Institute for Fiscal Studies

Spending Review 2015

Paul Johnson

Presentation to CIPFA pensions network annual conference

11 November 2015

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The new fiscal charter

- Commits government to an overall surplus from 2019–20 onwards
  - unless growth (actual or forecast) drops below 1% p.a.
- Aiming to achieve a budget surplus not obviously inappropriate
  - debt-to-gdp ratio is what matters, but overall surplus could help this be brought down more quickly
- Commitment to hit surplus in a specific year is inappropriate
  - even with get out clause the rule not sufficiently flexible

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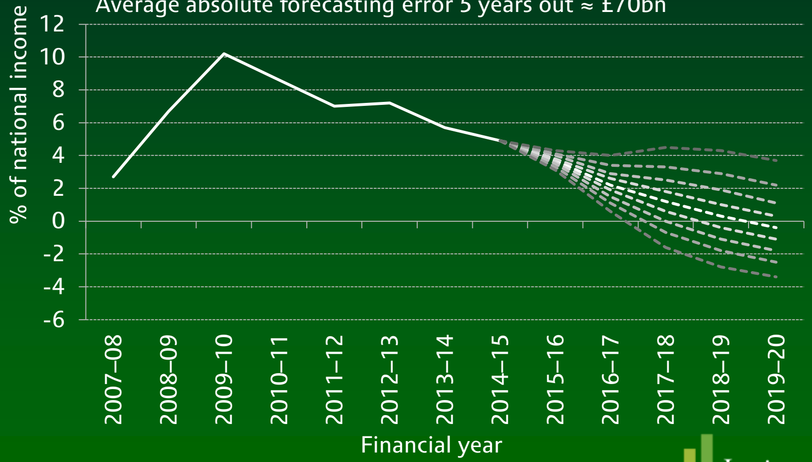
Eliminating the deficit in this parliament?

Past forecast errors suggest 55% chance of a surplus in 2019–20
Forecast surplus in 2019–20 of £10bn
Average absolute forecasting error 5 years out ≈ £70bn



Source: Office for Budget Responsibility.

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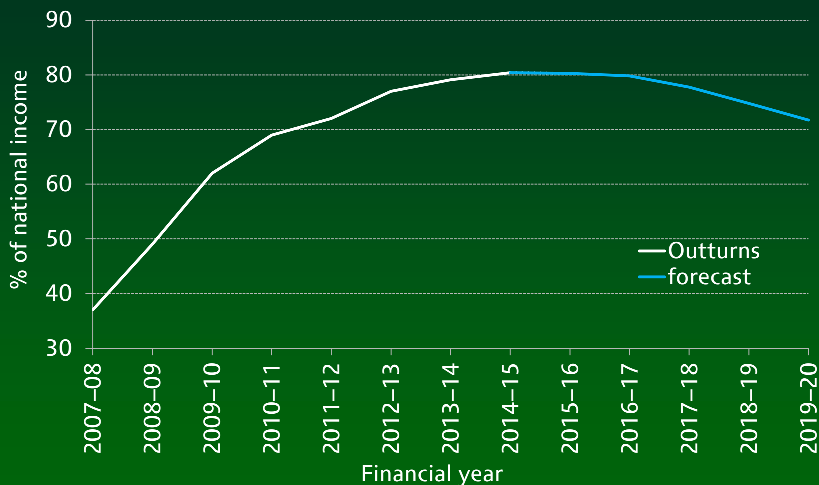
Leaving high public sector net debt



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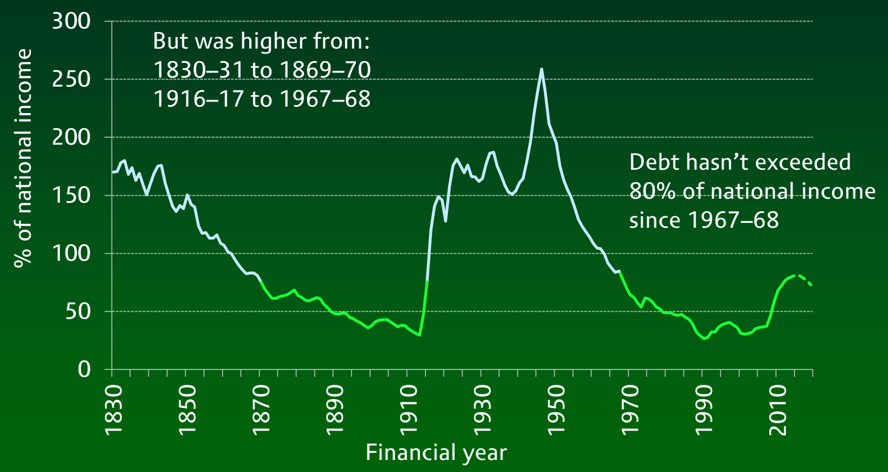
Notes and sources: see Figure 2.2 of Post-election Austerity: Parties' Plans Compared.

