# A brief guide to the UK public finances

Office for **Budget Responsibility**

**THE independent Office for Budget Responsibility** was established in 2010 to monitor the public sector's finances. Twice a year – usually alongside each Budget and Spring or Autumn Statement – we produce detailed forecasts for the coming five years, assessing the likely impact of any policy decisions and expected developments in the economy. We then use these forecasts to assess the Government's performance against the fiscal targets that it has set itself for the management of the public finances.


This guide provides a brief introduction to the UK public finances and to the terms used to describe them in the official statistics. In doing so we are looking at the finances of the public sector as a whole – which encompasses not just central government, but also the devolved administrations, local councils and public corporations. The figures presented in this guide are taken from our March 2022 forecast, which covers the five fiscal years up to 2026-27. Each fiscal year runs from April to March.

# Overview

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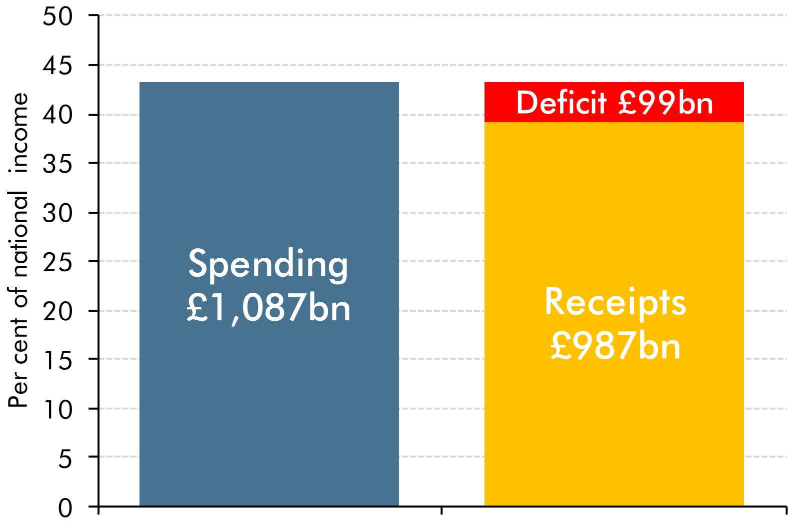
**IN each forecast we assess** how the public finances are likely to evolve on the basis of existing Government tax and spending policies and our best guess at the likely evolution of the economy. In particular we try to estimate:

- **How much money the public sector will raise** from taxes and other sources of revenue. In 2022-23, we expect it to raise £987.5 billion, equivalent to around £35,000 per household or 39.3 per cent of national income.

- **How much it will spend** on things like public services, state pensions and debt interest. In 2022-23, we expect it to spend £1,087 billion, equivalent to around £38,000 per household or 43.2 per cent of national income.

- Whether it will spend more or less than it raises – in other words **whether it will run a budget deficit or surplus**. In 2022-23, we expect a deficit of £99.1 billion. Because the growth in receipts outpaces that of spending, we expect the deficit to fall over the next five years to reach £31.6 billion.

Spending and receipts in 2022-23




- **How much will be added to – or paid off – the national debt** in each year. In 2022-23, we expect debt to be equivalent to 95.5 per cent of national income, down slightly from the 40-year peak of 95.6 in 2021-22. It is equivalent to around £2.5 trillion or £87,000 per household. We expect the ratio of net debt to national income to fall gradually over the next five years to reach 83.1 per cent in 2026-27. In cash terms we expect it to stand at £2.5 trillion by then. Taking out the effect of Bank of England (BoE) loans to banks and building societies, the debt ratio falls slightly across the forecast to stand at 79.8 per cent of national income in 2026-27.

