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Fiscal Studies



2015–16: the squeeze continues

Carl Emmerson

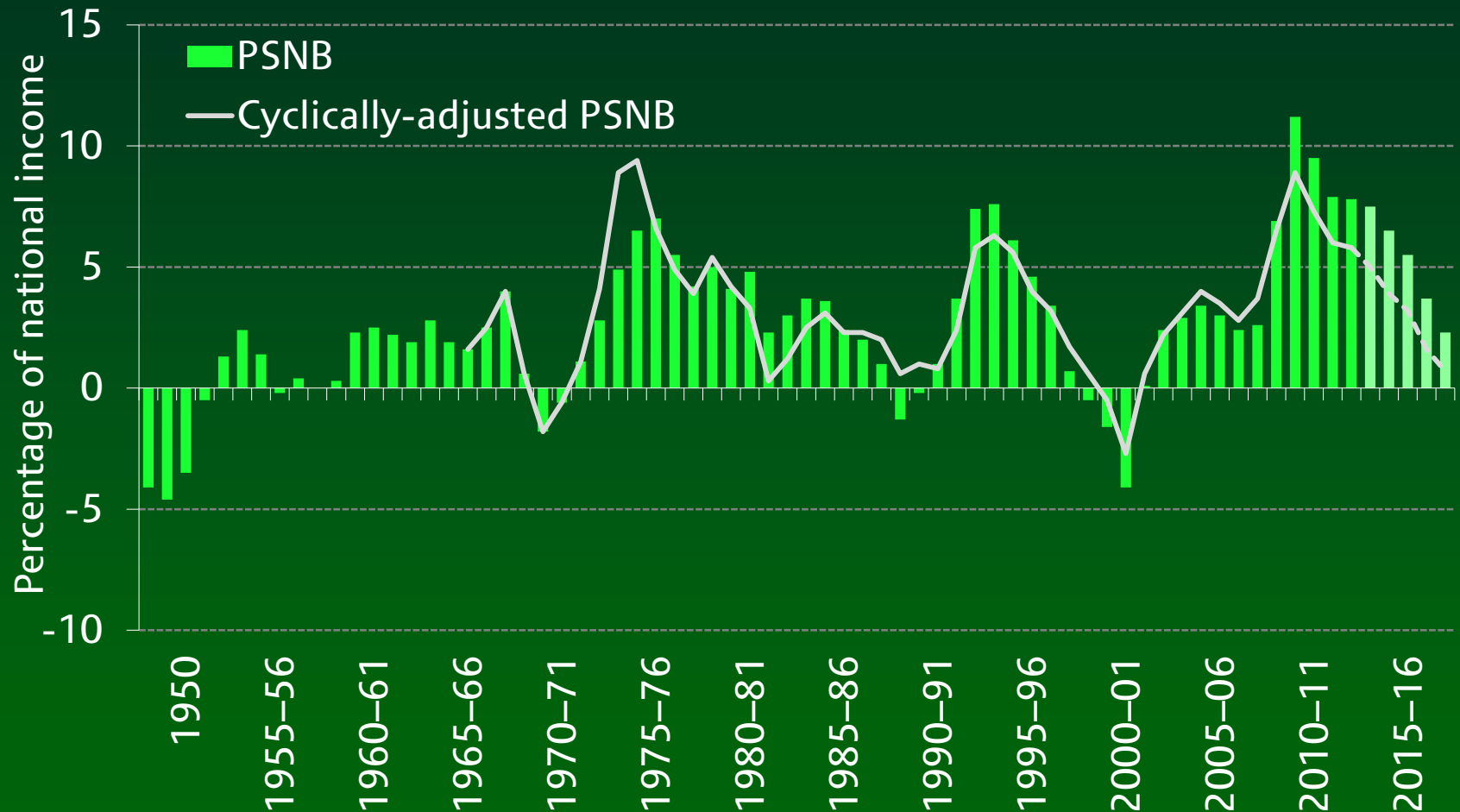
Presentation for IFS and IfG background briefing on “The 2015–16 Spending Round”, Friday 7 June 2013, IfG, London.

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.

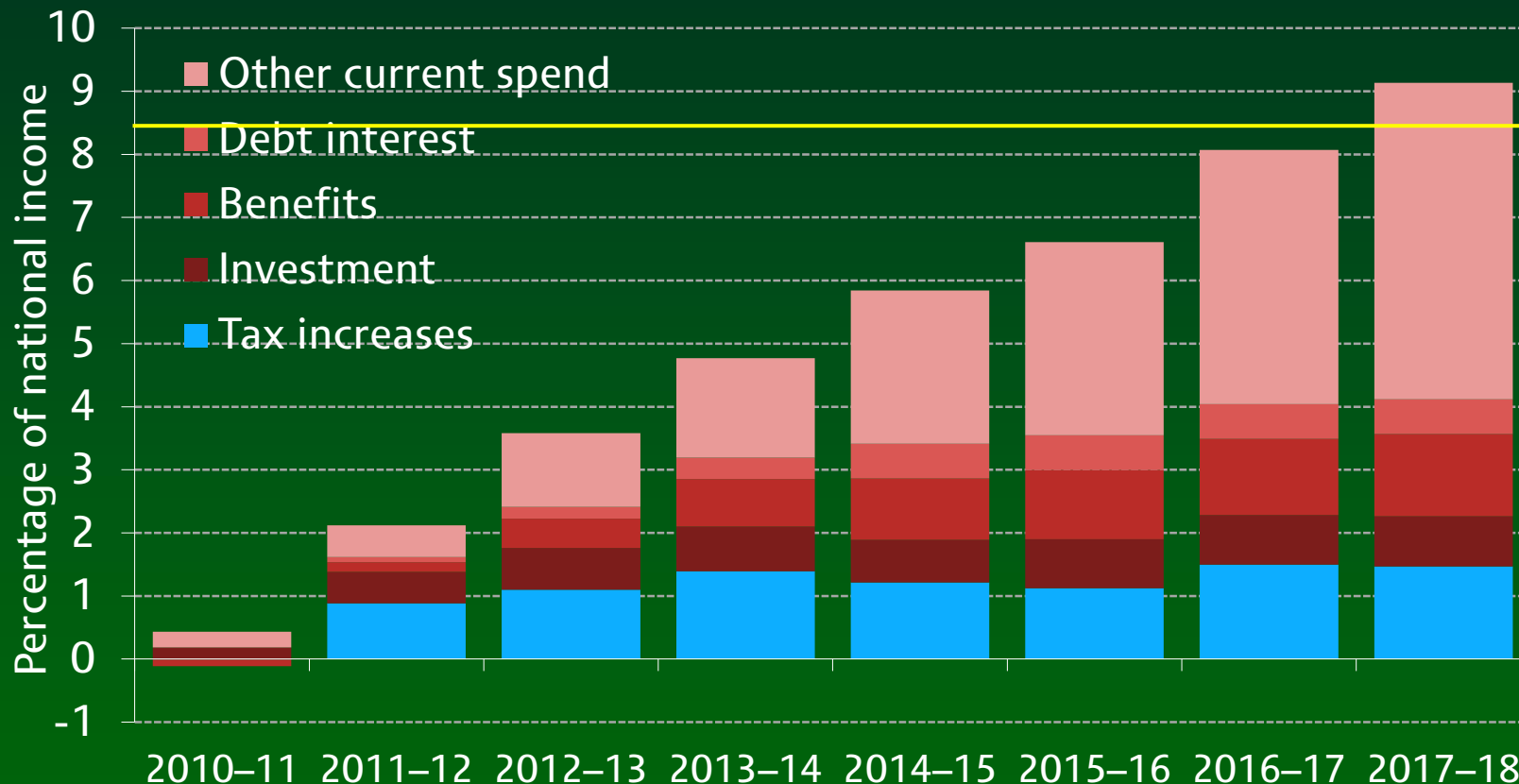
Source: ONS; OBR.



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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

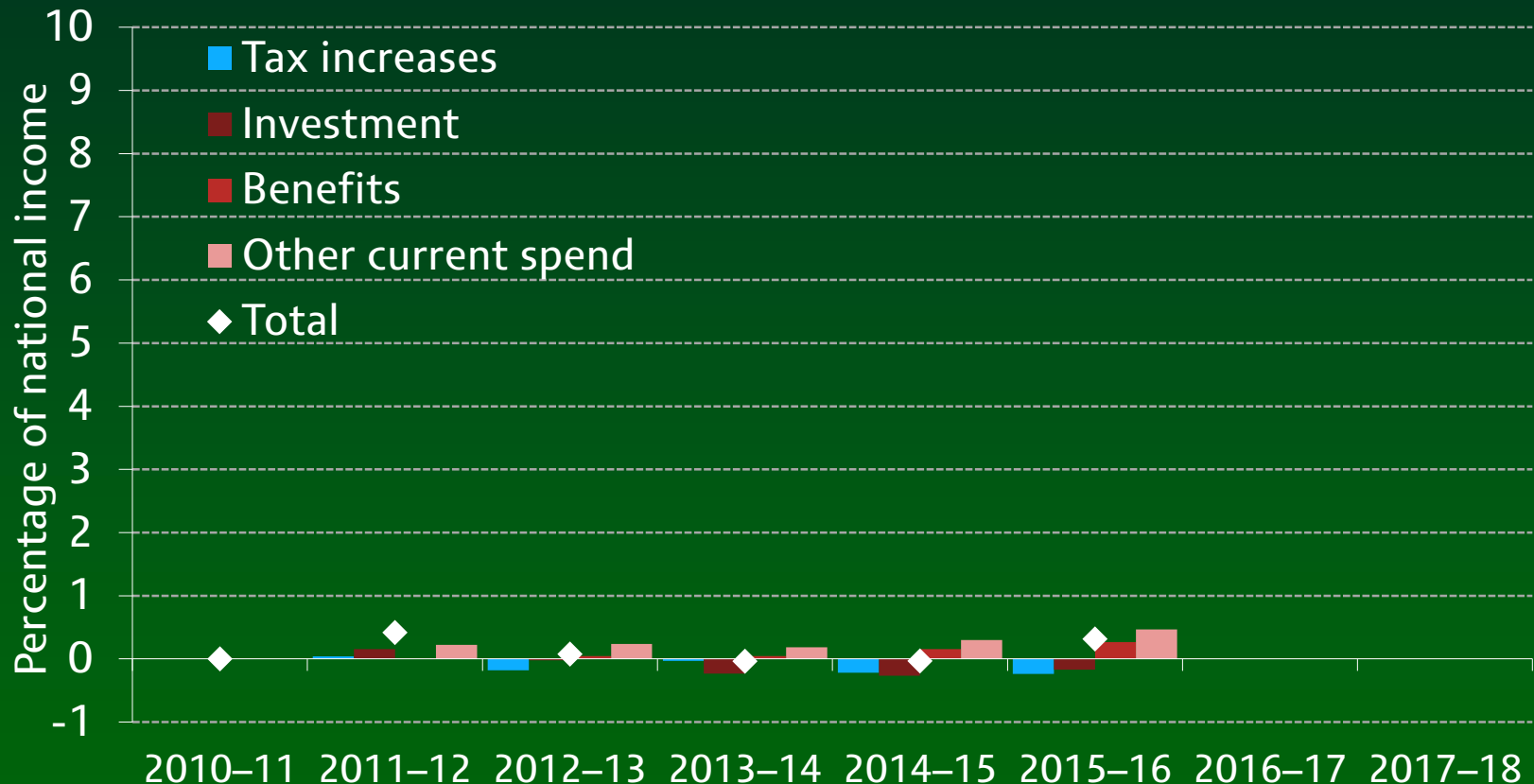


Notes: Figures include realised underspends by government departments and latest estimate of Exchequer savings from changing to CPI indexation.
Source: Tetlow (2013).



