O, Blessed Revisions

Fiscal windfall and what to do with it

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November 2015

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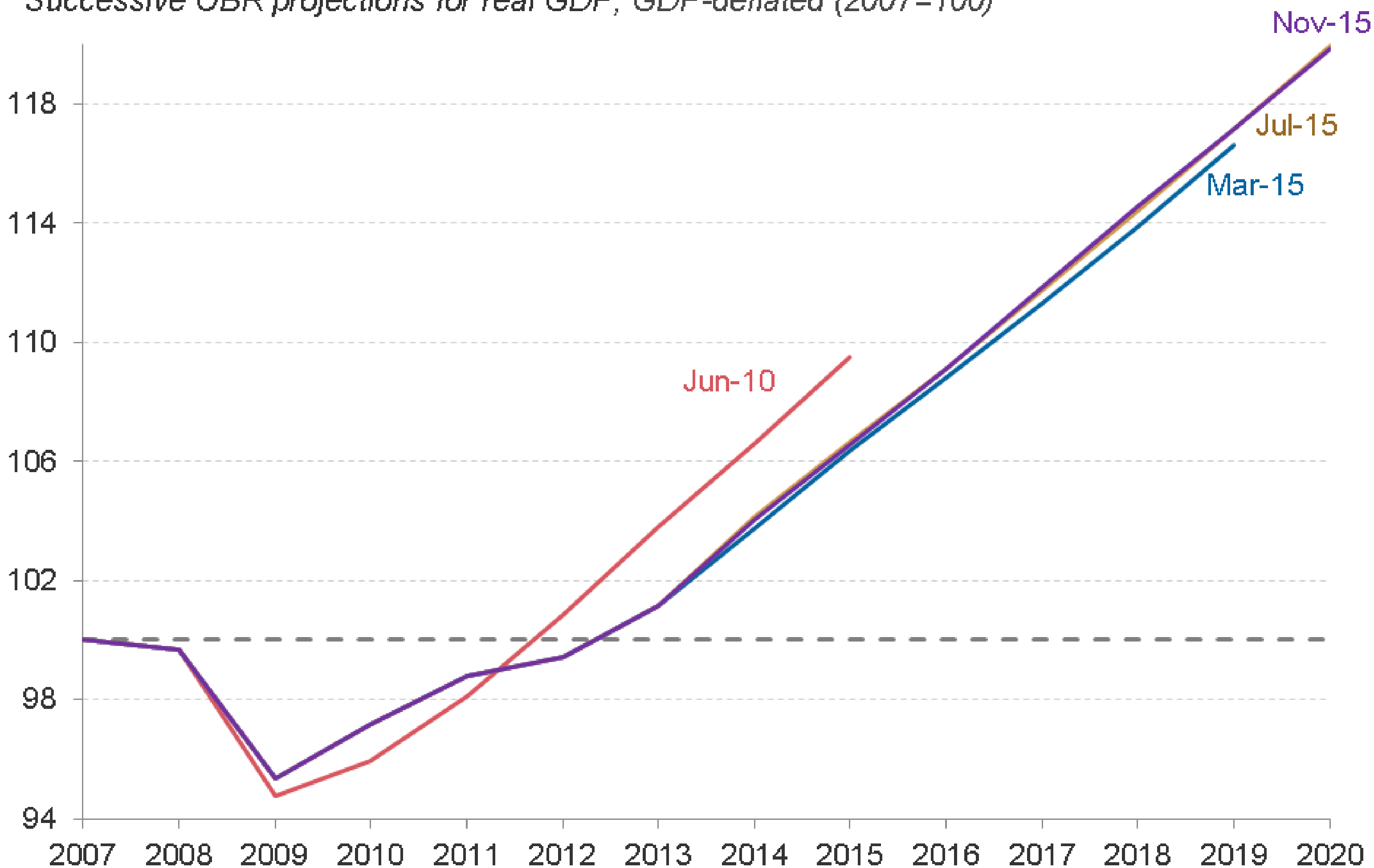
THE ECONOMIC OUTLOOK

Growth unchanged, but earnings and income projections downgraded

Very little difference between July and November GDP projections

Successive OBR projections for real GDP, GDP-deflated (2007=100)



OBR growth forecasts were pushed outwards over the course of the last parliament

The outlook improved slightly between the March and July Budgets, but very little changed yesterday

But projection for household income growth was pushed outwards again

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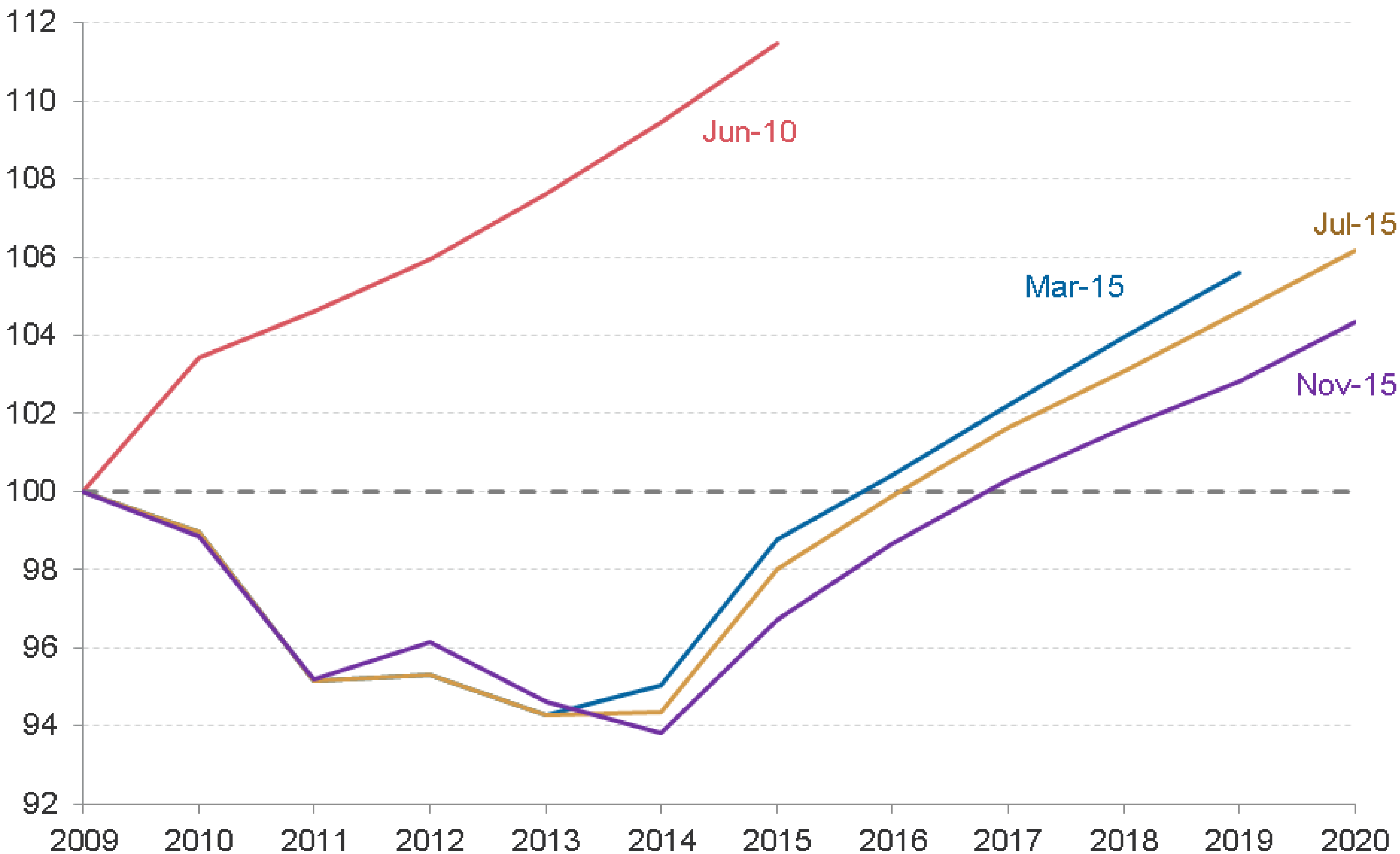
Successive OBR projections for real-terms per capita hhold income, CPI adjusted (2009=100)



Despite the unchanged GDP picture, the OBR again downgraded its projection for disposable household income growth

Weaker than expected growth in 2014-15 means average income is projected to be just 4% higher than 2009 in 2020

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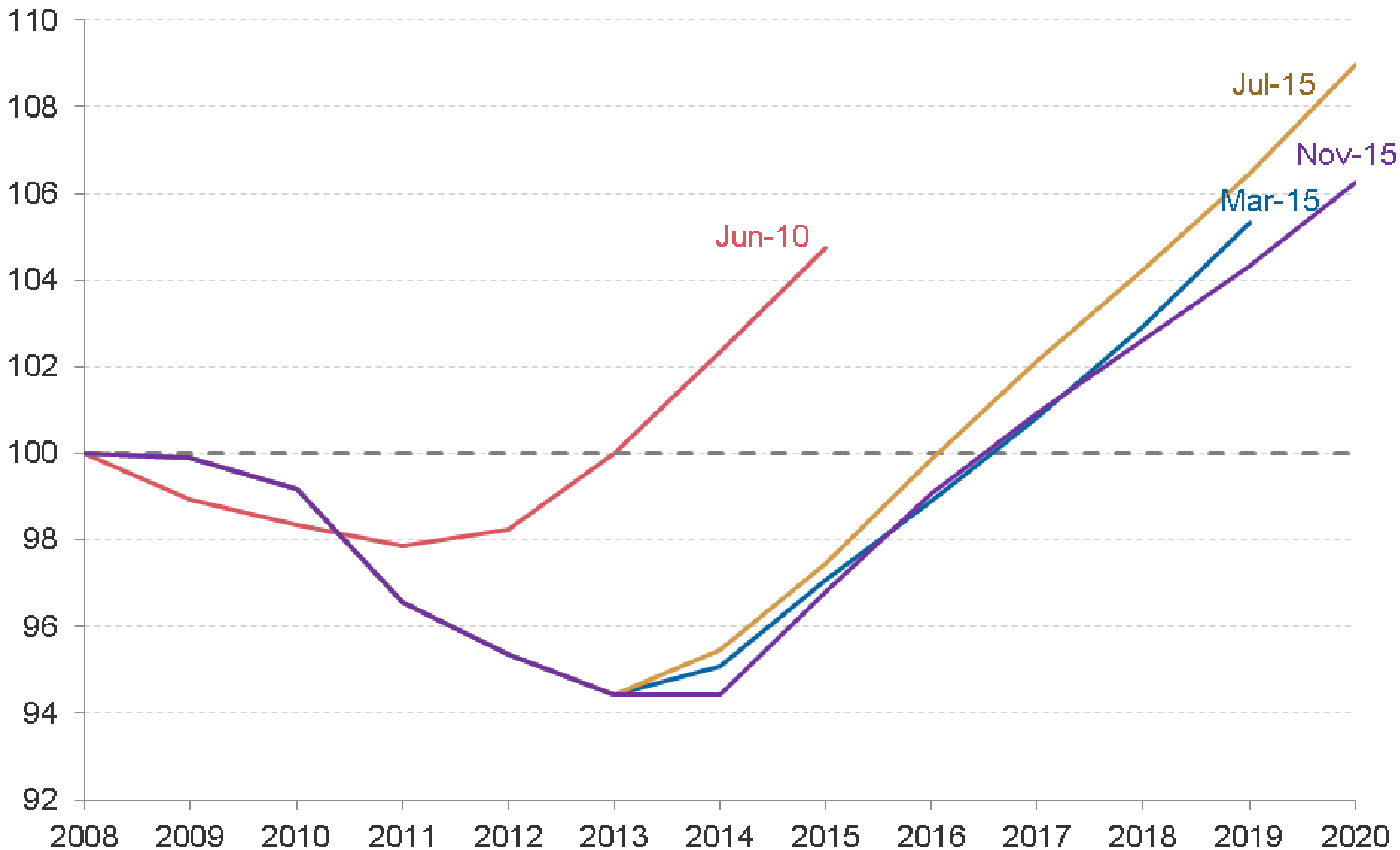
As was projection for average weekly wage growth

