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Fiscal sustainability report and **Welfare trends report 2015**

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Chairman

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Outline of presentation

- **Fiscal sustainability report**
  - Summary of long term projections
  - Balance sheet: crisis legacy and spending pressures
  - Outlook for North Sea oil and gas revenues
- **Welfare trends report**
  - Summary of welfare spending
  - Risks in medium term projections
  - UK spending in international context

FSR long-term projections

- Broad brush 50-year projections, not precise forecasts
- Based on ‘unchanged policy’: not always easy to define
- First 5 years consistent with March *EFO* forecast
- Focus beyond the current fiscal consolidation

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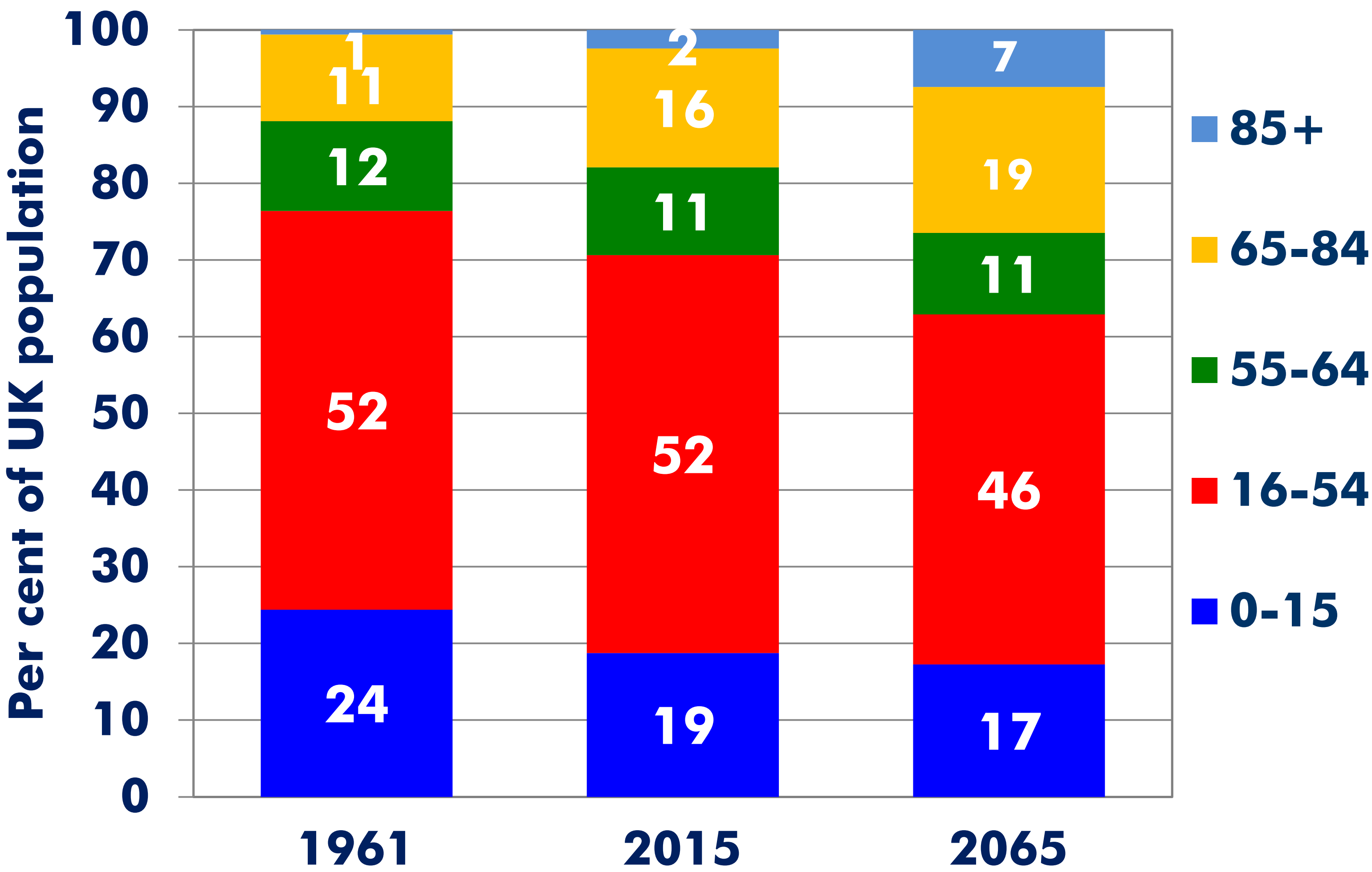
The ageing population



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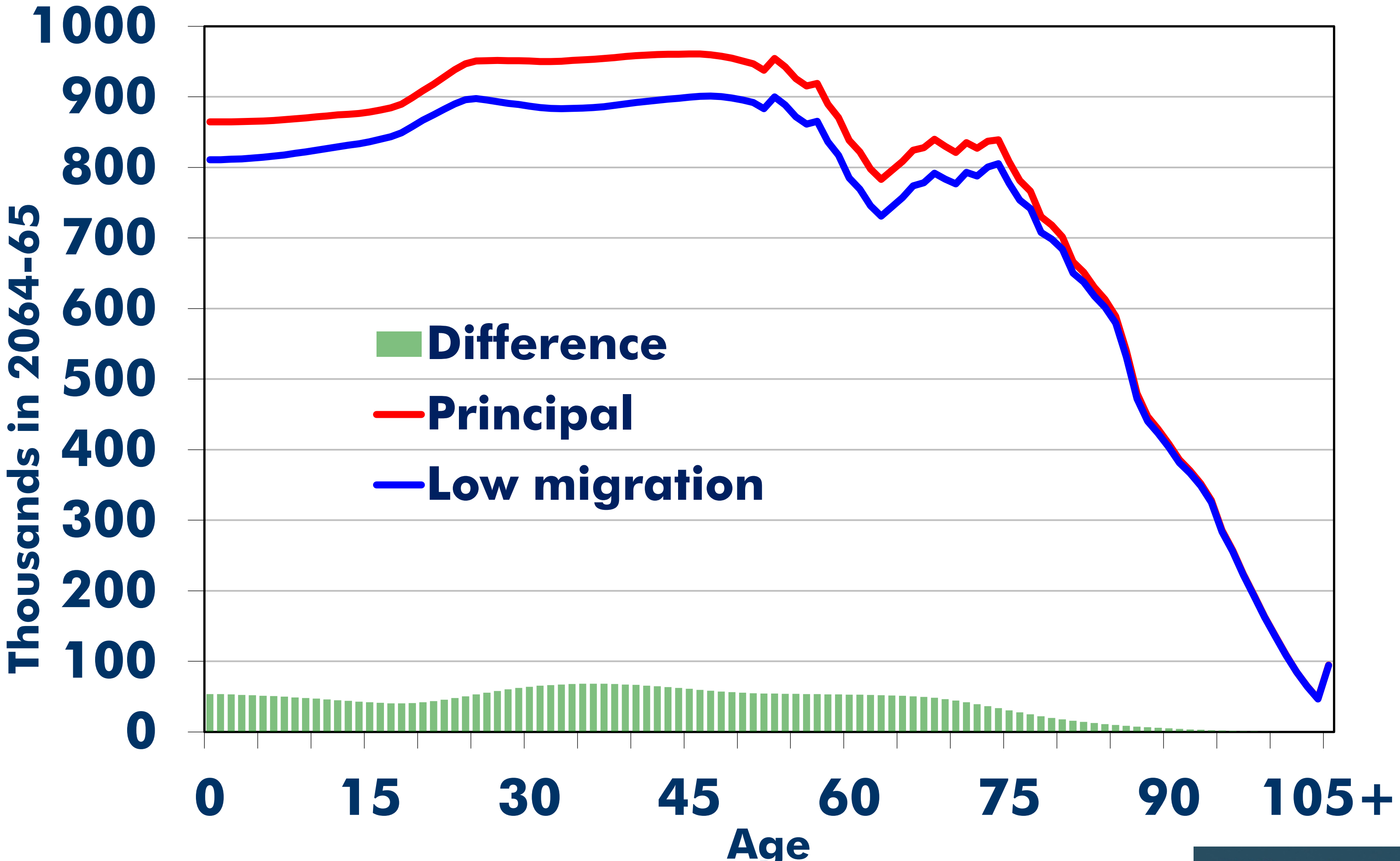
Impact of higher inward migration



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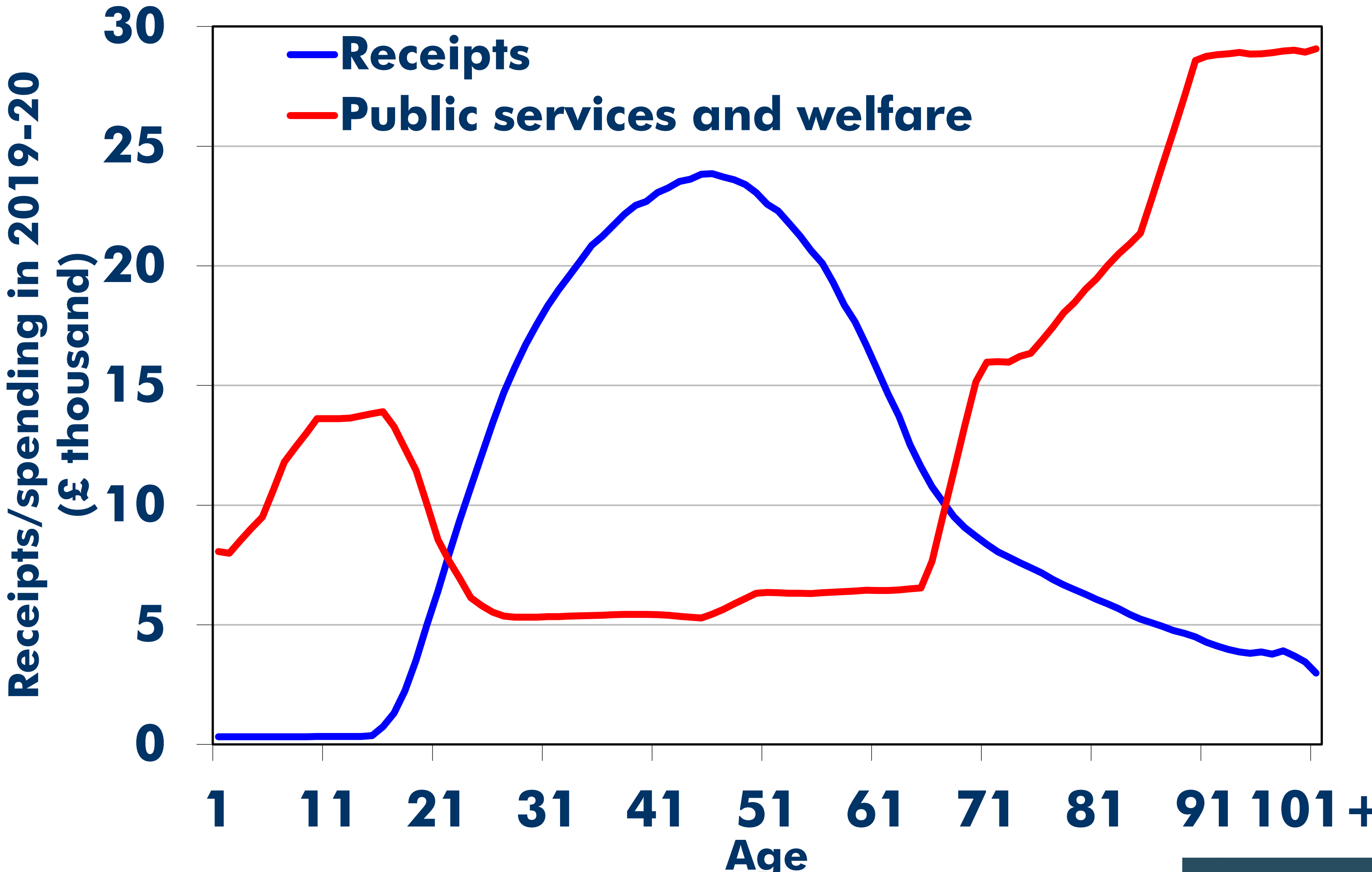
Revenues and public spending by age



