Fiscal aims and austerity: the parties' plans compared

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Fiscal Aims and Austerity: The Parties' Plans Compared

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Executive summary

- The existence of the independent Office for Budget Responsibility has greatly increased the transparency of the UK's official economic and public finance forecasts and increased confidence that these are not based on politically-motivated wishful thinking. This has made it harder for politicians to borrow inappropriately for short-term gain and so has reduced the benefits of fiscal rules and targets. Such rules are, however, still useful as a statement of a government's fiscal objectives and as a way of holding it to account if it deviates.
- The current government has just set out a new set of fiscal aims to replace the fiscal mandate and supplementary target that have been in operation since June 2010. More importantly, given that we are less than five months from a general election, each of the three main UK political parties has also set out its fiscal objectives.
- The current government and each of the three main parties have all set out more-or-less specific targets for borrowing in the next parliament. All but the Conservatives have also said explicitly that they want debt to be falling as a share of national income by the end of the next parliament (or earlier). However, the debt targets look unlikely to be constraining if the borrowing targets are met.

All parties would need to tighten fiscal policy but by less than the coalition's plans imply

- Perhaps oddly, current government policy (as set out in the 2014 Autumn Statement) implies a substantially tighter fiscal stance than is strictly required either by the government's own new fiscal aims or by any of the targets outlined by the three main UK parties.
- The latest official forecast is for the current budget (revenues less non-investment spending) to move into surplus in 2017–18, and then for the public finances to strengthen further to reach an overall budget surplus (revenues less total spending) of 1.0% of national income in 2019–20. This equates to a surplus on the current budget of 2.3% of national income.

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- In contrast, the government's new fiscal mandate only requires it to be forecast to achieve a balance on the cyclically-adjusted current budget by the third year of the rolling five-year forecast horizon (currently 2017–18). This means that fiscal policy could be loosened by 2.3% of national income (or £43 billion in 2015–16 terms) in 2019–20 and the government would still be on course (just) to meet its mandate.

- The Liberal Democrats and Labour, whose borrowing targets are almost identical to that just adopted by the government, could run similarly looser fiscal policy (relative to the plans set out by the current government in the 2014 Autumn Statement) – allowing them to spend more or tax less to the tune of around £43 billion in 2019–20 and still remain on course (just) to achieve their targets.

- The Conservatives have said they would aim for a tighter fiscal position than advocated by the current fiscal mandate or by Labour and the Liberal Democrats. Specifically, they have said they would aim to achieve an overall budget surplus by the end of the parliament. If they wanted to be on course just to achieve this, they could loosen fiscal policy by 1.0% of national income (or £20 billion in 2015–16 terms) in 2019–20 relative to the plans set out by the current government in the 2014 Autumn Statement.

Announced tax increases and spending cuts will deliver some of the required borrowing reduction …

- The current government has already announced and legislated for tax increases and cuts to welfare spending that are expected to reduce borrowing by 0.8% of national income in the next parliament. They have also pencilled in a further squeeze on spending on public services and investment in 2015–16 (which will reduce borrowing by a further 0.6% of national income).

- So far, none of the three main parties has explicitly said that it would reverse any of these plans. Therefore, we assume in our analysis that all three would deliver them.

… but additional, as yet unspecified, cuts would also be required

- However, this leaves a 2.8% of national income reduction in borrowing – under the government's current plans – that has not been fully specified. In the absence of further tax increases or cuts to welfare spending, this would have to be found from cuts to departmental spending. To reduce borrowing by this much would require departmental spending being 14.1% lower in real terms in 2019–20 than it is set to be in 2015–16 (this equates to a cut of £51 billion in 2015–16 prices). This is on top of the 8.6% (£38 billion in 2015–16 prices) real cut expected between 2010–11 and 2015–16.

- If the Conservatives used up all their room for manoeuvre against their fiscal target (i.e. borrowed an extra 1.0% of national income) and gave all the additional money to departments, they could reduce this required squeeze on public services between 2015–16 and 2019–20 to 8.3% (£30 billion in 2015–16 prices).

- If Labour and the Liberal Democrats used up all their room for manoeuvre against their fiscal targets (i.e. borrowed an extra 2.3% of national income) and gave all the additional money to departments, they could reduce the required squeeze on public services to under 2% (less than £7 billion in 2015–16 prices).

New policies suggested by the parties do little to fill this gap

- These cuts to departments could be reduced further if the parties announced additional net tax increases or cuts to welfare spending. However, so far none of the parties has announced significant net tax increases or welfare spending cuts.
- The package of measures announced so far by the Conservatives on which we have specific details actually amounts (according to their costings) to a giveaway of 0.2% of national income. Implementing this would increase the real-terms cut required to departmental budgets to 9.1%. If the Conservatives were to find the full £12 billion of welfare cuts that they have suggested they want to achieve (so far, they have only set out £3 billion of cuts), this would reduce the cut required to departments to 6.7% (£24 billion in 2015–16 prices).
- The package of tax and benefit measures announced by the Liberal Democrats amounts to a giveaway of 0.1% of national income. This increases the cuts required to departments to 2.1% (£8 billion in 2015–16 prices).
- The tax and benefit measures announced by Labour so far amount to a small net takeaway, which reduces the overall cut required to departmental spending to 1.4% (£5 billion in 2015–16 prices).

More spending but higher debt

- The government's revised supplementary target aims for debt to be falling as a share of national income between 2015–16 and 2016–17. Both Labour and the Liberal Democrats have said that they want to see debt falling as a share of national income in the next parliament. The Conservatives have not set out an explicit debt target. However, their objective to achieve an overall budget surplus does imply a declining path for debt.
- The fiscal targets set out by Labour and the Liberal Democrats (and the current government's fiscal mandate) allow for a higher level of spending (particularly on investment) for a given level of tax revenues than the Conservatives' borrowing target allows. However, this would come at the cost of debt falling less quickly as a share of national income. For example, running a deficit of 1.2% of national income per year over the decade from 2020–21 would result in debt falling by 9% of national income less over that period than if the budget were balanced each year. Debt falling less quickly would have two costs: more public spending would have to be devoted to making interest payments on debt, and the UK would be less well placed to absorb any future large shocks that pushed up public debt, as the financial crisis did in 2008.
- This choice between higher spending with higher debt and lower spending with lower debt may be one of the key dividing lines in the election between Labour and the Liberal Democrats on the one hand and the Conservatives on the other. It is therefore incumbent on each of the parties to provide the electorate with more detail of why they are advocating a particular stance, how they will achieve the required borrowing reductions, and what their objectives really mean for the quality and quantity of public services and the ability of the UK's public finances to deal with future pressures.

1. Why have fiscal rules?

The government's ability to borrow and accumulate debt, if used appropriately, can be welfare improving. But, if used inappropriately, it can be welfare reducing. This briefing note summarises the basic rationale for fiscal rules, looks at some of the issues the next government will face when setting its own fiscal rules and discusses the implications of alternative fiscal targets being proposed by the Conservatives, Labour and the Liberal Democrats.

When the government borrows, it effectively transfers the burden of paying for spending onto future taxpayers. This might be appropriate when the borrowing is for investment spending, as the future taxpayers funding the spending may benefit directly from it, or perhaps when a future generation will be so much richer than the current generation that it makes sense to redistribute away from the former.

Since 2007–08, the government has borrowed vast sums of money, much more than it needed to finance investment, and certainly not as part of a reasoned strategy of redistribution away from a (hopefully) richer future generation. This recent experience has highlighted another rationale for borrowing, which is to allow gradual adjustment to large shocks, when short-term revenues and spending needs do not match up. Borrowing can also be useful as a tool for output stabilisation, particularly in situations where monetary policy has become ineffective or its impact less certain.

In summary, there are plenty of situations where borrowing might be sensible and very few situations where we would expect to see exactly zero borrowing for a sustained period of time. However, too much borrowing can be problematic – for example, if the government pre-commits future generations to an excessively high debt burden, risking default. Even if the debt burden is affordable, it might not reflect an 'optimal' allocation of resources between generations; in order to repay the debt, the cost to future generations might be larger than the initial benefits from postponing the payment.

We therefore might expect 'good practice' in terms of borrowing and debt policy to have the following features: debt should be reduced in the good times, so that in the bad times it can be increased in order to help individuals and firms adjust to shocks. In the long run, perhaps a government should only commit future generations to paying for spending that those future generations will benefit from themselves. And finally, we might think that there should be some limit to how much we pre-commit future taxpayers to, not only on fiscal sustainability grounds but also because it involves making a choice on behalf of people who have no power to resist.

These best practices will often involve short-term sacrifice for a longer-term benefit. However, our electoral system encourages politicians to value short-term gains much more highly than potential costs that might occur in the next parliament, when they might no longer be in office. Voters themselves may be too short-termist or may not take into account the effects of their actions on unborn generations.

Low and sustainable debt is clearly desirable, all other things equal. But there is a trade-off between the long-run benefits of maintaining low debt and the cost of imposing the higher taxes or lower spending required to achieve it. The political reality is that maintaining low borrowing can be difficult. Aware of these pressures, policymakers may want to set themselves additional constraints. They can do this by announcing fiscal rules, which make it more likely that they will stick to their stated policy by imposing an 'embarrassment cost' of deviation.

Past examples of fiscal rules include Gordon Brown's 'golden rule' and the coalition's fiscal mandate. Both were implemented in an attempt to gain credibility with voters and the markets. More recently, on 15 December 2014, the government updated its fiscal mandate.

The next government could choose an entirely new set of fiscal rules. In May, the UK electorate will have a choice between alternative parties and their fiscal rules and strategies. This briefing note aims to inform that choice, by describing the coalition government's original and recently-reformed rules and its record on meeting them (Section 2), presenting the alternative fiscal targets that have been suggested by each of the three main UK parties (Section 3), assessing how well they might translate into a sensible fiscal rule (Section 4) and considering the implications of these targets for the size of fiscal consolidation required beyond the next election (Section 5). Section 6 draws some conclusions.

