

Office for
**Budget
Responsibility**

Economi'r DU a'r goblygiadau ar gyfer trethi Cymru
UK economy and the implications for Welsh taxes

Andy King

Pwyllgor Cyfrifoldeb Cyllidebol / Budget Responsibility Committee

Cynhadledd ar drethi Cymru / Welsh taxes conference

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Outline

- Background: the Office for Budget Responsibility
- UK economy and fiscal forecasts: March 2019
- Welsh taxes forecast: March 2019
- Scottish income tax: outturns for 2016-17 and 2017-18
- Medium-term fiscal risks: *2019 Fiscal risks report*
 - Macroeconomic risks
 - Tax-specific risks
 - A Brexit stress test
- Conclusions

The Office for Budget Responsibility

The remit of the OBR

- **Five initial tasks:**
 - Medium-term economic and fiscal forecasts
 - Assessment of progress against fiscal targets
 - Scrutiny of tax and welfare measure costings
 - Long-term and balance sheet analysis
 - Evaluation of past forecast accuracy
- **Additional tasks:**
 - Forecasting devolved tax receipts (since 2012)
 - Regular report on trends in welfare spending (since 2014)
 - Regular fiscal risks report (since 2017)
- **But no policy advice**

The OBR and Welsh taxes

- **Forecasting devolved taxes in Wales**
 - Forecasts produced since 2014
 - From this year: official independent forecaster for Welsh Govt
 - Build on the work by Bangor University
 - Transparent about judgements, uncertainty and process
 - Central forecasts, but will inevitably differ from outturn

