2015–16: the squeeze continues

Carl Emmerson


Available at http://www.ifs.org.uk/projects/418 (with bonus slides)
Introduction

• The Government’s deficit reduction plan and how 2015–16 fits within this

• The cuts planned under the last spending review (2011–12 to 2014–15) and those implied by the plans for 2016–17 & 2017–18

• What the 2015–16 spending round might mean for individual departments

• Outlook for public sector pay and employment
Deficit to fall from post WW2 peak

Notes: Data prior to 1955–56 are calendar rather than financial year. Data exclude Royal Mail and APF transfers.
Source: ONS; OBR.
Disease and cure

Mar 2013: 8.6% national income (£133bn) hole in public finances, offset by 9.1% national income (£141bn) consolidation over 8 years

Notes: Figures include realised underspends by government departments and latest estimate of Exchequer savings from changing to CPI indexation.

Aggregate impact of measures largely as planned in SR2010 in this parliament ...

Change in discretionary policy and delivered spending plans, between November 2010 Autumn Statement and March 2013 Budget

- Tax increases
- Investment
- Benefits
- Other current spend
- Total

Notes: Figures include realised underspends by government departments. Source: Author’s calculations.
... but greater fiscal tightening pencilled in for the next parliament

Change in discretionary policy, and delivered spending plans, between November 2010 Autumn Statement and March 2013 Budget

Notes: Figures include realised underspends by government departments. Source: Author’s calculations.
International comparison
UK compared to 29 other advanced economies

- **Deficit**
  - 3rd highest deficit pre-crisis (2007)
  - 9th largest increase over the crisis
  - 6th largest projected fall to 2018

- **Tax and spend**
  - 17th highest spending and 21st highest tax pre-crisis
  - 11th largest rise in spending and 17th largest fall in tax over the crisis
  - 5th largest projected cut to spending and 14th largest projected rise in tax to 2018

Source: Author’s calculations using data in Table STA-T1 and STA-T3, IMF, *Fiscal Monitor: April 2013*. 
6–year squeeze on public service spending

Note: Figure shows total public spending less spending on net social benefits and public sector net debt interest. Data exclude 3G and 4G spectrum sales and Royal Mail pension transfer.
Public Sector Net Investment

Percentage of national income

- Budget March 2010
- Budget 2013

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The outlook for DEL and AME

Note: DEL and AME figures from 2013–14 adjusted for changes for local government funding for Business Rates Retention and Council Tax Benefit localisation.
Managing Annually Managed Expenditure?

• DEL should not include unpredictable/uncontrollable spending
  – failure of the pre-1992 spending regime was to allow a boost to structural spending to be hidden by falling cyclical spending in the late 1980s boom

• AME not subject to firm limits so departments may not face the same incentive to manage it as with their cash limited DEL spending

• Cap on working age social security spending could help force active decisions over how best to manage this spending

• But frequent and regular reviews should consider all – both rising and falling – components of public spending
Departmental spending: SR2013 and beyond

Real DEL spending (2010–11 = 100)

- Spending Review 2010 period
- 'Unchanged policy' projections

Will be allocated between departments in 2013 Spending Round

Will be allocated between departments after next election

Note: DEL and AME figures from 2013–14 adjusted for changes for local government funding for Business Rates Retention and Council Tax Benefit localisation.
Departmental spending: 2010–11 to 2017–18

• Current plans imply cuts of
  – 18.4% to total DEL over 7 years from April 2011, with just under half done over the first 4 years
  – 2.8% to be implemented in 2015–16
  – further 7.6% to occur over 2016–17 and 2017–18

• Budget 2013: “Fiscal consolidation for 2016–17 and 2017–18 is expressed as a reduction in TME. It would, of course, be possible to do more of this further consolidation through tax instead”
  – implied DEL cuts over these years equivalent to £23bn in today’s terms
  – cutting DEL at the same rate as planned over SR2010 years would require £9bn of tax rises/welfare cuts (or other cuts to AME) or higher borrowing in 2017–18
  – further tax rises and/or welfare cuts after next election?
Central government sharing the cuts unevenly...

