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Autumn 2017 Budget: Options for easing the squeeze

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Presentation at the Institute of Chartered Accountants in England and Wales

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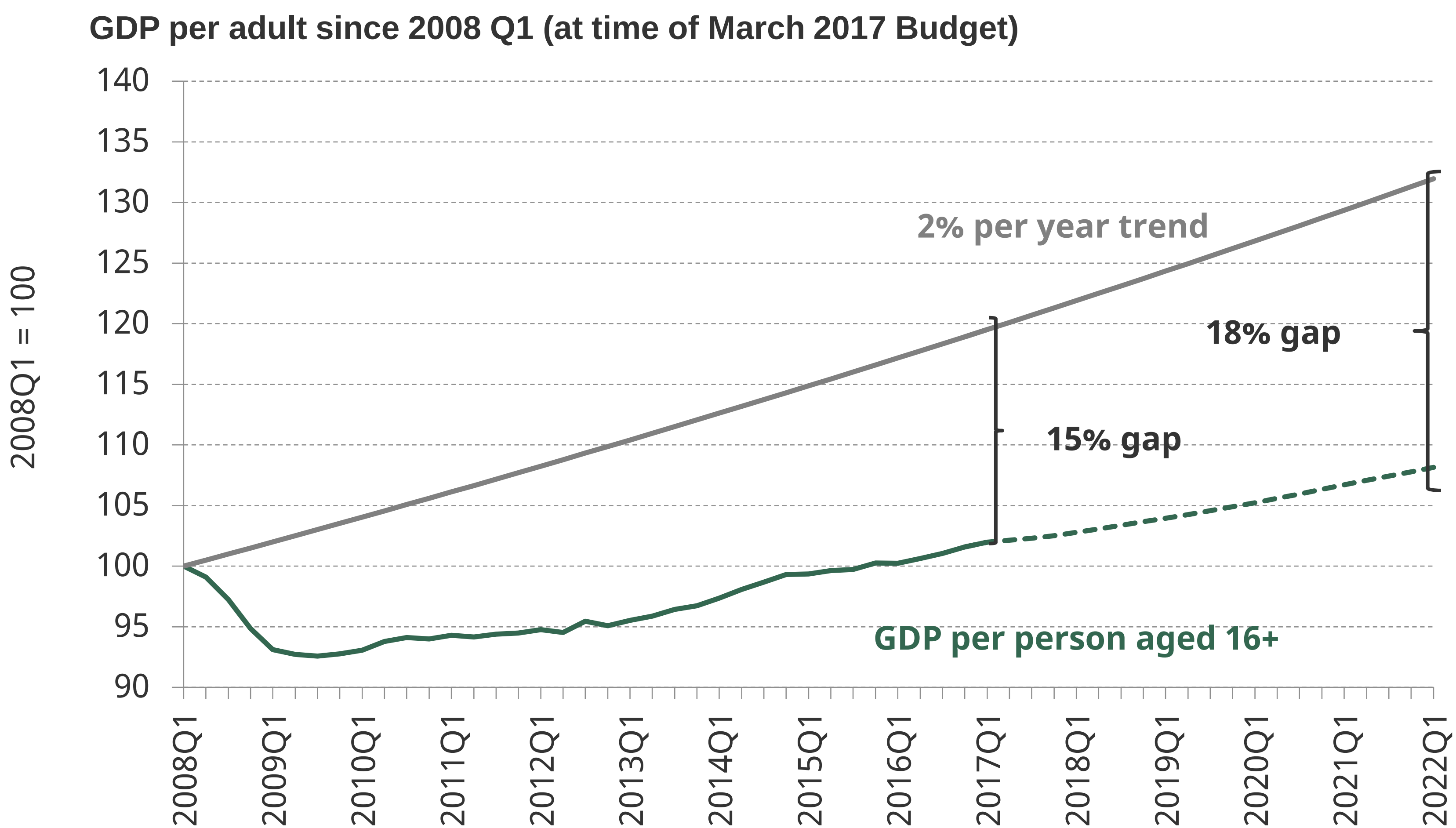
The March Budget plan

Terrible economic performance is important backdrop



Notes and sources: see Figure 2.1 of *Autumn 2017 Budget: Options for easing the squeeze*

The rise and fall of the deficit

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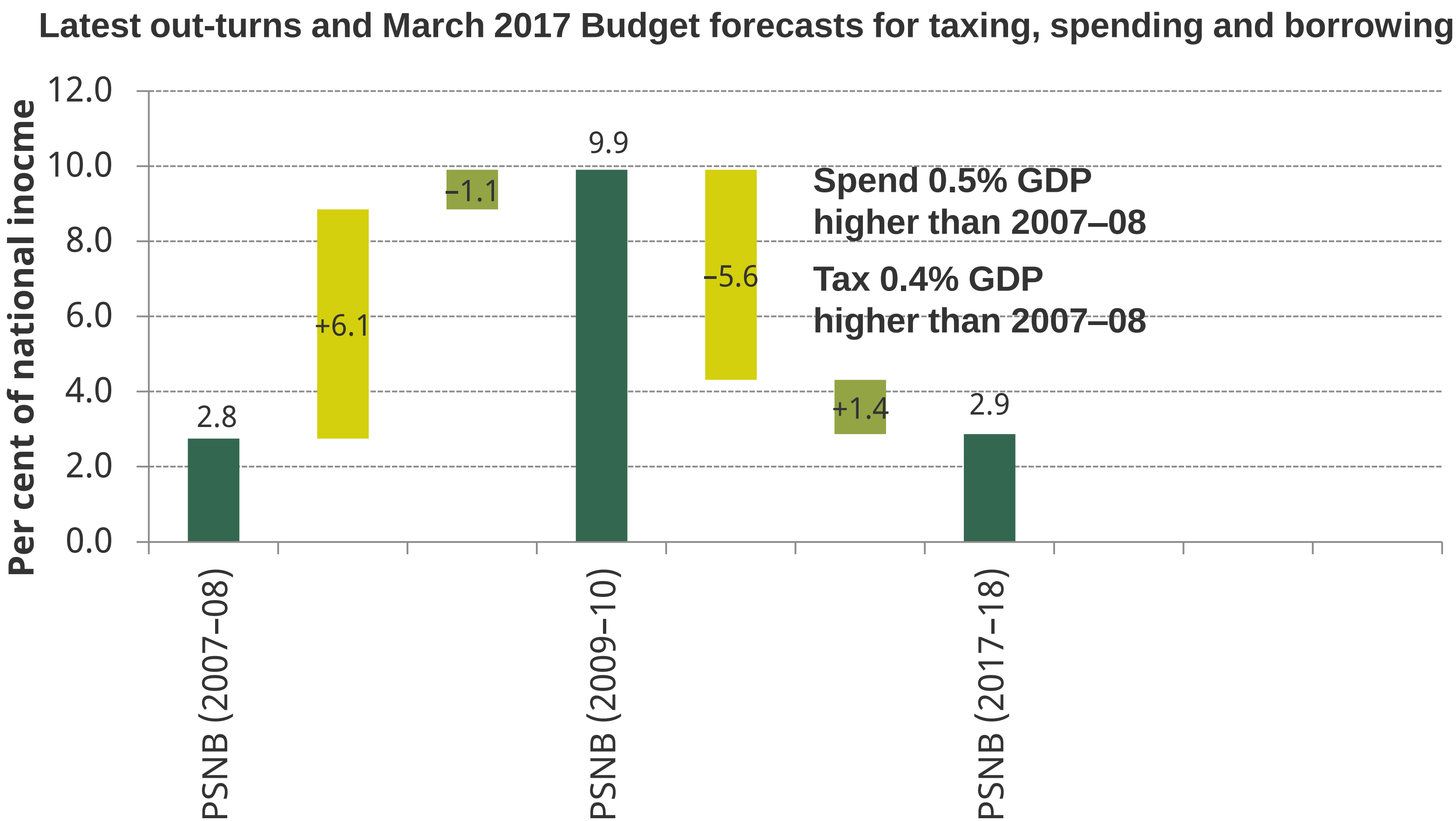

Notes and sources: see Figure 2.2 of *Autumn 2017 Budget: Options for easing the squeeze*

Further deficit reduction to come

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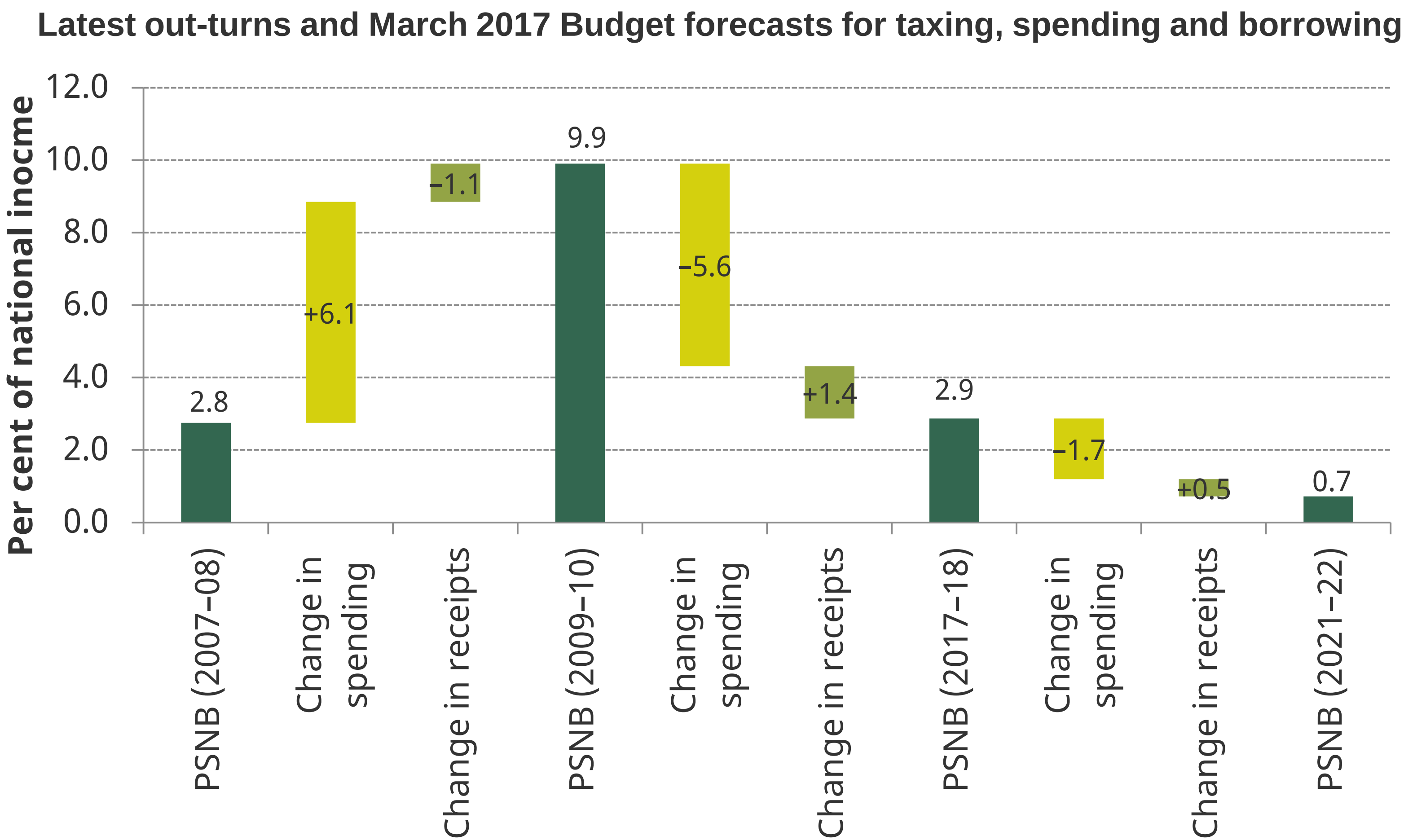

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Policy changes doing most of the work

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

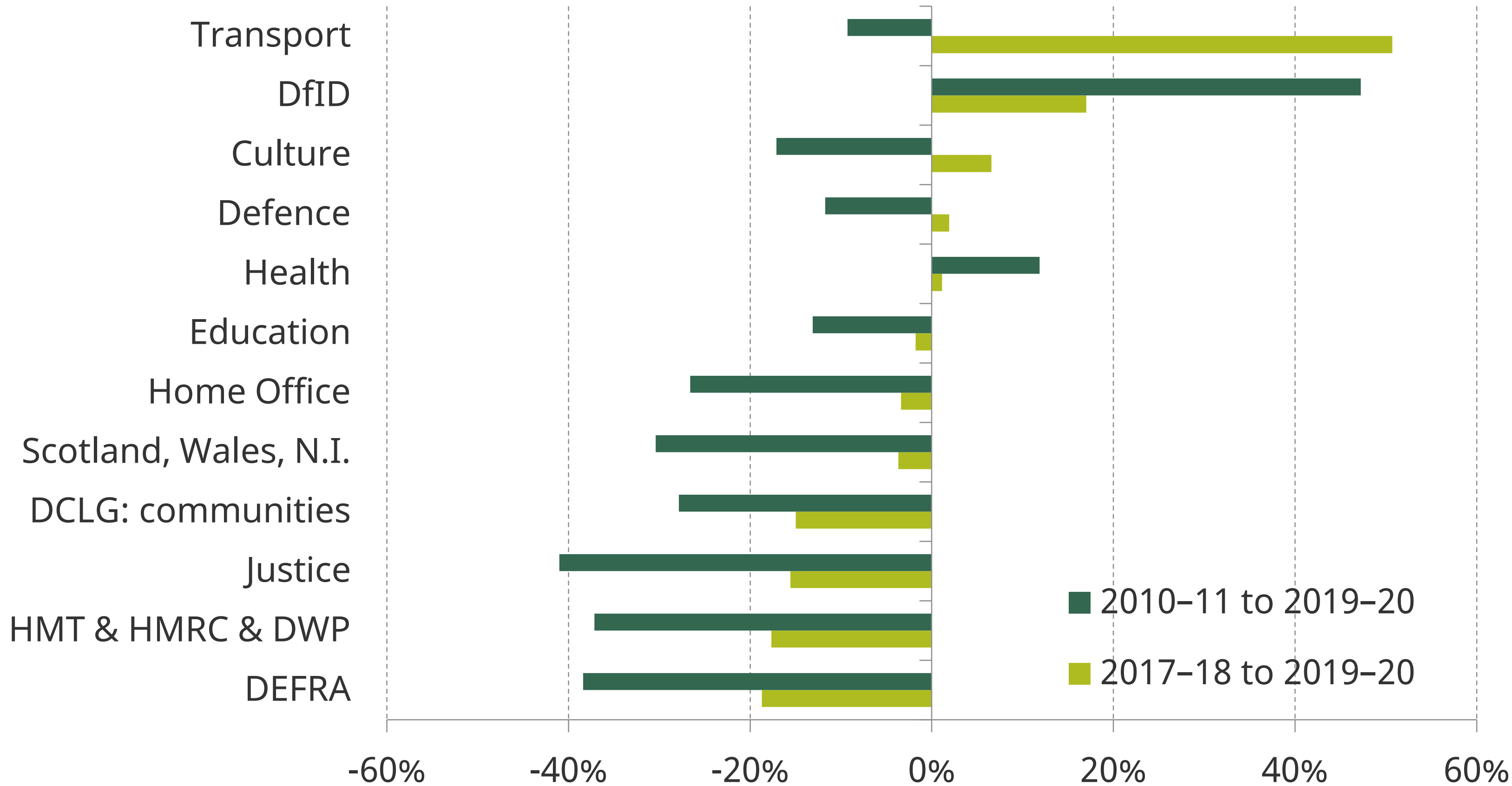
- Mostly from measures already in place
- Largest cut to come is benefits freeze

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



Notes and sources: see Figure 2.10 of *Autumn 2017 Budget: Options for easing the squeeze*

Where would this leave tax and spend?

