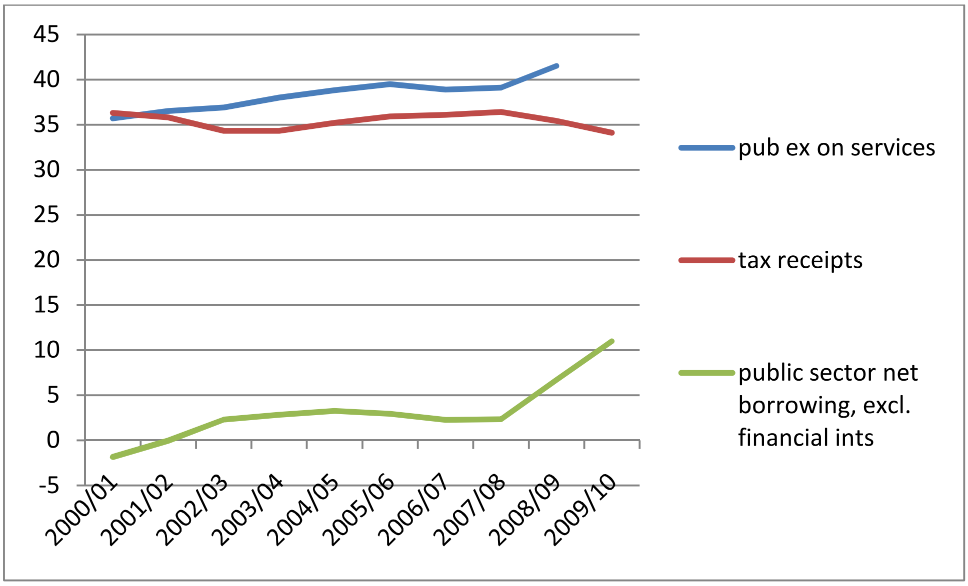
The Government's Spending Cuts

Since the General Election in May 2010 produced a change of government in the UK, public expenditure policy has changed. While the outgoing Labour administration had a plan to reduce the deficit and the volume of debt, the new coalition government plans to reduce them faster. This note asks the questions: how did the deficit arise? What are the plans to reduce it, and what are the implications for public sector jobs?

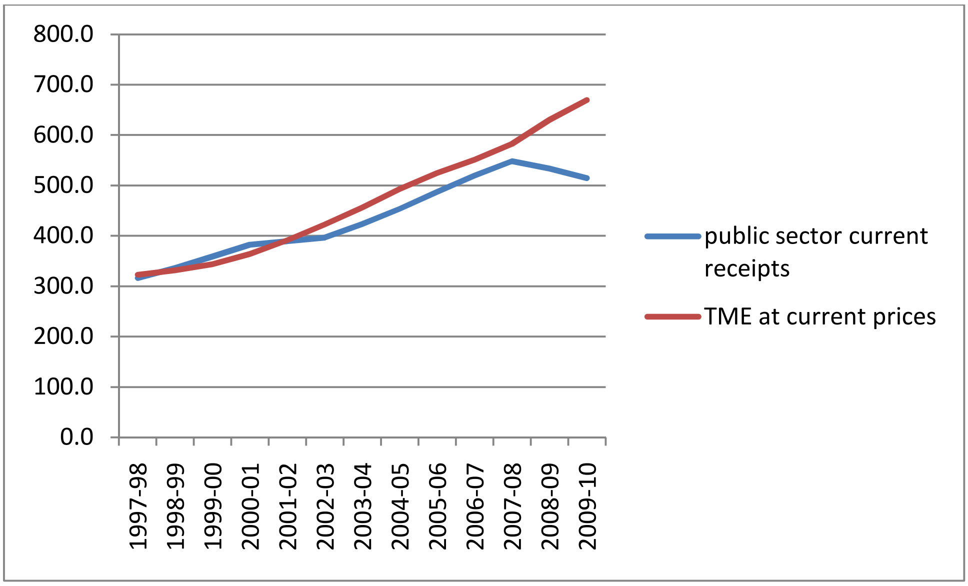
The deficit that the new government inherited had been growing since 2001 at least, but it accelerated after 2007 as the tax revenues sharply fell with the recession. Taking away the impact of the rescue of the financial sector, spending on services grew from 35.7% of GDP in 2000-2001 to 41.5% of GDP in 2008-2009. Meanwhile tax revenues as a % of GDP fell over the period from 36.3 to 35.4, with a 1 percentage point dip in 2008-2009. These figures are graphed, along with the net borrowing (less intervention spending) in Fig. 1

