"Just the Facts"
Previewing the Comprehensive Spending Review

1. Introduction

On Wednesday 20 October 2010, George Osborne will announce the findings of the coalition government's Comprehensive Spending Review (CSR) to the House of Commons. The media reports that the CSR will result in the most significant falls in public spending Britain has experienced since the war, while some commentators predict widespread job losses, poorer public services, and significant public unrest. But what should we really expect from the CSR? Is it really the exercise in fundamentally shrinking the state that some people would have you believe?

This short briefing examines the spending totals detailed in the June 2010 Emergency Budget, which set the overall framework for the CSR. Essentially, the CSR is an exercise in fleshing out *some* of the spending totals contained in the budget – setting Departmental Expenditure Limits (DELs) for every government department and outlining the policy measures being undertaken to keep spending within these limits.

A clear-eyed analysis of the 2010 budget figures shows that the spending cuts due to be announced in the CSR are not nearly as severe as the political rhetoric would have you believe. While there are indeed going to be significant cuts to some *areas* of public spending, total expenditure will only fall very slightly over the five years to 2015-16 – by 1.5 percent in real terms.

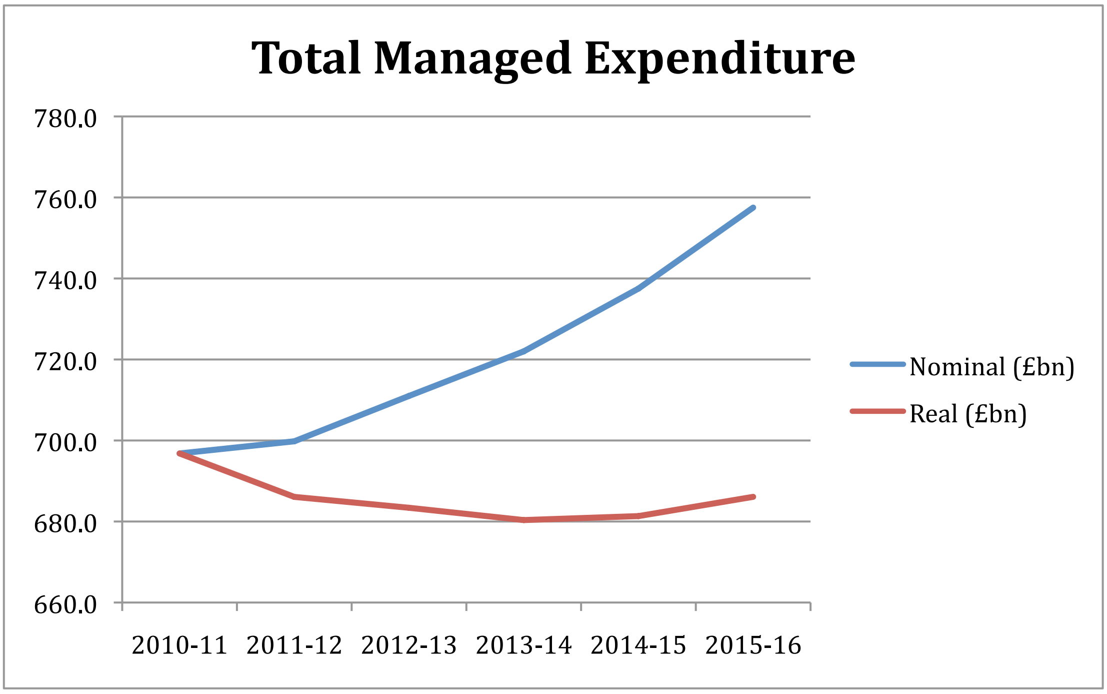
2. Total Managed Expenditure (TME)

TOTAL MANAGED EXPENDITURE

	Nominal (£bn)	% Change	Real (£bn)	% Change
2010-11	696.8		696.8	
2011-12	699.8	0.4	686.1	-1.5
2012-13	711.0	1.6	683.4	-0.4
2013-14	722.0	1.5	680.4	-0.4
2014-15	737.5	2.1	681.3	0.1
2015-16	757.5	2.7	686.1	0.7
TOTAL CHANGE	60.7	8.7	-10.7	-1.5

