The outcome of the 2010 Spending Review

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This note gives a brief summary of the measures announced in the 2010 Spending Review.

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1 Introduction

The Chancellor presented the 2010 Spending Review statement to the House of Commons on 20 October, setting out the Government's spending plans for the period 2011/12 to 2014/15. The Spending Review document is available on the Treasury website. A separate Library note is available setting out the background to the Spending Review.[1]

Plans for the overall level of public spending had been set out in the June Budget. The Spending Review announced small increases to this total.. Its main role was to announce how the Government planned to allocate public spending between welfare and departmental spending and between departments.

The Spending Review announced a further £10.6 billion of savings in non-departmental spending by 2014/15. These savings allow the cuts to departmental spending to be less than they otherwise would be. Nevertheless, the cuts are significant: departments other than health and overseas aid will see average real terms cuts of 19% over the period. The Government claims that this reduction is lower than that implied by the previous Government's plans – a claim which has been challenged.

The average departmental cut in programme and administration spending is 8.3% in real terms over the four years covered by the Spending Review. Capital spending is to be cut by 29% on average. In both cases there is significant variation between departments in the extent of the cuts. Spending in a number of areas has been prioritised:

- NHS spending will increase in real terms in each year of this Parliament
- The commitment that overseas aid spending will reach 0.7% of Gross National Income by 2013 will be honoured
- An increase in the schools budget every year in real terms.

According to the Institute for Fiscal Studies (IFS), cuts to real total spending over the Spending Review period will be the deepest since the Second World War and the cuts to spending on public services (as opposed to welfare) will be the deepest since the four years beginning in April 1975.

While the Chancellor has defended the fairness of the Government's measures, these claims have been disputed by the Opposition and the IFS. Some commentators have also said that the spending review is a gamble at a time when the economic recovery is fragile

2 Total spending

The Spending Review announced a small increase (around £2 billion a year) in the overall level of public spending compared with the June Budget. This £2 billion will be used for capital spending. Total spending still falls in real terms in each year covered by the Spending Review.

[1] SN/EP/5674

Total Managed Expenditure

	2010/11	2011/12	2012/13	2013/14	2014/15
£ billion (nominal)					
June 2010 Budget	696.8	699.8	711.0	722.0	737.5
Spending Review	696.8	701.8	713.0	724.2	739.8
Annual % change (real terms)					
June 2010 Budget		-1.4%	-0.7%	-1.0%	-0.5%
Spending Review		-1.2%	-0.7%	-1.0%	-0.5%

Sources: HM Treasury, Spending Review 2010, Table 1.1
HM Treasury, Budget June 2010, Table C13
Library calculations
Note: real terms calculation used GDP deflator

3 Savings in non-departmental spending

The Spending Review announced a further £10.6 billion of savings in non-departmental savings by 2014/15. Of these, around £7 billion come from further welfare savings (in addition to the £11 billion announced in the Budget). The largest element of these comes from removing child benefit from families with a higher rate taxpayer. Details of the non-departmental savings are in the table below.

