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Prospects for public sector finances: the squeeze on spending continues

Gemma Tetlow

Presentation to the CIPFA Pensions Network CFO Briefing

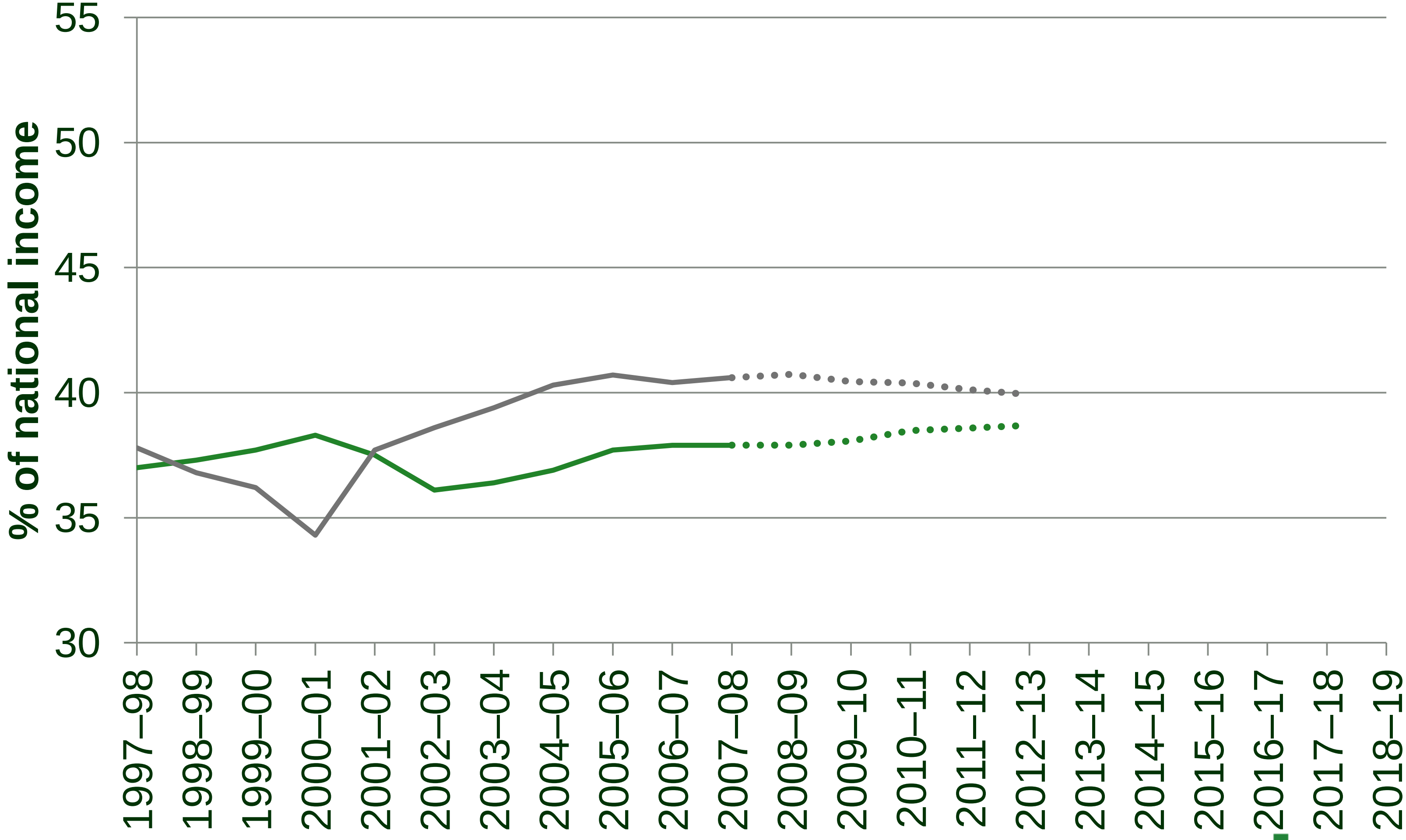
24 November 2014, London

Overview of the public finance situation

- Financial crisis and recession revealed large structural deficit
  - Necessitated active policy response to reduce borrowing from a post-World War II high of 10.2% of GDP
- Roughly halfway through a large fiscal consolidation
  - Budget plans imply deep spending cuts through to 2018–19 in order to eliminate the deficit in that year
  - Spending cuts and tax rises have largely been implemented as planned so far but weak growth has meant deficit has not fallen as forecast in 2010
- Parties differ somewhat in their objectives for reducing borrowing
  - None have given much detail about how this will be achieved
- Potential developments in the Autumn Statement
  - Tax revenues have been weaker than forecast so far this year, despite growth turning out largely as expected
  - Is this a temporary or permanent phenomenon?

