

The distributional impact of the 2010 Spending Review

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CASE, 26 January 2011

Outline of presentation

- The distributional effects of spending changes:
 - Allocating spending (and cuts) to households
 - How much of each service is being cut?
- Present impacts by:
 - Point in the income distribution
 - Family type
- Combine tax & benefit changes with service cuts to illustrate overall impact
- Explore wider uses of this type of analysis in tax & spending debates

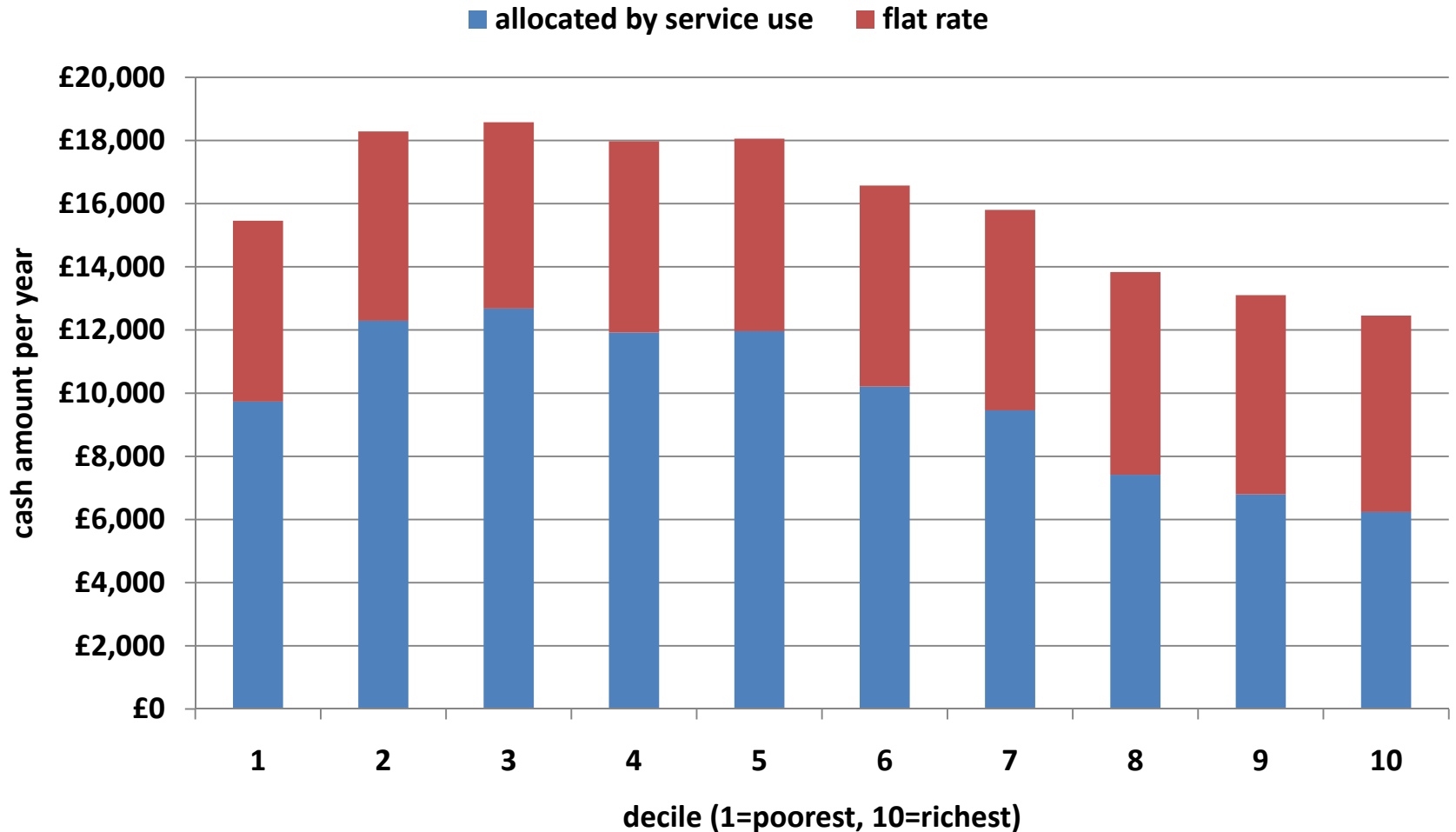
Modelling the distributional effects of public spending

- Tim Horton and Howard Reed (September 2010) '*Where the Money Goes: How we benefit from public services*'
<http://www.tuc.org.uk/extras/wherethemoneygoes.pdf>
- We use household data on service **use** to model the effects of spending on several areas, most importantly:
 - Health (GHS)
 - Education (FRS)
 - Social Care (BHPS)
 - Social Housing (FRS)
 - Transport (EFS)
 - Crime (BCS)

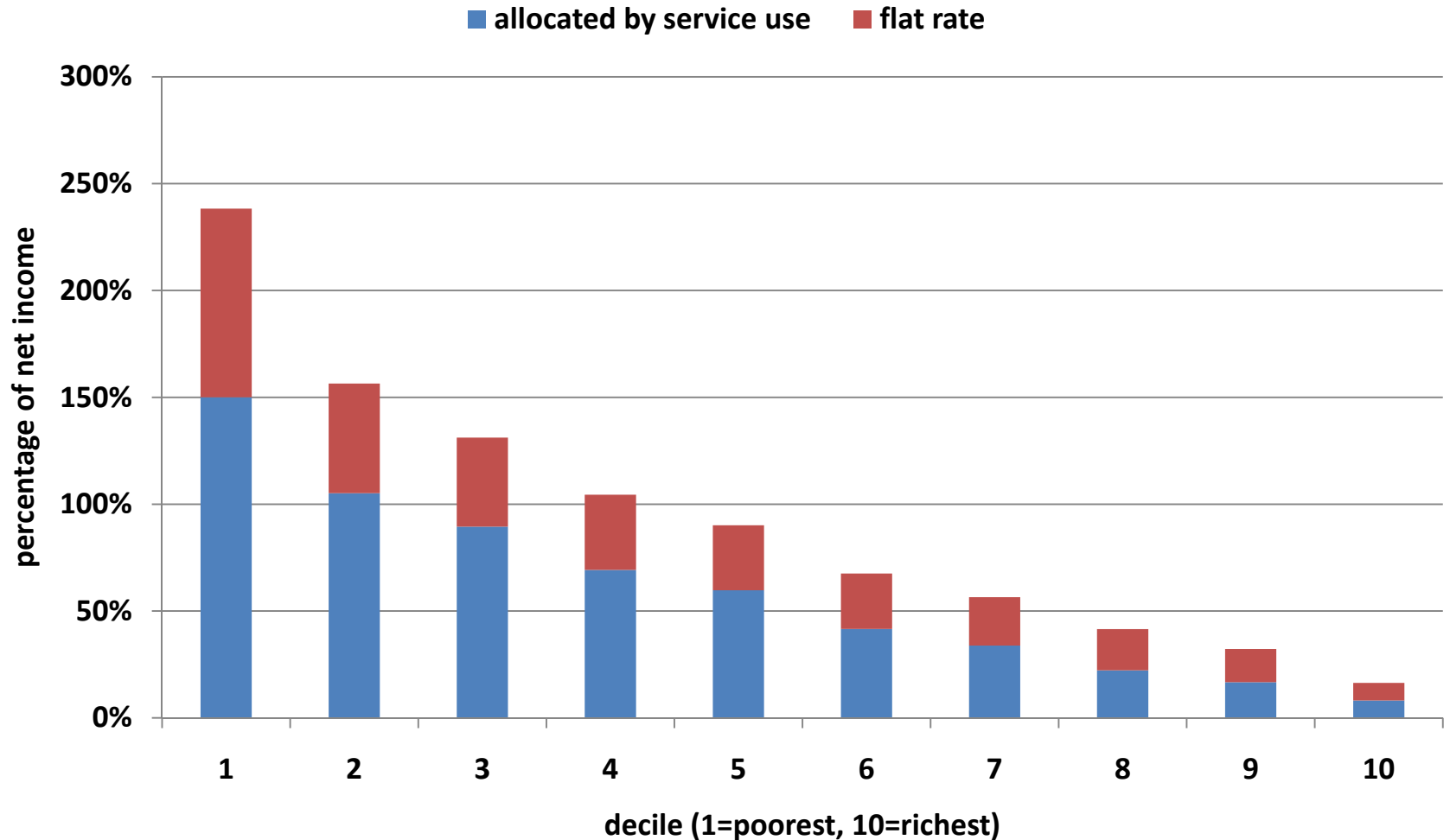
Modelling the distributional effects of public spending

- Where we have no data to assign services to households or where it doesn't make sense conceptually (e.g. defence, environmental protection etc.) we allocate services on a **flat-rate** cash basis according to household size
- The model only includes 'services-in-kind' – not transfer payments such as benefits or tax credits (which other studies have looked at, e.g. IFS)
- We include current *and* capital spending (assuming capital spending has similar distributional impacts to current)
- Thus the model allocates *all* spending on services to households (Treasury's analysis in CSR Appendix B only allocated around 50% of spending at best)

