

7. Options for further departmental spending cuts

Rowena Crawford and Soumaya Keynes (IFS)

Summary

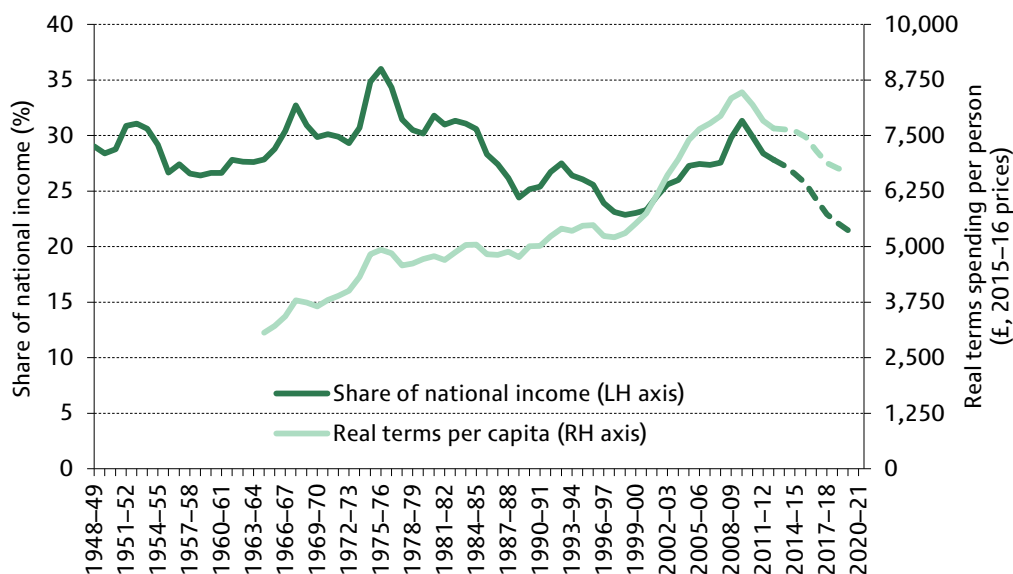
- Coalition government plans imply real departmental spending cuts of 9.5% between 2010–11 and 2015–16. Real health, official development assistance and day-to-day schools spending has been protected, leaving other departments to face cuts averaging 20.6% over this period.
- Departmental spending between 2010–11 and 2014–15 has differed from the original coalition plans. Resource (non-investment) spending has been cut more than originally intended in cash terms, but inflation has turned out lower than forecast, so it has still been cut less than originally expected in real terms (7.8% compared with 8.3%). Real capital spending cuts have turned out much lower than originally planned (13.6% rather than 25.9%) due to lower-than-forecast inflation and decisions since 2010 to top up these spending plans.
- The 2014 Autumn Statement plans imply real cuts to departmental spending between 2015–16 and 2019–20 of 14.1%. This would take the total cut since 2010–11 to 22.2% and return real departmental spending to around its 2002–03 level.
- The Office for Budget Responsibility forecasts that these cuts to departmental spending would entail significant reductions in general government employment: a cut of 900,000 between 2015–16 and 2019–20, on top of a cut of 500,000 between 2009–10 and 2015–16. This would reduce the size of the government workforce, and its share of total employment, to its lowest level since at least 1971.
- However, departmental spending cuts after 2015–16 will be implemented by the next government, and all three main UK political parties have announced fiscal rules that would allow them to increase spending relative to the Autumn Statement plans. Given their fiscal rules and stated policy intentions, the Conservatives' plans could imply cuts to departmental spending of as little as 6.7% between 2015–16 and 2019–20, the Liberal Democrats as little as 2.1% and Labour as little as 1.4%.
- Smaller cuts to spending and further restrictions on public sector wage growth could both reduce future government employment cuts relative to current forecasts. A real wage freeze between 2015–16 and 2019–20 would imply cuts to government employment of around 750,000 if departmental spending is cut by 14.1%, 400,000 if it is cut by 6.7%, 150,000 if it is cut by 2.1% or 100,000 if it is cut by 1.4%.
- A 2015 spending review would allocate departmental budgets for beyond April 2016. There is apparent consensus between the three main UK parties that spending on health and official development assistance will remain protected from cuts. However, other departments face considerable uncertainty about their budgets between 2015–16 and 2019–20. What seems certain is that some will face large cuts – on top of those already delivered – regardless of the outcome of the general election.

7.1 Introduction

Current coalition plans from the 2014 Autumn Statement imply deep cuts to public service spending beyond the next general election, on top of large cuts over this parliament. Around 60% of the government’s overall fiscal consolidation is planned to come from cuts to public service spending. Figure 7.1 illustrates how spending on public services has changed over time, and how it is forecast to change on the basis of current plans through to 2019–20.¹ Public service spending in 2019–20 is forecast to be at its lowest share of national income since at least 1948 (when data on this measure of spending are available from), though only slightly below its level at the end of the 1990s.²

It is important to bear in mind, however, that national income has grown considerably since the 1930s or 1940s. Therefore spending the same *share* of national income in 2019–20 as in the 1930s still implies a much greater *amount* of spending in pounds – even after controlling for inflation and population growth. Figure 7.1 also shows real-terms public service spending per person (in 2015–16 prices) over time. Over the period from 1964–65 to 1996–97, real public service spending per person grew by an average 1.7% per year, while over the period 1996–97 to 2009–10 it grew by an average 3.8% per year. Public service spending is forecast to be reduced from around £8,500 per person in

Figure 7.1. Spending on public services as a share of national income and in real terms per person over time



Note: Population figures are mid-year population estimates for the UK.

Source: ONS; DWP benefit expenditure tables, 2014, <https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2014>; OBR, *Economic and Fiscal Outlook: December 2014*, <http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/>.

¹ Public service spending is defined here as total spending less social security less debt interest spending.

² The Office for Budget Responsibility (OBR) has also shown that on a slightly different measure of public service spending ('government consumption of goods and services') for which a longer time series is available, public service spending in 2019–20 will be at its lowest share of national income since the 1930s. See chart 3.36 of OBR, *Economic and Fiscal Outlook: December 2014*, <http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/>.

2009–10 to around £6,700 in 2019–20 (an average cut of 2.4% per year and a total cut of 21.3%), which is around the level it was at in the early 2000s.

This is not to deny that the cuts to public service spending planned over this and the next parliament are very large. Real public service spending per capita has not been cut for more than two consecutive years at any point since the series began in 1964–65, whereas current plans imply 10 consecutive years of cuts. The size of the cuts ultimately planned is also large, at 21.3% (or £1,800 per person, 2015–16 prices); the largest cut previously was between 1975–76 and 1977–78 when real public service spending per capita was cut by 7.3% (£400 per person, 2015–16 prices).

However, it is the next government which will be responsible for implementing any cuts to public service spending after 2014–15, and further cuts may not be as deep as the coalition plans set out in the 2014 Autumn Statement imply. The three main UK political parties have all announced fiscal rules that would allow them to increase spending relative to current plans if they wanted to.³ In addition, they could decide to implement a combination of further tax rises and further benefit cuts in order to lighten the load of deficit reduction on public service spending.

This chapter sets out the context for the spending choices the next government will have to make. We focus on ‘departmental expenditure limits’ (DELs), the sum of which is spending by Whitehall departments on the delivery and administration of public services. This is an important measure of spending as it is the budget that is allocated to departments by HM Treasury. However, data on this basis are only available back to 1997–98 (when the Treasury started planning spending using this definition).⁴

In Section 7.2, we describe the overall cuts to resource (non-investment) DEL and capital (investment) DEL that the coalition government has planned between 2010–11 and 2015–16 and how these plans – and the implied cuts – have changed over time. We also discuss how these cuts have been allocated between Whitehall departments over this period. In Section 7.3, we consider the period beyond the general election. We describe the evolution of total DEL through to 2019–20 under the coalition’s 2014 Autumn Statement plans, and also the possible outlook for DEL given the three main UK political parties’ proposals and fiscal rules. We then illustrate how spending for different departments could look over the next parliament given these spending totals. Section 7.4 concludes.

7.2 Choices made so far: 2010–11 to 2015–16

Departmental spending

When the government plans public spending, it splits the total into two major categories: annually managed expenditure (AME) and departmental expenditure limits (DELs). AME includes areas of spending such as debt interest payments and social security, which HM

³ For more detail, see R. Crawford, C. Emmerson, S. Keynes and G. Tetlow, ‘Fiscal aims and austerity: the parties’ plans compared’, IFS Briefing Note BN158, 2014, <http://www.ifs.org.uk/publications/7495>.

⁴ DEL is a narrower definition of spending on public services than that used in Figure 7.1 since it excludes from total public spending not just social security and debt interest spending but also some other components of spending including net public service pension payments, transfers to the EU and local authority self-financed expenditure.

Treasury has previously argued are hard to plan in advance.⁵ The Office for Budget Responsibility (OBR) produces forecasts for AME through to the end of the forecast horizon at each Budget and Autumn Statement. DELs are spending by departments on administration and public services and are planned in advance, typically every two or three years in spending reviews.

The coalition government allocated DELs between departments for the years 2011–12 to 2015–16 in the 2010 and 2013 Spending Reviews. In this section, we focus on these decisions made by the coalition. Technically, the next government could change spending plans in 2015–16 since the financial year will have only just started.⁶ However, the two governing parties have signed up to the existing allocations, and Labour has signed up to the current spending allocations.⁷

Table 7.1 summarises the latest forecasts for total public spending, DEL and AME between 2010–11 and 2015–16. Total spending is planned to fall by just 3.2% in real terms between 2010–11 and 2015–16, but this rather small average annual fall of 0.6% in headline spending masks some very different trends in the components of spending. AME, of which around three-fifths is spending on social security, will have increased in real terms by a cumulative 3.7% between 2010–11 and 2015–16. Departmental spending, on the other hand, will have been cut by 9.5% in real terms.

