Autumn Budget 2017

Briefing from Prospect • @MartinProspect www.prospect.org.uk

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Autumn Budget 2017 – initial summary

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Introduction

This second Budget of 2017 is the first of what is intended to be a new sequence of annual Autumn Budgets, interspersed with spring "statements" on the state of the economy and public finances with fewer new policy measures.[1] This briefing focuses on issues that may be of particular interest to Prospect members.

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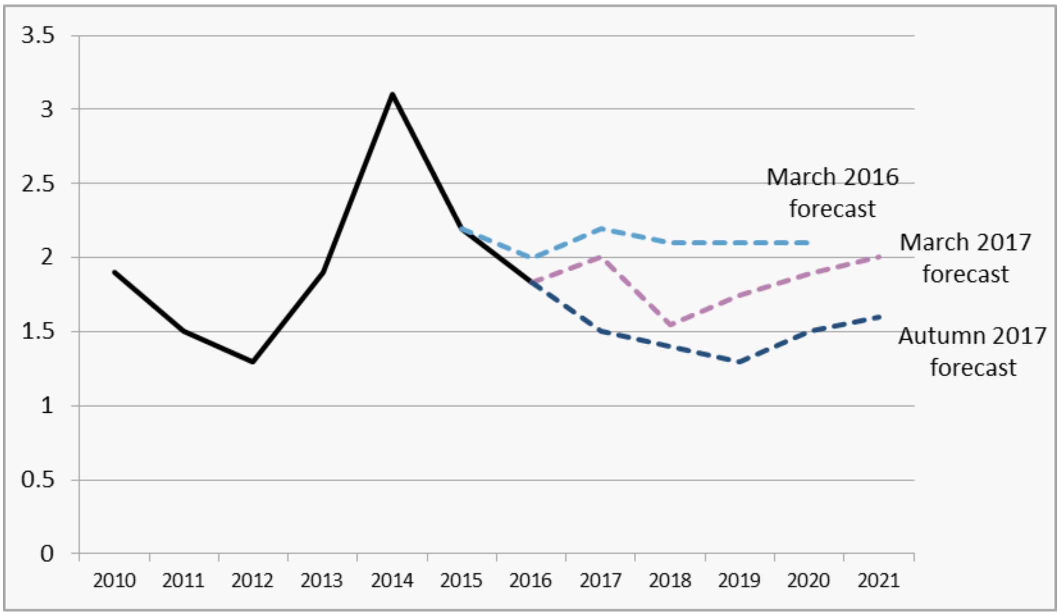
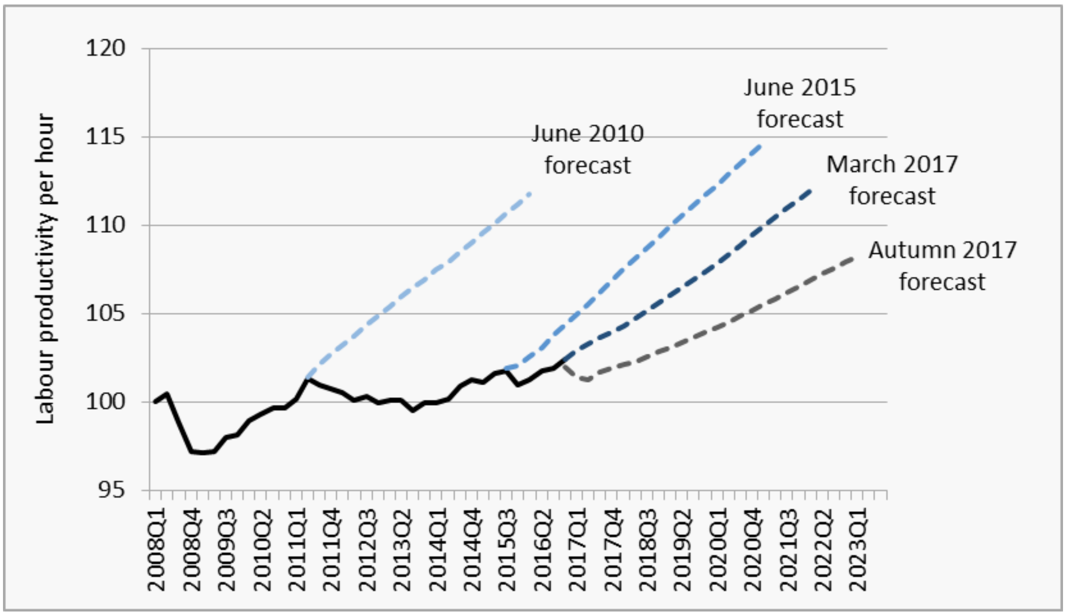
[1] https://www.gov.uk/government/news/7-things-you-need-to-know-about-the-new-budget-timetable

Economy

As expected, **official growth forecasts** from the independent Office for Budget Responsibility (OBR)[2] have deteriorated since March. This leaves expectations for growth over the parliament significantly below those forecast in March 2016, and the economy set to be around 3% (or around £60bn) smaller in 2020 than was then expected.



