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The third most important thing that happened yesterday?

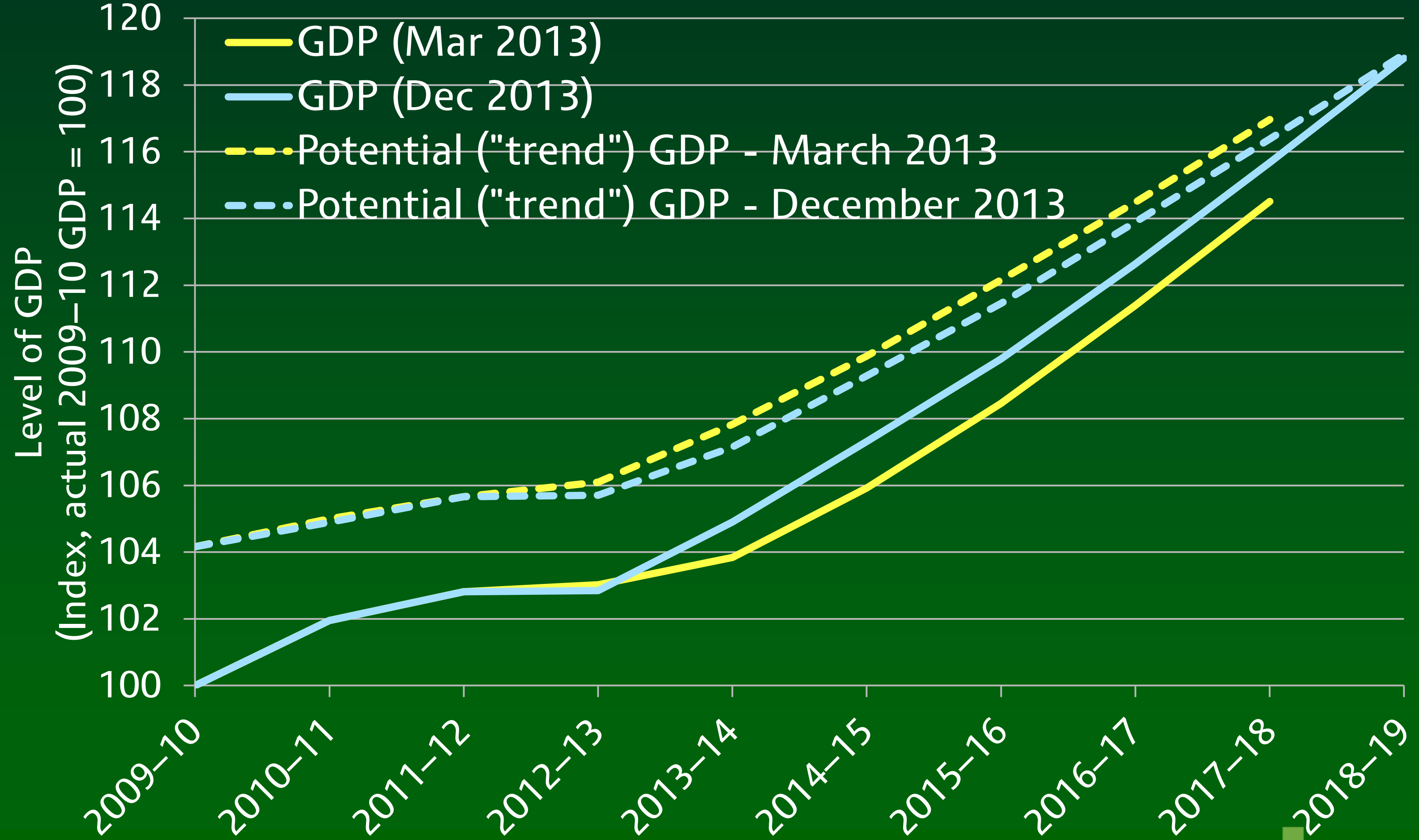
Carl Emmerson

E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

IFS hosts two ESRC Research Centres

Faster growth in GDP – but only temporary

Comparison of forecasts for real GDP growth and trend GDP



Sources: OBR; Author's calculations.

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Changes in borrowing forecasts since March 2013

Public sector net borrowing, £ billion

	2012–13	2013–14	2014–15	2015–16	2016–17	2017–18	2018–19
Budget 2013	**120.9**	**119.8**	**108.4**	**95.5**	**67.0**	**42.7**	**–**
AS 2013	**115.0**	**111.2**	**96.0**	**78.7**	**51.1**	**23.4**	**–2.2**

Notes: Numbers might not sum due to rounding.
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Forecasting changes							
Tax	–4.3	–3.4	–9.6	–13.2	–14.5	–14.6	
Spend	–1.6	–3.2	–2.9	–3.7	–1.8	–5.3	
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Neutral switch							
Tax		–3.0	–3.0	–2.5	–3.1	–4.7	
Spend		3.0	3.0	2.5	3.1	4.7	
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Measures							
Tax		–0.0	+0.1	–0.5	+0.4	+0.6	
Spend		–2.0	+0.0	+0.6	0.0	0.0	
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Source: HM Treasury; Office for Budget Responsibility; IFS calculations.

