RF

Resolution Foundation

BRIEFING

Bending the rules

Autumn Statement response

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Summary

Against a backdrop of significant political and economic uncertainty, Autumn Statement 2016 provided the first official take on the economic impact of the decision to leave the EU and the government's response to it. The OBR's view is that the Brexit vote is costly for the UK economy, although not as costly as some others have forecast. It expects the British economy to grow significantly more slowly next year, at 1.4 per cent, as business investment falls and household consumption slows in the face of a renewed squeeze on family budgets.

In total it forecasts the economy will be £26 billion smaller in real terms in 2020-21 than was expected at the March Budget. As a result, GDP per capita is expected to have grown by just 6.8 per cent between the start of the financial crisis and that year, compared to more than 25 per cent in similarly-lengthed recoveries from downturns in the 1980s and 1990s.

This grim economic news is underpinned by a downward revision to expectations of the UK's already very poor productivity performance. Productivity growth is now expected to average just 1.6 per cent between 2016-17 and 2020-21, compared to the 2.1 per cent expected at the Budget and the 2.5 per cent average recorded before the financial crisis.

This economic effect of Brexit means that the OBR also thinks the Brexit vote is expensive – coming with a price tag of an extra £59 billion of borrowing between now and 2020-21. Crucially the government's answer to that fact was not only to simply accept it (rather than engaging in any new fiscal tightening), but to increase borrowing by a further £26 billion. *The additional public investment that forms a large part of this additional expenditure is welcome, but the OBR believes it will be more than offset by bigger falls in private investment.*

Alongside a wider deterioration in our ability to bring in tax revenue, the Brexit impact and the Chancellor's decision to borrow even more takes the total extra borrowing by the British state to £122 billion by 2020-21. To put the scale of this deterioration into context it is worth noting that, for all the deep cuts to public services and welfare happening over the course of this Parliament – not to mention economic growth – public sector net debt as a proportion of GDP is forecast to actually end this Parliament at a higher level than it started.

The effect of this major increase in borrowing is to make redundant all of the fiscal rules the Chancellor inherited from his predecessor. In response the Chancellor has not only chosen to replace the rules with significantly looser alternatives (to achieve 2 per cent structural borrowing and falling debt in 2020-21, rather than an absolute surplus in that year) but to change the role of fiscal rules full stop.

Where George Osborne and Gordon Brown used fiscal rules as an anchor for their fiscal policy, Philip Hammond is instead seeing them as a worst case scenario ceiling. Indeed, there is so much leeway between his announced fiscal stance and rules that even were another fiscal hit of the order of Brexit to occur they would still not be breached. Looking at the actual fiscal policy adopted by HM Treasury, rather than the rule announced, it looks much more like they are aiming to run a small current budget surplus rather than meet the announced fiscal rules, a policy similar to that adopted by the Coalition government before 2015 and advocated by several parties in the run up to the last general election.

While most of the initial response to the Autumn Statement has focused on the impact on the public finances, the effect on family finances is just as important. Looking ahead on the basis of the OBR's new forecasts and the government's policy decisions, the picture for living standards is if anything more concerning. The earnings people bring home from work are obviously affected by the same economic changes that have undermined the public finances. Average earnings are now forecast to be £830 a year lower than expected in 2020, with this decade now set to be the weakest one for wage growth since the 1900s. Growth of just 1.6 per cent between 2010 and 2020 compares with an increase of 12.7 per cent in the 2000s and over 20 per cent in every other decade since the 1920s.

Family incomes are made up of more than what happens in the labour market – tax, benefits and other policy measures are also key. In recent months it looked like the government recognised that they had inherited welfare cuts that would mean significant income falls for the very 'just managing' families that Theresa May has rightly highlighted as deserving support. Indeed the Autumn Statement did include some welcome measures to tackle letting agent fees for private renters and a reduction in the taper rate at which benefits are taken away as families earn more.

But overall the rhetorical commitment to just managing families has not been delivered upon, with the giveaway from that reduced taper being wiped out more than twice over by just the additional takeaway from higher inflation combining with a freeze on benefits over the next three years. When set against all other policy changes announced since the 2015 election, the Autumn Statement only undoes 7 per cent of the hit from benefit cuts to the bottom half of the income distribution.

Taking all this together we can look at the outlook for family incomes in the coming years, and it paints a grim picture. Our new income forecast brings together lower earnings growth, higher inflation, and tax/benefit changes. It shows that overall, the rest of this parliament looks set to be as grim as the last, with incomes growing by an average of 0.2 per cent a year, compared with 0.5 per cent a year between 2010-11 and 2014-15. While top earners were hit the hardest following the financial crisis, the big difference looking forward is that the biggest losers are lower income families, with the entire bottom third of the income distribution set to see incomes fall in the years ahead.

The Autumn Statement was set against an unusually uncertain backdrop…with implications for the public finances and for families

Amid much uncertainty as to what the future holds following the vote to leave the EU five months ago, the big news in Philip Hammond's first (and last)[1] Autumn Statement was always going to relate to the OBR's latest assessment of the country's economic outlook.

With a significant deterioration in the public finances widely anticipated ahead of time – our own forecast was for an £84 billion real-terms increase in borrowing over the course of the parliament as a result of changed economic circumstances[2] – there was much discussion of how the Chancellor might react. While he was clear that the new backdrop would mean abandoning his predecessor's goal of delivering an overall surplus by 2019-20, questions remained as to what new rules he would implement.

The run-up to the Autumn Statement was also characterised by discussion of 'just about managing' families – the so called 'JAMs'. The Prime Minister has identified these low to middle income working households as being at the heart of her new government's focus,[3] putting pressure on the Chancellor to overhaul the policy legacy he inherited that was set to *lower* incomes within this group over the coming years.

In this note, we consider the implications of the OBR's latest assessment for the finances of both just managing families and the government.

[1] From next year the government will present an Autumn Budget and a Spring Review.

[2] M Whittaker, *Pressing the reset button: the public finance options facing the new Chancellor at the Autumn Statement*, Resolution Foundation, November 2016

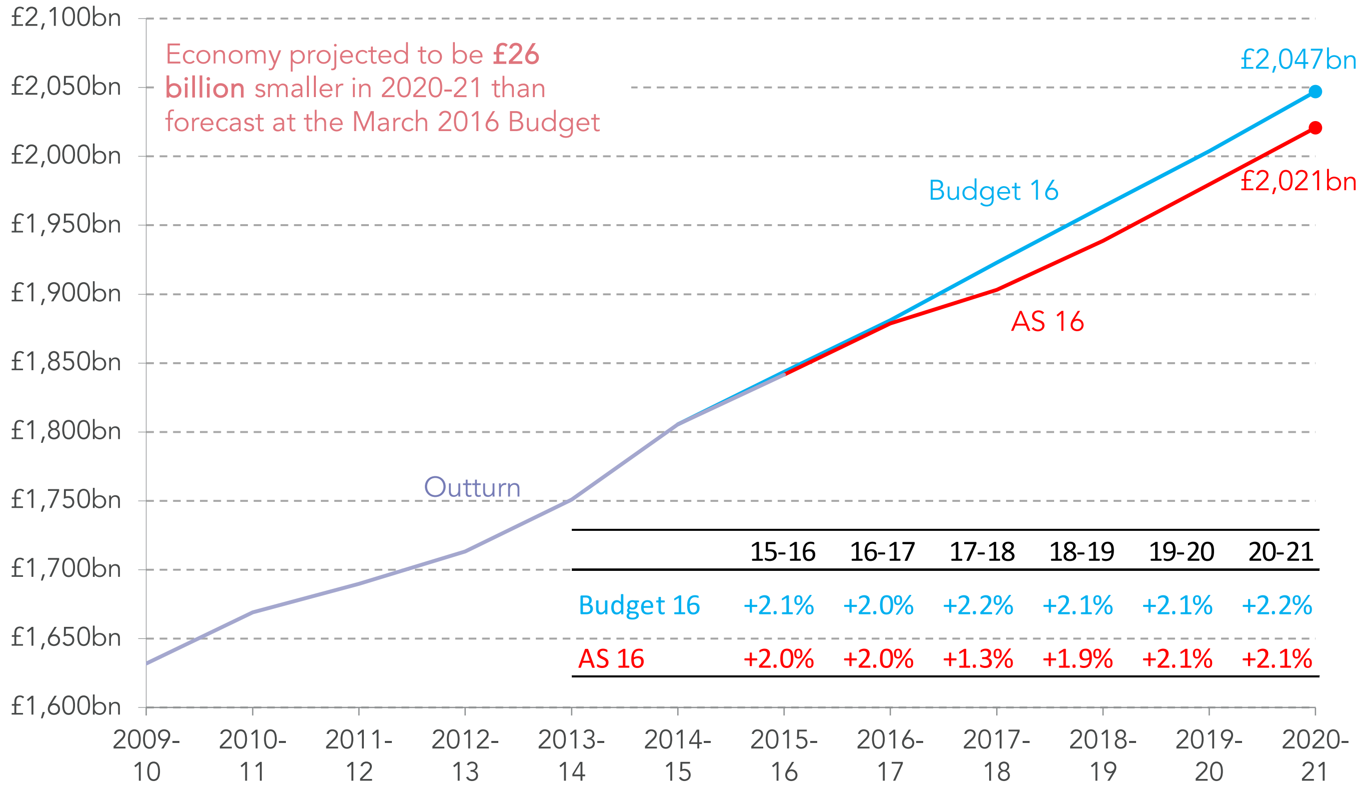
[3] Statement from the new Prime Minister Theresa May, 13 July 2016

The economy is set to be £26 billion smaller than previously thought by the end of the parliament, though there is huge uncertainty

Figure 1 shows that downward revisions in the OBR's economic growth projections mean that the UK economy is forecast to be £26 billion smaller in 2020-21 than had been thought at the time of the March Budget. As the embedded table shows, this is primarily a product of a sharp slowing of growth in 2017-18. Forecasts for both the immediate post-referendum period (2016-17) and the longer-term (2019-20 and 2020-21) are largely unchanged from March.

Figure 1: GDP outturn and projection at Budget 2016 and Autumn Statement 2016

Chain linked GDP



	15-16	16-17	17-18	18-19	19-20	20-21
Budget 16	+2.1%	+2.0%	+2.2%	+2.1%	+2.1%	+2.2%
AS 16	+2.0%	+2.0%	+1.3%	+1.9%	+2.1%	+2.1%

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

Relative to many predictions ahead of the Autumn Statement, this level of revision is relatively modest. Given the elevated level of uncertainty associated with this assessment – not least in relation to the form of Brexit the UK ultimately adopts – this is probably a sensible approach. It is based on an assumption that the UK leaves the EU in April 2019 and five 'key judgements':

» Post-referendum uncertainty for firms lowers business investment and therefore trend productivity growth;

» Higher near-term inflation reduces real earnings and therefore private consumption;

» Net trade is boosted in the near-term by the decline in Sterling;

» Trade-intensity declines during the transition to Brexit; and

» Net migration falls (though there is no revision relative to the March outlook because the OBR states that it would have increased its net migration assumption in the absence of the Leave vote).

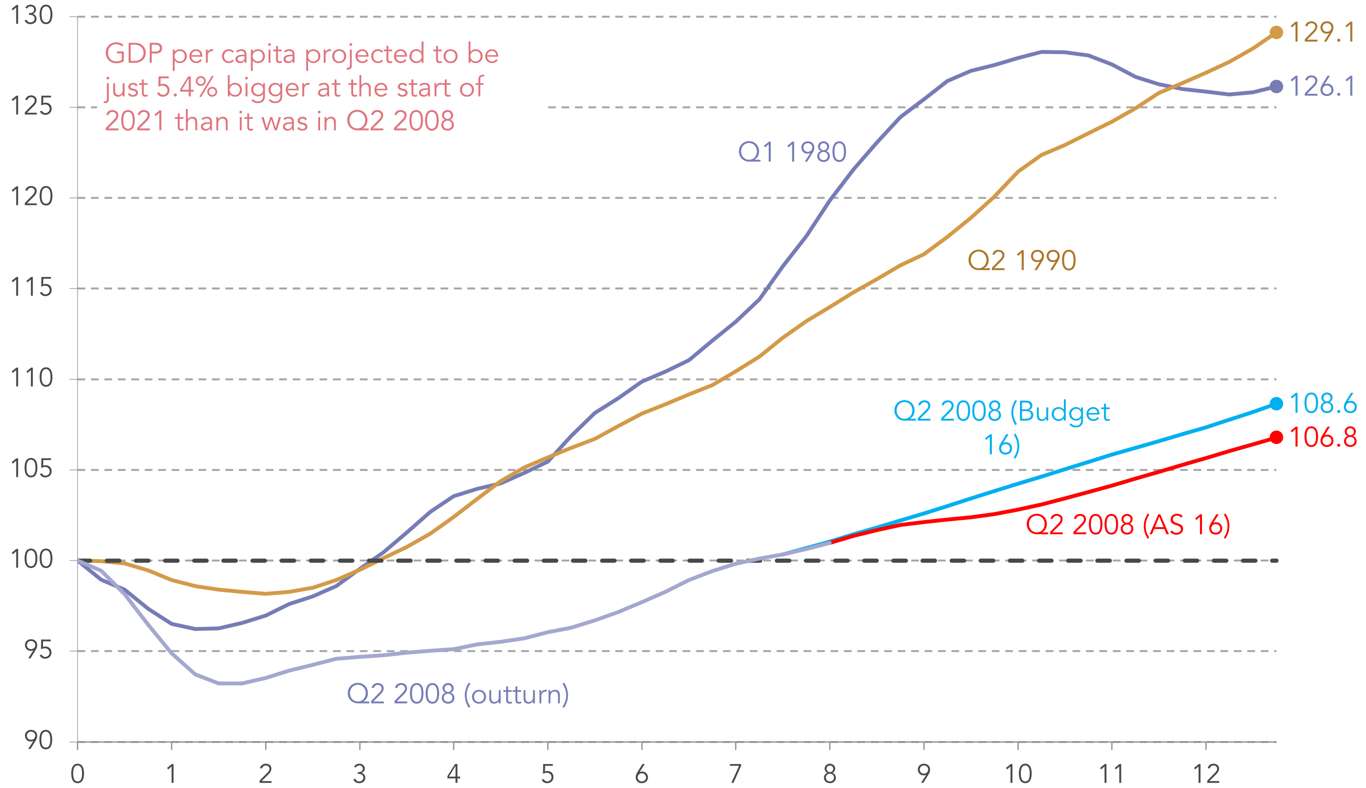
This approach explicitly avoids both any potential reduction in trend productivity associated with lower international trade and any reduction in consumer demand other than that generated by the inflationary squeeze on household budgets. However, it also assumes no fiscal savings after the UK leaves the EU, with the relevant funds being recycled into domestic policy.

