HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

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Spring Budget 2017: Background briefing

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Inside:

Contents

Contributing Authors:
Paul Bolton, school spending
Daniel Harari, economic situation
Rachael Harker, NHS spending and social care
Richard Keen, welfare
Feargal McGuinness, labour market
Federico Mor, industrial strategy
Mark Sandford, business rates
Antony Seely, introducing an Autumn Budget
Dominic Webb, current account

Summary

This briefing sets out the background to the Spring Budget 2017 which will take place on Wednesday 8 March 2017. The Office for Budget Responsibility (OBR) will publish revised forecasts for the economy and public finances on the same day.

Economic situation

Growth in the UK economy during the second half of 2016 continued unaffected by the EU referendum result. In 2016 as a whole, GDP growth was 1.8%.

Consumers' appetite to spend – the bedrock of recent economic growth – will be tested by the increase in inflation currently underway, which is anticipated to continue. This is mostly the result of the fall in the pound since the EU referendum, causing import prices to rise. Consumer prices were up 1.8% in the year to January, mostly due to higher petrol prices and the period of falling food prices coming to an end.

Rising inflation is forecast to reach around 3% later this year, which will eat into consumers' purchasing power. This is the main reason GDP growth is forecast to slow to 1.4% in both 2017 and 2018 (based on the latest average forecast of economists).

Without unexpectedly higher income growth, an acceleration in household borrowing and/or reductions in savings rates, overall economic growth will need to come from elsewhere to prevent a sharper slowdown. It is unlikely to come from investment, which is forecast to remain weak, and government spending is not likely to provide any meaningful boost to GDP. Instead, the hope – and expectation – is that the fall in the pound will boost the performance of UK exporters, thereby contributing to growth in 2017 and 2018.

Public finances

In 2015/16 the government had to borrow £72 billion to make up the difference between its spending and its income from taxes and other revenues. Since its 2009/10 peak the UK's borrowing, often referred to as the deficit, has halved. Despite the improvement, borrowing remains above the levels seen before the 2007-2008 financial crisis. The Office for Budget Responsibility – the UK's fiscal watchdog – forecast in November that borrowing will fall to £22 billion by the end of this Parliament.

At over 80% of GDP, public sector net debt – largely the stock of borrowing arising from past deficits – remains relatively high by recent and international standards. The OBR forecast that the debt-to-GDP ratio will begin falling between 2017/18 and 2018/19.

The Government's objective and targets for the public finances

The Government would like to reach a budget surplus at some point in the next Parliament. This is its overall objective for the public finances. A surplus is reached when the government spends less than it receives in taxes and other revenues.

The Government has targets for government borrowing and debt aimed at achieving its overall objective. The OBR will assess performance against the borrowing and debt targets, which were revised in Autumn Statement 2016, alongside Spring Budget 2017.

Moving to an Autumn Budget

From autumn 2017, the Chancellor is moving the Budget from March to the autumn. This is intended to put an end to tax announcements being made twice a year in the Budget

and Pre-Budget Report or Autumn Statement. In 2017 there will be both a Spring Budget and an Autumn Budget.

Business rates revaluation

The next revaluation of the business rates paid on commercial properties will come into effect on 1 April 2017. The revaluation will see some businesses pay more rates and some pay less. However, many businesses and sectors have stated that the increases they face will have a damaging effect on their finances. The Government is expected to announce further support to those businesses facing the steepest increases in the Spring Budget.

The tax-free personal allowance and higher rate threshold

The Government is committed to raising the income tax-free allowance to £12,500 by the end of this Parliament. It is also committed to raising the point at which people start paying the higher rate of tax to £50,000. The Chancellor may, in the Spring Budget, choose to announce increases over the coming years to take the allowance and threshold closer to the pledged levels.

NHS and adult social care spending pressures

Both the NHS and adult social care face significant financial challenges. Costs are rising, the population is growing and ageing, and needs are becoming more complex.

Although health spending has been protected relative to other public services, there are concerns that increasing demand and costs threaten the financial stability and sustainability of the NHS.

Adult social care hasn't received similar spending protection, and local government – who fund social care – have seen their funding reduced. The Government has taken some action to address the funding pressures. Some stakeholders have questioned whether the action taken is sufficient.

School spending pressures

Concerns about the spending pressures faced by schools have been intensified by the planned introduction of a National Funding Formula in England. As with any change of this type there are expected to be winners and losers. Even after taking Government steps to limit the impact into account, some schools will face reductions in cash funding per pupil towards the end of this Parliament.

Welfare changes

A significant number of previously announced changes to welfare will come into effect in April 2017. Most were announced at Summer Budget 2015. Changes include:

- limiting support for children in Child Tax Credits and Universal Credit for new claims and births;
- removing the Work Related Activity Component of Employment Support Allowance for new claims;
- reducing the Universal Credit taper rate – the rate at which UC is reduced as a recipients earnings increase – from 65% to 63%;
- withdrawing entitlement to Housing Benefit from some 18-21 year olds
- replacing existing bereavement payments with Bereavement Support Payment for new claims

Amendments to Personal Independence Payment (PIP) eligibility are also due to take effect on 16 March 2017. The changes clarify the regulations and reverse the effect of two recent Upper Tribunal judgments, which interpreted the regulations in ways which the Government believes are contrary to the original policy intent.

The Government has committed to make "no new cuts" to social security and tax cuts during this Parliament.

Further information

The Library will publish a summary of Spring Budget on the evening of 8 March.

The Library briefing, *The Budget and the annual Finance Bill*, discusses the way that Parliament debates the Budget and scrutinises the Finance Bill.

The Library will publish Economic Indicators and Regional and National Economic Indicators on 6 March.

Look out for Spring Budget related blogs on the Library's blog, Second Reading.

International Women's Day

International Women's Day will be celebrated on 8 March 2017, the same day as the Spring Budget.

This year the global theme is *Be Bold for Change*, encouraging urgent action to accelerate gender parity. The UN's theme is "Women in the Changing World of Work: Planet 50:50 by 2030", focusing on the economic empowerment of women.

On 2 March an International Women's Day debate was held in the House of Commons. The Library has published the following briefings that may be of interest in the context of the Spring Budget:

- *Women around the world: International Women's Day 2017*, 27 February 2017
- *Women in public life, the professions and the boardroom,* 24 February 2017
- *Women and the economy,* 1 March 2017

1. Economic situation

Summary

Growth in the UK economy during the second half of 2016 continued unaffected by the EU referendum result. GDP increased by 0.6% in Q3 2016 compared with the previous quarter and by 0.7% in Q4 2016, supported by robust consumer spending. In 2016 as a whole, GDP growth was 1.8%.

Consumers' appetite to spend, the bedrock of recent economic growth, will be tested by the increase in inflation currently underway and which is anticipated to continue. This is mostly the result of the fall in the pound since the EU referendum (down 12% as of 1 March), causing import prices to rise. Consumer prices were up 1.8% in the year to January, mostly due to higher petrol prices and the period of falling food prices coming to an end. Consumer price inflation is forecast to reach approximately 3% later this year and early next year.

Rising inflation will eat into consumers' purchasing power. This is the main reason GDP growth is forecast to slow to 1.4% in both 2017 and 2018 (based on the average of economists' latest forecasts).

Without unexpectedly higher income growth, an acceleration in household borrowing and/or reductions in savings rates, overall economic growth will need to come from elsewhere to prevent a sharper slowdown. It is unlikely to come from investment, which is forecast to remain weak, and government spending is not likely to provide any meaningful boost to GDP. Instead, the hope – and expectation – is that the fall in the pound will boost the performance of UK exporters, thereby contributing to growth in 2017 and 2018.

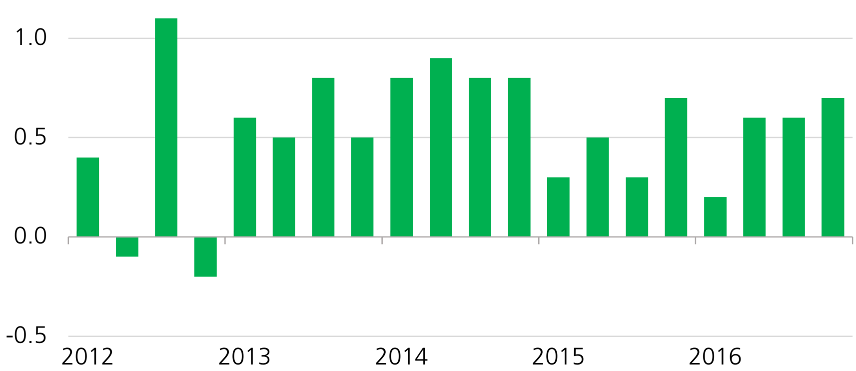
1.1 Recent growth

Growth in the UK economy during the second half of 2016 continued uninhibited by the EU referendum result. GDP increased by 0.6% during Q3 2016 compared with the previous quarter and by 0.7% in Q4 2016 – in line with average growth rates in the years preceding the referendum.[1]

GDP growth has not slowed since the EU referendum.

Quarterly real GDP growth

% change in real GDP on previous quarter



Source: ONS, series IHYQ

1 ONS, *Second estimate of GDP: Quarter 4 (Oct to Dec) 2016*, 22 February 2017

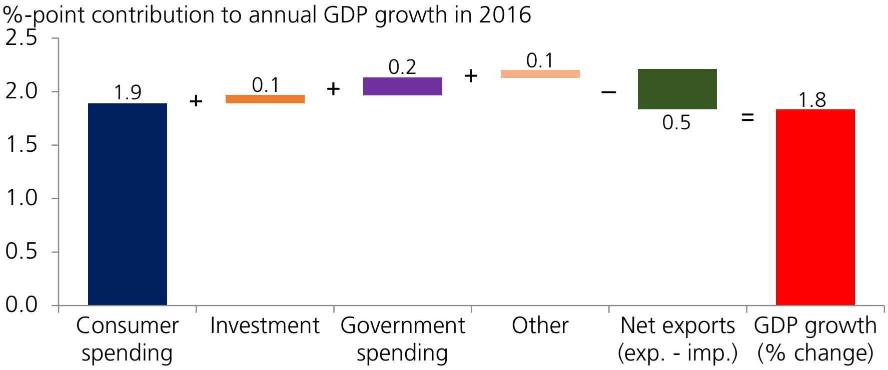
In 2016 as a whole, GDP growth was 1.8%, revised lower from 2.0% in the most recent estimate, due mainly to downgraded growth in Q1 2016. This compares to growth of 2.2% in 2015 and 3.1% in 2014.

2016 growth was dependent on consumer spending.

Growth was dependent on consumer spending, which increased by 3.1% for the year as a whole, its strongest annual expansion since 2004. Meanwhile, other parts of the economy fared less well. Total investment grew by only 0.5% in 2016, with business investment falling by 1.5%. Exports rose by 1.4%, while imports increased by 2.5%, resulting in net trade subtracting 0.5 percentage points from 2016 growth.

GDP growth in 2016 dependent on household spending

%-point contribution to annual GDP growth in 2016



Source: Library calculations based on data in ONS, Second Estimate of GDP Q4 2016

Looking at how industries performed in 2016, consumer-focused services industries like retail trade, restaurants and hotels grew robustly by 5-6%.[2] Service industries overall grew by 2.9% in 2016. The manufacturing sector grew by 0.7%, while the construction sector saw a 1.5% increase.[3]

Box 1.1: Regional economic growth over the recovery

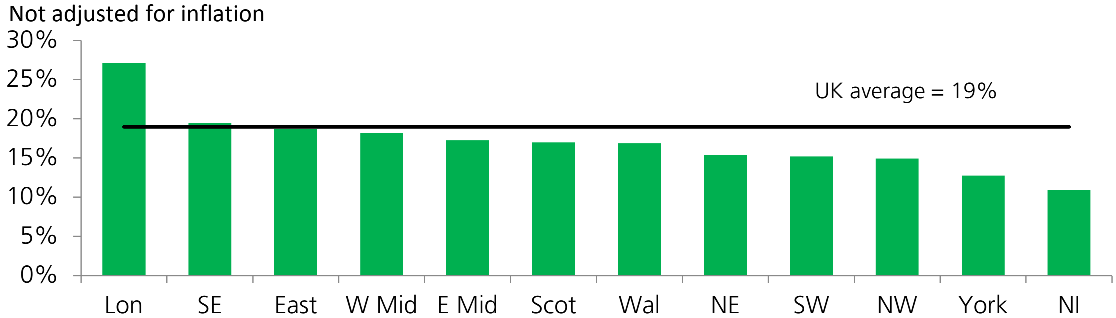
Growth in economic output over the recovery from the 2008/2009 recession has been uneven over the regions and countries of the UK, with London experiencing faster growth than the rest of the country.

Regional/country economic growth figures are available up to 2015 and are not adjusted for inflation, unlike the growth figures we usually use for the UK.

From 2010 to 2015, London saw the fastest growth, at 27%, over this whole period, followed by the South East at 19%. Slowest growth was in Northern Ireland (11%) and Yorkshire & the Humber (13%). The UK average was 19%. The chart below shows figures for all regions and countries.

Total GVA growth by UK region/country (workplace based), 2010-2015

Not adjusted for inflation



2 ONS dataset, UK GDP(O) low level aggregates, 22 February 2017

3 See also "UK shopping habits boost economic growth after Brexit vote", Financial Times, 22 February 2017 for further analysis of the sectors contributing to growth.

Regional/country figures are slightly different to those we normally use for the UK as a whole, measuring Gross Value Added (GVA) instead of GDP, although they are very similar. GVA is GDP excluding taxes and subsidies on products (so GVA does not include VAT, for example). Further information and statistics can be found in the Library briefing *Regional and local economic growth statistics*.

1.2 The fall in the pound and inflation

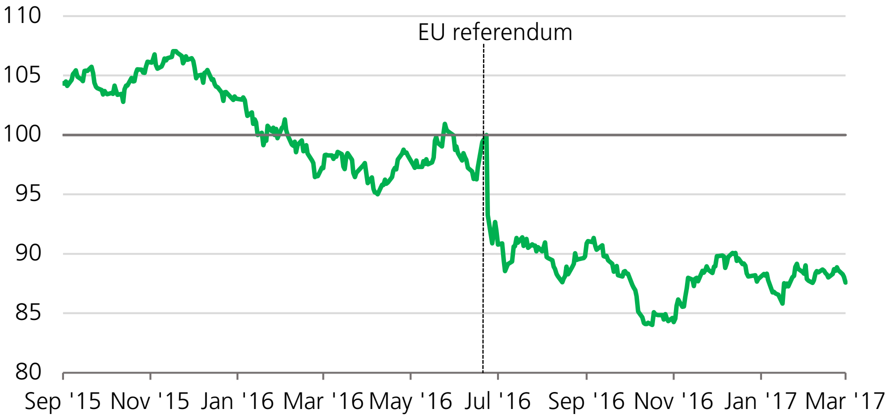
In the wake of the EU referendum result, the pound fell sharply on international foreign exchange markets. It's always difficult to ascribe movements in the foreign exchange markets to particular factors, but this downward move presumably reflects the view that UK economic prospects are now weaker (due to the expectation that trade and investment with the EU will be made more difficult).[4]

As of 1 March 2017, the pound has fallen by 12% against a basket of the UK's main trading partners' currencies since the 23 June EU referendum, and by 18% compared with its peak in November 2015 (see chart below).[5] Against the US dollar, the pound is 17% lower than at the time of the referendum, while against the euro it is down by 11%.

The pound has fallen by 12% since the EU referendum and by 18% since November 2015.

UK£ exchange rate index against main trading partners

Index, where 23 June 2016 =100; daily values from 1 Sep'15 to 1 Mar'17



Source: Bank of England

The decline in the pound makes it more expensive for those in the UK to purchase imported goods and services that are denominated in foreign currencies.

