

Resolution Foundation

BRIEFING

Are we nearly there yet?

Spring Budget 2017 and the 15 year squeeze on family and public finances

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Summary

Spring Budget 2017 offered the Office for Budget Responsibility (OBR) and the Chancellor the chance to respond to **better-than-expected economic news in recent months**, following grim forecasts about the outlook for Brexit Britain back in November's Autumn Statement. Both have largely ignored it.

In the short-term growth forecasts have been revised up, to 2 per cent in 2017 from 1.4 per cent. The **near-term borrowing outlook has also improved**, with public sector net borrowing expected to come in a significant £16.4 billion lower this year than expected back in November. The OBR has considered these improvements, but decided they make little difference to their medium-term estimate of the capacity of the British economy or the health of the public finances.

The OBR has assumed that **almost none of the recent improvement in the public finances lasts**, with future years' borrowing forecasts almost exactly in line with their Autumn Statement forecasts. That means borrowing is projected to rise next year (to £58.3 billion) and end the forecast period just £0.4 billion lower than previously thought (at £16.8 billion). **Relative to the £122 billion borrowing downgrade set out in the Autumn Statement, yesterday's revisions reversed just 19 per cent.**

Against this backdrop the Chancellor has largely chosen to do nothing, banking the short term improvement while **retaining £26 billion worth of headroom against his fiscal rule** that structural borrowing be below 2 per cent of GDP in 2020-21. The latter decision reinforces the sense that fiscal rules now act as a ceiling to, rather than target for, fiscal policy.

Because of a slower pace of deficit reduction from 2019-20, **the Chancellor is now not on course to achieve his ultimate fiscal 'objective' of eliminating the deficit altogether until 2025-26**, a full 15 years after George Osborne started to raise taxes and cut spending.

While the economy is set to grow faster this year, the OBR expects slower growth in the following three years. By the end of the forecast period in 2022, the economy is expected to be slightly smaller than forecast in November. That means **GDP per capita will have grown by just 7.9 per cent in nearly 14 years since the start of the 2008 recession**, compared to 29 per cent at the same stage after the 1980 recession and 33 per cent after the start of the 1990 downturn.

While the OBR's assumed trajectory for growth has changed little since the Autumn Statement, the shape of the forecast growth looks somewhat different. Employment is expected to be higher, leaving productivity and pay growth somewhat lower. Average productivity growth between 2016 and 2021 is now expected to be just 1.3 per cent, while nominal pay growth is revised down from the second quarter of 2018 onwards. When combined with rising inflation, this means that **real earnings are set to actually fall later this year and are only projected to return to their pre-crisis peak after the end of the OBR's forecast period in late 2022, 15 years after the pay squeeze began**. If the OBR forecast comes to pass, this will have been the worst decade for pay growth for 210 years.

So, despite the economy performing better than expected recently, the big squeezes on both public and household finances look set to continue. While the Chancellor cannot simply wish lower inflation or higher productivity into being, for low and middle income families the pay squeeze is compounded by his failure to reverse large and highly regressive benefit cuts due in coming years. These will see a single earning couple with two kids lose £1,630 in 2020-21, while larger families will lose much more.

While the Chancellor inherited most of these benefit changes from his predecessor, he did announce a 2 percentage point increase in the Class 4 National Insurance paid by the self-employed to coincide with the abolition of flat rate Class 2 National Insurance. This is a **welcome and progressive change that will mean the bottom 54 per cent of self-employed earners pay less National Insurance, or none at all**. Those earning over £16,250 will pay more, with anyone earning over

£50,000 paying a little over £600 more tax each year. At a household level these National Insurance changes are highly progressive, with the majority of revenue raised coming from the top ten per cent of households.

These changes should however be part of a wider reform of self-employed taxation and an increase in the support the self-employed receive, including with the likes of maternity pay and pension saving.

*Despite the focus received by this National Insurance change, it stands in stark contrast to benefit cuts planned for the coming years by virtue of being both modest and progressive. The real inequity lies with the fact that the combination of low pay growth and regressive benefit cuts means, all told, **the next four years (2016-17 to 2020-21) are on course to be even worse for the poorest third of households than the four years following the financial crisis (2007-08 to 2011-12).***

Tackling rising inflation or stubbornly low productivity growth is not straightforward but, in the face of a severe living standards squeeze, the Chancellor should recognise that now is not the time to be adding to the pressure on low and middle income working families with substantial benefit cuts. Luckily for him and them, the Chancellor has two Budgets this year and will have the chance to think again.

The last ever Spring Budget delivered some near-term good news for the Chancellor, but the medium-term outlook is little altered

The OBR's projections give, and the OBR's projections take away. In November – the last Autumn Statement – the change was most definitely negative, with a £122 billion upward revision in cumulative projected borrowing. The Chancellor himself was responsible for £26 billion of that, but £96 billion of it was the product of changes in the OBR's forecasts. The Chancellor will therefore be relieved that for his first and last Spring Budget the same has not happened. Instead, borrowing has been revised down.

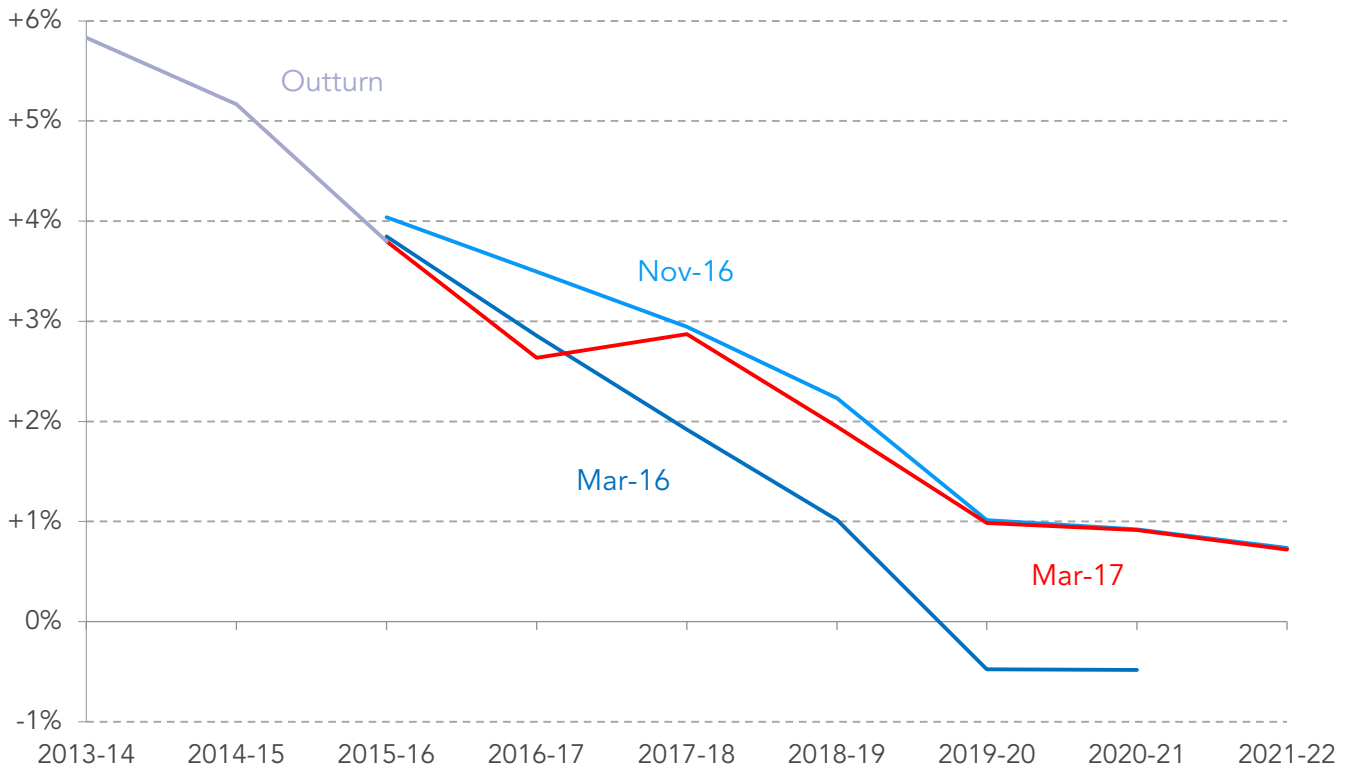
While undoubtedly good news, the improvement is very clearly front-loaded. Public finance outturns for January showed that borrowing in 2016-17 looked on course to be significantly lower than previously forecast.^[1] Reflecting on these figures and much else besides, the OBR has now revised down borrowing for this year from 3.5 per cent of GDP to 2.6 per cent. That puts it no higher than in 2007-08 and lower than forecast in March 2016. In part this is down to methodological changes and to some EU payments being paid in 2017-18 rather than the previously expected 2016-17, but a large part is down to higher-than-expected tax receipts.

Welcome thought this unexpected improvement is, borrowing in future years is forecast to quickly move back towards a very similar trajectory to the one set out in November's Autumn Statement. Indeed, as Figure 1 shows, borrowing is now forecast to be higher in 2017-18 than this year. In the final three years of the forecast, the deficit is forecast to be almost identical to the levels set out in November. The big picture therefore is that the outlook for borrowing remains much higher today than at the 2016 Budget, before the EU referendum.

[1] www.budgetresponsibility.org.uk/docs/dlm_uploads/February-2017-Commentary-on-the-Public-Sector-Finances.pdf

Figure 1: Successive borrowing forecasts

Public sector net borrowing as a share of GDP



Source: OBR, Economic and Fiscal Outlook, various

Cumulative borrowing is on course to be £24 billion lower than projected in November, reversing just 19 per cent of the Autumn Statement’s £122 billion downgrade

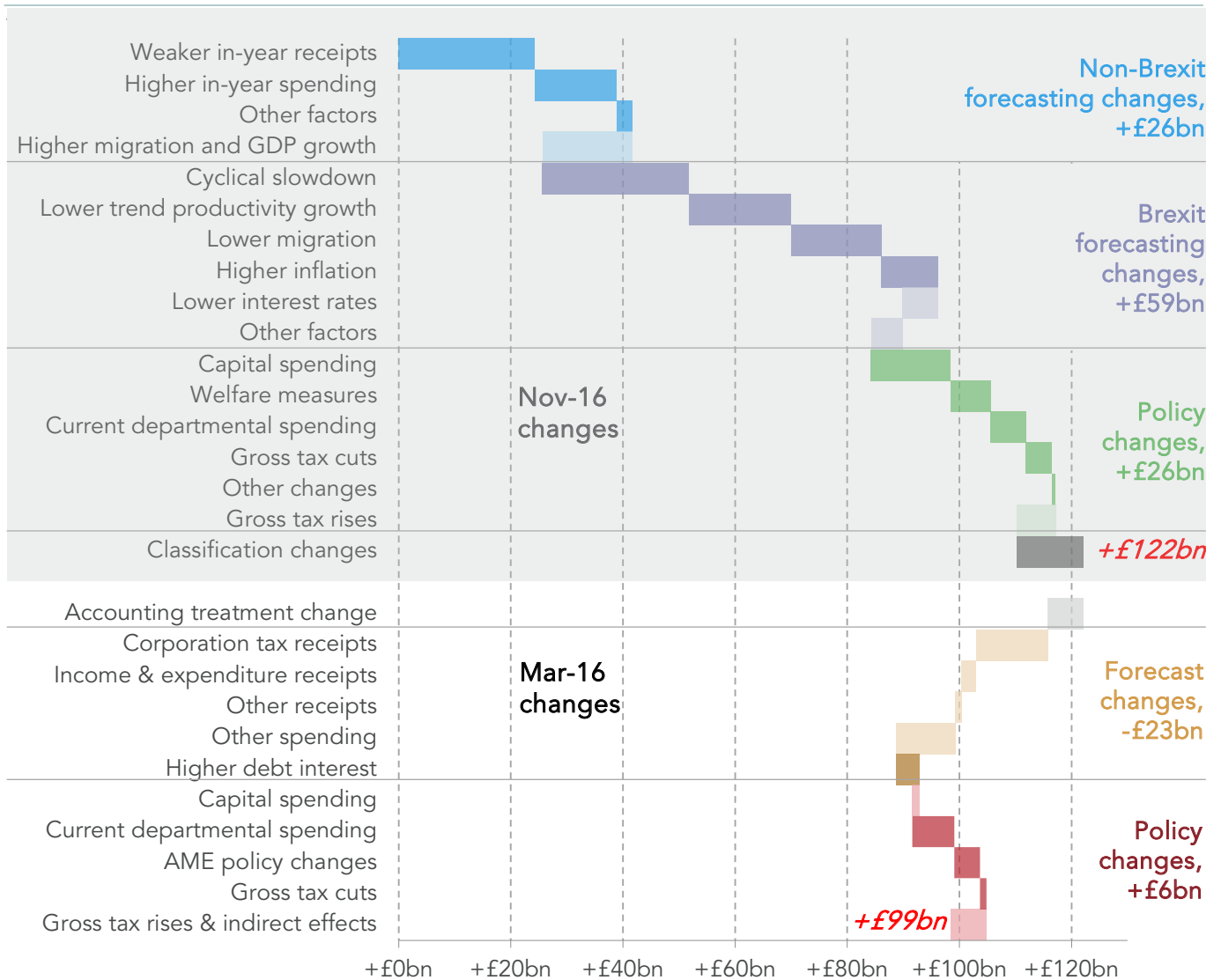
Over the full range of the forecast period – covering the six years from 2016-17 to 2021-22, borrowing is forecast to be £24.0 billion lower than previously forecast (with £16.4 billion of this coming in 2016-17). This includes methodological, forecast and government policy changes.

Yet this revision must be seen in the context of what went before. It reverses just 19 per cent of the £122 billion downgrade delivered in November, and therefore leaves borrowing £99 billion higher over the five years to 2020-21 than forecast last March.^[2]

Figure 2 sets out the different reasons for the change in cumulative borrowing over the course of the last year. It shows the drivers of both the £122 billion deterioration at the Autumn Statement and the £24 billion improvement this time around. The largest positive changes relative to the Autumn Statement have come from accounting changes, a higher Corporation Tax forecast, a lower forecast for certain elements of government spending and money raised through tax increases (discussed below). Higher debt interest and decisions to increase spending have pushed in the opposite direction.

[2] To make a direct comparison we exclude 2021-22 from this figure – removing just £0.4 billion of the overall £24 billion improvement.

Figure 2: The causes of higher borrowing over this parliament relative to the March 2016 forecast



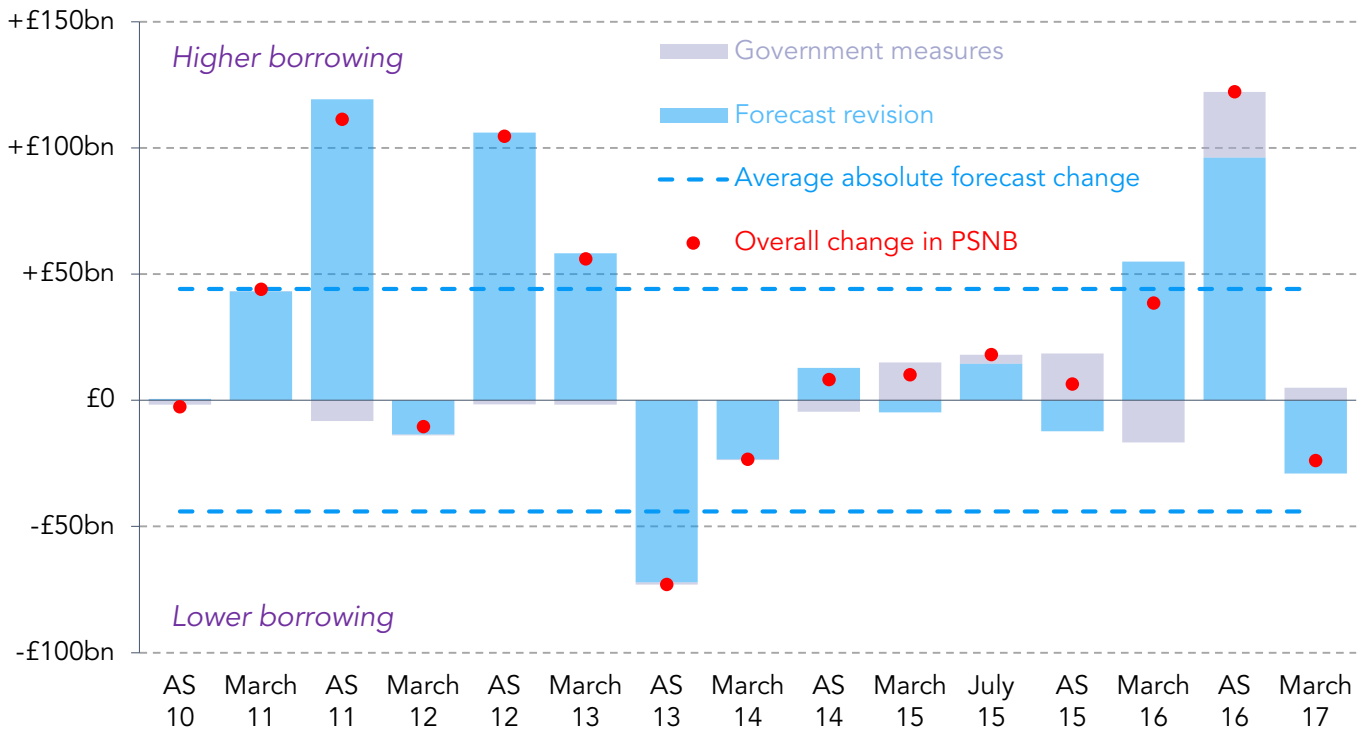
Source: OBR, *Economic and Fiscal Outlook*, various

Figure 3 compares the change in borrowing over the forecast horizon with the scale of revisions made at each of the OBR's previous 14 fiscal outlooks. Before considering policy changes, a forecast reduction of £29 billion over the six years from 2016-17 (in line with our pre-Budget projection for the potential forecast change^[3]) is well within the absolute £44 billion average recorded across the OBR's outlooks. Despite the Chancellor loosening overall borrowing by a cumulative £5 billion over the period, the net cumulative reduction in borrowing of £24 billion represents the first improvement in the net borrowing outlook for three years.