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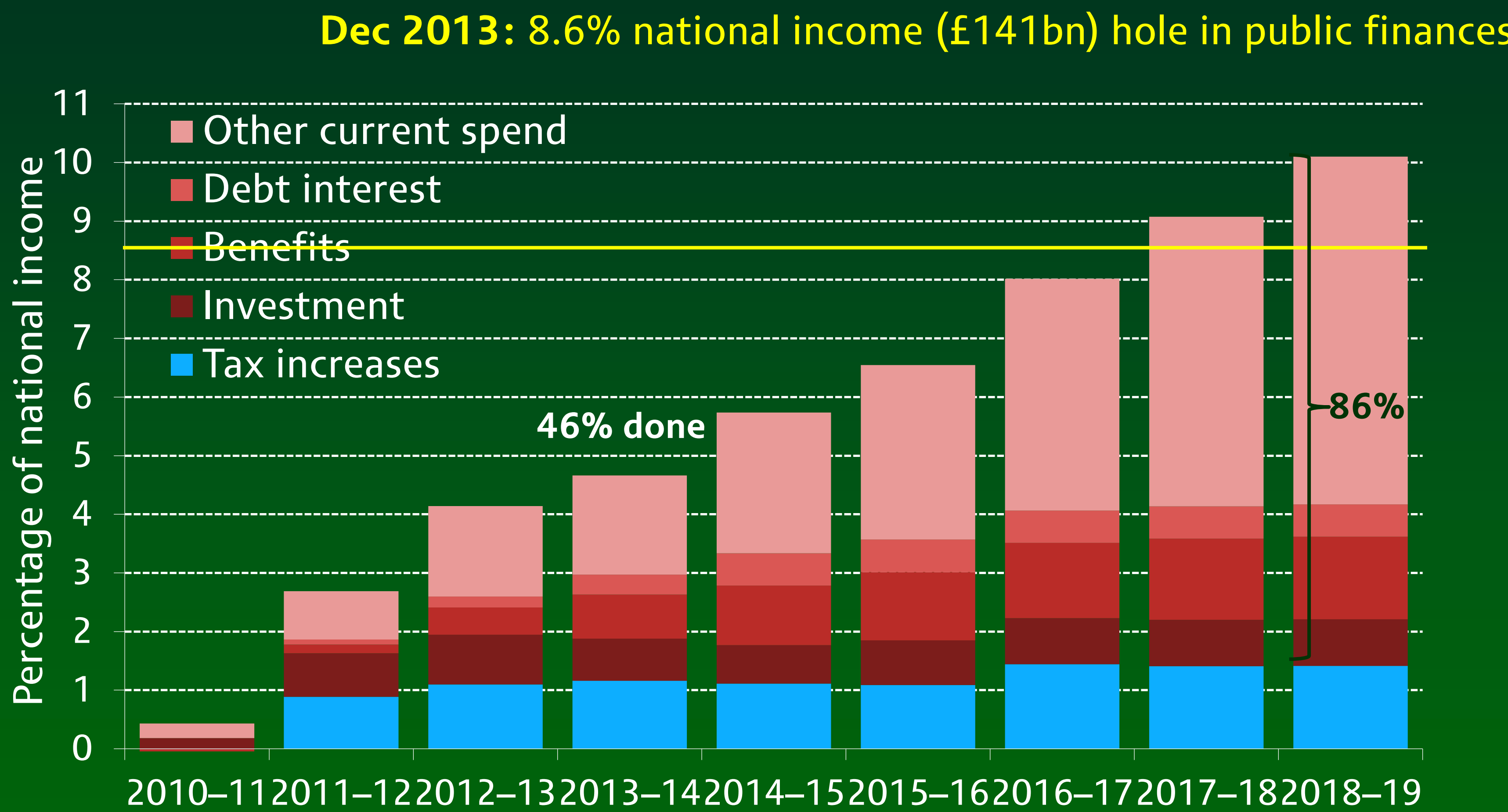
The cure (December 2013): 10.1% national income consolidation over 9 years (£166bn)



Sources: HM Treasury; OBR; Author's calculations.