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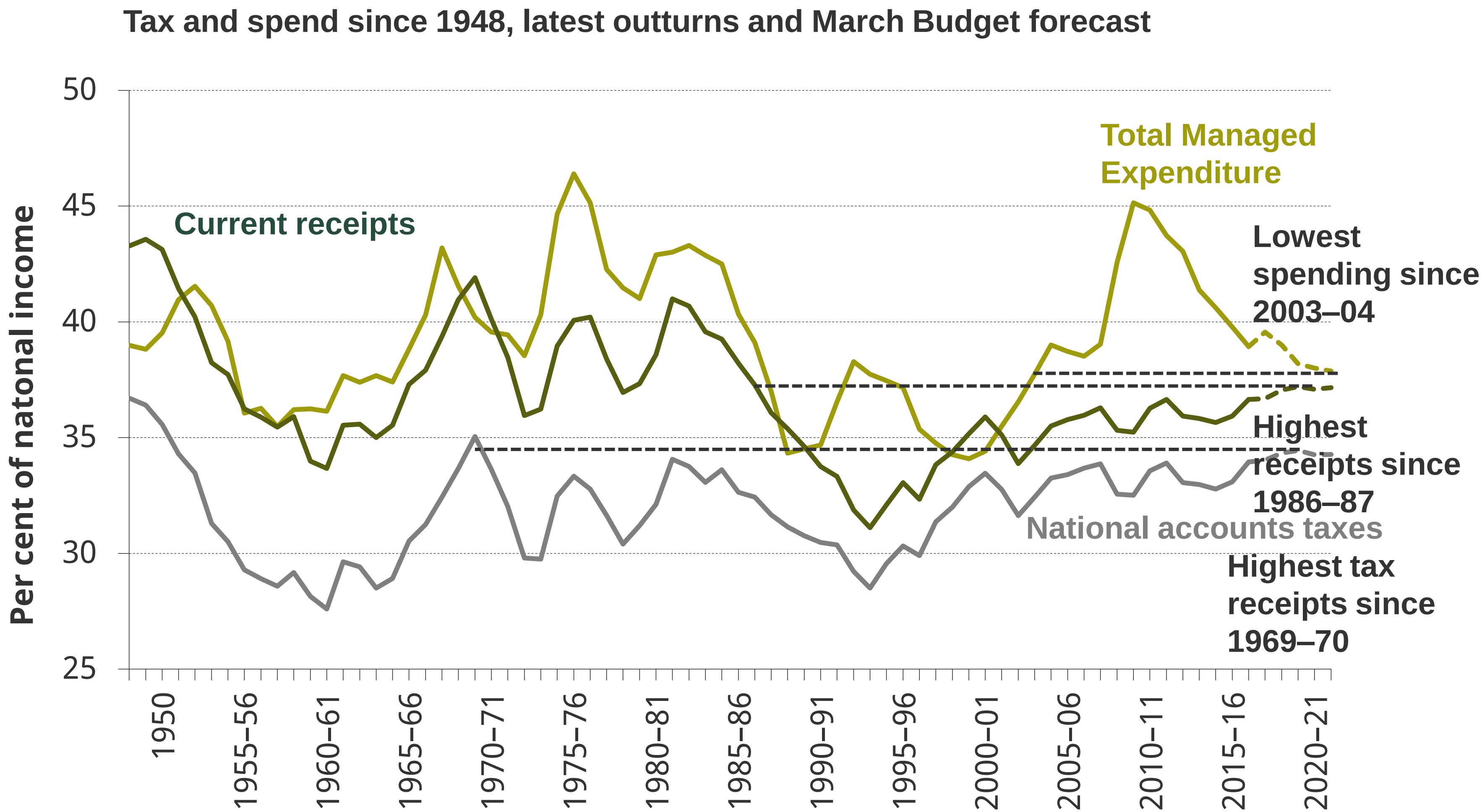

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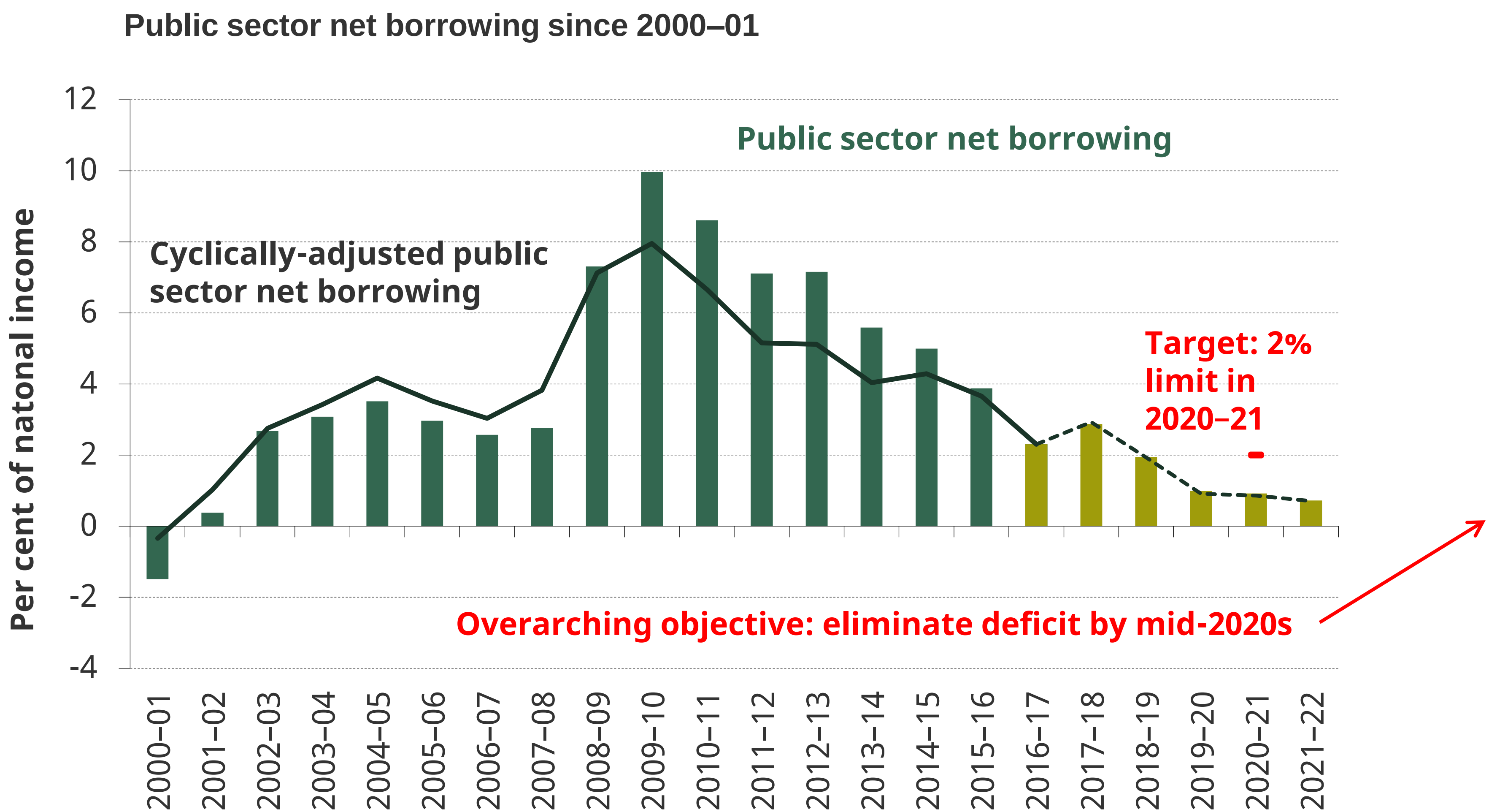
Where would this leave the deficit?



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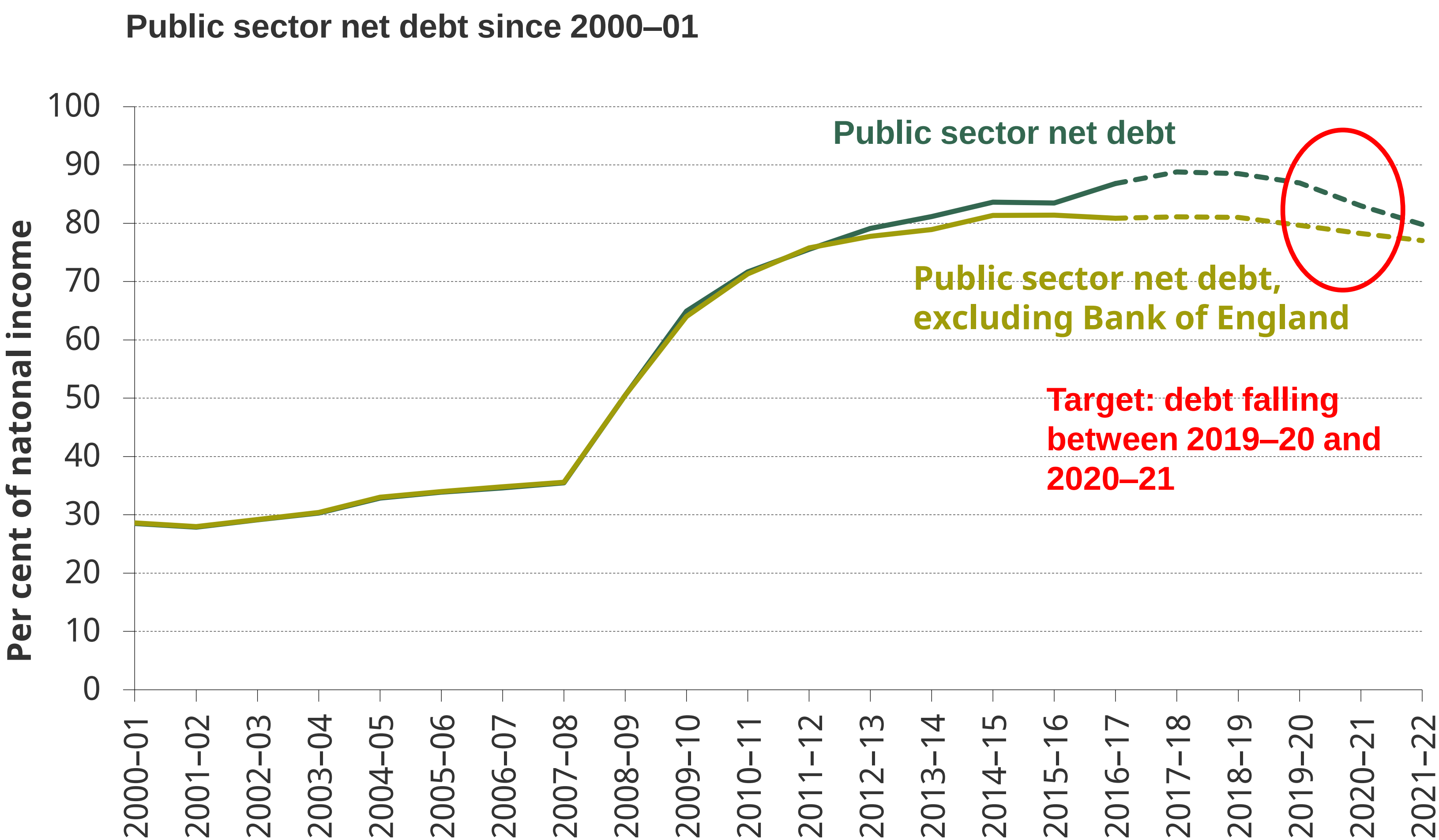
Where would this leave debt?



