NEW ECONOMICS FOUNDATION

Austerity by stealth

Policy briefing | Dominic Caddick and Alfie Stirling | February 2023

Summary

Since 2010, the impact of austerity on public services has been devastating. Suppressed public sector pay has caused a crisis in recruitment and retention, leaving public services critically understaffed[1]. Cutting corners on investment has left nine in ten schools in need of repair[2] and a £10bn backlog of repairs in the NHS[3]. This weakening of public services also rendered us woefully underprepared for the pandemic, which resulted in over 170,000 lives lost and among the highest excess deaths per capita globally prior to the rollout of vaccines[4]. Now, in the midst of a cost of living crisis, public services are overwhelmed and under resourced, and workers are under paid: leading to the most significant strike action in a generation.

Against this backdrop, this briefing looks at the 2022 autumn statement and analyses the latest public spending announcements on services in the context of both the previous decade of austerity and future economic forecasts. Even before the autumn statement, overall day-to-day spending on public services (resource departmental expenditure limits, RDEL) in 2021/22 was already down 16.9% since 2009/10, after adjusting for the effects of inflation and population growth, or £45.9bn in cash terms (all £ figures in this briefing have been converted to 2022/23 prices based on the consumer price index (CPI), unless otherwise stated). But with relative 'protection' for budgets like the NHS, schools, and defence, the percentage cuts for many unprotected budgets and departments are far deeper still.

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[1] Bolieau, O'Brien and Zaranko (2022). Green Budget 2022 – Chapter 4: Public spending, pay and pensions. Institute for Fiscal Studies. Retreived from: https://ifs.org.uk/publications/public-spending-pay-and-pensions

[2] Vinter, R (2022). Government urged to act as nine in 10 schools in England in need of repair. The Guardian. Retrieved from: https://www.theguardian.com/education/2022/jul/31/schools-england-in-need-of-repair

[3] Goodier and Campbell (2022). Cost of eradicating NHS repairs backlog hits £10bn for first time. The Guardian. Retrieved from: https://www.theguardian.com/society/2022/oct/13/cost-eradicating-nhs-england-repairs-backlog

[4] Cuffe, R (2021) Does the UK have highest Covid death toll in Europe? BBC. Retreived from: https://www.bbc.co.uk/news/57268471

Coming out of the latest autumn statement, the plans going forward told an almost paradoxical story of two halves. Over the next couple of years budgets are set to be squeezed in real terms as inflation bites into existing departmental settlements, with real terms spending per capita falling from 11.1% below 2009/10 levels in 2022/23 to 12.4% in 2024/25. Then, from 2025/26, a new round of austerity was pencilled in, with cuts rising to £20.1bn a year by 2027/28. But curiously, and despite the new cuts, real spending per capita would stop falling and instead rise to just 8.7% below 2009/10 levels by 2027/28.

This briefing takes a closer look at the assumptions and forecasts from the autumn statement. It shows that the true effect of austerity to come is likely understated by implausibly low forecasts for inflation, that see CPI move significantly below the Bank of England's target, and even turning negative. New analysis for this paper shows that, if it is instead assumed that the Bank does its job, and inflation rests at 2% from the middle of the decade onwards, then this would imply real terms cuts – not growth – to spending of 2.0% between 2022/23 and 2027/28. In this more plausible scenario for inflation, real spending on public services in 2027/28 would be £28.0bn lower than the government's current projection, £8.9bn below spending today, and £24.9bn below 2009/10 levels.

The 2022 autumn statement

In November, the chancellor Jeremy Hunt revealed his spending intentions at the 2022 autumn statement. This laid out his stance for the next five years, 2022/23 to 2027/28. In short, the chancellor announced that the government was protecting existing plans for day to day spending (RDEL) in cash terms over the next two years (2023/24 and 2024/25), and increasing this spending by 1% a year in real terms, in the three years that follow (2025/26 to 2027/28)[5].

Austerity by stealth

The chancellor made it sound like a good news story. But the hard reality is a deliberate shrinking of the public sector, first as inflation bites into existing spending review plans, and then as budgets are reduced in proportion to the size of the economy as a whole. Overall, real terms budgets in 2027/28 will be barely higher than they were in 2009/10.

