

Just how AUSTERE is **AUSTERITY?**



Despite the rhetoric of the past few years, cuts in overall government spending have been small. However, the government has made specific political choices to protect or increase spending in some areas whilst reducing it in others. But, says **RYAN BOURNE**, this shouldn't be confused with general 'austerity'

The prominent economic debate in the 2010-2015 Parliament was how far and how fast the then Coalition government should seek to reduce the budget deficit. The 2015 election likewise featured discussion of how to 'finish the job' on fiscal consolidation.

Yet many misconceptions exist about how far the UK government has, and plans to, reduce government spending to achieve that objective.

For most of the past six years, a perusal of almost any newspaper would have found reference to 'savage', 'deep' or 'dangerous' cuts to government expenditure. Are these claims justified?

We can combine evidence from the last Parliament with the Conservative government's forward plans for spending to ask: just how austere will so-called austerity be between 2010 and 2020?

The coalition's overall record on spending 2010/11-2014/15

In fact, overall government spending in cash terms rose from £714 billion in 2010/11 to £746.7 billion in 2014/15.

Given that nominal GDP growth was faster than this over the same time period, overall spending as a proportion of GDP did, of course, fall. At the beginning of the Parliament spending

was 45.3 per cent of national income and, at the end of the parliament, it was 40.8 per cent¹.

But what really matters is how far that spending goes in terms of its purchasing power, i.e. what has happened to real spending. Inflation was relatively high across this same period. But even adjusting for this, the figures above represent a *cut in real spending of just 2.1 per cent over four years*.

In other words, during the four years of the last Parliament for which the Coalition controlled the budget, *just over 2p was cut for every £1 the government had spent back in 2010/11*. To put it another way, real spending was cut by just 0.5 per cent per annum.

You could argue that in order to see the impact of government spending cuts on actual public service delivery, it is better to look at real spending per capita.

After all, the population has also risen during that period. Adjusting in this way shows a decline of just under 5 per cent (see Table 1). More significant, yes, but certainly not 'savage'.

Changed composition of spending 2010/11-2014/15

Why then do we hear so much about spending as if it has been cut to the bone?

There are two main reasons.

The first is that, even though real spending has only been cut slightly, this is still highly unusual in Britain's post-war history – in the past, the state has only tended to grow.

The public sector has become used to ever higher spending, and real cuts therefore provide a shock.

Secondly, these headline figures mask large changes in the composition of spending since 2010, arising from both political promises and demographic trends which affect spending.

The coalition government pledged to maintain spending in real terms on the NHS, to increase spending significantly on international development aid and to institute increases in the state pension as a result of its 'triple-lock' (at the same time as the pensioner population is rising). Some schools spending was also protected. Debt interest payments rose as we ran large deficits.

Ring-fencing or even increasing spending in these areas means that spending elsewhere has to be cut much more deeply to meet a given target.

This can be shown clearly by looking at the functions of government and how spending on these different areas changed (Figure 1).

Measured in this way, spending on international services (including foreign aid) rose by 26 per cent above inflation, health spending by 4.7 per cent, and the social protection budget (welfare in its broadest sense) by 6.0 per cent.

