

Gordon Brown
and the public finances:
sticking to the rules?

Robert Chote, Director, Institute for Fiscal Studies
David Hume Institute
Edinburgh, 2 November 2005

Outline

- Background to fiscal policy
- The fiscal rules
- The public finances under Labour
- Reforming the framework
- Do taxes need to rise?

Why tax and spend?

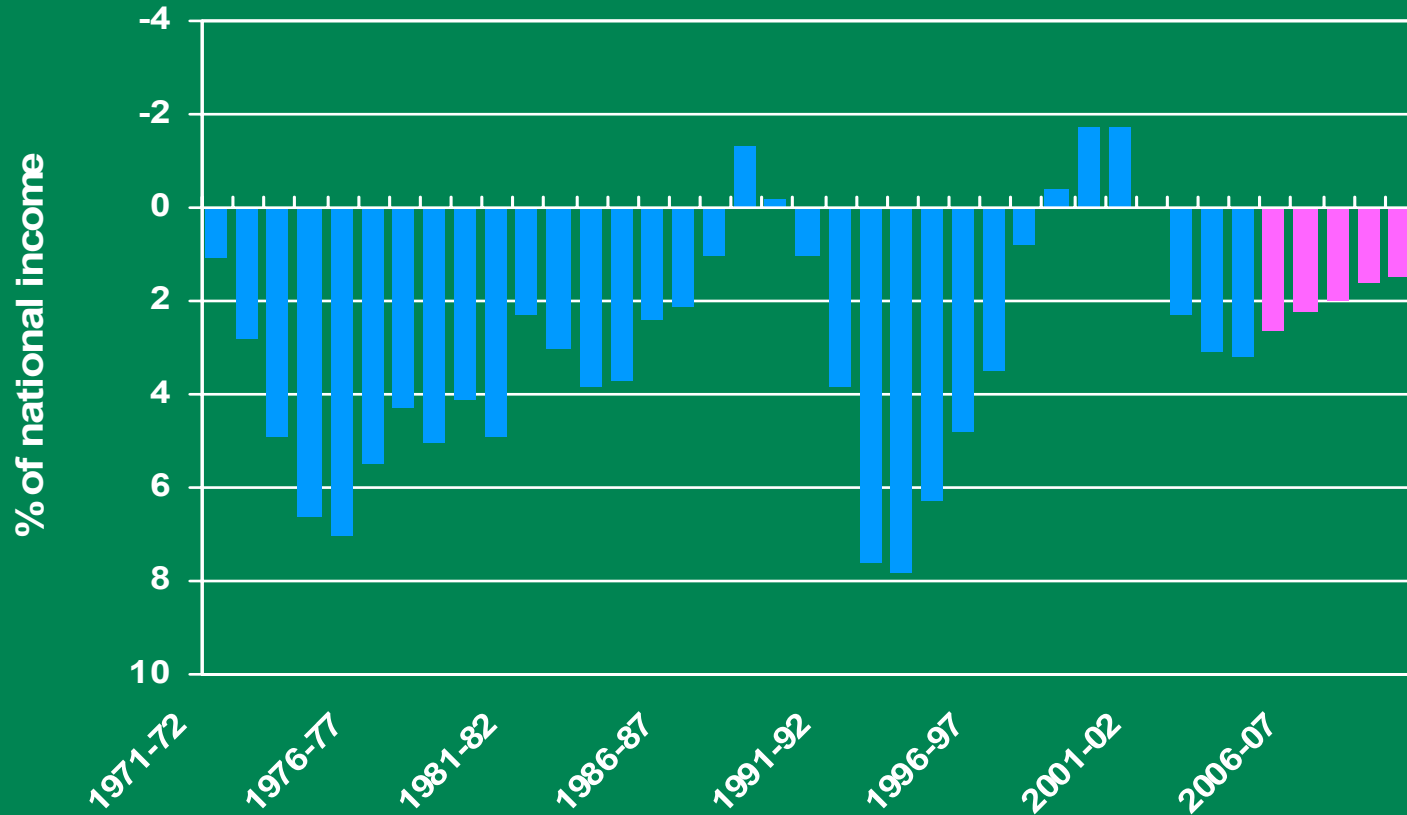
- Providing public goods
 - Defence, criminal justice
- Replacing missing markets
 - Unemployment insurance, higher education
- Paternalism and spillovers
 - Schools, pensions, tobacco duties
- Redistribution
 - Taxes, cash benefits, benefits-in-kind

Tax, spend and borrow

• Spending	41.8% of GDP	(£519bn)
• Revenues	39.3% of GDP	(£487bn)
<hr/>		
• Borrowing	2.6% of GDP	(£32bn)

HMT Budget 2005 forecast for 2005-06

Public sector net borrowing

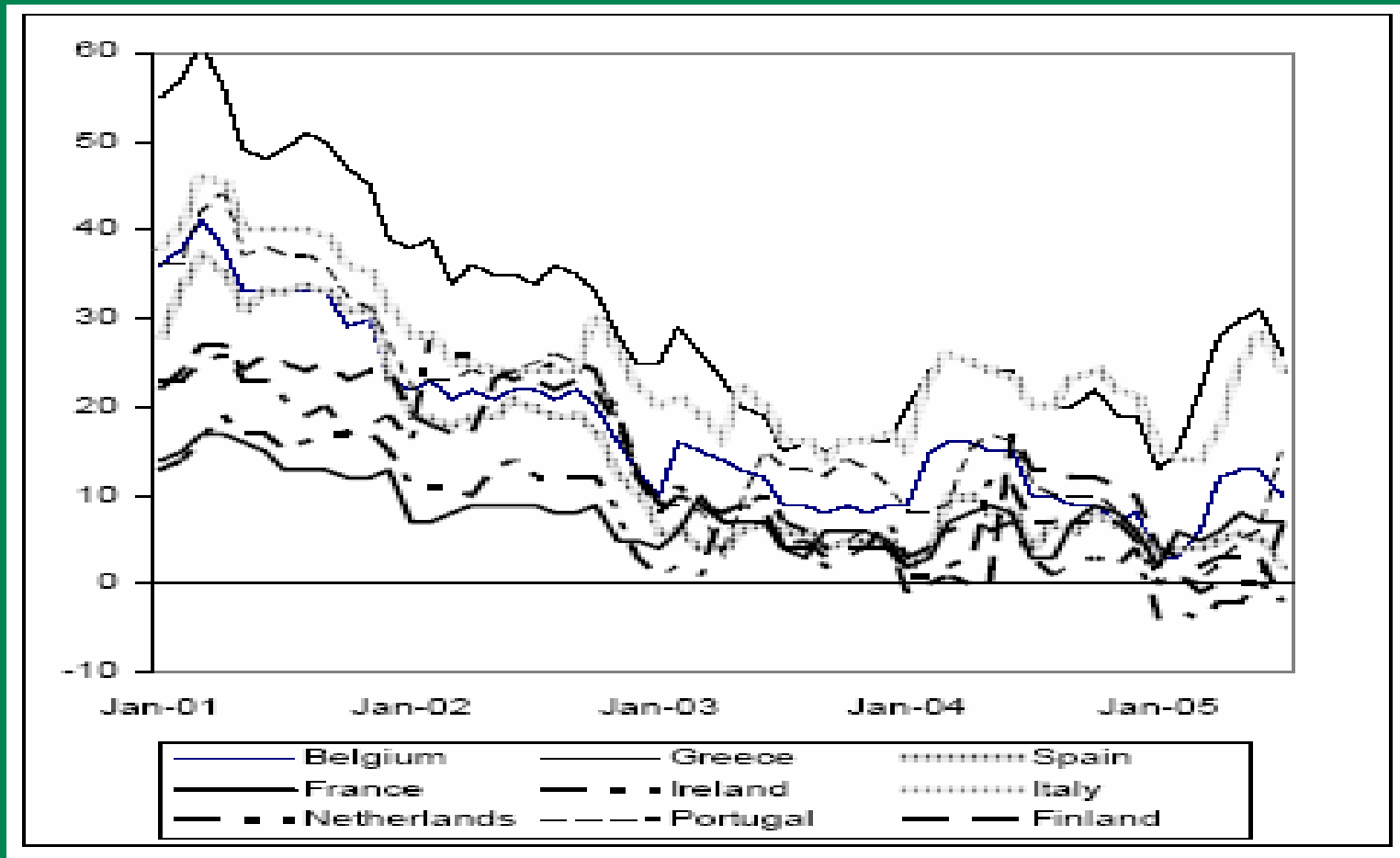


Why borrow?

- Mis-forecasting spending and/or revenues
- Inter-generational fairness
- Stabilizing tax rates
- Macroeconomic management
- Political expedience

Little reward for fiscal virtue?

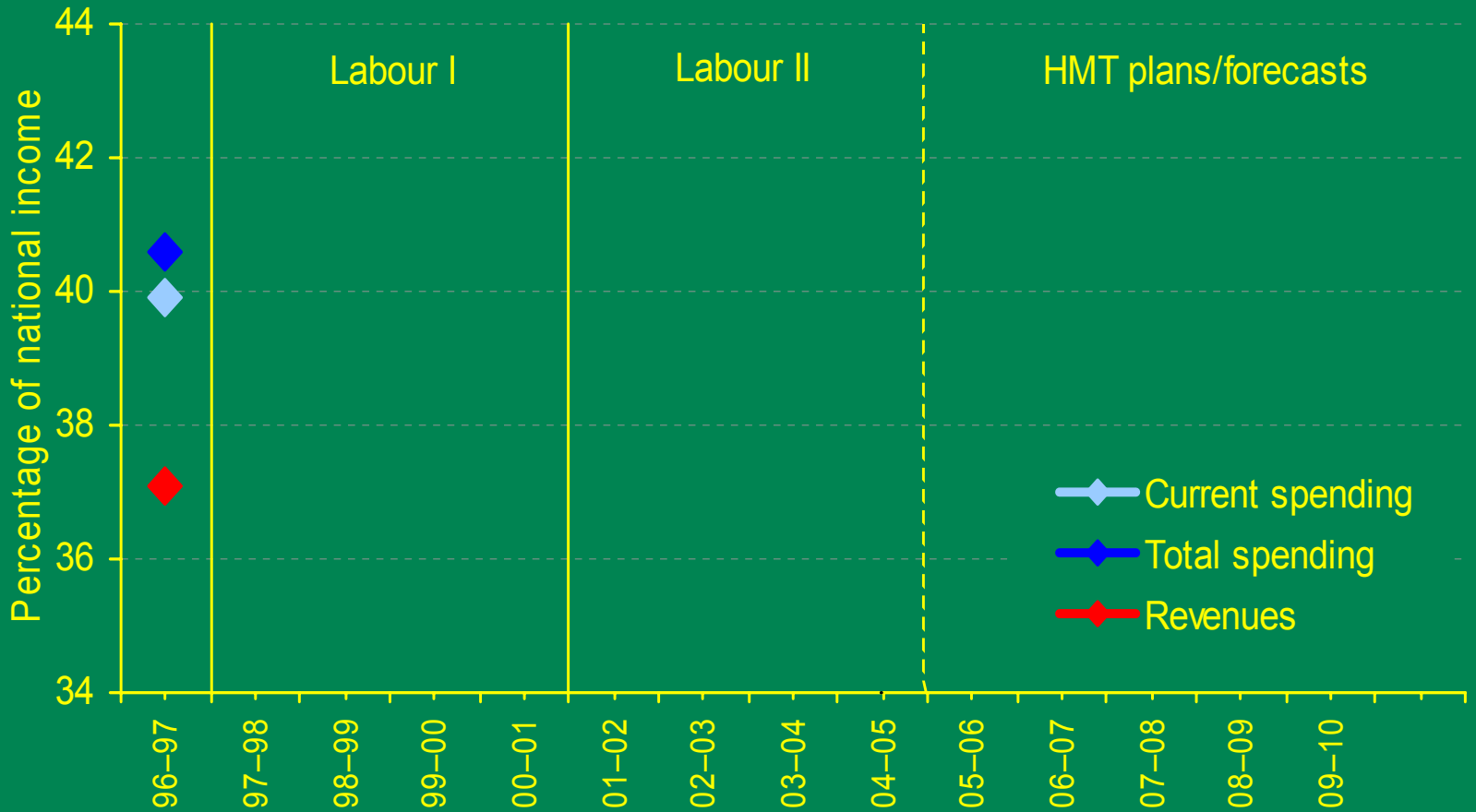
10-year bond yield differentials with Germany



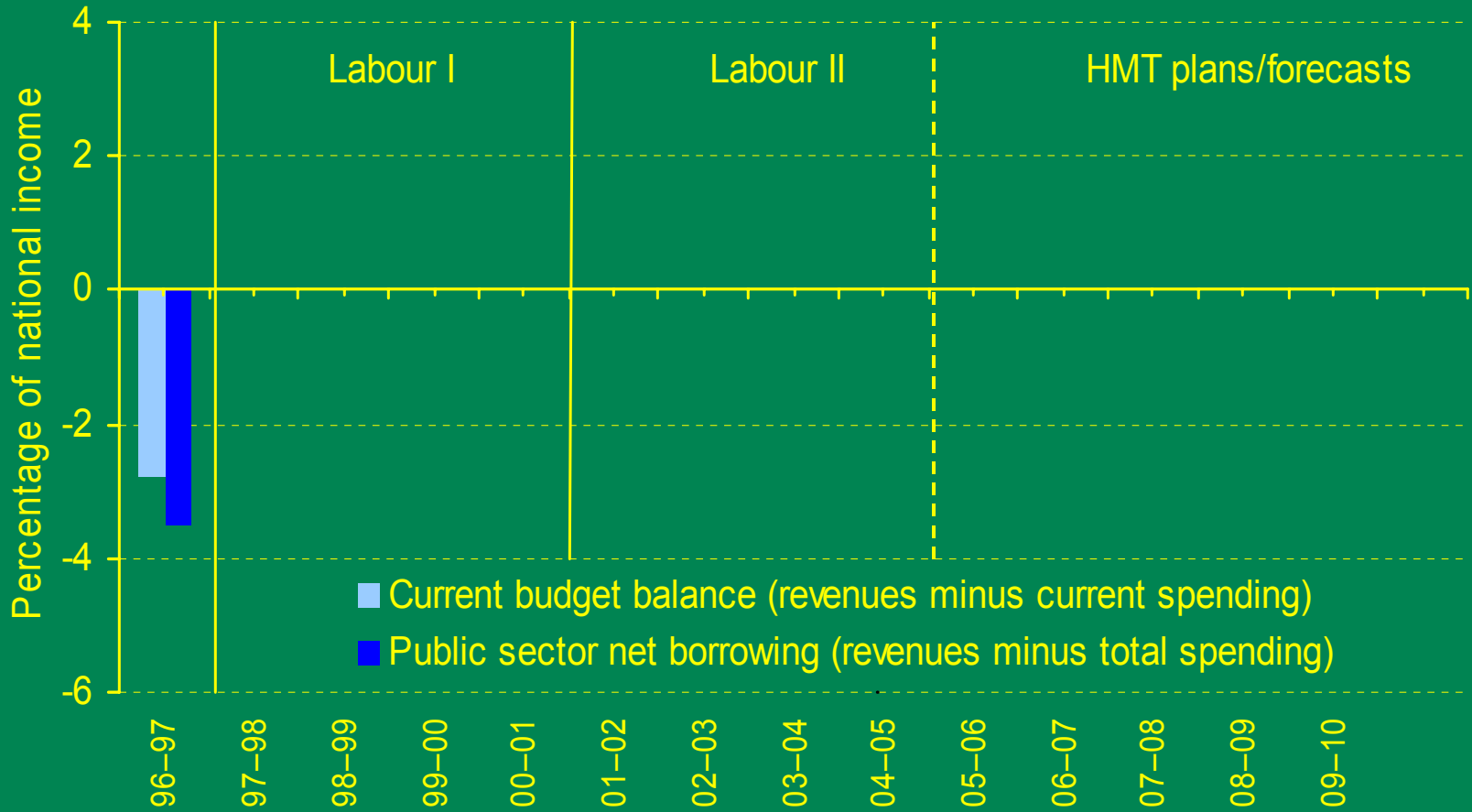
Gordon Brown's fiscal rules

- Sustainable investment rule
 - keep debt at a “stable and prudent” level
 - defined as below 40% of national income
 - to be met every year in current economic cycle
- Golden rule
 - only borrow to invest
 - receipts must cover current spending
 - implies surplus or balance on current budget
 - judged over the economic cycle, not year by year