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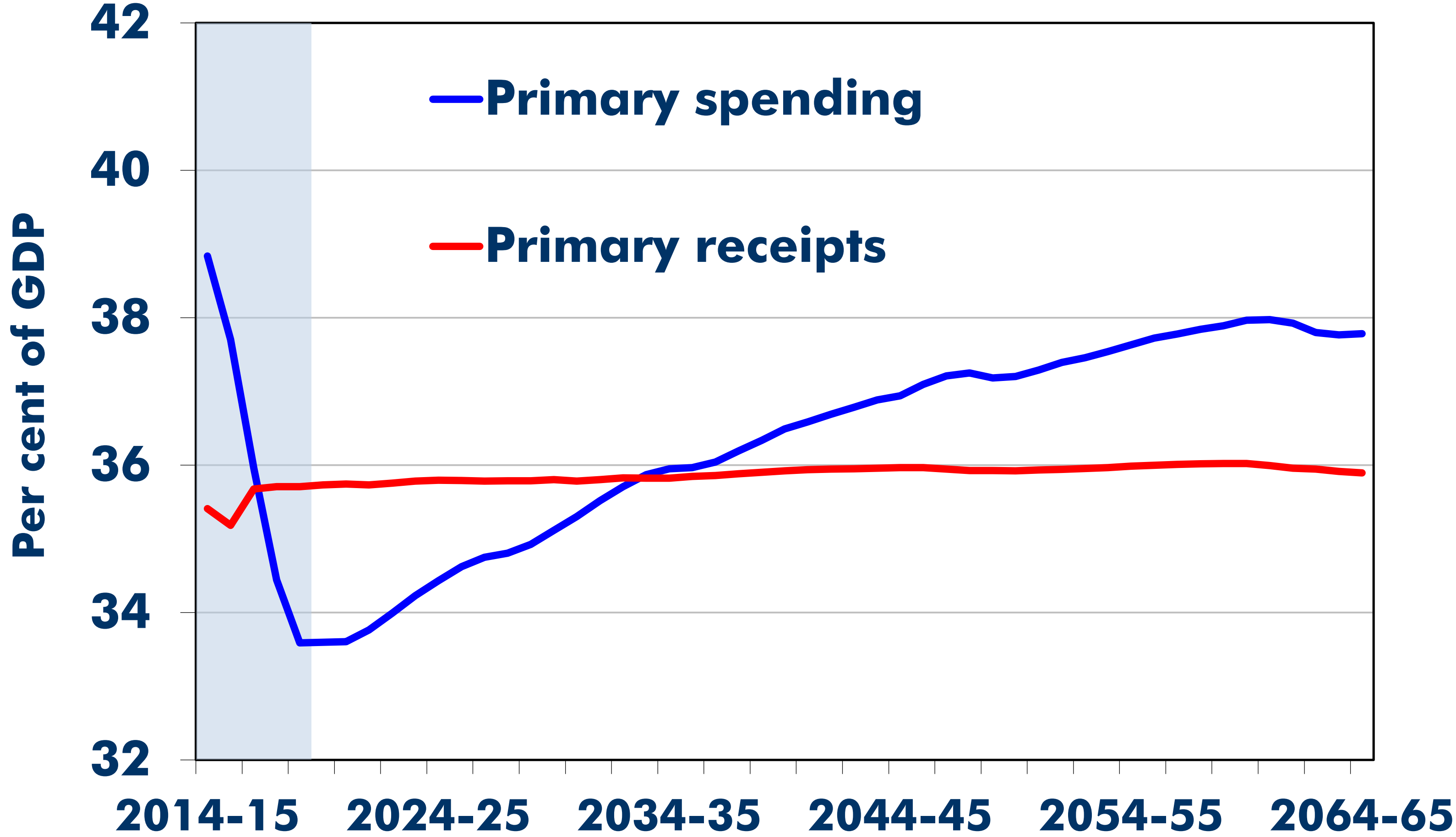
Revenue and spending projections



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Spending

- Non-interest spending rises 4.2% of GDP (£79bn) between end of medium-term forecast and 2064-65
- Main drivers: health, state pensions and long-term care, all as a result of the ageing population
- Main offset: falling cost of public service pensions, thanks to falling public employment and reforms
- State pension spending rises by 2.2% of GDP. Would be if 0.9% if earnings link rather than 'triple lock'

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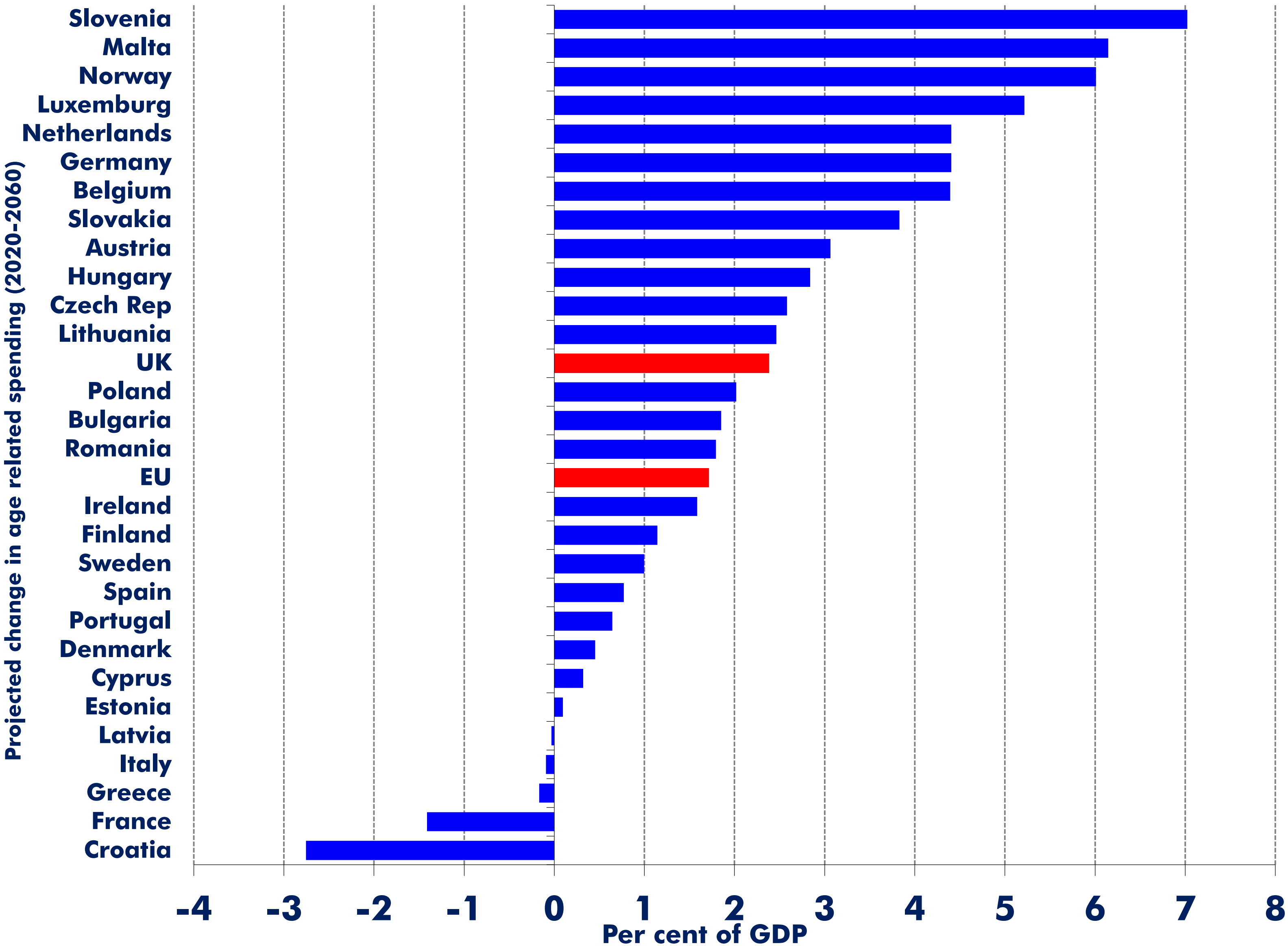
Age-related spending in the EU



Receipts

- Non-interest receipts broadly flat as % GDP between end of medium-term forecast and 2064-65

- Ageing population pushes receipts up a little because the retired pay tax on savings income and spending but contribute little to output

- We look at oil and gas receipts over a 30-year horizon separately

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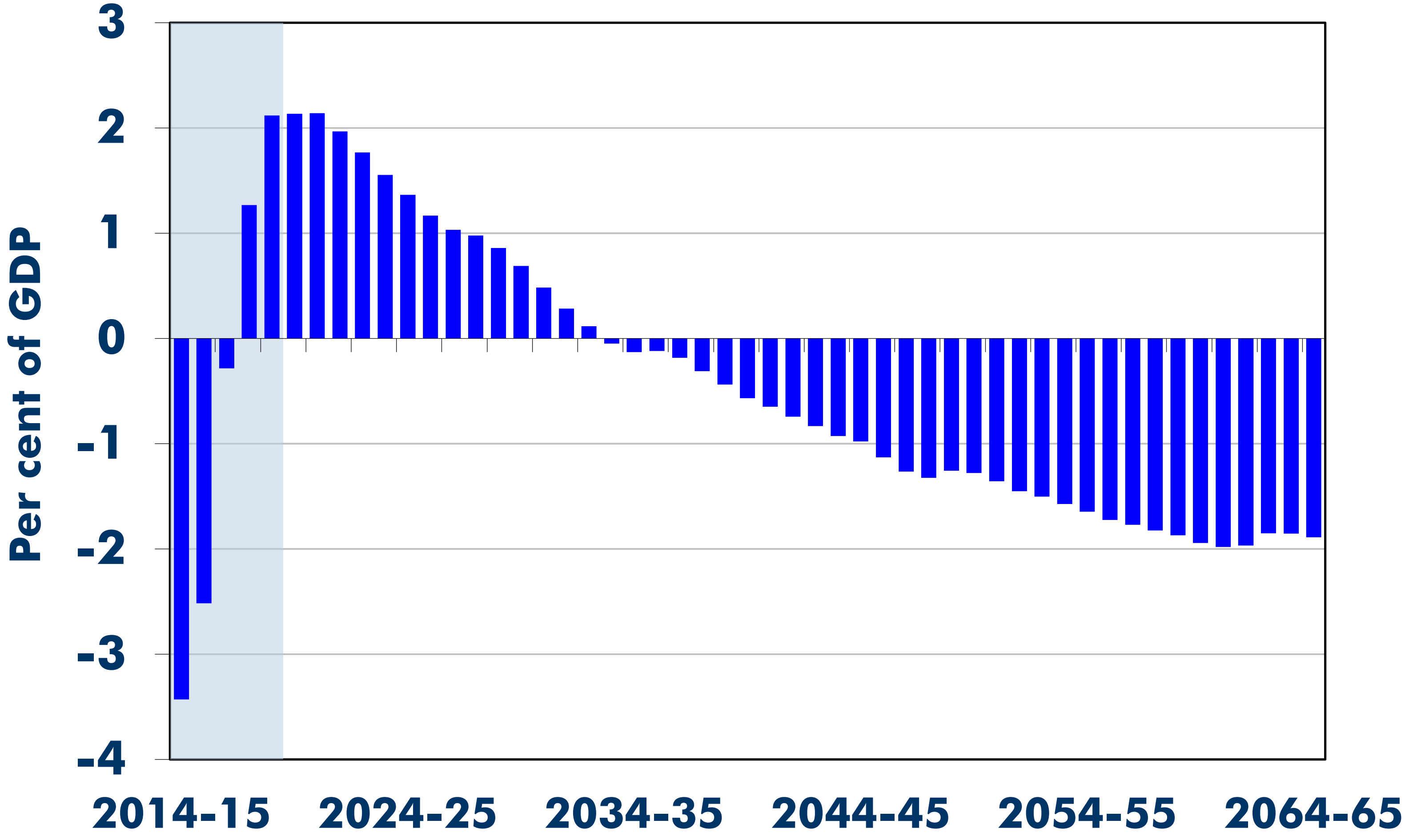
Primary budget balance



