Ben Zaranko, Institute for Fiscal Studies

Presentation to
CIPFA SE

29 January 2021

@TheIFS

Spending Review 2020
The outlook for the economy and public services

Economic
and Social
Research Council

Today’s presentation

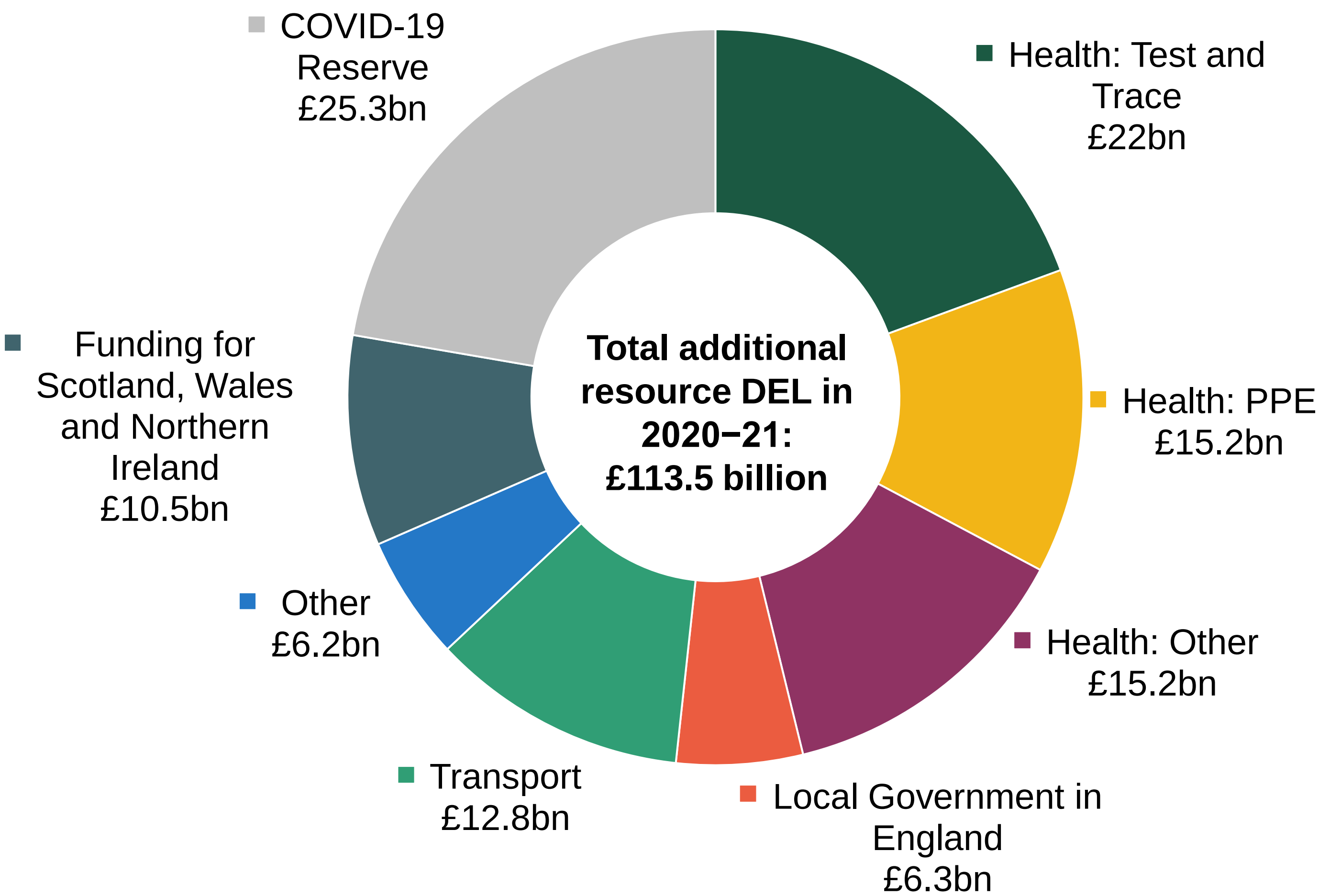
- **Spending Review 2020:** what did we learn and what does it mean?
  - Public services
  - The economy and public finances
  - The longer-term fiscal outlook
  - Regional inequalities and the ‘levelling up’ agenda (time permitting)

The 2020 Spending Review

Public service spending: what happened?

- More funding for public services in response to COVID-19
  - £113 billion this year and £55 billion next year

An eye-watering £113 billion of COVID funding for public services this year



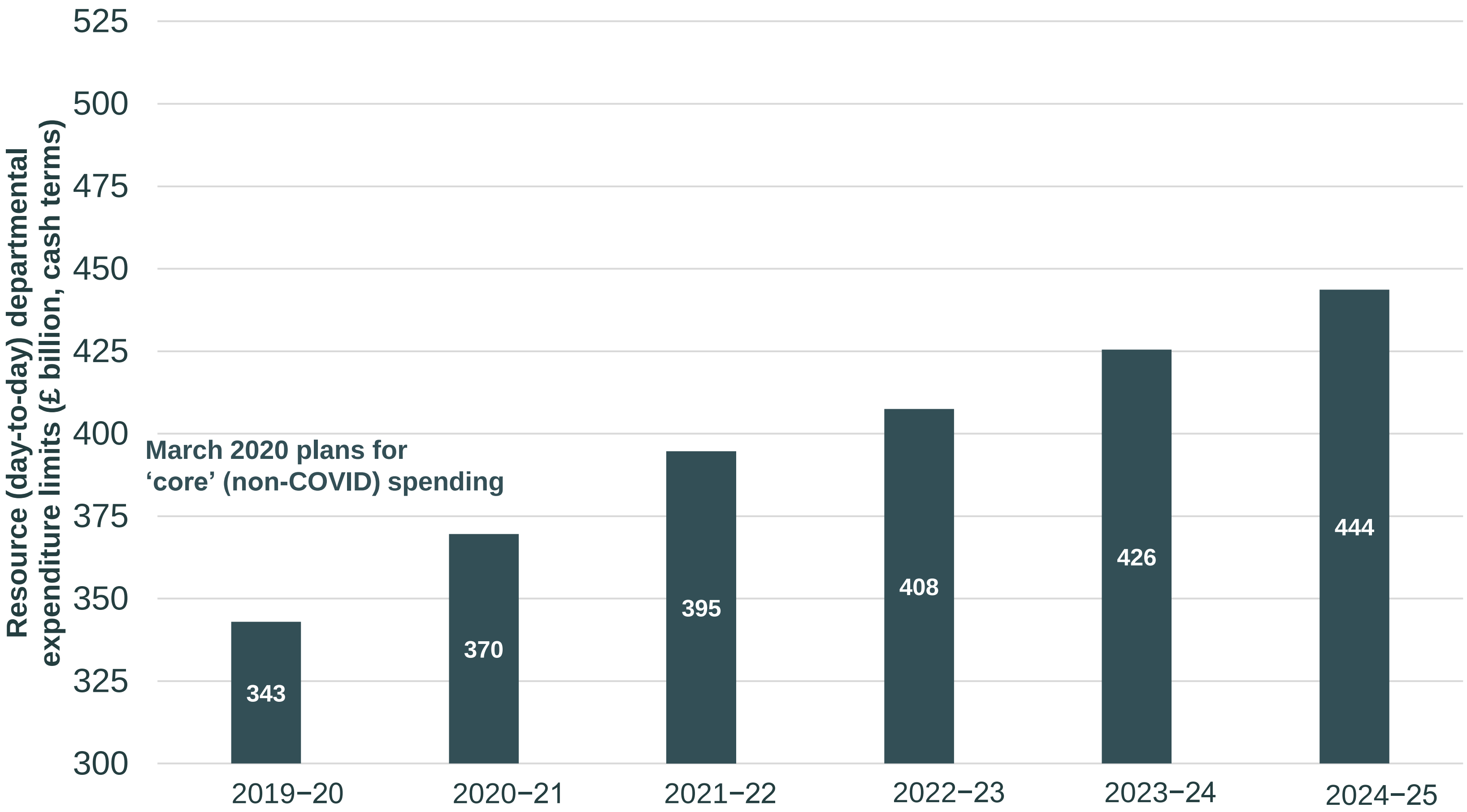
Source: HM Treasury, Spending Review 2020

Public service spending: what happened?

- More funding for public services in response to COVID-19
  - £113 billion of this year and £55 billion next year

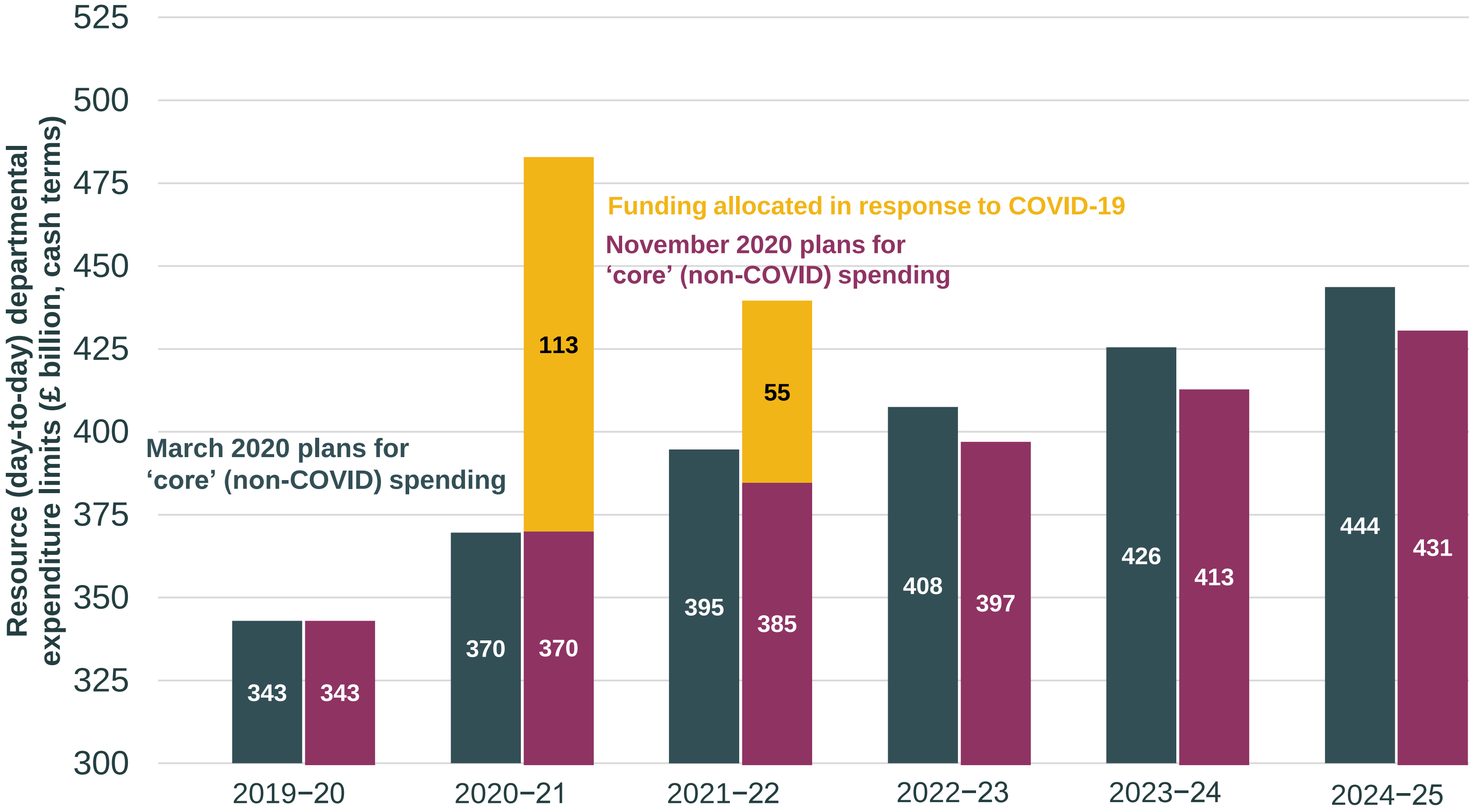
- But sizeable cuts to resource (day-to-day) funding for 'core' services next year and beyond, relative to what was previously planned
  - £10 billion cut from March plans for non-COVID spending in 2021−22
  - Rising to £13 billion by the end of the Parliament

Changes to plans for day-to-day public service spending



Source: Author's calculations using HM Treasury Budget 2020, HM Treasury Spending Review 2020, and OBR Economic and Fiscal Outlook November 2020. Adjusted for the reclassification of the Scottish Block Grant Adjustment.

Changes to plans for day-to-day public service spending



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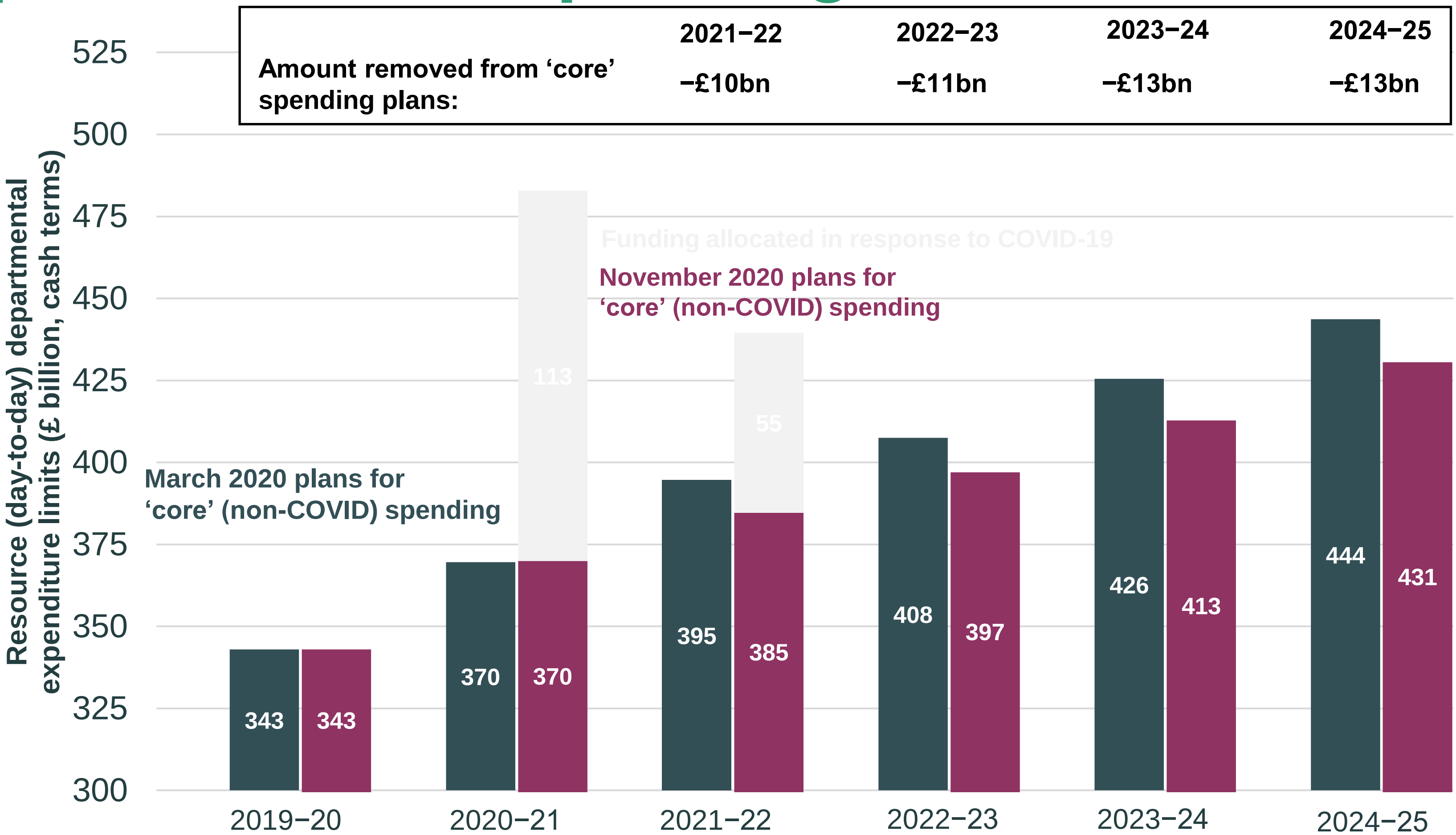

