



HM TREASURY

# UK Fiscal Strategy

Presentation to OECD Senior Budget Officials

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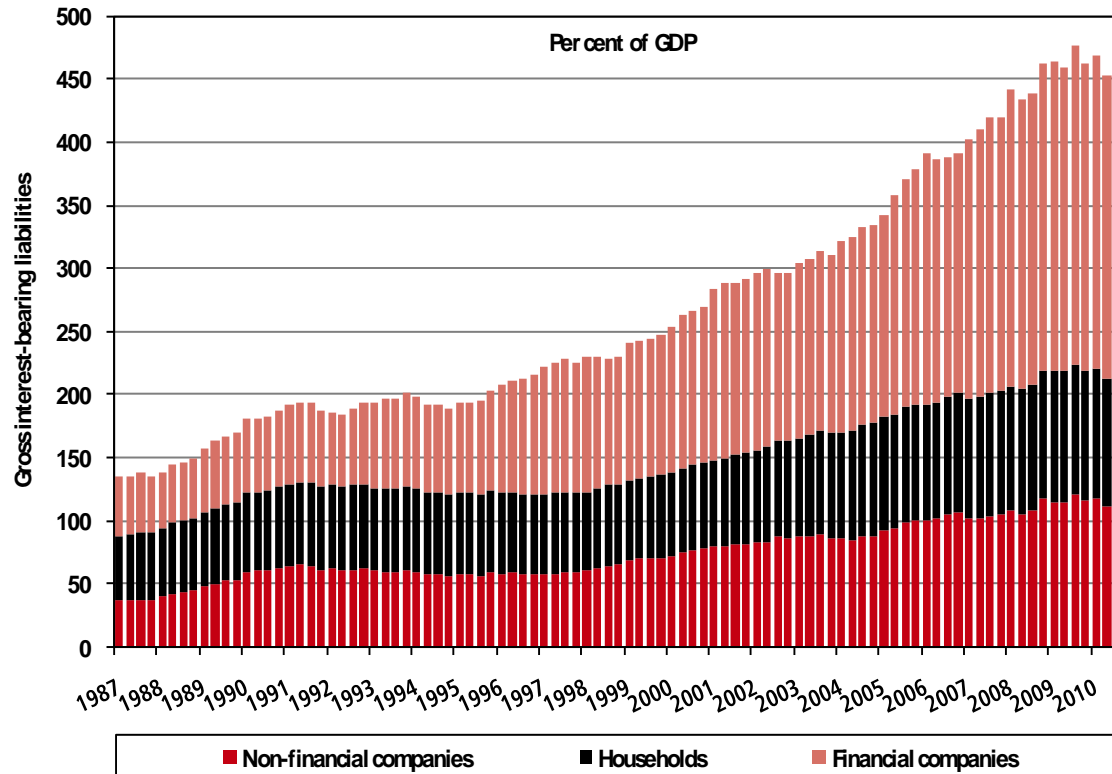
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June 2011

UNCLASSIFIED

- 1. Origin of the UK fiscal deficit**
- 2. Fiscal policy response and framework reform**
- 3. Implications and recent developments**

