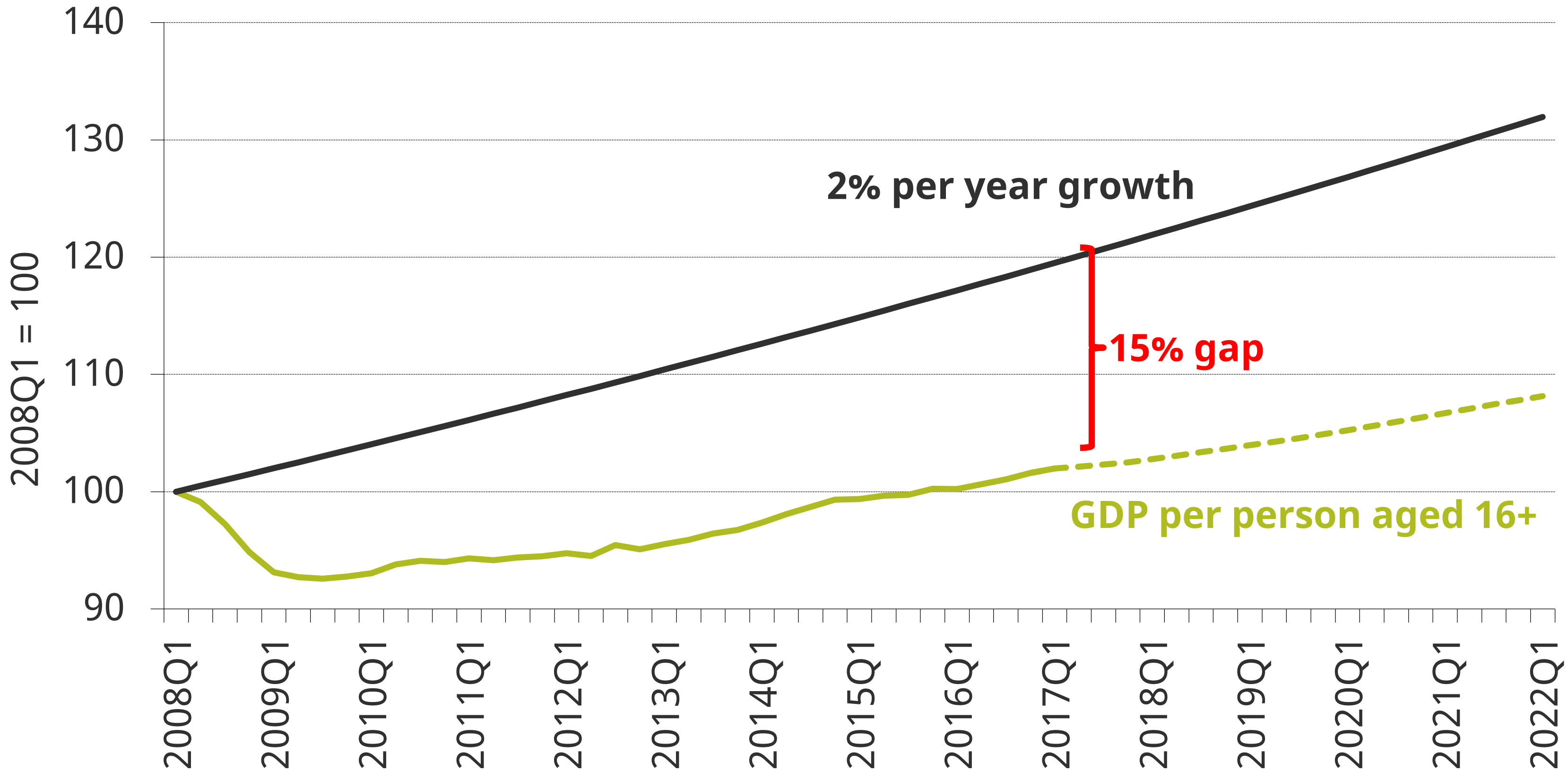
# Where next for tax & spend?

Carl Emmerson

Presentation at IFS / IfG briefing "What next for tax and spend?"
London, 12 July 2017

