

Office for
**Budget
Responsibility**

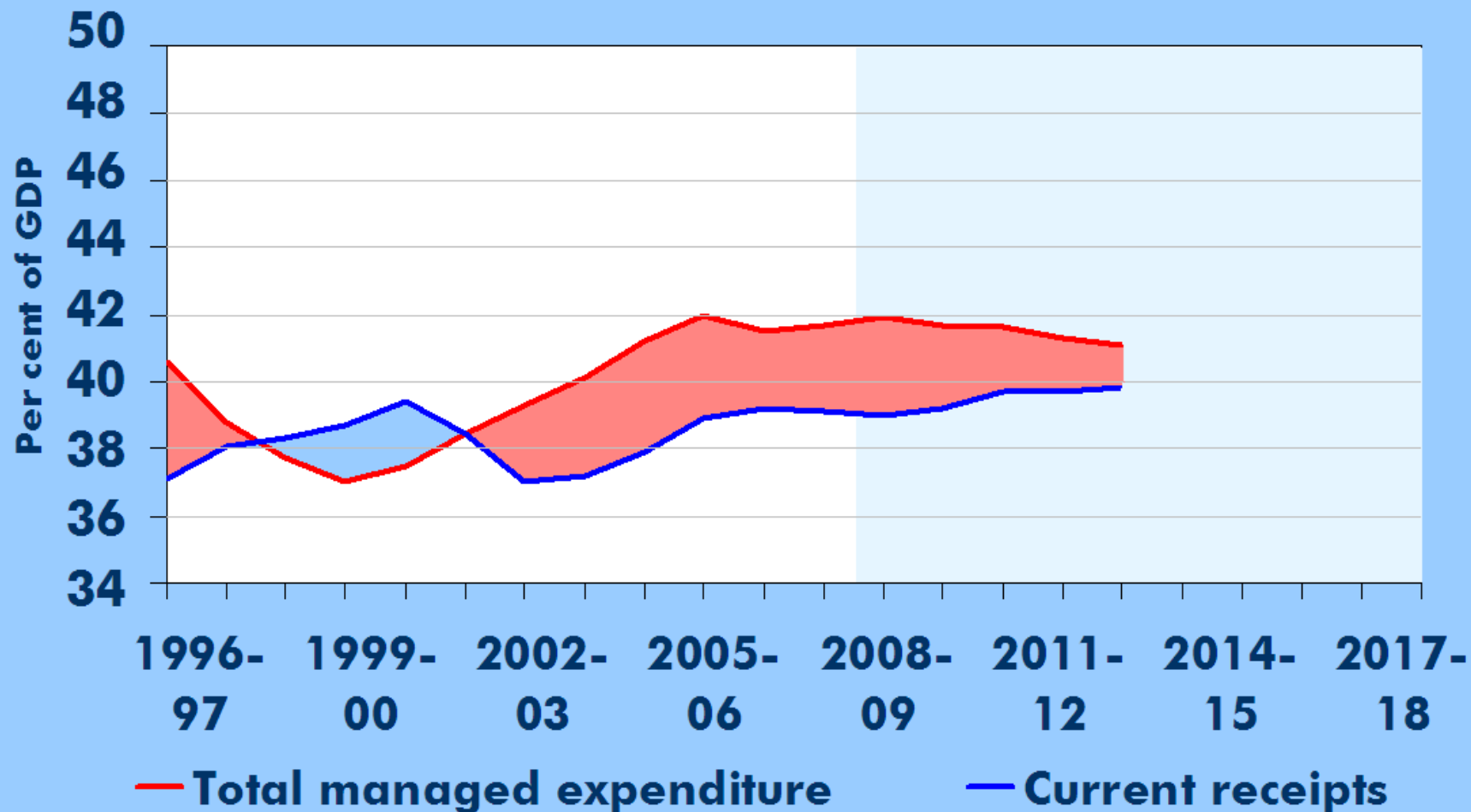
The crisis, the consolidation and Britain's public finances