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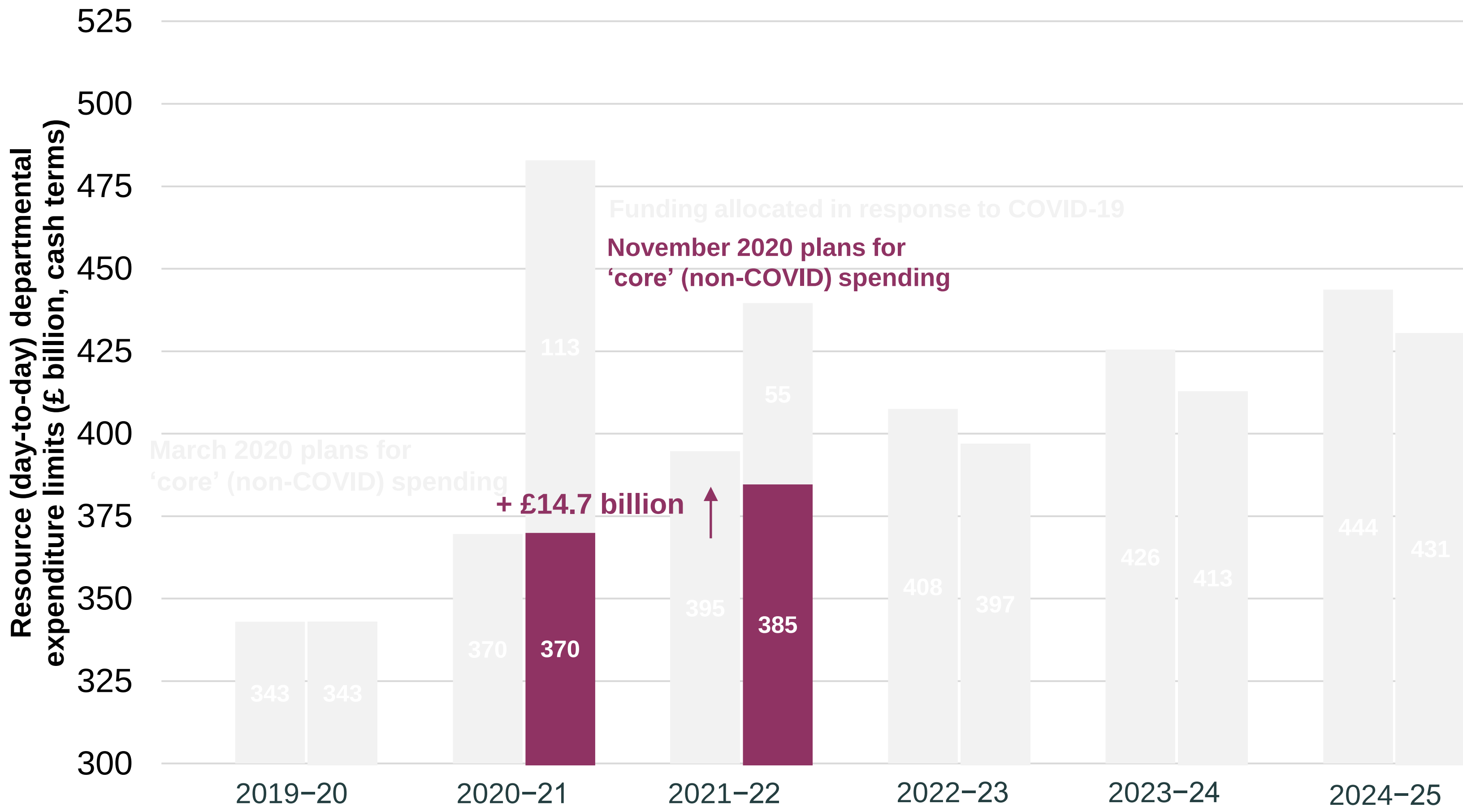
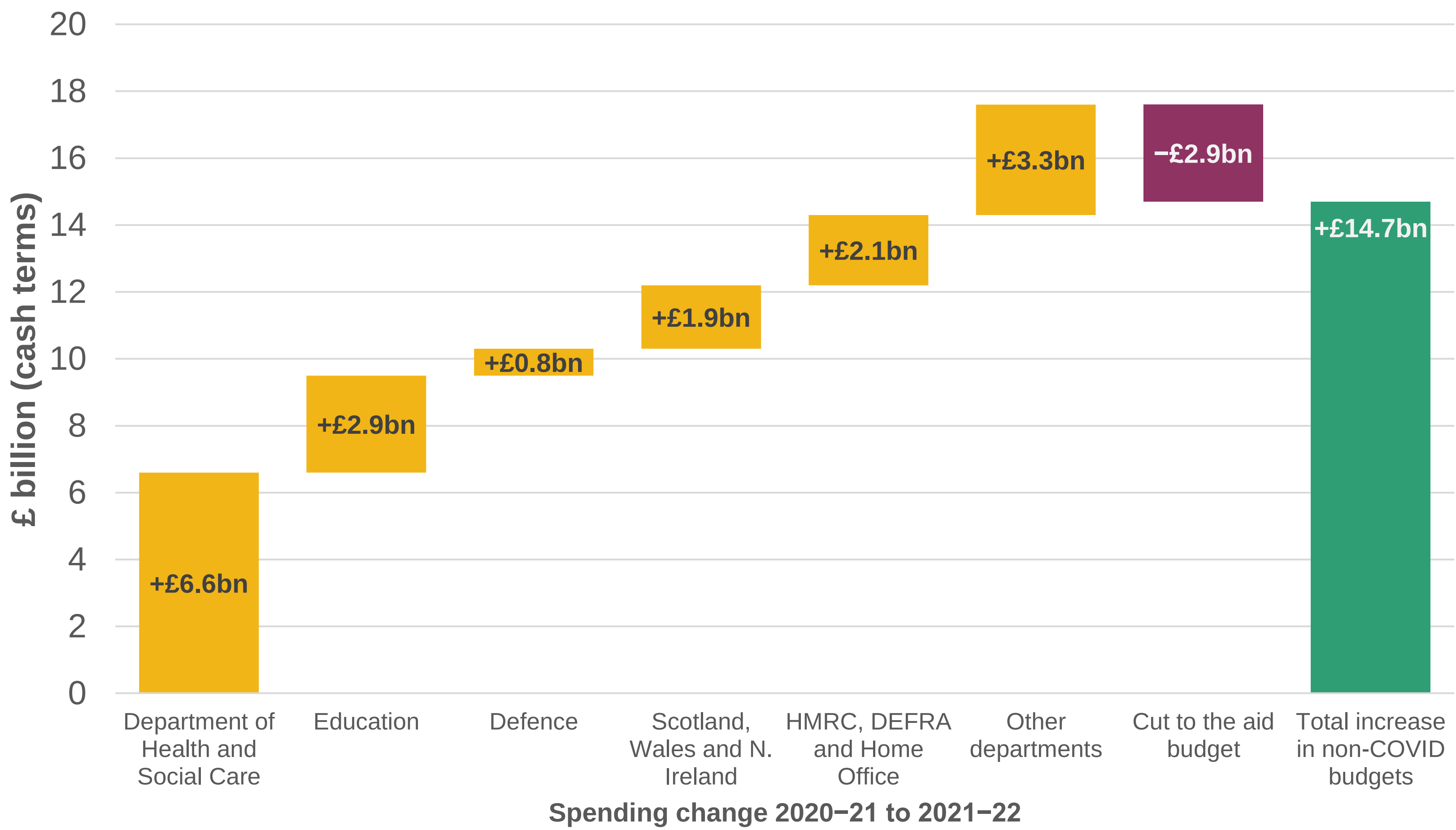


Source: Author’s calculations using HM Treasury Budget 2020, HM Treasury Spending Review 2020, and OBR Economic and Fiscal Outlook November 2020. Adjusted for the reclassification of the Scottish Block Grant Adjustment.

Where is the £14.7 billion going?

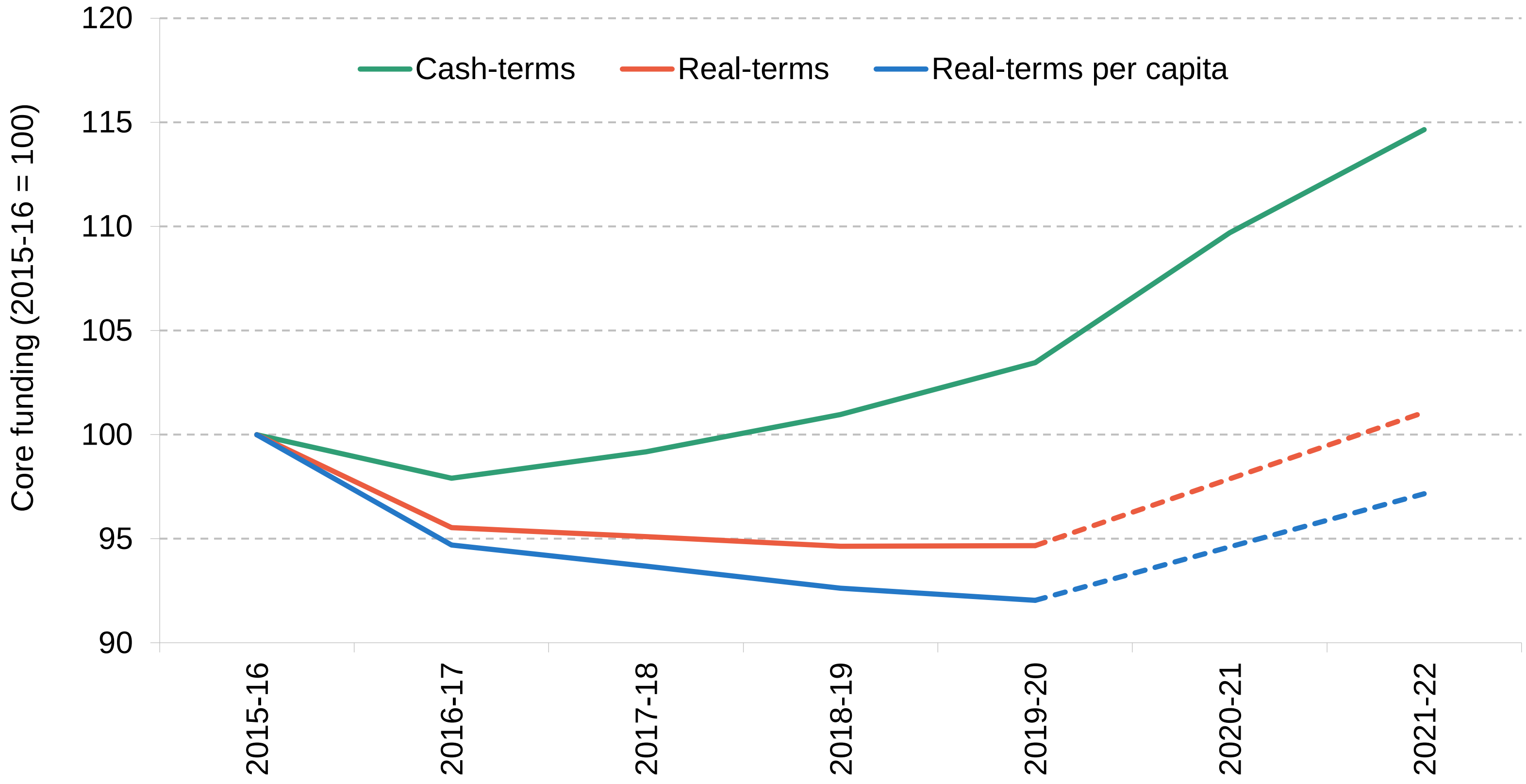


Source: Author's calculations using HM Treasury Spending Review 2020.

Local Government

- £2.2 billion (4.5%) increase in 'core' funding for councils next year
    - Less than £0.3 billion from the government
    - Other £1.9 billion from increases in council tax of up to 5%
        - Assumes councils make full use of allowable increases
        - The actual increase in core funding is likely to be lower

Councils' core funding in 2021–22 projected to be 3% lower in real per-person terms than in 2015–16

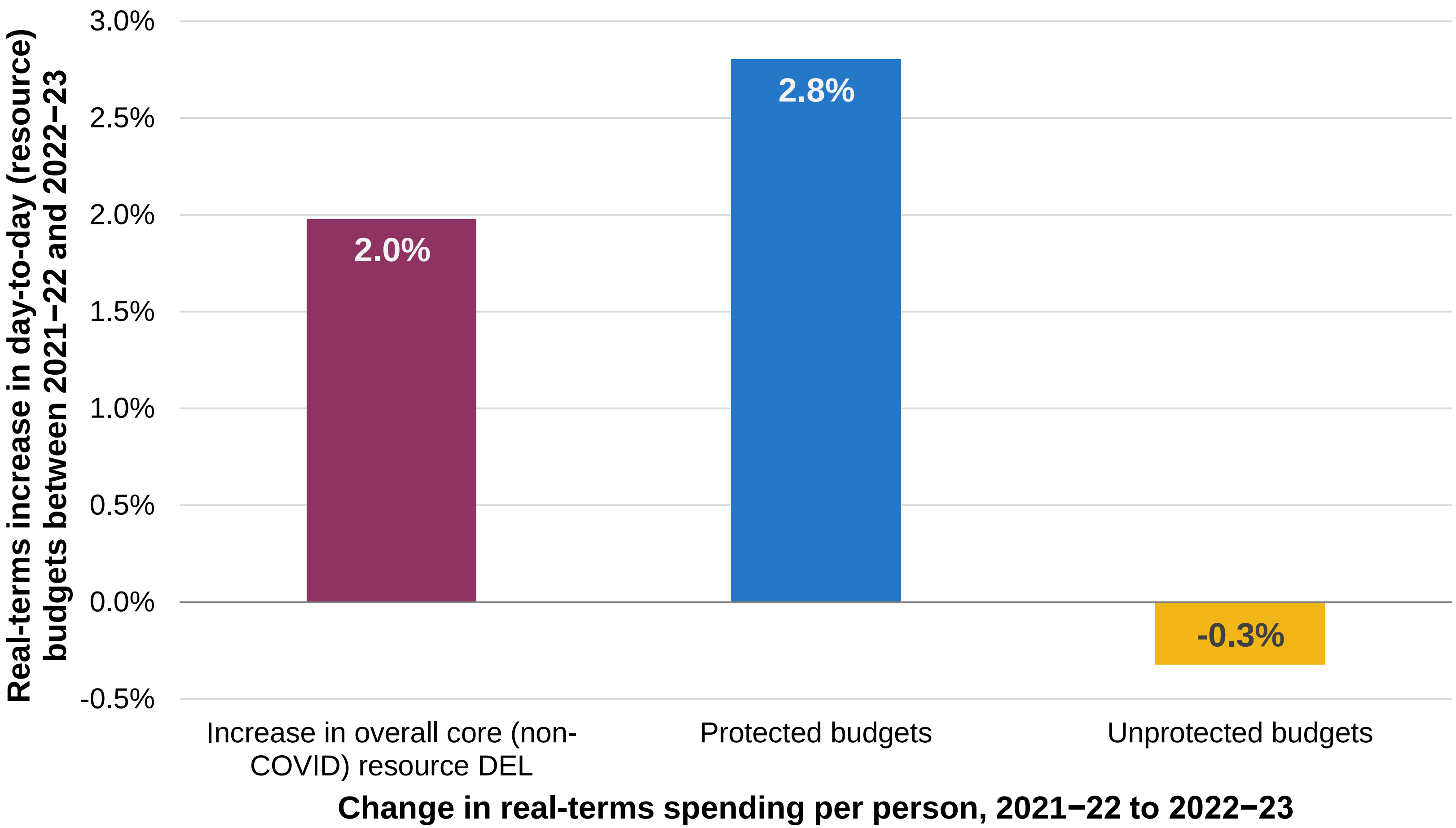


Source: K. Ogden and D. Phillips, Assessing England's 2021-22 Local Government Finance Settlement, IFS Briefing Note, December 2020

What about after next year?

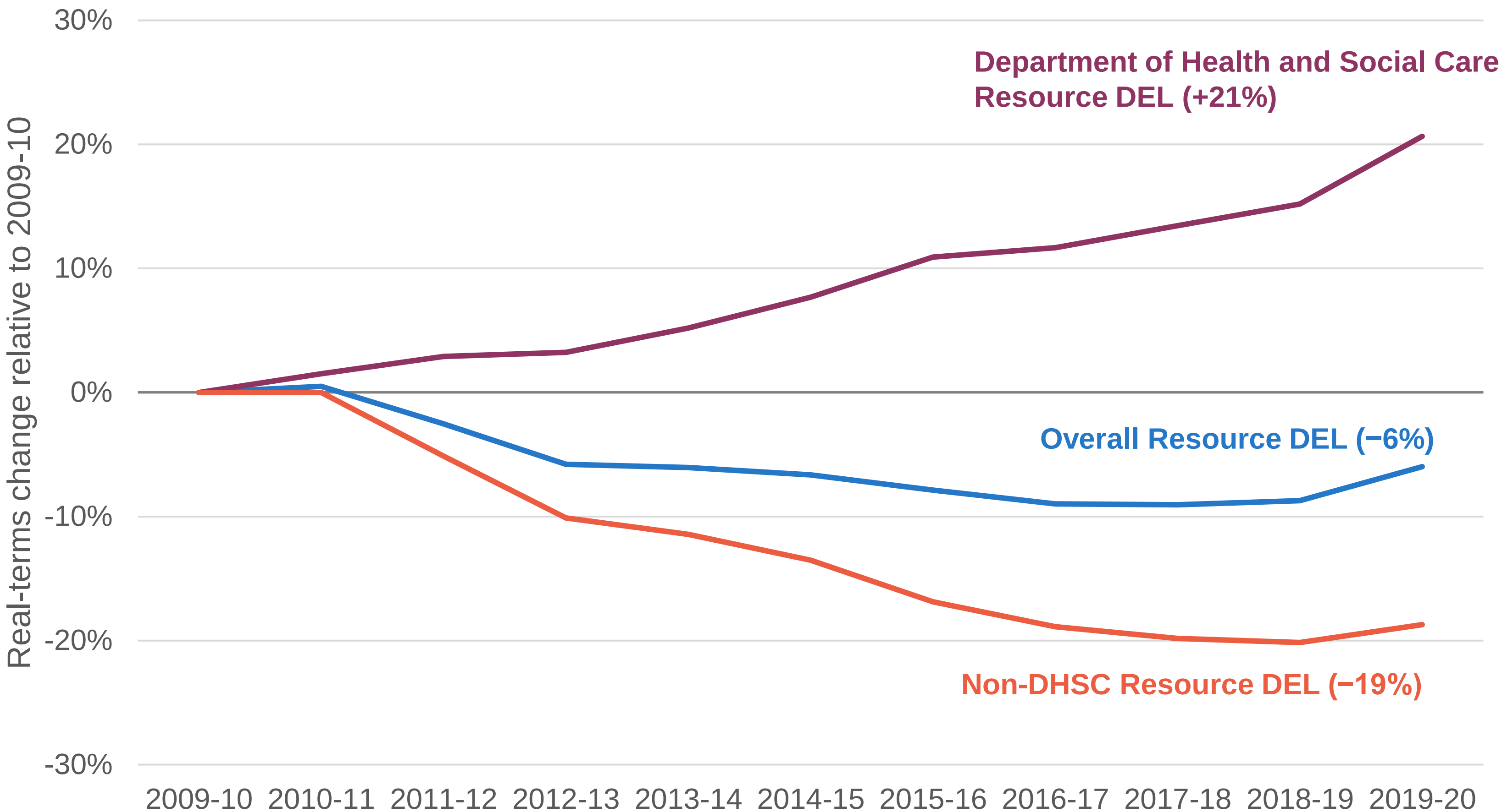
- The government has made several multi-year commitments
  - NHS England, schools in England, Defence
  - **Together:** £223bn (57%) of the £397bn available for 2022−23
    - Plus associated funding for Scotland, Wales and N. Ireland
- Aid spending reduced from 0.7% to 0.5% of national income next year – but set to increase in line with the economy after that
- Implies very tight settlements for remaining public services

Unprotected budgets are facing a squeeze after next year



Note: Figures are for HM Treasury definition of core resource DEL (excluding depreciation) per capita. Protected budgets include: NHS England; schools in England; the Barnett consequentials of increases in NHS and schools spending for Scotland, Wales and Northern Ireland; Ministry of Defence; and estimated ODA RDEL.
Source: Author's calculations using HM Treasury Spending Review 2020 and OBR Economic and Fiscal Outlook, November 2020.

