

Office for
**Budget
Responsibility**

Britain's public finances

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Outline

- Why do governments tax, spend, lend and borrow?
- The public finances today: a snapshot
- The crisis and the repair job
- Some historical and international perspective
- The policy debate: Plan A versus Plan B

Why do governments tax, spend and lend?

- Providing 'public goods'
 - Defence, criminal justice
- Replacing 'missing markets'
 - Unemployment and incapacity insurance, higher education
- Influencing behaviour: paternalism and spillovers
 - Schools, pensions, libraries, tobacco duties, green taxes
- Redistributing resources
 - Taxes, cash benefits and benefits in kind

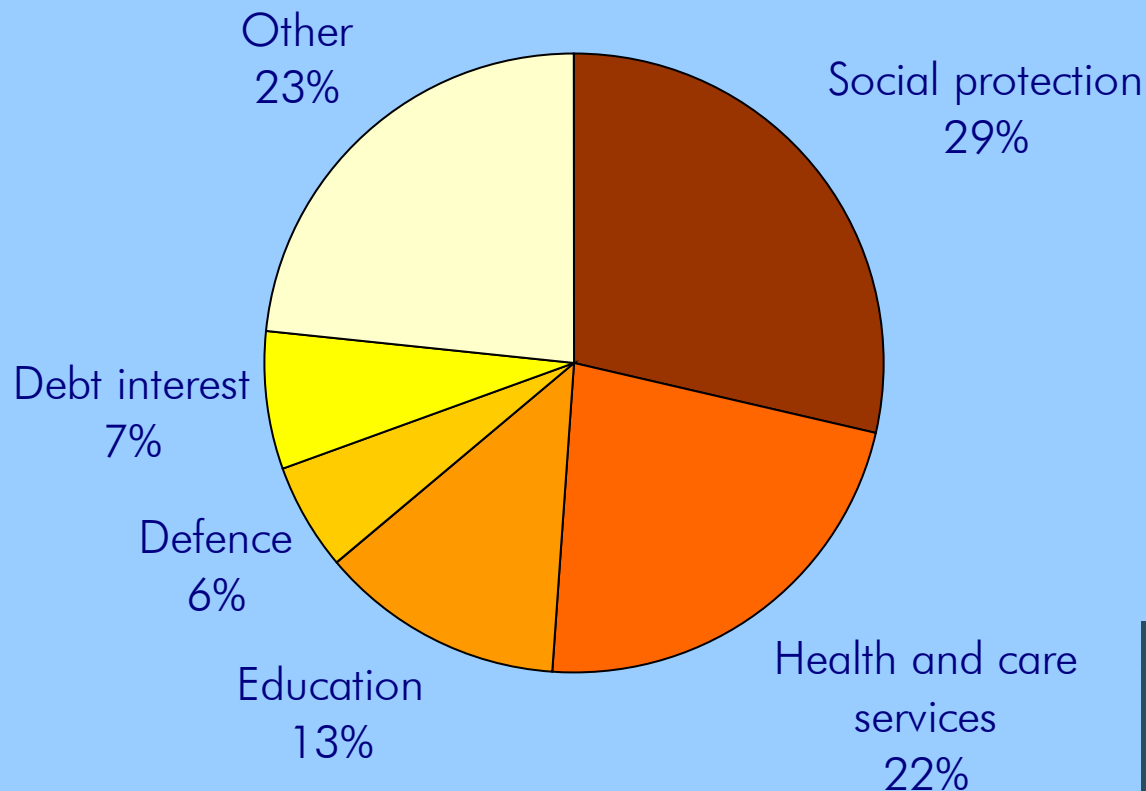
Why do governments borrow?

- Revenue and spending forecast errors
 - It is hard to ensure revenues equal spending even if you try
- Inter-generational fairness
 - Wars, capital spending, training doctors and teachers
- Stabilizing tax rates
 - Using the deficit as a shock absorber helps avoid costly tax rate changes
- Macroeconomic management
 - Automatic and discretionary changes help stabilise total spending
- Political expedience
 - Voters like having money spent on them more than paying taxes

The public finances today: a snapshot

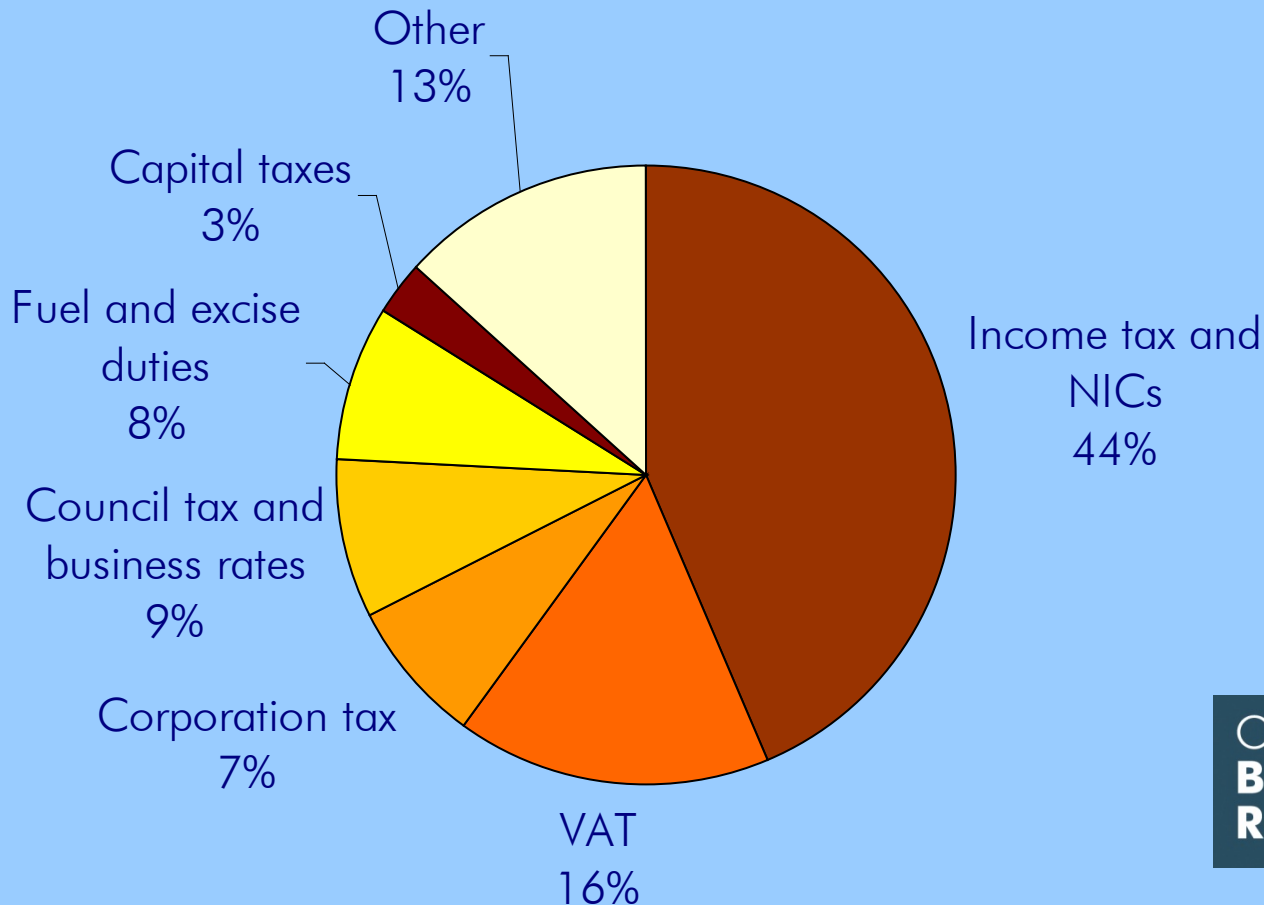
Public spending in 2011-12

- We estimate that the public sector will spend £703 billion this year
 - Equivalent to £26,000 per family or 46.2% of national income



Public sector receipts in 2011-12

- We estimate that the public sector will raise £576 billion this year from taxes and other receipts
 - Equivalent to £21,300 per family or 37.8% of national income



Public sector borrowing in 2011-12

Public sector spending	£703bn	46.2% of GDP
Public sector receipts	£576bn	37.8% of GDP
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Public sector borrowing	£127bn	8.4% of GDP

- Deficit down from post-war peak of 11.2% in 2009-10
- Government still borrowing £1 for every £5 it spends

Public sector net debt in March 2011

Gross Debt

of which: gilts	£919bn	62% of GDP
: treasury bills	£63bn	4% of GDP
: national savings	£99bn	7% of GDP

less liquid assets

of which: forex reserves	£53bn	4% of GDP
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Public sector net debt	£905bn	60% of GDP
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- Debt highest share of GDP since 1968

But is this the whole story?

