

## Paul Johnson's Opening remarks

24 November 2016

No more Autumn Statements. Hurrah. If there has been any promise made by any chancellor I have been able to welcome more warmly I can't remember it. Of course that's partly just a personal preference. I'm getting too old to pull two all-nighters a year in response to fiscal events. But more seriously we have had far too much, far too bad, policy in Budgets, Autumn Statements and pre budget reports over the years. The temptations for Chancellors to use their two days to make too many headline grabbing announcements is great indeed. As I said in a letter to Mr Hammond back in September, along with colleagues from the IfG and CIOT, moving to one fiscal event a year should reduce "the frequency of new significant changes of direction, release resource for better consultation, produce higher quality legislation and more effective implementation, and make life simpler for taxpayers". Let's hope.

And Mr Hammond in any case made a pretty good start. Not too many rabbits from the hat.

Otherwise, yesterday was notable for three big things:

- 1) The downgrade in the economic forecasts, and consequent downgrade in forecast living standards. The OBR think national income in 2020-21 will be £30 billion lower than they projected back in March – that's equivalent to £1,000 per household;
- 2) The new, much looser, fiscal rules and the turning of a £10 billion surplus in 2019-20 into a £20 billion deficit that year;
- 3) The clear prioritisation by Mr Hammond to direct most of what largesse he felt able to afford to paying for additional investment spending – roads, housing, research and development – to support the economy in the long run, rather than to pay to support the incomes of the "just-about-managing", or indeed public services, in the short run.

## Forecasts and public finances

The OBR's economic forecasts are noticeably more upbeat than the Bank of England's. Earlier this month the Bank projected growth of 1.4, 1.5 and 1.6% in 2017, 2018 and 2019 respectively. The OBR's projections are for growth of 1.4, 1.7 and 2.1%. That's quite a big difference. Overall the Bank forecast GDP would grow by 4.9% from 2016 Q3 to 2019 Q4. In the OBR forecast, GDP grows by 5.8% over the same period. This is especially striking given that the Bank's forecasts in May were almost identical to the OBR's March forecasts.

Further out, OBR forecasts remain relatively robust in the two years after 2019, though, as they put it, when looking for information about government policy on exiting the EU in 2019 they were left "little the wiser as regards the choices and tradeoffs the government might make".

In the context of that uncertainty the OBR had to make some fiscal forecasts. In their view borrowing will be £32 billion higher in both 2019-20 and 2020-21 than they forecast back in March. In the latter year £10 billion of that deterioration is down to policy decisions, £18 billion relates to forecasting and modelling changes (including some arising from weak revenues this year), and the residual £4 billion to classification changes.

One important thing to say is that £18 billion is not a huge change in forecast four years out. OBR put £15 billion of that £18 billion down to the Brexit vote. If that turns out to be the effect, that's a somewhat smaller hit than many forecasters were suggesting. For the long run the OBR say that productivity growth will return to trend by the mid 2020s, so that the projected economic hit from Brexit doesn't grow further.

The second important thing to note is that in the face of deteriorating forecasts Mr Hammond neither tightened fiscal policy nor followed his predecessor's example of sticking with previous spending plans. He loosened by an annual £10 billion or so. And he loosened in a rather specific way, mostly by increasing planned capital spending. Given the choice between jam today in the form of more money in people's pockets and jam tomorrow in the form of potential economic returns from greater investment, he went for jam tomorrow.

Strikingly he responded not at all to calls for more money for either the NHS or social care. I'm going to stick my neck out and suggest he won't be able to do that for much longer.

Often announcements of additional capital spending are overhyped. That was not the case yesterday. The additional capital spending plans are significant. They will take public sector net investment to around 2.3% of GDP – pretty much exactly Labour's pre-crisis planned level of investment, and well above the average over the last 30 years.

And then there are the new fiscal rules. Rather than aiming for Budget balance in 2019-20 Mr Hammond will be happy borrowing 2% of national income, that's about £40 billion, in 2020-21. Remember that at the last election the then Shadow Chancellor, Ed Balls, said he was aiming to balance the current budget by 2018-19, i.e. borrow just to invest. Keeping to that over the parliament would have allowed borrowing of just over 2% of GDP in 2020-21. To misquote Michael Heseltine, it wouldn't be far from the truth to say that the new fiscal plans aren't Osborne's, they are Balls'.

Mr Hammond then wants to get to budget balance at some point in the next parliament. That inevitably sounds rather woolly. Given uncertain times, though, a degree of woolliness is probably sensible. This makes a fair stab at getting an appropriate balance between providing us with a clear fiscal direction and anchor on the one hand, and enough flexibility in the face of uncertainty on the other. That said it wouldn't take a huge downgrade in trend growth forecasts of GDP in 2020 for us to miss the target. And getting to balance in the next parliament will still require an additional dollop of austerity on top of the full decade's worth we'll have had by then.