Over the five years to 2015-16, nominal TME will actually rise by 8.7 percent, from £696.8bn in 2010-12 to £757.5bn in 2015-16. However, if you allow for 2 percent a year inflation then – in constant 2010-11 prices – public spending falls by 1.5 percent over the period, from £696.8bn to £686.1bn. Quite plainly, that *is* a cut, but it is not a hugely significant one, especially when you consider that TME grew by almost 60 percent in real terms under the Labour goverments led by Tony Blair and Gordon Brown.

The chart below displays this modest spending reduction in graphical form.



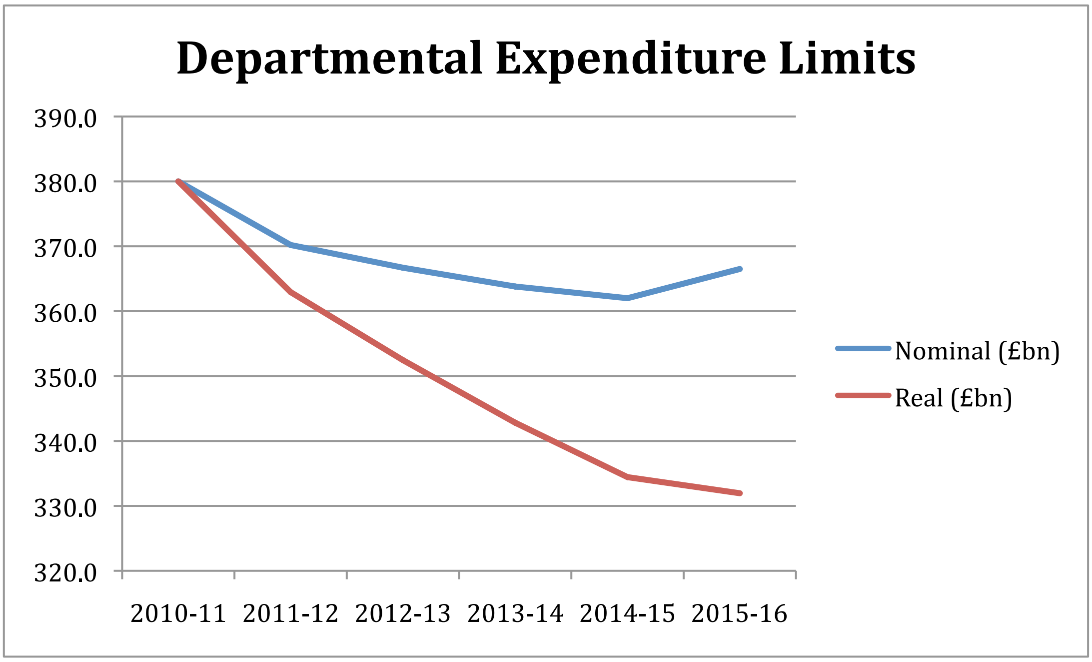
3. Departmental Expenditure Limits (DELs)

But how does the modest decline in Total Managed Expenditure proposed by government fit with the 10, 25, and even 40 percent cuts that are being talked about? The answer is that the cuts in question are not cuts in TME, but rather reductions in Departmental Expenditure Limits – the total amount of discretionary spending allocated to each government department. This is only one half of total public spending – the other half is Annually Managed Expenditure (AME). Here's what is going to happen to DELs between now and 2015-16:

DEPARTMENTAL EXPENDITURE LIMITS

	Nominal (£bn)	% Change	Real (£bn)	% Change
2010-11	380.0		380.0	
2011-12	370.2	-2.6	362.9	-4.5
2012-13	366.7	-0.9	352.5	-2.9
2013-14	363.8	-0.8	342.8	-2.7
2014-15	362.0	-0.5	334.4	-2.4
2015-16	366.5	1.2	332.0	-0.7
TOTAL CHANGE	-13.5	-3.6	-48.0	-12.6

