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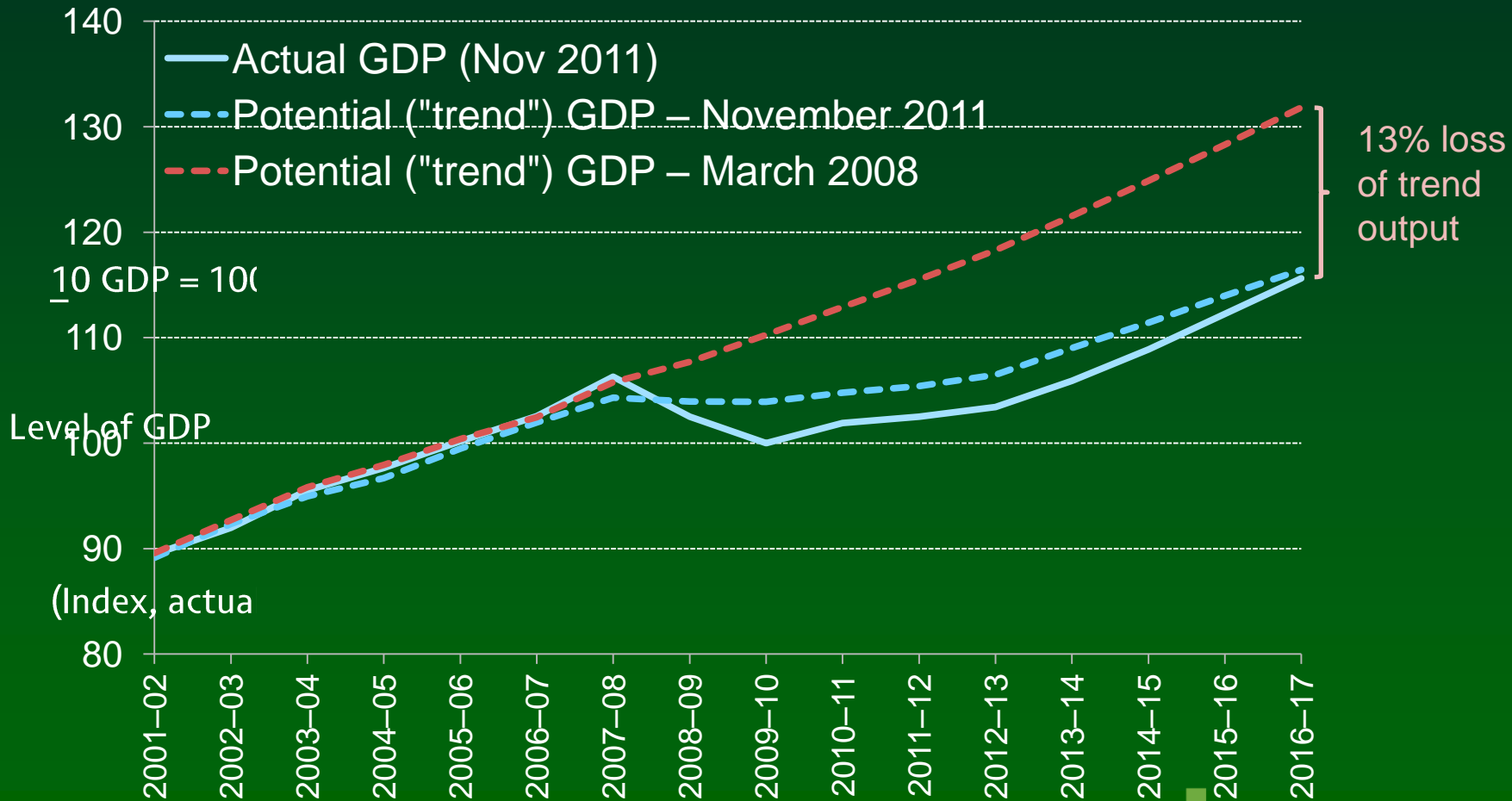
The UK fiscal outlook: an age of austerity

Rowena Crawford

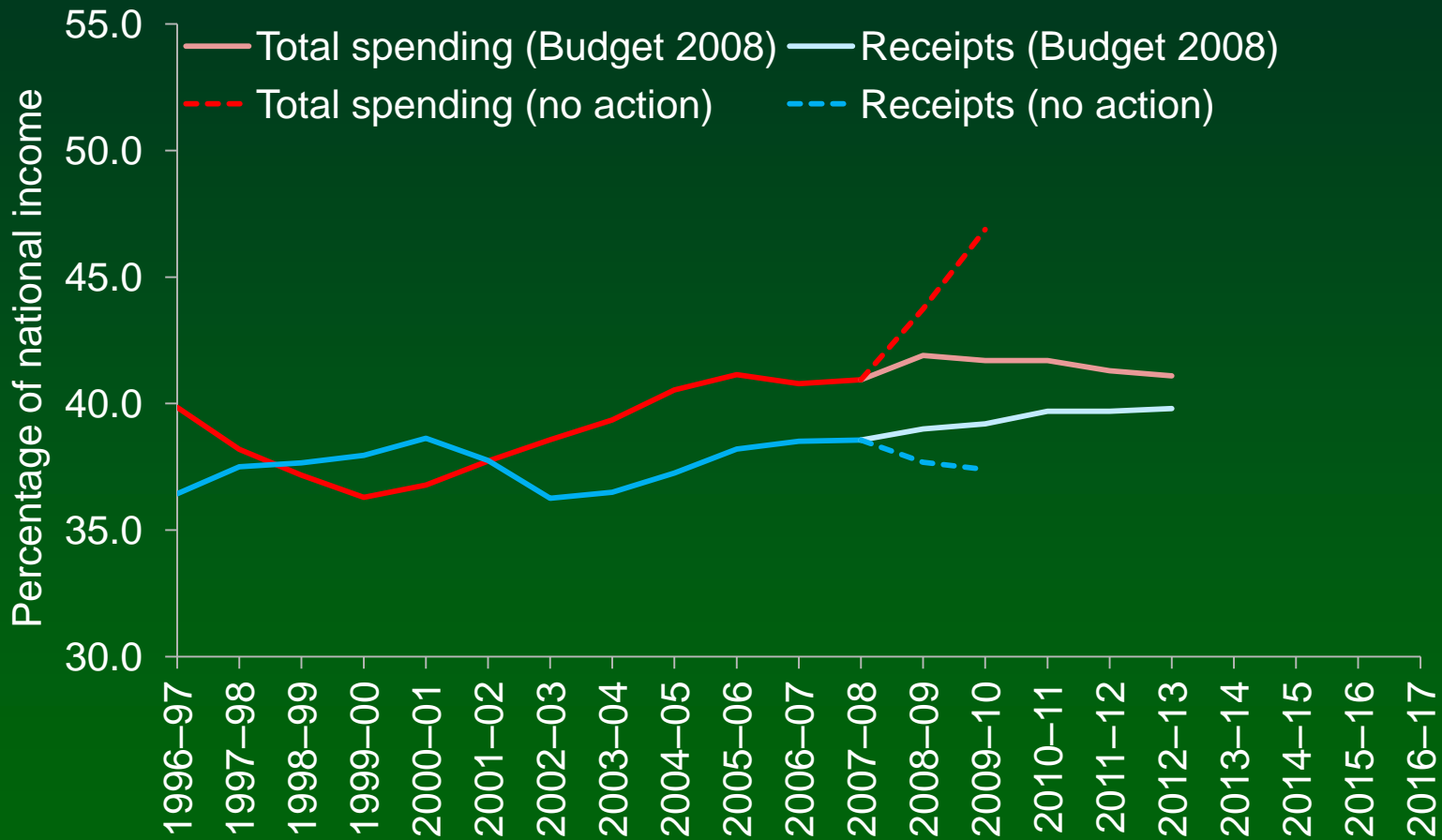
EBEA Bank of England conference, 27th June 2012

