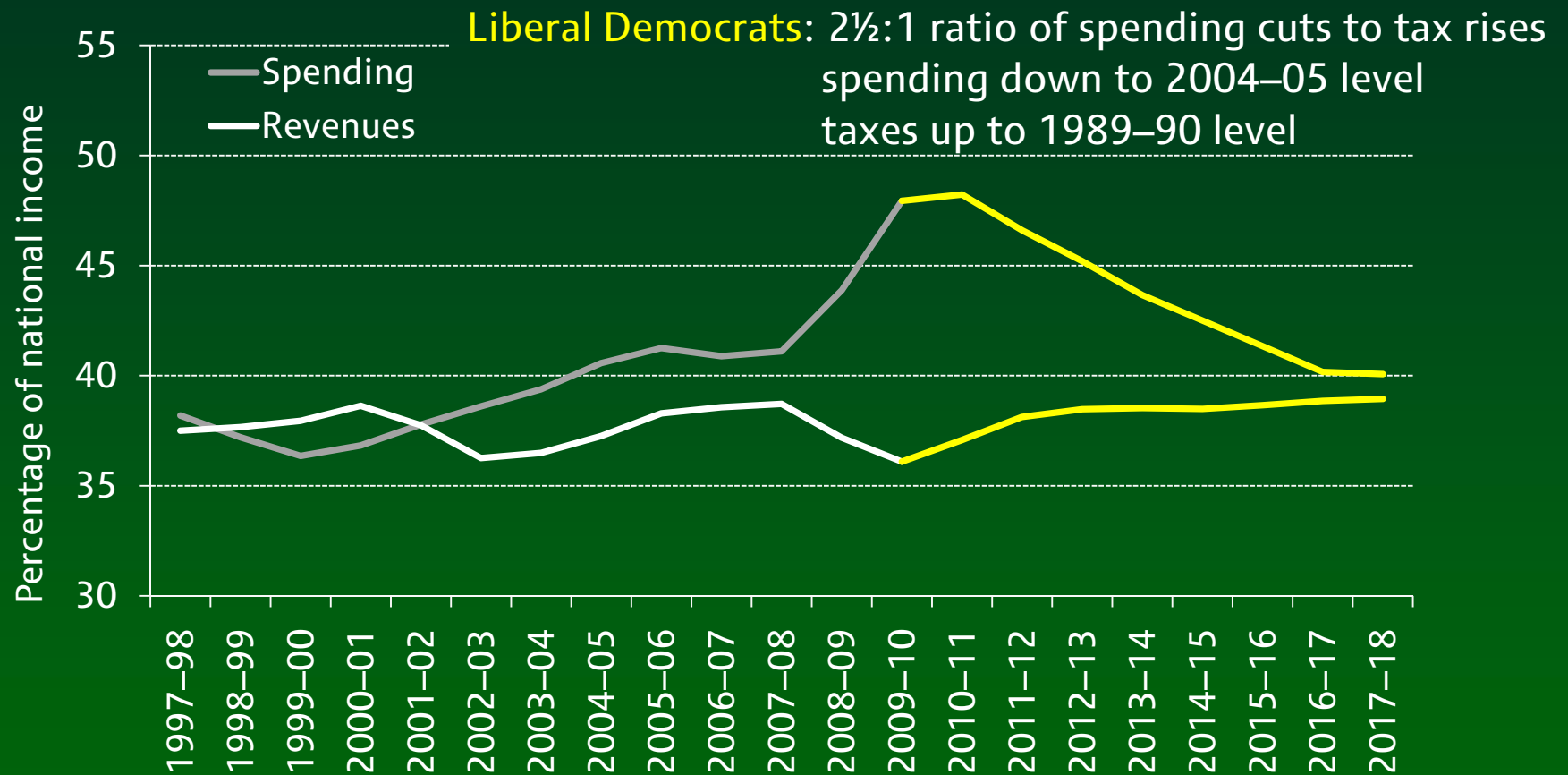
“a significantly accelerated reduction in the structural deficit over the course of a Parliament”?



