



Institute for  
Fiscal Studies



## The UK public finances

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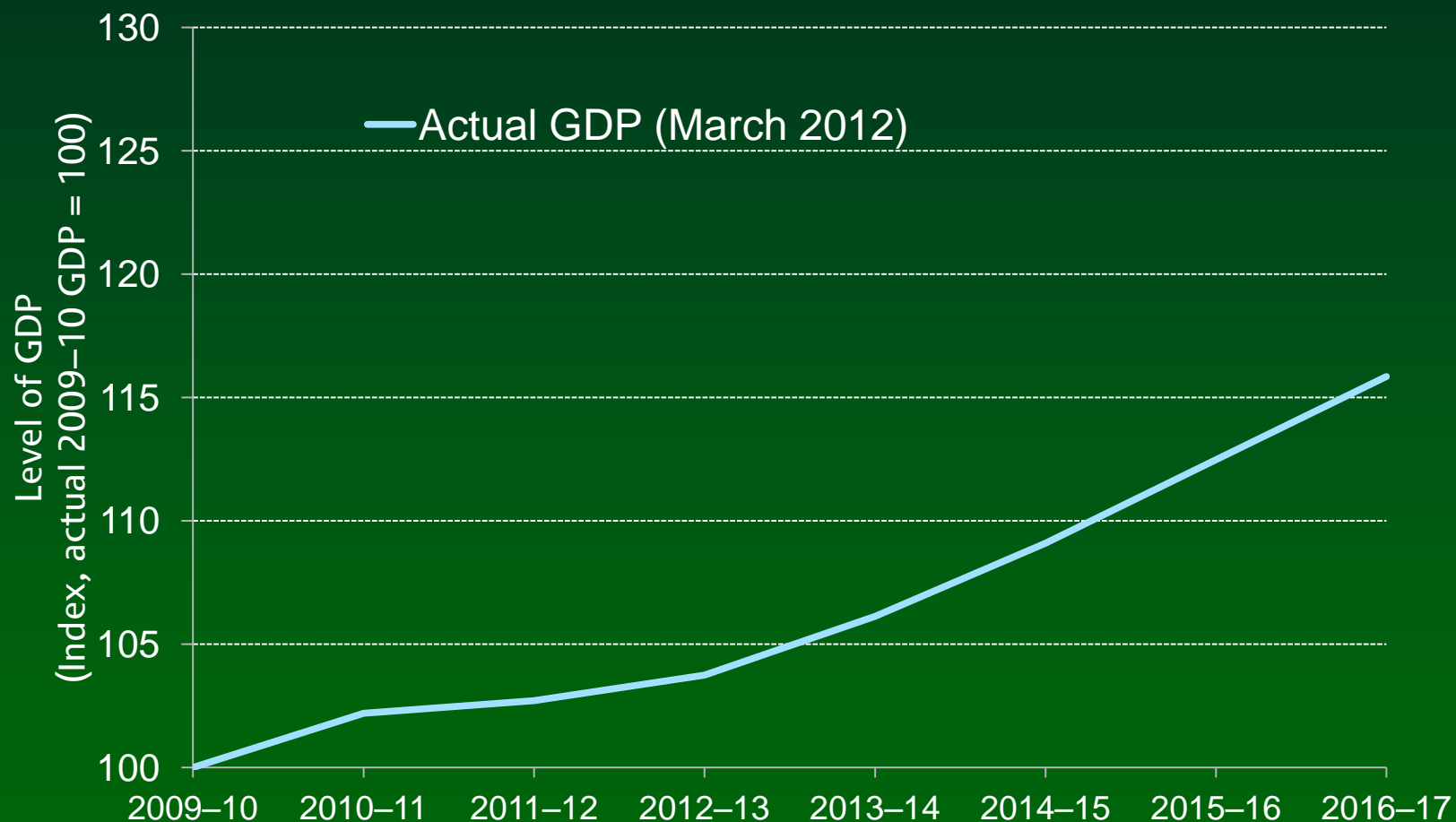
Carl Emmerson

Presentation at Oxford Economics, UK Outlook Conference,  
London, 1 November 2012

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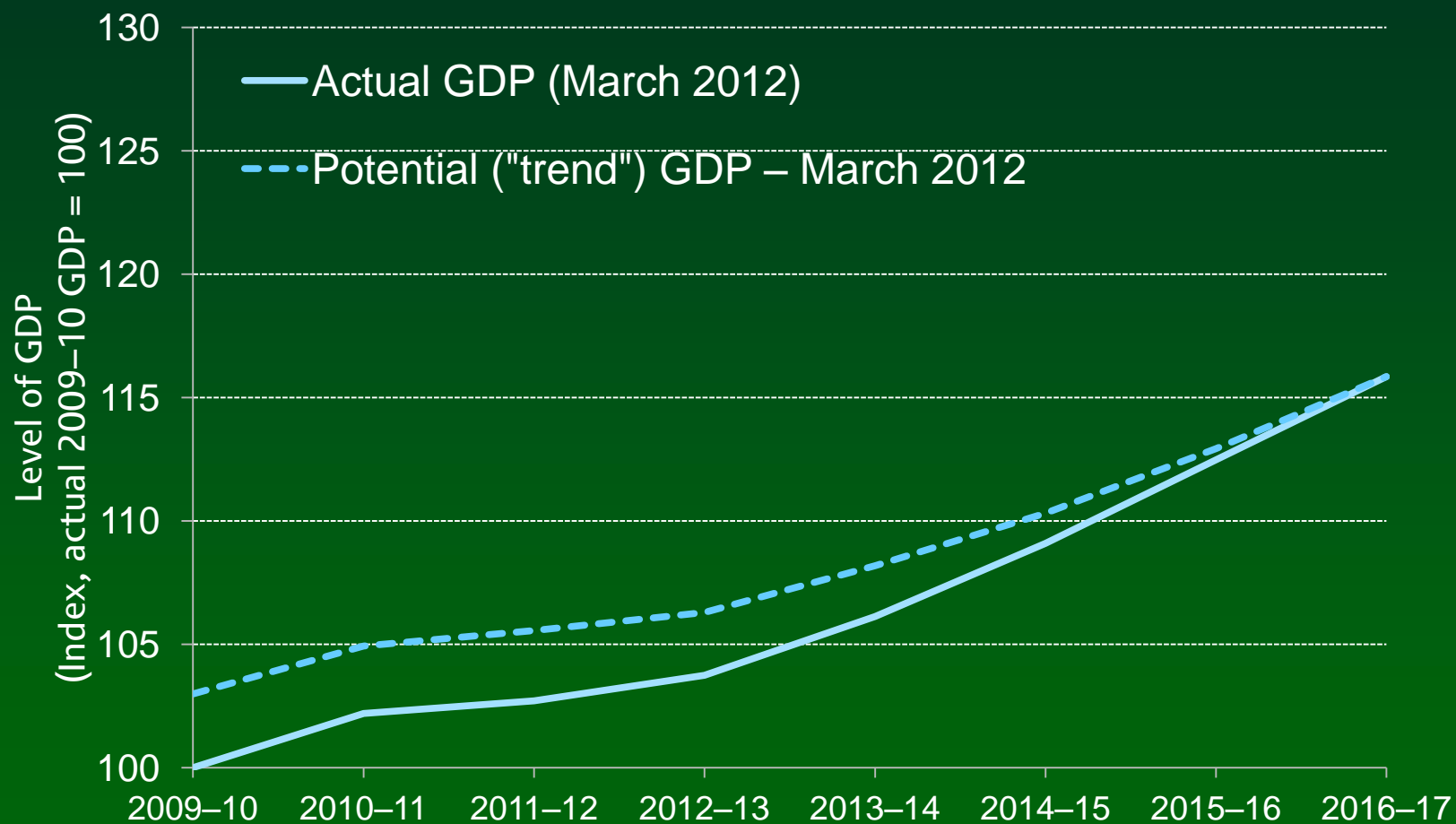
# Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP



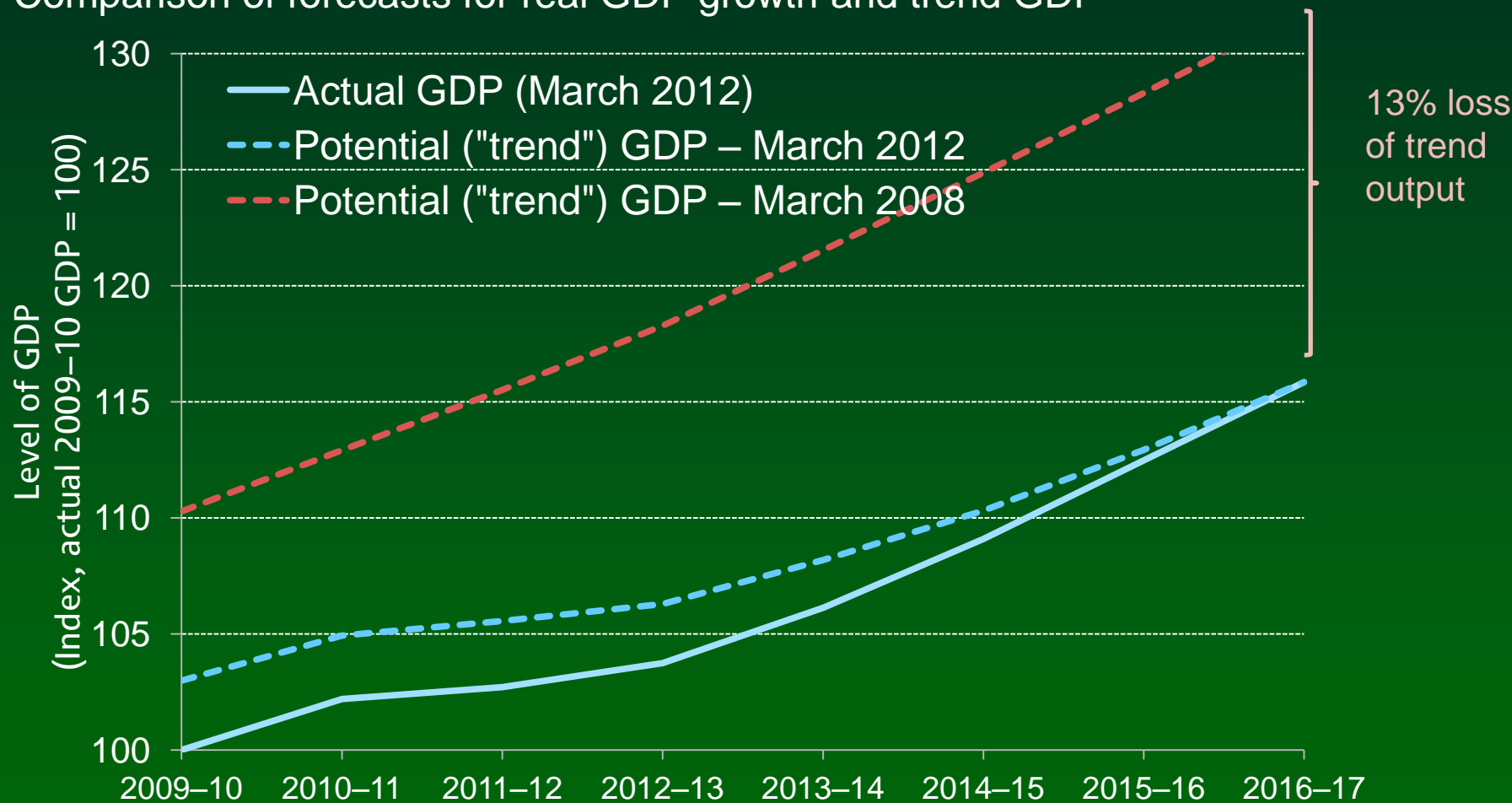
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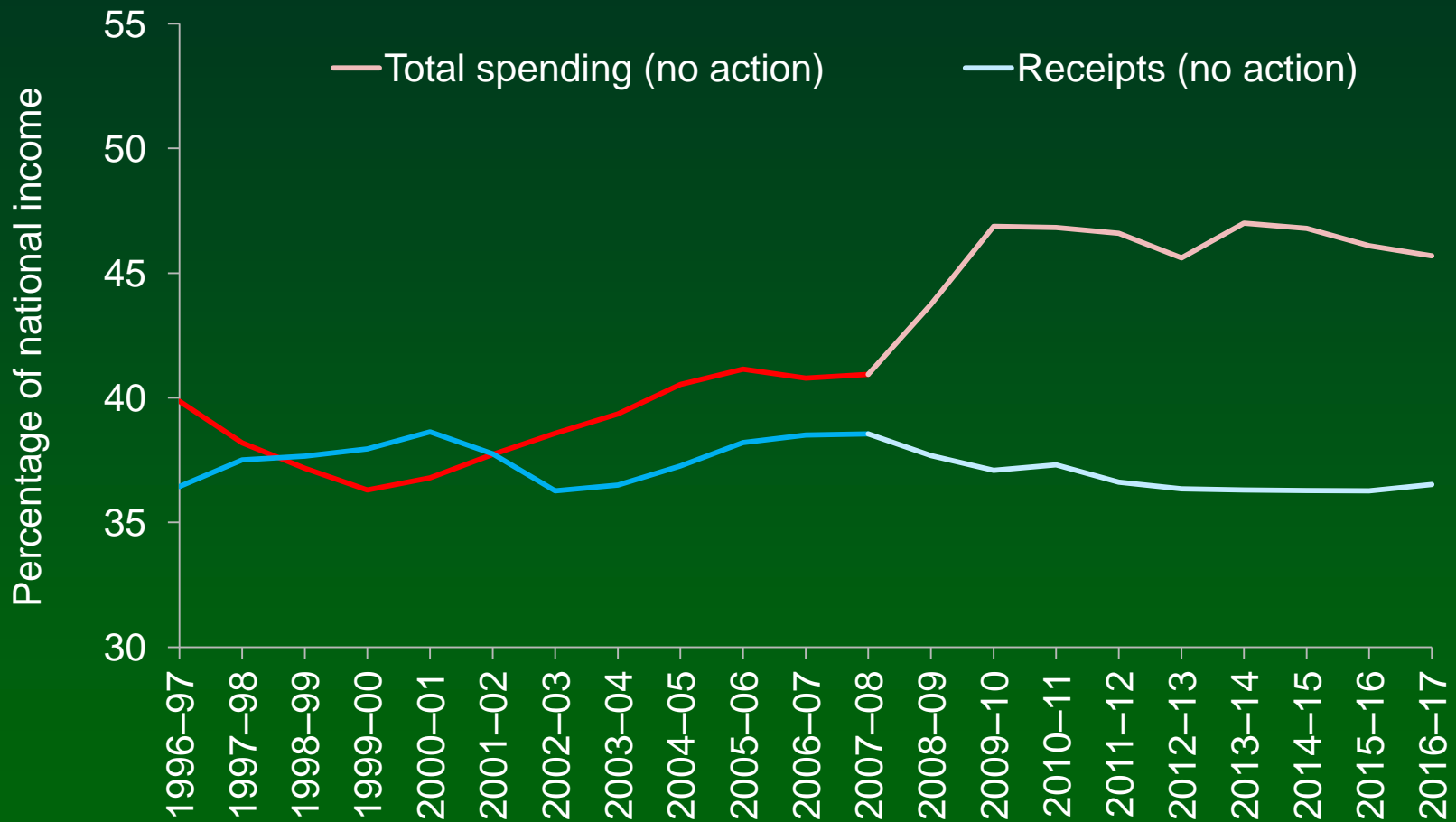


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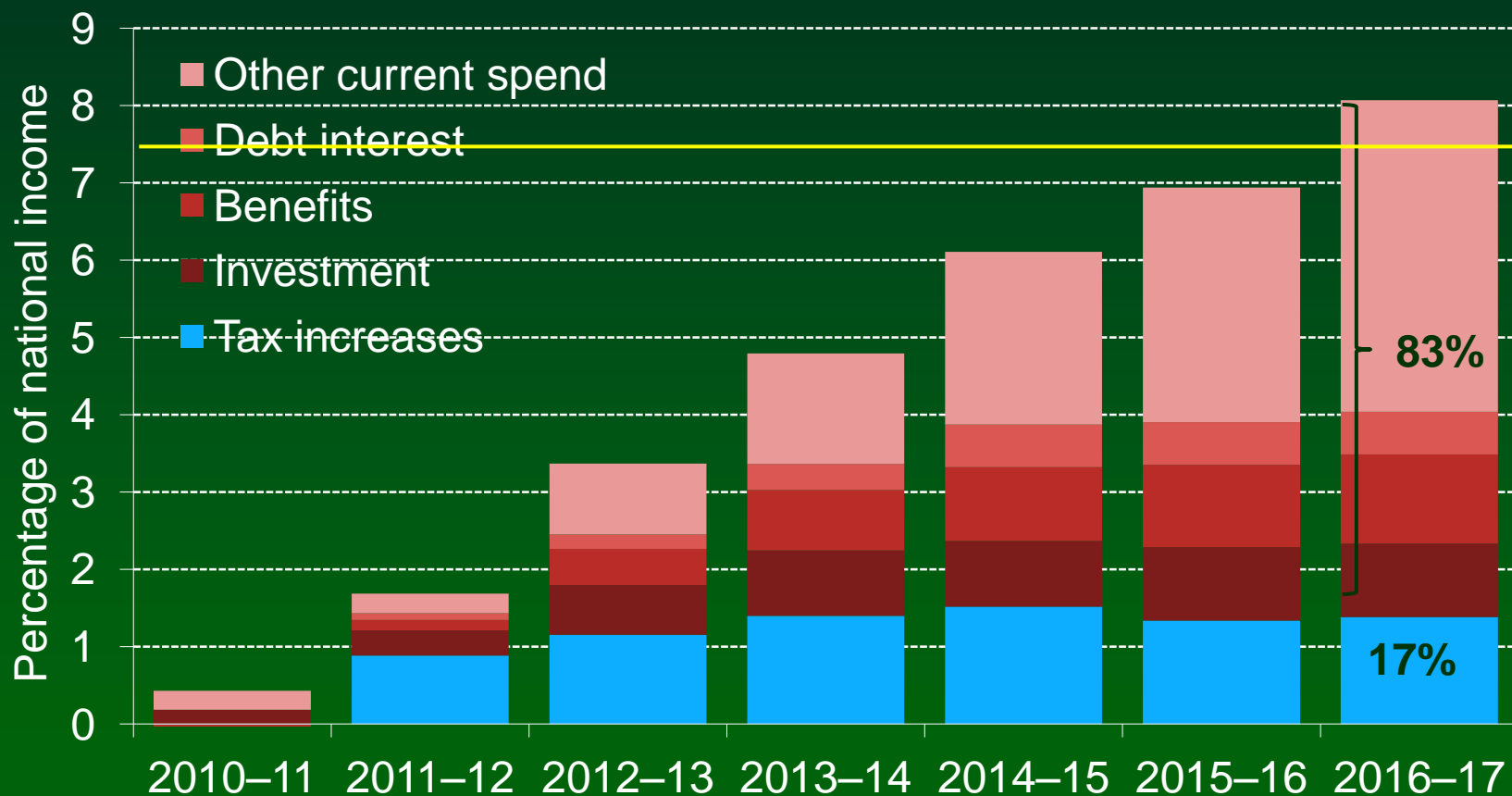


