The 2015-16 Spending Round

A briefing note to accompany the IfG/IFS press briefing on 7 June 2013

Joshua Harris and Julian McCrae

Summary

Fiscal consolidation is taking longer than planned. The Chancellor announced in the 2010 Emergency Budget that the budget deficit would be balanced within four years, but this is now forecast to happen in 2017-18. We are still as far away from the target as we were in 2010. Indeed, it would not be surprising if not just 2015 but also 2020 was an 'austerity' election.

So far the Government has successfully stuck to planned spending reductions, with most departments actually underspending. There have been no major giveaways through spending. In this area, the Government has held its nerve. The problems for the consolidation have come through a lack of growth in the economy, resulting in lower than expected tax revenues. This means spending as a share of GDP is higher than planned – even if the cash level of spending is as expected – which is why the Chancellor imposing a further round of spending cuts on departments.

However, what matters is not so much how quickly the Government has initially cut, but how sustainably it is making cuts and whether it can maintain momentum. The Government's financial statistics reveal relatively little about this. So when examining its record to date, it is important to ask what is happening to the underlying drivers of costs, such as headcount and wages.

Looking forward, the Government's commitment to ongoing spending cuts has remained firm. Both governing parties are currently committed to the same tight spending totals lasting well into the next parliament, with Labour under pressure to clarify its position. The disagreements, both between and within parties, are around the allocation of the implied spending cuts. These will not be resolved until after the next election. Watch for any signals in this Spending Round that the current ring-fences will not continue after the election, or that new areas are in effect being added.

If politicians have remained committed to austerity, so too has a sizeable proportion of the wider population. Polling by YouGov shows that 56% of people think cutting the deficit is necessary, compared to 29% thinking it unnecessary.[1] If anything, attitudes are hardening. For example, the percentage of those who think that the Government is cutting spending too quickly has steadily declined from its level near 60% in early 2011 to 44% in May 2013.[2]

While the population accepts the necessity of fiscal consolidation, it does not think that the Coalition is doing it fairly. The Chancellor's speech, and what he focuses on, will indicate where the political energy and planning have gone in preparing for the Spending Round. Will there be a lot of small 'good news' measures to disguise the overall impact (a feature of his 2010 speech) or will we see the crafting of a careful strategy which openly balances the inevitable pain in a politically sustainable way?

---

[1] YouGov Archive, *The Economy,* retrieved 31 May 2013 <http://d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/bhc73m97ue/YG-Archives-Pol-Trackers-Economy-280513.pdf>

[2] *Ibid.*

This government promised radical decentralisation, but it is not clear that spending decisions will reflect this. How much money will be set aside to support localism – such as the Single Local Growth Fund formed in response to the Heseltine Review? How will the Government respond to the London Finance Commission recommendations for greater fiscal devolution to the capital?

While attention will focus on the time up to June 26th, the day the Chancellor announces the 2015-16 departmental spending allocations, the period immediately following this announcement is actually the most important for public spending. This is when the hard work of planning what to do within these limits, and preparing for the inevitable tough decisions in the coming parliament, starts in earnest for departments. Departments need to invest now in understanding the choices available, and identifying areas in which collaboration with other departments or agencies – or even other tiers of government – would enable greater savings to be made. This may require quite a different way of running Whitehall.

