

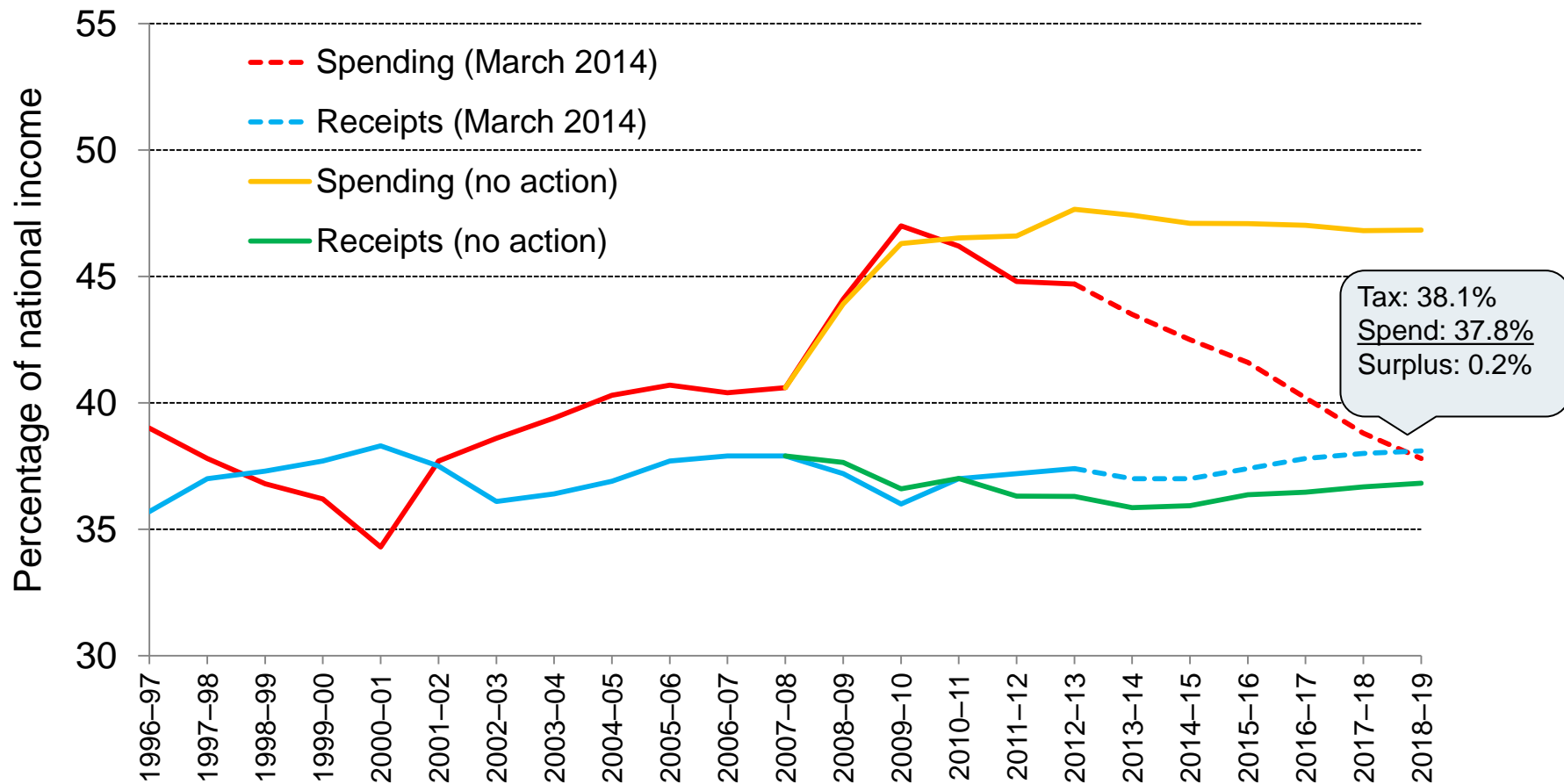
**UNIVERSITY
OF ABERDEEN**

Austerity post 2015

**Presentation by David Heald at the
'Five Years of the Institute for Government':
Academic Conference, 12 May 2014**

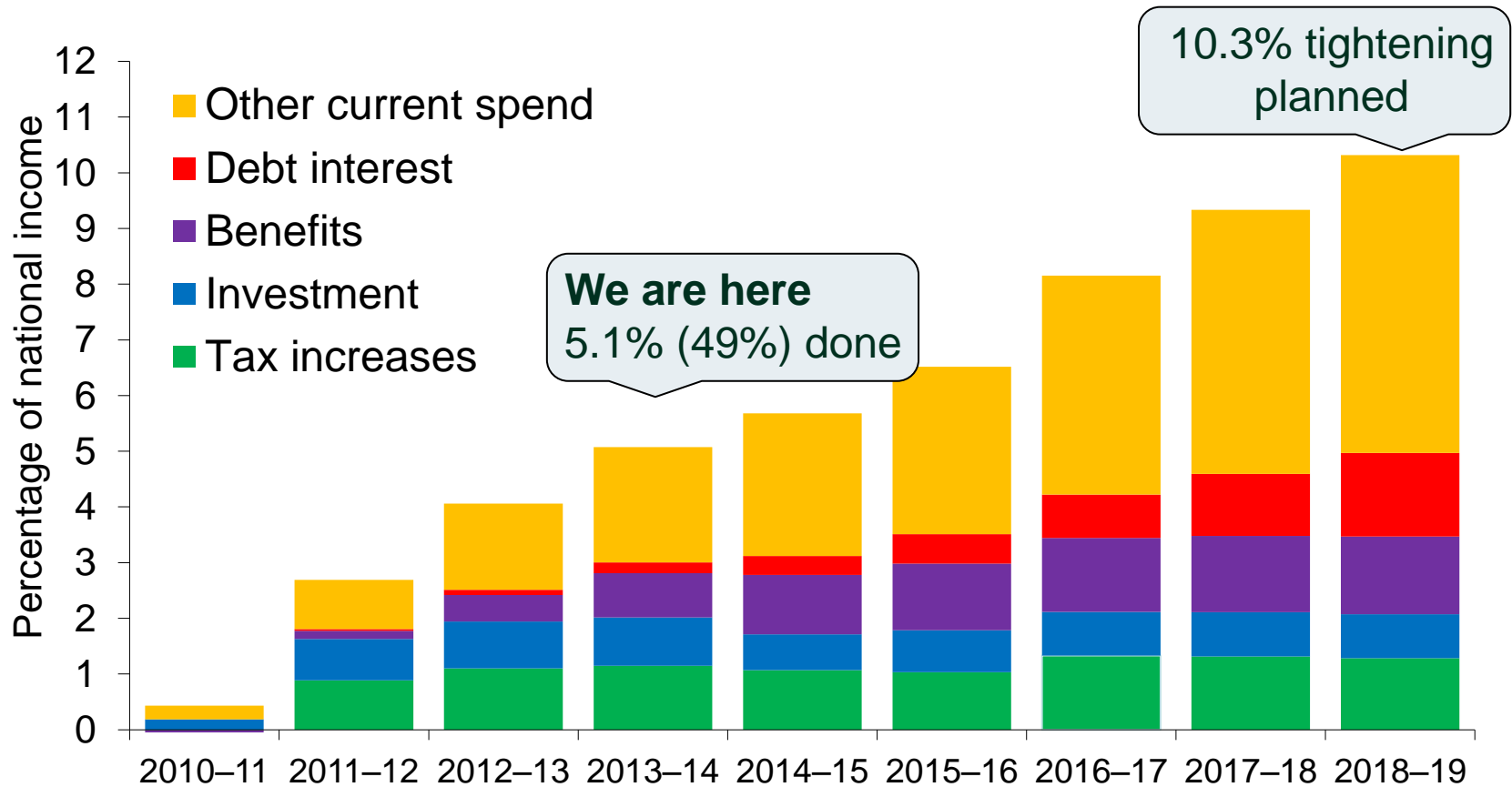
Thanks are due to the Institute for Fiscal Studies (permission to use slides 2 and 3) and to the Office for Budget Responsibility (permission to use slides 4 and 5). Interpretation of the data is solely my responsibility

