The 2007 Comprehensive Spending Review: A Challenging Spending Review?

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1. Introduction

Since 1998, the Labour government has used biennial spending reviews (in 1998, 2000, 2002 and 2004) to set out its public spending plans. Within a pre-announced overall envelope for public spending these provided a division both within and between two broad categories of spending. The first of these are the Departmental Expenditure Limits (DELs), which cover more predictable spending by government departments (such as spending on schools and hospitals). The second category of expenditure covers the more demand driven elements of public spending (such as spending on social security and debt interest payments), this is known as Annually Managed Expenditure (AME).[1] Despite occurring every other year spending reviews have covered a three year period, with the last year of a spending review period being subject to a re-assessment by being the first year of the next spending review period.

The Labour government's fifth spending review is set to be published this month in the form of a Comprehensive Spending Review (CSR). This will announce departmental spending plans for the three fiscal years from April 2008 to March 2011. The Government has said that the reasons for the additional year's delay between the last Spending Review and this one are firstly that they decided not to reconsider the 2007–08 spending plans that were set out in the Spending Review of 2004, and also that they wanted a "comprehensive" Spending Review (the previous "Comprehensive Spending

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[1] Further details on the current structure of public spending in the UK can be found in Emmerson,C., Frayne, C. and Love, S. (2004), *A Survey of Public Spending in the UK*, IFS Briefing Note No. 43 (http://www.ifs.org.uk/publications.php?publication_id=1791).

Review" was in July 1998, the others have been standard "Spending Reviews"). Further details can be found on the Treasury website.[2]

The spending plans over the period April 2008 to March 2011 are expected to be tight in comparison with spending increases seen in Labour's last four spending reviews. The Treasury's current fiscal projections require public spending to fall (and tax receipts to rise) as a share of national income over this three year period if they are to meet their borrowing forecasts. This is in contrast to Labour's last four spending reviews which have all planned and delivered increases in public spending as a share of national income.

In advance of the publication of the CSR, this briefing note examines what we already know about the CSR settlement, what remains to be announced and what this might imply for government departments and public services. Section 2 looks at how total spending has evolved under Labour so far. Sections 3 and 4 examine what we already know about the spending totals for the CSR. Section 5 looks at what settlements might be possible for the spending areas that have yet to be announced and section 6 considers whether the final spending totals will indeed be as tight as the CSR is likely to set out.

2. Public spending growth under Labour

The Treasury predicts that total managed expenditure (TME), the broadest measure of government expenditure, will be £587 billion in 2007–08. This equates to 42.6% of national income. This compares to 40.6% of national income in the last full financial year before Labour came to power (1996–97). This 2.0% of national income increase in total public spending is equivalent to £28 billion in current (2007–08) terms.

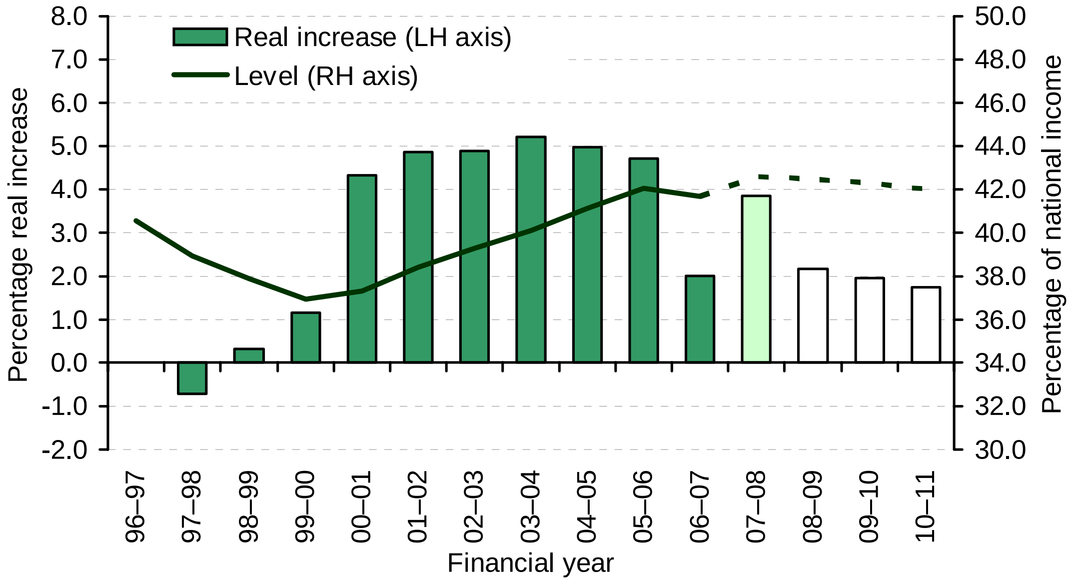
During their first two years in office, the Labour government largely kept their manifesto promise to stick to the Conservatives' spending plans during the years 1997–98 and 1998–99. This, coupled with strong economic performance during these years, meant that public spending declined as a share of national income between in 1997–98 and 1998–99 (as shown in figure 1).

Public spending plans during Labour's other years in office were set out in the Comprehensive Spending Review of 1998 and the Spending Reviews of 2000, 2002 and 2004. The increases in spending after economy-wide inflation (hereafter referred to as "real terms") and the level of public spending as a share of national income during these years are shown in figure 1. The bars in figure 1 show the annual real increase in spending (left-hand axis) while the line shows the level of spending as a percentage of national income (right-hand axis). As a result of departmental under-spending and continued strong economic performance during 1999–2000, public spending continued to

[2] See http://www.hm-treasury.gov.uk/spending_review/spend_csr07/spend_csr07_index.cfm

decline as a share of national income during the first year covered by the 1998 Comprehensive Spending Review. Since then (with the exception of the 2006–07 financial year), public spending has grown in real terms more quickly than national income has and so public spending has increased as a share of national income and is expected by the Treasury to peak at 42.6% of national income in 2007–08. If delivered this would be the highest share of national income spent publicly since John Major was Prime Minister in 1994–95.