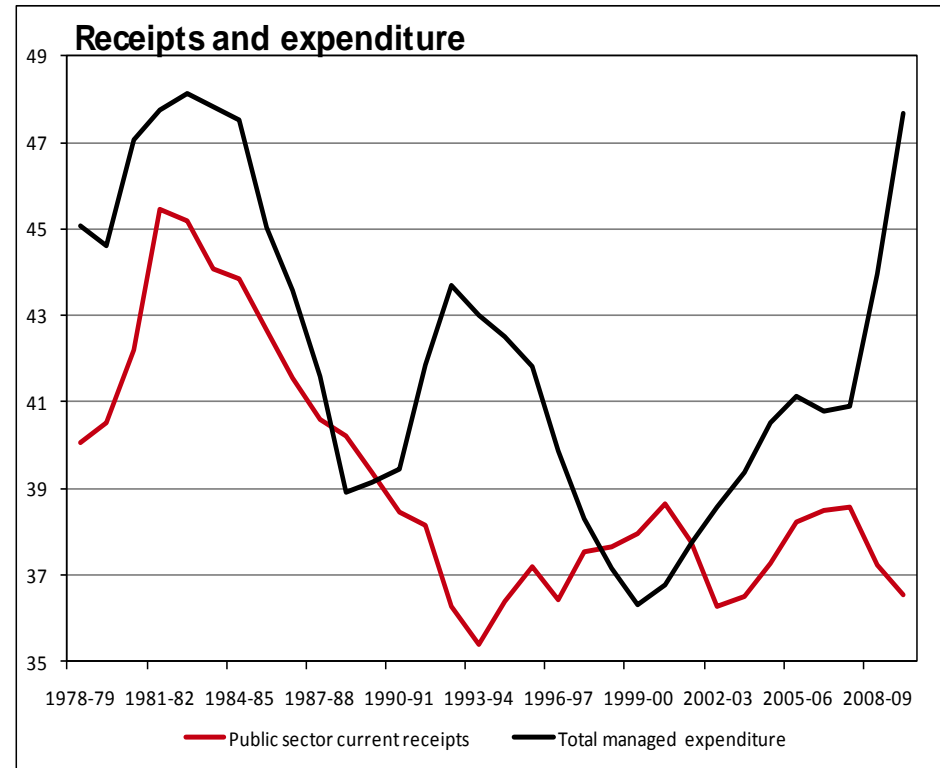
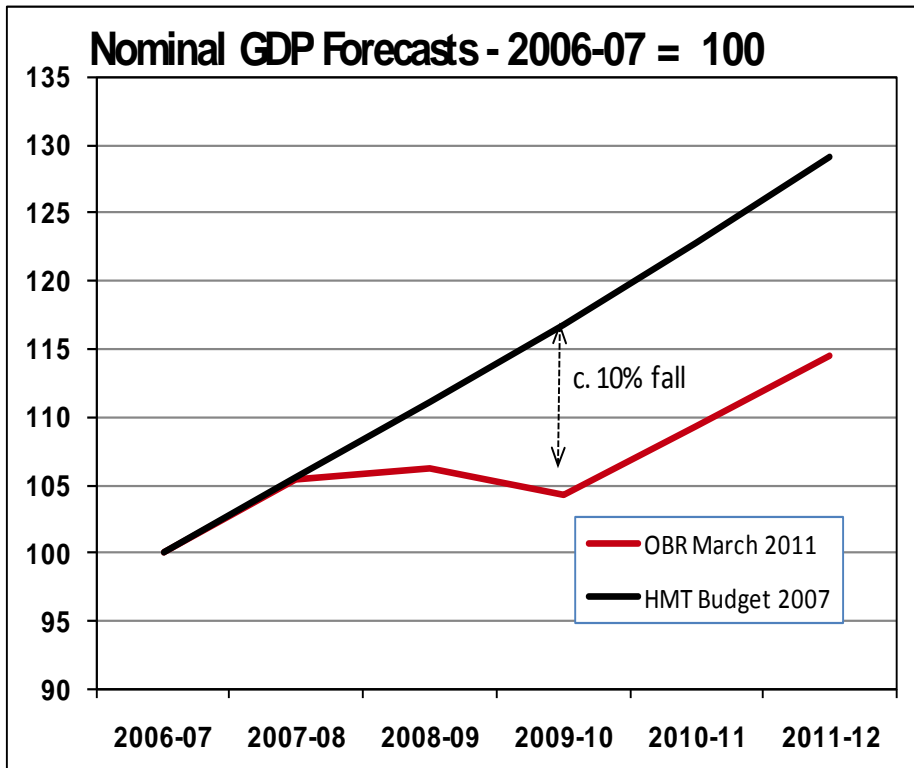
## Private sector debt in the UK