Average public spending on services by household income: cash terms



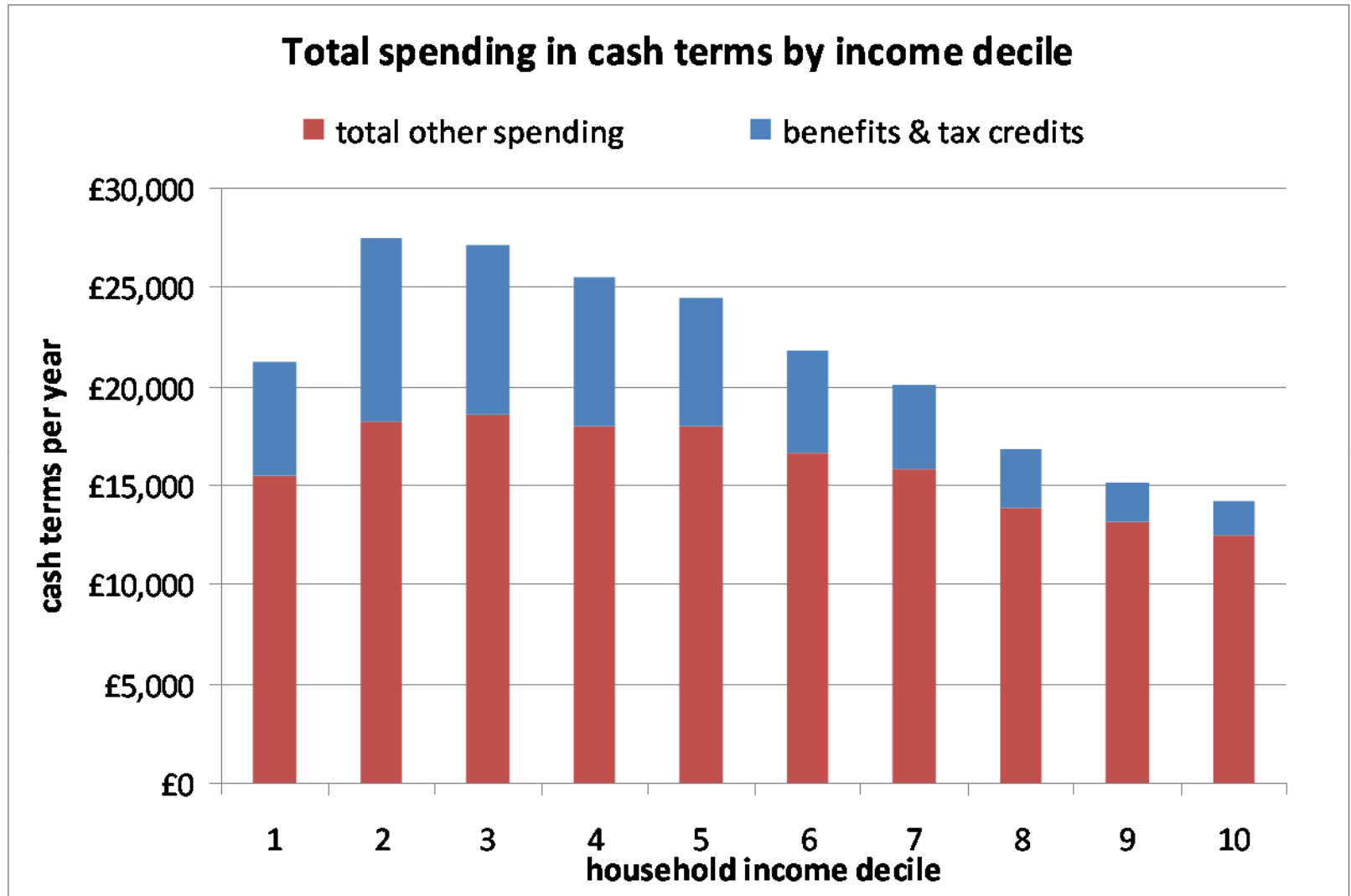
Average public spending on services by household income: percentage of net income



What is the real value of public services?

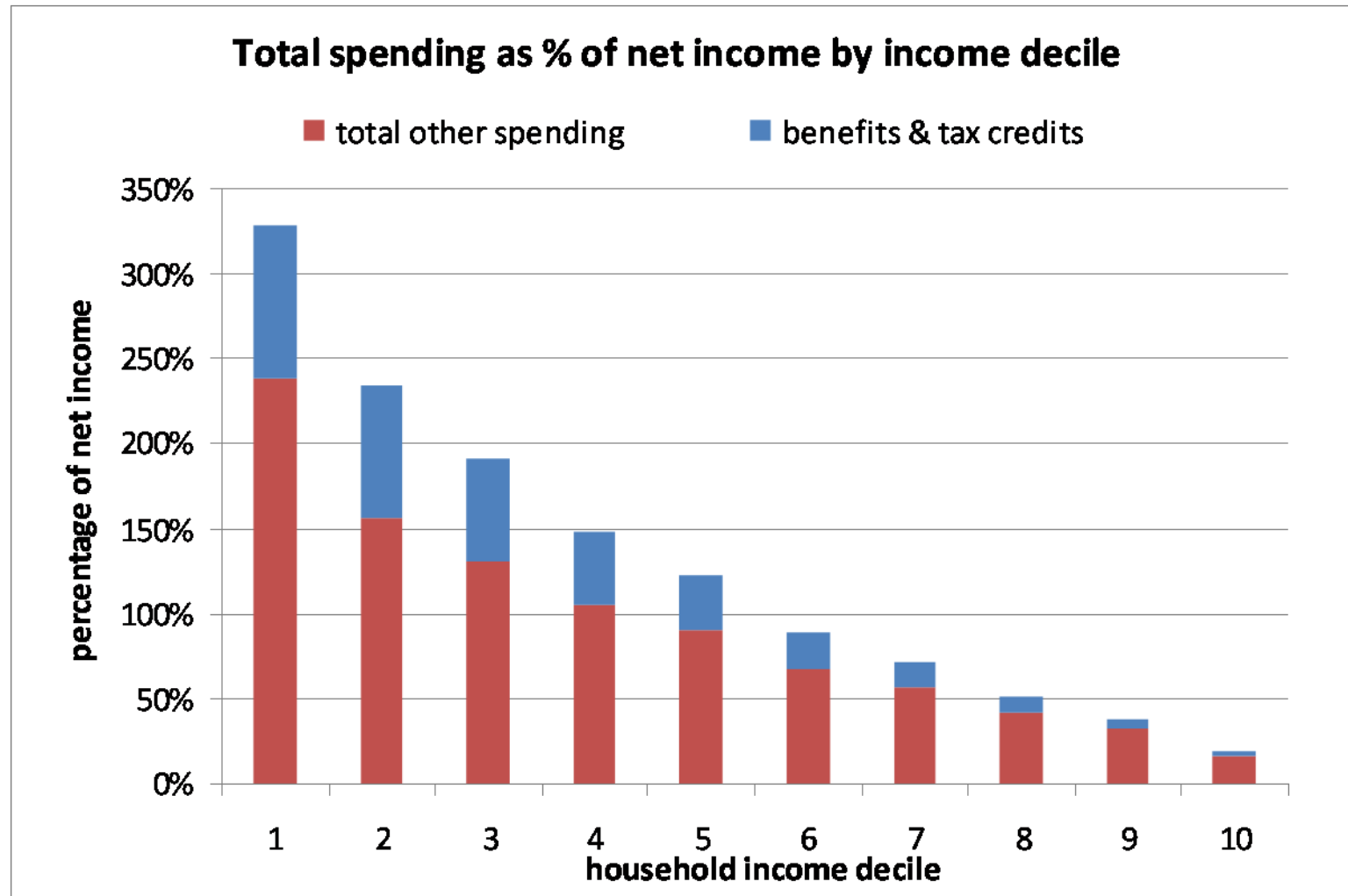
- Difference between 'cost' and 'value':
 - Private sector comparators
 - Willingness to pay for services
 - The indispensability of core public goods
- Value accruing to 'non-users':
 - Option value / insurance
 - Future value
 - Externalities from others' service use

