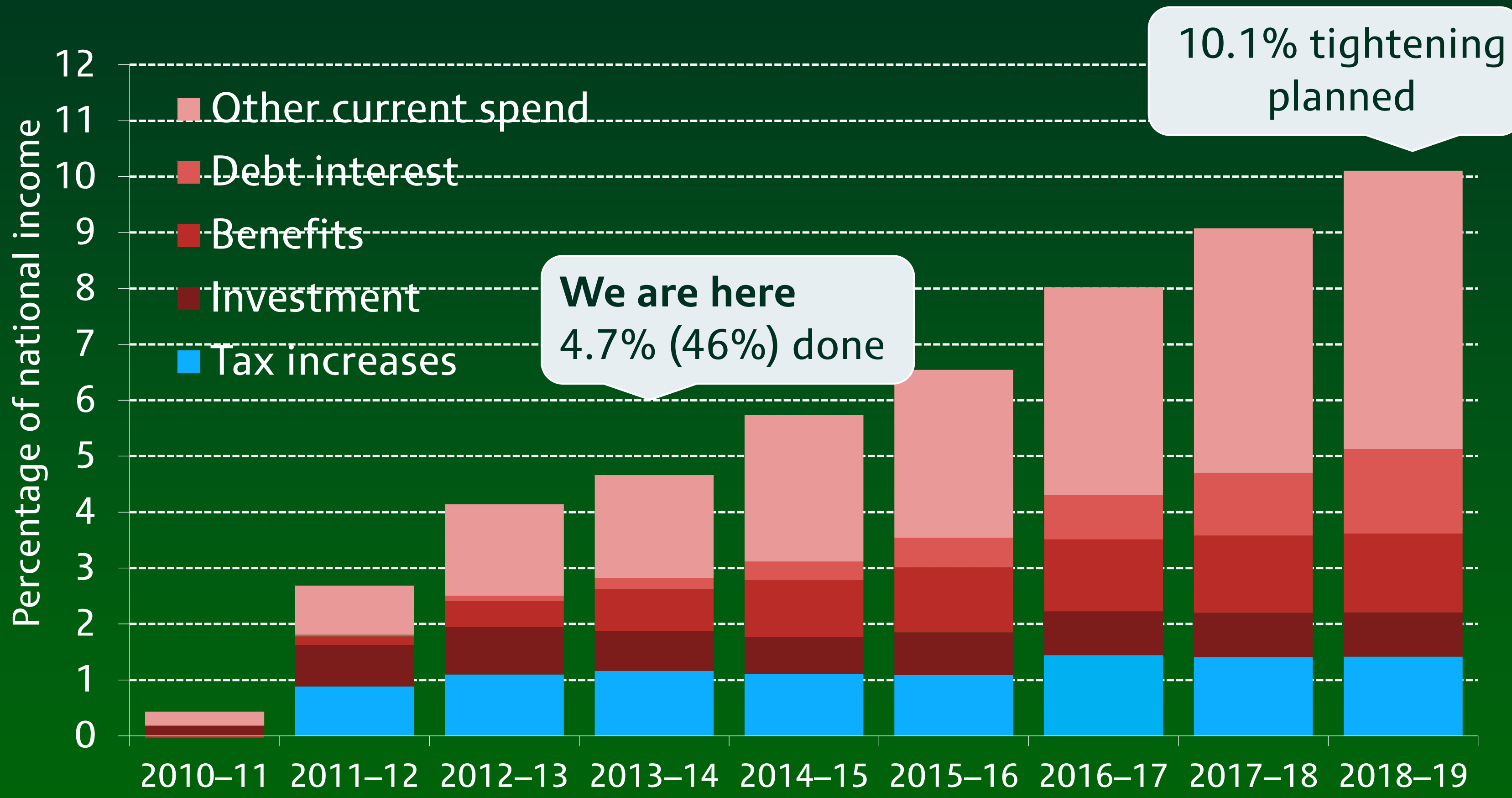
Budget 2014: don't forget austerity…

Carl Emmerson, Presented to BBC journalists, NBH, London, 10th March 2014
Paul Johnson , Presented to BBC journalists, Millbank, London, 13th March 2014

(www.ifs.org.uk/budgets/showindex)

The planned consolidation



Notes and sources: see Figure 1.2 of *The IFS Green Budget: February 2014*.

