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SERIES EDITORS: TOM CLARK AND ANDREW DILNOT

SPENDING ON PUBLIC SERVICES

Carl Emmerson
Chris Frayne

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Spending on public services

Election Briefing Note 2 shows that public spending as a share of GDP is now lower than it was at the end of the previous Parliament. This Briefing Note looks in detail at public spending, starting with National Health Service and education spending and comparing the increases in spending over this Parliament with the record of the previous Conservative government.

1. Spending on the NHS

The 1997 Labour Party manifesto committed the government to 'raise spending on the NHS in real terms every year'. Historically, this did not necessarily imply any difference from the increases in spending seen in the past, as, since 1979–80, the NHS has received a real increase in spending every year.[1] Despite the pledge to keep to the departmental spending plans set down in the November 1996 Budget in the first two years of the Parliament, the government did add to the NHS allocations in both 1997–98 and 1998–99.[2] This was consistent with the policy of the previous Conservative administration, which often made additional resources available to the NHS over and above its planned levels of spending.[3]

Despite these additional funds, NHS spending over the first two years of this Parliament grew by an average of just 2.2% a year in real terms – a lower increase than the 3.1% achieved over the Conservatives' 18 years in office. The July 1998 Comprehensive Spending Review set the spending plans for the next three years and allocated larger real increases in spending to the NHS for 1999–2000 to 2001–02.[4] Again, this did not necessarily mark a break from the past, since the NHS had often experienced years of lower increases in spending followed by years of larger increases in spending.

Despite the Chancellor's assertion that the 'first innovation of the Comprehensive Spending Review is to move from the short-termism of the annual cycle and to draw up public expenditure plans not on a one year basis but on a three year basis',[5] the March 2000 Budget gave the NHS a further

[1] C. Emmerson, C. Frayne and A. Goodman, *Pressures in UK Healthcare: Challenges for the NHS*, Commentary no. 81, IFS, London, 2000 (http://www.ifs.org.uk/health/nhsspending.pdf).

[2] Among other things, additional funds were made available in 1997–98 from a reduction in spending on defence (£168m) and on the public sector nuclear industry (£102m) and in 1998–99 from funds in the contingency reserve that were not needed (£1.2bn). For more details, see A. Dilnot and C. Giles (eds), *The IFS Green Budget: January 1998*, Commentary no. 69, IFS, London, 1998.

[3] See A. Dilnot and P. Johnson, *Election Briefing 1997*, Commentary no. 60, IFS, London, 1997.

[4] HM Treasury, *Comprehensive Spending Review, July 1998*, HM Treasury, London, 1998 (http://www.hm-treasury.gov.uk/pub/html/csr/index.html).

[5] The Chancellor's speech announcing the Comprehensive Spending Review. Source: *Hansard*, 14 July 1998, column 187.

substantial increase in resources in both 2000–01 and 2001–02. This Budget also set out NHS spending plans for 2002–03 and 2003–04, which again were added to in the recent March 2001 Budget. As a result, the spending increases seen over this Parliament do now genuinely appear to represent a break from those seen previously. As shown in Table 1, spending is set to increase by an average 4.8% a year over this Parliament, compared with 2.6% a year in the previous Parliament and 3.1% over the Conservatives' four terms. These increases are also considerably higher than the 3.5% average annual increases that the NHS has received over its entire history.

Table 1. Real increases in NHS spending, various periods

	Annualised average real increase (%)
Comparisons across Parliaments	
This Parliament: *April 1997 to March 2001*	4.8
This Parliament: *April 1997 to March 2002*	5.1
Last Parliament: *April 1992 to March 1997*	2.6
Conservative years: *April 1979 to March 1997*	3.1
of which:	
John Major's period in office: *April 1991 to March 1997*	3.3
Margaret Thatcher's period in office: *April 1979 to March 1991*	3.0
Other periods of interest	
Current planned expenditure: *April 2001 to March 2004*	5.7
First two years of this Parliament: *April 1997 to March 1999*	2.2
Five-year increase from start of first CSR: *April 1999 to March 2004*	6.4
Highest five-year increase in history of the NHS: *April 1971 to March 1976*	6.4
Last 47 years: *April 1954 to March 2001*	3.8
History of NHS (last 51 years): *April 1950 to March 2001*	3.5