Weak short-term growth thought to reflect a permanent problem

Comparison of forecasts for real GDP growth and trend GDP

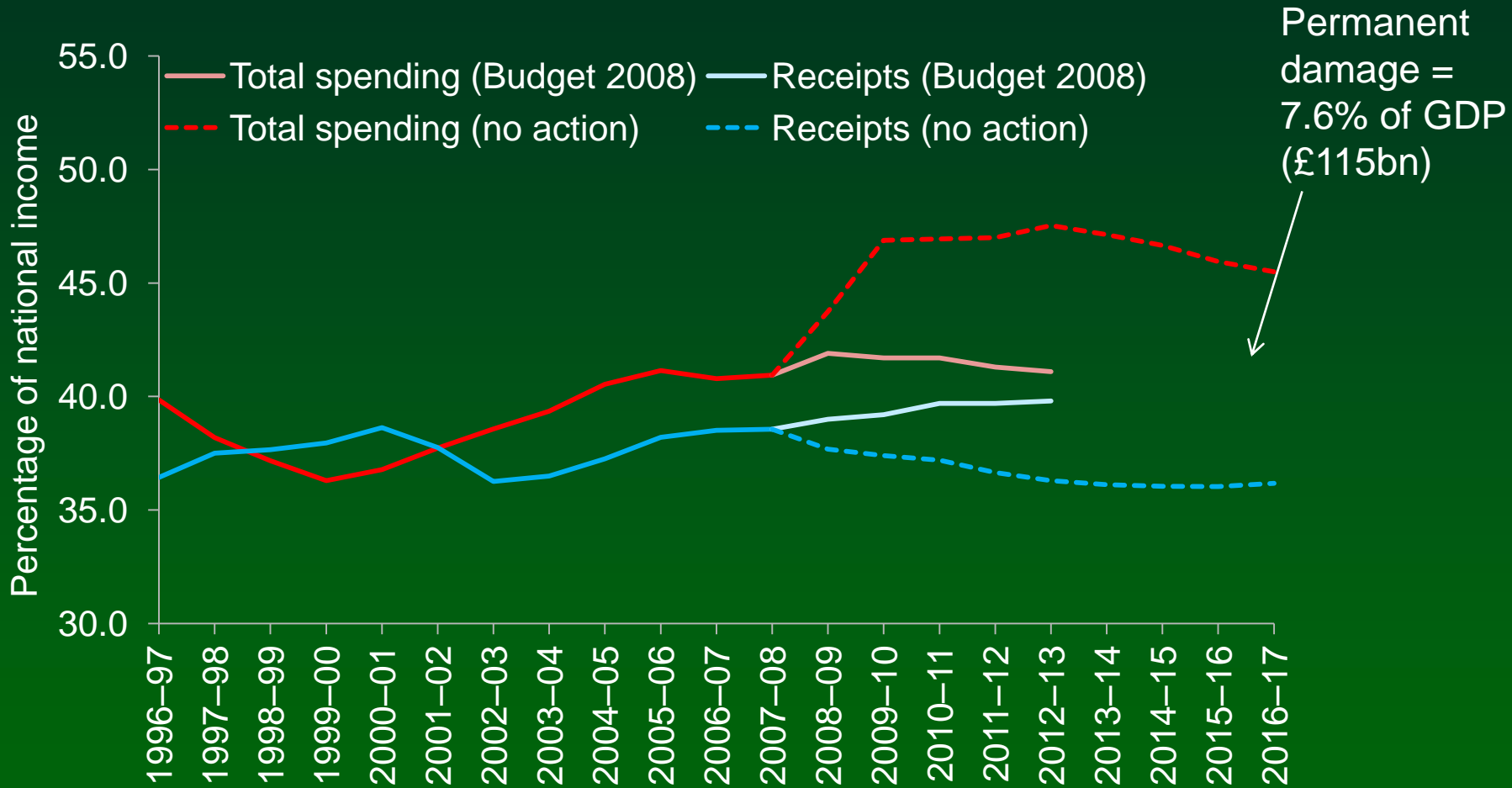


The “hole” in the public finances



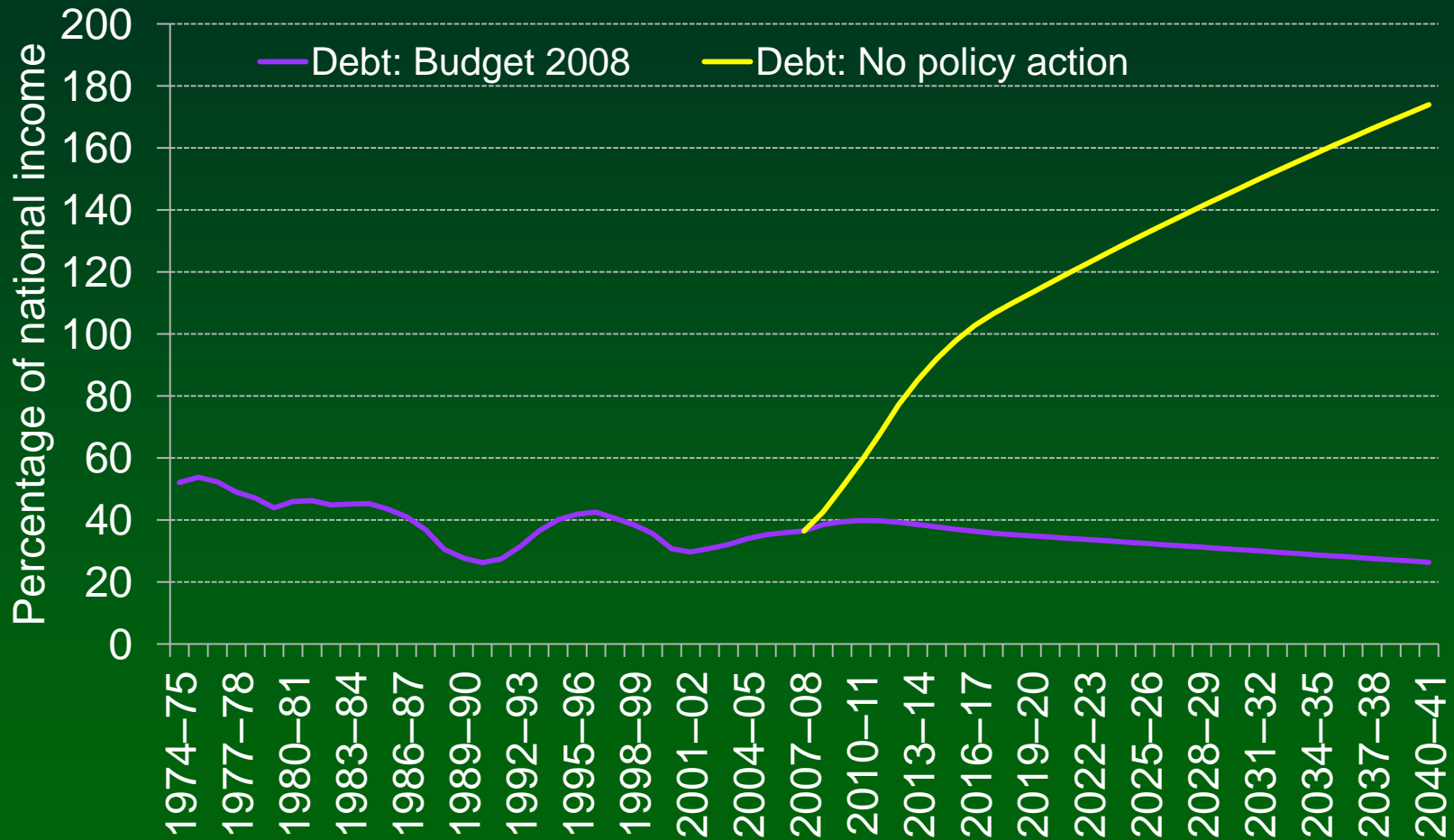
Sources: Authors' calculations using HM Treasury and Office for Budget Responsibility figures. (Updated version of Figure 3.6 of *The IFS Green Budget: February 2012*.)

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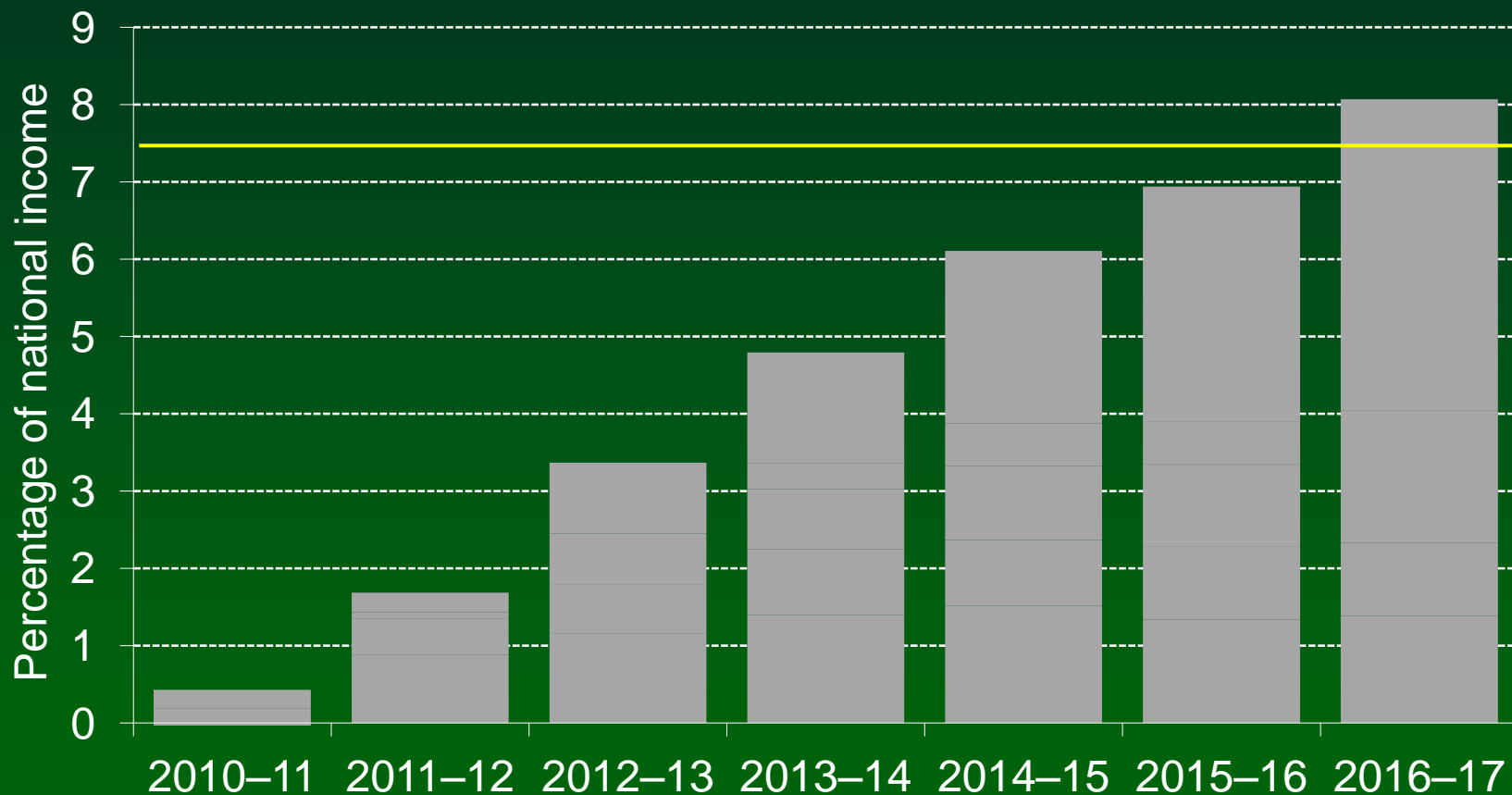
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No action would not have been sustainable



