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Tax revenues and spending on social security benefits and public services since the crisis

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Executive summary

In the aftermath of the global financial crisis and associated recession, government borrowing soared to more than 10% of national income. Borrowing has since been reduced through a combination of net tax rises, cuts to the generosity of the working-age social security system and cuts to public service spending. In this briefing note, we provide an overview of what has happened to each of these areas since the crisis, highlighting where (and when) the spending cuts have fallen, and consider the long-term outlook for the make-up of public expenditure.

Key findings

- **The recovery in GDP per person since the financial crisis has been extraordinarily weak.** Indeed, the UK has experienced its slowest-ever post-recession recovery. Official forecasts suggest that GDP per person in 2023 will be 24% lower than it would have been had it grown by 2.3% per year since 2008 (its long-run trend rate).

- **Both tax rises and (to a greater extent) spending cuts have contributed to a reduction in government borrowing.** Government borrowing in 2018–19 fell to 1.9% of national income, below its pre-crisis level. Current receipts exceeded current spending (i.e. non-investment spending) for the first time since 2001–02.

- **Tax revenues are at their highest sustained level as a share of national income since the early 1950s.** This has been driven in large part by a significant package of discretionary policy measures. Substantial tax cuts have been offset by an even more substantial package of tax rises.

- **Departmental spending is now on an upwards trajectory but austerity has not been 'undone'.** Total day-to-day spending on public services is still set to be 3% lower in real terms in 2020–21 than it was in 2010–11 (9% lower in per-person terms). Outside of the Departmental of Health and Social Care, spending is set to be 16% below 2010–11 levels (21% in per-person terms).

- **Discretionary government policy measures taken since 2010 mean that social security spending in 2019–20 is around £39 billion lower than it would otherwise have been.** Despite these substantial cuts to the generosity of the system, spending on working-age social security as a share of national income is at around pre-crisis levels. Spending on pensioner social security is above pre-crisis levels as a share of national income and is forecast to rise from 2020–21.

- **Public spending continues to be increasingly allocated to providing healthcare and pensions.** The decision to prioritise and increase spending on some areas while cutting others has altered the make-up of public spending. Rising spending on health, pensions and overseas aid has been offset by falling spending on defence, education and public order and safety. Demographic and other cost pressures mean that this trend is likely to continue in the years to come.

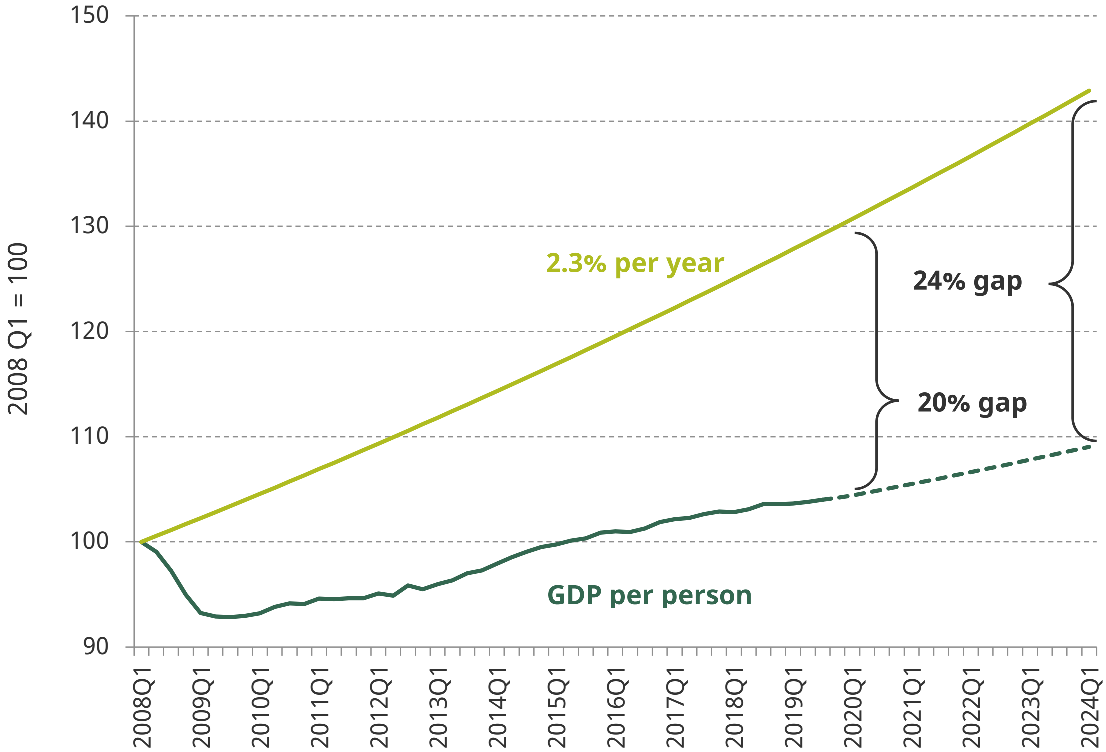
The recovery in GDP per person since the financial crisis has been weak

The global financial crisis and associated recession led to a sharp downturn in national income, with GDP per person falling by more than 7% between the first quarter of 2008 and final quarter of 2009. More striking – and more important for subsequent living standards – is the weakness of the subsequent economic recovery. Growth since the global financial crisis has been sluggish at best, with the UK economy experiencing its slowest-ever post-recession recovery.[i] Consequently, GDP per person did not return to its pre-crisis level until the middle of 2015, and remains far below where we might have expected prior to the crisis. This is shown in Figure 1: national income per person is currently around 20% lower than the level it would have been had output per person instead grown by 2.3% per year (the long-run trend rate) in real terms since 2008.