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

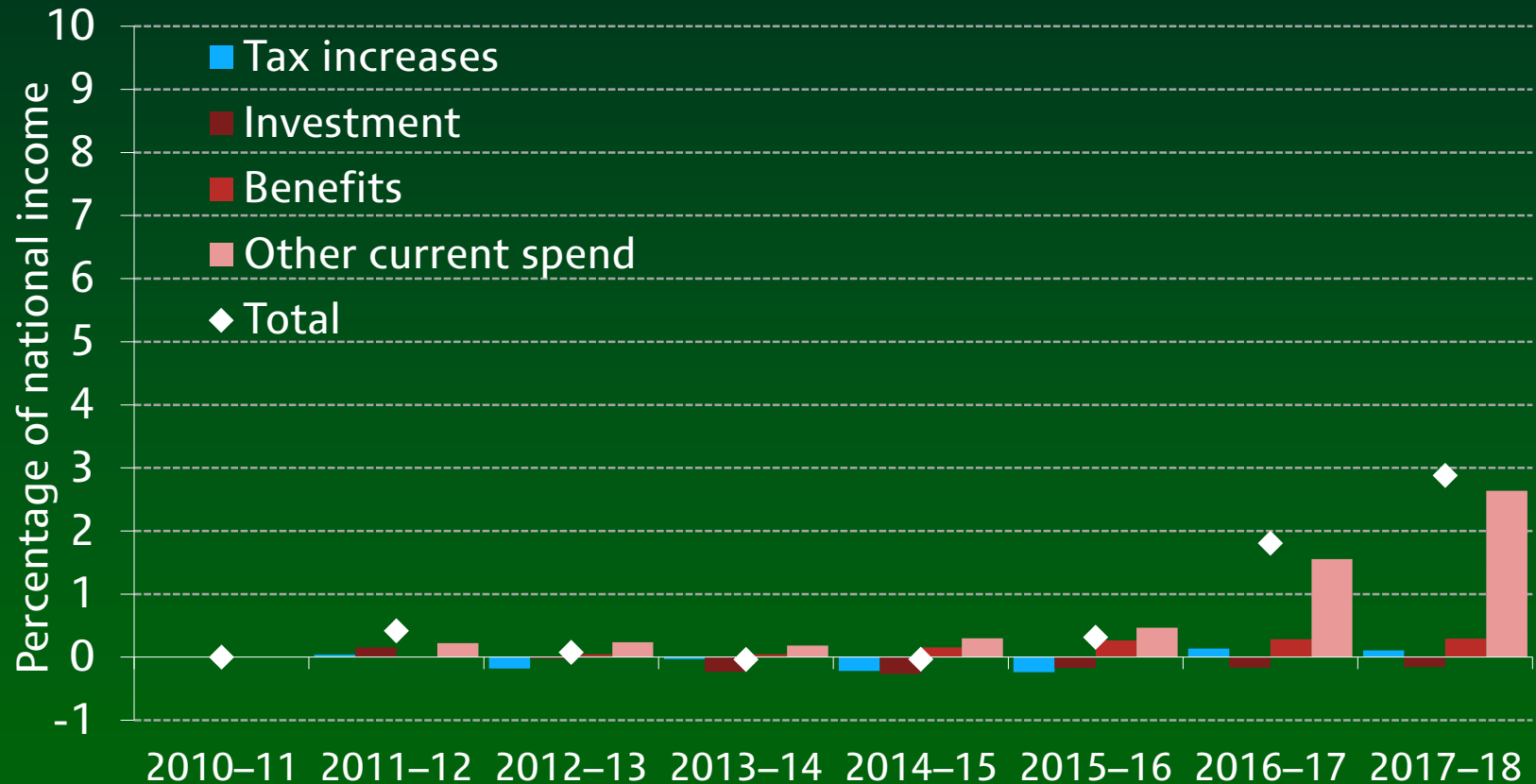


Notes: Figures include realised underspends by government departments.

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

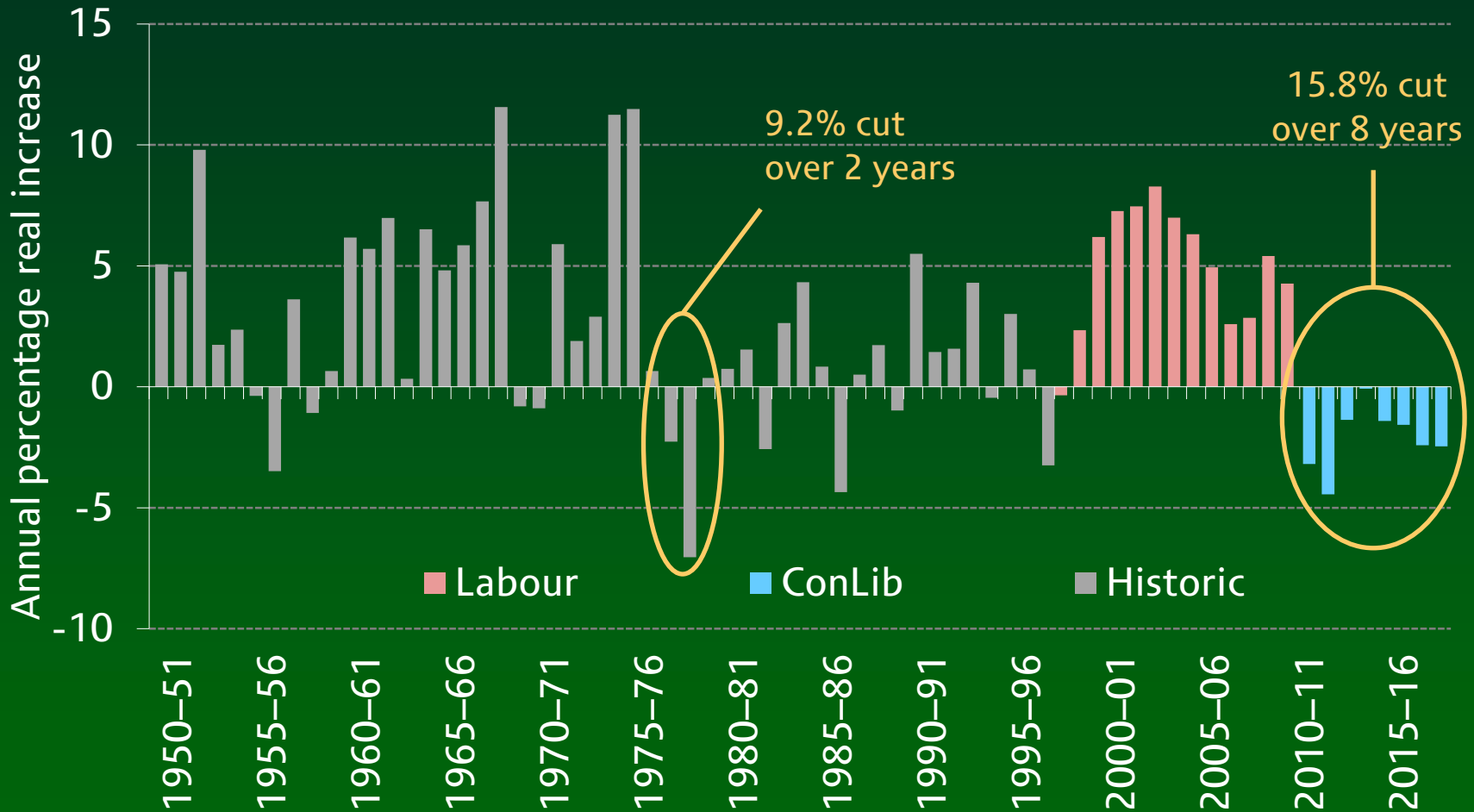
UK compared to 29 other advanced economies

- 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*.

