Isabel Stockton

IFS Green Budget 2022: Outlook for the public finances

11 October 2022

@TheIFS

Nuffield Foundation
citi
Economic and Social Research Council

A much changed outlook

Economic outlook worse than in March

- remains very uncertain

Support for household and non-domestic energy bills

- adds substantially to near-term spending

Higher inflation

- increases spending on benefits and state pensions
- pressure on public services

Debt interest spending

- affected by higher inflation and interest rates

Outlook for revenues

Key determinant of revenues will be the size of the economy

- Citi forecast weaker real growth; higher inflation means nominal growth much closer to OBR’s March forecast

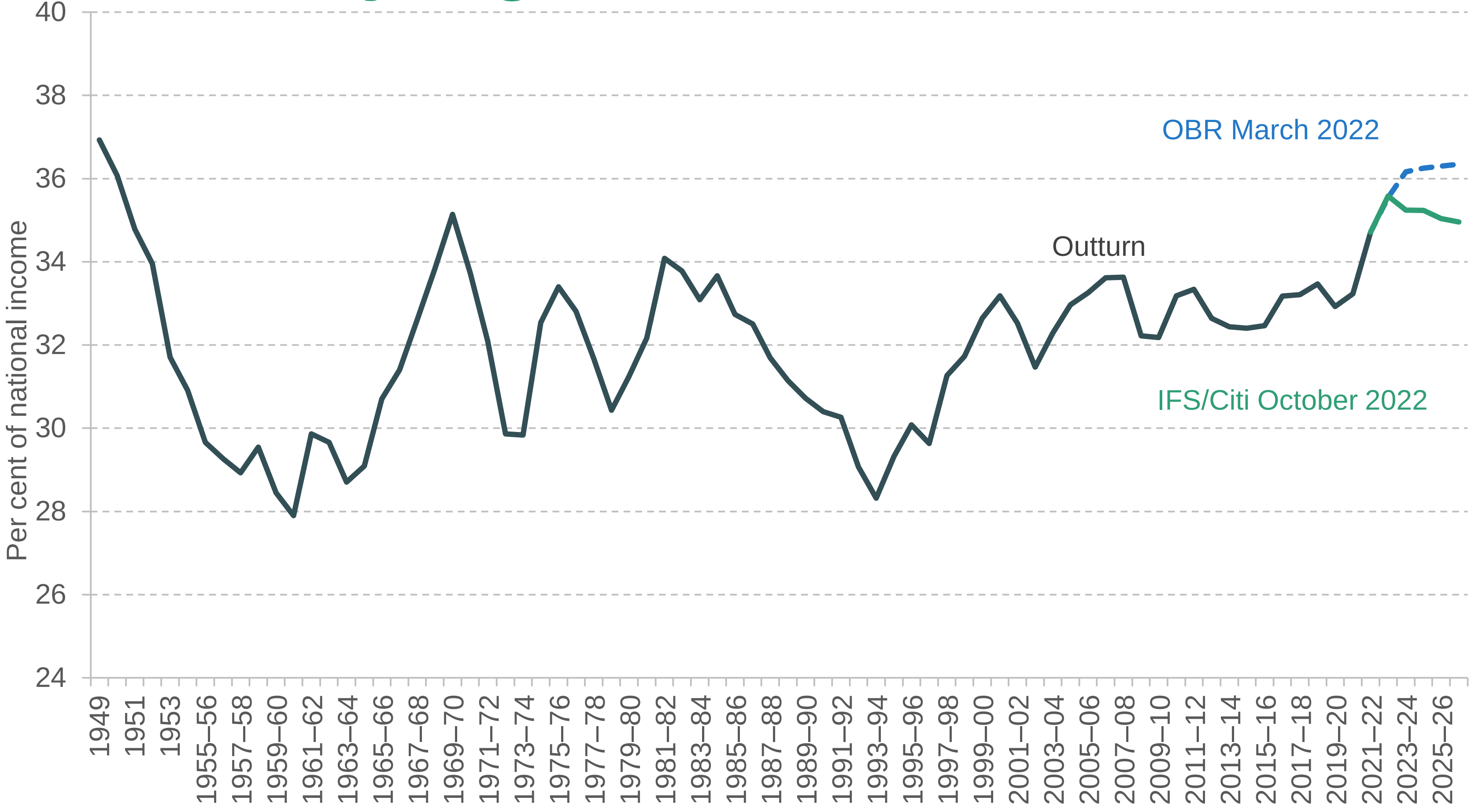
Substantial policy announcements since March

