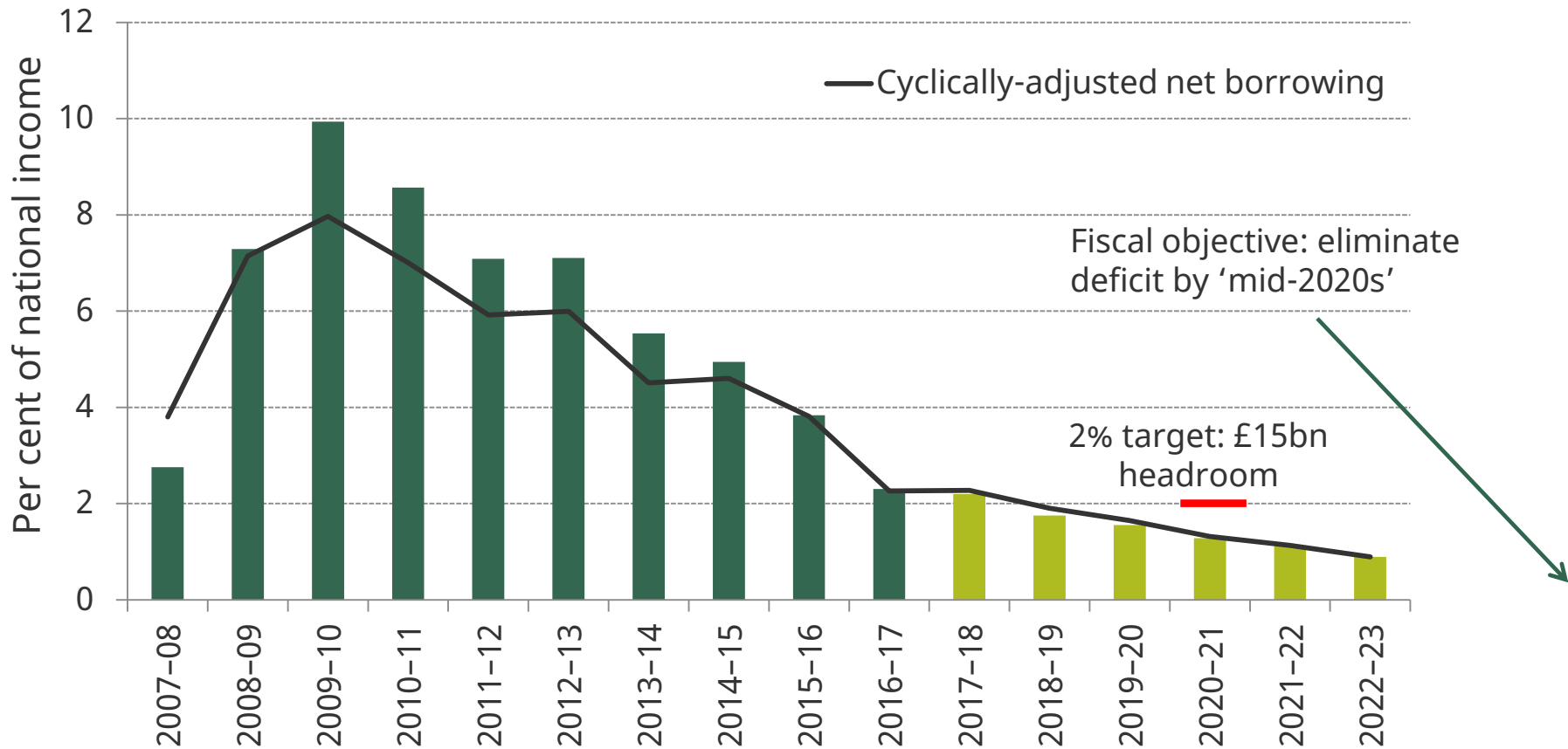


Spring Statement 2018: more difficult choices ahead

Carl Emmerson

Wednesday 14 March 2018

Forecast deficit



Source: Office for Budget Responsibility *Economic and Fiscal Outlook*.

Challenges ahead

Deficit forecast to fall from 2.2% of national income in 2017–18 to 0.9% in 2022–23

- debt falling but still twice pre-crisis share of national income

Substantial economic and policy risks around this forecast

- even if correct eliminating deficit by mid-2020s extremely difficult

Regardless of this target, which history suggests won't be met, the UK public finances face substantial pressures which need addressing

- will weaknesses in tax system be addressed?
- how will we respond to long-run public service spending pressures?

Weaker-than-forecast growth would push up borrowing

- 1% smaller economy increases deficit by 0.5% of national income

Composition of growth matters too

Several taxes very reliant on few people for a large share of revenues

- increased by reforms since 2010 for income tax, capital gains tax, inheritance tax and stamp duty land tax
- 56% of adults pay income tax compared to 66% in 2007–08
- revenues sensitive to the behaviour and performance of the richest: 1% of income tax payers pay 28% of income tax revenue
- makes the path of revenues more uncertain
- 5% of EU citizens in the top 5% of UK earners, but 10% for EU-15

Workforce trends a large and growing public finance issue

40% of growth in the workforce since 2008 has been due to self-employment and company owner-managers

- tax advantaged relative to employees at current cost >£10 billion
- forecasts suggest cost will increase by £4.5 billion by 2021–22

Taylor Review recommended closer alignment of tax treatment

Chancellor's response:

“While we agree with the review that the small differences in contributory benefit entitlement no longer justify the scale of difference in the rates of NI contributions paid in respect of employees and the self-employed, we are clear that **we have no plans to revisit this issue.**”

If the workforce trend continues public finance cost will grow yet become politically harder to correct

OBR forecast currently predicated on relatively smooth transition

- November 2016 assessment that GDP would be 2% lower in 2020 as a result, weakening public finances by £15bn in 2020–21
- high degree of uncertainty around precise effect

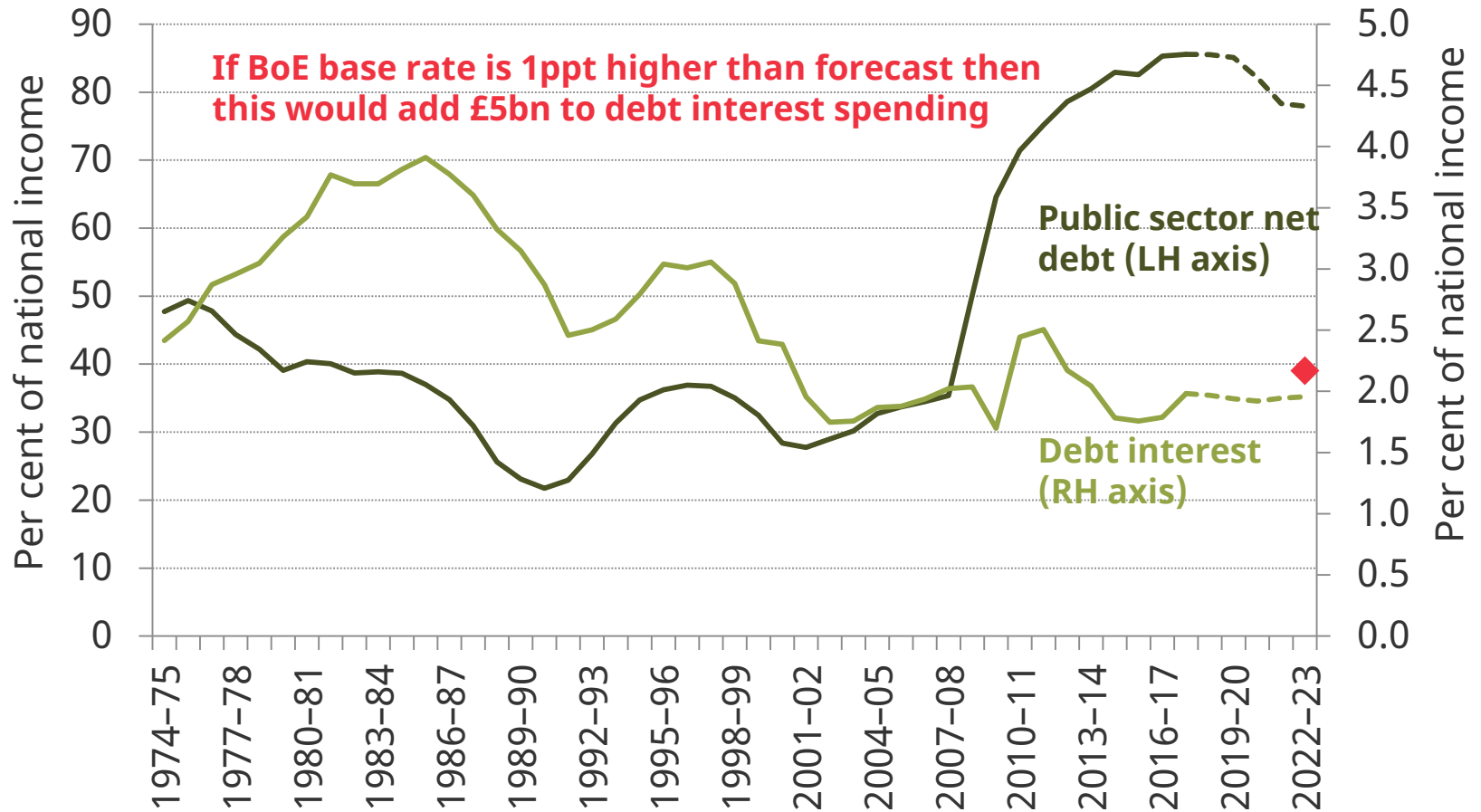
Effect of a ‘hard Brexit’ estimated to be much bigger

- leaked civil service estimate of an 8% smaller economy in long run consistent with other forecasts: again highly uncertain

Accounting of fiscal flows between UK and the EU could provide an upside risk for the public finances

- up to £3bn in 2020–21 rising to £5.8bn in 2022–23 (\approx £60m rising to \approx £120m per week), rising further thereafter
- public finance impact of a weaker economy highly likely to dominate

Interest rate risk



Source: Office for Budget Responsibility *Economic and Fiscal Outlook*.

