



HM Treasury

Restructuring Fiscal Spending for New Priorities – The UK Experience

Conrad Smewing



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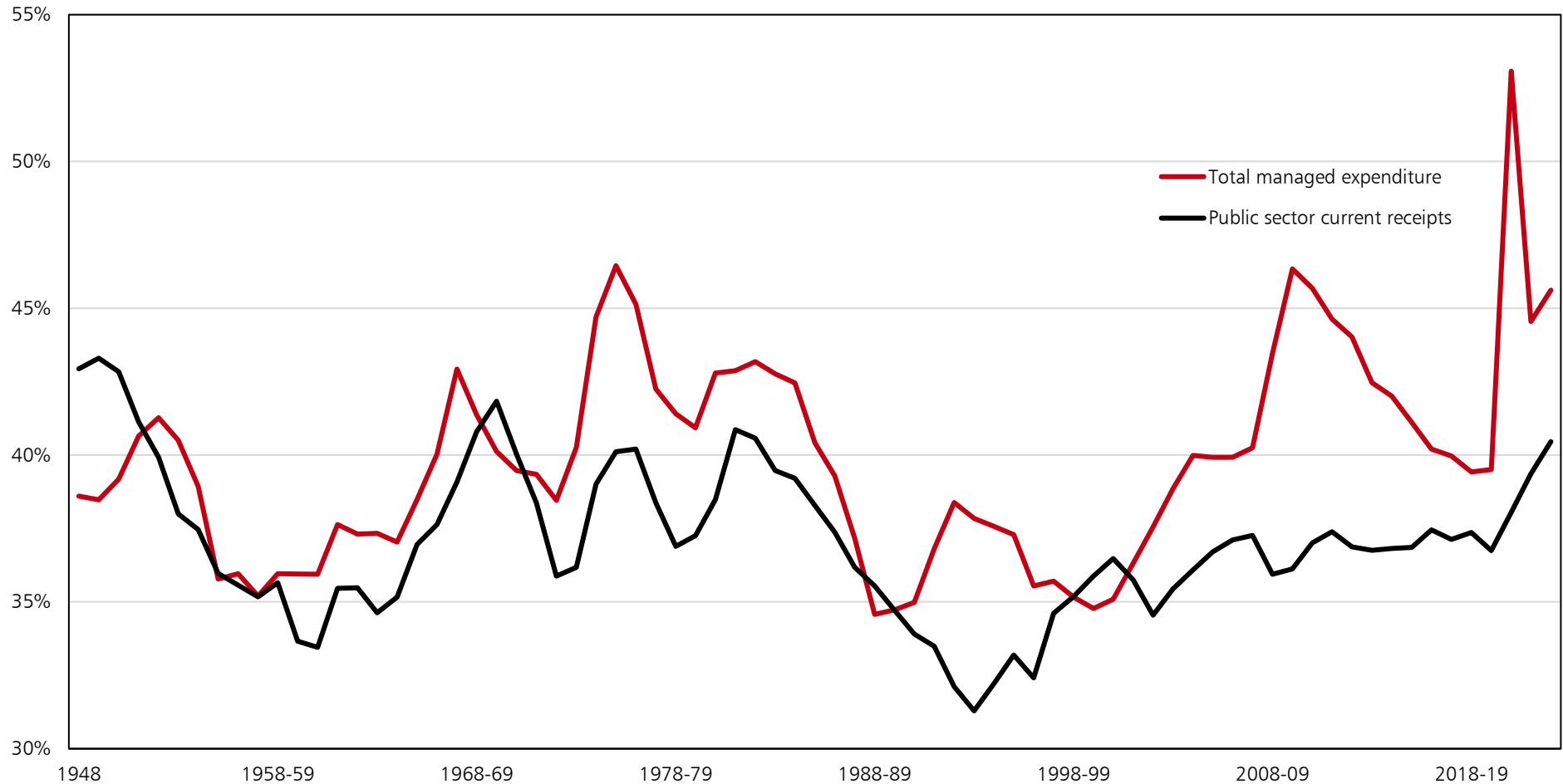
Evolution of UK Public Spending

Shifting priorities in UK public spending

- UK public spending has risen as a share of GDP over the long term.
- Within that, there have been significant shifts in public spending priorities driven by long term trends in demands on the state.
- But there has also been significant volatility in response to shocks, e.g.:
 - 2008 financial crisis
 - COVID pandemic
 - Energy price shocks

UK public spending has fluctuated as a share of the economy since WW2; with a clear upward trend since the 1990s.

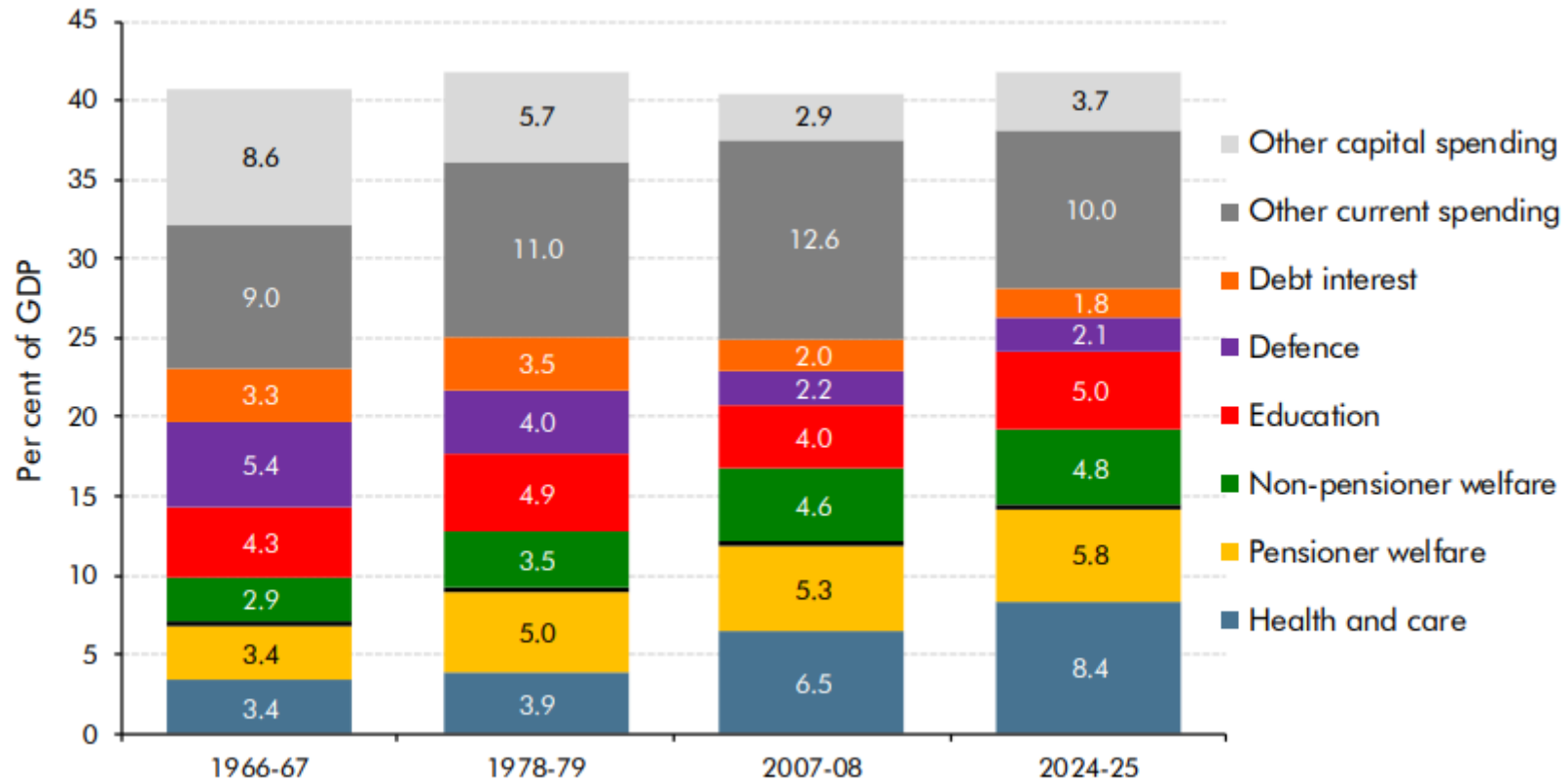
UK Total Managed Expenditure & Public Sector Current Receipts, as a % of GDP