The outlook for the UK economy remains weak. A global economic slowdown and ongoing uncertainty surrounding the nature of the UK's forthcoming departure from the European Union are contributing factors to modest growth forecasts for the years ahead.[ii] On the basis of OBR March 2019 forecasts, by the end of 2023 the gap between actual GDP per person, and where it would have been had it grown by 2.3% per year since 2008, will have increased to 24%.

This substantial reduction in the size of the economy, relative to what we would have reasonably expected prior to the financial crisis, has adversely affected the incomes, finances and living standards of millions of households. It has also had a profound effect on the public finances.

Figure 1. GDP per person since 2008Q1



Note and source: See end section.

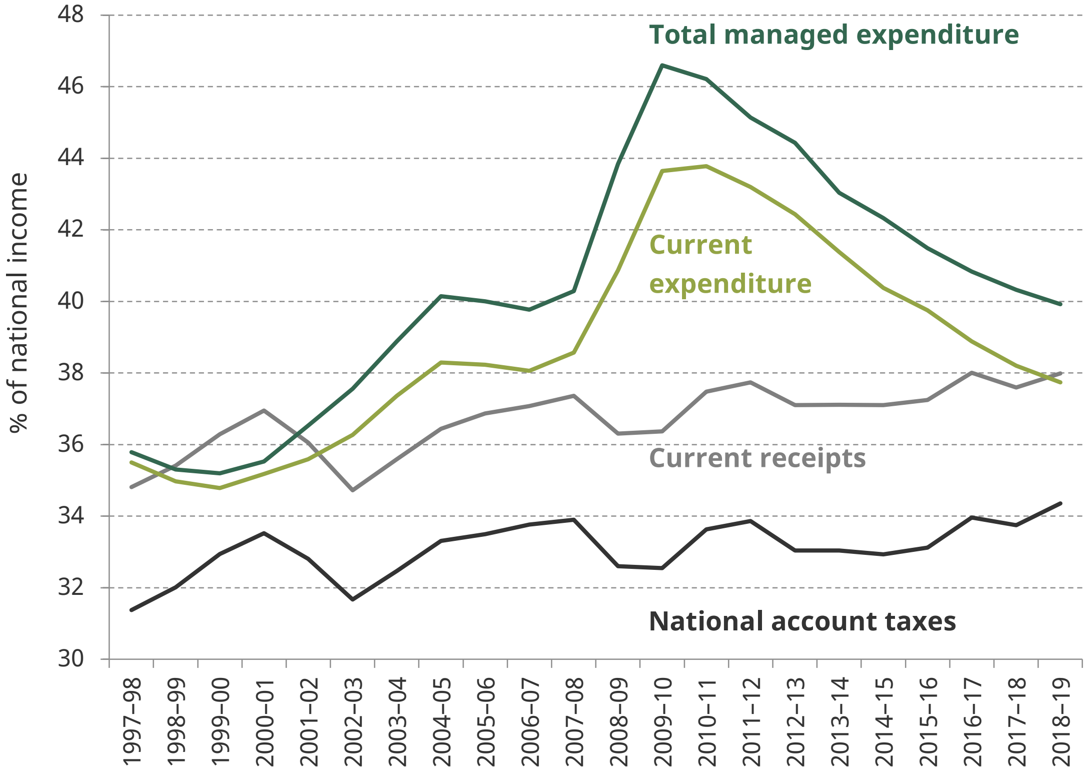
Both tax rises and (to a greater extent) spending cuts have contributed to a reduction in government borrowing

In the aftermath of the financial crisis, government spending sharply increased as a share of national income – in part because of the contraction in the size of the economy, and in part because of an increase in cyclical social security expenditure and the Labour government's fiscal stimulus package. At the same time, tax receipts fell. This led to an enormous increase in the government's budget deficit to more than 10% of national income – as can be seen in Figure 2 as the gap between the grey and dark green lines.

The reduction in the deficit over the past decade has been driven in large part by a reduction in spending from 46.6% of national income in 2009–10 to less than 40% in 2018–19. Government receipts (shown by the grey line) have edged up from 36.4% of national income in 2009–10 to 38.0% in 2018–19. If we look just at *tax receipts* (ignoring non-tax receipts; shown by the black line), revenues increased from 32.5% to 34.4% of national income over that period, and are now at their highest sustained level as a fraction of national income since the early 1950s.

As a result of spending cuts and tax increases, the budget deficit (as measured by public sector net borrowing) fell to 1.9% of national income in 2018–19, its lowest level since 2001–02, and below its pre-crisis level. If we instead look at the *current* budget balance (the gap between day-to-day spending and current receipts, i.e. excluding spending on investment), the government ran a small surplus in 2018–19 for the first time since 2001–02.

Figure 2. Public sector receipts and spending since 1997–98



Note and source: See end section.

Increase in tax burden since 2009 driven by the net effect of a significant package of discretionary policy measures

The previous section showed that tax revenues as a share of national income have increased over the past decade (the black line in Figure 2). In principle, this can arise because of growth in the economy, and therefore underlying tax bases, pushing up revenues or because of discretionary changes to the tax system that boost revenues. Table 1 decomposes the change in tax revenues as a share of national income since 2009–10 into that which is estimated to arise from budget announcements made since May 2010 and the remainder.

Table 1. Change in tax revenues since 2009–10

	2019–20	2023–24
% of GDP		
Increase in tax revenues	+1.9	+2.1
Of which:		
Underlying increase in revenues	+0.9	+1.1
Discretionary measures announced since May 2010	+0.9	+1.0
£ billion (2019–20 terms)		
Increase in tax revenues	+40.8	+46.2
Of which:		
Underlying increase in revenues	+20.4	+23.7
Discretionary measures announced since May 2010	+20.4	+22.5
Of which:		
Tax rises from 2010–15 parliament	+64.1	+63.3
Tax cuts from 2010–15 parliament	−54.6	−53.5
Total net tax rise from 2010–15 parliament	+9.5	+9.8
Tax rises from 2015–17 parliament	+34.9	+34.3
Tax cuts from 2015–17 parliament	−18.8	−21.5
Total net tax rise from 2015–17 parliament	+16.1	+12.8
Tax rises from 2017–19 parliament	+6.2	+10.9
Tax cuts from 2017–19 parliament	−11.3	−11.0
Total net tax rise from 2017–19 parliament	−5.2	−0.1

Note and source: See end section.