Average public spending (total) by household income: cash terms



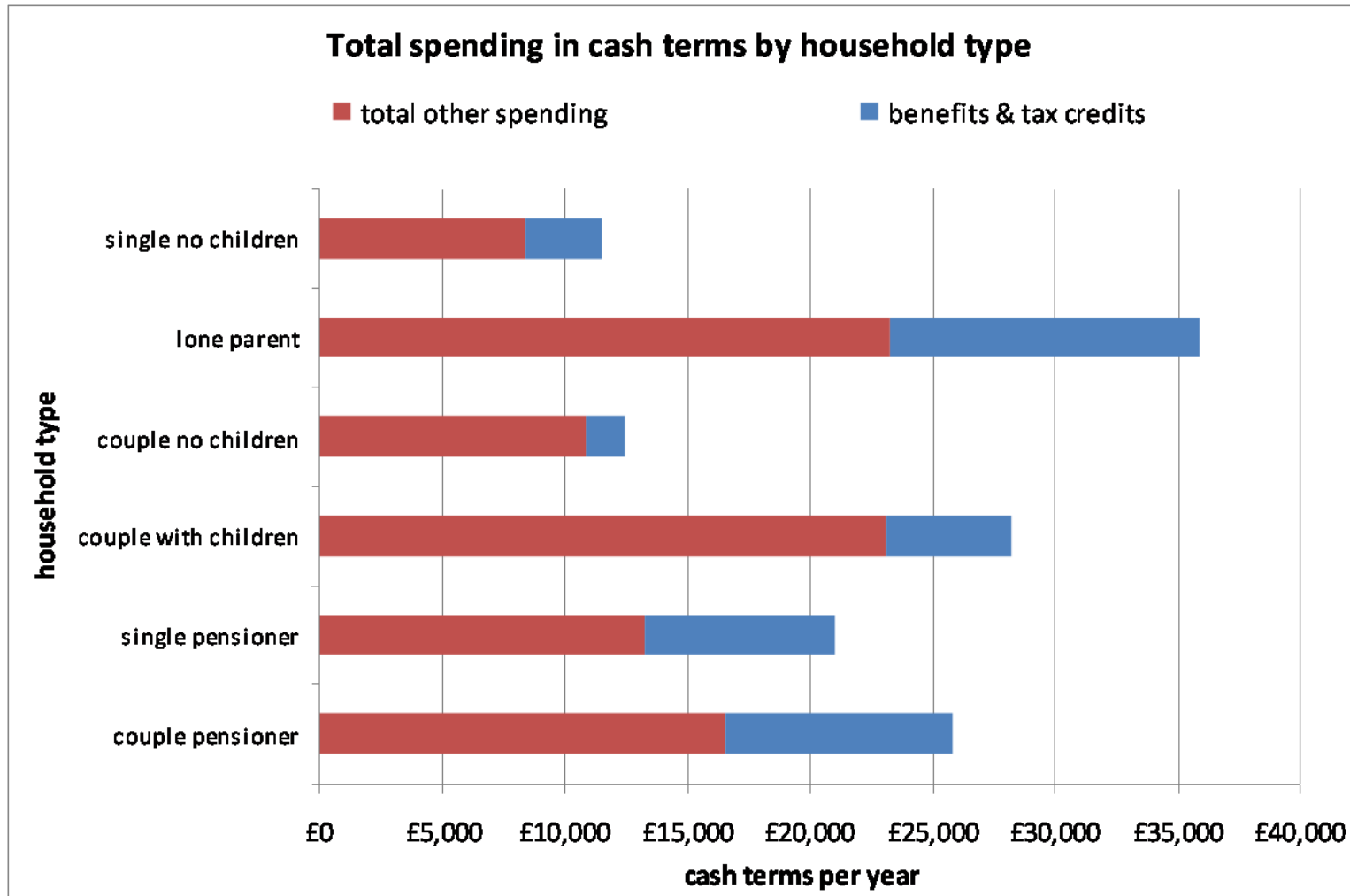
Average annual spending per household, in cash terms, by household income decile (2007-08)

Average public spending (total) by household income: percentage of net income



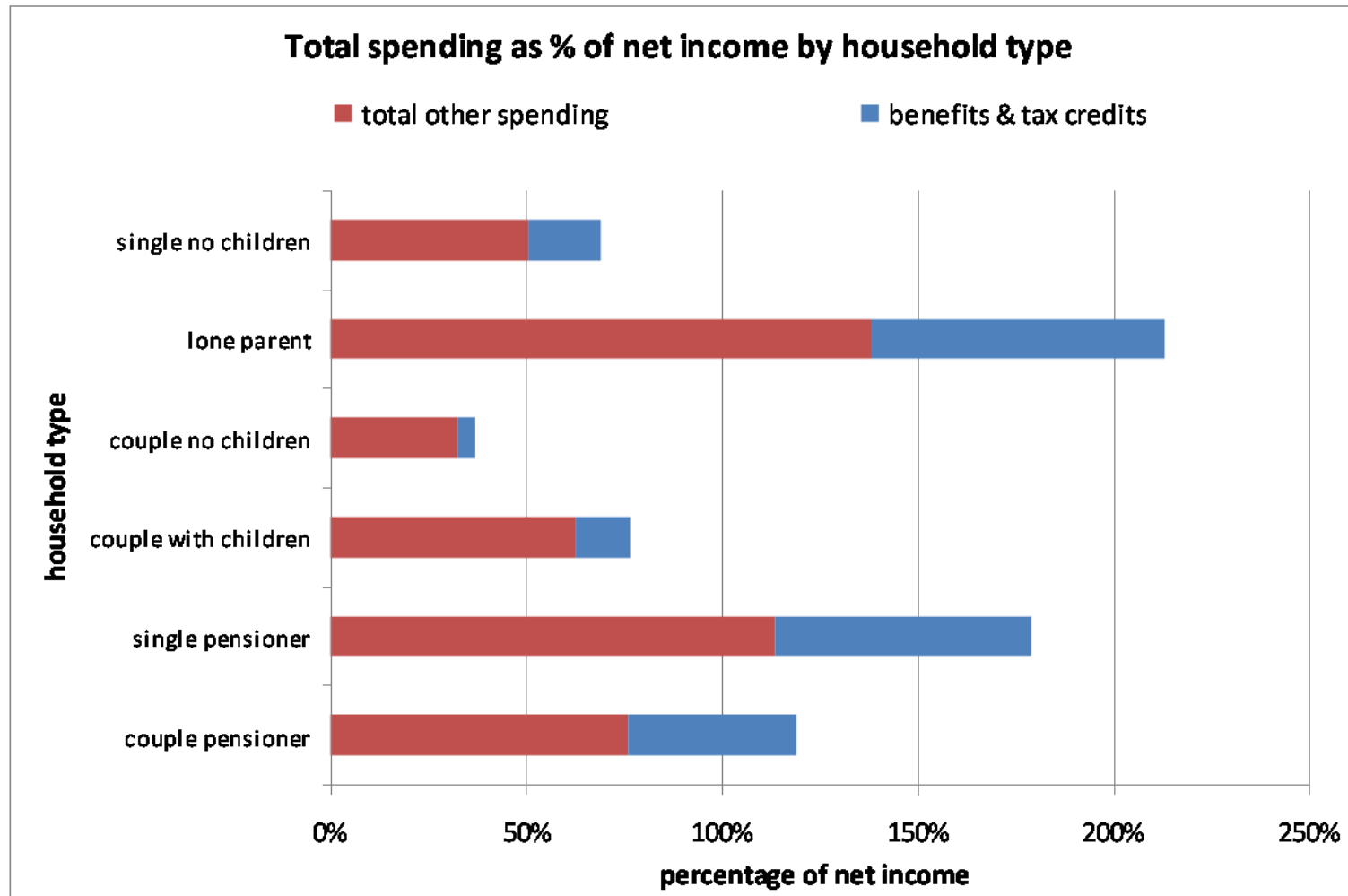
Average annual spending per household, as a proportion of net household income, by household income decile (2007-08)

Average public spending (total) by household type: cash terms



Average annual spending per household, in cash terms, by household type (2007-08)

Average public spending (total) by household type: percentage of net income



Average annual spending per household, as a proportion of net household income, by household type (2007-08)

How big are the cuts?

Total spending cuts by 2014-15:	£81bn
- Reduced debt interest	-£10bn
- Reduced benefits/tax credits	-£18bn
= Nominal spending cuts	£53bn
At 2010-11 prices:	£48bn

Which services are being cut?

- Spending review gives **departmental** spending totals
- Our model analyses spending by **function**
- A detailed mapping is available between the two – but only *ex post*
- *Ex ante* we have to make assumptions about the scale of cuts by service area

Spending cuts by service – easier cases

Overall cuts by 2014-15 in real terms:

Health	0%
Education (schools)	-10%
Transport	-15%

Spending cuts by service – our assumptions in harder cases

Mainly these are where large portions of expenditure are devolved to local authorities:

Social care	-20%
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Social housing	-24%
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Or where funding is only part of a departmental settlement:

Policing	-20%
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HE/FE, adult education	-27%
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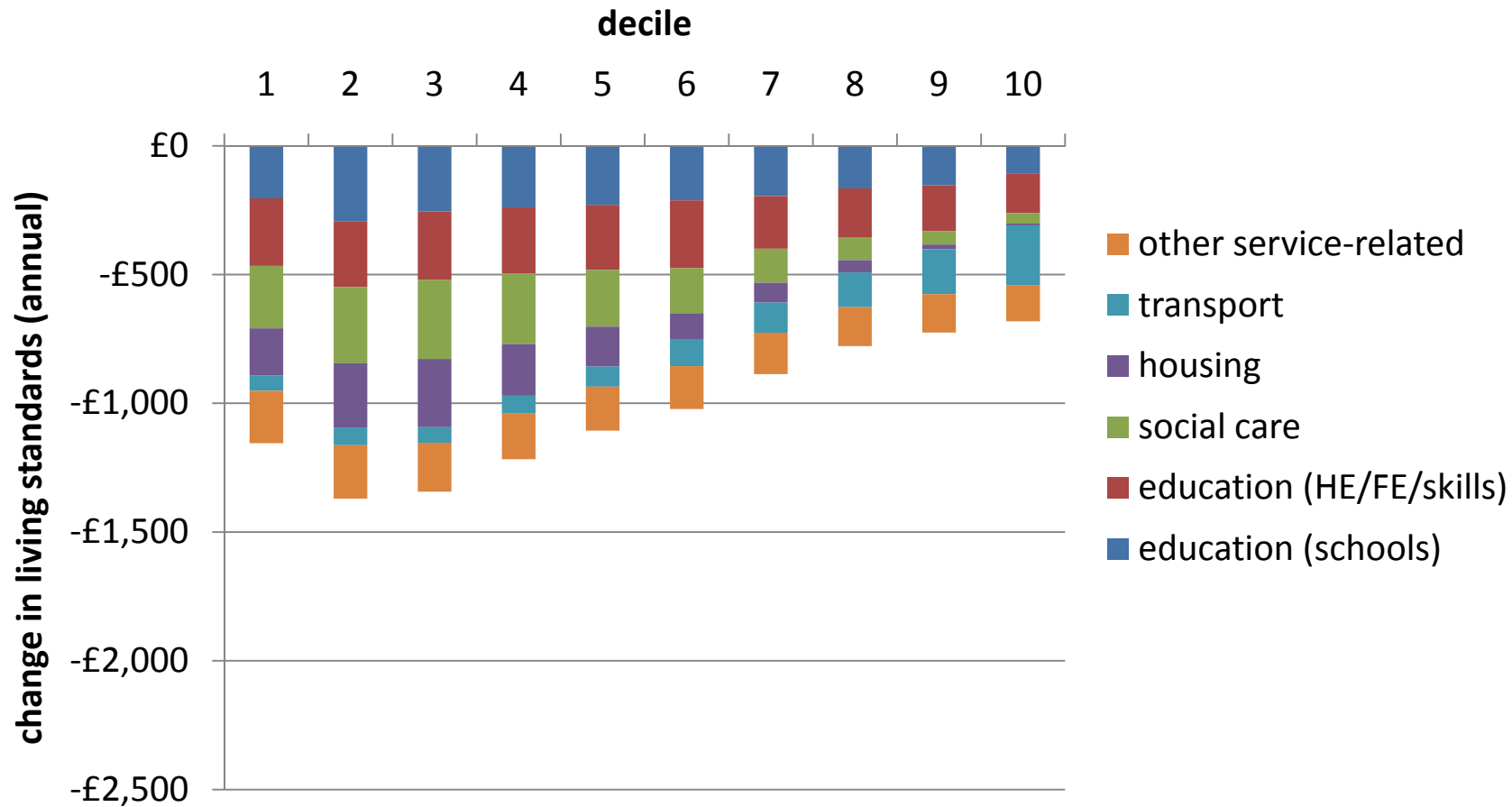
Spending cuts by service – other assumptions

‘Other income related’ categories – average reduction of 18%

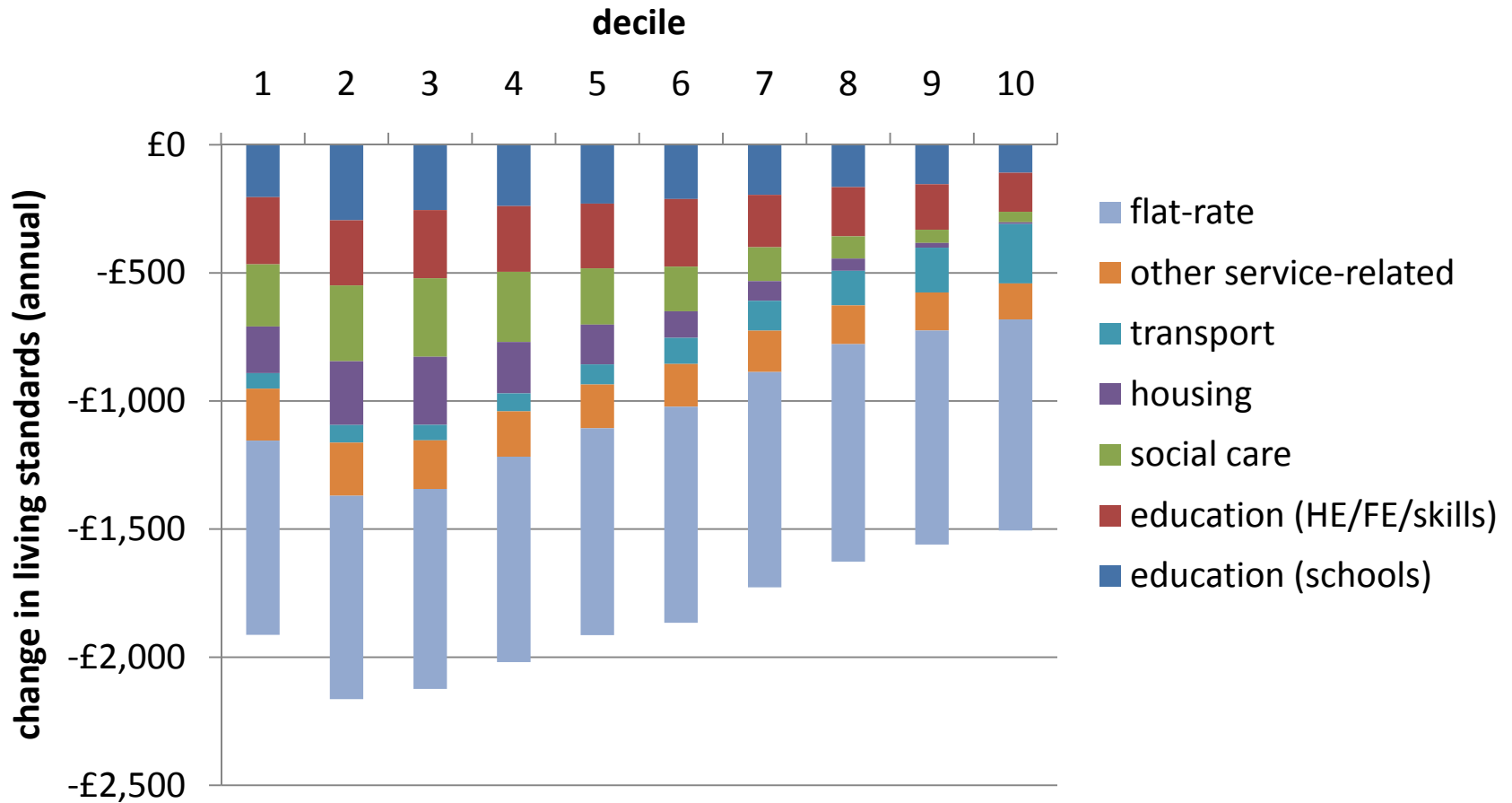
‘Flat rate’ categories – average reduction of 18%
...except defence (8%)

Overall spending reduction (as a proportion of all public spending on services-in-kind): 12%

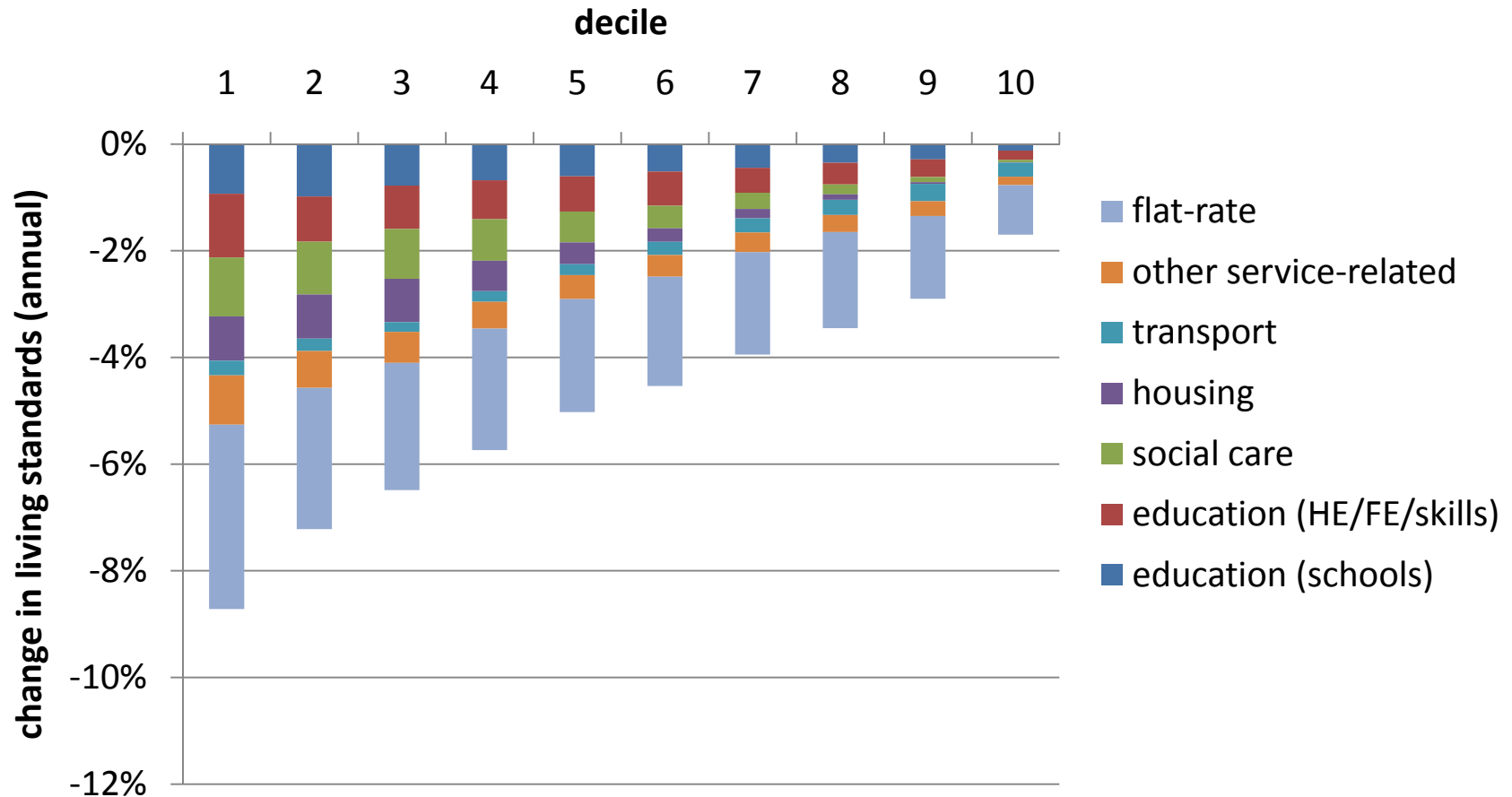
Effects of spending cuts by income group: cash terms, allocating services related to household use only