Many of these budgets were cut substantially after 2010



Source: Author’s calculations using OBR Economic and Fiscal Outlook (various) and HM Treasury Public Expenditure Statistical Analysis (various).

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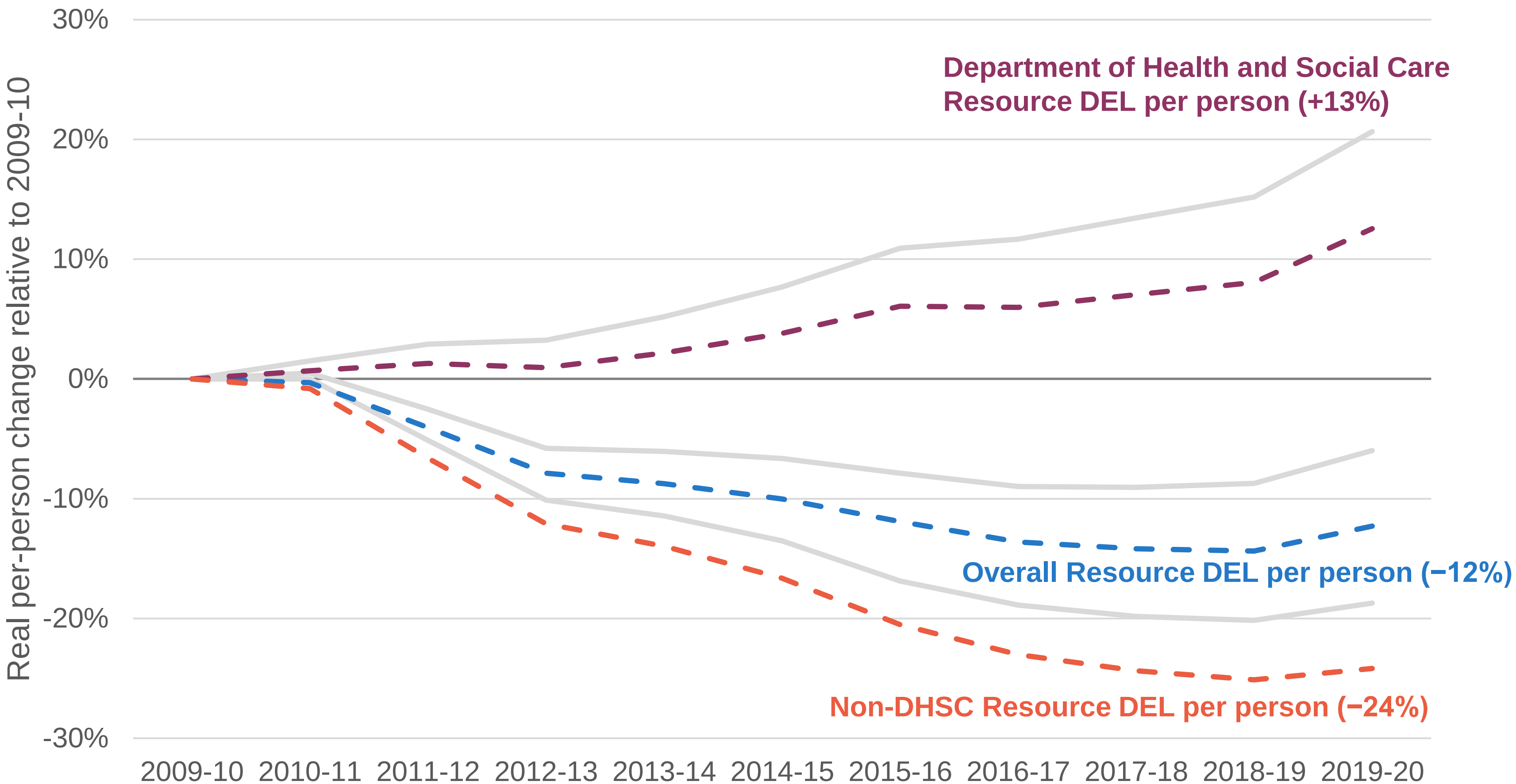
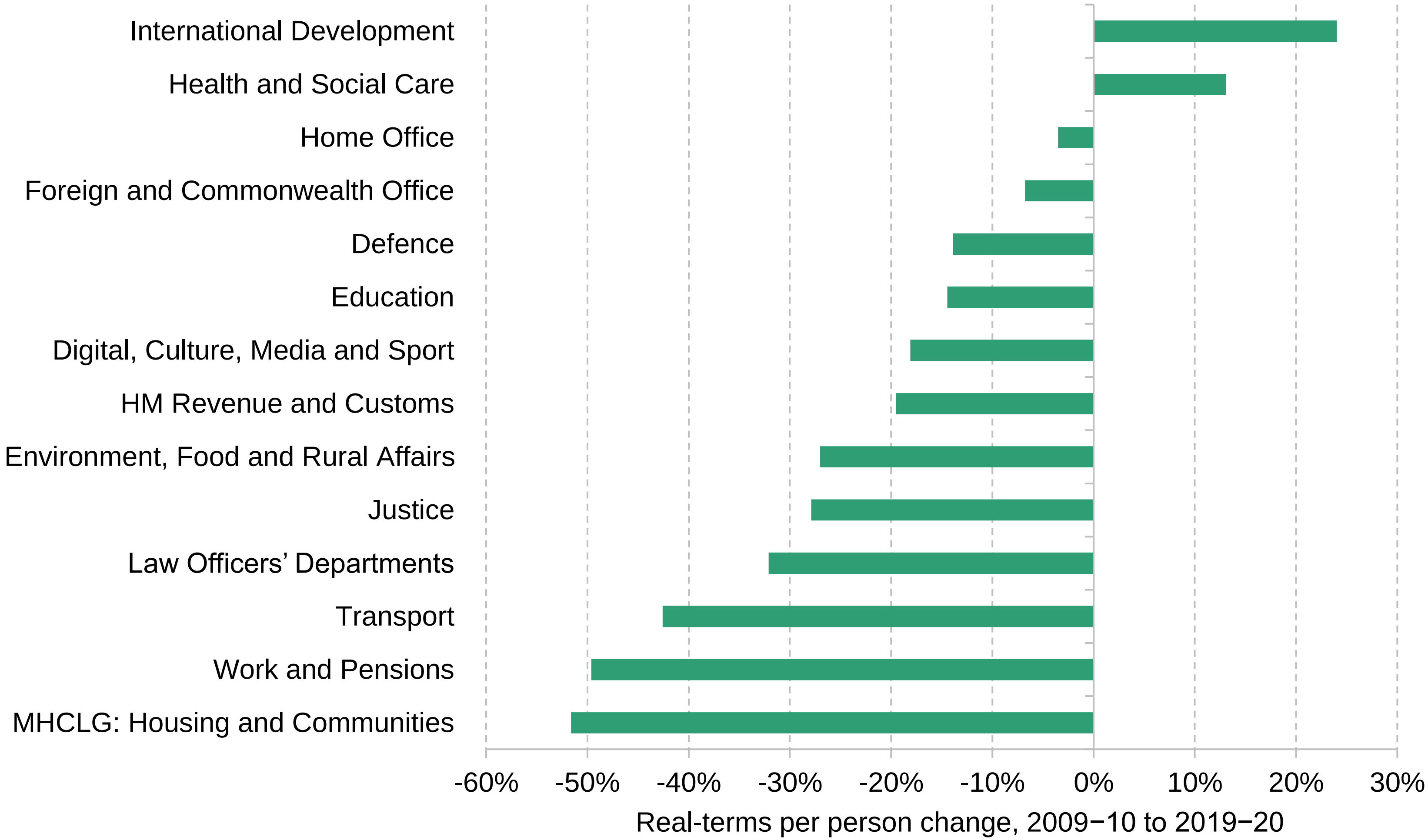


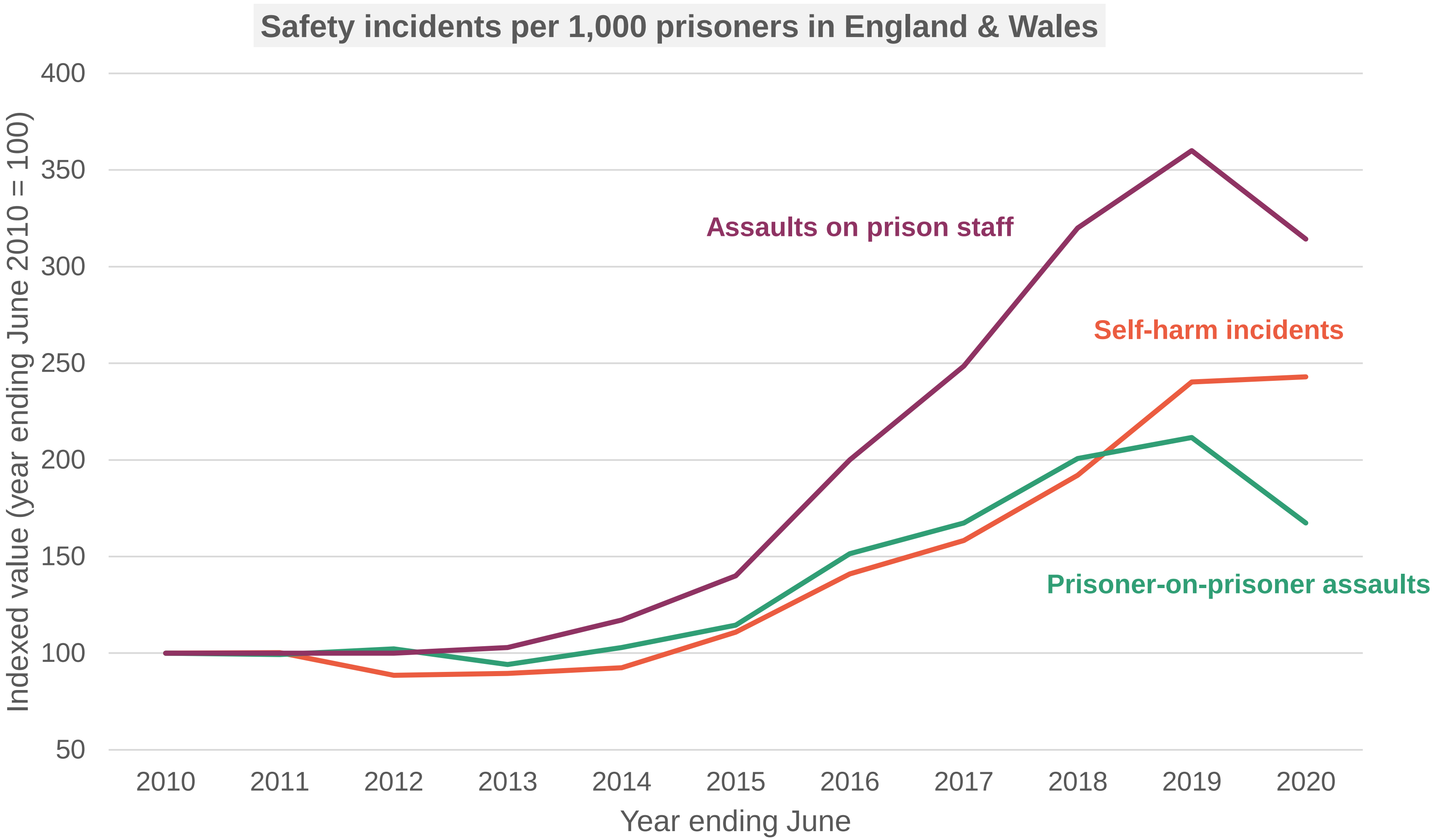
Source: Author's calculations using OBR Economic and Fiscal Outlook (various) and HM Treasury Public Expenditure Statistical Analysis (various).

Changes in departmental resource budgets over the decade to 2019−20



Source: Author's calculations using HM Treasury Public Expenditure Statistical Analysis (various).

Some services were showing signs of strain even pre-pandemic



Source: Author's calculations using Ministry of Justice, Safety in Custody Statistics.

The 2021 Spending Review

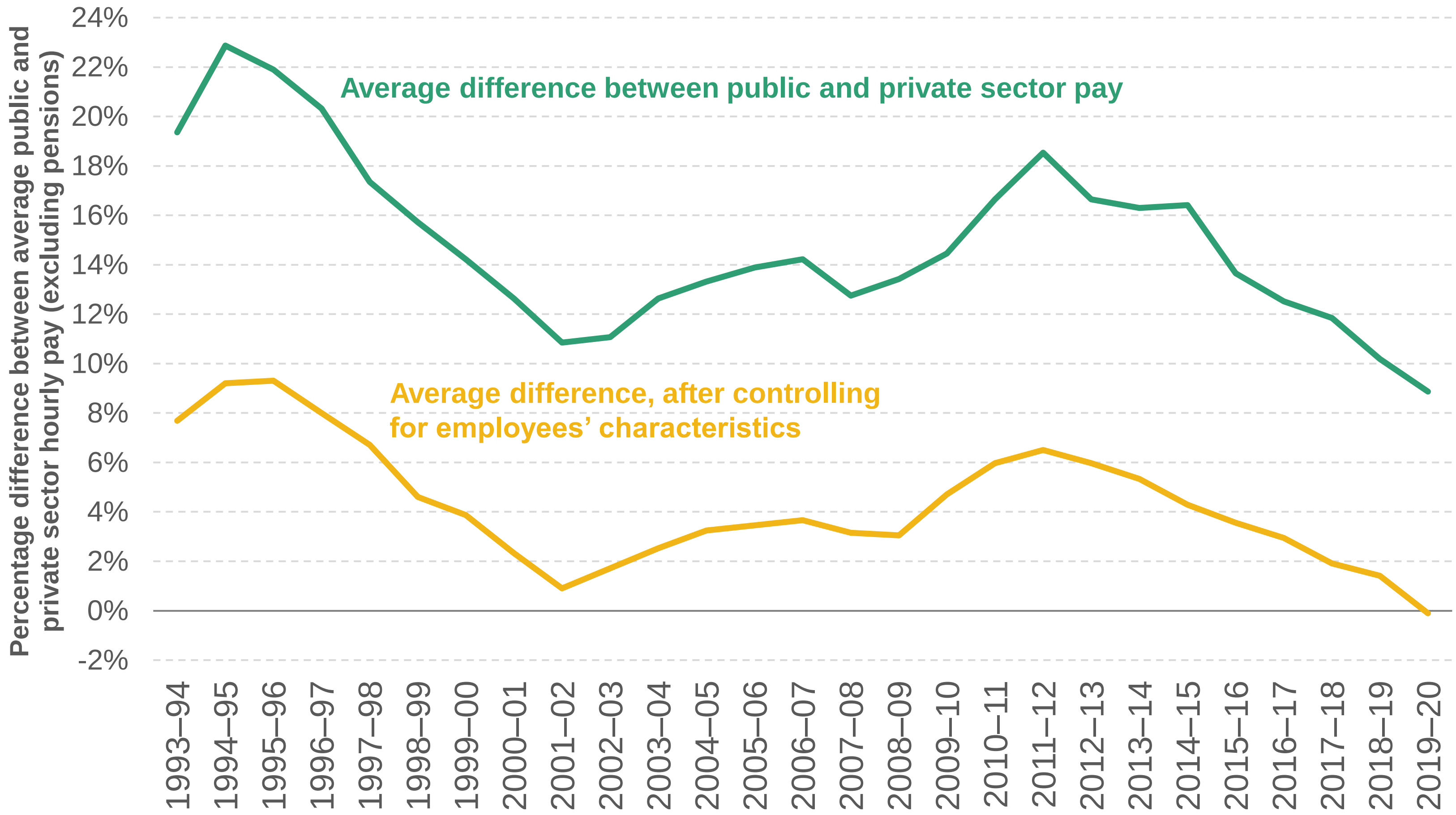
- 2021 Spending Review likely to cover three years up to 2024−25
- On the basis of provisional spending plans, non-priority areas are facing a tight settlement
  - Not set in stone!
    - Chancellor may decide to top up, or pare back, his plans
    - Provisional plans also assume that NHS reverts to pre-COVID spending plans after next year: seems highly unlikely
- All things considered: could be a tough few years ahead for public services not protected by existing political commitments

Public sector pay

- Public sector pay frozen in cash terms next year
  - Exemptions: lower earners (<£24k p.a.) and all NHS workers
  - Result: less than ½ public sector workforce affected by freeze
  - Probably saves only between £1 and £2 billion

- This latest freeze comes on the back of a decade of pay restraint

This comes on the back of a previous decade of pay restraint



Note: Figures show are for hourly pay (excluding pensions). Difference controlling for workers' characteristics controls for differences in age, education, experience and region, all interacted with sex, following the same methodology as in Cribb, Emmerson and Sibieta (2014). Source: Author's calculations using Labour Force Survey.

