

# Public Spending

**ELECTION BRIEFING 2005**

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## Summary

- In its first three years in office, Labour saw public spending drop to a 39-year low as a share of national income, since when it has risen sharply. The overall increase in public spending seen between 1997 and 2005 is the 2<sup>nd</sup> largest among the OECD countries on which we have comparable information. But even the increases planned by Labour through to March 2008 would still leave the state spending a smaller share of national income than it did in the early 1990s.
- Public spending on the NHS, transport and education has increased much faster since Labour came to power than it did during the Conservatives' 18 years in office. By historical standards, spending in these areas has grown particularly quickly during Labour's second term in office.
- The period from April 1999 to date represents the largest sustained increase in spending on the NHS since its inception. This has meant that the Prime Minister's pledge to bring health spending up to the EU average has been met, if the benchmark is the simple average of EU health spending in 1998. However, UK health spending in 2005–06 is likely to be below the more meaningful weighted average of health spending among other EU countries in 1998, let alone what they have spent on healthcare more recently.

## 1. Introduction

As in previous general elections, the appropriate size of the state is a key issue. This Briefing Note describes the trends in public spending since Labour came to office in 1997 and compares them with those seen previously in the UK and in other OECD countries.

Section 2 compares the levels of public spending under Labour to date with historical levels and spending in other OECD countries. Section 3 compares the growth in the main components of public spending seen under Labour with growth seen under previous governments. It also provides some international comparisons – in particular, an assessment of whether the Prime Minister's pledge to increase health spending to the EU average by 2005 has been fulfilled.

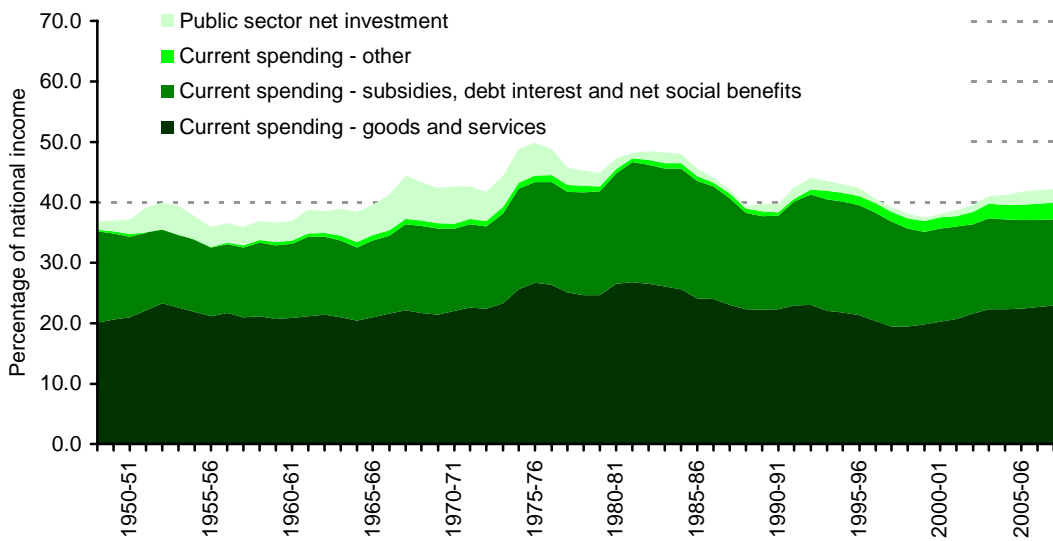
## 2. Total public spending

### 2.1 UK public spending over time

The size of the state, measured by public spending as a share of national income, is shown in Figure 1. Since the Second World War, total public spending (current spending plus public

sector net investment) has fluctuated between 35.9% and 49.9% of national income. It was at its lowest in 1957–58 and its highest in 1975–76. The current government inherited a level of 40.6% in 1996–97, from which it subsequently fell to 37.4% of national income in 1999–2000, the lowest since 1960–61. Since then, public spending has increased, reaching 41.2% of national income in 2004–05. This increase, unlike that in the early 1980s and the 1990s, has taken place during a period of relatively strong economic performance and therefore is not explained by the costs of rising unemployment. Under current government projections, public spending is set to increase further to 42.2% of national income in 2007–08. While this is greater than the levels of public spending seen in the last 10 years, it would still be below the level seen in the early 1990s.

Figure 1. Public spending since 1948–49



Note: Projections are from 2005 Budget. Current expenditure includes depreciation.

Sources: ONS, series ANBT; HM Treasury, *Public Finances Databank*, London, March 2005 (<http://www.hm-treasury.gov.uk/media/C62/B0/March05WEB.xls>); HM Treasury, *Budget 2005*, London, March 2005 ([http://www.hm-treasury.gov.uk/budget/budget\\_05/budget\\_report/bud\\_bud05\\_report.cfm](http://www.hm-treasury.gov.uk/budget/budget_05/budget_report/bud_bud05_report.cfm)).

