National Institute of Economic and Social Research

NIESR's Response to the Autumn Statement

17 November 2022

UKRI Economic and Social Research Council

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Main Points

- The Chancellor should have provided more support to UK households at a time when they are suffering the largest fall in their real incomes since records began in 1956. Given that fiscal targets are arbitrary, these could have been set to enable the Chancellor to bring forward more spending while still committing to sustainable public finances in the medium run.
- The Chancellor has tightened fiscal policy by around £60 billion over five years and also delayed meeting the fiscal target of a falling debt to GDP ratio by 2 years, giving him more flexibility to hit his fiscal targets. In a bid to ensure debt is on a sustainable trajectory within the new 5-year fiscal target, the Chancellor has announced a cumulative £30 billion in tax rises and £30 billion in spending cuts. Against a background of persistent higher interest rates, the cost of servicing government debt remains high, which leaves the UK's public finances vulnerable to economic uncertainty.
- The UK has gone from £48 billion in tax cuts announced in September to raising taxes for all working people over the next few years. This, in combination with an expanded windfall tax on profits made by energy companies, presents significant uncertainty to businesses and households.
- Maintaining previous spending commitments for public infrastructure projects and providing increased expenditure for key social institutions is appreciated, but the Chancellor should have gone further to prevent systematic vulnerability and encourage sustainable growth, especially beyond the immediate horizon of the next 2 years.
- The switch to more targeted support for energy bills is a step in the right direction, but the overall rise in energy prices and a lack of support for low-income households will mean that many are worse off. The government's policy still involves an expensive universal subsidy which will disproportionately benefit high-income earners, as they use a much greater amount of energy.
- The increases in the living wage along with Universal Credit and pensions rising with inflation, presents a positive direction of travel for the households hardest hit by inflation. However, tax rises, the further increases in energy bills for those not on Universal Credit and wages not keeping up with inflation, will mean households are likely still far worse off than they were last year.

Background

“The Chancellor’s decision to ask the OBR to provide an analysis of the measures contained in the Autumn Statement and of the fiscal position more generally is very welcome as it will provide credibility to the government’s plans. However, the emphasis should not be on hitting arbitrary fiscal targets, especially while households are locked in the middle of a cost-of-living crisis and the economy is tottering on the edge of a recession. What is needed is a fiscal plan, coordinated under OBR scrutiny to ensure credibility and economic soundness, that could help fuel economic growth and limit further reductions in UK households’ standard of living.”

— Prof Stephen Millard (Deputy Director, Macroeconomics)

Today’s Autumn Statement was made against a background of high inflation and falling GDP. Rising inflation and interest rates over the course of 2022 had led to a marked worsening in the overall fiscal position as the Office for Budget Responsibility (OBR) forecast for government interest payments in 2022-23 rose from £83 billion to £120.4 billion. But the position was made worse by a string of policy announcements – and the uncertainty created by them – across five major fiscal policy events up to and including the Autumn Statement.

Back in May the then Chancellor Rishi Sunak’s announcement of support for households to pay their energy bills and the Energy Price Guarantee (EPG) announced in early September acted to increase government spending by £86.4 billion over two years. The ‘growth plan’ announced in the former Chancellor Kwasi Kwarteng’s mini-budget on 23 September added a further £48.2 billion to the government deficit in 2027-28. But the announcements on 3 and 17 October by the new Chancellor Jeremy Hunt cancelled all of this except for £21.1 billion, most of which reflects the decision to scrap the health and social care levy before it was introduced next April.

Against this background of a worsening fiscal position, the key questions for the Chancellor in today’s Autumn Statement were the extent to which fiscal policy should be tightened over the medium term and, for a given fiscal tightening, how much of this tightening should be carried out now versus in the future. Our view is very much that now was not the time for fiscal policy to tighten given the current economic situation of high inflation and falling real incomes and GDP. In that light, the increase in support for the economy in the near term announced today and the new targets – in particular setting the date for the public-sector debt to GDP ratio to be falling further into the future – are steps in the right direction.

That said, we would again stress our opposition to fiscal policy being run in order to hit what are, essentially, arbitrary fiscal targets. Rather, we would argue for a fiscal plan, coordinated under OBR scrutiny to ensure credibility and economic soundness, that could help fuel economic growth and limit further reductions in UK households’ standard of living. Indeed, NIESR have long argued for a new fiscal framework that seeks to provide certainty in a world where policy makers need to strike the right balance between flexibly responding to economic shocks, such as Covid and the war in Ukraine, and maintaining credibility so as not to face high risk premia on their debt.