Policy risk: highly likely policies?

Manifesto commitment to increase income tax personal allowance to £12,500 and higher-rate threshold to £50,000 by April 2020

- estimated cost of £1.0bn and £0.7bn respectively in 2020–21

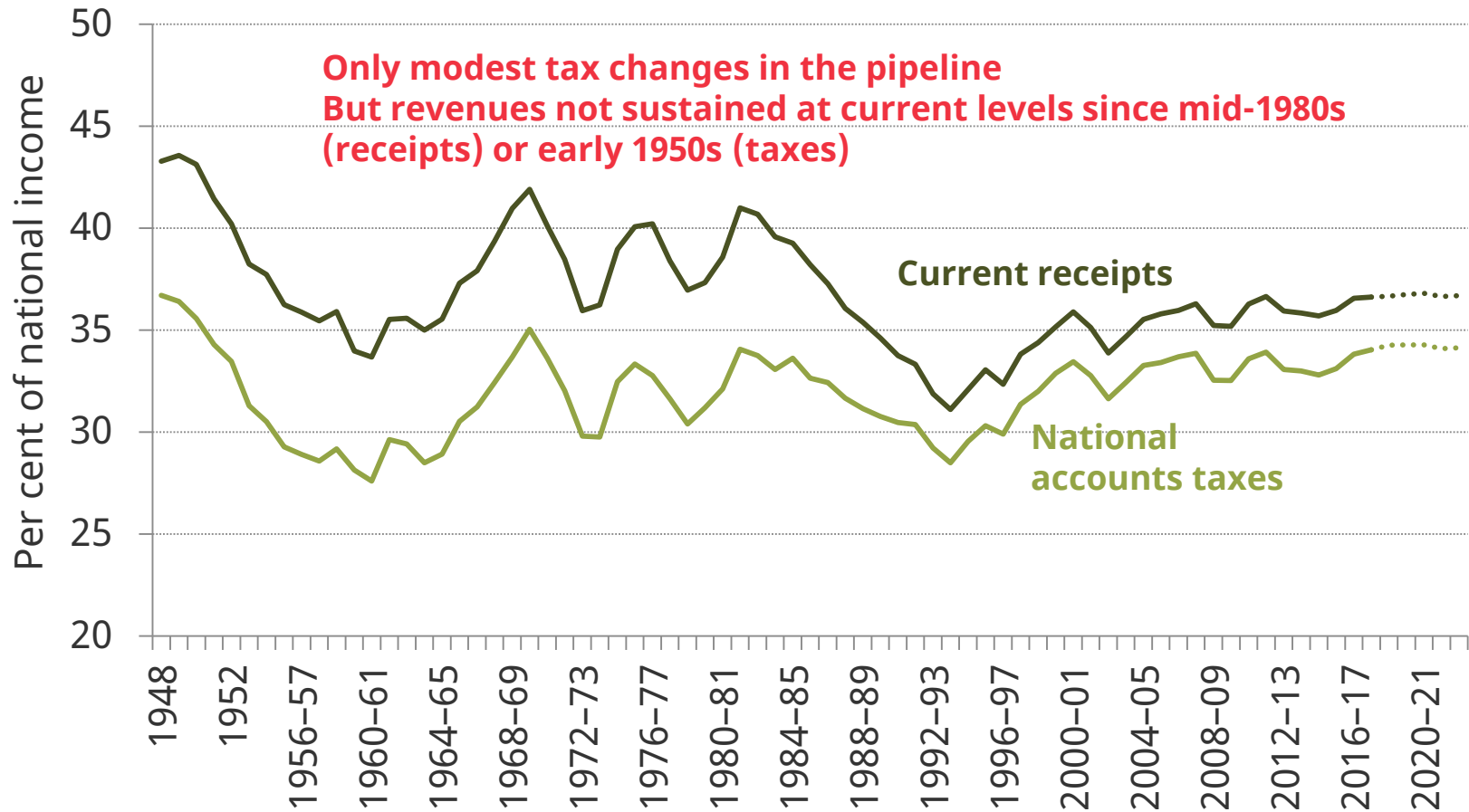
Forecasts assume fuel duties RPI indexed from April 2019 onwards

- freeze throughout this parliament would cost £3.3bn in 2022–23

Review of higher education student finance

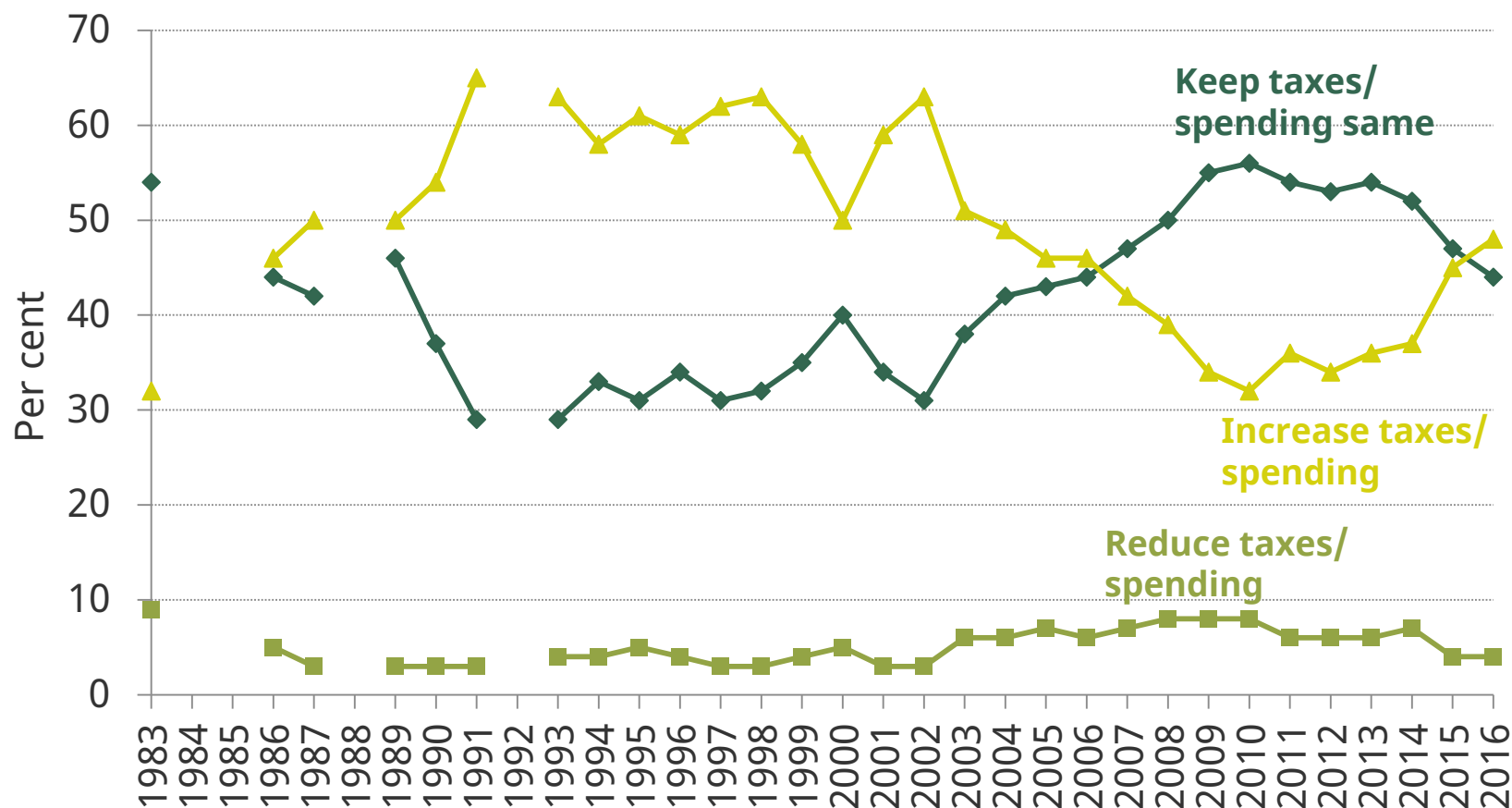
- likely resulting measures would weaken the public finances