### **Tax and spending measures**

Beyond the additional capital spending there is not a terribly long list of significant new measures announced yesterday. Indeed there is a growing list of policies announced in previous fiscal events which are being more or less

quietly abandoned – more evidence in the case against two fiscal events a year. Some of the changes announced yesterday are worth commenting on.

First, at around £900 million a year, one of the more expensive measures announced was yet another freeze to fuel duty – the seventh year in a row this has happened. If the policy is never to increase fuel duty again, as seems to be the case, we should just be told rather than being told always that it will rise with inflation next year and then that never happening. This is turning into a really big problem both for the Treasury and for our approach to the taxation of motoring.

Second, the cost of the fuel duty freeze is near enough offset by the increase in Insurance Premium Tax. Mr Hammond wasn't guilty of too many fiscal infelicities yesterday, but the way in which he announced the increase in IPT was certainly one of them. It is half the rate of VAT, he said, as if in explanation of the rise. Well, so it should be - in fact it should be lower. It's only the value of the insurance – premiums net of pay outs – which one should think of as being VATable. That would imply an IPT rate much less than 10%, not more.

Third, the tax changes affecting certain benefits in kind were much more meagre than I at least felt we had been led to expect. They affect only a small number of very specific salary sacrifice arrangements and don't get at all at the highly beneficial NI treatment of many non cash benefits.

Fourth, a quick word about an issue on which the Chancellor had no proposals, but which he has promised to review and then consult upon – the taxation of different ways of working. The OBR has again highlighted concerns over increasing levels of incorporation – that is people declaring themselves to be companies rather than employees or self employed – undermining the tax base. The basic problem is that the tax system taxes income quite differently according to whether it is earned by an employee, a self-employed person or a company. There are some quite fundamental issues here, right at the centre of tax design, about how we tax different forms of income. We look forward to

being consulted. Luckily we have thought quite hard about this and have some ideas.

Finally, the one small offer to the JAMs was a cut in the taper rate for Universal Credit from 65% to 63%. This is a small increase in generosity relative to the cuts announced last year. My colleagues will explain it in more detail. But we shouldn't allow the growing absurdity of the policy making process around Universal Credit to be lost on us. This is a benefit announced in 2010 which, with a fair wind, might be largely rolled out by 2020, several years late. Detailed changes to its future design have been made in fiscal statement after fiscal statement apparently at chancellorial whim. There is a rational process to go through to design this benefit, of which one part is the trade-off between lower work allowances, announced last year, and a lower taper rate, announced yesterday. What we have seen has not been a rational process. This is not how to design and introduce the biggest reform to our welfare system in decades.

### **Living standards**

Which brings me nicely to the issue of what all this means for living standards. As far as the measures announced yesterday are concerned, the answer is "not a lot". They pale into insignificance alongside the benefit and tax credit cuts announced last year, not to mention the increases in the personal allowance and the larger tax increases implemented since 2010.

However, the outlook for living standards has deteriorated rather sharply since March. The OBR is forecasting both lower nominal wage growth as a result of lower productivity, and higher inflation resulting from the exchange rate depreciation. Overall real average earnings are forecast to rise by less than 5% between now and 2021. That means they will be 3.7% lower in 2021 than was projected in March. To put it another way around half of the wage growth projected for the next five years back in March is not now projected to happen. On these projections real wages will, remarkably, still be below their 2008 levels in 2021. One cannot stress enough how dreadful that is – more than a decade

without real earnings growth. We have certainly not seen a period remotely like it in the last 70 years.

In addition the projections imply that the real value of the National Living Wage will rise by just over 20% rather than by 25% over the course of this parliament while the real value of working age benefits like JSA that are currently frozen in cash terms will fall by 7.7% rather than 6.5%.

### **Conclusion**

Overall, despite some of the headlines, I think we can count the OBR as having been modestly upbeat relative to some other forecasters. Even so the outlook for living standards and for the public finances has deteriorated pretty sharply over the last 9 months. Mr Hammond has responded by increasing capital spending and hence increasing borrowing further. His new fiscal rules, being more relaxed than those of his predecessor, allow him this luxury. Given the still very considerable uncertainties over the direction of the economy he may well find he needs all of the headroom he has left himself.

Given that uncertainty it seems right that this Autumn Statement had the feeling of a “wait and see” fiscal event. To return to where I started. We will also wait and see whether this really is the last Autumn Statement. We have been here before after all. Chancellor Kenneth Clarke also moved from a separate Autumn Statement and Spring Budget to a single Autumn Budget. That didn’t survive a change of occupancy at number 11.