In the current financial year (2019–20), tax revenues are 1.9% of national income higher than they were in 2009–10, equivalent to £40.8 billion in today's terms. Of this, £20.4 billion (around half) is the estimated net impact of policy measures announced since the May 2010 general election, implying that, absent these changes, revenues would have increased as a share of national income by the equivalent of £20.4 billion in today's terms.

We can then decompose the net increase in tax from discretionary measures into those announced in the 2010–15 parliament under the coalition government, those announced by the Conservative government between 2015 and 2017, and those announced since May 2017. The estimated impact of measures during the 2010–15 parliament was to boost revenues in 2019–20 by £9.5 billion. But within that *net* effect, there are large tax cuts (totalling £54.6 billion) and even bigger tax rises (totalling £64.1 billion). The most significant tax cuts during that parliament were increases in the income tax personal allowance, cuts to the rates of fuel duties, and cuts to the main rate of corporation tax. The largest tax rises announced were the introduction of the bank levy, the increase in the main rate of VAT, and the abolition of contracting out into defined benefit pension arrangements.

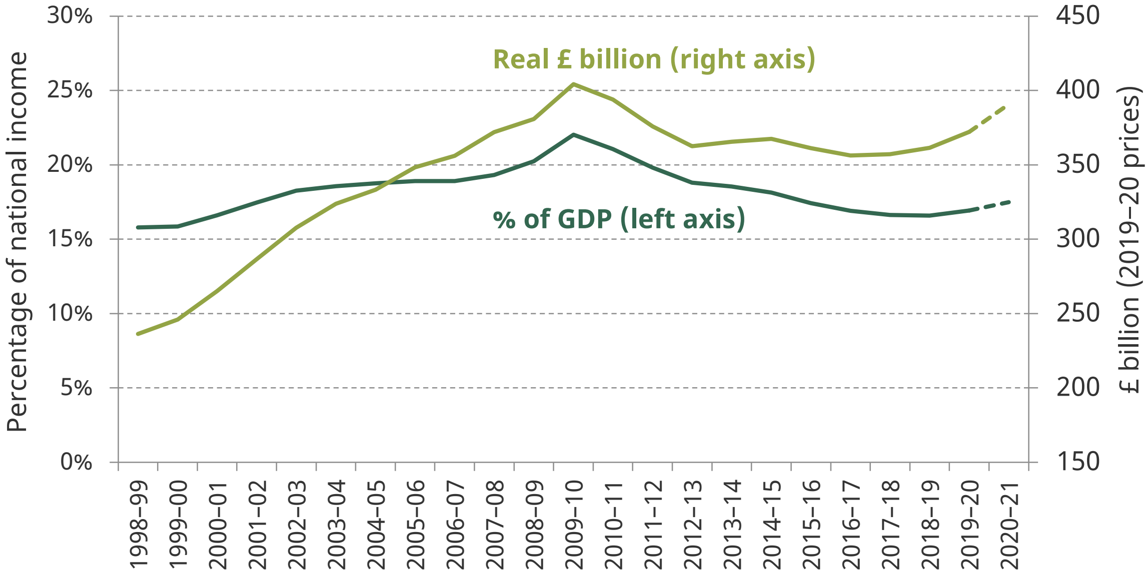
Measures announced between May 2015 and May 2017 are estimated to have had the net effect of boosting tax revenues in 2019–20 by £16.1 billion (£34.9 billion of tax rises, less £18.8 billion of tax cuts). The biggest tax rises announced between 2015 and 2017 were the apprenticeship levy, increases in council tax, and reforms to the taxation of dividends. These were all announced by George Osborne at the Summer Budget and Autumn Statement of 2015, following the 2015 general election. The most significant tax cuts were further increases in the income tax personal allowance and further reductions in the main corporation tax rate.

The discretionary tax measures made since the May 2017 general election are smaller in scale. The estimated net effect in 2019–20 has been to reduce tax revenues by £5.2 billion in 2019–20 (with tax rises of £6.2 billion offset by tax cuts of £11.3 billion). By far the biggest tax cut announced since 2017 has been increases in the personal tax allowance and higher-rate threshold for income tax, offset in part by further increases in council tax.

Departmental spending has faced substantial cuts since 2010, but is now on an upwards trajectory

We now focus on spending by central government departments on the delivery and administration of public services, which accounted for 42.5% of total government spending in 2018–19. Over the course of the late 1990s and 2000s, total departmental expenditure increased steadily both in real terms and as a share of national income, reaching £404 billion (in today's prices) and 22.0% of national income in 2009–10. Since then, this component of spending has been subject to sizeable cuts. Between 2009–10 and 2016–17, total departmental budgets were cut by around 12%, or £48 billion in today's prices, with the bulk of these cuts being made between 2009–10 and 2012–13. Since 2016–17, departmental spending has been increasing in real terms and by next year (2020–21) is set to be around £14 billion (3.4%) below its 2009–10 peak. That is, after a decade of near-uninterrupted economic growth, departmental spending on public services is still set to be lower in real terms than where it started.

