

THE 2010 SPENDING REVIEW:

Implications for the state and its reach

The Coalition Government has said that the 2010 Spending Review 'will be a complete re-evaluation of the Government's role in providing public services'. 'It is time to rethink how government spends our money,' the Chancellor has said. On 30 July 2010, a British Academy Forum sought to address the 'big questions'. Professor Andrew Gamble FBA summarises the discussion.

THE NEW COALITION GOVERNMENT has made tackling the deficit in the public finances its chief priority. Some immediate cuts were announced in the emergency budget, but much more drastic measures were promised for the autumn with the completion of the comprehensive spending review. Most Departments apart from Health and International Development were asked to plan for cuts of 25 per cent and 40 per cent. The Chancellor, George Osborne, announced that he wanted 80 per cent of the reduction in the deficit to come from spending cuts and only 20 per cent from tax increases.

Cuts on this scale, if delivered, would be unprecedented, greater than the cuts achieved in any period since 1945 including 1976–77, 1980–82, and 1992–94. According to Michael Portillo, Chief Secretary to the Treasury in 1992–94, the Government at that time only managed to achieve a ratio of spending cuts to tax increases of 50/50. The austerity implied by the Coalition Government's plans will last a full Parliament, requiring greater political determination and cohesion in the face of political unpopularity and the lobbying from special interests than most previous Governments have displayed. The Coalition Government in its rhetoric at least is promising a fundamental review of all aspects of state activity, in order to reduce state expenditure substantially, transferring many functions to the private sector or doing without them altogether.

Principles

Periods of large fiscal adjustment are an opportunity to consider the most appropriate size of the state and the principles which justify public rather than private spending. This was the subject of the British Academy Forum held on 30 July 2010. An extreme libertarian might argue that there should be no state spending at all because it involves coercion of the citizens through the extraction of taxes, and therefore is always illegitimate, while an extreme collectivist might claim that all spending should be controlled and directed collectively, because only in this way can the good society be realised. Between these two extremes there are many different possibilities for the balance that can be struck between spending that is public and spending which is private, between the state and the individual. The argument has tended to focus not on whether the state should exist at all, or on whether it



Figure 1. Chancellor of the Exchequer George Osborne makes his Budget Speech, June 2010. Photo: Reuters/ David Moir.

should include everything, but on whether it should be minimal or maximal in the functions it performs. Proponents of a minimal state wish to limit those functions to the provision of security, the administration of justice and the protection of property rights, while proponents of a maximal state want to add protection against risk and the equalising of opportunities for all citizens.

One influential way of analysing where the boundary should be struck between public and private from the libertarian side, as Samuel Brittan pointed out, has been to assume that all spending should ideally be private, and to justify public spending on technical grounds because the good in question is a public good, or there is an externality, or a separate argument for redistribution can be made. But there are other starting points as well, depending on different conceptions of the fundamental purpose of government. For utilitarians the purpose of government is to promote the greatest happiness of the greatest number, for libertarians it is to protect human rights, for communitarians it is to promote identity and social cohesion, and for egalitarians it is to diffuse power and resources as widely as possible.

One difficulty in deciding how big the state should be is to know how big it actually is. One of the simplest if crudest methods for measuring the size and activity of the state is to express public expenditure as a proportion of GDP. This remains a useful indicator, but is only a starting point. The state needs to be considered in its different roles as provider, purchaser, redistributor and regulator. State expenditure

needs to be disaggregated by programmes (defence, health, education, welfare) and the different ways these are delivered (for example through transfer payments to individuals, purchase of services, direct provision of services) – as Michael Lipton emphasised. A very different way of thinking about the state, as Douglas Wass argued, is the extent of its capacities to regulate and influence all other activities.

Historical patterns

In the last hundred years there has been a very substantial growth in the size of the state in the United Kingdom. Before the 20th century public expenditure as a proportion of GDP was below 10 per cent. It rose dramatically in both world wars, to a peak of 47 per cent in 1918 and 65 per cent in 1944, falling sharply once the war was over, but never to the same level before it.