Successive OBR projections for real average earnings growth, CPI adjusted (2008=100)



Growth has been downgraded in 2014 (outturn) and from 2017 onwards (projection)

The OBR states that the weaker future path is in part due to the application of the apprenticeship levy which acts as a payroll tax

Meaning that *typical* pay is unlikely to return to its 2009 peak until the end of the decade

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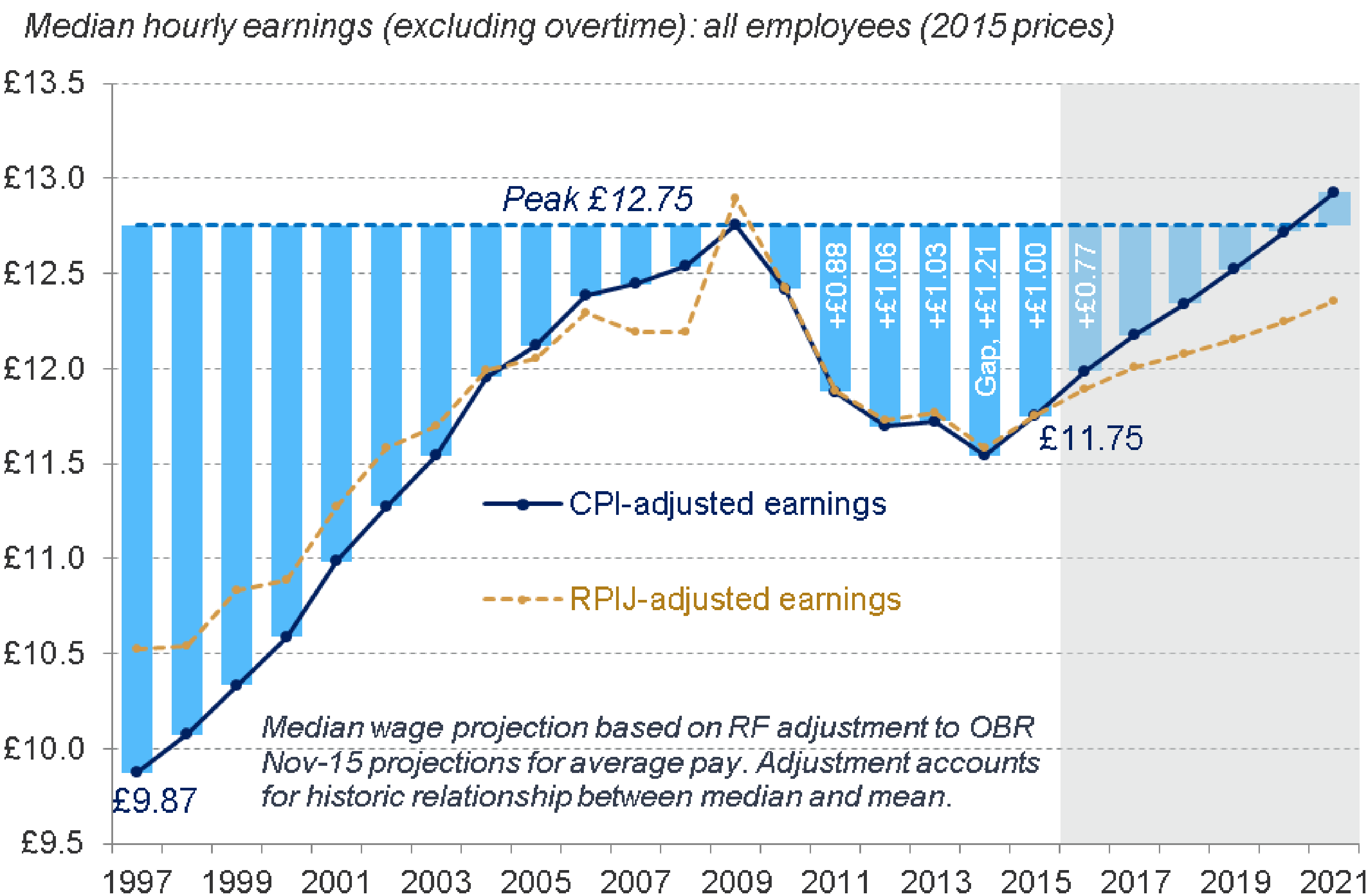
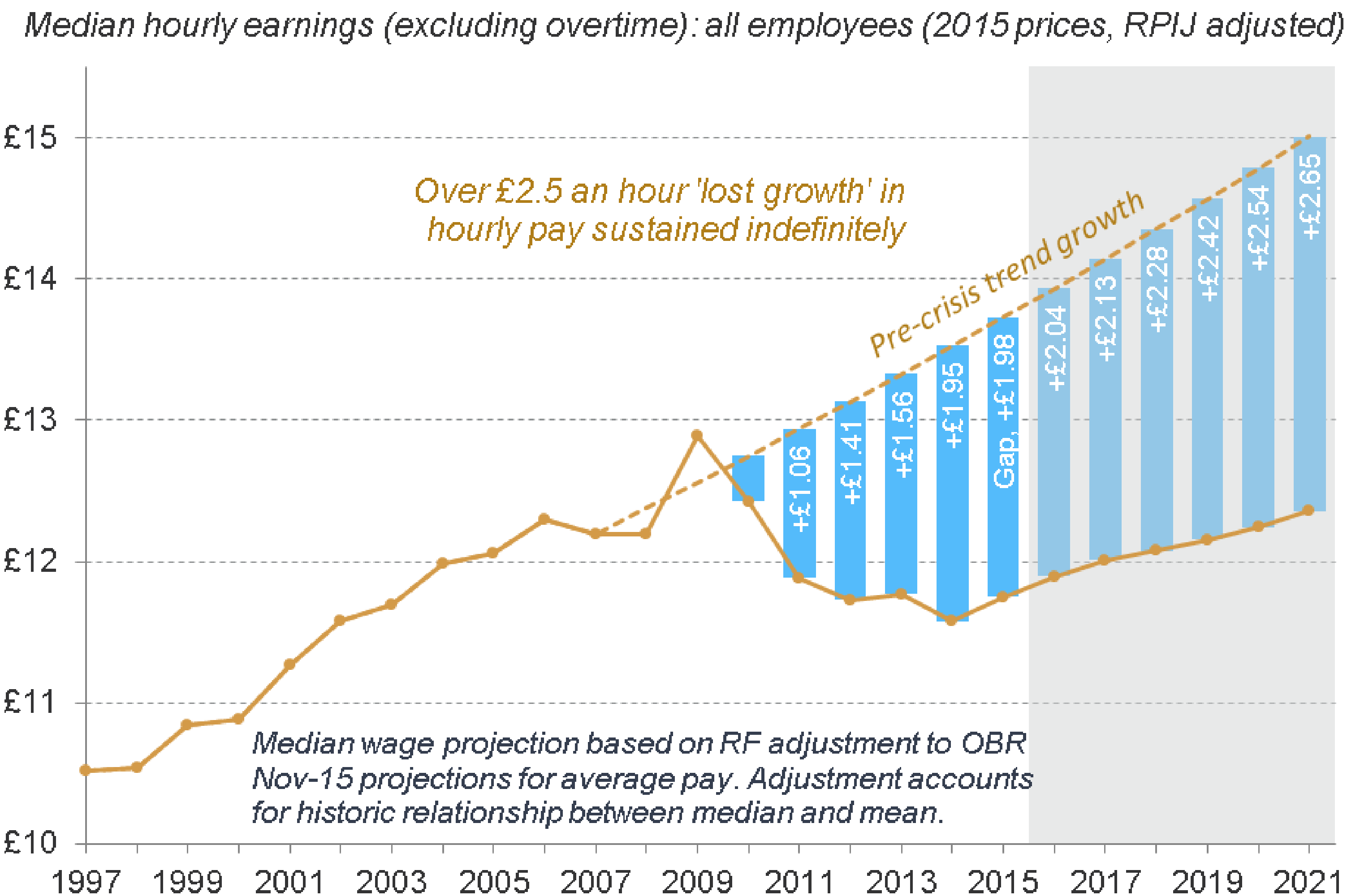


RF projection covers OBR average weekly figure into a median hourly one and implies more than a decade of lost wage growth

Measured against an RF projection for RPIJ, wage recovery looks even further away