# The big fiscal picture

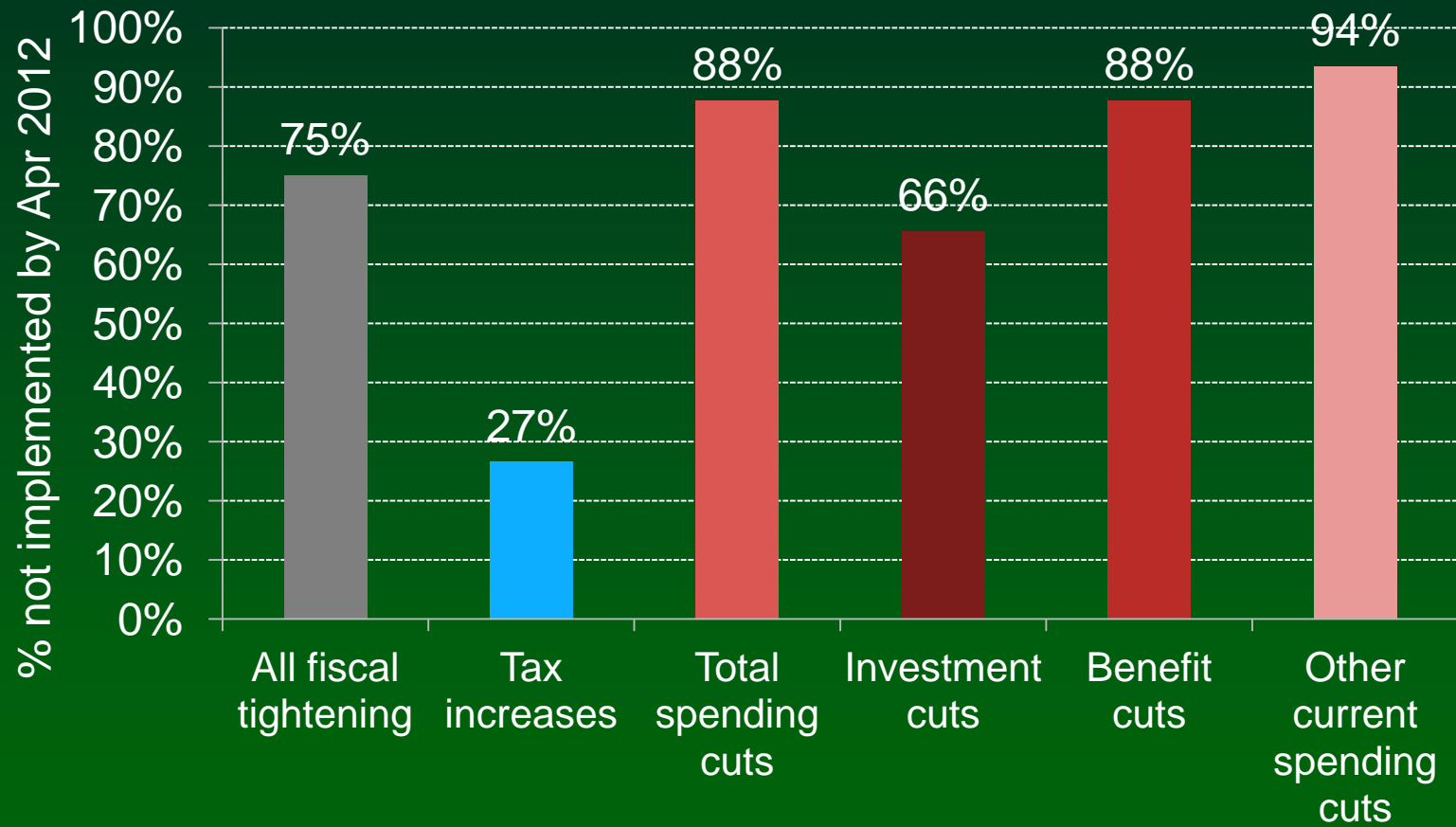


# The cure (March 2012): 8.1% national income consolidation over 7 years (£123bn)

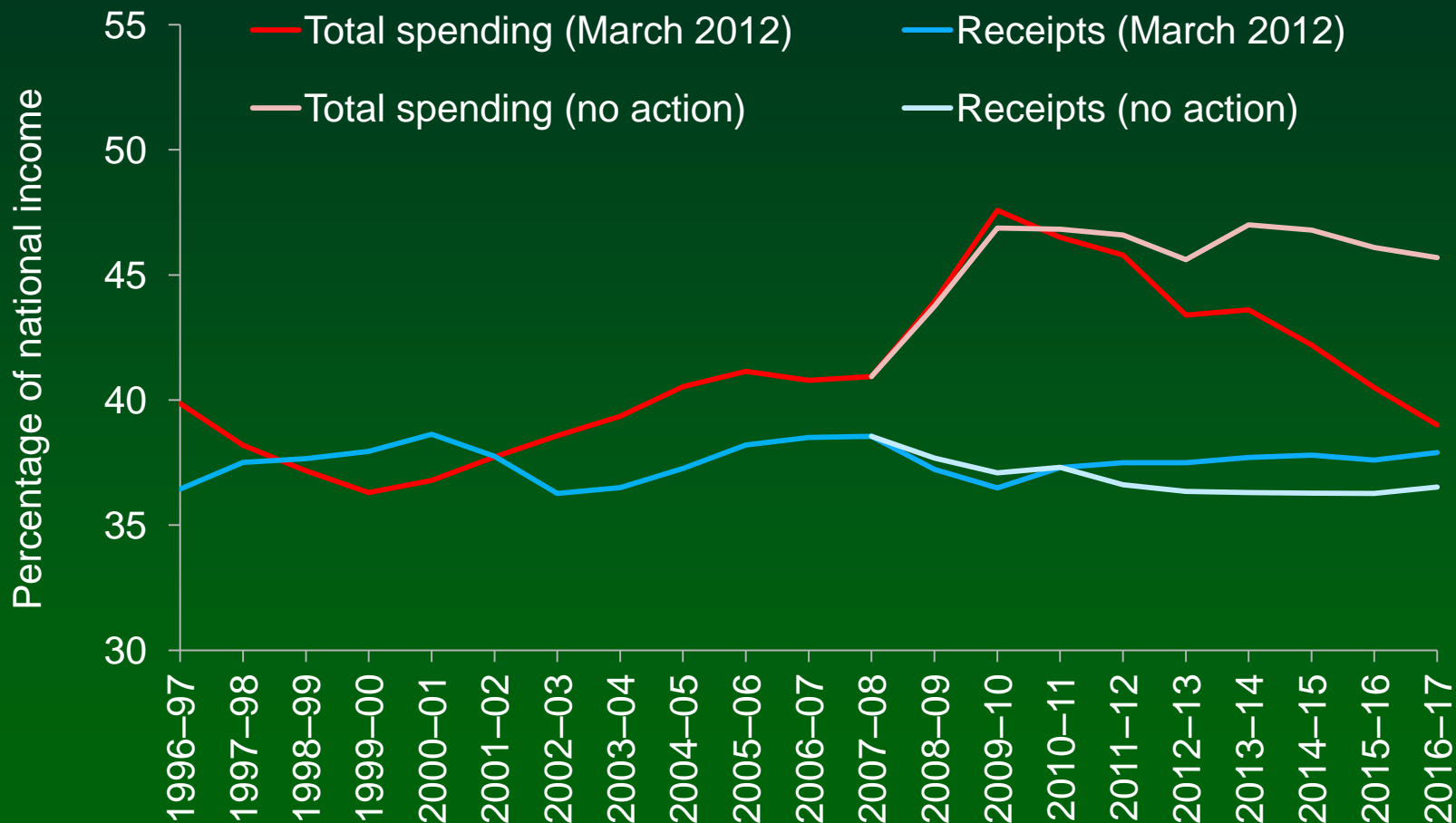
**Mar 2012:** 7.6% national income (£115bn) hole in public finances



# The pain to come



# Spending and revenues back to pre-crisis levels





# Economic developments since the Budget

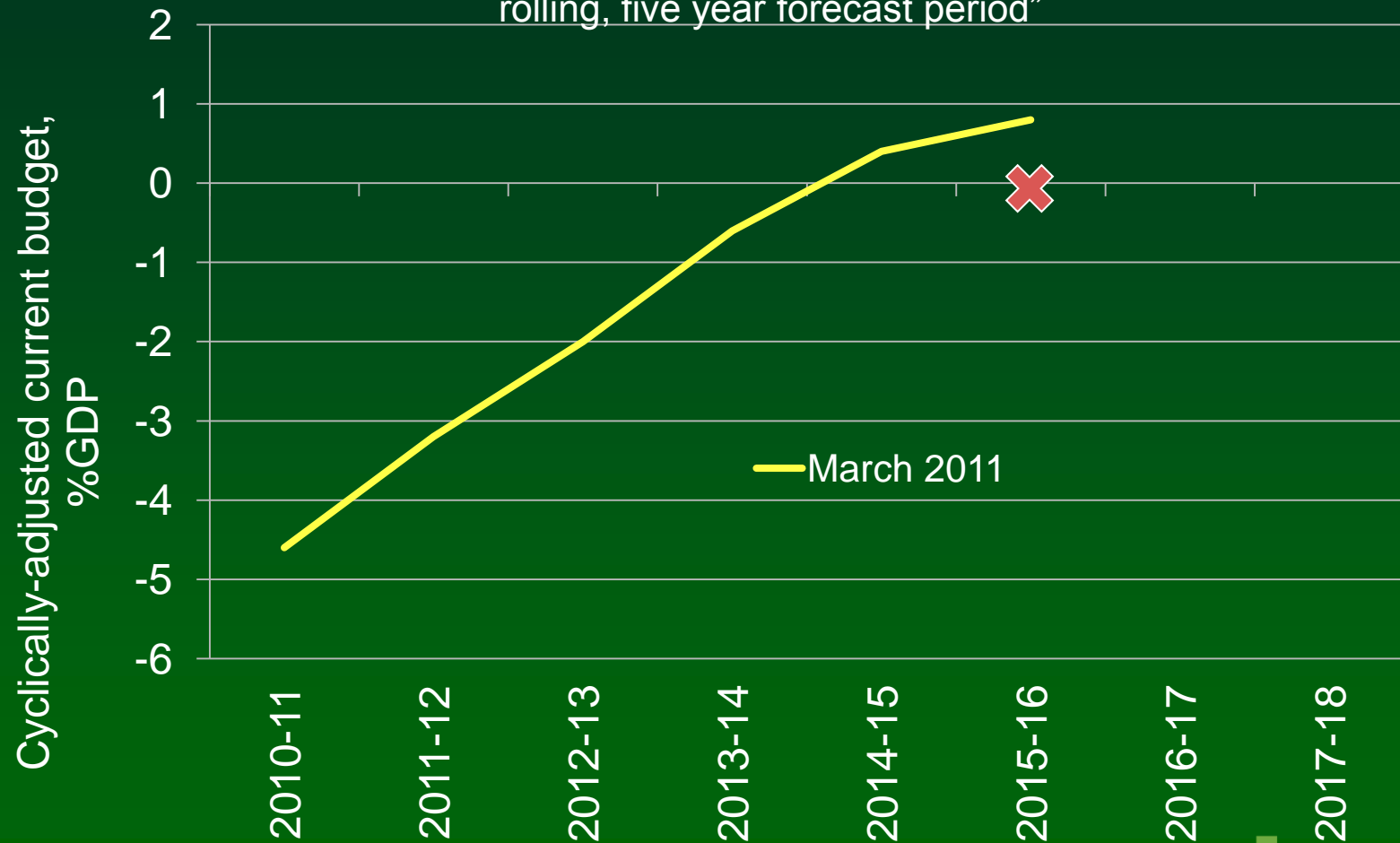
- Outlook for growth has been revised down
  - OBR March 2012 forecast growth of 0.8% in 2012 and 2.0% in 2013
  - average of independent forecasters has moved from 0.5% and 1.7% in March 2012 to –0.3% and 1.1% in October 2012
- Public finances have performed weakly over first half of 2012–13
  - underlying borrowing is higher than in same months of 2011–12
  - if central government receipts continue to grow at the same rate for the rest of 2012–13, and all other receipts and spending come in as forecast, then borrowing would be £15bn higher than forecast
- Unless all additional borrowing temporary further tax rises or spending cuts would be required to reduce deficit as previously intended

# Judging the health of the public finances: The Chancellor's fiscal targets

- Fiscal mandate
  - Structural current budget must be forecast to be in balance or surplus at the end of the rolling five-year forecast horizon (currently 2016–17)
  - Imbalances between spending and revenues that purely reflect temporary economic weakness are alright
  - Can borrow for investment
- Supplementary target
  - Debt must be falling as a share of GDP in 2015–16