2. The current fiscal rules

2.1 What are the fiscal rules?

For most of this parliament, the government has had two fiscal rules:

- The original **fiscal mandate** stated that the cyclically-adjusted current budget – that is, borrowing for non-investment spending, after adjusting for the economic cycle – should be forecast to be in balance or surplus at the end of a rolling five-year forecast horizon.
- The original **supplementary target** was for public sector net debt to be falling as a share of national income between 2014–15 and 2015–16.[2]

On 15 December 2014, the coalition government chose to publish an updated Charter for Budget Responsibility.[3]

- The revised **fiscal mandate** is now a forward-looking aim to achieve cyclically-adjusted current budget balance by the end of the third year of the rolling, five-year forecast period.
- The revised **supplementary target** is now an aim for public sector net debt as a share of national income to fall between 2015–16 and 2016–17.

So the revisions mean that the fiscal mandate now looks forward three years rather than five years, while the supplementary target now depends on the path of debt (as a share of national income) between 2015–16 and 2016–17 rather than between 2014–15 and 2015–16.

[2] In March 2014, a second supplementary target was added, which related to the government's policy on welfare spending (the 'welfare cap'). For more detail on this policy, see R. Crawford, C. Emmerson and S. Keynes, 'Public finances: risks on tax, bigger risks on spending?', in C. Emmerson, P. Johnson and H. Miller (eds), *The IFS Green Budget: February 2014*, IFS Report R91, 2014 (http://www.ifs.org.uk/budgets/gb2014/gb2014_ch2.pdf).

[3] See https://www.gov.uk/government/publications/charter-for-budget-responsibility-autumn-statement-2014-update.

2.2 How sensible are the fiscal rules?

As described in much more detail in chapter 4 of the 2013 IFS Green Budget, the fiscal mandate has many desirable features.[4] Targeting a cyclically-adjusted measure allows the government to borrow in response to the ups-and-downs of the economic cycle, so that the government would not have to undertake a fiscal consolidation in response to a deterioration of the public finances that was believed only to reflect temporary weakness in the economy. The fiscal mandate is a rolling target, which allows policy to adjust gradually to permanent shocks. The target also excludes borrowing for investment spending, which helps to avoid the temptation to focus spending cuts on those areas where the effects will only be felt in the future (i.e. investment spending) in order to prop up day-to-day spending in difficult times.[5]

The revised fiscal mandate looks forward over a shorter time frame than the original fiscal mandate. In 2010, when the original five-year target horizon was set, the Office for Budget Responsibility (and others) estimated that there was a sizeable permanent hole in the public finances and the government judged that it was appropriate to close this over a five-year period. When George Osborne first announced his fiscal mandate, he said that he would consider shortening the time horizon at some point over this parliament as he made progress towards reducing borrowing. However, over the following two years, the Office for Budget Responsibility (OBR) increased its estimate of the size of the hole, and so on each occasion the government used the flexibility allowed by its rolling target to extend the date at which it would deal with the problem. That is, it left the tax rises and spending cuts planned for this parliament essentially unchanged but pencilled in further spending cuts for the coming parliament to finish dealing with the larger problem. (This is discussed in more detail in Section 2.3.)

Over the last two years, the OBR has not revised up its estimate of the size of the problem. It therefore seems consistent with the government's original beliefs about the appropriate pace of fiscal tightening that it should now aim to achieve a current budget balance within the shorter three-year time frame now mandated. It would, however, have been preferable (instead of announcing this ad hoc change) to devise a more systematic and transparent process of revising the fiscal targets. A commitment to review any fiscal objectives at a particular point in time, or once a particular outcome has been achieved (or, conversely, when a particular size of adverse shock materialises), would be an improvement on current policy.

In contrast, the supplementary target – both the original one and the revised one – has few features to recommend it. Requiring only that debt falls as a share of national income between two fixed dates does nothing to ensure the long-run sustainability of the public finances, as (under the revised target) it says nothing about the path of debt beyond 2016–17.

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[4] See C. Emmerson, S. Keynes and G. Tetlow, 'The fiscal targets', in C. Emmerson, P. Johnson and H. Miller (eds), *The IFS Green Budget: February 2013,* IFS Report R74, 2013 (http://www.ifs.org.uk/budgets/gb2013/GB2013_Ch4.pdf).

[5] A 2000 HM Treasury paper asserted that, under the fiscal mandate's predecessors, 'capital programmes were cut as a way of meeting short term current pressures, with long term detrimental effects' (page 2 of HM Treasury, 'Planning sustainable public spending: lessons from previous policy experience', 2000). However, this 'lesson learned' did not prevent the last Labour government from planning deep cuts to investment spending in the aftermath of the financial crisis.

2.3 Is the government on course to meet its fiscal rules?

At each fiscal event, the OBR forecasts the path of the public finances. If, on the basis of the forecasts, there is a greater than 50% chance that the cyclically-adjusted current budget will be in surplus by the end of the forecast horizon, the OBR concludes that the government is meeting its original fiscal mandate. If this is the case by the third year of the forecast horizon, then the government is also meeting its new, revised, fiscal mandate.

The OBR's latest central projections (shown in Table 2.1) suggest that the government is meeting both the original and the revised fiscal mandate, as the cyclically-adjusted current budget is forecast to be in surplus by 0.7% of national income in 2017–18 rising to 2.3% of national income in 2019–20. As the OBR's forecasts are central forecasts (meaning that it judges that there is a 50% chance borrowing will be greater or smaller than the amount forecast), the government appears to be meeting both its original fiscal mandate and its revised mandate with some room for error.

Table 2.1. Latest OBR forecasts for current budget, borrowing and debt

	2013–14	2014–15	2015–16	2016–17	2017–18	2018–19	2019–20
As a % of GDP							
Current budget deficit	4.2	3.5	2.6	0.8	–0.5	–1.4	–2.3
Cyclically-adjusted current budget deficit	2.6	2.7	2.2	0.5	–0.7	–1.5	–2.3
Public sector net borrowing	5.6	5.0	4.0	2.1	0.7	–0.2	–1.0
Cyclically-adjusted public sector net borrowing	4.1	4.2	3.6	1.8	0.5	–0.3	–1.1
Public sector net debt	78.8	80.4	81.1	80.7	78.8	76.2	72.8

Source: Out-turns and forecasts are taken from table 4.47 of Office for Budget Responsibility, *Economic and Fiscal Outlook: December 2014* (http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

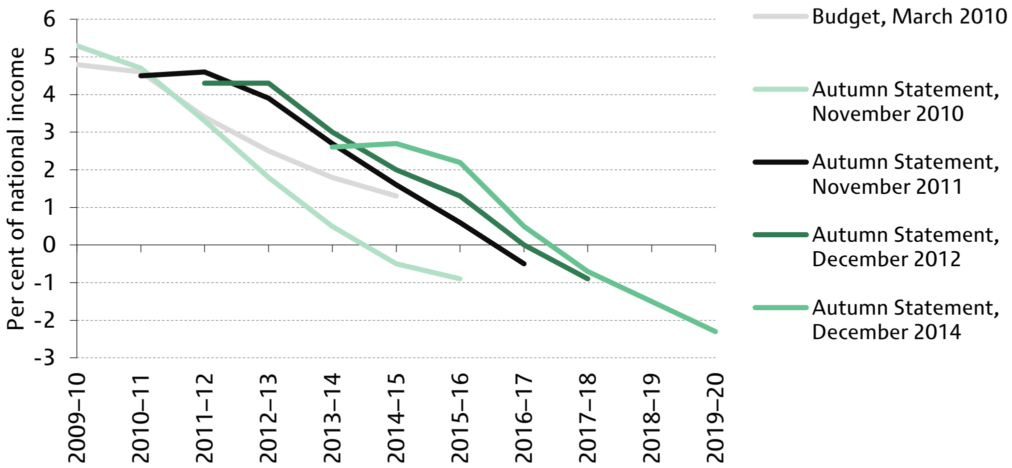
The same is not true of the supplementary target. Debt is not forecast to start falling as a share of national income until 2016–17, one year later than required by the original supplementary target. Given that this rule did not have a solid economic underpinning, missing it may well be preferable to changing fiscal policy in order to comply with it. However, it would have been far better to have replaced the target with something more appropriate (or for it not to have been introduced by the last Labour government or retained by the coalition government). Unfortunately, when revising the supplementary target, the government failed to take this opportunity. It is now aiming for debt to fall as a share of national income in 2016–17 (which, according to the latest OBR forecasts, it is on course to achieve).

Has the government always been on track to meet its fiscal mandate?

The government has always been on track to meet the original fiscal mandate, as shown in Figure 2.1. However, Figure 2.1 also shows how on two occasions the nature of the rolling target has worked in the government's favour: in the Autumn Statements of

November 2011 and December 2012, as the forecast horizon was extended, the date by which the government was expecting to achieve a cyclically-adjusted current budget balance was also postponed. This highlights a potential danger of rolling targets: that the government could always promise to meet the target for the future, but never actually meet it. However, this is also potentially a positive feature of the target, allowing the government to respond more flexibly as circumstances change, just as they were judged to have done in November 2011 and December 2012.

Figure 2.1. Historic forecasts of the structural current budget deficit



Note: The transition from the 1995 European System of Accounts to the 2010 European System of Accounts (ESA95 to ESA10) between the March 2014 Budget and the December 2014 Autumn Statement affected measures of GDP and the current budget deficit. Therefore note that some of the difference between the December forecast and the earlier forecasts reflects accounting changes, rather than a change in the underlying fiscal forecast. All figures exclude the effects of temporary financial interventions associated with the financial crisis and the effects of cash flows between the Asset Purchase Facility (APF) and HM Treasury.
Source: OBR historical official forecasts database, available at http://budgetresponsibility.org.uk/data/; OBR, *Economic and Fiscal Outlook: December 2012* (http://budgetresponsibility.org.uk/economic-and-fiscal-outlook-december-2012/); OBR, *Economic and Fiscal Outlook: December 2014* (http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/).