And there appears to be no sign of any sustained 'catch-up' in pay growth

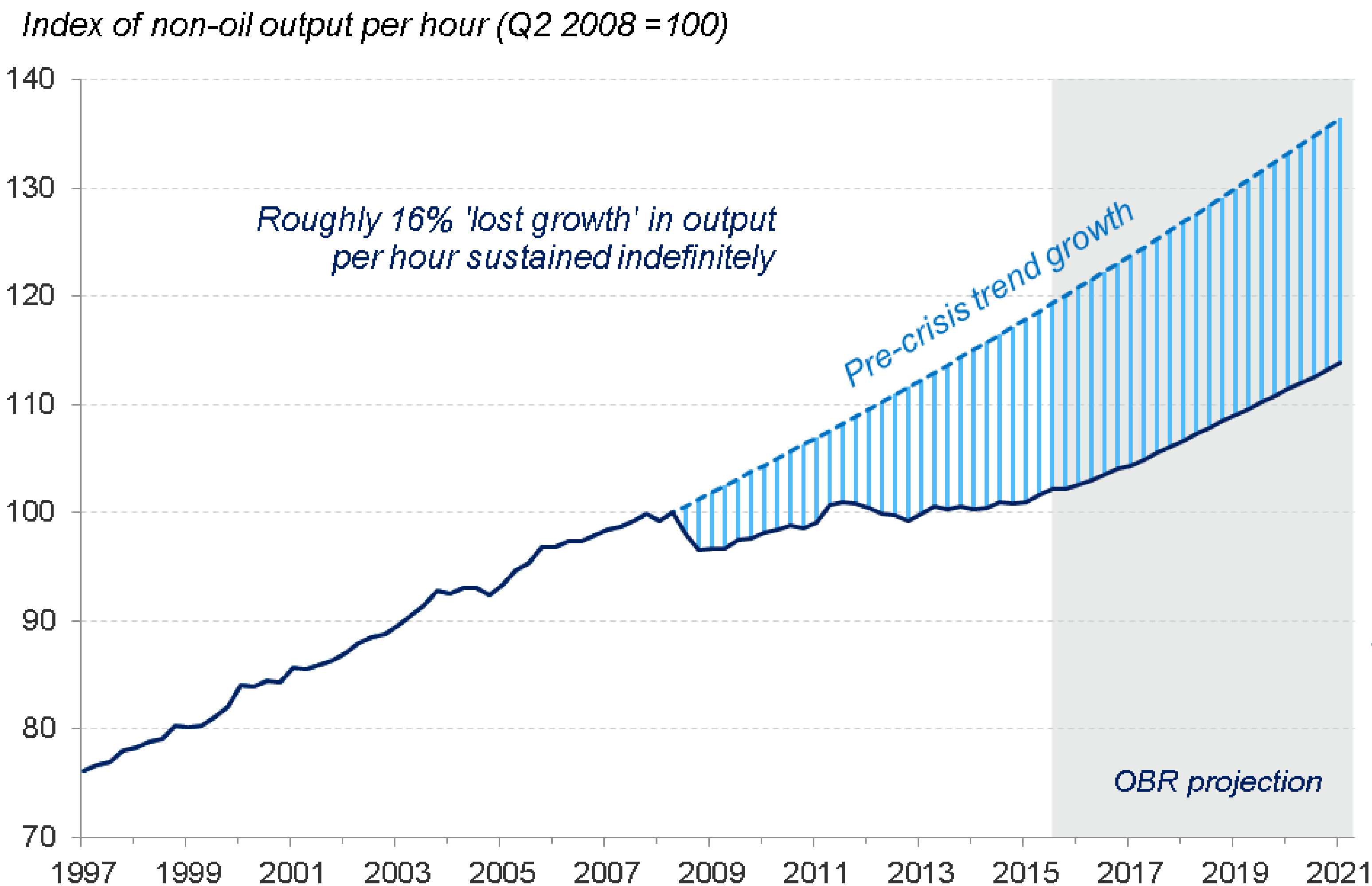
RF



Real-terms growth in average weekly earnings has been above pre-crisis trend over much of 2015. But that effect is set to disappear as inflation heads back towards target

The absence of a 'bounce' means the crisis has created a permanent 'pay gap'

Corresponding to a permanent reduction in UK productivity



Productivity growth has started to return but is not yet back to trend

The OBR projection (which has been marginally downgraded) suggests it will remain slightly below trend over the forecast period

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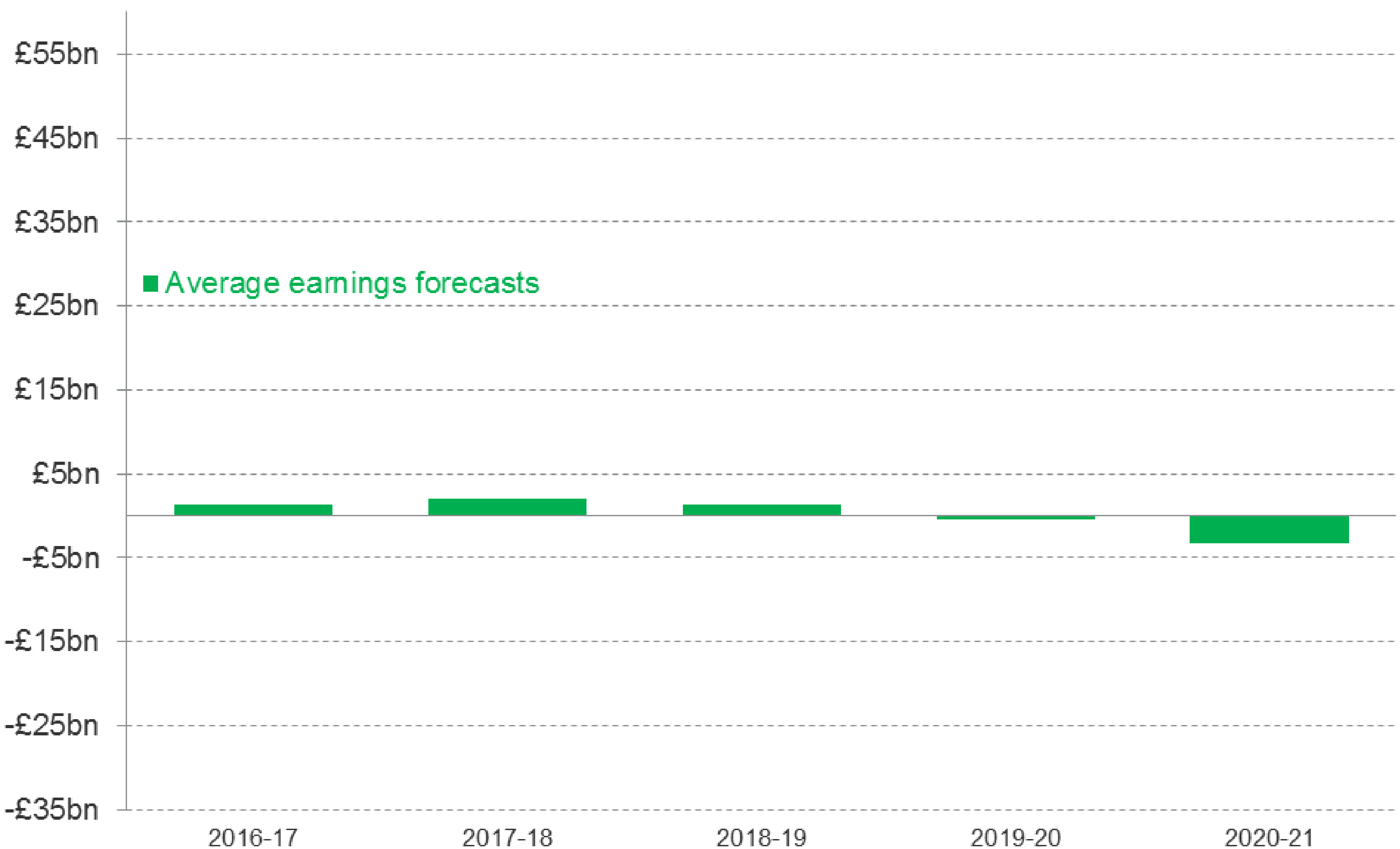
THE PUBLIC FINANCES OUTLOOK

Exploring the 'fiscal windfall'

Weaker pay growth reduces projected tax receipts relative to the July Budget

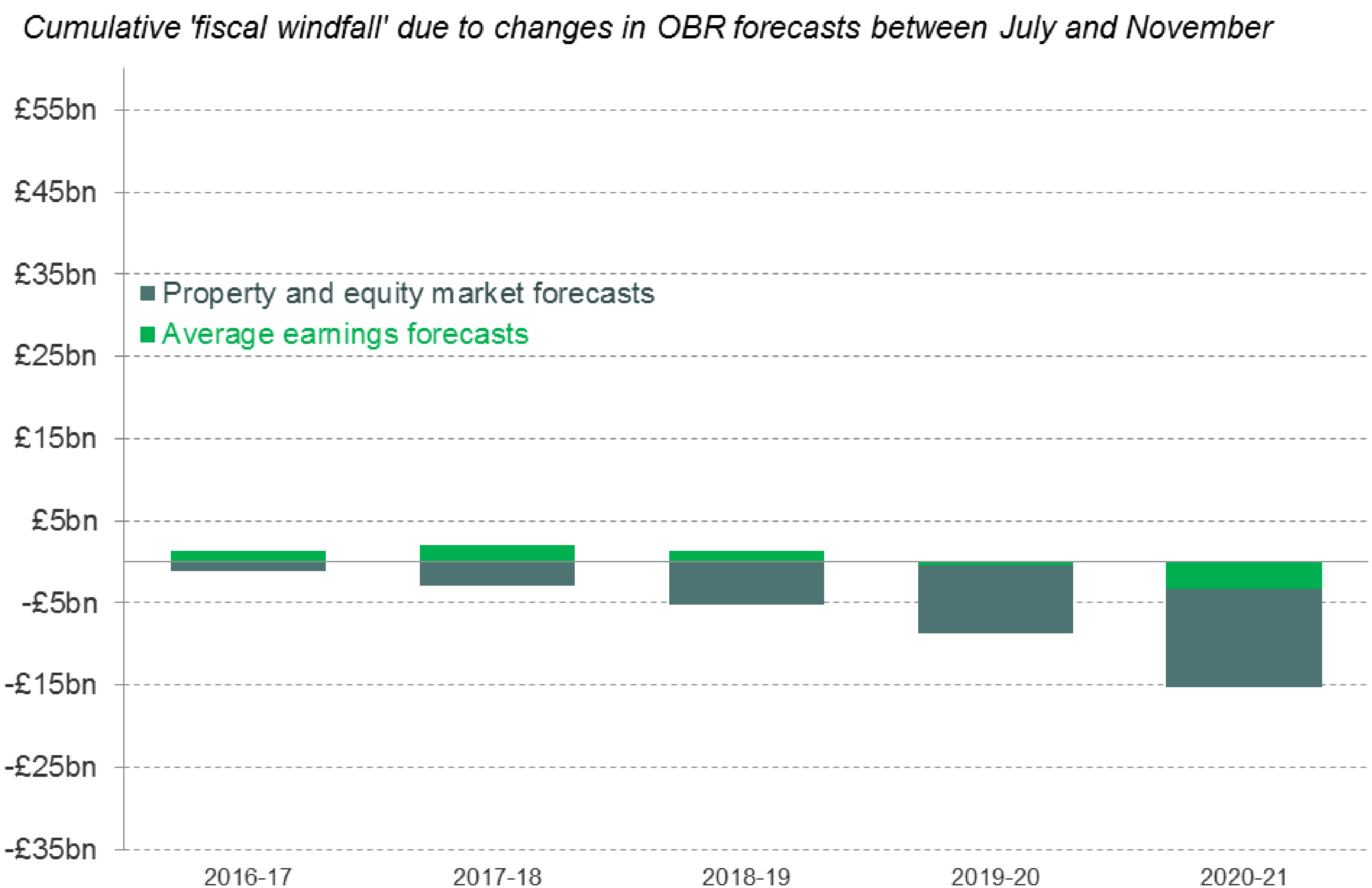
Cumulative 'fiscal windfall' due to changes in OBR forecasts between July and November



Tax receipts related to earnings forecasts are projected to be a little higher in the near-term than in July

But slower wage growth creates a cumulative drag of £3.3bn by 2020-21

Weaker forecasts for housing transactions and equity markets reduce receipts further



Revised forecasts for property and equity market performance increases the cumulative drag to around £15bn by 2020-21