Table 7.1. Latest plans for spending, 2010–11 to 2015–16

	<i>£ billion, 2015–16 prices</i>		<i>Average annual real growth rate 2010–11 to 2015–16</i>	<i>Cumulative real growth</i>
	2010–11	2015–16		
Total managed expenditure	£770.9	£746.2	–0.6%	–3.2%
<i>of which:</i>				
AME	£368.0	£381.5	0.7%	3.7%
DEL	£402.9	£364.7	–2.0%	–9.5%
<i>of which:</i>				
Resource DEL (excluding depreciation)	£348.5	£316.8	–1.9%	–9.1%
Capital DEL	£54.4	£47.9	–2.5%	–11.9%

Note: Resource DEL and DEL adjusted for business rates retention scheme. Total managed expenditure and AME adjusted to include negative tax credits as spending in years before 2015–16, and to exclude 50% of retained non-domestic rates revenues prior to 2013–14 to account for a reform allowing local authorities to retain 50% of business rates raised locally (not making this adjustment would overstate the cut to DEL).

Source: HM Treasury, *Public Expenditure Statistical Analyses 2014* (PESA 2014), available at <https://www.gov.uk/government/statistics/public-expenditure-statistical-analyses-2014>; HM Treasury, *Autumn Statement 2014*, available at <https://www.gov.uk/government/topical-events/autumn-statement-2014>; DCLG, *Local Government Financial Statistics*, 24, 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/316772/LGF524_web_editio_n.pdf.

⁵ It is worth noting, however, that a relatively large proportion of AME spending can be forecast reasonably accurately in advance (e.g. spending on child benefit, the state pension and public service pensions). For more detail on the method for planning public spending, see S. Keynes and G. Tetlow, ‘A survey of public spending in the UK’, IFS Briefing Note BN43, 2014, <http://www.ifs.org.uk/publications/1791>.

⁶ This happened after the 2010 election, when the new coalition government announced £5 billion of in-year spending cuts prior to its June 2010 ‘emergency budget’ (see footnote 10 in Chapter 1).

⁷ Source: <http://labourlist.org/2014/01/full-text-ed-balls-commits-labour-to-budget-surplus-and-announces-50p-tax-rate-plan/> and <http://www.telegraph.co.uk/news/politics/labour/10095595/Labour-will-work-within-George-Osbornes-spending-plans-Ed-Balls-says.html>.

Table 7.1 also makes the distinction between departmental capital and resource spending. Capital spending typically includes investment in things such as building schools and roads, whereas resource spending covers current spending on things such as public sector pay. Between 2010–11 and 2015–16, capital spending by departments (CDEL) is planned to have been cut by slightly more than resource spending (RDEL) in percentage terms, by a cumulative 11.9% in real terms compared with 9.1% (though less in absolute terms, by £6.5 billion compared with £31.7 billion). However, this is not how the cuts to capital and resource DEL were originally planned to compare.

Changes to departmental spending since 2010

Resource and capital DELs for each department for the three years up to 2014–15 were first set in the October 2010 Spending Review. The first column of Table 7.2 sets out the real cuts to spending that were planned at the time: overall DEL was planned to be cut by 10.6%, with capital DEL being cut by 25.9% and resource DEL being cut by 8.3%. Originally, then, capital DEL was forecast to be cut to a much greater extent than resource DEL.

Departments' budgets are set in spending reviews in nominal terms, and therefore the real cut to DEL can deviate from that originally planned for two reasons: because the government changes its nominal spending plans and/or because inflation turns out to be higher or lower than originally expected.

The second column of Table 7.2 illustrates the real change in DEL that would now be expected given the latest inflation forecasts if the government had kept to its original nominal spending plans. At the time of the 2010 Spending Review, the latest OBR forecasts were that economy-wide prices were expected to increase by an average 2.4% per year between 2010–11 and 2014–15 (measured by the GDP deflator). The latest OBR forecasts from December 2014 are that economy-wide inflation would average just 1.8% per year over this period. Since inflation has turned out lower than forecast in 2010, in

Table 7.2. Plans for spending: as made in the 2010 Spending Review, and updated for inflation and policy changes

	<i>Real change in DEL, 2010–11 to 2014–15</i>			<i>Latest planned real change in DEL, 2010–11 to 2015–16</i>
	<i>Original plans, original inflation</i>	<i>Original plans, actual inflation</i>	<i>Out-turns & latest plans, actual inflation</i>	
<i>Percentage</i>				
DEL	–10.6%	–8.8%	–8.6%	–9.5%
Resource DEL	–8.3%	–6.4%	–7.8%	–9.1%
Capital DEL	–25.9%	–24.4%	–13.6%	–11.9%
<i>£ billion (2015–16 prices)</i>				
DEL	–£56.7bn	–£35.4bn	–£34.7bn	–£38.2bn
Resource DEL	–£42.1bn	–£22.2bn	–£27.3bn	–£31.7bn
Capital DEL	–£14.6bn	–£13.2bn	–£7.4bn	–£6.5bn

Note: Spending Review 2010 plans are calculated using the latest out-turns for spending in 2010–11, combined with plans as described in PESA 2011, adjusted for Machinery of Government and classification changes that have taken place since. Original inflation taken as forecast in June 2010.

Source: Past editions of Public Expenditure Statistical Analyses; Office for Budget Responsibility June 2010 forecast; latest inflation from ONS series ABMI and YBHA; forecasts from the OBR's December 2014 Economic and Fiscal Outlook.

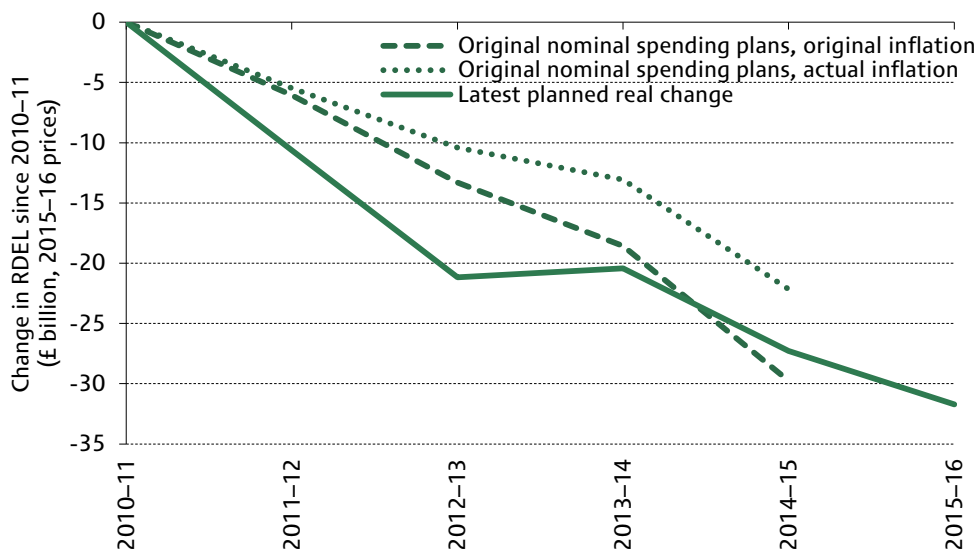
the absence of other changes the real cut to DEL would have been smaller than originally planned, at 8.8% for total DEL, 6.4% for resource DEL and 24.4% for capital DEL.

However, the government did not stick to its nominal 2010 spending plans. This can be seen by the difference between the second and third columns in Table 7.2, where the latter shows the latest plans for the real change in DEL (i.e. taking the latest nominal spending plans and the latest inflation out-turns/forecasts). Since 2010–11, the government has reduced nominal spending on resource DEL further (for example, in the 2012 Autumn Statement, the government announced a 1% cut to unprotected departments’ resource budgets in 2013–14 and a 2% cut in 2014–15), increasing the planned real cut to 7.8%. This is still a smaller real cut than the one originally expected, though, due to the lower inflation out-turn).

In contrast, nominal spending on capital DEL has been increased relative to the original plans, with ‘capital packages’ announced in the 2011 and 2012 Autumn Statements resulting in sizeable increases in CDEL for departments such as the Department for Transport and the Department for Business, Innovation and Skills.⁸ These increases in capital spending have nearly halved the planned real cut to capital DEL, to 13.6%. As described in Chapter 1, this has led to the investment cuts implemented by the coalition over the period to 2014–15 being less than those implied by the spending plans it inherited from the previous Labour government.

When did these changes to the planned real cuts emerge? Figures 7.2a and 7.2b show the *profile* of real cuts to resource DEL and capital DEL (respectively) since 2010–11. They show how these profiles differ when we compare the original plans from 2010, the original plans but adjusted for the latest inflation figures, and the latest plans.

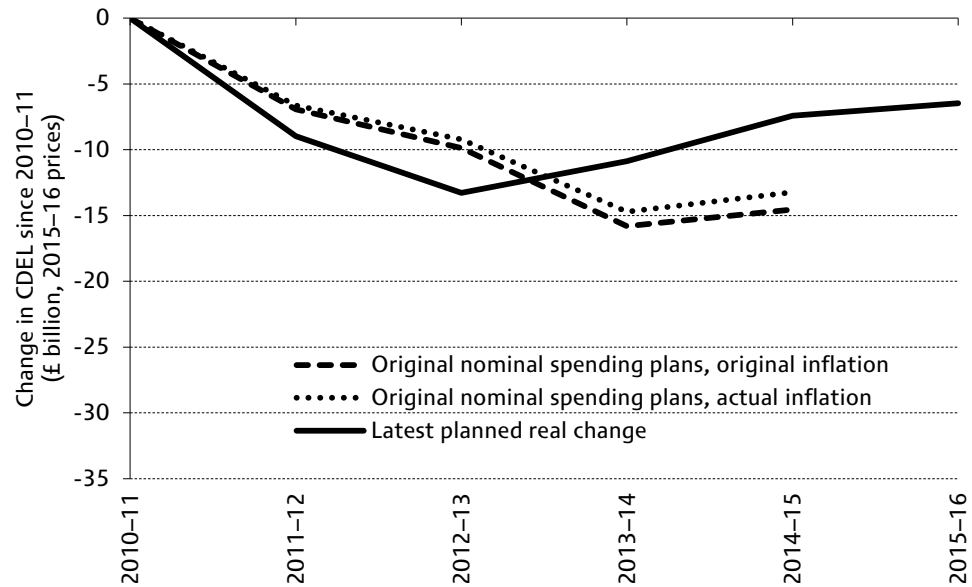
Figure 7.2a. Real change in resource DEL (£ billion, 2015–16 prices)



Note: As for Table 7.2.
Source: As for Table 7.2.