Figure 1. Total managed expenditure



Sources: Total managed expenditure from table B1 of HM Treasury, *Public Sector Finances Databank*, London, August 2007 (www.hm-treasury.gov.uk/media/7/1/pfd_210807.xls) and table C4 of HM Treasury, *Budget 2007*, London, March 2007 (www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_index.cfm). GDP and GDP deflators up-to-date as of 29 June 2007 from HM Treasury website (www.hm-treasury.gov.uk./media/2/F/gdpdeflators_290607.xls).

3. The overall CSR spending envelope

While detailed public spending plans for the years 2008–09, 2009–10 and 2010–11 will not officially be set out until the CSR is published in October, Gordon Brown, when Chancellor, announced what the overall spending envelope will be and also what the settlements for several government departments will be. This section looks at what overall spending figures have been announced; the next section looks at the various individual departmental settlements that have already been made.

In his March 2007 Budget Gordon Brown confirmed that current spending – that is spending on items such as social security benefits and the salaries of public sector workers – would increase by an average of 1.9% a year in real terms while net investment spending – that is spending on items such as schools and hospitals – would rise to 2¼% of national income.[3] As shown in the first row of table 1, this latter commitment is equivalent to a 3.7% a year average real increase in net investment spending over these three years.

Table 1. Comparison of real increases in current and capital spending

Average annual increase (%)	*Current*	*Capital*	*Total*	*GDP growth*
2007 CSR: April 2008 to March 2011	+1.9	+3.7	+2.0	*+2.4*
Labour				
To date: April 1997 to March 2008	+2.9	+13.7	+3.2	*+2.8*
Spending Reviews: April 1999 to March 2008	+3.6	+15.3	+4.0	*+2.6*
First two years: April 1997 to March 1999	–0.3	+6.8	–0.2	*+3.3*
Conservatives				
April 1979 to March 1997	+1.7	–5.0	+1.5	*+2.1*

Source: As Figure 1.

The Treasury's 'cautious' assumption used for its public finance assumptions suggest that the economy will grow in real terms by 2.4% a year over the period from April 2008 to March 2011. Therefore the figures announced so far for current and investment spending imply that investment spending will grow as a share of national income while current spending will fall. The overall effect is that, while total public spending is forecast to grow in real terms, it is planned to decline as a share of national income from 42.6% of national income in 2007–08 to 42.0% in 2010–11.

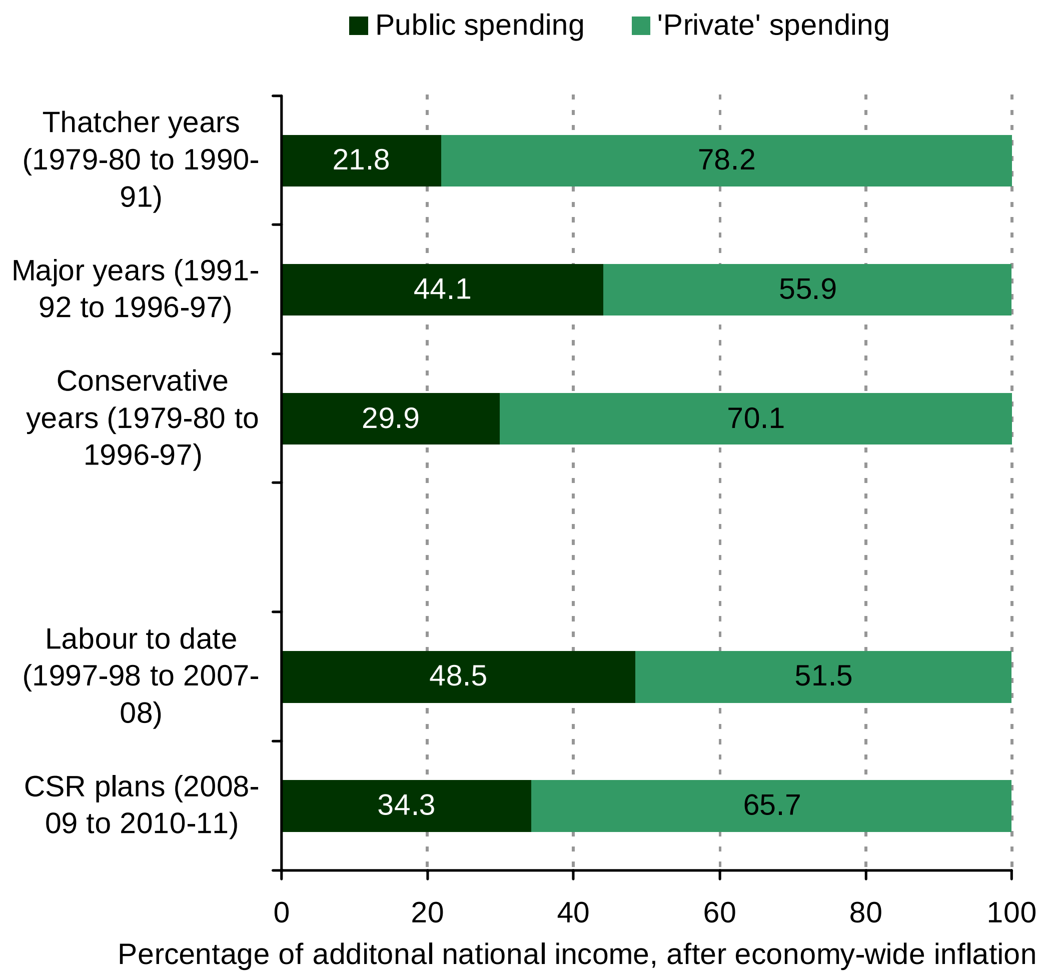
The forecast growth in total spending is, as shown in Table 1, considerably slower than that seen over the period covered by Labour's previous four spending reviews (April 1999 to March 2008). Over this period total public spending has grown on average by 4.0% a year in real terms, whereas it is set to grow at just half this rate – 2.0% a year in real terms. At 1.9% per annum, the expected real growth in current spending is only slightly higher than that delivered by the Conservatives during their 18 years in office from 1979–80 to 1996–97. The expected growth in current spending is, however, greater than that delivered by Labour during their first two years in office from 1997–98 to 1998–99.