[3] M Whittaker, *Economy drive: Prospects and priorities ahead of the last Spring Budget*, Resolution Foundation, February 2017

Figure 3: Changes in borrowing at successive fiscal events

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

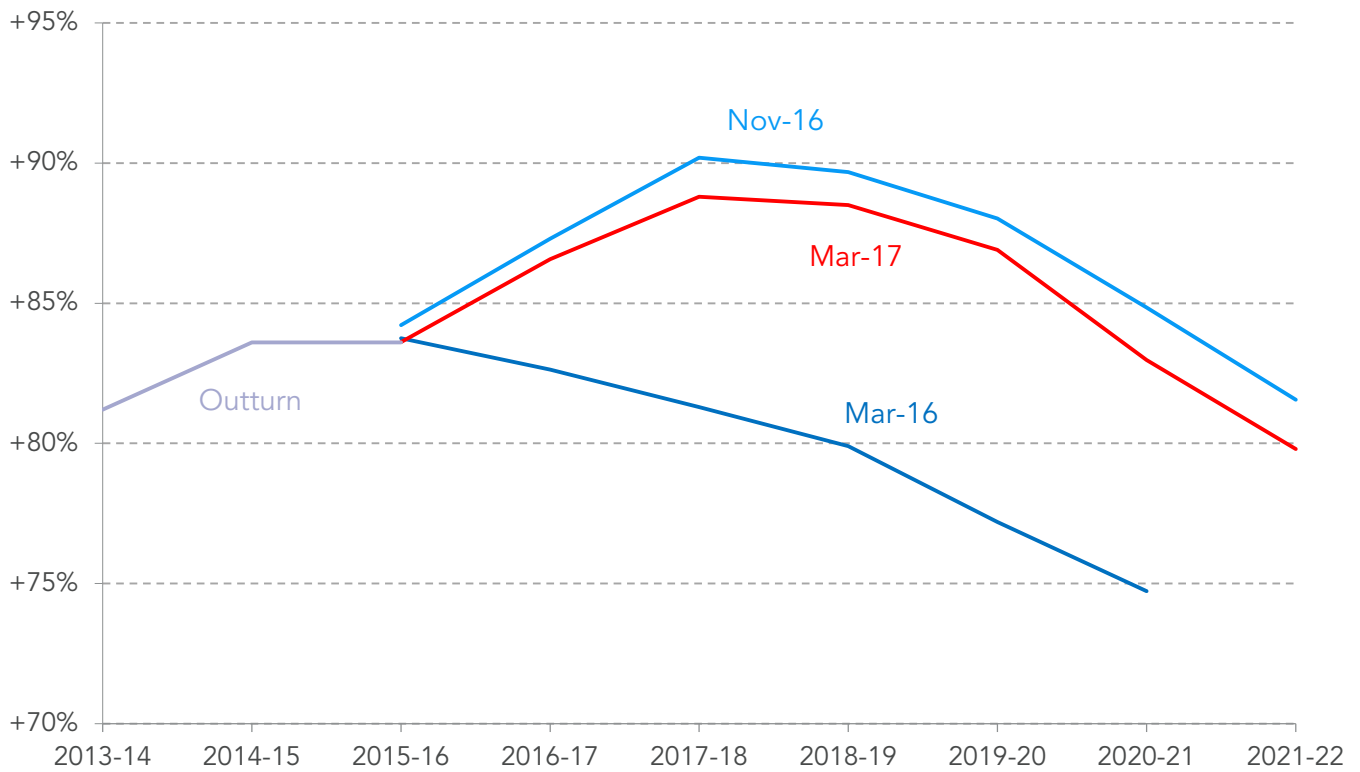


Source: OBR, *Economic and Fiscal Outlook*, various

Given the slightly lower projection for borrowing, it should be unsurprising that the debt forecast has also improved marginally – as shown in Figure 4. Once again though, it remains much higher than projected last March. Debt remains on course to end the parliament higher than in 2013-14, falling to 79.8 per cent of GDP in 2021-22.

Figure 4: Successive public sector debt forecasts

Public sector net debt as a share of GDP

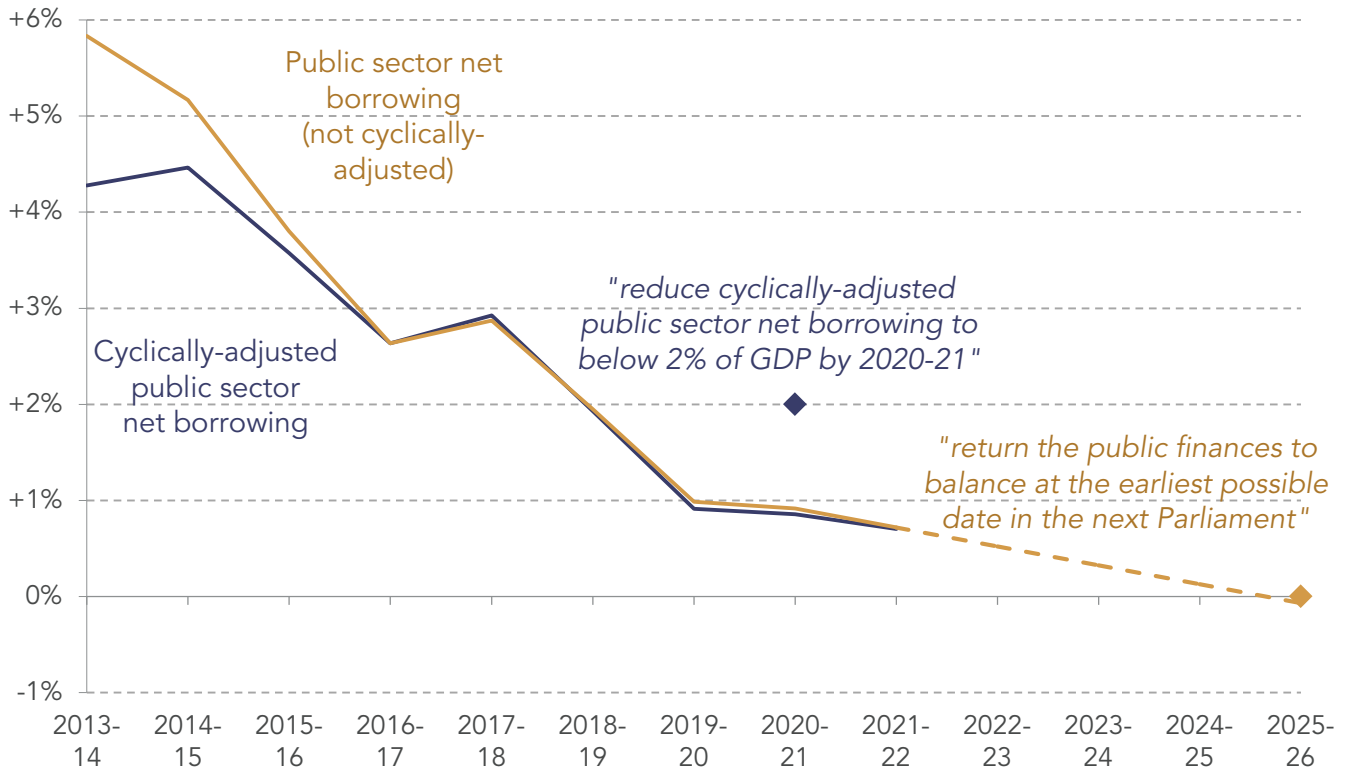


Source: OBR, Economic and Fiscal Outlook, various

The outlook for debt means that the government is forecast to meet its supplementary fiscal rule; that debt be falling as a share of GDP in 2020-21. Figure 5 shows the outlook for its main fiscal mandate; to “reduce cyclically-adjusted public sector net borrowing to below 2 per cent of GDP by 2020-21”. Against this rule, the Chancellor retains significant headroom of over 1 per cent of GDP – equivalent to around £26 billion. Given current levels of economic uncertainty, that provides a welcome and sensible level of flexibility, but it is worth noting that it represents more of a conceptual ‘ceiling’ to fiscal policy than a fiscal ‘target’.

Figure 5: Borrowing measures and the Chancellor’s fiscal rules

Public sector net borrowing as a share of GDP



Source: OBR, Economic and Fiscal Outlook, various

The government’s ultimate ‘objective’ for fiscal policy is to “return the public finances to balance at the earliest possible date in the next Parliament”. Overall borrowing in 2021-22 is forecast to be 0.7 per cent of GDP. While this would be a relatively low level of borrowing by historical standards, the pace of deficit reduction is set to slow significantly in the final two years of the forecast. If this pace were maintained in subsequent years, fiscal contraction is projected to last until 2025-26 – the end of the next parliament. The period of fiscal consolidation would therefore total three full parliaments.

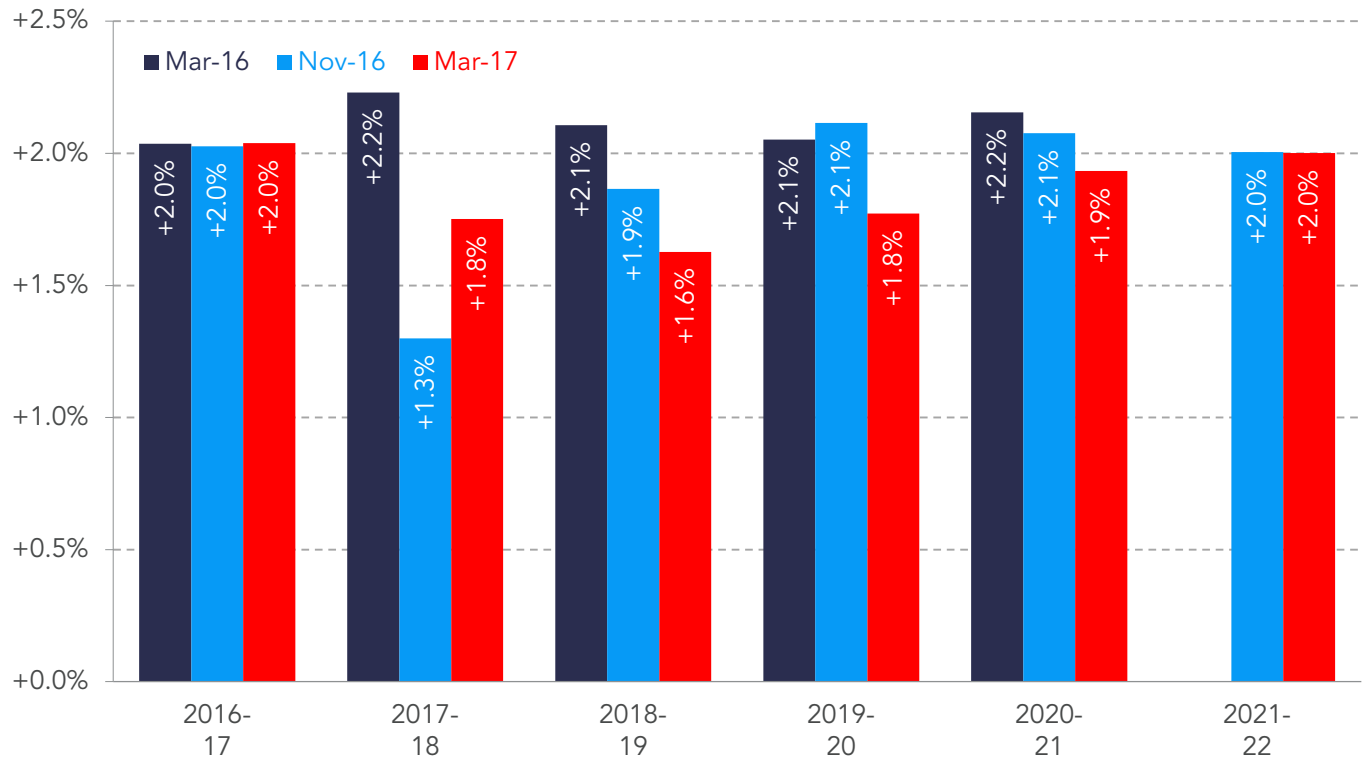
Stronger near-term economic growth is expected to be more than wiped out by slower medium term growth

While the modest improvement in the borrowing outlook will have come as a relief to the Chancellor, there is no such good news in the OBR’s economic forecast.

Figure 6 compares year-on-year growth rates for GDP at the last three fiscal outlooks. While the downgrade between the March 2016 Budget and November’s Autumn Statement is clear, the March 2017 revisions move in different directions. Growth is expected to be broadly in line with past expectations in 2016-17, but significantly stronger than projected in November in 2017-18. Thereafter however, it is expected to be weaker in each remaining year of the forecast.

Figure 6: Projected GDP growth

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

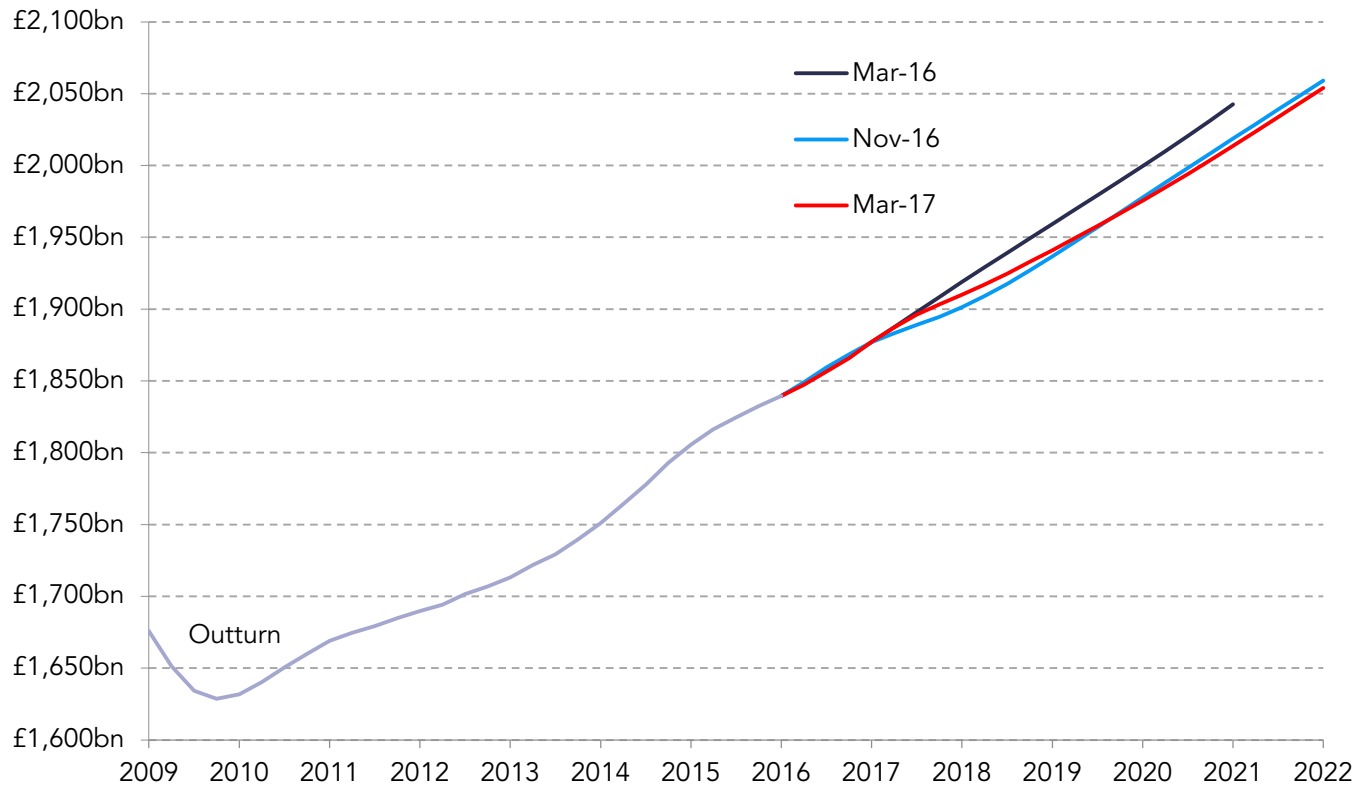


Sources: OBR, *Economic and Fiscal Outlook*, various

Figure 7 converts these projections (captured on a quarterly basis) into alternative projected trajectories for GDP. It highlights stronger-than-previously-expected growth in the near-term, but an overall weakening of the outlook relative to the Autumn Statement. By the end of the forecast – in Q1 2022 – the economy is forecast to be £5.3 billion smaller than the November projection suggested. This downgrade comes on top of an already-significant deterioration in the outlook at the Autumn Statement. As such, the latest forecast implies that the economy will be £29 billion smaller at the start of 2021 than the OBR was expecting before the EU referendum at Budget 2016.