- new energy profits levy to raise £28 billion over next four years
- £43 billion/year of tax cuts remain from September ‘mini budget’

Our central forecast: revenues down £44 billion in 2026–27

- very sensitive to the path of the cash size of the economy: nominal growth up ½ppt/year would add £28 billion to revenues in 2026–27

Tax burden to fall but remain historically high



National accounts taxes. Figure 3.6 of the 2022 IFS Green Budget.

Outlook for spending

Higher inflation increases state pension and benefit spending

- up another £4 billion in 2023–24 rising to £14 billion in 2026–27

Support with energy bills

- May 2022 package costs £15 billion in 2022–23
- Energy Price Guarantee: cost highly uncertain, we allow for £114 billion over two years

Departmental spending

- assume existing settlements kept to: real generosity down £5 billion this year, £14 billion in 2023–24 and £23 billion in 2024–25
- reduces planned growth in real day-to-day spending from 3.3% a year to 1.6% a year (compared to 0.4% a year over 4 years from April 2016)
- overseas aid: assume spending remains at 0.5% of GNI, saving £5 billion/year from 2024–25 onwards

Debt interest spending

Increased cost of borrowing, and more borrowing, to push up debt interest spending

In 2023–24 we forecast spending of £103 billion

- twice the £51 billion forecast by the OBR in March
- £10 billion higher than we forecast two days before the ‘mini budget’

In 2026–27 we forecast spending of £66 billion

- £18 billion higher than the £47 billion forecast by the OBR in March
- (£1 billion higher than we forecast prior to the ‘mini budget’)

