IFS Green Budget 2019
Public finances: which way forward?

Isabel Stockton
Total expenditure is at its lowest level since 2006-07

Notes and sources: see Green Budget 2019, Figure 4.1

Options for the Public Finances
Current receipts have slowly increased

Notes and sources: see Green Budget 2019, Figure 4.1
First current budget surplus in seventeen years

Notes and sources: see Green Budget 2019, Figure 4.1
Public sector net borrowing and net debt

Notes and sources: Figures 4.2 and 4.B1, Green Budget 2019

Options for the Public Finances
Public sector net borrowing and net debt

Notes and sources: Figures 4.2 and 4.B1, Green Budget 2019
Public sector net borrowing and net debt

Per cent of national income

-3 0 3 6 9 12 15


Deficit (left axis)  Net debt (right axis)

Notes and sources: Figures 4.2 and 4.B1, Green Budget 2019
The fiscal mandate: out of reach, out of date?

Current fiscal targets

• Balanced budget by the mid-2020s
• Fiscal mandate: cyclically adjusted deficit below 2% of national income in 2020-21
• Additional targets on debt and welfare spending
Changes since the March forecast: Borrowing in 2020-21

Notes and sources: Figure 5.1, Green Budget 2019
Changes since the March forecast: Borrowing in 2020-21

Fiscal mandate (£46bn)

Per cent of national income

March forecast: £21bn
Cyclically adjusted: £19bn

Notes and sources: Figure 5.1, Green Budget 2019
Changes since the March forecast: Borrowing in 2020-21

Notes and sources: Figure 5.1, Green Budget 2019

Options for the Public Finances
Changes since the March forecast: Borrowing in 2020-21

Notes and sources: Figure 5.1, Green Budget 2019
Changes since the March forecast: Borrowing in 2020-21

Fiscal mandate (£46bn)

£27bn

£21bn

£19bn

+£14bn

+£13bn

Notes and sources: Figure 5.1, Green Budget 2019
Changes since the March forecast: Borrowing in 2020-21

Fiscal mandate (£46bn)

- March forecast: £21bn
- Cyclically adjusted: £19bn
- Student loan accounting: +£14bn
- Spending Round: +£13bn
- Corporation Tax and Pensions: +£4bn

Notes and sources: Figure 5.1, Green Budget 2019
Changes since the March forecast: Borrowing in 2020-21

Fiscal mandate (£46bn)

- March forecast: £21bn
- Cyclically adjusted: £19bn
- Student loan accounting: +£14bn
- Spending Round: +£13bn
- Corporation Tax and Pensions: +£4bn
- Adjusted forecast: £50bn

Notes and sources: Figure 5.1, Green Budget 2019

Options for the Public Finances
Changes since the March forecast: Borrowing in 2020-21

Notes and sources: Figure 5.1, Green Budget 2019
Adjusting the baseline borrowing forecast

Forecast headline borrowing, accounting for

• weaker near-term growth as forecast by Bank of England
• temporary boost to growth from Spending Round giveaway
• direct fiscal saving from EU transfers banked
• departmental spending growth beyond 2020–21 sufficient to cover NHS and schools pledges

No adjustment for strong growth in borrowing since March
• spending growth might not persist

Do not allow for any net tax cuts
Borrowing under different Brexit scenarios

Smooth and orderly Brexit (based on OBR)

Per cent of national income

Average GDP growth: 1.3%

£55bn
£52bn
£43bn
£46bn
£49bn

Notes and sources: see Tables 4.2 and 5.1, Green Budget 2019

Options for the Public Finances
Borrowing under different Brexit scenarios

Benign no-deal scenario (based on IMF/OBR)

Average GDP growth: -0.3%

£49bn

£44bn

£68bn

£92bn

£85bn

£71bn

Per cent of national income

2019–20

2020–21

2021–22

2022–23

2023–24

Notes and sources: see Tables 4.2 and 5.1, Green Budget 2019
Time for new fiscal targets?

All current targets expire within forecast period

- Budget: opportunity to set out new fiscal rules or targets
- Why fiscal targets?
  - self-commitment
  - strengthen Treasury’s position in 2020 Spending Review

Targets flexible enough for a no-deal Brexit are too loose for a smooth Brexit

- set new targets once Brexit uncertainty reduced
- in the meantime, limit permanent increases in net day-to-day spending and net tax cuts
Time for new fiscal targets?

Borrow to invest?
• future generations benefit from good investments made today
• public sector assets as well as liabilities: target public sector net worth instead of debt?
• concerns about transparent and credible measurement

Borrow during a temporary downturn?
• automatic stabilisers
• discretionary stimulus, especially when monetary policy ineffective
• key considerations: timely,
• targeted to regions/industries with greatest cost of lost output
• temporary, to restore fiscal sustainability in the longer term
Fiscal response to a no-deal Brexit

In the short to medium term
• case for a temporary stimulus package
• illustrative scenario:
  – 1% of national income
  – implemented in 2020-21, in place for two years

In the longer term
• trade barriers and lower net migration → a smaller economy
• higher taxes or lower spending needed
• IMF benign no-deal scenario would require long-run additional fiscal tightening of 1½ % of GDP or £33 billion (compared to smooth Brexit)
Borrowing under different Brexit scenarios

Benign no-deal scenario (based on OBR)

Average GDP growth: -0.3%

Notes and sources: see Tables 4.2 and 5.1, Green Budget 2019
Borrowing under different Brexit scenarios

Deficit in % of national income

Benign no-deal scenario (based on OBR) plus a stimulus package

Average GDP growth: +0.2%

Notes and sources: see Tables 4.2 and 5.1, Green Budget 2019

Options for the Public Finances
Debt under different Brexit scenarios

Debt could reach its highest level since the mid-1960s, with headline debt increasing further depending on BoE policy action.

- No deal with illustrative stimulus
- No deal without illustrative stimulus
- Smooth and orderly Brexit

Notes and sources: see Green Budget 2019, Figure 4B.1, Table 4.2 and Table 5.1

IFS Green Budget 2019
Long-run outlook for public sector net debt

Notes and Sources: Figure 4.6, Green Budget 2019

Options for the Public Finances
Public finances under pressure

Medium-term forecast under current plans and smooth Brexit
• borrowing at ~2% of national income for next five years

Long-run consequences of a no-deal Brexit
• IMF benign scenario adds ~1½% of national income to borrowing

Regardless of Brexit, the next recession might not be far away
• ‘typical’ recession adds around ~1¾% of national income for two years

Spending pressures on health, social care and pensions
• OBR: increase of ~2% of national income each decade

This is not the moment for substantial and permanent net tax cuts
Conclusions

Outlook for borrowing worsened dramatically since March, now on course to breach Government's fiscal mandate.

Benign no-deal Brexit scenario

• case for a short-term stimulus, but
• more austerity required in the long run

Fiscal policy adrift without any credible fiscal anchor

• major risks to long-term sustainability of public finances from health and social care, pensions and future economic growth