Other functions of government saw significant real-terms cuts. These included

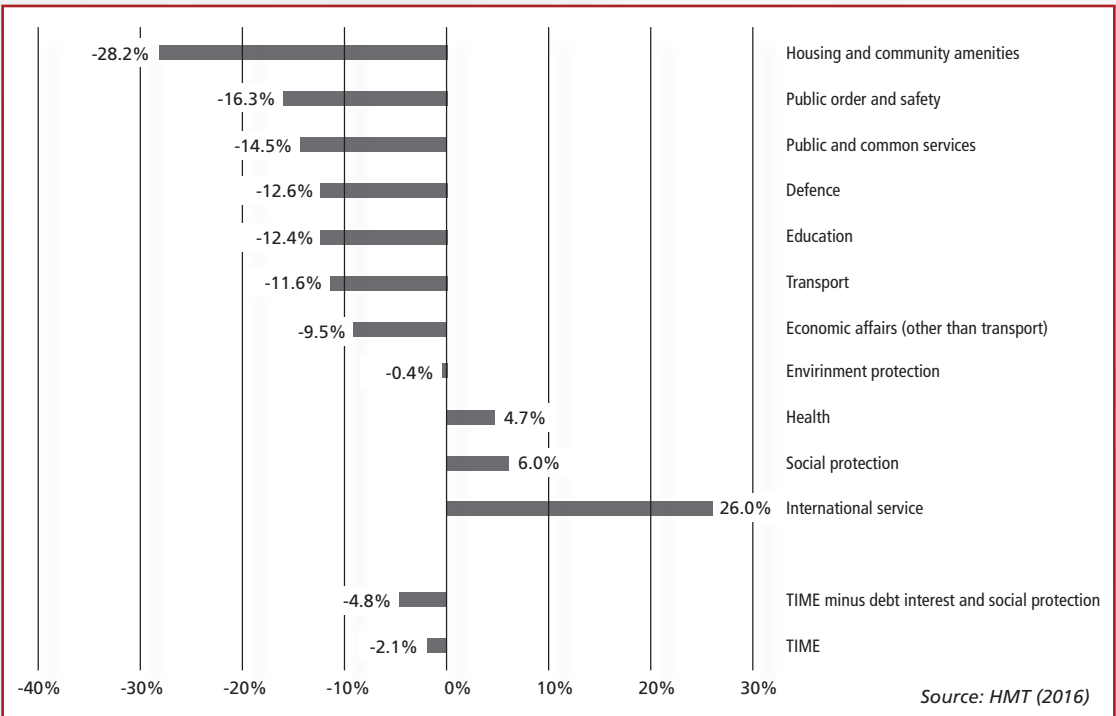
Table 1: Real spending per capita (2015/16 prices), 2010/11 to 2014/15

	2010/11	2011/12	2012/13	2013/14	2014/15
Real spending (£billion)	£764	£755	£744	£747	£755
Change in real spending since 2010/11		-1.2%	-2.5%	-2.2%	-2.1%
Real spending per capita	£12,168	£11,923	£11,682	£11,654	£11,569
Change in real spending per capita since 2010/11		-2.0%	-4.0%	-4.2%	-4.9%

Source: OBR (2016), ONS (2016).

¹ These figures use GDP calculated at market prices. Some would argue that GDP at factor cost is more appropriate. Using this measure, both figures would be about five percentage points higher.

Figure 1: Real changes in government spending by function 2010/11 to 2014/15



housing and community amenities (28.2 per cent in real terms), public order and safety (16.3 per cent in real terms) and, perhaps more surprisingly, education (12.4 per cent cut in real terms).

In short, there was modest spending restraint in the last Parliament, but this masks the fact that political choices were made to increase spending in some areas, maintain it in others and make deeper cuts elsewhere. However, these were genuine choices about priorities – the cuts overall do not reflect ‘deep austerity’.

The Conservative government's plans to 2019/20

The Conservatives have pledged to restrain government spending growth further to complete the job of deficit reduction.

This commitment is now somewhat in doubt given the Chancellor's promise to ‘reset’ fiscal policy in the fall out

from the Brexit referendum, but, in the medium term, the government will have to engage in more spending restraint to meet its declared aim of getting the debt-to-GDP ratio back on a downward path.

Examining the last Budget, the figures are clear that over the course of this Parliament the Conservatives had planned not just to increase overall spending in nominal terms but also deliver a slight increase in spending in real terms (up 0.9 per cent between 2014/15 and 2019/20).

Once again, the flat-lining of spending overall masks some big changes in its composition.

Spending on areas such as

social protection will rise, not least due to a combination of an ageing population and the continuation of the guaranteed increases to state pensions.

The government has also promised more resources for the NHS, is protecting defence and aid spending and has pledged to maintain other pensioner benefits. This all necessitates cuts in the remaining functions.

The reckoning up

Assuming that the plans outlined in the last budget are delivered, what will be the overall shape of spending changes after a decade of ‘austerity’?

Overall government

References

- HMT (2016) *Public Expenditure Statistical Analyses 2016*. Updated: 21 July 2016.
- ONS (2016) *GDP deflators at market prices, and money GDP: June 2016 (Quarterly National Accounts)*. London: Office for National Statistics.
- OBR (2016) *Economic and Fiscal Outlook*. March 2016. London: Office for Budget Responsibility.

spending will rise in nominal terms from £714.0 billion in 2010/11 to £810.4 billion in 2019/20.