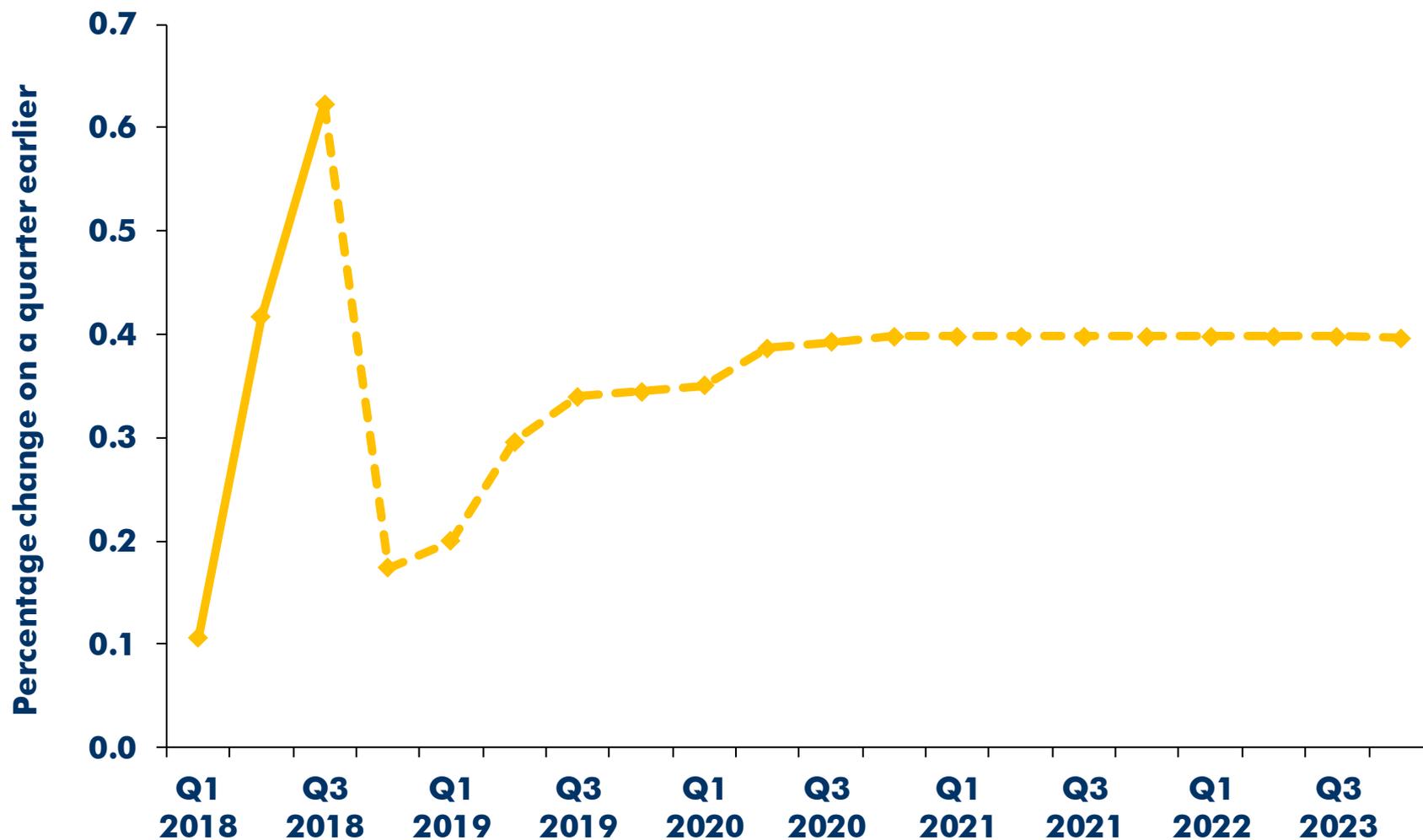
March 2019 *EFO*

UK economy forecast

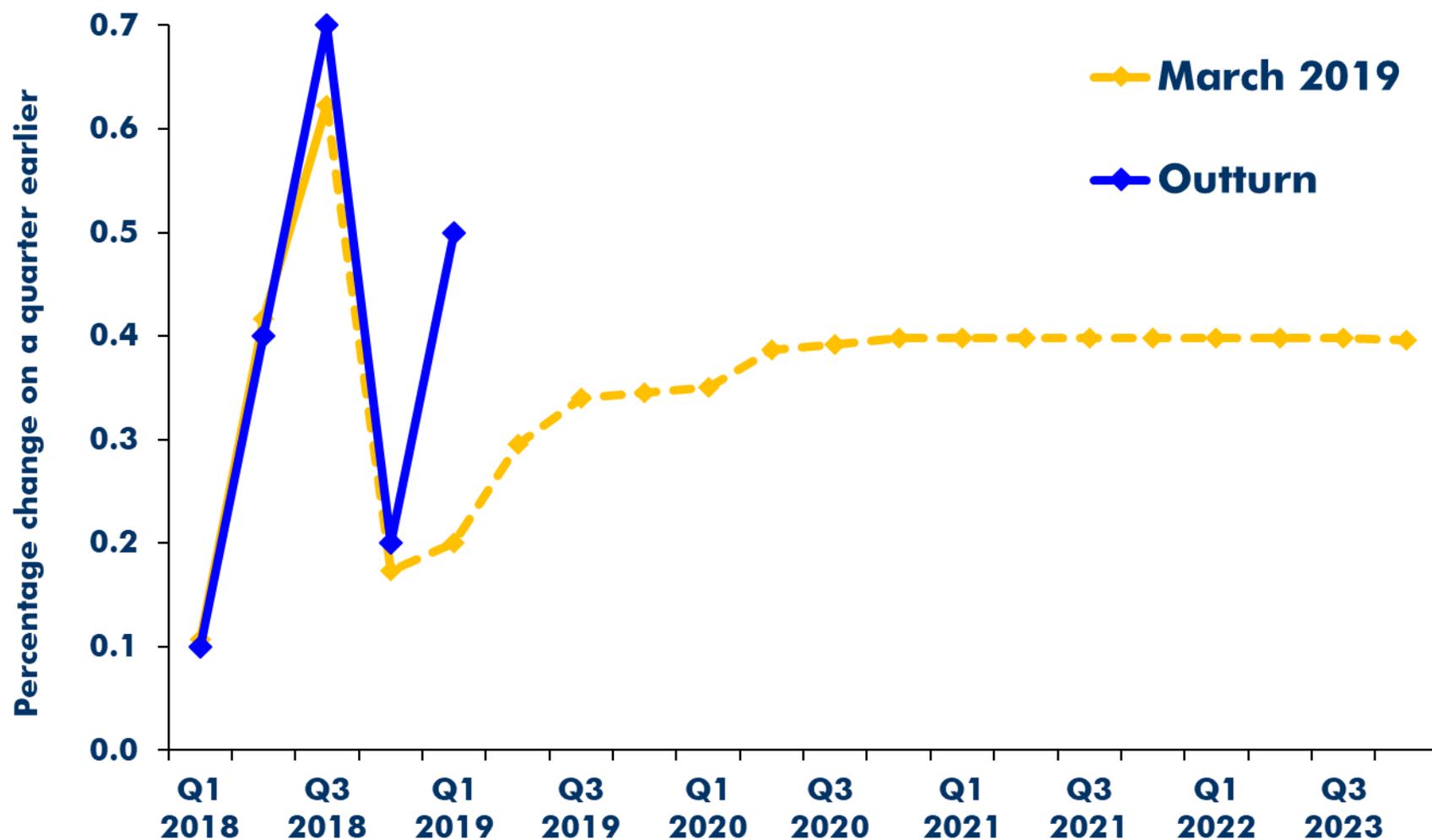
UK economy forecast: summary

	Percentage change on previous year, unless otherwise specified						
	Outturn			Forecast			
	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Real GDP	1.7	1.4	1.2	1.5	1.6	1.6	1.6
Nominal GDP	3.9	3.1	3.2	3.4	3.5	3.6	3.6
CPI	2.8	2.3	2.0	1.9	2.0	2.0	2.0
Wages and salaries	4.0	4.1	3.1	3.5	3.5	3.4	3.5
Non-oil profits	2.9	2.9	2.2	3.0	3.3	3.6	3.6
House prices	4.5	2.8	0.2	2.2	3.9	4.1	4.2
Property transactions (000s)	1208	1194	1180	1247	1291	1328	1362