⁸ Other departments benefiting most include the Department for Education, the Ministry of Defence and the Department for Communities and Local Government.

Figure 7.2b. Real change in capital DEL (£ billion, 2015–16 prices)



Note: As for Table 7.2.

Source: As for Table 7.2.

Probably the most striking feature of Figure 7.2a is the difference between the actual fall in resource DEL between 2010–11 and 2012–13 and what was originally planned (using the latest inflation estimates). The much larger cut to resource DEL than originally planned was the result of particularly large underspends by departments in 2012–13 and unusually large transfers of spending from 2012–13 to 2013–14 via the system of ‘budget exchange’. The spending restraint applied in 2012–13 was so much larger relative to that in 2013–14, that it now seems that underlying RDEL saw a small real-terms increase between 2012–13 and 2013–14. The reason for this particularly high restraint in 2012–13 is likely political. Towards the end of 2012–13, it became clear that there was a significant chance that borrowing would increase slightly in nominal terms between 2011–12 and 2012–13. Anxious to avoid such an (economically meaningless but politically awkward) event, it would seem that departments came under pressure either to reduce spending or to shift it into the 2013–14 financial year.⁹ Beyond 2013–14, the latest plans are for RDEL to continue to fall at a similar rate to what was originally planned.

For capital DEL, the coalition government spent slightly less than it had planned for the two years up to 2012–13. However, the ‘capital packages’ announced in the 2011 and 2012 Autumn Statements increased CDEL budgets in 2013–14, 2014–15 and 2015–16, and therefore reduced the real cut in capital DEL relative to what was originally planned. These packages were not enough to reverse the overall decline in capital spending: in real terms CDEL is implied to be around £6.5 billion lower in 2015–16 than it was in 2010–11.¹⁰

⁹ Table 2.5 in the 2013 Budget (available at <https://www.gov.uk/government/publications/budget-2013-documents>) summarises the underspends and budget exchange that contribute to lower spending in 2012–13, and which slightly increase spending in 2013–14 and 2014–15. Note the row titled ‘Exceptional inter-period flexibility’, which apparently shifted £0.4 billion of spending from 2012–13 into later years, after the window for making such transfers had theoretically closed.

¹⁰ Furthermore, capital DEL is forecast to decrease between 2015–16 and 2017–18, before starting to increase again as total public sector gross capital expenditure is increased in line with national income from 2018–19.

To summarise, there are two main differences between the out-turn/latest plans for DEL and what was originally planned in the 2010 Spending Review. First, nominal resource DEL has been lower each year than was planned in 2010. However, since inflation has also turned out lower than was expected at that time, the real cut to resource DEL between 2010–11 and 2014–15 is actually slightly smaller than originally envisaged. Second, nominal capital DEL has been increased from 2012–13 onwards relative to what was allocated in the 2010 Spending Review, and therefore the real cut to capital DEL between 2010–11 and 2014–15, while still large, is now forecast to be much smaller.

Cuts by department

The cuts to DEL over the period 2010–11 to 2015–16 have been distributed very unequally between departments. In the 2010 and 2013 Spending Reviews, large areas of spending were protected. The government pledged to increase real spending on the National Health Service (NHS) and non-investment spending on schools, and to increase spending significantly on official development assistance (which makes up the bulk of the budget of the Department for International Development) so that it reaches at least 0.7% of gross national income.

These protections for such large areas of spending meant much bigger cuts to the other, ‘unprotected’, departments. Between 2010–11 and 2015–16, a real cut of 9.5% to overall departmental spending means a cut of 20.6% for unprotected departments.

The latest plans for cuts by department

Figure 7.3 summarises the latest estimates of the real cuts to total, capital and resource spending by department between 2010–11 and 2015–16. The only departments planned to see real increases in their overall DELs are the Department of Health, the Department for International Development and the Department of Energy and Climate Change, which are currently expected to see increases in their overall budgets of 6.2%, 35.3% and 9.5% respectively. The first two of these are not surprising given the government’s commitments to protect spending on the NHS and official development assistance. The third is slightly more surprising, but is explained by a package of ‘green’ policies announced at the 2013 Autumn Statement and a re-profiling of some funding intended for investment in carbon capture and storage technology that has been delayed.¹¹

In contrast, despite pledging to protect non-investment spending on schools, the budget for the Department for Education is planned to be cut in real terms by 7.4% between 2010–11 and 2015–16. In large part, this is due to a reduction in capital spending, which is forecast to be cut by 41.2%. However, there are also cuts to total non-schools resource spending, which includes spending on further education, sixth forms and early years services.¹²

The Department for Transport and the Ministry of Defence have also fared relatively well, with cuts to their budgets of 6.5% and 10.7% respectively (compared with the average cut of 9.5%).¹³ Other departments such as the Department for Business, Innovation and Skills, the Home Office, the Ministry of Justice and the Department for Work and Pensions

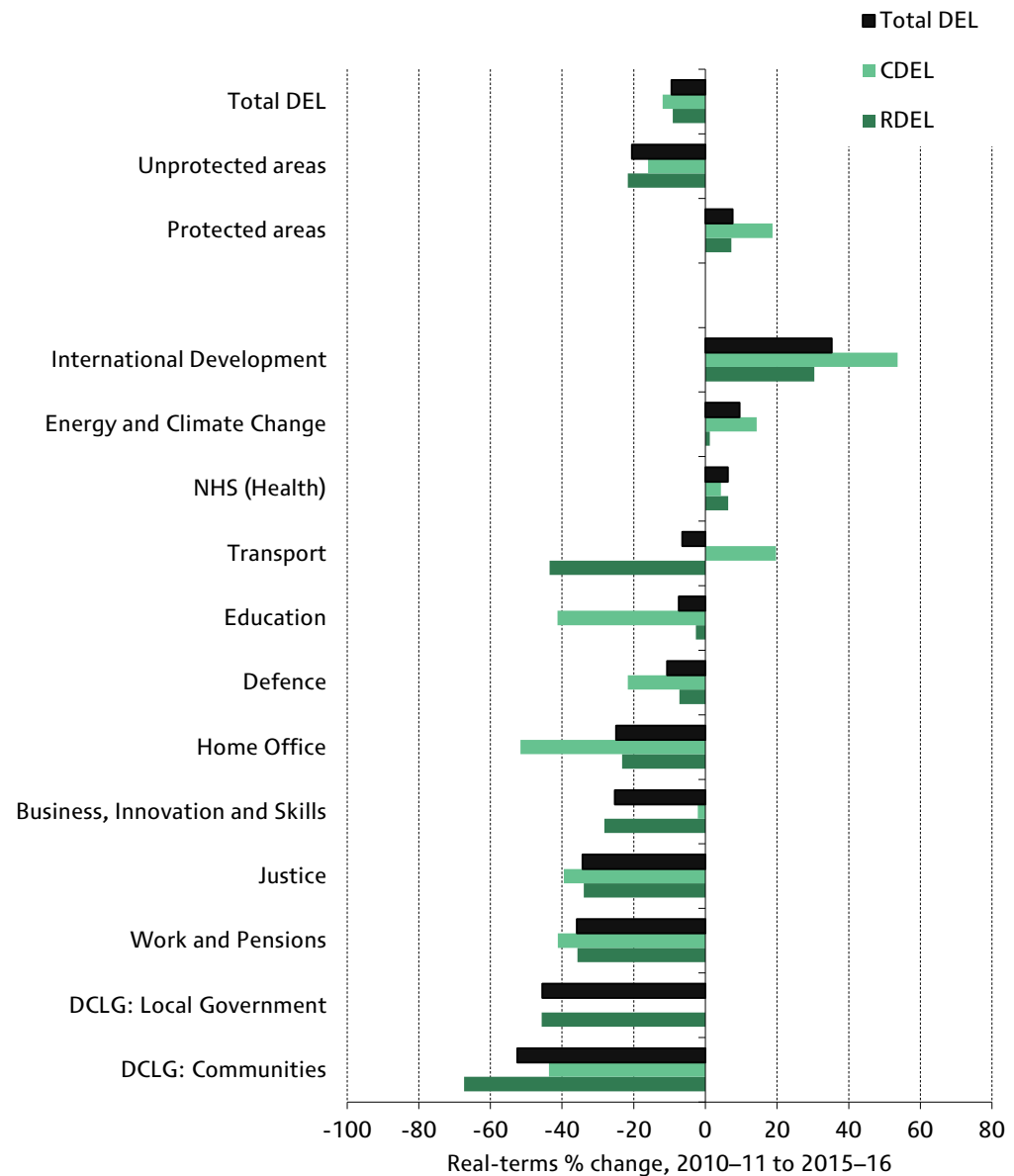
¹¹ For more details, see table S3.2 in the Energy and Climate Change Select Committee Memorandum available at <https://www.gov.uk/government/publications/main-estimate-2014-15-select-committee-memorandum>.

¹² For more information on schools spending and the Department for Education budget, see <http://election2015.ifs.org.uk/schools>.

¹³ Figures for the Ministry of Defence exclude the cost of operations.

face relatively tight settlements, with cuts to their budgets of between 20% and 40%. However, the Department for Business, Innovation and Skills has perhaps fared better than its headline budget suggests: it is planned to face lower-than-average cuts to its capital DEL (of around 2.2%), and a large proportion of its 28.2% cut to resource DEL reflects a major reform to how higher education is financed in England.¹⁴

Figure 7.3. Real-terms cuts to DELs from 2010–11 to 2015–16, by department, ranked by size of overall cut



Note: Figures for the Ministry of Defence exclude the cost of operations and the special reserve. Department for Transport 2015–16 RDEL is adjusted to include £0.9 billion transferred from RDEL to CDEL in 2015–16. £1.6 billion has been removed from the Department for Business, Innovation and Skills CDEL to adjust for financial transactions. Not shown are the Law Officers' departments, the Foreign and Commonwealth Office, the Department for Environment, Food and Rural Affairs, the Department for Culture, Media and Sport, the devolved administrations, the Chancellor's departments, the Cabinet Office, and small and independent bodies.

