Sugar Rush
*Spring Statement response*

March 2018
Summary

For his first Spring Statement, the Chancellor told us he was feeling “positively Tigger-like” about the UK economy. The problem for him, and for all of us, is that the Office for Budget Responsibility (OBR) is feeling a lot less so. Having hugely downgraded economic and public finance forecasts in the Autumn Budget just four months ago, the official forecaster has given the Chancellor a ‘sugar rush’ outlook, with some small good news in the short term but headaches further out. Indeed when it comes to the long-term outlook for the UK economy, the OBR has taken one of Theresa May’s favourite mantras to heart and told us that “nothing has changed” with projections for growth and pay remaining grim by historical and international standards.

The ongoing pessimism comes despite slightly sunnier short-term forecasts for the Chancellor. A strengthening world economy has provided a welcome tailwind, lifting the projection for UK growth in 2018 from 1.4 per cent to 1.5 per cent. The public finance forecasts also registered small improvements, with borrowing for 2017-18 forecast to fall to £45.2bn – some £4.7 billion lower than expected in November – on the back of more robust tax receipts. This improvement allowed the Chancellor to talk about next year as a turning point for the public finances, when the current budget deficit is forecast to be eliminated and the debt to-GDP ratio to fall.

But these near-term improvements made little difference to the OBR’s assessment of the overall trajectory of the UK economy. On growth, the OBR sees recent upgrades as almost entirely cyclical rather than reflecting an underlying improvement, believing that strong productivity growth at the end of 2017 reflects measurement error not a genuine improvement in the UK’s growth potential. The result is that stronger growth in the near term is matched by weaker growth further out, with the overall size of the economy being just £3 billion bigger at the start of 2023 than projected back in November and still £36 billion smaller (at the start of 2022) than expected at the time of the March 2017 Budget. To put it another way, only 12 per cent of the downgrade from the Autumn Budget has been unwound.

And, while UK growth prospects have been downgraded, those of other major countries have improved recently. Indeed the OBR expects UK growth between 2017 and 2022 to be a full quarter (24 per cent) slower than that for the Euro area.

The story of short-term improvement but deep-rooted pessimism also drives what remains a truly terrible set of forecasts for pay and living standards. The good news is that next year the OBR does now expect pay to grow, albeit only by 0.4 per cent. But real pay growth is then revised down in later years, never rising above 1 per cent throughout the forecast horizon. The result is that pay is still not on course to be back at pre-crisis levels until 2025, a full 17 years of lost growth.

Household incomes in turn are also forecast to grow below 1 per cent a year right through to 2023, leaving average incomes at the start of 2021 some £1,400 lower than forecast back in March 2016. This weak income performance reflects the coming together of gloomy economic forecasts and the fact that, despite no new policies being announced in the Spring Statement, significant cuts to working-age benefits announced in July 2015 are being rolled out in the years ahead.

Indeed, only one-fifth of the £10 billion worth of cuts announced in the Summer Budget of 2015 that directly affect household incomes have so far been delivered. Further cuts in 2018–19 will amount to £2.5 billion, with that figure rising again – to £2.7 billion – in 2019–20. These cuts will of course affect different families very differently. By 2022–23, the poorest third of households are expected to be £745 a year worse off than they would have been had no policy changes been made after March 2015. In contrast, the richest third will be £140 better off.

As with family incomes, public spending also remains under considerable strain. Certainly it’s clear that austerity is far from over. While capital spending per capita is set to rise by 24 per cent between now and 2022–23, day-to-day spending per person is set to continue falling right through to the end of the forecast period, after a brief lull this year and next. Even during that overall
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lull, some departments are set for big cuts. The Ministry of Justice is set for a 12 per cent cut in day-to-day spending over the next two years for example, while central government funding of local government is set for a 19 per cent fall. Looking beyond 2022-23, further cuts would be required if the Chancellor intends to meet his ultimate fiscal ‘objective’ of running an absolute surplus before the end of the next parliament in 2027-28.

The Chancellor did hold out some hope for those worried about the effects of such a long period of post-financial crisis austerity, telling the House of Commons that “If, in the autumn, the public finances continue to reflect the improvements that today’s report hints at, then … I would have capacity to enable further increases in public spending and investment in the years ahead”. This is the ‘light at the end of the tunnel’ he has talked about, with improvements in the public finances being shared out between deficit reduction, spending on public services and tax cuts. Philip Hammond seems to have rediscovered George Osborne’s pre-crisis fiscal policy of “sharing the proceeds of growth”.