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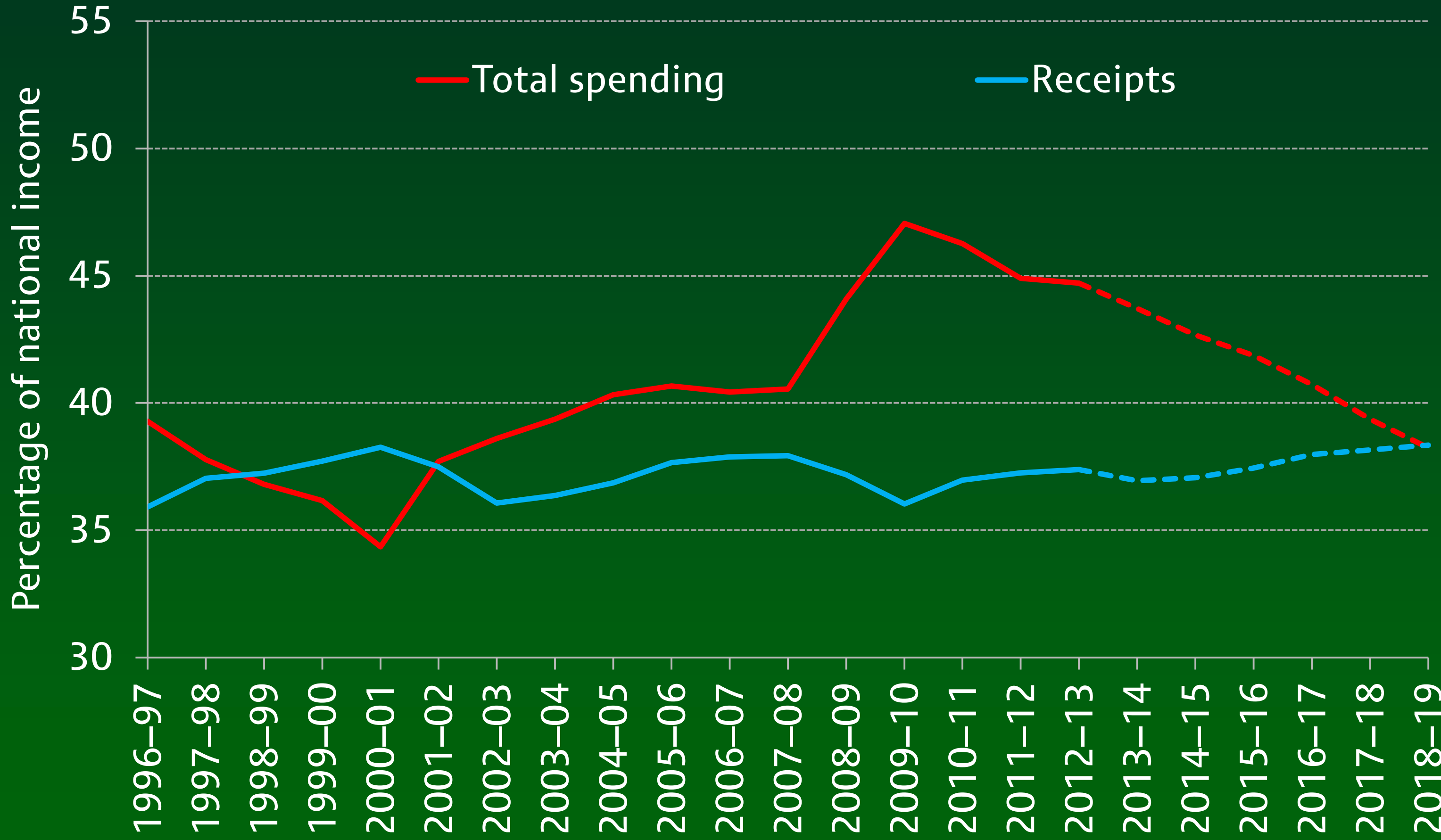
Spending and revenues over time



Note: Figures exclude Royal Mail Pension Plan and Asset Purchase Facility transfers.
Source: ONS; OBR; Author's calculations.