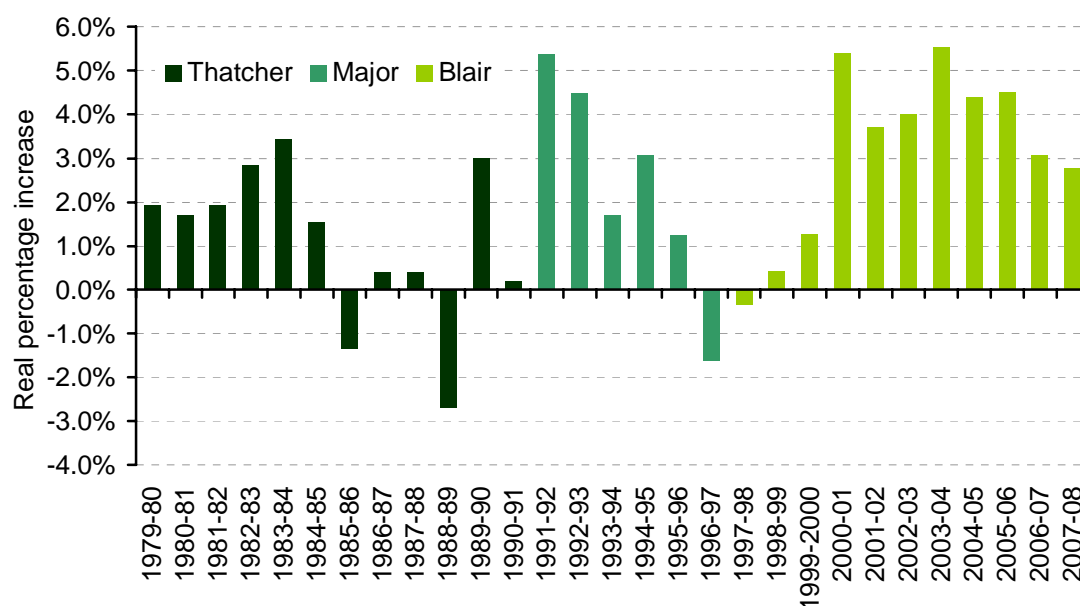
Also shown in Figure 1 is the breakdown of public spending into current spending (by component) and public sector net investment. In the period since the Second World War, current spending on goods and services (including depreciation) peaked at 26.8% of national income in 1981–82 and reached a low of 19.4% in 1998–99. Cash transfers (in the form of net social benefits, subsidies and debt interest payments) peaked at 25.6% of national income in 1984–85 compared with a low of 11.4% of national income in 1956–57. (Other current spending was negative in the early 1950s and is set to reach a high of 2.7% of national income in 2007–08.)

Public sector net investment reached an all-time high of 7.1% of national income in 1967–68. It had fallen to 0.7% by the time Labour came to power and then dropped further to 0.5% in 1999–2000. Since then, and less quickly than it had hoped, the government has raised it to 1.6%. In 2005–06, it is forecast to jump to 2.1% of national income, which if delivered would be the highest level of public sector net investment since 1979–80. The four-year period from 1997–98 to 2000–01 (i.e. Labour’s first parliament) represents the lowest four-year period of public sector net investment since the Second World War. The fact that public sector net

investment has been so much lower over the last 20 years than in the 1970s reflects in large part the privatisation of utilities and the decline of social housing.<sup>1</sup>

Figure 2 shows the increase in total public spending for each year since 1979–80, split by Prime Minister, after taking account of economy-wide inflation. Between 1979 and 1984, public spending grew due to a combination of the implementation of the Clegg pay awards, keeping to the commitment made to NATO by the previous Labour administration to increase defence spending by at least 3% a year until 1985 and also weak economic performance which increased spending on social security benefits. The following four years to 1989 saw negative or low growth in total spending, in part due to strong economic performance reducing spending on social security benefits. The early years of John Major's premiership saw large increases in public spending, in part due to rising unemployment but also due to the large increases in NHS spending (see Figure 8 later) allocated at the time of the internal market reforms. Spending then grew less quickly in 1995–96 and was cut in real terms in 1996–97. During Margaret Thatcher's premiership public spending grew in real terms by an average of 1.1% a year, while during John Major's premiership it grew by an average of 2.4% a year.

Figure 2. Annual increase in total public spending, by Prime Minister since 1979–80



Note: Projections are from 2005 Budget.

Source: As Figure 1.

<sup>1</sup> For more information on the changes in public sector net investment during the 1980s and 1990s, see T. Clark, M. Elsby and S. Love, 'Trends in British public investment', *Fiscal Studies*, 2002, vol. 23, pp. 305–42.

Between April 1997 and March 2000, there were relatively small increases in public spending. This was due to a combination of relatively low planned increases in spending on public services in 1997–98 and 1998–99 (combined with underspends on departmental spending in both of those years),<sup>2</sup> a large underspend by government departments in 1999–2000 and strong economic growth putting downward pressure on social security and debt interest payments throughout these three years. In 2000–01 (the last full financial year of Labour’s first term), spending grew by 5.4% in real terms.

During Labour’s second term, between April 2001 and March 2005, there have been larger increases in public spending averaging 4.4% a year after economy-wide inflation. These have been due to increases in spending on public services and also to increases in the generosity of transfer payments to lower-income families with children and lower-income pensioners. Taking the period since Tony Blair became Prime Minister as a whole, spending has grown in real terms by an average of 3.0% a year. Spending is forecast to grow at a slightly lower rate between April 2006 and March 2008, because of the Spending Review 2004 settlement being tighter than its predecessors and because of less expensive announced increases in the generosity of benefits and tax credits in those years.