In real terms, DELs fall by £48bn – a 12.6 percent drop over the projected period. This figure applies to DELs in total. The point of the CSR is to set the DELs for each individual department, and within this exercise there are going to be significant variations. Health and International Development are guaranteed annual real terms rises, while the Education and Defence departments are semi-protected, with total cuts not expected to be more than 10 percent. The expected range for other departments is thought to be cuts of between 25 and 40 percent. According to Policy Exchange's Andrew Lilico this suggests an average 33 percent reduction to their DELs over the period covered by the CSR.



4. Annually Managed Expenditure (AME)

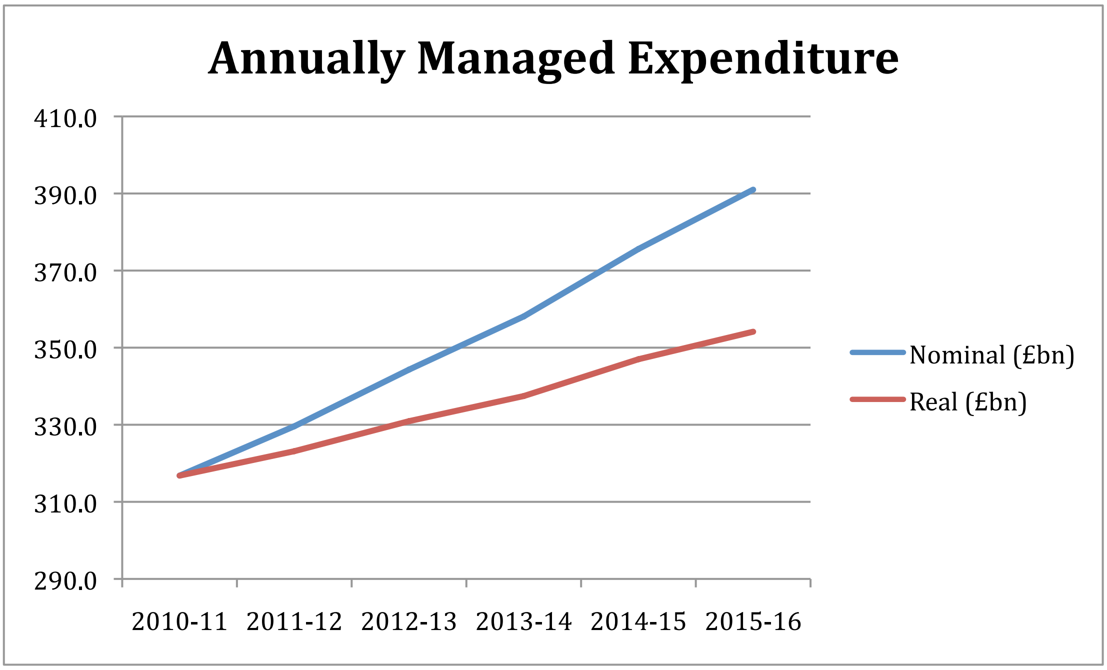
The cuts to DELs outlined above are clearly significant, and some unprotected departments will experience a real squeeze. However, it is important to remember that DELs are only one part of public spending. AME is almost as substantial, and here the picture painted by the June Budget is very different.

AME consists of those areas of public spending that are not within government departments' discretionary control in the short-term. Spending on things like social security (benefits and pensions), tax credits, net payments to the EU, and debt interest payments fall within this category.

