The economic, fiscal and funding outlook

Kate Ogden, IFS
David Phillips, IFS
Worsening growth outlook (from a higher base)

Real GDP forecasts

2024 growth forecast: +0.7%
+1.8%
+0.1%

Source: OBR Economic and Fiscal Outlook, Bank of England Monetary Policy Report
But with higher inflation boosting nominal growth

Higher inflation, and more tax rich growth, more than offsets impact of lower real growth on revenues

Freeze to income tax and NICs thresholds now forecast to raise £51 billion in 2027–28 (£14 billion higher than under the March 2023 forecast)

Source: OBR Economic and Fiscal Outlook
All of the windfall spent…

On average over the final three years of the forecast, 93% of the windfall is offset through fiscal loosening.

In November 2022, Mr Hunt offset just 18% of the deterioration since March 2022 through fiscal tightening.
Tax cuts paid for by spending cuts

Tax cuts announced in Autumn Statement 2023

Cuts in NICs rate only offset 1/5 of the freeze in NICs and income tax thresholds

Tax burden still set to rise to over 37% of GDP (up from 33% pre-COVID)

Public spending set to take up over 3% more of GDP than pre-COVID – with around half of this increase due to higher debt interest

Source: OBR Economic and Fiscal Outlook

Note: The reduction in real-terms generosity of public service budgets refers to the cash top-up to Total Departmental Expenditure Limits (TDEL) that would be required to maintain the real-terms generosity of spending plans at the level specified in the 2023 Spring Budget. Source: IFS calculations using OBR Economic and Fiscal Outlook (March and November 2023), HM Treasury Spring Budget 2023, and HM Treasury Autumn Statement 2023.
Departmental settlements are now less generous across the board

Planned average real-terms growth in selected day-to-day budgets over the parliament

- March 2023 plans
- November 2023 plans

Overall Resource DEL
Health and Social Care
Justice
Education
Home Office
Defence
Core spending power

Average real-terms growth 2019–20 to 2024–25

Cuts pencilled in for after the next election

Illustrative change in day-to-day funding implied by latest plans, 2024–25 to 2028–29

- 0.9% growth in line with NHS workforce plan
- 3.6% held flat in real-terms
- 0.0%
- 1.8% constant as a share of GDP
- 1.8% constant as a share of GDP
- 30.6% growing to fund March 2023 Budget announcements

Cuts for unprotected budgets in England, accounting for Barnett consequentials for Scotland, Wales, and Northern Ireland
- -1.8%
- -3.4%
- Cuts for other unprotected budgets (incl. local government, further education, courts, prisons, HMRC, etc)
- C. £20bn required in 2028–29 to avoid cuts
- Constant as a share of GDP
- Growing to fund March 2023 Budget announcements

Funding in 2023-24 stretched less far than planned

- Relatively large cash increase in 2023-24 at last settlement (~9%)
- Inflation has been much higher than expected (6.1% vs 3.2%)
  - Far outweighs additional social care funding (£365m announced post-settlement)

- Even this likely understates cost rises facing councils this year
  - Timing effect, as contracts updated with a lag
  - NLW increased 9.7% April 2023
  - First half of 2023, children’s social care spending up 16%; homelessness up 26%
  - Budgeted to drawdown £1.9bn reserves in 2023-24 and likely to exceed this
What was announced at the settlement for 2024?

Significant increase in CSP of £3.9bn (6.5% cash-terms) in 2024-25:

- £2.1bn from **council tax**, just over half the total increase (and additional rises for some)
- £1.2bn from continued indexation **business rates** revenues and RSG to CPI (6.6%)
- £1.0bn increase in **social care grants** (pre-announced, plus £365m post-settlement for 2023 and £205m in 2024)
- £406m reduction in **Services Grant**
- ‘One-off’ **funding guarantee** increased from £133m to £197m

- Inflation expect to fall (to 1.7%) → real-terms increase of 4.7%
- But high inflation this year still feeding through to costs
- NLW set to increase by 9.8% in April 2024
How have plans changed?

Real-terms CSP compared to 2021-22, under different plans

Note: Real-terms figures reflect the most recent GDP deflator forecasts when plans were announced.

Local Govt Funding Outlook
How has CSP changed since 2015?

