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Resolution Foundation

BRIEFING

How to spend it

Autumn Budget 2018 response

October 2018

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Summary

Defying expectations of a quiet Budget, the Chancellor yesterday delivered a statement with bigger political and economic shifts than many anticipated. Given the task of delivering a Prime Ministerial promise to 'end austerity' with a parliamentary arithmetic that rules out significant tax rises, Philip Hammond seized the lifeline of a much improved public finance forecast to significantly ease, but not end, austerity.

The Office for Budget Responsibility's (OBR's) economic forecasts are only slightly improved from those in March. Now, as then, we have higher inflation and slower growth than we'd like. The former is now easing (though the OBR's projection is slightly higher than it was in March), while the latter (while marginally improved) appears here to stay. On these forecasts, which assume a smooth Brexit, GDP per capita is set to grow by 4.9 per cent between 2018 and 2023, compared with an IMF forecast of 5.5 per cent across the rest of the G7 and 5.9 per cent in the US.

But if the Chancellor did not get lots of good news on the economic forecasts, he got a whole heap of it on the public finances. The OBR gave the Chancellor a £11.9 billion windfall this year, and a cumulative improvement of £68.5 billion over the next five years on the back of higher tax receipts and slightly faster growth. Along with classification changes the total fiscal windfall amounts to £73.8 billion.

The Chancellor has chosen to spend almost all of that windfall, making use of 75 per cent of it over the period as a whole.

In the short-term this has given him some wriggle room to both reduce borrowing (debt-to-GDP is now projected to fall significantly this year as a result) and provide a Brexiteer-friendly income tax cut in April as we leave the EU. Initially this mainly benefits higher income families, at a cost of £2.8 billion, while in future years it becomes even more regressive with almost half going to the top ten percent of households alone, albeit for a slightly lower cost of £1.8 billion.

Longer-term he has chosen to use up almost all (97 per cent) of the windfall that exists in 2022-23 to try and meet the Prime Minister's promise to 'end austerity'. At the price of abandoning his fiscal objective of an actual budget surplus in the next decade, Philip Hammond has been able to raise day-to-day public service spending by £28 billion in 2022-23, and put £1.7 billion into Universal Credit.

That spending boost enabled the Chancellor to say that overall spending on day-to-day public services (resource DEL, or RDEL) will now be rising (the Budget actually announced a small decrease in already rising capital spending). Indeed, overall day-to-day departmental spending per person is now set to rise by 4 per cent between this year and 2022-23, rather than fall by 4 per cent as previously planned. This is a very significant shift that marks an end of a key feature of British politics and economics since 2010.

But it is not quite the end of austerity he labelled it as. Existing promises of extra spending in some areas (most obviously the £21.4 billion increase for the NHS in 2022-23, but also plans to increase aid and defence spending broadly in line with economic growth) mean the Chancellor's numbers imply ongoing cuts in other day-to-day public services, from prisons to local government.

Which departments actually get cut – and by how much – will be a matter for the Spending Review next year. But unprotected departments will still, on average, record cuts in every year from 2020-21. And their per capita real-terms budgets are set to be 3 per cent lower in 2023-24 than 2019-20. If allocated equally this would mean real-terms per capita RDEL cuts between 2009-10 and 2023-24 of 48 per cent, 52 per cent and 77 per cent for the departments of Justice, Business and Transport respectively.

Even after the significant extra spending outlined in the Budget, the growth in overall public spending remains well below historic norms. As such, the major reductions since 2010 will not be unwound. In 2022 the share of the economy spent on day-to-day public services will be 14 per cent, down from 18 per cent in 2010.

That may be in part why the Chancellor also held out the possibility of further future increases in spending. His decision to spend this Budget's forecast improvements means he has intentionally retained precisely the same headroom (£15.4 billion) against his fiscal mandate (that cyclically-adjusted public sector net borrowing not exceed 2 per cent of GDP by 2020-21) that he had in March. He has repeatedly implied that in the event of a positive Brexit deal some of this headroom could be used for public spending increases, to further ease austerity from the plans detailed above.

On family budgets, austerity has also been eased but far from ended. The very welcome £1,000 increase in Universal Credit work allowances will deliver a £630 boost to lower-income families and in most cases more than offset losses created by the 2015 cuts to work allowances for renters with disabilities or with children. By putting back into the new benefit around three-quarters of the funds that George Osborne tried to take out, the Chancellor has ensured, so long as the expected gains from people taking up more of their entitlements materialise, it is no longer less generous than the legacy system it replaces.

However, the cash freeze in working-age benefits is set to continue next year. That saves the Exchequer £1.5 billion, but costs a couple with children in the bottom half of the income distribution £200 on average. More generally 75 per cent of the benefit cuts announced in 2015 remain government policy, with half of those directly affecting family budgets still to be rolled out.

The confirmation that the National Living Wage will rise to £8.21 next April is welcome news, but the OBR also expects sluggish average wage growth to continue. Pay packets are not set to return to pre-crisis levels until the end of 2024– a staggering 17 years after problems emerged at Northern Rock.

This Budget was a bigger deal than many expected – with a significant easing of austerity. But austerity has not been ended. And there will be tougher choices for Chancellors in the years ahead. Brexit must be delivered smoothly, public spending will remain tight, forecasts may not always be so rosy, living standards are set to be sluggish and the tax rises to meet pressures in the 2020s from our ageing society will still be needed – as and when there's a government with the majority to deliver them. Austerity has been eased, but there are still tough times ahead.

The OBR has provided the Chancellor with a significant fiscal windfall, and he's chosen to use almost all of it

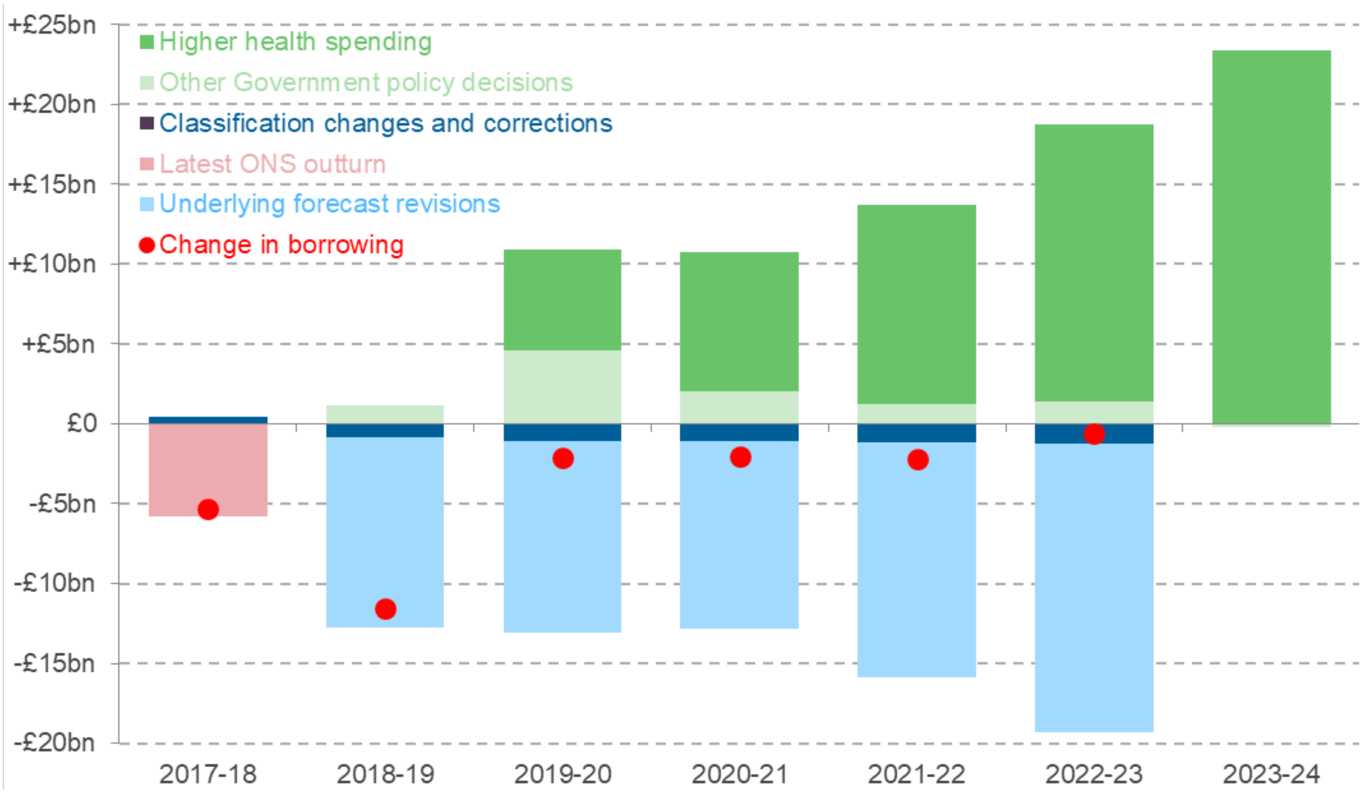
As expected ahead of the Budget, the Chancellor received a sizeable present from the OBR yesterday. On a pre-measures basis, the fiscal watchdog lowered its borrowing projection for the current financial year by £11.9 billion relative to its position at March's Spring Statement meaning that instead of projecting government borrowing to come in at £37.1 billion in 2018-19, the OBR now forecasts a total of £25.5 billion.

That improvement has been driven by both stronger tax receipts and lower spending on welfare and debt interest in the first half of 2018-19 than had previously been expected. And the OBR expects the improvement to persist into future years. Thanks in part to its belief that the economy has greater growth potential than previously thought (reflecting a reduction in its estimate of the sustainable rate of unemployment and an increase in its estimate of labour market participation – with only a partial offset from a lower assumption for potential average hours), the OBR now expects nominal GDP growth to be stronger over the course of its forecast than it previously set out. Its nominal GDP forecast is also boosted by higher whole economy inflation.

As a result of these revisions, the £11.9 billion public finance improvement in 2018-19 evolves into a £18.1 billion improvement by 2022-23. As Figure 1 shows, the Chancellor has chosen to bank the windfall in the form of lower borrowing in 2018-19, with a £11.6 billion reduction relative to the Spring Statement forecast. Thereafter however, the Chancellor is set to spend nearly all of the windfall provided each year.

Figure 1: The Chancellor is banking better public finance news in 2018-19, but spending his windfall in subsequent years

Change in cumulative PSNB over forecast horizon in successive OBR statements (nominal)

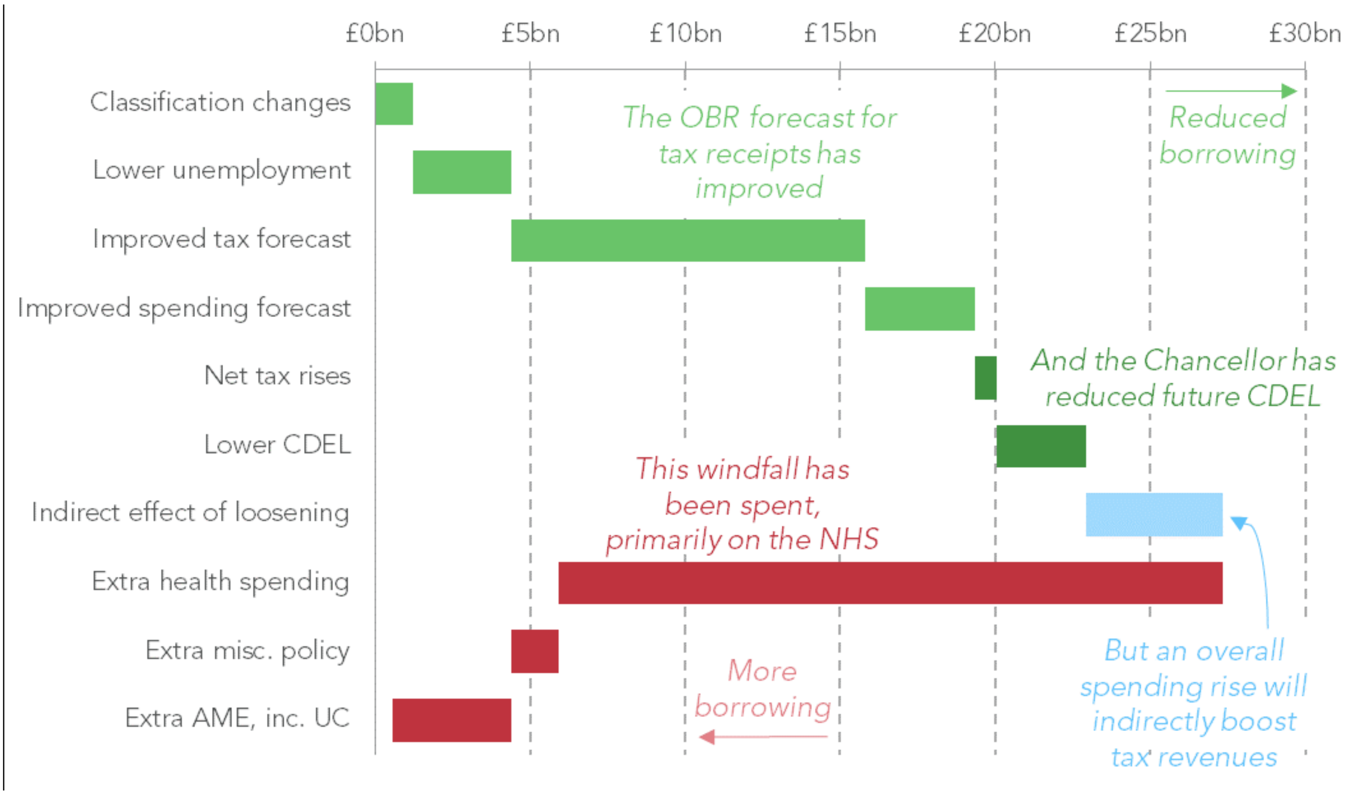


Source: OBR, Economic and Fiscal Outlook, October 2018

The £18.1 billion windfall in 2022-23 actually rises to £19.3 billion once we include classification changes. The Chancellor has chosen to spend 97 per cent of this, leaving borrowing just £0.6 billion lower than at the Spring Statement. As Figure 2 shows, most of this will go on higher health spending delivered as part of the new five-year NHS plan.