Though longer period gives different perspective



Notes and sources: see Figure 5.2 of *The IFS Green Budget: February 2015*.

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Revisiting tax credit cuts

- Increase in tax credit taper rate and reduction in work allowances forecast to raise £4.4bn in 2016–17
  - part of the £12bn of welfare cuts by 2019–20
- Compensation via direct tax cuts would be extremely badly targeted
- Three options
  - don’t do it: could reverse cuts to existing tax credits at no long-run cost
  - do it only for new claims: would make savings more quickly but would disincentivise current claimants from moving off tax credits
  - do it gradually: part in April 2016, part in April 2017, etc.
- Problem: how to pay for this?
  - higher taxes or more borrowing are options
  - but: unless forecast welfare spending comes down a more generous welfare system would breach the welfare cap

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All deficit reduction through spending cuts

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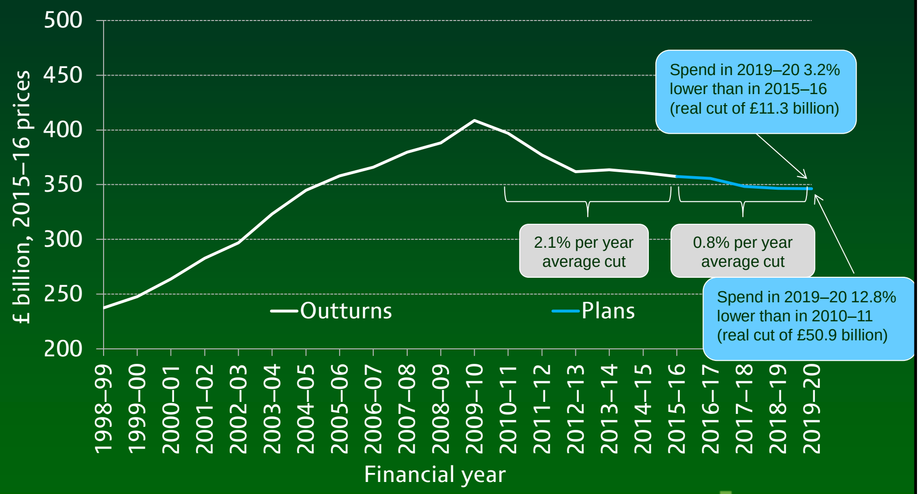
Notes and sources: see Figures 3.1 and 4.1 of Post-election Austerity: Parties' Plans Compared.

Four more years of departmental spending cuts



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Source: IFS Fiscal Facts, with TME and DEL adjusted for Eurostar sale (http://www.ifs.org.uk/tools_and_resources/public_finances)

Departmental cuts: the next chapter

- July Budget implies departmental spending to be cut by 3.2% in real terms between 2015–16 and 2019–20
  - capital spending up 11.5%; day-to-day spending cut by 5.1%
- NHS, schools, overseas aid and defence spared from brunt of cuts
- Unprotected day-to-day spending, after taking account of the Barnett formula, set to be cut by around 27%
  - brings total cut since 2010–11 up to 50%
  - further deep cuts likely for areas such as Home Office and Ministry of Justice
  - outlook for local authority budgets depends on whether local tax revenues sufficient to cover grant cuts and any new responsibilities
- On-line tool allows you to see if you can make the sums add up
  - http://www.ifs.org.uk/publications/8008

