



Filling the Hole: How do the Three Main UK Parties Plan to Repair the Public Finances?

2010 Election Briefing Note No. 12 (IFS BN99)

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Summary

- The financial crisis and the recession have prompted a huge increase in government borrowing over the last two years. The Treasury believes that a significant part of this increase will persist even after the economy fully recovers. Discretionary tax increases and spending cuts are therefore needed to keep government debt and interest payments on a sustainable path.
- Given that this fiscal repair job is likely to be the major domestic policy challenge for the next government, it is striking how reticent all three main UK parties have been in explaining how they would confront the task. Their public spending plans are particularly vague. Our analysis thus necessarily involves making some informed assumptions about how they would proceed.
- Since the impact of the crisis became apparent in the Treasury's forecasts for the public finances, the current Labour government has set out a fiscal tightening that will build gradually to 4.8% of national income or £71 billion a year in 2010–11 terms. The opposition parties have not challenged this number and we assume that they would aim for the same.
- The Labour government's 2010 Budget set out the size of its planned tightening in each year. It aims to withdraw the temporary fiscal stimulus package this year, start tightening in 2011–12 and finish the job in 2016–17, with the pain front-loaded in the earlier years. The Liberal Democrats have informally endorsed this tightening profile.
- The Conservatives want to start tightening earlier and proceed more quickly. They plan an additional £6 billion tightening this year and would aim to get almost all the repair job done a year earlier than Labour and the Liberal Democrats in 2015–16.
- The Conservatives' greater ambition would make a relatively modest difference to the long-term outlook for government borrowing and debt. The Conservative plans imply total borrowing of £604 billion over the next seven years, compared with £643 billion under Labour or the Liberal Democrats. Assuming no further change in borrowing beyond 2017–18, we project that the Conservative plans would return government debt below 40% of national income in 2031–32, the same year as it would under Labour or the Liberal Democrats.

¹ This series of Election Briefing Notes has been funded by the Nuffield Foundation, grant OPD/36607. The Nuffield Foundation is an endowed charitable trust that aims to improve social well-being in the widest sense. It funds research and innovation in education and social policy and also works to build capacity in education, science and social science research. More information is available at <http://www.nuffieldfoundation.org/>. Any views expressed are those of the authors and not necessarily those of the Foundation. The authors are grateful to Luke Sibieta for helpful discussions and comments on earlier drafts. Any errors and omissions are the responsibility of the authors.

- Differences between the parties are much more pronounced with regards to the composition of the tightening. Labour favours a 2:1 ratio of spending cuts to tax rises (£47 billion and £24 billion, respectively), the Liberal Democrats a 2½:1 ratio (£51 billion and £20 billion) and the Conservatives a 4:1 ratio (£57 billion and £14 billion). Measured as shares of national income, the Labour and Liberal Democrat plans would reduce public spending to a level last seen in 2004–05 and increase tax revenues to their highest since the peak of the late 1980s boom in 1989–90. The Conservatives would reduce total spending to the level seen in 2003–04 and increase revenues to the level seen in 2006–07.
- Measured as a share of national income and converting into 2010–11 terms, Labour has already put a £17 billion tax increase into the pipeline for the coming Parliament. We estimate that its goals for borrowing and the overall composition of the fiscal tightening would require it to announce further tax increases worth around £7 billion. The Conservatives have announced a £6 billion net tax cut on top of what is in the pipeline from Labour, but their goals would probably require them to reverse about half of it. The Liberal Democrats have announced a £3 billion tax increase on top of what is in the pipeline and would not need to do anything further. The rise in the tax burden by 2016–17 would be largest under Labour and lowest under the Conservatives, with the Liberal Democrats in the middle.
- Far more significant is the gap in the parties' plans for reducing public spending. None has announced plans for significant cuts to social security spending and, without them, their plans would require deep cuts to spending on public services. Over the four years starting in April 2011, both Labour and the Liberal Democrats would need to deliver the deepest sustained cut to spending on public services since the four years from April 1976 to March 1980. Starting this year, the Conservative plans imply cuts to spending on public services that have not been delivered over any five-year period since the Second World War.
- Once we take into account their various pledges to protect spending in certain areas, in real terms the Conservatives would need to cut public services spending in their unprotected areas by £63.7 billion, Labour by £50.8 billion and the Liberal Democrats by £46.5 billion between April 2011 and March 2015. Of these, the Conservatives have announced measures that would bring about 17.7% of the total cuts they need, leaving a shortfall of £52.4 billion. Labour has announced measures that would bring about 13.1% of what it would need, leaving a shortfall of £44.1 billion. The Liberal Democrats have announced measures that would bring about 25.9% of what they would need, leaving a shortfall of £34.5 billion.
- Forecasting components of public spending beyond 2014–15 becomes very difficult, but all three parties would be likely to require further cuts to spending on public services between 2014–15 and 2016–17. Over this period, the cuts would be smallest under the Conservatives, as they would have already done most of the job over the previous five years, and greatest under the Liberal Democrats, if they are to meet their aspiration of avoiding further net tax rises.
- Both Labour and the Conservatives claim to have identified efficiency savings that could help achieve the spending cuts they need. But all governments presumably try to spend public money as efficiently as they can, whatever the fiscal climate. So presumably they would aim to deliver these efficiency savings whether there was a need to cut spending or not. If so, they do not narrow the gap between the quality and quantity of public services that would be delivered in a world of spending cuts versus a world without. In any case, genuine efficiency savings do not reduce the size of any relative shortfall between the different parties' stated plans, as they would be available to whoever forms the next government.

- The parties are all aiming to deliver at least two-thirds of their fiscal tightening through spending cuts rather than tax increases, and have not announced any measures cut welfare spending substantially. When the last Conservative government required a significant fiscal tightening in the early 1990s they aimed to split the burden roughly 50:50 between tax increases and spending cuts. This might suggest that all the parties are overambitious in the amount they think they can squeeze out of public services. Whoever forms the next government, that points to greater reliance on tax increases and welfare cuts after the election than the parties are willing to admit to beforehand.

1. Introduction

The financial crisis and the recession have prompted a huge increase in government borrowing over the last two years, as the gap between what the public sector spends and raises from taxes has widened to an extent not seen since the Second World War.² The Treasury believes a significant part of this increase in government borrowing is ‘structural’ – in other words, that it will not disappear automatically as the economy recovers. This means that, in the absence of discretionary tax increases and spending cuts, government borrowing would remain high by historic standards, pushing the government’s debt burden and interest payments onto an unsustainable upward path.

Confronted with this prospect, the three main parties all accept that a significant fiscal tightening will be necessary over the coming Parliament, and perhaps beyond. Given that this is likely to be the defining task of the next administration, it is striking how reticent all three parties have been in explaining exactly how they would go about it. The Conservative and Liberal Democrat manifestos do not even state clearly how big a fiscal tightening they would seek to achieve, and by when, assuming that the public finances evolve as the Treasury currently expects. And all three parties are particularly vague about the cuts in public spending that they all think should deliver the majority of the fiscal tightening. The blame for this lies primarily with the current government’s refusal to conduct a Spending Review before the election. It claims that it cannot do this until the autumn, because the outlook for the public finances is uncertain. But the outlook for the public finances will still be uncertain in the autumn. Uncertainty is a fact of fiscal life: any responsible government would face up to it, and seek to reduce it, not use it as something to hide behind.

This Briefing Note examines what the parties have said (explicitly and implicitly) about the scale, timing and composition of the fiscal repair job ahead, teasing out the differences and similarities. Section 2 begins by setting out the overall size of the fiscal tightening that each party is looking to achieve. Section 3 examines the timing of the deficit reduction. Section 4 looks at the composition of the cut in borrowing – in other words, which part of this cut in borrowing would come from spending cuts and which from tax increases – under each of the parties’ plans. Section 5 describes which tax increases each of the parties has already given firm details of and which have yet to be announced. Section 6 examines the parties’ published spending plans in detail; we set out the implications for cuts to spending on public services, including quantifying which parts of these cuts the parties have already ‘identified’ and which have yet to be found. Section 7 concludes.

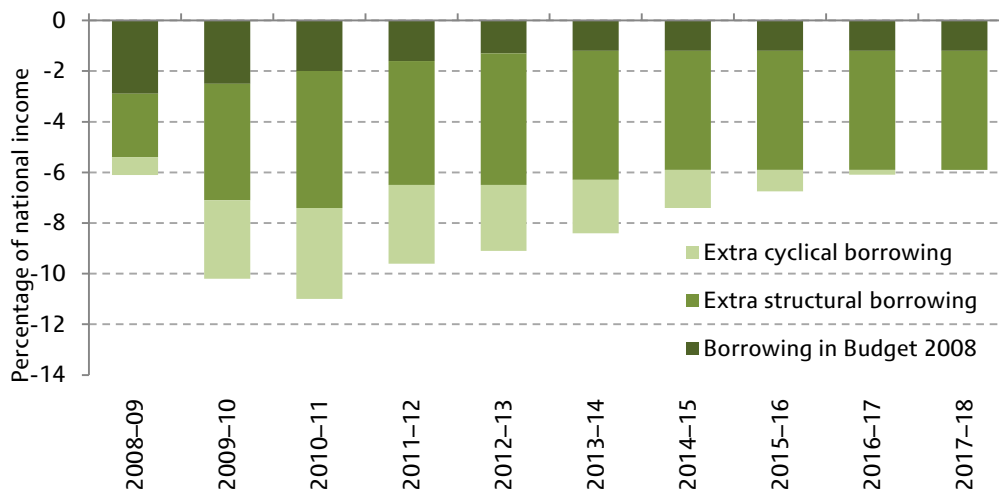
² The evolution of the public finances during Labour’s period in office up to and through the financial crisis and recession is described in R. Chote, R. Crawford, C. Emmerson and G. Tetlow (2010), *The public finances: 1997 to 2010*, Election Briefing Note No. 6, London: Institute for Fiscal Studies (<http://www.ifs.org.uk/publications/4822>).

2. The size of the tightening

The current government has been much more explicit about the eventual size of the fiscal tightening that it thinks will be necessary than the opposition parties have. Its judgement reflects the Treasury’s analysis of the size of the fiscal problem we confront.

The easiest way to illustrate this is to look at how the Treasury’s latest forecasts imply that public sector borrowing would evolve in the absence of the tax and spending decisions that the government has taken since the impact of the financial crisis and the recession first became apparent (most of which the opposition parties say they would persist with). As Figure 2.1 illustrates, the Treasury’s Budget 2010 forecast implies that the structural deficit would be around 4.7% of national income (£69 billion in 2010–11 terms) larger in the long term than it thought in the ‘pre-crisis’ Budget of 2008. The main reason is that the Treasury believes that the crisis has permanently reduced the likely cash size of the economy, which pushes up expected public spending and reduces expected tax revenues as shares of national income.³

Figure 2.1. Budget 2010 borrowing forecasts ignoring post-crisis discretionary policy changes



Notes: For the purpose of this figure, we have assumed that the economy returns to its sustainable level of activity (i.e. the output gap equals zero) in 2016–17. The Treasury does not publish its estimate of the output gap beyond 2014–15 (see chart B3 of HM Treasury, *Budget 2010*, March 2010, http://www.hm-treasury.gov.uk/budget2010_documents.htm). Sources: Authors’ calculations using HM Treasury, *Budget 2008*, *Pre-Budget Report 2008*, *Budget 2009*, *Pre-Budget Report 2009* and *Budget 2010*, all available at <http://www.hm-treasury.gov.uk/>.

The spending cuts and tax increases announced or projected by the current government in Pre-Budget Report 2008, Budget 2009, Pre-Budget Report 2009 and Budget 2010 add up to a fiscal tightening worth an eventual 4.8% of national income or £71 billion – in other words, just sufficient to slightly more than fill the additional structural deficit that the Treasury believes that the crisis has caused. This means that, in the long term, the Treasury would expect the ‘disease’ and ‘cure’ to broadly offset each other, leaving government borrowing much as expected back in Budget 2008.

³ A fuller exposition can be found in R. Chote, R. Crawford, C. Emmerson and G. Tetlow (2010), ‘Fiscal Tightening: Why and How?’, in Chapter 2 of R. Chote, C. Emmerson and J. Shaw (eds), *The IFS Green Budget: February 2010*, London: Institute for Fiscal Studies (<http://www.ifs.org.uk/budgets/gb2010/10chap2.pdf>). Some updated analysis, which takes into account the new forecasts and measures contained in the March 2010 Budget, can be found in G. Tetlow (2010), *Public finances: less to repair, a bit more done*, Presentation at IFS Post Budget 2010 Briefing, 25 March (<http://www.ifs.org.uk/budgets/budget2010/tetlow.pdf>).

Neither opposition party has formally challenged or endorsed the Treasury's latest assessment of the scale of the fiscal problem or the eventual tightening that will be necessary. In September last year, Vince Cable, the Liberal Democrat Deputy Leader and Shadow Chancellor, said that he thought that the necessary fiscal tightening would be much larger, arguing that 'A reasonable assumption is that a correction of around 8 per cent of GDP is required'.⁴ But the Liberal Democrat manifesto expresses no such view and indeed the Treasury has reduced its own estimate of the size of the hole and the necessary tightening since then (albeit from a significantly lower figure than Dr Cable's).

Given the lack of any clear statement in either opposition manifesto, we assume for the purposes of this Briefing Note that silence implies consent and that all three parties would aim to deliver an eventual fiscal tightening of the same size – 4.8% of national income. Needless to say, this assessment could change in future Budgets and Pre-Budget Reports, whoever is in power.

3. The timing of the tightening

Each party has provided some information about the desired timing of the tightening. All three have targets for some measure of government borrowing in at least one year. The government also has a complete set of forecasts for borrowing in each year out to 2014–15, which in turn implies the size of the desired tightening in each year until then. It has also made illustrative assumptions about the size of the additional tightening it would deliver to finish the job in 2015–16 and 2016–17. We now examine the targets of each party and their implications for the path of borrowing and debt.

