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

Source: Office for Budget Responsibility.

Where next for tax & spend?
Budget 2016 forecast: deficit

Source: Office for Budget Responsibility.

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Budget 2017 forecast: deficit

Source: Office for Budget Responsibility.

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Budget 2017 forecast: deficit

Source: Office for Budget Responsibility.

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2% of GDP limit on structural deficit
Budget 2017 forecast: public sector net debt

Per cent of national income

2007–08
2008–09
2009–10
2010–11
2011–12
2012–13
2013–14
2014–15
2015–16
2016–17
2017–18
2018–19
2019–20
2020–21
2021–22

Source: Office for Budget Responsibility.
Budget 2017 forecast: tax & spend

Source: Office for Budget Responsibility.

Where next for tax & spend?
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)

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

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

Where next for tax & spend?
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

Source: Office for National Statistics, author’s calculations.
Public spending by region

United Kingdom
England
London
South East
East of England
South West
East Midlands
North West
West Midlands
North West
Yorkshire and the Humber
Scotland
North East
Wales
Northern Ireland

Spend/GVA
£450m addition

Source: Office for National Statistics, author’s calculations.

Where next for tax & spend?
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

Where next for tax & spend?
Forecast public sector pay differential

Source: Cribb (2017) “Public sector pay in the next parliament”
What might an end to austerity look like?

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

Loosening in 2021–22 (£bn)

Debt as a % of GDP in 2021–22

Income tax cuts and NI spending only

Maintain public service spending as a share of GDP

Maintain public service spending and reverse tax rises and welfare cuts in pipeline

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

Where next for tax & spend?
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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