Bringing tax and spend back to pre-crisis levels



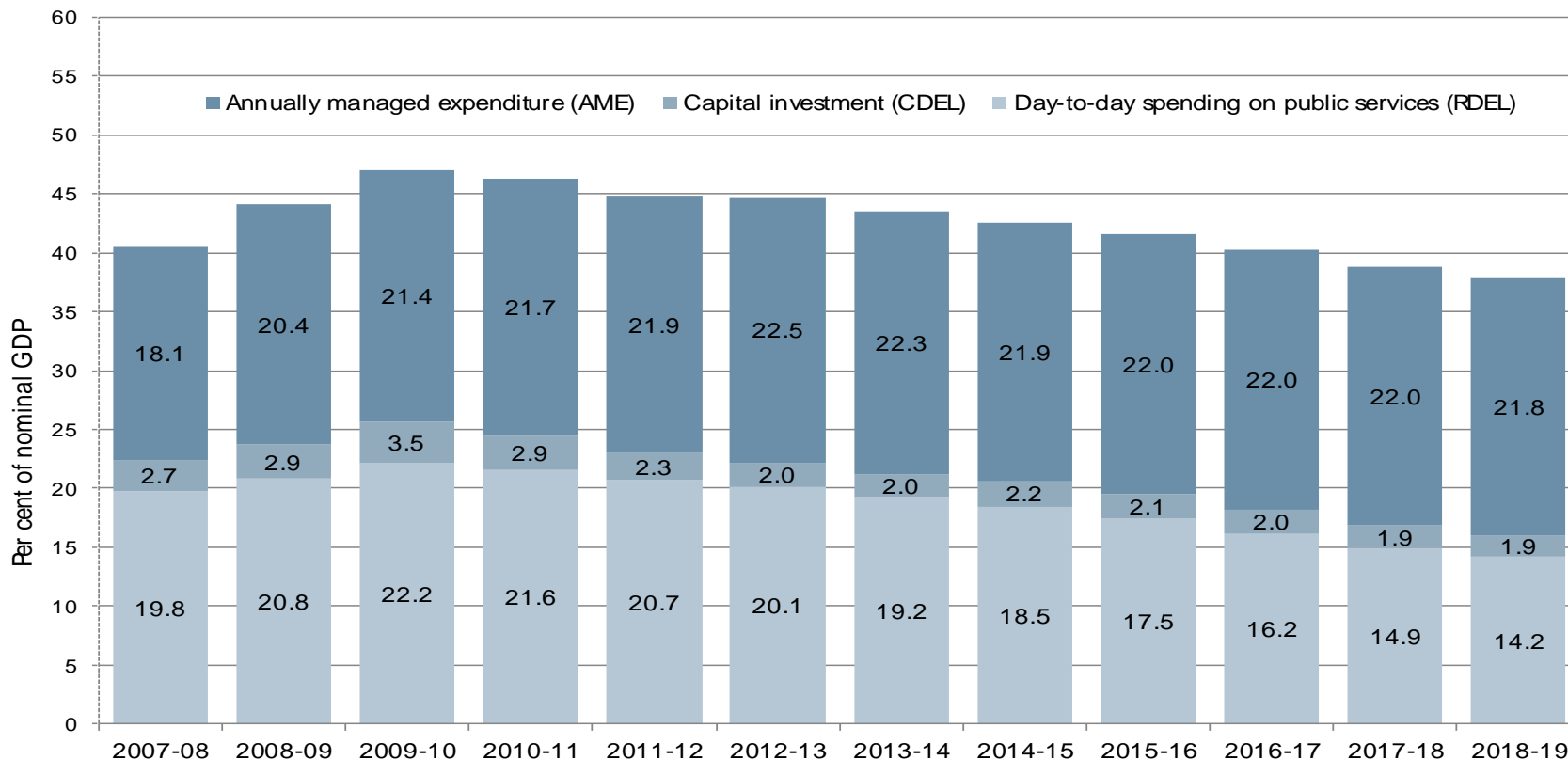
Note: Excluding Royal Mail and Asset Purchase Facility transfers. Source: ONS; OBR.