- PSND often criticised as a measure of the public sector's financial health, as it fails to take account of future debts that will arise because of past government action
- Some prefer to look at the public sector's balance sheet in the same way you would look at a private sector one
- Now possible thanks to 'Whole of Government Accounts'
- Built up from accounts of 1500 constituent public bodies
- WGA includes physical and illiquid financial assets, plus present value of some future cash flows

WGA public sector assets 2009-10

Land, buildings and dwelling	£354bn
Physical infrastructure	£233bn
Taxes due	£105bn
Loans and deposits	£68bn
Shareholdings in banks	£65bn
Treasury loans to financial institutions	£58bn
Military equipment	£36bn
Student loans	£28bn
Overseas government bonds	£24bn
Other	£237bn
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Total	£1208bn 86% of GDP

WGA public sector liabilities 2009-10

Public service pension liabilities	£1132bn
Gilts, treasury bills and National Savings	£966bn
Provisions (mostly nuclear decommissioning)	£102bn
Amounts payable under PFI contracts	£27bn
Other	£192bn
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Total	£2419bn 173% of GDP

- Does not include contingent liabilities where the chance of having to pay is <50% – mostly guarantees for the financial sector

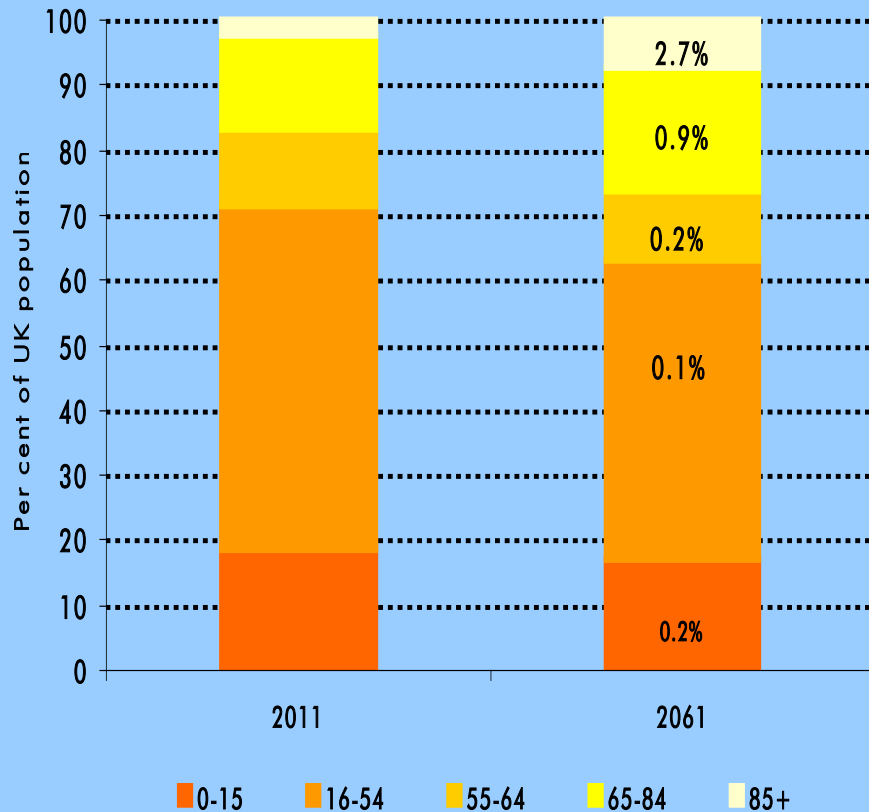
So is the public sector insolvent?

WGA liabilities	£2419bn	173% of GDP
WGA assets	£1208bn	86% of GDP
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WGA net liabilities	£1212bn	86% of GDP

- No. Its greatest asset is not included in the WGA – the right to levy future taxes
- Judging fiscal sustainability therefore requires analysis of long-term prospects for spending and revenues, taking into account demographics, health care etc

Assumptions: demography

Figures refer to annual growth rates



- Ageing population – past rises in life expectancy and falls in fertility plus baby boom ‘bulge’
- ONS population projections
- Our central projection assumes:
 - 65+ proportion rises from 17% in 2011 to 26% in 2061
 - Net inward migration averages roughly half recent levels
- We also show sensitivity to older and younger age structures and higher net migration

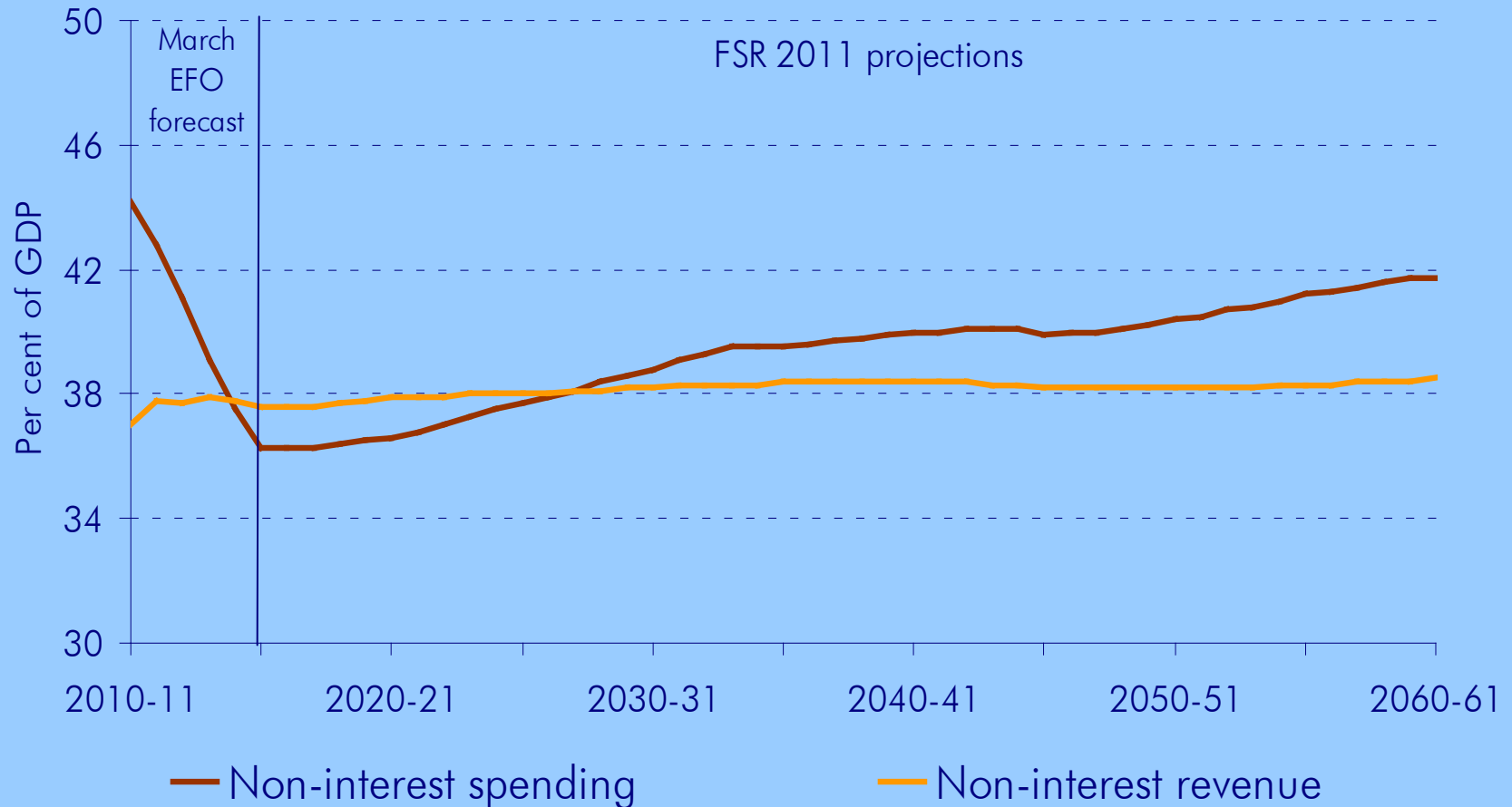
Results: non-interest spending

	Per cent of GDP						
	Estimate		FSR Projection				
	2010-11	2015-16	2020-21	2030-31	2040-41	2050-51	2060-61
Health	8.2	7.4	7.7	8.5	9.1	9.5	9.8
Long-term care	1.3	1.2	1.3	1.5	1.8	1.9	2.0
Education	6.3	5.0	5.1	5.2	5.0	5.0	5.0
State pensions	5.7	5.5	5.2	6.1	6.8	6.9	7.9
Pensioner benefits	1.2	1.0	1.0	1.2	1.2	1.2	1.2
Public service pensions	2.0	2.0	1.9	1.8	1.6	1.5	1.4
Total age-related spending	24.6	22.0	22.1	24.3	25.6	26.0	27.3
Other social benefits	6.2	4.9	5.1	5.1	5.0	5.0	5.0
Other spending	13.3	9.4	9.4	9.4	9.4	9.4	9.4
Spending	44.2	36.3	36.6	38.8	40.0	40.4	41.7