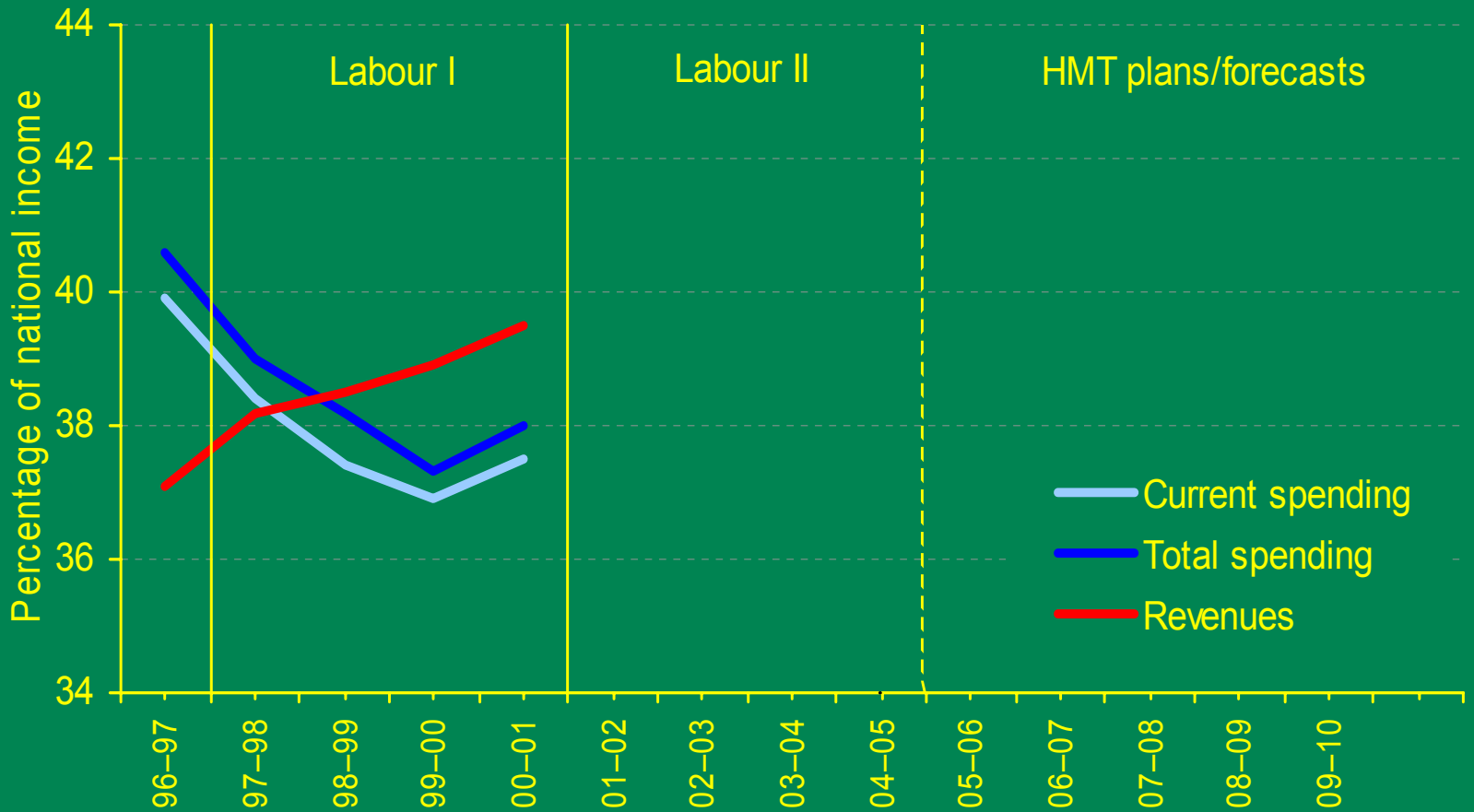
Spending and revenues



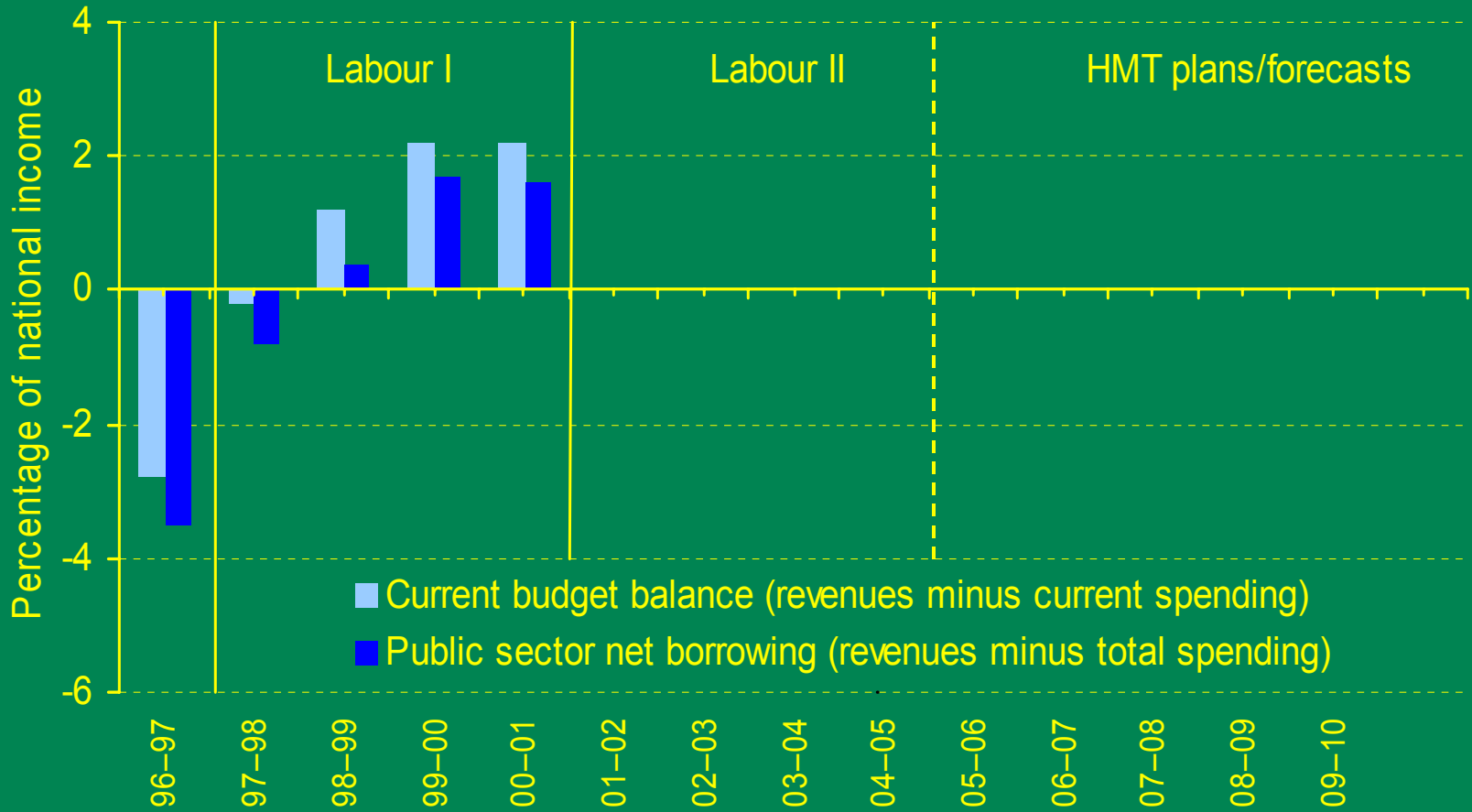
Current and total budget balances



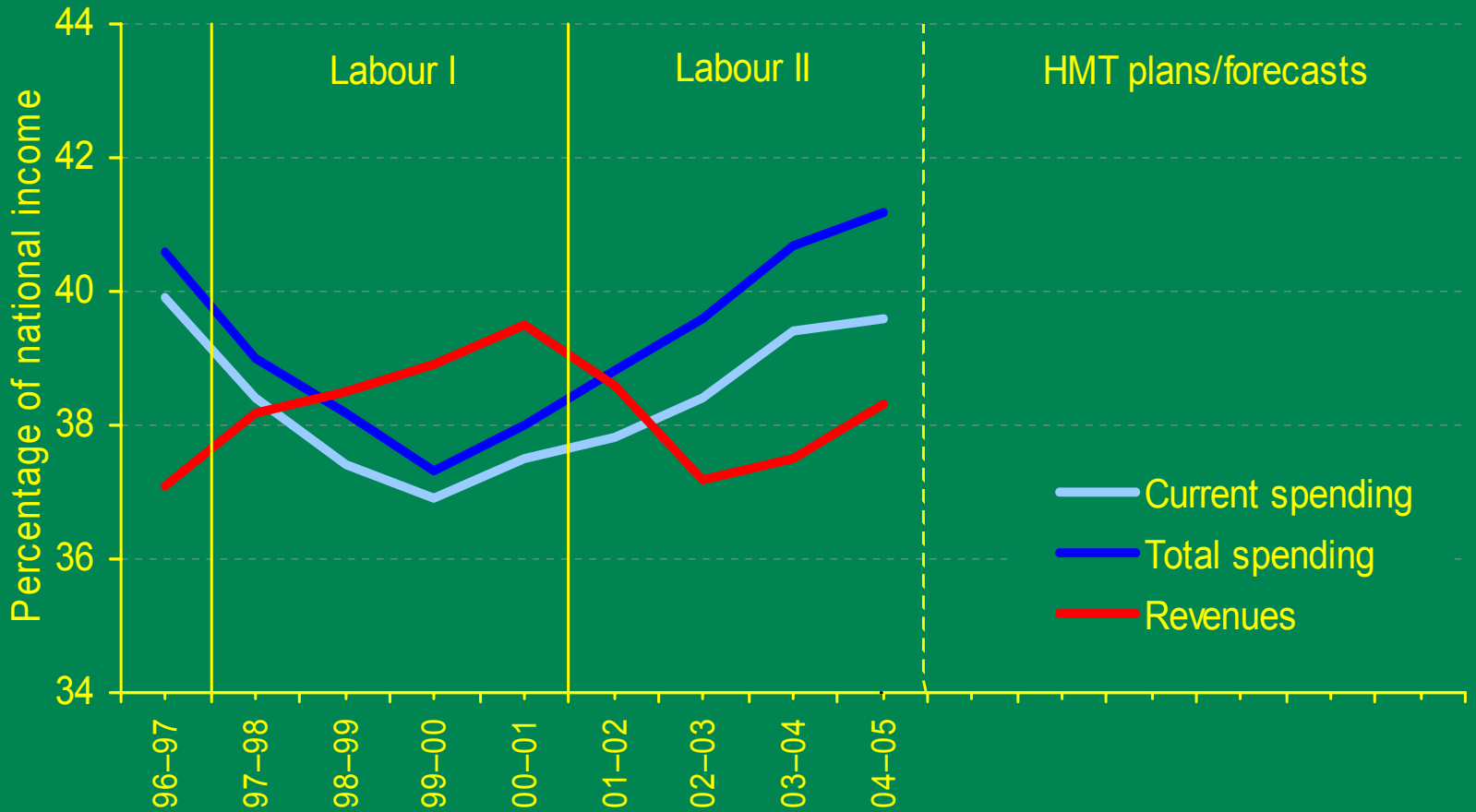
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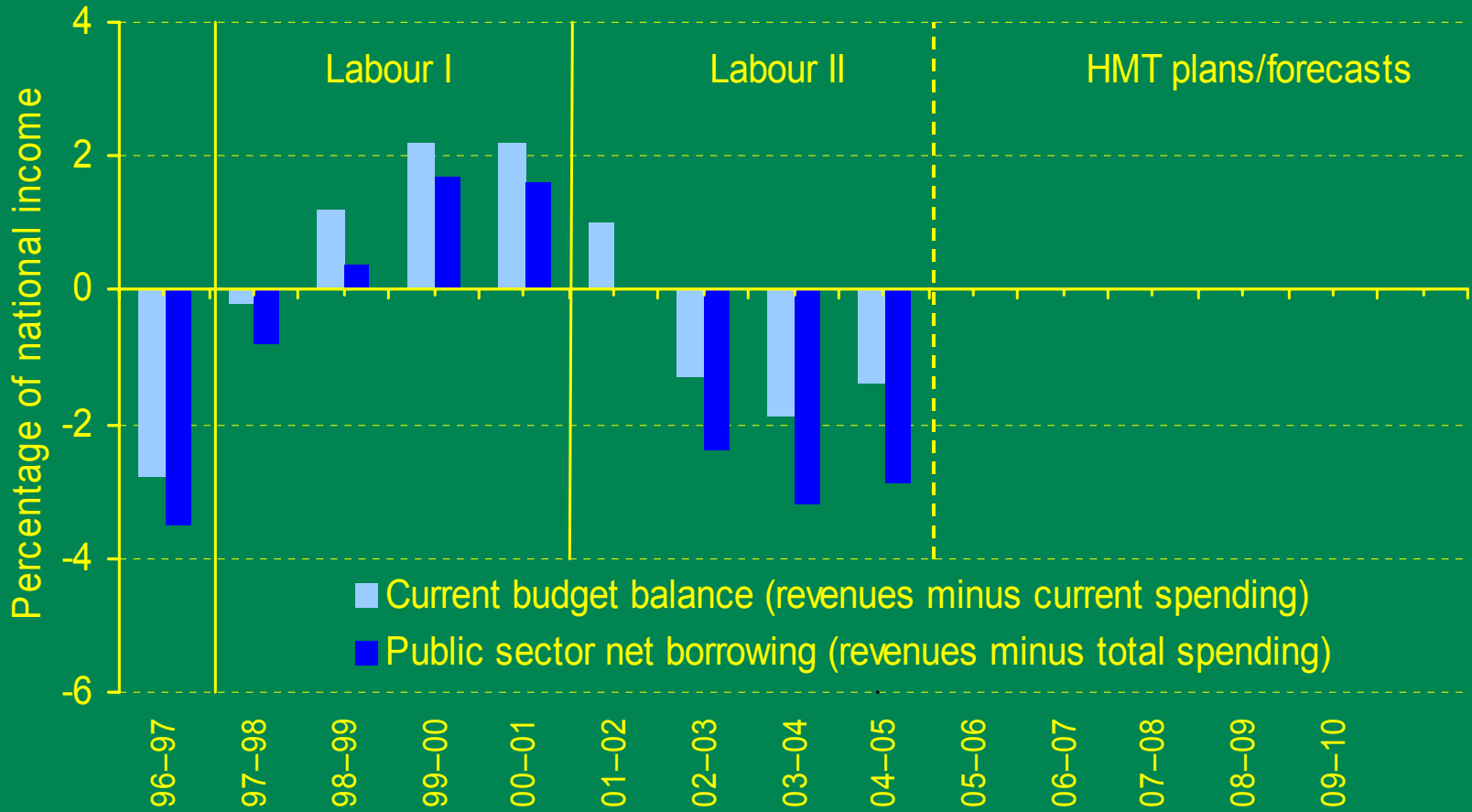
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Spending and revenues

