

Global Britain Briefing Note

How Much Should Public Spending Shrink ?

By at least fifteen per cent, or £ 101 billion per year

Summary & Conclusions

The IMF, international rating agencies and British commentators have warned that the UK fiscal position is unsustainable. This **Briefing Note** looks at the **broad magnitudes** involved and (in Tables 2, 3, 4 & 5 below) simulates the effect of reducing Government Spending at different rates.

The economic and fiscal projections set out in the Government's 9th December 2009 Pre-Budget Report¹ are taken as a "given" – with one exception. The exception is the amount of Government Spending in the years ending March 2012 and thereafter, which, for the purposes of the illustrative exercise which follows, is treated as the variable.

Given the fragility of the public finances following the bail-out of the banking sector and the use of Quantitative Easing (printing money), the conclusion is that:-

an immediate reduction in Government Spending of a minimum of 15% is needed to return the UK's fiscal position to a sustainable position by 2015.

Under such a scenario (Table 2 below) of a 15% reduction in Government Spending of £ 101 billion (from £ 676 billion in 2009-10 to £ 575 billion in 2010-11) with no further increases until 2015-16 at the earliest, Government Spending comes into balance with the Tax Take in 2011-12. Thereafter, the Tax Take comfortably exceeds Government Spending. The outcome is that by March 2015 the cumulated total amount of outstanding government debt ("PSND" – Public Sector Net Debt) reduces by a quarter, from £ 799 billion at end-March 2010 to £ 601 billion at end-March 2015. Expressed as a proportion of GDP, PSND reduces from 57% in 2010 to 33% in 2015.

By cutting Government Spending in the year to end-March 2011 to £ 575 billion (which is £ 101 billion less than the £676 billion spent in the year to end-March 2010) an incoming government would be returning the economy to a level of spending last seen (in money terms) in, say, 2005. As a proportion of 2010-2011 GDP, £ 575 billion would be 39.1%. A reduction to that level is perfectly feasible: Government Spending as a proportion of GDP when Gordon Brown was Chancellor was lower than 39.1% for six years and just above 39.1% for another year². [Detailed breakdowns of Spending & Tax Take for the year to end-March 2010 are given in the **Appendix** on page 6 of this Briefing Note.]

The other simulations show that a reduction of only 10% in Government Spending would hardly make an impression on PSND by 2015 (Table 3). Table 4 shows that a reduction in Government Spending of 20% would almost halve PSND by 2015: desirable, but (hopefully) not absolutely necessary. Table 5 shows that a reduction of 30% in Government Spending would reduce PSND to less than 5% of GDP by 2015.

The Government's Plans for 2010-2015

1. In December 2009, in its Pre-Budget Report ("PBR")¹, the British Government set out its economic projections and plans for tax and spending for the period up to 2015. These are summarised below in Table 1.

Table 1: Pre-Budget Report¹: UK Government's Key Projections as at Dec. 2009							
Years to end-March	2010	2011	2012	2013	2014	2015	Total 2010-2015
A: Nominal GDP ^a £ bn	1409	1472	1544	1635	1735	1841	
B: Govt. Spending ^b £ bn	(676)	(706)	(716)	(734)	(752)	(776)	(4360)
C: Tax Take ^b £ bn	498	530	576	617	656	694	3570
D: Surplus ^b £ bn	(178)	(177)	(140)	(117)	(96)	(82)	(790)
E: End-year PSND ^b £ bn	799	986	1139	1270	1379	1473	
F: Line E divided by line A	56.7%	67.0%	73.8%	77.7%	79.5%	80.0%	
<i>a: PBR, Table B 1, page 165</i>							
<i>b: PBR, Table B13, page 189</i>							

2. These projections give only a *partial* view of the real state of the economy, since they exclude the impact of what is described as “financial intervention” involving, *inter alia*, propping-up banks, printing money and using it to buy British government debt (“gilts”)³.
3. PBR projections show both Government Spending and the Tax Take growing year-on-year to 2015. Over the period 2010-2015, the “deficit” – the difference in any one year between Government Spending and the Tax Take – is projected to shrink somewhat. **However, it continues to be a deficit.** Even as late as 2015, annual Government Spending is still projected to exceed the Tax Take by £ 82 billion.
4. Consequently (Table 1, line E) the cumulated total amount of outstanding government debt (“PSND” – Public Sector Net Debt) is projected to increase by 84% between end-March 2010 (£ 799 billion) and end-March 2015 (£ 1473 billion) – even before taking into account the effects of “financial intervention” by the government.

