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Isabel Stockton

Gambling on growth: The outlook for the public finances

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Economic and Social Research Council

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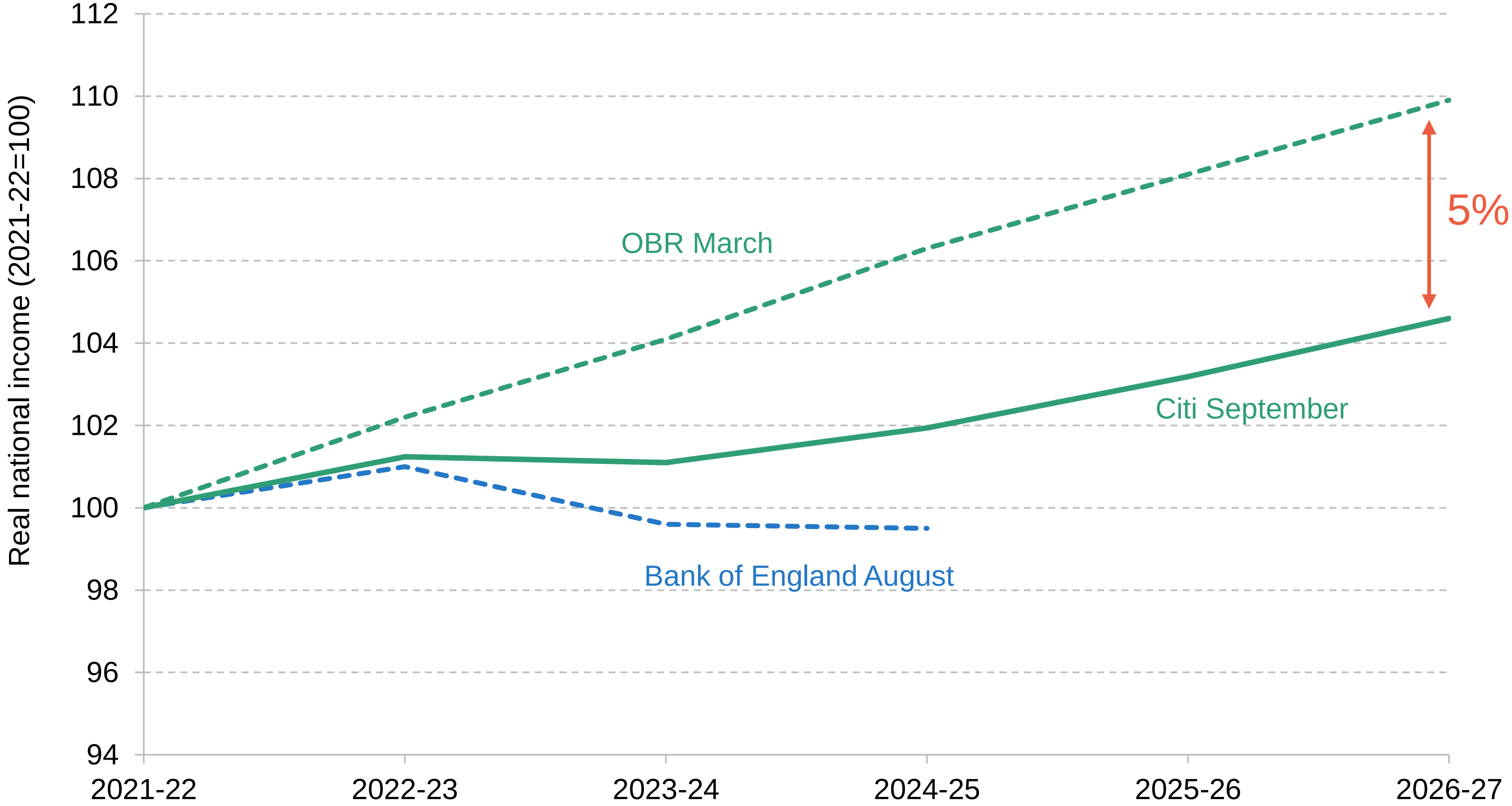
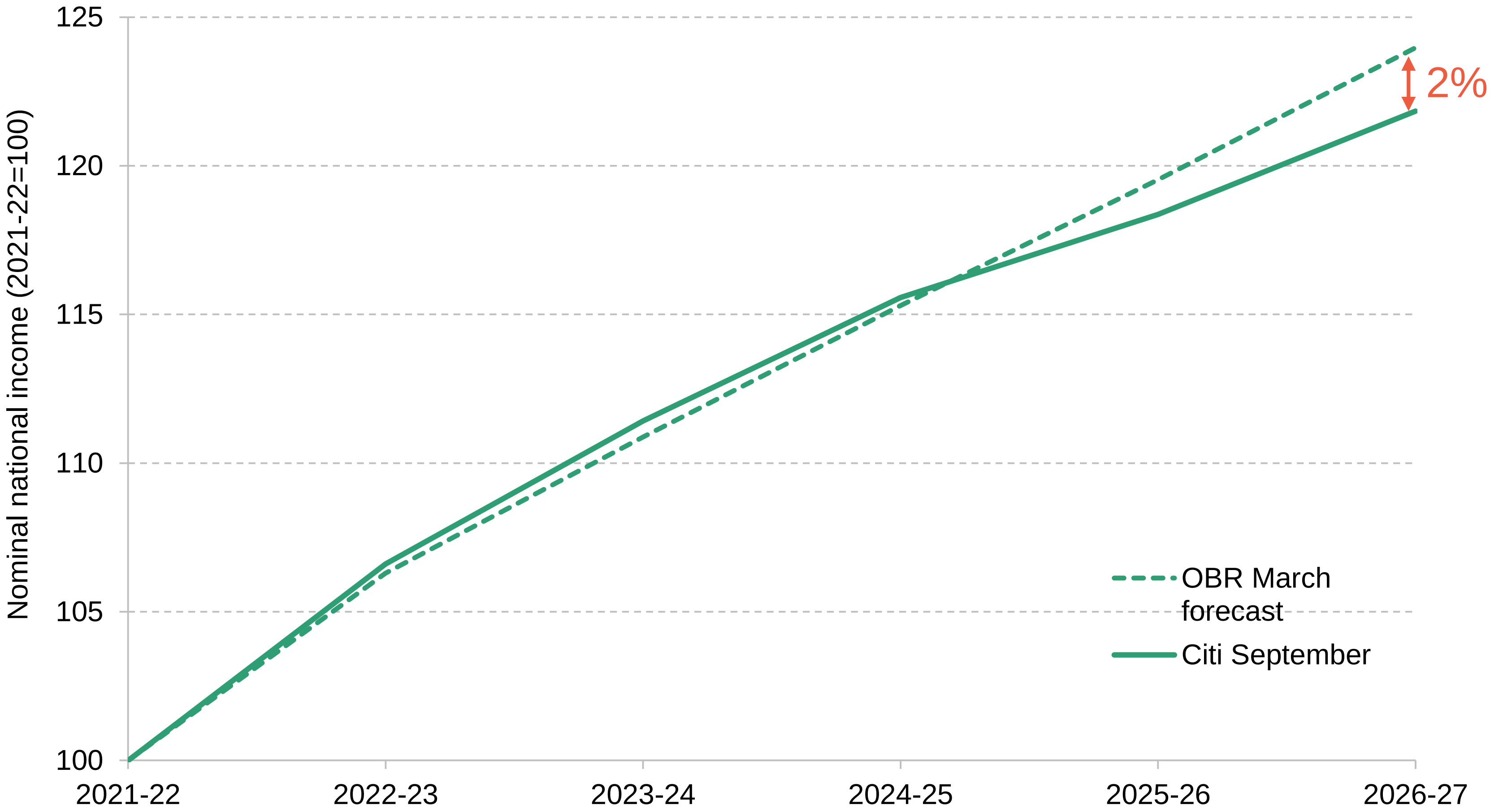
A shallower recession due to the Energy Price Guarantee