@TheIFS

# Output per head only just above 2008Q1 level




**Source: Office for Budget Responsibility.**

# The Government's fiscal rules

**Rules introduced in November 2016 (replacing the 2015 vintage)**

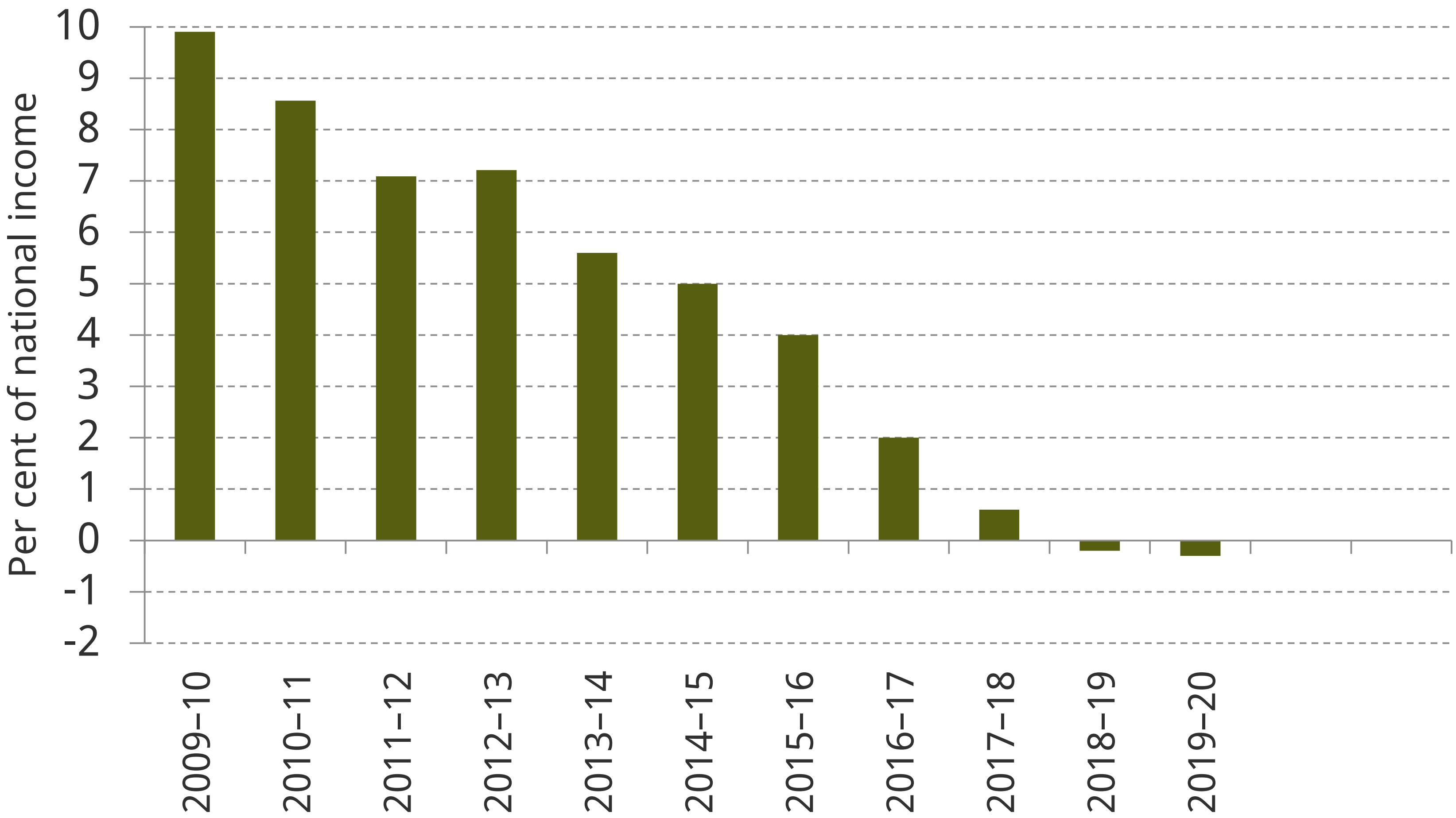
- forecast welfare-in-scope spending to be below a cap
- structural borrowing to be below 2% of national income by 2020–21
- public sector net debt to fall as a share of national income in 2020–21
- headline surplus as soon as possible in the next Parliament

**Conservative Party manifesto**

- "balanced budget by the middle of the next decade"