In fact, despite the Government's vocal criticism of David Cameron's proposed third fiscal rule (that increases in national income should be shared between growth in public spending and growth in private spending), the spending plans for the CSR years would, if delivered, comply with such as rule. For example in May 2007, the then Financial Secretary to the Treasury, John Healey, stated

[3] Paragraph 6.47 of HM Treasury (2007), *Budget 2007*, London (www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_index.cfm).

that "the third fiscal rule that some have proposed would inevitably lead to deep public service investment cuts".[4] However, as figure 1 and table 1 show, the plans laid out for overall spending during the CSR years in fact imply public spending falling as a share of national income and hence imply that the 'proceeds of growth' will be shared between public and private spending, as has been proposed by Mr Cameron. Indeed the fact that these total spending plans would comply with the Conservatives fiscal rule has enabled the shadow Chancellor, George Osborne, to pledge that "a Conservative Government will adopt these spending totals".[5]

Figure 2. Sharing the proceeds of growth?



Source: As Figure 1.

The extent to which the additional resources that have been generated by economic growth have been spent by the Government as opposed to not being

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[4] Source: answer to Parliamentary Question by Mr Andy Slaughter (Hansard, House of Commons, 10 May 2007, column 292).

[5] http://www.timesonline.co.uk/tol/comment/columnists/guest_contributors/article2373661.ece

spent by the Government is shown in Figure 2. (Note this is not quite the same as saying "spent publicly" or "spent privately" since, for example, over a quarter of public spending is given to individuals to spend in the form of benefits or tax credits). Over the 18 year period of Conservative Governments from 1979–80 to 1996–97, on average, just under thirty pence in every pound generated by the economy was spent publicly. In contrast, the period under new Labour to date, from 1997–98 to 2007–08, has seen nearly fifty pence in every pound generated by the economy spent publicly. The extent to which the spending plans inherited by Mr Darling from his predecessor at the Treasury differ from those actually delivered by Mr Brown is also clear in Figure 2. These plans imply about thirty-five pence in every pound generated by the economy being spent publicly, which, if delivered, would be more similar to that seen under the Conservatives than that seen to date under Labour.

It is unclear whether or not these spending plans for the CSR period, which imply a real terms increase in spending but a decline in spending as a share of national income, constitute a 'cut' in public spending. In other words, whether in order to continue to provide the same standard of service public spending needs to increase in line with economy-wide inflation or at the (typically) faster rate at which national income grows. If productivity improvements can be made over time in the public sector, then it may be possible to provide the same public services at lower cost. This would suggest that cutting public spending as a share of national income – or indeed even in real terms – would not necessarily imply a cut in the services provided. On the other hand, in order to attract the same quality of workers into the public sector, wages may need to keep pace with growth in wages in the private sector and so a cut in at least some components of public spending as a share of national income may constitute a cut in the services provided. In addition the 'productivity' of social security benefits and tax credits will depend in part on whether one considers the impact they have on reducing poverty relative to an absolute or a relative income definition.

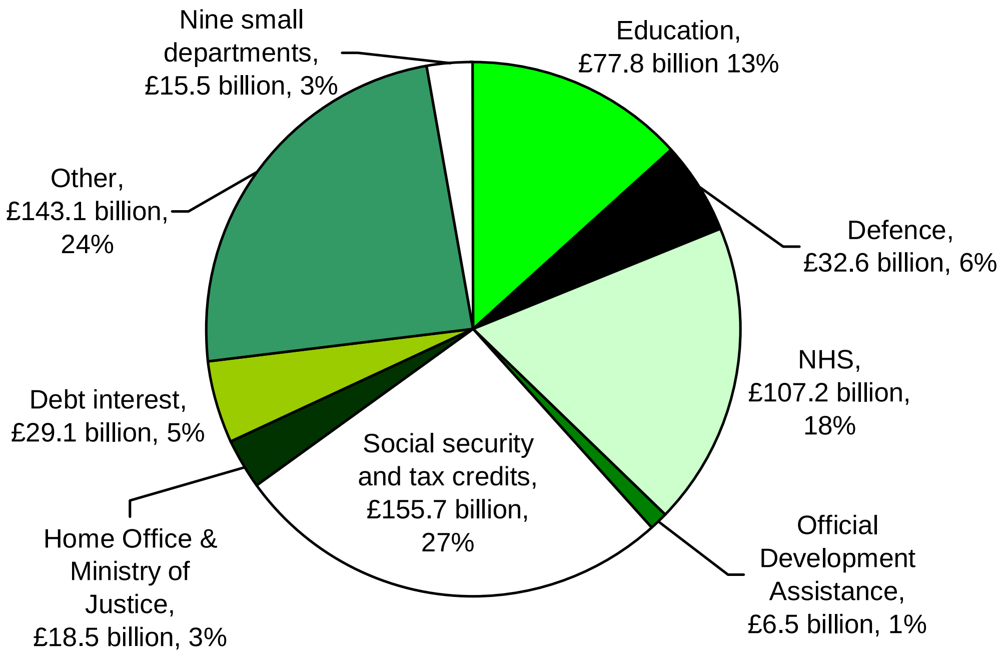
At the time of the last general election, the Labour government described the Conservative proposal to reduce public spending by 2% of national income as a £35 billion cut in spending, with Mr Darling stressing that "The Conservative Party is committed to making cash cuts of £35 billion from Labour's public spending plans – cuts so large they could only be found from cutting deep into front-line public services, including schools, hospitals and the police." However, the £35 billion figure was exaggerated by being in 2011–12 prices rather than current terms, which at the time (in 2005–06) would imply a figure of £25 billion. Using the methodology employed by Labour at the last election, but keeping to current (2007–08) rather than future terms, the forecast 0.6 percentage point decline in public spending as a share of national income is equivalent to an £8 billion cut in spending.