The improvements he mentioned are the fact that, unlike the growth figures, the £4.7 billion fall in borrowing this year is more or less sustained through to the end of the forecast period (when it stands at £4.2 billion). Cumulative borrowing over the six years from 2017-18 to 2022-23 has therefore been revised down by £20 billion since November. However sharing the proceeds of that lower borrowing is unlikely to offer much respite to public services or families facing significant welfare cuts.

First, that’s because if even all of the £4.2 billion figure fed into extra day-to-day spending it would amount to an increase of just 1.2 per cent. But it’s also worth noting that, far from increasing the spending power of departments in this Spring Statement, the Chancellor actually cut it. Inflation (as measured by the GDP deflator) increased slightly in yesterday’s Outlook relative to November but, rather than rising with inflation, day-to-day departmental spending was held constant in cash terms in the period beyond the current Spending Review (which runs up to 2019-20 for current spending). As a result current departmental spending actually fell by 0.1 per cent of GDP, driving £1.5 billion of the public finance ‘improvement’ in 2022-23 that the Chancellor is talking about sharing. Far from robbing Peter to pay Paul, this is a complex way of robbing Peter to give back to Peter.

In practice, while the Chancellor has stuck to the approach of not taking policy decisions in this Spring Statement, he does face much bigger decisions and more difficult trade-offs in this year’s Autumn Budget if he intends to help everyone see the light at the end of the tunnel of public spending restraint that he has talked of. Simultaneously delivering an absolute surplus and raising spending on public services will require either tax rises (rather than the tax cuts he has promised) or for Britain to achieve what he has called on it to do and ‘beat the forecasts’. Planning for the former, while hoping for the latter might be a sensible approach.

In that context it is welcome to see the Treasury announce some significant consultations on important areas that matter for protecting the tax base in the years ahead. Two stand out. Looking at options for taxing digital firms on the basis of their revenue earned in the UK rather than profit reported here makes sense given the very low taxes paid by such companies, but is far from straightforward. Also welcome and more easily done, but probably less popular, is the suggestion of extending to the private sector, public sector reforms that tackle the practice of people that look like employees using off-payroll working to reduce taxes. In the years ahead the Treasury will need to act on such consultations, as well as other big challenges our tax system faces from the low taxation of wealth to the growth in use of electric vehicles.
The OBR has provided the Chancellor with a ‘sugar rush’ outlook, with good news in the near-term but headaches further out

As expected, the first ever Spring Statement provided the Chancellor with some good news in the near-term – on growth, on borrowing and on debt. But further out many of the same headaches remain. As Table 1 shows, the OBR's latest Economic and Fiscal Outlook follows up better figures on growth in productivity and GDP per capita in the next couple of years, with modest downward revisions across much of the forecast period.

Table 1: Year-on-year growth in selected metrics: OBR Nov-17 and Mar-18 projections

<table>
<thead>
<tr>
<th>Year</th>
<th>Productivity (real non-oil output/hour)</th>
<th>GDP per capita (real-terms)</th>
<th>PNSB as a share of GDP</th>
<th>PNSD as a share of GDP</th>
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</thead>
<tbody>
<tr>
<td>2016-17</td>
<td>0.2%</td>
<td>0.4%</td>
<td>1.0%</td>
<td>1.2%</td>
</tr>
<tr>
<td>2017-18</td>
<td>0.1%</td>
<td>0.7%</td>
<td>0.8%</td>
<td>1.0%</td>
</tr>
<tr>
<td>2018-19</td>
<td>0.9%</td>
<td>0.8%</td>
<td>0.8%</td>
<td>0.8%</td>
</tr>
<tr>
<td>2019-20</td>
<td>1.1%</td>
<td>0.9%</td>
<td>0.7%</td>
<td>0.7%</td>
</tr>
<tr>
<td>2020-21</td>
<td>1.2%</td>
<td>1.1%</td>
<td>0.8%</td>
<td>0.7%</td>
</tr>
<tr>
<td>2021-22</td>
<td>1.3%</td>
<td>1.2%</td>
<td>1.0%</td>
<td>0.9%</td>
</tr>
<tr>
<td>2022-23</td>
<td>1.3%</td>
<td>1.2%</td>
<td>1.0%</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

Notes: Green text = upgrade; Red text = downgrade
Source: OBR, Economic and Fiscal Outlook, various

By 2022-23, the picture is a little improved relative to the Autumn Budget Outlook. Net borrowing as a share of GDP is down from a projected 1.1 per cent to 0.9 per cent, and the forecast for net debt as a share of GDP has been lowered from 79.1 per cent of GDP to 77.9 per cent. But precious little of the major downgrade that was delivered just four months ago has been reversed in this latest forecast. Just 12 months ago, the OBR had projected that the annual deficit would drop to 0.7 per cent by 2021-22 – a lower deficit than is now projected for the following year.

