



- Tough Spending Review as expected – cuts totalling £81bn by 2014/15.
- Welfare spending cuts of £7bn – take total to £18bn.
- Public sector job losses of 490,000.
- Sectoral implications broadly in line with our existing baseline projections.
- Impact will feed into our regional, county and local authority forecasts by mid-November.

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### Overview

The Comprehensive Spending Review (CSR) confirmed the government's intention to stick to its hard line on delivering a further £81bn of spending cuts by 2014/15, slightly down from the £83bn outlined in its June Emergency Budget. The Chancellor reiterated his commitment to significant spending reductions, while ring-fencing health, education and spending on overseas aid. Spending cuts on current and capital budgets were a bit less severe than announced in the Emergency Budget, funded mostly by a fresh package of welfare cuts amounting to £7bn.

While the CSR does not alter the big picture in terms of the impact of the spending cuts on the UK economy, it does provide more details of which departments will bear the biggest burden of the cuts. This in turn has major implications for which regions, sectors and households will be most affected.

The major losers among the big-spending departments were Communities and Local Government, a key funder of local councils (-27%); Business Innovation and Skills (-25%), the Home Office (-23%), and the Ministry of Justice (-23%). In contrast, a fortunate few will continue to see some growth – the NHS (1.3%), Work and Pensions (2.3%), and the small Department for International Development (37%).

Question marks remain over the achievability of these spending targets. A significant part of the savings is expected to come from back-office consolidation rather than front-line services. However if this proves too difficult then the government may be forced to reconsider its ring-fencing promises or tax policy in order to meet its deficit reduction targets. The Chancellor's assertion that the cost in terms of public sector jobs will be 490,000 –

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the majority of which will occur from natural turnover – remains, in our view, the best-case scenario. While our new baseline macroeconomic forecasts to be published next week will incorporate these changes, clearly many risks remain. Our updated regional forecasts will be available by mid-November.

### Sectors

- Construction and public administration & defence suffer the most.
- Business services fare slightly less well than in our previous forecast.
- Transport equipment has better growth prospects than in our previous forecast.

Our initial impressions are that the sectoral impact of these measures is broadly in line with our existing baseline projections. But as noted below, three sectors – business services, electrical & optical equipment and transport equipment – will see rather different outcomes from those envisaged previously.

All sectors will be affected, but construction and public administration & defence will suffer the most. For departments in the latter category, with front-line public sector roles relatively protected, it was clear that a significant part of the tightening would need to be delivered from reductions

in back-office operations. The CSR confirms this, with most departments expecting to reduce their administrative costs by around a third. This will hit outsourcing and consultancy and we expect business services to see somewhat less healthy growth over the medium term than in our previous forecast.

Within the construction industry, the housing sector will take a big hit from the reduction in the social housing budget. Moreover, there are serious doubts about the government's ability to realise its plans for building an additional 150,000 homes by 2014/15. The overall picture of weakening construction sector growth from 2011 remains intact, despite infrastructure spending plans coming out slightly better than expected. However, this outcome, together with the science budget emerging with slightly more funds, suggests that transport equipment and electrical & optical equipment will not be hit as hard as previously forecast.

### Regions

- Substantial welfare cuts will affect all regions.
- The North West, the North East, Wales and London stand to be most affected.
- Public sector job cuts and wage freezes will affect London, Wales,

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The announced reforms will adversely affect all parts of the UK, with no region or local area immune. The substantial welfare cuts will affect all regions although with a relatively higher proportion of the community reliant on benefits, the North West, the North East, Wales and London stand to be most affected. The cuts in public sector jobs and the wage freeze for those earning over £21,000 will also affect London, Wales, and the North East most – Northern Ireland is also vulnerable – given that the public sector is a relatively large employer in these regions. The closure of selected RAF bases, such as Kinloss and Lossiemouth in Scotland, the result of an 8% squeeze in MoD spending, will undoubtedly affect the local economies where linkages with the private sector have been established.

To mitigate the impact of the obvious pinch that will hit households across all regions, the government has announced a range of supportive measures.

