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Spending Review 2010

Parliament rising to the challenge

The 2010 spending review took place against a complicated backdrop that has developed over the past decade or so, compounded by events across the world in 2007/8. These global events were brought about by irresponsible lending by some banks and the inability of other institutions to recognise the toxic nature of debt that they were sold, in the form of securitised loans. Effectively, someone had worked out that if good and bad mortgages were put together, the loans granted to NINJAs (no income, no job or assets) would magically become less insecure.

The result was the banking collapse that exacerbated the tendency of many governments, including our own, to borrow to cover current as well as capital expenditure, rather than collecting sufficient tax to cover the outlay. Perhaps we should all share some of the blame, because few of us actively considered that asset values could not continue rising for ever and that the bubble had to burst. In our defence, this is not the first time that it has happened – nor will it be the last. But the end of the 'dotcom' boom in 2000 should have acted as a greater warning to us all.

As a result, the UK is currently one of the most indebted countries in the world with sovereign debt representing some 77% of gross domestic product (GDP) – nothing like as bad as Greece's 130%, or Italy's 118%, but bad enough. In fact, at £109 billion, our structural deficit is the largest in Europe.

Whether or not we were, as the Chancellor claimed, on "the brink of bankruptcy", there can be no doubt that such high levels of borrowing are unsustainable. To put this into context, we are currently paying £120 million every day of the year in interest. One of the reasons that this is manageable at the moment is because we enjoy the best credit rating at "AAA". If the ratings agencies and money markets felt that we would no longer be able to afford to pay the interest, they would slash our rating and the interest rates we pay would rise.

As the Chancellor pointed out, we do not wish to saddle our children with the interest on the interest on the interest of the debts we were not ourselves prepared to pay.

The choice is simple; we face cuts in spending or massive increases in taxation.

Outline

The plan is to eliminate the structural (as opposed to cyclical) deficit over the life of this parliament. This does not, however, mean that spending will fall immediately and this is something that needs to be recognised when looking at the principal measures put in place.

Cuts are essential

Next year, current expenditure will be £651 billion, then £665 billion the year after, £679 billion the year after that, before reaching £693 billion in 2014-15. In fact interest payments will reach £63 billion by 2014/15, because, as the Chancellor said, it takes time to turn "the debt supertanker". However, the cuts put in place will reduce interest payments by a total of £5 billion over the course of the spending review, compared with what would otherwise have been the case. That is the equivalent of building 16 new hospitals and represents capital spending falling from £51 billion next year to £47 billion in 2014/15.

How will this be achieved?

Accepting a fair share of the burden

The Chancellor repeated the fairness mantra, that those with the broadest shoulders should bear the greatest burden, reinforcing this with a commitment to reform so that savings can be made and waste eliminated. His other point – perhaps to pre-empt fears about possible double-dip recession – was that he wanted to encourage growth through the measures introduced.

Many of the measures had already been announced, others were widely predicted. So this review, in some respects, brings together the known and guessed at, with a smattering of good news announcements as well.

Public service reform

Hopefully job losses will be balanced by new job creation elsewhere

The principal thrust of reform is to secure better value for money – something all politicians talk about, but few have managed to achieve. In particular, many Quangos are being abolished or integrated and some assets will be sold, but in an effort to cut Whitehall costs by £6 billion (twice as much as promised) departmental administrative budgets will be cut by a third.

This will, of course, result in some job losses – estimated at 490,000 over 4 years by the Office for Budget Responsibility – but with a staff turnover of 8% it is anticipated that a large proportion of this can be accounted for by simply not replacing leavers (although some redundancies are inevitable).

Many of the public sector job losses can probably be made up by the private sector, which created 178,000 jobs during the third quarter of 2010 alone.

Importantly, there will be a re-balancing of responsibilities so that local government is able to take more decisions and be accountable to their communities, rather than having central decisions made for them. It is hoped that this will result in a massive reduction in bureaucracy, leaving more for front-line services. For example, Government revenue grants to local authorities will no longer be ring-fenced, except for schools and public health grants. Councils will also be able to fund key projects by borrowing against future increases in locally-collected business rates.