# Income

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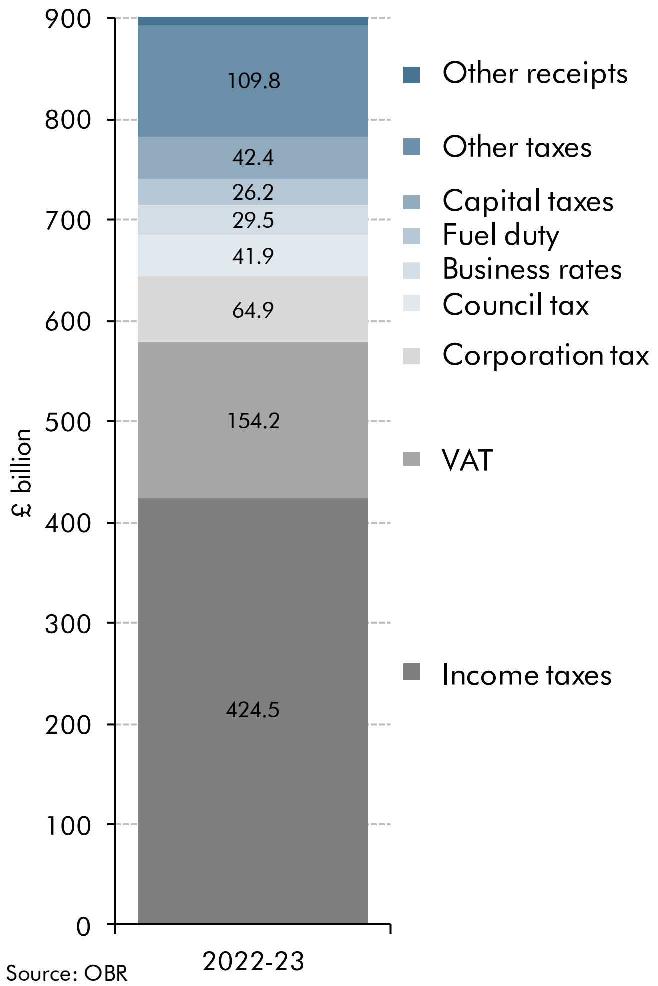
**IN 2022-23, we expect the public sector's income** to amount to £987.5 billion, equivalent to £35,000 per household or 39.3 per cent of national income. This income is called 'public sector current receipts' in the official statistics and comes from many sources. Taxes are the most important at 90 per cent of the total in 2022-23. The taxes that bring in the most money are income tax and National Insurance contributions, which together are expected to raise around £425 billion. Value added tax (VAT) is the next most important, expected to raise £154 billion. Other big taxes include corporation tax, council tax, business rates, VAT refunds, fuel duty, capital gains tax and stamp duty land tax. No other tax is expected to raise more than £20 billion.

Sources of public sector receipts




Source: OBR

The public sector also receives other revenues, including interest earned on its assets (such as foreign exchange reserves and student loans), while public corporations generate some income.

Over the next five years, we expect total receipts to rise by 19 per cent, faster than the growth in the cash size of the economy. We expect most taxes to rise more quickly than the growth of the economy as a whole, including income tax (driven in part by wages and salaries growing faster than nominal GDP, and frozen tax thresholds dragging more income into higher tax brackets), VAT (due to a rise in the share of consumption on standard rated goods) and corporation tax (due in part to higher profits than expected). But some tax receipts are expected to fall, for example tobacco duty from 2023-24 onwards (because people are smoking less).



