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Economic Bulletin

LABOUR'S £17,500 BILL FOR FAMILIES

- Labour's plans on infrastructure, welfare, employment legislation, tuition fees and shale gas could cost every household nearly £17,500 in just one parliamentary term (see Table 8).
- Their infrastructure plans alone could lead to a cost over £14,000 per household over the parliamentary term (see Table 2).
- Their pledges on employment legislation could lead to the loss of 1.3 million jobs by 2024/25 and cost the UK Treasury over £10bn a year by 2024/25 (see Table 4).
- The pledge to end tuition fees could cost over £50bn over the parliamentary term (see Table 5).
- The proposed ban on fracking could hit Treasury revenues and add over £9.5bn to Britain's trade deficit over the parliamentary term (see Tables 6 & 7).

SUMMARY

In 2010, the UK's budget deficit was the highest in the western world as a proportion of GDP, equating to nearly £200 billion. Since then, significant progress has been made in reducing the budget deficit, helping to shield the UK from turbulent economic times. It is, of course, hoped that this progress will continue for the remainder of this Parliament.

However, the danger now is that, if implemented, some of Labour's economic and welfare proposals would undo much of this progress. While a Labour government may seem unlikely today, turbulent political times mean that anything is possible. Bookmakers still offer 6/1 on there being a Labour majority at the next general election. So it must be useful to try to estimate the effect of those Labour economic plans which have been put forward so far.

This paper examines Labour's proposals in five areas:

- infrastructure
- welfare
- employment laws
- tuition fees and
- a ban on fracking

Obviously, as with any long-term estimate, a degree of caution is required as there will inevitably be much uncertainty. But these spending pledges alone could cost every household in the UK £17,500 in just one parliamentary term (see table 8 in appendix). There may, of course, be more spending commitments made by the Labour Party over the coming years, which could add to the potential burdens for UK taxpayers.

1. LABOUR'S INFRASTRUCTURE SPENDING PLANS

The Shadow Chancellor has pledged to borrow or raise taxes to fund £250bn of infrastructure investment. He would also borrow an additional £100bn for a National Infrastructure Bank, which is planned to leverage a further £150bn of private sector funds. This makes a total spending envelope of £500bn.

The Labour Party's £500bn infrastructure pledge is central to their mission of "full employment and an economy that works for everyone". It is, of course, odd for the Labour Party to pledge "full employment" when unemployment is at just 4.9% in the UK, according to Office for National Statistics (ONS). This is the lowest level for a decade.

However, the Shadow Chancellor has indicated that the money is likely to be financed by further borrowing. He said that *"it would be better to borrow because interest rates are so low"*, meaning that the Labour Party could borrow up to £350bn for its infrastructure programme.

Ten year government bond yields (gilt yields) are indeed today trading at record lows, currently at just 1.05%, according to Bloomberg Markets. However, ten year bond yields have typically been much higher in previous years, ranging from 2% to 5% from 2007 – 2013 (see Table 1). There is no guarantee that yields will be trading at record lows in 2020, particularly as inflationary pressures are mounting.

Table 2 shows how the cost of financing Labour's planned infrastructure borrowing would increase from £2.1bn in 2020/21 to £10.5bn by the end of the parliament. It is based on two key assumptions:

- That bond yields will revert to their long-term historical average of 3% in 2020/21.
- That the proposed £350bn of infrastructure borrowing is spread evenly over the parliamentary term, averaging £70bn a year.

Table 1: Historical 10-Year Bond Yields

October 2016	1.05%
January 2013	2%
January 2010	3.9%
January 2007	5%
Average (Central Scenario)	3%

Source: UK Investing

Table 2: Potential Cost of Borrowing £350bn

	2020/21	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**Total cost over term**
Collective borrowing	£70bn	£140bn	£210bn	£280bn	£350bn	£350bn
Bond yield payments (3%)	£2.1bn	£4.2bn	£6.3bn	£8.4bn	£10.5bn	£31.5bn
						£381.5bn
						£14,130 per household*

** Based on 27 million households in the UK*

2. WELFARE PROPOSALS

The Labour Party has, so far, made the following pledges on welfare that could increase costs for taxpayers.