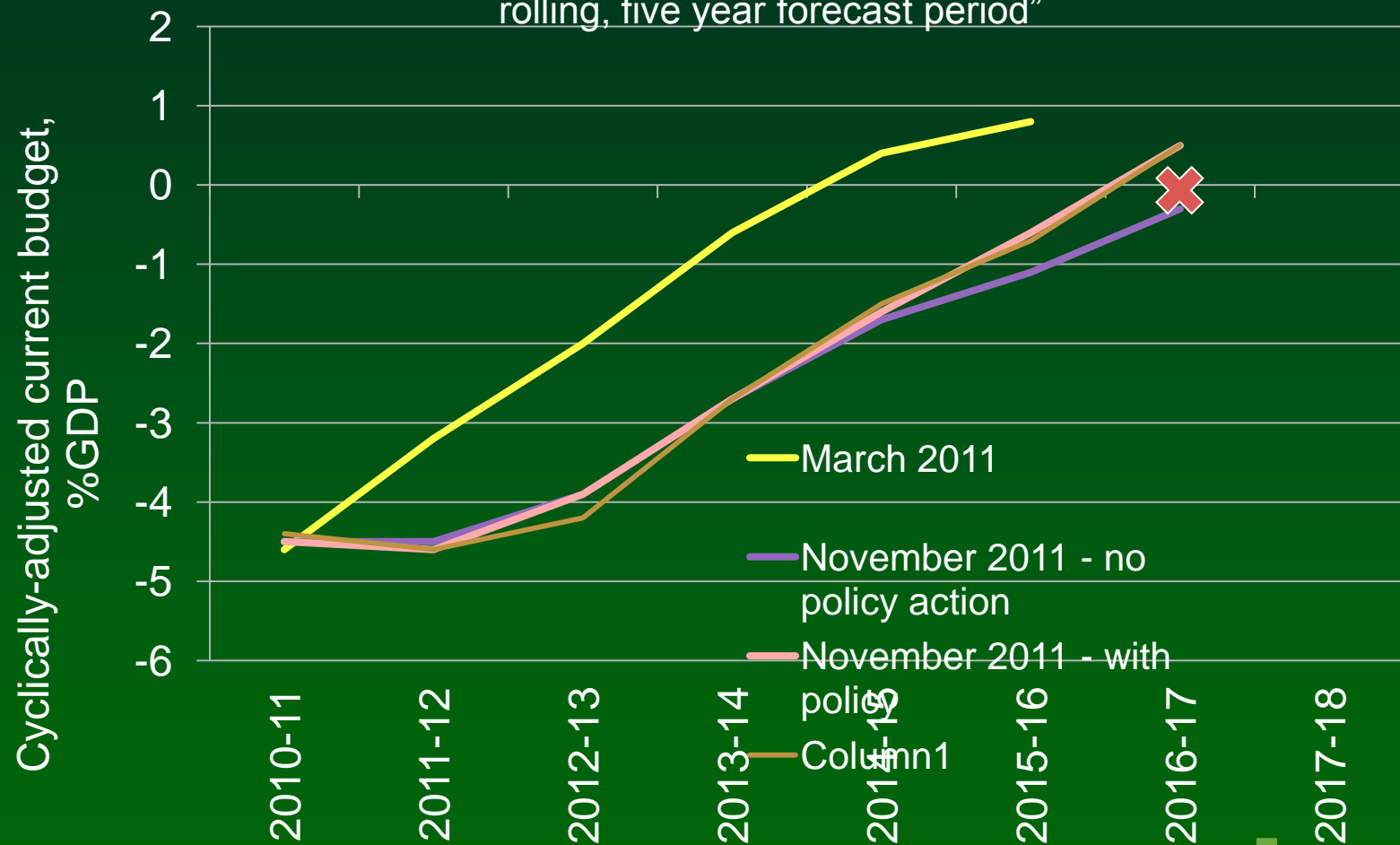
# Meeting the fiscal mandate

**Fiscal mandate:** “cyclically adjusted current budget balance by the end of the rolling, five year forecast period”



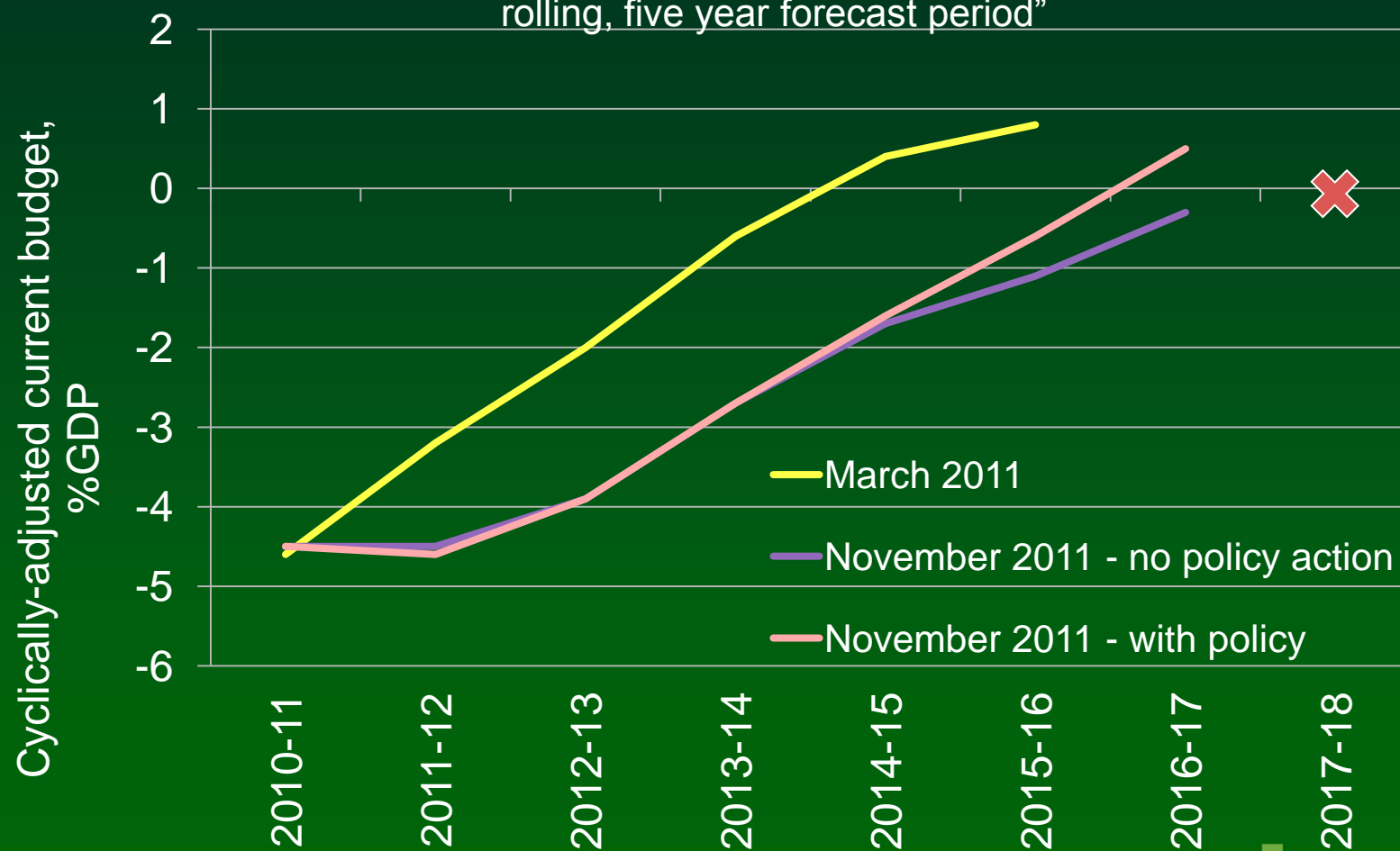
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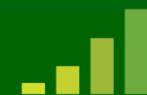
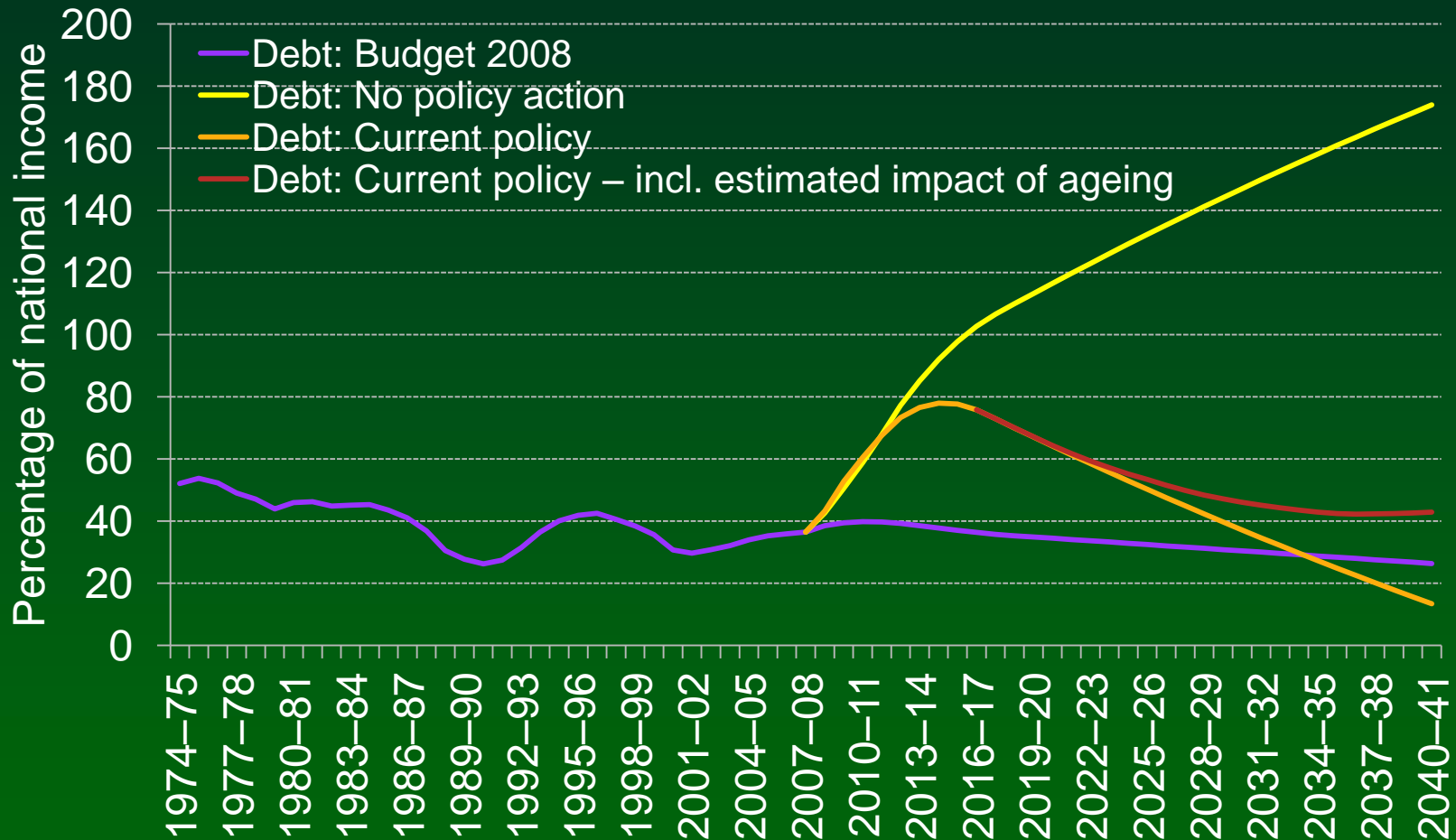
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# Debt back on a more sustainable path