Notes: NHS spending is defined here as UK National Health Service expenditure net of NHS charges and receipts. For the periods in office of each political party and each Prime Minister, we assign financial years according to who was in office for the majority of months in that financial year. For example, Margaret Thatcher, who was Prime Minister from May 1979 to November 1990, is assumed to have determined public spending in the years from 1979–80 to 1990–91 inclusive.

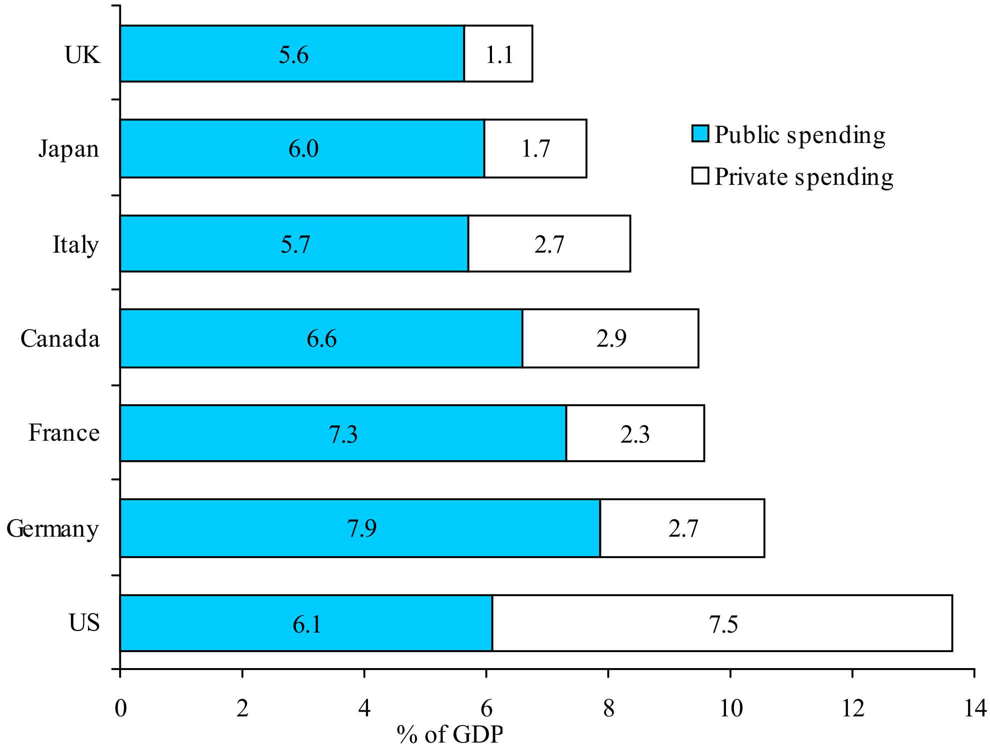
Sources: Department of Health, *The Government's Expenditure Plans*, various years (http://www.doh.gov.uk/dohreport/report2000/dr2000.html); Office of Health Economics, *Compendium of Health Statistics*, various years; HM Treasury, *Financial Statement and Budget Report, March 2001*, Hc279, The Stationery Office, London, 2001 (http://www.hm-treasury.gov.uk/budget2001/index.html). Spending figures deflated using the latest GDP deflators from the Office for National Statistics.

The planned increases in spending over the next three years to March 2004, which the current government has committed to, are set to average 5.7% a year in real terms – significantly higher than the increases seen in recent years. Interestingly, the five-year increase in spending from the start of the Comprehensive Spending Review in April 1999 is set to average 6.4% a year, which is equal to the highest-ever five-year increase that the NHS has received.

