TOUCHSTONE
EXTRA

Making the Case for Public Spending

by Robert Tinker

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About the author

Robert Tinker was senior researcher at the Fabian Society until August 2015. His research covers a number of areas, including public finance and economic issues, poverty and inequality and public services.

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Touchstone Extras

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Key findings

Since 2010 the UK has experienced a period of austerity unlike any in living memory. It has involved a massive fiscal consolidation borne almost entirely by cuts to spending on public services and working age social security. On current plans the squeeze will come to an end in 2019–20; but the long-term impacts of this experiment on society and the economy remain uncertain.

This report presents the 'big picture' behind these issues. In today's climate of austerity a debate about the long-term functions of public spending has been side lined; so this report begins with an overview of how spending by government contributes to the well-being of society and the smooth running of the economy (Chapter 1). It then moves on to consider how UK public spending has evolved throughout recent history (Chapter 2) and sets these trends in an international context (Chapter 3). The report ends with an analysis of spending in the UK since 2010 and plans for further fiscal tightening in the current parliament (Chapter 4).

1 What is public spending for?

Public money is critical to social and economic stability and advancement in our market-based economy. It means there's a healthy and skilled workforce; early-stage research and innovation; new housing and transport links; stable, broadly distributed economic consumption; and a national guarantor ready to step in when crisis looms.

This report identifies the seven key dimensions of public spending:

Box 1: What is public spending for?

Things that the market wouldn't otherwise supply Intervention through public spending is necessary to secure the supply of 'public goods' that everybody benefits from, such as clean air, a stable climate and national security.

Providing insurance against risk When personal misfortune befalls us, public spending acts as a safety net through insurance-style guarantees.

Helping manage costs at different times in life Public spending helps us manage times in life when our costs are high and our incomes are low, such as when raising children or during retirement.

Good living standards for all Redistribution through tax and public spending helps to ensure that nobody falls too far behind the normal standard of living in society.

Broad-based employment The government is an employee in its own right, but public spending also supports employment indirectly and is a source of economic stability.

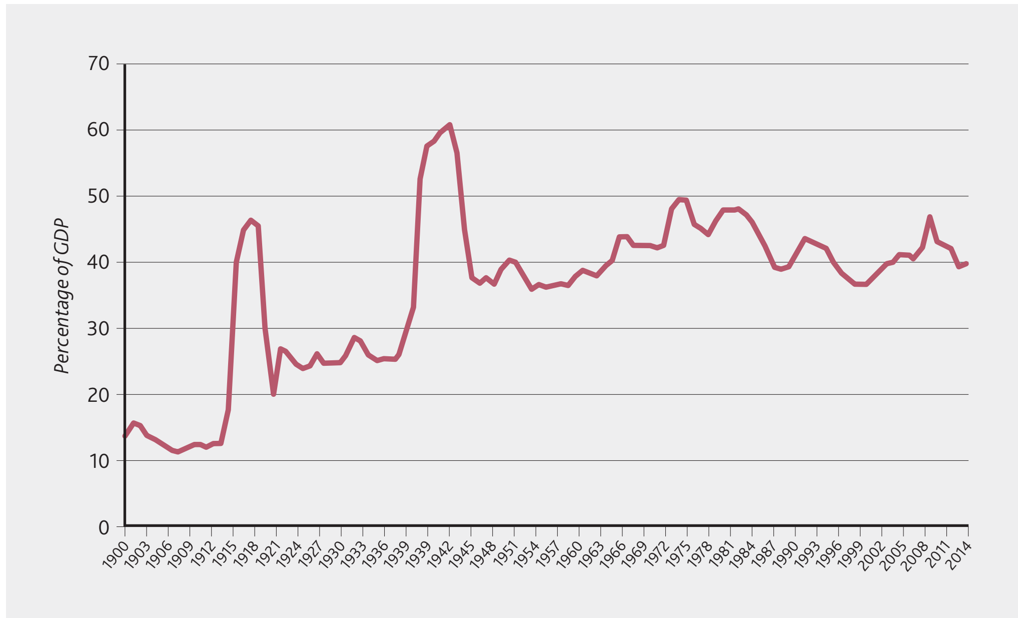
Growth and prosperity Public spending can raise GDP in the short term and contributes to sustainable increases in economic prosperity through investment.

Economic and social stability The ups and downs of the economic cycle can cause instability (especially at times of crisis), which public spending helps to stabilise by supporting demand.

2 *Public spending in the UK over time*

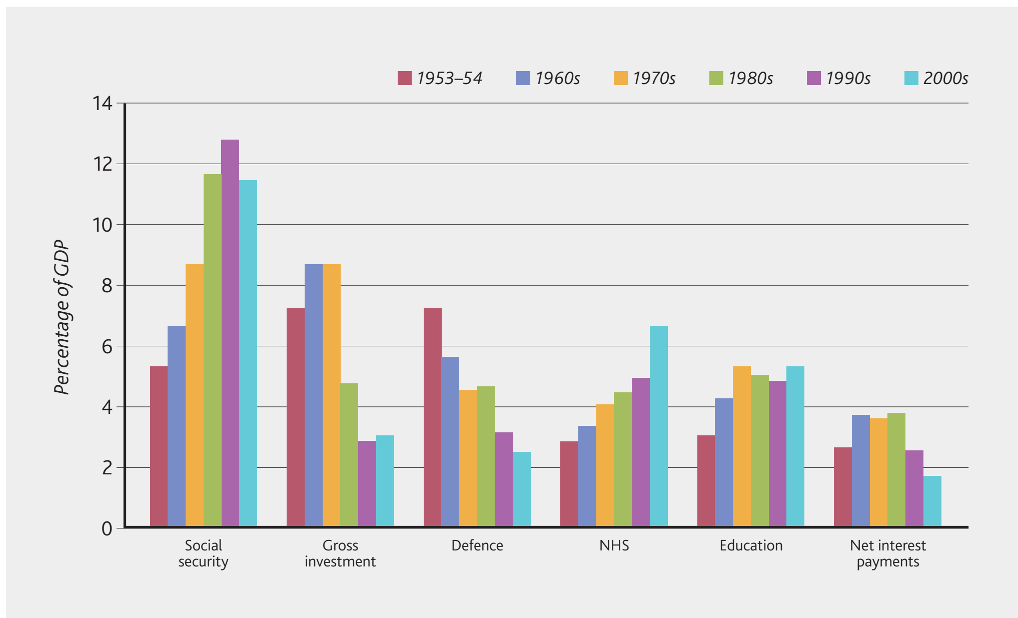
Public spending has not always been at the level it is today. As the figures below illustrate, government expenditure has risen steadily from a low level at the beginning of the twentieth century to an average of 40 per cent of GDP in the post-war era.

Figure i: UK public spending, 1900–2014



Source: Bank of England

Figure ii: Shifting components of public spending since the 1950s



Adapted from Fabian Society: *2030 Vision*

This evolution is explained by two factors: the cyclical ups and downs of the economy which, other things being equal, cause spending to fluctuate as a share of GDP; and discretionary actions by governments to increase or decrease spending (with discretionary action recognised as an important economic policy tool following the great depression). Both of these factors were at play in the late 1990s, when New Labour's decision to reduce expenditure as the economy boomed saw spending plummet as a share of GDP by 2000.

As well as changes in the total, the composition of spending has also shifted over time. In contrast to the early twentieth century, today social security and health constitute the largest areas of government spending. These changes reflect the combined pressures of growth in national prosperity, rising public expectations, the emergence of new social needs and the influence of demographic change.

During the 2000s, the Labour government made substantial investments in the public sector and recent evidence suggests that much of the money was well spent. For example, productivity data show that almost all of the extra investment in health translated into better outcomes. Improvements in education were good, albeit less compelling than in health. And there was a steady decline in the numbers claiming out-of-work benefits, with many of these savings recycled into more generous entitlements for older people and families with children.

3 Public spending internationally

Just before the financial crisis, government spending as a share of the economy was average by international standards – comparable to Germany and well below the level seen in successful Nordic economies.

At other times the UK has been an outlier. In the late 1990s the UK's expenditure was one of the lowest in the OECD. Increases in social spending during the 2000s explicitly aimed to 'catch up and keep up' with European norms, and by the end of Labour's time in office health spending had risen from a low to high position among the OECD; education spending rose less rapidly to a middle-ranking position; but spending on cash transfers remained very low by OECD standards.

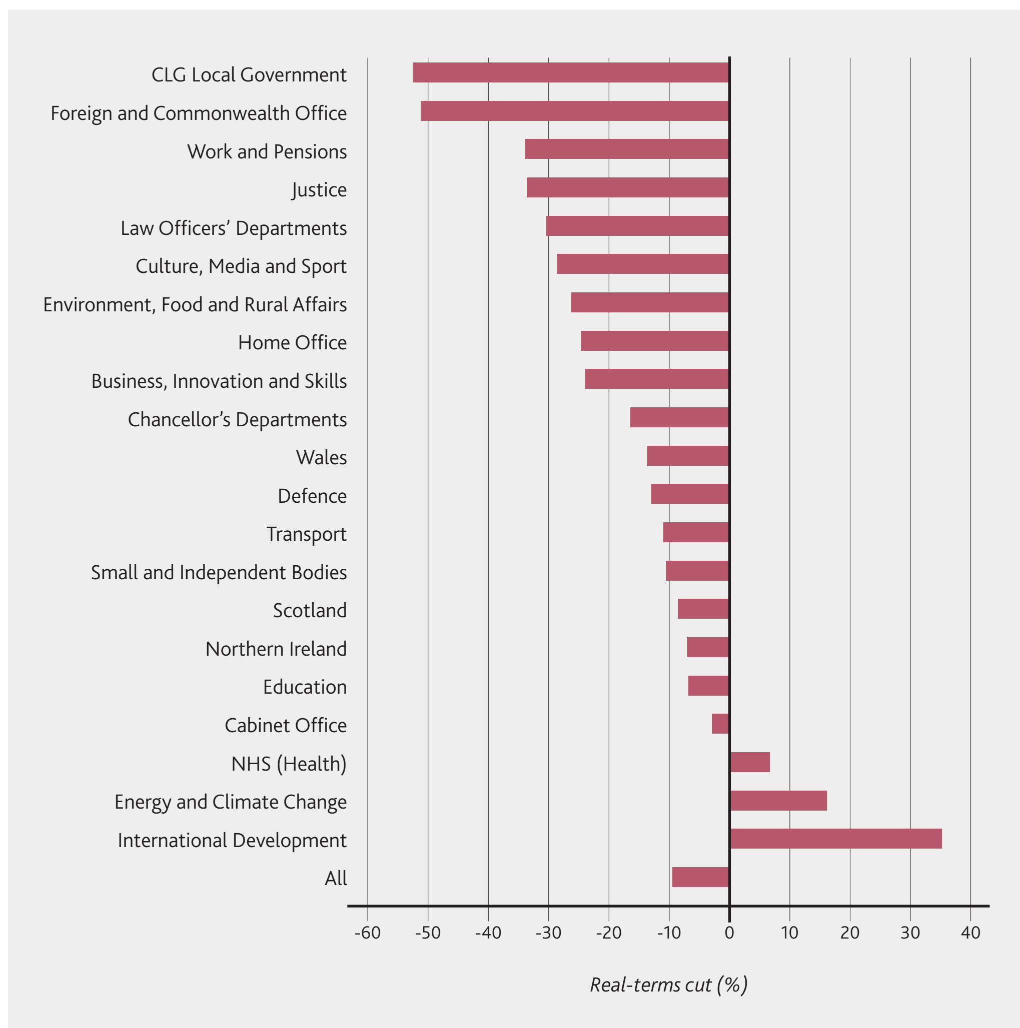
Within the range seen in the OECD, there is little evidence that high social spending is associated with poor economic performance. Many successful economies spend significantly more on the social sector than the UK, while others spend considerably less. Even countries with 'small states' have had to respond to the upward pressures on spending from growing prosperity and public expectations; the same areas of economic activity have grown – but in the private sector, as the case of healthcare in the United States illustrates.