Inflation cushions the hit to the cash size of the economy



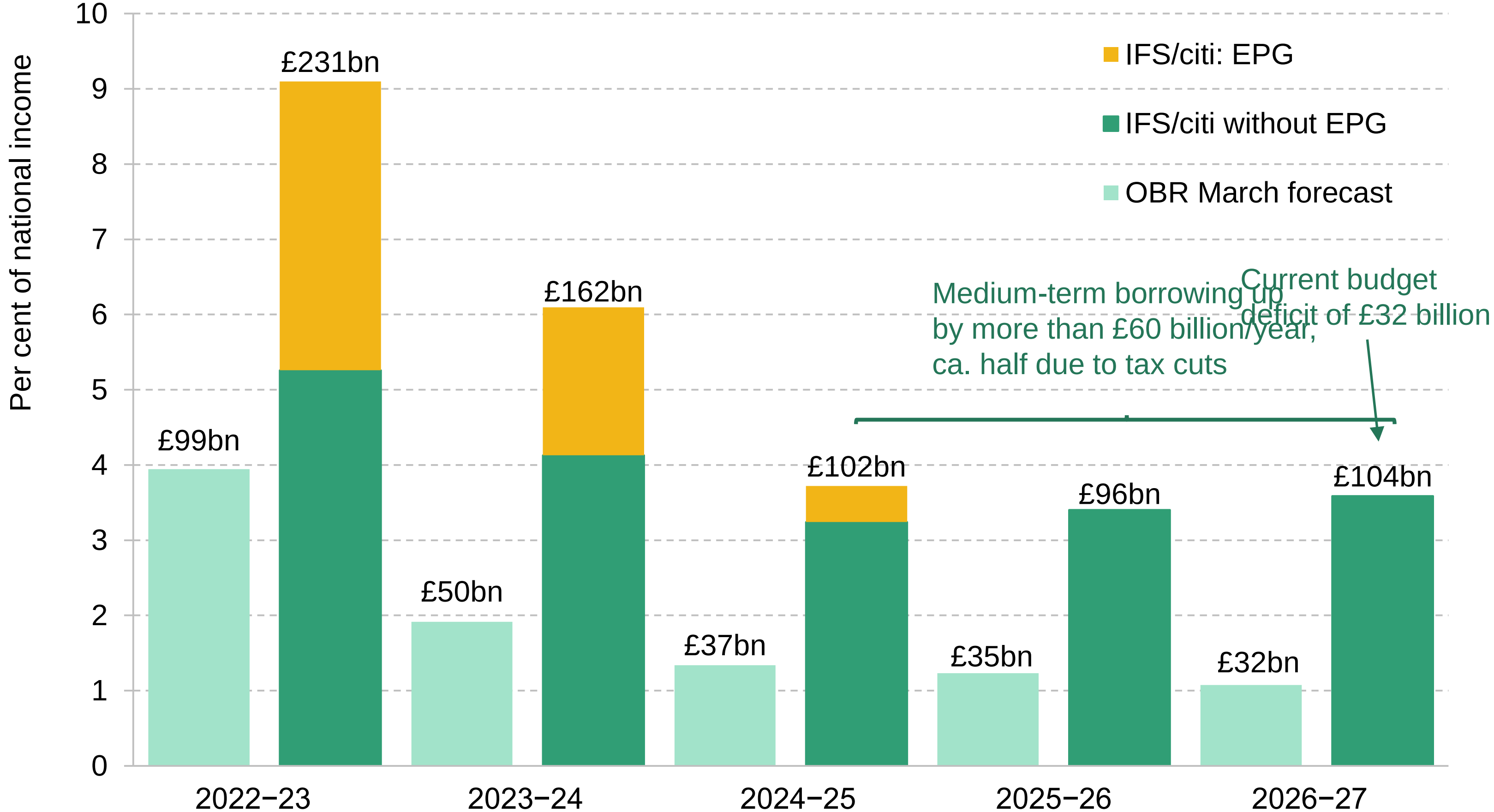
Impacts of higher inflation on revenues and spending

- Tax liabilities depend on cash quantities
  - nominal GDP matters more for revenues than real GDP
- Higher spending on debt interest
  - Depends on inflation (index-linked) and interest rates, both up
- Higher spending on pensions and working-age benefits