Source: PESA 2014, Autumn Statement 2014.

¹⁴ For more details, see C. Crawford, R. Crawford and W. Jin, *The Outlook for Higher Education Spending by the Department for Business, Innovation and Skills*, IFS Report R86, 2013, <http://www.ifs.org.uk/comms/r86.pdf>.

Box 7.1. The shifting role of the state

During the current period of austerity, public spending on official development assistance, health and some aspects of education has been protected. This means that these areas will account for an increasing proportion of public service spending over time. Table 7.3 shows that UK health and international services spending accounted for 27.4% and 2.1% (respectively) of all public service spending in 2013–14, compared with 24.5% and 1.6% in 2007–08 (respectively); the proportion of public service spending on education was maintained at 19.1% over the same two years. In contrast, the proportion of public service spending accounted for by most other service areas has declined over this period – and particularly so for public order and safety and transport.

Table 7.3. Composition of public service spending over time

Function	1999–2000	2007–08	2013–14
Health	21.9%	24.5%	27.4%
Education	18.7%	19.1%	19.1%
Defence	11.1%	8.2%	7.7%
Public order and safety	8.2%	7.7%	6.4%
Transport	3.5%	5.0%	4.3%
Recreation, religion and culture	3.4%	2.9%	2.5%
International services	1.6%	1.6%	2.1%
Other	31.5%	31.1%	30.5%
<i>Memo: Real public service spending per capita (2015–16 prices)</i>	£5,500	£7,900	£7,600

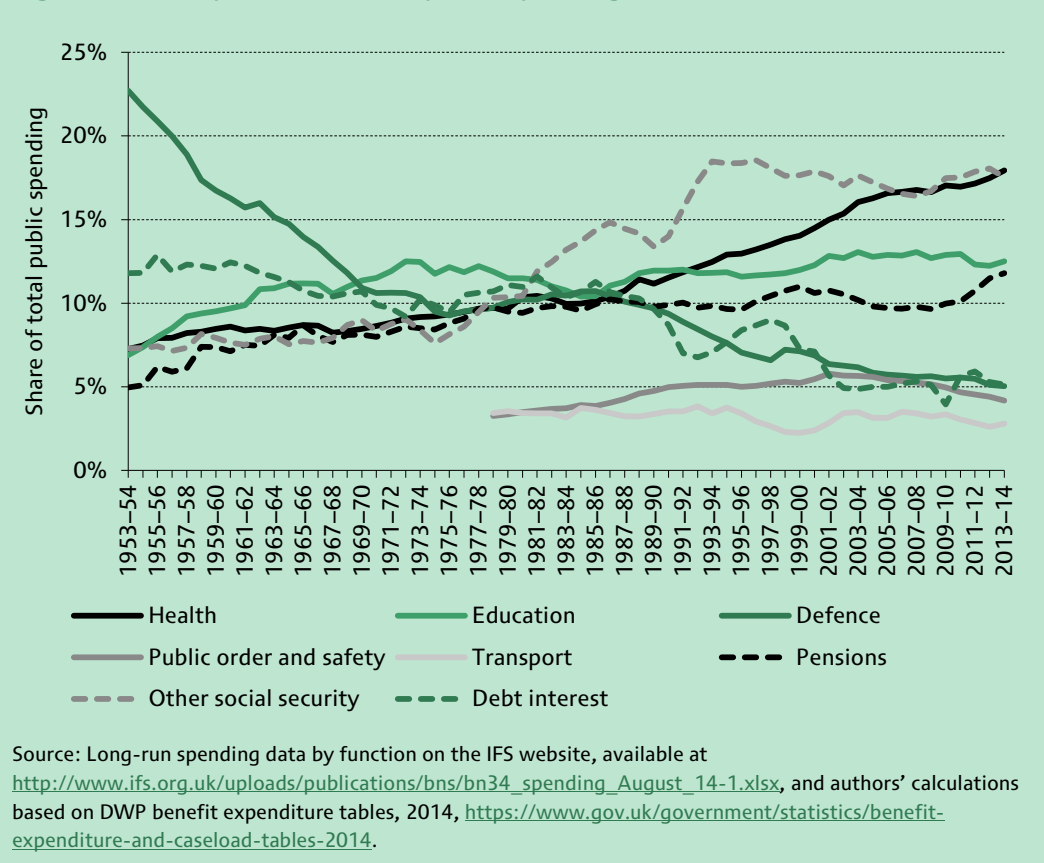
Source: HM Treasury, ‘Public spending statistics release: November 2014’, <https://www.gov.uk/government/statistics/public-spending-statistics-release-november-2014>.

Table 7.3 also sets out the composition of public service spending in 1999–2000. The period between 1999–2000 and 2007–08 stands in contrast to the subsequent period in that the relative importance of international services was stable, the relative importance of transport increased and the relative importance of defence fell sharply. However, the share of public service spending going on health and education increased between 1999–2000 and 2007–08 (though the difference was much less spectacular for the latter). In other words, for more than the past decade an enduring trend has been an increasing focus of public service spending on health services.

This change in the composition of state spending is even more apparent looking over a longer period of time and also considering how spending on social security has changed. This is illustrated in Figure 7.4. The increase in health spending has been a very long-run trend, with health spending increasing from 7% of total public spending in 1953–54 to 18% of total spending in 2013–14 (this is discussed in more detail in Chapter 8). Social security has also steadily been accounting for an increasing proportion of spending over time: spending on the state pension and other social security accounted for 5% and 7% (respectively) of total spending in 1953–54, but 12% and 18% (respectively) of total spending in 2013–14.^a The state has therefore become increasingly focused on the provision of health and social security, which together accounted for nearly half of all public spending in 2013–14.

^a More detail on the long-term trends and recent changes to benefit spending can be found in A. Hood and L. Oakley, ‘The social security system: long-term trends and recent changes’, IFS Briefing Note BN156, 2014, <http://www.ifs.org.uk/publications/7438>.

Figure 7.4. Composition of total public spending over time



The department facing the largest budget cuts is the Department for Communities and Local Government (DCLG). DCLG is unique in that it has two separate DELs: the 'DCLG: Local Government' budget includes general and specific grants to local authorities, while the 'DCLG: Communities' budget includes the department's main programme expenditure and administration costs (including, for example, central government spending on social housing). The DCLG: Communities budget is forecast to be cut by 52.5% in real terms, while the DCLG: Local Government budget is forecast to be cut by 45.5%. This latter figure, however, overstates the cut to local authority spending power over this period, since local authorities also have other sources of revenue – including council tax, retained business rates and user charges – which have typically fallen less over this period than central government grants. In its December 2014 Economic and Fiscal Outlook, the OBR forecast that local authority spending would fall in real terms by between 15% and 20% from 2010-11 to 2015-16.¹⁵

Cuts to the budgets of the devolved administrations of Scotland, Wales and Northern Ireland are not shown in Figure 7.3. The budgets of the devolved administrations are determined by the Barnett formula on the basis of cuts being applied to spending in England. This is discussed in more detail in an IFS Briefing Note,¹⁶ which also illustrates that flaws in the way the Barnett formula interacts with devolved taxes mean that, at the

¹⁵ Authors' calculations based on chart 4.5, Office for Budget Responsibility, *Economic and Fiscal Outlook: December 2014*, <http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/>.

¹⁶ D. Phillips, 'Business as usual? The Barnett formula, business rates and further tax devolution', IFS Briefing Note BN155, 2014, <http://www.ifs.org.uk/publications/7442>.

moment, Scotland and Northern Ireland are facing smaller cuts to their funding than are being applied to comparable spending in the rest of the UK.

The cuts to spending since 2010–11 are large and have not been shared equally between departments. However, as described in Section 7.1, these cuts come after a decade of rapid spending increases, which were also not shared equally. Box 7.1 provides some additional long-run context by illustrating the implications of the recent cuts for the composition of public service spending over time.¹⁷

Changes to departments' plans since 2010–11

As shown earlier in Table 7.2, further cuts to nominal spending on top of the 2010 plans have been more than offset by the fall in inflation relative to what was expected in 2010, and so the real-terms cut to overall DEL is expected to be 8.6%, rather than the 10.6% cut expected at the time of the 2010 Spending Review. Table 7.4 shows the revisions to DEL by department.

Up to 2014–15, the Department of Health has seen no change to its cash budget relative to that announced in the 2010 Spending Review. It is therefore now expected to see a real increase in its budget of 4.6% between 2010–11 and 2014–15, rather than the 2.5% expected in 2010, as a result of lower-than-forecast inflation. The Department for Education, the Department for Business, Innovation and Skills and the Department for Transport are also now expected to see smaller real-terms cuts to their budgets over this period than was planned in the Spending Review – as a result of both lower inflation *and*

Table 7.4. Real change in departments' overall DEL, as originally planned and according to the latest plans

	<i>Real change in DEL, 2010–11 to 2014–15</i>			<i>Latest planned real change in DEL, 2010–11 to 2015–16</i>
	Original plans, original inflation	Original plans, actual inflation	Out-turns & latest plans, actual inflation	
Health	2.5%	4.6%	4.6%	6.2%
Education	-10.5%	-8.7%	-5.5%	-7.4%
Defence	-6.8%	-4.9%	-7.5%	-10.7%
Home Office	-18.7%	-17.0%	-19.4%	-24.9%
Ministry of Justice	-26.7%	-25.2%	-28.9%	-34.3%
Business, Innovation & Skills	-29.4%	-27.9%	-21.7%	-25.3%
Transport	-19.0%	-17.3%	-5.7%	-6.5%
<i>Memo: Total DEL</i>	-10.6%	-8.8%	-8.6%	-9.5%

Note: Spending Review 2010 plans are calculated using the latest out-turns for spending in 2010–11, combined with plans as described in PESA 2011, adjusted for Machinery of Government and classification changes that have taken place since. Original inflation taken as forecast in June 2010. Ministry of Defence DEL excludes the cost of operations and the special reserve (£1.1 billion in 2015–16). Department for Transport 2015–16 RDEL is adjusted to include £0.9 billion transferred from RDEL to CDEL in 2015–16. £1.6 billion has been removed from the Department for Business, Innovation and Skills CDEL to adjust for financial transactions.