4 Public spending in the UK since 2010

The cuts to public spending imposed after the 2010 general election slowed growth and prolonged the UK's recession for longer than was necessary. Government borrowing has fallen far less quickly than was originally planned due to slower than forecast growth in tax receipts, meaning the deficit is larger than necessary today.

Overall, spending on public service departments was reduced by 9.5 per cent in the last parliament. However, protections for some areas of spending (notably the NHS) have led to cuts falling unequally across the public sector. Government spending that was not protected in the last parliament experienced cuts averaging over 20 per cent.

Figure iii: How the pain has been shared across departments, 2010–11 to 2015–16



Source: IFS

As a result of the cuts imposed since 2010, the composition of public spending is becoming increasingly focused on a small number of current spending items, notably the NHS and pensions, and away from investment in the future. A number of short-term indicators in the NHS, older people's care, early years and education point to declining service quality in the public sector.

In its July 2015 budget the new government set out plans to achieve an overall budget balance by 2019–20. Recent analysis suggests that, if delivered, these plans will inflict significant hardship on already disadvantaged groups and lead unprotected service spending to fall by a third between 2010 and 2011 and the end of the decade. It is likely that these plans will be very difficult to deliver without service quality failing to match public expectations.

1 What is public spending for?

At a time when the attention is on spending reductions, it is easy to forget that in each year of this parliament government expects to spend over £700bn of public money. This money performs many vital functions that are critical to social and economic stability and advancement in our market-based economy. It means there's a healthy and skilled workforce; early-stage research and innovation; new housing and transport links; stable, broadly distributed economic consumption; and a national guarantor ready to step in when crisis looms. This chapter provides an overview of these functions.

Providing things that the market wouldn't otherwise supply

Private market exchange is useful for supplying a whole range of goods and services, but there are some things to which the price mechanism is not well accustomed. Clean air, national security, the courts, a stable climate and roads are goods that all people have reason to value highly but that markets struggle to deliver. Under these circumstances, public spending has an important and long-standing role in ensuring a socially optimal level of supply.

Today economists call this class of goods and services 'public goods'. The utility of public goods is not confined to the individual purchaser (think of clean air or the police force) and the personal use of these goods does not deplete the stock for others (such as the use of roads). Under these conditions, private markets do not function optimally and this is one reason why institutions such as the Army or the legal system would not be delivered without non-market intervention.[1]

The theory of public goods is a relatively recent development in economics. However, the way in which these characteristics make special claims on government expenditure has been recognised for centuries. Adam Smith noted that intervention on behalf of the public was necessary when "the profit could never repay the expense of any individual or small number of individuals".[2] The image of the 'night watchman' state associated with nineteenth-century capitalism captures a similar insight – that public order and defence represent goods that are rarely upheld privately.

These were the original functions of government and remain an important dimension of public spending today. Governments need to grapple with new risks of all kinds, from terrorism and pandemic disease to cyber security and resilience. While over decades defence spending has shrunk as a share of national income, the UK continues to devote more to defence than many comparable nations.

In practice there are relatively few cases of 'pure' public goods. But many goods share enough similar qualities that it is efficient for government intervention to prevent under-supply by the market. Early stage capital expenditure and R&D are areas of spending that underpin dynamic, competitive economies; however, the high uncertainty and risk associated with these investments make them susceptible to market failure, leading to a gap between socially optimal rates of investment and projects delivered.[3] This is one reason why many countries have developed state investment or infrastructure banks that aim to reduce these distortions.[4]

On the other hand, there are some goods that are often delivered through non-market means because they possess a public or shared character that makes extensive private participation inappropriate. In the case of parks and green spaces or other goods such as the BBC, it has been argued that the social benefit of these goods derives in part from their being delivered on a non-profit basis.[5]

Providing insurance against risks

As discussed above, in the nineteenth century public spending was strongly oriented towards the supply of a limited number of public goods. Defence expenditure accounted for over 20 per cent of GDP and social welfare provision was limited to voluntary associations, such as Friendly societies.[6] Towards the end of the century, however, the first examples of social insurance emerged in Europe, initially in Bismark's Germany and later in the UK. These reforms laid the foundations for the modern welfare state and the insurance-style guarantees against risk and misfortune that remain a key function of public spending today.

The welfare state acts as an insurance system for managing unpredictable events in the life cycle. For example, when people's family or employment situations change at short notice they may become eligible for support in the form of social security payments. This part of the safety net is designed to help people while they are in tough times and support them to get back on their feet. For example, recent analysis shows that less than half of the newly unemployed are still in receipt of support from Jobseeker's Allowance within three months of making a claim and only one in ten is receiving the payment after a year.[7] The overwhelming majority of people are successfully supported back into work.

Public spending also provides insurance against the longer-term risks associated with old age or ill health. For these purposes, pooling resources in an insurance system such as the welfare state is not only equitable but also an efficient use of resources. In the case of health, the Wanless Review, an independent analysis commissioned by the last Labour government, concluded that general taxation continues to represent the most efficient and equitable means of funding the NHS.[8] A more recent review of health care systems in 11 developed nations based on data over the ten years to 2013 ranked the UK highest across indicators of quality, access and efficiency.[9]

This form of support is a safety net for everyone, but tends to benefit low-income groups most: poorer households are more likely to face risks like unemployment or disability; most support is now means tested; and over time entitlements have lost value relative to earnings so offer very limited protection for mid and high earners. For all these reasons support for this sort of spending is low and declining, with recipients often stigmatised, even though it accounts for a relatively small proportion of public spending.

Helping to manage costs at different times in life

People's lives are not homogenous. Over time, most people become employed, experience some rise and fall in earnings, raise children and retire.[10] The costs associated with these periods of the life cycle vary, and often costs are highest when incomes are lowest. A large part of what public spending on the welfare state does is even out the mismatches between income and consumption, horizontally redistributing resources between different periods to create a smoother journey across the life cycle.

The role of public spending in redistributing resources from 'us to us' was one of the original arguments in favour of the welfare state. Writing in 1901, Seebohm Rowntree saw the mismatch between people's resources and needs, observing that: "The life of a labourer is marked by five alternating periods of want and comparative plenty." Employment, earnings, disability and family composition still vary over time, but today Rowntree's periods of 'want and plenty' are subject to much less extreme variation because people's benefits at one period in time are financed by the taxation paid in others.[11] People are taxed throughout their lives in broad proportion to their ability to pay and receive support from government when their incomes are low or the costs associated with their particular circumstances are high.

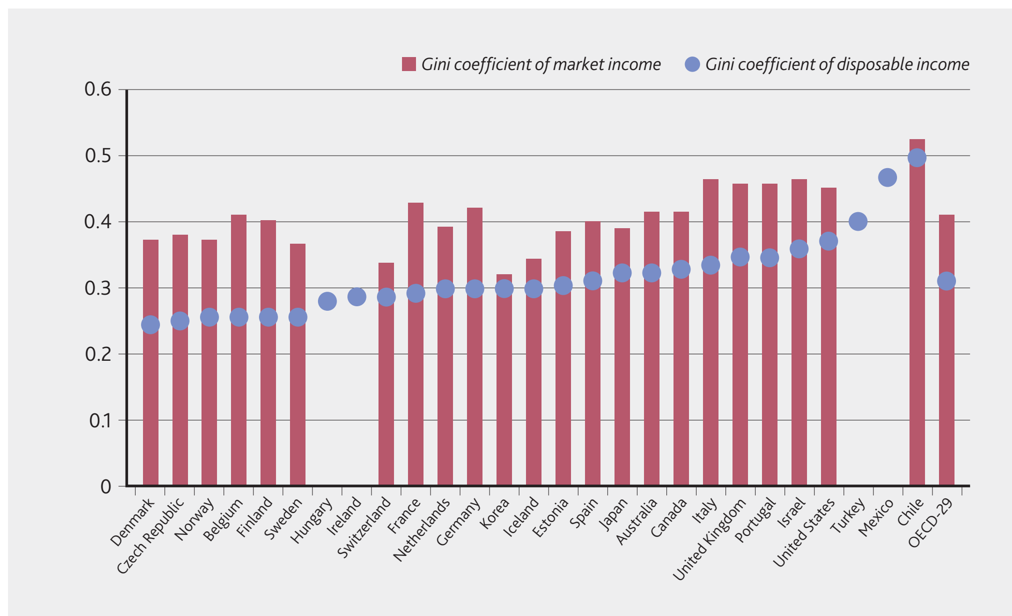
In contrast to 'safety net' support, lifecycle redistribution is one of the most popular aspects of the welfare state because it benefits everybody. It is 'collectivist' in that a single individual cannot expect to pay in and take out exactly the same amount over their lives. However, many people do: at any one time around half of the population (including pensioners) receive more from the benefit system alone than they pay in taxes and the proportion is greater when 'in kind' benefits from public services are included.[12] It is right that people who have paid taxes all their lives receive support in the form of cash transfers or 'in kind' entitlements. And as the Office for Budget Responsibility (OBR) noted last year, "at any one time around half the UK population receives income from at least one social security benefit – and over a lifetime most people will".[13] At different points across our lives the welfare state provides substantial support to nearly all of us.