Labour

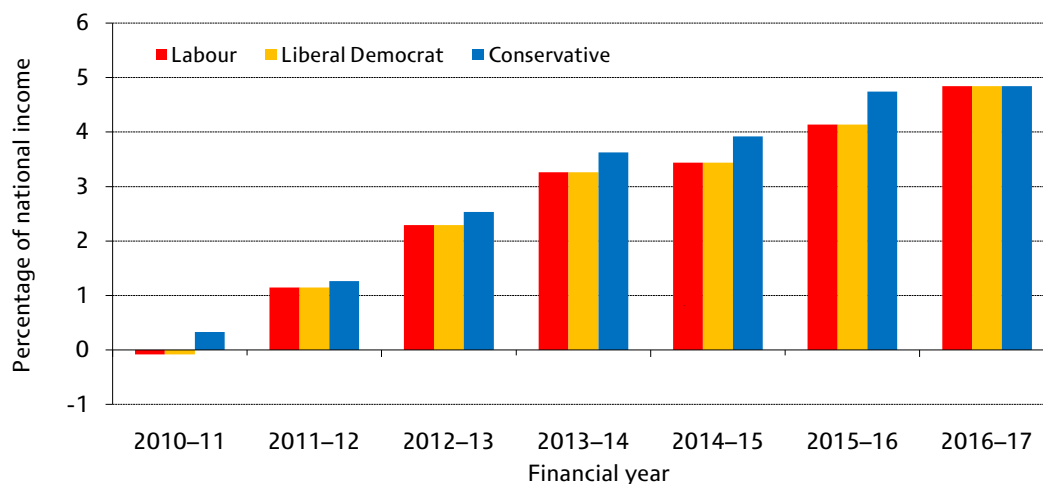
The Labour Party has two specific targets for government borrowing set out in legislation:

- The Fiscal Responsibility Act 2010 commits it to halve the overall budget deficit by 2013–14 from its 2009–10 level as a share of national income. On current estimates, this would require borrowing in 2013–14 to be no higher than 5.8% of national income.
- The Fiscal Responsibility Order 2010 sets out a second (more stringent, but more easily altered) target to reduce borrowing to no more than 5.5% of national income in 2013–14.

However, the forecasts set out by the Treasury in Budget 2010 imply that the government is currently planning to deliver a fiscal tightening slightly more ambitious than would be necessary to achieve even the more binding of these two targets. Looking at the combined impact of the tax and spending measures announced after Budget 2008, the government plans to move from an insignificantly small net fiscal loosening of 0.1% of national income (£1 billion) in 2010–11 to achieve the eventual tightening of 4.8% of national income in 2016–17 (as shown in Figure 3.1).

⁴ <http://www.reform.co.uk/LinkClick.aspx?fileticket=RQ0obqjHA9A%3d&tabid=118>.

Figure 3.1. The timing and size of the fiscal tightening: the main parties' plans



Note: See main text for assumptions.

Source: Labour borrowing plans are based on figures from HM Treasury, Budget 2010 (<http://www.hm-treasury.gov.uk/budget2010.htm>). Figures for the Liberal Democrats and Conservatives are authors' calculations based on stated targets for deficit reduction from each of the parties.

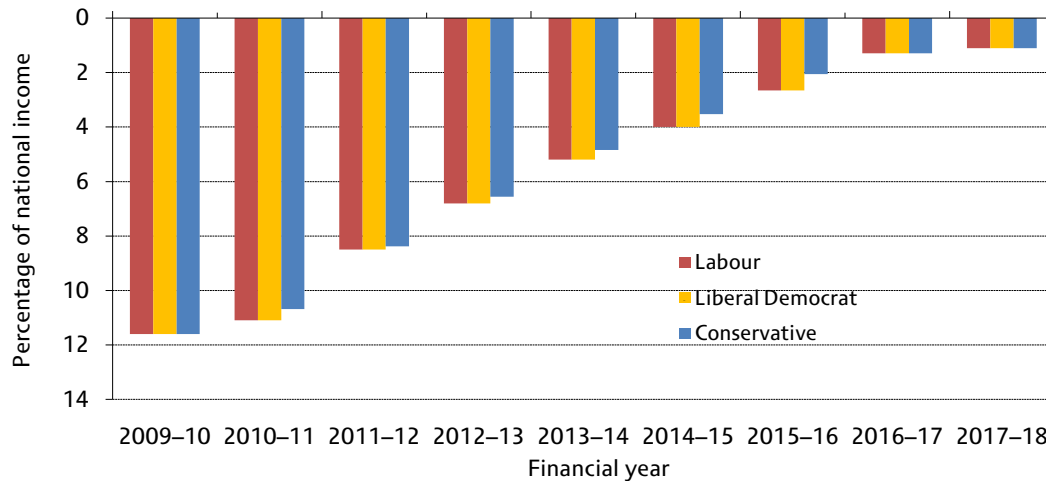
Perhaps surprisingly, given the concern Labour has expressed about derailing the economic recovery by tightening too quickly, the party's chosen tightening path is front-loaded. The additional discretionary tightening added each year gradually declines from 1.5% of national income in 2010-11 (reflecting the removal of the bulk of the fiscal stimulus package that was in place in 2009-10) to 1.0% of national income in 2013-14. Doubtless coincidentally, the planned additional tightening then dips down to just 0.2% of national income in the likely pre-election year of 2014-15, before rising again to 0.7% of national income in 2015-16 and 2016-17.⁵

The Budget forecast that the government's tightening would be sufficient to reduce borrowing to 5.2% of national income in 2013-14 – some 0.3% of national income lower than would be necessary to comply with the Fiscal Responsibility Order (see Figure 3.2). Total borrowing is then forecast to fall to 4.0% of national income in 2014-15. We estimate that if the Treasury extended its forecast, it would show borrowing falling to 1.3% of national income by the time the tightening is completed in 2016-17 and then to 1.1% of national income from 2017-18 onwards, once the small remaining temporary 'cyclical' deficit has been eliminated by the recovery of economic activity to its sustainable level.⁶

⁵ Note that this tightening is in addition to the much smaller one already planned in Budget 2008. See paragraph C15 of the March 2010 Budget for more details.

⁶ The 'sustainable' level of economic activity is the level consistent with stable inflation and unemployment. The Treasury's latest forecast, from Budget 2010, shows an output gap (the difference between sustainable output and actual output) of 1.9% in 2014-15. We assume that the output gap does not close completely until 2016-17 and so we assume there will still be some cyclical borrowing in 2016-17. Thus total borrowing does not actually fall to 1.1% until 2017-18 – shown in Figure 3.2.

Figure 3.2. Public sector net borrowing profiles compared



Note: As Figure 3.1.

Source: As Figure 3.1.

For the Liberal Democrats and the Conservatives, we assume that the Treasury's forecasts for tax and spending under Labour's policies are correct and then add in the other parties' announced plans for additional tax and spending measures. To the extent that the other parties' planned borrowing levels differ from the plans set out in Budget 2010, we assume the other parties need additional measures (discretionary giveaways or takeaways) to bring this about.

Liberal Democrats

The Liberal Democrat manifesto says that, in addition to delivering its tax plans, the party would set out spending plans this autumn to 'at a minimum, halve the deficit by 2013-14'.⁷ On the face of it, this looks like adopting the less stringent of Labour's two legislative targets and therefore seeking a less ambitious fiscal consolidation than that set out in Budget 2010. But the party has told us that this pledge should be seen as 'shorthand' for pursuing the same consolidation path as Labour. We therefore assume that the Liberal Democrats have the same planned tightening and the same target for borrowing in each year as set out in Budget 2010 (Figures 3.1 and 3.2). Again there is a contrast here with the views set out by Dr Cable last autumn, when he said not only that the adjustment would likely need to be larger than the government planned, but that it should also be completed more quickly than the government planned.⁸

Conservatives

The Conservatives have said that they want to start cutting borrowing sooner and reduce borrowing more quickly than the Labour government plans to. The Conservative manifesto states that they would 'reduce the deficit more quickly than Labour year-on-year' and that they would eliminate 'the bulk of the structural current budget deficit over a Parliament'. The latter is not a particularly precise objective and the government would claim that it is on course to achieve it already. But the Conservatives were slightly more specific in their draft bill to create an Office for Budget Responsibility, which was published on 5 January 2010. This states that 'The Chancellor will announce a mandate for falling debt as a % of GDP and a cyclically adjusted balanced current budget by the end of the forecast horizon'.

⁷ http://network.libdems.org.uk/manifesto2010/libdem_manifesto_2010.pdf, page 98.

⁸ <http://www.reform.co.uk/LinkClick.aspx?fileticket=RQ0obqjHA9A%3d&tabid=118>.

The Conservatives have not said how far their forecasting horizon would extend, so we assume for the purposes of this Briefing Note that they would stick to the current Treasury practice and that their planned June 2010 'emergency' Budget would therefore contain medium-term fiscal projections running for five years to 2015–16. The Treasury's forecasts in Budget 2010 imply that the structural current budget deficit (under the government's plans) would be 0.6% of national income (or £9 billion in 2010–11 terms) by 2015–16. So the Conservatives would need an additional tax increase or spending cut of this size by 2015–16 to meet their target.

The Conservatives have also announced that they would cut Labour's existing spending plans for 2010–11 by £6 billion and use the proceeds to cut borrowing this year. But most of the ongoing savings from this spending cut would be offset by a net tax cut the following year (discussed below). On their own, these two policies would leave borrowing almost the same in 2011–12 as under Labour's plans. But we assume that the Conservatives also implement additional tightening measures gradually between 2011–12 and 2015–16 in order to achieve their target for the latter year. Specifically, we assume they would implement measures to achieve an additional cut in borrowing of 0.12% of national income (or £1.8 billion in 2010–11 terms) on top of Labour's plans in 2011–12 and then additional measures worth the same amount in each of the following four years, so that after five years the total additional cut in borrowing would amount to 0.6% of national income (or £9 billion in 2010–11 terms). This would result in a total fiscal tightening of 4.7% of national income (or £69 billion in 2010–11 terms) under the Conservative plans by 2015–16, which is shown in Figure 3.1.

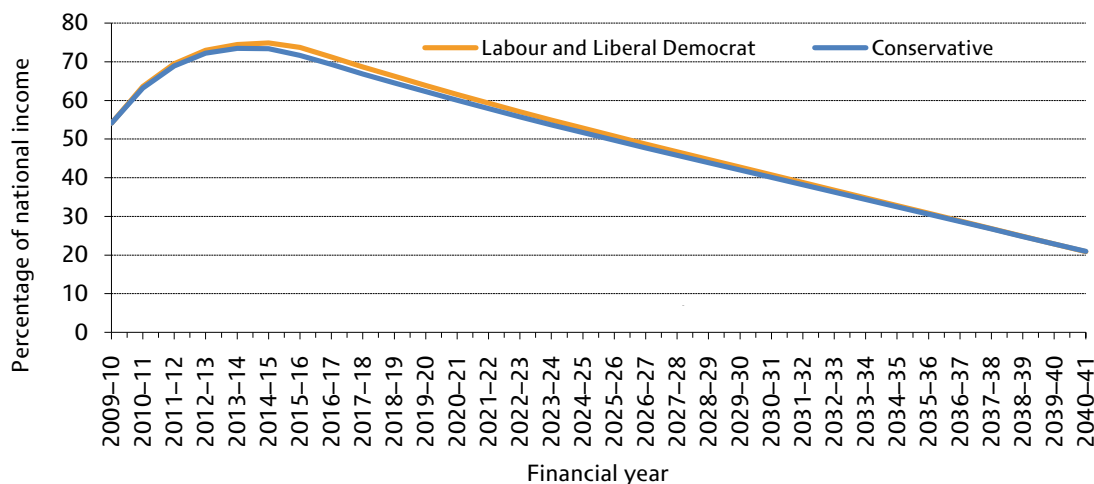
As we noted above, the current government's plan is for a fiscal tightening ultimately amounting to 4.8% of national income (or £71 billion in 2010–11 terms) by 2016–17. The Conservatives' stated targets would not actually require a tightening quite as large as this. However, we assume here that they would also implement an additional 0.1% of national income (or £1 billion in 2010–11 terms; figures do not sum due to rounding) tightening in 2016–17, so that the total fiscal tightening is the same size as that under Labour and Liberal Democrat plans by 2016–17 (Figures 3.1 and 3.2).

A big difference?

As best we can tell from the statements they have made to date, all three parties aim to implement a fiscal tightening of 4.8% of national income, or £71 billion, by 2016–17. The only real difference is that the Conservatives would aim to get most of the job done a year earlier, by 2015–16.

This does not make an enormous difference to the total amount of government borrowing over the next few years or to the long-term profile for government debt. Over the next seven years (2010–11 to 2016–17 inclusive), Labour and the Liberal Democrats plan to borrow £643 billion, while the Conservatives would end up borrowing £604 billion, about £38 billion or just 6% less. Figure 3.3 shows profiles for future debt levels under each of the three parties' plans. Under the assumptions we have made for growth and borrowing going forwards, debt would not return below 40% of national income (the ceiling Labour set itself in 1997) until 2031–32 under Labour or the Liberal Democrats, and would get there in the same year under the Conservatives. The more significant differences between the parties lie in how they intend to implement the tightening – in other words, the balance between tax increases and spending cuts. This is discussed in the next section.

Figure 3.3. Debt high for a generation?



Note: Forecasts for debt levels assume that non-debt interest spending and revenues remain constant as a share of national income from 2017–18 onwards, while inflation is assumed to run at 2¾% a year and real growth in national income at 2½% a year. Average nominal interest rates on government debt are assumed to rise from 4.6% (the level forecast in the March 2010 Budget for the end of the Treasury’s forecast horizon, 2014–15) to equal nominal GDP growth between 2017–18 and 2027–28. From 2027–28 onwards, nominal interest rates are assumed to equal nominal GDP growth. This implies that total net debt interest payments decline/rise as a share of national income as net debt falls/rises, which in turn implies a strengthening/weakening of the current budget over time.

Source: Authors’ calculations based on the borrowing totals shown in Figure 3.2.

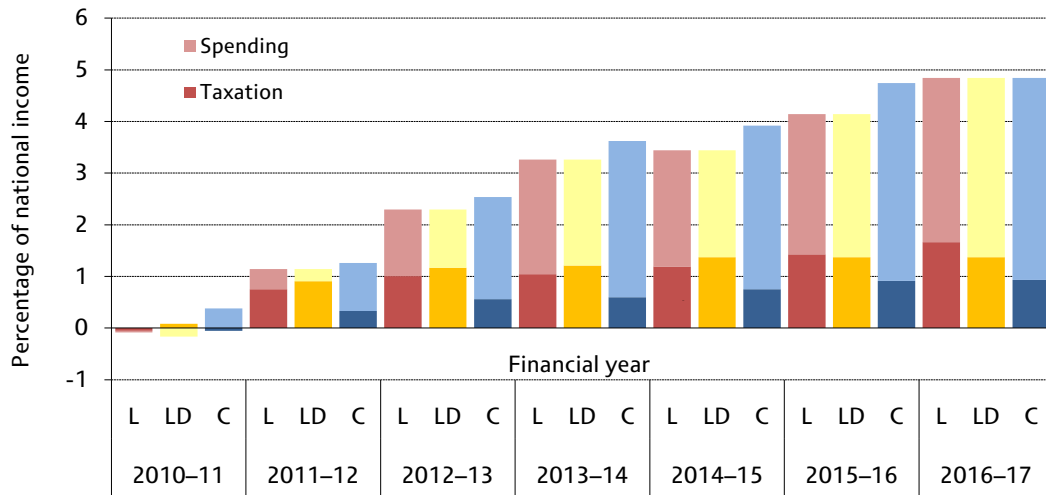
4. The composition of the tightening

Though the ultimate size of the fiscal tightening to be implemented appears to be the same under all three main parties, the composition of the measures would be different. This section sets out what we know of each party’s plans.

