Challenges facing the public finances

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Challenges facing the public finances

Public sector spending and receipts since 2000–01

Source: Figure 3.2 of the Green Budget

Per cent of national income

Total managed expenditure

Current receipts

4th highest deficit among 28 advanced economies in 2015: £76 billion

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Public sector spending and receipts since 2000–01

Source: Figure 3.2 of the Green Budget

Almost twice the average from 1948 to 2008

Deficit of £68.2 billion (3.5% GDP) in 2016–17

Source: Figure 3.2 of the Green Budget
Public sector spending and receipts since 2000–01

Steady deficit reduction over next two years

Total managed expenditure

Current receipts

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

But hardly any deficit reduction beyond that

2021–22: Deficit of 0.7% of GDP

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

Per cent of national income

Source: Figure 3.3 of the Green Budget

Large increase over next couple of years, partly due to Bank of England Term Funding Scheme (TFS)
Public Sector Net Debt since 2000–01

- Large fall in PSND in 2020 due to TFS
- Deficit would have to be 4% of national income to miss the target

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

- Some large tax rises: eg apprenticeship levy and insurance premium tax

Source: Figure 3.5 of the Green Budget
The consolidation plan in detail

<table>
<thead>
<tr>
<th>2015-16 deficit</th>
<th>Net tax rises</th>
<th>Welfare cuts</th>
<th>DEL squeeze from real freeze</th>
<th>Real DEL cut</th>
<th>Underlying changes</th>
<th>2019-20 deficit</th>
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<td>£ billion</td>
<td>-17</td>
<td>-12</td>
<td></td>
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</tbody>
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Largest welfare cuts include 4 year benefit freeze and universal credit

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

Challenges facing the public finances

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Consolidation plans: now and pre-election

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Consolidation plans: now and pre-election

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£ billion

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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

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

Economy 1.2% smaller in 2020–21

Leads to increase in borrowing of £8.2 bn (2016–17 terms)
OR: £6.8 billion per 1% downgrade

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

Inflation forecast to be higher than thought in March

In total, increases borrowing by £2.8 billion

Source: Figure 3.16 of the Green Budget
Forecasts for household inflation: CPI

In November, the Bank expected even more inflation

If correct, this would increase borrowing by a further £1.1 billion

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