Figure 2: Most of the Chancellor's windfall will be spent on health

Reduction in 2022-23 borrowing forecast relative to the Spring Statement

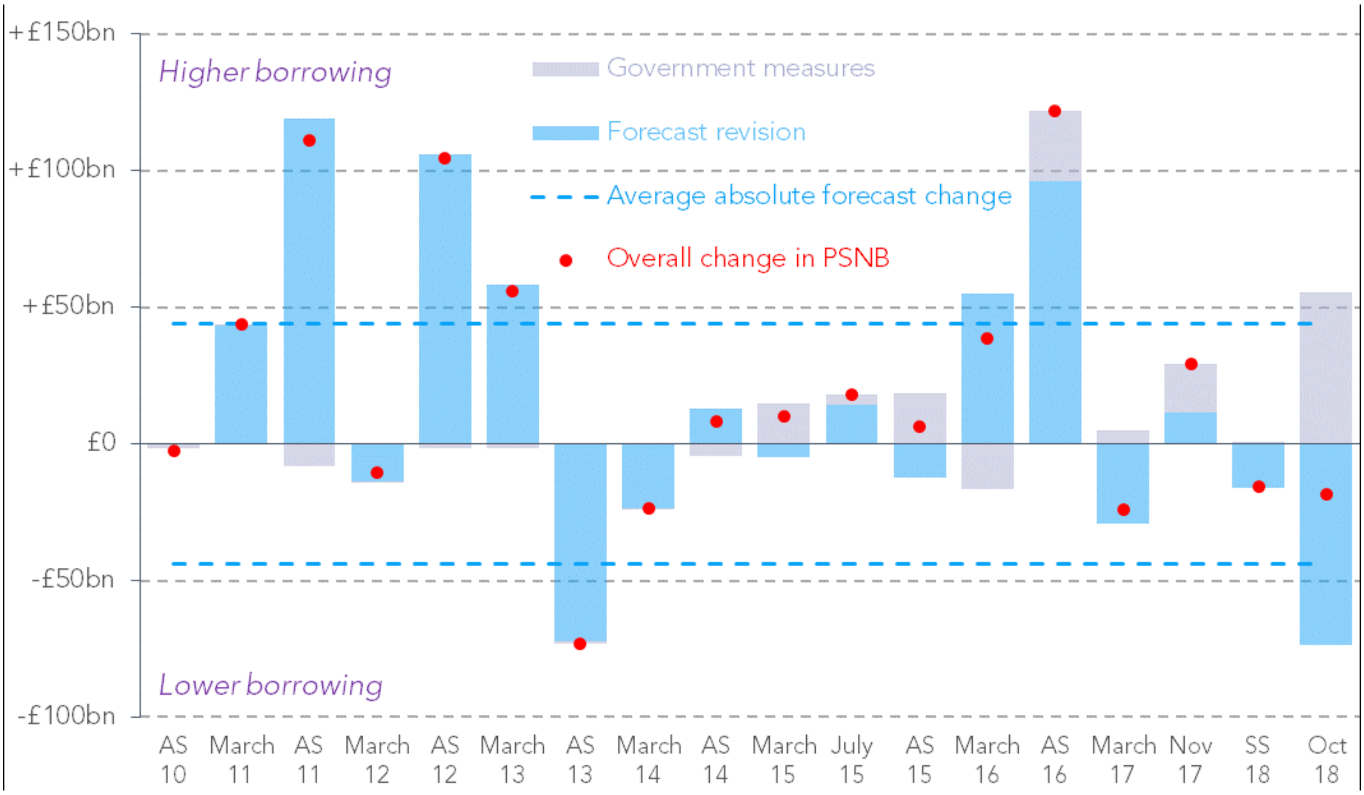


Source: OBR, Economic and Fiscal Outlook, October 2018

On a cumulative basis, the underlying forecast revisions add up to a £68.5 billion windfall across the five years from 2018-19 to 2022-23. As Figure 3 shows, once the £5.3 billion of classification changes and corrections are added in, the total forecast change amounts to £73.8 billion. Overall then, the Chancellor is making use of three-quarters (75 per cent) of this £73.8 billion, with higher health spending accounting for £44.9 billion and other (tax and spending) measures accounting for £10.4 billion. Combined, this represents the largest discretionary fiscal giveaway since the creation of the OBR and means that, across the five years, borrowing is set to be just £18.9 billion lower than previously thought.

Figure 3: On a cumulative basis, the Chancellor is making use of three-quarters of the windfall provided to him

Change in cumulative PSNB over forecast horizon in successive OBR statements (nominal)



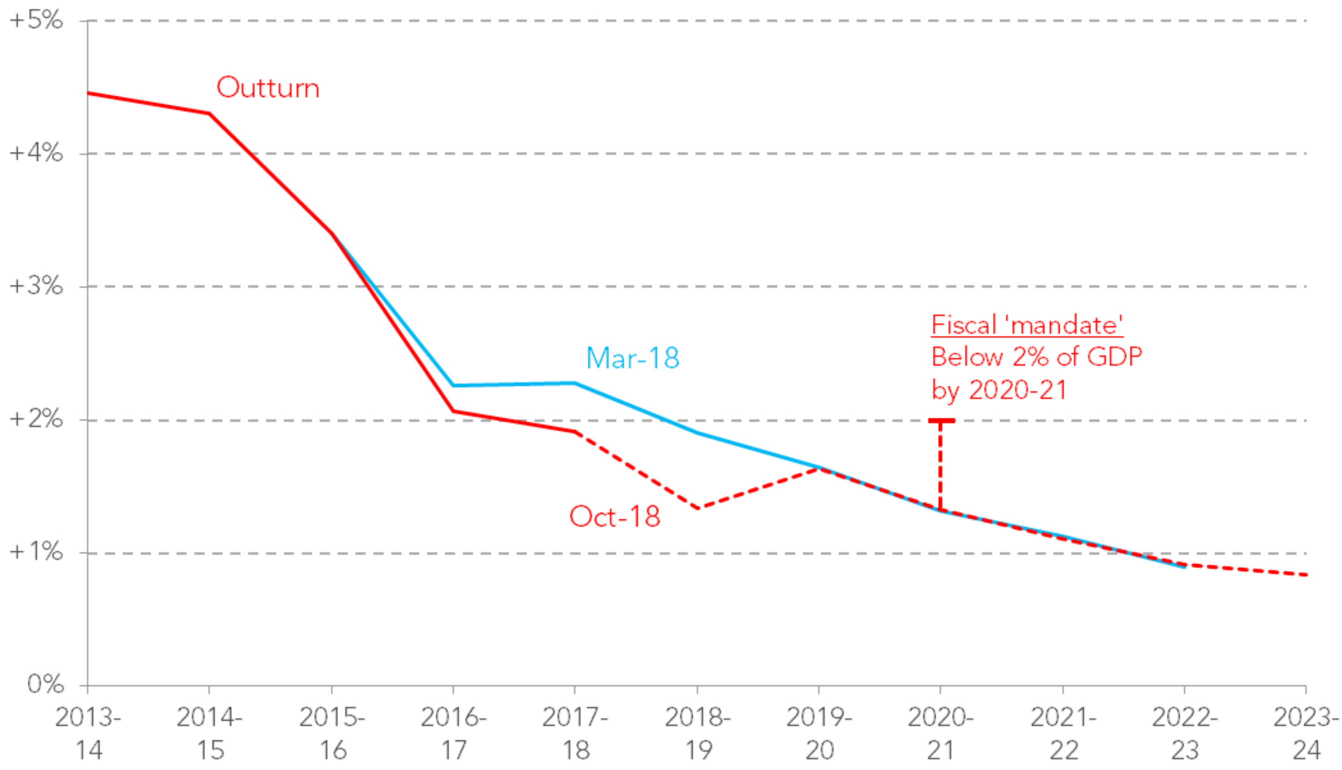
Source: OBR, Economic and Fiscal Outlook, various

As Figure 4 shows, this approach leaves the Chancellor's headroom against his fiscal 'mandate' – to have cyclically-adjusted net borrowing below 2 per cent of GDP by 2020-21 – almost entirely unchanged at £15.4 billion. The structural deficit is forecast to be lower in 2017-18 and 2018-19 than was thought in March, but thereafter it very closely matches the previous trajectory.

As Figure 5 shows, such headroom is broadly in line with the average enjoyed at all fiscal events since 2010. The windfall has therefore allowed him to fund NHS spending without having to lower his headroom to a level below what might be considered 'normal'.

Figure 4: The Chancellor's headroom against his fiscal 'mandate' is almost entirely unchanged from March

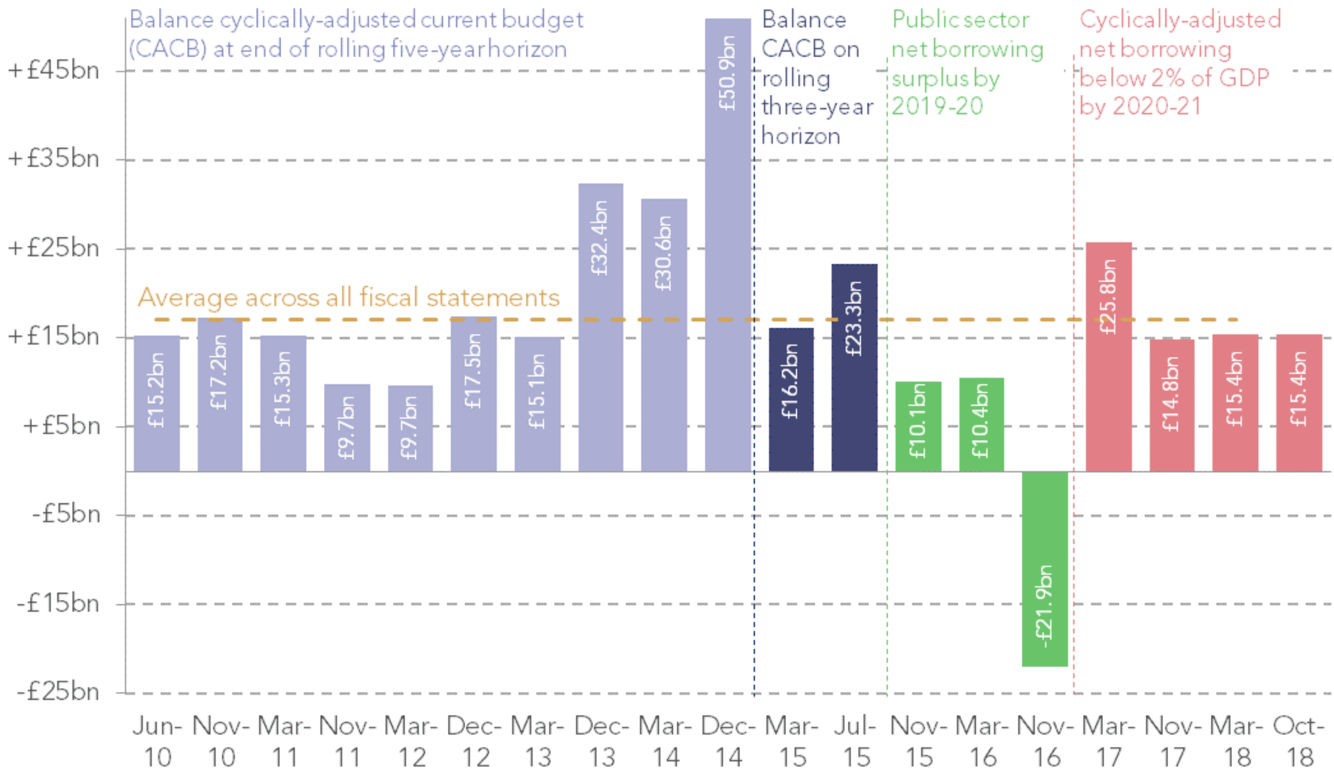
Cyclically-adjusted public sector net borrowing as a share of GDP



Source: OBR, Economic and Fiscal Outlook, various

Figure 5: Headroom of £15.4 billion is broadly in line with historical averages and unchanged from the Spring Statement

Forecast headroom against fiscal mandate in successive OBR Economic and Fiscal Outlook publications

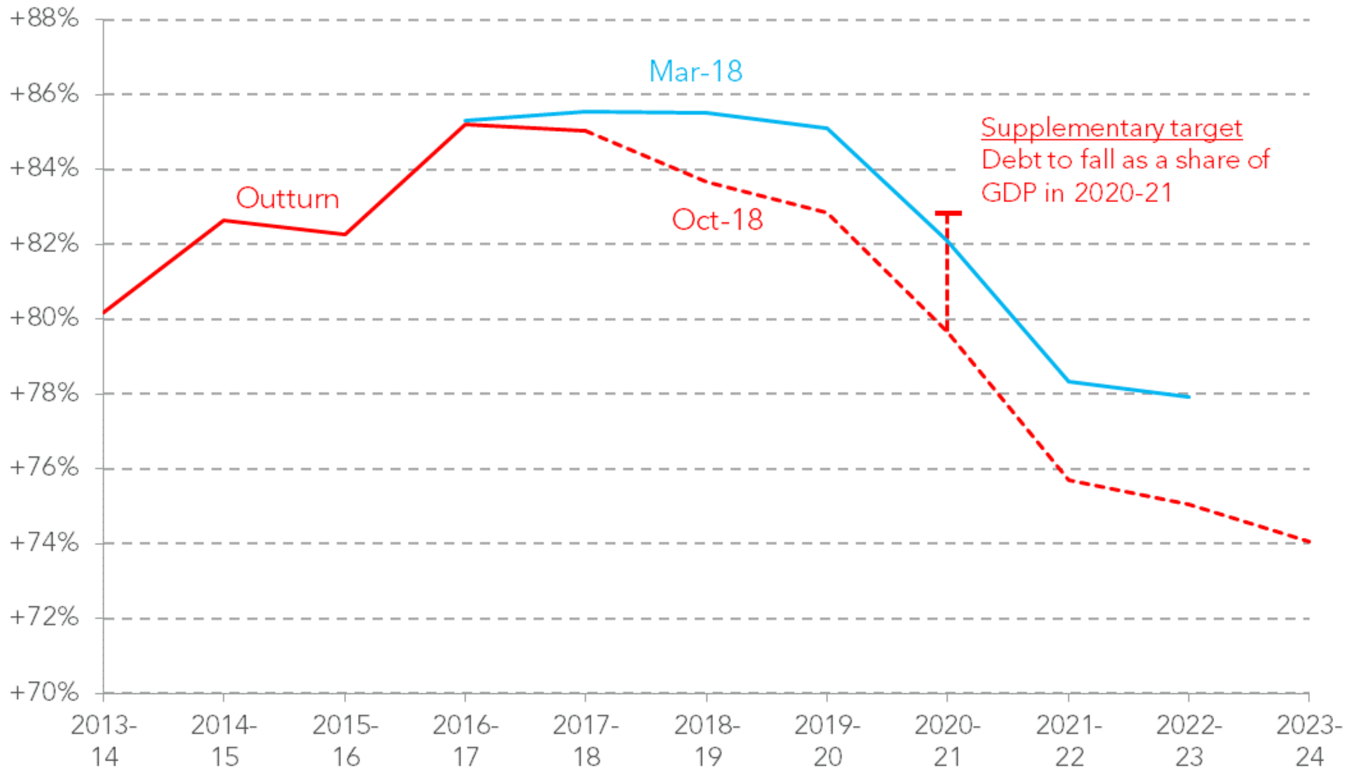


Source: OBR, Economic and Fiscal Outlook, various

While borrowing is left broadly unchanged by the end of the forecast horizon, the reduction in the deficit in 2017-18 and 2018-19 *does* help to lower the government's debt-to-GDP ratio. Higher nominal GDP also lowers the ratio, as depicted in Figure 6.

Figure 6: Public sector net debt forecasts have been lowered, with debt to GDP falling in each year after 2016-17

Public sector net debt as a share of GDP



Source: OBR, Economic and Fiscal Outlook, various

Debt-to-GDP is now expected to have peaked in 2016-17, with a modest reduction in 2017-18 and sharper falls in subsequent years. By 2020-21, the ratio is set to have fallen to 79.7 per cent. This represents a drop of 3.2 per cent of GDP relative to 2019-20, meaning the Chancellor remains on target to meet his supplementary debt rule (for the debt-to-GDP ratio to fall in 2020-21). While an improvement on the Spring Statement projection, it is worth noting that the unwinding of the Bank of England's Term Funding Scheme continues to account for the majority (2.3 percentage points) of this drop. The debt projection also depends on the government's stated plans to sell student loans.

