

Institute for
Fiscal Studies



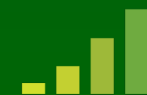
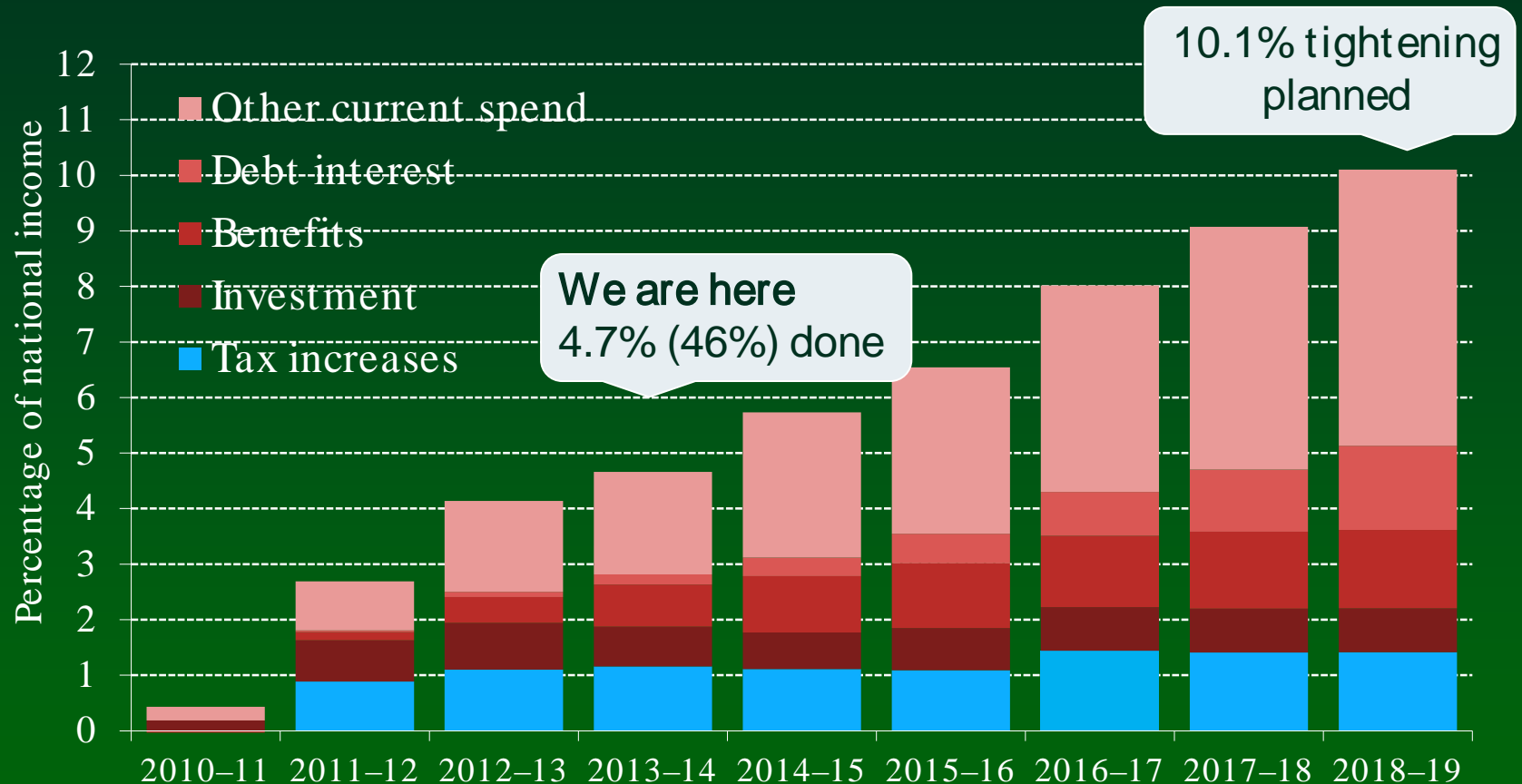
The IFS Green Budget 2014

Paul Johnson

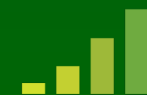
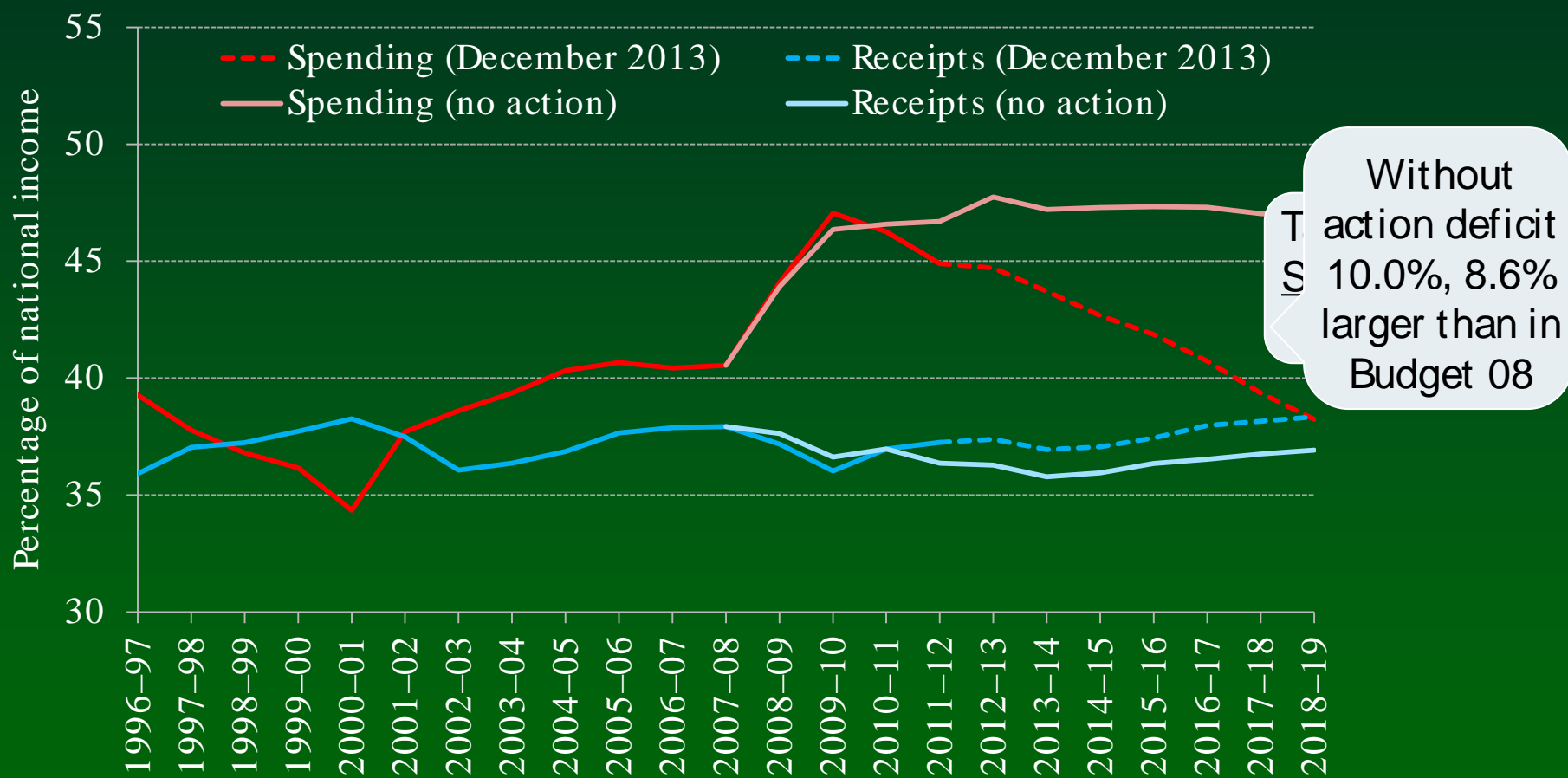
For David Hume Institute March 4 2014



