



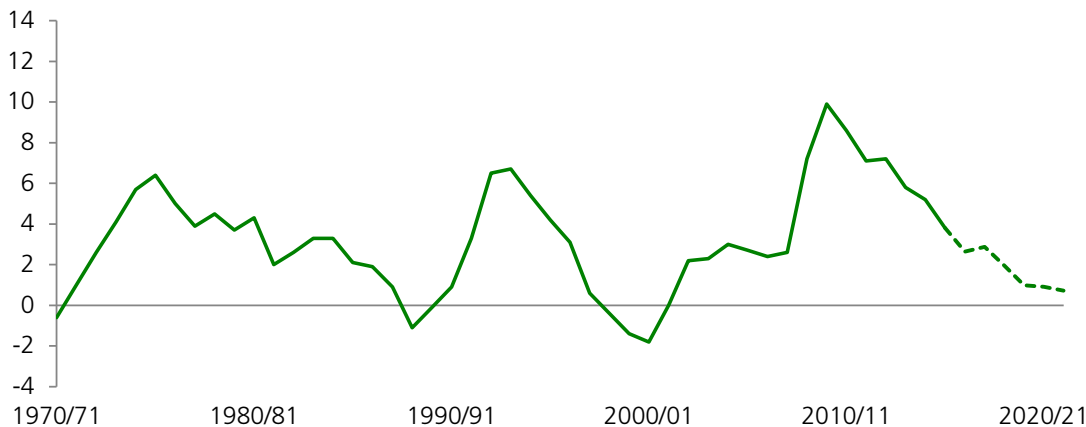
BRIEFING PAPER

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The budget deficit: a short guide

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Budget deficit
% of national income



notes: excludes public sector banks; dotted line shows forecasts

source: ONS AND OBR, excludes public sector banks

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1. What is the budget deficit and how big is it?

When the government spends more than it receives in tax and other revenues it needs to borrow to cover the difference. This borrowing is known as 'public sector net borrowing', but is often referred to as the deficit.

In 2017/18, government revenue is forecast to be £744 billion while government spending is forecast to be £802 billion. The deficit is therefore forecast to be £58 billion, equivalent to 2.9% of national income.

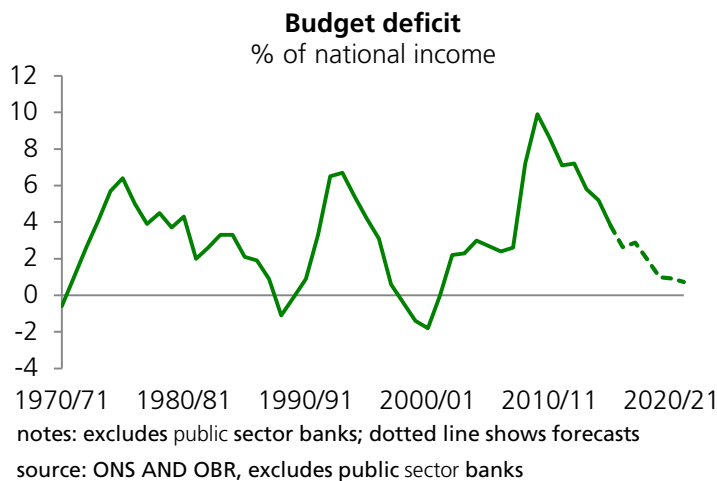
Borrowing will finance around 7%, or nearly £1 in every £13.80, of public spending. Borrowing of £58 billion is equivalent to around £890 per head of UK population.

2. What are the trends over time?

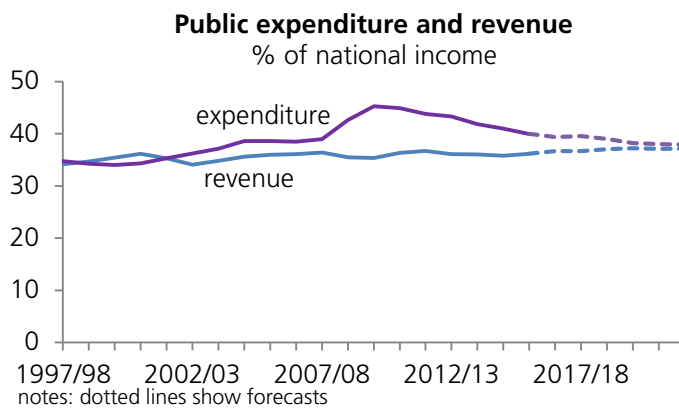
It is not unusual for the government to borrow. Since 1970, the government has had a surplus in only seven years.

The annual average budget deficit has been 3.3% of national income since 1970. It has varied significantly over this period as the chart below shows. Large budget deficits occurred in the mid-1970s and early 1990s and more recently after the financial crisis. Borrowing peaked at £152 billion (9.9% of national income) in 2009/10.

The Office for Budget Responsibility forecast that the deficit will fall to around £17 billion in 2021/22.