Core spending power since 2015

Real-terms

Real-terms per capita

Core spending power in cash terms since 2015

Index: 2015-16 = 100

Note: Change in core spending power excludes the impact of rolling in grants.
Source: Provisional local government finance settlement 2024-25; OBR EFO – November 2023; ONS 2022-based population estimates.
Very similar CSP increases by deprivation

Note: Social care grants includes rolled-in MSIF workforce fund in 2023–24. Deprivation deciles are based on IMD 2019 Average Score at the upper-tier authority level. Main council types only.
Source: Provisional local government finance settlement 2024-25; and OBR EFO – November 2023; English Indices of Deprivation, 2019.
What might happen after 2024-25?

- **Council tax**: underlying OBR assumption that referendum limits will be unchanged
  - Is this plausible as inflation (and earnings growth) expected to be closer to 2%?
- **BR revenues**: CPI expected to fall so will increase more slowly
- **Grant funding**: Tight spending plans (if stuck to) imply cuts
  - Local govt saw larger than avg grant cuts during austerity (as able to raise own revenue)
  - But >90% of grant funding for main councils ring-fenced for social care → harder to cut?
  - Cuts in line with average (3.4% real-terms) would mean c£150m fall in grants each year
Scenarios for 2025-26 onwards

Year-on-year changes in core spending power for main councils

CT referendum limits: 3% plus 2%
Grants: cut by 3.4% real-terms p.a.

Note: Main council types only. Assumes 1% p.a. growth in council taxbase and maximum use of council tax flexibilities. BR revenues indexed to CPI and include changes in rolled-in grants, except for MSIF. Excludes above-baseline growth and assume no base growth.
Scenarios for 2025-26 onwards

Year-on-year changes in core spending power for main councils

CT referendum limits: 3% plus 2%
Grants: frozen in cash terms

Note: Main council types only. Assumes 1% p.a. growth in council taxbase and maximum use of council tax flexibilities. BR revenues indexed to CPI and include changes in rolled-in grants, except for MSIF. Excludes above-baseline growth and assume no base growth.
Scenarios for 2025-26 onwards

Year-on-year changes in core spending power for main councils

CT referendum limits: 2% plus 1%

Grants: cut by 6.8% real-terms p.a.

Note: Main council types only. Assumes 1% p.a. growth in council taxbase and maximum use of council tax flexibilities. BR revenues indexed to CPI and include changes in rolled-in grants, except for MSIF. Excludes above-baseline growth and assume no base growth.

Scenarios for 2025-26 onwards

<table>
<thead>
<tr>
<th>CT referendum limits</th>
<th>Grant funding</th>
<th>Average annual change in CSP cash (real-terms)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3% plus 2% ASC precept</td>
<td>3.4% real-terms cut p.a.</td>
<td>3.8% (2.0%)</td>
</tr>
<tr>
<td>3% plus 2% ASC precept</td>
<td>Cash freeze</td>
<td>4.0% (2.2%)</td>
</tr>
<tr>
<td>2% plus 1% ASC precept</td>
<td>6.8% real-terms cut p.a.</td>
<td>2.2% (0.4%)</td>
</tr>
</tbody>
</table>

Likely to see small real-terms increases in funding each year
But more downside risk than upside
And reliance on council tax for increases presents challenges…
Scenarios for 2025-26 onwards

Average annual change in core spending power between 2024-25 and 2028-29

CT referendum limits: 3% plus 2%

Grants: cut by 3.4% real-terms p.a.

- Least deprived
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- Most deprived

Note: Main council types only. Assumes 1% p.a. growth in council taxbase and maximum use of council tax flexibilities. BR revenues indexed to CPI and include changes in rolled-in grants, except for MSIF. Excludes above-baseline growth and assume no base growth, and no changes to grant allocations.

Pain delayed?

- Expect councils to be reliant on CT for overall increases in funding → larger increases in more affluent areas
- Govt could address this ad hoc through grant allocations, but harder when funding constrained
- We still lack a proper local government finance system
  - “The government remains committed to improving the local government finance landscape in the next Parliament… Now is not the time for fundamental reform”
  - Funding increasingly disconnected from patterns of need across the country
- Reform must happen at some point, and will only get more difficult