Real GDP growth

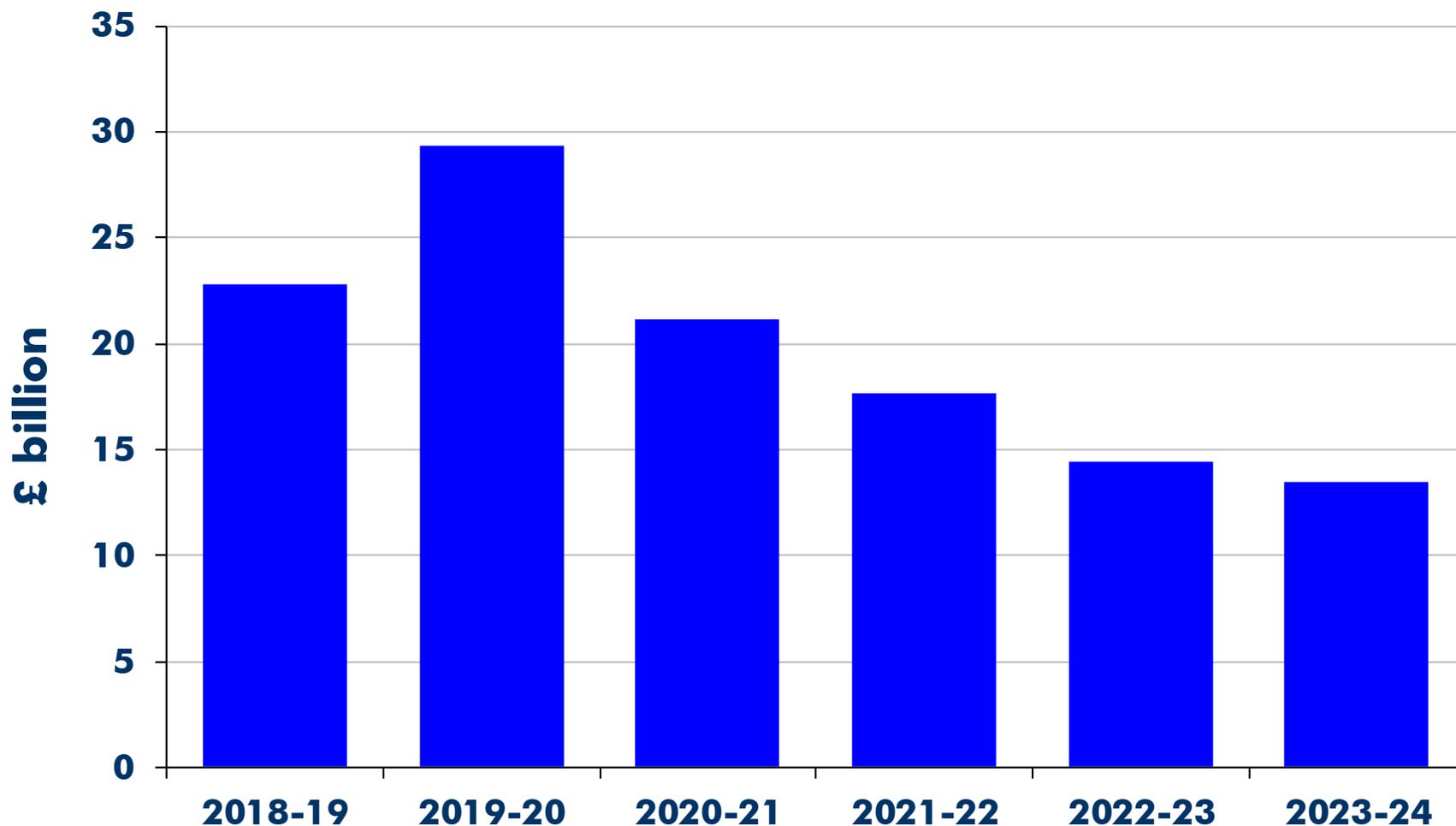


Real GDP growth

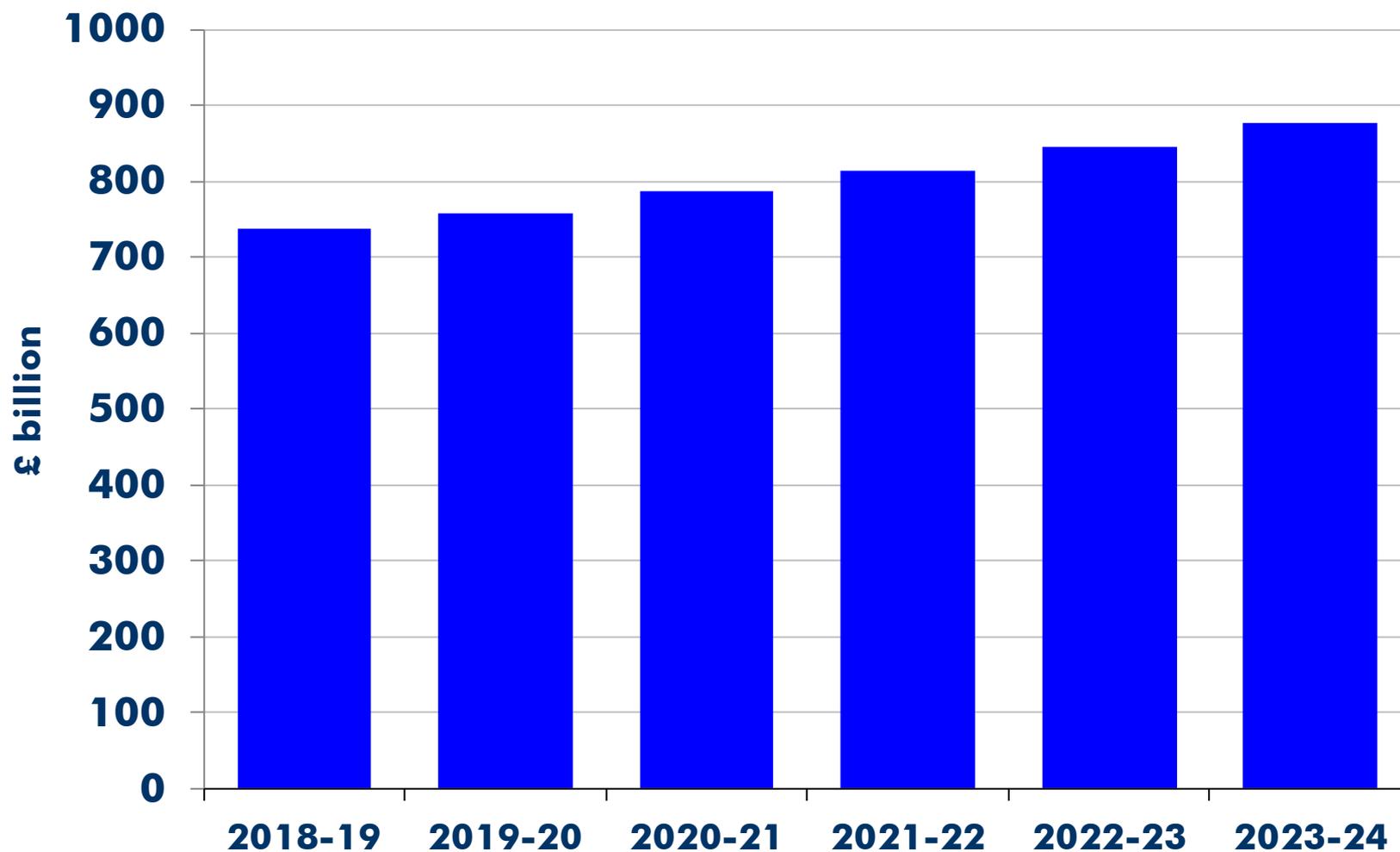


March 2019 *EFO* UK fiscal forecast

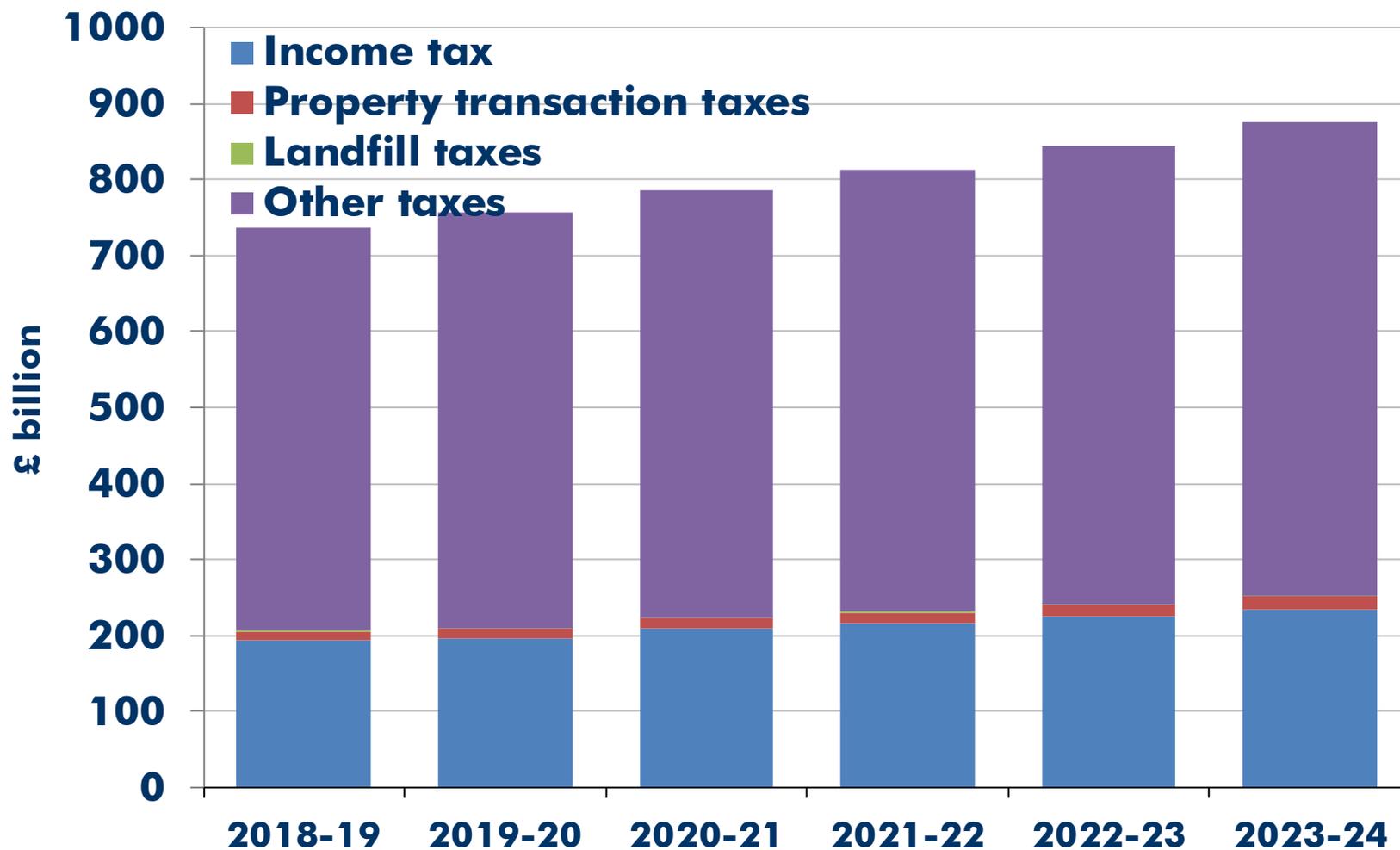
Public sector net borrowing



Receipts



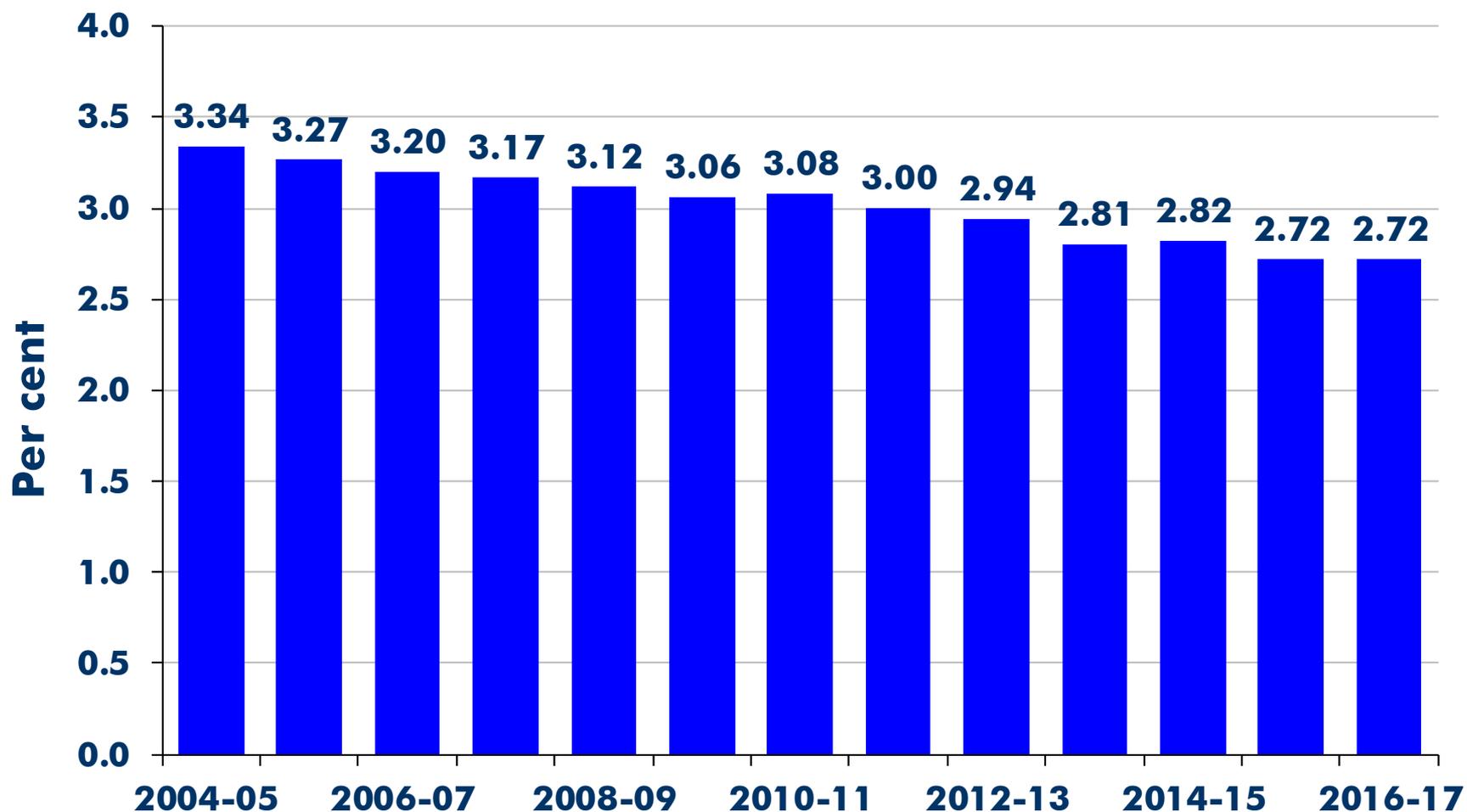
Receipts



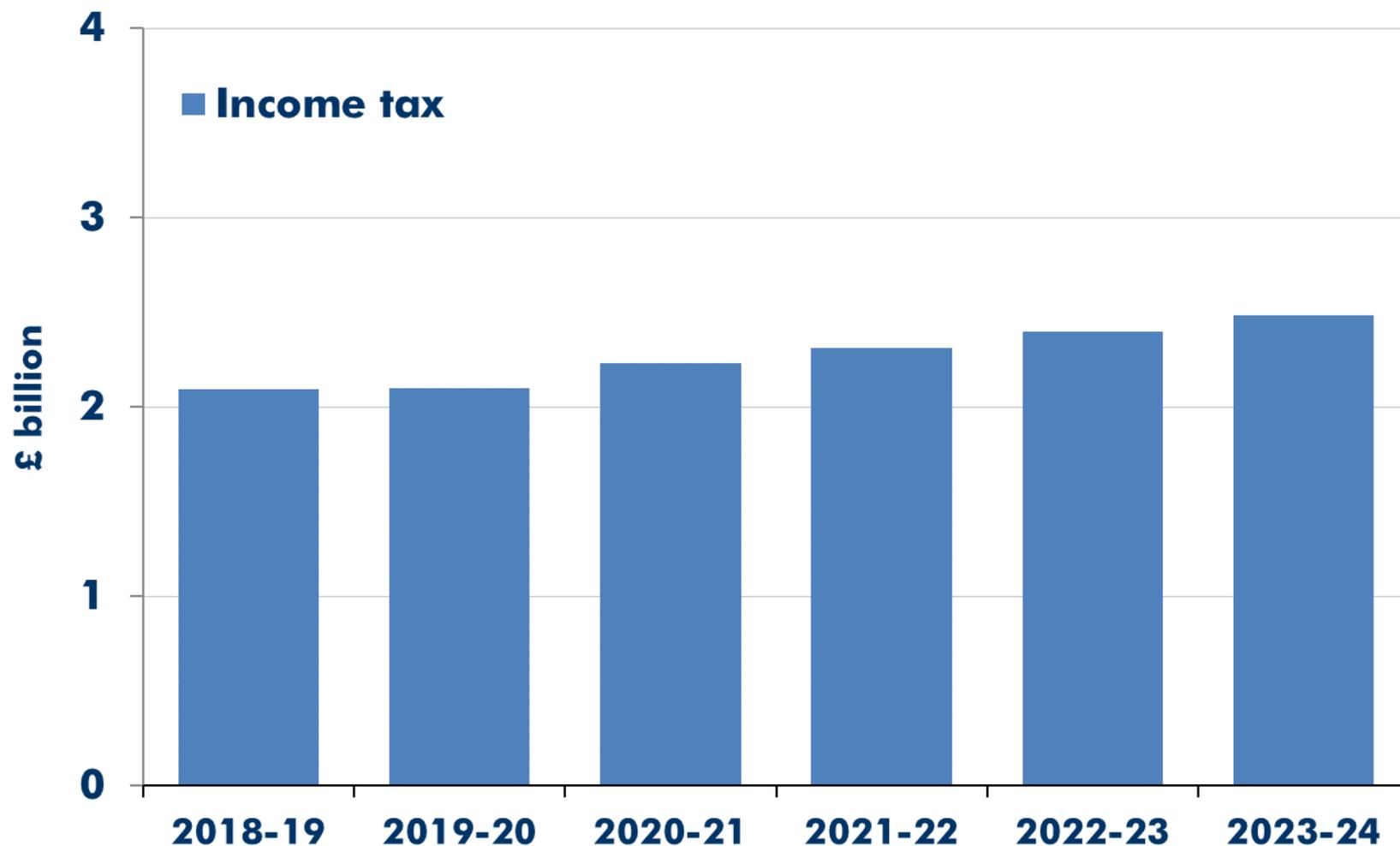
March 2019 *EFO*

Welsh devolved taxes

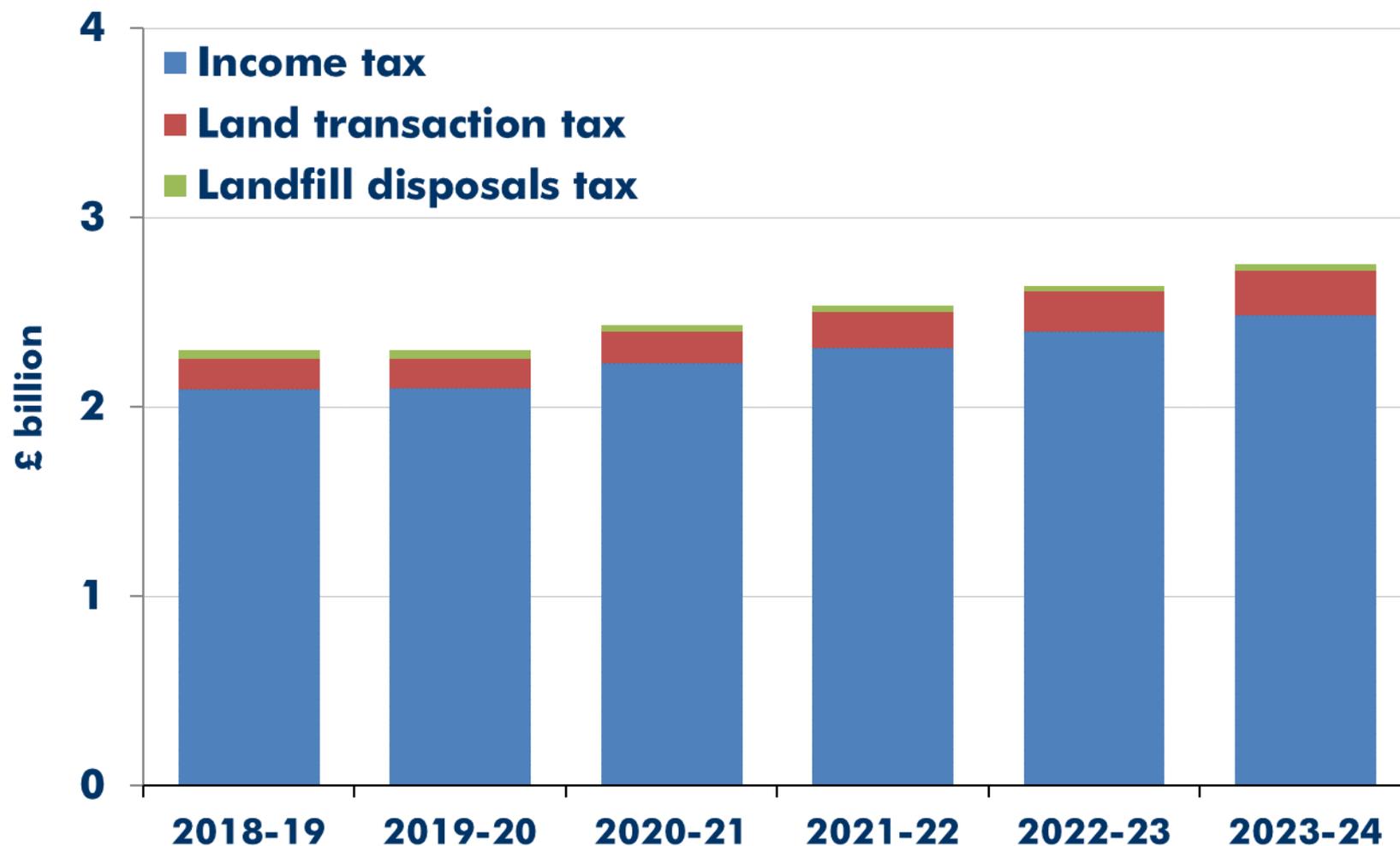
Welsh share of income tax



Welsh devolved taxes forecast



Welsh devolved taxes forecast



Sources of forecast risk

Income tax data

- First year WRIT liabilities (summer of 2021)
- Survey of Personal Incomes (SPI) currently 2016-17
- Real-Time Information (RTI) PAYE: tax and earnings
- UK-level income tax monthly receipts

Policy costings behavioural effects

- Cross-border migration and residency: English-Welsh border

Land transaction tax and land disposals tax

- Highly concentrated tax bases