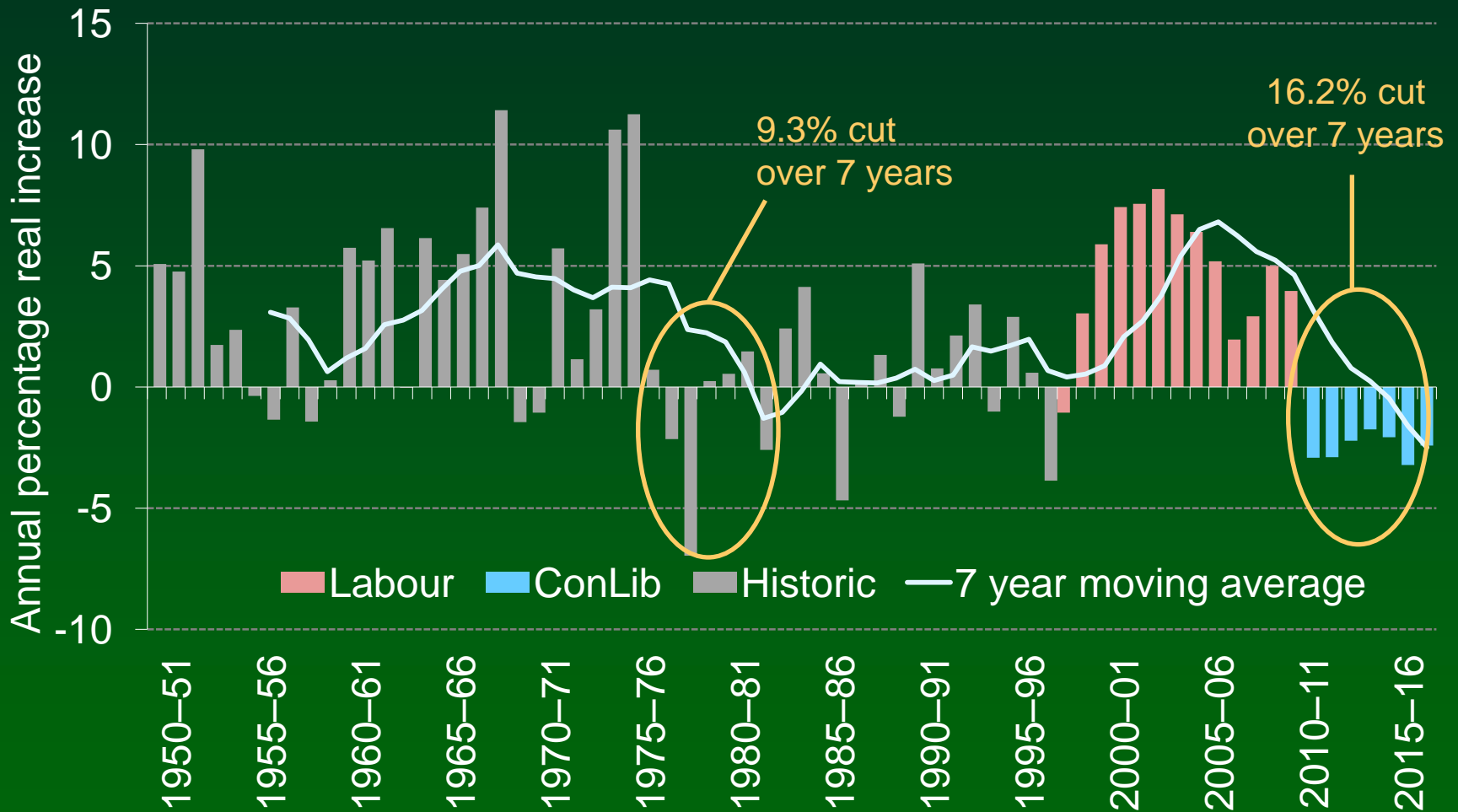
- but to remain above pre-crisis levels for a generation



# Can the tight spending plans be delivered?

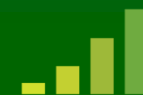
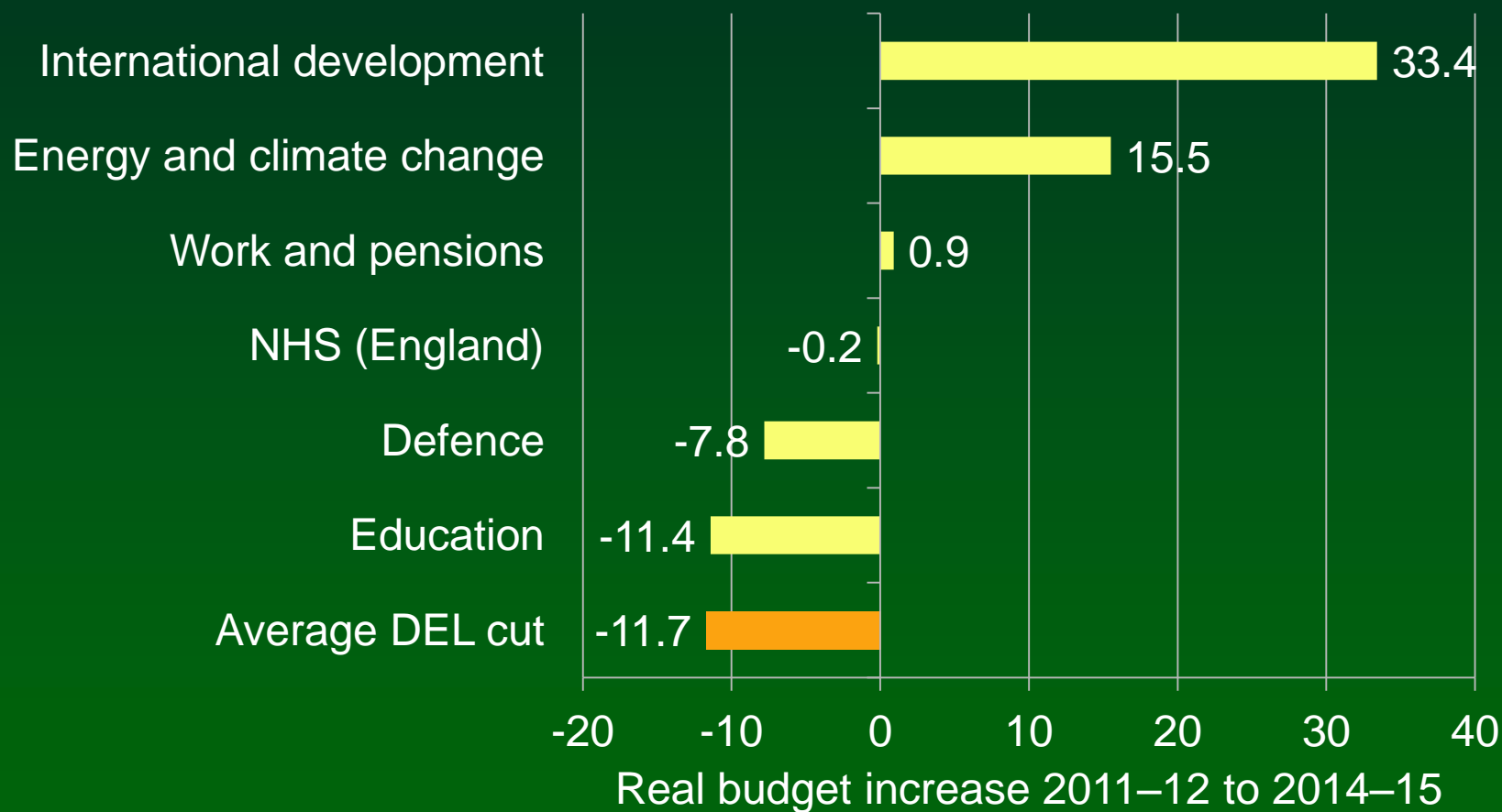
- Such cuts to public service spending not done in the UK before
  - never more than 2 consecutive years of cuts previously
  - spending plans imply April 2010 to March 2017 will be the tightest 7 years for public service spending since WWII
- Only comparable international experience is Ireland in late 1980s
- On the other hand cuts follow a period of big spending increases
  - 12 consecutive years of real increases (1998–99 to 2009–10)
  - by 2016–17 total public service spending will be the same as in 2004–05 in real terms (2000–01 as a % of national income)