The prices of materials and fuels bought by UK manufacturers for processing – the first stage of the production process – have been going up: these input prices increased by 20.5% in January compared with a year ago, compared with a 0.5% decline in June.[6]

Producer input prices are up by over 20% on the year due to higher import prices.

This is unsurprising, given that most commodities (including oil) are traded on world markets and priced in dollars. Therefore a fall in the

4 Of course, this view may change and other factors will also influence the pound's future movements.

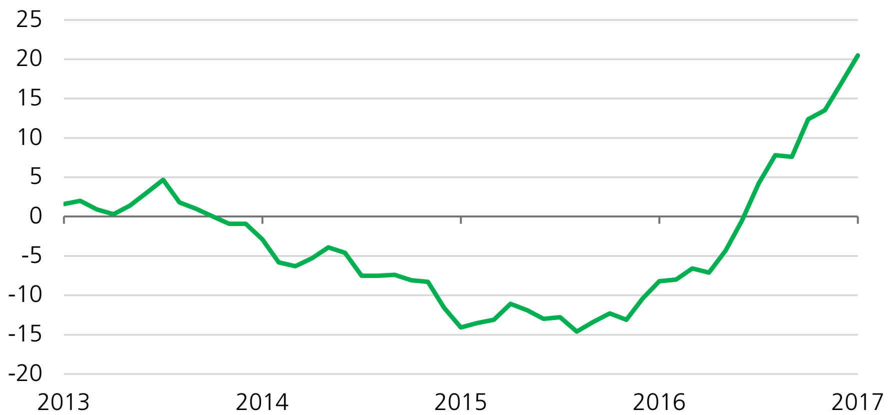
5 This is the Sterling Exchange Rate Index measuring sterling's value against a 'basket' of currencies, 'trade-weighted' (based on currencies' relative importance in UK trade). Data are from the Bank of England.

6 ONS, UK producer price inflation: Jan 2017, 14 February 2017

pound leads to higher imported commodity prices in sterling. Of course, changes in the price of the commodities themselves are also important. Commodity prices have increased since the time of the Autumn Statement in November, with oil prices having risen from around $45 to $56 in early March. One key factor behind that is the agreement in late November 2016 among the OPEC group of oil-exporting countries to restrict production in an effort to boost prices.[7]

Producer input prices

Annual % change, monthly data



Source: ONS, UK producer price inflation

Not all of the higher import costs will necessarily be passed on to consumers.

Producers may not pass on all of these higher costs to other companies further up the production chain. What they do will depend on the company's other costs (wages for example), as well as its ability and desire to pass these costs on. Similarly, retailers may not pass on the full cost on to consumers, accepting lower profit margins to preserve market share.

In addition, the full impact of higher import prices will not be immediate as some firms will have agreed contracts to pay a fixed price for their imports; only when those contracts expire and new contracts are negotiated will the full impact be felt. Businesses may also protect against short-term movements in the exchange rate by hedging their exposure to such changes via financial products.[8] In other words business may make investments that offset any potentials losses from changes in the exchange rate.

Overall, around 30% of the main measure of consumer price inflation, the CPI, is accounted for by imports. Some consumer products see their prices respond quickly to changes in import prices – petrol prices for instance. Food prices are also sensitive to import prices given that 50% of food and drink in the UK is imported. The Bank of England notes that the "pass-through" of higher import prices to consumer prices takes place gradually. It estimates that it can take four years for the full impact of a change in the value of the pound to be felt.[9]

7 "OPEC Confounds Skeptics, Agrees to First Oil Cuts in 8 Years", Bloomberg, 30 November 2016
8 National Institute of Economic and Social Research (NIESR), *National Institute Economic Review, February 2017*, Box B, page F58
9 Bank of England, *Inflation Report: November 2016*, pages 26-28

In recent months, rising producer costs are starting to feed through into higher prices faced by consumers in the shops. In January 2017, prices were 1.8% higher than a year before, the highest rate of inflation since June 2014 (although still on the low side historically).[10]

Consumer prices were up 1.8% on the year in January

Commenting on the most recent inflation figures the ONS head of inflation provided a summary of recent developments:

> The latest rise in CPI was mainly due to rising petrol and diesel prices, along with a significant slowdown in the fall in food prices.[11]

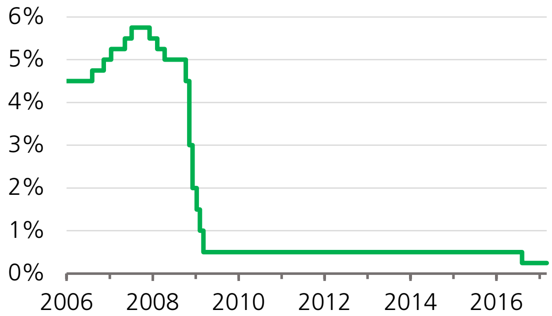
The future path of food prices will be important as it accounts for nearly 10% of the total inflation index and falling food prices – in part due to competition among retailers – was a factor in the period of very low inflation experienced in recent years. How much of the increase in their costs will supermarkets pass on?

Box 1.2: Monetary policy

Monetary policy has been left unchanged since the Bank of England's Monetary Policy Committee (MPC) cut its main interest rate (the Base Rate) from 0.5% to 0.25% on 4 August 2016, the first change since March 2009. The MPC cited its forecasts (at that time) of a markedly weaker growth outlook in the short to medium term, following the vote to leave the EU, as the reason for loosening monetary policy.

As well as cutting interest rates, the MPC agreed a series of other measures designed to boost the economy, including expanding its quantitative easing (QE) programme, whereby the Bank creates new money to buy financial assets from financial institutions, by £70 billion (£60 billion of government debt and £10 billion of corporate debt). Planned QE now totals £445 billion (£435 billion of government debt and £10 billion of corporate debt).[12]

Bank of England base rate, %



At its most recent meeting in early February, the MPC unanimously agreed to leave policy unchanged. It updated its economic forecasts to show stronger GDP growth, and continues to expect inflation to rise above its 2%-target in 2017 and remain there until the end of its forecast horizon in early 2020 (see main text below for more on its inflation forecasts).

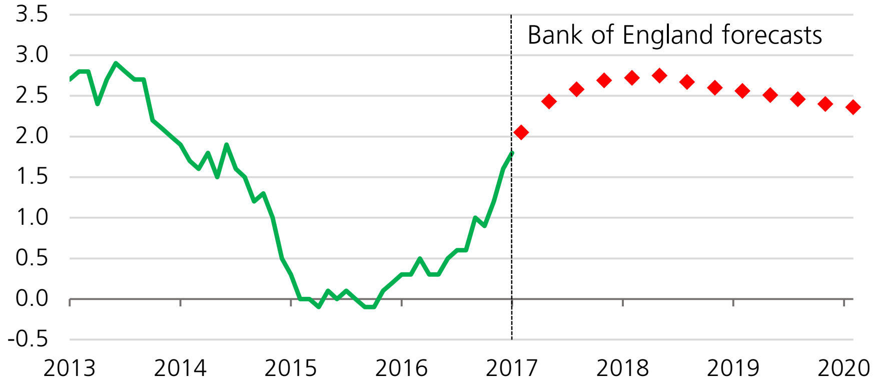
The MPC provided guidance that despite the anticipated above-target inflation it will leave rates unchanged as raising interest rates to lower inflation would only be achieved at the cost of higher unemployment. However, it did warn that "there are limits to the extent to which above-target inflation can be tolerated" if, for example, inflation expectations started to rise. For the time being though, the MPC is keeping its options open, noting that "monetary policy can respond, in either direction, to changes to the economic outlook".[13]

Looking ahead, the recent rise in consumer price inflation is to continue. In a recent survey, the average forecast of economists was for annual CPI inflation to rise to 2.9% in the final quarter of 2017.[14] The Bank of

[10] ONS, *UK consumer price inflation: Jan 2017*, 14 February 2017
[11] ONS, *Prices economic commentary: Feb 2017*, 14 February 2017, 2. Statistician Comment
[12] Bank of England, *Monetary policy summary*, 4 August 2016
[13] Bank of England, *Monetary policy summary*, 4 February 2017
[14] HM Treasury, *Forecasts for the UK economy: a comparison of independent forecasts*, 15 February 2017 [these are not Treasury forecasts]

England forecasts CPI inflation to rise to 2.7% in Q4 2017 and peak at 2.8% in Q2 2018, before easing to 2.4% by Q1 2020.[15]

Consumer price inflation expected to rise
Annual % change in CPI, monthly data and quarterly forecasts



Source: ONS, series D7G7 and Bank of England projections from February 2017 Inflation report: mode forecasts based on market interest rate expectations and other policy as announced

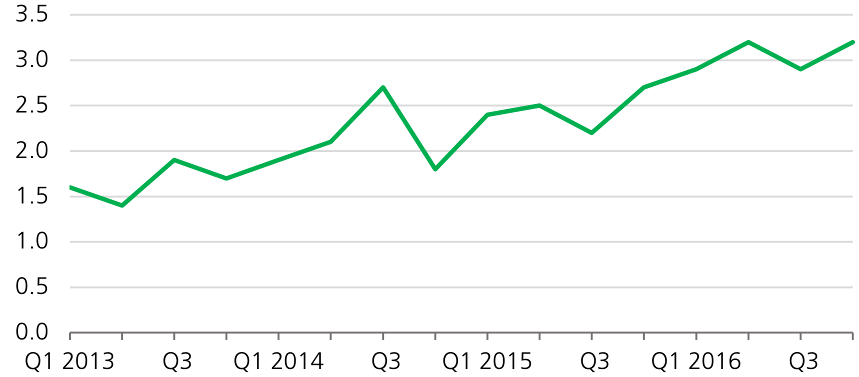
1.3 Consumer spending

The period of very low inflation – it was at or below 1.0% for two years prior to November 2016 – boosted the purchasing power of households, which in turn supported consumer spending growth.

Consumer spending growth has been strong…

The EU referendum did not negatively impact the appetite of households to keep spending, unlike many economists had predicted. Indeed, the annual rate of consumer spending growth of 3.2% in Q4 2016 was the equal highest (with Q2 2016) since Q4 2007.[16]

Consumer spending growth has been strong recently
Quarterly data, % change on same quarter of previous year



Source: ONS, series KGZ7

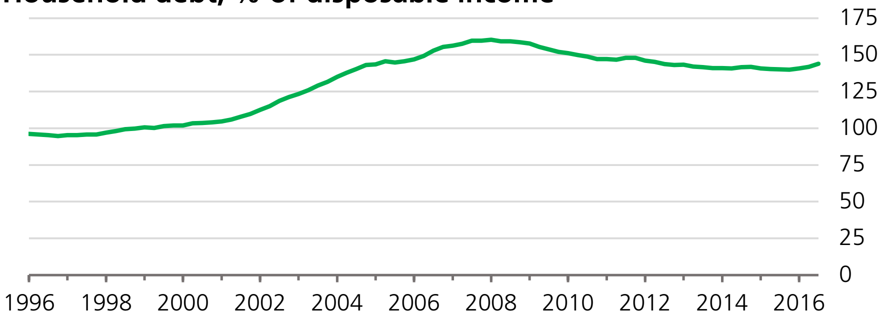
There is some evidence that the strength of consumer spending has been bolstered by households saving less and borrowing more. The declining cost of borrowing in recent years – due to the low interest rate environment – has made it more attractive for households to borrow. As the Bank of England notes:

15 Bank of England, *Inflation Report: February 2017*, current fan chart data
16 ONS dataset, Summary of Records: UK Second Estimate of GDP, 22 February 2017

> …the easing in credit conditions is likely to have supported consumption growth in recent years. And credit conditions are likely to continue to support consumption in coming quarters.[17]

Household debt as a proportion of income fell during and after the financial crisis, and remained broadly stable thereafter. Over the course of 2016, however, this ratio increased.[18]

Household debt, % of disposable income



Sources: ONS, series NNPP (debt) and rolling 4-quarter total of OWND (income)

The increase in debt was mostly due to faster growth in consumer credit (non-mortgage borrowing) – credit cards, car loans, personal loans etc. – rather than in mortgage debt (which makes up the vast majority of total household debt). At the end of 2016 growth in this form of consumer borrowing rose by over 10% compared with a year ago.[19]

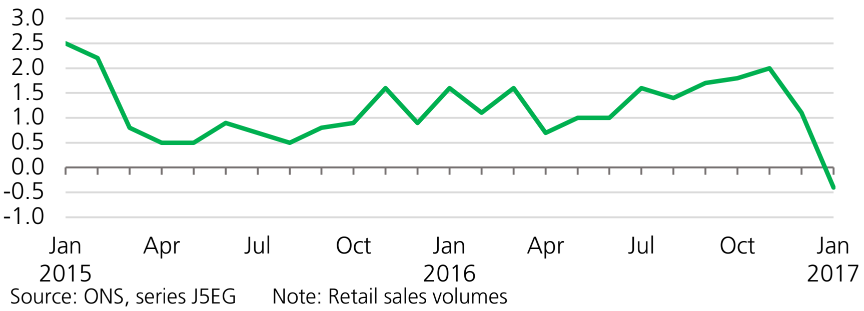
As discussed earlier, the consumer has been the main engine of overall growth recently. The outlook for consumer spending is less rosy, with rising inflation expected to reduce the purchasing power of households in 2017 and 2018, as wages are not expected to rise sufficiently to offset higher prices (see section 1.4 for more on wage forecasts). It is possible that households will overcome this squeeze on their incomes by saving less and/or borrowing more.

…but may be slowing.

Recent data point to tentative signs of consumers reining in their spending. For example, retail sales growth, which had been buoyant in the second half of 2016, has slowed abruptly in the past few months. In the three months to January 2017, retail sales fell 0.4% on the previous three-month period, the first decline on this measure since December 2013.[20]

Growth in retail sales growth falling in recent months

% change of 3 month average compared with previous 3 month period



Source: ONS, series J5EG Note: Retail sales volumes

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17 Bank of England, *Inflation Report: February 2017*, page 11
18 For more see Library briefing, *Household debt: statistics and impact on economy*
19 Bank of England, *Money and Credit statistical release*, 1 March 2017
20 ONS, *Retail sales in Great Britain: Jan 2017*, 17 February 2017

The ONS noted that rising food and fuel prices are having an impact:

> …the evidence suggests that increased prices in fuel and food are significant factors in this slowdown.[21]

Retail sales data can be volatile, and it only makes up around one third of total consumer spending, so it is too early to draw firm conclusions from these figures alone.

Nevertheless, there are a few other signs of consumers being more cautious of late. For example, consumer credit growth has started to ease a little at the beginning of 2017,[22] and, according to the GfK consumer confidence survey, households are becoming less likely to make major purchases, although overall consumer confidence remains broadly steady.[23]

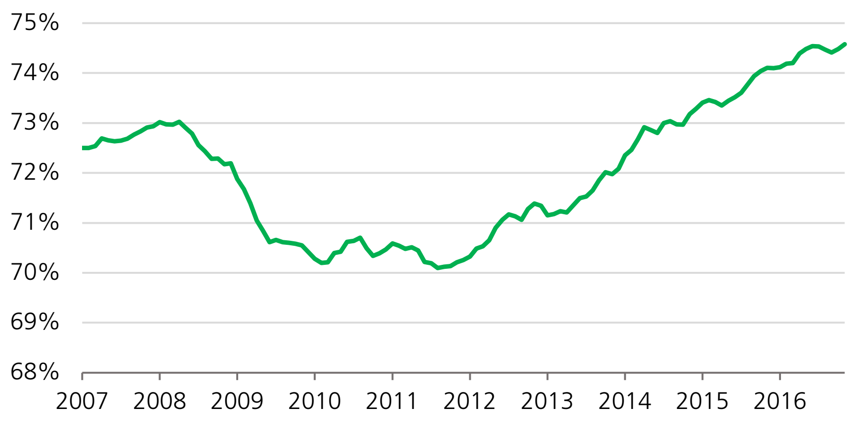
1.4 Labour market

Employment and unemployment

31.84 million people in the UK were in work in the three months to December 2016. The employment rate was 74.6%, the highest since comparable records began in 1971.[24]

After several years of strong growth between 2012 and 2015, employment levels increased more slowly during the second half of 2016. The number of people in work increased by 37,000 in Q4 2016 compared to the previous quarter. This is modest compared to rates of growth during 2015, when quarterly increases in employment averaged 148,000.