Public sector pay

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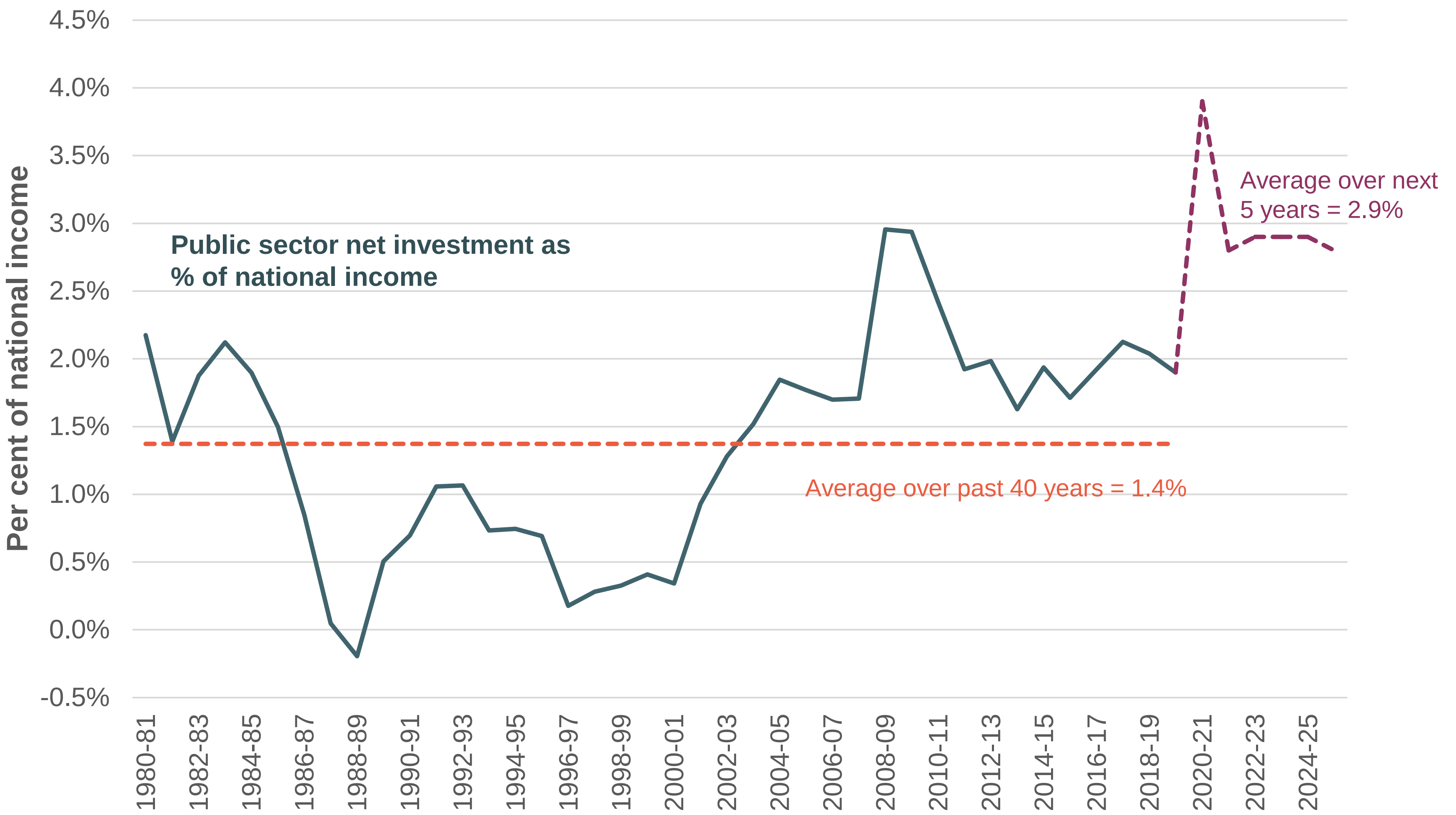
- This latest freeze comes on the back of a decade of pay restraint

- This year, amidst COVID-induced recession: pay freeze unlikely to cause too many issues with recruitment
- After that: another pay cap/freeze looks difficult – not least due to pressure for a (well-deserved) pay rise for key workers

Investment spending

- Capital spending plans left largely unchanged
  - Allocation of the large sums that had already been announced

Public sector net investment



Source: Author’s calculations using OBR Public Finances Databank and Economic and Fiscal Outlook November 2020.

Investment spending

- Capital spending plans left largely unchanged
  - Allocation of the large sums that had already been announced
- National Infrastructure Strategy: focus on transition to net zero and addressing regional imbalances
  - e.g. Crossrail 2 cancelled; *“frees up investment to raise the performance of public transport networks in the regional cities”*
- Review of the Green Book to place greater weight on alignment with the government’s strategic objectives (e.g. ‘levelling up’)
- Numerous announcements on regional funding

‘Levelling up’ and regional funding

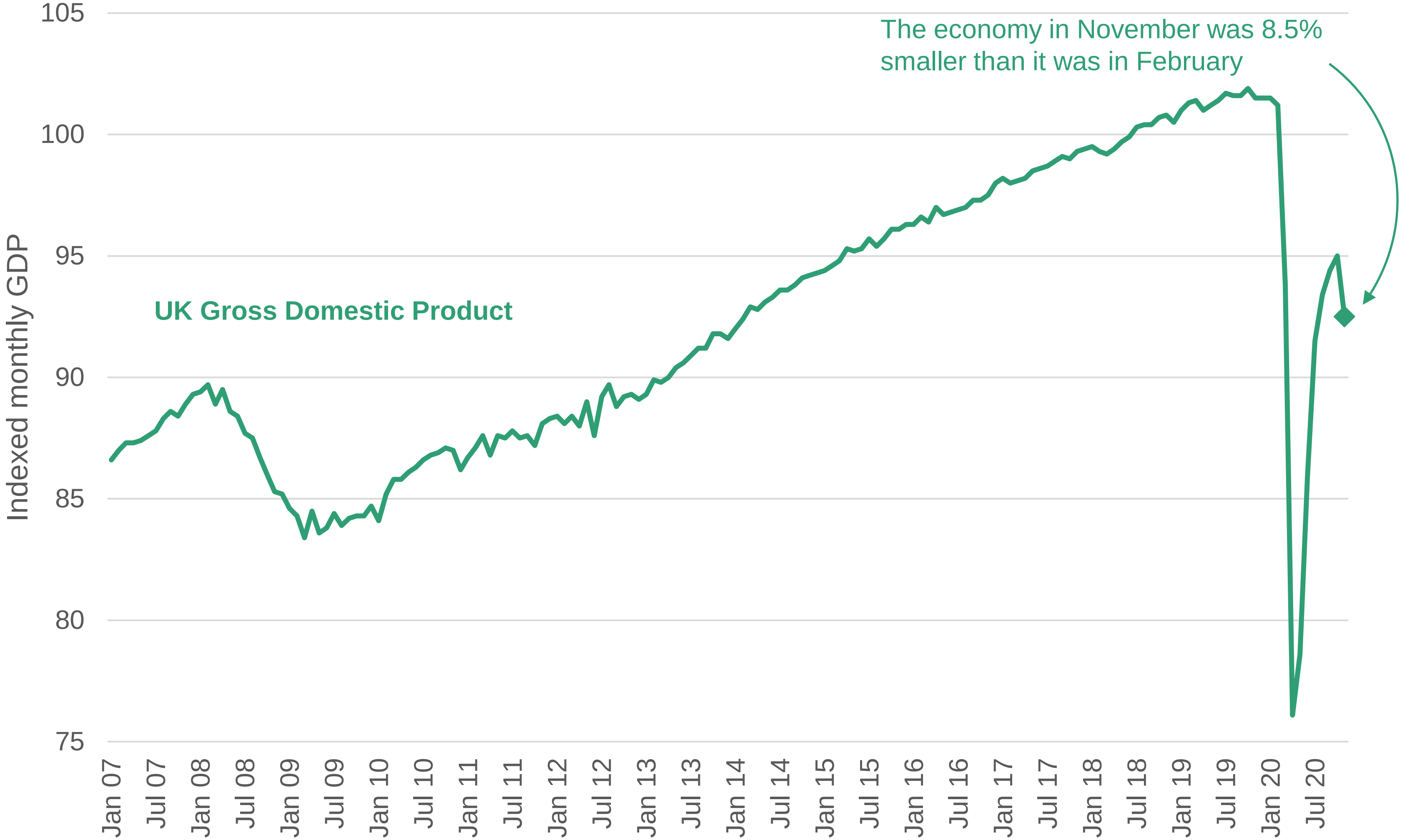
- Tackling geographic inequalities is a clear priority for this government and ‘levelling up’ was a major focus of SR 2020

- Numerous announcements on regional funding but questions remain
  - e.g. lack of clarity around design of UK Shared Prosperity Fund
  - New ‘Levelling Up Fund’: modest in size; managed centrally; adds to rather than simplifies the schemes already in place
  - At least eight place-based spending schemes in England alone
    - Strong case for rationalising these existing schemes

- ‘Levelling up’ agenda cannot be divorced from devolution

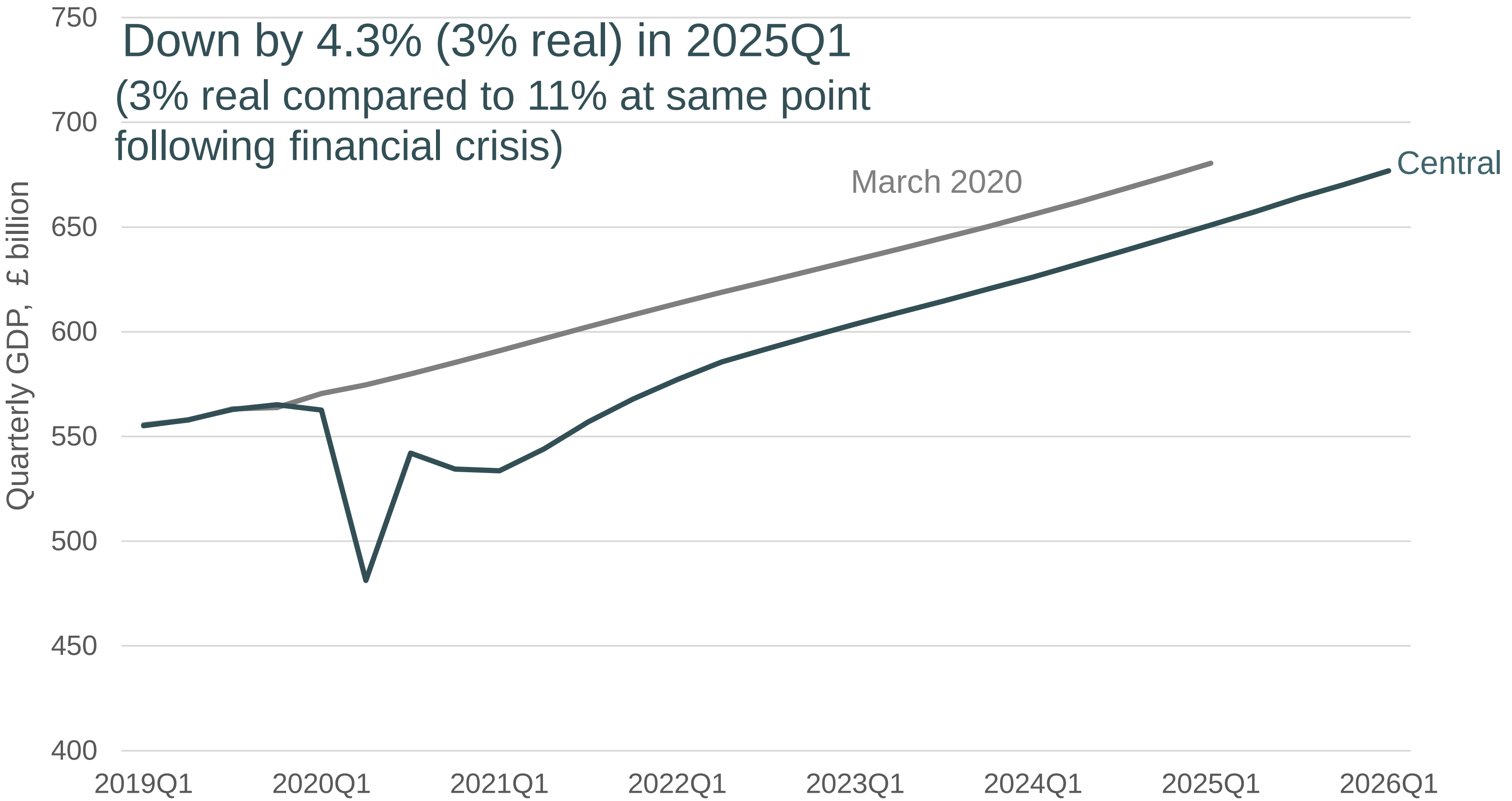
The economic and fiscal outlook

Output remains considerably below pre-crisis levels



Source: Office for National Statistics.

Looking ahead, the OBR expect a permanent hit to nominal GDP



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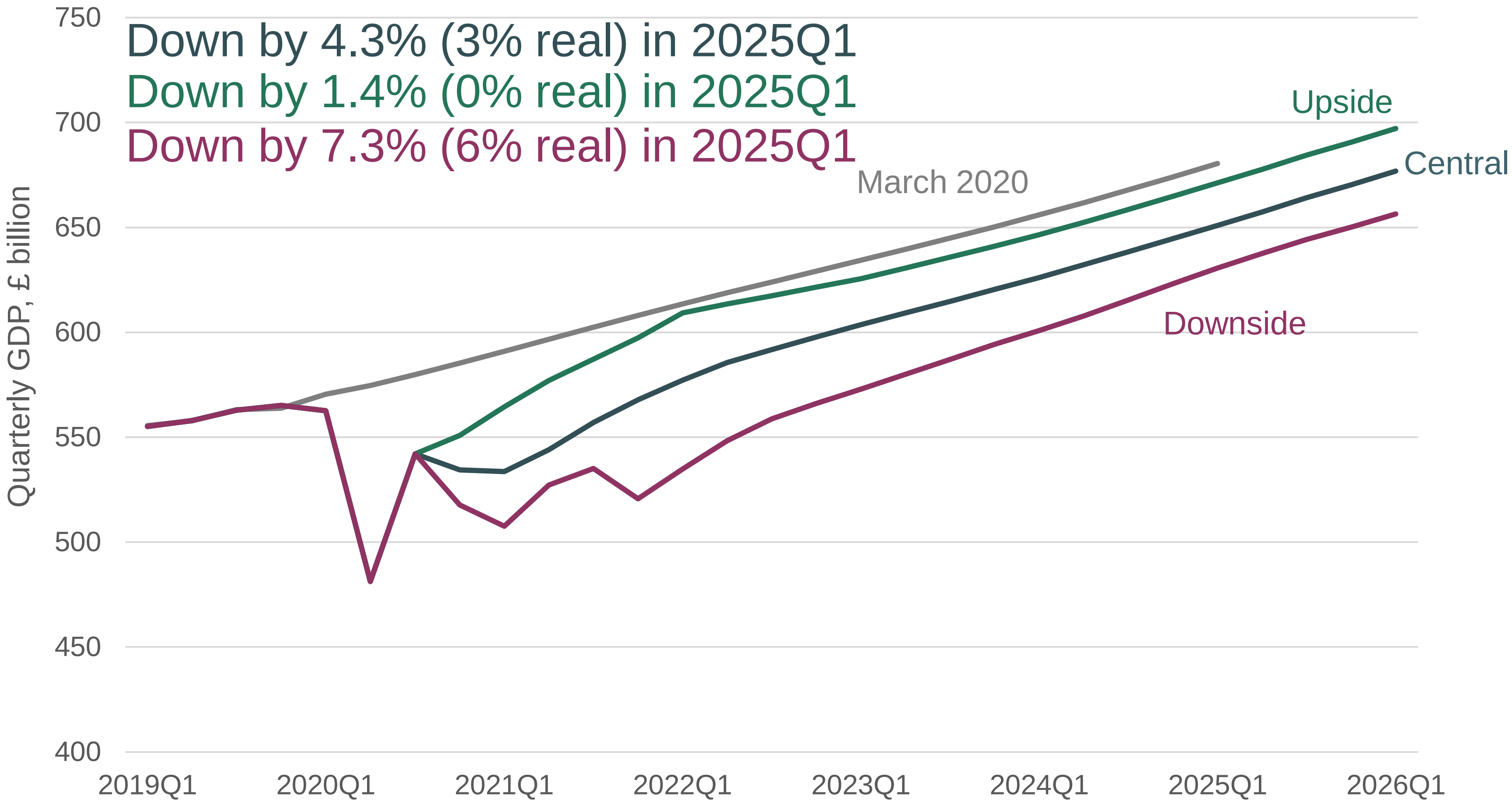