Debt interest

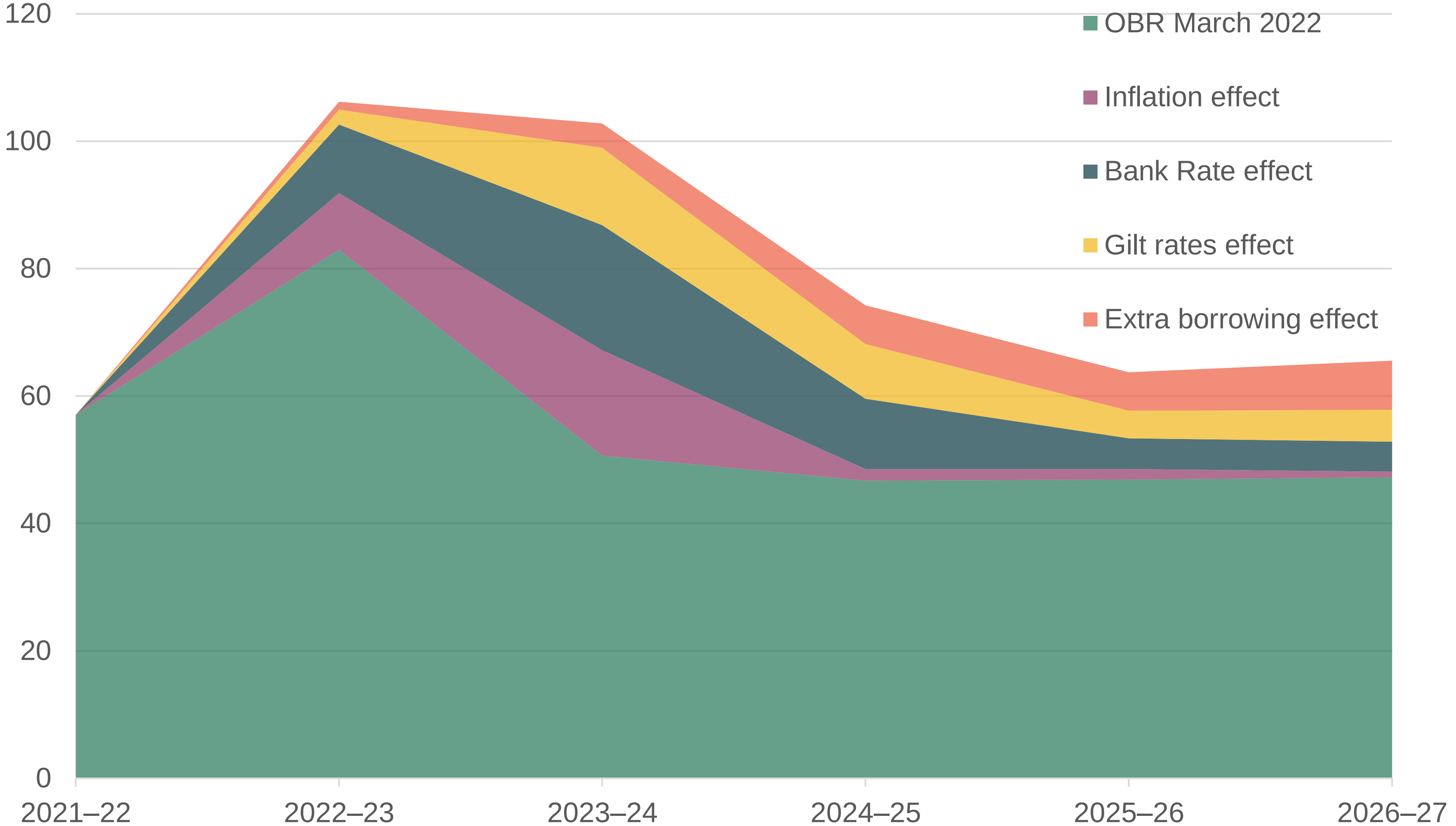


Figure 3.10 of the 2022 IFS Green Budget.