Fiscal Space

"The series of unfortunate events that caused a turmoil in the financial markets and public finances has left the Chancellor rushing to unleash a fiscal contraction to fulfil arbitrary fiscal targets amidst the headwinds the economy is facing. Given the current economic climate of persistent high inflation and sluggish growth, the changes made to the fiscal targets are a step in the right direction as they enabled him to provide at least some support to households this year."

- Hailey Low (Associate Economist)

- The Chancellor announced a roughly £60 billion fiscal consolidation.
- He also announced two new fiscal targets: first, to have public-sector debt as a percentage of GDP falling in 5 years; second, to have public sector borrowing below 3% of GDP by the same point in time. This represents a 2-year extension of the previous 3-year target.
- The OBR now forecast borrowing in 2022-2023 to increase by £78 billion relative to their forecast in March, mainly driven by higher spending on servicing government debt and the EPG, with higher debt interest spending (£120.4 billion this year).
- The net cumulative effect of all the policies announced in the past six months coupled with the Autumn Statement is to add £40 billion to borrowing for 2022-2023 but take off £40 billion by 2027-2028.
- Public sector borrowing this year is expected to be 7.1% of GDP as compared to the previously forecasted 3.9%. However, public sector net debt is expected to rise to a 63-year high in 2025-2026 at 98 per cent of GDP before starting to fall in 2027–2028.
- The present persistent high inflation rate benefits public finances by reducing the real value of public-sector debt when we take into account the "inflation tax" as in this analysis. This inflation tax is omitted from the conventional budget deficit which makes the headline deficit misleading when inflation is as high as it currently is.
- Against the backdrop of several severe economic shocks and a looming recession, it is unwise to impose a large and drastic fiscal operation just to fulfil the government's arbitrary fiscal targets. It risks cornering the UK in an economic doom loop, worsening the imminent recession, and reducing growth.
- Fiscal sustainability will be achieved by a long-term plan to put the debt-to-GDP ratio on a downward path; a short-sighted fiscal package will delay the economic recovery that is needed to underpin fiscal sustainability.

Tax Changes

"Today, the Chancellor has announced an effective tax rise for all working people by freezing thresholds on personal incomes taxes. Given that the latest ONS data indicates that real wages fell by 2.6 per cent on the year, we had hoped the Chancellor would not implement this policy in the lower thresholds – as it will further squeeze budgets that are already at capacity due to the cost-of-living crisis. That being said, the lowering of the top rate of income tax threshold to £125,140 as well as decreases to the capital gains and dividend tax reliefs are suitable measures since affected households are in a much better place to cope with surging prices. While we appreciate the Chancellor's mention that his increases to windfall taxes are temporary, we wonder whether the extension of what was once a one-off policy will set an unhelpful precedent for future Chancellors looking to fill self-dug 'fiscal holes'."

- Paula Bejarano Carbo, (Associate Economist)

- The Chancellor's decision to freeze personal income tax thresholds for a further two years until 2028 is an effective tax rise for all working people. This decision will increase government tax receipts as more people are 'dragged' into higher thresholds or into paying tax for the first time due to wage inflation. Failing to raise the lower thresholds in line with inflation will cause serious strain to budgets that are already squeezed by the cost-of-living crisis.
- However, the lowering of the top rate of income tax threshold and decreases to the capital gains and dividend tax reliefs are suitable measures as affected households spend lower proportions of their income relative to lower deciles and are thus in a better place to cope with the surging costs of food, energy and housing.
- The windfall tax on energy companies' excess profits – originally a 25 per cent levy imposed by former Chancellor Sunak in May 2022 – has now been raised to 35 per cent and extended by three years until March 2028. Furthermore, there will be a 40 per cent tax on profits of certain electricity companies. This will raise £14 billion. While we appreciate that these companies are in a good position to pay this extra levy, we are concerned that the extension and amplification of this policy will generate business uncertainty and set an unhelpful precedent for future Chancellors.
- Small businesses will particularly feel some strain from today's decision to freeze the NICs Secondary Threshold and the VAT registration threshold. At the same time, banks will see their surcharge fall to 3 per cent from 8 per cent on profits above £100 million. Taken together, these decisions contrast somewhat with the Chancellor's note that all businesses will be paying their fair share. However, we think that increasing relief for retail, hospitality, and leisure is a good starting point for ensuring a sustainable post-Covid recovery for our services sectors – which make up 80 per cent of GDP.
- We question the decision to scrap the recent cut to stamp duty from March 2025 onwards, since this relief, together with forecast growth in the construction sector, could be effective in giving the housing market a needed boost and rendering it more accessible to first-time buyers. The timed end date of this policy might lead to speculation that the Chancellor is prioritising the curation of a short-term boom over sustained growth.

