Local Government Association

Finance Panel
23 November

Item 1

Autumn Statement

Purpose of report

For discussion and direction.

Summary

The Chancellor of the Exchequer is expected to make his Autumn Statement to Parliament on 5 December. The Statement is likely to have implications for the outlook for councils' future funding. This note provides an advance outline of the issues and invites Members to consider the LGA's possible objectives for communications around the Statement.

Recommendation

Members are invited to consider the messages in **paragraph 23**.

Action

LGA Officers to proceed as directed.

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1. The Chancellor of the Exchequer is expected to make his Autumn Statement to Parliament on 5 December. The Statement is likely to have implications for the outlook for councils' future funding. This note provides an advance outline of the issues and invites Members to consider the LGA's possible objectives for communications around the Statement.

The economic and fiscal background

2. The global economy is still living with the events in the financial markets of 2008 and 2009. In those years markets stopped being able to price credit risk and a vast credit bubble burst as a result. Lenders and borrowers throughout the financial system were put at risk. Some failed, often spectacularly. Ever since, credit markets have been sustained mainly by bank nationalisations and central bank intervention. A large amount of risk, much of it potentially still mispriced, remains in the system. As the Governor of the Bank of England said last month:

   I am not sure that advanced economies in general will find it easy to get out of their current predicament without creditors acknowledging further likely losses, a significant writing down of asset values and recapitalisation of their financial systems. (Sir Mervyn King, Governor of the Bank of England, 24 October 2012)

3. Financial players are still deleveraging and repairing their balance sheets. This is bad news for anyone who cannot avoid continuing to borrow, but particularly bad news for the largest borrowers: governments. Their special problem is that they are accountable both for their own financial viability, and for the performance of their countries' economies. They need both to limit the debt they are unloading onto a reluctant market, and to balance deficit reduction against the economic impact of taking the deficit stimulus away.

4. The British Government based its fiscal policy on an economically-expansionary deficit in the period after 2001-02, and maintained it at a steady 3 per cent or so of GDP in most years between then and the 2008 crash, when it ballooned as tax revenues fell off and spending grew, reaching 11.1 per cent of GDP by 2009-10. A significant proportion of the continuing UK Government deficit is structural.

5. Historically, governments have tended to get out of difficult deficit situations by combining a number of approaches; these tend to be

   5.1. growth, which (a) shrinks the ratio of deficits and debt to GDP and (b) boosts tax receipts;

   5.2. inflation, which does the same thing but also cuts the real value of public spending;

   5.3. putting up taxes;

5.4. cutting spending.

6. In the UK right now, both growth and inflation are not only low by historical standards, but growth is much lower than expected when the path for the public finances was set. This means the two least painful deficit reduction options are not going to help much.

7. Meanwhile, the Government's political reluctance to put up taxes has been reinforced by the reality of what is happening to the tax base. Tax receipts in 2012-12 are forecast to account for above their average share of GDP over the last two decades. Forecast growth in overall receipts has, however, been marginal. Tax increases since 2010 worth over 2 per cent of GDP have simply arrested a decline. The underlying tax base is stagnating.[1]

8. This economic and tax background means an ideological filter is not needed to explain the Government's choice to focus two-thirds of its deficit reduction on spending measures (although it may well be appropriate to apply one).

The public spending problem

9. Although the Government is focussing its deficit reduction efforts on managing spending, it is with one exception not planning to cut total spending year on year[2]. Current spending is forecast to rise in every year until 2016-17, albeit by a marginal amount: just over 1 per cent a year in cash. The Government's public spending cuts in reality take two forms:

    9.1. reductions in forecast – not actual - spending compared to previous projections and plans;

    9.2. actual cuts to some programmes made necessary by the Government's choices to increase spending on some items within a fixed total.

10. The Government has previously committed to protect real-terms spending growth in the NHS, schools, defence procurement and foreign aid.

11. The Government also has no choice but to allow growth in demand-led spending on debt interest and welfare payments. The Government's cuts in welfare entitlements only mitigate the growth pressures in this expenditure: it is projected to continue growing.