Long-run debt interest spending

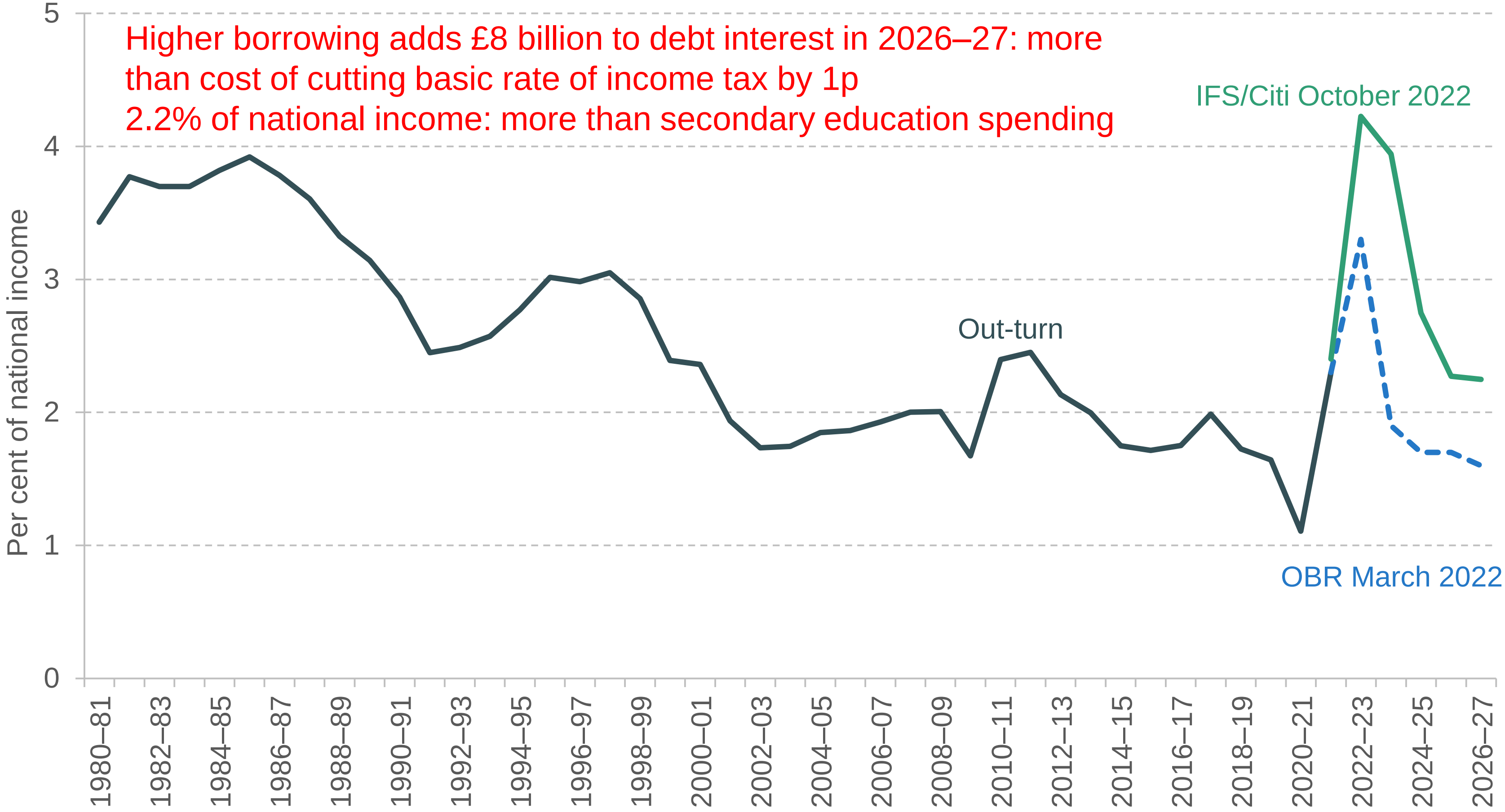


Figure 3.11 of the 2022 IFS Green Budget.

Forecast borrowing

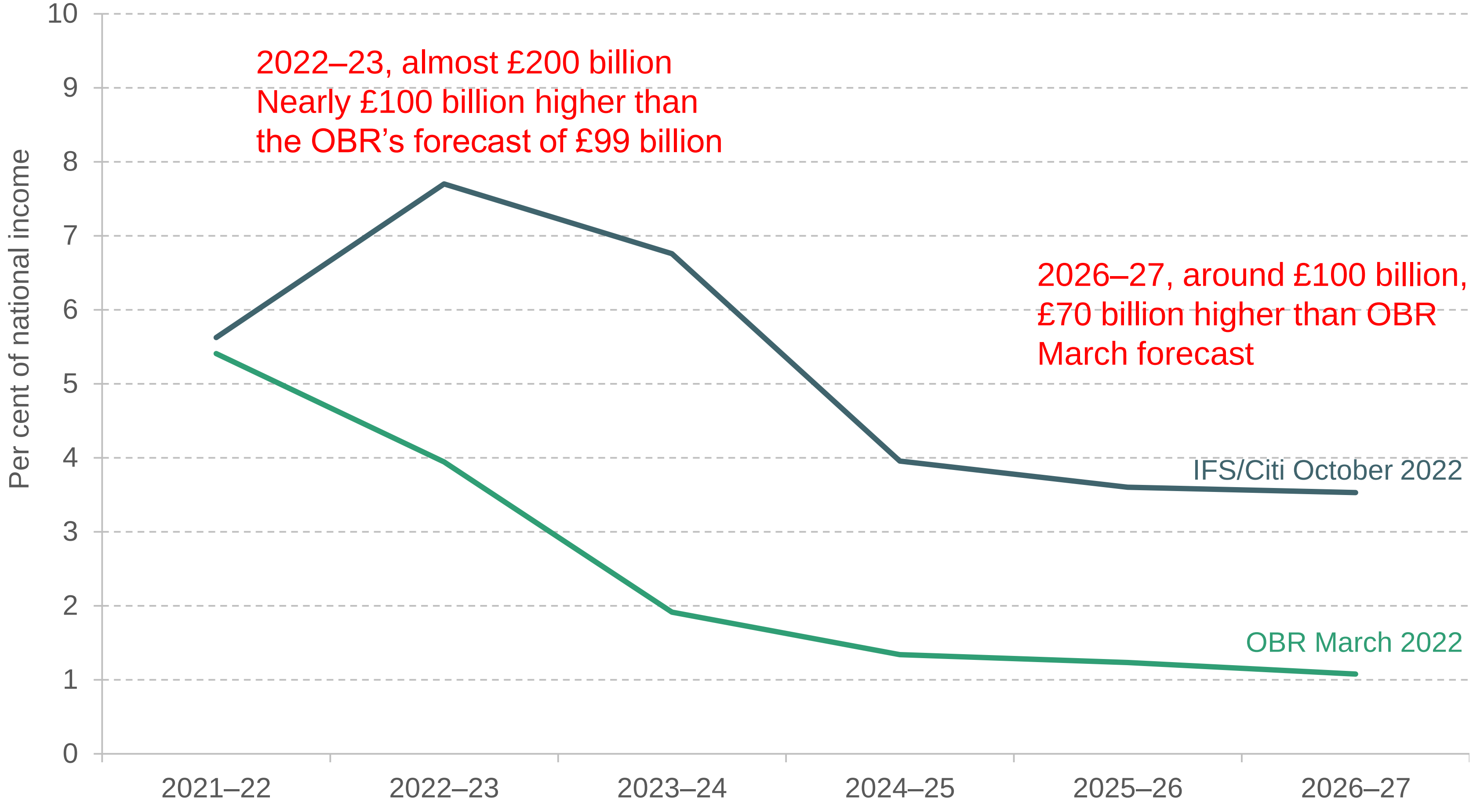