ANNUALLY MANAGED EXPENDITURE

	Nominal (£bn)	% Change	Real (£bn)	% Change
2010-11	316.8		316.8	
2011-12	329.6	4.0	323.1	2.0
2012-13	344.3	4.5	330.9	2.4
2013-14	358.1	4.0	337.4	2.0
2014-15	375.6	4.9	347.0	2.8
2015-16	391.0	4.1	354.1	2.1
TOTAL CHANGE	74.2	23.4	37.3	11.8

Here, despite the political rhetoric about unprecedented cuts, there will continue to be substantial spending rises over the next five years. In real terms, AME will rise by £37.3bn (or 11.8 percent) between now and 2015-16. This is driven in large part by debt interest costs (which will be 39.1 percent higher in 2015-16 than they are today) but also by increased welfare bills and EU contributions. It is because AME will continue to rise that the proposed cuts to DELs will not deliver substantial overall cuts in public expenditure.



5. Current vs. Capital Spending

Total Managed Expenditure is not just split into Departmental Expenditure Limits and Annually Managed Expenditure. It can also be broken down into current spending and capital spending. First, some definitions:

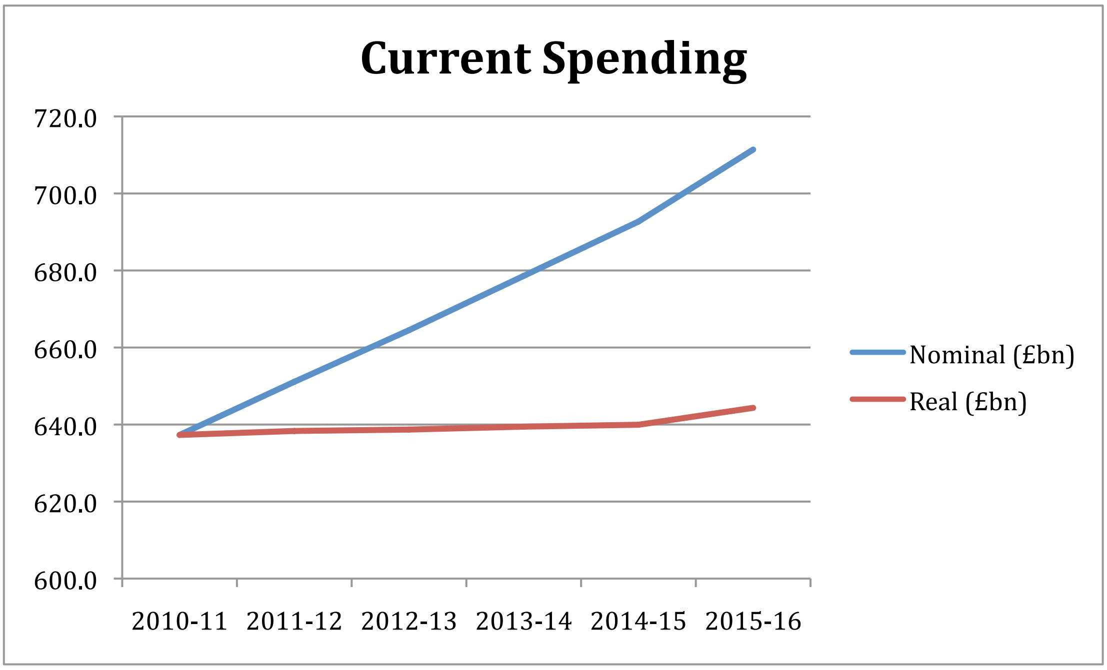
Current expenditure is recurring spending or, in other words, spending on items that are consumed and only last a limited period of time (i.e. most public spending).

Capital expenditure is spending on assets. It is the purchase of items that will last and will be used time and time again in the provision of a good or service (i.e. new roads, or hospitals, IT projects, and so on).

Looking at the way the cuts are being distributed between capital and current spending is quite instructive. First, current spending. As the table below shows, current spending will rise (albeit slowly) every year between now and 2015-16, in real terms. The total rise will be 1.1 percent over the period, from £637.3bn to £644.3bn. That is not to say that every department will see a real terms rise. Indeed, it is likely that greater rises in health spending will be offset by real terms falls in other areas.