Savings in non-departmental spending, £ million

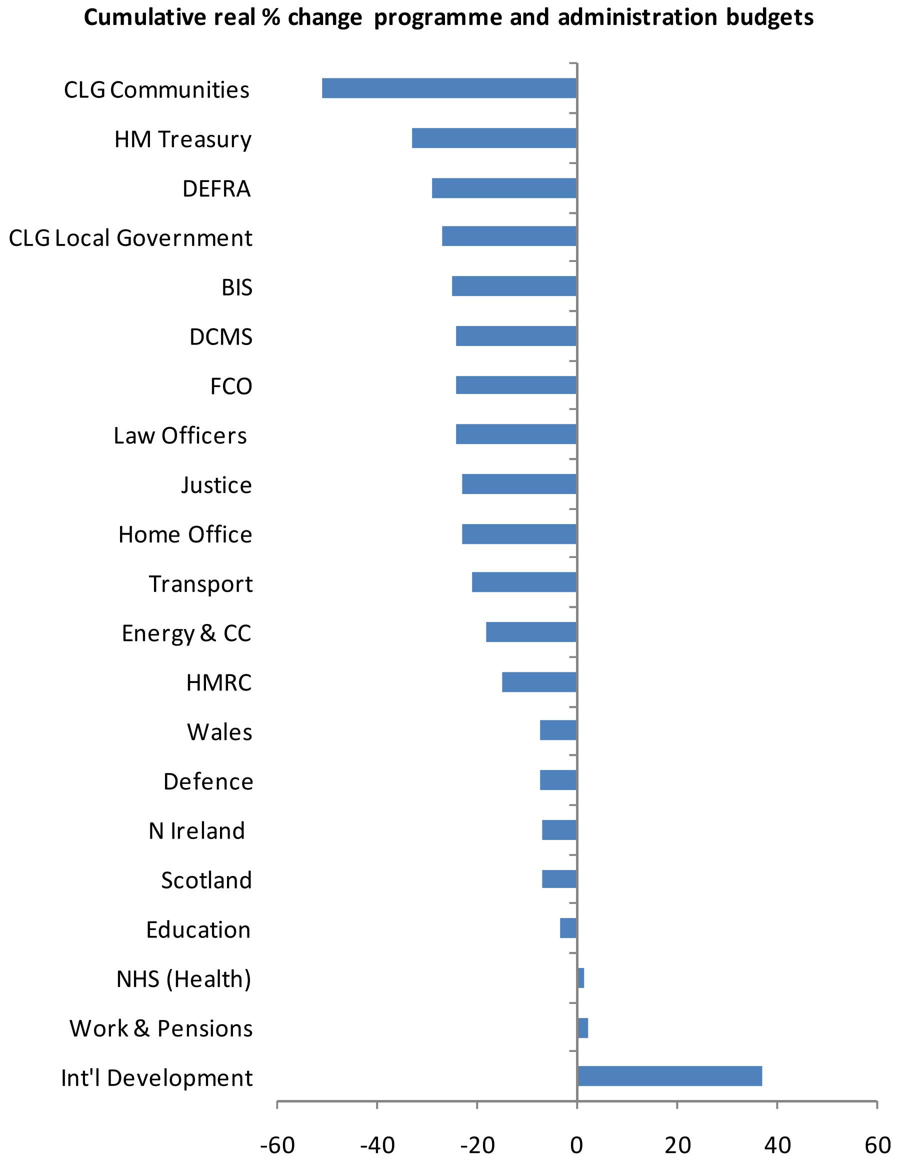
	2011/12	2012/13	2013/14	2014/15
Welfare measures				
Contributory Employment and Support Allowance: time limit for those in the Work Related Activity Group to one year	-	1,025	1,530	2,010
Child benefit: remove from families with a higher rate taxpayer from January 2013	-	590	2,420	2,500
Total welfare	**320**	**2,555**	**5,990**	**7,040**
Other Annually Managed Expenditure (AME)				
Public sector pensions: increase in employee contribution rates	-	160	1,270	1,760
Carbon Reduction Commitment: no recycling of revenues	715	730	995	1,020
Total: other AME	**335**	**1,285**	**2,770**	**3,515**
Total	**655**	**3,840**	**8,760**	**10,555**

Source: HM Treasury, Spending Review 2010, Table 3, page 12
Note: only those items which yield a saving of more than £1 billion are shown in the table. For further detail, see Table 3 of the Spending Review document

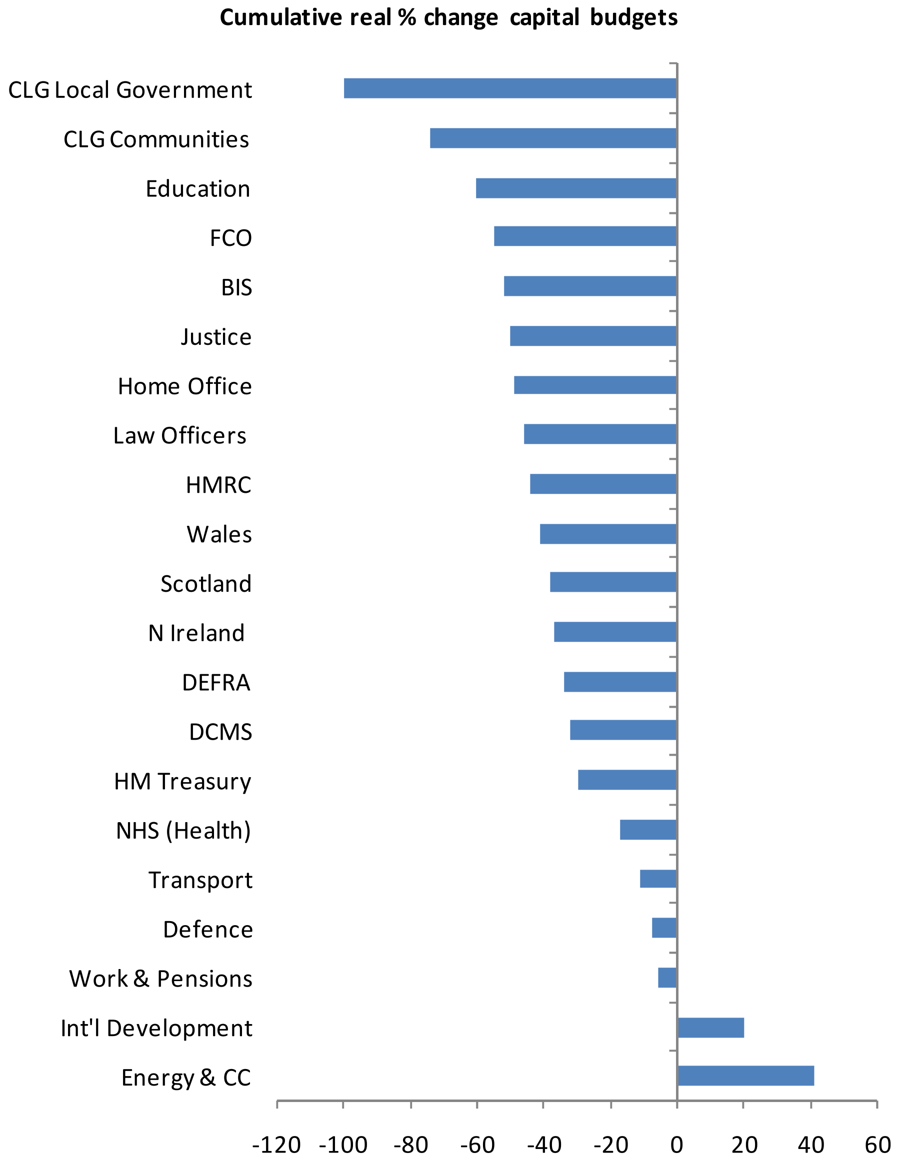
These savings allow the cuts in departmental spending to be lower than they otherwise would be.