Underpinning the OBR’s grim medium-term outlook is an assumption that the pick-up in productivity growth recorded in the second half of 2017 will not be sustained into 2018

The big news at the Autumn Budget was the OBR’s decision to significantly downgrade its projection for trend productivity growth. Having consistently been wrong in assuming that a return to pre-crisis levels of productivity growth was just around the corner, it set out a new more pessimistic trajectory that had major ramifications for overall growth, for the public finances and for household living standards.

But, as Figure 1 shows, just at the point the OBR blinked, productivity growth took off: growth in Q3 and Q4 2017 was the strongest recorded since 2011. If this growth were sustained, the outlook for the economy over the coming years would be much improved. But the OBR has taken the view that it is a little more than a blip. It expects productivity to have fallen at the start of 2018, with slower growth over the remainder of the period such that the level of output per hour in 2023 is almost precisely where it was projected to be back in November.
The OBR's near-term productivity position is informed by an assessment that the pick-up in the last two quarters owed much more to an unexpected drop in average working hours than to stronger output growth or weaker employment growth. As proved to be the case in 2011, when hours also dropped sharply and productivity growth spiked, the OBR expects this drop to prove temporary. Figure 2 sets out the new forecast, with the recent drop in hours assumed to be fully reversed at the start of 2018. Average hours are thereafter expected to follow a similar pattern to the one set out in November.
The upshot is that the overall outlook for the economy is little changed, with only 12 per cent of the GDP downgrade being clawed back.

Figure 3 provides a fuller picture on the GDP forecast than the one set out in Table 1. It again shows the near-term improvement and medium-term deterioration relative to the November forecast, but this time we can also see how far below the March 2017 projections the latest outlook remains. And yesterday’s growth figures are even further down on those set out in the last Budget before the EU referendum of June 2016.
The effect of these successive downgrades is made clearer still in Figure 4. Despite the better near-term picture outlined yesterday, the chart shows that the OBR expects the UK economy to be just £3 billion bigger at the start of 2023 than had been projected in November. That reverses just 12 per cent of the downgrade reported in November however. Relative to the March 2017 Budget forecast, the economy is still expected to be £36 billion smaller at the start of 2022 than previously thought.
Looking further back, had the economy continued to follow the trajectory forecast in the March 2016 Outlook, it would have reached the start of 2023 some £85 billion (or 4 per cent) larger than is now projected. This disappointing picture on growth runs counter to the picture in many other advanced economies, with the UK dropping from the top to the bottom of the G7 growth league over the course of 2017. As Figure 5 shows, the OBR projects the UK to grow much more slowly than the Euro area average until 2022.
In cumulative terms, this outlook means the UK economy is forecast to record growth between 2016 and 2022 that is nearly one-quarter (24 per cent) lower than across the Euro area. To put this into context, were the UK to grow in line with the Euro area forecast its economy would be £54 billion larger in 2022 than now projected.

This slower growth of course comes on top of what was already a very deep downturn and sluggish recovery. Figure 6 compares trajectories for GDP per capita in the 15 years following the downturns of 1980, 1990 and 2008, assuming the OBR’s latest projection holds true. Relative to the pre-recession peak in Q4 1979, GDP per capita had grown by 35 per cent after 15 years (a period which included the recession and recovery of 1990). The same distance out from the pre-recession peak of Q2 1990, GDP per capita was up 37 per cent. Yet the OBR’s latest figures imply the equivalent figure 15 years on from the start of the financial crisis will be just 7 per cent.
Borrowing has been revised down by a cumulative £20 billion over the six years from 2017-18 to 2022-23, but remains £37 billion higher than had been projected in the five years to 2021-22 just 12 months ago

Unlike the outlook for growth, Table 1 showed that the latest OBR projection provides better news on the deficit in every year of the forecast relative to November. Borrowing is set to be £4.7 billion lower than previously thought in 2017-18, which is a smaller improvement than many had anticipated.\(^1\) The OBR says this is because it expects local authorities to underspend their budgets by less than the ONS is assuming.\(^2\)

While smaller than had been expected, this improvement in annual borrowing is expected to persist in future years, with borrowing coming in £4.2 billion lower than previously projected in 2022-23. On a cumulative basis, the revisions imply a £20.3 billion reduction in total borrowing in the six years from 2017-18 to 2022-23.