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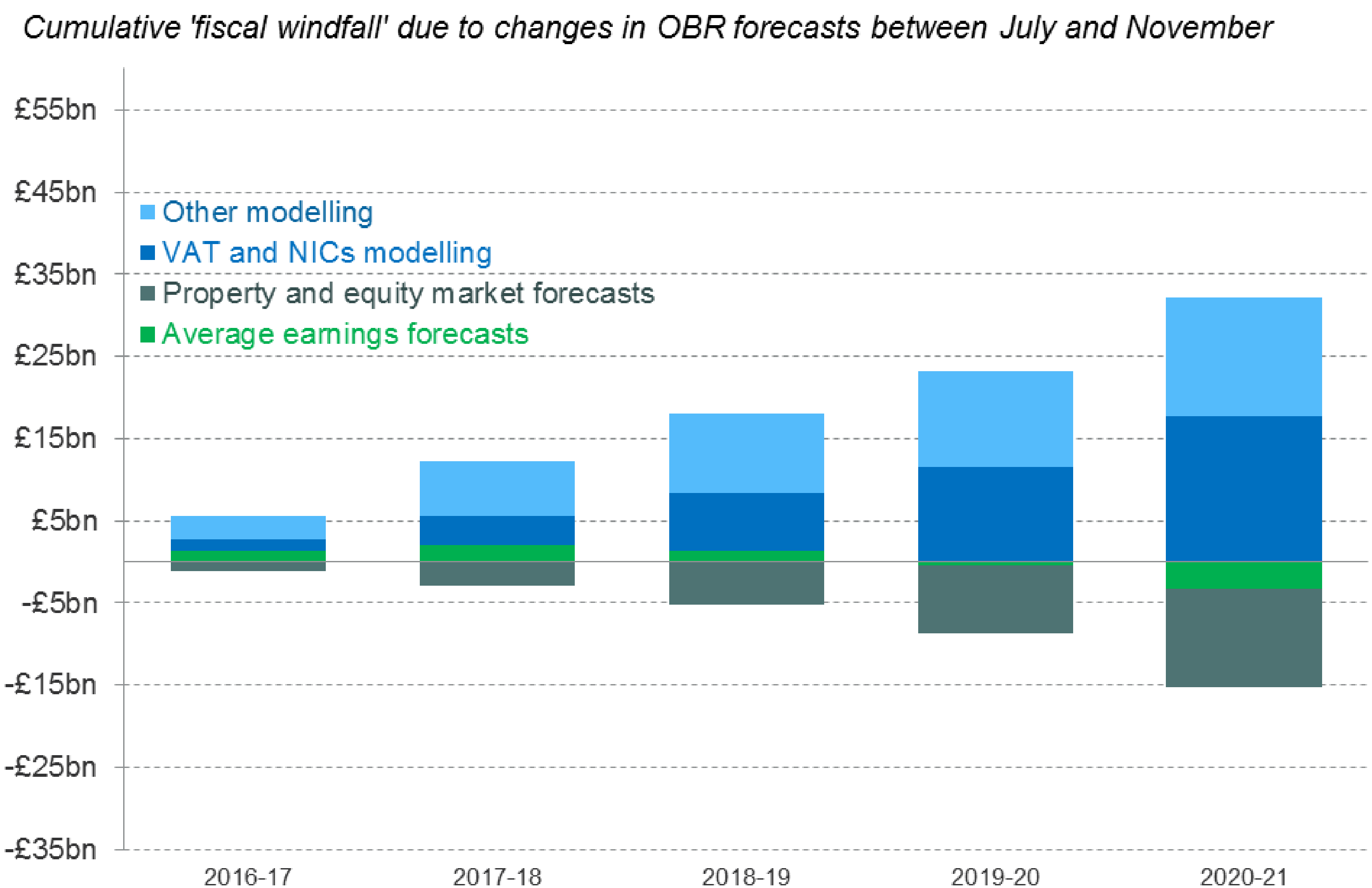
But changes in OBR modelling provide a more than offsetting fiscal boost



OBR changes correct for longstanding problem with VAT deduction modelling and align NICs model with HMRC version

Other modelling changes relate to income tax and corporation tax receipts

Together, these changes provide an £18.9bn boost

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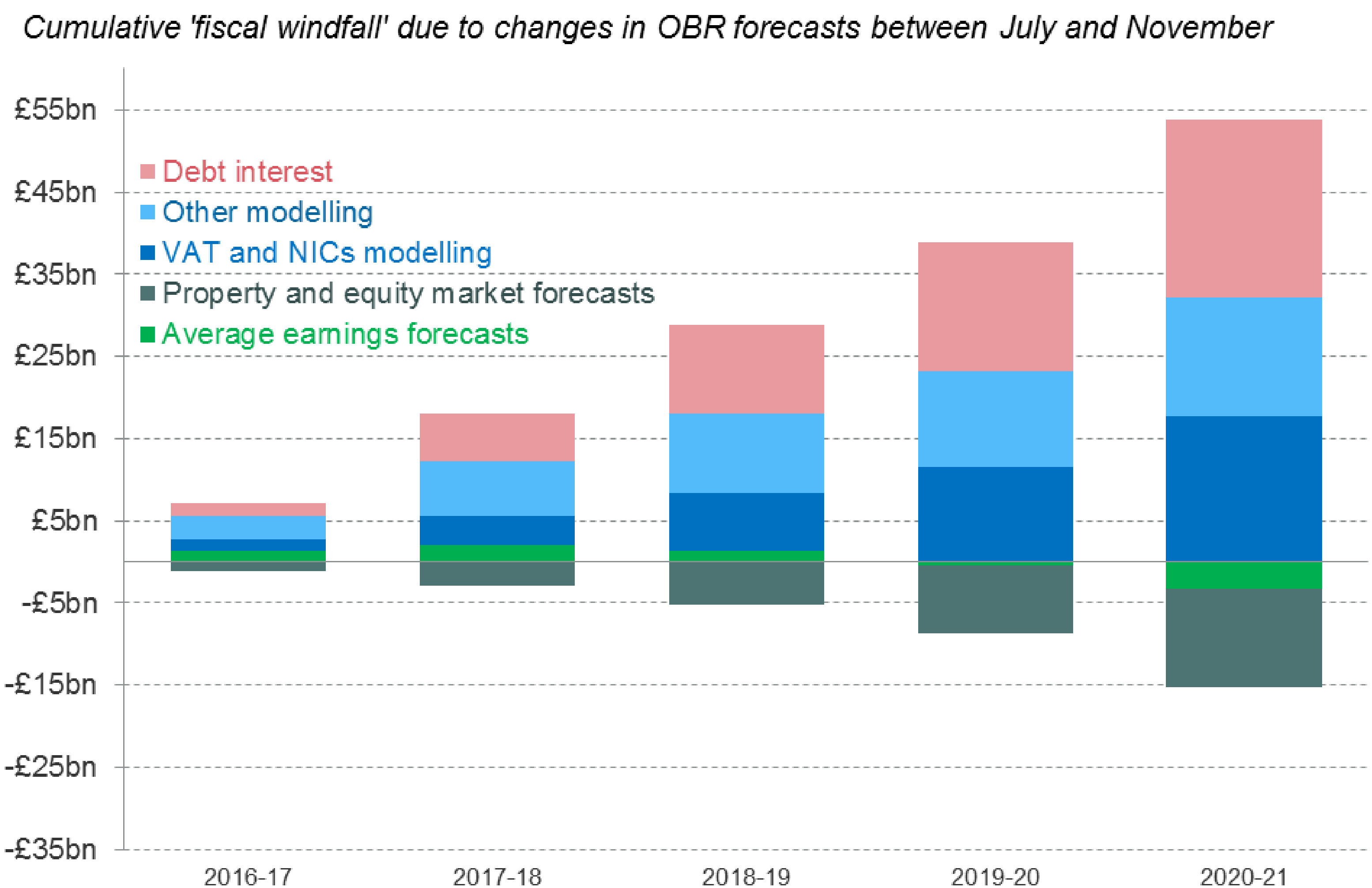
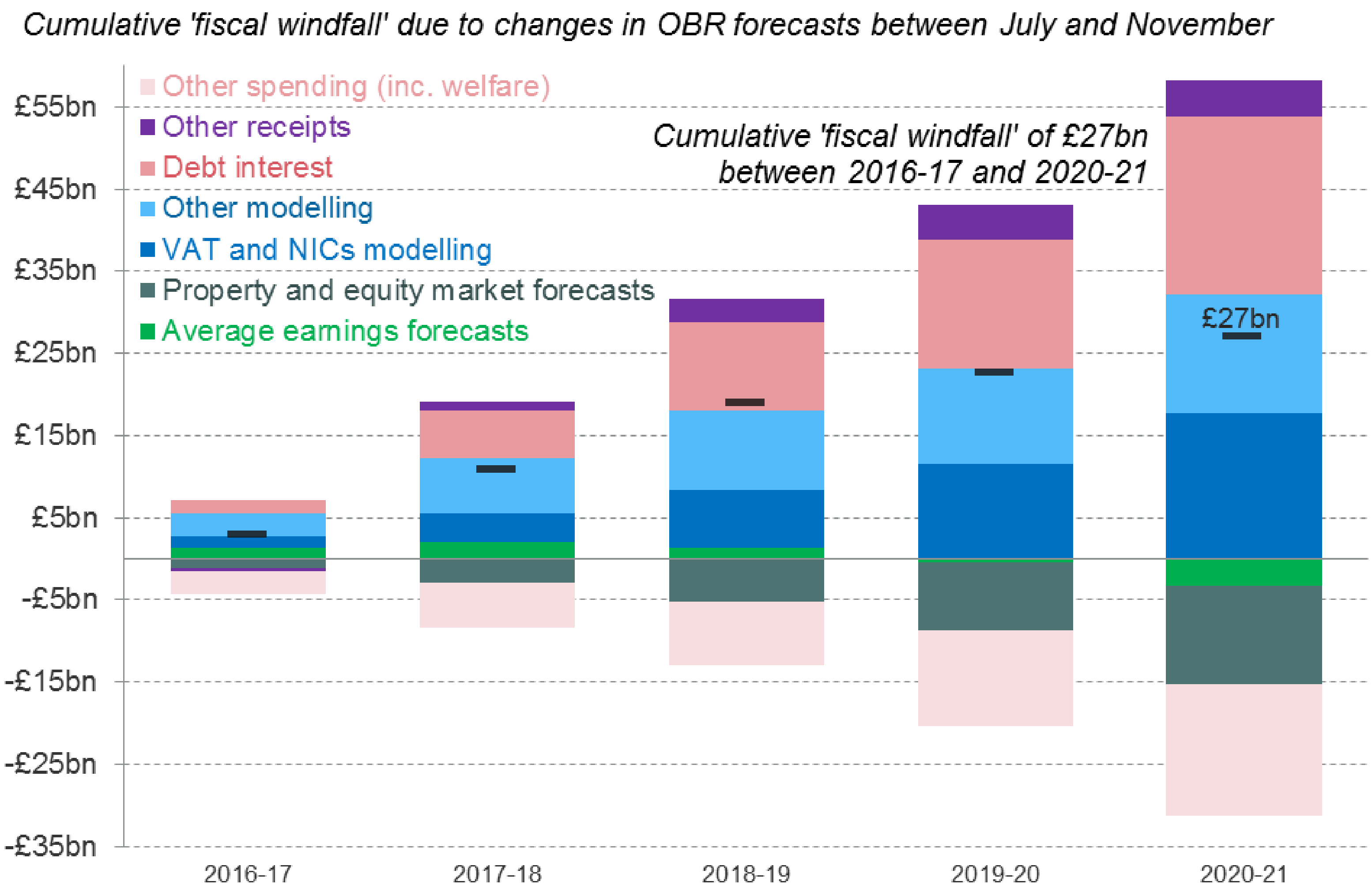
Lower interest rate assumptions significantly reduce debt interest costs



The fiscal boost associated with lower debt interest payments builds each year over the forecast period – from £1.7bn in 2016-17 to £6bn by 2020-21

This produces a cumulative boost of £21.7bn by 2020-21

Adding in other forecasting changes results in an overall 'fiscal windfall' of £27bn