Source: OBR

Spending on social security and health have grown steadily over time, while defence spending and debt interest have fallen

Key components of public spending over time (% GDP)

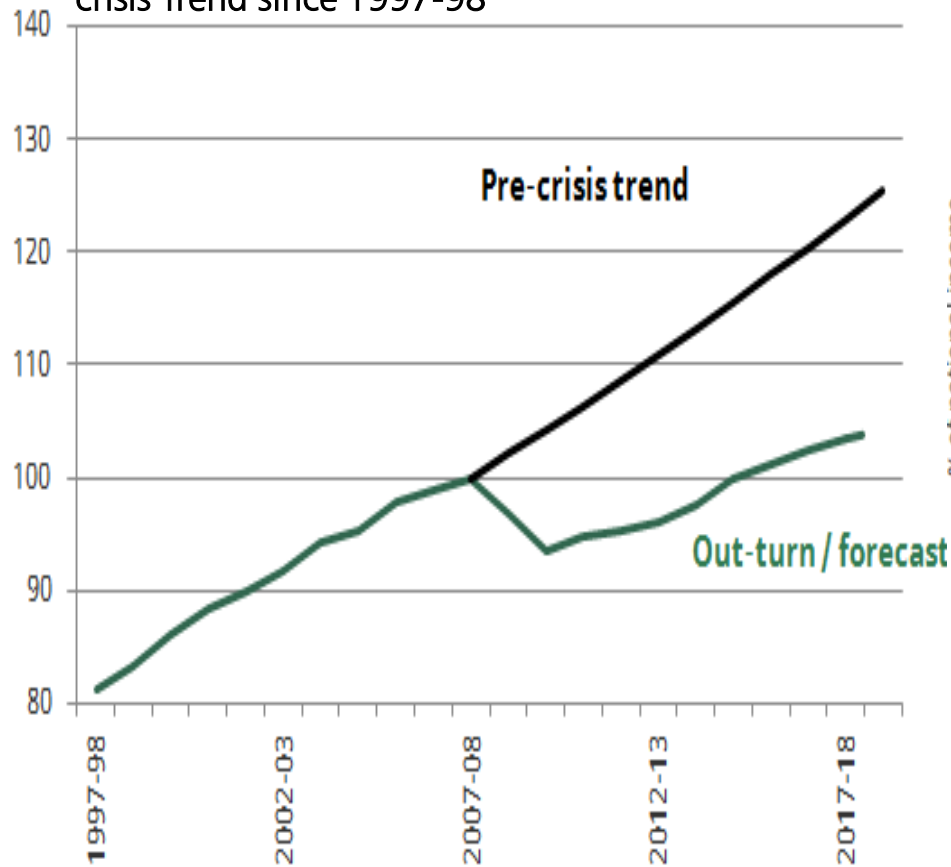


Source: Bank of England, DHSC, DWP, HMT, IFS, OBR

Source: OBR 2021
 * 2024-25 based on 2021 projections

The long-term trend masks significant more rapid shifts in response to shocks, e.g. the 2008 financial crisis...

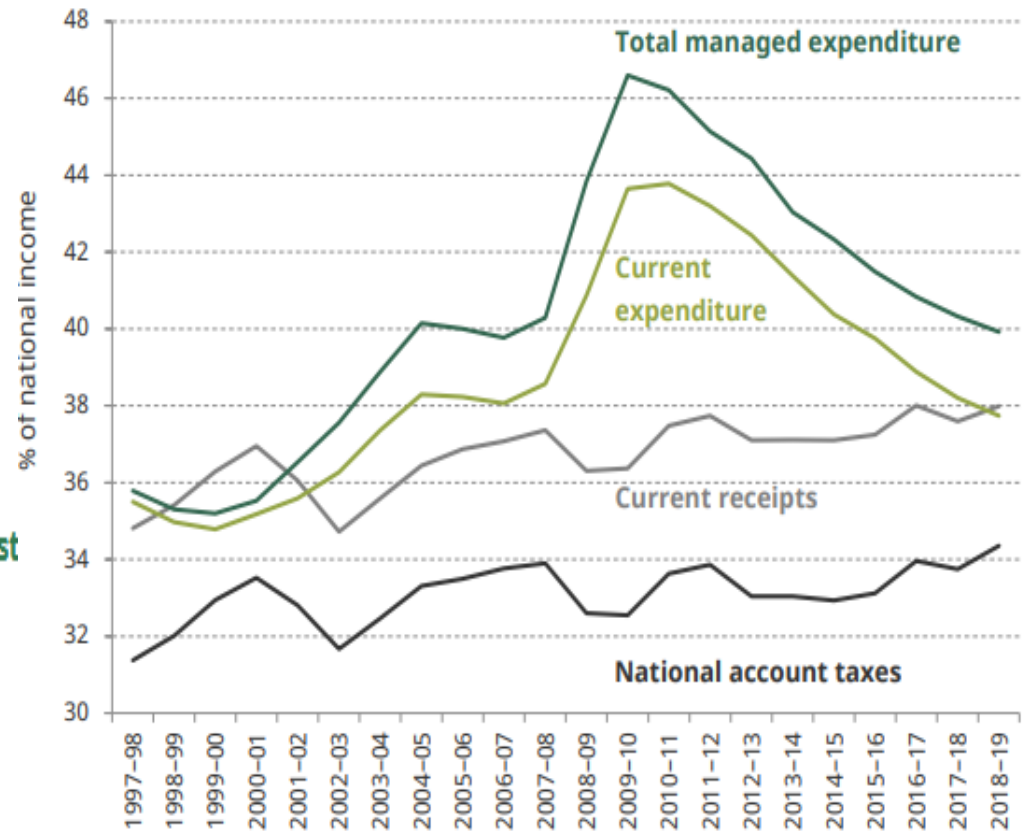
Real GDP per Capita – Outturn and pre-crisis Trend since 1997-98