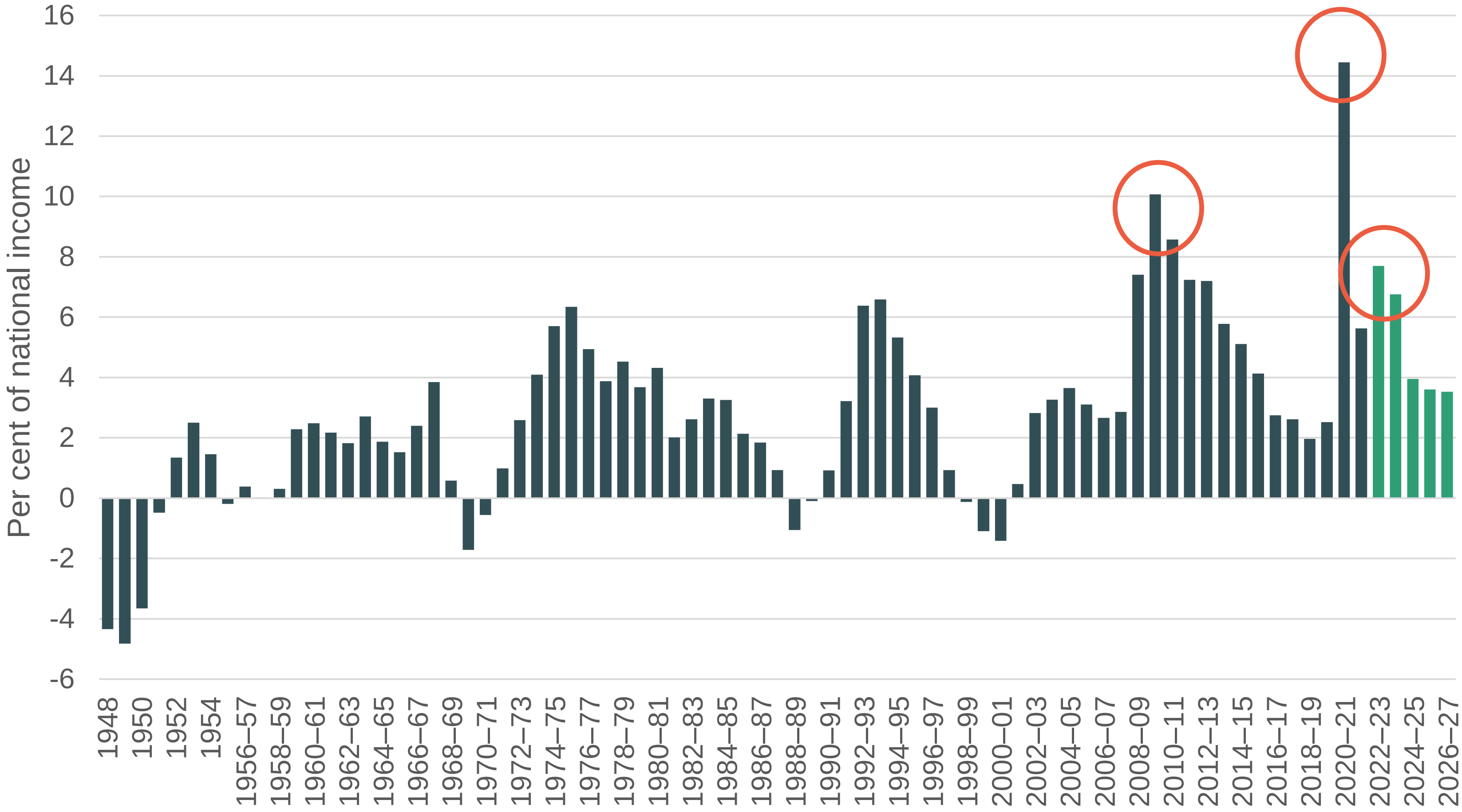