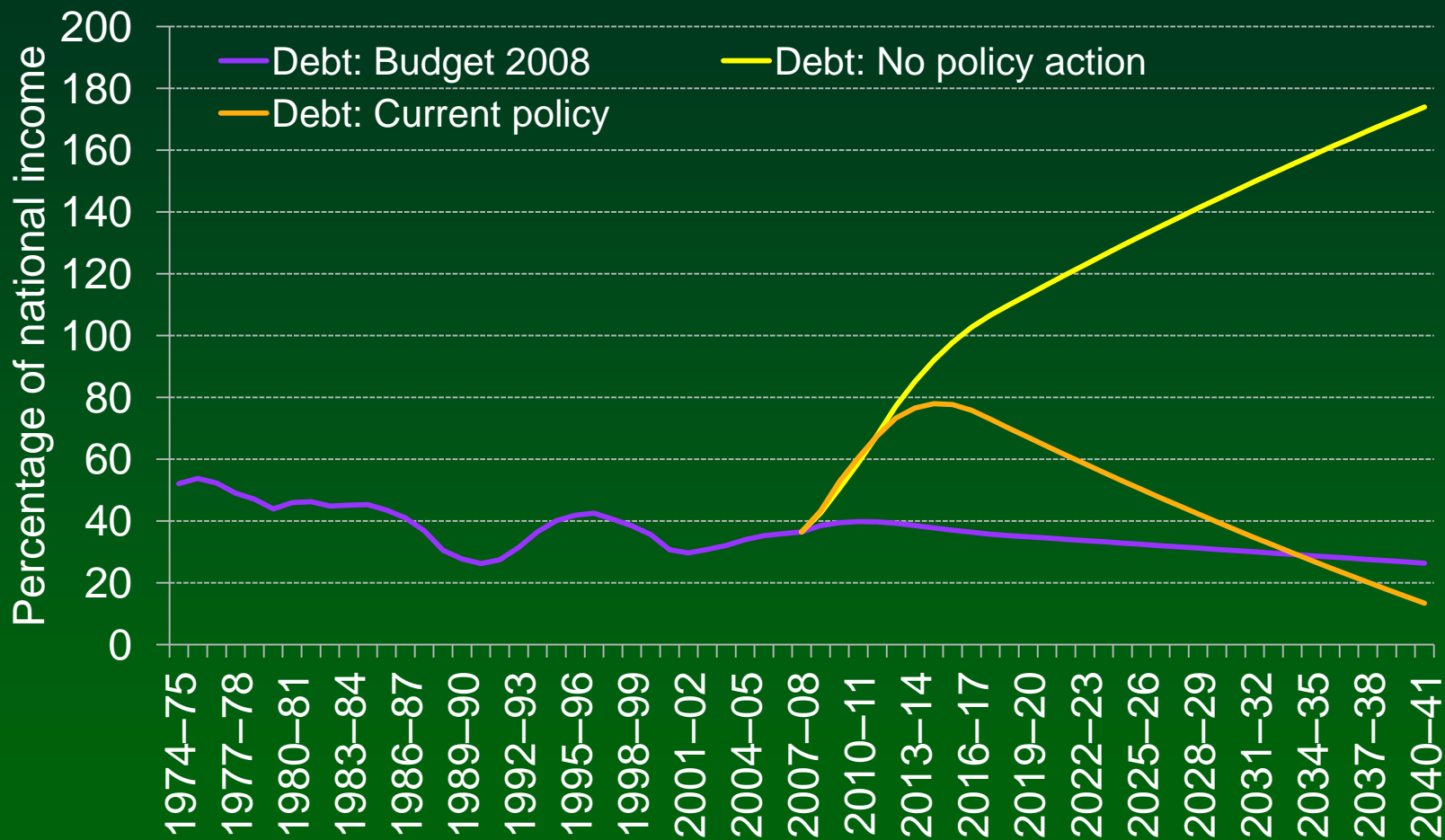
The cure (March 2012): 8.1% national income (£123bn) consolidation over 7 years

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



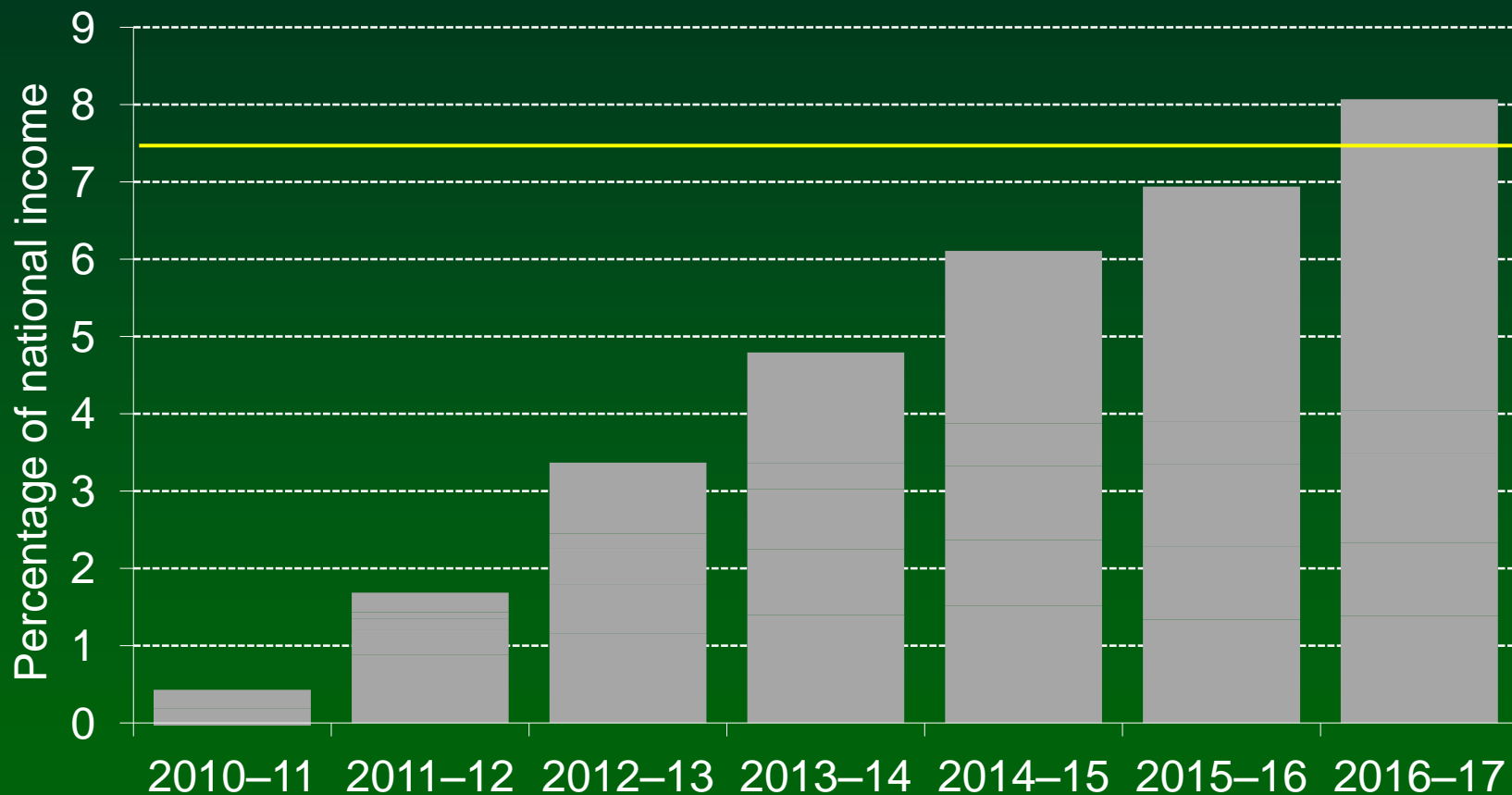
Debt back on a more sustainable path

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



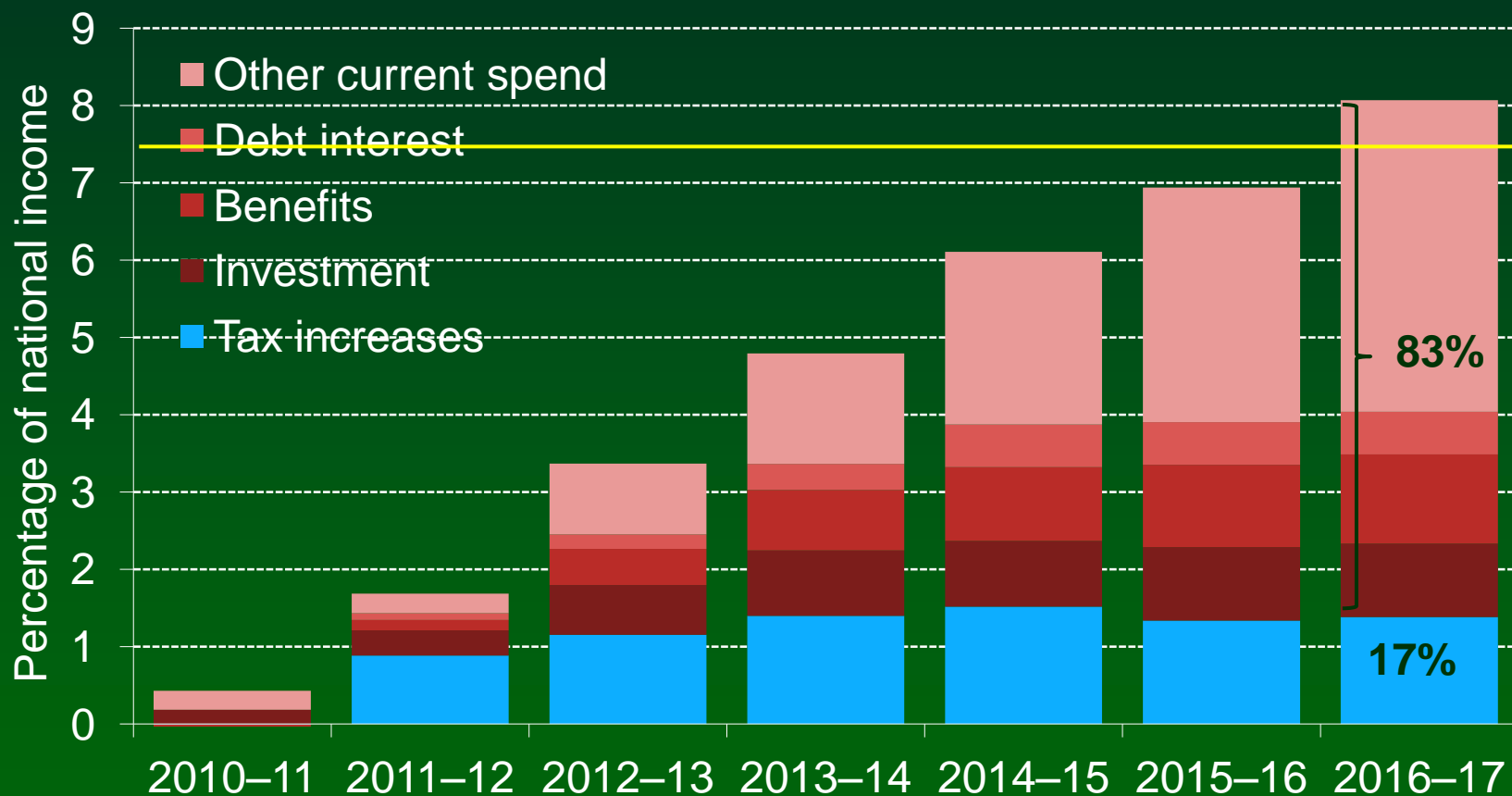
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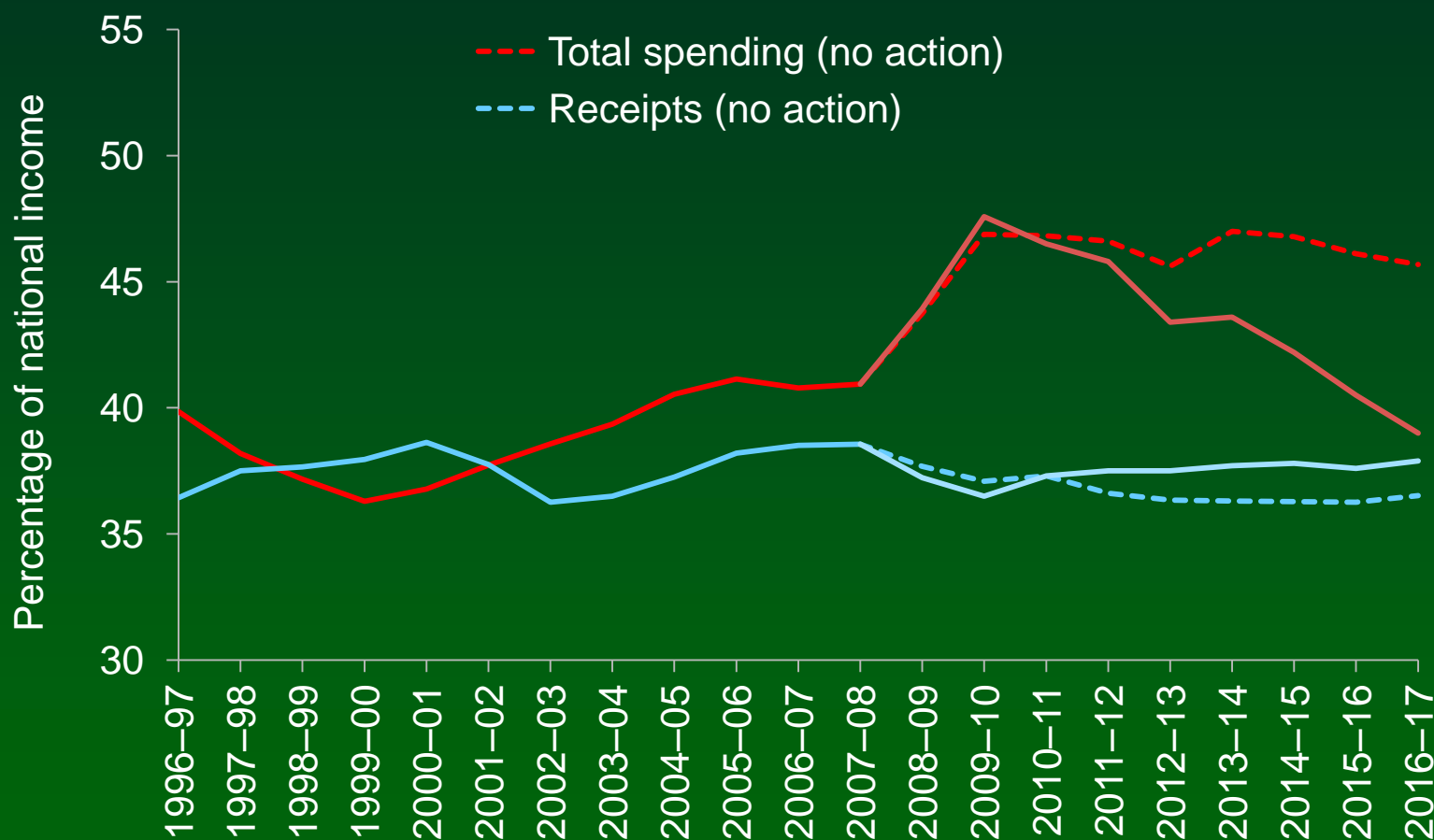


The cure (March 2012): 8.1% national income (£123bn) consolidation over 7 years

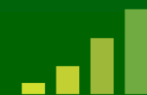
Mar 2012: 7.6% national income (£115bn) hole in public finances



