Autumn 2017 Budget: Options for easing the squeeze

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Presentation at the Institute of Chartered Accountants in England and Wales

London, 30th October 2017
The March Budget plan
Terrible economic performance is important backdrop

GDP per adult since 2008 Q1 (at time of March 2017 Budget)

2008Q1 = 100

Notes and sources: see Figure 2.1 of Autumn 2017 Budget: Options for easing the squeeze
The rise and fall of the deficit

Latest out-turns and March 2017 Budget forecasts for taxing, spending and borrowing

<table>
<thead>
<tr>
<th>PSNB (2007–08)</th>
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<td>9.9</td>
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Spend 0.5% GDP higher than 2007–08
Tax 0.4% GDP higher than 2007–08

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<td>2.9</td>
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Notes and sources: see Figure 2.2 of Autumn 2017 Budget: Options for easing the squeeze
Further deficit reduction to come

Latest out-turns and March 2017 Budget forecasts for taxing, spending and borrowing

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<th>Year</th>
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<td>PSNB (2017-18)</td>
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<td>-1.7</td>
</tr>
<tr>
<td>PSNB (2021-22)</td>
<td>0.7</td>
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Notes and sources: see Figure 2.2 of Autumn 2017 Budget: Options for easing the squeeze
Policy changes doing most of the work

Net tax rise of £6 billion in 2021–22 relative to 2017–18
  - Largest new tax measure is reduction in dividend allowance

Benefit cuts worth £12 billion saving in 2021–22
  - Mostly from measures already in place
  - Largest cut to come is benefits freeze

Cuts to departmental spending as a share of national income save £24 billion by 2021–22
  - Investment spending to increase
  - Large cuts to day-to-day spending
Spending cuts not shared equally across departments

Real terms departmental budget cuts, 2010–11 to 2019–20

Transport
DfID
Culture
Defence
Health
Education
Home Office
Scotland, Wales, N.I.
DCLG: communities
Justice
HMT & HMRC & DWP
DEFRA

2010–11 to 2019–20
2017–18 to 2019–20

Notes and sources: see Figure 2.10 of Autumn 2017 Budget: Options for easing the squeeze
Where would this leave tax and spend?

Tax and spend since 1948, latest outturns and March Budget forecast

Notes and sources: see Figure 2.2 of Autumn 2017 Budget: Options for easing the squeeze
Where would this leave the deficit?

Public sector net borrowing since 2000–01

Public sector net borrowing

Cyclically-adjusted public sector net borrowing

Overarching objective: eliminate deficit by mid-2020s

Notes and sources: see Figure 2.6 of Autumn 2017 Budget: Options for easing the squeeze
Where would this leave debt?

Public sector net debt since 2000–01

Target: debt falling between 2019–20 and 2020–21

Notes and sources: see Figure 2.7 of Autumn 2017 Budget: Options for easing the squeeze
Developments since March
Data so far this year paints a rosier picture

Borrowing last year now thought to have been £45.7 billion, £6 billion lower than forecast in March

Borrowing running behind the March forecast this year too

Not all of this improvement is likely to persist for the whole year

- Self-assessment receipts expected to be much weaker than last year

But a number of taxes are performing better than expected so far
Data so far this year paints a rosier picture

Growth in tax receipts: OBR March forecast for year as a whole and year to date

Notes and sources: see Figure 3.6 of Autumn 2017 Budget: Options for easing the squeeze
Data so far this year paints a rosier picture

A number of taxes are performing better than expected so far
  - Could lead to improvement of around £6 billion

Spending on benefits and contributions to the EU also lower than expected
  - Could save around £2¾ billion

Improvements come in spite of weaker-than-expected growth

If strength persists, would lead to lower medium-term borrowing
  - Worth around £12 billion by 2021–22
Policy changes since March will increase borrowing slightly

Reversal of self-employed National Insurance contributions (NICs) measure costs £500 million per year
  - May have a bigger effect in the long-run

Confidence and supply deal: £450 million per year for two years
  - On Health, Education and Infrastructure in Northern Ireland
Policy changes since March will increase borrowing slightly