UK employment rate, 2007-2016
% of people aged 16-64 in work



Unemployment has similarly started to level out, having seen a sustained fall from 2013 onwards. Unemployment in Q4 2016 was broadly unchanged compared to the previous quarter at 1.58 million. The unemployment rate has reached 4.7%, its lowest level since mid-2005.

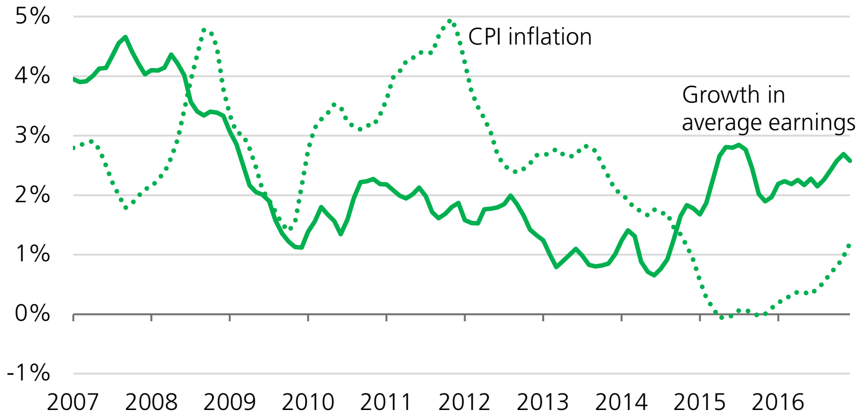
21 ONS, *Retail sales in Great Britain: Jan 2017*, 17 February 2017
22 Bank of England, *Money and Credit statistical release*, 1 March 2017
23 GfK for European Commission, *Consumer confidence index*, 28 February 2017
24 All data in this subsection are taken from ONS, *UK Labour Market, February 2017*, 15 February 2017, unless otherwise stated.

The number of vacancies in the economy has been fairly steady since early 2015, albeit at a high level of around 750,000 vacancies.

Earnings

Set against the positive picture for employment and unemployment is the trend for average earnings, which continue to grow more slowly than before the 2008 recession. Average weekly pay excluding bonuses grew by 2.6% in October-December 2016 compared to the previous year. That compares to an average annual growth rate of around 4% between 2001 and 2007. After adjusting for (CPI) inflation, average weekly earnings in 2016 were around the same level as in 2005.

Average weekly pay excluding bonuses, annual % change
Employees in Great Britain; three month average



The prolonged weakness in average earnings growth can be attributed in part to weak productivity growth since the recession, as discussed in section 1.7: employers' ability to offer an increase in wages will depend on there being some increase in the value of output. More recently, low inflation may have lessened the pressure on employers to increase pay in cash terms. The Bank of England has also suggested that the number of people available for work may be greater than previously thought (meaning there is still room for the unemployment rate to fall further), lessening the bargaining power of the existing workforce.[25]

As can be seen from the above chart, earnings have been increasing well ahead of consumer prices for the past two years (even if percentage increases in cash terms are below pre-recession levels). This is thanks in part to near-zero inflation for much of 2015-2016. This trend, however, looks unlikely to continue for much longer: forecasters expect weak productivity growth to restrain earnings growth in the short term. An increase in other labour costs, including the apprenticeships levy and ongoing pensions auto-enrolment for employees in small firms, is also expected to act as a drag on wages. Meanwhile, the anticipated rise in inflation through 2017 and into 2018

Real (inflation-adjusted) earnings growth is slowing as inflation rises.

[25] Possible reasons for recent weakness in growth in average earnings are discussed in detail in the box on pages 18-20 of the Bank of England *Inflation Report, February 2017*.

will narrow the gap between growth in prices and growth in earnings, bringing closer the two lines on the chart.[26]

Consequently, various commentators suggest there will be very little growth in real earnings over this period, as was also indicated in the OBR's November 2016 forecasts. However, the outlook is sensitive to a wide range of factors, as the Bank of England observes: "There is considerable uncertainty about the outlook for wage growth."[27]

1.5 Trade and current account

The UK's current account balance – the trade balance (exports minus imports) plus the balance of income and transfers moving into and out of the UK – has deteriorated in recent years. In 2015 (the last full year for which data are available), the current account deficit was £80 billion, equivalent to 4.3% of GDP. While this is down slightly on the 4.7% of GDP seen in 2014, it is still high by historical standards. The current account deficit with the EU was £90 billion in 2015 while the UK ran a surplus of £10 billion with non-EU countries.

The main reason for the rise in the current account deficit is not the trade deficit (the difference between exports and imports) which was a relatively modest 1.6% of GDP in 2015. More important is the primary balance which measures flows of profits, dividends and interest between the UK and abroad. The primary balance was in surplus every year between 2000 and 2011, peaking at 2.4% of GDP in 2005. It went into deficit in 2012 and the deficit was 1.4% of GDP in 2015.

The large decline in the pound since the EU referendum will boost the sterling value of overseas investments (held in foreign currencies) and income earned on them.[28] This should lead to an improvement in the primary balance, and therefore the current account balance.

The average independent forecast is for the current account deficit to be £77 billion in 2017 falling to £55 billion in 2018.[29] These are both lower than the OBR's November 2016 forecast of a deficit of £99 billion in 2017 and £87 billion in 2018.[30]

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26 For example, see: Simon Kirby et al, *Prospects for the UK Economy*, National Institute Economic Review, 31 January 2017; Martin Beck and Andrew Goodwin (Oxford Economics), *The UK economic outlook*, Institute for Fiscal Studies Green Budget 2017, Chapter 2, pages 46-7; Bank of England, *Inflation Report, February 2017*, p39

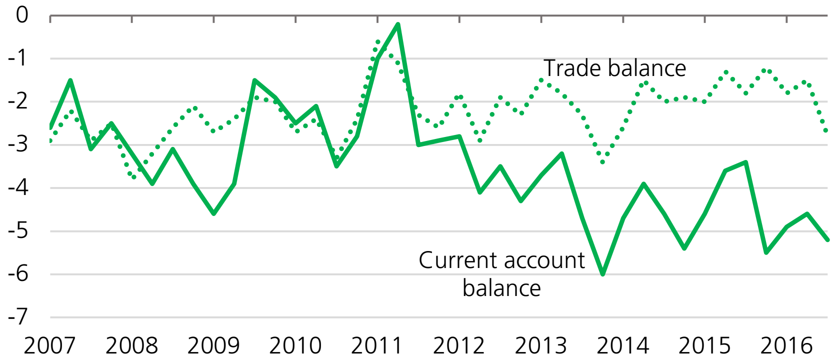
27 Bank of England, *Inflation Report, February 2017*, pages 20,38-9

28 Martin Beck and Andrew Goodwin (Oxford Economics), *The UK economic outlook*, Institute for Fiscal Studies Green Budget 2017, Chapter 2, page 53

29 HM Treasury, Forecasts for the UK economy: a comparison of independent forecasts, February 2017

30 OBR, Economic and fiscal outlook, November 2016, Table 3.4

Current account and trade balance, % of GDP
Quarterly data



Source: ONS, Balance of Payments

The fall in the pound may also provide a boost to exports by making them more competitive. It is too early to say for sure whether the recent fall in sterling's value has had this effect, but many forecasters expect a pick-up in export growth in 2017 and 2018. For example, the Bank of England expects the lower value of the pound to support exports and reduce demand for imports:

The lower pound may provide a boost to UK exports.

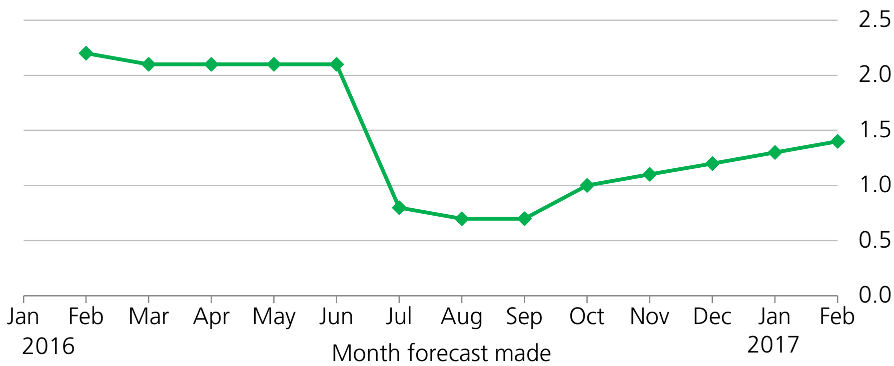
> That depreciation [of sterling since November 2015] will support net trade through two key channels — reducing domestic demand for imports and supporting UK exports … however, the timing and size of these effects is uncertain and will depend on how companies anticipate and respond to Brexit. Net trade is projected to support GDP growth in the coming quarters.[31]

1.6 Growth outlook

After being downgraded sharply following the referendum, economists' forecasts for GDP growth in 2017 have been rising after the stronger-than-expected performance in the second half of 2016 following the EU referendum. The latest average forecast is for growth of 1.4% in 2017, up from a low of 0.7% last summer.[32] The Bank of England is more optimistic, forecasting GDP growth of 2.0% in 2017.[33]

Average forecast for growth in 2017 is 1.4%.

2017 GDP growth forecasts have recovered
Consensus forecast for full-year 2017 GDP growth (%)



Source: HM Treasury survey of independent forecasts

31 Bank of England, *Inflation Report: February 2017*, pages 15-16
32 HM Treasury, Forecasts for the UK economy: a comparison of independent forecasts, February 2017
33 Bank of England, *Inflation Report: February 2017*

In its most recent forecasts made at the November 2016 Autumn Statement, the OBR forecast GDP growth of 1.4% in 2017. Given that growth outturns since then have come in stronger than it expected at the time, the OBR may revise up its 2017 forecast a little (though its expectations of developments and changes in fiscal policy will also be factored in).

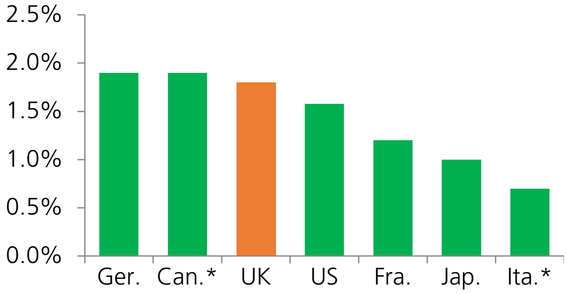
Box 1.3: International comparisons of GDP growth and US policy

Although not every G7 economy has yet reported full-year 2016 GDP growth figures, Germany (1.9%) and Canada (1.9%, IMF forecast) are at present estimated to have seen the highest growth rates in 2016, with the UK's 1.8% very close behind (these figures can and will be revised).

In January 2017, the IMF forecast GDP growth in the UK to be 1.5% in 2017, the same as Germany. Italy is forecast to experience the lowest growth (0.7%) in the G7 in 2017, while the US is forecast to have the highest at 2.3%.[34] However, this is based on the assumption that a new fiscal stimulus in the US is introduced. There is currently uncertainty surrounding US fiscal policy and what shape, scope and size any government investment plan may take. The Trump administration's approach to international trade and its unhappiness with the existing global system have also yet to play out in terms of concrete policy. More protectionist trade policies could impact on US and international growth.[35]

2016 GDP growth (%) in G7 countries

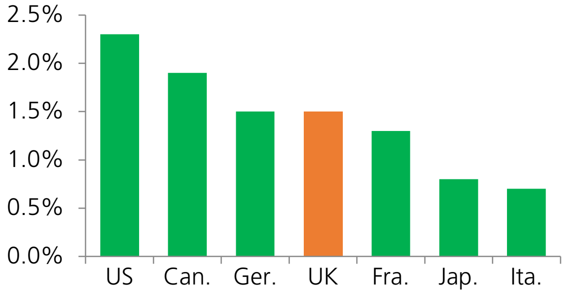
Outturns or *IMF forecasts from Jan.2017



Source: OECDstat and IMF, WEO update, Jan'17

2017 GDP growth (%) in G7 countries

IMF forecasts from January 2017



Source: IMF, World Economic Outlook update, Jan'17

Economists on the whole expect that consumers will not provide the same support to growth as they did in 2016. This is mostly due to rising inflation, largely a result of the fall in the pound since the EU referendum and higher energy prices, eating into households' purchasing power.

Assuming we do see a slowdown in consumer spending in this and upcoming years, GDP growth will need to come from elsewhere to prevent a sharper slowdown. It is unlikely to come from investment, which is expected to remain weak, and government spending will likely not provide any meaningful boost to GDP (and quite likely act as a drag on growth).

Instead, many expect that net trade (exports minus imports) will tangibly contribute to GDP growth in 2017 and 2018. This is anticipated to come from a combination of:

(i) slower growth in imports, as they become more expensive due to the fall in the pound; and

[34] IMF, [World Economic Outlook update](), January 2017

[35] National Institute of Economic and Social Research (NIESR), *National Institute Economic Review, February 2017*, page F2

(ii) an acceleration in export growth, as UK goods and services become more competitive internationally and growth in UK export markets accelerates.[36]

Some forecasters expect that net trade will become the main driver of growth by 2018.[37]

In summary, economic growth in the next couple of years will likely be reliant on consumers continuing to spend – via unexpectedly higher income growth, saving less and/or borrowing more – or from an improvement in the performance of UK exporters.

Box 1.4: The Government's industrial strategy

During her leadership campaign and early into her premiership, Theresa May signalled a return to a more active and explicit industrial strategy, compared with the previous Coalition Government and Cameron Government – although there is also a significant degree of continuity with previous policies.

The publication of the green paper called Building our Industrial Strategy on 23 January 2017 is the latest development in this policy area. The current Government's strategy marks a clear shift towards more prominence and emphasis placed on industrial strategy, and an aspiration to do more regionally across the UK, seemingly building on the Northern Powerhouse & Midlands Engine approach.

The strategy set out in the green paper is not "the last word, but [the] start [of] a consultation." The Government invites organisations and the public to respond. The consultation closes on 17 April 2017.

The Government's industrial strategy aims to:

- build on UK strengths and extend excellence into the future;
- close the gap between the UK's most productive companies, industries, places and people and the rest; and
- make the UK one of the most competitive places in the world to start or grow a business.

The green paper identifies 10 'pillars' for the industrial strategy that are said to drive growth. The actions described under each pillar are a mixture of existing policies and 'new commitments'.

The bulk of the strategy proposes 'horizontal' policy interventions, such as investments in skills, research and infrastructure, facilitating access to finance and keeping costs down for businesses. There is also a sectoral focus through the proposed "sector deals": the Government will work with sectors that organise themselves behind strong leadership to help deliver upgrades in productivity, through industry-led solutions.

1.7 Productivity, Brexit and the longer-term outlook

Productivity

Productivity – how much is produced for a given input (such as an hour's work) – is directly linked to living standards, with a country's ability to improve its standard of living over time almost entirely dependent on productivity growth.

Productivity is also crucial in determining the long-term growth rates of an economy. In other words, stronger productivity growth leads to stronger GDP growth. This, in turn, increases tax revenues and lowers government budget deficits. Of course, lower productivity growth results in the opposite: lower GDP growth and higher budget deficits.