Next: Spending

# Spending

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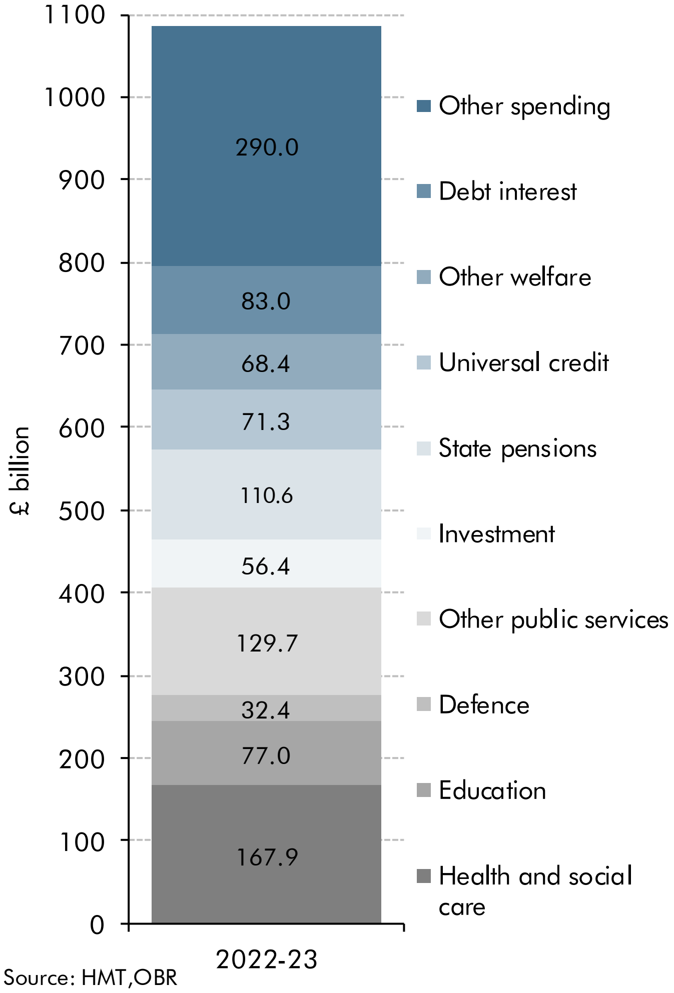
**THE public sector raises money in order to spend it**, mostly on the day-to-day costs of providing public services, on capital investment and on cash transfer payments that support the incomes of various individuals and families.

Public sector spending




Source: HMT,OBR

In 2022-23, we expect public spending to amount to £1,087 billion, which is equivalent to around £38,000 per household or 43.2 per cent of national income. This is called 'total managed expenditure' and covers many different types of spending.

In 2022-23, we expect central government departments to spend £407.0 billion on the day-to-day ('current') running costs of public services, grants and administration. This is 37 per cent of public spending. The biggest items are health (£167.9 billion), education (£77.0 billion) and defence (£32.4 billion). This spending is usually subject to multi-year limits set by the Treasury – known as 'resource departmental expenditure limits' or 'RDEL'.

We also expect the public sector to spend £113.6 billion – 10 per cent of the total – on capital investment (such as roads and buildings) and on loans to businesses and individuals. Around 75 per cent of this will be spent by government departments, again usually subject to multi-year Treasury limits – 'capital departmental expenditure limits' or 'CDEL'. Some of the remainder will be carried out by local authorities (mostly roads, schools and housing) and public corporations (like Transport for London), and 3 per cent of capital investment is on business and student loans.

The Government set out detailed department-by-department plans for RDEL and CDEL in its 2021 Spending Review. This set RDEL and CDEL plans for all departments for 2022-23 to 2024-25.



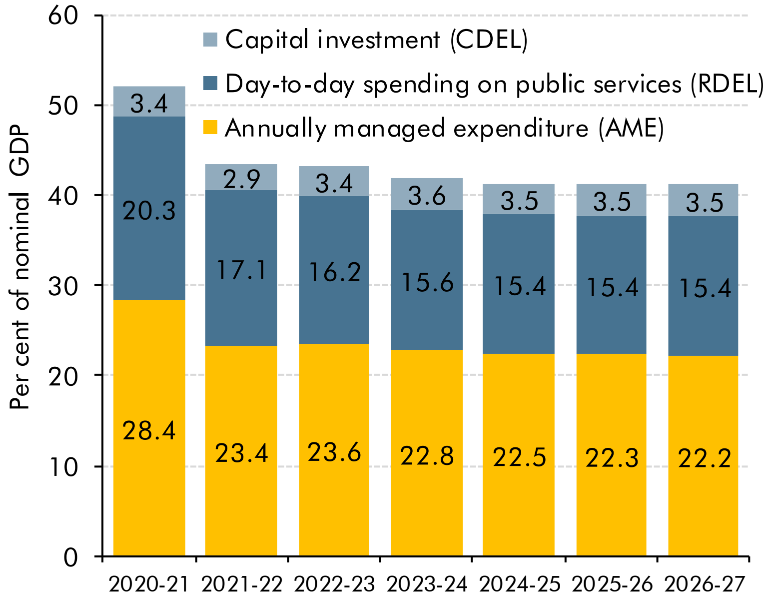
Next: Spending continued

The biggest component of 'annually managed expenditure' or 'AME' is cash transfers through the welfare system, expected to cost £250.3 billion in 2022-23. 54 per cent of these are paid to pensioners, with state pensions the largest item at an expected £110.6 billion. Other big items include universal credit and the tax credits and benefits it is replacing (£71.3 billion) and disability benefits (£28.2 billion, around half paid to people of working age).