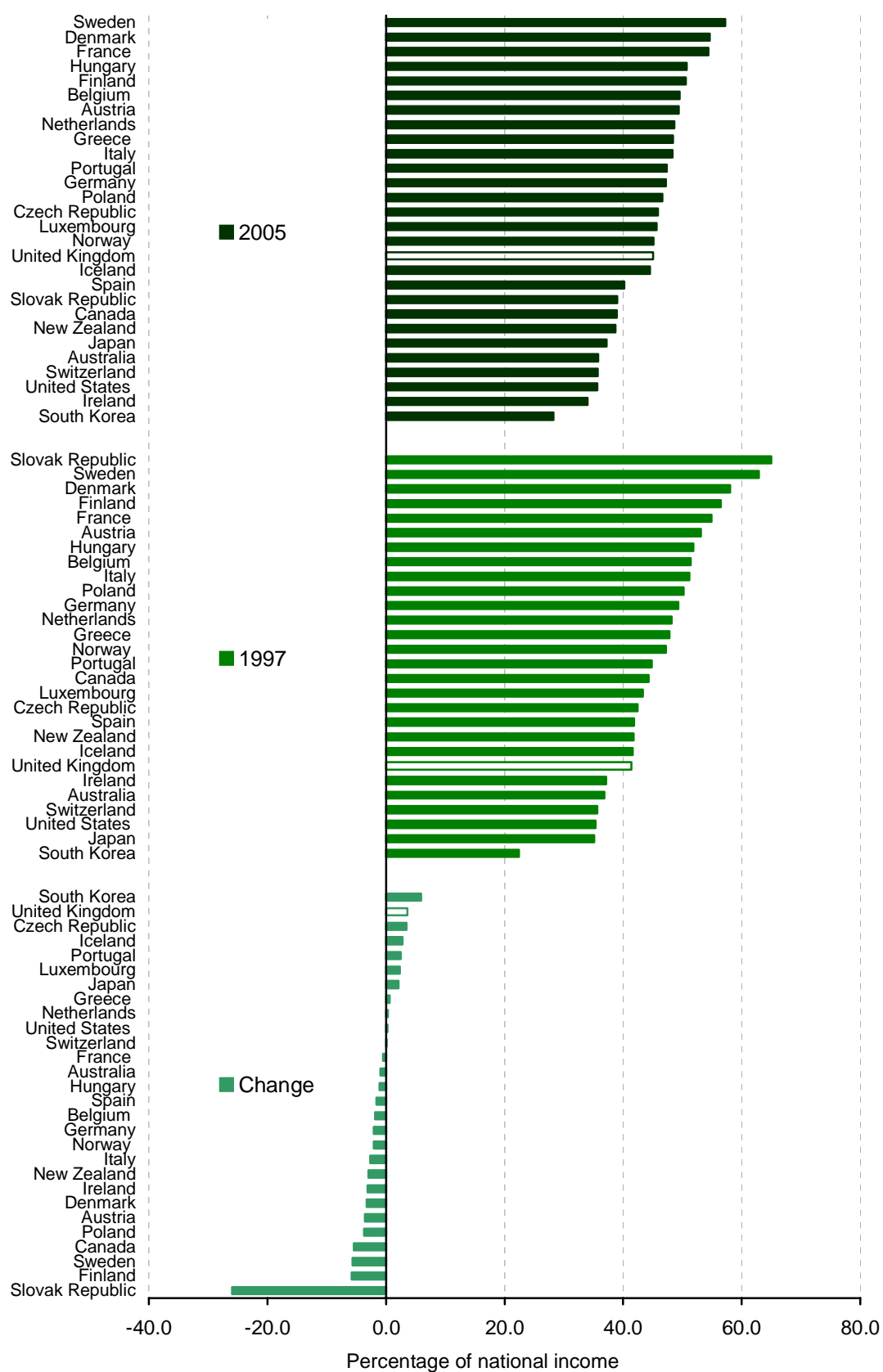
## 2.2 International comparison of total public spending

Figure 3 shows estimates of public spending as a share of national income across OECD countries. In 1997 out of the 28 countries on which we have comparable information, the UK had the 22<sup>nd</sup> largest share of national income spent publicly. Since then, the UK has seen the 2<sup>nd</sup> largest increase in public spending as a share of national income, with only South Korea (which is the country with the smallest amount spent publicly) seeing a larger increase. As a result, the UK is now estimated to have the 17<sup>th</sup> largest proportion of national income spent publicly.

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<sup>2</sup> For more details of underspends in 1997–98, 1998–99 and 1999–2000, see figure 3.6 of A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2001*, Commentary no. 83, IFS, London, 2001.

Figure 3. General government total outlays



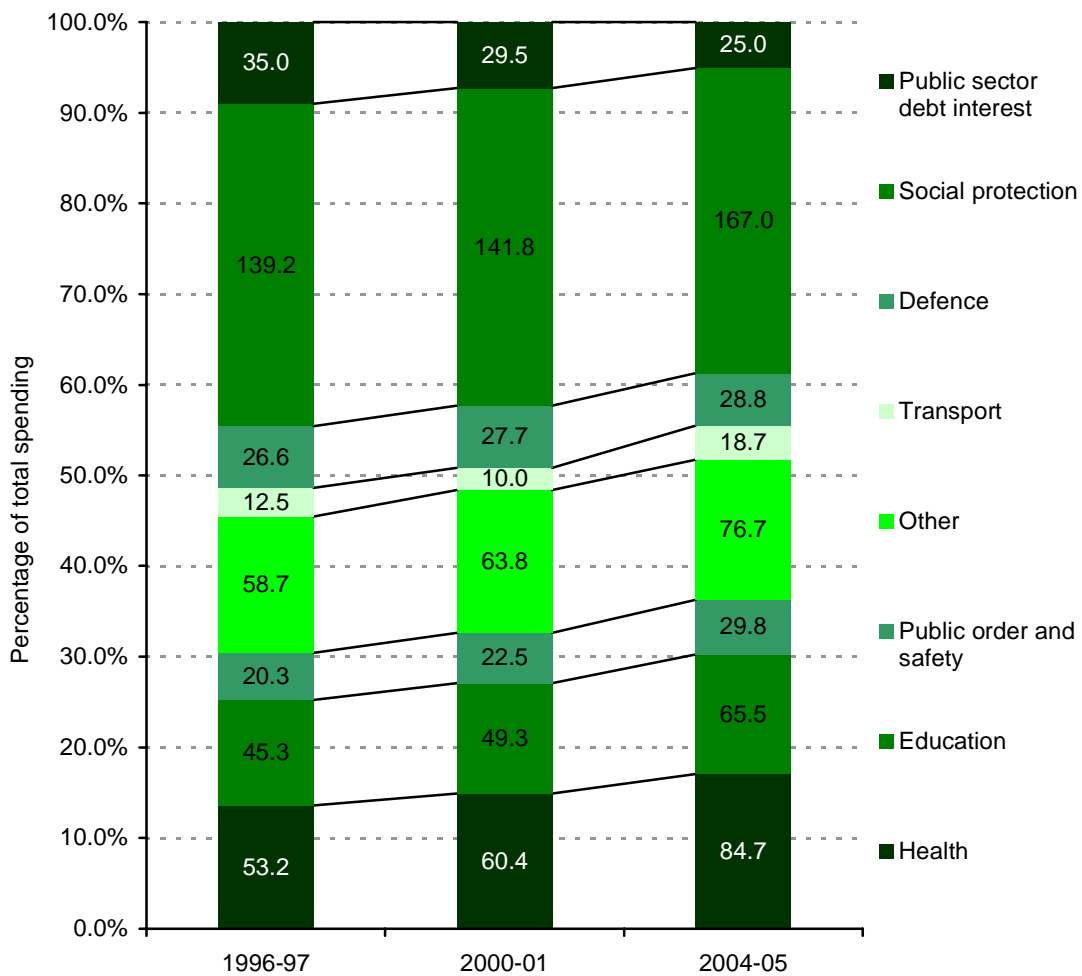
Source: Annex table 25, OECD Economic Outlook 76 database, December 2004

([http://www.oecd.org/document/61/0,2340,en\\_2825\\_32066506\\_2483901\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/61/0,2340,en_2825_32066506_2483901_1_1_1_1,00.html)).