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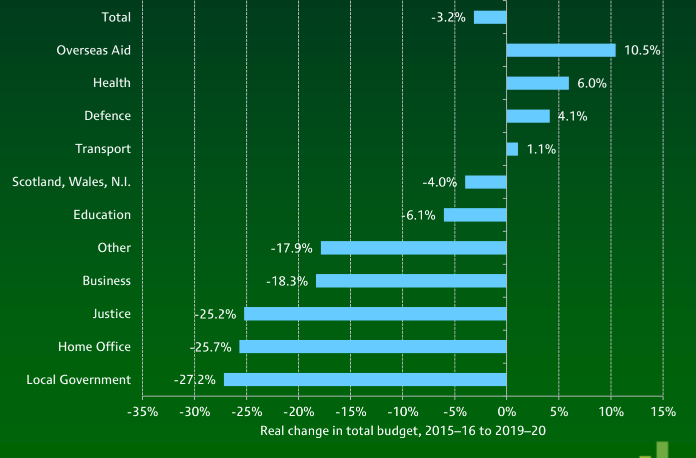
If cuts are made proportionally to resource and capital budgets



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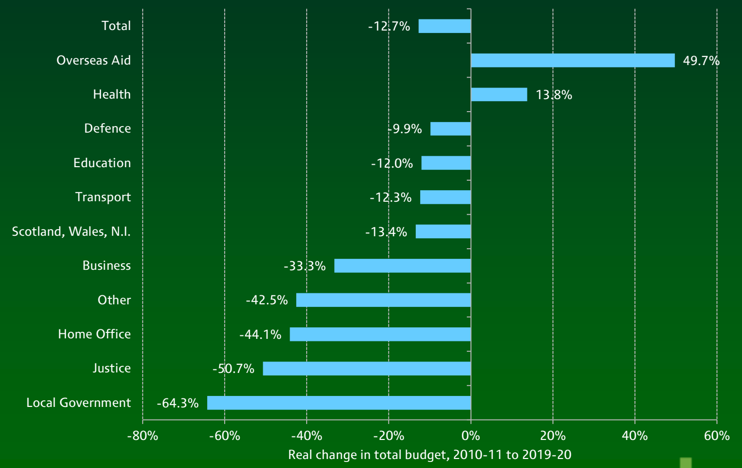
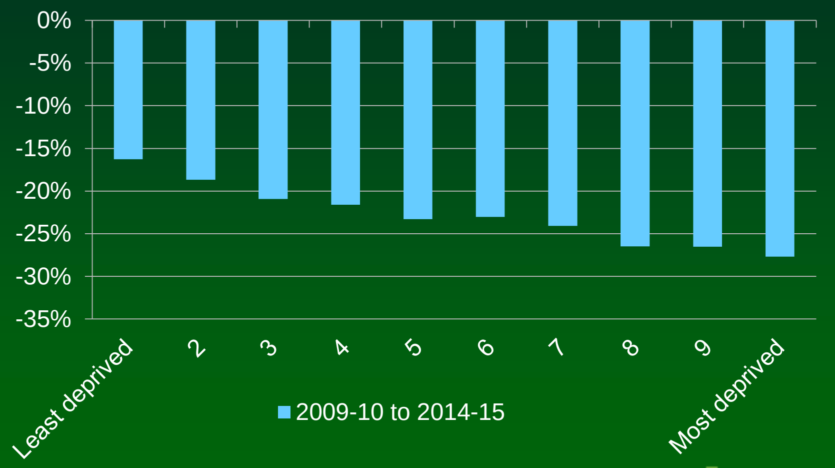
Which would imply some huge cuts since 2010



Local government spending: 2009–10 to 2014–15

- Cuts in spending power not quite as dramatic as chart suggests
- Between 2009–10 and 2015–16, LA spending cut by
  - 20% in real terms: same as avg across other ‘unprotected’ depts
  - 23% per person in real terms
- Largest average cuts in London and North East
  - London: £279 per person, 27% (non-transport spending)
  - North East: £261 per person, 27% (non-transport spending)
- Smallest average cuts in South East
  - £112 per person, 16% (non-transport spending)

Most deprived areas have seen largest cuts



Notes: Authors' calculations using DCLG data. For further details see Innes and Tetlow (2015), http://www.ifs.org.uk/publications/7617. Deprivation defined using the Index of Multiple Deprivation.