4 Departmental spending

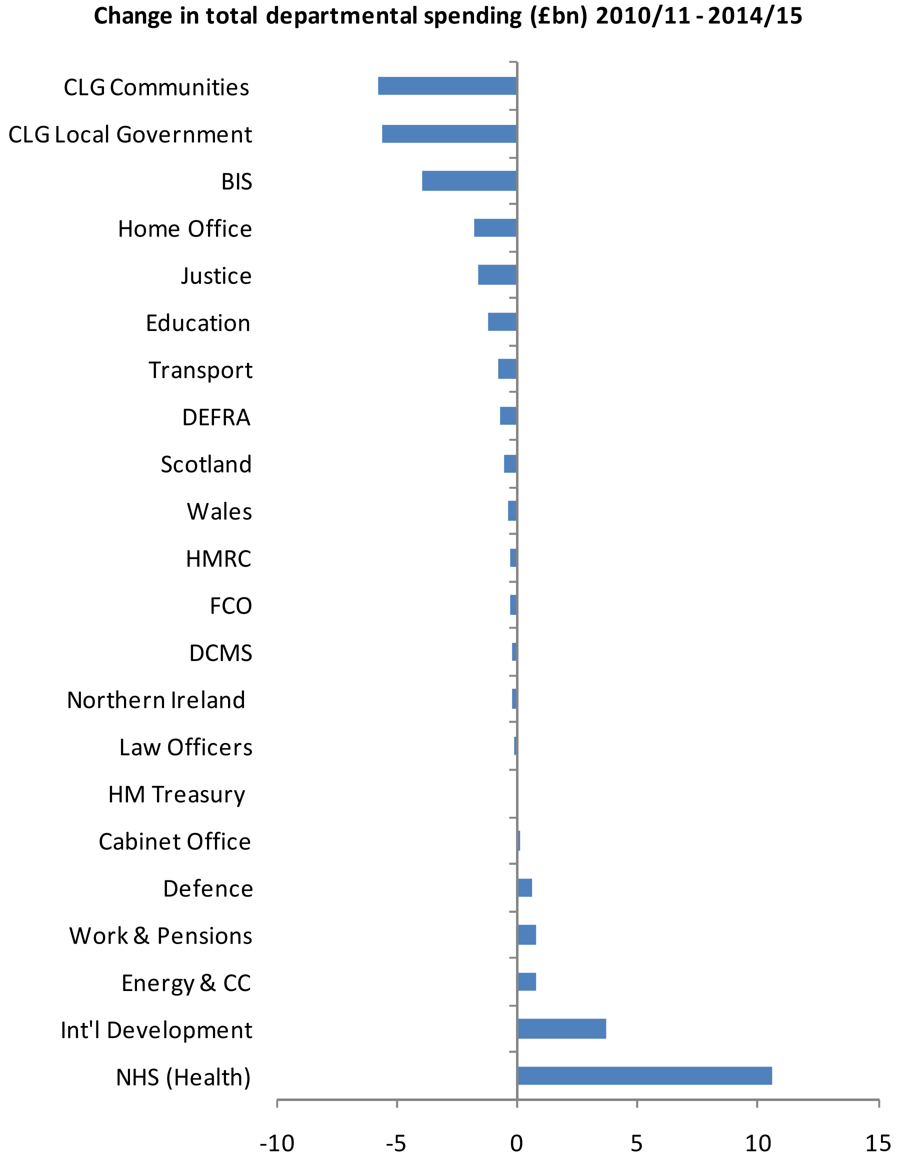
The chart below shows cumulative real changes over the Spending Review period in departmental programme and administration budgets. This is essentially current DEL spending. As the chart shows, nearly all departments see real terms cuts with only International Development, Work and Pensions and Health seeing increases. The average cut is 8.3% but many departments see much greater cuts, with the Department for Business, the Communities and Local Government Department, DEFRA and the Treasury all seeing cuts of 25% or more.