Spending and revenues, without action

Public sector receipts and total managed expenditure, 1997 to 2018



Source: Emmerson and Tetlow (2014), http://www.ifs.org.uk/publications/7238

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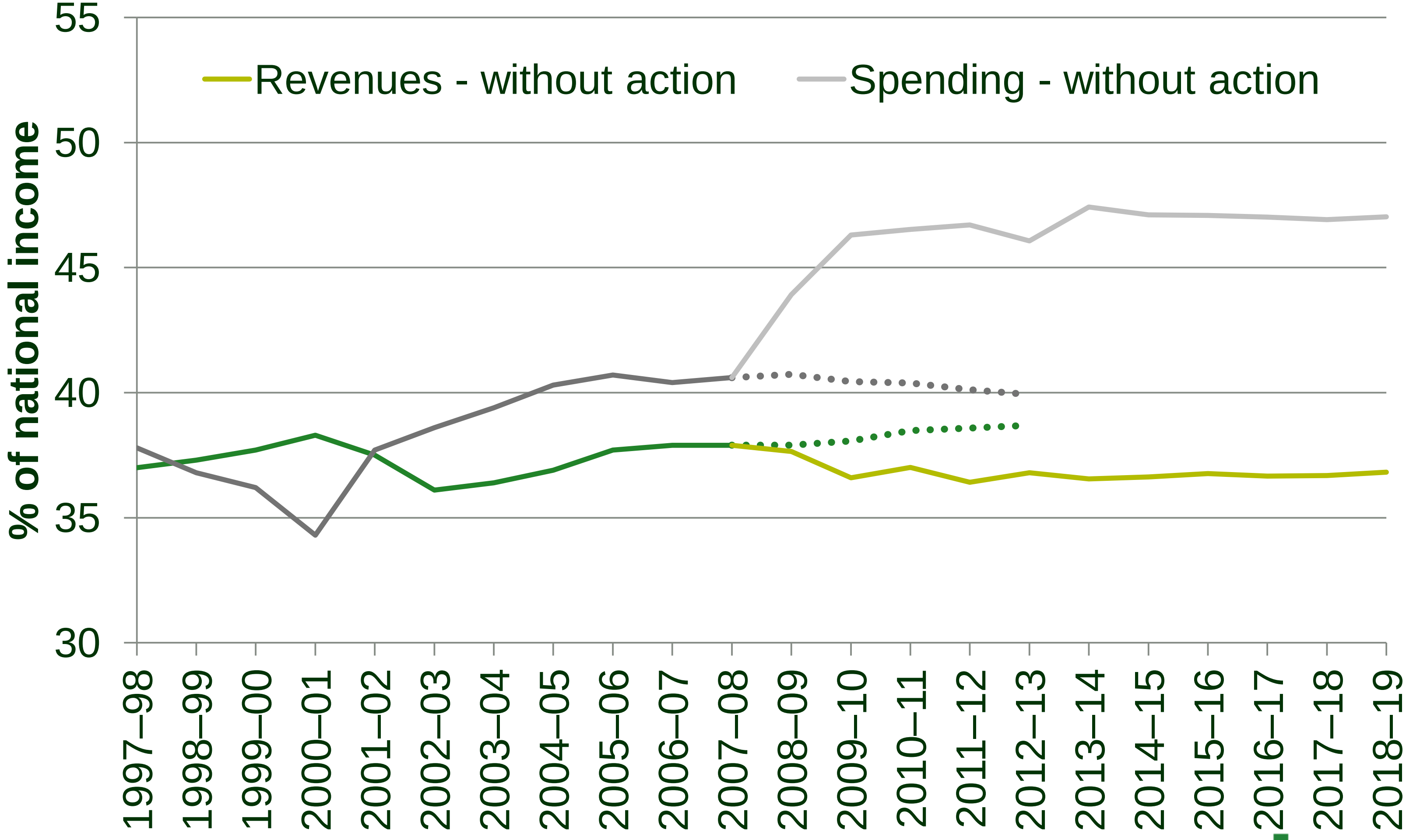

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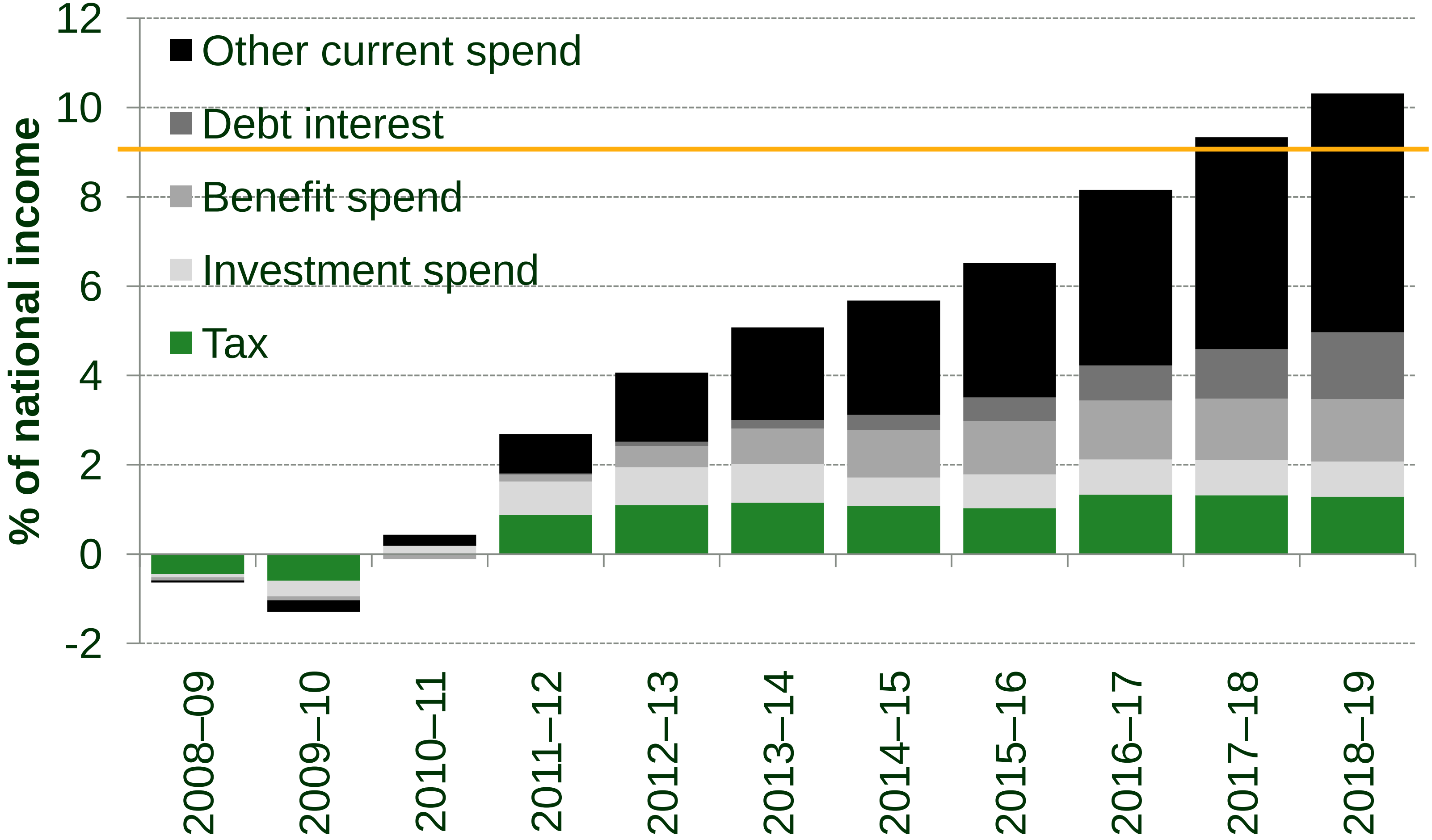
The policy response

12% from tax rises
8% from investment spending cuts
14% from welfare spending cuts
52% from other current spending

March 2014: 8.8% national income (£152bn) hole in public finances, offset by 10.3% national income (£178bn) consolidation over 9 years



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Spending and revenues, with action