Global Britain Simulations of the Impact on PSND of Reducing Government Spending: Key Assumptions

1. Tax increases and Tax Take as set out in the PBR and summarised in Tables 1 to 5.
2. GDP (which incorporates the Government’s projections of inflation⁴) to rise as set out in the PBR and in Tables 1 to 5.
3. Government Spending in the year to end-March 2010 as set out in the PBR and in Tables 1 to 5 below.
4. Government Spending in the single year ended March 2011 to be reduced compared to the previous year by:-
 - Simulation I: 15% (Table 2)
 - Simulation II: 10% (Table 3)
 - Simulation III: 20% (Table 4)
 - Simulation IV: 30% (Table 5)

5. Government Spending in the years to end-March 2012, 2013, 2014 and 2015 to be held at the same level in money terms as in the year to end-March 2011.
6. All deficits and surpluses (the differences between Government Spending and Tax Take) applied to increasing or decreasing PSND (Public Sector Net Debt).

Table 2: Global Britain Simulation I: 15% Reduction in Govt. Spending							
A.Years to end-March	2010	2011	2012	2013	2014	2015	Totals 2010-2015
B. Govt. Spending £ bn	(676)	(575)	(575)	(575)	(575)	(575)	(3551)
C. Tax Take £bn	498	530	576	617	656	694	3570
D. Surplus £ bn	(178)	(45)	+1	+42	+81	+119	+20
E. End-year PSND £ bn	799	844	843	801	720	601	
F. End 2015 GDP £ bn	1409	1473	1544	1635	1735	1841	
G. E divided by F	56.7%					32.6%	

Table 3: Global Britain Simulation II: 10% Reduction in Govt. Spending							
A.Years to end-March	2010	2011	2012	2013	2014	2015	Totals 2010-2015
B. Govt. Spending £ bn	(676)	(608)	(608)	(608)	(608)	(608)	(3716)
C. Tax Take £bn	498	530	576	617	656	694	3570
D. Surplus £ bn	(178)	(78)	(32)	+9	+48	+86	(146)
E. End-year PSND £ bn	799	877	909	900	852	766	
F. End 2015 GDP £ bn	1409	1473	1544	1635	1735	1841	
G. E divided by F	56.7%					41.6%	

Table 4: Global Britain Simulation III: 20% Reduction in Govt. Spending							
A.Years to end-March	2010	2011	2012	2013	2014	2015	Totals 2010-2015
B. Govt. Spending £ bn	(676)	(541)	(541)	(541)	(541)	(541)	(3381)
C. Tax Take £bn	498	530	576	617	656	694	3570
D. Surplus £ bn	(178)	(11)	+35	+76	+115	+153	+190
E. End-year PSND £ bn	799	810	775	699	584	431	
F. End 2015 GDP £ bn	1409	1473	1544	1635	1735	1841	
G. E divided by F	56.7%					23.4%	

Table 5: Global Britain Simulation IV: 30% Reduction in Govt. Spending							
A.Years to end-March	2010	2011	2012	2013	2014	2015	Totals 2010-2015
B. Govt. Spending £ bn	(676)	(473)	(473)	(473)	(473)	(473)	(3041)
C. Tax Take £bn	498	530	576	617	656	694	3570
D. Surplus £ bn	(178)	+57	+103	+144	+183	+221	+529
E. End-year PSND £ bn	799	742	639	495	312	91	
F. End 2015 GDP £ bn	1409	1473	1544	1635	1735	1841	
G. E divided by F	56.7%					4.9%	

Appendix

Government Spending & Tax Take in the year ended March 2010

<i>Govt Spending by Function</i>		<i>Tax Take by Type</i>	
	<u>£ bn</u>		<u>£ bn</u>
Social protection	190	Income Tax	140
Health	119	National Insurance	95
Education	88	VAT	67
Defence	38	Excise Duties	44
Public order & safety	36	Corporation Tax	34
Debt interest	30	Business Rates	24
Housing & Environm.	30	Council Tax	25
Personal social services	29	<u>Other</u>	<u>68</u>
Transport	23		
Industry, agr. & employmt.	21		
<u>Other</u>	<u>72</u>		
<u>TOTAL</u>	<u>676</u>	<u>TOTAL</u>	<u>498</u>

Source: PBR¹ page 14. Further detail is in PBR Chapter B: The Public Finances, pp 163-206

References:

- 1 Pre-Budget Report: Cm 7477, Dec 2009: www.hm-treasury.gov.uk
- 2 PBR page 206 Table B24
- 3 PBR page 196 *et seq.* Financial Interventions. See especially page 196, B 108: “ONS have not yet been able to calculate the impact of RBS & Lloyds’ balance sheets on PSND”
- 4 PBR page 165 Table B1

End/15th January 2010

Global Britain

Lord Stoddart of Swindon
(Independent Labour)

Lord Pearson of Rannoch
(United Kingdom Independence Party)

Lord Willoughby de Broke
(United Kingdom Independence Party)

Lord Harris of High Cross *(1924- 2006)*
(Cross-Bencher)

Briefing Note No 57: How Much Should Public Spending Shrink ?

15th January 2010