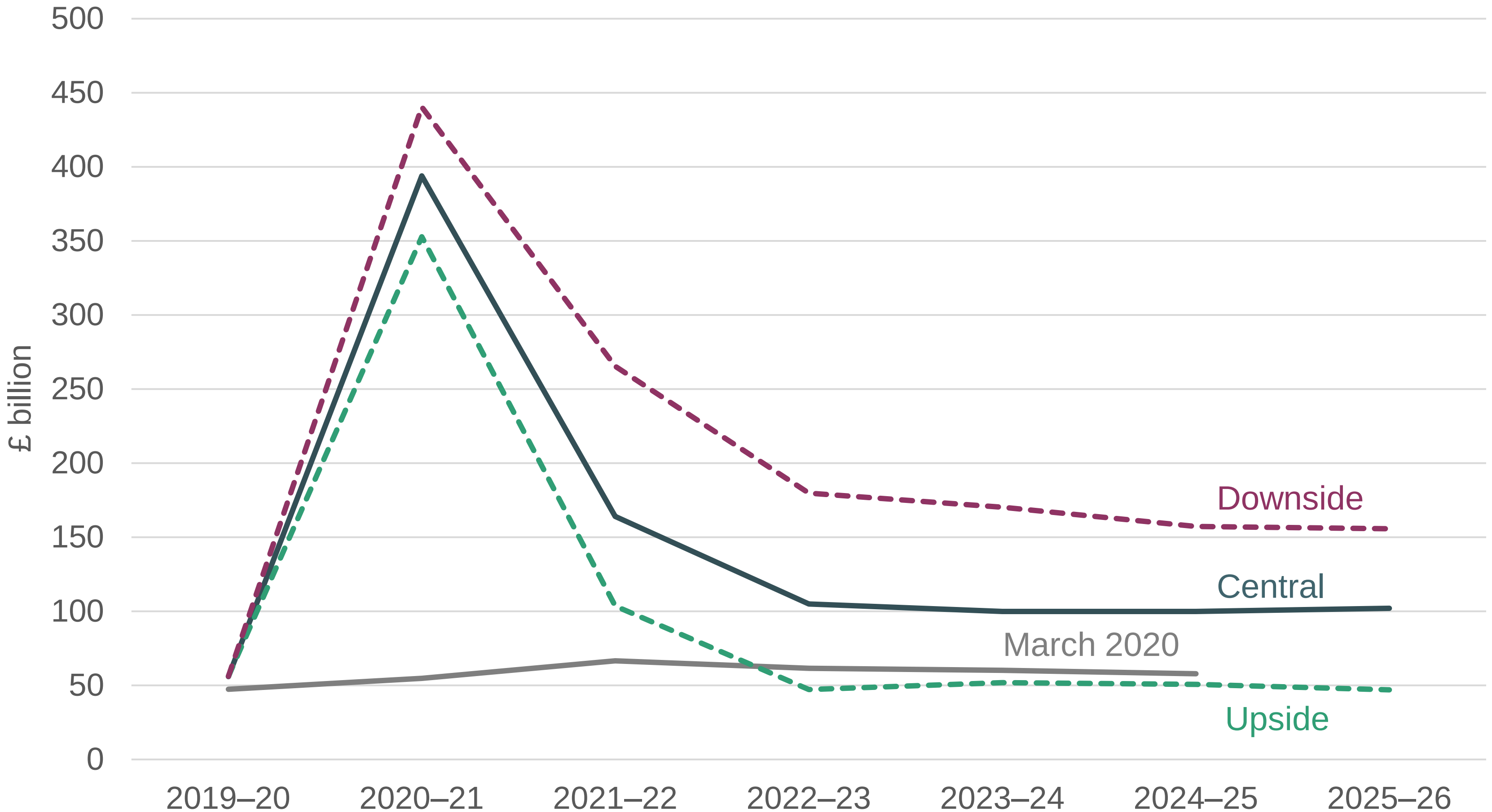
Changes since November

- New lockdown and associated restrictions on activity worsen near-term economic outlook (central scenario perhaps too optimistic)

- Next year and beyond: new lockdown does not mean OBR's central scenario is necessarily too optimistic
  - Key assumptions around vaccine rollout & scarring effects unaffected

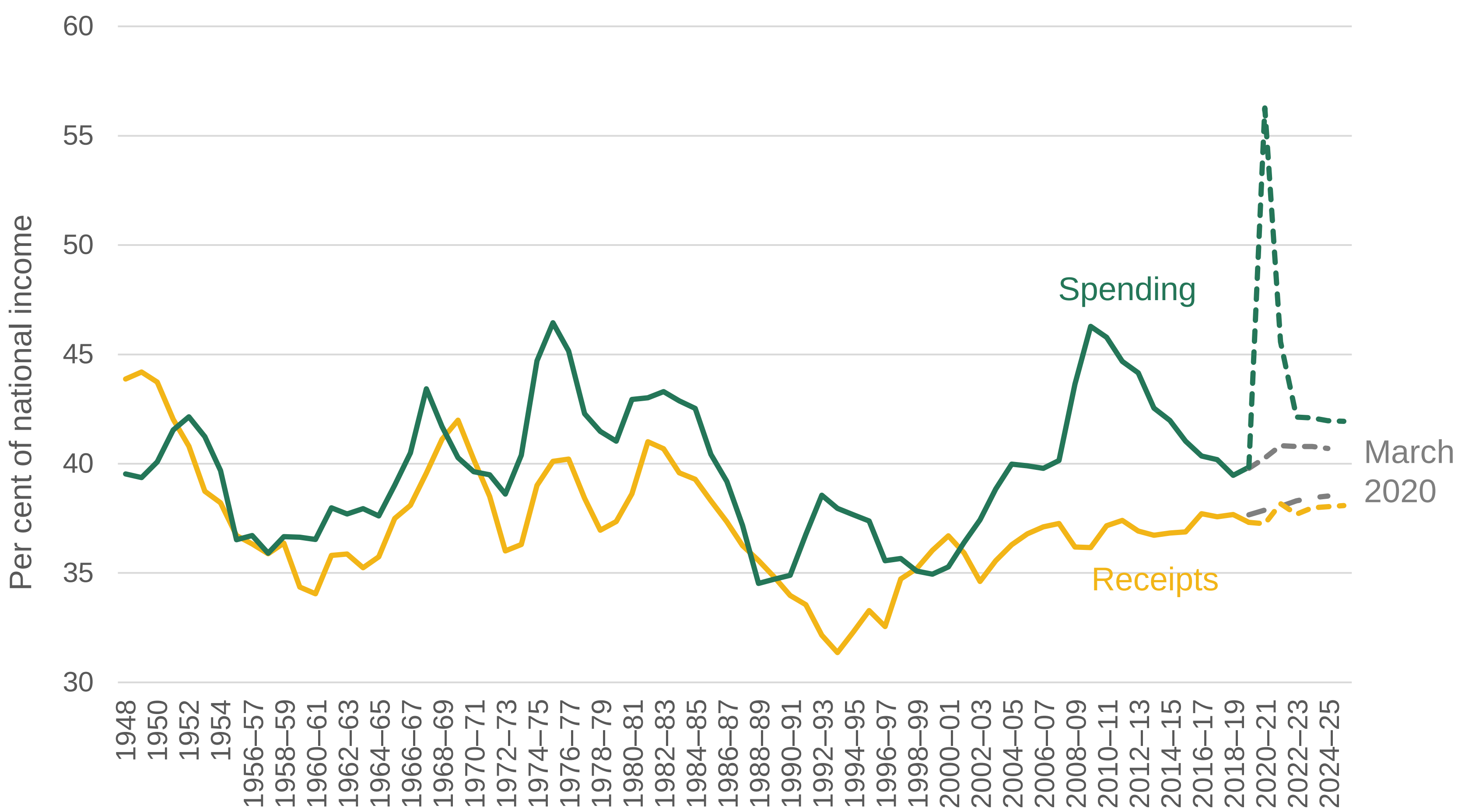
  - Scarring effects – and extent to which they can be mitigated – will be crucial determinant of economic recovery

Persistent increase in borrowing under central scenario



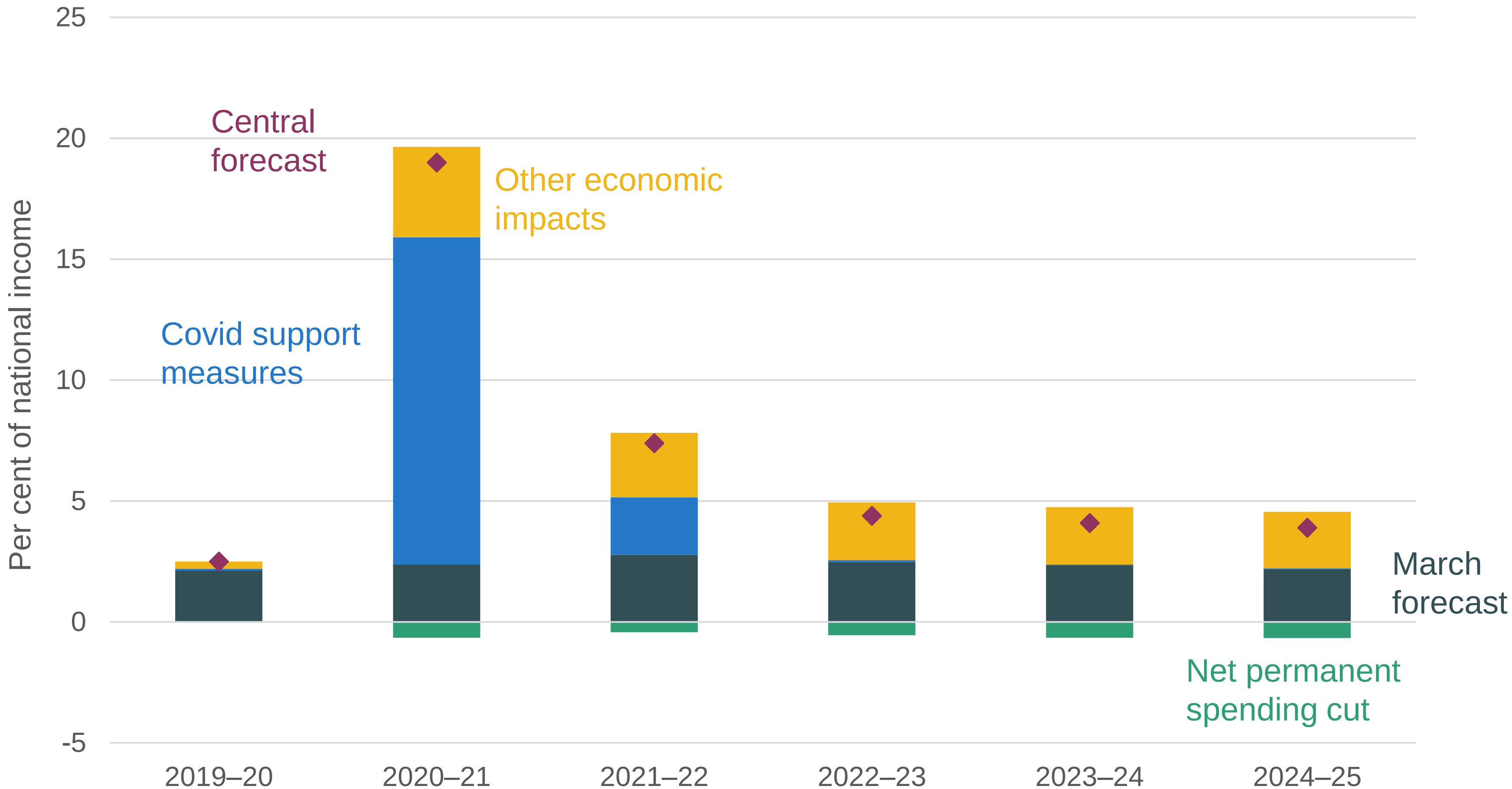
Source: Office for Budget Responsibility.

Spending elevated as a share of national income



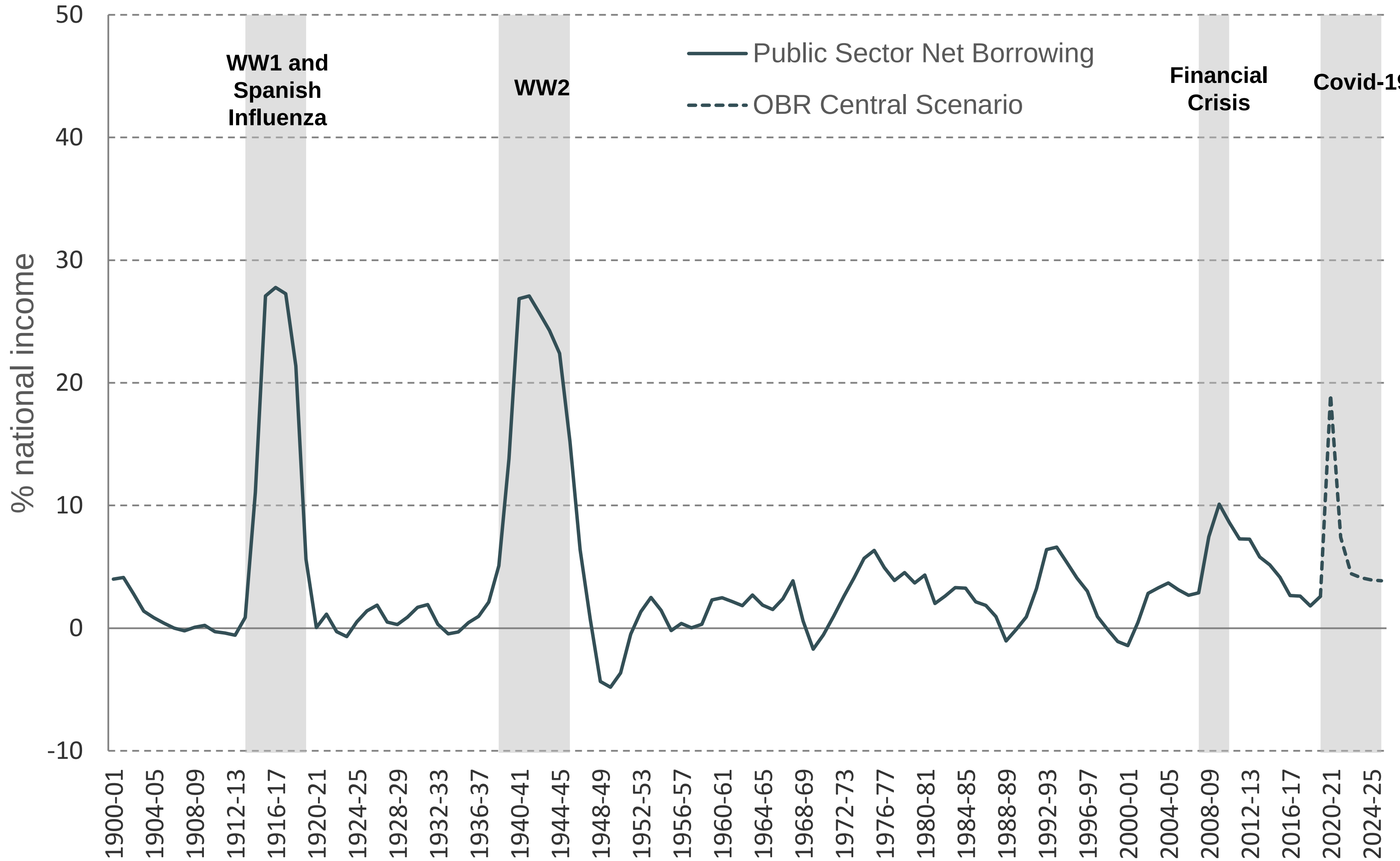
Source: Office for Budget Responsibility.