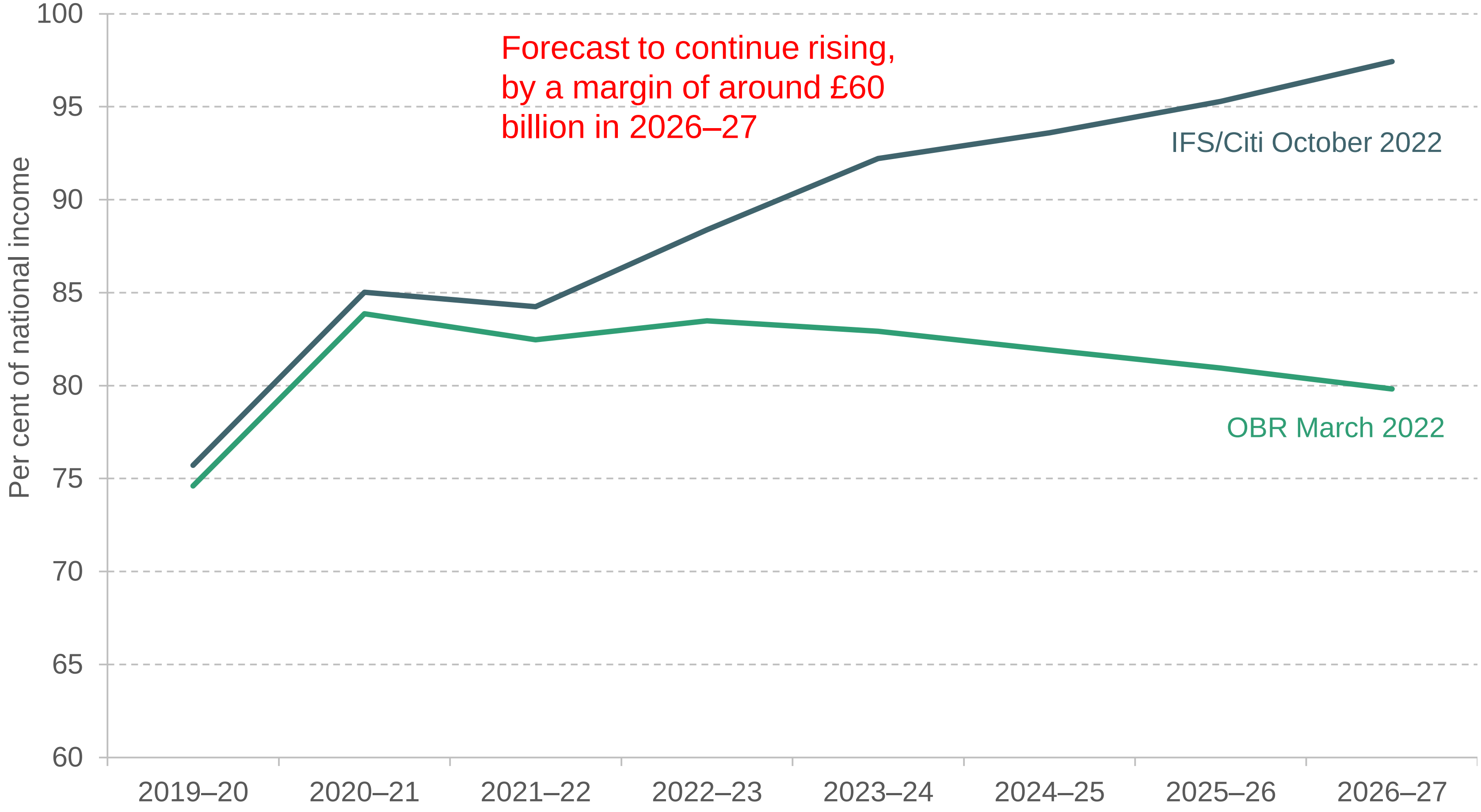