# 7-year squeeze on public service spending

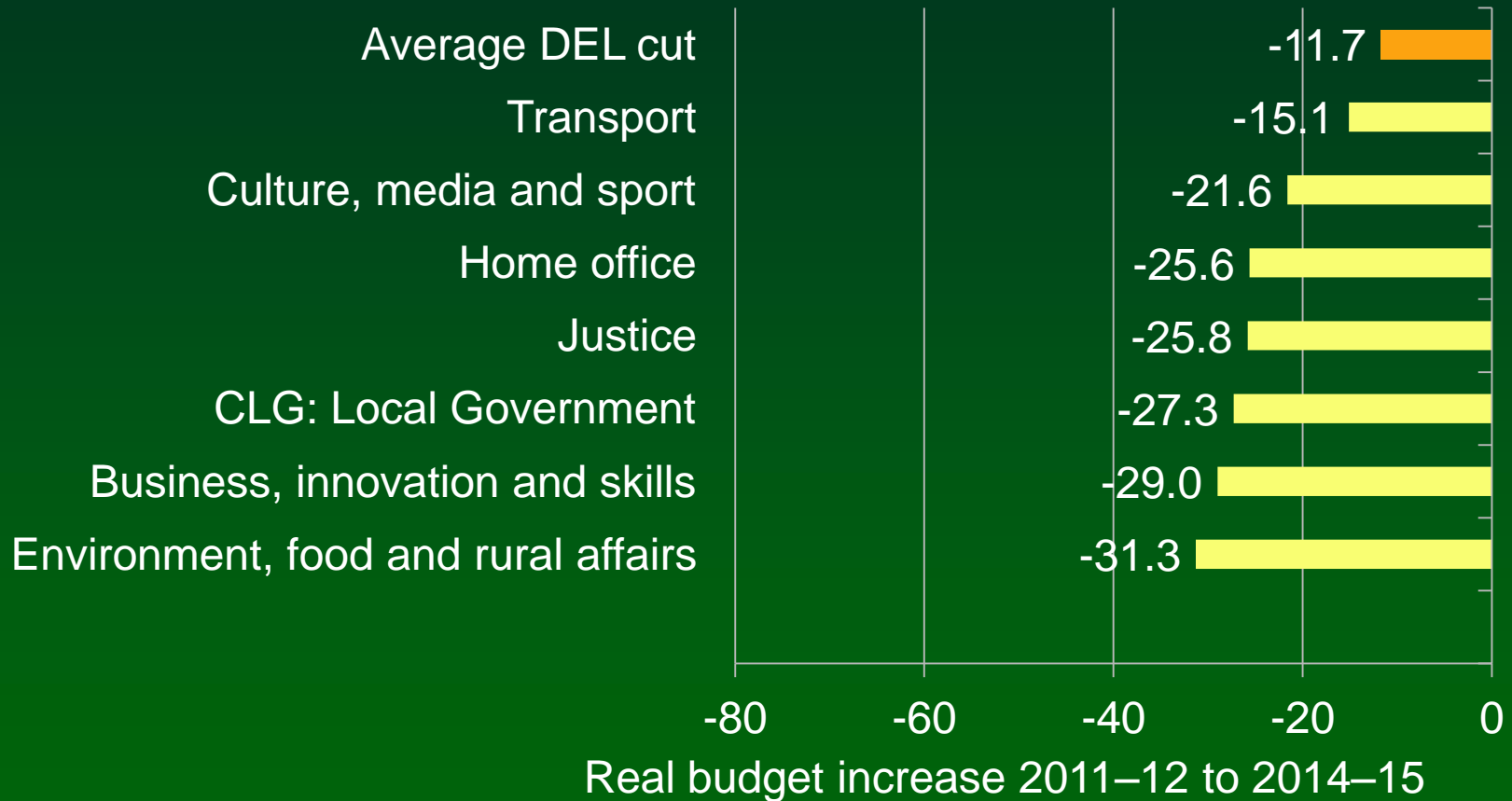




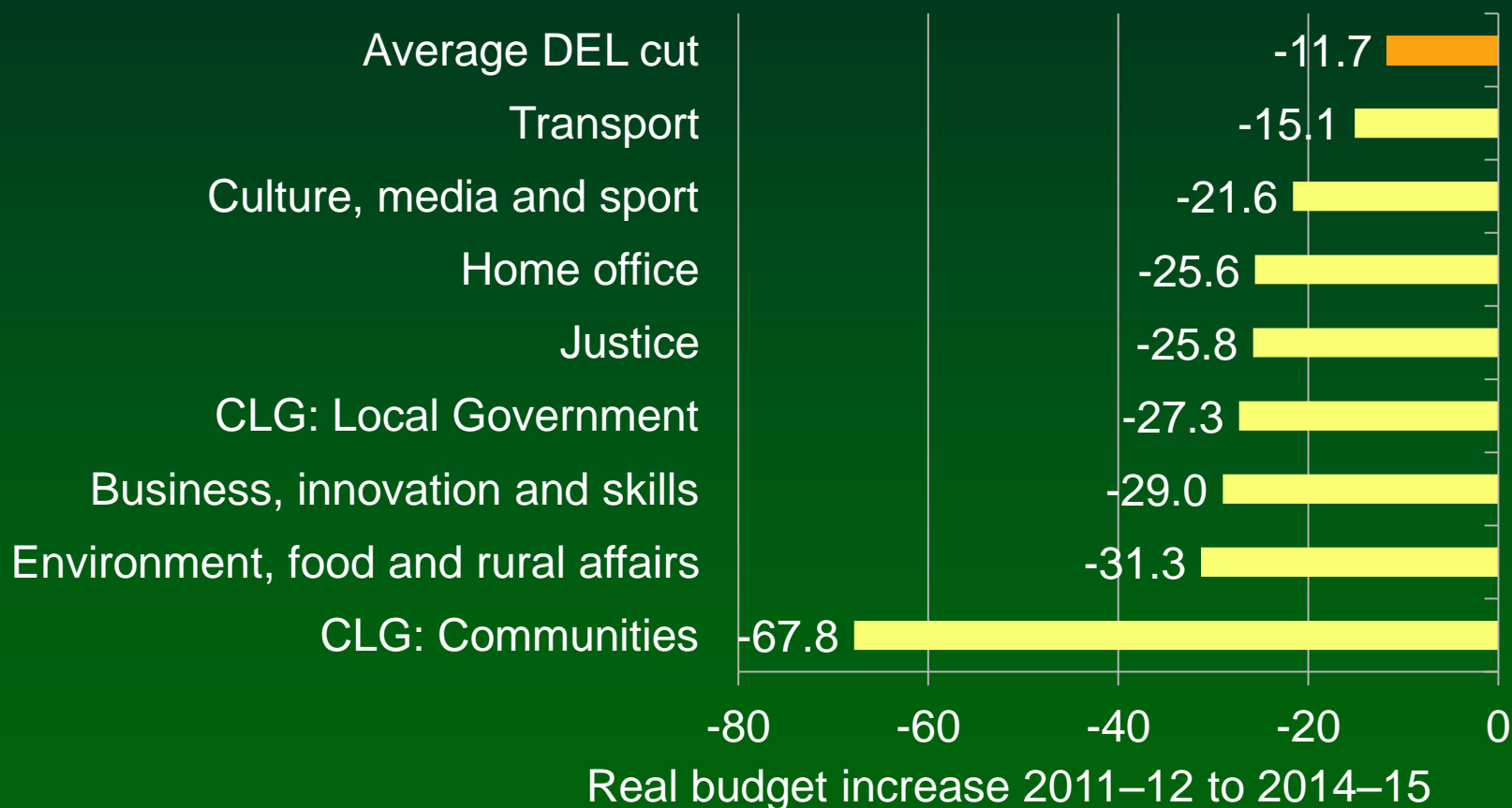
# Whitehall departments: 'winners'



# Whitehall departments : 'losers'

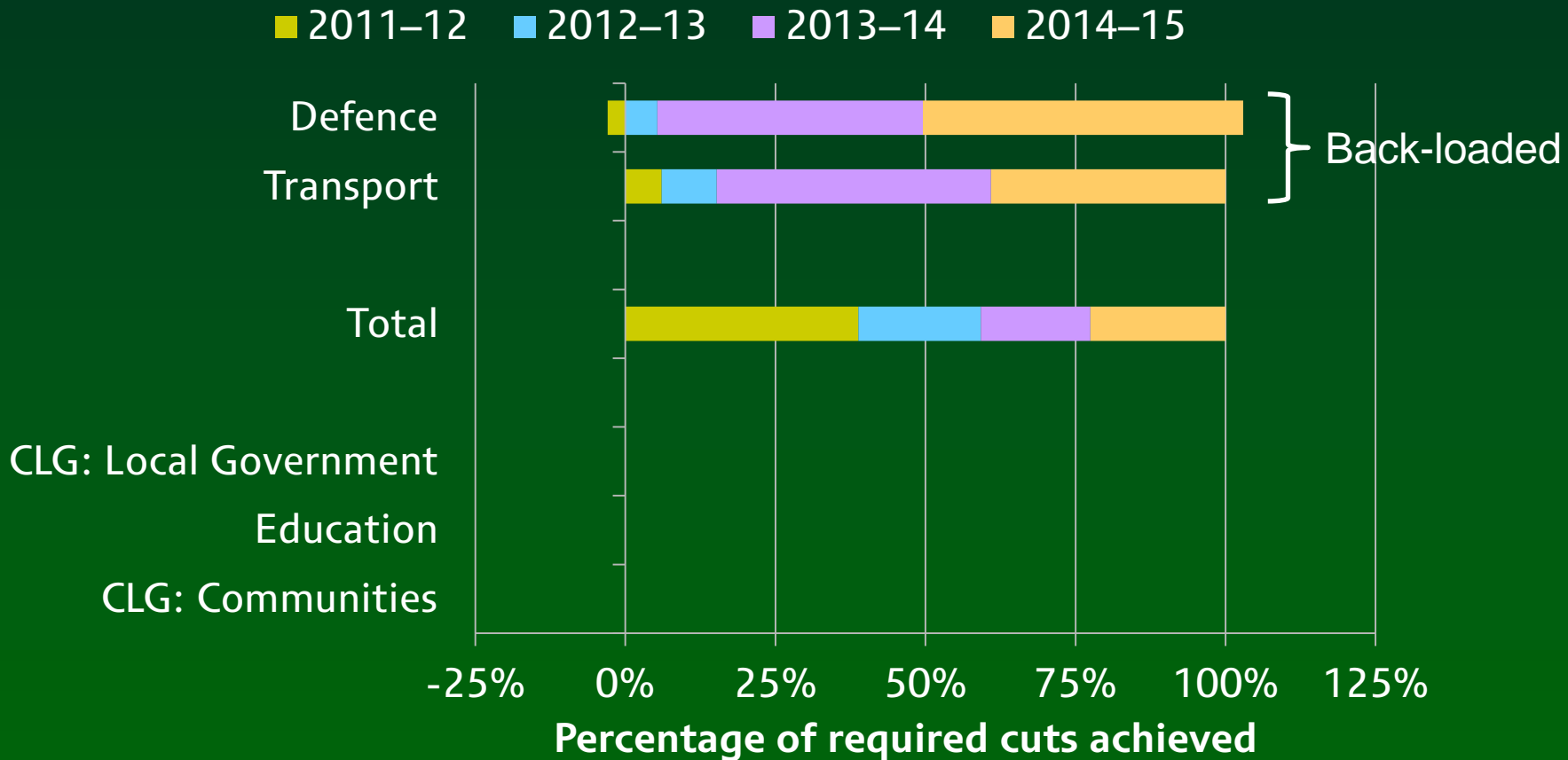


# Whitehall departments : 'losers'



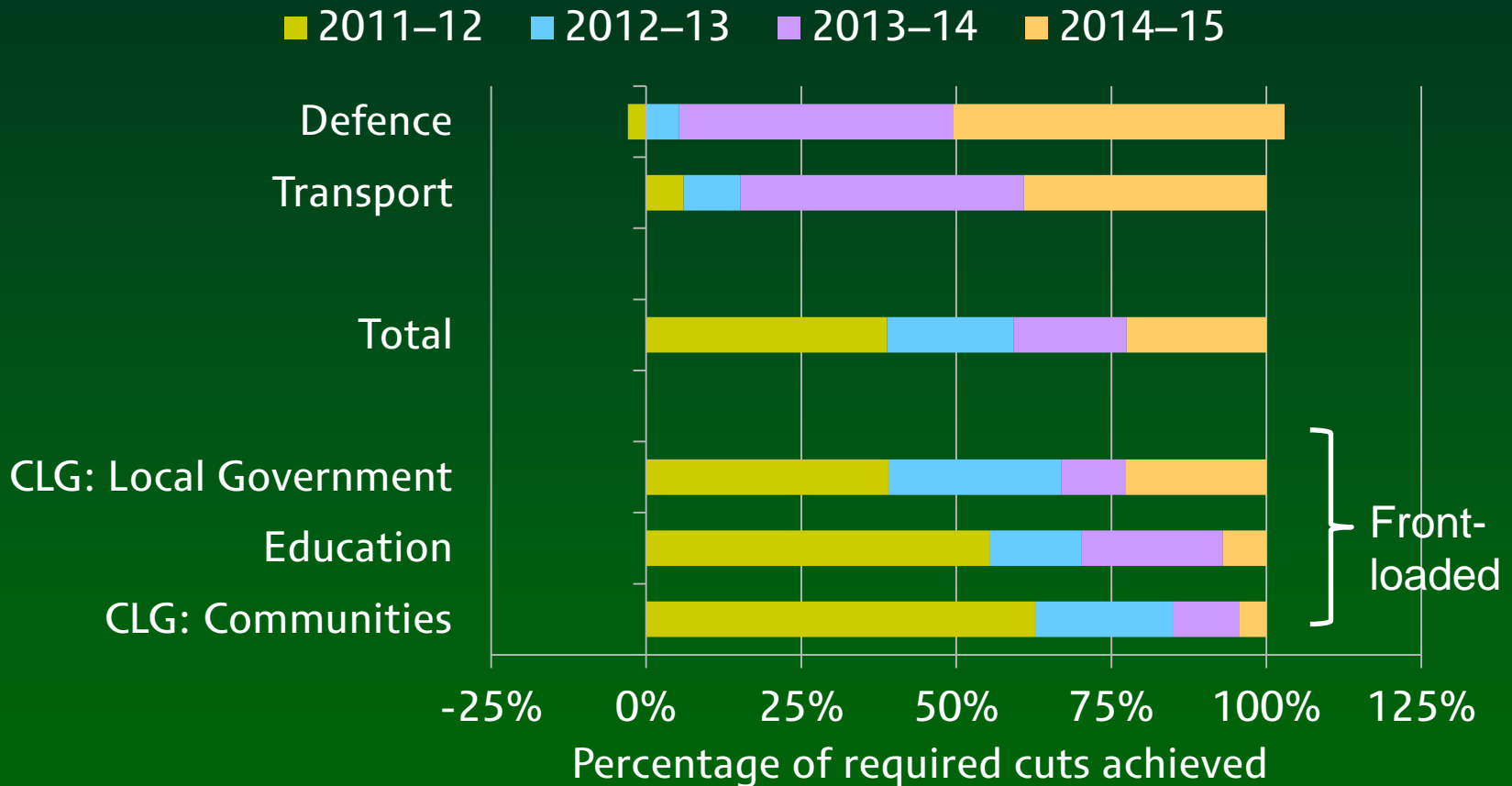
# How far have we gone so far?