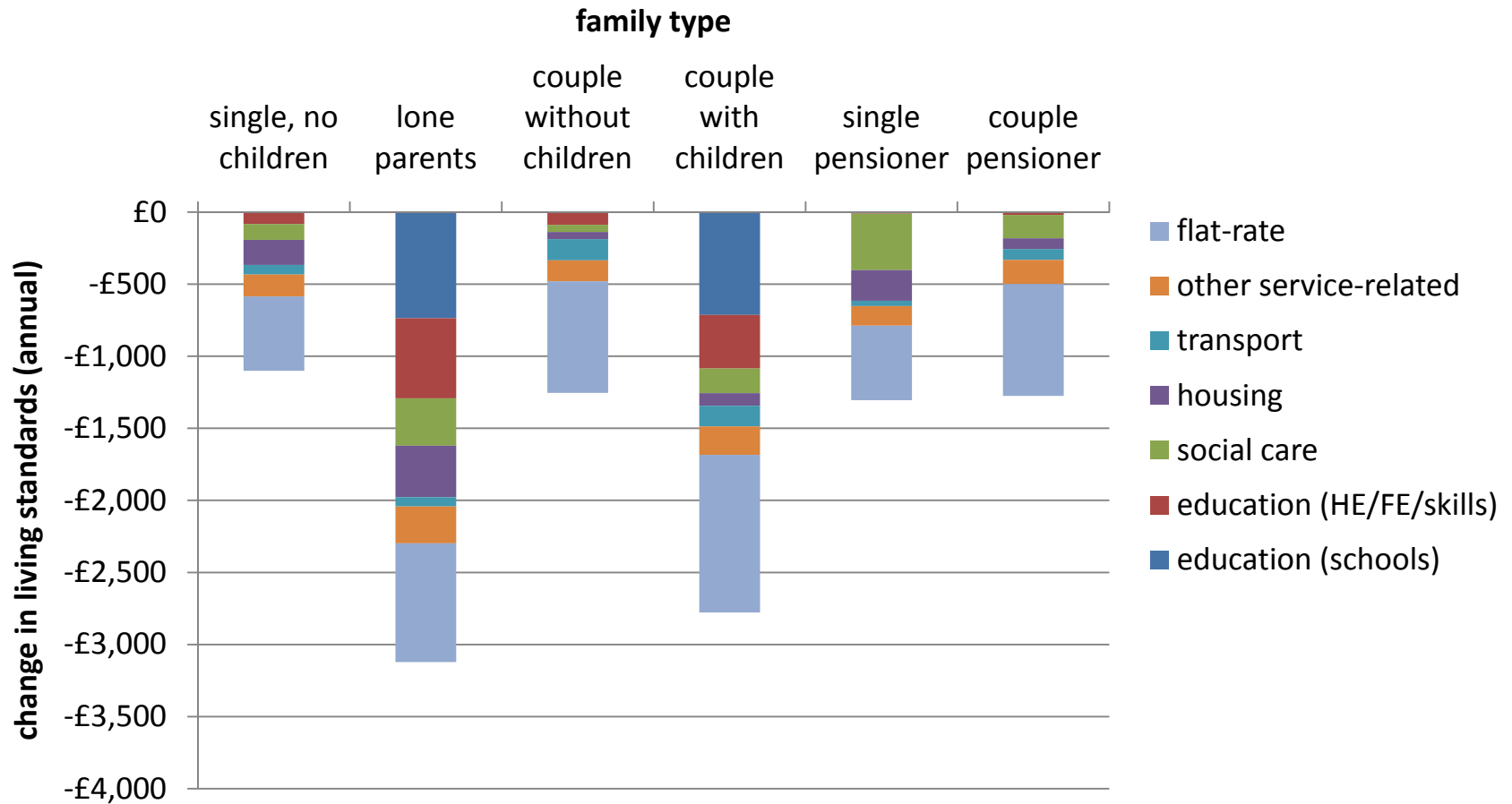
Effects of spending cuts by income group: cash terms, all services



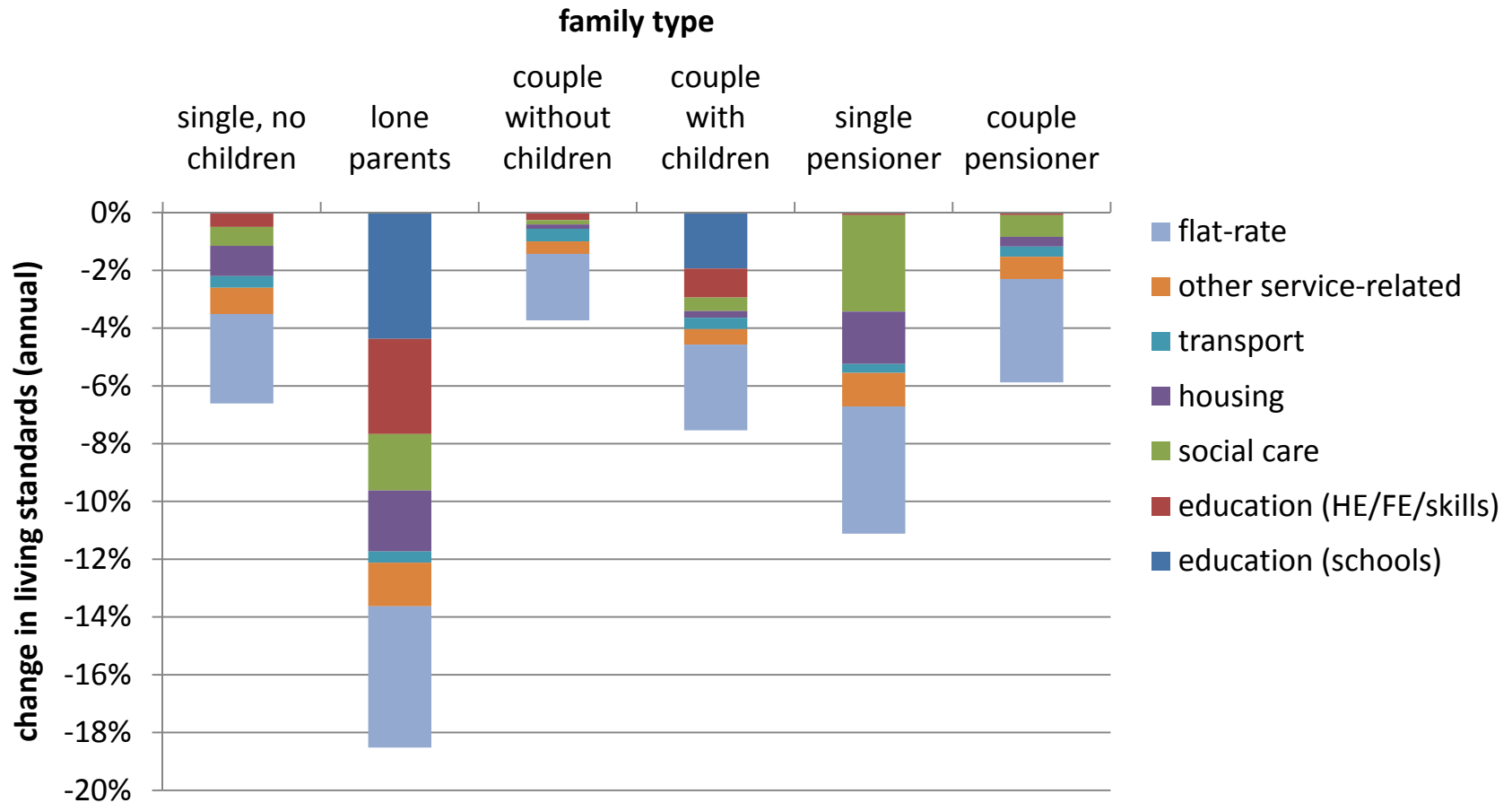
Effects of spending cuts by income group: as % of net income **plus value of services**, all services



