Budget 2015: What the Chancellor said and didn't say

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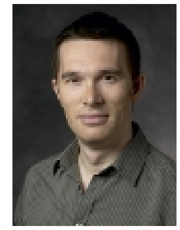
*Who would have thought an election was around the corner? **John Van Reenen** looks at what George Osborne had to say in the budget speech as well as what he didn't say; the Chancellor neither mentioned the productivity problem nor did anything to address it. Indeed, several of his policies will make it worse.*

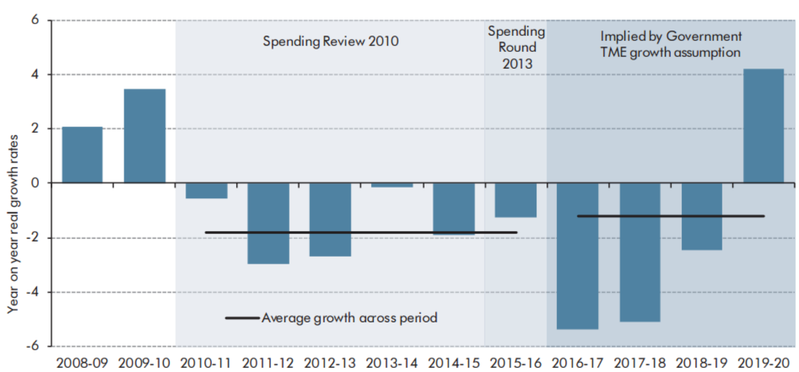


What the Chancellor said

The big news in the budget is that the Chancellor is no longer aiming for a budget surplus of £23 billion (1 per cent of national income) in 2019-2020, as he was in his December Autumn Statement. Instead the surplus will be only £7 billion with the difference mainly due to less spending cuts.

As the fiscal watchdog, the OBR pointed out today this means that public service spending (DEL) is in for a "roller coaster" ride with enormous cuts between now and 2019, followed by a splurge (Figure 1).

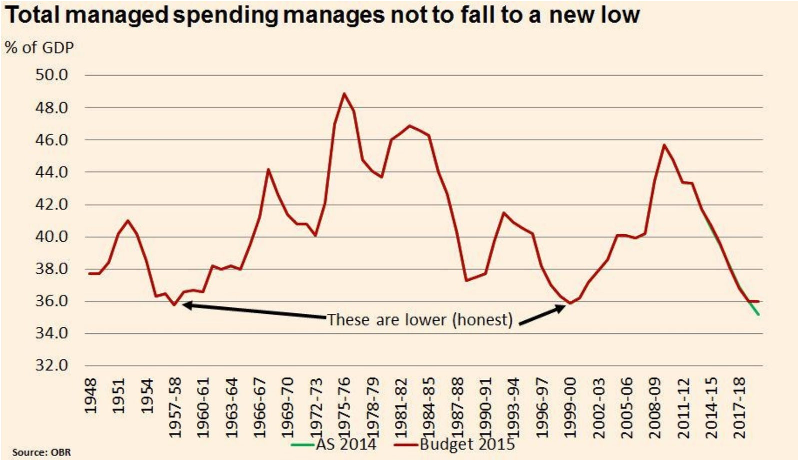
Figure 1: The Roller Coaster ride for public service spending



Note: RDEL series excludesmajor historical switches with AME as well as switches with AME in forecast years. Details are available in the supplementary fiscal tables on our website. Source: OBR

How come such an odd fiscal path? Well, as Figure 2 shows this is so the Chancellor can say that spending as a fraction of GDP will be 36 per cent of GDP in 2019-20, instead of 35 per cent as in the Autumn Statement. This is politically important because 36 per cent is marginally above the level in 1999-2000 (35.9 per cent). But don't squint or you'll miss it. But it will not formally be the lowest level since 1948 as the OBR and Labour have been unhelpfully pointing out for the last three months.

