



Perspectives by Ruth Lea

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2010 Spending Review: the Chancellor did stick to his plans

Introduction: little change to the spending totals

Much as we expected in the last Perspective, the Chancellor basically stuck to his overall spending plans in the Spending Review.^{1,2} In broad macroeconomic terms, therefore, there was little change in terms of the impact on the economy.

The speculation that he would relax his plans by either significantly easing his spending totals and/or back-end loading the cuts was not borne out by events. In the event the Chancellor made the following changes to the plans:

- He modestly increased Total Managed Expenditure (TME, total public spending) by £3bn in cash terms by FY2014, mainly for capital expenditure and which went to the departments (the Departmental Expenditure Limits (DELs)).
- He made further savings to the Annually Managed Expenditure (AME) component.³ He found another £7bn of welfare savings by FY2014, in addition to the £11bn in the Budget, and £3.5bn of other AME savings (including increased employee contributions to public sector pensions and no recycling of revenues of the Carbon Reduction Commitment).
- He transferred the AME savings to DELs.

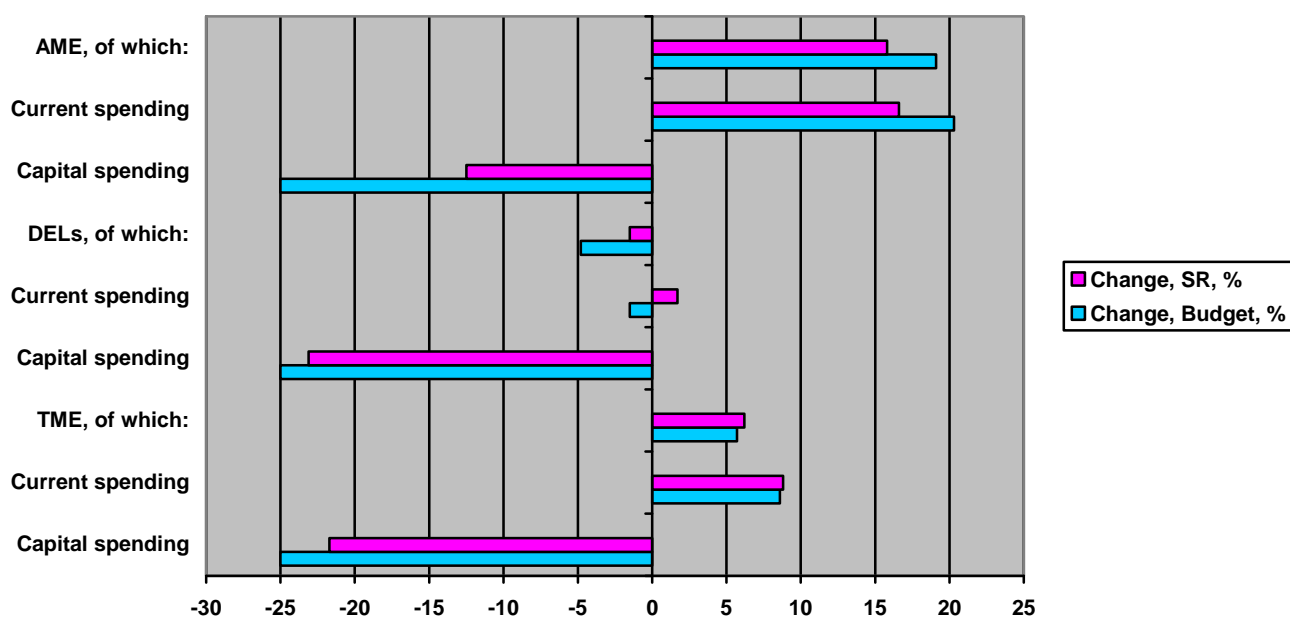
The overall cash terms effect for the years FY2010 to FY2014 of these changes was:

- To increase the rise in TME from 5.7% in the June Budget to 6.2% in the Spending Review.
- To reduce the rise in AME from 19.1% in the Budget to 15.8% in the Spending Review.
- To reduce the fall in DELs from (minus) 4.8% in the Budget to (minus) 1.5% in the Spending Review.
- To reduce the fall in total capital spending from (minus) 25% in the Budget to (minus) 21.7% in the Spending Review.