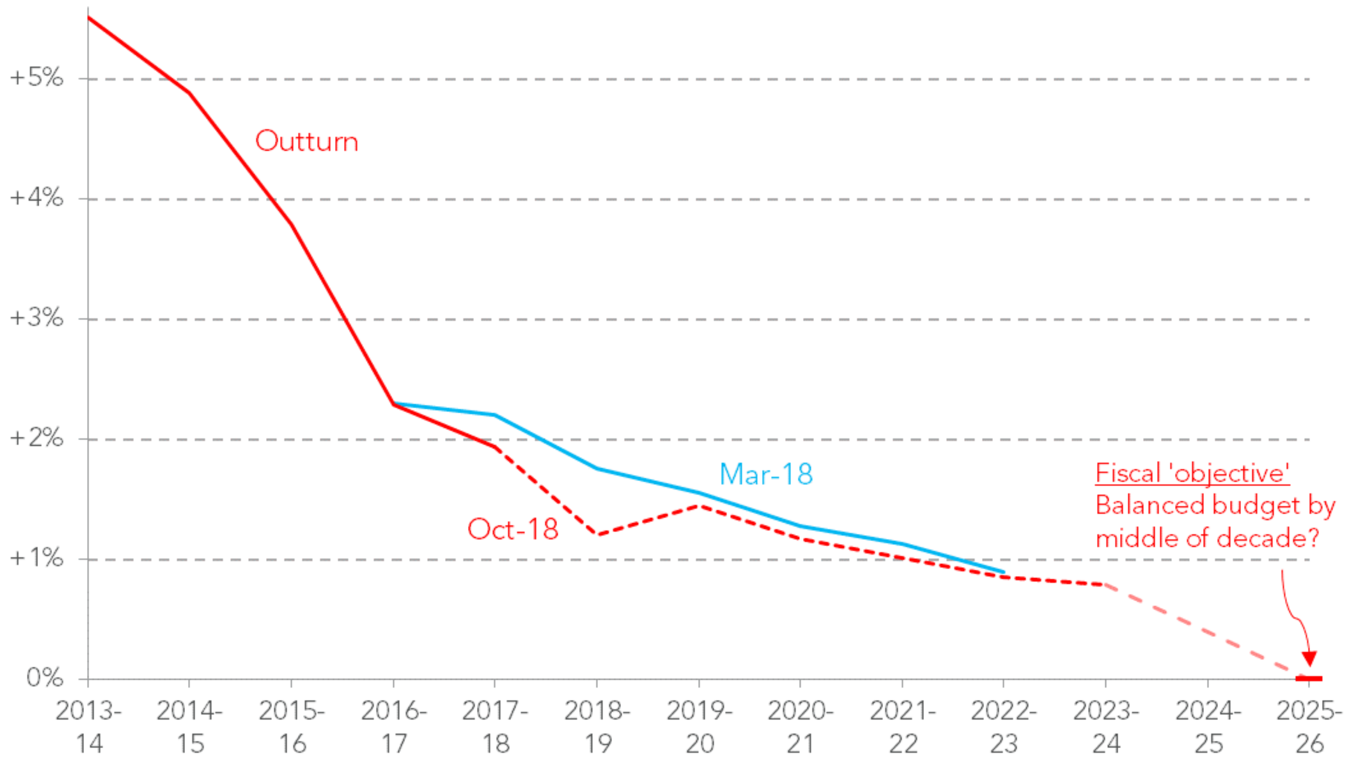
By 2023-24, debt is projected to have fallen to 74.1 per cent of GDP – its lowest level since 2010-11, though still more than double the ratio of 2007-08 (35.2 per cent).

Overall then, the public finances look a little healthier – or at least no weaker – than in March. But the fact that the Chancellor chose to use almost the entirety of the windfall he was given – with almost no reduction in borrowing relative to previous plans by 2022-23 – implies that he has given up on his wider fiscal 'objective'.

That objective, which was reaffirmed in the 2017 Conservative party manifesto, involved him returning a balanced budget "by the middle of the next decade". Yet, while 2024-25 and 2025-26 are beyond the OBR's forecast horizon, this target does not appear to be easily within reach. As Figure 7 shows, net borrowing is forecast to be 0.8 per cent of GDP in 2023-24, meaning that public spending would need to shrink – or taxes rise – by that amount just to reach budget balance. The pace of deficit reduction would need to increase significantly again after 2023-24 for this to happen.

Figure 7: Further consolidation of the public finances would be needed to hit the government's fiscal 'objective'

Public sector net borrowing as a share of GDP



Source: OBR, Economic and Fiscal Outlook, various

Although economic forecasts could improve again in future, spending pressures are likely to make this a difficult target to meet, with the OBR commenting:

> *"Achieving the broader balanced budget fiscal objective in 2025-26, looks challenging (although this lies beyond our formal forecasting horizon). In particular this is a period in which population ageing will continue to exert upward pressure on spending, and more so than in recent years when the State Pension age has been rising".*[5]

[5] OBR, *Economic and Fiscal Outlook*, October 2018

In large part, the Chancellor has used the windfall to significantly ease – but not quite end – austerity for public services

This was of course billed as the Budget in which the Chancellor would 'end austerity', delivering on the pledge made by the Prime Minister at the Conservative party conference.[5] Ahead of the Budget, we looked at what that would take.[6] We concluded that it would require some combination of ensuring that no department need face any further cuts in real-terms per capita spending after 2019-20, along with taking action to support household incomes by reversing at least some of the remaining social security cuts initially set out at Summer Budget 2015.

Given his use of the large windfall provided by the OBR, how close has the Chancellor come to this outcome?

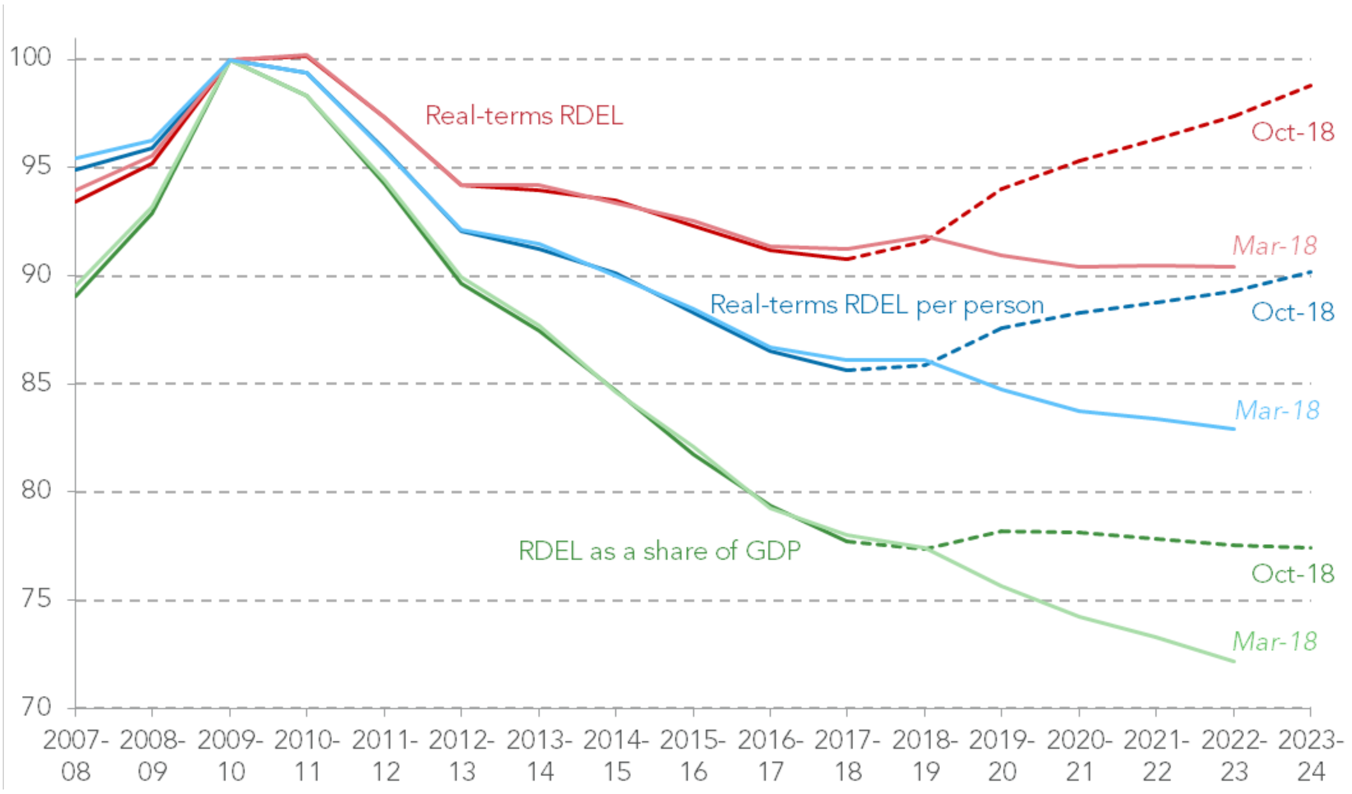
Figure 8 sets out the overall RDEL 'resource' departmental expenditure limit, or day-to-day spending total in real-terms, real-terms per capita, and as a share of GDP. The significant change from the Spring Statement is obvious, with real spending per person now forecast to rise in each year rather than fall (though spending as a share of GDP will be broadly flat). Indeed, overall day-to-day departmental spending per person is now set to rise by 4 per cent between 2018-19 and 2022-23, rather than fall by 4 per cent as previously planned. This is undoubtedly a major change of direction. However, on each measure spending will still be lower in 2023-24 than in 2013-14 – and this is at a time when need per person may be rising due to demographic change.

[5] Theresa May speech at the Conservative party conference, 3 October 2018

[6] M Whittaker, Tunnel Vision: Autumn Budget 2018 and 'ending austerity', October 2018

Figure 8: The outlook for day-to-day departmental spending has changed significantly

Tndices of real-terms resource departmental expenditure limits: 2009-10 = 100 (GDP-deflator)

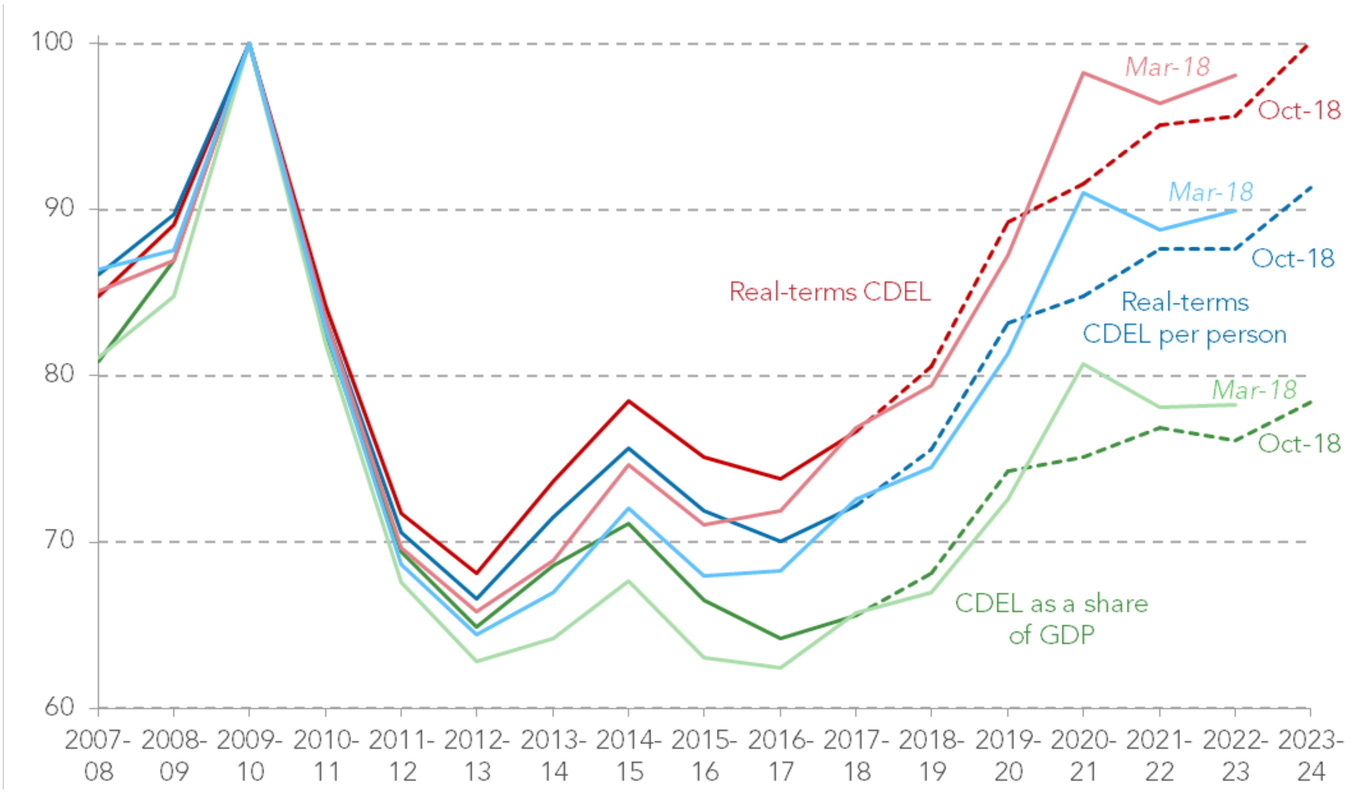


Source: OBR, *Economic and Fiscal Outlook*, various

Some of this increased RDEL comes from a reduction in (unallocated) capital spending, as Figure 9 shows. Public sector net investment is now forecast to return to its pre-crisis norm of around 2.2 per cent of GDP, but no higher.

Figure 9: Future capital spending has been cut, but is still set to rise

Indices of real-terms capital departmental expenditure limits: 2009-10 = 100 (GDP-deflator)

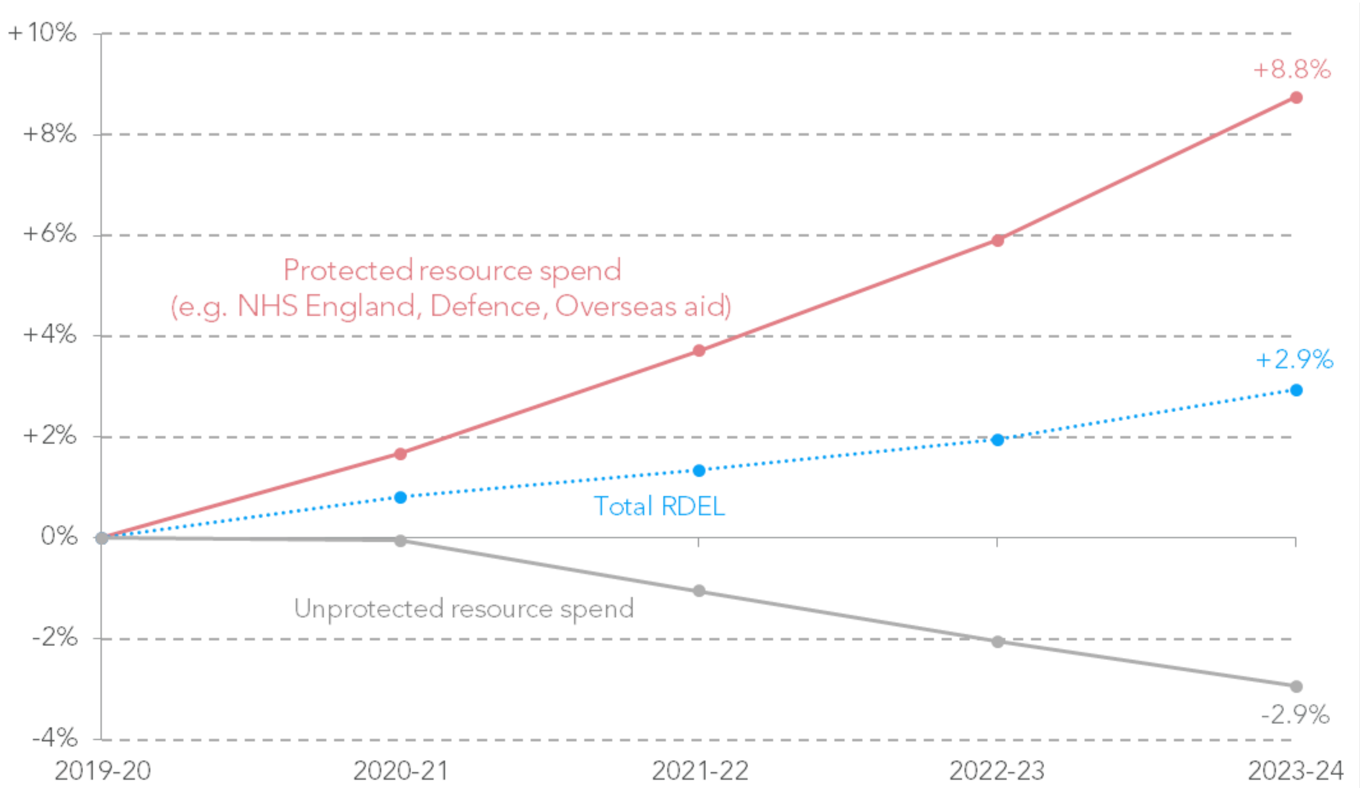


Source: OBR, Economic and Fiscal Outlook, various

These are the outlooks for all departments combined. But with health spending increasing, and defence and aid spending linked to the size of the economy, some departments must be less lucky. As Figure 10 shows, unprotected departments are still facing real day-to-day spending cuts per person of 2.9 per cent between 2019-20 and 2023-24.