**Robert Chote
Chairman**

NLGN, 30 January 2013

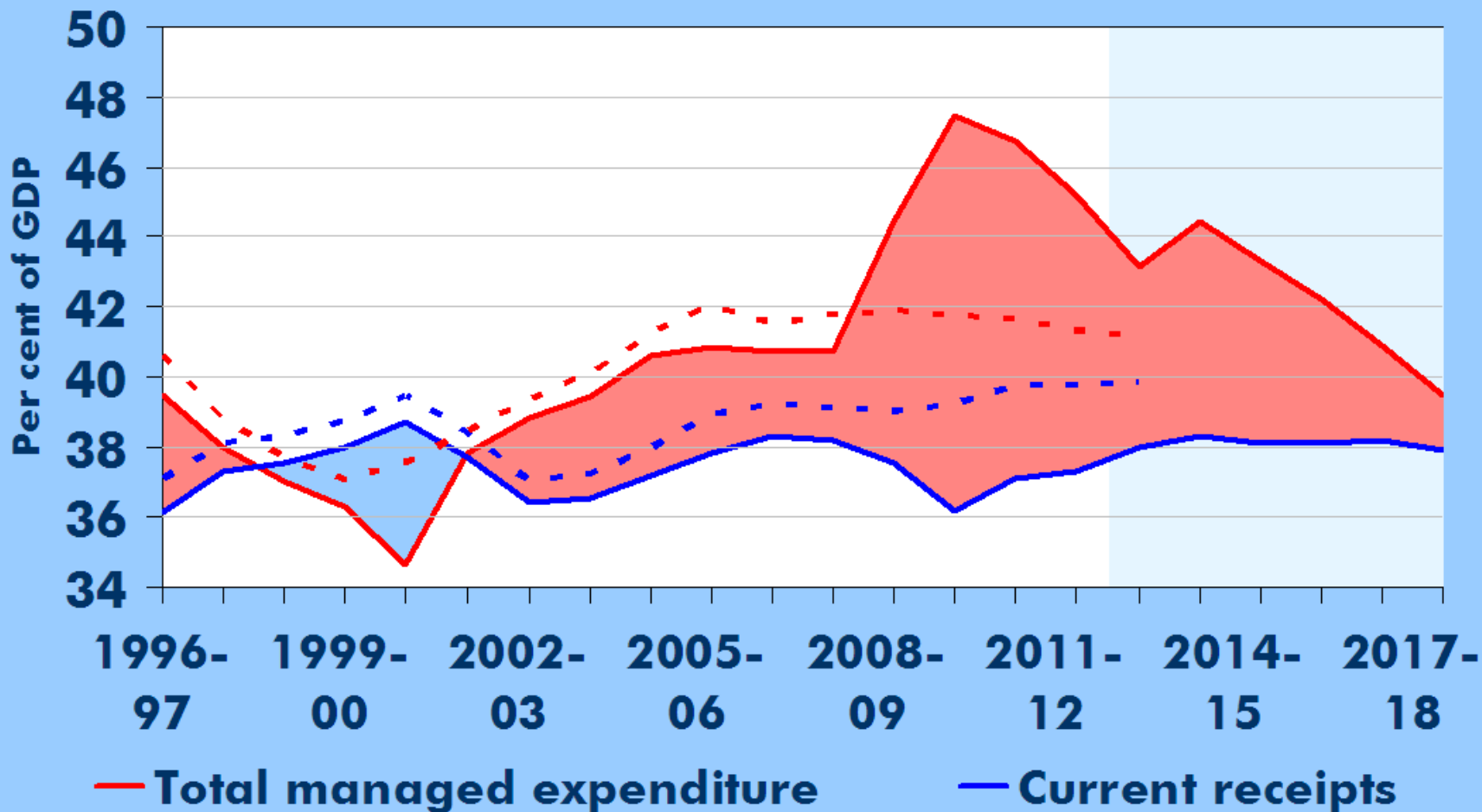
Public spending and receipts

Budget 2008 forecast



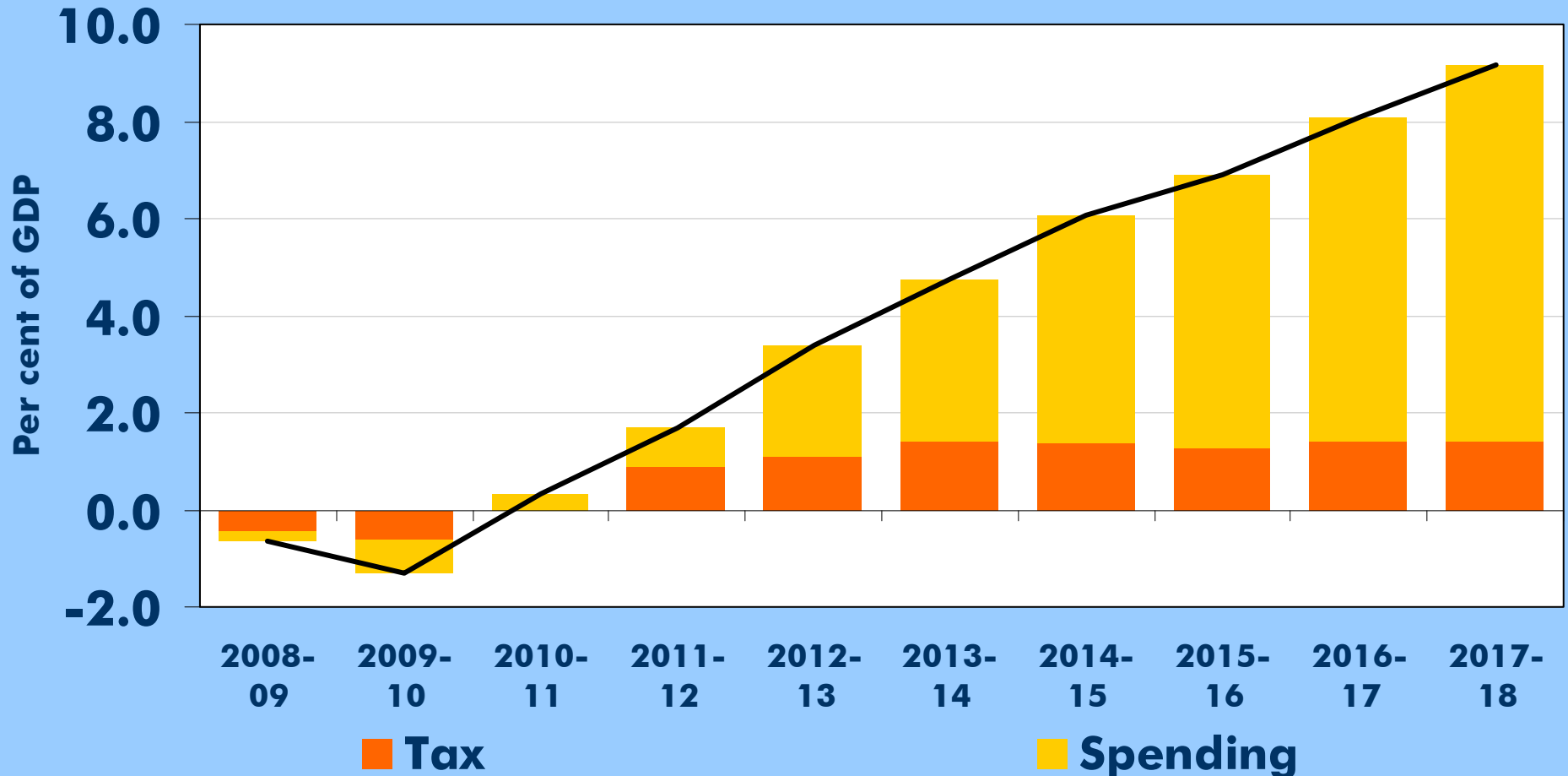
Public spending and receipts

Budget 2008 and December 2012 forecasts



• The increase in the deficit results more from an increase in spending than a fall in receipts as %GDP