During the remainder of the spending review period, the lack of new funds to meet the costs of inflation will deliver an implied cut of £29.9bn by 2023/24, compared to the expected real terms value of these budgets when they were set at the October 2021 Spending Review (Figure 1 below for the latest plans compared with a counterfactual scenario based on

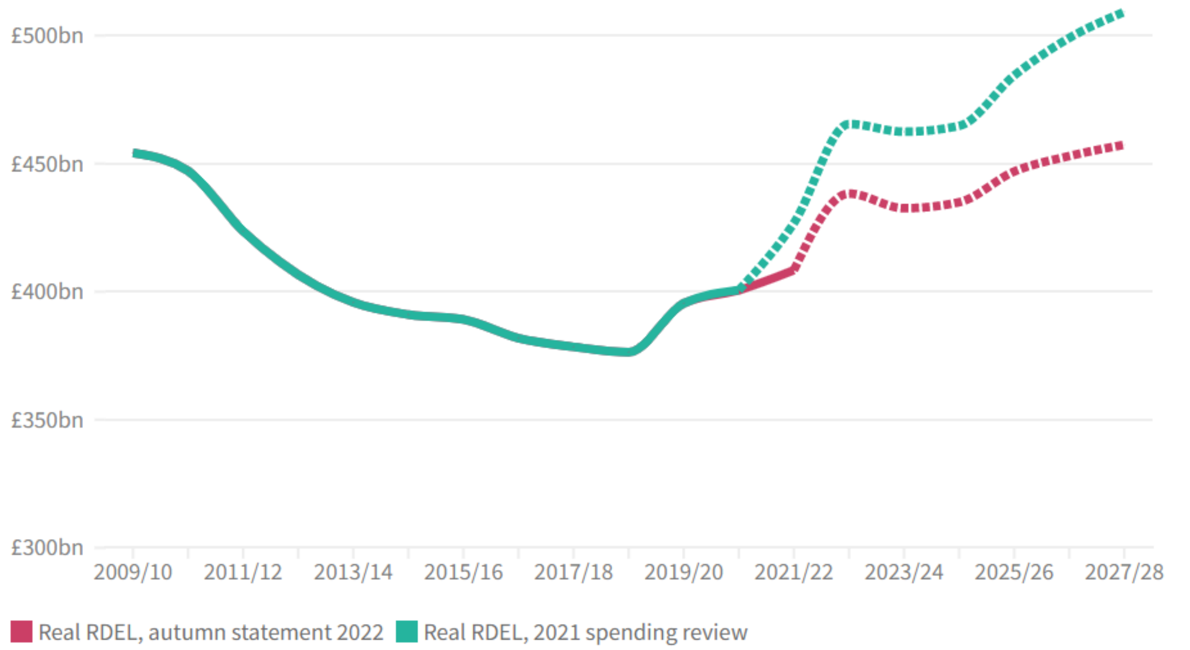
[5] Hunt, J (2022). The Autumn Statement 2022 speech. Retrived from: https://www.gov.uk/government/speeches/the-autumn-statement-2022-speech

previous plans).[6] Beyond the spending review, the government's new announcement of growth of 1% a year in real terms reduces day to day spending on services by £20.1bn a year by 2027/28, compared to the Office for Budget Responsibility's (OBR) previous baseline. This is because the OBR had previously assumed public spending would remain flat in relation to the size of the economy in the years following the spending review period, which would have implied much faster real terms growth than 1% a year. However, comparing only to this counterfactual underestimates the scale of the cuts relative to what the government initially intended when they set the spending review. Spending on public services would have been even higher in 2027/28 if the commitment to increase budgets by "3.3% a year in real terms" within the spending review period had been maintained up to 2024/25. Compared to this counter factual, the size of the cuts in 2027/28 is £51.9bn a year relative to the implied plans set out just one year previously.