The cuts in capital spending are much greater in percentage terms than those for current spending, averaging 29% in real terms over the Spending Review period. The Departments for Energy and Climate Change and International Development are the only two which see real increases. A number of departments, including Communities and Local Government and Education see real terms cuts of over 50% over the four year period.



The charts above show the percentage change in departmental budgets. However, the size of these budgets varies hugely between departments: the NHS budget is over £100 billion while the Treasury's is £0.2 billion. The chart below shows the absolute change in total DEL for each department in nominal terms. Communities, Local Government and the Business Department are again the biggest losers with the NHS and International Development the biggest winners. A table showing the total departmental budgets is at the end of this note.



4.1 Is the Government cutting less than Labour?

The Chancellor said that the cuts to departmental spending would be lower than had been planned under Labour:

> The average savings in departmental budgets will be lower than the previous Government implied in their March Budget. Instead of cuts of 20%, there will be cuts of 19% over the four years, so I thank the Opposition for their support and input and look forward to their votes.[2]

The Spending Review document, however, said that departmental cuts would be at the same pace as planned under Labour:

> departmental budgets other than health and overseas aid will be cut by an average of 19 per cent over four years, the same pace as planned by the previous government.[3]

Making comparisons between the cuts which would have occurred under a Labour government and those planned by the Coalition government is not straightforward. First, as Labour did not set out departmental spending plans beyond 2010/11, these claims must be based on assumptions about how spending would have evolved under Labour. Secondly, there are issues with the baseline for comparison, as the Coalition has made in-year cuts to spending in 2010/11. This affects calculation of the percentage fall in spending.

What does seem to be clear is that total departmental spending in 2014/15 under the Government's plans will be lower than the level implied by Labour's March Budget.[4] A *Financial Times* report indicated that the Government's plans for departmental spending in 2014/15 are £10 billion lower than those implied by Labour's plans.[5] The OBR's Pre-Budget forecast, which was based on the previous Government's policies, showed total departmental spending of £379 billion in 2014/15 compared with the Spending Review total of £369 billion.[6]

5 Distributional Impact

Annex B of the Spending Review document considers the distributional impact of policy decisions.

5.1 Tax, tax credits and benefits

The chart below shows the impact of tax, tax credit and benefit policy decisions in simple monetary terms by income decile. This incorporates, in green, Spending Review changes and, in black, changes both announced in the June Budget and changes announced by the previous Government but not reversed by the new Government.

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2 HC Deb 20 October 2010 c965

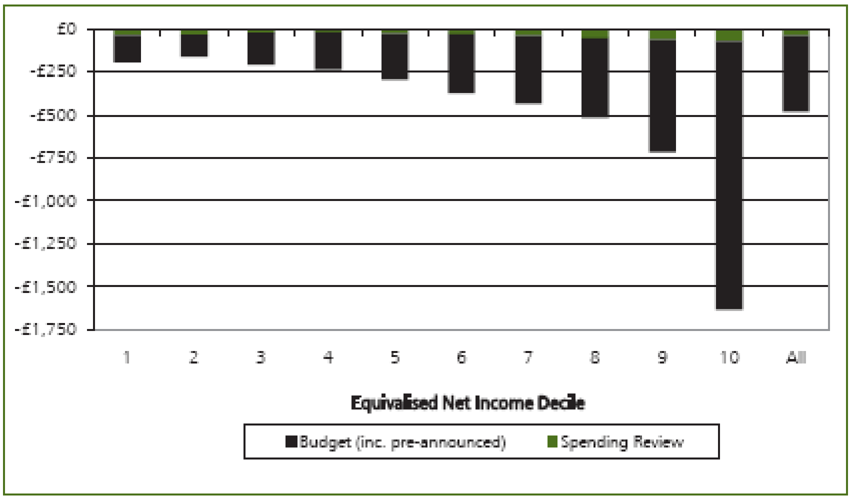
3 HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, p1