How do we compare internationally?

One of the justifications for the large increases in NHS spending planned for the next three years is that, compared with other countries, the UK spends a relatively low share of GDP on healthcare. Figure 1 shows that the UK's healthcare sector, at 6.7% of GDP, takes the smallest share of national income of all the G7 countries. The US is the biggest health spender among this group, with almost 14% of its GDP going to healthcare. Germany and France also have relatively large healthcare sectors: they take up 10.6% and 9.6% of their GDP respectively. Health spending in Japan and Italy is closer to that of the UK; both countries have a public sector of similar size but a larger private sector.

Figure 1. Public and total health expenditure as a percentage of GDP in the G7 countries, 1998



Source: *OECD Health Data 2000: A Comparative Analysis of 29 Countries*, CD-ROM.

It should be noted, however, that a lower share of GDP spent on health than in other countries should not necessarily be taken to imply a lower, or in some way less adequate, standard of healthcare. There are likely to be different costs of production and different levels of health – for example, due to exercise, diet and smoking patterns – between countries.[6] Despite being the second-lowest spender among G7 countries, Japan has the highest life expectancy for both

[6] For a discussion of all these issues, see, for example, O. Morgan, 'A cue for change: global comparisons in healthcare', Social Market Foundation, Discussion Paper no. 41, 1999.

men and women and the lowest level of infant mortality.[7] Levels of health spending could also vary due to different countries having different desired levels of healthcare.

Looking closer to home, within the EU, only Luxemburg (5.9%) and the Republic of Ireland (6.4%) have a smaller healthcare sector than the UK. Current government policy is that health spending should be increased towards the EU average. Across the European Union, average health spending in 1998 was 8.7% of GDP, with the average once the relatively low UK spending is excluded being 9.1% of GDP.[8] While the government's planned increases in NHS spending could increase health spending by 1.0% of GDP between 1998–99 and 2003–04, these increases alone will not be sufficient to close the gap between UK health spending and the EU average by March 2004. For example, assuming that the UK private sector and spending elsewhere in the EU remain constant as a share of national income, the gap between the UK and average spending in 2003–04 will still be equal to 1.3% of GDP, or £13.3bn in 2001–02 prices.

2. Spending on education

In contrast to the pledge made on the NHS, the 1997 Labour Party manifesto was more generous to education, stating that 'Education will be our number one priority, and we will increase the share of national income spent on education as we decrease it on the bills of social and economic failure'. Table 2 shows that, over the Conservatives' 18 years in office from 1979, education spending increased by an average 1.5% a year in real terms. Despite supposedly being the government's number one priority, education spending received an average real increase in spending of just 2.0% a year over the first two years of the Parliament, lower than the 2.9% average annual increase in GDP for the same period.

Along with health, education was the big winner from the July 1998 Comprehensive Spending Review.[9] Unlike health, the July 1998 education spending announcement implied a break from the past, since the Conservatives had been relatively less generous to education than they were to health. Again like health, the March 2000 Budget added additional resources to the supposedly fixed spending entitlements. As a result, spending over this Parliament is set to increase by 3.6% a year. Planned average increases in spending over the next three years from April 2001 to March 2004 are even

[7] C. Emmerson, C. Frayne and A. Goodman, *Pressures in UK Healthcare: Challenges for the NHS*, Commentary no. 81, IFS, London, 2000 (http://www.ifs.org.uk/health/nhsspending.pdf).

[8] Countries have been weighted by the size of their GDP. Currencies have been converted using 1998 exchange rates. An alternative methodology is to use purchasing power parities, but in practice this makes little difference. For a discussion of the weighted and the less meaningful unweighted averages, see L. Chennells, A. Dilnot and C. Emmerson (eds), *The IFS Green Budget: January 2000*, Commentary no. 80, IFS, London 2000 (http://www.ifs.org.uk/gbfiles/gb2000.shtml).