Policy risk: tax



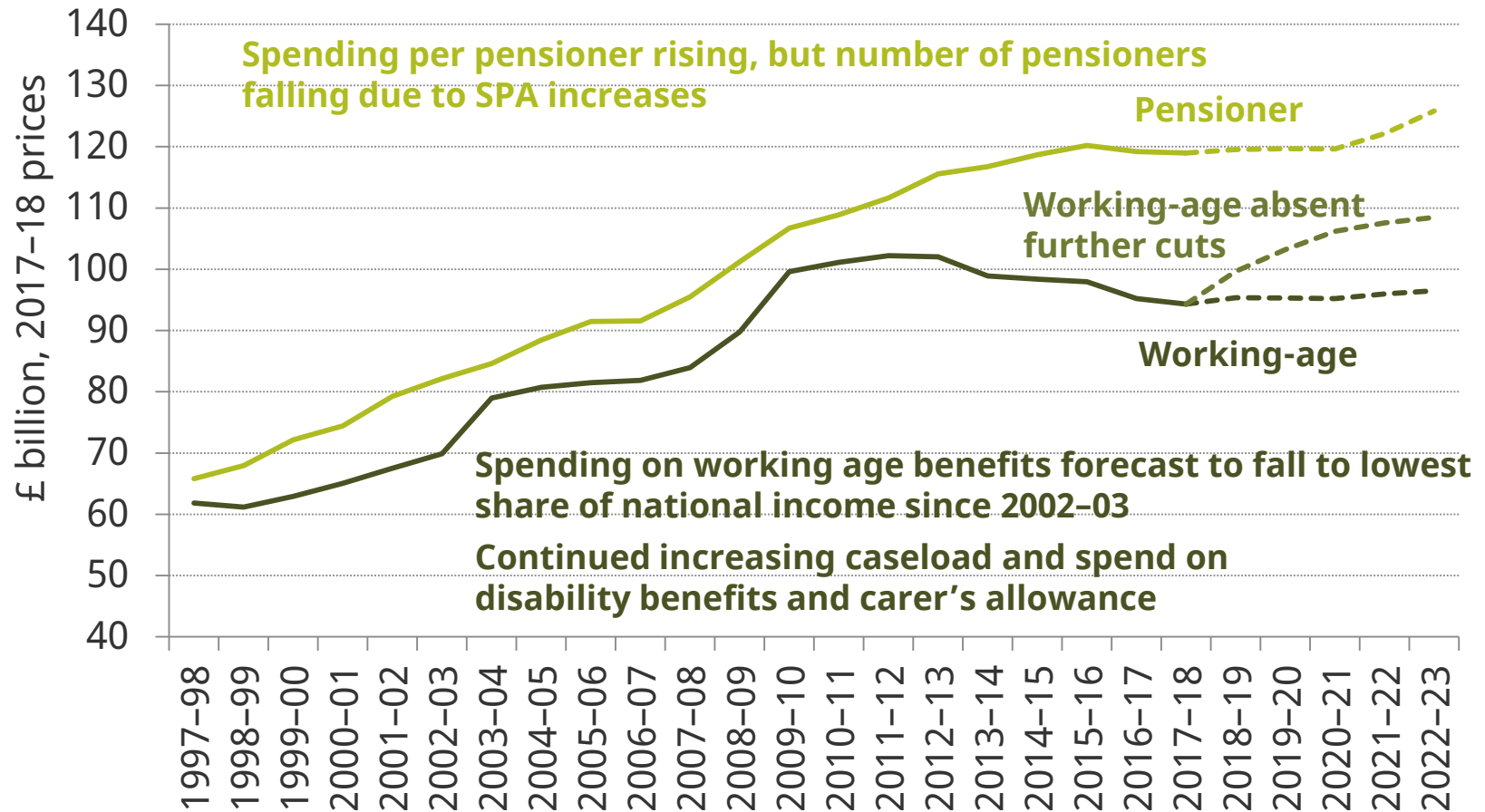
Source: Office for Budget Responsibility *Economic and Fiscal Outlook*.

Attitudes to taxation and spending on health, education and social benefits



Source: British Social Attitudes Survey (<http://www.bsa.natcen.ac.uk/latest-report/british-social-attitudes-34/key-findings/context.aspx>).

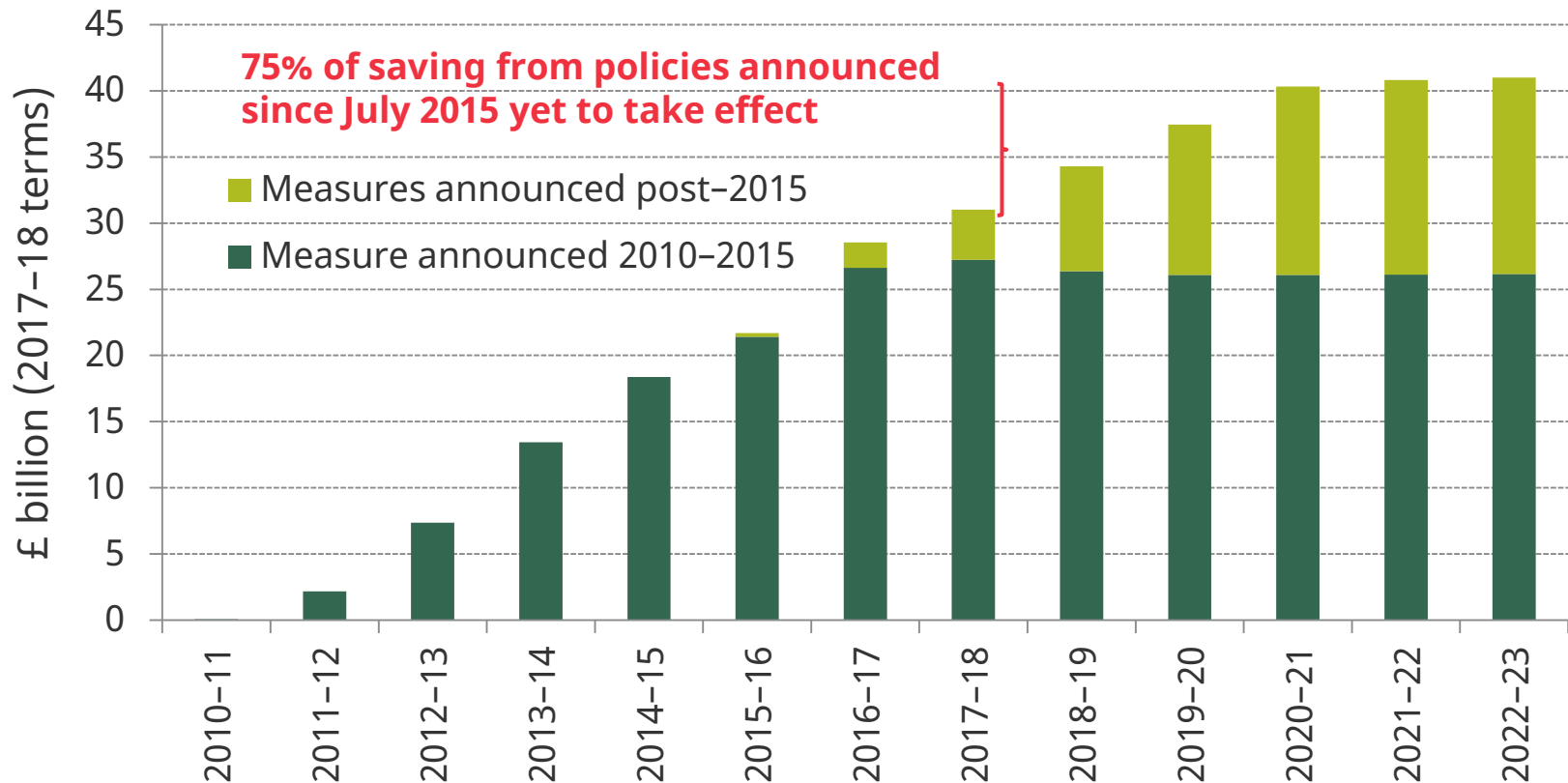
Policy risk: benefits



Source: DWP Benefit Expenditure Tables (<https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2017>).

Still more welfare cuts to come

Forecast saving from welfare measures announced since June 2010

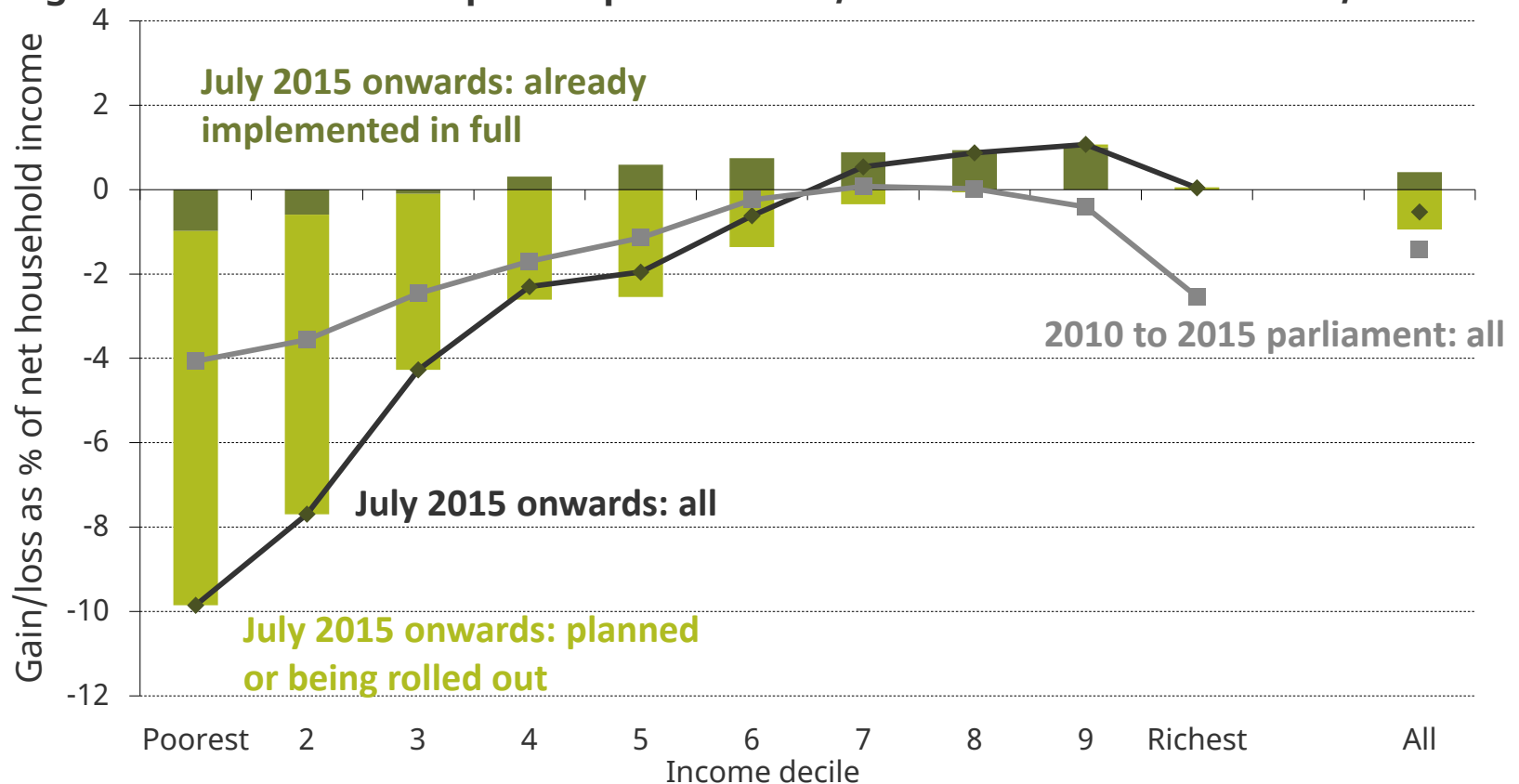


Note: Effect of move to CPI indexation held constant from 2015-16 onwards; Excludes triple lock.