The 2015-16 Spending Round

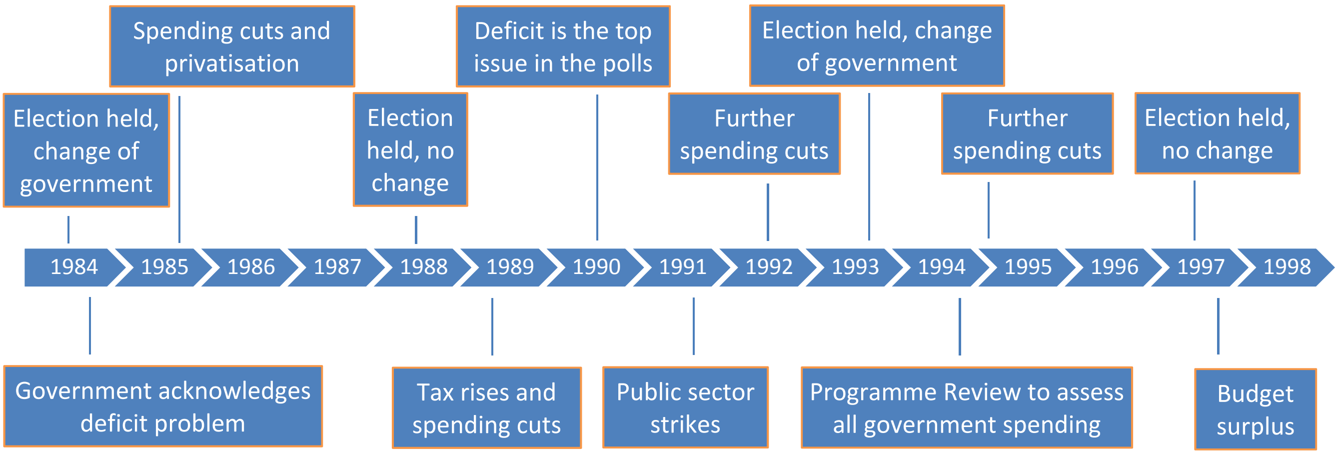
There is more to come, for a long time to come

The bad news is well known. This fiscal consolidation is taking longer than the Government planned. The Chancellor announced in the post-election 'emergency' Budget 2010 that the budget deficit would be balanced within four years. The original consolidation plan envisaged a few years of deep cuts to spending, with results showing by mid-parliament and the Government reaping the electoral rewards of growth and controlled finances in 2015.

This plan has been blown off course. Balancing the structural budget deficit is now forecast to happen in 2017-18. We are still as far away in time from the target as we were in 2010. In any case, the Chancellor's fiscal target was just to balance the deficit in order to slow the growth of debt, not reduce the stockpile. With debt now forecast to peak at around 90% of GDP, deeper cuts for longer are likely to be necessary after 2017-18 if government want public finances that could withstand another major economic shock.

Canada is a classic case study of recent effective fiscal consolidation, involving very substantial spending reductions. However, people usually focus on the final phase, which returned Canada's finances to a stable position within a few years. This took place against a backdrop of strong growth – something the UK, like the rest of Europe, is sorely lacking. But before this final phase there were a series of failed attempts lasting for more than a decade. The timeline below shows the Canadian experience.

Figure 1: Canadian fiscal consolidation, 1984-98



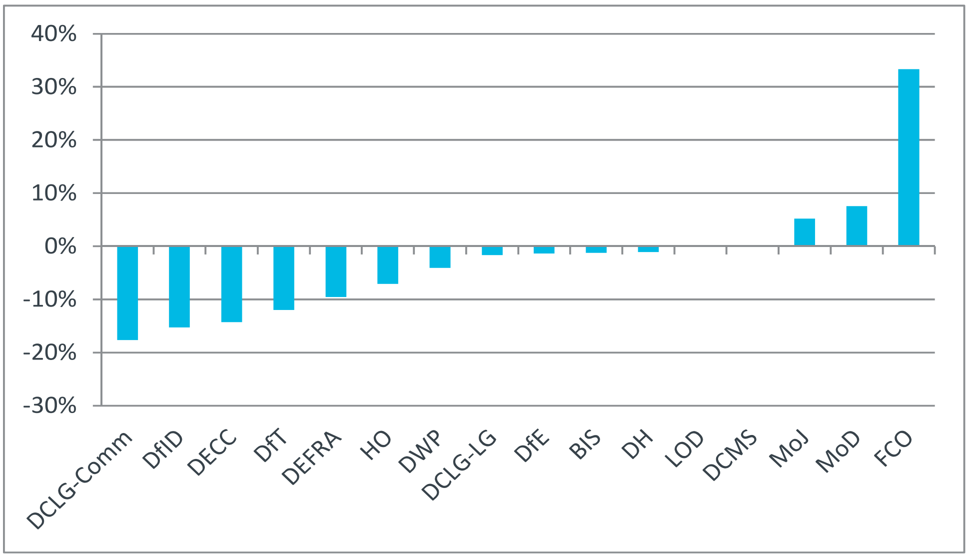
If the UK experience proves to be as drawn out as the Canadian one, we should expect not just 2015 but also 2020 to be an austerity election. Spending reductions are set to be a long-term feature of UK public finances, rather than a short and sharp experience. When the Chancellor stands up to speak on 26 June 2013 will he be frank about the long-term reality of austerity?