4. CSR settlements already announced

Figure 3 shows the forecast composition of TME in 2007–08. This shows that the largest single areas of public spending are the NHS, education and social security and tax credit expenditure. These account for 18%, 13% and 27% of public spending respectively.

Although the CSR will not be published in full until later this month, the spending settlements for many departments have already been announced. These settlements are shown in Table 2 and are discussed in this section.

Figure 3. Planned public spending in 2007–08



Note: The largest components of 'other' spending are transport, culture, housing and environmental protection. The nine smaller departments are HM Revenue and Customs, HM Treasury, the administrational part of the Department for Work and Pensions, the Cabinet Office, the Privy Council Office, National Savings and Investments, the Central Office of Information, the Food Standards Agency and the Government Actuary's Department.
Sources: Table 1.12 of HM Treasury, Public Expenditure Statistical Analyses 2006, Cm, 6811, May 2006 (www.hm-treasury.gov.uk/economic_data_and_tools/finance_spending_statistics/pes_publications/pespub_pesa06.cfm); HM Treasury, 2004 Spending Review, Cm. 6237, July 2004 (http://www.hm-treasury.gov.uk/spending_review/spend_sr04/spend_sr04_index.cfm); table B16, page 240, of HM Treasury, 2006 Pre-Budget Report, December 2006 (http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr06/prebud_pbr06_index.cfm).

Home Office, Ministry of Justice and other smaller departments

The earliest announcements (such as those for the Home Office, the Ministry of Justice and some smaller departments) were for very tight spending settlements. Collectively the Home Office, the Ministry of Justice[6] and the nine

[6] Prior to the reorganisation of government departments, the then Chancellor Mr Brown announced that the budget for the Home Office would be frozen in real terms, while the budget for the Department for Constitutional Affairs would be cut by 3½% a year in real

other smaller departments, which taken together are expected to spend around £34 billion (or about 6% of forecast TME) in 2007–08, will see a real spending cut averaging 2.6% a year between April 2008 and March 2011. This compares to a forecast average real cut in spending in these areas over the current financial year of 0.4%. This decline in real spending over the CSR period will mean that total spending in these areas will fall by 0.3% of national income, which (as shown in the bottom row of table 2) equates to a £4.8 billion (=£1.7bn + £3.1bn) cut in current terms. Delivering these cuts without a detrimental impact on service quality in these areas will undoubtedly be difficult. Indeed, if it were not, then presumably the government should have announced larger reductions in spending in these areas in the July 2004 Spending Review, or preferably even earlier.

Table 2. Comparison of early settlements for 2007 CSR and spending increases during previous periods

Real average annual growth in:	TME	*Announced so far*				TME minus announced so far
		Home Office & Ministry of Justice	Nine small depts	Defence	Education	
Labour plans to date: 1997–98 to 2007–08	+3.2	n/a	n/a	+0.9	+4.5	n/a
First two years: 1997–98 to 1998–99	–0.2	n/a	n/a	+2.5	+0.4	n/a
Spending Reviews						
Overall: 1999–00 to 2007–08	+4.0	+4.1	n/a	+0.6	+5.5	+4.0*
Delivered so far: 1999–00 to 2006–07	+4.0	+4.5	n/a	+1.1	+5.4	+4.0*
Plans: 2007–08	+3.8	+1.4	–1.9	–3.5	+6.0	+4.3
CSR 2007: *2008–09 to 2010–11* Real avg growth (%)	+2.0	–0.7	–5.0	+1.5	+2.2	+2.1
Implied spending increase as share of GDP (2007–08 terms)	–£8.0bn	–£1.7bn	–£3.1bn	–£0.9bn	–£0.1bn	–£4.0bn

terms. This amounted to a real cut in their combined budget of 0.7% a year on average. Since the reorganisation of these two departments into the new Home Office and the new Ministry of Justice, the government has confirmed that the combined budgets of these two departments are still set to be cut in real terms by the same amount (source: Response to PQ by Mr Hoban, House of Commons, Hansard column 1184W).