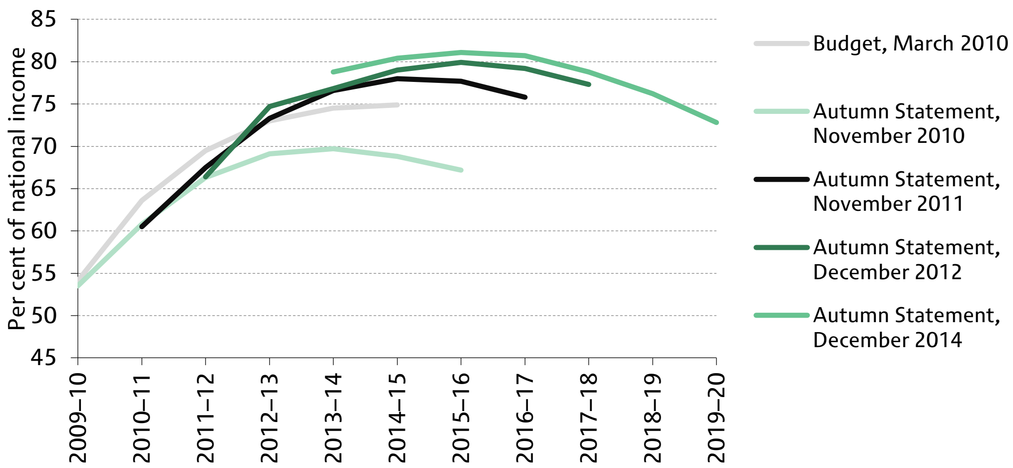
If the government had pushed back the date of achieving a budget balance simply as a way of delaying having to implement painful measures that it never intended to carry out, this would be an abuse of the spirit of the target. However, over the past parliament, each time the government delayed the date at which it expected to achieve a cyclically-adjusted current budget balance, it has coincided with an obvious weakening in the public finances (rather than, for example, a forthcoming general election leading to planned tax rises or spending cuts being deferred). On these occasions, it therefore appears that there was appropriate justification for the government taking advantage of the flexibility allowed by the rule.

The December 2014 Autumn Statement was the first time under this government that the cyclically-adjusted current budget was forecast to be in surplus by the third year of the forecast horizon and therefore the government would not have been on course to meet its revised fiscal mandate had it introduced this at any earlier stage in this parliament.

When did the government first look likely to miss its supplementary target?

The government has been on track to miss its original supplementary target since the Autumn Statement of December 2012, as shown in Figure 2.2. As discussed in more detail in chapter 4 of the 2013 IFS Green Budget, because the target was not particularly meaningful in the first place, this potential breach probably does not matter, except to the extent that the government's credibility might be damaged in the eyes of its creditors or the public. Since the forecast horizon was first extended to include 2016–17 (in the Autumn Statement of 2011), it has always been the case that the OBR has forecast that public sector net debt as a share of national income would be lower in that year than in the previous year and therefore the government would have been on course to meet its revised supplementary target had that been in place at that point.

Figure 2.2. Historic forecasts of public sector net debt



Note: The transition from the 1995 European System of Accounts to the 2010 European System of Accounts (ESA95 to ESA10) between the March 2014 Budget and the December 2014 Autumn Statement affected measures of GDP and public sector net debt. Therefore note that some of the difference between the December forecast and the earlier forecasts reflects accounting changes, rather than a change in the underlying fiscal forecast. Figures exclude banks.
Source: HM Treasury, *Budget 2010* (http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/budget2010_documents.htm); OBR's Economic and Fiscal Outlook, various years.

For the period of this parliament, the coalition government has been working to two fiscal targets. It appears to have paid no penalty for being on course to miss one of them – the old supplementary target stating that debt should be falling in 2015–16. This may be because the supplementary target is not a terribly coherent rule and additional fiscal action to remain on course to meet it was not seen as appropriate.

The flexibility allowed by the fiscal mandate has been used: few net additional spending cuts or tax rises were implemented over this parliament despite the sharp deterioration in the public finances relative to forecast. Instead, further cuts have been pencilled in for the next parliament. This was consistent with a forward-looking fiscal rule designed to provide exactly that flexibility. The fact that the current budget deficit is now smaller than it was in 2010, and that the government is aiming for a sizeable current budget surplus in five years' time, potentially provides a justification for shortening the timescale over which the fiscal mandate operates. What we still lack is some kind of sensible anchor for the debt level – a rule simply saying debt should be falling in a particular year remains suboptimal. We also lack any useful 'meta rule' setting out when it would be reasonable to expect the stated rules to change.

3. The parties' proposed fiscal rules

With not much time left in this parliament, the new fiscal mandate and supplementary target might well not be much more than a symbolic gesture. Recall that in 2010 the then Labour government legislated for its own fiscal rule, stating that the deficit must have halved by 2014–15. In the event, despite the tighter fiscal policy pursued by the coalition government, poor economic performance ensured that this rule was missed – a good illustration of why such fixed targets are inappropriate and such legislation little more than symbolic. An incoming government could choose to revise the existing fiscal targets – just as the current coalition government did when it took office in 2010. However, if the revised fiscal mandate and the revised supplementary target are legislated with the support of the three main UK parties,[6] it is, perhaps, more likely that they will remain intact after the general election.

The main UK parties have each given some indications of what their fiscal targets would be in the next parliament. Although none of them has been completely explicit about these rules, we describe here what they have said so far and assess their rules on the basis of the information we have.

3.1 What have the Conservatives pledged?

The Conservatives have so far pledged that they will achieve an overall budget surplus – i.e. total tax and non-tax revenues in excess of total spending – in the next parliament, provided the recovery is sustained.[7] However, it is unclear when exactly 'in the next parliament' they plan to achieve this target. They have no explicit debt target but, as the path of borrowing determines the path of debt, a commitment to achieve an overall surplus does imply an implicit debt target. On the basis of the coalition's stated policies through to 2019–20, the latest OBR forecasts (set out in Table 2.1) suggest that the Conservatives' target to achieve an overall budget surplus would be met in 2018–19 and that debt would start to fall as a share of national income from 2016–17.

If the Conservatives maintain investment spending (net of depreciation) as a share of national income from 2018–19, as per stated current government policy,[8] then in a sense their zero borrowing target could be interpreted as a target of a surplus in the current budget (i.e. tax and non-tax receipts in excess of non-investment spending) of at least 1.2% of national income (since public sector net investment is forecast to be 1.2% of national income in 2018–19).

According to the latest OBR forecasts, the overall budget is forecast to be in balance in 2018–19, then continuing to strengthen, with a forecast 1.0% of national income surplus in 2019–20 (£23 billion in that year's terms, or £20 billion in 2015–16 terms). Therefore this means that the Conservatives' fiscal target could, in principle, be met with a looser fiscal policy stance than is currently envisaged. However, if the Conservatives wanted to have more than a 50% chance of meeting their aspiration of achieving budget balance by

[6] See, for example, 'Ed Balls: Labour will back coalition charter on tackling deficit', *The Guardian*, 15 December 2014 (http://www.theguardian.com/politics/2014/dec/15/ed-balls-labour-back-coalition-charter-deficit).

[7] Source: http://www.politics.co.uk/comment-analysis/2013/09/30/george-osborne-s-conference-speech-in-full.

[8] See page 135 of Office for Budget Responsibility, *Economic and Fiscal Outlook: December 2014* (http://cdn.budgetresponsibility.independent.gov.uk/December_2014_EFO-web513.pdf).

the end of the parliament, they would likely want to aim for some surplus, rather than an exact budget balance, in order to build in some margin for error. A clear lesson from the revisions made to the public finances in recent years is that even the 1.0% of national income surplus forecast for 2019–20 could easily be revised away with a movement in the forecast. The OBR forecasts suggest that, on the basis of previous forecast errors, there is nearly a 40% chance that the government will still be borrowing in 2019–20 (rather than achieving the forecast 1.0% of national income surplus).

3.2 What has Labour pledged?

Labour has pledged to achieve a surplus on the current budget and falling national debt in the next parliament.[9] These pledges are similar in spirit to the fiscal mandate and supplementary target. However, prior to the publication of the government's revised fiscal mandate and revised supplementary target, Labour had not been precise on *when* it was intending to achieve a surplus on the current budget, saying, for example, 'how fast we can go will depend on the state of the economy and public finances we inherit'.[10] In addition, Labour had pledged to abolish the 'discredited idea of rolling five year targets',[11] preferring instead to say that it would aim to achieve a surplus on the current budget 'as soon as possible within the next Parliament'.[12] However, it now seems that the revised fiscal mandate – an aim to balance the cyclically-adjusted current budget on a rolling three-year horizon – is acceptable to Labour, as the Shadow Chancellor Ed Balls has indicated that Labour will support the government's proposed revised fiscal targets.[13]

Under the OBR's latest forecasts the current budget is forecast to be in surplus by £50 billion in 2019–20 (in that year's prices, or £43 billion in 2015–16 terms). This suggests that Labour could run significantly looser fiscal policy than is implied by the coalition government's forecasts and still meet their fiscal rules. Of course, if Labour wanted to factor in some margin for error, then it may not choose to use all of the extra spending that its fiscal rule allows.