~~7-year~~ 8-year

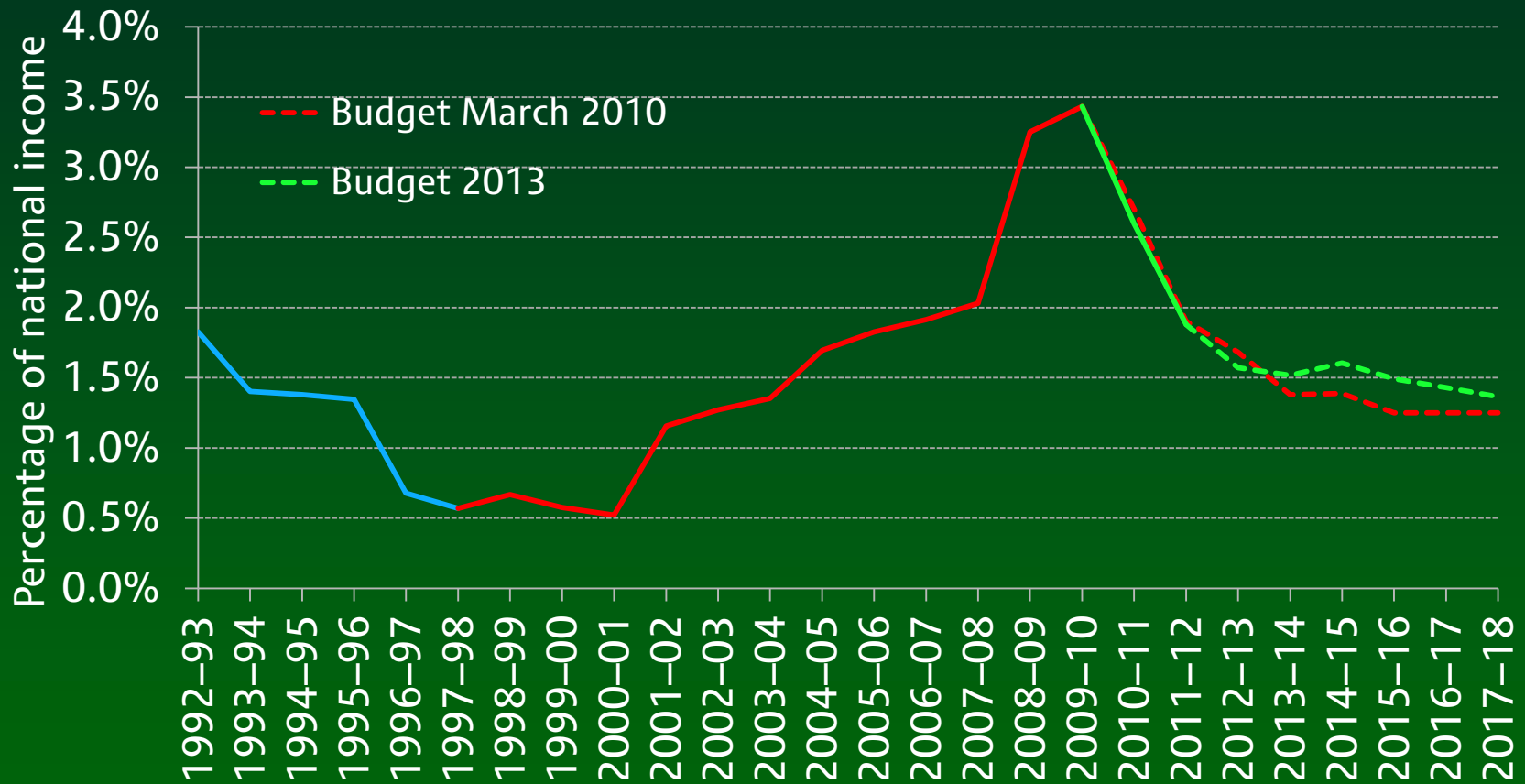
~~6-year~~ squeeze on public service spending



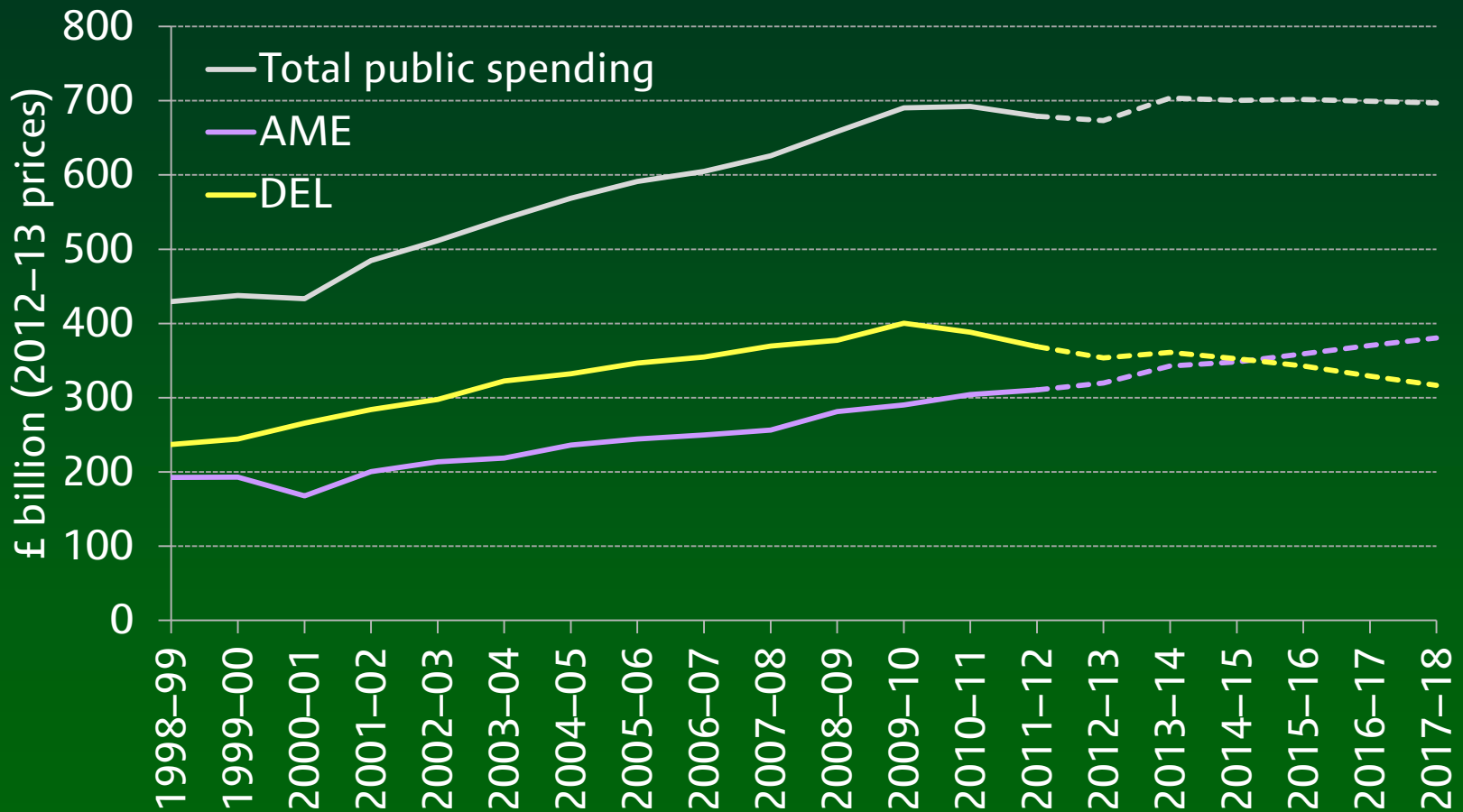
Note: Figure shows total public spending less spending on net social benefits and public sector net debt interest. Data exclude 3G and 4G spectrum sales and Royal Mail pension transfer.