As a result, GDP per capita is set to be just 7 per cent above its pre-crisis level by 2021

Whatever the precise scale of the Brexit-effect on growth, it is apparent that it is set to be negative in the near-term. Following on from a deep downturn and sluggish recovery, these latest projections imply that GDP per capita – a better measure of living standards than overall GDP – is set to be just 6.8 per cent higher in 2021 than it was immediately before the financial crisis hit. As Figure 2 shows, this far out from the start of the downturn, GDP per capita had grown by 29.1 per cent after the 1990s recession and 26.1 per cent after the 1980s one.

Figure 2: GDP per head following recent recessions

Indices of real GDP per capita by number of years since pre-recession peak (peak = 100, chain volume measure)



Sources: ONS, *Series IHXW* & OBR, *Economic and Fiscal Outlook*, various

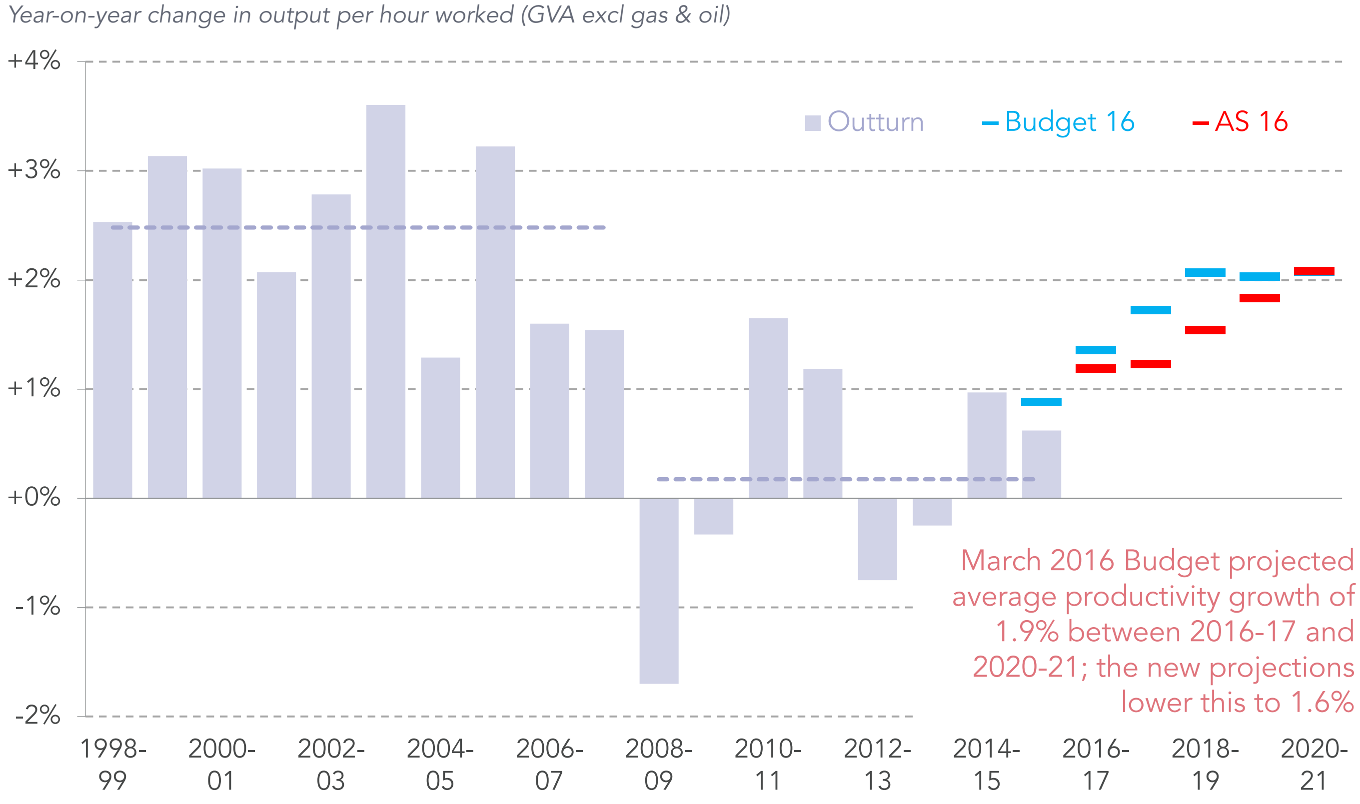
At the heart of this disappointing performance is the post-crisis stagnation in productivity growth, with the latest outlook delivering a further downgrade

Output per hour[4] worked grew at an annual average of 2.5 per cent between 1998-99 and 2007-08, but it has subsequently fallen well below this level. At the March Budget, the OBR stated that it believed more of the weak post-crisis productivity growth to be a *permanent* shift in the UK's growth capacity than it previously thought – implying a reduction in *trend* growth. That overall judgement is unchanged in the OBR's long-term outlook, but – as noted above – it *is* expecting uncertainty to reduce investment and productivity growth during the Brexit process. As such, it has lowered its medium-term assessment of trend productivity growth once again in its latest assessment.

Trend productivity growth is projected to be 1.8 per cent by the end of the parliament, taking until 2026-27 to return to 2 per cent (which is itself lower than the assumed trend of 2.2 per cent in place before the March Budget).

Despite this downward revision in trend productivity growth, *actual* productivity growth is set to match the level forecast in March by the end of the parliament, with the economy experiencing some temporary above-trend catch-up. Nevertheless, as Figure 3 shows, the outlook for the coming years is gloomier than the one set out in March: productivity growth is set to average 1.6 per cent between 2016-17 and 2020-21, compared with an expected 1.9 per cent at the time of the Budget.

Figure 3: Labour productivity outturn and projections



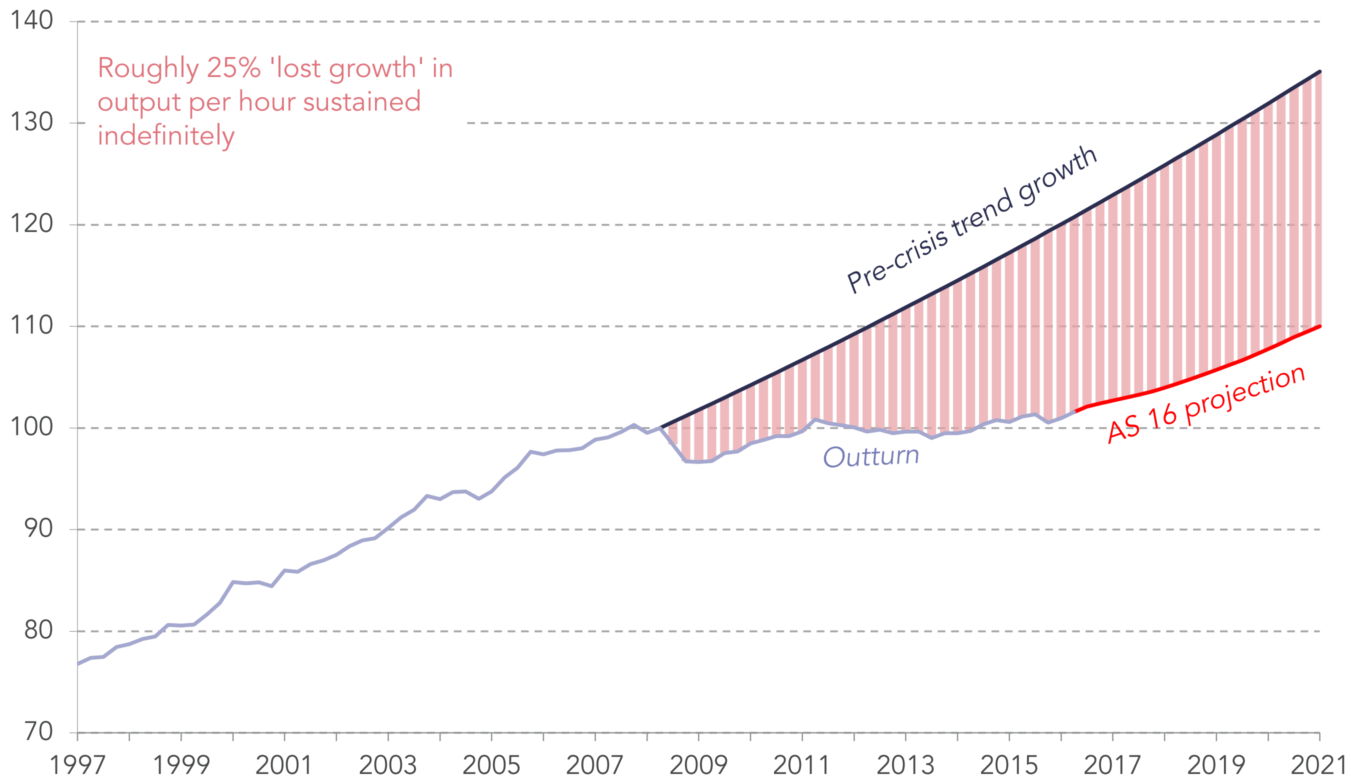
Sources: ONS, *Series KLS2 & YBUS* & OBR, *Economic and Fiscal Outlook*, various

[4] Non-oil.

Output per hour is already 19 per cent lower than it would have been in the absence of the post-crisis stagnation. The latest OBR figures imply that this productivity 'gap' will rise to 25 per cent by the start of 2021, as set out in Figure 4. With trend growth not expected to match the pre-crisis level, this gap is set to widen over the coming years, with serious consequences for Britain's living standards.

Figure 4: 'Lost' labour productivity

Index of non-oil output per hour (2008 Q2 = 100)



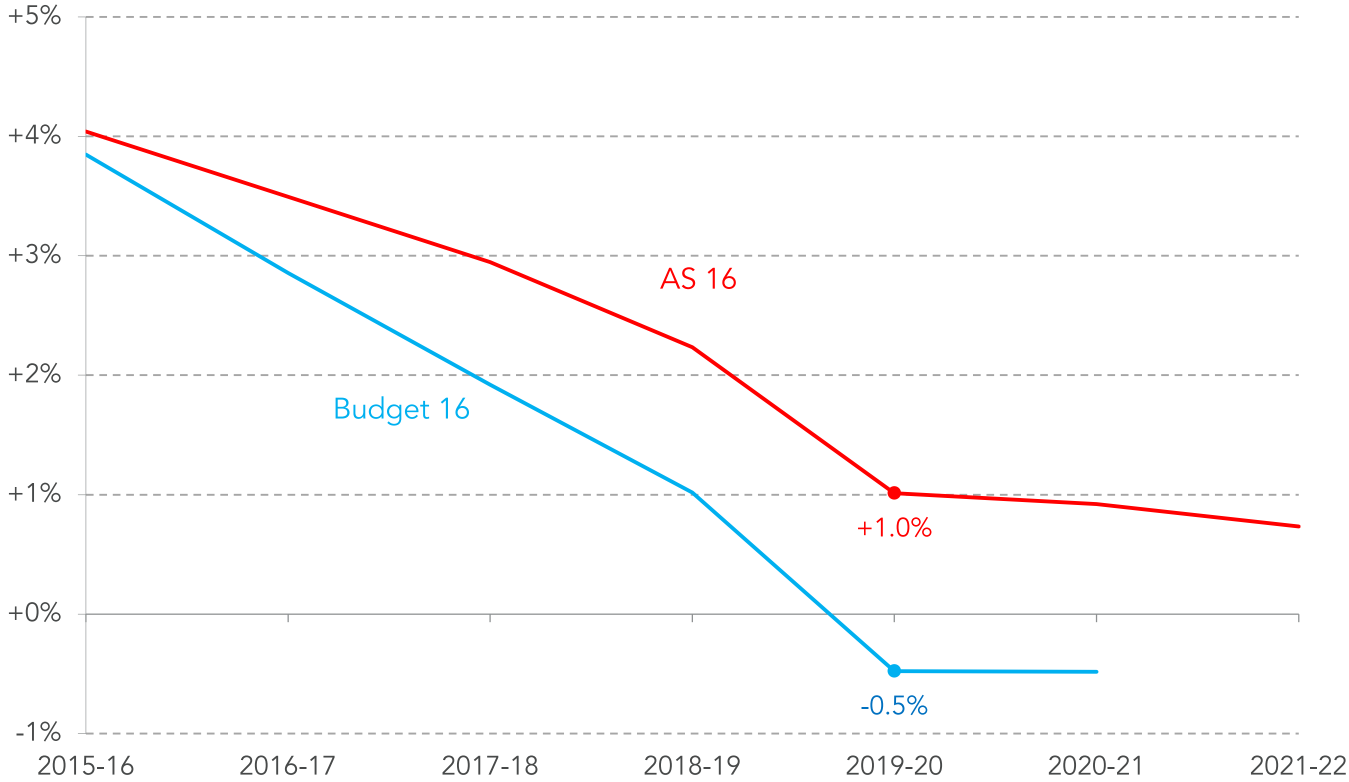
Sources: ONS, *Series KLS2 & YBUS* & OBR, *Economic and Fiscal Outlook*, November 2016

The growth downgrades have contributed to a £122 billion deterioration in the public finances

The worsening of the economic outlook has been accompanied by a downgrade in the outlook for the public finances. Public sector net borrowing (PSNB) was projected to reach -0.5 per cent of GDP in 2019-20 at the time of the Budget (that is, an overall budget *surplus*). Now however, it is forecast to stand at +1.0 per cent of GDP instead, with a similar scale of deficit persisting into the first year of the next parliament – as shown in Figure 5.