CURRENT SPENDING

	Nominal (£bn)	% Change	Real (£bn)	% Change
2010-11	637.3		637.3	
2011-12	651.1	2.2	638.3	0.2
2012-13	664.5	2.1	638.7	0.1
2013-14	678.6	2.1	639.5	0.1
2014-15	692.7	2.1	639.9	0.1
2015-16	711.4	2.7	644.3	0.7
TOTAL CHANGE	74.1	11.6	7.0	1.1

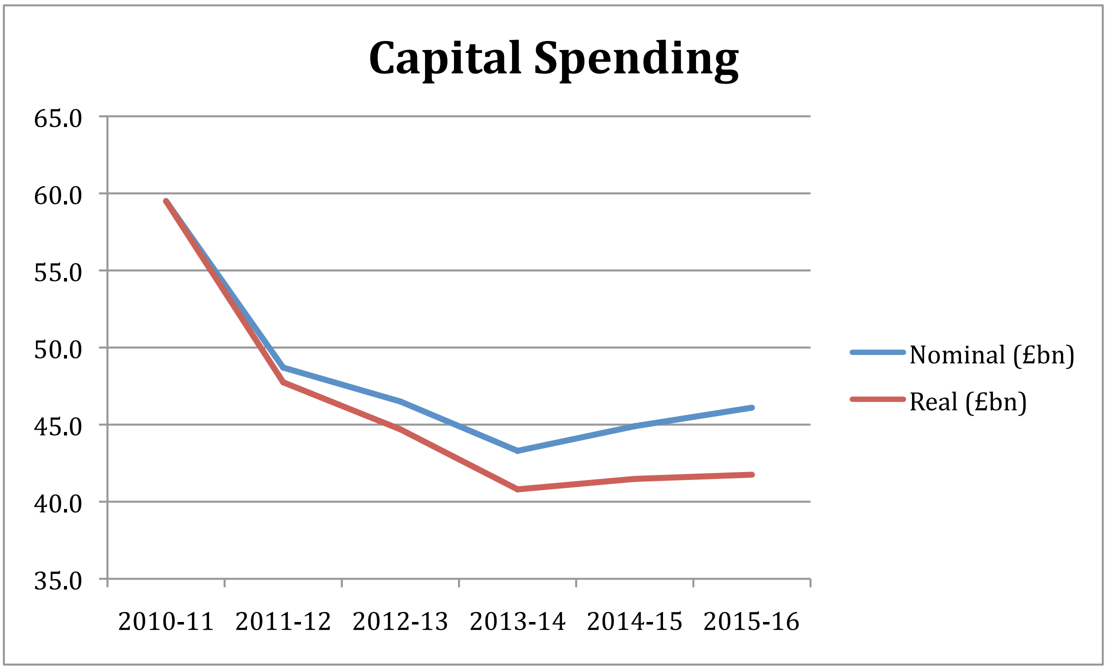


However, while current spending is protected under the plans laid out in the June Emergency Budget, capital spending will be cut quite severely, falling by 29.8 percent (or £17.7bn).