Interest payments on the national debt are expected to cost £87.2 billion in 2022-23. This includes the interest government pays to private sector holders of the bonds it issues – known as 'gilts' – and also the interest paid by the Bank of England on the money created during the 'quantitative easing' of monetary policy since the late 2000s financial crisis and recession. Net debt interest (interest paid minus interest received) is expected to be 7.6 per cent of non-interest receipts in 2022-23 before falling to 3.3 per cent in 2026-27.

Over the next five years, we expect public spending to rise by 11 per cent in cash terms, slightly slower than the economy will as a result of temporary spending to support living costs receding and a sharp fall in debt interest costs.

Public spending




Source: OBR, HMT

Spending on some items rises more quickly (e.g. the cost of state pensions as ageing increases the number of claimants and the triple-lock increases the amount), and on other items it is almost flat (e.g. spending on capital investment). The Government's multi-year spending plans mean that RDEL will rise by 11 per cent in cash terms by 2026-27.



Next: Deficits or surpluses

# Deficits or surpluses

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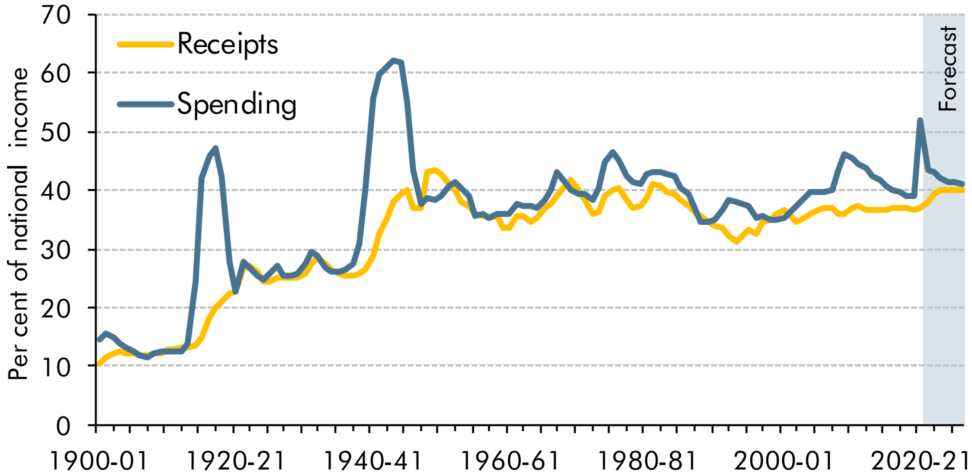
**WHEN total spending in a year is higher than total receipts**, the Government needs to borrow to cover the difference. This gap is known as the budget deficit or 'public sector net borrowing'. When receipts are higher than spending, the government runs a surplus. Deficits and surpluses are similar to losses or profits for a company.