12. What this means in practice is that about three-quarters of all current spending is protected and will grow. The remaining spending is being cut hard as a result. The

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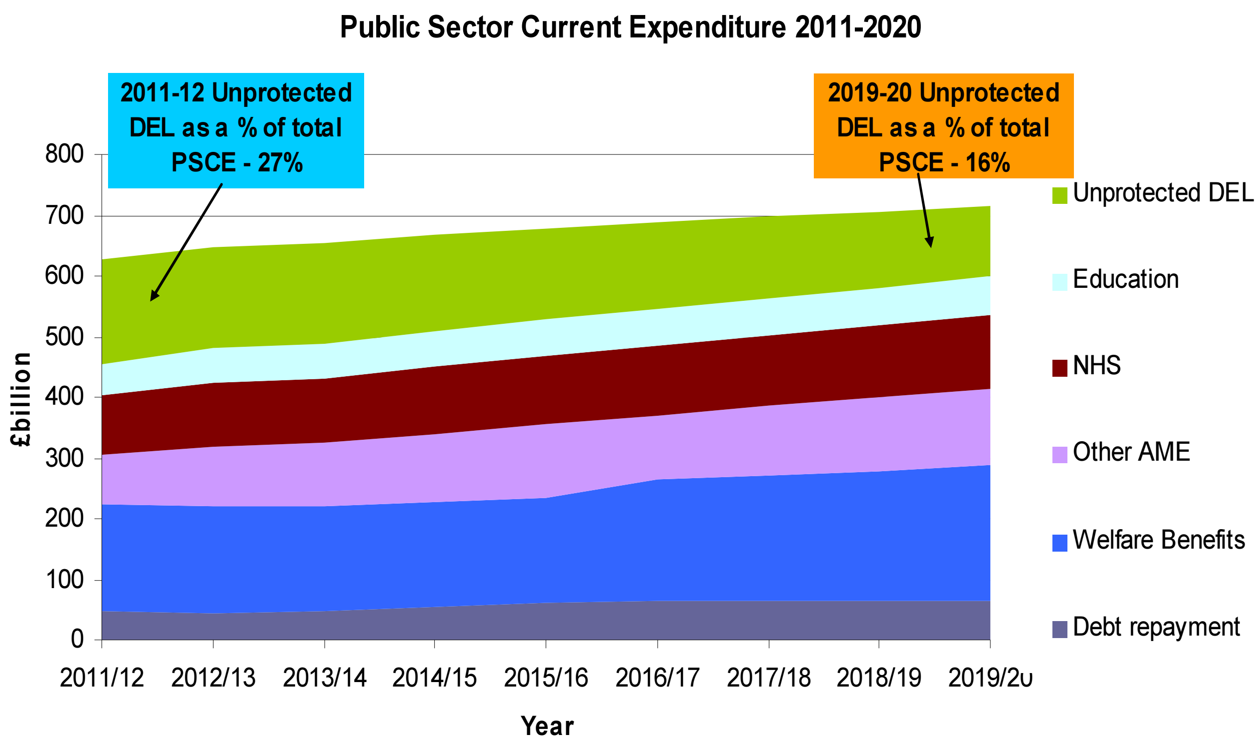
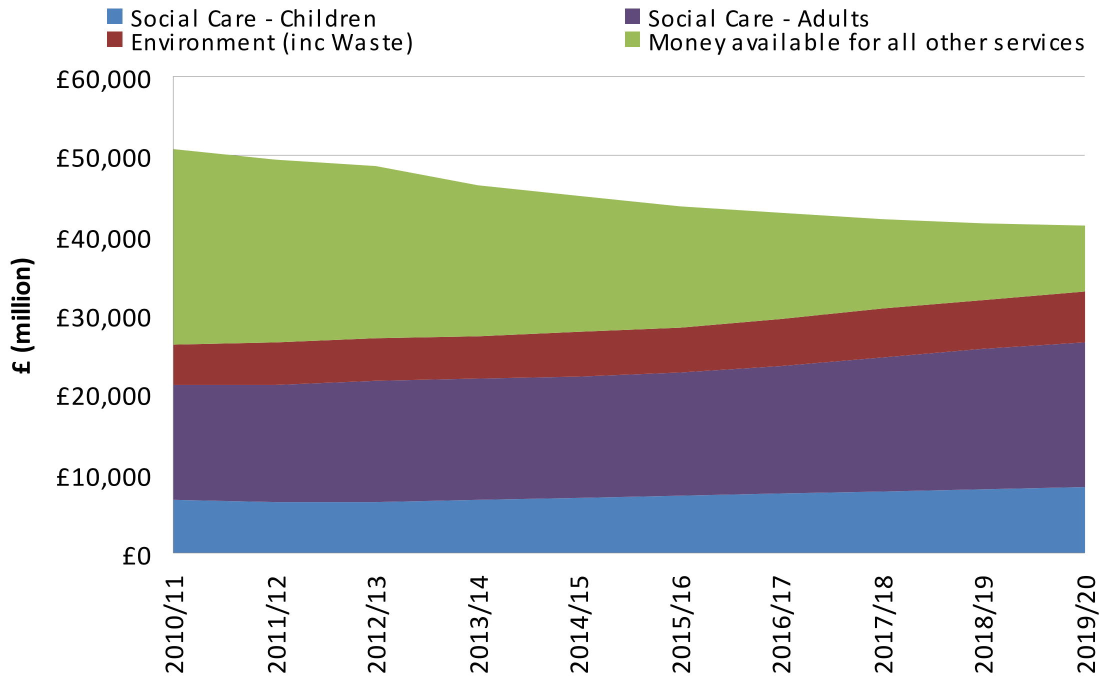
[1] This is not principally a problem caused by economic slowdown: there is a structural decline in the base for many important taxes such as fuel duty (cars are using fuel ever more efficiently), tobacco duty (fewer people smoke), or the council tax and business rates (real-terms contraction by policy choice). There are some economic factors, too. Corporation tax receipts used to be heavily dependent on the financial sector which is now not only unprofitable but has amassed ample losses to offset against future tax bills. Wages are stalled, so taxable incomes are not rising.
[2] A drastic capital cut in 2012-13 means that is the only year in which Total Managed Expenditure falls year on year, by 1.9 per cent.