Note: The nine smaller departments are HM Revenue and Customs, HM Treasury, the administrational part of the Department for Work and Pensions, the Cabinet Office, the Privy Council Office, National Savings and Investments, the Central Office of Information, the Food Standards Agency and the Government Actuary's Department. 'TME minus announced so far' also assumes that Mr Darling allocates £1bn to AME margin in 2008–09, £2bn in 2009–10 and £3bn in 2010–11.
* Growth in 'TME minus announced so far' for the periods 1999–00 to 2007–08 and 1999–00 to 2006–07 includes growth in spending on the nine small departments.
Source: Planned growth in expenditure for April 2006 to March 2008 from Table 1.12 of HM Treasury, *Public Expenditure Statistical Analysis 2007*, Cm. 7091, April 2007 (www.hm-treasury.gov.uk/media/E/B/pesa07_complete.pdf) and HM Treasury, *2004 Spending Review*, Cm. 6237, July 2004 (www.hm-treasury.gov.uk/spending_review/spend_sr04/spend_sr04_index.cfm). Announced spending growth from April 2008 to March 2011 from page 136 from HM Treasury, *Budget 2006*, March 2006, HC 968 (www.hm-treasury.gov.uk/budget/budget_06/bud_bud06_index.cfm); page 143 of HM Treasury, *Pre-Budget Report 2006*, December 2006, Cm. 6984 (www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr06/prebud_pbr06_index.cfm); page 157 of HM Treasury, *Budget 2007*, March 2007, HC 342 (www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_index.cfm).

Education

The March 2007 Budget announced that education spending would grow in cash terms to £90.0 billion in 2010–11. Since education spending in 2007–08 is now expected to be £77.8 billion, this now equates to 2.2%[7] a year average real terms increases in education spending, as shown in Table 2. Such an increase is considerably slower than education spending is expected to have grown over the period from April 1999 to March 2008 (during which time it has grown on average by 5.5% a year in real terms).

The education spending plans will, if delivered, lead to spending falling as a share of national income. In their 2005 election manifesto, Labour committed to "continue to raise the share of national income devoted to education". Since the 2005 election, spending on education has increased as a share of national income. While the planned fall will not offset this fully (in other words, spending would remain above the 2004–05 level throughout the period covered by the 2007 CSR) it may make it hard for the government to fulfil some of their aspirations for improvements in education in the UK.

In Budget 2006 the government stated that they have an aspiration to "increase funding per pupil towards today's private sector day school levels".[8] Average private school spending per pupil was £8,000 in 2005–06, compared to £5,270

[7] At the time he presented the Budget in March, the cash spending plans set out by Mr Brown implied education spending growing in real terms by 2.4% a year over the CSR period from its 2007–08 level. However, recent upwards revisions to spending on student loans in 2007–08 now mean that the education cash spending plans for 2008–09, 2009–10 and 2010–11 imply a lower (2.2% a year) real growth rate.

[8] Source: Budget 2006, page 145.

per pupil in the state sector in the current year (all in 2005–06 prices). Over the CSR years, state school spending per pupil will grow by 3.2% a year in real terms (in other words, faster than growth in overall education spending, which is in part due to falling numbers of school pupils). If state school spending per pupil were to continue to grow by 3.2% a year in real terms after the CSR period, this pledge would be unlikely to be met before 2020–21.

Defence

The final departmental settlement that has been announced is that for defence. Mr Darling confirmed on 25th July 2007[9] that defence spending will increase in cash terms from £32.6 billion in 2007–08 to £36.9 billion in 2010–11, which equates to an average of 1.5% a year real growth. This is about the same as average annual real growth in defence spending over the first ten years of the Labour government (during which time defence spending has grown on average by 1.4% a year). So, while the overall spending envelope for the CSR is tight, defence is one department which will see real spending increasing at about the same rate as it has been used to in recent years.

5. Trade-offs within the remaining CSR envelope

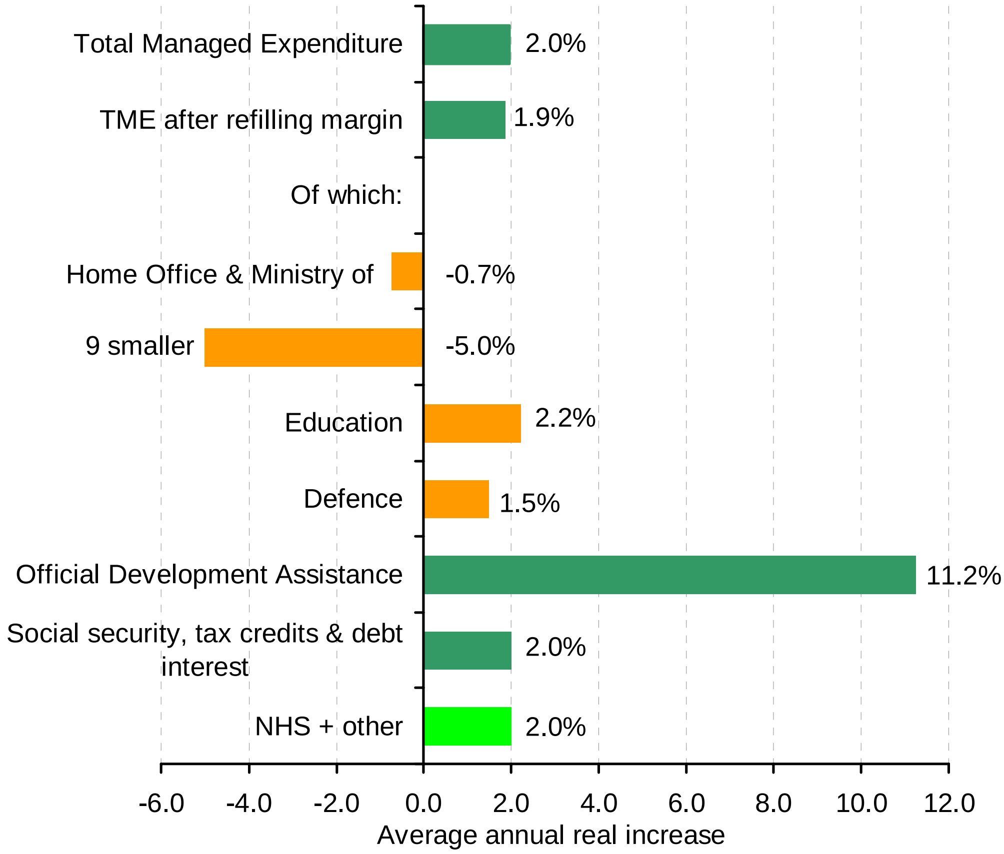
Taking into account all the announcements made so far, about three-quarters of TME in each of the CSR years has not yet been allocated. Some of this will be allocated to AME with the remainder to be allocated between the as yet unannounced spending areas. The most significant of these is spending on the NHS. This section examines how the remaining budget could be allocated and what this implies for the trade-offs between the remaining areas.