# March Budget 2015 forecast: deficit

Institute for Fiscal Studies




**Source: Office for Budget Responsibility.**

# Budget 2016 forecast: deficit

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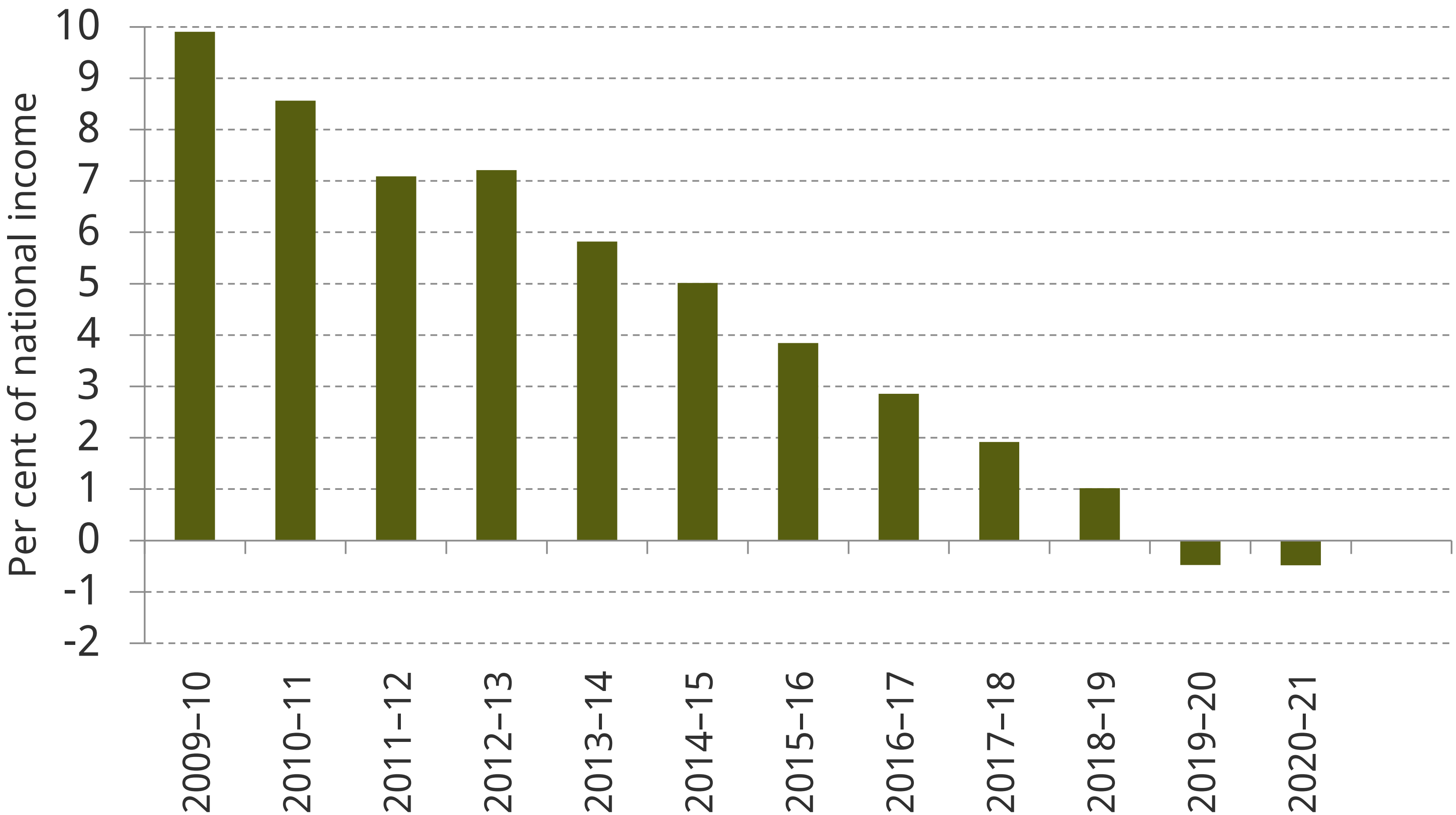
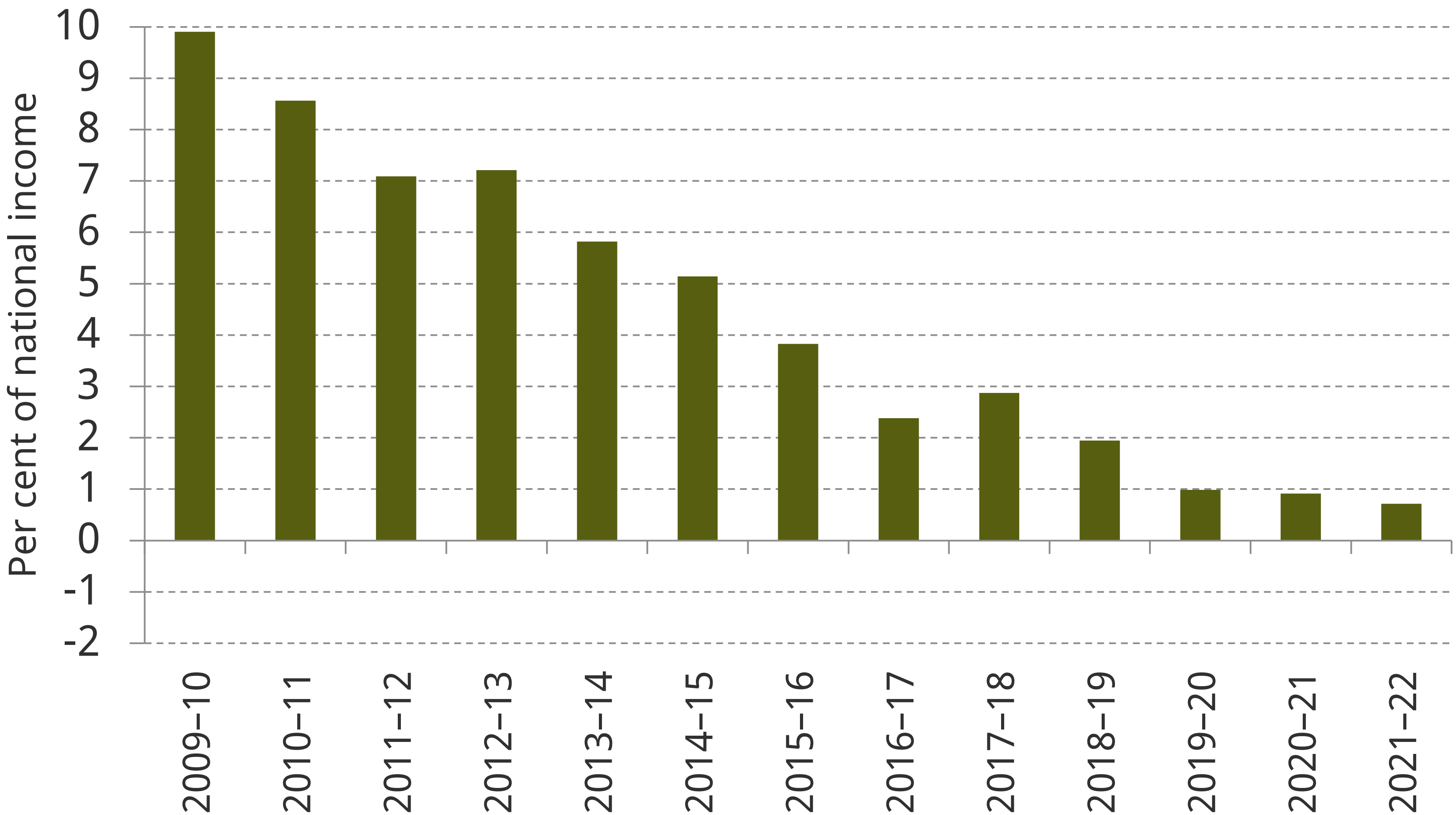