Public Sector Net Investment



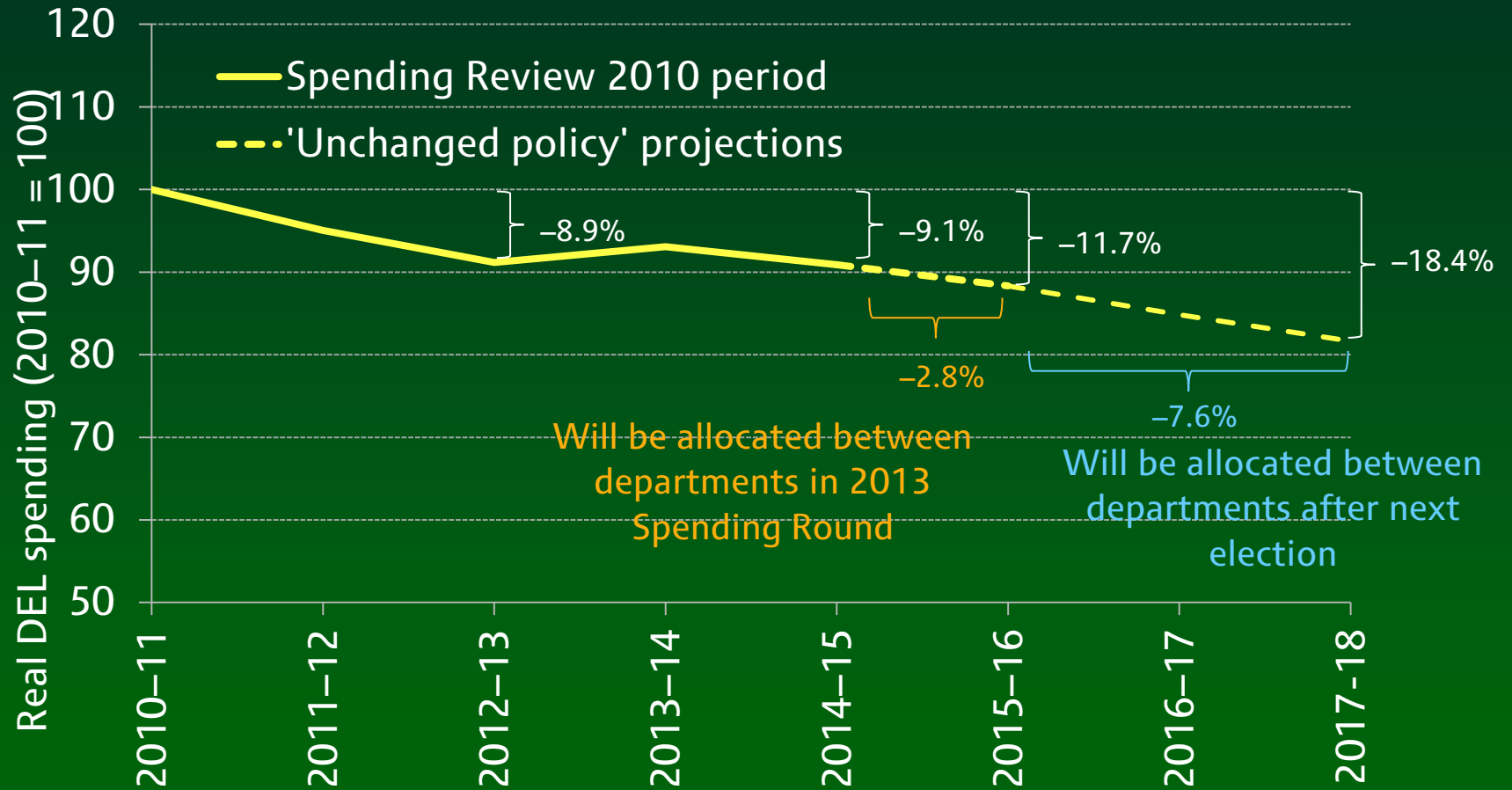
The outlook for DEL and AME



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

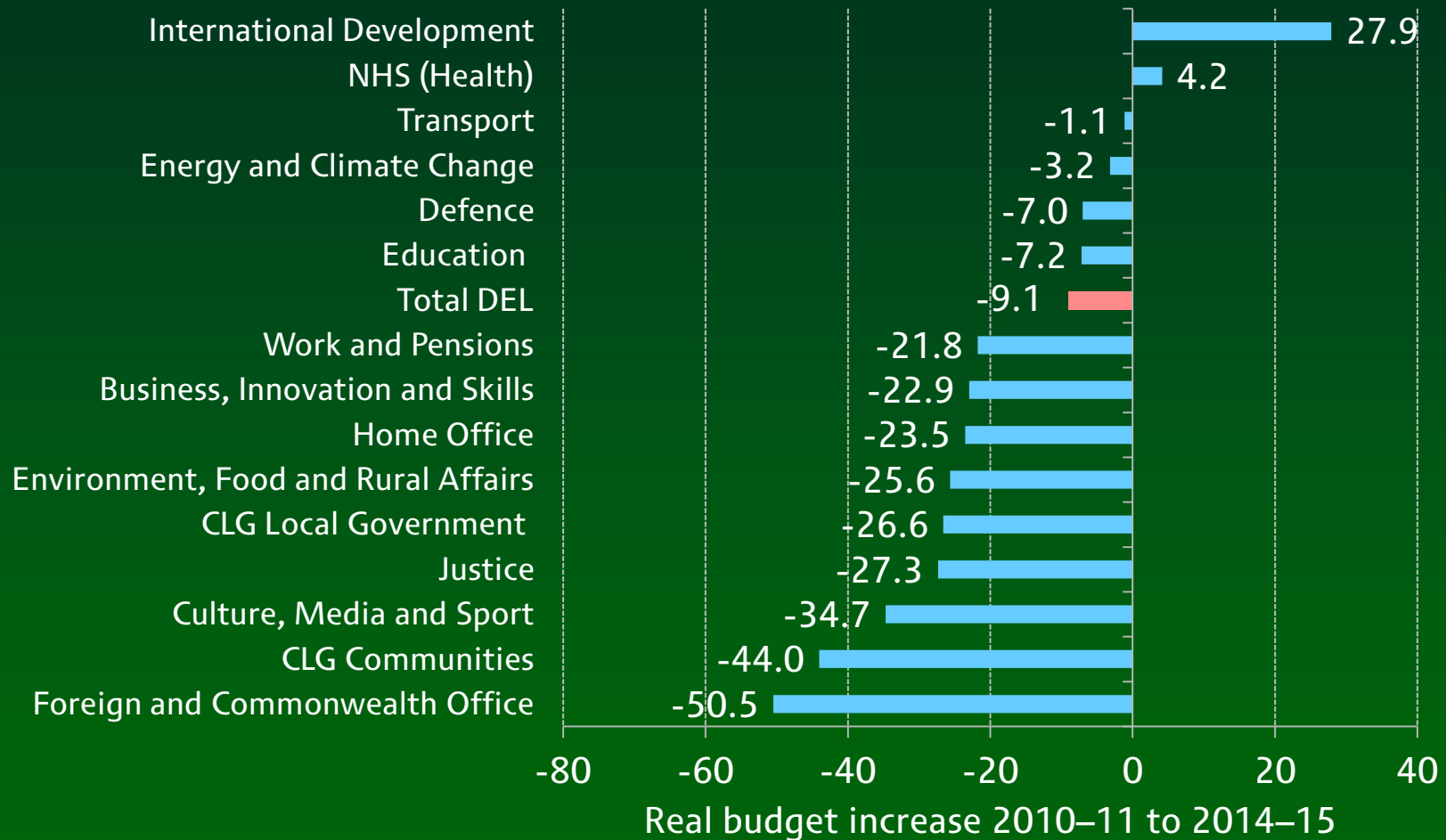


Departmental spending: 2010–11 to 2017–18

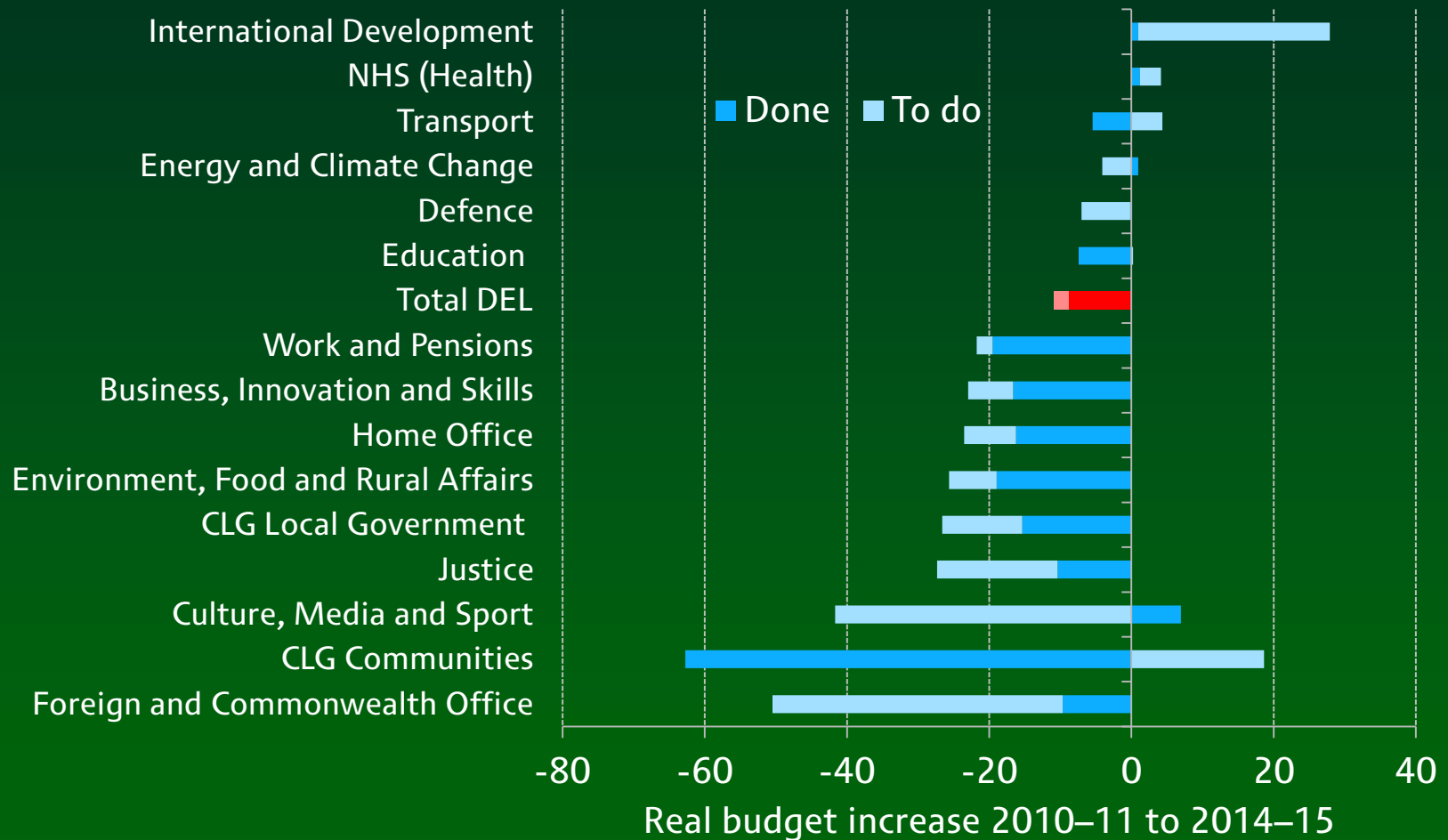
- Current plans imply cuts of
 - 18.4% to total DEL over 7 years from April 2011, with just under half done over the first 4 years
 - 2.8% to be implemented in 2015–16
 - further 7.6% to occur over 2016–17 and 2017–18
- Budget 2013: “Fiscal consolidation for 2016–17 and 2017–18 is expressed as a reduction 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...



... some front-loaded and some back-loaded



(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
 - http://www.ifs.org.uk/ff/spending_review2013.xlsm



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:

	Defence & Home Office		
	-2%	-4%	-6%
Local government			
Business, Innovation and Skills			
Transport			
DEFRA			
DCMS			

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:

	Defence & Home Office		
	-2%	-4%	-6%
Local government	-12%	-11%	-10%
Business, Innovation and Skills	-11%	-10%	-9%
Transport	-9%	-8%	-8%
DEFRA	-12%	-11%	-10%
DCMS	-12%	-11%	-10%

- These are cuts to total DEL: cuts relative to an adjusted baseline could look different



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



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.