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

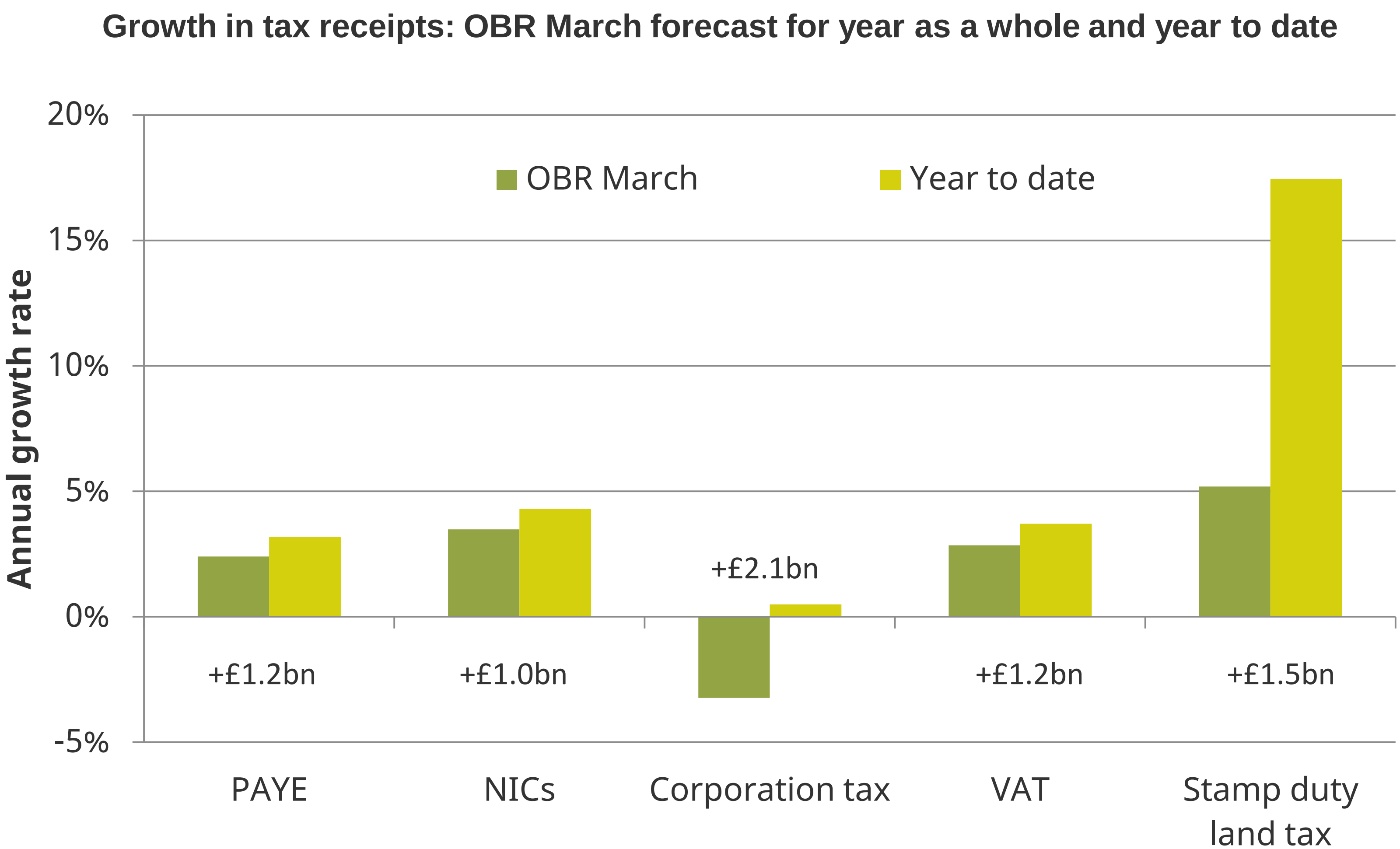
Borrowing running behind the March forecast this year too

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



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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

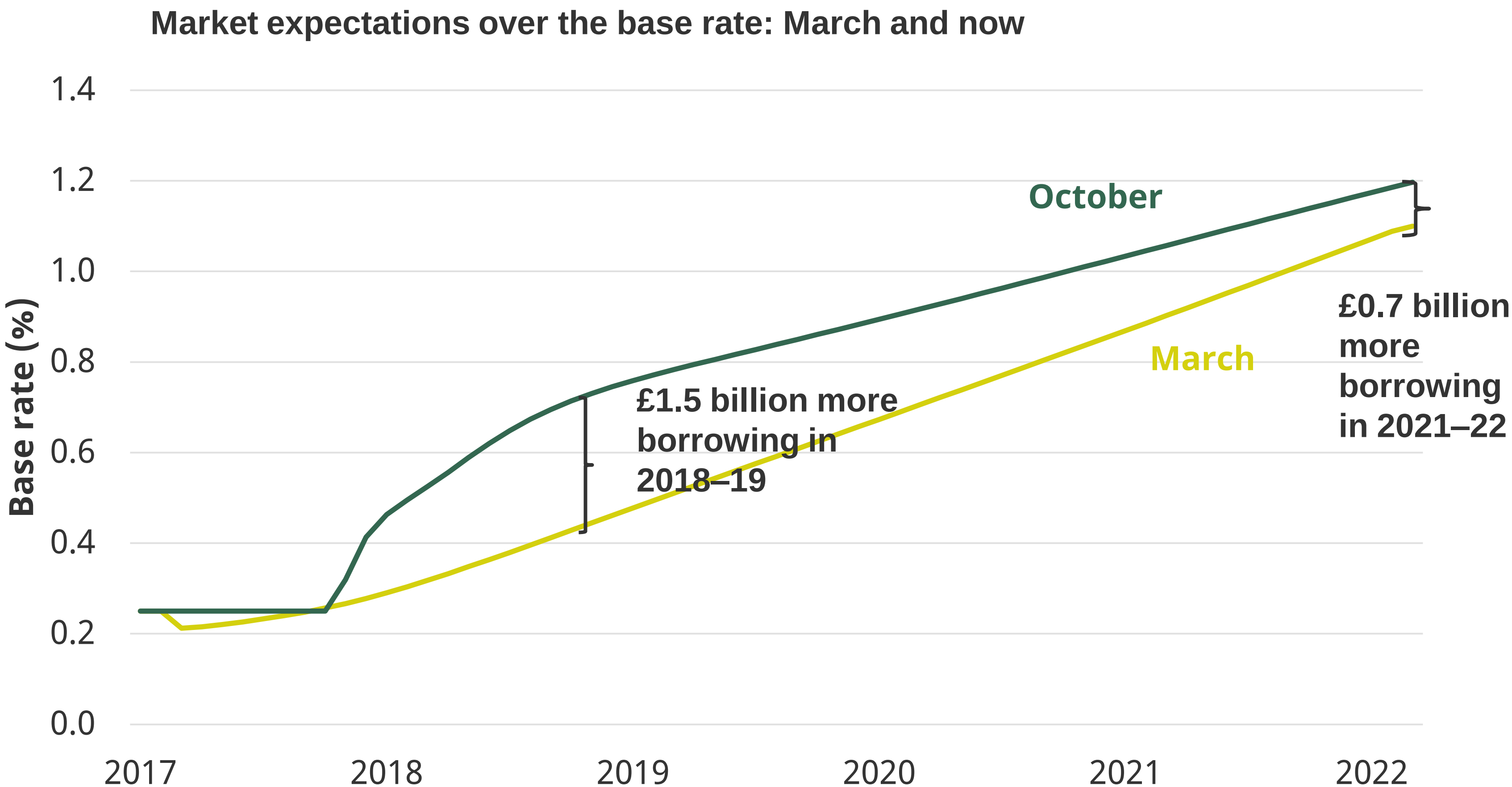
Policy changes since March will increase borrowing slightly

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



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Independent forecasters have downgraded growth forecasts slightly

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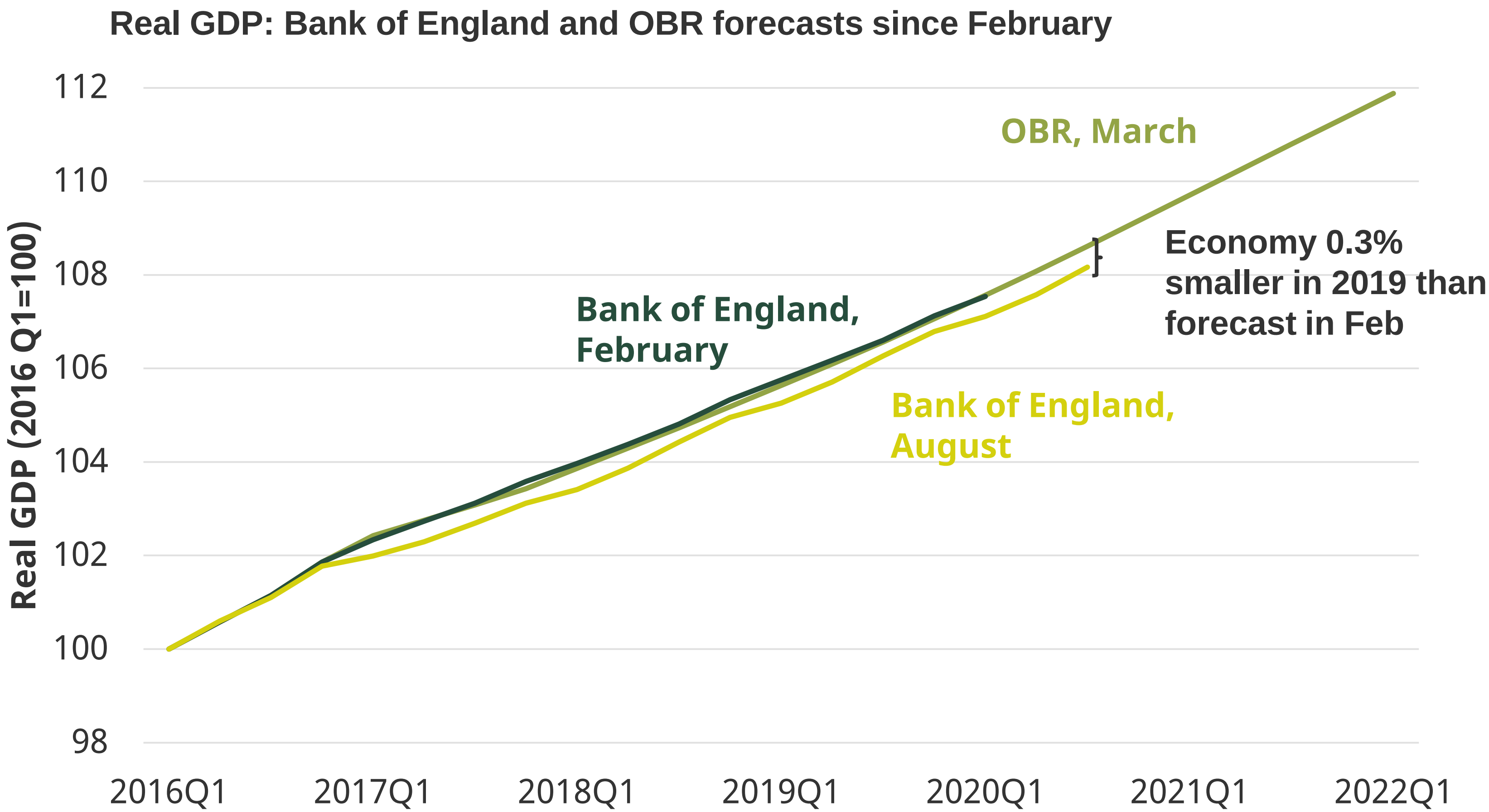

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Taking these changes together, borrowing could be slightly down on the March forecast

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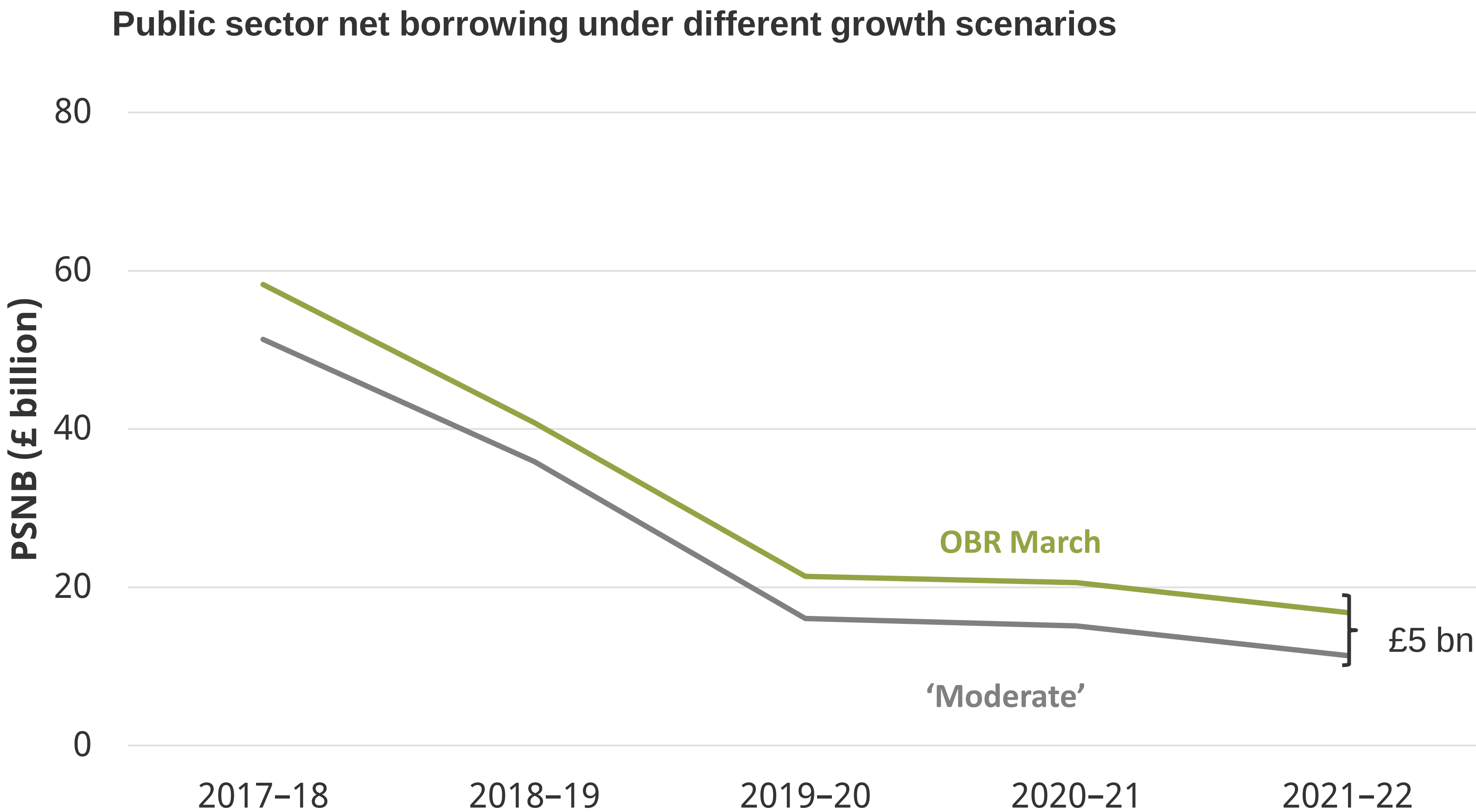