4 Opening remarks by Carl Emmerson at IFS briefing on the Spending Review, 21 October 2010

5 "Figures reveal picture of deeper cuts", *Financial Times*, 21 October 2010

6 Office for Budget Responsibility, *Pre-Budget forecast*, June 2010, Table 4.8; HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, Table A.9

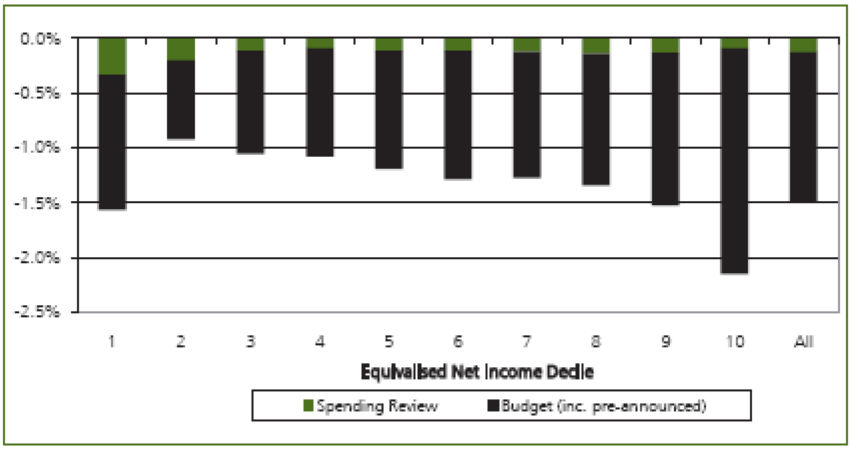
Chart B.4 Impact of Spending Review and Budget measures (including pre-announcements) in cash terms (£ per year) by income distribution (2012-13).



In simple cash terms, the combined effects of Spending Review and Budget (including pre-announced) decisions hit higher income groups harder. The Spending Review itself, unsurprisingly, has a smaller impact via tax, tax credit and benefits than the Budget. However, the distributional impact is flatter.

When these figures are displayed as a share of net income, the chart appears very different:

Chart B.5 Impact of Spending Review and Budget measures (including pre-announcements) as a per cent of net income by income distribution (2012-13).



Including the Budget and pre-announced measures, the highest income groups are hit hardest as a share of net income, followed by the *lowest* income decile.

Looking solely at the Spending Review (in green), the two lowest income deciles are most adversely affected by tax, tax credit and benefit policy decisions. It should be noted that the Treasury draws attention to the large numbers of "households with temporarily low incomes", such as students and the self-employed, in the lowest income decile.[7]

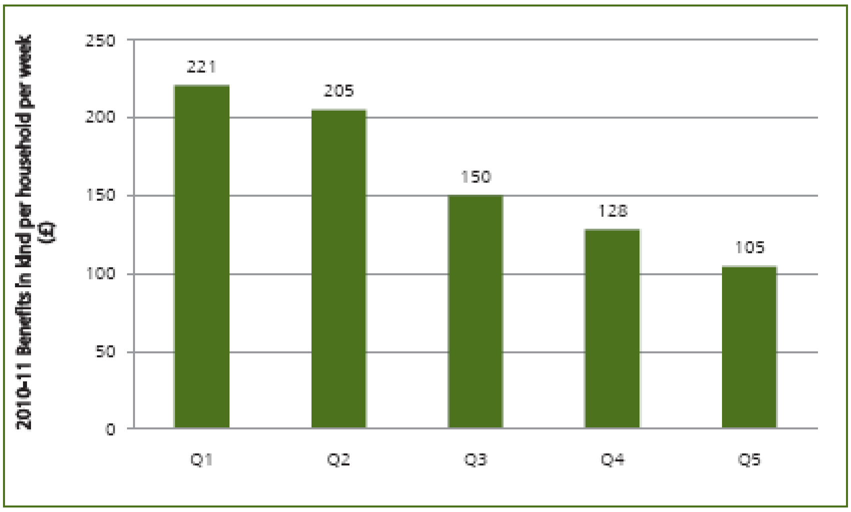
Nevertheless, in terms of proportions of net income, the tax, tax credit and benefit changes announced in the Spending Review are regressive.