**Source: Office for Budget Responsibility.**

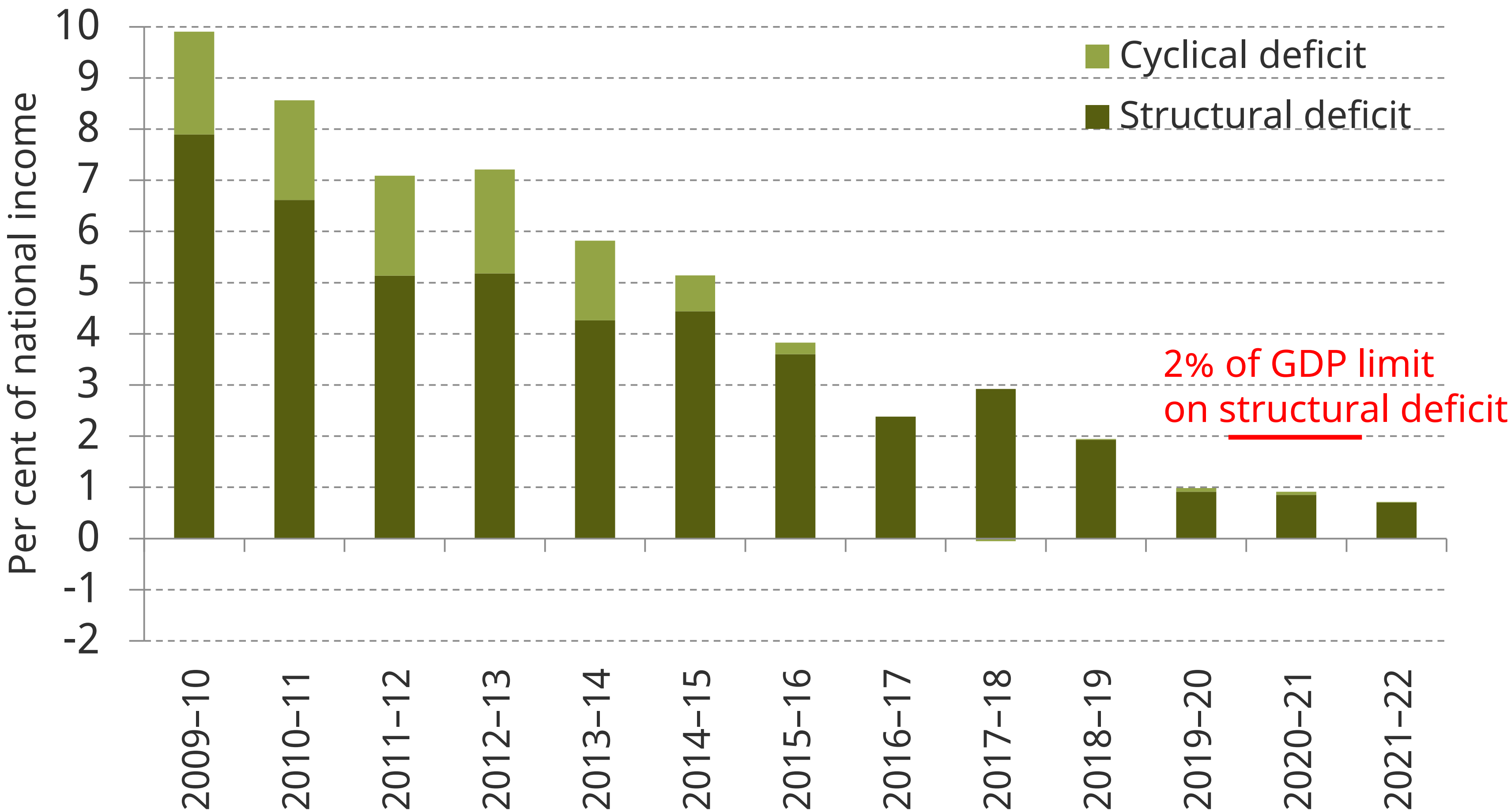
# Budget 2017 forecast: deficit




**Source: Office for Budget Responsibility.**

# Budget 2017 forecast: deficit

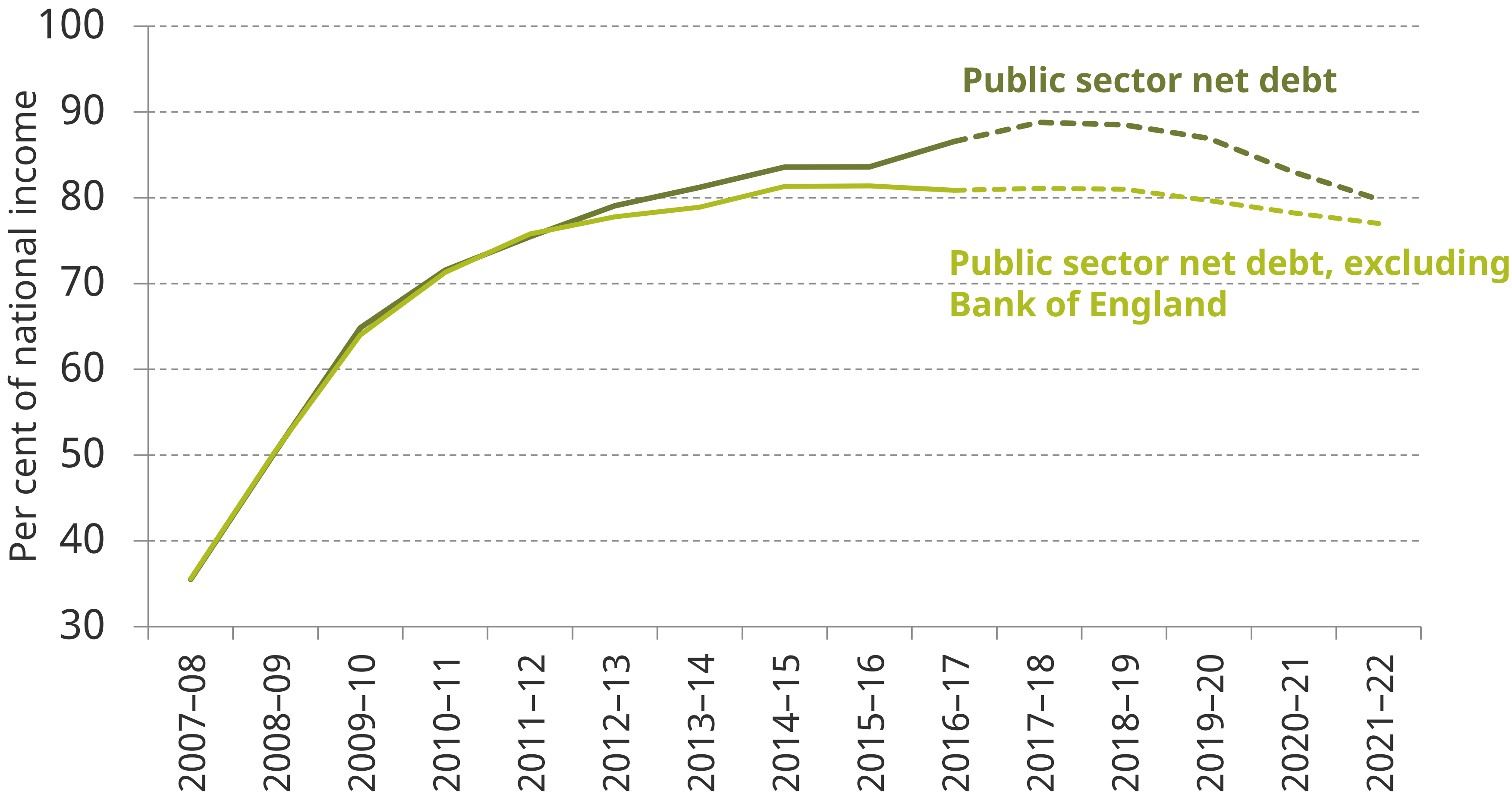
Institute for Fiscal Studies




**Source: Office for Budget Responsibility.**

# Budget 2017 forecast: public sector net debt

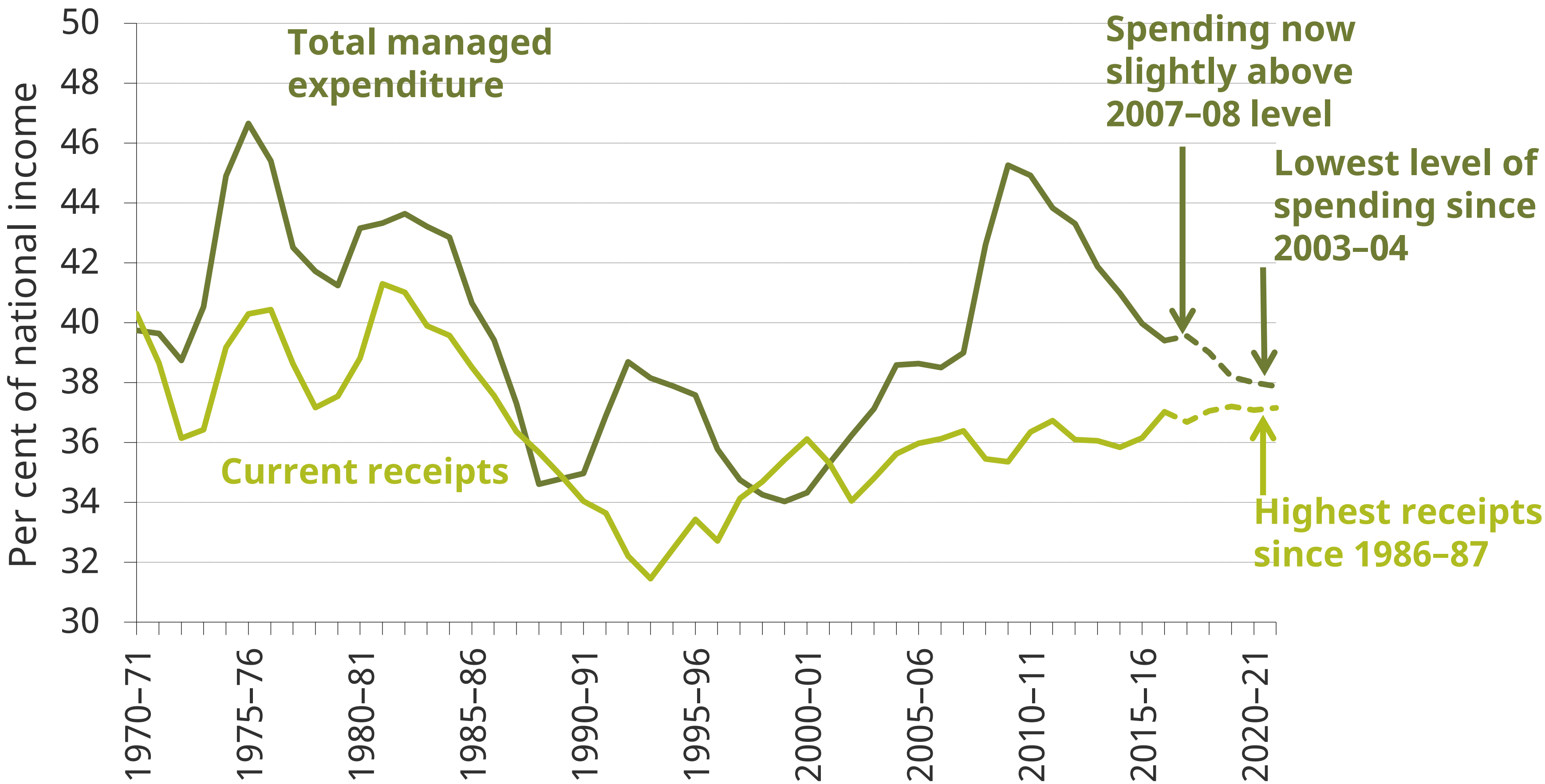
Institute for Fiscal Studies




**Source: Office for Budget Responsibility.**

# Budget 2017 forecast: tax & spend

Institute for Fiscal Studies




**Source: Office for Budget Responsibility.**

# Further tax rises and spending cuts (1/3)

## Rising tax burden

- £5bn net tax rise from discretionary measures, includes increase in dividend tax and council tax rise earmarked for social care
- rate of corporation tax cut from 19% in 2017–18 to 17% in 2020–21, not doing this would raise £5bn
- RPI indexation of rates of fuel duties from April 2018, not doing this would cost £4bn in 2021–22

## Conservative manifesto recommitted to further income tax cuts

- £12.5k personal allowance and £50k higher-rate threshold by 2020 would reduce revenues by about £2bn

# Further tax rises and spending cuts (2/3)

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## Benefit cuts

- measures in the pipeline cut spending by £11bn in 2021–22, more in the long-run
- mostly from working-age families as new claims for the less generous Universal Credit and more new births in large families

## Conservative manifesto committed to

- means-testing winter-fuel payments, cut of up to £2bn per year
- move from triple to double-lock state pension indexation from 2020, projected cut to spending over the longer-term
- but both since abandoned

# Further tax rises and spending cuts (3/3)

**Spending on public services**

- being increased in real terms by £37bn by 2021–22
- represents a cut to spending as a share of national income of £17bn
- this £17bn cut comprises a £27bn cut to day-to-day spending alongside a £10bn boost to investment spending

**Conservative manifesto commitments on schools, NHS and social care**

- appeared consistent with spending plans set out in March Budget

# Additional challenges

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**Spending pressures**

- for example: population growing and ageing and history suggests health-care costs will rise
- OBR projects these pressures equate to 1.0% of GDP between 2021–22 and 2025–26

**Receipts: immigration**

- OBR reduced forecast receipts in 2020–21 by £6bn due to lower expected net immigration
- meeting tens of thousands target could hit revenues by a similar magnitude