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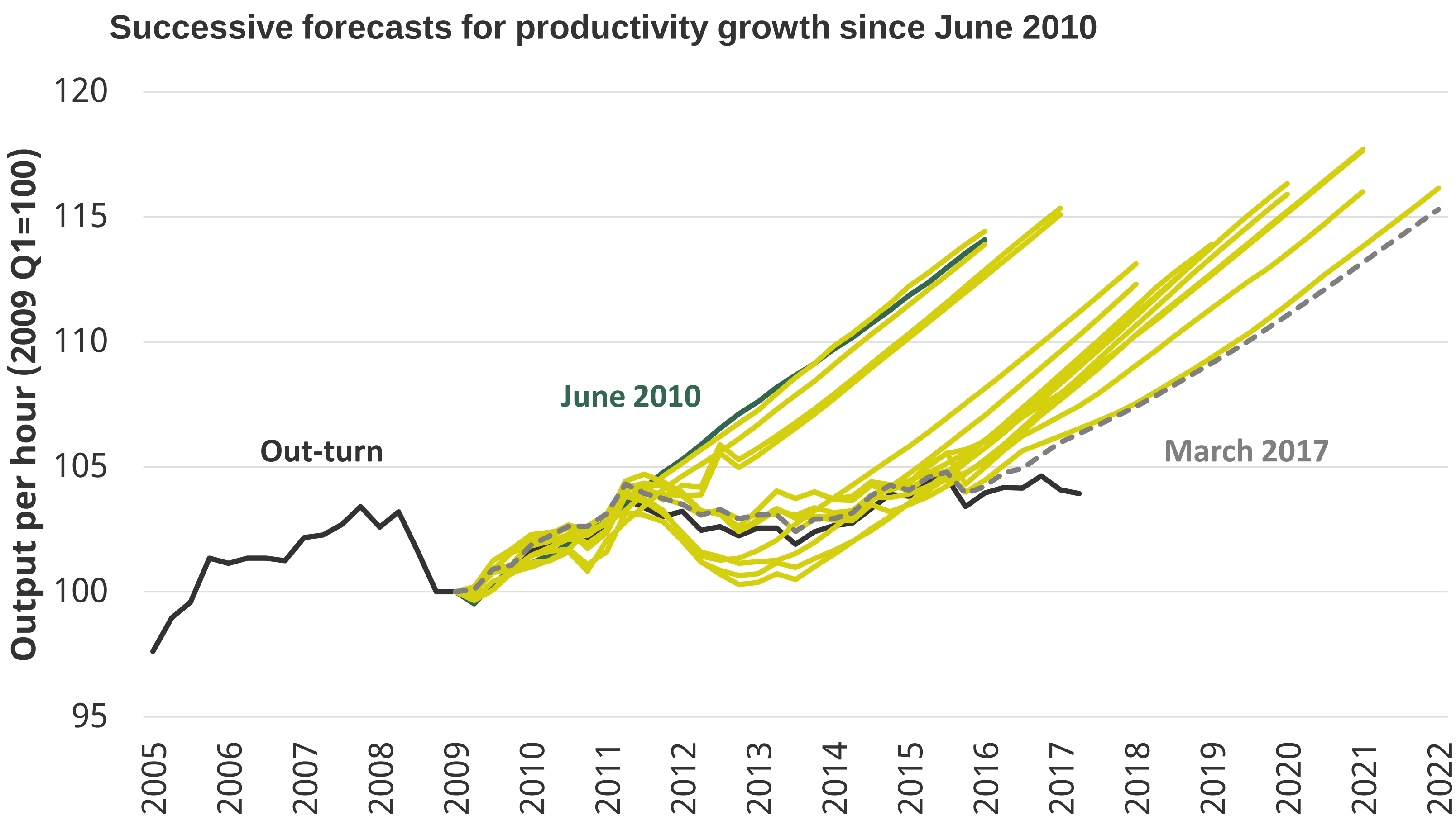
But a substantial productivity downgrade seems likely

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



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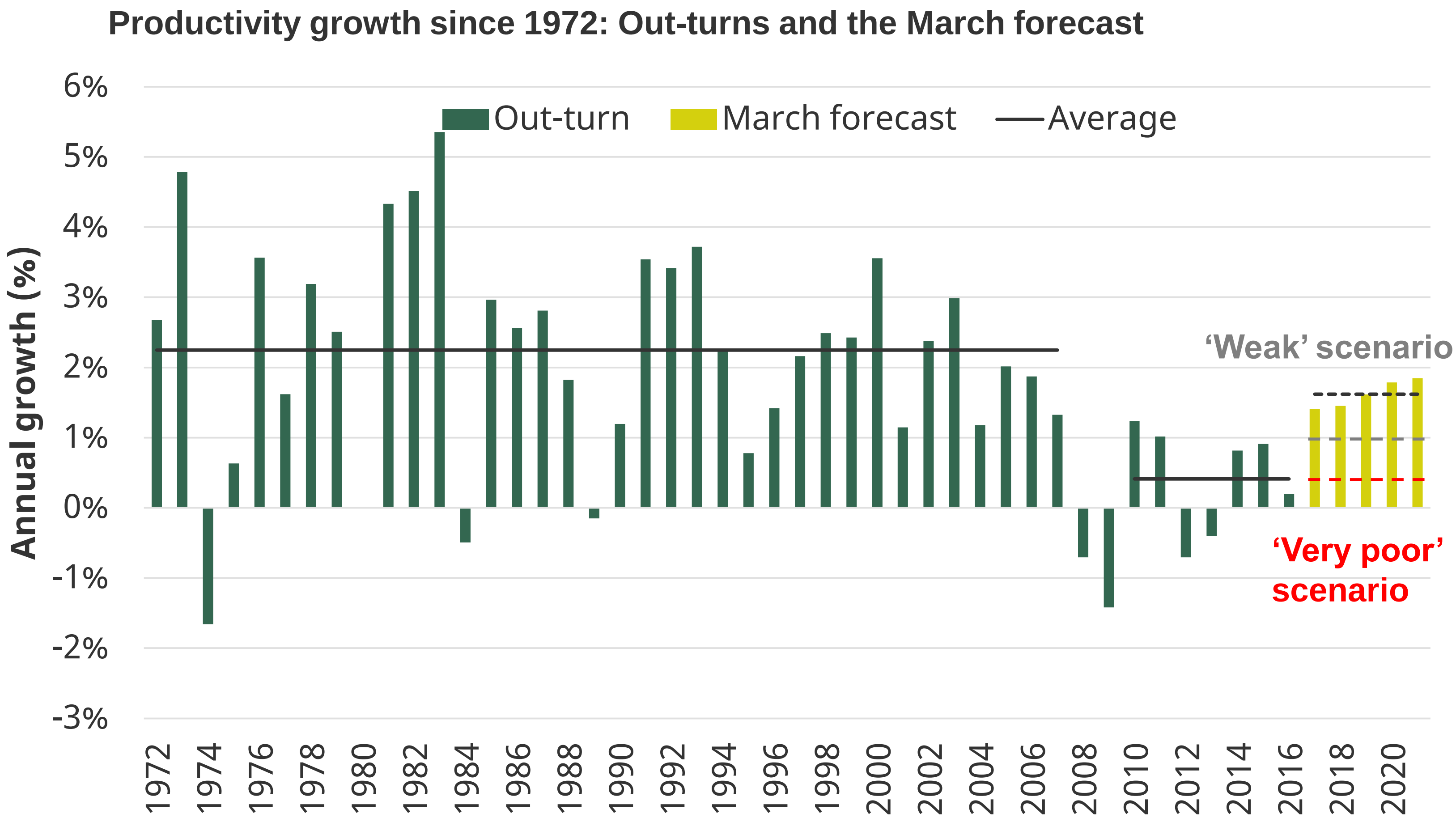
Recent productivity performance has been historically terrible