In order to examine the trade-offs between NHS spending and other departmental DELs we need to make some assumptions about how some elements of non-DEL spending will increase. One of the first decisions that Alistair Darling will have to make in drawing up the final CSR settlement is how much of the TME budget should be assigned to the AME margin (previously known as the contingency reserve). These are funds not allocated to particular spending areas but kept aside for any unforeseen events – for example, in recent years these have been used to tackle BSE and the 2005 outbreak of foot-and-mouth disease. When Gordon Brown was Chancellor, in each of his spending reviews, he allocated £1 billion to the AME margin in the first year of the spending review, £2 billion to the second year and £3 billion to the third year. If we assume that Mr Darling will continue to follow this pattern, the second bar in figure 4 shows that the remainder of TME can grow by a slightly lower 1.9% a year in real terms. Once the departments whose

[9] http://www.mod.uk/DefenceInternet/DefenceNews/DefencePolicyAndBusiness/NewCarriersConfirmedInDefenceBudgetIncrease.htm

settlements are already known are taken into account (see section 4), this leaves the remainder of public spending growing by 2.1% a year in real terms.

Figure 4. Real growth in spending over CSR period, by department



Note: As Figure 2.
Source: As Figure 2.

Spending on debt interest payments and underlying expenditure on social security and tax credits are, in large part, out of the government's hands. As a baseline, we assume that these elements of spending grow at 2.0% a year in real terms. This is slightly slower than is expected during the current financial year (when real growth is expected to be 2.5%) but is faster than was forecast in the Budget of 2007 for 2006–07 (when real growth was expected to be 1.3%). The assumption that we make about spending growth in these areas is quite important for the implied trade-off between other spending areas since, as shown in figure 3, spending on these two areas alone is expected to account for nearly a third of TME in 2007–08. Under the baseline assumption of 2.0% growth, social security, tax credit and debt interest payments would fall by 0.2% as a share of national income over the CSR period, which equates to a £2.3 billion cut in spending in current terms.

If social security spending were to grow by just 2.0% a year over this period, it is likely to mean that very little additional money could be found within this envelope to meet, for example, the government's target for Child Poverty to be half its 1998–99 level by 2010–11. Work by Brewer *et al* (2006), updated by Brewer and Browne (2007)[10] suggests that an additional £3.8 billion would need to be spent on targeted support for lower-income families with children by 2010 if the government is to have a 50:50 chance of meeting its target. To move towards this gradually, Mr Darling could plan to announce an extra £1.3 billion of spending in each of the next three Pre-Budget Reports (in 2007, 2008 and 2009). As the 2007 PBR will be presented on the same day as the CSR, it seems unlikely that Mr Darling will this year find sufficient money to announce any additional spending unless he is willing to increase the overall spending envelope beyond that bequeathed from Mr Brown.

Finally, in order to focus on the trade-offs between spending on the NHS and other domestic departmental spending areas we will also make an assumption about growth in spending on Official Development Assistance (ODA). Since the government made an election manifesto pledge to increase ODA spending to 0.7% of national income by 2013[11], we assume that the government chooses to increase ODA spending during the CSR period so as to remain on a linear course to reach the 0.7% target in the 2012–13 financial year. This implies real increases in spending of 11.2% a year during the CSR period. While this would be a substantial increase, it is actually slightly lower than the 13.9% a year real increase which is expected over the current financial year (2007–08). Also, while a growth rate of 11.2% would be substantial, ODA spending currently constitutes such a small share of total spending that this growth in ODA as a share of national income over the CSR years equates to just £1.8 billion additional spending by 2010–11 in current terms.

Figure 4 summarises the real growth rates announced for the CSR period so far and also those we have assumed for certain other spending areas. Taking all these into account, the remainder of TME) could grow at 2.0% a year in real terms (as shown by the bottom bar in figure 4). The main remaining areas of Government are the NHS, environmental protection, transport and housing all of which might be considered to have relatively strong claims on budget increases. However in total spending on these other areas is, at least under our assumptions, set to fall as a share of national income (from 18.2% to 17.9% of national income). This 0.3% fall as a share of national income equates to a £3.5 billion cut in spending in current terms, which would be almost half of the £8.0 billion cut in spending in current terms that Mr Darling needs to find over the CSR period to keep to the intended spending limits.

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[10] Brewer, M. and J. Browne (2007) *Estimates of the costs of meeting the Government's child poverty target in 2010/11: Update after the Budget 2007*, Evidence to the Treasury Select Committee, April 2007 (www.ifs.org.uk/publications.php?publication_id=3973); Brewer, M., J. Browne and H. Sutherland (2006) *Micro-simulating Child Poverty in 2010 and 2020*, Joseph Rowntree Foundation: York (www.jrf.org.uk/bookshop/eBooks/9781859355091.pdf)

[11] The UN General Assembly has had a target for ODA spending as a share of gross national income by developed countries of 0.7% since 1970.