Figure 3.12 of the 2022 IFS Green Budget.

Three peaks in post WW2 borrowing in quick succession



Forecast public sector net debt



Underlying debt excluding Bank of England. Figure 3.14 of the 2022 IFS Green Budget.

So what to do?

Fiscal mandate for debt to fall in three years time missed

Push back to five years giving more time for additional growth or new spending squeeze?

Additional growth would be welcome and ease trade-offs

- £60 billion needed on our central scenario, falls to £40 billion if (big!) 0.25ppt per year boost to growth

Pro-growth planning and regulation reforms proposed in 2011

“In the event that these measures have an impact on growth, there is likely to be some lag before the effects are realised; the effects will also depend on how the measures are implemented.

…

Set against this uncertainty, we judge there is insufficient evidence at this stage to adjust our trend growth assumptions in light of these measures.”

Box 3.1, page 39 of Office for Budget Responsibility, *Economic and fiscal outlook – March 2011*

So what to do?

Fiscal mandate for debt to fall in three years time missed

Push back to five years: more time for additional growth or new spending squeeze?

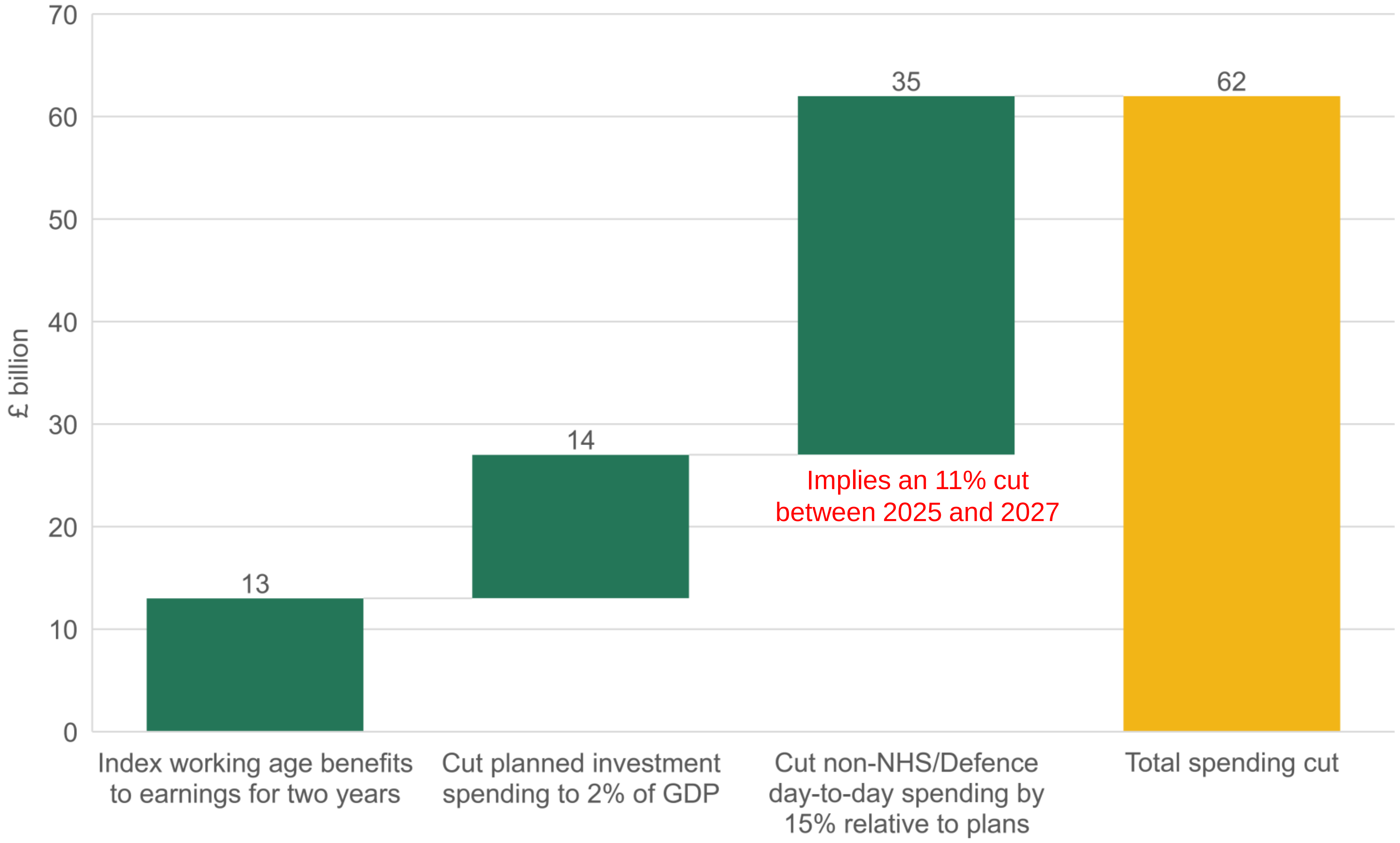
Additional growth would be welcome and ease trade-offs

- £60 billion needed in our central scenario, falls to £40 billion if (big!) 0.25ppt per year boost to growth
- OBR have sensibly previously chosen not to increase productivity forecast in response to promises of supply side reforms

Could pencil in lower spending from 2025–26

- OBR should be wary of a promise to cut unspecified spending in four years’ time

Illustrative £60bn spending cut



Conclusions

- £30 billion headroom against fiscal targets has gone due to £43 billion of tax cuts and worse economic outlook
- More growth would help, but rationale for the OBR is to ensure politically motivated wishful thinking does not affect forecasts
- Falling debt easier to achieve in five years' time rather than three, but promises to cut unspecified future spending may not be credible
- Need to avoid situation where 'in each new budget the government promised their books would balance tomorrow – but tomorrow never seemed to arrive'