Paul Johnson's opening remarks: 9 July 2015

I said after the March budget that there was only one eye-catching change to the fiscal numbers since the Autumn Statement. That was the decision not to create a big surplus in 2019-20 and instead allow spending to rise after 2018-19, when budget balance was to have been reached.

Well, there were more eye catching changes than that yesterday. But the long term plan did change again. In the March Budget, and indeed in the Conservative manifesto, we were promised budget balance by 2018-19. That magic moment has now been shifted back to 2019-20. In part that reflects a gentler than planned path for spending cuts, including welfare spending cuts. The gentler path does not however represent a let up in the overall scale of cuts – other than for defence. Spending in unprotected departments (those other than health, overseas aid, schools and, now, defence) will still have fallen by about a third in real terms between 2010-11 and 2019-20.

The Budget was certainly not short on measures. The scorecard shows net tax increases of £6.5 billion a year by 2020. Whether these are all fully realised remains to be seen. The OBR scores 14 tax raising measures at various levels of uncertainty between medium high and very high in terms of the likelihood that they will actually raise the expected revenues. Meanwhile most of the tax cutting measures are scored as rather more certain in their effects. And while there was plenty of action, it is difficult to discern any clear sense of direction in tax policy.

Of course benefit cuts were at the centre of the budget strategy. The Chancellor did not manage to find the £12 billion of cuts by 2017-18 he has repeatedly promised, announcing just £7 billion worth of cuts by then. But he did announce measures which should reduce spending by £12 billion by 2019-20. The biggest cut to tax credits was the reduction to the work allowances in Universal Credit. This represents an interesting choice: to focus cuts in the tax credit/universal credit system on families in work much more than those out of work.

So this budget will lead to a lower welfare country as the Chancellor promised. The figures are quite clear though – this was a tax raising budget, not quite consistent with the boast that it was aimed at a lower tax country. We told you before the election that post election budgets tend to raise at least £5bn in tax – and this one expects to bring in a little more than that. As for a higher wage country. Well the only sure way of achieving that is to raise productivity. We still await details of how that is to be tackled. Simply forcing wage increases by government fiat by hiking the minimum wage is more of a gamble.

Public spending and the public finances

Relative to the March Budget, borrowing forecasts rose for each of 2016-17, 2017-18 and 2018-19 despite increases in tax receipts resulting both from forecast changes and policy announcements. One result is that budget balance is now expected in 2019-20 not in 2018-19.

The increase in borrowing and delay in reaching budget balance is largely down to an easing in the planned public service spending cuts through to 2018–19. But the good news for most public services largely ends there. The additional protection offered to defence spending and the pushing of some of the cuts into 2019-20 means that we still think that the peak to trough cut in real terms spending on the remaining unprotected departments will be close to a third. We expect cuts to unprotected departments between 2015-16 and 2019-20 of around £19 billion to be announced in the Spending Review in the Autumn.

An important part of the Chancellor's chosen route to achieving these cuts is to hold public sector pay down for a further four years, raising it by just 1% a year from 2016-17. If private sector pay rises as expected we think this will take public sector pay levels well below their long term average relative to pay in the private sector and indeed well below anything seen since we can readily make comparisons back to the early 1990s. Up to now public sector pay restraint has merely served to match changes in the private sector. We are entering a new and much tougher phase.

Welfare cuts

The biggest single cut to welfare spending is set to come from extending the freeze in working age benefits, tax credits and local housing allowance out to 2020. That will affect 13 million families who will lose an average of £260 a year as a result of this one measure. After about 2017 this will mean that most benefit rates will have fallen back behind their 2008 levels both relative to price inflation and relative to earnings growth.

The next biggest cut comes from the reduction to work allowances in Universal Credit. This represents a substantial shift in the design of the UC system. The work allowance is the amount that a claimant can earn before benefit starts to be withdrawn. Significant allowances were an integral part of the design of UC, intended to give claimants an incentive to move into work. This reform will cost about 3 million families an average of £1,000 a year each. It will reduce the incentive for the first earner in a family to enter work. The equivalent changes in the current tax credit system will have much the same effect. These are changes that will alter the effects and structure of the system quite substantially.

Relative to one alternative policy which would have been simply to reduce the levels of child tax credit, the policy the government has chosen will protect those on the lowest incomes, mostly those not in work, at the expense of low earners.

There has been much discussion about the extent to which the proposed higher minimum wage for those aged 25 and over will offset the effects of reduced tax credits. There are two important points here.