The overall picture is that, ultimately, Labour looks set to implement the largest discretionary net tax rise (1.7% of national income, or £24 billion in 2010–11 terms) and the smallest discretionary net spending cut (3.2% of national income, or £47 billion). The Conservatives look set to do the smallest discretionary net tax rise (0.9% of national income, or £14 billion) and the largest discretionary net spending cut (3.9% of national income, or £57 billion). The Liberal Democrats’ plans are in the middle: a net tax rise of 1.4% of national income and a net spending cut of 3.5% of national income (£20 billion and £51 billion, respectively).⁹ Figure 4.1 shows our calculation of the composition of the fiscal tightening (tax increases and spending cuts) in each year from 2010–11 to 2016–17 for each party. Figure 4.2 shows the impact of these measures (along with the impact of automatic changes to tax revenues and spending as the economy recovers from recession) on the overall level of revenues and spending as a share of national income under each party’s plans.

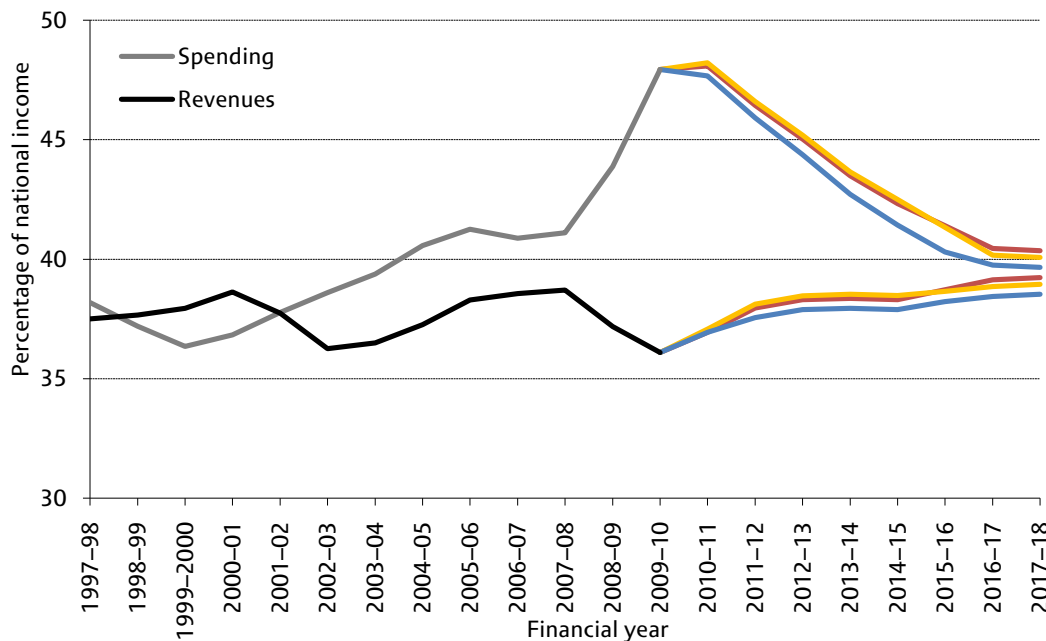
⁹ All these figures are in addition to measures already announced in Budgets and Pre-Budget Reports up to Budget 2008.

Figure 4.1. Composition of discretionary fiscal tightening



Note: 'L' denotes Labour, 'LD' denotes Liberal Democrats and 'C' denotes Conservatives. See main text for assumptions. Source: As Figure 3.1.

Figure 4.2. Total spending and revenues



Note: Red lines show Labour's spending and revenue plans, yellow lines show Liberal Democrat spending and revenue plans and blue lines show Conservative spending and revenue plans. See main text for assumptions.

Source: Outturns up to 2008-09 are from HM Treasury, *Public Finances Databank*, April 2010. Figures for 2009-10 are estimated outturns from *Budget 2010*. Figures for Labour from 2010-11 to 2014-15 are forecasts from HM Treasury, *Budget 2010*. Forecasts for Labour from 2015-16 onwards are authors' calculations based on figures in *Budget 2010* and Labour Manifesto 2010. Forecasts for Liberal Democrats and Conservatives from 2010-11 onwards are authors' calculations based on their respective 2010 election manifestos.

The following subsections set out exactly what we know about each party's overall plans for tax and spending and – where we do not have full details – how we have assumed they would complete the required tightening. All the figures in this section are expressed as percentage of national income (or as percentage of national income multiplied by 2010-11 national income – GDP – to get £ billion figures). Sections 5 and 6 describe each party's specific tax and spending plans in more detail.

Labour

Labour is looking to cut borrowing by 10.7% of national income between 2009–10 and 2017–18 (as shown in the 1st column of the first row of Table 4.1).¹⁰ From Budget 2010, we know that it plans to cut borrowing by 7.8% of national income by 2014–15, with 5.6 percentage points coming from a decline in spending as a share of national income and 2.2 percentage points coming from an increase in revenues (shown in the 17th and 12th rows of Table 4.1).

To bring about this spending decline, the government has lowered its spending projections in the Budgets and Pre-Budget Reports (PBRs) since Budget 2008 sufficiently to deliver a 2.2% of national income (post-crisis) discretionary spending cut. On top of this, spending will decline by 0.7 percentage points as a result of reversing the temporary fiscal stimulus measures that were in place in 2009–10 and 2.7 percentage points will come from the economic recovery and other factors.

To bring about the revenue rise it is looking for, the government has had to announce tax measures (since Budget 2008) amounting to a 1.2% of national income discretionary tax increase (or £17 billion in 2010–11 terms).¹¹ In addition, revenues will rise by 0.9 percentage points as a result of reversing the temporary fiscal stimulus measures that were in place in 2009–10 and 0.1 percentage points will come from the recovery and other economic factors. The discretionary measures announced by Labour since Budget 2008 so far therefore split into one-third tax increases and two-thirds spending cuts, which Chancellor Alistair Darling has argued is the right mix.¹² It also broadly mirrors the composition of the increase in government borrowing seen over the last two years, in which the rise in spending as a share of national income has been about twice as large as the fall in tax revenues measured on the same basis.

To bring about the 2.9% of national income fall in borrowing that the government is aiming for between 2014–15 and 2017–18, Labour would need to implement further tax and spending measures amounting to 1.4% of national income or £21 billion in 2010–11 terms (as shown in Table 4.1). To continue to split these additional measures into one-third tax increases and two-thirds spending cuts would require additional tax measures (as yet unannounced) of 0.5% of national income (£7 billion) and further spending cuts of 0.9% of national income (£14 billion). This would bring the total discretionary tax increase under Labour's plans to 1.7% of national income (or £24 billion in 2010–11 terms) and the total discretionary spending cut to 3.2% of national income, or £47 billion (as shown in Figure 4.1 and in the top half of Table 4.1). This would see the overall fiscal tightening implemented through roughly two-thirds net spending cuts and one-third net tax rises (i.e. a ratio of 2:1).

¹⁰ This is based on the forecasts from Budget 2010 and does not take into account the fact that the provisional outturn for borrowing in 2009–10 was 0.2% of national income lower than forecast in *Budget 2010*. It is not possible to decompose the provisional outturn into revenues and spending. Therefore, in this section, we use Budget 2010 forecasts for all fiscal aggregates.

¹¹ Note that this figure is greater than the £13.6 billion tax increase cited in the IFS Election Briefing Note looking at the measures to come into place in the next parliament. This is because the £17.0 billion includes the revenue raised from measures such as the new 50p income tax rate that came into force in April 2010. See table 2.1 of S. Adam, M. Brewer, J. Browne and D. Phillips (2010), *Taxes and benefits: the parties' plans*, IFS Election Briefing Note No. 13).

¹² The fiscal tightening measures announced by Labour for 2013–14 (1.0% of national income tax increase and 2.2% of national income spending cut, as shown in Figure 3.1) amount to £18 billion and £38 billion, respectively, in 2013–14 terms. These, as far as we can tell, are the fiscal measures to cut borrowing that the Chief Secretary to the Treasury, Liam Byrne, and others have described as '£19 billion will come from increased taxes and £38 billion from cuts in public spending, with the rest coming from a return to growth in the economy' (see, for example, <http://www.parliament.the-stationery-office.co.uk/pa/cm200910/cmhansrd/cm100330/debtext/100330-0020.htm>). In evidence to the Treasury Select Committee on the 2009 Pre-Budget Report, Mr Darling said 'That does therefore have a consequence on the amount of money that we can spend, but, equally, spending I know is taking about two-thirds of the strain and tax about a third because I also needed to make sure that I could fulfil the promise that I had made that we wanted to protect front-line services in the NHS, for example' (<http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtreasy/180/9121603.htm>).

Under these Labour plans, by 2017–18 total public spending would be 40.4% of national income, with total revenues at 39.2% (as shown in Figure 4.2). This would bring spending as a share of national income back down to the level seen in 2004–05 and total revenues up to the highest level since the peak of the late 1980s boom (1989–90).

Liberal Democrats

While the Liberal Democrats have announced an intention to achieve the same total cut in borrowing as Labour over the next eight years, their plans for total tax and spending differ. In the period up to 2014–15, the Liberal Democrats have said they would introduce a net tax increase of 0.2% of national income (or £3 billion in 2010–11 terms) on top of Labour's plans. Since they are aiming for the same total level of borrowing, this would allow them to increase spending relative to Labour's plans by the same amount up to 2014–15. Thus between 2009–10 and 2014–15, the total borrowing cut the Liberal Democrats are aiming for is 7.8% of national income, requiring discretionary tax increases of 1.4% of national income and discretionary spending cuts of 2.1% of national income. This is a smaller spending cut and a larger tax increase than Labour is aiming for.

Between 2014–15 and 2017–18, the Liberal Democrats' plans require them to implement a further 1.4% of national income fiscal tightening (in order to cut total borrowing by a further 2.9% of national income). The Liberal Democrats have said in their manifesto that 'over and above our planned new levy on the profits of banks [which they expect to bring in revenue rising to 0.2% of national income in 2014–15], we will seek to eliminate the deficit through spending cuts. If, in order to protect fairness, sufficient cuts could not be found, tax rises would be a last resort'.¹³ We have therefore assumed in Figure 4.1 that the Liberal Democrats would succeed in their stated ambition and implement the additional fiscal tightening after 2014–15 entirely through spending cuts.

This means that the total discretionary tax increase under the Liberal Democrats would be 1.4% of national income (or £20 billion in 2010–11 terms), while the total discretionary spending cut would amount to 3.5% of national income (or £51 billion). This would see the fiscal tightening implemented through roughly five-sevenths net spending cuts and two-sevenths net tax rises (i.e. a ratio of 2½:1).

Under these Liberal Democrat plans, by 2017–18 total public spending would be 40.1% of national income, with total revenues at 38.9% (as shown in Figure 4.2). As with Labour's plans, this would bring spending as a share of national income back down to the level seen in 2004–05 and total revenues up to the highest level since the peak of the late 1980s boom (1989–90).

¹³ Liberal Democrat Manifesto 2010, page 96.

Table 4.1. Target change in fiscal aggregates, % of national income and £billion (2010–11 terms)

	Labour		Liberal Democrat		Conservative	
	% GDP	£bn	% GDP	£bn	% GDP	£bn
1. Change in borrowing, 2009–10 to 2017–18	-10.7	-157	-10.7	-157	-10.7	-157
2. Change in tax burden, 2009–10 to 2017–18	3.1	46	2.9	42	2.4	35
3. Reverse fiscal stimulus measures	0.9	13	0.9	13	0.9	13
4. Net tax change announced	1.2	17	1.4	20	0.8	11
5. Measures to come	0.5	7	0.0	0	0.2	3
6. Other	0.6	8	0.6	8	0.6	8
7. Change in spending, 2009–10 to 2017–18	-7.6	-111	-7.9	-115	-8.3	-122
8. Reverse fiscal stimulus measures	-0.7	-10	-0.7	-10	-0.7	-10
9. Post-crisis discretionary spending cuts	-3.2	-47	-3.5	-51	-3.9	-57
10. Other	-3.7	-54	-3.7	-54	-3.7	-54
11. Change in borrowing, 2009–10 to 2014–15	-7.8	-114	-7.8	-114	-8.3	-121
12. Change in tax burden, 2009–10 to 2014–15	2.2	32	2.4	35	1.8	26
13. Reverse fiscal stimulus measures	0.9	13	0.9	13	0.9	13
14. Net tax change announced	1.2	17	1.4	20	0.8	11
15. Measures to come	0.0	0	0.0	0	0.0	0
16. Other	0.1	2	0.1	2	0.1	2
17. Change in spending, 2009–10 to 2014–15	-5.6	-82	-5.4	-80	-6.5	-96
18. Reverse fiscal stimulus measures	-0.7	-10	-0.7	-10	-0.7	-10
19. Post-crisis discretionary spending cuts	-2.2	-33	-2.1	-30	-3.2	-46
20. Other	-2.7	-39	-2.7	-39	-2.7	-39

Note: Figures for changes in borrowing, spending and revenues relative to 2009–10 are based on the Budget 2010 forecasts for these fiscal aggregates in 2009–10 (and not on the latest outturns). This is because, though outturn figures are available for public sector net borrowing, no such figures are available for public sector revenues or current spending. All the tax-raising measures required by each party will need to be in place in 2016–17 at the latest to achieve the fiscal targets set out in Figure 3.2.

Source: Authors' calculations based on commitments made in Labour, Liberal Democrat and Conservative election manifestos and using figures from HM Treasury, *Budget 2010*.

Conservatives

The Conservatives are aiming to cut borrowing more by 2014–15 than Labour or the Liberal Democrats. Specifically, given the assumptions mentioned above, we estimate that the Conservative fiscal targets would require borrowing to be cut by 8.3% of national income by 2014–15, or 0.5% of national income (£7 billion) more than Labour and the Liberal Democrats are aiming for.

The Conservatives, in their manifesto, have explicitly set out various tax and spending changes that (they estimate) would cut taxes by 0.4% of national income (or £6 billion in 2010–11 terms) relative to Labour's plans and cut spending by 0.5% of national income (or £7 billion) relative to Labour's plans; in other words, a net cut in borrowing relative to Labour's plans of about £1 billion.