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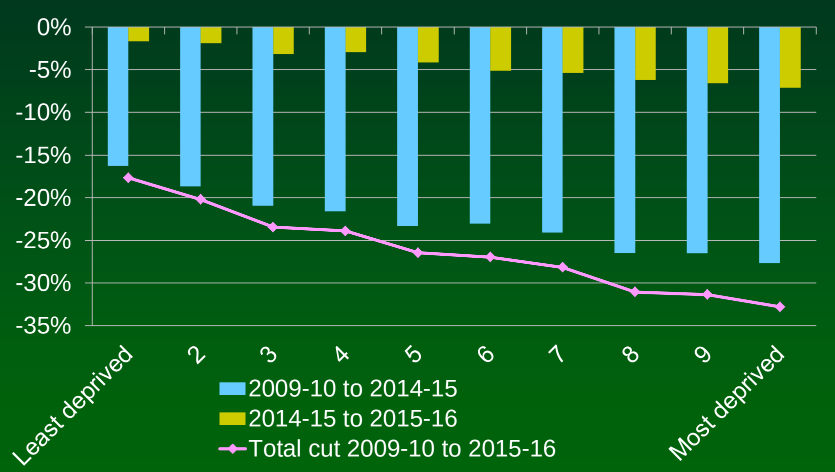
Further cuts for local authorities in 2015–16: same areas see largest cuts again



Notes: Authors' calculations using DCLG data. For further details see Innes and Tetlow (2015), http://www.ifs.org.uk/publications/7617. Deprivation defined using the Index of Multiple Deprivation.

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Future cuts likely to be concentrated on same LAs

- New settlement funding assessment means all areas see same % cut to main elements of central government grant
  - So authorities that have less local revenue raising capacity see largest cuts to spending power…
- Also not updated to account for changing 'needs'
  - Areas with fastest population growth see spending per head squeezed more
  - 8 fastest growing boroughs are all in London:

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Business rates retention

- Overall LAs will keep full business rate revenue
  - But not true of individual LAs
- They keep growth in their own revenues
  - Winner will be those with biggest cash terms (not %) growth
- What extra responsibilities will LAs have to take on?

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Can spending cuts be delivered?

- Coalition government successful in keeping to its spending plans

But:

- Easiest cuts presumably done first
- Public sector wage restraint harder when private sector wages rising
  - public sector wages set to fall to lowest level relative to private sector wages in over twenty years

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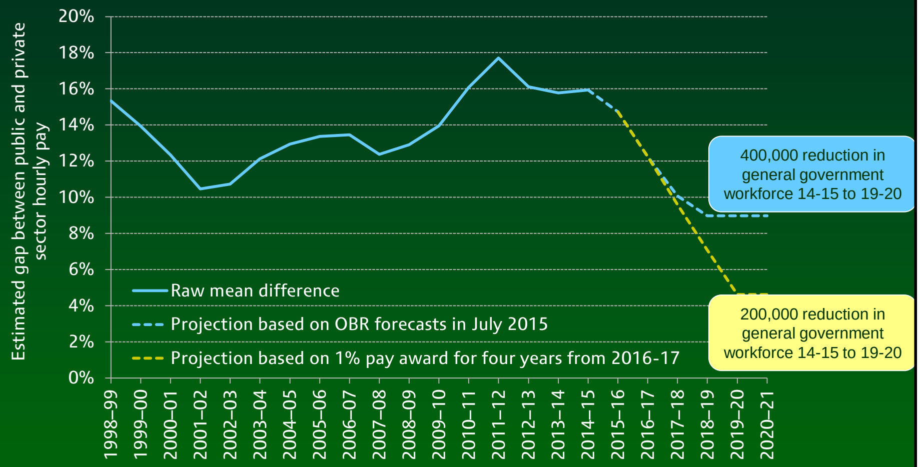
Falling value of public pay relative to private sector



Notes: Data up to 2014–15 estimated using Labour Force Survey. Projections are based on OBR forecasts. The second projection adjusts OBR forecasts for the announcement of 1% pay awards from 2016–17 to 2019–20, which was made by HM Treasury after the OBR produced its July 2015 forecasts.

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But:

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- Public sector wage restraint harder when private sector wages rising
  - public sector wages set to fall to lowest level relative to private sector wages in over twenty years
- Other cost pressures:
  - population continuing to grow and age
  - £4.4bn per year rise in pension costs faced by public sector employers due to recent revaluation and increased employer NICs

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The longer term

- Growing and ageing population
- Even with optimistic assumptions over health spending, projected to add 3.9% of national income to spending over next fifty years
- Even if we achieve balance by 2020 the years ahead will require some combination of:
  - Tax rises
  - Further cuts to non health/non pension spending
  - Cuts to health and pensions

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Overview

- Significant fiscal tightening has already happened
  - But a long way still to go
- Nearly all the work being done on the spending side
  - Hence the Budget welfare cuts
- Big additional cuts to be announced in the SR
  - Another 25% off many budgets
- Next set of cuts will be harder to achieve than those already implemented

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