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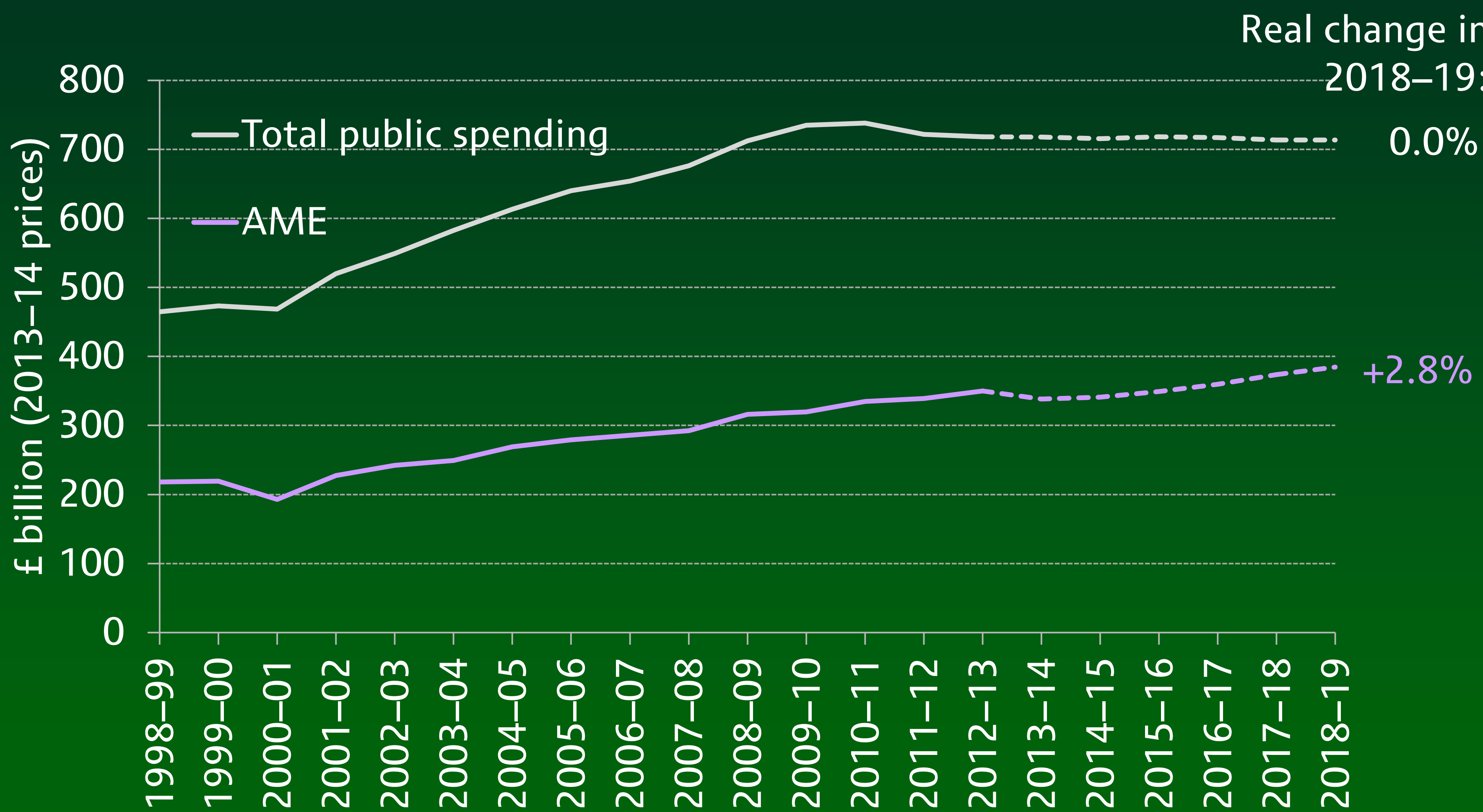
A freeze on total spending, but annually managed spending forecast to rise



Note: DEL and AME figures from 2013–14 are adjusted for changes for local government funding for Business Rates Retention.

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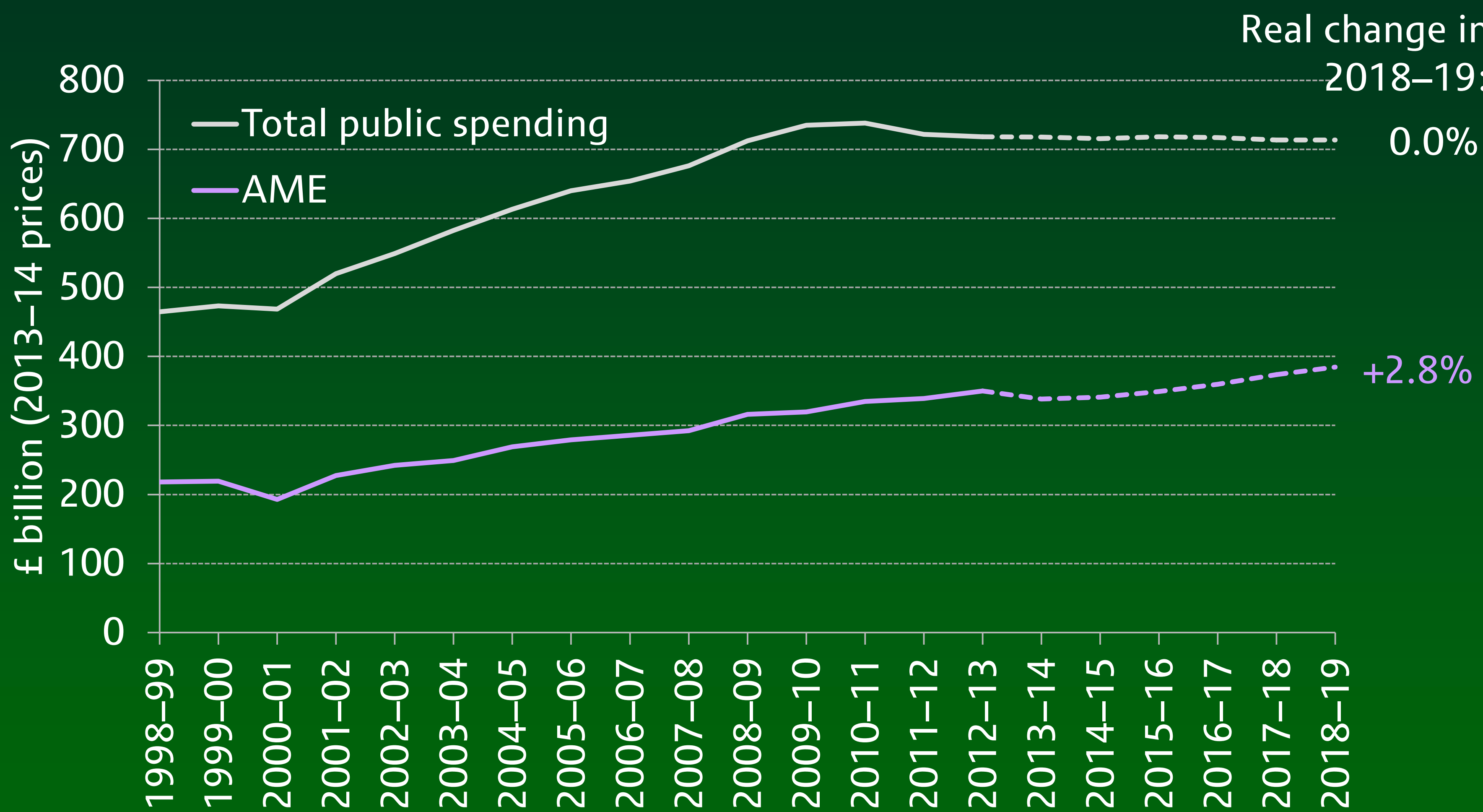
Absent further AME cuts, departmental budgets to keep falling