### 3. Public spending by function

We now look at trends in the components of public spending. Figure 4 shows the composition of public spending in 1996–97 (the last full financial year of the last Conservative government), 2000–01 (the last full financial year of Labour’s first term) and 2004–05 (the last full financial year of Labour’s second term). It shows that the proportion of public spending that has gone on health and education has increased from 25.2% in 1996–97 to 30.3% in 2004–05. In part this reflects the government’s decision to allocate relatively more resources to the NHS and to schools in each of its four reviews of public spending that it has carried out to date. It also reflects the fact that low interest rates and the budget surpluses recorded early in Labour’s period in office have reduced debt interest payments in nominal terms, and therefore also as a share of total public spending. Social protection absorbed 33.7% of total public spending in 2004–05, compared with 35.6% in 1996–97. Savings from falling unemployment have been offset by the government’s greater generosity to low-income pensioners and families with children.

Figure 4. Composition of UK public spending



Note: Figures in £ billion, 2005–06 prices.

Source: HM Treasury website ([http://www.hm-treasury.gov.uk/media/325/FC/pesa2005\\_chapter3\\_tables.xls](http://www.hm-treasury.gov.uk/media/325/FC/pesa2005_chapter3_tables.xls)).

Table 1. Increases in various components of public spending

	Long-term trend	Average annual real increase in spending over:					
		Conservative years April 1979 to March 1997	Labour years to date April 1997 to March 2005	Labour 1 <sup>st</sup> parliament April 1997 to March 2001	Labour 2 <sup>nd</sup> parliament April 2001 to March 2005	Labour spending plans April 2005 to March 2008	
Social security	3.7	3.5	2.3	1.1	3.5	1.0	
NHS	3.7	3.1	6.1	5.0	7.1	7.2	
Education	4.0	1.5	4.7	2.8	6.7	3.4	
Defence	-0.3	-0.3	1.0	1.7	0.4	1.3	
Transport	n/a	0.5	5.1	-4.9	16.2	2.5	
Public order & safety	n/a	4.1	4.9	3.2	6.6	3.1	
Total spending (TME)	2.6	1.5	3.0	1.7	4.4	3.5	
Current spending	2.8	1.7	2.8	1.7	3.8	2.9	
Net investment	-0.2	-4.6	13.4	-2.2	31.4	16.2	
National income	2.5	2.1	2.8	3.2	2.4	2.6	

Notes: 'Current spending' includes depreciation. For details of long-term trends, see C. Emmerson, C. Frayne and S. Love, *A Survey of Public Spending in the UK*, Briefing Note no. 43, IFS, London, 2004 ([http://www.ifs.org.uk/publications.php?publication\\_id=1791](http://www.ifs.org.uk/publications.php?publication_id=1791)).

Sources: HM Treasury, *Public Expenditure Statistical Analyses 2005* and previous PESAs; Office for National Statistics, *Blue Book: HM Treasury Public Spending Statistics*; Department of Health Annual Report; Office of Health Economics; HM Treasury, *2004 Spending Review and previous Spending Reviews*.



### 3.1 Trends over time

The real average annual rates at which public spending in each of the six main areas has increased over time are shown in Table 1. Since Labour came to power in 1997, there have been particularly large average annual increases in spending on the NHS (6.1% a year), transport (5.1% a year) and education (4.7% a year). These areas of public spending received much smaller average annual increases during the 18 years of Conservative governments from 1979 to 1997 (3.1%, 0.5% and 1.5% respectively). Spending on both defence and public order & safety has grown slightly faster under Labour than under the previous four Conservative governments. In contrast, spending on social security benefits (including the new tax credits) has grown less quickly under new Labour (averaging 2.3% a year in real terms) than it did over the period from 1979 to 1997 (when it averaged 3.5% a year in real terms), which in large part reflects the falls in unemployment seen since 1997.

With the notable exception of defence, spending on each of the components shown in Table 1 has grown much more quickly over Labour's second parliament than over its first. The government's spending plans were much less generous in the first half of the first parliament than subsequently because of its 1997 manifesto commitment to abide for two years by the spending plans in Kenneth Clarke's November 1996 Budget and then spending continued to fall as a share of national income due to the significant underspend by government departments in 1999–2000.

