

8. Public services: deep cuts coming

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Summary

- The December 2009 Pre-Budget Report pencilled in a real freeze in total public spending over the four years from 2011–12 to 2014–15. But spending on debt interest, social security and other ‘annually managed expenditure’ is likely to grow in real terms. Keeping to these overall spending plans would therefore require deep cuts in ‘departmental expenditure limits’ (DELs) – Whitehall spending on public services and administration (although the government could also cut welfare bills).
- In the absence of new measures to reduce spending on benefits and tax credits, we estimate that spending on public services and administration would have to be cut in real terms by 3.0% a year on average in 2011–12 and 2012–13 and by 2.7% a year on average in 2013–14 and 2014–15. This would be a cumulative cut of 10.9% after four years, or £42.0 billion by 2014–15 (in 2009–10 prices). This would reverse almost all of the increase in DELs as a share of national income seen since Labour took office. If we include the 0.5% cut in DELs confirmed for 2010–11, the total real cut over the next five-year parliament would be 11.4% or £43.8 billion.
- On a historically comparable definition of public service spending, we estimate that the four years from 2011–12 would be the tightest for spending on public services since April 1976 to March 1980 and that the five years 2010–11 to 2014–15 would be the first five consecutive years of real cuts since data began in 1948–49.
- The government has promised to ‘protect’ spending on priority areas, including health, schools and overseas aid, in the years 2011–12 and 2012–13. The commitment to freeze NHS spending in real terms in 2011–12 and 2012–13 would still imply the tightest two-year squeeze for the health service in the last 60 years.
- Protecting large areas of spending from cuts means that the pain will be even more severe for the remaining areas of departmental spending. These other areas – including defence, higher education, transport and housing – would likely see their budgets cut by 12.9% on average over the two years or by £25.8 billion by 2012–13.
- Beyond 2012–13, the government has not promised to protect any area of spending except overseas aid. Were it to continue ‘protecting’ all its priority areas for a further two years, other budgets would have to be cut by a total of 23.8% (or £47.4 billion) by 2014–15 (including the £25.8 billion that would be required by 2012–13).
- The Conservative Party has promised to protect overseas aid (like Labour) and to increase NHS spending in real terms. Under Labour’s plans for spending overall, this would imply £45.7 billion in cuts in unprotected areas by 2014–15. As the Conservatives propose to protect fewer services than Labour, the percentage cut required across other departments is substantially smaller, at 18.3%. However, if the Conservatives’ plan to protect aid and the NHS were combined with the more ambitious tightening plan implied by their proposed fiscal targets, then the cuts in their unprotected areas could be more like 22.8% or £57.1 billion by 2014–15.

8.1 Introduction

The December 2009 Pre-Budget Report (PBR) forecast that public sector borrowing would be reduced from 12.6% of national income this year to 5.5% of national income by 2013–14 and to just 1.0% of national income by 2017–18. However, this desired narrowing of the budget deficit relies in large part on projections that total public spending will barely change in real (inflation-adjusted) terms over the four years from April 2011 to March 2015. This would be in sharp contrast to the real increases in public spending set to average 3.4% a year over the 14 years from April 1997 to March 2011.

Maintaining such tight control of public spending would at any time imply difficult choices over where to spend more and where to spend less, particularly as some public services may require real increases in spending simply to stand still (thanks to demographic pressures or the rising costs of recruiting and retaining appropriate staff, for example). However, as this chapter describes, hard-to-avoid increases in some items of spending – such as debt interest repayments and, at least under current policies, social security benefits – mean that the outlook for spending on public services over the next few years will be particularly difficult. Indeed, it is inevitable that some areas of public service delivery will have to be scaled back under the government's current plans.

Section 8.2 sets the scene for the forthcoming public spending squeeze by comparing the growth in overall spending implied by the plans set out in the December 2009 PBR with what has happened since Labour came to power in May 1997 and with what has happened over the longer term. Section 8.3 describes the trade-off that the current government – or its successor – would face in the next Spending Review between departmental spending and other areas of public spending if the projections for overall spending set out in the December 2009 PBR are to be adhered to. The current government has promised that, if re-elected, some areas of spending – including schools and the NHS – will not see their spending cut in real terms in 2011–12 or 2012–13, while spending on overseas aid will continue to be increased sharply. Section 8.4 looks at these pledges and assesses how generous they are. Section 8.5 then considers possible outcomes for departmental spending in the last two years of the government's current forecasting horizon, 2013–14 and 2014–15, and over the four-year period (2011–12 to 2014–15) as a whole. Section 8.6 concludes.

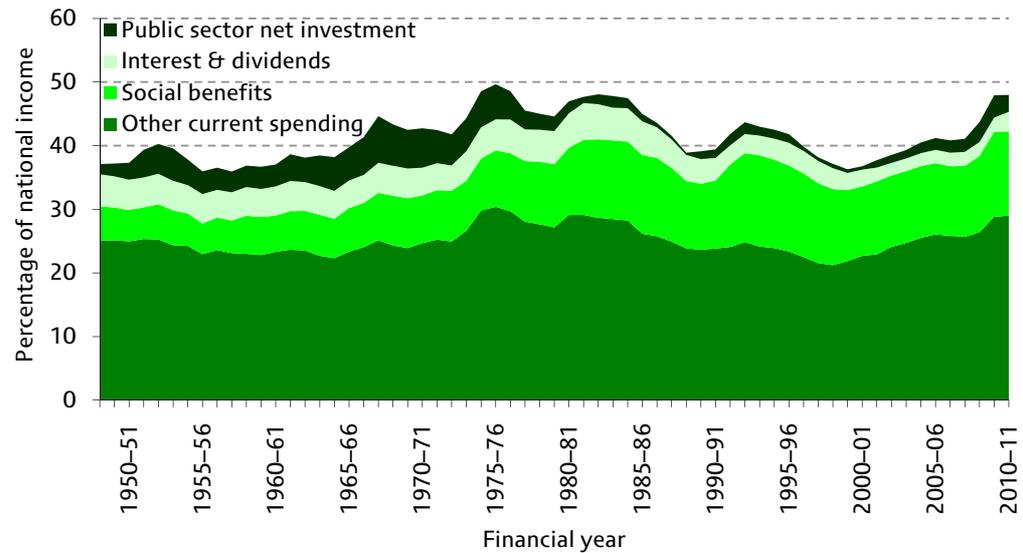
8.2 Trends in UK public spending

Total spending since 1948–49

The Treasury predicts that total managed expenditure (TME), the broadest measure of government expenditure, will be £675.7 billion in 2009–10. This equates to 48.0% of national income, or just under £11,280 for every person in the UK.

Figure 8.1 shows how public spending as a share of national income has varied since 1948–49. TME climbed from 37.1% of national income in 1948–49 to a peak of 49.7% in 1975–76. Spending on health, education and contributory benefits, such as the basic state pension, grew particularly quickly. Conversely, defence spending fell sharply after the end of the Korean War in 1953. Between 1975–76 and 1998–99, public spending fell as a share of national income, due initially to cuts in public sector net investment and then to cuts in current spending on public services (including education). Public spending fell particularly sharply during the late 1980s and late 1990s as a strong economy reduced

Figure 8.1. Composition of public spending since 1948–49



Notes: Projections are from the December 2009 PBR. Current expenditure includes depreciation.

Sources: Measures of public spending are ONS series ANLO, ANLT, ANLY, ANNW and ANNZ from table 2.3C of *Financial Statistics Freestanding Time Series Data*, <http://www.statistics.gov.uk/statbase/tsdtimezone.asp>. GDP is ONS series BKTL from table A2 of *United Kingdom Economic Accounts*, <http://www.statistics.gov.uk/statbase/tsdtimezone.asp>. HM Treasury, *2009 Pre-Budget Report: The Economy and Public Finances – Supplementary Material*, December 2009, http://www.hm-treasury.gov.uk/d/pbr09_chartstables.pdf.

expenditure on social benefits and debt interest payments. Conversely, the early 1990s saw public expenditure increase as weak economic performance pushed up spending in these areas. Figure 8.1 shows that public spending has risen again as a share of national income since April 1999, with the current year (2009–10) forecast to see the highest level of public spending as a share of national income since 1982–83.

We now describe trends in spending under the current Labour government in more detail.¹

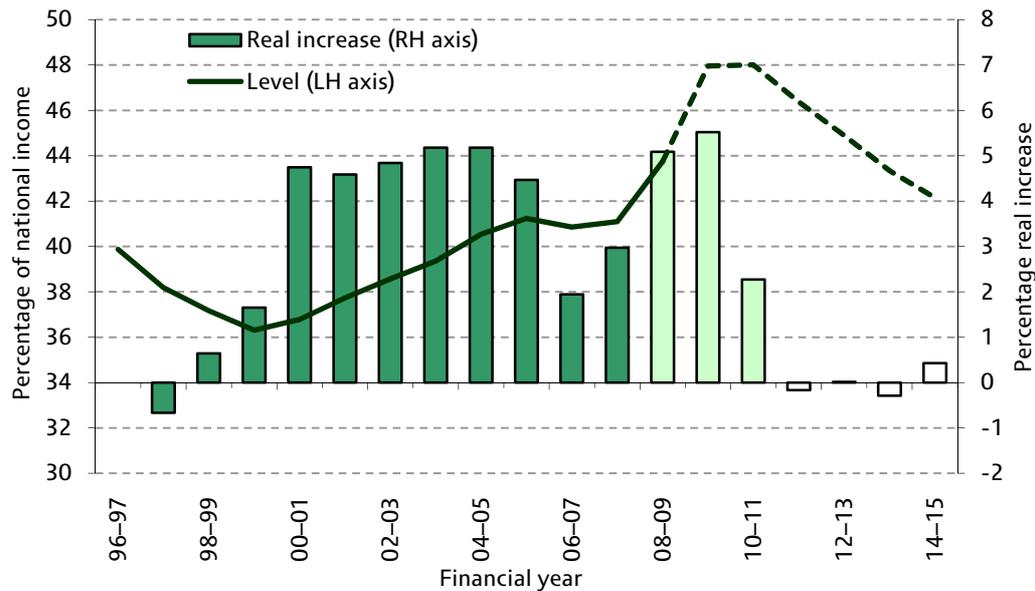
Growth in public spending under Labour to date

In 1996–97 – the last full financial year before Labour came to power – total public spending stood at 39.9% of national income. As the solid line (measured on the left-hand axis) in Figure 8.2 shows, this had fallen to 36.3% of national income in 1999–2000. This decline reflected a combination of strong economic performance and low growth in spending on public services. Low growth in spending on public services in 1997–98 and 1998–99 had been planned by the previous Conservative government, and the incoming Labour government chose largely to continue to adhere to these plans once it came into office, in line with Labour’s 1997 manifesto commitment to ‘stick for two years within existing spending limits’.²

¹ More details of trends in public spending, and how it is planned, can be found in R. Crawford, C. Emmerson and G. Tetlow, *A Survey of Public Spending in the UK*, Briefing Note 43, IFS, London, September 2009, <http://www.ifs.org.uk/publications/1791>.

² Labour Party general election manifesto, *New Labour because Britain Deserves Better*, 1997.

Figure 8.2. Total managed expenditure



Notes: Light green bars represent the years covered by the CSR 2007. White bars are Treasury plans for years not yet covered by a Spending Review.

Sources: Figures for TME from 1996–97 to 2007–08 are from table B1 of HM Treasury, *Public Sector Finances Databank*, 4 January 2010, http://www.hm-treasury.gov.uk/d/public_finances_databank.xls, while figures for 2008–09 onwards are from tables B13 and B15 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm. Figures for the GDP deflator are from HM Treasury, http://www.hm-treasury.gov.uk/data_gdp_fig.htm.

In July 1998, the government presented the results of the first Comprehensive Spending Review (CSR), which set out departmental spending plans for 1999–2000, 2000–01 and 2001–02. Spending continued to fall as a share of national income in 1999–2000, as some departments underspent their budgets, but since then public spending has increased. It reached 41.2% of national income in 2005–06, due to increases in spending on public services (in particular, education and health) and large increases in the generosity of targeted support aimed at lower-income families with children and lower-income pensioners.

The bars in Figure 8.2 (and the right-hand axis) show the annual real³ increase in spending since 1996–97. Relatively large real increases in spending were seen in each year from 2000–01 to 2005–06. Lower growth in public spending in 2006–07 and 2007–08 meant that public spending stabilised as a share of national income.

Cash departmental spending plans for the years 2008–09 to 2010–11 were set by the 2007 CSR. As we highlight later (see Table 8.1), the real-terms increases in spending that are now expected to occur over those years are significantly higher than had been envisaged in CSR 2007. This is because inflation has turned out to be lower than expected and additional spending has been required on, in particular, social security benefits and debt interest payments as a result of the recession. The increase in spending as a share of national income, above that expected in CSR 2007, is even more dramatic, as national

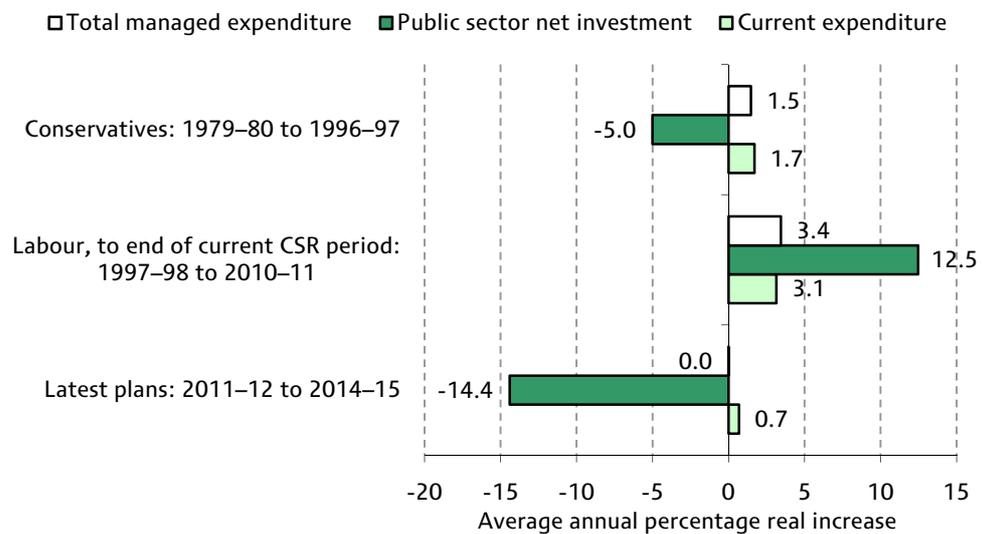
³ Throughout this chapter, we refer to changes in ‘real’ spending, by which we mean spending calculated by deflating spending with growth in the GDP deflator. While this might not be the appropriate deflator for the increase in the cost of goods and services purchased by public spending, it could be considered the most appropriate deflator when considering the cost to the taxpayer.

income is now much lower than was previously expected (reflecting both a shrinking real economy and low inflation). As a result, public spending is expected to total 48.0% of national income this year (2009–10) and next. Low real growth in spending and a rebound in nominal national income growth over the following four years are expected to return spending to 42.2% of national income by 2014–15.

Investment and non-investment spending

Total public spending can be split into investment and current (non-investment) spending. Figure 8.3 shows how each of these fared under the 18 years of Conservative governments from 1979–80 to 1996–97 and over the period from 1997–98 to 2010–11 (the last year for which we have detailed spending plans from the current government), as well as what the latest plans imply for the four-year period from 2011–12 to 2014–15.

Figure 8.3. Average growth in TME, current spending and investment spending



Note: Current spending includes depreciation.

Sources: Out-turn data from table B1 of HM Treasury, *Public Sector Finances Databank*, 4 January 2010, http://www.hm-treasury.gov.uk/d/public_finances_databank.xls. Forecasts from table B13 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm. Figures for GDP deflator from HM Treasury, http://www.hm-treasury.gov.uk/data_gdp_fig.htm.

While total public spending is (on present plans) set to be frozen in real terms over the four-year period from April 2011 to March 2015, there is a sharp difference in the growth rates for current and net investment spending. Current spending, which makes up the majority of spending (as shown in Figure 8.1), is to rise by an average of 0.7% a year in real terms, while net investment spending is forecast to fall by an average of just over 14% a year. This is in sharp contrast to the experience under Labour since 1997–98, with current spending growing by 3.1% a year while net investment spending grows by 12.5% a year in real terms. The government's future spending plans are considerably less generous on average even than those delivered over the 18 years of Conservative governments from 1979–80 to 1996–97.

The planned squeeze on investment spending is in conflict with the government's stated policy regarding investment. In its November 2000 document *Planning Sustainable Public*

Spending: Lessons from Previous Policy Experience, the Treasury criticised the investment spending decisions made by the previous Conservative governments, stating:

Lesson 5: Avoid a bias against capital investment

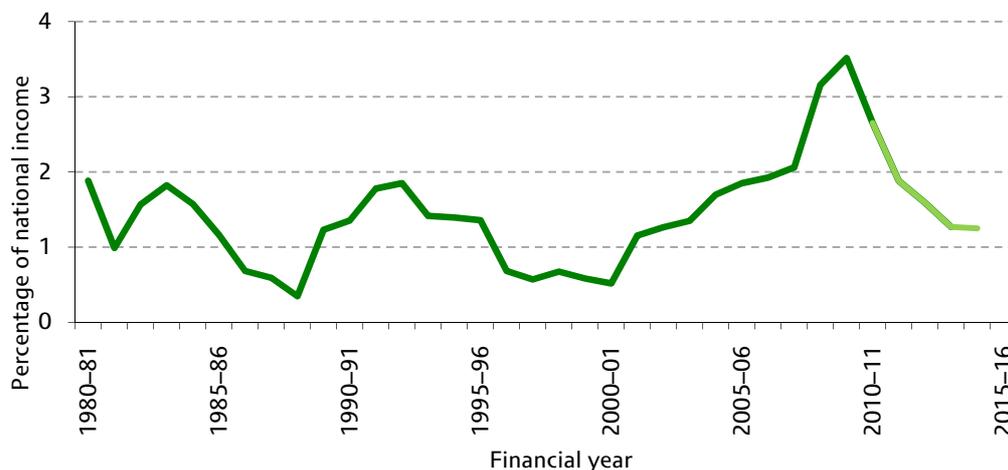
The previous framework made no distinction between capital and current spending, despite their different economic effects. Investment was not protected. As a result, capital programmes were cut as a way of meeting short term current pressures, with long term detrimental effects.⁴

In the November 2008 review of the government’s fiscal framework, the Treasury claimed that capital spending would rightly continue to get favourable treatment:

setting policies to balance the cyclically-adjusted current budget will continue to protect capital spending and support inter-generational fairness, maintaining investment now to support the long-term productivity and competitiveness of the economy.⁵

This stated objective of maintaining investment seems rather inconsistent with the plan to cut cash investment spending over the next Spending Review period, which was pencilled in by the December 2009 PBR. As shown in Figure 8.4, this cut in cash spending will lead to all of the increase in public sector net investment as a share of national income seen between 2001–02 and 2007–08 being reversed (figures for 2008–09 and 2009–10 are inflated by the recession, the decision to bring investment spending forward from 2010–11, and some temporary investment in the now nationalised banks). This will return public service investment spending to slightly below the level delivered in the early 1990s. It is hard, however, directly to compare the level of public investment spending under the current Labour government with the level in the 1980s, since the

Figure 8.4. Public investment to be cut back to early 1990s levels



Sources: Figures shown are for public sector net investment. Figures to 2007–08 are from table B2 of HM Treasury, *Public Sector Finances Databank*, 4 January 2010, http://www.hm-treasury.gov.uk/d/public_finances_databank.xls. Figures for 2008–09 onwards are from table B14 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm.

⁴ <http://www.hm-treasury.gov.uk/d/86.pdf>.

⁵ HM Treasury, *The Government’s Fiscal Framework*, November 2008, http://www.hm-treasury.gov.uk/d/pbr08_fiscalframework_518.pdf.

public sector was involved in a far wider range of activities in the 1980s. Most notably, any investment in the state-owned industries and companies (which have now largely been privatised) counted as public sector investment at that time.

‘Plannable’ and other spending

For planning purposes, the current government splits TME into two components:

- **Departmental expenditure limits (DELs)** are yearly limits for departmental programme expenditure, which are formally set for three years at a time by Spending Reviews (although they can be, and often are, subsequently revised) and can be broadly thought of as the amount central government spends delivering and administering public services.
- **Annually managed expenditure (AME)** is expenditure that the government argues is not easily subject to firm limits set several years in advance, such as spending on social security benefits and debt interest (though Box 8.1 discusses some components of AME that arguably could be planned in advance, just like DELs).

Figure 8.5 shows how the past annual percentage real increases in total spending under the current Labour government have been distributed between growth in DEL and growth in AME. The bars for total expenditure are the same as those shown in Figure 8.2.

Although departmental spending growth has been somewhat lower in recent years, over the whole period from 1999–2000 to 2009–10 growth has been positive in every year. Particularly high growth in AME can be seen in 2004–05 and 2008–09. The former was the result of increases in the generosity of tax credits and the pension credit. High growth in 2008–09 predominantly reflects the costs of rising unemployment and payments made to rescue the banking sector. In 2010–11, departmental spending is forecast to be cut in real terms, although this was not what was envisaged at the time of the CSR 2007.

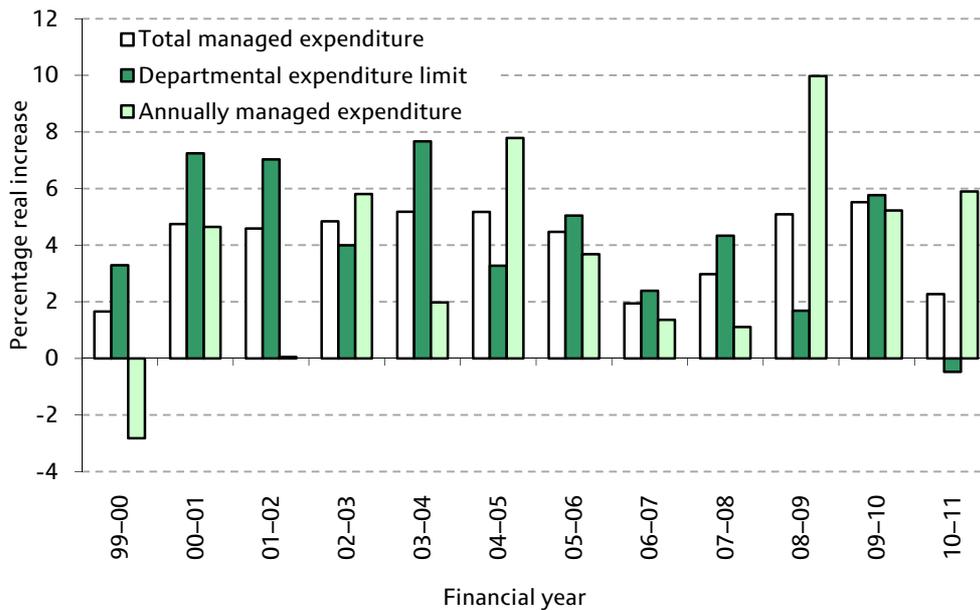
Box 8.1. Alternative ways of planning public spending

Some components of AME could reasonably be planned in advance, like DELs.

- **State pension:** The government determines the generosity of payments and the eligibility criteria. The number of recipients of the state pension and the value of their entitlements should be relatively easy to predict for the next few years, given the current National Insurance records of those approaching the state pension age. In June 2009, the Department for Work and Pensions forecast that spending on the basic state pension, the State Earnings-Related Pension Scheme (SERPS) and the state second pension (S2P) would account for £69 billion in 2010–11, which is over one-fifth of AME.
- **Child benefit:** The government determines the generosity of payments and the eligibility for child benefit. The number of recipients is relatively easy to predict and so spending on child benefit over the next few years could be planned in advance.

A broader method of planning public spending has existed in the past. Under the previous Conservative government, public spending was planned using a ‘[new] control total’, which planned not just departmental spending for the subsequent three years, but also included all non-cyclical social security spending: so as well as including spending on the state pension and child benefit, payments to, for example, lone parents and those with disabilities were also included.

Figure 8.5. Growth in DELs and AME



Sources: Figures for total spending as in Figure 8.2. Figures for DEL and AME from 1999–2000 to 2007–08 are from various editions of HM Treasury, *Public Expenditure Statistical Analyses*, http://www.hm-treasury.gov.uk/pespub_index.htm. Figures for DEL and AME in 2008–09 onwards are from HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm and include spending by central government on the nationalised banks as part of AME.

Table 8.1 compares the original plans for spending over the CSR 2007 period with the latest forecast for out-turns and shows the relative generosity of CSR 2007 for the DEL and AME components. The first row shows the average real spending growth over the three years of the review implied by the Treasury’s original cash plans and expected inflation at the time the plans were set. The second row shows the real growth that would have resulted if these cash plans had been adhered to, bearing in mind that inflation differed from the rates assumed by the Treasury when these plans were drawn up. The third row shows the actual average growth in real spending now forecast over the CSR 2007 period.

Table 8.1. Growth in TME, DELs and AME over the 2007 CSR period

Time period	TME	DELs	AME
<i>April 2008 to March 2011</i>			
Original plans	2.0	2.0	2.0
Adjusted for actual inflation	2.5	2.5	2.5
Latest forecast	4.3	2.3	7.0

Sources: HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm; HM Treasury, *2007 Pre-Budget Report and Comprehensive Spending Review*, Cm. 7227, October 2007, http://www.hm-treasury.gov.uk/d/pbr_csr07_completereport_1546.pdf.

Table 8.1 shows that real spending is now expected to grow more than twice as fast over the period April 2008 to March 2011 as was envisaged at the time of the CSR 2007. The lower-than-expected inflation rates mean that the cash spending plans now imply much faster real growth over this period than was originally planned. There is also now projected to be much higher cash spending on AME than was originally planned, owing largely to rising debt interest and benefits payments during the recession. The growth in

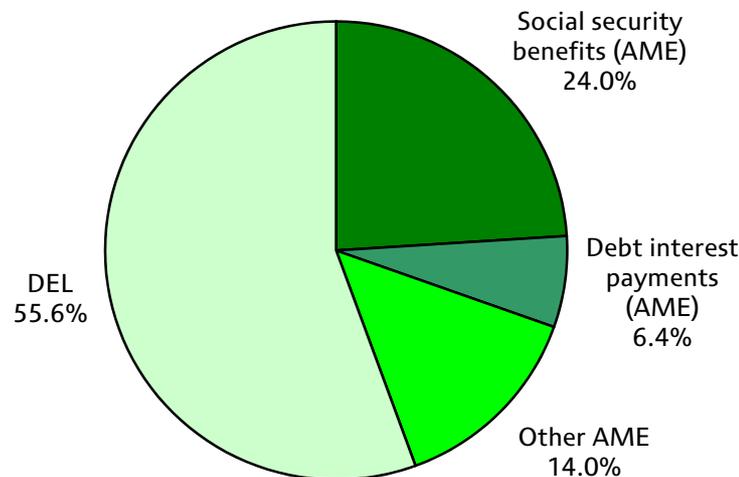
DELs, by contrast, is projected to be similar to that planned in the CSR 2007. The latest forecast is actually for slightly lower growth than the inflation-adjusted CSR 2007 plans. This is the result of extra 'efficiency savings' identified for 2010–11 and the investment spending that was brought forwards from that year into 2008–09 and 2009–10. These both act to depress the apparent growth rate of departmental spending to 2010–11.

8.3 Overall outlook for Spending Review 2010

In the December 2009 PBR, the Treasury pencilled in a real freeze in TME for the four years 2011–12 to 2014–15. This would be the lowest average real increase in spending since the four-year period 1996–97 to 1999–2000. This implies that the next Spending Review, which will presumably be held in 2010 and could (but might not necessarily) cover the three years 2011–12 to 2013–14, is going to be tight and especially painful for departments which have become accustomed to the large budget increases they have seen in recent years. As we will discuss below, current plans suggest this could well be the lowest sustained period of growth in spending on public services since the late 1970s, following the last Labour government's request for a loan from the International Monetary Fund (IMF).

Figure 8.6 shows the latest forecast for the composition of TME in 2010–11. Departmental spending is expected to be slightly more than half (55.6%) of total spending. The largest component of AME is social security benefits, which make up almost a quarter of total spending. Debt interest payments are projected to be 6.4% of total government spending in 2010–11, leaving 'other AME' to contribute 14.0% to total spending.

Figure 8.6. Planned composition of TME in 2010–11



Note: These figures for TME include spending by central government on the financial sector.

Source: Table B15 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm.

In order to know exactly what DELs will be beyond the end of the current Spending Review period, we would need to know how much of TME is set to be spent on AME from 2011–12 onwards. Regrettably, the Treasury did not publish its forecasts for AME over the period 2011–12 to 2014–15 in the Pre-Budget Report and so there are no official published figures for the projected split of TME into AME and DEL after 2010–11. It is known, however, that the Treasury does (for internal use) produce such projections since

these were contained in a document from the Treasury (dated from the time of Budget 2009) that was leaked to the Conservatives and published in September 2009. Under questioning by the House of Commons Treasury Select Committee after the 2009 PBR, Chancellor Alistair Darling stated ‘we cannot publish, because we have not done a Spending Review yet, our decisions in relation to [annually managed expenditure and the departmental total]’ and ‘what we publish are the Departmental Expenditure Limits when they are fixed, we publish the AME forecasts ... when they are fixed, what we do not do though is publish every assumption, every estimate because that is not an indication of what the government’s policy is’.⁶

While there are no official figures for the projected split of TME into DEL and AME after 2010–11, it is possible to make some reasonable projections for the growth in components of AME under current policies. Subtracting these predictions from the growth in total expenditure that the government has pencilled in provides an indication of how tight spending growth would need to be for DELs. The remainder of this section sets out our assumptions about growth in AME over the four-year period from April 2011 to March 2015, and the implications for growth in total DELs over the same period. The subsequent two sections then discuss the implications of these plans for total DELs for individual spending areas.

Growth in annually managed expenditure, 2011–12 to 2014–15

Debt interest payments

As a result of the financial crisis and associated recession, public sector net debt is forecast to almost double – from just under 40% of national income in 2007–08 to just under 80% of national income in 2014–15. The implication of this is that interest payments on the accumulated national debt will increase rapidly over the next few years. Figures contained in the December 2009 PBR suggest that gross debt interest payments are forecast by the Treasury to grow by around 9.4% a year in real terms on average over the period from 2010–11 to 2014–15 (from £45 billion to £71 billion in cash terms, or from 3.1% of national income to 3.9% of national income).⁷

Social security spending

Future spending on social security, which accounts for more than half of AME, can also be estimated on the basis of current policies. While reforms could reduce spending growth in this area, they might take time to have a significant effect unless they involve reductions in benefit rates for existing recipients. Figures leaked from the Treasury to the Conservative Party and published in September 2009 provided forecasts made in April 2009 for spending on social security for 2011–12, 2012–13 and 2013–14. These implied that, on average, this spending was projected to grow in real terms (that is, after taking account of economy-wide inflation, as measured by the GDP deflator) by 1.4% a year over

⁶ 16 December 2009, <http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtreasy/uc180-iii/uc18002.htm>.

⁷ The December 2009 PBR contains figures for public sector gross debt interest spending up to, and including, 2010–11 in table 2.8 of HM Treasury, *2009 Pre-Budget Report: The Economy and Public Finances – Supplementary Material*, December 2009, http://www.hm-treasury.gov.uk/d/pbr09_chartstables.pdf. Figures for later years were calculated in the following way. First, ‘public sector net debt interest payments’ were computed by taking the difference between the primary balance (which is borrowing excluding net debt interest payments) and total borrowing, both measured as a share of national income, from table B2 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm. These were converted to £ billion using the PBR projections for GDP in table B1. To get gross debt interest payments, ‘interest and dividends’ received were added back in; these were taken from table 2.9 of the PBR *Supplementary Material*.

these three years. The expectation of above-inflation increases is unsurprising given that most benefits are uprated either in line with growth in prices or more quickly, and that the number of pensioners is increasing as longevity extends and the baby boomers start reaching the state pension age. While unemployment might well fall over this period – and therefore perhaps lead to an overall reduction in spending in real terms – the Treasury, by convention, makes the more cautious assumption that it will remain constant. Thus, in the Treasury's forecasts at least, this will not put downward pressure on social security spending.

As no similar figures for growth in social security spending were released by the Treasury with the December 2009 PBR, we simply adjust the previous projected growth rate for each individual year to take account of the fact that the Treasury now forecasts that the retail price index (RPI) will increase slightly faster, relative to economy-wide inflation – as defined by the GDP deflator – than it did at the time of the Budget. This is important, as overall spending beyond April 2011 is planned by the Treasury, and defined in this chapter, relative to economy-wide inflation, whereas a large proportion of social security spending is on benefits that are uprated in line with the RPI. This methodology gives an average annual real increase in social security spending of 1.5% a year over the three years 2011–12, 2012–13 and 2013–14. As the document leaked from the Treasury did not contain a forecast for growth in spending on social security in 2014–15, we simply assume that it will increase by a further 1.5% that year, i.e. in line with the average increase over the previous three years (and, by coincidence, the increase projected for 2013–14).

Other annually managed expenditure

Other AME includes areas of spending such as expenditure by local authorities that is financed via local taxes (mainly the council tax), spending on tax credits (as these are not covered by the Treasury's definition of social security used above), spending on providing pensions to retired former public servants (which has been increasing quite quickly in recent years) and the UK's net contribution to the European Union (which has been increasing very quickly in recent years). While locally financed spending could be reduced by central government through greater use of its powers to cap the council tax rises of individual councils, this would do little to help reduce government borrowing since spending cuts would be associated with (almost) equivalent reductions in council tax revenues.⁸ Reductions in tax credit expenditure would, like reductions in social security spending, require reductions in generosity for existing claimants if significant savings were to be delivered quickly. However, some cuts in this area – albeit relatively small ones – have been proposed by the Conservatives and the Liberal Democrats and so it is perhaps less difficult to imagine further policy proposals aimed at reducing spending on tax credits (see Chapter 7). In contrast, it is difficult to imagine reductions in spending on the pensions of former public sector workers or on the UK's European commitments in the near term.

The leaked figures from the Treasury mentioned above provided estimates for total spending on these areas of 'other AME' in each of 2011–12, 2012–13 and 2013–14. These implied that, on average, this spending was projected to grow in real terms by 3.1% a year over these three years. For the following analysis, we simply assume that forecast real spending growth in each of these years will be the same as it was forecast to be in the

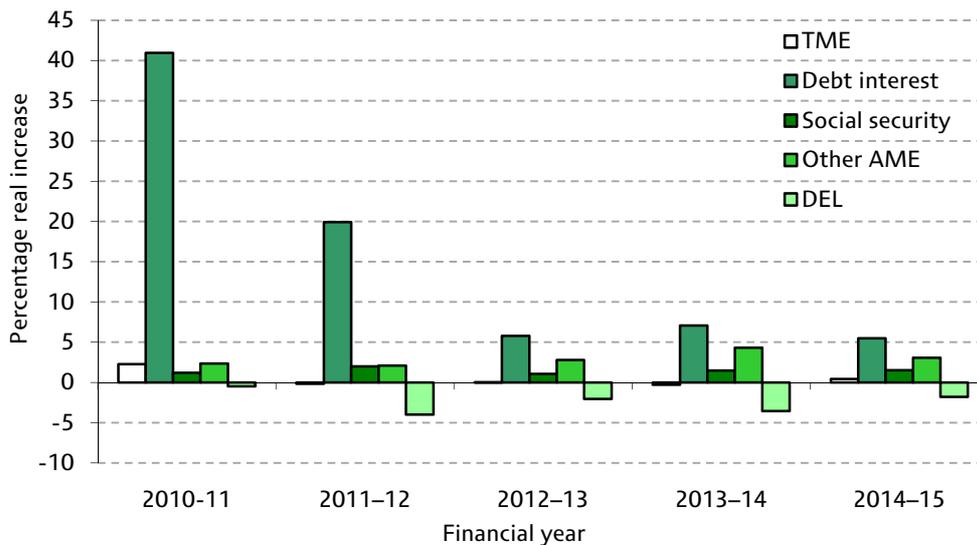
⁸ Overall, reductions in local authority self-financed expenditure and commensurate reductions in council tax would strengthen the public finances slightly through reductions in spending on council tax benefit.

leaked document. As the document does not contain a forecast of growth in spending on 'other AME' in 2014–15, we simply assume that it will increase by a further 3.1% in this year, i.e. in line with the average increase over the previous three years.

Implications for departmental spending, 2011–12 to 2014–15

Our assumed growth rates for each of these broad components of AME in the four years 2011–12, 2012–13, 2013–14 and 2014–15 are shown in Figure 8.7. Also shown are the forecasts for real increases in TME – from the December 2009 PBR – and the implication of the AME spending assumptions set out above for growth in overall DEL.

Figure 8.7. How much might be left for departments? (1)

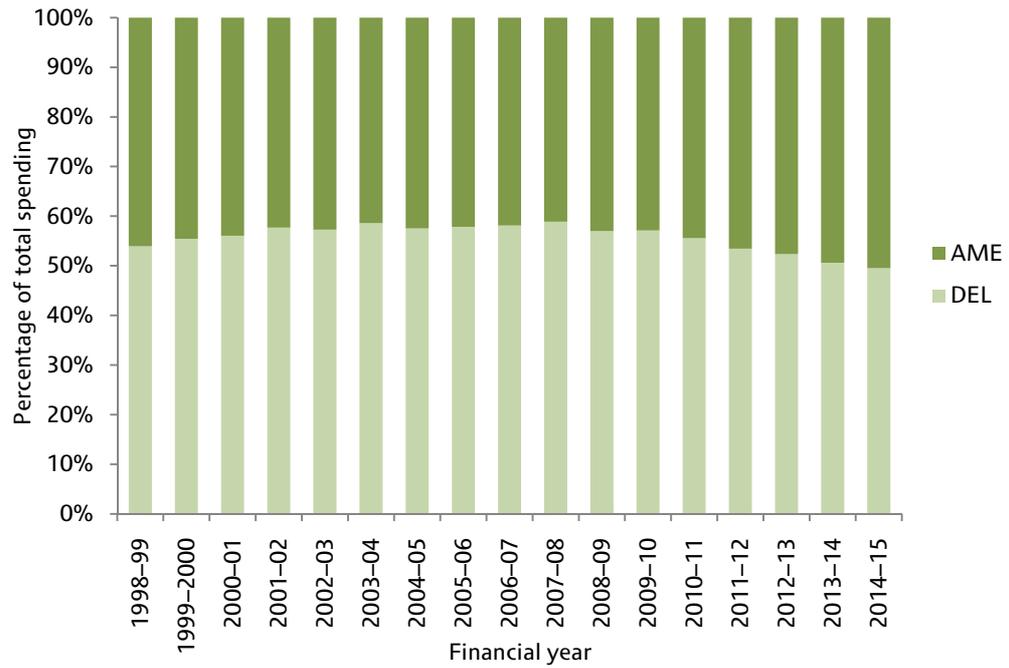


Sources: 2010–11 forecasts and forecasts for TME are from HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm. Other projections are authors' calculations based on: the December 2009 PBR; HM Treasury, *2009 Pre-Budget Report: The Economy and Public Finances – Supplementary Material*, December 2009, http://www.hm-treasury.gov.uk/d/pbr09_chartstables.pdf; and internal HM Treasury forecasts for AME growth over the period 2011–12 to 2013–14.

Based on the assumptions for AME growth set out above, on current policies, real-terms DELs would need to be cut by 4.0% in 2011–12, 2.0% in 2012–13, 3.6% in 2013–14 and 1.8% in 2014–15 – or by 2.9% a year on average over the four years. This gives a cumulative real cut over the four years of 10.9% or £42.0 billion a year in 2009–10 prices by 2014–15. Taking into account the 0.5% cut in DELs the Treasury has confirmed for 2010–11, current plans imply DEL falling in real terms in every year of the next five-year parliament. The cumulative real cut over the five years is 11.4%, or £43.8 billion in 2009–10 prices. These real cuts in spending would be in sharp contrast to the increases seen over the years between 1999–2000 and 2009–10, as was shown in Figure 8.5.

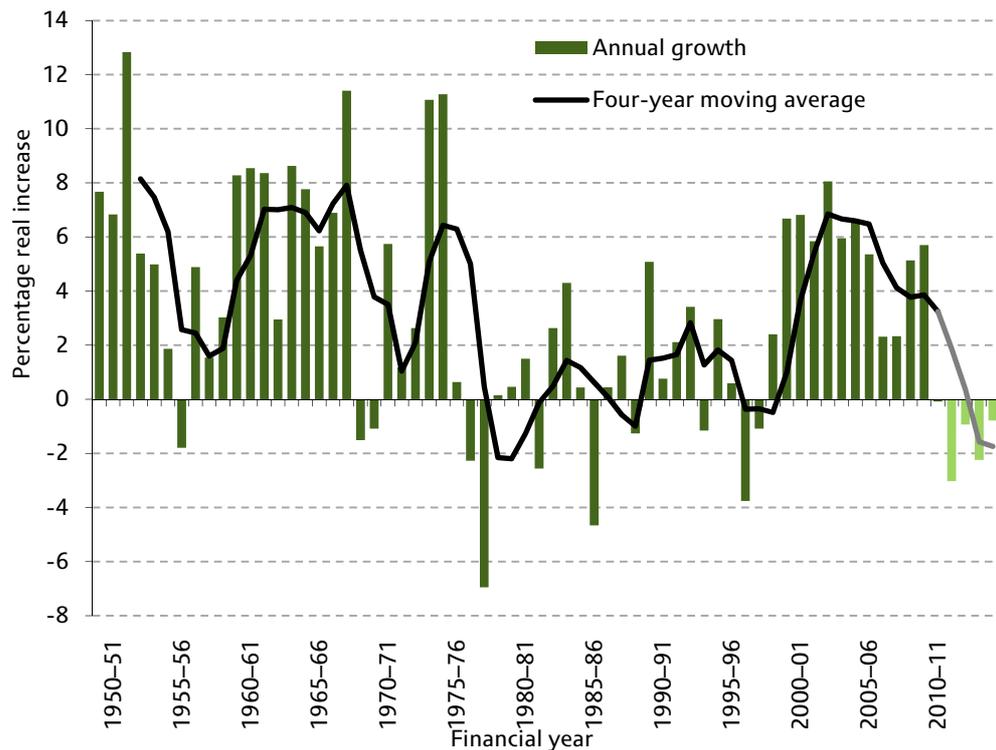
As Figure 8.8 shows, under the above-outlined assumptions about growth in AME, by 2014–15 less than half of total public spending would be on DELs. This has not been seen in any of the years since 1998 when the government introduced the DEL and AME split used to plan public spending.

Figure 8.8. Composition of spending: DEL/AME split



Sources: As for Figures 8.5 and 8.7.

Figure 8.9. Estimated spending on public services under current policies



Note: Spending on public services defined as total public spending less both gross interest payments and welfare payments.

Sources: Historical data are from ONS series ANLY, ANLT, ANNW, ANNZ and ANLO from table 2.3C of *Financial Statistics Freestanding Time Series Data*, <http://www.statistics.gov.uk/statbase/tsdtimezone.asp>. Forecasts are from HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm and HM Treasury, *2009 Pre-Budget Report: The Economy and Public Finances – Supplementary Material*, December 2009, http://www.hm-treasury.gov.uk/d/pbr09_chartstables.pdf. Forecast data are authors' calculations.

Since the DEL and AME split was only introduced in 1998, direct comparisons with previous periods (for example, the spending squeeze implemented when New Labour first came to power) cannot be made using these definitions. However, Figure 8.9 compares future spending on public services with spending in previous decades using a slightly broader definition of spending on public services. Specifically, Figure 8.9 shows the annual real growth, and four-year moving average real growth rate, of total public spending less both gross interest payments and spending on welfare payments, using data from the Office for National Statistics that go back to 1948–49. This can be considered, broadly, to be a measure of spending on public services. This measure of spending is projected to be cut, in real terms, each year from 2010–11 to 2014–15 (inclusive). If this is delivered, it would be the first time there have been five consecutive years of real spending cuts on this measure since the data began in 1948–49. The average annual cut over the four years 2011–12 to 2014–15 is projected to be 1.7% a year, which would be the lowest average increase over a four-year period since the four years from April 1976 to March 1980 – the period following the UK’s loan from the IMF.

The next Spending Review could cover the three years 2011–12, 2012–13 and 2013–14 – this would be in line with previous Spending Reviews, which have produced plans on a three-year horizon. However, the current government has now made specific spending commitments (discussed in Section 8.4) that cover only the first two of these years. This might suggest that the Spending Review, under a Labour government, would cover only a two-year horizon. This would also be consistent with the argument that Mr Darling, and others in the government, have made that the economic outlook is currently too uncertain for them to be able to set out detailed longer-term spending plans.⁹

We also do not know the time period for which a potential incoming Conservative government would set its spending plans. The Conservatives could continue Labour’s practice of planning spending on a three-year basis, they could shorten the horizon to two years or plausibly they could extend it to a fourth year. Having a longer horizon would be consistent with the argument that a more detailed plan for cutting spending is required.

Given that we have figures for total public spending for four years (from 2011–12 to 2014–15) and that we have more specific spending commitments from the government for two years, we focus in the remainder of this chapter on the outlook for departmental spending over these two- and four-year horizons (rather than a three-year horizon, which would be more consistent with the Labour government’s planning since 1998).

The outlook for departmental spending, 2011–12 to 2014–15

Table 8.2 shows the average real increases in TME, in each broad component of AME and therefore in DEL for (i) the two years 2011–12 and 2012–13, (ii) the following two years (2013–14 and 2014–15) and (iii) over all four years. As mentioned above, on average over these four years, DELs are – on current policies – estimated to be cut by 2.9% a year in real terms. In contrast, the October 2007 CSR – the least-generous Spending Review under Labour to date – planned for increases in DEL spending averaging 2.0% a year in

⁹ In his December 2009 PBR speech, Mr Darling said ‘We have already set out clear and firm departmental budgets for the next financial year, but to try and fix each department’s budget now, for the next five years, is neither necessary or sensible’ (http://www.hm-treasury.gov.uk/prebud_pbr09_speech.htm). In evidence to the House of Commons Treasury Select Committee, he said ‘I do not think it would be right to do a spending review now where you would say department by department this is what you are getting for the next few years, simply because of the uncertainty we have got’ (<http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtreasy/uc180-iii/uc18002.htm>).

real terms. The average annual forecast cut in DELs amounts to 3.0% over the first two years (2011–12 and 2012–13) and 2.7% over the final two years (2013–14 and 2014–15).

At least since 1998–99, we can estimate the extent to which such tight spending plans for DELs would reverse the increases that have occurred under Labour to date. As shown in Figure 8.10 (the bars and the right-hand axis), in real terms DELs are forecast to be 65% higher in 2010–11 than they were in 1998–99. By 2014–15, the cuts that we estimate are implied by current policies would reverse almost a third of this increase – leaving DEL spending 47% higher than in 1998–99, or back to the level seen in 2006–07.

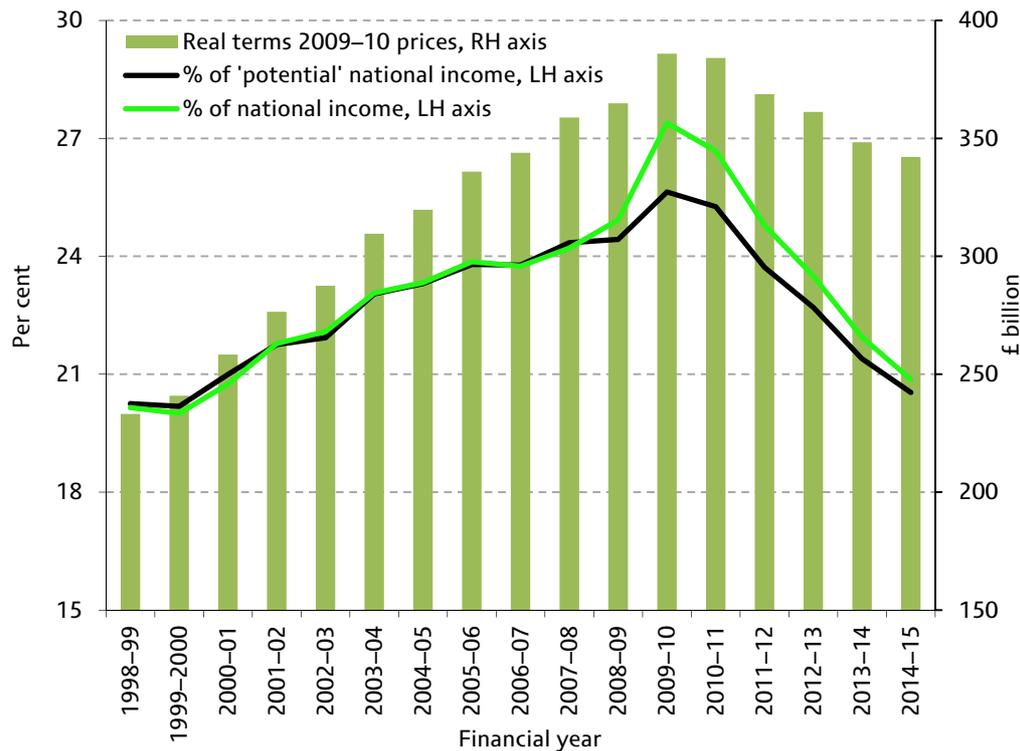
It might be more appropriate to look at spending not in real terms but instead as a share of national income; in particular, some of the costs of providing a given standard of public service (such as the public sector pay bill) might rise by more each year than economy-wide inflation. The green line in Figure 8.10 (and the left-hand axis) therefore shows DELs as a share of national income. However, looking at DELs as a share of contemporaneous national income is slightly misleading since in downturns, when nominal national income is low, departmental spending as a share of national income will be inflated by the denominator effect, whilst in a boom, when nominal national income is high, DELs as a share of national income will appear much lower. Therefore, the black line in Figure 8.10 shows DELs as a share of ‘potential’ national income (i.e. smoothing out the ups and downs of the economic cycle). These two series track one another closely during the early 2000s but the impact of the ‘denominator effect’ can be clearly seen in the current year – DELs are substantially larger as a share of actual national income than as a share of ‘potential’ national income. Looking at DELs as a share of ‘potential’ national income shows that the cuts over the four years from 2011–12 would be sufficient to reverse almost all of the increase seen since Labour came to power.

Table 8.2. How much might be left for departments? (2)

	Average annual real growth (%)		
	First two years: 2011–12 and 2012–13 (i)	Next two years: 2013–14 and 2014–15 (ii)	All four years: 2011–12 to 2014–15 (iii)
<i>Provisional spending plan</i>			
TME	–0.1	+0.1	0.0
Memo: cumulative change	–0.2	+0.1	0.0
Memo: £/year by end year	–£1.1bn	+£1.0bn	–£0.1bn
<i>Projections</i>			
Debt interest	+12.6	+6.3	+9.4
Social security	+1.5	+1.5	+1.5
Other AME	+2.4	+3.7	+3.1
Total AME	+3.5	+3.0	+3.2
Residual: DEL	–3.0	–2.7	–2.9
Memo: cumulative change	–6.0	–5.3	–10.9
Memo: £/year by end year	–£22.9bn	–£19.1bn	–£42.0bn

Sources: As for Figure 8.7.

Figure 8.10. Labour's boost to spending on public services to be reversed?



Sources: As for Figures 8.5 and 8.7. Historical data on national income and the output gap are from table A1 of HM Treasury, *Public Sector Finances Databank*, 4 January 2010, http://www.hm-treasury.gov.uk/d/public_finances_databank.xls. Forecasts for national income and the output gap are from tables B1 and B2 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm.

8.4 Departmental spending in 2011-12 and 2012-13: sharing the pain?

We now examine what the projected cuts to overall DELs, summarised in Table 8.2, and the specific pledges already made by the government in the December 2009 PBR might mean for various different areas of departmental spending in 2011-12 and 2012-13.

Present government spending plans

In the December 2009 PBR, the government set out some specific pledges to protect real-terms spending on various priority areas. The first column of Table 8.3 takes the 3.0% a year cut to DEL that our figures suggest would be required over the two years 2011-12 and 2012-13 (as shown in the first column of Table 8.2) and sees what would be left over once these spending commitments are taken into account.

The 3.0% a year cut in 2011-12 and 2012-13 cumulates to a 6.0% cut in DELs by the second year, or £22.9 billion in 2009-10 prices. However, with the government having committed not to cut spending in some areas and, indeed, to increase real spending in some other areas, even larger cuts will have to be found in the unprotected areas.

Table 8.3. Estimated average increases in DELs, before and after specific commitments

	Average real growth, 2011–12 and 2012–13 (%)	
	PBR planned fiscal tightening	Faster fiscal tightening
TME	-0.1%	-0.7%
Memo: cumulative change	-0.2%	-1.4%
Memo: cut £/year by end year	-£1.1bn	-£9.8bn
DEL	-3.0%	-4.2%
Memo: cumulative change	-6.0%	-8.2%
Memo: cut £/year by end year	-£22.9bn	-£31.6bn
Meet overseas aid (ODA) target	+11.3%	+11.3%
'Protect' front-line NHS	0.0%	0.0%
Residual: DEL less ODA & NHS	-5.0%	-6.8%
Memo: cumulative change	-9.7%	-13.1%
Memo: cut £/year by end year	-£25.0bn	-£33.7bn
'Protect' front-line schools	+0.7%	+0.7%
'Protect' front-line 16-to-19 education	+0.9%	+0.9%
'Protect' front-line Sure Start	0.0%	0.0%
Residual: DEL less ODA, NHS, schools & Sure Start	-6.7%	-9.1%
Memo: cumulative change	-12.9%	-17.3%
Memo: £/year by end year	-£25.8bn	-£34.5bn

Sources: Authors' calculations using HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm; HM Treasury, *Public Expenditure Statistical Analyses 2009*, July 2009, http://www.hm-treasury.gov.uk/pespub_pesa09.htm; Department for Children, Schools and Families, *Departmental Report 2009*, Cm. 7595, June 2009, <http://publications.dcsf.gov.uk/eOrderingDownload/DCSF-Annual%20Report%202009-BKMK.PDF>; House of Commons Library, *The UK & the 0.7% Aid Target, and the International Development (ODA Target) Bill*, SN/EP/3714, 18 January 2010, <http://www.parliament.uk/commons/lib/research/briefings/snep-03714.pdf>.

The 2005 Labour Party manifesto pledged to increase spending on overseas aid to 0.7% of gross national income (GNI), which is the long-standing United Nations (UN) recommended level for developed countries, by 2013.¹⁰ The government reiterated its commitment to this target in the December 2009 PBR¹¹ and the Conservatives have also stated that, if elected, they would honour this commitment, with David Cameron saying 'We are today reaffirming our commitment to meet the internationally agreed goal: 0.7 per cent of Gross National Income spent on aid by 2013'.¹² The Liberal Democrats are also

¹⁰ 'Now, for the first time ever the UK has a clear timetable – 2013 – for achieving the UN target of 0.7 per cent of national income devoted to development' (page 90 of *The Labour Party Manifesto 2005*).

¹¹ Paragraph 6.34 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm.

¹² Speech by David Cameron, 'One world conservatism', 13 July 2009, http://www.conservatives.com/News/Speeches/2009/07/David_Cameron_One_World_Conservatism.aspx.

committed to increasing overseas aid to this level.¹³ Recent years have seen sharp increases in overseas aid, but further sharp increases (averaging 11.3% a year in real terms) would be required if this commitment is to be met in 2013.

In the December 2009 PBR, the government also said that spending on 'front-line' NHS services, by which it means non-investment spending in the NHS¹⁴ (technically 'near-cash' spending), would not be cut over these two years but instead would be frozen in real terms. Here, the Conservatives have a similar, but slightly more generous, pledge than Labour. David Cameron has stated that 'the Conservatives will increase spending on the NHS every year so we can protect frontline services'.¹⁵ The potential implications of the Conservative Party's pledge on NHS spending for other departmental spending is discussed in more detail in Box 8.2 at the end of Section 8.5.

Taking the government's commitments on overseas aid and the NHS into account leads to the average cut required across other DELs being 5.0% a year after inflation over 2011–12 and 2012–13. In other words, an average cut in other DELs of almost 10% will be required by the end of the second year, or £25.0 billion in 2009–10 prices.¹⁶

The Chancellor also committed in the December 2009 PBR to increase spending on 'front-line' schools (which we take again to mean non-investment schools spending) by 0.7% a year in real terms over these two years, and to boost non-investment spending on participation in education at ages 16 to 19 by 0.9% a year in real terms. In addition, non-investment spending on Sure Start is to be frozen in real terms. These commitments would increase the average real-terms cut required in other DELs (comprising areas such as defence, transport, housing and higher education) to 6.7% a year. In other words, by the end of the second year, spending on these other areas would need to have been cut by a cumulative 12.9%, or £25.8 billion in 2009–10 prices.¹⁷

So, to summarise, the government's plans imply, at least on our calculations, a £22.9 billion real cut in DELs, comparing 2012–13 to 2010–11. But it wants to spend £2.1 billion more on overseas aid and £800 million more on front-line schools and 16-to-19 education, while spending the same on the front-line NHS and Sure Start. This would leave cuts of £25.8 billion – or one pound in every seven – to be found from other areas of departmental spending.

Such tight plans for overall DELs, while protecting large parts of spending such as the NHS and schools from cuts, would lead to deep cuts to overall spending on other public services being required. This raises an important issue: if the overall DEL cuts are to be delivered, is it sensible to protect such large areas of government spending on public services from cuts? Since overall public spending is, in real terms, projected to be broadly flat under Labour's commitments, current spending on the NHS would continue to take up about 17p out of every £1 spent by the government, while current spending on

¹³ See pages 22 and 23 of Liberal Democrats, *Pocket Guide to Liberal Democrat Policies*, July 2009, <http://www.libdems.org.uk/siteFiles/resources/PDF/Pocket%20Guide%20July%202009.pdf>.

¹⁴ Paragraph 6.24 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm.

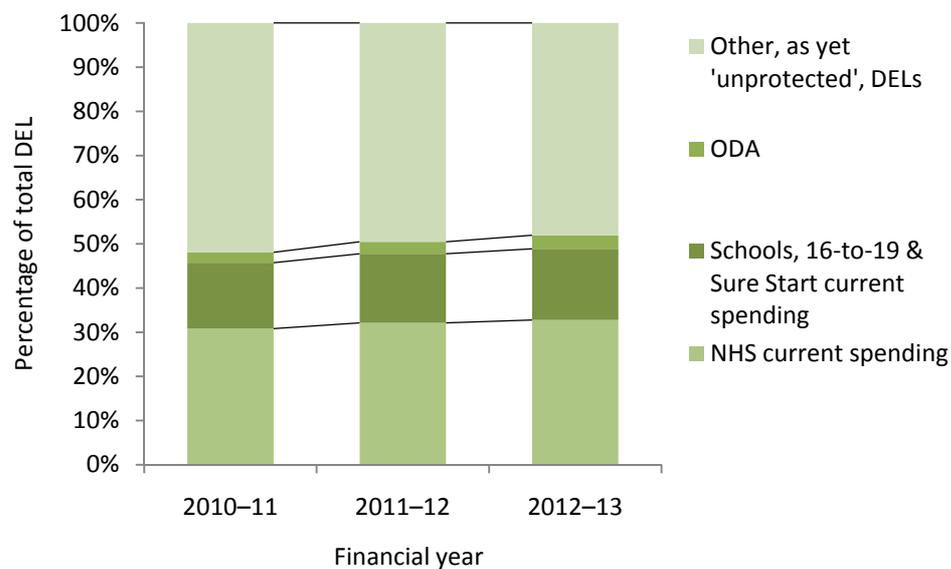
¹⁵ Speech by David Cameron, 'Our health priorities', 2 November 2009, http://www.conservatives.com/News/Speeches/2009/11/David_Cameron_Our_health_priorities.aspx.

¹⁶ The £ billion figure has risen from £22.9 billion as £2.1 billion extra is needed to finance the additional real-terms spending on overseas aid.

¹⁷ The £ billion figure has risen from £25.0 billion as £0.8 billion extra is needed to finance the additional real-terms spending on schools and 16-to-19 education.

schools, which is presently about 7p out of every £1 spent by the government, would see its budget share rise very slightly. However, as DELs overall are to be cut, spending on the 'protected' areas of public service spending would rise as a share of total DEL. This is shown for the two years 2011–12 and 2012–13 (and for the 2010–11 baseline) in Figure 8.11. The government has committed to protecting nearly half of 2010–11 DELs. Current NHS spending would rise as a share of DEL from 30.8% to 32.8%, current spending on schools, 16-to-19 education and Sure Start would rise from 14.9% to 16.1%, while overseas aid would rise from 2.3% to 3.1%. This would leave other DELs falling as a share of overall DEL from 51.9% to 48.1%. This squeeze would be across areas that include defence, transport, higher education and housing, as well as capital spending on the NHS and schools. In 2010–11, 29p out of every £1 spent by the government is projected to be spent on these areas, but this would fall to 26p per £1 by 2012–13.

Figure 8.11. 'Other DELs' set for a tight squeeze?



Notes: 'Other DELs' includes investment spending on the NHS, schools, 16-to-19 education and Sure Start, as well as all other departmental spending.

Sources: As for Table 8.3.

Reduce borrowing more quickly by cutting public service spending more

It is possible that after the election, whoever forms the new government might decide that they want to reduce borrowing more quickly than is currently planned. To deliver a faster reduction in borrowing, with at least some of this brought about by larger cuts to departmental spending, would obviously imply a tighter squeeze on departmental budgets. This subsection considers the outlook for DELs under the assumption that a government were to attempt to halve the deficit from its 2009–10 level by 2012–13, rather than by 2013–14 as the PBR 2009 plans suggest, with two-thirds of the additional fiscal tightening required to meet this target being delivered through cuts to DELs. (This is the policy scenario outlined in Section 2.4 of Chapter 2.)

The implications of halving the deficit in three years instead of four, with two-thirds of the extra reduction in borrowing coming from cuts to DELs, are shown in the right-hand column of Table 8.3. This shows that overall DELs would need to be cut by, on average, 4.2% a year in real terms in 2011–12 and 2012–13.

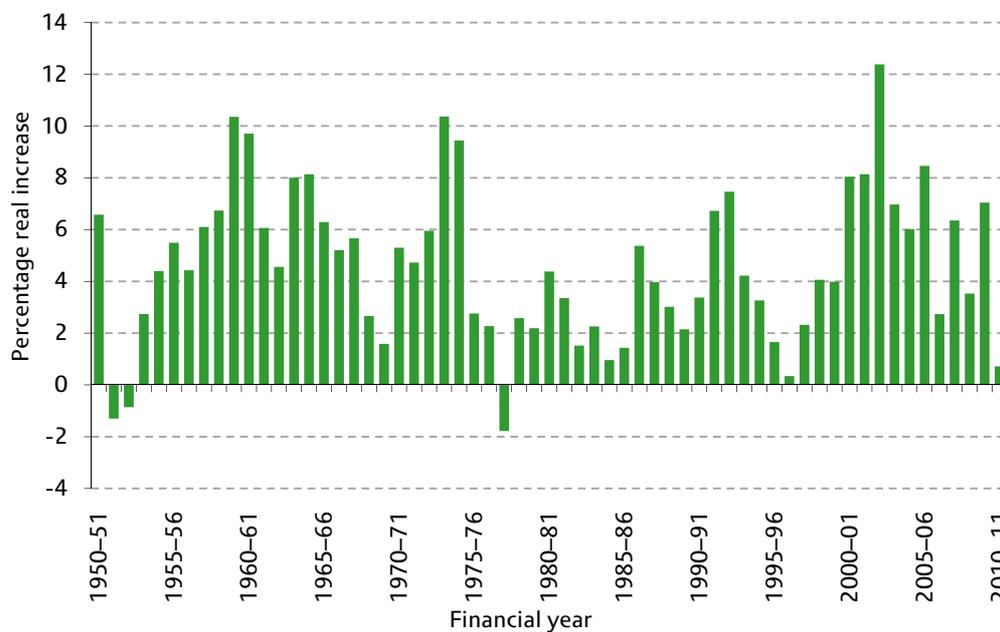
Taking into account the government’s commitments on overseas aid, the NHS, schools, 16-to-19 education and Sure Start, this would require average real cuts in spending on other areas of 9.1% a year. This would cumulate to an average cut of 17.3% by the end of the second year, or £34.5 billion. This underlines the difficulty that would be faced if one wanted to cut borrowing more quickly, through cuts to public service spending, while also maintaining pledges to ‘protect’ real-terms spending on large parts of those public services. This argument is consistent with the fact that the Labour government and the Conservatives have both felt unable to commit to deeper cuts to public spending while at the same time promising not to cut spending on schools and hospitals.

Outlook for NHS spending

Notwithstanding talk of ‘protecting’ its budget, a real freeze in NHS spending (or at least in its non-investment spending) would be a much tougher environment than in the years of plenty. It would also come at a time of upward pressure on its budgets – for example, from the increasing number of older individuals. Recent analysis by researchers at the King’s Fund and the Institute for Fiscal Studies has estimated that the changing age structure of the population will add an average 1.1% a year to the pressure on the NHS budget over the period from April 2011 to March 2017 (although this figure is slightly smaller for the first three years and slightly larger thereafter).¹⁸

On a historical basis, it is also the case that a two-year real freeze in its budget would not be a particularly generous settlement for the NHS. As shown in Figure 8.12, spending on the NHS has risen in real terms in every single year since 1977–78, and that it has only once had consecutive years without a real-terms budget increase; that was not long after its inception some 60 years ago.

Figure 8.12. NHS spending increases since 1948: freezing not protecting?



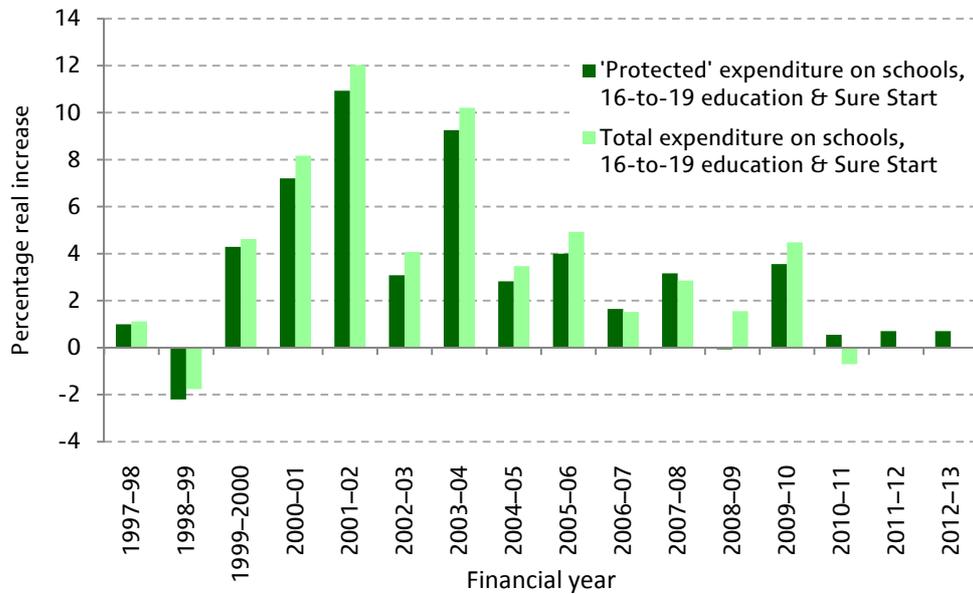
Source: Authors’ calculations using HM Treasury, *Public Expenditure Statistical Analyses 2009*, July 2009, http://www.hm-treasury.gov.uk/pespub_pesa09.htm and Office of Health Economics.

¹⁸ See pages 16 and 17 of J. Appleby, R. Crawford and C. Emmerson, *How Cold Will It Be? Prospects for NHS Funding: 2011–17*, July 2009, Kings Fund, London, <http://www.ifs.org.uk/publications/4567>.

Outlook for spending on ‘front-line’ education

While the Labour government is keen to be seen to be protecting ‘front-line’ education services, the real increases in spending pledged in the December 2009 PBR may well still feel like a squeeze after the funding increases of recent years. The dark green bars in Figure 8.13 show the annual real increases since Labour came to power in the components of spending on schools, 16-to-19 education and Sure Start that the government has pledged to ‘protect’ (i.e. non-investment spending).

Figure 8.13. Protection for ‘front-line’ education?



Note: ‘Protected’ expenditure is non-investment expenditure.

Sources: Authors’ calculations based on tables 5.2 and 5.4 of HM Treasury, *Public Expenditure Statistical Analyses 2009*, July 2009, http://www.hm-treasury.gov.uk/pespub_pesa09.htm; previous PESAs, 2000–01 to 2008 (all available from http://www.hm-treasury.gov.uk/pespub_index.htm); HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm.

Particularly large increases in spending in these areas were seen during the early 2000s. While spending growth has slowed somewhat since, with the notable exception of 2008–09 growth has still tended to exceed the 0.7% a year average increase in spending across these areas¹⁹ that is planned for 2011–12 and 2012–13. An average 0.7% a year growth will be the lowest two-year period of growth since the period 1997–98 to 1998–99. As acknowledged by Secretary of State for Children, Schools and Families, Ed Balls, in a recent interview with the *Financial Times*, the government’s schools spending plans imply ‘the toughest settlement for schools for the next three years since 1997, by far’.²⁰

Figure 8.13 also shows the annual real increases in total spending on schools, 16-to-19 education and Sure Start since 1997–98. Growth in total spending was typically slightly higher than the growth in current spending over this period, as there have been large increases in capital spending under the Labour government. The real decrease in total spending on schools, 16-to-19 education and Sure Start in 2010–11 is caused by the

¹⁹ 0.7% for schools, 0.0% for Sure Start and 0.9% for 16-to-19 education averages to 0.7% a year across these areas.

²⁰ Source: ‘Ed Balls: “I’m totally against a class war strategy”’, *Financial Times*, 10 January 2010, <http://www.ft.com/cms/s/0/2bda7132-fe1d-11de-9340-00144feab49a.html>.

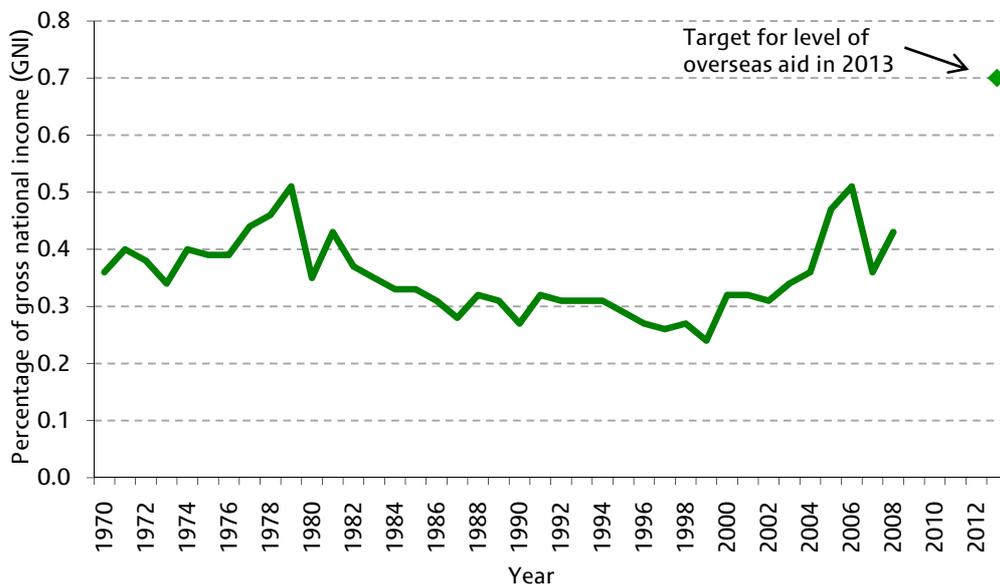
government bringing forwards some £800 million of investment in schools from 2010–11 into 2009–10 as part of its fiscal stimulus package. Similarly, this boosts the apparent real growth rate of total schools spending in 2009–10. Since the government has made no announcement on what settlement the ‘unprotected’ areas of spending on schools, 16-to-19 education and Sure Start (which comprise about 10% of their total budgets) can expect after 2010–11, the growth in total spending is unknown. However, if the ‘unprotected’ areas receive the same 6.7% a year cuts that we calculate will need to be experienced across ‘unprotected’ DELs as a whole, total spending on schools, 16-to-19 education and Sure Start would be approximately frozen in real terms over the two years 2011–12 and 2012–13.

Outlook for spending on overseas aid

Current commitments by the government – and the Conservatives – suggest that the only likely clear winner from the next Spending Review is overseas aid, notwithstanding the fact that voters tell the pollsters that it is one of the areas that they would be happiest to see cut.²¹ As shown in Figure 8.14, Labour has increased the overseas aid budget quite dramatically since 1999, and it is now running at levels not seen since the last time Labour was in power, in the late 1970s. If the pledge made by both parties to boost spending to 0.7% of GNI is met and then maintained, this will be a much greater level of spending on overseas aid by the UK than has been seen at any point in the last 40 years.

Furthermore, after 2013, spending on overseas aid may increase further above this level. At the climate change conference in Copenhagen in December 2009, the government announced that it intends to spend additional amounts (over and above the 0.7% of GNI

Figure 8.14. Overseas aid spending to reach record levels?



Sources: Table 7 of Department for International Development, *Statistics on International Development 2009*, <http://www.dfid.gov.uk/Documents/publications/sid%202009/Table%207.xls>; House of Commons Library, *The UK & the 0.7% Aid Target, and the International Development (ODA Target) Bill*, SN/EP/3714, 18 January 2010, <http://www.parliament.uk/commons/lib/research/briefings/snep-03714.pdf>.

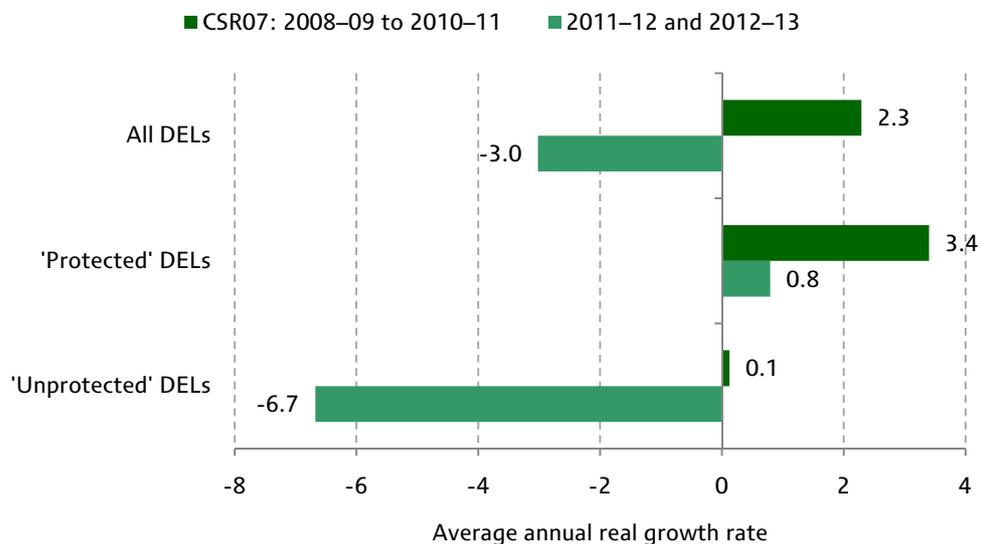
²¹ Slide 15 of *Ipsos MORI Public Spending Index*, June 2009, <http://www.ipsos-mori.com/Assets/Docs/poll-public-spending-charts-june-2009.pdf>.

target) on overseas aid between 2013 and 2020 as part of the plans to combat global climate change.²²

Outlook for spending on other DELs

As discussed above, starting with Labour's plans for total spending and taking account of its commitments on overseas aid and non-investment spending on the NHS, schools, 16-to-19 education and Sure Start leads to an average real cut of 6.7% a year being made across other DELs for the two years 2011–12 and 2012–13. Figure 8.15 compares this with the average growth seen over the 2007 CSR period, 2008–09 to 2010–11. Spending on these areas is forecast to be broadly flat over the three years to 2010–11, so average annual cuts of 6.7% a year will represent a sharp slowdown in spending growth. But this is also somewhat true of spending on the supposedly 'protected' areas of spending. These would, under the current government's commitments, see average increases in spending averaging 0.8% a year over the two years 2011–12 and 2012–13, but they have received an average increase of 3.4% a year over the three years to 2010–11.

Figure 8.15. A significant reduction in DEL growth: losers and losers?



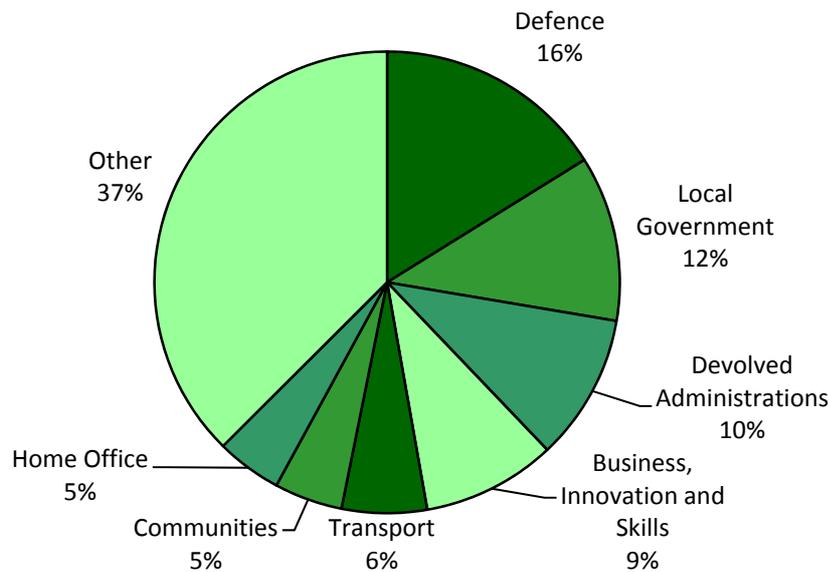
Notes: 'Protected' DELs include overseas aid and non-investment spending on the NHS, schools, 16-to-19 education and Sure Start. 'Unprotected' DELs include investment spending on the NHS, schools, 16-to-19 education and Sure Start, as well as all other departmental spending.

Sources: As for Table 8.3, plus HM Treasury, *2007 Pre-Budget Report and Comprehensive Spending Review*, Cm. 7227, October 2007, http://www.hm-treasury.gov.uk/d/pbr_csr07_complereport_1546.pdf.

We do not know which departments will bear the brunt of the cuts to spending in 'unprotected' areas. Figure 8.16 shows the planned composition of DEL spending in 2010–11 that is not 'protected' under Labour's spending plans for 2011–12 and 2012–13. There are a large number of small government departments which account for 37% of the 'unprotected' departmental spending. The largest single 'unprotected' departments are the Ministry of Defence (£36 billion in 2009–10 prices, or 16% of 'unprotected' DELs), the Local Government component of Communities and Local Government (£26 billion, or 12% of 'unprotected' DELs), the Department for Business,

²²14 December 2009, <http://www.number10.gov.uk/Page21753>.

Figure 8.16. Planned composition of ‘unprotected’ DEL spending in 2010–11



Notes: ‘Devolved Administrations’ includes the ‘unprotected’ portions of the budgets of Scotland, Wales and the Northern Ireland Executive. ‘Other’ includes the Department for Children, Schools and Families, the Home Office, Ministry of Justice, Department for Work and Pensions, the ‘unprotected’ portion of the budget of the Department of Health, the Chancellor’s departments, the Department of Energy and Climate Change, the Department for Environment, Food and Rural Affairs, the Cabinet Office, the Foreign and Commonwealth Office, the Northern Ireland Office, independent bodies, the Law Officers’ departments, modernisation funding and the DEL reserve.

Sources: As for Table 8.3, plus table B17 of HM Treasury, *Pre-Budget Report 2009*, December 2009, http://www.hm-treasury.gov.uk/prebud_pbr09_repindex.htm.

Innovation and Skills (£21 billion, or 9% of ‘unprotected’ DELs) and the Department for Transport (£13 billion, or 6% of ‘unprotected’ DELs).

Defence

The Ministry of Defence is the largest single ‘unprotected’ department, and so it is perhaps unlikely that it will be able to escape significant budget cuts. This would introduce painful constraints. Existing commitment spending on equipment is already coming under fire for being unaffordable: an independent review of defence acquisition published in October 2009 found that the total cost overrun of currently approved projects could be around £35 billion, and that ‘the Ministry of Defence has a substantially overheated equipment programme, with too many types of equipment being ordered for too large a range of tasks at too high a specification. This programme is unaffordable on any likely projection of future budgets’.²³

The Liberal Democrats’ deputy leader and Treasury spokesman, Vince Cable, has suggested cuts to big-ticket programmes including, but not limited to, the Trident nuclear submarines,²⁴ but no firm plans for defence spending cuts for 2011–12 onwards have yet

²³ Pages 16 and 6 of *Review of Acquisition for the Secretary of State for Defence: An Independent Report by Bernard Gray*, October 2009, <http://www.mod.uk/NR/rdonlyres/78821960-14A0-429E-A90A-FA2A8C292C84/0/ReviewAcquisitionGrayreport.pdf>.

²⁴ See pages 47–49 of V. Cable, *Tackling the Fiscal Crisis: A Recovery Plan for the UK*, Reform, London, September 2009, <http://www.reform.co.uk/Research/ResearchArticles/tabid/82/smId/378/ArticleID/950/refTab/56/Default.aspx>. Possible cuts to the defence budget are also discussed in M. Chalmers, ‘Preparing for the lean years’, Royal

been announced by the government. The government has said that it will conduct a root-and-branch defence review, which both the Conservatives and the Liberal Democrats have argued for.²⁵ However, it will not report until after this year's general election and so substantive questions about cuts to defence spending will likely remain unanswered until then.

Higher education

Higher education is another area where public spending cuts are likely to be felt. Some possible options for increasing the cost to future graduates in order to reduce the taxpayer burden without adversely affecting unit funding or the number of student places were discussed in last year's Green Budget.²⁶ For example, the rate of interest charged on student loans could be increased from the RPI to the Bank of England base rate of interest. The government launched, with the support of the Conservatives, the Independent Review of Higher Education and Student Finance in November 2009, with the task of advising the government on the future of fees policy and financial support for students, but this will also not report until after the general election.²⁷

Housing and transport

As discussed in Section 8.2, the cuts to public spending over the next few years will be felt disproportionately on investment spending. Over the two years 2011–12 and 2012–13, while total public spending is projected to remain constant in real terms, public sector net investment spending is forecast to be cut in real terms by an average 20.0% a year. The cuts to 'unprotected' DELs are therefore likely to be severely felt by capital-intensive departments, such as the Communities part of Communities and Local Government, which is involved in housing, and the Department for Transport. These departments are each forecast to spend more than half of their DELs on capital in 2010–11, and together to account for almost one-quarter (23%) of all public sector gross investment. Capital spending by the Department of Health and the Department for Children, Schools and Families is also not to be 'protected' under the present Labour plans and, since together these are forecast to account for nearly a fifth of gross investment, cuts to capital spending by these departments are also likely.

8.5 Departmental spending after 2012–13

As shown in Table 8.2, the average annual real growth in DEL forecast for the two years 2013–14 and 2014–15 is –2.7%. While some parts of spending on the NHS, schools, 16-

United Services Institute, Future Defence Review Working Paper 1 http://www.rusi.org/downloads/assets/FDR_Working_Paper_1.pdf and in C. Guthrie and A. Hull, 'Defence – a reality check', in C. Oppenheim and T. Dolphin (eds), *Opportunities in an Age of Austerity: Smart Ways of Dealing with the UK's Fiscal Deficit*, Institute for Public Policy Research, London, November 2009, http://www.ippr.org.uk/members/download.asp?f=/ecomm/files/age_of_austerity.pdf&a=skip.

²⁵ 'Ministers to start defence review', BBC website, 7 July 2009, http://news.bbc.co.uk/1/hi/uk_politics/8137934.stm. See also article by shadow secretary of state for defence, Liam Fox, 'There's a war on – someone tell Labour', 8 July 2009, http://www.conservatives.com/News/Articles/2009/07/Liam_Fox_Theres_a_war_on_-_someone_tell_Labour.aspx and V. Cable, *Tackling the Fiscal Crisis: A Recovery Plan for the UK*, Reform, London, September 2009, <http://www.reform.co.uk/Research/ResearchArticles/tabid/82/smid/378/ArticleID/950/reftab/56/Default.aspx>.

²⁶ Pages 189–191 of H. Chowdry, R. Crawford, C. Emmerson and G. Tetlow, 'Public spending: set for a squeeze', in R. Chote, C. Emmerson, D. Miles and J. Shaw (eds), *The IFS Green Budget, January 2009*, IFS, London, January 2009, <http://www.ifs.org.uk/budgets/gb2009/09chap9.pdf>.

²⁷ For details, see <http://hereview.independent.gov.uk/hereview/>.

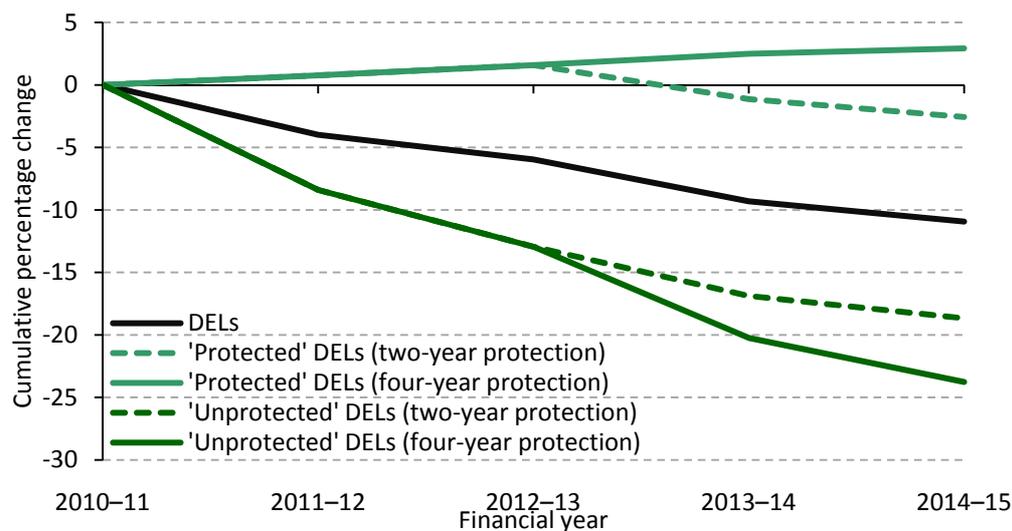
to-19 education and Sure Start are ‘protected’ over the previous two-year period, the Labour government has not indicated whether this protection would be continued after 2012–13. The only exception is spending on overseas aid, which is to be increased to the target level of 0.7% of GNI by 2013. Therefore, two possible scenarios could be considered for departmental spending in 2013–14 and 2014–15, assuming that total spending is set at the levels outlined in PBR 2009:

- First, that the ‘protected’ areas of DEL mentioned above (with the exception of overseas aid) are not ‘protected’ after 2012–13 and receive the same average real cut in growth rate as the ‘unprotected’ areas. We will refer to this as the ‘two-year protection’ scenario.
- Second, that the ‘protected’ areas of DEL (again with the exception of overseas aid) receive the same real growth rates over 2013–14 and 2014–15 as they will over the previous two years. We will refer to this as the ‘four-year protection’ scenario.

In both scenarios, it is assumed that spending on overseas aid is increased at the rate needed to meet the 0.7% of GNI target in 2013–14 and is maintained at that percentage of GNI in 2014–15. Figure 8.17 shows what these scenarios imply for the cumulative percentage real cuts required in DEL budgets after 2010–11 for the ‘protected’ and ‘unprotected’ components of DEL. Figure 8.18 shows the equivalent cumulative real £ billion changes.

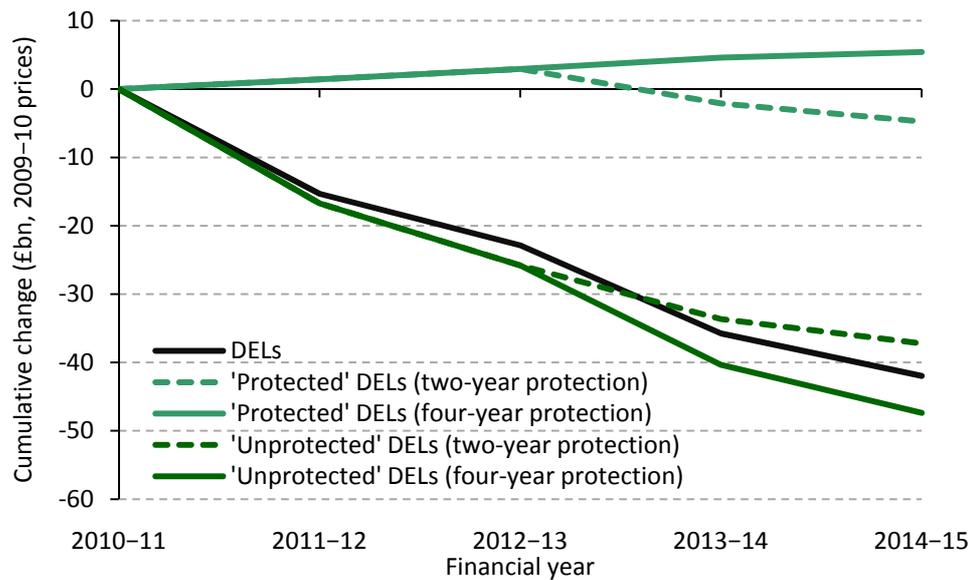
Figure 8.17 shows that the cumulative real-terms cut in DEL by 2014–15 (compared with the 2010–11 baseline) is projected to be 10.9%, which, as Figure 8.18 shows, is equivalent to £42.0 billion in 2009–10 prices (both numbers were also shown in Table 8.2). If Labour’s ‘protected’ areas of public spending were only ‘protected’ for the two years Labour has announced and then given the same average cut as all other DELs over 2013–14 and 2014–15 (with the aforementioned exception of overseas aid), then these

Figure 8.17. Scenarios for cumulative growth in ‘protected’ and ‘unprotected’ DELs, 2010–11 to 2014–15 (percentage change)



Notes: ‘Protected’ DELs include spending on overseas aid, and front-line (non-investment) spending on the NHS, schools, 16-to-19 education and Sure Start. ‘Unprotected’ DELs include investment spending on the NHS, schools, 16-to-19 education and Sure Start, as well as all other departmental spending. Sources: As for Table 8.3.

Figure 8.18. Scenarios for cumulative growth in 'protected' and 'unprotected' DELs, 2010–11 to 2014–15 (real £ billion change)



Notes: 'Protected' DELs include spending on overseas aid, and front-line (non-investment) spending on the NHS, schools, 16-to-19 education and Sure Start. 'Unprotected' DELs include all other departmental spending. Sources: As for Table 8.3.

areas would see a cumulative real-terms cut in their budgets of 2.6% by 2014–15. The 'unprotected' areas, on the other hand, would, under this scenario, see a cumulative real-terms cut in their budgets of 18.7% over the same period, or £37.2 billion in today's prices.

In the alternative scenario, where the protection Labour has planned over 2011–12 and 2012–13 is continued for a further two years, the 'protected' areas would see a cumulative real-terms increase in their budgets of 2.9% between 2010–11 and 2014–15, while the 'unprotected' areas would experience a real-terms cut of 23.8%, or £47.4 billion in today's prices.

However, if there is a change of government at the next election, the areas of spending that might be protected could change. Furthermore, plans for total spending (and hence the amount of money available to be shared among departments) might also change. Box 8.2 considers what the outlook for DELs might be under a Conservative government, assuming that the NHS is protected from cuts and that the target for overseas aid is met. We outline the implications under two scenarios for total spending growth: (i) that growth in total spending is as set out in PBR 2009 and (ii) that a Conservative government seeks to cut borrowing more quickly by cutting spending more aggressively (in the way outlined in Section 2.4 of Chapter 2).

Box 8.2. Scenarios for cumulative DEL growth under Conservative Party plans to protect the NHS and ODA over the next parliament

The Conservative Party has stated that, if elected in 2010, it would increase spending on overseas aid to meet the UN target by 2013 (like Labour), and increase spending on the NHS in real terms. David Cameron has stated that ‘the Conservatives will increase spending on the NHS every year so we can protect frontline services’.^a This suggests that the Conservative Party’s pledge on NHS spending is potentially more generous than Labour’s, for three reasons:

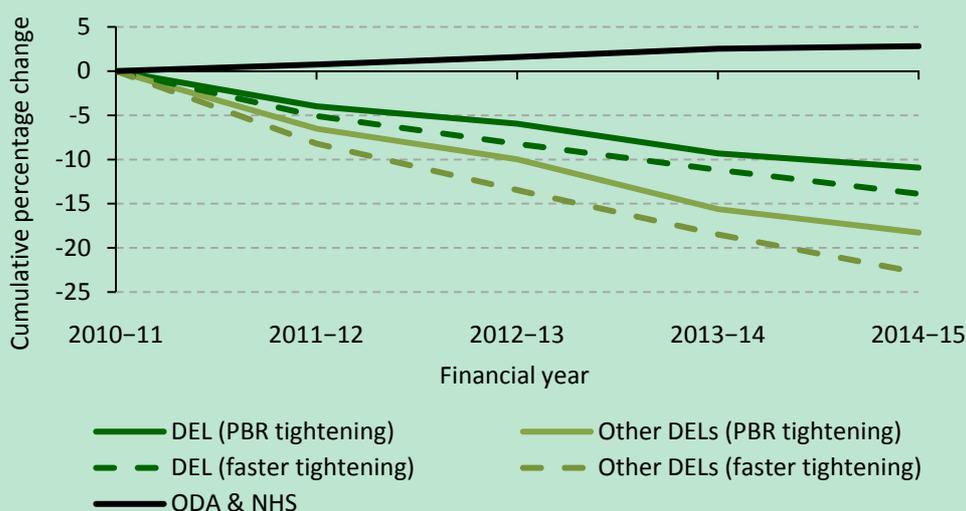
- (a) The Conservatives would increase, rather than merely freeze, the NHS budget in real terms.
- (b) The pledge presumably applies to a whole parliament (i.e. for the four years 2011–12 to 2014–15) rather than just the two years to which Labour has committed.
- (c) It presumably applies to the entirety of the NHS budget, whereas the Labour commitment only applies to non-investment spending (although this comprises 95% of NHS spending).

Unlike Labour, the Conservatives have not promised to protect front-line schools spending, 16-to-19 education or Sure Start.

Figures 8.19 and 8.20 show what these spending commitments would imply for the cumulative change in spending on other DELs over the next parliament, in percentage and in real £ billion terms respectively, under two scenarios:

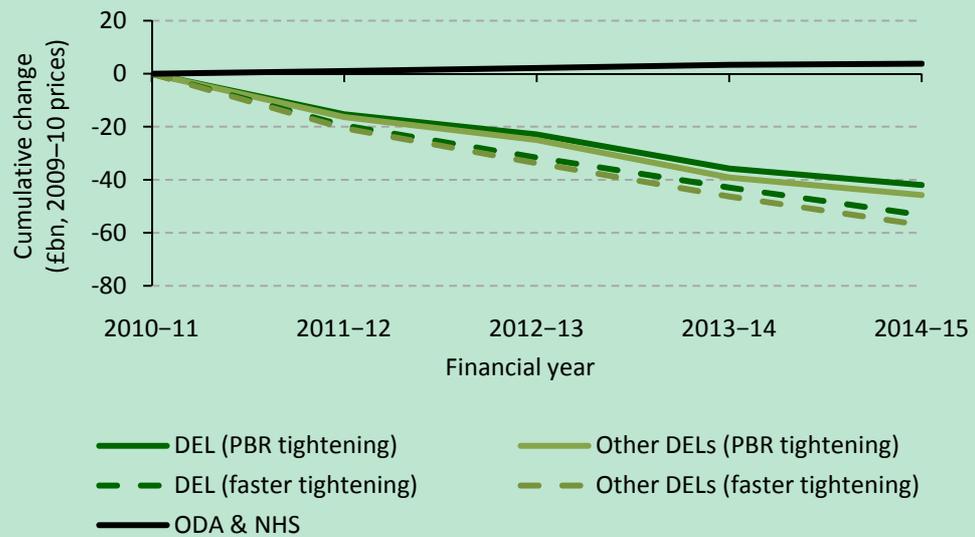
- first, the current PBR plans for total spending;
- second, a more ambitious six-year fiscal consolidation plan (which aims to halve the deficit in three years and return the structural current budget to balance in 2015–16, with two-thirds of the additional fiscal tightening delivered through cuts to public services). This scenario, consistent with current Conservative proposals to reduce borrowing more quickly, is set out in Section 2.4 of Chapter 2.

Figure 8.19. Scenarios for cumulative DEL growth if ODA and the NHS are ‘protected’ over the next parliament (percentage change)



Sources: As for Table 8.3.

Figure 8.20. Scenarios for cumulative DEL growth if ODA and the NHS are 'protected' over the next parliament (real £ billion change)



Sources: As for Table 8.3.

Under the PBR plans for total spending, protecting ODA and the NHS would require a cumulative cut in other DELs by 2014–15 (relative to their 2010–11 level) of 18.3%, or £45.7 billion in 2009–10 prices. If, however, protecting ODA and the NHS were combined with the tighter fiscal consolidation plan, this would imply cuts to other DELs of 22.8%, or £57.1 billion in 2009–10 prices.

a. Speech by David Cameron, 'Our health priorities', 2 November 2009, http://www.conservatives.com/News/Speeches/2009/11/David_Cameron_Our_health_priorities.aspx.

8.6 Conclusion

The financial crisis and recession have knocked a substantial hole in the government's finances. The majority of the government's plan for dealing with this relies on freezing real-terms public spending for the four years 2011–12 to 2014–15. Though the government has declined to conduct a detailed Spending Review or to publish its forecasts for spending on unchanged policies for the years beyond 2010–11, making reasonable assumptions we can deduce what this freeze in total spending might mean for spending on public services. Increases in real-terms spending on debt interest payments are unavoidable and spending on social security benefits and other areas of annually managed expenditure is also likely, in the absence of significant policy change, to increase in real terms.

As a result, our best estimate is that departmental expenditure limits would, under current policies, have to be cut by 3.0% a year on average in 2011–12 and 2012–13 and by 2.7% a year on average in 2013–14 and 2014–15 to keep to the Treasury's plans for total spending. This amounts to a cumulative cut in DELs of 10.9% (or £42.0 billion in 2009–10 prices) after four years. (Combined with the 0.5% cut in DELs already confirmed for 2010–11, this gives a total cut over a five-year parliament of 11.4%, or £43.8 billion in 2009–10 prices.) If delivered, this would be sufficiently deep to reverse almost all of the

increase in DELs as a share of 'potential' national income seen since Labour came to power. Looking further back, on a historically comparable slightly broader definition of public service spending, the period 2011–12 to 2014–15 would be the tightest four-year period for spending on public services since April 1976 to March 1980 and the five years 2010–11 to 2014–15 would be the first five consecutive years of real cuts since comparable data began in 1948–49.

The government has made specific commitments to 'protect' spending on some of its priority areas – including overseas aid, health and schools – in the years 2011–12 and 2012–13. The only winner from the next Spending Review is likely to be overseas aid, with Labour, the Conservatives and the Liberal Democrats signed up to large growth in its budget. In other supposedly 'protected' areas, pain would still be felt under Labour's plans. For example, a two-year freeze in the NHS budget would be the tightest two years for the NHS in 60 years.

Protecting large areas of spending from cuts means that the pain will be even more severe for all the other areas of departmental spending. These other areas – comprising, among others, defence, higher education, transport and housing – would, on our estimates, see their budgets cut by 12.9% (or £25.8 billion) by 2012–13. Aiming to halve the deficit one year earlier while maintaining the government's commitment to 'protect' spending in key areas would, under current policies, increase the required cuts in these areas to 17.3% (or £34.5 billion) by 2012–13.

Beyond 2012–13, the government has made no specific pledges to protect any areas of spending except overseas aid. Were it to continue 'protecting' all its priority areas for a further two years, the 'unprotected' budgets would have to be cut by a total of 23.8% (or £47.4 billion) by 2014–15 – this includes the £25.8 billion that would be required by 2012–13. To avoid imposing this level of pain on the 'unprotected' budgets, the government could choose instead to impose some cuts to the health and schools budgets after 2012–13.

The Conservative Party has promised to protect overseas aid (like Labour) and to increase NHS spending in real terms. Under Labour's plans for spending overall, this implies £45.7 billion in cuts in unprotected areas by 2014–15. As the Conservatives propose to protect a smaller share of total DELs than Labour, the percentage cut required across other departments is substantially smaller at 18.3%. However, if the Conservatives' plan to protect aid and the NHS were combined with the more ambitious tightening plan implied by their proposed fiscal targets (with the majority of this additional tightening delivered through cuts to public service spending rather than through tax rises or benefit cuts), then the cuts required in their unprotected areas would be 22.8% or £57.1 billion by 2014–15.

There are likely to be no easy choices for departmental spending over the next five years. The government has been keen to focus on the fact that, in real terms, current spending is forecast to grow over the next five years. However, the plans imply large cuts to investment spending. Furthermore, increasing demands for spending on debt interest and social security mean that the government's present plans for spending would also require deep cuts to departmental budgets beyond 2010–11.