Figure 10: Although RDEL per person is forecast to rise, unprotected departments still face cuts

Cumulative real-terms change in RDEL per person from 2019-20 (GDP deflator)



Source: OBR, *Economic and Fiscal Outlook*, various

But departments' spending allocations have not been set beyond 2019-20. And the Chancellor did hint that their outlook could change again next year, saying:

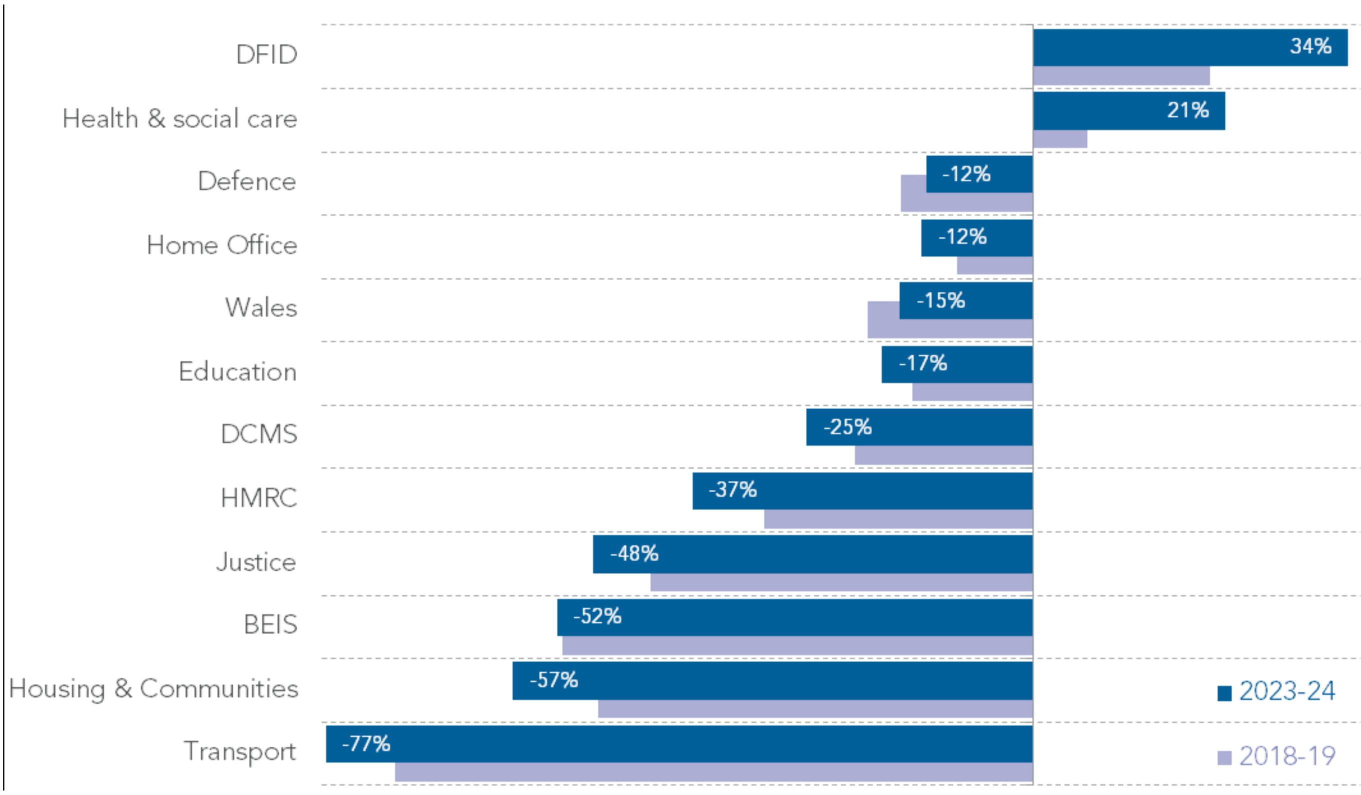
> *"When our EU negotiations deliver a deal, as I am confident they will, I expect that the "Deal Dividend" will allow us to provide further funding for the Spending Review".*[7]

Figure 11 sets out both the scale of day-to-day budget changes that have happened for some departments since 2009-10, and the overall cuts implied by the new forecasts by 2023-24. It shows, for example, that real day-to-day spending per person on HMRC has already fallen by 29 per cent, and that this is forecast to rise to 37 per cent over the next five years (assuming further cuts are shared equally across unprotected departments). In contrast, real-terms spending per person on health and social care is set to be 21 per cent higher in 2023-24 than 2009-10.

[7] Rt Hon Philip Hammond MP, Budget 2018: Philip Hammond's speech, 29 October 2018

Figure 11: Some departments are facing further large budget cuts over the next five years

Real change in departmental resource budgets (RDEL per person, GDP deflator) relative to 2009-2010



Source: HMT, PESA 2018; Fiscal statements; and RF analysis

So thanks to the forecast improvement, the Chancellor has come close to being able to say that austerity has ended for departments – though has fallen somewhat short.

Some of the windfall has gone on household budgets, but here too austerity has been eased, not ended

The other focus of the Chancellor's efforts to end austerity was a boost to household finances via cuts to personal taxation and increases in benefit spending. He set out a package comprising of, on the tax side of the ledger:

- Meeting the Conservative manifesto commitment to increase income tax thresholds to £12,500 (in the case of the personal allowance) and £50,000 (in the case of the higher-rate threshold) by 2020-21 a year early, at a cost of £2.8 billion in 2019-20 (falling to £1.8 billion in 2023-24, due to a cash freeze in 2020-21).
- Freezing fuel duty for the ninth year running, at a cost of £0.8 billion in 2019-20.
- Freezing duties on beer, cider and spirits next year, at a cost of £0.2 billion in 2019-20.
- Partially offsetting these tax cuts with the previously announced decision not to proceed with the abolition of class 2 National Insurance contributions made by the self-employed (affording a saving to the public purse of £0.3 billion by 2023-24).

And on the benefits side of the ledger:

- Increasing Universal Credit (UC) work allowances by £1,000 next year, at a cost of £0.5 billion in 2019-20 (rising to £1.7 billion in 2023-24 due to the ongoing roll-out of UC).
- Providing additional funding to support the transition from the existing benefit system to UC, at a cost of £0.1 billion in 2019-20. This funding represents a package of measures that should help families who are moved from the existing benefit system onto UC to transition smoothly. But it does not go as far as reforming underlying design flaws such as the Minimum Income Floor for the self-employed.

Focusing first on the improvement in UC's generosity,[5] Table 1 shows how successive key changes have affected the incomes of families working full time at the minimum wage who are entitled to UC.

[5] A note of caution should be raised given what appears to be a last minute submission to OBR of the details of this policy measure. For example, the accompanying HMT policy costings document describes the work allowance increase as 'a fixed cash increase' which could imply that rather than being uprated by CPI as is standard practice for work allowances, this additional amount may erode in real terms. For the purpose of our modelling we have assumed that it will be uprated in line with CPI in future years.

Table 1: The impact of changes to Universal Credit since Summer Budget 2015 for families working full time at the minimum wage, 2019-20

Impact of changes to Universal Credit for full-time minimum wage earner, 2019/20

	March Budget 2015	Summer Budget 2015		Autumn Statement 2016	Autumn Budget 2018		Overall impact on income
	Work allowances	Work allowances	Income change	Income change: 63% taper	Work allowances	Income change	
Households without housing costs							
Single parent	£9,290	£5,030	-£2,770	+£200	£6,030	+£630	-£1,940
Couple with children	£6,780	£5,030	-£1,140	+£200	£6,030	+£630	-£310
No dependent children	£1,400	£0	-£910	+£300	£0	+£0	-£610
Limited capability for work	£8,180	£5,030	-£2,050	+£200	£6,030	+£630	-£1,220
Households with housing costs							
Single parent	£3,330	£2,430	-£580	+£250	£3,430	+£630	+£300
Couple with children	£2,810	£2,430	-£250	+£250	£3,430	+£630	+£630
No dependent children	£1,400	£0	-£910	+£300	£0	+£0	-£610
Limited capability for work	£2,430	£2,430	+£0	+£250	£3,430	+£630	+£880

Notes: Work allowances and minimum wage rates are uprated to 2020 using OBR November 2016 economic assumptions

Notes: Assumes that work allowances in place before the Summer Budget 2015 are uprated by CPI in 2018-19 and 2019-20. Estimates are rounded to nearest £10.

Source: RF analysis of DWP Benefit Rates 2018-19 and OBR, various

We find that:

- The over £3 billion of cuts announced at Summer Budget 2015 led to a reduction in UC award of up to £2,770 a year for working families, although the precise size of impact varies by family type and tenure.
- The reduction in the taper rate at Autumn Statement 2016, which increased spend by £0.9 billion, provided a relatively small income boost to most working families. It offset losses from work allowance cuts entirely for couples with children who rent.
- The latest boost to work allowances (£1.7 billion additional spend) provide a £630 boost to working families and offsets half of the original cut overall.

The two boosts to in-work support since the 2015 Summer Budget will mean that most working families who rent and have children and/or disability will have had their original losses as a result of Summer Budget 2015 policy changes more than offset (unless they have very low earnings of less than their work allowance).

Overall then, the taper reduction and boost to work allowances have offset around three-quarters of the 2015 cuts to work allowances. Taking account of recent forecasting changes, the boost to work allowances and further support to help ease the transition to UC, the OBR estimates it will now mean the government spends an additional £2 billion a year compared to the legacy system.

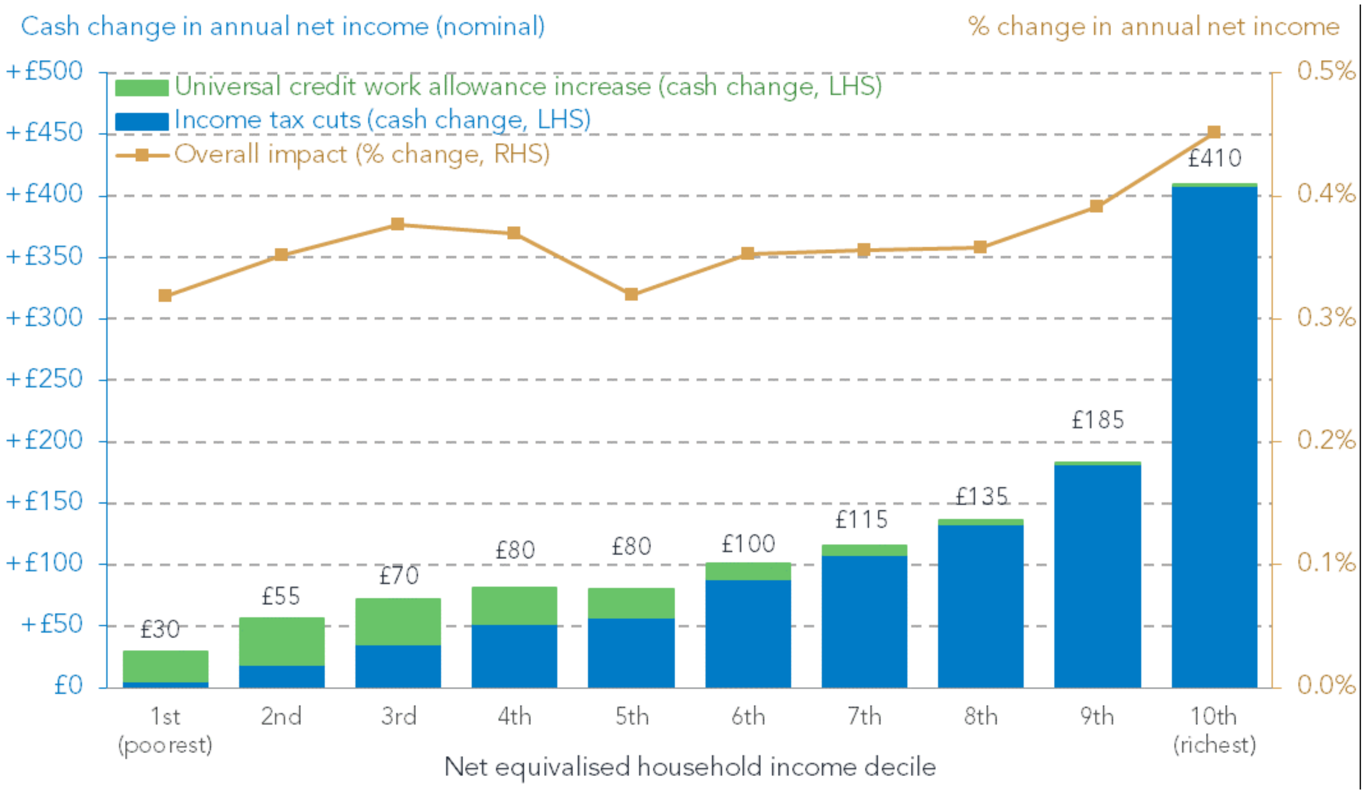
Whether UC, once in steady state, will overall provide more support to families than the current system depends greatly on the extent to which UC delivers an expected boost to take-up. Without an increase in take-up, UC will be £1.5 billion less generous a year in 2023-24; assuming it achieves a full take-up effect, it will be £1.6 billion more generous.

It is also worth noting that the latest delays to the point at which the managed migration process is started at any sort of volume have led the OBR to assume that the roll out of UC will now not be complete until the middle of 2024.

In the more immediate term, Figure 12 shows the effects of the income tax and UC work allowances changes when they take effect next year, accounting for the fact that UC will only be partially rolled out at that point. We focus on these because they are the biggest-ticket tax and spending measures respectively, and also those that have the most direct impact on household living standards.

Figure 12: Tax cuts and benefit increases next year are concentrated in the top half of the income distribution

Impact of tax and benefit policies on annual net household income, 2019-20



Notes: The impact of work allowance cuts is estimated on the basis of 32 per cent of the roll-out schedule having been completed by 2019-20. Estimates take into account take-up.
Source: RF analysis using OBR, Policy costing database; OBR, Economic and Fiscal Outlook, various; RF analysis using IPPR tax-benefit model

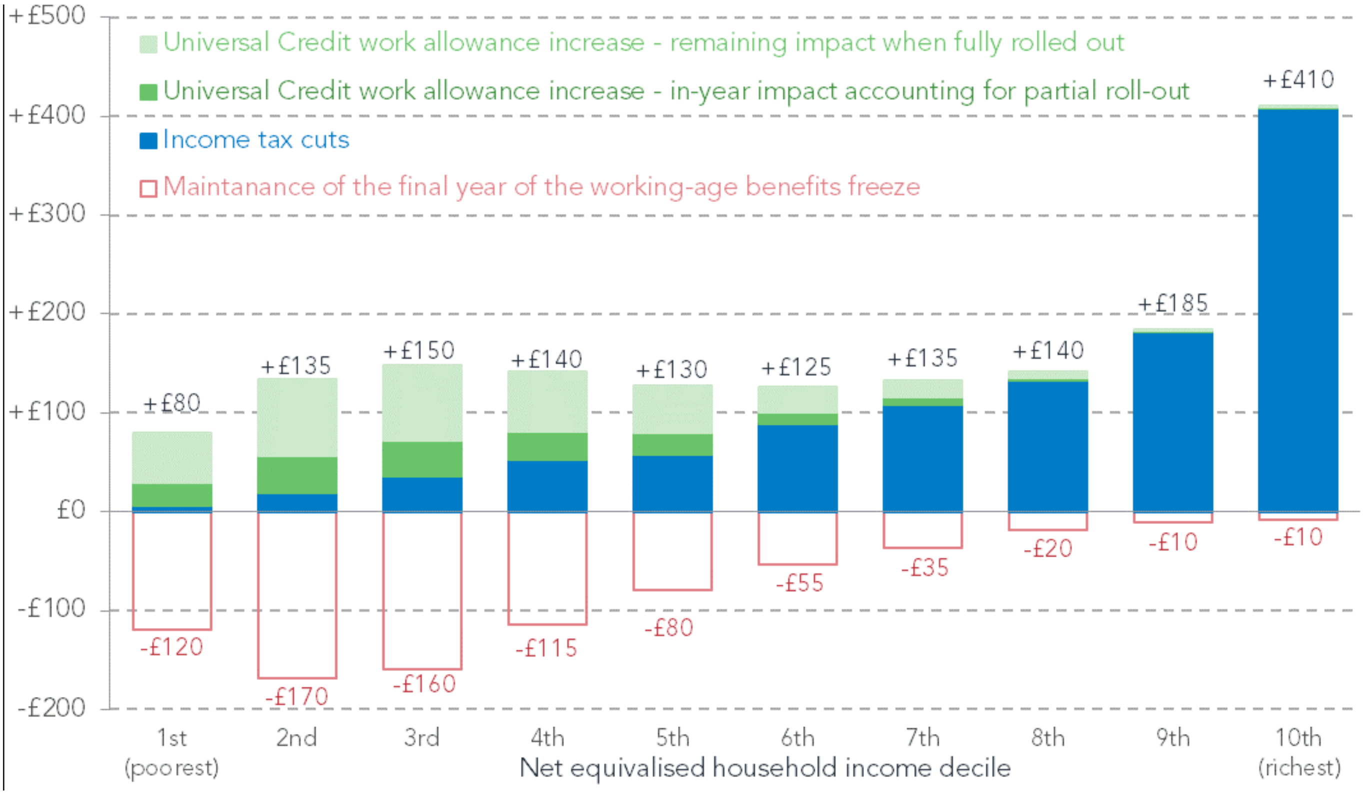
Figure 12 makes clear that the work allowance increase is progressive, with the vast majority (86 per cent) of spending flowing to the bottom half of the income distribution. The picture is reversed in the case of the income tax cut however, with 84 per cent of gains flowing to the top half of the income distribution and 37 per cent to the top decile alone. These figures rise even further by the end of the forecast period in 2023-24 – to 89 per cent and 45 per cent respectively.