As Figure 7 shows however, the outlook remains much gloomier than the one prevailing in March 2017. Borrowing in 2021-22 is now projected to be £15 billion higher than had been forecast a year ago, with a cumulative increase in borrowing over the five years from 2017-18 to 2021-22 of £37 billion (over this same five year period the improvement between November 2017 and March

\(^1\) We had projected an in-year improvement of between £7 billion and £11 billion. See M Whittaker, *A man for all seasons? What the Chancellor can expect from in the OBR’s Spring outlook*, Resolution Foundation, March 2018.

\(^2\) OBR, *Economic and Fiscal Outlook*, March 2018, para 1.6
2018 is £16.1 billion). And just two years ago (at the March 2016 Budget), the OBR forecast that the deficit would be entirely eliminated by 2019-20. The latest projection instead suggest the deficit will stand at £33.9 billion, some £44.3 billion higher than assumed then.

**Figure 7:** Overall borrowing has been revised down, but only a fraction of November’s downgrade for later years has been reversed

Public sector net borrowing as a share of GDP

Despite the borrowing downgrade relative to the position prior to last November, the Chancellor remains well on course to meet his ‘fiscal mandate’ – of cyclically-adjusted borrowing being lower than 2 per cent of GDP in 2020-21. As Figure 8 shows, he has marginally increased the £15 billion of headroom projected in the Autumn Budget.
This lack of change in the Chancellor’s 2020-21 headroom hides some factors pulling in opposite directions. As Figure 9 shows, the OBR has upgraded its forecast for receipts for instance. But a higher forecast for Bank Rate (and RPI) has raised the projected cost of debt interest (more than offsetting the effects of a reduced stock of debt). In addition, a reduction in the projected output gap for 2020-21 reduces headroom when using a cyclically-adjusted borrowing measure.
And the ‘end of austerity’ remains some way off, with public service cuts potentially persisting for another decade

If the government were to have retained the earlier fiscal goal of balancing the cyclically-adjusted current budget (i.e. excluding investment), it could now almost celebrate success. The current budget is expected to be in surplus from next year but, with the OBR assessing the economy to be above potential, the cyclically-adjusted current budget is not projected to return to surplus until 2019-20 on a financial year basis. The remaining gap is small, however, at £3.2 billion in 2017-18 and £1.3 billion in 2018-19.

The government is, however, much further off meeting its broader fiscal ‘objective’ – of returning the overall budget (including capital spending) to balance “at the earliest possible date in the next parliament”. The OBR notes that merely sustaining the pace of deficit reduction projected for the period after the current Spending Review would only deliver a balanced budget by 2027-28. And it says that this would mean that per capita departmental spending would “continue to fall each year in real terms”.

Even before considering this eventuality, Figure 10 shows cuts in departmental spending per person that are due over the existing forecast horizon. ‘Resource’ DEL (day-to-day, or ‘current’ spending on public services) per capita is set to be 4 per cent lower in 2022-23 than in 2017-18, representing an overall 17 per cent reduction from a 2010-11 baseline. In contrast, capital budgets (which are much smaller in absolute terms) are forecast to rise by 24 per cent per person over the next five years – returning roughly to where they were pre-crisis.

These real-terms spending levels are a little lower than set out in November, thanks to the fact that the government fixed cash terms departmental spending beyond the Spending Review period at the Autumn Budget. With the GDP deflator coming in a little higher in yesterday’s Outlook than in November, the effect is to reduce real-terms spending towards the end of the forecast. Indeed, relative to a counterfactual in which real-terms departmental spending were held constant in real-terms, these new cuts account for £1.5 billion of the £4.2 billion reduction in borrowing projected in 2022-23.

As ever of course, the aggregate DEL figures hide a range of experience for different departments: some have been sheltered from real cuts, while others have had substantial budget reductions. Figure 11 sets out the scale of day-to-day budget change due in 2018-19 and 2019-20 across a selection of departments. It shows, for example, that day-to-day spending in local government is set to fall by 19 per cent over the next two years. Similarly, day-to-day spending in Transport is due to fall by 18 per cent. In contrast, real-terms spending on Health is set to rise by 1 per cent.
These spending allocations relate to the changes set out at Autumn Budget 2017. More recently however, the government has allocated £1.6 billion for 2018-19 to try and cover costs associated with leaving the EU (with roughly the same again expected in 2019-20). As Figure 11 shows, this increase is substantial for some departments – amounting to 21 per cent of Defra’s 2018-19 resource budget, for example. In some instances, the Brexit-related funding increases more than offset baseline spending cuts, though that is not always the case.

