National Institute of Economic and Social Research

Press Release

For immediate release

The macroeconomic implications of the parties' fiscal plans

As we approach the UK's General Election this May, the economy, and in particular the path and pace of fiscal consolidation over the next Parliament, will dominate the political debate. While it is clear that the next parliamentary term will be one of considerable fiscal consolidation, there is nevertheless ample scope to deviate from the Coalition's plans.

Understanding the implications of the political parties' fiscal policy proposals should therefore be an important feature of the political debate. Discussion has so far focused on what the major parties' announcements mean for public sector borrowing and the possible impacts for public services, tax and welfare spending. These are vitally important topics, but fiscal policy is first and foremost a macroeconomic policy instrument – it is designed to influence the future path of the economy as a whole.

New analysis out today by Simon Kirby, a Principal Research Fellow at NIESR, looks at the impact of alternative fiscal paths on the wider economy via macroeconomic variables such as economic growth, interest rates and unemployment. We examine these through a series of illustrative simulations using NIESR's global econometric model, NiGEM. This enables us to simulate the dynamic process of the economy, and allows for feedback to the public finances.

NIESR's latest forecasts for the UK and global economies, which takes the Coalition Government's fiscal plans as given, are used as the baseline. We then illustrate how fiscal plans could vary in line with the announced policies of fiscal targets of each party:

- The Conservative party has announced its ambition to reach an absolute surplus. We have introduced two scenarios for the Conservative party, since they also have a stated aim to reduce welfare spending by an additional £12 billion.
- The Labour party has announced that it will target a surplus on the public sector's current budget in the next parliament.
- The Liberal Democrats' ambition is to run a cyclically-adjusted current budget that is in balance.

Under both the Labour and Liberal Democrat fiscal targets, public sector borrowing would be used to fund investment. The Office for Budget Responsibility (OBR) forecasts a closing of the negative output gap by 2019-20; that implies that the cyclically-adjusted current balance and the actual current balance will be the same, leaving no difference between the stated fiscal targets of the Labour and Liberal Democrat parties by the end of the next parliament. The scenarios we run for them are therefore identical.

The table below shows the impact of each parties' plans compared to the forecast baseline.

Impacts of implied fiscal plans on key macroeconomic variables

		GDP growth	GDP level	Unemployment rate	Average real consumer wage level	Bank rate	Effective exchange rate	PSNB as % of GDP	PSND as % of GDP
Implied Conservative Party plan	2017	0.1	0.1	−0.1	0.1	0.0	0.5	0.3	0.2
	2018	0.1	0.2	−0.1	0.1	0.1	0.5	0.6	0.7
	2019	0.2	0.4	−0.2	0.2	0.3	0.3	0.9	1.5
Implied Conservative plan with additional cuts to welfare spending	2017	0.2	0.2	−0.1	0.1	0.0	0.7	0.3	0.1
	2018	0.1	0.4	−0.2	0.2	0.2	0.6	0.7	0.6
	2019	0.3	0.6	−0.3	0.3	0.5	0.4	1.0	1.8
Implied Labour Party plan	2017	0.3	0.3	−0.2	0.1	0.0	1.2	0.6	0.5
	2018	0.2	0.5	−0.3	0.3	0.3	1.1	1.3	1.5
	2019	0.5	1.0	−0.4	0.5	0.7	0.8	2.0	3.6
Implied Liberal Democrat plan	2017	0.3	0.3	−0.2	0.1	0.0	1.2	0.6	0.5
	2018	0.2	0.5	−0.3	0.3	0.3	1.1	1.3	1.5
	2019	0.5	1.0	−0.4	0.5	0.7	0.8	2.0	3.6

Source: NiGEM simulations.
Notes: GDP is volume series, reference year 2011. GDP, average real consumer wage, effective exchange rate are all per cent difference from baseline. GDP growth, Unemployment rate, Bank Rate, Public sector net borrowing (PSNB) and public sector net debt (PSND) are percentage point difference from baseline. PSNB and PSND are fiscal year.

NIESR's analysis highlights the near-term positive effects to GDP growth, real consumer wages and unemployment that stem from the implied alternative plans to the current Coalition government's. These alternatives are funded via greater borrowing/smaller surpluses than implied by the Coalition's plans. At the same time, we would expect the Bank of England to respond by raising interest rates, thereby dampening some of the positive macroeconomic effects. The positive effects on the level of GDP are only temporary; in each scenario, in the longer-run the GDP is unchanged from its baseline level.

Undoubtedly, the parties themselves will disagree with aspects of our analysis. On one level they are correct: each will have a different set of priorities if elected, and the precise tax and spending decisions introduced will reflect those. However, given announcements to date, it is our view that this is a fair reflection of the potential macroeconomic impacts of their different approaches.

The next government should expand the remit of the OBR to include responsibility for the auditing of all parties' manifestos. If given the appropriate resources and authority by Parliament, the OBR could help to improve significantly the quality of information on parties' tax and spending plans in the run-up to future general elections.

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Notes for Editors:

1. This press release is based on an article entitled “The macroeconomic implications of the parties' fiscal plans”, written by Simon Kirby, and contained in the *National Institute Economic Review No. 231 February 2015*.

   This is a quarterly, peer reviewed, economic and social sciences journal. The full *Review* is published from midnight on Tuesday 10 February.
2. For a copy of the article, or to organise an interview, please contact Brooke Hollingshead in the NIESR press office on 020 7654 1923 / b.hollingshead@niesr.ac.uk
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