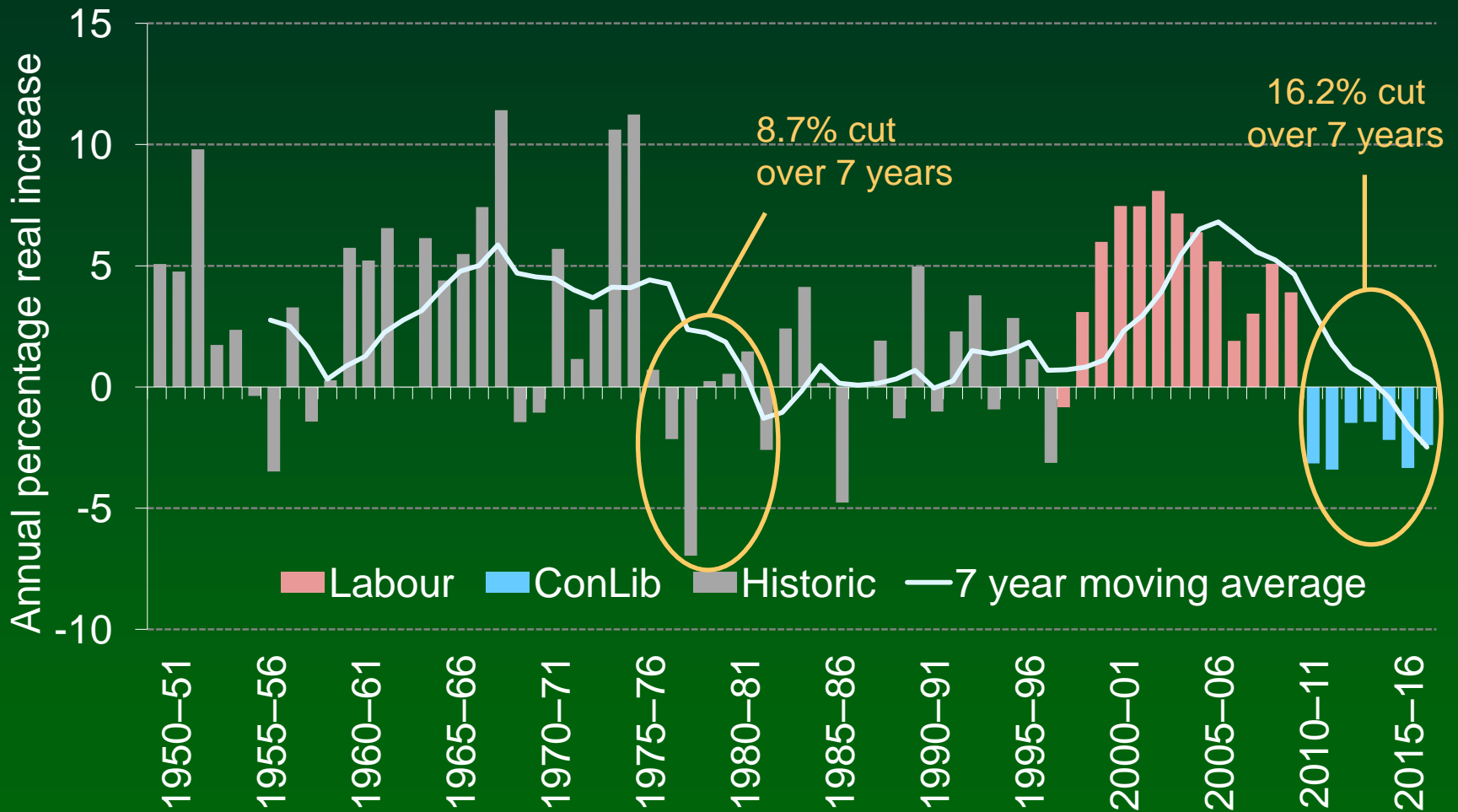
Spending and revenues back to pre-crisis levels



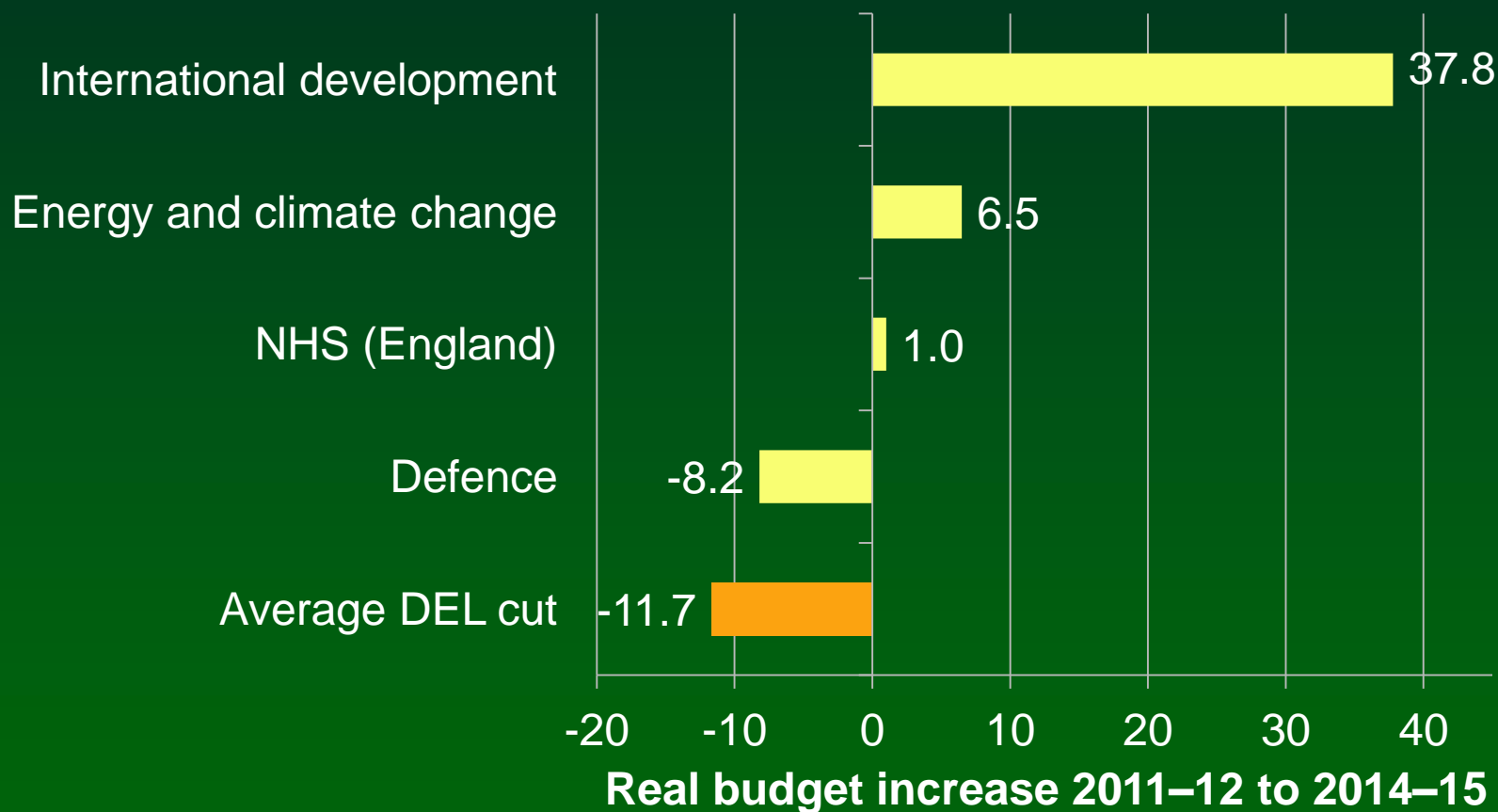
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7-year squeeze on public service spending



Whitehall departments: 'winners'