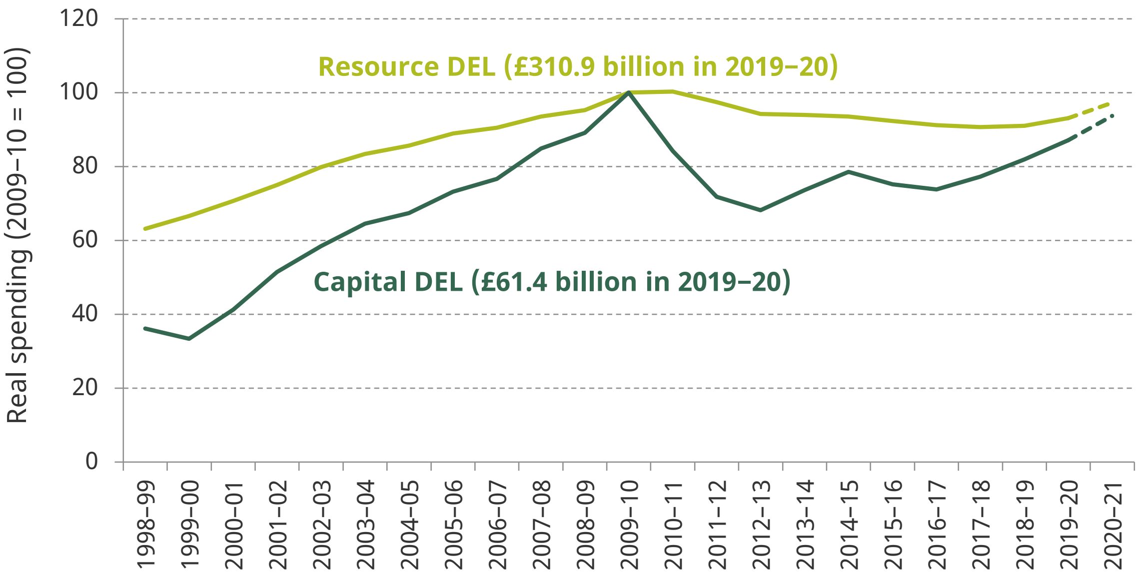
Figure 3. Total departmental expenditure



Note and source: See end section.

Of the £372.3 billion of departmental spending planned for the 2019–20 financial year, 83.5% of the total (£310.9 billion) represents day-to-day (resource) spending, with the remaining 16.5% (£61.4 billion) being departments' capital (investment) budgets. These two areas have fared very differently over the past 20 years. Figure 4 shows that in the run-up to 2009–10, capital spending increased more rapidly than did resource spending (an average annual real growth rate of 9.7% for CDEL between 1998–99 and 2009–10, versus 4.3% for RDEL). After 2010, while the majority of the cuts in cash terms fell on the resource budget (owing to its greater size), the relative cuts to the capital budget were considerably deeper. Both are now increasing: between this year and next, day-to-day (resource) departmental budgets are set to grow by 4.4% in real terms and capital budgets by 7.5%.

Figure 4. Resource and capital departmental expenditure limits



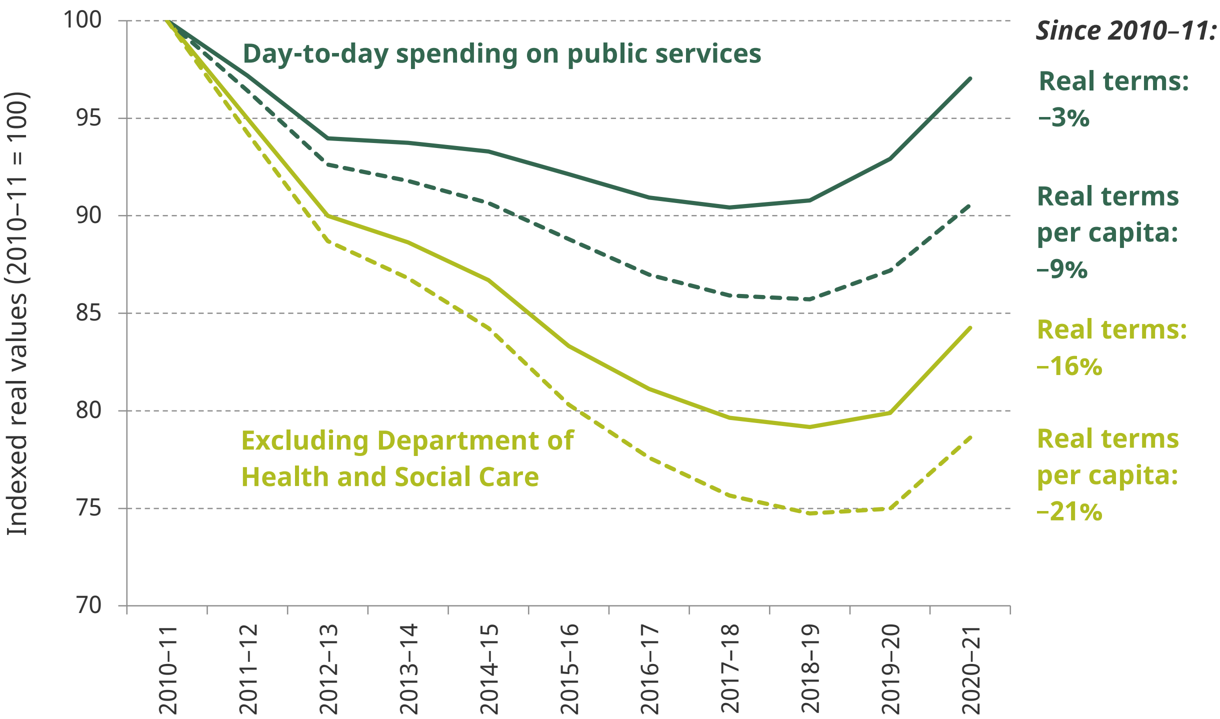
Note and source: See end section.