3.3 What have the Liberal Democrats pledged?

The Liberal Democrats have pledged to balance the cyclically-adjusted current budget from 2017–18 onwards and have said that 'from 2017/18, debt must fall as a proportion of our national income every year – except during a recession – so it reaches sustainable levels around the middle of the next decade'.[14]

The first objective sounds perfectly consistent with the government's new fiscal mandate. However, in a June 2014 speech, Nick Clegg suggested that only investment that 'enhances economic growth or financial stability' would be excluded from headline borrowing when calculating the Liberal Democrats' measure of the current budget.[15] This

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[9] Source: http://press.labour.org.uk/post/104918318074/speech-by-ed-miliband-mp-on-the-deficit.

[10] Source: http://press.labour.org.uk/post/74420740121/ed-balls-announces-binding-fiscal-commitment-that.

[11] Ibid.

[12] Source: http://www.labour.org.uk/issues/detail/deficit.

[13] See 'Ed Balls: Labour will back coalition charter on tackling deficit', *The Guardian*, 15 December 2014 (http://www.theguardian.com/politics/2014/dec/15/ed-balls-labour-back-coalition-charter-deficit).

[14] Source: http://www.libdems.org.uk/policy_paper_121.

[15] Source: http://www.libdemvoice.org/nick-clegg-on-the-liberal-democrats-unique-mission-40763.html.

could imply a tighter fiscal stance than under the standard definition of the cyclically-adjusted current budget. Deviating from the standard definition of investment spending might be sensible in principle (see chapter 4 of the 2013 Green Budget for further discussion). However, in practice, a deviation from National Accounting measures of investment – where the independent Office for National Statistics determines what spending does and does not score as an investment – could lead to a loss in transparency.

Assuming that the Liberal Democrats instead retain the current definitions of what counts as investment spending, they, like Labour, could in principle choose to run significantly looser fiscal policy than is implied by the coalition government's forecasts and still meet their fiscal rules. But again the potential for significant revisions to be made to public finance forecasts suggests that they might wish to aim to overachieve their target and therefore choose not to use all of this potential room to manoeuvre.

4. How similar are the parties' fiscal targets and how sensible are they?

The policies announced so far by the main UK parties highlight many areas of agreement, but some of disagreement.

4.1 A target for borrowing

Targeting a fixed date or not?

In contrast to the fiscal mandate's rolling target, the policies announced so far by each of the parties all seem to imply that they will aim to achieve a target level of borrowing by a fixed date, either giving specific years or referencing 'by the end of this parliament'. Labour appears to have gone slightly further in its explicit rejection of a five-year rolling target (despite its subsequent support for the three-year rolling target set by the new fiscal mandate).

The main advantage of a fixed-date target is that it is simple, transparent and therefore easy to verify. It also makes it more difficult for the government to move the goalposts in order to meet its target. Having a fixed-date target might have avoided the situation of 2005, when the economic cycle was redated in the government's favour at exactly the moment that Gordon Brown looked likely to miss his target to balance the current budget over 'the economic cycle' without this adjustment.

However, fixed-date targets can have undesirable consequences, most of which stem from the reduction in flexibility as the end date approaches. On the eve of the target date, the government might be faced with a significant forecasting error. This would leave it with the choice of either a sudden policy change (perhaps even a temporary in-year spending cut or tax rise) or abandoning the target. This would not lend itself to good policymaking.

In the presence of an independent fiscal watchdog, there is arguably less need for a fixed-date target to hold the government to account. Unlike in the 2000s, we now have the OBR, which provides fiscal forecasts that we can expect to be free from politically-motivated wishful thinking, at each fiscal event.

To adjust for the economic cycle or not?

The Conservatives and Labour have suggested targeting a headline figure for borrowing, while the Liberal Democrats have suggested that they would target a cyclically-adjusted figure. However, both the Conservatives and Labour have conditioned their policies on the prevailing strength of the economy, which implies that they are implicitly intending to adjust for the ups-and-downs of the economic cycle in some way.

Making a distinction between temporary weakness or strength in the public finances and the amount of borrowing that is expected to endure is reasonable. Otherwise, the government might be encouraged to tighten fiscal policy in response to a temporary negative shock, which could increase the costs to households of the shock, only to find that once the economy has recovered the tightening could be unwound.

The question then becomes whether one should target an official 'cyclically-adjusted' measure, or a simple headline measure combined with some discretionary room for manoeuvre according to the cycle. The disadvantage of an explicit cyclical adjustment is that it relies on an estimate of the output gap, or the amount of spare capacity in the economy, alongside an adjustment for the impact the estimated output gap is expected to have on the public finances. The output gap is extremely difficult to measure, even *ex post*, which can lead to a loss of transparency, and the appropriate adjustment to make to the public finances for a given size of output gap is not known with certainty.[16] However, with such calculations done transparently by the OBR, this is arguably better than the Chancellor applying his or her own ad hoc 'judgement' to decide when it is appropriate to deviate from the headline target.

In an economic boom, the headline fiscal target would be less constraining than a cyclically-adjusted target. Requiring the Chancellor to take a tighter fiscal stance than his target implies does not seem to be an issue for the current government. However, in the past, governments have been tempted to spend boom-induced surpluses, rather than save them for a rainy day. It might therefore be more sensible to choose a cyclically-adjusted target, which would not allow extra spending when revenues were temporarily flattered.

How far …

The Conservatives, Labour and the Liberal Democrats differ in terms of the size of the fiscal consolidation that their fiscal rules suggest they might implement.

The Conservatives' balanced budget target, combined with an assumption that they would spend 1.2% of national income on investment in 2019–20 (as per current coalition government policy), means that they are effectively targeting a current budget surplus of at least 1.2% of national income. This is a more stringent target than that of Labour and the Liberal Democrats: in the long run, it appears that the Liberal Democrats are targeting at least current budget balance, whereas Labour is explicitly targeting a current budget surplus.

Table 4.1 summarises how the outlook for borrowing in 2019–20 might differ under the different parties, assuming that they would all borrow as much as their fiscal rules allow and that they would all spend 1.2% of national income on investment in 2019–20. Of

[16] Note that this question would become largely academic if we returned to a world in which forecasters assume the economy will be at capacity by the end of the forecast horizon. Recent history has been fairly unusual, in that there have been output gaps forecast for five years in the future. Usually with a five-year forecast horizon, the cyclically-adjusted measure would be exactly the same as the headline measure.

course, Labour and the Liberal Democrats could increase borrowing for investment and still meet their fiscal targets.

With this assumption for investment, and absent no further major permanent shocks to the public finances, each of the three targets is consistent with sustainable long-run public sector net debt. However, the targets do imply different paths for debt. A larger overall consolidation will mean that, as the economy grows, public sector net debt will fall more quickly as a share of national income. On the other hand, it also implies more tax increases or spending cuts.

Table 4.1. Potential outlook for borrowing in 2019–20 given alternative parties' fiscal rules

	Fiscal rule	Borrowing in 2019–20		
		% of GDP	£bn, nominal	£bn, 2015–16 prices
Coalition	Cyclically-adjusted current budget balance by third year of rolling forecast horizon (currently 2017–18)	−1.0	−23.1	−21.6
		Assumed fiscal rule implies:		
Conservatives	Budget surplus by end of next parliament	0.0	0.0	0.0
Labour	Current budget surplus by end of next parliament	1.2	26.9	25.1
Liberal Democrats	Cyclically-adjusted current budget balance by end of next parliament	1.2	27.5	25.7

Note: Borrowing in 2019–20 under the coalition plans is given by the OBR's forecasts in the Autumn Statement 2014. Borrowing in 2019–20 for each of the parties assumes that they achieve exactly a balance (rather than a surplus) on their chosen definition of borrowing in 2019–20. The Labour and Liberal Democrat figures assume that net investment in 2019–20 is 1.2% of national income (as was forecast by the OBR in its December 2014 Economic and Fiscal Outlook); the Liberal Democrat figure also assumes that there is £0.6 billion of cyclical borrowing in 2019–20 (again as was forecast by the OBR in its December 2014 Economic and Fiscal Outlook).

… and how fast?

Conditional on the overall size of the consolidation, there is then the question of how quickly it should be implemented. A faster consolidation means public sector net debt would fall slightly more quickly, although it also means that cuts to spending or increases in taxation would be concentrated over fewer years. While there is still some ambiguity over how quickly each party would achieve their target, all agree that they would achieve their target by the end of the next parliament at the latest, and ideally earlier.

4.2 A target for debt

An implicit or an explicit debt target?

All of the three parties have an explicit or an implicit target for debt to be falling as a share of national income in the next parliament. This would mean a lower share of future spending devoted to debt interest repayments and would leave the UK government with more flexibility if it had to respond to another large shock to the public finances or perhaps to the burden of an ageing population.

The Conservatives do not have an explicit target for debt (aside from the new supplementary target, which is to aim to have debt falling as a share of national income between 2015–16 and 2016–17). However, since they have a target for borrowing (i.e. an overall budget surplus), as long as national income is growing this will implicitly lead to debt falling as a share of national income. In contrast, both Labour and the Liberal Democrats have an explicit target to reduce debt as a share of national income.[17]

How far and how fast?

The parties agree that they would all like debt to start falling as a share of national income in the next parliament. Where they differ is on how quickly it should fall. In the short term, there is not much of a difference between the alternative rules.

If borrowing was as currently forecast up to 2016–17, but thereafter was 1.2% of national income (equivalent to constant investment spending as a share of national income and a current budget balance), by 2019–20 debt could be 3.9% of national income higher than under coalition policy.[18] This is not a negligible difference, but it is not huge in the context of debt of more than 80% of national income this year.

If, however, these different policies were to persist, then in the long run there would be a much more significant difference. For example, suppose the public finances evolved as the OBR forecasts up to 2019–20 and then over the subsequent decade the government ran a budget balance. Compared with an ongoing deficit of 1.2% of national income, this would lead to public sector net debt almost 9% of national income lower.