Now aiming for tighter fiscal position than planned pre-crisis

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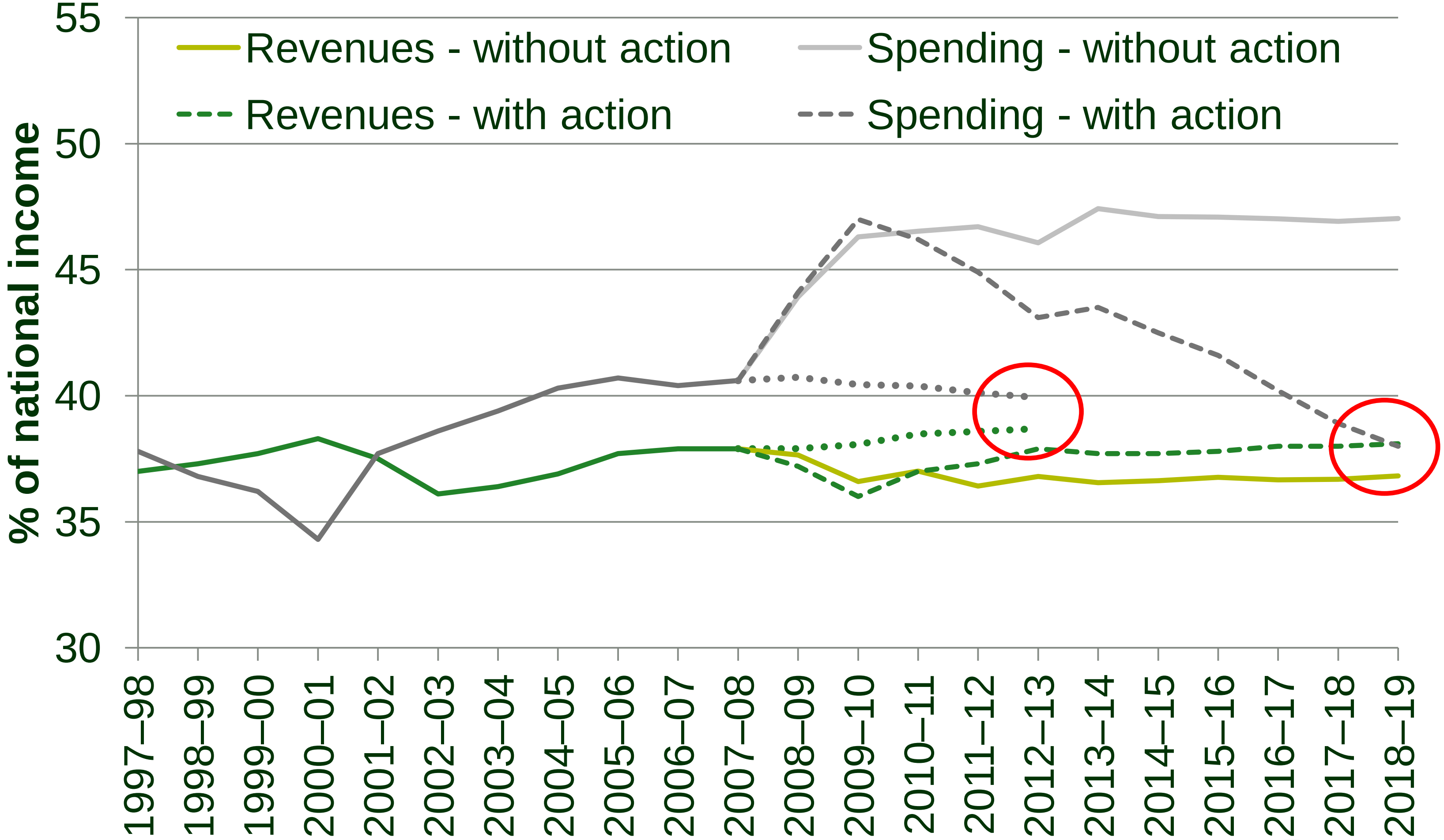

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Spending and revenues, with action

Implies tax burden slightly above pre-crisis level and at 30 year high

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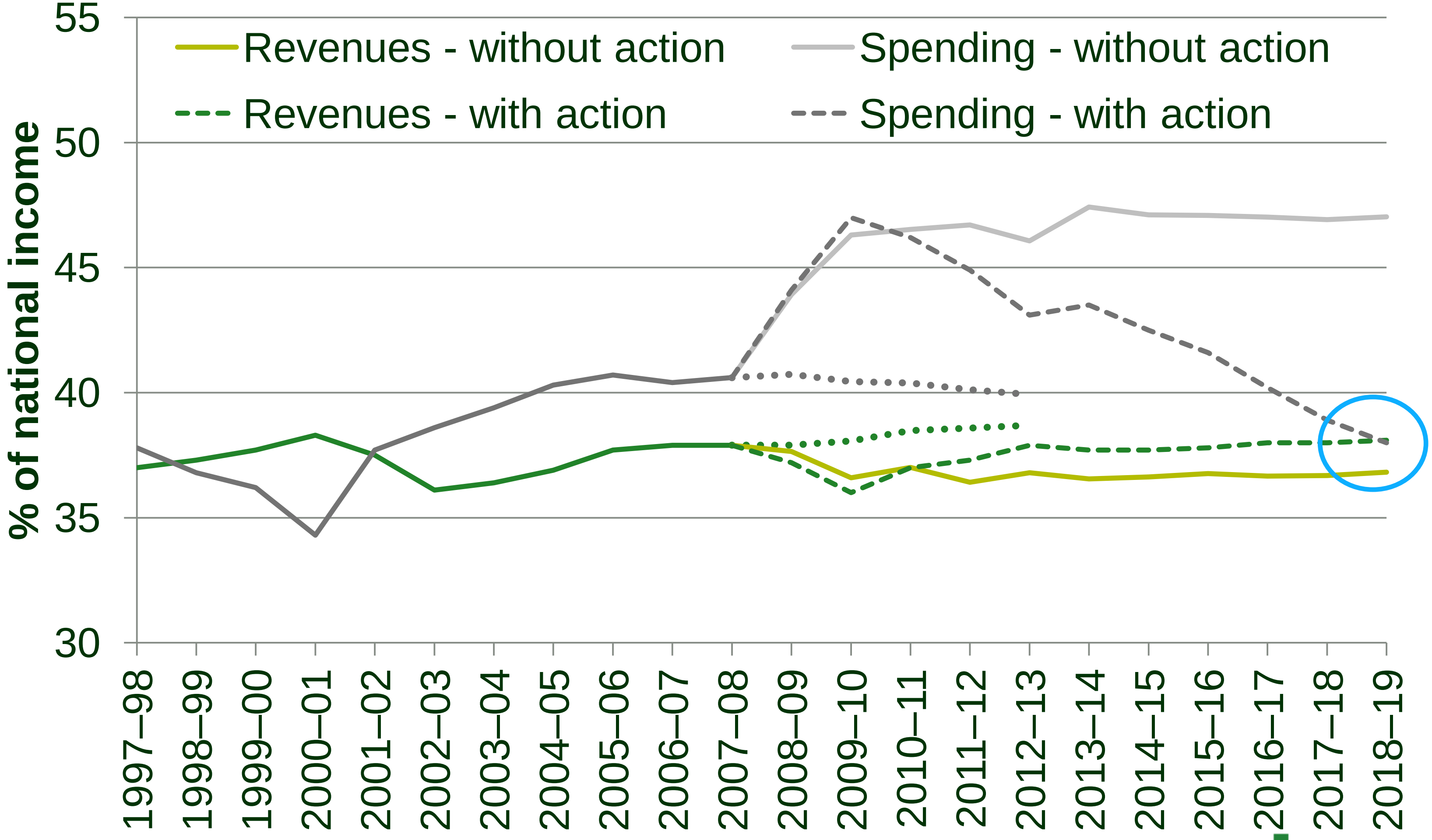