Figure 7: GDP outturn and projection

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



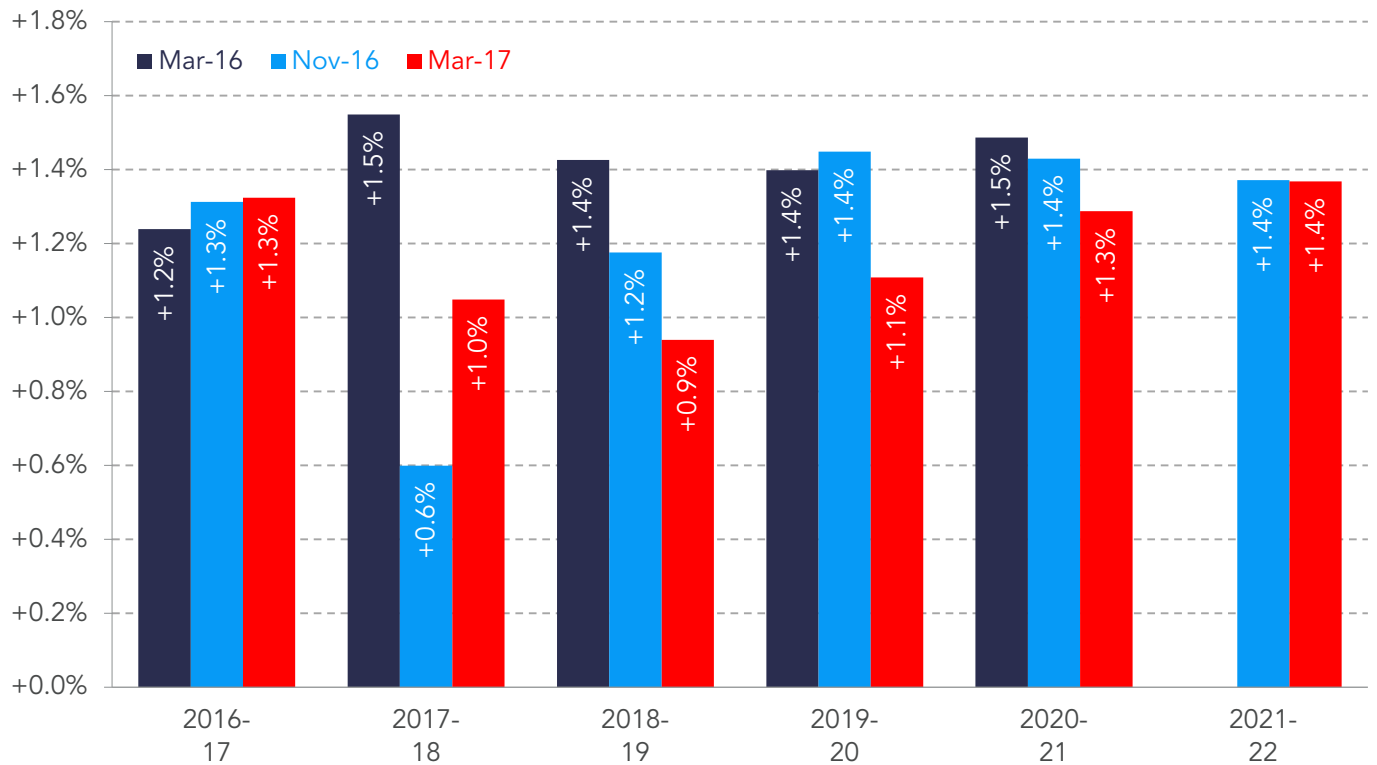
Sources: OBR, Economic and Fiscal Outlook, various

Accounting for population growth, GDP per capita is set to be just 7.9 per cent above its pre-crisis level by 2021

We can repeat this exercise for GDP per capita, providing a better sense of how growth might translate into living standards. Figure 8 sets out the financial year growth rates and displays a similar pattern to the headline GDP chart: namely, a near-term improvement followed by a sizeable slowing from 2018-19.

Figure 8: Projected GDP per capita growth

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

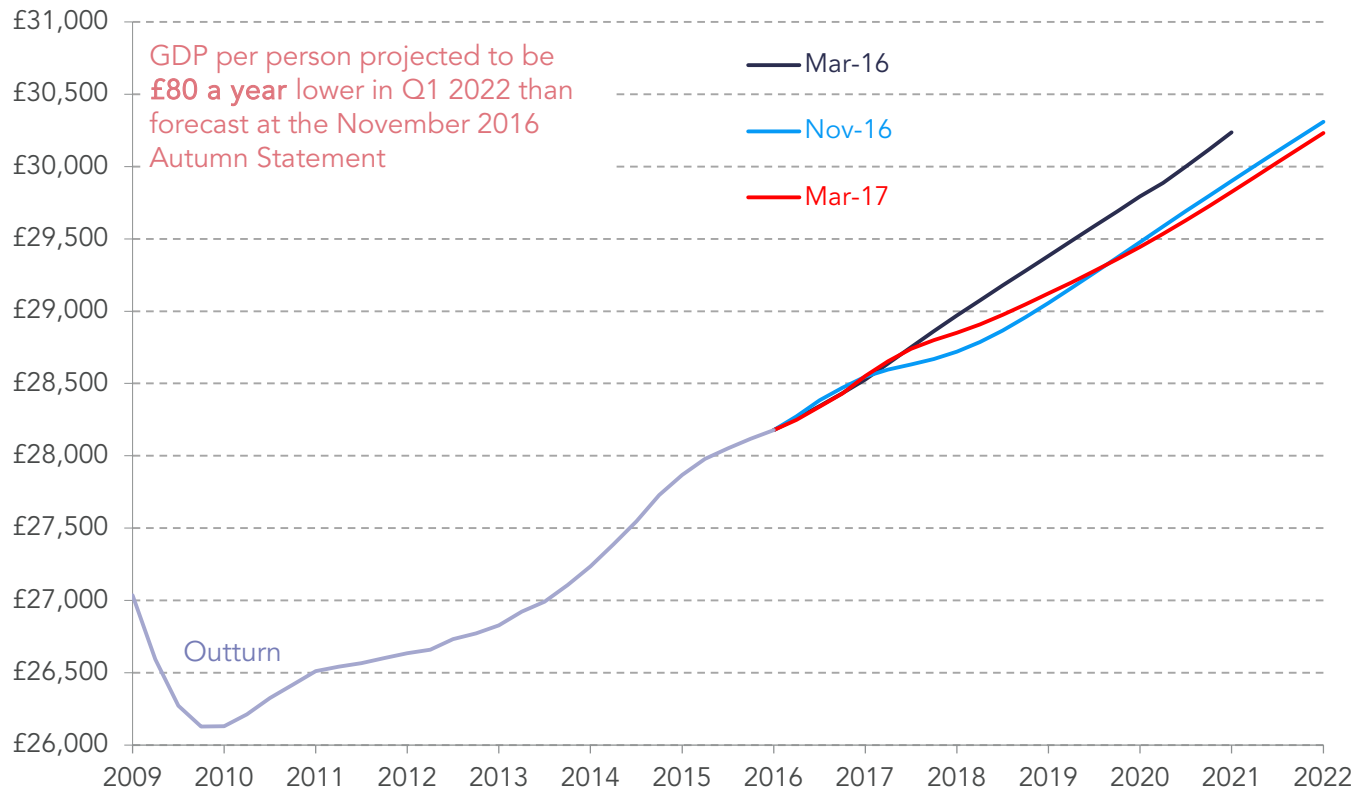


Sources: OBR, *Economic and Fiscal Outlook*, various

Converting this into trajectories for GDP per capita, Figure 9 again highlights the dominance of the latter – more negative – period overall. Output per person is now expected to be £80 a year lower in Q1 2022 than was thought in November. Relative to the Budget 2016 projection it is forecast to be £410 lower (by the start of 2021).

Figure 9: GDP per capita outturn and projection

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

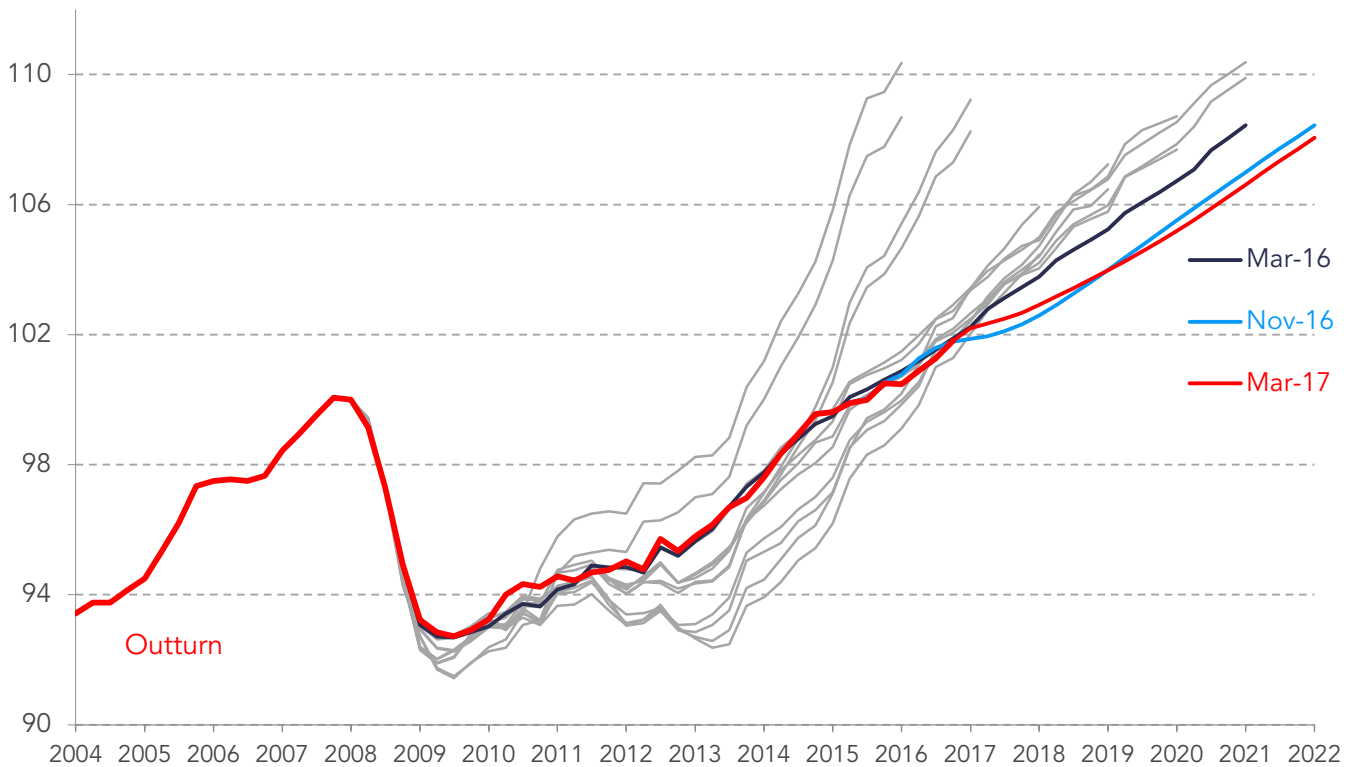


Sources: OBR, Economic and Fiscal Outlook, various

The downgrade in per capita growth is the latest in a long line of revisions. As Figure 10 shows, the OBR has consistently pushed its projections out over the course of its fiscal outlooks. GDP per capita is now projected to be roughly 8 per cent higher than Q1 2008 by the start of 2022. Back at the November 2010 Autumn Statement the OBR forecast that this point would be reached by the middle of 2015.

Figure 10: Successive GDP per capita projections

Indices of real-terms GDP per capita: outturn and successive OBR projections (CVM, Q1 2008 = 100)

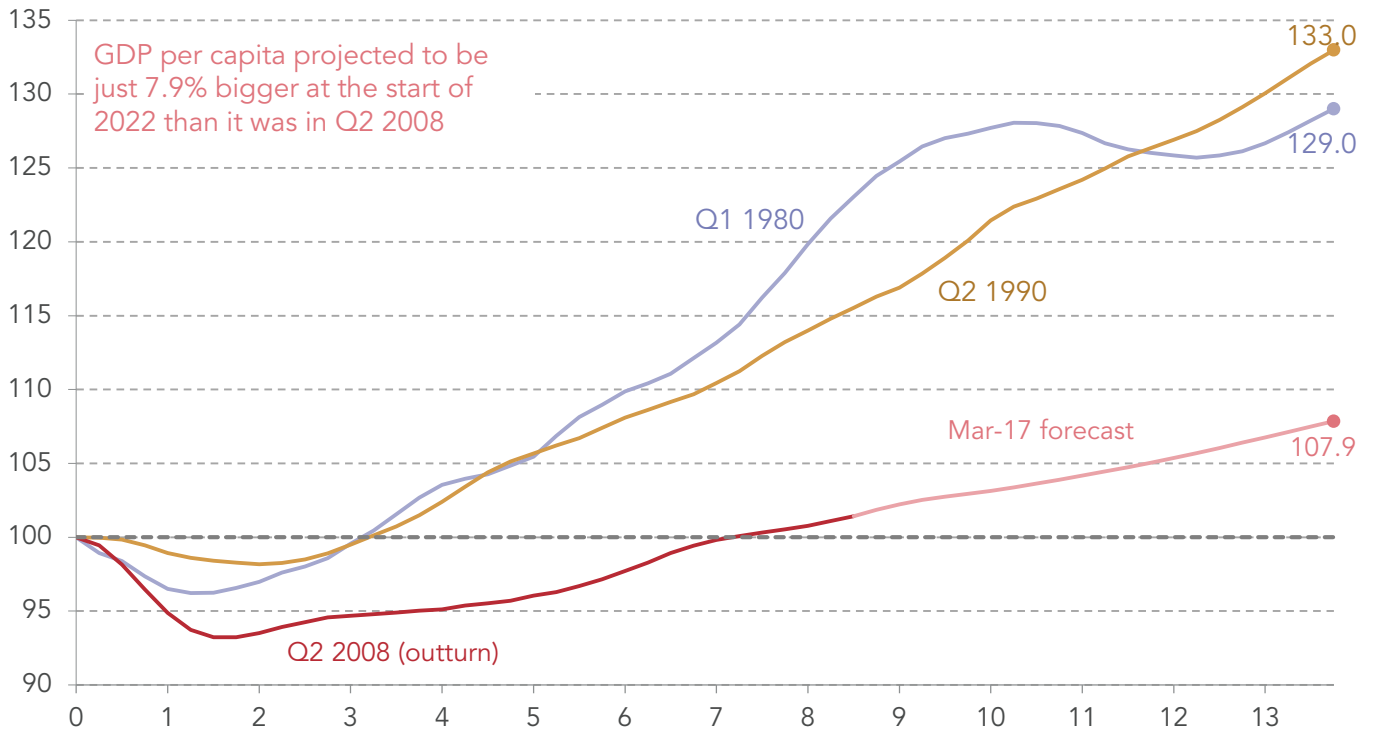


Sources: OBR, Economic and Fiscal Outlook, various

The implication of this disappointing growth is that the post-crisis recovery in GDP per capita has been sluggish by historic standards. Figure 11 compares trajectories for output per person following the three most recent recessions. The latest outturn data shows that GDP per capita is just 1.4 per cent higher than the final quarter before the economy entered recession. At this same point (eight and a half years) into the 1980 recovery, GDP per capita was 23.1 per cent higher. Following the 1990 recession it was 15.5 per cent up.

Figure 11: GDP per capita following recent recessions

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



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

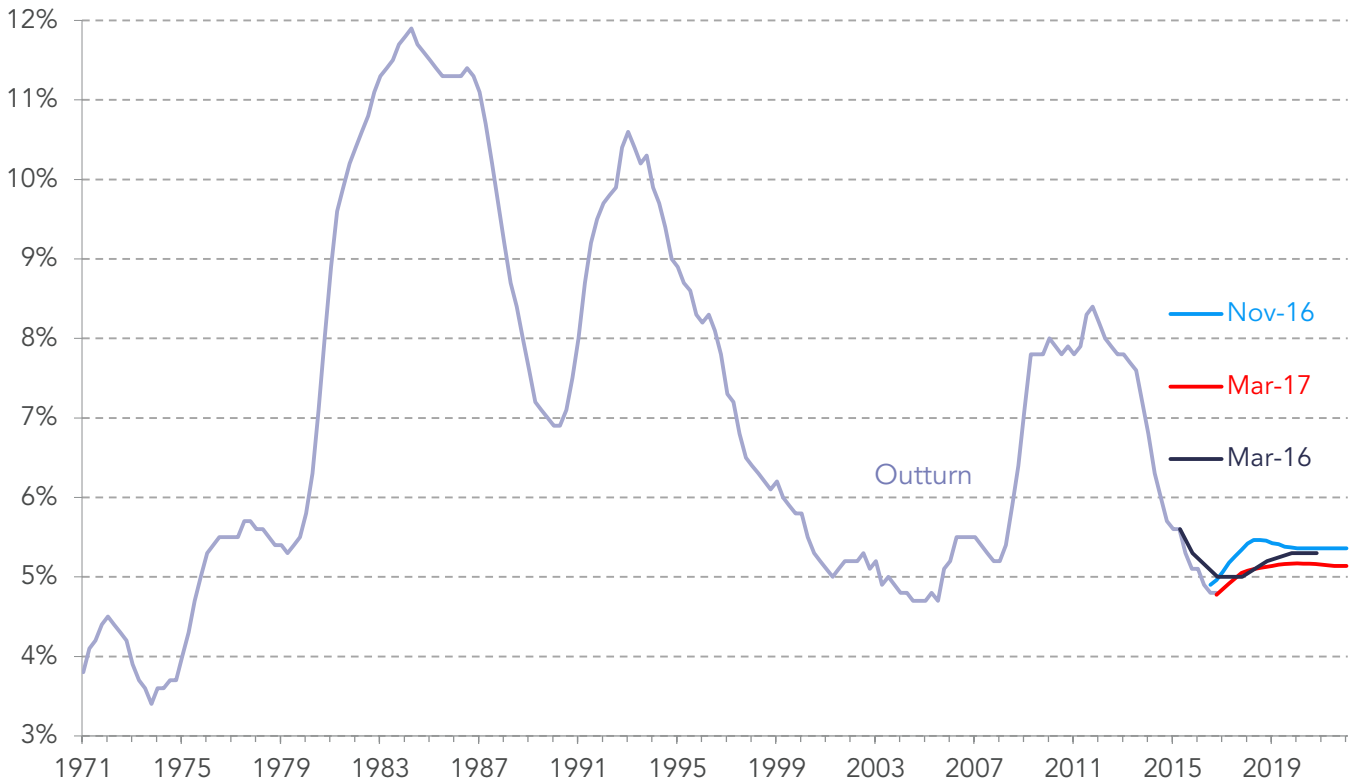
Rolling out to the end of the forecast period – nearly 14 years on from the start of the downturn – GDP per capita is forecast to be 7.9 per cent higher than in Q2 2008. Yet at the same stage following the 1980 recession it was 29 per cent higher (and already in a recovery phase following the 1990 dip). At the same point following the 1990 recession, GDP per capita was 33 per cent higher.

The employment projection has improved, though the employment rate is still expected to fall over the coming years

There is better news in relation to the OBR’s projections on employment and unemployment. As Figure 12 shows, the unemployment rate is forecast to end the period at 5.1 per cent – lower than the figure of 5.4 per cent included in the Autumn Statement. That’s equivalent to around 70,000 fewer people being unemployed. This reflects both the shallower slowdown in GDP growth that has transpired in the near-term and a reduction in the OBR’s assumption about the equilibrium level of unemployment.