Decomposing the increase in forecast borrowing



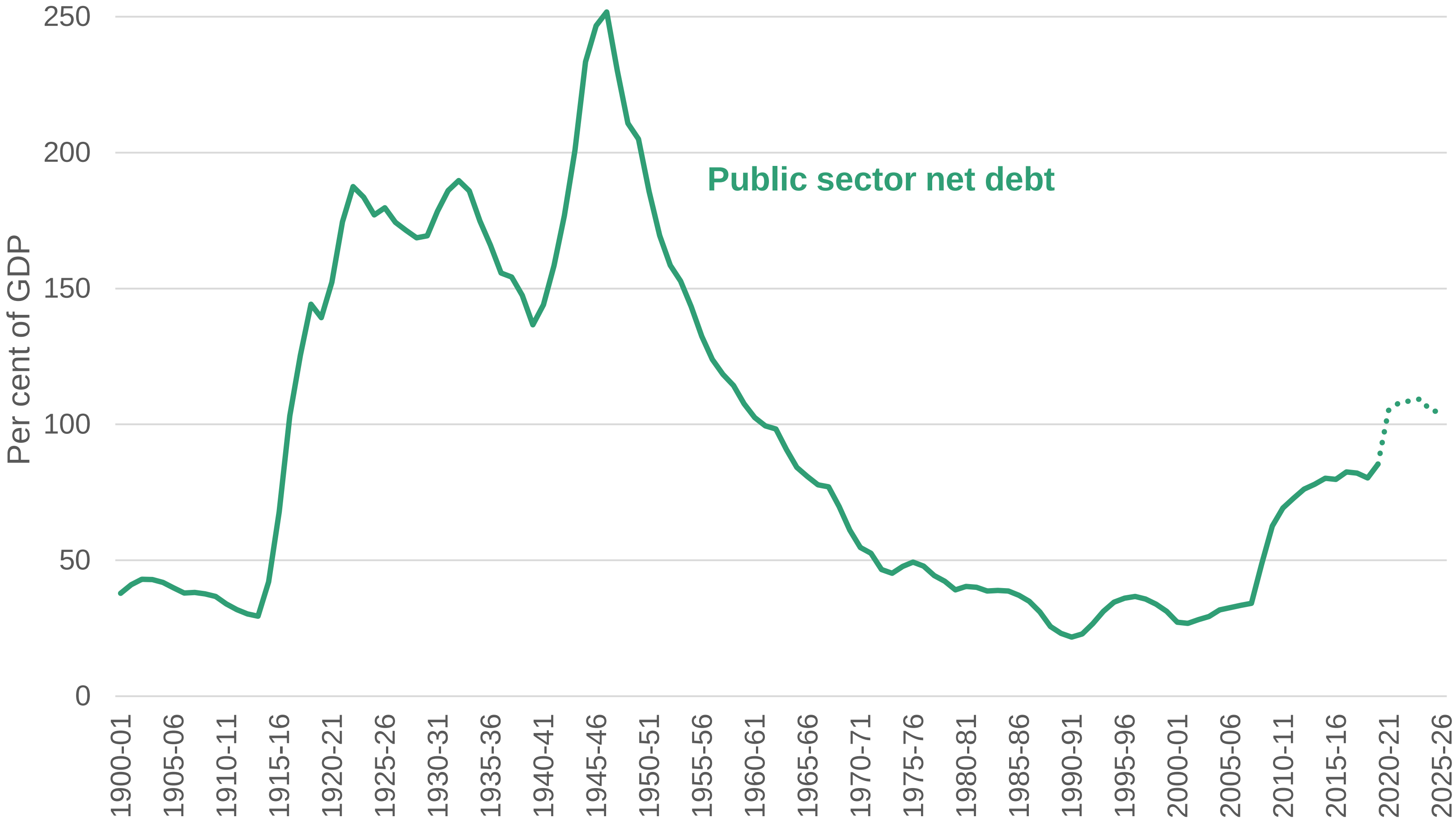
Source: Office for Budget Responsibility.

Borrowing in historical perspective



Source: Office for Budget Responsibility.

Debt in historical perspective

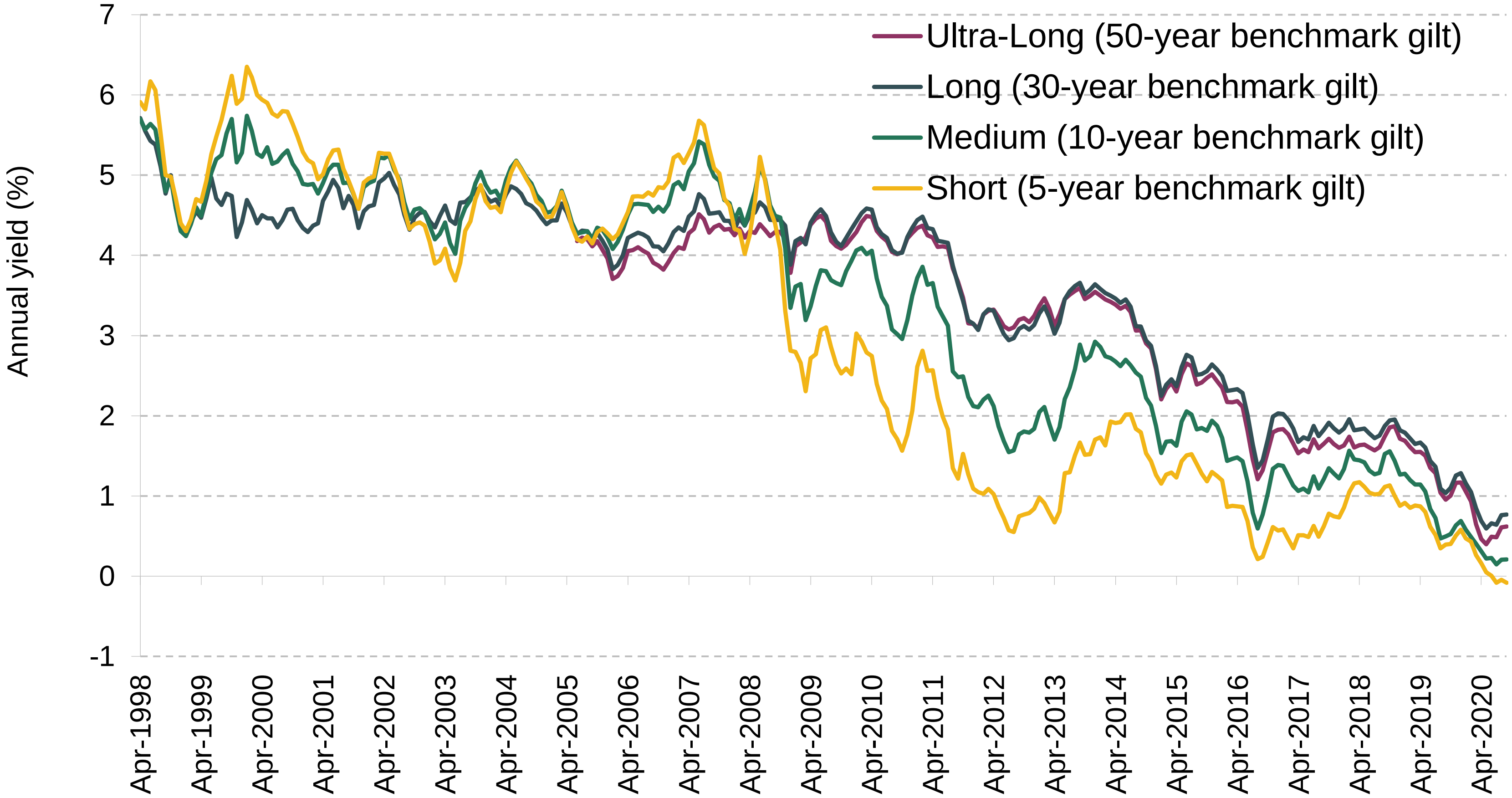


Source: Office for Budget Responsibility. Dotted line shows OBR's central scenario.

Increased public sector debt not an urgent problem

- Borrowing costs are low

Falling UK bond yields over time



Notes and sources: IFS Green Budget 2020, Figure 5.11.

Increased public sector debt not an urgent problem

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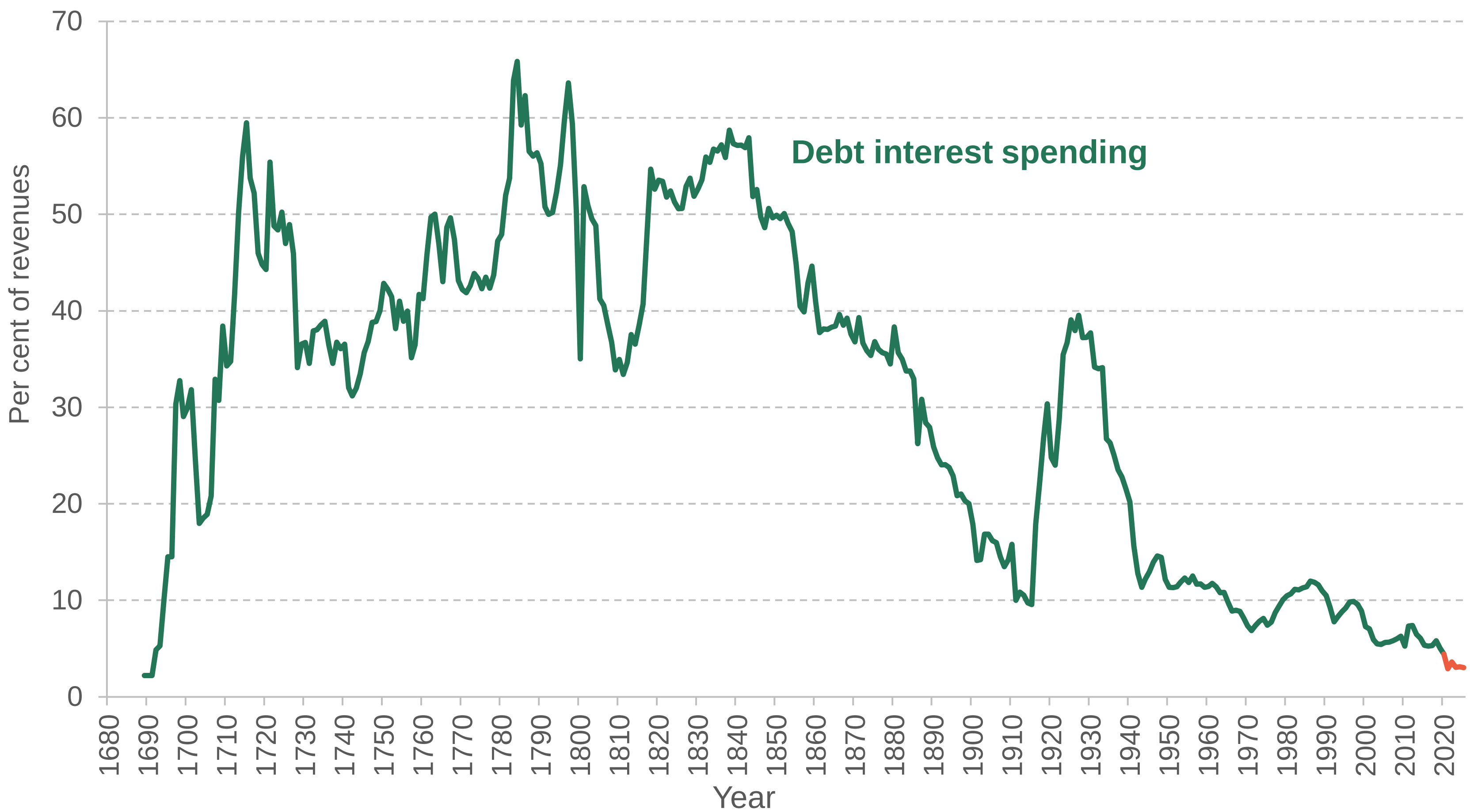
- Debt interest spending is low as a share of revenues

Debt interest low as a share of revenues

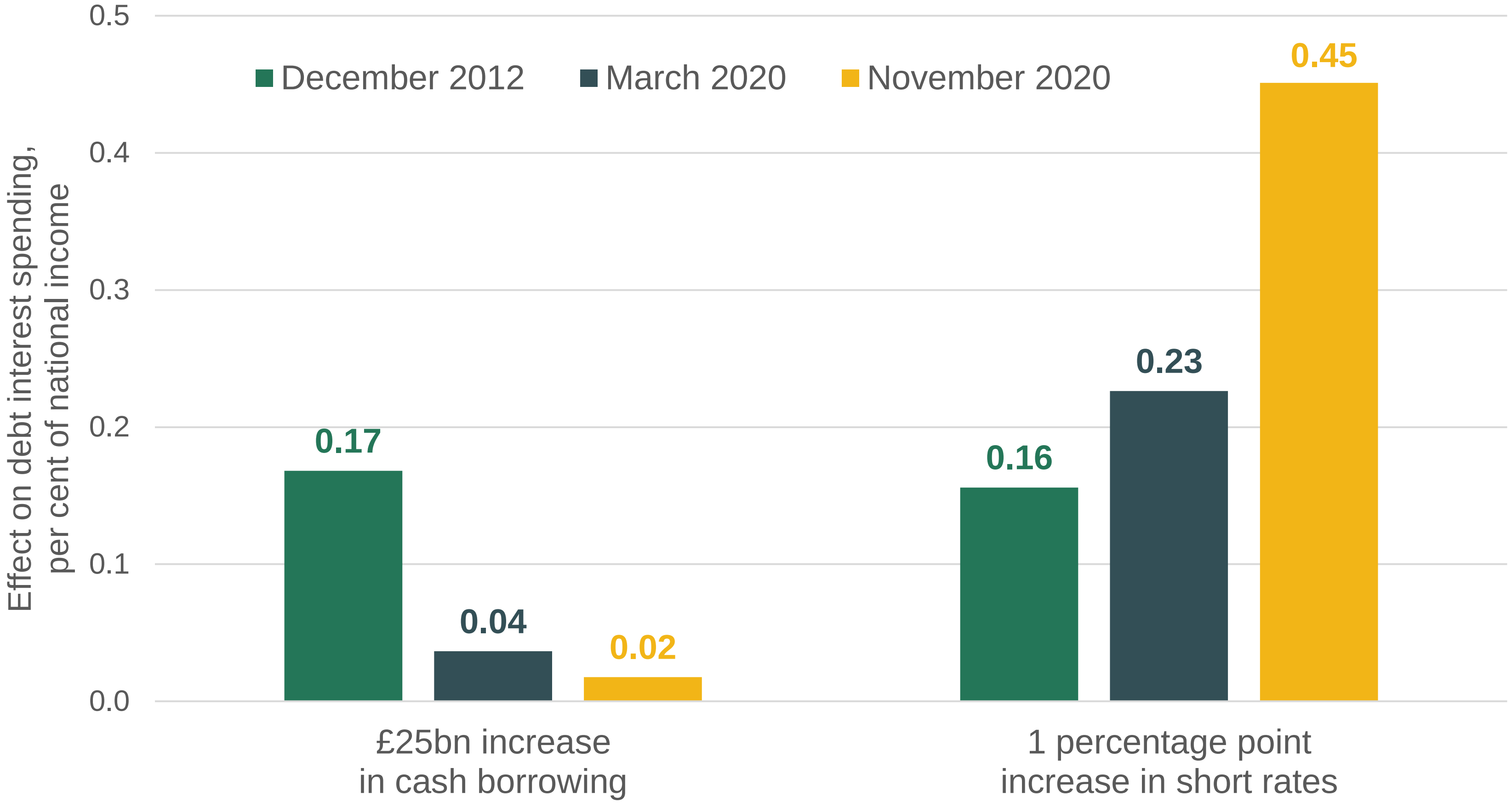


Notes and sources: IFS Green Budget 2020, Figure 4.14.

Increased public sector debt not an urgent problem

- Borrowing costs are low
- Debt interest spending is low as a share of revenues
- On the other hand: debt interest spending is now more exposed to interest rate rises

Debt interest spending down, but much more exposed to rate rises



Source: Office for Budget Responsibility.

Increased public sector debt not an urgent problem

- Borrowing costs are low
- Debt interest spending is low as a share of revenues
- On the other hand: debt interest spending is now more exposed to interest rate rises
- There are good reasons to expect tax rises eventually

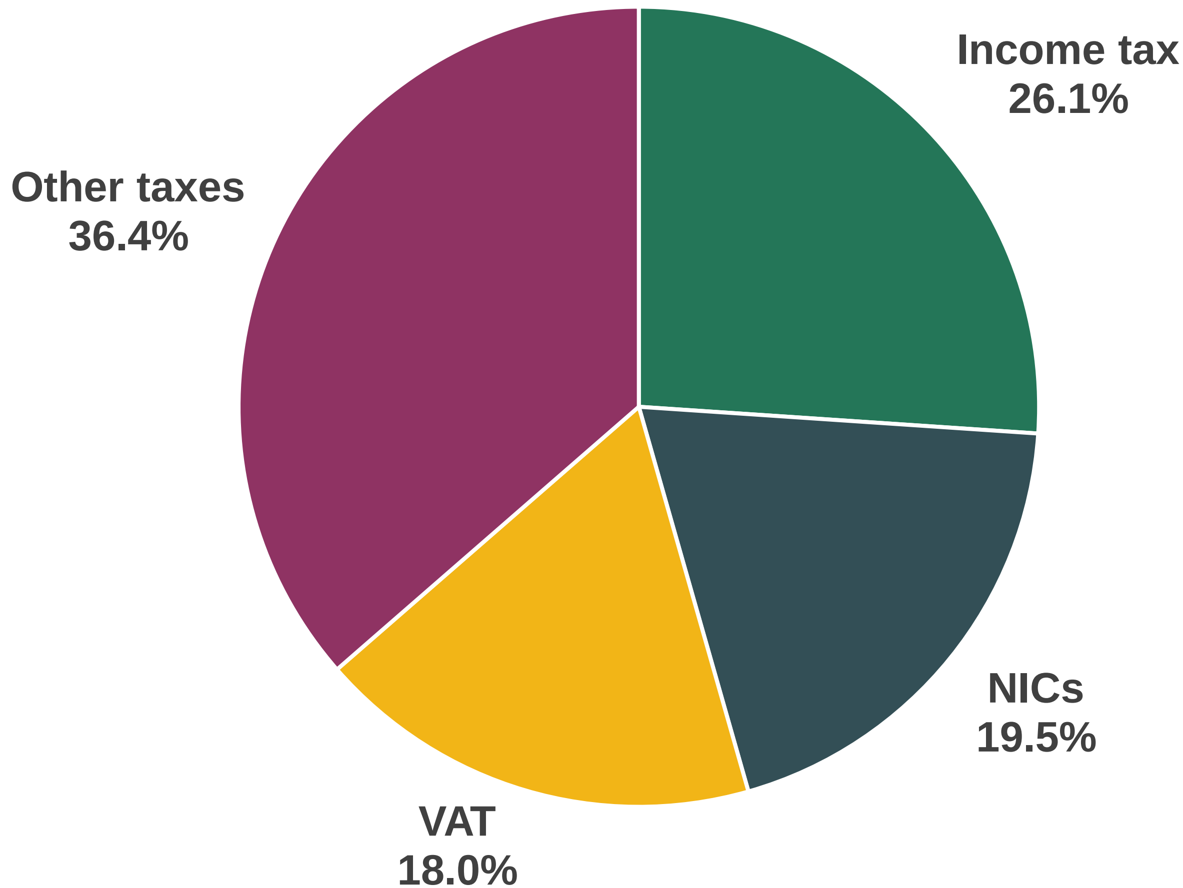
Reasons to expect tax rises (1)