# Additional challenges: Brexit

**Size of impact uncertain**

- increased tariff and non-tariff barriers would reduce growth and weaken public finances

**Impact of reduced economic activity on the public finances**

- investment heavy composition of hit to GDP likely to weaken the public finances by more in the long-run than over period to 2021–22
- possibly by around £3½bn a year

**Payments to the European Union**

- forecasts do not allow for any one-off 'divorce' settlement …
- … but have not allocated any saving from the £8bn per year of net EU contributions

# The new Government

**Confidence and supply arrangement with the DUP**

- additional £450m per year for two years, more to follow?
- significant sum for Northern Ireland, but tiny sum for the UK public finances
- but would be expensive to boost UK-wide spending by equivalent amount: 1.3% of UK GVA ≈ £22bn per year

# Public spending by region

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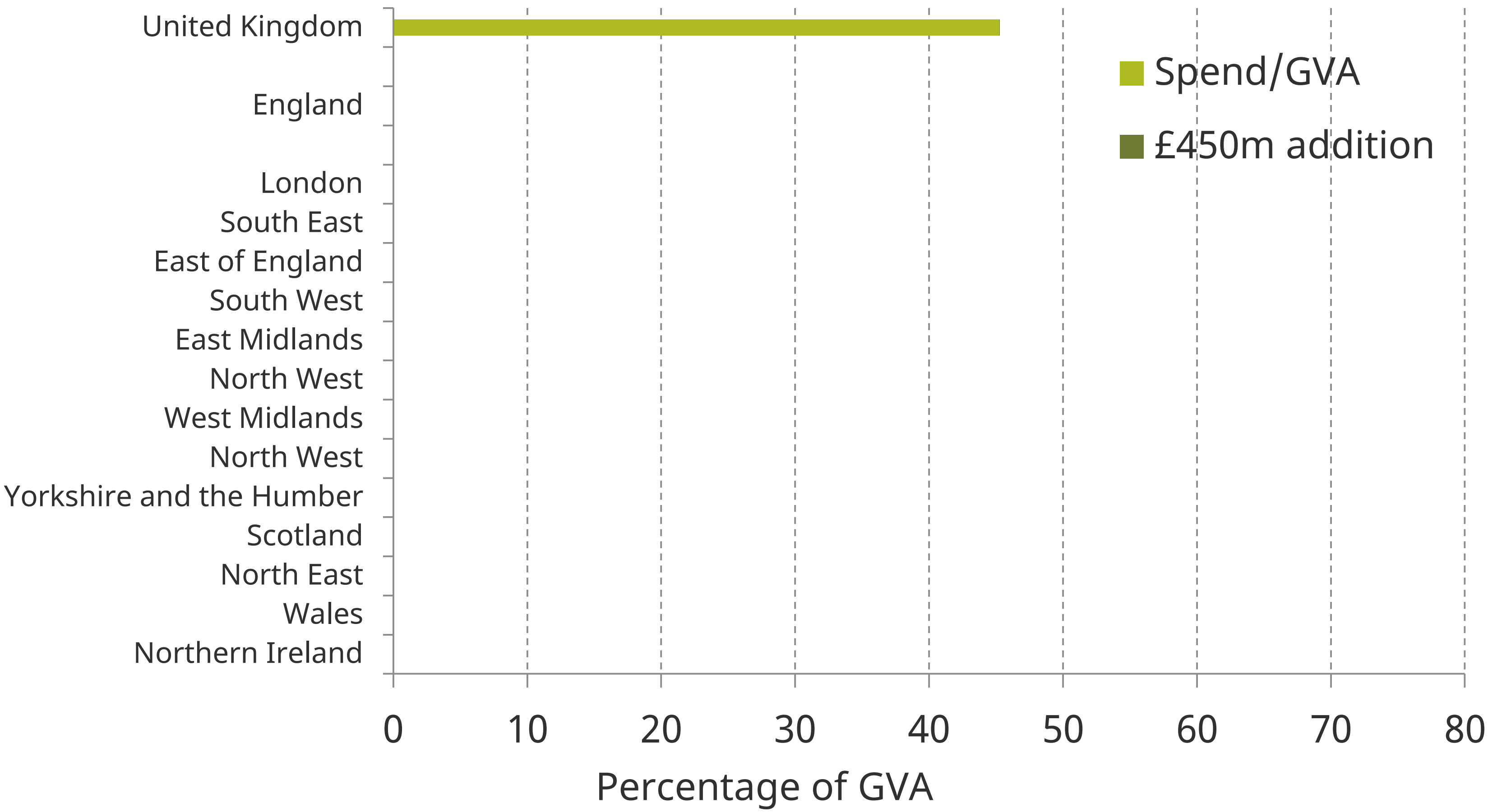
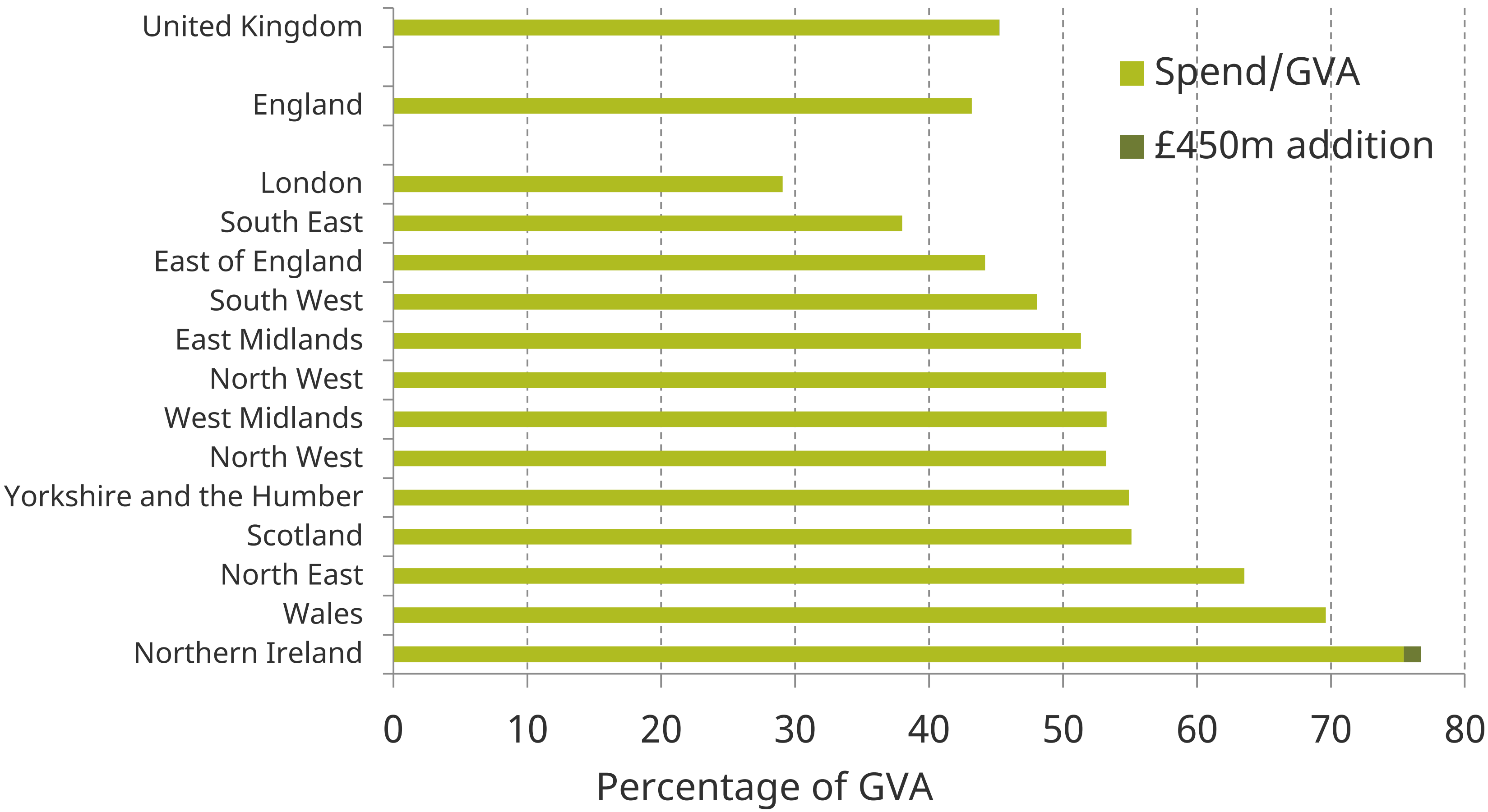