Supporting good living standards for all

The mission of the welfare state is to ensure that nobody falls below a minimum standard of living and redistribution through taxation and public spending helps reduce poverty (and inequalities more generally) by sharing income more equally between groups. Calculations by the Office for National Statistics (ONS) show that in 2014 before redistribution the richest fifth of households had on average fifteen times the income of the poorest, compared to four to one after the effect of cash transfers.[14]

The proportion of public spending accounted for by cash transfers is partly related to the cyclical position of the economy, with calls on redistribution through taxation and benefits rising when wages are low or unemployment is high. But structural reasons such as the number of people with low pay or the prevalence of high housing costs also influence the levels of redistribution countries adopt. As Figure 1 (page 12) shows, compared with other developed countries the UK has high inequalities prior to the effects of redistribution; far above the average for the OECD. These large 'market' inequalities mean that although the UK engages in an average level of redistribution for this group of countries, it still has larger than average levels of post-transfer income inequality.

Figure 1: Gini coefficient for market incomes and net incomes, late 2000s, OECD



Source: OECD SOCX

Redistribution isn't achieved only through static transfers, and other forms of spending can be organised in more or less redistributive ways. For example, spending on public services provides 'in kind' income, which is available to everybody, but benefits provide most to the least well off. The ONS calculates that in 2014 the poorest fifth of households in the UK received benefits in kind from public services equivalent to £7,500 compared with £5,500 received by the top fifth.[15] This is because those with the greatest need for services are often in households at the lower end of the income distribution, and in particular tend to have more children in state education. Recent studies have shown the UK public services are considerably more redistributive than the average for the OECD.[16]

In recent years a debate has opened up in the UK over the appropriate balance between cash transfers and services for the purposes of redistribution. While studies show that the success of anti-poverty strategies depends on both methods of redistributing income, evidence also shows that 'money matters'.[17] Among EU countries there is a stronger association between spending on cash benefits and reductions in child poverty.[18] A recent systematic study of cognitive development, school achievement and social-behavioural development showed clearly that income has an impact on the outcomes of children from poorer backgrounds.[19]

Organising taxation and public spending so that they spread resources to those with the least opportunities serves the interests of fairness by ensuring that everyone has the capabilities they need to flourish in today's society and pursue a life they have reason to value. But evidence shows that it also promotes economic stability and long term prosperity. Recent studies from the IMF and OECD have found that over time lower inequality is associated with more stable and more enduring cycles of economic growth.[20]

Promoting employment

As well as supporting people who are outside the labour market, public spending can also actively promote employment. Government is a significant employer its own right: in 2010 (following significant job losses during the recession) the public sector accounted for around one fifth of the workforce.[21]

In recent years public sector employment levels have been declining as services have been cut. Salaries have also fallen in real terms due to pay settlements of between zero and one per cent in cash terms. This is the wrong priority at a time of economic recovery because public sector pay acts to support consumer demand, especially in areas of the country where private sector employment is weak.[22] Indeed, recent modelling work suggests that increasing public sector pay could have positive economic impact on economic output, with a neutral or even positive effect on the public finances.[23]

Government spending on services can also affect employment indirectly. For example, international evidence shows that countries which invest in publicly funded childcare for children from newborn to age two tend to have higher maternal employment rates.[24] The international picture is supported by recent econometric analysis in the UK, which shows a positive relationship between the availability of free early education places and maternal labour supply.[25]

The social impacts of investment in services such as childcare are complemented by positive economic spillovers. Estimates by the IPPR think tank on the impact of universal childcare for pre-school-aged children suggest that over four years the exchequer would gain between £5,000 and £20,000 for each parent returning to work, solely as a result increased tax revenues (these estimates do not include savings derived from social security costs).[26] By supporting consumer demand (through higher household incomes and employment rates), this investment also contributes to a stronger and more stable economy.

Providing growth and prosperity

Government itself is major purchaser of goods and services. The National Audit Office estimates that in 2013 the government spent £187bn on goods and services. It is estimated that around half of this total went to the private sector through contracted-out services.[27]

Public spending on areas such as education, research and development, transport and housing generates short-term growth and lays the foundations on which future prosperity depends. In the short term, spending on future investment boosts growth by raising demand in the economy. The size of the impact on national income from changes to tax and spending (known as the 'fiscal multiplier') is the subject of ongoing debate among economists, but the impact is thought to be significant.[28] For example, recent estimates show that in the long term £1 of infrastructure spending increases economic activity by over £2.80.[29]

This boost to output from investment spending is thought to be greater when economies are in recession and is the reason many favour capital expenditure as a form of fiscal stimulus.[30] For example, modelling in the UK's recent downturn found that a £30bn boost to infrastructure spending would have resulted in a one per cent increase in output at the time.[31] This figure could underestimate the growth generated because the complementary qualities of capital expenditure mean investment in roads, housing and other physical assets often 'crowd in' spending from elsewhere in the economy.[32]

Today there are many long-term projects that will lay the foundations for future prosperity and can be served only by government investment or part-investment. However, investment spending has suffered in today's climate of austerity: net public investment currently stands at around 1.5 per cent of national income, down from three per cent in 2008 and 5.6 per cent in 1975–1976; in the July 2015 budget the government trimmed a little more off these totals (roughly £1bn a year).[33]

Some of the fall in investment is explained by the large-scale privatisations that took place during the 1980s. However, research also points to underlying structural weaknesses (including relatively low levels of public investment) that lead the UK to under invest relative to other OECD economies such as France, the US and Canada.[34] According to one study, the UK's annual GDP growth in the decade after 2000 could have been five per cent higher had infrastructure investment matched the trend of other international economies.[35]

Public investment is only one part of overall investment in the economy. However, uncertainty regarding the future and factors such as high sunk costs and long payback periods mean it is crucial for the government to use its balance sheet to support outside investment from the private sector.[36] This is one reason why many advanced economies have established state investment banks to provide a basis on which private investment can multiply.[37]

It is in the long term, however, that spending for investment matters most. Over time sustainable increases in economic prosperity are achieved through maintaining a high overall investment share and by making improvements to the supply-side of the economy – the discovery and exploitation of new ideas, processes and technologies that improve productive capacity and raise living standards.[38] Physical and human capital are the cornerstones of this process. However, it is the dividends from making improvements to the stock of human capital that are especially significant. Recent evidence presented to the LSE's Growth Commission shows how bringing UK educational attainment into line with Australia or Germany would result in huge increases to output.[39] These investments are underpinned by spending on research, innovation and new technologies – the think tank NESTA estimates that in the decade up to 2012 63 per cent of the UK's productivity growth came either directly or indirectly from innovation.[40]

Preserving economic and social stability

As well as driving forward the ideas, technologies and research that lead to national prosperity and growth, public spending preserves economic and social stability when it comes under threat. By acting ‘counter cyclically’, government can provide a brake by reducing spending when the economy is at risk of overheating and support demand through discretionary activity when it is weak.

When the economy contracts and national income falls, more people find themselves without work and wage increases slow for those in employment. The UK’s labour market experience was more positive in the recent recession compared with previous slowdowns, though employment gains were accompanied by wage reductions and increased underemployment, with unemployment also still higher than ahead of the crisis.[41] In such circumstances government spending on social security grows as more people find themselves in need of out-of-work and in-work benefits and support for other costs. This provides an additional demand and helps preserve the social fabric of societies when the economy would otherwise be weaker.

This is often referred to the work of the ‘automatic stabilisers’ because it doesn’t rely on active policy change to take effect. However, when demand is weak government can also bring stability to the economy through discretionary action. This function of public spending was also illustrated in 2008, when the UK government took unprecedented action to nationalise two major banks facing collapse in the wake of the financial crisis. Combined with the Bank of England’s ‘quantitative easing’ programme of asset purchases, this prevented a much deeper recession and reduced damage to households.[42] A similar experience was replicated elsewhere in the world: modelling work shows that by 2010 US GDP would have been over 11 per cent lower in the absence of the discretionary stimulus spending implemented by the Obama administration to stabilise the economy.[43]

Crises on the scale of 2008 are rare events, yet the role of public spending in smoothing the less exceptional cyclical patterns of the economy is also an important one. It is normal for economies to experience periods of strength (where taxes flow in and unemployment and welfare costs fall) and weakness (when the reverse occurs). Without support via the automatic stabilisers and active government spending these ups and downs would put even greater pressure on the fabric of communities and harm individual well-being.

2 Public spending in the UK over time

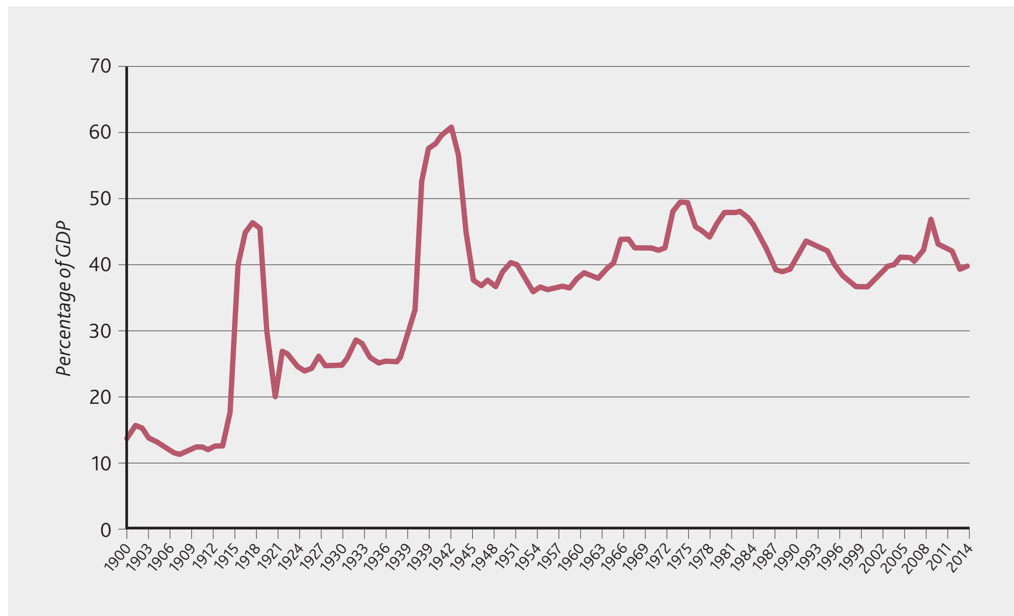
In the last 100 years public spending has risen from a low level at the beginning of the twentieth century to an average of 40 per cent of GDP in the post-war era. At the same time, the composition of total expenditure has evolved, reflecting rising national prosperity and public expectations and the emergence of new social needs. This chapter considers these trends in more detail.

The evolution of government spending

In 2014–15 the government spent approximately £735bn of public money. This is a very significant sum: spread across the population it represents an average of £27,000 for every household in the country or 42.5 per cent of national income.[44] Around £52bn of this total will go towards capital investment – spending which creates assets that bring enduring benefits over many years. The remainder will be split between two forms of current spending: departmental spending, which contributes to the running of hospitals, border controls, the police service and other services (£339bn); and 'annually managed expenditure', such as pensions, working-age social security and other costs such as the interest government pays on its debt. Added together, this represents the UK's 'total managed expenditure' (TME).