The Government has successfully stuck to its spending reductions so far

Despite ongoing economic weakness and the need for a fresh round of spending reductions, the control of spending has been a success so far. The Government has reduced spending with very few failures. Its real problem has been a lack of growth in the economy, resulting in lower than expected tax revenues. Figure 2 shows the expected outturns for resource departmental expenditure limits (DEL) in 2012-13 relative to the amount expected in Spending Review 2010.[3] Most departments show an outturn below the level expected in Spending Review 2010. Some of these fall short by very considerable amounts: the communities budget of the Department for Communities and Local Government (DCLG), the Department for International Development (DfID), Department of Energy and Climate Change (DECC) and Department for Transport (DfT) are more than 10% below. In contrast, only three of the main spending departments show a higher outturn. For the Ministry of Defence (MoD) and the Foreign Office (FCO), this is largely to do with reserve claims around conflicts and peacekeeping. The overspend at the Ministry for Justice was due to a number of additional spending liabilities, including over £150m of emerging cost pressures in the prisons and probation service.

[3] Resource DEL (Department Expenditure Limits) includes main current programme costs of departments and Non-Departmental Public Bodies, as well as administration costs.

Figure 2: Resource DEL 2012-13. Latest expected outturn as % Spending Review 2010



Source: Spending Review 2010; Budget 2013

So while this Government has been criticised for policy U-turns, few of these decisions involved substantial spending implications. Some have created headaches in departmental spending reduction plans – such as abandoning changes to sentencing in the case of the Ministry of Justice (MoJ), and finding an extra £112 million (mn) for school sports in the case of the Department for Education (DfE) in 2010. Most have been relatively 'cheap' policy changes in the context of £720 billion (bn) of public spending.

This is especially true when compared to the U-turns taken on revenue, such as the repeated postponement of fuel duty escalator increases – costs which run into many billions. In fact, tightening spending has contrasted with a general loosening of policy on raising revenue. The Chancellor has chosen to forgo large amounts of revenue by introducing discretionary tax reductions. Some of these reductions were intended from the outset as part of the Coalition's strategy, with significant price tags attached: for example, in 2016-17 raising the income tax personal allowance and reducing corporation tax reductions combined will cost the Treasury £18.7bn.[4] There have been no comparable major giveaways through spending. The Government, assisted by the Treasury's tight control of departmental spending limits, has held its nerve.

How sustainable are the cuts to date?

However, it is important to look at the underlying drivers of spending reductions inside departments. As the National Audit Office have pointed out, while departments 'took effective action' in reducing costs, 'departments are less well placed to make the long-term changes needed'.[5] Underspends are not necessarily a sign that the underlying spending reductions are sustainable.

The Government's financial statistics reveal relatively little about the nature of the underspends. Some are easily traced; for example, the Department for Education underspent on apprenticeships by £165m in 2012-13, in part because fewer employers than expected

[4] Adam, S., *Budget Measures*, Institute for Fiscal Studies, p.27, retrieved 4 June 2013 <http://www.ifs.org.uk/budgets/budget2013/budget_measures.pdf>

[5] National Audit Office, *Cost reduction in central government: Summary of progress,* February 2012, Paragraphs 13-14, retrieved 3 June 2013 < http://www.nao.org.uk/wp-content/uploads/2012/02/10121788.pdf>

provided places. But in many cases it is harder to determine what is actually happening. For example, the Home Office transferred a lot of spending between budget lines, with the resource DEL underspend appearing to reflect a transfer of pension liabilities to AME, rather than a real reduction in costs.

It is also difficult to follow the emerging financial risks through these financial statistics. For example, academy schools and foundation trust hospitals can underspend money that has been transferred to them, which can count as an underspend in the overall government figures. However this money remains in these organisations' bank accounts rather than being returned to the Treasury. They can spend it when they wish in the future. The figures are less good at transparently showing these growing spending liabilities.