- Rishi Sunak has talked of a "sacred duty" to "leave the public finances strong"
  - Under OBR central forecast, a fiscal consolidation of:
    - ≈£15bn would stop debt rising in 2025–26
    - ≈£20bn would deliver a current budget balance in 2025–26 (£66bn in downside scenario)
- Decade of austerity for (most) public services + post-pandemic pressures → spending cuts on that scale look near impossible
  - Points to need for (at least some) tax rises

Reasons to expect tax rises (2)

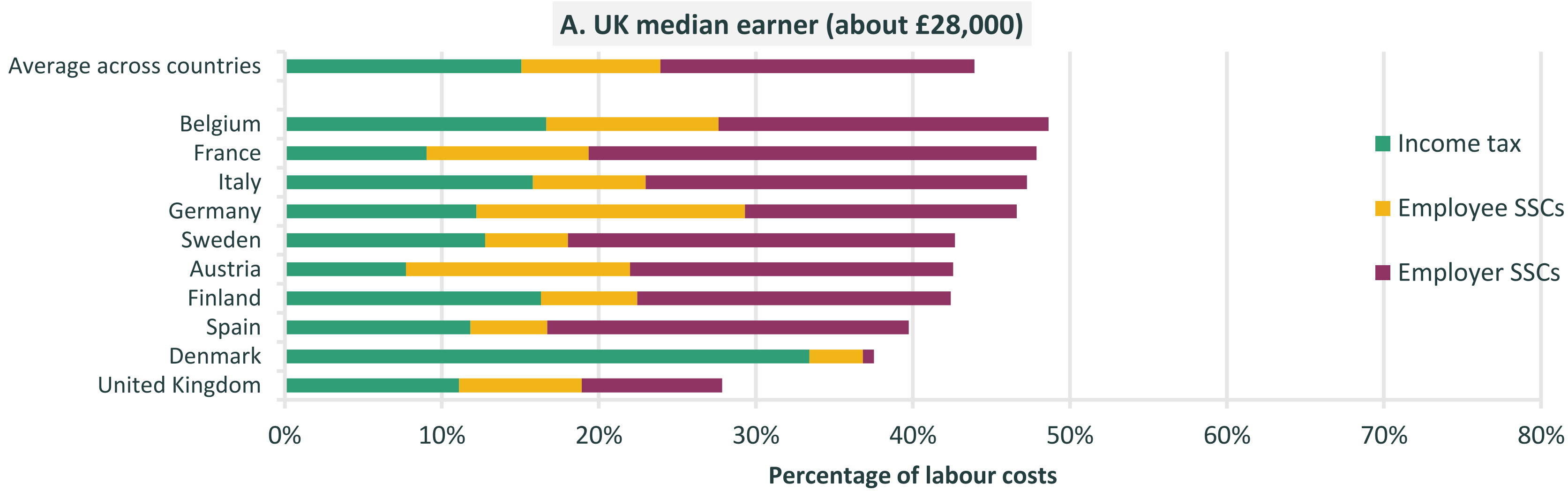
- There are plenty of post-pandemic spending pressures, e.g.
  - Make increase to Universal Credit permanent: ≈£7bn
  - U-turn on new squeeze to non-Covid spending: ≈£11bn
  - Continue any of the £55bn Covid spending planned for 2021–22?
- On top of that, huge spending pressures associated with ageing
  - Health, social care, pensions
    - OBR estimates annual increase ≈£39bn per decade
- Longer term, tax rises look all but inevitable
  - (Probably after the next general election)

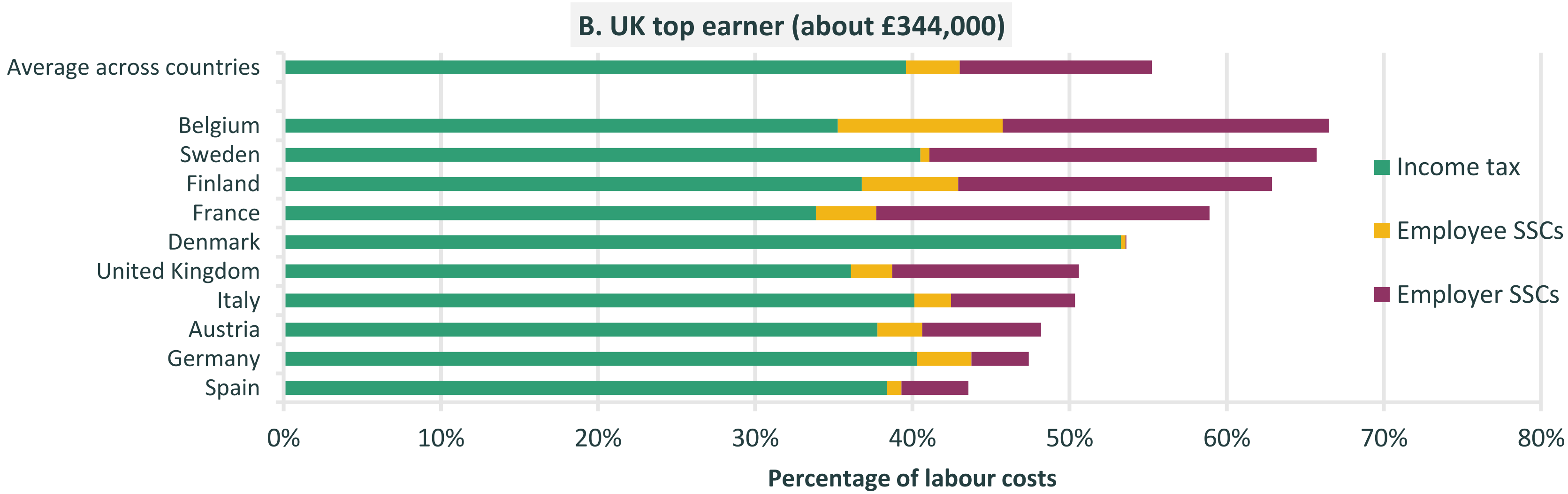
Sources of UK tax revenue, 2019–20



Source: Office for Budget Responsibility.

Average income tax and social security contribution rates, 2016





Source: M. Conte, H. Miller and T. Pope, 'How do other countries raise more in tax than the UK?', IFS Report, June 2019

Summary and final thoughts

- We are living through an unprecedented economic dislocation
  - The short-term figures are astonishing – but much more depends on the longer-term economic damage and policy response
- SR 2020: huge sums for Covid response; quite austere elsewhere
  - But no return to the deep spending cuts of the 2010s
- Increased public sector debt is not an urgent problem
  - Now is not the time for a fiscal tightening
  - Strong reasons to expect tax rises eventually

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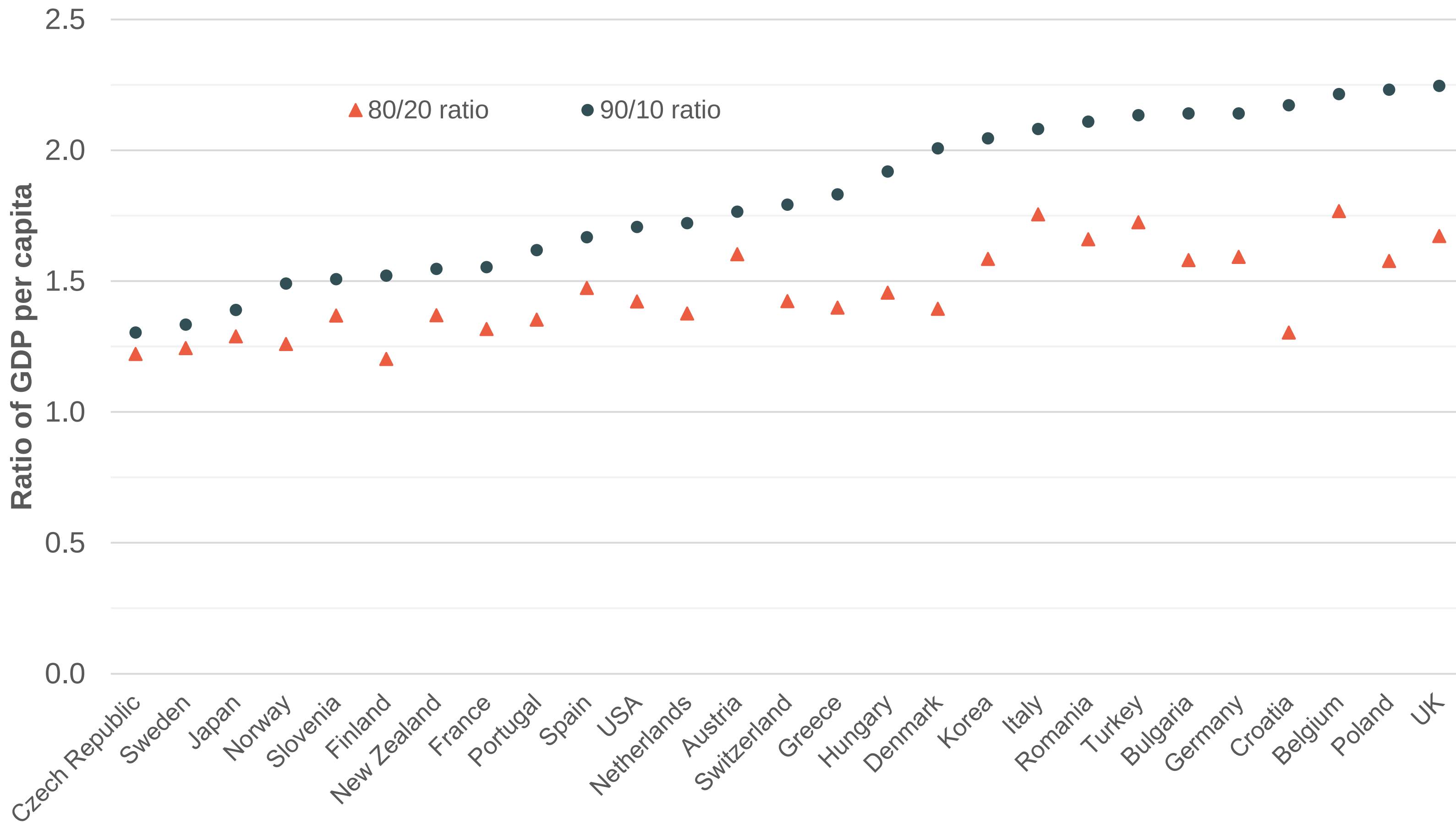
Additional content: ‘Levelling up’

The UK is among the most geographically unequal developed countries

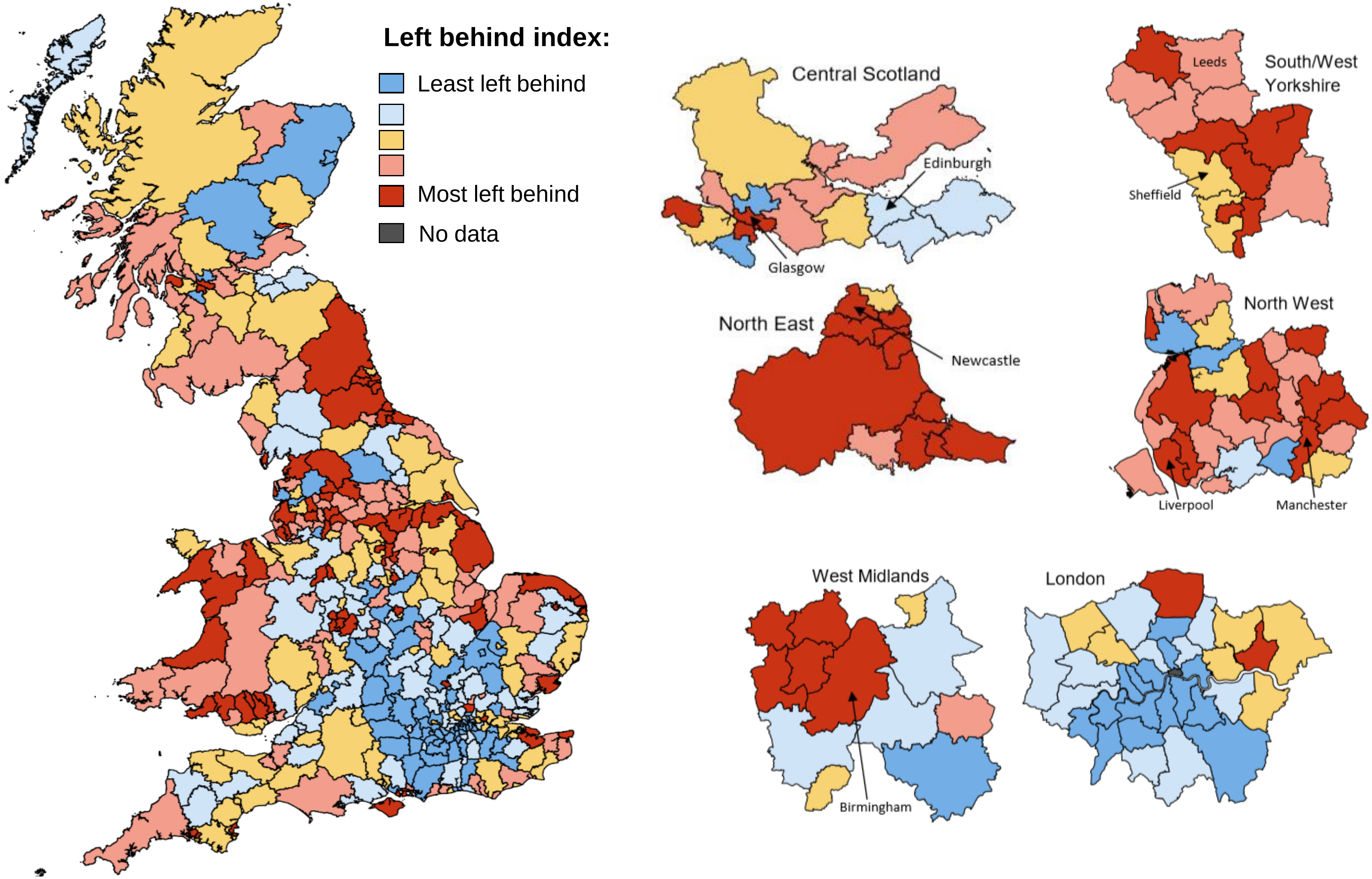


Source: Author's calculations using OECD Stat Regional GDP

‘Levelling up’

- Tackling geographic inequalities is a clear priority for this government and ‘levelling up’ was a major focus of SR 2020
- Still waiting on lots of the details – but likely focus on ‘left-behind’ areas
  - There is no single definition of being ‘left-behind’
- We consider pay, degree-level qualifications, incapacity benefits and employment, and combine these into one measure
  - Local authorities are mapped by quintiles (fifths) of this index.
- These areas are found across the country but some clear geographic patterns emerge

Where might be in need of ‘levelling up’?