The faster reduction in public sector debt comes at the cost of lower public spending relative to revenues. However, lower debt might give greater room for manoeuvre if there is a future shock, and it also implies lower debt interest spending, leaving a greater proportion of revenues to be allocated to (for example) public services.

This latter point could be important given the future pressures on public spending implied by an ageing population. As people live for longer, there will likely be an increased demand for public spending on health, social care and pensions. The OBR in July 2014 estimated that in 50 years' time, this could add up to extra spending of as much as 4.8% of national income (£91 billion in 2015–16 terms).[19]

5. What have the three main parties told us about how they would achieve their fiscal targets?

Meeting the current coalition government's desired levels of borrowing – or the targets announced by the three main UK parties – would require spending cuts or tax increases that have not yet been specified.

Current government plans

The latest official forecasts show borrowing falling from 5.0% of national income in 2014–15 to a surplus of 1.0% of national income in 2019–20. However, only 1.7

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[17] An explicit target might be considered more transparent given that the sustainability of the public finances is largely a function of the path of *debt*. However, an explicit debt target is difficult to adjust for the cycle, and the appropriate time frame to restore debt to a 'reasonable' level might be well beyond a policy-relevant time frame.

[18] This illustrative example assumes that the extra borrowing has no effect – either positive or negative – on growth.

[19] Office for Budget Responsibility, *Fiscal Sustainability Report: July 2014* (https://www.gov.uk/government/publications/charter-for-budget-responsibility-autumn-statement-2014-update).

percentage points of the reduction is expected to be as a result of underlying improvements in the public finances. The rest is as a result of policy action, amounting to a fiscal tightening of 4.3% of national income.

Table 5.1 summarises the composition of the extra tightening beyond 2014–15 implied by the coalition's plans. A small proportion is expected to come from tax increases (0.2% of national income) and a slightly larger proportion from cuts to social security spending (0.6% of national income). The remaining borrowing reduction is implicitly set to be delivered through cuts to current spending on public services (3.2% of national income) and cuts to investment spending (0.2% of national income), as well as some savings due to a lower burden of debt interest payments as a direct result of reducing borrowing (1.2% of national income).

Table 5.1. Implied and specified fiscal tightening by the coalition

	% of national income	
Total implied	5.3	
Of which:		
Already announced		
Tax	0.2	Includes all tax changes that generate extra revenue between 2014–15 and 2019–20. Includes, for example, the increase in National Insurance contributions associated with ending contracting out.
Benefits	0.6	Includes savings from announced government policies – for example, savings from the replacement of disability living allowance with personal independence payments and further savings from the change in benefits uprating from the RPI to the CPI.[a]
Debt interest	1.2	Estimated savings between 2014–15 and 2019–20 from paying lower debt interest payments.
Investment	0.1	Announced savings from cuts to investment spending up to 2015–16.
Other current spending	0.5	Departmental budget allocations announced up to 2015–16 are expected to result in a reduction of 0.5% of GDP in 'other current spending'.
Unspecified		
Current spending	2.7	This unspecified consolidation comes from cuts to 'other current spending' expected to come between 2015–16 and 2019–20.
Investment	0.1	Implicit savings from the government's policy assumption that investment spending will fall as a share of GDP up to 2017–18. Beyond 2015–16, these cuts have not been allocated.

[a] Note that this does *not* include the £12 billion of cuts to social security spending that George Osborne has announced he would try to deliver if he were in office after the next election or any other policy aspirations stated by politicians but not yet legislated for (see https://www.gov.uk/government/speeches/new-year-economy-speech-by-the-chancellor-of-the-exchequer). (One exception is the triple lock for the state pension, which is not actually in legislation but is incorporated in the OBR's official fiscal forecasts and thus in the 'government announced plans' that we show here.)
Source: Authors' calculations based on past Budget and Autumn Statement documents.

Part of the cut to spending on public services has been set out in detail: the coalition government has set out spending plans for all central government departments for 2015–16, and is expecting this to deliver a fiscal tightening of 0.6% of national income (0.1% of national income from investment and 0.5% of national income from current spending). To date, government departments have, in aggregate, been successful in keeping to their spending limits, with actual spending tending to come in slightly below the total allocation.

In contrast, the further cuts to investment and other current spending implied from 2016–17 onwards (totalling 2.8% of national income) have not been set out in detail. They are shown as the 'unspecified' components in Table 5.1. If implemented, these cuts would represent a huge cut to public services spending. Given OBR forecasts for non-departmental spending, it would require a cut to departments' budgets of 14.1% relative to economy-wide inflation over the four years from 2015–16 to 2019–20. Protecting the budgets of the NHS, schools and official development assistance (ODA) from cuts over this period would imply cuts to 'unprotected' departments averaging 26.3% over these four years.[20] This would come on top of a cut of 9.5% across all departments over the five years from 2010–11 to 2015–16 (and of 19.9% across 'unprotected' departments).

The overall fiscal tightening planned by the coalition government and the composition of what has been announced so far are shown in the left-hand two bars in Figure 5.1. The 'unspecified' element of the planned consolidation is what will have to be found from public service spending (current and investment spending), in the absence of any further announcements from the coalition government of tax increases or cuts to social security spending.

The parties' plans

The three main UK parties' fiscal targets would all allow for the consolidation to be somewhat smaller than is set out in the latest official government forecasts. However, none of the parties could expect to meet its stated targets for reducing borrowing and debt and avoid further austerity entirely. The relative size of the implied minimum consolidation required to adhere to each of the parties' fiscal targets is shown in Figure 5.1.

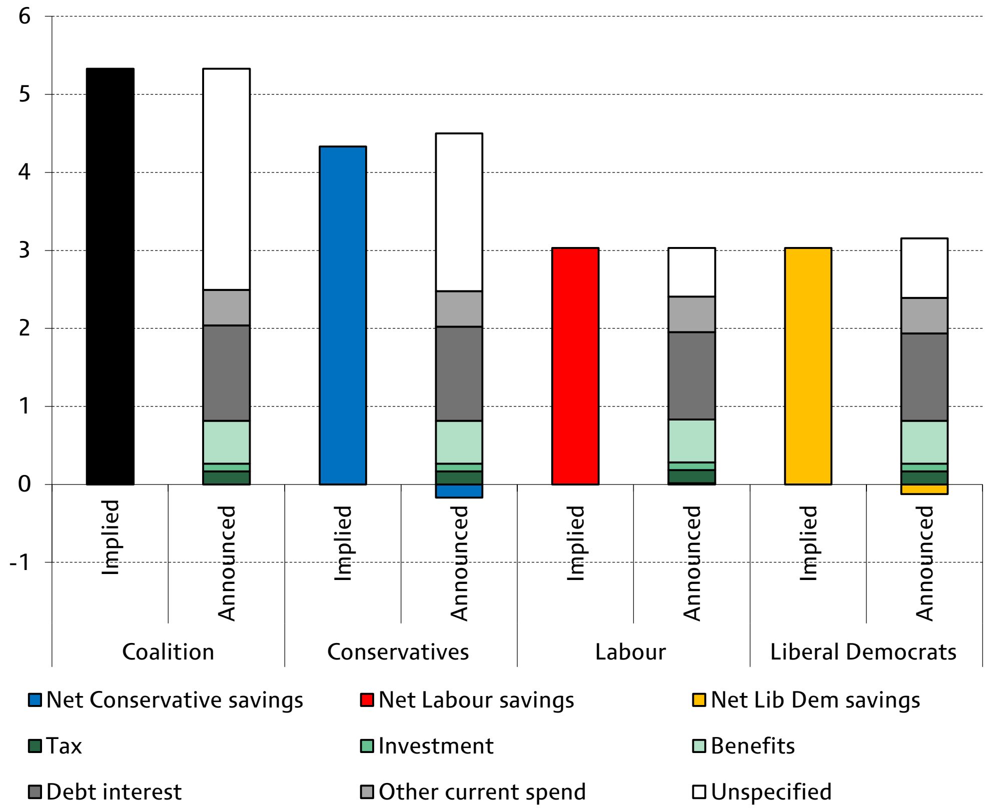
The fiscal rules suggested by Labour and the Liberal Democrats are significantly looser than current government policy. Assuming that they would both keep to coalition plans to spend 1.2% of national income on investment in 2019–20, their rules would allow them to borrow around 2.3% of national income more than current government policy. In other words, Labour and the Liberal Democrats might need to achieve a fiscal consolidation of 3.0% of national income over the next parliament (i.e. the 5.3% of national income implied by the coalition's forecasts, less the 2.3% of national income current budget surplus currently forecast for 2019–20 under the coalition plans). This is

[20] All three of these areas have had their budgets 'protected' over the current parliament. All of the three main parties have suggested that they would continue to protect the NHS and ODA in the next parliament as well. The Liberal Democrats have suggested that they would also seek to protect schools spending, and Labour has hinted that it might (see, for example, http://www.theguardian.com/education/2014/dec/15/tories-will-slash-school-spending-liberal-democrats-claim). Therefore, in this briefing note, we group together all three of these spending areas as 'protected' and class the other areas as 'unprotected'.

shown as the 'implied' fiscal tightening for Labour and the Liberal Democrats in Figure 5.1.[21]

The Conservatives' rule requires a larger tightening than Labour's or the Liberal Democrats', but still not as large as the tightening implied by coalition policy. If the Conservatives wanted just to achieve budget balance in 2019–20, they would need to implement a fiscal consolidation worth 4.3% of national income over the next parliament (i.e. the 5.3% of national income tightening implied by the coalition's forecasts less the 1.0% of national income overall budget surplus forecast for 2019–20). This is shown as the 'implied' fiscal tightening for the Conservatives in Figure 5.1.