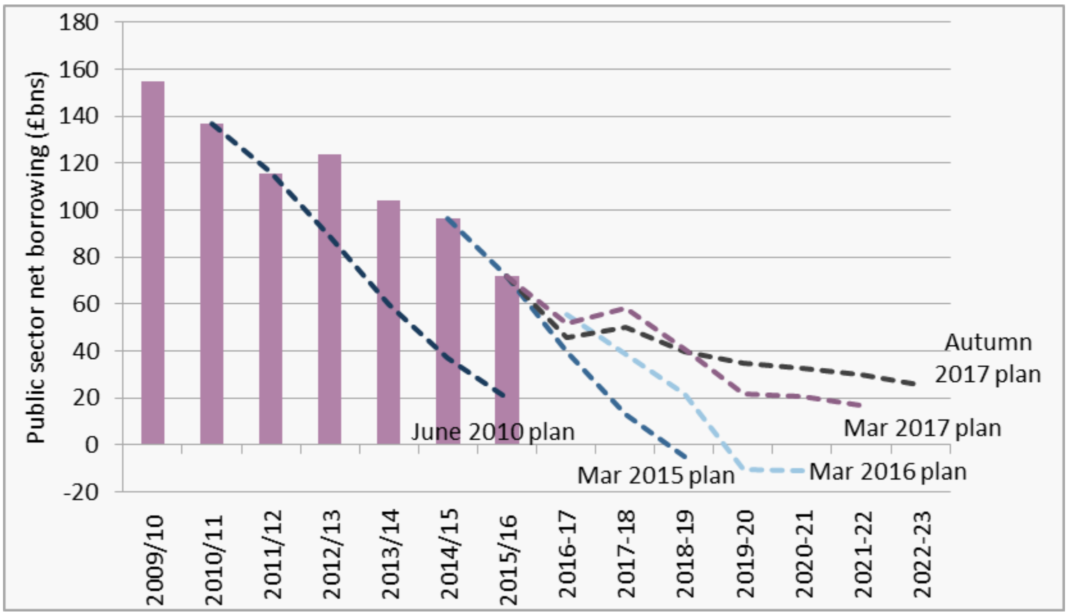
A key factor behind this deterioration is the judgement of the OBR that there are no longer grounds to assume that **labour productivity** growth will return to historic trends. It now expects productivity to remain sluggish for the remainder of the forecast period.



[2] http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2017/

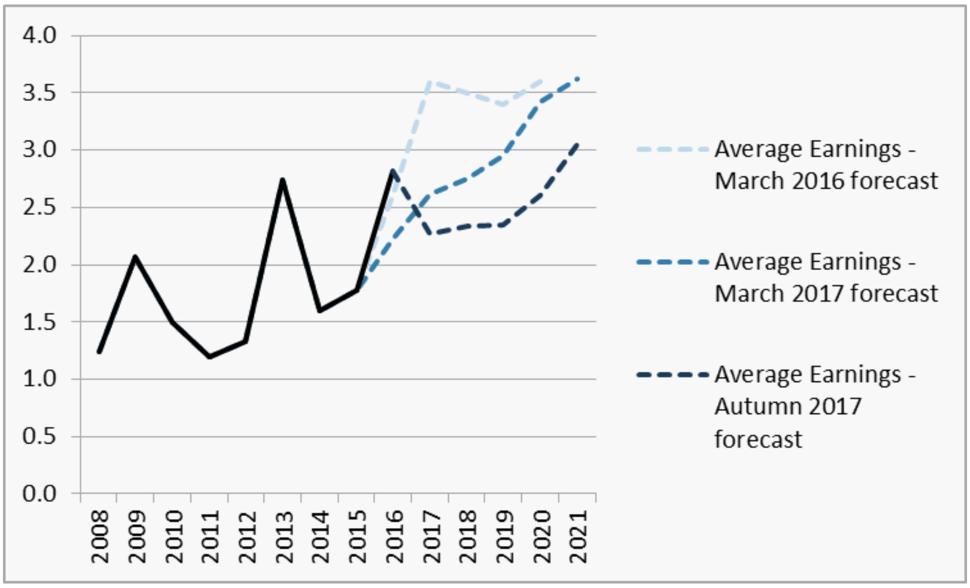
Public finances

Lower growth forecasts have resulted in a significant deterioration of the outlook for the public finances. Lower tax revenues as well as some additional spending commitments have forced the Chancellor to increase planned borrowing, meaning he is now on course to borrow around £38bn more over the rest of the Parliament than planned in March.