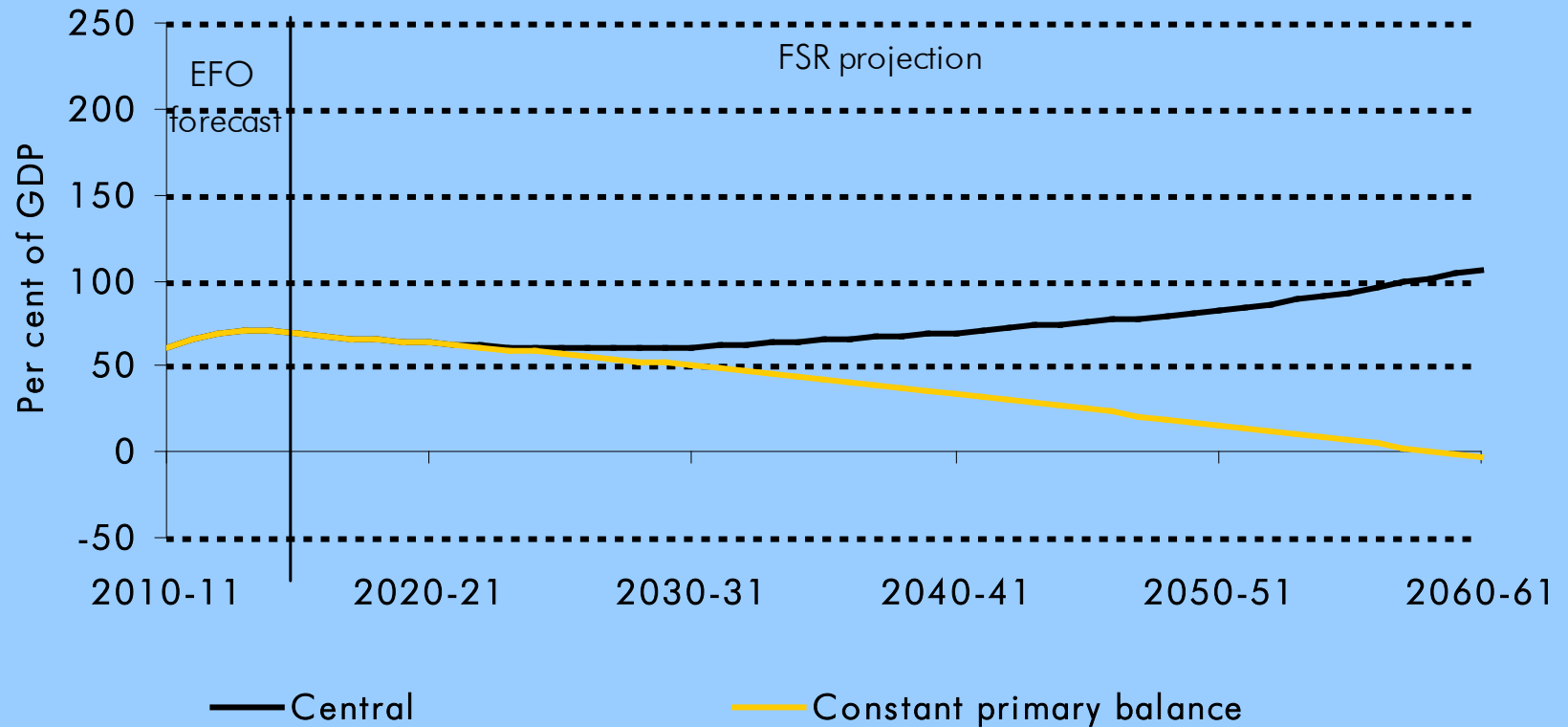
Results: non-interest revenues

	Per cent of GDP						
	Estimate		FSR projection				
	2010-11	2015-16	2020-21	2030-31	2040-41	2050-51	2060-61
Income tax	10.3	10.7	10.8	10.8	10.9	10.8	10.9
NICs	6.5	6.6	6.6	6.5	6.5	6.4	6.4
Corporation tax	2.9	2.9	2.9	2.8	2.8	2.8	2.8
VAT	5.8	6.1	6.2	6.3	6.4	6.3	6.4
Capital taxes	1.0	1.2	1.3	1.4	1.5	1.6	1.7
Other taxes	10.4	10.1	10.2	10.3	10.4	10.4	10.4
Revenue	37.0	37.6	37.9	38.2	38.4	38.2	38.5