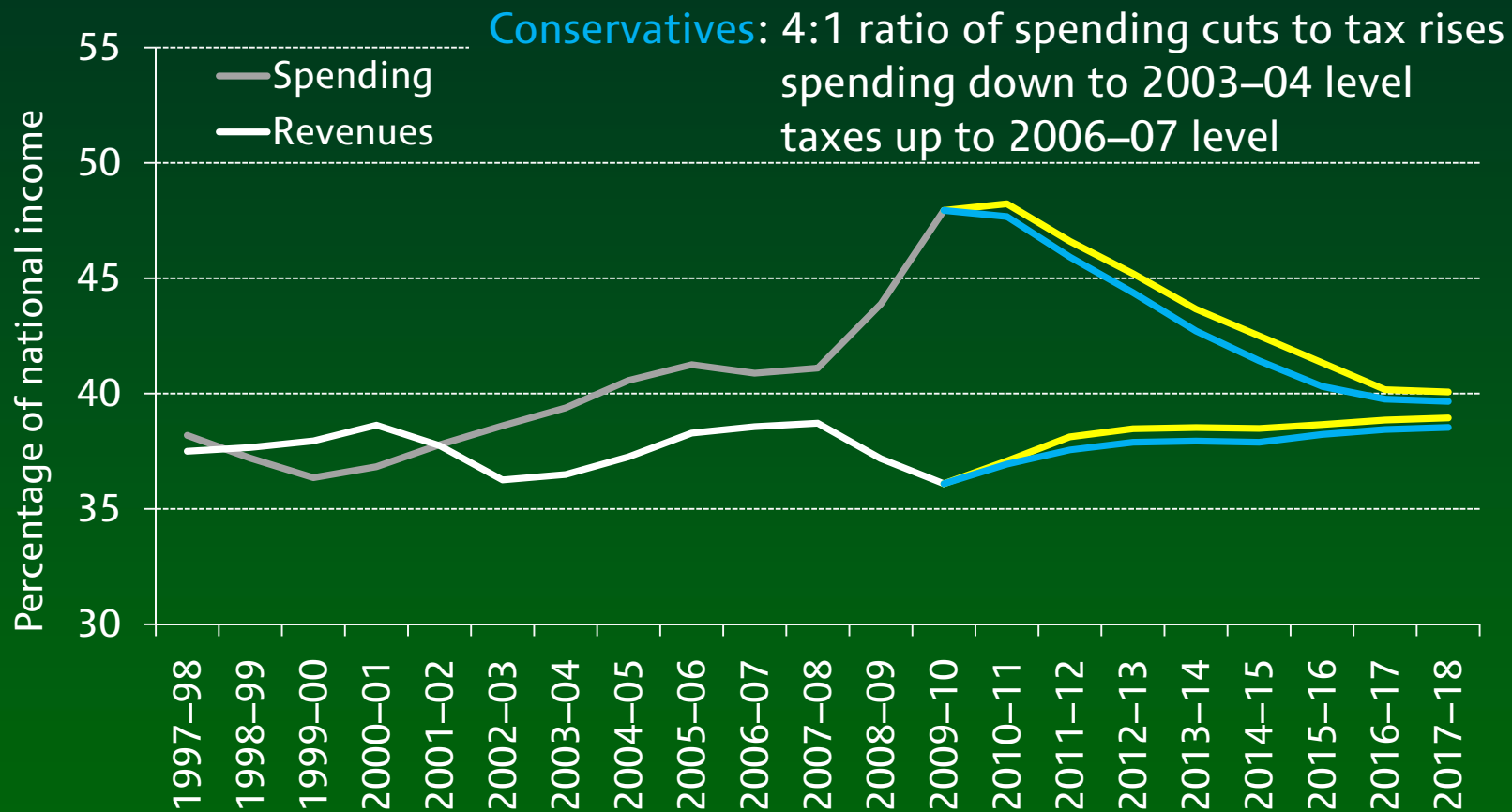
## Size and timing of the fiscal tightening (2/2)

- Key Budget input will be the estimated size of the fiscal hole
  - role of the Office for Budget Responsibility key
  - forecasts should be central (not cautious), based on as transparent set of assumptions as possible and acknowledge key risks
  - explicit margin of error should be built into the policy target