Source: Past editions of Public Expenditure Statistical Analyses; Office for Budget Responsibility June 2010 forecast; latest inflation from ONS series ABMI and YBHA; forecasts from the OBR's December 2014 Economic and Fiscal Outlook.

¹⁷ The division of spending into different service areas in Box 7.1 differs from that used in Figure 7.3 because the mapping between service areas and government departments changes over time, and long-run data are only available on a 'functional' rather than a 'departmental' basis.

increases in nominal spending plans. Moreover, the real cuts to these departments' budgets now planned up to 2015–16 will still not be as large as those originally planned in the 2010 Spending Review for the period up to 2014–15. Other departments have not fared so well. The Ministry of Defence, the Home Office and the Ministry of Justice are all now expected to see larger cuts to their budgets between 2010–11 and 2014–15 than was originally expected – they have experienced cuts to their nominal budgets since 2010 that more than offset the beneficial impact of lower-than-forecast inflation.

Table 7.5 gives more detail on how departments' budget allocations have changed since the 2010 Spending Review, breaking down budgets into capital DEL and resource DEL (excluding depreciation). The Department of Health has seen no change to either its

Table 7.5. Real change in departments' resource DEL (excluding depreciation) and capital DEL, as originally planned and according to the latest plans

	<i>Real change in DEL, 2010–11 to 2014–15</i>			<i>Latest planned real change in DEL, 2010–11 to 2015–16</i>
	<i>Original plans, original inflation</i>	<i>Original plans, actual inflation</i>	<i>Out-turns & latest plans, actual inflation</i>	
Health				
<i>Resource DEL</i>	2.5%	4.6%	4.6%	6.3%
<i>Capital DEL</i>	1.9%	4.0%	4.0%	4.3%
Education				
<i>Resource DEL</i>	–4.0%	–2.0%	–1.4%	–2.7%
<i>Capital DEL</i>	–56.9%	–56.0%	–34.4%	–41.2%
Defence				
<i>Resource DEL</i>	–12.3%	–10.4%	–5.1%	–7.2%
<i>Capital DEL</i>	–2.9%	–0.9%	–15.0%	–21.6%
Home Office				
<i>Resource DEL</i>	–17.3%	–15.6%	–18.0%	–23.3%
<i>Capital DEL</i>	–42.6%	–41.4%	–41.4%	–51.6%
Ministry of Justice				
<i>Resource DEL</i>	–25.4%	–23.9%	–27.7%	–33.9%
<i>Capital DEL</i>	–48.3%	–47.2%	–47.2%	–39.5%
Business, Innovation & Skills				
<i>Resource DEL</i>	–26.5%	–24.9%	–24.6%	–28.2%
<i>Capital DEL</i>	–53.0%	–52.0%	1.6%	–2.2%
Transport				
<i>Resource DEL</i>	–36.9%	–35.6%	–38.7%	–43.4%
<i>Capital DEL</i>	–6.3%	–4.3%	17.7%	19.7%
<i>Memo: Total DEL</i>	–10.6%	–8.8%	–8.6%	–9.5%
<i>Memo: Total RDEL</i>	–8.3%	–6.4%	–7.8%	–9.1%
<i>Memo: Total CDEL</i>	–25.9%	–24.4%	–13.6%	–11.9%

Note: Figures for the Ministry of Defence exclude the cost of operations and the special reserve. Department for Transport 2015–16 budget adjusts for a reclassification of £0.9 billion from resource to capital DEL. £1.6 billion has been removed from the Department for Business, Innovation and Skills CDEL to adjust for financial transactions.

Source: Past editions of Public Expenditure Statistical Analyses; Office for Budget Responsibility June 2010 forecast; latest inflation from ONS series ABMI and YBHA; forecasts from the OBR's December 2014 Economic and Fiscal Outlook.

resource budget or its capital budget, and so both have benefited fully from the lower-than-expected inflation.

The Department for Education has benefited from increases in both its resource and capital budgets, and so the real cut to each is lower than originally planned, and by more than just the beneficial impact of lower-than-forecast inflation. These budget increases were the result of specific policy action, such as the extension of free school meals, grants for apprenticeships and additional funding for extra school places.

The Department for Business, Innovation and Skills and the Department for Transport are both now expected to see smaller real cuts than originally planned, and Table 7.5 illustrates that this is driven by increases in their capital budgets – which are both now forecast to increase in real terms between 2010–11 and 2014–15 rather than being cut as originally intended. This is the result of extra funding allocated in Autumn Statements and Budgets since 2010. Specific examples of increases in funding for the Department for Business, Innovation and Skills include £0.2 billion of funding for the Regional Growth Fund (announced in the 2012 Budget) and £0.3 billion of funding for ‘Research Council infrastructure’. The Department for Transport also did relatively well from the capital package announced in the 2012 Autumn Statement, receiving £0.8 billion extra funding for long-term investment for new roads in 2014–15.

The Home Office, the Ministry of Justice and the Ministry of Defence are all facing larger real-terms cuts than originally planned (despite lower-than-forecast inflation), largely due to the extra spending restraint announced in the 2012 Autumn Statement, the 2013 Budget and the 2013 Autumn Statement. Table 7.5 indicates that for the Home Office and Ministry of Justice these greater cuts are driven by greater-than-planned cuts to resource DEL; their capital DEL allocations are unchanged since the 2010 Spending Review. The Ministry of Defence budget has seen big changes to its resource and capital budgets, with cuts to its resource budget decreased and cuts to its capital budget increased. Some of the extra capital cuts have come through lower-than-planned spending on single-use military equipment (SUME).¹⁸ Whereas departments are typically not allowed to cut capital DELs to ease the burden on resource DELs, the Ministry of Defence has transferred part of its SUME budget to its resource budget (having received appropriate permission from HM Treasury). Since 2010–11, the Ministry of Defence has increasingly used this as a way of easing the pressure on resource spending, transferring £1.5 billion in 2014–15, compared with £0.7 billion in 2010–11.

To summarise, the ‘winners’ relative to the 2010 Spending Review allocations are the Department of Health, the Department for Education, the Department for Business, Innovation and Skills and the Department for Transport. These departments either benefited from lower-than-expected inflation or from policies increasing their 2014–15 budgets, or both. The losers include the Home Office and the Ministry of Justice. These departments have faced the full brunt of the extra cuts to resource spending implemented by the coalition government since the 2010 Spending Review.

¹⁸ Single-use military equipment is military assets that cannot be used by civilian organisations for the production of goods and services (i.e. they have a single use: in the military). This includes weapons systems (planes, tanks, guns etc.) and ammunition (bullets, bombs etc.).

7.3 Options for the 2015 Spending Review

The outlook for total DEL: 2015–16 onwards

Autumn Statement plans

The coalition government has not explicitly planned DEL for the years after 2015–16. However, it has pencilled in plans for total spending (DEL plus AME) through to 2019–20, and since the OBR has forecast AME for the same years, DEL is the implicit residual after AME has been subtracted from total spending.

The latest plans published in the 2014 Autumn Statement suggest that there are still large cuts to come and that there may even be an acceleration of the cuts seen over this parliament. Table 7.6 describes these plans, which are for total public spending to be cut at an average 0.6% per year in real terms between 2015–16 and 2019–20. Within the total, there is a similar trend to the one seen over this parliament – namely, increasing AME and falling DEL. Given the OBR forecast for AME to increase at an average annual rate of 2.2%, the implied real cut to DEL is an average 3.7% per year between 2015–16 and 2019–20. This is nearly twice the 2.0% per year average real cut to DEL over the period 2010–11 to 2015–16. Taking the whole period 2010–11 to 2019–20, DEL is implied to be cut by a cumulative 22.2% in real terms. By the end of this period, this would take DELs back to around the same level in real terms in 2019–20 as they were in 2002–03.

Within departmental spending, the outlook is quite different for resource and capital DEL.¹⁹ Capital DEL is implied to increase by an average 1.8% per year in real terms from 2015–16 to 2019–20, as a result of the coalition government’s plan to increase public sector gross investment in line with national income from 2017–18 onwards. This would not be enough to reverse entirely the cuts to capital spending over this parliament; overall between 2010–11 and 2019–20, there is still forecast to be an overall cut, of 5.4%. On the other hand, the implied real cut to resource DEL is 4.6% per year between 2015–16 and 2019–20 – a large acceleration from the average annual real cut of 1.9% between

Table 7.6. Planned departmental spending, 2015–16 to 2019–20

	<i>Real change, 2015–16 to 2019–20</i>		<i>Real change, 2010–11 to 2019–20</i>	
	<i>Average annual</i>	<i>Cumulative</i>	<i>Average annual</i>	<i>Cumulative</i>
Total managed expenditure	–0.6%	–2.3%	–0.6%	–5.4%
<i>of which:</i>				
Annually managed expenditure	2.2%	9.0%	1.4%	13.0%
Departmental spending limits	–3.7%	–14.1%	–2.8%	–22.2%
<i>of which:</i>				
Resource DEL	–4.6%	–17.3%	–3.1%	–24.8%
Capital DEL	1.8%	7.3%	–0.6%	–5.4%

Note: Resource DEL excludes depreciation. DEL, resource DEL and AME are adjusted for the business rates retention scheme. TME and AME adjusted to include negative tax credits as spending in years before 2015–16.

Source: PESA 2014; Autumn Statement 2014.

¹⁹ We can estimate implied totals for resource DEL and capital DEL because within total spending the government has also pencilled in plans for public sector gross investment up to 2019–20.

2010–11 and 2015–16. Over the four years, this would amount to a total cut of 17.3%, bringing the real cut between 2010–11 and 2019–20 to 24.8%.

How these plans might differ under a new government

After the general election in May 2015, the new government will almost certainly change the plans for departmental spending from those implied in the 2014 Autumn Statement.²⁰ While the three main political parties have all signed up to the new fiscal mandate to achieve a cyclically-adjusted current budget surplus in 2017–18, they disagree on how they would achieve the necessary fiscal consolidation in 2016–17 and 2017–18. Beyond 2017–18, they also disagree on how much further consolidation is desirable.