Social issues

The disadvantaged must be cared for

An additional £2 billion will be allocated over the period to provide for social care and money will be made available for 150,000 new affordable homes to be built over the next four years, while £1.1 billion is being made available for Disabled Facilities grants.

Security featured prominently in the review, as recently flagged by the Strategic Defence Review, but the principal focus will be on security at home. While police spending is to fall by 4% a year. The Government is determined that this should not result in a fall in front-line policing efficiency. £1.3 billion will be provided to maintain the existing prison estate and fund essential new-build projects, but plans for a new fifteen hundred place prison have been deferred.

The NHS will be protected with total health spending rising by above inflation each year. However, efficiency savings will be expected in return for additional funding, which will rise to £114 billion by 2014/15.

Taxation

Banks must contribute too

It was made clear that the financial services sector (largely the banks) will be expected to make a significant and ***sustainable*** contribution towards tax revenues, so the banking levy has been made permanent. Banks will also be required to sign up to the Code of Practice on Taxation, which only four out of fifteen have so far done.

More generally, there will be a clampdown on tax and welfare fraud – this will affect those who work in the so-called 'black economy' as well as welfare cheats.

Pensions

As already announced, the basic state pension will, in future, increase in line with the highest of inflation, average earnings and 2.5%, so that there will never again be derisory 75p a week increases.

The link to earnings has been too long coming

The age at which pensions can be drawn was already set to rise from 65 to 68 by 2046. In fact women are already going through a process of having their state pension entitlement put back from 60 to 65. This will now change so that the state pension age will reach 66 by 2020 for everyone, with the additional change starting in 2018, not 2016 as had been widely forecast.

While reaffirming that the Government wishes public service pensions to be a gold standard, it is recognised that some reform – as outlined in John Hutton's interim report – is essential. When the scheme was established in the 1950s, taxpayers covered half the cost; now it is two thirds, which is unsustainable. The results of the final review will be available in 2011.

Welfare reform

Welfare spending now accounts for one third of all public spending and increased by 45% during the past 13 years. Yet the system is failing so many people from the young to the elderly. It also unfairly benefits some non-working families at the expense of hard-working ones.

A new simple Universal Credit system is therefore proposed that will mean that it is always better to work than not and the Chancellor has set aside £2 billion over the next four years to facilitate changes over the next two parliaments, to ensure that the result is fair. No family that doesn't work will receive more in benefits than the average income of a family that does go out to work.

The system is failing many people

The Child Tax Credit is being increased above the rate of inflation for the next two years but, as expected, Child Allowance will no longer be available to higher rate taxpayers – which the Chancellor says is fair.

For older people, benefits such as free eye tests, prescriptions, bus passes and TV licences (for the over 75s) will remain, while the Winter Fuel Payment will remain at the level set by the previous Chancellor and the Cold Weather Payments made permanent.

Education

While the Train to Gain programme is to be abolished, 50% more will be put into the adult apprenticeships programme, helping 75,000 new apprentices a year by the end of the four year period. The Department for Business, Innovation and Skills will have to make £400 million savings in administrative costs, but the 7.1% overall saving in costs will not require any savings in the science budget, which is protected at £4.6 billion a year, as this is seen as vital to economic growth. There should, however, be some efficiency savings.

Science has long been a powerhouse of the economy

Environment

Capital funding of up to £1 billion will be made available for one of the world's first commercial scale carbon capture and storage demonstration projects. £200 million will also be invested in the development of off-shore wind technology and manufacturing at port sites.

Alternative energy must be embraced

£1 billion has been set aside for the creation of a Green Investment Bank and 'Green Deal' will encourage home energy efficiency at no upfront cost to homeowners, allowing the Warm Front programme to be phased out.

Summary

As expected, this is a harsh review from which few people will emerge unscathed. There are some capital projects relating to the infrastructure which will benefit the construction sector as well as easing travel for commuters and businesses. Investments in schools will rise and a new £2.5 billion pupil premium will support the education of disadvantaged children.

Overall, however, the aim of this review is to halt the rise in public borrowing and we can only hope that, by cutting £81 billion from public spending over four years, it works. But it must do so without reducing economic growth by too much.