- To abolish the spare room subsidy (also known as the "bedroom tax")
- To remove the welfare cap
- To reverse the "pay to stay" principle
- To intervene in the rental market housing sector

2.1 Spare Room Subsidy

The spare room subsidy saved £490 million in 2013-14 and £525 million in 2014-15, according to Government figures. There is also strong evidence to suggest that this reform has led to a more efficient allocation of social housing. A recent evaluation of the spare room subsidy suggests there is now a declining proportion of lets to those who under-occupy their new home, and an increase in the proportion of lets to families from 36.3 per cent in 2012-13 to 40.7 per cent in 2013-14.

There has also been a reduction of 100,000 in the number of people affected by the spare room subsidy. According to the the Minister of State for Welfare Reform Lord Freud, half of these households have successfully downsized, with 45,000 remaining in the social sector and 12,000 moving into the private sector. This more efficient allocation of social housing is vital for the 1.36m people on social housing waiting lists.

2.2 Welfare Cap

Figures from the Institute of Fiscal Studies (IFS) suggest that the direct savings from the welfare cap are modest, saving the Exchequer around £100m a year. Government estimates put the average figure slightly higher at around £112.5m.

However, it is important to note that these figures do not include any saving from changes in behaviour as a result of claimants having been capped. The IFS found that those affected by the cap were 41% more likely to secure employment than without it. Furthermore, a study from the Department for Work and Pensions (DWP) found that individuals in 19% of capped households were in work after a year compared to just 11% of uncapped households.

As of May 2016, at least one person in 23,100 households subjected to the benefit cap had moved into work, according to data from the DWP. If these households are now, on average, earning 60% of median UK earnings (roughly £16,500 per household), they would be contributing £2,113 each to the Exchequer on an annual basis in income taxes and national insurance contributions. This would equate to nearly £50m a year (see Table 3).

2.3 Pay to Stay Principle

The former Chancellor, George Osborne, estimated that the Pay-to-Stay Principle would save the government £250m a year and affect 10% of social housing tenants. The Pay-to-Stay Principle means that households earning over £31,000 outside London or over £40,000 in London will be forced to pay higher rents if they reside in social housing.

Table 3: Cost of Welfare Reforms

	Cost per year	Cost over 5 year parliamentary term
Introducing Spare Room Subsidy	£0.51bn*	£2.55bn
Repealing Welfare cap (direct)	£0.10bn	£0.50bn
Repealing Welfare cap (indirect)	£0.05bn	£0.25bn
Repealing Pay to stay principle	£0.25bn	£1.25bn
TOTAL	£0.91bn	£4.55bn

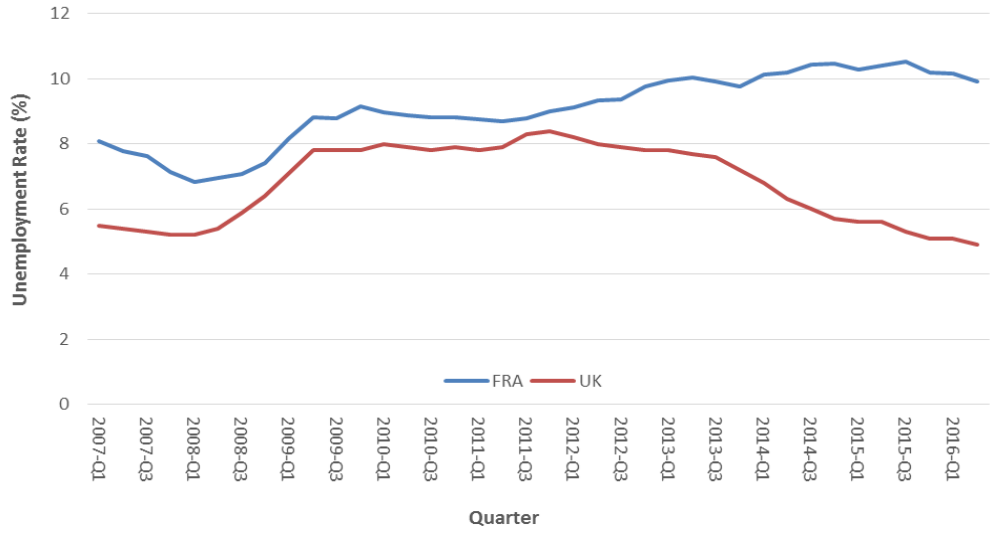
Note: Figures rounded to 2.d.p
**Average annual saving from 2013-14 to 2014-15*