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

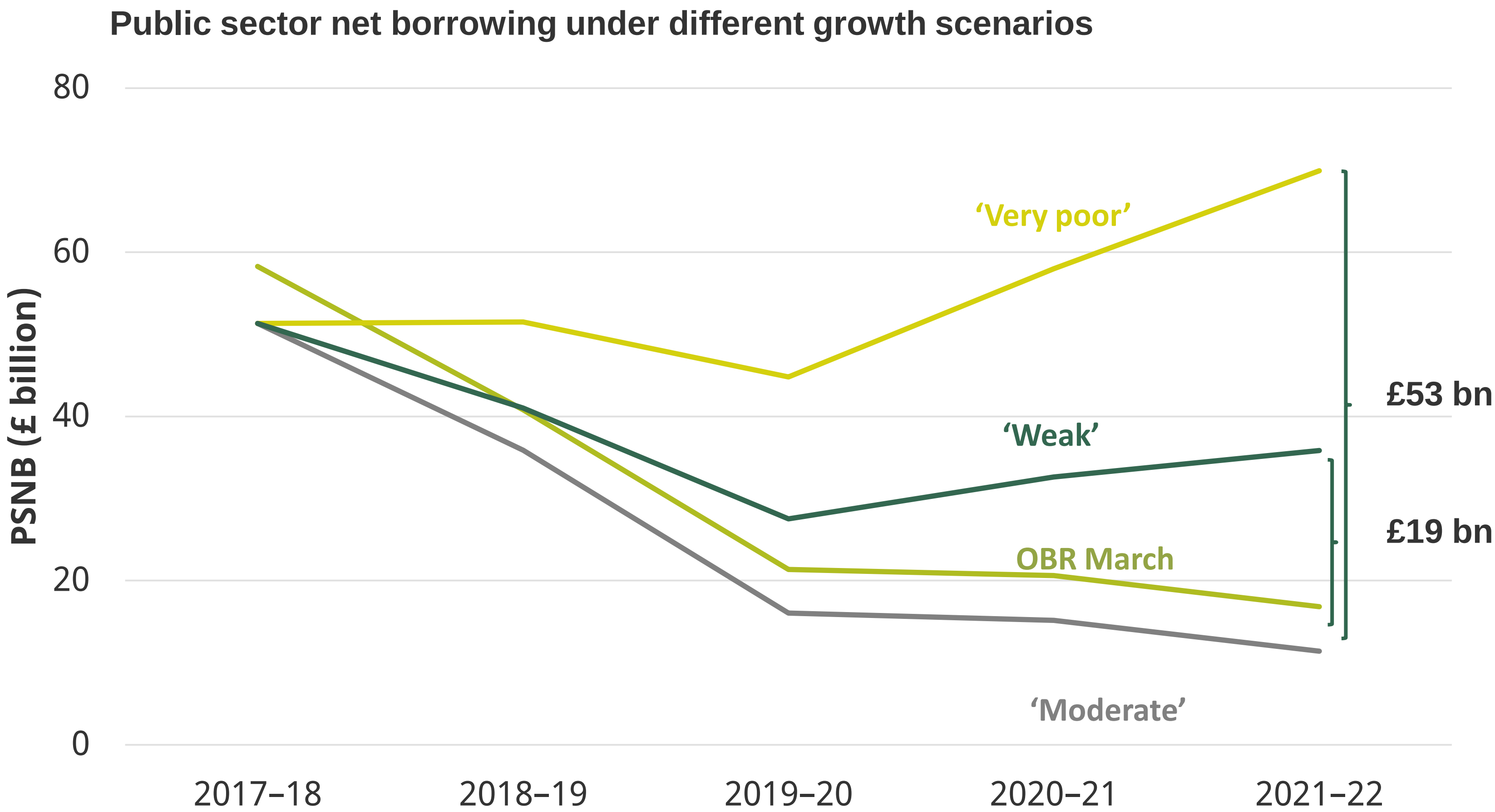
‘Very poor’ productivity scenario

- 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



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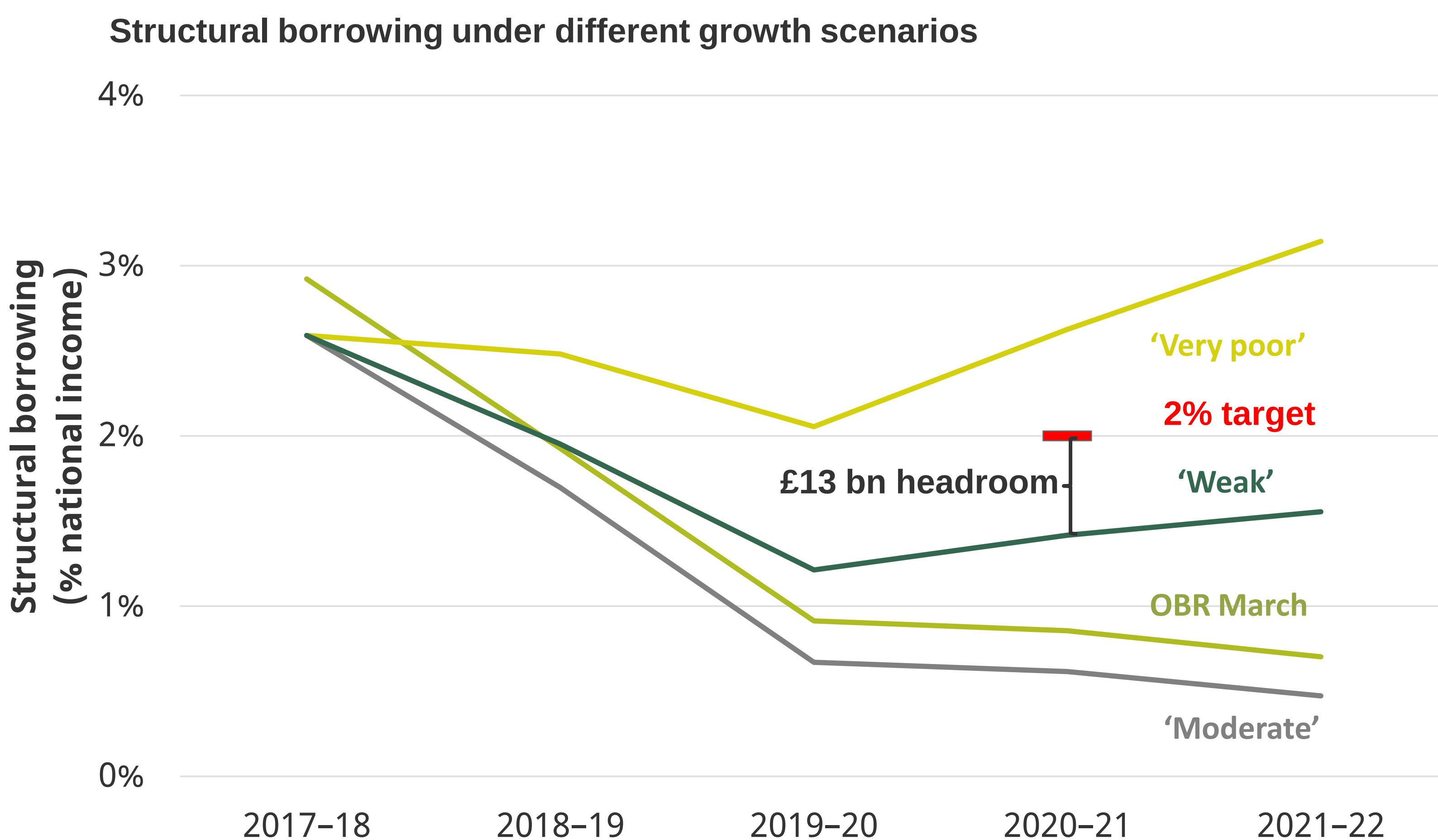
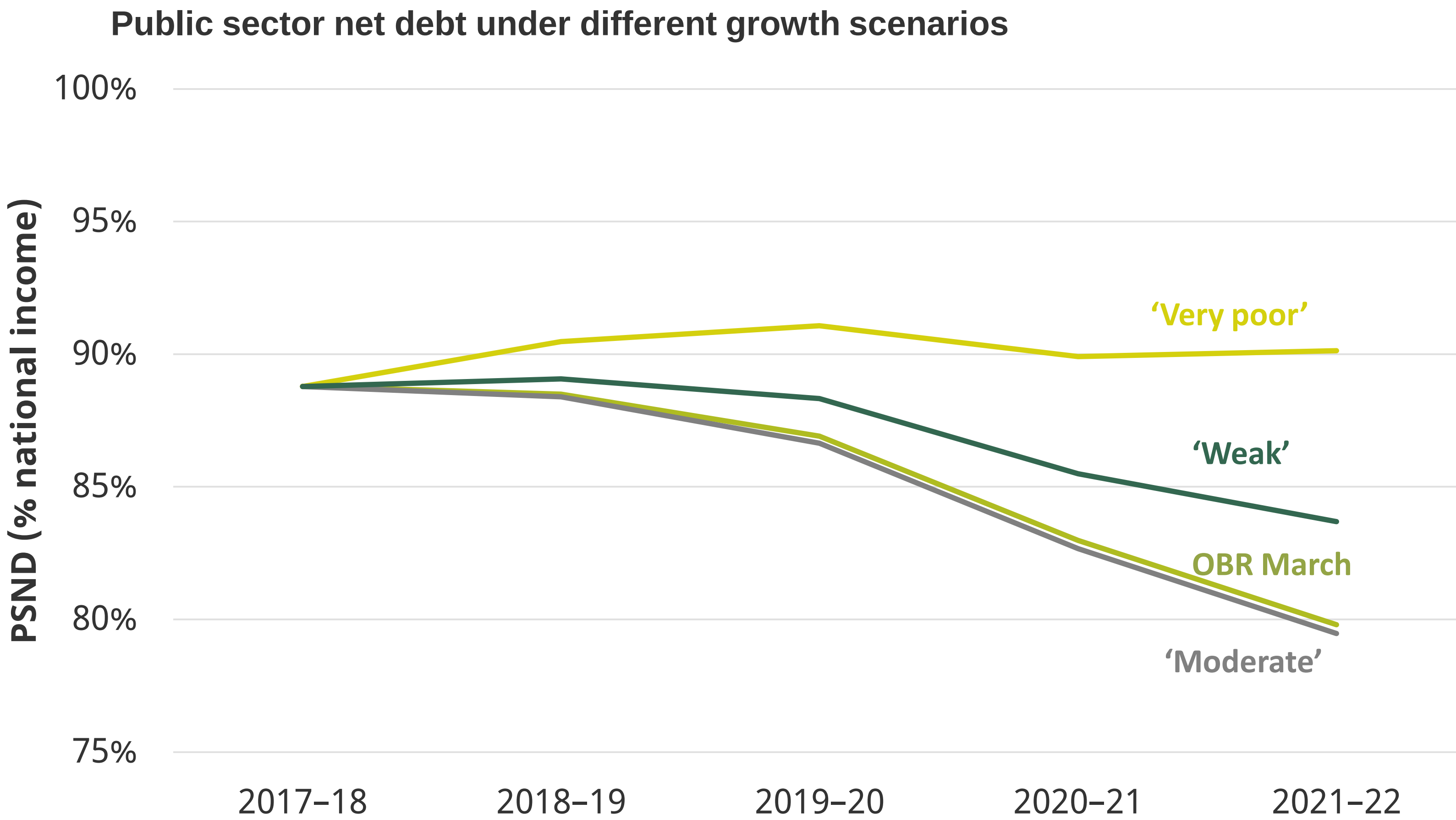
All of which would be structural



Notes and sources: see Figure 3.8 of *Autumn 2017 Budget: Options for easing the squeeze*

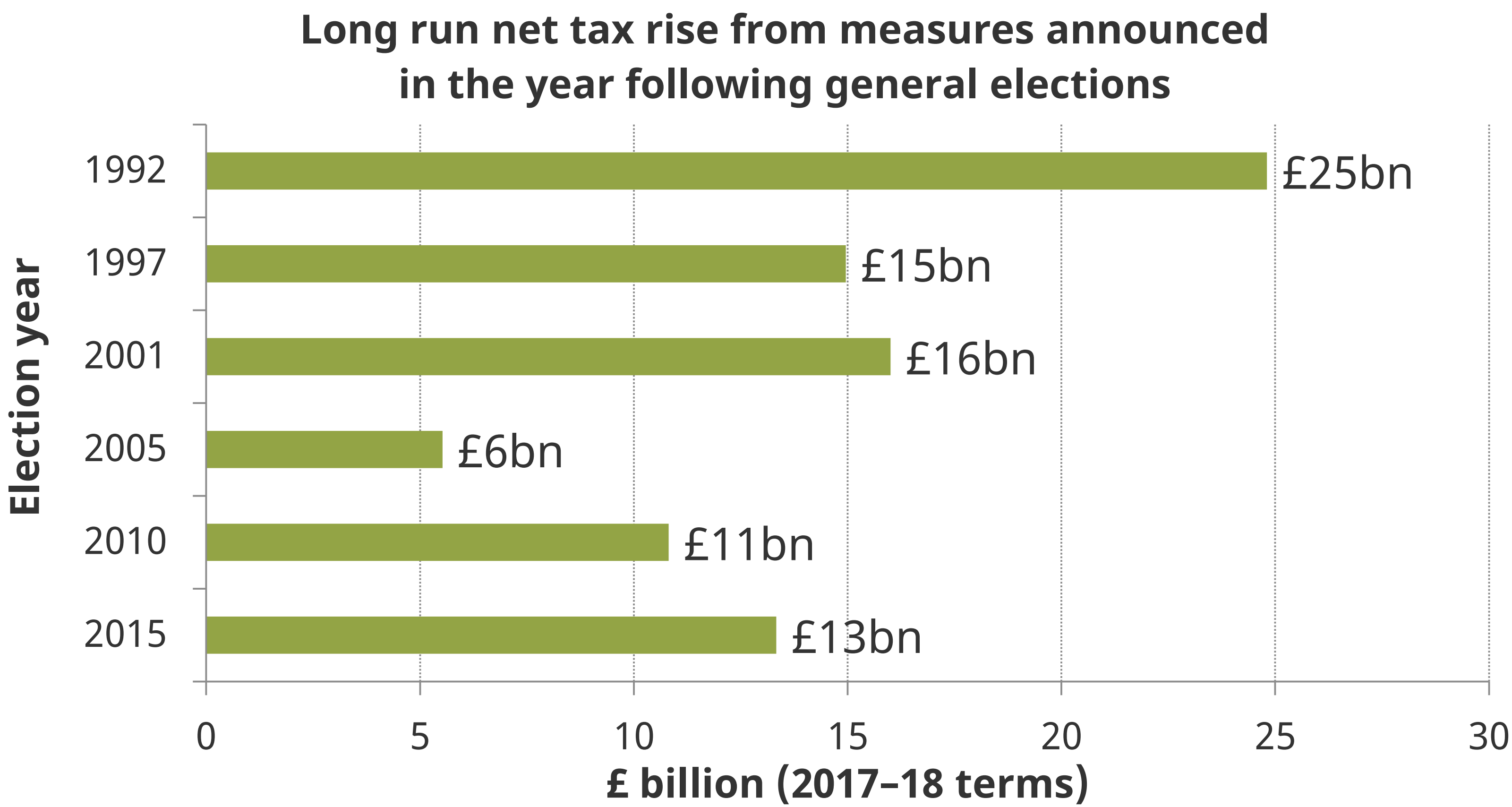
And the National Debt would rise as a result



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



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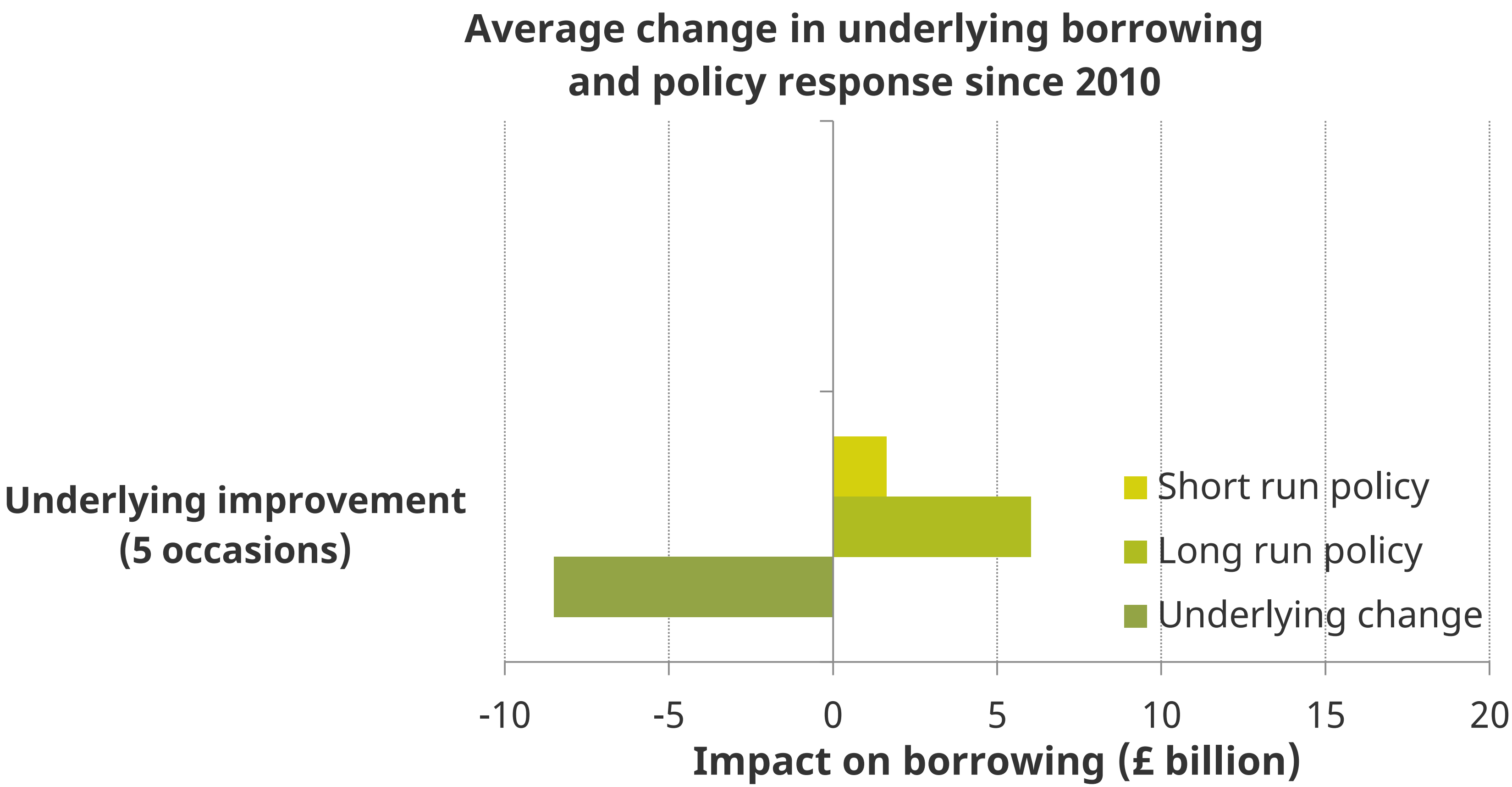
Asymmetric response to public finance news



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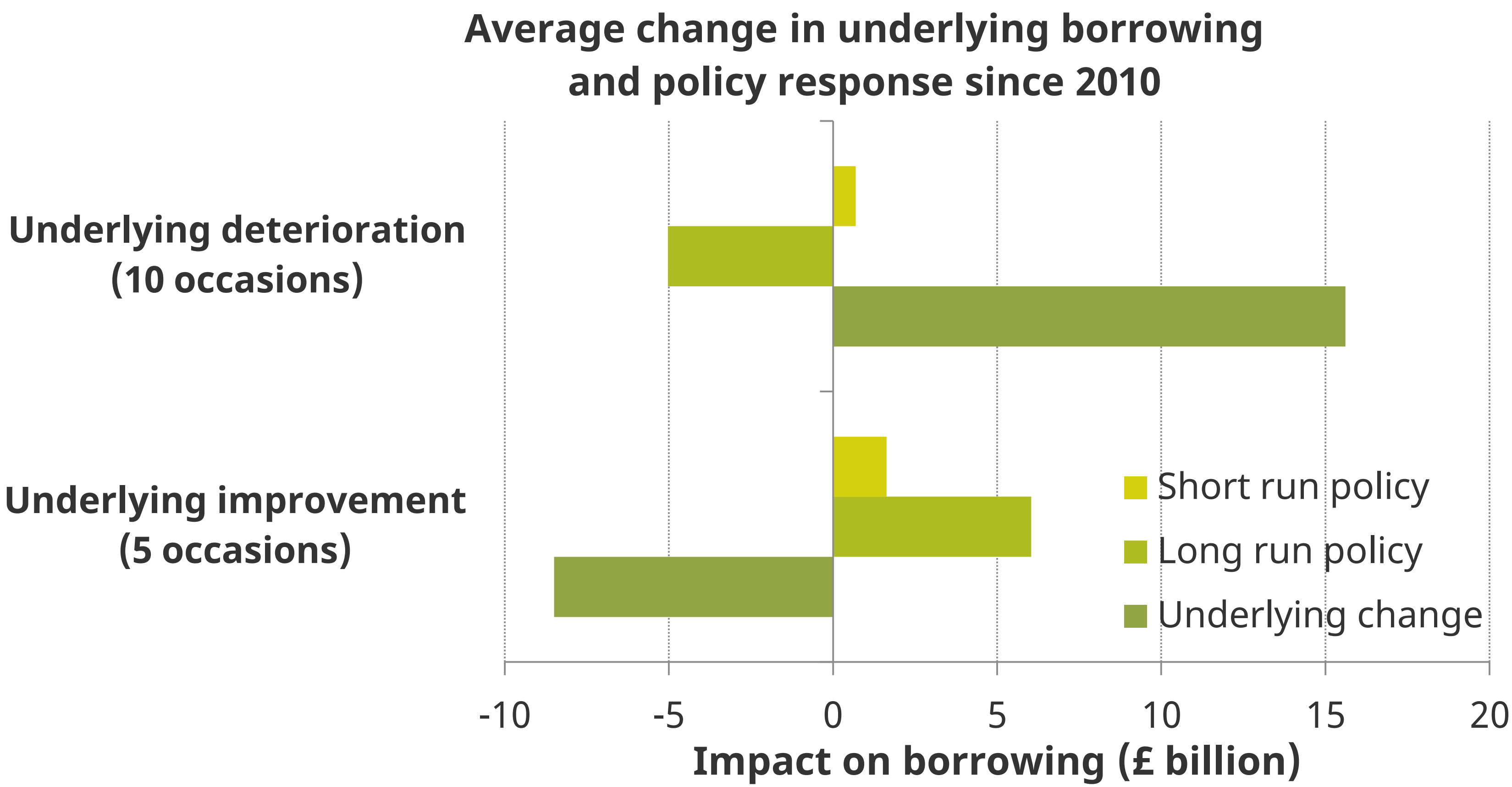
Asymmetric response to public finance news