Index: 2007-08=100

Source: IFS (2018)

Expenditure and receipts since 1997-8

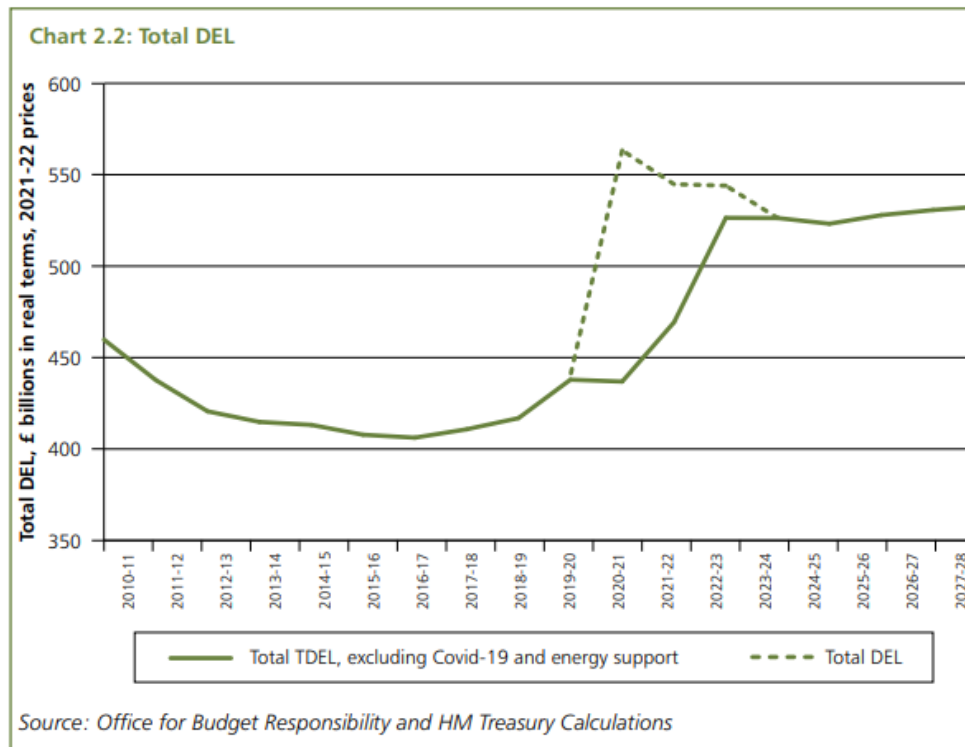


Source: IFS (2019)

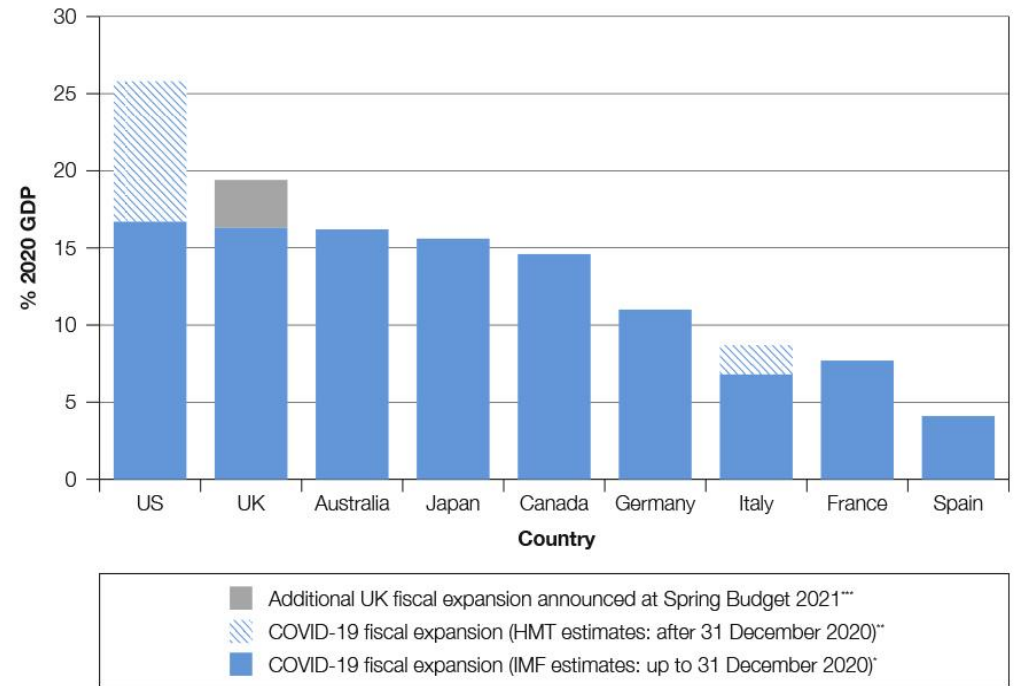


...the Covid pandemic...