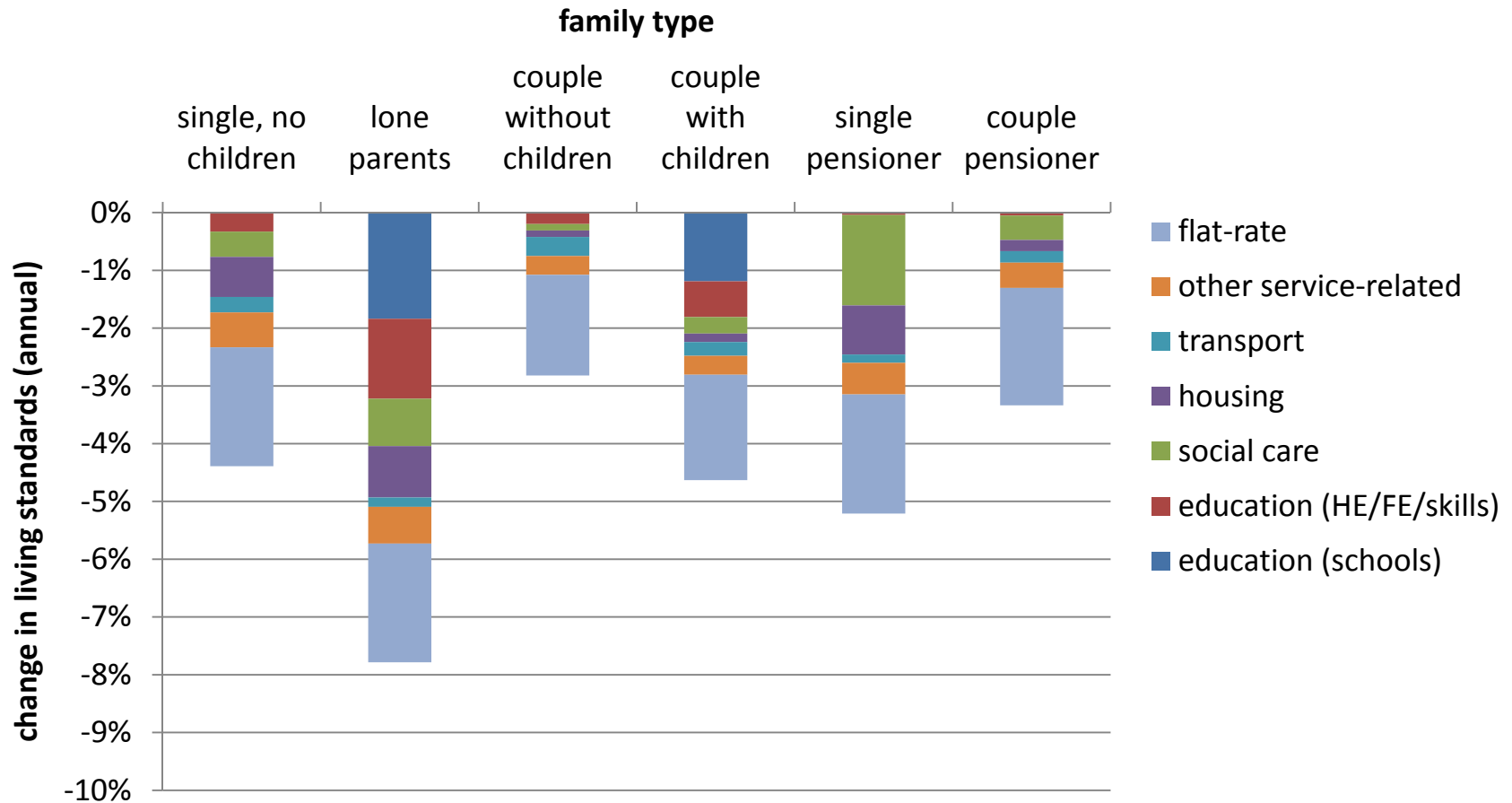
Effects of spending cuts by family type: cash terms, all services



Effects of spending cuts by family type: as % of net income, all services



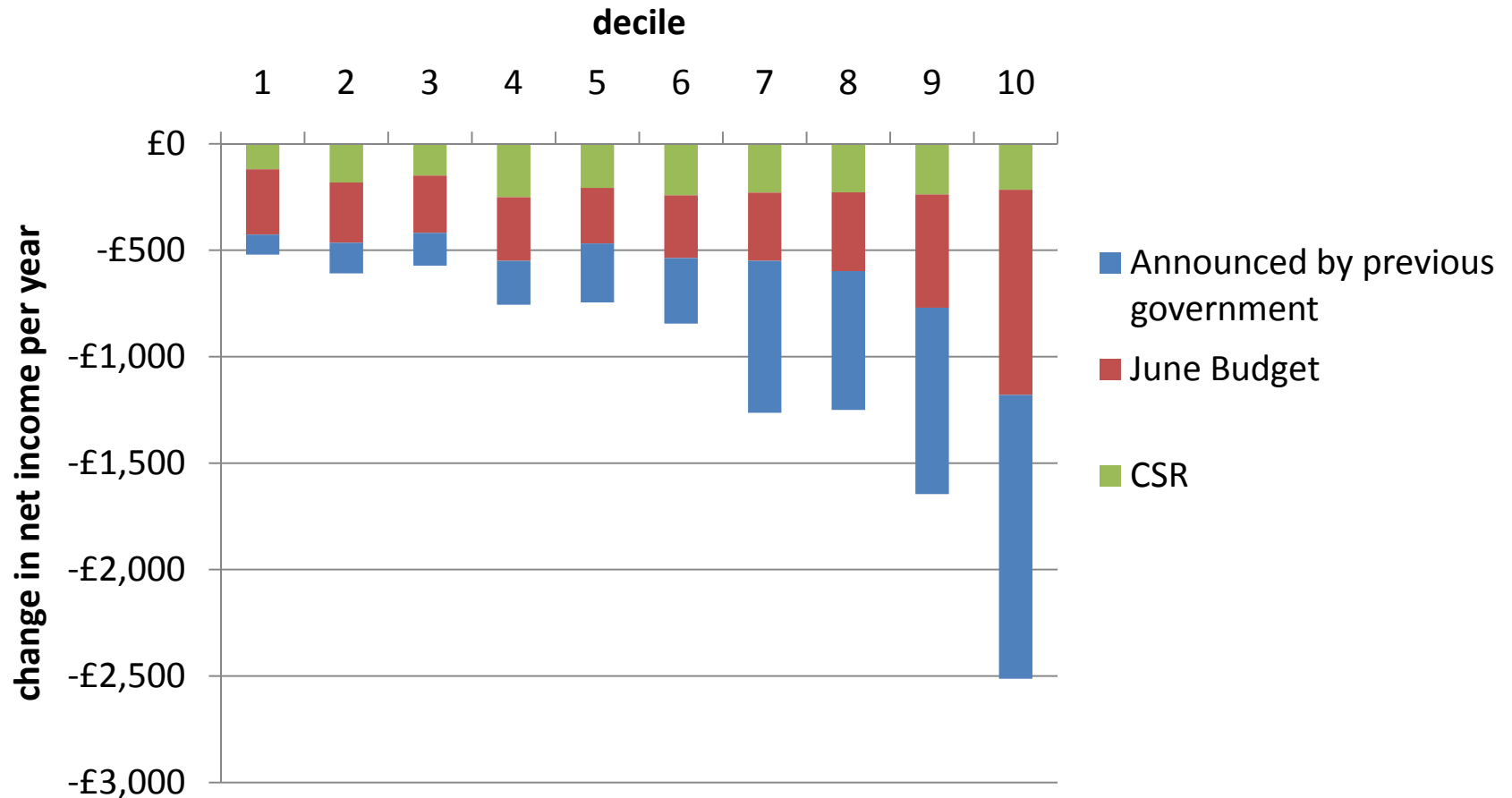
Effects of spending cuts by family type: as % of net income plus service value, all services



What about the tax & welfare measures?

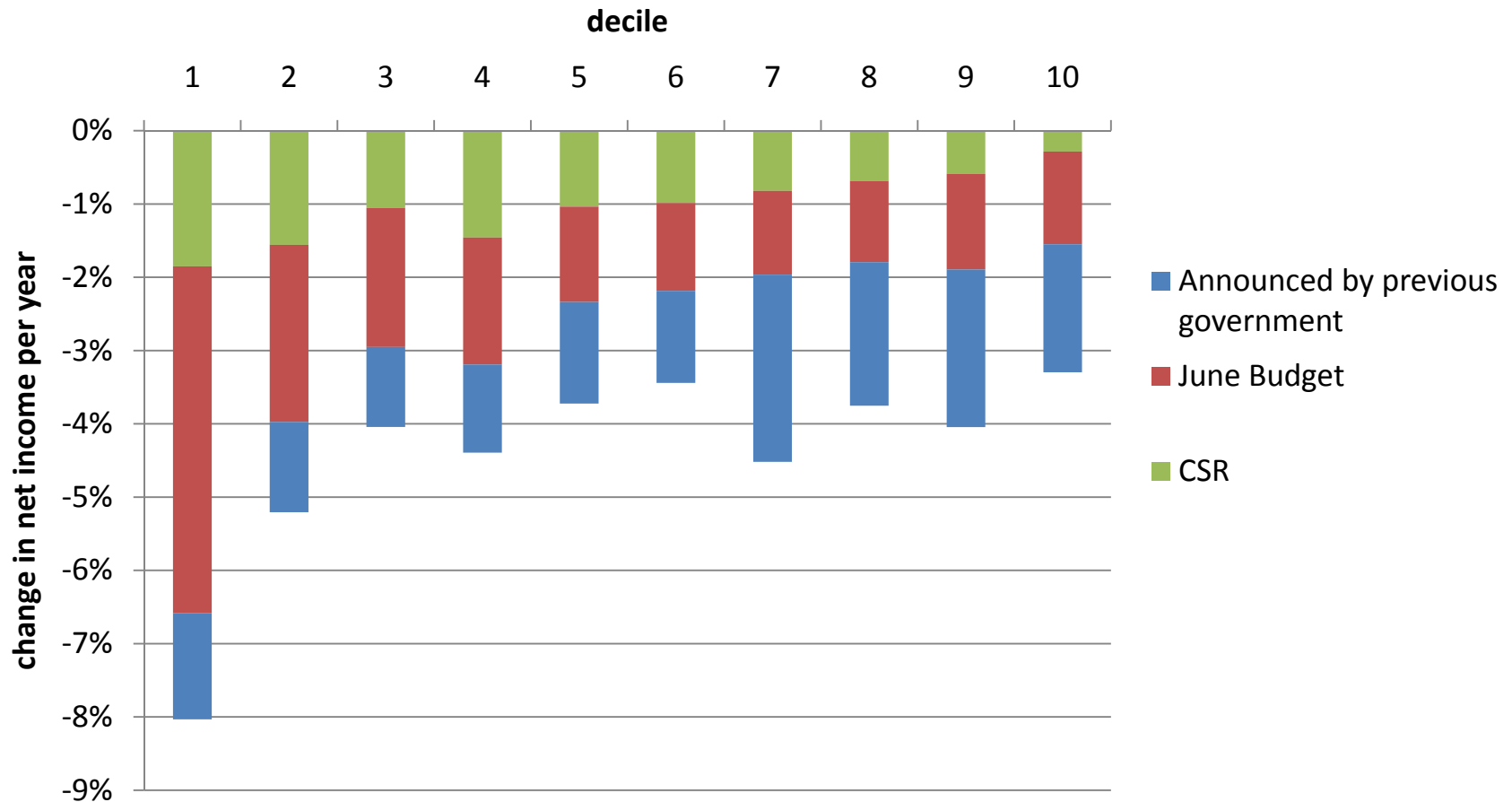
- We can use figures from IFS post-CSR briefing to show the impact of the tax and benefit changes
- Note that IFS attempted to model all benefit and tax credit measures (except the universal credit) whereas HMT (in CSR Appendix B) modelled only a subset