Chart 1 below and table 1 in the annex provide the details, where:

- Total Managed Expenditure=TME
- Annually Managed Expenditure=AME
- Departmental Expenditure Limits=DELs
- TME=AME+DELs

Chart 1 Change (cumulative %) between FY2010 and FY2014 for public spending, in cash terms: Spending Review compared with the Budget



Sources: HM Treasury, *Budget 2010*, HC61, June 2010, table C13; HM Treasury, *Spending Review 2010*, Cm7942, October 2010, tables 1.1 and A1.

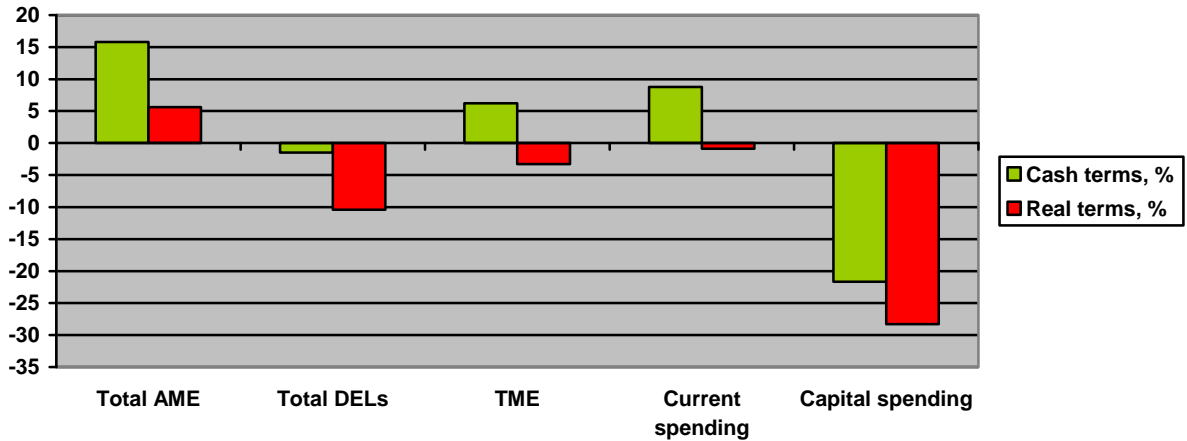
Inflation takes a toll

The data so far discussed are in cash terms. When allowance is made for inflation the numbers look decidedly less generous. The real terms figures quoted here use the Budget's forecast for the GDP deflator, as is conventional, which shows a cumulative increase in the deflator of nearly 10% between FY2010 and FY2014. Arguably this is on the optimistic side. CPI inflation is running above target and inflation in the public sector tends to run ahead of inflation in the economy as a whole – though this may not be the case over much of the forecast period given the prospective pay freezes. Chart 2 below and table 2 in the annex provide the relevant data.

The main points to make real terms data are:

- AME spending is still expected to rise by 5.6%, such is the pressure on budgets by the still rising welfare bills and the exploding debt interest payments.
- DELs are projected to fall by a cumulative 10.4% over the 4 years.
- TME is projected to fall by a cumulative 3.3% over the 4 years – an average annual decrease of 0.8%.
- Capital spending is due to fall 28.3%, despite the extra resources allocated in the Spending Review.

Chart 2 Spending, changes in cash and real terms, FY2010-FY2014, %



Source: HM Treasury, *Spending Review 2010*, Cm7942, October 2010, tables 1.1 and A1, author’s calculations

Comparisons with earlier years: not so bloodcurdling after all

There has been much rhetoric surrounding the depths of the cuts and the dangers to growth of the current government’s fiscal retrenchment package. The next set of charts does suggest that this rhetoric has been somewhat overdone, certainly when it comes to the overall spending totals.