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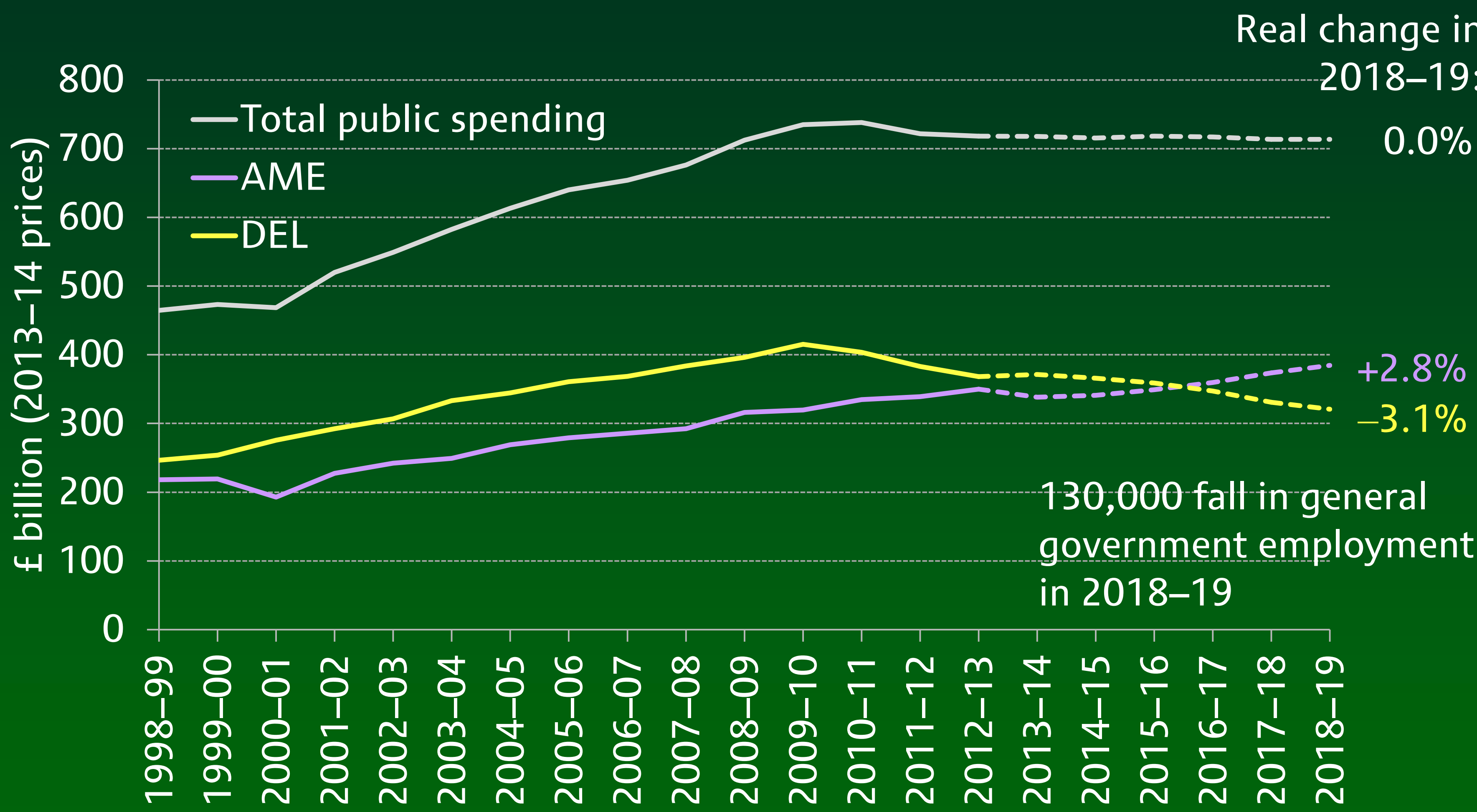