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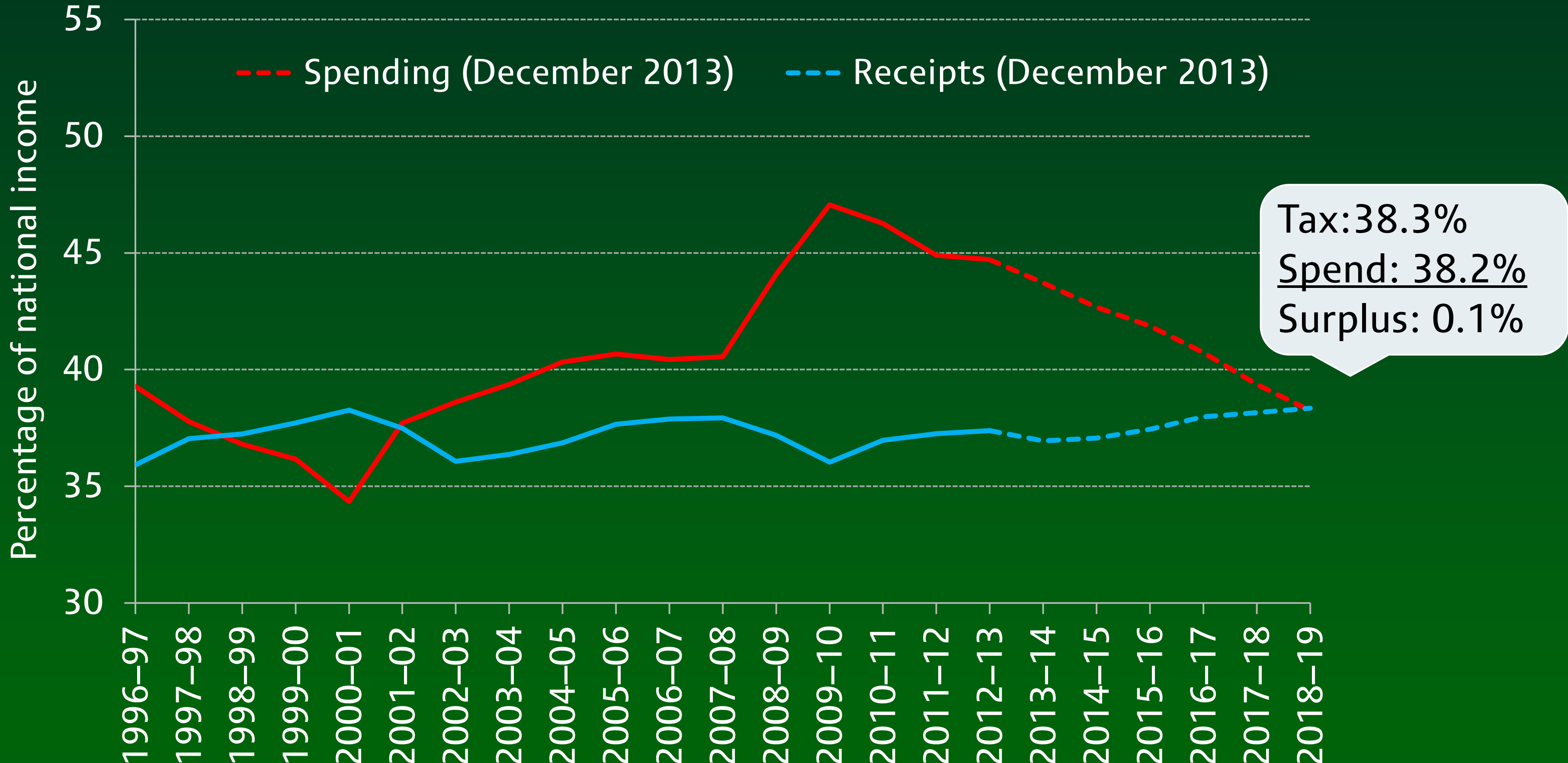
Bringing tax and spend back to pre-crisis levels



Notes and sources: see Figure 1.1 of *The IFS Green Budget: February 2014*.