In a recent briefing note, we explored how public spending might differ under each of the three main parties, given their fiscal rules and what other plans they had announced so far.²¹ Perhaps somewhat surprisingly, all the parties' preferred fiscal rules allow for looser fiscal policy than is currently planned. The Conservatives are aiming for an overall budget surplus, which in 2019–20 could allow up to £21.3 billion of extra spending for departments relative to the 2014 Autumn Statement plans.²² Labour and the Liberal Democrats are targeting a surplus on the current budget and cyclically-adjusted current budget respectively. These fiscal rules would be consistent with up to £45 billion extra non-investment spending for departments by 2019–20.²³

Figure 7.5 and Table 7.7 compare the cuts to departmental spending implied in the 2014 Autumn Statement with the most generous DEL settlement that would be consistent with each party's fiscal rules, assuming that Labour and the Liberal Democrats do not increase investment spending over the Autumn Statement plans.²⁴ Table 7.7 also illustrates how these cuts would differ if we take into account the parties' stated policy intentions (as of December 2014) on welfare spending and taxes.²⁵ For the Conservatives, these amount to a net tax and benefit takeaway of £5.2 billion (assuming they meet their aspiration to cut £12 billion from welfare spending), and for Labour a net tax and benefit takeaway of

²⁰ As mentioned previously, technically the incoming government could also change departmental spending in 2015–16. However, the two governing parties have signed up to the existing allocations, and Labour has signed up to the current spending allocations.

²¹ R. Crawford, C. Emmerson, S. Keynes and G. Tetlow, 'Fiscal aims and austerity: the parties' plans compared', IFS Briefing Note BN158, 2014, <http://www.ifs.org.uk/publications/7495>.

²² The Autumn Statement forecast an overall budget surplus of £21.6 billion in 2019–20 (2015–16 prices; £23.1 billion in 2019–20 prices), but not all of this would be available to spend on departments since increased borrowing relative to the Autumn Statement plans would likely require increased spending on debt interest.

²³ £45.2 billion for the Liberal Democrats, who are targeting a cyclically-adjusted budget balance, compared with £44.6 billion for Labour, which is targeting a headline current budget balance. This extra spending takes into account the extra debt interest spending that would be implied by higher borrowing (and higher debt) in earlier years relative to Autumn Statement 2014 plans.

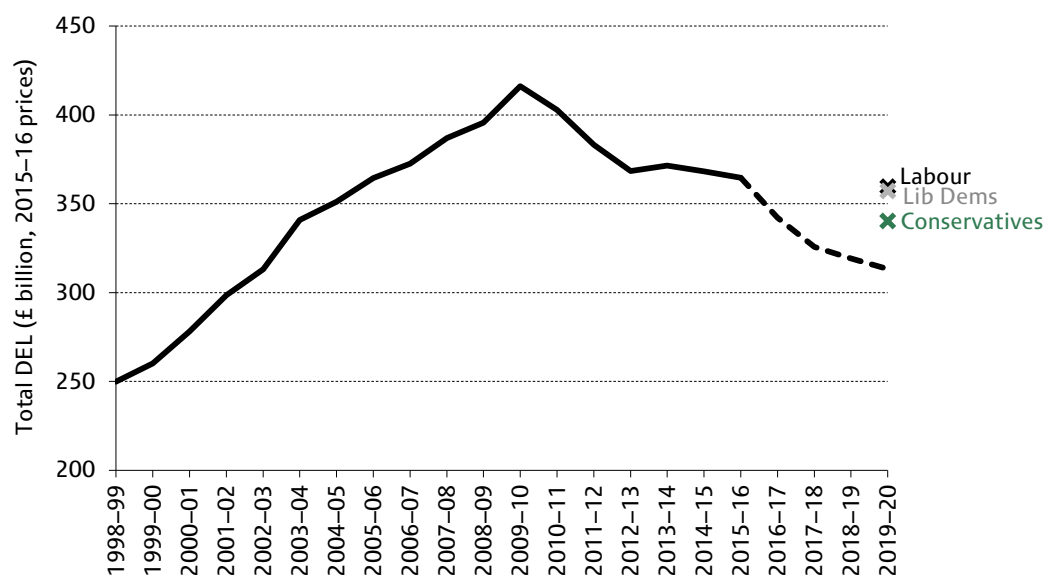
²⁴ This is perhaps a controversial assumption, given that Labour and the Liberal Democrats are both targeting measures of borrowing that exclude investment, and so they could both increase investment spending and still keep to their fiscal rules. In the absence of specific details to the contrary, for now we assume that they keep to the coalition investment spending plans.

²⁵ The most significant policies announced by Labour are the decisions to reverse the under-occupancy penalty (otherwise known as the spare room subsidy or the bedroom tax), to increase the top rate of income tax from 45p to 50p, to cap child benefit increases at 1% in 2016–17 and to introduce a 'mansion tax' on homes worth more than £2 million. For the Liberal Democrats, the major policies we include are the mansion tax on homes worth more than £2 million, an increase in the personal allowance to £12,500 by 2020–21, an increase in capital gains tax, limits to pensions tax relief, and an increase in the dividend tax rate for higher-rate taxpayers. For the Conservatives, we include their stated intentions to raise the higher-rate threshold to £50,000 by 2020–21, to increase the personal allowance to £12,500 by the same year, and to implement £12 billion of welfare cuts (of which approximately £9 billion are as yet unspecified). A full description of what policies we have included for each party is available in R. Crawford, C. Emmerson, S. Keynes and G. Tetlow, 'Fiscal aims and austerity: the parties' plans compared', IFS Briefing Note BN158, 2014, <http://www.ifs.org.uk/publications/7495>.

£1.4 billion (2015–16 prices) – taking these into account would slightly reduce the cuts implied to departmental spending. The Liberal Democrats have announced specific net tax and benefit policies that imply a small net giveaway of £1.2 billion (2015–16 prices), which would need to be offset by slightly greater cuts to departmental spending.

The Conservatives' fiscal rules, combined with their policy announcements so far and their stated intention for welfare spending cuts, imply that they could cut total DEL by 6.7% between 2015–16 and 2019–20, i.e. by less than the 14.1% implied by the 2014

Figure 7.5. Real total departmental spending: Autumn Statement plans and potential spending under alternative parties' proposals



Note: Potential departmental spending under the alternative parties' proposals assume that they all stick to the Autumn Statement 2014 plans for investment, that they borrow the maximum amount their fiscal rules allow, and that they implement their specific tax and benefit reforms and stated intentions as of December 2014.

Source: Spending Review 2010; various editions of Public Expenditure Statistical Analyses; the OBR's 2014 Economic and Fiscal Outlook.

Table 7.7. Potential departmental spending, 2015–16 to 2019–20, under alternative parties' proposals

	<i>Real change, 2015–16 to 2019–20</i>		<i>Real change, 2010–11 to 2019–20</i>	
	<i>%</i>	<i>£ billion</i>	<i>%</i>	<i>£ billion</i>
2014 Autumn Statement plans	-14.1	-51.4	-22.2	-89.5
<i>Given parties' fiscal rules:</i>				
Conservatives	-8.3	-30.1	-16.9	-68.3
Labour	-1.9	-6.8	-11.2	-44.9
Liberal Democrats	-1.7	-6.2	-11.0	-44.4
<i>Given parties' fiscal rules and stated intentions:</i>				
Conservatives	-6.7	-24.9	-15.5	-53.1
Labour	-1.4	-5.2	-10.8	-43.3
Liberal Democrats	-2.1	-7.5	-11.3	-45.7

Note: As for Figure 7.5.

Source: As for Figure 7.5.

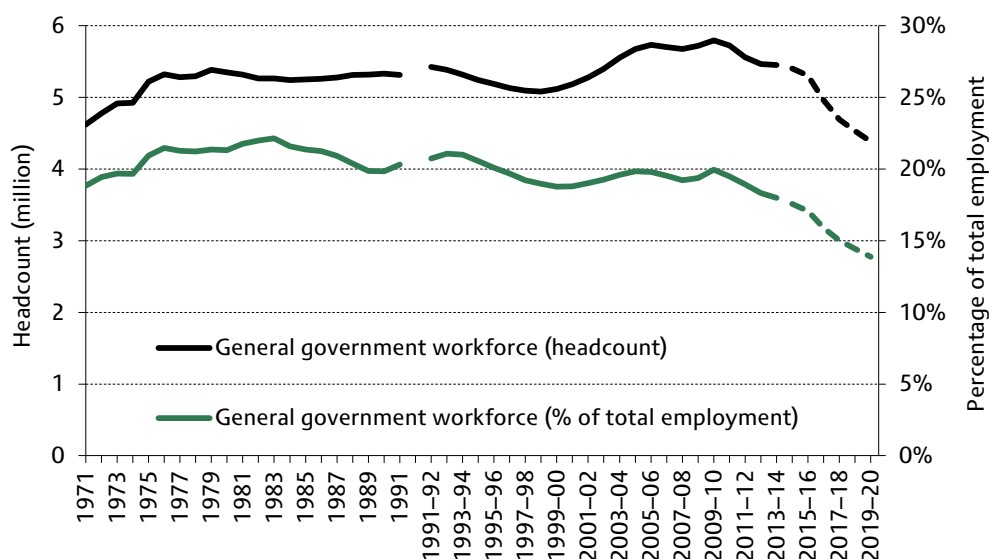
Autumn Statement. Labour’s fiscal rule and announced policies would allow a cut of just 1.4% and the Liberal Democrats’ announcements are consistent with a 2.1% cut.

The implications for government employment

On the basis of the spending cuts pencilled in by the 2014 Autumn Statement, the OBR has forecast that general government employment will fall by around 900,000 between 2015–16 and 2019–20. This would be on top of cuts of around 500,000 between 2009–10 and 2015–16.²⁶

Figure 7.6 illustrates how the OBR’s forecasts for general government employment compare with historical levels.²⁷ General government employment is projected to fall to below 4.4 million in 2019–20, which would be the lowest level seen over the period since 1991–92 for which consistent data are available and would probably be the lowest level since at least 1971.²⁸ The 10 years since 2009–10 would be the longest period of consecutive annual cuts to general government employment since 1971, and the average cut to employment, forecast at around 140,000 per year, would be considerably greater

Figure 7.6. General government employment over time



Note: The discontinuity in the data at 1991 is caused by changes in the methodology for calculating general government employment post-1991 that mean the series are not fully consistent with each other. Headcount for 1971 to 1991 is measured at mid-year. Community Programme employees, who were in the public sector from 1983 to 1988 before being transferred from general government to the private sector in 1988Q3, are excluded. Polytechnic staff were transferred out of general government into the private sector in 1988, but are included in general government from 1989 to 1991 to remove this discontinuity. Figures exclude the reclassification of workers in further education and sixth-form colleges in England to the private sector in 2012.

