



PERSPECTIVE

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Public Sector Borrowing: keep a grip

RUTH LEA

In a speech to the CBI in Manchester (of 20 January 2005), the Governor of the Bank of England urged the Chancellor to maintain a firm grip on government borrowing.¹ This message is all the more important for the markets and their concerns for fiscal rectitude as the Chancellor's forecasts of public sector finances have been poor in recent years, as we have argued on previous occasions.^{2,3}

Taking, for example, a comparison of the Chancellor's forecasts for the current balance from recent Pre-Budget Reports (PBRs) and comparing them with the outturns for the financial years ending just over two years later (for example using the forecast for financial year 2003/04 from the November 2001 PBR and comparing it with the outturn for 2003/04) indicates just how poor the Chancellor's forecasts have been. This is shown in the table at the foot of this page.

The Treasury's forecast for 2000/01 was over-pessimistic and was reasonably accurate in 2001/02. But for the latest three years the forecasts have proved to be significantly over-optimistic. Taking the discrepancies in forecasts for the whole five year period gives

an average error of -- £11.1 billion. In other words, the Treasury was, on average, over-optimistic on its forecasts over the period 2000/01 to 2004/05 to the tune of £11 billion.

As we have discussed before,⁴ nearly all independent commentators agree that there is structural current account deficit (a "black hole") and, whoever, wins the election, they will have to put up taxes or get spending under control if the public finances are to be managed prudently. These commentators include the:

- IMF;
- OECD,
- IFS;
- ITEM Club;
- CEBR;
- NIESR;
- BCC; and
- CBI.

The Government is currently unprepared to accept that there is a "black hole" because it is unprepared to accept that there are problems with its record on forecasting the public finances. The Prime Minister, for example, commenting on the independent commentators' forecasts of "black holes", said:

The current balance: comparison of PBR forecasts and outturns (£ billion)

	2000/01	2001/02	2002/03	2003/04	2004/05*
Forecast	2.0† (PBR 1998)	12.0† (PBR 1999)	14.0 (PBR 2000)	4.0 (PBR 2001)	3.0 (PBR 2002)
Outturn‡	20.5	9.4	- 13.9	- 20.7	- 16.0
Difference	18.5	- 2.6	- 27.9	- 24.7	- 19.0

* The forecast outturn for 2004/05 is taken from Ruth Lea, *Pollyanna, not Prudence: The Chancellor's finances*, Centre of Policy Studies, November 2004.

† Including windfall tax and associated spending.

‡ The data are taken from the ONS, *Public sector finances: December 2004*, 21 January 2005.



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“I think that they are wrong for the simple reason that the Treasury forecasts on the economy have been proved right.”

Hansard, 19 January 2005, col. 806.

Looking ahead it is clear that the Chancellor remains optimistic and probably over-optimistic. Taking 2007/08, for example, the 2004 PBR forecasts a current budget surplus of £4 billion.⁵ If his average annual error in the past five years (£11 billion) persists into the future, then rather than having a current budget surplus of £4 billion in 2007/08, the public finances would show a deficit of £7 billion. If this estimate eventually turned out to be correct, then a Labour Government, if it stuck to its current spending plans, would clearly need to increase taxes to return the

current budget to balance and avoid breaking the golden rule.

References

1. Chris Giles, “Bank governor urges Brown to keep grip on borrowing”, *Financial Times*, 21 January 2005.
2. Ruth Lea, *The price of the profligate Chancellor: higher taxes to come*, Centre for Policy Studies, March 2004.
3. Ruth Lea, *Pollyanna, not Prudence: The Chancellor’s finances*, Centre of Policy Studies, November 2004.
4. Ibid.
5. HM Treasury, *Pre-Budget Report*, Cm 6408, December 2004.

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