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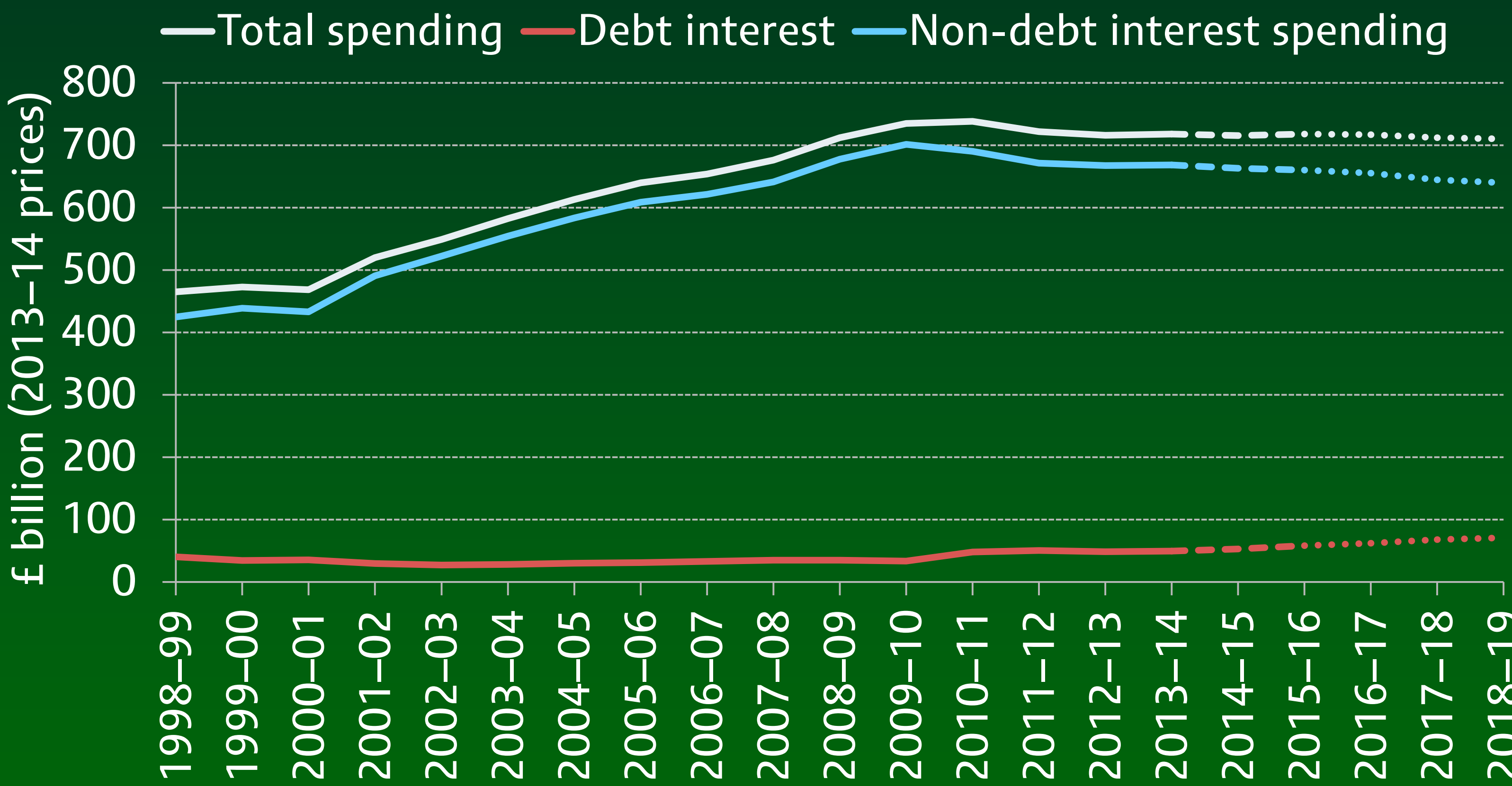
Planned cuts to spending