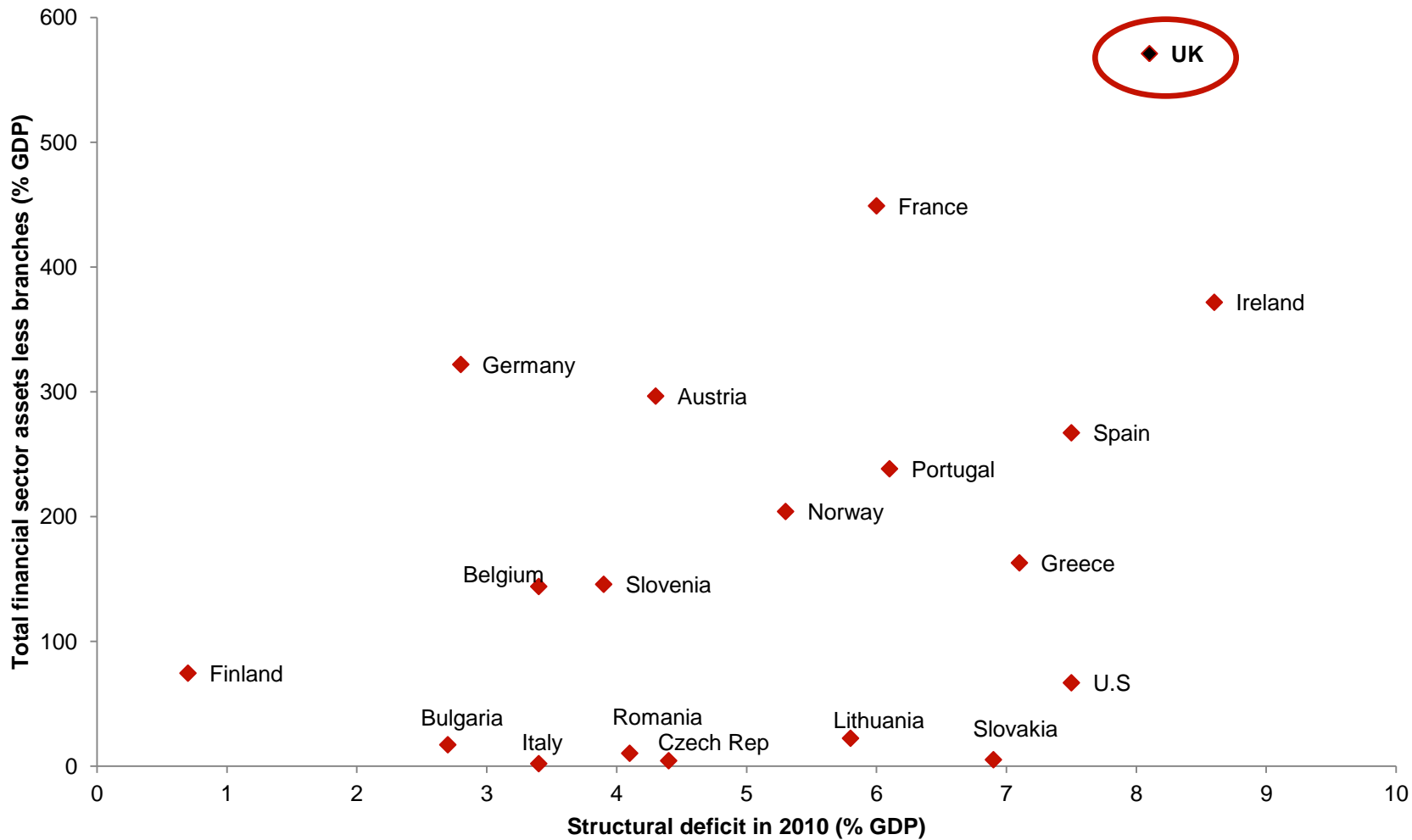
Source: Office for National Statistics.

- Increasing reliance on government, consumer debt and financial sector drove imbalances:
  - By 2007 UK had the largest structural deficit of any G7 economy.
  - The UK's current account went from near balance in 1997, to more than a 3% deficit by 2006.
  - Financial services' share of GDP rose from 6½% in 1997 to 8½% in 2007, while manufacturing's share nearly halved.

# Impact of crisis exposes large structural deficit



# Consequences



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- Early, decisive **action to reduce the deficit**.
  - Setting plans to restore the public finances to a sustainable path. Consolidation plans result in debt peaking in 2013-14.
- Significant **fiscal framework reform** to rebuild credibility.
  - Creating the Office for Budget Responsibility, to provide independent, transparent and credible forecasts.
  - Introducing a clear, forward-looking fiscal mandate, to guide decisions over medium term.
- **Reform of financial sector regulation** to help prevent build-up of systemic risks
  - Overhaul of tripartite system of financial regulation, will legislate to create a Financial Policy Committee within the BoE and a Prudential Regulation Authority.
  - Independent Commission on Banking published interim report on 11<sup>th</sup> April.
- **Structural reform** to support economic growth
  - Government published a micro-economic “Plan for Growth” alongside Budget 2011 to complement macroeconomic stability