**Source: Office for National Statistics, author's calculations.**

# Public spending by region




**Source: Office for National Statistics, author's calculations.**

# Public sector pay

**Government spends £180 billion a year remunerating 5.1 million public sector workers**

**Recent policy on public sector pay scales**

- freeze in 2011–12 and 2012–13 for all but lowest paid workers
- rise by 1% p.a. on average from 2013–14 through to 2019–20

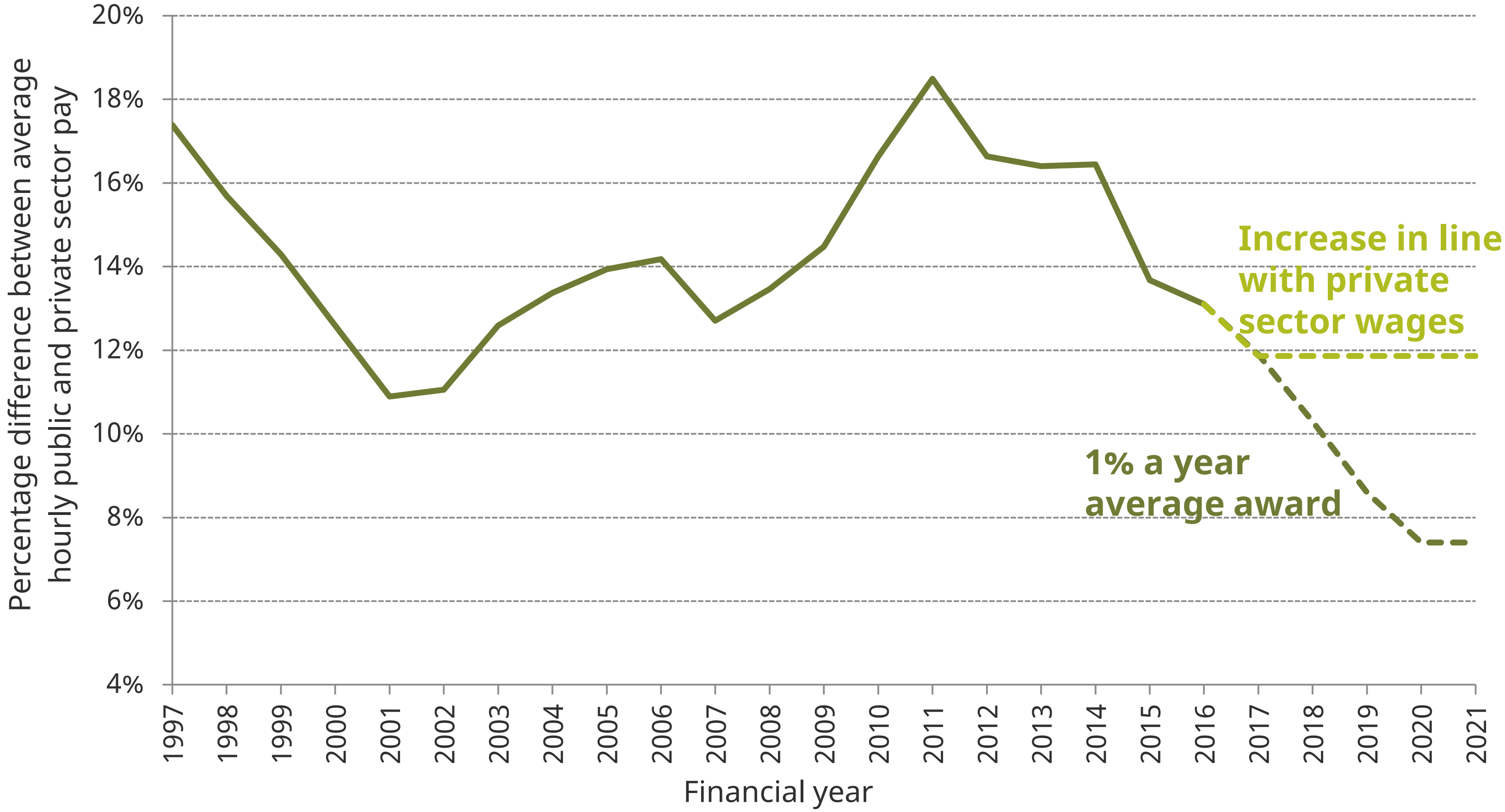
**Increases costly for public service providers**