Long term revenue and spending projections

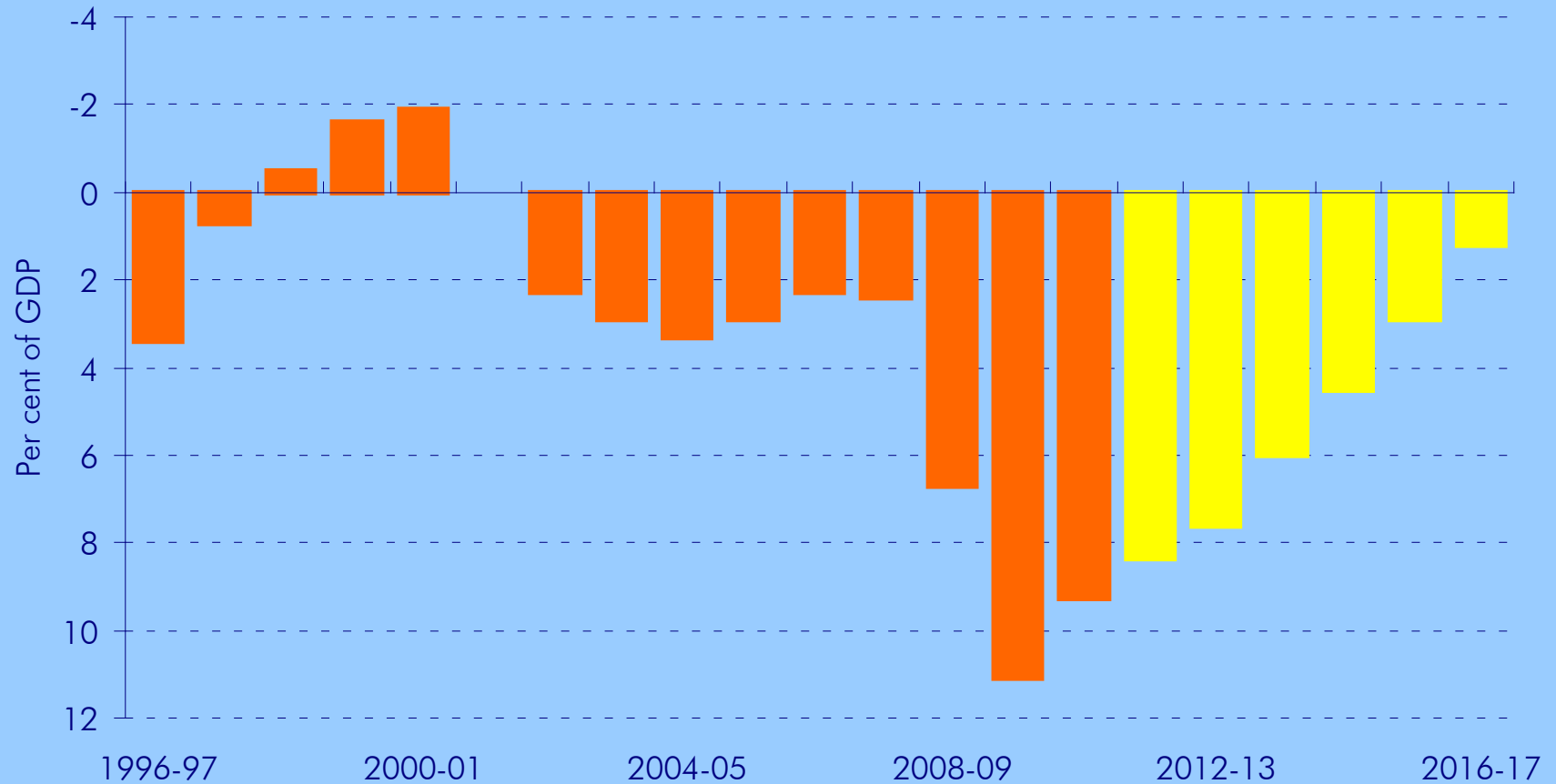


Public sector net debt

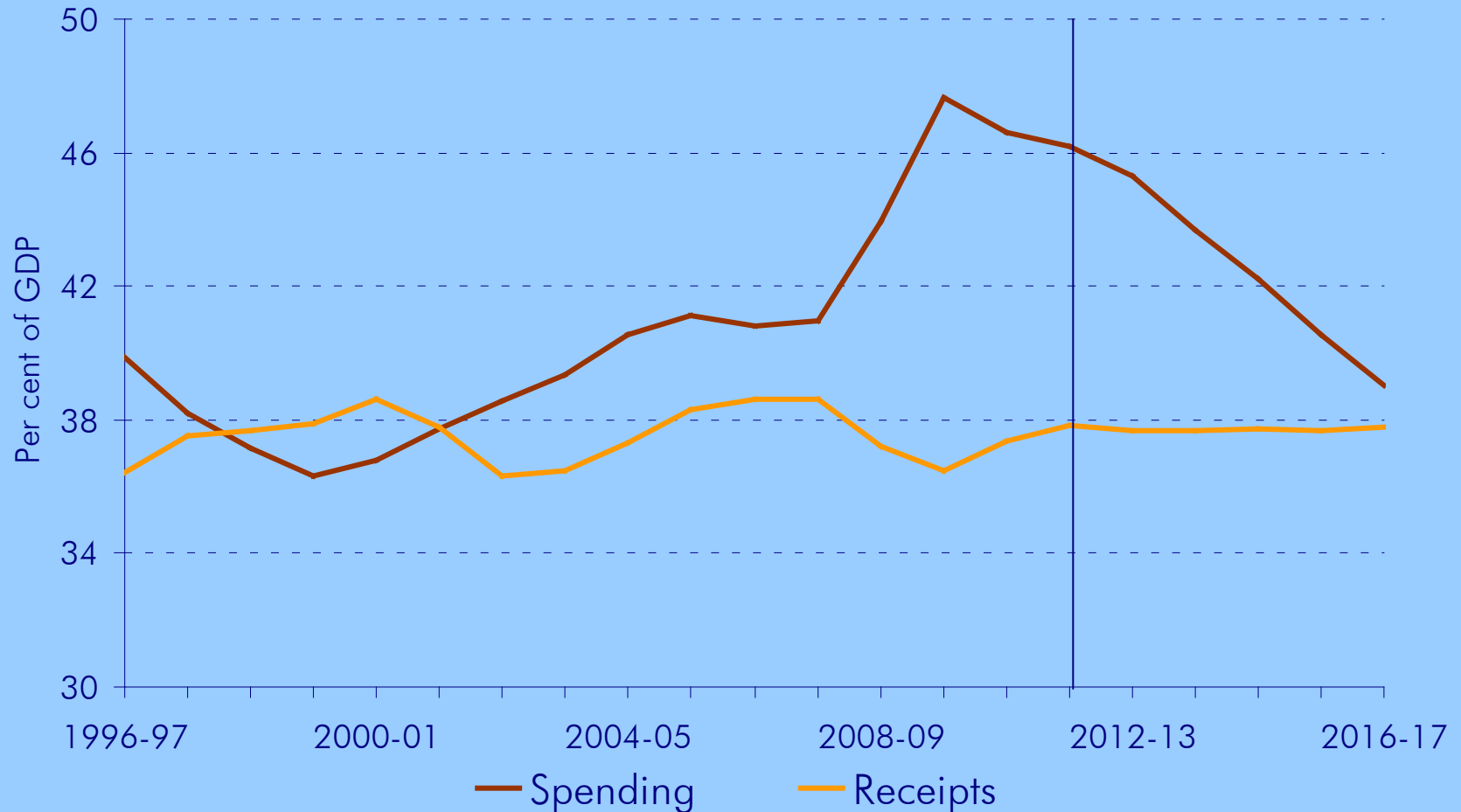


The crisis and the repair job

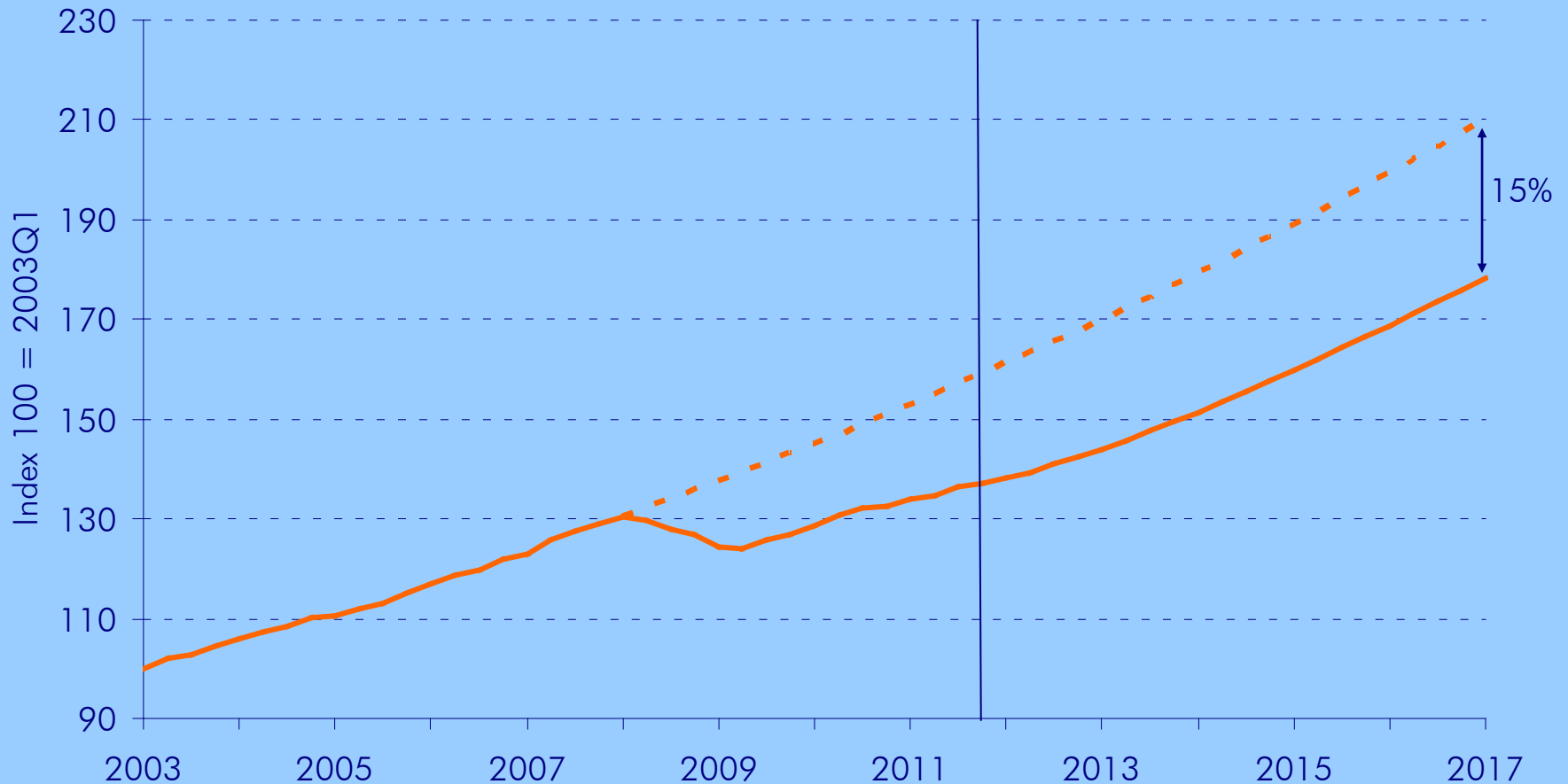