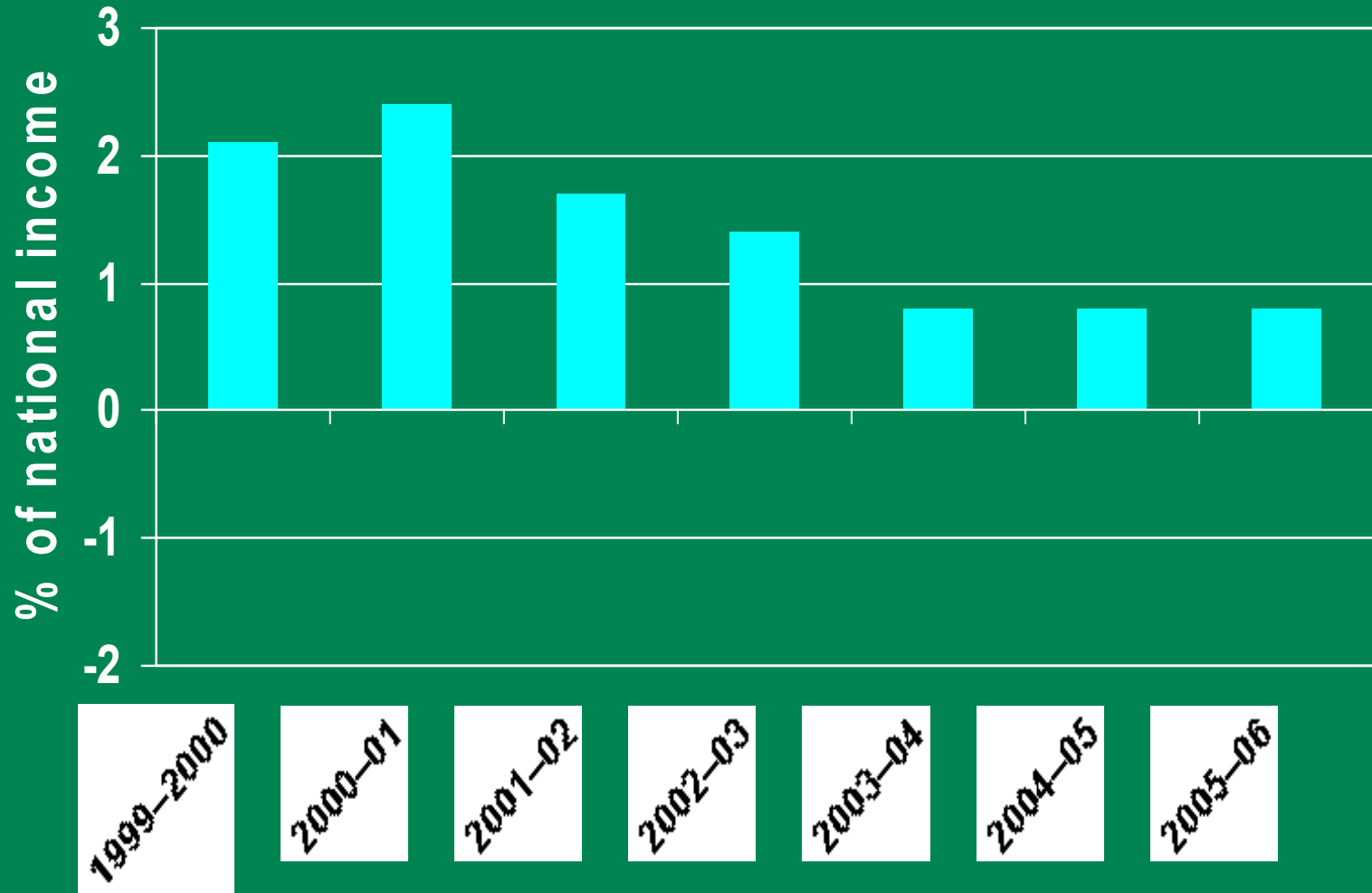


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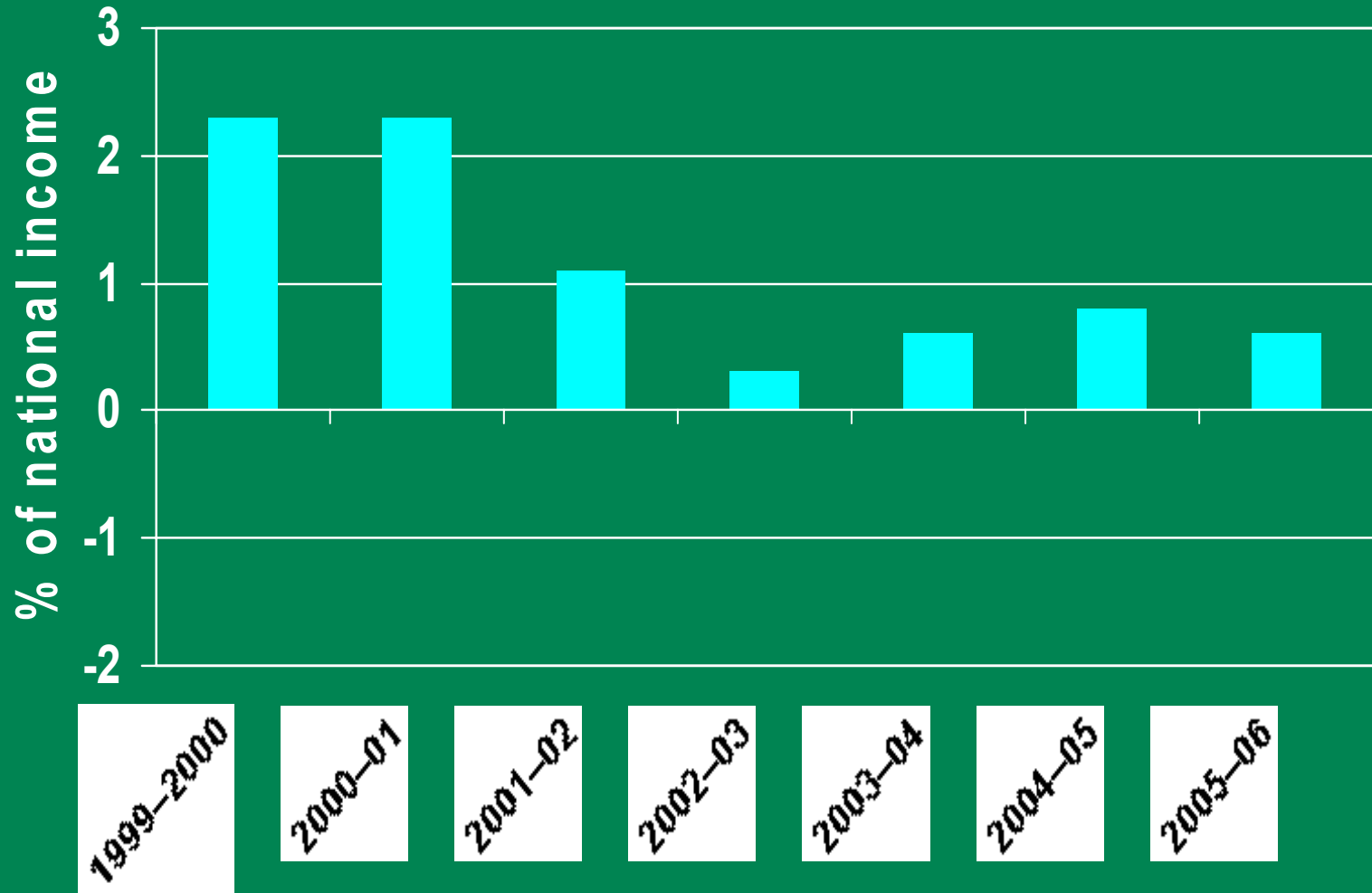
Fiscal position weakens

Current budget balance (Budget 2001)



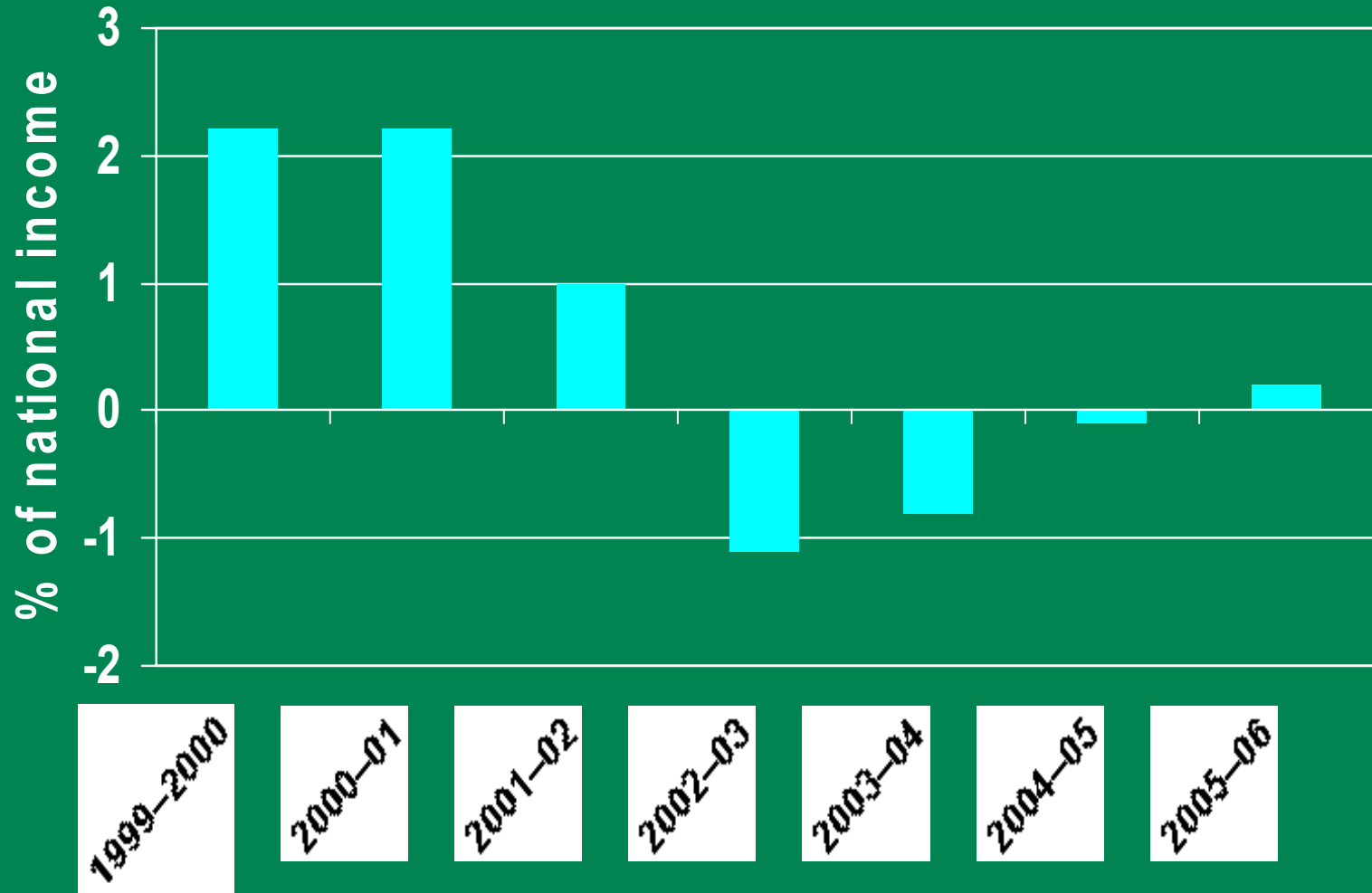
Fiscal position weakens

Current budget balance (Budget 2002)



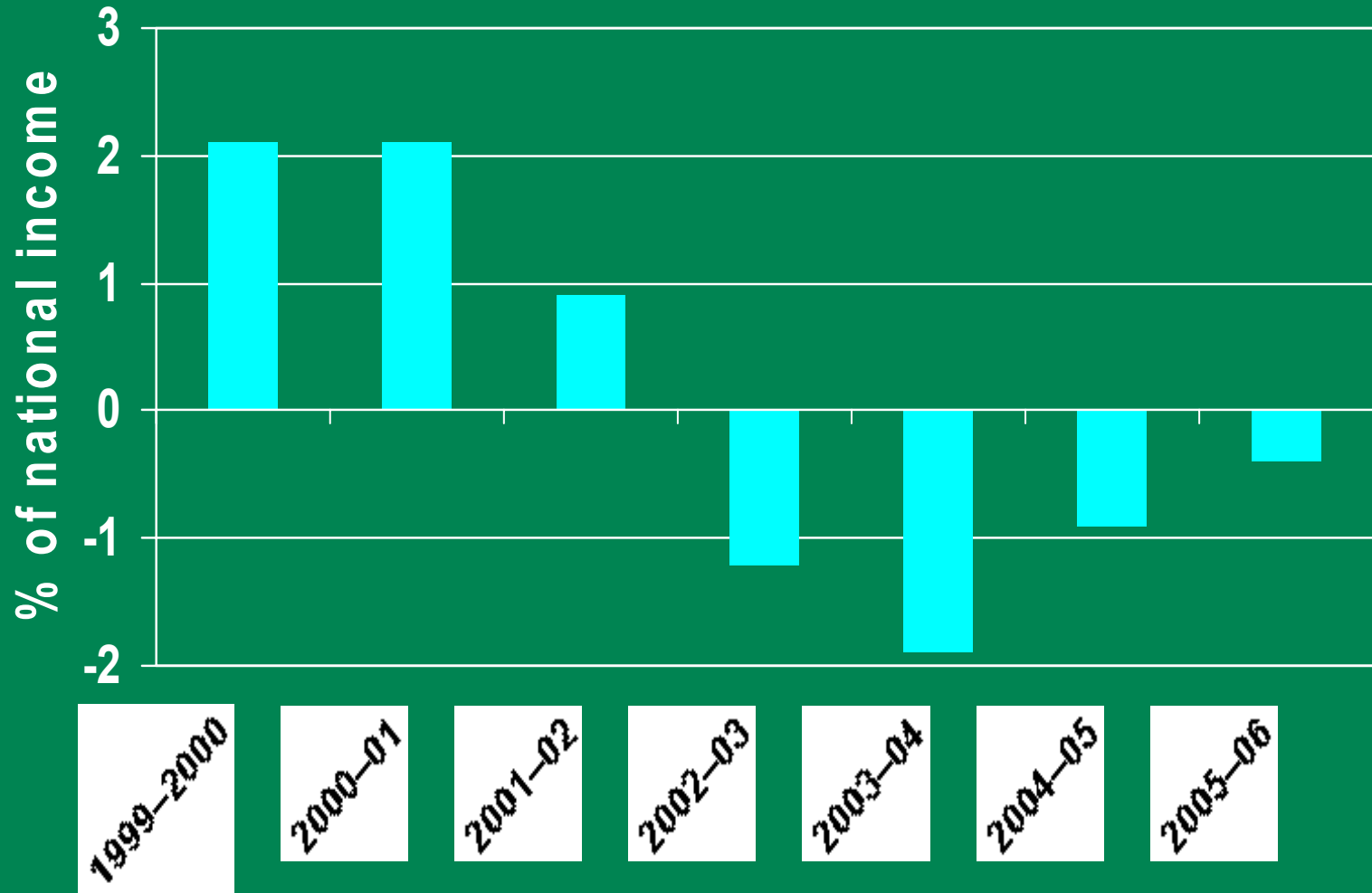
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Current budget balance (Budget 2003)



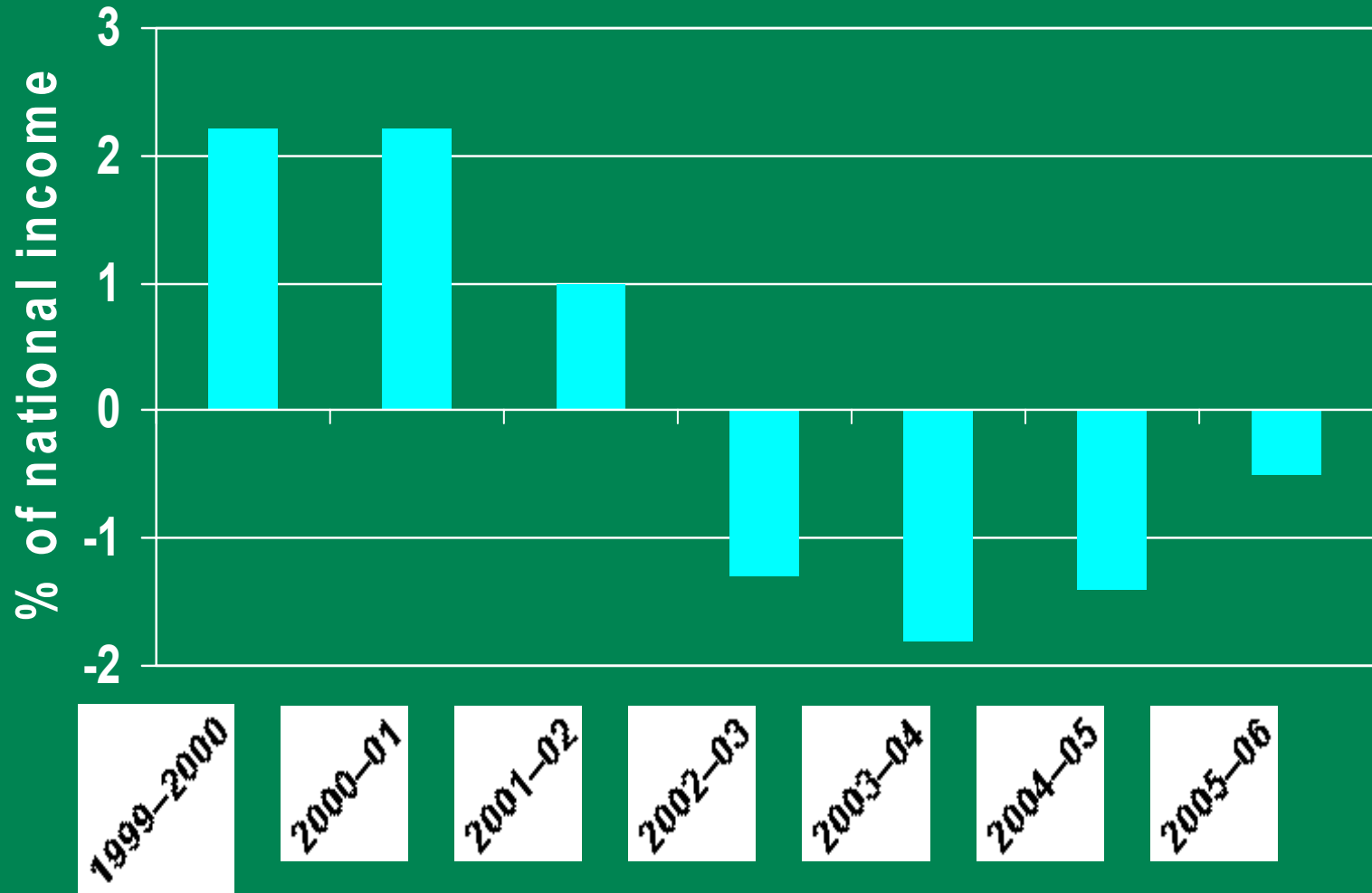
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Current budget balance (Budget 2004)