[6] Here, and in the rest of this briefing, we use the consumer price index (CPI) measure of inflation rather than the output price measure (GDP deflator) which previously has been more commonly used for public spending.This is because the imported price shock from the past two years has driven an unusually large wedge between the two, rendering measures of output prices less useful in guaging true inflationary pressures, both on the costs of delivering public serices themselves and on the purchasing power of public sector salaries. The government is likely to have been referring to a GDP deflator measure of inflation or similar, and not CPI, when making it's various commitments on public spending. This also contributes to larger real terms cuts due to inflation in our analysis, compared to that by government.

Figure 1: The 2022 autumn statement delivered up to £51.9bn in annual cuts compared to what was promised at the spending review just one year earlier

Real value (£ billion, CPI adjusted 2022/23 prices) of resource departmental expenditure limits, including original 2021 spending review plans (SR21) and the 2022 autumn statement (forecast data as dashed lines), 2009/10 to 2027/28.



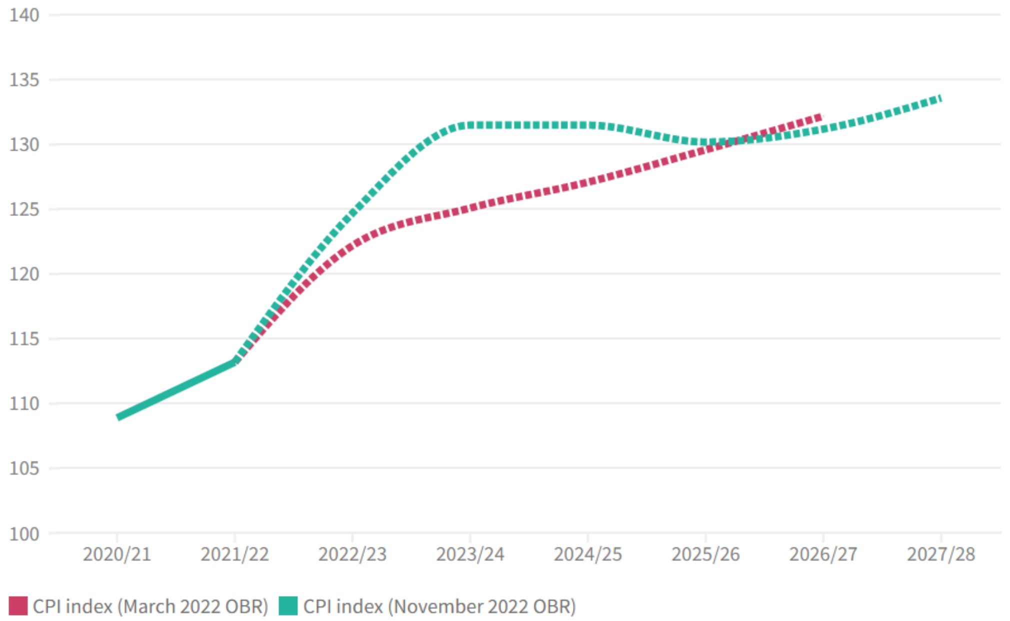
Source: NEF analysis of HMT Public Expenditure Statistical Analyses 2013-2022, Spending Review 2021, Autumn Statement 2022 and Office for Budget Responsibility data. From 2025-26 we assume nominal RDEL for SR2021 grows in line with nominal GDP.

But the story doesn't end there. There is a curious feature in the public spending forecast: despite tens of billions of cuts a year after 2025/26, spending is still being forecast to rise by 1% a year in real terms between 2025/26 and 2027/28. The reason both these statements are true at the same time is due to the nature of macroeconomic adjustment being forecast by the OBR from around the middle of the decade. While the level of nominal GDP has been revised down by only 0.6% after 2023/24, CPI inflation has has been revised down by up to a massive 3%. This makes it possible to cut spending significantly as a proportion of GDP, but nonetheless still see small real terms growth (see Figures 2 to 5 below).

Figure 2 and 3: Inflation forecasts changed a lot between the OBR's spring and autumn forecasts

Figure 2

The Consumer Price Index forecast in the OBR economic and fiscal outlooks for March and November 2022, the index (100 = 2015), for the 2020-2028 forecast period.



