Centre for Policy Studies

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Economic Bulletin

BUDGET 2017: THE CPS VERDICT

- **The Budget was dominated by the OBR's slashing of productivity forecasts, which wiped 3 percentage points off predicted economic growth over the next five years.**
- **As a result, Britain will borrow more and is further away from achieving a budget surplus.**
- **Given these constraints, the Chancellor could have done a lot worse. In particular, the changes to Universal Credit were necessary, and the help on business rates and freezing of the VAT threshold will help firms of all sizes.**
- **Measures on housing were deeply disappointing, however. No concrete steps on planning were announced, and abolishing stamp duty for first-time buyers could actually make things worse.**
- **Hammond should be commended for not going on a spending splurge – but this Budget will do little to solve the UK's productivity woes.**

1. THE OVERALL OUTLOOK

The big story of the Autumn Budget 2017 is the major change made to the UK's productivity forecasts. Since the financial crisis, forecasters have projected that productivity growth will eventually return to pre-crisis levels. This has not materialised, with productivity levels effectively flatlining since 2011.

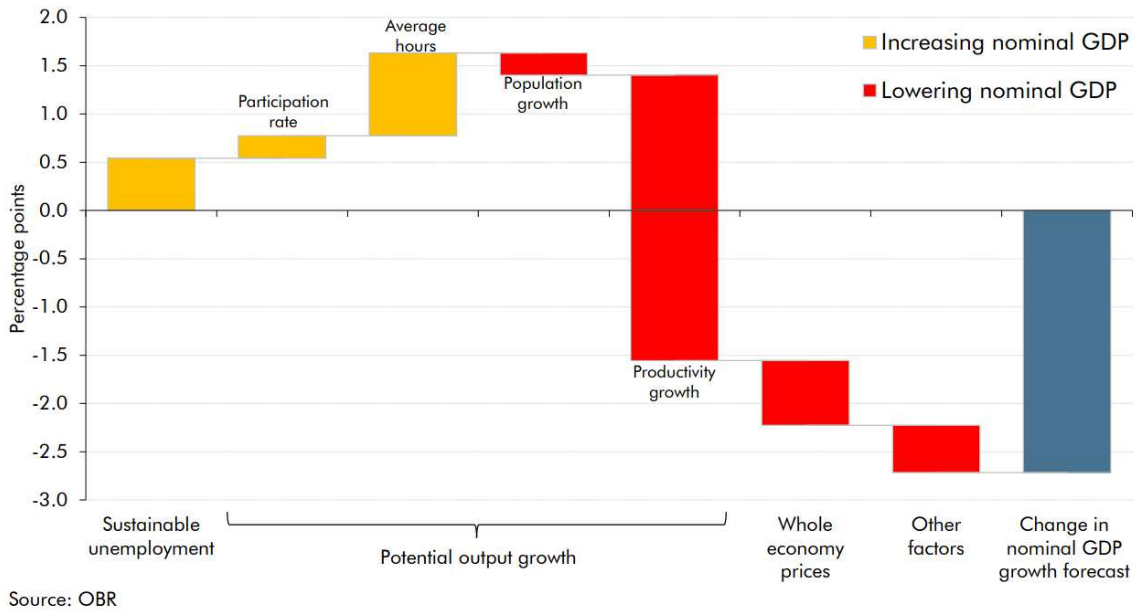
In recognition of this, the Office for Budget Responsibility (OBR) has dramatically slashed the UK's output-per-capita forecasts over the next five years. In 2019, for example, the OBR has revised productivity growth down by 0.7 percentage points compared to its forecast in March 2017 (see Table 1). There will be a large knock-on impact on the public finances, as overall levels of economic activity will be hampered. The OBR predicts the new productivity forecasts will result in 3 percentage points of GDP growth being wiped out over the next five years (see Figure 1).

Table 1: Changes to productivity growth forecasts

	MARCH 2017 OBR FORECAST (%)	CURRENT FORECAST (%)
2017	1.6	0
2018	1.5	0.9
2019	1.7	1
2020	1.8	1.2
2021	1.9	1.3

Source: March and November 2017 Economic and Fiscal Outlooks

Figure 1: Sources of revision to nominal GDP growth from 2017-18 to 2021-22



Source: November 2017 Economic and Fiscal Outlook

The UK economy is now predicted to be some £65 billion smaller by 2020 than was projected in March of this year. Accordingly, the UK's net borrowing projections have seen an improvement in the immediate term but a significant decline in the years towards the end of the parliament.