Between 1920 and 1939 it averaged 23–28 per cent, and between 1947 and 1965 it averaged 34–39 per cent. From 1966 to 1973 public spending increased to an average of 40–43 per cent, before briefly rising as result of the economic crisis of the mid 1970s to 46–48 per cent between 1974 and 1977.

The great fiscal contraction begun by Labour and continued under the Conservatives brought the average spend down to 40–45 per cent between 1978 and 1986, and then from 1987 to 2008 it fell back to an average of 35–40 per cent, although on a rising curve after 1999. The financial crisis of 2007–08 saw public spending rise sharply above 45

Two traditions of thinking

Jeremy Bentham (1748–1832) is an extremely interesting figure when thinking about the state, partly because he himself was so contradictory. He both favoured the most minimal state possible, but also gave justifications for state activity in terms of ensuring security and equality – in due course that would allow for a much greater expansion of the state. His notion of frugal government, at which all governments should perhaps aim, was to reduce delay, vexation and expense in achieving the greatest happiness of the greatest number.

Bentham's concept of the agenda and non agenda of government was picked up by John Maynard Keynes FBA (1883–1946), but used to promote the idea of a more active state. In the famous quotation from *The End of Laissez Faire* (1926), Keynes says, 'The important thing for government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do those things which at present are not done at all.' Keynes thought that the task of economics was to distinguish the agenda from the non agenda – services that were technically social and services that were technically individual. The task of politics was to devise forms of government within a democracy which could accomplish the agenda. In some ways it is a satisfying division, but one that is difficult to achieve in practice.



Jeremy
Bentham



John Maynard
Keynes FBA

per cent once more, in response to the recession and the additional expenditure incurred in bank bailouts and fiscal stimulus.

Political pressures

This does not amount to an inexorable rise of the state. There have been two large increases as result of the two world wars, and after each a new higher plateau was established. There has been a tendency for some upward incremental drift, but generally for the last 60 years Britain has had a 40 per cent state, and it has proved very difficult either to increase or to reduce it substantially. There are many reasons why public expenditure has been so hard to reduce. Increased demands and expectations, the pressures of democratic politics, growing complexity and interdependence, and multilevel governance all contribute. But it is still surprising, as Tim Besley and Mark Littlewood pointed out, that there has not been greater readiness to have a more radical look at the size and functions of the state. Many contributors at the Forum suggested this was due to the political pressures faced by Ministers and civil servants, which made large cuts unfeasible, and meant that few discussions of first principles ever take place in Government. Affordability and political feasibility tend to govern the process, and this means that cuts when they are implemented involve salami slicing of existing activities, rather than the cutting out of whole areas of activity.

Another key consideration is the appropriate level for the control of budgets. These can be at the level of central government, local/regional government, the service providers (whether public, private or third sector) or citizens themselves. As Tim Besley pointed out, there is much talk about the virtues of localism, but there is an unwillingness in practice to think beyond the mechanisms of the bureaucratic, centralised state. One of the big uncertainties is how far citizens want to be entrusted with direct control over services, to assume the personal responsibility which has previously been exercised by state agencies on their behalf. Sue Cameron suspected that whatever citizens said they wanted, they would still blame government if things went wrong.

Three models

The Coalition Government inherited a level of spending which is currently more than 45 per cent of GDP as a result of the recession. The fiscal position at the moment is sustained by a large amount of borrowing. For the purposes of the Forum's discussion, it was assumed that three broad choices confronted the Coalition: it could choose to attempt to stabilise public spending at around 44 per cent of GDP; it could seek to reduce it to 38 per cent of GDP; or it could seek to reduce it further to 25 per cent of GDP – although as Peter Riddell pointed out, in practice Governments never think in terms of targets like these; they may want to shrink or expand the state but they have little idea what the result will be.