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Implies total spending back to 2002 levels, but….

Spending and revenues, with action

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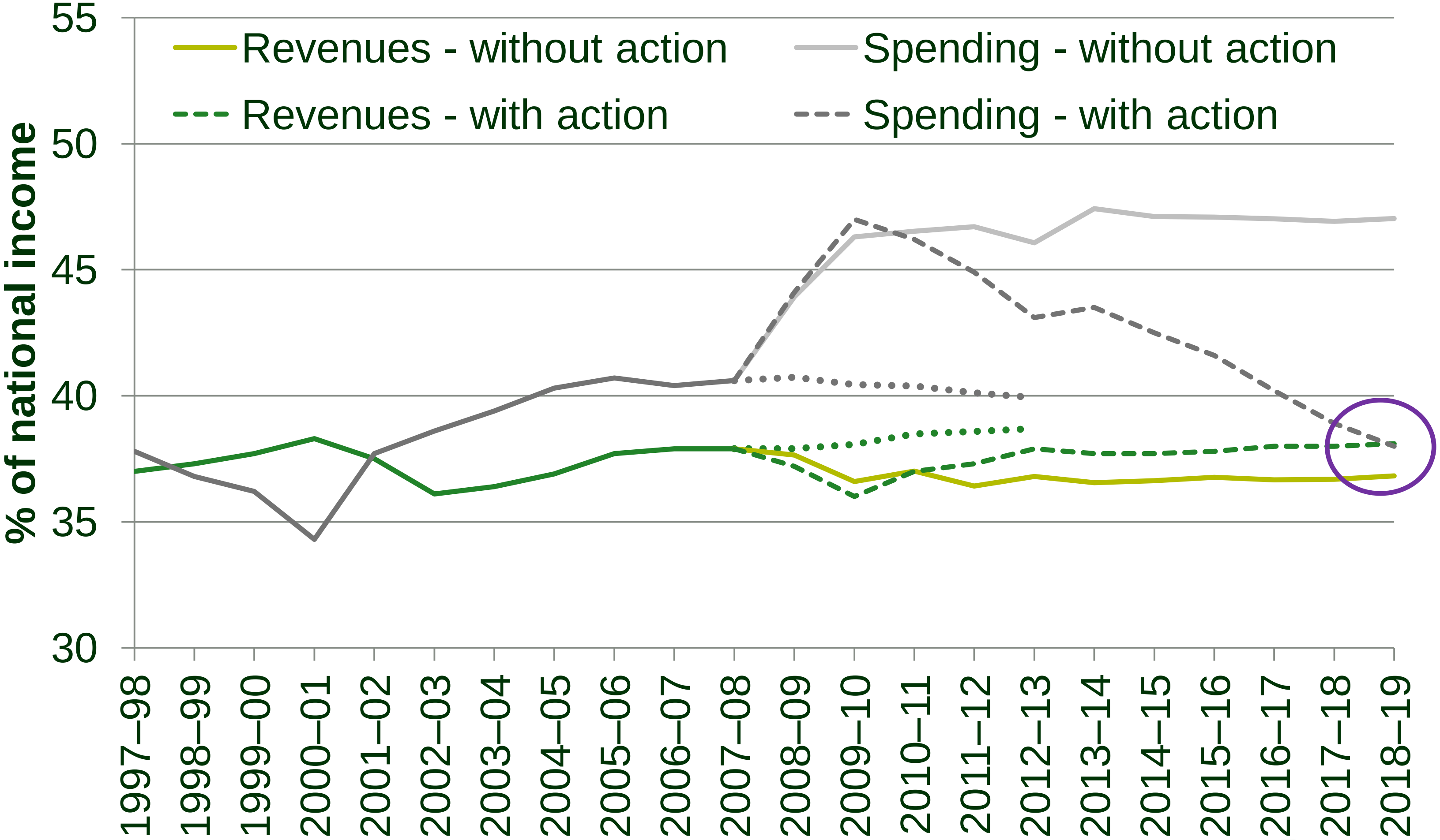