CAPITAL SPENDING

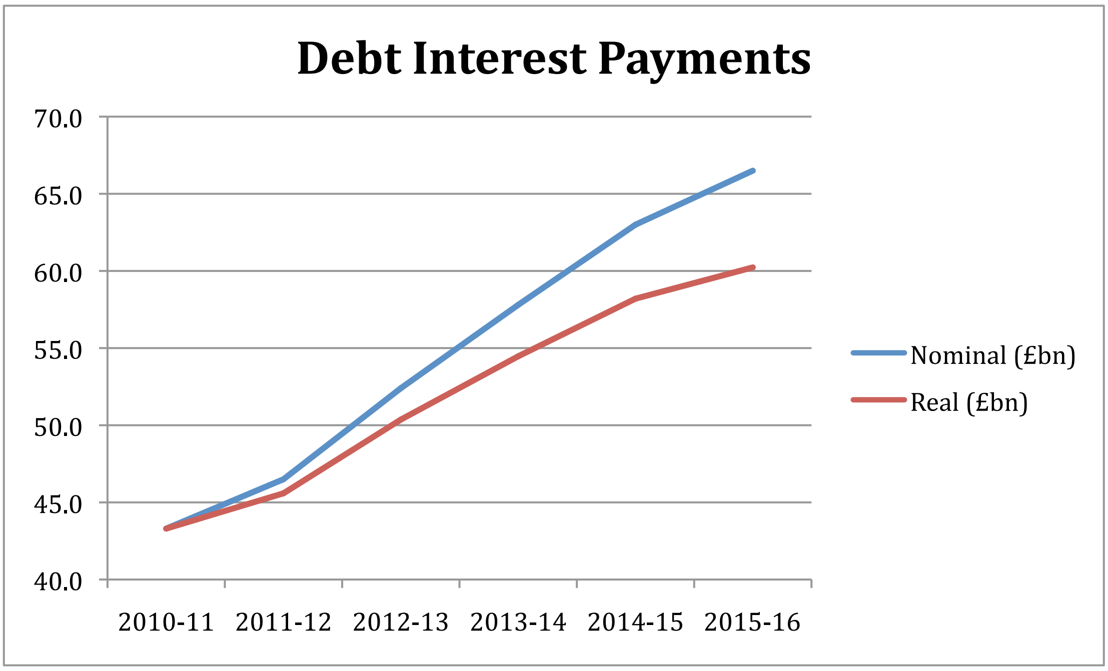
	Nominal (£bn)	% Change	Real (£bn)	% Change
2010-11	59.5		59.5	
2011-12	48.7	-18.2	47.7	-19.8
2012-13	46.5	-4.5	44.7	-6.4
2013-14	43.3	-6.9	40.8	-8.7
2014-15	44.9	3.7	41.5	1.7
2015-16	46.1	2.7	41.8	0.7
TOTAL CHANGE	-13.4	-22.5	-17.7	-29.8

Again, it is quite clear that just as DELs are due to be cut while AME continues to rise, the Chancellor's axe is going to fall heavily on capital spending while current spending survives relatively unscathed.



6. Debt Interest Payments and Total Managed Expenditure

As noted above, debt interest payments are set to rise significantly over the next five years. In real terms they will go from £43.3bn in 2010-11 to £60.2bn in 2015-16 – a rise of almost 40 percent.



The table below displays annual figures for projected debt interest payments.