Operations

- HMRC income tax 'C' flagging operations: How will they evolve?
- WRA: Compliance activities and evolution of tax gaps

Fiscal framework forecast risks

- Fiscal framework sets net spending power:
 - i.e. after block grant adjustment (BGAs).
- So asymmetric surprises matter:
 - i.e. difference between forecast and outturn for (a) our England & NI forecast that feeds into BGAs matters as much as that for (b) our Welsh taxes forecasts.
- Base year levels not a risk, but growth thereafter is
- And UK spending decisions matter via block grant

**Scottish income
tax outturns:
2016-17 and 2017-18**

First year of outturn: 2016-17

Large downside surprise in 2016-17 outturn:

- Forecast share: 7.08 per cent (£11.4 billion)
 - Outturn share: 6.68 per cent (£10.7 billion)
 - Difference: -0.40 ppt (-£700 million)
-
- 6.3% forecast error on Scottish liabilities versus 0.7% on UK-wide liabilities

First year of outturn: 2016-17

	Scottish share in 2016-17 (per cent)
a) SPI 2015-16 (postcode-based, no adjustment)	7.11
b) SPI 2015-16 (postcode-based, adjusted for population change, used in March 2018 forecast)	7.08
c) SPI 2016-17 (postcode-based)	6.88
d) SPI 2016-17 ('S' flag)	6.83
e) 2016-17 Outturn (used in October 2018 forecast)	6.68
<i>Projection error (c - b)</i>	<i>-0.20</i>
<i>Identification error (d - c)</i>	<i>-0.05</i>
<i>Unknown remaining error (e - d)</i>	<i>-0.15</i>
<i>Total forecast error (e - b)</i>	<i>-0.40</i>

Second year of outturn: 2017-18

Smaller surprise in yesterday's outturn for 2017-18

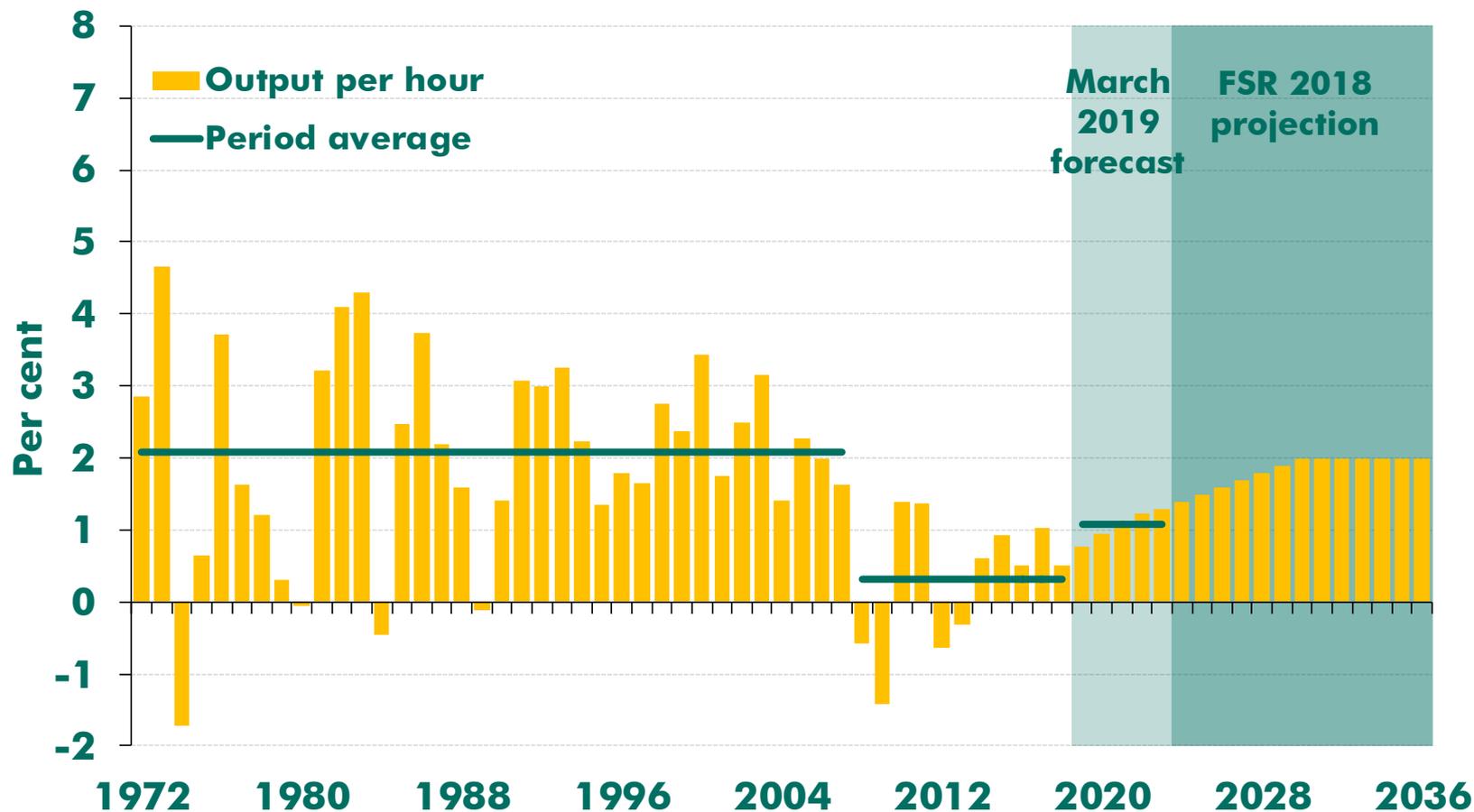
- Forecast share: 6.64 per cent (£11.1 billion)
 - Outturn share: 6.61 per cent (£10.9 billion)
 - Difference: -0.03 ppt (-£161 million)
-
- 1.5% forecast error on Scottish liabilities almost in line with 1.1% error on UK-wide liabilities