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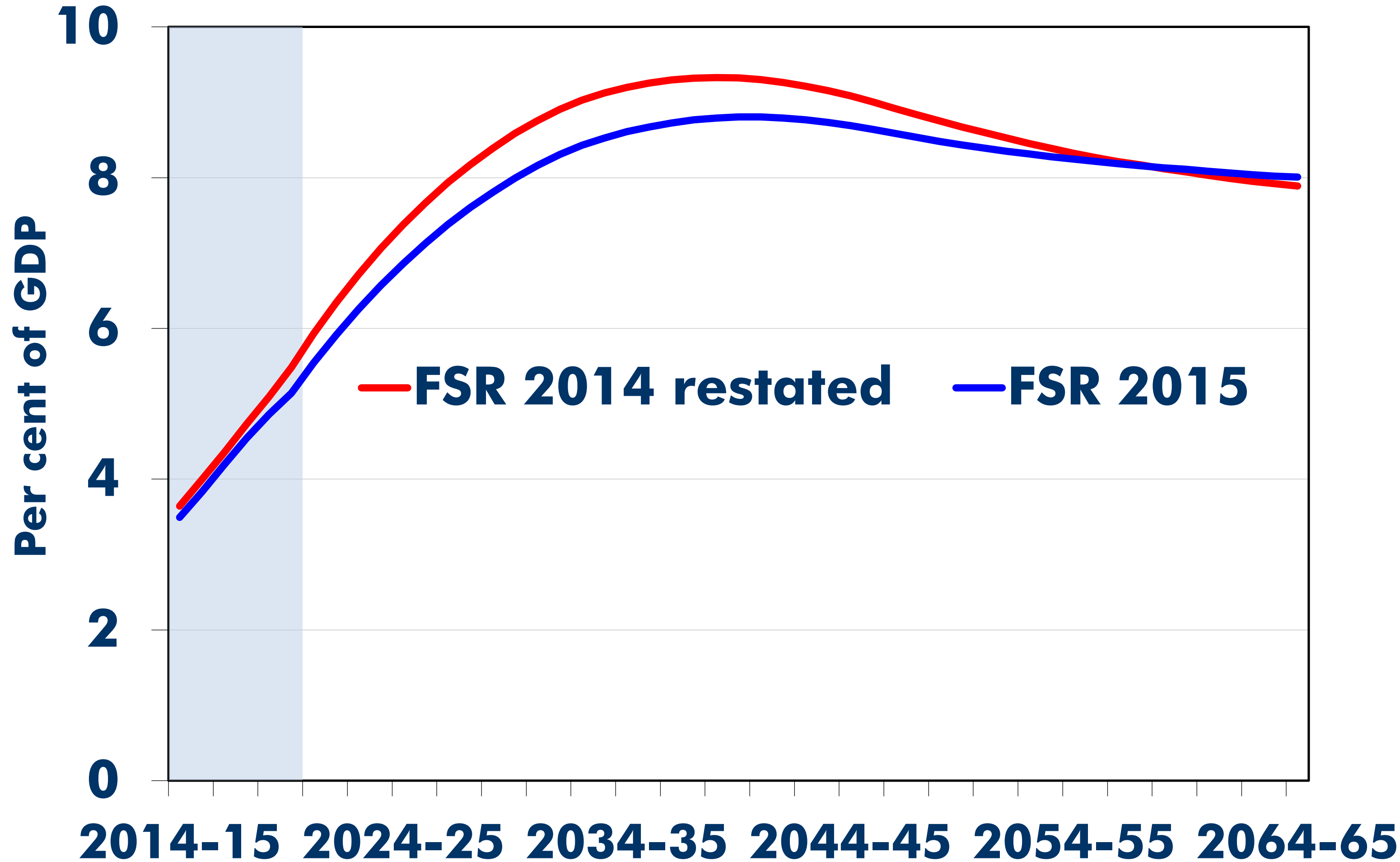
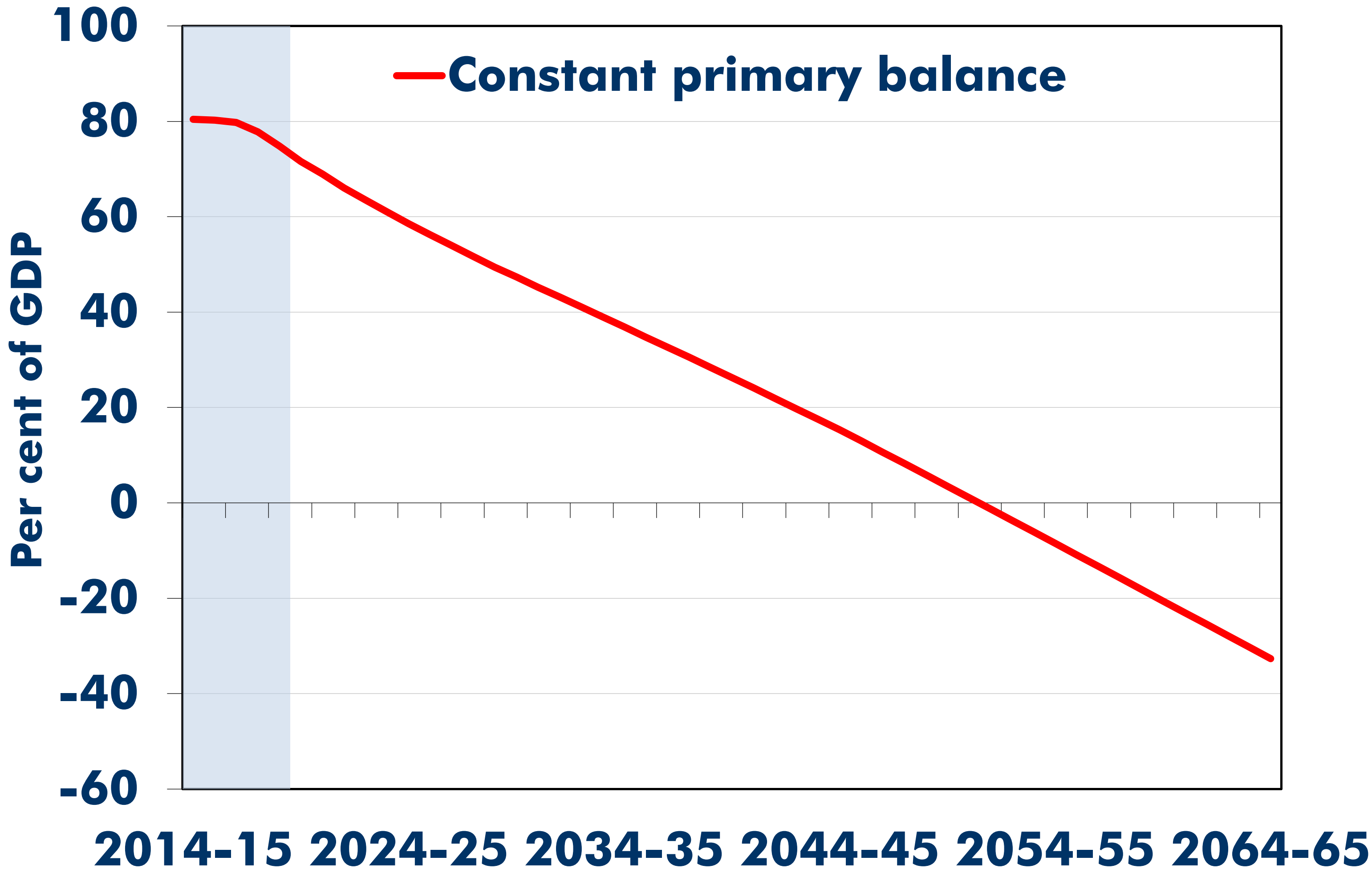
Impact of student loans on net debt



Public sector net debt



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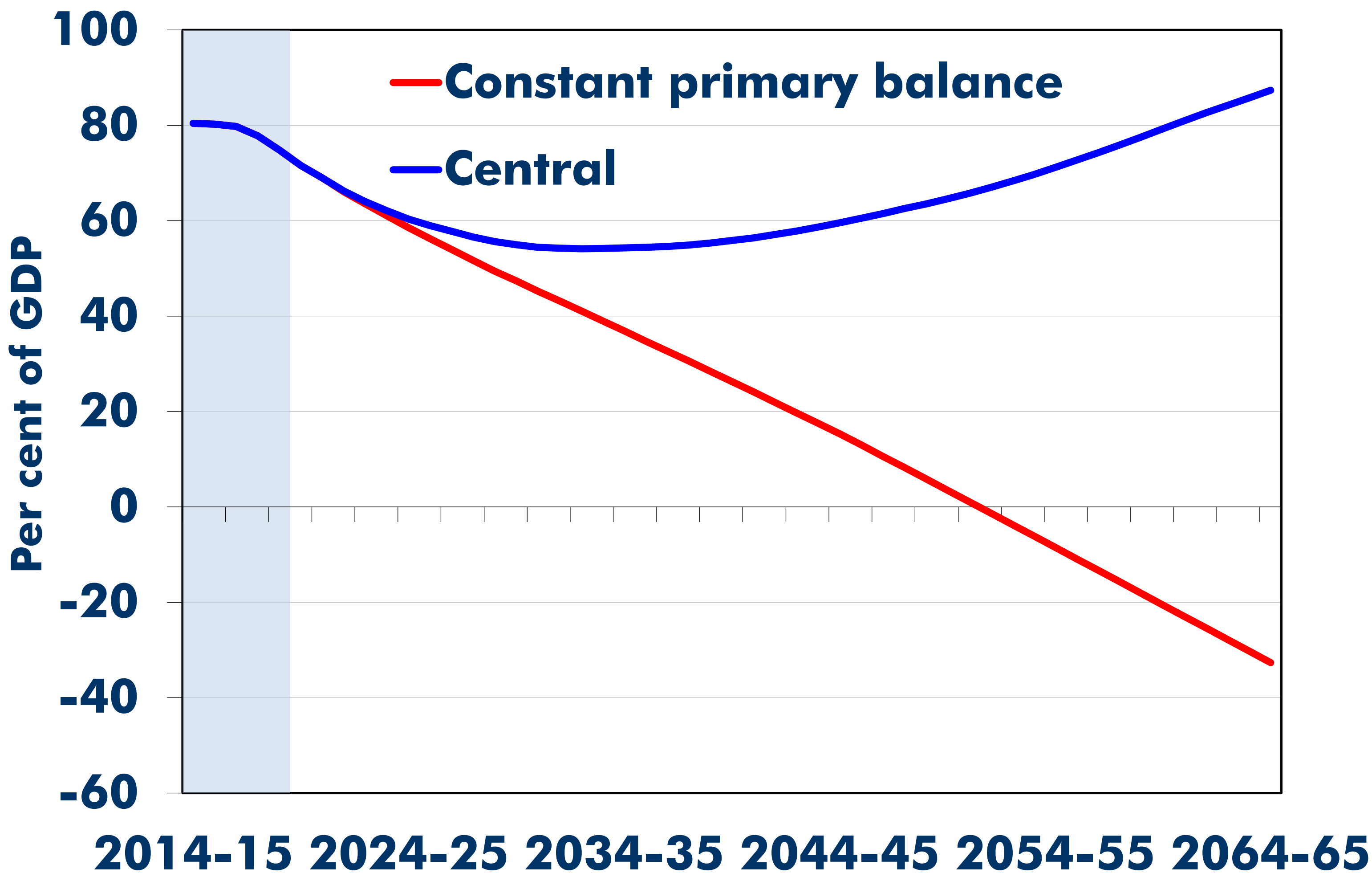
Public sector net