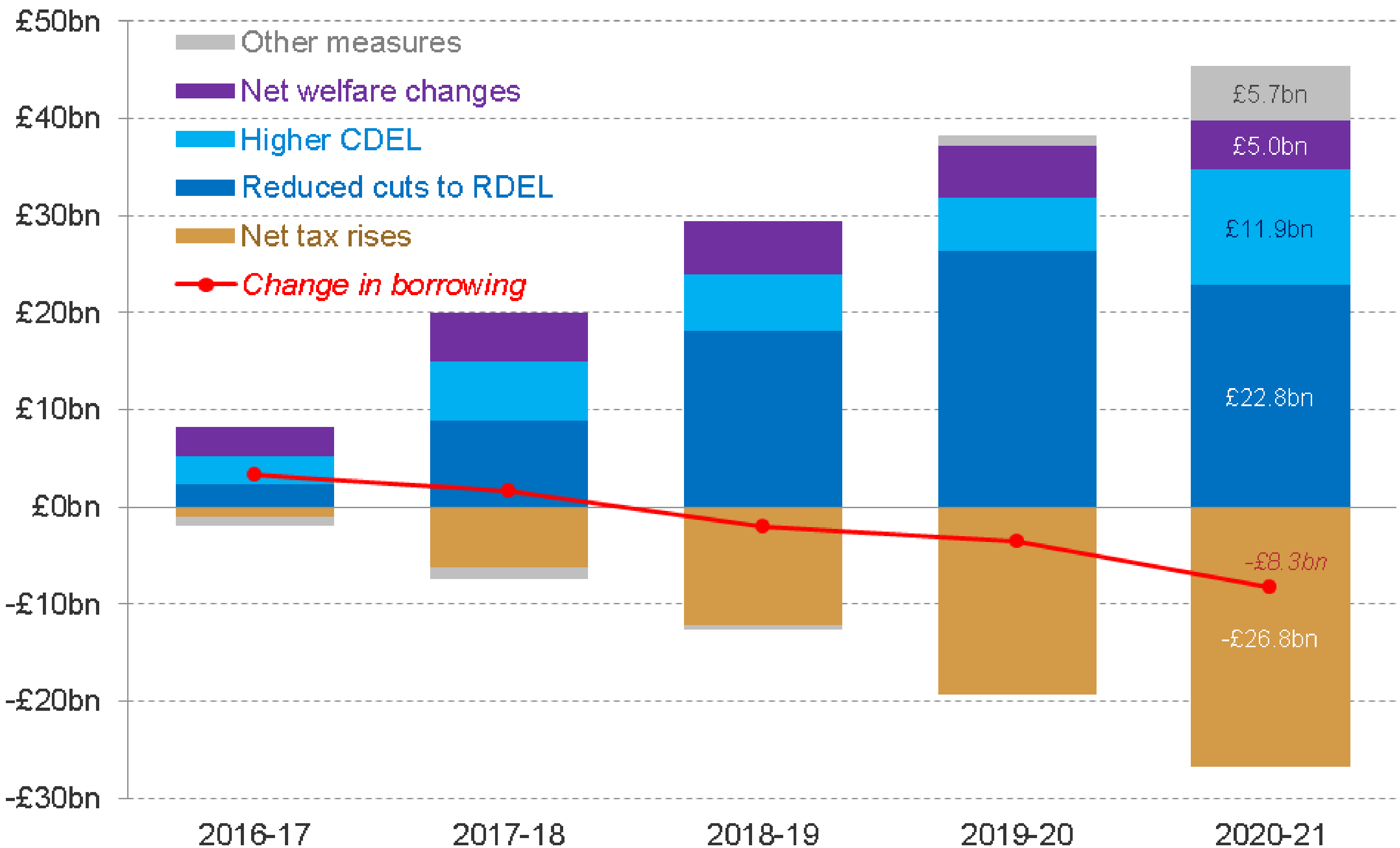
The VAT and NICs modelling accounts for 2/3 of the overall £27bn boost by 2020-21

Removing all of the modelling changes would entirely remove the fiscal boost

These are improvements, but uncertainty of such modelling is very clear

With around 2/3 of that £27bn windfall set to be spent

Cumulative costs/savings associated with AS and SR policy measures



Policy measures in AS2015 and SR2015 represent a net £18.7bn giveaway between 2016-17 and 2020-21, representing just over 2/3 of the £27bn windfall

The remaining £8.3bn is used to reduce cumulative borrowing, but the giveaways are front-loaded

TAXES AND BENEFITS

TCs U-turn; UC no-turn

Very welcome reversal of the Summer Budget tax credit cuts, but no change in UC

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Govt reversed most controversial elements of tax credit cuts (reduction in income threshold and increase in taper)

Cumulative cost of £9.3bn, but 2020-21 in-year cost of just £465m

Didn't reverse:

- Cash freeze in value of benefits
- Reduction in income rise disregard
- Reduced eligibility for new claims (loss of family element and two child rule)
- Reduction in work allowances in Universal Credit

Introduced:

- Uprating of Minimum Income Floor for s/e in line with NLW
- Tightened childcare eligibility criteria
- Housing Benefit savings

Delaying, but not eradicating, large entitlement reductions among 3m working households

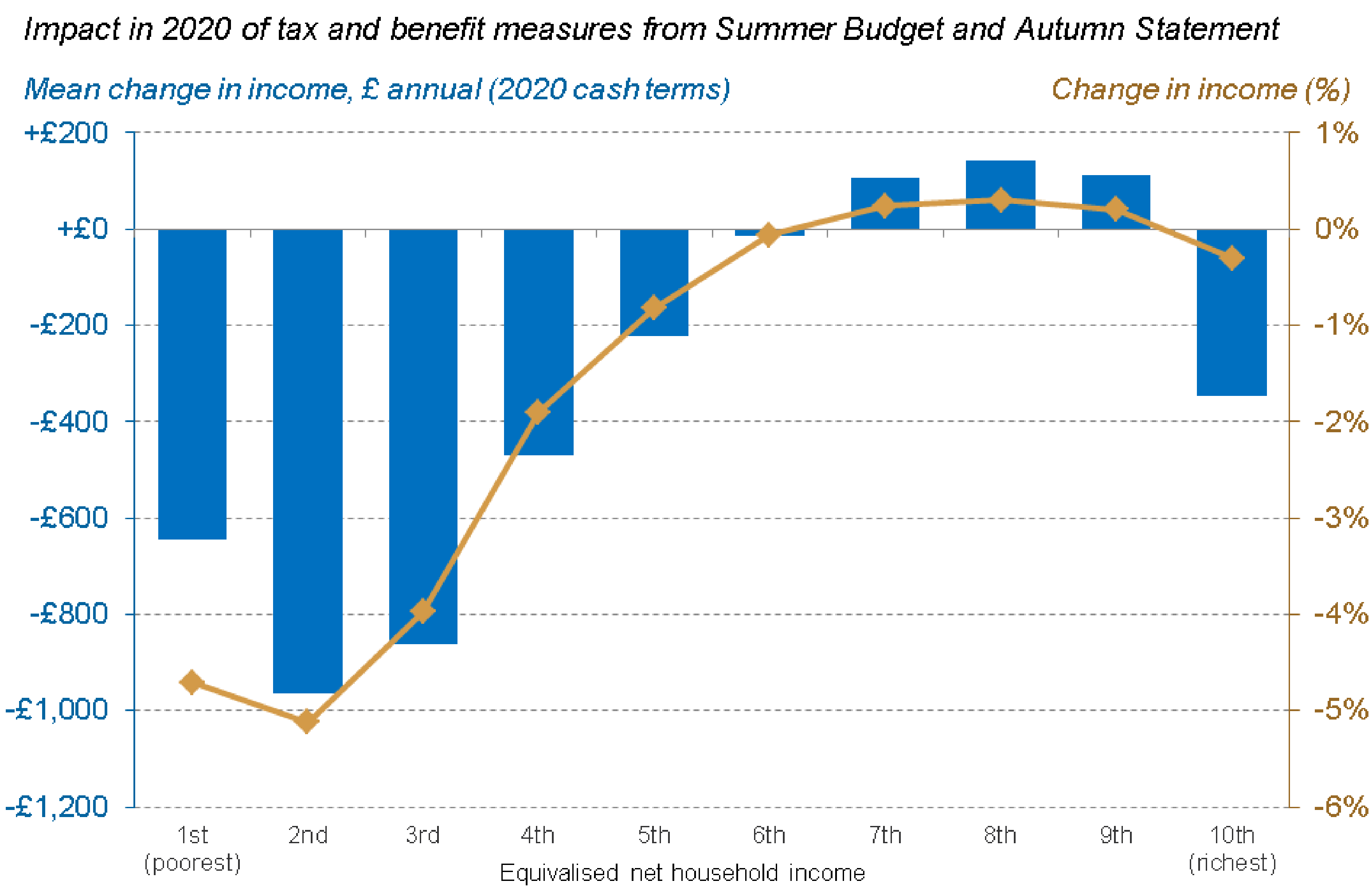
Pre-Autumn Statement

- Tax credit cuts meant 3.3m working households were set to lose an average of £1,300 in April 2016
- Gradual roll-out of UC meant that by 2020, losses would be a function of the UC work allowance cuts, the cash freeze in benefits and reductions in family support

Post-Autumn Statement

- April 2016 losses are now avoided, but the final outcome is largely unchanged: working households on UC will continue to face a reduced entitlement once UC is fully implemented
- Even after accounting for the NLW and tax cuts, the full suite of Summer Budget and Autumn Statement changes will produce average losses for working UC recipients of around £1,000 in 2020
- That rises to £1,300 for working families with children

Once fully implemented, the remaining cuts leave bottom half hholds £650 worse off on average



Claimants moved from tax credits to UC under 'managed transition' will benefit from welcome transitional protection in cash terms

But OBR projections show those protections won't apply to the vast majority of UC claimants in this parliament

Notes: Assumes UC fully in place. Accounts for: increases to the PTA and HRT in Apr-16 and Apr-17; pensions tax relief restriction; UC work allowances cuts, working-age benefit freeze; limiting social rents to LHA rates; full implementation of new claimant 'flow' effects. Also accounts for introduction of NLW. Source: Resolution Foundation analysis using the IPPR tax-benefit model

And some families faring much worse

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Impact of 2015 Summer Budget and Autumn Statement on net incomes for different family types, Universal Credit system, 2020, £cash

	pre-Summer Budget		*post-Autumn Statement*		*Change*	
Description	Gross household earnings	Net household income	Gross household earnings	Net household income	Gross household earnings	Net household income
Single (no kids), full-time, wage floor, renter *works 35 hours a week at wage floor, rent £80 a week*	£14,780	£13,470	£16,970	£14,610	+£2,190	+£1,150
Single (1 child), part-time, wage floor *works 20 hours a week at wage floor*	£8,450	£16,280	£9,700	£13,480	+£1,250	-£2,800
Single (1 child), full-time, low earning *works 37.5 hours a week at £11.50 an hour*	£22,640	£20,450	£22,640	£18,930	+£0	-£1,530
Couple (2 kids), wage floor *main earner works 37.5 hours a week, second earner works 20 hours, both earn wage floor*	£24,290	£25,890	£27,880	£25,840	+£3,600	-£50
Couple (3 kids), wage floor *main earner works 37.5 hours a week, second earner works 20 hours, both earn wage floor*	£24,290	£29,620	£27,880	£26,560	+£3,600	-£3,060
Couple (2 kids), low earning, renters *main earner works 37.5 hours a week earning £11.50 an hour, second earner works 20 hours earning wage floor, rent £170 a week*	£31,090	£33,690	£32,340	£32,590	+£1,250	-£1,100
Couple (2 kids), mid earning *both work 37.5 hours a week earning £14.50 an hour*	£56,590	£45,830	£56,590	£45,800	+£0	-£30
Couple (2 kids), high earning *main earner works 37.5 hours earning £40.50 an hour, second earner works 20 hours a week earning £23 an hour*	£103,350	£72,370	£103,350	£72,490	+£0	+£120
Couple (no kids), very high earning *both work 37.5 hours a week and both earn £40.50 an hour*	£158,420	£106,460	£158,420	£106,620	+£0	+£150

Notes: Figures relate to modelled hypothetical outcomes in 2020-21 on the assumption that these families are on Universal Credit and are making a new claim. All figures are presented in cash terms. Impacts cover the effects of direct tax and benefit changes, but assume no behavioural change or dynamic effects. Wage floors reflect OBR projections for 2020 (A National Minimum Wage of £8.10 and a National Living Wage of £9.30). We do not take account of the cost of formal childcare. Figures may not sum due to rounding (all are rounded to nearest £10). Inflation and earnings projections are taken from OBR assumptions published at the Autumn Statement 2015.
Source: Resolution Foundation analysis using RF microsimulation model.