Figure 5: Successive borrowing forecasts

Public sector net borrowing as a share of GDP



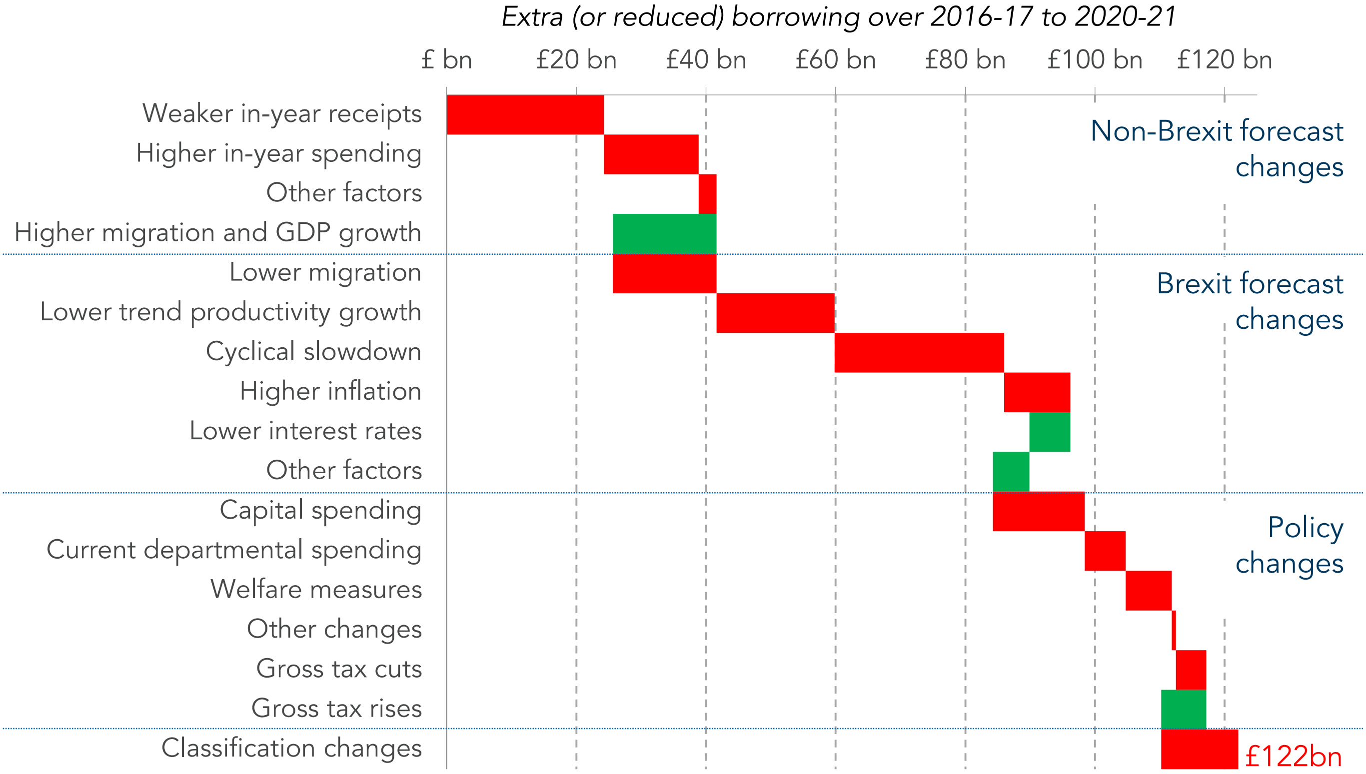
Source: OBR, *Economic and Fiscal Outlook*, various

In nominal terms, this means that a projected £10 billion surplus in 2019-20 converts to a £22 billion deficit. In cumulative terms, the revisions point to £122 billion extra borrowing over the five years from 2016-17 to 2020-21, relative to the Budget forecast. This deterioration is primarily the product of three factors:

- Brexit-effects;
- Non-Brexit forecasting changes; and
- Higher government spending.

Figure 6 provides a breakdown. It shows that 48 per cent of the total – £59 billion – is ascribed to forecast changes 'related to the referendum result and exiting the EU'. Within this, the major effects relate to 'cyclical slowdown', 'lower trend productivity growth' and 'lower migration'. Non-Brexit forecasting changes account for a further 21 per cent of the £122 billion total. These were driven primarily by weaker than expected receipts in the current fiscal year, reflecting the less tax-rich nature of the UK economy than the OBR previously projected. Higher in-year spending also contributed to higher borrowing. The OBR's theoretical expectations for higher than previously thought levels of migration in the absence of the referendum result work in the opposite direction, lowering borrowing relative to the March projections – but these are entirely offset by post-Brexit forecasts for lower migration.

Figure 6: The causes of higher borrowing over this parliament relative to the March forecast



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

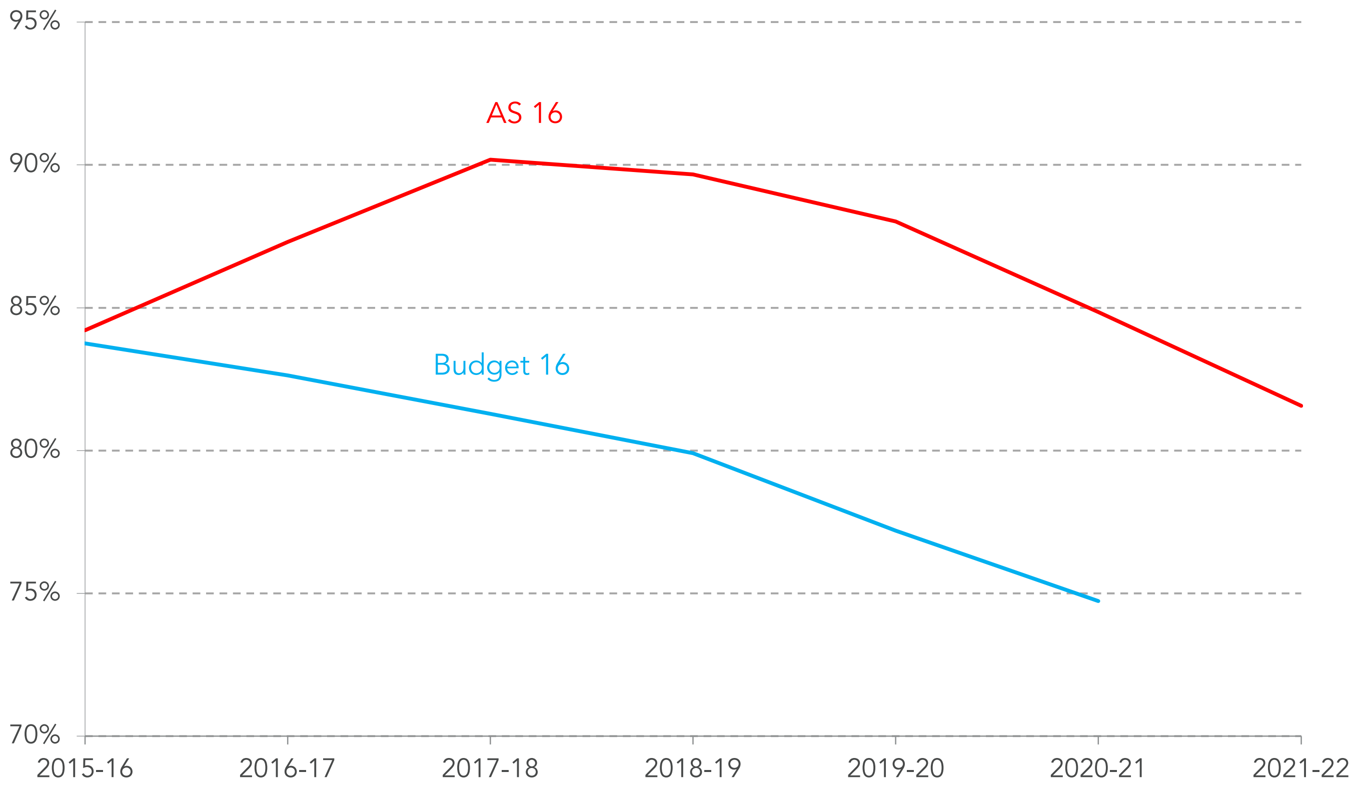
Taken together, these Brexit and non-Brexit forecasting changes represent an £84 billion increase in cumulative borrowing (very close to the £84 billion real-terms deterioration we forecast ahead of the Autumn Statement).

Classification changes (mainly related to corporation tax receipts) add an additional £12 billion to the borrowing total, with policy changes accounting for the remaining £26 billion. These include £14 billion in extra capital spending and £7 billion in welfare measures. Newly announced tax rises reduce the cumulative borrowing total by £7 billion, though these are partially offset by £5 billion in tax cuts.

Higher borrowing over the parliament feeds through to a higher stock of debt. As Figure 7 shows, public sector net debt (PSND) as a share of GDP has been revised up in future years by around 10 percentage points. It is forecast to peak at 90 per cent in 2017-18 and end the parliament at 84.8 per cent – a little above its level in 2015-16 (84.2 per cent).

Figure 7: Successive public sector debt forecasts

Public sector net debt as a share of GDP



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

Prompting a 'reset' of the government's fiscal rules

Given these big changes in the fiscal outlook, it is perhaps unsurprising that there have also been changes to the government's fiscal rules. Since the last general election, the government has aimed to follow three rules (as well as the welfare cap):

1. A target for a surplus on PSNB by the end of 2019-20.
2. A target for PSND to be falling as a proportion of GDP in each year up to 2019-20.
3. Beyond that, and in 'normal times', a target for a surplus on PSNB in each subsequent year.[5]

The first two of these rules have now been dropped, while the third remains in aspirational form. The updated *Charter for Budget Responsibility* has three new rules (again in addition to the welfare cap):

1. A target to reduce *cyclically-adjusted* PSNB to below 2 per cent of GDP by 2020-21.
2. A target for PSND to be falling as a proportion of GDP in 2020-21.

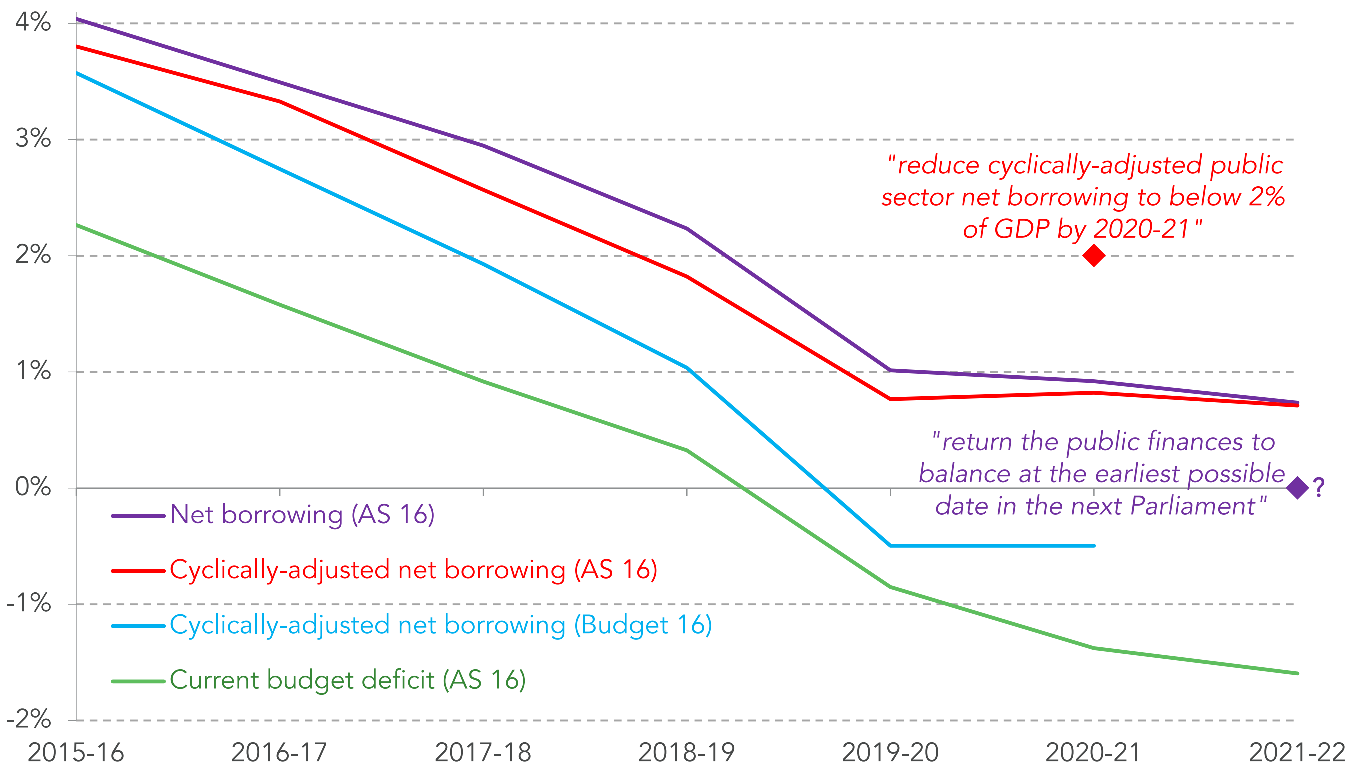
[5] HMT, *Charter for Budget Responsibility: Summer Budget 2015 update*, July 2015

3. And an objective to 'return the public finances to balance at the earliest possible date in the next parliament.'[6]

Moving from a target of a budget surplus in 2019-20 to one of keeping cyclically-adjusted borrowing below 2 per cent of GDP in 2020-21 represents a very significant loosening in the constraints faced by the Chancellor. Ignoring cyclical adjustment for a moment (which is expected to make little difference in 2020-21), 2 per cent of GDP in 2020-21 is forecast to be £45 billion, while net borrowing is expected to be £21 billion, as shown in Figure 8. The Chancellor could therefore afford to double borrowing in 2020-21 – or add on again the current forecast change due to the Brexit vote (£15 billion) – and still meet his goal.