Public sector net borrowing



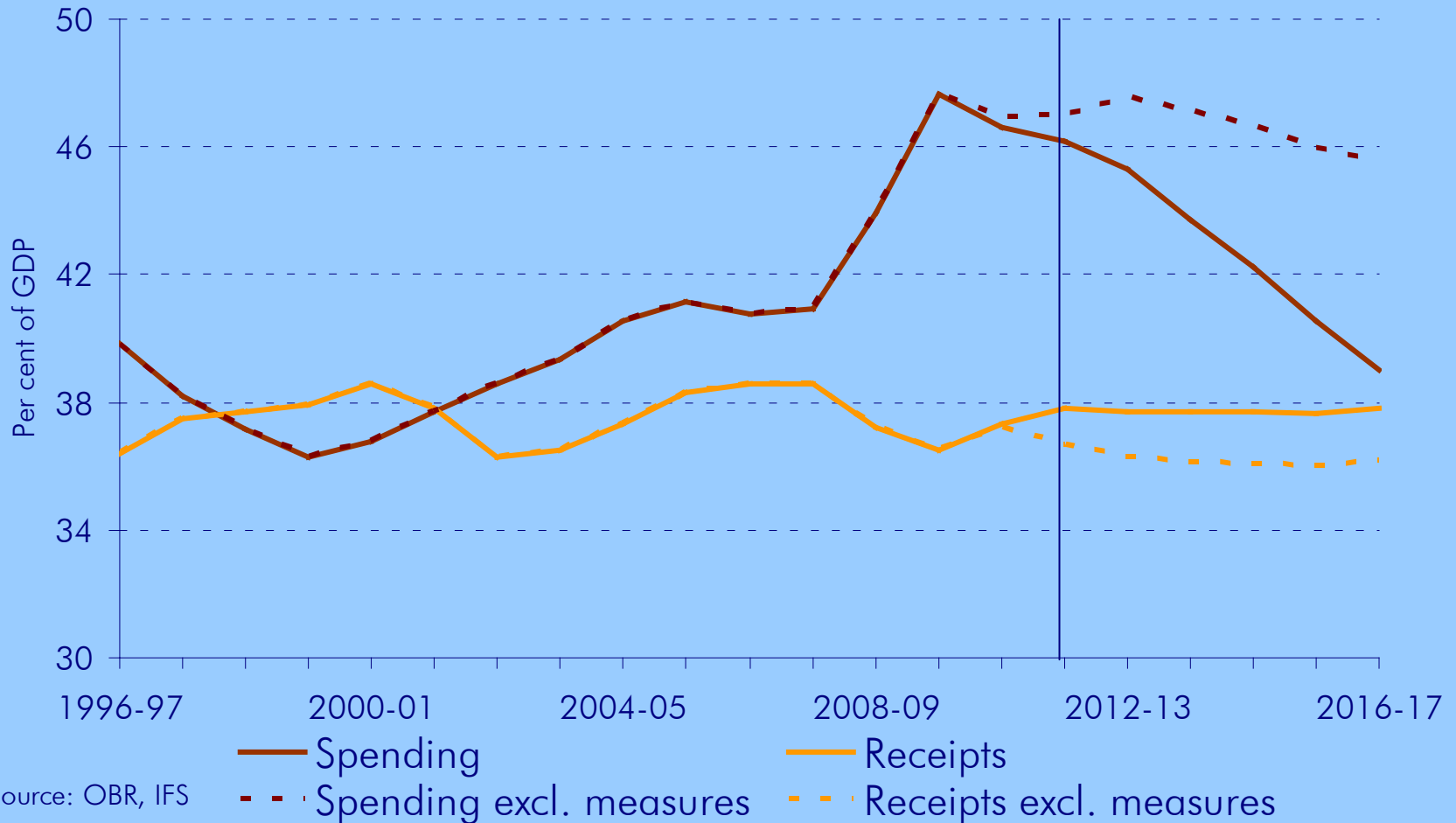
Total public spending and receipts



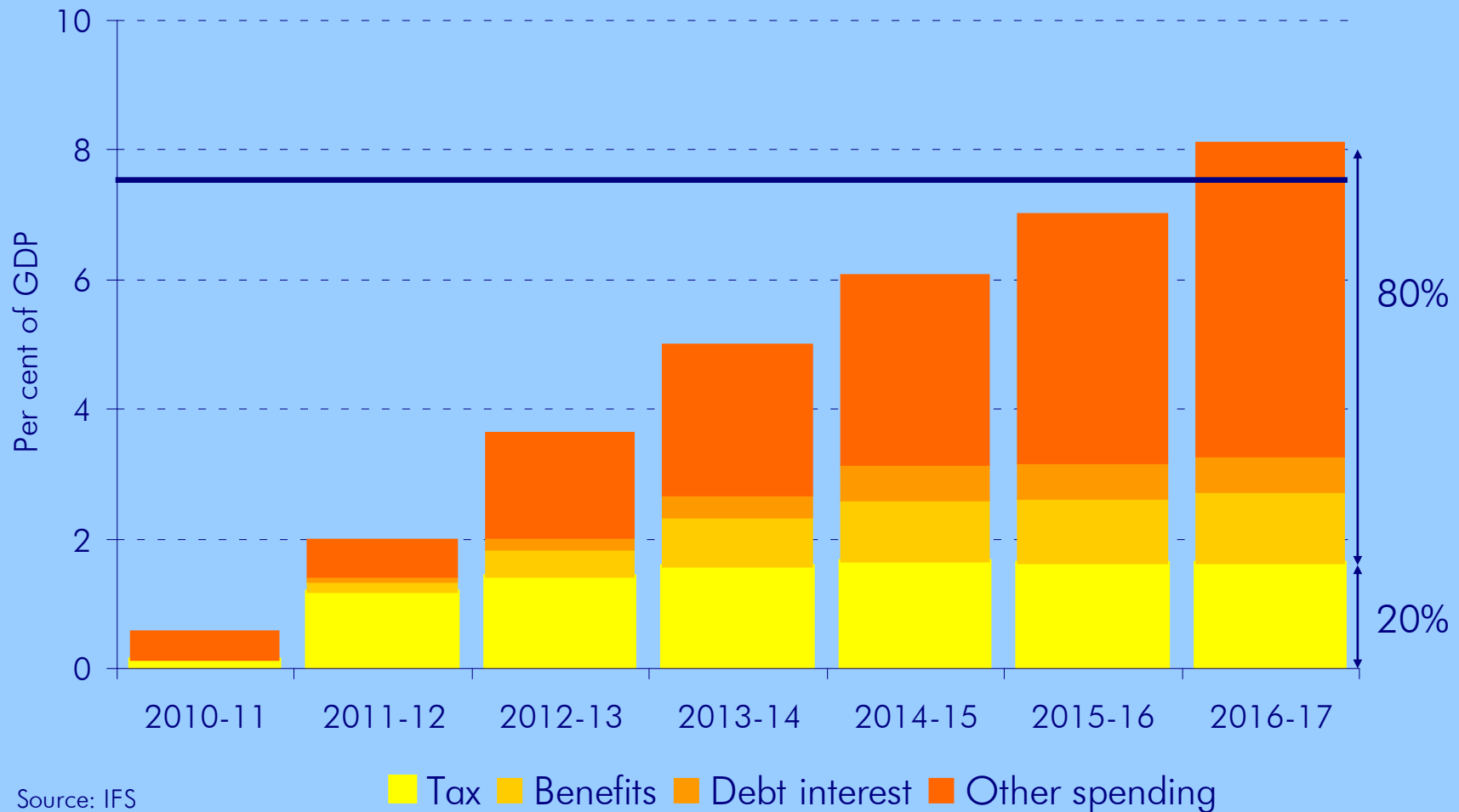
Nominal GDP: total cash size of economy