Fig 1 Spending on services, tax receipts and net borrowing as a % of GDP 2000-2001 to 2009-2010



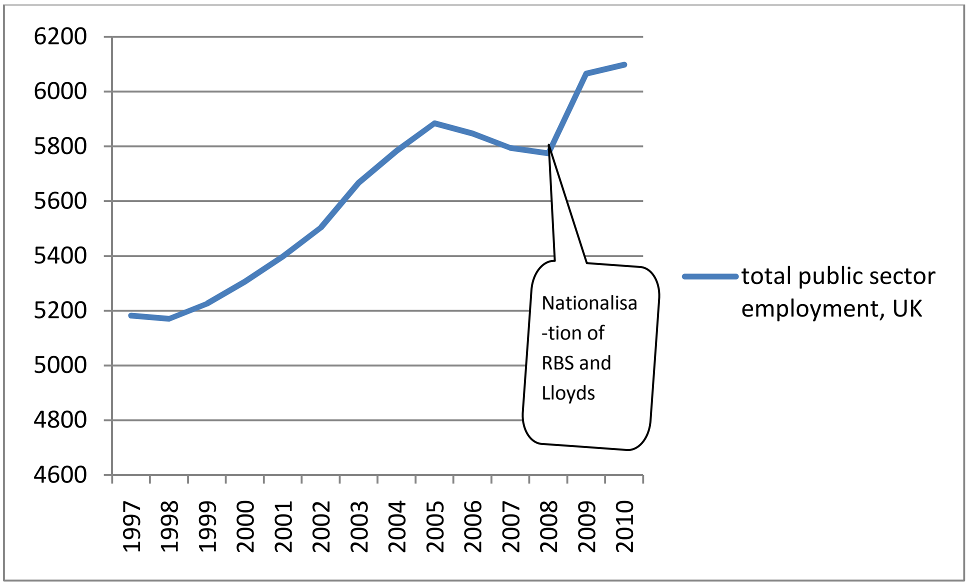
The cash spending and net revenue figures, in current prices, are shown in Fig 2.

Fig 2 Total Managed Expenditure and Current Receipts, 1997-8 to 2009-10[1]



The increases in service spending mostly went to education and health, which increased their spend as a % of GDP from 4.6% to 5.8% and from 5.5% to 7.7% of GDP respectively. During most years of the Labour governments 1997-2010 there were increases in the numbers of people employed in the public sector, following a period of annual reductions during the previous administrations, as is shown in Fig 3[2]. Clearly, reversing the growth in spending would involve reversing the growth in personnel.

Fig. 3 Total Public Sector Employment, United Kingdom, 000s



The last Labour budget before the election was in March 2010. This budget contained a plan to reduce the deficit[3] from 2010-2011 from 12.2% of GDP to 11.2%, then to gradually reduce it to 4.2%

[1] HM Treasury, Public Finances Database, June 2010

[2] Source: Office for National Statistics, database, July 2010

[3] Deficit defined as the 'Treaty Deficit', as set out in the Maastricht treaty for non-Euro EU members, and the Stability and Growth Pact for the Eurozone countries, promising to keep to fiscal rules including no deficit of more than 3% of GDP and no outstanding debt of more than 60% Of GDP.

in 2014-2015. The incoming Liberal/Conservative coalition produced a budget in June 2010 that promised to comply with the Maastricht norms and get the deficit down to below 3% by 2014-2015 on a steeper path of deficit reduction than the outgoing government. The two plans for the deficit and the debt are shown in Table 1