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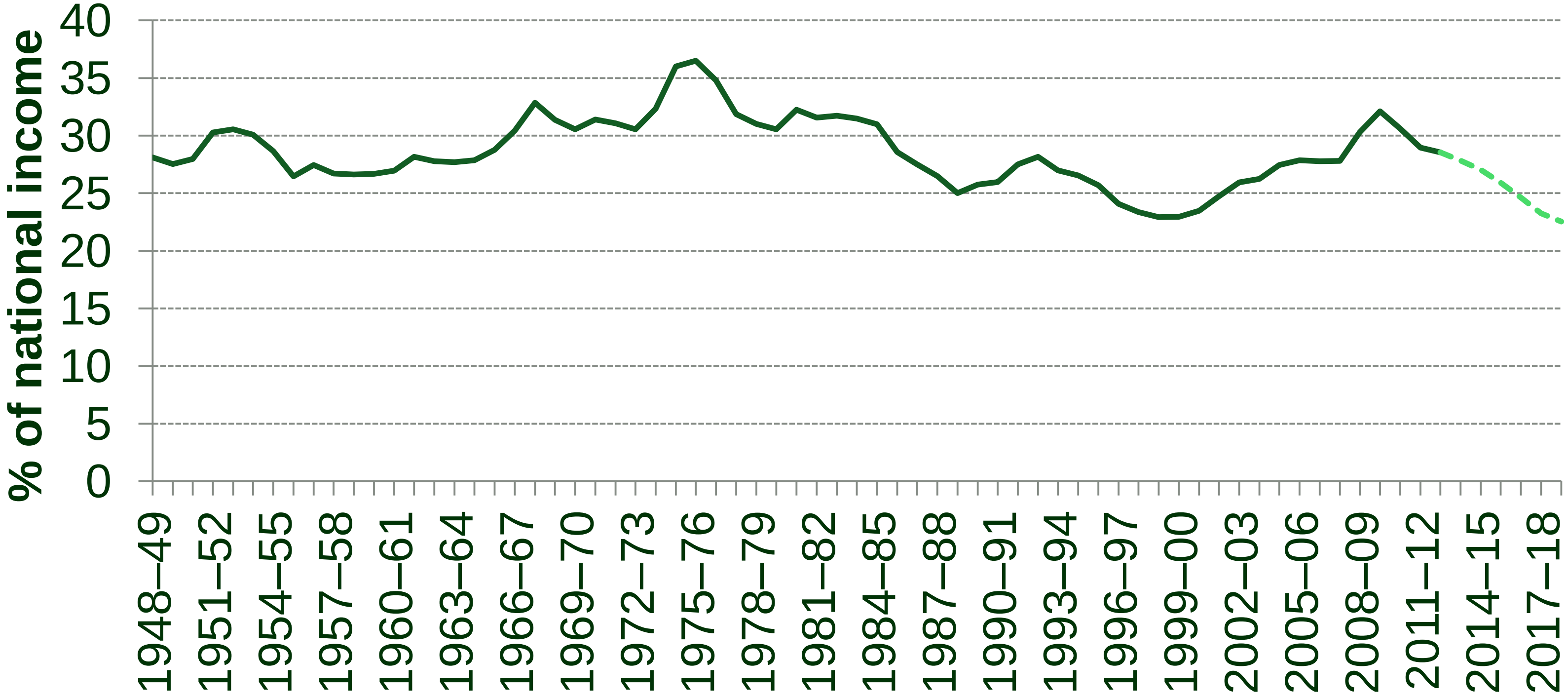
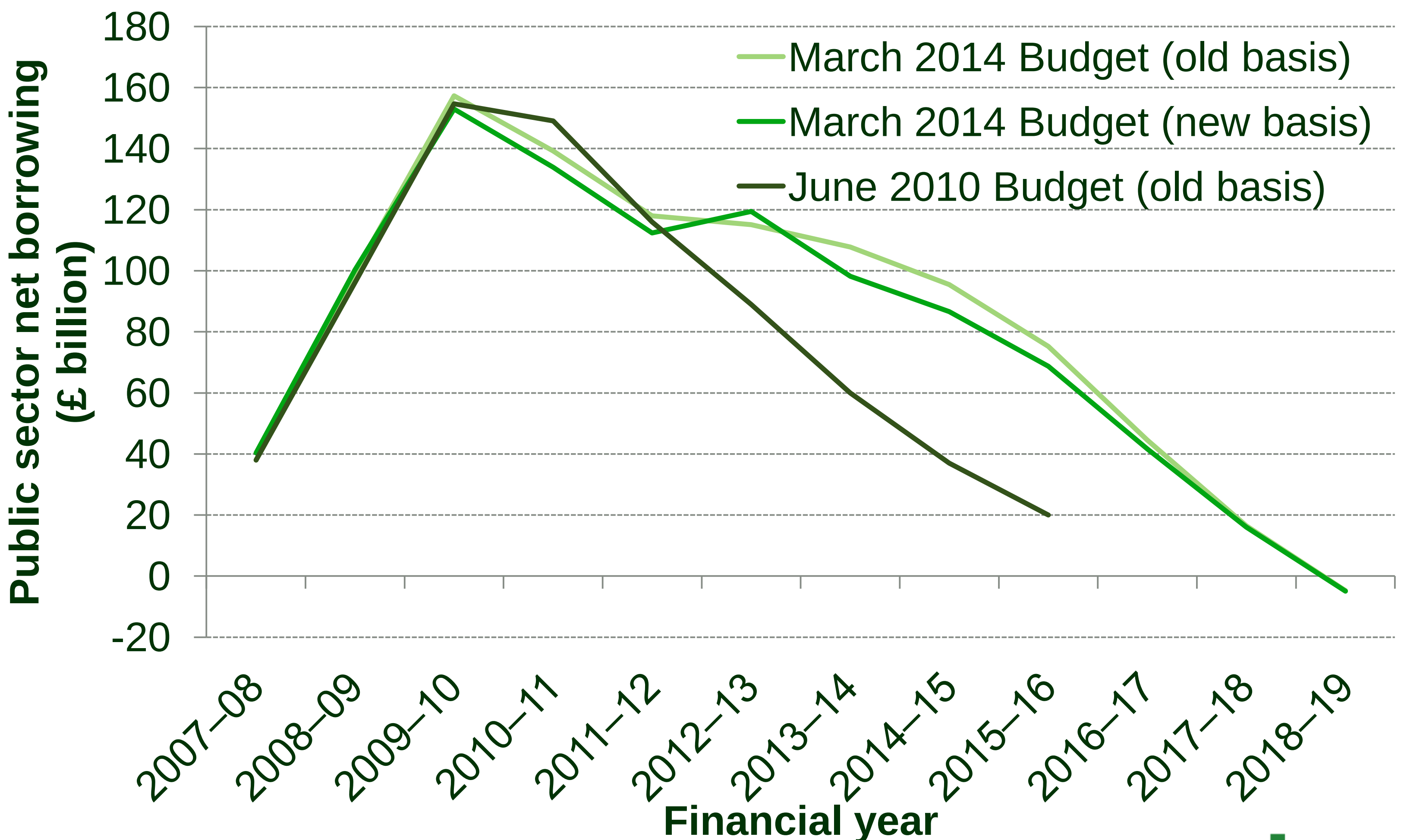
… high spending on social security and debt interest implies relatively little for public services

- Public service spending reduced to the share of national income seen at the end of the 1990s (technically: lowest since at least 1948)