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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

Possible benefit giveaways? (2/2)

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

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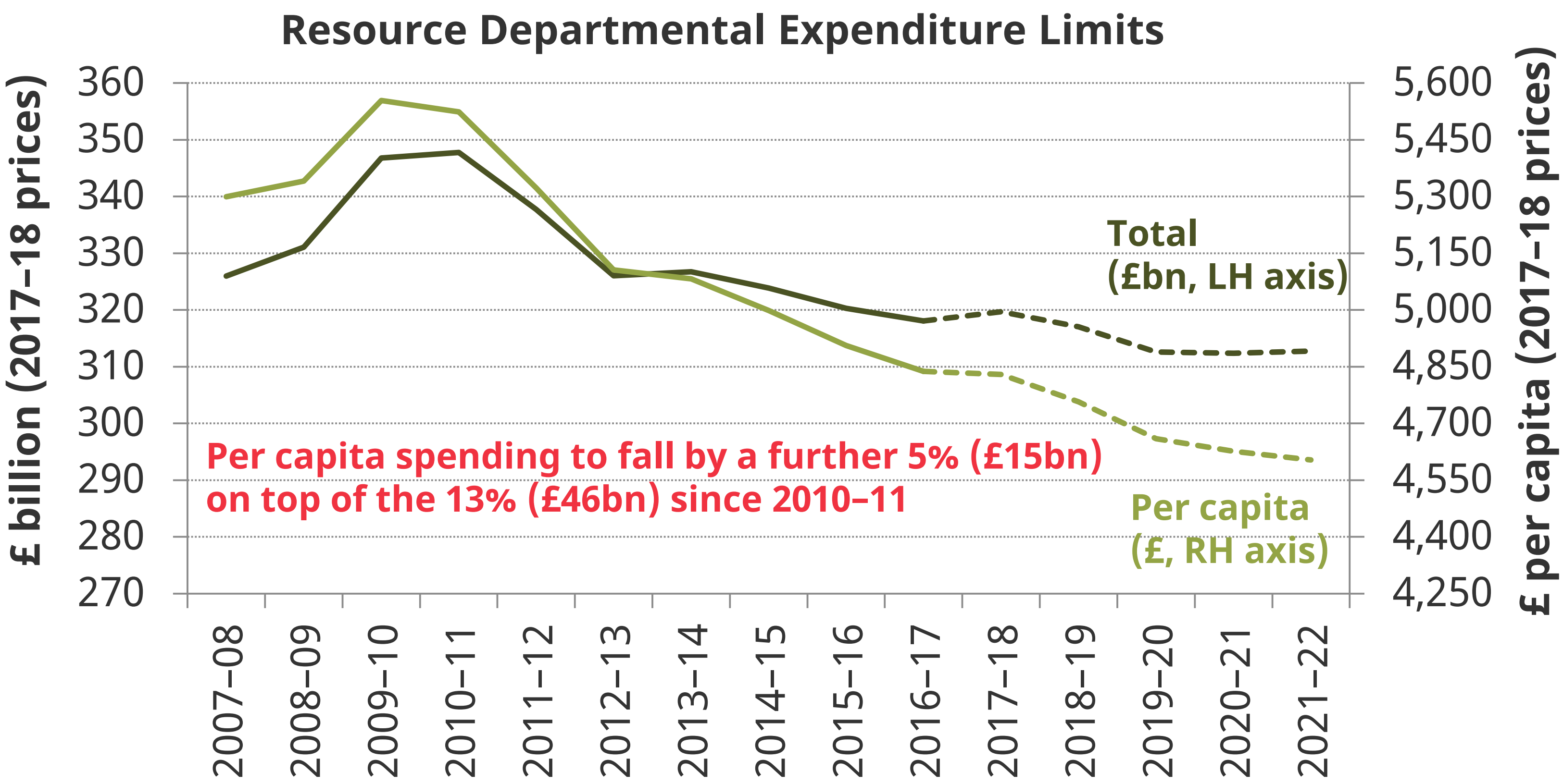

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Retaining public sector pay cap not risk free

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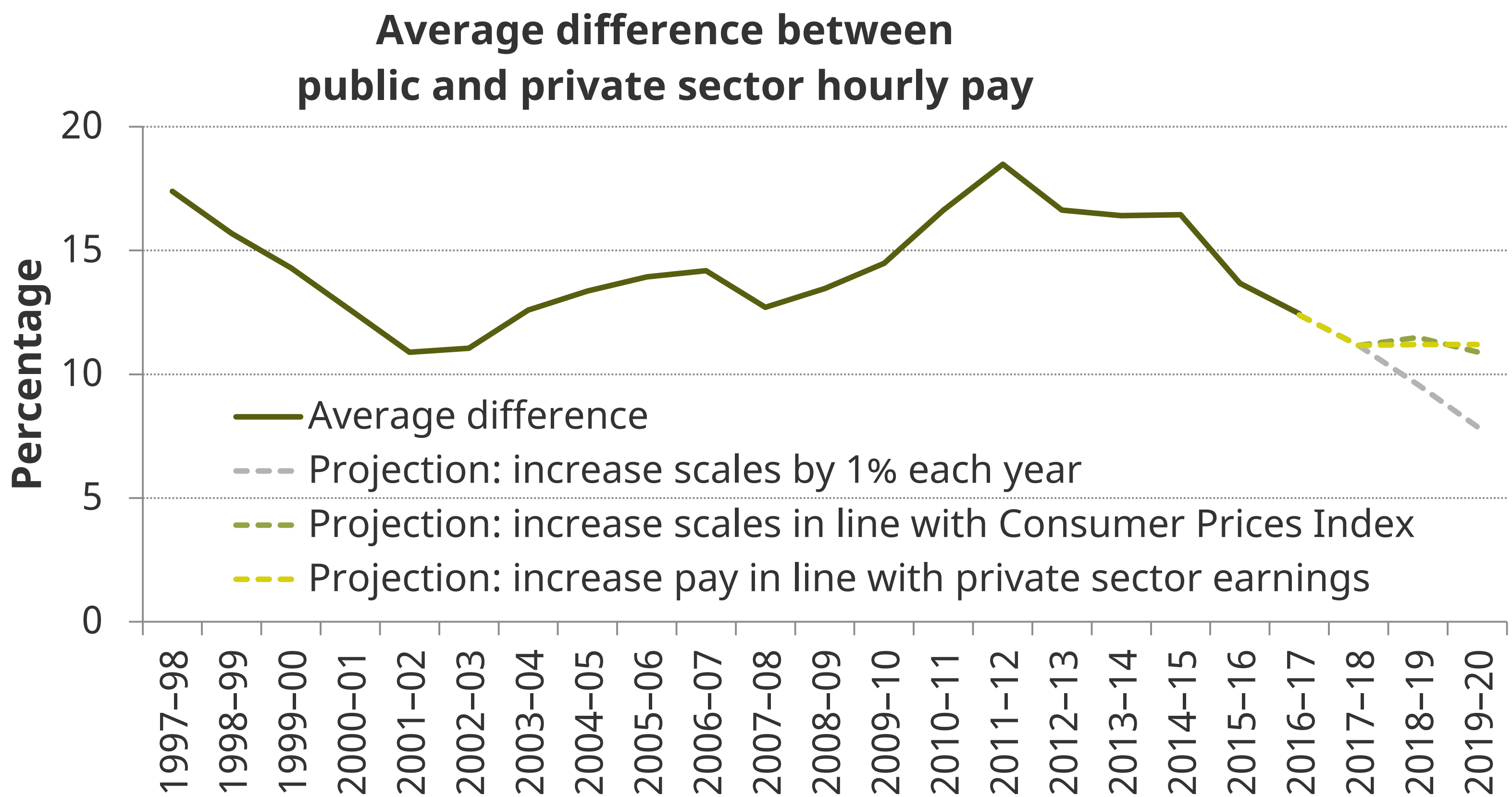

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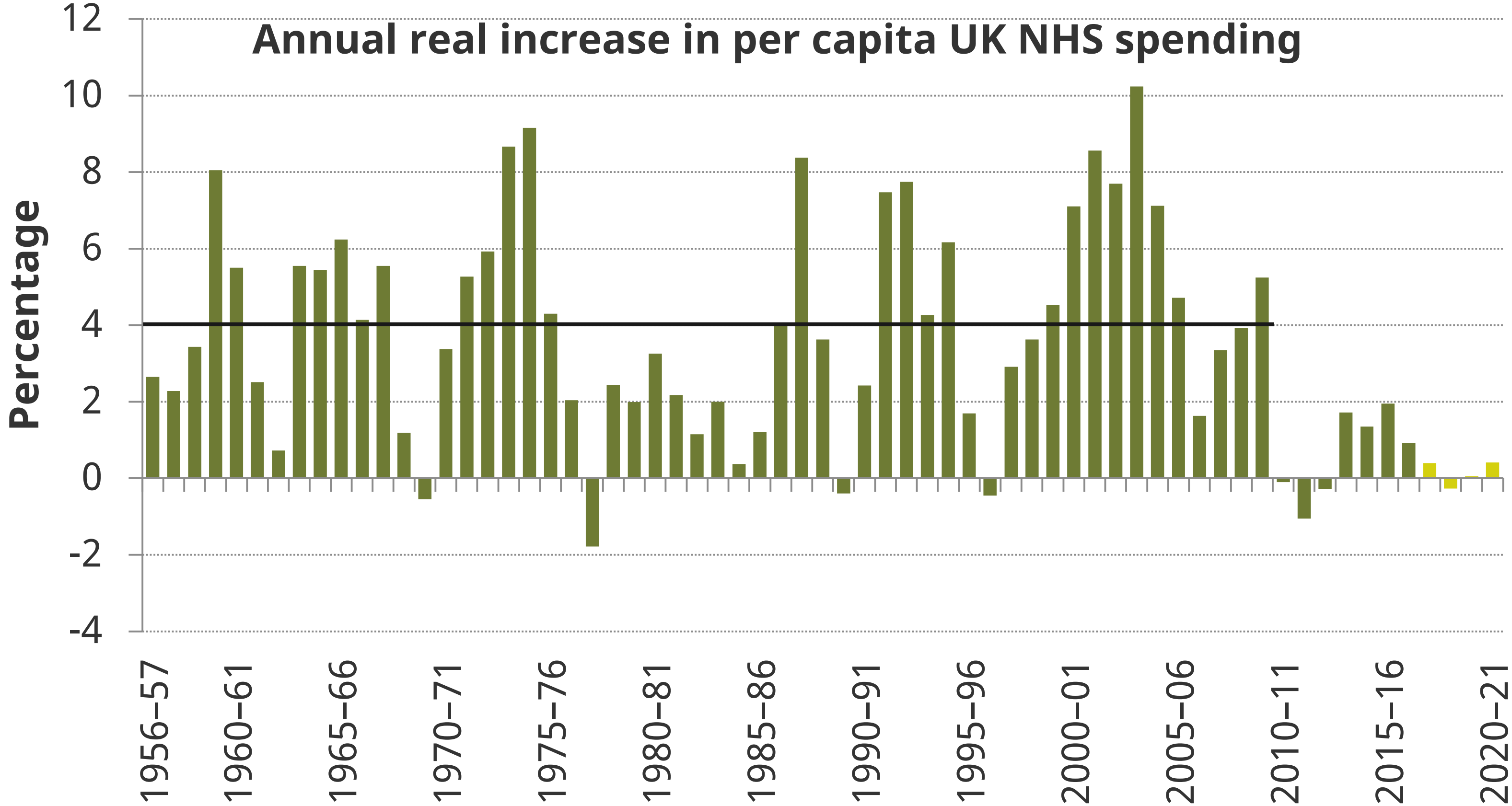
NHS: extremely tight spending settlement