Source: Data taken from Office for Budget Responsibility's (OBR) March and November 2022 Economic and Fiscal Outlooks

Figure 3

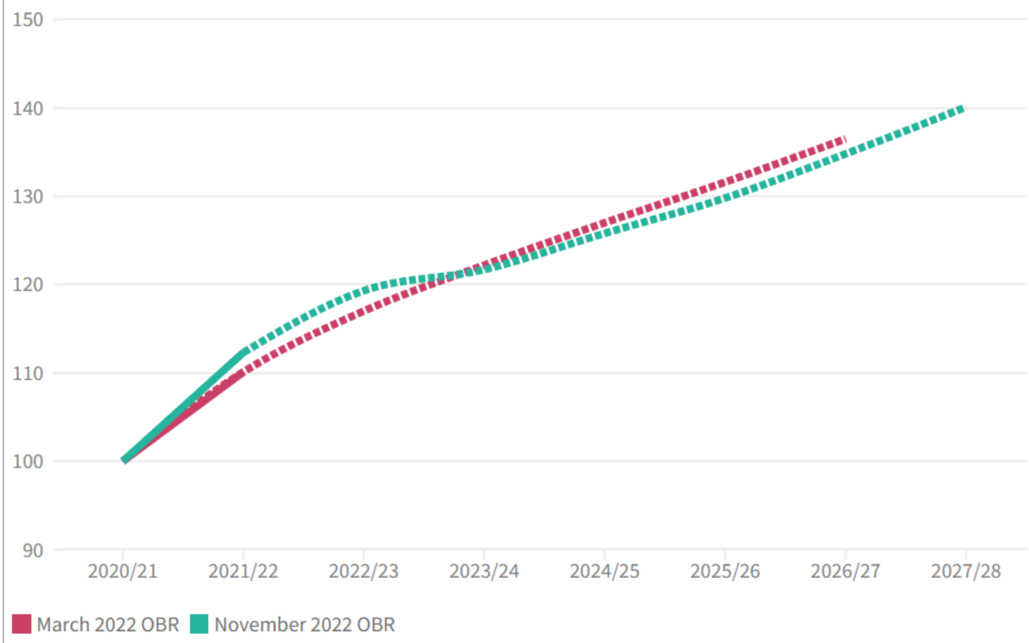
The Consumer Price Index forecast in the OBR economic and fiscal outlooks for March and November 2022, (inflation %), for the 2020-2028 forecast period.

Source: Data taken from Office for Budget Responsibility's (OBR) March and November 2022 Economic and Fiscal Outlooks

Figure 4 and 5: GDP forecasts remained similar between the OBR's spring and autumn forecasts

Figure 4

The nominal gross domestic product forecast in the OBR economic and fiscal outlooks for March and Novemember 2022, the index (100 = 2020/21), for the 2020-2028 forecast period.



Source: Data taken from Office for Budget Responsibility's (OBR) March and November 2022 Economic and Fiscal Outlooks (EFOs).

Figure 5

The nominal gross domestic product forecast in the OBR economic and fiscal outlooks for March and November 2022, growth rate (%) for the 2020-2028 forecast period.

Source: Data taken from Office for Budget Responsibility's (OBR) March and November 2022 Economic and Fiscal Outlooks (EFOs).

Notes: Between the March and November EFOs the ONS made revisions to the GDP statistics– therefore some of the lower forecast in Nominal GDP will be down to methodological changes as well as economic and policy factors.