Cuts since 2010 have not been shared equally: day-to-day spending outside of health has been cut by 16% over the decade to 2020–21

The dark green line in Figure 5 shows the path for day-to-day spending on public services since 2010–11. Announcements in the 2019 Spending Round mean that by 2020–21, overall day-to-day spending is set to return to around the real-terms level it was in 2011–12, and just 3% below the level it was in 2010–11. If we also take account of population growth over that decade, day-to-day spending per person will still be 9% lower next year than it was in 2010–11. Around two-thirds of the cuts to day-to-day spending will have been reversed by 2020–21, and around one-third of the cuts in per-person terms.

Looking at the aggregate level of departmental spending masks substantial differences across departments, however. The cuts since 2010 have fallen far from equally. Some budgets – most notably the NHS – have had repeated protection from cuts.[iii] Stripping out the Department of Health and Social Care therefore makes a big difference to the overall picture. The settlements in Spending Round 2019 are sufficient to reverse around a quarter of the cuts to other day-to-day public service spending seen since 2010–11. In 2020–21, spending is planned to be 16% below the 2010–11 level in real terms and 21% below in real per-person terms (also shown in Figure 5).

Figure 5. Day-to-day spending on public services over the past decade

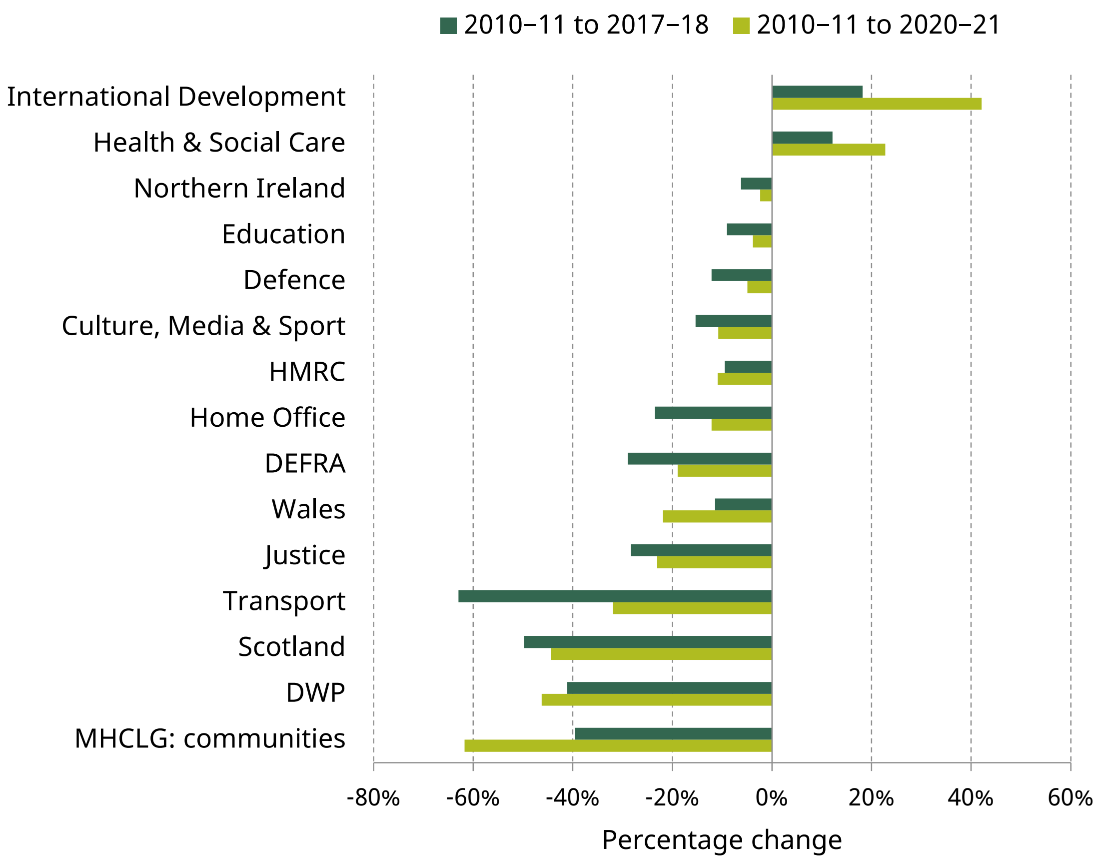


Note and source: See end section.

We can also examine in more detail how specific departmental budgets have changed. Figure 6 shows how day-to-day budgets changed by department between 2010–11 and 2017–18, and how they are set to change between 2010–11 and 2020–21 on the basis of existing spending plans. Clearly, there are some relative winners and losers. The Department for International Development day-to-day budget is set to be 42% higher in real terms in 2020–21 than in 2010–11, while the Department of Health and Social Care day-to-day budget will have increased by almost a quarter in that time. Other areas have been less fortunate. The Home Office and the Department for Environment, Food and Rural Affairs (DEFRA) each saw real-terms cuts of around a quarter up to 2017–18. Both have seen budget increases since then (hence the difference between the dark and lighter green bars in Figure 6) but are still set to have a lower day-to-day budget next year than a decade previously (12% and 19% lower, respectively). And despite increases in day-to-day funding for the Department for Education and the Ministry of Justice next year, budgets in those departments will be 4% and 23% lower, respectively, than in 2010–11.