Still a long way to go fiscally



Bringing tax and spend back to pre-crisis levels



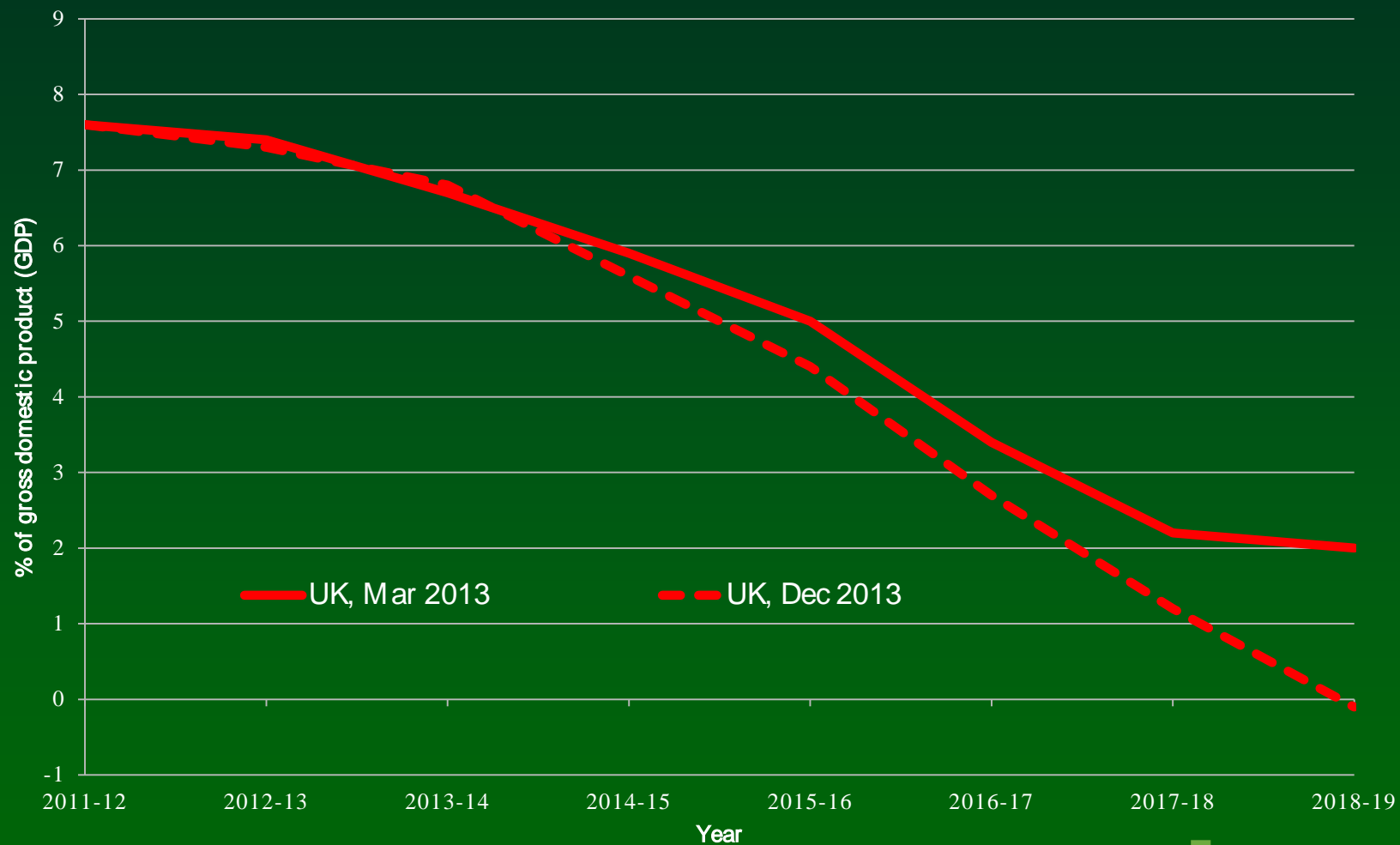
What does this mean for Scotland?

- Until recently Scottish fiscal balance somewhat stronger than in UK as a whole
 - North sea oil revenues more than offset higher spending
- But we expect gap between spending and taxes to have been slightly bigger in Scotland than in UK in 2012-13
 - As a result of reduced oil revenues

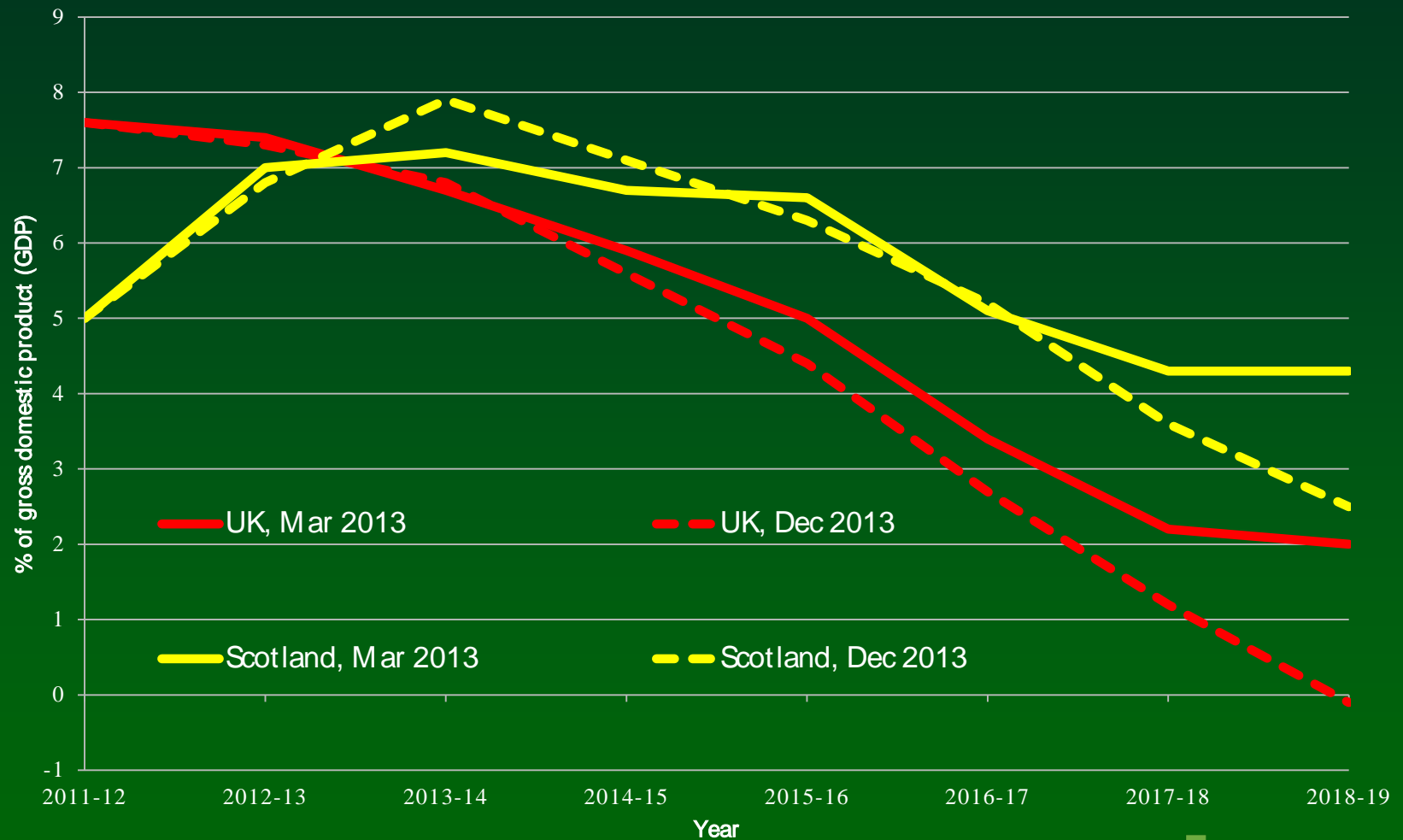
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 - As a result of reduced oil revenues
- And while OBR forecasts were generally more positive in December they were gloomier about path of oil revenues