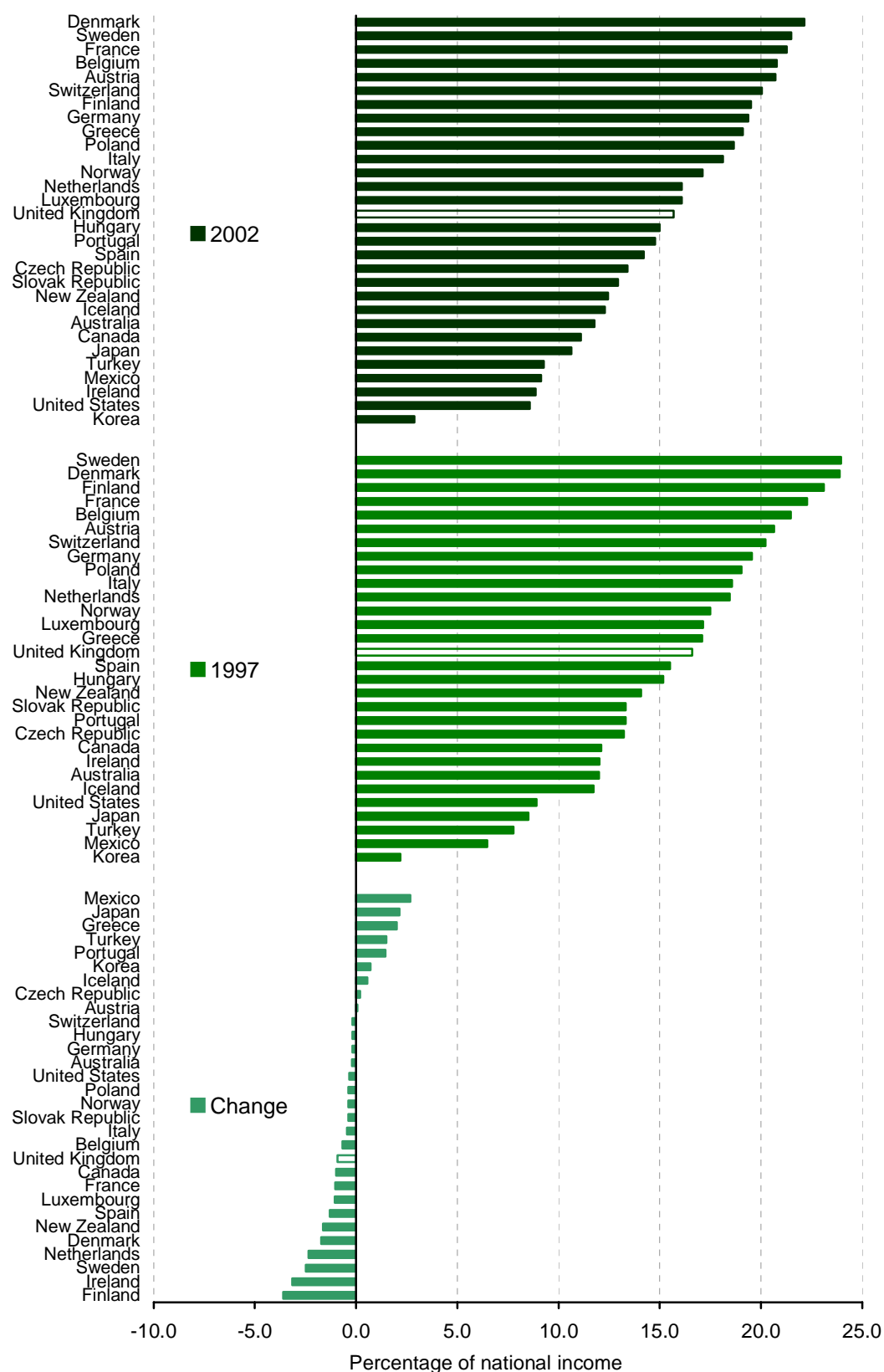
Table 1 also shows the real increases in public spending implied by the plans set out in the government's 2004 Spending Review. Under these plans, the NHS would continue to see very large increases in spending. Spending on education and on public order & safety would continue to grow as a share of national income, but less quickly than the increases seen since April 1997. In contrast, the plans suggest that spending on transport will grow in line with growth in the national economy, which is a much lower rate of increase than that experienced since new Labour came to power in 1997.

### 3.2 International comparisons of spending by function

Comparable information on spending on different components of public spending in different countries is only available for a limited number of areas. Figure 5 shows spending on social protection (excluding spending on health, which is dealt with separately in Figure 6) across 30 OECD countries in 1997 and 2002. On this measure, the UK had the 15<sup>th</sup> largest share of national income spent on social protection (which comprises social security payments and spending on active labour market programmes) in both 1997 and 2002 (and had the 20<sup>th</sup> largest increase in spending between the two years).

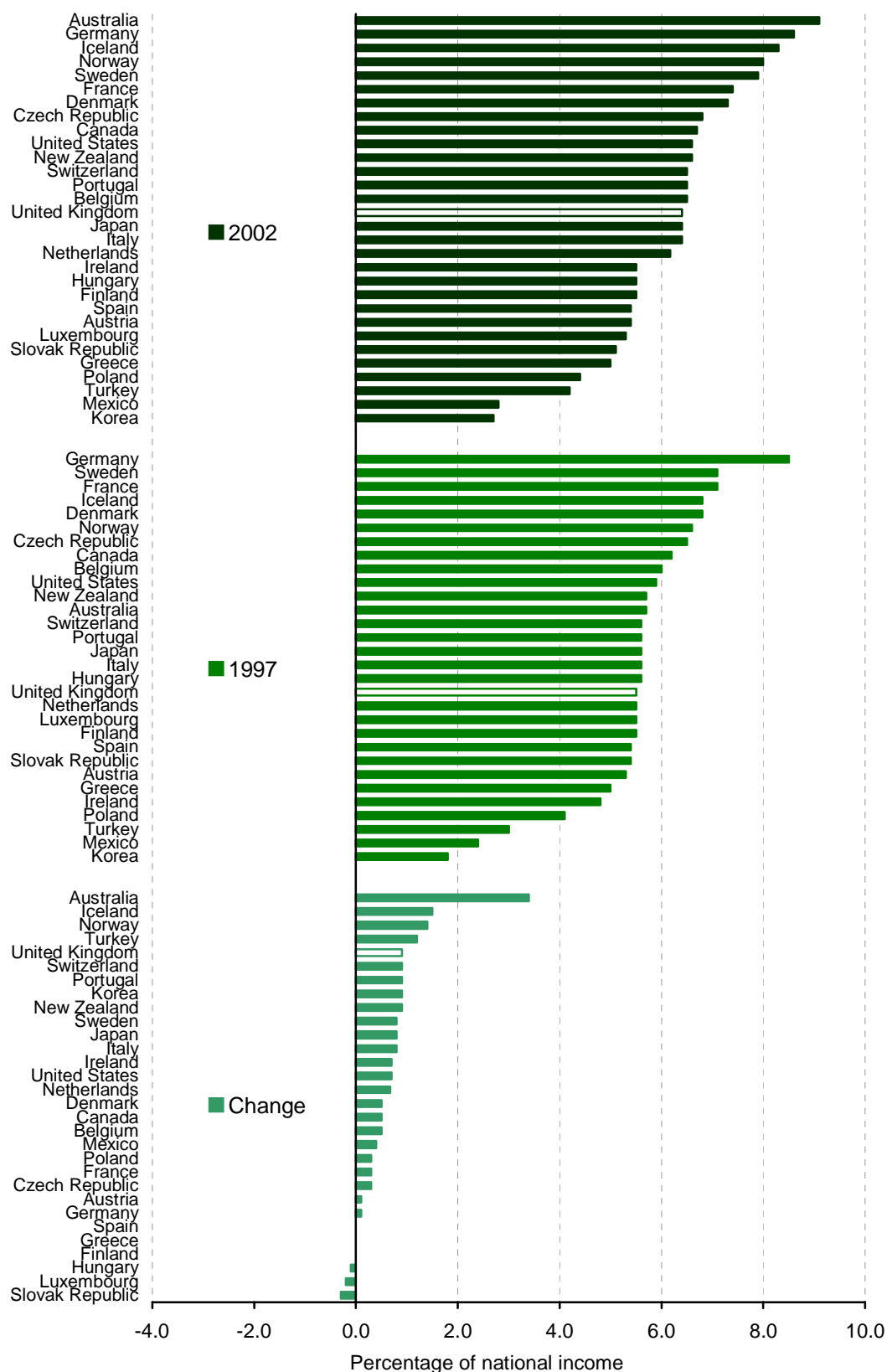
Figure 6 shows spending on health across the same 30 OECD countries in 1997 and 2002. The UK had the 18<sup>th</sup> largest share of national income spent on health in 1997. Since then, it has had the 5<sup>th</sup> largest increase in health spending as a share of national income, which has moved it to being the 15<sup>th</sup> largest spender. As we show in the next section, NHS spending has increased quickly between 2002 and 2005 (and is set to continue increasing quickly through to March 2008 regardless of which of the three main parties wins the next election), which may have moved the UK further up this 'league table'.