Similarly, the cuts to capital budgets did not fall equally across departments. As ever, the Department of Health and Social Care was relatively (though by no means entirely) protected from cuts, and its capital budget has been steadily increased in recent years. As a result, the DHSC capital budget in 2020–21 is set to be 16% higher in real terms than in 2010–11. In sharp contrast, capital budgets for the Home Office and the Department for Education will have been halved in real terms over the decade.[iv]

Figure 6. Changes in day-to-day budgets by department since 2010–11

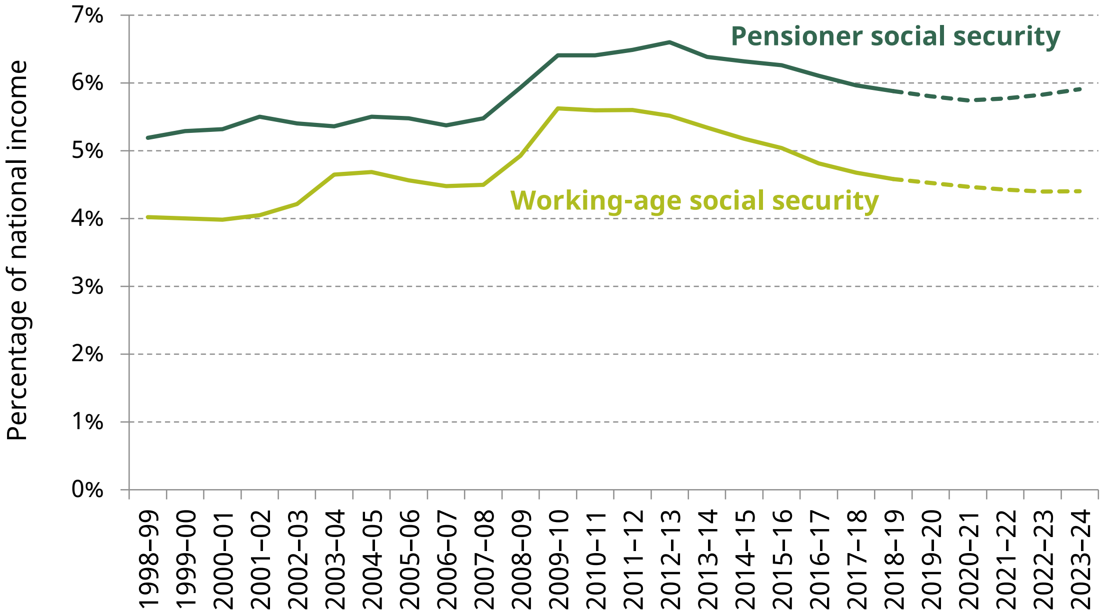


Note and source: See end section.

Working-age social security spending now at pre-crisis levels and forecast to continue falling

Cuts to working-age social security have also contributed to the reduction in public spending as a share of national income since 2009–10. Figure 7 shows how after a sharp increase during the financial crisis and associated recession, spending on working-age benefits has fallen steadily as a share of national income. It is currently at its pre-crisis (2007–08) level as a fraction of GDP – and hence £12.7 billion higher in real terms – and is projected to continue falling to 4.4% of national income by 2023–24, below its pre-crisis level and the lowest level since 2002–03.

Figure 7. The outlook for spending on benefits and tax credits



Note and source: See end section.

One important reason for this has been discretionary policy measures designed to reduce the generosity of the social security system. Savings from cuts to the generosity of the social security system since June 2010 amount to approximately £39 billion this year. That is, discretionary government policy measures taken since 2010 mean that social security spending in 2019–20 is around £39 billion lower than it would otherwise have been in the absence of those measures. The biggest driver of this has been changes to make the indexation of working-age benefits considerably less generous. Most cuts are now fully in place; the main change still working its way through the system is the 'two-child limit' in tax credits and universal credit. Despite these substantial cuts to the generosity of the system, spending on working-age social security as a share of national income is at around pre-crisis levels. That is a result of a combination of higher housing costs pushing up housing benefit spending, more claimants of disability and incapacity benefits, and weak earnings growth feeding through to higher expenditure on in-work support.

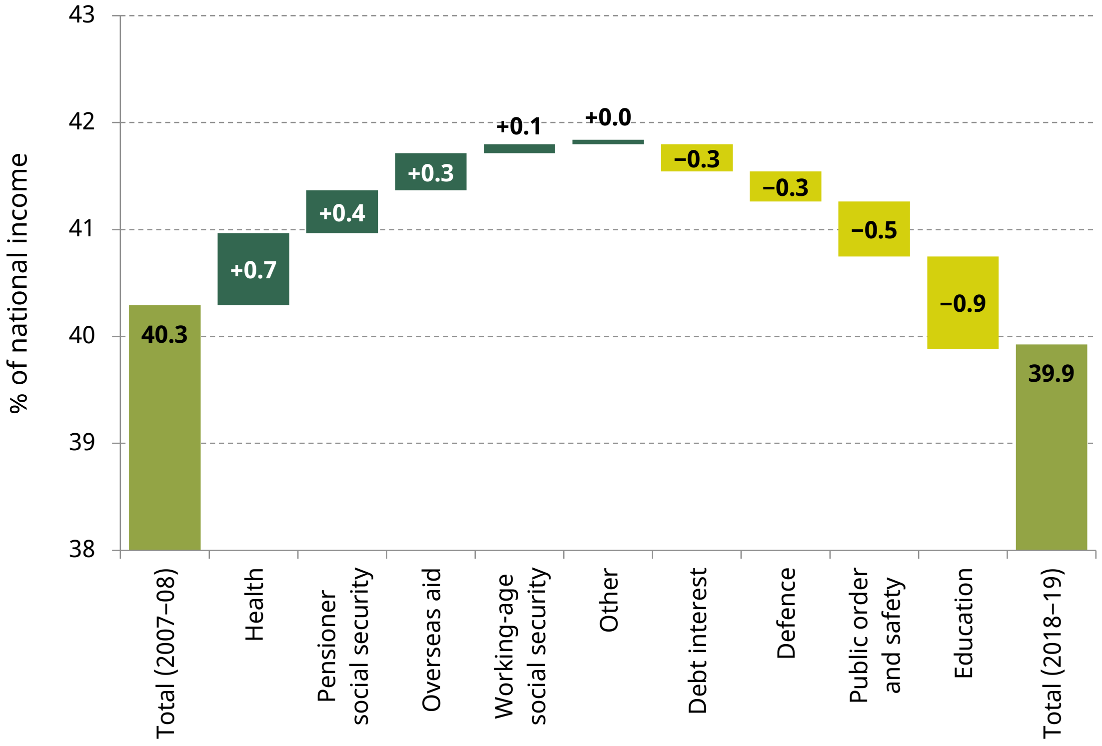
Spending on pensioner social security has also fallen as a share of national income since 2012–13 (though remains slightly above its pre-crisis level). This has to a large extent been driven by increases in the state pension age, and in particular the female state pension age, since 2010. Existing pensioners have benefited from the 'triple lock' on the state pension and have for the most part been protected from wider benefit cuts. After the state pension age reaches 66 in October 2020, the proportion of the population aged above the state pension age will start to rise again (until 2026, when the state pension age will start to rise towards 67); pensioner social security is therefore projected to start increasing again from 2020–21.

Public spending continues to be increasingly allocated to providing healthcare and pensions

By 2018–19, government spending as a share of national income – one measure of the size of the state – had returned to broadly the level it was back in 2007–08. But one consequence of the decision over the last decade to prioritise and increase spending on some areas, while cutting others, has been to alter the make-up of public spending. A decomposition of the change in spending as a share of national income between 2007–08 and 2018–19 is provided in Figure 8. This shows that while spending has risen as a share of national income in some areas, such as health, pensioner social security and overseas aid, it has fallen in others, such as defence, public order and safety, and education. The overall reduction in public spending between 2007–08 and 2018–19 of 0.4% of national income (equivalent to around £8 billion in today's terms) has therefore not been split evenly.

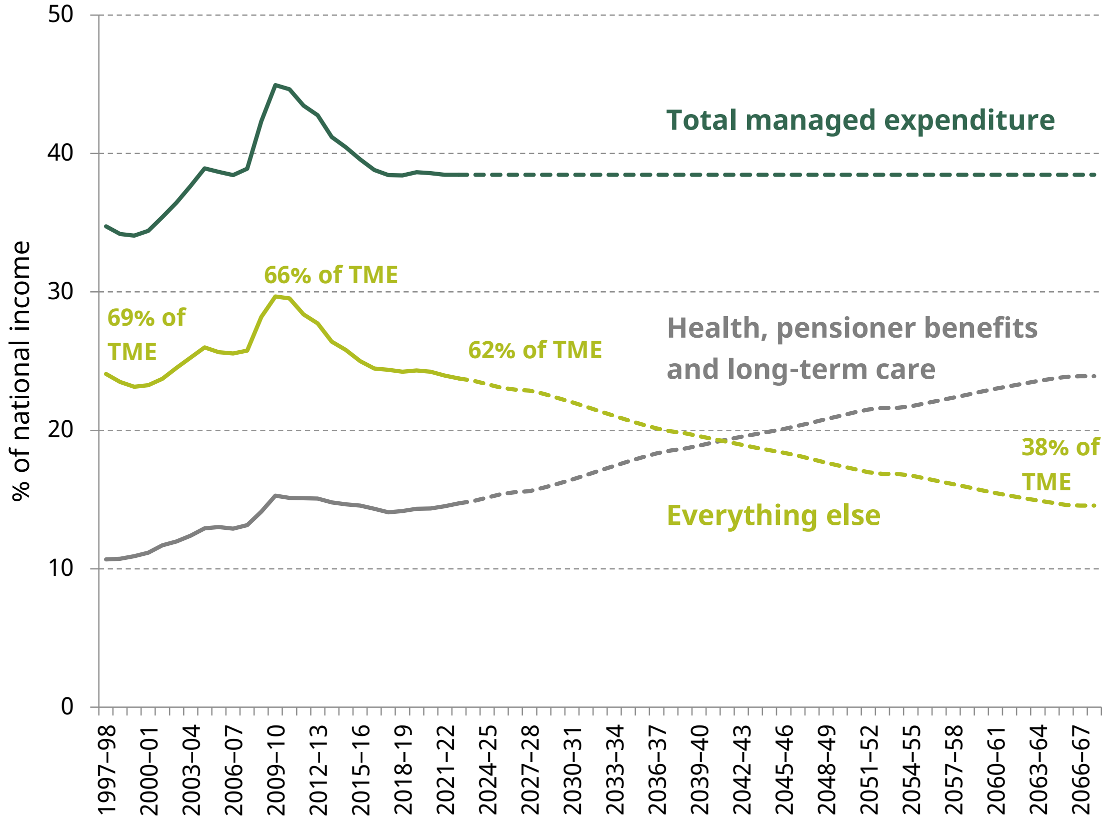
The proportion of public spending accounted for by health and pensioner benefits has increased markedly: from 29.7% in 2007–08 to 32.7% in 2018–19. This is not a phenomenon unique to austerity, but is the continuation of a long-run trend: 30 years ago these items accounted for just 24.5% of total public spending, and 40 years ago just 21.0%.

Figure 8. Public spending as a share of national income, 2007–08 and 2018–19 compared



Note and source: See end section.

Figure 9. OBR long-term projections of public spending



Note and source: See end section.