Government has not always spent what it does today, even as a share of national income. The evolution of this total over the last 100 years reflects changing needs and new public preferences, punctuated by large increases at times of crisis when national income falls. From a low level of around 15 per cent of national income at the beginning of the Edwardian era, government spending grew to around 25 per cent under the inter-war governments. In the post-war era total government spending increased, averaging a little over 40 per cent of GDP, with lows in 1957–58 and highs in 1975–76.[45]

Figure 2: UK public spending, 1900–2014



Source: Bank of England

The first major decrease occurred from the mid-1970s. Between 1978–79 and 1996–97 annual spending increased at one per cent below its previous trend of 2.8 per cent at a time of strong growth, leading spending to fall as a share of the economy.[46]

By restraining spending as the economy boomed in the late-1990s, New Labour continued this retrenchment and saw total spending plummet to 36 per cent of GDP by 2000.[47] But soon Labour rejected the permanent 'small state' option it had inherited from the previous Conservative government and increased spending as a share of the economy. From this point on, total spending increased at an average annual rate of 4.5 per cent and contributed to some of the largest increases in public service spending on record.[48] Nevertheless, by 2007 public spending was just under the average for the previous 50 years and Labour was planning for spending to slow before the financial crisis hit.[49]

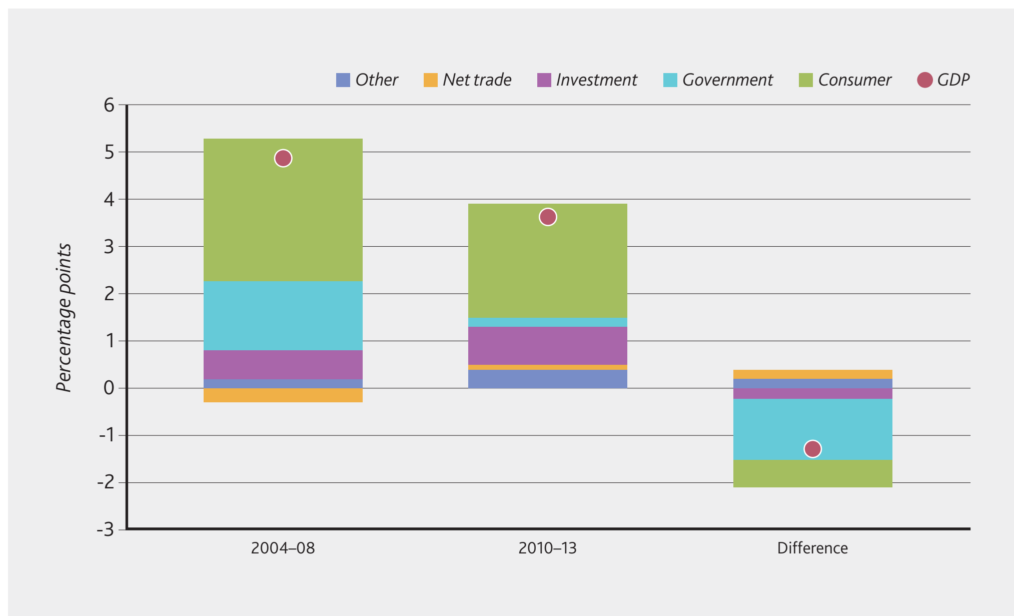
In an international context, this recent profile of public spending in the UK is unremarkable. In the 1990s spending fell below the OECD average, before increases after 2000 brought it back into line with, and eventually a little above, the average for the OECD. Spending as a proportion of GDP rose in all countries in response to the crash of 2008, while it has fallen back since (more rapidly in the UK than in many other countries).

Economic circumstances and the discretionary measures of governments

Some of the fluctuation in spending over time is explained by cyclical factors related to the ups and downs of the economy. When national income falls, government spending totals increase as a share of the economy (as they did dramatically after 2007–8) and some areas of expenditure such as social security benefits increase automatically as firms make job cuts and wage growth slows.

In these circumstances it is prudent for government to borrow as other sources of demand in the economy weaken. This is illustrated in Figure 3 (page 18), which shows the fall in GDP between the general election in 2010 and 2013 as the new government imposed austerity.

Figure 3: Contributions to GDP growth



Adapted from TUC (2015), *The Price of Austerity*

The data above support the view that cutting public spending sharply can lead to slower economic growth.[50] The precise magnitude of the impact on national income from cuts to public spending is a matter of continued debate, though a number of bodies (notably the IMF) revised up their estimates during the recession and the OECD has recently warned that cuts on the scale planned by the UK government in the period ahead will hit growth.[51]

These cyclical dynamics apply during periods of expansion too. Other things being equal, strong economic growth puts downward pressure on social security spending as the number of people in employment grows and the tax base strengthens. Stronger growth also leads to public spending falling as a share of national income, when planned spending rises less quickly than GDP.

The cyclical position of the economy only explains so much of the fluctuation in spending observed over the past century. As the extreme case of expenditure in the two world wars illustrates, increases and decreases in spending are also determined by the active policy decisions of governments. The impact of discretionary spending was further demonstrated after 2000, where expenditure rose at an above average rate at a time of economic prosperity as a result of Labour's pledge to invest in public services.

The changed composition of spending

Increases in total spending are only one part of the story because they mask important changes that have occurred in the composition of expenditure over time. In the last 100 years increasing peace and prosperity has enabled developed countries to 'grow public' and this is reflected in the steady rise in social spending observed in the second half of the twentieth century.

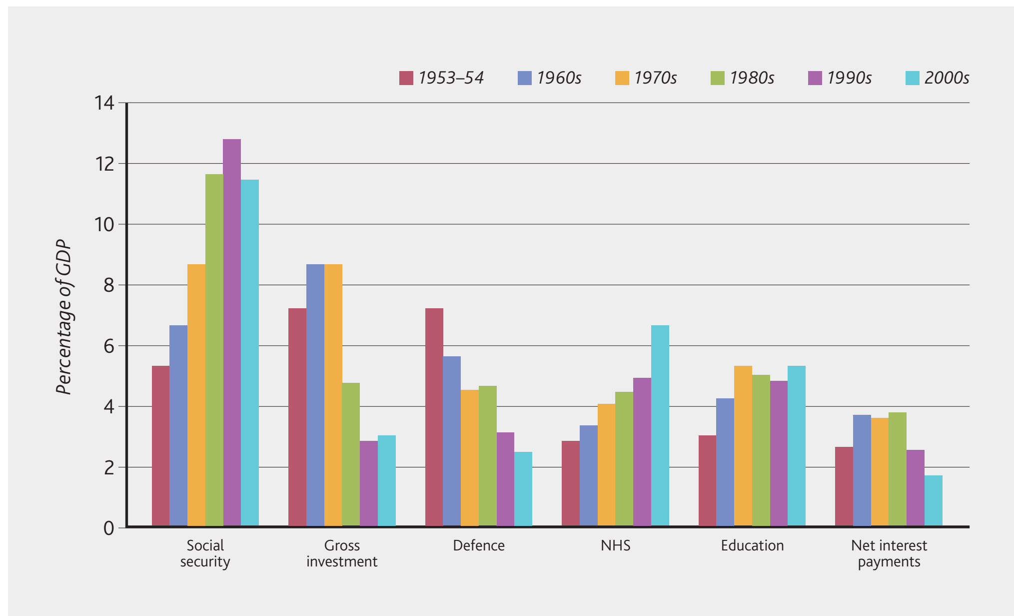
Today social security constitutes the largest area of government spending.[52] What began life with the Beveridge Report as an insurance system for the elderly, unemployed and infirm has evolved into a system of transfers to support the living standards of the working and retired population. Widening eligibility, increased generosity and changing need has seen spending on this area grow threefold since the late 1940s. From four per cent of GDP in 1948–9, social security spending had risen to 11.5 per cent by 1996–7 as spending on transfers increased under the Conservative government due to high levels of unemployment and economic inactivity.[53]

During Labour's last period in office, spending on cash transfers (including to pensioners) and tax credits increased substantially as part of a drive to secure decent living standards among historically disadvantaged groups, including low-paid working families.[54] As a result, pensioner poverty fell and major progress towards the goal of ending child poverty had been achieved by the time the government left office.[55] But the increases were sustainable too: just before the crisis in 2007, working-age and pensioner social security spending was around 10.5 per cent of GDP, just below the average for the previous three decades.[56]

Health spending has also experienced rapid increases over time and today is the second-largest area of government spending. From 1949–50 health spending rose from 2.5 per cent of GDP to around seven per cent before the crisis. Between the 1970s and the 1990s growth in health expenditure was interspersed with periods of lower spending. However, over Labour's period in office, spending on this area more than doubled in real terms, rising from 5.3 per cent of GDP in 1997–8 to 8.4 per cent in 2009–10.[57] This reflected the government's pledge to match the European average for spending on health in response to public concern over poor service quality and led to a marked improvement in patient outcomes.[58]

Long-term increases in social spending as a proportion of GDP have been offset by proportional decreases in other areas. The expansion of the welfare state was achieved first by growing overall spending and then by tilting the balance of expenditure away from areas such as capital investment and defence. As Figure 4 (page 20) shows, investment spending fell from nine per cent of GDP in the 1960s and 1970s to three per cent in the last 20 years. Similarly, defence spending has been reduced from nine per cent of national income in the mid-1950s to just over two per cent today.

Figure 4: Shifting components of public spending since the 1950s



Adapted from Fabian Society: *2030 Vision*

Needs, preferences and the costs of service delivery

Sometimes the compositional shifts that have taken place in public spending are interpreted with an air of pessimism. Advocates of small government see increases in social spending as evidence of an overweening state. Others worry that the upward pressures on social spending mean that services such as the NHS and social care are rapidly becoming unaffordable or that future generations will be forced to accept a less generous level of public provision.

The growth of social spending in advanced economies is partly to do with demographics. But a larger proportion of the increase is explained by public preferences and the costs of service delivery in disproportionately labour-intensive sectors. In the century ahead there will be less headroom to significantly increase social spending as a share of national income to the extent that was achieved over the last 100 years. However, demographics is not destiny and spending increases in these areas can still be achieved affordably.