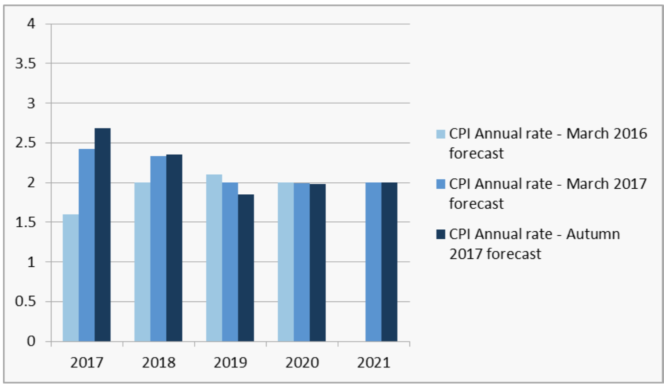


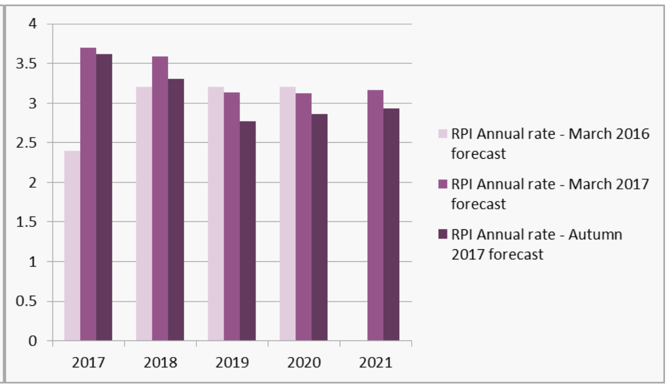
Wages and living standards

Forecast **average earnings growth** across the economy (including private and public sectors) was revised down after the 2016 referendum, and has been revised down again for this Budget.

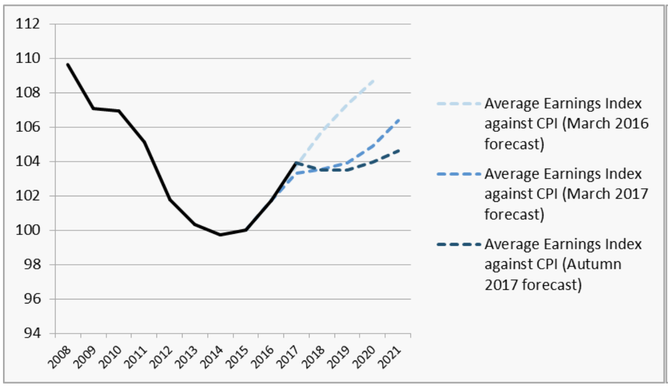


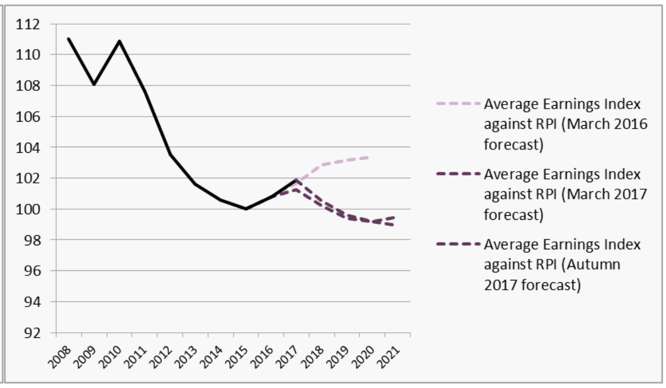
Forecasts for the **cost of living** have increased significantly since March 2016, but at this Budget forecasts for CPI remained similar to those of March 2017, and forecasts for RPI fell somewhat (though remain much higher than March 2016).





The result is that forecasts for real earnings adjusted for RPI are similar to November, but when adjusted for CPI the outlook has deteriorated significantly.





To illustrate the scale of these changes, on the March 2016 forecast a worker on median earnings of around £26,000 today could expect to be earning around £3,900 more in cash terms in 2021, and about £500 more in real terms (adjusting for RPI).

By the March 2017 forecast, they could expect to be earning around £3,200 more in cash terms but £450 *less* in real terms.

By today's forecast those figures change again to £2,600 more in cash, and £750 less against RPI.

These impacts will not be significantly affected by **income tax measures** contained in the Budget. The Chancellor did not continue with previous policy of introducing above-inflation increases in the personal tax allowance or higher rate threshold, increasing these only in line with inflation, though he reiterated the Government's manifesto commitment to increase these to £12,500 and £50,000 respectively by 2020.

Freelancers and the self-employed

The abolition of **Class 2 NICs** was due to take effect from next April, but has been pushed back by one year, saving the Government around £400 million in 2018-19.

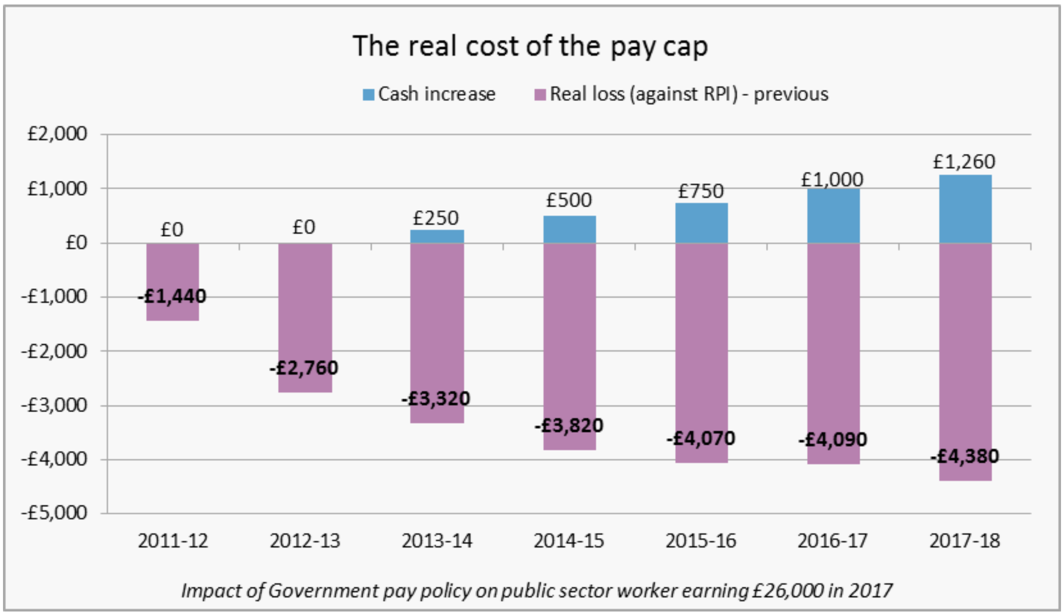
The Chancellor appears to have backed off an immediate extension of new **rules on personal service companies** to private sector engagers, which Prospect feared could result in many genuine freelancers and self-employed workers being misclassified as PAYE employees and paying more in tax as has happened as a result of their application to the public sector, but it is reported he will consult on the idea.[3]