As an alternative to using the Government's financial statistics, we can look at trends in the underlying cost drivers to get a better idea of what is happening. For example, the pattern of headcount reductions in the Civil Service illustrates some of the issues.

Starting after the Spending Review in 2010 Q3, Figure 3 compares the actual reductions made in the size of the Civil Service to a steady, straight-line reduction towards the objective of having a 380,000-strong workforce by 2015.[6] As is common with headcount reductions, the Civil Service initially achieved a much faster reduction than against a straight-line reduction. The rate of cutting headcount is now slowing, with some departments starting marginally to increase their headcount again.[7]

Projecting the latest rate forward shows the Civil Service only just meeting the objective by the end of 2015 if the current rate is maintained and the pace does not slow further.[8] What matters is not so much how quickly the Civil Service initially cut, but how sustainably this was done and whether it can maintain momentum. The latest figures suggest that the Civil Service may risk slowing down and not meeting the objective.

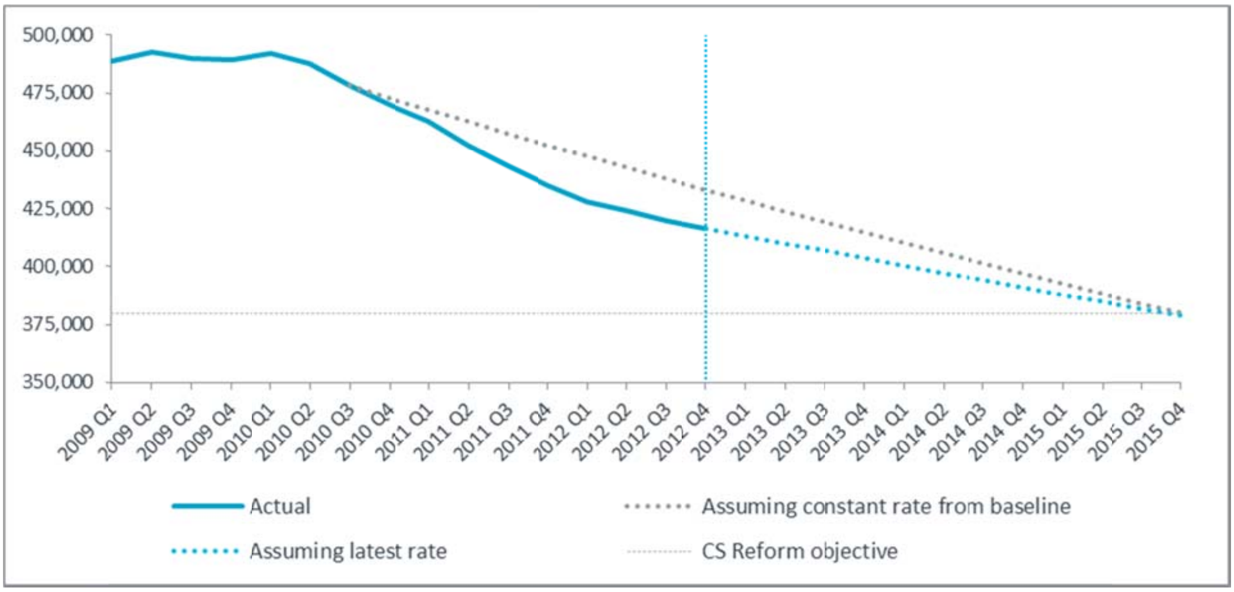
---

[6] HM Government, *Civil Service Reform Plan*, June 2012, p.11

[7] The Institute for Government's analysis of headcount figures is available as Whitehall Monitor #19 available, along with other releases from the Whitehall Monitor project, at http://www.instituteforgovernment.org.uk/our-work/more-effective-whitehall/whitehall-monitor

[8] The Civil Service Reform Plan specifies the objective should be met 'by 2015'. We have interpreted this to mean 'by the end of 2015' in Figure 3. If this target were brought further forward, the Civil Service would need to increase the rate of cuts to staff headcount.

Figure 3: Actual and projected paths towards Civil Service Reform Plan objective



Source: ONS public sector employment figures. Projections by the Institute for Government

So when examining the Government's record to date, it is important to ask what is happening to the underlying drivers of costs, such as headcount and wages. To what extent can initial momentum be sustained to keep the Government on track?