Policy measures post Budget 08



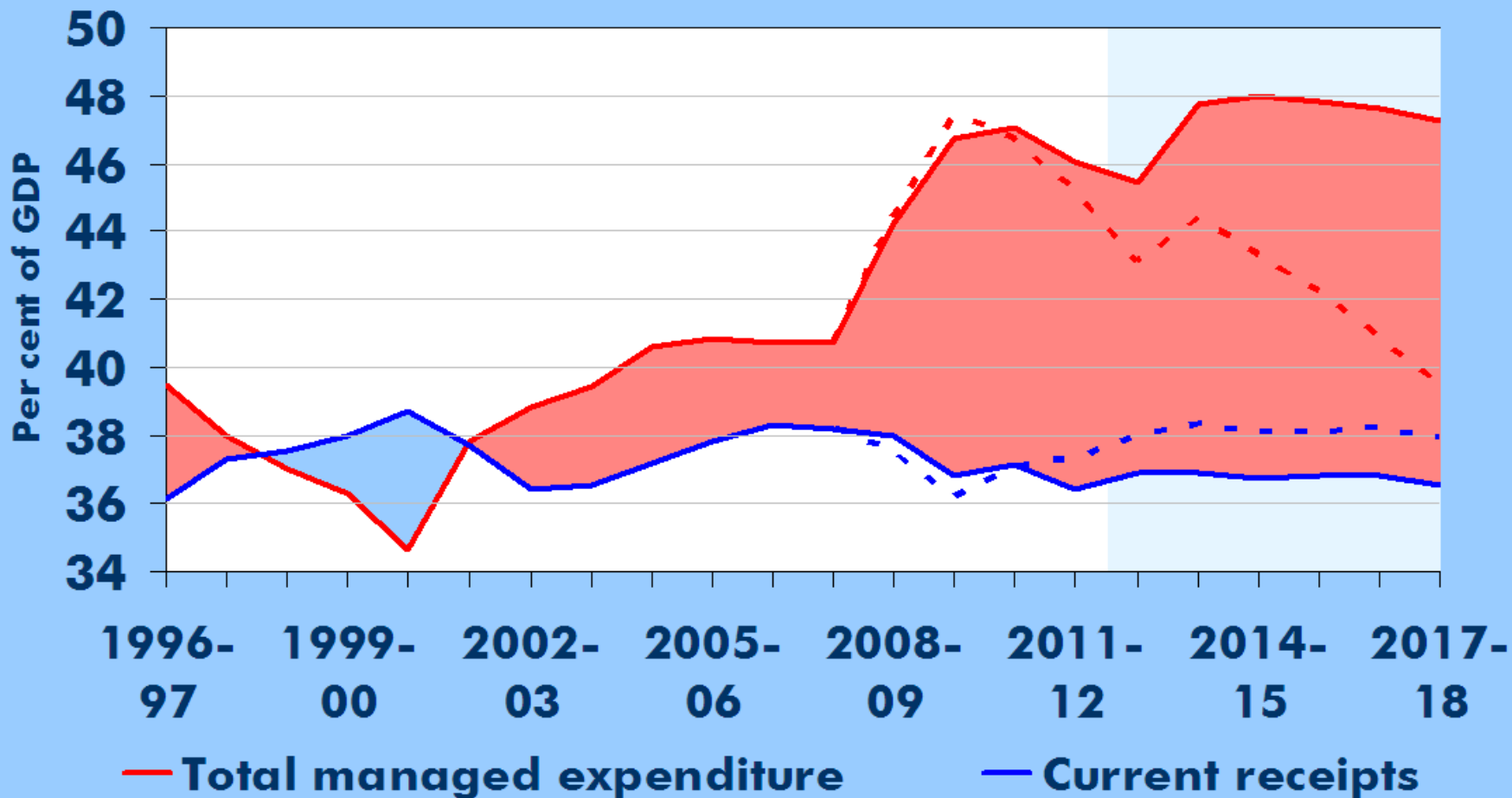
NB: Measures include re-costing of previously implemented measures, notably 50p income tax rate

Source: Institute for Fiscal Studies

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Public spending and receipts

December 2012 forecast: including and excluding post Budget 2008 measures



How the public explain austerity

“The Government is taking various steps, including some increases in taxation and cuts in public spending, to reduce the deficit in the public finances.

Different people have suggested different underlying reasons for the Government's actions.

Which two or three of these do you think are the MOST important reasons for these actions?”

(YouGov, 11-12 December, 1805 GB adults)

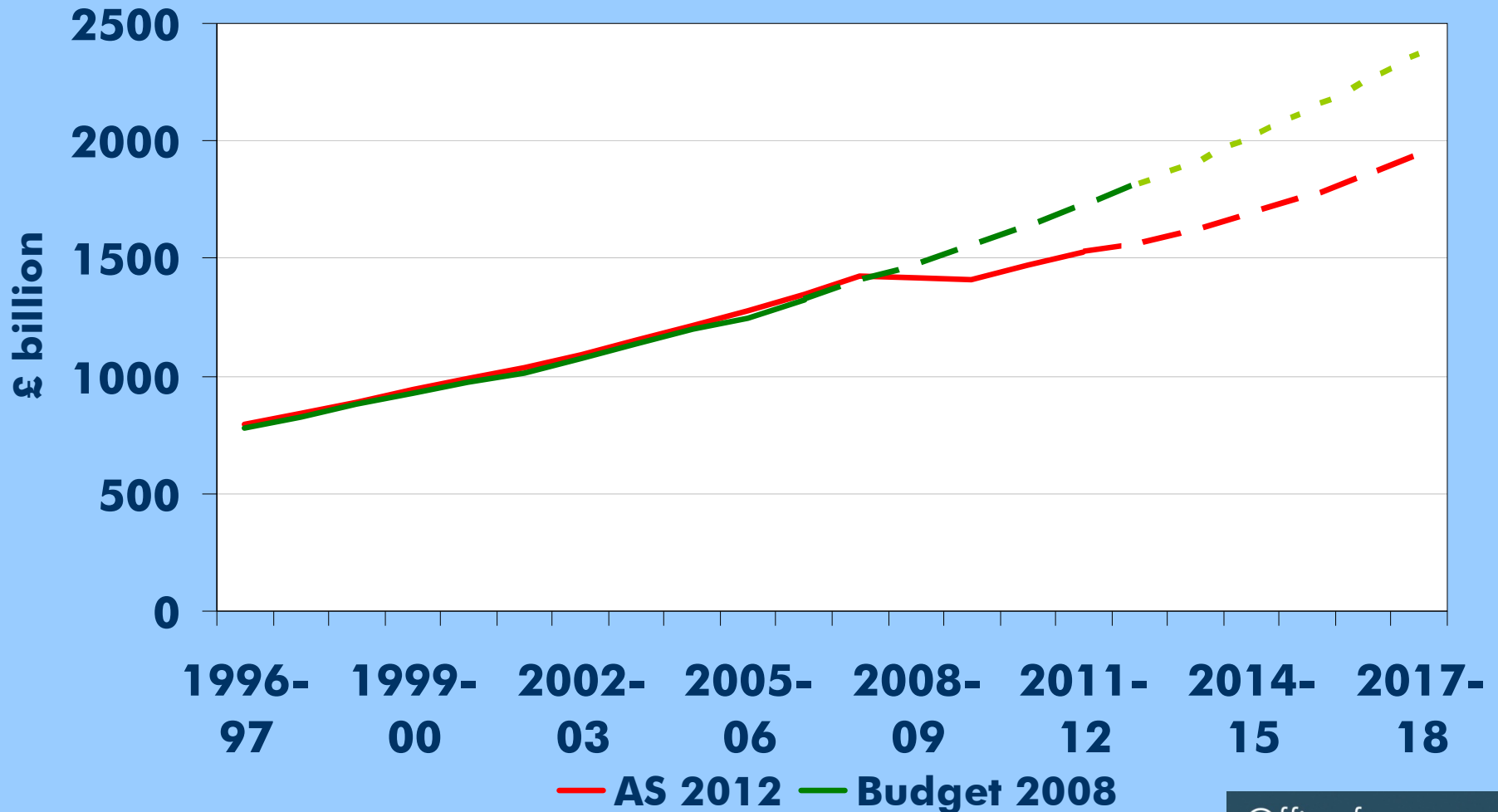
How the public explain austerity

Banks in Britain and other countries were greedy, dishonest and badly behaved – we are now paying for their mistakes	64%
Labour spent too much when it was in government – the present government is clearing up the mess it inherited	41%
Millions of people borrowed too much and lived beyond their means – we are now all having to pay for their irresponsible behaviour	40%
The Conservatives believe in a smaller role for the state and less public spending – the deficit gives them an excuse to do what they want to do anyway	28%
Britain's economy is going to be smaller for the foreseeable future than most people expected prior to the financial crisis – we are now having to adjust to this reality	27%
Ministers are frightened of the financial markets – there is no need to raise taxes or to cut spending as much as the government is doing	14%
Not sure	8%

From the crisis to the public finances

- **Big fall in nominal GDP relative to pre-crisis trend**
 - Pushed up spending fixed in cash terms or linked to inflation as % of GDP
- **Weaker labour market (but not as weak as it might have been)**
 - Pushed up spending on welfare
 - Lowered average tax rate and receipts as % of GDP
- **Revenue-rich financial sector hit disproportionately hard**
 - Reduced corporation tax and income tax as % of GDP
- **Weaker housing and stock markets**
 - Prices and transactions (and thus receipts) fell more than money GDP
- **Consumer price inflation high relative to money GDP / earnings**
 - Fewer people in higher tax brackets reduced receipts relative to GDP
 - Benefit rates became more generous relative to GDP
- **Unusually low bond yields**
 - Offset impact of higher borrowing on debt interest costs
 - Reduced interest and dividend receipts

Nominal GDP projections



• Nominal GDP shortfall about 19% in 2017-18 (18% for non-oil GVA). Mostly lower potential output

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The fall and rise in receipts

Change in share of GDP	Crisis (09-10 v 07-08)	Consolidation (17-18 v 09-10)
Income tax and NICs	-0.5	+0.2
VAT	-0.4	+1.1
Onshore corporation tax	-0.7	-0.2
UK oil and gas	-	-0.3
Capital taxes	-0.7	+0.5
Fuel and excise duties	+0.4	-0.5
Business rates and council tax	+0.3	-0.3
Interest and dividends	-0.4	+0.5
Other	+0.2	+0.6
Total	-2.0	+1.7
<i>Memo: policy measures</i>	-0.6	+2.0
<i>Memo: financial sector</i>	-0.4	0

Public spending during the crisis

2009-10 versus 2007-08	Nominal % change		Change in share of GDP	
	Budget 08	Outturn	Budget 08	Outturn
Total spending, <i>of which</i>	+10.2%	+15.0%		
Public services/admin (current + capital DEL)	+9.8%	+13.0%		
Social security and tax credits	+11.6%	+19.6%		
Central government debt interest	+1.3%	+0.8%		