Total DEL



Estimates of discretionary fiscal expansion announced in 2020 and 2021

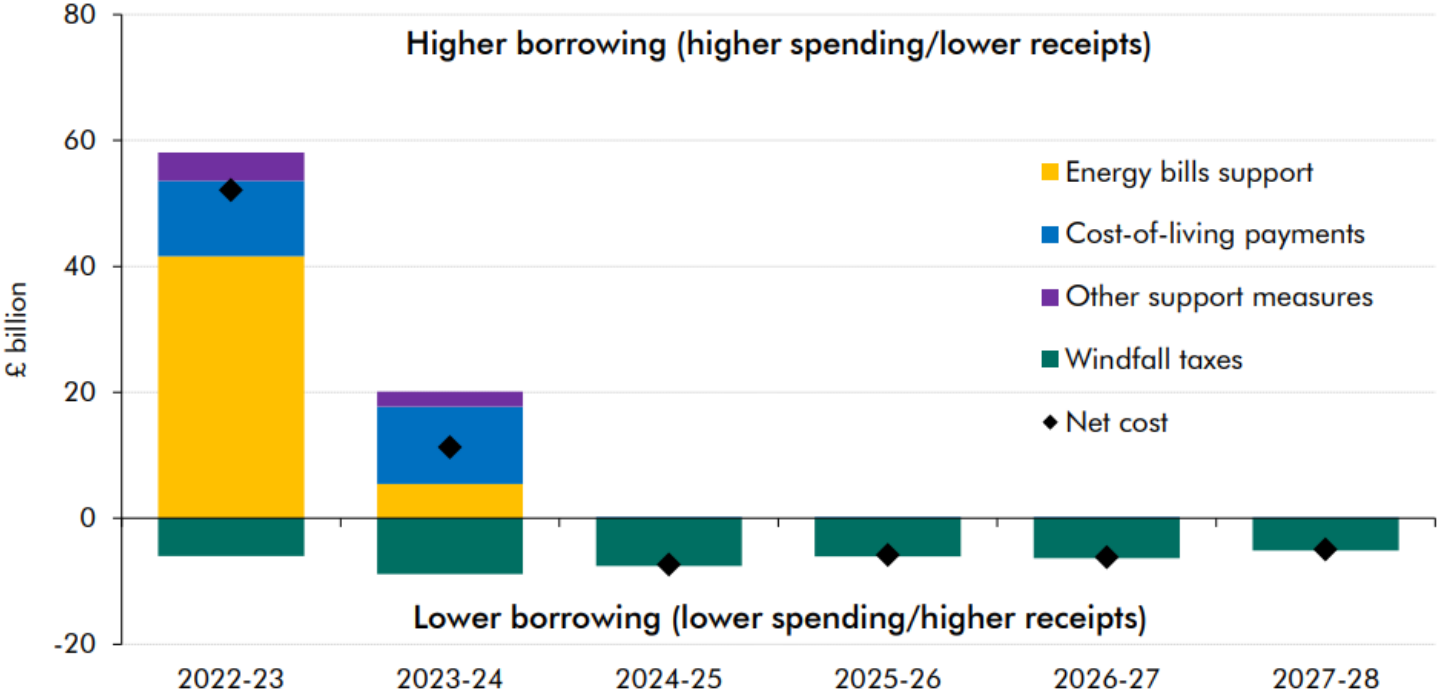


Source: HMT Spring Budget 2023

Source: HMT Spring Budget 2021

...and the energy shock following Russia's invasion of Ukraine

Chart 3.4: The Government's fiscal response to higher energy prices



Source: OBR

Source: OBR (2023)



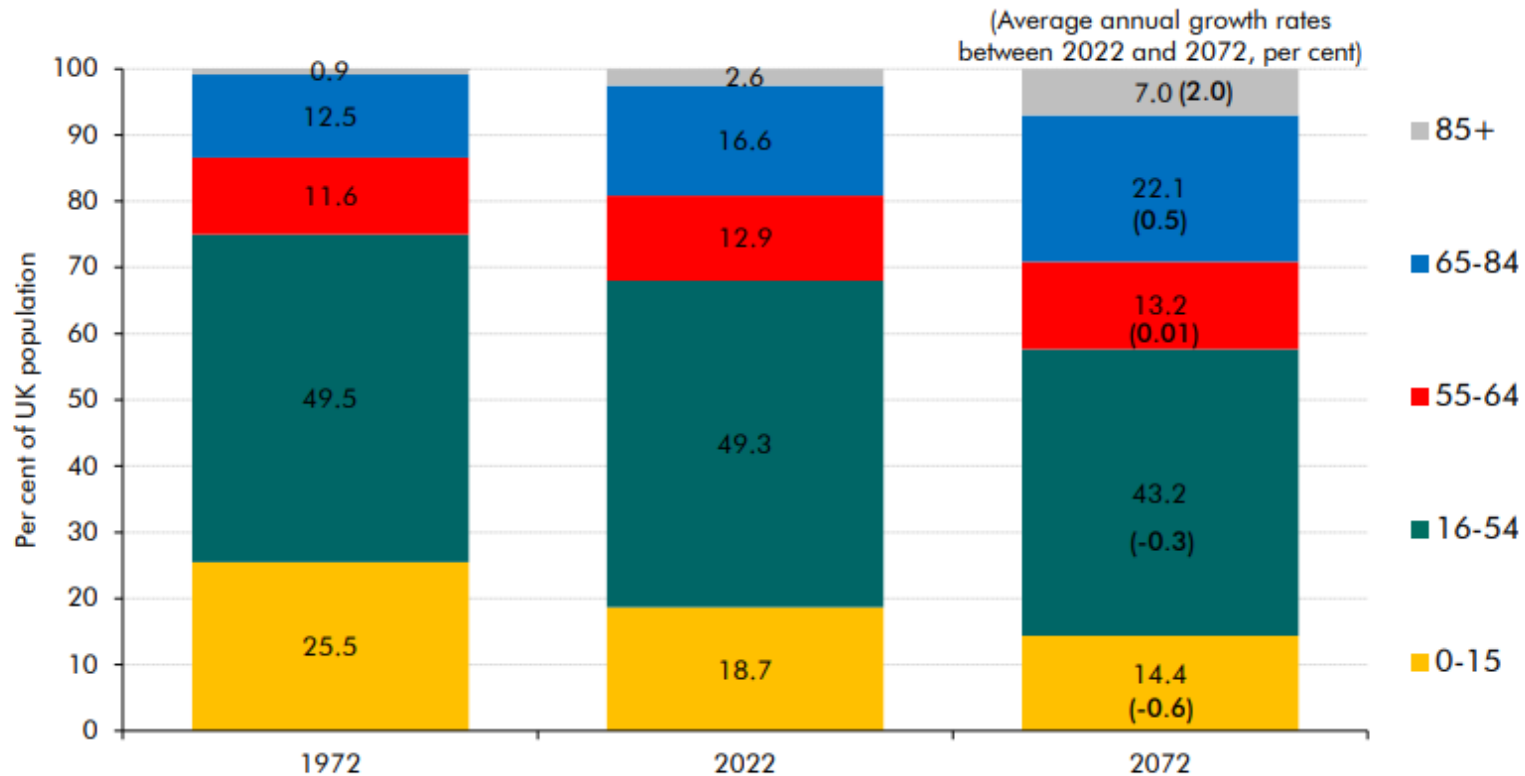
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Future trends in UK public spending

Future trends in UK public spending

- Some future trends in UK public spending are relatively clear, most notably:
 - Continued demographic change; and
 - The energy transition to net zero
- And of course there are significant risks that could materialize, for example:
 - Geopolitical tensions
 - Debt interest
 - Recessions, pandemics, financial crises and many more...