The income tax changes cost far more than the UC changes (upon initial introduction), meaning their regressive nature dominates in the overall pattern of changes announced in the 2018 Autumn Budget that take effect next year. The top 10 per cent of households have gains 14 times higher than the bottom decile in cash terms (£410 compared to £30), and their proportional income increases are 42 per cent higher.

To put these 2019-20 changes in context, Figure 13 displays them alongside the full impact of the UC work allowance increases (i.e. the scale of the income changes if UC were fully rolled out next year), and also the impact of the final year of the working-age benefits freeze which the Chancellor chose to maintain in the Budget.

Figure 13: Tax cuts and benefit increases next year do not offset the impact of the final year of the benefits freeze for those in the bottom half of the income distribution

Impact of tax and benefit policies on annual net household income, 2019-20 (nominal)



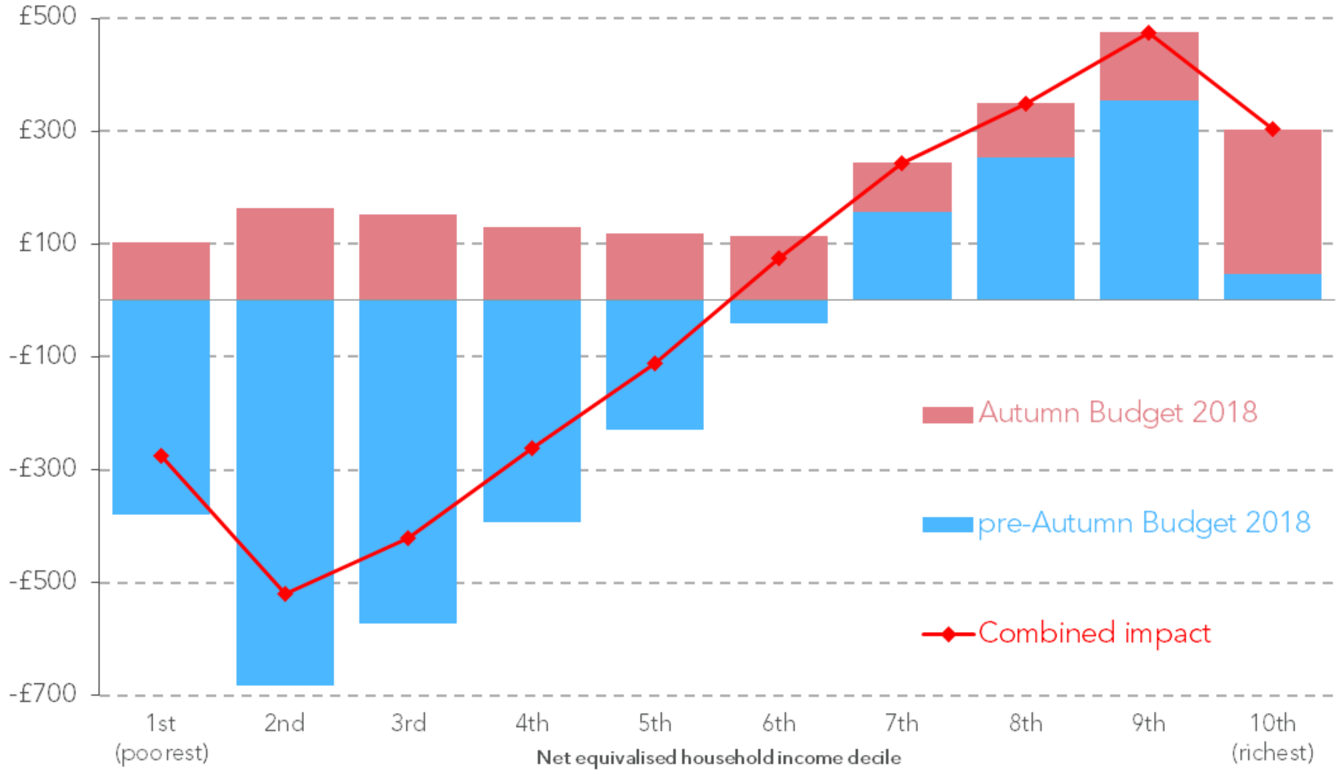
Notes: The impact of work allowance cuts is estimated on the basis of 32 per cent of the roll-out schedule having been completed by 2019-20. Estimates take into account take-up
Source: RF analysis using OBR, Policy costing database; OBR, Economic and Fiscal Outlook, various; RF analysis using IPPR tax-benefit model

Two things are clear from this. First, while the longer-run impacts of UC work allowance increases improve the distributional picture on that presented in Figure 12, those on the highest incomes continue to gain far more than the rest. And second, the major Budget 2018 tax and benefit giveaways are not sufficient to offset one of several planned and maintained cuts to welfare spending that disproportionately affect those on the lowest incomes. Even when UC is fully rolled out, those in the bottom 30 per cent of the income distribution will – on average – gain less from work allowance and income tax changes (£120) than they will lose from the final year of the benefits freeze (£150). Even in this limited account of major tax and benefit changes taking effect in 2019-20, it is clear that elements of austerity are being maintained when it comes to household living standards.

For a fuller and longer-run picture, Figure 14 rolls this picture out to the end of the OBR forecast period – 2023-24 – incorporating all Budget 2018 tax and benefit policy measures and setting these against all those since the 2015 General Election. The combination of the £1,000 boost to work allowances with income tax cuts means that cash gains are relatively even across the distribution, apart from the larger gains from the increase in the Higher Rate Threshold for the richest 10 per cent of households.

Figure 14: New tax and benefit policy changes provide a long term boost to both low and high income households

Impact of tax and benefit policies announced since March 2015 before and after the Budget 2018: 2023-24



Notes: Includes announced income tax cuts, additional hours of free childcare, removal of family element, alcohol & fuel duty freeze, limiting support to two children, work allowance cuts, pension tax relief cut, Class 2 NICs abolition & re-instatement, benefit freeze, reducing UC taper to 63%, abolition of six-week wait, HB run-on, further UC transitional measures & £1,000 work allowance boost. Assumes full entitlement, full UC roll-out & measures affecting new claims/births 85% in place. Estimates take into account take-up

Source: OBR, Economic and Fiscal Outlook, various. RF analysis using IPPR tax-benefit model.

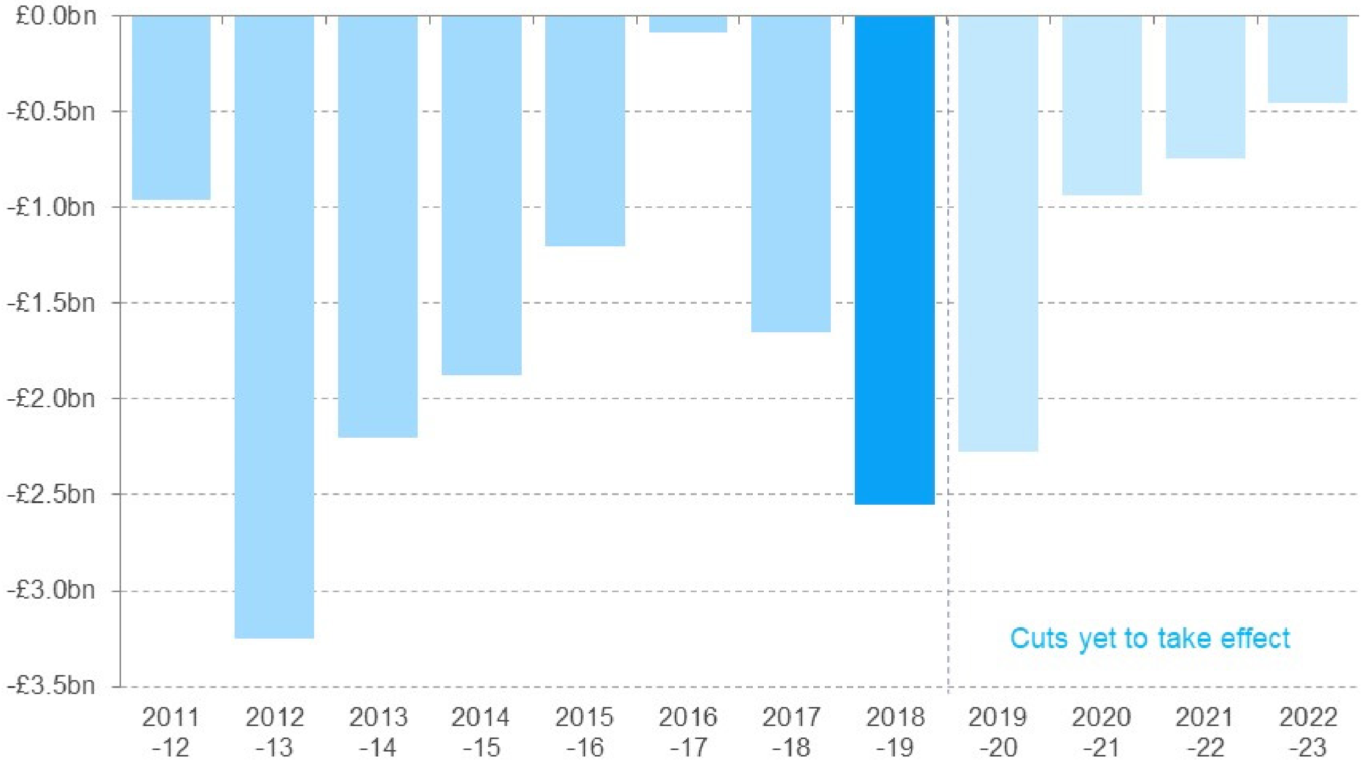
It is clear from Figure 14 that measures to boost the incomes of the poorest half of households in Budget 2018 only partially offset the overall losses of policies announced since Summer Budget 2015. Of the around £12 billion of intended welfare cuts by the end of this decade only a quarter have been reversed.

Figure 15 sets out the reduction in government spend associated with those working-age benefit cuts directly affecting household incomes in each year from 2011-12 to 2022-23.[6] Of the cuts announced in Summer Budget 2015, the policies modelled in the chart amount to over £8 billion, with 50 per cent of those cuts yet to take effect.

[6] Analysis excludes reductions in social rent which do not directly impact on household incomes.

Figure 15: Over £4 billion of further working-age welfare cuts are due over the next five years

Reduction in government spend due to working-age benefit cuts taking effect in each

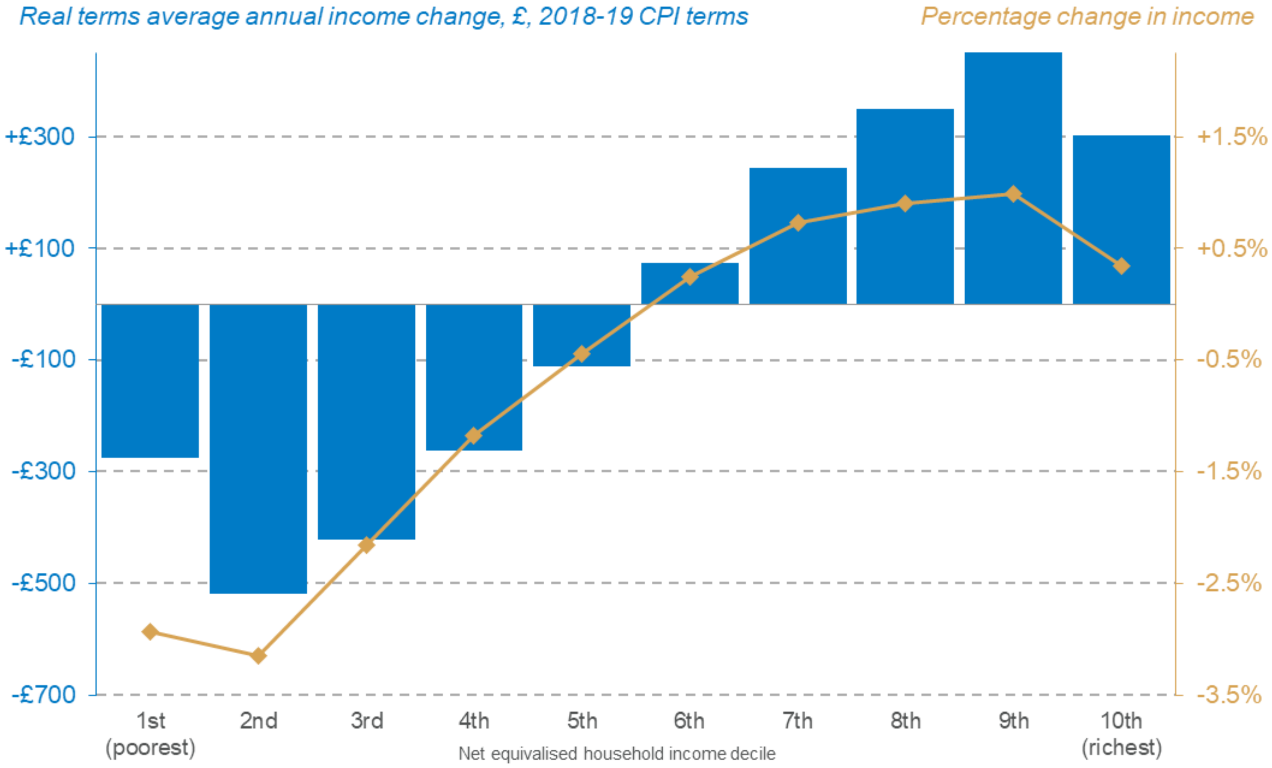


Notes: Savings relate to the first year in which working-age benefit cuts are implemented and exclude reductions in social rents that do not impact directly on household income.
Source: Resolution Foundation analysis using OBR, Policy costing database and OBR. Economic and Fiscal Outlook, various

Figure 16 shows that the overall effect of government tax and benefit policies put into place since May 2015 is expected to be strongly regressive. Compared to policies that would otherwise have been in place in 2023-24, the poorest fifth of households are expected to be an average of £400 a year worse off. In contrast, the richest fifth are forecast to record an average gain of £390 a year.

Figure 16: Distributional impact of tax and benefit policies announced since March 2015: 2023-24

Real terms average annual income change, £, 2018-19 CPI terms



Notes: Includes announced income tax cuts, additional hours of free childcare, removal of family element, alcohol & fuel duty freeze, limiting support to two children, work allowance cuts, pension tax relief cut, Class 2 NICs abolition & re-instatement, benefit freeze, reducing UC taper to 63%, abolition of six-week wait, HB run-on, further UC transitional measures & £1,000 work allowance boost. Assumes full entitlement, full UC roll-out & measures affecting new claims/births 85% in place. Estimates take into account take-up.

Source: OBR, Economic and Fiscal Outlook, various. RF analysis using IPPR tax-benefit model.