2019 *Fiscal risks report*

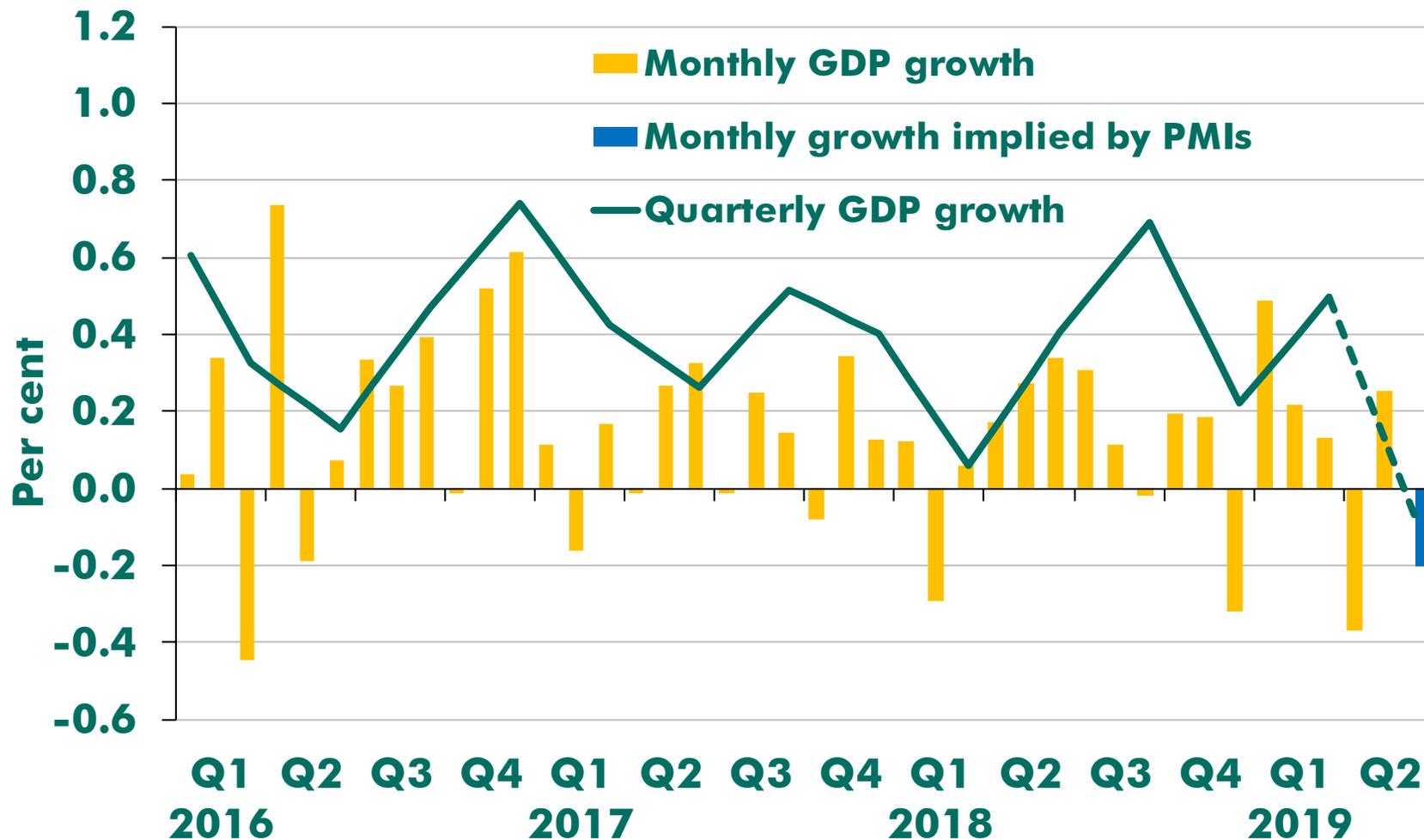
Medium-term fiscal risks

- Shocks and pressures, plus austerity fatigue and Brexit
 - Uncertainty over prospects for potential GDP growth
 - One-in-two chance of a recession in any five years
 - Tax bases under pressure, e.g. from behaviour and technology
 - Spending pressures, e.g. from ageing and other cost pressures
- Significant medium-term policy risks
 - ‘Balanced budget’ objective being downplayed
 - Big spending increases off-timetable (NHS settlement)
 - Potential PMs have big shopping lists
 - Possibility of disruptive no-deal Brexit