Changes to student loan system a considerable long-term cost, but little effect on short run measures

- Freezing fees at £9,250 small cut to University funding in short-run
- Repayment threshold to £25,000 means more debt written off
- Long-run cost of £2 billion a year, but not until 2046

Total effect of policy measures already announced increases borrowing in 2019–20 by £1.5 billion
Higher interest rates likely to mean higher borrowing in the short term

Market expectations over the base rate: March and now

Notes and sources: see Figure 3.5 of Autumn 2017 Budget: Options for easing the squeeze
Independent forecasters have downgraded growth forecasts slightly

Real GDP: Bank of England and OBR forecasts since February

Economy 0.3% smaller in 2019 than forecast in Feb

Bank of England, February

Bank of England, August

OBR, March

Notes and sources: see Figure 3.1 of Autumn 2017 Budget: Options for easing the squeeze
Taking these changes together, borrowing could be slightly down on the March forecast.

Public sector net borrowing under different growth scenarios

Notes and sources: see Figure 3.7 of *Autumn 2017 Budget: Options for easing the squeeze*
But a substantial productivity downgrade seems likely

OBR have stated a productivity growth downgrade is likely

- Robert Chote: “for now we are minded to revise down potential productivity growth significantly”
Productivity forecasts have been consistently optimistic

Successive forecasts for productivity growth since June 2010

Notes and sources: see Figure 3.3 of Autumn 2017 Budget: Options for easing the squeeze
Recent productivity performance has been historically terrible

Productivity growth since 1972: Out-turns and the March forecast

Out-turn  March forecast  Average

Notes and sources: see Figure 3.4 of *Autumn 2017 Budget: Options for easing the squeeze*
A substantial productivity downgrade seems likely

OBR have stated a productivity growth downgrade is likely

- Robert Chote: “for now we are minded to revise down potential productivity growth significantly”
- Only slightly offset by an expected increase in hours and employment forecasts

‘Very poor’ productivity scenario

- 0.4% annual growth considered new normal
- Average real growth 2017-2021: 0.7% (1.8% in March)

‘Weak’ productivity scenario

- Downgrade halfway towards average of last seven years
- Average real growth 2017-2021: 1.3% (1.8% in March)
Weaker productivity would mean higher borrowing

Public sector net borrowing under different growth scenarios

Notes and sources: see Figure 3.7 of Autumn 2017 Budget: Options for easing the squeeze
All of which would be structural

Structural borrowing under different growth scenarios

Notes and sources: see Figure 3.8 of Autumn 2017 Budget: Options for easing the squeeze
And the National Debt would rise as a result

Public sector net debt under different growth scenarios

Notes and sources: see Figure 3.9 of Autumn 2017 Budget: Options for easing the squeeze
So what’s a Chancellor to do?
Elections tend to be followed by tax rises

Long run net tax rise from measures announced in the year following general elections

Election year | £ billion (2017-18 terms)
--- | ---
1992 | £25bn
1997 | £15bn
2001 | £16bn
2005 | £6bn
2010 | £11bn
2015 | £13bn

Notes and sources: see Figure 3.10 of Autumn 2017 Budget: Options for easing the squeeze.
Asymmetric response to public finance news

Average change in underlying borrowing and policy response since 2010

Notes and sources: see Figure 3.11 of Autumn 2017 Budget: Options for easing the squeeze.
Asymmetric response to public finance news

Average change in underlying borrowing and policy response since 2010

Underlying deterioration (10 occasions)

Underlying improvement (5 occasions)

Impact on borrowing (£ billion)

Notes and sources: see Figure 3.11 of Autumn 2017 Budget: Options for easing the squeeze.
Options for tax rises

One option is to announce tax rises
- if so could do worse than increasing rate(s) of one of the main taxes
- NICs rates rose in early 1990s, early 2000s and early 2010s

Could decide not to cut rate of corporation tax from 19% to 17%
- boost revenues by around £5 billion
- require House of Commons vote and break manifesto commitment

Politics makes any significant tax takeaways difficult
- apart from the seemingly obligatory “tax avoidance” measures?
Tax cuts more likely?