Table 1 Deficit and debt projections, March and June 2010

	08-9	09-10	10-11	11-12	12-13	13-14	14-15	15-16
Deficit, March 2010 budget	6.7	12.2	11.2	8.6	6.9	5.3	4.2	
Deficit June 2010 budget	6.8	11.3	10.1	7.6	5.6	3.6	2.2	1.2
Debt, March 2010 budget	55.5	71.4	80.5	86.0	88.7	88.7	89.2	88.7
Debt June 2010 budget	55.8	71.2	78.9	83.6	85.5	84.9	83.1	80.4

Whoever won the May 2010 election was to be faced with a large deficit and debt and would probably have made both cuts in spending and increases in taxation. The Coalition has announced that it will publish its Comprehensive Spending Review, the first since 2007, on 20th October 2010. It has started making statements and provoking a debate about how best to reduce the deficit and debt. The plan is outlined in the June 2010 budget:

"This Budget takes urgent action to eliminate the bulk of the structural deficit through plans for additional consolidation of £40 billion per year by 2014-15. These plans include:

- £32 billion per year by 2014-15 from spending reductions. This includes £30 billion of current spending reductions and no further reductions in capital spending beyond those already announced;

- as part of these spending reductions, the Budget announces £11 billion of welfare reform savings designed to reward work and protect the most vulnerable, including adopting the Consumer Prices Index for the indexation of benefits, tax credits and public service pensions from April 2011.

- The Budget also announces a two year freeze in public sector pay, except for those earning less than £21,000 a year;

- £8 billion per year from net tax increases. This includes an increase in the main standard rate of Value Added Tax (VAT) to 20 per cent and the standard and higher rate of Insurance Premium Tax (IPT) to 6 per cent and 20 per cent from 4 January 2011.

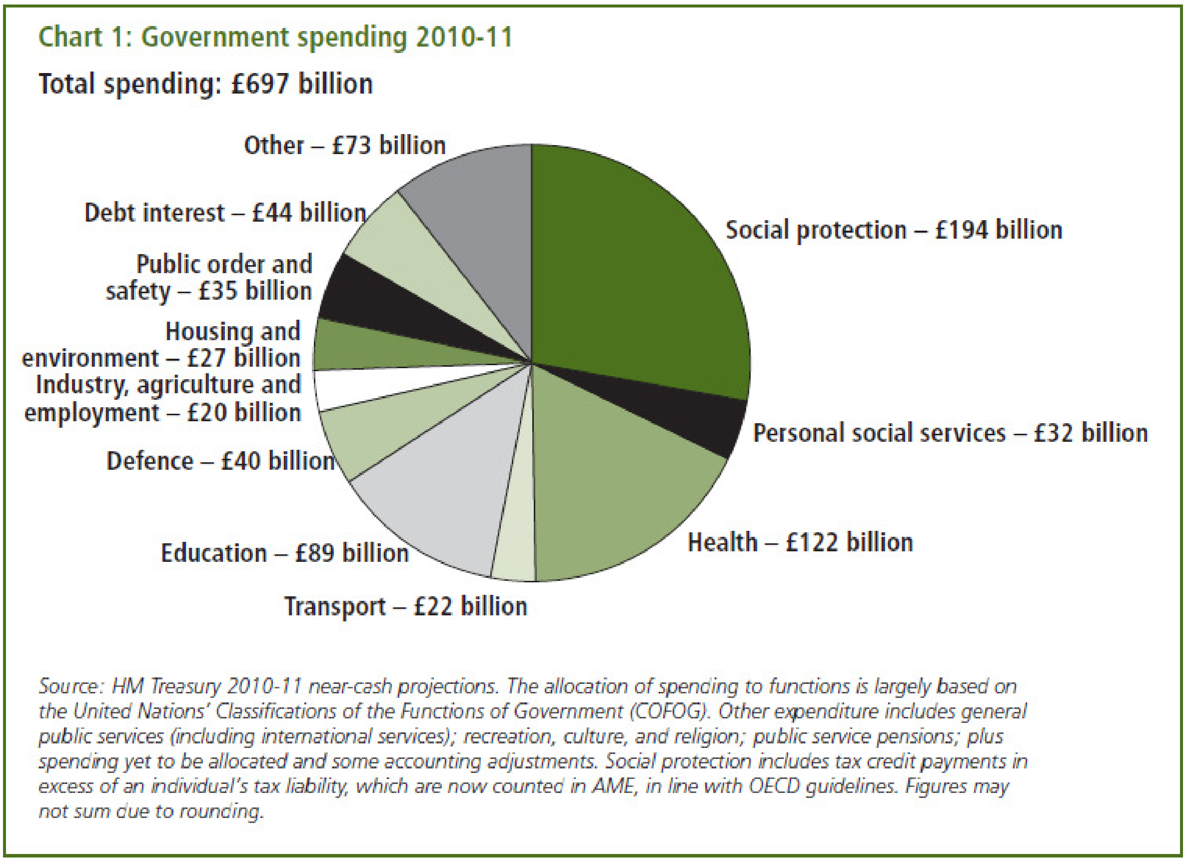
- By 2014-15, 80 per cent of the additional consolidation measures set out in this Budget will be delivered through spending reductions.