How plausible are further cuts?

Of course, as well as taking longer, the current plans involve deeper spending cuts than were envisaged in Spending Review 2010. Measures announced since the pre-crisis baseline of the 2008 Budget will reduce public spending by 9.1% of national income by 2017-18, which is larger than the 6.5% planned by the Coalition in 2010.[9]

So how long can governments continue to reduce spending? Some experienced voices suggest scepticism. Göran Persson, who was prime minister of Sweden during a major consolidation in the 1990s, put the situation about cuts bluntly: 'You have two years. If you are not in command of the process by then, you will lose momentum and soon face the next election – where you will be replaced.'[10] The political momentum necessary to pursue spending reductions can often falter two or three years into them. Recent coverage of pressures on the NHS, particularly A&E services, may be a sign that pressures on budgets will increase in the future.[11]

So far the Government's commitment to ongoing spending cuts has remained firm. Both government parties are currently committed to the same tight spending totals until well into the next parliament. However, clearly politics is affecting the process. The Coalition felt it could

[9] Tetlow, G., *Cutting the deficit: three years down, five to go?*, Institute for Fiscal Studies, retrieved 4 Jun 2013 <http://www.ifs.org.uk/publications/6683>

[10] McCrae, J., Myers J. & Glatzel, K., *Undertaking a fiscal consolidation*, Institute for Government, December 2009, p.8, retrieved 31 May 2013 <http://www.instituteforgovernment.org.uk/publications/undertaking-fiscal-consolidation>

[11] See for example recent research by the Kings Fund which finds that for the final quarter of 2012/13 nearly 6% of patients waited 4 hours or longer in A&E: Appleby, Humphries, Thompson, and Galea, *How is the health and social care system performing? June 2013*, The Kings Fund, retrieved 4 June 2013 <http://www.kingsfund.org.uk/publications/how-health-and-social-care-system-performing-june-2013>, And also press reports such as Kuchler, H., 'Jeremy Hunt admits to pressure on UK's NHS emergency departments', *Financial Times online*, 15 May 2013, retrieved 3 June 2013 < http://www.ft.com/cms/s/0/92f49474-bd3c-11e2-890a-00144feab7de.html> and 'NHS: Accident and Emergency units 'in crisis'', *Sky News online*, 10 May 2013, retrieved 3 June 2013 < http://news.sky.com/story/1089128/nhs-accident-and-emergency-units-in-crisis>

not agree the *allocation* of the implied spending cuts beyond fixing the bare minimum needed: departmental spending totals for election year. This is why we are having only a one-year Spending Round for 2015-16. But current departmental disagreements are between ministers seeking to protect their own budgets, rather than arguing against the need for cuts in principle.

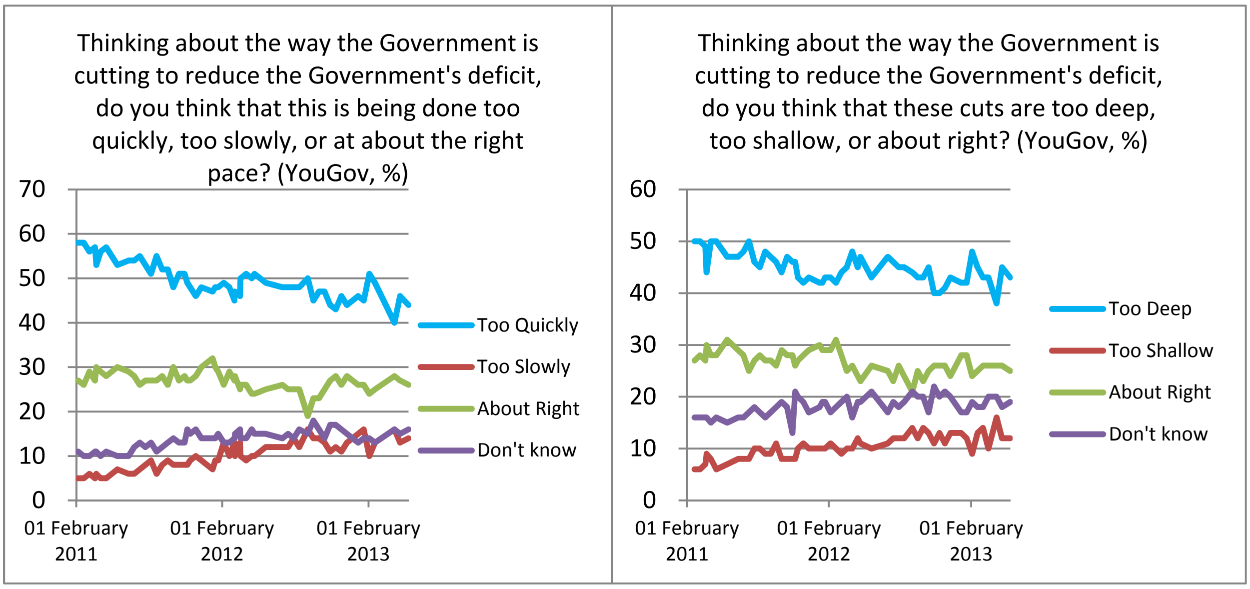
The real decisions about long-term spending allocations are being saved for after the next election. Those decisions will almost certainly use the headline figures in this Spending Round as their baseline, providing clues as to where likely cuts might fall after the election. Watch for any signals that the effective ring-fences will not continue (such as overseas aid and pensioners' welfare), or that new areas are added (such as defence and policing).