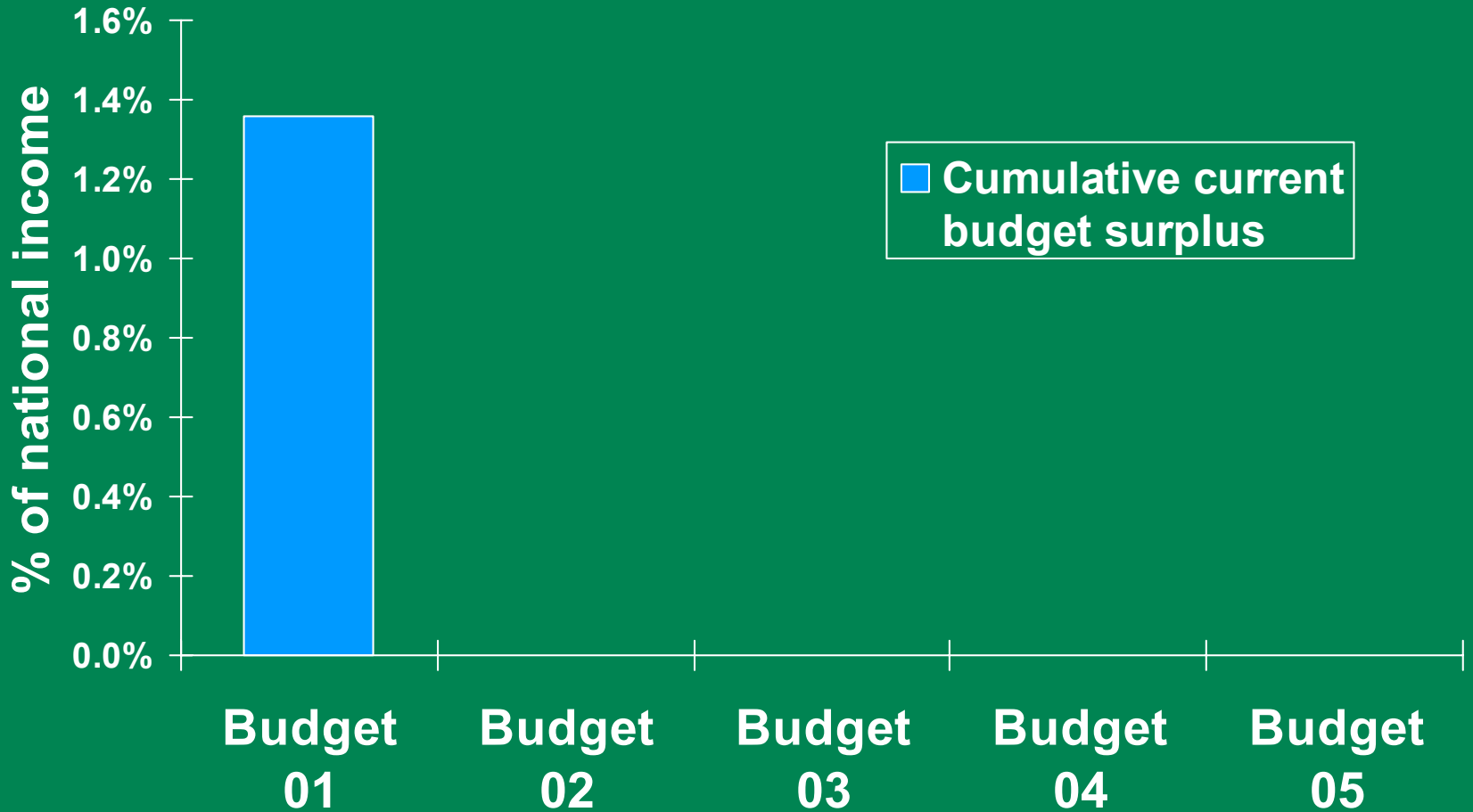


Fiscal position weakens

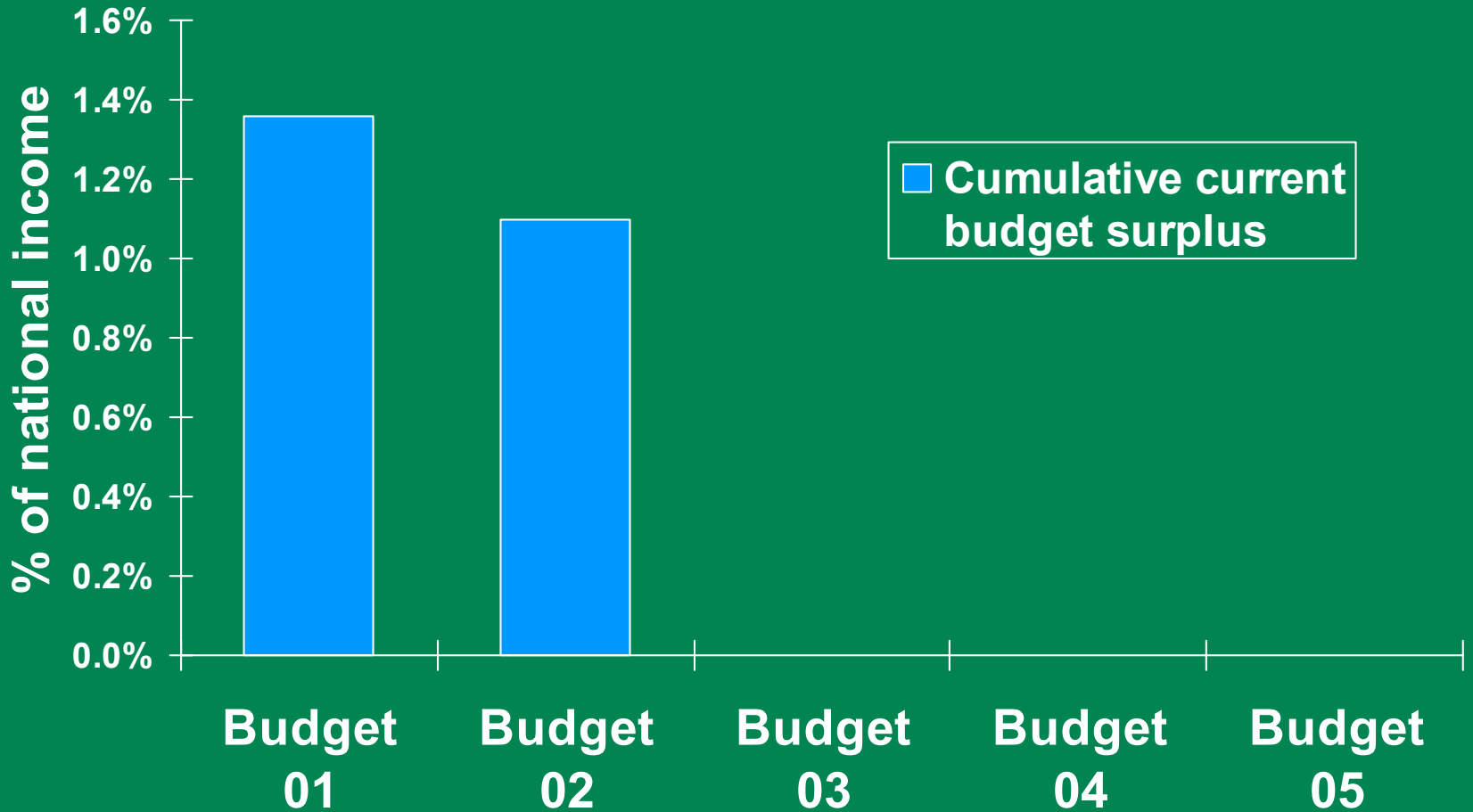
Current budget balance (Budget 2005)