[7] HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, para B.38

5.2 Spending on public services

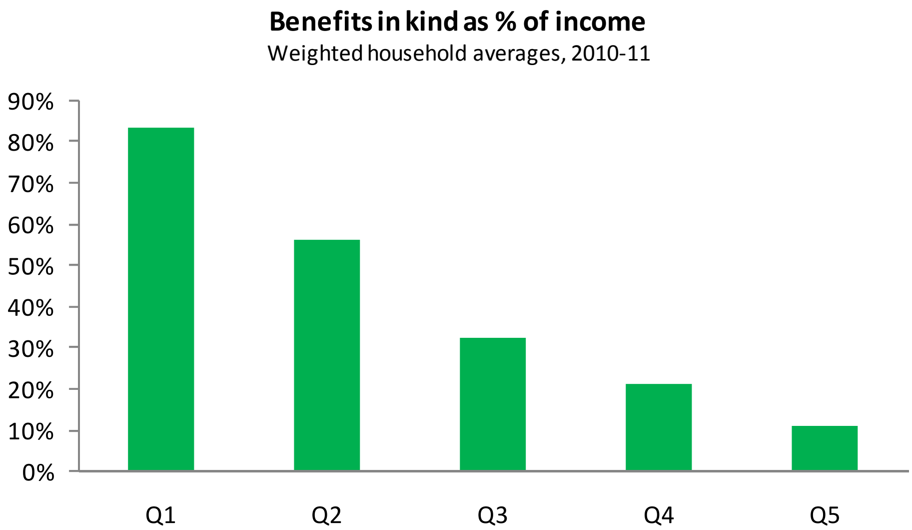
The Spending Review report incorporates for the first time some limited analysis of the impact on different income groups of changes to expenditure on public services.[8] It should be noted that the analysis accounts for around 50% of public expenditure.[9] The chart below shows the estimated benefits in kind considered by the analysis by income quintile:

Chart B.1 Household consumption of benefits in kind by net equivalised income quintile (£ per week 2010-11)



Lower income groups benefit most from the public services expenditure considered by the analysis: the lowest income 20% of households receive more than double that of the highest income 20%.

When these figures are expressed in relation to household income, the differences are more stark:[10]



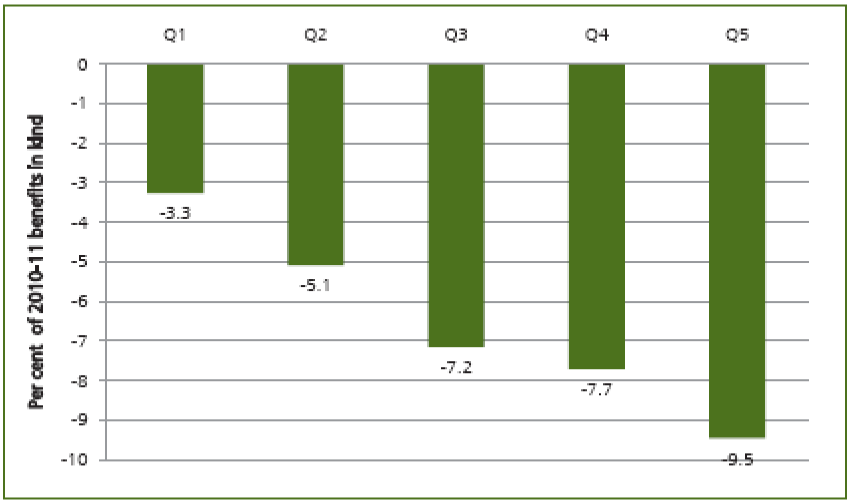
8 HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, para B.1
9 HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, para B.7
10 Based on HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, table B.1

The benefits-in-kind used in the Treasury analysis (which cover half of public expenditure) are equivalent to 83% of average income in the lowest income quintile, compared with 11% of average income in the highest income quintile.

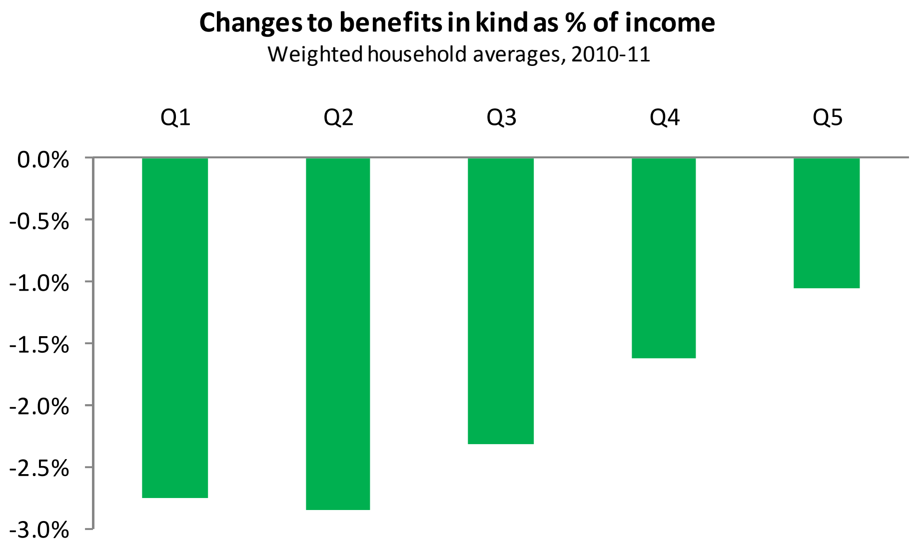
Therefore one would expect spending cuts to have a disproportionate impact on poorer households.

