Autumn Budget 2018: IFS analysis

Paul Johnson's Opening Remarks

So now we know. When push comes to shove it's not tax rises and it's not the NHS that Mr Hammond is willing to gamble on, it's the public finances. Because yesterday's Budget was a bit of a gamble. Yes the OBR reduced borrowing forecasts so he was able to find more money without committing to more borrowing. But what the OBR gives the OBR can take away. Suppose the public finance forecasts deteriorate significantly next year. They might. There's perhaps a one in three chance of that. What will he do then? It's hard to see austerity starting up again with promised spending increases not materialising. The chances of getting sizeable tax rises though parliament are next to nil. It's surely borrowing that would take the strain. Fair enough. That's a judgment. But it's a judgment that could see debt ratchet upwards.

For now though Mr Hammond will be thanking his lucky stars for the OBR. After all who would have believed a Treasury forecast which just happened to allow more than £20 billion of additional spending on the NHS without either any tax increases or any effect on forecast borrowing? And that really is the story of yesterday's Budget. Lots of extra money for the NHS "paid for" by better borrowing forecasts.

There was something missing though. Back in March Mr Hammond made the following announcement "I can confirm that at this year's Budget I will set an overall path for public spending for 2020 and beyond. With a detailed spending review in 2019. To allocate funding between departments. That is how responsible people budget. First you work out what you can afford. Then you decide what your priorities are. And then you allocate between them".

I took that to mean he would be announcing a total envelope for the forthcoming spending review period. He didn't. There are some revised assumptions in the OBR forecasts, but no spending total has been set. So while this was a big Budget in many ways, it lacked the expected punchline. And as for working out what you can afford and then deciding on priorities, he has instead decided on priorities – NHS, NHS and NHS – before deciding total spending.

So to the inevitable question, "is austerity over?". Well we will only really know when we have some firmer plans, but from the numbers we have I think we can say the following:

- There was a big upward revision to overall spending plans;
- Spending on the NHS will rise substantially – though less quickly than spending has risen on average over its 70 year history;
- Total day to day spending on public services (RDEL) is planned to rise by about 8% between now and 2023-24, but spending outside of protected areas is essentially flat – and indeed ticks up next year before falling a bit. It falls on a per capita basis;
- Despite more money for Universal Credit there are still £4 billion or so of net welfare cuts working their way through the system, most obviously with the freeze to the rates of most working age benefits next April;
- Total spending is set to rise in real terms but to fall very slightly as a fraction of national income.

Does that add up to the end of austerity? On a narrow definition perhaps it does, on wider definitions it doesn't, at least not yet. But whatever the precise definitions this is certainly a considerable easing in spending control and a change of fiscal direction. Any idea that there is a serious desire to eliminate the deficit by the mid 2020s is surely for the birds.

One might also question the Chancellor's claim to be taking a "balanced" approach. When the fiscal forecasts got worse in 2016 and 2017 he didn't cut spending or increase taxes in response, he accepted more borrowing. But now they have improved he has increased planned spending and maintained expected borrowing. Keep doing that and the deficit can only go one way.

All that said, this is no bonanza. Many public services are going to feel squeezed for some time to come. Cuts are not about to be reversed. If I were a prison governor, a local authority chief executive or a headteacher I would struggle to find much to celebrate. I would be preparing for more difficult years ahead.

The public finances

It’s important to put improvements in the forecasts in context. Yes they got better. Borrowing this year is set to be £12 billion less than forecast in March. But that is still nearly £30 billion *more* than was forecast in March 2015. Borrowing next year, after the measures announced yesterday, is forecast to be £2 billion less than expected in March this year, but £40 billion *more* than forecast in March 2016.

Equally don’t forget that borrowing has come down a very long way from its post crisis peak at over £150 billion. It is now back below its immediate pre-crisis level and its long-term pre-crisis average. It is too easy to get excited by this year’s changes and lose sight of the bigger picture.

But what does explain the improvements which allowed the Chancellor space for his largesse? Rather unexcitingly it mostly comes down to small scale improvements in a range of forecast tax revenues. They keep coming in a bit better than expected and the OBR has altered its forecasts to reflect that. It has also again reduced its view of the likely long run equilibrium unemployment rate. And while the forecasting changes were quite big for this year and next they were of a boringly average magnitude into the medium term.

Of course all of these are estimates with a wide range of uncertainty around them. What the OBR gives this year it can quite easily take away again next year. If it does then the Chancellor will have painted himself into a bit of a corner. He’s going to struggle to reimpose austerity having announced its end. Could he resort to sizeable tax rises? More likely he would just allow borrowing to persist at a higher level.

And when considering the public finances don’t forget the debt. The deficit is down a lot on its peak. Debt is not, it is 50% of national income higher than it was pre-crisis, and it is set to fall only gradually – by about 3% of national income between now and 2023-24 once Bank of England interventions are stripped out. It is not on a decisively downward path into the long run.

Spending

On the spending side there really is only one story in town – that’s the increase in spending on the NHS. While spending on the NHS in England is set to be around £20 billion higher by 2023-24 than it is today, day-to-day spending on all other public services is set to be essentially flat.