Figure 5.1. Implied and announced fiscal tightening by the three parties (% of GDP)



Note: Assumes that Labour and the Liberal Democrats achieve cyclically-adjusted current budget balance and the Conservatives achieve exact overall budget balance in 2019–20. Underlying figures are provided in Table A.1 in the appendix.
Source: Authors' calculations based on party announcements and Budgets and Autumn Statements since 2008.

All three parties seem to be committed to delivering most of the changes to tax policy and welfare spending that have already been announced by the current government. These include plans to increase revenue from National Insurance contributions in April 2016 (by ending contracting out for defined benefit pension arrangements) and to replace disability living allowance with personal independence payments. The three parties have

[21] Of course, Labour or the Liberal Democrats could choose to spend more on investment in 2019–20, at the cost of higher borrowing, without breaking their fiscal rules. This would reduce the implied fiscal tightening compared with that shown in Figure 5.1 (but not the implied cuts to current spending by departments).

also all committed to delivering the public service spending plans set out for 2015–16, which imply a real cut to departmental expenditure limits of 0.9% in that year.[22]

Together these policies amount to a fiscal tightening of 1.3% of national income and, if delivered, would help all of the parties to achieve the fiscal tightening they require. These are shown under 'announced' policies for each of the parties in Figure 5.1.

By implementing any consolidation, and therefore reducing borrowing, each of the parties also benefits from lower debt interest spending. However, as each of the parties would borrow more over this period than under current government plans (assuming they each borrow as much as their fiscal targets would allow), the debt interest savings would be slightly smaller than under current government policy. Our illustrative assumptions about how Labour and the Liberal Democrats would meet their fiscal targets suggest they may save 0.10% of national income less from debt interest spending than would be the case under current government policy (in other words, they may be spending £2.0 billion more (in 2015–16 terms) on debt interest in 2019–20). Similarly, our illustrative projections for borrowing under the Conservatives, consistent with their fiscal rule, suggest that they may save 0.02% of national income less from debt interest spending than would be the case under current government policy (in other words, they may be spending £0.3 billion more (in 2015–16 terms) on debt interest in 2019–20).[23] Again, the debt interest savings for each party are shown in Figure 5.1.

After taking into account the future fiscal consolidation from all these sources, each of the parties is still left with a further unspecified fiscal tightening. Under coalition plans, unallocated cuts are implicitly all to come from further cuts to investment and current public service spending beyond 2015–16. For each of the political parties, the unspecified future tightening is even less certain, in the sense that the parties are likely to differ in terms of how much of the further tightening they would achieve through cuts to public service spending as opposed to cuts to social security spending or tax increases.

All the parties have started to set out what policies they would implement after the election, if elected. Table 5.2 lists each of the parties' major policy announcements so far. This is not intended to be an exhaustive list, but rather to be illustrative of each party's fiscal position, based on *specific policies* that they have outlined so far and the costings that each of the parties has produced for its own policies.[24] Based on these costings, we have shown the net effect of the measures on borrowing, labelled as 'Unspecified', in Figure 5.1.

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[22] More accurately, Labour has said that it would deliver the same level of current spending on public services in that year. It has not explicitly committed to the investment spending plans for that year. However, for simplicity and in the absence of any firm commitment to an alternative level of spending, we assume here that Labour would deliver the same current and investment spending plans in 2015–16 as set out by the coalition government.

[23] Specifically, we assume that the profile of borrowing under the Conservatives would be as forecast by the OBR under current coalition government policy up to 2018–19, but then equal to zero in 2019–20. We assume that the profile of borrowing under Labour and the Liberal Democrats would be the same as forecast by the OBR under current coalition government policy up to 2016–17, but between 2017–18 and 2019–20 we assume a cyclically-adjusted current budget balance (which implies headline borrowing of 1.4% in 2017–18, 1.3% in 2018–19 and 1.2% in 2019–20). We assume that the interest rate payable on the additional borrowing is given by the gilt rate as forecast by the OBR in the 2014 Economic and Fiscal Outlook.

[24] In particular, we do not update costings where clearly circumstances have changed since the figures were first announced. The numbers are intended to be illustrative, rather than the much more precise analysis that we will do once the parties' manifestos have been published in the run-up to the election.

Table 5.2. Major specific policies announced by Labour, the Conservatives and the Liberal Democrats

Party	Policies announced that affect revenues/spending in 2019–20
Conservatives	• Raise the higher-rate threshold to £50,000 by 2020–21 • Raise the personal allowance to £12,500 by 2020–21 • Freeze working-age benefits for two years (excluding pensioner benefits and disability benefits) • Reduce the benefits cap to £23,000 per year from £26,000 • Withdraw housing benefit from young people • New apprenticeships
Labour	• Reverse the under-occupancy penalty (‘bedroom tax’/‘spare room subsidy’) • End the ‘shares for rights’ scheme • Reintroduce the Schedule 19 stamp duty reserve tax • Increase the top rate of income tax from 45p to 50p • Withdraw the winter fuel payment from higher-rate income tax payers • Increase child benefit by 1% in 2016–17 (below inflation) • Compulsory jobs guarantee, paid for by a one-off bankers’ tax and restricting pension contribution relief to a maximum of 20% for those with an income of over £150,000 • Cut business rates, funded by a reversal of the government’s plans for a cut in the main rate of corporation tax • Introduce a mansion tax on homes worth more than £2 million • Increase spending on the NHS • Abolish the married couple’s tax allowance • Introduce a 10p starting rate of income tax • Impose a windfall tobacco tax (one-off, so no effect in 2019–20) • Extend free childcare extension to 25 hours a week • Increase the bank levy
Liberal Democrats	• Introduce a mansion tax on homes worth more than £2 million • Increase the personal allowance to £12,500 by 2020–21 • Increase capital gains tax • £250 bonus for anyone receiving the carer’s allowance/premium for a continuous 12 months • Offer free childcare for all 2-year-olds, paid for by abolishing the married couple’s tax allowance • Two-thirds discount on bus travel for 16- to 21-year-olds • Abolish free TV licences and winter fuel payments for higher-rate taxpaying pensioners • Extra £1 billion of spending on the NHS • Limit the lifetime pensions tax allowance to £1 million • Raise the dividend tax rate for higher-rate taxpayers • End the ‘shares for rights’ scheme

The Conservatives have announced an aspiration to cut spending on social security by a total of £12 billion (which we assume is in 2017–18 and is therefore equivalent to £11.1 billion in 2015–16 terms). However, in terms of specific measures, so far they have only announced a freeze on most working-age benefits and a reduction in the benefits cap, which they estimated would together save around £3.0 billion (in 2015–16 terms). Until further details are announced of where the rest of the social security spending cuts will come from, we only include these £3.0 billion of social security cuts as 'announced' policy.[25] As things stand, this is more than offset by the estimated cost of the Conservatives' promise to increase the income tax personal allowance and higher-rate threshold, leaving the net impact of 'announced' Conservative policy as a small giveaway worth around 0.2% of national income.

The Liberal Democrats' policy announcements so far also amount to a net giveaway. Their pledge to increase the personal allowance to £12,500 by the end of the parliament costs more than they expect to raise from a mansion tax. Overall, their proposed policies amount to a small giveaway of around 0.1% of national income.

Of the main parties, Labour has perhaps been the most cautious of the three in that, at least on the basis of its own costings, it appears to have managed not to announce an overall net giveaway. Just looking at tax and social security spending policies, Labour has announced a small net takeaway of 0.1% of national income.

Taking this all together, the Conservatives have the largest gap between the fiscal tightening implied by their fiscal rule and the specific policies that they have announced so far. Their plans currently contain an unspecified 2.0% of national income fiscal consolidation. The Liberal Democrats have a 0.8% of national income unspecified consolidation, and Labour a 0.6% of national income unspecified consolidation. The next subsection discusses how these unspecified tightenings could be achieved through alternative combinations of tax increases, social security spending cuts and/or cuts to departmental spending.

Implications of the alternative fiscal rules

We turn now to consider the possible implications of the parties' fiscal consolidations for departmental spending beyond 2015–16. Specifically, we set out what real-terms cuts would be required to departmental spending in order to achieve the borrowing reduction required by each of the parties and by the government's current fiscal forecasts, and what size of additional tax increases and/or cuts to social security spending would be required to partially or fully negate the need for further departmental spending cuts.

Figure 5.2 illustrates the trade-offs faced by each party (and the current coalition government) between cutting departmental spending in real terms between 2015–16 and 2019–20 and instead cutting social security spending and/or increasing taxes, given its fiscal objective and assuming it borrows as much as this objective allows.