Distributional impact of tax, benefit and tax credit measures – cash terms



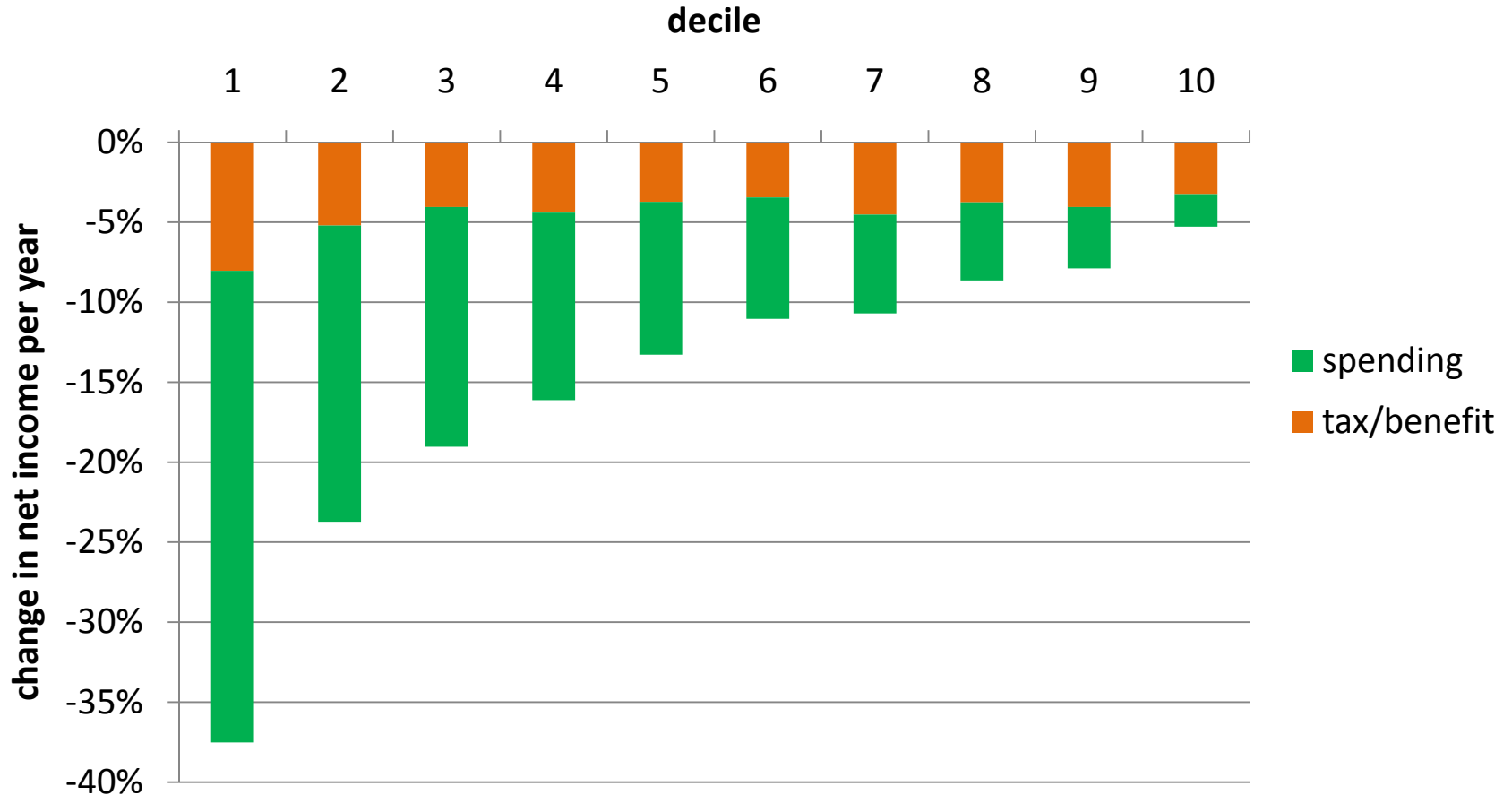
Source: IFS post-CSR briefing, 21 October

Distributional impact of tax, benefit and tax credit measures – as % of net income



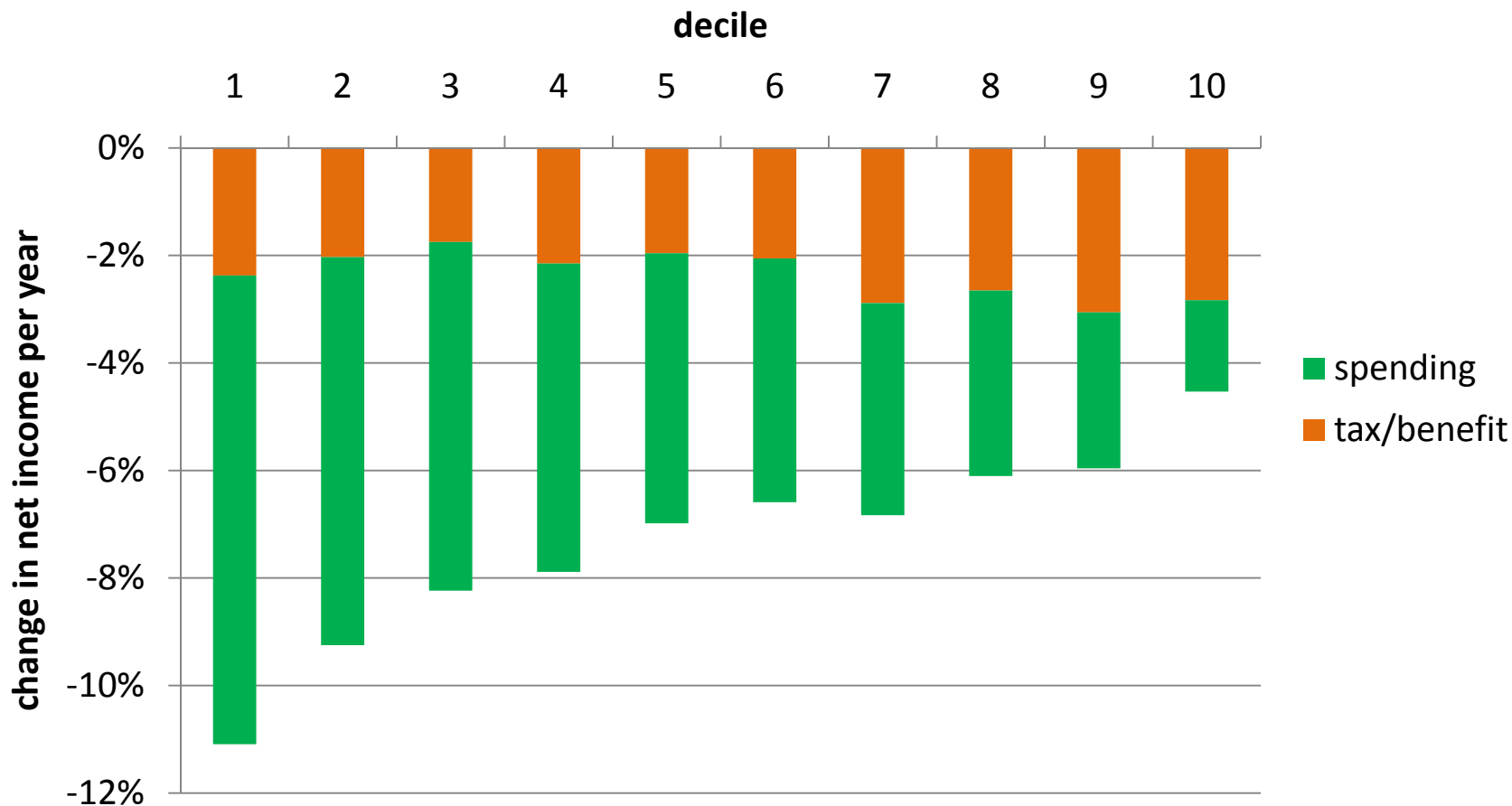
Source: IFS post-CSR briefing, 21 October