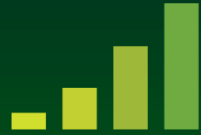
Public sector employment

- 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





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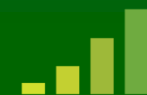
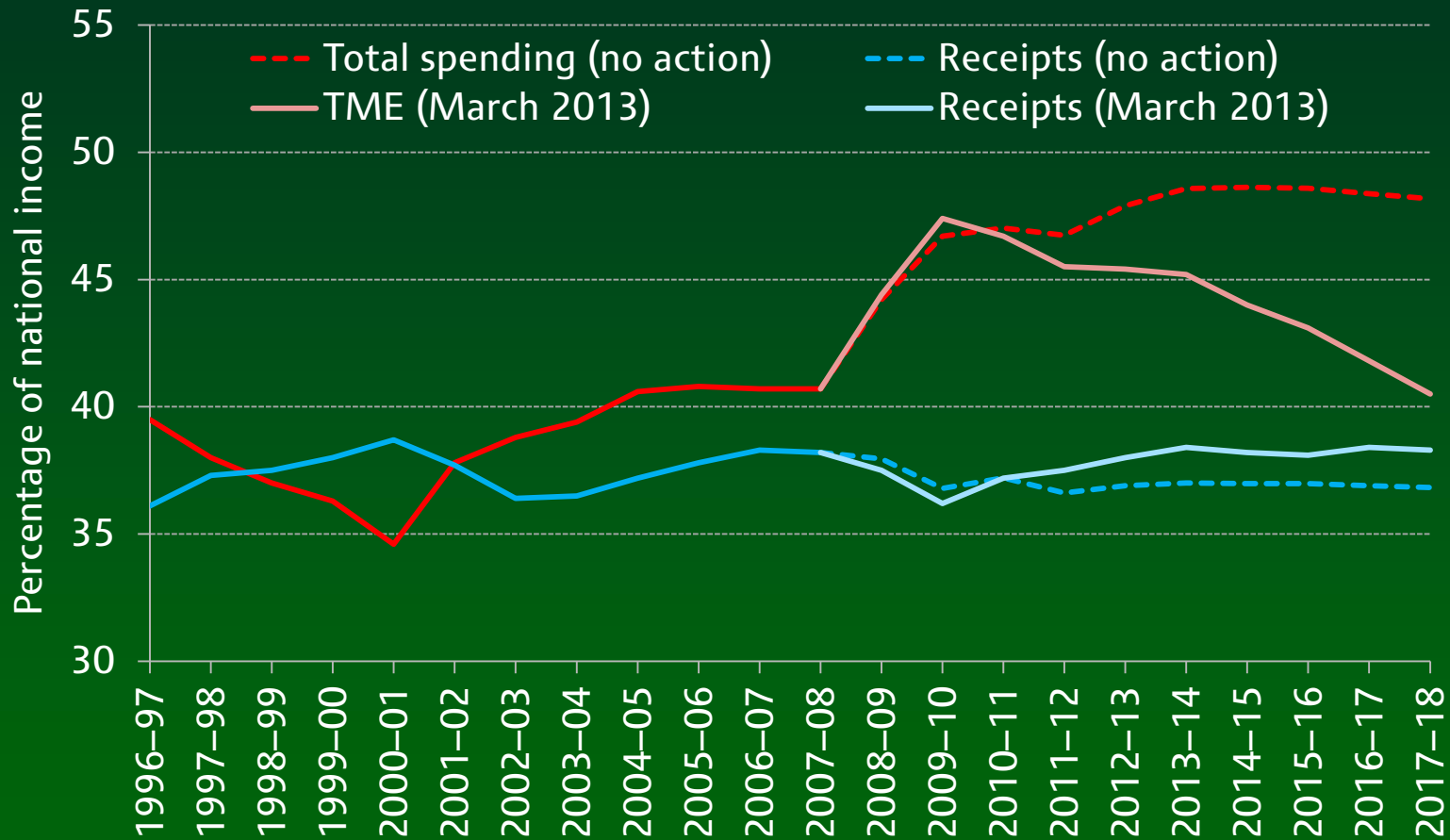
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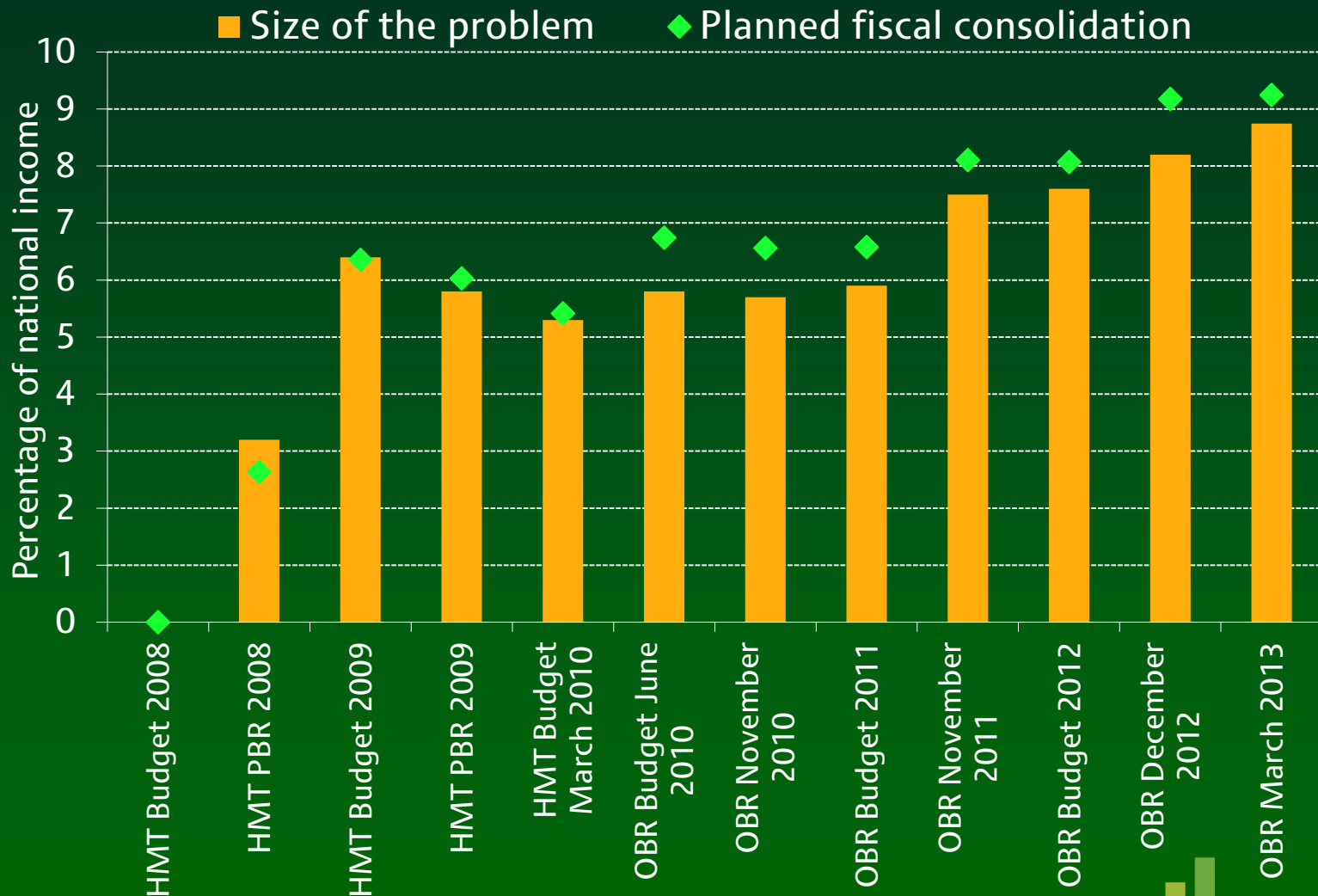
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http://www.ifs.org.uk/budgets/gb2013/GB2013_Ch6.pdf
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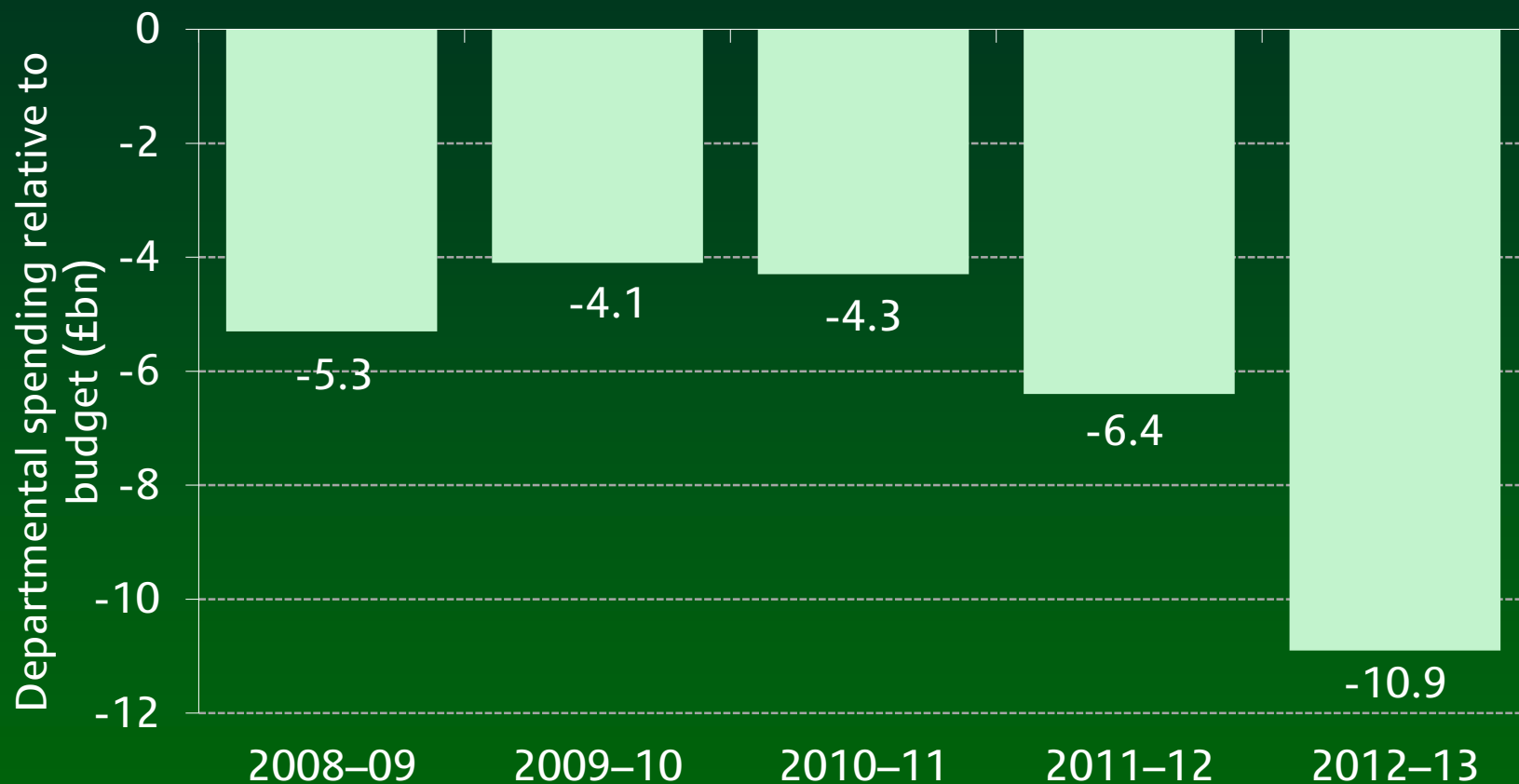
Spending and revenues back to pre-crisis levels