3. STRONGER EMPLOYMENT PROTECTIONS

3.1 A new 'French-style' Framework of Union Rights

Labour is seeking to implement a new 'French-style' framework of union rights. France has an unemployment rate of 10% compared to the UK's 4.9%, and much of this difference is attributed to France's strict labour laws. Since the financial crisis, France's unemployment rate has consistently fluctuated between 9% and 10%, while the UK's unemployment rate has fallen dramatically to 4.9% - the lowest rate for a decade (see Figure 1).

Figure 1: France and UK unemployment since financial crisis



Source: ONS and OECD

Figure 2: France's employment protection compared to other developed nations

Source: HSBC link

France's labour laws are the most stringent in Europe (see Figure 2). The lack of reform in France's labour market goes some way to explaining France's poor economic performance, according to analysis from HSBC. Furthermore, the International Monetary Fund (IMF) suggests that restrictions on firm-level bargaining along with costly and uncertain dismissal procedures act as a major disincentive for employers to offer full-time contracts. The OECD also suggests that strong protection accorded by open-ended contracts in France hinders labour mobility.

France's complex labour code, inefficient labour courts and a broader lack of flexibility in the labour market has not only contributed to high unemployment rates, it also appears to be promoting the widespread use of fixed-term contracts (known as CDDs in France), leading to increased insecurity for some French workers. The IMF reports that over half of French workers below 25 are on fixed-term contracts. Furthermore, the use of fixed-term contracts is growing: since 2000, the proportion of new short-term contracts in the French economy has risen by 11 percentage points, according to data from Acoss.

3.2 A ban on zero hours contracts & increasing the National Living Wage

The proposed blanket ban on zero hours contracts may contribute to higher unemployment. It is estimated by the CIPD that there are just over 1 million people, or 3.1% of the UK workforce, who are employed under a zero-hours contract – although the Office for National Statistics projects that the figure is lower.

In December 2015, the CIPD published the paper "Zero-hours and short-hours contracts in the UK: Employer and employee perspectives". It concluded that the proportion of zero-hours contract employees who are either satisfied or very satisfied with their job is 65%, which is slightly higher than for employees as a whole. Furthermore they suggest that an outright ban on zero-hours contracts could do more harm than good. Prohibiting contracts that give employees an option to turn work down could lead to some of them withdrawing from the labour force.

Labour has also said that it would increase the National Living Wage to £10 an hour by 2020, an 11% increase compared to plans set out by the Government. The Office for Budget Responsibility claims that Government plans for a £9 an hour minimum wage by 2020 would lead to 60,000 fewer jobs being created. This figure can be expected to increase if the National Living Wage were increased to £10 an hour.

3.3 Cost of Labour's employment plans

The 'French-style' framework of union rights, a National Living Wage of £10 an hour in 2020 and a ban on zero hours contracts can be expected to result in higher unemployment in the UK. We have set out three likely scenarios for the increase in unemployment that could be attributed to these three proposals. Under the central scenario, 1.28m jobs are lost by 2024/25, costing £10.2bn a year by the end of the parliamentary term.

