Paul Johnson's opening remarks: IFS Budget briefing 2016, 17 March 2016

The Chancellor made rather too much of the £27 billion the OBR found down the back of the sofa in November. As I've said on a number of occasions, that was a small change to forecasts and, being cumulated over several years, was not a useful number. What Mr Osborne didn't tell us yesterday is that rather than finding £27 billion the OBR lost £56 billion down that same sofa. As it happens, the total *loss* to the sofa across the two fiscal events is £29 billion.

That loss largely arises from changes in assumptions about future productivity growth feeding in to lower economic growth over the rest of the parliament. If the OBR is right about that we should all be worried. This will lead to lower wages and living standards, not just lower tax revenues for the Treasury.

It inevitably causes problems for the fiscal target – to get to budget surplus by 2019-20. Indeed these changes cost the Chancellor more than £13 billion in that year. He made up just slightly more than that £13 billion through policy measures. But this is a rather odd £13 billion. More than half of it is purely temporary – shifting tax revenues into that year and shifting capital spending out. The target would not be forecast to be met without both this shuffling of money between years and a wholly unspecified spending cut of £3.5 billion on top of the specific cuts announced in November. The Chancellor is confident that the efficiencies can be found to achieve this spending cut, but won't be able to tell us where they will come from until 2018.

In the longer term the public finances are kept on track only by adding yet another year of planned austerity on the spending side. Spending in 2020-21 will be £10 billion less than planned.

Of course it easy to focus on these specific numbers – the Chancellor's target forces us to do so. But it is important not to lose sight of the wider picture. Whether or not he just gets to budget surplus in 2019-20 is economically irrelevant. If the deficit hasn't completely gone by then it will, dreadful economic news aside, be nearly gone. That will represent a huge turnaround over the decade.

There is some real reform going on as well though. Increases to ISA limits and the introduction of new lifetime ISAs are part of what looks like a long term strategy to take increasing amounts of savings income out of tax. A new sugar tax extends the remit of our "sin taxes" to discourage unhealthy behaviour. The corporate tax system is being substantially changed in ways which will limit some avoidance activities, but also in ways which will add to some real costs. Capital Gains Tax has taken another dip on its long term up-and-down rollercoaster ride. And the income tax personal allowance and higher rate threshold are both rising, at considerable cost.

Public finances and spending

Mr Osborne had three fiscal rules – the welfare cap; the rule which said debt should fall as a fraction of national income every year; and the rule to get to budget surplus by 2019-20.

He broke his welfare cap in November, and it is now broken by a bigger margin. He told us yesterday he is on course to break his debt rule by the end of this month. The surplus rule is the last rule standing.

If that rule has one great merit it is its simplicity and transparency. There's no need to worry about the difference between cyclical and structural deficits as was the case with previous fiscal rules. Nor is there any need to worry about differences between capital spending and current spending. But yesterday we discovered that no rule is that straightforward. According to this rule the public finances in 2019-20 matter a lot more than those in 2018-19. And you could certainly see that in the numbers. The forecasts, including policy action, got worse by £17 billion in 2018-19, and by nothing in 2019-20.

A lot of that was achieved by the simple expedient of moving capital spending forward and corporation taxes back. Like all rules this one can create behaviour change that is rather less useful than the change it was supposed to create.

The focus on the 2019-20 target is obvious throughout. There is no net tax increase over the period as a whole, yet there is a tax increase of over £6 billion in 2019-20 specifically. Capital spending increases in 2017-18 and 2018-19 but falls in 2019-20. There is no proposed additional spending cut in 2018-19, there is a £3.5 billion cut plus an extra £2 billion impost on public sector employers in 2019-20.

The problem for the Chancellor though is perhaps less that some of these changes were made, and more that he is running out of wriggle room. His chances of him having a surplus in 2019–20 are only just the right side of 50:50. But it is also important to remember that the rule gets suspended if, at any point, growth drops below 1%. With lower expected growth in the economy the chances of this happening is now greater. (The OBR puts the chances of the growth dropping below 1% in 2020 at as much as 35%).

These risks are exacerbated by the fact that there are in fact £8 billion of tax cuts in the Budget. These are pretty definite long term cuts, some of which will become more expensive over time. There are £5 billion of tax rises (5 is less than 8). But even of this £5 billion a good £2 billion is uncertain – much of it coming from anti-avoidance measures.

If there was another downgrade in fiscal forecasts of a similar magnitude and the Chancellor did wish to remain on course to deliver a budget surplus in 2019–20 then this would surely require more real policy change – presumably incorporating at least some permanent tax rises and specific spending cuts. *Given* the chancellor's objectives, that would be the appropriate response.

The underlying deterioration in the public finances can't be smoothed away so easily in any case. On these forecasts the Chancellor has now effectively lost the scope to raise public service spending in 2020-21. The OBR has day-to-day spending by central government on public services flat that year, therefore falling as a fraction of national income. Yet another year of austerity pencilled in.

Corporate taxes

The biggest help to the 2019-20 figures comes from delaying new rules to ensure that groups pay their corporate tax earlier. This flatters the public finances temporarily as revenues are brought forward. The temporary flattering is now due to happen not in 2017-18, as originally planned, but in 2019-20. Very handy.