Source: Office for Budget Responsibility *Policy Measures Database*, various *Economic and Fiscal Outlook*; IFS calculations.

And these will hit those in the bottom half of the income distribution

Long run distributional impact of personal tax/benefit reforms since 2010/2015



Notes: Reforms assessed relative to following the default uprating rules in place at the start of the parliament. Baseline incomes are also those that would have applied under the system in place at the start of the parliament.

Source: 2010 to 2015 from Figure 3.1 of Browne and Elming (2015) <https://www.ifs.org.uk/publications/7534>; IFS calculations.

Policy risk: benefits

Will benefit cuts continue as forecasts assume?

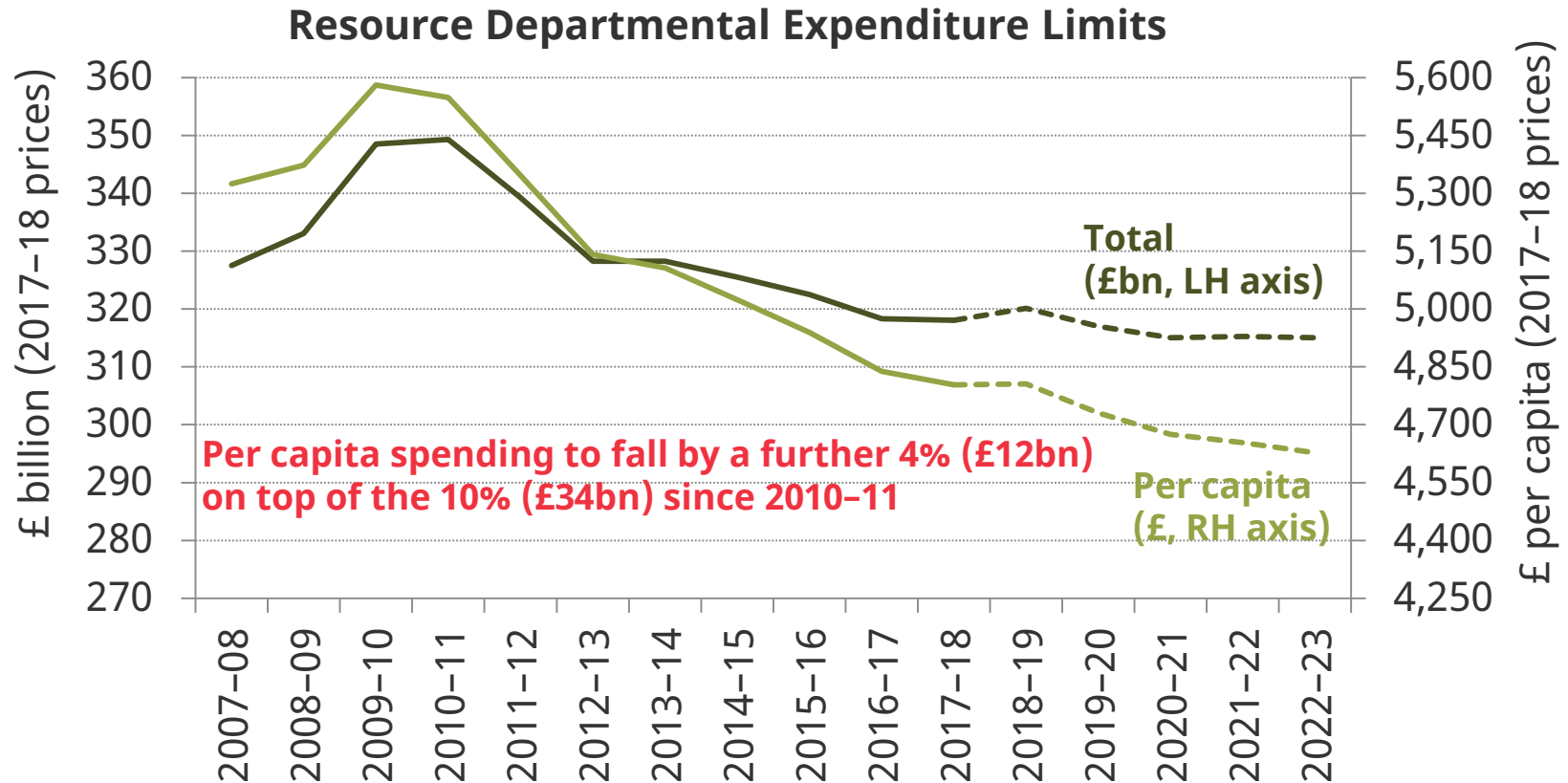
- July 2015 tax credit cuts and March 2016 disability benefit cuts examples of significant policy reversals

Universal credit continues to be rolled out across the country and is, on average, less generous than the legacy benefits it replaces

Losers include tax credit recipients who:

- own their own home
- have significant amounts of unearned income or financial assets
- are self-employed with a low reported income

Policy risk: day-to-day spending on public services



Source: Office for Budget Responsibility *Economic and Fiscal Outlook*.

The next Spending Review

2015 Spending Review covered the period up until March 2020

Next review in 2019, spending envelope to be set in the Autumn 2018 Budget

Forecasts imply day-to-day departmental spending over the three years 2020–21, 2021–22 and 2022–23:

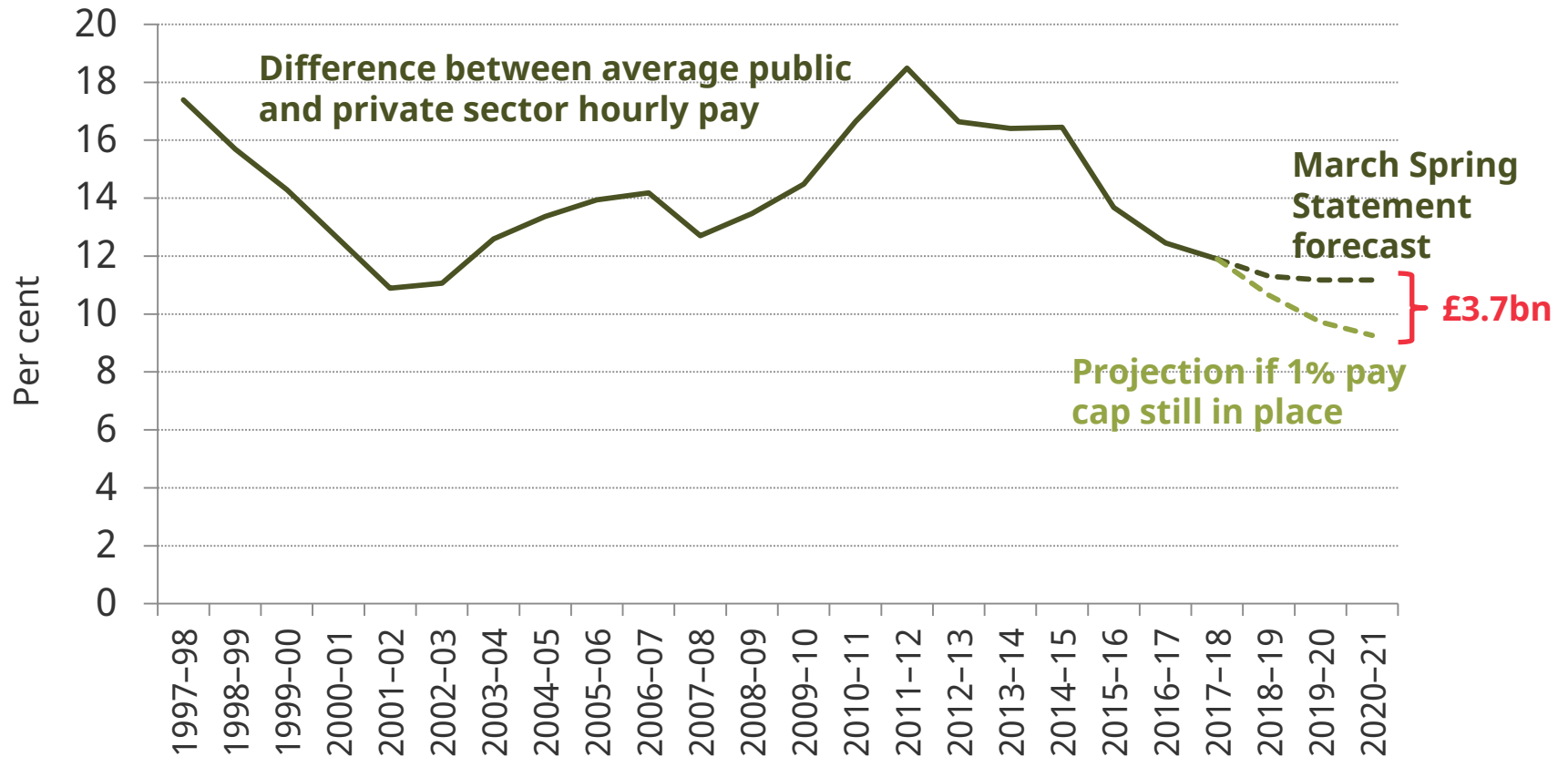
- falling in real per-capita terms by 2%: cost of £7bn to avoid
- falling by 0.7% of national income: cost of £14bn to avoid