The planned consolidation



The squeeze on public spending

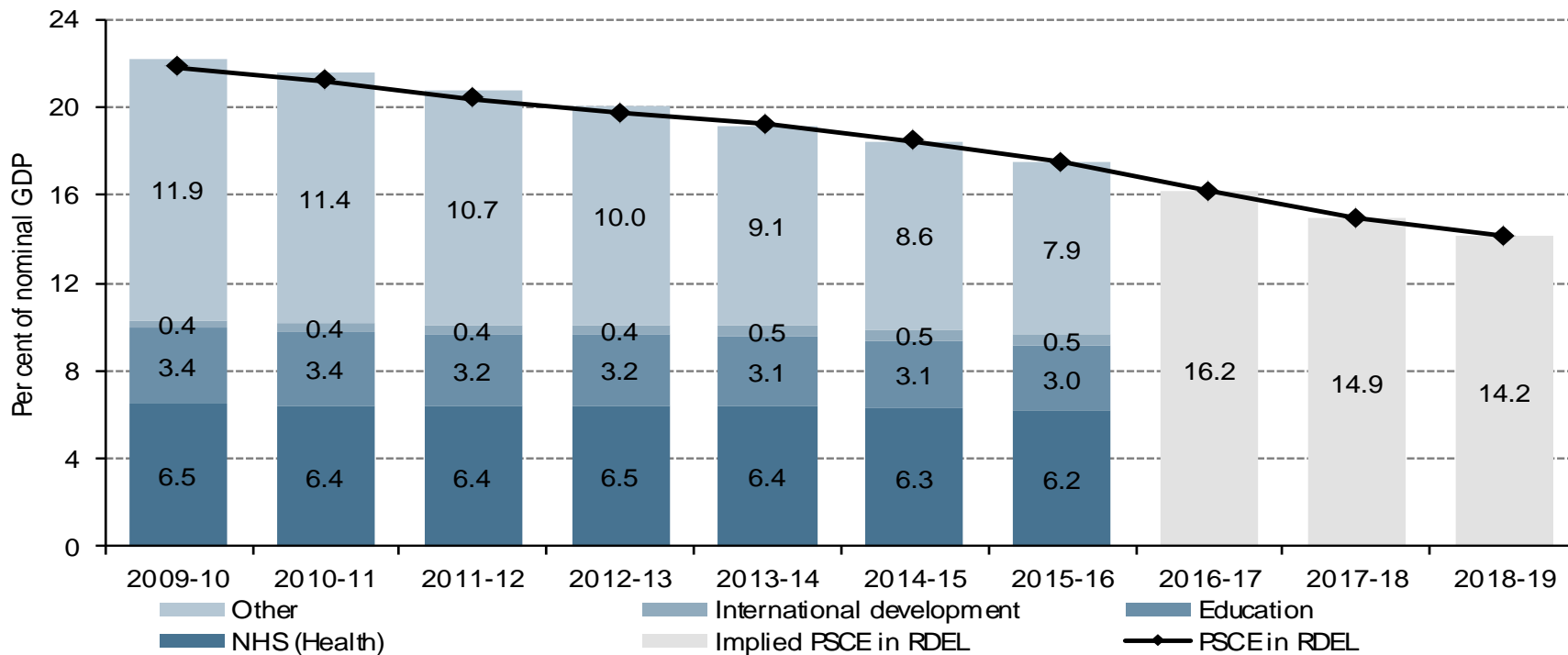
Budgetary presentation



Source: OBR and HMT. AME includes Single Use Military Equipment.

The squeeze on public spending

Current spending on public services and administration



Plans for RDEL excluding depreciation up to 2015-16. Beyond 2015-16 based on implied Public Sector Current Expenditure (PSCE) in RDEL calculated from the Government assumption for TME. Other includes unallocated amounts.