Figure 12: Unemployment outturn and projections

Unemployment rate among those aged 16+: outturn and successive projections

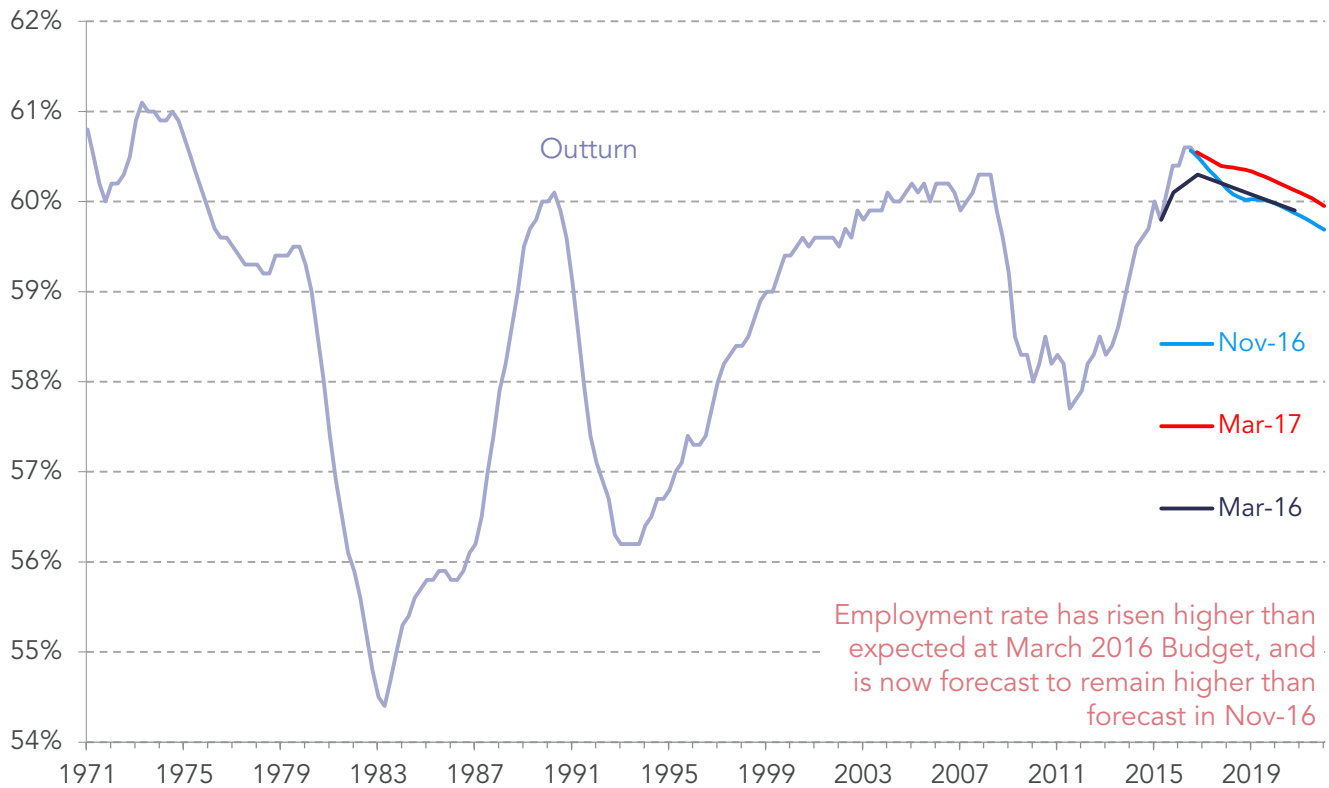


Sources: ONS, Series MGSC & OBR, Economic and Fiscal Outlook, various

The OBR has similarly revised its outlook on employment. Figure 13 shows that rate is projected to fall in the period to 2022, but that this reduction is now gentler than the one projected in November. The implication is that 150,000 more people will be in work at the start of 2022 than was thought at the time of the Autumn Statement.

Figure 13: Employment rate outturn and projections

Employment rate among those aged 16+: outturn and successive projections



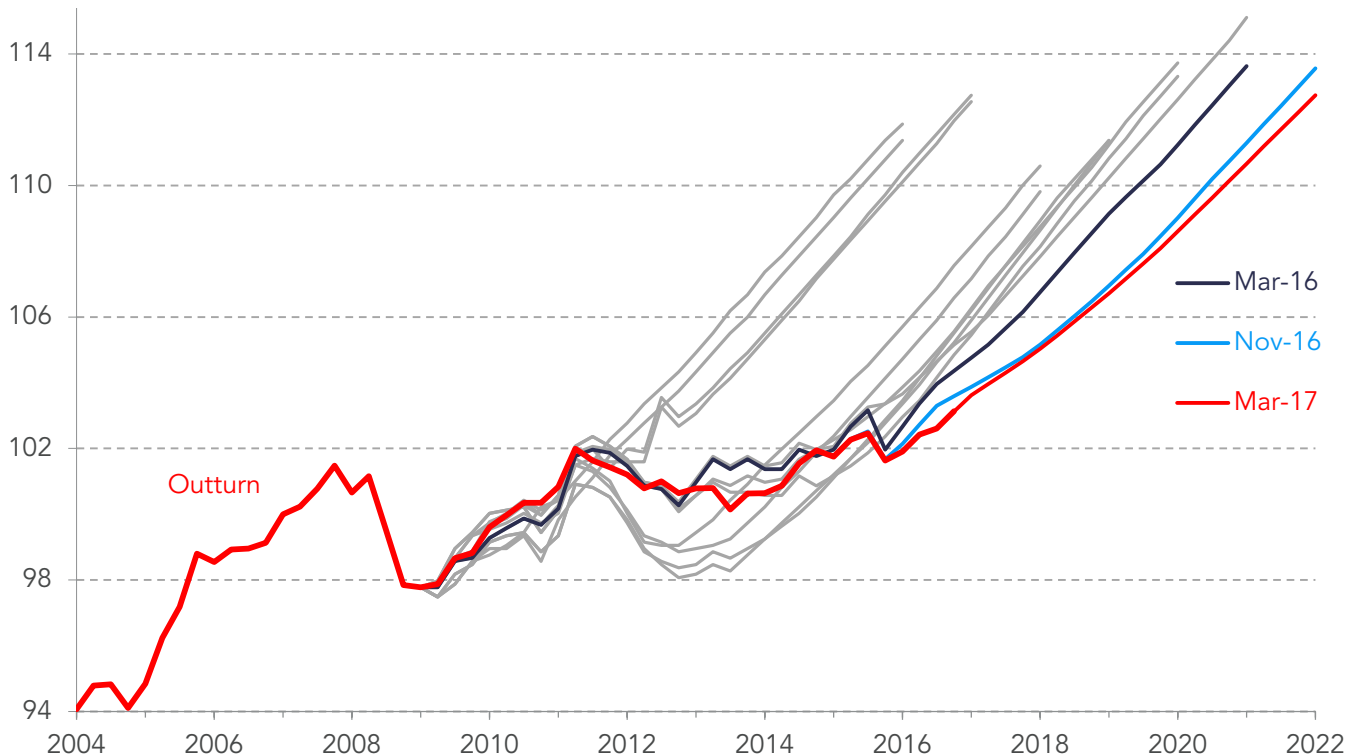
Sources: ONS, Series MGSR & OBR, Economic and Fiscal Outlook, various

But higher employment and lower output implies a further downgrade in the productivity projection

As Figure 14 highlights, despite repeated OBR projections for a return to pre-crisis trend growth in output per hour, productivity has broadly flat-lined since 2007. The Budget 2017 outlook has again pushed the forecast line out to the right, such that it is now expected to be 12.7 per cent higher in Q1 2022 than in Q1 2007 – the same point it had been expected to reach at the start of 2017 back at Budget 2012.

Figure 14: Successive labour productivity projections

Real-terms non-oil output per hour: outturn and successive OBR projections (CVM, Q1 2007 = 100)

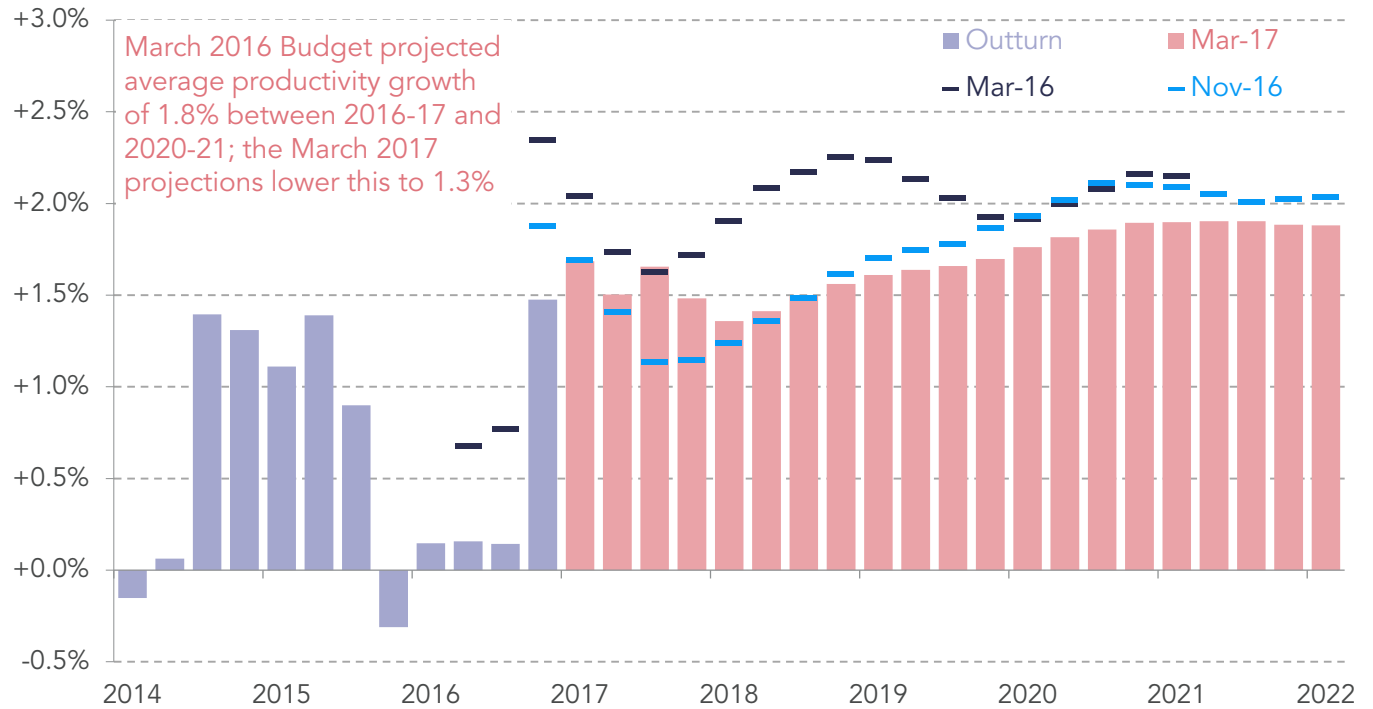
Sources: ONS, Series KLS2 & YBUS & OBR, *Economic and Fiscal Outlook*, various

With the productivity puzzle proving so persistent, the OBR downgraded its assessment of *trend* productivity growth at last year's Budget. It subsequently lowered its medium-term trend expectation at the Autumn Statement, in recognition of the likely impact of uncertainty on productivity during the Brexit process.

Yet, as Figure 15 shows, some near-term improvements in the productivity outlook presented alongside yesterday's Budget are forecast to be more than offset by lower productivity growth from the end of 2018 onwards. At Budget 2016, the OBR expected productivity growth to average 1.8 per cent between Q2 2016 and Q1 2021; that figure was revised down to 1.5 per cent at the Autumn Statement; and now stands at just 1.3 per cent.

Figure 15: Labour productivity outturn and projections

Year-on-year change in real-terms output per hour worked: outturn and successive OBR projections (GVA excl. gas & oil)

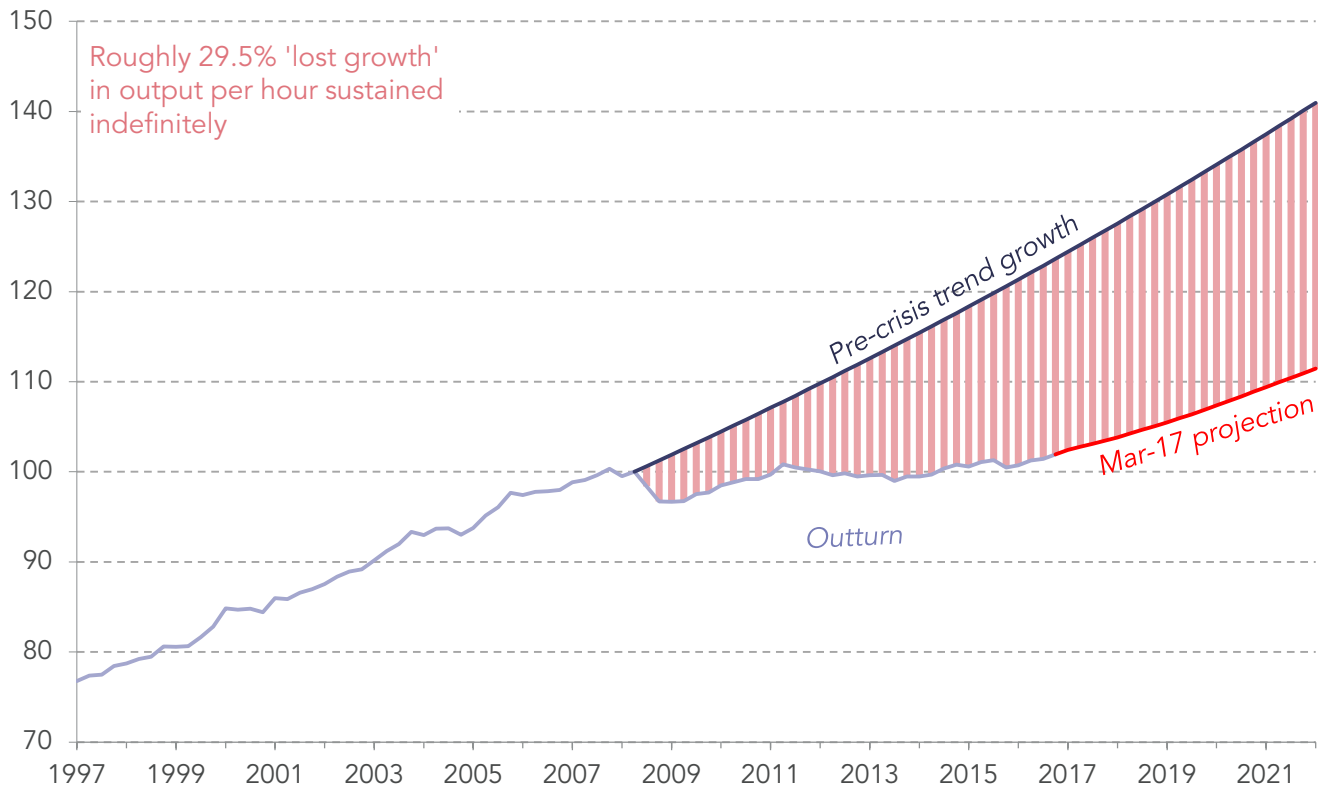


Sources: ONS, Series KLS2 & YBUS & OBR, Economic and Fiscal Outlook, various

Further slowdown in productivity growth increases the scale of the lost productivity since 2008. Figure 16 sets this out by presenting a simple counterfactual in which productivity continues to grow at its same pre-crisis pace and comparing the outcomes. It shows that output per hour is currently 21.7 per cent lower than it might otherwise have been. By the start of 2022 the gap is projected to reach 29.5 per cent, with no sign of any ‘catch-up’ growth that might reduce the scale of this hit.

Figure 16: 'Lost' labour productivity

Index of real-terms non-oil output per hour: outturn and projection (Q2 2008 = 100)



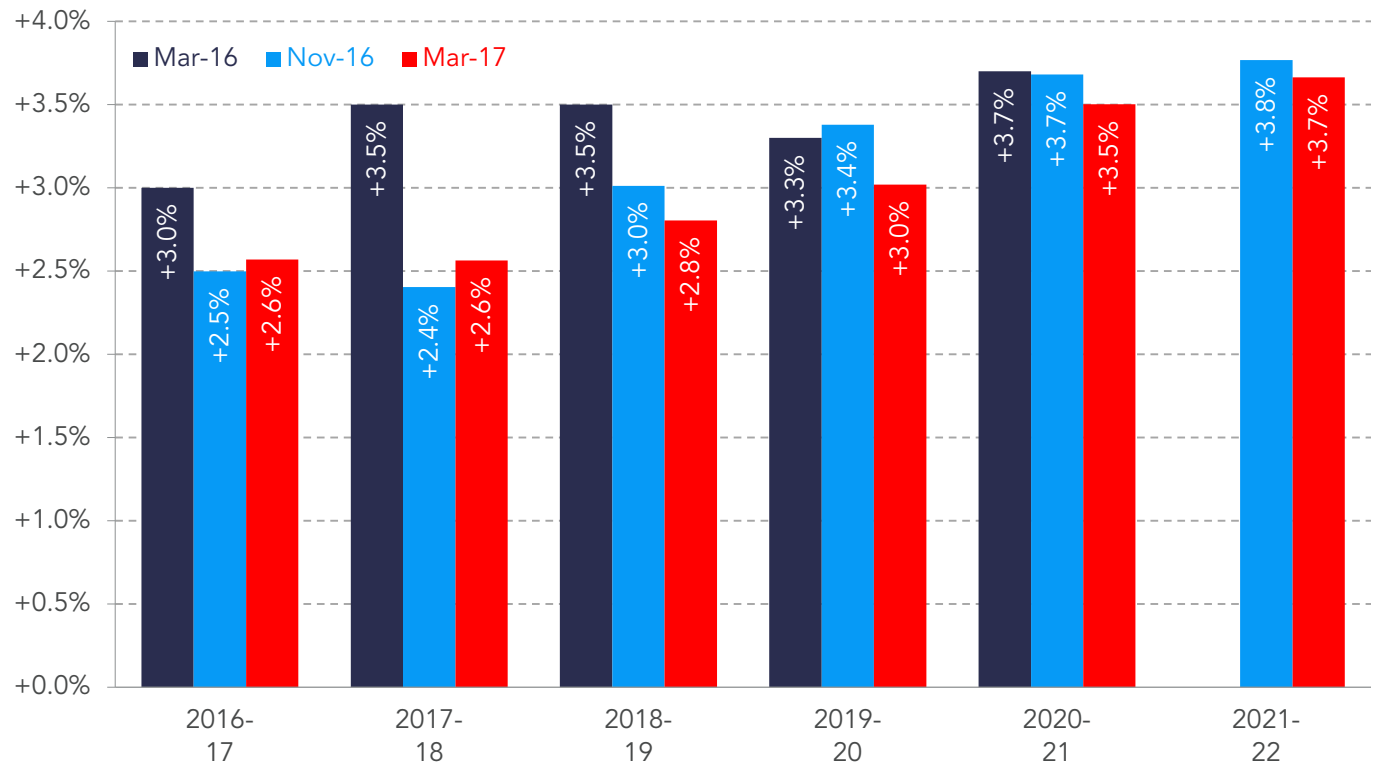
Sources: ONS, Series KLS2 & YBUS & OBR, Economic and Fiscal Outlook, November 2016

With nominal pay growth projections falling as well

Slower productivity growth feeds through to slower nominal pay growth in the OBR's projections. In line with many other measures, Figure 17 shows that the near-term picture has improved slightly relative to the Autumn Statement forecast, but that any gains are then wiped out by slower wage growth from 2018-19 onwards.