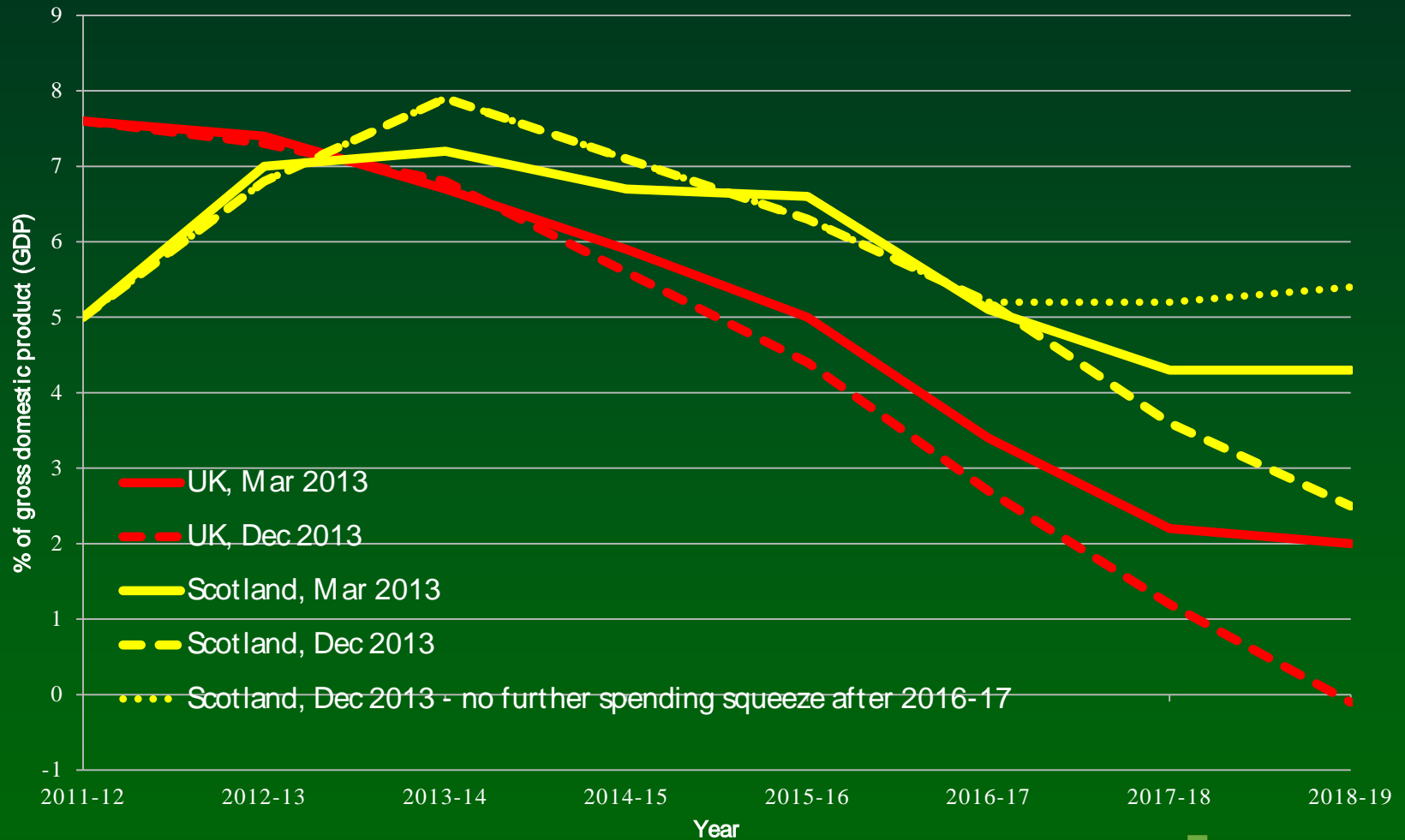
PSNB UK and Scotland



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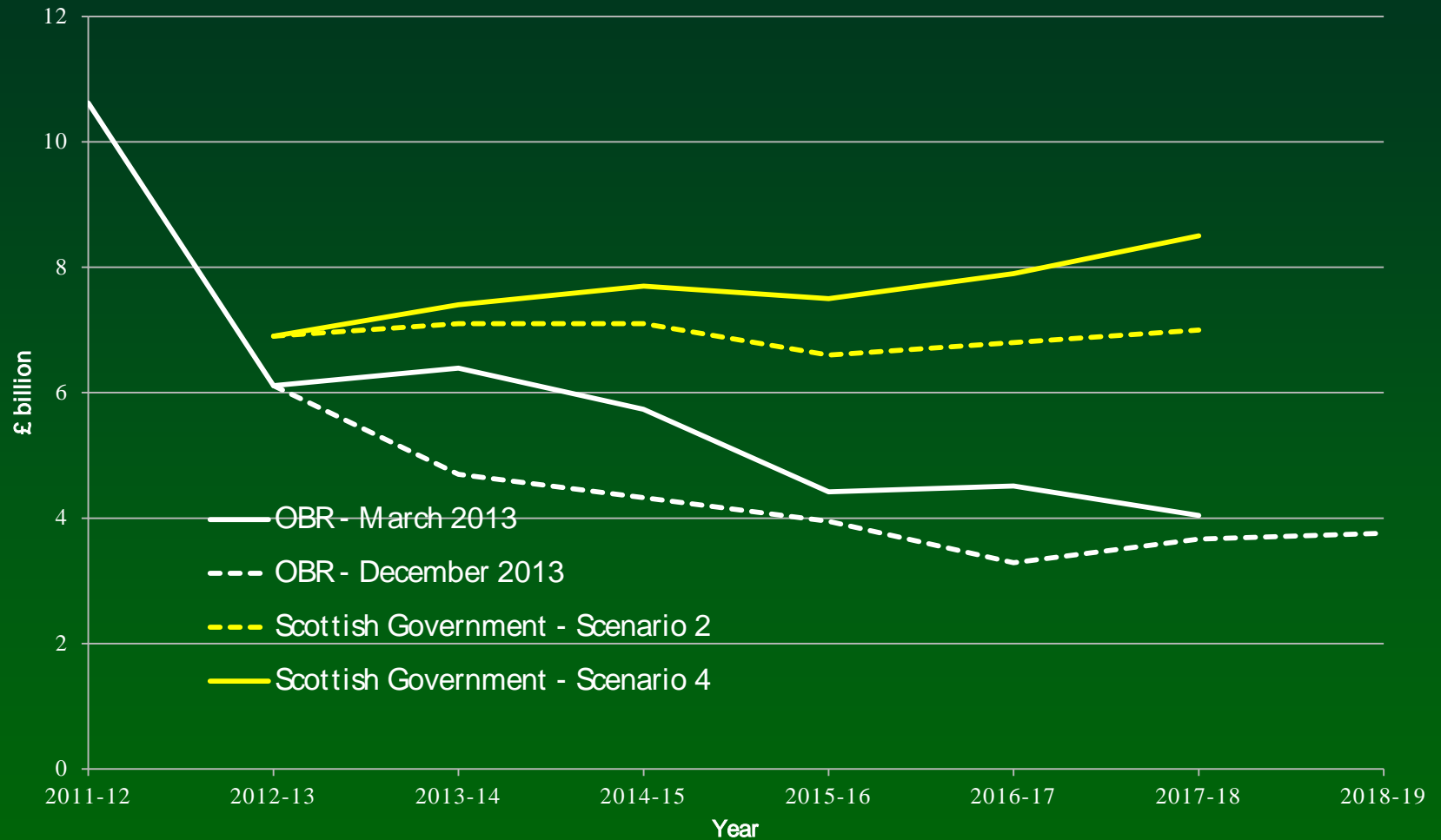
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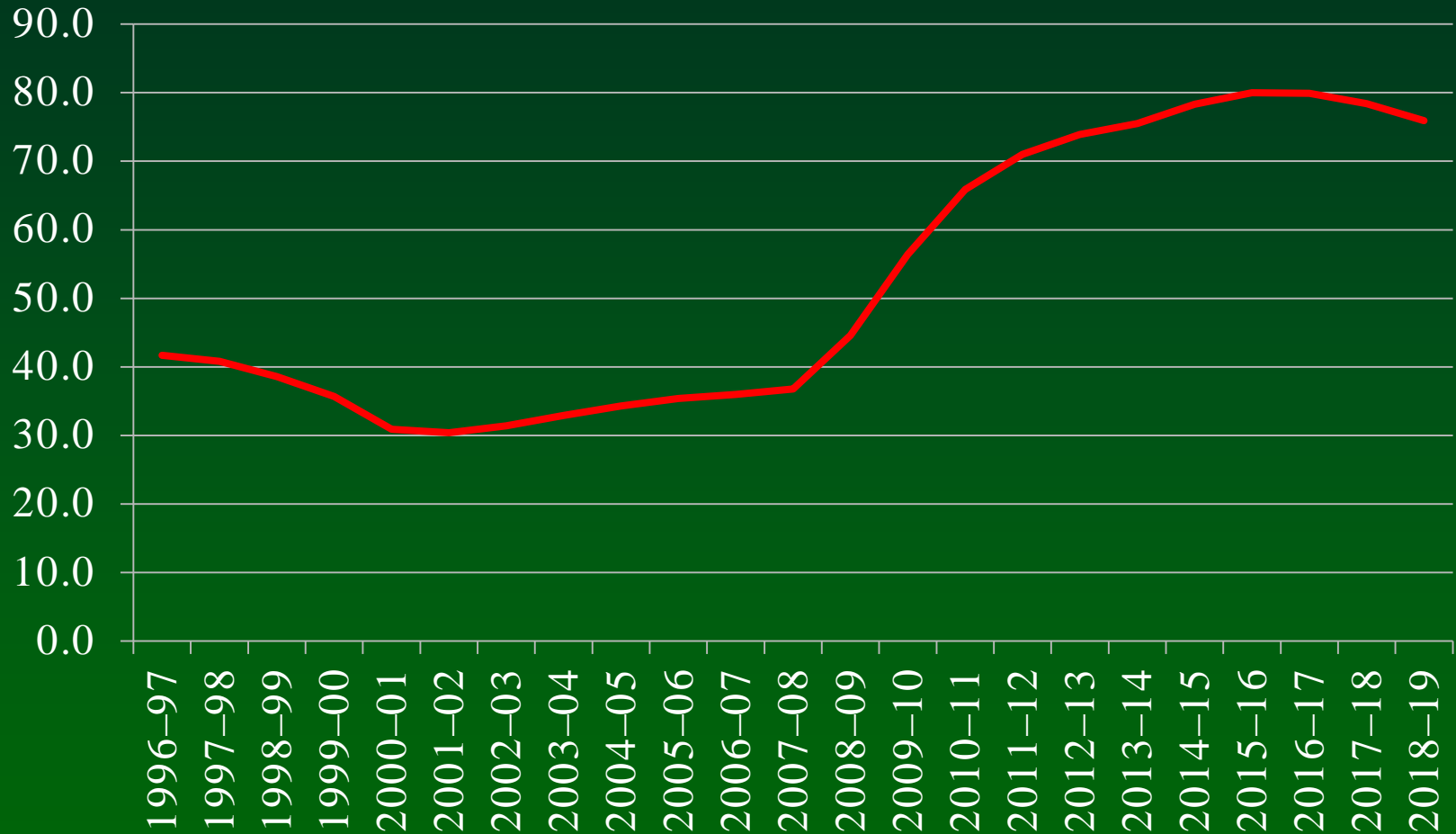
Oil revenue forecasts