First, quite different groups are affected by the different policies. They have different aims and different effects. Many of the gainers from the higher wage are single childless or married to someone on higher earnings. They are outside the tax credit system altogether.

Second, it is easy to construct examples of families which would lose overall and ones which would gain from the combined changes. There is little value in this trading of examples. In general the more important tax credits are to someone's income at present the less likely they are to be compensated by the higher minimum wage. But the key fact is that the increase in the minimum wage simply cannot provide full compensation for the majority of losses that will be experienced by tax credit recipients. That is just arithmetically impossible. The gross increase in employment income from the higher minimum wage is about £4 billion. Welfare spending as a whole is due to fall by £12 billion and, even excluding the effects of the four year freeze tax credit spending is due to be cut by getting on for £6 billion. And of course many of the recipients of the higher minimum wage will not be tax credit recipients. Unequivocally, tax credit recipients in work will be made worse off by the measures in the Budget on average.

Continuing down the list of welfare cuts size the next biggest is an odd one. Reducing social sector rents by 1% a year for four years from 2016-17 is scored as saving £1.4 billion in housing benefit by 2020. By holding rents down it should have that effect. But it is odd indeed to count what is clearly an increase in subsidy to social tenants, as a welfare cut. This is an additional cost that will fall on local authorities and housing associations.

The OBR took the unusual step of warning the Chancellor that his strategy of instructing Housing Associations as to their policies could have the unintended consequence of bringing them into the public sector. If that were to happen recorded public debt and borrowing would rise.

My colleague Andrew Hood will talk in more detail about these and other changes to welfare benefits including the much vaunted reduction in the benefit cap – an element of the benefit system which receives a remarkable amount of attention considering how little money it actually saves.

Tax changes

Welfare cuts may have taken centre stage. But tax changes were more numerous and bigger. £14 billion of tax increases were partially offset by £8 billion of tax cuts. It is rather hard to pin down a coherent narrative around the changes though.

The tax cuts include a further increase in the income tax personal allowance, though the biggest, and perhaps most surprising given that we already have the lowest rate in the G20, is a further 2% cut in corporation tax by 2020.

As for the rest there is a continuation of some earlier themes, not least of which is a further reduction in the value of pension tax relief for those on high incomes through a complex, distortionary and difficult to justify phasing down of the annual contribution limit to £10,000. This will bring to £6 billion a year the additional tax revenue raised from reducing pension tax relief. It remains to be seen whether the consultation on pension taxation presages a complete overhaul of the tax treatment. Recent changes have not augured well for sensible decision making. Real and costly subsidies to pension saving, notably the £14bn a year subsidy from allowing the majority of pension contributions to escape National Insurance Contributions entirely, have been maintained while the neutral treatment in the income tax system has been undermined.

Additional complexity is also to be introduced to inheritance tax by the new family home allowance, an allowance which will add yet further to the generous treatment of owner occupied housing. The tax treatment of rental housing will be made less attractive though. At present if you own a property which you let out to tenants you can set any mortgage interest costs against tax due on rent received. The Budget red book states that this means that "the current tax system supports landlords over and above ordinary homeowners" and that it "puts investing in a rental property at an advantage". This line of argument is plain wrong. Rental property is taxed more heavily than owner occupied property. There is a big problem in the property market making it difficult for young people to buy, and pushing up rents. The problem is a lack of supply. This change will not solve that problem.

As well as an array of anti-evasion and anti-avoidance measures there are three other big tax increases: to insurance premium tax, to VED and to the Climate Change Levy. All look more or less opportunistic. The latter, which both increases tax on business consumption of energy – already taxed more heavily than household energy consumption – and reduces the relationship between tax paid and the carbon content of the energy, seems to have little coherent rationale.

This was a big Budget in some respects. It was a deeply disappointing Budget for those of us who hoped the Chancellor might take the chance to improve, simplify and reform our creaking tax system. This was not the Budget of a tax reforming Chancellor.

Conclusion

There were many more measures on welfare and tax. My colleagues will talk about a lot of them today. Given the array of benefit cuts it is not surprising that the changes overall are regressive – taking much more from poorer households than richer ones. Looking over the period of the consolidation as a whole, poorer households have done worse than those in the middle and upper middle parts of the income distribution though it remains the case that the some of the biggest losers have been those right at the very top of the income distribution.

An analysis of the significant changes to student and university finance we will leave for a separate short publication, either tomorrow or early next week.