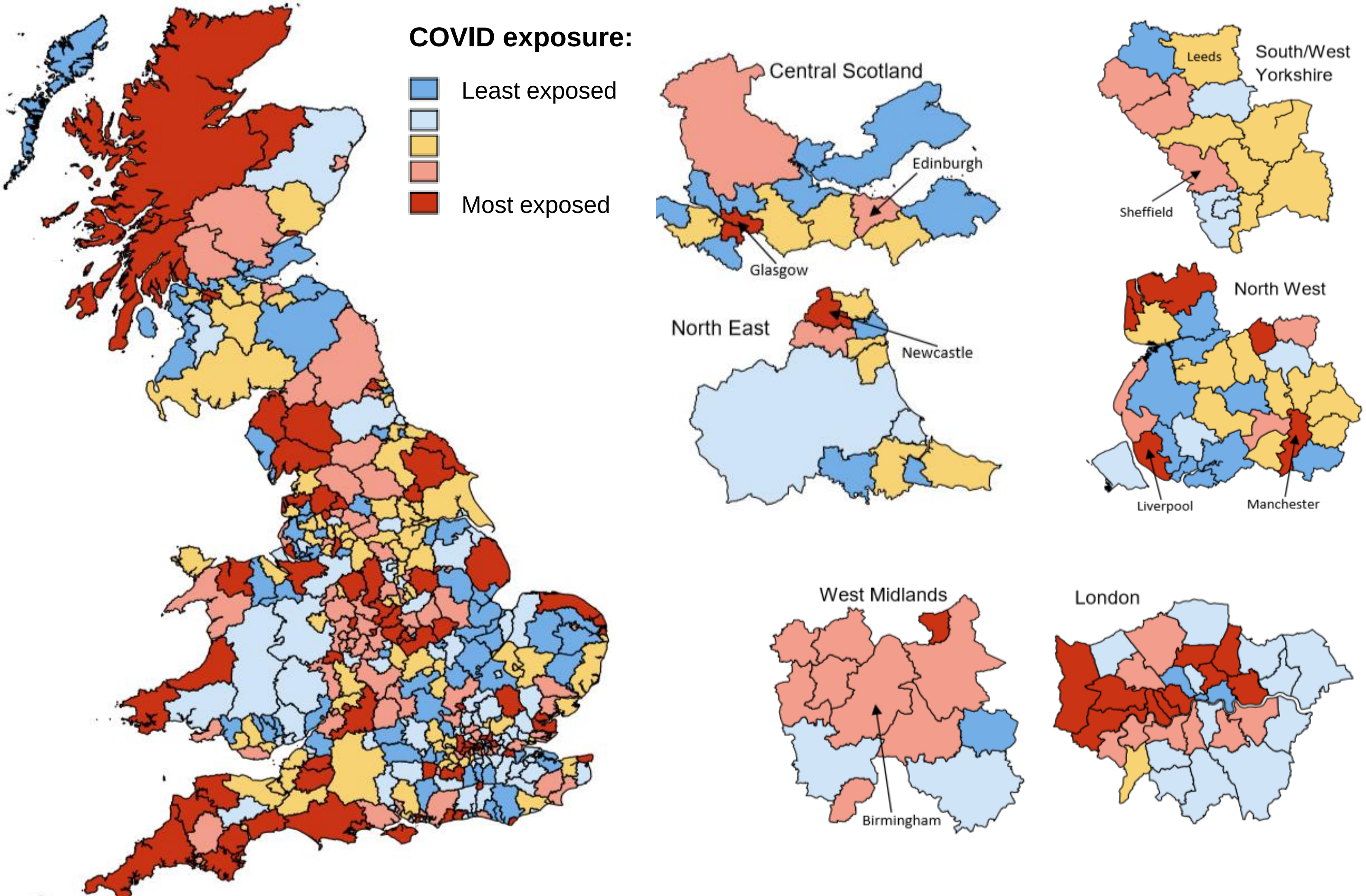


Source: A. Davenport and B. Zaranko, ‘Levelling up: where and how?’, IFS Green Budget 2020, https://www.ifs.org.uk/publications/15055

Which areas have been hardest hit by the economic impacts of Covid-19?

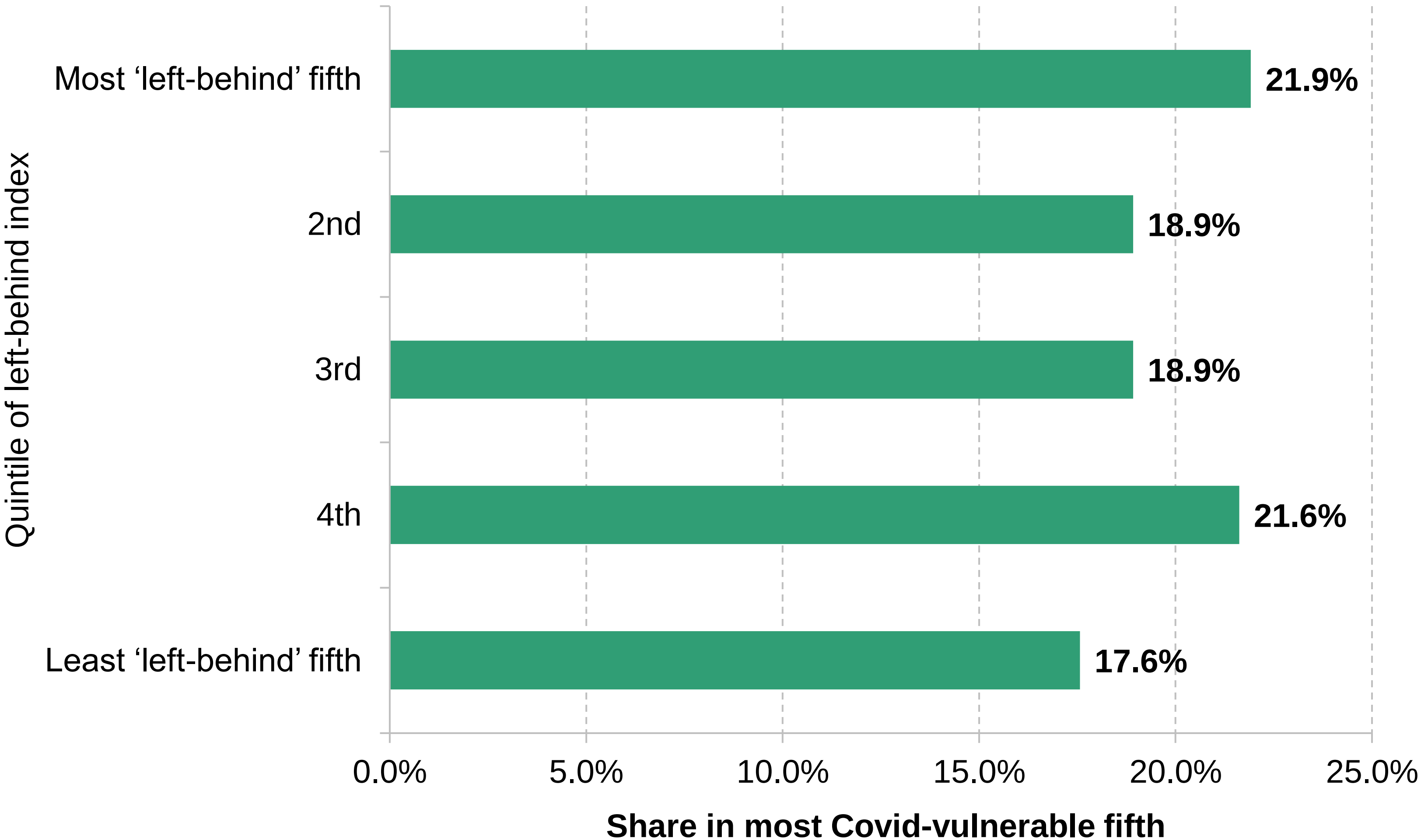
- The economic impacts of the pandemic have varied greatly by area
- Long-term implications are still highly uncertain
- Here, we focus on short-term economic impact and look at:
  - The share of workers in affected industries
  - The proportion of eligible workers ever furloughed
  - The fall in job vacancies from April-June 2019 to April-June 2020

Which areas have been hardest hit by the economic impacts of Covid-19?



Source: A. Davenport and B. Zaranko, ‘Levelling up: where and how?’, IFS Green Budget 2020, https://www.ifs.org.uk/publications/15055

No systematic relationship between the two measures



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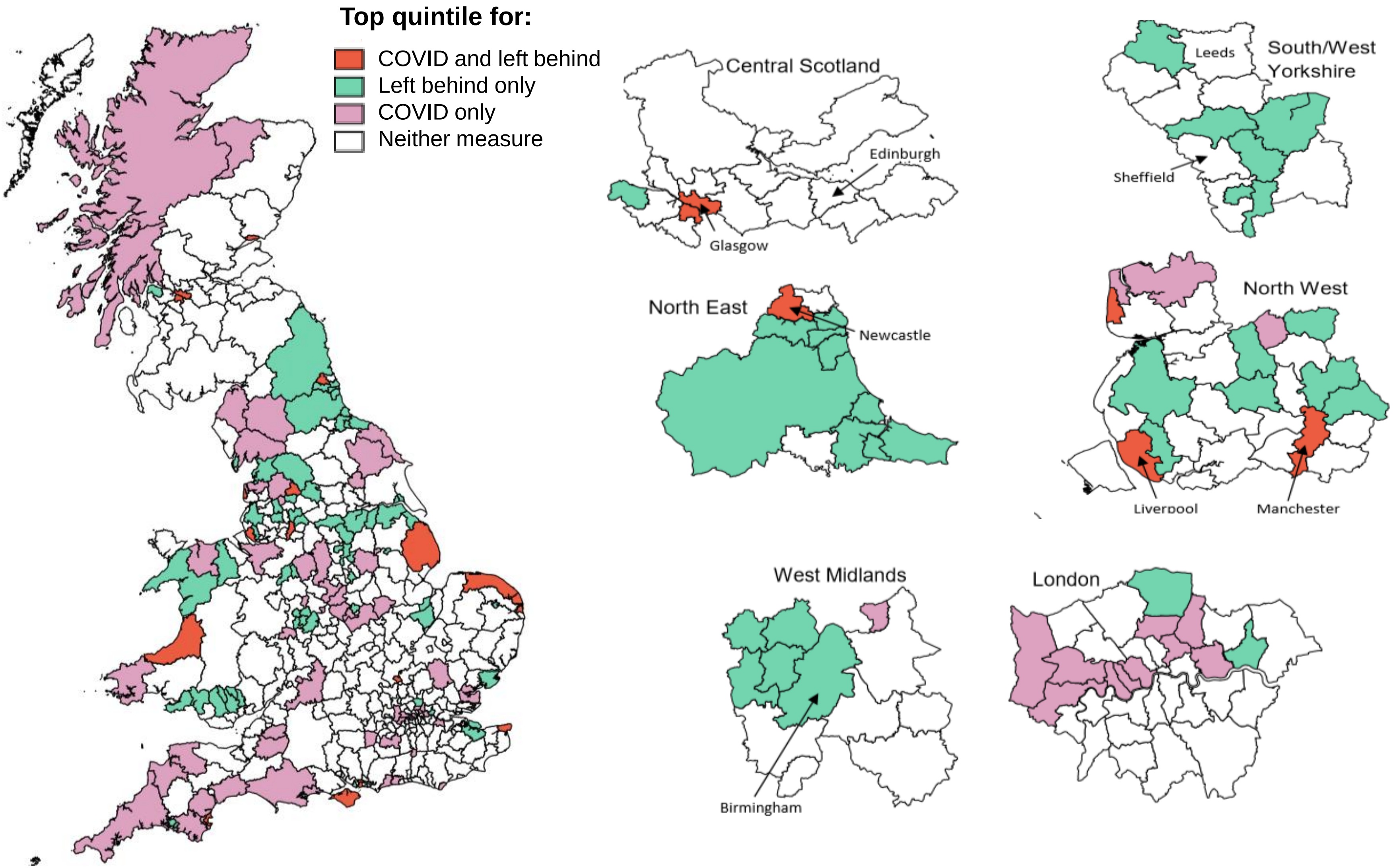
But some areas look vulnerable on both fronts



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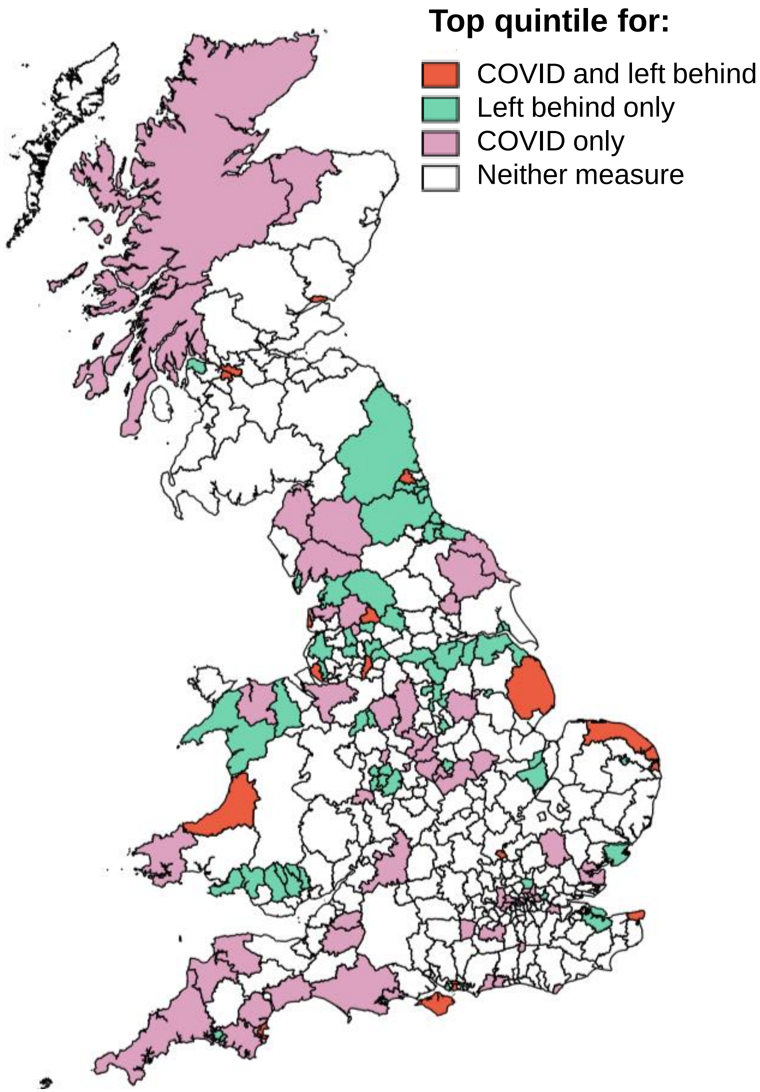
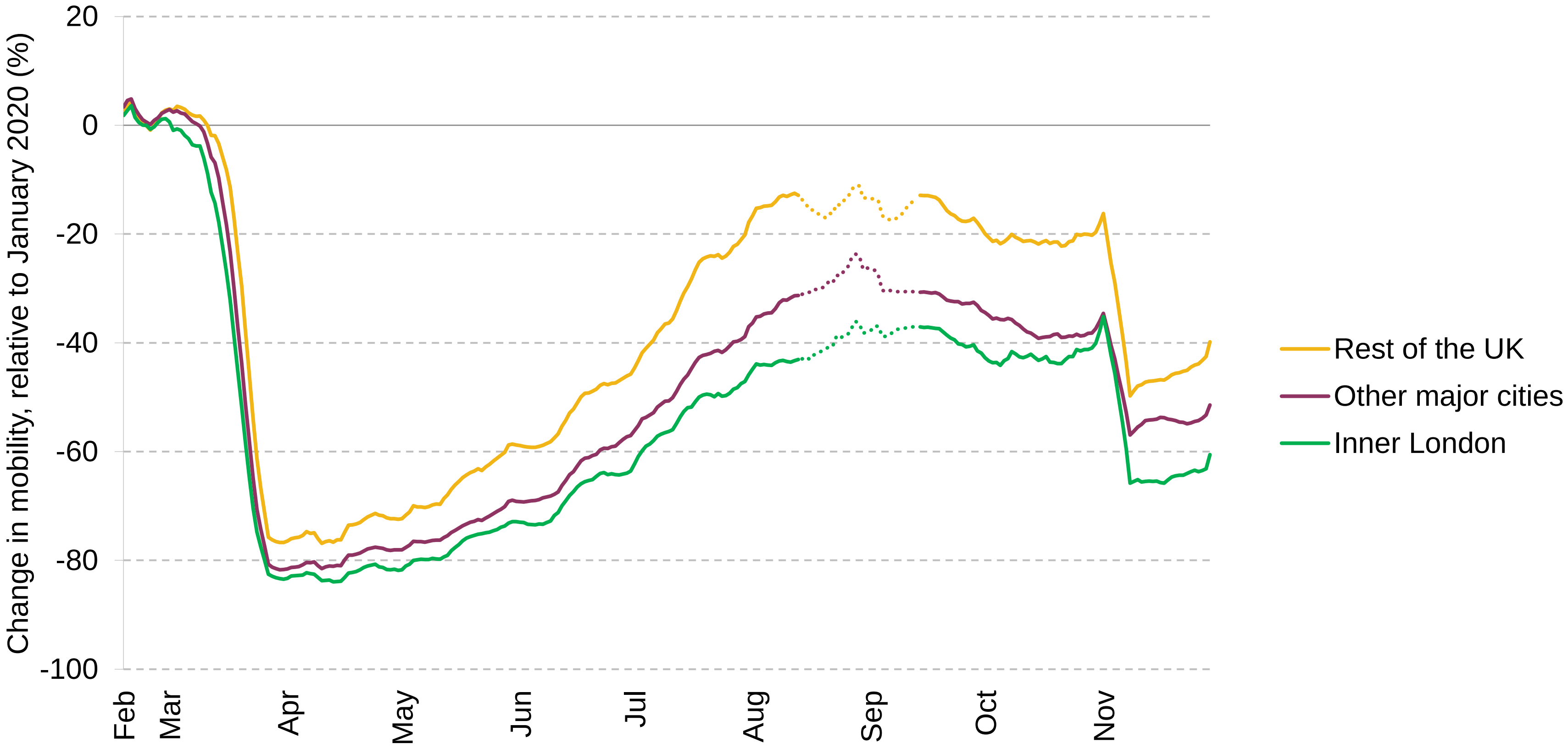


In general, the local authorities facing the worst short-term economic effects from COVID are not those that were already 'left behind'. But some city-centres and coastal communities appear vulnerable on both fronts:

Blackpool	Luton
Ceredigion	Manchester
Dundee	Newcastle
East Lindsey	North Norfolk
Glasgow	Pendle
Great Yarmouth	Portsmouth
Isle of Wight	Thanet
Liverpool	Torbay

Source: A. Davenport and B. Zaranko, 'Levelling up: where and how?', IFS Green Budget 2020, https://www.ifs.org.uk/publications/15055

Another perspective: centres of major cities have seen greatest reductions in footfall – changing patterns of need?



Source: K. Ogden and D. Phillips, 'Changing consumer behaviour has big implications for councils, not just businesses, and especially for those in major cities', December 2020, https://www.ifs.org.uk/publications/15239

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