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What has changed since last year?

% GDP in 2064-65	**Primary balance**	**Net debt**
FSR 2014	**-1.7**	**85**
Higher departmental spending and weaker receipts at end of medium term forecast etc	*-0.7*	*+21*
Move from low migration to principal population projections	*+0.5*	*-19*
FSR 2015	**-1.9**	**87**

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Sensitivity analysis

- Considerable uncertainty around 50 year projections

- Outlook for debt would be worse if:
  - Primary surplus at end of *EFO* forecast smaller
  - Population structure older
  - Long run interest rates higher relative to long run growth rates
  - Health spending had to rise to offset weak productivity growth
  - Health & education spending move with demographics from 2015-16 onwards

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Achieving sustainability

- Fiscal gap: PSND of 40% of GDP in 2064-65
  - Permanent tightening of 1.1% of GDP (£20bn) from 2020-21 or 0.4% of GDP each decade in central scenario
    - Slightly more than last year
  - Permanent tightening of 3.3% of GDP from 2020-21if per capita health spending rises 3.3% a year in real terms to compensate for likely weakness of productivity growth

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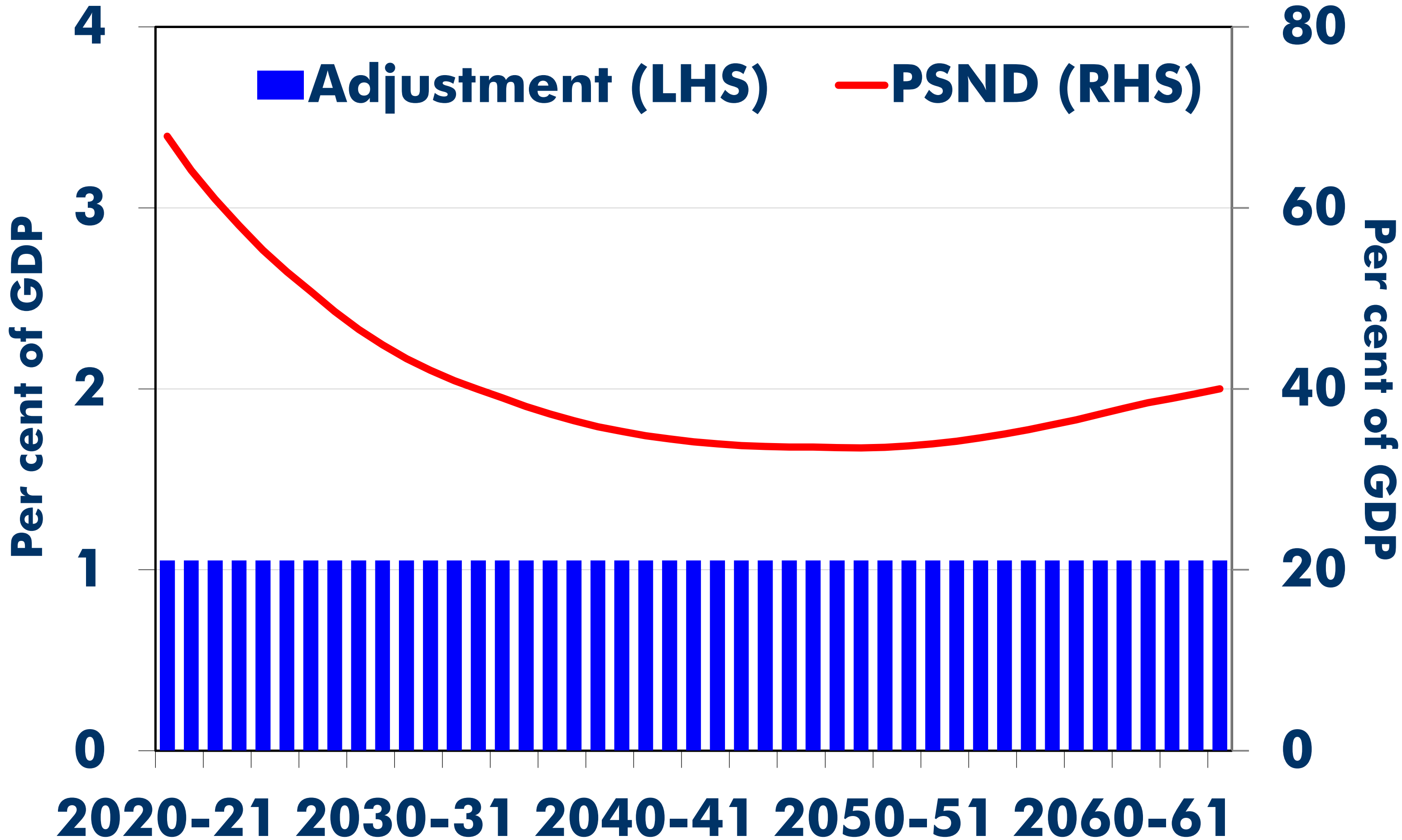
Timing the response: one-off



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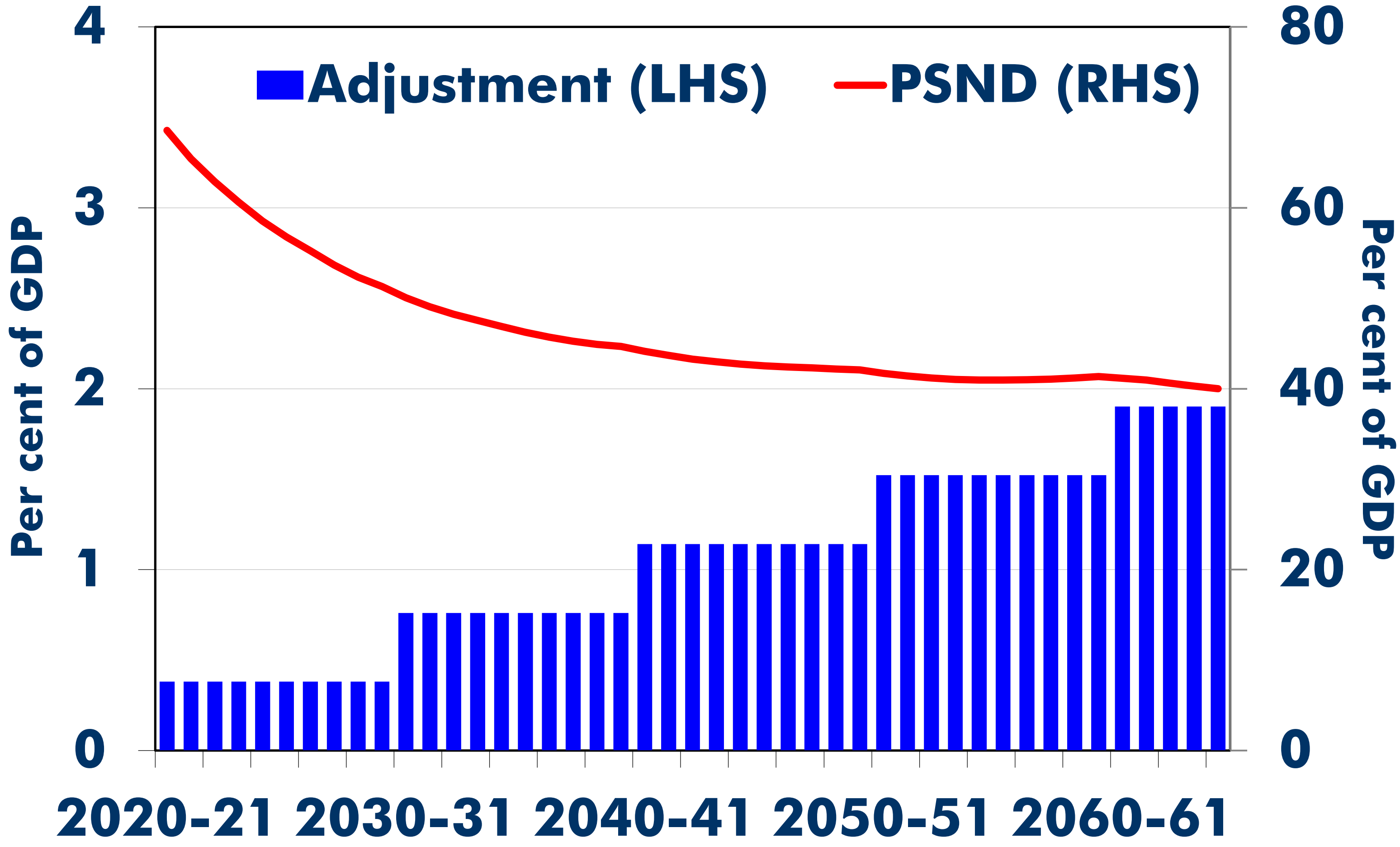
Timing the response: decade by decade