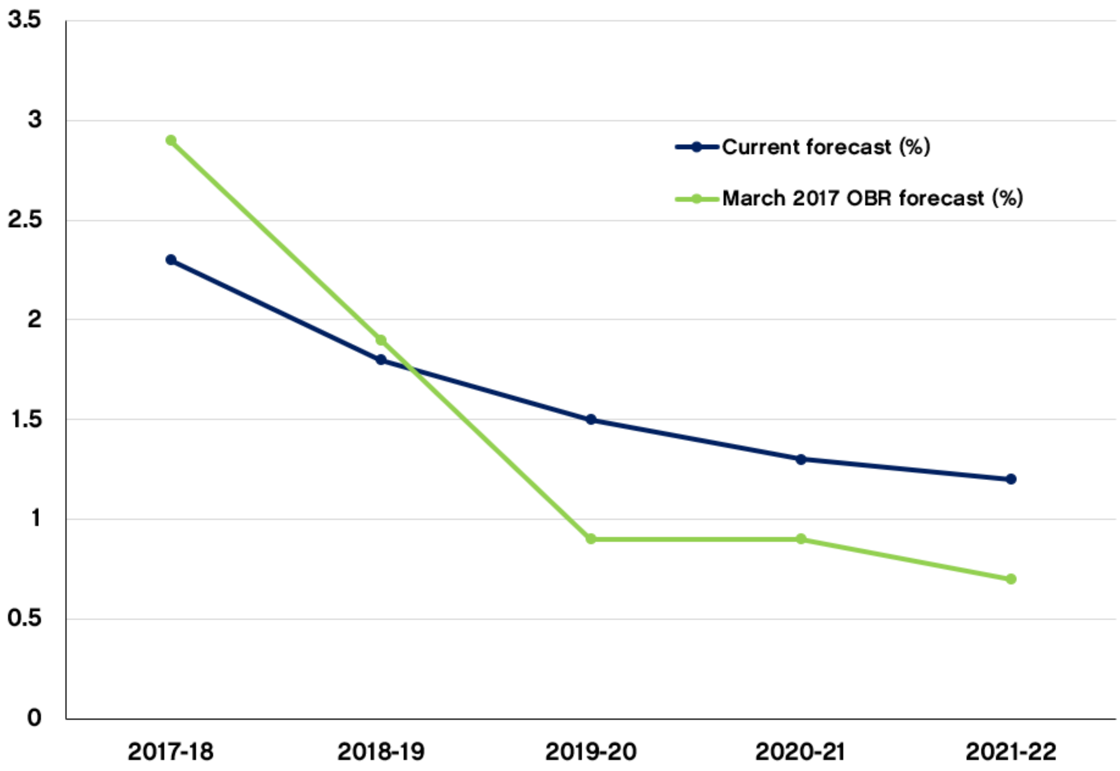
In the 2016 Budget, it was predicted that the public finances would record a £10.1 billion surplus by 2019-20. Now, that is expected to be a deficit of £34.7 billion. And by 2021-22, structural borrowing (that which cannot be removed through economic growth) is projected to be 1.2% of GDP, up from the 0.7% of GDP predicted in March this year (see Figure 2).

The Chancellor is still on course to meet his fiscal rule of having structural borrowing below 2% of GDP by the end of the parliament. It does, however, mean that Britain is further away from achieving a budget surplus – something which last occurred in 2000-1.

Another factor that will contribute to higher borrowing is the tax and spending decisions made by Philip Hammond yesterday. Over the forecast period, it is estimated that these will add around £22.5bn to the UK's debt pile. The largest impact will be in 2019-20, when the Budget measures will add nearly £10bn to the deficit (see Table 2).

It is notable, however, that the tax and spending changes are small in macroeconomic terms. The decline in Britain's borrowing projections have largely been down to the changes in underlying forecasts (see Figure 3) – the biggest factor being the slashing of productivity growth estimates.

Figure 2: Projections for the UK's Structural Budget Deficit



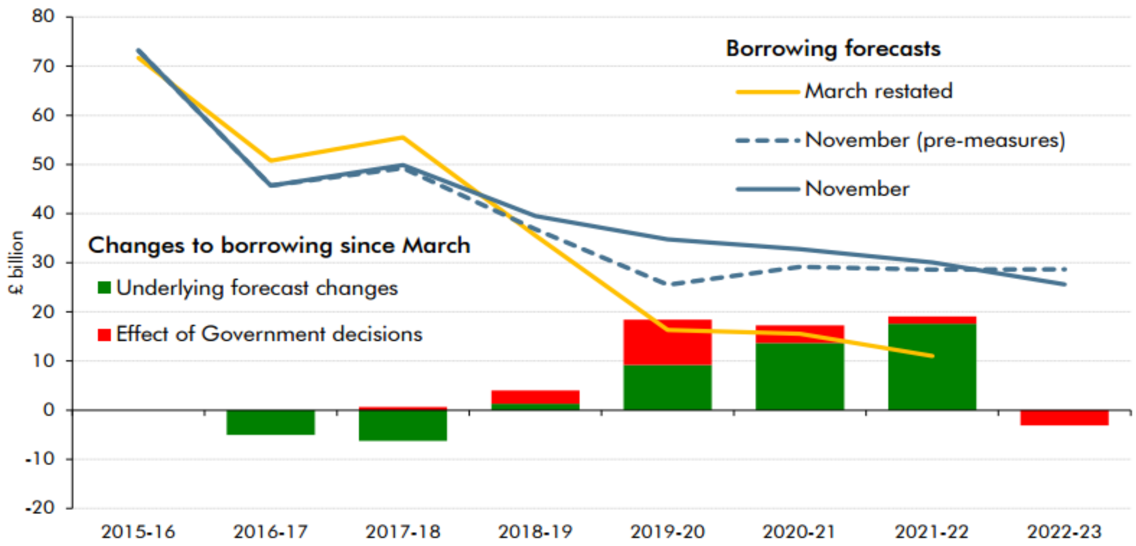
Source: March and November 2017 Economic and Fiscal Outlooks