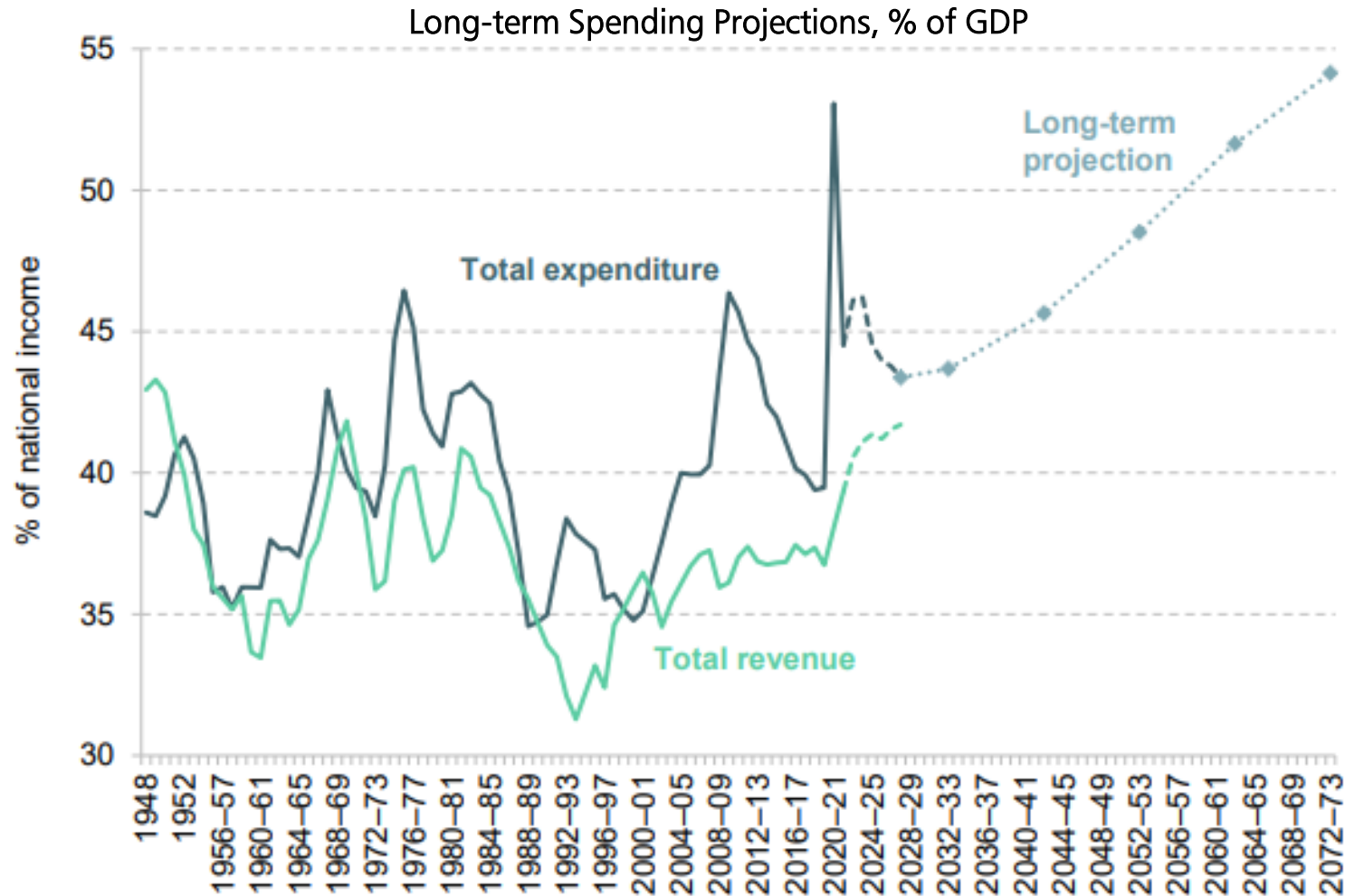
Looking ahead, health and social care costs from an aging population will continue to put upward pressure on spending...



Note: 2022 and 2072 readings are from the OBR low migration baseline.
Source: ONS, OBR

Source: OBR (2022)

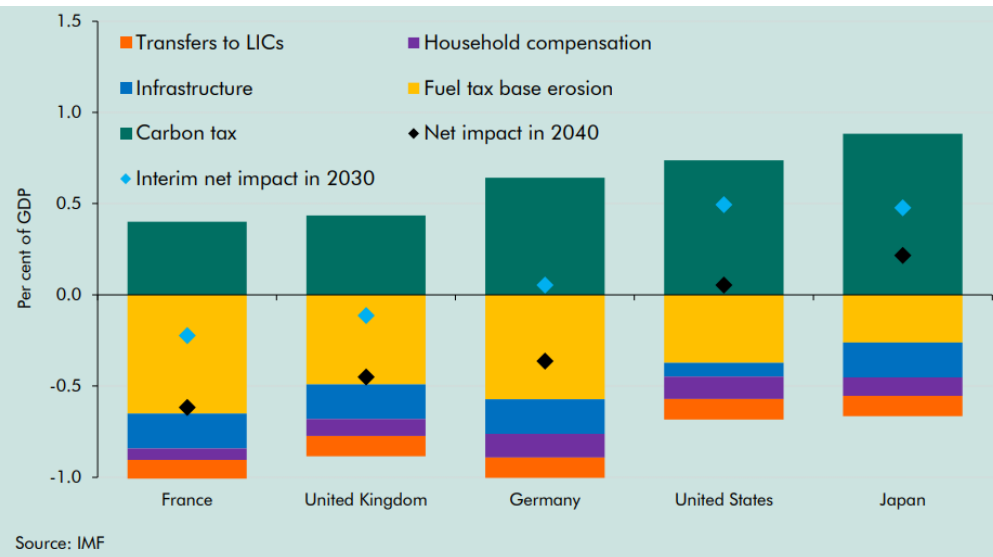
...projected to take it above 50% of GDP in the second half of the century