Figure 17: Nominal growth in annual pay

Year-on-year growth in nominal average employee earnings: successive projections

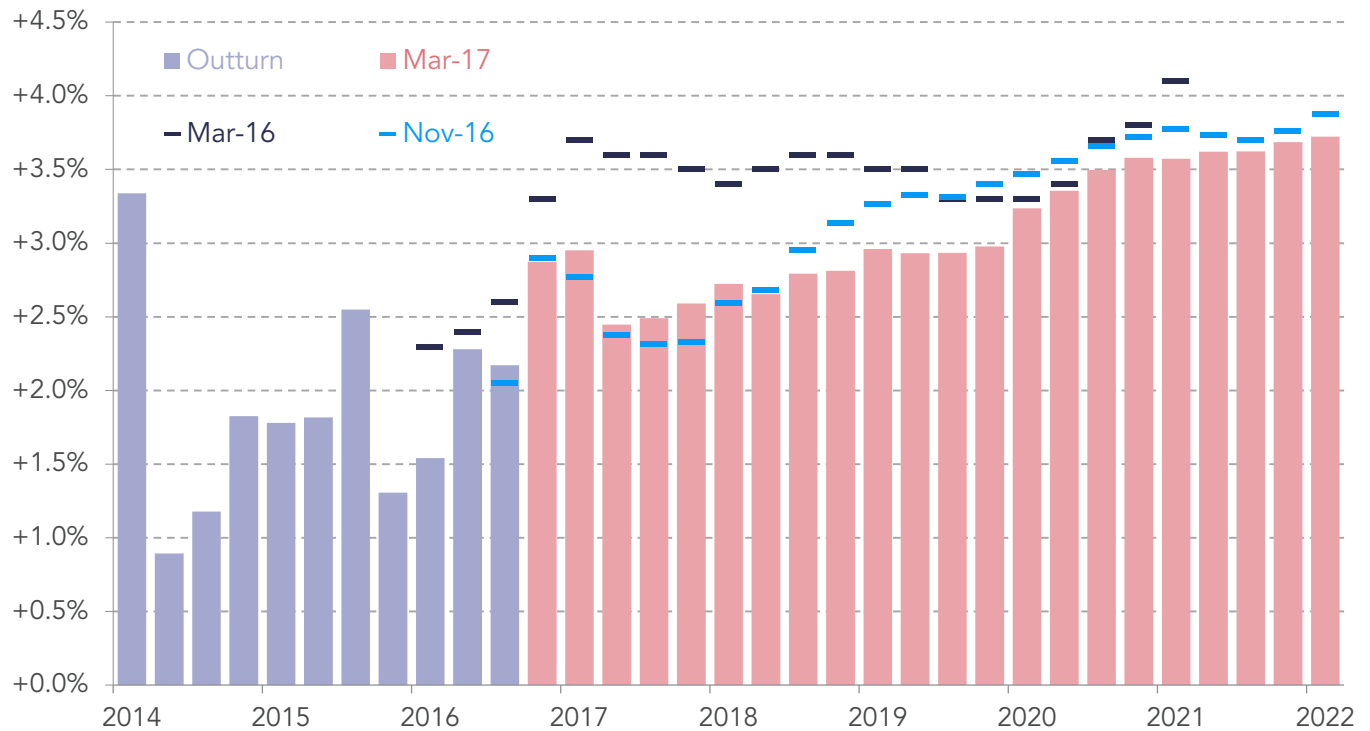


Sources: OBR, Economic and Fiscal Outlook, various

The quarterly profile provides more detail. Figure 18 shows that nominal earnings growth is now projected to be lower than forecast at the Autumn Statement in every quarter from Q2 2018 onwards.

Figure 18: Successive nominal pay projections

Year-on-year growth in nominal average employee earnings: outturn and successive projections



Sources: OBR, Economic and Fiscal Outlook, various

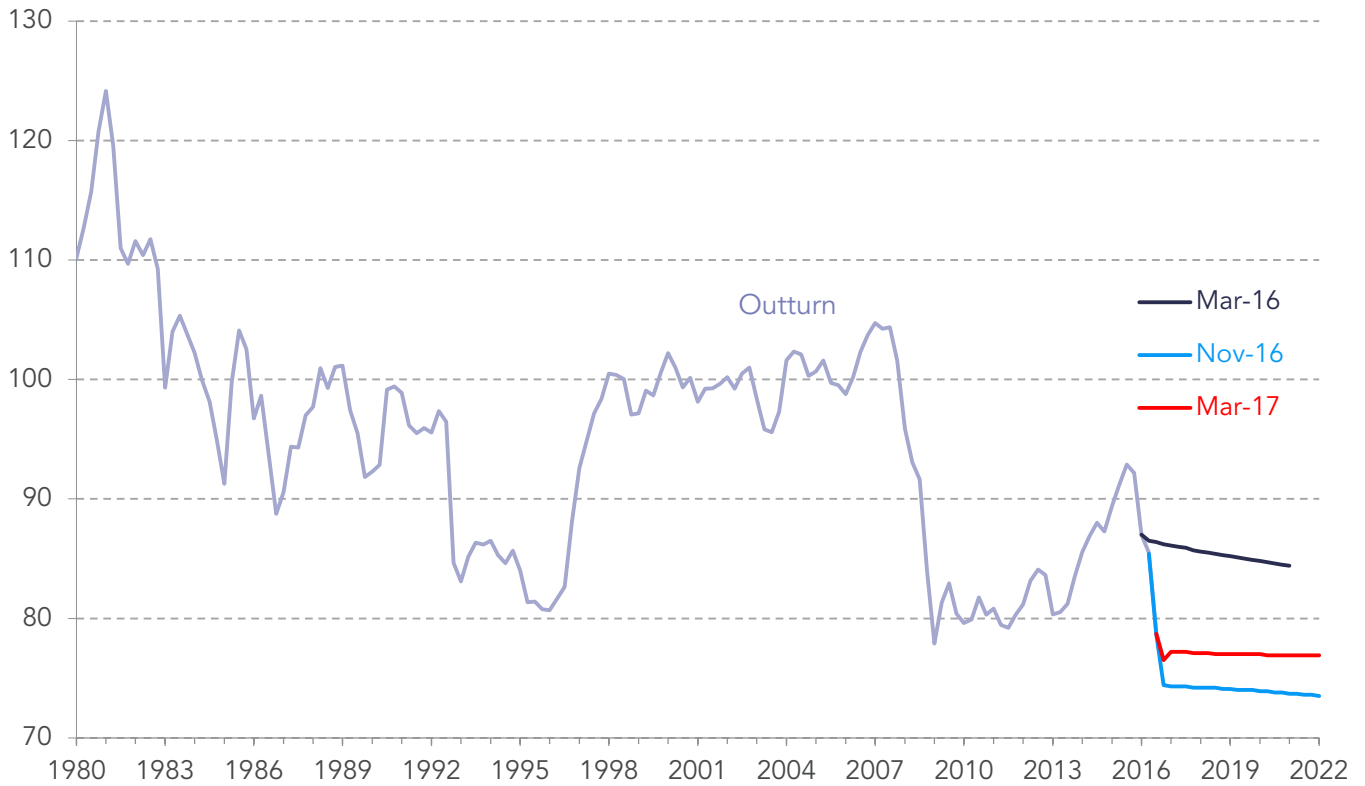
Real-terms pay growth is being further held back by rising inflation

While the brighter near-term outlook presented by the OBR on a number of economic measures has much to do with the recognition that – contrary to expectations at the Autumn Statement – little in the economy has so far changed in response to the EU referendum result last June, the one area in which there *has* been clear movement is in relation to inflation.

The depreciation in sterling – presented in Figure 19 – has started feeding through to higher inflation. Although the currency has held up better than the OBR expected in November, the depreciation is still having a clear effect. In combination with recent increases in the price of oil and price rises announcements by utility companies, this is expected to raise the price level further still in the coming months.

Figure 19: Trade-weighted sterling exchange rate

Quarterly average trade-weighted sterling exchange rate: outturn and projection (Jan 2005 = 100)

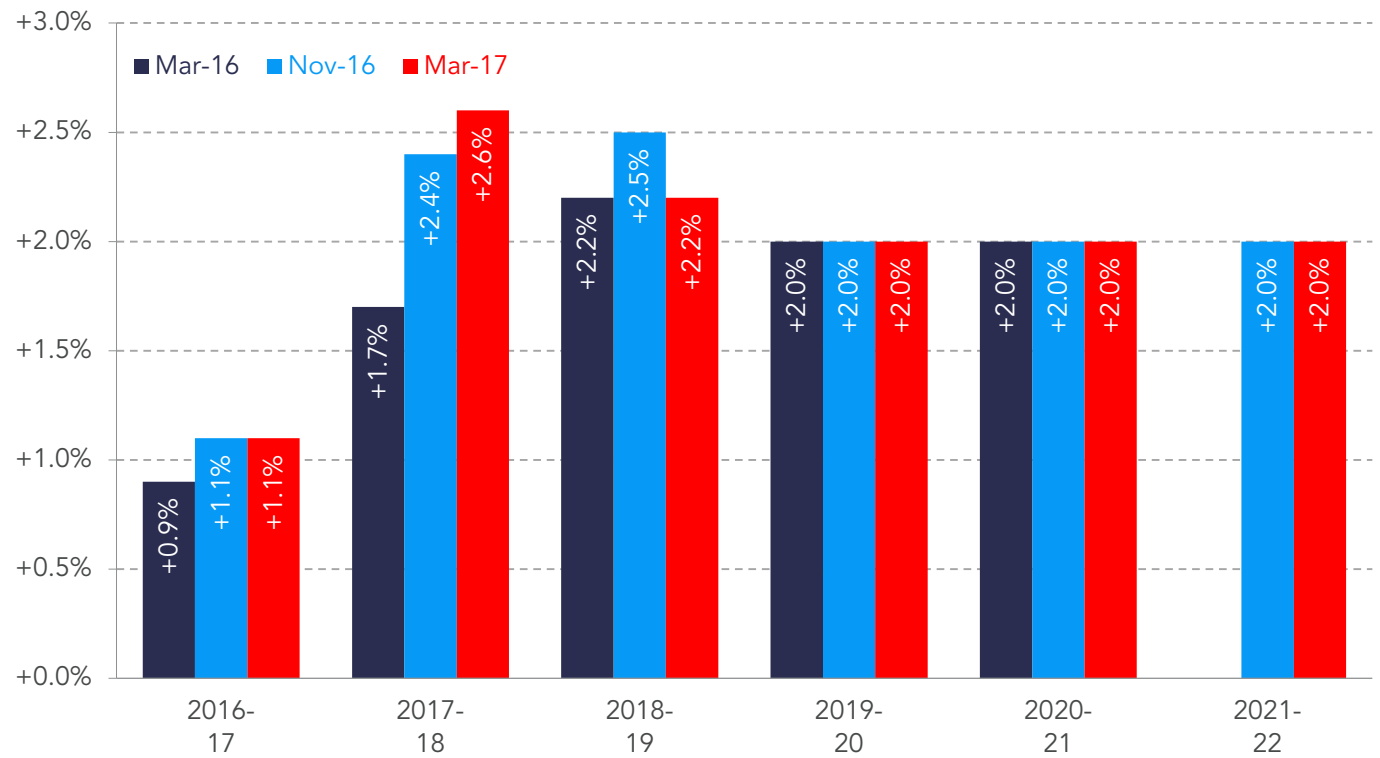


Sources: Bank of England & OBR, *Economic and Fiscal Outlook*, various

Figure 20 compares inflation expectations at each of the last three fiscal outlooks. From 2019-20, the OBR has consistently expected CPI to match the Bank of England target of 2 per cent. But projections for earlier periods jumped significantly between Budget 2016 and November’s Autumn Statement. The latest forecast raises the inflation forecast in 2017-18 still further, but then lowers the forecast inflation back in line with the Budget 2016 projection in 2018-19.

Figure 20: CPI inflation

Successive projections

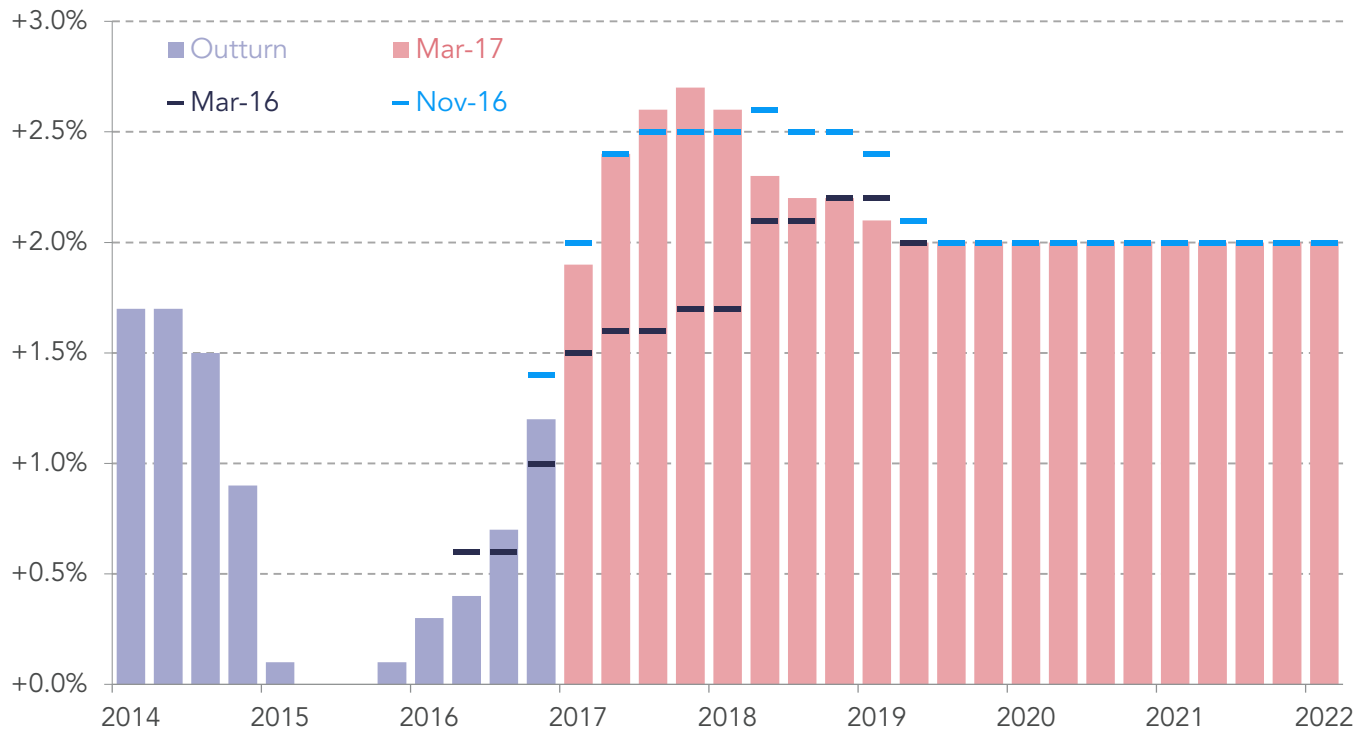


Sources: OBR, *Economic and Fiscal Outlook*, various

Breaking this change in projection into its quarterly profile again provides more detail. Figure 21 shows inflation is now expected to be higher in the second half of 2017 than previously thought, but lower across much of 2018, meaning a steeper but shorter period of inflation rising above and then falling back in line with the Bank's forecast.

Figure 21: Successive CPI inflation projections

Outturn and successive projections

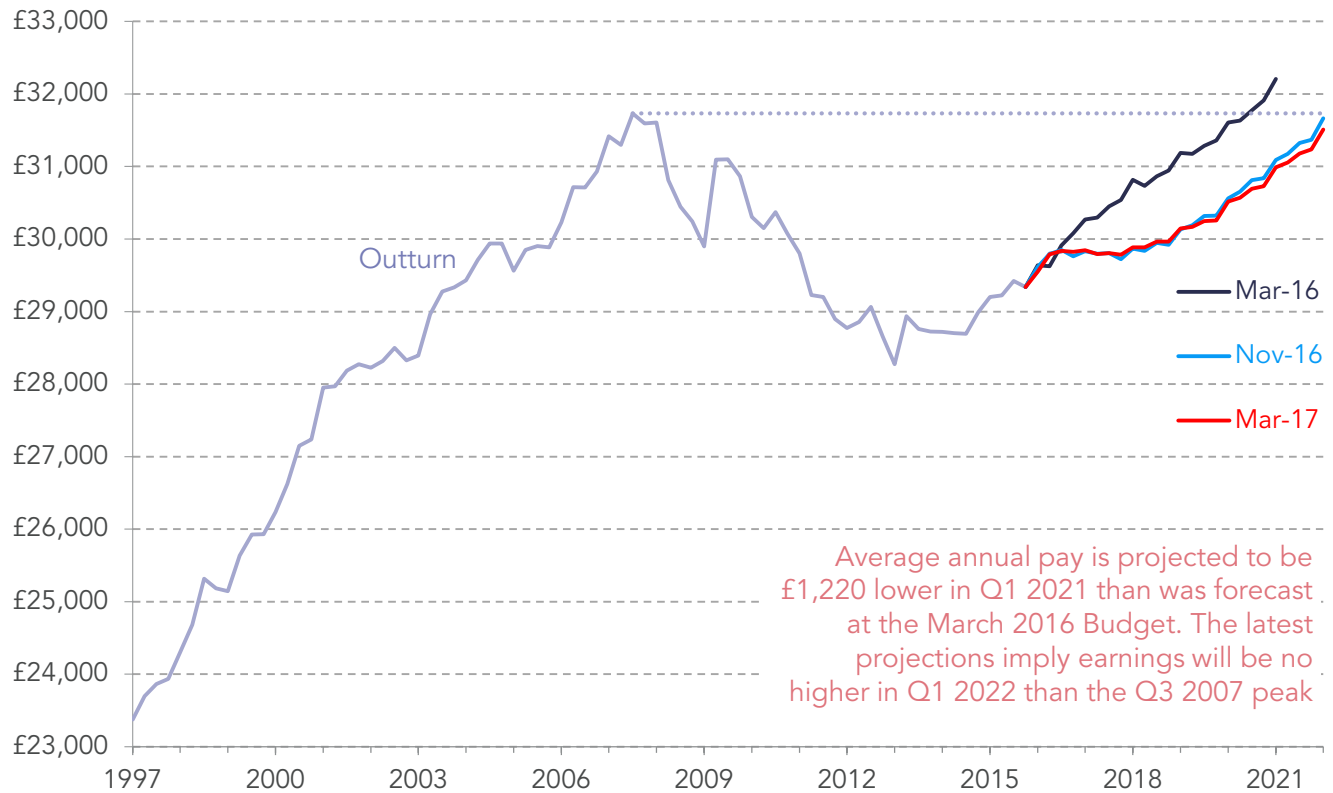


Sources: OBR, Economic and Fiscal Outlook, various

Combining nominal pay and inflation forecasts suggests that real pay growth is going to come in lower than expected at the Autumn Statement over the course of the forecast period. Figure 22 shows that the difference is marginal, but non-trivial: average annual earnings are set to be £150 lower at the start of 2022 than previously thought. The downgrade is again much bigger when measured against Budget 2016, with average earnings in Q1 2021 expected to be £1,220 lower than previously forecast, reflecting the catastrophic downgrade to pay growth forecasts in Autumn Statement 2016.