36 Martin Beck and Andrew Goodwin (Oxford Economics), *The UK economic outlook*, Institute for Fiscal Studies Green Budget 2017, Chapter 2, page 53

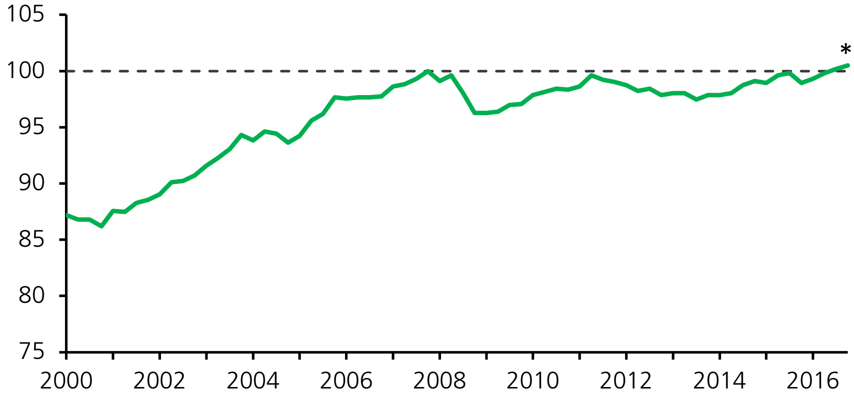
37 For example, National Institute of Economic and Social Research (NIESR), *National Institute Economic Review, February 2017*

Productivity – as measured by output per hour worked – was growing at its historical average rate of around 2% per year in the decade prior to the 2008/2009 recession. Since then it has stagnated. The level of labour productivity in Q4 2016 was only a little higher (+0.5%) than it was nine years earlier in Q4 2007 (the pre-recession peak level).[38]

Productivity has been stagnant.

Productivity (GDP per hour) has stagnated since 2007

Index where Q4 2007 level = 100 (quarterly data)



Source: ONS; * Q4 2016 figure is based on 'flash' preliminary estimate of GDP per hour

The persistent weakness in productivity has puzzled economists and there are many alternative theories to explain it, including: weakness in investment that has reduced the quality of equipment employees are working with; the banking crisis leading to a lack of lending to more productive firms; employees within firms being moved to less productive roles; and slowing rates of innovation and discovery. None is sufficient on its own to explain entirely what has happened, making it difficult to predict when and if productivity growth will return to pre-crisis rates.

In its November 2016 forecasts, the OBR left this long-term trend productivity rate unchanged, but lowered its assessment of productivity growth over the next five years. Productivity growth in 2017 was lowered from 1.7% to 1.3%, while for 2018 it was downgraded from 2.0% to 1.4%.[39] The OBR cited lower investment due to uncertainty surrounding the Brexit negotiations as the main factor for this downgrade:

> …we do expect uncertainty to reduce investment and productivity growth in the run-up to – and in the transition phase after – the UK's exit from the EU.[40]

OBR lowered its short-term but not medium-term GDP forecasts

Mainly as a consequence of expected lower productivity growth, reduced investment and squeezed household incomes (as inflation rises), the OBR in November cut its GDP growth forecasts for 2017

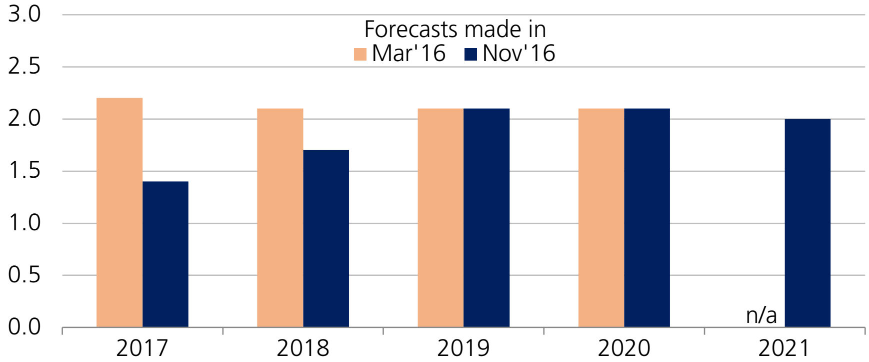
38 For more on the reasons behind the "productivity puzzle" see Barnett, A, Batten, S, Chiu, A, Franklin, J and Sebastiá-Barriel, M (2014), "The UK productivity puzzle", *Bank of England Quarterly Bulletin 2014 Q2*, and Duncan Weldon, "Stunted growth: the mystery of the UK's productivity crisis", Guardian, 25 April 2016

39 OBR, *Economic and fiscal outlook*, November 2016, p93, table 3.7

40 OBR, *Economic and fiscal outlook*, November 2016, p43-4, paras 3.22-3.24

(from 2.2% to 1.4%) and 2018 (from 2.1% to 1.7%). However, its forecasts for 2019 and 2020 were left unchanged.

OBR GDP growth forecasts for 2017 and 2018 lowered in November
Forecast for annual GDP growth (%) in each year



Source: OBR, Economic and fiscal outlook, Mar'16 and Nov'16

Brexit's impact on productivity and long-term growth

The UK's new trading arrangements with the EU and other countries following Brexit will be important in determining its impact on productivity and thus growth. Most economists believe the end result will be an economy less open to trade and foreign investment, likely lowering long-term productivity – the main driver of long-term growth.

As already mentioned, the OBR did not change its pre-referendum expectation of the economy's long-run productivity growth rate. Specifically the OBR stated that, unlike a number of other organisations, it did not lower this to reflect the anticipated lower trade intensity that is expected after Brexit:

> We have not revised trend productivity growth lower explicitly to reflect lower trade intensity (as the Treasury did in its pre-referendum analysis) given the lack of certainty around this link.[41]

For more on the potential impact of Brexit on long-term productivity and economic growth see section 6 of Library briefing *Productivity in the UK.*

[41] OBR, *Economic and fiscal outlook*, November 2016, p93, table 3.7

2. Government borrowing and debt

Summary

Government borrowing: the budget deficit

In 2015/16 the government had to borrow £72 billion to make up the difference between its spending and income. Since its 2009/10 peak the UK's borrowing – often referred to as the deficit – has halved. Despite the improvement, borrowing remains above the levels seen before the 2007-2008 financial crisis.

In November 2016, the OBR forecast that borrowing will continue to fall over the next five years. By the end of this Parliament the OBR believe the government will be borrowing £22 billion and by 2021/22, £17 billion.

In 2017 the UK's borrowing is expected to be broadly similar to the average for advanced economies, but higher than the average for EU nations.

Government borrowing: 2016/17 so far

Borrowing in 2016/17 looks likely to be lower than the OBR forecast in November 2016, perhaps by £5 billion to £10 billion. However, uncertainty over the final borrowing figure still remains: there are two months of data still to come, and the provisional data released for the first 10 months of 2016/17 is likely to be revised.

Government debt

At over 80% of GDP, public sector net debt – largely the stock of borrowing arising from past deficits – remains relatively high by recent and international standards.

In November 2016, the OBR forecast the debt-to-GDP ratio to begin falling between 2017/18 and 2018/19.

2.1 The deficit: public sector net borrowing

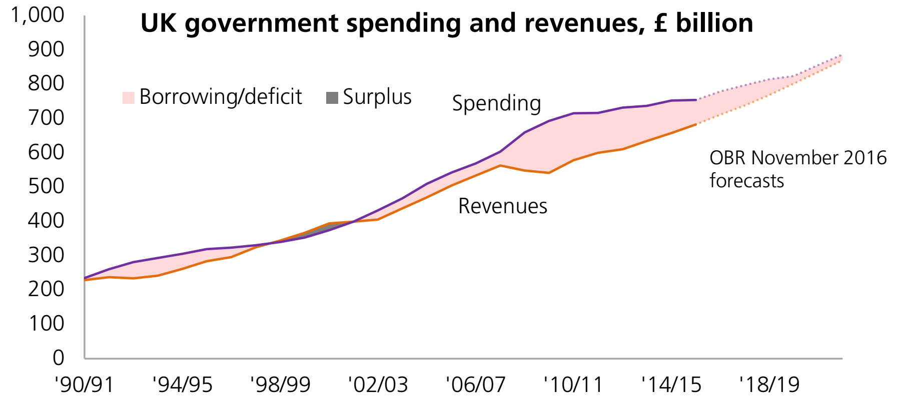
When the government spends more than it receives in taxes and other revenues it needs to borrow to cover the difference. This borrowing is known as 'public sector net borrowing', but is often referred to as the deficit.

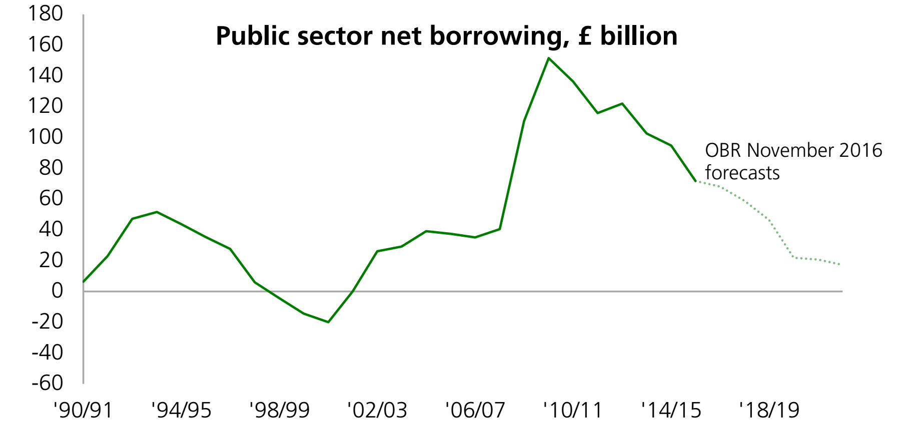
Public sector net borrowing, often referred to as the deficit, was £72 billion in 2015/16, equivalent to 3.8% of GDP.

Borrowing has fallen considerably since the high levels it reached during the financial crisis. Borrowing has more than halved since its peak of £152 billion in 2009/10, falling to £72 billion in 2015/16; this level of borrowing is equivalent to 3.8% of GDP.[42] Despite improvements, borrowing of 3.8% of GDP is still some way above the pre-financial crisis average. Prior to 2008/09, such a level was last seen in 1995/96.

In November 2016, the OBR forecast borrowing to fall to £22 billion in the last year of this Parliament, and £17 billion by the end of the forecast period in 2021/22.

42 These figures are in nominal terms. Borrowing as a share of GDP is shown in the chart. All public sector figures exclude public sector banks.



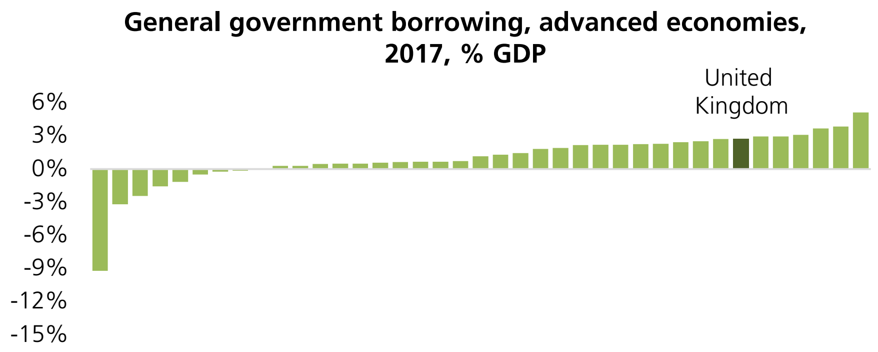


Compared with their previous forecast, the OBR's November 2016 forecast increased borrowing in all years to 2021. The increases were a result of the OBR updating its underlying forecast – allowing for changes in the economy and public finances – and policy changes made by the government.

International comparisons

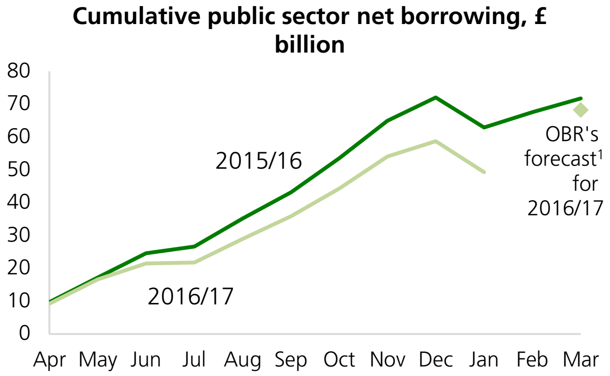
In October 2016, the IMF – who use a slightly different measure of governments' net borrowing – forecast that UK government borrowing will be 2.7% of GDP in 2017, higher than the European Union average of 1.8% and similar to the average for advanced economies of 2.7% of GDP.[43,44]

Forecasts for 2017 suggest that UK government borrowing will be similar to the average for all advanced economies, but higher that the EU average.



[43] IMF. *World Economic Outlook Database*, October 2016
[44] Advanced economies as defined by the IMF.

Box 2.1: Borrowing may be lower in 2016/17 than the OBR forecast



[1] OBR's November 2016 forecast

Provisional data on borrowing has been published for the first 10 months of 2016/17.[45] The data suggests that borrowing for the whole of 2016/17 may be lower than the OBR forecast in November 2016.

For the OBR's forecast for 2016/17 to be met borrowing needs to fall by £3.5 billion – a 5% decrease – compared with 2015/16. So far borrowing is £13.6 billion lower than it was at the same point of 2015/16.

However, accounting changes made by the ONS since the OBR's November forecast mean the latest data and the forecast aren't calculated on the same basis. The Institute for Fiscal Studies – an economic think tank – suggest that "even on a like-for-like basis borrowing is likely to end up between £5 billion and £10 billion lower than the OBR forecast."[46]

Uncertainties remain

While there are only 2 months of data left to be published for 2016/17 considerable uncertainties remain as to what full-year borrowing will be. The OBR specifically highlights that financial sector bonuses will affect income tax receipts and that central government spending and the borrowing of local government and public corporations are volatile and prone to significant revision.[47]

2.2 The current budget deficit

The current budget deficit was £40 billion in 2015/16, equivalent to 2.1% of GDP.

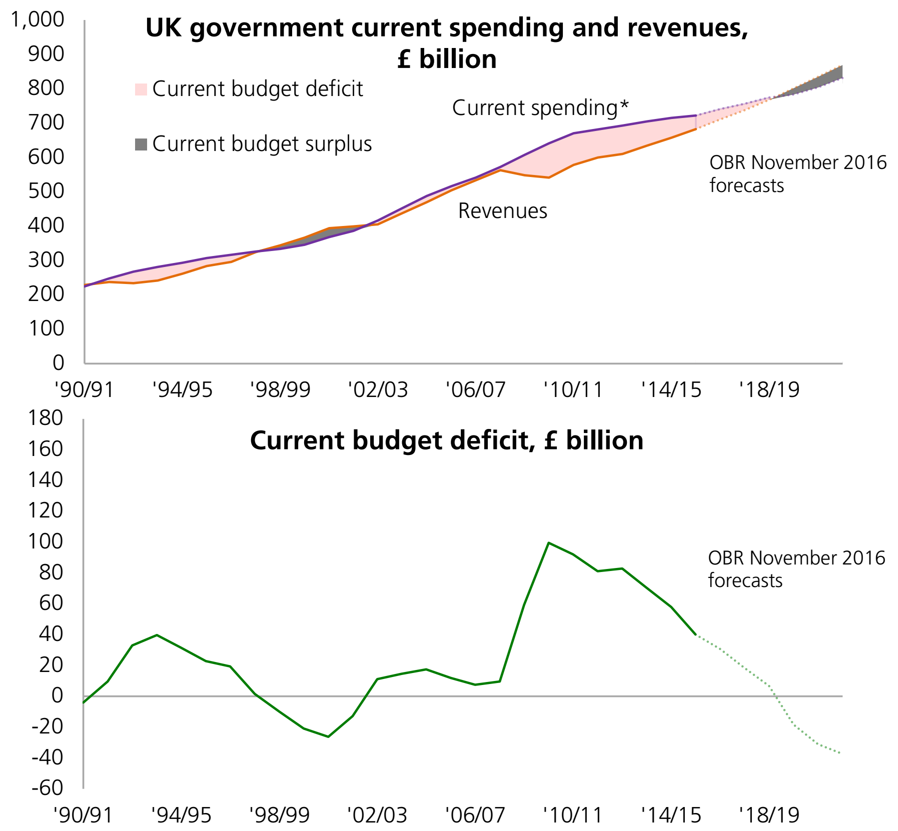
The current budget deficit is the difference between the government's current spending – day-to-day spending on running public services, grants and administration – and its income from taxes and other revenues. Unlike public sector net borrowing, the current budget deficit doesn't include investment spending and therefore is said to measure the degree to which taxpayers meet the cost of paying for the services provided to them.