Figure 8: Borrowing measures and new fiscal targets

Measures of borrowing as a share of GDP



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

The supplementary requirement for PSND to be falling as a share of GDP in 2020-21 also currently does little in terms of binding the Chancellor's hands. It is forecast to be falling from 2018-19, dropping by 3.2 percentage points between 2019-20 and 2020-21.

The final target – returning the public finances 'to balance' in the next parliament has very little in common with a fiscal rule. It is both sufficiently vague in its timing and so far in the future to mean that it will have no bite on the Chancellor's plans in the near-term.

Where George Osborne and Gordon Brown used fiscal rules as an anchor for their fiscal policy, Phillip Hammond is instead seeing them as a worst case scenario ceiling. Looking at the actual fiscal policy adopted by HM Treasury, rather than the rule announced, it looks much more like

[6] HMT, *Charter for Budget Responsibility: autumn 2016 update*, November 2016

they are aiming to run a small current budget surplus rather than meet the announced fiscal rules, a policy similar to that adopted by the Coalition government before 2015 and advocated by several parties in the run up to the last general election.

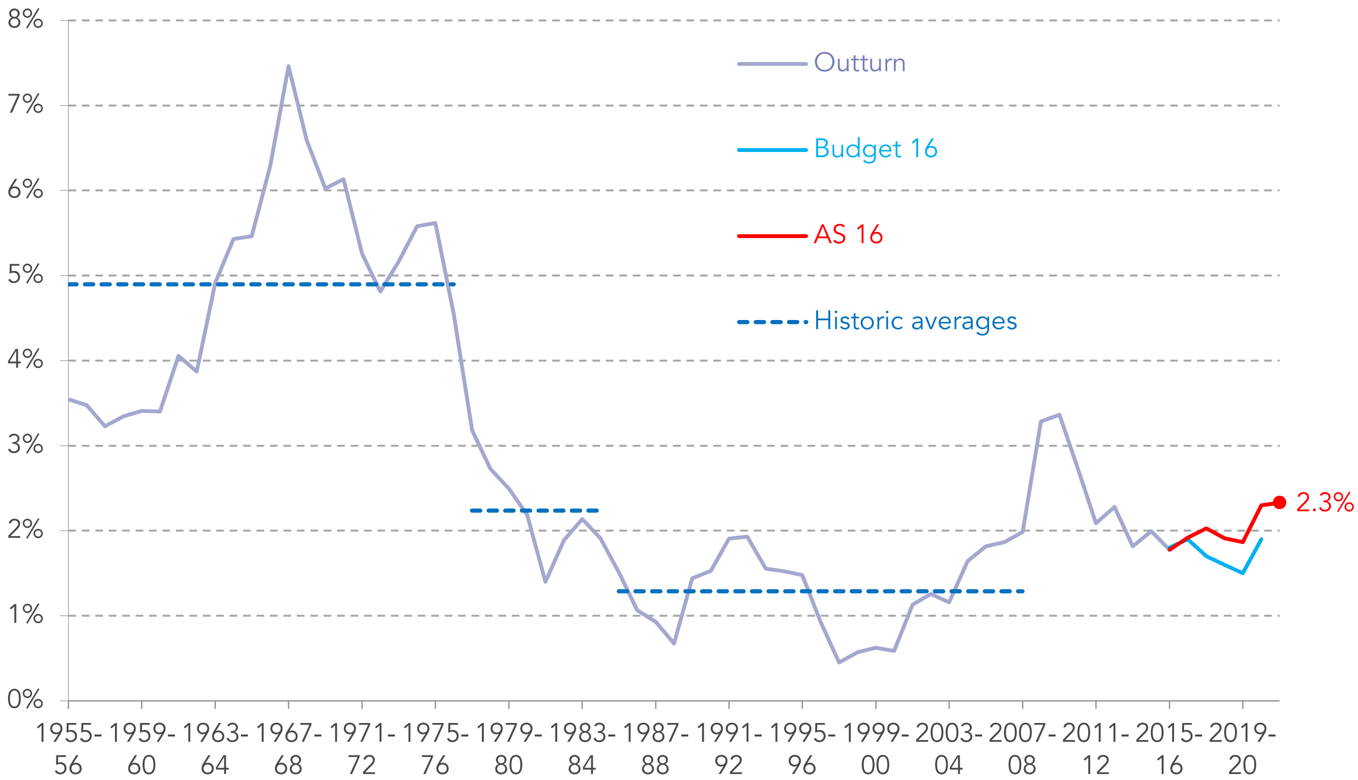
Given the high level of uncertainty facing the government, it is sensible for the Chancellor to have shifted away from the fiscal targets he inherited. It is sensible too that he has built in significant fiscal margin, though this comes at the risk of the rules failing to provide any anchor on government policy going forward. Alongside retaining a fiscal margin, the Chancellor has also opened up significant fiscal headroom – some of which he has used to boost government investment.

And a sizeable increase in government investment

Ahead of the Autumn Statement, Philip Hammond made clear his determination to boost investment, arguing that the UK's "stock of public infrastructure... languishes near the bottom of the developed-countries' league table after decades of under-investment".[7] As Figure 9 shows, the plans set out in the Autumn Statement are set to raise public sector net investment to 2.3 per cent of GDP by 2020-21, up from a projection of 1.9 per cent in the Budget. This would mark only the second time since the 1970s (after 2008-2011) that such a level of investment has been secured.

Figure 9: Public sector net investment

Public sector net investment as a share of GDP



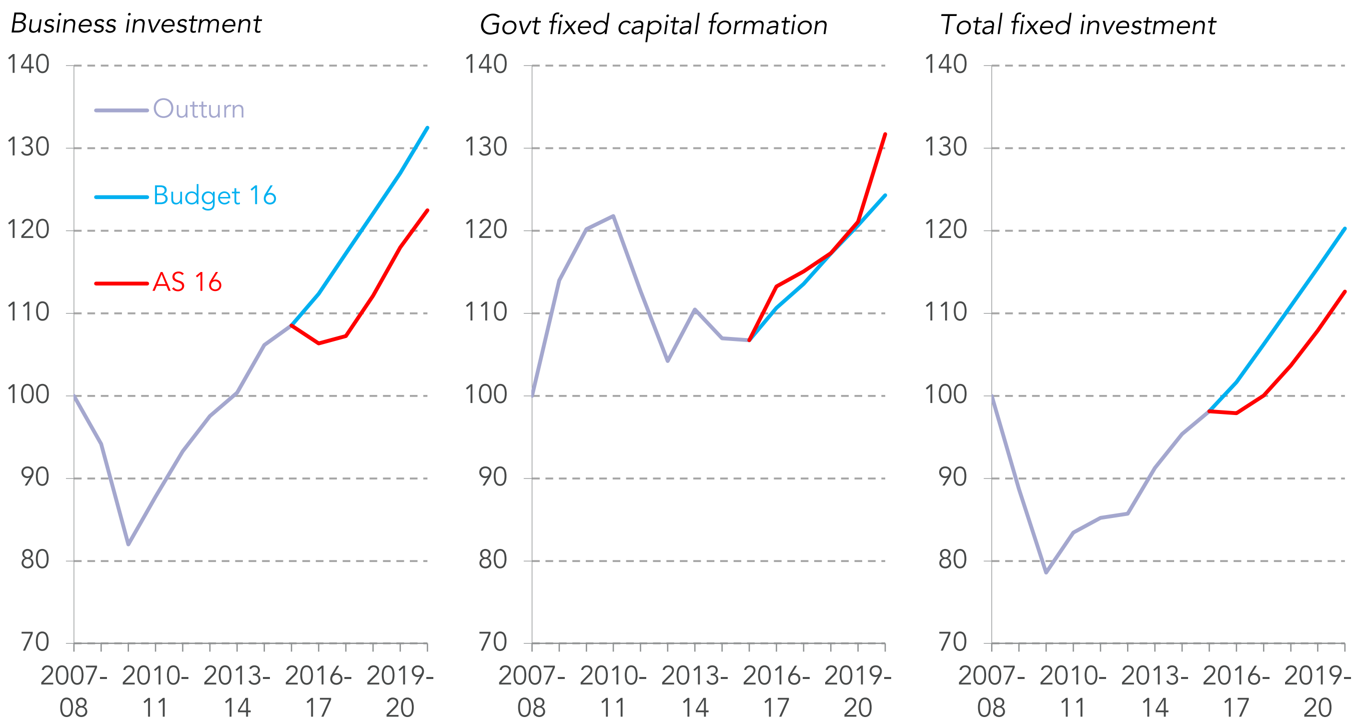
Source: OBR, *Economic and Fiscal Outlook*, various & OBR, *Public finances databank*

[7] P Hammond, An economy that works for everyone, Speech to Conservative Party Conference, 3 October 2016

Given the UK's chronic productivity problem, the Chancellor's commitment to raise government investment over the parliament is very welcome. However, as Figure 10 shows, the government's approach is not expected to be replicated by the private sector.

Figure 10: Business and government investment indices

CVM investment indices, 07-08=100



Sources: ONS, *Series NPEL, DLWF, L636, L637, L634 & L635* & OBR, *Economic and Fiscal Outlook*, various

The chart shows that government investment is projected to rise by 23.4 per cent between 2015-16 and 2020-21, roughly 7 percentage points higher than had been anticipated at the March Budget. However, business investment is set to rise by 9 percentage points less than was previously forecast. Because private sector investment forms a much larger share of overall investment than government investment, the combined effect of these trends is for overall investment to rise by 14.8 per cent over the course of the parliament – some 8 percentage points less than projected in March.

Scenarios set out by the OBR to test the sensitivity of its forecasts give a sense of the overwhelming importance of productivity to the outlook for the public finances. The central forecast, discussed above, results in cyclically-adjusted borrowing of 0.8 per cent of GDP in 2020-21. But a 'weak productivity' scenario (which simply requires that the weak post-crisis productivity trend continues) would mean much higher borrowing, at 2.2 per cent of GDP (thereby breaking the new deficit rule). Conversely, were productivity growth to return to its average from the second half of the 20th century (2.8 per cent), there would be a 1.4 per cent cyclically-adjusted *surplus* by 2020-21.

The OBR describes its productivity projection as its "most important and most uncertain" judgement. As we'll see below, it is also the key driver of the outlook for living standards.

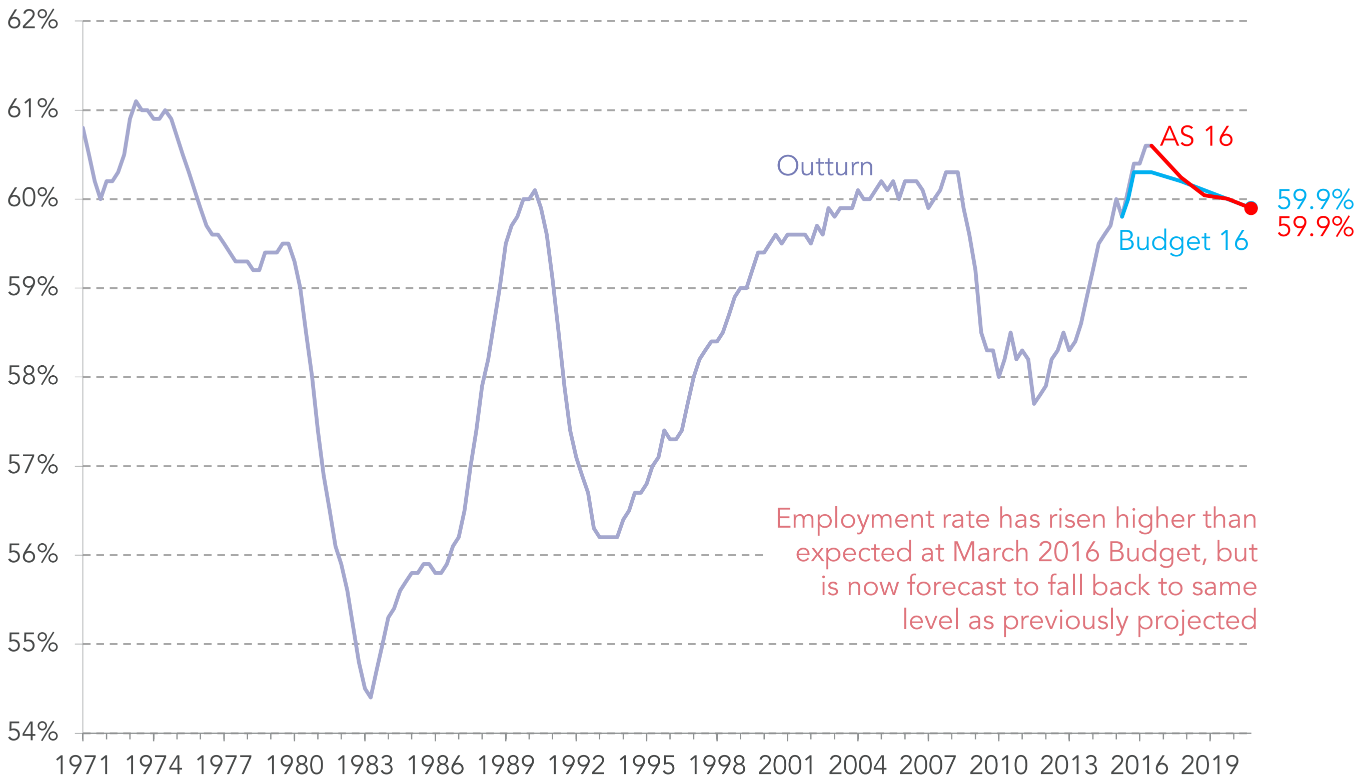
The new OBR projections also have implications for household incomes, with some near-term employment effects

While most initial attention is likely to focus on the fiscal consequences of the new OBR figures, families will be much more directly impacted by what the revisions mean in terms of jobs and pay.