Figure 22: Real-terms average annual earnings outturn and projections

Average annual employee earnings, CPI-adjusted: outturn and successive projections (Q4 2016 prices)



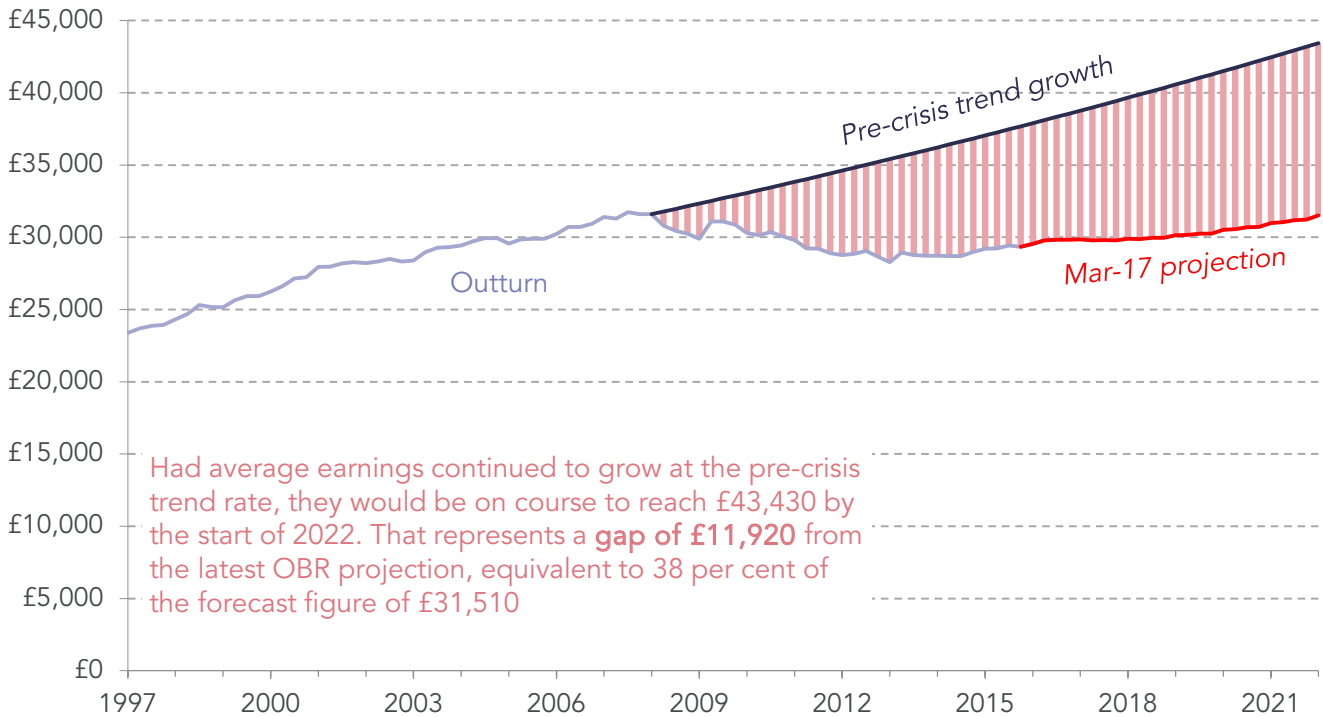
Sources: ONS, Series DTWM, ROYK, MGRZ, MGRQ; OBR, Economic and Fiscal Outlook, various

Somewhat incredibly, this outlook means that average earnings will still not have returned to their pre-crisis level by the end of the forecast period in 2022. A simple extrapolation of the average increase recorded over the final four quarters of the forecast would mean that the pre-crisis level would only be restored in the final quarter of 2022. That would constitute 15 full years of lost pay growth.

Relative to a counterfactual in which pay growth had continued at the same rate recorded between 1997 and 2007, these projections for average earnings imply a cost of £11,920 per employee – as highlighted in Figure 23.

Figure 23: 'Lost' earnings growth

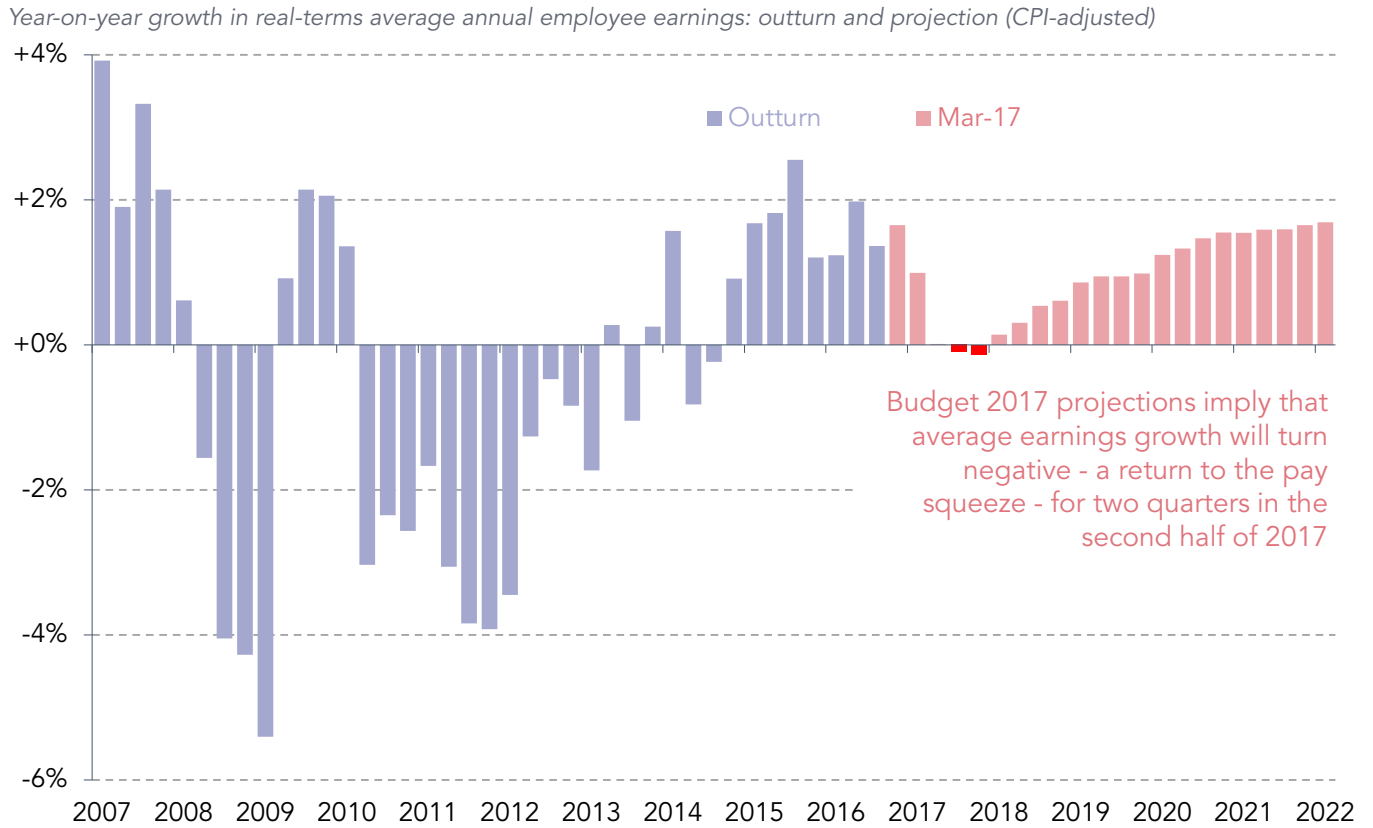
Average annual employee earnings, CPI-adjusted: outturn and projection (Q4 2016 prices)



Sources: ONS, Series DTWM, ROYK, MGRZ, MGRQ; OBR, Economic and Fiscal Outlook, various

In the main, this bleak outlook on earnings constitutes a continuation of the sluggish growth recorded in recent years. However, as Figure 24 highlights, the OBR expects wage growth to turn briefly and mildly negative in the final two quarters of 2017.

Figure 24: Year-on-year growth in average annual earnings

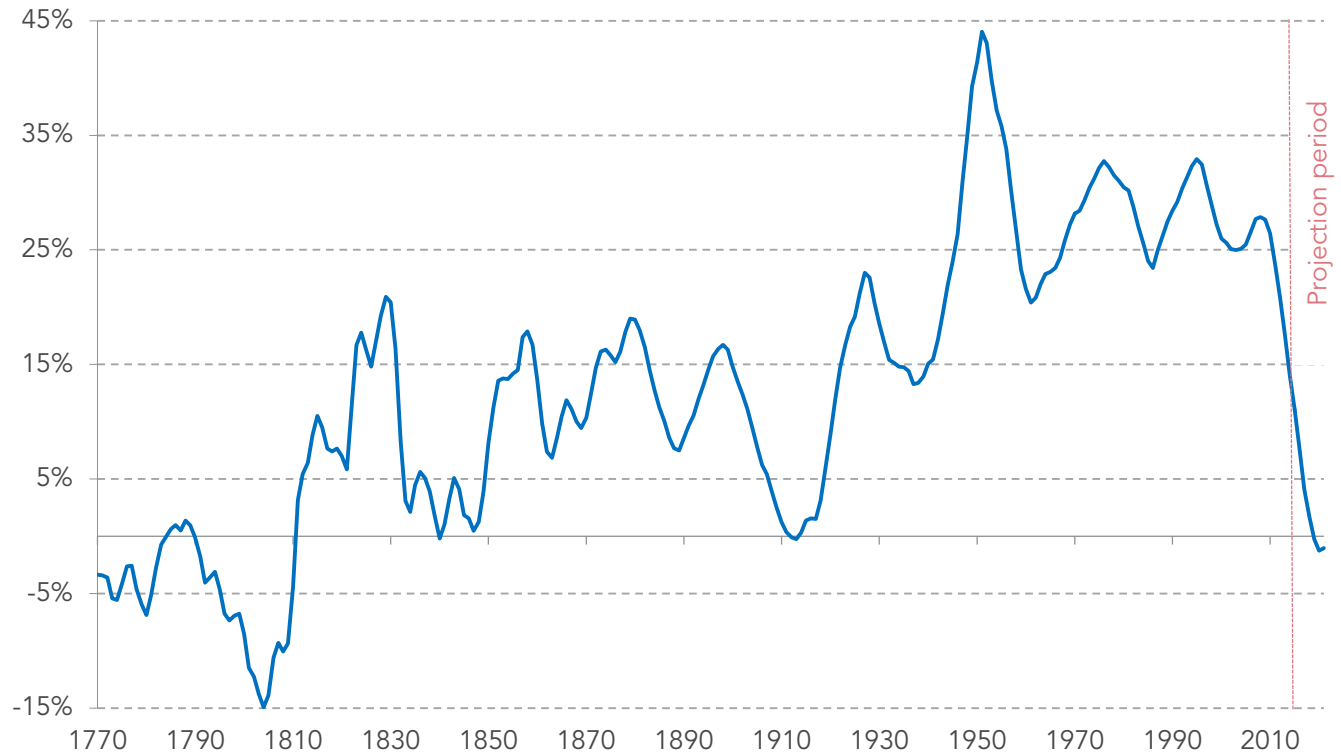


Sources: ONS, Series DTWM, ROYK, MGRZ, MGRQ; OBR, Economic and Fiscal Outlook, various

While small relative to the scale of pay falls experienced in much of the post-crisis period, the return of a pay squeeze will be difficult to take for many workers. Broadening out to the much longer term, Figure 25 combines this latest projection from the OBR with estimates of how real earnings have grown over the past three centuries. The slight deterioration in the real pay outlook since the Autumn Statement, when combined with falling real pay at the beginning of this decade and only a couple of recent recovery years, means we are on course for average pay across the decade to 2020 to be lower than the average for the decade before. That would represent the worst decade for real earnings growth in 210 years.

Figure 25: Decadal real-terms earnings growth since the 1700s

Change in average pay between last 10 years and 10 years before (CPI and predecessors-adjusted)



Notes: Growth compares average earnings in most recent decade with average earnings in the decade before.

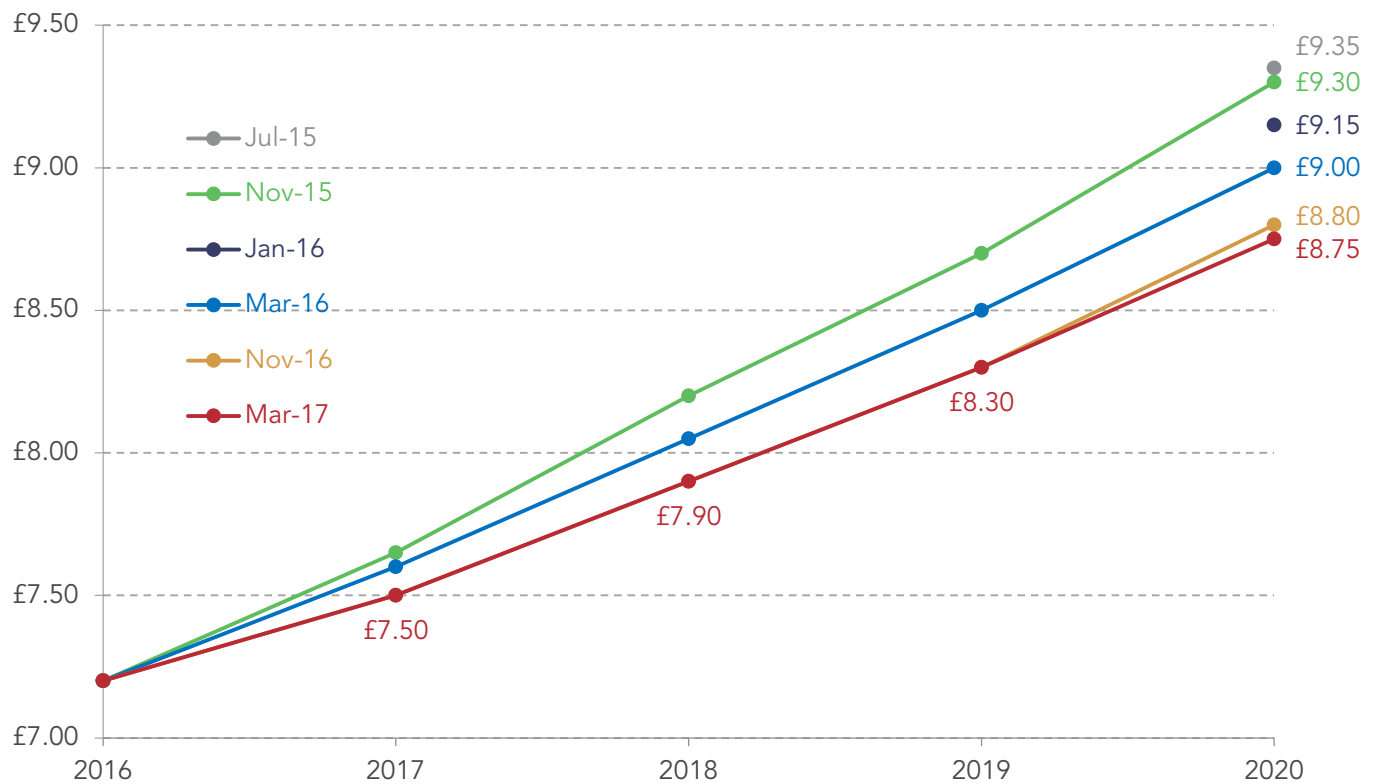
Sources: OBR, *Economic and Fiscal Outlook* (various); Bank of England, *Three Centuries of Economic Data*; ONS (various)

Slower wage growth impacts too upon the trajectory of the National Living Wage (NLW). The government’s stated ambition is for the NLW to reach 60 per cent of median earnings in 2020. Successive fiscal events have led to estimates for the cash value of the NLW in 2020 – originally forecast at the Summer Budget 2015 to be £9.35 – being adjusted downwards.

Figure 26 shows that yesterday’s Budget continues that trend, though with only a modest reduction in the projected figure for 2020 (£8.75, or 5p lower than the Autumn Statement projection) and with the indicative path in 2018 and 2019 unchanged. While lower than the much-discussed target of £9 in 2020, linking the earnings of those at the bottom of the pay ladder to those in the middle remains an approach that balances prudence in uncertain economic times with above-average pay rises for the UK’s lowest earners.

Figure 26: 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 continued deterioration in the forecast for real earnings growth over the rest of this parliament will of course affect individual families in different ways. By way of illustration, Table 1 summarises the impact of the economic forecast changes between the last three fiscal events on ten example families. A number of these families represent those ‘ordinary working families’ that the government has set its political focus on. The table shows each family’s forecast income at the end of the parliament, along with the impact of the economic revisions between each of the fiscal events that have taken place over the past year.

