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Why worries about public borrowing may be misplaced

The forthcoming borrowing figures may not be as gloomy as expected, says Roger Bootle

How long can we keep borrowing?

By Roger Bootle

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On top of the gloom currently encircling the world economy, here at home there has also recently been a return to pessimism about the prospects for the public finances.

Apparently, senior officials at the Treasury are so depressed about the situation that they are tearing their hair out. If things really are so grim, then the consequences will be either more austerity to bring the public finances into line, or the Government will just have to live with borrowing being higher than forecast.

More austerity would be politically difficult and, to an old-fashioned Keynesian like myself, economically damaging. By contrast, simply accepting that the target will not be met, and/or pushing the date of its achievement well into the next parliament, would do no notable economic damage. Nor, I reckon, would it seriously harm the Government’s credibility in the financial markets. But abandoning the Chancellor’s objective of achieving a balanced budget by the end of the parliament would be a very severe political embarrassment to him. It might well scupper his chances of becoming Prime Minister.

We get the latest snapshot of where things stand this Friday, when the monthly borrowing figures for December are released.


Britain's Chancellor of the Exchequer George Osborne

When the Coalition came to power in 2010, George Osborne set himself the objective of **achieving by 2015 balance on the “cyclically adjusted current” budget**. (Best not to ask.) In the event, he managed to get about half way. In plain vanilla terms, he reduced the deficit from over £150bn to about £90bn, amounting to a halving in relation to GDP, from 10pc to 5pc. As a result, the total stock of government debt continued to climb from about 60pc of GDP in 2010 to about 80pc in 2015, compared with the Government’s original forecast of less than 70pc.

Most of the shortfall in the pace of reduction of public borrowing arose from the economy turning out to be weaker than expected. The rest – amounting to about a third of the total – was due to a drop in the tax to GDP ratio, ie the tax-take. This itself reflected the disproportionate growth of low-paying jobs (which generate less tax) and the effects of the substantial rises in the personal tax allowance.

When the Conservatives came to power last year, Mr Osborne set himself the tougher objective of bringing **total borrowing down to zero3532872b**by the end of this parliament. This seemed to be pretty plausible, but recent borrowing numbers have called it into question. Indeed, over four months, the 12-month rolling sum of public borrowing has levelled off at about £80bn, or 4.5pc of GDP.

What has gone wrong? The main reason for the disappointing performance is the slowdown in the growth of tax receipts, and that reflects the weaker performance of the economy – again. Over and above this, low inflation hasn’t helped either. This has restrained VAT receipts and excise duties. Meanwhile, the modesty of pay rises has restrained the growth of income tax and national insurance payments. Admittedly, low inflation has also helped to **keep interest rates** and bond yields low and that has contained the Government’s debt interest bill.

As long as the economy continues to grow reasonably well – which I expect – then I am not seriously worried about the public finances. Before too long, inflation will start to rise again and so will the growth of GDP measured in money terms. Continued real economic growth of 2pc to 3pc would see the deficit falling, and the ratio of government debt to GDP dropping back gradually to more acceptable levels.

Admittedly, given a very serious slowdown or, even worse, a recession, the borrowing out-turn would be appreciably higher. And it would be exacerbated by the fact that, given the starting point, this would probably be accompanied by deflation (ie falling prices). But this is unlikely.

Of course, government fiscal policy has been widely criticised. This is perfectly normal. Interestingly, there have been virulent attacks from both Left and Right. From the Left comes the accusation the Government has tightened too much too quickly. From the Right comes the accusation that it has not tightened enough. The Left does not recognise any financial constraints at all, while the Right does not recognise the adverse effects of fiscal tightening on aggregate demand. By contrast, although I have my criticisms and quibbles, including about the shape of government spending and tax policies, I reckon that, given that the Government accepted the overshoot of its original plans, the pace of borrowing reduction has been about right.

For Friday’s borrowing figures the market seems to expect about £10.5bn on the month. I know this sounds horrendous, but December is usually a high borrowing month. Moreover – wait for it – it comes just before January, which usually shows a surplus. This year’s may be particularly large as stamp duty receipts and self-assessment income tax payments should be buoyant.

As it happens, I reckon the figures may be better than the market expects. In December 2014 we made a £3bn one-off payment to the EU that was not repeated last year. Moreover, our esteemed overseas aid agency, DFiD, made some payments to the World Bank in November, whereas last year they were made in December.

It is fitting that this month’s figures should be so dependent on these items of public spending, EU payments and overseas aid, because they loom large in our fiscal affairs, not just in December but all year round. Indeed, together they cost the Exchequer about £25bn, more than a quarter of the Government’s overall deficit.

Roger Bootle is executive chairman of Capital Economics
roger.bootle@capitaleconomics.com