Figure 5. Public spending on non-health social protection



Notes: The main social policy areas are as follows: Old age, Survivors, Incapacity-related benefits, Health, Family, Active labour market programmes, Unemployment, Housing, and Other social policy areas. We exclude health spending as this is analysed separately in Figure 6. For Turkey, information beyond 1999 is not available so 1999 is used instead of 2002. For Hungary, information before 1999 is not available so 1999 is used instead of 1997. Source: OECD, Social Expenditure database, 2004 (<http://www.oecd.org/dataoecd/56/37/31613113.xls>).

Figure 6. Public spending on health



Notes: Turkey refers to 2000 not 2002, while Australia and Japan refer to 2001 not 2002. Public health spending in the Netherlands is not available from 1998 onwards; for the purposes of this graph, we have assumed that 67.8% of total health spending is financed publicly, which was the case in 1997.

Source: Table 12, OECD Health Data 2004

([http://www.oecd.org/document/16/0,2340,en\\_2825\\_495642\\_2085200\\_1\\_1\\_1\\_1.00.html](http://www.oecd.org/document/16/0,2340,en_2825_495642_2085200_1_1_1_1.00.html)).

### Has the UK met the EU average level of health spending?

The 2001 Labour Party manifesto stated that ‘over time we will bring UK health spending up to the EU average’. In November 2001, the Prime Minister went further and confirmed that he would like to see UK health spending reach the European average by 2005.<sup>3</sup>

When the pledge to increase health spending to the EU average was made, the latest information on health spending across EU countries was from 1998. In that year, the UK had a relatively low level of health spending – as shown in Figure 7, only three EU countries (Finland, Ireland and Luxembourg) spent a smaller proportion of their national income on health.

The latest information on total health spending (which includes private health spending) is from 2002, and this is also shown in Figure 7. Out of the 15 EU countries, there were then five spending a smaller proportion of their national income on health than the UK (Austria, Spain, Ireland, Finland and Luxembourg).

There are at least four ways in which the average across the EU countries can be calculated, shown in Table 2. Perhaps the most obvious is simply to add the spending across the 15 countries and then divide by 15 – this gives a figure for 1998 of 8.0% of national income. This figure includes the UK, so it may seem more appropriate to take the average across the other EU Member States. As the UK is a relatively low spender, the average across the 14 other EU countries is slightly higher, at 8.1% of national income.