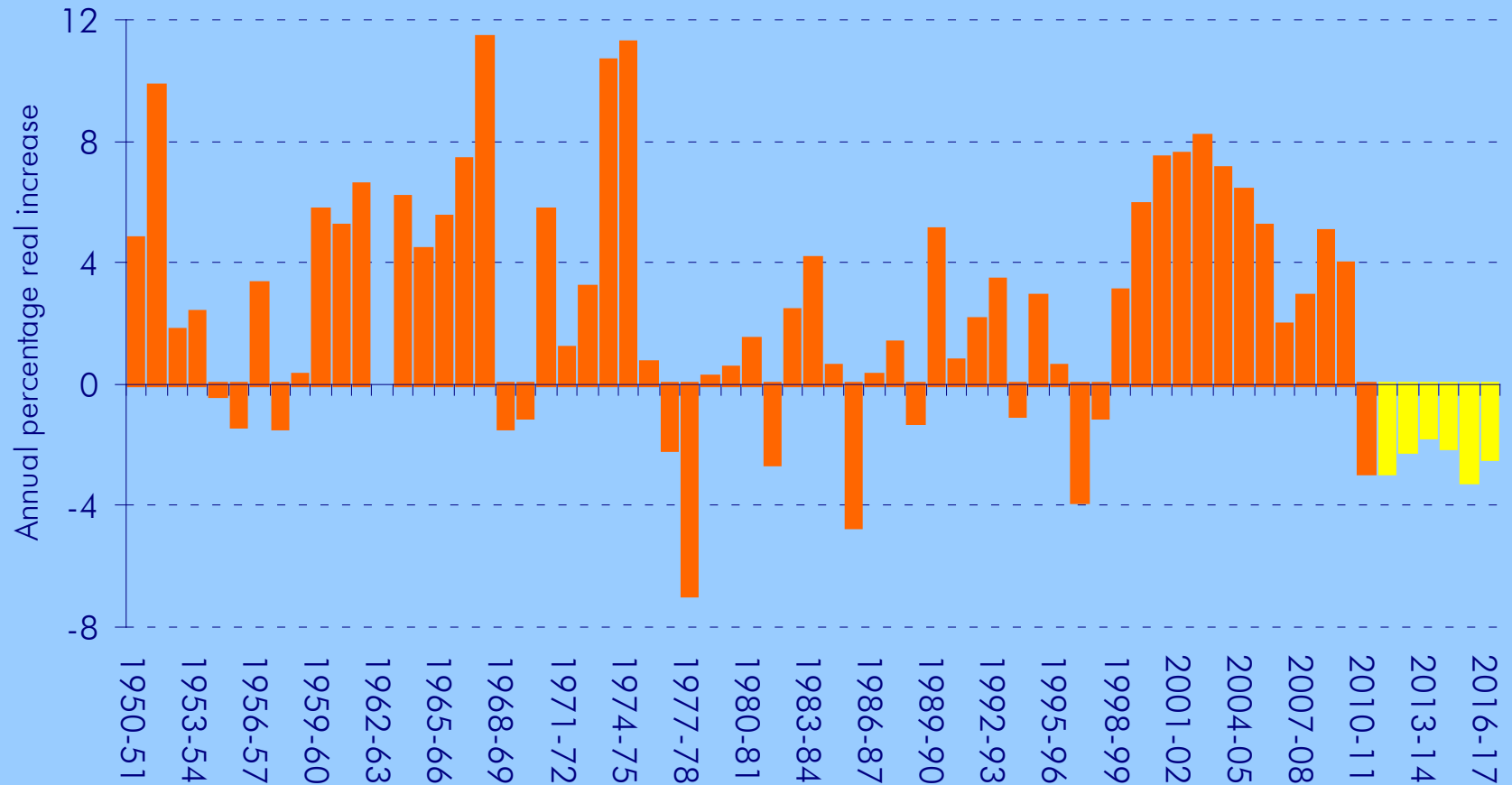
Total public spending and revenues



Policy measures from autumn 2008



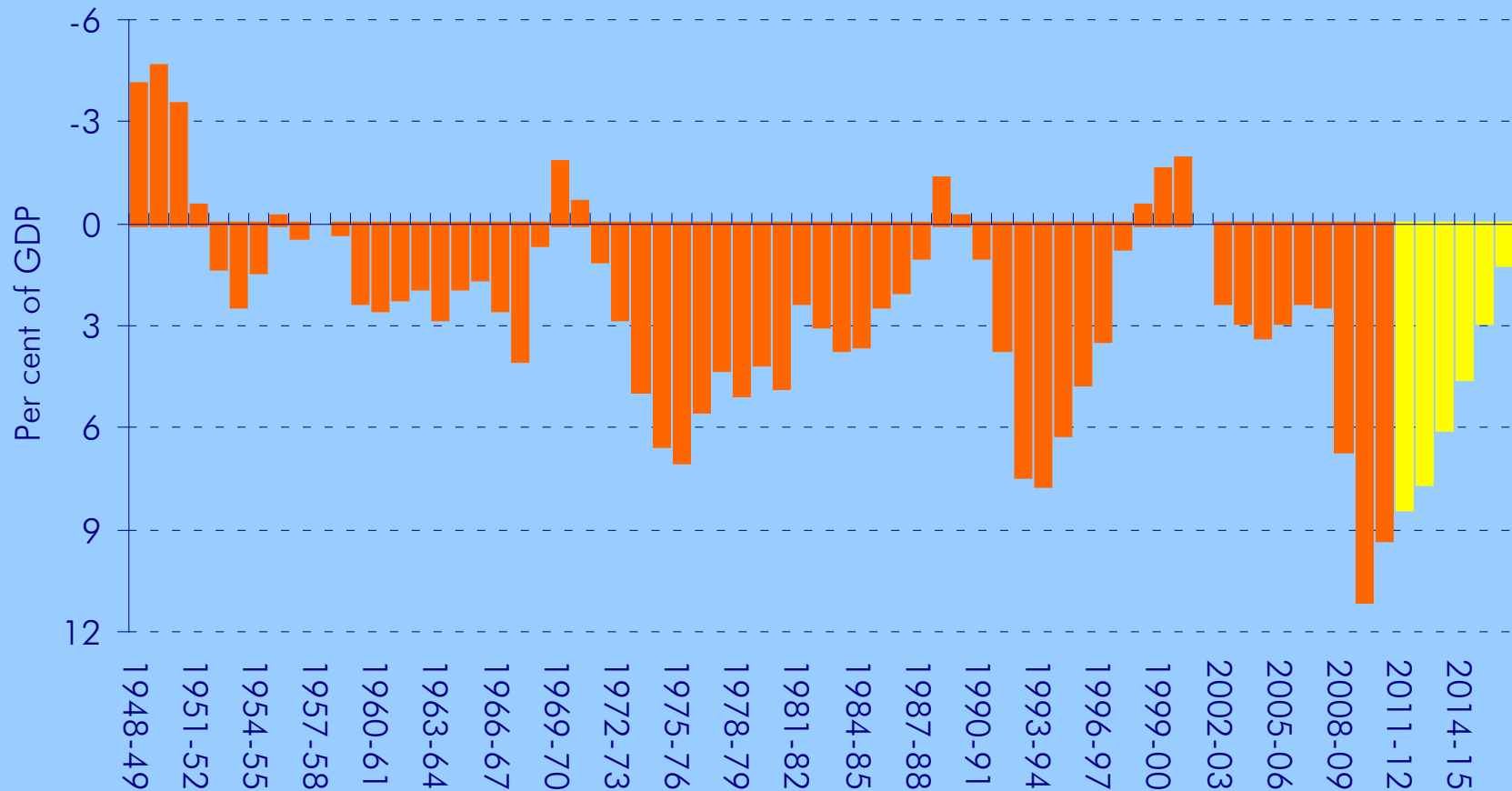
Bigger squeeze on public services spending