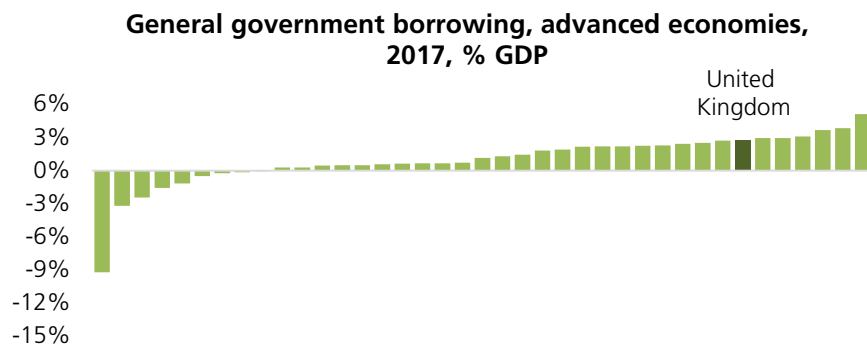


The big increase in the budget deficit from 2008 onwards was caused by both an increase in government spending and a fall in government revenue. Public spending increased from 39% of national income in 2007/08 to 45% in 2009/10. At the same time, government revenue fell from 36% of national income to 35%.



3. How does the UK's budget deficit compare with other countries?

In October 2016, the IMF – who use a slightly different measure of governments' net borrowing – forecast that UK government borrowing will be 2.7% of GDP in 2017, higher than the European Union average of 1.8% and similar to the average for advanced economies of 2.7% of GDP.^{1,2}



4. How is the budget deficit financed?

The budget deficit is financed by sale of government bonds. These are essentially interest paying "IOUs" which the government sells to investors. Purchasers of government bonds include pension funds, insurance companies, households and overseas investors. At the moment, the government has to sell a large volume of bonds as the budget deficit is high. This explains why the previous Coalition Government attached so much importance to deficit reduction, which it believed important to maintain the confidence of the bond markets and keep interest rates low.

5. How much interest does the government pay on its borrowing?

Interest payments on borrowing are a significant part of government expenditure. Interest is paid on all outstanding government debt,

¹ IMF. [World Economic Outlook Database](#), October 2016

² Advanced economies as defined by the IMF.

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accumulated over many years. In 2017/18, gross debt interest payments are forecast to be £56 billion; net debt interest payments are forecast to £42 billion.

The lower net interest figure includes the impact that the Bank of England's [quantitative easing](#) has on the government's debt interest payments. The Bank has bought government debt from private investors such as pension funds and insurance companies to get money into the economy. As some of the government's debt is being held by another public sector body – the Bank of England – it means that when the government comes to make interest payments it is giving these payments to another part of the public sector. The net effect for the public sector, or government, is a debt interest payment of £0.³

6. What is the current budget deficit?

The current budget deficit is the difference between government's day-to-day spending and its revenues, or more formally its current spending and current receipts. This measure differs from the overall budget deficit as it does not include government spending on net investment.

The current budget deficit is forecast to be £18 billion in 2017/18, equivalent to 0.9% of national income.

7. What is the structural deficit?

A distinction is often drawn between the cyclical and structural elements of the budget deficit. The size of the deficit is influenced by the state of the economy: in a boom, when the economy is above its potential, tax receipts are relatively high and spending on unemployment benefit is low. This reduces the level of borrowing. The reverse happens in a recession when borrowing tends to be high.

The structural deficit is that part of the deficit that is not related to the state of the economy. This part of the deficit will not disappear when the economy recovers. It thus gives a better guide to the underlying level of the deficit than the headline figure. The structural deficit cannot be directly measured so it has to be estimated.

The economy is forecast to run slightly above its potential in 2017/18, so the structural deficit is forecast to be larger than the actual deficit.

8. How much did the financial crisis contribute to the budget deficit?

This is not a straightforward question. Government support for the banks took a variety of different forms, including share purchases, loans and guarantees which have different effects on the public finances. Guarantees, for example, are more likely to give rise to contingent liabilities which will only materialise under certain circumstances. This is

³ The actual cost to the public sector of the government debt held by the Bank of England is the Bank's rate of interest on the loan used to buy the debt from the private investors

quite different from purchases of bank shares where there is an outlay of cash.

While the overall level of support for the banks was very large, the impact on the deficit was comparatively small. The Government has said that the financial crisis accounted for around 5%-6% of the deficit in 2008 and 2009.

9. What is the difference between the deficit and government debt?

The deficit is the difference between government revenue and spending, usually measured over a single financial year. Debt is the total amount owed by the government which has accumulated over the years. As a result, debt is a much larger sum of money. Public sector net debt is forecast to be £1,830 billion (i.e. £1.83 trillion), or 88% of national income at the end of 2017/18. This is equivalent to around £28,100 per person in the UK.

10. Where can I find more information?

The Office for Budget Responsibility (OBR) has produced [a brief guide to the public finances](#), which provides a brief introduction to the UK public finances and to the terms used to describe them in the official statistics.

The ONS has produced [a data driven explanation](#) of the deficit and debt.

Those wishing to delve further into technical areas are pointed towards the Office for National Statistics' (ONS') Public Sector Finances [Methodology Guide](#). The ONS have also produced a [public sector finance glossary](#) and an analysis of [longer term trends](#).

Data on the deficit, debt, expenditure and receipts are available from the OBR's [public finances databank](#). Some of the series begin in the 1920s, and the data includes forecasts.

The Library update and publish the following relevant briefings:

- [Public finances](#)
- [Government borrowing, debt and debt interest: statistics](#)
- [Government borrowing and debt: international comparisons](#)

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