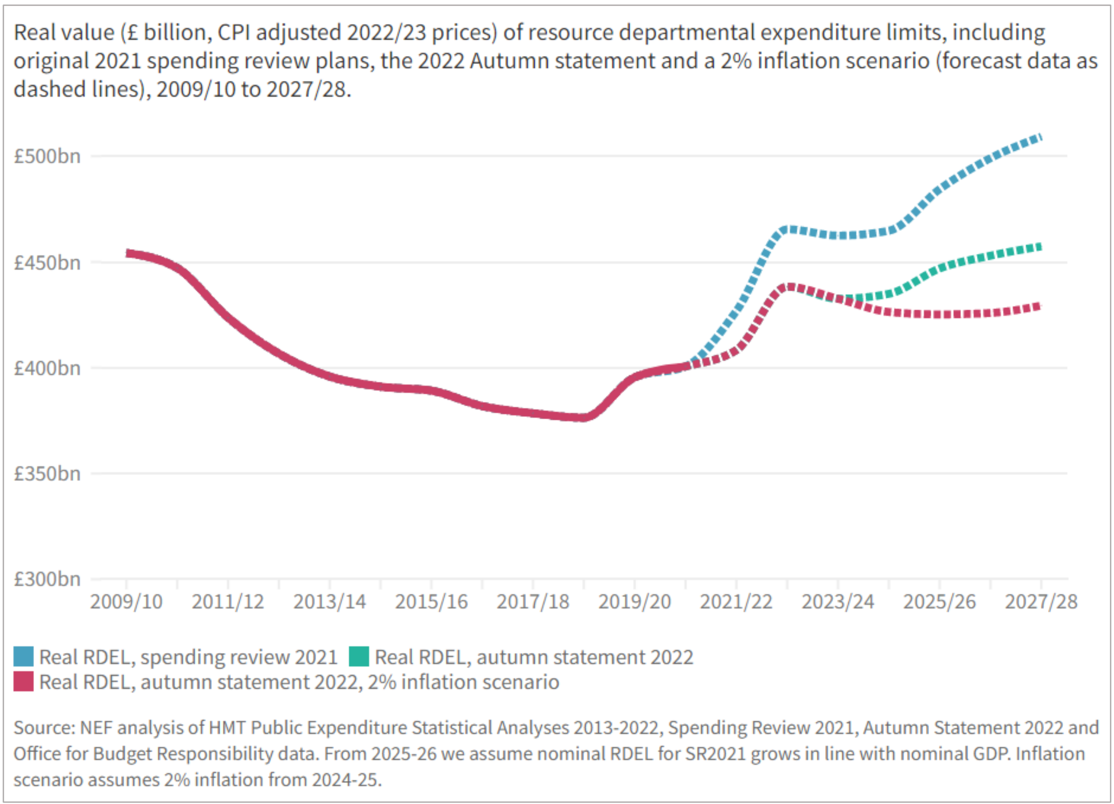
However, the issue is that the OBR's forecast for CPI – though consistent with their data at the time of publishing – can only be considered plausible if it is also assumed that the Bank of England will no longer do its job. In reality, we would expect the Monetary Policy Committee to intervene, and for the Bank to attempt to prevent inflation from falling far below their 2% target, if indeed they let it fall below at all.

This has significant implications for the outlook of the public finances in terms of their future spending power. Taken at face value, if inflation were to rest at 2% from 2024/25 onwards, rather than going negative, then the government's commitment to 1% a year real increases would require up to a £28bn increase on current plans in 2027/28.

Observed behaviour suggests this is not what the current government would actually do in such an eventuality. As discussed above, a similar commitment was dropped from the current spending review at the 2022 autumn statement, with budgets now only protected in cash terms, leading to significant real terms cuts. If inflation actually settled at 2%, and government reacts in a similar way by only preserving the cash value, rather than real terms value, of the current spending plans, then the £28bn figure becomes the value of additional real terms cuts under a more plausible outlook for inflation.

Under this scenario, real terms spending in 2027/28 would also be £8.9bn below the level today and £24.9bn below that of 2009/10. Compared to our counterfactual scenario discussed above – where the government first delivers its original spending review plans and thereafter spending tracks nominal GDP (in line with the OBR's baseline assumption) – the total value of annual cuts in 2027/28 for our 2% inflation scenario would be up to £79.9 billion (Figure 6 below).

Figure 6: Higher inflation could increase implied cuts since 2021 even futher



Department spending in the context of historical austerity and population growth

However, only looking at headline public spending misses a number of important parts of the picture. Our analysis also takes a slightly more textured look at the pressures on public spending, by both disaggregating budgets by department, and adjusting for population growth. In order to forecast spending for individual departments beyond the current spending review period, in line with the OBR, we assume protections continue for the NHS in England, core schools, defence and official development assistance.[7] Non-protected budgets and departments, therefore, increase in line with the remaining funds within the governments planned envelope for nominal spending.