The Chancellor also backed off an expected reduction in the **turnover threshold for compulsory VAT registration by small businesses**, which could have added considerable bureaucratic burdens to many freelancers, but has said he will consult on reforming the current framework.

The Chancellor has also announced that businesses below the VAT threshold will not be mandated to use **Making Tax Digital**, and then only for VAT obligations, until April 2020 at the earliest, which should be welcome to many small sole traders expecting to be subject to the new system from April 2019.

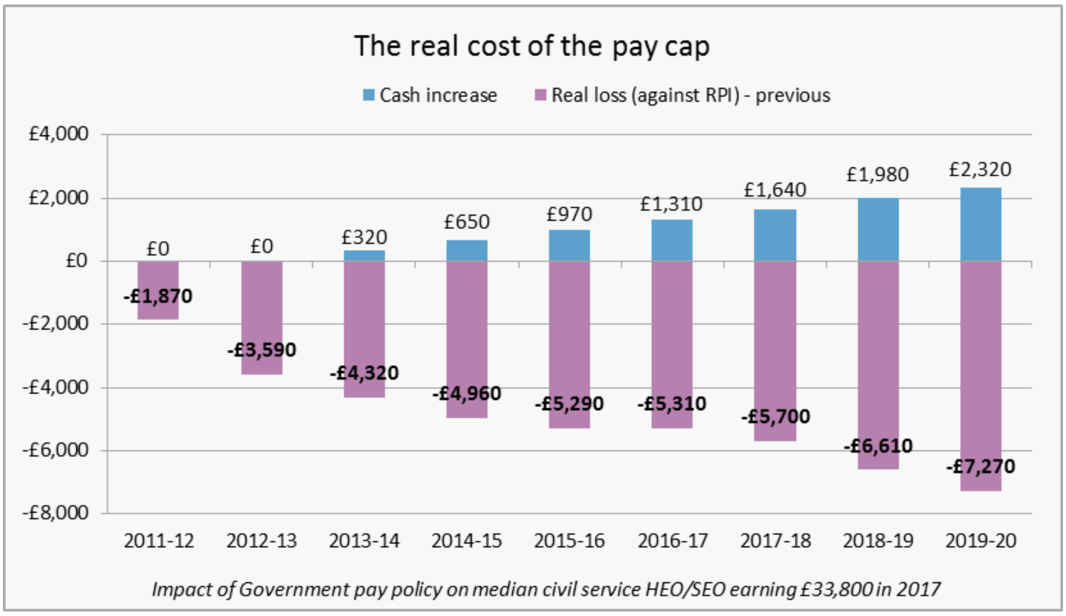
Public sector pay, employment and funding

Against the latest official inflation forecasts, the Government's **public sector pay policy** has cost the average public sector worker (earning around £26,000 in 2017) a total of around £24,000 over the 7 years since 2010.



[3] https://www.ft.com/content/48adc7d0-cdf6-11e7-b781-794ce08b24dc

For a skilled civil servant – for example a median HEO/SEO earning £33,800 in 2017 – that figure increases to around £31,000 over the seven year period.



Impact of Government pay policy on median civil service HEO/SEO earning £33,800 in 2017

The Budget provided little new guidance on the future of **public sector pay restraint**.

In relation to the NHS, the Chancellor referred in his speech to discussions between the Health Secretary and health unions on "pay structure modernisation … to improve recruitment and retention", and said that if these talks "bear fruit" he would "protect patient services by providing additional funding for such a settlement".