The hole in the public finances has increased



Departments have been underspending

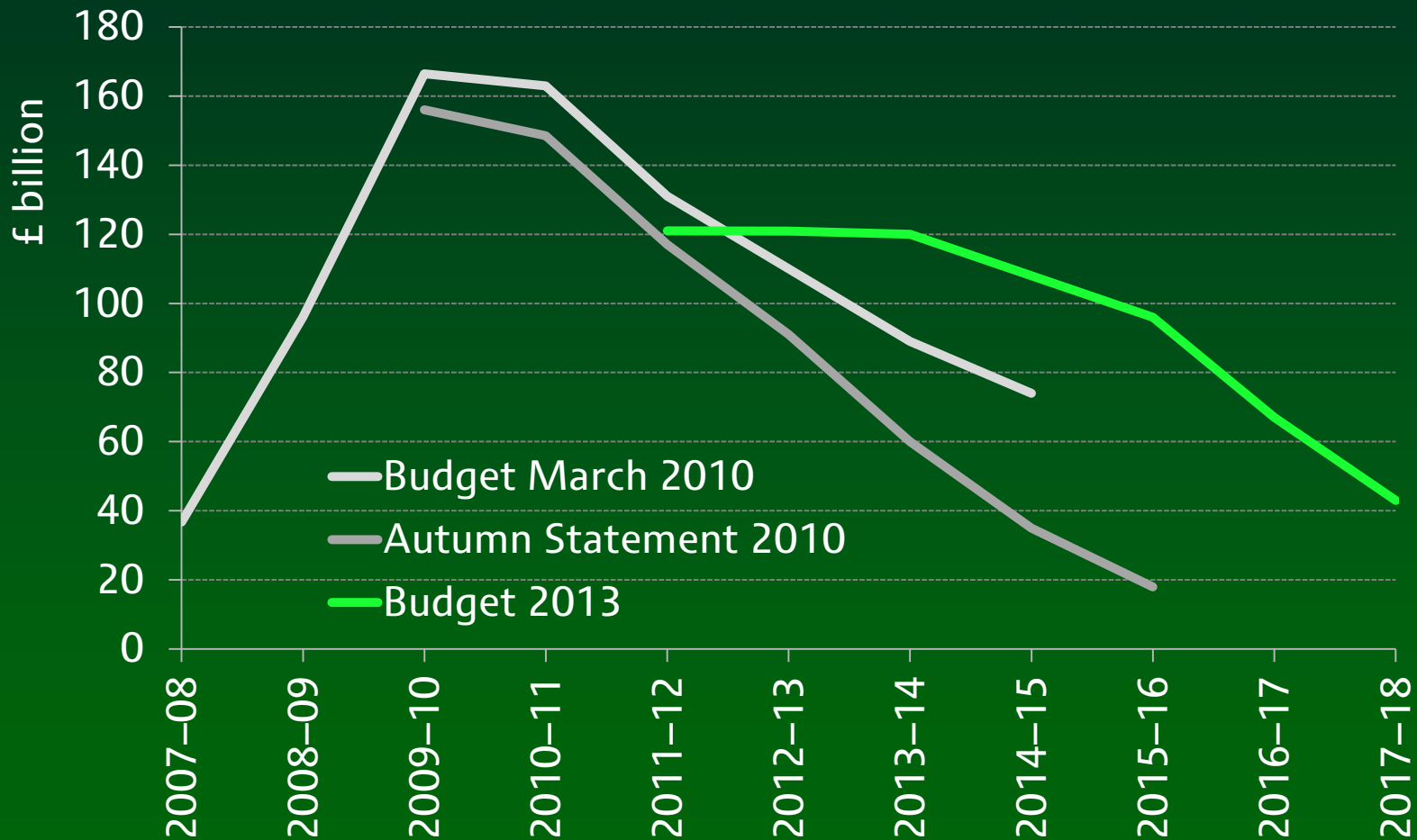


Note: Spending relative to 'final' plans up to 2010-11, and relative to PESA plans after 2011-12.

Source: OBR March 2013 EFO Fiscal Supplementary Tables Table 2.15.



Cutting the deficit?



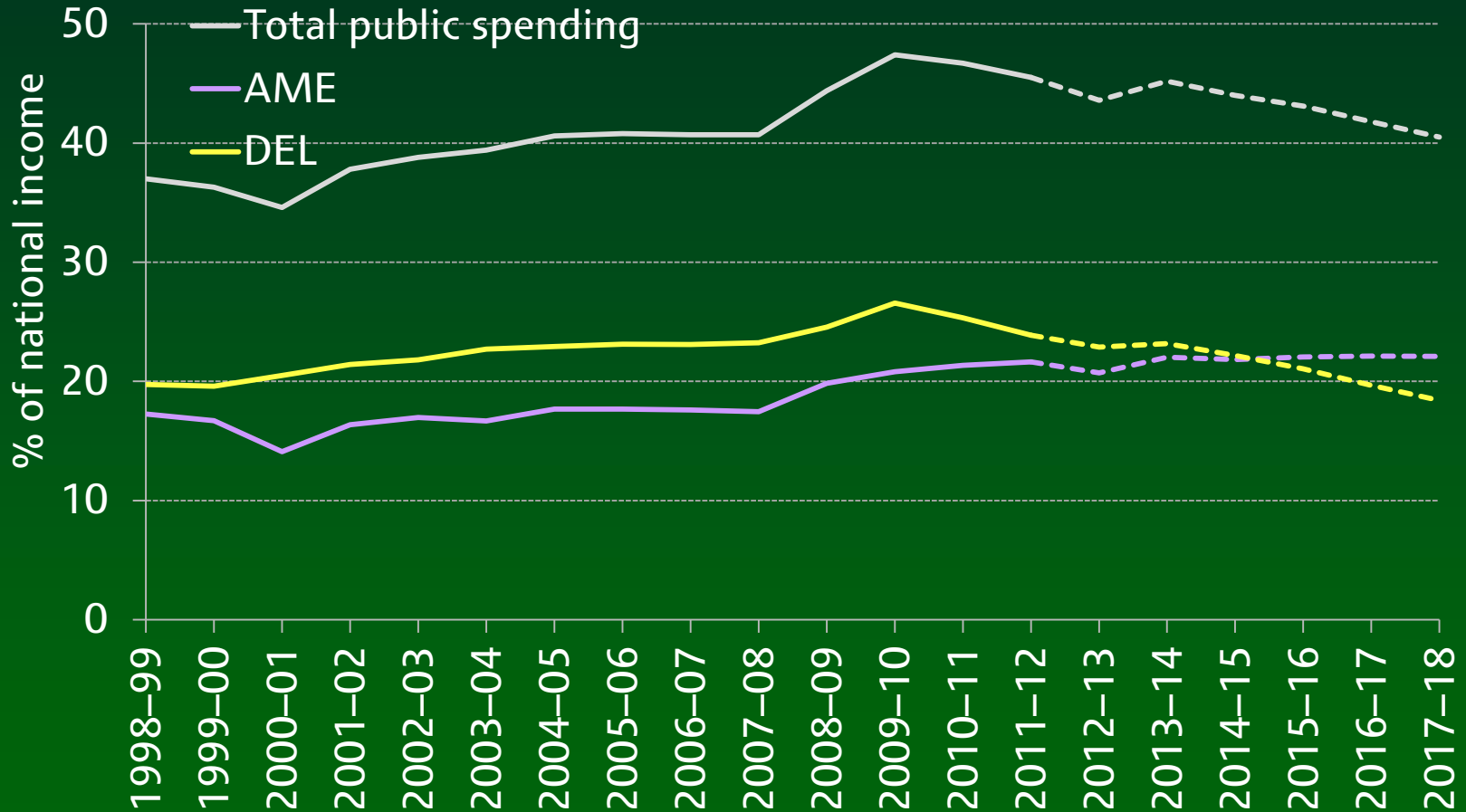
International comparison: tax, spend and borrow

Comparison of IMF forecasts for the UK and 29 other advanced economies show:

UK rank	Tax	Spend	Borrow
<i>Level</i>			
Pre-crisis (2007)	21 st highest	17 th highest	3 rd highest
Peak/trough	19 th highest	16 th highest	4 th highest
2018	19 th highest	20 th highest	8 th highest
<i>Change</i>			
Pre-crisis (2007)-peak/trough	17 th largest fall	11 th largest rise	9 th largest rise
Peak/trough-2018	14 th largest rise	5 th largest cut	6 th largest cut
2007-2018	14 th largest rise	9 th largest cut	6 th largest cut

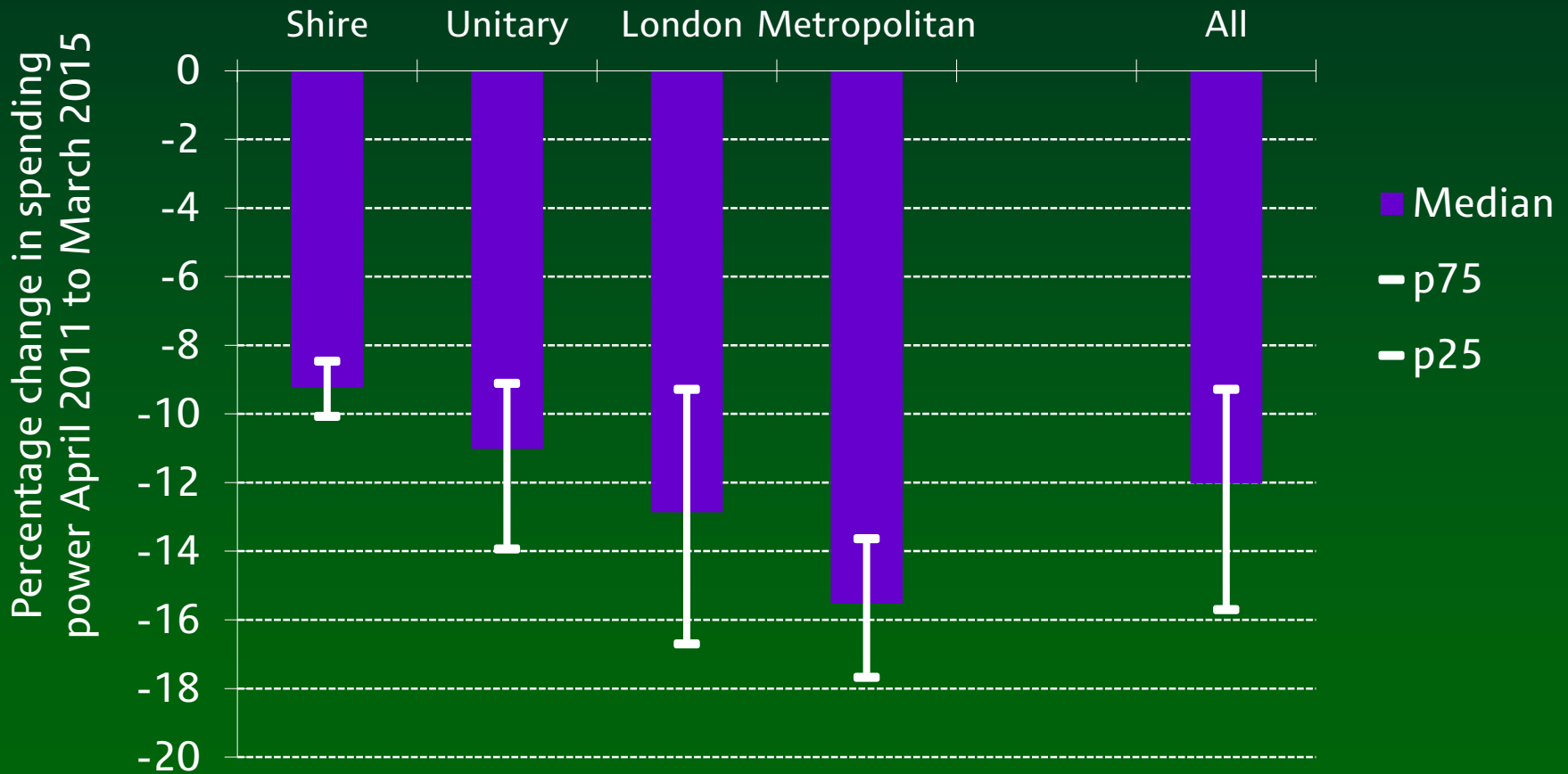
Source: Table STA-T1 and STA-T3, IMF, *Fiscal Monitor: April 2013*.