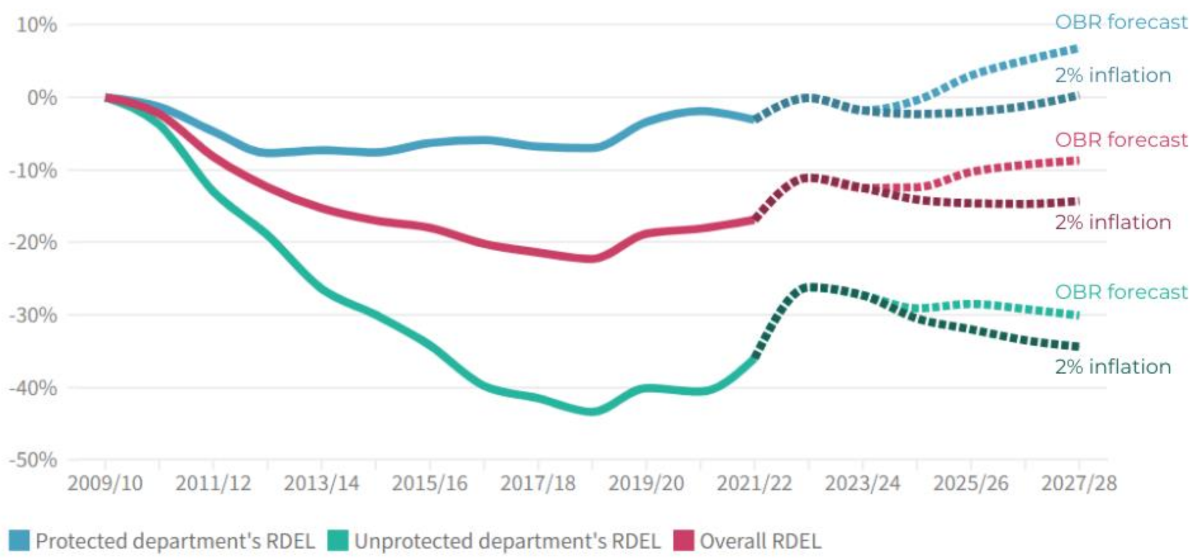
Figure 7 below sets out a summary of this analysis. The effects of the more realistic 2% inflation scenario are striking. In this world, even those departments that currently have some portion of their budget protected, will see real spending in 2027/28 essentially no

[7] HM Treausry (2022). Autumn Statement 2022. Sections 2.34, 2.40, 2.52, 2.55. Retrieved from: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1118417/CCS1022065440-001_SECURE_HMT_Autumn_Statement_November_2022_Web_accessible__1_.pdf

higher than it was in 2009/10, after adjusting for population growth. For non-protected budgets, population adjusted spending can be expected to fall to 30.1% below 2009/10 levels, or 34.4% in our 2% inflation scenario. For overall spending on services, and assuming inflation does rest at 2%, the government's latest plans imply that by 2027/28 only around a third of the cuts since 2009/2010 will have been reversed. Essentially two thirds of the deepest austerity remains.

Figure 7: Only protected departments better off by 2027/28 but higher inflation could all but reverse this

Percent change in resource departmental expenditure limits (RDEL) per capita for unprotected, protected and total departmental spending in real terms (CPI) under OBR forecast and 2% inflation from 2024-25 onwards, 2009/10 to 2027/28 compared with 2009/10 levels, forecast values from 2022/23 indicated by a dotted line