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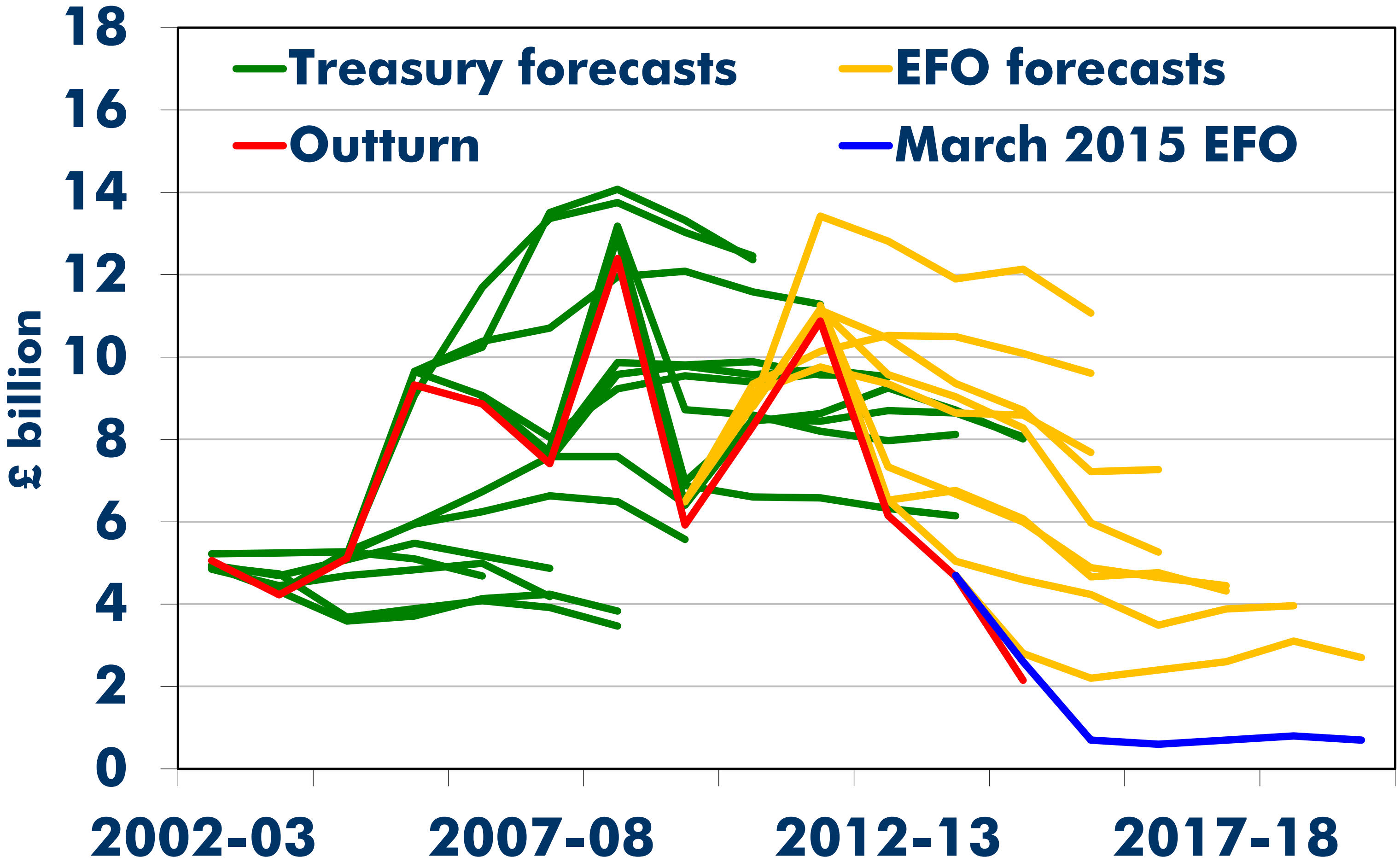
Oil and gas receipts



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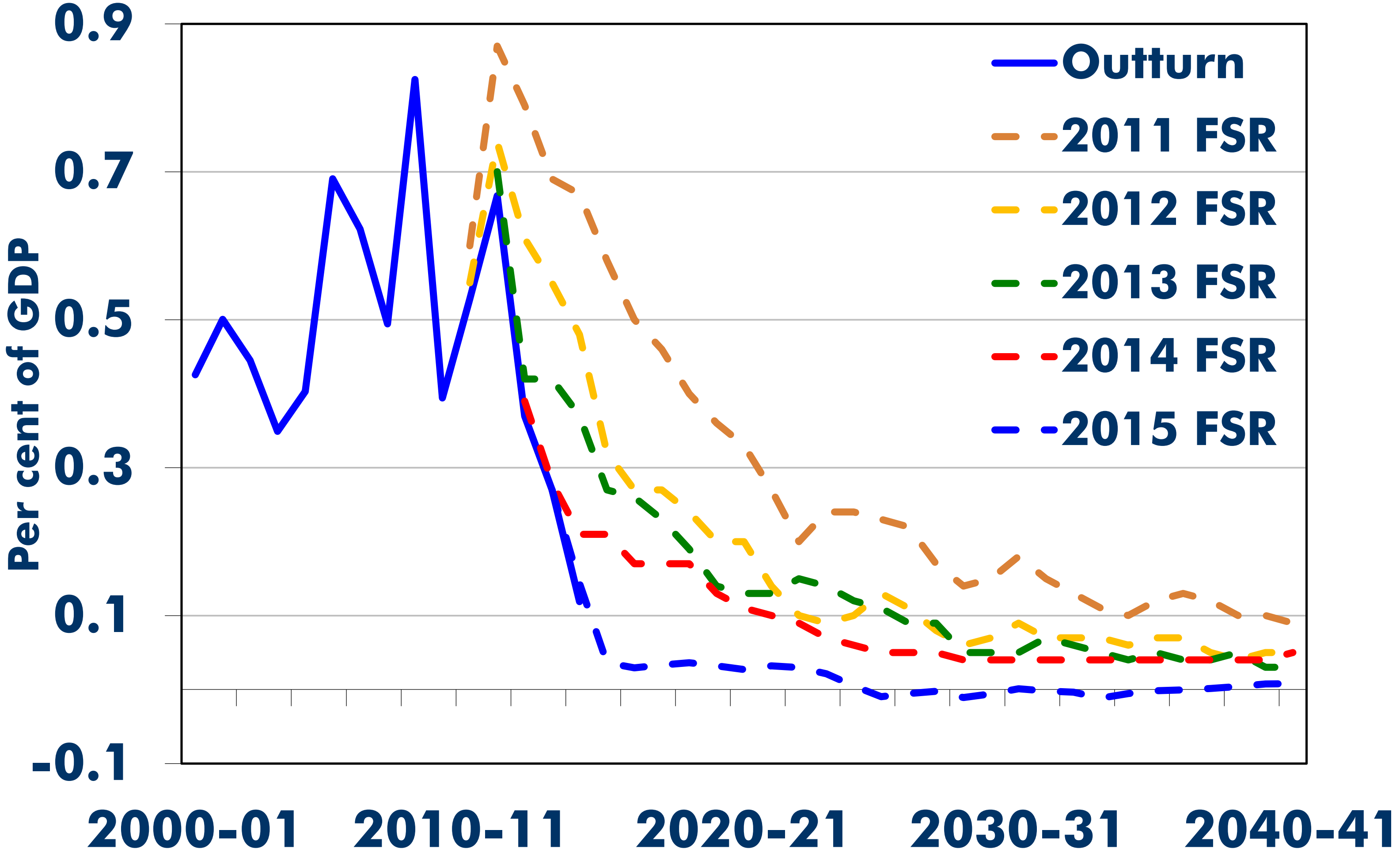

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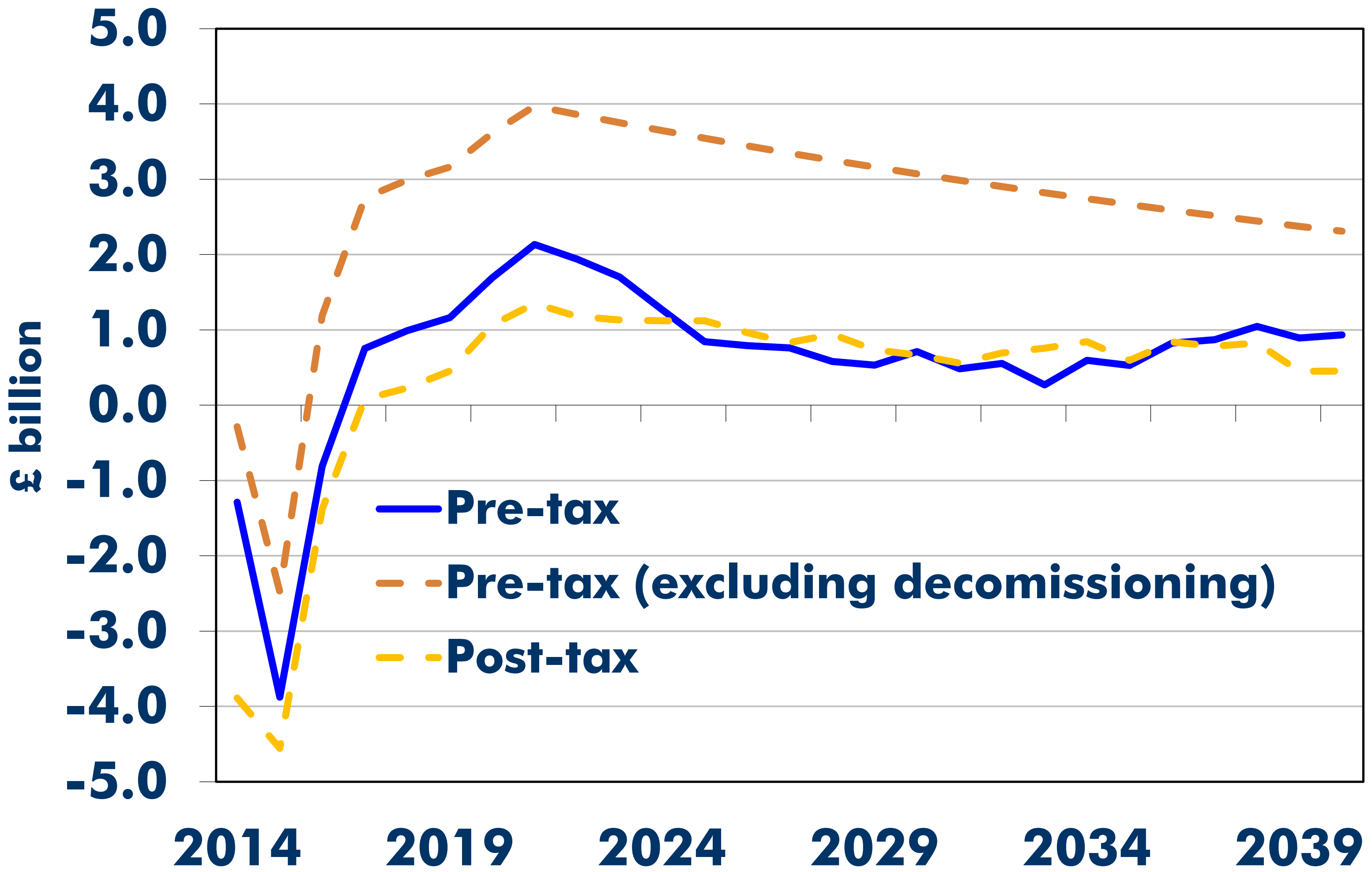
Implied pre and post tax profits