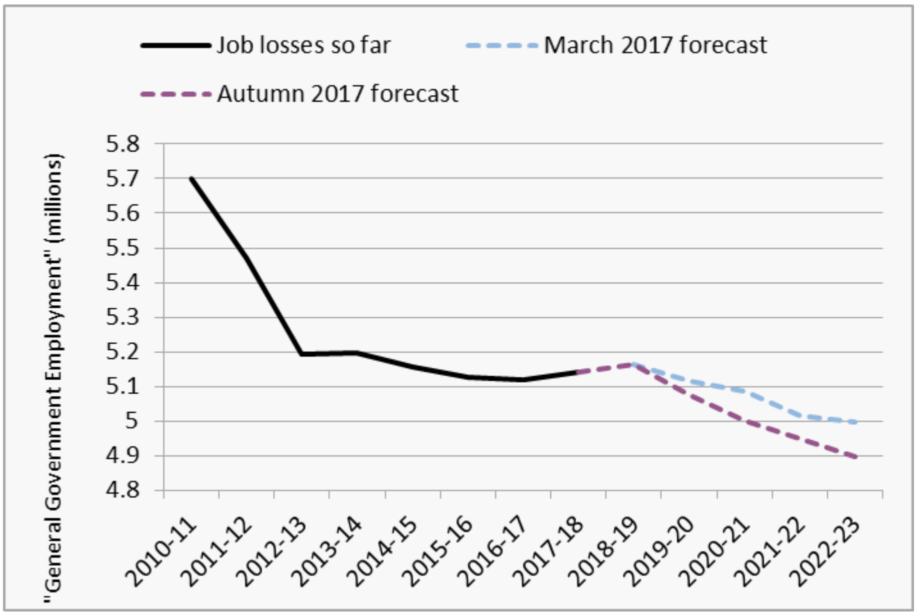
For other groups of staff, the Budget provided even less clarity, stating that:

> *"In September 2017 the government announced its intention to move away from the 1% basic public sector pay award policy, which is paid to public servants in addition to any incremental pay progression and allowances. The government will ensure that the overall pay award is fair to public sector workers, as well as to taxpayers, and reflects the vital contribution they make to delivering high quality public services.*
>
> *"In 2018-19, for those workforces covered by an independent Pay Review Body (PRB), the relevant Secretary of State will shortly write to the PRB Chair to initiate the 2018-19 pay round, before later submitting detailed evidence outlining recruitment and retention data and reflecting the different characteristics and circumstances of their workforce. Each PRB will then make its recommendations in the spring or summer, based on the submitted evidence. Secretaries of State will make final decisions on pay awards, taking into account their affordability, once the independent PRBs report."*

It should be borne in mind that around 55% of public sector workers, including 90 per cent of civil servants, are not covered by any Pay Review Body.

No new resources for public sector pay were allocated in the "Red Book", and media reports in the wake of the Budget seem to have confirmed that "apart from in the NHS, any increase in public sector pay above 1 per cent next year will have to be met from [departmental] budgets."[4]

The Office for Budget Responsibility assumes that average public sector pay rises will move into line with the private sector by 2020-21 (at which point average earnings are forecast to rise 3%) but that this will be at the expense of departmental budgets and **public sector headcount**.[5] It now expects 250,000 jobs to be lost from the public sector over the next five years – 100,000 more than in March.



The Budget announced that an additional £3bn would be allocated over 2018-19 and 2019-20 to enable departments to **prepare for Brexit**, with the allocation of these resources to be determined in early 2018. (Likely recipients may include the Border Force and HMRC's customs operations, but many other departments and bodies including environmental and regulatory agencies are likely to face resource pressures as Brexit looms).

Ahead of the March Budget the Chancellor reiterated its plan to find £3.5bn of additional annual **"efficiency" savings** from departmental spending by 2019-20, £1bn of which will be reinvested in "priority areas", with details to be published in Autumn 2017.[6]

In support of this, on 17th November the Government published a report on "unlocking public value", commissioned from Sir Michael Barber earlier in the year. The central focus of the report is a recommendation to develop a new framework for measuring public

[4] https://twitter.com/iainjwatson/status/933355968959795201
[5] "In September, the Government announced that the 1 per cent cap on public sector pay rises would be lifted in 2018-19, two years earlier than planned. We have assumed that this will lead to higher average pay growth, bringing it into line with the whole economy average by 2020-21. But we have assumed that the cost will be met by squeezing non-pay spending and by reducing the workforce". http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-november-2017/
[6] https://www.gov.uk/government/news/efficiency-review-to-drive-productive-public-services

service outcomes to enable better focus on raising productivity, as well as better use of data and the encouragement of "disruptive innovation".[7]

The Budget claims that, in addition to £1 billion of "low value spend" reprioritised to new priorities announced in the 2016 Autumn statement, "a further £1.4 billion reduction has been delivered by a number of savings in low value spend, announced in the previous parliament" as well as cuts to Overseas Development spending allowed by applying the 0.7% target to lower GDP forecasts. The further £1.1 billion savings will no longer be sought "given potential new spending and administrative pressures faced by departments in 2019-20".

In response to the Budget's lack of new commitments on public sector pay, Prospect General Secretary Mike Clancy said:

> *"Workers cannot have been clearer in the run up to this budget that they need a pay rise.*
>
> *"The government has squandered an opportunity to listen and completely ignored the views and experience of the labour market. As private and public sector wages continue to stagnate the government has turned a blind eye to a growing problem.*
>
> *"The Chancellor has failed to listen to the public and continues to ignore the facts – public sector workers pay has dropped by 15 per cent in real terms over the last seven years.*
>
> *"A vague commitment to listen to Pay Review Bodies is nowhere near enough. 55% of public sector workers are not covered by a pay review body and without the promise of new money any pay rise seems very far off.*
>
> *"Public sector workers need a pay rise, but instead the Chancellor has condemned them to years of dealing with problems of recruitment, retention and morale.*
>
> *"Every single public sector worker has shouldered cuts to staffing levels and services alongside falling real pay. This is unacceptable and we will be campaigning tirelessly to get the pay cap lifted.'"*[8]