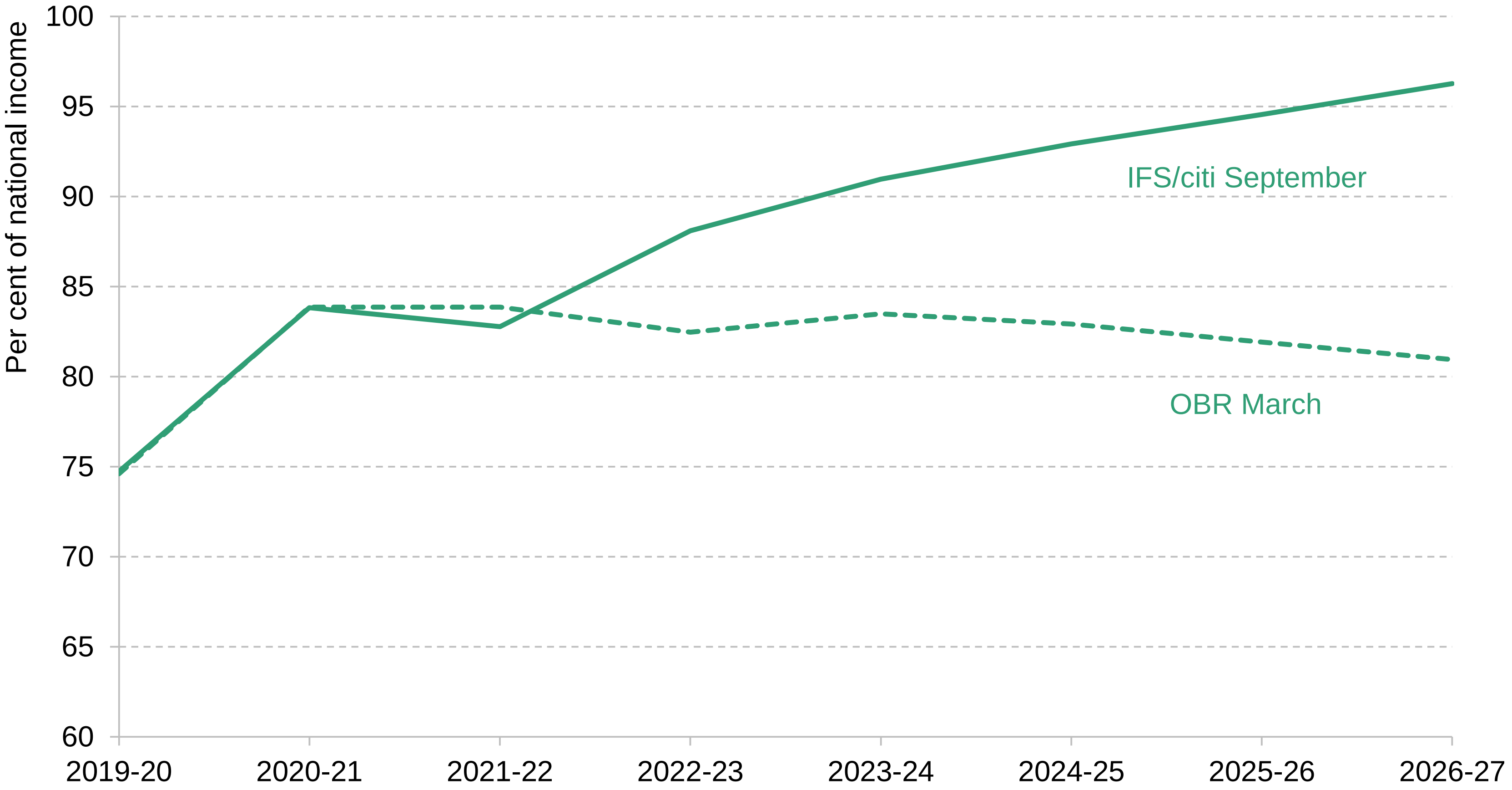
New policy commitments

- Cost of the Energy Price Guarantee large, highly uncertain, assumed temporary
- Reversing National Insurance rise and cancelling planned large rise in the rate of corporation tax matters more in the long run
  - around £30 billion/year in lost revenue
- We do *not* include other potential policies, including
  - bringing forward cut to basic rate of income tax
  - increasing defence spending to 3% of GDP by 2030
  - topping up departmental budgets

Persistent increase in borrowing above March forecast



Debt forecast to rise even once Energy Price Guarantee expires



More growth would help

- More growth would clearly ease the trade-offs facing the Chancellor
- Need more than 0.7% on growth each year just to stabilise debt
  - equivalent to drop in average growth in the UK between the 25 years pre-financial crisis, versus the 2010s
  - either extraordinarily good luck, or a huge policy success
- Counting on headline tax cuts to deliver this is a gamble, at best
  - likely needs a concerted effort of reform and investment across planning, education, tax design, trade, etc

Conclusions

- Economic outlook materially deteriorated since March
  - Inflation cushions the hit to revenues at the cost of tighter-than-intended spending plans
- Tax cuts account for half the >£60 billion medium-term increase in borrowing compared to OBR's March forecasts
  - Current budget deficit of ~1% of national income and debt on a rising path even after Energy Price Guarantee expires
- Main fiscal targets legislated in January missed by a wide margin
- More growth would help, but generating enough growth even just to stabilise debt would be ambitious

The Institute for Fiscal Studies
7 Ridgmount Street
London
WC1E 7AE

www.ifs.org.uk