However, the Spending Review Report does emphasise that the nature of the cuts made (largely sparing education, health and social care expenditure), means that this impact is not as dramatic as the chart above suggests.[11] The chart below shows that, as a proportion of consumption of those benefits-in-kind analysed, higher income groups are hit harder:

Chart B.3 Changes in benefits in kind as a percentage of 2010-11 household consumption of benefits in kind.



When these changes are compared with household incomes, those in the second decile are hit hardest, followed by the poorest households. The highest income households are hit least hard:[12]



[11] HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, para B.19

[12] Based on HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, table B.1 and chart B.3

The spending changes announced (and analysed by the Treasury) may therefore be characterised as regressive on the basis of proportions of household income. BBC Economics Editor, Stephanie Flanders, notes that the nature of public spending means this result was almost unavoidable:[13]

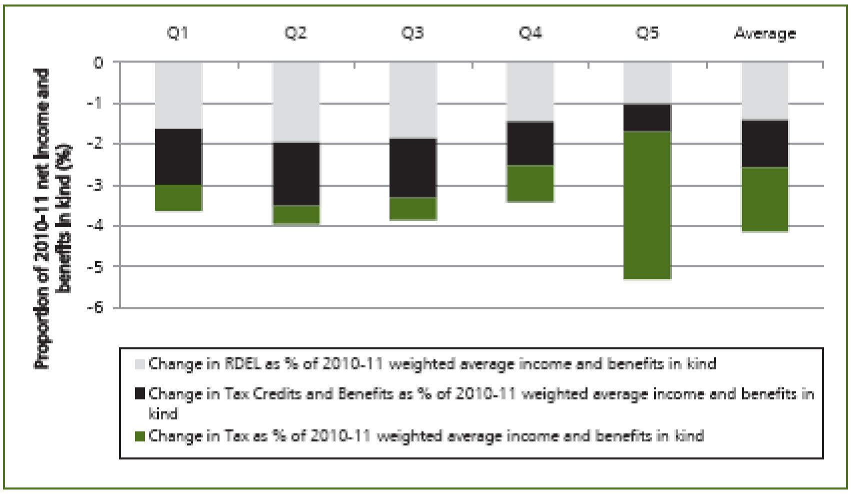
> It would have been almost impossible for the government to avoid this outcome: to cut the deficit, they need to cut government spending, and the lower half of the population is much more dependent on the things that government provides than the top half.

Nevertheless, she notes that "looking at the universal benefits that this spending review has left intact, many economists would say that they have not tried as they might have done to even the score".[14]

5.3 Overall impact

The Treasury have calculated estimates of the combined impact of modelled changes to tax, tax credits, benefits and benefits-in-kind as a proportion of net household income. It should be noted that this includes June 2010 Budget decisions and those announced by the previous Government and retained:

Chart B.6 Impact of the consolidation on households as a per cent of (2010-11) net income (including household benefits in kind)



Overall, the policy changes have the greatest impact on the highest income quintile. This is largely attributable to tax changes (including the decision to retain part of the last Government's National Insurance rise and the new 50p rate of income tax). The second poorest 20% of households are the next most affected.

5.4 Limitations

The analysis above is based on a large range of assumptions and is necessarily simplistic. Annex B of the Spending Review report includes full examinations of the limitations of the various methodologies used.