Announcements and developments relevant to key sectors

Defence

No additional resources for defence were announced, despite the pressure on the defence budget from cost overruns[9] and the impact of the devaluation of sterling,[10]

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[7] https://www.gov.uk/government/news/sir-michael-barber-report-into-improving-value-in-public-spending-published
[8] https://www.prospect.org.uk/news/id/2017/November/22/Budget-fails-workers-on-pay
[9] https://www.nao.org.uk/wp-content/uploads/2017/01/The-Equipment-Plan-2016-2026.pdf
[10] It was estimated in 2016 that if the fall in the value of sterling against the dollar from $1.50 to $1.30 is not reversed within two years, the cost of the UK's defence imports could increase by around £700m a year from April next year. 18 months on the pound is around $1.32. https://rusi.org/commentary/MoD-post-brexit-spending-power-assumptions-numbers-calculations-and

knock-on effects of uncertainty on shipbuilding, aerospace and other manufacturing industries[11], and political pressure for increased spending. [12][13]

Industry federation ADS expressed disappointment that the Budget did not contain "decisive action to support supply chain productivity".[14]

Energy

Energy companies have long been calling on the Chancellor to commit to extending the **carbon price floor** to 2025,[15] as have many policy commentators,[16] to provide greater certainty and incentivise necessary investment in low carbon generation capacity.

The Budget states that "The government is confident that the Total Carbon Price, currently created by the combination of the EU Emissions Trading System and the Carbon Price Support, is set at the right level, and will continue to target a similar total carbon price until unabated coal is no longer used."

Energy commentators have described this as short on detail[17] and highlighted recently published research has suggested that freezing the current level could in fact result in a resurgence of coal-powered generation.[18]

The Budget also promised no new Carbon Levies until 2025, implying that there will be no more "contracts for difference" for nuclear or other low-carbon technologies. A separate document on a replacement for the Levy Control Framework subsidy cap, says new levies will be considered once the total cost of support is falling.[19]

Energy UK have commented:

> *"Given the great advances the industry has made in delivering cleaner energy at the lowest cost to consumers, the lack of ambition from the government to build on this progress is disappointing and, coupled with the need to decarbonise heat, seems at odds with the plans set out in the recent Clean Growth Strategy.*
>
> *"Over half of generation now comes from low carbon sources and the recent CfD auction showed how far the cost of offshore wind has fallen - thanks to providing the necessary certainty for investment which drives down the cost of*

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[11] https://www.ft.com/content/7892c6f2-aceb-11e7-beba-5521c713abf4
[12] http://www.mirror.co.uk/news/politics/four-tory-former-defence-ministers-11548409
[13] https://www.thesun.co.uk/news/4939913/defence-secretary-gavin-williamson-defence-saving-royal-marines-chop/
[14] https://www.adsgroup.org.uk/news/newsroom/budget-industry-awaits-decisive-action-to-boost-productivity/
[15] https://www.ft.com/content/883b0d82-81ac-11e6-bc52-0c7211ef3198; https://uk.reuters.com/article/uk-britain-utilities-carbon/four-uk-power-firms-call-for-carbon-price-floor-extension-idUKKBN1CR0YQ; https://www.theguardian.com/business/2017/oct/23/uk-energy-firms-call-on-chancellor-to-boost-carbon-tax
[16] https://policyexchange.org.uk/publication/next-steps-for-the-carbon-price-floor/; https://www.auroraer.com/insight/carbon-price-thaw-post-freeze-future-gb-carbon-price-2/
[17] https://www.carbonbrief.org/autumn-budget-2017-key-climate-energy-announcements
[18] https://www.auroraer.com/insight/carbon-price-thaw-post-freeze-future-gb-carbon-price-2/
[19] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/660986/Control_for_Low_Carbon_Levies_web.pdf

decarbonisation, benefits customers and the wider economy.

"Postponing further support for renewables until 2025 denies the opportunity for other technologies and projects to follow suit and prevents taxpayers from reaping the benefits of the cost reductions their funding has made possible."[20]

Environment and Food

An additional £76 million was announced for **food and coastal defence schemes** over the next three years, bringing food defence investment to over £2.6 billion between 2015-16 and 2020-21.

IT and telecoms

The Budget states that 385 million from the previously announced telecoms component of the "National Productivity Investment Fund" will be allocated to "projects to develop next generation 5G mobile and full-fibre broadband networks".

Justice

Advance discussion of the Budget highlighted the fact that "policy experts say prisons are in more urgent need of a funding boost, as are counter-terrorism activities."[21] No new resources were announced however.

Nuclear

According to one commentary the ruling out of further **carbon electricity levies** until 2025 means that "additional new nuclear schemes beyond Hinkley C … will all be on hold unless they can find a way to proceed without government support".[22]

The Nuclear Industry Association commented:

"Pressure is undoubtedly on the nuclear industry to deliver at a lower cost than the strike price agreed for Hinkley Point C and work is underway to ensure it does.

"However there is no getting away from the facts which show 65% of the UK's generating capacity from 2010, including all but one of the UK's current nuclear fleet due to close by 2030. The Chancellor's decision means there is a risk progress towards a predominately low carbon grid system could stall."