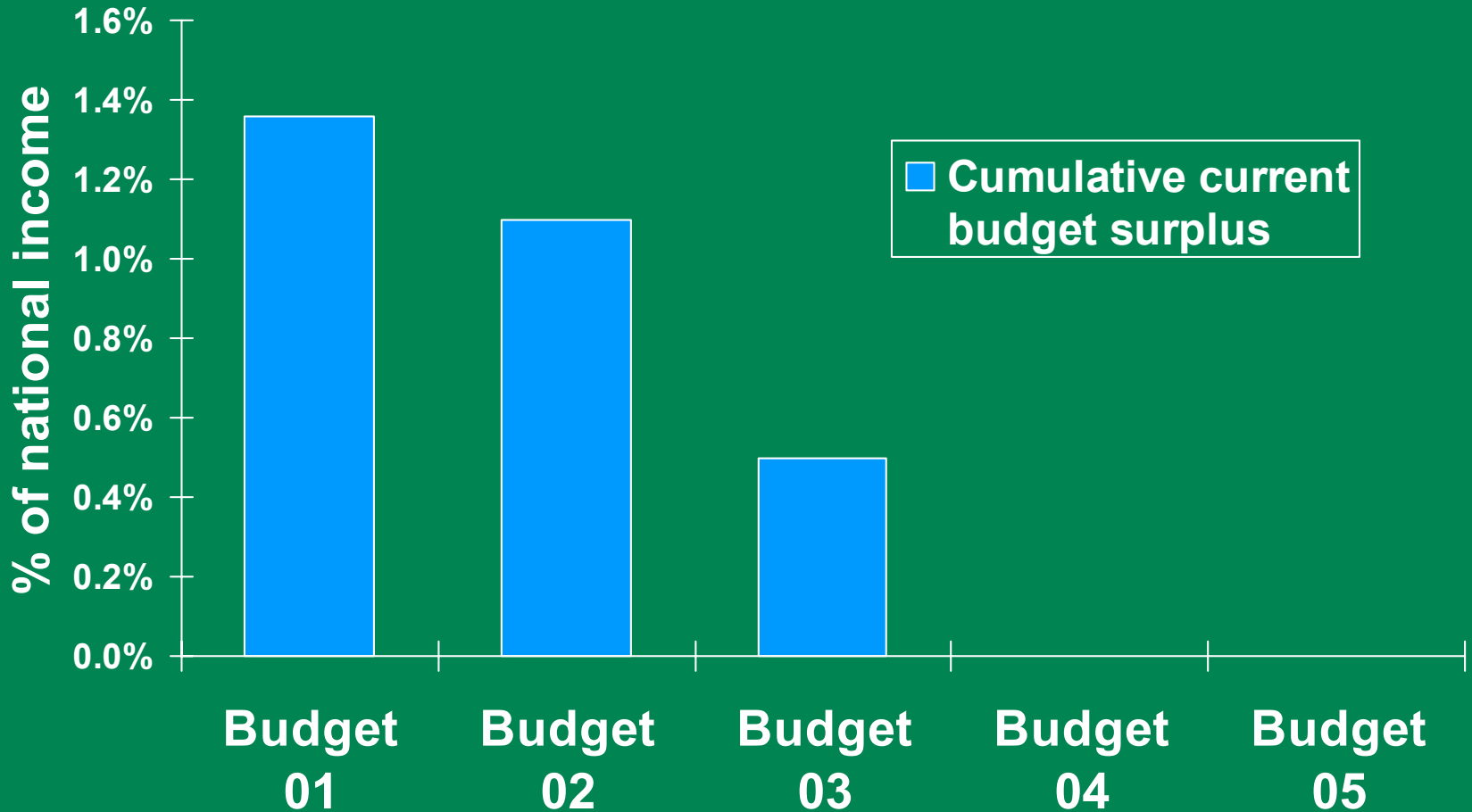
Overachieving the golden rule



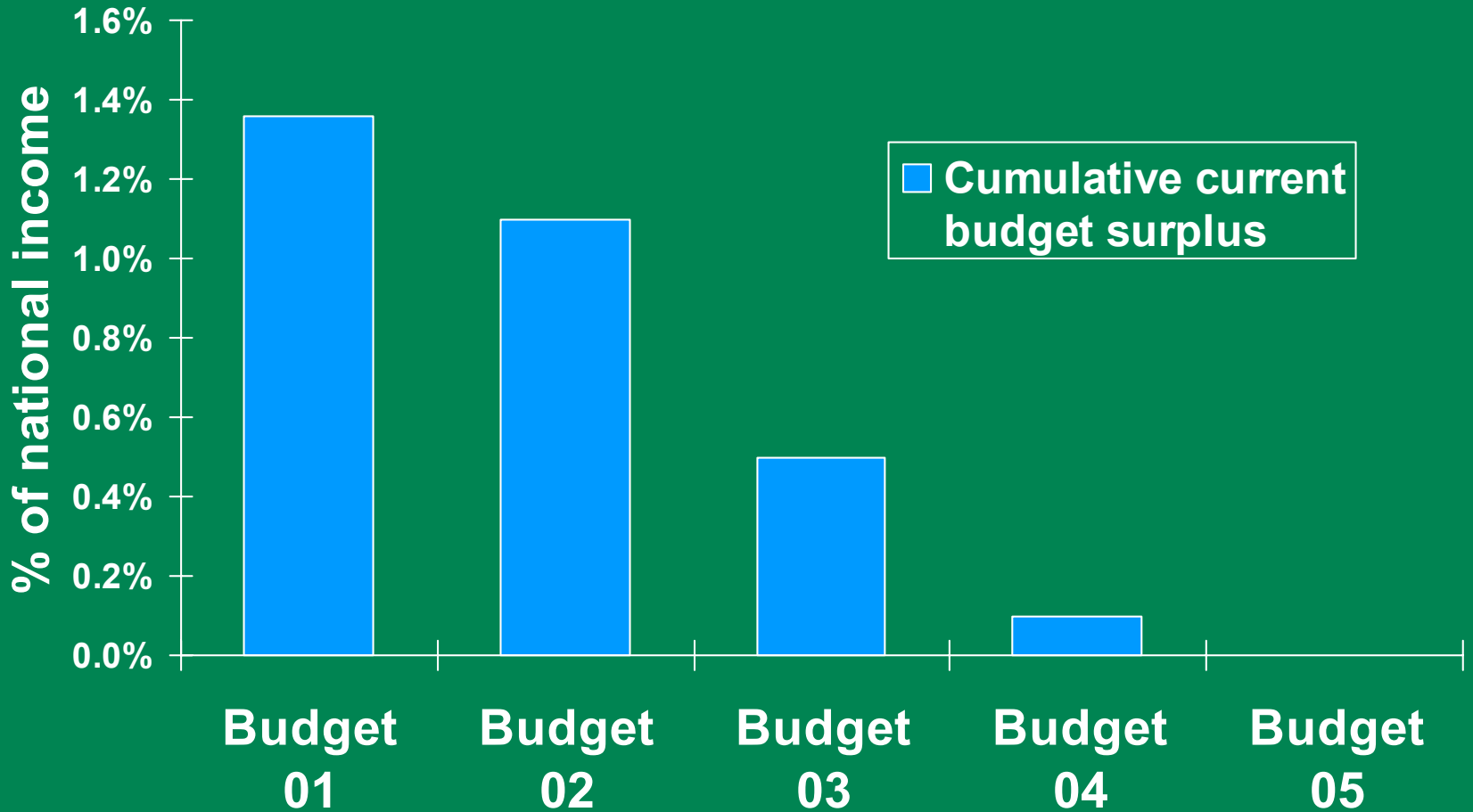
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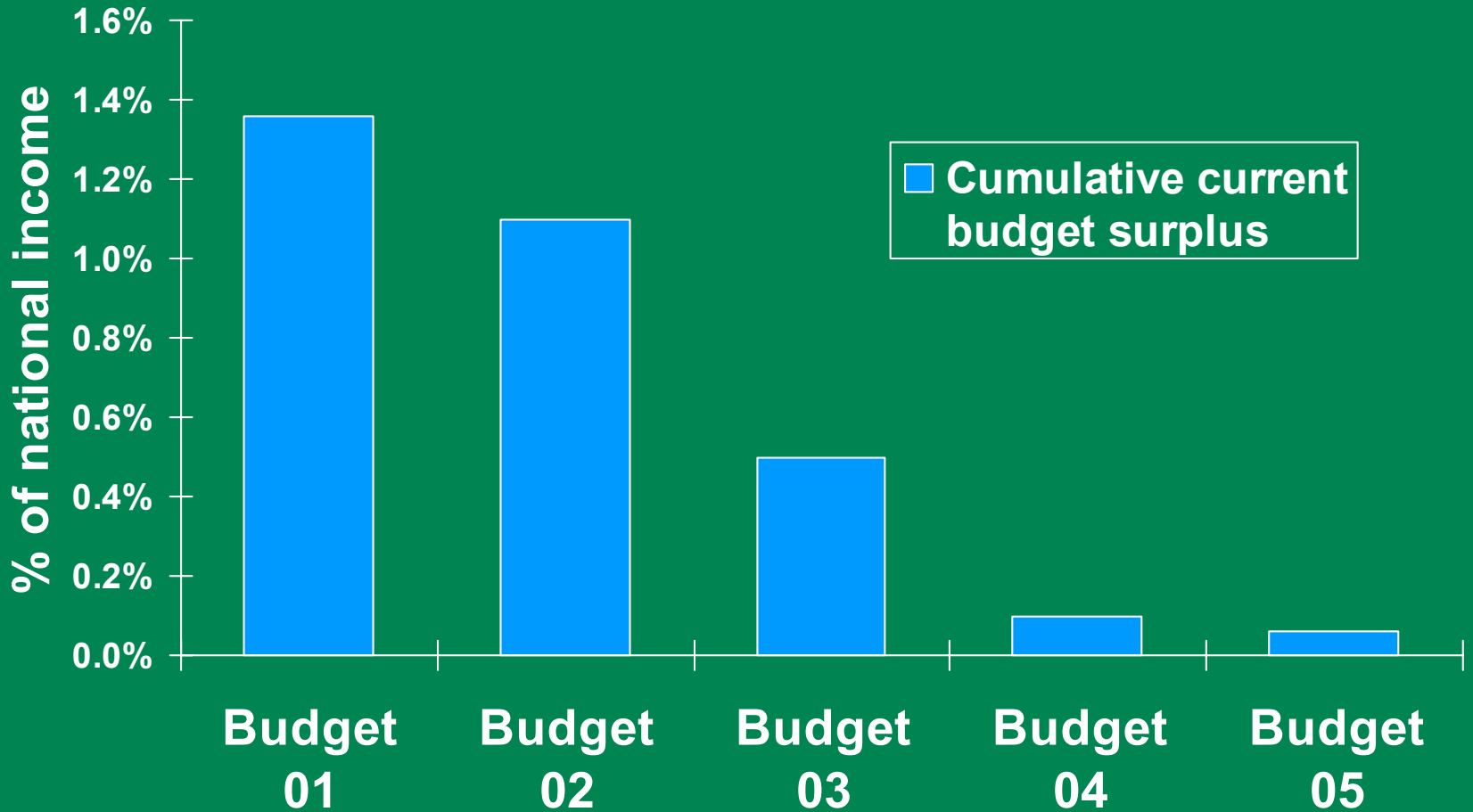
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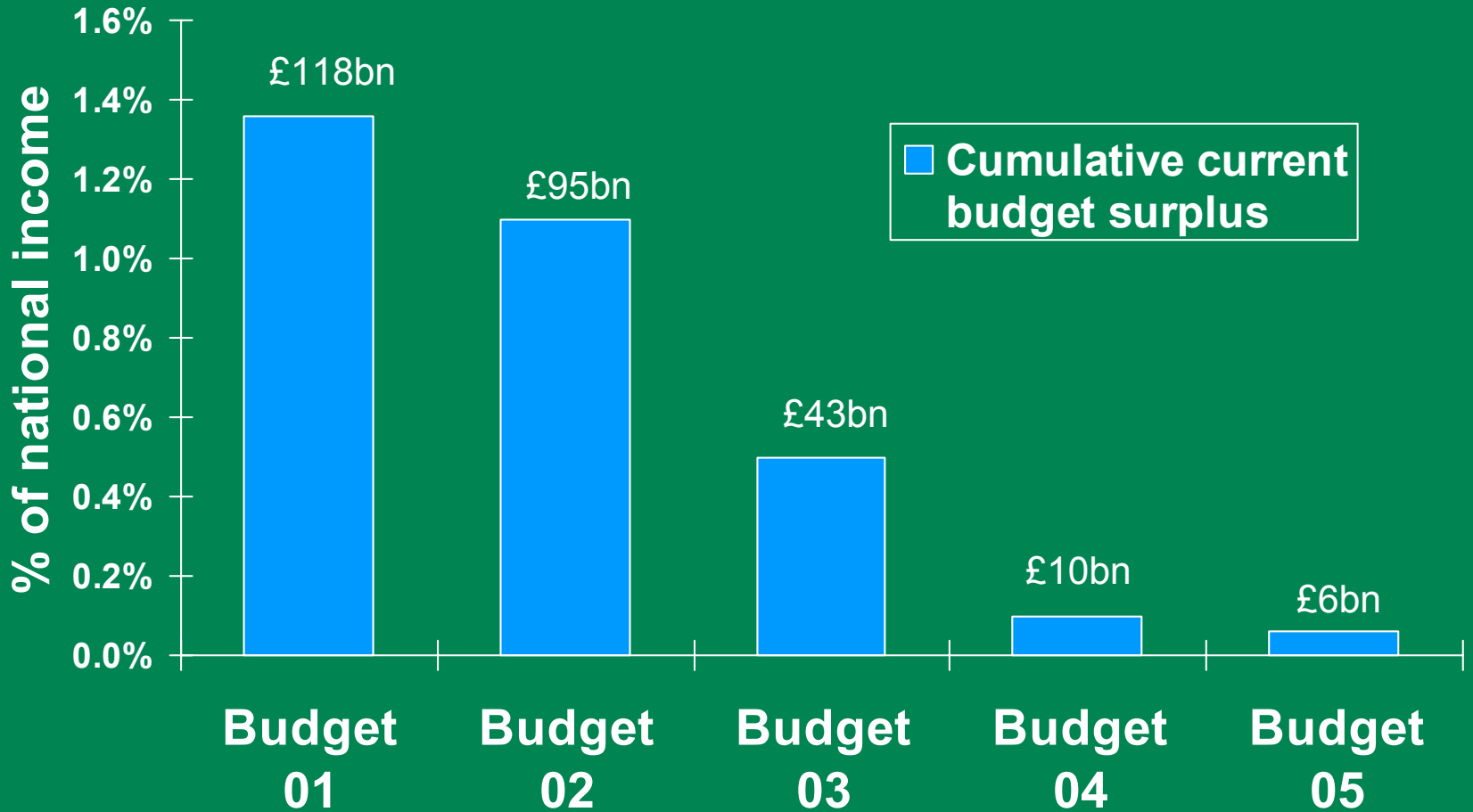
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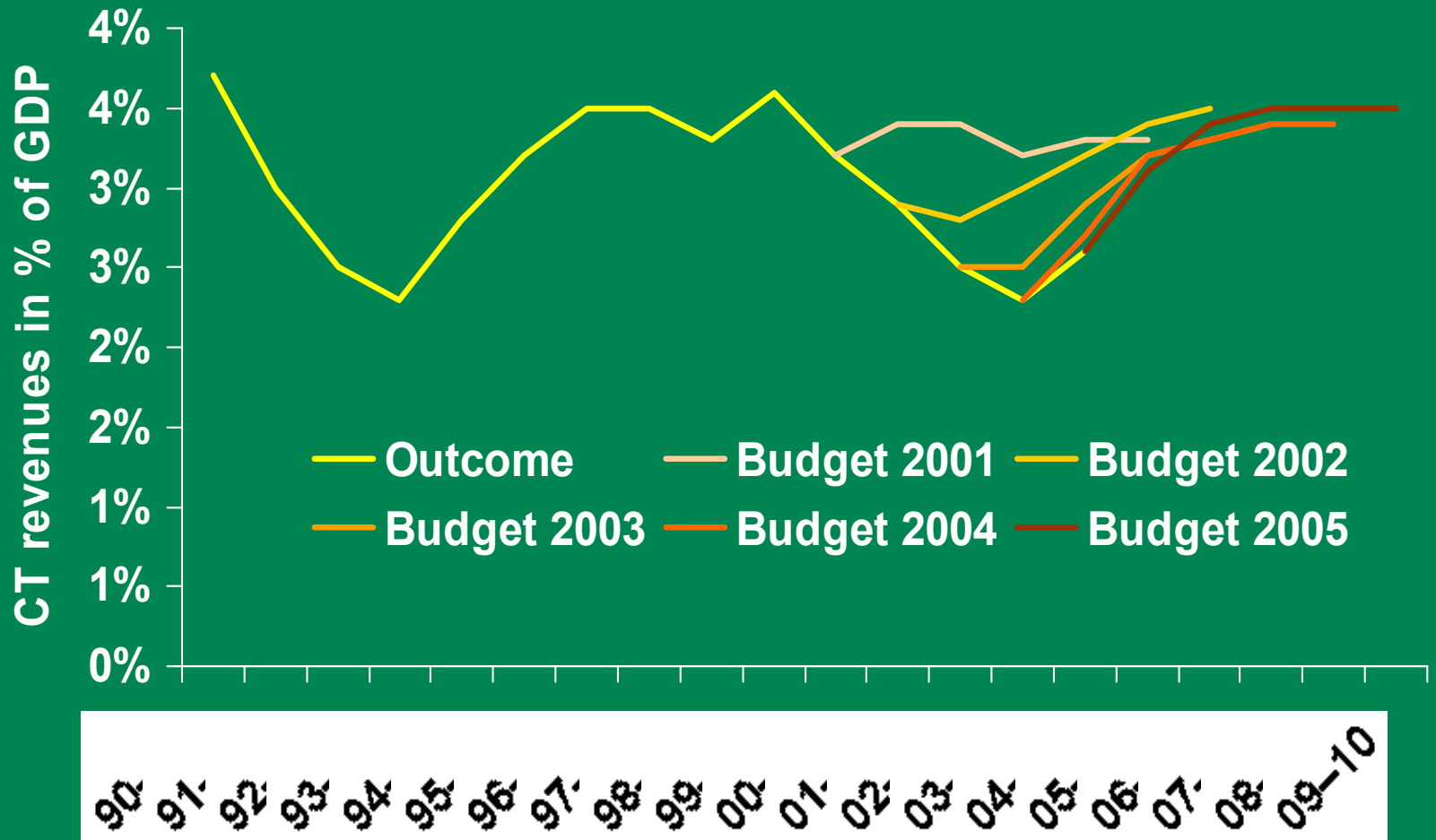
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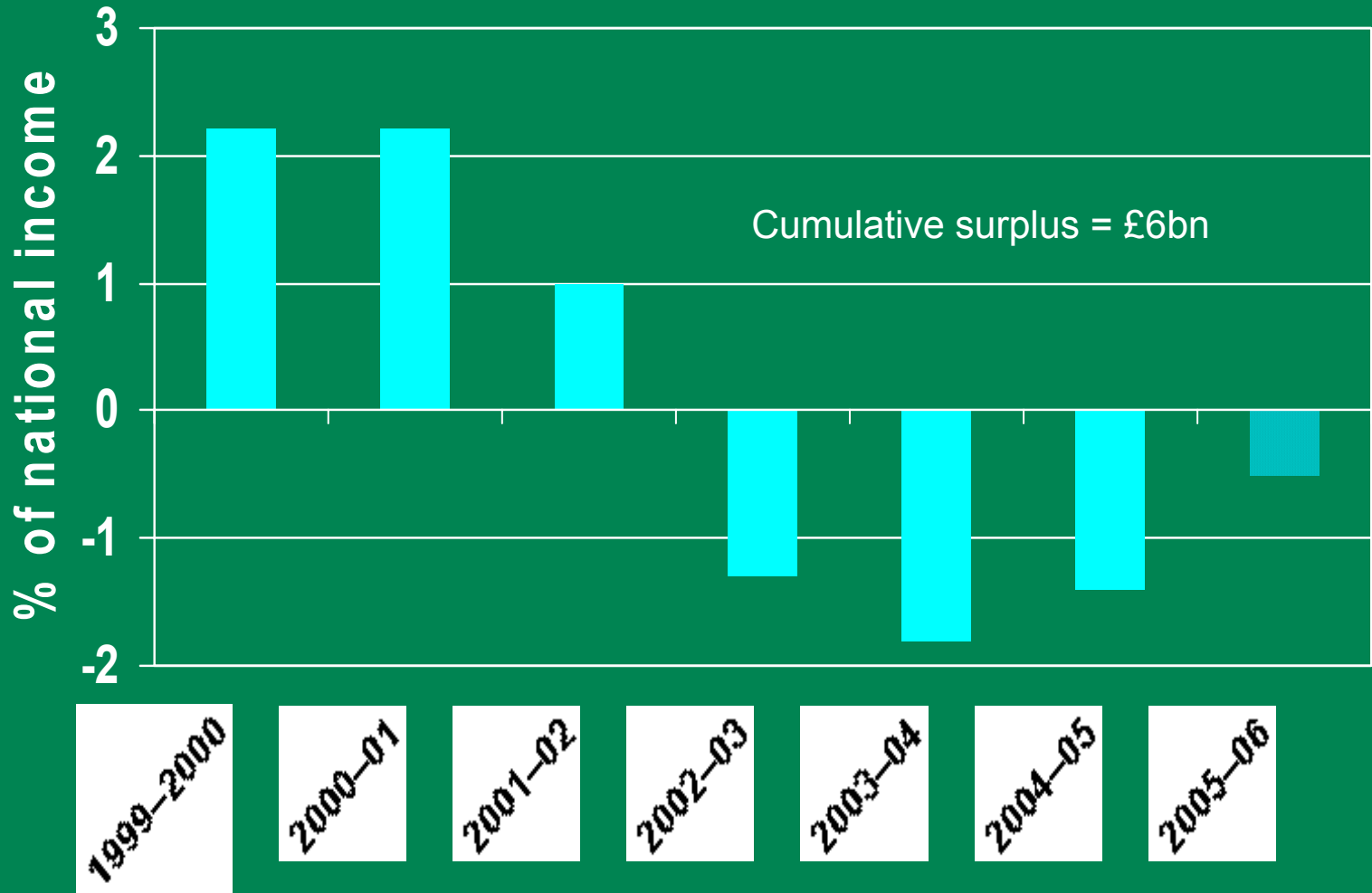
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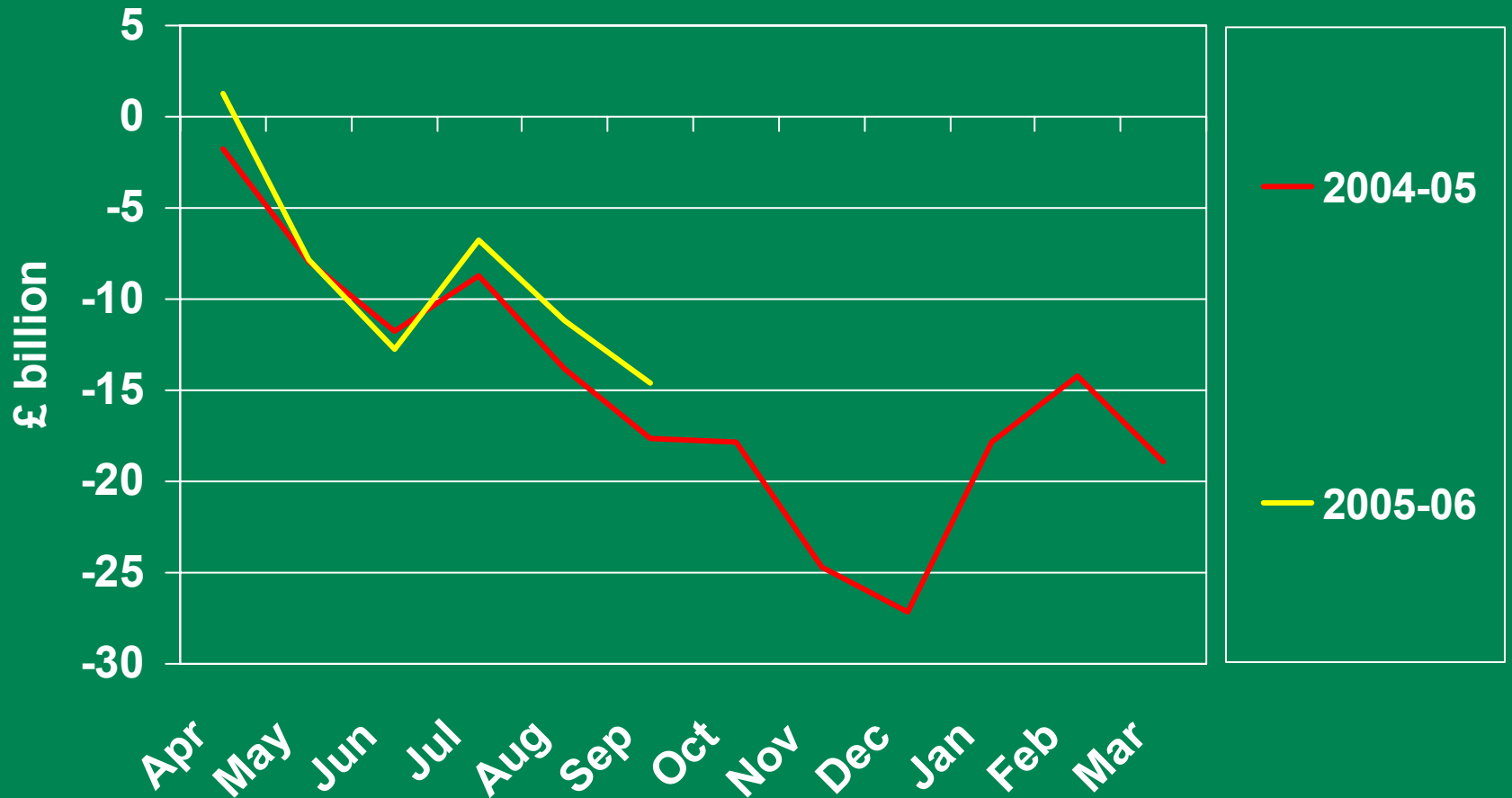
HMT corporation tax forecasts