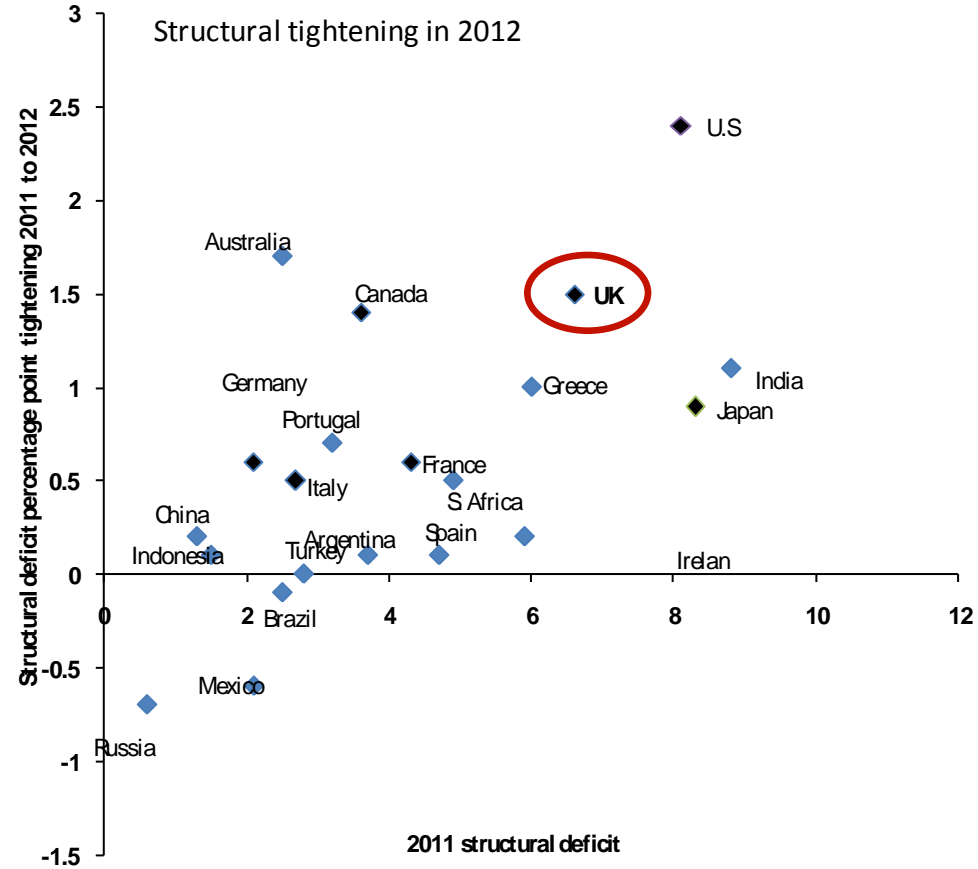
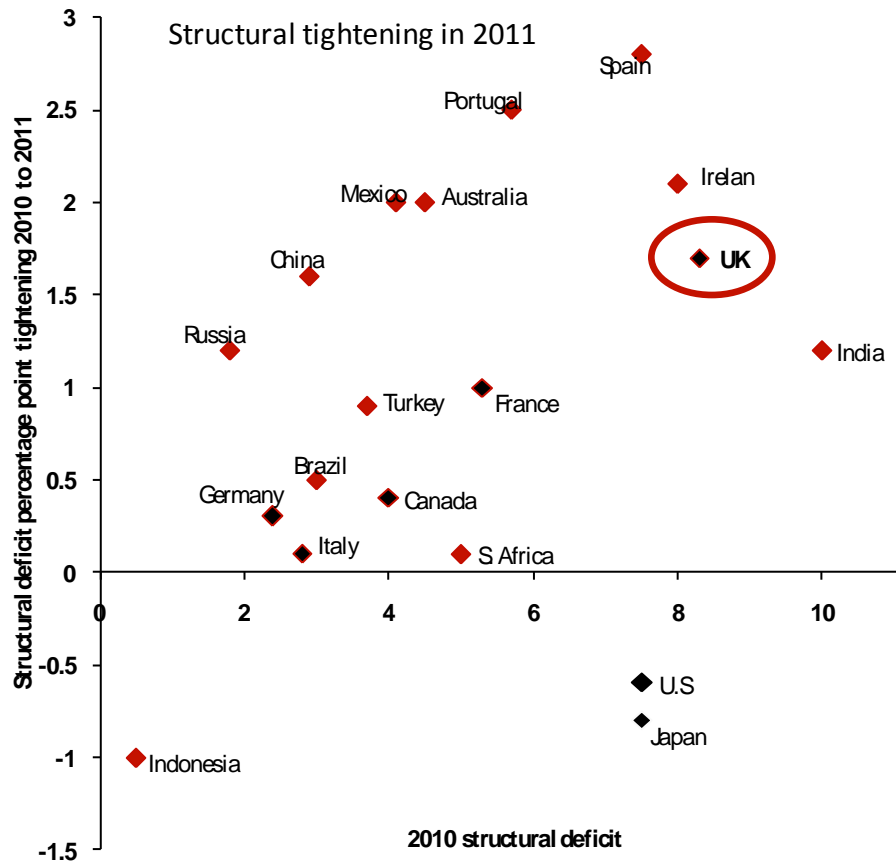
- The Government plans a total consolidation of **£126 billion by 2015-16** (6.6 per cent of GDP).
- Taking the consolidation as a whole, **76 per cent will be delivered by lower spending** by 2015-16.
- This is consistent with OECD and IMF research, which suggests that **fiscal consolidation efforts that largely rely on spending restraint promote growth**.