Public services would still face pressures from an ageing population

But desire to eliminate the deficit by the mid-2020s

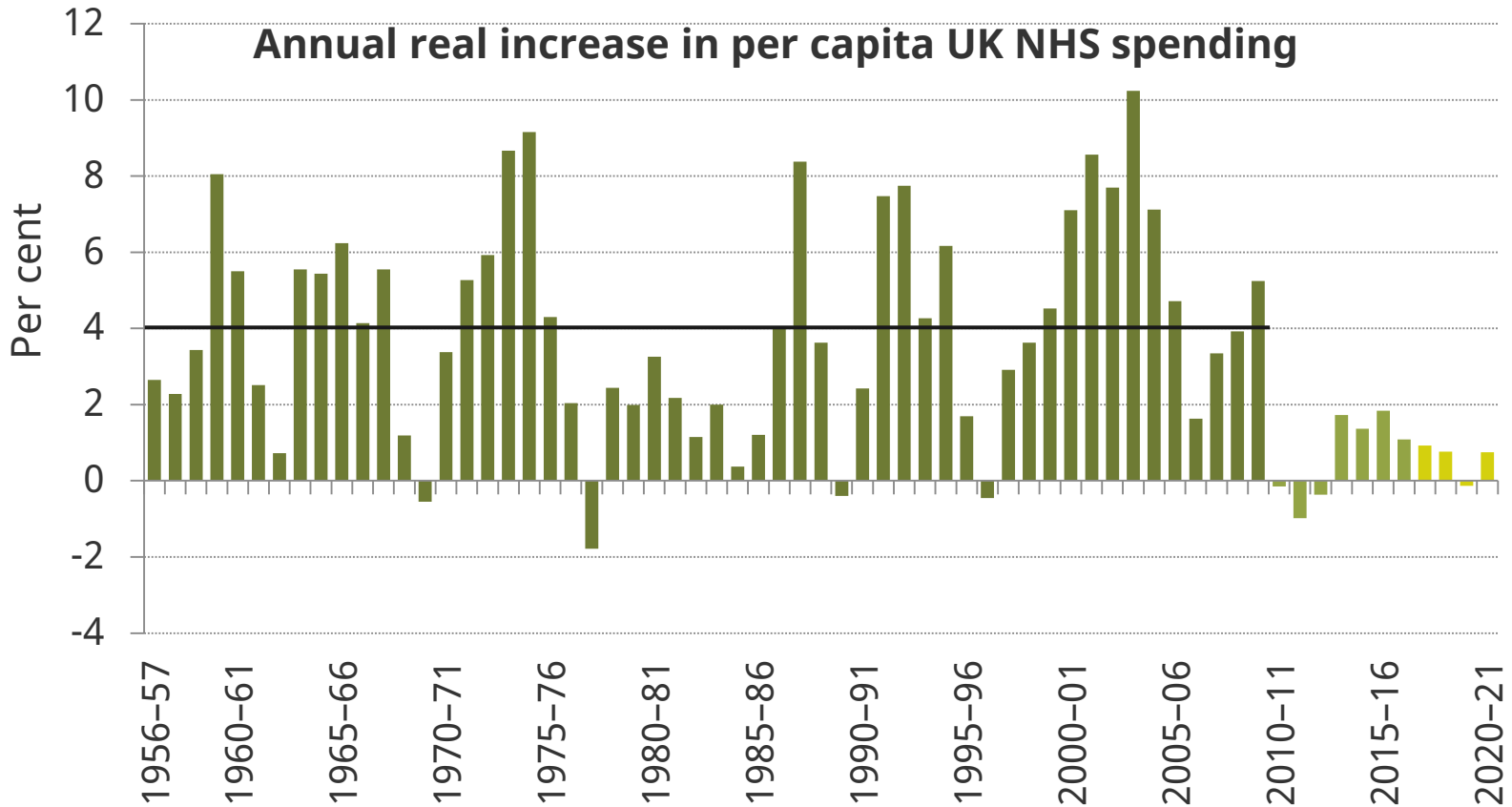
- structural deficit in 2022–23 of 0.9% of national income (£18bn in today's terms)

Public sector pay



Source: IFS calculations using Labour Force Survey microdata. Forecast based on OBR EFO March 2018 forecasts for public sector and overall earnings growth. Projection with 1% pay cap in 2018-19 and 2019-20 includes 0.5% pay drift p.a. and a one-year transition for public sector earnings growth to rise to reach private sector earnings growth afterwards.

NHS: extremely tight spending settlement

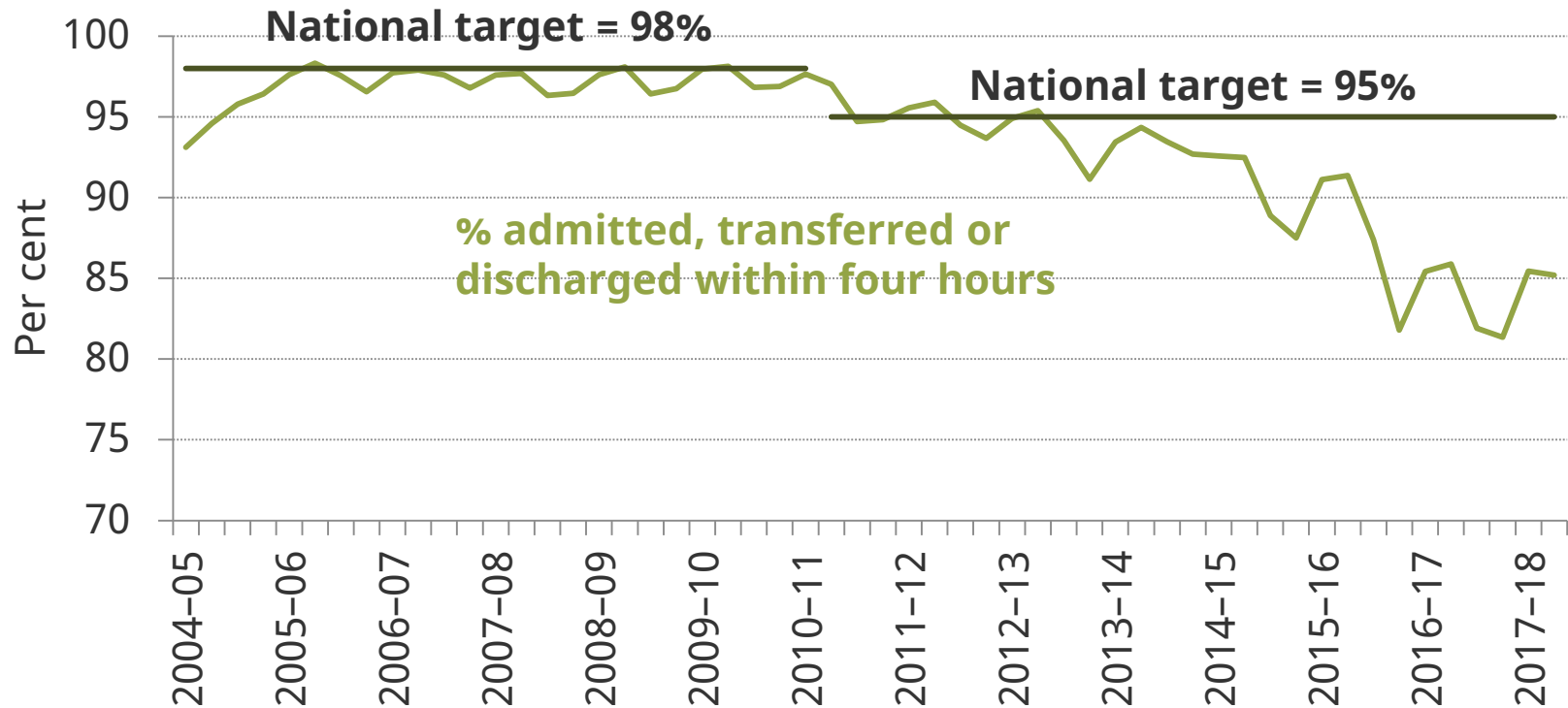


Notes: UK health spending forecast to increase at the same rate as English DH spending between 2017-18 and 2020-21.

Sources: Nominal spending data from the Office of Health Economics (1955-56 to 1990-91), HM Treasury Public Expenditure Statistical Analyses (1991-92 to 2019-20), and 2017 Conservative Manifesto (2020-21). Real spending (2017-18 prices) is calculated using the March 2018 OBR GDP Deflator. ONS annual population estimates and population forecasts (June 2016-based).