Figure 11 compares Budget and Autumn Statement projections for the employment rate. Even in March, the proportion of adults in work was expected to fall over the forecast horizon – in part reflecting the demographics of an ageing society. As so often in recent years, the outturn surpassed expectations, with the employment rate continuing to rise in 2016. However, from this higher than expected starting point, the OBR now expects a sharper reduction. As a result, the employment rate is projected to be 59.9 per cent in Q1 2021 – exactly in line with the March forecast.

Figure 11: Employment rate outturn and projections

Employment rate among those aged 16+

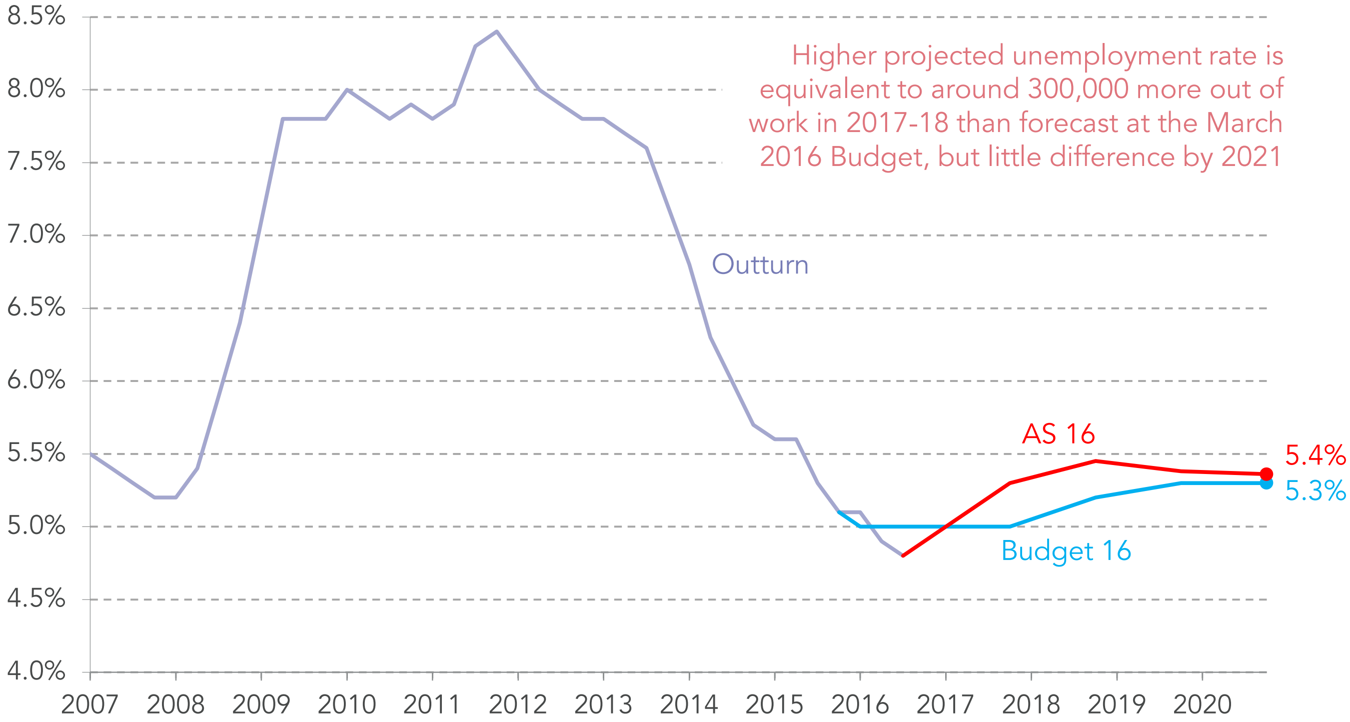


Sources: ONS, *Series MGSR* & OBR, *Economic and Fiscal Outlook*, various

Unemployment also outperformed expectations following the March Budget, with Figure 12 showing it falling to just 4.8 per cent by the middle of 2016. Again, however, the correction is now projected to be sharper than the one forecast in March. It is projected to spike in the near-term, with an additional 300,000 people out of work in 2017-18 relative to the previous forecast. As with the employment projection however, this effect is expected to ease over the second half of the parliament.

Figure 12: Unemployment outturn and projections

Unemployment rate among those aged 16+

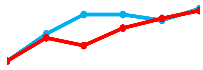
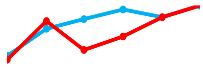
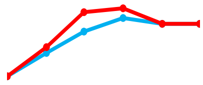
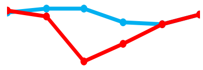
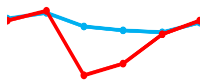


Sources: ONS, *Series MGSC* & OBR, *Economic and Fiscal Outlook*, various

And an £830 reduction in average earnings by 2021 relative to previous expectations

Real-terms pay prospects rest on forecasts for both nominal pay growth and inflation. We can also distinguish between hourly pay growth and weekly (which is affected by changes in working hours). Table 1 compares Budget and Autumn Statement projections across each of these measures, highlighting the overall impact on real-terms pay growth expectations.

Table 1: Projections for pay and inflation

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	
Average weekly earnings growth							
Budget 16	+1.8%	+2.8%	+3.5%	+3.5%	+3.3%	+3.7%	
AS 16	+1.8%	+2.7%	+2.4%	+3.0%	+3.4%	+3.7%	
Average hourly earnings growth							
Budget 16	+2.2%	+3.2%	+3.5%	+3.8%	+3.6%	+4.0%	
AS 16	+2.1%	+3.5%	+2.4%	+2.9%	+3.6%	+4.0%	
CPI inflation							
Budget 16	+0.1%	+0.9%	+1.7%	+2.2%	+2.0%	+2.0%	
AS 16	+0.1%	+1.1%	+2.4%	+2.5%	+2.0%	+2.0%	
Real-terms average weekly earnings growth							
Budget 16	+1.7%	+1.9%	+1.8%	+1.4%	+1.3%	+1.6%	
AS 16	+1.7%	+1.5%	-0.0%	+0.5%	+1.3%	+1.6%	
Real terms average hourly earnings growth							
Budget 16	+2.0%	+2.2%	+1.8%	+1.7%	+1.6%	+1.9%	
AS 16	+2.0%	+2.3%	-0.0%	+0.4%	+1.5%	+2.0%	

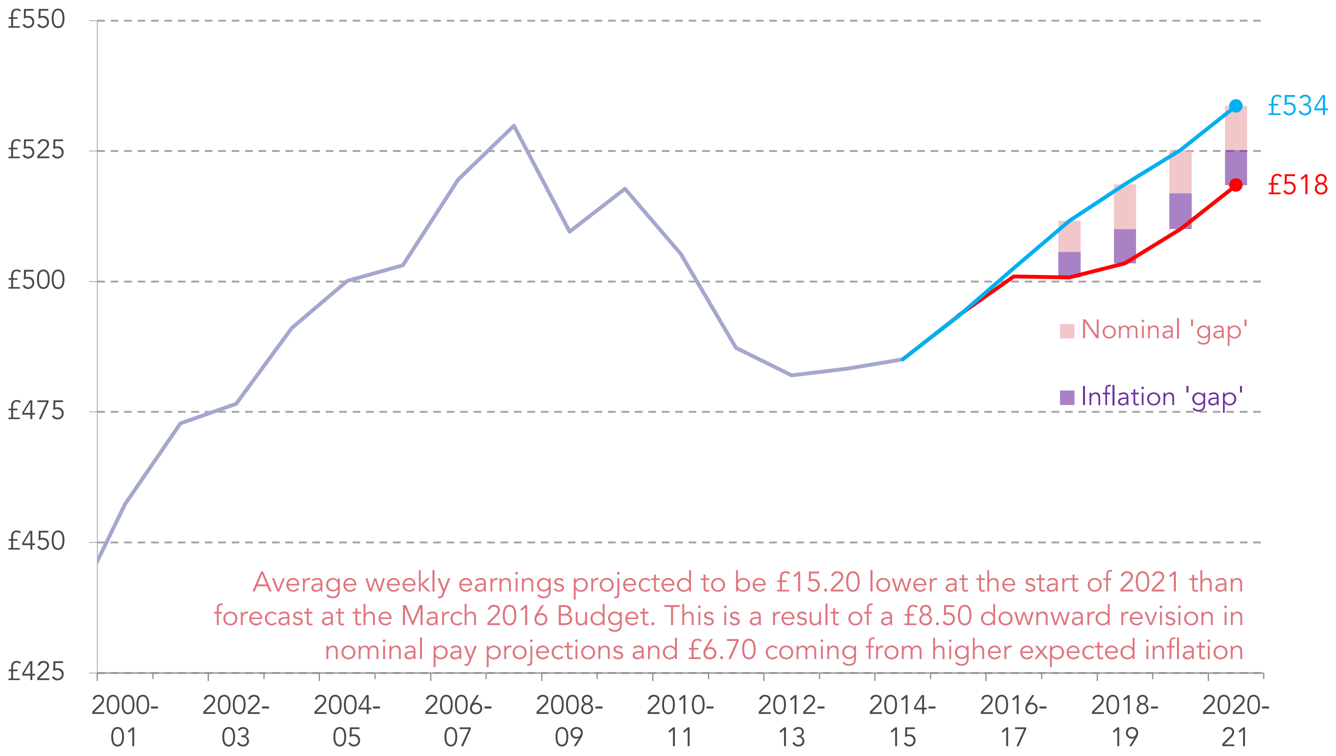
Sources: OBR, *Economic and Fiscal Outlook*, various

Nominal pay growth is forecast to weaken and inflation is expected to rise (with the latter being one of the more certain projections in the OBR outlook following the decline in the value of Sterling). As before, most of the divergence from the previous forecasts is expected to arrive in 2017-18 and 2018-19. As a result, real pay is expected to fall very marginally in 2017-18, with the effect most visible in the middle of 2017.

Figure 13 puts this in context, by setting out the trajectory of average weekly earnings in the period since 1997. It shows that average weekly pay is expected to be £15.20 lower in 2020-21 than had previously been thought – representing an annual reduction of roughly £830. Of this, around £370 (or 44 per cent) is a product of higher inflation and £460 (or 56 per cent) results from lower nominal pay growth expectations.

Figure 13: Real-terms average weekly earnings outturn and projections

Average weekly earnings (2015-16 prices, CPI-adjusted)



Notes: Assumes median pay grows in line with the OBR's average earnings projection.

Sources: ONS, *Series DTWM, ROYK, MGRZ, MGRQ*; ONS, *Labour Market Statistics*; ONS, *Annual Survey of Hours and Earnings* & OBR, *Economic and Fiscal Outlook*, various

Such an outcome would leave real earnings no higher in 2020-21 than they were in 2006-07. It would also mean that pay growth over the decade from 2010 would be the weakest since the 1900s. Total growth of just 1.6 per cent in the decade to 2020 compares with growth of 12.7 per cent in the 2000s and over 20 per cent in every other decade since the 1920s.