## Total consolidation

	Per cent of GDP					
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
<b>Policy inherited by the Government</b>	<b>0.1</b>	<b>1.7</b>	<b>2.5</b>	<b>3.4</b>	<b>4.0</b>	
Spending	-	0.9	1.5	2.2	2.8	
Tax	0.1	0.8	1.0	1.1	1.2	
<i>Spending share of consolidation (per cent)</i>	-	54	61	67	71	
<b>Total discretionary consolidation</b>	<b>0.6</b>	<b>2.7</b>	<b>3.7</b>	<b>5.1</b>	<b>6.1</b>	<b>6.6</b>
Spending	0.4	1.4	2.3	3.4	4.4	5.0
Tax	0.3	1.3	1.4	1.7	1.7	1.6
<i>Spending share of consolidation (per cent)</i>	59	53	62	67	73	76



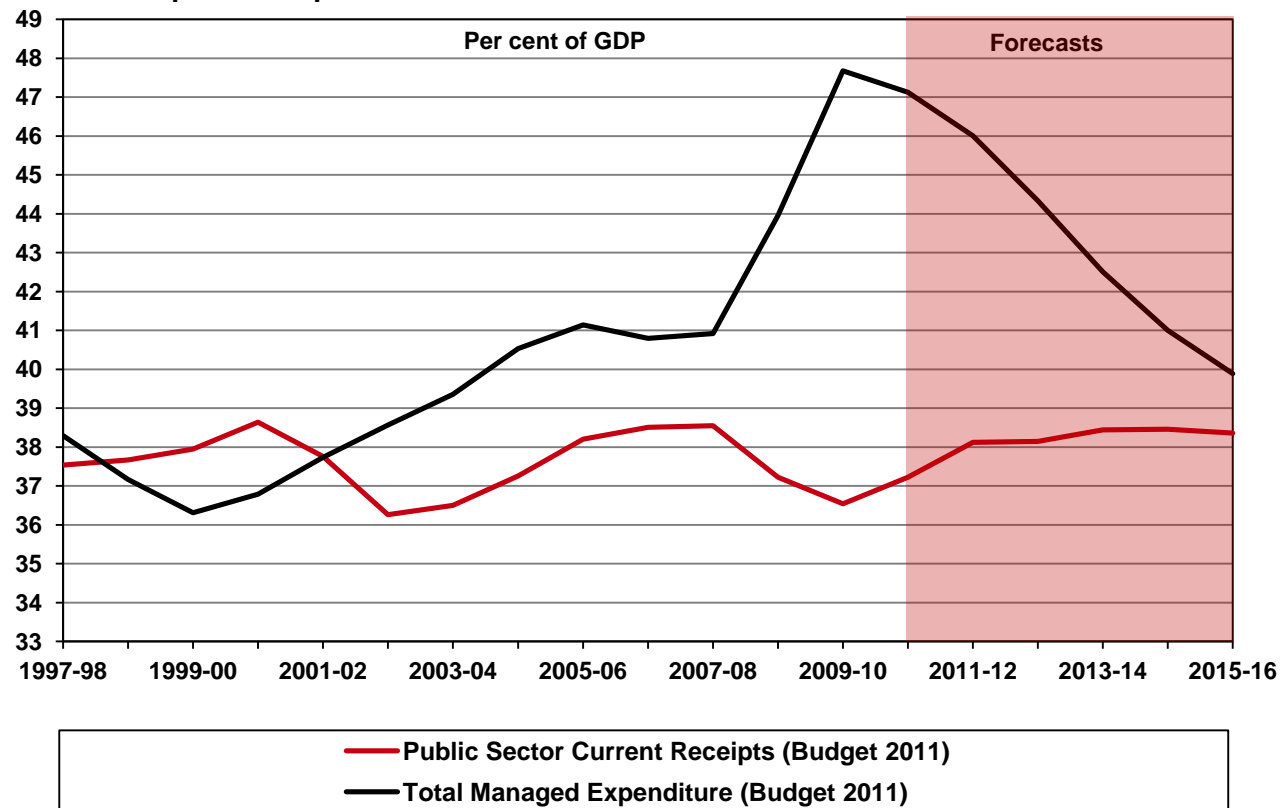
# Pace of consolidation in line with other countries given scale of deficit