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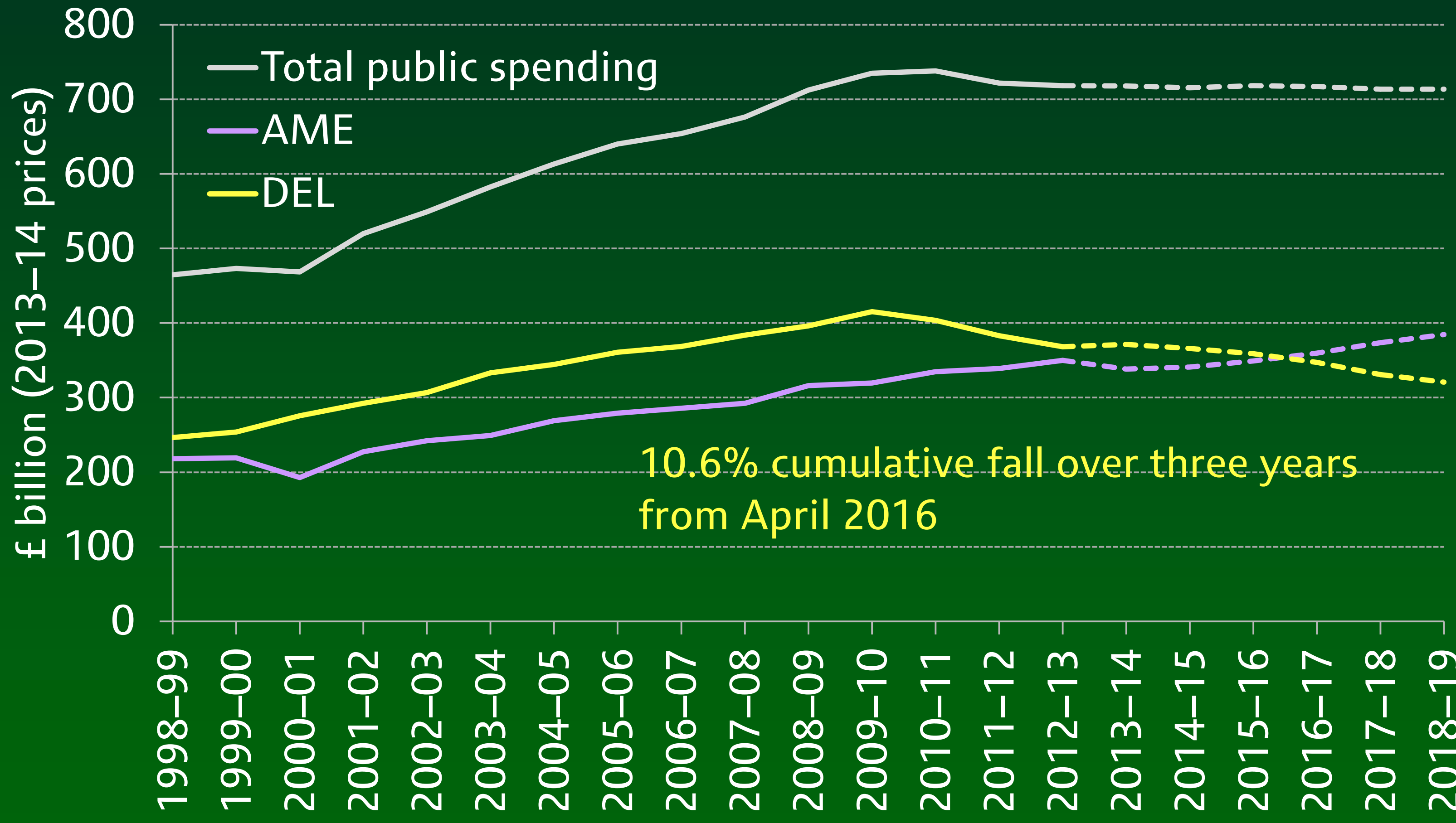