The current budget deficit was £40 billion in 2015/16, equivalent to 2.1% of GDP. It has fallen by close to three-fifths since its post-financial crisis peak of £100 billion in 2009/10.

In November 2016 the OBR forecast that the current budget would reach a surplus in 2019/20. If a surplus is reached the government will be receiving more in taxes and other revenues than its current spending – the day-to-day spending on running public services, grants and administration.

Opposition parties have proposed targets for the public finances that focus on the current budget, rather than public sector net borrowing.[48] Focusing on the current budget would allow borrowing for investment purposes.

45 ONS. *Public sector finances: Jan 2017*, 21 February 2017
46 IFS Press Release, *IFS analysis of today's public finance figures*, 21 February 2017
47 OBR. *Commentary on the Public Sector Finances release: January 2017*, 21 February 2017
48 HC Deb. 20 July 2016:c904-905; *Liberal Democrats: 2015 Manifesto*; SNP, *What do the SNP propose as an alternative to austerity?*



note: * current spending including depreciation

2.3 Public sector net debt

Public sector net debt is the overall level of government indebtedness, built up over many years. Broadly speaking it is the stock of borrowing arising from past deficits.

Public sector net debt – broadly speaking the stock of borrowing from past deficits – was 83.7% of GDP at the end of 2015/16.

Before the financial crisis, public sector net debt was around 35-36% of GDP. As a result of the crisis, debt increased sharply. Public sector net debt was 84% of GDP at the end of 2015/16, a debt to GDP ratio not seen since the mid to late 1960s.[49]

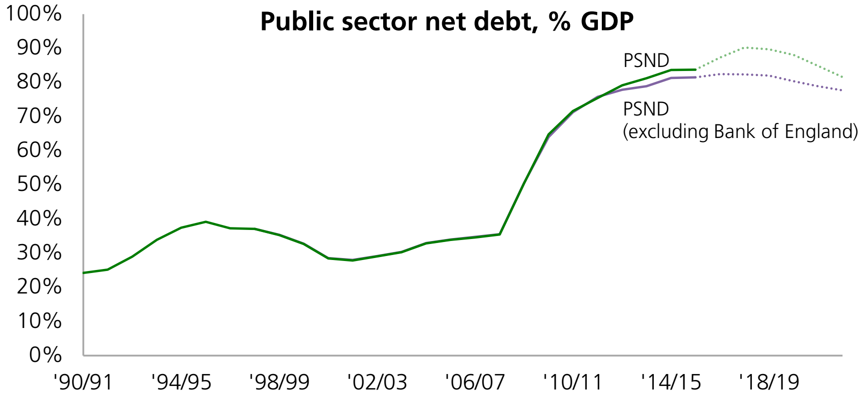
The OBR's forecasts for the debt-to-GDP ratio were higher in all years to 2021 in their November 2016 forecast, compared with its March 2016 forecasts. The OBR also forecast that the ratio would begin to fall two year later than they had previously thought. The OBR expect the debt-to-GDP ratio to fall between 2017/18 and 2018/19. In March 2016 they forecast the ratio to first begin falling between 2015/16 and 2016/17.

Debt excluding the Bank of England

Following the EU referendum result, in August 2016, the Bank of England (the Bank) took some action to support the economy. The Bank's package of measures have some impact on public sector net debt, as the Bank is part of the public sector. The impact is largely temporary, so the ONS and OBR have published a measure of public

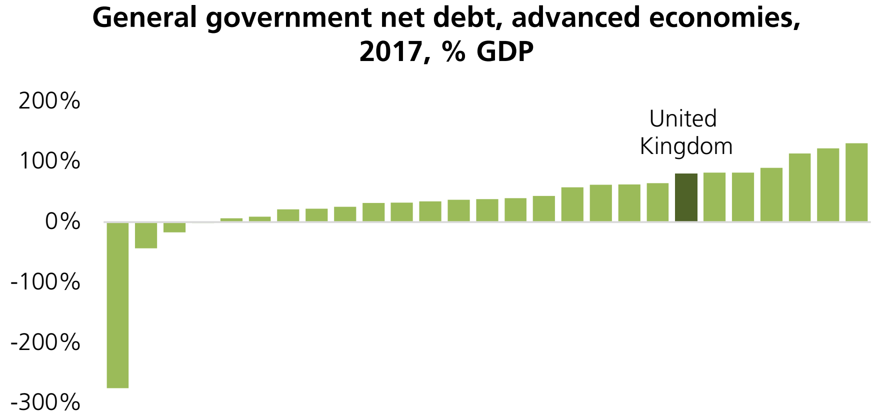
49 OBR. *Public finances databank*, January 2017

sector net debt that excludes the Bank of England. On this measure the path of public sector net debt is smoother and peaks in 2016/17.



International comparisons

By international standards the UK's net debt is relatively high. The IMF – who produce data using a slightly different measure of debt – forecast that the UK's general government net debt in 2017 will be 80% of GDP. The IMF forecast that the UK's net debt will be higher than the EU average of 66% and higher than the average amongst advanced economies of 72% of GDP.[50]



The UK's government net debt is relatively high by international standards.

[50] IMF. *World Economic Outlook Database*, October 2016

3. Objective and targets for the public finances

Summary

Alongside Spring Budget 2017 the OBR will assess performance against the Government's targets for borrowing and debt.

The targets – revised in Autumn Statement 2016 – support the Government's overall objective for the public finances, which is reaching a budget surplus during the next Parliament. A surplus will see government spending being less than the income raised from taxes and other revenues.

The Government's borrowing target – its fiscal mandate – is for public sector net borrowing, adjusted for the ups and downs of the economic cycle, to be less than 2% of GDP in 2020/21.

The Government's debt target is for public sector net debt as a percentage of GDP – the debt-to-GDP ratio – to be falling in 2020/21.

The Government also has a target for welfare spending – the welfare cap. Alongside Budget 2017 the OBR will monitor welfare spending in the cap, but this will not constitute a formal assessment of the welfare cap. A formal assessment will only happen in the OBR's first forecast of the next Parliament.

At Autumn Statement 2016 the Chancellor announced changes to the Government's objective for managing the public finances: its objective for fiscal policy. The Chancellor also announced new targets for the public finances – the fiscal targets – which are aimed at achieving the Government's objective for fiscal policy.[51] The targets focus on borrowing, debt and welfare spending.

The fiscal targets are, in the opinion of the OBR, "less constraining" than their immediate predecessors".[52] The Institute for Fiscal Studies (IFS) – an economic think-tank – view them as 'more relaxed' and 'much looser'.[53]

The OBR's forecasts, published alongside Budget 2017, will include an assessment of the Government's performance against their fiscal targets.

3.1 The objective

The Government's objective for fiscal policy is to return the 'public finances to balance at the earliest date in the next Parliament'. The objective aims to provide sustainable public finances, ensure confidence in the economy, and support the effectiveness of monetary policy.

51 The objective and targets came into force when an update to the Charter for Budget Responsibility, which contains the objective and targets, was approved by the House of Commons on 24 January 2017
52 OBR. *Economic and fiscal outlook – November 2016*, para 1.10
53 IFS. *Autumn Statement 2016 briefing: Paul Johnson's opening remarks*, 24 November 2016

3.2 Borrowing target

The Government has targets to support it in achieving its overall fiscal objective. Chief amongst these is the fiscal mandate, a target for controlling the level of borrowing.

The fiscal mandate focuses on an adjusted version of borrowing. The fiscal mandate is:

- a target to reduce cyclically-adjusted public sector net borrowing to below 2% of GDP by 2020/21.

The adjustment means the target focuses on structural borrowing, or the element that remains once borrowing related to the ups and downs of the economy are removed. This is what is meant by 'cyclically-adjusted': removing the parts of borrowing related to the economic cycle. See Box 3.1 for more on this.

Fiscal mandate: a target to reduce cyclically-adjusted public sector net borrowing to below 2% of GDP by 2020/21.

Box 3.1: Structural borrowing, cyclical elements and the output gap

Structural borrowing

Structural borrowing is the level of borrowing we would expect to remain if the economy was running at a sustainable level of employment and activity. Structural elements are the underlying or persistent part of government borrowing, which are unrelated to the economic cycle. The OBR never know what the economy's normal level is, so they estimate it through the output gap.

The OBR estimated the output gap to be 0.2% of GDP in 2015/16; that is, the economy was thought to be running 0.2% below capacity. As the economy was thought to be running slightly below capacity in 2015/16, the OBR judged structural borrowing to be a little lower than overall borrowing. The remaining part of overall borrowing was thought to be cyclical – related to the economic cycle – which should disappear as the economy returns to capacity.

Cyclical elements of borrowing

Cyclical elements of borrowing refer to the effect of the economic cycle on the level of government borrowing. In a recession, government borrowing tends to increase as tax receipts are reduced and spending on benefits increases. The reverse happens when the economy is growing strongly. These effects are sometimes known as the economy's 'automatic stabilisers'.

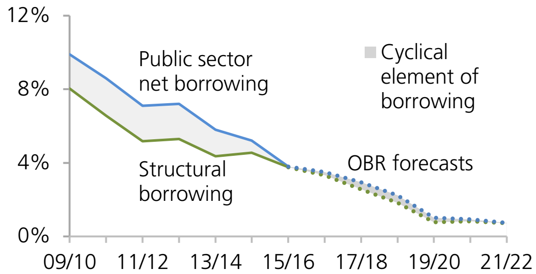
The output gap

The difference between the actual level of economic output and what could be achieved if the economy was operating at full potential is known as the 'output gap'. A negative output gap suggests that the economy is operating below its potential level and has idle resources. A positive output gap suggests that the economy is operating above potential or overheating.

A big problem for policymakers is that the level of potential output cannot be directly measured and consequently neither can the output gap. Therefore economists must estimate what the output gap is. The OBR estimates that the output gap was close to -4% of GDP in 2009/10 and is currently around -0.2% of GDP.

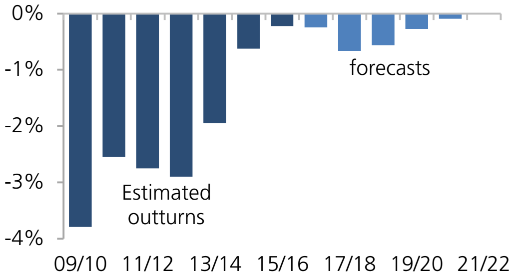
Borrowing and structural borrowing

% of GDP



OBR output gap estimates

% of GDP



The OBR will judge whether the Government is on track to meet the fiscal mandate in its forecasts for Spring Budget 2017. The OBR's November 2016 forecast suggested that the Chancellor could loosen fiscal policy – spend more or raise less taxes – by around £25 billion in 2020/21 and still meet the target.[54]

Previous target

The previous fiscal mandate – introduced in Summer Budget 2015 – was for a budget surplus to be achieved in 2019/20. This would have meant government spending being less than income received from taxes and other revenues in 2019/20. The previous target was viewed by the OBR as "ambitious relative to the fiscal performance of past governments."[55] The target was dropped following the EU referendum result, along with the other fiscal targets.[56]

The current fiscal mandate has been described as looser, compared to the previous target as:

- a 2% of GDP target requires less tightening in the public finances than reaching budget balance; and,
- borrowing that is a result of weakness in the economy is not included in the current cyclically-adjusted target.

3.3 The debt target

The fiscal mandate is supplemented with a debt target. The supplementary target is for public sector net debt as a percentage of GDP – the debt-to-GDP ratio – to be falling in 2020/21. The OBR will make a judgement alongside Budget 2017 as to whether the Government is meeting the target.

Supplementary debt target: a target for public sector net debt as a percentage of GDP to be falling in 2020-21.

The IFS has pointed out that the timing of the target makes it "particularly easy to meet given temporary factors that are likely to reduce PSND [public sector net debt] in that year."[57] The temporary factors refer to a Bank of England scheme, the loans for which are expected to begin being repaid to the Bank in 2020/21.[58] The loans are part of the public sector's debt, so when they are repaid they decrease debt. The IFS estimate that this effect means that in order for the supplementary debt target not to be met the budget deficit would have to be around or over 4% of GDP in 2020/21.[59]

Previous target

The previous supplementary debt target – introduced and replaced at the same time as the fiscal mandate – was for the debt-to-GDP ratio to be falling in each year of the current Parliament. Alongside Budget 2016

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54 IFS. *The IFS Green Budget 2017*, February 2017, page 78
55 OBR. *Economic and fiscal outlook July 2015,* 8 July 2015, para 5.18
56 For more on the background to the change see the Library briefing *The Office for Budget Responsibility and Charter for Budget Responsibility*.
57 IFS. *The IFS Green Budget: February 2017*, page 78
58 The scheme is the Term Funding Scheme, under which up to £100 billion of loans are to be made available to UK banks and building societies until the end of February 2018, with the loans to be repaid within four years of being taken out
59 IFS. *The IFS Green Budget: February 2017*, page 78

the OBR judged that the target was being missed: it expected the debt-to-GDP ratio to rise between 2014/15 and 2015/16.[60]

3.4 The Welfare Cap

The Government has a further target for controlling spending on around 55% of welfare spending. The main areas of welfare spending excluded from the cap are pensions and Jobseekers Allowance payments.

Alongside Spring Budget 2017 the OBR will monitor welfare spending in the cap, but this will not constitute a formal assessment of the welfare cap. A formal assessment will only happen in the OBR's first forecast of the next Parliament. The cap is only breached if spending exceeds the cap at the point of the OBR's formal assessment.

The OBR will monitor welfare spending in the Spring Budget, but won't make a formal assessment.

The target for the welfare cap is:

- to ensure that expenditure on welfare in 2021/22 is contained within a predetermined cap and margin set by the Treasury at Autumn Statement 2016.

As well as setting a cap level for 2021/22, the Government has also set a pathway for the cap in the years running up to the target year, and a margin.

The Library briefing *The welfare cap* has more.

The Library briefing *The Office for Budget Responsibility and Charter for Budget Responsibility* discusses all of the targets and their predecessors.

60 OBR. Economic and Fiscal Outlook – March 2016, para 5.15

4. Introducing an Autumn Budget

Summary

At Autumn Statement 2016 the Chancellor Philip Hammond announced that from autumn 2017 the Government would present a single autumn Budget, to allow for greater Parliamentary scrutiny of Budget measures ahead of their implementation. This is intended to put an end to tax announcements being made twice a year in the Budget and Pre-Budget Report or Autumn Statement.

The Office for Budget Responsibility (OBR) has a statutory duty to present updated fiscal and economic forecasts twice a year. They have, thus far, presented their forecasts alongside the Budget and Autumn Statement. In the future the OBR will publish one set of forecasts alongside the Autumn Budget and their other set of forecasts in spring. The Government will present a formal response to the OBR's spring forecast.

The changes mean that there will be a Spring Budget and Autumn Budget in 2017. In 2018 there will be an Autumn Budget and the OBR will publish an updated forecast in spring.