[9] HM Treasury, *Comprehensive Spending Review, July 1998*, HM Treasury, London, 1998 (http://www.hm-treasury.gov.uk/pub/html/csr/index.html).

higher, at 5.6% a year in real terms. This is slightly below the 5.7% a year real increase in spending planned for the NHS over the same period.

Table 2. Real increases in education spending, various periods

	Annualised average real increase (%)
Comparisons across Parliaments	
This Parliament: *April 1997 to March 2001*	3.6
This Parliament: *April 1997 to March 2002*	4.0
Last Parliament: *April 1992 to March 1997*	1.7
Conservative years: *April 1979 to March 1997*	1.5
of which:	
John Major's period in office: *April 1991 to March 1997*	2.1
Margaret Thatcher's period in office: *April 1979 to March 1991*	1.2
Other periods of interest	
Current planned expenditure: *April 2001 to March 2004*	5.6
First two years of this Parliament: *April 1997 to March 1999*	2.0
Five-year increase from start of first CSR: *April 1999 to March 2004*	5.4

Notes: UK education spending, excluding the sale of the student loan book in 1997–98 and 1998–99. For the periods in office of each political party and each Prime Minister, we assign financial years according to who was in office for the majority of months in that financial year. For example, Margaret Thatcher, who was Prime Minister from May 1979 to November 1990, is assumed to have determined public spending in the years from 1979–80 to 1990–91 inclusive.
Sources: HM Treasury, *Public Expenditure Statistical Analyses*, various years (most recent – http://www.hm-treasury.gov.uk/docs/2001/pesa_0304.html); HM Treasury, *Financial Statement and Budget Report*, various years (most recent – http://www.hm-treasury.gov.uk/budget2001/index.html). Spending figures deflated using the latest GDP deflators from the Office for National Statistics.

Since education spending has grown more quickly than growth in the economy (3.6% versus 2.9%), the government has met its manifesto commitment to increase spending as a share of GDP. This has increased from 4.7% in 1996–97 to 4.9% in 2000–01. Current forecasts suggest that the planned increases will see it continue to climb, to 5.3% in 2003–04. Average education spending over this Parliament will be 4.7% of GDP, which is actually lower than the 5.0% achieved by the Conservatives in the last Parliament. This is because education spending fell continuously as a share of GDP from 5.1% in 1992–93 to 4.5% in 1999–2000 and has only started increasing since April 2000. It is important to remember that, while spending as a share of GDP is a good measure of the government's priorities, the changes in economic growth should also be taken into account. Over the last Parliament, GDP grew by an annual average 2.6% compared with forecast growth of 2.9% over the first four years of this Parliament. This means that an increase in the share of GDP spent on education represents a higher real increase in such spending during this Parliament than during the previous one.

3. Other areas of government spending

Election Briefing Note 2 highlights the fact that total public spending has grown less quickly under this Parliament than under either the previous Parliament or the Conservatives' entire period in office from 1979, while the NHS and education have received significantly greater increases in spending than in either of those two periods. This has been possible because combined spending on the NHS and on education only make up 27% of total public spending, and spending in other areas has grown less quickly.

Social security spending

Social security spending, defined here to include items such as the working families' tax credit that have previously been considered to be social security benefits, has grown in real terms by an average of just 1.1% a year over this Parliament compared with 3.9% a year over the last Parliament, as shown in

Table 3. Real increases in selected components of public spending over various periods

	Real average annual increase over: Tories from 1979 to 1997	Last Parliament, April 1992 to March 1997	This Parliament to March 2001	This Parliament to March 2002	Labour's planned increase from April 2001 to March 2004
Total spending	1.7	2.0	1.4	1.9	3.7
of which:					
Education	1.5	1.7	3.6	4.0	5.6
NHS	3.1	2.6	4.8	5.1	5.7
Social security	3.6	3.9	1.1	1.7	2.2
Defence	–0.2	–3.0	–1.3	–1.2	–0.2
Transport	n/a	–2.9	–1.4	–0.0	11.5
Debt interest	n/a	8.5	–3.6	–6.1	–5.7
Memo: GDP growth	2.1	2.6	2.9	2.8	2.5