Source: IMF Fiscal Monitor April 2011

## • Implementation of consolidation plans now underway

Receipts and expenditure



## Spending

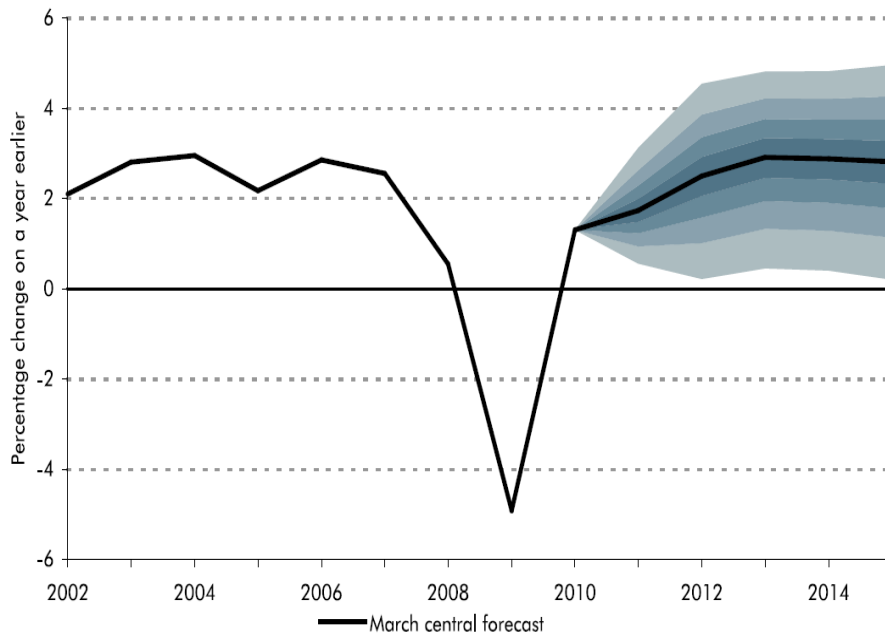
- Plans as far as possible protect most productive public investment expenditure
- Spending Review set fixed departmental budgets for 2011-12 to 2014-15
- Public Expenditure Cabinet Committee to oversee departments' implementation
- Reform of AME, including legislation introduced on Welfare Reform and Pensions and Savings Bills

Taxation: majority of tax consolidation has been implemented, including the increase in standard rate of VAT by 2.5 percentage points, to 20 per cent.