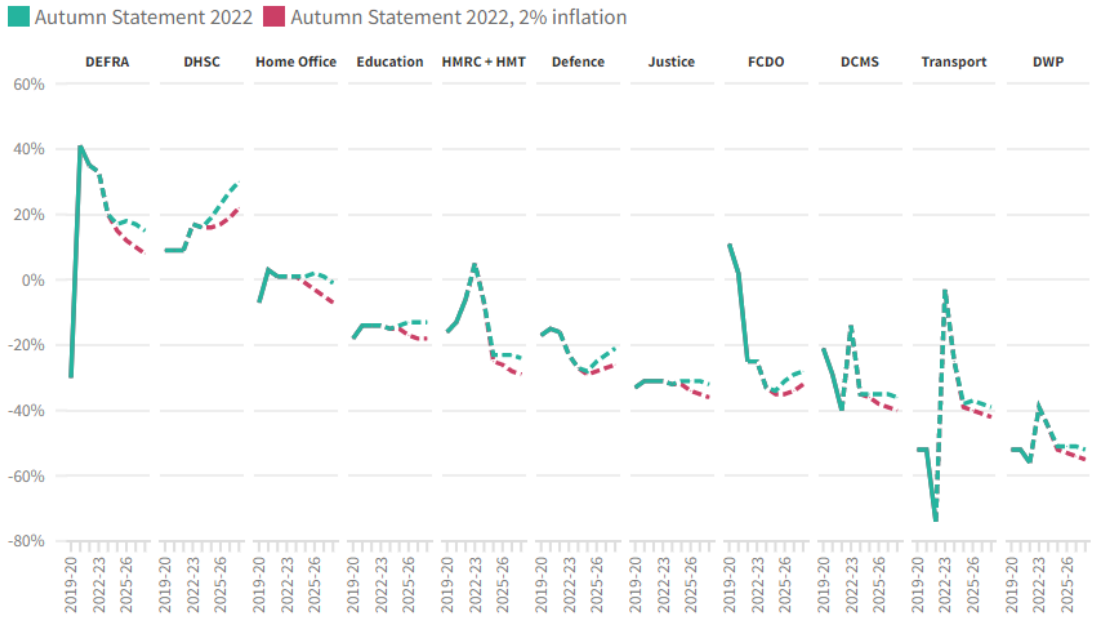


Source: Note: Protected RDEL is measured by RDEL for health and social care, education, defence and foreign, commonwealth and development departments. As departmental RDEL is not provided after 2024-25 this has been calculated per department as a fixed share of total 'unprotected' RDEL based on 2024-25 figures. This is after protecting a 3.1% real terms increase in health and social care spending per year, a constant spend per pupil in real terms and a fixed defence and foreign, commonwealth and development spend as % GDP. Population forecasts taken from the Office for National Statistics.

We also break the same analysis down for selected departments, which shows a high degree of variation across budgets and time. For example, while the per capita budget for the Department of Health and Social Care is 30.1% higher than 2009/10 levels (22.1% in our higher inflation scenario) in 2027/28, work and pensions, transport, and culture media and sport fall by 52.0%, 38.5% and 36.1% respectively over the same period (even outside of 2% inflation).

Figure 8: Different inflation forecasts could flatten or even reverse any real terms increase in departmental spending

Percent change in resource departmental expenditure limits (RDEL) per capita for selected departments in real (CPI) terms under OBR forecast and a 2% inflation from 2024-25 onwards, 2019/20 to 2027/28 compared with 2009/10 levels, forecast values from 2022/23 indicated by a dotted line.



Source: NEF analysis of HMT Public Expenditure Statistical Analyses 2013-2022 and Office for Budget Responsibility data. As departmental RDEL is not provided after 2024-25 this has been calculated per department as a fixed share of total 'unprotected' RDEL based on 2024-25 figures. This is after protecting a 3.1% real terms increase in health and social care spending per year, a constant spend per pupil in real terms and a fixed defence and foreign, commonwealth and development spend as % GDP. Population forecasts taken from the Office for National Statistics.

Conclusion

There is little credible justification for a second round of austerity. The UK does not face a fiscal crisis per se, but rather three alternative crises. First, a macroeconomic one in terms of our exposure to global price changes, especially fossil fuels, and due in part to a failure to ramp up renewable energy generation and improve energy efficiency. Second, a distributional crisis, in terms of the disproportionate impact of the rising cost of living on the lowest income families. And third, a crisis in public services and welfare that can no longer provide an effective safety net after being under resourced for more than a decade. The one thing that all three of these crises have in common is that they were made worse by austerity. The UK cannot afford to go down this path again.

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