Source: Authors’ calculations using Office for National Statistics, *Economic Trends Annual Supplement 2004* (for 1971 to 1991 figures), Office for National Statistics, *Public Sector Employment Statistics* (for 1991–92 to 2013–14 figures) and Office for Budget Responsibility, *Economic and Fiscal Outlook December 2014* (for forecasts). Total employment is measured using ONS series MGRZ.

²⁶ Numbers in this section exclude the effects of the reclassification of 196,000 workers in further education and sixth-form colleges in England to the private sector in 2012. In order to compare the general government workforce consistently over time, we classify them to the public sector in all years.

²⁷ A more detailed discussion of the changes in public sector employment over time is available in J. Cribb, R. Disney and L. Sibieta, ‘The public sector workforce: past, present and future’, IFS Briefing Note BN145, 2014, <http://www.ifs.org.uk/publications/7113>.

²⁸ Figures exclude employees of nationalised financial corporations.

than the average employment cut during the 1990s (which was around 50,000 per year between 1991–92 and 1998–99).

Furthermore, it is worth bearing in mind that the size of the labour force has grown over time, not least due to population growth. Figure 7.6 therefore also illustrates general government employment as a share of total employment over time. In 2013–14, general government employment was 18% of total employment – already a lower percentage than at any point since 1971. Current OBR forecasts imply that the share of the total workforce working in general government would shrink to 14% in 2019–20.

The cuts to general government employment after 2015–16 are forecast by the OBR, on the basis of public spending plans laid out in the 2014 Autumn Statement, to be at a greater rate than has been experienced since 2009–10: an average 230,000 per year over the four years up to 2019–20 compared with an average 80,000 per year over the six years up to 2015–16. This is caused by two factors. First, as described above, the Autumn Statement plans imply acceleration in the cuts to departmental spending after 2015–16, which all else equal would imply a greater rate of cuts to government employment in future. Second, government employment has been protected to some extent over the period up to 2015–16 by coalition government policies to restrain public sector pay growth. The OBR employment forecasts do not assume that such policies continue, and so greater wage growth over the period beyond 2015–16 would result in greater forecast employment cuts even if the average cut to departmental spending were the same.

These forecasts for general government employment are all based on the coalition government's plans for departmental spending that were pencilled in by the 2014 Autumn Statement. However, as discussed above, future levels of departmental spending will be the responsibility of the new government, and the three main parties' plans all differ from one another and from the Autumn Statement plans. Table 7.8 therefore illustrates how the potential DEL levels implied by the parties' fiscal rules and policy plans described above might result in different cuts to general government employment. All the parties' proposals could enable lower cuts to departmental spending than implied by the Autumn Statement plans, and therefore projected cuts to general government employment are lower – at around 550,000 on the basis of what departmental spending

Table 7.8. Cuts to general government employment

	Real change in DEL, 2015–16 to 2019–20	Change in general government employment, 2015–16 to 2019–20	
		OBR forecast for public sector pay growth	Public sector pay grows in line with CPI
2014 Autumn Statement plans	-14.1%	-900,000	-750,000
<i>Given parties' fiscal rules and stated intentions:</i>			
Conservatives	-6.7%	-550,000	-400,000
Labour	-1.4%	-300,000	-100,000
Liberal Democrats	-2.1%	-300,000	-150,000

Note: Potential reductions in general government employment are calculated by IFS replications of OBR forecasts, given the different potential changes to resource DEL between 2015–16 and 2019–20. Changes in general government employment are rounded to nearest 50,000.

Source: Authors' calculations based on parties' stated policies and the OBR's 2014 Economic and Fiscal Outlook.

might look like under the Conservatives and at around 300,000 on the basis of what departmental spending might look like under Labour or the Liberal Democrats.

The future cuts to general government employment may be mitigated if the government continues with policies to restrain public sector pay. The employment cuts described so far are calculated using the OBR's assumption that paybill per head in the public sector grows by an average of 2.9% per year in nominal terms between 2015–16 and 2019–20 (0.9% per year relative to the consumer price index). If pay growth were lower than this, the cuts to government employment would be reduced (since a given total paybill could finance the employment of more workers). For example, if public sector pay grew in line with consumer prices between 2015–16 and 2019–20 (forecast to be 1.9% per year), then the cuts to general government employment under the Autumn Statement plans for departmental spending would fall to 750,000 (illustrated in the final column of Table 7.8). However, this would entail a four-year freeze to real pay in the public sector, over a period in which the OBR forecasts imply that private sector wages are expected to grow by around 8% in real terms.

The 2015 Spending Review

The total cut to departmental spending over the next parliament will be decided by the next government. Within that total, the allocation of departmental budgets for 2016–17, and potentially subsequent years, will be decided in a spending review, which is expected to be held by the end of 2015.

Which years should it cover?

The spending review will set departments' budgets for a number of years, but there is no fixed rule that sets how many. Between 1998 and 2004, spending reviews occurred every two years and covered three years, with the last year's spending plans being reviewed in the following spending review. The 2007 review covered the three years from 2008–09 to 2010–11. Under the coalition government, the 2010 Spending Review covered four years (from 2011–12 to 2014–15), while the 2013 Spending Review covered just one year (2015–16).

The advantage of covering a longer period is that it gives departments a better indication of the resources they are likely to receive in future. This gives them more time to plan, and more information on which to base potential investment or other long-run decisions, which ought to lead to better policy-making. It also makes it harder for the government to publish borrowing projections that depend on spending cuts in future years without specifying which departments would be required to cut their spending. The disadvantage of covering a longer period is that economic, fiscal and/or societal circumstances can change (or better information can emerge), and it is valuable for the government to have the option to respond to such changes through altering overall spending or departmental allocations.

At the start of this parliament, we recommended that the government hold a four-year spending review, with a 'mini review' to reassess plans half way in light of any changes.²⁹ The coalition government did hold a four year review, but while it has subsequently tweaked these initial plans (described above), it did not appear to do so on the basis of a

²⁹ Source: C. Emmerson, 'UK public finances: fiscal repair needed', 2010, http://www.ifs.org.uk/docs/ifs_ifg0510.pdf.

systematic 'mini review' taking into account overall and department-specific changes in circumstances. This invites the concern that the plans set out in four-year reviews may become more fixed than they perhaps should be.

Given this, we suggest that whoever forms the next government conducts a full four- or five-year spending review in 2015, setting fixed plans for the first two full years of the next parliament (2016–17 and 2017–18) and indicative plans for the following two or three years. The next government should also commit to a 'mini review', which would report no later than Autumn 2017 and which would firm up the indicative plans for 2018–19 onwards. This is along the same lines as the recommendations of others, including a Fabian Society commission and the Institute for Government.³⁰

How might the cuts be allocated between departments?

Over this parliament, the government has protected the NHS, schools (non-investment) spending and official development assistance (ODA) from real cuts. This has meant an increase in the fraction of departmental spending going towards these protected areas, from 39.3% in 2010–11 to 46.7% in 2015–16, and larger-than-average cuts to the other 'unprotected' areas.

Going forwards, much of this protection looks set to remain. The three main UK parties have pledged to protect NHS spending in real terms: the Liberal Democrats have promised to increase annual spending on the NHS by £8 billion in 2020–21, the Conservatives have suggested they would also seek to do this,³¹ and we assume Labour would do the same. This is discussed in more detail in Chapter 8. There also appears to be a broad consensus regarding the target to spend at least 0.7% of gross national income on ODA.

There is less certainty over whether schools spending will be protected going forwards. The Liberal Democrats' pre-manifesto states – and Nick Clegg has been reported to have vowed – that they would protect the whole education budget (i.e. going further than the coalition government went over this parliament).³² However, while Labour has hinted that it might protect spending on schools,³³ neither Labour nor the Conservatives appear to have explicitly signed up to real-terms protection of schools spending.

Table 7.9 shows the implied real-terms cuts to other departments' spending if the NHS and ODA are protected beyond 2015–16, and if non-investment spending on schools is also protected. Under coalition plans for total spending, such protection would mean the unprotected areas would face a further cut of 27.0% by 2019–20, taking the cumulative total between 2010–11 and 2019–20 to 42.0%.

However, each of the parties has the scope to reduce the spending squeeze for these unprotected areas significantly whilst still complying with their proposed fiscal rules. The columns for the different parties take the total DEL settlements from Table 7.7 – i.e. the

³⁰ Source: Fabian Society, *2030 Vision: The Final Report of the Fabian Society Commission on Future Spending Choices*, 2013, available at <http://www.fabians.org.uk/spendingchoices/> and the Institute for Government, *Preparing for the Next Spending Review*, 2014, available at <http://www.instituteforgovernment.org.uk/publications/preparing-next-spending-review>.

³¹ As reported by, for example, *The Telegraph*, <http://www.telegraph.co.uk/news/nhs/11331265/David-Cameron-hints-Tories-prepared-to-give-NHS-8bn-boost.html>.

³² The pre-manifesto is available at http://www.libdems.org.uk/policy_paper_121. See also <http://www.theguardian.com/education/2015/jan/18/nick-clegg-protect-education-budget-end-illiteracy>.

³³ See <https://www.tes.co.uk/article.aspx?storycode=6454228> and <http://www.theguardian.com/politics/2014/dec/11/ed-balls-attacks-george-osborne-cuts-depression-era>.