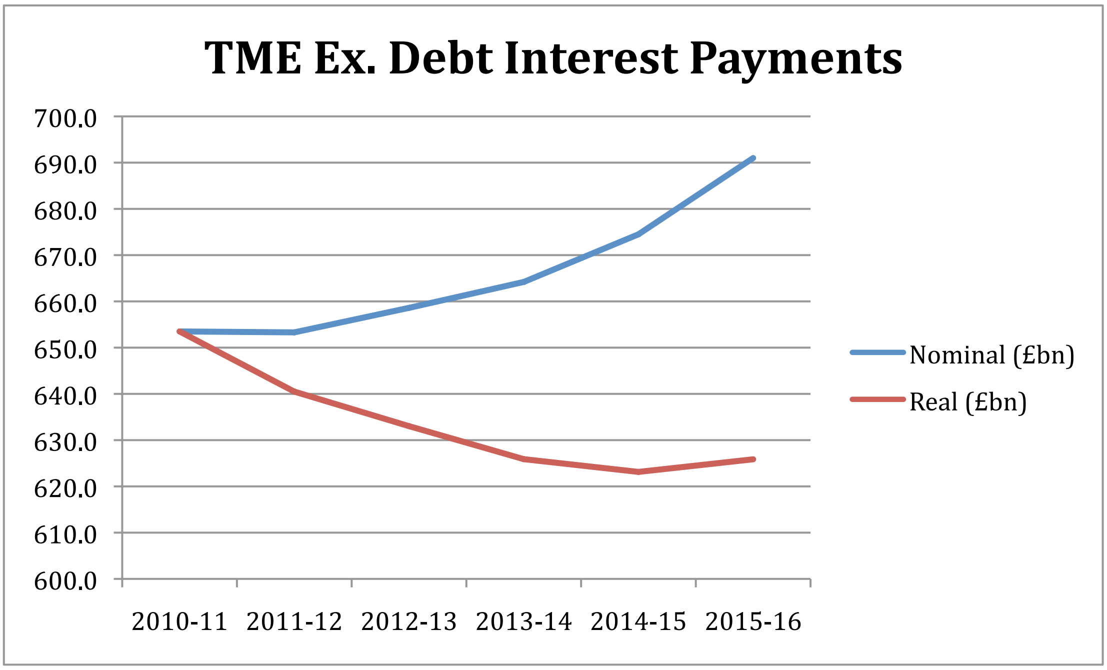
DEBT INTEREST PAYMENTS

	Nominal (£bn)	% Change	Real (£bn)	% Change
2010-11	43.3		43.3	
2011-12	46.5	7.4	45.6	5.3
2012-13	52.4	12.7	50.4	10.5
2013-14	57.8	10.3	54.5	8.1
2014-15	63.0	9.0	58.2	6.9
2015-16	66.5	5.6	60.2	3.5
TOTAL CHANGE	23.2	53.6	16.9	39.1

It is probably fair to argue that debt interest payments are the only part of public spending that are truly beyond the control of the government of the day, except in so far as their policy decisions may impact on interest rates, or prevent the public sector from running up more debt. Essentially then, there is not much the government can do (short of sovereign default) to get out of making interest payments. It may therefore be instructive to look at projections for Total Managed Expenditure excluding debt interest payments over the next five years.

TME EX. DEBT INTEREST PAYMENTS

	Nominal (£bn)	% Change	Real (£bn)	% Change
2010-11	653.5		653.5	
2011-12	653.3	0.0	640.5	-2.0
2012-13	658.6	0.8	633.0	-1.2
2013-14	664.2	0.9	625.9	-1.1
2014-15	674.5	1.6	623.1	-0.4
2015-16	691.0	2.4	625.9	0.4
TOTAL CHANGE	21.0	3.2	-27.6	-4.2



The conclusion to be drawn from this is that, based on the projections contained in the June 2010 Emergency Budget, Total Managed Expenditure excluding debt interest payments will fall by £27.6bn in real terms in the period 2010-11 to 2015-16 – a drop of 4.2 percent. Again, this *is* a significant cut, but it pales in comparison to the unprecedented spending rises overseen by the last government.

Conclusion

An unbiased assessment of the spending totals outlined in the Emergency Budget allows us to say the following about what is going to happen to public spending over the next five years. In constant 2010-11 prices (assuming 2 percent a year inflation):

- Total Managed Expenditure will go down by 1.5 percent.
- Departmental Expenditure Limits will be cut sharply, by 12.6 percent.
- Annually Managed Expenditure, meanwhile, will rise by 11.8 percent.
- Current spending will rise very slowly, by a total 1.1 percent over the period.
- Capital spending will fall rapidly, by a total of 29.8 percent over the period.

The point of the Comprehensive Spending Review is to divide up the total figure for Departmental Expenditure Limits between the various government departments, and to outline the policy measures that will be undertaken to keep spending within those limits.

The ring-fencing of Health and International Development, and the semi-protected status of Education and Defence, means that much more significant cuts will have to be made to the Departmental Expenditure Limits of other departments.

However, it is important to remember that cuts in Departmental Expenditure Limits will largely be counter-balanced by rises in Annually Managed Expenditure. The fall in total spending will be correspondingly modest. It is also important to bear in mind that the focus of the overall cuts will be on capital expenditure. The noticeable impact on the average public service user will therefore be limited.

Finally, it may be that the fairest measure on which to assess the coalition government's spending plans is that of Total Managed Expenditure excluding debt interest payments. On this basis, public spending will fall by 4.2 percent over the five years to 2015-16. Whatever we hear about particular cuts to specific spending areas on Wednesday, this is the overall figure to keep in mind.