Source: HM Treasury, Budget 2014; HM Treasury, *Public Expenditure: Statistical Analyses*, July 2013

Context

- Striking periodisation in UK public finances:
 - 1993-97 Fiscal consolidation under Kenneth Clarke
 - 1997-99 Continued fiscal consolidation under Gordon Brown, holding inherited plans
 - 2000-07 Strong planned growth in public spending
 - 2007-10 Holding to 2007 plans during global financial crisis
 - 2010-15 Mostly expenditure-based fiscal consolidation under Coalition Government
 - 2015-19 Wholly expenditure-based fiscal consolidation in skeleton forward plans
- Post Budget 2014, the IFS estimates that planned fiscal consolidation will be 10.3% by 2018-19, representing eliminating the 8.9% estimated deterioration in the public finances since Budget 2008, 1.2% to remove the then deficit, and 0.2% surplus target. Macroeconomists argue as to whether the size of the 'hit' to the economy and public finances would have been smaller if there had been different macroeconomic policies after 2010
- Because of shortage of time for this presentation, all figures presented as ratio to GDP. However, ratio depends on denominator as well as numerator. Therefore must also look at path of public expenditure in nominal and real terms, and at composition (COFOG shows marked changes since 1990). Normally, expect a positive Relative Price Effect (public sector input prices rise faster than GDP deflator), so real terms over-estimate resource growth. Hunch that the reverse has been happening since 2010 (real wage reductions), so cuts in services not as deep as might seem from numbers. The opposing factor is that rapid population increase depresses per capita spend. 'Protection' for the NHS would mean real age-adjusted per capita spend in 2018-19 that is 9.1% lower than in 2010-11
- Note the narrow band (circa 36-38%) for tax/GDP since 1996-97 (Slide 2)

Thematic Question 1: Sustainability

Fiscal sustainability: Is the question about how to adjust to the UK being much poorer than expected or a desire to reduce the role of the state? This is one of the reasons why 'austerity' has become such a politicised word. OBR's 50-year fiscal projections indicate that present policies would involve a higher public expenditure/GDP ratio (demographic ageing etc), but are not particularly frightening at circa + 5%

Economic sustainability: Fiscal projections relate to public spending and taxation revenues, leading to claims about the 'unaffordability' of present public services. However, there is a broader question of what an economy can afford, as evidenced by US healthcare (18% of GDP), as opposed to what the government pays for. If governments provide less (load-shedding), at least four effects can be expected:

- (a) the revenues constraint will tighten (more taxpayers feel they get nothing back)
- (b) the market for 'talent' will drive up public sector costs (lost monopsony power)
- (c) more tax expenditures and 'coerced' private spending (car insurance as precedent to reduce coverage loss; enforcing higher minimum or living wage)
- (d) regulatory and competition issues will become more prominent and difficult

Political sustainability: Have UK political preferences changed so much that the outcome projected in slide 5 will in fact occur, or would the spending brakes be taken off after 2015 election? Political lock-ins have become a feature of British politics: Labour on tax and spend in 1997; Conservatives on spend up to September 2008; and Labour on spending and welfare cap in the run-up to the 2015 General Election. Remember Kenneth Clarke's later tease that 1997 legacy plans were not intended for implementation

Thematic Question 2: Institutional Performance

- Because the UK is such a fiscally centralised state, the 1998 spending control system (TME/DEL/AME) could be turned towards rapid spending growth in the 2000s and unprecedented expenditure cutbacks in the 2010s. These developments were the political choices of elected governments, nothing to do with spending being out of control. On conformity of outturn aggregate numbers with political goals, HM Treasury scores highly. The downsides are examined below and on slide 9
- The creation of the Office for Budget Responsibility has quelled the rows about bias in macroeconomic forecasts, though blame for forecast errors has been outsourced
- Parliamentary processes for the scrutiny of public expenditure are woefully inadequate, a reflection of long-standing Executive domination as well as lack of motivation and expertise within Parliament and staffs. Big questions about (a) whether Value-for-Money was secured from the 2000s' spending surge and (b) what are the effects of reductions on service quality, institutional resilience, and regulatory capacity. Issue of whether to establish a Parliamentary Budget Office, in part to undertake tasks (eg costing alternative policy proposals) that are outside the statutory remit of OBR and might be too politically risky for IFS
- On the International Budget Partnership's Open Budget Survey 2012, the UK came 3rd out of 100 countries. That should not be the basis for complacency, as some informal processes (spinning and arbitraging) are dysfunctional, not least in terms of public understanding. Forward data on spending by tier of government and function are longstanding gaps, as are sufficiently long time series