NHS: clear signs of strain

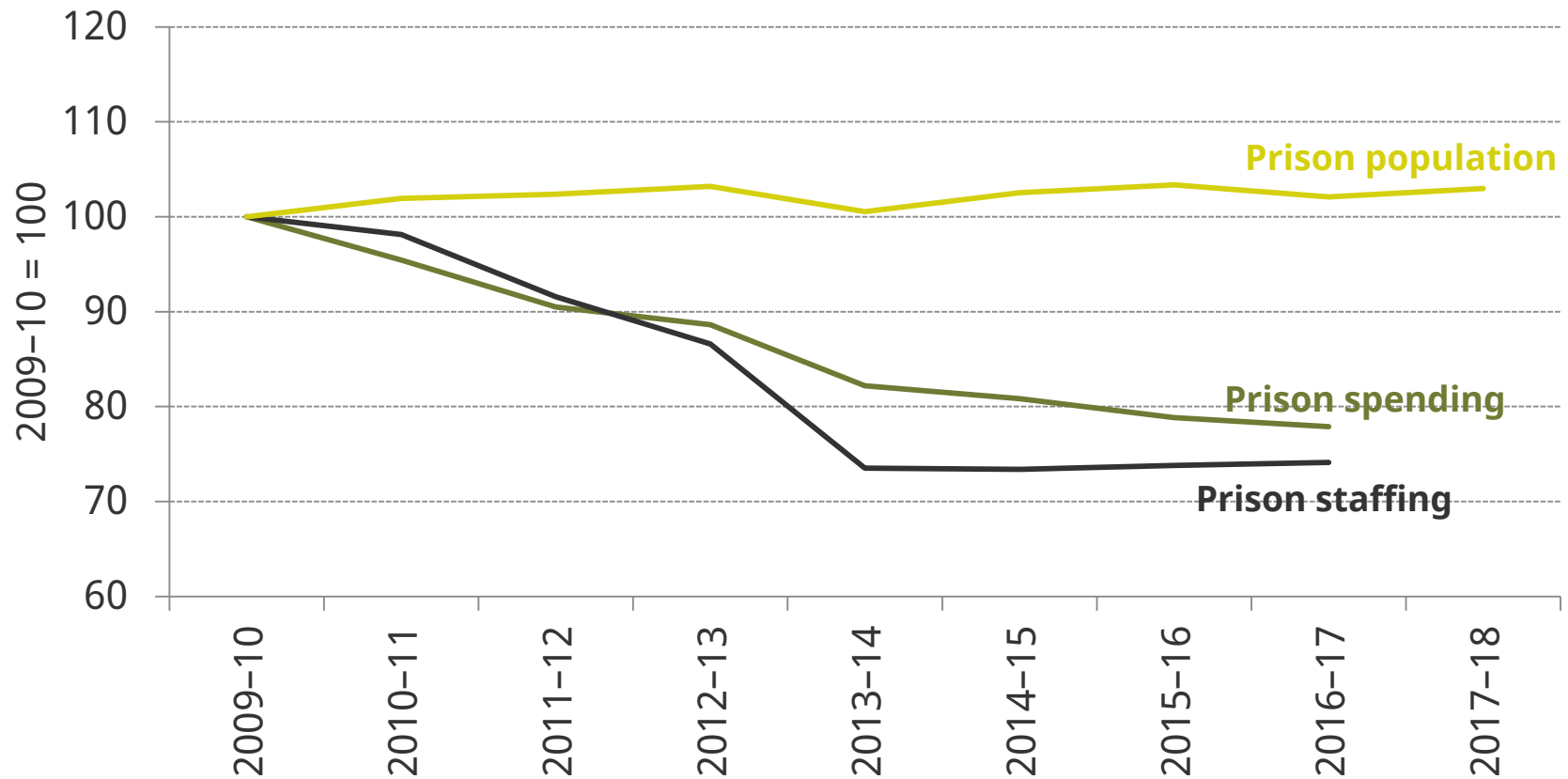
A&E patients in England increasingly less likely to be seen within 4 hours



Notes: Figures for type 1 admissions.

Sources: see NHS England (<https://www.england.nhs.uk/statistics/statistical-work-areas/ae-waiting-times-and-activity/ae-attendances-and-emergency-admissions-2017-18/>).

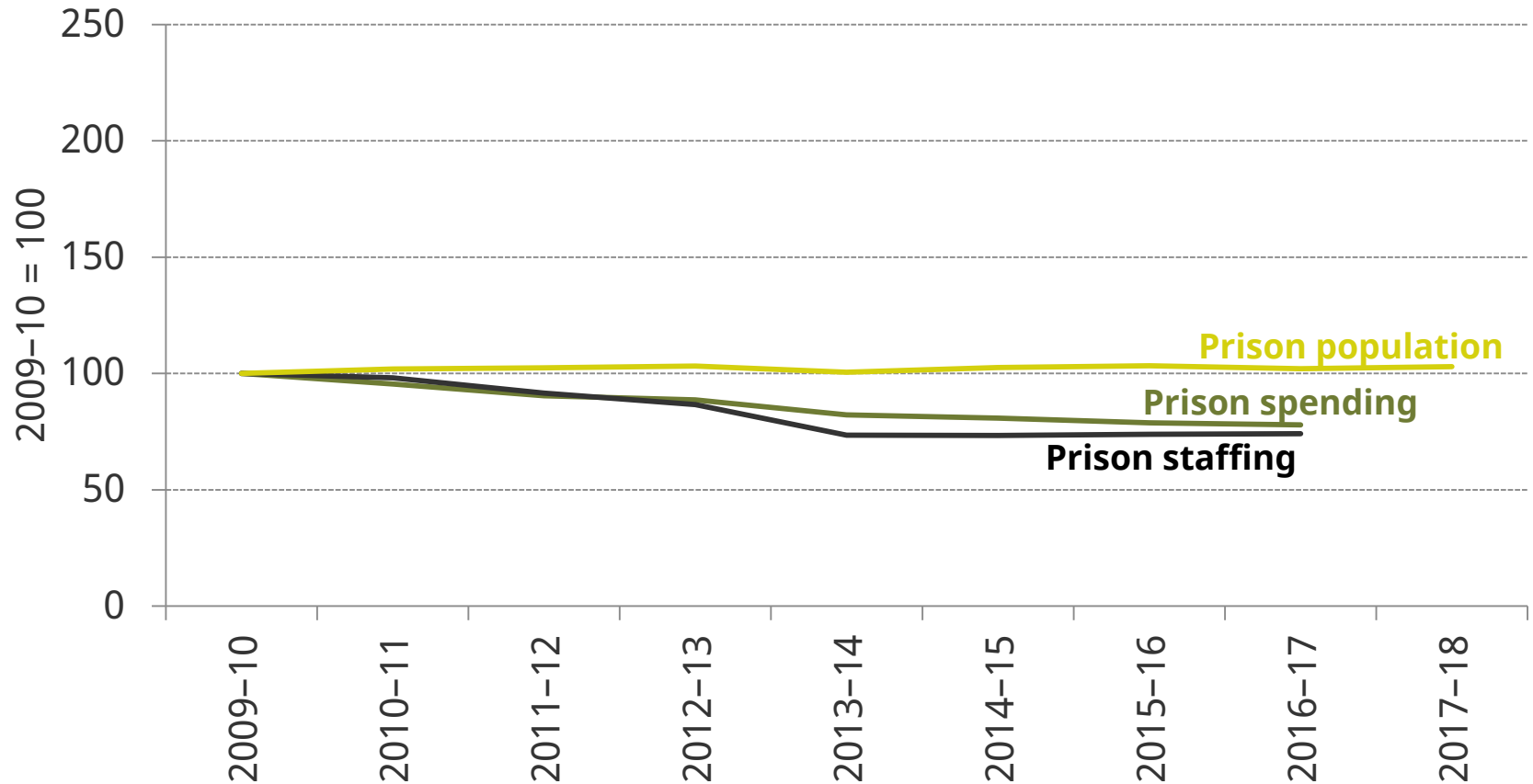
Prisons: spending and staff cut



Notes and sources: Institute for Government, *Performance Tracker: Autumn 2017*

(<https://www.instituteforgovernment.org.uk/publication/performance-tracker-autumn-2017/law-and-order/prisons>).