The trade-off between the NHS and the other remaining departments

The top line in figure 5 takes the overall real growth rate for remaining public spending (2.0%, shown by the bottom bar in figure 4) and shows the combinations of growth rates for NHS spending and other spending that would be possible within our estimated budget for spending across these areas. For example, if there were to be a real freeze in spending in other areas, NHS spending could grow by 4.6% a year in real terms (this is the point where the top line crosses the horizontal axis in figure 5).

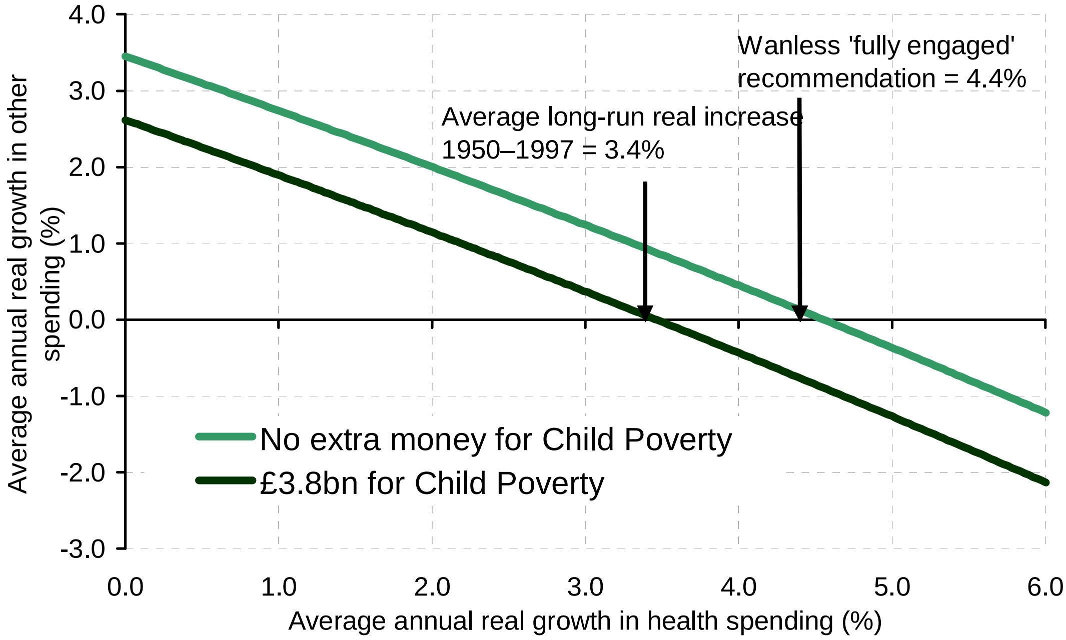
The lower line in figure 5 shows the trade-off possible between NHS spending and other spending if, in addition to the underlying growth in social security spending and debt interest payments assumed above, Mr Darling also announces a further £3.8 billion of spending targeted at low income families with children by 2010–11. Under this scenario, if spending on other areas was frozen in real terms, then NHS spending could grow by 3.3% a year in real terms (the point where the lower line crosses the horizontal axis in figure 5).

The 2002 Wanless Review[12], which was commissioned by the Treasury, envisaged that, even under the most optimistic assumptions about future individual behaviour and improvements in productivity in the NHS (which is what the 2002 Wanless Review termed the ‘fully engaged’ scenario) NHS spending would need to increase by 4.4% a year in real terms over the CSR period in order to deliver a high quality health service. As figure 5 shows, if NHS spending were to grow at this rate, the remainder of public spending could grow by just 0.1% if no additional money is allocated to child poverty reductions, or 0.9% real cuts if the extra £3.8 billion were allocated to reduce child poverty. This implies a tight settlement for these other areas. However even if such a tight settlement were deliverable, 4.4% growth in NHS spending may no longer be sufficient to deliver the improvements that the Wanless Review envisaged. A more recent report produced by Derek Wanless states that “neither the assumed rate of productivity improvement nor the changes in personal behaviour that the more optimistic scenarios in the 2002 review envisaged have been achieved”[13]. This suggests that even 4.4% a year real growth in spending on the NHS would be insufficient to deliver the progress towards a “world class health service” that the 2002 report hoped for. Given that some of the other unannounced areas – such as housing, transport and environmental protection – may also have strong claims to future spending increases, an even tighter squeeze on these spending areas in order to deliver greater increases in NHS spending may not be feasible.

[12] Wanless, D. (2002) Securing our future health: Taking a long-term view, HM Treasury: London.

[13] Page 69 of Wanless, D. (2007) *Our future health secured? A review of NHS funding and performance,* King’s Fund: London.

Figure 5. Potential trade-off between NHS and other spending



Instead of assuming that NHS spending grows by 4.4% a year, we could assume that NHS spending grows at the average long-run rate seen prior to new Labour being in office. Between April 1950 and March 1997, NHS spending grew by 3.4% a year in real terms. This would be less than half the rate (7.2%) that the NHS has received over new Labour's spending reviews to date. As shown in figure 5, if 3.4% real growth in NHS spending were delivered over the CSR years, the remainder of public spending could grow by 0.9% a year in real terms. This is about the same rate of growth in these other parts of Government as Gordon Brown was expecting in the current financial year at the time he presented his Budget in March 2007. Alternatively, if the Government wanted to allocate an additional £3.8 billion to reduce child poverty, it would have to freeze spending on all the remaining spending areas in real terms.