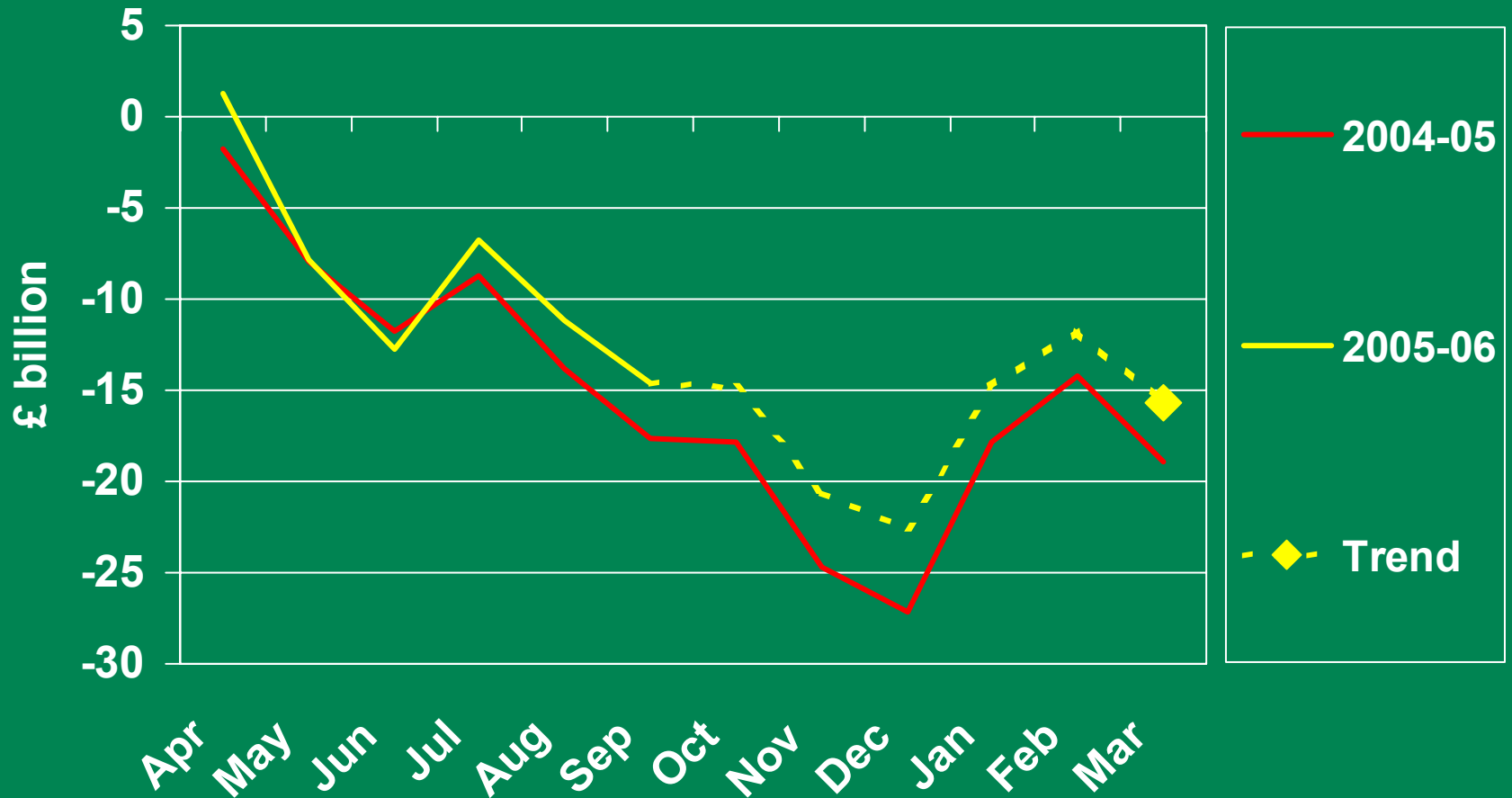
Current budget balance (Budget 2005)