Finally, to illustrate how these post-2015 general election policy changes play out in the real world, Table 2 sets out their effects on the net household incomes of ten example families.

Table 2: Impact of policy changes between recent fiscal events and Budget 2018 for different family types

Net household incomes for different family types, Universal Credit system, 2023-24 (CPI-adjusted to 2018-19 prices)

Net household incomes (before housing costs)	Income forecast for 2023-24 in Oct-18	Change in income forecast since...	
		Mar-18	Mar-15
1. Single (no kids), full time, self-employed, low earning *works 37.5 hours per week and earns equivalent of NMW per hour*	£14,260	-£150	+£0
2. Single (no kids), full time, earning wage floor *works 37.5 hours per week at NMW/NLW (£7.20), rents privately at 30th pctile (£110 per week, 1 bed)*	£13,190	+£20	+£200
3. Single (1 child), part time, earning wage floor *works 20 hours per week at NMW/NLW (£7.20)*	£13,320	+£620	-£2,910
4. Single (1 child), full time, low earning, renting *works 37.5 hours per week at p25 wage (£8.60), rents social housing at average rents (£85 per week, 2 bed)*	£18,110	+£630	-£670
5. Couple (2 kids), full time single earner on wage floor *main earner works 37.5 hours per week at NMW/NLW (£7.20)*	£21,140	+£630	-£1,630
6. Couple (2 kids), low earning/wage floor, renting *main earner works 37.5 hours per week at p25 wage (£8.60), second earner works 20 hours per week at NMW/NLW (£7.20), rents privately at 30th pctile (£170 per week, 3 bed)*	£29,980	+£630	-£510
7. Couple (3 kids), low earning/wage floor, renting *main earner works 37.5 hours per week at p25 wage (£8.60), second earner works 20 hours per week at NMW/NLW (£7.20), rents privately at 30th pctile (£170 per week, 3 bed)*	£29,870	+£630	-£3,450
8. Couple (no kids), low/mid earning *both work 37.5 hours per week, main earner at median wage (£12.10), second earner at p25 wage (£8.60)*	£29,050	+£30	+£210
9. Couple (2 kids), low/mid earning *both work 37.5 hours per week, main earner at median wage (£12.10), second earner at p25 wage (£8.60)*	£37,120	+£60	+£290
10. Couple (no kids), high earning *both work 37.5 hours per week at p90 wage (£26.40)*	£81,120	+£390	+£1,190

Notes: Figures relate to modelled hypothetical outcomes in 2023-24 on the assumption that these families receiving in-work benefits are in the Universal Credit system and are making a new claim. All scenarios use the latest OBR economic forecasts, in order to isolate the effect of policy changes. All figures are presented in 2018-19 prices, deflated using CPI. Impacts cover the effects of direct tax and benefit changes, the introduction of the National Living Wage and new childcare support, but assume no behavioural changes or dynamic effects. Wage floors (NMW and NLW) reflect OBR projections for 2023. Figures may not sum due to rounding (all are rounded to nearest £10). Inflation and earnings projections are taken from OBR forecasts.

Source: RF analysis using RF microsimulation model

The penultimate column shows how Budget 2018 tax and benefit policy changes have affected these families' projected incomes, with all families gaining apart from family 1 (whose income decreases as a result of the reversal of the decision to abolish class 2 National Insurance contributions scored at Budget 2018).

The final column takes a longer view, showing the net change to projected household incomes from policy changes implemented from Summer Budget 2015 onwards. Echoing the distributional analysis presented above, it is clear that even after the softening of benefit cuts and the tax cuts announced in Budget 2018, the net effect of policy changes since spring 2015 will be to substantially reduce household incomes for families on low- and middle-incomes, while having an income-increasing effect on better-off households.

Looking in detail at three family types:

» Family 3 – a single parent with one four-year-old child, working part-time on the wage floor – is expected to have a net household income in 2023-24 that is £2,910 or 17.9 per cent lower (in 2018-19 prices) than it would have been if policy changes since spring 2015 had not taken place. This loss comes almost entirely from cuts to working-age benefits, and is only marginally reduced by the increased UC work allowance announced in Budget 2018. This family's gross earnings are below the income tax personal allowance so they do not gain from changes to taxation policy.

» Family 7 – a couple with three young children, where one partner works full time on a low wage and the other works part time on the wage floor – is expected to experience the largest cash changes (out of the ten examples) to their household income. Tax changes since Spring 2015 increase their net earnings by £210, but this small change is dwarfed by the £3,650 cut to their benefit income imposed by the two-child limit under UC and other cuts to the overall generosity of in-work benefits. This leaves them facing a 10.4 per cent net cut in household income due to policies announced since Spring 2015.

» Family 10 – a high-earning couple with no children – stand out compared to the other example families as the ones experiencing the largest increase in net household income, both in cash terms and in proportion to their income. Changes to tax policy since 2015 leave this household £1,190 (or 1.5 per cent) better off in 2023-24 than they would have been had no policy changes occurred.

Overall, the clear conclusion of both these case studies and our fuller distributional analysis is that despite the softening of cuts to working-age benefit spending and the tax cuts the Chancellor offered in the 2018 Budget, austerity will continue to bear down on living standards of the lower to middle income households in the years to come.

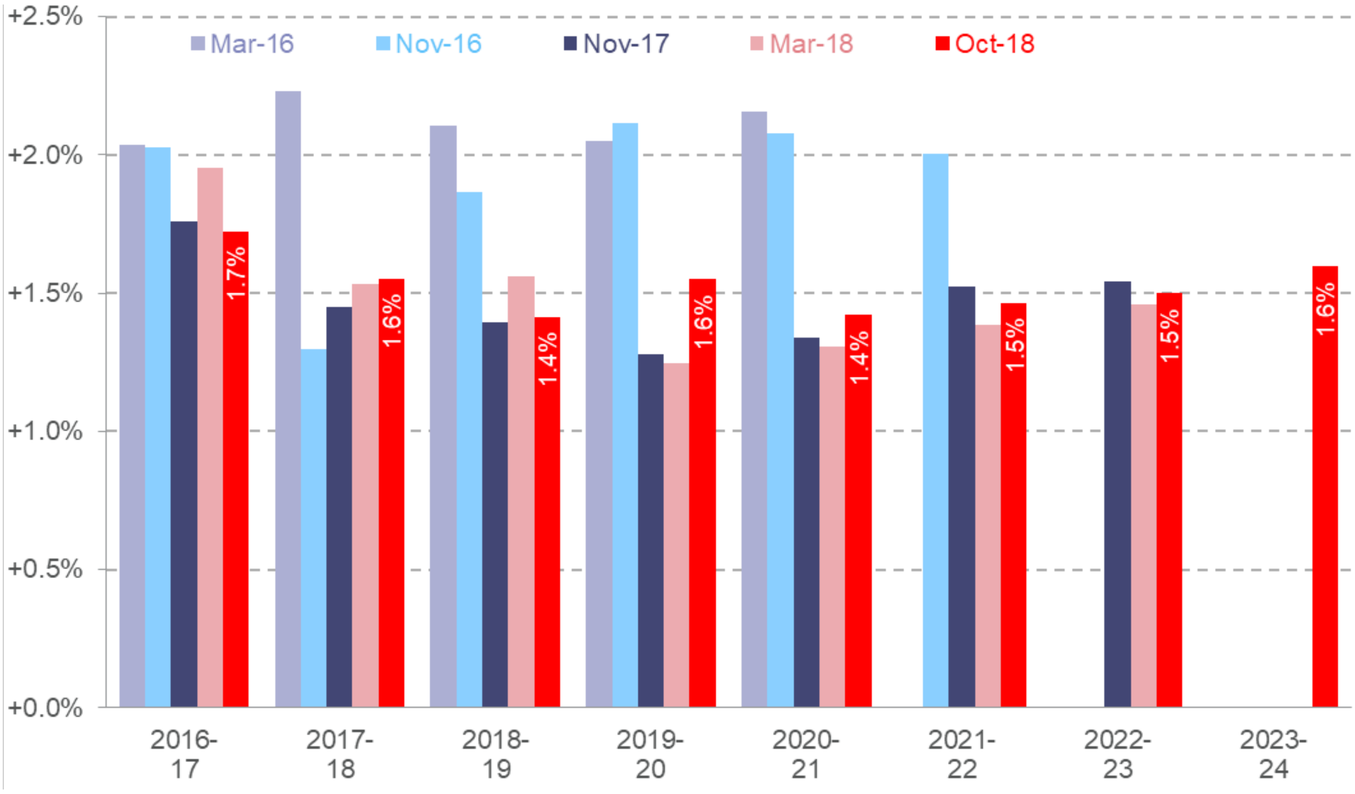
The public finance windfall is a product of stronger nominal growth, but real growth projections remain weak by historical standards

As noted above, the OBR's borrowing upgrade is based in part on a reassessment of potential growth in the economy. Alongside higher whole economy inflation this boosts nominal GDP – and therefore tax receipts.

And, stepping back from this picture of little change, it is worth remembering how much lower GDP growth projections remain relative to those that prevailed just two years ago. Figure 17 sets out projected growth rates at five recent fiscal events, highlighting the extent to which the OBR downgraded its forecasts between 2016 and 2017. The modest improvement in the latest projections make very little headway into this earlier downgrade.

Figure 17: The latest GDP projection is slightly improved, but still significantly down on the forecasts of 2016

Year-on-year growth in real-terms GDP: successive OBR projections (CVM)

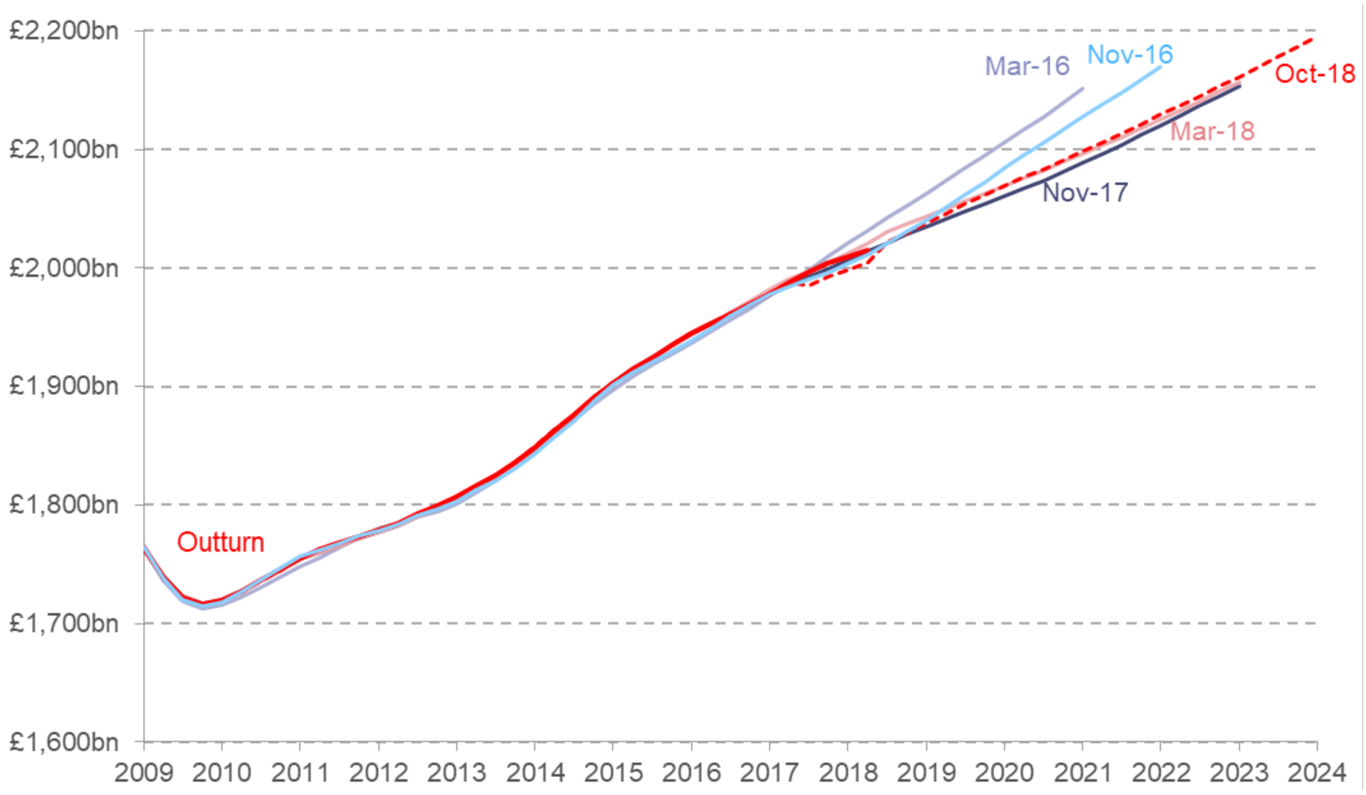


Source: OBR, Economic and Fiscal Outlook, various

That effect is made clearer still in Figure 18. It shows that the economy is now projected to be £3.9 billion larger at the start of 2022 than was forecast in March, but that it still on course to be £40.5 billion smaller than had been expected in November 2016. And the difference is even greater relative to the growth trajectory implied in March 2016.

Figure 18: The economy is forecast to be marginally bigger in the coming years than was projected in March, but still much smaller than thought two years ago

Real-terms GDP: outturn and successive OBR projections (CVM, rolling four-quarter total)

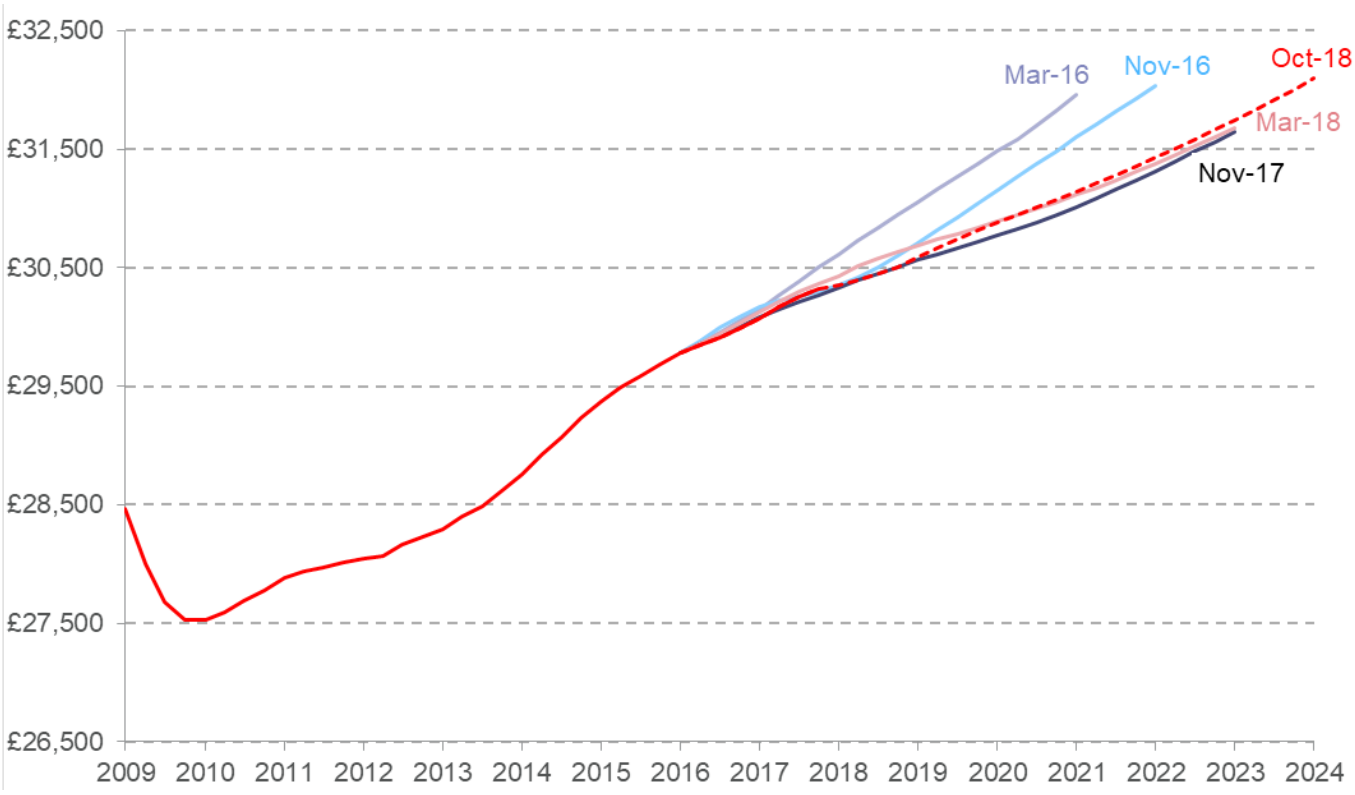


Source: OBR, Economic and Fiscal Outlook, various

Switching to GDP per capita, so as to better capture the impact on living standards, Figure 19 shows that the latest projections imply that each member of the population will be better off by £52 a year at the start of 2022 relative to the March projection. This forecast remains £600 lower than in November 2016 however.