- The Regional Growth fund, which will support private sector projects that promise to generate sustainable growth in areas currently dependent on the public sector, has seen its funding rise to £1.4bn. The aim of this fund is to reach out to SMEs in regions outside the greater South East.
- The UK-wide £1bn Green Investment Bank is meant to encourage investment in green infrastructure. Regions where offshore wind farm industries are emerging, such as the East of England, stand to benefit from this initiative.
- Significant investment in scientific research and healthcare will benefit all regions.
- Several capital investment projects have been announced in all regions under which a range of infrastructure improvements, scientific research and healthcare expansion will be funded and supported by the government.
- Regions in the north of England will benefit from a high-speed rail link to London.
- The midlands, Scotland and Wales will see improvements and increased capacity on bus and rail links.
- London and the south will continue to benefit from a number of transport initiatives, including Crossrail.

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- The impact of welfare cuts is particularly harsh in London, which has a large proportion of benefit recipients. In addition the loss of public sector jobs will hit the capital disproportionately, while the cuts in housing benefit and the announcement that new tenants moving into social housing will pay 80% of the market rent (up from 50%) will add to problems for the least well-off in the capital.

In general, while infrastructure improvements may generate some construction and related activity in the short term, the full benefits of such investments can only be assessed in the longer term. Meanwhile, the squeeze on household finances and the impact of welfare cuts will overshadow the positives and dampen regional performance. Despite the hits to London's economy, we retain our view that the south of England will retain its position as the driver of UK growth.

### Households

- Two groups – public sector workers and those on very low incomes – will suffer disproportionately from the spending cuts.
- Pensioners have escaped lightly from the changes.

The fiscal measures announced this year, taking the June Emergency Budget in conjunction with the Spending Review, entail widespread belt-tightening over the next few years, but bear down heavily on two groups: public sector workers and those on very low incomes. The public sector is set to lose almost 500,000 jobs spread across local authorities, quangos and Whitehall. For public sector employees, those earning over £21,000 face a pay freeze for the next two years, as well as higher pension contributions which will continue to depress disposable incomes when the pay freeze ends.

Lowest income households are likely to be among the hardest hit in terms of the proportion of net income lost. Among the measures hitting this group hard are the one-third cut in Employment Support Allowance (which replaces incapacity benefit) for the long-term sick; the impact of the freeze in working tax credits and reductions in help for child care on working single parents; and the increase from 25 to 35 in the age threshold for housing benefit. At the other extreme, the retention of free bus passes, TV licences, eye tests and prescriptions and the continuation of winter fuel allowances mean that pensioners have escaped lightly from the changes.

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**Overall, the impact to potential output is not as severe as had been originally feared. It remains to be seen, however, whether other aspects of the CSR end up being a long-term drag on actual output.**

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### Long-term growth potential

- Expenditure has been boosted in areas that would improve growth and competitiveness in the long term, including the science budget,
- Substantial investment in green projects in hope of triggering green economy jobs.

There had been concerns that the cuts would imperil long-term growth due to reduced investment and expenditure in key areas such as education, skills and research. Responding to these concerns, the government claimed to give priority to long-term growth in the CSR by maintaining or increasing expenditure in areas that would improve growth and competitiveness, including the science budget.

This has alleviated the major concern regarding investment in the future, but the measures have involved cuts in other areas.

- While key transport infrastructure projects in London, the English regions and on the national rail and road network have been funded, and others will be progressed through PFI; local road building will suffer.

- Total schools funding will continue to rise in real terms but per pupil funding will decline.
- Science research funding will be preserved in nominal terms although other areas of research will, consequently, decline.
- Funding for adult apprenticeships will increase but at the expense of other parts of the skills budget.
- There will be substantial investment – in green projects in the hope of triggering green economy jobs – at the expense of flood defences and animal welfare.

Overall, the impact to potential output is not as severe as had been originally feared. It remains to be seen, however, whether other aspects of the CSR end up being a long-term drag on actual output.

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