2010–11 to 2018–19:
Total spending: –3.8% (–£28.3bn)
Debt interest: +46.9% (+£22.5bn)
Non-debt interest: –7.4% (–£50.8bn)



Notes and sources: see Figure 2.6 and Table 2.3 of *The IFS Green Budget: February 2014*.

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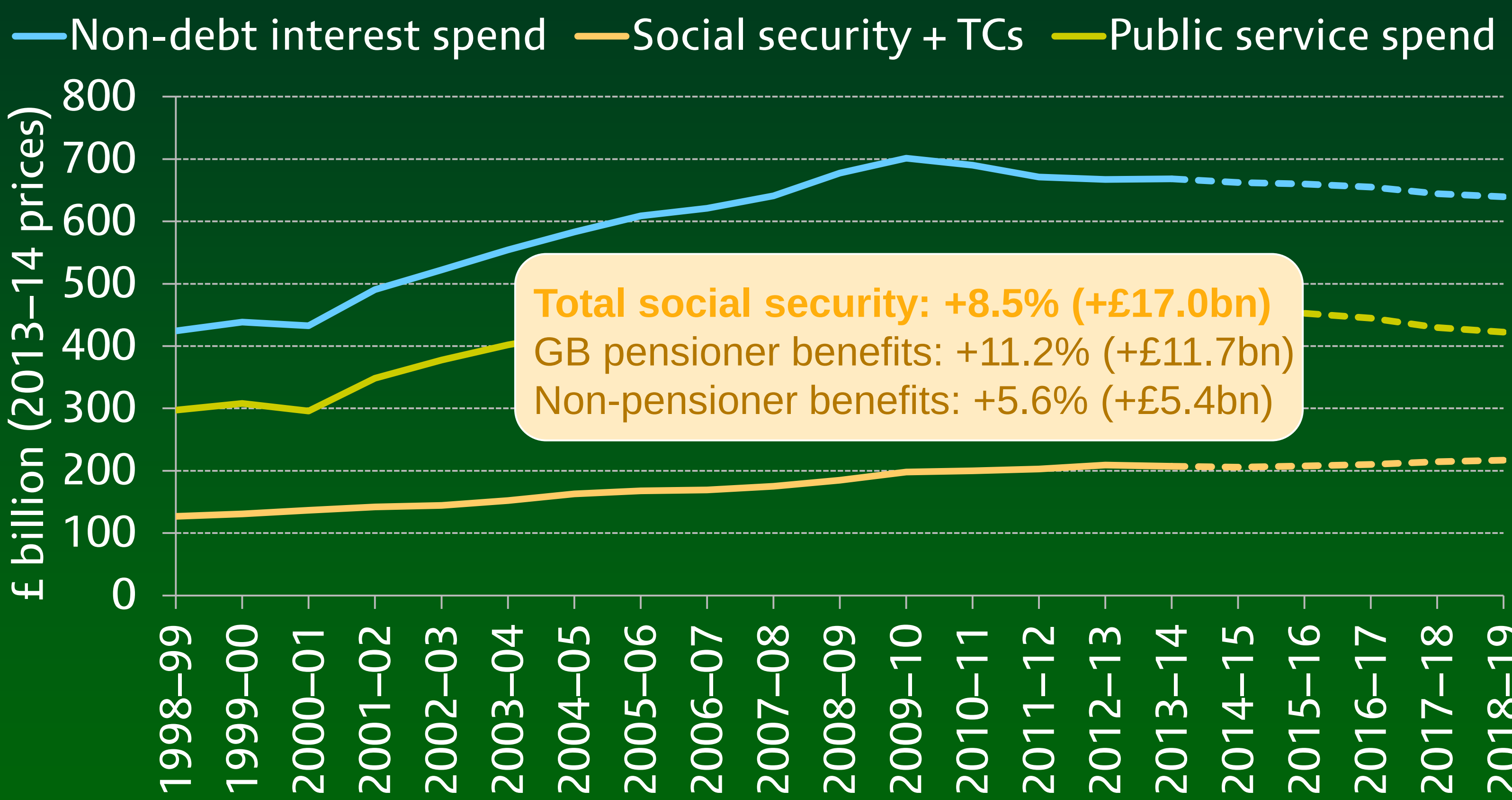
Planned cuts to spending