All three options are in principle compatible with different purposes and different styles of government; but they also embody different political judgements about how the state can best promote the prosperity of a market economy. There is no necessary correlation between the amount the Government spends and the extent to which the state penetrates all corners of civil society. The Government could spend 50 per cent of GDP, but in the form of transfer payments rather

than directly providing services itself. At the same time a 25 per cent state could still have regulatory and monitoring capacities which made it very intrusive in shaping all aspects of economic and social life. Spending by itself is not an indicator of how much or how little the state intervenes, or the way in which it intervenes.

44 per cent state

A 44 per cent state has only been approached during wars and in the aftermath of major financial crises, but it also moved towards this level during 1966–73, and again before the financial crisis of 2007–08. It is associated with the Nordic countries, the countries with advanced welfare states, high taxation and high spending, and dynamic private sectors. It supports a large role for the state in promoting national competitiveness (economic or military) through strategic investment in human capital, the research base, and infrastructure, while at the same time providing high levels of social security and social solidarity through universal health, education and welfare programmes. A condition for this model to work is a very broad tax base and therefore high levels of tax compliance, and a political culture which accepts the trade-off between high taxation and social cohesion. Vernon Bogdanor wondered why in the aftermath of the financial crisis and the discrediting of the market-led model of the previous thirty years, this model does not command more support.

38 per cent state

A 38 per cent state has been the default position of British Governments since 1945. It was broadly achieved between 1947 and 1965, and again after 1987 until the financial crash. This level of spend has been typical of other Anglosphere states, including the United States. The public sector is sizeable and the role of government extensive, but greater weight is placed on the private than on the public sector. There is a hybrid welfare state and a hybrid political economy. The lines between the public and the private sector are constantly changing the strategic role of the state is uneven, and there is often conspicuous underinvestment in human and social capital.

25 per cent state

The 25 per cent state was last seen in the UK in the 1920s and 1930s. Contemporary exemplars of such a state include Hong Kong and Switzerland. It allows much lower taxation than in either of the other two models, and therefore very high individual incentives which encourage entrepreneurialism and individual responsibility. The welfare state is residual but can still be very important in certain areas – for example, Hong Kong provides cheap subsidised rented accommodation for the great majority of its workers. Inequality tends to be higher than in either of the other two models. Taxes would become flat and proportional rather than progressive.

Conclusion

The view of most of the participants in the Forum was that the Government would find it hard to live up to its rhetoric of radical cuts, and would settle in most areas for reductions in current activities which are politically least painful, rather than a deeper review of what the state should and should not be doing. That would require determining the agenda and non-agenda of Government as Bentham

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and later Keynes advocated. The Coalition is unlikely to do things differently from its predecessor, but it may yet still surprise us.

A lot may depend on how the public reacts. Avner Offer argued that in certain circumstances people were unable to assume responsibility for themselves, while Peter Taylor-Gooby suggested that many people would only become involved if their own interests were directly concerned, for example over their children's education. This scepticism was countered by Tim Besley, who argued that there did seem to be a great appetite among people involved in the voluntary sector to change the way things are done. The fate of the Big Society programme may depend on which of these views is closer to the truth about contemporary Britain.

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The British Academy Forum 'The 2010 Spending Review: Implications for the state and its reach' was chaired by Professor Peter Hennessy FBA (Queen Mary, University of London).

The following participants at the Forum are cited above: Professor Tim Besley FBA (London School of Economics); Sir Samuel Brittan (*Financial Times*); Sue Cameron (*Financial Times*); Professor Michael Lipton FBA (University of Sussex); Mark Littlewood (Institute of Economic Affairs); Professor Avner Offer FBA (University of Oxford); Peter Riddell (Institute for Government); Professor Peter Taylor-Gooby FBA (University of Kent); Sir Douglas Wass (former Permanent Secretary, HM Treasury). A full list of Forum participants can be found at www.britac.ac.uk/policy/2010_spending_review.cfm, along with the slides of Professor Gamble's presentation to the Forum.

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