Continued public support for austerity

If politicians have remained committed to austerity, so too has a sizeable proportion of the wider population. One of the features of the UK's fiscal consolidation has been the enduring public acceptance of the need for it. Recent polling shows 56% believe that cutting the government deficit is necessary, compared to 29% thinking it unnecessary. This figure has been virtually unchanged for at least two years.[12]

At the same time, as Figure 4 shows, the percentage of those who think that the Government is cutting spending too quickly has steadily declined from its level near 60% in early 2011 to 44% in May 2013. While most seem to think that the government is cutting too deep and too quickly, attitudes have been hardening across the spectrum as the economy has failed to revive: the percentage of those who think the Government is cutting too slowly has increased from around 5% to 14%.[13] This hardening of attitudes is replicated when respondents are asked about the depth of cuts, rather than the speed, as shown in Figure 5.

Figures 4 and 5: Opinion polling results on deficit reduction, February 2011 to May 2013



Source: YouGov, *The Economy*

[12] Question: *Thinking about the way the Government is cutting spending to reduce the Government's deficit, do you think this is necessary or unnecessary?*, YouGov Archive, *The Economy*, retrieved 31 May 2013 <http://d25d2506sfb94s.cloudfront.net/cumulus_uploads/document/bhc73m97ue/YG-Archives-Pol-Trackers-Economy-280513.pdf>

[13] *Question: Thinking about the way the Government is cutting spending to reduce the Government's deficit, do you think this is being done too quickly, too slowly, or at about the right pace?, Ibid*.

While the population accepts the necessity of fiscal consolidation, and appears to be hardening in its attitude towards the speed and depth of the necessary cuts, it does not think that the Coalition is making cuts fairly. Although initially opinion was pretty much equally divided, since mid-2010 the figures have settled at around 30% thinking the Government is cutting fairly and around 55% thinking its decisions are unfair.[14]

But what do people mean by fairness? In-depth work with groups of voters shows that people are prepared to accept cuts to their own interests if they see the corresponding interests of others equally affected. So in the Canadian case, cuts to western farmers' grain transport subsidies were more acceptable because eastern farmers' milk subsidies were also being cut. In the UK, reductions in public sector pensions were arguably more acceptable as all groups, including teachers and nurses, were included and there were strong arguments that private sector workers had already faced such reductions. No single measure is therefore fair or unfair according to this view; rather, the package of cuts and spending decisions is taken as a whole.[15]

It's therefore important to be upfront about the trade-offs required in spending reductions. Look out for whether the Chancellor lays out a difficult package of decisions, showing how the various elements reinforce each other, or whether he instead amplifies any good news stories, thereby trying to mask the severity of cuts elsewhere. In the speech accompanying Spending Review 2010, George Osborne included around twice as many positively presented announcements as negatively presented ones.[16] The Chancellor's speech, and what he focuses on, will indicate where the political energy and planning have gone in preparing for the Spending Round – either using small measures to disguise the overall impact of cuts, or crafting a careful strategy to balance the inevitable pain in a politically sustainable way.