The outlook for spending



Variation in local authority cuts across England]

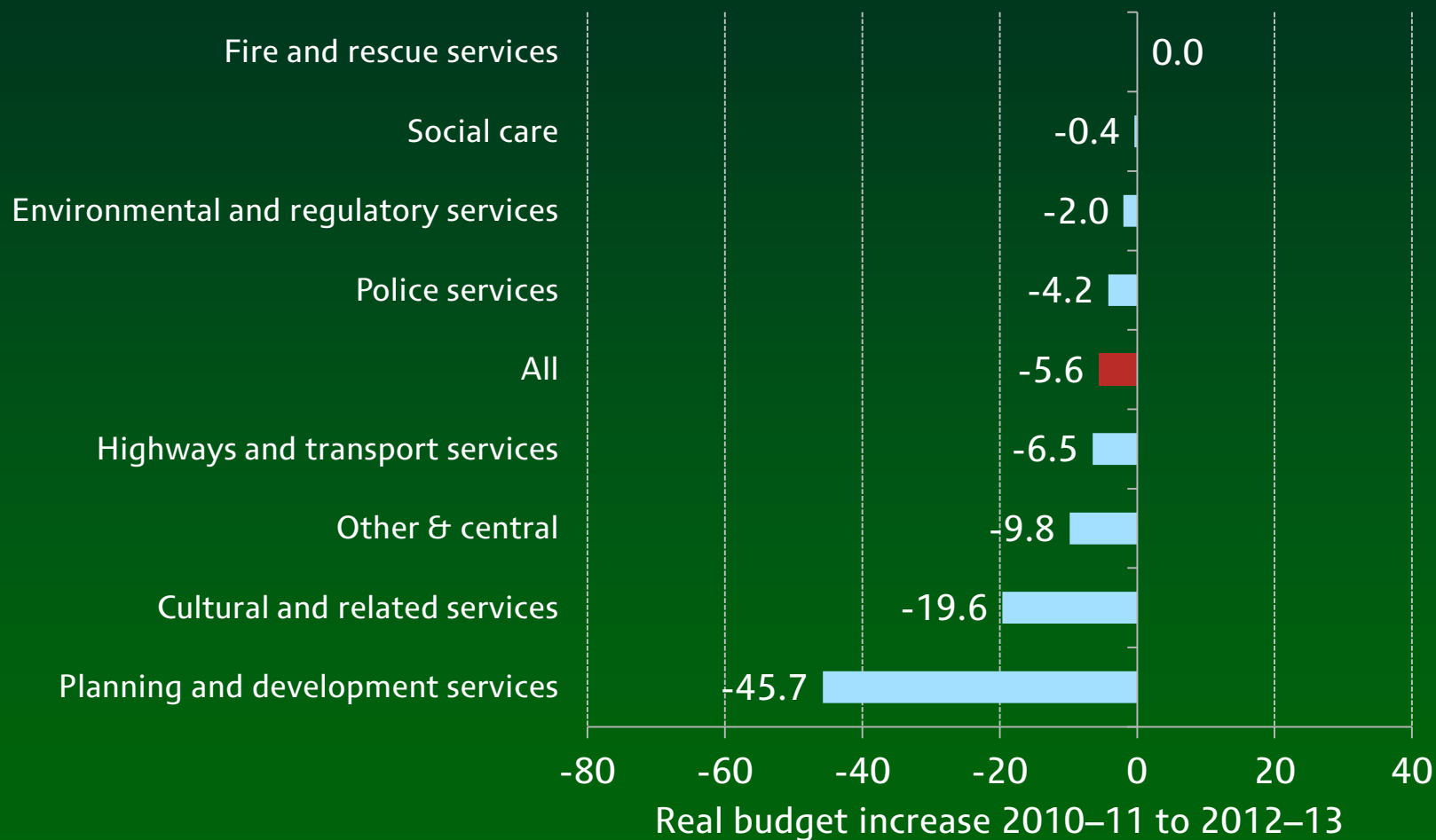
Change in spending power (grants and council tax revenue) among English local authorities between April 2011 and March 2015



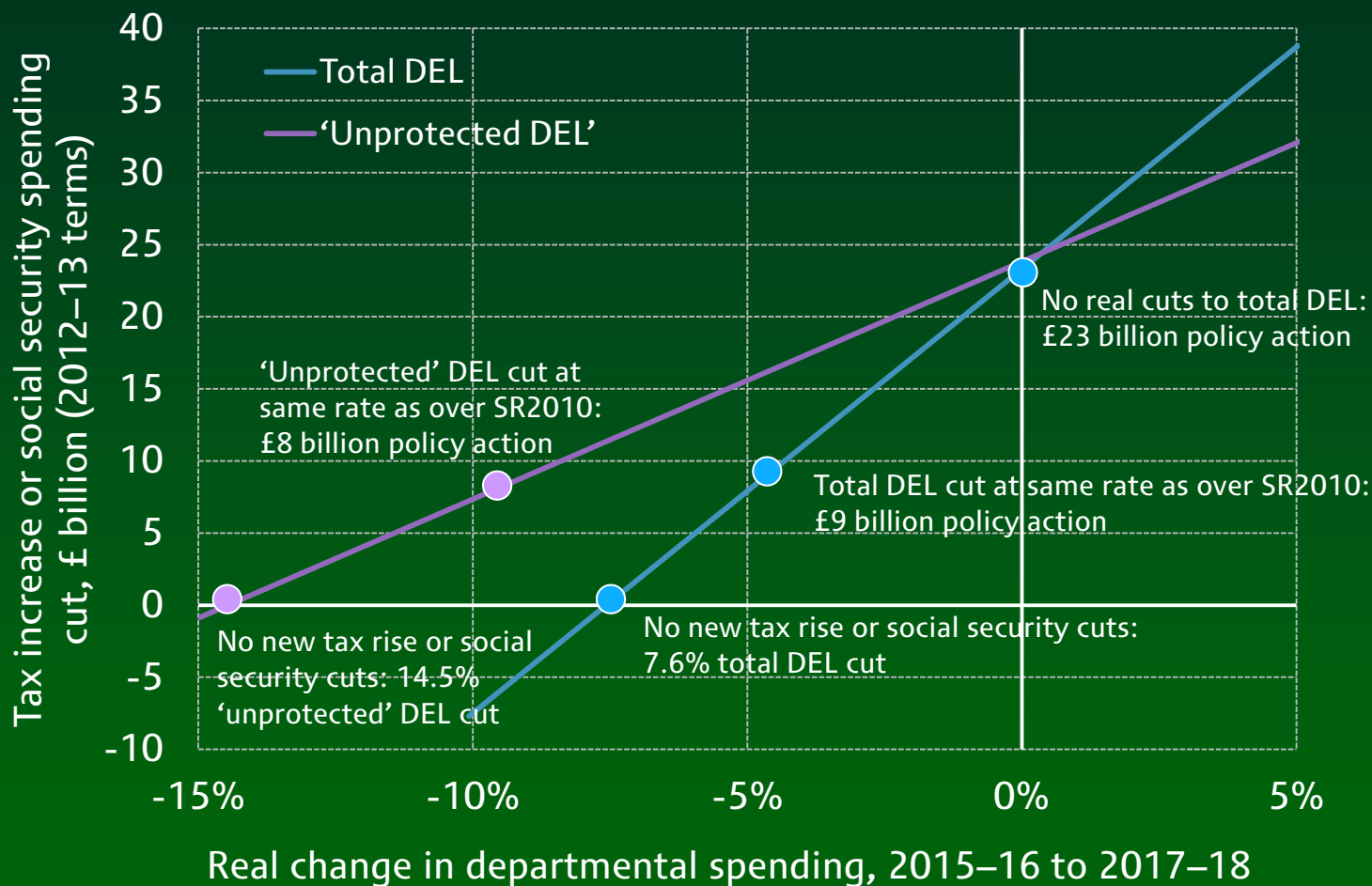
Notes: Spending power aggregated to the levels of local government shown in the Figure. Excludes spending by the GLA and fire authorities.
Source: Author's calculations using data from DCLG.