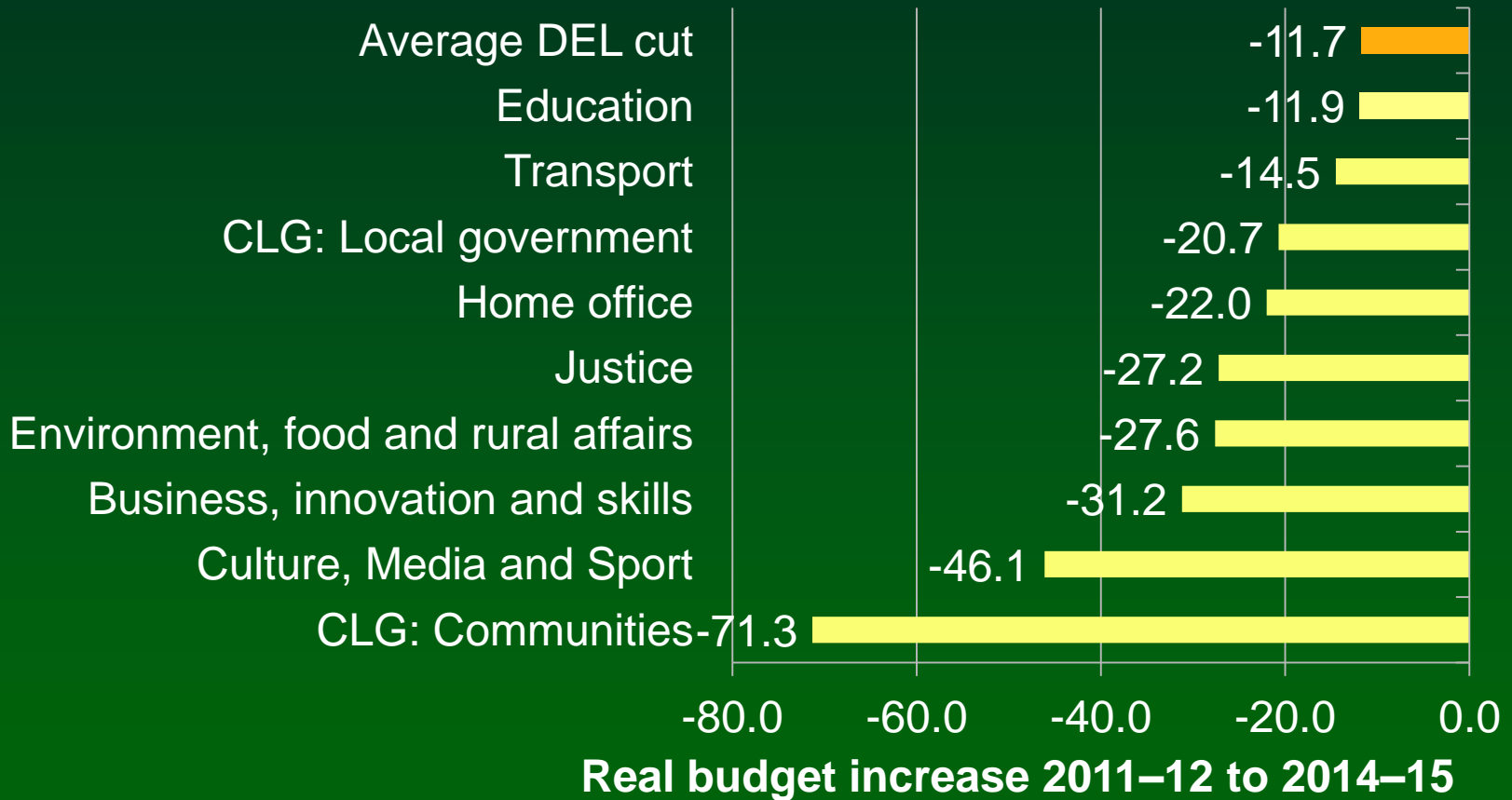
DEL = Departmental Expenditure Limits

Notes and sources: see Figure 5 of *"The changing composition of public spending"*, IFS Briefing Note 119



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Whitehall departments : 'losers'



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Risks to the public finances

Risks to the public finances – short term

- Lots of macro economic uncertainty
- Government may yet prove unable or unwilling to implement the planned spending cuts
 - Just under half of the real cut to spending planned between 2009-10 and 2016-17 will have been implemented by the end of 2012-13

Can the tight spending plans be delivered?

- Have such cuts been done before?

- 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
- What about elsewhere?
 - consider 29 advanced economies since (generally) 1970s
 - only example of comparable cuts is Ireland: over 1987 to 1989
 - lack of examples could well be because comparable cuts have not been attempted rather than that they cannot be delivered
 - other countries may do larger cuts post-crisis than the UK is planning

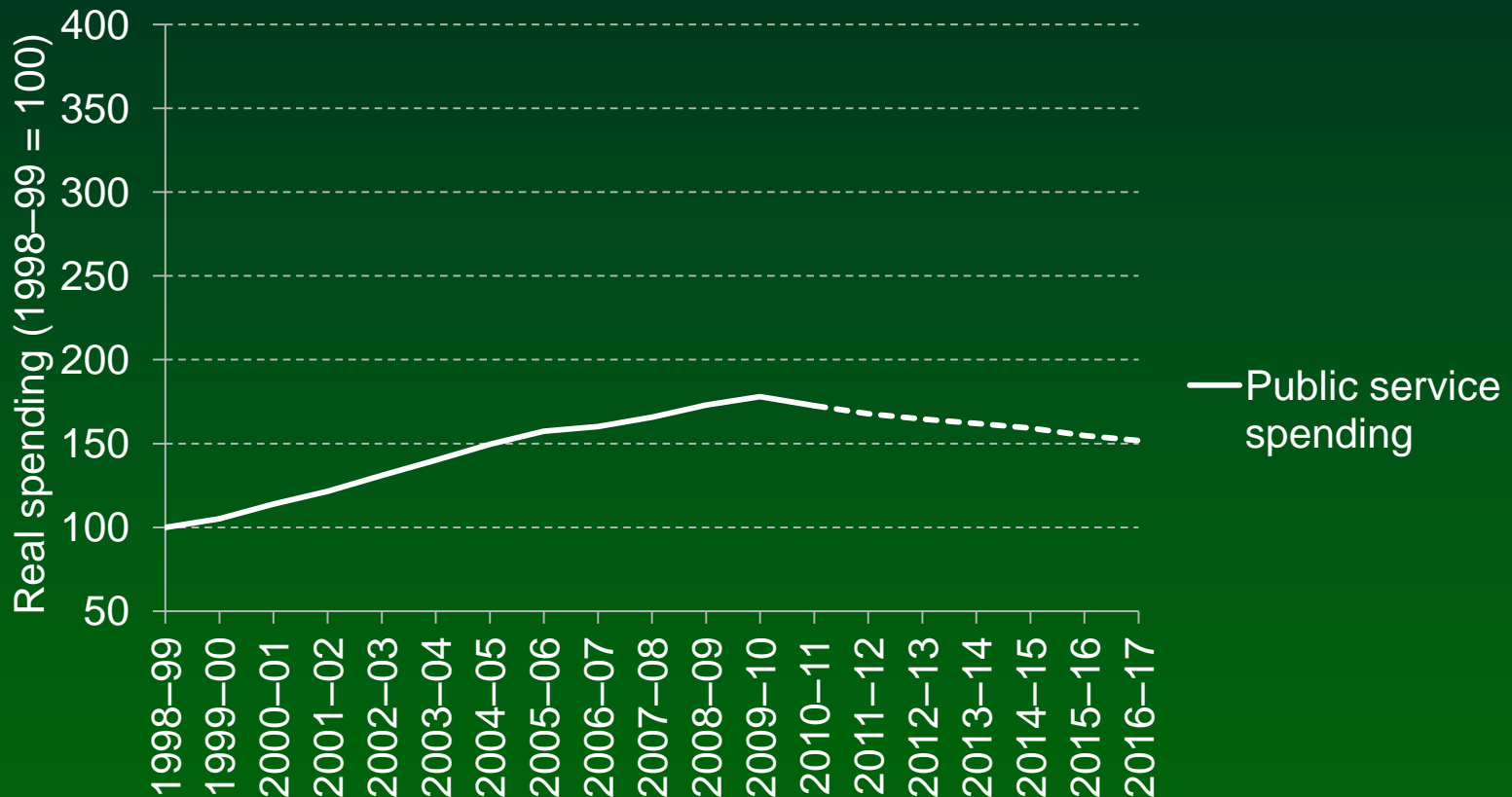
Can the tight spending plans be delivered?

- How tight will they feel?

- 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)
- Does not imply not painful
 - arguably more painful to experience 5 years of spending increases followed by 5 years of cuts than no spending increase for 10 years
- Not necessarily those areas that saw the largest increases that will see the largest cuts