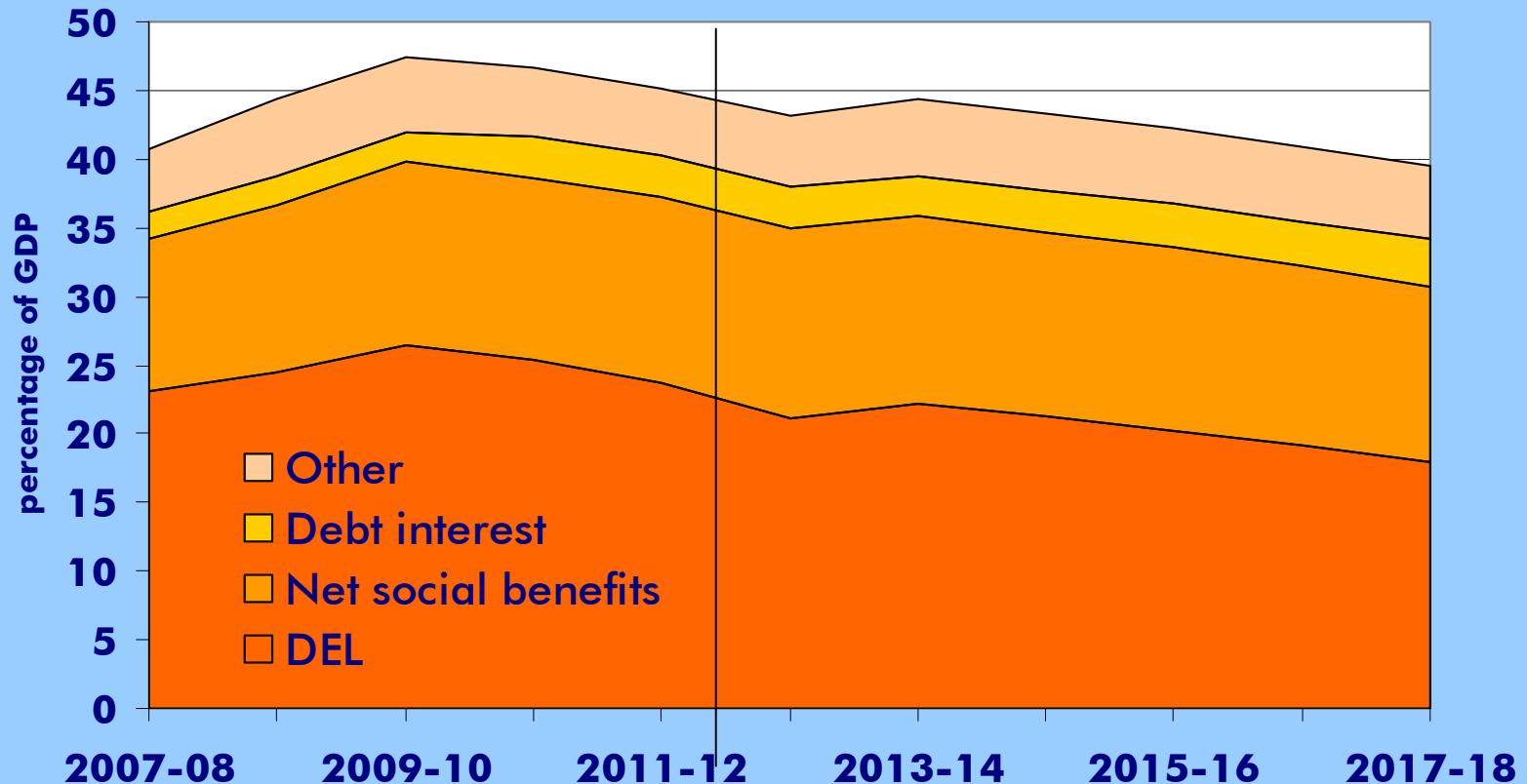
- **Why did nominal spending rise more quickly than expected?**
 - Public services: underspend in 07-08 plus stimulus spending
 - Welfare: inflation and unemployment higher than expected
 - Debt interest: more borrowing but lower borrowing costs

Public spending during the crisis

2009-10 versus 2007-08	Nominal % change		Change in share of GDP	
	Budget 08	Outturn	Budget 08	Outturn
Total spending, of which	+10.2%	+15.0%	0	+6.7
Public services/admin (current + capital DEL)	+9.8%	+13.0%	-0.1	+3.3
Social security and tax credits	+11.6%	+19.6%	+0.1	+2.4
Central government debt interest	+1.3%	+0.8%	-0.2	0

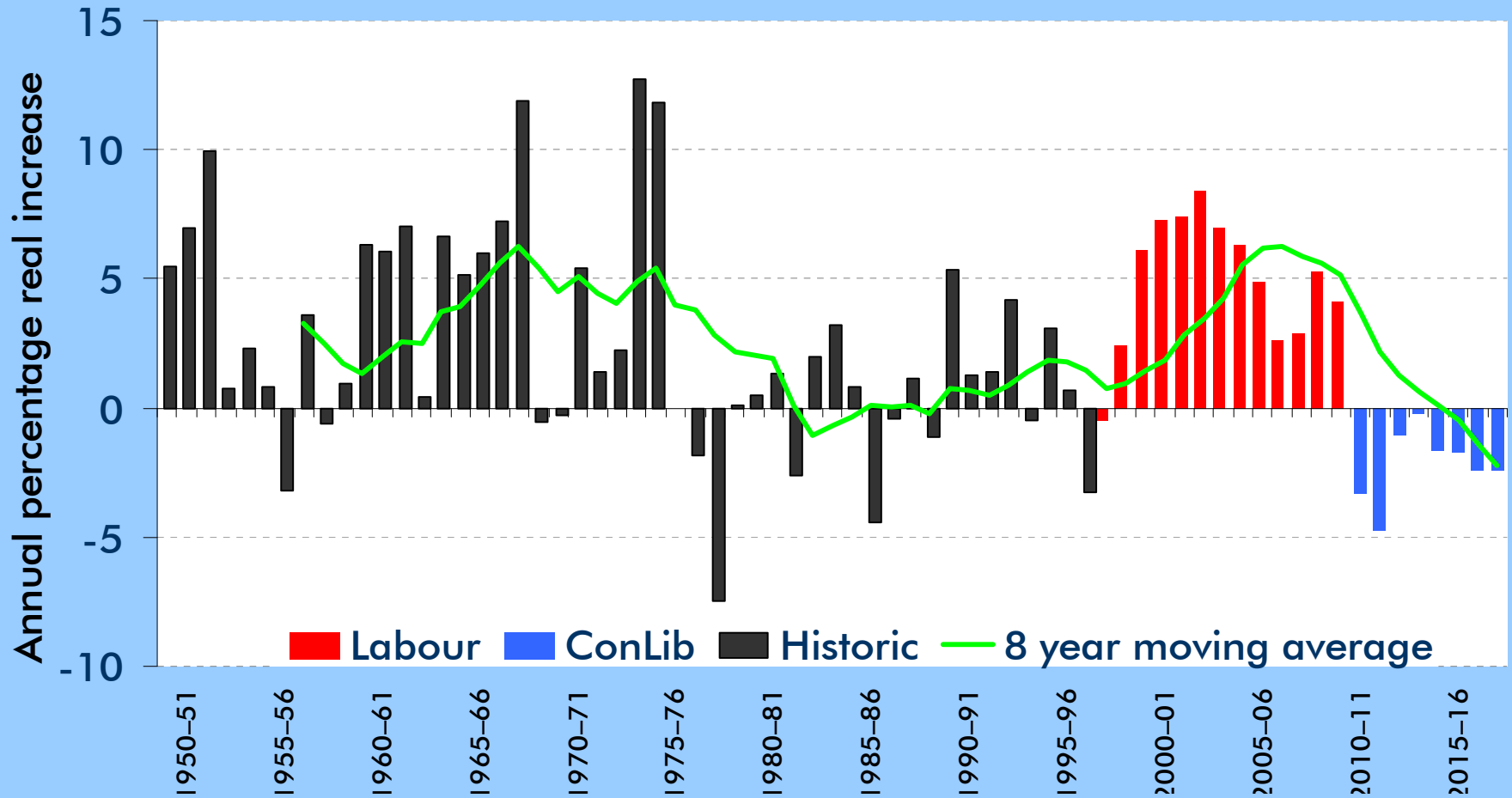
- Nominal spending and GDP were both expected to rise by c.10% in Budget 2008, leaving spending/GDP unchanged
- But nominal spending rose by 15% while nominal GDP fell by 1.2%, so spending jumped sharply as a share of GDP

