

FOCUS: ECONOMICS

Is the UK spent?



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Pensions, PFIs – is the UK spent?

The scale of public spending

There has been huge publicity and political debate of late concerning the state of the UK's economy and the levels of public spending. The debate has ranged from which political party will make the most cuts / spend the most following the 2010 elections to dire warnings concerning the level of public spending in relation to GDP.

Figure 1 below illustrates public spending vs tax receipts:

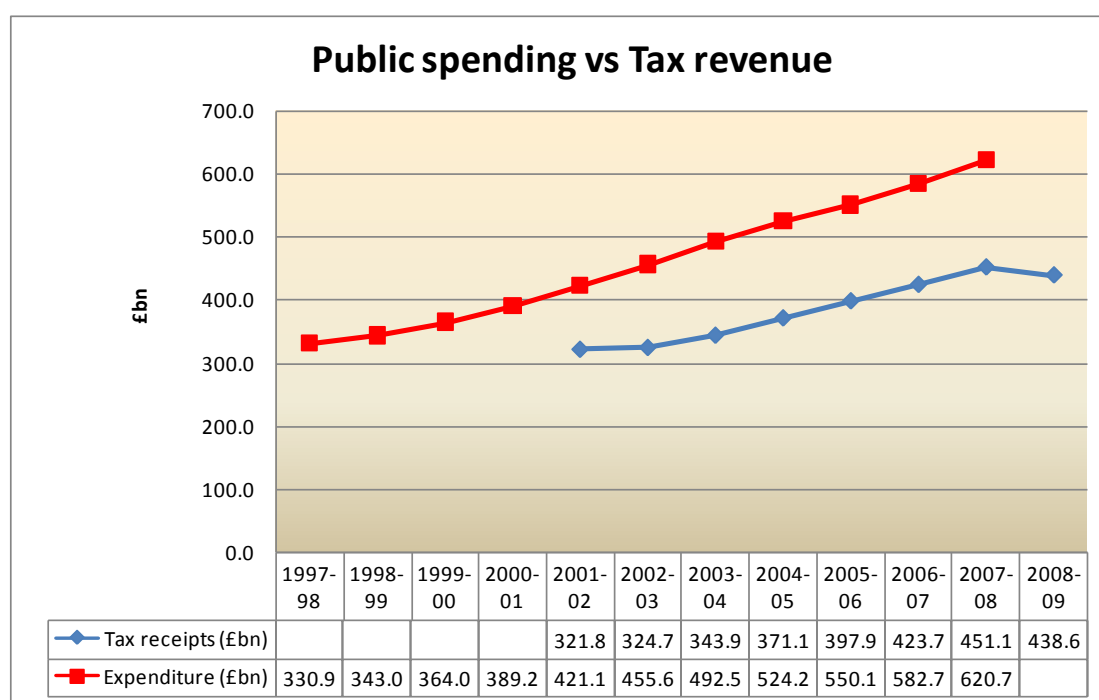


Figure 1

Source: HM Treasury, HMRC, National Statistics

The interesting point to bear in mind is that tax revenue is falling in 2008/09 and a further fall to £394 bn is predicted in 2009/10; however, no corresponding fall in public spending is predicted. In brief, spending is outstripping the tax take by some distance.

How is the gap funded? – borrowing: The public sector net borrowing requirement was £19.9 billion in May and now stands at £30.5 billion after only two months of the financial year, twice the level recorded a year ago. The UK's net debt now stands at £774.8 billion, equivalent to 54.7 per cent of the UK's GDP, data from the Office of National Statistics shows.