Notwithstanding these funding increases – which are of course matched by increased service requirements – it’s clear that public service spending cuts have some way still to run.
Government debt is projected to have peaked, but it remains elevated and is set to fall slowly over the coming years

While the scale of the annual deficit might resemble those prevailing before 2008, national debt in 2017-18 remains higher as a proportion of GDP than at any point since 1965-66. It is projected to have reached a turning point, with debt projected to fall as a share of GDP in each future year of the projection period. But the falls in 2018-19 and 2019-20 are minor, as Figure 12 shows. Beyond this, the end of the Bank of England’s Term Funding Scheme plays an important role in the projected debt falls.

Figure 12: Debt may have stabilised, but projected falls are marginal in the short-term

Public sector net debt as a share of GDP

The country’s fiscal challenges have therefore not gone away. Projected national debt of nearly £1.9 trillion in 2020-21 remains some £128 billion higher than the figure that had been forecast just two years ago at the March 2016 Budget.
Very little has changed on the outlook for living standards, with November’s gloom persisting and households still in the midst of a longer squeeze than the one endured immediately after the financial crisis.

Just as the OBR’s *Outlook* provides some good news for the Chancellor in the near-term with little altering over the medium-term, so the prospects for household incomes appear slightly improved in the next year or two but unchanged further out.

Table 2 provides a summary, comparing yesterday’s figures on annual growth in both real-terms earnings and real household income with those set out in November. It shows that the squeeze on real earnings that took hold in 2017-18 looks now to have been a little weaker than was thought at the Autumn Budget. And projected growth in 2018-19 has been revised up from zero to 0.4 per cent. But thereafter, earnings growth is now expected to come in lower than previously thought.

### Table 2: Year-on-year growth in pay and income: OBR Nov-17 and Mar-18 projections

<table>
<thead>
<tr>
<th></th>
<th>Annual earnings (real-terms, CPI-adjusted)</th>
<th>Real household income (real-terms, CPI-adjusted)</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Nov-17</td>
<td>Mar-18</td>
</tr>
<tr>
<td>2016-17</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
<tr>
<td>2017-18</td>
<td>-0.6%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>2018-19</td>
<td>0.0%</td>
<td>0.4%</td>
</tr>
<tr>
<td>2019-20</td>
<td>0.6%</td>
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<td>2020-21</td>
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<td>2021-22</td>
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<tr>
<td>2022-23</td>
<td>1.1%</td>
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</tr>
</tbody>
</table>

Notes: Green text = upgrade; Red text = downgrade

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

It’s a similar picture on incomes, with better growth (or a more modest squeeze) in 2017-18, 2018-19 and 2019-20 being followed by a weaker performance in the following three years. The net effect of this pattern of upgrades and downgrades is to increase incomes marginally over the forecast period, as shown in Figure 13. The squeeze on incomes that had been assumed to play out over the course of 2018-20 now appears gentler, but subsequent growth is also more muted. Taking all this together, average real-terms incomes are now expected to stand at £20,470 at the start of 2023 – up £135 from £20,335 in the November *Outlook*. 
But the chart also makes clear that this outcome remains very much worse than the one set out last March. Back then, average incomes were expected to reach £20,660 by the start of 2022; now they are forecast to fall £370 short of that – so only 29 per cent of the downgrade in this figure reported at the Autumn Budget has been reversed. And average incomes at the start of 2021 are projected to come in some £1,400 lower than had been forecast in March 2016.

As Figure 14 shows, while the drop in incomes after Q3 2015 is now projected to be shallower than had been forecast in November, the duration of the squeeze remains unchanged from the previous Outlook. At 19 quarters (or nearly five years), that means households are projected to be in the midst of a longer sustained reduction in incomes than the one recorded immediately after the financial crisis (17 quarters between Q4 2007 and Q4 2011).
The pay squeeze should end in the coming months, but recovery to pre-crisis wage levels isn’t due until 2025

The OBR’s projections for growth in average pay in 2017-18 and 2018-19 have been revised up from 2.3 per cent and 2.2 per cent in November to 2.5 per cent and 2.7 per cent in yesterday’s Outlook. Such a revision brings it much closer in line with the Bank of England’s position, in terms of both the level of growth and its direction of travel. As Figure 15 shows however, wage growth is expected to fall back in 2019-20. The pace of growth is then projected to start rising again – but more slowly than had been forecast in November. In this regard the OBR appears to remain more pessimistic than the Bank.[4]

In this instance, the pattern of near-term improvement and medium-term deterioration in growth prospects results in a final figure for average wages at the start of 2023 which is almost precisely in line with the one returned at the Autumn Budget. Figure 16 sets this comparison out, and also shows the trajectories implied by the March 2016 and March 2017 forecasts. Pay is now expected to be £885 lower at the start of 2022 than had been forecast last March, and £1,780 lower at the start of 2021 than had been projected back in March 2016.
Beyond the OBR’s projection period, we assume that real-terms pay growth continues to rise at the same pace as in the final two years of the forecast. This approach implies that average wages won’t return to their pre-crisis peak until the start of 2025 – broadly as projected in November. That means UK workers continue to face a 17-year period of lost growth on pay.