Chart 3a shows that, even in real terms, spending in FY2014 will still be higher than in FY2008. In FY2010 prices, spending was around £650bn in FY2008, before shooting up to £690bn in FY2009 and £700bn in FY2010. In FY2014 it is projected to be £674bn. It is a sobering thought that, at £674bn, spending will still be nearly 50% higher in real terms than it was at the turn of the millennium – such was the impact of Chancellor Brown’s sustained, yet completely unsustainable, spendthrift policies.

Chart 3b provides the year-on-year changes in total public spending since FY1970. In comparison with the 4% decrease in FY1977, after the IMF had been in, the projected cuts look quite modest. As we explain above, TME is expected to fall by only 3.3% in real terms over the forecast period – and it is spread over four years – so perhaps the blood-curdling language is inappropriate. The falls in public spending in the 1980s and the 1990s reflected economic growth (so fewer cyclical welfare payments) as well as fiscal prudence.

Chart 3c shows that public spending as a % of GDP is projected to fall to around 41% in FY2014, back to the levels of FY2007, and still well above the 37% of the late 1990s. But these projections do rely on the OBR’s Budget GDP forecasts being accurate.⁴ If the GDP forecasts disappoint then the spending/GDP ratio will overshoot. And, of course, the Chancellor’s borrowing forecasts will probably overshoot as well.