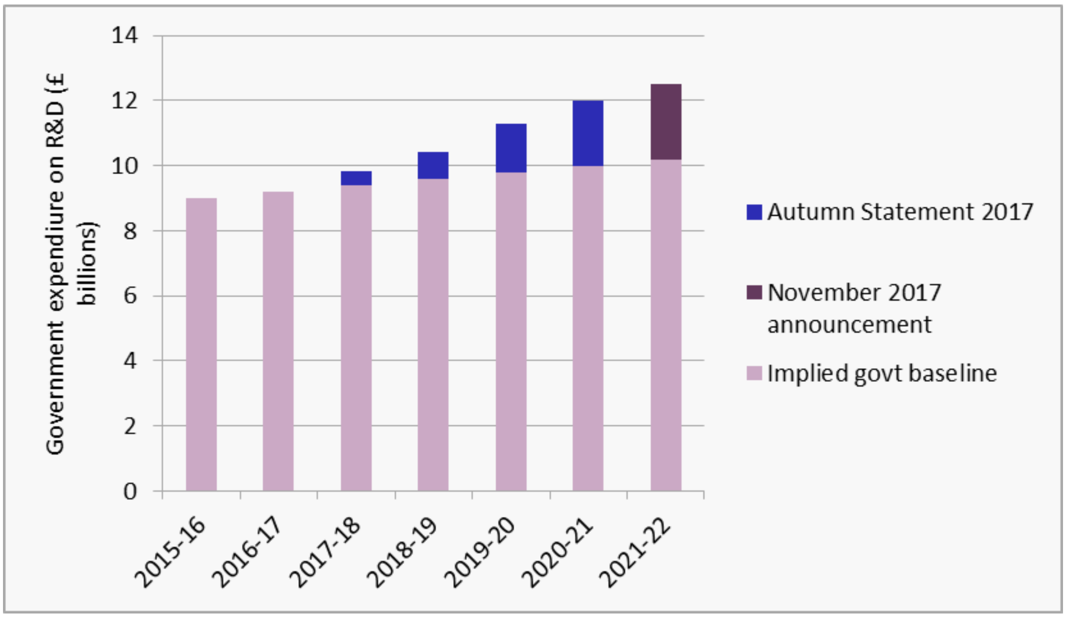
Science

[20] http://www.energy-uk.org.uk/press-releases/370-2017/6374-energy-uk-responds-to-the-2017-autumn-budget.html
[21] https://www.ft.com/content/0635965e-cdf5-11e7-9dbb-291a884dd8c6
[22] https://www.carbonbrief.org/autumn-budget-2017-key-climate-energy-announcements

The 2016 Autumn Statement announced additional **public expenditure on Research and Development** rising from 2017-18 to £2bn of annual spending in 2020-21.

On 20 November 2017, shortly in advance of this Budget, the Government announced a further additional expenditure on R&D of £2.3bn in 2021-22.[23] (This is presumably drawn from the £7bn total "National Investment Productivity Fund" earmarked for that year in the 2016 Autumn Statement but not previously allocated to specific areas of spending).

According to the Government's figures, this amounts to an increase on previous plans of around 23% by 2021-22.



The Budget states that

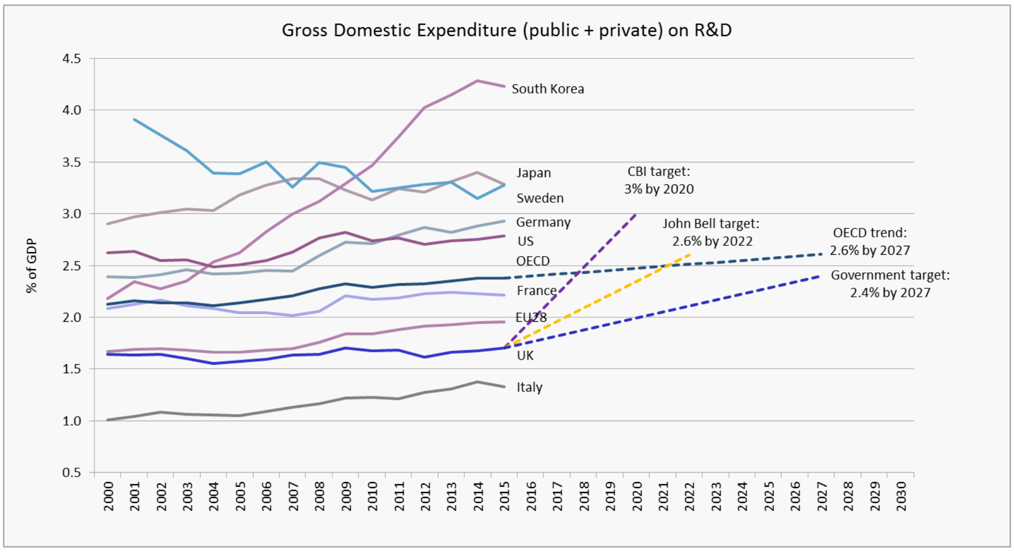
> *"The Industrial Strategy White Paper will provide further detail on what this funding will support, including:*
>
> *• support for our creative and digital industries by developing pioneering immersive technology for creative content, and launching a new AI and machine-learning programme targeted at the services sector*
>
> *• £170 million for innovation to transform productivity in the construction sector*
>
> *• new support to grow the next generation of research talent and ensure that the UK is able to attract and retain the best academic leaders globally"*

In addition to this the Budget announced an increase in the R&D tax credit to 12 per cent.