While no new tax and benefit policies were announced yesterday, existing policies are set to drag on living standards – especially in the bottom half of the distribution – for a few more years

The persistence of the gloomy picture on pay is matched by a consistently bleak outlook in relation to the ongoing roll out of benefit cuts introduced in Summer Budget 2015. Set out as a package to save £12 billion a year by the end of the decade, these cuts primarily consist of:

- A four-year freeze to most working age benefits, set to save over £4.5 billion a year by 2019-20 and lead to a real-terms reduction in benefit income of 6.5 per cent for almost 11 million families.
- A cut to Universal Credit (UC) work allowances, which help determine the level of support paid to working families – especially important for those with children. Expected to impact over 3 million working families a year by 2022-23, this measure saves over £3 billion a year even taking into account a £0.7 billion giveaway in Autumn Statement 2016 (which reduced the rate at which UC is withdrawn by 2 percentage points).
The removal of the family element for new families claiming tax credits or UC (worth up to £545 a year per family, affecting 400,000 families in 2018-19) and the limiting of support from the child element (worth up to £2,800 a year per child, affecting 150,000 families in 2018-19) to two children for new births, and ultimately new claims. By 2022-23, we expect three-quarters of the eventual number of families with three or more children, at a given point in time, to be affected.

Of all of these cuts, the one set to have the most bite in the coming financial year is the benefit freeze. Once expected to save £3.5 billion a year by 2019-20, it is now set to save over £4.5 billion a year due to higher than anticipated inflation.

As Figure 17 shows, so far the benefit freeze (constituting no real change in April 2016 and a 1 per cent real-terms reduction in April 2017) has amounted to a £40 a year real-terms reduction for an unemployed person, rising to £105 a year for a couple with two children. By 2019 however (due to a real-terms reduction of 3 per cent from April 2018, followed by an expected 2.2 per cent cut in April 2019), the same two families are expected to lose a further £210 a year and £570 a year respectively. That means roughly 85 per cent of the losses associated with the benefit freeze are still to hit for each family.

The effect of the remaining working-age benefit cuts is expected to grow over the next five years as more families move onto UC, with the caseload set to rise from around 730,000 (largely unemployed) cases today to 7 million (including working families with children) by 2022-23. Benefit cuts will also grow as an increasing number of families are affected by measures to limit support for those with either new births or new claims.
Figure 18 sets out the reduction in government spend associated with those working-age benefit cuts directly affecting household incomes in each year from 2011-12 to 2022-23. Of those cuts announced in Summer Budget 2015, the policies modelled in the chart amount to almost £10 billion of savings by 2022-23. To date, only one-fifth of these cuts have been delivered, with nearly £8 billion more set to arrive over the next five years. The biggest single year cuts are due in 2018-19 (£2.5 billion) and 2019-20 (£2.7 billion), meaning the next two years are set to bring the sharpest cuts in support since 2012-13.

Figure 19 shows that the overall effect of government tax and benefit policies put into place since May 2015 (including the welcome introduction of the National Living Wage (NLW)) is expected to be strongly regressive. Compared to policies that would otherwise have been in place in 2022-23, the poorest third of households are expected to be an average of £745 a year worse off. In contrast, the richest third are forecast to record an average gain of £140 a year.
Drilling down to just those low-to-middle income households that are the focus of the Resolution Foundation’s work – those ‘just about managing’ in-work and in the bottom half of the income distribution – the average income loss rises to £1,000 a year in 2016-17 price terms.

Although the government remains committed to further increasing the Personal Tax Allowance to £12,500 and the Higher Rate Threshold to £50,000 by 2020, additional tax cuts will do very little to improve the picture for lower income households. Only a seventh of such an increase would benefit the poorest half of households, with the vast majority of the gains going to the richer half of households and over a third to the richest 10 per cent alone. We do not model the impact of this change because it remains an unfunded commitment at this stage. On the latest OBR projections, inflation alone is set to lift the thresholds to £12,360 and £48,460 by April 2020 leaving an estimated £1.4 billion unfunded commitment if the pledge is to be met in 2020-21.[6]

As shown in previous Resolution Foundation work, the shape of the living standards challenge coming over the next few years is such that the UK looks set to experience the largest rise in income inequality since the 1980s.[7] And crucially, unlike that earlier period, the next wave of inequality is set to be more about a bottom that is left behind rather than a top that is racing ahead.