# Framework Reform: Office for Budget Responsibility

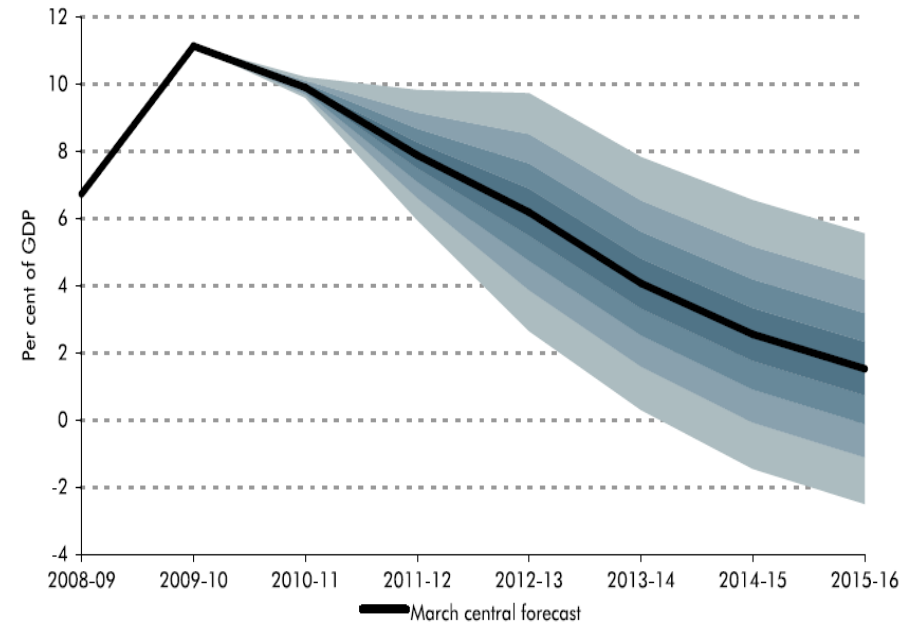
- The creation of the OBR has added to the credibility of the UK's fiscal framework.
- The OBR has produced all the official forecasts of the economy and public finances since the General Election, independently of ministers.
- The OBR has now been placed on a permanent, legislative footing through the Budget Responsibility and National Audit Act 2011, which received Royal Assent on 22 March.