In the years and decades ahead, demographic pressures from an ageing population and other cost pressures on the health service are set to push spending on health, long-term care and pensioner benefits ever higher. In its July 2018 Fiscal Sustainability Report, the Office for Budget Responsibility (OBR) projected that, on current policy, spending on these three areas would increase from around 14.3% of national income today to 15.1% in 5 years' time (equivalent to around £18 billion extra in today's terms) and to 18.9% in 20 years' time (an extra £100 billion in today's terms). Figure 9 shows the implication of the OBR's projected increase in age-related spending (health, pensioner benefits and long-term care) on other components of public expenditure, assuming no increase in the overall size of the state. That is, it illustrates by how much other areas of spending would have to be squeezed if the government met the pressures on health, pensions and care but without increasing the overall level of spending (and taxes). Spending on everything else – which includes spending on schools, the police and defence – would need to be dramatically cut back to pay for the costs of an ageing population: it would fall from around 24% of national income (62% of total spending) in 2022–23 to less than 15% of national income (38% of total spending) by 2067–68. The current range and quality of public services could not be maintained in that scenario.

Voltaire once quipped that while some states have an army, the Prussian army had a state. On current trends, we are heading for a National Health Service with a state attached. We will need to grapple with this fiscal reality eventually. Any major spending commitments made during the election campaign should be assessed with this in mind.

Notes and sources

Figure 1

Note: 2.3% is the trend rate of growth in real GDP per person between 1970–71 and 2007–08.

Source: Office for Budget Responsibility, Economic and Fiscal Outlook March 2019, supplementary economy table 1.5, https://obr.uk/efo/economic-fiscal-outlook-march-2019/.

Figure 2

Note: Current expenditure includes depreciation. Figures are accurate as of the 24 September 2019 public finances data release.

Source: Office for Budget Responsibility, Public Finances Databank, 30 September 2019, https://obr.uk/data/.

Table 1

Note: Figures may not sum due to rounding.

Source: Authors' calculations using OBR Public Finances Databank (accessed November 2019) and OBR Policy Measures Database (accessed November 2019), https://obr.uk/data/.

Figure 3

Note: DEL figures for 2019–20 onwards have been adjusted to remove the impact of the change in employer contribution rates to public service pension schemes, and for announcements in Spending Round 2019.

Source: Authors' calculations based on supplementary expenditure table 4.3 of the OBR's March 2019 Economic and Fiscal Outlook, table A.1 of the OBR's October 2018 Economic and Fiscal Outlook, and HM Treasury's Public Expenditure Statistical Analyses (various), Spending Round 2019 and September 2019 GDP deflators.

Figure 4

Note: 'Resource DEL' and 'Capital DEL' refer to the OBR definitions of public sector current expenditure in resource DEL (PSCE in RDEL) and public sector gross investment in capital DEL (PSGI in CDEL), respectively. Figures for 2019–20 onwards have been adjusted to remove the impact of the change in employer contribution rates to public service pension schemes, and for announcements in Spending Round 2019.

Source: Authors' calculations using OBR Economic and Fiscal Outlook March 2019, various HM Treasury Public Expenditure Statistical Analyses and HM Treasury Spending Round 2019.

Figure 5

Note: 'Day-to-day spending' refers to the OBR definition of public sector current expenditure in resource DEL, which differs from the Treasury definition of resource DEL excluding depreciation. Spending Round 2019 figures have been adjusted so as to be on a consistent basis with the OBR's historically consistent series for PSCE in RDEL and to strip out the effect of changes to public service pension contributions.

Source: Authors' calculations using OBR Economic and Fiscal Outlook March 2019, various HM Treasury Public Expenditure Statistical Analyses, HM Treasury Spending Round 2019 and ONS population figures.

Figure 6

Note: Resource budgets shown here exclude depreciation.

Source: Authors' calculations using HM Treasury Public Expenditure Statistical Analyses (various), Spending Round 2019 and September 2019 GDP deflators.

Figure 7

Note: Figures are for the UK, but assume that the split between working-age and pensioner social security is the same for the UK as for GB.

Source: Authors' calculations using 'GB welfare', 'UK welfare' and 'Table 2a' in DWP Benefit Expenditure and Caseload Tables 2019, https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2019.

Figure 8

Source: Total managed expenditure from OBR Public Finances Databank (accessed November 2019). Working-age and pensioner social security data are as for Figure 7. Spending data for health, defence, education, and public order and safety are from HM Treasury Public Expenditure Statistical Analyses, spending by function tables. 'Debt interest' refers to gross debt interest, taken from ONS series JW2P. 'Overseas aid' refers to official development assistance, from Department for International Development statistics.

Figure 9

Note: Dashed lines represent projections beyond the forecast period. Total managed expenditure is assumed to stay constant as a percentage of national income from 2022–23 onwards.

Source: Authors' calculations using data from supplementary table 1.1 of OBR's July 2018 Fiscal Sustainability Report (https://obr.uk/fsr/fiscal-sustainability-report-july-2018/), various HM Treasury Public Expenditure Statistical Analyses, DWP Benefit Expenditure Caseload Tables 2019 (https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2019) and OBR Public Finances Databank (accessed November 2019).

Endnotes

[i] J. Smith, J. Leslie, C. Pacitti and F. Rahman, *Recession Ready? Assessing the UK's Macroeconomic Framework*, Resolution Foundation Macroeconomic Policy Unit, September 2019, https://www.resolutionfoundation.org/publications/recession-ready/.

[ii] B. Nabarro and C. Schulz, 'Global outlook: sea change' and B. Nabarro and C. Schulz, 'Recent trends to the UK economy', in C. Emmerson, C. Farquharson and P. Johnson (eds), *The IFS Green Budget: October 2019*, https://www.ifs.org.uk/publications/14426.

[iii] G. Stoye and B. Zaranko, 'UK health spending', IFS Election Briefing Note, November 2019, https://www.ifs.org.uk/election/2019/article/uk-health-spending.

[iv] For further detail, see R. Crawford and B. Zaranko, 'Spending Round 2019: keeping perspective', in C. Emmerson, C. Farquharson and P. Johnson (eds), *The IFS Green Budget: October 2019*, https://www.ifs.org.uk/publications/14424.