PUBLIC SERVICES

Shallower cuts in day-to-day budgets and increased capital spending

Planned revenues are now slightly higher and spending is marginally increased

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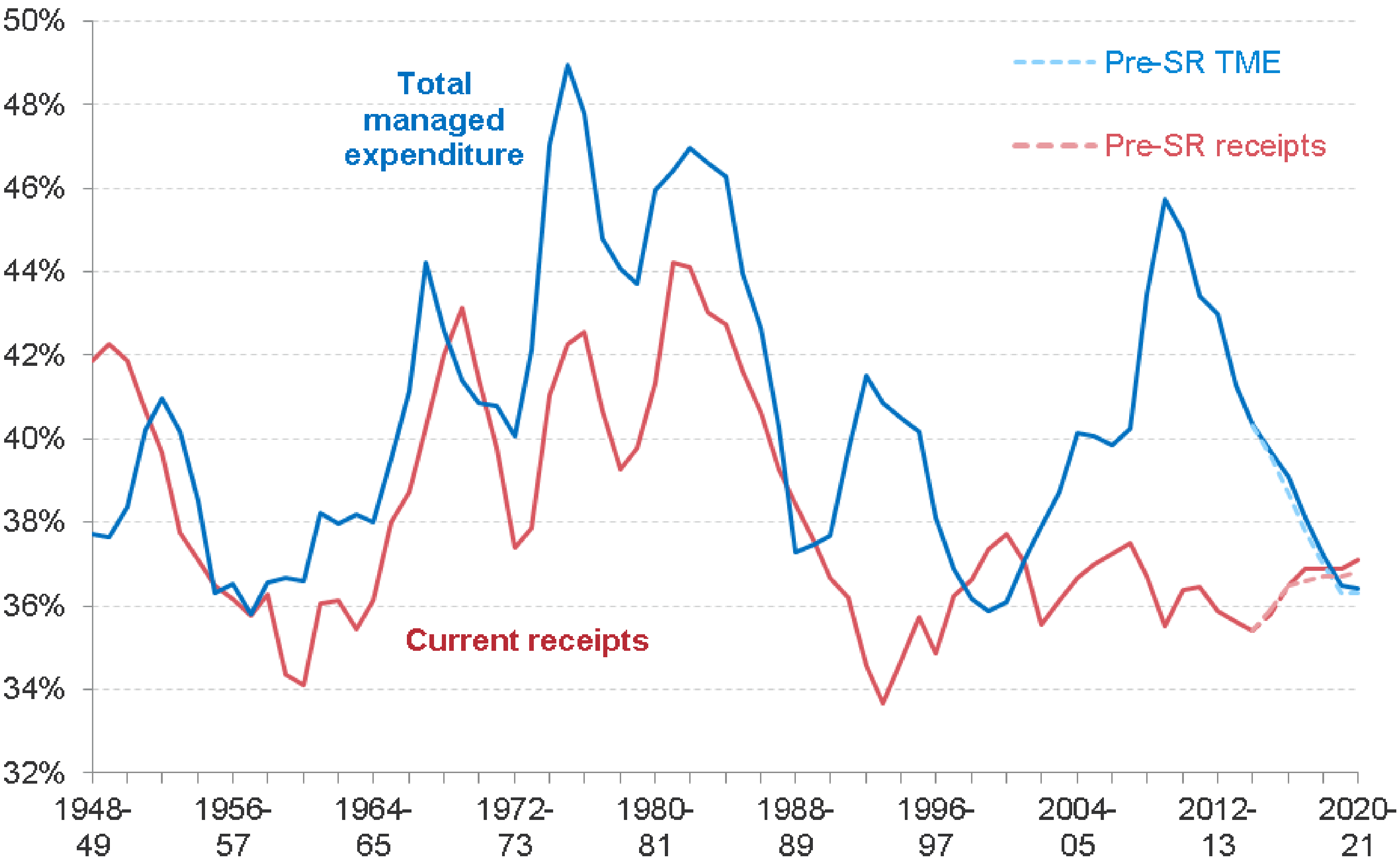
Government spending and receipts as a share of GDP



TME is set to fall to 36.5% of GDP by 2020-21 instead of 36.3% as previously projected

That's still the fourth lowest level of state spending as a share of national output since 1948

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Cuts to day-to-day budgets are significantly shallower than implied pre-election

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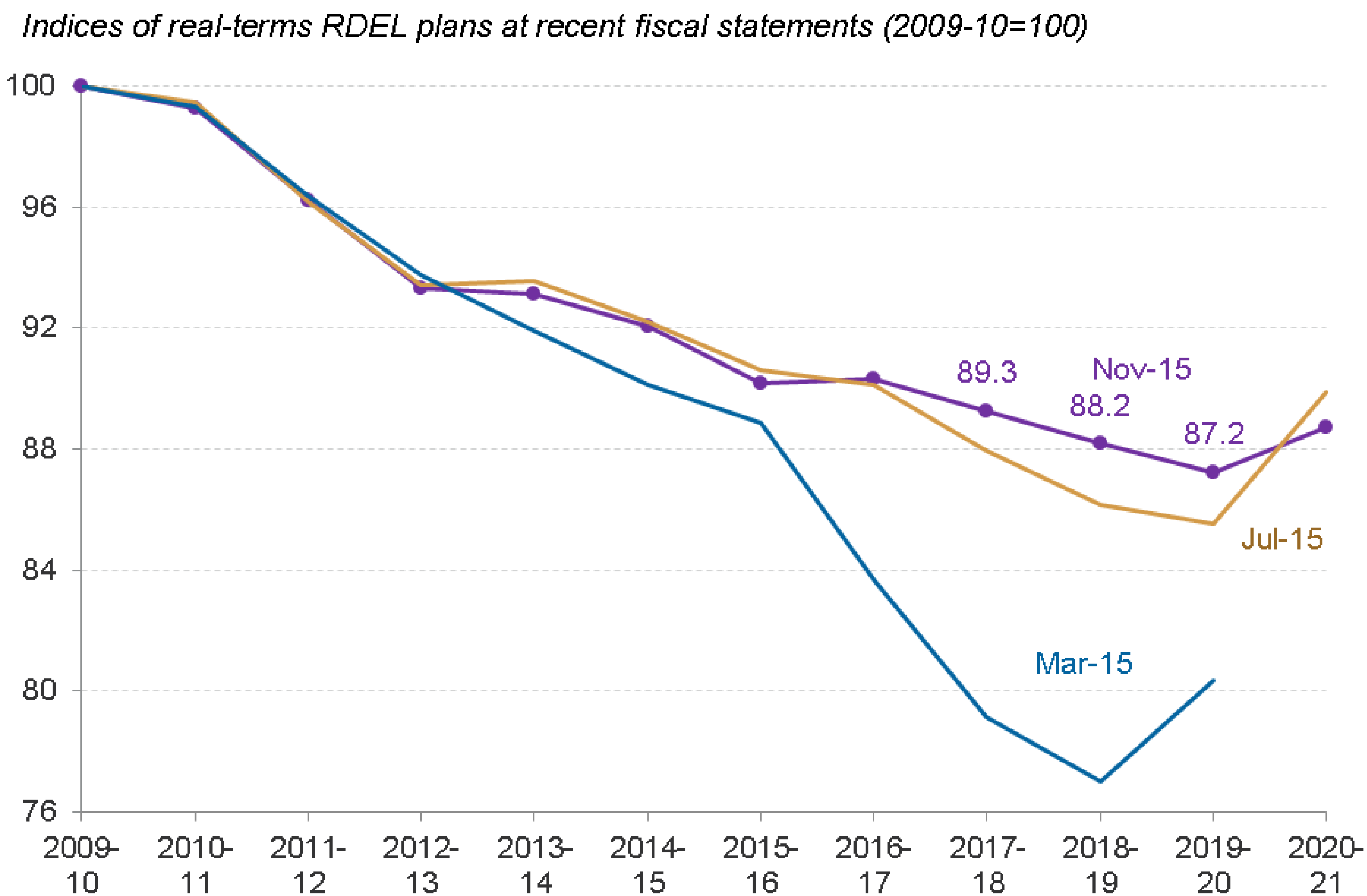

The total real-terms fall over the period of consolidation (2009-10 to 2019-20) is set to amount to £45bn, with £10bn coming in the next four years

In July, the corresponding figures were £50bn and £18bn; in March, they were £70bn and £30bn

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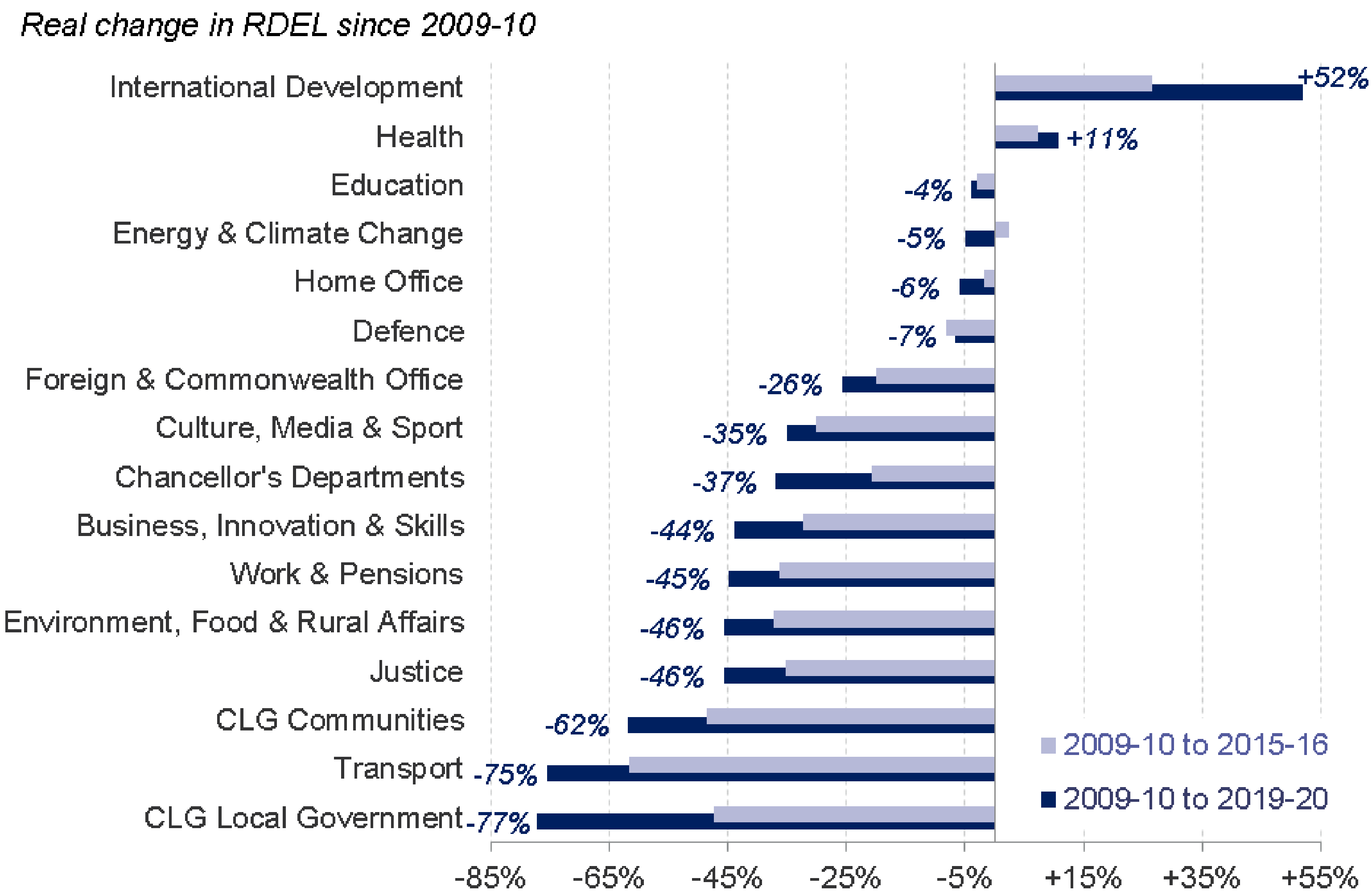
But many departments are still facing cumulative cuts in excess of two-fifths