# Composition of the cure (1/3)



## Composition of the cure (2/3)

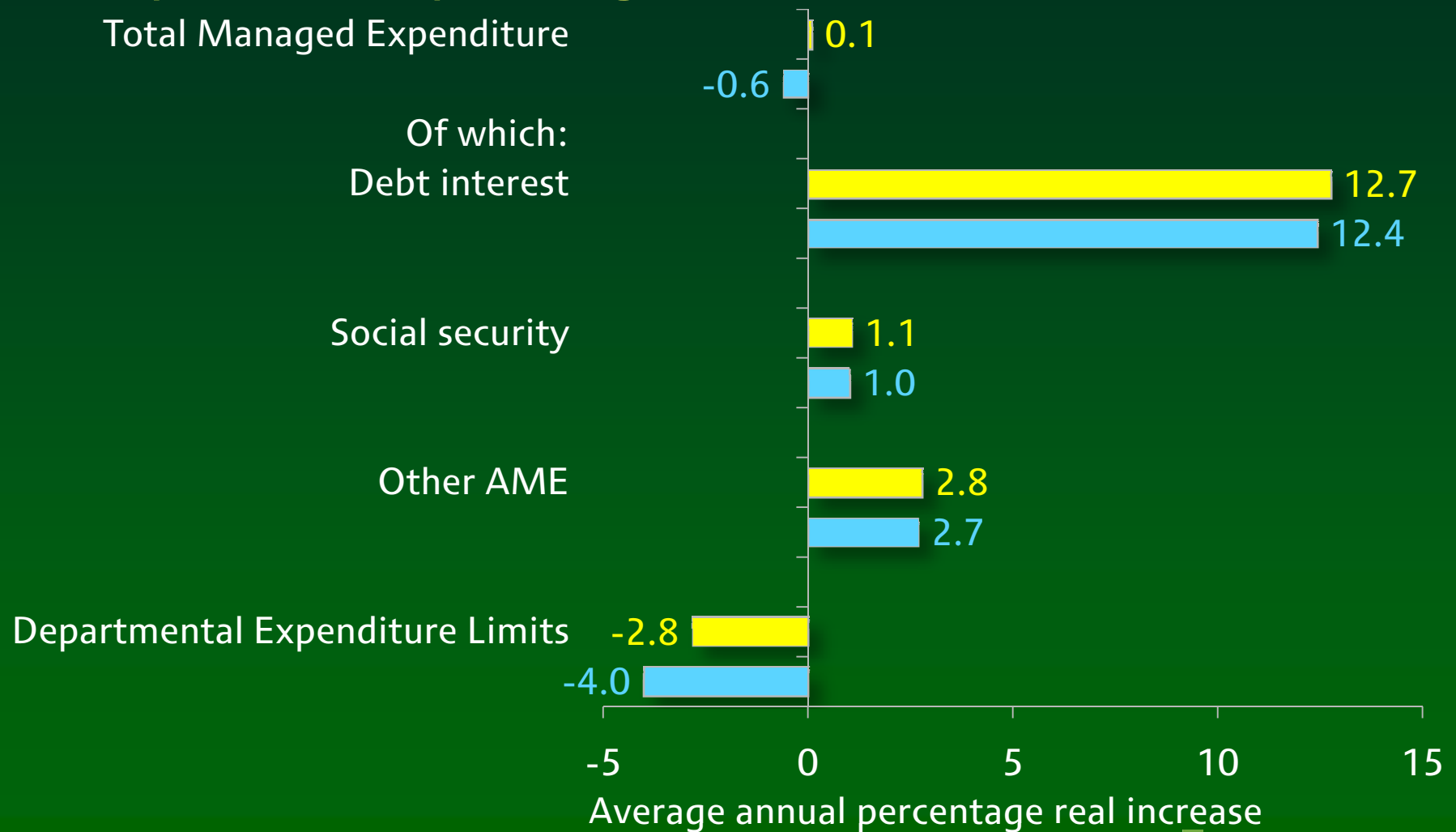


## Composition of the cure (3/3)

- Coalition agreement states: “the main burden of deficit reduction borne by reduced spending rather than increased taxes”
  - consistent with both parties manifesto commitments
  - but also leaves open the possibility of greater reliance on tax rises
- Key Budget judgement is over mix of tax rises and spending cuts
  - should cure be closer to what was prescribed in the Liberal Democrat manifesto or that prescribed in the Conservative manifesto?
  - judgement might depend on the size of the hole identified by the OBR
- A large increase in tax would likely involve an increase in income tax, national insurance or VAT
  - for example roughly 1% of national income would be raised through an increase in the main rate of VAT to 21% (£15.75 billion)



## Scope of the Spending Review? (1/3)



Note: Increases are expressed relative to Labour's planned 2010–11 spending levels

Source: Figure 6.1 and Tables 6.1, 6.2 and 6.3 of <http://www.ifs.org.uk/publications/4848>

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## Scope of the Spending Review? (2/3)

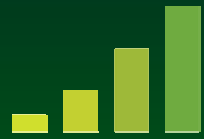
- Manifesto plans imply deep cut to spending on public services
  - **Liberal Democrats**: April 2011 to March 2015 set to be tightest four-year period since April 1976 to March 1980
  - **Conservatives**: April 2010 to March 2015 set to be tightest five-year period since (at least) World War II
- Coalition agreement commits Government to:
  - £3.8 billion increase in overseas aid spending
  - year-on-year real increases in NHS spending
  - state pension to rise by greater of 2.5%, prices and earnings from April 2011 instead of earnings from April 2012 (cost £300 million p.a.)
- Without significant cuts to welfare spending cuts to non-ODA non-NHS Whitehall departments would be very deep
  - average 25% by 2014–15 under 4:1 split of spending cuts to tax rises (total cut £63 billion)

## Scope of the Spending Review? (3/3)

- Forthcoming Budget should
  - set out detailed forecast for all components of AME spending
  - indicate which are up for review in forthcoming Spending Review
  - could include parts of social security budget as cuts here might be sensible to lighten load on public services
- Return to “new control total” sensible
  - plan non-cyclical social security spending over the same horizon as departmental spending
  - help demonstrate a co-ordinated long-term strategy for support provided through public services and welfare benefits
- Advantages to extending Spending Review to five years
  - demonstrate intent to long-term government and increase credibility of deficit reduction
  - review at half way stage?

# Summary

- Key Budget input will be estimated size of the fiscal hole
  - role of OBR key
  - should use central assumptions and have explicit margin of error
- Key Budget judgement is over mix of tax rises and spending cuts
  - should cure be closer to what was prescribed in the Liberal Democrat manifesto or that prescribed in the Conservative manifesto?
  - judgement might depend on the size of the hole identified by the OBR
- Scope of Spending Review should be broadened
  - include parts of social security budget as cuts here might be sensible to lighten load on public services
  - extension to five years, review at half way stage?



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