Traditionally the Budget has been in March, prior to the start of the tax year on 6 April. It has been the practice in recent years for Chancellors to make tax announcements twice a year, using the Pre-Budget Report or Autumn Statement as a second fiscal event. In his Autumn Statement on 23 November 2016 the Chancellor Philip Hammond announced that from autumn 2017 the Government would present a single autumn Budget, to allow for greater Parliamentary scrutiny of Budget measures ahead of their implementation:

> No other major economy makes hundreds of tax changes twice a year, and neither should we, so the spring Budget in a few months will be the final spring Budget. Starting in autumn 2017, Britain will have an autumn Budget announcing tax changes well in advance of the start of the tax year.

Mr Hammond went on to explain that as the Office for Budget Responsibility has a statutory duty to present updated fiscal and economic forecasts twice a year, then each spring, when the second of these was published, the Government would present a formal response:

> From 2018, there will be a spring statement responding to the forecast … Parliament has mandated the OBR to produce a report to Parliament twice a year and has mandated the Government to reply. From 2018, therefore, there will be a spring statement responding to the forecast from the OBR but no major fiscal event. If unexpected changes in the economy require it, I will of course reserve the right to announce actions at the spring statement, but I will not make significant changes twice a year just for the sake of it.
>
> This change will allow for greater parliamentary scrutiny of Budget measures ahead of their implementation. It is a long-overdue reform to our tax policy-making process and brings the UK into

> line with best practice recommended by the IMF, the Institute for Fiscal Studies, the Institute for Government and many others.61

The Chancellor's announcement was generally welcomed by tax professionals.[62] Writing in *Taxation*, Andrew Hubbard, the magazine's editor, saw the decision as "positive, even for somebody like me who enjoys the adrenaline rush of analysing the press releases after a set-piece event … slowing down the pace and having a more measured approach to making tax policy and law … must be the right thing."[63] As part of its presentation on the Autumn Statement, the Institute for Fiscal Studies (IFS) director, Paul Johnson, said:

> No more Autumn Statements. Hurrah. If there has been any promise made by any chancellor I have been able to welcome more warmly I can't remember it … We have had far too much, far too bad, policy in Budgets, Autumn Statements and pre budget reports over the years. The temptations for Chancellors to use their two days to make too many headline grabbing announcements is great indeed.
>
> As I said in a letter to Mr Hammond back in September, along with colleagues from the IfG [Institute for Government] and CIOT [Chartered Institute of Taxation], moving to one fiscal event a year should reduce "the frequency of new significant changes of direction, release resource for better consultation, produce higher quality legislation and more effective implementation, and make life simpler for taxpayers". Let's hope.[64]

In January the Institute for Government published a joint report with the IFS and the CIOT on tax policy, making a series of recommendations. The authors suggested that the commitment to a single fiscal event was "an important move that opens the way to a more professional approach to tax policy making":

> By taking Treasury and HMRC officials and ministers off the treadmill of twice-yearly tax policy making with only around 12 working weeks between the Autumn Statement and the Budget, it should give scope for the further steps we suggest below on consultation and external engagement – and open the way for enhanced parliamentary scrutiny. Simply doing less should enable change to be done better. But previous chancellors have made similar commitments – only to be tempted back by a mix of opportunity and external expectation. So if this change is to endure, it needs to be buttressed by changes to entrench it.[65]

Further information is given in two Library briefings:

- *The Budget and the annual Finance Bill*, SN813, 13 February 2017
- *The Office for Budget Responsibility and Charter for Budget Responsibility*, SN5657, 1 February 2017.

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61 HC Deb 23 November 2016 c910. See also, *Autumn Statement*, Cm 9362, November 2016 para 4.1-4.3 and, HM Treasury press notice, *The new Budget timetable: 7 things you need to know*, 23 November 2016

62 See, for example, Chartered Institute of Taxation (CIOT) press notice, *Chancellor takes up Institutes' proposal for fewer Budgets*, 23 November 2016 & Association of Tax Technicians (ATT) `press notice, *Tax experts call for consultation on new Budget timetable to ensure it delivers intended benefits*, 23 November 2016

63 "Harbinger of stability?", *Taxation*, 1 December 2016

64 "Paul Johnson's Opening remarks", *IFS Autumn Statement analysis*, 24 November 2016

65 IfG, IFS, CIOT, *Better Budgets: making tax policy better*, January 2017 p42

5. Potential tax changes

Summary

Business rates

Business rates are a property tax paid on non-domestic properties. The amount of tax paid is the product of two items:

- the properties rateable value – broadly speaking, what the property could rent for
- the multiplier – the number of pence of tax due on each pound of rateable value

Rateable values are updated, normally every five years. This is done to ensure that they stay broadly in line with properties' annual rental value. The next revaluation will come into effect on 1 April 2017. A revaluation was due in 2015, but was postponed.

There has been some controversy over the upcoming revaluation. At any revaluation, some businesses will face rateable values that rise and some will see rateable values fall. Many businesses and sectors have stated that the rate rises will have a damaging effect on their finances. In Spring Budget 2017 the Government is expected to announce further support to businesses facing the steepest increases.

Income tax personal allowance and higher rate threshold

In Autumn Statement 2016 the Chancellor confirmed the Government's intention to raise the income tax-free allowance – the personal allowance – to £12,500 by the end of this Parliament. The Chancellor also confirmed that the point at which people start paying the higher rate of tax – the higher rate threshold – would increase to £50,000 over the same time period. Both were commitments in the Conservative Manifesto. The pledge on the higher rate threshold doesn't apply to Scotland: from April 2017 the Scottish Parliament is responsible for setting income tax rates and thresholds.

The Government has not yet set out the path for achieving their desired allowance and threshold by April 2020. The Chancellor may take the opportunity to do so in the Spring Budget.

5.1 Business rates revaluation

All non-domestic properties in England, Scotland and Wales pay non-domestic rates or 'business rates'. Each non-domestic property is assigned a 'rateable value'. The rateable value is then multiplied by a 'multiplier' (set separately in each territory) to produce the annual business rates bill.

Rateable values are subject to regular updating, normally every five years. This is done to ensure that they stay broadly in line with properties' annual rental value. Revaluations are carried out by the Valuation Office Agency (VOA) in England and Wales and by the Scottish Assessors in Scotland.

The next revaluation in England, Scotland and Wales will come into effect on 1 April 2017. Business rate bills for the financial year 2017-18 will therefore be based on the new valuations.

The previous revaluation came into effect on 1 April 2010.[66] The Government decided in 2013 to postpone the upcoming revaluation for two years.

At any revaluation, some businesses will face rateable values that rise significantly and some will fall significantly. Rate rises are likely to be significant in London and in other economically buoyant areas. Many businesses and sectors have stated that the rate rises will have a damaging effect on their finances. To limit the impact on businesses, a transitional scheme in England and Wales caps the annual rise in bills applying to certain properties (see section 3 of the Library briefing *Business rates: the 2017 revaluation* for further details).

The VOA has published some high-level cumulative statistics on rateable values. The impact in particular sectors, or by local authority or Parliamentary constituency, have been discussed in the media, but no data have been published.

Sajid Javid, the Secretary of State for Communities and Local Government, said in the annual local government finance settlement:

> It is clear to me that more needs to be done to level the playing field and to make the system fairer. I am working closely with my right hon. Friend the Chancellor to determine how best to provide further support to businesses facing the steepest increases. We expect to be in a position to make an announcement in the Budget in just two weeks' time.[67]

A letter from Mr Javid and David Gauke, Chief Secretary to the Treasury, to Conservative MPs has been circulated in the media. It said there had been "a relentless campaign of distortions and half-truths" about the revaluation and that most businesses would not see any rise in their bills.

It also said: "This year's revaluation has been preceded by a series of reports claiming that rates are going to soar, that appeals are being banned and that hundreds of thousands of businesses will be forced to close. Such claims are simply untrue."[68]

5.2 Income tax: personal allowance and higher rate threshold

In Autumn Statement 2016 the Chancellor confirmed the Government's intention to raise the income tax personal allowance to £12,500 and the higher rate threshold to £50,000 by the end of this Parliament. This was a commitment in the Conservative Manifesto. The Government has not yet set out the path for achieving these levels by April 2020. The Chancellor may take the opportunity to do so in the Budget.

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[66] Sections 29-30 of the *Growth and Infrastructure Act 2013* delayed the 2015 revaluation until 2017 in England. Both the Scottish and Welsh governments subsequently also chose to delay revaluation to 2017.[66] The following English and Welsh revaluations will take place in 2022.

[67] HCDeb 22 Feb 2017 c1075

[68] Sam Coates, "No 10 defends shake-up of business rates", *The Times*, 20 Feb 2017

Here we discuss these two features of the income tax system, how they have changed since 2010 and what we may expect for the rest of this Parliament.

Personal allowance

The income tax system gives most people a 'personal allowance', an amount of income that they don't pay income tax on. In 2016/17 the personal allowance is £11,000 which means that most people are not paying income tax on the first £11,000 of their income. Most people with incomes below £11,000 won't be paying any income tax in 2016/17.

Not all income taxpayers receive a personal allowance. Those with incomes over £100,000 have their personal allowance gradually reduced. In 2016/17 those with an income over £122,000 will receive no personal allowance.[69]

Higher rate threshold

Once a person's income goes over the personal allowance they begin paying income tax at the basic rate of 20% until they reach the point where they start paying the higher rate of 40%. This point is often described as the higher rate threshold, which is the sum of the personal allowance and the amount of income that a person pays the basic rate on – the basic rate limit. In 2016/17 the basic rate limit is £32,000; if we add the personal allowance of £11,000 to this we have a higher rate threshold in 2016/17 of £43,000.

Increasing the allowance and threshold

Unless the government intervenes, the personal allowance and the basic rate limit – and consequently the higher rate threshold – increase by inflation each year. However, since May 2010 the Coalition Government and current Government have announced above inflationary increases to the personal allowance, and have made other changes to the higher rate threshold.

Previous Parliament

By the end of the previous Parliament, in April 2015, the personal allowance was £2,835 higher than it would have been if the Coalition Government had uprated it by the retail price index (RPI), which was the measure used to increase the allowance when the Coalition came to power. This meant that a basic rate payer paid £567 less in income tax than they otherwise would have. The policy took 2.6 million people out of income tax altogether.[70]

The Coalition Government's policies meant the higher rate threshold was £10,380 lower in April 2015 than it would have been if uprated by RPI. This meant that most higher-rate taxpayers paid £471 more tax in 2015/16.[71] The policy led to an increase of over 2 million in the number of individuals subject to the higher or additional rate of income tax.

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69 This measure was announced in Budget 2009 and was introduced in April 2010.
70 IFS, *The Coalition Government's Record on Tax*, March 2015, page 8
71 The extra income tax paid would actually be £1,509. However, the loss to higher-rate taxpayers is less than this because the NICs upper earnings limit (and upper

The changes made to the personal allowance and higher rate threshold cost the Government around £8 billion by 2015/16.[72]

Current Parliament

So far the Government has announced above inflation increases in the personal allowance and higher rate threshold in both 2016/17 and 2017/18. In April 2017 the personal allowance is set to be £11,500 and the higher rate threshold £45,000. These increases are set to cost around £3.5 billion in 2017/18.[73]

The Conservative Manifesto pledged a personal allowance of £12,500 and higher rate threshold of £50,000 by the end of this Parliament. Based on the OBR's current forecasts, inflation would take the personal allowance to £12,340 and the higher rate threshold to £48,440 by April 2020. The OBR estimates it will cost the government roughly £1.3 billion to raise the allowance and threshold to meet the pledged levels in April 2020.[74]

Scotland

From April 2017 the Scottish Parliament will have responsibility for setting income tax rates and thresholds for Scottish income taxpayers.[75]

The Scottish Parliament has decided to freeze the higher rate threshold in 2017/18.[76] This means that Scottish income taxpayers will face a higher rate threshold of £43,000, while the threshold in the rest of the UK will be £45,000.

The Scottish Government intends to increase the higher rate threshold by a maximum of inflation in each year following 2017/18.[77]

profits limit for the self-employed) is aligned with the income tax higher-rate threshold, so reductions in the higher-rate threshold that result in more income being taxed at 40% rather than 20% also result in more earnings being subject to employee NICs at 2% instead of 12%.

72 IFS, *The Coalition Government's Record on Tax*, March 2015, Table 2.1. This cost includes the knock on impact on the NICs Upper Earnings Limit.

73 OBR. *Economic and fiscal outlook – July 2015*, supplementary fiscal tables, Table 2.40 ; OBR. *Economic and fiscal outlook – March 2016*, supplementary fiscal table, Table 2.43

74 OBR, *Economic and fiscal outlook – November 2016*, para 4.13

75 These powers are for non-savings and non-dividend income

76 Scottish Government, *Scottish Income Tax 2017/18*

77 Scottish Government, *Draft Budget 2017/18: Updated Income Tax Policy Forecasts*, February 2017

6. Spending pressures

Summary

NHS and adult social care in England

Both the NHS and adult social care face significant financial challenges. Costs are rising, the population is growing and ageing, and needs are becoming more complex.

Although health spending has been protected relative to other public services, there are concerns that increasing demand and costs threaten the financial stability and sustainability of the NHS.

Adult social care hasn't received similar protection, and local government – who fund social care – have seen their funding reduced. The Government has taken some action to address the funding pressures. Some stakeholders have questioned whether the action taken is sufficient.

School spending in England

There has been a growing focus on the cost pressures faced by schools following the Government's decision to freeze spending per pupil in cash terms, over this Parliament. The National Audit Office – the UK's government-spending watchdog – have reported that once the impact of inflation and increasing school-specific costs are taken into account, schools have not experienced such a reduction in their spending power since the mid-1990s.

The focus on school funding has been intensified by the planned introduction of a National Funding Formula (NFF) in England. As with any such change of this type there are expected to be winners and losers. Even after Government steps to limit the impact are taken into account, some schools will face reductions in cash funding per pupil towards the end of this Parliament, if the timetable for introduction the NFF is followed.

6.1 NHS England

The NHS in England is facing significant financial challenges as a consequence of the ageing and growing population, the rising cost of new drugs and treatments and the need to maintain safe staffing and access to care. Although health spending has been protected relative to other public services, there are concerns that increasing demand and costs threaten the financial stability and sustainability of the NHS.

Funding required and allocated

NHS England's A Call to Action estimated its required budget to 2020/21. This process indicated that the NHS would require an additional £30 billion of funding by 2020/21.

The NHS's settlement in Spending Review 2015 included a £10 billion real terms increase in NHS funding in England between 2014/15 and 2020/21. £6 billion of the increase will be delivered by the end of 2016/17 and £4.8 billion of additional capital funding will be provided every year for the next 5 years.

As shown in the table below, this additional funding does not meet the expected NHS funding requirements put forward by NHS England. The funding gap is expected to be met by NHS England making £22 billion of efficiency savings by 2020/21.