Rising social spending reflects a general tendency for countries to allocate an increasing proportion of extra national income to the social sector. There is a strong relationship between the overall level of national income and social spending, because additional demand for 'superior goods' such as education, health or old-age care tend to rise faster than national income. Researchers at the OECD estimate that around two-thirds of the real growth in health spending in the UK between 1981 and 2002 is explained by this factor.[59] In the UK most of this additional demand has been met through increases in public spending – in 2008 around 87 per cent of healthcare expenditure was financed this way.[60] But in periods where government spending has been low, private health spending has increased: between the mid-1970s and 1999 private health spending increased from 0.5 per cent of GDP to 1.4 per cent, before falling back again following increases in public spending after 2000.[61]

Additionally, many public services are worker-intensive, with costs that rise in line with earnings (which ordinarily rise faster than prices) and with lower productivity levels than the economy as a whole (as an inevitable result of the labour-intensive nature of many services rather than inefficiencies in delivery). This means the social sector can be expected to pull in more people over time and grow as a share of national income. This characteristic is sometimes described as a failing (a 'cost disease'), but slower productivity and above-inflation costs reflect the fact that these services need to be labour intensive to produce good outcomes and is a quality shared with other sectors of the economy, such as retail. From the economic point of view, falling costs in the dynamic, high-productivity sectors of the economy should allow citizens to enjoy growing levels of healthcare and education from which everybody benefits.[62] This means that a redistributive and progressive system of taxation is likely to be increasingly important to securing high-quality public services in the years ahead.

The pressures described above are augmented by demographic effects. For example, in the NHS the OBR suggests ageing might add 0.7 per cent of GDP to healthcare costs between 2020 and the early 2030s. Rising public service costs could add a further 1.3 per cent, a total of two per cent in just a decade. However, these forecasts are subject to significant uncertainty.[63] The size and structure of the population in particular (which is influenced by factors including longevity, net migration and fertility) has important implications for the public finances. For example, in the OBR judgement the age profile of inward migration to the UK reduces age-related pressure on the public finances.[64] This suggests the positive benefits that migration can bring for public service delivery deserve greater recognition in public debate.

We get the services we pay for…

Under New Labour, one charge made against various administrations was that spending increases on this scale meant the government was unable to secure cost efficiencies or guarantee value for money to tax payers. Perhaps understandably, many wondered whether the rate of increased spending would be matched in rising service improvements.

In fact, recent data show that productivity in the public sector remained broadly constant over Labour's 15 years in office.[65] In the case of health, despite a dramatic rise in resources, productivity performed better than the public sector as a whole and almost all the extra real spending translated into better outcomes. This happened because productivity gains almost cancelled out above-inflation increases in unit costs.

As one independent analysis of the last government's public service record concluded, "Labour spent a lot and achieved a lot".[66] By contrast, the decades before New Labour came to power were a period in which spending fell as a share of the economy, along with public service outcomes. The number of people waiting for a hospital appointment increased by 50 per cent between 1988 and 1998 to reach a record 1.3 million.[67] A report by the Audit Commission in 2002 found that falls from this peak were explained by Labour's "substantial investment in treating people who have been waiting longest".[68]

Increased public spending has also contributed to a marked improvement in school outcomes. Throughout the 1970s and 1980s the proportion of children at the end of compulsory education achieving the equivalent of five or more grades A*–C at GCSE was flat at around 25 per cent. This began to rise over the 1990s, but markedly increased following continued investment throughout the 2000s. By 2010–11 the proportion achieving the equivalent of five or more grades A*–C at GCSE had risen to almost 80 per cent.[69]

Poorer outcomes are reflected in attitudinal data collected at the time. In the years up to 1997 the British Social Attitudes survey reported overall satisfaction with the NHS falling below 40 per cent of respondents. After 2000 indicators of satisfaction began to rise again with 70 per cent of respondents in 2010 indicating that they were quite or very satisfied with the way that the NHS is run.[70]

Achieving better performance for the same inputs should always be the focus of government. But the data on inputs and outcomes tell a clear story: resources do matter to service quality in the public sector, and the outcomes New Labour achieved were related to its willingness to reverse years of retrenchment in the public sector.

Box 2: What did Labour achieve?

The largest beneficiary of the extra money was the NHS and education, which led to significant improvements in outcomes. Social security spending dipped slightly as a percentage of national income, as the economy recovered from the 1990's recession. There was a steady decline in the numbers claiming out-of-work benefits and Labour chose to recycle much of these savings into more generous entitlements for older people and families with children (both in and out of work). This led to significant reductions in relative poverty among children and pensioners.

- Labour set out an ambitious agenda to raise outcomes overall, narrow socio-economic gaps and modernise public services.
- Public spending went up by 60 per cent, from 39.5 to 47.4 per cent of GDP when the crisis hit after 2008. This was a large rise but the UK started from a low point, with part of the increase a direct result of the global financial crisis and the consequent drop in GDP it caused. For most of Labour's time in office, spending levels were unexceptional by historic UK and international standards.
- The extra spending went mainly on services. Health and education both increased as a proportion of all public spending. There were new hospitals, schools, equipment and ICT, 48,000 extra FTE teachers, 3,500 new children's centres, more doctors and nurses, and many new programmes aimed at neighbourhood renewal.
- Nearly all the extra cash Labour spent on benefits went on children and pensioners. Benefits for working-age people unrelated to having children fell as a proportion of GDP.
- Access and quality in public services improved. Waiting times for health services fell. Pupil-teacher ratios improved. Young children had greater access to early years' education. Poor neighbourhoods had better facilities and less crime and vacant housing.
- Outcomes improved and gaps closed on virtually all the socioeconomic indicators Labour targeted, such as poverty for children and pensioners and school attainment.
- On some key things Labour did not explicitly target, there was no progress. Poverty for working-age people without children rose. There was no real change in levels of income inequality. Wage inequalities grew and disparities in regional economic performance persisted.

3 Public spending internationally

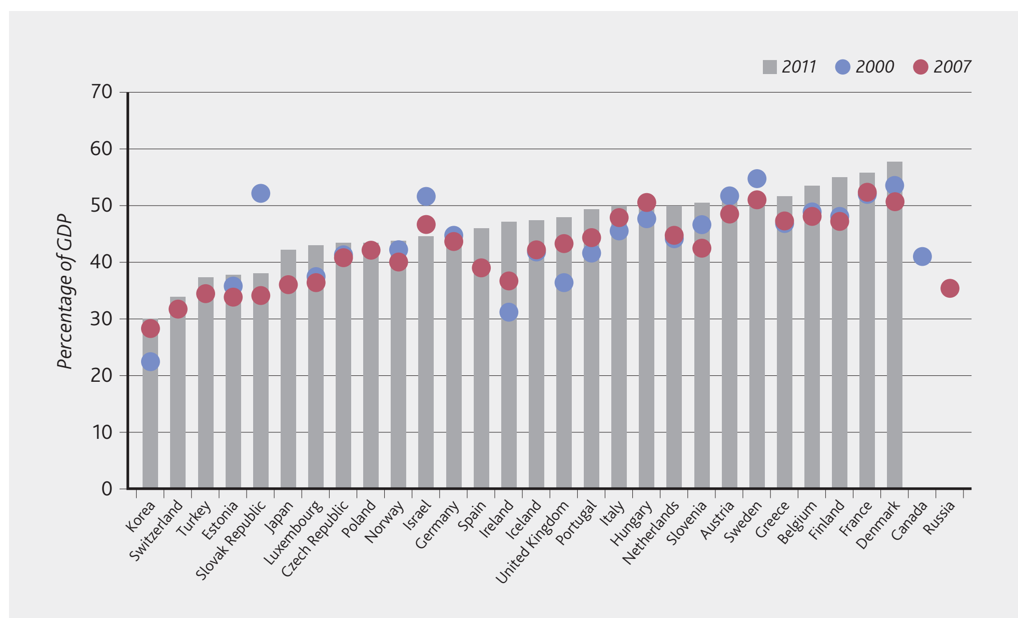
This chapter puts recent trends in the UK's expenditure in an international context. It is sometimes said that the British state is too large. But by the standards observed among most developed countries public spending is unremarkable. Many countries spend more than the UK, whereas a number spend less – there is no link between economic performance and the level of public spending within the range seen in the OECD.

UK spending in relation to international standards

It is sometimes said that spending is too high in Britain and that governments should aim to reduce the size of the state. Following the financial crisis, spending has been above the average for the post-war years. However, over time the UK's public spending has been normal by the standards of the OECD.

Figure 5 below shows that just before the financial crisis UK public spending as a share of the economy was unremarkable when compared to other advanced economies. At around 43 per cent of national income spending was just above the OECD average – comparable to Germany and well below that seen in successful Nordic economies.

Figure 5: General government expenditure in the OECD



Source: OECD SOCX

The earlier data points show the evolution of total spending in the OECD over the last decade. By 2000 Labour's decision to match the previous Conservative government's budget plans had taken spending to a very low level compared with other countries. At 36 per cent of national income only Ireland, Korea and Estonia had lower spending in this group of nations.[71]

The low levels that public spending reached between 1997 and 2000 was reflected in the scale of its subsequent growth. Between 1997 and 2007 the UK had the second-largest rise in overall spending levels among the OECD.[72] Yet it was from a low base: the UK moved from being the country with the 22nd largest level of spending as a share of national income to round the centre of the distribution.[73]

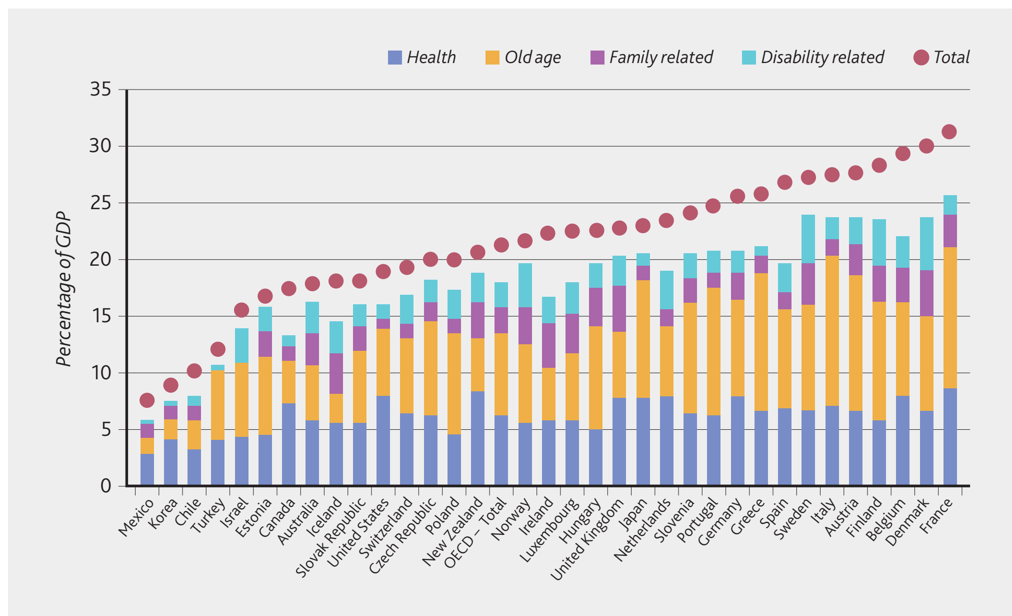
Social spending forms an important part of international spending…