Figure 2: "Not the lowest spending since 1948, honest Gov"



Source: Chris Giles, FT, OBR

What the Chancellor didn't say

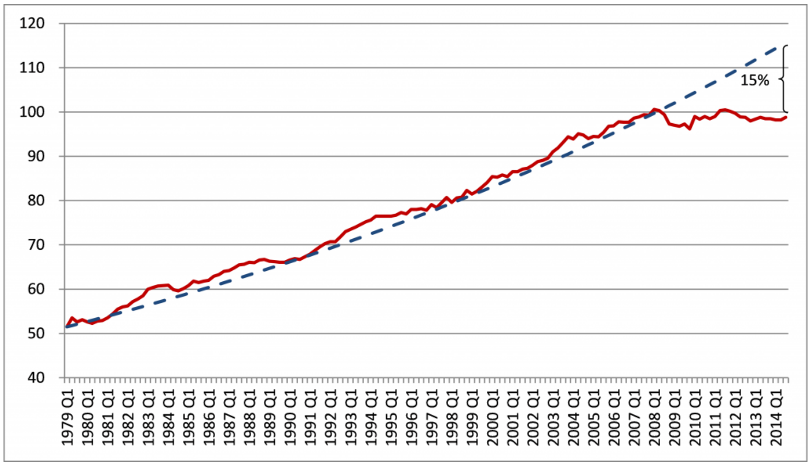
But the (revised downwards) 2.6 per cent GDP growth last year is nothing to boast about. Britain's GDP per person is a full 16 per cent lower than we would have expected on pre-crisis trends, a truly abysmal performance (see Figure 3). A major factor here is lousy productivity growth (GDP per hour) which – as the OBR lamented – actually *fell* by 0.3 per cent in the last quarter of 2014. The UK is 17 per cent less productive than the G7 average.

It is surprising and depressing that the Chancellor neither mentioned the productivity problem nor did anything to address it. Indeed, several of his policies will make it worse. For example, in this budget £2.2 billion has been pencilled in for a continuation of the awful Help to Buy Scheme which subsidises house demand for first time buyers. But without a serious way of delivering an increase in housing supply this will simply lead to further escalation in house prices.

Further, the Conservative fiscal plan is to deliver a balance on the total budget by 2018-19, whereas the other main parties are focused on balancing the current budget (which excludes public investment). This matters, because the Conservative fiscal rules leave little room for the government to borrow for investment. Low rates of investment, especially in infrastructure and R&D, have been an important cause of low productivity. The cuts in public investment of 40 per cent over the first two years of this Parliament were a huge policy error and contributed to the slowest recovery this Century. The Conservative fiscal targets risks repeating exactly the same mistake that the UK has made over and over again which is to fail to invest properly for the future.

The OBR has marginally revised growth upwards next year, and a big part of this is due to the growth in immigration. Ironically, the Prime Minister has pledged to renew the failed target to reduce net immigration to under 100,000 per year (it now runs at almost 300,000). So expect further limits on overseas students and highly talented workers that could have aided productivity growth

Figure 3: UK productivity growth – GDP per hour worked, 1979Q1 to 2014Q3



***Source*: Whole Economy GDP per hour worked, seasonally adjusted (2011=100). ONS Statistical Bulletin, Labour Productivity, Q3 2014, downloaded 6 February 2015.**

The Budget Takeaway

The Chancellor announced some tax takeaways (e.g. an extra £4.4 billion from the bank levy) and giveaways (e.g. £5.7 billion in extra personal allowances) and we can expect more of the latter in the election campaign. But what the public is still unprepared for is the scale of austerity to come: all main parties have signed up to the Charter for Budget Responsibility which means balancing the cyclically adjusted current budget by 2017-18. It is hard to see how this will be done without further tax rises, especially given the proposed cuts in unprotected public services. Tax rises have occurred after each of the last five elections, so don't be surprised if there are a few unexpected tax shocks after polling day.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

About the Author

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