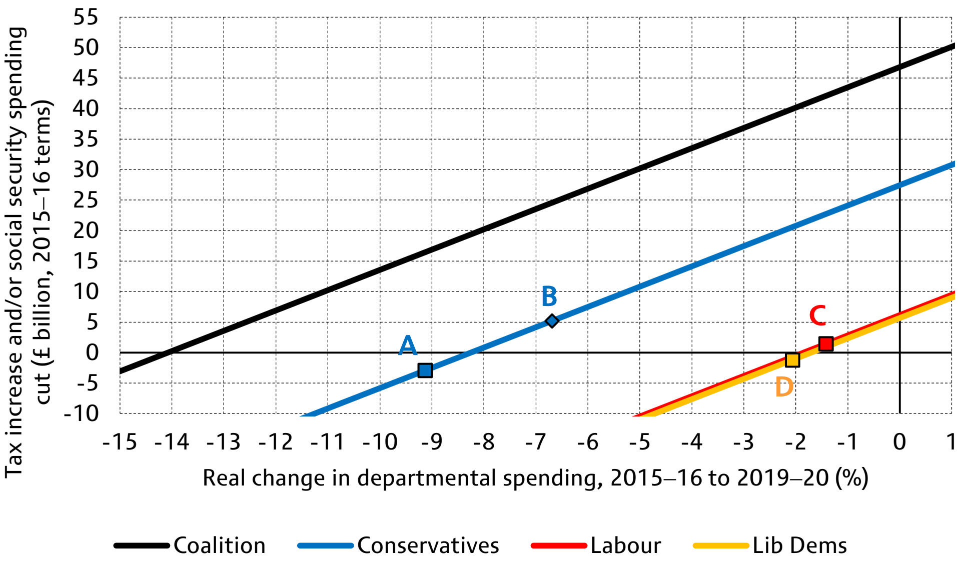
The 'Coalition' line shows the alternative combinations of departmental spending cuts and tax rises / social security spending cuts that would be possible given the coalition government's borrowing plans set out in the 2014 Autumn Statement. In the absence of

[25] Similarly, we are not including as 'announced' policy the Conservative Party's aspiration to raise £5 billion over the next parliament from anti-avoidance measures. These additional revenues are inherently uncertain – else they would presumably be factored into the current coalition government's forecasts. Furthermore, to the extent that such opportunities do prove to be available, we would presumably expect whichever party is in power after the election to seek to take advantage of them.

any further policy action (i.e. no net tax increase or cut to social security spending beyond what the government has already legislated), departmental spending would need to be cut by 14.1% in real terms between 2015–16 and 2019–20 (this corresponds to the point at which the coalition line crosses the horizontal axis). This would mean departmental spending being £51 billion lower (in 2015–16 prices) in 2019–20 than it is planned to be in 2015–16.[26]

If the coalition government wanted to meet its borrowing plans without cutting departmental spending at all in real terms beyond 2015–16, it would need to increase taxes or reduce social security spending by £47 billion (in 2015–16 terms).[27] This corresponds to the point at which the coalition line crosses the vertical axis. To give a sense of scale, this equates to around a 12p increase in the basic rate of income tax or a 9p increase in the main rate of VAT, or roughly a 50% reduction in spending on non-pensioner benefits.

Figure 5.2. Trade-off between tax increases and/or further benefit cuts and smaller cuts to departmental spending (assuming no change in borrowing)



The lines for each of the parties illustrate alternative combinations of departmental spending cuts and tax increases / welfare spending cuts, assuming that each party: (a) satisfies its fiscal rule precisely (i.e. gets its chosen measure of borrowing to exact balance, rather than achieving a surplus); (b) enjoys the reduction in debt interest spending associated with its fiscal consolidation (as shown in Figure 5.1); and (c) implements the overall level of fiscal consolidation planned for 2015–16 by coalition policy (the 'announced' components of benefits, tax, investment and other current spending described in Table 5.1 and shown by the green and grey bars in Figure 5.1).

[26] These figures for cuts to departmental spending and other similar figures cited in the text below are summarised in Table 5.3.

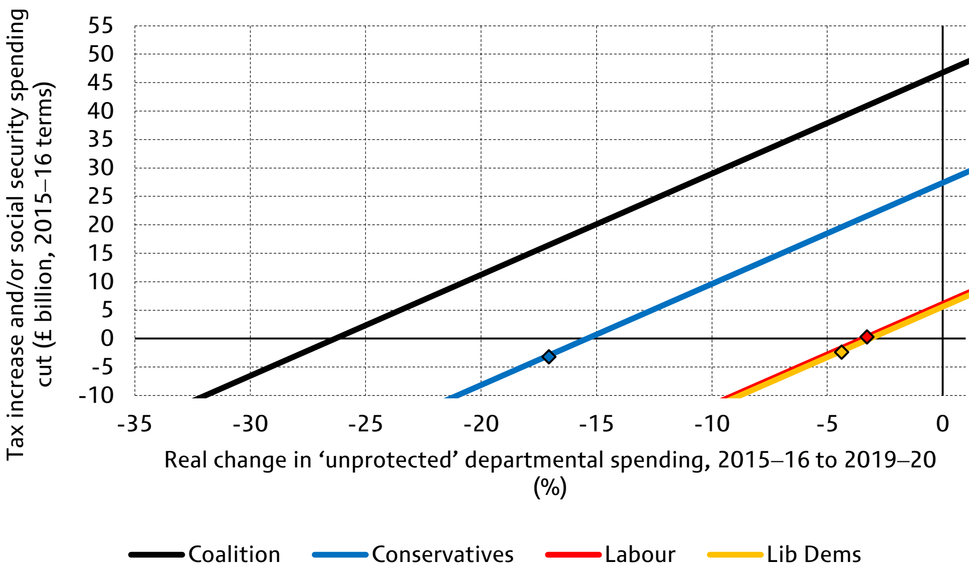
[27] Some readers might wonder why this figure (£47 billion) is not the same as the 'corresponding' figure for the real-terms cut to departmental spending referred to in the previous paragraph (£51 billion). The interested reader should refer to Box A.1 in the appendix.

The 'Conservatives' line illustrates that, in the absence of any new policies on tax or social security spending, their fiscal rule would imply that they would need to cut departmental spending by (at least) 8.3% in real terms between 2015–16 and 2019–20 (this corresponds to the point where the Conservatives line crosses the horizontal axis). Their tax and welfare spending policy announcements so far amount to a net giveaway of £2.9 billion in 2015–16 terms; this would therefore imply a slightly larger cut to departmental spending – of 9.1% (point A on the Conservatives line). However, if the Conservatives announce specific policies that do reduce welfare spending by a further £8.1 billion (thereby achieving their aspiration to reduce welfare spending by £12 billion, or £11.1 billion in 2015–16 terms), then departmental spending would need to be cut by a smaller 6.7% (point B on the Conservatives line).

The Labour Party has been explicit that it would reduce departmental spending each year until the current budget was balanced. The point at which the 'Labour' line in Figure 5.2 crosses the horizontal axis illustrates that, in the absence of any policy announcements on tax or welfare, Labour would need to cut departmental spending by 1.9% in real terms between 2015–16 and 2019–20 in order to achieve exactly a current budget balance in 2019–20. However, its announced tax and benefit policies so far suggest a net takeaway of £1.4 billion (2015–16 terms), which implies that a smaller cut to departmental spending of 1.4% is required (point C on the Labour line).

The fiscal tightening implied by the Liberal Democrats' fiscal rule would require a 1.7% real cut to departmental spending between 2015–16 and 2019–20 in the absence of any tax or benefit policies (other than those planned by the current coalition government). However, their announced tax and benefit policies so far suggest a net giveaway of £1.2 billion (2015–16 terms), which implies a larger cut would be required to departmental spending of 2.1% (point D on the Liberal Democrats line).

Figure 5.3. Trade-off between tax increases and/or further benefit cuts and cuts to departmental spending for 'unprotected' departments



Note: 'Unprotected' departments are defined as all areas excluding the NHS, schools and ODA. This figure assumes that the NHS and schools experience a real freeze in their budgets from 2015–16 to 2019–20 and that ODA spending grows in line with gross national income over this period.

Table 5.3. Summary of the implications for departmental spending

	% change in real terms		£ billion change (2015–16 prices)	
	2015–16 to 2019–20	2010–11 to 2019–20	2015–16 to 2019–20	2010–11 to 2019–20
Total departmental spending				
Coalition government	–14.1	–22.2	51.4	89.5
Conservatives (without policies)	–8.3	–16.9	30.1	68.3
Conservatives (with policies, point A on Fig. 5.2)	–9.1	–17.7	33.3	71.5
Labour (without policies)	–1.9	–11.2	6.8	44.9
Labour (with policies, point C on Fig. 5.2)	–1.4	–10.8	5.2	43.3
Lib Dems (without policies)	–1.7	–11.0	6.2	44.4
Lib Dems (with policies, point D on Fig. 5.2)	–2.1	–11.3	7.5	45.7
'Unprotected' departmental spending				
Coalition government	–26.3	–41.0	51.3	99.8
Conservatives (without policies)	–15.4	–32.3	30.0	78.6
Conservatives (with policies)	–17.1	–33.6	33.2	81.8
Labour (without policies)	–3.4	–22.7	6.7	55.3
Labour (with policies)	–3.3	–22.6	6.4	54.9
Lib Dems (without policies)	–3.2	–22.5	6.1	54.7
Lib Dems (with policies)	–4.4	–23.5	8.5	57.1

Note: 'Unprotected' departments are defined as all areas excluding the NHS, schools and ODA. This table assumes that the NHS and schools experience a real freeze in their budgets from 2015–16 to 2019–20 and that ODA spending grows in line with gross national income over this period. Between 2010–11 and 2014–15, total departmental spending has been cut by 8.6% in real terms and the budgets of 'unprotected' departments by 17.6%. The equivalent figures for the period 2010–11 to 2015–16 are 9.5% and 19.9%.

Figure 5.2 showed the picture for total departmental spending. However, arguably this is not the key trade-off that each party faces. The parties appear to have reached a consensus that the NHS, official development assistance (ODA) and potentially schools should be protected from cuts after the next election, as they have been throughout this parliament.

Protecting such large areas of departmental spending would deepen the implied cuts to other departments. Over this parliament (from 2010–11 to 2014–15), departmental budgets have been cut on average by 8.6% in real terms. However, protection for the NHS, schools and ODA mean that other, 'unprotected' departments have seen a cut of 17.6%. Over the five years from 2010–11 to 2015–16, the cut to departmental budgets is planned to be an average of 9.5% but the cut to the 'unprotected' departments is expected to average 19.9%. Over the next parliament, protection for the NHS, schools and ODA would make a huge difference for the cuts implied to 'unprotected' areas.