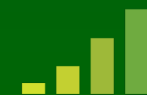
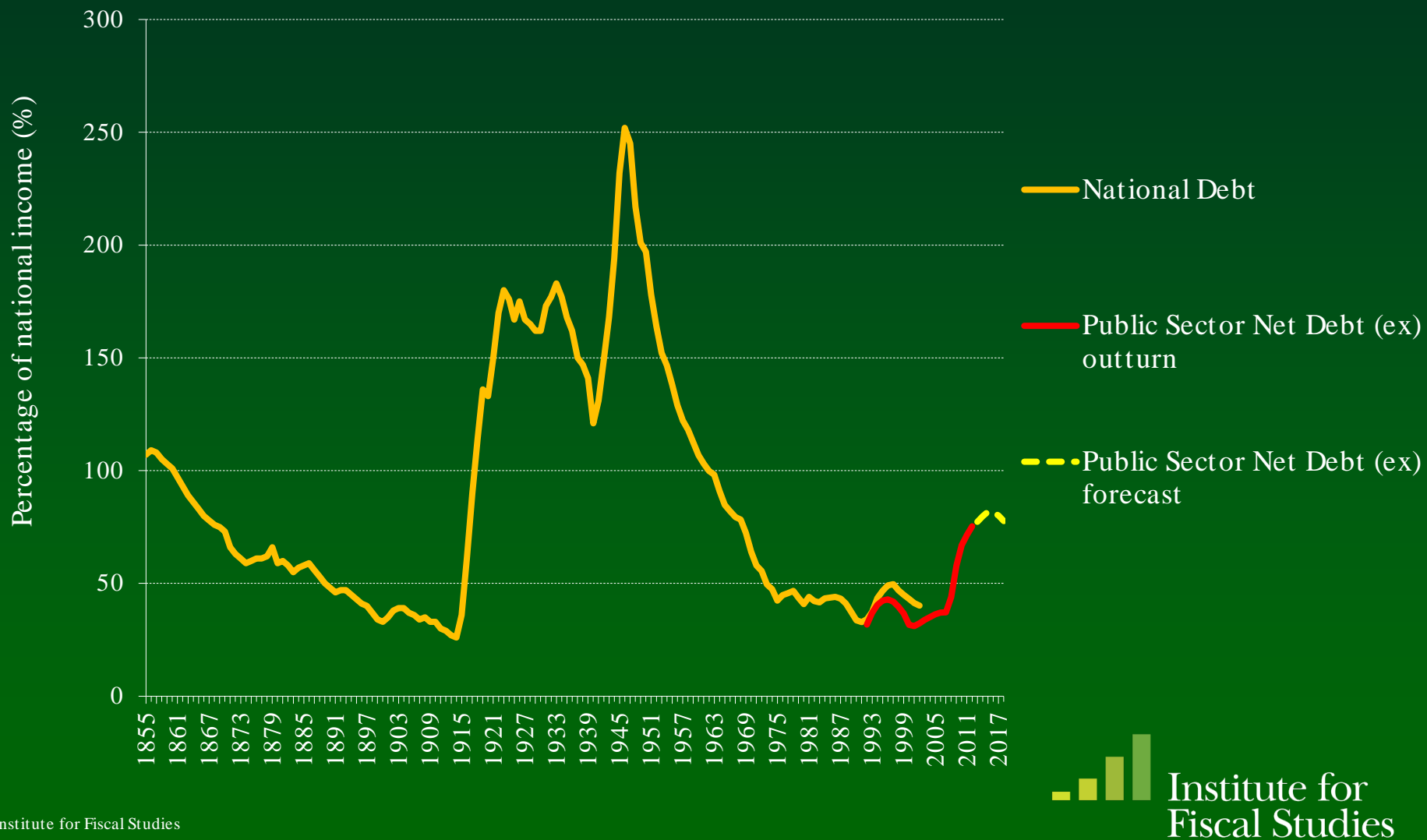
Oil revenue forecasts



Debt as a share of national income 1996-2018



Debt in longer run perspective



How might the public finances differ under Labour?

- “The next Labour government will balance the books and deliver a surplus on the current budget and falling national debt in the next Parliament”
 - “How fast we can go will depend on the state of the economy and public finances we inherit”
- Coalition planning £26 billion current budget surplus in 2018–19
- Labour could cut taxes and/or increase day-to-day spending by up to £26 billion and meet their pledge in 2018–19
 - Could also spend more on investment
- Current budget surplus less constraining than budget surplus
 - Trade off between benefits of higher spending/lower tax and cost of debt falling less rapidly

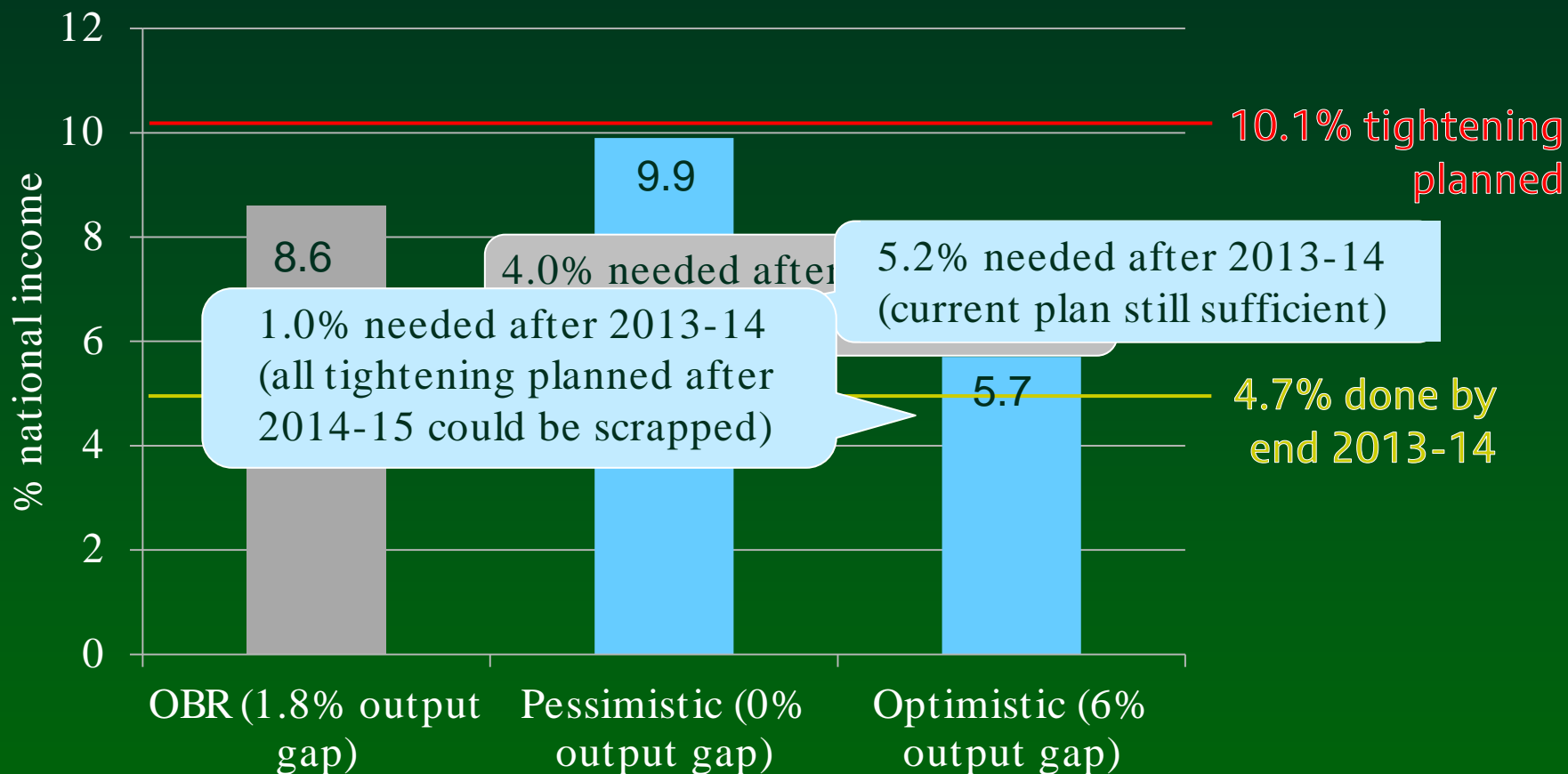
Plenty of risks still remain

- How big a consolidation is actually required?
- How will tax revenues recover?
- Are spending cuts deliverable?