Notes: Includes spending financed by the windfall tax. Hence figures given for growth in total spending over the current Parliament and under Labour's plans are slightly higher than those shown in Election Briefing Note 2, Table 1, which excludes the windfall tax and associated spending. UK education spending excludes the sale of the student loan book in 1997–98 and 1998–99. UK NHS spending is net of NHS charges and receipts. Social security spending includes benefit expenditure administered by the DSS, administration costs of running the DSS plus expenditure on the working families' tax credit and the disabled person's tax credit in order to ensure consistency over time. Spending on defence excludes revenues from the sale of married quarters in 1996–97 and 1997–98. Debt interest is central government interest payments only.

Sources: Department of Health, *The Government's Expenditure Plans*, various years (most recent – http://www.doh.gov.uk/dohreport/report2000/dr2000.html); Office of Health Economics, *Compendium of Health Statistics*, various years; Department of the Environment, Transport and the Regions, *Transport 2010: The 10 Year Plan*, DETR, London, 2000 (http://www.detr.gov.uk/trans2010/index.htm); HM Treasury, *Public Expenditure Statistical Analyses*, various years (most recent – http://www.hm-treasury.gov.uk/docs/2001/pesa_0304.html); HM Treasury, *Financial Statement and Budget Report*, various years (most recent – http://www.hm-treasury.gov.uk/budget2001/index.html). Spending figures deflated using the latest GDP deflators from the Office for National Statistics.

Table 3. This is particularly important since spending on social security is the biggest single element of public expenditure, comprising 30% of all government spending. As in spending on health and education, there is an interesting contrast between the first two years of the Parliament and the subsequent years. Between April 1997 and March 1999, social security spending fell by an average 1.0% a year, while in the following two years, from April 1999 to March 2001, it is forecast to rise by an average of 3.3% a year. While this is partly explained by the fact that unemployment fell by more in the first two years of this Parliament than it did in years three and four, it is also true that many of the increases in social security benefits, such as the working families' tax credit, income support for those with children, the basic state pension and the minimum income guarantee for pensioners, have come in the second half of this Parliament.

Going forward, the government's forecasts for social security spending imply an average 2.2% a year real increase in spending over the next three years. It is important to note that these are based on current policies. Hence the cost of measures that the government is currently consulting on, and, if re-elected, seems likely to implement, is not included in the current plans. These measures include the integrated child credit, the employment tax credit and the pension credit.[10]

Spending on other areas

Table 3 also shows that the current government has benefited from reductions in debt interest spending averaging 3.6% a year between April 1997 and March 2001. This compares with an 8.5% average annual real increase in spending on debt interest over the last Parliament. This reduction in debt interest is a result both of the increases in taxes and reductions in overall public spending described in Election Briefing Note 2 leading to a lower stock of debt and of low interest rates reducing the interest payments for any given amount of debt.

The current government has also cut defence spending, by 1.3% a year on average. This compares with larger average cuts of 3.0% a year over the last Conservative Parliament, but is greater than the 0.2% average annual cut seen over the Conservatives' period in office from 1979 to 1997. Government plans imply that this cut will be matched going forward, with defence spending being cut by an average of 0.2% per year over the next three years.

Transport spending has been cut by an annual average of 1.4% a year over the first four years of this Parliament, which is due to a combination of tight planned expenditure in 1997–98 and 1998–99 and of a significant DETR

[10] For details of the integrated child credit, see M. Brewer, M. Myck and H. Reed, *Financial Support for Families with Children: Options for the New Integrated Child Credit*, Commentary no. 82, IFS, London, 2001 (http://www.ifs.org.uk/taxben/icc.shtml). For details of the employment tax credit, see A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2001*, Commentary no. 83, IFS, London, 2001, (http://www.ifs.org.uk/gbfiles/gb2001.shtml). For details of the pension credit, see T. Clark, *Recent Pensions Policy and the Pension Credit*, IFS Briefing Note no. 17, 2001 (http://www.ifs.org.uk/pensions/bn17.pdf).