Spending Changes

“The Chancellor has announced several spending changes, retaining some of the government’s previous spending commitments and plans on infrastructure investment. Maintaining the levels of public investment in the short term is a step in the right direction, but public investment spending could and should be increased, especially in the long term, where the announced freeze translates into a cut in real terms.”

- Edmund Cornforth, (Associate Economist)

- Increased public-sector investment in the short term needs to be complemented by a long-term commitment; despite Total Public Sector Gross Investment rising to £135bn in 2023/24, this falls to £132bn from 2024-2028. Freezing it at this level represents a fall in public-sector investment in real terms and risks a long-term decline in public sector capital, again signalling short-term prosperity over sustained long-term growth.
- The government’s commitment to continuing key investment projects – with HS2, Sizewell C, and Northern Powerhouse Rail going ahead – will go some way to protecting the UK economy from systematic vulnerability and stagnation in its public capital, but we question whether the measures go far enough in building energy security and sustainable growth. In our UK Economic Outlook we recommended increasing capital investment, not just maintaining current levels.
- Keeping Overseas Aid at 0.5% for an indeterminate amount of time until the “fiscal situation allows” is a disappointing decision. NIESR research suggests that this has a negligible impact on the public finances and negatively effects the UK economy through a decline in exports. Foreign aid is one of the most efficient and productive uses of spending, with every £1 spent on aid delivering at least triple its value in aid recipient regions.
- The government has decided to invest an additional £3.3bn in the NHS in both 2023/24 and 2024/25, provide new grant funding of £1bn and £1.7bn for adult social care in 2023/24 and 2024/25 respectively, and increase the core schools budget by £2.3bn in both 2023/24 and 2024/25. This is appreciated and will help to maintain the capacity of our key social institutions, but NIESR again questions what will happen in the long term after this period; the NHS and the social care system cannot be fixed with a temporary funding boost and require a sustained investment to return us to adequate levels of service.

Energy Plan

"The Chancellor's switch to a more targeted approach is a good starting point, but those low-income households not on welfare will be left without sufficient support. Their incomes will not be able to keep up with another increase in their energy bills"

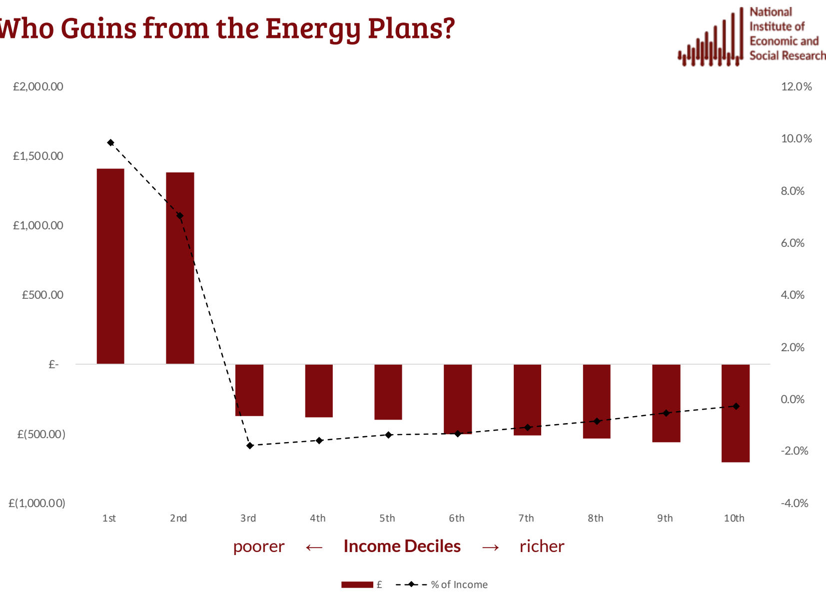
- Max Mosley (Economist)

"The announcement that the energy price guarantee will be extended beyond April 2023, with a rise in the cap and with more targeted support for low-income households, is a step in the right direction. However, there still exist more cost-efficient and equitable alternatives, which would also encourage overall lower energy usage – such as the variable price cap that NIESR has long been proposing."