- International Development: 27.9%
- NHS (Health): 4.2%
- Transport: -1.1%
- Energy and Climate Change: -3.2%
- Defence: -7.0%
- Education: -7.2%
- Total DEL: -9.1%
- Work and Pensions: -21.8%
- Business, Innovation and Skills: -22.9%
- Home Office: -23.5%
- Environment, Food and Rural Affairs: -25.6%
- CLG Local Government: -26.6%
- Justice: -27.3%
- Culture, Media and Sport: -34.7%
- CLG Communities: -44.0%
- Foreign and Commonwealth Office: -50.5%

Real budget increase 2010–11 to 2014–15

Note: Figures show cumulative change in total DEL after economy-wide inflation.
... some front-loaded and some back-loaded

International Development
NHS (Health)
Transport
Energy and Climate Change
Defence
Education
Total DEL
Work and Pensions
Business, Innovation and Skills
Home Office
Environment, Food and Rural Affairs
CLG Local Government
Justice
Culture, Media and Sport
CLG Communities
Foreign and Commonwealth Office

Real budget increase 2010–11 to 2014–15

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Note: Figures show cumulative change in total DEL after economy-wide inflation.
(English) local government cuts

- Income from council tax means that cuts to local authority grants overstate cut to spending power of local authorities
  - by 2014–15 the spending power of English local authorities projected to be 12.2% below 2010–11 levels

- Significant variation in size of these cuts across the country
  - councils relatively more reliant on grant income typically seeing larger cuts to their spending power
  - a quarter of areas to see cuts of more than 15.7%, larger average cuts in London and other metropolitan areas than in shire England

- Over 2011–12 and 2012–13 cuts by local authorities have fallen unevenly across different service areas
  - fire services and social care not cut, environmental services and police spending relatively protected
  - on average cultural & related services cut by 20%, planning & development services cut by 46%
The 2015–16 Spending Round (1/3)

- Budget 2013 set the total spending envelope for 2015–16, given OBR forecast for non-departmental spending:
  - implied total DEL to be cut in real terms by £9.8 billion or 2.8%, with resource DEL being cut by 2.7% (£8.4bn) and capital DEL by 3.3% (£1.4bn)
  - over SR2010 years total DEL is forecast to be cut by an average of 2.4% a year: to cut at this rate would require an extra £1 billion from welfare spending/other non-departmental spending

- Note the widely quoted £11.5bn cuts to resource DEL number differs from the £8.4bn stated above since the latter
  - is in current terms
  - includes the OBR’s projected 2014–15 underspend
  - excludes £1.5bn of cuts already scored in 2014–15
The 2015–16 Spending Round (2/3)

• “Health, schools and Official Development Assistance will be protected”
  – setting the reserve at £3½bn and the Barnett consequences of these protections would mean average cut of around 8% elsewhere
  – protecting defence from cuts too would increase this to 10%

• Settlements claimed with 7 departments
  – Ministry of Justice, Communities, Treasury, Energy & Climate Change, Cabinet Office, Foreign & Commonwealth Office, Northern Ireland Office
  – actual settlements not published: average cuts of around 8% would not change picture for other departments

• Do-It-Yourself spending round spreadsheet available online for you to make your own allocations
The 2015–16 Spending Round (3/3)

- Assume: NHS, schools and overseas aid protected, 7 early settlers see resource DELs cut by an average of around 8%, capital cuts shared equally and reserve set at £3.5bn

- If other resource DELs cut in proportion to SR2010 then:

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<thead>
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• These are cuts to total DEL: cuts relative to an adjusted baseline could look different

Source: Author’s calculations using http://www.ifs.org.uk/ff/spending_review2013.xlsm
Public sector pay

- Budget 2013 extended 1% average public sector pay increase to 2015–16
  - lower than projected economy-wide inflation (1.8%), CPI inflation (2.1%) and average earnings growth (3.8%)
  - central government paybill in 2014–15 projected (in summer 2012) to be £94.5bn and this is currently just over half of general government paybill
  - pay falling by 0.8% relative to economy-wide inflation cuts real DEL by around £1bn to £1½bn
Public-private pay differentials to return to pre-crisis levels around 2015–16?

Change in public-private pay differential relative to 2007–08

Change since 2007–08 (ppt)

-3 -2 -1 0 1 2 3 4


Notes: Data to 2012–13 estimated using LFS data. Forecasts take OBR forecasts for whole economy earnings growth and for public sector pay per head, but adjust for the 2015–16 public sector pay squeeze announced in Budget 2013.
Public sector employment

- 410,000 fewer public sector workers in Dec. 2012 than in Dec. 2010
- OBR March 2013 forecast that between 2010–11 and 2017–18 general government employment to fall by 1 million
- But
  - departments plan to cut paybill faster to 2014–15 than OBR assumes: implies a fall of 150,000 more than forecast by OBR by 2017–18, rising to 250,000 if paybill trend persists
  - 2015–16 public sector pay policy not incorporated into the OBR’s forecast: likely to boost employment by around 30,000
Conclusions

• Average real DEL cut in 2015–16 projected at 2.8%
  – unprotected departments could see planned cuts averaging 8%
  – some departments could see a cut to their total budget of 10% between 2014–15 and 2015–16?