High scenario: The high scenario assumes that unemployment rises geometrically to reach levels observed in France by 2024/25.

Central scenario: The central scenario, used for our calculations, assumes that unemployment reaches 8.75% by 2024/25, which is 1.25 percentage points lower than France's current unemployment rate.

Low scenario: The low scenario suggests that unemployment reaches 7.5% by 2024/15, which is half way between the UK's and France's unemployment rates.

Table 4: Cost of Unemployment arising from Corbyn's Employment Legislation plans

	Current	2020/21	2021/22	2022/23	2023/24	2024/25	% point increase due to Corbyn's proposals
Unemployment rate (%) High scenario*	4.9%	6%	7%	8%	9%	10%	5.1
Central projection	4.9%	5.75%	6.5%	7.25%	8%	8.75%	3.85
Low scenario	4.9%	5.5%	6%	6.5%	7%	7.5%	2.6
Increase in number of unemployed (central scenario)**		287,963	542,048	796,133	1,050,218	1,304,303	
Cost per year for State (central scenario)***		£2.30bn	£4.34bn	£6.37bn	£8.40bn	£10.43bn	Total cost over parliamentary term: £31.85bn

Note: Figures rounded to 2.d.p

**The high scenario assumes that Jeremy Corbyn's policies lead to the UK having an unemployment rate equal to France's by 2024/25.*

***This relates to the additional number of unemployed people under the central projection scenario compared to the current unemployment rate of 4.9%. Every 0.1 percentage point increase in unemployment leads to a further 33,878 unemployed in the UK.*

**** Based on the central scenario of unemployment. An assumption of a cost to the State of £8,000 per unemployed person comes from Professor Paul Gregg.*

4. ENDING TUITION FEES

In his 2015 leadership bid, Jeremy Corbyn pledged to scrap tuition fees. He reiterated this pledge at a conference in August 2016. The costs associated with this would be £7.1bn a year to remove fees and £3bn a year for the restoration of maintenance grants, according to reports from the Guardian newspaper.

The Institute for Fiscal Studies has previously costed Labour's pledge during the 2015 election of reducing the tuition fee cap from £9,000 to £6,000. They estimated that this reduction in the cap would cost the Exchequer £3.2 billion a year. Given that Corbyn's policy would – assuming all other things are equal – cost around three times this amount, the figures set out by the Guardian appear to be accurate.

Table 5: Cost of Abolishing Tuition Fees

Annual cost of tuition fee pledge	£10.1bn
Cost over five year parliamentary term	£50.5bn

5. A BAN ON FRACKING

It is estimated that without any UK shale development, 75% of the UK's gas would need to be imported by 2030, according to the Oil and Gas Authority. A greater dependence on imported gas would increase energy insecurity and increase costs for consumers (transportation, liquefaction and regasification of gas can add up to 50% to the wholesale price, according to UKOOG). The Lords Economic Affairs Committee has concluded that, although price cuts are not likely to be as great as those observed in the US, indigenous production of shale is likely to be cheaper than imports of Liquefied Natural Gas (LNG).

If a potential shale gas production phase could reach scale, the potential benefits could be large, according to the Institute of Directors (IoD). The IoD estimates that production could reach 865bcf by 2025, which would equate to £3.3bn of gas production for that year. In addition, a ban on fracking could have significant implications for the UK's balance of trade. Any gas that is not produced in the UK would have to be imported. This could add over £9bn to the UK's trade deficit over the 2020/21 – 2024/25 parliamentary term.

An Ernst & Young (EY) report has also identified that around 64,500 jobs could be created as a result of the UK's shale industry (other estimates claim that the figure could be as high as 74,000 (IoD)). Table 6 uses the figures given by EY, which suggest 6,100 direct jobs and 58,400 indirect jobs. Assuming that the average job pays £35,000, the cost to the exchequer in foregone income taxes and national Insurance contributions arising from no employment in the UK's shale industry could be £2.59bn over the parliamentary term.