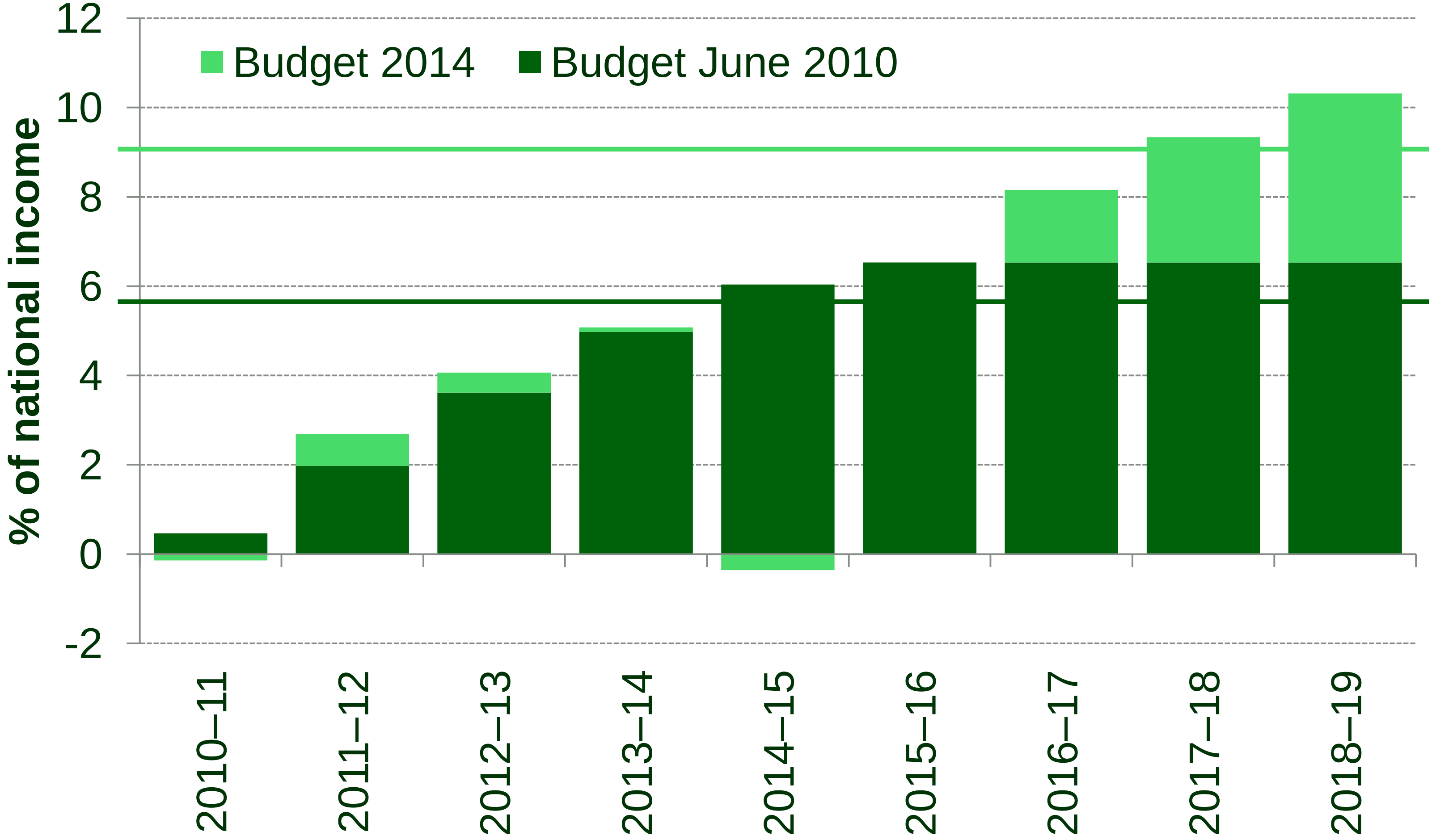
Note: Figure shows total public spending less spending on social security benefits and debt interest.

Deficit reduction: have they stuck to the plan?



Source: Office for National Statistics and Office for Budget Responsibility.

Originally planned tax increases and spending cuts delivered but more announced...



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Planned cuts to public spending

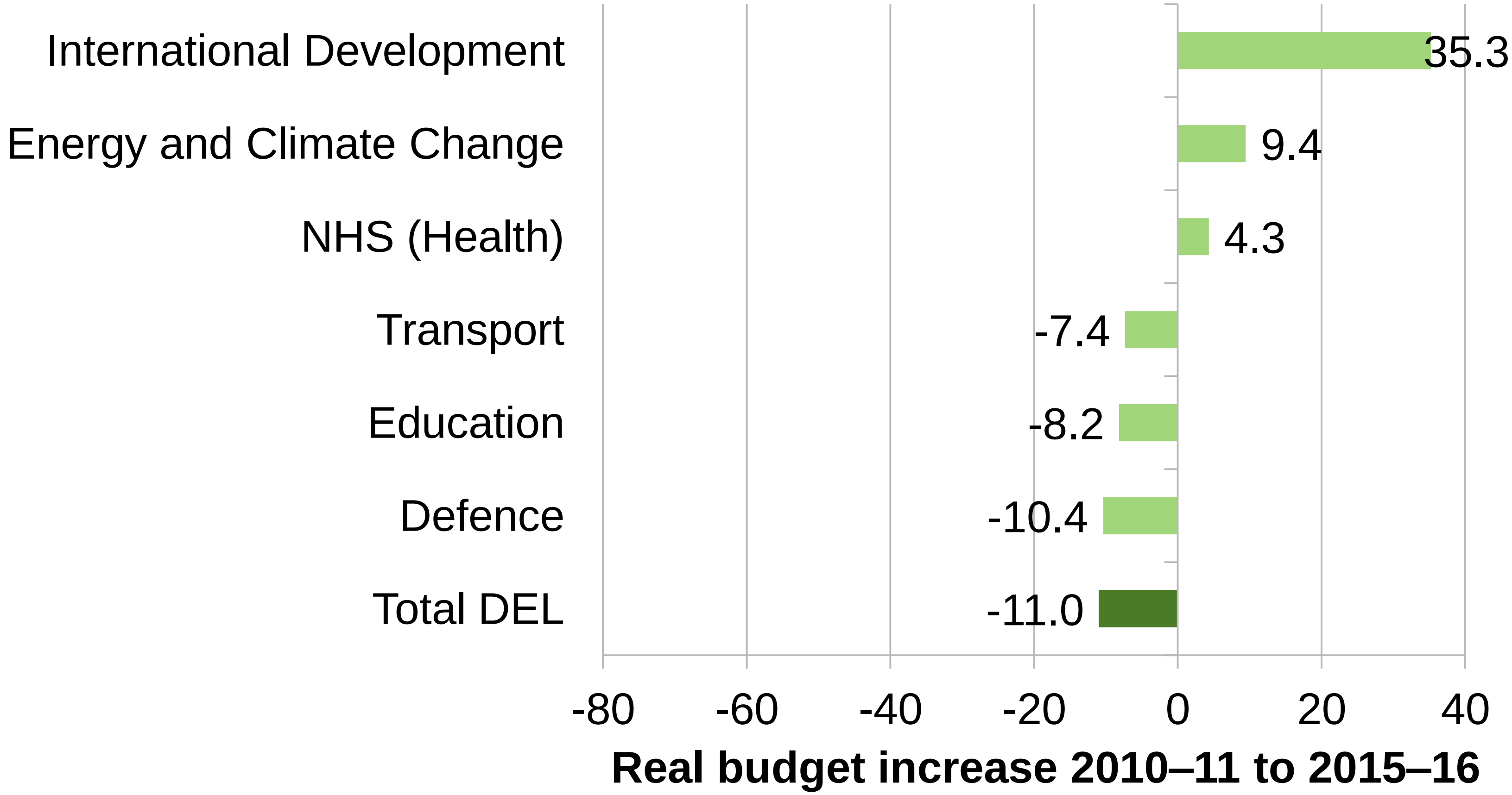
Based on current plans from Budget 2014:

Between 2010–11 and 2018–19 and after economy-wide inflation

- Total spending cuts of 5%
- But
  - debt interest spending rising
  - social security spending, particularly on pensioners, rising
  - other non-departmental spending such as on PAYG spending on public service pensions and UK contribution to the EU budget rising
- Departmental spending on public services to be cut by 20%

Whitehall departments: 'winners'

Departmental budget in 2015–16 compared to 2010–11, after economy-wide inflation



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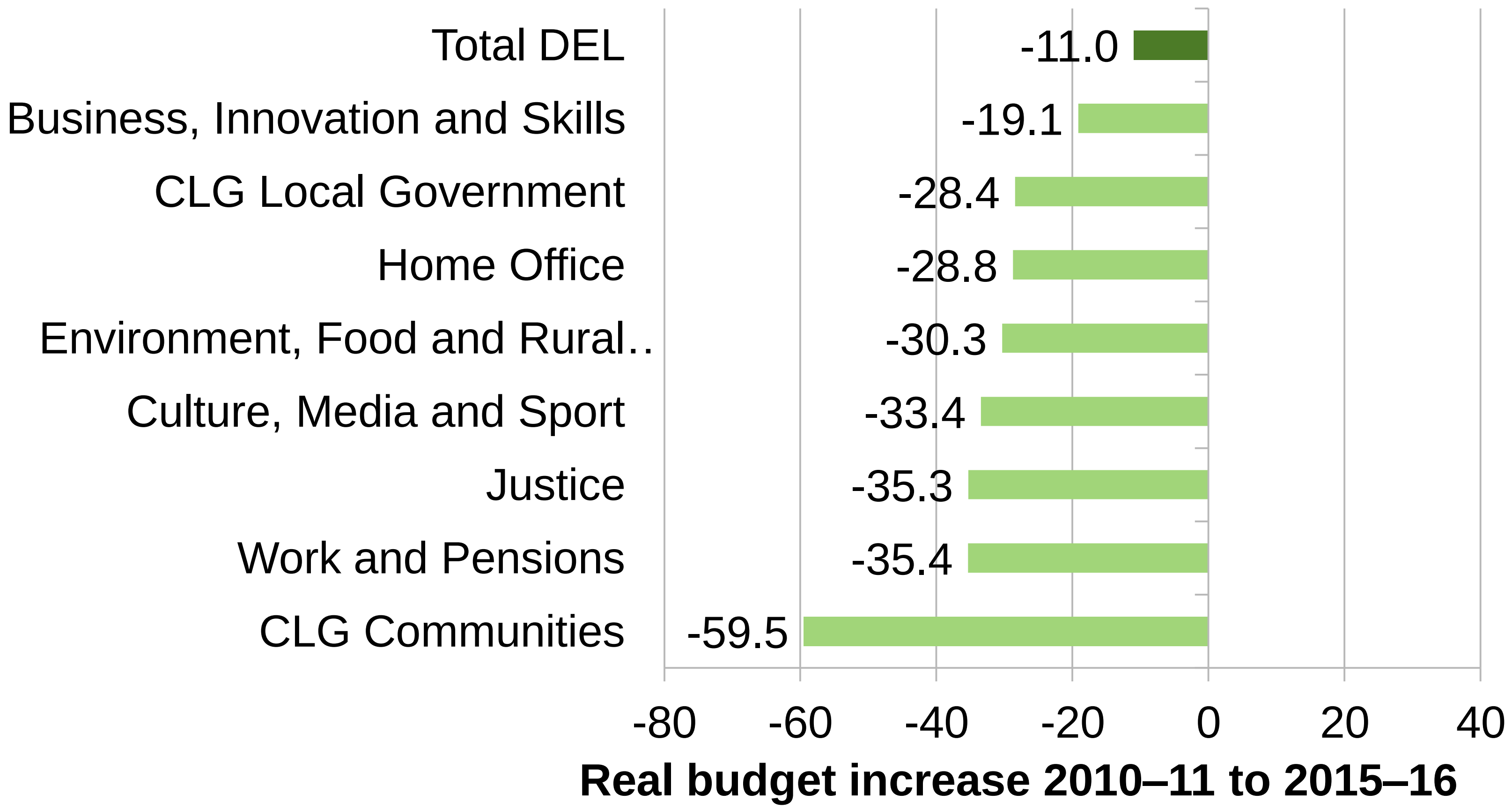
Whitehall departments: 'losers'

Departmental budget in 2015–16 compared to 2010–11, after economy-wide inflation



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Departmental spending cuts not set in stone (1)

- Detailed plans for spending in 2015–16 set out in Spending Review 2013
  - Conservatives, Labour and Liberal Democrats have all said they would stick to these levels of (current) spending
- Departmental spending beyond 2015–16 not explicitly planned
  - Equals planned total spending less OBR forecasts for social security and other non-departmental spending

  ➔ Changes in these will have implications for departmental spending

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Departmental spending cuts not set in stone (2)

- Could choose to cut social security further
  - £12 billion would reduce departmental spending cuts between 2015–16 and 2018–19 to the same rate as over 2010–11 to 2015–16
  - Cut to DEL of 17% between 2010–11 and 2018–19
  - If NHS, schools and aid remain protected from cuts then 'unprotected' areas would face cuts averaging 31%
  - £12 billion equivalent to 6% of all social security spending, 11% of non-pension spending, or 13% of spending on non-pensioners
- Could choose to have a higher level of total spending
  - Labour and Liberal Democrats have suggested they would be happy with a higher level of borrowing than currently planned for
  - Could spend around £26 billion a year more by 2018–19 and still achieve their suggested deficit targets
  - Cut to DEL of 13% between 2010–11 and 2018–19

Are these cuts deliverable?
A reason to think yes...