**Table 2. Average health spending across the EU, 1998 and 2002**

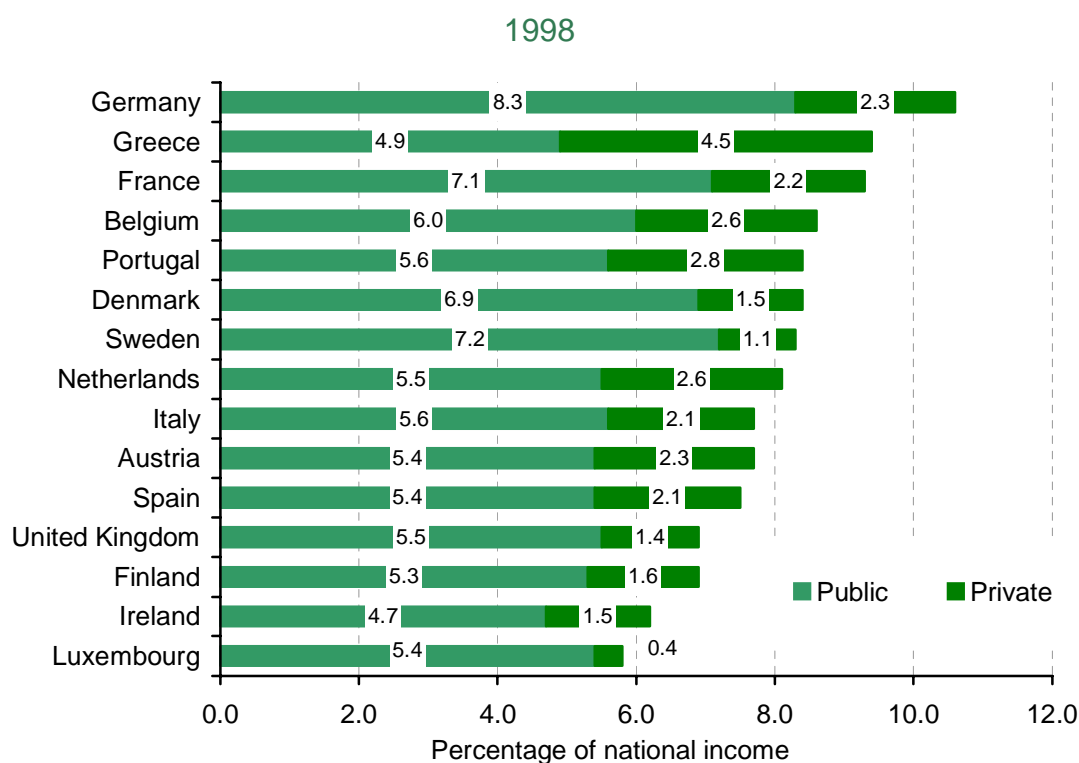
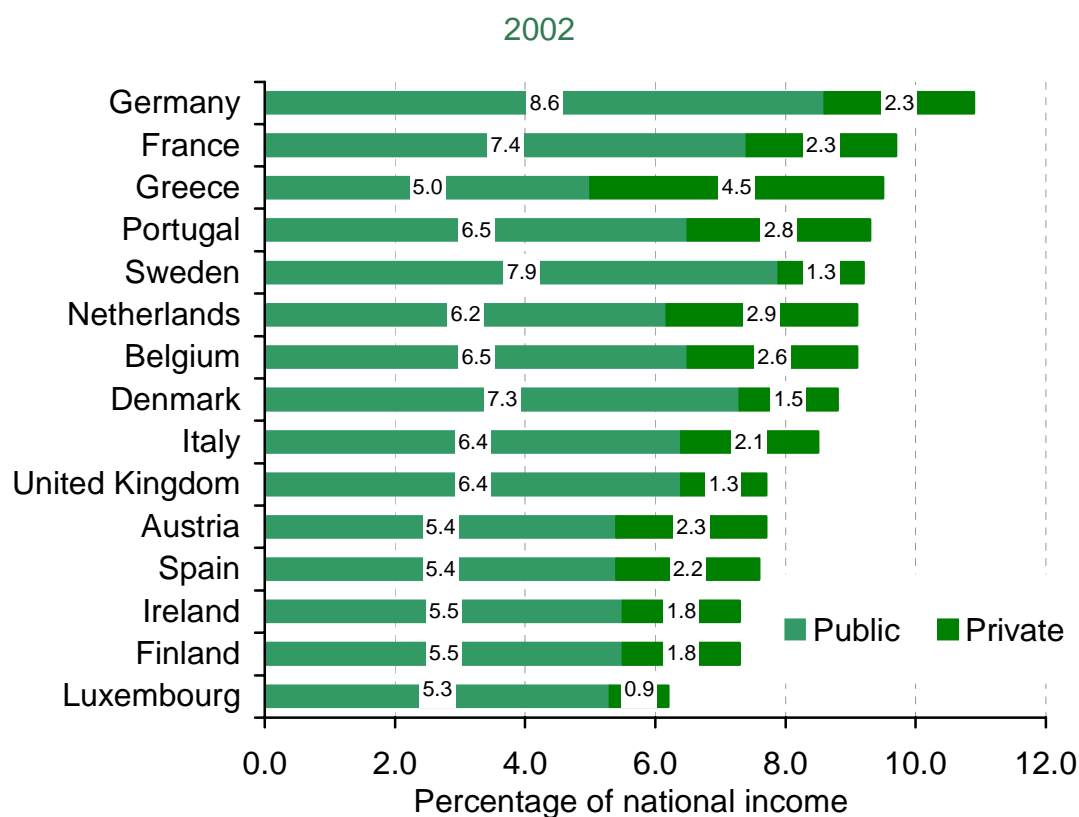
Measure of the EU-15 average	% of national income spent in:	
	1998	2002
Unweighted average, including the UK	8.0	8.5
Unweighted average, excluding the UK	8.1	8.6
Weighted average, including the UK	8.6	9.1
Weighted average, excluding the UK	8.9	9.3

Sources: Total health spending as a share of GDP taken from table 12, OECD Health Data 2004 ([http://www.oecd.org/document/16/0,2340,en\\_2825\\_495642\\_2085200\\_1\\_1\\_1\\_1.00.html](http://www.oecd.org/document/16/0,2340,en_2825_495642_2085200_1_1_1_1.00.html)); GDP in current US\$ using PPPs taken from OECD Factbook 2005, Economic, Environmental and Social Statistics (<http://thesius.sourceoecd.org/vl=10405438/cl=47/nw=1/rpsv/factbook/02-01-01-t01.xls>).

These ‘averages’ are in fact unweighted averages – this means that each country is treated the same, regardless of size. This is not a meaningful measure of the average level of health spending undertaken by citizens of the EU since it gives the same weight to the small and relatively low-spending countries of the Republic of Ireland and Luxembourg as it does to the much larger and relatively high-spending countries of France and Germany. An alternative methodology is to calculate the total amount of spending in EU countries and divide it by the total amount of national income across the same countries. This is known as a weighted average. Across the 15 Member States of the EU, the weighted average for health spending in 1998 is estimated to have been 8.6% of national income. If the relatively low-spending UK is excluded, this rises to 8.9%.

<sup>3</sup> See *Hansard*, 28 November 2001, column 964.

Figure 7. Public and private health spending across the EU-15



Note: The split between public and private spending in the Netherlands is not available from 1998 onwards. For the purposes of this graph, we have assumed that 67.8% of total health spending is financed publicly, which was the case in 1997.

Source: Tables 10 and 12, OECD Health Data 2004

([http://www.oecd.org/document/16/0,2340,en\\_2825\\_495642\\_2085200\\_1\\_1\\_1\\_1.00.html](http://www.oecd.org/document/16/0,2340,en_2825_495642_2085200_1_1_1_1.00.html)).