How large a fiscal consolidation is required?

- Independent forecasters disagree on the size of the ‘output gap’
 - ‘Output gap’ = difference between level of national income and potential/trend level of national income; amount of spare capacity
- It determines the division of borrowing into:
 - Cyclical: Will disappear as the economy recovers
 - Structural: Will not just disappear as the economy recovers

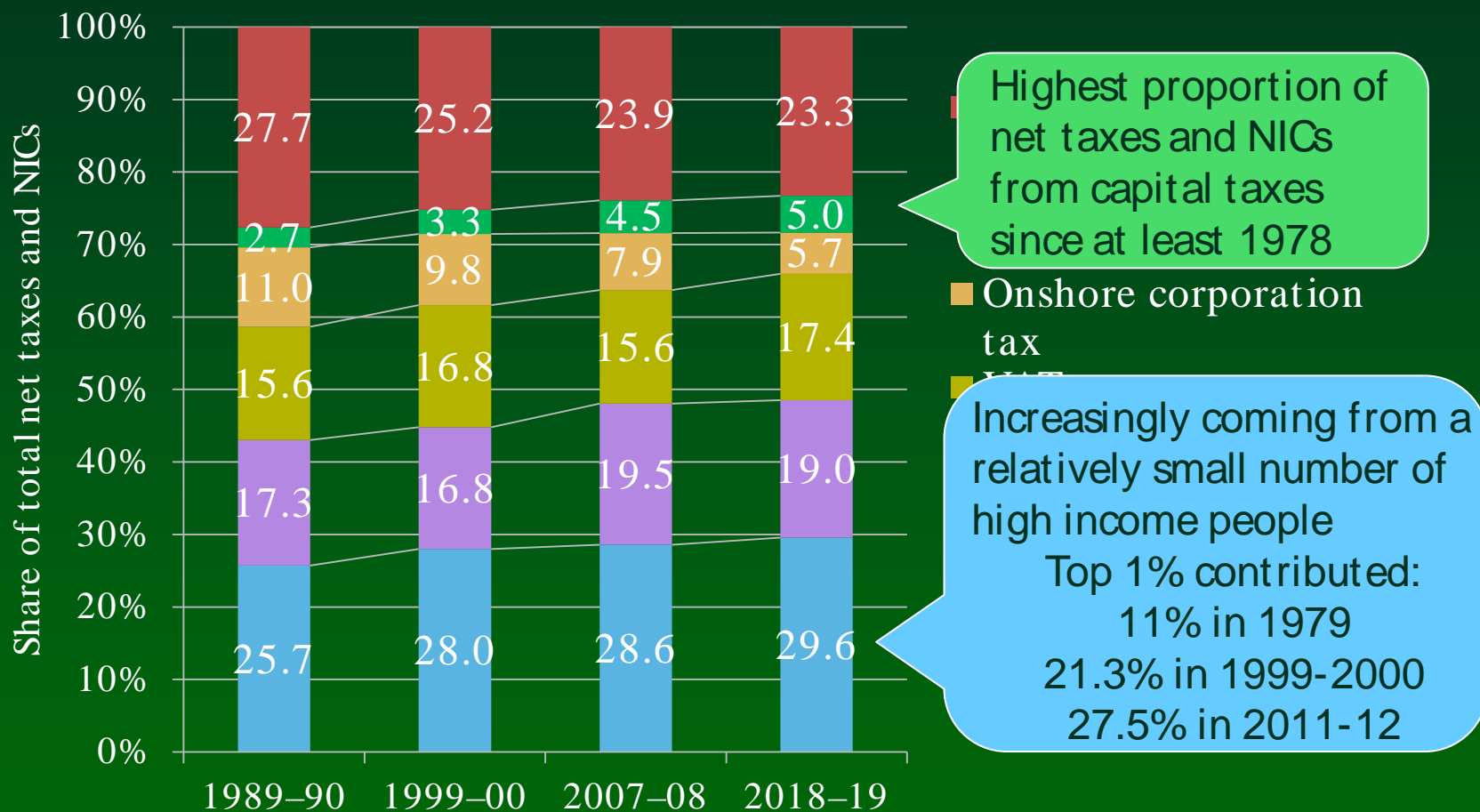
How large a fiscal consolidation is required?



Figures illustrate tightening required for structural borrowing in 2018–19 to be forecast to be the same as was forecast for the medium term in Budget 2008 (1.2% of national income) – i.e. to offset all of the permanent increase in structural borrowing arising from the financial crisis.

Risks to future tax revenues

Changing composition of revenues?



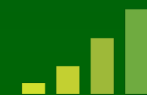
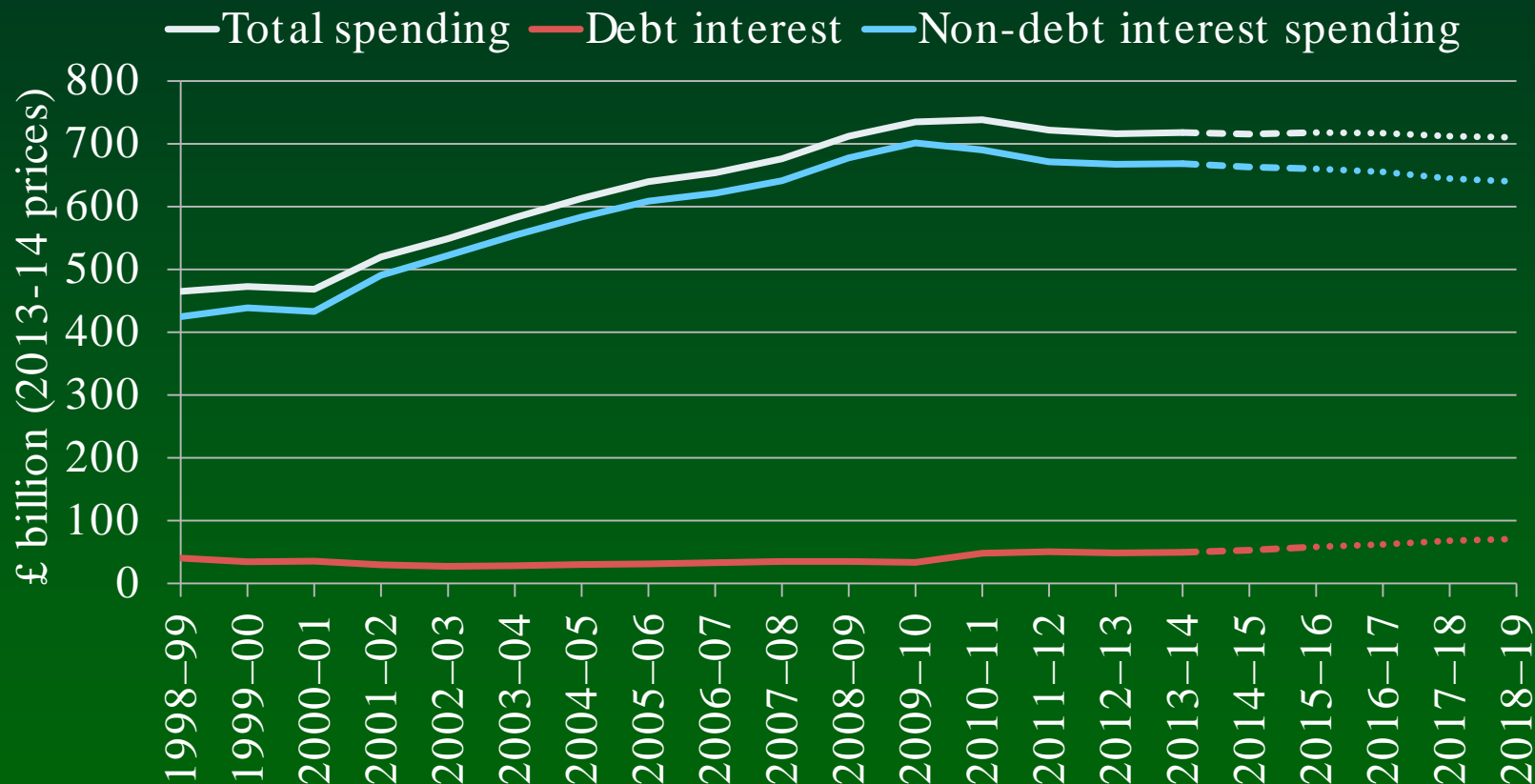
Planned cuts to spending

2010–11 to 2018–19:

Total spending: -3.8% ($-\pounds 28.3\text{bn}$)

Debt interest: $+46.9\%$ ($+\pounds 22.5\text{bn}$)

Non-debt interest: -7.4% ($-\pounds 50.8\text{bn}$)