Chart 3.6: GDP fan chart



Source: ONS, OBR

Chart 1.2: Public sector net borrowing fan chart

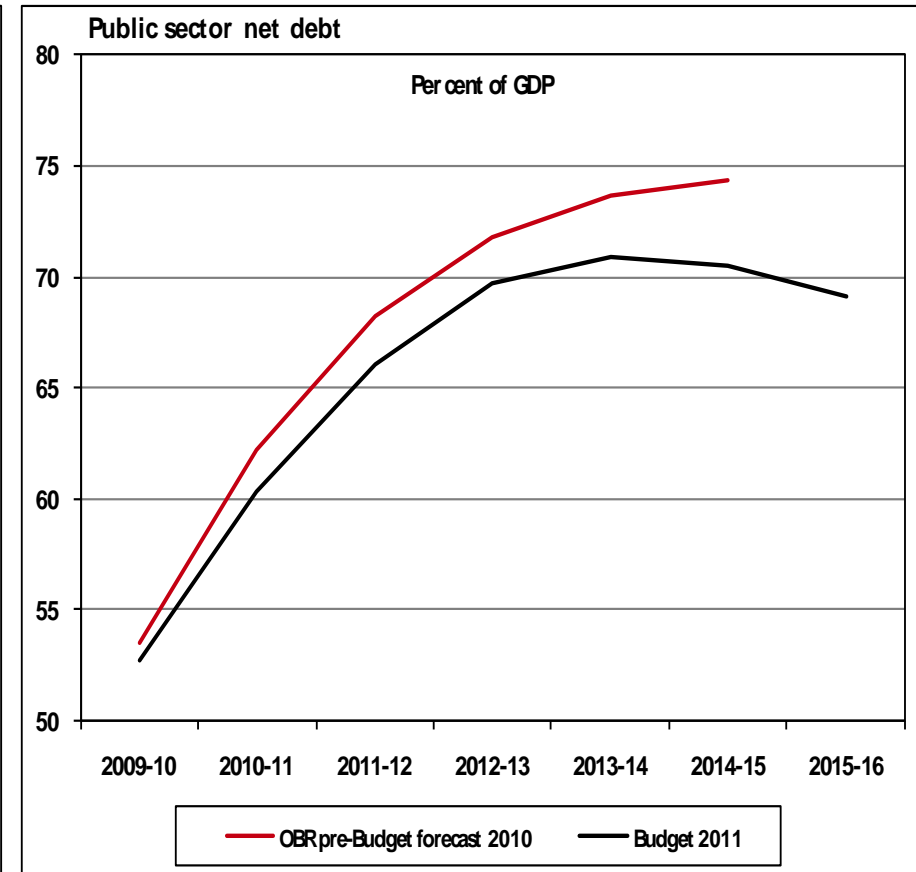
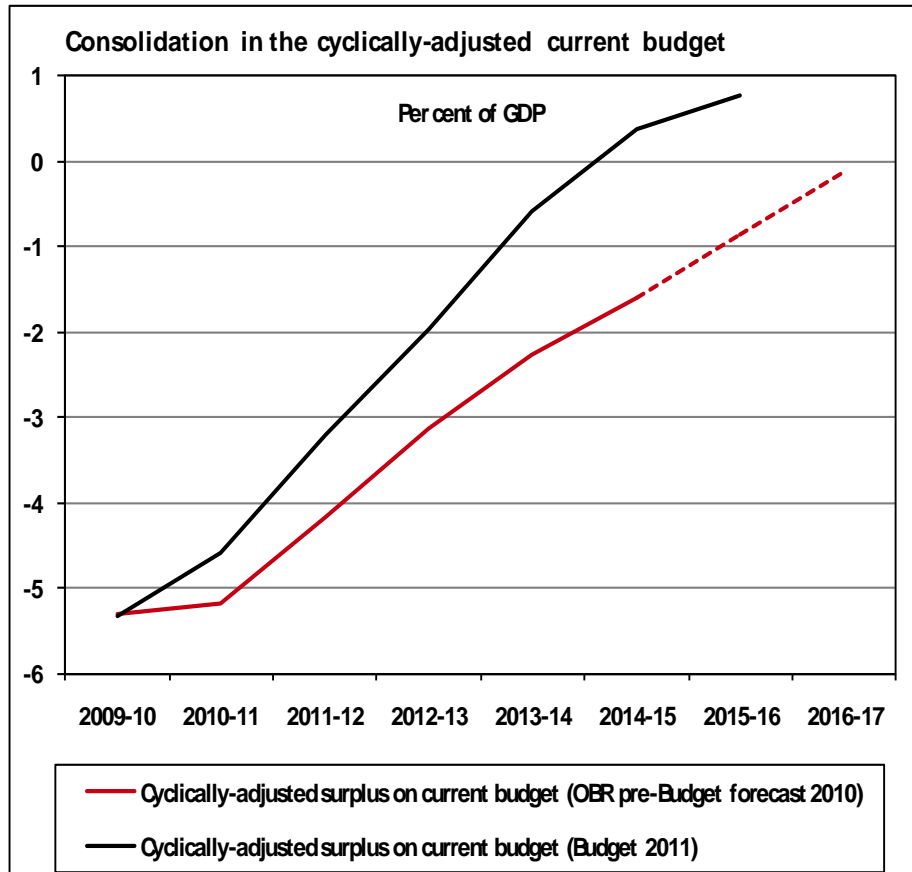


Source: ONS, OBR

- Previous backward-looking fiscal rules allowed Government to enter crisis with weak fiscal position.
- The new mandate is forward-looking, based on independent OBR forecast, to ensure fiscal policy always set to deliver medium-term sustainability.
- **The fiscal mandate is based on:**
  - the **current balance**, to protect the most productive investment expenditure; and
  - a **cyclically-adjusted** aggregate, to allow some flexibility at a time of economic uncertainty.
- **Mandate for fiscal policy:**
  - a forward-looking deficit mandate, to achieve **cyclically-adjusted current balance by the end of the rolling, five-year forecast period**. At this Budget, 2015-16.
  - supplemented by a target for public sector **net debt as a percentage of GDP** to be falling at a fixed date of 2015-16.

**The mandate provides the flexibility for fiscal policy to support the economy in the face of unexpected shocks, with the Government held to account by the independent OBR.**

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## 10 year yield spread to bunds

