Managing Fiscal Risks in the UK

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Outline

I. Scale and Sources of Fiscal Risks in the UK

II. HMT’s Managing Fiscal Risk Report

III. Mitigating Fiscal Risks

IV. Lessons from UK Experience
I. Scale and Sources of Fiscal Risk in the UK:
a. Scale of Fiscal Risks: Debt

Chart 1.D: Volatility in government debt vs. GDP growth (2000-16)

Source: OECD
I. Scale and Sources of Fiscal Risk in the UK:
b. Scale of Fiscal Risks: Borrowing


*absolute error
Source: IMF Forecast Evaluation Database
I. Scale and Sources of Fiscal Risk in the UK: c. Sources of Fiscal Risks: Borrowing Errors

Chart 1.F: Breakdown of average PSNB forecast error (2010-18)

Source: OBR and HM Treasury calculations
*t = year of the forecast
I. Scale and Sources of Fiscal Risk in the UK:
d. Sources of Fiscal Risks: Debt Shocks

Sources of Unanticipated Increase in Government Debt: 2007-10
(Percent of 2010 GDP)

Source: IMF (2012)
II. HMT’s Managing Fiscal Risks Report:
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b. Managing Fiscal Risks: Governance
III. Mitigating Fiscal Risks:

a. Macroeconomy

Chart 2.1: Periods of historic debt reduction

Table 2.A: Economic conditions during periods of historic debt reduction

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<td>Reduction in debt (% of GDP)</td>
<td>5.0</td>
<td>5.3</td>
<td>2.6</td>
<td>2.4</td>
<td>1.8</td>
<td>1.5</td>
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<tr>
<td>Primary balance (% of GDP)</td>
<td>1.6</td>
<td>1.5</td>
<td>-0.7</td>
<td>1.8</td>
<td>2.3</td>
<td>0.2</td>
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<td>Real growth (%)</td>
<td>3.0</td>
<td>2.9</td>
<td>3.4</td>
<td>3.3</td>
<td>3.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>3.6</td>
<td>9.5</td>
<td>14.0</td>
<td>6.2</td>
<td>1.1</td>
<td>1.7</td>
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<tr>
<td>Interest rate (%)</td>
<td>5.3</td>
<td>8.0</td>
<td>10.8</td>
<td>11.5</td>
<td>6.0</td>
<td>1.2</td>
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Source: ONS, OBR and HMT calculations
III. Mitigating Fiscal Risks:

a. Macroeconomy

Chart 2.K: Projections of public sector net debt with illustrative shocks

Chart 2.L: Projections of debt interest payments with illustrative shocks

Source: ONS, OBR and HMT calculations
III. Mitigating Fiscal Risks:

b. Financial Sector

Chart 2.C: Bank of England balance sheet

Chart 2.D: The Bank capital and income framework, illustration
III. Mitigating Fiscal Risks:  
c. Revenue

Chart 4.A: Self-employment in the workforce

Chart 4.C: Tax due on £50,000 of income in 2017-18

Source: OBR Fiscal risk report
III. Mitigating Fiscal Risks:
d. Expenditure

Chart 5.8: Old Age Dependency Ratio (OADR)

Source: ONS publication on Population estimates, mid-2017

Chart 3.12: Health care spending under alternative other cost pressure assumptions

Source: OBR
III. Mitigating Fiscal Risks

e. Balance Sheet Review

Chart 6.D: Changes in PSNFL components over time

Source: ONS
Note: ‘Other’ includes non-life insurance technical reserves, provisions for call under standardised guarantees, and financial derivatives and employee stock options.
III. Mitigating Fiscal Risks
f. Inflation-linked Debt

Share of Inflation-Linked Debt (G7 Countries, Latest Year)

Annual Issuance of Inflation-linked Debt

Source: HM Treasury (2018)
III. Mitigating Fiscal Risks

g. Retiring the Private Finance Initiative

There are three main reasons to retire PFI

1. Long-run cost
   - PFI tended to be more expensive over the life of the contract.
   - This was masked because it was off-balance-sheet.

2. Flexibility
   - The nature of the contracts meant less flexibility to adapt to changing service needs.

3. Transparency
   - The OBR described PFI as a “fiscal illusion”.
   - Retiring it will increase fiscal transparency.

Comparative cost of PFI

Source: NAO (2018)
IV. Lessons from UK Experience (i)

1. It is possible to be open about fiscal risks without losing market or public confidence (may even improve)

2. Sources of fiscal risks vary between countries and over time – reporting and management needs to be regular and adaptive

3. However, there are some common themes and challenges: Biased forecasts, financial fragility, SoEs, subnationals, contingent liabilities

4. Fiscal stress testing can yield some novel and striking insights about the scale and sources of fiscal vulnerability

5. Outsourcing fiscal risk disclosure and analysis to a fiscal council can enhance credibility, comprehensiveness, and accountability
IV. Lessons from UK Experience (ii)

6. Fiscal risk management requires dedicated internal reporting and management structures (not captured in budgets/accounts)

7. Tackling fiscal risks requires creativity and a mix of fiscal policy and management changes (often undoing previous creativity)

8. Focus reforms where circumstances enables one to make progress and continue to keep other risks on the public radar

9. Reducing fiscal risks takes time: (i) analyse; (ii) disclose; (iii) stem the flow; and (iv) tackle the stock

10. Measuring progress in reducing overall fiscal exposure remains a challenge (for OBR’s Fiscal Risks Report 2019!)
Thank You!

OBR’s Fiscal Risks Report 2017:

HM Treasury’s Managing Fiscal Risks 2018: