Funding the Future

Why is Reeves objecting to benefits payments when the O...

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As The Guardian noted yesterday:

Rachel Reeves should refine her fiscal rules to prevent the need for emergency spending cuts, the International Monetary Fund has suggested in its annual review of the UK economy, as it upgraded its forecasts for UK growth this year.

Adding to the clamour from backbench Labour MPs incensed by the government's proposed welfare cuts, the Washington-based organisation said the chancellor should examine ways to avoid having to make short-term savings when there is a downturn in economic forecasts.

Let me explain this.

Reeves' targets relate to balancing events over a five-year period. In other words, events that might, or might not, happen are included in the calculation of what is possible to do now, even though the decision to act now does, of necessity, mean that future events are contingent on current behaviour.

Let me take an obvious example. The government could decide to restore the winter fuel allowance, remove the two-child benefit cap and unfreeze benefits. That is an entirely plausible course of action for it to take. In five years' time, it is almost certain as a result that:

* GDP will be higher, since the payments made will all recycle, almost immediately back into the economy.
* Children will be fitter.
* They will be better prepared for school, and eventually for work.
* There will be more parents available for work.
* There will be reduced demand for other government support services.

In other words, the current decision has a future consequence, but unless you decide those are the consequences of the current action, that current action is not possible, because the current action is dependent on that future consequence.

To put this another way, you have to decide what the multiplier effect of current decisions is when deciding to undertake them. And when deciding on that multiplier effect, you have to decide whether to appraise such impacts narrowly, looking solely at the impact on tax revenues, for example, or more broadly. The broader approach would allow for all the matters I note above, and what consequences they might have.

The Treasury is notoriously unwilling to ascribe appropriate multiplier effects to decisions made. Historically, they have always taken very narrow views. They have also used what most people think to be very low multiplier rates. These are those used by the Office for Budget Responsibility, with this data coming from 2020, which is the last time they appeared to refer to this issue in their reports:

Table A: Fiscal multipliers

	Impact of a one per cent of GDP increase in category on real GDP					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Tax	0.33	0.30	0.23	0.14	0.05	0.00
RDEL	0.34	0.31	0.22	0.10	0.03	0.00
CDEL	1.00	0.83	0.43	0.23	0.07	0.00
CJRS	0.15	0.14	0.11	0.06	0.02	0.00
Other AME	0.60	0.57	0.43	0.23	0.07	0.00

The jargon on the left is translated as follows (care of the Institute of Government's 2024 article on this issue):

Annually managed expenditure (AME) – demand-led spending, on things like pensions and benefits, where budgets are not fixed in advance.

Capital departmental expenditure limits (CDEL) – spending on things that are expected to produce an enduring asset for the public sector, like infrastructure, IT and buildings.

Resource departmental expenditure limits (RDEL) – day-to-day spending on things like salaries, medicines and other recurring purchases.

In other words, the multipliers used in this area assume that, at most, the cash spent can create a return of £1.90 for every pound spent, over five years.

But isn't that enough to justify this spend, come what may?

So what is Reeves' objection to spending on relieving poverty when it appears that even using these extraordinarily unsophisticated assumptions, doing so pays? I am bemused.