



PRESS RELEASE
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**THE UK'S FISCAL POSITION IN 2002:
AN UPDATE ON NIESR'S GENERATIONAL ACCOUNTS**

The National Institute of Economic and Social Research has just completed a review of the Government's long-term fiscal position taking account of increases in public spending announced so far, together with the implications of population change.

The study, carried out by Dr James Sefton (NIESR and Imperial College), found that tax increases or spending reductions of about £5bn are needed to bring the position of the public sector into long-term balance. This position contrasts with that of many other countries where it is believed there are significant fiscal imbalances.

It is also found that the fiscal position is largely generationally neutral. There is a possibility that fiscal policy can transfer significant resources to those currently alive from future generations, but in the UK fiscal policy is generationally fair.

These results show a modest improvement to the position shown in an earlier study carried out by Dr Sefton in 1998¹. There a need for tax increases or spending cuts of £6bn was identified. This improvement has taken place despite the substantial increases in public expenditure which have been announced. Such spending includes increased spending on the National Health Service, the introduction of the second state pension and the pension credit as well as rises to the basic pension. This extra spending has been offset by sharp rises in direct tax revenues and the position has also been helped by falling interest payments associated with a declining level of government debt.

It is important though to make the following qualifications to this result:

- Under current policy it is assumed that National Insurance Contribution rates adjust so that total National Insurance Contributions are always sufficient to pay for all contributory social benefits. This assumes that compared to 1998, future National Insurance Contribution Rates are to be higher in order to pay for the Second State Pension. If an assumption had been made that National Insurance Contribution Rates were kept at their levels prior to the introduction of the Second State Pension, the fiscal adjustment would be of the order of £7.5 bn.

FOR FURTHER INFORMATION CONTACT
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¹ The results of the original accounts for 1998 were published in the *Economic Journal*, Volume 110, November 2000. The update was carried out with financial support from HM Treasury. The assumptions underlying the study, and the conclusions drawn from it, are the responsibility of NIESR and do not necessarily reflect the views of HM Treasury.

- That all benefits except the Minimum Income Guarantee (MIG), WFTC, CTC and the Pension Credit are price indexed. As these four benefits are directly linked to income they are assumed to be wage-indexed. It is worth noting that the Government has only guaranteed to increase the MIG in line with wages for the length of the current parliament, but it has stated that its ambition is that it will continue to increase at this rate. However, if all other benefits were similarly linked to wages then a very severe fiscal adjustment would be necessary.
- Health Expenditure is assumed to rise significantly until 2005 in line with government policy. After 2005, as a standard methodological convention, it is assumed to rise in line with GDP per capita growth. This would be below the historical average growth rate of health expenditure which has been approximately 1% faster. Naturally, faster growth would have to be financed by higher revenue for the fiscal position to be maintained.

Background information: changes to the Generational Accounts

In 1998 the National Institute of Economic and Social Research compiled the first set of Generational Accounts for the UK. In March 2002 these accounts have been updated in line with current data and take into account all changes to government policy prior to the UK Budget in April 2002. The methodology for compiling the accounts has remained the same so that the results are directly comparable across time.

The principal changes to government policy in the period since the compilation of the first set of accounts are:

- The introduction of the Second State Pension in the 'Child Support, Pensions and Social Security Bill' in 1999.
- The introduction of the Pension Tax Credit announced in the Pre-Budget Report 2001.
- A substantial increase in planned expenditure on the NHS, with the aim of attaining the European average expenditure on Health by 2005.
- A significant increase in the generosity of the basic pension.

Further to these, the accounts have also been refined by

- The inclusion of improved data on the impact of Working Families Tax Credit.
- The inclusion of improved data on the impact of the Disabled Living Allowance and Attendance Allowance.
- Improved estimates of the beneficiaries of health and long term care spending.

The National Institute of Economic and Social Research is Britain's longest established independent economic research institute with over sixty years experience of applying academic excellence to the needs of business and policy makers. The Institute's objective is to promote, through quantitative research, a deeper understanding of the interaction of economic and social forces that affect people's lives so that they may be improved. www.niesr.ac.uk

Professor James Sefton is a Research Fellow at the National Institute of Economic and Social Research. He is also Director of UBS Warburg's Equities Quantitative Group and Professor of Economics at Imperial College's Management School. His first book was a set of Reconciled National Accounts for the UK and more recently he constructed the first set of Generational Accounts for the H.M. Treasury. He has published widely in academic journals in areas as diverse as mathematical analysis, control feedback theory, econometrics, economics and finance. He was educated at Christ's College, Cambridge from where he received a Ph.D. in Systems Theory.