The composition of spending



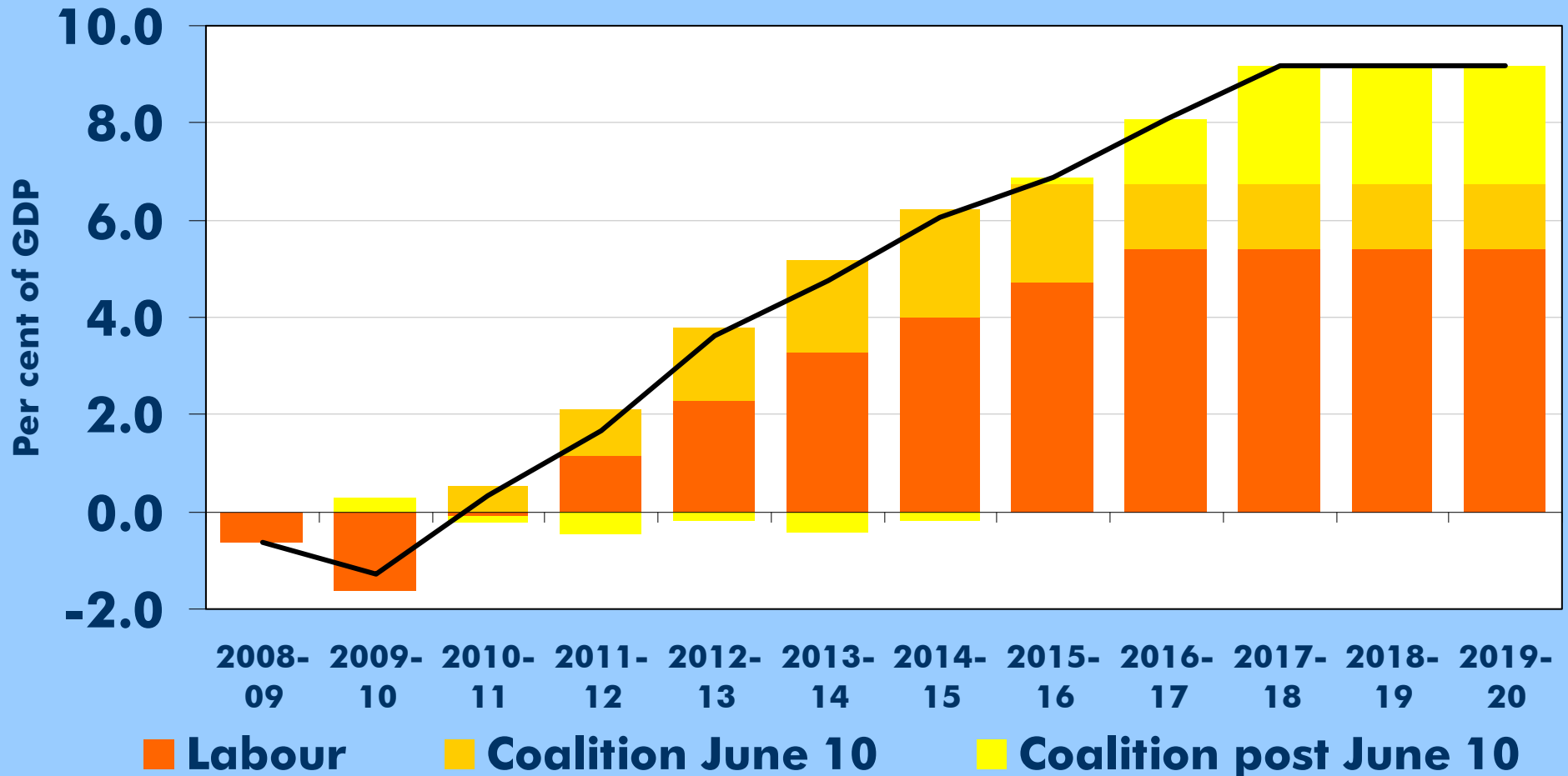
- **Total spending returns to pre-crisis level**
- **Debt interest, welfare and other spending rises**
- **So DELs have to fall sharply**
- **Welfare stable at post crisis level. Why?**

Real public services spending



Note: Figure shows total public spending less spending on welfare benefits and debt interest. Adjusted for Royal Mail, SLS and spectrum proceeds.