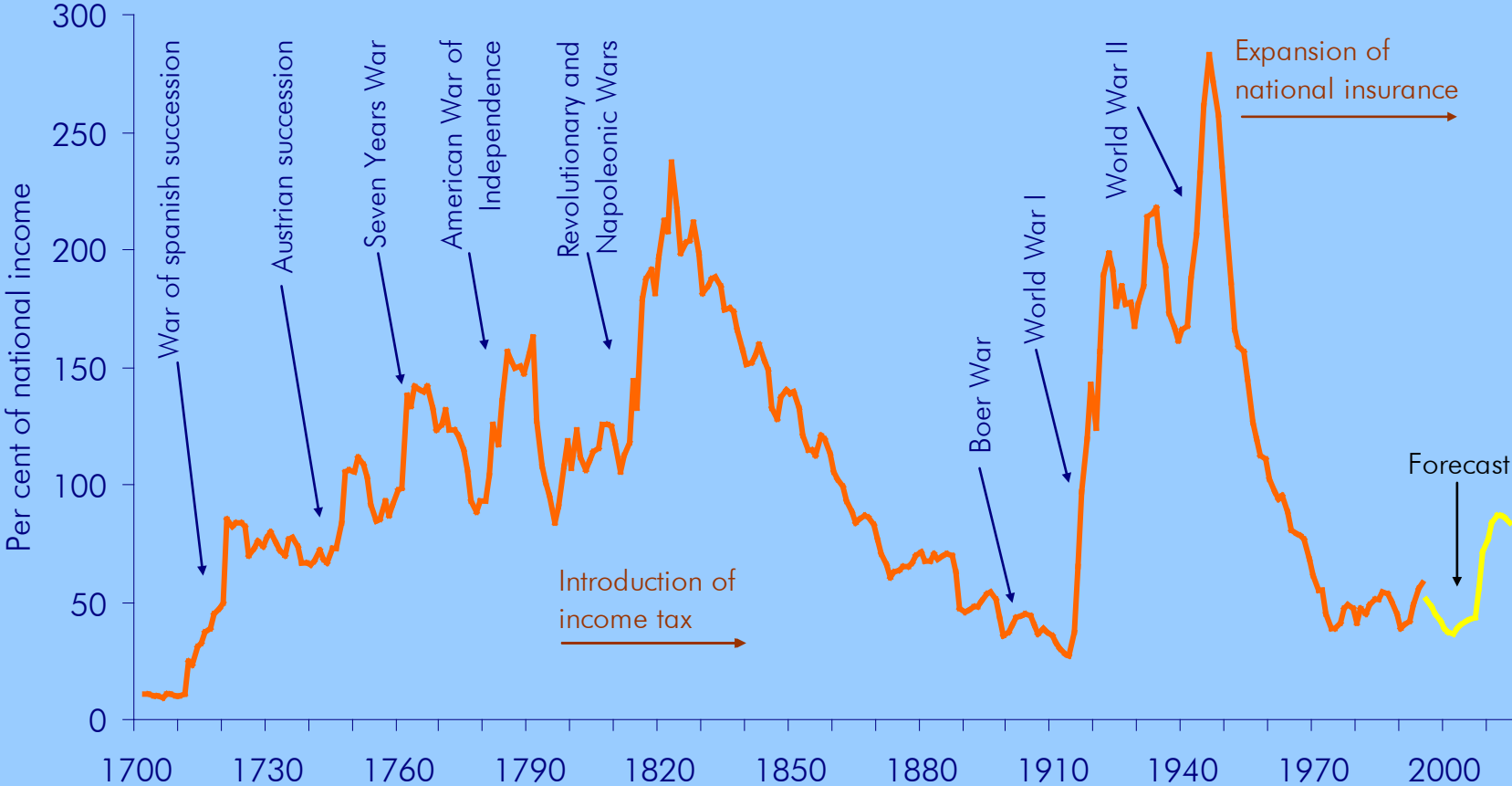
Source: IFS

Some historical and international perspective

Net borrowing as a share of GDP

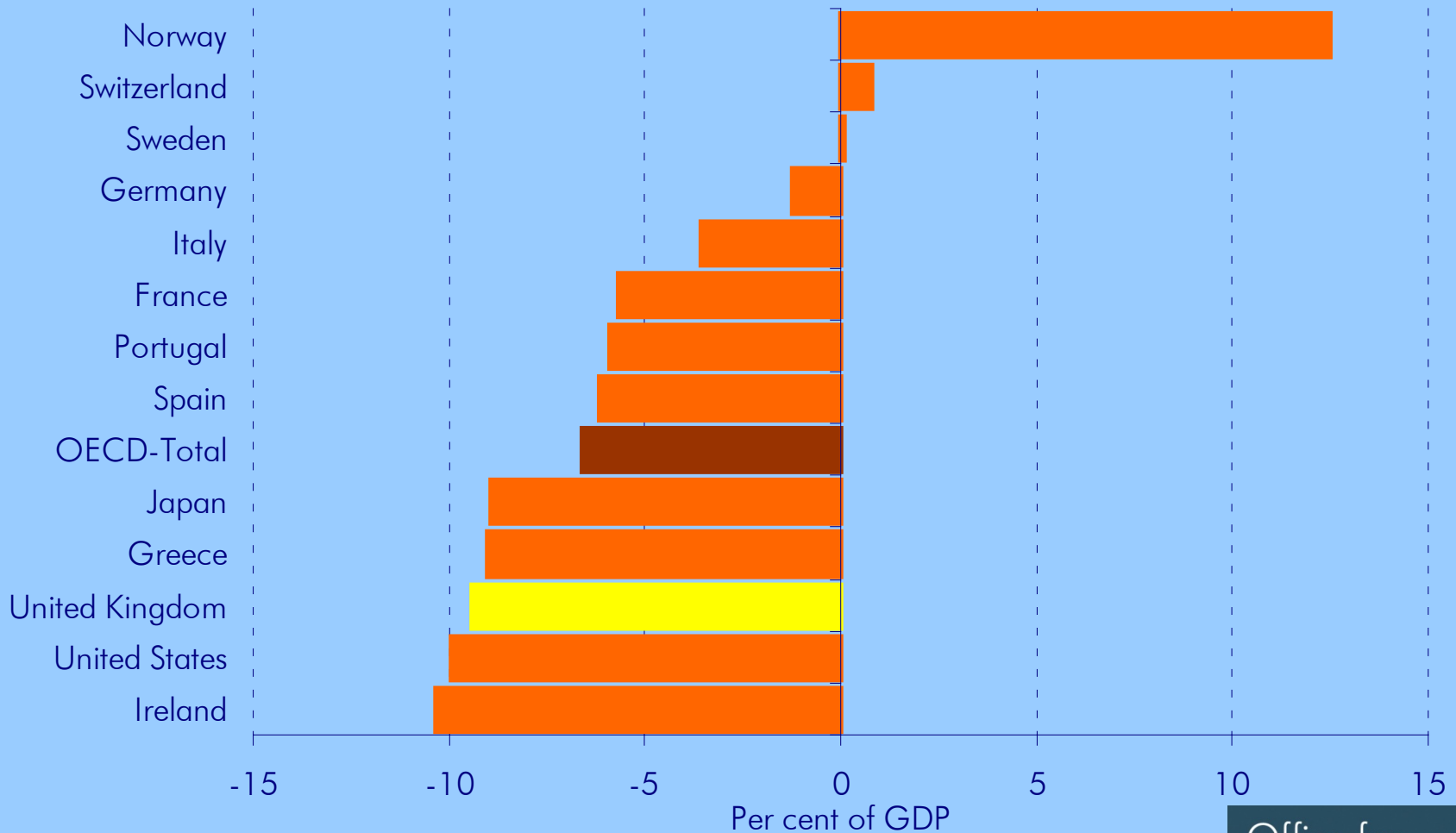


National debt since 1700



Selected OECD budget deficits

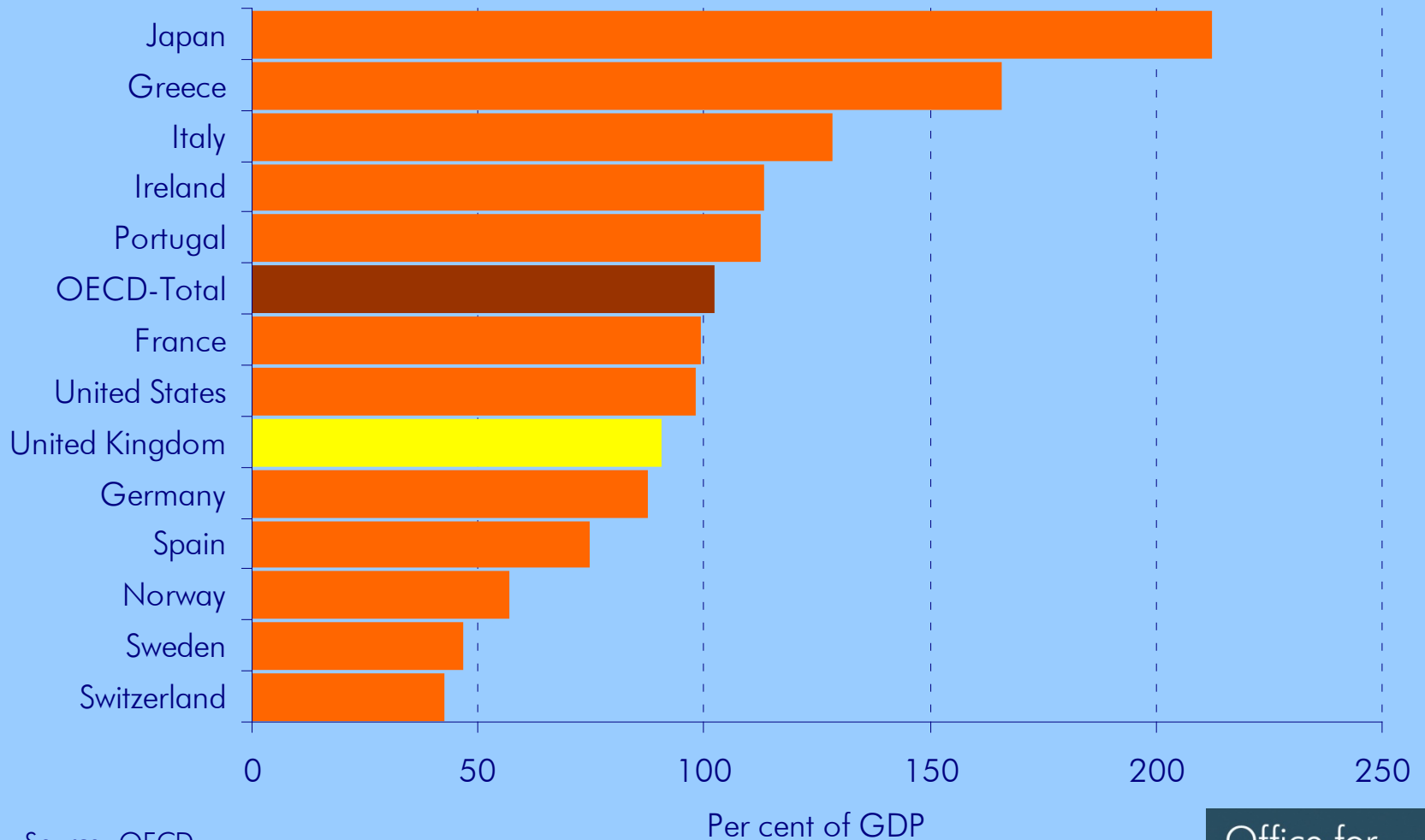
Government net lending/net borrowing in 2011



Source: OECD

Selected OECD debt ratios

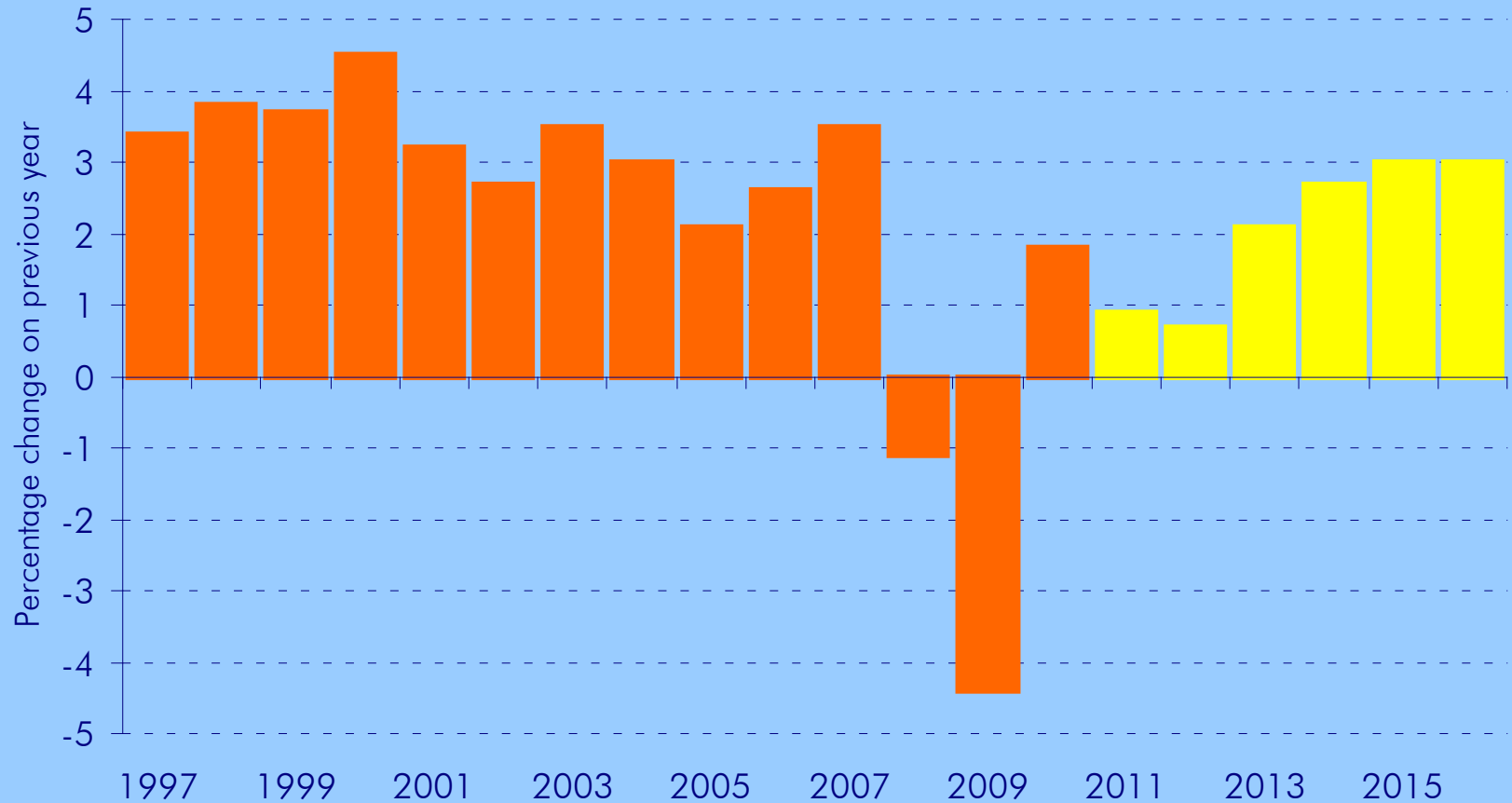
Government gross financial liabilities in 2011