Protections for health, schools, aid and – in this Spending Review – defence mean that DEL cuts have been shared across other departments

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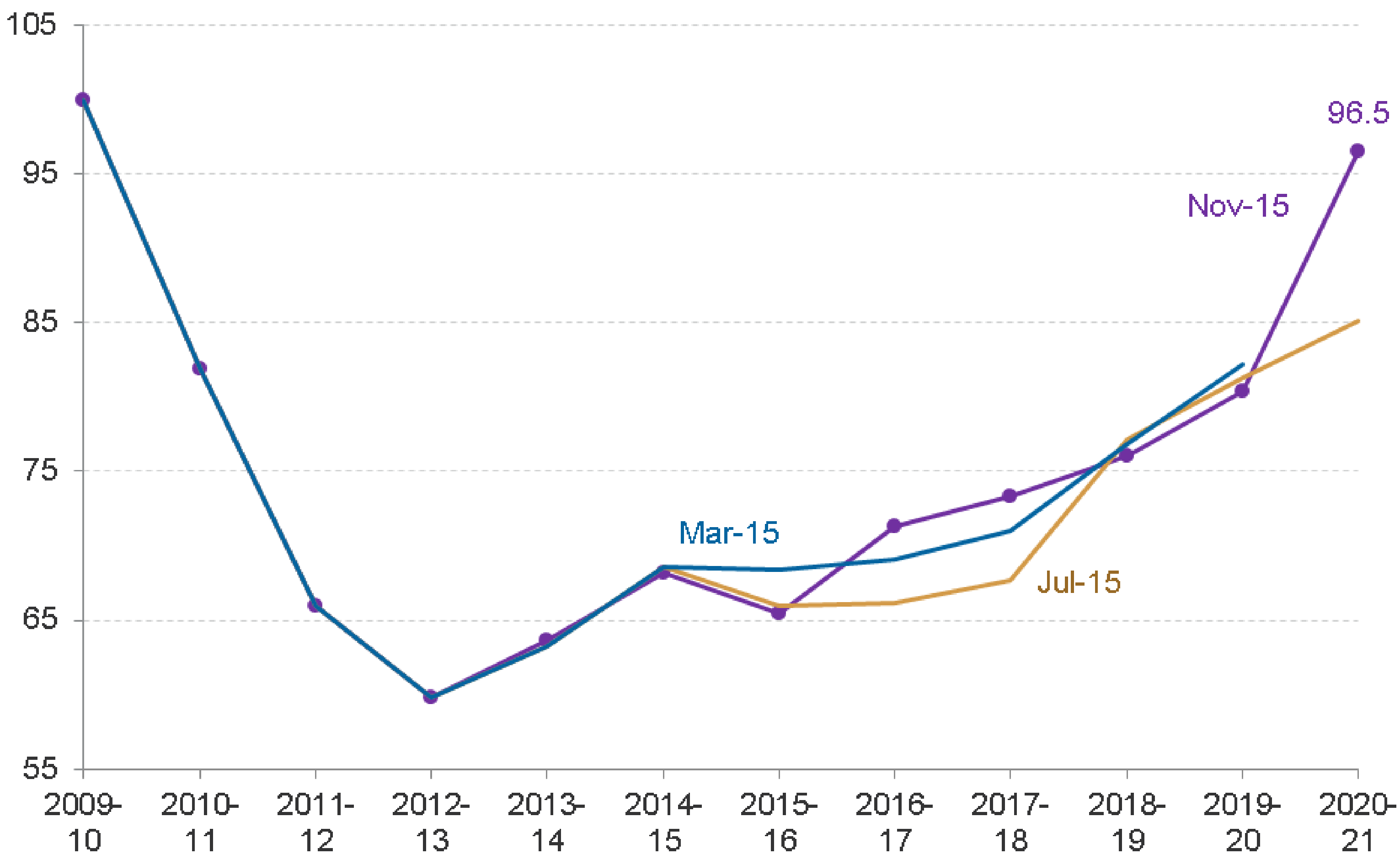
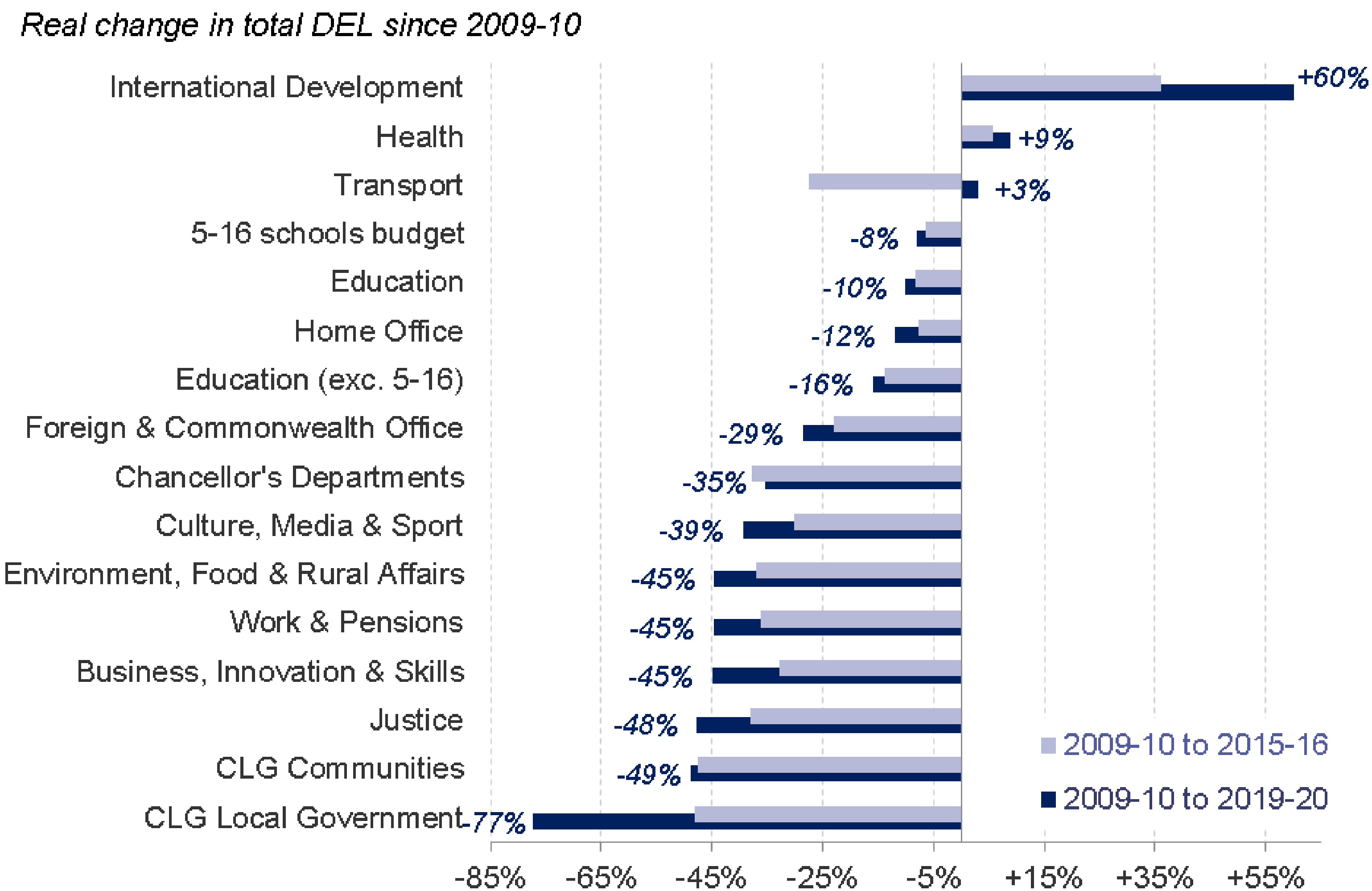
Capital spending is set to rise – with a significant boost in 2020-21

Indices of real-terms CDEL plans at recent fiscal statements (2009-10=100)



Much of this capital boost will come in the Transport department, with budgets continuing to fall in real-terms in many other departments

Helping to reduce the overall DEL cuts faced in some departments



Because capital forms such a large part of the Transport budget and has been significantly boosted in SR2015, a cumulative cut in DEL of more than ¼ is set to become a cumulative increase of 3%

