



IFS

The Institute for Fiscal Studies

**ELECTION  
BRIEFING 2001**

SERIES EDITORS: TOM CLARK AND ANDREW DILNOT



---

**PUBLIC SPENDING: WHAT ARE THE  
OPTIONS BEYOND MARCH 2004?**

*Carl Emmerson*

### **Funding**

We would like to thank the Economic and Social Research Council ([www.esrc.ac.uk](http://www.esrc.ac.uk)) for supporting this work through funding for the ESRC Centre for the Microeconomic Analysis of Fiscal Policy (Grant number M544285002).

This document is published on the IFS website, [www.ifs.org.uk/election/index.shtml](http://www.ifs.org.uk/election/index.shtml) (May 2001).

# Public spending: What are the options beyond March 2004?

The Labour party's manifesto only contains details of public expenditure plans to the financial year 2003–04. The Conservative's manifesto commits them to spending £8bn less than Labour's plans in that year, and says that, "We will be a tax-cutting government". Whoever wins the next election might well have to make choices about public spending and taxation in both 2004–05 and 2005–06. Higher growth in public spending would be likely to facilitate improvement in the quality of public services while lower growth in public spending would be likely to allow lower levels of taxes as a share of national income.

This short note outlines some possible scenarios for the path of public spending beyond March 2004. If Labour were to be re-elected, and their plans for public spending met, then spending would be 40.3% of national income in 2003–04. Whoever was the government at that point would have to decide what level of spending growth should continue beyond that point. If spending were to increase in line with growth in national income then, for a given level of public borrowing, taxes would need also to be kept constant as a share of national income. If total spending were to grow by less than growth in national income then some reductions in the tax take as a share of national income would be possible without increasing public borrowing. Figures for this are shown in table 1 and assume 2.5% real annual growth in national income. Under this assumption spending growth of 2% a year in real terms would allow reductions in tax as a share of national income of £2bn a year. Alternatively spending could be increased more quickly than national income. Again assuming 2.5% growth in national income increases in spending of 3.3%, which is the same increase as planned in the last spending review, would require increases in taxes as a share of national income of £3bn a year for borrowing to be left unchanged.<sup>1</sup>

The chosen growth in public spending beyond 2003–04 is likely to have implications for the quality of public services. Both Labour and the Conservatives have pledged to large real increases in spending on the NHS and on education between April 2001 and March 2004 of 5.7% and 5.6% a year in real terms respectively. It is, as yet, unknown whether the main political parties believe that these increases in spending should persist beyond March 2004. In addition we do not know what plans they have for social security spending. Under Labour's plans for public spending this is forecast to grow at 2.2% a year in real terms over the next three years, significantly below the 4.1% growth seen on average from 1950–51 to 1999–2000.<sup>2</sup>

---

<sup>1</sup> For more details see HM Treasury (2000), *Spending Review 2000*, London: The Stationary Office, Cm. 4807 (<http://www.hm-treasury.gov.uk/sr2000/index.html>).

<sup>2</sup> Source: Emmerson, C. and Leicester, A. (2000), *A survey of the UK benefit system*, Briefing Note No. 13, London: IFS (<http://www.ifs.org.uk/taxsystem/contents.shtml>).

Both main parties have stressed the need for large real increases in spending on the NHS (5.7% per year) and education (5.6% per year) over the next three years. This makes it interesting to consider what would happen if this growth were to continue beyond that point. The fiscal implications of this happening would in large part depend on what happens to the path of social security spending. Social security spending is forecast to grow by 2.2% a year in real terms over the next three years. On the basis of Labours' spending plans growth in spending on these three areas is forecast to be 4.0% a year in real terms over the next three years; constituting nearly 60% of government spending. For the purpose of this illustrative exercise we assume that growth in these three areas continues at this rate beyond 2003–04.

Table 1 shows that if total spending growth is to remain in line with the expected growth in national income then our scenario implies growth of just 0.6% a year in the remaining 40% of government. If overall spending were to grow more slowly than this, then such 'other' spending would likely be cut. Higher growth in total public spending of 3.3% a year would allow the large increases in spending on the NHS, education and social security to continue while growth in other areas of public spending would be likely to be able to grow by 2.4% a year in real terms.

**Table 1. A menu of options for the next Government.**

Growth in total spending from 2003–04 onwards	Spending as % of GDP in 2005–06	Resulting tax increase, £bn / year from 2004–05 onwards	Assumed growth in NHS, education and social security spending	Growth in spending on other areas
1.0	39.2	–6	4.0	–3.0
2.0	39.9	–2	4.0	–0.6
2.5	40.3	0	4.0	0.6
3.3	41.0	3	4.0	2.4
3.8	41.4	5	4.0	3.6

Note: Assumes GDP growth of 2½ percent a year. £bn figures in 2000–01 prices. Growth in NHS, education and social security spending assumed to remain at the growth forecast over the next three years. Social security spending includes spending on the working families tax credit and the disabled persons tax credit.

In the examples outlined above we have assumed that social security spending only grows at 2.2% a year in real terms. Historically it has grown faster than this – for example over the 18 years of Conservative government from 1979 to 1997 it grew by an average of 3.6% a year in real terms. Higher growth in social security spending would make it harder to achieve any of the scenarios outlined above, and it is worth noting that the Labour party's commitment to a pension credit, integrated child credit and employment tax credit are not yet included planned spending. We have also not taken into account any other objectives that the next government may have – for example if the goal of abolishing child poverty is to be met then this is likely to require ongoing real increases in the generosity of some transfer payments.

It will always be the case that, for a given level of public borrowing, higher or lower levels of public spending as a share of national income imply higher or lower levels of taxes. While we do not expect political parties to publish detailed spending proposals for the whole of the next parliament indications of

the desired growth in spending on key services such as the NHS and education would certainly be informative. Similarly if parties propose lower growth in spending then they should state in which areas of public spending they believe lower growth should occur.