Figure 19: GDP per capita is projected to be £52 higher at the start of 2022 than was thought in March, but still £600 lower than forecast in November 2016

Real-terms GDP per capita: outturn and successive OBR projections (CVM, rolling four-quarter total)

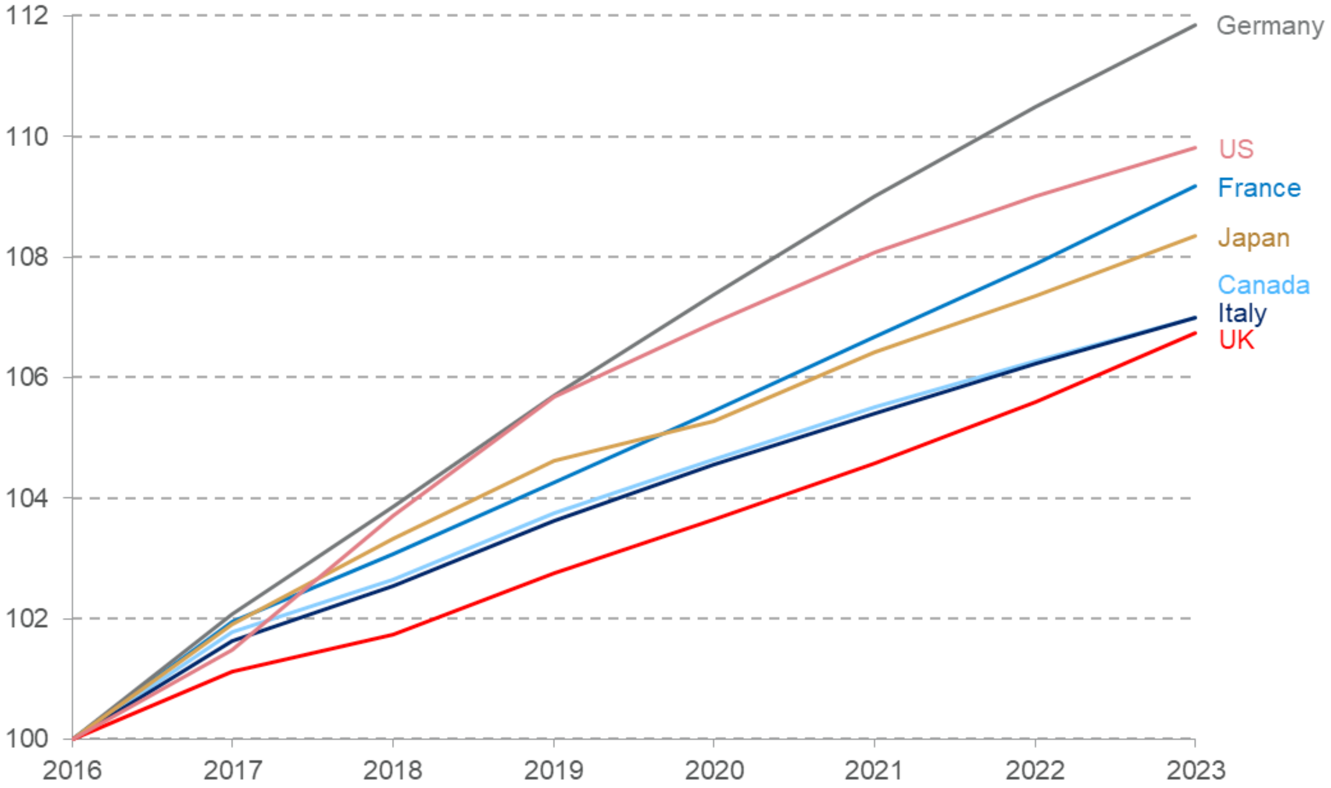


Notes: xx
Source: OBR, Economic and Fiscal Outlook, various

And UK growth projections continue to lag those in other advanced economies. Figure 20 compares the OBR's projection for GDP per capita with that produced earlier this month by the IMF in relation to the rest of G7 nations.

Figure 20: UK GDP growth is projected to lag the G7 average in the near-term

Indices of projected real-terms GDP per capita (2016 = 100)



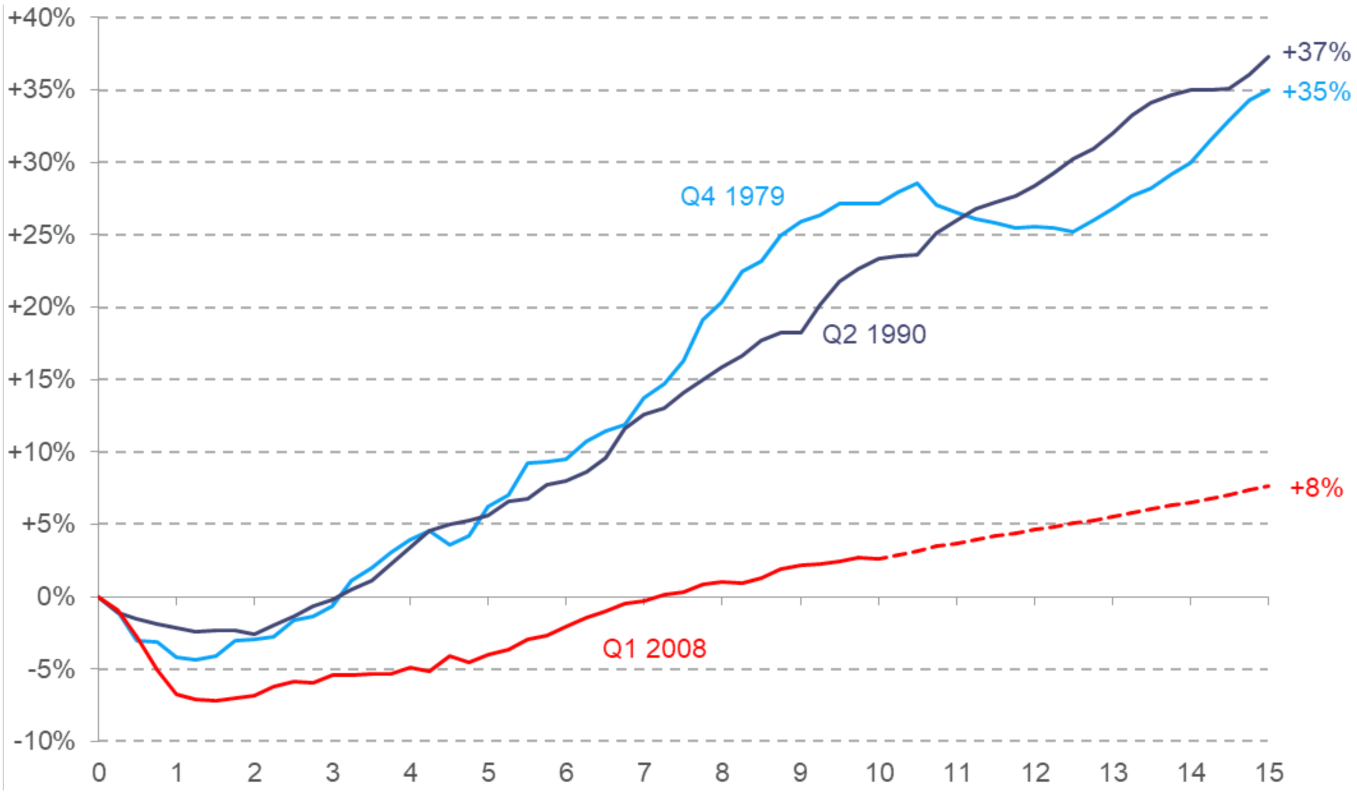
Source: OBR, Economic and Fiscal Outlook and IMF, World Economic Outlook

Near-term, UK growth is forecast to fall below many of the other advanced economies, before recording some modest catch up in the latter part of the projection period. Between 2018 and 2023, the cumulative UK growth rate is projected to be 4.9 per cent. That compares with an average in the rest of the G7 of 5.5 per cent, and a figure in the US of 5.9 per cent. Were the UK to follow the growth projected for the rest of the G7, the economy would be £12 billion larger in 2023 than the OBR is currently projecting.

To put recent economic growth into context, Figure 21 compares the pattern of the post-crisis downturn and recovery with those recorded around the recessions of 1980 and 1990. Ten years on from the start of the latest downturn, GDP per capita was just 2.6 per cent higher than the pre-crisis peak of Q1 2008. In contrast, GDP per capita had grown by 27.2 per cent at the same stage following the 1980 recession and was up 23.3 per cent ten years on from the 1990 downturn.

Figure 21: GDP per capita is set to grow by just 8 per cent over the 15 years from the start of the post-crisis downturn

Cumulative growth in real-terms GDP per capita by number of years since pre-recession peak



Source: OBR, Economic and Fiscal Outlook, various

Applying the OBR's projections for the next five years, the UK faces the prospect of recording a level of GDP per capita that is just 8 per cent higher than it was 15 years earlier – in contrast to respective growth of 35 per cent and 37 per cent following the 1980 and 1990 recessions.

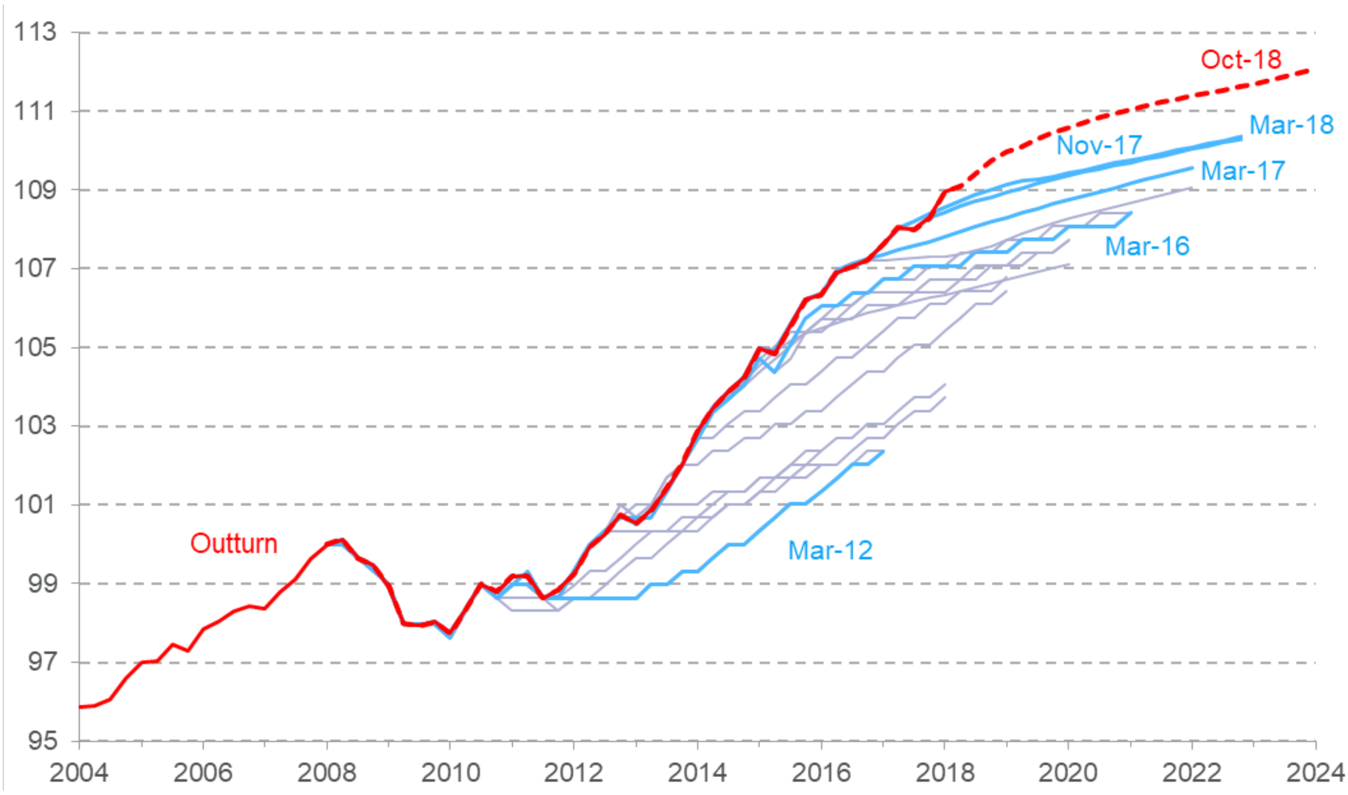
And the outlook for living standards – while little changed – remains disappointing

On living standards, the story of the last decade has been one of strong employment but weak pay growth. Yesterday's Economic and Fiscal Outlook implied that the first part of this story at least would continue over the coming years.

Following the incorporation of new data in its cohort model, the OBR is now assuming that labour market participation will be higher than expected over the course of its forecast. In addition, it has lowered its assessment of the sustainable rate of unemployment (from 4.5 per cent to 4 per cent) – reflecting the continued absence of any strong pick-up in pay pressure even as unemployment has fallen. As a result of these two revisions, the OBR now expects employment to be 400,000 higher at the end of its forecast than it did back in March, as Figure 22 shows.

Figure 22: Employment is projected to be 400,000 higher at the end of the forecast than was thought back in March

Indices of number of people in employment, 16+: outturn and successive OBR projections (Q1 2008 = 100)

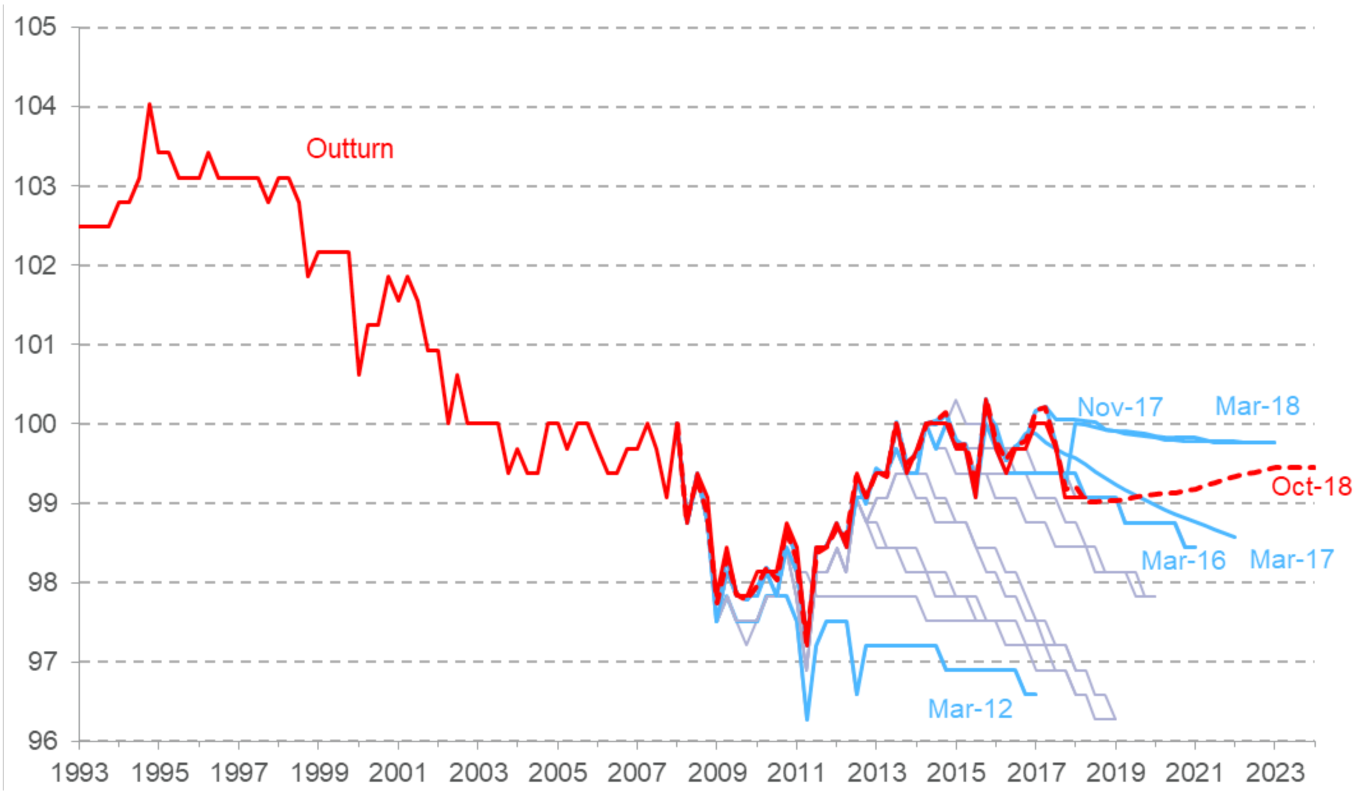


Source: OBR, Economic and Fiscal Outlook, various

However, average weekly hours of work are now expected to fall back a little relative to the Spring Statement projection. As Figure 23 set out, average hours dipped at the end of 2017. Back in March, the OBR expected a swift rebound, followed by a gentle reduction over the course of the forecast period. However, that rebound has not materialised, and the OBR is now projecting a slower pick-up over the near-term, resulting in a plateau by the end of the period that comes in below the March forecast.