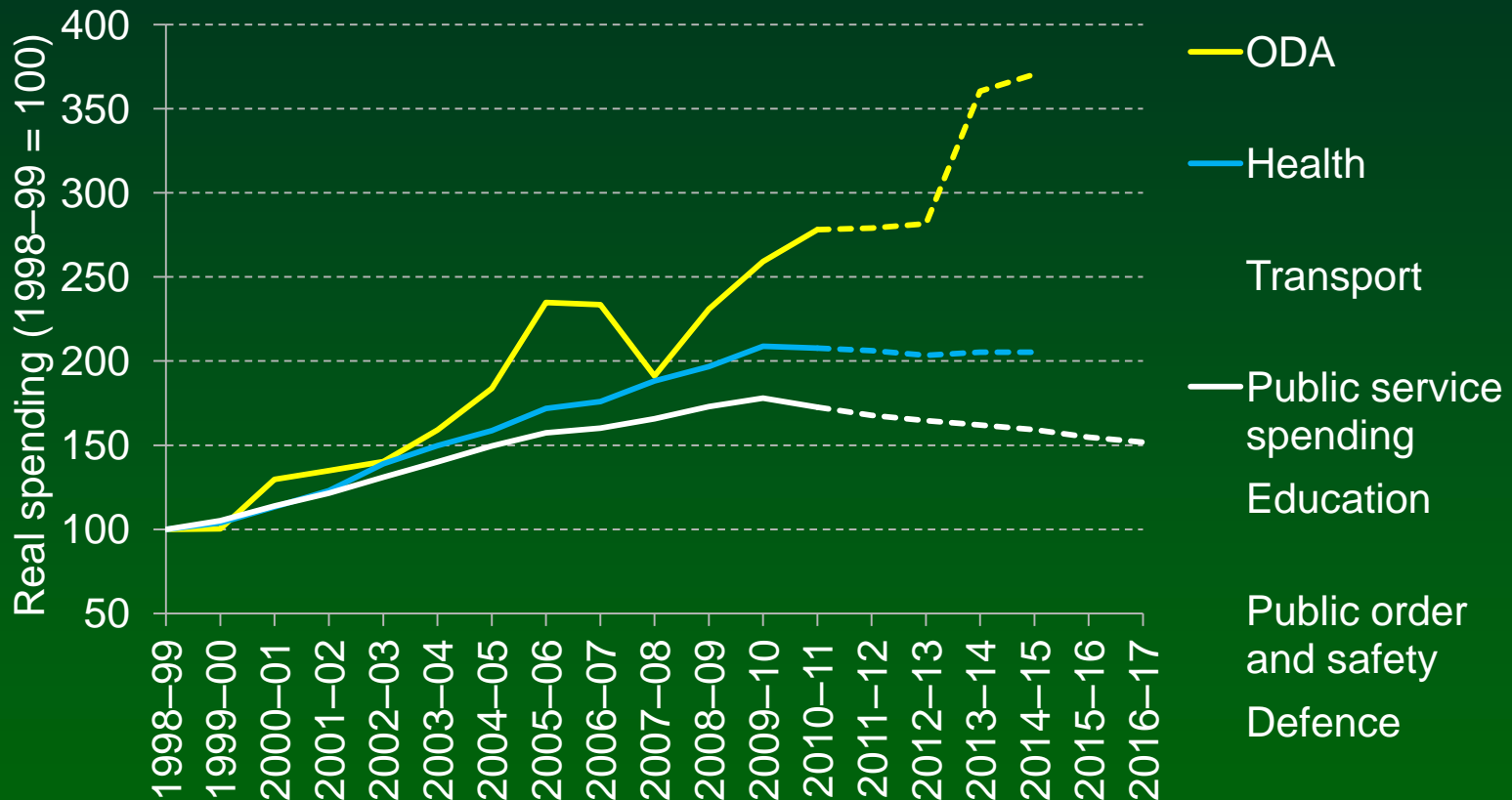
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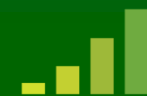
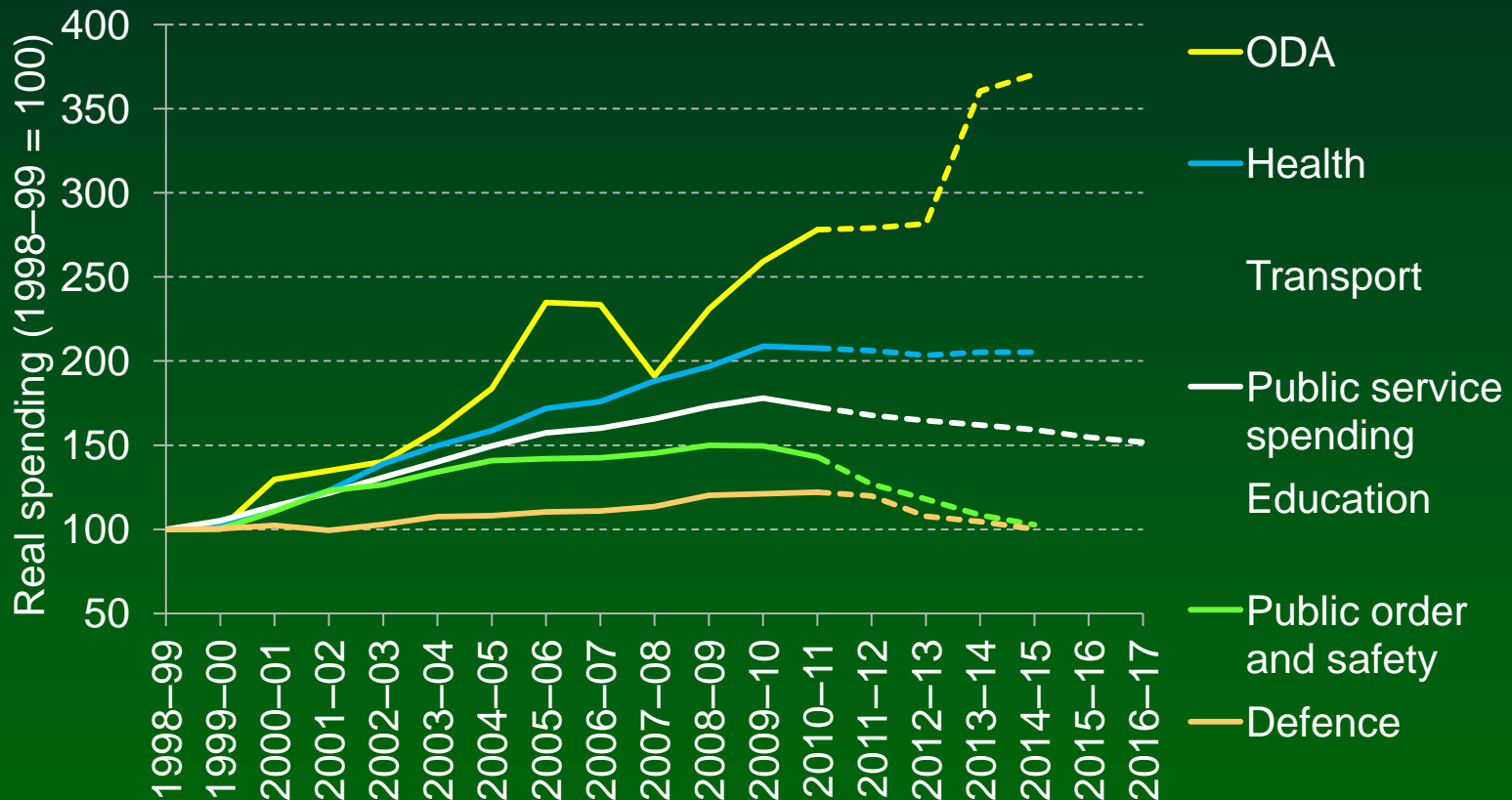
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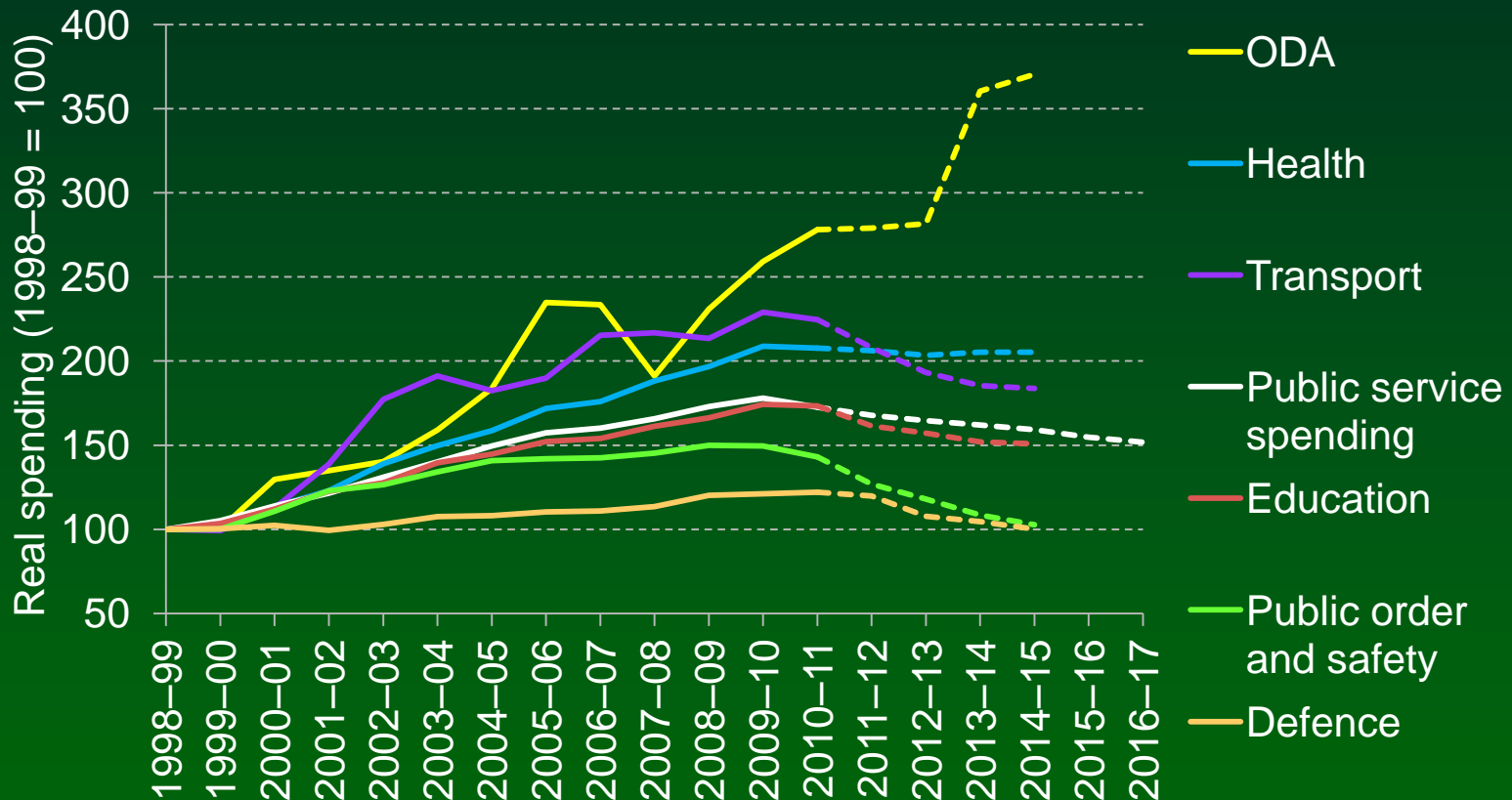
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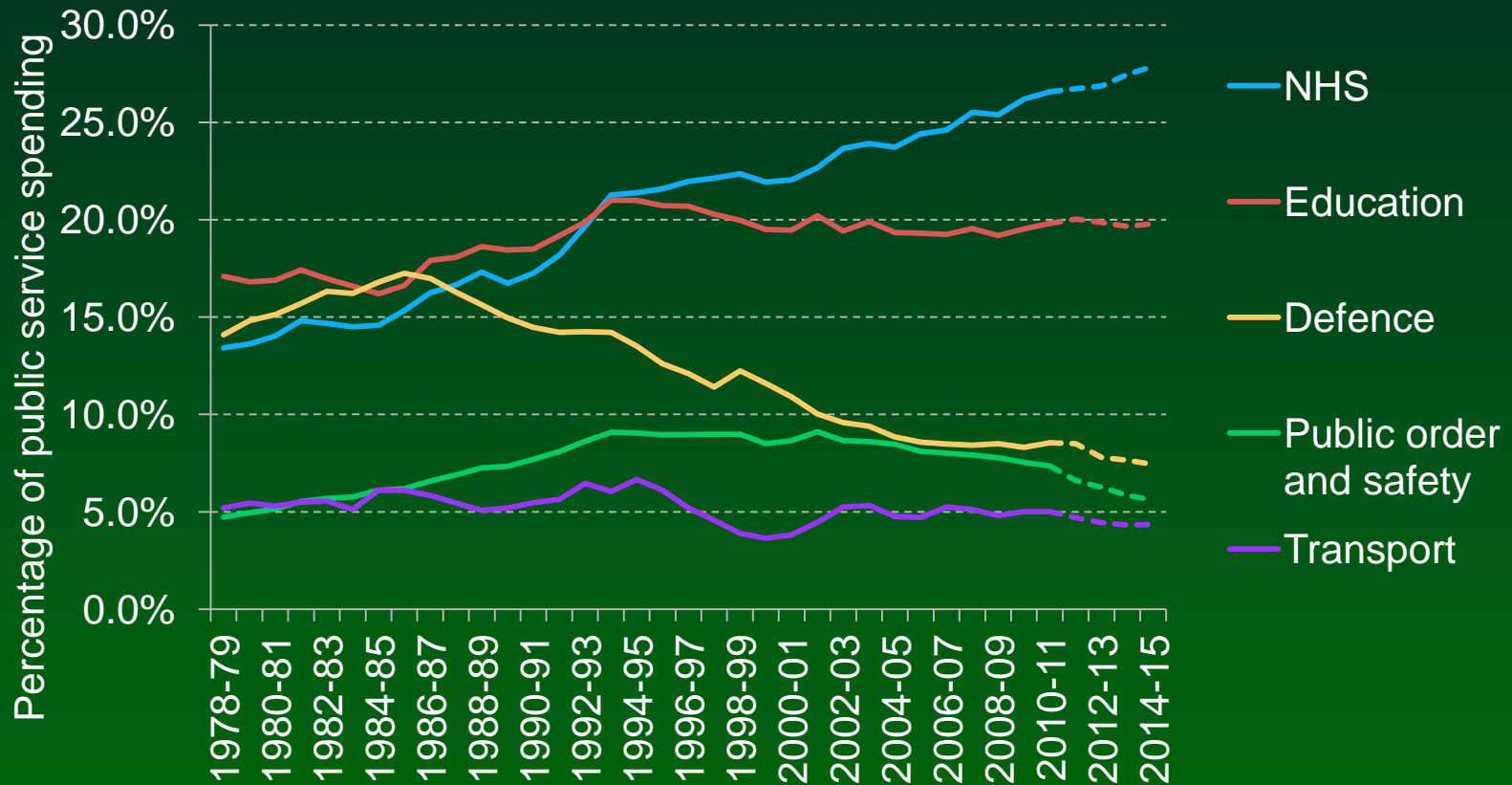