£6 billion net tax rise already still to come and tax burden forecast to rise to level not maintained since 1950s

Conservative manifesto commitment to increase income tax personal allowance to £12.5k and higher-rate threshold to £50k

- would now only cost £1.1 billion a year
- on top of £12 billion spent increasing personal allowance since 2010

Another freeze in fuel duties would cost £¾ billion a year

- on top of the £5.4 billion cost of freezing them since 2010
- would cost £¼ billion if frozen for petrol but not diesel
Possible benefit giveaways? (1/2)

£12 billion of cuts in benefits for working age families are still in the pipeline, on top of £29 billion implemented since 2010–11

Universal credit being rolled out nationwide

- rollout 8% complete in September, rising to 13% in March
- less generous than legacy system, cash terms protection for existing recipients

Concern with time taken before claimants receive first full payment

- paid monthly in arrears
- 7 waiting days before unemployed can claim: return to 3 waiting days would cost of £0.3 billion a year
Most working age benefits to be frozen for next two years

- 4 year freeze (2015–16 to 2019–20) initially expected to save £3.4 billion
- rising inflation means now on course to save £4.6 billion
- could move to 1% increase for two years, or cancel final year of freeze, and keep broadly to the original saving
- could scrap final two years at cost of around £4 billion
Day-to-day public service spending squeezed

Resource Departmental Expenditure Limits

Per capita spending to fall by a further 5% (£15bn) on top of the 13% (£46bn) since 2010-11

Notes and sources: see Figure 2.10 of Autumn 2017 Budget: Options for easing the squeeze.
Retaining public sector pay cap not risk free

Average difference between public and private sector hourly pay

Notes and sources: see Figure 4.1 of Autumn 2017 Budget: Options for easing the squeeze.
NHS: extremely tight spending settlement

Annual real increase in per capita UK NHS spending

Notes and sources: see Figure 4.2 of Autumn 2017 Budget: Options for easing the squeeze.
NHS: managing to do more

English hospital activity per capita

Percentage change, 2009-10 to 2016-17

- English DH spending per capita: 3.2%
- A&E attendances: 7.7%
- Non-elective (emergency) admissions: 6.7%
- Elective admissions (overnight admissions and daycases): 15.7%
- First outpatient attendances: 15.1%

Notes and sources: see Figure 4.3 of Autumn 2017 Budget: Options for easing the squeeze.
NHS: clear signs of strain (1/2)

A&E patients in England increasingly likely to wait more than 4 hours

% admitted, transferred or discharged within four hours

National target = 98%
National target = 95%

Notes and sources: see Figure 4.4 of Autumn 2017 Budget: Options for easing the squeeze.
NHS: clear signs of strain (2/2)

% waiting more than 18 weeks from referral to treatment in England

Notes and sources: see Figure 4.5 of Autumn 2017 Budget: Options for easing the squeeze.
NHS: clear signs of strain (2/2)

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Notes and sources: see Figure 4.6 of Autumn 2017 Budget: Options for easing the squeeze.
Prisons: spending and staff cut

Notes and sources: see Figure 4.6 of Autumn 2017 Budget: Options for easing the squeeze.
Prisons: assaults on staff, assaults on prisoners and prisoner self-harm up

Notes and sources: see Figure 4.6 of Autumn 2017 Budget: Options for easing the squeeze.
So what’s a Chancellor to do? (1/2)

Mr Hammond has been dealt a tricky hand

If forecast productivity growth were unchanged public finance outlook would be slightly stronger than in March

Likely productivity downgrade would, if significant, dominate

- downgrading halfway towards recent experience could increase forecast borrowing in 2021–22 from £17 billion to £36 billion
- fiscal targets for this parliament could still be met, albeit with much reduced headroom
So what’s a Chancellor to do? (2/2)

Unlikely to announce a significant fiscal tightening

Budget giveaways seem likely, but an “end to austerity” unlikely
  – choosing between competing spending demands difficult

Chances of eliminating the deficit anytime soon keep receding
  – possible public finances will perform much better than expected
  – but perhaps time to admit that a firm commitment to running a budget surplus from the mid-2020s onwards is no longer sensible
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