- forecasts suggest indexing to private sector wage growth would cost £9bn in 2021–22 absent additional cuts to employment/non-paybill spending

**In near-term higher pay would also boost tax receipts and public service pension contributions**

- would unwind over the longer-term as economy adjusts and public service pension outgoings increase

# Forecast public sector pay differential




**Source: Cribb (2017) "Public sector pay in the next parliament"**

# What might an end to austerity look like?

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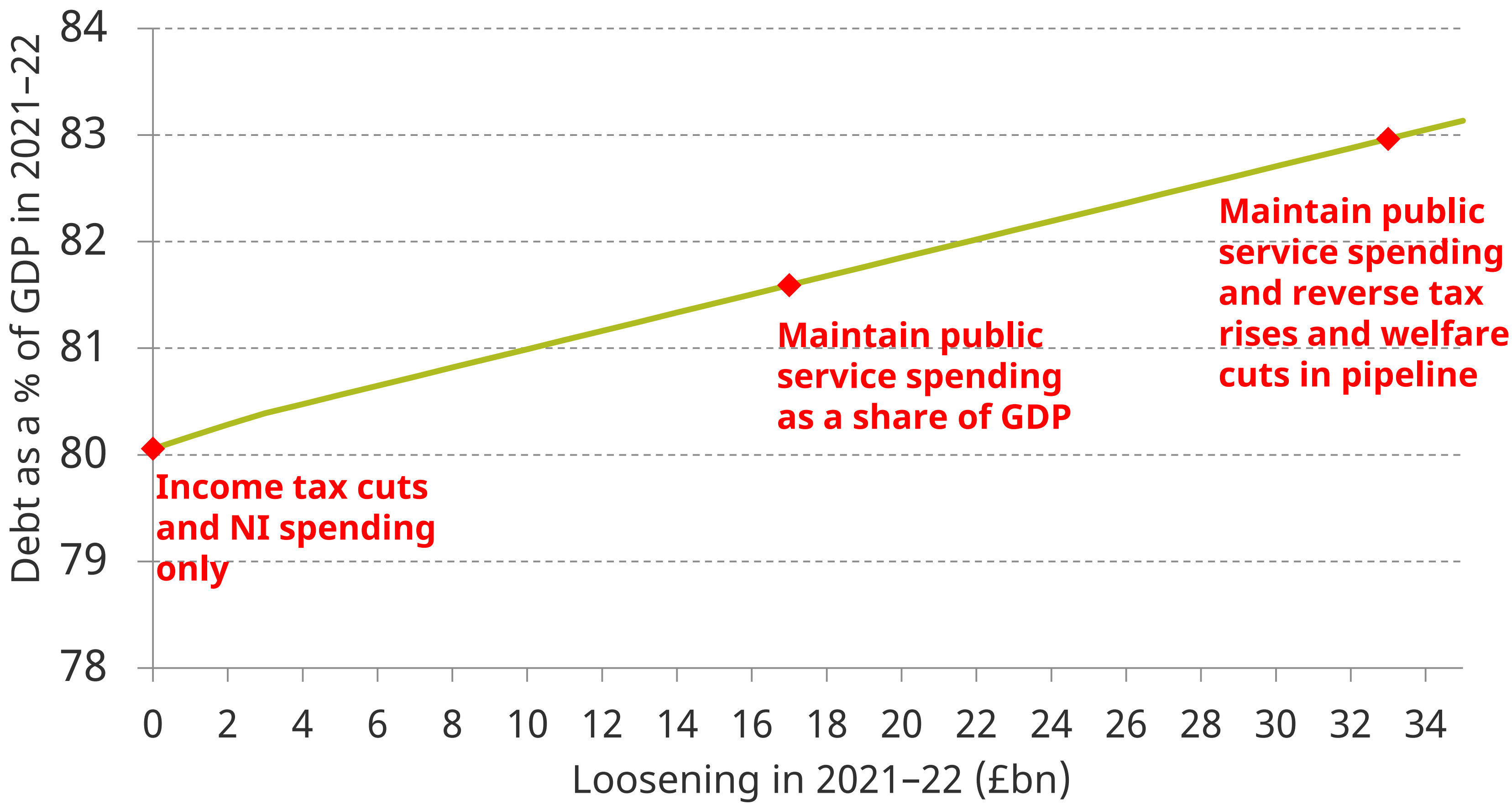
**Cancel planned cuts to public service spending as a share of GDP?**

- £17bn in 2021–22

**Go further and cancel net tax rises and benefit cuts in the pipeline?**

- £5bn and £11bn respectively
- doing all three would mean on course to borrow more than 2% of GDP in 2020–21 and likely abandonment of commitment to eliminate deficit

# Trade-off between loosening and debt




**Note: estimates allow for a boost to near-term GDP from additional borrowing using OBR multipliers.**
**Source: Office for Budget Responsibility; author's calculations.**

# Conclusions

**Terrible growth since start 2008**

- despite this OBR judges that there is no spare capacity in the economy
- suggests further tax rises/spending cuts needed if deficit to fall further

**Plans imply considerable tightening ahead**

- tax rises and welfare cuts in the pipeline, additional cuts to spending on public services as a share of national income
- eliminating deficit by mid 2020s would still not be easy

**Government could choose to loosen policy**

- but "an end to austerity" would require a sizeable giveaway, greater government debt and, most likely, yet another relaxing of fiscal targets

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