## Whitehall departments: timing of cuts



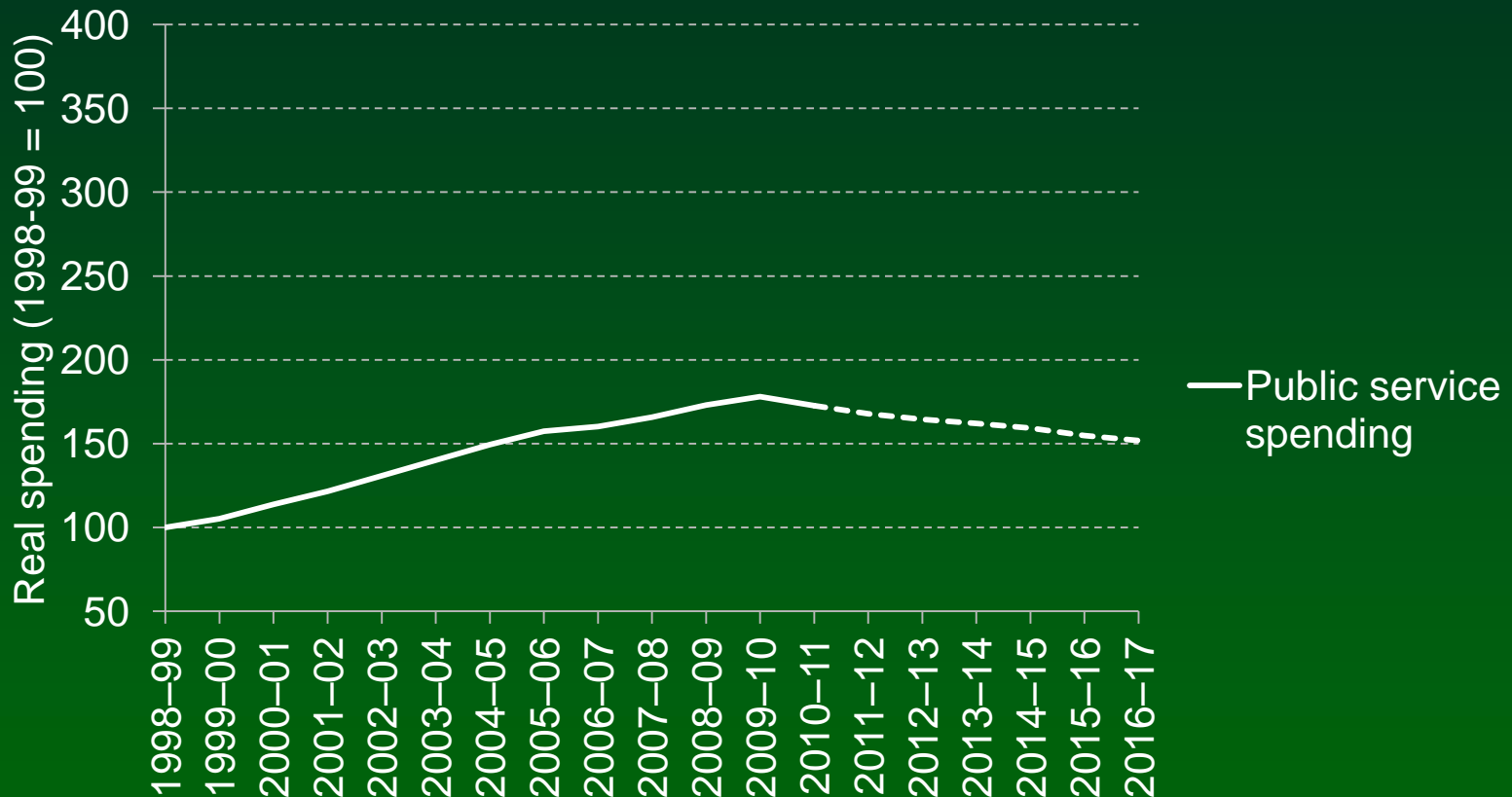
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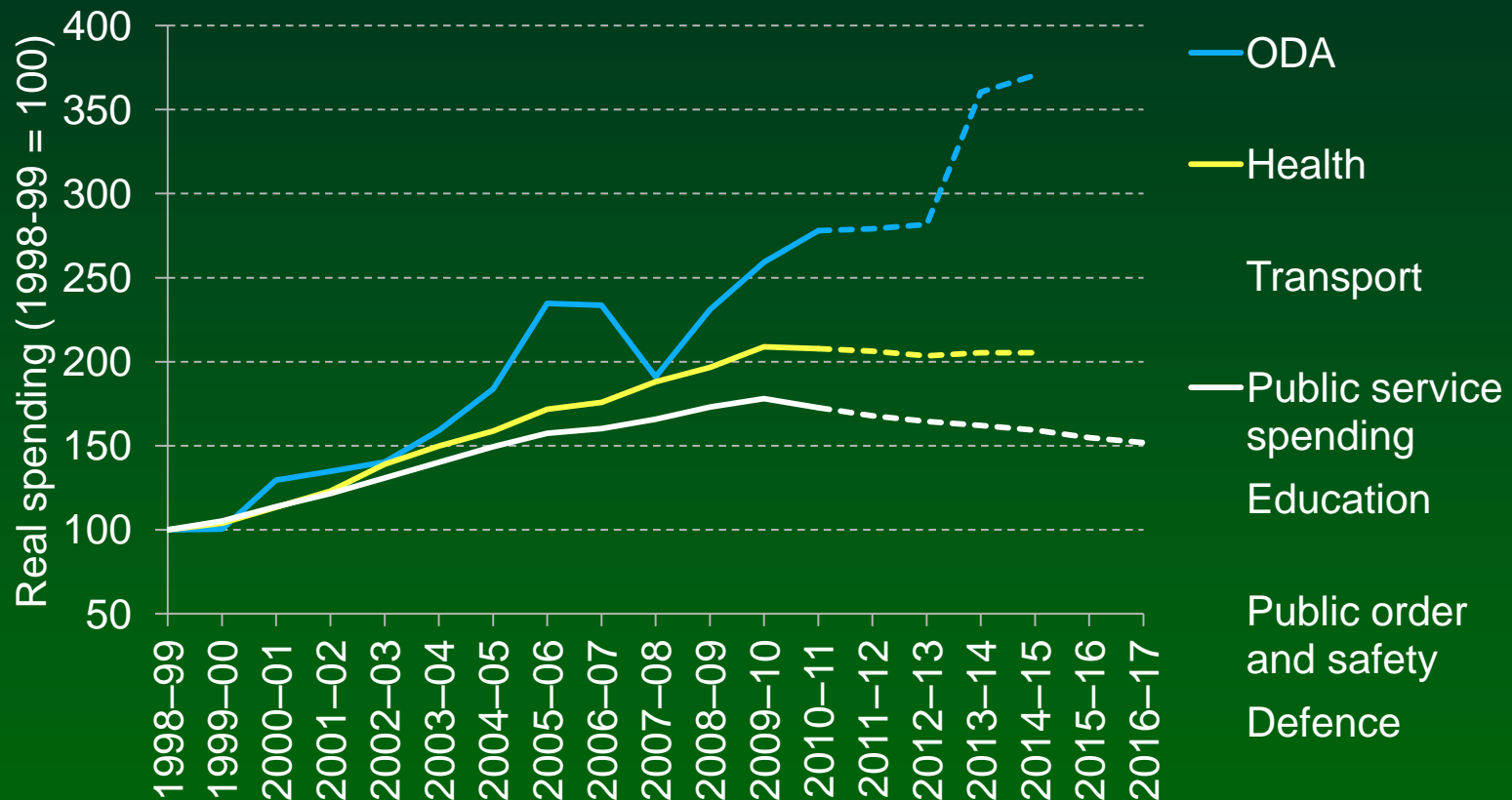
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- How tight will they feel?