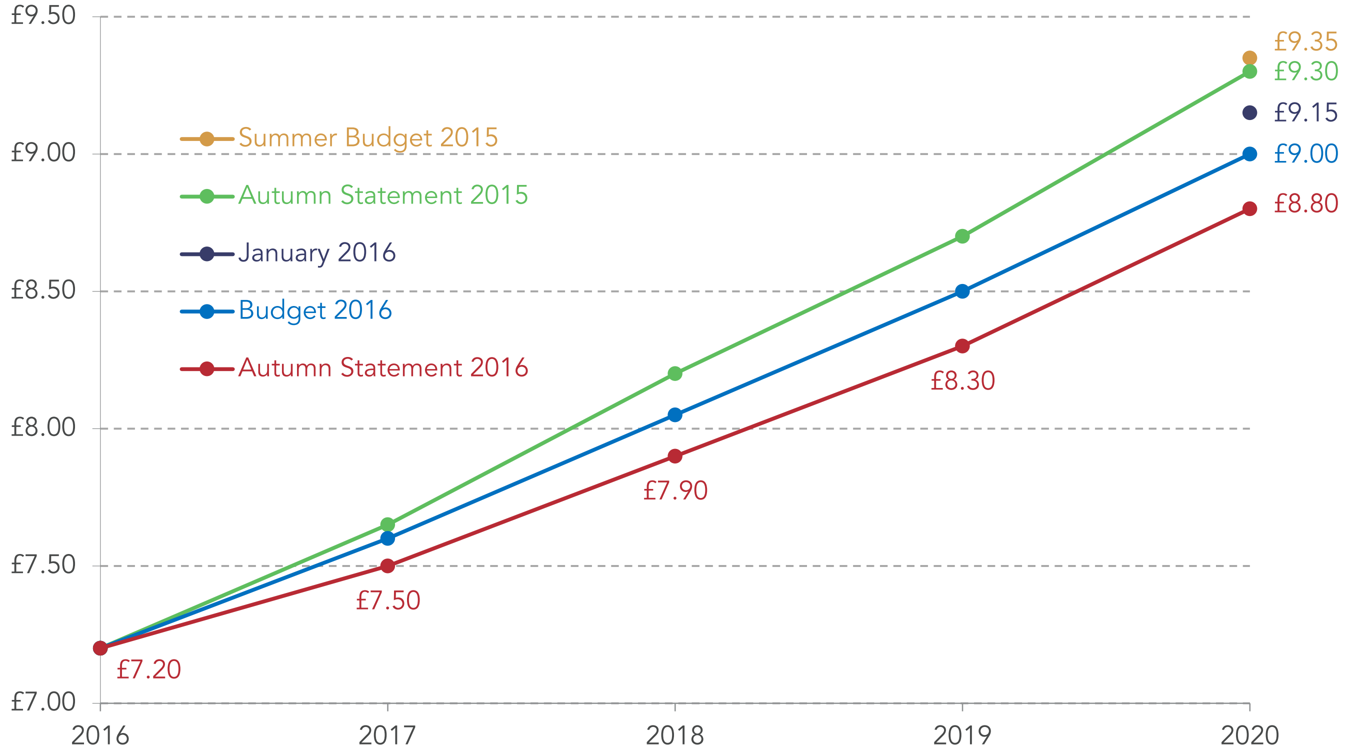
The Autumn Statement provided some modest support for just managing families

While the wider pay picture appears relatively gloomy, the Autumn Statement provided good news for the lowest paid workers. The Chancellor announced that the National Living Wage (NLW) – the wage floor for those aged 25 and over – will rise by 4 per cent to £7.50 from April 2017, meaning a £600 pay rise for full-time NLW workers.

This increase is a little smaller than may have been expected back in March. That's because the guiding principle for the NLW is for it to be linked to median pay among those aged 25 and over. Tethering the earnings of those at the bottom to typical earners remains a sensible way – especially in uncertain economic times – of ensuring that the NLW rises meaningfully but sustainably. Nevertheless, as Figure 14 shows, to date the history of the NLW is one of downward, rather than upward, revision.

Figure 14: Successive OBR projections of the National Living Wage

Successive OBR projections of National Living Wage rate to 2020, cash



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

The government's ambition is for the NLW to reach 60 per cent of median hourly earnings for those aged 25 and over by April 2020. Based on this trajectory, the OBR forecasts that the NLW will be £8.80 in 2020, somewhat below the figure of £9 much discussed at the March Budget. Underlining the uncertainty of such predictions, the Low Pay Commission's analysis, also published on Wednesday but which draws on independent forecasts for wage growth, projects an NLW of around £8.60 in 2020.[8]

Looking beyond incomes, the Chancellor has also introduced a group of measures designed to reduce living costs for just managing families:

» Most significantly, he has announced a further £1.4 billion to support house building, with the aim of increasing housing supply and reducing pressure on housing costs. This is expected to lead to an additional 40,000 homes being built.

» Banning letting agency fees for prospective tenants is a further sign of support, potentially helping the 28 per cent of low to middle income households currently housed in the private rented sector by increasing transparency of where costs lie. The long run impact of this reform and potential feed through to rent levels is as yet unclear.

» A further freeze in fuel duty will also be of help to low to middle income households – though gains will be spread across the income distribution – with the average driver expected to be around £130 a year better off compared to the pre-2010 fuel duty escalator.

The only tax and benefit measure designed to specifically help low to middle income working households – the 'just managing' – came in the form of a 2 per cent reduction in the Universal

[8] Low Pay Commission, *National Minimum Wage: Low Pay Commission Report Autumn 2016*, November 2016

Credit (UC) taper, at a cost of £0.6 billion per year by 2020. Previously the UC taper was set at 65 per cent, meaning that for every pound earned above the work allowance (see below) a non-taxpayer worker keeps 35p. When the payment of income tax and National Insurance is also taken into account that return falls to 24p. Now from April 2017 taxpayers in receipt of UC will keep 25p of each pound earned, a 1.4p improvement.

Any increase in the incentives for workers to progress and increase earnings is welcome, but this change is obviously relatively small. A taxpayer working an additional eight hours at the NLW in 2020 would be better off by only one pound following the taper reduction (a non-taxpayer would be better off by £1.40).

But these are more than offset by losses driven by inherited policy

This particular welfare change – and the wider package aimed at helping 'just about managing' families – must be viewed in the context of significant cuts to UC set in train by the Chancellor's predecessor at the Summer Budget 2015. Key for working families is the cut in the value of 'work allowances'. These are a net earnings level up to which no benefit income is withdrawn. Once earning more than the work allowance, benefit entitlement is reduced at the taper rate (now 63 per cent of net earnings from April 2017).

Table 2 sets out the cut in the value of work allowances expected by 2020 announced at previous fiscal events, compared to the gains from the taper reduction announced at the Autumn Statement. A single parent could lose up to £2,840 a year by 2020 and couple parents up to £1,220 from this cut alone, but both would gain only £200 a year from the taper reduction if working full time at the NLW. We could expect a maximum gain of up to around £500 a year for a family earning £30,000 a year (less than 10 per cent of families on UC earn more than this amount).

Table 2: Losses from UC work allowance cuts this parliament and potential gains from 2 per cent taper reduction, 2020 (cash)

	Pre-Summer Budget			Pre-Autumn Statement			Income loss	Max gain for FT NLW worker from 2% taper
	Annual limit	Weekly hours at NMW	Weekly hours at NLW	Annual limit	Weekly hours at NMW	Weekly hours at NLW		
Higher work allowance - without housing costs								
Single parent	£9,200	22	20	£4,900	12	11	-£2,840	£200
Couple with children	£6,700	16	14	£4,900	12	11	-£1,220	£200
No dependent children	£1,400	3	3	£0	0	0	-£920	£300
Limited capability for work	£8,100	20	17	£4,900	12	11	-£2,130	£200
Lower work allowance - with housing costs								
Single parent	£3,300	8	7	£2,400	6	5	-£620	£250
Couple with children	£2,800	7	6	£2,400	6	5	-£290	£250
No dependent children	£1,400	3	3	£0	0	0	-£920	£300
Limited capability for work	£2,400	6	5	£2,400	6	5	-£40	£250

Notes: Work allowances and minimum wage rates are based on OBR November 2016 economic assumptions

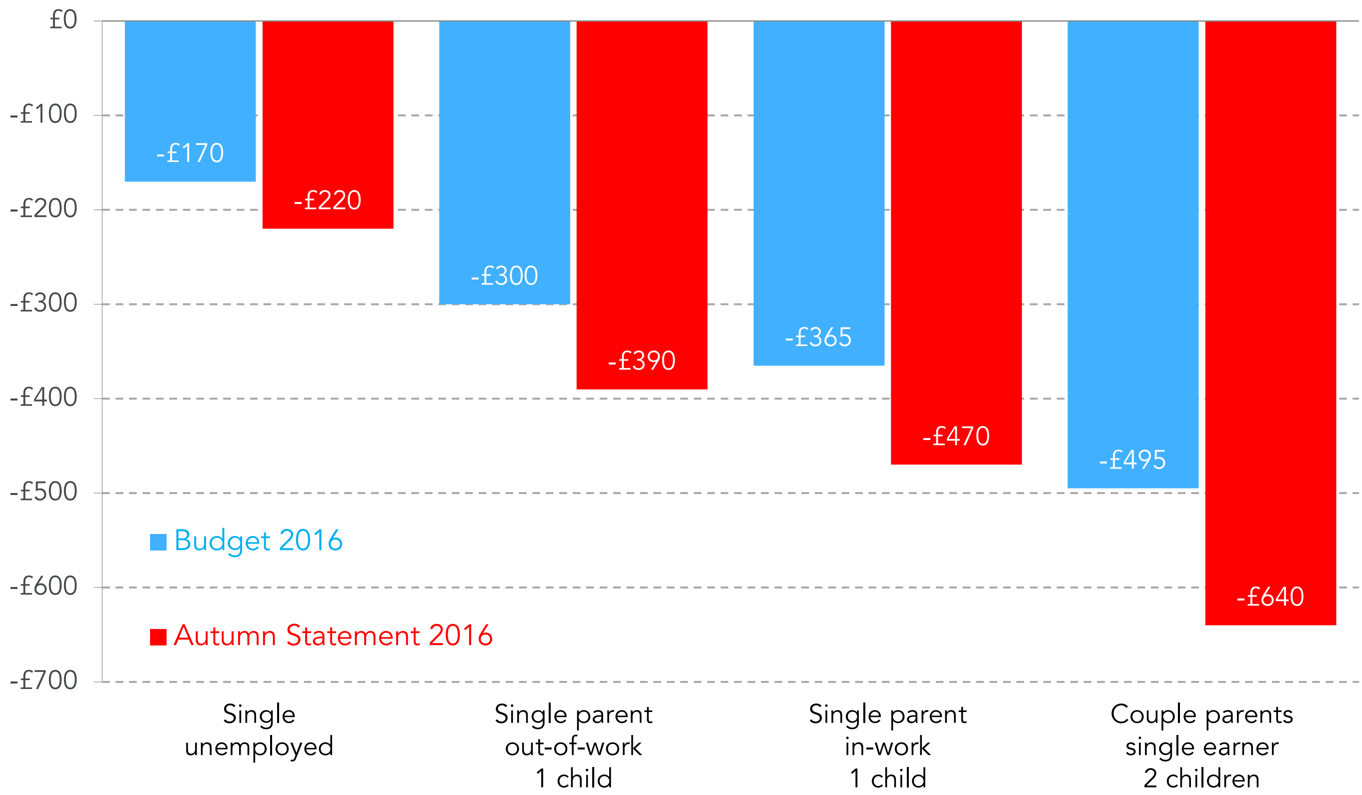
Source: RF analysis using OBR, *Economic and Fiscal Outlook*, various

In addition to cuts to work allowances, the other key element of inherited welfare cuts is the freeze of working age benefits at their current cash rates until April 2020. The higher inflation forecast contained in the OBR's latest assessment means that the real impact of this policy on the incomes of those households receiving in- or out-of-work support has got significantly bigger.

Figure 15 shows how expected losses have increased for different family types since the Budget. A couple with two children could lose an extra £145 due to higher inflation. Losses are greater for families with children because they receive more support.

Figure 15: Change in income due to benefit freeze by 2020

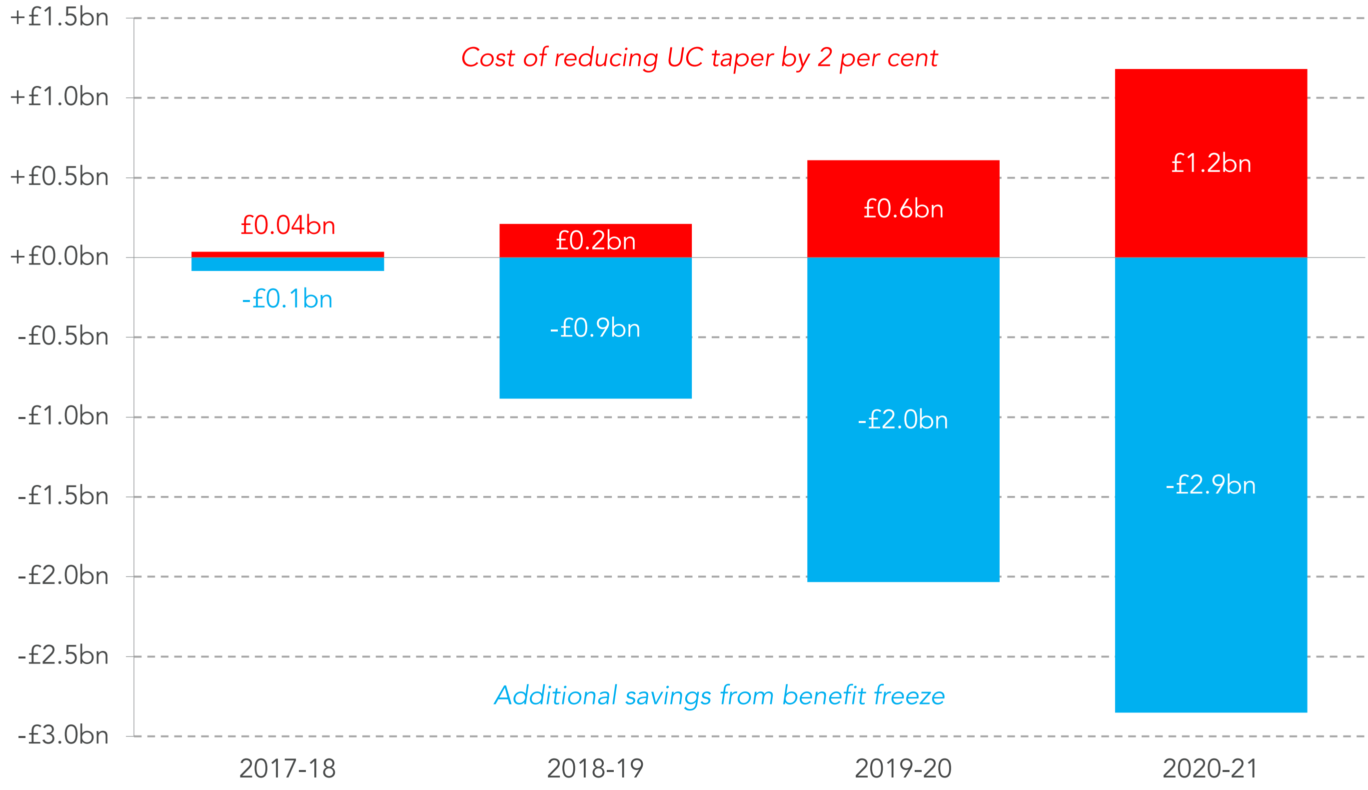
Real-terms annual change in income (CPI-adjusted, 2016-17 prices)



Source: RF analysis using OBR March 2016 and Autumn Statement 2016 economic assumptions

Higher inflation also means that the benefit freeze is expected to lead to greater savings for the government by 2020. At Budget 2016, the benefit freeze was expected to save £3.6 billion in 2020; accounting for the latest inflation projections suggests that saving will now be £0.8 billion higher at £4.4 billion a year in 2020. Figure 16 compares the cumulative savings associated with higher inflation with the £1.2 billion cumulative additional spend resulting from the UC taper reduction announced in the Autumn Statement. As it makes clear, the new giveaway is set to cost the government less than half the amount it will save over the course of the parliament as a result of the unexpected increase in inflation.