What implications are there for localism?

The Coalition entered power firmly committed to localism. Among OECD countries, the UK is second only to New Zealand in channelling public spending through central government. The UK channels more than 70%, compared with an OECD average of 48%.[17]

---

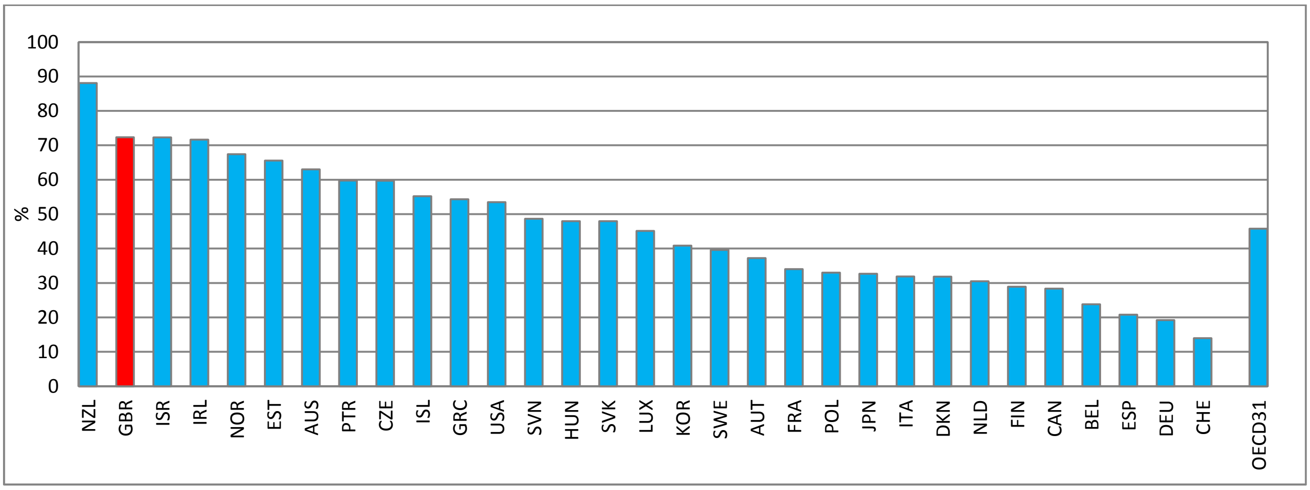
[14] *Question: Thinking about the way the Government is cutting spending to reduce the Government's deficit, do you think this is being done fairly or unfairly?, Ibid*.

[15] PwC commissioned BritainThinks in July 2010 to convene a Citizens' Jury, in which the Institute for Government acted as a 'Citizens' friend'. Further information about the Citizens' Jury including the full report is available at: http://www.pwc.co.uk/government-public-sector/issues/a-citizens-view.jhtml, retrieved 31 May 2013

[16] Speech analysis by Institute for Government using version of Chancellor's statement published by HM Treasury at http://www.hm-treasury.gov.uk/spend_sr2010_speech.htm, retrieved 31 May 2013

[17] Figures and chart from OECD, *Government at a Glance 2011*, chapter 3.6 Figure 6.1, retrieved 27 May 2013 <http://dx.doi.org/10.1787/888932389930>

Figure 6: General government expenditure through central government, 2009



Source: OECD, *Government at a Glance 2011*

Our work with Whitehall departments indicates strongly that the Civil Service knows it has gone as far as it can in cutting public spending within departmental silos without more innovative cross-departmental approaches being introduced. As we warned in 2009, the centralised nature of Whitehall carries dangers:

Rather than pushing limits down to lower levels of government, we push limits down through expenditure silos, particularly health and education. There is a clear risk that such a process leads public services to retreat to delivering their core services, rather than encouraging the public sector as a whole to innovate better ways of delivering across the piece.[18]

Such arguments suggest the need to push spending cuts to a lower tier of government – or to a lower level of service delivery – with greater discretion to adapt programmes. This Government was publicly committed to decentralisation, so we might expect this to be a major theme of the Spending Round. But will actual decisions reflect this philosophy?