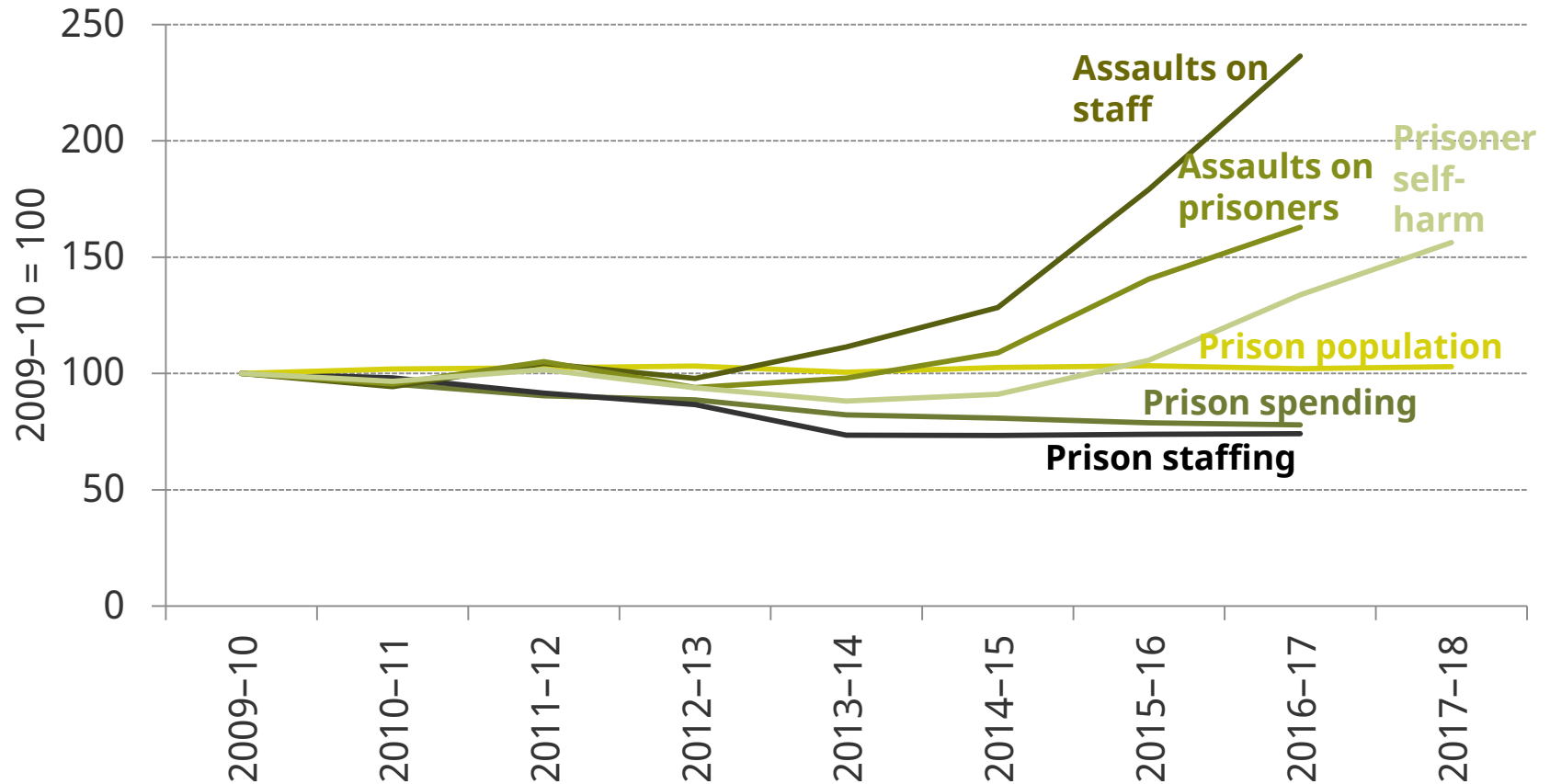
Prisons: spending and staff cut



Notes and sources: Institute for Government, *Performance Tracker: Autumn 2017*

(<https://www.instituteforgovernment.org.uk/publication/performance-tracker-autumn-2017/law-and-order/prisons>).

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



Notes and sources: Institute for Government, *Performance Tracker: Autumn 2017*

(<https://www.instituteforgovernment.org.uk/publication/performance-tracker-autumn-2017/law-and-order/prisons>).

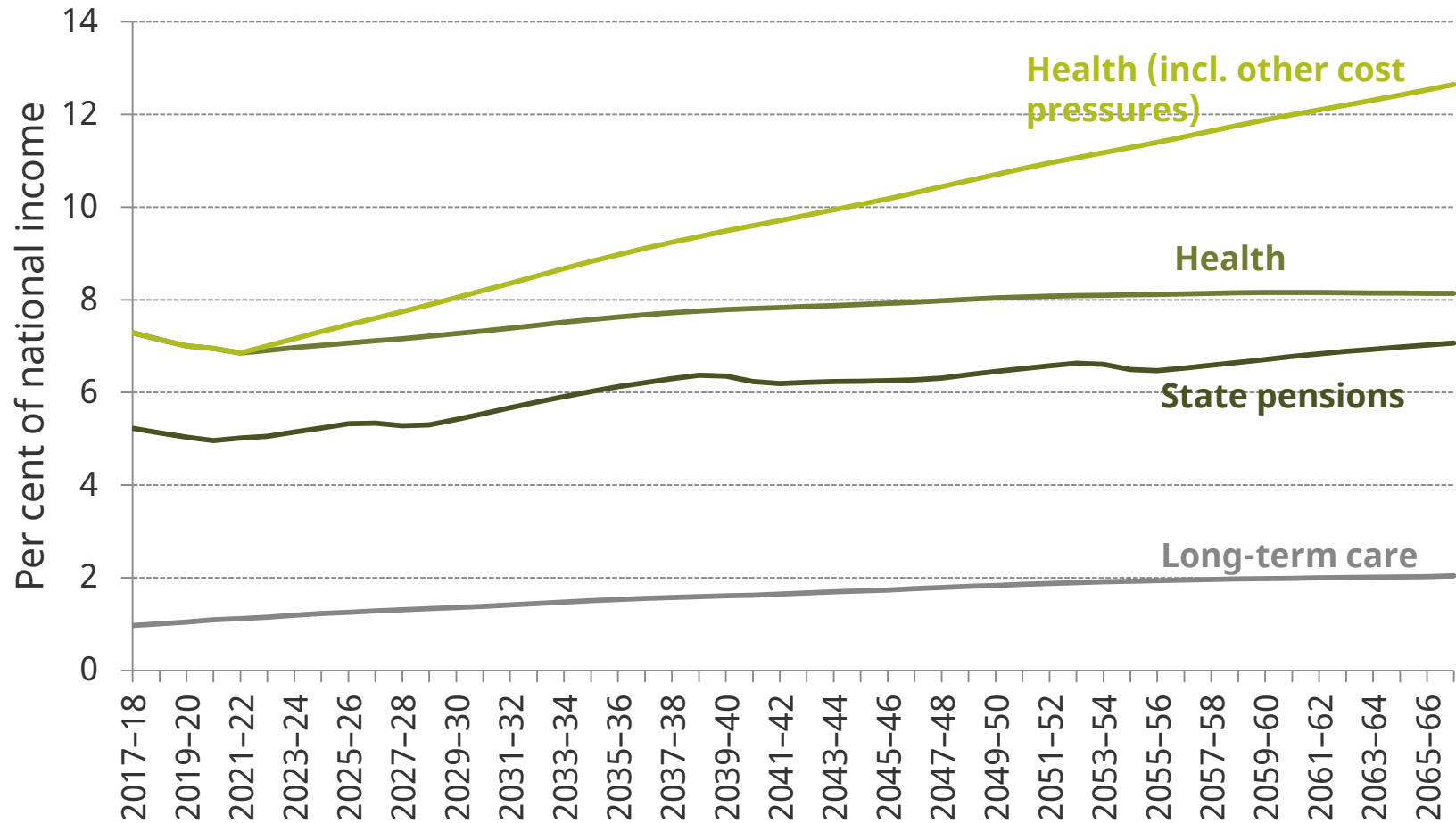
Demographic change and the public finances

A known pressure on public spending

- spending on health care and pensions greater on average for older people, and increasing proportion of the population at older ages

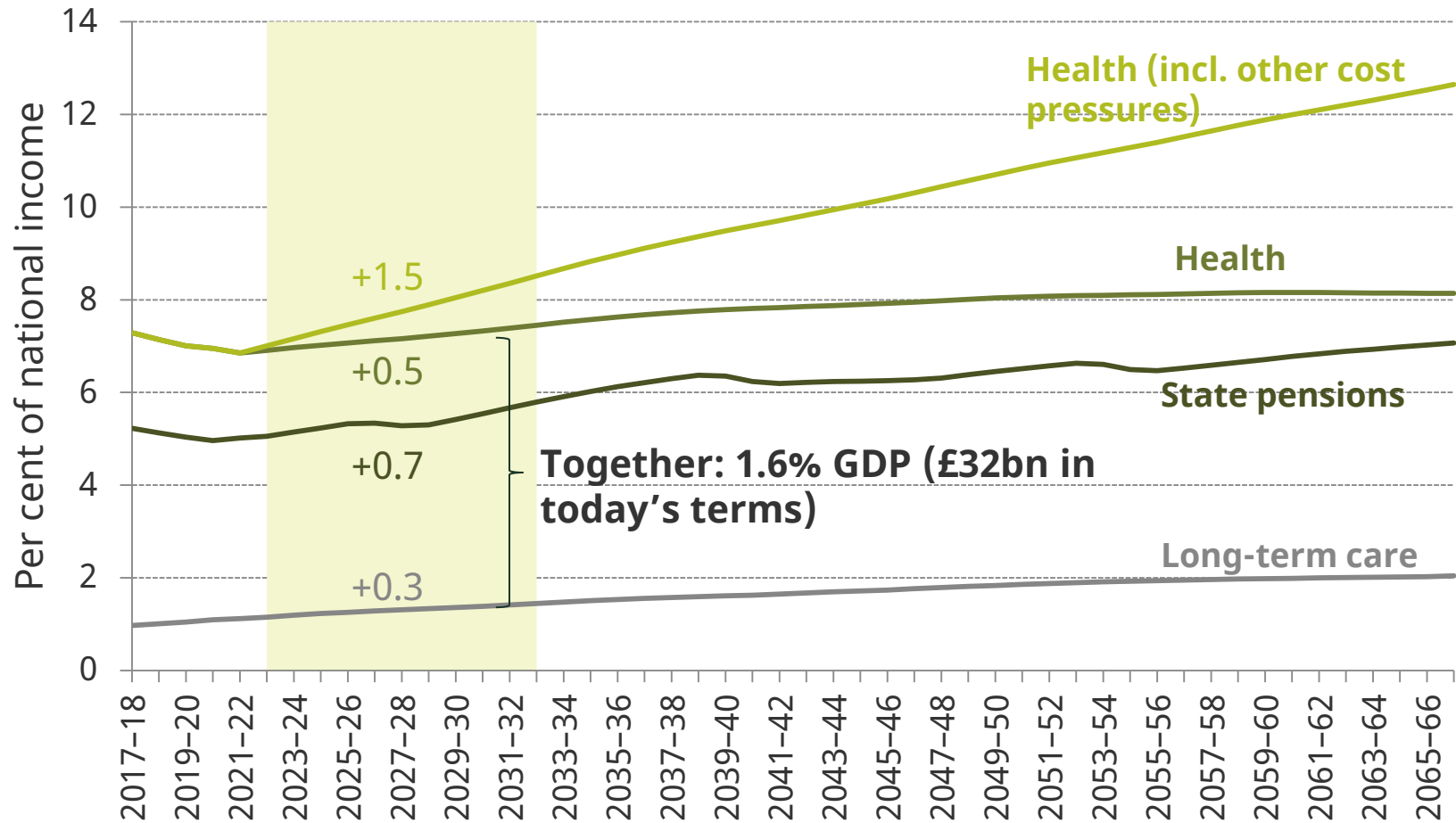
Pressures very significant in the long run – but are also not negligible over the next decade