Source: IFS (2023)

The energy transition represents a complex challenge to long-term fiscal sustainability

Effect on 2040 primary fiscal balances of a global net zero scenario



Source: IMF

Net zero public investment plans to 2024-25 and OBR FRS 2021 scenarios

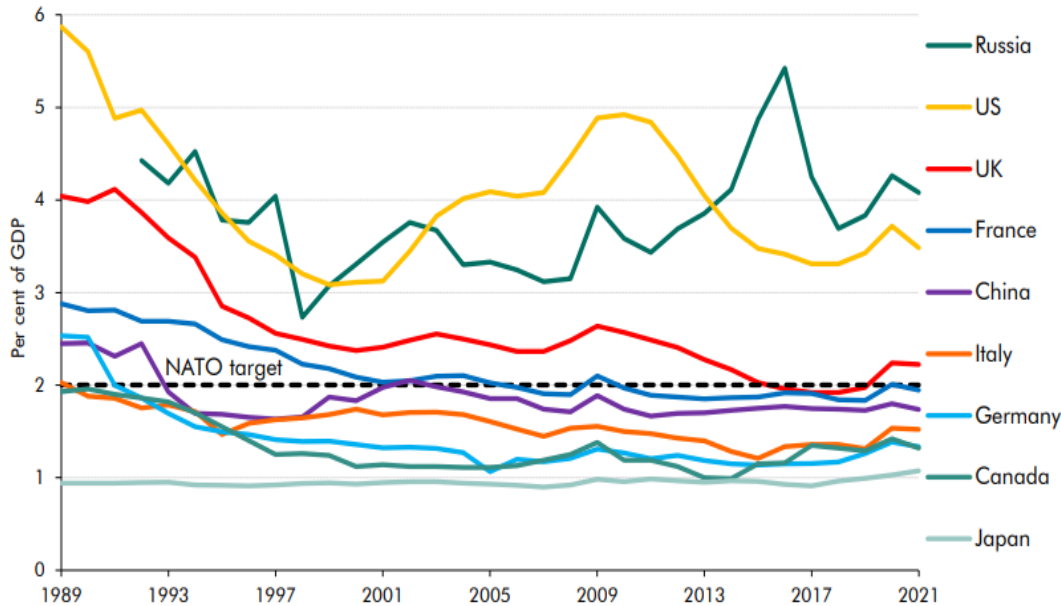
	£ billion (2019 prices)						
	Announced Government investment	2021 Fiscal risks report public investment scenarios					
		Total			Difference		
		Low	Central	High	Low	Central	High
Total	22.5	16.5	25.4	33.7	6.0	-2.9	-11.3
<i>of which:</i>							
Surface transport	6.4	5.9	6.2	6.4	0.5	0.2	0.0
Buildings	8.6	4.1	10.9	17.2	4.5	-2.2	-8.6
Power	3.8	1.9	2.4	2.9	1.9	1.4	0.9
Industry	1.2	0.4	1.0	1.7	0.8	0.2	-0.5
Other	2.5	4.2	4.9	5.6	-1.7	-2.4	-3.2

Note: FRR 2021 scenarios are our low, central and high net zero real public investment scenarios over the period from 2021-22 to 2024-25. Announced spending is our October 2021 EFO analysis of the Government's emissions-reducing spending plans for the same years (see Box 3.3 of our October 2021 EFO), deflated to 2019 prices using the GDP deflator.

Source: OBR (2023)

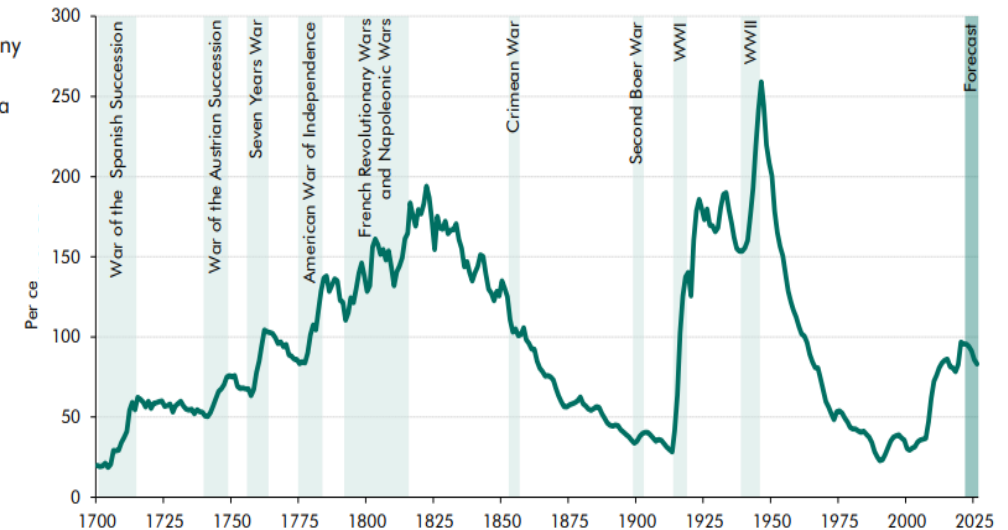
The fair winds experienced in previous decades could reverse. There are risks from geopolitical tension on defence spending...