graph below illustrates the point. Using the Office for Budget Responsibility's projections for spending after 2015, we estimate that unprotected spending will fall, on existing policies, from 27 per cent of total current spending to 16 per cent over the course of this decade.



Source: Office for Budget Responsibility, Budget 2012; LGA estimates

13. Grants to local government are of course part of this unprotected category and are being cut in cash by 28 per cent between 2011-12 and 2015-16. By combining projections for those grants with projections of modest growth in revenue from localised business rates and the council tax, the LGA has derived a revenue projection for councils for the rest of the decade. Councils also face their own need to protect some spending: for the purposes of the LGA's modelling we assumed that spending on social care and waste fell into that category. The resulting model, which we published in July, showed that council spending on all other services – the "residual of a residual" - was likely to fall by two-thirds over the decade. If council debt interest payments and concessionary travel were to be added to the tally of protected spending, remaining budgets face cash cuts of nearer 90 per cent over the decade under the assumptions in the model. Although this model has been challenged by some Ministers as too pessimistic, it is worth noting that our revenue projections assume a return to growth in council tax revenues which the same Ministers have ruled out since the model was published.



Graph 2: LGA projections of future council revenue and spending

Source: LGA, July 2012

14. We do not expect the Autumn Statement to make major revisions to the Government's fiscal approach. Nor do we expect it to open up the prospect of a further full-dress spending review. Most likely, the Government will take a minimalist approach to revising its spending plans in advance of a 2015 election, by adding a single year of detailed plans for 2015-16 at some point over the next year and leaving a multi-year spending review to the next Parliament. We can probably also expect some action to shore up tax receipts, probably through anti-avoidance measures.