Projected demographic pressures on public spending



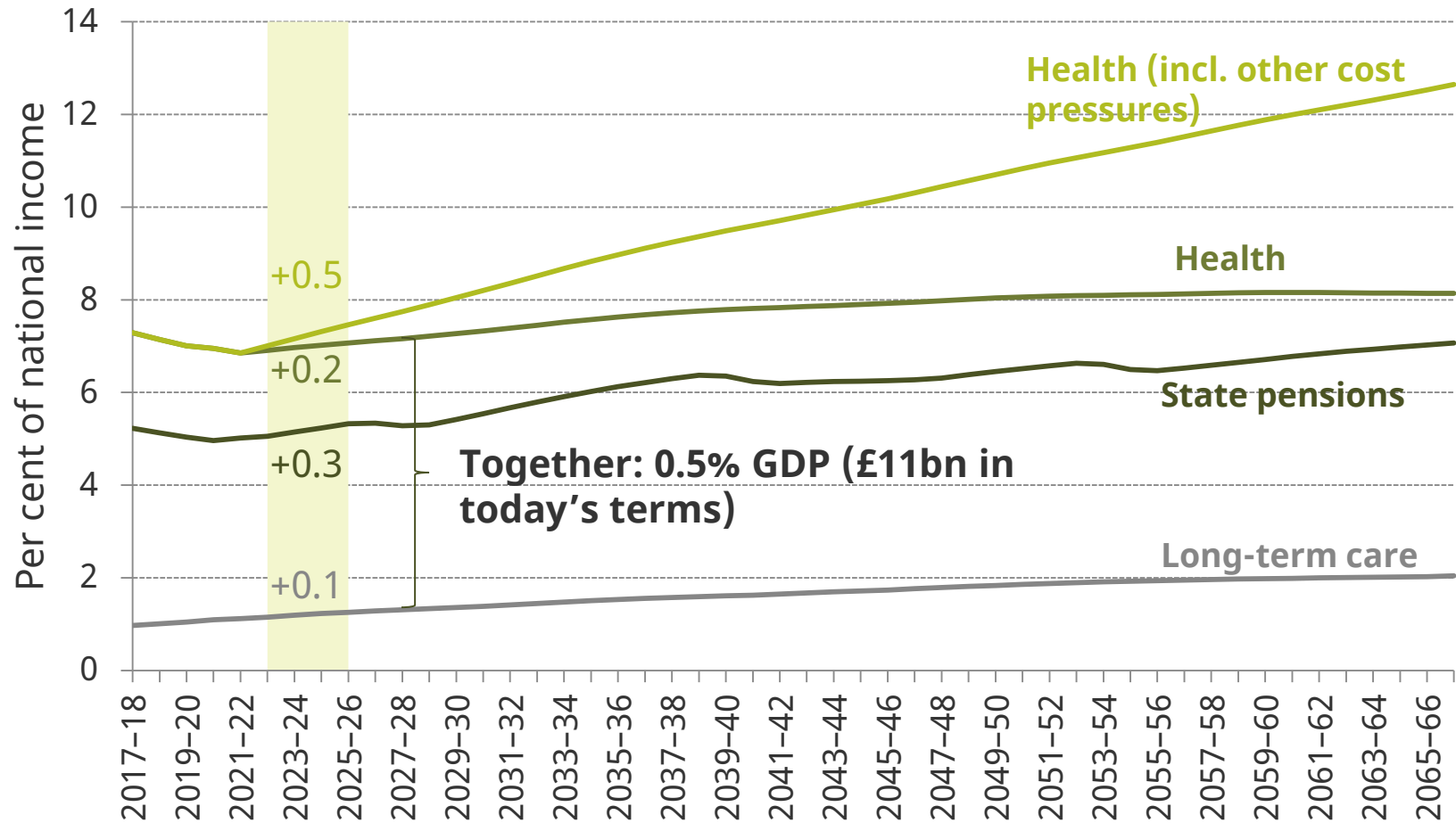
Source: Office for Budget Responsibility, *Fiscal Sustainability Report January 2017*.

Projected demographic pressures on public spending



Source: Office for Budget Responsibility, *Fiscal Sustainability Report January 2017*

Projected demographic pressures on public spending



Source: Office for Budget Responsibility, *Fiscal Sustainability Report January 2017*

A known pressure on public spending

- spending on health care and pensions greater on average for older people, and increasing proportion of the population at older ages

Pressures very significant in the long run – but are also not negligible over the next decade

- Additional spending of 1.6% GDP on health, long-term care and pensions over decade after 2022–23 just from ageing population

Even by mid-2020s pressure from these spending areas of 0.5% GDP

Moving away from the triple-lock would not help much in short run

Additional cost pressures in health and long term care

Spring Statement consultations

Spring Statements intended to “consider longer-term fiscal challenges and start consultations on how they can be addressed”

Some important consultations announced yesterday

- including on the taxation of digital businesses, which is a big and difficult issue to solve

But very many significant and politically difficult long-term fiscal challenges ahead

- public finance pressures from ageing, taxation of a changing labour market, declining revenues from vehicle taxation, etc

These do need addressing

Conclusions

Deficit forecast to fall from 2.2% of GDP this year to 0.9% in 2022–23

- working-age benefits cut
- continued squeeze on day-to-day public service spending

Considerable risks from how economy and policy evolve

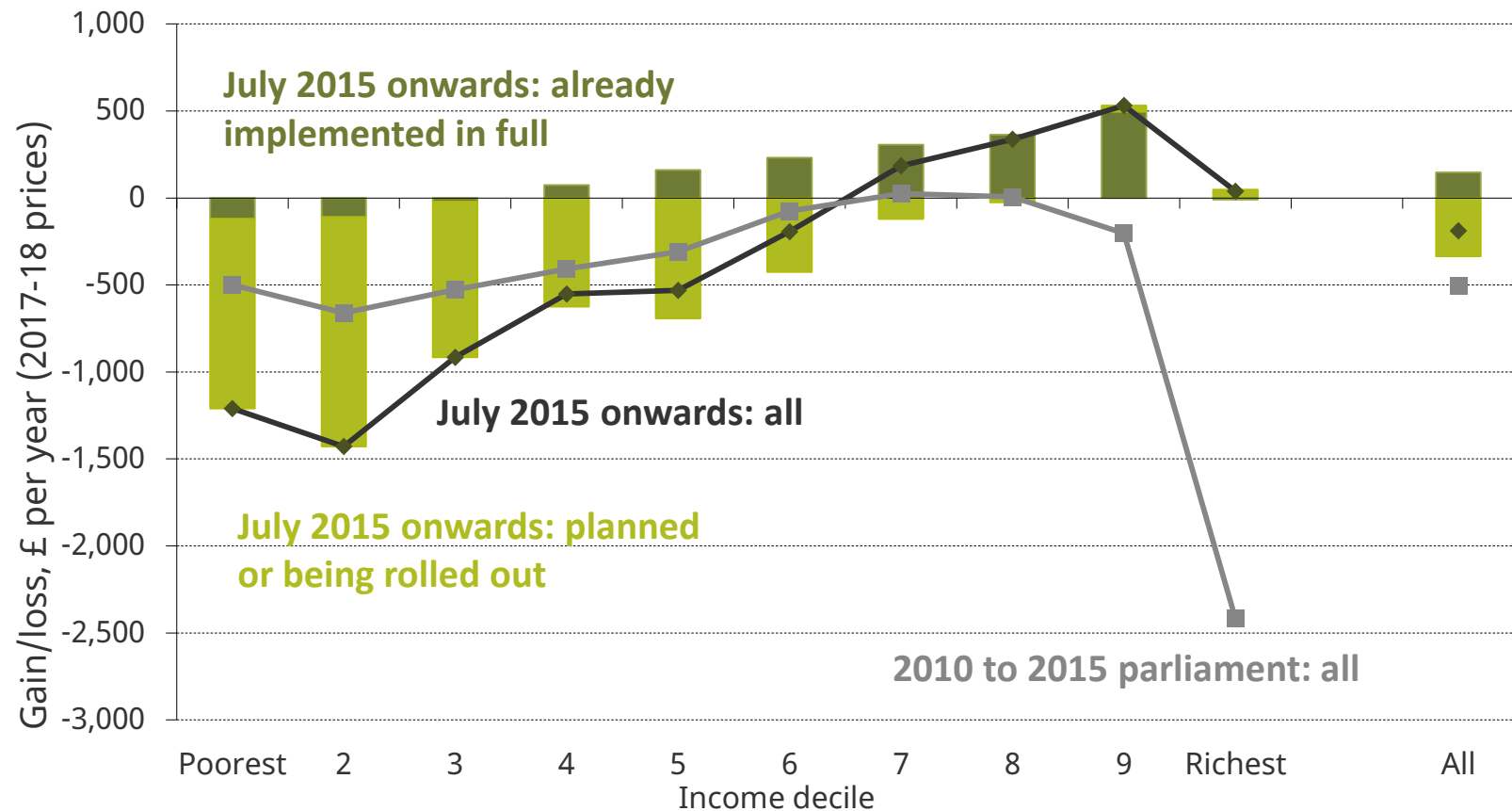
Regardless of whether or not the deficit is eliminated by mid-2020s the UK public finances face substantial pressures

Many significant and politically difficult long-term fiscal challenges ahead that need addressing

The following slide provides additional information which was added after the presentation was held on 14 March 2018.

Gains and losses in cash terms

Long run distributional impact of personal tax/benefit reforms since 2010/2015



Notes: Reforms assessed relative to following the default uprating rules in place at the start of the parliament.

Source: 2010 to 2015 from Figure 3.1 of Browne and Elming (2015) <https://www.ifs.org.uk/publications/7534>; IFS calculations.