In real terms this will reflect a cut in overall expenditure of just 1.3 per cent in total over a ten-year period (see Figure 2). Given population growth over that period, real spending per head will have fallen further than this – in total by 7.4 per cent.

But within these totals, real spending by departments will have fallen by 13 per cent, whilst annual managed expenditure, which includes debt interest payments and the state pension, will have risen by 11.3 per cent.

In other words, the small overall cut to expenditure masks large changes to spending on particular activities. Of course, all of these forward-looking projections of spending

are subject to change. But evidence from the last Parliament suggests that, by-and-large, decisions in the spending review tend to stick.

Conclusion

What then can we conclude about the severity of austerity given current plans? There are five key conclusions from this analysis:

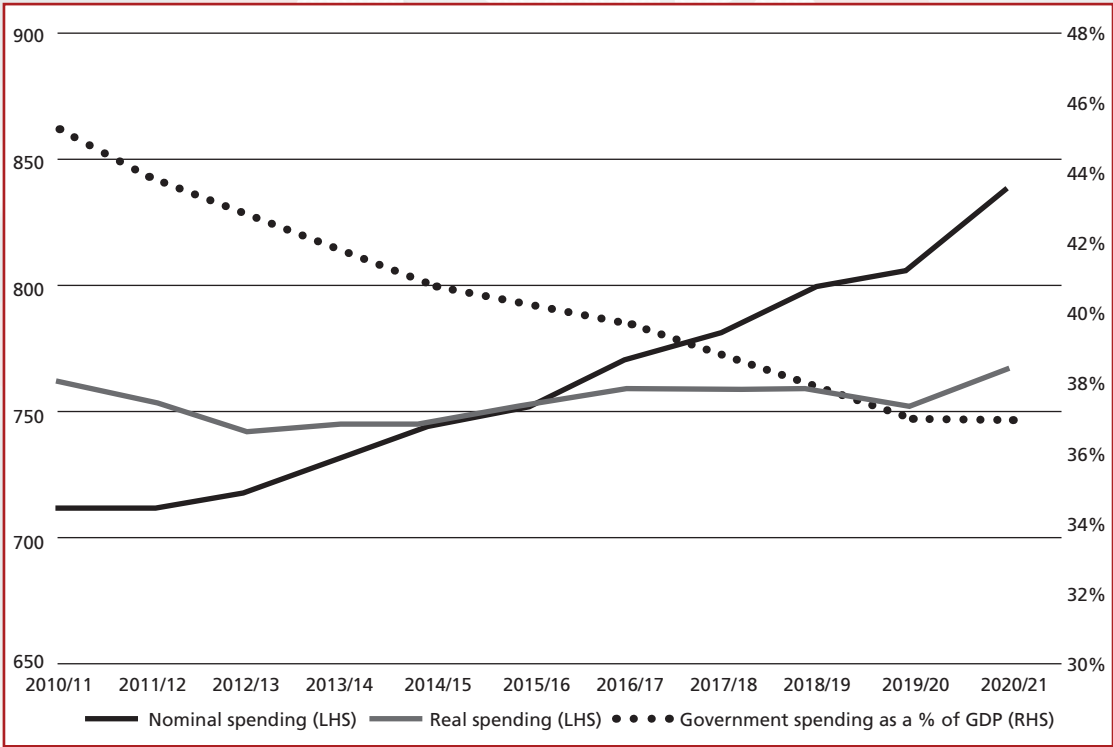
- 1. Overall spending will have only been cut very modestly over the period 2010 to 2020.
- 2. Holding spending down in this way should lead to a significant fall in the spending-to-GDP ratio if real national income growth is robust.
- 3. This level of spending as a proportion of GDP is still high by long-term historic standards: approximately the same proportion of GDP at market prices

as it was in 2000 and five percentage points higher than in 1960.

- 4. The overall spending totals mask a significant increase in spending in some areas, not least social protection spending, whilst departmental expenditure will have been cut significantly.
- 5. Even within departmental spending, significant ring-fencing of certain budgets (such as health, some schools spending and aid) means some departments will see very deep cuts overall whilst others have been insulated from restraint for a decade•

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Figure 2: Nominal and real expenditure (£ billion; real expenditure in 2015/16 prices) and spending as a proportion of GDP



Source: OBR (2016).