To achieve a total additional cut in borrowing of £7 billion relative to Labour's plans by 2014–15 would require additional tax rises or spending cuts. We assume that all of this additional amount will be found through further spending cuts. Making this assumption would bring the overall composition of discretionary measures under the Conservatives' plans by 2014–15 to about 80% spending cuts and 20% tax increases (as shown in Figure 4.1) – the Conservatives have stated in their manifesto that this is their preferred composition.¹⁴

After 2014–15, the Conservatives' plans imply borrowing being cut by a further 2.5% of national income, with further discretionary measures amounting to 0.9% of national income (or £13 billion in 2010–11 terms) being required to bring this about. We assume (as shown in Figure 4.1) that these additional measures would comprise 80% discretionary spending cuts and 20% discretionary tax increases, to maintain the 4:1 overall composition. This implies that the Conservatives would need to announce additional tax increases worth around £3 billion.

This means the total discretionary tax increase under the Conservatives would be 0.9% of national income (or £14 billion in 2010–11 terms), while the total discretionary spending cut would amount to 3.9% of national income (or £57 billion).

Under these Conservative plans, by 2017–18 total public spending would be 39.7% of national income, with total revenues at 38.5% (as shown in Figure 4.2). This would bring spending as a share of national income back down to the level seen in 2003–04 and total revenues up to the level seen in 2006–07.

Spending takes the strain

The parties have given us a far from full picture of their plans for the composition of the tightening, but the outlines are clear enough. The Conservatives are planning to achieve about 80% of the tightening through spending cuts, the Liberal Democrats probably around 72% and Labour 66%, with the rest coming from tax increases. It is worth noting that on the last occasion when a UK government confronted a fiscal repair job of anything like the magnitude of the current one, in the early 1990s, we estimate that the then Conservative Chancellors Norman Lamont and Kenneth Clarke aimed for a roughly 50:50 split between discretionary tax increases and discretionary spending cuts.¹⁵ This at least raises the question of whether it is plausible to expect spending to take as much of the strain as the parties are currently claiming. We examine what spending cuts of this magnitude would imply in Section 6, but first we look briefly at the parties' tax plans.

5. Filling the hole ... by taxing more

Labour tax plans

Labour's tax plans were set out in Budget 2010. As mentioned above, the party has announced new tax raising measures that will amount to 1.2% of national income (or £17 billion in 2010–11 terms, equal to about £550 per family) by 2014–15. Thereafter, its target for borrowing, combined with

¹⁴ 'These actions will allow us to reduce the deficit more quickly than Labour year-on-year while avoiding the most damaging part of their jobs tax. It will also lower the proportion of the reduction of the structural deficit that is accounted for by tax increases, from about one third towards one fifth. This is in line with international best practice, as well as the Treasury's own internal analysis.'

¹⁵ The Spring 1993 Budget (Norman Lamont's last) and the Autumn 1993 Budget (Kenneth Clarke's first) combined set out discretionary measures that were projected to increase tax revenues by 2.0% of national income in 1996–97. An extrapolation of the data in chart 5.2 (page 87) of the November 1993 Budget reveals that discretionary spending (as measured by the new control total) in 1996–97 was cut by around £13 billion in 1992–93 prices, which is 1.8% of national income.

the assumption we have made that it would continue to favour reducing borrowing through two-thirds spending cuts and one-third tax rises, would require it to implement further tax-raising measures amounting to 0.5% of national income (or £7 billion in 2010–11 terms, equal to about £200 per family) by 2016–17.

The measures announced for the period up to 2014–15 include: a set of income tax changes affecting people with income over £100,000 (raising £7.5 billion); the increase in all rates of National Insurance contributions (NICs) by 1 percentage point from April 2011 (raising £6.0 billion); increases in fuel, tobacco and alcohol duties (raising £3.0 billion).¹⁶

Liberal Democrat tax plans

The Liberal Democrats announced in their manifesto that they would not reverse any of the planned tax increases set out by the Labour government in Budget 2010. In addition to these plans, they would immediately introduce a new levy on bank profits, which they estimate would raise about £2 billion in 2010–11.

On top of this tax rise, they have announced a package of tax changes, which they estimate to be roughly revenue neutral – tax cuts for some groups being paid for by tax rises for others. The one tax cut they have announced is an increase in the income tax personal allowance to £10,000 from April 2011. They estimate this would be paid for by increasing capital gains tax (raising £1.9 billion), restricting tax relief on pension contributions (£5.5 billion), a new ‘mansion tax’ (£1.7 billion), reforms to air passenger duty (£3.3 billion) and anti-avoidance measures (£4.6 billion).¹⁷

Taking the Liberal Democrat costings at face value, the net effect of these plans would be to increase taxes slightly more (0.2% of national income, or £3 billion in 2010–11 terms) by 2014–15 than Labour plans to. We can be pretty confident that the Liberal Democrats’ headline giveaway would cost roughly what they claim it would. Whether their revenue-raising measures would yield what they expect is much more uncertain – although we cannot say with confidence whether they would be more likely to raise too much revenue or too little. On the one hand, their estimates of the revenue to be raised from tackling avoidance and evasion seem optimistic; on the other hand, their estimates of the revenue to be raised from the rest of the package if anything look pessimistic. The only way to find out for sure would be to suck it and see.¹⁸

If the Liberal Democrats’ package does indeed raise a net 0.2% of national income in revenue as they hope, then their borrowing targets and goals for the composition of the tightening do not imply the need to announce any further tax-raising measures – although they have wisely not ruled this out.

Conservative tax plans

The Conservatives have said they would reverse part of the Labour government’s planned increase in NIC rates from April 2011. This policy would cost the Exchequer £5.6 billion in 2011–12 relative to Labour’s plans (and, based on the difference between this and the Treasury estimate of Labour’s NI increase, bring in roughly £0.4 billion relative to an unchanged system). (We estimate that the

¹⁶ All these are Treasury estimates. Full details of these policies and their impact on household finances are discussed in S. Adam, M. Brewer, J. Browne and D. Phillips (2010), *Taxes and benefits: the parties’ plans*, IFS Election Briefing Note No. 13).

¹⁷ All figures are Liberal Democrats’ own estimates of revenue implications (page 100, Liberal Democrat Manifesto 2010). For a discussion of these costings see S. Adam, M. Brewer, J. Browne and D. Phillips (2010), *Taxes and benefits: the parties’ plans*, IFS Election Briefing Note No. 13).

¹⁸ This assessment is taken from S. Adam (2010), *Do the Liberal Democrats’ plans add up?* IFS Observation, April 2010 (<http://www.ifs.org.uk/publications/4820>).

cost of this tax cut would be lower than this as the cut in employers' NICs feeds through into higher wages or higher profits and therefore tax receipts. But our understanding is that this would not be reflected in the Budget costing for such a measure and we have not assumed this in the calculations for this note.) The Conservatives have also said they would not implement Labour's planned broadband levy (costing £175 million) or Labour's proposed increases in cider duty (costing £60 million).

In addition, the Conservatives have announced that they would: cut the income tax liability of some married couples (costing £550 million); introduce a new bank levy (raising £1 billion); freeze council tax for two years (costing £1.3 billion in lost tax revenue); raise inheritance tax thresholds (costing £1.2 billion), abolish stamp duty on properties up to £250,000 for first-time buyers (costing £0.3 billion) and extend the charge for individuals who claim non-domiciled status (from which £1.5 billion would be required to cover the cost of the inheritance tax and stamp duty cuts); a temporary waiving of some employers' National Insurance for new businesses (costing £250 million).¹⁹

If the Conservatives have costed these measures correctly, the net effect of these plans would be to deliver a 0.4% of national income (£6 billion) tax cut by the end of the next Parliament, partially offsetting the 1.2% of national income (£17 billion) tax increase that they would inherit from Labour. But to retain a split between fiscal tightening measures that is 80% spending cuts and 20% tax increases, the Conservatives would need in time to reverse roughly half the net tax cut they have just announced. Specifically, they would need further tax rises amounting to 0.2% of national income (or £3 billion in 2010–11 terms). During the first televised prime ministerial debate, the Conservative leader David Cameron said of the Liberal Democrats' proposed income tax cut: 'It's a beautiful idea, a lovely idea. We cannot afford it'.²⁰ This is a slightly odd accusation for a party advocating a £6 billion net tax cut to make of one proposing a £3 billion net tax increase.

Summary

Labour has already put a £17 billion tax increase into the pipeline for the coming Parliament and we estimate that its goals would require it to announce further tax increases worth around £7 billion. The Conservatives have announced a £6 billion net tax cut on top of what is in the pipeline, but their goals would probably require them to reverse half of it. The Liberal Democrats have announced a £3 billion tax increase on top of what is in the pipeline and would not need to do anything further. On the basis of their own plans and what they would inherit, the rise in the tax burden by 2016–17 would be largest under Labour and lowest under the Conservatives, with the Liberal Democrats in the middle (as shown in Figure 4.2).

6. Filling the hole ... by spending less

Table 4.1 shows that all three main parties are looking to cut public spending as a share of national income between now and 2017–18 in order to help close the gap between government revenues and government spending. Some of this fall will come about automatically – as the economy recovers from recession and spending on, for example, unemployment benefit starts to fall – but some of this fall in total spending will need to be brought about through hard decisions about what the public sector will and will not provide in future.

¹⁹ These figures are Conservatives' own assessment of the costs of these policies. For a discussion of these costings and a discussion of the policies' impacts on households see S. Adam, M. Brewer, J. Browne and D. Phillips (2010), Taxes and benefits: the parties' plans, IFS Election Briefing Note No. 13).

²⁰ http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/16_04_10_firstdebate.pdf.

This section focuses on the changes to government spending required by each of the three main parties between 2010–11 and 2014–15. As Table 4.1 shows, by 2014–15 the Liberal Democrats are looking to cut spending by 5.4% of national income from its 2009–10 level, Labour by 5.6% and the Conservatives by 6.5%. We focus for most of this section on the years up to 2014–15; we provide only a short and on spending in 2015–16 and 2016–17. This is because official forecasts for spending are only available up to 2014–15. Furthermore, 2014–15 might be the last full financial year of the next Parliament and so this section sets out the likely implications for spending under a new government through the next Parliament. It should be remembered, though, that while we assume that Labour and the Conservatives rely on spending cuts to the same degree to deliver the fiscal tightening after 2014–15 as before it, the Liberal Democrats are back-loading their spending cuts into 2015–16 and 2016–17. Focusing on the size of the spending cut required by 2014–15, and the proportion of it that has been identified to date, therefore flatters them to some degree, as we discuss in the later subsection on spending plans in 2015–16 and 2016–17.

The 2007 Comprehensive Spending Review provided detailed plans for spending on all areas for the years 2008–09 to 2010–11. As there has not been a spending review since then, there are currently no detailed plans for spending from 2011–12 onwards, only aggregate figures for what total spending is planned to be under the current Government. (It is these figures for total spending which show that the Labour government is aiming to cut total spending by 5.6% as a share of national income by 2014–15.) Therefore, in this section we examine what each party’s plans for total spending this year and over the next four years would mean for spending on different areas, and to what extent each party has identified where cuts will be made and what cuts are as yet unannounced.

In order to express the changes in spending over time in terms that are most salient, throughout most of the section we will talk about how spending is likely to change from the level Labour are planning for 2010–11 after taking account of economy-wide inflation – that is, the “real terms” change in each component of spending.

Since the Treasury is expecting real terms growth in national income (GDP) over the next four years, any given real terms cut in spending would translate into a larger cut in spending as a share of national income. Therefore, at the end of this section, we conclude by examining how the various policies set out by each party contribute to the cut in spending as a share of national income that they are aiming to achieve by 2014–15 (as discussed and illustrated in Section 4).

Spending plans: 2010–11 to 2014–15

Total spending

The reduction in spending as a share of national income under the Labour Party’s plans, shown in Figure 4.2, will require approximately a real terms freeze in spending between 2011–12 and 2014–15 (the actual cumulative cut after four years amounts to 0.2%). The Liberal Democrats’ plans imply that total spending would grow in real terms by an average of 0.1% a year (or a cumulative increase of 0.3% after four years), while the Conservatives’ plans imply real terms spending cuts averaging 0.6% a year (or a cumulative cut of 2.3% after four years).

Debt interest, Social Security and other Annually Managed Expenditure

Total public spending is divided, for planning purposes, into spending on departments that can be set several years in advance (Departmental Expenditure Limits – DELs) and spending on other areas that are harder to plan in advance (Annually Managed Expenditure – AME). Though there are no official figures for the projected growth in individual components of public spending after

2010–11 (the last year in the current spending review period)²¹, it is possible to make reasonable projections for the growth in components of AME under the Labour government's current policies, and therefore also under the Conservative and Liberal Democrat proposed policies.

Labour AME plans

Figures contained in Budget 2010 suggested that, under Labour's current policies, gross debt interest payments would grow by 12.7% a year on average in real terms over the period 2010–11 to 2014–15.²² This gives a cumulative real increase of 62% by the end of this four year period.

No figures for the growth in social security spending were released by the Treasury at the time of Budget 2010. However, figures leaked from the Treasury to the Conservatives in September 2009 (and dating from the time of Budget 2009) suggest that spending on social security for 2011–12 to 2013–14 would grow by an average 1.4% a year in real terms over these three years. Adjusting these figures for the fact that retail price inflation forecasts differed between Budget 2009 and Budget 2010 (which affects social security spending, as most benefits are uprated in line with the Retail Price Index), and the fact that social security spending was boosted by some temporary measures in 2010–11, implies that on current policies spending on social security would increase by an average 1.1% a year over 2011–12 to 2013–14. We assume that social security also grows by 1.1% in real terms in 2014–15. This gives a cumulative increase in social security spending of 4.4% over this four year period under current government policies.

Other AME includes areas of spending such as expenditure by local authorities that is financed via local taxes, spending on tax credits, spending on pensions paid to retired public sector workers, and the UK's net contribution to the European Union. The leaked figures from the Treasury mentioned above implied that spending on these areas of 'other AME' would increase by an average 3.1% a year in real terms over the three years 2011–12 to 2013–14. We assume that these forecasts for the growth in spending on 'other AME' are still accurate, and that spending in 2014–15 will also increase by a further 3.1%. This would give a cumulative increase in 'other AME' spending of 12.8% over this four year period.

Taken together this means that total spending on AME is projected to grow by an average 3.5% a year under current Labour policies over the period from 2011–12 to 2014–15 (as shown in Figure 6.1), a cumulative increase of 14.7% over the four year period.

Liberal Democrat AME plans

The Liberal Democrats are planning to follow the same timescale for deficit reduction as was set out by Labour in Budget 2010 (as described in Sections 2 and 3). This implies that borrowing follows the same path as it would under Labour, and consequently gross debt interest payments would be the same – growing at an average annual real rate of 12.7%.