Table 7.9. Real-terms changes to DEL under illustrative scenarios for each party

	Autumn Statement	Conservatives	Labour	Liberal Democrats
<i>2015–16 to 2019–20</i>				
Total DEL	–14.1%	–6.7%	–1.4%	–2.1%
Total less Dept Health and ODA:				
<i>If Dept Health gets real freeze</i>	–22.3%	–10.8%	–2.7%	–3.7%
<i>If Dept Health gets ‘£8bn’</i>	–23.8%	–12.4%	–4.3%	–5.3%
Total less Dept Health, ODA, schools: ^a				
<i>If schools not protected</i>	–22.3%	–10.8%	–2.7%	–3.7%
<i>If schools (resource) frozen</i>	–27.0%	–13.1%	–3.3%	–4.5%
<i>2010–11 to 2019–20</i>				
Total DEL	–22.2%	–15.5%	–10.8%	–11.3%
Total less Dept Health and ODA:				
<i>If Dept Health gets real freeze</i>	–35.4%	–25.9%	–19.2%	–20.0%
<i>If Dept Health gets ‘£8bn’</i>	–36.7%	–27.2%	–20.5%	–21.3%
Total less Dept Health, ODA, schools: ^a				
<i>If schools not protected</i>	–38.2%	–29.1%	–22.7%	–23.5%
<i>If schools (resource) frozen</i>	–42.0%	–31.0%	–23.1%	–24.1%

^a Assumes the Department of Health gets a real freeze from 2015–16 to 2019–20.

Note: The columns for each party are the most generous possible DEL settlement consistent with their proposed fiscal rules, given their stated intentions on net tax and benefit policies as of December 2014, and assuming that they stick to the Autumn Statement plans for capital spending.

Source: Authors’ calculations based on the parties’ announcements and the OBR’s 2014 Economic and Fiscal Outlook.

most generous possible DEL settlement consistent with each party’s proposed fiscal rules, given its stated intentions on net tax and benefit policies as of December 2014, and assuming that it sticks to the Autumn Statement plans for capital spending. For example, the Conservatives would only need to cut total DEL by 6.7%, and so protecting the NHS, ODA and non-investment spending on schools as over this parliament would require unprotected departmental spending to be cut by a further 13.1% (rather than the 27.0% under the Autumn Statement plans). Labour could afford this protection with only 3.3% cuts to other unprotected areas, while the Liberal Democrats would need cuts of 4.5%.

Alternatively, the next government could choose *not* to maintain the protections seen over this parliament. If the next government decided to cut schools spending at the same rate as unprotected areas, then this would imply larger cuts to other areas. For example, if the Conservatives were not to protect schools spending beyond 2015–16, then the implied cut to departmental spending on areas other than the Department of Health, official development assistance and schools (non-investment) could be 10.8% (rather than 13.1%).

How spending will be allocated between other departments is clearly not yet known and will depend to a large extent on the preferences of whoever forms the next government. However, in Table 7.10, we illustrate the real cut each department would face in its budget between 2015–16 and 2019–20 if the cuts between ‘unprotected’ departments were shared ‘equally’. By ‘equally’, we mean that all departments see the same percentage cut to their resource DEL as each other and the same percentage cut to their capital DEL as each other. Since the capital intensity of departments varies, the percentage cut to total

DEL will vary across departments. We also assume that the devolved administrations of Scotland, Wales and Northern Ireland receive budgets calculated on the basis of the spending settlements of other departments using the Barnett formula.

For example, in the first column, we take the 2014 Autumn Statement plans for DEL and assume that NHS spending will be frozen in real terms, ODA spending increased in line with national income and (non-investment) schools spending frozen in real terms. Sharing out the proportional cuts to resource DEL and capital DEL equally between other departments and the residual part of the education budget (and taking into account the Barnett consequential of those decisions) implies that departments such as the Home Office, Ministry of Justice and Business, Innovation and Skills would face budget cuts of 40% or more. The Department for Transport, which is relatively capital intensive, would only see its budget cut by less than 6%.

Table 7.10. Real-terms changes to departments' DEL, 2015–16 to 2019–20, under illustrative scenarios for each party

	Autumn Statement	Conservatives	Labour	Liberal Democrats
Total DEL	-14.1%	-6.7%	-1.4%	-2.1%
Resource DEL	-17.3%	-8.8%	-2.7%	-3.5%
Capital DEL	+7.3%	+7.3%	+7.3%	+7.3%
<i>Assumed 'protected':</i>				
ODA	+9.7%	+9.7%	+9.7%	+9.7%
Health	0.0%	+3.2%	+3.2%	+3.2%
Education	-	-	-	0.0%
<i>Assumed not 'protected':</i>				
Education	-9.0%	-17.6%	-6.7%	-
Defence	-36.2%	-13.8%	-4.6%	-10.2%
Home Office	-46.3%	-18.7%	-7.4%	-14.6%
Ministry of Justice	-45.3%	-18.3%	-7.2%	-14.1%
Business, Innovation and Skills	-40.1%	-15.7%	-5.7%	-11.9%
Transport	-5.7%	+1.1%	+4.1%	+3.2%
Devolved administrations	-9.0%	-5.8%	-2.2%	-1.7%
All other departments	-34.8%	-13.1%	-4.2%	-9.5%
<i>Memo: What is 'protection'?</i>	ODA: increase with GDP Dept of Health: real freeze Education: schools (resource) real freeze	ODA: increase with GDP Dept of Health: 0.8% a year real increase Education: none	ODA: increase with GDP Dept of Health: 0.8% a year real increase Education: none	ODA: increase with GDP Dept of Health: 0.8% a year real increase Education: real freeze

Note: For 'protected' departments, we assume that both their capital and resource budgets are increased at the same rate. For 'unprotected' departments, we assume that their resource budgets are cut by the same percentage as each other and that their capital budgets are cut by the same percentage as each other, with the exception of the devolved administrations, where we calculate their budgets using the Barnett formula and the settlement for other departments. Total DEL cuts for each party are from Table 7.7, and we assume that no party deviates from the 2014 Autumn Statement plans for total capital spending. 2015–16 departmental budgets are consistent with Figure 7.3.

Source: Authors' calculations based on parties' policy announcements and the OBR's 2014 Economic and Fiscal Outlook.

These cuts across departments would differ under the alternative parties' proposals because their fiscal rules and stated intentions on net tax and benefit policies could imply quite different levels of resource and/or capital DEL over this period, and they have pledged to protect different areas of spending. In the final three columns of Table 7.10, we illustrate the possible implications of different levels of resource DEL spending and different areas of protection, but we maintain the assumption that all parties stick to the 2014 Autumn Statement capital spending plans. For all parties, we assume that they increase official development assistance spending in line with national income and increase real NHS spending by £8 billion by 2020–21 (in 2020–21 prices). We assume that the Liberal Democrats protect the total education budget, while we assume no protection to any part of the education budget for the Conservative and Labour parties.

The differences between the cuts implied by the scenarios highlight the uncertainty that departments now face regarding their budgets beyond 2015–16. The Department for Education, for example, could face no overall cut (as pledged by the Liberal Democrats). Or, under the assumptions outlined in the 'Conservatives' column, its budget could be cut by 17.6%. Even departments for which there is not the same explicit difference between the parties over their protection face considerable uncertainty.

The figures in Table 7.10 all assume that the cuts to resource DEL and the cuts to capital DEL are spread evenly between unprotected areas. Obviously, if this were not the case, then the cuts across departments could look very different. And, of course, if any of the parties wanted any room for manoeuvre against their fiscal rules, then this would imply larger cuts to overall departmental spending than the figures set out for them in this section (closer to the figures described for the Autumn Statement 2014 plans).

7.4 Conclusion

The coalition government's fiscal consolidation package has entailed large cuts to public spending, and particularly large cuts to spending on public services – the latter cuts are planned to contribute around 60% of the government's total fiscal consolidation package. Between 2010–11 and 2015–16, the government plans to have cut spending by Whitehall departments on administration and the delivery of public services by 9.5%. Since some areas of spending have escaped real-terms cuts – specifically, spending on health and official development assistance and non-investment spending on schools – the cuts to some areas have been much greater than this. The average cut to departmental spending excluding the aforementioned protected areas will reach 20.6% by 2015–16.

Further cuts to departmental spending of 14.1% were implied by the 2014 Autumn Statement between 2015–16 and 2019–20. This would take the total real-terms cut to departmental spending since 2010–11 to 22.2%. If the protection afforded to health, official development assistance and non-investment spending on schools were continued through to 2019–20, then, under the Autumn Statement plans for total departmental spending, other 'unprotected' areas of spending would need to be cut by 27.0% after 2015–16. This would take the total cut since 2010–11 to 42.0%.

Even figures of this magnitude disguise some additional pressures on spending that departments face. The UK population is growing – expected to be by around 0.7% per year between 2015–16 and 2019–20 – which would imply the cuts to departmental spending *per head* are even greater than those described above. The implications of this

for the NHS are discussed in Chapter 8. There are also some government policies that increase the cost to departments from 2016–17 onwards – for example, the ending of contracting out into defined benefit pension schemes, which will increase employer National Insurance contributions in the public sector by £3.3 billion per year (around 1% of total departmental spending in 2016–17).³⁴ These additional commitments will exacerbate the squeeze on departments’ budgets.

However, it will be up to the next government to implement further cuts to departmental spending cuts after 2015–16, and all three main UK political parties have announced fiscal rules that would in principle allow them to increase spending relative to the plans set out in the 2014 Autumn Statement. The parties’ proposed fiscal rules and their policy announcements up to December 2014 suggest that the Conservatives could reduce the cut to departmental spending over this period to 6.7%, the Liberal Democrats to 2.1% and Labour to 1.4% – if they chose to increase borrowing to the full extent allowed by their rules and implemented their stated policy intentions as of December 2014.

Departments will have their budgets set for 2016–17, and potentially later years, in a spending review in 2015. We suggest that this sets firm budgets for departments for two years and indicative budgets for the remainder of the parliament, and that whoever forms the next government commits to holding a mini spending review no later than Autumn 2017 to firm up those indicative plans. So far, there seems to be consensus between the three main UK parties that official development assistance will continue to be protected going forwards and that NHS spending will be increased in real terms. However, all other departments face considerable uncertainty over how their budgets might evolve between 2015–16 and 2019–20. What seems certain is that some will face large cuts – on top of those already delivered – regardless of the outcome of the general election.

³⁴ Table 2.1 of HM Treasury, *Budget 2013*, 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221885/budget2013_compl_ete.pdf.