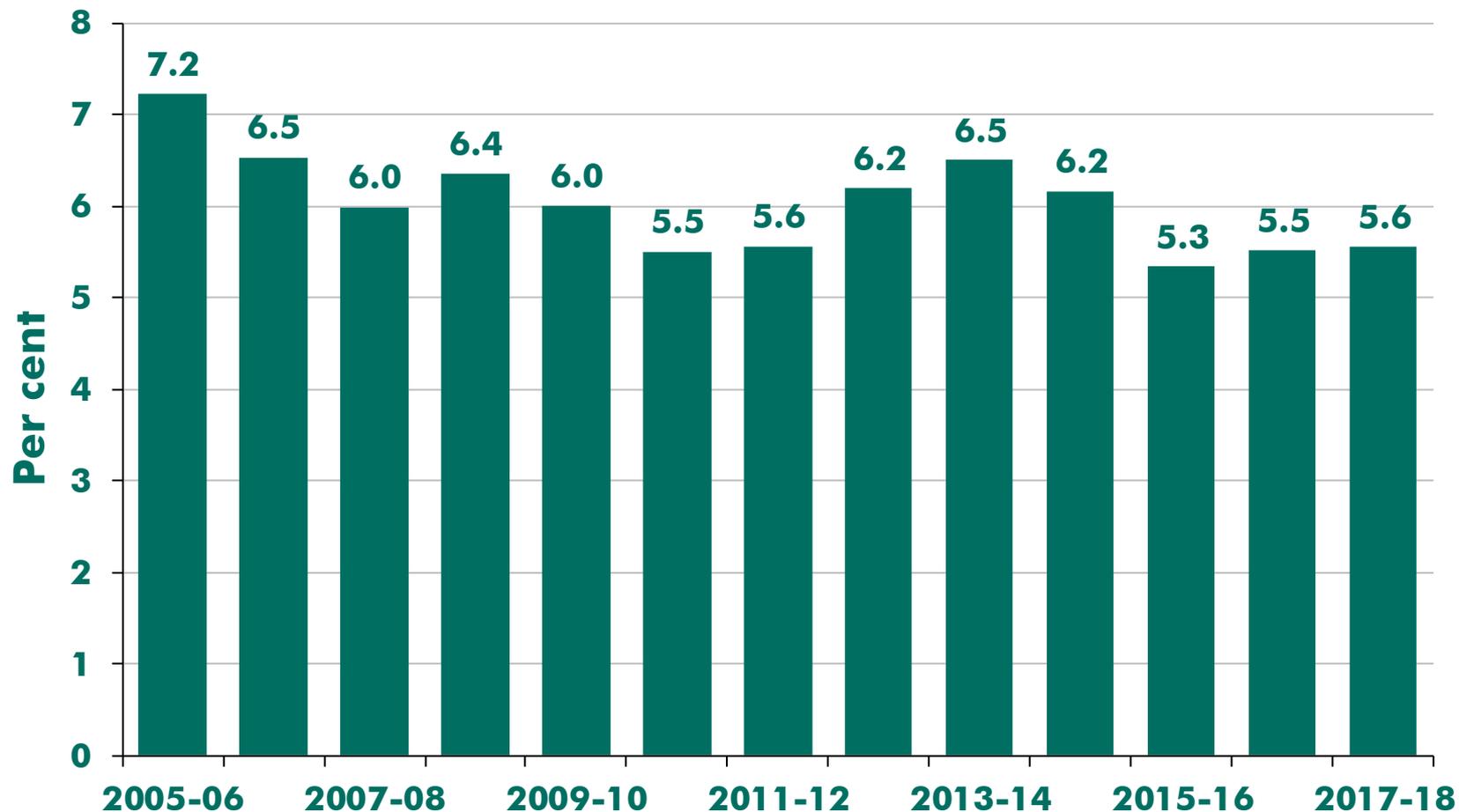
Productivity growth risk



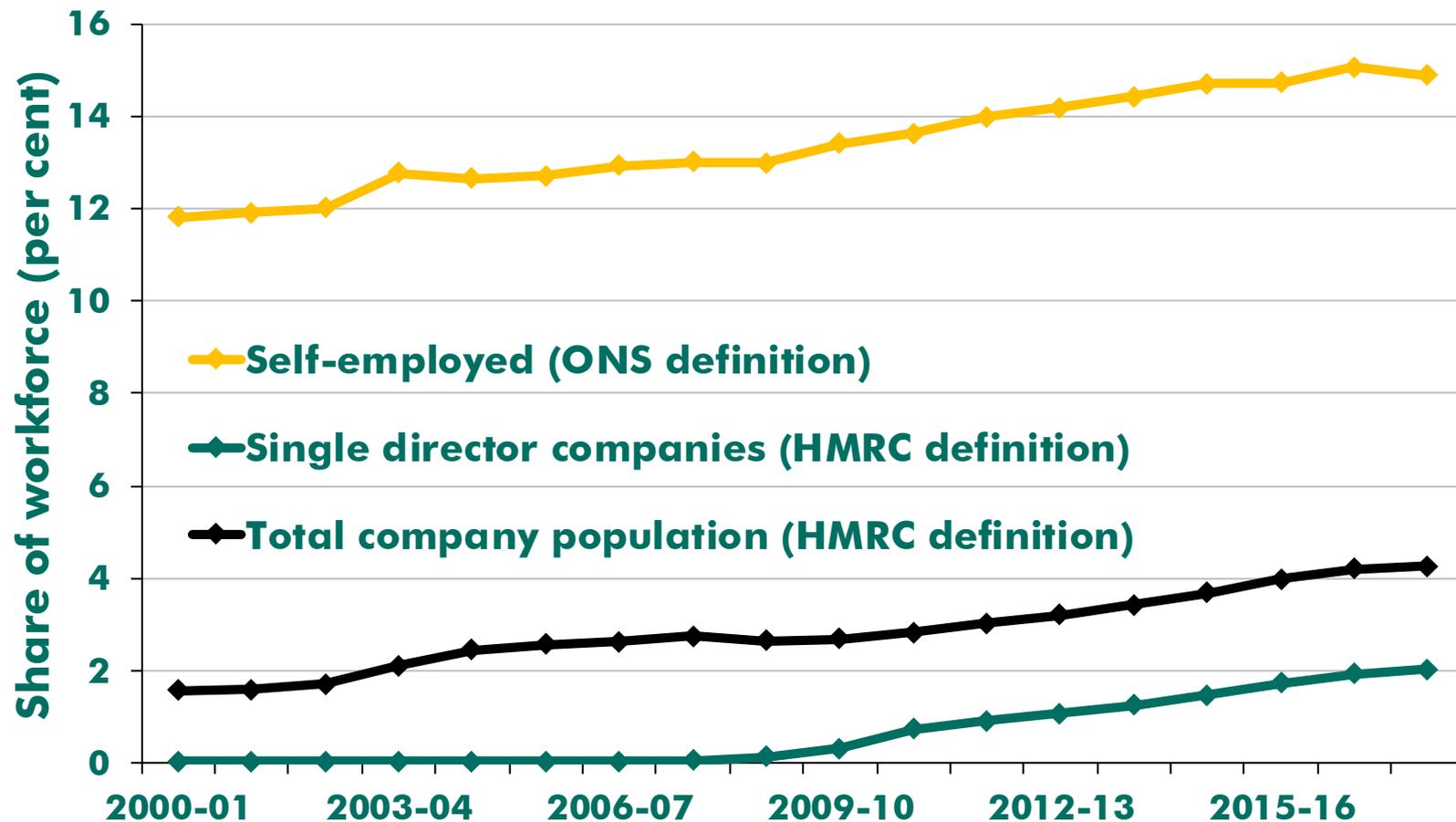
Recession risk?



Revenue risks: Non-payment of taxes due



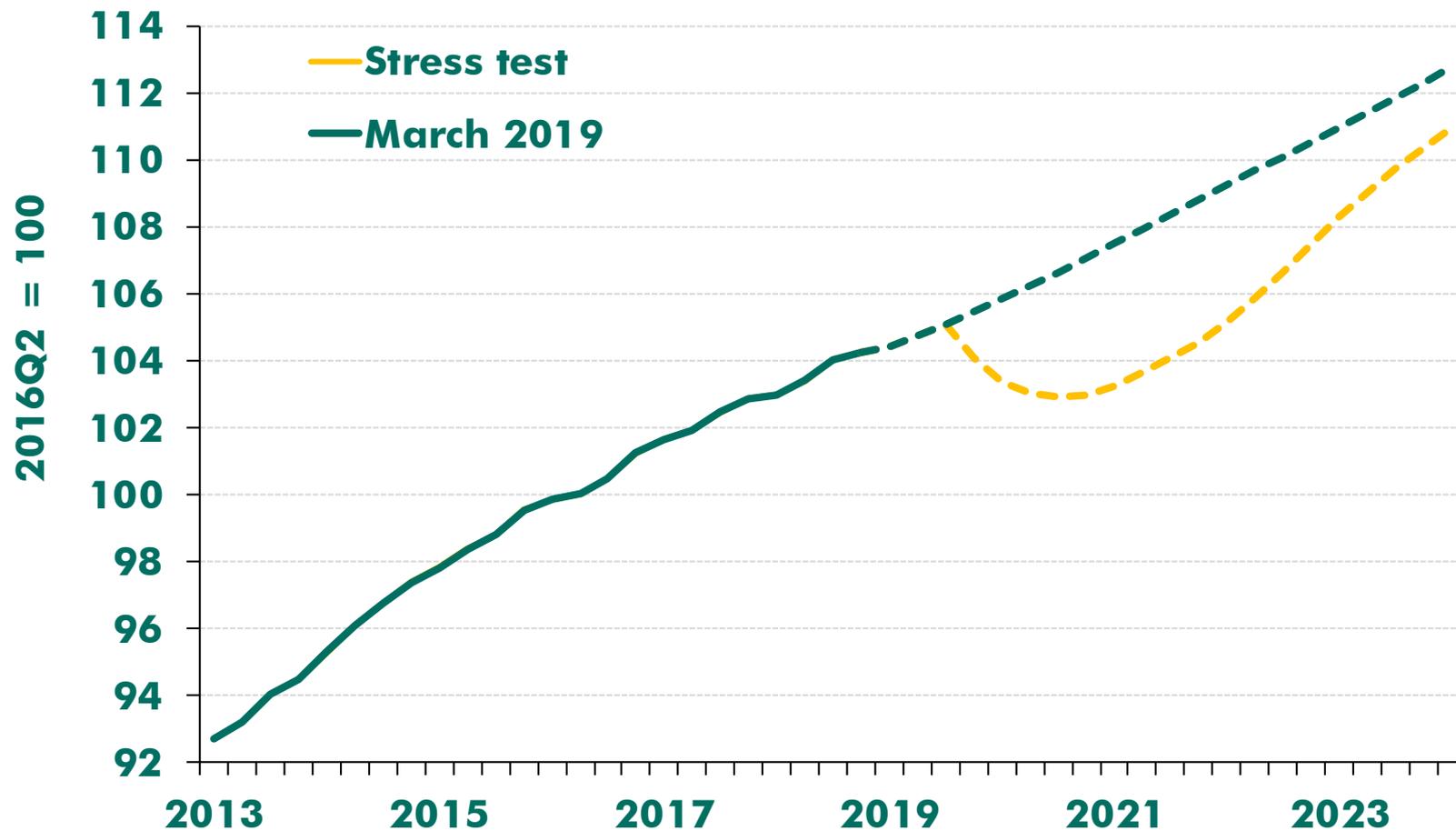
Revenue risks: Tax-motivated incorporations