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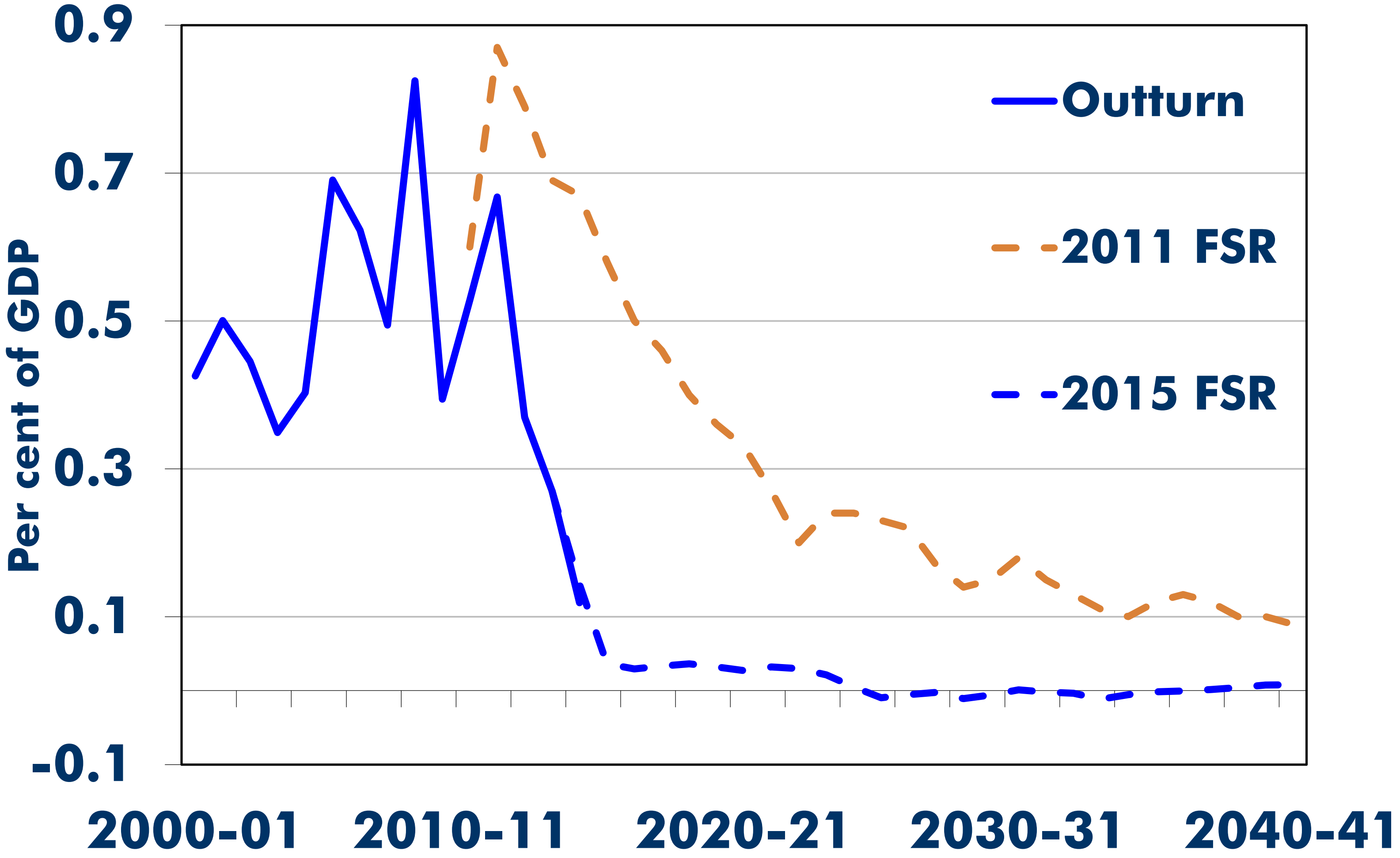
Oil and gas receipts



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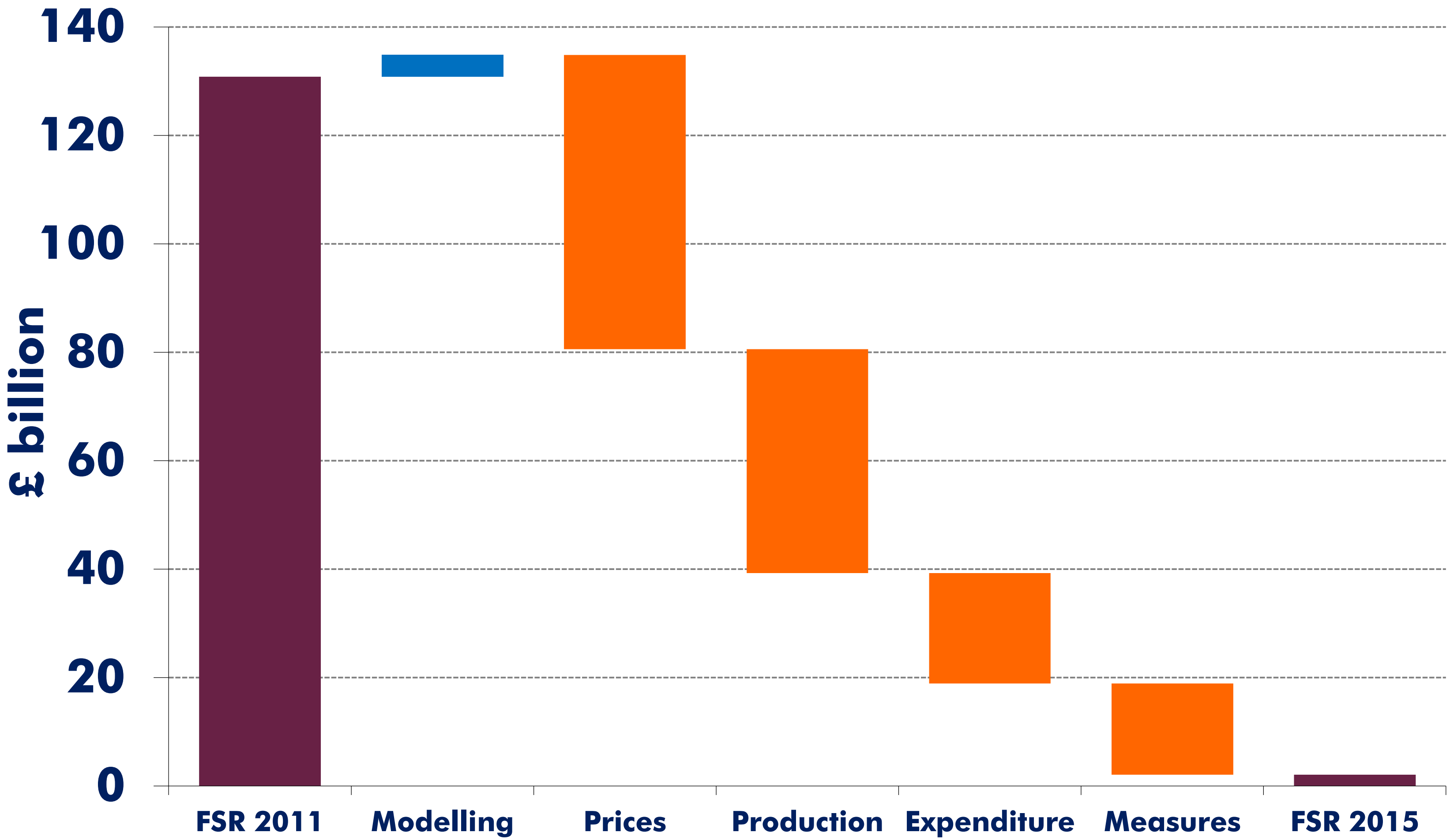
Cumulative revenues: 20-21 to 40-41



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Public sector balance sheet

- Focus normally on public sector net debt
- But also information from WGA
  - Prepared under commercial accounting rules
  - Broader coverage than public sector net debt
    - Includes illiquid assets, public service pensions, PFI, provisions and (in notes) contingent liabilities
  - Latest version for 2013-14
  - Published for five years

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Financial crisis and the balance sheet

- Gap between PSND inc and ex public sector banks has narrowed from £1.5tr in 2008 to £0.3tr as balance sheets shrink and Lloyds reclassified
- Crisis related contingent liabilities down to £0.3bn from £9.9bn a year ago (as RBS contingent capital facility withdrawn)
- PSND falling in 2015-16 as £20bn of crisis-related assets to be sold. But swapping one asset for another, so little impact on WGA net liabilities

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WGA points to spending pressures

- Provisions up from £131bn last year to £141.8bn
  - Nuclear decommissioning up £7.6bn to £77.5bn, mostly thanks to Sellafield – clean-up likely to be longer and more expensive. Further increases likely when NDA finishes work.
  - Clinical negligence up £2.9bn to £26.6bn. Unprecedented number of new claims as legislation seen likely to lower lawyers' fees. These account for a third of negligence costs.

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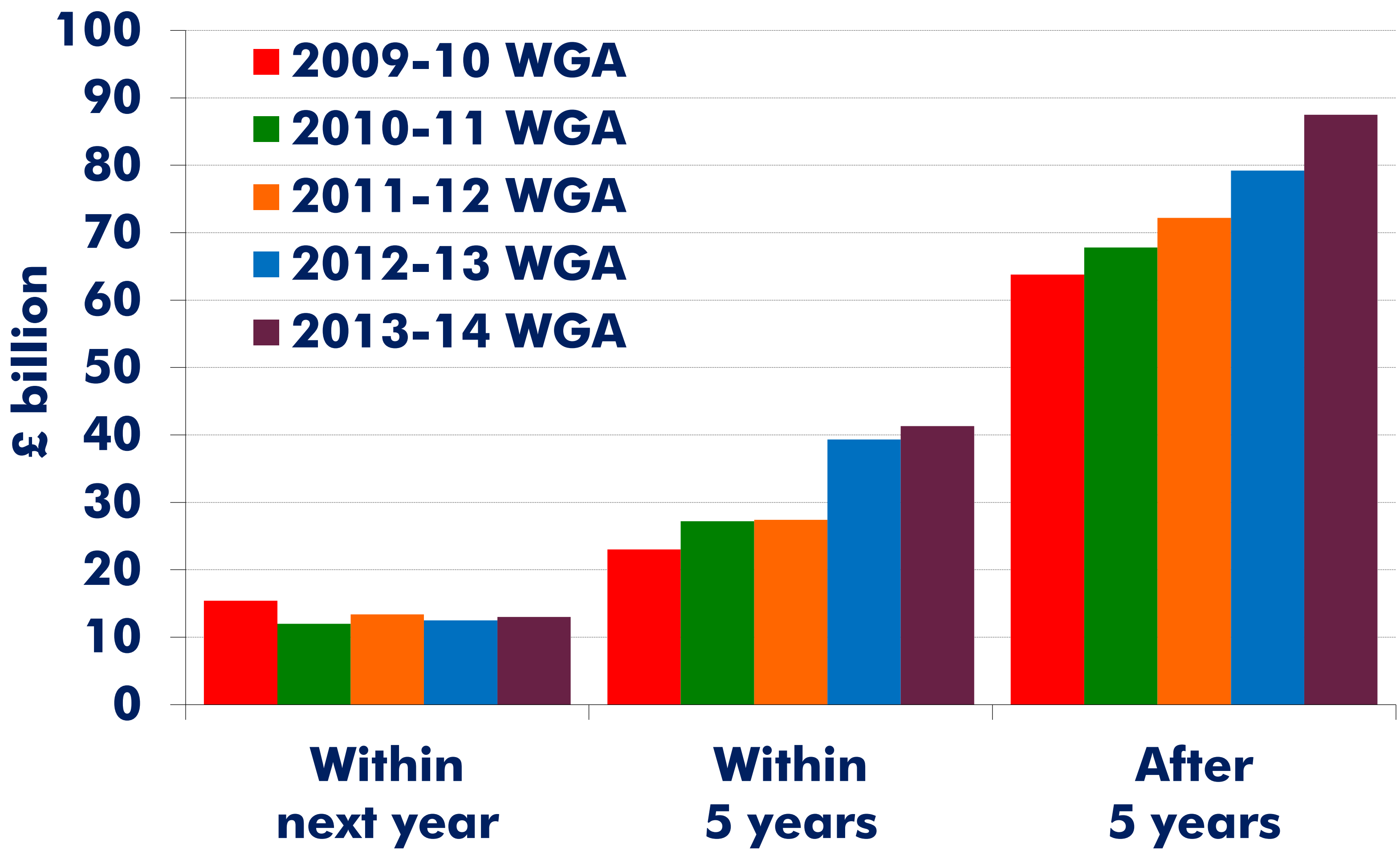
Longer-term provisions mounting



