The Chancellor prepares the medicine

2010/24

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The Chancellor has not been short of advice as he prepares for judgement day next week. The emergency Budget, promised by both the Conservatives and Lib-Dems in their election manifestos, takes place on 22 June just 42 days after the Coalition Agreement was signed.

It will be an important, possibly historic, moment not just for the Chancellor but arguably for the Coalition and the country as a whole, as the picture of the economy takes shape and the framework for what by all accounts will be one of the most challenging Spending Reviews that the country has faced for a long time, is set.

The Coalition came in promising that the economy would be its top priority and things have moved pretty quickly as a result. They began with the Chancellor's announcement in the first week of a new office to provide independent assessments of the nation's finances, the Office for Budget Responsibility (OBR;) this published its first assessment this week, an 80 page *"dose of economic realism"* according to one City analyst. Things moved on a week later to the announcement of an initial savings package, £6.2bn worth of cuts to be achieved this year. And they continued last week with announcements from the Chancellor about how the Coalition would go about conducting this year's Spending Review, *"we are committed to carrying out Britain's unavoidable deficit reduction plan in a way that strengthens and unites the country."* In between, we've had the Prime Minister's team talk to the country, "*we must tackle Britain's massive deficit and growing debt"* and the Chancellor's set piece Mansion House speech.

The trail is therefore being carefully laid and a sector like education is very much in the forefront as the government seeks to strip out what it sees as *'bureaucratic encumbrance,'* re-direct funding to the frontline and ratchet up demands in return.

The context is a fairly significant review of just what government does and why. The question may be financial, 'why do we spend money on this or that' but the outcome may be a major overhaul of just what role the state should play and just how public services should be offered. Evidence is emerging of a series of questions being asked within Whitehall which will ultimately shape how things are done and why. The Chancellor's recent speech about the procedures for the Spending Review, for instance, cited nine full-frontal questions that Depts should ask before committing funds. The very first question is, *"is the activity essential to meet government priorities?"* others include, "*does the government need to fund this activity?" "does the activity provide substantial economic value?"* and *"how can the activity be provided more effectively?"* Just last week in his 'Denning' lecture, Vince Cable spelt out how such questioning was being played out *we now have a window of opportunity for a genuine public debate about what government does and just as importantly how it does it. We should not waste it. This is just what I have asked my officials to do at the Dept of Business*in his Dept of Business, Innovation and Skills; *""*

So as we move into this more challenging, probing period, what pointers have we got about the state of the economy and about the sort of advice that the Chancellor has been receiving about future funding options?

This week has seen a number of statistics released on the health of the economy. Inflation, for instance, based on the Consumer Price Index, fell slightly to 3.4%, with hopes of a level 2% early next year, unless the Chancellor changes things drastically in next week's Budget. Unemployment has dropped slightly from March to 2.47m but with continuing concerns about the number of economically inactive people, up to record levels at 8.19m, the number of people out of work for more than a year, up 85,000 to 772,000 and the number of young people out of work, up 11,000 to 926,000.

But perhaps the most significant figures have come from the Office for Budget Responsibility (OBR,) significant because they are the first set of independent figures on the economy from this new body and as such are being viewed with more regard and less suspicion than previous government figures. The headline messages from their June 2010 *'Pre-Budget forecast'* are that growth forecasts should be trimmed back to 1.3% this year and 2.6% next year with a similar figure for the medium-term. These contrast with the Alistair Darling projections in his March 2010 Budget of 1-1.5% for this year and 3-3.5% next year. Secondly, that interest payments on the debt alone are likely to reach £67bn by 2014/15, not far off what the government currently spends on schools. Thirdly, and more optimistically, that net borrowing will be lower than Alistair Darling had predicted, £23bn lower over the next five years largely because of higher tax receipts and fourthly, that the chances of slipping into a double dip recession, something that rears its head in occasional media headlines, are in the OBR's view "*unlikely*."

These and other figures in the OBR's Report were, according to its chairman, *"our best shot at an impossible task"* but whether they confirm George Osborne's claims that Labour have left things in a mess or whether they are being used to soften us up for cuts ahead, remains unclear. *The Times* opted for the former, arguing that it was now clear that a further £85bn in savings was needed and even more ominously that *"the economy may never recover from the banking crisis." The Independent* took the latter path arguing that things are not as bad as "*the dramatic rhetoric"* of senior Ministers suggests. As for the experts, the Institute of Fiscal Studies point to the forthcoming Budget as being "*painful*."

On the medicine needed, plenty of bodies have offered prescriptions.

The Reform think tank, for example, in their alternative Budget, '*Taking the tough choices*,' took the Canadian model as its example to suggest a number of areas where savings could be found using a ratio of seven-eighths spending reduction, one-eighth tax rises. Nothing would be ring-fenced and the savings would be spread across Depts over the lifetime of the Parliament. The biggest chunks, just over £55bn would come from welfare and health while education would contribute £35.7bn and business £19bn. Specifically these savings would come from abolishing Building Schools for the Future, phasing out "*most*" teaching assistants, incentivising schools to reduce costs, reducing low-value skills programmes and charging interest on student loans.

Another think tank, the Social Market Foundation, in its recent '*Axing and Taxing*' Paper proposed a 60:40 split between cuts and tax rises. Their view was that "*investment in skills, education and infrastructure should be maintained to foster social mobility and economic growth."* They would thus recycle savings into more effective skills provision where possible. Finally, the CBI in a Paper on *'Reforming public services and balancing the budget*,' called for a much more co-ordinated and efficient system to deliver public services. It leaves the Chancellor carefully weighing out the medicine.

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The Chancellor is advised about what medicine is needed