The Budget and the plans the Government inherited represent a total consolidation of £113 billion per year by 2014-15 and £128 billion per year by 2015-16, of which £99 billion per year comes from spending reductions and £29 billion per year from net tax increases. By 2015-16, 77 per cent of the total consolidation will be delivered through spending reductions."[4]

As a principle, the government has decided to reduce the deficit in a ratio of 80% (or 77% depending on which year) contribution from spending cuts and 20% from tax increases. In the current year, 2010-2011, total spending is £697 billions, the plan is cut annual spending by £99 billion by 2015-2016. If all these projections are in constant prices, this implies a 14.3% cut in spending.

What is this likely to mean for public services? There has been some talk of 'ring-fencing' some services, such as the NHS, although there have also been announcements of reorganisation and expenditure savings in that sector. The June 2010 budget breakdown by sector is set out in Fig. 3

Fig 3 Government Spending 2010-2011



The above announcement of an £11 billion cut in the welfare bill by cutting entitlements will only be partially successful, since the growth in unemployment will increase demands for social protection. Let us assume they manage to save £6billion on welfare payments. This leaves £93 billion left to find.

In the past, the first candidate has been capital projects, for which contracts have yet to be signed. Under Labour, public sector capital spending grew from less that 1% to more than 2% of GDP, much of it through the PFI/PPP format with capital raised by the private sector which then leased assets to the state, such as schools and hospitals. Already the Labour plan to rebuild all the secondary schools has been all but abandoned. Other capital cuts will no doubt follow in the CSR in October, but the totals announced in the June 2010 budget indicate a sudden cut in 2010-2011, then a levelling off

[4] Budget June 2010, p.2

from 2012-2013. In 2008-2009 capital spending was £48billion. The planned Capital Departmental Expenditure Limits are shown in Table 2

Table 2 Capital DEL 2008-2009 to 2015-2016 £bn

2008-9	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
48.5	56.6	51.6	41.4	39.6	37.0	38.7	40.8

Source: Budget June 2010

This is not as drastic a cut as would be implied by bringing capital expenditure down to the pre-Labour levels of around 1% of GDP, and represents about £10 billion per annum. It does, though, mark an abrupt end to Labour's policy of renewing the public sector infrastructure, reversing the previous under-investment.

Assuming this £10bn saving, this leaves £83billion left to find from an annual budget of around£503 billion (this is £697 minus the £194bn of Social Protection element, already covered), a required cut of roughly 16 per cent. If the whole of the NHS budget is to be ring-fenced, a promise not yet made, the cut of £83bn would be from £503bn minus £122 bn, or £381bn, or 22%.

The warm-up to the Comprehensive Spending Review has been talking about 25-40%, the normal procedure of trying to scare bigger than necessary offers from departments. If we assume that the whole saving comes from DEL and that 70% of DEL is salaries, the cuts in salaries will be £38 billion. Given an average staff cost (including overheads) of £50,000 per annum, this implies 700,000 job cuts, or 14% of the total jobs in 2010. Referring back to Figure 3, this implies reversing the growth in employment all the way back to the beginning of the Labour administration in 1997. The June 2010 budget plans to make these cuts over the life of the parliament, by 2015-2016, so we can expect job cuts of 140,000 per annum.

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