Table 1: Impact of economic forecast changes this parliament for example family types

Net household incomes for different family types, Universal Credit system, 2020-21, current policy, CPI-adjusted to 2016-17 prices

<i>Net household incomes (before housing costs)</i>	Mar-16 income forecast	Impact of Mar-16 to Nov-16 economic forecast changes	Impact of Nov-16 to Mar-17 economic forecast changes	Impact of Mar-16 to Mar-17 economic forecast changes
1. Single (no kids), full time, self-employed, low eaming <i>works 37.5 hours per week at average self-employed hairdresser earnings</i>	£12,050	-£400	-£40	-£440
2. Single (no kids), full time, self-employed, high eaming <i>works 37.5 hours per week at average self-employed management consultant earnings</i>	£37,310	-£1,070	-£110	-£1,180
3. Single (no kids), full time, eaming wage floor, renting <i>works 37.5 hours per week at NMW/NLW, rents privately at 30th pctile</i>	£13,150	-£330	-£50	-£380
4. Single (1 child), part time, eaming wage floor <i>works 20 hours per week at NMW/NLW</i>	£12,180	-£160	-£10	-£170
5. Single (1 child), full time, low eaming, renting <i>works 37.5 hours per week at p25 wage, rents social housing at average rents</i>	£16,690	-£240	+£0	-£240
6. Couple (2 kids), full time single earner on wage floor <i>main earner works 37.5 hours per week at NMW/NLW</i>	£19,620	-£280	-£10	-£290
7. Couple (2 kids), low eaming/wage floor, renting <i>main earner works 37.5 hrs per week at p25 wage, 2nd earner works 20 hrs per week at NMW/NLW, rents privately at 30th pctile</i>	£29,090	-£330	-£30	-£360
8. Couple (3 kids), low eaming/wage floor, renting <i>main earner works 37.5 hrs per week at p25 wage, 2nd earner works 20 hrs per week at NMW/NLW, rents privately at 30th pctile</i>	£29,020	-£340	-£20	-£360
9. Couple (2 kids), low/mid eaming <i>both work 37.5 hours per week, main earner at median wage, second earner at p25 wage</i>	£35,890	-£860	-£100	-£960
10. Couple (no kids), high eaming <i>both work 37.5 hours per week at p90 wage</i>	£77,450	-£1,910	-£260	-£2,170

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

All of the family types shown here have seen a reduction in their forecast household income in 2020-21 between the forecasts at Budget 2016 and at Spring Budget 2017. The largest falls took place between Budget 2016 and Autumn Statement 2016, as the OBR took an initial assessment of the prospects for the UK economy after the EU referendum. The OBR's forecast at Spring Budget 2017 further revised down real earnings growth and this is reflected in further (but small) downward revisions in the forecast for household incomes between Autumn Statement 2016 and Spring Budget 2017.

Rising inflation will also make existing benefit cuts bite harder

As Table 1 showed, the greatest economic-driven impact on household incomes for the families with children included in our examples occurred between the March 2016 and November 2016 outlooks. A key driver of these falls in net incomes is higher-than-expected inflation.

That same increase in inflation projections will raise the ‘bite’ of the benefit freeze. Announced at the Summer Budget 2016, a four-year benefit freeze (starting in April 2016) will mean that most working-age benefits^[4] will not be uprated until April 2020. Despite a slight reduction in projected inflation since the Autumn Statement, the continued post-referendum increase means that the impact of the benefit freeze is expected to be greater than anticipated this time last year.

The real-terms squeeze is now expected to amount to a 5.9 per benefit cut cent in total, up from a forecast of 4.4 per cent in March 2016. This has increased the expected savings from the measure by £0.9 billion a year in 2020, or an extra £2.7 billion over the next four years.

While good news for the Exchequer, this is of course bad news for those families affected. Figure 27 shows how expected losses have increased for different family types since Budget 2016. If inflation follows the pattern set out in yesterday’s outlook, a single earning couple with two children would be an additional £185 a year worse off by 2020.

Figure 27: 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 March 2017 economic assumptions

[4] In summary, excluding disability and carer benefits and premia as well as statutory payments.

Inherited policy changes continue to push down on income growth projections for low and middle income households

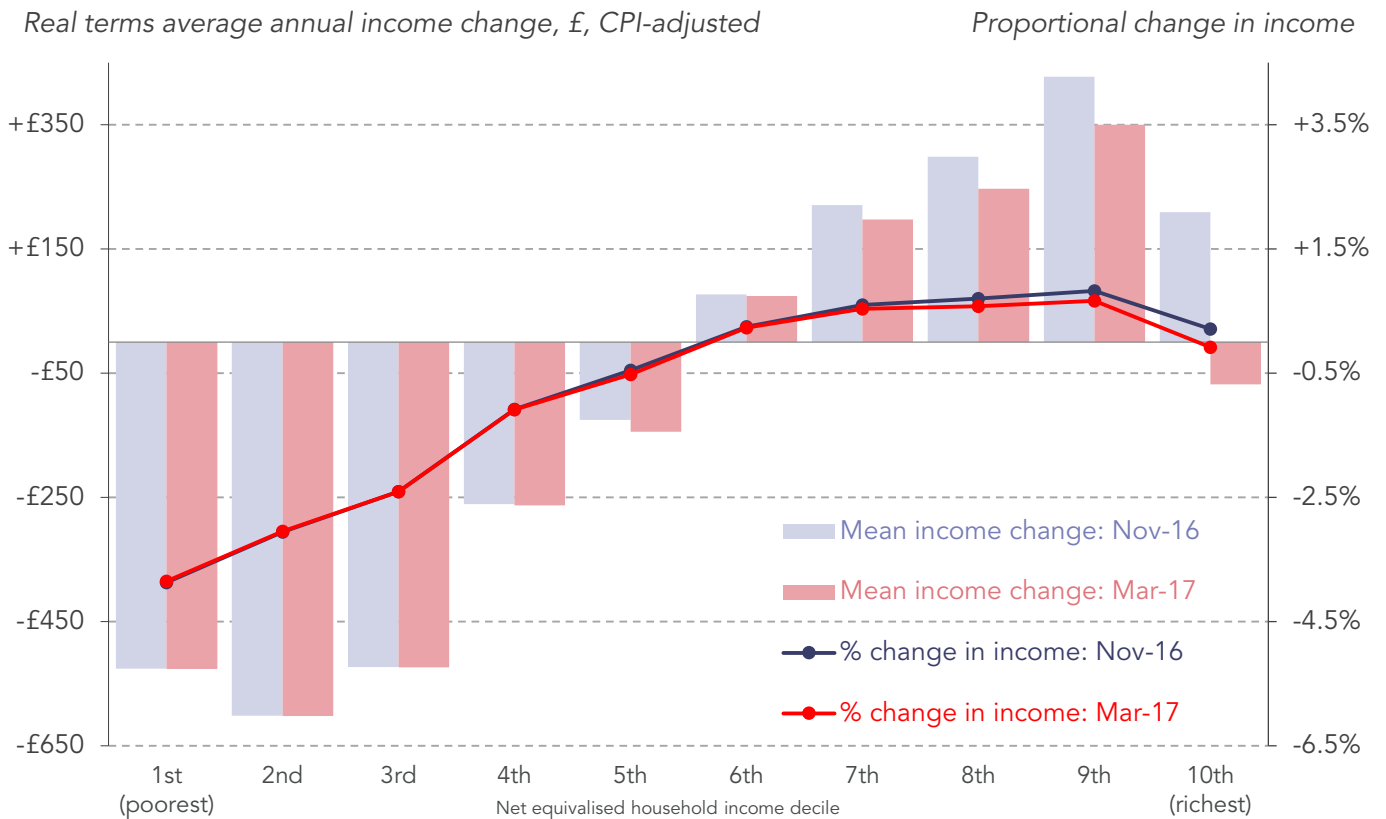
Beyond changes to self-employed National Insurance (discussed in detail below), there was little in the way of new policy that will directly affect household incomes in yesterday's Budget.

The one exception was the reduction in the tax-free Dividend Allowance from £5,000 to £2,000 from April 2018. This is a measure that will overwhelmingly affect richer households. The latest estimates of dividend income published by HMRC shows that three-fifths of dividend income is received by those with a personal income of greater than £50,000 a year. Yet while this is clearly a measure targeted on higher income households, in raising just £0.9 billion a year by 2021-22, it is small relative to the ongoing fallout of more than £12 billion of working-age welfare cuts announced in the Summer Budget 2015.

Those welfare changes were coupled with policy changes intended to boost incomes – the NLW, income tax cuts and additional hours of free childcare for working parents. At Autumn Statement 2016 the Chancellor announced additional support in UC through a reduction in the UC taper rate of 2 per cent, increasing spend by £0.6 billion in 2020. All these measures will gradually affect households as they are put into place across the parliament, making it important to consider them in the round when assessing their impact on household incomes.

Figure 28 shows the impact of all these tax and benefit policies announced this parliament by net equivalised household income decile. The analysis consistently uses the latest OBR economic assumptions to ensure only policy changes are highlighted. The blue bars and line show the cumulative impact of all policies announced this parliament up to and including Autumn Statement 2016, the red bars and line show the same but also including the measures announced at Spring Budget 2017. These show that – despite some modest progressive changes yesterday – the sum of measures announced so far this parliament continue to leave the poorest half of households 2.2 per cent, or an average of £410 a year, worse off in 2020.

Figure 28: Cumulative impact of tax and benefit policies announced this parliament pre- and post-Budget 2017: 2020



Notes: Includes the introduction of the National Living Wage, announced income tax cuts, additional hours of free childcare for working parents, 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%, capital gains tax and in the most recent period increasing Class 4 NICs to 11 per cent and reducing the Dividend Allowance. Assumes full entitlement take-up and accounts for the transition to UC and gradual impact of measures affecting new claims/births in the Tax Credit/Universal Credit system.

Source: RF analysis using the IPPR tax-benefit model & OBR, *Economic and Fiscal Outlook*, March 2017

In addition to the measures shown here, the government remains committed to increasing both the personal allowance and higher rate threshold for income tax to £12,500 and £50,000 respectively by the end of this parliament. On current projections for CPI, further above-inflation increases in the thresholds are needed to meet these pledges (they are expected to reach £12,310 and £48,210 respectively). Closing these gaps would cost £1.3 billion in April 2020 and, as previous Resolution Foundation research has shown, around four-fifths of this extra spend will go to the richest half of households.^[5]

Though self-employment tax reform provides some modest gains for the lower earning members of the group

As noted above, the largest new revenue increases announced in yesterday’s Budget came from changes to the taxation of dividends and self-employment income.

The move to increase the main rate of National Insurance (NI) for the self-employed from 9 per cent now to 10 per cent in 2018-19 and then 11 per cent from 2019-20, is a welcome change.

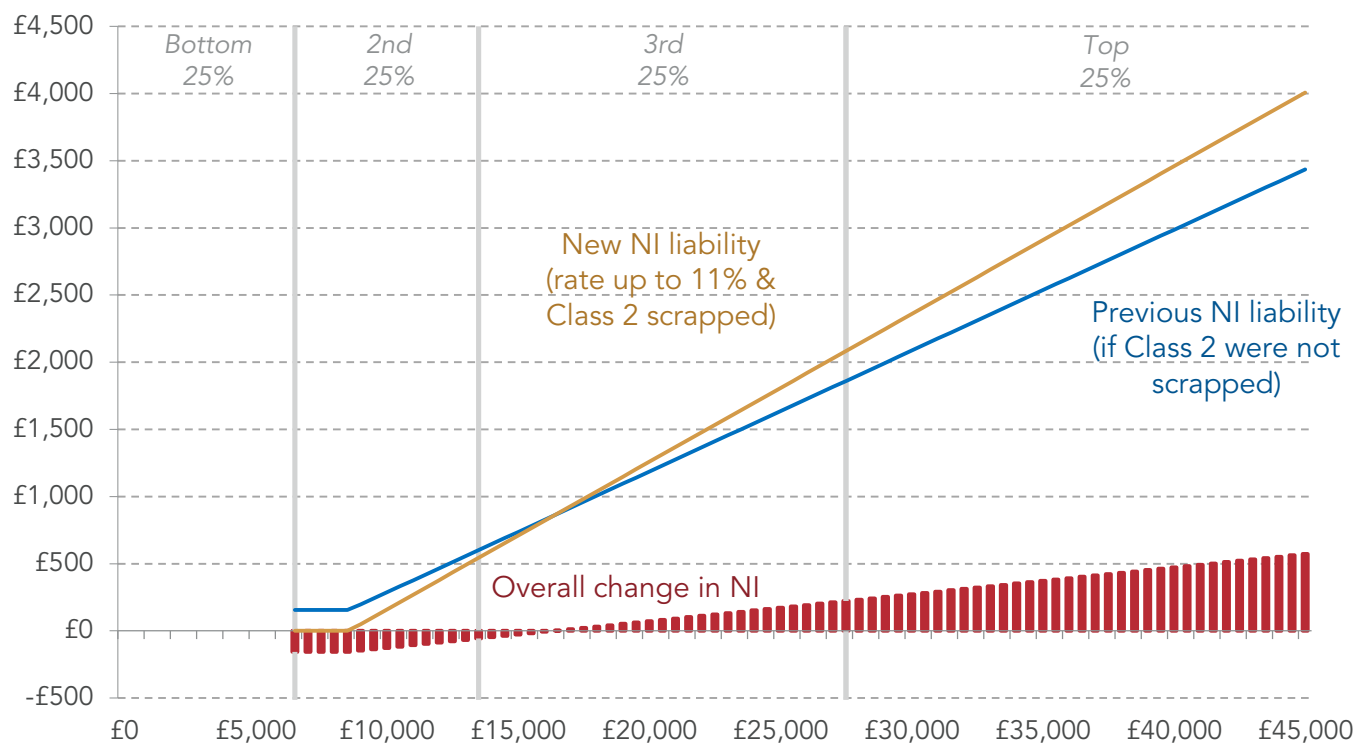
[5] A Corlett, et al, *Bending the Rules: Autumn Statement response*, Resolution Foundation, November 2016

Taken in combination with already-planned abolition of Class 2 NI – a flat payment of around £150 a year for most self-employed people. The move is also progressive, with 54 per cent of the self-employed will be made better off as a result of these combined changes in 2019-20. It will also narrow the now-arbitrary tax gap between employees (who pay 12 per cent and incur employer national insurance bills) and the self-employed.

As Figure 29 shows, the lowest earners will be unaffected either way as they already pay no NI. Many other low and middle earners will be better off overall, because they gain from scrapping the Class 2 charge of over £150 and are largely protected from rate increases due by the relevant threshold (the Lower Earnings Limit) – which is expected to be over £8,500 in 2019-20. The greatest losers would be anyone earning above the upper threshold – by April 2019 likely to be around £47,000 – who would pay a little over £600 more tax each year. By way of context, note that

Figure 29: National Insurance liabilities with and without planned reforms

Total self-employment National Insurance paid in 2019-20 by income

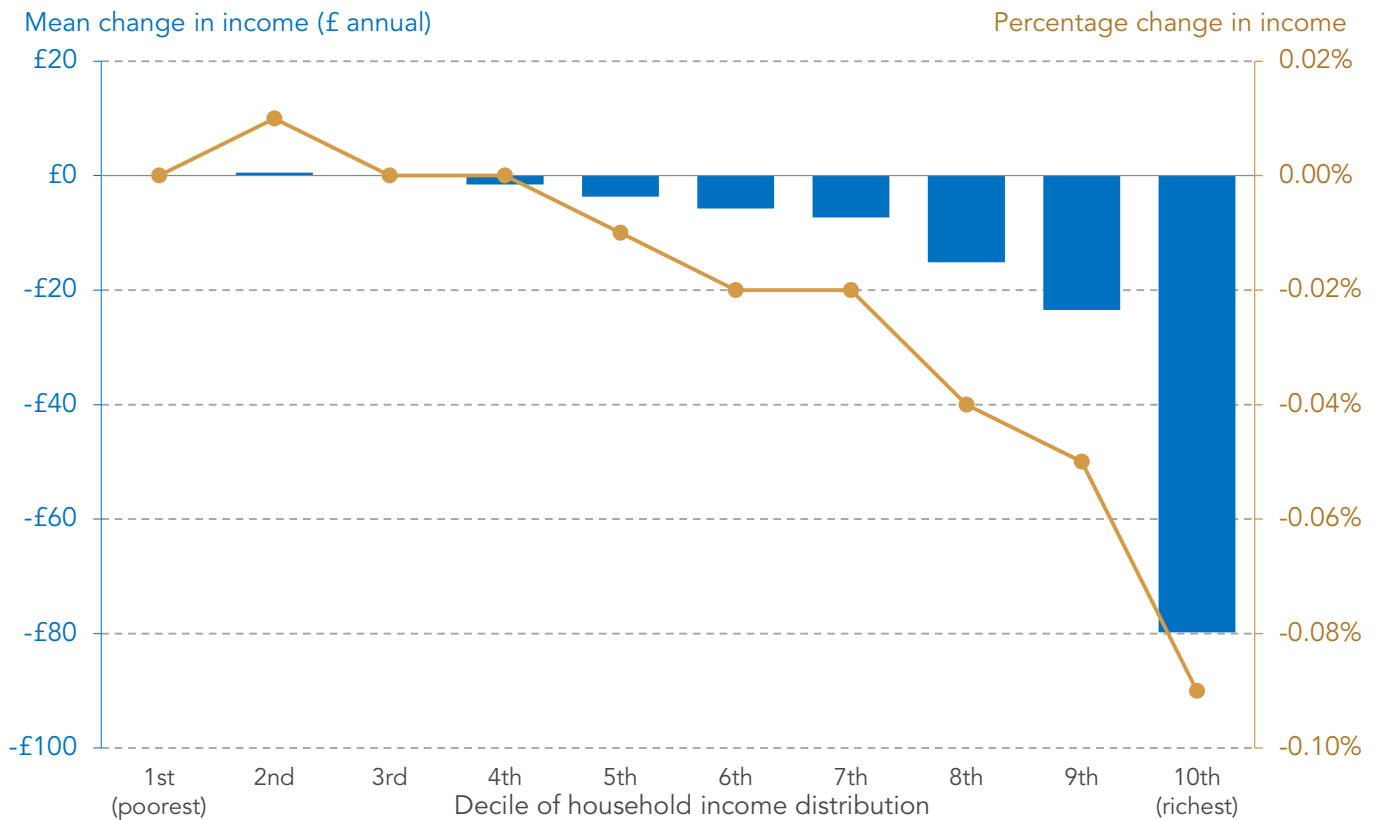


Source: RF analysis using projected tax rates and thresholds, and the Family Resources Survey 2014-15.

the average self-employed hairdresser will earn £12,700 in 2019-20 and the average management consultant £51,100 (assuming these grow in line with average earnings).