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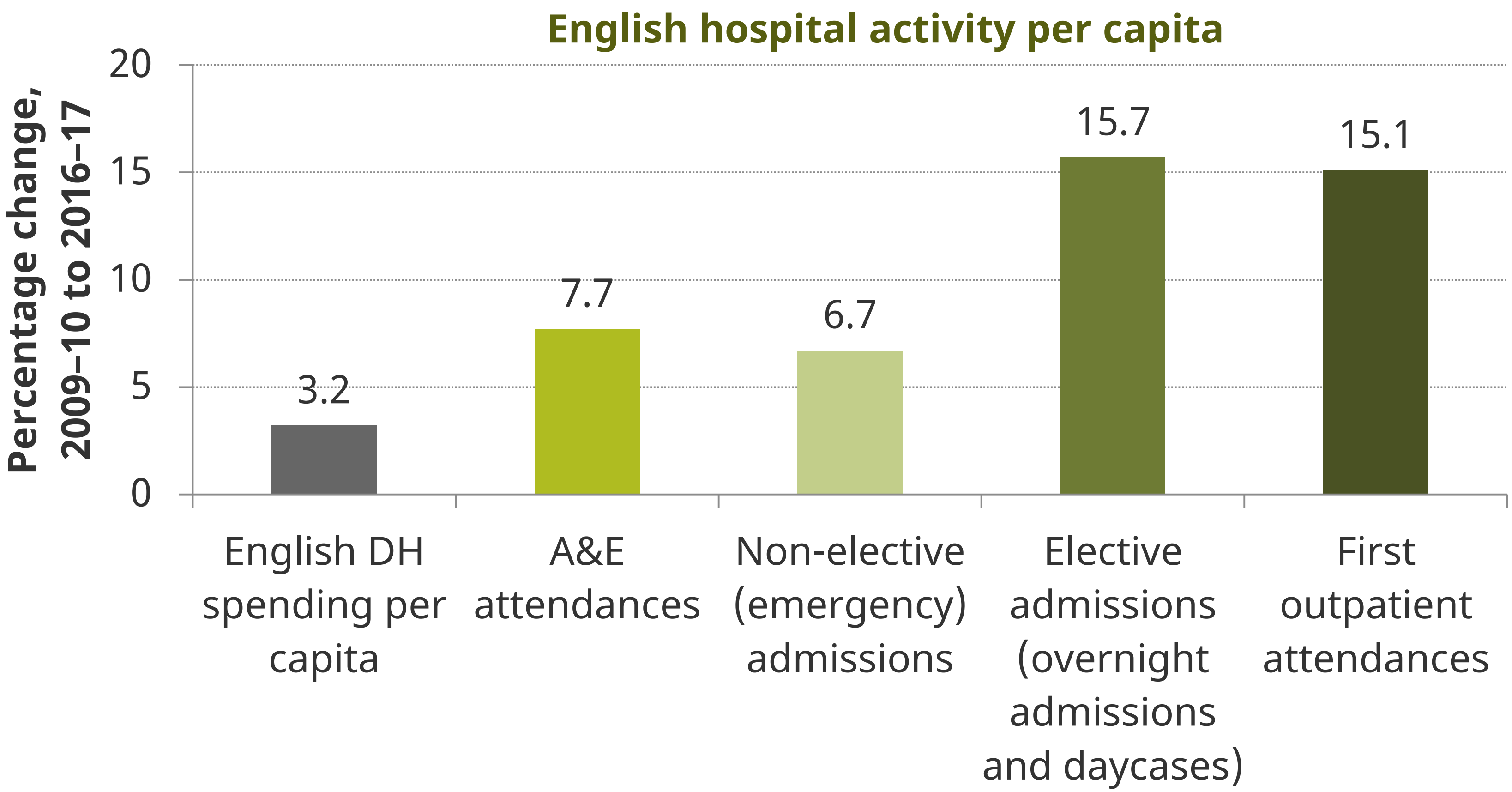
NHS: managing to do more



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NHS: clear signs of strain (1/2)

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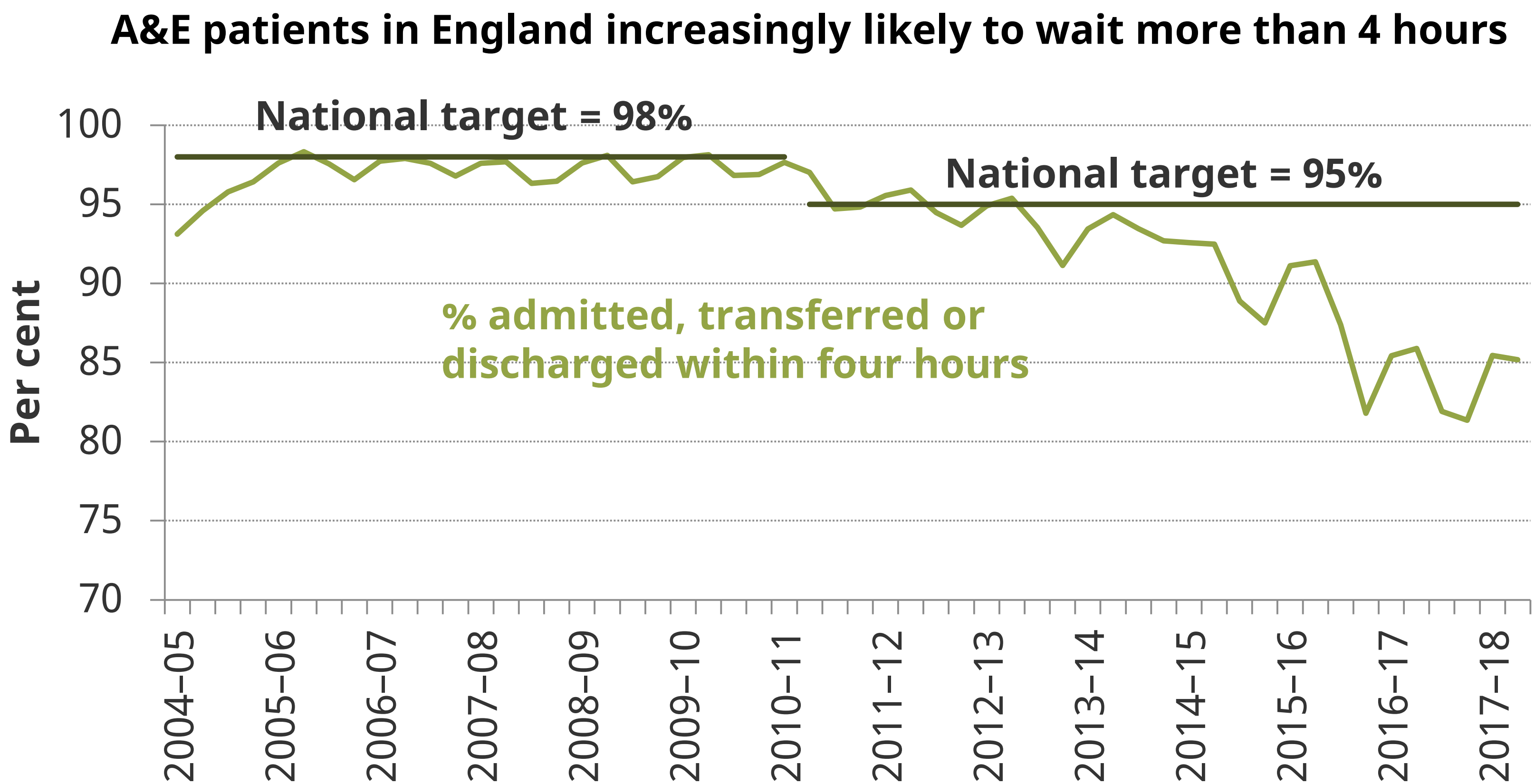

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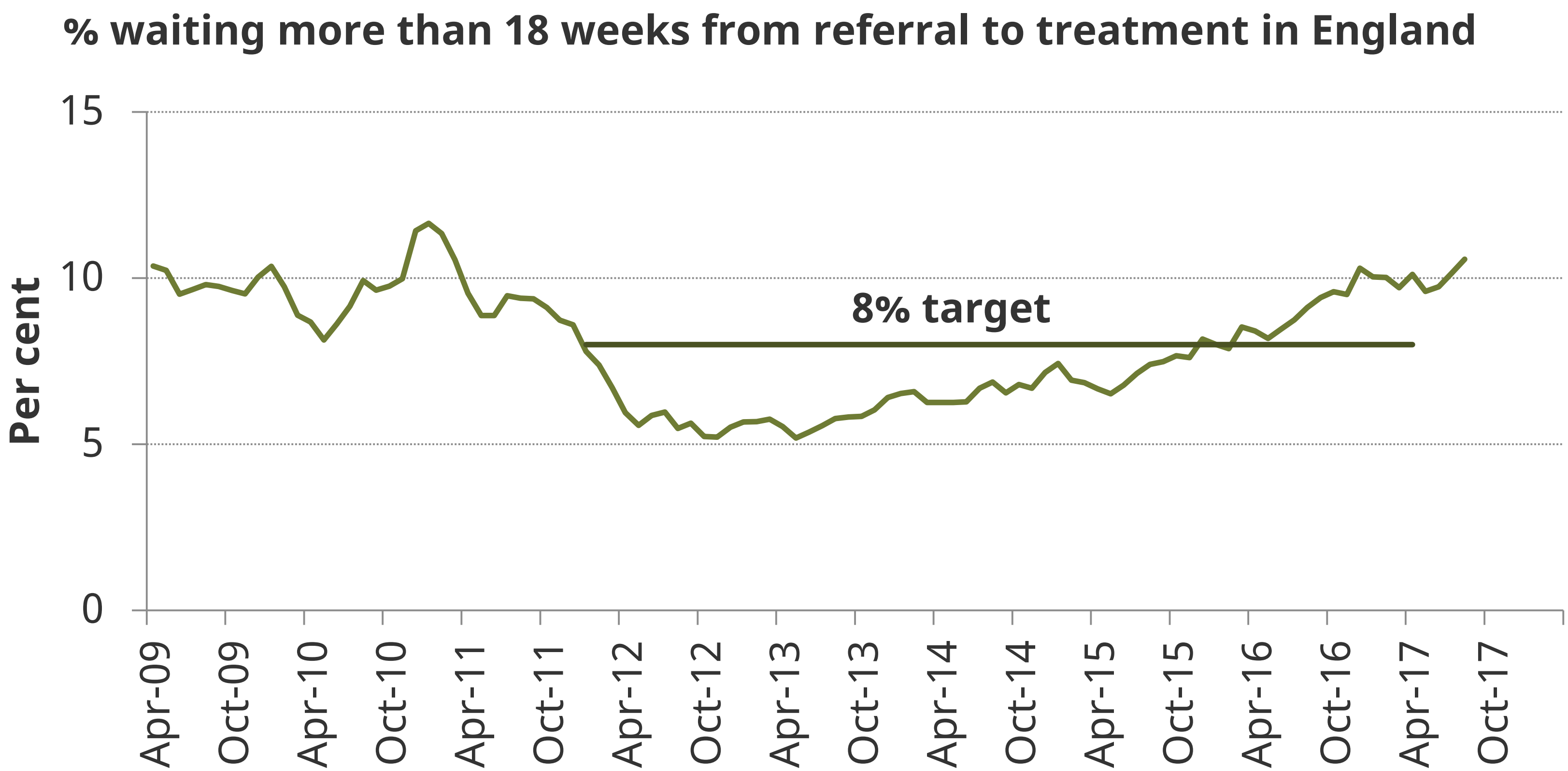
NHS: clear signs of strain (2/2)



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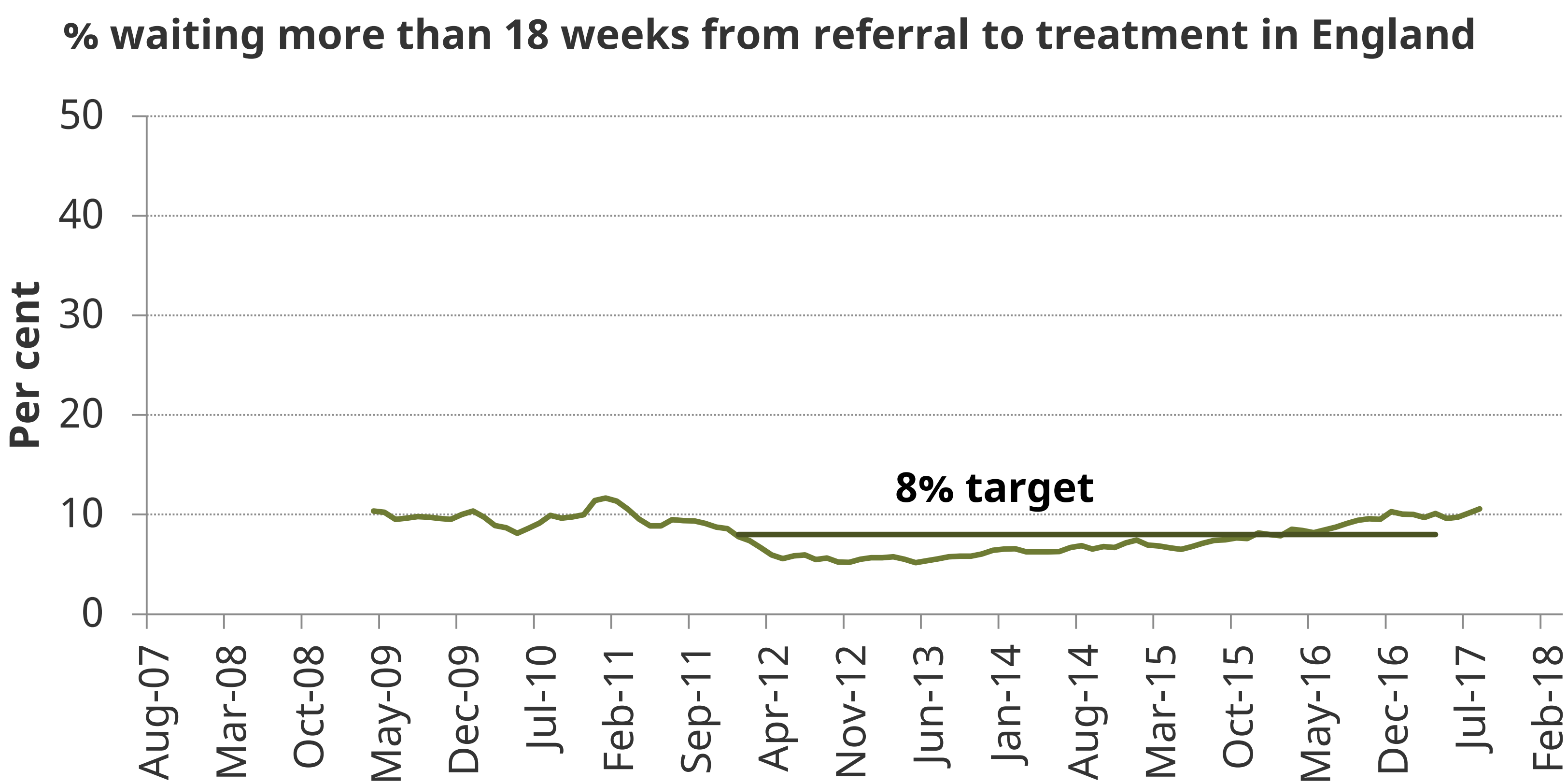