Chart 3a Total public spending in FY2010 prices, £bn, annual data

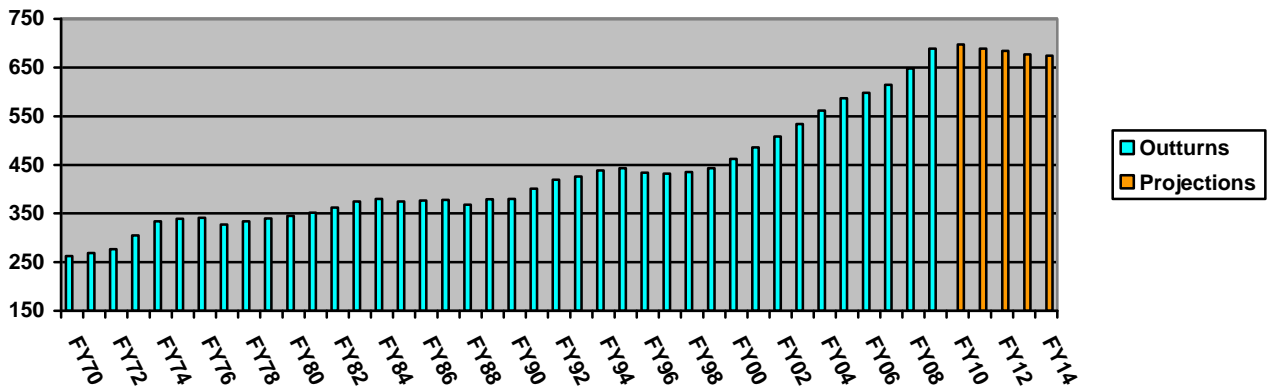


Chart 3b Total public spending in FY2010 prices, annual change, %, annual data

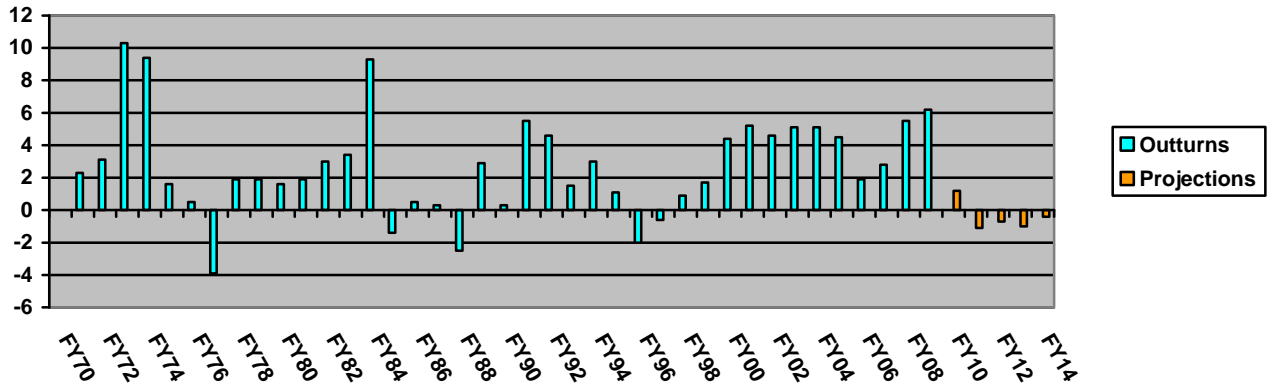
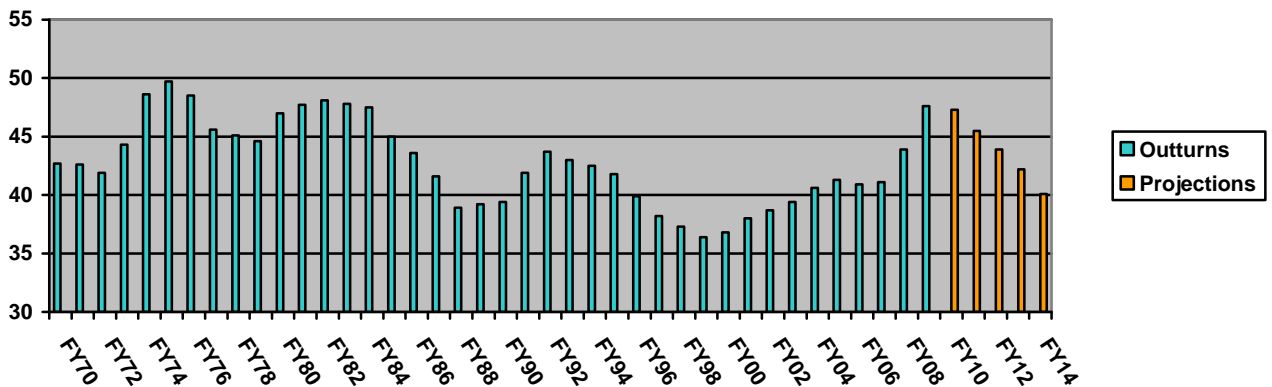


Chart 3c Total public spending as % of nominal GDP, annual data



Sources: HM Treasury, *Budget 2010*, HC61, June 2010; HM Treasury, *Spending Review 2010*, Cm7942, October 2010.

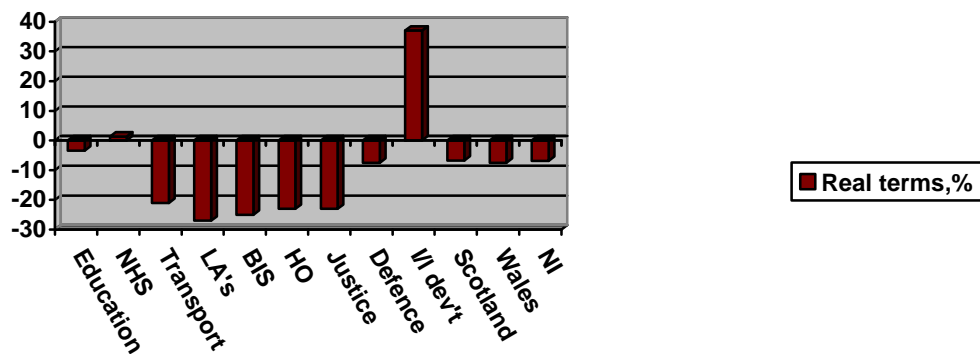
Spending Review: departmental details

When it comes to discussing the separate departmental budgets, then bloodcurdling language does become more appropriate in some cases. Because of the still rising AME budgets, the ring-fencing of the NHS (a huge budget) and the determination to meet the 0.7% of GDP target by 2013 for international aid, the money left for the other departments is very tight.

Chart 4 shows how the different budgets have fared:

- Education, which does not include universities, has been lightly spared, facing a cumulative cut of just 3.4%. The schools budget was ring-fenced.
- Health has been awarded a cumulative real terms increase of 1.3%.
- Transport is to face 21% cut, central government grants to local authorities are 27% down, BIS 25% down, Home Office and Justice Department are both 23% down.
- Defence was partly spared with a cumulative reduction of 7.5%
- As already discussed the international aid budget is set to grow very fast – from £8.5bn in FY2010 to £11.5bn in FY2014.
- The budgets for the devolved governments were also partly spared. Scotland is 6.8% down, Wales 7.5% down and Northern Ireland 6.9% down.

