Fiscal Policy: The Budget
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MSc, BA (Hons)
Specializing in macro/micro policy & development economics

Abstract

Public spending

Government budget

Public debt

Agenda

What is fiscal policy?

Public spending and receipts

Public debt and yields

Conclusions
In the context of the government
What is a budget?
How is it similar / different to a household budget?

Fiscal policy – understanding the tools
What are the two key tools of fiscal policy?

The budget
The budget puts forth the government’s fiscal policy with regards to key areas:

**Spending**
- Infrastructure
- Education
- Health
- Everything else...

**Taxation**
- Income tax
- Personal allowance
- Corporation tax

**Borrowing**
- Government debt
- Bonds / Gilts
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Designing the national budget

Balanced Budget
Taxes = Spending

Budget Surplus
Taxes > Spending

Budget Deficit
Taxes < Spending

Leads to built up public debt

Spending vs. Income

What the budget looks like in practice?
Public sector spending 2015-2016

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What the budget looks like in practice?
Public sector receipts

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax</td>
<td>£170 billion</td>
</tr>
<tr>
<td>National Insurance</td>
<td>£113 billion</td>
</tr>
<tr>
<td>VAT</td>
<td>£131 billion</td>
</tr>
<tr>
<td>Corporation tax</td>
<td>£26 billion</td>
</tr>
<tr>
<td>Excise duties</td>
<td>£23 billion</td>
</tr>
<tr>
<td>Business rates</td>
<td>£36 billion</td>
</tr>
<tr>
<td>Council tax</td>
<td>£29 billion</td>
</tr>
<tr>
<td>Other (taxes)</td>
<td>£9 billion</td>
</tr>
<tr>
<td>Other (non-taxes)</td>
<td>£38 billion</td>
</tr>
</tbody>
</table>

What does an expansionary / contractionary budget looks like?

- **Expansionary**
  - Innovation, productivity and human capital
  - Rebalancing the economy (job growth, convergence of peripheral regions)
  - Reducing taxes

- **Contractionary**
  - Fiscal consolidation (current path of most developed economies)
  - Welfare cuts, lower healthcare spending etc.
  - Sustainable spending

Can you think about recent expansionary and contractionary budgets?

<table>
<thead>
<tr>
<th>Year</th>
<th>Budget Deficit</th>
<th>Balanced Budget</th>
<th>Budget Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1920</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1950</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Today</td>
<td></td>
<td></td>
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</tbody>
</table>

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Public debt

Fiscal policy in the developed world has relied on public sector borrowing

Public debt: how debt accumulates

How big are government debts for developed countries?

- USA: 103%
- Japan: 243%
- UK: 90%
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Net borrowing in the UK: fiscal policy
Public sector net debt as a % of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Budget 2014 (77.3% of GDP)</th>
<th>AS 2014 (80.4% of GDP)</th>
<th>Budget 2015 (80.4% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-15</td>
<td>77.3</td>
<td>80.4</td>
<td>80.4</td>
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<tr>
<td>2015-16</td>
<td>76.7</td>
<td>81.1</td>
<td>80.2</td>
</tr>
<tr>
<td>2016-17</td>
<td>78.3</td>
<td>80.7</td>
<td>79.8</td>
</tr>
<tr>
<td>2017-18</td>
<td>78.5</td>
<td>78.8</td>
<td>77.8</td>
</tr>
<tr>
<td>2018-19</td>
<td>74.2</td>
<td>76.2</td>
<td>74.8</td>
</tr>
<tr>
<td>2019-20</td>
<td>74.2</td>
<td>72.8</td>
<td>71.6</td>
</tr>
</tbody>
</table>

Public debt: a look at the UK
Projections of public sector net debt (under different policy assumptions)

Bond yields
% Higher yields
Investor requires higher returns for purchasing government bonds

% Lower yields
Safe assets - investors buy safe government bonds and expect less due to lower default/credit risk

Yields dictate how much an investor receives as part of this investment.
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Yields - who is risky and who is safe? (market perceptions)
10 year government bond yields
% annum

Source: Datastream

Conclusion

- Budgets are very important in planning for Government
  - They give economists an idea of what to expect in terms of taxation and spending
  - They also influence day to day activity
- Most budgets, currently, are run on deficits and therefore require additional debt to finance spending
  - Debts are key instruments when it comes to a nation's investment and spending
  - We see the power of yields and how we can understand credit risk via bond yield volatility