Policy measures post Budget 08

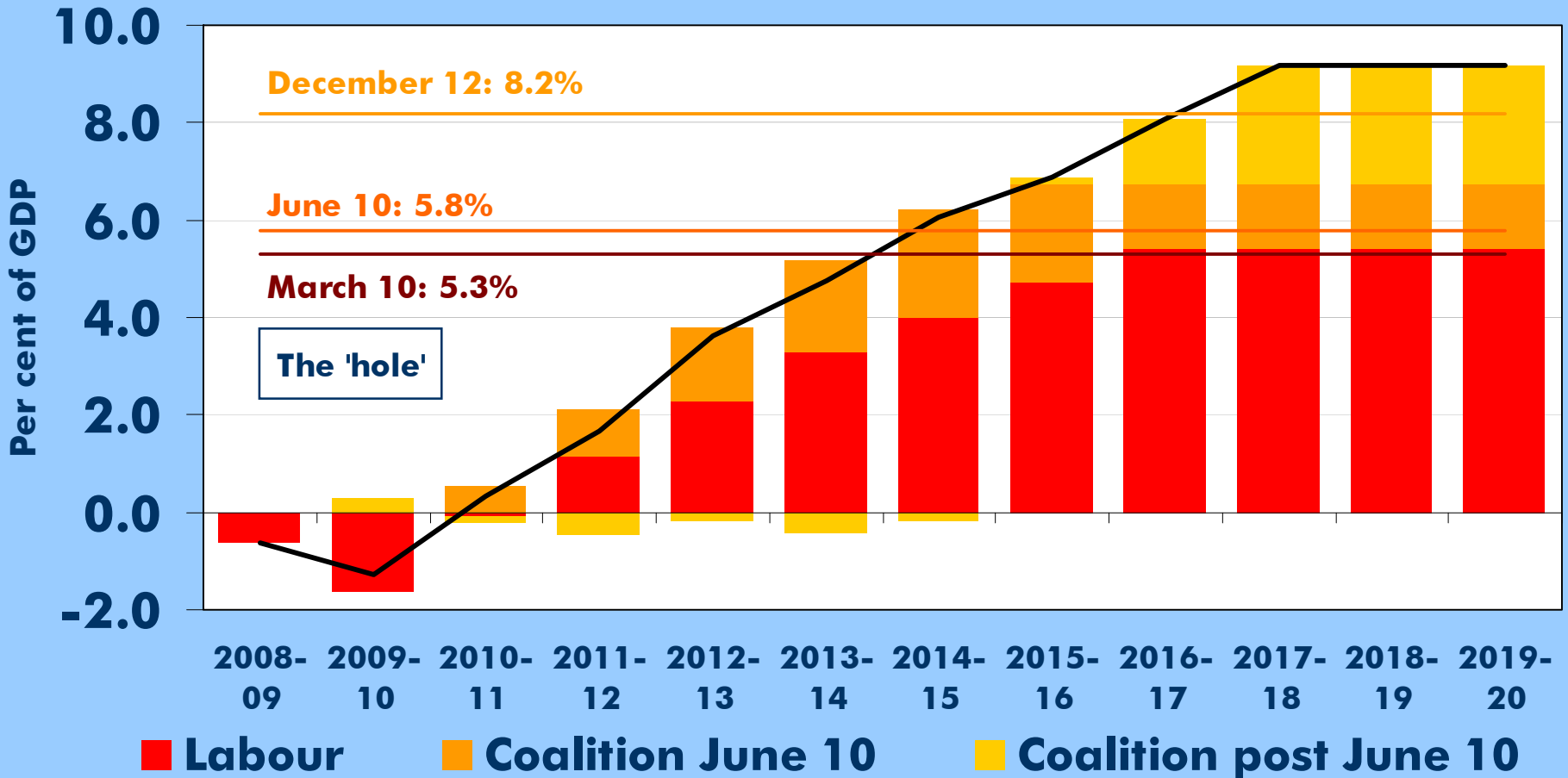


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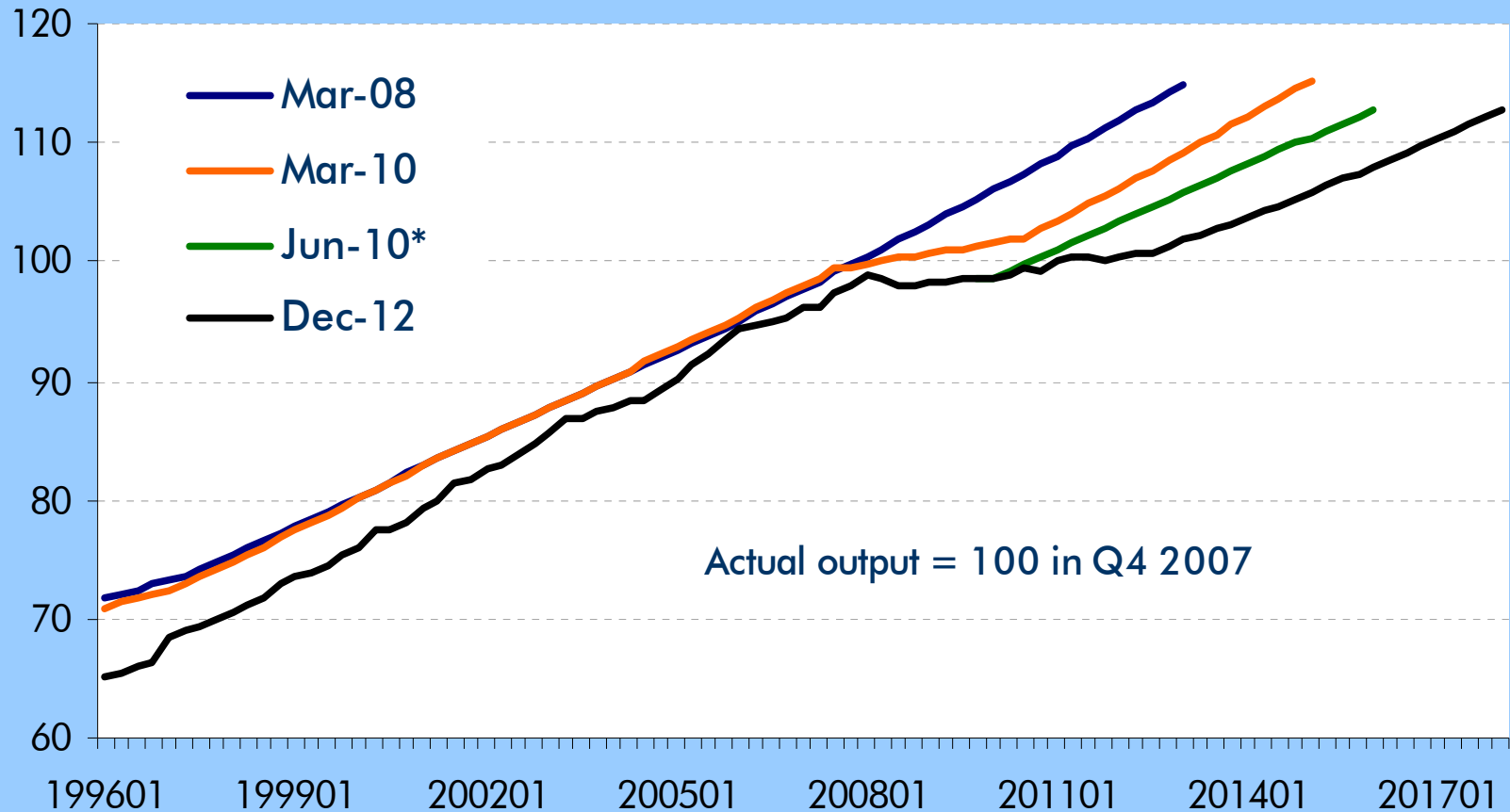
Source: Institute for Fiscal Studies