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[6] OBR, Economic and Fiscal Outlook March 2018

By way of illustration, Table 3 sets out the combined impact of various economic and policy changes in recent years on the future incomes of a selection of example families. It presents income estimates for each family in 2022-23, using the latest OBR Outlook. It then shows how much higher or lower each family’s income would be if the economic and policy assumptions underpinning the November 2017, March 2017 and March 2015 Outlooks were used instead.

Table 3: Impact of economic and policy changes on net household incomes for different family types: 2022-23 (CPI-adjusted to 2016-17 prices)

<table>
<thead>
<tr>
<th>Income forecast for 2022-23 in Mar-18</th>
<th>Change in income forecast since…</th>
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<tbody>
<tr>
<td></td>
<td>Nov-17</td>
</tr>
<tr>
<td>1. Single (no kids), full time, earning wage floor, renting works 37.5 hours per week at NMW/NLW, rents privately at 30th percentile</td>
<td>£12,030</td>
</tr>
<tr>
<td>2. Single (1 child), part time, earning wage floor works 20 hours per week at NMW/NLW</td>
<td>£11,910</td>
</tr>
<tr>
<td>3. Couple (2 kids), low earning/wage floor, renting main earner works 37.5hrs pw at p25, 2nd earner works 20hrs pw at NMW/NLW, rents privately at 30th percentile</td>
<td>£27,970</td>
</tr>
<tr>
<td>4. Couple (3 kids), low earning/wage floor, renting main earner works 37.5hrs pw at p25, 2nd earner works 20hrs pw at NMW/NLW, rents privately at 30th percentile</td>
<td>£27,900</td>
</tr>
<tr>
<td>5. Couple (2 kids), low/mid earning both work 37.5 hours per week, main earner at median wage, second earner at p25 wage</td>
<td>£35,230</td>
</tr>
<tr>
<td>6. Couple (no kids), high earning both work 37.5 hours per week at p90 wage</td>
<td>£75,990</td>
</tr>
</tbody>
</table>

Notes: Figures relate to modelled hypothetical outcomes in 2022-23 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 2022. 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.

In most instances, the income projections are all but unchanged from those prevailing at the time of the Autumn Budget. The largest reduction in household income is £90, for the high earning couple – Family 6. This equates to a 5p an hour decrease in the nominal wage rate for the earners in this family in 2022-23, a very small difference indeed.

As already discussed, the forecast revisions taking place between March 2017 and November 2017 had a much larger impact. The November Outlook implied both lower nominal earnings growth and higher inflation, producing a large deterioration in the living standards prospects across all family types featured here. For example, the OBR revised down its forecast for the National Living Wage (NLW) at the end of the decade by around 30 pence, which feeds through into fall in real income for Family 1 – a single person with no children working full-time on the NLW – of over £300.

The biggest changes in projected incomes come in relation to the economic and policy backdrops prevailing in March 2015 however. The result is bad news for almost all of our example families, with policy changes providing the majority of the reduction in forecast incomes for most family
types. Looking in detail at two of these examples:

» Family 2 – a single parent working part-time on the NLW with one child – is expected to be significantly worse off in 2022-23 than forecast in early 2015. Their real net earnings are higher than forecast (by £600), as a result of the NLW. But their benefit income is projected to be £3,430 lower – overall this family is projected to be £2,830 worse off. This family illustrates that, although a welcome policy move, the NLW does a poor job of targeting financial support at those families most in need of it. Reductions in the generosity of Universal Credit and the four-year benefits freeze (which is now having a larger impact than originally forecast as a result of higher inflation forecasts) are projected to have a larger negative impact on this family’s living standards than the boost from the NLW will provide.

» Family 4 – a dual-earning couple with three children – is expected to be £4,070 worse off in 2022-23 than had been expected three years ago. Higher inflation and lower earnings growth have cut the projection for this family’s real net earnings by £400. In addition, this family loses £3,770 as a result of policies announced since Summer Budget 2015. Again, this figure reflects the balance of the NLW, tax cuts and welfare cuts, with the policy of limiting welfare support to a maximum of two children having a particularly large effect here.

With longer-term fiscal pressures becoming more apparent, the Chancellor’s decision to launch a range of consultations on tax is a good move – though he has missed some big issues

There may have been no tax and spend decisions in the Spring Statement but the Chancellor did use the occasion to launch a raft of consultations covering largely technical taxation topics. Seemingly dry in nature nonetheless these represent an important longer term shift in much-needed reform of the tax base given the pace of technological change, wider threats to that base and longer term fiscal pressures driven by an ageing population. We highlight just a few of them here.