2010–11 to 2018–19:
Non-debt interest: –7.4% (–£50.8bn)
Social security: +8.5% (+£17.0bn)
Public services: –13.8% (–£67.8bn)



Notes and sources: see Figure 2.6 and Table 2.3 of *The IFS Green Budget: February 2014*.

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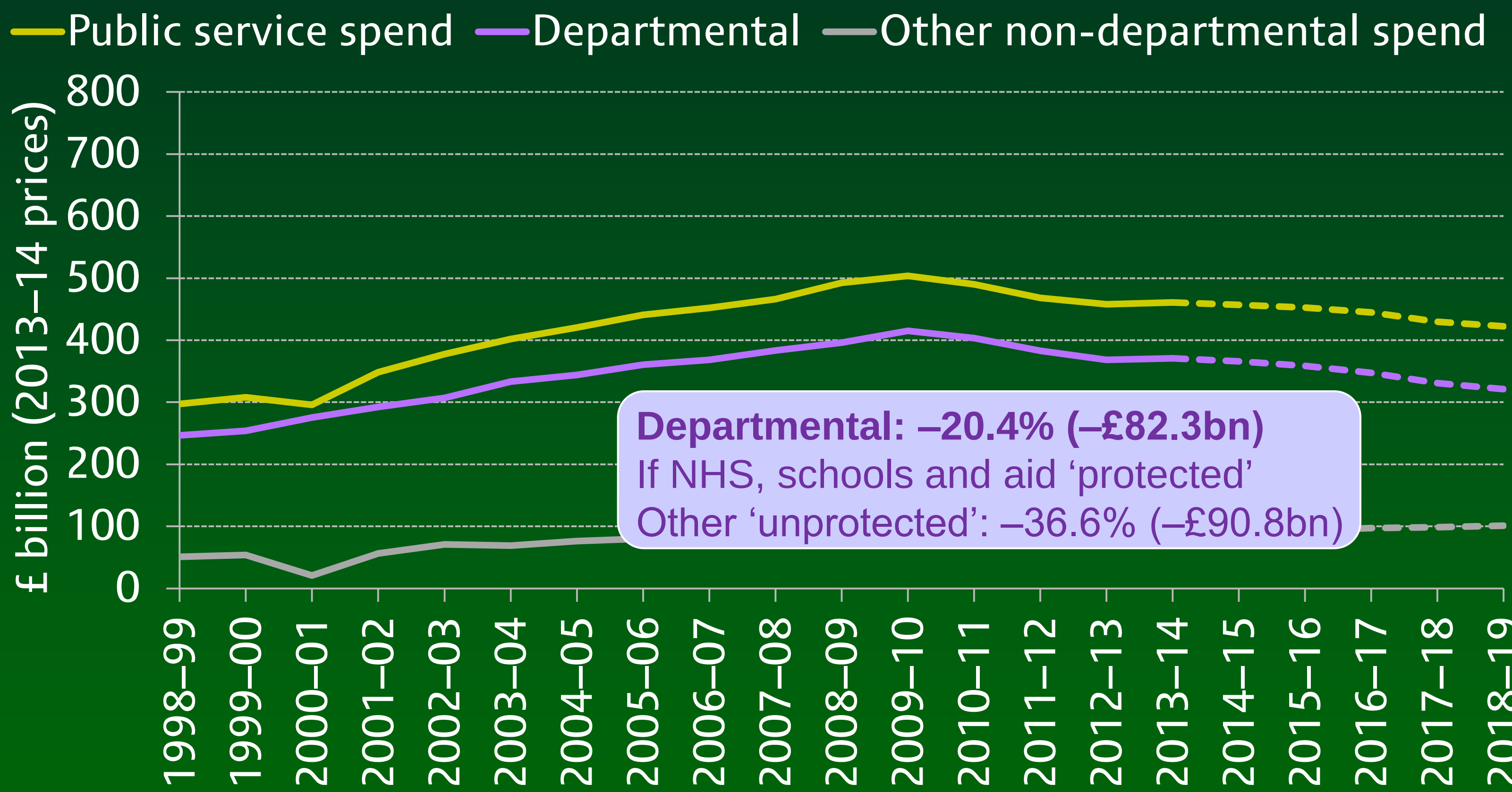
Planned cuts to spending