Figure 23: Average hours have failed to rebound since the end of 2017, resulting in a lower projection for the coming years

Indices of average weekly hours of work: outturn and successive OBR projections (Q1 2008 = 100)

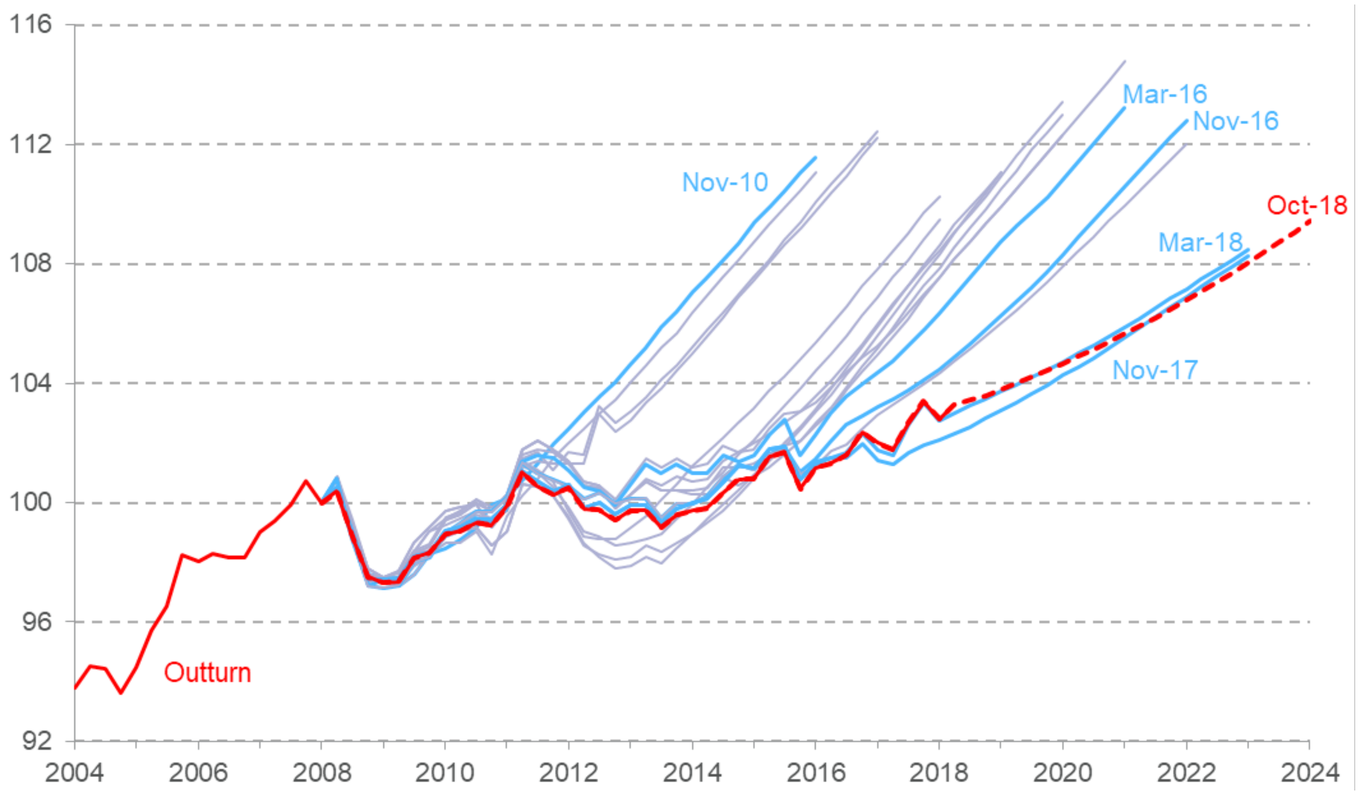


Source: OBR, Economic and Fiscal Outlook, various

The outlook for hourly pay growth rests, as ever, with prospects for productivity growth. The OBR regularly acknowledges that its projection for growth in output per hour is both the "most important", yet "most uncertain" element of its forecast for the economy. And, following a near-decade of post-crisis stagnation, it lowered its forecast for trend productivity growth to reflect an assumption that we should no longer expect to simply return to the pre-crisis 'norm'. This remains the basis of the OBR's projection, with little changing in the latest Outlook relative to March, as highlighted in Figure 24.

Figure 24: The productivity growth projection is little changed from March

Indices of non-oil GVA per hour: outturn and successive OBR projections (Q1 2008 = 100)



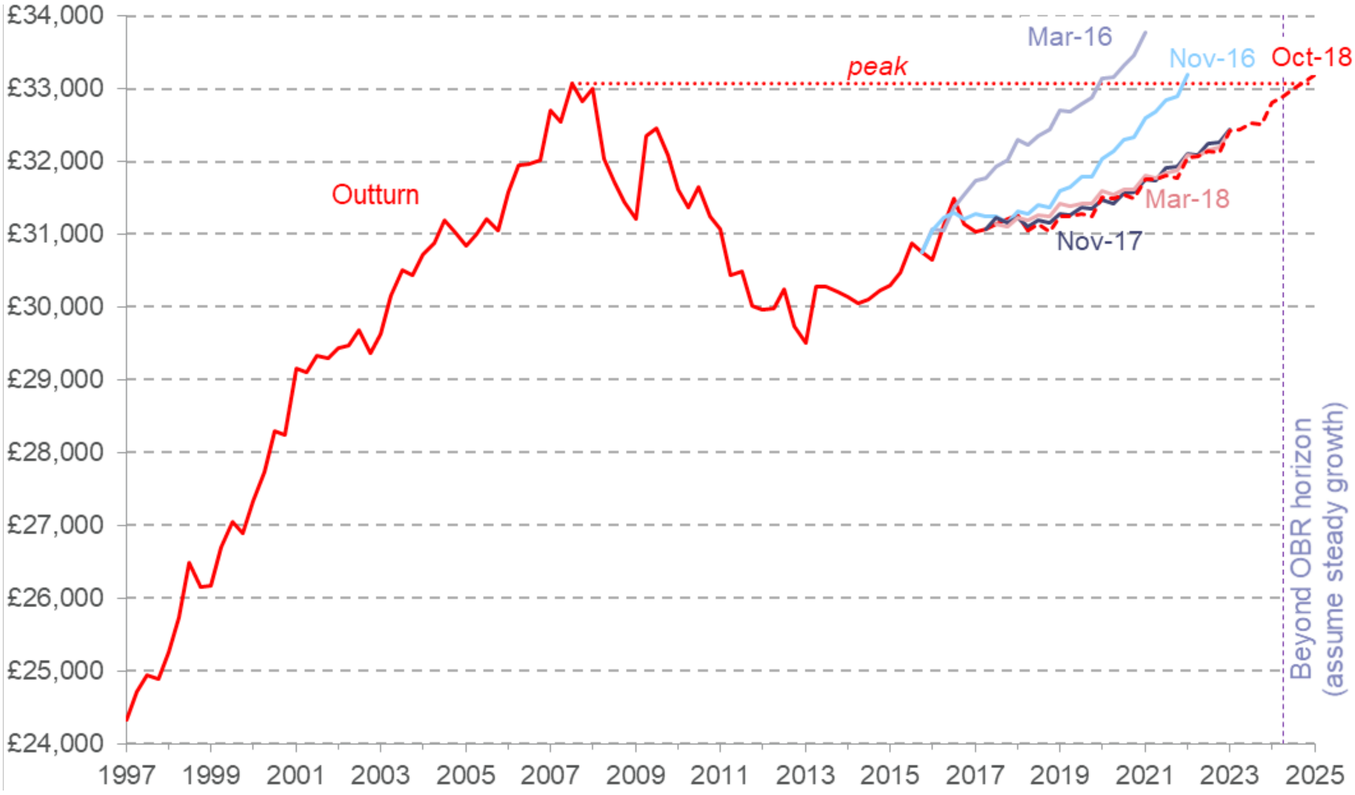
Source: OBR, Economic and Fiscal Outlook, various

With the inflation projection also little altered since March (though marginally higher over most of the forecast period), there is no real change in the forecast for average real-terms earnings growth in the latest Outlook.

There is good news with the confirmation that the National Living Wage will rise to £8.21 next April, and it is encouraging to hear the government talk about the prospect of ending low pay altogether. But the OBR continues to expect sluggish average wage growth. Figure 25 compares the latest forecast with those in place at other recent fiscal events. It shows that projected average pay growth remains significantly lower than prevailed in either March 2016 or November 2016. Average earnings are now expected to be around £50 a year lower at the start of 2022 than had been forecast in March, but £1,150 lower than the November 2016 Outlook implied.

Figure 25: The recovery in real-terms annual pay appears unchanged, with the pre-crisis peak not restored until the end of 2024

Average annual employee earnings, CPI-adjusted: outturn and successive OBR projections (2018-19 prices)



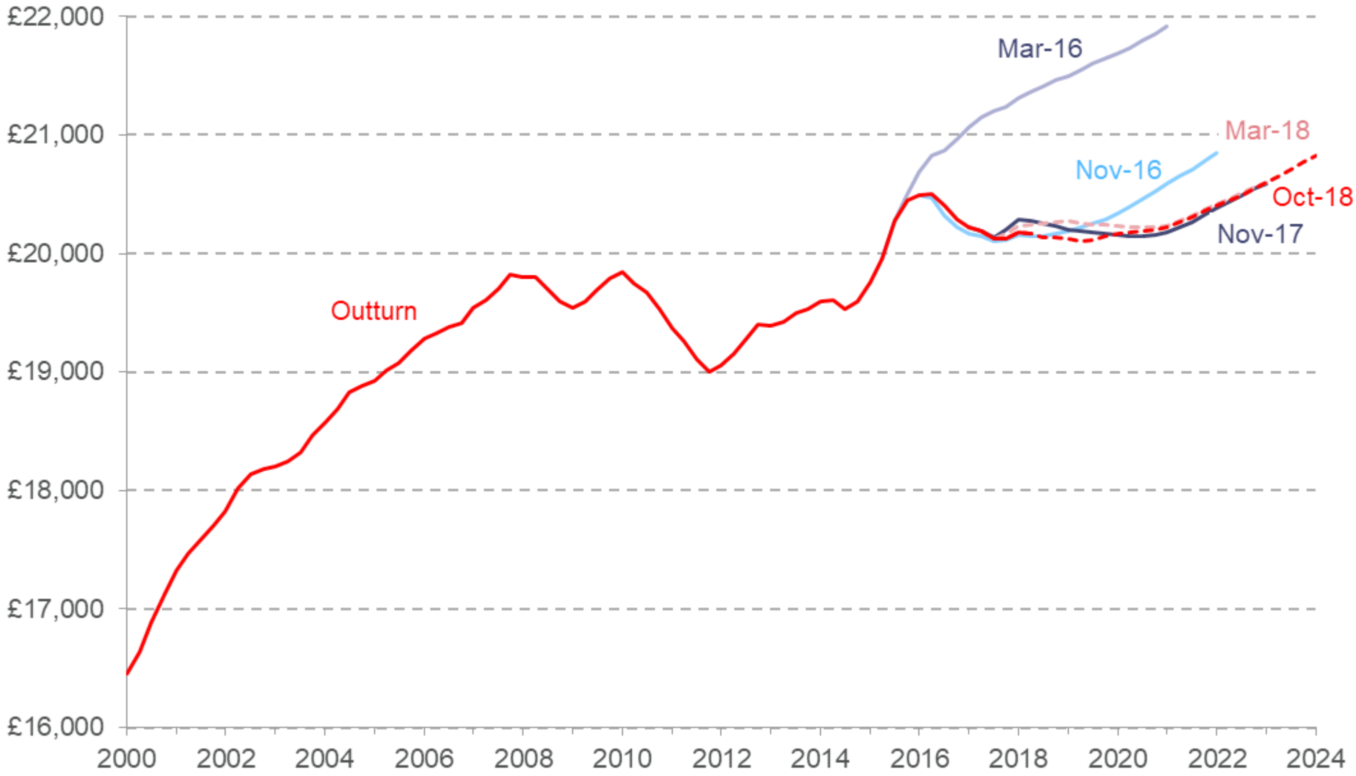
Source: OBR, Economic and Fiscal Outlook, various

And the point at which average earnings return to their pre-crisis peak remains some way off, with the cross-over now due to arrive at the end of 2024. Beyond the OBR's projection period, we assume that real-terms pay growth continues to rise at the same pace as in the final year of the forecast. This approach implies that average wages won't return to their pre-crisis peak until the end of 2024 – broadly as projected in March. That means UK workers are projected to have faced to face a 17-year period of lost growth on pay.

It's a similar picture on incomes, as shown in Figure 26. Taking together the OBR's projections for higher employment, lower hours and sluggish pay growth, along with changes in government tax and benefit policy, average real-terms incomes per person are projected to remain broadly flat over the next three years. Average real-terms income per person stood at £20,170 in Q2 2018 and is expected to rise by just £60 by the start of 2021. At the time of the March 2016 Economic and Fiscal Outlook, average per person income was expected to be £21,920 in Q1 2021 – some £1,690 higher than the latest projection suggests.

Figure 26: Household incomes are expected to continue to flat-line in the near-term, only passing their previous peak at the end of 2022

Annualised real household disposable income per capita: outturn and successive OBR projections (CVM)



Source: OBR, Economic and Fiscal Outlook, various

Household incomes are projected to start rising again from 2021, but will only return to their Q2 2016 peak at the end of 2022.

Conclusion

The Chancellor was given a seemingly impossible task ahead of the Budget, 'ending austerity' as per the Prime Minister's promise while keeping debt falling as a share of GDP. Ultimately he didn't achieve the first goal, but he did signal a very significant easing of austerity. That he was able to make such progress without having to rely on significant tax rises – indeed, he was able to deliver some tax cuts – owes much to the major windfall the OBR provided him with.

Yet tougher choices will inevitably have to be made in the coming years. A combination of delivering Brexit, lowering debt, supporting households left underwhelmed by the pace of living standards growth and dealing with demographic headwinds all point to a job that – like ending austerity itself – is not yet complete.

Resolution Foundation

Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:

- *undertaking research and economic analysis to understand the challenges facing people on a low to middle income;*
- *developing practical and effective policy proposals; and*
- *engaging with policy makers and stakeholders to influence decision-making and bring about change.*

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