In March 2012, George Osborne asked Lord Heseltine to report on creating the conditions for economic growth. His report criticised the currently centralised approach, arguing instead for a single pot of money for which local bodies – the business-led (and non-elected) Local Enterprise Partnerships (LEPs) – could bid. He recommended the size of the pot should be £49bn.[19]

In response to the Heseltine Review, the Government has agreed to create the Single Local Growth Fund. It has not yet committed funds to this, but its response to the review noted that the fund would be operational by 2015 'and further details will be set out at the Spending Round in June 2013'.[20] The level of funding the Government is prepared to commit to this fund will be indicative of the importance it attaches to LEPs. In the context of £11.5bn of spending cuts and an uncertain post-election position, it is hard to see much provision being made towards Lord Heseltine's £49bn figure. But the Government will have to go far beyond the £1.4bn allocated to the Regional Growth Fund over three years from 2010-11. Anything less

---

[18] Page, J., Pearson, J., Jurgeit, B. & Kidson, M., *Transforming Whitehall Departments*, Institute for Government, November 2012, retrieved 31 May 2013 <http://www.instituteforgovernment.org.uk/publications/transforming-whitehall-departments-0>
[19] Heseltine, M., *No Stone Unturned: In pursuit of growth*, BIS, March 2013, Annex D, retrieved 31 May 2013 <https://www.gov.uk/government/publications/no-stone-unturned-in-pursuit-of-growth>
[20] HM Treasury, *Government's Response to the Heseltine Review*, March 2013, Paragraph 1.13

than this will suggest the fund is not being taken seriously. It will also be important to note whether – given the Spending Round is for just one year – the Treasury is prepared to guarantee funding beyond 2015-16.

In any case, devolution is rarely successful when it is bureaucratic, rather than political, in nature. It requires political legitimacy and engagement – and real financial power. The London Finance Commission, which reported in mid-May 2013, argued for devolution of property taxes, business rates and Stamp Duty land tax to the capital.[21] Whether the political impetus for financial devolution to London is strong enough to overcome central government scepticism is another test case for decentralising power.

What happens next?

The most important period for public spending this year comes after the Chancellor announces departmental spending allocations. The current exercise merely sets totals in a Treasury spreadsheet. The hard work of planning what to do within these limits starts in earnest for departments after that.

As has been pointed out, there will be tough decisions about public spending to come after the 2015 election. Departments should invest now in understanding the choices available, and identifying areas in which collaboration with other departments or agencies – or even other tiers of government – would enable greater savings to be made. It will be impossible to have those discussions in the period of the run-up to the next spending review as at that stage departments – and their ministers – are competing over resources. Real spending reductions will only come about through collaboration, rather than the divide-and-conquer competition that spending rounds produce.

The Civil Service already knows this. In the Institute for Government's 2012 report on major change in government departments – *Transforming Whitehall Departments* – we found:

> Despite their shared interests, departmental change programmes have largely been driven in isolation from each other. But leaders in many departments believe they are now approaching the point where internal changes alone will not yield further large savings. As one interviewee said, 'there's really nothing left to squeeze'. This means collaborating will be essential, not optional, in future.'[22]

To enable this change in approach, Whitehall needs to look seriously at what incentives to put in place to drive cross-government work to identify further savings without jeopardising the quality of service provision. The Civil Service leadership – including politicians – will need to offer tangible commitment to enabling collaborative approaches to spending reductions. The Civil Service also needs to take a more strategic approach to financial management. It needs a much stronger ability to identify and deliver sustainable reductions in expenditure, rather than simply cutting short-term costs. After the spending round, it is essential that the Treasury provides increasing leadership in this area.

---

[21] London Finance Commission, *Raising the Capital,* May 2013, retrieved 31 May 2013 <http://www.london.gov.uk/priorities/business-economy/publications/raising-the-capital>

[22] Page J., Pearson J., Jurgeit, B. & Kidson, M., *Transforming Whitehall Departments*, Institute for Government (November 2012) p.44 (http://www.instituteforgovernment.org.uk/publications/transforming-whitehall-departments-0)