2010–11 to 2018–19:
Public services: –13.8% (–£67.8bn)
Departmental: –20.4% (–£82.3bn)
Other non-dept.: +16.8% (+£14.6bn)



Notes and sources: see Figure 2.6 and Table 2.3 of *The IFS Green Budget: February 2014*.

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Near-term growth likely to be revised up…

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	2014	2015	2016	2017	2018
Office for Budget Responsibility					
December 2013	2.4	2.2	2.6	2.7	2.7

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Av. independent forecasters					
November 2013	2.4	2.4	2.4	2.2	–
Bank of England					
November 2013	2.8	2.3	2.5	–	–

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December 2013	2.4	2.2	2.6	2.7	2.7
Av. independent forecasters					
November 2013	2.4	2.4	2.4	2.2	–
February 2014	2.7	2.5	2.4	2.4	2.4
Change	+0.3	+0.1	0.0	+0.2	–
Bank of England					
November 2013	2.8	2.3	2.5	–	–
February 2014	3.4	2.7	2.8	–	–
Change	+0.6	+0.4	+0.3	–	–

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Forecasts

- Headline public finances might not be significantly improved
  - while near-term growth up, near-term inflation likely down
  - nominal GDP more important than real GDP for revenues
- OBR December 2013 forecast borrowing in 2013–14 of £111.2bn
  - data from first ten months suggest it is on course (£109bn)
- Key judgement for OBR is how much spare capacity exists
  - less spare capacity means less scope for future growth
- Business surveys of capacity utilisation and recent sharp fall in unemployment might suggest less spare capacity
- But business surveys are difficult to interpret and many employees report they would like to work more hours
- OBR could decide not to revise down estimated spare capacity
  - for example they did this in December 2012

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Policies already in the pipeline

- Giveaways (from April 2014 unless otherwise stated)
  - personal allowance increased to £10k
  - NICs employment allowance of £2k introduced for most employers
  - corporation tax rate cut from 23p to 21p and to 20p in April 2015
  - business rates cut in April 2014 and ‘temporary’ small firm relief for small firms extended to April 2015
  - employer NICs abolished for (most) under 21s from April 2015
  - up to £1,000 of personal allowance transferable between adults who are married or in a civil partnership from April 2015
  - fuel duties frozen until September 2015
  - ‘tax-free childcare’ phased in from September 2015

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Policies already in the pipeline

- Takeaways
  - annual pension contribution limit reduced from £50k to £40k, and lifetime limit reduced from £1.5m to £1.25m from April 2014
  - alcohol and tobacco duties to rise by 2% more than RPI
  - most working age benefits, public sector pay, and higher rate threshold to be indexed by smaller of CPI or 1% in April 2014 and April 2015
  - enhanced temporary Annual Investment Allowance to expire on 31 December 2014

Likely/possible announcements

- Level of the new welfare cap to be announced
- Further increases in the personal allowance?
- Increased support for savers?
- Increases to the annual investment allowance?
- Freezing carbon price floor?
- Increase in the minimum wage?