• Significant cuts have been delivered with more to come
  – rising AME leaves total spending broadly flat in real terms
  – 2015–16 cuts on top of those in last Spending Review: some unprotected departments cut by 30%+ since 2010–11
  – two further years of cuts pencilled into the Government’s plans

• Public sector pay squeeze to 2015–16 on course to restore pay relative to private sector to pre-crisis levels
  – further squeezes to public sector pay beyond 2015–16 might be likely but would inevitably become harder to deliver
2015–16: the squeeze continues

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IFS references

Spending and revenues back to pre-crisis levels

Note: Spending in 2012–13 exclude Royal Mail transfer.
Source: ONS; OBR; Tetlow (2013).
The hole in the public finances has increased

Percentage of national income

- Size of the problem
- Planned fiscal consolidation

- HMT Budget 2008
- HMT PBR 2008
- HMT Budget 2009
- HMT PBR 2009
- HMT Budget March 2010
- OBR Budget June 2010
- OBR November 2010
- OBR Budget 2011
- OBR November 2011
- OBR Budget 2012
- OBR December 2012
- OBR March 2013

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Departments have been underspending

Note: Spending relative to ‘final’ plans up to 2010–11, and relative to PESA plans after 2011–12.
Source: OBR March 2013 EFO Fiscal Supplementary Tables Table 2.15.
Cutting the deficit?

Note: Data exclude Royal Mail and APF transfers.
Comparison of IMF forecasts for the UK and 29 other advanced economies show:

<table>
<thead>
<tr>
<th>UK rank</th>
<th>Tax</th>
<th>Spend</th>
<th>Borrow</th>
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<tbody>
<tr>
<td><strong>Level</strong></td>
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<tr>
<td>Pre-crisis (2007)</td>
<td>21\textsuperscript{st} highest</td>
<td>17\textsuperscript{th} highest</td>
<td>3\textsuperscript{rd} highest</td>
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<tr>
<td>Peak/trough</td>
<td>19\textsuperscript{th} highest</td>
<td>16\textsuperscript{th} highest</td>
<td>4\textsuperscript{th} highest</td>
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<td>2018</td>
<td>19\textsuperscript{th} highest</td>
<td>20\textsuperscript{th} highest</td>
<td>8\textsuperscript{th} highest</td>
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<tr>
<td><strong>Change</strong></td>
<td></td>
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<td>Pre-crisis (2007)-peak/trough</td>
<td>17\textsuperscript{th} largest fall</td>
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<td>Peak/trough-2018</td>
<td>14\textsuperscript{th} largest rise</td>
<td>5\textsuperscript{th} largest cut</td>
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Source: Table STA-T1 and STA-T3, IMF, *Fiscal Monitor: April 2013*. 
The outlook for spending

Note: DEL and AME figures from 2013–14 adjusted for changes for local government funding for Business Rates Retention and Council Tax Benefit localisation.
Variation in local authority cuts across England]
Change in spending power (grants and council tax revenue) among English local authorities between April 2011 and March 2015

Variation in spending power (grants and council tax revenue) among English local authorities between April 2011 and March 2015.

Notes: Spending power aggregated to the levels of local government shown in the Figure. Excludes spending by the GLA and fire authorities.
Source: Author’s calculations using data from DCLG.
LAs sharing the cuts unevenly (so far)

- Planning and development services: -45.7
- Highways and transport services: -6.5
- Social care: -0.4
- Police services: -4.2
- Environmental and regulatory services: -2.0
- Other & central: -5.6
- Cultural and related services: -19.6

Source: Author’s calculations using data from DCLG.
Beyond SR 2013: Trade off between DEL cuts and other policy action

- No new tax rise or social security cuts: 7.6% total DEL cut
- No new tax rise or social security cuts: 14.5% ‘unprotected’ DEL cut
- ’Unprotected’ DEL cut at same rate as over SR2010: £8 billion policy action
- Total DEL cut at same rate as over SR2010: £9 billion policy action
- No real cuts to total DEL: £23 billion policy action

Real change in departmental spending, 2015–16 to 2017–18
Employment

Note: To aid comparison all financial sector workers are attributed to the private sector for the whole period. Source: ONS.
The changing composition of public spending

- Soc. sec: all
- Soc. sec: pensioners
- Soc. sec: working age

Percentage of total public spending

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The changing composition of public spending

- Soc. sec: all
- Health
- Education
- Debt interest
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