

UK spending cuts: impact on sectors

Although all departments will feel the squeeze after the next election, spending cuts will fall disproportionately on some departments and sectors of the UK economy. Factors such as dependence on government spending, importance of capital spending and protected versus unprotected areas help us to develop a 'scorecard' for the most vulnerable sectors. The four sectors we expect to be hardest hit are office machinery & computers (i.e. IT equipment), weapons & ammunition, shipbuilding & repair and aircraft & spacecraft.

medical & precision instruments, computer services and construction all receive a significant share of total spending (collectively accounting for one third of public sector demand).

However, both the Conservatives and Labour have promised to ring-fence spending on 'frontline' health and overseas aid in the years 2011/12 and 2012/13. In addition, Labour has also protected spending on frontline education. This leaves other large departments particularly vulnerable. In a previous Daily, we identified defence, transport, housing and higher education as being most vulnerable to large cuts.

Sectors most dependent on government

The Office for National Statistics (ONS) provides input-output data on the value of consumption across 123 UK sectors of the UK economy - 30 of these sectors account for 86% of public sector spending. We can use this data to estimate which sectors are most dependent on government spending as a proportion of their total demand. This is the primary factor for determining exposure. Weapons & ammunition, pharmaceuticals, medical & precision instruments and office machinery & computers rely on the private sector to create at a minimum 60% of their demand. Ignoring small sectors with less than £1 bn of total intermediate demand, the eighteen most dependent sectors according to this metric are listed in the table opposite. We have also added construction and computer services because of the large proportion of total government spending they receive.

Sectors receiving most public money

Indeed, it is also useful to note which sectors receive the most spending as a proportion of total government outlays, as well as distinguishing between protected and unprotected areas of spending. Pharmaceuticals, other business services,

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20 sectors most reliant on govt. spending

	% reliance on public sector	% of total public sector demand	Protected?
Weapons & ammunition	86	1.7	No
Pharmaceuticals	79	6.9	Yes
Medical instruments	65	4.6	Yes
Office mach. & computers	63	3.2	No
Shipbuilding & repair	54	0.5	No
Clothing	50	0.5	No
Research & development	45	1.9	No
Railway transport	43	0.6	No
Aircraft & spacecraft	40	2.4	No
Furniture	38	0.8	No
Sewage & Sanitary services	30	1.7	No
Other service activities	28	0.8	No
Hotels, catering, pubs etc	26	1.8	No
Water supply	26	0.3	No
Toiletries	26	0.4	No
Printing & publishing	21	2.4	No
Legal activities	20	2.2	No
Receivers for TV & radio	19	0.3	No
Computer services	17	4.1	No
Construction	7	3.5	No

Source: ONS, RBS Group Economics
Input-output data for intermediate demand for 123 sectors

Capital budgets particularly vulnerable

The commitment to ring-fence certain departments' spending applies only to 'frontline' services, generally interpreted to mean current spending. Capital or investment spending – i.e. spending on productive assets that have a life longer than one year, such as a new school, hospital building or IT equipment - is in general more vulnerable than current spending across all departments. In recent years, capital spending has gradually been ramped up, from 1.4% of total spending in 2000 to 7.3% of the total for 2009/10.

However, in the latest Pre-Budget Report the Treasury said that it expects capital spending to be substantially lower in 2010/11. Indeed, the Institute for Fiscal Studies (IFS) estimates that net investment spending will fall by 14% per year on average between 2011 and 2015, taking it back to early 90s levels as a proportion of national income. Defence, transport, education and health have had the largest capital budgets in recent years.

Largest departmental capital budgets (£ bn)		
	2009/10	2010/11
Defence	9.0	8.8
Transport	8.0	7.3
Children, Schools & Families	7.4	6.7
Health	5.4	4.7
Business, Innovation & Skills	3.0	2.3
Energy & Climate Change	2.1	2.0
International Development	1.4	1.6
Home Office	0.8	0.8
Justice	0.9	0.7
Environment, Food & rural affairs	0.7	0.6
Culture, Media & Sport	0.5	0.6

Source: HMT Pre-Budget Report 2009

Large capital projects will be at particular risk, such as plans to replace the nuclear Trident submarines. Both Labour and the Conservatives have announced their intention to hold the first strategic defence review in 10 years if they form the next government. Large IT schemes such as identity cards and the children's database could also be under threat. This suggests that the computer services industry could be vulnerable, especially IT consultancies, which have been involved in a number of these large-scale projects and received some criticism for cost overruns too.

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Conclusion – putting all this together

Using the various factors identified such as dependence on public sector demand, importance of capital spending and protected versus unprotected areas we develop a 'scorecard' for the most highly exposed sectors to cuts in government spending. We exclude pharmaceuticals and medical & precision instruments as protected areas, leaving the four sectors most vulnerable to spending cuts after the next election as office machinery & computers (i.e. I.T. equipment), weapons & ammunition, shipbuilding and aircraft & spacecraft scoring five or four 'ticks' each.

Scorecard: 10 most vulnerable sectors (exc. health)					
	Tick if reliant on state*			2% or more of total public sector demand	Large capital budget
	>5%	>25%	>50%		
Office machinery & computers	✓	✓	✓	✓	✓
Weapons & ammunition	✓	✓	✓		✓
Shipbuilding & repair	✓	✓	✓		✓
Aircraft & spacecraft	✓	✓		✓	✓
Railway transport	✓	✓			✓
Computer services	✓			✓	✓
Research & development	✓	✓	✓		
Construction	✓			✓	✓
Sewage & Sanitary services	✓	✓			✓
Furniture	✓	✓			✓

Source: ONS, RBS
(*as % of total intermediate demand)

Despite being recipients of a significant proportion of public sector spending, computer services and construction are somewhat less exposed to public sector cutbacks as the public sector accounts for 'only' 17% and 7% of their total demand respectively. However, while this may be true for these sectors as a whole, many individual companies within the construction and computer services industries will have a much larger dependence on government spending as a proportion of their total revenue, and so could still come under substantial pressure as spending cuts are announced.

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