Figure 16: Cumulative change in spend from UC taper reduction of 2 per cent and additional savings from the pre-announced benefit freeze due to higher inflation



Source: RF analysis using OBR, *Economic and Fiscal Outlook*, various

Overall the Chancellor reversed only 7 per cent of the inherited policy-related hit to the poorest half of families

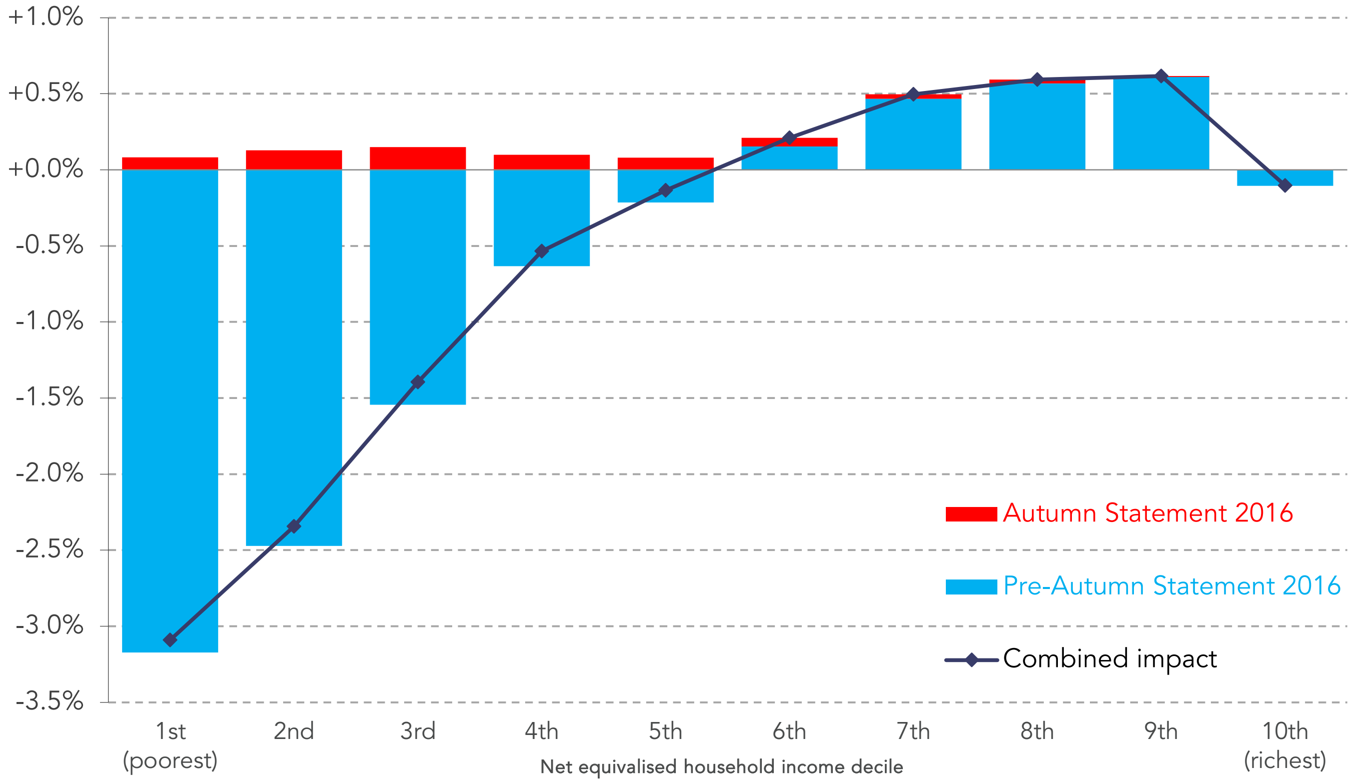
So the welfare changes announced at this Autumn Statement to boost incomes for lower income working families appear more limited than some of the key welfare cuts that came before. But as well as large welfare cuts, the Chancellor also inherited boosts to incomes via tax cuts, the introduction of the NLW and additional childcare support. It's therefore right to assess the Autumn Statement changes in the context of all this parliament's policies as a whole.

Focusing first on those families most affected, we estimate that by 2020 all working families entitled to UC will be made £1,200 a year worse off in today's prices (CPI-deflated). This stems from a combination of the benefit freeze and cuts to work allowances, and arises despite gains from income tax cuts, the NLW, additional hours of free childcare and the new 2 per cent reduction in the UC taper. That average loss rises to £1,400 for working families with children.

Figure 17 shows the impact of tax and benefit policies announced this parliament by net household income decile. The analysis uses the latest OBR economic assumptions throughout to highlight only the impact of policy changes. The blue bars show the cumulative impact of policies announced this parliament up to and including the last Budget. These show that the poorest half of households were set to be made worse off by an average of 1.6 per cent of net income, rising to over 3.2 per cent for the poorest tenth. The red bars, depicting changes to tax and benefit policy at Autumn Statement highlight the relatively small giveaways and show that the poorest half of households will gain by an average of 0.1 per cent of net income – reversing only 7 per cent of the overall losses already in train.

Figure 17: Cumulative impact of tax and benefit policies announced this parliament pre-Autumn Statement and net impact of those announced at Autumn Statement 2016: 2020

Proportional change in income by net equivalised household income decile

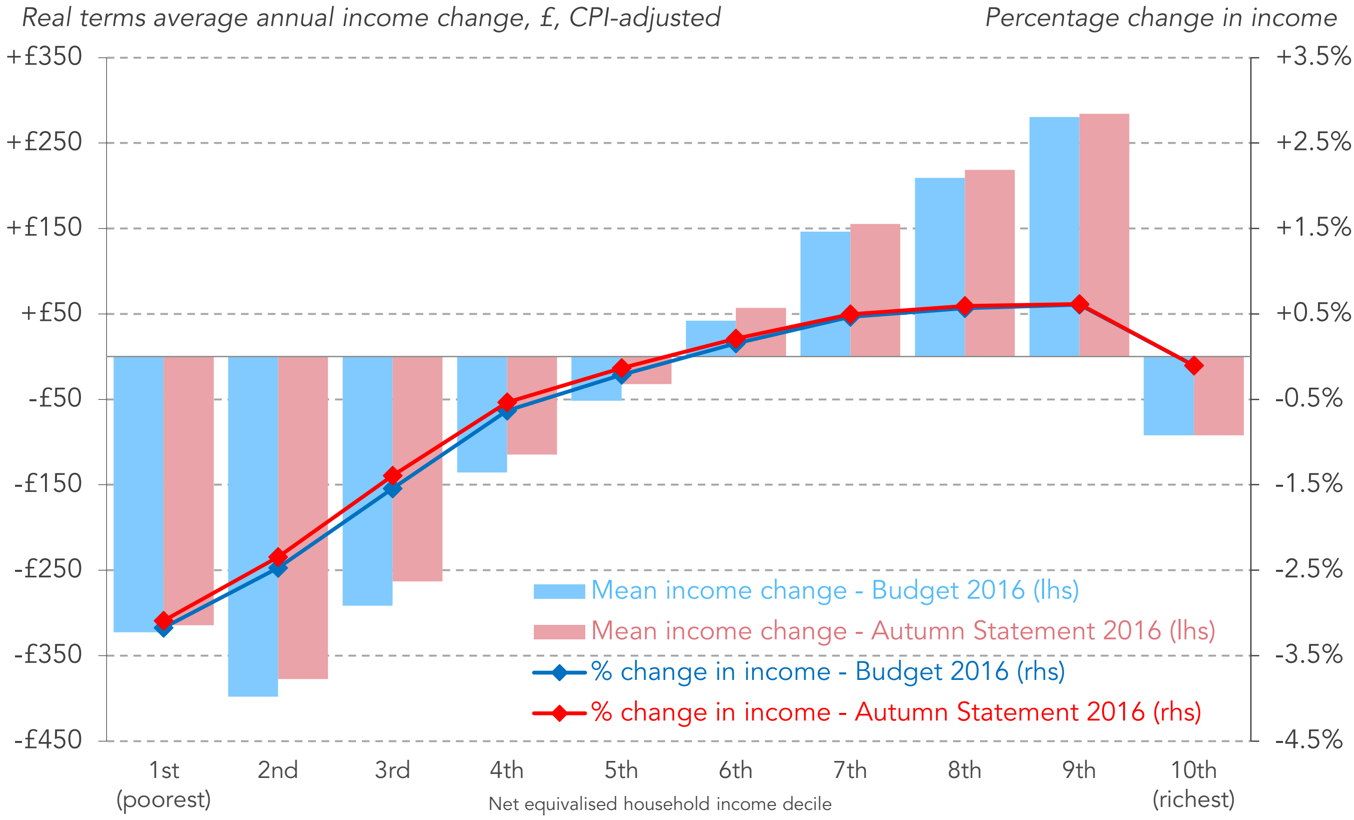


Notes: Includes impact of National Living Wage, announced income tax cuts, additional hours of free childcare, removal of family element, fuel duty freezes, limiting support to two children, work allowance cuts, pension tax relief cuts, Class 2 NICs abolition, benefit freeze & reducing UC taper to 63 per cent. Assumes full entitlement take-up, UC 80 per cent rolled out & measures affecting new claims/births half in place

Source: RF analysis using the IPPR tax-benefit model & OBR, *Economic and Fiscal Outlook*, November 2016

For completeness, Figure 18 provides the cumulative impact of policies pre- and post- Autumn Statement and also provides the average annual change in income from the measures. It shows that the poorest third of households will be an average of £325 worse off due to policy changes this parliament, and the richest third £255 better off. Overall, just managing families with children will be an average of £600 a year worse off in today's prices.

Figure 18: Cumulative impact of tax and benefit policies announced this parliament pre- and post- Autumn Statement: 2020



Notes: See Figure 17

Source: RF analysis using the IPPR tax-benefit model & OBR, Economic and Fiscal Outlook, November 2016

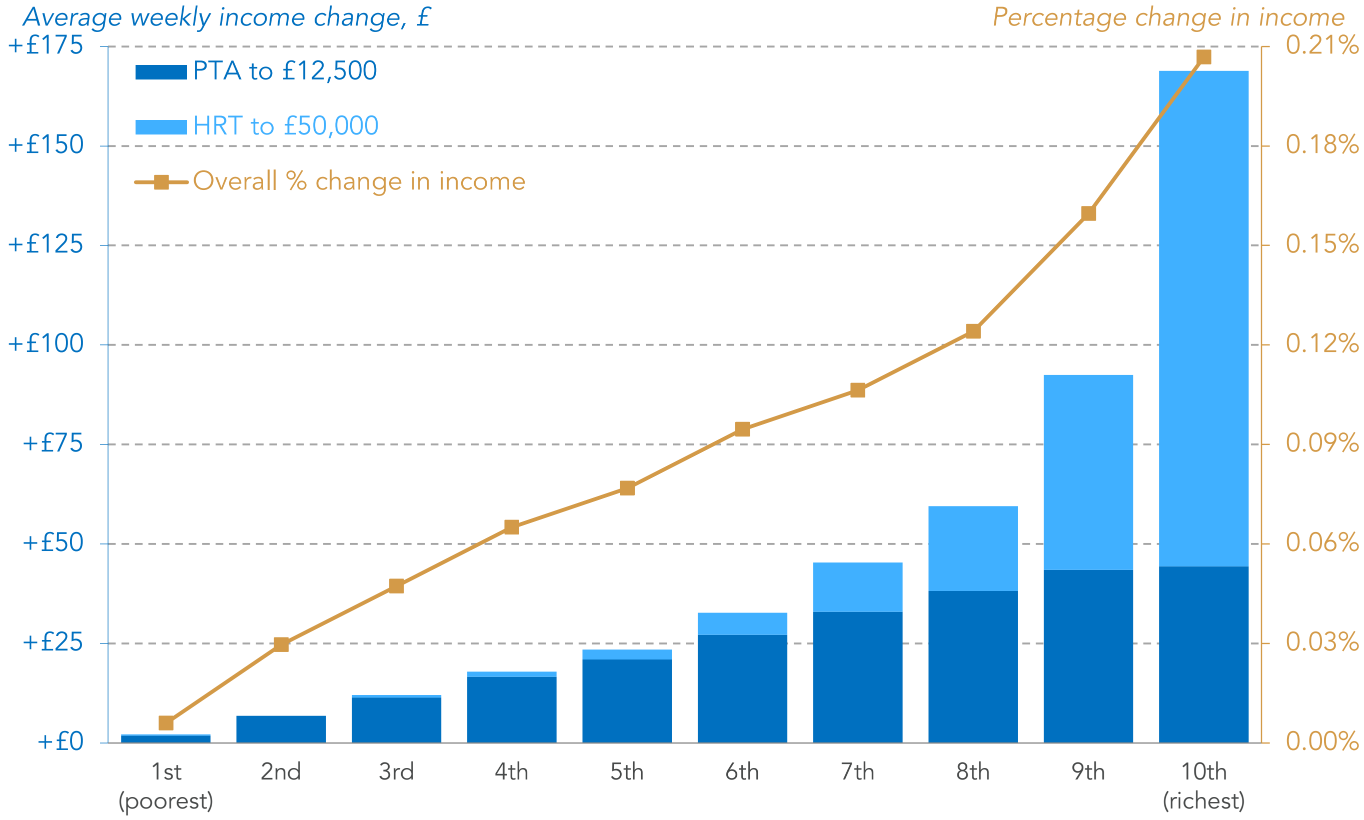
Yet the Chancellor re-committed to income tax giveaways that provide the largest gains to better-off households