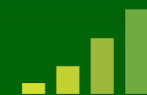
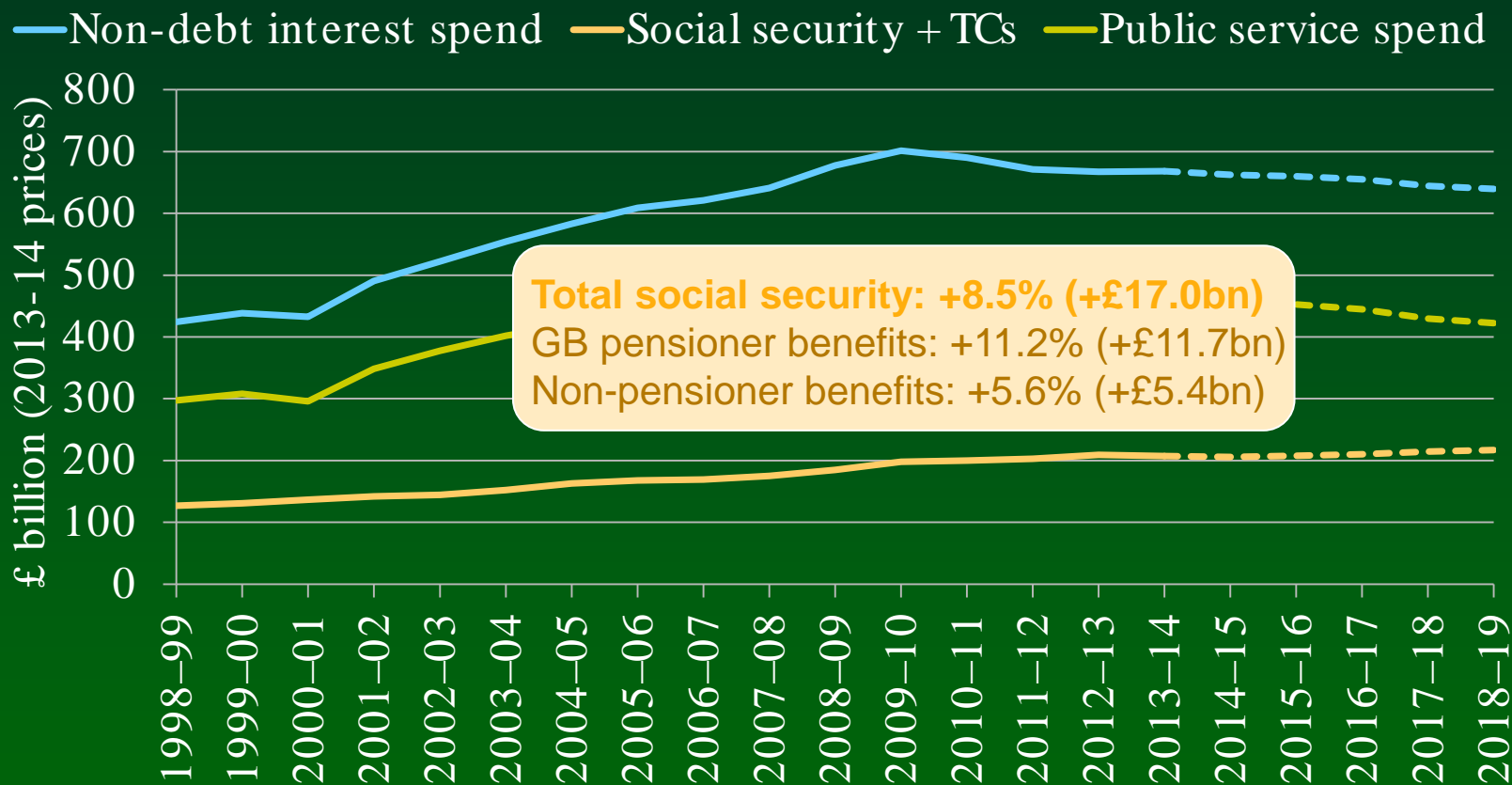
Planned cuts to spending

2010–11 to 2018–19:

Non-debt interest: -7.4% ($-\pounds 50.8\text{bn}$)

Social security: $+8.5\%$ ($+\pounds 17.0\text{bn}$)

Public services: -13.8% ($-\pounds 67.8\text{bn}$)



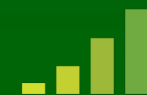
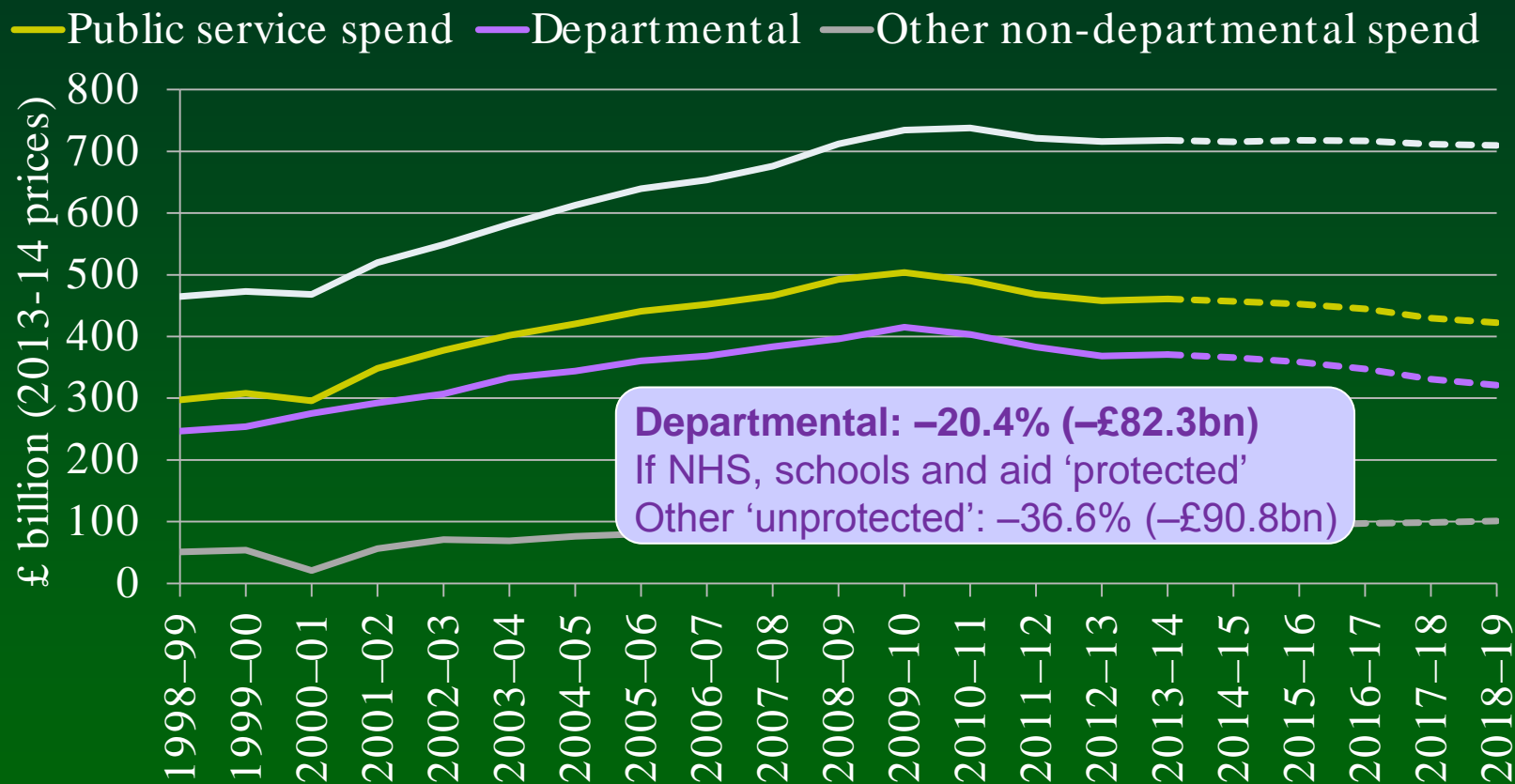
Planned cuts to spending

2010–11 to 2018–19:

Public services: -13.8% ($-\pounds 67.8\text{bn}$)

Departmental: -20.4% ($-\pounds 82.3\text{bn}$)

Other non-dept.: $+16.8\%$ ($+\pounds 14.6\text{bn}$)