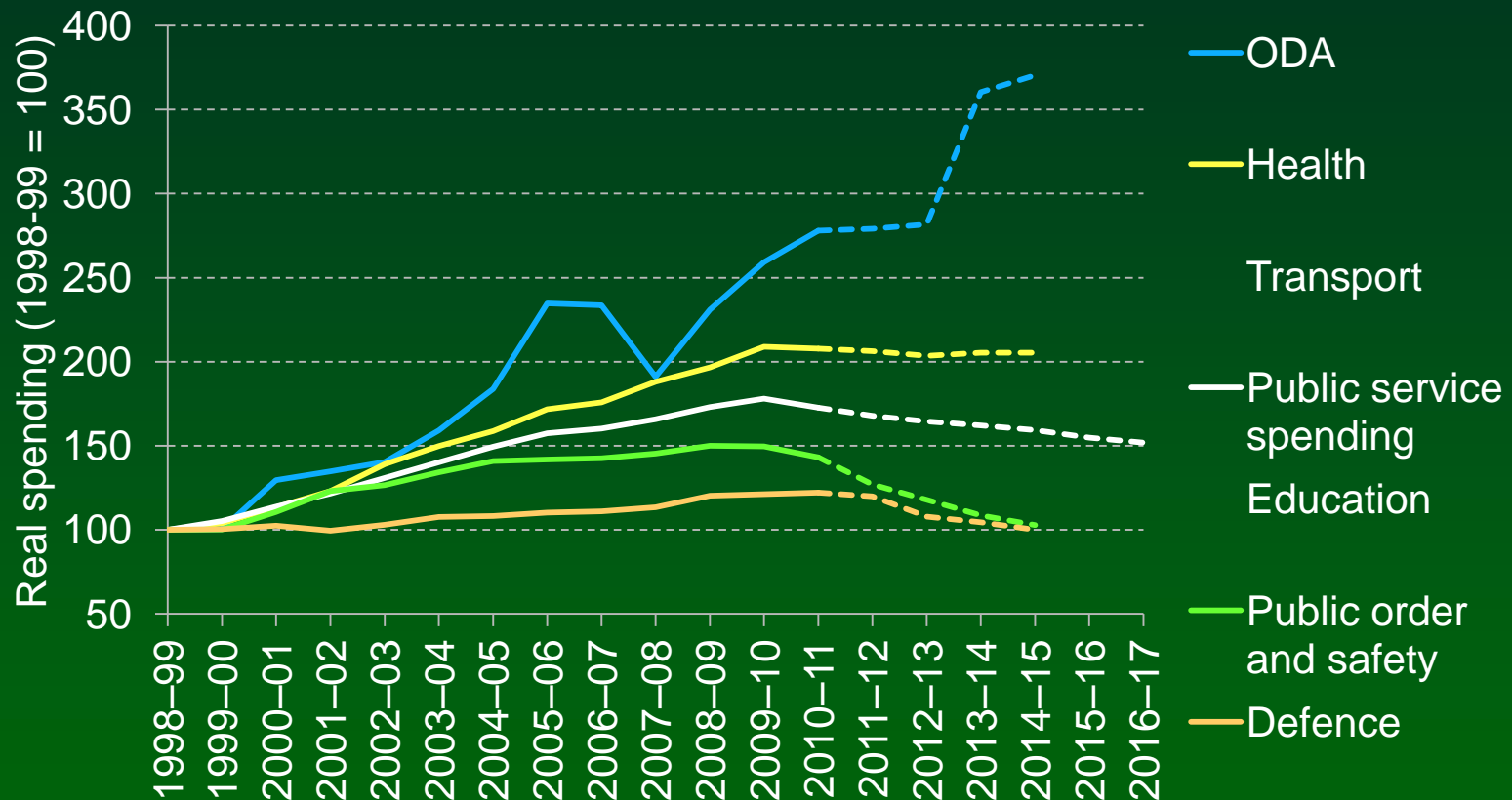
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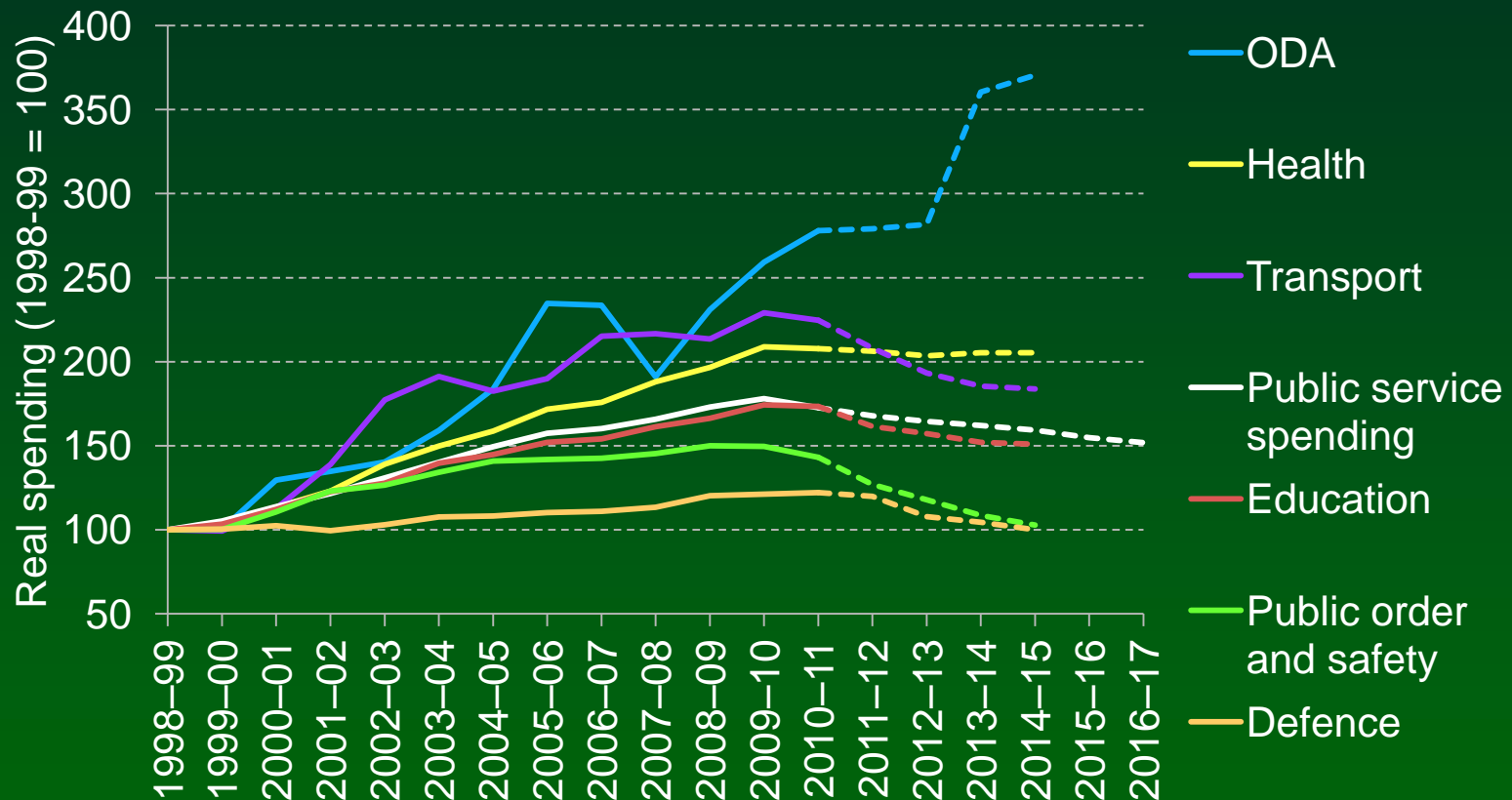
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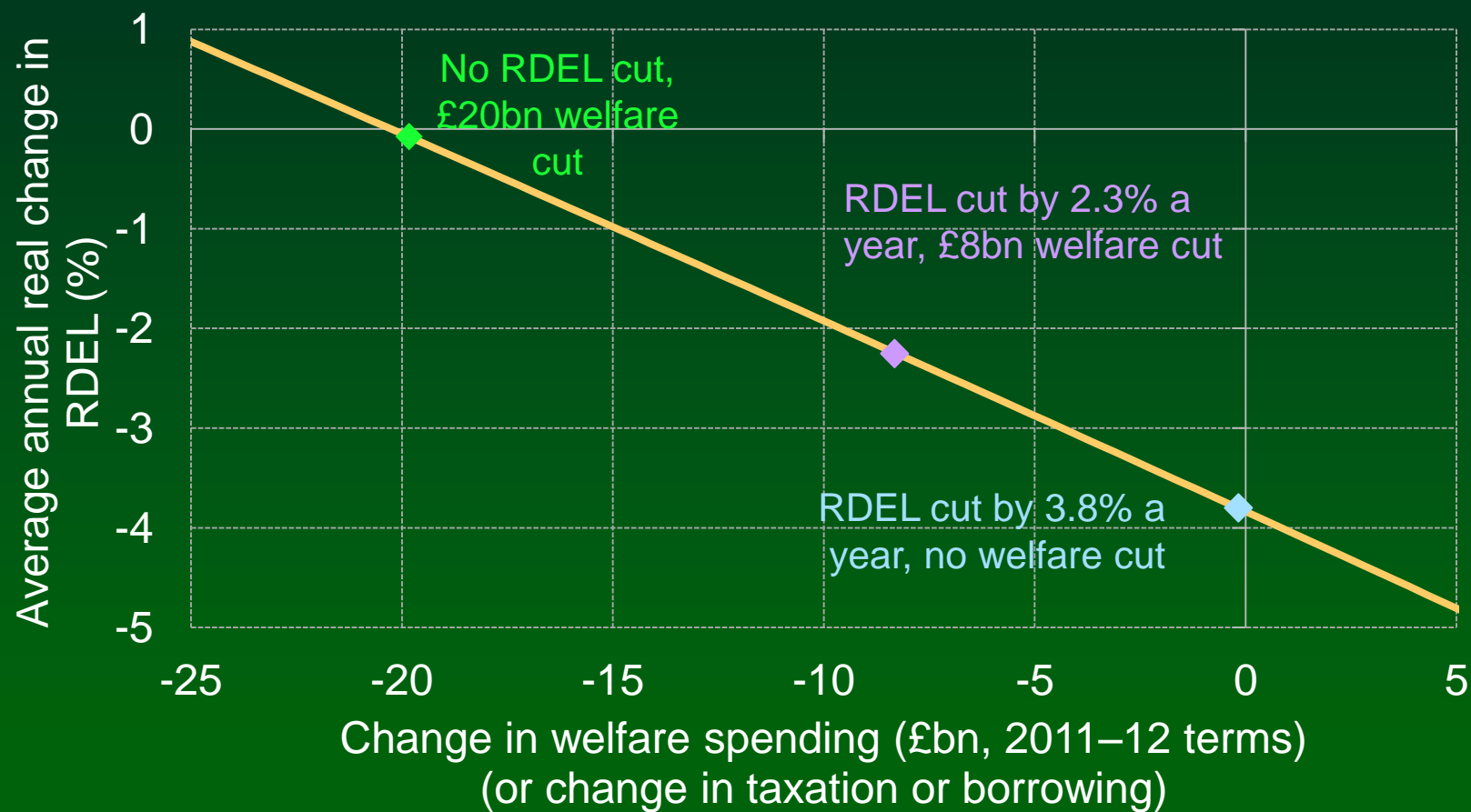


# Can the tight spending plans be delivered?

## - How tight will they feel?



# Trade-off between cuts to public service spending and welfare cuts: 2015–16 and 2016–17



Note: HM Treasury and IFS calculations. Resource Departmental Expenditure Limits (RDEL) is the non-investment component of the spending by central government on the delivery and administration of public services.



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# Conclusions

- Financial crisis and recession opened up large hole in the UK's public finances
- Government has a fiscal consolidation plan that lasts to 2016–17
  - Four-fifths coming from spending cuts
- Risks to the fiscal consolidation plan
  - Can cuts to public service spending be delivered?
    - UK has not achieved such a sustained period of cuts to public service spending since World War II
    - Also few comparable examples internationally
    - Areas facing biggest cuts are largely not those that saw big spending increases under Labour
  - What if the economy weakens further?
    - Temporary economic weakness is alright but additional permanent weakness is not
- More difficult decisions to be made in the next Spending Review



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# Growth is under performing

	OBR Budget forecast	Outturn
2012 Q1	0.3	-0.3
2012 Q2	0.0	-0.5
2012 Q3	0.6	?
2012 Q4	0.3	?
2013 Q1	0.6	?
<b>2012-13</b>	<b>1.0</b>	<b>??</b>

- Borrowing looks likely to overshoot in 2012-13
- Pressure on government to stimulate
  - Timely, targeted and temporary

# Longer term public spending issues

- Demographic pressures (ageing population) put upward pressure on spending

# OBR age-related spending projections

<b>% of national income</b>	<b>2016-</b>	<b>2021-</b>	<b>2041-</b>	<b>2061-</b>
Health	6.8	7.1	8.3	9.1
Long-term care	1.1	1.2	1.7	2.0

# OBR age-related spending projections

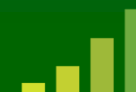
<b>% of national income</b>	<b>2016-</b>	<b>2021-</b>	<b>2041-</b>	<b>2061-</b>
	<b>17</b>	<b>22</b>	<b>42</b>	<b>62</b>
Health	6.8	7.1	8.3	9.1
Long-term care	1.1	1.2	1.7	2.0
State pensions	5.6	5.3	7.0	8.3
Pensioner benefits	1.1	1.1	1.3	1.2





# OBR age-related spending projections

<b>% of national income</b>	<b>2016-17</b>	<b>2021-22</b>	<b>2041-42</b>	<b>2061-62</b>
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Long-term care	1.1	1.2	1.7	2.0
State pensions	5.6	5.3	7.0	8.3
Pensioner benefits	1.1	1.1	1.3	1.2
Public service pensions	2.2	2.0	1.5	1.3
Education	4.5	4.6	4.4	4.5
<b>Total age-related spending</b>	<b>21.3</b>	<b>21.3</b>	<b>24.2</b>	<b>26.3</b>



# International comparisons

- Cyclically-adjusted borrowing compared to 28 other advanced economies

	UK rank	
2007 (pre-crisis)	4 <sup>th</sup> highest	Greece, Ireland, Portugal higher
Crisis peak	5 <sup>th</sup> highest	Greece, Ireland, Iceland, Spain higher
2016	15 <sup>th</sup> highest	
Increase: 2007-peak	9 <sup>th</sup> largest	
Decrease: peak-2016	5 <sup>th</sup> largest	Greece, Iceland, Ireland, Portugal larger

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