PRESS RELEASE

June 26th 2013

Professor John Van Reenen, Director of the Centre for Economic Performance, gives his verdict on Chancellor George Osborne’s Spending Round

The 2013 Spending Round is a strange beast, covering just a single year, 2015-16 rather than previous spending reviews, which typically covered three or four. Chancellor George Osborne’s 2010 Review covered a four-year period and aimed to eliminate the deficit in time for the 2015 election. As we know, this has spectacularly failed to happen with austerity now planned to go on until at least 2018.

The Chancellor is looking for an extra £11.5 billion cut from departmental expenditure (DEL), an extra 2.8% on average across the board. But since 60% of spending is ‘ring-fenced’ in health, schools and overseas aid, this means an 8% average cut on the unprotected departments. Remember that this is on top of the big departmental cut already planned and implemented.

The basic reason for the Spending Round is the fact that spending has actually not fallen since 2010. Despite the cuts in departmental money, the costs of pensions and welfare (AME) have risen inexorably upwards. On a like-for-like basis, the deficit has been stuck at around £120 billion for the last two years, and this is because UK economic growth has been extraordinarily disappointing: GDP is still about 2.6% smaller than it was before the crisis – the worst ‘recovery’ for over a century.

The Chancellor’s centrepiece of the Spending Round was infrastructure spending. Such spending is sorely needed for three reasons. The UK has historical weaknesses (especially in energy, transport and housing); these investments have big knock-on effects on growth; and the government can borrow at rock-bottom interest rates.

There is a consensus that the cuts to public investment of over 40% since 2010 were a huge policy mistake. Net investment looks like it will average under £30 billion a year over next five years, hardly making a major dent on these cuts. The efforts so far to boost infrastructure have been shambolic and ineffective. New orders for infrastructure have dropped to a 25-year
low despite the ‘Infrastructure Plan’ – a glorified wish-list – announced to great fanfare two years ago.

As announced in the last Budget, the increases in infrastructure spending have come at the expense of further cuts to current spending. We will have to wait until tomorrow to learn how ‘£100 billion of infrastructure investment will be allocated over the next Parliament’ (that is, nothing imminent). It does look like there will be £9.5 billion more in transport in 2015-16. Although better than nothing, a superior policy would have been to simply increase capital spending without further cuts. Public investment is like borrowing for a mortgage, not borrowing to increase consumption.

Professor Van Reenen says:

‘The Spending Round has been forced on the Chancellor because weak economic growth has blown a hole in the deficit reduction programme. I welcome the partial reversal of the hugely damaging cuts in public investment, but it is too little, too late. Rock-bottom interest rates mean we should be boosting investment substantially now. A longer-term plan for rebuilding our broken economy is desperately needed.’

The full response to the Spending review is available at John Van Reenen’s LSE Blog

ENDS

Notes for Editors
1. The Centre for Economic Performance is an independent ESRC funded research centre at the London School of Economics.
2. For more information, contact John Van Reenen, j.vanreenen@lse.ac.uk or Anna Graham, a.graham@lse.ac.uk.