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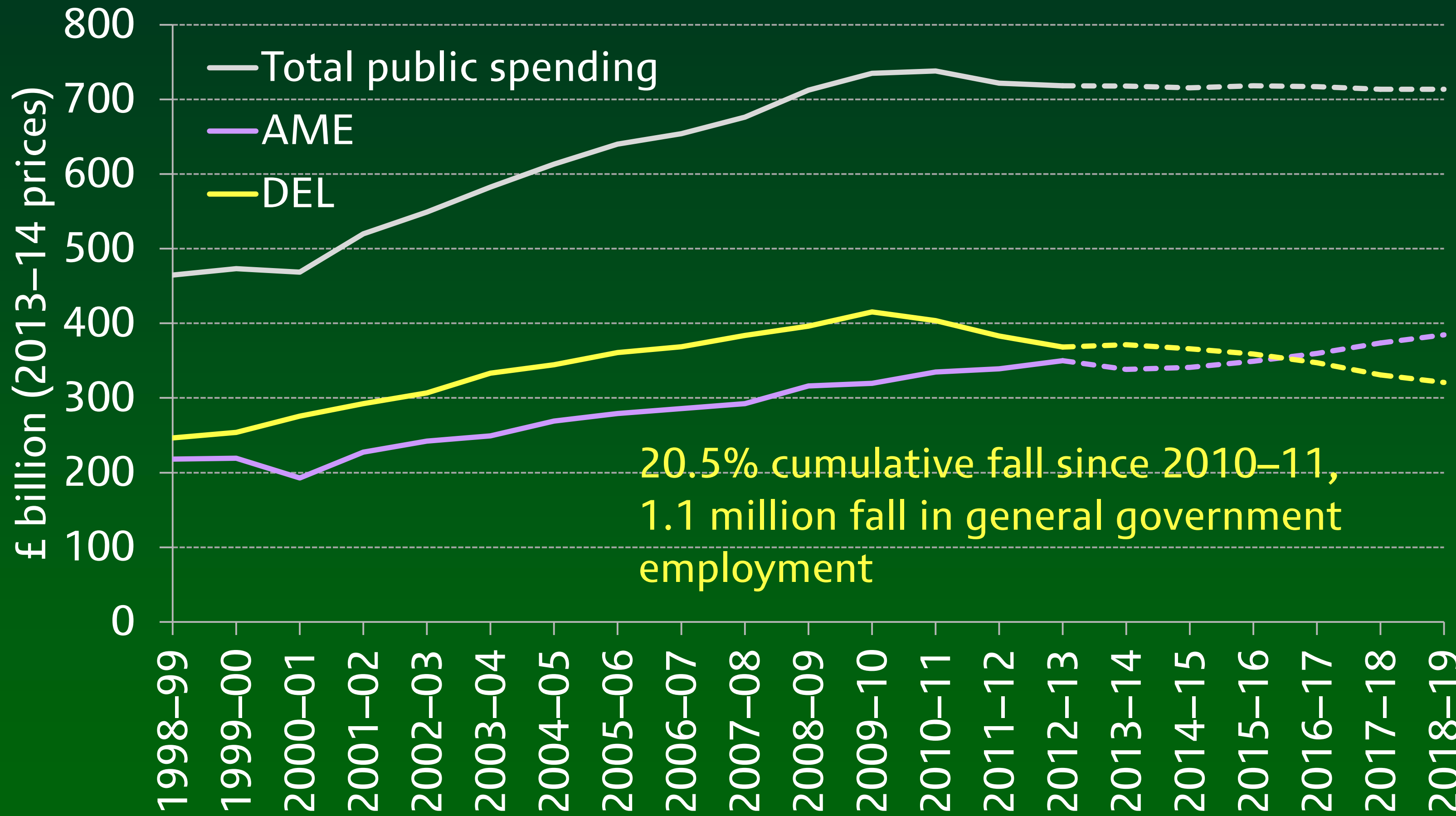

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Other pressures within DEL to bear in mind

Existing policies that cost money in 2016–17 onwards:

- Ending contracting out into DB pensions increases public sector employer NICs (£3.7bn a year)
- Dilnot reforms to social care funding (£1.0bn per year)
- New tax-free childcare scheme (£0.8bn per year)

Autumn Statement announced new policies for which money is available up to 2015–16 but not beyond:

- Free school meals extension (£0.8bn in 2015–16)
- Scrapping cap on HE student numbers (£0.3bn in 2015–16, increasing to £0.7bn in 2018–19 and further thereafter)
- Energy prices and efficiency (£0.3bn + £0.1bn in 2015–16)