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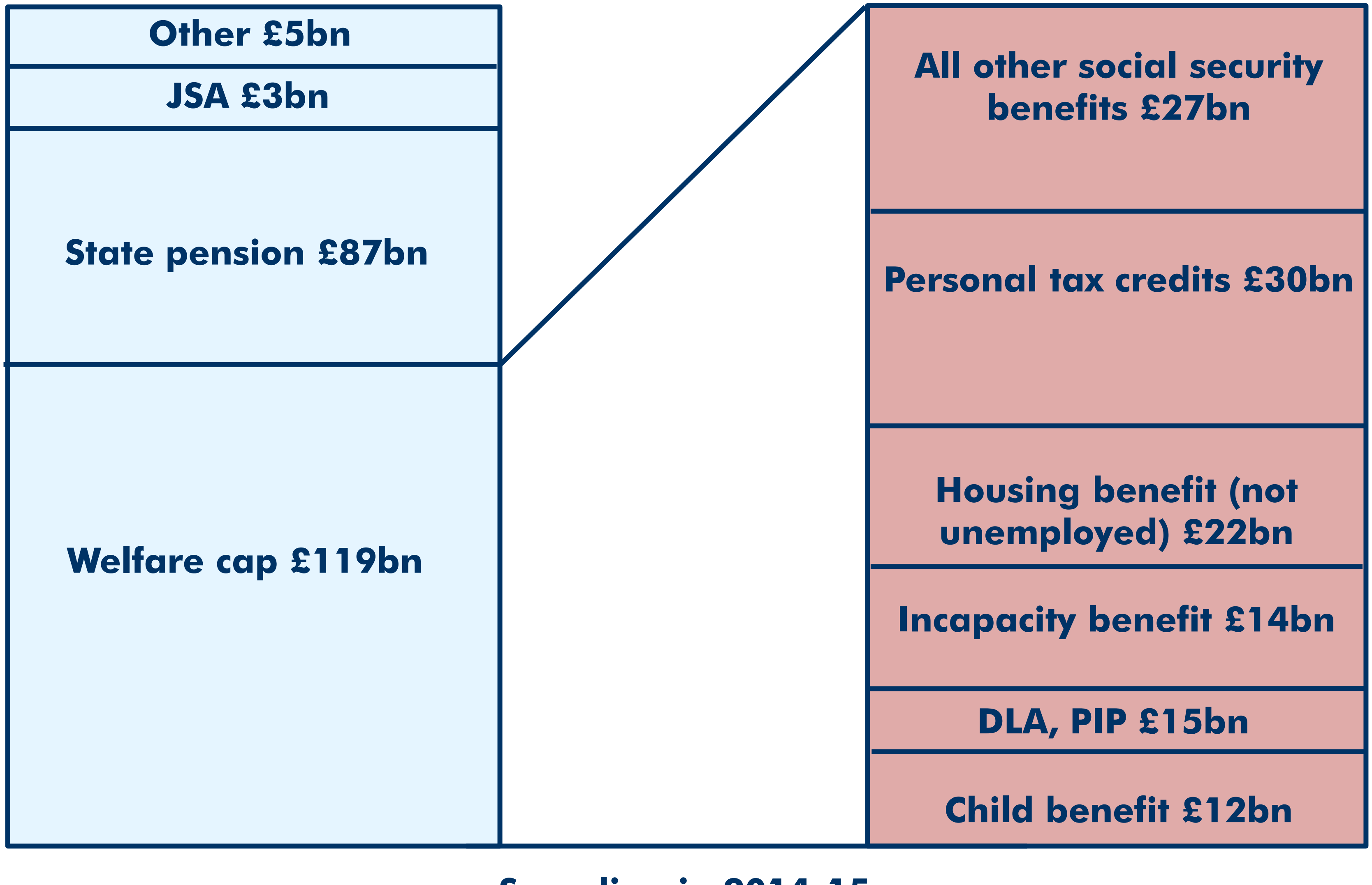
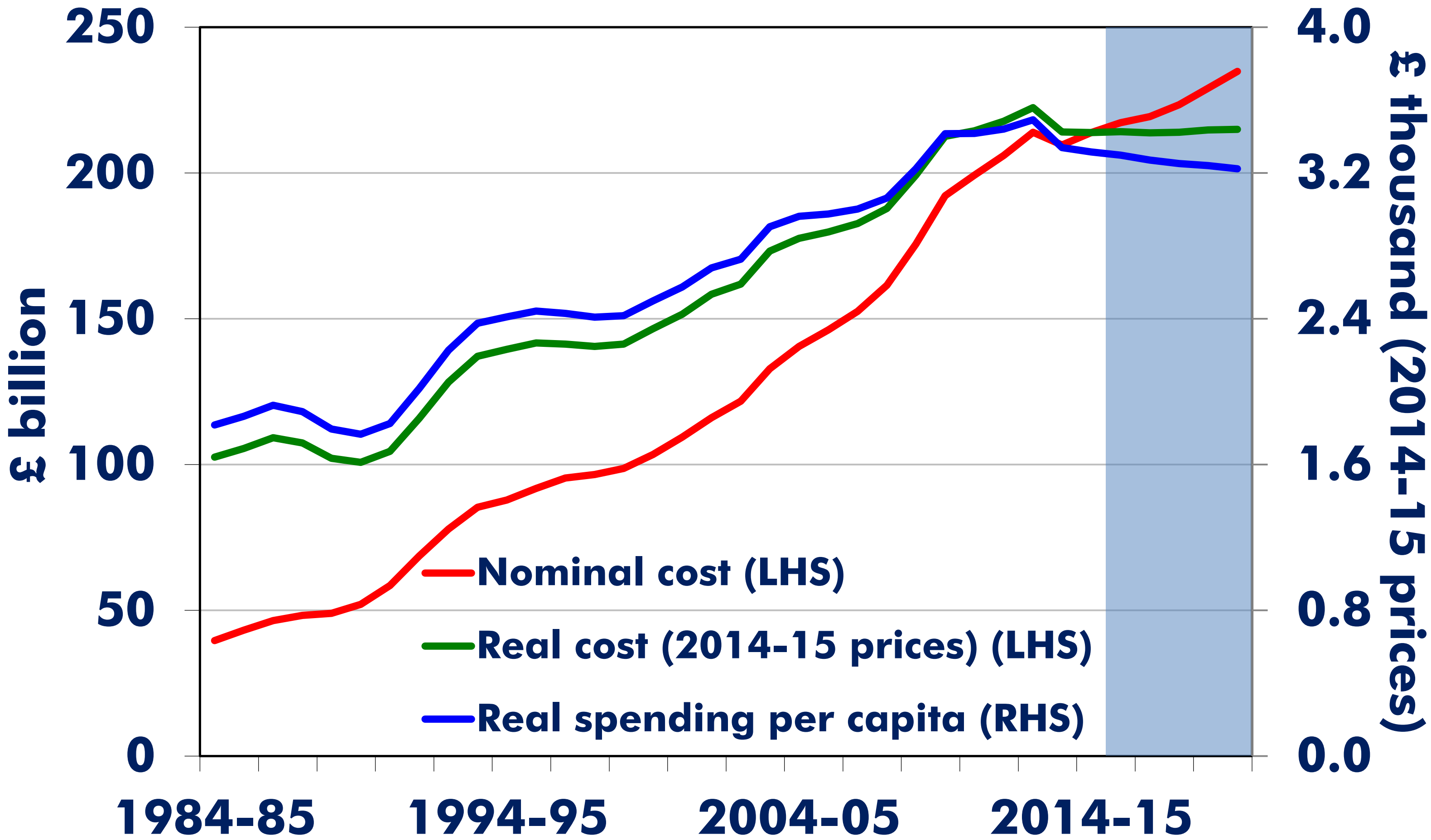
Coverage of the WTR



Total welfare spending in the UK



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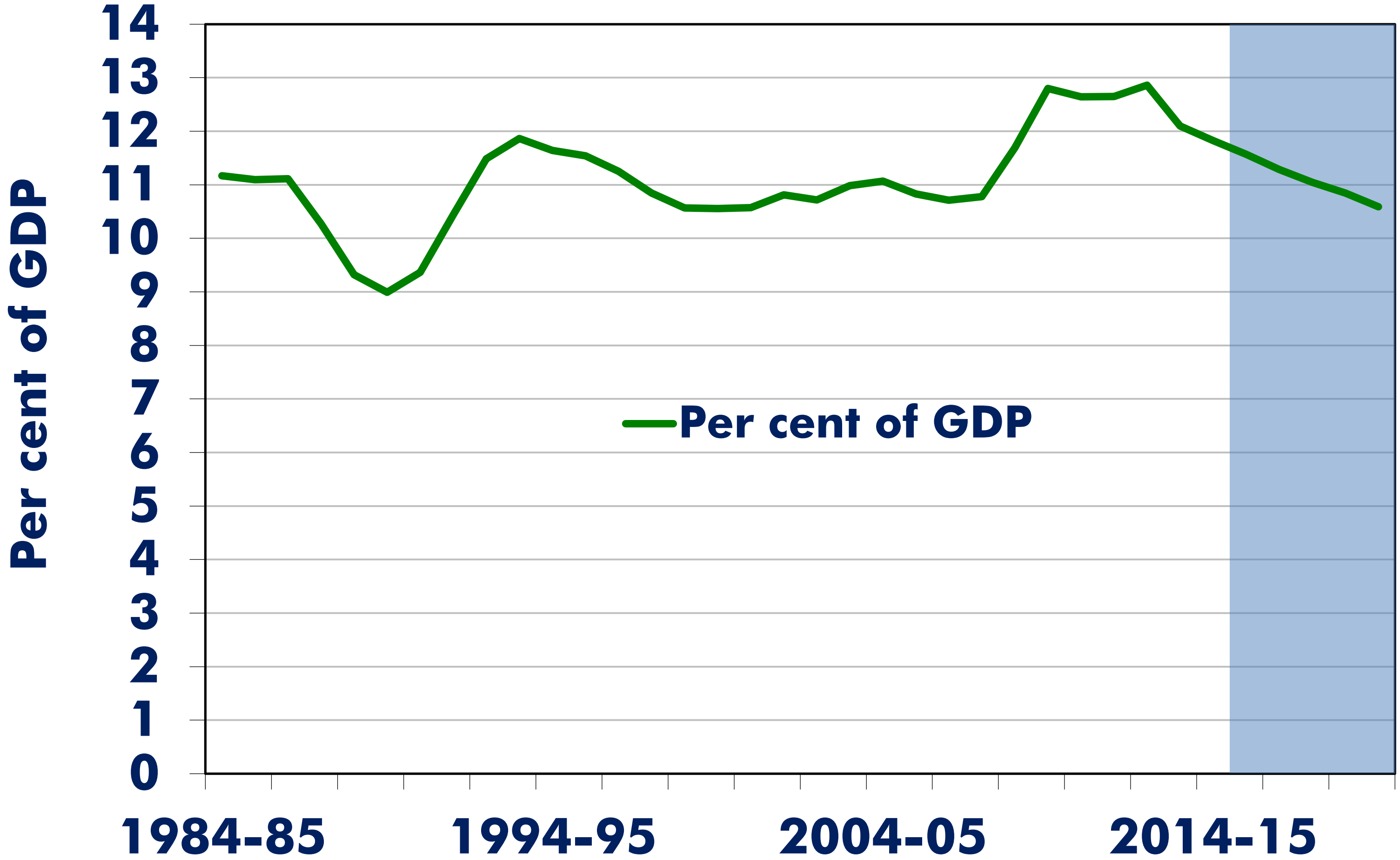