Can the tight spending plans be delivered?

- How tight will they feel?



No change in trends of 'priorities'



Risks to the public finances

Risks to the public finances – longer term

- Demographic changes put upward pressure on spending
- OBR age-related spending projections:

% of national income	2015-	2020-	2040-	2060-
	16	21	41	61
Health	7.4	7.7	9.1	9.8
Long-term care	1.2	1.3	1.8	2.0



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State pensions	5.5	5.2	6.8	7.9
Pensioner benefits	1.0	1.0	1.2	1.2

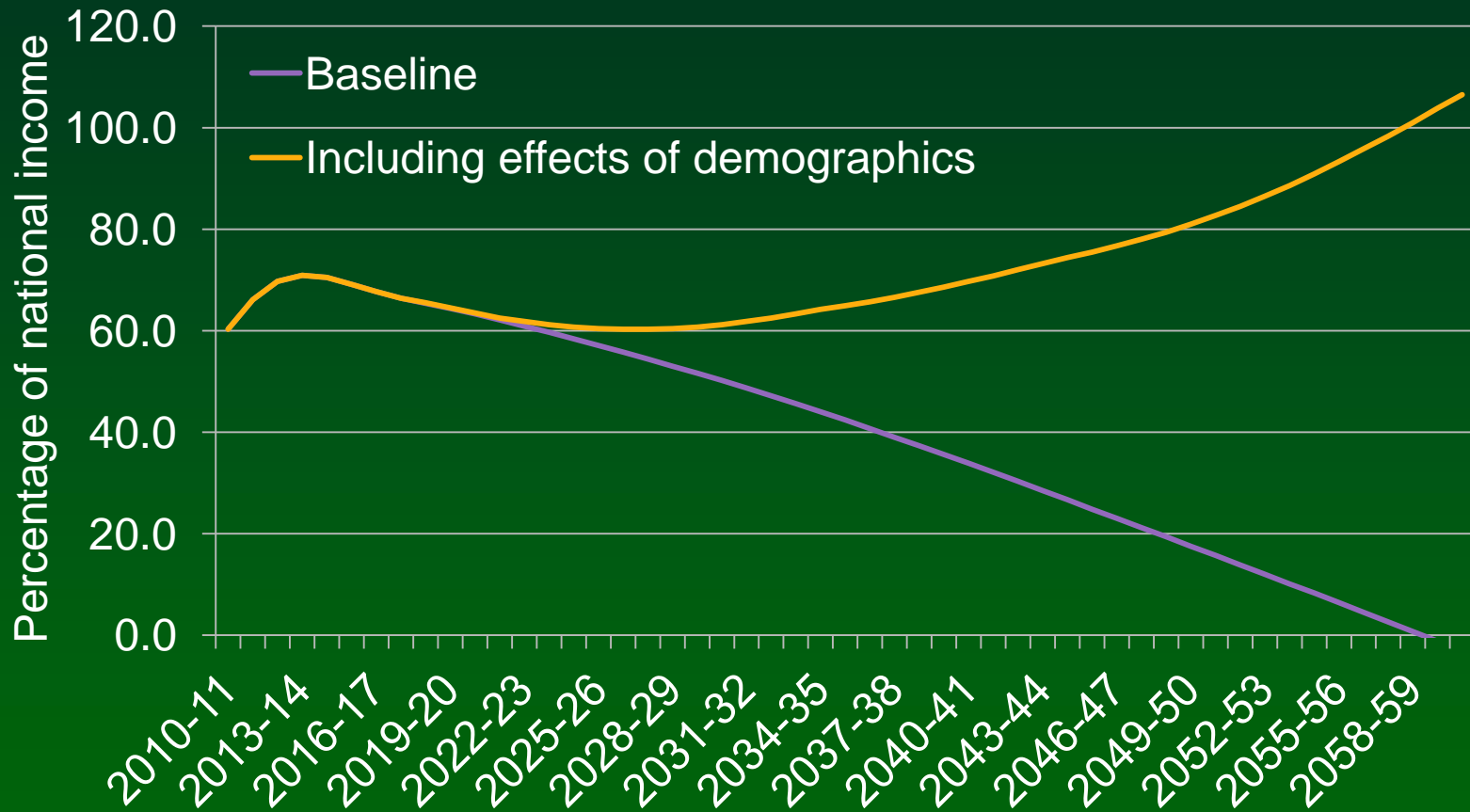
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State pensions	5.5	5.2	6.8	7.9
Pensioner benefits	1.0	1.0	1.2	1.2
Public service pensions	2.0	1.9	1.6	1.4
Education	5.0	5.1	5.0	5.0
Total age-related spending	22.0	22.1	25.6	27.3



Projected effect of demographics on debt



Risks to the public finances – longer term

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 - Increase taxes to pay for increased spending
 - Keep total spending fixed but reduce spending elsewhere
 - Reduce spending on age-related components to offset LR pressures

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 - Reduce spending on age-related components to offset LR pressures
 - Difficult
- Cannot postpone these choices indefinitely

Conclusions

- Permanent hit to public finances from financial crisis estimated at £115 billion a year (in today's terms)
- Response is a £123 billion fiscal tightening by 2016–17
- Seven years from April 2010 imply the tightest seven-year squeeze on 'public service' spending since at least end of Second World War
- Borrowing forecasts are very uncertain
- Delivery of planned spending cuts is one of the main risks
 - Such cuts are unprecedented in the UK
 - Only half of the real reduction in spending planned between 2009-10 and 2016-17 will have been implemented by the end of 2012-13
- Even if plans to 2015-16 implemented, not out of the woods yet
 - Demographic pressures loom and will need to be addressed soon



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The UK fiscal outlook: an age of austerity

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