underspend in 1999–2000. Over the five-year Parliament to March 2002, there is no forecast increase in transport spending. This compares with a cut in spending averaging 2.9% over the previous Conservative Parliament. Over the next three years, there is a substantial planned increase in transport spending, averaging 11.5% a year in real terms. Even if these planned increases are delivered by 2003–04, transport spending will still be lower in real terms than it was in 1994–95.

Public investment spending

Both the July 1998 Comprehensive Spending Review and the July 2000 Spending Review announced that there was to be a substantial increase in capital spending. In fact, as shown in Table 4, as yet this has failed to materialise. Over this Parliament, there have been reductions in real investment spending averaging 4.4% a year, implying a total decline of 16.4% over the four-year period. Even in cash terms, investment spending in 2000–01 was £4.3bn, which is less than the £4.7bn achieved in 1996–97, the last year of the previous Parliament.

Table 4. Real increases in net public sector investment spending over various periods

	Annualised average real increase (%)
Comparisons across Parliaments	
This Parliament: *April 1997 to March 2001*	–4.4
This Parliament: *April 1997 to March 2002*	15.8
Last Parliament: *April 1992 to March 1997*	–16.6
Conservative years: *April 1979 to March 1997*	–5.3
of which:	
John Major's period in office: *April 1991 to March 1997*	–9.9
Margaret Thatcher's period in office: *April 1979 to March 1991*	–3.0
Other periods of interest	
Current planned expenditure: *April 2001 to March 2004*	60.1
First two years of this Parliament: *April 1997 to March 1999*	–9.5
Last two years of this Parliament: *April 1999 to March 2001*	1.0

Notes: For the periods in office of each political party and each Prime Minister, we assign financial years according to who was in office for the majority of months in that financial year. For example, Margaret Thatcher, who was Prime Minister from May 1979 to November 1990, is assumed to have determined public spending in the years from 1979–80 to 1990–91 inclusive.

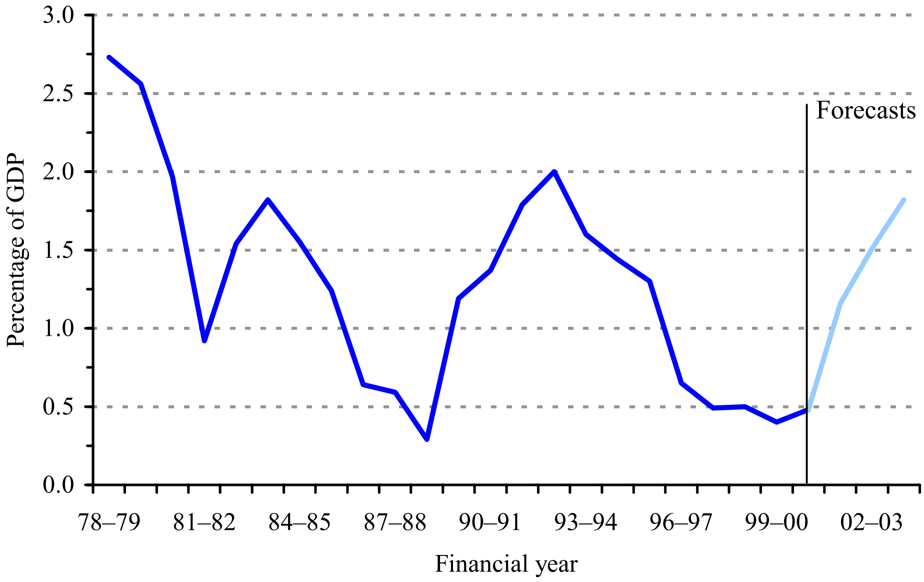
Sources: HM Treasury, *Financial Statement and Budget Report*, various years (most recent – http://www.hm-treasury.gov.uk/budget2001/index.html); ONS / HM Treasury Press Release, *Public Sector Finances: March 2001*, 23 April 2001 (http://www.statistics.gov.uk/pdfdir/psf0401.pdf). Spending figures deflated using the latest GDP deflators from the Office for National Statistics.

