Eliminating the deficit in this parliament?

Carl Emmerson

Presentation at IFS Public Finance Lecture, London

7 January 2015
Deficit to be eliminated by 2018?

- March 2015 Budget forecast an overall surplus in 2018–19
- Before the general election the Prime Minister stated:
  - “There’s a balanced plan to clear the deficit….. by 2018 we’ll be running a surplus”
  - David Cameron, Conservative Party Manifesto Launch, 14 April 2015
- New fiscal mandate requires the government to achieve a surplus on the headline public finances by 2019–20
  - and maintain a surplus thereafter
  - unless economic growth falls below 1%
Eliminating the deficit in this parliament?

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Source: Office for Budget Responsibility.
Eliminating the deficit?

Financial crisis led to largest budget deficit since WWII. Plans imply first budget surplus since 2000–01.
Public sector debt high by recent historical standards

% of national income

Financial year

Notes and sources: see Figure 5.2 of The IFS Green Budget: February 2015.
Public sector debt high by recent historical standards

But was higher from:
1830–31 to 1869–70
1916–17 to 1967–68

Debt hasn’t exceeded 80% of national income since 1967–68

Notes and sources: see Figure 5.2 of The IFS Green Budget: February 2015.
Is a budget surplus always a good idea?

• All else equal lower debt would
  – reduce debt interest payments
  – provide greater scope to increase debt in the event of an adverse shock

• But governments might want to borrow in some periods:
  – investment spending
  – output stabilisation
  – adjusting gradually to shocks
  – forecast errors
  – tax-rate smoothing
Deficit to be eliminated with tax rises and larger spending cuts

Source: Office for Budget Responsibility.
Significant tax rise over the next few years

• July 2015 Budget (£15.9bn of tax rises, £9.4bn of tax cuts)
  – increase in tax on dividend income (£2.0bn)
  – increase in insurance premium tax (£1.7bn)
  – increase in vehicle excise duty (£1.4bn)
  – restriction of pension tax relief for those on high incomes (£1.3bn)
  – restriction of interest deductibility on buy-to-lets (£0.7bn)

• November 2015 Autumn Statement (£7.5bn tax rise)
  – apprenticeship levy on employers with large paybills (£3.1bn)
  – raising of referendum threshold for council tax rises (£2.2bn)
  – increase in stamp duty for second homes & buy-to-lets (£0.9bn)
Significant cuts to working age benefits

- Government still planning £12bn cut to annual benefit spending by end of the parliament
  - but less than half delivered by 2017-18
  - £4bn from freeze to 2020, £4-5bn additional cuts to universal credit, £1½bn cuts to housing benefit spending (plus other smaller changes)
- Benefit spending excluding state pensions in 2020-21 forecast to be at its lowest as a share of national income for 30 years
Long-run impact of tax and benefit changes
All changes introduced May 2015-April 2019 fully in place

Change in net income

Poorest 2 3 4 5 6 7 8 9 Richest All

Note: Assumes full take-up of means-tested benefits and tax credits.
Change in departmental spending

Capital spending to rise, day-to-day spending to be squeezed

- Departmental spending to be cut by 2% in real terms by 2019–20: 12% cumulative cut since 2010–11
- Day-to-day spending across all departments set to be cut by 3% in real terms by 2019–20: 12% cumulative cut since 2010–11
- Departmental capital spending is to be increased by 5% in real terms up to 2019–20 but was cut over the last parliament
  - 2010–11 to 2015–16: cut by 17%
  - 2010–11 to 2019–20: set to be cut by 13%
Day-to-day spending cuts: 2015–16 to 2019–20

HMT estimates councils’ spending power to be reduced by 7%, on average. But could vary substantially across England.
Day-to-day spending cuts since 2010–11

Change in resource DEL (cumulative)

-100% -80% -60% -40% -20% 0% 20% 40% 60%

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Summary

• New fiscal mandate requires budget surplus from 2019–20 onwards
  – unless growth drops below 1% per year
  – advantages to reducing debt-to-GDP ratio, but there are reasons in favour of government borrowing in at least some years

• Plans imply the fiscal mandate being met
  – significant tax rises and cuts to working-age welfare

• Total day-to-day spending on departments to be cut less quickly over this parliament than last
  – but many departments still facing large cuts: e.g. transport and justice
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