Table 2: Fiscal Impact of tax and spending decisions

	2017-18	2018-19	2019-20	2020-21	2021-22
Total policy decisions	£-230m	£-6,045m	£-9,915m	-£3,315m	-£2,960m

Source: Autumn Budget 2017

Figure 3: Changes to Public Sector Net Borrowing [Underlying forecasts and government decisions]



Source: Economic and Fiscal Outlook November 2017

2. THE KEY BUDGET DECISIONS

a) Where Philip Hammond got it right

There were a number of potential political problems that could have arisen from this Budget. The Chancellor seems to have taken the relevant steps to avoid a repeat of the unravelling that was observed as his last Budget.

On the NHS, he has allocated a significant amount of new cash – nearly £3.4bn in additional resource spending and £4.2bn in capital spending over the next six years. Given the growing pressures arising from new treatments, an ageing population and growing demands for a loosening of constraints on staff salaries, this was a necessary move.

Changes to the administration of the Universal Credit system were also essential. If anything, this could have been done sooner to offer re-assurance to those in receipt of Universal Credit, given that the fiscal costs are marginal. For example, removing the seven-day wait and extending advances will only cost £170m next year. But the Chancellor's decision to fix the problems with the programme was admirable and right, as was his stirring defence of its core principles.

The Chancellor also dodged a bullet by the leaving the threshold for VAT registration for firms at £85,000. He stated in his Budget speech that this threshold is comparatively high compared to our competitors – but this is not a good reason to make the threshold less generous. Had he sought to do this, it would have damaged the UK's competitive business environment at a time of wider economic uncertainty, not to mention incurring the ire of thousands of small business owners.

b) Missed opportunity on housing

The Chancellor's target of constructing 300,000 homes a year is commendable. But the measures set out in this Budget are unlikely to lead to this. He has ruled out any changes to green belt boundaries, and there were no concrete announcements on the UK's planning system, which is a major impediment to house-building across the country.

Furthermore, other measures may actually make house affordability worse. For example, the OBR expects the stamp duty exemption for first-time buyers to increase house prices by 0.3%. That means that the main gainers from the policy will be people who already own property, rather than first-time buyers themselves.

c) Where's the productivity boost?

The Chancellor lauded the potential benefits of the Fourth Industrial Revolution at this Budget, claiming that the Government "chooses to run towards change, not away from it". As stated in the CPS's report "Why Britain needs more robots", the UK economy suffers from undercapitalisation that is partly responsible for Britain's lagging productivity. Hammond appears to appreciate that mechanisation can help solve this problem, announcing targeted assistance to that end. Equally important is to ensure that workers can benefit from new technologies, making the announcement of a national re-training scheme particularly welcome.

However, there did not appear to be much else announced that will boost productivity. Yes, bringing forward the decision to link business rates to CPI rather than RPI will alleviate some costs for many SMEs, allowing them to plough additional cash into investment. And there were some positive announcements on skills training. But there was little to spur on the housing market, no progress on infrastructure policy (in particular, Heathrow expansion is still very uncertain) and no movement on the annual investment allowance. Considering the many options for improving productivity outlined by the Centre for Policy Studies recently, this was a big missed opportunity to tackle the crisis.

3. CONCLUSION

The headline story from this Budget was the downgrading of productivity forecasts – a minute-long section of Philip Hammond's speech that will add as much to the deficit as the rest of it put together.

The policy decisions made at this Budget will also put further strain on the public finances, adding around another £22.5bn of debt over this parliament. But in macroeconomic terms this is relatively small – so the Chancellor should be commended for resisting the temptation to engage in a spending splurge.

Of course, within the constraints imposed by the productivity and GDP downgrade, the Chancellor did many things right – although there were arguably too many minor, interventionist initiatives. But the U-turn on Universal Credit was necessary and welcome, there was a cash boost for the NHS, and firms will benefit from the more generous offer on business rates. He also avoided some expected bear traps, such as punishing white van men by lowering the VAT threshold.

While the Chancellor has remained relatively prudent, it is disappointing that most of his promises will be funded by increasing the deficit. However, the real disappointment came on housing. Yes, a review of urban planning was promised. But abolishing stamp duty for first-time buyers will do little to help – and may even increase prices – without much more sweeping reform of our broken planning system, including tackling the sacred status of the green belt.

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