There is a series of other changes to business taxation. Some follow directly from the OECD BEPS recommendations, with the most important of these being a restriction on the amount of interest relief for corporate tax. This illustrates nicely the trade-offs the Chancellor has to make. On the one hand this will undoubtedly reduce avoidance opportunities. On the other it will reduce incentives for some genuine investments.

The further cut in the main rate of corporation tax, which was already due to fall to the lowest rate in the G20, was yet more evidence of the government's focus on making the UK an attractive proposition for multinational companies. There can be no doubting the ambition that comes with a cut in the headline rate from 28% to 17% in a decade, at considerable fiscal cost in a period of austerity.

Sugar tax

We have a new tax on sugary drinks. The case for a sugar tax is a sound one in economic terms. It is similar to the case for a tax on alcohol. It is rather harder to implement however, and a tax just on soft drinks is clearly only very partial. Only around 17% of added sugar consumed comes from soft drinks – though the proportion in households with children is a little higher. Obviously the soft drinks tax won't have any impact on the other 80+% of sugar consumption – indeed it might increase it as people move away from soft drinks to other sugary products.

That said taxing soft drinks, which have little or no other nutritional value, may well make sense as a first step. But the new tax has a rather curious structure. You might think that you want a tax on the amount of sugar in the drink, so that the tax per gram of sugar is constant, and the amount of tax paid rises in proportion to the amount of sugar. That's not the proposal. Tax will be levied at zero pence per gram of sugar for drinks containing 4g of sugar per 100ml, at 35p per 100g of sugar for drinks containing 5g per 100ml, falling to less than 15p per 100g for the most sugary drinks. It's hard to see the rationale for that.

Other excise duties

The sugar tax actually in some ways replicates the odd way in which we tax the alcohol content of wine and cider where tax per unit volume falls with the strength of the drink. Though, in the case of wine and cider the silly structure is forced on us by EU regulations. It seems we can construct sub-optimal tax structures without the help of the EU.

While duty on wine rose in line with inflation yesterday, duty on beer, spirits and cider was frozen. Spirits and strong cider are the tipples of choice among the heaviest drinkers. Their preference for strong cider at least is largely down to the fact that it bears much lower tax per unit alcohol than any other drink. In a bizarre aside Mr Osborne linked freezing spirits duty to the importance of whisky exports. Duties are not paid on exports. This is rhetorical nonsense.

The biggest excise duties of them all are the duties on petrol and diesel. These were again frozen. After six years of freezes (i.e. cuts in real terms) one must begin to wonder whether these duties will ever rise again, especially given current low oil prices. Real duties are now back at levels not seen since the mid 1990s. Add in the effects of improved efficiency and the cost of a driving a mile in a new car is now at easily its lowest level since then. Given that fuel duties bring in a handy £28 billion a year this has to be a big worry for the Treasury. Given that the harm created by driving in terms of increased congestion is rising, as is the harm from carbon emissions created by using petrol, we might also be worried by the economic and environmental cost of continuing with this policy.

Personal and savings taxes

Once more we are seeing large sums invested in increasing the tax free personal allowance, this time to £11,500 in April 2017 at a cost of £2 billion. The higher rate threshold is being raised to £45,000 at a cost of £0.5 billion. This latter move should stop the numbers paying higher rate tax from rising beyond 5 million – but it will still leave the numbers 2 million higher than was the case back in 2010.

The disingenuousness of the rhetoric on the personal allowance continues. The chancellor boasted yesterday that the increase in it "means another 1.3 million of the lowest paid workers taken out of tax altogether". No it does not mean that. Taken out of income tax, yes. But not taken out of direct taxes on income. It remains the case that National Insurance Contributions, which are just another tax on earnings, start to be paid once earnings rise above about £8,000. Low paid workers are not taken out of tax by raising the personal allowance.

Mr Osborne also continued to transform the taxation of savings. The limit on ISA contributions is now set to have doubled since 2010. The chancellor clearly has a preference for this sort of (TEE) saving – save out of taxed income, keep the returns tax free – over the (EET) pension treatment – save out of pre-tax income, pay tax later. He has continually increased the ISA limits while cutting pension limits. Of course if people respond by saving less in pensions and more in ISAs Mr Osborne will get more tax revenues today, his successors will get less tomorrow.

Two other changes to savings tax were the introduction of the LISA, which allows those aged under 40 to put £4,000 a year into an ISA with a 25% match from the government, and "help to save" which allows working tax credit recipients to get a 50% match on savings of up to £50 a month. These, along with Mr Osborne's continued commitment to the tax free lump sum within pensions, suggest that he has a surprising attachment to EEE savings vehicles. "Help to save" has a lot in common with the old Saving Gateway policy. When that was abolished (by none other than Mr Osborne) we at the IFS congratulated ourselves on the impact of our evaluation of the policy – which found no evidence that it increased total saving among the target group. We are not aware of any new evidence on this point.

Finally from me, I can't finish without mentioning capital gains tax. Mr Osborne, who raised CGT in 2010 and cut it yesterday, is following a long tradition of confused and indecisive chancellors who can't quite make up their minds about whether to prioritise protecting the income tax base by having a higher CGT rate or incentivising investment by having a lower rate. We need a serious plan and strategy here. This is not the way to make good tax policy.