- Government departments have (more than) delivered the budget cuts required in 2010–11, 2011–12, 2012–13 and 2013–14
  - likely that political cost of over-spending means that departments treat their budgets as a *cap* rather than a *target*

➔ Suggests mechanism is there: departments look like they can deliver the spending cuts if they are required to...
  - (though this will get harder!)

Are these cuts deliverable?
A reason to think no...

- But would a future government want to stick to these plans once the associated fall in service provision and/or quality becomes more apparent?
- Large cuts to public service spending still to come
  - these are likely to get harder/more painful to deliver
- The above figures also understate the squeeze on spending
  - additional spending commitments
  - demographic pressures

Additional spending commitments with no, or only temporary, additional funding

- Budget 2013
  - Ending contracting out into DB pensions increases public sector employer NICs (£3.3 billion a year)
  - Dilnot reform to social care funding (£1.0 billion)
  - Tax-free childcare scheme (£0.8 billion)
- Autumn Statement 2013
  - Extension of free school meals (£0.8 billion)
  - Scrapping cap on HE student numbers (£0.7 billion)
  - Energy prices and efficiency measures (£0.4 billion)
- Budget 2014
  - Higher contributions to public service pensions (£1 billion)
- Adds up to £8 billion (around 2% of departmental spending) to be found from within departmental spending

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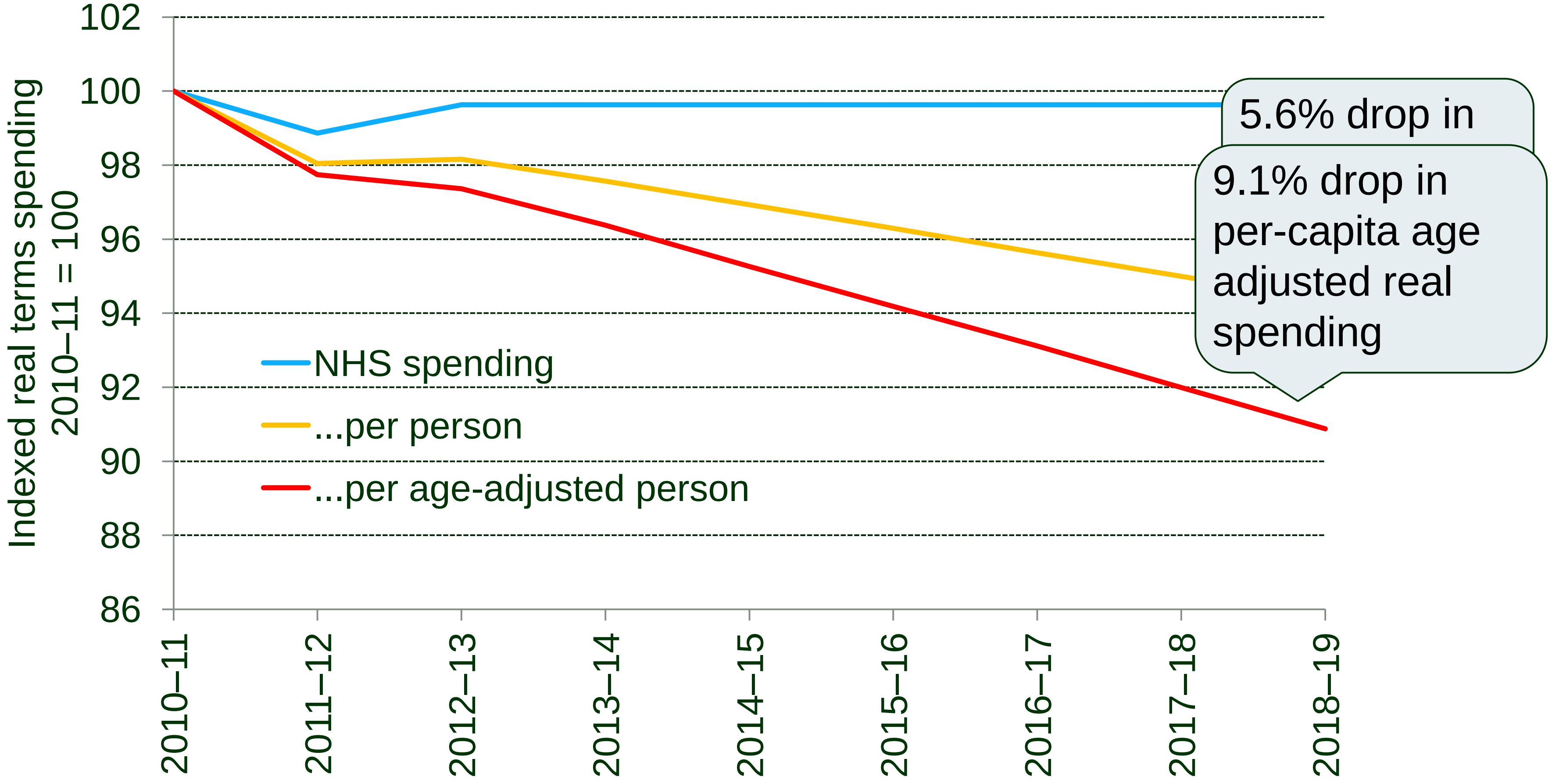
Demographic pressures

- Population increasing which increases demand for public services
  - ONS projects population will grow by 5.6% (3.5 million) between 2010 and 2018
- Public service spending forecast to fall by average 1.7% per year 2010–11 to 2018–19 but spending per person to fall by 2.4%
- Population also ageing which puts particular pressure on public services used more by older people
  - ONS projects population aged 65 and over will grow by 20.0% (2.0 million) between 2010 and 2018
- For example: real freeze in NHS spending between 2010–11 and 2018–19 would actually be a 9.1% cut in real age-adjusted NHS spending per person
  - NHS may be ‘protected’ but still considerable squeeze

Demographic pressure on the NHS budget



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