On a household (rather than individual) level, Figure 30 shows that the majority of revenue raised would be from the richest tenth of households, while almost none would come from the bottom half.

Figure 30: Household impact of combined self-employment NI reforms



Source: RF analysis using the IPPR tax-benefit model & OBR, *Economic and Fiscal Outlook*, March 2017

The Chancellor also announced that the government will consult on increasing the parental benefits on offer to the self-employed – which might include extending Statutory Maternity Pay to them. This also is welcome with reforms ideally bringing together tax and support changes into a single reform package.

The scale of gains and losses associated with tax and benefit policies vary from family to family

Of course, the precise extent to which families gain or lose as a result of the various policy changes announced so far this parliament vary from case to case. Table 2 presents ten example families and considers the impact of all of the measures brought in since the 2015 election. It shows each family’s forecast income at the end of the parliament based on Spring Budget 2017 economy forecasts under the policy assumptions at the time of the three most recent fiscal events.

Table 2: Impact of policy changes this parliament for example family types

Net household incomes for different family types, Universal Credit system, 2020-21, Mar-17 economy forecast, CPI-adjusted to 2016-17 prices

<i>Net household incomes (before housing costs)</i>	Start of parliament income forecast	Policy impact up to Budget 2016	Policy impact from AS 2016	Policy impact from Spring Budget 2017	<i>Combined impact from all policy changes this parliament</i>
1. Single (no kids), full time, self-employed, low earning <i>works 37.5 hours per week and earns average self-employed hairdresser earnings</i>	£11,290	+£400	+£0	-£80	+£320
2. Single (no kids), full time, self-employed, high earning <i>works 37.5 hours per week and earns average self-employed management consultant earnings</i>	£36,370	+£480	+£0	-£720	-£240
3. Single (no kids), full time, earning wage floor, renting <i>works 37.5 hours per week at NMW/NLW, rents privately at 30th pctile</i>	£11,450	+£1,320	+£0	+£0	+£1,320
4. Single (1 child), part time, earning wage floor <i>works 20 hours per week at NMW/NLW</i>	£14,410	-£2,480	+£80	+£0	-£2,400
5. Single (1 child), full time, low earning, renting <i>works 37.5 hours per week at p25 wage, rents social housing at average rents</i>	£17,260	-£1,060	+£250	+£0	-£810
6. Couple (2 kids), full time single earner on wage floor <i>main earner works 37.5 hours per week at NMW/NLW</i>	£20,960	-£1,810	+£180	+£0	-£1,630
7. Couple (2 kids), low earning/wage floor, renting <i>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</i>	£29,190	-£880	+£420	+£0	-£460
8. Couple (3 kids), low earning/wage floor, renting <i>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</i>	£31,900	-£3,670	+£430	+£0	-£3,240
9. Couple (2 kids), low/mid earning <i>both work 37.5 hours per week, main earner at median wage, second earner at p25 wage</i>	£34,820	+£110	+£0	+£0	+£110
10. Couple (no kids), high earning <i>both work 37.5 hours per week at p90 wage</i>	£74,710	+£570	+£0	+£0	+£570

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 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 forecasts.

Source: Resolution Foundation analysis using RF microsimulation model

Some families have seen positive revisions in their forecast household income.

- » ‘Family 1’ is expected to be £320 better off in 2020-21 as a result of policies implemented in this parliament. This is a result of increases in the income tax personal allowance and the impact of the abolition of Class 2 NI outweighing the impact of the increase in class 4 NI to 11 per cent by 2019-20.
- » ‘Family 3’ is also expected to be better off. This individual gains more from the introduction of the National Living Wage than they lose from the impact of higher inflation, and sees an overall policy related boost to their income of £1,320 by the end of the parliament.

However, most of the families with employees featured in Table 2 are forecast to be worse off.

- » ‘Family 6’ – a single-earning couple with two children – is expected to be £1,630 worse off in 2020-21 as a result of policy changes across this parliament. It loses £1,810 as a result of the policies announced up to Budget 2016; this reflects the balance of the NLW and tax cuts which boost this family’s income, being more than offset by welfare cuts that reduce it. It gains just £180 as a result of the changes announced at Autumn Statement 2016, with the boost to UC announced last November reversing only 10 per cent of the policy-squeeze on this family.
- » Family 8 – a dual-earning couple with three children – is expected to be £3,240 worse off in 2020-21. This family loses £3,670 as a result of policies announced up to and including Budget 2016. Again, this 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 just 12 per cent of this policy-related squeeze.

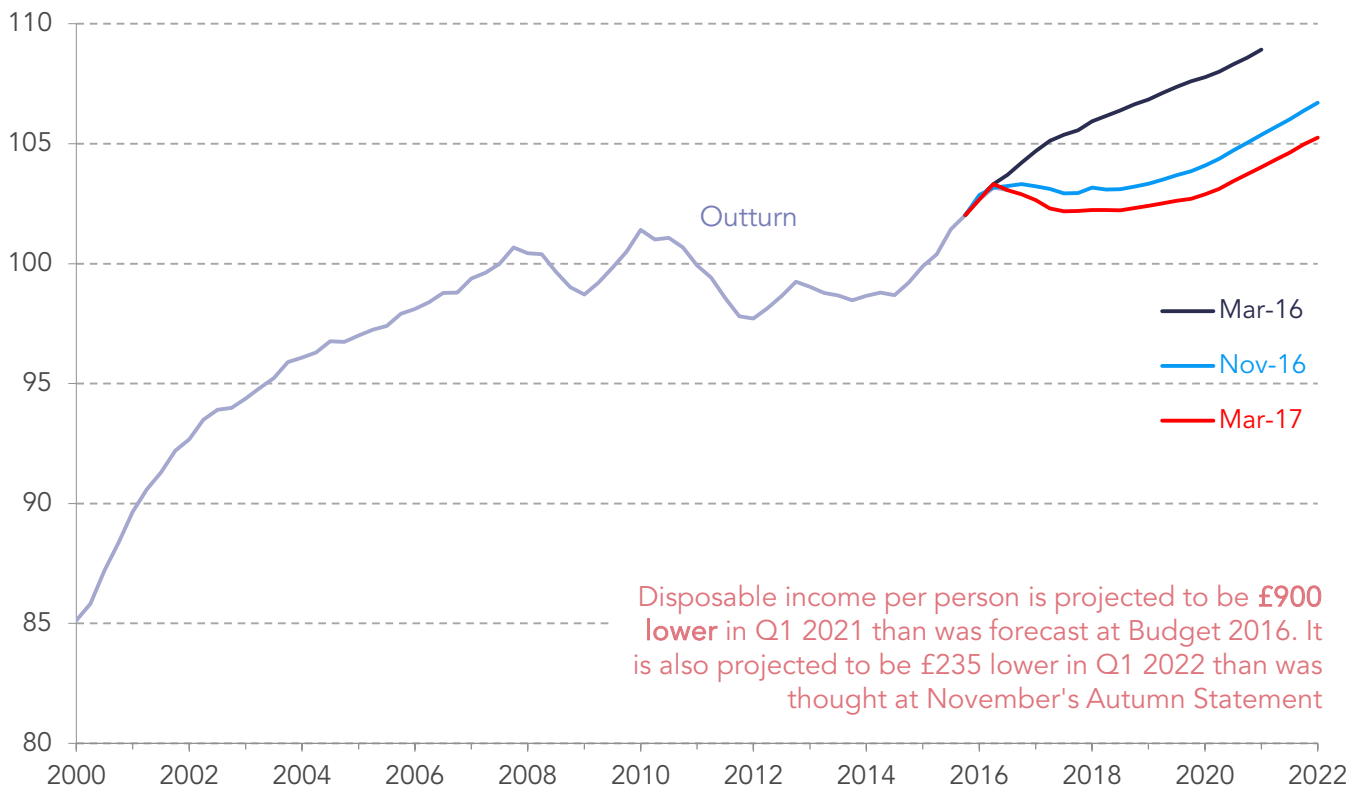
Overall, expectations for average income growth per person are lowered

So far we have looked at the impact of economic changes and policy changes in isolation. Bringing them together gives us an opportunity to consider the overall impact on household living standards.

At the aggregate level, reductions in real-earnings growth projections and a mix of tax and benefit changes underpin expectations of stagnation in average household incomes over the coming years. As Figure 31 shows, average income per person is projected to fall by 1 per cent (or £180) between Q2 2016 and Q3 2017. It is then projected to broadly flat-line through to the end of 2018, before picking up slowly towards the end of the forecast period.

Figure 31: Household income per capita outturn and projections

Indices of annualised real household disposable income per capita: outturn and successive projections: (Q3 2007 = 100)



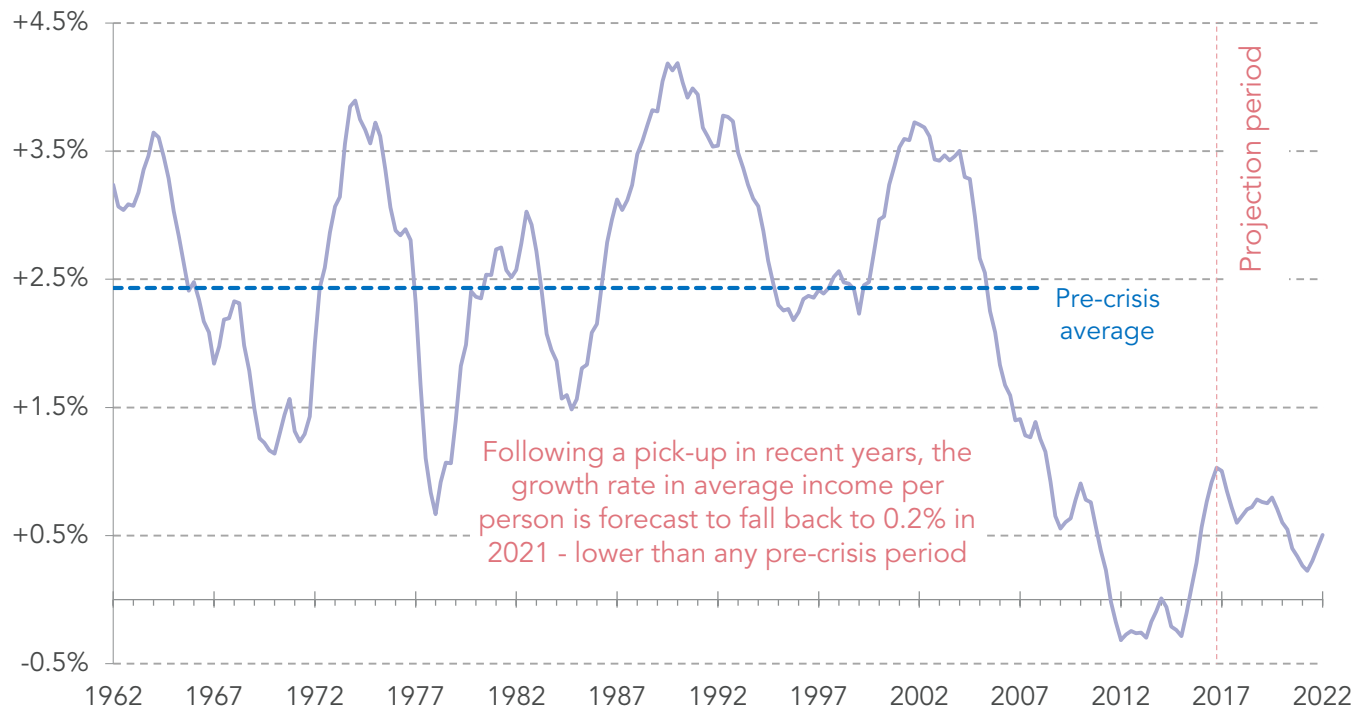
Sources: ONS, Series MGSC & OBR, Economic and Fiscal Outlook, various

Average disposable incomes per person are thus expected to reach £19,350 by Q1 2022, just £500 higher than today and £325 lower than projected at the Autumn Statement. The gap between the latest projection and Budget 2016 is bigger still, forecast to be £900 lower at the start of 2021 than previously thought pre-referendum.

Taking a longer view, Figure 32 plots rolling five-year average annual growth rates. The post-crisis years stand out as a period in which growth rates have dipped to levels rarely if ever seen over the previous 40 years. The measure was negative between 2011 and 2015 and, having briefly picked up thereafter, is now projected to fall back towards historically low levels. By 2021 it is forecast to drop to a five-year average of just 0.2 per cent, well below the pre-crisis average of 2.2 per cent.

Figure 32: Rolling-five year annual growth in real-terms income per capita

Rolling five-year average annual growth rate in real disposable household income per capita: outturn and Mar-17 projection



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

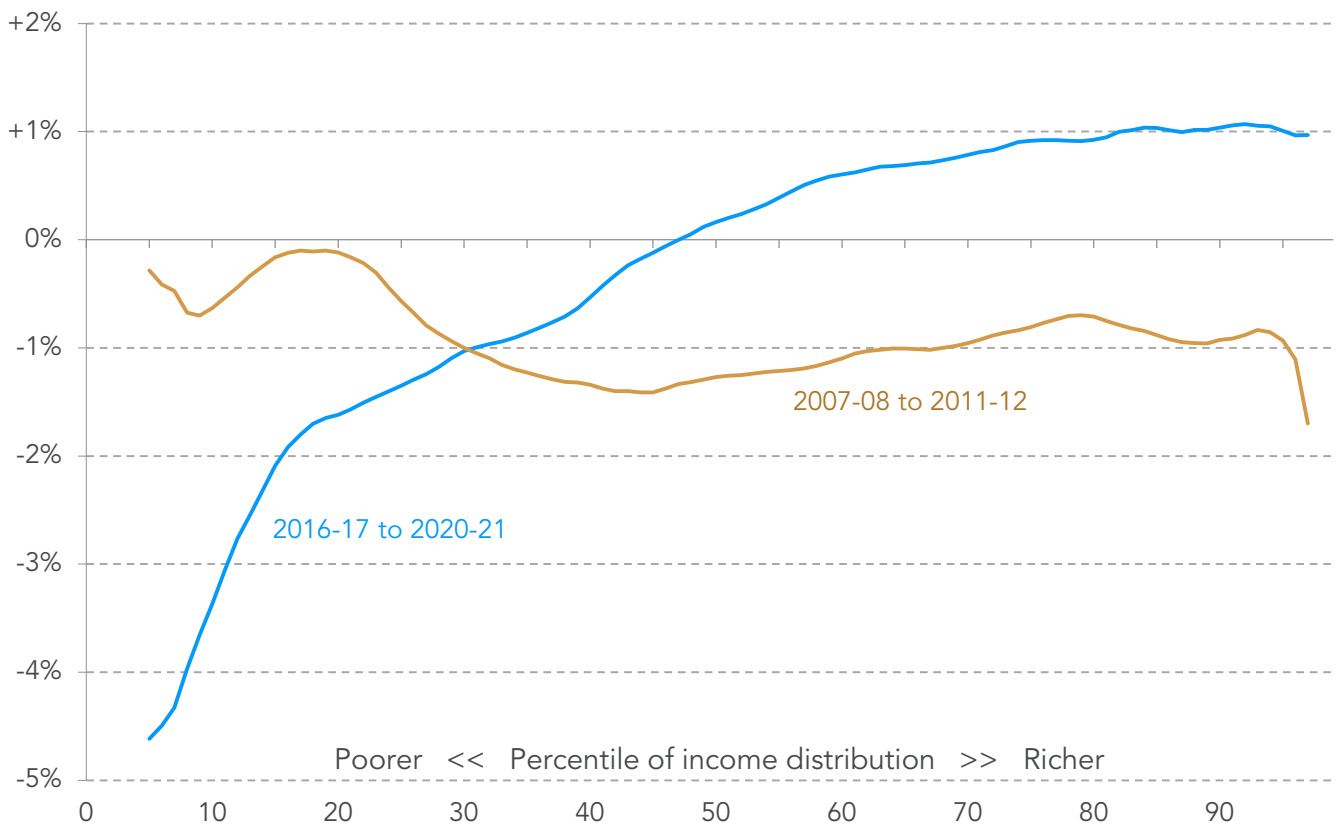
With a particularly bleak outlook for low and middle income households

While the picture on average incomes gives us a sense of the general direction of living standards in the coming years, it is important to look at different potential experiences across the income distribution too.

Figure 33 sets out annual average growth in after housing cost incomes among working-age households over the four years following the financial crisis. Building on the work set out in our annual review of living standards,^[6] we also present an updated projection for the current parliament.

[6] S Clarke & A Corlett, [Living Standards 2017: the past, present and possible future of UK incomes](#), Resolution Foundation, January 2017

Figure 33: Average annual household net income growth, working-age and after housing costs



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 75 per cent rolled out & measures affecting new claims/births half in place. Budget 2017 scenario uses policies announced by Budget 2017 and OBR economic assumptions in March 2017.

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

At the median, we forecast almost zero growth in income over the course of the parliament, with incomes *falling* by between 1 per cent and 5 per cent a year in the bottom third of the distribution. In contrast, we expect household income in the top half of the distribution to rise – albeit by a very meagre 0.5 per cent to 1 per cent a year.

Overall, income growth was weaker in the earlier period, but the shape of the previous income squeeze was somewhat different. During the four years after 2007-08, incomes stagnated or fell across the distribution but were squeezed hardest at the top. In contrast, the final four years of the current parliament look like being worse for poorer households than the financial crisis period itself.

Figure 33 underlines the impact that economic conditions have on household income growth. However policy also plays its part. Previously we have shown that a reversal of the working-age benefits cuts would significantly mitigate the effect of the squeeze on household incomes in the bottom third of the distribution.^[7] As always, it is worth remembering that these projections are not inevitable or unalterable. The Chancellor will have another opportunity to tackle the living standards challenge at the Autumn Budget.

[7] M Whittaker, *Economy drive: Prospects and priorities ahead of the last Spring Budget*, Resolution Foundation, March 2017

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- » *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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