NHS England - projected funding and costs based on current trends, 2016-17 to 2020-21

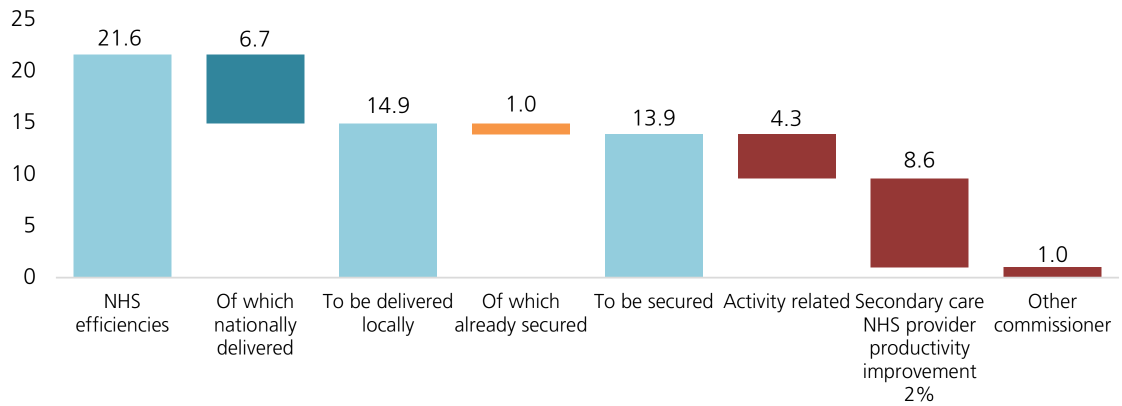
	2016-17	2017-18	2018-19	2019-20	2020-21
NHS England projected requirements (£billions)	113.0	118.0	124.0	130.0	137.0
Spending review settlement NHS TDEL (£billions)	106.8	110.2	112.7	115.8	119.9
Funding gap (£ billions)	-6.2	-7.8	-11.3	-14.2	-17.1

Sources:
NHS England, *The NHS belongs to the people: a call to action*, 11 July 2013, pages 15-16
HM Treasury, Public Expenditure Statistical Analysis, Table 9.11
and Library calculations

The chart below provides a high level breakdown of how NHS England expects to achieve the £22 billion of efficiency savings by 2020/21. Simon Stevens – NHS England's Chief Executive – discussed the breakdown as follows:

> £6.7 billion of it will be delivered national through a range of measures that the NHS nationally, the Department of Health and wider Government will be able to take, and that leaves us £14.9 billion to secure locally. Of that, £1 billion we already have in hand, so that leaves us just under £14 billion, of which £8.6 billion will come from the 2% provider tariff efficiencies and the rest from service change and the process that is now under way through the local planning processes—the sustainability and transformation plans that are being developed in 44 geographical footprints across the country.[78]

Breakdown of the 2020 £22 billion efficiency programme going into 2016/17[79]



Is the allocated funding sufficient?

Commentators have expressed concern over whether it is realistic that £22 billion of efficiency savings can be achieved – the Health Select Committee report gives a good summary of the main issues:

78 Health Select Committee, *The impact of the Spending Review on health and social care finances*, 12 July 2016, HC 139 2016-17, para 72
79 NHS England, *NHS Five Year Forward View Recap briefing for the Health Select Committee on technical modelling and scenarios*, May 2016, Chart 4.1

> …other than this high-level breakdown, many organisations observed that as yet, there is no detailed plan for how the £22 billion—or even the £9 billion or £15 billion of which Simon Stevens spoke—of savings will be made. NHS Providers told us that the Five Year Forward View "now needs to be complemented by a clear plan of how this destination will be reached including how the service will fund transformation in the middle years of the settlement". Likewise, the British Medical Association told us "there is still no credible plan to enable this unprecedented scale of efficiency savings to be made. This is even more unrealistic when we consider the fact that this expectation is balanced against the NHS priority for improving performance". Similar views were expressed by a number of other witnesses, including the Health Foundation, Nuffield Trust, King's Fund and NHS Clinical Commissioners.[80]

The King's Fund – a health think tank – has questioned whether NHS England is receiving the £10 billion increase in funding by 2020/21, as was reported in Spending Review 2015. The King's Fund say the actual overall real terms increase for NHS England by 2020/21 is £4.5 billion:

> Looking beyond this financial year, the Spending Review has now provided a settlement for the NHS to 2020/21. While the government has chosen to provide an additional £8 billion (in fact, £8.4 billion) for NHS England – £22 billion less than the estimated funding demand to 2020/21 – this change is based on 2020/21 prices, a somewhat unconventional way of calculating real changes for public spending. The real increase for NHS England also depends on real cuts of £3.4 billion in non-NHS England spending, such as capital expenditure, the budgets for Health Education England, Public Health England and arm's-length bodies such as the Care Quality Commission (CQC) and the National Institute for Health and Care Excellence (NICE). Using 2015/16 prices, the overall real increase for the NHS as a whole by 2020/21 will in fact be just £4.5 billion.[81]

More recently the Institute for Fiscal Studies (IFS) – an economic think tank – has estimated that while the extra NHS spending is enough to compensate the NHS for pressure created by a growing and ageing population over the next few years, it does not account for other cost and demand pressures.

The IFS looked at all Department for Health spending rather than NHS England only. They found that after adjusting for the ageing of the population, per capita real spending will be lower in 2019/20 than in 2009/10 and an additional £1.3 billion of DH spending would be needed in 2019/20 just to maintain 2009/10 levels.[82]

6.2 Adult social care

The combination of a growing and ageing population, increasingly complex care needs, reductions in funding to local government and

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80 Health Select Committee, *The impact of the Spending Review on health and social care finances*, 12 July 2016, HC 139 2016-17, para 73

81 The King's Fund, *Quality Monitoring Report 18*, February 2016

82 IFS, *IFS Green Budget 2017*, February 2017, Section 5: UK health and social care spending

increases in core care costs have placed adult social care services under increasing financial pressure.

Detail of the pressure

As social care funding is not ring-fenced – it is contained within the funding provided to local government – it is difficult to provide data on funding for adult social care. However, health think tanks and those in the sector have reported reductions in funding and spending.

Budgets and funding

In evidence submitted to the Health Select Committee the Association of Directors of Adult Social Services (ADASS) reported that adult social care budgets reduced by some £4.6 billion (31%) from 2010/11 to 2015/16.[83]

The health think tanks the Nuffield Trust, the Health Foundation and the King's Fund report that the social care funding gap is likely to be at least £1.9bn in 2017/18, and £2.3 billion by the end of this Parliament.[84] They called on the Government to immediately bring forward funding from the Better Care Fund to "address the critical state of social care".

Box 6.1: The Better Care Fund

The Better Care Fund is a pooled budget, shared by local authorities and the NHS, intended to incentivise and transform the integration of health and social care services.

From April 2017, the Spending Review and Autumn Statement 2015 made available social care funds for local government, rising to £1.5 billion by 2019/20, to be included in an improved Better Care Fund.

The Local Government Association has warned that funding pressures are increasing and estimated that social care was facing a potential funding gap of at least £2.6 billion.[85]

52% of local authorities reported that adult social care is their greatest immediate pressure in response to a survey on local government finance.[86]

Spending

There is evidence that local authorities' spending on adult social care has fallen. Local authorities' net social care expenditure on adult social care has reduced by around £1.1 billion in real terms between 2010/11 and 2015/16 and around £1.4 billion if we consider planned 2016/17 expenditure.[87]

The IFS point out that while real terms spending on adult social care has fallen, the population aged 65 and above has increased by around 16% between 2010/11 and 2015/16. They believe this means that the ability

[83] Health Select Committee, *The impact of the Spending Review on health and social care finances*, Written evidence submitted by the Association of Directors of Adult Social Services (ADASS) (CSR0086)
[84] The King's Fund, *The Autumn Statement: joint statement on health and social care*, November 2016
[85] LGA. *The LGA's submission to the Autumn Statement 2016*, 10 October 2016
[86] Local Government Information Unit, *Report: 2017 State of Local Government Finance survey*, 10 February 2017
[87] DCLG. *Local authority revenue expenditure and financing*

of local authorities to maintain 2015/16 levels of social care will depend on how much revenue is raised through council tax, and whether they want and can continue to protect social care relative to other services.[88]

Additional funding announced

In recognition of the funding pressures, the Government has announced three new sources of funding for local authorities with responsibility for adult social care:

- A new **Social Care Precept**, under which local authorities are able to increase council tax levels by up to 2% (above the referendum threshold) for each year between 2016/17 and 2019/20. In December 2016, the Government announced increased flexibility which will enable local authorities to, if they wish, bring forward the Social Care Precept, by raising council tax by up to 3% in 2017/18 and 2018/19;
- An improved **Better Care Fund**, which will include additional social care funds for local government, rising to £1.5 billion by 2019/20; and
- A new **Adult Social Care Support Grant**, which will provide £240 million to local authorities in 2017/18.

The Government expects the additional money to bring total dedicated social care funding to £7.6 billion over the four-year local government finance settlement period.[89]

Box 6.2: Further reading on NHS and adult social care funding pressures

Further details are available in the following publications:

- House of Commons Library, *The financial sustainability of the NHS in England*, 21 November 2016
- House of Commons Library, *Adult Social Care Funding (England)*, 20 February 2017
- Health Select Committee, *The impact of the Spending Review on health and social care finances*, 12 July 2016, HC 139 2016-17
- Institute for Fiscal Studies, *IFS Green Budget 2017*, February 2017
- Health Foundation, King's Fund and Nuffield Trust, *The Autumn Statement: Joint statement on health and social care*, 8 November 2016
- Local Government Association, *Adult social care funding: 2016 state of the nation report*, 2 November 2016
- Nuffield Trust, *Feeling the Crunch: NHS Finances to 2020*, August 2017

Whilst stakeholders have welcomed the additional adult social care funding announced by the Government, they contend that the funding is insufficient to address the scale of the pressures facing the care system.

88 IFS, *IFS Green Budget 2017*, February 2017, Section 5: UK health and social care spending

89 Department for Communities and Local Government, *Dedicated adult social care funding forms key part of continued long-term funding certainty for councils*, Press Release, 15 December 2016

6.3 School spending in England

At the time of the 2015 General Election the Government committed to increase the core schools budget in line with rising pupil numbers over this Parliament, but no more. In other words spending per pupil would be maintained or frozen, but not increased in cash terms. This was confirmed in the Spending Review 2015 which stated that the (total) schools budget would be protected in real terms. This could happen despite the freeze in cash spending per pupil because of rising pupil numbers. The schools budget is expected to increase from £39.6 billion in 2015-16 to £42.6 billion in 2019-20; a 7.7% increase, just higher than expected economy-wide inflation. Capital spending is planned to be £23 billion over the Parliament to help fund 600,000 new places and 500 new free schools to address rising pupil numbers.

Additional funding was announced in Budget 2016 to accelerate the transition to a new National Funding Formula and to fund the Government's expectation that all schools would become academies, or be on the path to becoming one, by 2020. This totalled £640 million over the Parliament for the UK as a whole. Autumn Statement 2016 announced £60 million of additional capital funding each year to 2020-21 to support the expansion of grammar schools.

Funding per pupil and cost pressures

The ongoing freeze in core funding per pupil has led to an increased focus on the size of the real terms cuts to funding per pupil that could be expected over this Parliament. Economy-wide inflation is expected to be just under 8% over the lifetime of this Parliament, which implies a similar size cut to the overall level of funding per pupil in real terms if the schools-sector faces the same cost pressures. This is unlikely.

A National Audit Office report on school finances from the end of 2016 used Department for Education (DfE) estimates to show that cost pressures facing schools would be 3.4% in 2016/17 rising to (a cumulative) 8.7% by 2019/20. School-specific costs include increases in contributions to pensions, National Insurance, and the Apprenticeship Levy, as well as staff pay. The NAO's calculations show a relatively small cash increase in spending per pupil over the Parliament, but an 8.0% cut in real funding per pupil by 2019/20. They conclude that, taking the cost pressures into account "Schools have not experienced this level of reduction in spending power since the mid-1990s."

The NAO's conclusion was supported by recent analysis of spending per pupil by the IFS. The NAO report said that the £3 billion savings that the DfE estimates schools would need to counteract cost pressures could be larger still with the financial impact of other policy changes. It added that the DfE had not clearly communicated to schools the scale and pace of savings needed and could not be assured that the savings will be achieved in practice.

Introducing a National Funding Formula

The focus on the size of the real terms cuts in pupil funding has been intensified by the planned introduction of a National Funding Formula

(NFF). More detail can be found in the Library briefing *School funding in England. Current system and proposals for 'fairer school funding'*.

Illustrative data was produced by the DfE at the end of 2016 which showed the impact of the NFF at a school level. This was aimed at informing the NFF consultation. As with any such change there are expected to be winners as well as losers. Even with limits to these and a transitional period while the NFF is introduced it will mean that some schools will face cash cuts in funding per pupil towards the end of this Parliament if the timetable for its introduction is as planned. Cuts in real terms funding at these schools will be greater than the level implied by the cost pressure estimates alone. An additional £200 million has been allocated for 2018-19 and 2019-20 above the flat cash per pupil level, described by the DfE as "…allowing us to combine significant protections for those facing reductions and more rapid increases for those set to gain."[90]

[90] DfE, *Schools and high needs national funding formulae: Executive Summary*, December 2016, para 9

7. Welfare changes

In September 2016 Secretary of State Damian Green reaffirmed the Government's commitment to make "no new cuts" to social security and tax credits. However, this April will be a time of considerable change whether or not Chancellor Philip Hammond holds to this commitment at Spring Budget 2017.

A number of welfare changes are due to take affect from 6 April, many of which were announced at Summer Budget 2015 and are central to achieving the Government's planned welfare savings. These changes sit alongside changes recently implemented, such as the introduction of a new, reduced benefit cap, and ongoing reforms, such as the roll out of Universal Credit.

7.1 Changes to take affect from April 2017

The following measures, mostly announced at Summer Budget 2015, will take affect from April 2017. Note that some measures will affect all benefit claimants while others will affect new claimants from April 2017 only.

Limit support to two children

Benefits: Child Tax Credits, Housing Benefit and Universal Credit

Measure: Limit support to two children (announced Summer Budget 2015)

In 2017-18 the child element within Child Tax Credits and Universal Credit is worth £2,780 per annum per child (not including the UC 'first child premium).

From: April 2017

Affecting: New claims and births from April 2017. Existing claimants will not be affected by this change.

DWP expected, in its July 2015 impact assessment, around 510,000 families to be affected by this measure in 2019-20. As of 2014-15 around 872,000 families with three or more children in the UK receive tax credits in respect of 3.01 million children.

Saving: Around £1.2 billion in 2019-20, rising to £1.59 billion in 2020-21 (note that savings will be greater in the long-run, as transitional protection is exhausted)

Library briefings: *Welfare Reform and Work Bill*

Remove the family element

Benefit: Child Tax Credits, Housing Benefit and Universal Credit

Measure: Remove the family element (announced Summer Budget 2015)

At present, families with children in receipt of Child Tax Credits receive a "family element" worth £545 per annum. UC claimants with children receive the same amount, referred to in UC as the "first child premium". From April 2017 all new claimants will not receive this element.

From: April 2017

Affecting: New claimants only. Existing claimants will not be affected by this measure.

DWP's July 2015 impact assessment estimated that around 970,000 families might be affected by this change in 2019-20.

Saving: Around £540 million in 2019-20, rising to £645 million in 2020-21 (note that savings will be greater in the long-run, as transitional protection is exhausted)

Library briefings: *Welfare Reform and Work Bill*

Abolish the ESA Work Related Activity Component

Benefit: Employment Support Allowance

Measure: Remove the Work Related Activity Component (announced Summer Budget 2015)

After having been assessed for Employment Support Allowance (ESA), successful claimants are placed either in the Work Related Activity Group (the WRAG) or Support Group. All ESA claimants receive a standard rate of £73.10 a week (equal to Jobseeker's Allowance (JSA)), plus either £29.05 a week for claimants in the WRAG or £36.55 (from April 2017) a week for claimants in the claimants in the Support Group. From April 2017 new ESA claimants placed in the WRAG will not receive this additional payment of £29.05; therefore, new ESA WRAG claimants will receive £73.10 a week, the same as JSA claimants.

From: April 2017

Affecting: New claimants only. Existing claimants will not be affected by this measure

As of August 2016 there were 428,800 claimants in the ESA Work Related Activity Group.

Saving: Around £345 million in 2019-20, rising to £450 million in 2020-21

Library briefings: *Abolition of the ESA Work Related Activity Component*

Reduce the Universal Credit taper rate (increased spending)

Benefit: Universal Credit

Measure: Reduce UC taper rate from 65% to 63% (announced Autumn Statement 2016)

The UC taper rate is the rate at which awards are reduced ("tapered away") once a claimant is earning in excess of their work allowance (see above). The UC taper rate will be reduced from 65% to 63% for all claimants from April 2017. This means that from April a claimant's UC award will be reduced by 63p for every £1 of net earning in excess of their work allowance, as opposed to by 65p for every £1.