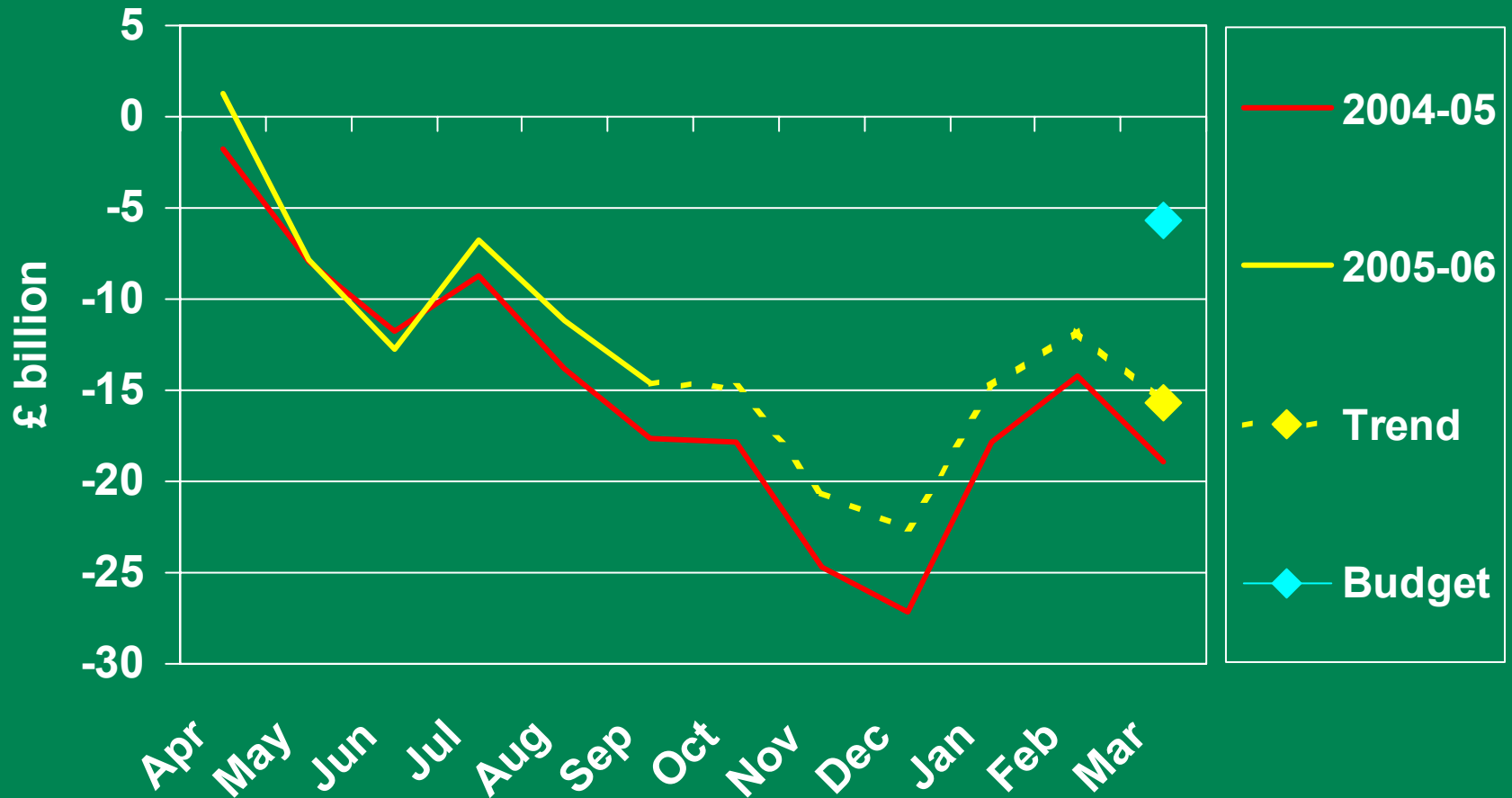
Cumulative current budget deficit



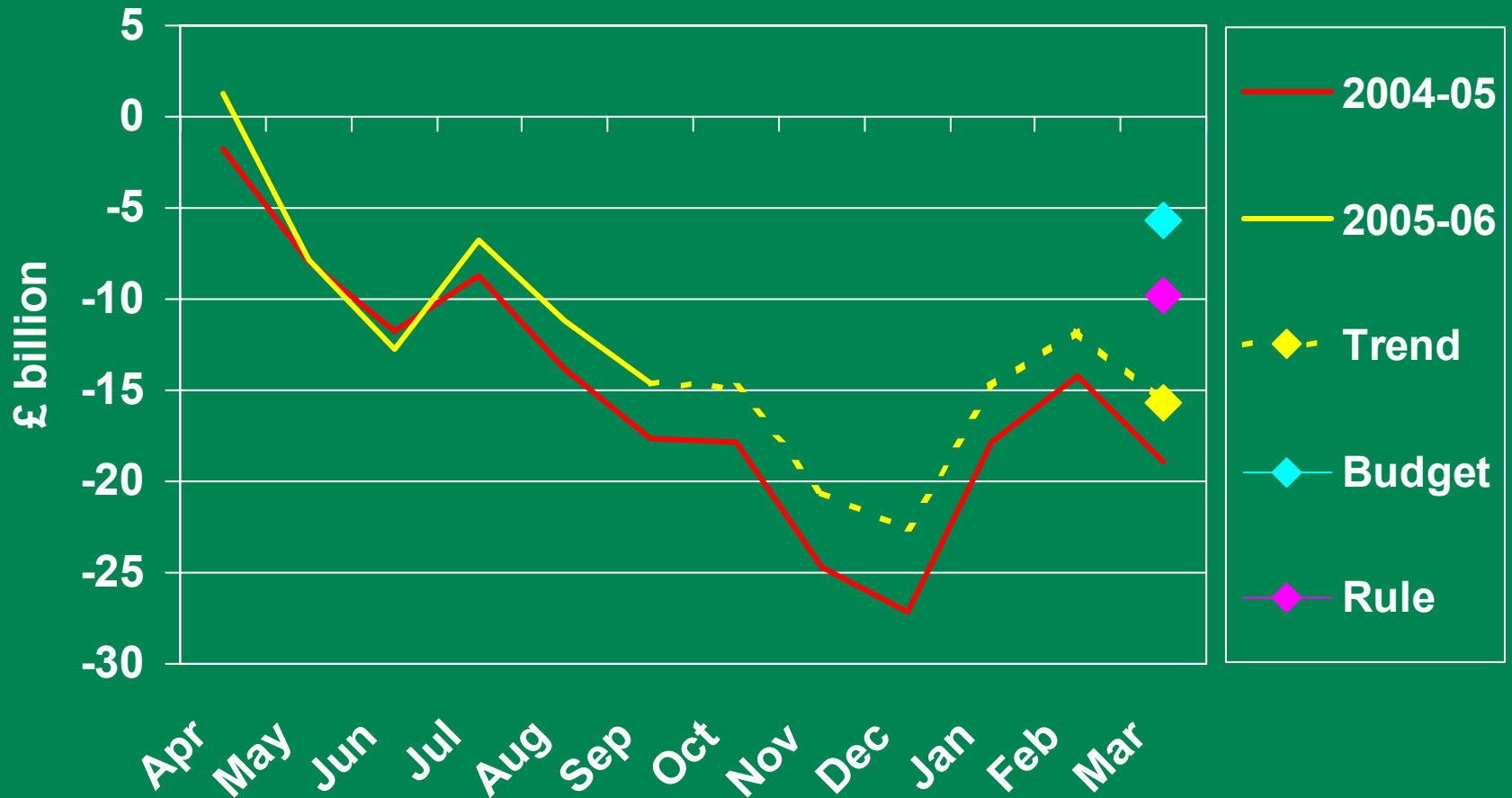
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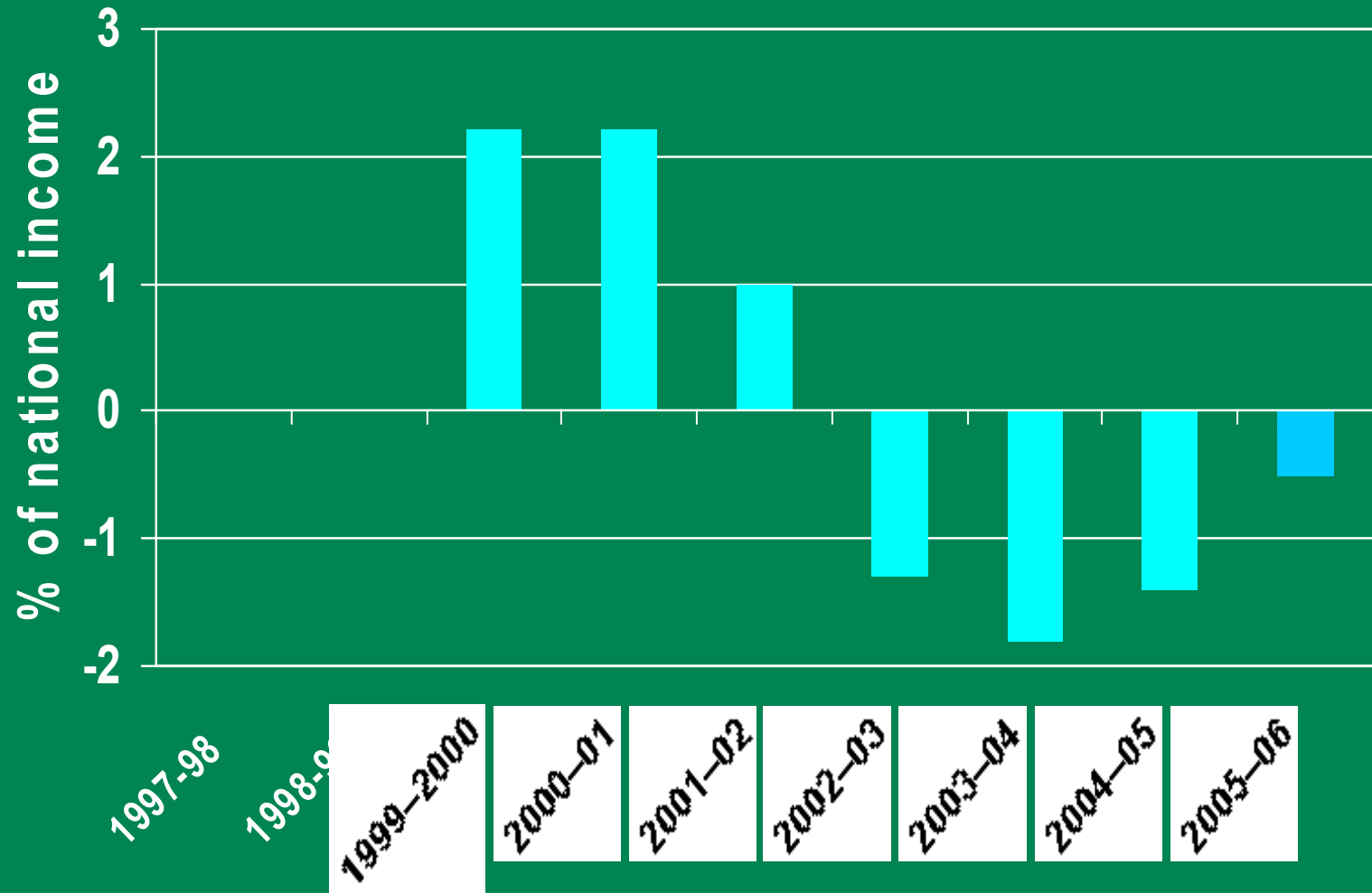
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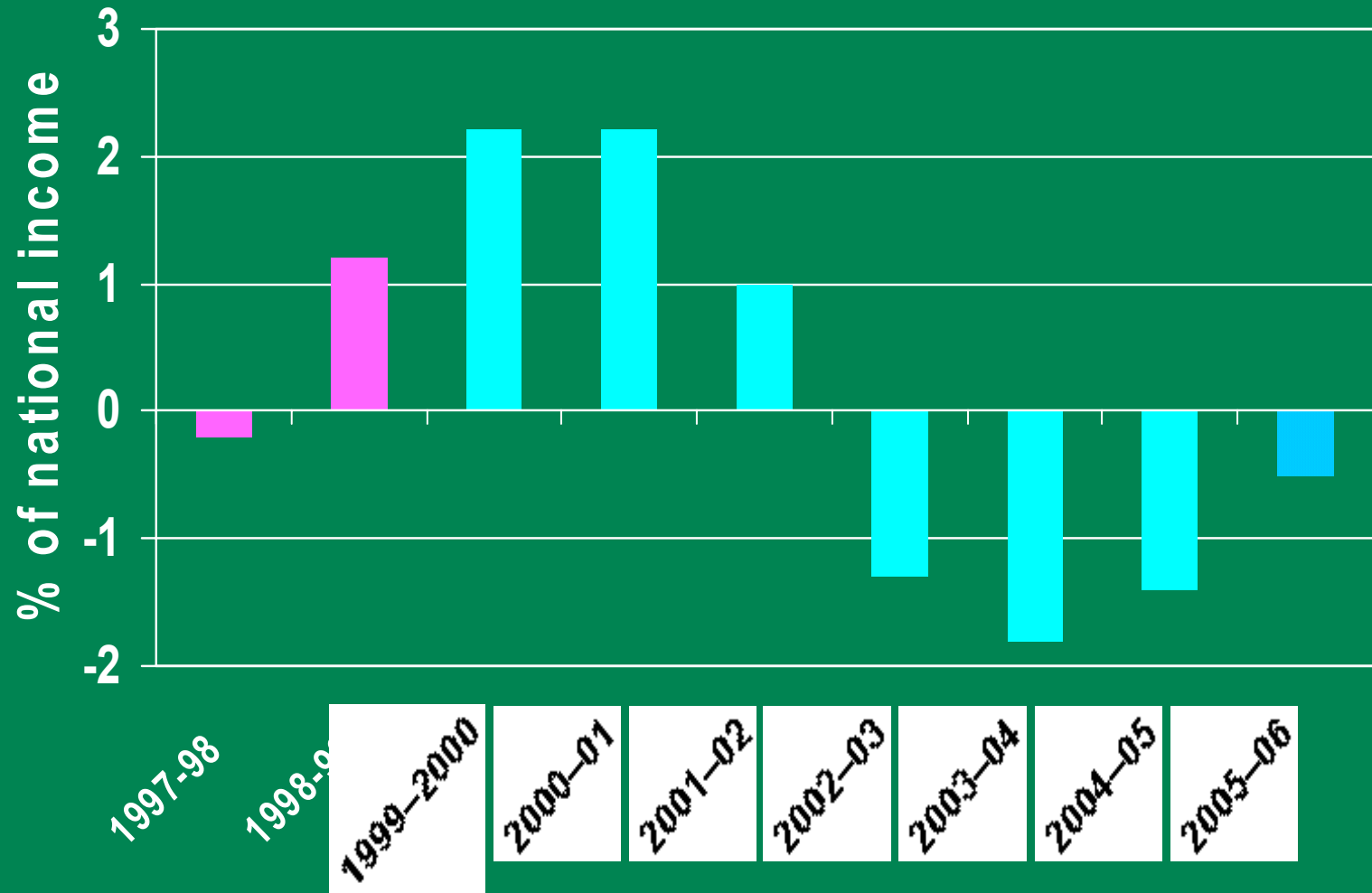
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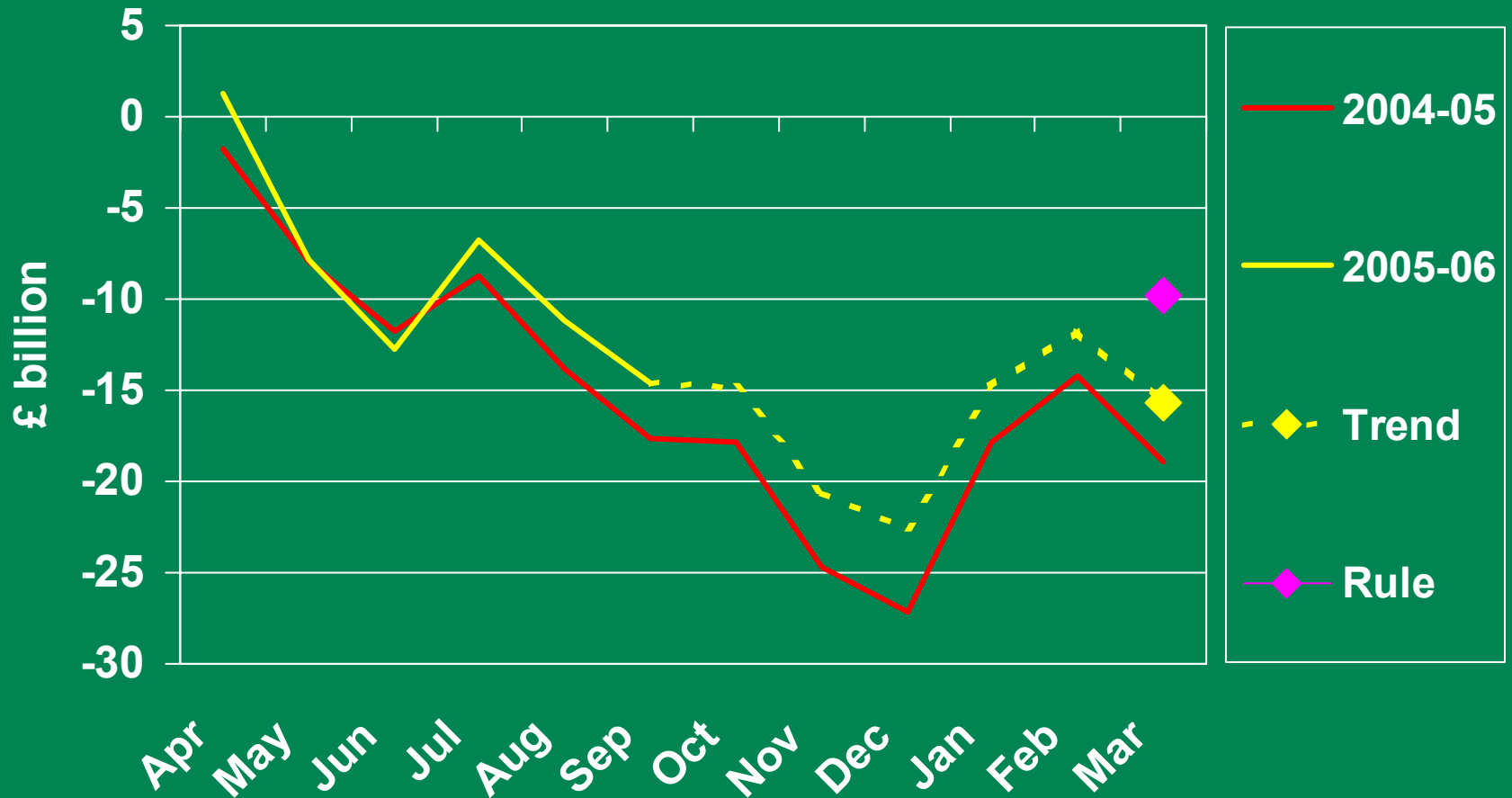
Longer cycle – bigger surplus



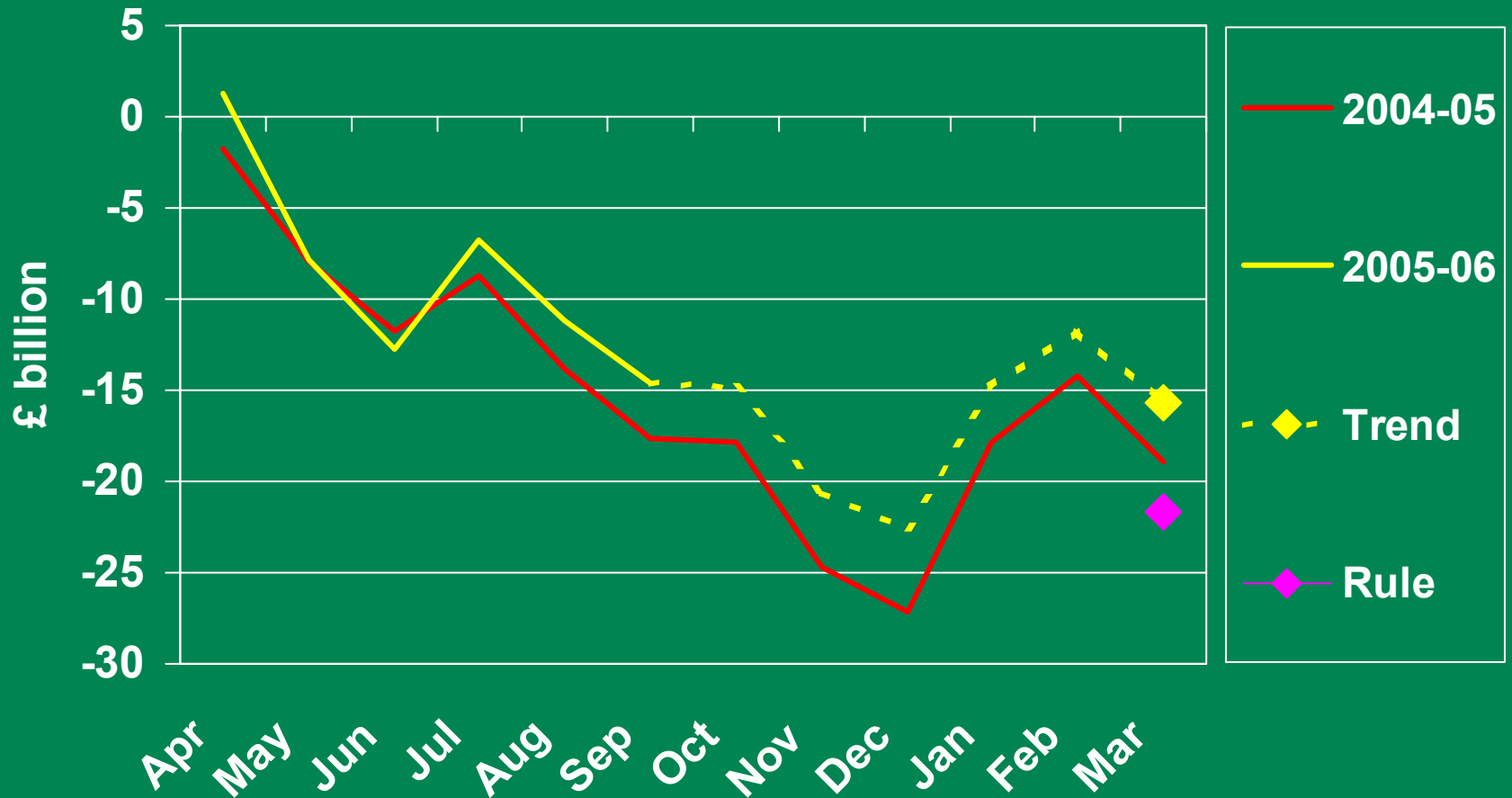
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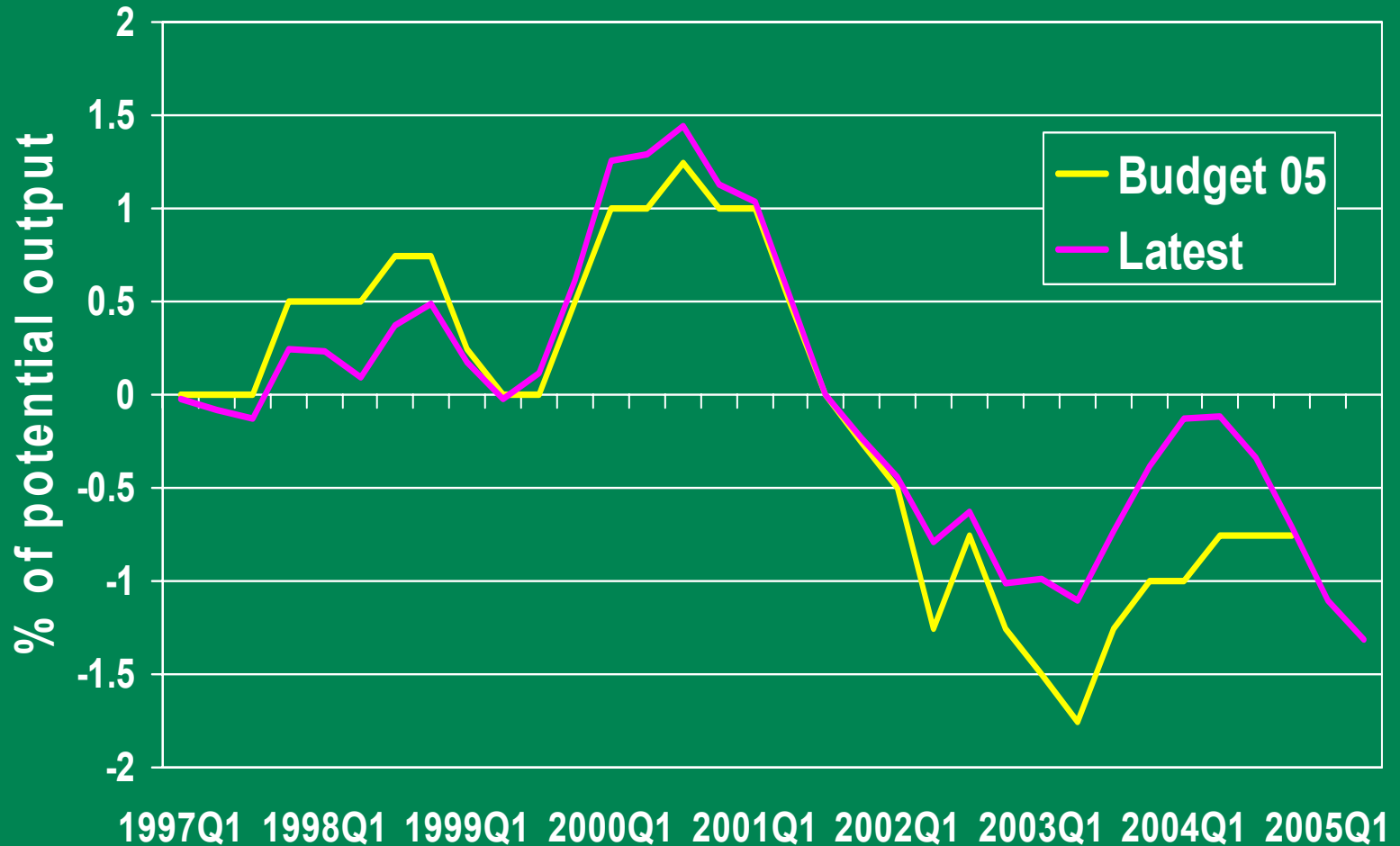
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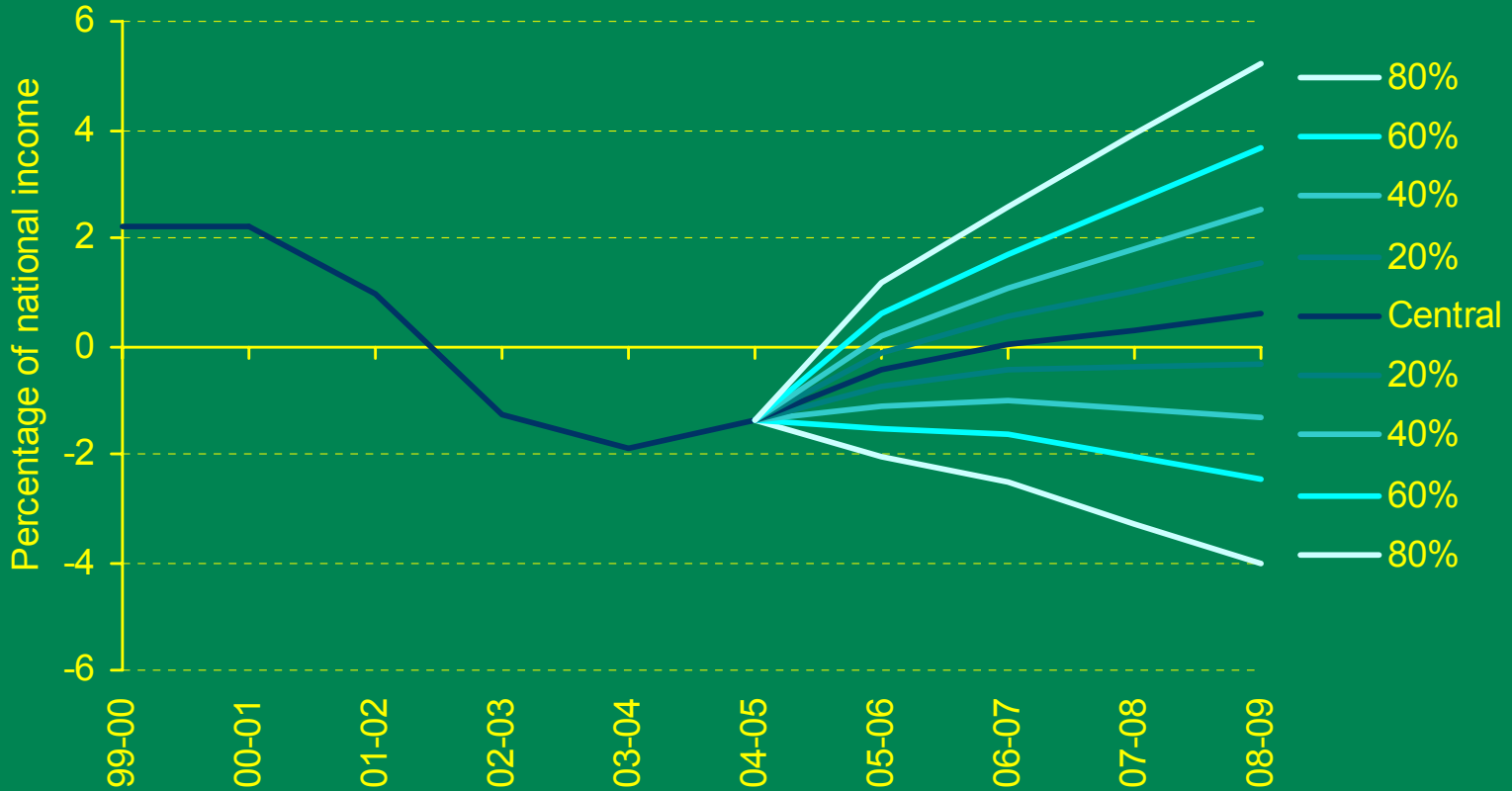
The output gap



