O, Blessed Revisions

Fiscal windfall and what to do with it

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THE ECONOMIC OUTLOOK

Growth unchanged, but earnings and income projections downgraded
Very little difference between July and November GDP projections

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.

Successive OBR projections for real-terms per capita household 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.
As was projection for average weekly wage growth

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.

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.

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.
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

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

Revised forecasts for property and equity market performance increases the cumulative drag to around £15bn by 2020-21
But changes in OBR modelling provide a more than offsetting fiscal boost

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

- Other modelling
- VAT and NICs modelling
- Property and equity market forecasts
- Average earnings forecasts

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
Lower interest rate assumptions significantly reduce debt interest costs

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

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

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.

Cumulative costs/savings associated with AS and SR policy measures

- £5.7bn
- £5.0bn
- £11.9bn
- £22.8bn
- £26.8bn
- £27bn

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TAXES AND BENEFITS

TCs U-turn; UC no-turn
Very welcome reversal of the Summer Budget tax credit cuts, but no change in UC

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

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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

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

Impact in 2020 of tax and benefit measures from Summer Budget and Autumn Statement

Mean change in income, £ annual (2020 cash terms)

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.

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.
And some families faring much worse

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

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.

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

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

Real change in RDEL since 2009-10

- International Development: +52%
- Health: +11%
- Education: -4%
- Energy & Climate Change: -5%
- Home Office: -6%
- Defence: -7%
- Foreign & Commonwealth Office: -26%
- Culture, Media & Sport: -35%
- Chancellor’s Departments: -37%
- Business, Innovation & Skills: -44%
- Work & Pensions: -45%
- Environment, Food & Rural Affairs: -46%
- Justice: -46%
- CLG Communities: -62%
- Transport: -75%
- CLG Local Government: -77%

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

Real change in total DEL since 2009-10

- International Development: +60%
- Health: +9%
- Transport: +3%
- 5-16 schools budget: -8%
- Education: -10%
- Home Office: -10%
- Education (exc. 5-16): -12%
- Foreign & Commonwealth Office: -16%
- Chancellor’s Departments: -29%
- Culture, Media & Sport: -35%
- Environment, Food & Rural Affairs: -39%
- Work & Pensions: -45%
- Business, Innovation & Skills: -45%
- Justice: -45%
- CLG Communities: -48%
- CLG Local Government: -49%

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%
THE CHANGING STATE

The shift towards spending on health and older people
This decade-long consolidation is fundamentally altering what government funds are spent on. 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

Composition of welfare spending (multi-year averages)

- Pensioner benefits
- Tax Credits
- Housing
- Disability
- Child Benefit
- ESA/I
- JSA/other

2005-07
- Pensioner benefits 45%
- Tax Credits 14%
- Housing 10%
- Disability 9%
- Child Benefit 7%
- ESA/I 5%
- JSA/other 10%

2013-15
- Pensioner benefits 47%
- Tax Credits 14%
- Housing 12%
- Disability 10%
- Child Benefit 5%
- ESA/I 6%
- JSA/other 6%

2019-20
- Pensioner benefits 51%
- Tax Credits 11%
- Housing 11%
- Disability 11%
- Child Benefit 5%
- ESA/I 6%
- JSA/other 6%

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

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

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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