Thematic Question 3: Political Choices

- One possibility is to recognise that one way to preserve universal access to services in more complex circumstances is to raise taxation (slide 2 suggests that this will not be easy)
- Neglect of taxation issues, notwithstanding the Mirrlees Report: bizarre marginal rate of income tax/benefit withdrawal structures from multiple and 'privatised' (eg university and charity) means tests. Tax legitimacy threatened by impression that tax is voluntary for some
- There are significant dangers from 'innovations', even if 'doing good by stealth':
 - 'financialisation' of public sector commitments, making them difficult to score
 - possibility of legal cases arising from 'mis-selling' of student loans, mimicking PPI
 - government guarantees as off-balance sheet successor to PFI
- Reducing expenditure by contracting the role of the state:
 - fees and charges to create bigger gap between gross and net expenditure (NB administrative costs and impact on effective marginal rates)
 - affluence-based exclusion from benefits and services (if for child benefit and legal aid, would the same logic apply to the NHS and school education?)
 - self-exclusion from public services because of prestige attached to private substitutes, stigma attached to use of public service, or real/perceived quality deterioration

If policy goes down this route, how important is coverage, place in international league tables, and effects on productive capacity of the economy?
- Critical issue of restoring confidence in the governmental system, which has suffered erosion of legitimacy and loss of respect for competence and capacity to deliver. Outcomes may depend heavily on recovery of GDP and avoidance of future 2008-type shocks



Five Years of the IfG

Reforming the Civil Service:
Andrew Massey, University of
Exeter

The Brief



- Ten minutes to discuss:
- What Practical Lessons can we draw from the theory of civil service reform and modernisation?
- How can these lessons help the next government progress reforms already underway or consider new ones?
- Given the time constraint, I will run these two together.

Lessons of Reform:

What is the purpose of Reform?

- Structure, role, performance in delivery? In terms of effectiveness or efficiency or both?
- In terms of Outcomes or outputs?
- Constitutional role and position with regard to Ministers and Policy making
- Reform in terms of recruitment, training, culture, demographics.
- All of the above have been addressed by reformers and observers of reform.

There is no theory of reform, there are theories and fashions and reform is difficult

- 19th Century, Northcote-Trevelyan
- World War 1 and Modernising Whitehall – Haldane
- World War 2 and the new model – draft in experts from where you find them to where you need them
- Post war, tinkering from Churchill's attempts at coordination to Fulton's review – all influenced by a welfarist basic state intervention view of society and the role of the state.
- Public Choice (Chicago, Virginia, Austria) brought in with the reforms from Thatcher to the present day – seeks small state and sees the business model as superior to a notion of the public sector ethos.
- Is reform politically voluntary (Thatcher) or enforced by circumstance (the Coalition)

Lessons?

Politics, Politics, Politics

- Context is important, Political, institutional, historical and temporal, geographical and economic. What works in London might work in Korea, but does so for different reasons – don't just copy.
- Understand what is driving the reform. Lack of money or lack of success? Was New Zealand wedded to NPM or simply bankrupt?
- Work towards clear outcomes, linked to the purpose of the reform.
- Micro-manage where necessary, but be strict in terms of limiting this – link it to a clear long-range strategy.
- Never underestimate the importance of Political support and the need for effective change management – eg the Efficiency Unit and also privatisation in Kenya.
- As Chisholm wrote, you need continuity and change, institutional memory to make it work and evidence to show why it ought to work.
- You have to sell the reform to those being reformed and to wider elites – link it in with broader needs and drivers – Stephen Wilks and Jonathan Slater on Boardisation of departments.

Life is not a bowl of cherries, it is a series of trade-offs