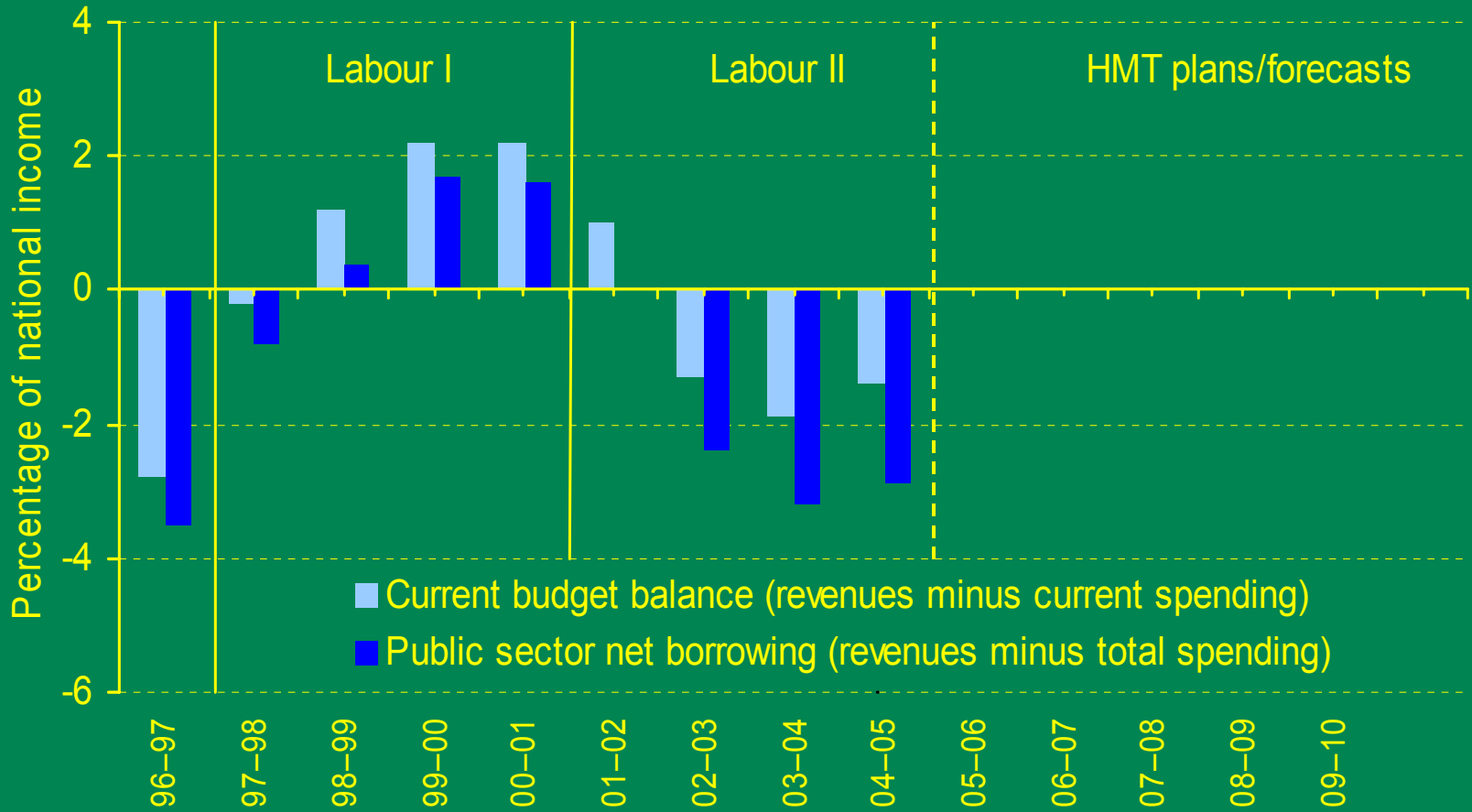
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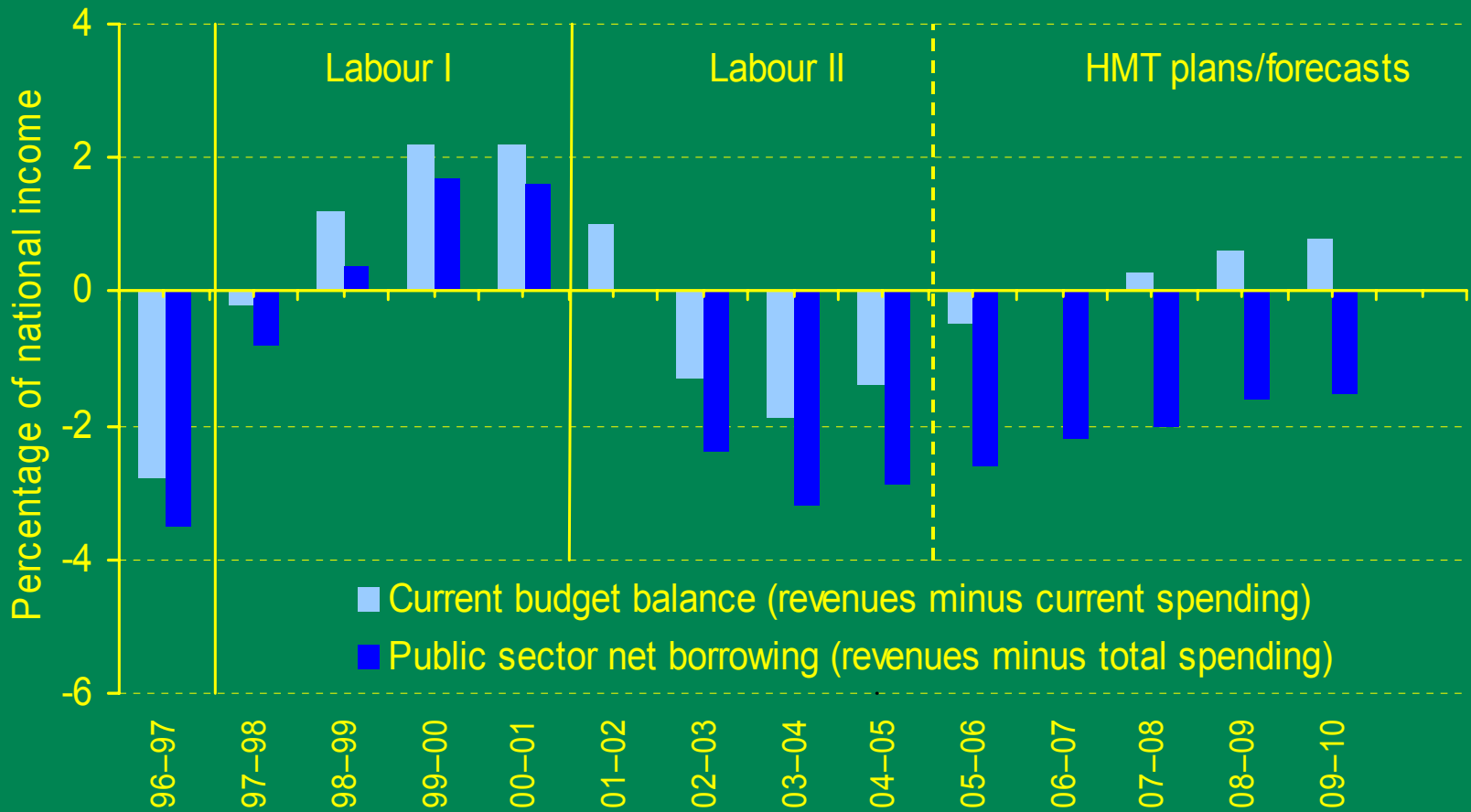
Be explicit about uncertainty



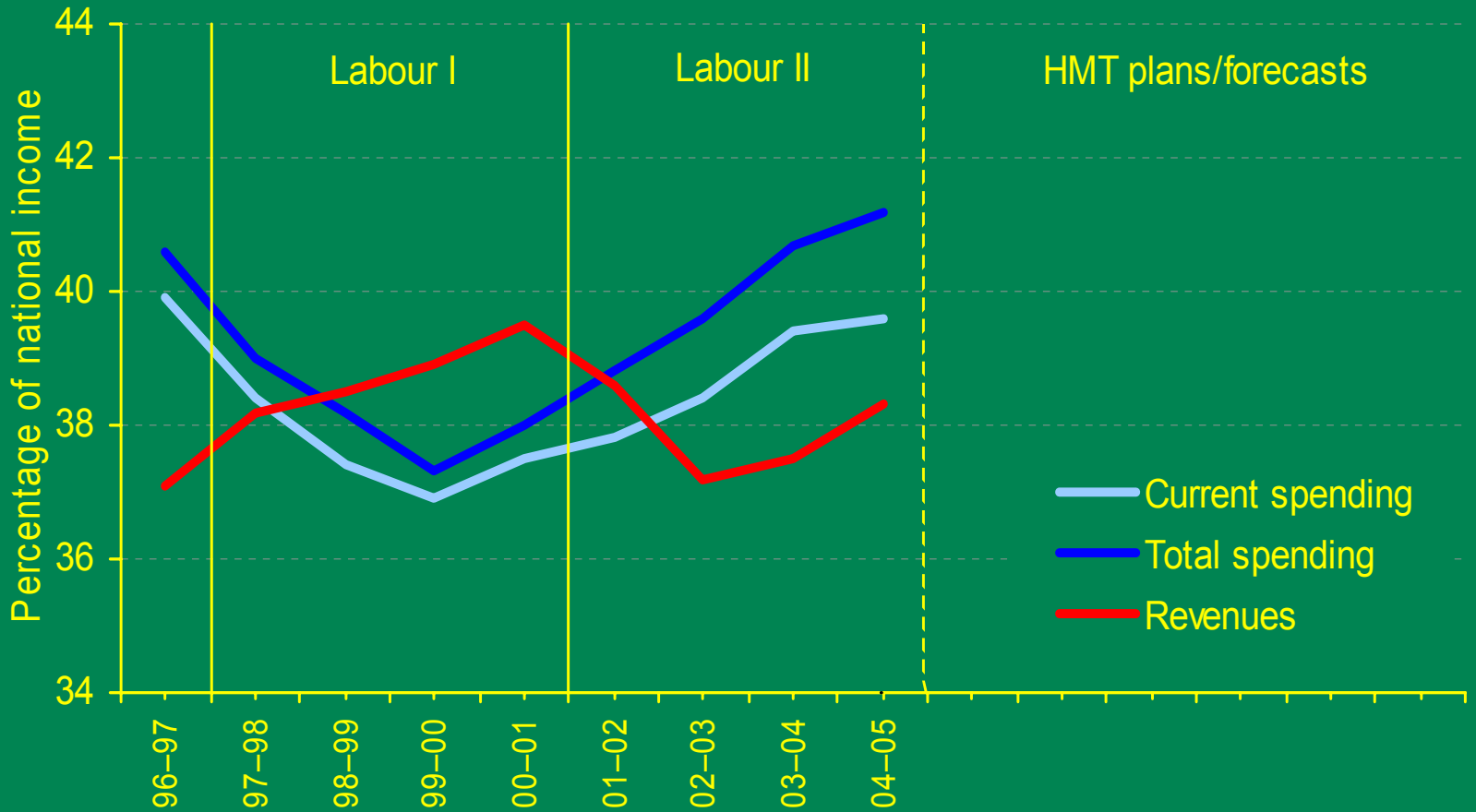
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Current and total budget balances



Spending and revenues



Spending and revenues