The Budget claims that this demonstrates "clear progress towards the government's ambition to raise the level of investment in R&D in the economy to 2.4% of GDP". In fact the Government's target would still be likely to leave the UK behind the OECD average,

[23] https://www.gov.uk/government/news/record-boost-to-rd-and-new-transport-fund-to-help-build-economy-fit-for-the-future

and falls some way short of targets recommended by the recently published Life Sciences Industrial Strategy commissioned by the Government from Sir John Bell[24] or the CBI.[25]



The Campaign for Science and Engineering welcomed the new resources while commenting:

> *"Such sizeable public investment brings a responsibility to spend it effectively. The new money is to be spent on modes of challenge-led funding that are relatively untested. It will be important to establish mechanisms to ensure these funds are well spent and to grow the UK's tried and tested research funding mechanisms to meet research priorities as well as political priorities. After all, the UK needs a thriving research base to generate the stream of ideas to create the products and services of tomorrow.*
>
> *"To reach their target of R&D investment across the economy of 2.4% of GDP, the Government must attract private investment of over £8bn of globally-mobile R&D budgets. To continue to invest here through the uncertainty of Brexit, research-intensive companies are clear that the UK must provide a competitive economy with a healthy research base and immigration and regulation systems that support international R&D."*[26]

As with the R&D funding previously announced for years 2017-18 to 2020-21, it seems likely that much if not all of these resources are intended for specific projects or match-funded partnerships with the private sector, rather than existing public sector programmes or institutions.

There are also continuing concerns over the impact of Brexit uncertainty on the UK's ability to attract relevant skills. The Budget states that:

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[24] https://www.gov.uk/government/publications/life-sciences-industrial-strategy
[25] http://www.cbi.org.uk/business-issues/prosperity/
[26] http://www.sciencecampaign.org.uk/news-media/press-releases/case-responds-to-autumn-budget-2017.html

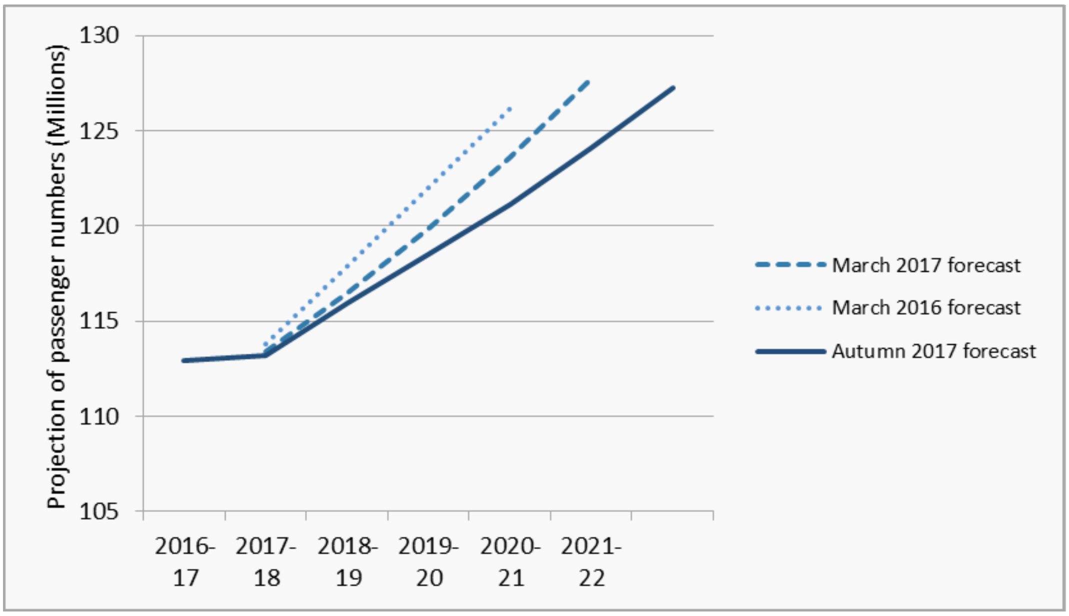
"the government is encouraging the best and the brightest international scientific and research talent to work in the UK. The government will: change immigration rules to enable world-leading scientists and researchers endorsed under the Tier 1 (Exceptional Talent) route to apply for settlement after three years; make it quicker for highly-skilled students to apply to work in the UK after finishing their degrees; and reduce red tape in hiring international researchers and members of established research teams, by relaxing the labour market test and allowing the UK's research councils and other select organisations to sponsor researchers."

Prospect has been arguing that focusing on Tier 1 routes misunderstands the collaborative nature of science and that there needs to be a relaxation at Tier 2.[27]

Transport

A partial freeze on **Air Passenger Duty** (for long haul flights) was announced but Airport Operators have expressed "disappointment .that the Government has not gone further".[28]

The OBR has been revising downwards its expectations for air passenger numbers since last year's referendum:



[27] See, for example, Prospect's recent submission to the Migration Advisory Committee at https://library.prospect.org.uk/download/2017/01901
[28] http://www.aoa.org.uk/2017/11/disappointing-the-chancellor-has-not-gone-further-on-apd/