This is a long term trend and a big one at that. Health spending will have risen from 23% of public service spending in 2000 to 29% in 2010, and is set to reach 38% by 2023-24. That is a remarkable increase. Other public services have been paying the price. At some point, we will need to pay more tax if we are to continue to increase spending on the NHS like this.

Again some historical perspective is important. Total day-to-day public service spending (RDEL) is 8% lower today than it was in 2009-10 and by 2023-24 it is still set to be slightly lower than its 2009-10 level. RDEL outside of health is 19% lower today than it was in 2010-11 and is set to stay broadly flat between now and 2023-24.

As for health, despite its favoured status, there is nothing particularly historic about these announcements. Depending on exactly what you are measuring spending is rising by between 2.6% a year (an estimate of total health spending increases between 2017-18 and 2023-24) and 3.4% a year (NHS England RDEL between 2018-19 and 2023-24). That compares with average increases of 3.7% a year over the NHS's entire history, and a 6% a year over the period of the last Labour government.

Two other points to note on spending. First, Mr Hammond provided some small relief for defence, social care and roads for next year. But that largesse does not extend beyond next year. Small cuts in unprotected RDEL are still planned for the period after 2019-20. This will still be a tough spending review.

Second, whilst capital spending is still set to rise and to reach a high level by historic standards, Mr Hammond actually raided some of the increases he announced a couple of years ago to pay for more day-to-day spending. Capital limits were cut by a pretty chunky £7 billion for 2020-21. Mind you the OBR had assumed that most of this would not have been spent in any case. To announce big increases in capital spending, fail to persuade the independent fiscal watchdog that you are capable of actually spending it, and then raid it a couple of years later, does not speak to the highest quality of spending control and planning.

Social Security

There was one other significant spending pledge – to increase the generosity of universal credit by increasing some work allowances, that is to increase the amount most can earn before their benefit gets withdrawn. With some other changes designed to smooth its roll out, this will increase planned spending on Universal Credit by around £2 billion a year. For many people this increase in work allowances will essentially undo the cuts announced by George Osborne in 2015 – though not for the childless non-disabled. Their work allowances were cut to zero in 2015 and there they remain.

These changes, on top of the cut in the taper rate announced last year, will help "make work pay" for many recipients. They are just about enough to push the expected cost (and hence generosity) of Universal Credit higher than the system it replaces. But this is a small increase in generosity compared to the cuts to working age benefits introduced since 2015 and it is small relative to cuts still to come in. Four years of benefit freezes, and the ending of family premiums and of payments in respect of third and subsequent children are a much bigger deal than this increase in work allowances.

And as for UC becoming on average a slight giveaway relative to the legacy system as opposed to a slight takeaway, that's not really the point. It is a huge change quite deliberately creating millions of winners and millions of losers. Something like a third of working age households will be entitled to some UC. Of those around a third will be at least £1,000 a year worse off under UC than under the legacy system while about a quarter will be at least £1,000 a year better off. (Note that these are medium term effects – it is not intended that people lose in cash terms as they move on to UC.)

Tax

At a cost of about £1.4 billion in 2020-21 the income tax personal allowance will rise to £12,500 and the higher rate threshold to £50,000. That will mean the personal allowance will be 55% higher in real terms than it was back in 2010-11. Taking account of offsetting cuts in the basic rate limit (the amount of taxable income you need before the higher rate kicks in) this has come at a cost of over £15 billion a year (£25 billion if you ignore those offsetting cuts). It means there will be nearly 6 million fewer income tax payers than there would have been had the allowance only been raised in line with prices since then. That's one of the reasons why more than 40% of adults pay no income tax in any given year.

The increase in the higher rate threshold is, on the other hand, something of a policy reversal rather than the continuation of a trend. Even after this increase it will be around 9% lower in real terms than it was in 2010-11 with the result that there will be around 900,000 more higher rate taxpayers than there would have been had it risen in line with inflation.

Of course these changes benefit the better off – though you only need £12,500 in income to benefit from the personal allowance increase. On average they will benefit over 30 million people by an average of around £44 a year, with the typical higher rate taxpayer gaining £156 and the typical basic rate taxpayer gaining £21. Contrast that with the changes to Universal Credit. They help far fewer people – about 2.4 million families – but help them a lot more, by over £600 a year.

There was a long list of other tax policies announced. The most important of these were:

- A cut in business rates for small retailers;
- A temporary increase in investment allowances and an industrial buildings allowance;

Institute for Fiscal Studies

- Changes to the rules governing the taxation of self employed contractors working for larger private companies;
- A new digital services tax.

My colleague Helen Miller will talk about all of these in more detail. Suffice to say at this point that each of these changes represents no more than a short term sticking plaster solution to some big underlying problems with the tax system.

To conclude

As well as looking at what was there, it is worth reflecting on what was not in the Budget. It wasn’t just lacking firm spending numbers. The OBR listed 15 separate policy “intentions” where firm policy is yet to be announced, everything from full devolution of business rates to local authorities, to extensions of automatic enrolment, to devolution of corporation tax to Northern Ireland. We still await a social care green paper. We still await a plan on funding further and higher education.

The tax changes that we did see all relate to real problems, but were all sticking plasters rather than long term solutions to those problems. There was no indication of a plan for future tax policy or for the all but inevitable tax increases to pay for our ageing population.

Ends