While not setting out any new details on the precise path for getting there, the Autumn Statement also renewed the government's commitment to meet the manifesto pledge of increasing the income tax personal allowance to £12,500 and the higher rate threshold to £50,000 by the end of the parliament. Such a move is expected to cost £1.3 billion by 2020 if the pledge is met in April 2020. The cost has fallen since the Budget because higher inflation would otherwise increase tax thresholds faster than previously expected – they are now expected to reach £12,340 and £48,440 by April 2020 respectively, even without further above-inflation increases.[9]

Figure 19 sets out the distributional impact of meeting those pledges which, in line with our previous research, shows that over four-fifths of the gains would go to the richest half of households. Such a share of the gains is equivalent to £1 billion of spend in 2020 – greater than the £0.6 billion spent in the same year to reduce the UC taper by 2 per cent.

[9] OBR, *Economic and Fiscal Outlook*, November 2016

Figure 19: Impact of meeting the pledge to increase the personal tax allowance to £12,500 and higher rate threshold to £50,000 in April 2020



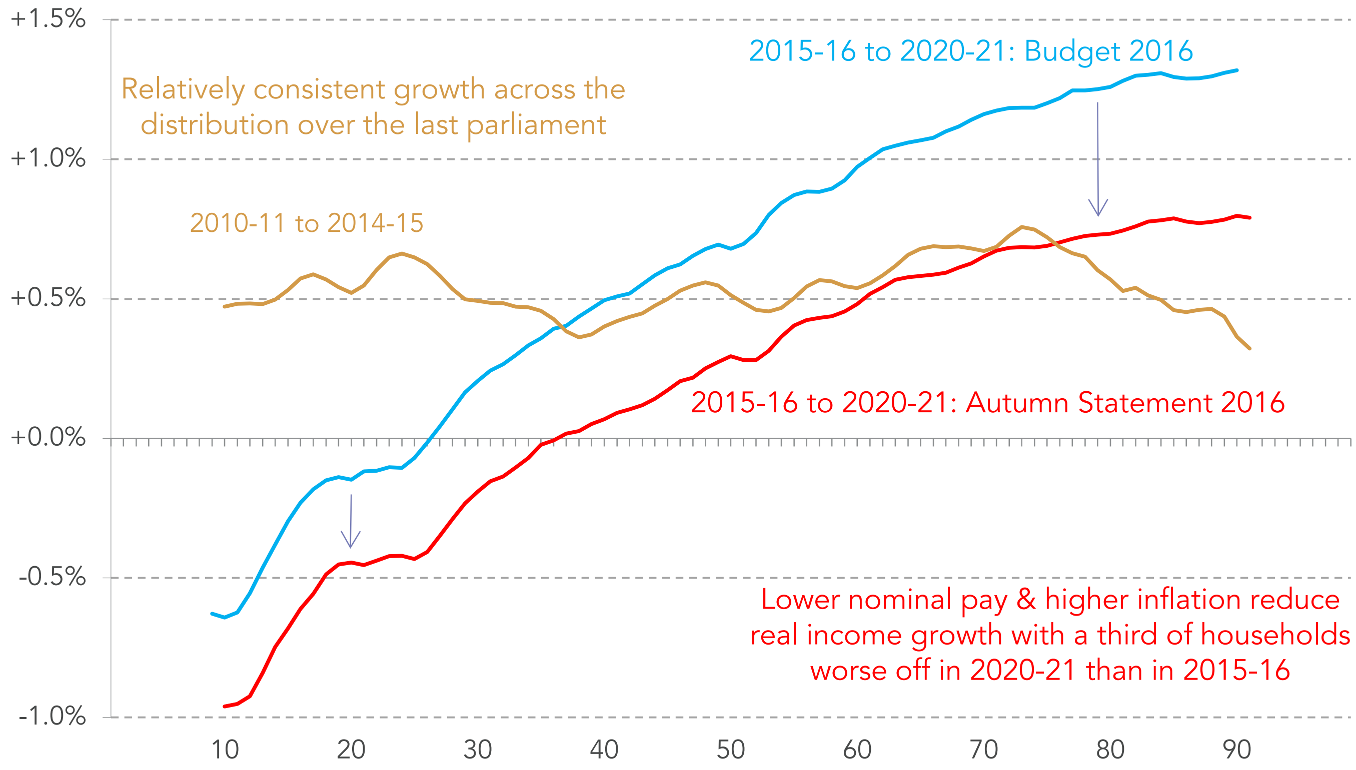
Source: RF analysis using the IPPR tax-benefit model & OBR, *Economic and Fiscal Outlook*, November 2016

The poorest third of households look set for a fresh income squeeze over the parliament

With policy measures tabled at the Autumn Statement making only a marginal difference, the outlook for incomes over this parliament is driven by the inherited tax and benefit policy mix and the by the OBR's revised economic forecasts. As Figure 20 shows, higher expected inflation and weaker earnings growth are set to reduce what was already historically weak income growth expected at Budget 2016 from an annual average of 0.6 per cent a year to 0.2 per cent a year.

Figure 20: Average annual household net income growth since 2010: comparing outturns, Budget 2016 and Autumn Statement 2016 assumptions

Proportional change in real-terms income (CPI-adjusted)



Notes: Includes impact of National Living Wage, announced income tax cuts, removal of family element, limiting support to two children, work allowance cuts, Class 2 NICs abolition, benefit freeze & reducing UC taper to 63 per cent. Assumes full take-up of benefits, UC 80 per cent rolled out & measures affecting new claims/births half in place. Growth from 2010-11 to 2014-15 uses outturn data from the Family Resources Survey. Budget 2016 scenario uses policies announced by Budget 2016 and OBR economic assumptions in March 2016. Autumn Statement 2016 scenario uses policies announced by Autumn Statement 2016 and OBR economic assumptions in March 2016.

Source: RF analysis using IPPR tax-benefit model and OBR, Economic and Fiscal Outlook, various & DWP Family Resources Survey

However, that average hides significant variation across the income distribution. For richer households, losses relate largely to the expected drop in real earnings, with average annual growth falling from over 1 per cent a year to just over 0.5 per cent a year. For the poorest third of households, incomes are expected on average to fall by 0.6 per cent a year.

This expected performance also compares poorly to growth across the income distribution in the previous parliament. Between 2010-11 and 2014-15 – years for which outturn survey data is available – growth was relatively weak at around 0.5 per cent a year, but it was evenly felt across the income distribution. Income growth looks set to be weaker for roughly three-quarters of households in the period to 2020-21 than in the last parliament, marking a worrying return of the income squeeze experienced after the financial crisis for many.

With families with children facing particularly sharp falls in incomes

These shifts in the outlook for income growth over the current parliament – the combination of changed economic assumptions and successive policy choices – will affect individual families very differently. By way of illustration, Table 3 summarises the impact of these policy and economic changes on ten example families, mainly representing the just managing. It shows each family's forecast income at the end of the parliament, along with the effects of successive changes on that income level.

Table 3: Impact of policy and economic changes this parliament for example family types

Net household incomes, Universal Credit system, 2020-21, CPI-adjusted to 2016-17 prices

Net household incomes (before housing costs)	Start of parliament income forecast	*Economic impact*	*Policy impact*		*Combined impact*
		Change from March to November forecasts	*Pre-Autumn Statement*	*Autumn Statement*	
1. Single (no kids), full time, earning wage floor *works 37.5 hours per week at NMW/NLW, rents privately at 30th pctile*	£11,700	-£250	+£1,360	+£0	+£1,110
2. Single (no kids), full time, low earning self-employed *works 37.5 hours per week and earns equivalent of NMW per hour*	£13,000	-£280	+£80	+£0	-£200
3. Single (1 child), part time, earning wage floor *works 20 hours per week at NMW/NLW*	£14,580	-£180	-£2,530	+£70	-£2,640
4. Single (1 child), full time, low earning, renting *works 37.5 hours per week at p25 wage, rents social housing at average rents*	£17,670	-£140	-£1,490	+£260	-£1,370
5. Couple (2 kids), full time single earner on wage floor *main earner works 37.5 hours per week at NMW/NLW*	£21,050	-£90	-£1,880	+£190	-£1,780
6. Couple (2 kids), low earning/wage floor, renting *main earner works 37.5 hours per week at p25 wage, second earner works 20 hours per week at NMW/NLW, rents privately at 30th pctile*	£29,630	-£150	-£1,150	+£430	-£870
7. Couple (3 kids), low earning/wage floor, renting *main earner works 37.5 hours per week at p25 wage, second earner works 20 hours per week at NMW/NLW, rents privately at 30th pctile*	£32,320	-£150	-£3,930	+£430	-£3,650
8. Couple (no kids), low/mid earning *both work 37.5 hours per week, main earner at median wage, second earner at p25 wage*	£33,980	-£810	+£170	+£0	-£640
9. Couple (2 kids), low/mid earning *both work 37.5 hours per week, main earner at median wage, second earner at p25 wage*	£35,750	-£800	+£60	+£0	-£740
10. Couple (no kids), high earning *both work 37.5 hours per week at p90 wage*	£76,850	-£1,820	+£500	+£0	-£1,320

Notes: Figures relate to modelled hypothetical outcomes in 2020-21 on the assumption that these families receiving in-work benefits are in the Universal Credit system and are making a new or changed claim. All figures are presented in 2016-17 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 2020. 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 2016 Budget and 2016 Autumn Statement.

Source: Resolution Foundation analysis using RF microsimulation model

The first thing to note is that, despite the consistently worsened picture when averaging across the income scale, not everyone loses out. Our first example – a single adult working full time on the wage floor – gains more from the introduction of the NLW (part of pre-Autumn Statement policy) than he loses from forecasted higher inflation. And, because he doesn't receive in work benefits, welfare changes do not affect him.

For our other examples though, the overall impact is negative, both for lower earners in receipt of in-work welfare support (families three to seven) and for middle and higher earning families largely outside the welfare system (families eight to ten). To explore a few examples of just about managing families in detail:

» Family 4 – a single parent working full time on a low wage – is expected to be £1,370 worse off in 2020 overall. This family loses £140 as a result of weaker economic forecasts (driven by a £540 reduction in gross pay, which is cushioned by lower tax payments and higher benefit receipts as a result of earning less). Cuts to in-work benefits announced in the fiscal events prior to the 2016 Autumn Statement – including the benefits freeze, and the reduction of work allowances and removal of the family element in UC – reduce 2020 incomes by a much greater

£1,490 (with tax cuts providing a very small offset here). The boost to UC (the lower taper rate) announced at the latest Autumn Statement reverses just 17 per cent (£260) of this policy-related squeeze (16 per cent of the overall squeeze).

» Family 5 – a single-earning couple with two children – is expected to be £1,780 worse off in 2020 overall. This family loses £90 as a result of worsened economic forecasts, and a much larger £1,880 as a result of pre-Autumn Statement policies. This reflects the balance of the NLW and tax cuts which boost this family's income, more than offset by welfare cuts that reduce it. The Autumn Statement boost to UC – worth £190 for this family – reverses just 10 per cent of this policy-related squeeze (also 10 per cent of the overall squeeze).

» Family 7 – a dual-earning couple with three children – is expected to be £3,650 worse off in 2020 overall. This family loses £150 as a result of worsened forecasts, and a much larger £3,930 as a result of inherited policies. Again, this latter figure reflects the balance of the NLW, tax cuts and welfare cuts, with the pre-Autumn Statement policy of limiting welfare support to a maximum of two children having a particularly large effect here. The Autumn Statement UC boost – worth £430 for this family – reverses 11 per cent of this policy-related squeeze (also 11 per cent of the overall squeeze).

Given the scale of revision and uncertainty in the economic forecasts presented by the OBR, it is inevitable – and right – that much of the initial discussion of Philip Hammond's first fiscal statement has focused on the outlook for public finances and his response to the circumstances he has inherited. However, over the coming weeks and months it is vital that just as much attention is paid to the finances of families.

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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