Public finances: tax rises ahead

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@TheIFS
Public finances: tax rises ahead

Down by 4.3% (3% real) in 2025Q1
Down by 1.4% (0% real) in 2025Q1
Down by 7.3% (6% real) in 2025Q1

March 2020

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Persistent increase in borrowing under central scenario
Spending elevated as a share of national income

Pre-financial crisis highest share since 1984–85

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Decomposing the increase in forecast borrowing

- Central forecast
- Other economic impacts
- Covid support measures
- March forecast
- Net permanent spending cut

Per cent of national income

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<tbody>
<tr>
<td>Increase</td>
<td>-1.7%</td>
<td>15.3%</td>
<td>4.6%</td>
<td>3.6%</td>
<td>2.5%</td>
<td>2.1%</td>
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Underlying debt to rise

Per cent of national income

March

Central

Downside

Upside

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Reasons to expect tax rises

- Under current forecast consolidation of
  - ≈£15bn would stop debt rising in 2025–26
  - ≈£20bn to deliver a current budget balance in 2025–26 (£66bn in downside scenario)
- Additional spending pressures, for example:
  - Make increase to Universal Credit permanent: ≈£7bn
  - U-turn on new squeeze to non-Covid spending: ≈£11bn
  - Continue any of the £55bn Covid spending planned for 2021–22?
- Don’t forget
  - Ageing: OBR estimates annual increase ≈£39bn per decade
  - Brexit: no deal scenario adds ≈£6bn
Debt interest spending down, but much more exposed to rate rises

- £25bn increase in cash borrowing:
  - December 2012: 0.17
  - March 2020: 0.04
  - November 2020: 0.02

- 1 percentage point increase in short rates:
  - December 2012: 0.16
  - March 2020: 0.23
  - November 2020: 0.45

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Conclusions

- Under OBR central scenario borrowing falls to 4% of national income in medium term while debt continues to rise.
- Much uncertainty, in particular forecast predicated on:
  - 3% long-run hit to real GDP (with EU trade deal)
  - no Covid spending beyond 2021–22
  - tighter path for non-covid spending kept to
- Tax rises look likely, but should wait until recovery well underway.
- Elevated debt, financed at a low maturity, exposes public finances to risk of Bank Rate rises occurring without improved growth outlook.