6. A firm and fixed settlement?

As outlined in the previous sections, the CSR looks set to be tight for many government departments. If delivered, this will make it difficult to bring about the high quality of public services and the reductions in poverty in the UK and elsewhere that the government aspires to unless significant further efficiency gains can be found. However, if reductions in inefficiencies were easy to identify and deliver they would presumably already have been done, perhaps having been identified by the 1995 Fundamental Expenditure Review carried out by the then Chief Secretary to the Treasury Michael Portillo, or the 1998 Comprehensive Spending Review carried out by the then Chancellor Gordon Brown, or the 2004 Gershon Review carried out by Mr Brown's advisor Sir Peter Gershon. This raises the question of whether higher spending totals would be required to meet the Governments aspirations for improved public services and reductions in poverty

During the periods covered by Labour's previous spending reviews, we have seen Gordon Brown top up spending plans in subsequent Budgets and Pre-Budget Reports and in some years he has also been able to reallocate money from AME to DELs when demands on, for example, social security have been lower than expected. Table 3 shows (for each period covered by Labour's previous spending reviews) the original plans for real terms increases in spending, the real terms increase in spending implied by these plans once we take account of actual inflation outturns and finally the actual real increases in spending that were delivered.

Table 3. Comparison of planned and actual real increases in spending over the periods covered by Labour's spending reviews

Average annual increase (%)	*TME*	*AME*	*DELs*
Labour's first two years (April 1997 to March 1999)			
Original plans	+1.0	n/a	n/a
Adjusted for actual inflation	+0.3	n/a	n/a
Latest outturn	–0.1	n/a	n/a
Comprehensive Spending Review 1998			
(April 1999 to March 2002)			
Original plans	+2.7	+2.2	+3.3
Adjusted for actual inflation	+3.3	+2.8	+3.8
Latest outturn	+3.4	+0.5	+5.6
Spending Review 2000			
(April 2001 to March 2004)			
Original plans	+3.2	+0.7	+5.3
Adjusted for actual inflation	+2.9	+0.4	+5.0
Latest outturn	+5.0	+2.6	+5.9
Spending Review 2002			
(April 2003 to March 2006)			
Original plans	+4.3	+3.0	+5.3
Adjusted for actual inflation	+4.3	+3.0	+5.2
Latest outturn	+5.0	+4.4	+5.5
Spending Review 2004			
(April 2005 to March 2008)			
Original plans	+3.2	+2.0	+4.1
Adjusted for actual inflation	+3.4	+2.2	+4.2
Latest outturn	+3.5	+2.8	+4.2
Comprehensive Spending Review 2007			
(April 2008 to March 2011)			
Current plans	+2.0	n/a	n/a

Source: As Table 2.

Source: Latest outturns: PESA 2004, PESA 2005, PESA 2006, PESA 2007. Original plans: Spending Review 2000, Spending Review 2002, Spending Review 2004, Budget 2007. GDP deflators: www.hm-treasury.gov.uk./media/2/F/gdpdeflators_290607.xls

During the period covered by Labour's first spending review (April 1999 to March 2002), Mr Brown was ultimately able to deliver much larger real increases in departmental spending than he originally announced both because inflation turned out to be lower than forecast and because he was able to reallocate a significant amount of money from AME to DELs. Table 3 shows that, taking into account actual inflation, Mr Brown's original spending plans from CSR 1998 implied that AME would (once actual rather than predicted inflation is taken into account) grow by 2.8% a year in real terms, while DELs would grow by 3.8% a year. However, growth in AME actually turned out to be just 0.5% a year on average. This, therefore, allowed Mr Brown to increase DELs by 5.6% a year on average while still maintaining overall TME growth at about the level he had initially planned – average TME growth turned out to be 3.4% a year compared to an increase of 3.3% that would have occurred had his initial cash spending plans been delivered.

In contrast, the periods covered by the Spending Reviews of 2000 and 2002 actually saw much faster growth in spending than was originally planned for in the spending reviews. Adjusting for actual inflation, the spending plans announced in Spending Review 2000 implied that TME would grow on average by 2.9% a year in real terms, whereas the latest figures show that spending actually grew by 5.0% a year over this period. This was in large part because AME growth was much higher than expected due to increases in the generosity of the new tax credits for lower income families with and without children and increases in payments to pensioners. DELs were also topped up slightly.

Over the period covered by the most recent spending review (April 2005 to March 2008) the latest outturns and forecasts suggest that DELs will grow at the same rate as was announced in Spending Review 2004. However, TME looks set to grow slightly faster than was anticipated as a result of higher than announced growth in AME. This was at least in part due to subsequent increases in the generosity of tax credits.

So in every period covered by Labour's previous spending reviews, spending outturns have been higher than was originally announced. Therefore, even if CSR 2007 suggests a very tight settlement, it is possible that over the next few years Mr Darling could announce additional spending for key areas in order to help to achieve some of the government's aspirations, such as the target to halve Child Poverty by 2010. However, assuming that Mr Darling wishes to maintain the same degree of caution in the public finances, such increases in total spending would, unless spending in other areas comes in lower than anticipated, only be possible if either current receipts come in more strongly than expected or he is prepared to announce further tax raising measures. Given recent turmoil in the financial markets and poor receipts of corporation tax so far during 2007–08, the more likely scenario in the current financial year at least seems to be that receipts will come in worse, rather than better, than was forecast in the March 2007 Budget. Further tough choices between scaling back aspirations or announcing further tax raising measures could therefore follow after this year's CSR.