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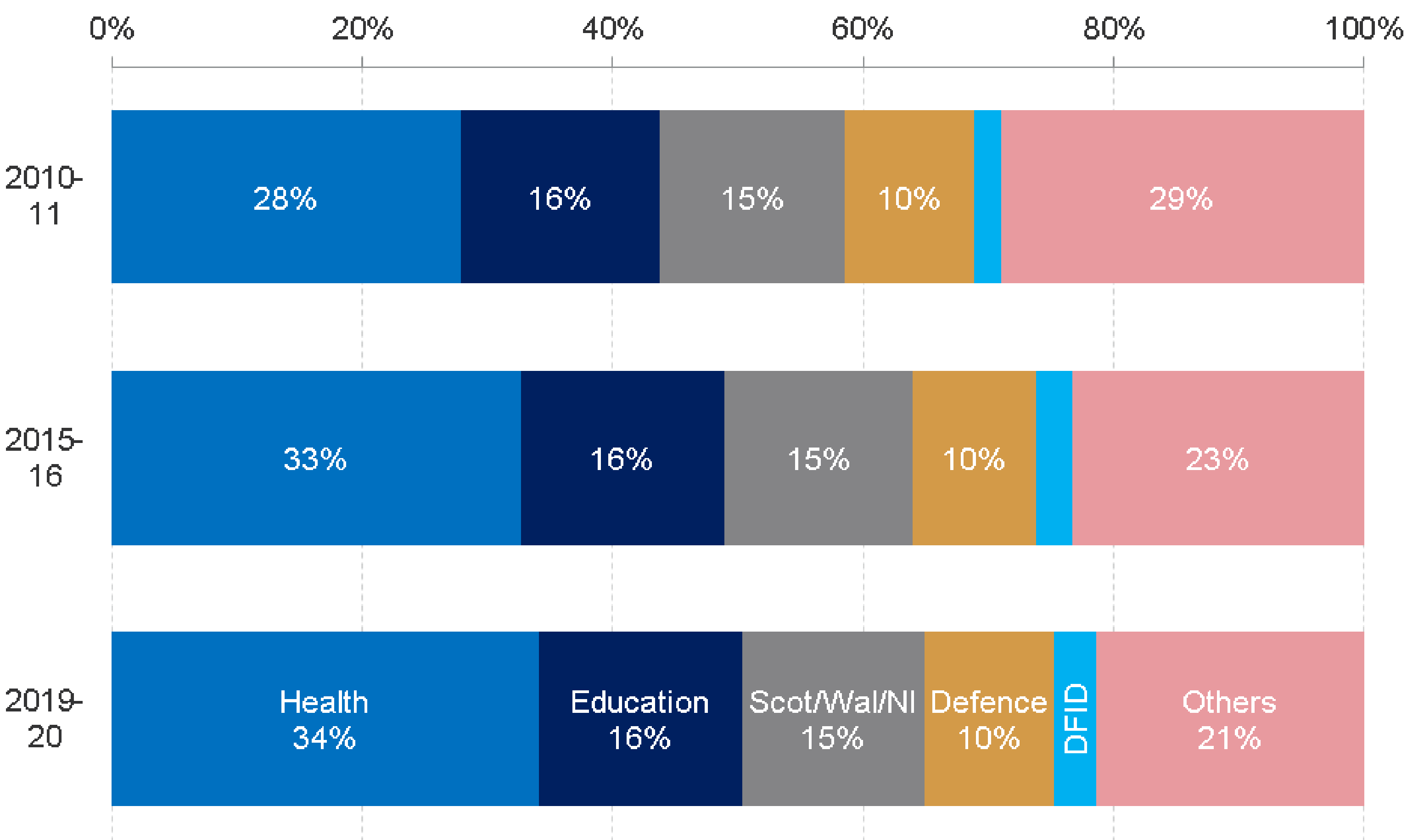
THE CHANGING STATE

The shift towards spending on health and older people

This decade-long consolidation is fundamentally altering what government funds

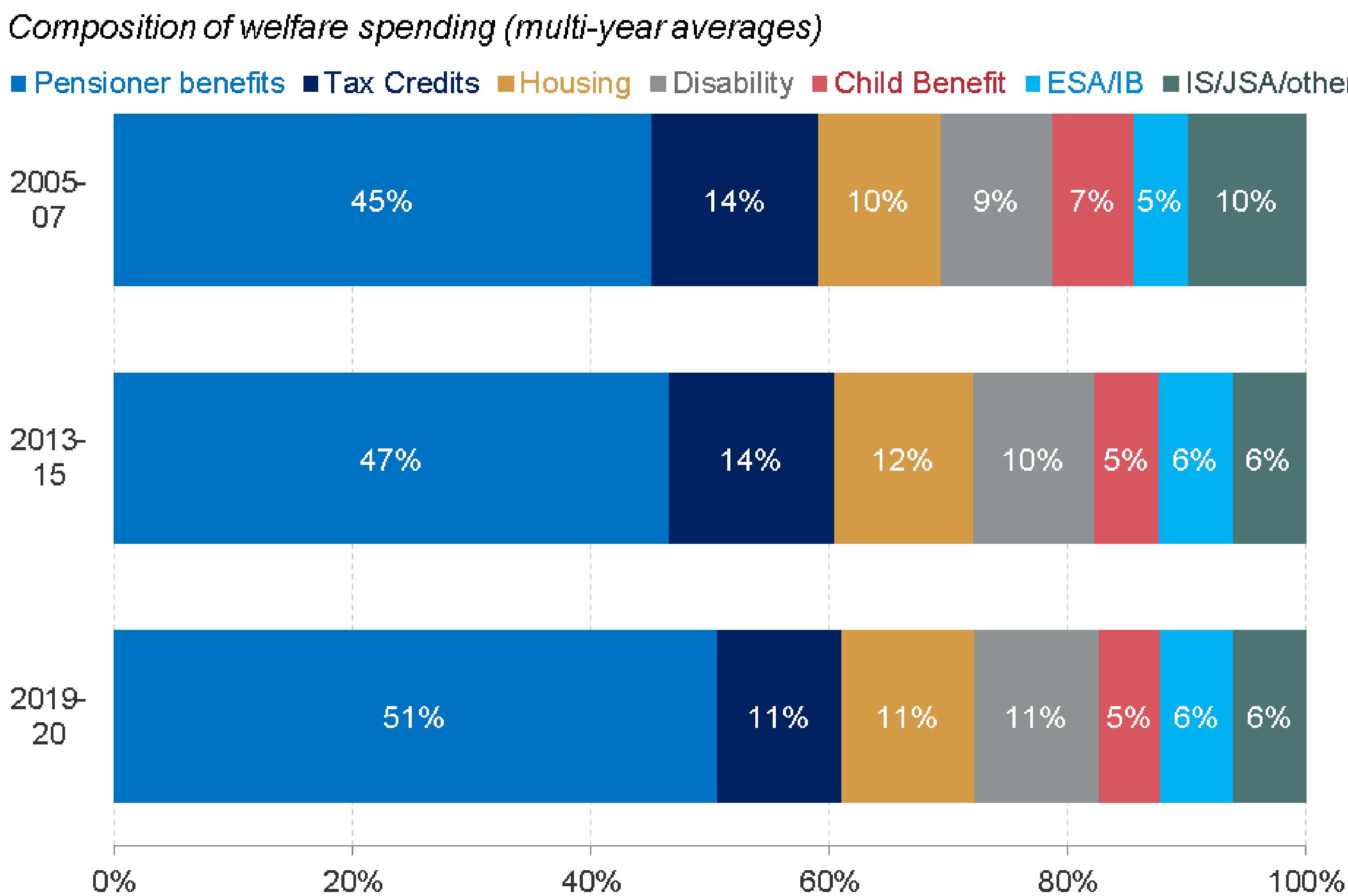
RF

Composition of total departmental spending



Taking all departmental spending together, health is set to increase from 28% of the total in 2010-11 to more than 1/3 by 2019-20

And radically changing the focus of welfare spending



Pensioner benefits accounted for 45% of total welfare spending immediately pre-crisis, but are set to account for 51% by the end of the decade

In contrast, tax credit and child benefit spending will have fallen from 21% to 16% of the total

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Notes: Pensioner benefits excludes Housing Benefit and Disability benefits (PIP, DLA,.AA)

Meaning the Chancellor is making “far reaching changes to what the state does and how it does it”

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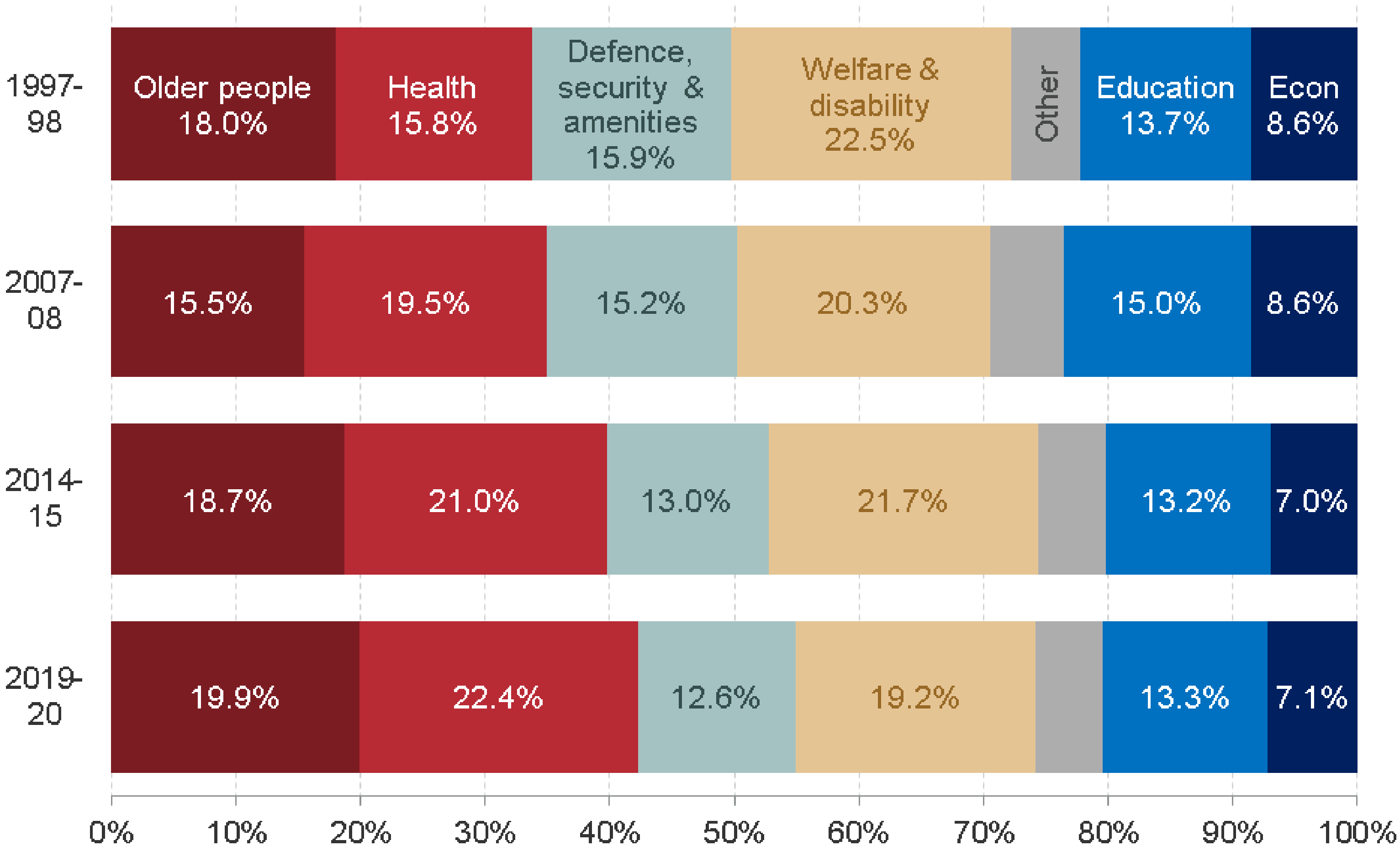
Composition of government non-debt interest spending



By 2019-20, the share of government spending flowing to older people and health could top 42%, its highest level since comparable records began in the 1990s

In contrast, the share allocated to education and economic affairs will have reached a new low of 20%

Notes: 2019-20 estimate is calculated by: first applying today’s split of functions by department to SR2015 allocations for 2019-20; and second by using welfare estimates for different groups.

2015 Autumn Statement and Spending Review

The morning after

Matthew Whittaker

November 2015

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