Chart 4 Departmental, current spending, real terms changes (%), FY2010-FY2014



Source: HM Treasury, *Spending Review 2010*, Cm7942, October 2010, table 1, selected departments

References

1. Ruth Lea, "2010 Spending Review: the Chancellor is likely to stick to his plans", *Arbuthnot Banking Group*, 18 October 2010.
2. HM Treasury, *Spending Review 2010*, Cm7942, October 2010
3. Annually Managed Expenditure (AME) includes welfare benefits, debt interest payments, payments to the EU.
4. Ruth Lea, "The OBR's economic forecasts are "challenging": but there'll be no "double dip", *Arbuthnot Banking Group*, 12 July 2010.

Annex

Table 1 Total Managed Expenditure (TME) (£bn), cash terms, FY2010 to FY2014, comparison of Budget data with Spending Review data

	FY10	FY11	FY12	FY13	FY14	FY14 minus FY10	FY10 to FY14 (%)
Annually Managed Expenditure (AME):							
BUDGET (£bn):							
Current spending	295	308	323	337	355	60	20.3%
Capital spending	8	7	7	6	6	-2	-25.0%
Total AME	303	315	330	343	361	58	19.1%
SR (£bn):							
Current spending	295	308	319	329	344	49	16.6%
Capital spending	8	7	7	6	7	-1	-12.5%
Total AME	303	315	326	335	351	48	15.8%
Departmental Expenditure Limits (DELS):							
BUDGET (£bn):							
Current spending	343	343	341	341	338	-5	-1.5%
Capital spending	52	41	40	37	39	-13	-25.0%
Total implied DELs	395	384	381	378	376	-19	-4.8%
SR (£bn):							
Current spending	343	343	345	350	349	6	1.7%
Capital spending	52	43	42	39	40	-12	-23.1%
Total DELs	395	386	387	389	389	-6	-1.5%
Total Managed Expenditure (TME)							
BUDGET (£bn):							
Total current spending	638	651	664	678	693	55	8.6%
Total capital spending	60	48	47	43	45	-15	-25.0%
Total TME	697	700	711	722	737	40	5.7%
SR (£bn):							
Total current spending	637	651	664	679	693	56	8.8%
Total capital spending	60	51	49	46	47	-13	-21.7%
Total	697	702	713	724	740	43	6.2%

Sources: HM Treasury, *Budget 2010*, HC61, June 2010; HM Treasury, *Spending Review 2010*, Cm7942, October 2010

(2) Total Managed Expenditure (TME) (£bn), real terms, FY2010 to FY2014

	FY10	FY11	FY12	FY13	FY14	FY14 minus FY10	FY10 to FY14 (%)
GDP deflator (% YOY)	2.9	1.9	2.3	2.6	2.7		
FY2010=100	100	101.9	104.2	107.0	109.8		9.8%
Total AME, cash terms	303	315	326	335	351	48	15.8%
Total AME, real terms	303	309	313	313	320	17	5.6%
Total DELs, cash terms	395	386	387	389	389	-6	-1.5%
Total DELs, real terms	395	379	371	364	354	-41	-10.4%
Total TME, cash terms	697	702	713	724	740	43	6.2%
Total TME, real terms (% change)	697	689 (-1.1)	684 (-0.7)	677 (-1.0)	674 (-0.4)	-23	-3.3%
Current spending, cash terms	637	651	664	679	693	56	8.8%
Current spending, real terms	637	639	637	635	631	-6	-0.9%
Capital spending, cash terms	60	51	49	46	47	-13	-21.7%
Capital spending, real terms	60	50	47	443	43	-17	-28.3%

Source: HM Treasury, *Spending Review 2010*, Cm7942, October 2010, tables 1.1 and A1. The GDP deflators are taken from the Budget forecasts.

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