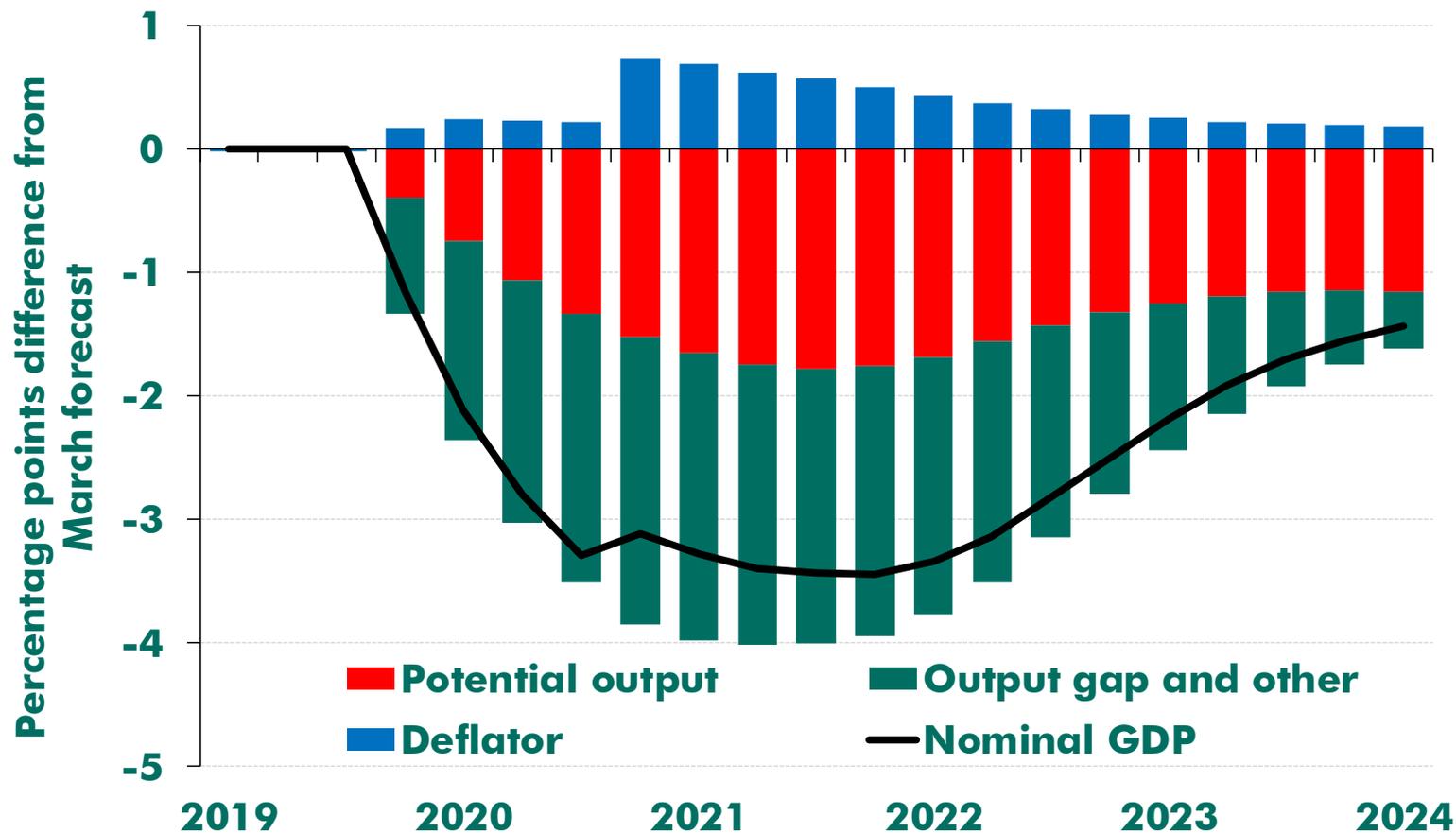
A no-deal Brexit stress test

- Based on the IMF's 'no deal, no transition' Scenario A in the April 2019 *World Economic Outlook*
- Not necessarily the most likely – a scenario not a forecast
- Less severe than some and than our 2017 stress test
- But useful to illustrate potential channels

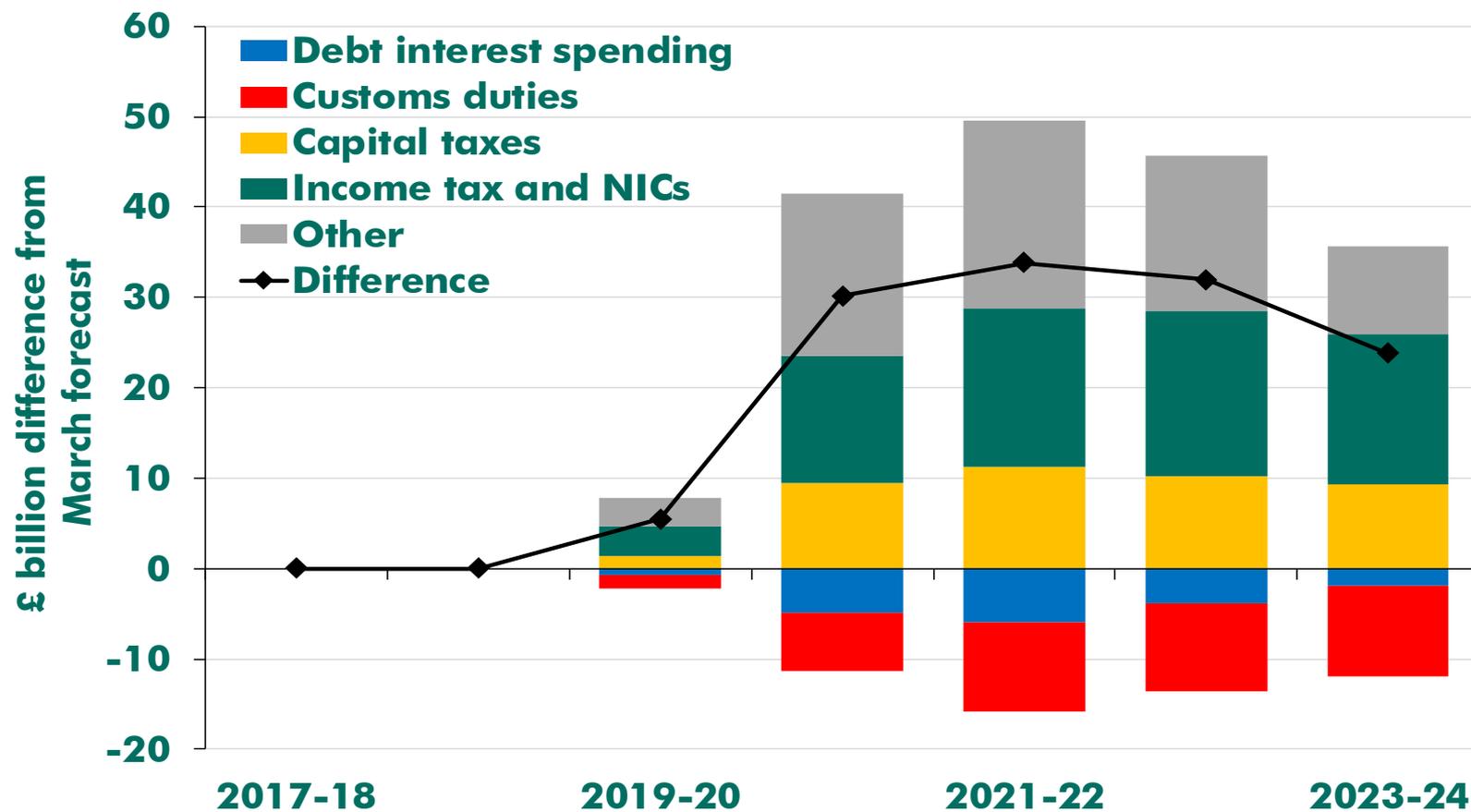
Stress test: real GDP



Stress test: nominal GDP



Stress test: borrowing



Conclusions

Conclusions

- **Central forecasts, but subject to uncertainty:**
 - UK-wide sources of fiscal risk
 - Plus, no outturn yet for the largest tax stream
 - Scottish experience shows scope for large surprises
- **Political and policy context:**
 - Brexit-related uncertainty remains significant
 - Potential PMs have big shopping lists
- **Implications for Welsh Government resources**
 - Relatively insulated via fiscal framework when plans already set
 - But subject to UK-level policy risk until that has happened