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Level of the new welfare cap to be announced

- Budget to set a cash cap for "welfare in scope" spending for four years from April 2015
  - central government spending on social security and tax credit less state pension, JSA and JSA passported housing benefit
- December 2013 Autumn Statement forecast "welfare in scope" spending of £118.8bn in 2015–16 rising to £126.9bn in 2018–19
- Cap breached if
  - projected spending rises above cap as a result of a policy change
  - or rises above a forecast margin as a result of a forecasting change
- If welfare spending rises undesirably then forcing an active decision could lead to better policy making

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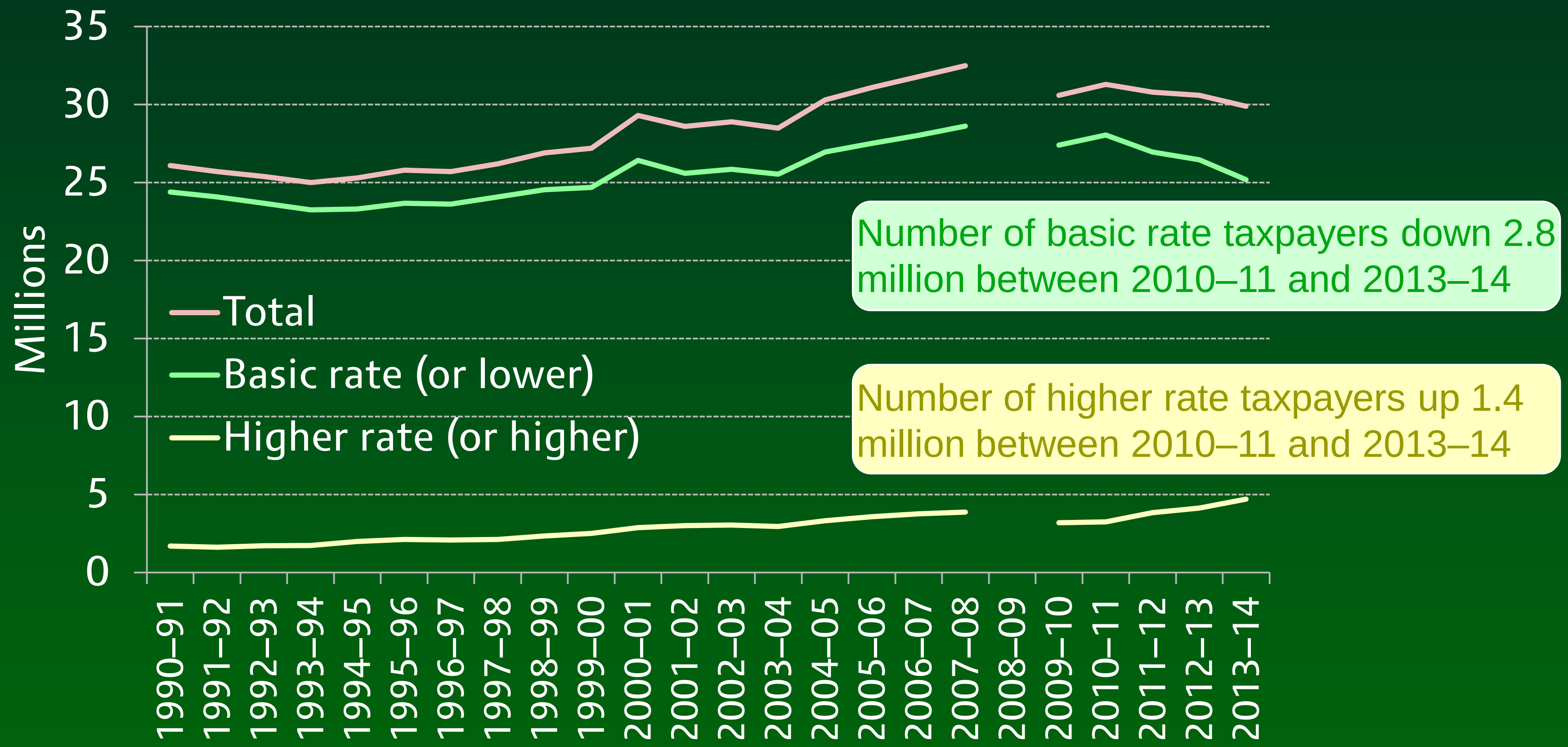
Further increases in the personal allowance?