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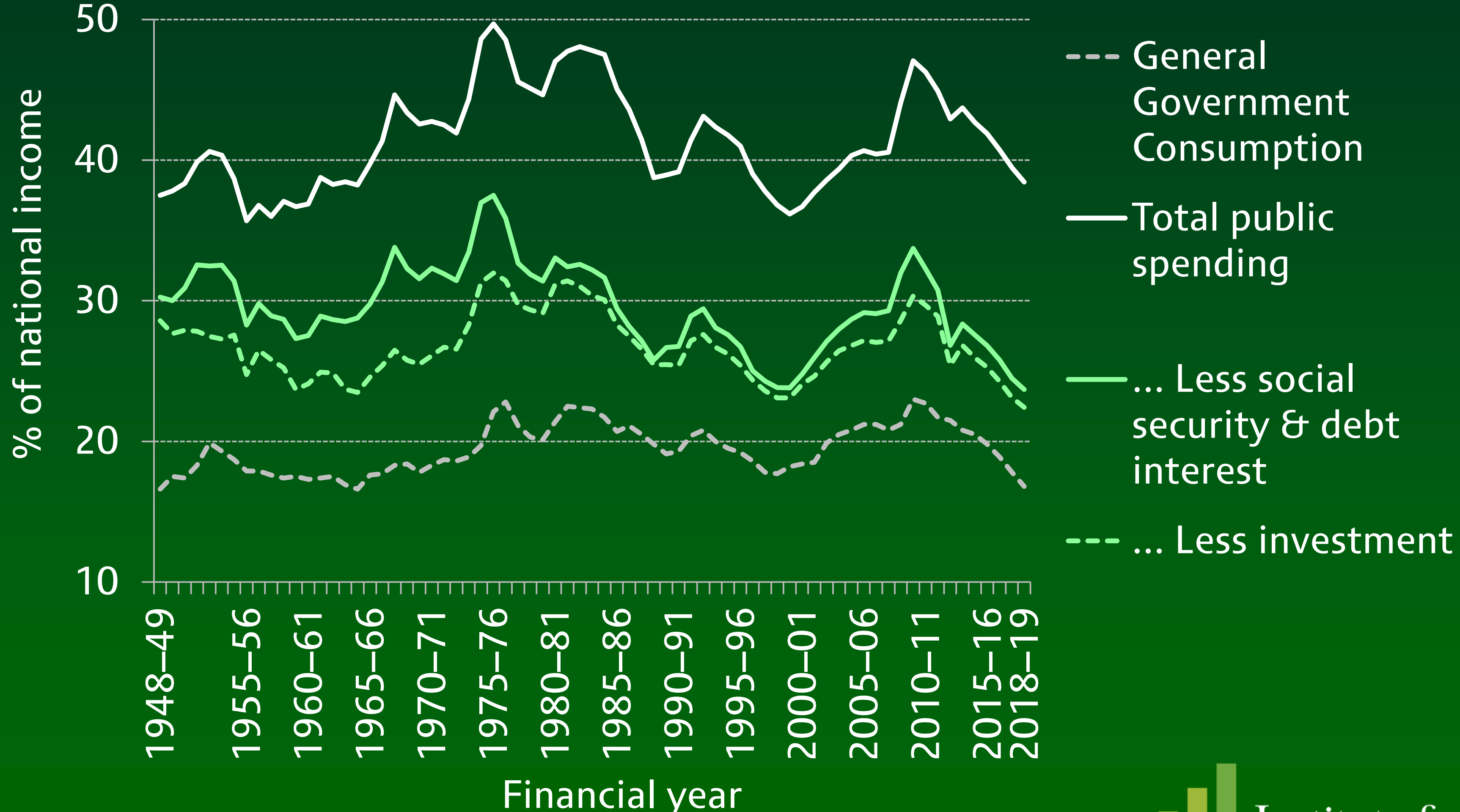
Without further benefit cuts, plans for total spending imply historically low public service spending



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Departmental spending beyond 2015–16

- DELs being cut by an average of 2.3% a year over the five years from April 2011 to March 2016
- Without further AME cuts the DEL cuts would accelerate to 3.7% a year over the three years from April 2016 to March 2019
- To reduce the DEL cut to 2.3% a year would require a further £12bn cut (in today's terms) to social security spending (or other AME) by 2018–19
- Compares to the estimated £25bn cut by 2018–19 from measures already announced by Mr Osborne
- Would still imply cumulative cut to DELs from April 2011 to March 2019 of 17.1%

Capping social security spending

- Budget to set cap for future spending on “welfare in scope”
  - social security and tax credit spending less state pension, JSA and JSA passported housing benefit
- OBR to assess compliance with the cap in each Autumn Statement
  - debate and vote in parliament needed to change cap or exceed it
- If welfare spending risen undesirably then forcing an active decision could lead to better policy making
- Could reduce risk in the public finances, but increase income risk faced by benefit recipients
- Better to review all spending frequently regardless of whether higher or lower than forecast, or at least cap individual components
  - proposed new annual OBR report on trends and drivers in welfare in scope spending could help with this

Strengthening the long run public finances?

- Chancellor re-iterated intention to increase the SPA
  - Pensions Bill already going through parliament plans to introduce reviews of the SPA every five years
  - confirmed principle that "people should expect to spend *up to a third* of their adult life in retirement"
- Long-run public finance projections suggest further adjustment is needed and increasing SPA is a coherent response to rising longevity
- Scrapping cap on student numbers will increase long run cost to the public finances of student loans
  - (costly because subsidised interest rate and not all loans repaid)
  - Treasury estimates around £0.7bn a year
  - "The new loans will be financed by selling the old student loan book": economically nonsense as selling an asset for what it is worth does not strengthen the public finances

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Conclusions

- Latest forecasts suggest underlying health of economy and public finances little changed since Budget
- New policy measures have little impact on borrowing through to 2017–18, further significant squeeze on spending pencilled in for 2018–19
- Budget surplus forecast for 2018–19 and debt to fall faster
- Under current policies over the three years from April 2016
  - Annually Managed Expenditure forecast to rise
  - 10.6% additional cut to departmental spending required
  - significant additional pressures on spending not accounted for
- Forecasts imply historically low levels of spending on public services in 2018–19
  - is this realistic, or might it imply either less deficit reduction or a combination of further net tax rises or benefit cuts?