Spring Statement 2018: more difficult choices ahead

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Forecast deficit

Cyclically-adjusted net borrowing

Fiscal objective: eliminate deficit by ‘mid-2020s’

2% target: £15bn headroom

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?
Economic risks

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
Risks from Brexit

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 (≈£60m rising to ≈£120m per week), rising further thereafter
- public finance impact of a weaker economy highly likely to dominate
Interest rate risk

If BoE base rate is 1ppt higher than forecast then this would add £5bn to debt interest spending

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

Only modest tax changes in the pipeline
But revenues not sustained at current levels since mid-1980s (receipts) or early 1950s (taxes)

Source: Office for Budget Responsibility Economic and Fiscal Outlook.
Attitudes to taxation and spending on health, education and social benefits

Per cent


Reduce taxes/spending
Increase taxes/spending
Keep taxes/spending same


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Policy risk: benefits

Spending per pensioner rising, but number of pensioners falling due to SPA increases

Spending on working age benefits forecast to fall to lowest share of national income since 2002-03

Continued increasing caseload and spend on disability benefits and carer’s allowance

Still more welfare cuts to come

Forecast saving from welfare measures announced since June 2010

- 75% of saving from policies announced since July 2015 yet to take effect
- Measures announced post-2015
- Measure announced 2010–2015

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.

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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 that 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

Per capita spending to fall by a further 4% (£12bn) on top of the 10% (£34bn) since 2010–11

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

Difference between average public and private sector hourly pay

March Spring Statement forecast

Projection if 1% pay cap still in place

£3.7bn

NHS: extremely tight spending settlement

Annual real increase in per capita UK NHS spending

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

NHS: clear signs of strain

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

% admitted, transferred or discharged within four hours

Notes: Figures for type 1 admissions.
Prisons: spending and staff cut

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

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

Projected demographic pressures on public spending

Per cent of national income

- Health (incl. other cost pressures)
- Health
- State pensions
- Long-term care

Together: 1.6% GDP (£32bn in today’s terms)

Source: Office for Budget Responsibility, Fiscal Sustainability Report January 2017
Projected demographic pressures on public spending

Per cent of national income

- Health (incl. other cost pressures)
- Health
- State pensions
- Long-term care

Together: 0.5% GDP (£11bn in today's terms)

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

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.

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