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Medium term forecasts

- **Almost 10% rise in cash terms from 14-15 to 19-20, equivalent to fall of 1.3 per cent of GDP**
- **Since last year**
  - **Incapacity benefit revised up:** assessment backlog and more claimants in support group
  - **Disability benefits revised up:** PIP slower than expected and delivering smaller savings
  - **JSA revised down:** unemployment falling quicker than expected
  - **Housing benefit revised down:** slow growth in households and lower claimant count
  - **Lower inflation saves £3bn by 16-17**
- **£7bn reduction since last year in 19-20**

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Medium-term welfare forecasts

Changes between 2014-15 and 2019-20 (per cent of GDP)	
Welfare spending subject to welfare cap	**-0.9**
Tax credits	-0.2
Housing benefit (inside cap)	-0.1
Incapacity benefits	-0.1
Disability benefits	-0.2
Other benefits	-0.3
Welfare spending outside the welfare cap	**-0.4**
State pension	-0.2
Unemployment benefits	-0.1
Other benefits	-0.1
Total welfare spending	**-1.3**

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Meeting the welfare cap

	£ billion				
	15-16	16-17	17-18	18-19	19-20
Welfare cap	**119.7**	**122.3**	**124.8**	**127.0**	**129.8**
2 per cent forecast margin	**2.4**	**2.4**	**2.5**	**2.5**	**2.6**
Difference between March forecast and cap	*0.8*	*-1.3*	*-3.0*	*-2.9*	*-3.2*

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Risks to the forecasts

- **Risks remain to the cap**
  - Housing benefit: trends in housing tenure and rents
  - Incapacity, disability and UC: delivery challenges
  - Inflation via uprating
- **To date good news on inflation has created space to pay for bad news on delivery**

- **Looking ahead, Conservative manifesto promised £12bn from welfare savings in 17-18**

- **But bear in mind that policy changes don't always raise/cost amount first estimated**

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Revisiting past costings

- **'Triple lock' pension uprating**
  - Forecast to cost £0.4bn in 14-15. Now £2.9bn
- **Switch from RPI/ROSSI to CPI uprating**
  - Forecast to save £2.6bn in 14-15. Now £2.1bn
- **Child benefit withdrawal at high incomes**
  - Forecast to save £2.2bn in 17-18. Now £1.6bn
- **Tax credits operational changes**
  - Forecast to save £1.2bn in 14-15. Now £0.4bn

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International context

- ‘Social protection’ as defined by OECD and EU (inc health and other benefits in kind)
- Compare UK and other Anglophone countries to OECD average and Continental Europeans (Bismarckian) and Nordics (higher spenders)

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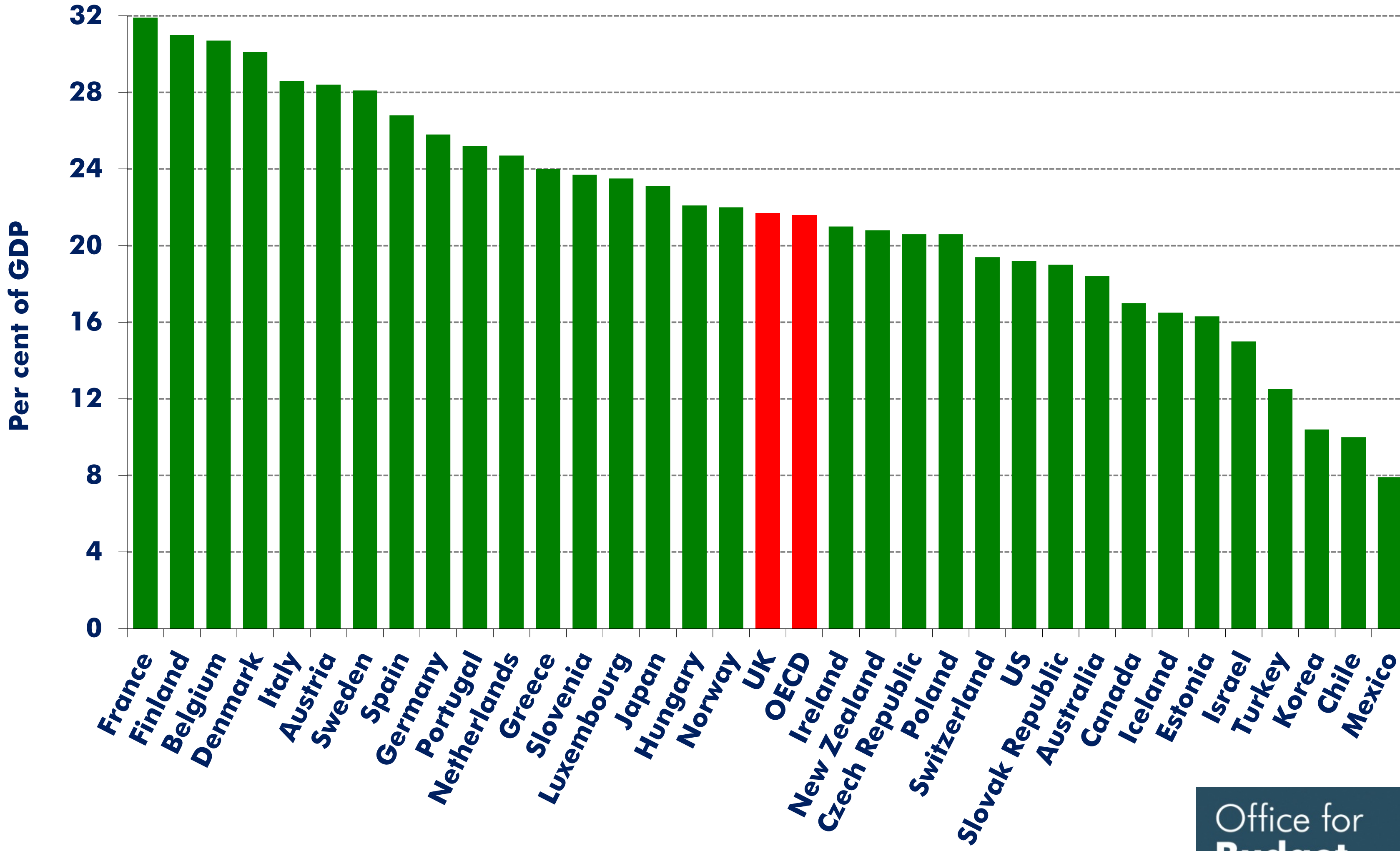
Public spending



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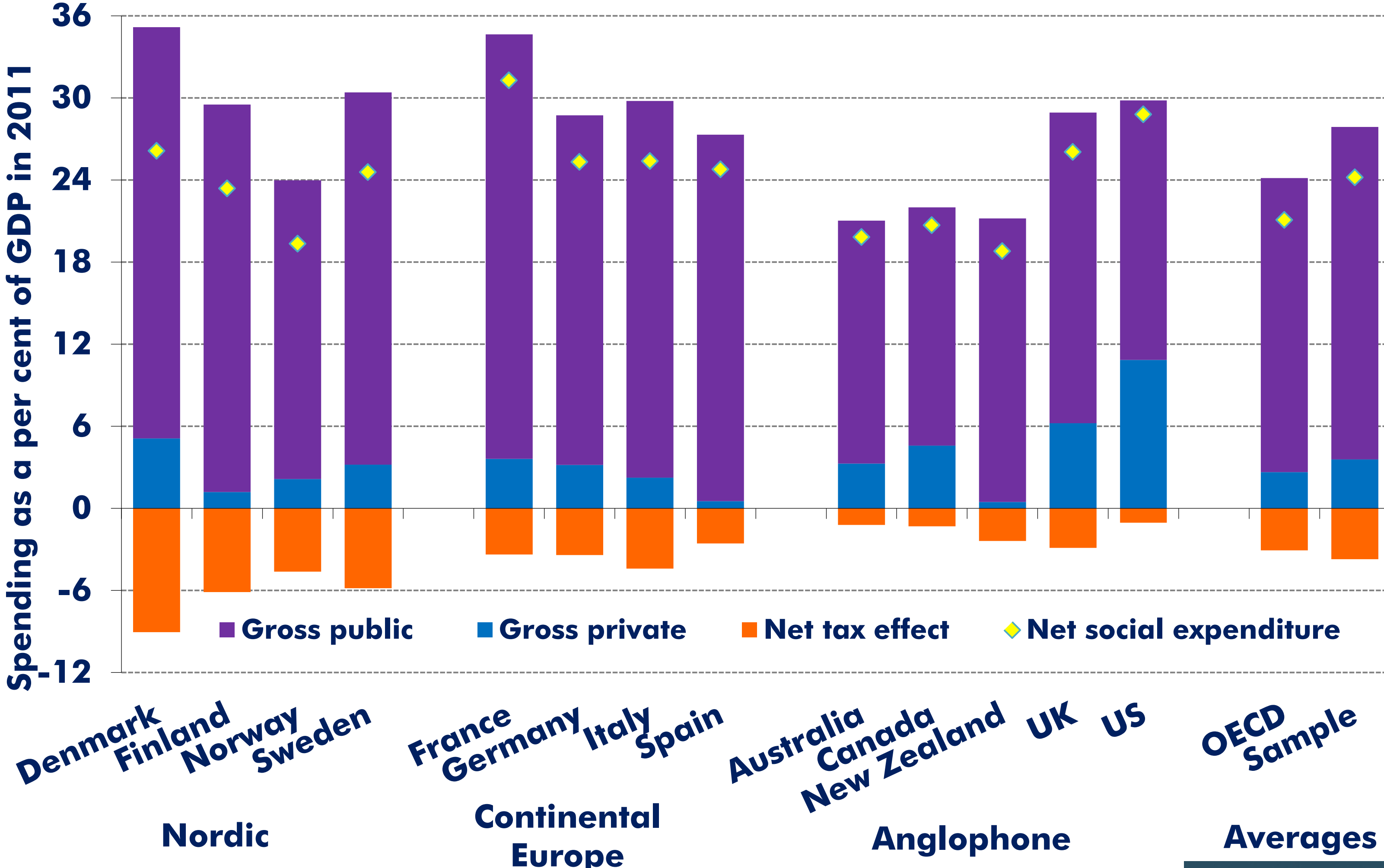
Net total spending



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Types of spending

- Reliance on private pensions unusual, but near average total spending given demography
- Near average spending on sick and disabled, but more cash support than benefits in kind
- Much less than average on unemployed, but partly because of separate housing benefit
- Spends more than any other country on family support, reflecting use of child credits to tackle poverty and generous uprating since recession