- Already increased to £10,000 in April 2014
  - increase of £2,545 at cost of £10.7 billion per year, taken 2.0 million out of income tax relative to the system Labour bequeathed
  - higher-rate threshold cut by £4,910 creating 1.1 million more higher rate income tax payers relative to the system Labour bequeathed

Number of taxpayers over time



Source: Table 2.1 of HMRC statistics. Data from 2008–09 unavailable.

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- By default would rise to £10,220 in April 2015
  - increase to £10,500 and not letting higher-rate taxpayers gain would cost around £1 billion, but would create more higher-rate taxpayers
  - keeping the number of higher-rate taxpayers unchanged (from this reform) and allowing them to gain the same amount would cost around £1.4 billion
- Largest gains would be in the upper middle of the income distribution
- If objective is to help the low paid a better tax cut would be to take people out of employee National Insurance

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Increased support for savers?

- In opposition George Osborne proposed exempting saving income from basic rate tax
- This wouldn't cost much now as interest rates low, but would be a significant medium-term giveaway
  - largest gains would be towards the top of the income distribution
- Could extend ISA limits
  - returns on funds held in ISAs not subject to income tax or capital gains tax
  - from April 2014 up to £11,880 can be placed in an ISA, and up to half this amount can go into a cash ISA
- Good reasons not to tax interest income

Increases to the annual investment allowance?

- Firms can offset 100% of plant & machinery investment against corporation tax up to the value of the Annual Investment Allowance
- Autumn Statement 2012 temporarily increased this allowance from £25k to £250k for two years from 1 January 2013
  - cost £670 million in 2013–14
- CBI have called for the higher limit to be extended
- Making the higher AIA permanent (and potentially widening its scope) would be attractive

Freezing carbon price floor?

- Carbon price floor is a tax on fossil fuels used to produce electricity
  - tops the price of carbon up to a floor
  - current policy: £18/tonne in 2015–16, target of £30/tonne in 2020
  - household bills up £10 p.a. in 2015–16 , £30 in 2020 and raises £1bn for HMT now, rising to £1.8bn in 2020
- Encourages investment in low-carbon electricity generation
  - boosts expected return by reducing downside risk
- But also advantages imports of carbon intensive goods over domestic production
- Widespread speculation this is going to be frozen in the Budget
  - would reduce cost of electricity for domestic firms and households
  - would also reduce incentive to invest in low-carbon electricity generation

Increase in the minimum wage?

- Minimum wage currently £6.31 an hour for those aged over 20
- George Osborne and Vince Cable (among others) have said they want to see an above-inflation increase
- Minimum wage has risen slightly compared to average earnings since the recession, but has fallen by 5% in real terms
- Broad consensus is that so far there has been little evidence of negative employment effects
  - but any large increase would carry risks
- Low Pay Commission has recommended an increase of 3.0% in October 2014 bringing it up to £6.50 an hour
  - recommendation likely to be approved in the Budget?

Conclusions

- Forecasts
  - 2014: real growth revised up and inflation revised down
  - 2013–14: headline deficit left broadly unchanged (at around £110bn)
- Key judgement for OBR is how to revise estimate of spare capacity
  - determinant of future growth and therefore need for further austerity
- Many measures already in the pipeline
- Level of new welfare cap and minimum wage to be announced
- Possible new announcements include
  - further increase to personal allowance in April 2015?
  - extension of annual investment allowance from January 2015?
- Whatever happens much austerity lies ahead, in particular planned cuts to day-to-day spending by government

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Budget 2014: don't forget austerity…

Carl Emmerson

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