²¹ Treasury refused an FOI request from IFS researchers to release their latest forecasts for AME spending under current policies, or even to reveal what spending on the areas of spending that the government has said they would protect in 2011–12 and 2012–13 would be.

²² The March 2010 Budget contains figures for public sector gross debt interest spending up to, and including, 2010–11 in table 2.8 of HM Treasury, *Budget 2010: The Economy and Public Finances – Supplementary Material*, March 2010, http://www.hm-treasury.gov.uk/d/budget2010_supplementary_material.pdf.pdf. Figures for later years were calculated in the following way. First, 'public sector net debt interest payments' were computed by taking the difference between the primary balance (which is borrowing excluding net debt interest payments) and total borrowing, the former measured as a share of national income from table C2 (and converted to £ billion using the Budget projections for GDP in table C1) and the latter measured in £ billion from table C3 of HM Treasury, *Budget 2010*, March 2010, http://www.hm-treasury.gov.uk/budget2010_documents.htm. To get gross debt interest payments, 'interest and dividends' received were added back in; these were taken from table 2.9 of the *Budget Supplementary Material*. The resulting estimates for gross debt interest payments, in cash terms, in 2009–10 to 2014–15 are: £30.8 billion, £41.6 billion, £49.8 billion, £59.6 billion, £66.4 billion and £73.8 billion.

The Liberal Democrats have announced in their manifesto some policies that would alter other areas of AME spending. Their policy to earnings index the state pension from April 2011 (rather than from April 2012) would increase social security spending from 2011–12 onwards, and their reform of winter fuel payments would increase social security spending from 2013–14 onwards. On the other hand, their plan to end government contributions to the Child Trust Fund would reduce social security spending. The net impact of these policies is that social security spending under the Liberal Democrats would grow at a very similar rate as under Labour's policies.

The Liberal Democrats have also pledged to cut the generosity of tax credits by means-testing them more aggressively. This would reduce other AME spending below the levels planned by Labour, resulting in an average annual growth rate of 2.8% a year. This gives a cumulative real increase of 11.6% over this four year period.

Overall the Liberal Democrat policies on social security spending and tax credits imply that spending on AME would grow slightly slower than it would under Labour between 2010–11 and 2014–15, at an average real rate of 3.4% a year (or cumulative growth of 14.3% after four years). In 2014–15 this would save them £1 billion in 2010 prices relative to Labour's plans.

Conservative AME plans

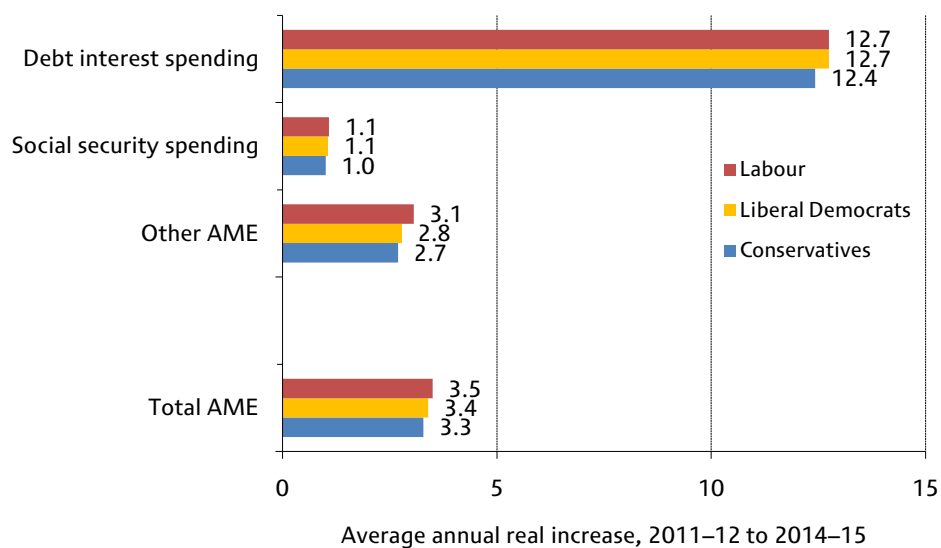
The Conservatives have said that they want to start cutting borrowing sooner and achieve the borrowing cut more quickly than the Labour government plans (as described in Section 3). This means that, over the four years 2011–12 to 2014–15, spending on debt interest would increase slightly less than it would under Labour's borrowing plans, averaging 12.4% a year in real terms. This gives a cumulative real increase of 59% over this four year period.

The Conservatives have also announced policies that would reduce other areas of AME spending relative to the Labour government's plans: they would cut government contributions to the Child Trust Funds of newborns from higher income families which would reduce social security spending and they would means-test the child tax credit more aggressively which would reduce other AME spending. Their pledge to freeze council tax also results in lower social security spending than under Labour (since council tax benefit payments would be lower) and lower levels of other AME spending (since local authorities' would be financing less spending from the council tax).²³ Under the Conservative plans, social security spending would therefore only grow by an average 1.0% a year in real terms, and other AME by an average 2.7% a year, meaning that overall AME will grow by an average 3.3% a year between 2011–12 to 2014–15 (or cumulative growth of 13.8% after four years). In 2014–15 this would save them £3 billion in 2010 prices relative to Labour's plans.²⁴

²³ In calculating the impact of the Conservatives' Council Tax pledge on tax revenues and spending, we have assumed that all councils would qualify for the additional grant without having to change their behaviour.

²⁴ The Conservatives also claim they can find £600 million from AME over three years by subjecting existing recipients of incapacity benefits to the more stringent eligibility test for Employment Support Allowance. They propose to increase the DEL of the Department for Work and Pensions by an equivalent amount. In aggregate terms, this is a small change and whether such AME savings exist relative to government policy has been questioned (see Brewer and Sibieta, *Not much disagreement on welfare reform*, for a discussion: <http://www.ifs.org.uk/publications/4831>). We do not therefore adjust AME or DEL under the Conservatives' plans for either policy.

Figure 6.1 Forecast annual average growth in Annually Managed Expenditure under parties' stated commitments



Spending on public services

If all the parties had the same plans for total public spending between 2010–11 and 2014–15, then the lower growth in AME implied by the Liberal Democrat and Conservative pledges would mean that these parties would need to reduce spending on public services by less than Labour would. However, as Figure 4.2 showed, the parties' plans for total public spending are not the same: by 2014–15, the Liberal Democrats are looking to cut spending to 42.5% of national income, Labour to 42.3% and the Conservatives to 41.4%.

The cuts to total spending that each of the parties has planned between 2010–11 and 2014–15, combined with the likely growth in spending on debt interest payments and welfare benefits (discussed above), imply extremely tight settlements overall for spending on public services. Five consecutive years of real cuts would be necessary under all three parties' plans, something we have not seen since the Second World War.

Over the four years, 2011–12 to 2014–15, Labour's plans imply an average annual cut to public service spending of 1.8%, while the Liberal Democrat plans imply an average cut of 1.7% a year. Either would be the deepest sustained cuts since the four years starting April 1976. The Conservatives plan to cut public service spending more deeply and to start sooner. Over the five years from April 2010, the Conservatives' plans imply an average real terms cut to public service spending of 1.9% a year. This has not been delivered over any five year period since the Second World War.

Labour public service spending plans

The 0.2% real cut to total spending Labour has planned over the period 2011–12 to 2014–15, combined with the likely growth in spending on AME, implies that spending on departments will be cut by an average 3.1% a year in real terms. In other words, by 2014–15 spending on departments under Labour would be £47.0 billion lower than Labour is planning to spend on departments in 2010–11. This is shown in Table 6.1, along with the implications of Labour's stated policies for some components of DEL.

Labour has made specific commitments on some areas of departmental spending. They have pledged to meet the UN target for spending 0.7% of Gross National Income on overseas aid (ODA) by 2013, and it seems reasonable to assume they will maintain ODA spending at least at this level

thereafter. This would require an increase in real terms ODA spending of £3.8 billion by 2014–15 relative to 2010–11, an average annual real growth rate of 9.1%.

The Labour government has also pledged to maintain in real terms non-investment spending on the NHS (95% of all NHS spending) and to ‘protect’ parts of education spending (non-investment spending on schools would receive a 0.7% a year real increase, non-investment spending on 16-19 participation a 0.9% a year real increase and non-investment spending on sure start would be maintained in real terms). However, it has only made these pledges for 2011–12 and 2012–13. It is not known what spending on the NHS and these parts of education would be from 2013–14 onwards. Table 6.1 therefore considers two possible scenarios. In the “No protection for years 3 & 4 scenario”, the NHS and the protected parts of education spending receive the same average cuts to their budgets as all other areas of non-ODA departmental spending in 2013–14 and 2014–15. In the “Continued protection for years 3 & 4” scenario, we assume that the NHS and protected parts of education have the same average annual growth rates in 2013–14 and 2014–15 as in the previous two years.

Under the first scenario, the unprotected areas of DEL will see cuts to their budgets of £40.2 billion by 2014–15, which is nearly one-fifth of their 2010–11 budgets (19.5%, equivalent to an average real cut of 5.3% a year). Under this scenario, the combined cut to the unprotected budgets and the ‘protected’ NHS and education budgets by 2014–15 would be £50.8 billion. (In other words, the additional £3.8 billion increase in ODA to meet the target means the cuts elsewhere need to be larger than the £47.0 billion overall cut.)

Under the second scenario, the unprotected areas would see cuts of £52.4 billion, which is just over one-quarter of their 2010–11 budgets (25.4% in total, an average cut of 7.1% a year). Under this scenario, there would be no real terms cut to the ‘protected’ NHS budget and the ‘protected’ areas of education would see their budgets rise by a total of £1.6 billion (figures do not sum due to rounding).

These figures do not take into account Labour’s pledge to provide sufficient funding to “maintain police officer numbers”.²⁵ While this pledge implies some additional pressures on spending, it is hard to quantify the exact cost of it. If this pledge could not be delivered within the Home Office budget receiving the average cut required across all unprotected departments (19.5% after four years, under the two year protection scenario), then the cuts required across other departments would be even larger. The largest departmental budgets that the Labour Party has not pledged to protect at all are defence, higher education, transport and housing.

²⁵ Page 85 of HM Treasury, *Budget 2010*.

Table 6.1 Implications of Labour's stated policies for DEL, relative to Labour's planned DEL for 2010–11 (£ billion, 2010–11 prices)

	2010–11	2011–12	2012–13	2013–14	2014–15	Average Annual change (%)	Cumul. change (%)
No protection for years 3 & 4							
Total DEL	0.0	-14.5	-26.0	-39.8	-47.0	-3.1	-11.9
Overseas Aid	0.0	+1.0	+2.2	+3.4	+3.8	+9.1	+41.8
NHS	0.0	0.0	0.0	-5.1	-7.7	-1.6	-6.4
Schools	0.0	+0.3	+0.6	-1.3	-2.3	-1.3	-5.0
16–19 participation	0.0	+0.1	+0.2	-0.2	-0.5	-1.2	-4.7
Sure start	0.0	0.0	0.0	-0.1	-0.1	-1.6	-6.4
Other	0.0	-15.9	-28.9	-36.4	-40.2	-5.3	-19.5
Continued protection for years 3 & 4							
Total DEL	0.0	-14.5	-26.0	-39.8	-47.0	-3.1	-11.9
Overseas Aid	0.0	+1.0	+2.2	+3.4	+3.8	+9.1	+41.8
NHS	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Schools	0.0	+0.3	+0.6	+1.0	+1.3	+0.7	+2.8
16–19 participation	0.0	+0.1	+0.2	+0.3	+0.4	+0.9	+3.6
Sure start	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	-15.9	-28.9	-44.4	-52.4	-7.1	-25.4

Note: See main text for assumptions.

Source: Authors' calculations.

The DEL cuts announced to date by the Labour government and how far they go to achieving the required cut in DEL are shown in Figure 6.2. The government has so far claimed that it will cut £5 billion of lower value programs by 2012–13 (£1.4 billion of which is from ending additional employment schemes put in place during the recession) and will freeze public sector pay and limit payments into public sector pensions (saving £3.4 billion and £1 billion respectively by 2012–13). Without taking into account the fact that the Labour government had pledged to protect some areas of departmental spending, this would contribute a total of £9.6 billion out of the £47 billion DEL cut required by 2014–15, leaving 79.5% of the cuts still to be found. This is shown in the leftmost column of Figure 6.2.

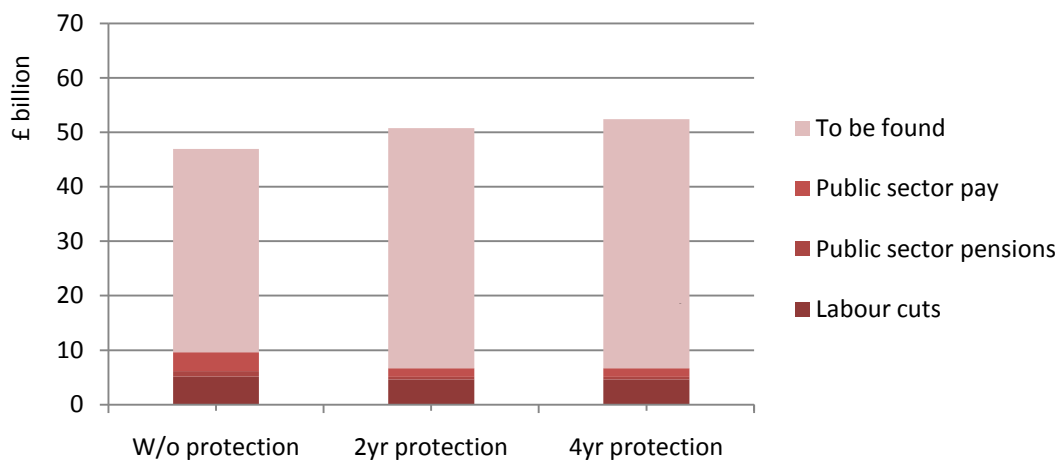
The Government also claims that it will find efficiency savings worth £11 billion in 2012–13 (increasing to £12 billion by 2013–14), and that this will help achieve the overall spending reduction. But to argue that efficiency savings (which are notoriously difficult to verify even after the event) contribute to the fiscal tightening in any meaningful sense is misleading. All governments presumably try to spend public money as efficiently as they can whatever the fiscal climate. If there are £11 billion of additional efficiency savings to be found in 2012–13 it is not obvious why most if not all of them could and should not be delivered if the government did not have to cut spending overall. If so, they do not narrow the gap between the quality and quantity of public services that would be delivered in a world of spending cuts versus a world without. For

what it is worth, the Government's claimed efficiency savings would represent a further 26.8% of the total cut in DELs.