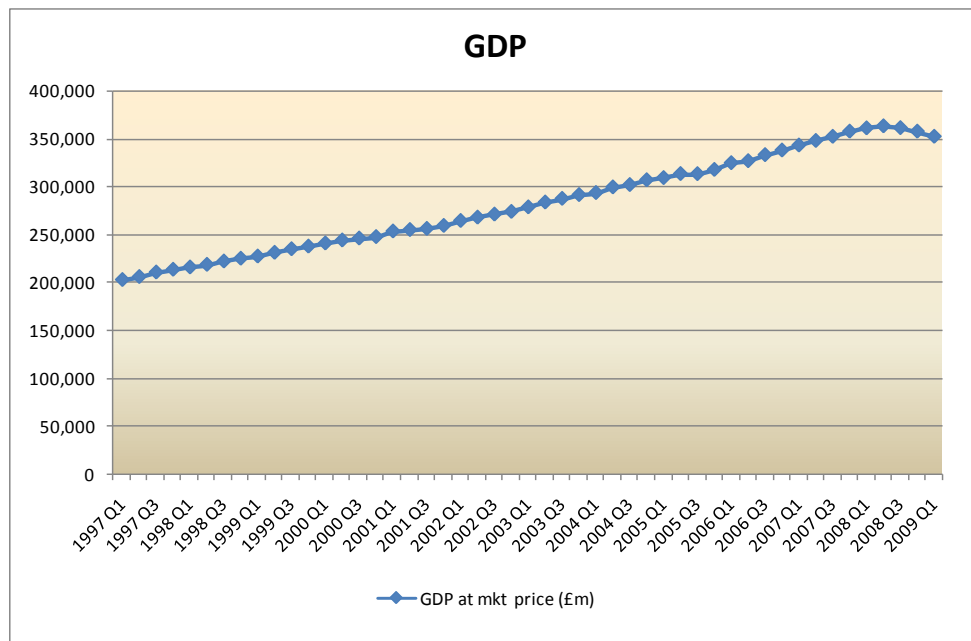
Chancellor Alistair Darling has predicted net borrowing over this year will hit £175 billion with a drop in tax revenues and spending on unemployment benefits soaring, along with the cost of recent financial bailouts.

Against this backdrop is the fact that huge liabilities are building in terms of public sector pensions and “off balance sheet” transactions in the form of PFIs (Private Finance Initiatives).

The public sector pension liability

An analysis conducted by the British-North American Committee (BNAC) calculated that the unfunded pension liability in the UK for the public sector is approximately 85% of GDP. That translates to an astonishing £1.18 trillion.

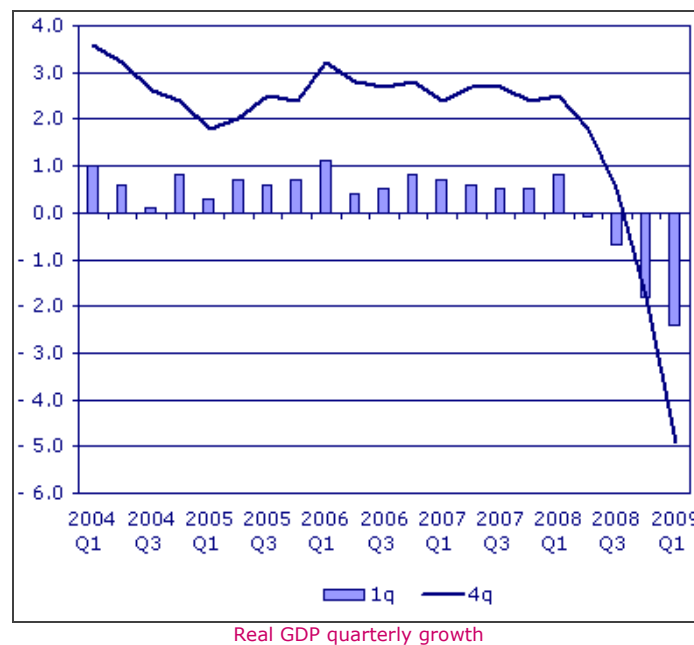
With GDP declining (see figures 2 and 3 below) this is a burden that will last for generations if it not addressed.



Source: National Statistics

Figure 2

Economy contracts 2.4% in Q1 2009.