Regardless of which average is taken, the UK had not reached the EU average by 2002, when total health spending was 7.7% of national income. Table 3 gives estimates of likely UK health spending in 2005–06 and 2007–08 assuming that private health spending remains constant as a share of national income and that all of the planned increase in NHS spending (shown in Figure 8) contributes to an increase in health spending. Under these assumptions, the UK will spend 8.6% of national income on healthcare in 2005–06.

**Table 3. Total (public and private) UK health spending**

	<b>% of national income</b>
1998	6.9
2002	7.7
<i>Estimated spending in 2005–06</i>	8.6
<i>Estimated spending in 2007–08</i>	9.2

Note: Estimated spending in 2005–06 and 2007–08 assume that all of the planned increase in NHS spending since 2002–03 contributes to an increase in health spending under the international definition and that private health spending as a share of national income remains at its 2002 level.

Sources: Total health spending as a share of GDP taken from table 12, OECD Health Data 2004 ([http://www.oecd.org/document/16/0,2340,en\\_2825\\_495642\\_2085200\\_1\\_1\\_1\\_1.00.html](http://www.oecd.org/document/16/0,2340,en_2825_495642_2085200_1_1_1_1.00.html)); HM Treasury, 2004 *Spending Review*, London, 2004 ([http://www.hm-treasury.gov.uk/spending\\_review/spend\\_sr04/spend\\_sr04\\_index.cfm](http://www.hm-treasury.gov.uk/spending_review/spend_sr04/spend_sr04_index.cfm)).

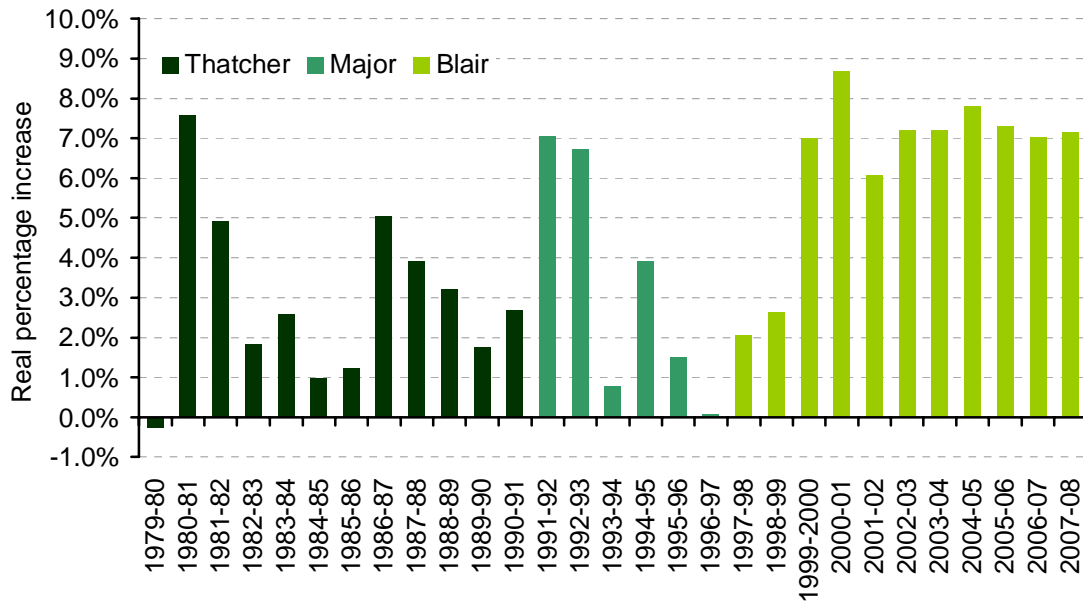
This would be sufficient for the UK to reach the unweighted average of health spending across EU countries in 1998. But it would still leave total health spending 0.3% of national income short of the more meaningful weighted 1998 average across the other 14 EU countries, of 8.9% of national income. Moreover, spending elsewhere in the EU has increased since 1998. By 2007–08, the planned increases in NHS spending, if delivered, should bring the UK to around the weighted average of EU health spending in 2002. At 9.2% of national income, UK health spending would be at the level spent in 2002 by Sweden, which was the 5<sup>th</sup> largest EU country in terms of the percentage of national income spent on healthcare.

To have met the more meaningful weighted EU average would have required the recent large increases in NHS spending (shown in Figure 8) either to have started before April 1999 or to have been even higher. However, the 2002 Wanless Review stated that ‘Given the expected workforce supply over the next few years, the Review believes that its projections for UK real terms spending growth of 7.1 to 7.3 per cent a year over the next five years are at the upper end of what could sensibly be spent’.<sup>4</sup> Given this finding, it is not clear that higher increases in spending over the period since April 1999 would have been a sensible way of meeting the weighted EU average sooner. Real annual increases in NHS funding in excess of 7.0% occurred previously, for example, in 1980–81 (with the implementation of the Clegg pay awards) and 1991–92 (at the time of the internal market reforms), as shown in Figure 8. However, the increases in NHS spending seen in the UK since April 1999, and planned to

<sup>4</sup> Paragraph 5.19, page 80 of D. Wanless, *Securing Our Future Health: Taking a Long-Term View*, Final Report, HM Treasury, London, 2002 ([http://www.hm-treasury.gov.uk/Consultations\\_and\\_Legislation/wanless/consult\\_wanless\\_final.cfm](http://www.hm-treasury.gov.uk/Consultations_and_Legislation/wanless/consult_wanless_final.cfm)).

continue at least until March 2008, represent the largest sustained increase in NHS funding since its birth.<sup>5</sup>

Figure 8. Annual increase in NHS spending, by Prime Minister since 1979–80



Source: As Table 1.

<sup>5</sup> For further details of NHS spending over time, see, for example, C. Emmerson, C. Frayne and A. Goodman, *Pressures in UK Healthcare: Challenges for the NHS*, Commentary no. 81, IFS, London, 2000 ([http://www.ifs.org.uk/publications.php?publication\\_id=1889](http://www.ifs.org.uk/publications.php?publication_id=1889)).