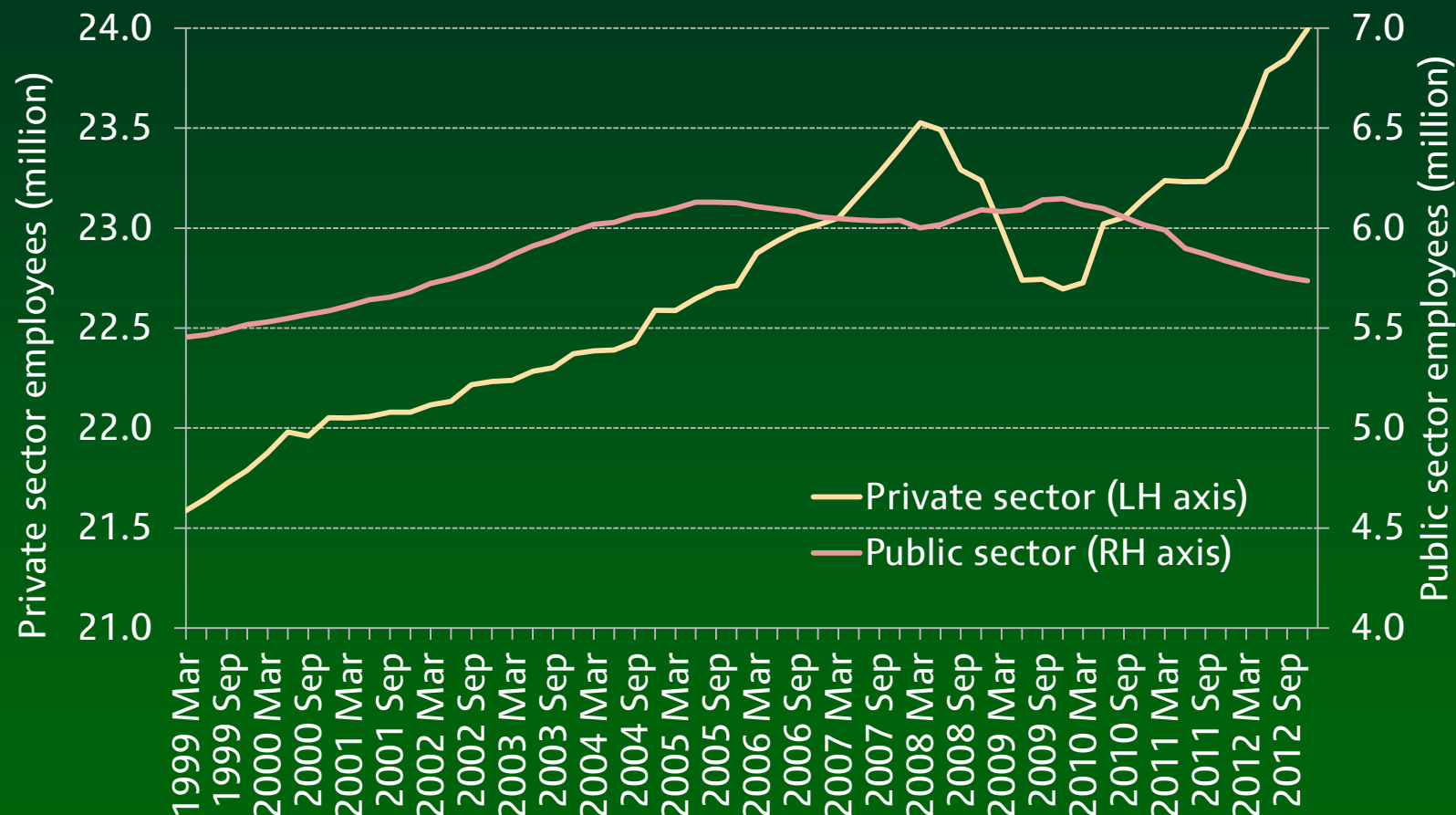
LAs sharing the cuts unevenly (so far)



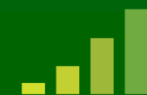
Beyond SR 2013: Trade off between DEL cuts and other policy action



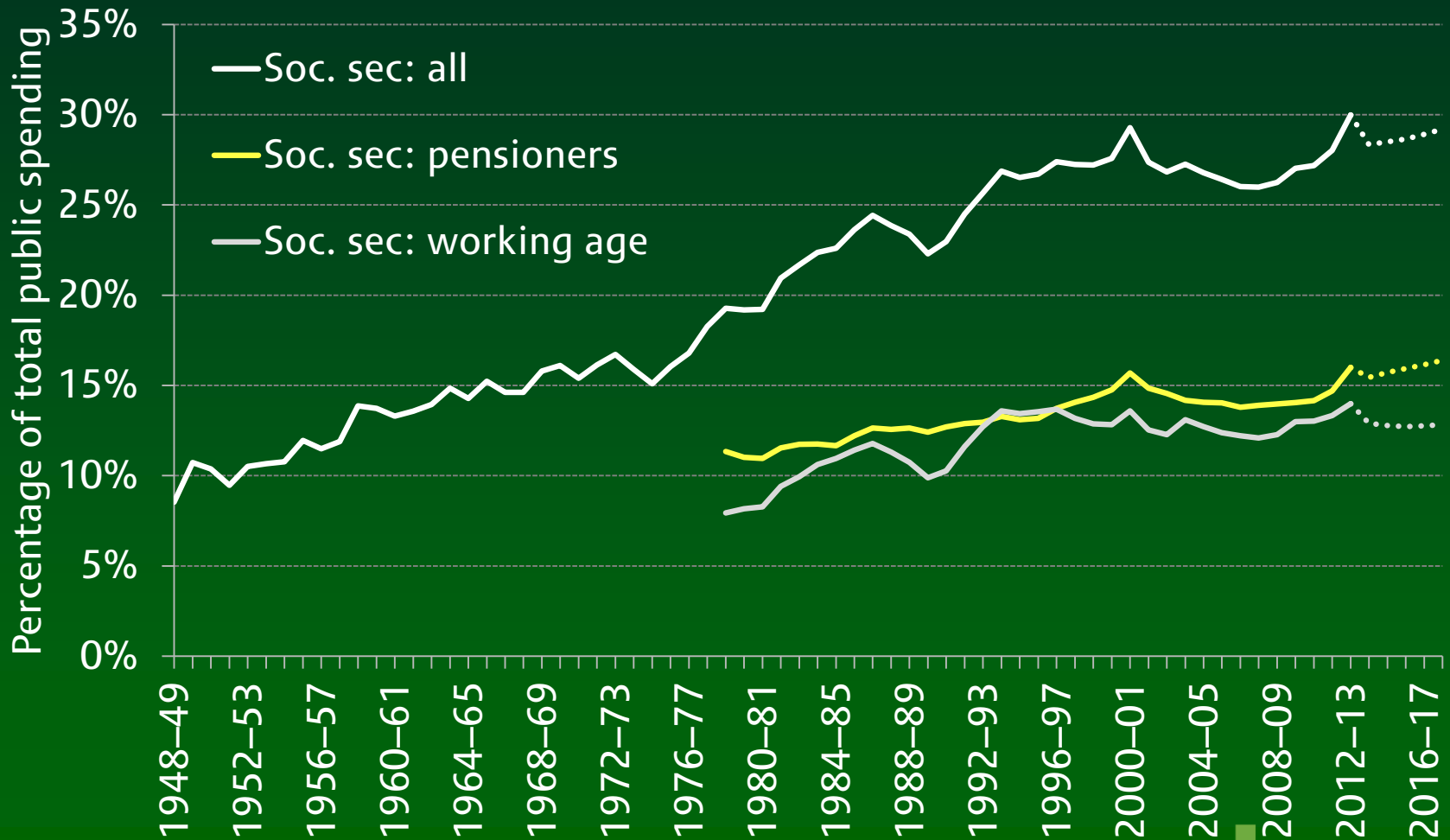
Employment



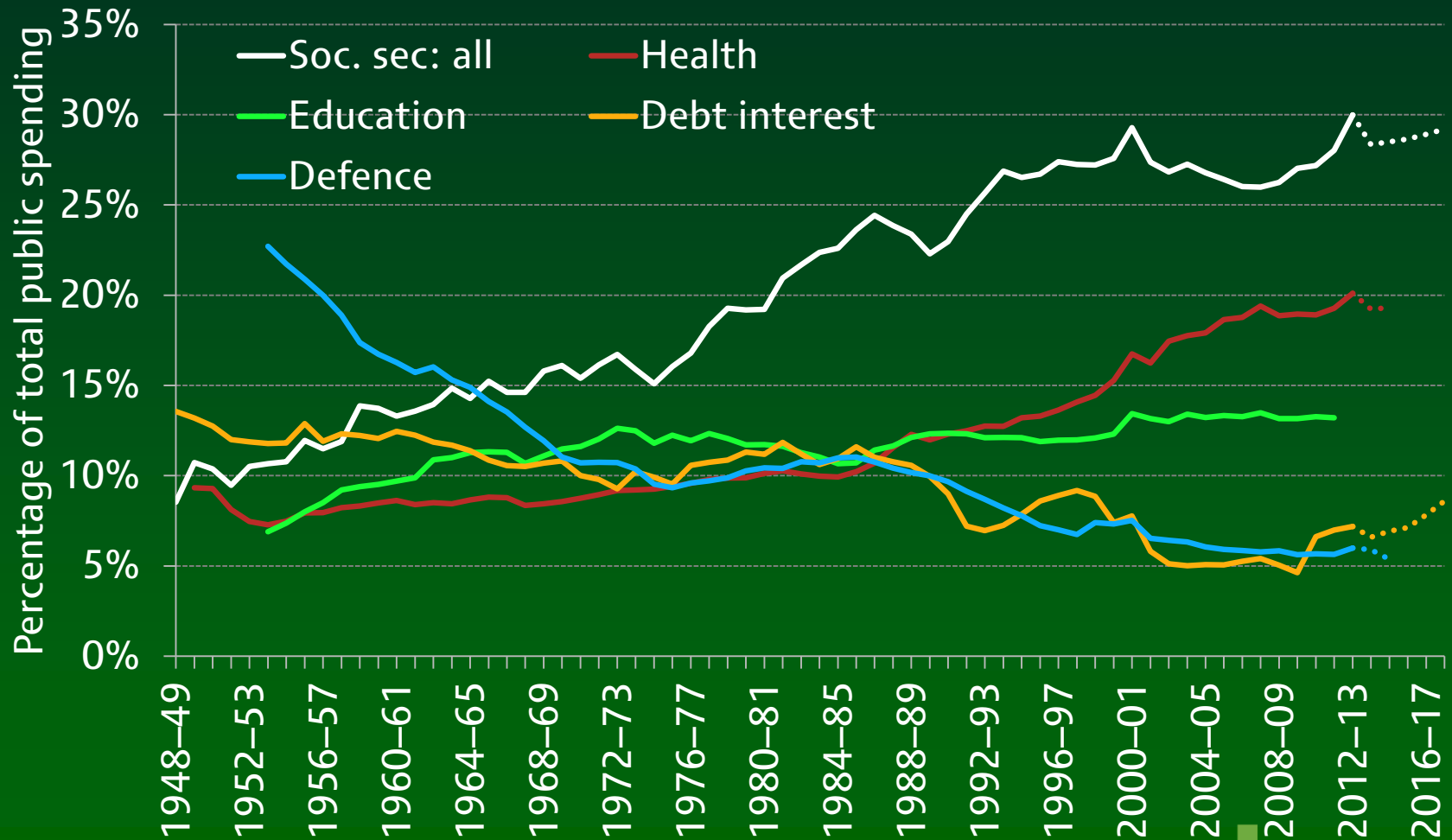
Note: To aid comparison all financial sector workers are attributed to the private sector for the whole period.
 Source: ONS.



The changing composition of public spending



The changing composition of public spending



The changing composition of public spending