Table 6: Costs of not pursuing fracking – Forgone income tax and NI receipts

	Number of jobs forgone	Average Salary	IT & NIC Receipts	Costs per year	Costs over five year parliamentary term
Jobs	64,500*	£35,000**	£8,033	£0.52bn	£2.60bn

Note: Figures rounded to 2.d.p

**Estimate by Ernst and Young*

***Ernst and Young suggests that salary ranges for direct jobs range from £36,000 to £160,000. Our figure of £35,000 is below this range due to this being an estimate for the average of both direct and indirect jobs.*

Table 7: Costs of not pursuing fracking – Additions to Balance of Payments Deficit

	2021	2022	2023	2024	2025	Total over 5 year parliamentary term
Gas Price Projections (DECC's low scenario)	30p per therm	31p per therm	33p per therm	36p per therm	38p per therm	
UK shale production estimates (IoD)	219bcf (219m MMBTU)	379bcf (379m MMBTU)	555bcf (555m MMBTU)	728bcf (729m MMBTU)	865bcf (865m MMBTU)	
Estimated value	£0.66bn	£1.17bn	£1.83bn	£2.62bn	£3.29bn	£9.57bn

Note 1: Figures rounded to 2.d.p
Note 2: Peak production of 1,121 bcf is expected by 2030. Expected gas demand is 2030 is 66.2bcm (2,338 bcf). This means that nearly 50% of the UK's gas demand could be met by shale gas by 2030.

Unit conversions

- *1bcf = 1million MMBTU*
- *1 MMBTU = 10 therms*

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APPENDIX

Table 8: Total cost of policy proposals over the five year parliamentary term
Infrastructure, welfare, employment laws, tuition fees & a ban on fracking

Capital cost of infrastructure borrowing	£350bn
Cost of servicing £350bn of Gilts for infrastructure	£31.50bn
Introducing spare room subsidy	£2.55bn
Repealing welfare cap (direct)	£0.50bn
Repealing welfare cap (indirect)	£0.25bn
Repealing pay to stay principle	£1.25bn
Cost of unemployment increasing (central scenario)	£31.85bn
Cost of abolishing tuition fees	£50.50bn
Cost of fracking ban (in foregone jobs' income tax and national insurance receipts)	£2.60bn
TOTAL COST	**£471bn**
Total cost per household*	**£17,444**

**27 million households in the UK*

Table 9: Additions to the annual budget deficit from 2020/21 to 2024/25

This excludes the £350bn addition to the debt from the capital cost of infrastructure borrowing

	2020/21	2021/22	2022/23	2023/24	2024/25
Gilt payments from infrastructure borrowing	£2.10bn	£4.20bn	£6.30bn	£8.40bn	£10.50bn
Repealing the spare room subsidy	£0.51bn	£0.51bn	£0.51bn	£0.51bn	£0.51bn
Repealing Welfare cap (direct cost)	£0.10bn	£0.10bn	£0.10bn	£0.10bn	£0.10bn
Repealing Welfare cap (indirect cost)	£0.05bn	£0.05bn	£0.05bn	£0.05bn	£0.05bn
Repealing the pay to stay principle	£0.25bn	£0.25bn	£0.25bn	£0.25bn	£0.25bn
New unemployment costs	£2.30bn	£4.34bn	£6.37bn	£8.40bn	£10.43bn
Costs of tuition fees	£10.10bn	£10.10bn	£10.10bn	£10.10bn	£10.10bn
Foregone IT & NIC receipts from shale jobs	£0.52bn	£0.52bn	£0.52bn	£0.52bn	£0.52bn
TOTAL	**£15.93bn**	**£20.07bn**	**£24.20bn**	**£28.33bn**	**£32.46bn**
Per household*	**£590**	**£743**	**£896**	**£1,049**	**£1,202**

**Based on 27 million households in UK*