From: April 2017

Affecting: Almost all in-work UC claimants.

Costing: Around £400 million in 2019-20, rising to £570 million in 2020-21

Library briefings: *Universal Credit: jam tomorrow?*

Withdraw entitlement to Housing Benefit from some 18-21 year olds

Benefit: Housing Benefit

Measure: End automatic entitlement of some 18-21 year olds

Entitlement to some young people aged 18 to 21 years old to Housing Benefit will be removed from April 2017. A related Budget *announcement set out plans to introduce a Youth Obligation for 18 to 21 year olds on Universal Credit from April 2017. Young people will be expected to participate in an "intensive regime of support from day 1 of their benefit claim, and after 6 months they will be expected to apply for an apprenticeship or traineeship, gain work-based skills, or go on a mandatory work placement."*

From: April 2017

Affecting: Some 18-21 year old Housing Benefit claimants
Certain categories of young people will be exempt from the removal of Housing Benefit, including vulnerable young people; those who may not be able to return home to live with their parents; parents; and those who have been in work for 6 months prior to making a claim.

Costing: Around £40 million in 2019-20

Library briefings: *Housing Benefit: withdrawing entitlement from 18-21 year olds*

Reverse changes to the eligibility criteria for Personal Independence Payment (from March)

Benefit: Personal Independence Payment

Measure: *Personal Independence Payment (PIP) is replacing Disability Living Allowance (DLA) for people of working age. On 23 February 2017, DWP laid before Parliament regulations to amend the PIP eligibility criteria from 16 March to "clarify the drafting and reverse the effect" of two recent Upper Tribunal judgments, which had interpreted the Schedule setting out the assessment criteria "in ways which the Government did not intend." The first judgment relates to the PIP daily living activity 3 ("managing therapy or monitoring a health condition"); while the second judgment relates to mobility activity 1 ("planning and following journeys"), specifically the assessment scores for those unable to undertake journeys due to psychological distress.*

From: 16 March 2017

Affecting: DWP's Equality Analysis estimates that around 3,000 claimants could ultimately be affected by reversing the effect of the judgment relating to daily living activity 3, while reversing the effect of the mobility activity 1 judgment could affect 336,500 claimants (with 161,500 no longer entitled to any mobility component)
The latter changes could affect people with a wide range of conditions including learning disability, autism, schizophrenia, anxiety conditions, social phobias and early dementia.

Costing: The Government states that failure to reverse the effect of the Upper Tribunal judgments would have led to "substantial unplanned increases to public expenditure" totalling £3.7 billion cumulatively between 2016-17 and 2021-22, and that the changes are necessary "to restore the original aim of [PIP], making sure that we are giving support to those who need it most."

Introduce Bereavement Support Payment

Benefits: Bereavement Support Payment (replacing Bereavement Payment, Bereavement Allowance and Widowed Parent's Allowance)

Measure: Bereavement Support Payment is to replace the existing bereavement benefits (the Bereavement Payment, Bereavement Allowance, and Widowed Parent's Allowance) for surviving spouses and civil partners widowed on or after 6 April 2017

From: April 2017

Affecting: Surviving spouses and civil partners widowed on or after 6 April 2017; existing claimants will not be affected

Costing: DWP expects that the impact on the public sector of Bereavement Support Payment will be an additional cost to the Department of approximately £45 million across the first two years of the reform. In the longer run however, when the benefit reaches steady state", savings of around £100 million a year are expected

Library briefings: *Bereavement Support Payment*

7.2 Changes recently implemented

Implementation of the following two changes – cuts to Universal Credit work allowances and implementation of a new, reduced benefit cap – began in 2016 and will continue to affect claimants this year.

Cut Universal Credit work allowances

Benefit: Universal Credit

Measure: Work allowances cut (announced Summer Budget 2015)
The Universal Credit (UC) work allowance is the amount of money an individual or family can earn before their maximum UC award starts to be reduced ("tapered away"). This level varies according to household circumstances (e.g. whether the household includes children) and whether the household is claiming support for housing costs.

From: April 2016

Affecting: Almost all in-work UC claimants
As of January 2017 there were around 170,000 in-work UC claimants in Great Britain, though this number is projected to rise as the roll out of UC continues.

Saving: Around £2.85 billion in 2019-20, rising to £3.19 billion in 2020-21 (savings published in table 2.2 Budget 2016)

Library briefing: *Universal Credit changes from April 2016*

Reduce the household benefit cap

Benefit: Household benefit cap

Measure: Benefit cap lowered (announced Summer Budget 2015)
The original benefit cap was rolled out from September 2013 at £350 per week for single claimants and £500 per week for families. In November 2016 the benefit cap was lowered to £300 per week for single claimants and £440 per week for families living in London and £260 per week for single claimants and £380 per week for families living elsewhere in Great Britain.

From: November 2016

Affecting: around 88,000 households
This estimate from DWP includes around 64,000 newly affected households together with those already affected by the existing, higher cap.

Saving: Around £305 million in 2019-20

Library briefings: *Benefit Cap* and *Reducing the benefit cap: potential impact*

7.3 Ongoing changes

The following changes, including wider reforms such as the roll out of Universal Credit and Personal Independence Payment, will continue this year.

Freeze most working age benefits

Benefits: Most working age benefits, including Child and Working Tax Credits, Child Benefit, Housing Benefit, Universal Credit and Jobseeker's Allowance

Measure: Freeze the value of most working age benefits at their 2015-16 value for four years, 2016-17 to 2019-20

Each year DWP and HMRC review the value of many benefits and tax credits to decide whether they are in need of 'uprating'. Over the long-term, this benefit 'uprating' ensures the 'real value' (that is, the 'purchasing power') of benefits keeps pace with inflation and/or increases in average earnings. Summer Budget 2015 announced that the most working-age benefits and tax credits would be 'frozen' (i.e. not uprated) at their 2015-16 values for four years, from 2016-17 to 2019-20.

From: April 2016

Affecting: Working age benefit claimants

Saving: Around £3.47 billion in 2019-20 and £3.58 billion in 2020-21.

Library briefings: *2017 Benefits Uprating* and *Welfare Reform and Work Bill*

Increase women's State Pension Age

Benefit: State Pension

Measure: Increase women's State Pension Age from 60 in April 2010 to equalise with men's State Pension Age at 65 in November 2018

From: April 2010

Affecting: Women born between 6 April 1950 and 5 December 1953

Subsequent increases to women and men's equalised State Pension Age will affect further cohorts of women born after 1953

Saving: The accelerated timetable for increasing women's (and later men's) State Pension Age legislated for by the Pensions Act 2011 is expected to save around £30.6 billion across a ten year period

Library briefings: *Increases in the State Pension age for women born in the 1950s*

Roll out Universal Credit

Benefits: Child and Working Tax Credits, Housing Benefit, Employment Support Allowance (income-related), Jobseeker's Allowance (income-related), Income Support

Measure: Universal Credit will replace the range of means-tested benefits and tax credits listed above

DWP is continuing the roll out of its new benefit, Universal Credit, to claimants across the UK. At present UC is available from all Jobcentre Plus offices in Great Britain; however, UC is not yet available to all claimants. "Gateway conditions" remain in place in most UC "Live Service" areas, meaning only certain claimants meeting select criteria can currently start a claim on UC. The UC "Full Service", destined to become the final version of UC operating in all areas for all claimants, is currently due to be rolled out to all Jobcentres by September 2018. Roll *out to pilot areas began in 2016 in Sutton, Croydon and Southwark; the DWP's Transition to Full Service publications provide further details.*

From: 2013 to around 2022

Affecting: Working age benefit claimants

Library briefings: *Universal Credit changes from April 2016*

Roll out Personal Independence Payment

Benefits: Disability Living Allowance and Personal Independence Payment

Measure: Roll out Personal Independence Payment and reassess working age Disability Living Allowance claimants for PIP
Personal Independence Payment was launched in April 2013 and is replacing Disability Living Allowance for people of working age. Reassessments for Disability Living Allowance claimants being moved onto PIP are continuing through 2017. The DWP publication DLA to PIP reassessments outcomes, October 2016 provides further details. Also see the OBR's Economic and Fiscal Outlook March 2016, pages 147 – 150.

From: 2013

Affecting: Claimants of disability benefits

Appendix 1: Sources of further information

Library's Brexit briefings

The Library has produced a range of briefings. The briefings, and other relevant parliamentary material, are pulled together in parliament's Brexit hub.

Section 6 of Productivity in the UK looks at the channels through which Brexit can affect future productivity – and growth – prospects.

HM Treasury

Autumn Statement 2016

Budget 2016

Autumn Statement and Spending Review 2015

Summer Budget 2015

Office for Budget Responsibility

Economic and fiscal outlook, November 2016

Economic and fiscal outlook, March 2016

Monthly commentary on the public finances

Public finances databank

Institute for Fiscal Studies

Green Budget 2017

Post-Autumn Statement 2016 Briefing

Post-Budget Briefing 2016

Post-Spending Review and Autumn Statement Briefing 2015

Green Budget 2016

Commentary on the January 2017 public finances

House of Commons Library

Economic indicators (an edition will be published on 7 March 2017)

House of Lords Library

2016 Budget: Overview and Reactions

House of Commons Treasury Select Committee

Inquiry into Autumn Statement 2016

Inquiry into Budget 2016

Inquiry into Spending Review and Autumn Statement 2015

Inquiry into Summer Budget 2015

Appendix 2: Economic and public finance data 1979-2021

Economic data, 1979-2021

	Real GDP growth %	Inflation RPI %	Inflation CPI %	ILO Unemployment Q4, %
1979	3.7%	13.4%	..	5.5%
1980	-2.0%	18.0%	..	8.0%
1981	-0.8%	11.9%	..	10.2%
1982	2.0%	8.6%	..	11.1%
1983	4.2%	4.6%	..	11.7%
1984	2.3%	5.0%	..	11.6%
1985	4.2%	6.1%	..	11.3%
1986	3.2%	3.4%	..	11.3%
1987	5.4%	4.2%	..	9.7%
1988	5.8%	4.9%	..	8.0%
1989	2.6%	7.8%	5.2%	7.0%
1990	0.7%	9.5%	7.0%	7.5%
1991	-1.1%	5.9%	7.5%	9.5%
1992	0.4%	3.7%	4.3%	10.4%
1993	2.5%	1.6%	2.5%	10.3%
1994	3.9%	2.4%	2.0%	9.0%
1995	2.5%	3.5%	2.6%	8.3%
1996	2.5%	2.4%	2.5%	7.8%
1997	3.1%	3.1%	1.8%	6.5%
1998	3.2%	3.4%	1.6%	6.1%
1999	3.3%	1.5%	1.3%	5.8%
2000	3.7%	3.0%	0.8%	5.2%
2001	2.7%	1.8%	1.2%	5.2%
2002	2.4%	1.7%	1.3%	5.1%
2003	3.5%	2.9%	1.4%	4.9%
2004	2.5%	3.0%	1.3%	4.7%
2005	3.0%	2.8%	2.1%	5.1%
2006	2.5%	3.2%	2.3%	5.5%
2007	2.6%	4.3%	2.3%	5.2%
2008	-0.6%	4.0%	3.6%	6.4%
2009	-4.3%	-0.5%	2.2%	7.8%
2010	1.9%	4.6%	3.3%	7.9%
2011	1.5%	5.2%	4.5%	8.4%
2012	1.3%	3.2%	2.8%	7.8%
2013	1.9%	3.0%	2.6%	7.2%
2014	3.1%	2.4%	1.5%	5.7%
2015	2.2%	1.0%	0.0%	5.1%
2016	1.8%	1.8%	0.7%	4.8%
2017	1.4%	3.2%	2.3%	5.3%
2018	1.7%	3.5%	2.5%	5.5%
2019	2.1%	3.2%	2.1%	5.4%
2020	2.1%	3.1%	2.0%	5.4%
2021	2.0%	3.2%	2.0%	5.4%

Sources: ONS (series, IHYP, CZBH, D7G7, MGSX)
OBR, Economic and fiscal outlook, November 2016, Table 3.7, and Economy Supplementary Tables 1.6 & 1.7

Public finance data 1979/80 to 2021/22

	Public sector net borrowing		Structural deficit		Public sector net debt	
	£ billion	% GDP	£ billion	% GDP	£ billion	% GDP
1979/80	8.5	3.7%	9.1	4.0%	98.2	45.0%
1980/81	11.5	4.3%	7.7	2.9%	113.8	45.6%
1981/82	6.0	2.0%	-0.3	-0.1%	125.2	45.3%
1982/83	8.5	2.6%	2.1	0.6%	132.5	43.9%
1983/84	11.8	3.3%	7.2	2.0%	143.6	43.6%
1984/85	12.5	3.3%	10.7	2.8%	157.0	44.3%
1985/86	9.0	2.1%	9.0	2.1%	162.5	41.7%
1986/87	8.4	1.9%	9.1	2.0%	167.8	40.1%
1987/88	4.7	0.9%	10.6	2.1%	167.4	35.6%
1988/89	-6.0	-1.1%	5.8	1.0%	153.7	29.3%
1989/90	-0.6	-0.1%	7.9	1.3%	151.9	26.2%
1990/91	6.2	0.9%	4.7	0.7%	151.1	24.2%
1991/92	23.0	3.3%	13.2	1.9%	165.8	25.2%
1992/93	47.1	6.5%	35.2	4.8%	201.9	29.0%
1993/94	51.6	6.7%	41.9	5.4%	249.8	33.9%
1994/95	43.8	5.4%	37.4	4.6%	290.0	37.5%
1995/96	35.3	4.2%	24.6	2.9%	322.1	39.2%
1996/97	27.7	3.1%	24.0	2.7%	347.0	37.3%
1997/98	5.9	0.6%	17.0	1.8%	358.6	37.1%
1998/99	-4.4	-0.4%	9.4	0.9%	357.8	35.3%
1999/00	-14.4	-1.4%	0.4	0.0%	349.3	32.7%
2000/01	-19.9	-1.8%	-4.4	-0.4%	316.7	28.5%
2001/02	0.0	0.0%	8.0	0.7%	323.1	27.9%
2002/03	26.1	2.2%	27.1	2.3%	356.2	29.1%
2003/04	29.2	2.3%	35.6	2.8%	391.0	30.3%
2004/05	39.1	3.0%	51.8	3.9%	446.5	32.9%
2005/06	37.4	2.7%	48.5	3.5%	487.2	33.9%
2006/07	35.1	2.4%	44.3	3.0%	523.6	34.6%
2007/08	40.4	2.6%	57.5	3.7%	557.2	35.5%
2008/09	110.7	7.2%	102.7	6.6%	767.1	50.4%
2009/10	151.6	9.9%	123.0	8.0%	1,010.6	64.8%
2010/11	136.3	8.6%	104.4	6.6%	1,156.0	71.6%
2011/12	115.9	7.1%	84.7	5.2%	1,251.4	75.4%
2012/13	122.1	7.2%	89.6	5.3%	1,362.7	79.1%
2013/14	102.6	5.8%	76.7	4.4%	1,465.6	81.2%
2014/15	94.8	5.2%	83.4	4.5%	1,554.0	83.6%
2015/16	71.7	3.8%	70.9	3.8%	1,605.9	83.7%
2016/17	68.2	3.5%	64.9	3.3%	1,724.8	87.3%
2017/18	59.0	2.9%	51.4	2.6%	1,839.9	90.2%
2018/19	46.5	2.2%	37.9	1.8%	1,904.0	89.7%
2019/20	21.9	1.0%	16.6	0.8%	1,945.2	88.0%
2020/21	20.7	0.9%	18.5	0.8%	1,950.2	84.8%
2021/22	17.2	0.7%	16.7	0.7%	1,951.7	81.6%

Source: OBR, ONS

Note: figures exclude public sector banks

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