Labour's commitment to protect ODA and parts of NHS and education spending means that any cuts to programs, pay or pensions which the government has announced that come from within these protected areas of spending would not count towards reducing DEL. Instead any savings in these areas would be recycled within the protected budget.²⁶ Under the two year protection scenario, only £6.7 billion of Labour's announced cuts would count towards the required reduction in DEL (which totals £50.8 billion by 2014–15). This leaves £44.1 billion worth of cuts (86.9% of the total required) still to be announced. The budgets of non-ODA DELs would amount to £378.4 billion after the already announced cuts. This is a cut of 11.7%. However, this assumes that spending on the NHS and education could be cut in 2013–14 and 2014–15.

If instead Labour were to continue protecting parts of the NHS and education budgets for a further two years, then the cuts elsewhere would need to be deeper. Under the four year protection scenario, again £6.7 billion of Labour's announced cuts would count towards the required reduction in DEL (which would now total £52.4 billion by 2014–15). This would leave £45.8 billion worth of cuts (87.3% of the total required) still to be announced. Given that the budgets of the non-protected departments would only amount to £200.2 billion after the already announced cuts, this is a cut of 22.9% and is likely to be no small ask.

Figure 6.2. Filling the hole in DEL plans? Labour



Liberal Democrat public service spending plans

The implications of the Liberal Democrat policies for DEL are described in Table 6.2. Their introduction of a levy on bank profits and reductions in AME spending in 2010–11 mean that they could increase DEL spending in 2010–11 by £3.3 billion relative to Labour's plans for 2010–11.²⁷ From 2011–12 onwards, DEL spending would fall, but again (because of their higher tax revenue and lower spending on AME) it would fall less each year than it would under Labour's policies. By

²⁶ We assume that £0.5 billion of the cuts to lower value programs are within the protected budgets and that savings from pay and pensions are found across departments in proportion to their 2008–09 total pay bills; employees within the NHS and schools accounted for about 55% of total pay in 2008–09.

²⁷ It is difficult to know whether the Liberal Democrats would, in fact, increase DELs. On the one hand, they have emphasised the importance of deficit reduction and so increasing DELs in-year may seem an unlikely action for them to take. On the other hand, they are critical of the Conservatives' plans to cut borrowing in 2010–11 (as it would withdraw stimulus from the economy while it was still weak) and so to do so themselves would also perhaps seem unlikely – though the borrowing reduction available to them would be about a third of the size of the proposed Conservative cut. For simplicity, we assume here that they increase DELs and thus borrow the same amount as Labour plan to in 2010–11.

2014–15, DEL would be £42.7 billion lower than Labour’s planned 2010–11 level, equivalent to an average real cut of 2.8% a year.

The Liberal Democrats have confirmed that they too would meet the target for ODA spending, and so spending on ODA would increase by the same amount as it would under Labour (by £3.8 billion, or 41.8%, in real terms by 2014–15). Since this is the only Liberal Democrat commitment on departmental spending, it leaves spending on all other areas of DEL facing cuts of £46.5 billion relative to Labour’s planned level for 2010–11. This would be equivalent to a 12.1% cumulative cut, or an average cut of 3.2% a year.

Table 6.2 Implications of Liberal Democrat stated policies for DEL, relative to Labour’s planned DEL for 2010–11 (£ billion, 2010–11 prices)

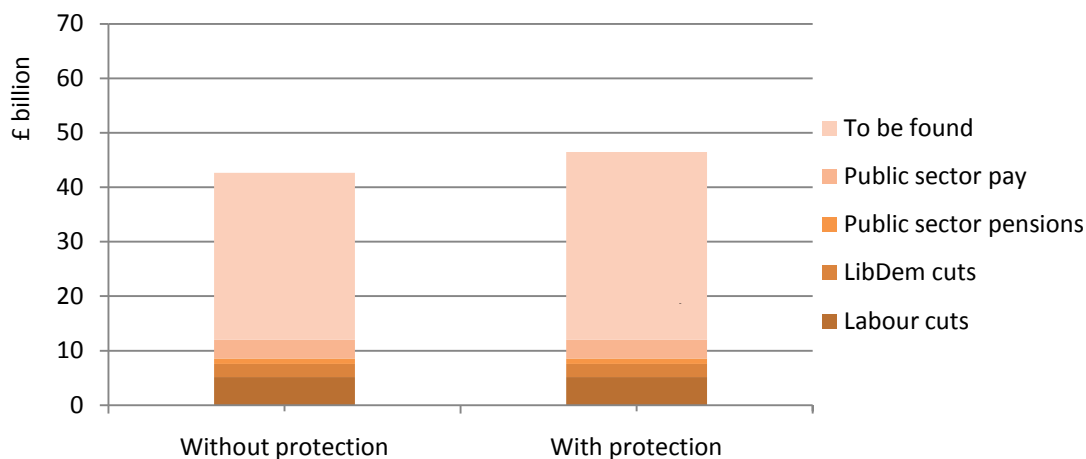
	2010–11	2011–12	2012–13	2013–14	2014–15	Average Annual change (%)	Cumul. change (%)
Total DEL	+3.3	–10.1	–21.9	–35.6	–42.7	–2.8	–10.8
Overseas Aid	0.0	+1.0	+2.2	+3.4	+3.8	+9.1	+41.8
Other	+3.3	–11.2	–24.0	–39.0	–46.5	–3.2	–12.1

Note: Average annual growth rates are calculated over four years, relative to Labour’s planned DEL spending in 2010–11. Cumulative changes are also expressed relative to Labour’s planned 2010–11 DEL spending. Source: Authors’ calculations – see main text for assumptions.

The Liberal Democrat plans imply that cuts to DEL of £42.7 billion need to be found, or £46.5 billion once their protection of ODA spending is taken into account. They have announced £2.4 billion of net savings through specific measures outlined in their manifesto (excluding their policy on public sector pay). The Liberal Democrats’ proposal to limit public sector pay rises to £400 a year for two years differs from Labour’s plans for cutting public spending, but the resulting total spending cut is expected by the Liberal Democrats to be about the same (£3.4 billion). We also assume they would implement the Government’s planned measures on public sector pensions, saving £1 billion.

If the Liberal Democrats were able to deliver these cuts in addition to cutting the £5 billion of lower value programs announced by Labour, then they will have announced £12.0 billion of cuts to departmental spending (see Figure 6.3). This would account for 25.9% of the £46.5 billion of saving they need, leaving another £34.4 billion of DEL cuts to be identified. Since the Liberal Democrats have not committed to protecting any departments’ budgets, these £34.4 billion of savings need to be found from a total ‘post-announced cuts’ non-ODA DEL budget of £377.0 billion – leaving them more options open than Labour.

Figure 6.3. Filling the hole in DEL plans? Liberal Democrats



Conservative public service spending plans

The Conservative plans to cut the deficit sooner and faster imply that they need to cut DEL by more than Labour, as described in Table 6.3. They have pledged to cut overall departmental spending in 2010–11 by £6 billion relative to Labour’s plan for that year and they have said that this cut would not come from either planned spending on ODA or the NHS or Ministry of Defence (MoD) budgets. Therefore, other departments would have to cut their budgets by an average of 2.8% in 2010–11, relative to the plans currently set out by the Labour government, in order to deliver this £6 billion saving. The Conservatives have not said which departments would have their budgets reduced in 2010–11 (meaning that they are providing considerably less detail over their spending plans for 2010–11 than either Labour or the Liberal Democrats). The largest of these potentially prunable departments is the Department for Children, Schools and Families whose budget is set to be £58.2 billion in 2010–11.

The Conservatives’ plan to cut borrowing more quickly implies greater cuts to spending than under Labour in future years as well. Their plans imply a total real terms cut to spending amounting to £59.4 billion (or 15.1%, relative to Labour’s plans for 2010–11) by 2014–15. This would be equivalent to an average annual cut in DEL of 4.0% relative to Labour’s 2010–11 level.

The Conservative party are committed to the same ODA target as Labour, which would require an increase in spending of £3.8 billion in real terms by 2014–15. They have also promised to increase real spending on the NHS year-on-year, although they have not said by exactly how much; for what follows, we have assumed an annual real growth rate of just 0.1%. This implies that spending on the NHS would be £0.5 billion higher in real terms in 2014–15 than Labour is planning to spend in 2010–11.

The MoD is also listed separately in Table 6.3. Though the Conservatives have pledged not to cut the MoD budget in 2010–11, they have not made any specific pledges regarding MoD spending after 2010–11. The table assumes that, for 2011–12 onwards, the MoD receives the same average annual real cut as all other areas of non-NHS, non-ODA spending.

Table 6.3 Implications of Conservative stated policies for DEL, relative to Labour's planned DEL for 2010–11 (£ billion, 2010–11 prices)

	2010–11	2011–12	2012–13	2013–14	2014–15	Average Annual change (%)	Cumul. change (%)
Total DEL	-6.0	-21.1	-34.2	-50.1	-59.4	-4.0	-15.1
Overseas Aid	0.0	+1.0	+2.2	+3.4	+3.8	+9.1	+41.8
NHS	0.0	+0.1	+0.3	+0.4	+0.5	+0.1	+0.4
MoD	0.0	-2.7	-5.0	-7.8	-9.4	-6.3	-23.0
Other	-6.0	-19.6	-31.6	-46.1	-54.3	-7.0	-25.1

Note: Average annual growth rates are calculated over four years, relative to Labour's planned DEL spending in 2010–11. Cumulative changes are also expressed relative to Labour's planned 2010–11 DEL spending.

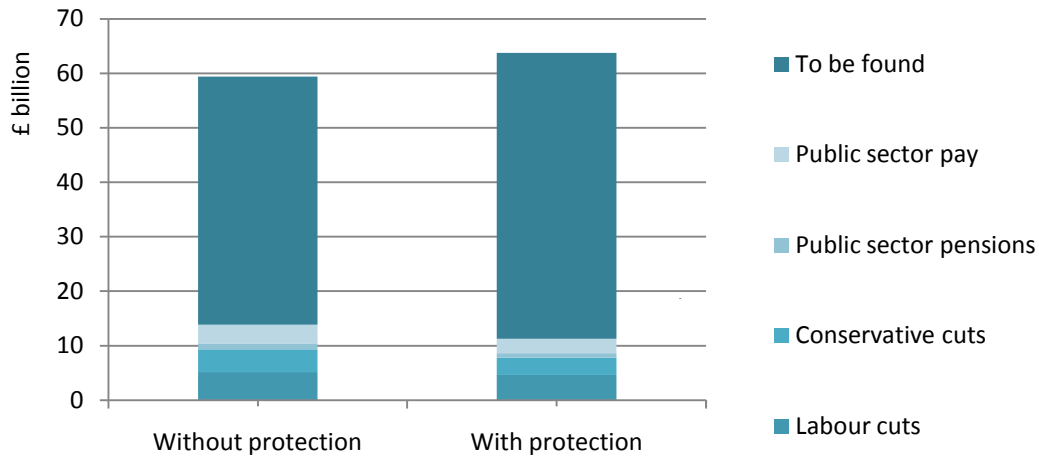
Source: Authors' calculations – see main text for assumptions.

The Conservatives have said they would cut spending on Whitehall administration and quangos by £3 billion over the next Parliament and cut spending on advertising by £1.1 billion in 2011–12, and that these cuts would be over and above anything the Labour government has identified. The Conservatives have also pledged to cut public sector pay and pensions. Though their proposals in this area differ slightly from Labour's, the overall saving is about the same. Without taking their plans to protect the NHS into account, if the Conservatives did manage to make all these savings on top of those identified by Labour then they will have spelled out £13.8 billion of cuts, out of a required total of £59.4 billion. This is shown in the left column in Figure 6.4. However, taking into account their plans to protect NHS spending and ODA, the required cuts to DEL would be £63.7 billion and only £11.3 billion of the above identified cuts would count.²⁸ The Conservatives therefore need to find another £52.5 billion worth of DEL cuts, equivalent to 82.3% of the total cuts required, and these would need to be found from the £241.4 billion of 'post-announced cuts' non-ODA, non-NHS departmental spending – a cut of 21.7%.

The Conservatives claim that they could find £12 billion of efficiency savings in the coming year, of which £6 billion would be recycled into their protected areas and £6 billion would be used to cut the overall DEL total in 2010–11. As with Labour, it is misleading to claim that this is a contribution to the fiscal tightening in the same way that, for example, their public sector pay cuts would be. The bottom line is that the Conservatives are promising to cut spending by £6 billion next year and they claim that they could deliver the same quality and quantity and quality of public services as Labour would. That is unverifiable in advance and would be unverifiable in retrospect and presumably the Conservatives would be seeking to eliminate that waste even in the absence of a spending cut.

²⁸ To calculate what part of the announced cuts and efficiencies would be within the 'protected' NHS budget, we have assumed that the cuts to quangos and administration would be found across departments proportional to their 2010–11 DELs and we assume that savings from pay and pensions are found across departments in proportion to their 2008–09 total pay bills – employees within the NHS accounted for about 31% of total pay in 2008–09.

Figure 6.4. Filling the hole in DEL plans? Conservatives

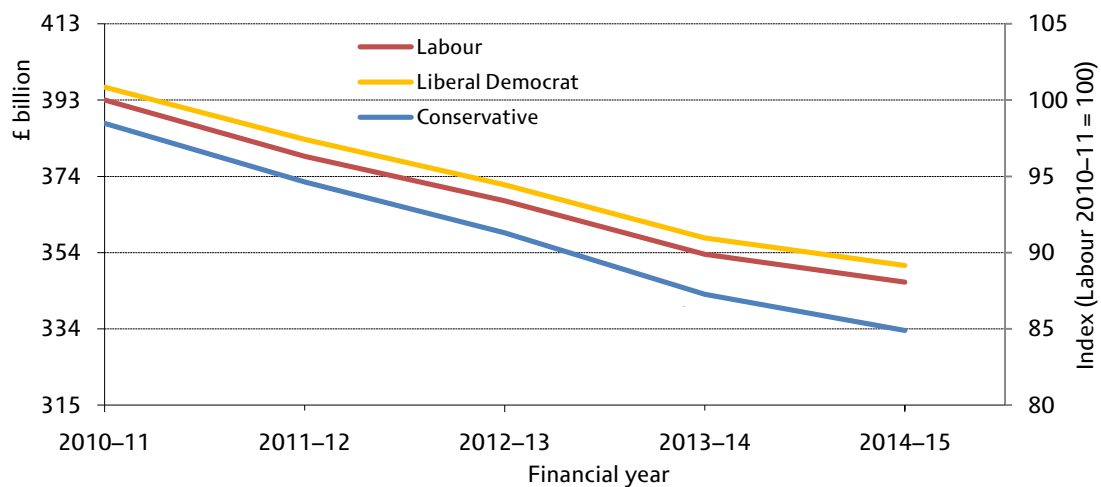


Note: “Conservative cuts” comprises the amounts the Conservatives say would be cut from Whitehall administration, quangos and advertising. Under the “with protection” scenarios we assume that the savings on pay in each department are proportional to that department’s pay bill in 2008–09; the cuts to administration are assumed to be made proportional to each department’s 2010–11 DEL.

