***The 2010 Emergency Budget was more transparent than any recent Budget about its likely impact on Departmental spending. But the detail is still to come in the impending Spending Review***

## Introduction

Although the 2010 Emergency Budget is likely to have the greatest impact of any budget for many years, it actually merits rather less comment than recent Labour Budgets and Pre-budget Reports (PBRs) – hence this somewhat shorter update than some of the commentaries we have produced in the recent past.

There are two main reasons for this apparent paradox. The first is that the Budget has set the broad fiscal framework and clear targets for reducing the deficit, but the detail of how this will be achieved will not become clear until the Spending Review has been completed. What the Budget did do was confirm the date on which the Spending Review will report – 20 October 2010. This sets a challenging timetable to complete a complex and rigorous process, explained in more detail in our note last week. (http://www.i-a4e.com/blog/wp-content/uploads/2010/06/The-2010-Spending-Review.pdf )

The second reason is that the Chancellor was much more open than his predecessor about the impact of his macro-level proposals on individual spending departments. After previous Budgets and PBRs we have been heavily reliant on independent experts such as the Institute for Fiscal Studies (IFS) to crunch the numbers and work out the implications, and especially estimate the likely impact on Departmental spending plans. However Mr Osborne, unlike Mr Darling, has told us himself what the impact of his proposals will be

## The scale of the challenge

In a new spirit of increased openness, the Budget report states clearly and for the first time, the extent by which the government estimates spending will have to fall to meet its new fiscal target of eliminating the structural current deficit by "the end of the forecast horizon" (2015/16). To achieve this the Treasury calculates that unprotected Departmental Expenditure limits (DELs) – that is those other than health and overseas development – will need to be cut by an average of 25%. However since the media is likely to report this in cataclysmic terms, it is worth noting that we have been in much the same boat for some time. For although this government intends to cut deeper and faster than Labour, it has not, unlike Labour, committed to protect education spending and has also made some cuts to welfare spending, which, as part of Annually Managed Expenditure (AME), offset cuts in DELs. . As a result the cuts needed to DELs are broadly the same as they were before the election – the IFS calculated that Labour's March 2010 budget implied average cuts to unprotected DELs of between 20 and 25%.

However the net effect on individual departments and budgets may still be better or worse than this headline 25%, for a number of reasons. First, the government has already said that it will ensure that the burden of cost reduction is less severe on both education and defence. The IFS have calculated that if these two areas suffer cuts of only 10%, the average reduction elsewhere would have to be a third.

Second, the above numbers assume no further cut in AME, notably on welfare and public sector pensions. Such reductions are quite likely, either by design or because the targeted reductions in DELs prove impossible to achieve. The IFS has again calculated that the overall cut in DELs would be a mere 20% if AME could be reduced by £13bn, at 2010/11 prices; and would be only 15% if cuts of £26bn in AME could be achieved. Alternatively, combining a reduction in AME of £13bn with reductions to education and defence of only 10% would leave other Departments back where they started – facing a 25% cut in DELs in cash terms, or 14% in real terms, by 2014/15.

For a view on how hard all of this will be to achieve, please read any of our other Budget or public expenditure commentaries over the past year– we do not propose to repeat it all here, except to note that the IFS has again pointed out that no-government has achieved, or even attempted six consecutive years of public spending reduction since the Second World War. Indeed the new Office of Budget Responsibility estimates that the government has only a 60% chance of achieving its own fiscal target

## Other observations

There are some other points in the budget which are worthy of note.

First, the government proposes no further cuts in capital spending beyond those already announced by its predecessor and those included in its own initial package of £6.2bn spending reductions. This and the fact that it has set a target to balance the fiscal *current* deficit, excluding capital, suggest that it at least recognises the value of public sector investment – which is not to say that the largely inherited reductions in spending that the government will now implement, are not already steep – see Figure 1.

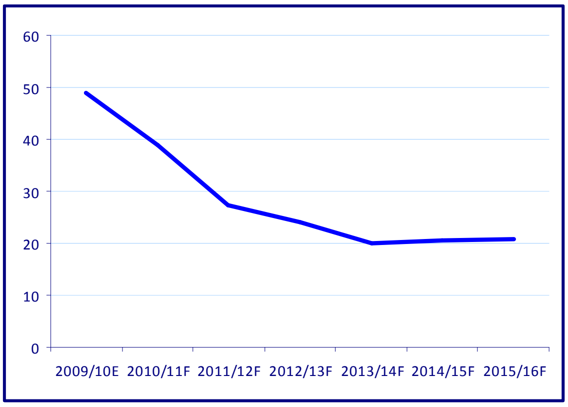


**Figure 1 – Public Sector Net Investment 2009-16 (£bn)**

Second, all the calculations that the IFS and others make about the scale of cuts needed are of course dependent on the government achieving what it is proposing. There is, for example, no guarantee that with RPI inflation currently running at more than 5%, the government will be able to hold the line on a public sector pay freeze for two years.

Finally, the Budget announced various cuts in welfare benefits in order to make some inroads into AME, notably through reductions in tax credit entitlement. However these will further increase disincentives to work by adding to the problem of very high so-called marginal effective tax rates for those coming off benefits. This only adds to a problem which the government's welfare reforms, as explained in our recent note (http://www.i-a4e.com/blog/wp-content/uploads/2010/05/Coalition-proposals-for-welfare-reform.pdf) are expressly designed to address by making it easier and more fiscally advantageous for those on benefit to seek work. So it can be argued that the immediate imperative of cutting spending is already impeding progress towards other, more long term policy objectives.

## Implications

So what does all this mean for the public service industry? The short answer is: very little that we did not already know – except at the margin of exactly how much money will be saved and where.. As noted above, the Budget has confirmed and refined the scale of the fiscal challenge and has inflicted some immediate pain with regard to tax and benefit reduction. But the depth and allocation of the pain as regards public spending remains to be addressed during a long hot summer of Spending Review. Perhaps it is time for all of us to stop going on about the scale of the cuts – the worst since Thatcher, the worst in living memory, the worst since the Second World War. Like winning a World Cup overseas, maybe it's time to start thinking about how we actually do something we have never achieved.

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