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Policy measures since Budget 08

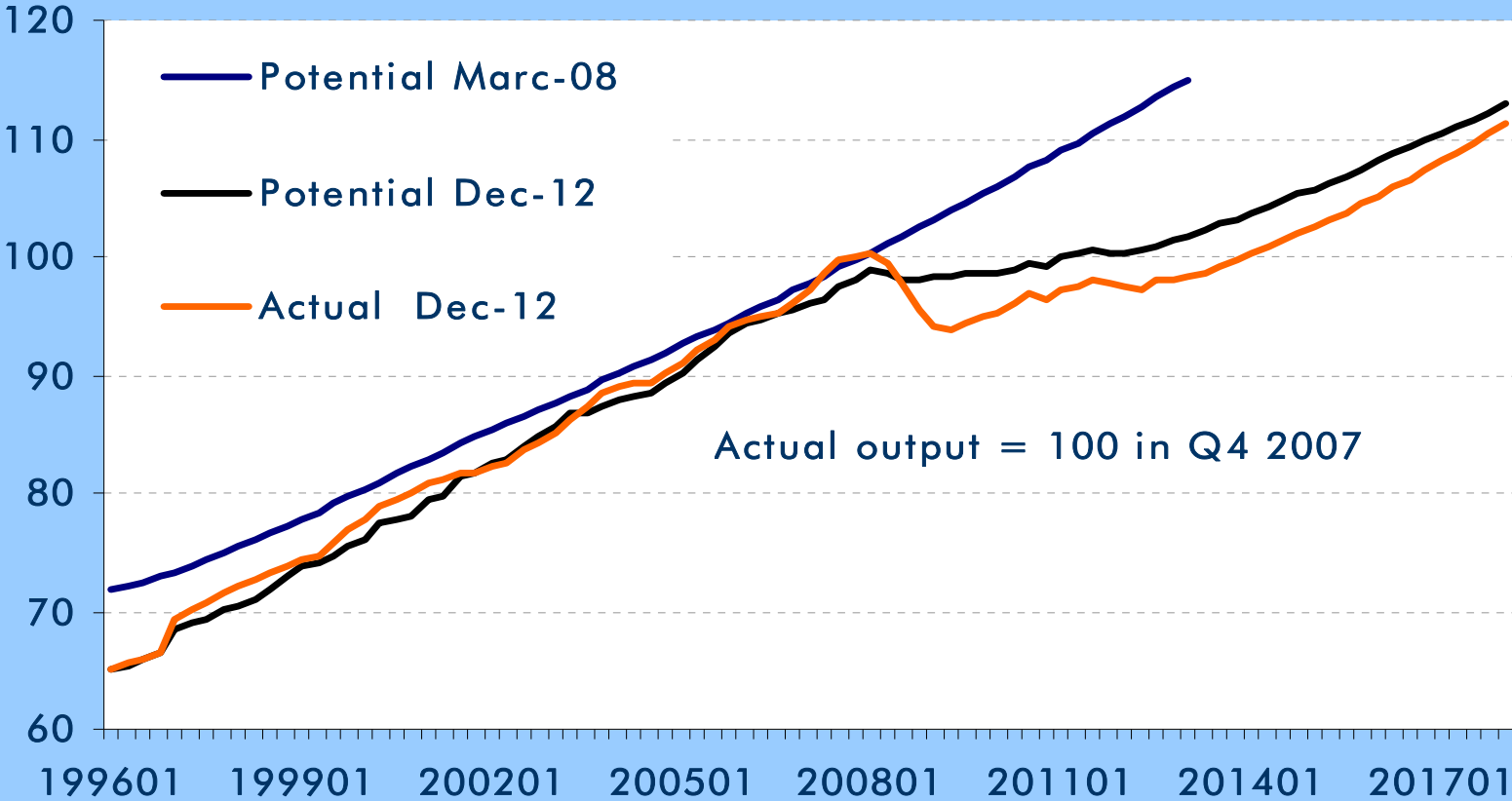


Forecasts of potential GDP



*In June 2010 the OBR had not produce a historical potential output series

The outlook for GDP



Conclusion

- **Economy likely to remain significantly smaller than pre-crisis trends suggested, even if policymakers can boost growth and soak up spare capacity**
- **Loss of economic potential limits ability of the economy to rebound and reduce the budget deficit**
- **But huge uncertainty about the size of the hit to potential and the reasons for it**
- **So scale of fiscal consolidation necessary to close the gap remains very uncertain**