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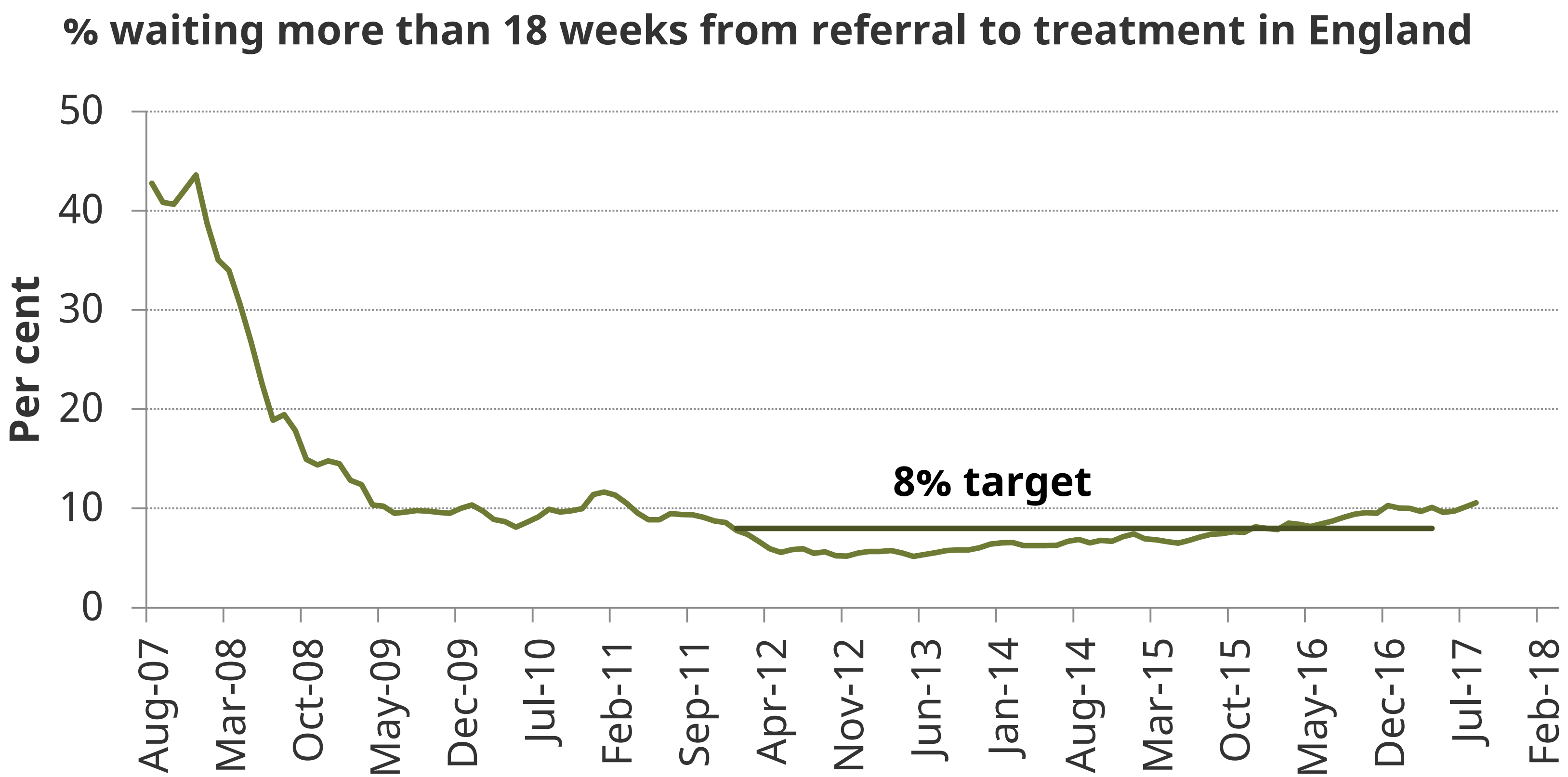

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Prisons: spending and staff cut

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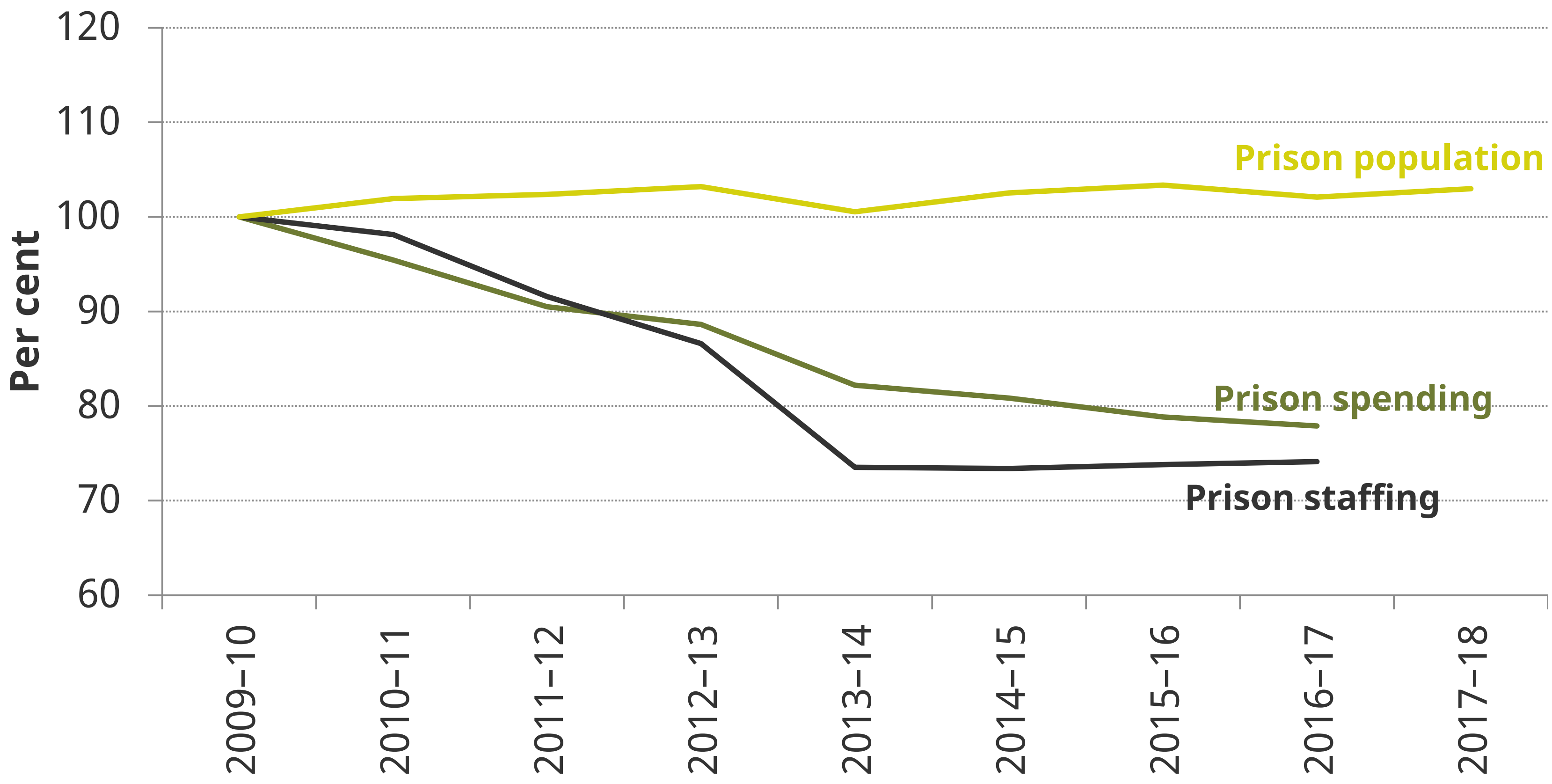

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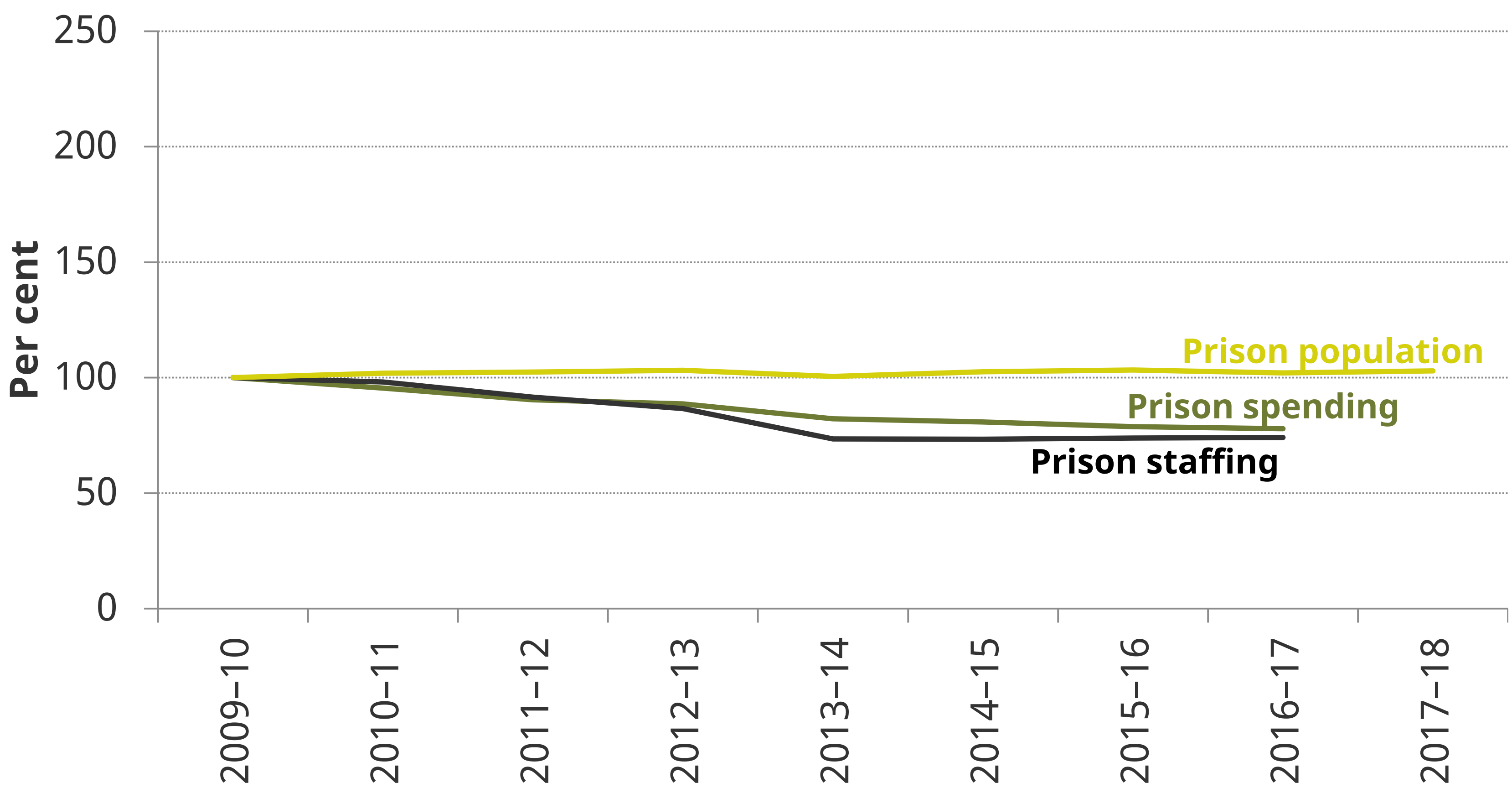
Prisons: spending and staff cut



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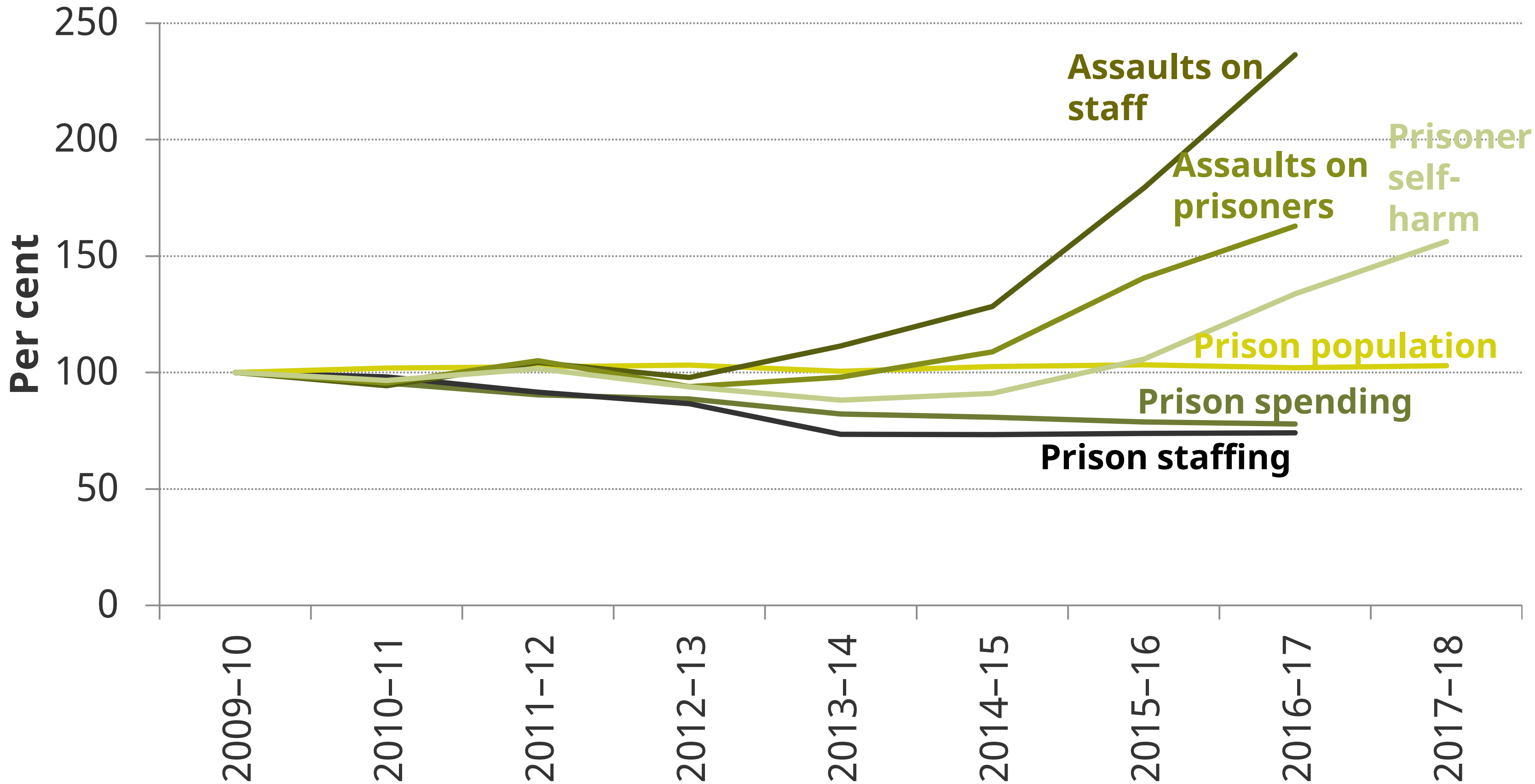
Prisons: assaults on staff, assaults on prisoners and prisoner self-harm up



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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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