- Kemar Whyte (Principal Economist)

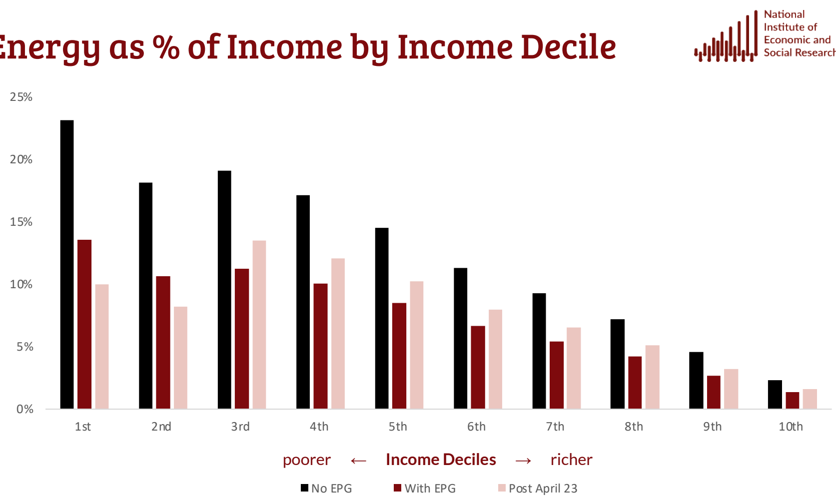
- The EPG has held energy prices at £2,500 for the typical household. We have previously called for this approach to be changed, which was initially due to expire in April 2023, because it provides a general subsidy that is fiscally expensive, fails to help poorest households enough and lacks incentives to save energy.
- The Chancellor today announced that the overall cap would rise to £3,000 for the typical household from April 2023, until it expires in March 2024. This will be supported by a further £900 Cost of Living payment to those on Universal Credit, £300 for pensioner households and £150 for those on disability benefits.
- Taking these together, this appears to provide sufficient support for those on Universal Credit, but little support to those low-income households not on means-tested benefits. The Chancellor did say that a further £1 billion will be provided via a new Household Support Fund to local authorities to help those who "fall through the cracks", however this will likely not be sufficient.
- It was evident that the policy in its current state was not sustainable in the long-term, but the announcements made today have done very little to change this. The Office for Budgetary Responsibility (OBR) estimates that the combined cost of the EPG and the energy bill relief scheme (EBRS) this year is £43.2 billion with the EPG set to costs a further £12.8 billion in 2023-24.
- Alternative measures, such as increases to the living wage, and uprating Universal Credit and pensions in line with inflation, will go some way to alleviating some of the fall in real incomes, but will likely not offset all of the drop.
- A Variable Price Cap – which would increase the cost of energy with usage – would have been a better approach as it is able to provide support for those on Universal Credit, and most other low-income households

- Chart 1 shows who gains and loses from the announced energy plan across the income distribution. As a result of the increase in the energy price cap, most income deciles lose out. The inclusion of the £900 cost of living payment to those on Universal Credit mean only the bottom two deciles benefit.



Notes: estimates include cost of the energy price cap rise, support measures for those on Universal Credit and household support fund

- Chart 2 shows the distribution of energy bills as a proportion of income, showing those on low incomes but not on Universal Credit (third to fifth income deciles) have higher bills than those on Universal Credit.



Notes: post-23 estimates include Universal Credit support measures

Implications for Levelling Up

"The sharp slowdown in growth and the largest squeeze on living standards in a generation will hit hardest the most vulnerable households that are concentrated in some of the most deprived areas of the country, especially the three devolved nations and the North East. Disparities will deepen while low growth and low productivity trap most of the country in a vicious circle of low investment, low wage and low skill. Sustained regional regeneration requires targeted investment and above all local design and delivery of policies on skills, housing, transport and R&D underpinned by devolved decision making and fiscal powers".

- Prof Adrian Pabst, Deputy Director for Social and Political Economy

- On Levelling Up, the Chancellor announced two decisions. First, a second round of the Levelling Up Fund will allocate at least £1.7 billion to a number of "priority local infrastructure projects", with bids agreed by the end of 2022.
- Second, devolution deals for mayors in Suffolk, Cornwall, Norfolk and an area in the north east as well as 'trailblazer' devolution deals with Greater Manchester and the West Midlands Combined Authorities with potentially decentralising powers in areas such as skills, housing and transport. In addition, funding for the three devolved nations based on the Barnett formula will amount to £1.5 billion for Scotland, £1.2 billion for Wales and £650 million for Northern Ireland.
- While both announcements mean that capital spending for Levelling Up projects is not being cut, the fundamental problems with the government's Levelling Up strategy endure – fragmented funding, local authorities spending inordinate time and precious resources on competing with one another for small pots of money, and a lack of decision-making powers and fiscal firepower.
- Sustained regional regeneration requires devolving powers in areas such as skills, housing, transport and R&D, underpinned by greater local control over tax and spending decisions, all of which needs a sound evidence base in order to simulate the impact of policy interventions.