Between the 1980s and 2007 the increase in spending made by many OECD economies was linked to social investment. In this case social spending refers to benefits or cash transfers aimed at households in fields such as old-age entitlements, support for families, health and unemployment and active labour market policies.[75] Over this period public social spending in the OECD increased from around 15 to 19 per cent of GDP and today these countries dedicate on average over one-fifth of national income for the purposes of social expenditure.[76]

Many successful economies such as Germany, Finland and Denmark have higher-than-average levels of public social spending (between 25 and 30 per cent of national income) whereas others, such as Korea, spend half the average. In 2014 the UK was very close to the average for the OECD, with social expenditure at just over 21.5 per cent of GDP.[77]

Similarly, the UK is normal among its OECD comparators in prioritising health and old-age items of public social spending. At the time of writing consistent data for social expenditure in the OECD are available up to 2011, when spending was high as a share of GDP as a result of the recession. However, the data show that around one-third of all public social spending in the UK goes towards health – higher than the average for the OECD.[78]

Figure 6: Public social spending in the OECD, 2011



Source: OECD SOCX

For many years low levels of social expenditure meant the UK was an outlier among the OECD.[79] Spending increases during the 2000s explicitly aimed to 'catch up and keep up' with international norms, but by the time Labour left office the UK's position was middling. Between 1997 and 2009:

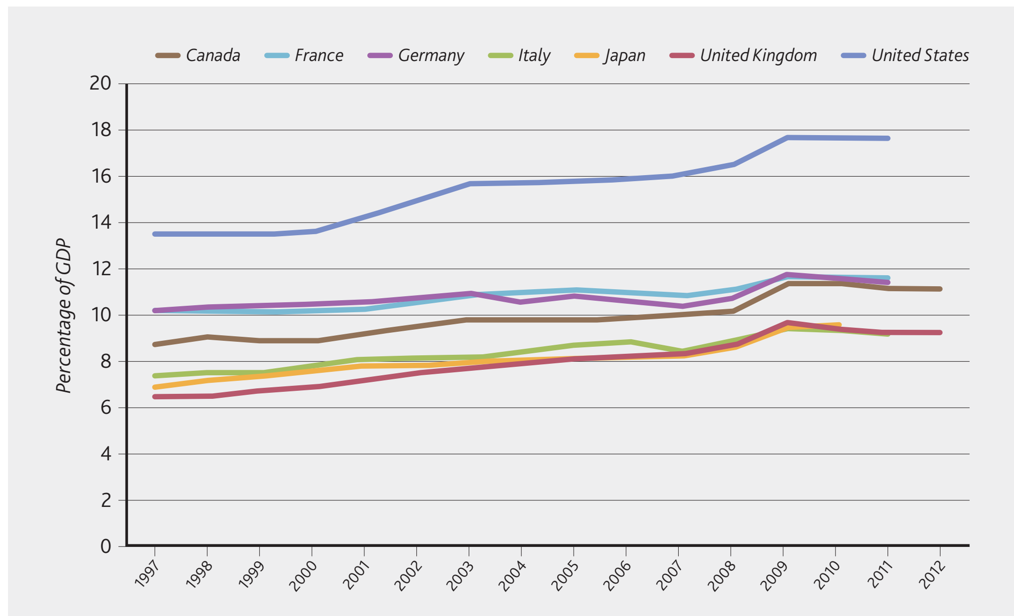
- health spending rose from a low to high position among the OECD (21st to 9th)
- education spending rose from a low to a middle-ranking position among the OECD (19th to 14th)
- spending on cash transfers was very low and remained low among the OECD (20th to 17th).[80]

…even in 'small states'

The data on social spending presented above confirm the view that liberal market economies such as the US and Korea fund the social sector less generously than others. Nevertheless, even 'small states' have had to respond to the pressures from the rising prosperity and demographic change described earlier.

As the case of healthcare in the US shows, these countries have experienced growth in the same areas of economic activity as the higher-spending countries, though a larger proportion is private than public.[81] Private expenditure includes social benefits between non-public bodies and individuals, such as occupational pensions, employer-provided health plans and individual retirement accounts.[82]

Figure 7: Total healthcare expenditure of G7 nations, compared



Source: ONS

There is little relationship between the level of public spending and economic performance

Among its international comparators Britain's level of public spending is normal. But it is sometimes said that a high level of public spending is a drag on economic performance; in 2010 the Chancellor, George Osborne, argued that he aspired to "an economy where the state does not take almost half of all our national income, crowding out private endeavour".[83] However, the data on social spending internationally challenge the assumption that high social spending correlates negatively with economic performance. Within the range seen in the OECD there is little observed link between economic performance and the level of public spending.

Many successful economies spend significantly more on the social sector than the UK, while others spend considerably less. Empirical studies of economic growth from the 1960s to the 1990s show little clear connection between countries' level of social spending and their growth rate.[84] More recent analysis confirms this view.[85] A study of the UK's economic performance by economists at the LSE argued that: "There is no reliable evidence suggesting that the growth potential of an economy is limited by the size of the government over the wide range that we observe in the OECD countries... The historical diversity of international experiences suggests that different types of market economy can be successful with high or moderate levels of state spending – for example, Scandinavia versus the US."[86]

There are also reasons unrelated to trend GDP that countries may favour higher public social spending compared with a small-state option. Evidence suggests that economies with low public spending as a share of GDP can struggle to deliver social goods as equitably or efficiently as others with more normal expenditures.

The clearest case is the US healthcare system, which is consistently found to perform poorly on access and quality indicators despite expenditure being almost double the OECD average – in short, the US healthcare system is much more expensive to finance than the NHS, but does not achieve the same coverage as the UK's. In a study of international healthcare systems, patients in the UK were the least likely to report cost-related access issues.[87] By contrast, figures from the Congressional Budget Office suggest that by 2024 around 31 million Americans will be without health insurance, even following the Obama administration's Affordable Care Act.[88] A recent analysis of the data found that higher costs in the US system reflect "substantially higher prices and more fragmented care delivery that leads to duplication of resources and extensive use of poorly coordinated specialists". Relative to other OECD economies, spending is higher and service quality lower.[89]

In Singapore, where spending is very low at approximately 18 per cent of national income, social protection is highly residualised through strictly means-tested public assistance schemes. The risks associated with ageing lie with individuals and families, who are required to save for old age in defined contribution individual savings accounts.[90] Policies and programmes designed to reduce poverty and vulnerability account for around six per cent of GDP, well below other Asian economies such as Japan, where expenditure is closer to the OECD norm. As a result, inequality as measured by the gini coefficient is high by the standards of the OECD.[91]

4 Public spending in the UK since 2010

Today Britain is approximately half-way through a period of fiscal retrenchment, which on current plans will end in 2019–20. The profile of this consolidation has changed in important ways since it was embarked upon in 2010–11. Notably, borrowing has fallen far less quickly than was originally planned. Nevertheless, the scale and pattern of cuts to public spending are unmatched in recent history and are set to have far-reaching implications for the role of the state in the future.

The coalition government's ambition to fix public finances within a single parliament

The global financial crisis of 2008 was the economic event of a lifetime and took the UK from a position of moderate but sustainable borrowing to one that was unsustainable in the long term.[92] When the full impact of the crash fed through to the British economy a large gap between government revenues and spending opened up. Tax receipts fell faster than national income, bringing borrowing to a post-war high of 10 per cent of GDP.[93] And as the size of the economy contracted cash spending totals set in 2007 enlarged as a share of the economy, bringing government expenditure to 46 per cent of GDP.[94]

A proportion of the damage caused to the public finances has been cyclical (meaning it will eventually disappear once the economy returns to strong growth). However, government forecasters judged that a large part was structural, meaning that revenues were assessed to be permanently lower than projected. In response, each of the main parties set out plans at the time to repair this damage through fiscal consolidation based on spending cuts and tax rises.

In 2010 the newly elected coalition government set out its plans to repair the damage to the public finances within the course of one parliament.[95] This implied an overall consolidation amounting to £128bn by 2015–16.[96] At the time this was reflected in the forecasts of the newly established Office for Budget Responsibility (OBR), which anticipated the current budget (spending less investment) reaching a small surplus in 2014–15 before strengthening slightly by the end of the forecast period.

Fiscal tightening of this scale was historically unprecedented. It was also more heavily weighted towards spending cuts than alternative proposals, international comparators and advice from macroeconomists at the time. Around 80 per cent of the government's total consolidation (£99bn) was identified in cuts to public spending.[98] A large proportion of these reductions were identified from spending, which has a disproportionately positive impact on growth. Capital expenditure was slashed by 47 per cent in the 2010 Spending Review, despite being excluded from the government's primary fiscal rule (which focused on day to day 'current' expenditure).[99]

Poor economic performance made this goal unachievable…

In practice deficit reduction drifted far from the course originally set out by the coalition government: by 2015–16 the current budget was still in deficit to the tune of £70bn.[100] The failure to eliminate borrowing as planned is explained by the poor performance of the economy after the 2010 election. This was exacerbated by austerity and an unprecedented fall in living standards, which caused growth to be much less tax rich than would otherwise have been the case.[101]

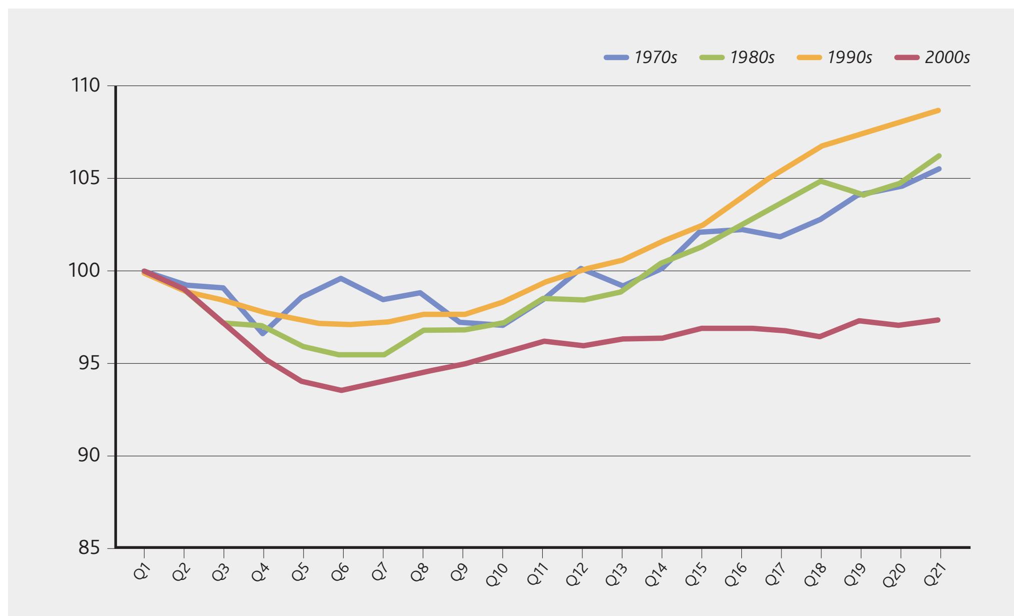
In 2010 commentators warned that removing demand from the economy at a rate of £20bn per year would choke off the UK's nascent recovery.[102] Many were concerned that growth at home was still not broad based and foreign demand was depressed due to the ongoing crisis in the Eurozone. It was not the time to take a gamble with growth.

