Opening remarks

Paul Johnson

Downward revisions in the outlook for tax revenues, fiscal rules expected to be met by the merest whisker, investment spending plans being cumulated over several years, a complex array of small policies aimed at promoting growth, fiddling with tax credits, backing away from pre-announced increases to fuel duties. Mr Osborne’s second Autumn Statement had more in common with some of Mr Brown’s Budgets and Pre Budget Reports than perhaps either of them would care to admit.

But yesterday much of the Chancellor’s thunder was stolen by the independent Office for Budget Responsibility. Mr Brown kept all his forecasts very much in house. And yesterday the OBR did its job. It gave the Chancellor news that he did not want to hear, and he was obliged to accept it and, to a degree at least, act upon it.

In fact none of us should have been too happy to hear what the OBR had to say. Robert Chote and his colleagues now believe that the potential output of the economy will be a full three and half per cent smaller in 2016 than they had expected back in March. The consequences for all of
our living standards are just as profound as they are for Mr Osborne and his fiscal rules.

**The fiscal rules and spending cuts**

First those fiscal rules. On previous plans the fiscal mandate (that is that we should expect to achieve cyclically adjusted current budget balance within five years) would have been missed, even though back in March it looked like there was a fair bit of headroom. Indeed the Chancellor was then achieving his target with time to spare – just before the planned date of the next general election in fact.

The change arose because the OBR forecast a structural deficit 1.6% of GDP greater than they previously thought. Yesterday the Chancellor had to pencil in two more years of substantial spending cuts to deal with most, but not quite all, of this additional problem and is now just on course for meeting his mandate.

That will extend to six years the period for which total spending will have been cut year on year. One begins to run out of superlatives for describing quite how unprecedented that is. Certainly there has been no period like it in the UK in the last 60 years. The scale of the additional cuts is itself substantial. In 2016-17 spending is now planned to be £15
billion less, in real terms, than in 2014-15. That is even after the
dramatic reductions seen in this parliament. Relative to a world in which
spending stayed the same relative to national income the cut in the first
two years of the next parliament is bigger still – nearer £30 billion.

Of course the Chancellor has not told us anything about where those
spending cuts will come from – those are decisions for a future spending
review. One presumes that he is keeping his fingers crossed that
something will turn up which will make such deep cuts unnecessary; and
clearly much uncertainty remains. He has ended up on course to be in
exactly the place he wanted to avoid – promising further spending cuts
in the period after the next election.

This is also where the last Labour Government’s fiscal plans – as set out
in Alistair Darling’s March 2010 Budget – would have left them under
previous growth forecasts. With the worse economic outlook, their
slower fiscal squeeze – with smaller tax rises and less deep spending cuts
– would, if it had been implemented, now of course have implied even
higher debt levels over this parliament than those we will in fact see.
That would have left an even bigger job to do in the next parliament.
So the fiscal mandate is met – just – because we have some unspecified cuts announced for the next parliament.

Mr Osborne has a second fiscal rule – the supplementary target. It is a curious rule. It simply states that public sector net debt should be falling as a percentage of national income in 2015-16. On the OBR’s central forecast it will fall by a minuscule 0.3% of national income between 2014-15 and 2015-16. Tiny adjustments to growth or the public finances could lead to this target being missed – and as we saw yesterday we are not in a world where adjustments are often tiny.

The squeeze on incomes

It is not only public spending that is being squeezed. So are incomes. The OBR now predicts that average real earnings will fall by nearly 3% in 2011 and will fall again in 2012. Real household disposable income will fall by 4.7% between 2009 and 2012 – easily the biggest three year drop since records began in the mid 1950s.

Again we are running out of superlatives to describe just how extraordinary are some of these changes. Our own estimates suggest that real median household incomes will be no higher in 2015–16 than
they were in 2002–03, more than a decade without any increase in living standards for those in the middle of the income distribution. We estimate that in the period 2009-10 to 2012-13 real median household incomes will drop by a whopping 7.4% - another record matched only by the falls seen between 1974 and 1977.

The tax and spending measures announced yesterday did little to alter the pattern of income changes. Apparent plans to index benefits less quickly than last September’s inflation didn’t materialise. Some of those out of work, and certainly pensioners dependent on state benefits, will be faring rather better than working families over the coming period.

Failure to index some elements of tax credits, and the reversal of previous decisions to increase child tax credits in real terms, will leave some poorer families worse off and will lead to an increase in measured child poverty. Yet another failure to implement pre-announced increases in fuel duties will benefit those somewhat further up the income distribution.

Public pay and pensions
One group whose incomes are certainly being squeezed is public sector workers, many of whom are striking today over pension changes. The Chancellor announced two years of average 1% a year pay rises in the public sector to follow the current two year pay freeze. Analysis we are presenting today suggests that this will be enough to undo the average estimated pay premium that men in the public sector currently enjoy relative to men in the private sector.

Our analysis also indicates the extent of differences across the country. Looking at pay alone, public sector workers appear, on average, to do relatively badly in London and the South East and really rather well in some other areas including Wales and the North of England. One can see why the Chancellor has tasked the Pay Review Bodies with considering how public sector pay can be made more responsive to local labour markets. He is not the first chancellor to seek greater regional differentiation in public pay. We will await the reports from the PRBs with some interest.

Of course the immediate issue of concern is today’s strike over pension reforms. The government’s proposed reforms would significantly cut the average generosity of public sector schemes. But they will leave public sector workers with pension provision on average substantially more
generous than those enjoyed by private sector workers. And as we have just seen this does not reflect any general penalty on the pay side.

**Growth**

Finally we come to the topic which Mr Osborne wanted to put at the forefront of his statement – growth. The truth is we – like the OBR – have relatively little to say about the likely effects of the myriad of measures announced.

Extra infrastructure spending over the next three years may be welcome – though it looks to us like the actual net increase over that period is nearer £4 billion than £5 billion and it is important to put in the context of planned cuts in capital spending of more than £17 billion between 2010-11 and 2013-14. The £20 billion of potential additional spending on infrastructure by pension funds looks at present to be more of an ambition than a done deal – and we at least have little clarity as to what the nature of this potential additional spending might be.

“Credit easing” might boost the availability of cheaper loans for small companies – but again both the details and the effects remain to be seen.
It is hard for governments to use fiscal policy to boost growth in the short run if they rule out an overall fiscal stimulus. We can at least say for this government that it is trying a fair range of options.