The gap between receipts and spending

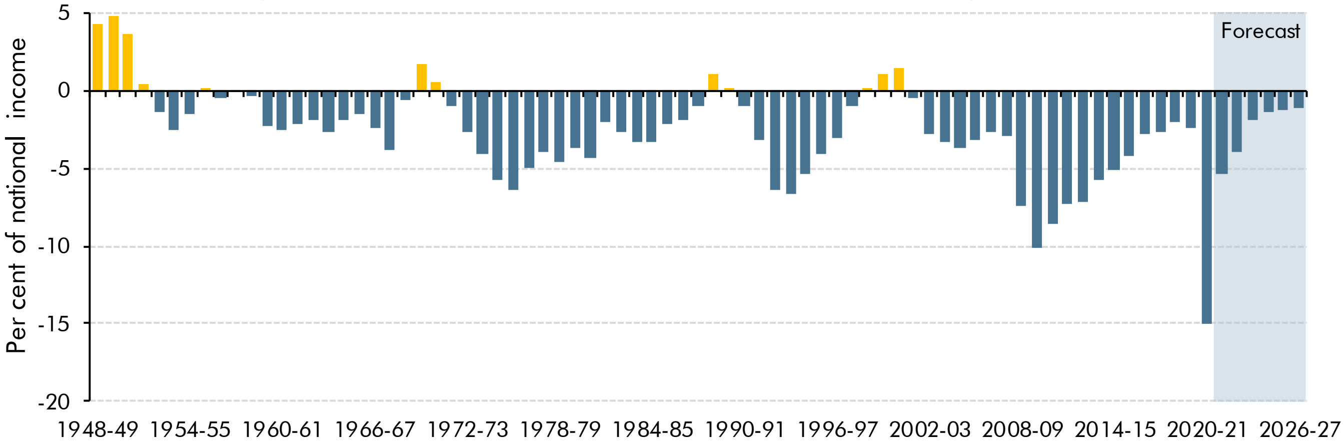



Source: ONS, OBR

In 2022-23, we expect a deficit of £99.1 billion or 3.9 per cent of national income. This is a sharp fall from the 2020-21 peak of £321.9 billion, which was the highest since the second world war. Thereafter we expect the growth in receipts to outpace that of spending and the deficit to fall over the next five years. We expect the deficit to be £31.6 billion in 2026-27 when receipts are expected to be 40.1 per cent of national income and spending 41.1 per cent.

Swings into deficit have become steadily more pronounced over the post-war period. And budget surpluses have been achieved in only 12 years since 1948 and only five years since 1971-72.

Public sector budget deficit since 1948 (Public sector net borrowing)




Source: ONS, OBR



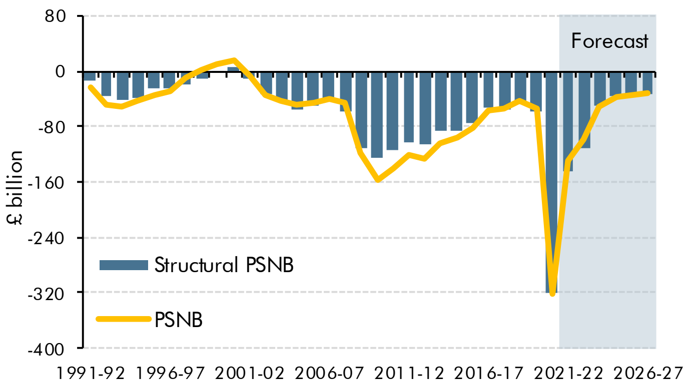
Next: Deficits or surpluses continued

Movements in the budget deficit are in part the result of the ups and downs of the economy. When the economy is strong, the deficit will be lower as taxes flow in and welfare spending costs are reduced. The opposite is true when the economy is weak.

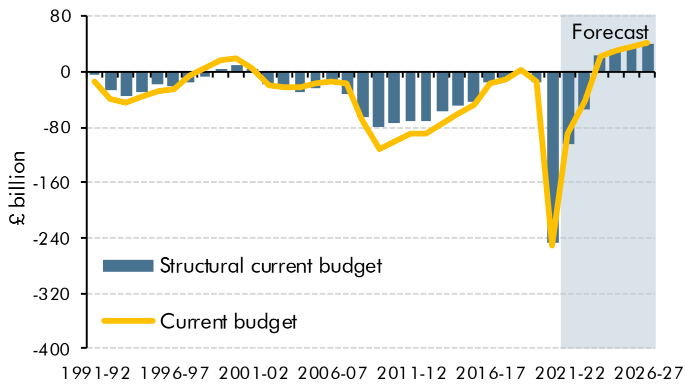
The 'structural' budget deficit is an estimate of how large the deficit would be if the economy was operating at a normal, sustainable level of employment and activity. We never know precisely what this 'normal' level would be, so these estimates are always uncertain. Currently this concept is particularly problematic, due to the effect on potential output of temporary public health measures that have been used to control the Covid pandemic. Using our usual mechanical approach, we currently estimate that the economy will be 0.3 per cent above normal capacity in 2022-23. This is thanks to supply bottlenecks creating excess demand, a tight labour market nad discretionary fiscal easing. So we judge that the structural deficit is slightly larger than the overall deficit, with a 'cyclical' part of the deficit that would disappear automatically as the economy returns to a normal level of activity.