Before long these concerns over the size and timing of retrenchment had been vindicated when throughout 2011 and 2012 economic output flatlined.[103] In its retrospective judgement, the OBR now estimates that spending cuts knocked at least 1.5 per cent off GDP between 2010–11 and 2011–12.[104] This meant that, unlike in previous recessions, a period of broadly flat spending (which has in practice meant significant real-terms cuts in public service spending in many areas) has not been sufficient to bring down the deficit.

Unprecedented declines in living standards caused by weak nominal wage growth made the job even harder because the tax take has been lower.[105] Recent analysis shows, had the government had been able to collect the income tax receipts of £195bn it forecast in 2010, public sector net borrowing would have been around one-third smaller than it was by the end of the last parliament.[106] This effect has been compounded by labour market trends such as the growth in self-employed and part-time workers (who on average have lower earnings) and reforms to the tax system that have taken large numbers of people out of tax altogether.[107]

Taken together, these factors led to one of the slowest recoveries from recession on record.[108] Latest estimates show that the economy returned to its pre-recession peak in the second half of 2013, much slower than the experience of other recent recessions. However, the effect of population growth since the UK entered recession in 2008 means that in 2015 national income per head still lags behind its pre-recession peak.[109]

Figure 8: GDP growth following previous recessions



Source: ONS

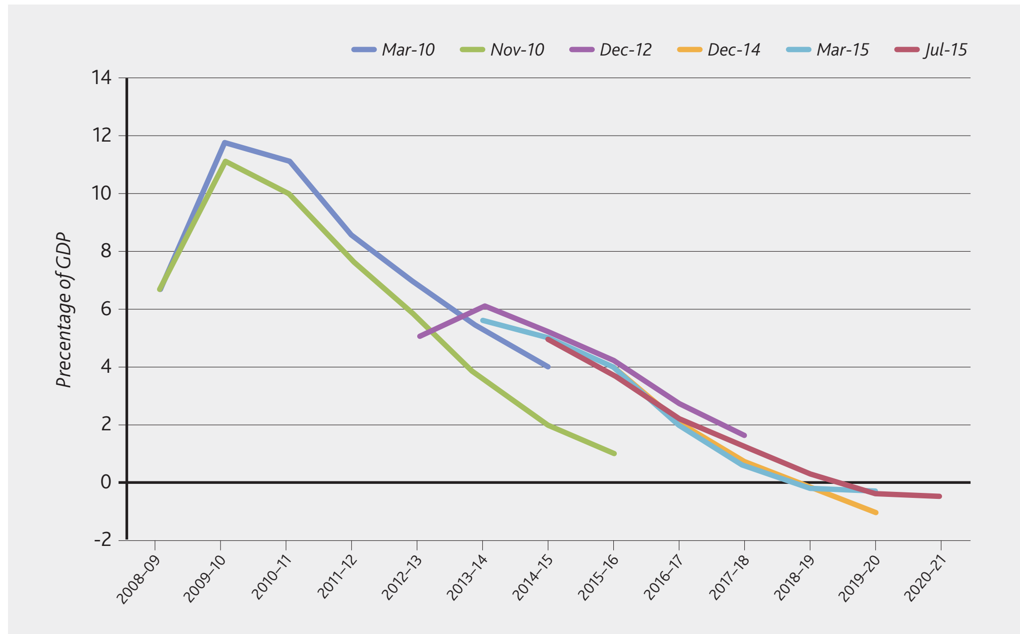
…meaning there is more pain to come…

The consequence of poor economic growth was that between 2010 and 2015 the coalition government borrowed much more than it planned to. In the last parliament the coalition borrowed more than Labour did in its entire 13 years in office.[110]

In order to offset this higher-than-predicted level of borrowing, the last government could have pencilled in further consolidation in the remaining years of its time in office, either in the form of fresh spending cuts or new tax rises. Instead, in the mid-years of the parliament, each time the government's borrowing forecasts deteriorated it chose to extend the timeline for deficit reduction outwards from 2015–16. Although a significant shift, this was compatible with the self-imposed rules governing the coalition's fiscal policy, which required borrowing (measured by the cyclically adjusted current budget) to be forecast to be in balance at the end of a rolling five-year forecast.

The decision to delay increasing amounts of pain into the current parliament is illustrated in Figure 15 (page 31), which compares different vintages of public sector net borrowing (which, as discussed below, is distinct from the spending position faced by individual public services) since 2007–8. In the space of five years the end point for deficit reduction was pushed back from 2015–16 to 2019–20. In March 2015 these plans were revised again when it was announced that austerity would come to an end in 2018–19, a year earlier than planned. Then finally, in July 2015, the expected date of the government's budget balance was again revised, this time to 2019–20.[111]

Figure 9: Forecasts of public sector net borrowing



Source: IFS

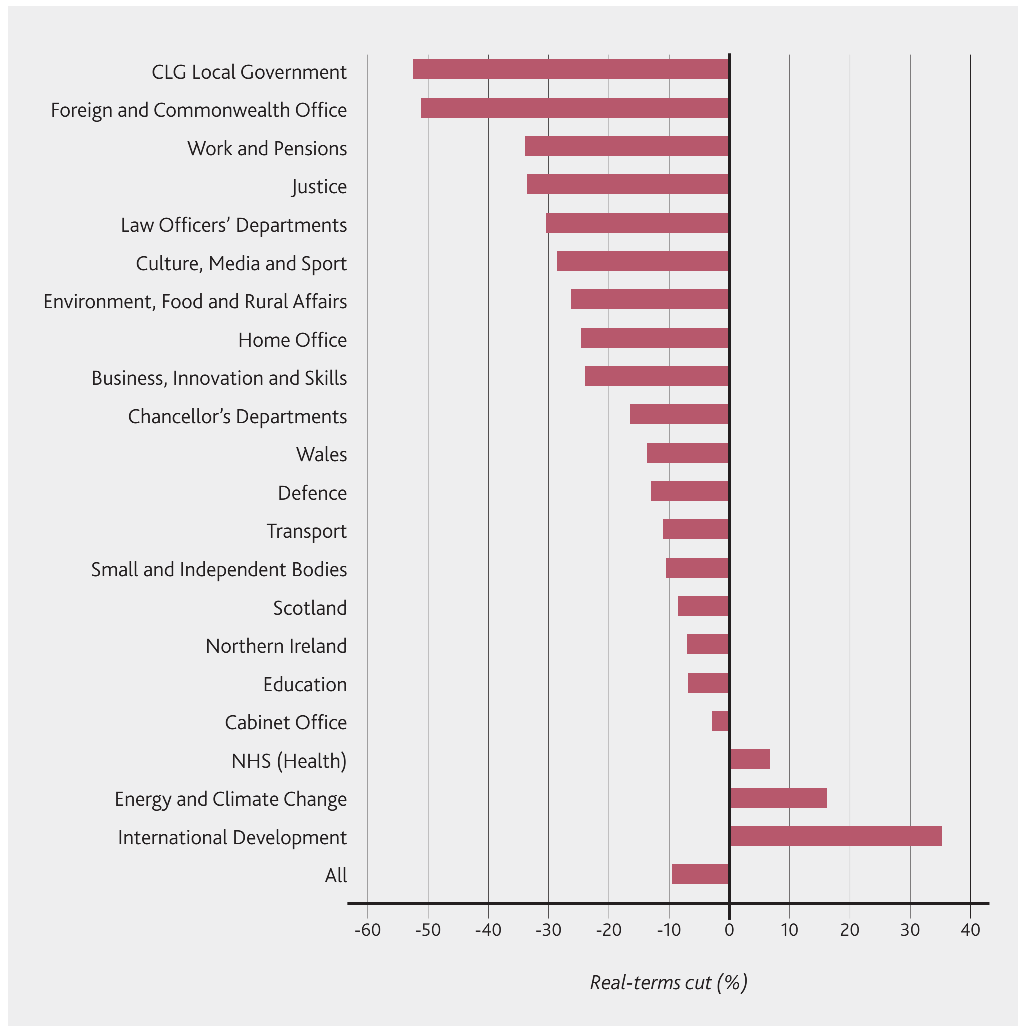
The later forecasts for borrowing in this figure show that as the coalition government extended the timetable for deficit reduction it also increased the amount of austerity it planned to impose. Between the coalition government's first and final budget of the last parliament, the overall size of the squeeze on the spending increased by around £54bn.[112]

...but large cuts to public services have still taken place...

The reason more austerity is said to be needed after 2015–16 is the prolonged weakness of growth in the last parliament. The coalition government's experiment with austerity delayed output by three years and, even as it began to strengthen throughout 2013, growth didn't feed through into improved underlying borrowing figures.[113] So low tax revenues and ongoing debt service costs meant borrowing was high at the same time that severe cuts were taking place to public spending.

Between 2009–10 and 2014–15 total managed expenditure fell by 2.9 per cent in real terms.[114] This apparently modest decline is a huge break with the course of spending over the last 60 years. Yet the true scale of cuts to spending can be seen only at the level of individual department budgets. Over the last parliament budgets for public service departments fell by an average of 9.5 per cent in real terms. However, as Figure 10 (page 32) shows, because this average cut was not spread equally between departments 'unprotected' areas of spending experienced cuts of over 20 per cent.[115]

Figure 10: How the pain has been shared across departments, 2010–11 to 2015–16



Source: IFS

...as reforms to the tax and benefit system have hit the least well off hardest

In the last parliament, the coalition government also reduced the generosity of spending on (predominately working-age) benefits and tax credits by £16.7bn, relative to an unchanged policy position from 2010.[116] By far the most significant reform over the long run was the coalition government's decision to permanently index most working-age benefits to CPI inflation, which typically grows at a slower rate than previously used indexes (RPI and Rossi). Between April 2013 and April 2015, nominal increases in most working-age benefits were capped at one per cent.[117] Along with the five-year cash freeze announced at the most recent budget (July 2015), working-age benefits will have fallen by eight per cent in real terms between 2013 and 2020.[118]

Additionally, the generosity of tax credits was reduced; child benefit was withdrawn for households containing an individual with a taxable income of over £50,000 and frozen or limited to nominal increases of one per cent between 2010 and 2015; reforms were made to the maximum rent covered by housing benefit for private-sector tenants; and the bedroom tax was introduced for social tenants considered to under-occupy their home.