15. We do, though, expect the Autumn Statement to revise tax and spending projections in the light of the latest economic forecasts. At the time of the Budget, the Office for Budget Responsibility gave the Government a 60 per cent chance of meeting its fiscal mandate on existing plans. Since then, new data and forecasts have suggested that the downside risk to the Government's plans have increased:

    15.1. borrowing outturns have been above forecast, and receipts below; October's borrowing was £8.6 billion, compared to £6 billion in October 2011, in part due to a 10 per cent fall in corporation tax receipts;

    15.2. growth projections for the UK and its major export markets have been revised down, with the EU Commission now forecasting growth of 0.9 per cent in the

Eurozone in 2013 compared to the 1.1 per cent forecast by the Office for Budget Responsibility alongside this year's Budget.

16. Those developments would suggest that the Government needs to take further action on tax and/or spending in order to remain on track to meet its 2015 fiscal mandate. A recent estimate by the RSA and Social Market Foundation indicated that the Government needed to make an additional £22 billion of spending cuts or tax rises by 2017-18.

17. The political climate remains unfavourable to tax increases. We can expect the Government to concentrate any further adjustment on spending. Among the avenues it might consider pursuing are:

    17.1. further measures to contain growth in welfare spending; the Chancellor's Budget indicated that the Government was considering a further package of welfare cuts worth up to £10 billion a year and some details of what that might involve have since been discussed in the press;

    17.2. using the emerging evidence of underspends in Whitehall departments to justify further cuts in departmental budgets for 2013-14.

18. It is a possibility, of course, that grants to councils will be included in any further downward revision of 2013-14 spending plans.

A response from the LGA

19. Our work in July showed that councils face a £16.5 billion funding gap by the end of the decade. The prospect of further council tax freezes makes that larger. As the separate paper for this meeting of the Panel argues, the Government has also proposed a number of adjustments to the 2013-14 settlement that would be the equivalent of a further £1 billion reduction in grants.

20. At the same time, the Audit Commission's report *Tough Times II* has shown that auditors are raising concerns about financial stress in a number of councils. Both small districts and major cities are affected, and some newspaper reports are already identifying individual places. Demographic pressures of social care remain pressing and care funding is, by general consent, in crisis.

21. And – wider Keynsian arguments about the pace of deficit reduction apart – it is clear that the budget pressures on councils are affecting their ability to take measures to promote local economic growth.

22. None of this is to diminish the importance of the actions councils are taking to reduce costs and improve efficiency and productivity. Two-thirds of councils are now engaged in shared services. Many are sharing chief executives and other officers. The pilot work on community budgets is demonstrating that material savings can be made through better collective working across the local public sector. But all of these are necessary measures to address the existing funding gap, and they only help to manage it, not close it.

23. Members are invited to consider the following messages which might shape our overall approach to the Autumn Statement:

    23.1. councils' track record as the most efficient part of the public sector is a reason why they are coping better with the existing plan to impose greater cuts on them than on other frontline public services; but it is not a reason why they can cope with yet further cuts; the emerging evidence shows that the limits of what is possible have already been passed in some places;

    23.2. the crisis in adult social care requires extra funding, now;

    23.3. ringfenced protection on some central Government budgets is no longer looking justifiable;

    23.4. artificial constraints on the local taxbase compound the nation's overall fiscal problem and must be lifted;

    23.5. the evidence from the four pilots shows that the potential medium-term contribution of community budgets to reducing the cost of services locally cannot be ignored;

    23.6. the Heseltine Review and City Deals have identified ways to boost growth by using existing budgets better under devolved control; these must be taken seriously and implemented;

    23.7. locally-funded capital expenditure is about the most effective short-term demand stimulus there is: councils have shown they can borrow under the prudential code in a responsible way; and moreover tend to have strongly positive balance sheets; the Government should free up council borrowing by removing the cap on HRA borrowing so councils can invest in social housing; and there is also a case for taking council borrowing out of the Treasury's PSBR measures altogether;

    23.8. the Government cannot continue localising extremely hard political choices about spending while continuing to duck tough decisions about low-value central Government policies such as free TV licences or concessionary fares for well-off pensioners.

24. Members will also wish to be aware that we are also further building our evidence base to make these arguments, including by updating the July future funding modelling, and by commissioning an external report which aims to affirm the role that local government can play in driving economic development at a local level; to get a sense of how that role is affected by policy reform and spending cuts; and to set out new options for the future where councils support growth, new jobs and wealth creation. An interim report is likely to be available shortly.