Defence expenditure as a percentage of GDP



Source: SIPRI

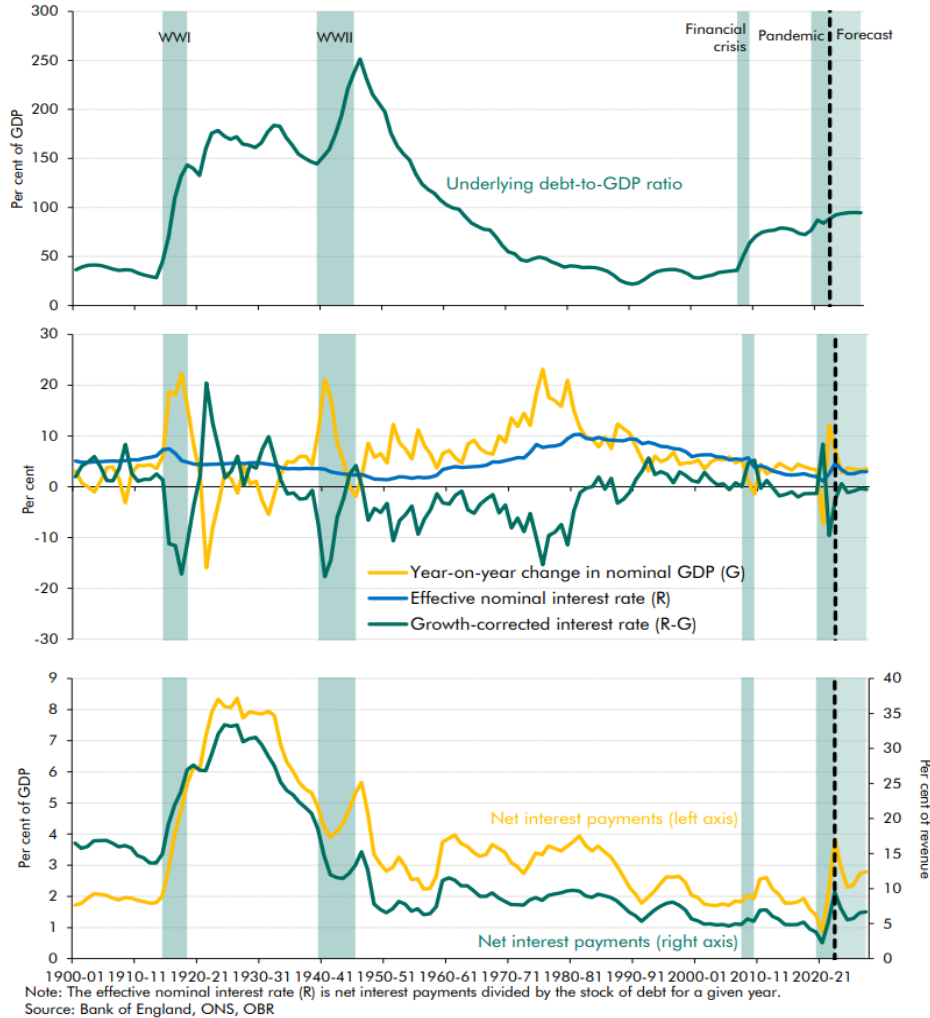
Public sector net debt during periods of conflict and peace



Note: Financial year data used from 2016-17. Highlighted periods represent conflicts where annual central government borrowing exceeded 2 per cent of GDP in any one year.
Source: Bank of England, OBR

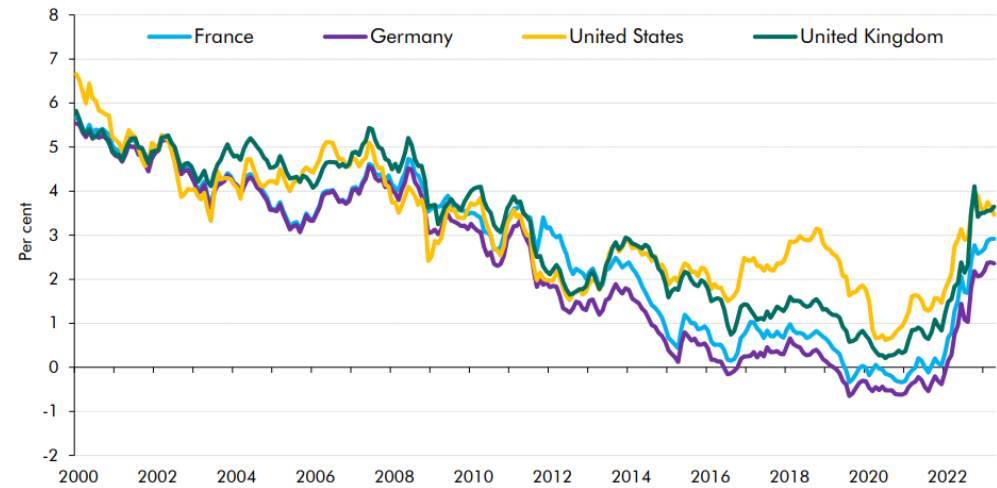
Source: OBR (2022)

...and on debt interest from recent increases in both government debt and bond yields



Source: OBR (2023)

