



# anticipating budget cuts

With the public sector faces inevitable budget cuts, David Walker looks at the hard choices facing those in the firing line.

■ **Choose your metaphor, as long as it's scary. Try ice and snow. The public sector is entering a glacial age (says Steve Bundred, Chief Executive of the Audit Commission). At best, spending will be frozen as we move into the next decade; at worst it will melt away quicker than an icicle in spring sunshine.**

Alternatively it's apocalypse now. Malcolm Prowle of Nottingham Business School talks of catastrophic reductions. Masochists are having a field day. Carl Emerson of the Institute of Fiscal Studies (IFS) predicts 'two parliaments of pain'. Spending is going to be 'eye-wateringly tight,' say commentators.

Doom mongers are out in force. Projections of public spending come in three sizes: bad, worse and Armageddon. Public sector executives could be forgiven if they started

digging shelters in the back garden and stocking up on tinned goods for the duration – which will be until at least 2020 or even 2040 according to the darkest predictions.

## grim predictions

Are things really as bad as the colourful language suggests? In his April Budget Chancellor Alistair Darling – himself hardly a bundle of fun – set out official predictions for the general shape of the public accounts, and they are grim. The Institute for Fiscal Studies, which is scrupulously independent, says they don't tell the full story, which is even worse.

But not quite yet – the freeze doesn't start until next year at the earliest. Besides, we can't make direct inferences from the big financial picture for spending by individual

local authorities (which can make discretionary adjustments to council tax and charges), or for individual services. There's a danger, too, that downwards adjustments to spending and taxation are held to be inevitable, when they rest on choices – by ministers, councillors, taxpayers and the voting public.

The Chancellor (in the face of criticism from the Conservative opposition in Parliament) did not change the aggregate spending plan that has been running since April 2008. And that's generous. Public spending is rising by 4.6% a year in real terms and that looks likely to continue during the final year of the three year planning period, 2010-2011. (As a proportion of a shrinking gross domestic product, public spending is rising fast.)

So public sector employment remains

buoyant and no dramatic cuts in public services are in prospect for at least 12-15 months, though that won't stop individual groups of public sector staff complaining or the emergence of gaps between demand and supply.

### 2011 spending plan

As things stand, a new spending plan would come into force in April 2011 and money will be scarce. But spending would continue to grow, according to the Treasury's Budget projection, by 0.7% a year in real terms till the end of March 2014. Now, however, we are in the realm of speculation. If spending on schools and healthcare were protected (which both Labour ministers and their Tory shadows seem to agree on), disproportionate reductions would be visited on defence, social care, policing, universities and the rest; as for public sector investment, it would disappear. (Only if, miraculously, the Private Finance Initiative, which has had to be bailed out by the state, were to revive would further schools and hospitals get built.)

### brutal changes

The Institute for Fiscal Studies guesses that spending on everything except schools and health could shrink by 2-3% a year in real terms between 2011 and 2014. Since up to two thirds of spending goes on staff, that has to mean brutal changes to public sector employment. The Tories have talked about cutting pay by 10% in real terms. Big cuts in headcount are also implied. Unless private sector employment is growing markedly, to take up the slack, the logic of that is more joblessness.

Of course between now and the start of the new spending period, we have the little matter of elections to the Westminster Parliament. The fiscal 'envelope' is one thing. Decisions made by a new government with its own sense of priorities and commitments are another. Calculations also depend on assumptions about the net cost of government borrowing – now low, because interest rates are so low – and economic recovery, whose green shoots are so avidly looked for, high and low.

David Cameron wants to avoid being pinned down. The more specific Tory commitments, the louder the opposition, even before the elections. Public sector staff are not, the polls say, inclined to support the present

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government; would they vote Tory if it meant pay and job cuts?

Temperamentally and ideologically, the Tories might prefer to cut spending rather than raise taxes in order to stabilise then reduce government borrowing as a proportion of GDP. Most experts say they would probably have to do both.

### firing line

Inescapably local authorities are going to be in the firing line, as spenders and service providers and, to a limited extent, bodies which raise revenue. So far they have had a 'good crisis'. In England, the Local Government Association cites Lancashire and Essex county councils, and their efforts to increase credit and job training; strong counter-cyclical action has been taken by Gateshead and Salford councils among others.

But next, they will have to think about their own finance and organisations. Lucy de Groot, who recently stood down from the chief executive's job at the Improvement and Development Agency, says councils have innovated but must now 'think outside the box'. They will have to look at their business and staffing models, staff and organisational structures and consider economies of scale.

Mike Turley of the business services firm Deloitte says this is a great opportunity to revive 'shared services'. District councils will have to band together to purchase finance, human resources and other services at lower cost. Supplying companies such as Serco are licking their lips – on the assumption that they can supply services at lower cost and councils will have no option but to contract for them.

### freedom and flexibility

Some commentators think that councils will acquire more freedom and flexibility. Roger Latham, the former Chief Executive of

Nottinghamshire County Council and incoming President of the Chartered Institute of Public Finance and Accountancy, argues that the UK is one of the most centralised states in the world. Our systems of planning, managing and controlling public expenditure are very much 'command and control' and where this is abandoned 'savings of between 30% and 40% have been achieved, simply by getting rid of wasteful, non-value added, and redundant activities, especially in relation to inspection'.

### choices begin

But here is where the politics and choices begin. The balance between private consumption and collective activity could in theory shift. Councils could raise more money – for example if land and property were taxed at levels seen in other countries. The IFS has guessed £2800 worth of extra tax per household a year at today's prices will be needed between now and 2018 to restore a desirable balance between revenues, spending and borrowing.

Say student fees rose £500 and council tax £500 (over eight years), the BBC licence fee were increased £15, the extra tax would be £1785. Adjust corporation tax, value added tax, stamp duty, inheritance tax and so on, the extra income tax required could shrink well below £1,000 per household – or 3% of median household income now, a smaller proportion of median income in 2018, assuming economic growth picks up. Is that excessively onerous? The judgement is necessarily based on values and political proclivities.

What is certain is that a lot more attention is going to be paid to the distribution of spending and payments than during the period between 2000 and 2011, when money was flowing. There's talk of more 'targeting' of benefits and a move away from 'universal' payments such as old age pensions and child benefit. But universal benefits tend to command universal assent and taxpayers at large may be less willing to pay for benefits that are confined to the few, however needy.

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**David Walker is managing director, communications and public reporting at the Audit Commission. These are his views.**