Comparing the parties’ public service spending plans

What the parties’ plans imply for departmental spending between 2010–11 and 2014–15 are compared in Figure 6.5. Departmental spending would be highest under the Liberal Democrats in all these years. (Beyond 2014–15, the Liberal Democrats would need a larger cut in public spending and therefore probably a larger cut in DELs than either Labour or the Conservatives. However, we do not know at what level they would reach under Labour in the first place – this is discussed below.) The Liberal Democrats’ proposed net tax increase would allow them to spend more than Labour until 2014–15 while still having the same plan for the reduction of borrowing. Their plans to reduce AME also mean that a greater proportion of their spending would be spent on public services. The Conservatives on the other hand would have the lowest DEL spending in all years. While their pledges imply the lowest growth in AME over this period out of the three parties, their much tighter plan for total public spending more than offsets this. Relative to Labour’s planned 2010–11 level of DEL spending, by 2014–15 real terms spending on DEL would be 15.1% (£59.4 billion), 11.9% (£47.0 billion) or 10.8% (£42.7 billion) lower under the Conservatives, Labour and the Liberal Democrats respectively.

Figure 6.5. DEL spending plans, by party, £ billion

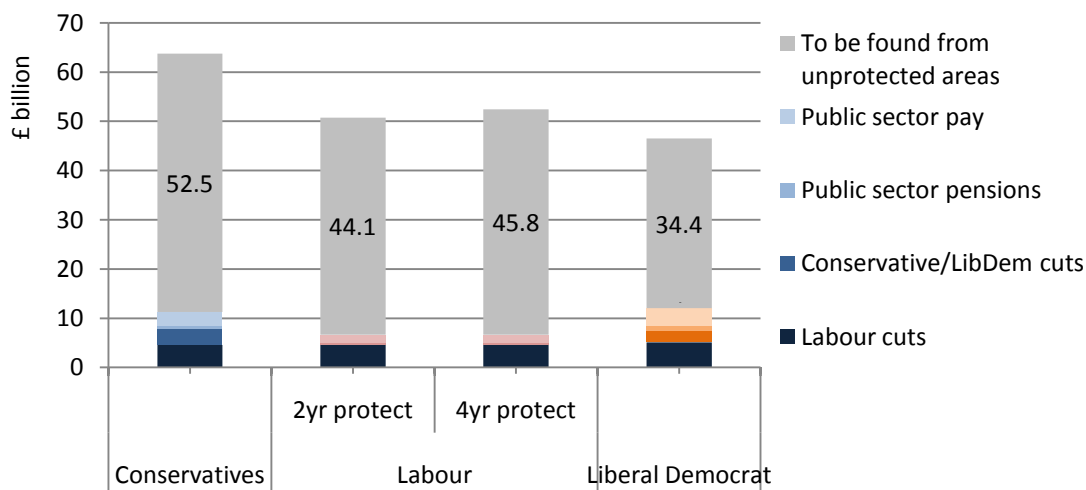


All three parties' plans imply large cuts to departmental spending between 2010–11 and 2014–15. Once we take into account their various pledges to protect certain departments, the Conservatives need to find DEL cuts of £63.7 billion, Labour £52.4 billion (or £50.8 billion if parts of the NHS and education were protected for two years rather than four), and the Liberal Democrats £46.5 billion. All three parties would need to find further spending cuts after March 2015. However, with the Conservatives planning to have achieved a slightly larger reduction in borrowing by March 2015, they would require a smaller spending cut thereafter than either Labour or, in particular, the Liberal Democrats (as shown in Table 4.1).

Bringing together the figures presented for each party individually in Figures 6.2, 6.3 and 6.4, Figure 6.6 sums up how the parties compare in terms of the size of the cut required by 2014–15 and how much detail they have provided on where these cuts to DEL will come from.

The Conservatives have announced measures²⁹ (excluding efficiency savings) that would reduce departmental spending by £11.3 billion, just 17.7% of the total cuts they need to implement. Similarly, the Labour Party has made few announcements of solid spending cuts. Their cuts to spending (excluding efficiency savings) amount to £6.7 billion, which would contribute only 13.1% of the required cut under the “2yr protection” scenario and just 12.7% of the required cut under the “4yr protection” scenario. The Liberal Democrats have made no pledges of efficiency savings but they have announced cuts amounting to £12.0 billion, equivalent to 25.9% of the total spending cut they require.

Figure 6.6. Not filling the hole in DEL to 2014–15, the parties compared



It is immediately clear in Figure 6.6 that the majority of the cuts in departmental spending required have yet to be spelled out by any party; the Conservatives and Labour being worse offenders on this score than the Liberal Democrats.

As we have noted, it is misleading to count claimed efficiency savings as contributing to the required spending cuts. Labour claims that it will find efficiency savings worth £15 billion in 2010–11, thanks to the efficiency drive that accompanied the last Spending Review, a further £11 billion by 2012–13 and then an extra £1 billion in 2013–14. The Conservatives claim that they could find an additional £12 billion of efficiency savings in 2010–11, half of them outside their protected areas. Labour say that these savings are either unachievable or ones that they are planning to

²⁹ These measures comprise £3 billion cuts to Whitehall administration and quangos, £1.1 billion cuts to advertising budgets, plus cuts to public sector pay and pensions (which we assume amount to the same total as Labour’s proposed cuts – £4.4 billion).

achieve already. If any of the efficiency savings that the two parties claim to be achievable are actually achievable in a painless way, then presumably whoever is in power will implement them.

Spending plans: 2015–16 and 2016–17

By 2014–15, the Conservatives plans imply that they would need to cut real terms public spending (relative to the level planned by Labour for 2010–11) by £16.5 billion, while Labour would need a £1.1 billion spending cut and the Liberal Democrats could increase spending by £1.8 billion. Given the likely increases in spending on the components of AME, we estimate these changes in total spending would imply cuts to total real terms DELs amounting to £59.4 billion under the Conservatives' plans, £47.0 billion under Labour and £42.7 billion under the Liberal Democrats (as discussed above and shown in Figure 6.5). Part of the reason that the spending cut is larger under the Conservatives up to 2014–15 is that they are aiming to cut borrowing more quickly (as discussed in Section 3). So they would have less work to do to cut borrowing beyond 2014–15.

Table 6.4 Cuts required to public spending under the three parties' plans

<i>£ billion (2010–11 prices)</i>	Labour	Liberal Democrat	Conservative
Change in total spending: to 2014–15 ^a	–1.1	1.8	–16.5
<i>Of which:</i>			
Change in AME	45.8	44.4	42.9
Change in DEL	–47.0	–42.7	–59.4
<i>Of which:</i>			
Announced	–9.6	–12.0	–13.8
To be announced	–37.3	–30.6	–45.6
Change in total spending: 2014–15 to 2016–17	3.0	–5.0	5.7
<i>Of which:</i>			
Change in AME	?	?	?
Change in DEL	?	?	?
Change in total spending: to 2016–17 ^a	1.8	–3.2	–10.8

Note: a relative to Labour's 2010–11 base.

Table 6.4 examines the implications of the parties' deficit reduction plans for spending in 2015–16 and 2016–17. In order to achieve the composition of fiscal tightening set out in Figure 4.1 (and assuming that each party delivered its plans, discussed above, for spending and revenues up to 2014–15), the Conservatives could afford for total spending to increase in real terms by £5.7 billion between 2014–15 and 2016–17. Over this period, Labour could increase spending by £3.0 billion in real terms. On the other hand, if the Liberal Democrats are to meet their aspiration of achieving all of the deficit reduction over these two years through cuts to spending rather than any further tax increases, they would have to cut total real terms spending by £5.0 billion. In other words, the outlook for total spending would be likely to be tightest under the Liberal Democrats and loosest under the Conservatives over this period. Unfortunately, as we have no official forecasts for components of spending beyond 2014–15, we cannot calculate with much confidence what the precise impact of these plans for total spending would be on AME and DEL spending beyond 2014–15.³⁰ However, given how small these increases in total spending are (and, indeed, the Liberal

³⁰ The DWP website contains forecasts for spending on social security (http://research.dwp.gov.uk/asd/asd4/long_term.asp). However these have not been updated since May 2008 (and

Democrat plans imply real cuts to total spending) it seems likely that further cuts to DELs would also be required over this period.

Cutting spending as a share of national income: 2010–11 to 2014–15

All three parties are aiming to reduce government borrowing largely through cuts to public spending as a share of national income. However, the composition of the fiscal tightening differs slightly between the parties. As Section 4 set out, between 2009–10 and 2014–15, the Conservatives would look to cut spending by 6.5% of national income, while Labour would aim to cut it by 5.6 percentage points and the Liberal Democrats by 5.4 percentage points. If real terms spending was to grow less quickly than real national income, spending would decline as a share of national income.³¹ Therefore, real terms cuts to any areas of spending would cut that component of spending as a share of national income by even more. In this subsection we examine what the figures for real terms growth/cuts in different components of spending discussed above imply for changes in spending as a share of national income between 2010–11 and 2014–15.

Labour planned cuts to spending as a share of national income

Between 2010–11 and 2014–15 Labour are looking to cut spending by 5.8% of national income. This is slightly bigger than the cut between 2009–10 and 2014–15 (shown in Table 4.1 and in the first bar of Figures 6.7a and 6.7b) because they plan to increase spending by 0.2% of national income between last year and this year. Figure 6.7a shows how changes in various components of spending, along with pledged cuts to certain areas of spending, will contribute to this cut in spending as a share of national income under the assumption that parts of the NHS and education are only ‘protected’ for two years. (Figure 6.7b shows the equivalent figures under the assumption that these budgets are protected for four years.)

Over the next four years our estimates (discussed above) suggest that spending on debt interest payments will grow quickly and rise by 1.2% of national income. This increases the cut to spending as a share of national income required elsewhere from 5.8% of national income to 7.0% of national income. Social security spending, and spending on other areas of AME, are projected to grow less quickly than national income under current policy, thereby reducing the share of national income to be found elsewhere by 0.9% of national income.

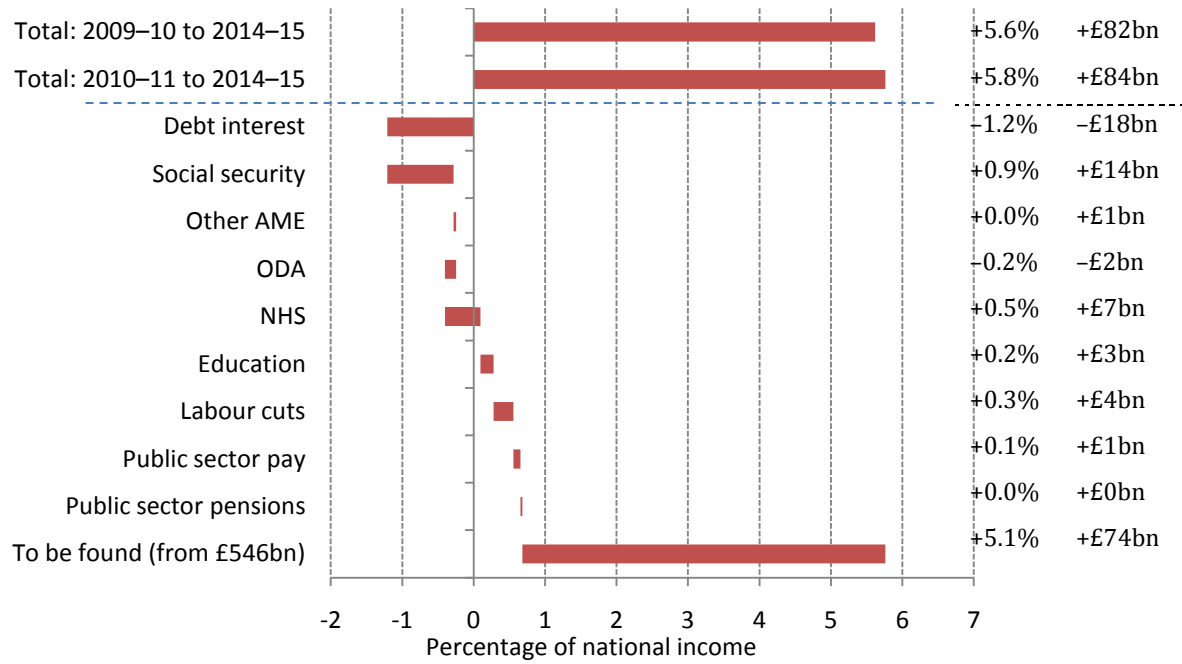
Spending on ODA is planned to increase as a share of national income, increasing the cut required elsewhere. Labour’s spending commitments for large parts of the NHS and education budgets result in lower growth in spending on these areas than the growth in national income, and thus these areas actually contribute to the cut in total spending as a share of national income required. For example, freezing most of NHS spending in real terms would reduce its spending by 1.0% of national income, equivalent to £14 billion in today’s terms, if this ‘protection’ were afforded for four years.

Labour’s claimed cuts to lower priority spending and their policies on public sector pay and pensions contribute to cuts in spending of 0.3%, 0.1% and 0.0% of national income respectively. What is most clear from Figures 6.7a and 6.7b, however, is that the source of the majority of the required cuts in total spending has yet to be identified: assuming four years’ protection for the NHS and education, a 4.4% of national income required cut, equivalent to £65 billion in today’s terms, has yet (as far as we can discern) to be identified.

therefore relate to the economic outlook as of Budget 2008 which is before the financial crisis struck). DWP refused an FOI request from IFS researchers to release their latest forecasts.