These overall reductions in investment spending reflect cuts in the first two years of this Parliament averaging 9.5% a year, followed by two years in which spending has only increased by an average 1.0% a year despite significant planned increases. Government departments – in particular, the Department for Education and Employment and the Department for the

Environment, Transport and the Regions – failed to spend up to their entitlements in 1999–2000.[11] The latest aggregate figures for net investment spending in 2000–01 show that considerable underspending occurred in that year too.[12] This underspend is significant, even when compared with the March 2001 Budget projection, made just four weeks before the end of the financial year, which forecast investment spending of £7.4bn in 2000–01. The latest figures suggest that the out-turn was £4.3bn.

The reductions in public sector net investment, and the failure of government departments to deliver the planned increases in public spending, are perhaps even more surprising when it is noted that they follow the last Parliament, in which there were real cuts in net investment spending averaging 16.6% a year. In fact, throughout the Conservatives' period in office, increases in current spending were partially sustained through cuts in the real capital budget averaging 5.3% a year.

Figure 2. Public sector net investment as a percentage of GDP, 1978–79 to 2003–04



Source: HM Treasury, *Financial Statement and Budget Report, March 2001*, Hc279, The Stationery Office, London, 2001 (http://www.hm-treasury.gov.uk/budget2001/index.html).

Public sector net investment as a share of GDP over time is shown in Figure 2. It has fluctuated substantially over the last 20 years – for example, increasing from 0.3% of GDP in 1988–89 to 2.0% in 1992–93 before falling back to 0.6% of GDP in 1996–97. The current government identified these cuts in investment as one of the key 'problems with previous approaches to public

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[11] For more details, see A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2001*, Commentary no. 83, IFS, London, 2001 (http://www.ifs.org.uk/gbfiles/gb2001.shtml).

[12] Unfortunately, no breakdown of this latest figure for net investment spending by government departments is available yet.

spending' from which, it argued, lessons had to be learned.[13] Despite this, over the last four years, the current government spent an average of less than ½% of GDP per year on public sector net investment – easily the lowest figure for any four-year period since the Second World War. The average over the last two years of the Parliament, which were covered by the first Comprehensive Spending Review, is actually lower than the average over the first two years of the Parliament. Why so much of the planned investment has failed to materialise – or, at least, to show up in the official statistics – has yet to be satisfactorily explained.

The plans for the next three years are for real increases averaging 60.1% a year. If delivered, these would clearly be rapid increases in spending – although from a base that is very low by historical standards, due to cuts in public investment spending since 1992–93.

Offsetting the cuts in traditional public investment, shown in Figure 2, there has been considerable growth in privately delivered but publicly sponsored investment spending under the Private Finance Initiative (PFI). This now represents 0.4% of GDP.[14]

Looking forward, total publicly sponsored investment by 2003–04 should be comparable to the levels seen at the beginning of the 1990s. This depends, first, on the current planned large increases in public spending actually being delivered, and, second, on PFI spending being included alongside traditionally financed projects. Even if these assumptions are granted, whether these planned levels of investment represent a significant break depends on the new investment being sustained, not cut back, as was the case after previous years of high public investment, notably 1983–84 and 1992–93.

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[13] HM Treasury, *Planning Sustainable Public Spending: Lessons from Previous Policy Experience*, November 2000 (http://www.hm-treasury.gov.uk/pdf/2000/spending_lessons0311.pdf).

[14] Source: HM Treasury, *Financial Statement and Budget Report, March 2001*, Hc279, The Stationery Office, London, 2001 (http://www.hm-treasury.gov.uk/budget2001/index.html).