Distributional impact of tax/benefit and spending measures – as % of net income



Source: spending – Landman Economics, tax/benefit – IFS

Distributional impact of tax/benefit and spending measures – as % of net income and value of services received



Source: spending – Landman Economics, tax/benefit - IFS

Conclusions

- Impact of the CSR on households appears to be very regressive under reasonable assumptions about how the benefits of public spending are distributed
- Poorest are hit 15 times harder than the richest if you measure changes as a proportion of income
- Poorest are hit 5 times harder than the richest if you measure changes as a proportion of income *plus* the value of public spending received
- Families with children and single pensioners hit hardest in percentage terms (due to education and social care cuts, respectively)

Online calculator

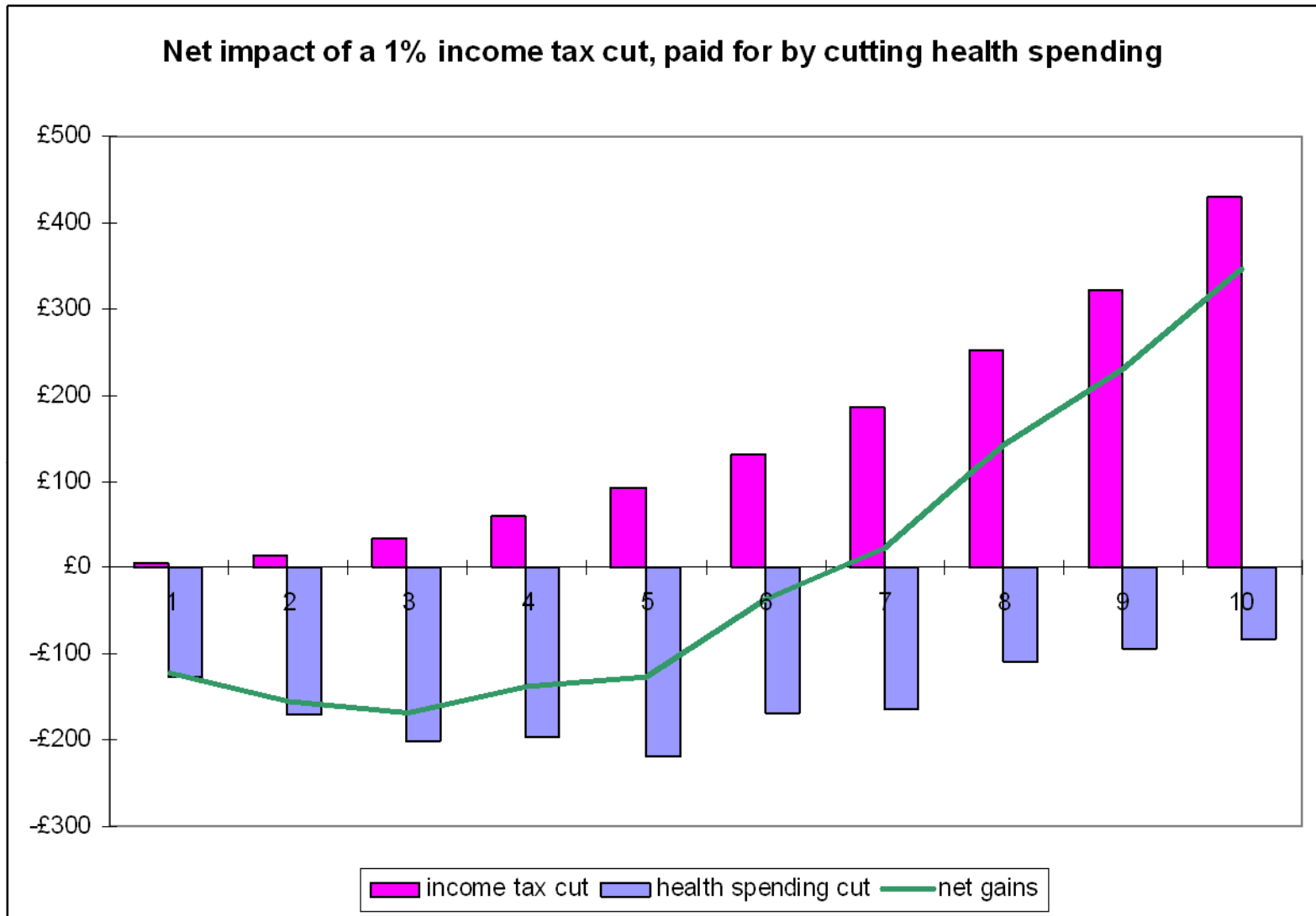
- You can calculate how much households in your income group, region, housing tenure and family structure lose on average at:

<http://www.touchstoneblog.org.uk/2010/10/how-much-do-you-stand-to-lose-from-the-csr-cuts/>

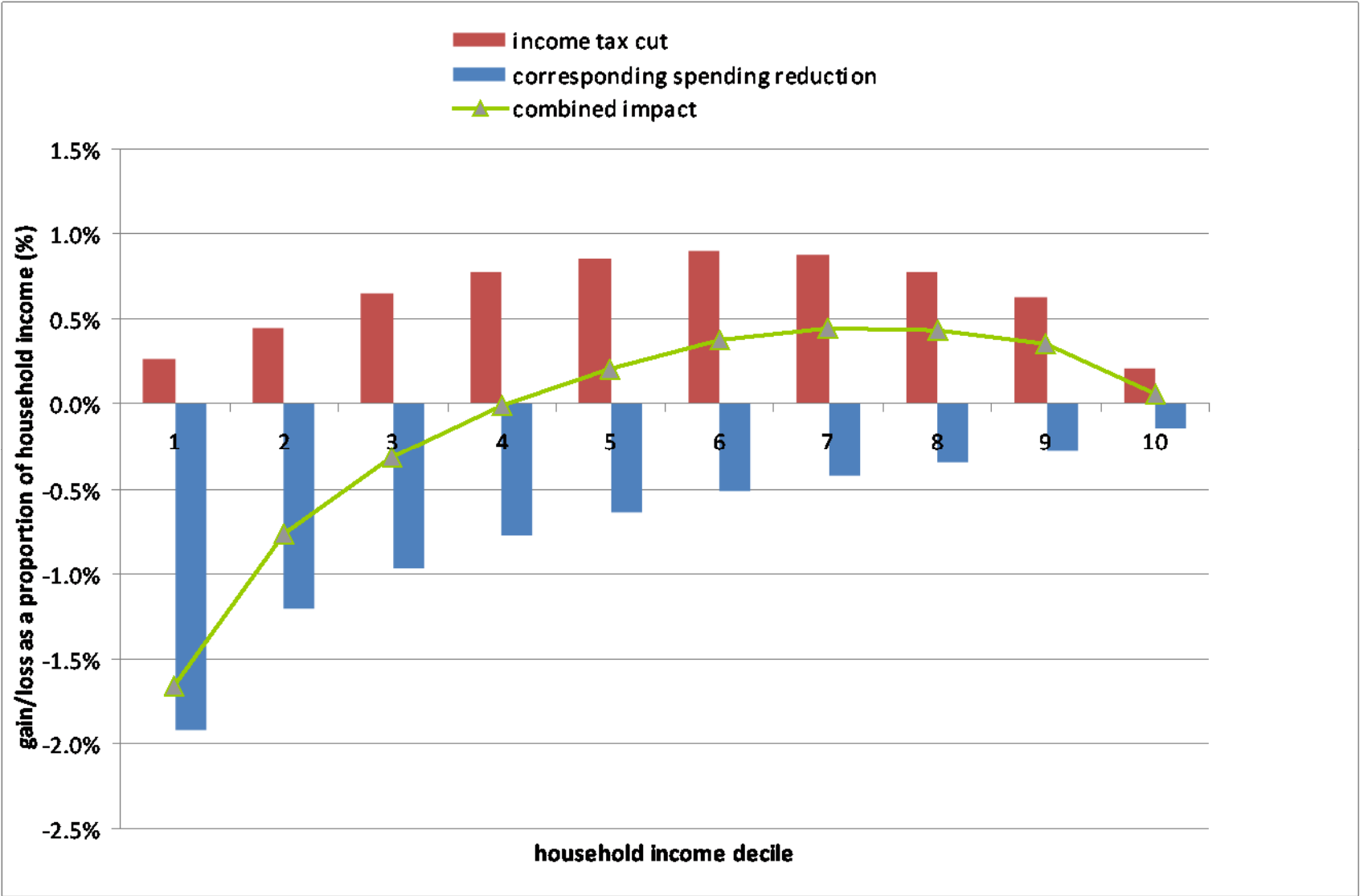
Reshaping debates on tax & spending

- Unlike tax paid, people don't have a sense of the value they get from public services (Hedges, 2005)
- This technique can help to personalise the value of public services – might help people to value it more?
- Potentially creates a new perspective on debates – e.g. cuts, waste, etc.

Calculating the net impact of tax cuts



The real impact of the Budget's income tax cut?



Net distributional impact of the Budget's £3.7 billion income tax cut

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