The headline deficit is the difference between total receipts and total spending, but people are also interested in the 'current deficit' (or surplus). This counts all receipts and all current spending, but excludes spending on net investment. As long as net investment is positive, the current deficit will be smaller than the overall deficit. We expect the current deficit to be £42.7 billion in 2022-23, switching to a surplus of £40.6 billion by 2026-27.

Public sector net borrowing




Current budget balance




Source: ONS, OBR

# Debt

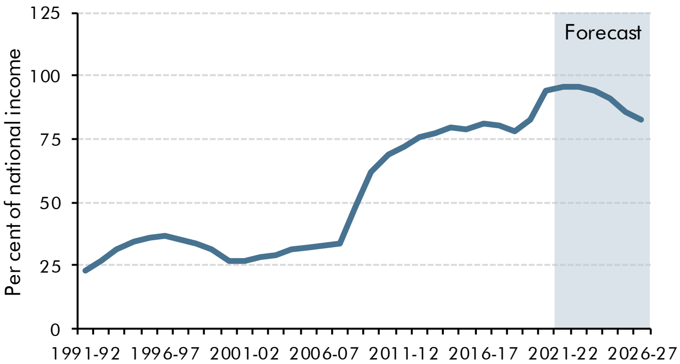
**SO far we have been looking at the flows** of spending and receipts that take place each year and the deficits and surpluses they result in. But because governments run deficits much more often than they run surpluses, they have built up a significant stock of outstanding debt over time.

Generally speaking, if the public sector runs a deficit in a particular year, debt will rise in cash terms. But it can still fall as a share of national income if the cash size of the economy is growing sufficiently strongly. (That said, it is also important to be aware that some government activity adds to its debt without adding to the deficit in any given year, most significantly providing loans to students and businesses where the loans are financial assets for the government, provided they are expected to be repaid in future.)

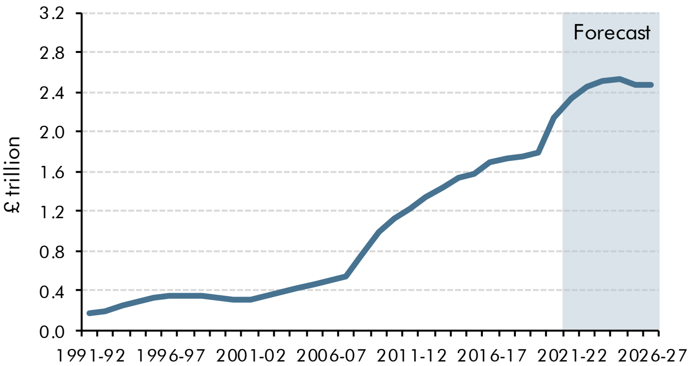
The most widely watched measure of debt in the UK is 'public sector net debt', which subtracts the relatively small amount of assets that the Government could readily turn into cash if required (for example, foreign exchange reserves) from the gross total. We expect public sector net debt to reach 95.5 per cent of national income in 2022-23 which is equivalent to around £2.5 trillion or £87,000 per household – slightly below its 2021-22 peak which was the highest since 1962-63. We expect the ratio of net debt to national income to fall gradually over the next five years to reach 83.1 per cent in 2026-27. In cash terms, we expect it to stand at £2.5 trillion by then.

One of the Government's legislated fiscal targets is to make sure that debt (on a slightly different measure that removes the effect of BoE schemes, including loans to banks and building societies) is falling relative to national income in three years' time, thereby beginning to reverse the big increase associated with the financial crisis, pandemic and associated recessions and Government response. The reduction in borrowing over the forecast period and rebound in the economy means that target is met, with debt on this measure rising in 2022-23 and then falling gradually over the forecast period.