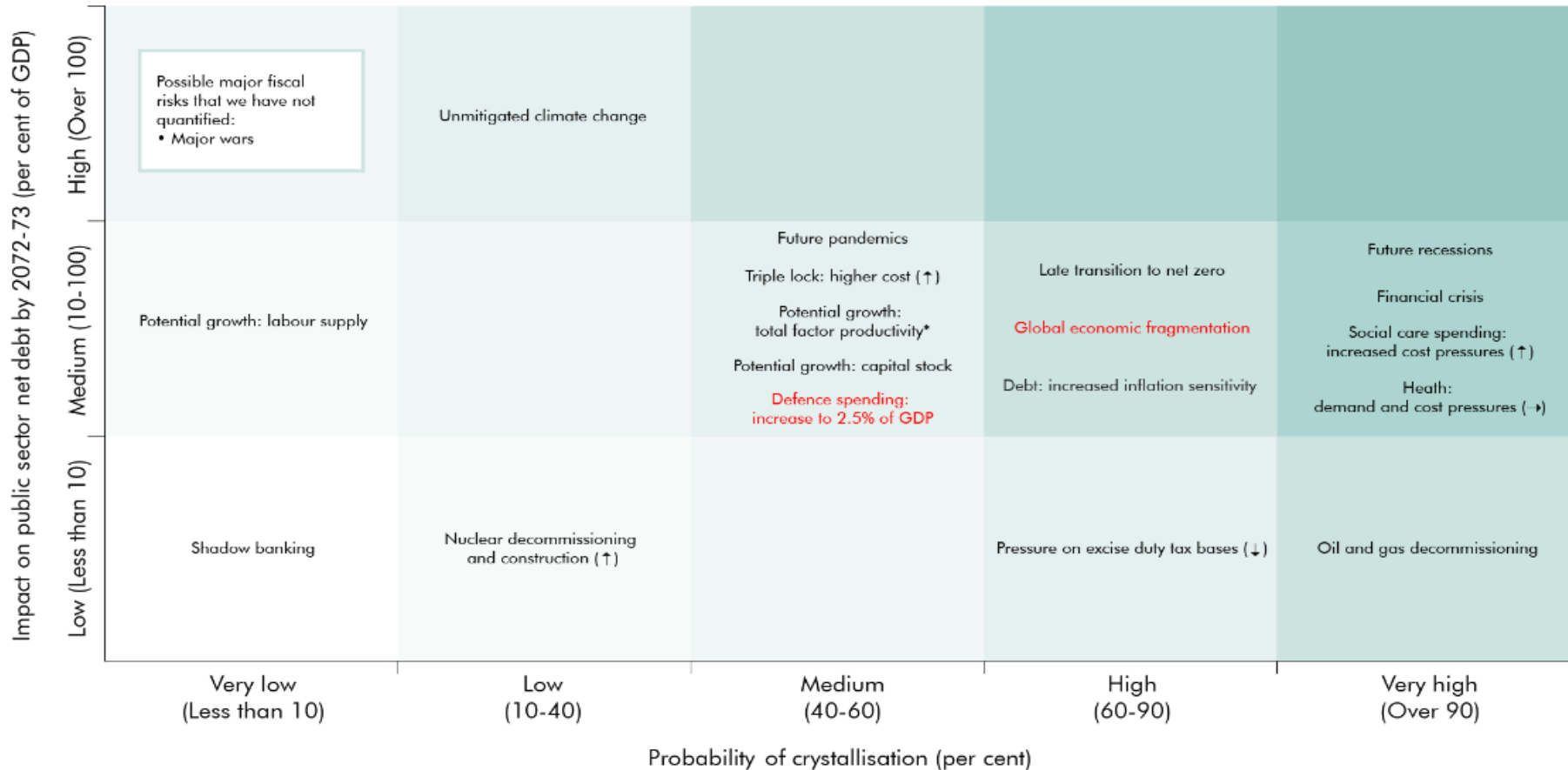
10-year nominal government bond yields



Source: OECD

And of course these are not the only risks

OBR Fiscal Risks Register (July 2023)



* denotes crystallised but remains active

Source: OBR

Source: OBR (2023) Red = Added in 2023



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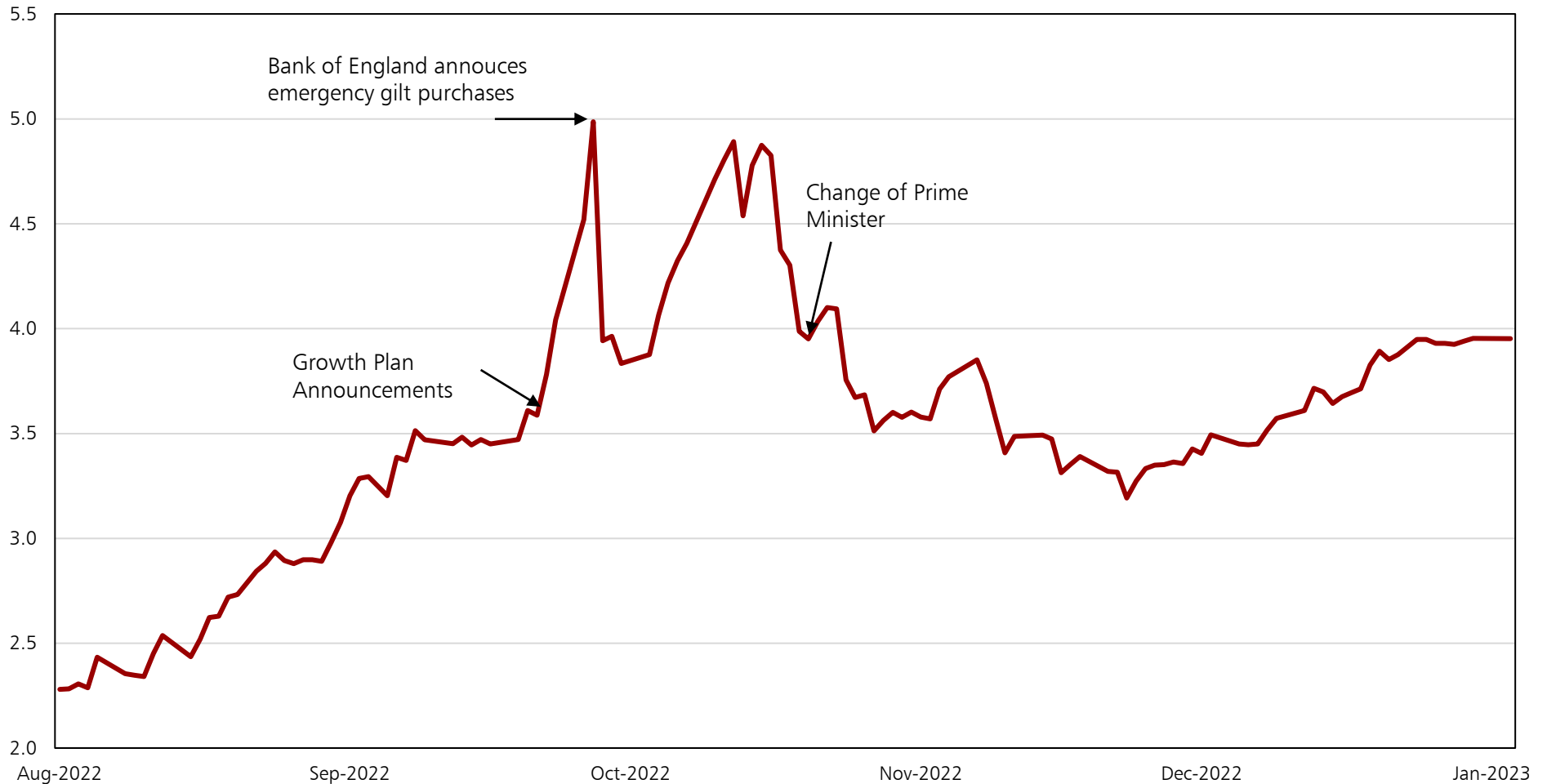
Managing changes

Restructuring the public finances in the face of long-term trends and unexpected shocks is not straightforward...

- Ultimately managing changes in public spending priorities is a matter of political choice.
- Fiscal credibility is crucial to allow borrowing to cushion rapid changes induced by shocks...
- ...but in the long run budget constraints bite, and tax and spend policies need to adjust.
- Transparency on the position of the public finances helps build both fiscal credibility and the broader coalition in society needed to argue for change.
- Independent fiscal institutions, like the OBR in the UK, can bring significant benefits to that transparency, on both short-term risks and long-term trends.

...and it is crucial to retain market confidence while doing so

UK 30-yr Gilt Yields %



Source: Bloomberg