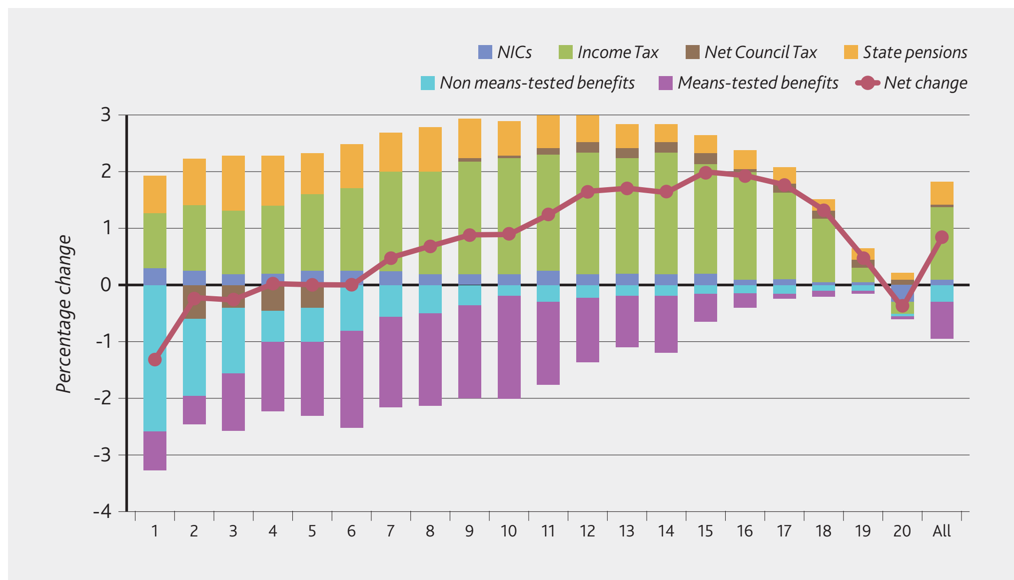
When they were announced, these reforms were forecast to reduce spending on benefits and tax credits by £19bn, compared to an inherited policy scenario. Social security expenditure is falling as a share of national income and on current forecasts will continue to do so. However, given the scale of the cuts undertaken in this area, it is striking that, measured in cash terms, real benefit expenditure is expected to be unchanged in 2015–16 from when the coalition government came to power (£220bn).[119] This is because, despite the significant reductions in generosity, macroeconomic and demographic factors such as rising pensioner spending, stagnant wage growth and rising private sector rents have kept real spending high.[120]

At the July 2015 budget a further £13bn of working-age welfare cuts were announced by the Chancellor, George Osborne. On current plans the largest proportion of these reductions (£6bn) will come from large cuts to the tax credits system and the level of support individuals will receive in 'work allowances' under the government's system of Universal Credit. This will mean that families are able to earn less before support via Universal Credit is withdrawn, weakening the incentive to move into work.[121] Another significant saving (£4bn) will be achieved by continuing the freeze in working-age benefits until 2020–21, meaning benefits will lose value relative to prices and earnings.[122]

Recent analysis has shown that of the profile of cuts in the last parliament were regressive across the income distribution and disproportionately affected families with young children.[123] They are also shown to be at odds with the government's stated objective of encouraging households into work: recent analysis shows that the majority of these cuts fall on working-age households that are already in employment.[124]

This regressive profile was reflected in the further cuts announced at the government's July 2015 budget. A further £12bn of social security cuts will fall disproportionately on the poorest households, especially families with children.[125] Recent forecasts suggest that by 2020 plans announced in that budget could increase the number of children in poverty by 1.2 million compared with a pre-budget baseline.[126]

Figure 11: Percentage change in household disposable income by income vingtile group due to policy changes, 2010 to 2014–15



Source: LSE

How the cuts impact on the shape of the state

Between 2010 and 2015 total public spending will have almost fallen back to the level it was in 2004–5 during Tony Blair's second term as prime minister (40.7 per cent of GDP). However, this fall masks a change of much greater magnitude: beneath the totals a significant shift is underway in the composition of spending and how the state distributes its resources.

The upward pressures on some areas of public spending (such as social security) combined with the coalition government's decision to protect other areas (such as health) mean the state is becoming increasingly focused on the NHS and pensions (together they accounted for 47.5 per cent of all spending in 2013–14).[127] This is not to imply that the recent NHS funding settlements have been generous: between 2009 and 2012 the average annual rate of growth in health spending was 1.6 per cent compared to between seven and eight per cent between 2004 and 2009.[128] Bodies such as The King's Fund estimate that, other things being equal, the NHS requires real annual growth of between three and six per cent in order to stand still.[129] So current funding settlements are leading to a funding gap and deteriorating financial position within the NHS.

Health and pensions are very important items of spending but so is spending on the future, such as children's social security, education, capital investment, innovation and other employment-creating spending. Strong dynamic economies rely on continuous investment in tomorrow's economic and social development as well as in the population's health and its older people. An overall spending settlement which forces government to finance items of current spending with significant expenditure reductions in areas like children's benefits, quality child care, skills and community regeneration will store up problems for the future.

The full impact of these cuts will be revealed only in future outcomes for those who depend on services, which statistics will not record for years. However, a number of short-term indicators provide early warning signals of declining service quality since 2010.

Box 3: Early warning signals of falling service quality[130]

Healthcare

- The LSE's recent assessment of the coalition government's record on social policy highlighted that the proportion of patients treated within 18 weeks fell between 2010 and 2014; major A&E departments have failed to meet operational standard of 95 per cent of patients waiting less than four hours since the last quarter of 2011–23; figures show a drop during 2013–14 in the proportion of patients receiving definitive cancer treatment within 62 days of an urgent GP referral.
- Data collected by the British Social Attitudes survey show public satisfaction with the NHS falling from a high of 70 per cent in 2010 to 60 per cent in 2013. 2011 saw the largest drop in satisfaction ever recorded by the British Social Attitudes survey.[131]
- Recent studies by The King's Fund find that NHS performance has slipped, with waiting times at their highest level for many years and an unprecedented number of hospitals reporting deficits.[132] A recent analysis by the same think tank found that "the NHS is now entering seriously dangerous financial territory which will have ramifications for patients and for all levels of NHS management".[133]
- The number of people waiting for a week or more to see a GP rose by almost 50 per cent between 2012 and 2014.[134]

Older people's care

- The LSE's recent assessment of the coalition government's record on social policy highlighted that as a result of support thresholds rising the number of people receiving adult care services through English local authorities has dropped substantially under the coalition – from 1.78 million in 2008–9 to 1.27 million in 2013–14, a 29 per cent fall in the total caseload.

Early years

- The LSE's recent assessment of the coalition government's record on social policy highlighted that the number of Sure Start centres fell from 3,631 in April 2010 to 3,019 in June 2014; the national evaluation of children's centres reported that nearly three out of four centre managers said service delivery had been affected by cuts in 2011–12.

Schools

- Both the NAO and Ofsted have recently raised concerns about the pace of improvement in the education system.[135]
- A number of bodies have warned of a growing recruitment crisis in schools and recent polling has found that a third of teachers plan to leave the profession over the next five years.[136]

More austerity will further reduce the state's reach

The newly elected Conservative government is hoping to achieve an overall budget surplus amounting to £10bn or 0.4 per cent of national income by 2019–20, strengthening slightly the following year. The decision to target an overall budget surplus (so that revenues exceed all spending) implies a tighter path consolidation compared with the coalition government's mandate, which targeted current expenditure. If achieved, this would take overall government spending to just over 36 per cent of the economy, the lowest level since 2000–1 and the fourth lowest since the Second World War.[137]

Detailed plans for how these reductions in overall spending will be achieved have not been set beyond 2015–16. Recent analysis by the IFS indicates that, assuming the government does not change its plans for the overall spending envelope, plans imply cuts to unprotected departmental spending of just under £24bn between 2015–16 and 2019–20. If this scenario were to materialise, these unprotected departments would have faced cumulative total real cuts of an average of around 50 per cent between 2010–11 and 2019–20.[138] With any 'low-hanging fruit' from departmental budgets removed in the years of the last parliament, further cuts on this scale will cause service quality to fall far below public expectations and inflict significant hardship on disadvantaged groups. It is likely that another parliament of austerity will lead to:

- **Recruitment and retention problems in the public sector** Cutting public sector pay is not a 'free lunch' for the Treasury and sooner or later pay cuts will affect the quality of service. Most public services are labour intensive, with costs that increase in line with rising earnings and further years of pay restraint will see the public sector struggle to maintain workforce quality. The OBR's best estimate is that between now and 2020 a further fall in general government employment of 200,000–400,000 is likely.[139]
- **A growing funding gap in local government** Analysis by the Local Government Association shows that in order for councils to maintain an existing level of service provision in each of the core spending areas, the gap between council income and expenditure will grow from around £3bn in 2015–16 to almost £10bn by the end of the decade. This study indicates that in the current parliament savings will be achieved increasingly through service reductions rather than efficiencies.[140]
- **Poorer-quality public services** Further reductions in departmental spending will lead to a poorer quality of public service, with higher access thresholds, less universal provision and longer waiting times in many key services. Recent analysis by the Resolution Foundation shows that, on current plans, by the end of the decade a number of unprotected departments face cumulative cuts of 50–75 per cent since 2009–10.[141]
- **A negative impact on UK growth** Before the last election, modelling by NIESR showed that the looser fiscal plans set out by the Liberal Democrats and the Labour party would have increased output by one per cent by 2019, compared with current plans.[142]

- **The unravelling of years of progress in reducing inequality and poverty** On current policy the outlook for poverty and inequality is concerning. Recent analysis by the Institute for Fiscal Studies has revealed substantial increases in in-work poverty and analysis by the Fabian Society found that, even before the announcement of further cuts to social security after 2016–16, a continuation of existing government policy will see an extra 3.6 million people falling into poverty between 2015 and 2030.[143] The Resolution Foundation think tank predicts that working-age and child poverty are set to rise precipitously.[144]

Conclusion

Public money is critical to social and economic stability and advancement in our market-based economy. This report has described how public expenditure achieves these outcomes and how its functions have evolved over time.

The level of public spending should not be totemic – governments should aim for 'big solutions' rather than fixating on the size of the state. But solutions to the greatest challenges facing the country, whether from preventing dangerous climate change, developing new medical breakthroughs or eradicating child poverty, will not be achieved by dramatically scaling back spending.

Nor should public spending be static. Over time government expenditure should evolve to take account of new social needs, economic circumstances and public preferences, as it has done for the last 100 years. These decisions should be made in the context of governments' long-term ambitions for the outcomes it wishes to achieve.

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