The first area of import relates to just who bears the burden of responsibility when it comes to determining whether a worker is deemed to be treated as an employee or self-employed for tax purposes when they work through their own company, via a consultation on ‘off-payroll working’. Moves in the public sector to place that liability on employers have led to a fall in workers operating on such a basis and being classified as self-employed. The consultation planned for later in the year will seek to understand the prospects for applying a similar change in the private sector.

As Figure 20 shows, this is made more important by the growth in such work – here captured as ‘owner-managers’ – across different areas of the private sector since 2009. For example the share of owner-managers in computer programming and consultancy has increased by almost half, from 4 per cent to 6 per cent of the sector workforce, over the last eight years.
The second area relates to the UK’s shifting tax base. The government has published a number of documents seeking to ensure that the tax system is able to adapt to what has been a rapidly growing digital economy. With growing concerns about a shrinking profits-based tax base, that makes a great deal of sense – although it is far from straightforward to do. Recent research by the Financial Times[^10] suggests that effective UK tax rates for the largest multinationals have fallen two percentage points (9 per cent) in the decade since the financial crisis. It is also worth noting that in 2016 Google and Facebook’s UK turnover amounted to almost £2 billion, but taxes paid came in at just over £40 million.[^11]

While welcome, these and other consultations or commitments to consult do not go far enough. For example, more work will be needed on how to further strengthen the tax base in the face of declining revenues flowing from fuel duty and on our inadequate approach to wealth taxation.

By gradually reducing a key source of government revenue, the planned transition to electric cars by 2040 poses a significant future fiscal headache. Fuel duties are expected to bring in £28 billion of revenue in 2017-18, while fuel sales also incur VAT at 20 per cent of the wholesale price plus the duty. For every pound spent on fuel at the pumps, about 65p goes to the exchequer. In contrast, for every pound spent on charging electric cars, the government receives only 5p in VAT payments while the tax rate on LPG and natural gas vehicles falls between the rates on petrol/diesel and electricity.

[^10]: [https://www.ft.com/content/2b356956-17fc-11e8-9376-4a6390addb44](https://www.ft.com/content/2b356956-17fc-11e8-9376-4a6390addb44)

[^11]: B Kentish, “Google paid £36 million in tax on UK revenues of £1 billion, reports show”, The Independent, 31 March 2017; and “Facebook’s UK tax bill rises to £5.1m”, BBC News, 4 October 2017
The OBR forecasts that, over the long run fuel duty receipts will fall from 1.4 per cent of GDP in 2017-18 to below 1 per cent of GDP by the middle of the next decade.\(^{[12]}\) Taking time now to plan how to deal with this likely revenue change should be a priority.

As the Resolution Foundation’s body of work for the Intergenerational Commission compiled over the last 18 months suggests – and more recently spelt out by the Commission’s Chair, David Willetts – the UK should look to reform wealth-related taxes to help tackle longer-term fiscal pressures.\(^{[13]}\) While the UK’s wealth has more than doubled from around 300 per cent of GDP in the late-1960s to approaching 700 per cent today, revenues raised from wealth have remained at around 2.5 per cent of GDP a year.

**Conclusion**

With next year expected to mark the point at which both the current deficit is finally eliminated and the debt-to-GDP ratio starts to fall, the Chancellor’s ‘tiggerish’ stance yesterday is understandable. But the light at the end of the austerity tunnel remains all too faint for the moment.

For households, the next few years are set to continue the post-crisis trend of disappointing living standards improvement. Ten years on from the start of the pay squeeze, recovery remains seven years away. And the vast majority of the large working-age welfare cuts announced back in July 2015 are still to bite, with low and middle income households likely to fare especially badly over the next two years. Despite some near-term improvement in yesterday’s forecasts, the UK remains in the midst of a squeeze on incomes that is set to last longer than the one experienced immediately after the financial crisis.

For the Chancellor too there are tough choices ahead. Philip Hammond has said that, come the next Autumn Budget, he wants to share the gains of lower borrowing forecasts between paying down the deficit, boosting public services and lowering taxes. Yet even with yesterday’s modest improvement in place, he isn’t expected to balance the overall budget – in keeping with his overall fiscal ‘objective’ – until the end of the next parliament. The implication is that something has to give. Either the UK economy will have to ‘beat the forecasts’, or he will need to introduce tax rises rather than tax cuts. Given longer-term fiscal challenges ahead, this latter course of action appears almost inevitable.

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\(^{[12]}\) OBR, *Fiscal Risks Report, July 2017*

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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