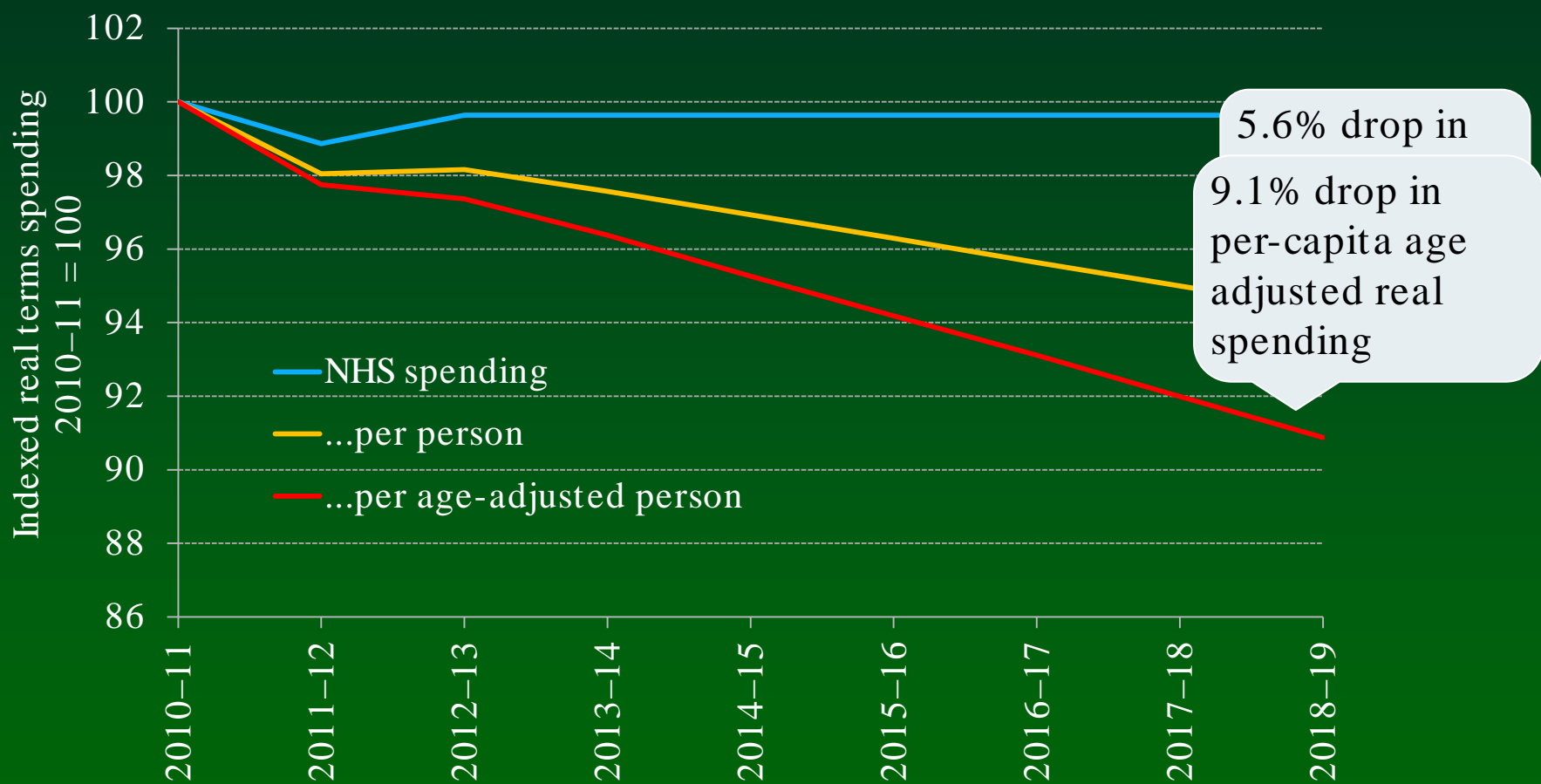
Departmental spending cuts not set in stone

- Departmental spending beyond 2015–16 not explicitly planned
- Government has mooted £12 billion cut to social security
 - £12 billion equivalent to 6% of all social security spending, 11% of non-pension spending, or 13% of spending on non-pensioners
- This would bring rate of departmental spending cuts between 2015–16 and 2018–19 down to same rate as over this parliament
- And may be even harder to deliver than raw figures suggest
 - Additional spending commitments
 - Demographic change

Demographic pressures

- ONS projects population will grow by 5.6% (3.5 million) between 2010 and 2018
- Public service spending forecast to fall by average 1.7% per year 2010–11 to 2018–19 but spending per person to fall by 2.4%
- Population also ageing population aged 65 and over will grow by 20.0% (2.0 million) between 2010 and 2018
- Real freeze in NHS spending between 2010–11 and 2018–19
 - Imply cuts in per capita spending

Demographic pressure on the NHS budget



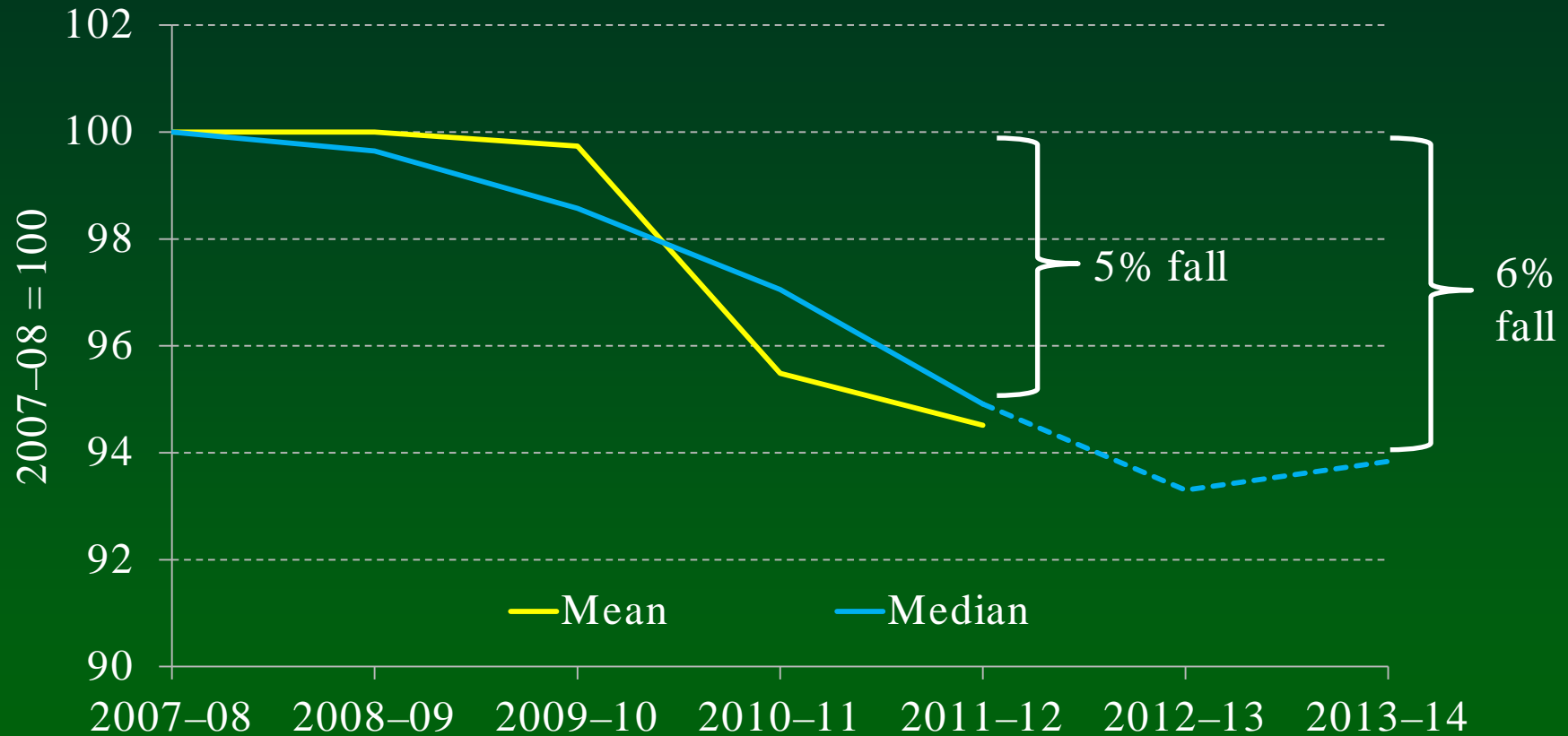
Other issues in the Green Budget

- Household incomes
- Policies to help low paid
- Childcare
- Business rates
- Pension tax

What is happening to household incomes?