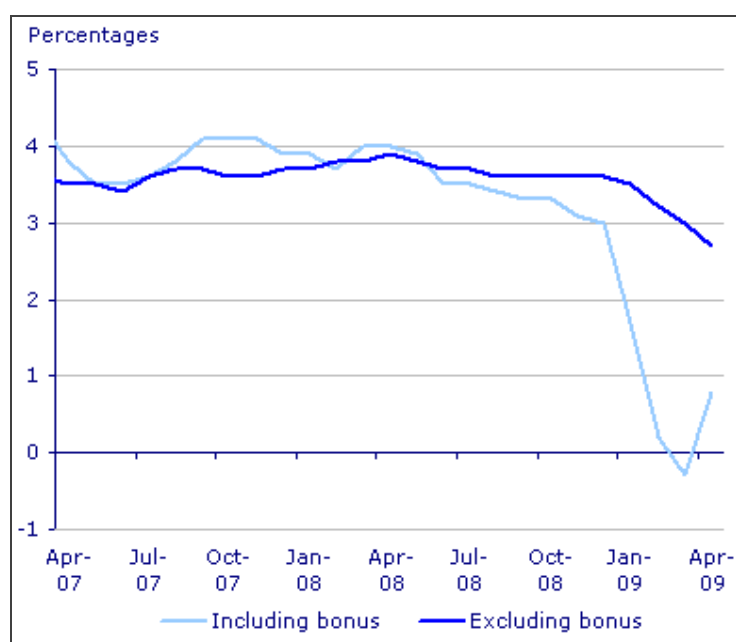
Source: National statistics

Figure 3

A failure to address public sector pensions will result in an intolerable burden on future generations. However, judging by the quality of current political debate, it a topic that is so hot no party wants to grasp it this close to an election for fear of being burned. Even if they were willing, what could they do that would not be portrayed as a vile attack on our hard working NHS, teachers etc? Further, any attempt at changing away from the rather cosy final salary schemes currently in place would provoke the anger of the unions – bringing forth images of the 80’s when Prime Minister Thatcher took on the NUM.

In the past, the argument has been something along the lines of public sector workers needing the reward of a super annuated final salary scheme as compensation for lower than average wages – but that has changed as many in the civil service, health sector and education enjoy salaries on a par or better than those in the private sector. At senior levels these are enhanced further by a generous bonus culture – often against fairly flimsy performance targets. Figure 4 below illustrates average earnings before and after bonuses.

Average Earnings



Comparison of pay growth

Source: Government statistics

Figure 4

Average earnings including bonuses rose by 0.8 per cent in the year to April 2009, up from the March rate of -0.3. Average earnings excluding bonuses, or regular pay, rose by 2.7 per cent in the year to April 2009, down from the March rate of 3.0. In the year to April, pay growth (including bonuses) in the private sector stood at 0.3 per cent compared with 3.6 per cent for the public sector. Excluding bonus payments, growth in the private sector stood at 2.6 per cent compared with 3.5 per cent for the public sector.

PFIs – what you don't see

Huge sums of money are being spent through Private Finance Initiatives – these are contractual schemes which, until now have not had to be declared by the government as being public spending – thus not laying them open to charges of not meeting EU budget deficit guidelines etc. Even though current accounting rules suggest they should appear as public spending, the government is looking for ways to delay the inevitable. On the face of it, they

are schemes that allow the building of schools, hospitals and infrastructure that might not otherwise be undertaken if purely public money was to be used (oh, yes – public money is often used in these schemes if private finance is lacking). They are promoted as offering “Value for Money” (a greatly over-used government term, meant to convey the idea of lower cost). A recent Radio 4 programme in the “File on Four” series explored this in greater detail.

[Link to transcript:

http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/23_06_09_fo4_pfi.pdf]

The essence of the programme is that PFI deals are being used to hide public spending and that they are not always lower cost than using only public money to fund capital projects. Further, the continued increase in spending promised by Prime Minister Brown only makes sense in the context of ever increasing PFI commitments. The PFI contracts are not free – they impose a long term commitment on the public purse, often for up to 40 years; yet another burden on the taxpayer that spans generations.

Conclusions

The UK economy appears to be stuck between a rock and a hard place: On the one hand GDP and tax revenues are declining with only the optimistic seeing any form of real recovery before the latter half of 2010, whilst public spending looks like continuing and the public sector pensions deficit gets ever higher. To cap it all, no political will seems to exist to tackle these areas with an election on the horizon in 2010.

The truth of the matter is that there will have to be very significant cuts in public spending or rises in taxation, otherwise the UK will borrow its way to bankruptcy. The problem with tax rises is that the overall tax take tends to go down as people avoid tax on the grounds that swingeing tax levels are unfair.

Where does this leave the UK? Building debt for future generations to pay off, or investing in the future? That is very much a matter of philosophy: whilst it is true that public spending creates jobs and delivers business to some private sector organisations that then pay tax, it does not directly add value to the UK economy except through the possibility of attracting inward investment from overseas. It does not directly generate exports that bring fresh money into the UK economy.

Until now the economy has relied heavily on the service sector to generate wealth and employment, having largely lost a lot of the more traditional manufacturing, engineering and business services sectors through off-shoring. With unemployment rising and a frightening increase in young people classed as NEETs (Not in Employment, Education or Training), it is hard to see how the economy can be turned around before the situation leads to civil unrest or just an intolerable increase in crime.

Perhaps now is the time to look at a way of encouraging a return to manufacturing, science and technology as “strategic” skills that the UK must encourage amongst our young people through the education system and in the form of meaningful apprenticeships that lead to jobs and careers in these sectors and the government must provide some real tax incentives to bring those value adding industries back to our shores.

Note: The views expressed in this paper are solely those of the authors and do not necessarily represent the policies of SVP (UK) or any of its associated companies.

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