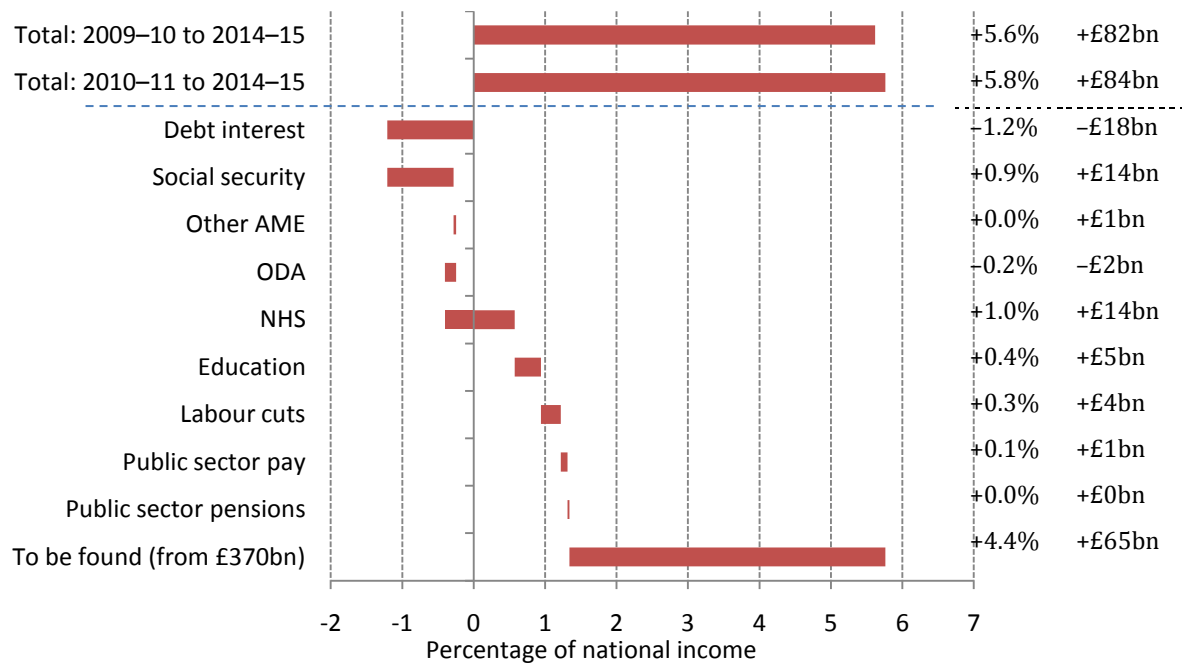
³¹ The Treasury forecasts that real terms growth in national income will average 3.2% a year over the four years 2011–12 to 2014–15.

Figure 6.7a. Filling the hole? Labour by 2014–15 (2 year protection)



Source: Authors' calculations.

Figure 6.7b. Filling the hole? Labour by 2014–15 (4 year protection)



Source: Authors' calculations.

To understand the scale of this number, we need to put it in the context of the overall budget from which it is to be cut. While the “protection” of much of the NHS and schools budgets is actually contributing to the required cut in spending as a share of national income, it also means that this remaining £65 billion of cuts could not come from these areas. Similarly, it could not come from ODA, debt interest or, we assume, from other AME (although in practice it could come from tax credits). It could come from other DELs or from social security spending (although in practice it

might be unlikely to come from the state pension which is the most expensive social security benefit). Under these assumptions the £65 billion of remaining cuts to spending as a share of national income under Labour would need to be found from £370 billion of total spending (total spending less spending on debt interest payments, other AME, ODA and the protected parts of the NHS and education budgets). This would be an average cut of 17% in spending. This assumes that spending on social security could be cut back further as a share of national income. If this were not the case the average cut would rise to 32%.

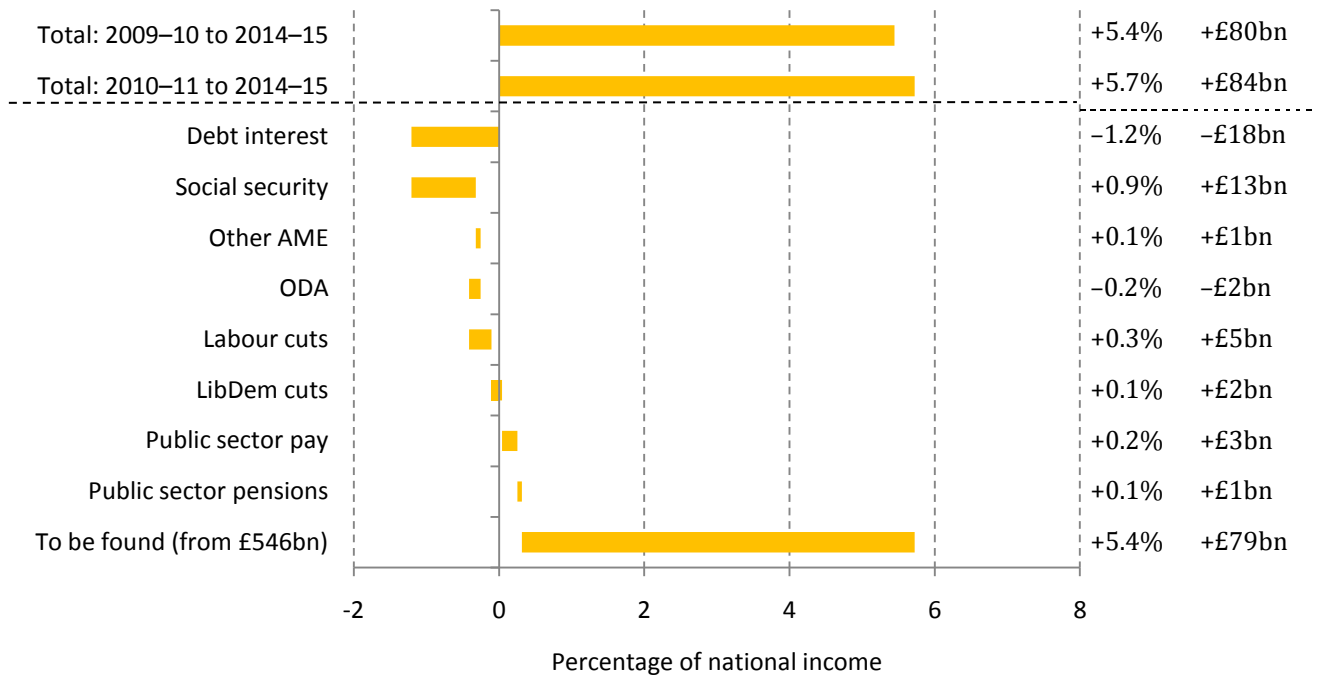
Liberal Democrat planned cuts to spending as a share of national income

Figure 6.8 contains the equivalent set of figures for the Liberal Democrats. The total cut in public spending as a share of national income implied by their plans from 2009–10 to 2014–15 is 5.4% of national income (or £80 billion in 2010–11 terms), as was shown in Table 4.1. Between 2010–11 and 2014–15 the cut to spending as a share of national income rises to 5.7% of national income (£84 billion in today's terms) which is due to an implied increase in spending as a share of national income between last year and this year.

High growth in debt interest spending as a share of national income is offset slightly by a fall in social security and other AME spending as a share of national income under current policies. Their pledge to meet the ODA target would increase the cut needed elsewhere. The remaining rows of Figure 6.8 take account of the low-value cuts that Labour have said they would implement (which we assume the Liberal Democrats could also implement), the spending cuts set out in the Liberal Democrats' manifesto, and their policies that imply reducing spending on public sector pay and pensions. This leaves spending cuts of 5.4% of national income, or £79 billion in 2010–11 terms, to be found. This is larger than the 4.1% of national income (£59 billion) spending cut to be found we identified above for Labour's plans. Note, however, this arises because the Liberal Democrats have not chosen to protect spending in areas such as the NHS or education, which means that the larger cuts in spending as a share of national income that they would need to deliver could, at least in principle, be shared more widely.

Assuming that the cuts could not come from ODA, debt interest or other AME then the £79 billion of remaining cuts to spending as a share of national income under the Liberal Democrats would need to be found from £546 billion of total spending. This would be an average cut of 14% in spending. This assumes that spending on social security could be cut back further as a share of national income. If this were not the case the average cut would rise to 19%. So although the Liberal Democrats have the largest cuts (as a share of national income) yet to announce they also have the largest pool of public spending to draw on for those cuts and this means that their cuts could be more widely spread and, as a result, less deep than Labour's cuts.

Figure 6.8. Filling the hole? Liberal Democrats by 2014–15

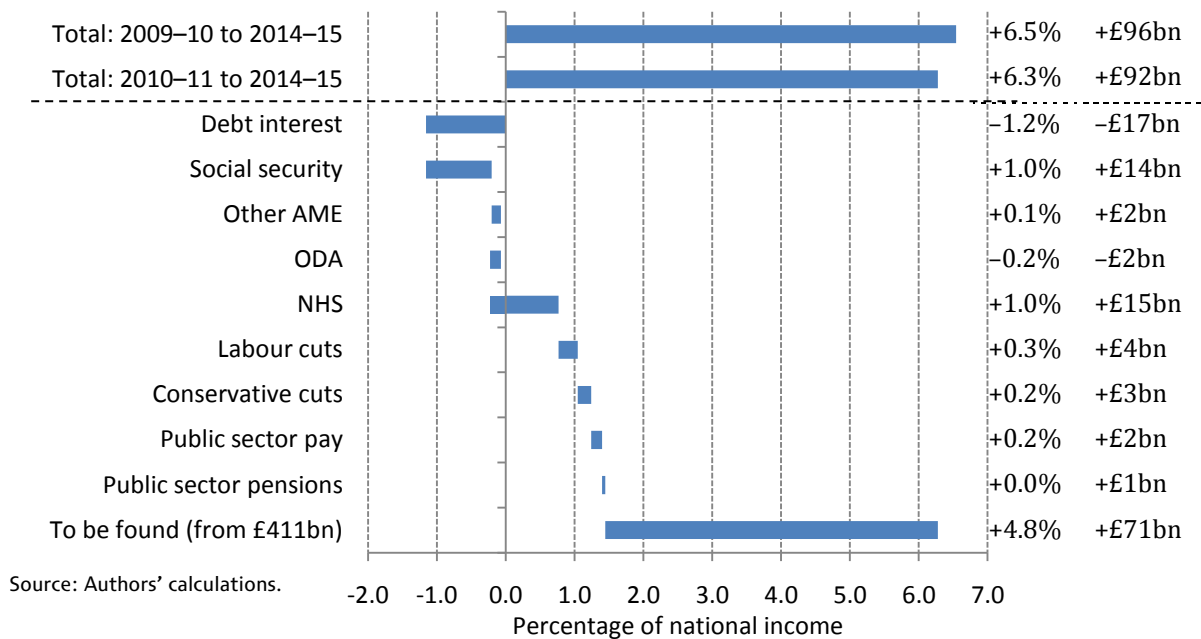


Source: Authors' calculations.

Conservative planned cuts to spending as a share of national income

Figure 6.9 constructs a similar description of the cuts to public spending as a share of national income implied by the Conservative party plans. Their total required cut is 6.5% of national income (£96 billion in 2010–11 terms) between 2009–10 and 2014–15, as was shown in Table 4.1. Between 2010–11 and 2014–15 this falls to 6.3% of national income (or £92 billion). This fall is due to the up-front spending cuts that they would strive to make in 2010–11 in order to reduce spending and borrowing in 2010–11. This would be sufficient to make public spending fall rather than climb as a share of national income between last year and this year, which is in contrast to the picture under either Labour (Figure 6.7) or the Liberal Democrats (Figure 6.8). Despite this, the cut in spending as a share of national income between 2010–11 and 2014–15 that the Conservatives would require is larger than either the Liberal Democrats or Labour and comes partly from their desire to reduce borrowing more quickly (Section 3) and, mostly, from their desire to bring about more of the reduction in borrowing through net spending cuts than through net tax rises (Section 4).

Figure 6.9. Filling the hole? Conservatives by 2014–15



High growth in debt interest spending as a share of national income is set to be offset slightly by a fall in social security and other AME spending as a share of national income, based on currently stated policies. Their pledge to meet the ODA target would, however, increase the cut required elsewhere. Their promise to increase the overall NHS budget year-on-year would, under our assumption of 0.1% a year real increase, reduce NHS spending by 1.0% of national income over the period from 2010–11 to 2014–15 and thereby reduce the spending cut as a share of national income required elsewhere. The remaining rows of Figure 6.9 take account of the low-value cuts that Labour have said they would implement (which we assume the Conservatives would also implement), the spending cuts set out in the Conservatives manifesto and their policies that imply reducing spending on public sector pay and pensions.

This leaves spending cuts of 4.8% of national income, or £71 billion in 2010–11 terms, to be found. This is a slightly larger amount than that to be found under Labour's plans but smaller than the 5.4% of national income (£79 billion) that we estimate would need to be found under the Liberal Democrats plans. Assuming that the cuts could not come from ODA, the NHS, debt interest or other AME then the £71 billion of remaining cuts to spending as a share of national income under the Conservatives would need to be found from £411 billion of total spending. This would be an average cut of 17% in spending. This assumes that spending on social security could be cut back further as a share of national income. If this were not the case the average cut would rise to 29%.

7. Conclusions

The voters in this election deserve to make an informed choice between the plans the parties have to repair our public finances. Unfortunately, all of them are vaguer than they could be or should be.

As far as we can tell, the parties all appear to be aiming for a fiscal tightening of the same size. The Conservatives want to start earlier and proceed more quickly, but not sufficiently so that this would make a dramatic difference to the outlook for government borrowing or debt. It is in the composition of the proposed tightening packages that the more significant differences lie.

On tax, the plans set out by the parties in their manifestos are dwarfed by the size of the tax increase that is already in the pipeline for the coming Parliament. Labour has set out no new proposals of significance, but would have to announce further tax increases in due course. The Conservatives are proposing a net tax cut, which makes the hole in the public finances that they would have to fill by other measures bigger. Indeed, they would probably have to reverse half the net tax cut they have just announced. The Liberal Democrats are proposing a modest net tax increase, which would do a little to begin filling the hole in. They need not announce further tax increases unless their plans raise less revenue than they hope or unless (as they have conceded might be the case) they discover that the squeeze on spending becomes unacceptably tight.

On spending, all the parties have a long way to go in identifying the substantial cuts they need to deliver. This is an inevitable consequence of the government's decision not to carry out a Spending Review before the election for the next three years. Our estimates suggest that over the period to 2014–15, the squeeze on public services under Labour and the Liberal Democrats would be the largest seen since the mid-1970s and under the Conservatives would be the largest seen since (at least) the Second World War. But the Conservatives would need smaller cuts in 2015–16 and 2016–17 than the other parties since they plan to begin the fiscal repair job earlier and proceed at greater speed.

It is striking that the parties are all aiming to deliver at least two-thirds of their fiscal tightening through spending cuts rather than tax increases, and that they have not announced any measures that would make big savings in welfare spending over this period. Bear in mind that when the last Conservative government faced the need for a significant fiscal tightening in the early 1990s, we estimate that the then Chancellors Norman Lamont and Kenneth Clarke aimed to split the burden roughly 50:50 between tax increases and spending cuts. This might suggest that all the parties are overambitious in the amount they think they can squeeze out of public services. Whoever forms the next government, that points to greater reliance on tax increases and welfare cuts after the election than the parties are willing to admit to beforehand.