- Earnings may be starting to outstrip prices
 - But different data gives different impressions
- Real earnings are still around 8% lower than October 2007
 - While employment is remarkably high
- Median real incomes about 6% below pre-recession peak
 - Probably turning up now

Average real net household incomes since 2007–08

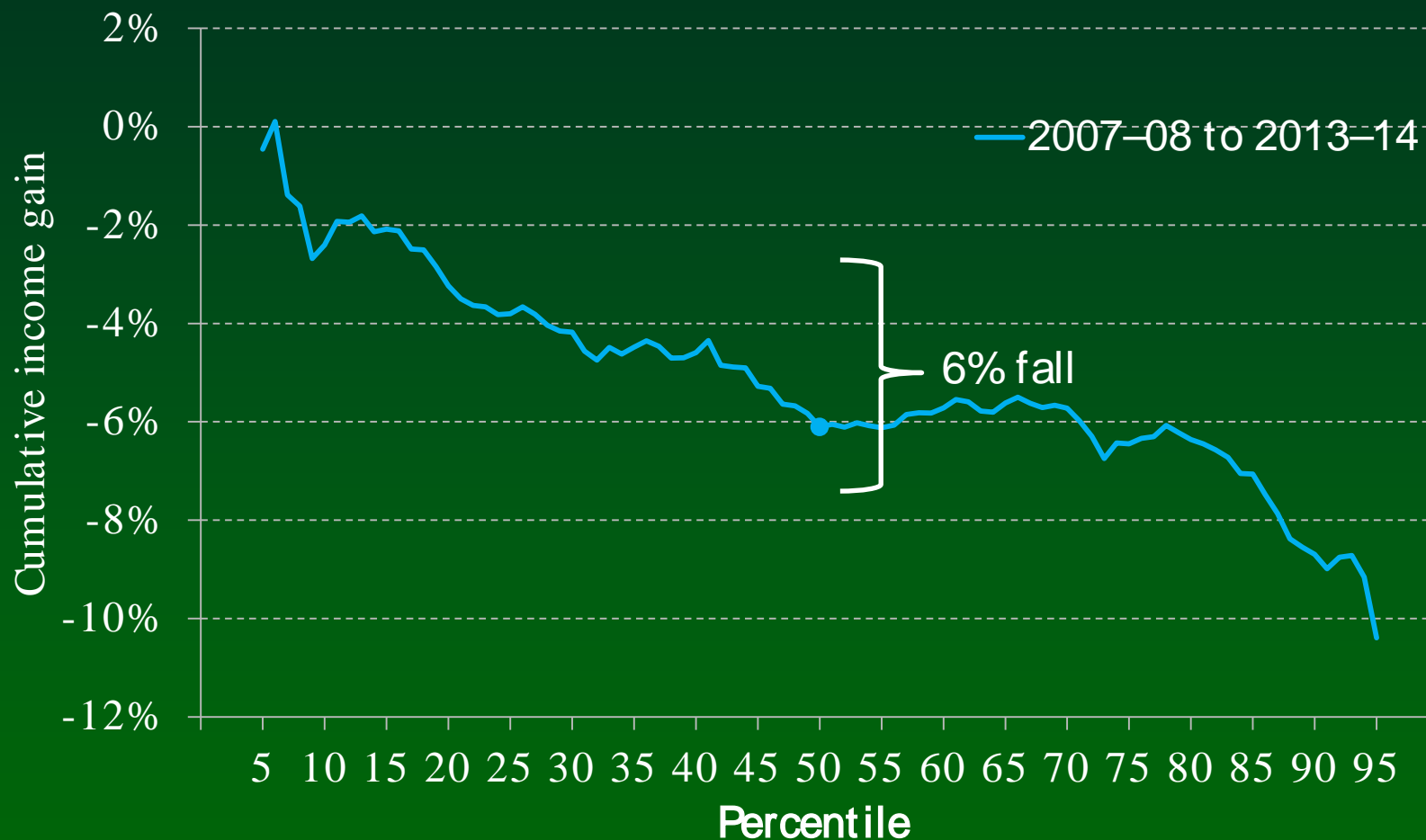


Note: Incomes deflated using the CPI
Source: Table 6.1 in Green Budget document

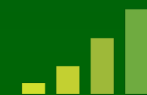
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Real income change by percentile since 2007–08



Notes and sources: see Figure 6.1 in Green Budget document



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 - Probably turning up now
- So far losses are bigger at the top than the bottom
- But differential inflation almost wipes out this differential
 - Better off have benefited from lower mortgages
 - Less well off hit by very fast rises in energy and food prices

Policy responses?

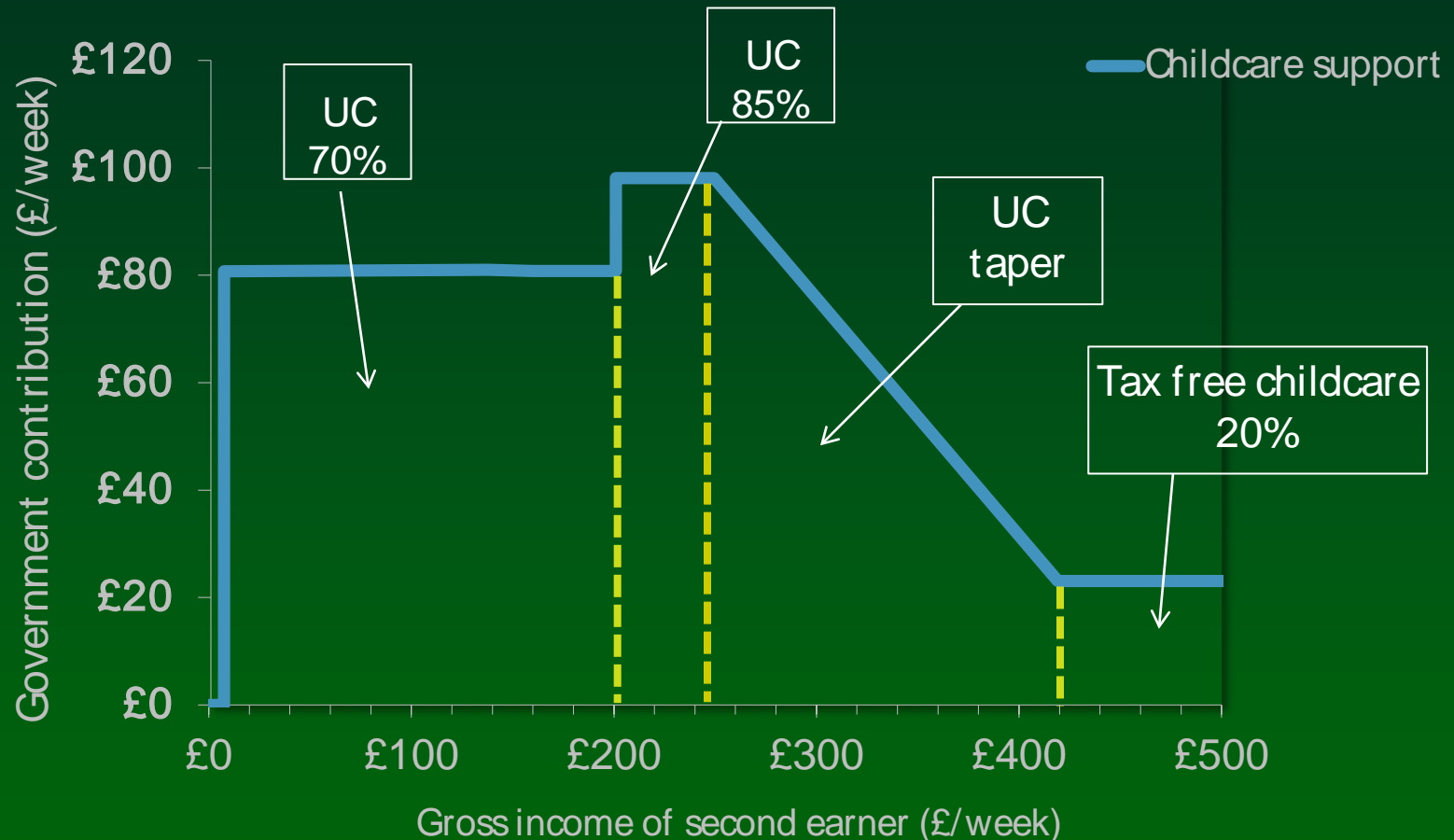
- One response is to help low paid through tax and benefit system
 - NICs cuts are better than further increases in the personal allowance
 - In-work benefits more targeted, but have their drawbacks
- Policies to increase pay directly, whether compulsory or voluntary, likely to face trade off between earnings and employment
 - Big increases always come with risks
- Increasing productivity must play role in long run policy

Childcare

- Cross party consensus that more should be spent even after two decades of rapid increases
 - Remarkable given the fiscal climate
- Lack of clarity about purpose
 - Universal childcare is not an effective route to social mobility
 - Evidence on labour supply effects is limited
- Current policy is complex and poorly designed
 - Some free provision
 - Some tax breaks
 - Some support through benefit system

The new system will create 3 regimes of subsidy...

Government contribution to childcare costs in a couple family with two pre-school children



Note: Authors' calculations using TAXBEN. The figure shows the situation facing the second earner in a couple family with two pre-school children that spends £115/wk on ECEC in April 2016. The first earner is assumed to earn £15,600 a year.

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 - “Temporary” reliefs for retail properties
 - Increasing by less than RPI this year
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 - Increasing by less than RPI this year
 - Delay in revaluations: with curious set of winners and losers
- There is scope for reform, but not in this piecemeal, complex and ill directed way

In conclusion

- Four years through a nine year fiscal consolidation
 - 4.7% out of the planned 10.1% tightening done by end 2013–14
- Uncertainties remain over
 - Size of the output gap
 - Tax revenues
 - Deliverability of spending cuts
- Household incomes remain well below pre-recession levels
- More rationality in tax and spending debates would, as ever, be welcome