Debt as a per cent of national income




Debt in cash terms




Source: ONS, OBR



Next: International comparisons

# International comparisons

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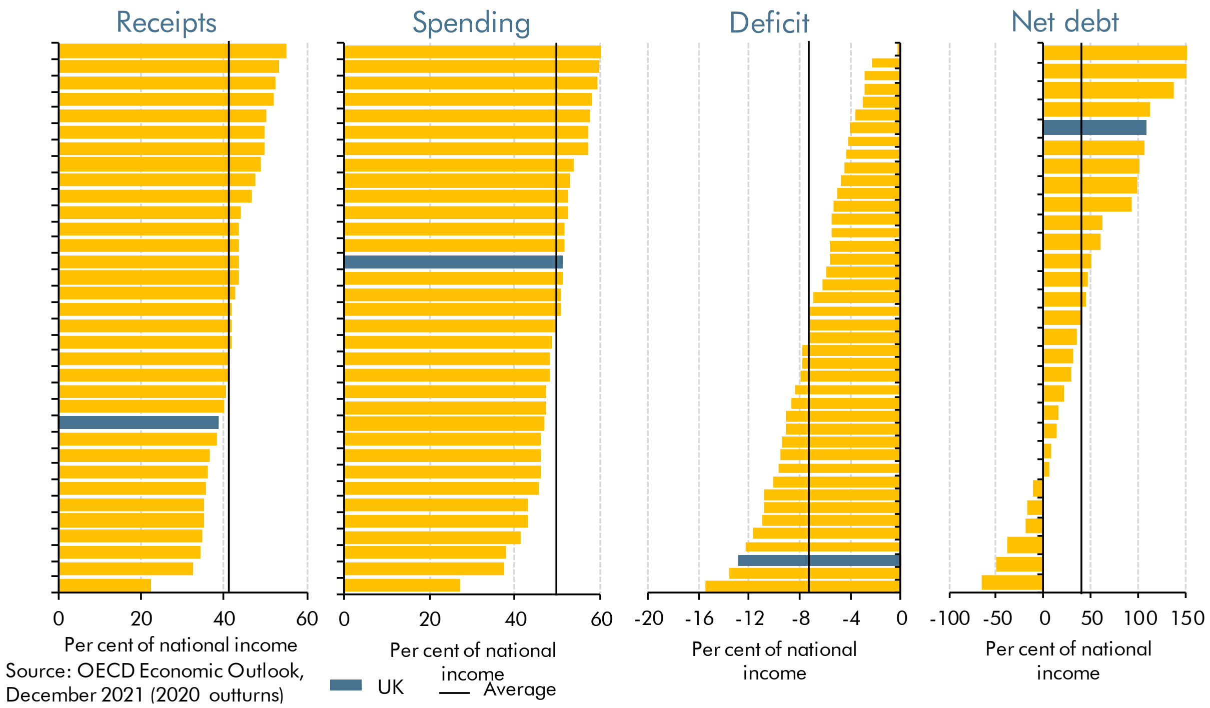
**HOW do the public finances** in the UK compare to those in other countries? To answer this question we can look at the data for 42 industrial countries produced by the Organisation for Economic Cooperation and Development (OECD). Unfortunately, the OECD data are not directly comparable with that we have presented so far: for example, the OECD does not cover public corporations, while it defines spending and revenue somewhat differently. These comparisons are from the first year coronavirus hit public finances worldwide. The impact of the pandemic has varied hugely between countries and has led to most countries shifting significantly from their usual fiscal position. The impact on the UK's public finances in particular was comparatively large.

Those caveats aside:

- The UK government raises somewhat less revenue relative to national income than the majority of other industrial countries – more than the US, Japan and Korea, but less than Scandinavian countries like Denmark and Norway.
- Public spending as a share of national income in the UK is slightly above the average of other industrial countries – the UK spends much more than Japan and Korea, but much less than Finland or France.
- Spending just above the international average, but raising less in revenue, leaves the UK running a budget deficit that's far above the industrial world average.
- Net debt in the UK is also higher than the average of other industrial countries.




Source: OECD Economic Outlook, December 2021 (2020 outturns)