5.5 IFS comment

The IFS agreed with the Treasury's finding that the benefit changes announced in the Spending Review would hit the bottom half of the income more than the top half (as a share

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13 BBC *Stephanomics* blog, *All in it together?*, 20 October 2010

14 Ibid

of income). The IFS disagreed with the Treasury's claim that the overall package of tax and benefit changes (including those announced by Labour) is progressive. Carl Emmerson, Acting Director, of the IFS said:

> So our analysis continues to show that, with the notable exception of the richest 2%, the tax and benefit components of the fiscal consolidation are, overall, being implemented in a regressive way. But this is not to say that it is unfair: fairness will always be in the eye of the beholder.[15]

The IFS emphasised the problems involved in estimating the distributional effect of changes in public spending on services (as opposed to benefits). It welcomed the Treasury's attempt to model these and noted its finding that the public service spending cuts announced in the Spending Review were regressive.[16]

The IFS's analysis was described by Nick Clegg as "distorted and a complete nonsense." He criticised their emphasis on tax and benefit changes saying they did not take proper account of public services and the pupil premium.[17]

6 Reaction

In his response to the statement, the Shadow Chancellor, Alan Johnson MP, described the Spending Review as a "reckless gamble with people's livelihoods [which] runs the risk of stifling the fragile recovery".[18] He acknowledged that spending had to be reduced but argued that front-line services must be protected.[19] The Shadow Chancellor said that the starting point in reducing the deficit must be growth and jobs. He concluded by saying:

> The difference between us is that the Government are removing almost twice as much from Department budgets, while we were looking for a much more gradual, much slower reduction, which would not stifle the very low levels of growth in our economy. It is our firm belief that the rush to cut the deficit endangers the recovery and reduces the prospects for employment in the short term and for prosperity in the longer term.[20]

The *Financial Times* described the Spending Review as "a gamble given the continuing weakness of the recovery" but supported the decision to cut spending provided growth in the economy returns.[21] *The Times* said that broadly speaking the priorities chosen by the Chancellor were correct but that the changes could be "very painful" for the poor.[22] *The Guardian* commented that the Spending Review was "a major gamble" at a time when economic conditions have deteriorated. Furthermore, the cuts would be focused on the sick, the poor and working parents.[23]

The IFS commented that the cuts to overall public spending over the Spending Review period would be the deepest in real terms since the Second World War and that cuts to spending on services would be the largest since the four years beginning in 1975.

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15 Opening remarks by Carl Emmerson at IFS briefing on the Spending Review, 21 October 2010
16 Ibid
17 "Clegg accuses respected IFS of 'distorted nonsense'", *Guardian*, 22 October 2010
18 HC Deb 20 October 2010 c967
19 HC Deb 20 October 2010 c968
20 HC Deb 20 October 2010 c969
21 "The chancellor spells out his austerity gamble" [Editorial comment], *Financial Times,* 21 October 2010
22 "A New Settlement" [Editorial], *The Times*, 21 October 2010
23 "The work of a gambler" [Editorial], *Guardian*, 21 October 2010

7 Appendix: Departmental spending totals 2010/11 to 2014/15

Total DEL, £ billion

	2010/11	2011/12	2012/13	2013/14	2014/15	Change: 10/11 to 14/15
Education	58.4	56.1	56.3	56.2	57.2	-1.2
NHS (Health)	103.8	105.9	108.4	111.4	114.4	10.6
Transport	12.8	13.0	13.1	12.5	12.0	-0.8
CLG Communities	9.0	5.3	4.0	3.4	3.2	-5.8
CLG Local Government	28.5	26.1	24.4	24.2	22.9	-5.6
BIS	18.6	17.6	16.7	15.5	14.6	-4.0
Home Office	10.1	9.4	9.0	8.4	8.3	-1.8
Justice	8.9	8.6	8.0	7.6	7.3	-1.6
Law Officers	0.7	0.7	0.6	0.6	0.6	-0.1
Defence	32.9	33.8	34.4	34.1	33.5	0.6
FCO	1.6	1.6	1.6	1.5	1.3	-0.3
Int'l Development	7.8	8.1	8.8	11.3	11.5	3.7
Energy & CC	2.9	3.0	3.4	3.5	3.7	0.8
DEFRA	2.9	2.6	2.5	2.3	2.2	-0.7
DCMS	1.5	1.6	1.5	1.3	1.3	-0.2
Work & Pensions	7.0	7.8	7.7	7.8	7.8	0.8
Scotland	28.2	27.3	27.6	27.5	27.7	-0.5
Wales	15.0	14.5	14.5	14.5	14.6	-0.4
Northern Ireland	10.5	10.3	10.3	10.3	10.3	-0.2
HMRC	3.7	3.8	3.6	3.5	3.4	-0.3
HM Treasury	0.2	0.2	0.2	0.2	0.2	0.0
Cabinet Office	0.4	0.5	0.4	0.3	0.5	0.1
Total DEL	**378.2**	**370.1**	**368.8**	**370.1**	**369.1**	**-9.1**

Source: HM Treasury, Spending Review 2010, Table A9, p85

Note: table excludes the Single Intelligence Account, Small and Independent Bodies, the Reserve and Special Reserve and Green Investment Bank. These are included in Total DEL.