Figure 5.3 shows a trade-off graph equivalent to Figure 5.2, but just for 'unprotected' departments, defined as total departmental spending less spending on ODA, the NHS and schools. This figure assumes that the NHS and schools experience a real-terms freeze in spending from 2015–16 onwards and that ODA spending continues to be increased in line with national income. The coalition's plans would, on this basis, imply cuts to unprotected departments of 26.3% between 2015–16 and 2019–20, bringing the cumulative cut since the start of this parliament to 41.0%. The cumulative cut after 2015–16 could be reduced to 15.4% if all of the extra spending allowed by the Conservatives' fiscal rule were spent on unprotected departments, or to 3.4% making the same assumption for Labour, or to 3.2% for the Liberal Democrats.

Taking into account the parties' announced specific policies, this would change to 17.1% under the Conservatives, 3.3% under Labour or 4.4% under the Liberal Democrats (on top of the 19.9% cut to unprotected departments over the five years from 2010–11 to 2015–16).

Table 5.3 summarises the implications for cuts to (overall and unprotected) departmental spending discussed in the text and provides some additional figures.

6. Conclusion

The current government set out plans in the 2014 Autumn Statement to achieve an overall budget surplus of 1.0% of national income by 2019–20. Somewhat unusually, this policy entails a tighter fiscal position in the medium term than is required by the government's newly-stated fiscal mandate, and it is also tighter than is strictly required by any of the three main UK parties' proposed fiscal objectives. Therefore, as we approach the general election, all of the three main parties are in a position where they could announce a net loosening relative to the coalition government's plans and still be on course to meet their fiscal targets. Whoever forms the next government may, of course, wish to build some room for error into their plans and thus choose to aim to overachieve their targets. However, so far none of the three parties has been explicit about how much caution it would want to incorporate in its plans.

Although the coalition government has set out an intention to achieve an overall budget surplus by 2019–20, it has not provided full details of how this would be brought about. Between 2014–15 and 2019–20, the government's objective to reduce borrowing requires active policy measures that will increase tax revenues and/or cut spending by 5.3% of national income. So far, it has only set out detailed plans for delivering just under half of this. In the absence of explicit measures to increase taxes or reduce social security spending, the remaining cut to borrowing would have to be found from further cuts to public services beyond 2015–16. This would require departmental spending being 14.1% lower in real terms in 2019–20 than it is planned to be in 2015–16. Adding this on to the cuts to departmental spending already planned between 2010–11 and 2015–16 would bring the overall cut to departments' budgets over the nine years up to 22.2% (which includes a 41.0% cut on average to spending other than on the NHS, schools and official development assistance).

This means that, while each of the three main UK parties could loosen fiscal policy relative to the current government's 'plan', this simply reduces the amount of 'unspecified' action they would need to take, rather than giving them room to announce new net giveaways in the run-up to (or after) the general election.

Of the three main parties, the Conservatives have set out the tightest objective for medium-term fiscal policy – they have said they would aim to achieve an overall budget balance by the end of the parliament. If they aimed just to meet their target, they would need a fiscal tightening in the next parliament that was 1.0% of national income smaller than required by the current government's plan. If they implemented all the tax and social security changes legislated by the current government, and stuck to the departmental spending plans set out for 2015–16 but implemented no other tax or benefit measures, this would imply a cut to departmental spending between 2015–16 and 2019–20 of 8.3% in real terms.

Labour and the Liberal Democrats have proposed targets for borrowing that are very similar to one another and to the current government's (recently-revised) fiscal mandate. If they wanted to aim just to achieve their targets (and stuck to the current government's plan to invest 1.2% of national income), Labour and the Liberal Democrats could borrow 2.3% of national income more in 2019–20 than currently planned by the government. Assuming, again, that they implemented all policies currently detailed by the government but no further tax rises or social security spending cuts, Labour and the Liberal Democrats would need to reduce departmental spending by just under 2% in real terms.

These implied cuts to departmental spending could be reduced if the parties chose instead to increase taxes or cut spending on social security. While some politicians have talked about doing one or other of these things, the specific policy proposals that have so far been put forward by each of the three main parties do little to ease the implied pressure on departmental budgets. The set of policies that Labour has explicitly talked about amount (according to its costings) to a roughly revenue-neutral package – that is, giveaways in some areas offset by roughly equal-sized takeaways elsewhere. Meanwhile, the sets of policies explicitly announced by the Conservatives and the Liberal Democrats actually amount to net giveaways. As we get closer to the election, each of the parties should give the voting public more detail on exactly what its plans are: how and how much spending on social security will be reduced, where and by how much taxes will be raised, and how much further public service spending will be cut.

The spending cuts required by Labour and the Liberal Democrats to achieve their stated borrowing targets would be significantly smaller than those required by the Conservatives. But this would obviously come at the cost of government debt remaining higher for longer. This would have two costs: more public spending would have to be devoted to making interest payments on debt, and the UK would be less well placed to absorb any future large shocks that pushed up public debt, as the financial crisis did in 2008.

The choice between higher spending with higher debt and lower spending with lower debt may be one of the key dividing lines in the election between Labour and the Liberal Democrats on the one hand and the Conservatives on the other. It is therefore incumbent on each of the parties to provide the electorate with more detail of why they are advocating a particular stance, how they will achieve the required borrowing reductions, and what their objectives really mean for the quality and quantity of public services and the ability of the UK's public finances to deal with future pressures.

Appendix

Table A.1. Implied and announced fiscal tightening by the three parties (% of GDP)

	Coalition	Conservatives	Labour	Liberal Democrats
Implied	5.3	4.3	3.0	3.0
Announced	2.5	2.3	2.4	2.3
Of which:				
Tax	0.2	0.2	0.2	0.2
Investment	0.1	0.1	0.1	0.1
Benefits	0.6	0.6	0.6	0.6
Debt interest	1.2	1.2	1.1	1.1
Other current spending	0.5	0.5	0.5	0.5
Net policy proposals	–	–0.2	0.0	–0.1
Unspecified	2.8	2.0	0.6	0.8

Note: 'Implied' fiscal tightening describes fiscal tightening as a share of national income between 2014–15 and 2019–20. We assume a baseline where each party carries out the tax rises and benefit cuts in the next parliament that have already been announced by the coalition government. Where a party has committed to reversing a particular tax or benefit policy, this is included in the net effects of policy proposals. The savings from debt interest are calculated factoring in the higher debt interest spending if each party chose to borrow the maximum amount for non-investment spending implied by its fiscal rule, plus 1.2% of national income for investment spending. Announced cuts to 'other current spending' only include the cuts between 2014–15 and 2015–16. Beyond that, we do not make an assumption about how the government expects to allocate any further cuts implied by its fiscal target.

Box A.1. Explaining 'inconsistencies' in £ billion figures

Figure 5.1 shows that under current coalition government plans, a further 2.8% of national income fiscal tightening is required after 2015–16 in order for borrowing to turn out as forecast. This equates to £54 billion in 2015–16 terms (since national income in 2015–16 is forecast to be £1,888 billion). In the absence of further tax increases or cuts to welfare spending, all this additional tightening would have to come from cuts to departmental spending. Figure 5.2 shows that this would imply departmental spending being 14.1% lower in real terms in 2019–20 than it is planned to be in 2015–16. In 2015–16, departmental spending is planned to be £365 billion (in 2015–16 prices); a 14.1% reduction would therefore equate to a real cut to departmental spending of £51 billion. But why is £51 billion not the same as the £54 billion figure above? And why does Figure 5.2 suggest that the coalition government could avoid any further real cuts to departmental budgets if it could find £47 billion of tax increases or welfare cuts – why is it not £51 billion?

There are two reasons for these apparent inconsistencies.

1) 'Prices' versus 'terms'

The real cut to departmental spending of £51 billion is expressed in 2015–16 *prices*, and is calculated by adjusting for inflation between 2015–16 and 2019–20. However, when we express figures in 2015–16 *terms*, we also adjust for the growth in real national income between 2015–16 and 2019–20. Since this is typically positive, the cut in 2015–16 *terms* is lower than the cut in 2015–16 *prices*. For example, between 2015–16 and 2019–20, national income is forecast to grow by 9.7% in real terms, and so the real cut to departmental spending expressed in 2015–16 terms is £47 billion (= £51bn/(1.097)).

The reason for thinking about things in a given year's 'terms' rather than 'prices' is so that we can more easily present trade-offs between spending cuts and tax increases. Many tax policies would be likely to raise an increasing amount in real terms each year as national income increases. By expressing the spending cuts in 2015–16 *terms*, we can compare them with tax rises that would raise a given amount in 2015–16, rather than expressing the spending cuts in 2015–16 *prices* and having to calculate how much the tax rises would raise in 2019–20 and converting that back into 2015–16 prices.

2) Getting the right 'counterfactual'

The fiscal consolidation required by 2019–20 that is described in Figure 5.1 is measured not relative to the public finances in 2015–16, but relative to what the public finances *would have looked like* in 2019–20 in the absence of any policy change. The underlying assumption in constructing this counterfactual is that total public spending would have increased in line with (trend) national income between 2015–16 and 2019–20 in the absence of any policy change. Adjusting the latest OBR forecast for non-departmental spending to account for policy announcements (using official estimates of the impact of these policy changes) suggests that non-departmental spending would have grown by 17.3% in real terms between 2015–16 and 2019–20 in the absence of policy change. That implies that departmental spending (which is the difference between total spending and non-departmental spending) would have grown by 1.7% in real terms over these four years *in the absence of any policy changes*.

Freezing departmental spending between 2015–16 and 2019–20 would therefore count as a cut relative to this 'no policy change' scenario, amounting to 0.4% of national income (£7 billion in 2015–16 terms), even though there is no real terms cut to departmental spending over the period.

The real cut to departmental spending of £47 billion (in 2015–16 terms), combined with this cut relative to the 'no policy change' baseline (of £7 billion in 2015–16 terms) gives the total £54 billion fiscal tightening (in 2015–16 terms) that would be achieved if all of the extra fiscal consolidation came from cuts to departmental spending.