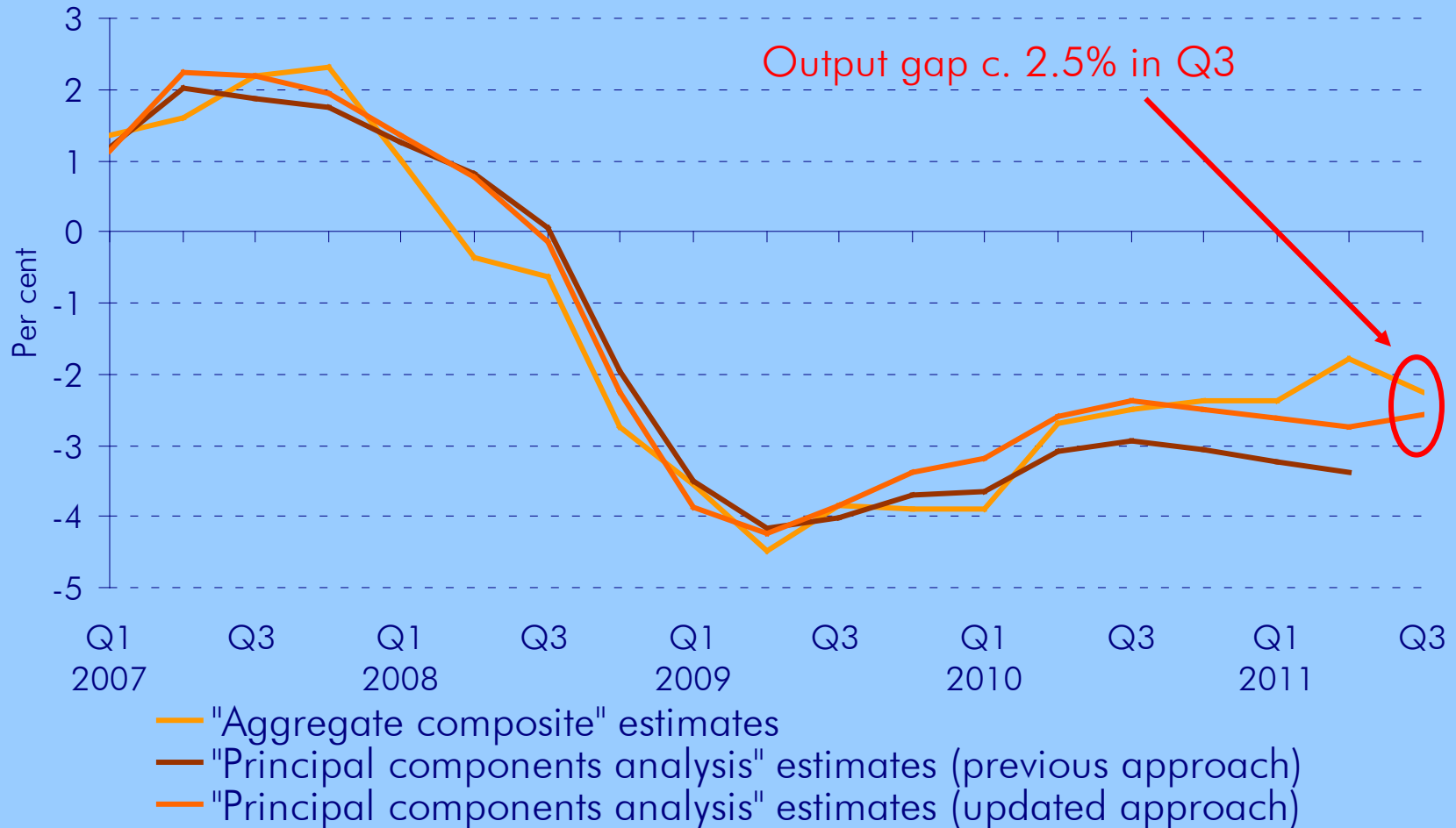
Source: OECD

The policy debate: Plan A versus Plan B

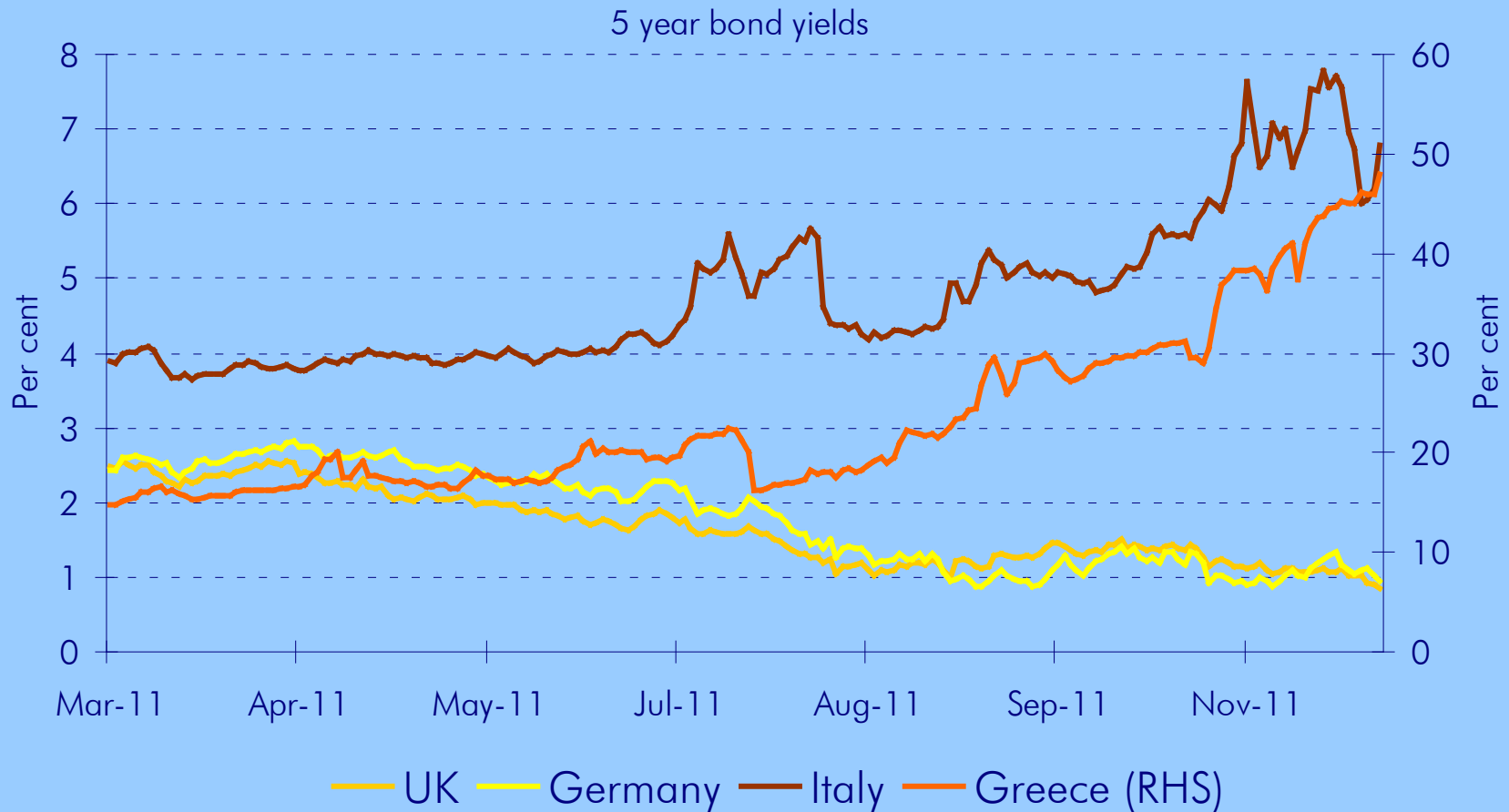
The backdrop: weak economic growth



The backdrop: economy has spare capacity



The backdrop: govt can borrow cheaply



Plan A versus Plan B

- Is there a temporary tax cut or spending increase large enough to give a material boost to the economy, but small enough not to push up the Government's borrowing costs in a self-defeating way?
- The Government says borrowing costs are low because it has a credible fiscal consolidation plan. A fiscal loosening would undermine confidence, push up debt interest costs and soon require even greater fiscal tightening
- The Opposition says borrowing costs are low more because we are outside the eurozone and because people are pessimistic about long term growth. Slowing the consolidation would boost growth and help cut the deficit
- Who's right? It's not for us to say!

The role of the OBR

- “to examine and report on the sustainability of the public finances” (Budget Responsibility and National Audit Act 2010)
- Overcome mistrust of ministerial analysis. Four main tasks:
 - Produce two five-year forecasts for economy and public finances
 - Judge progress towards the government’s fiscal targets
 - Scrutinise Treasury costing of tax and spending measures
 - Assess long-term sustainability and public sector balance sheet
- Demonstrating our political independence is key
 - Various legal safeguards
 - But transparency is key