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The UK's reduction in aid spending

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Executive summary

In the Spending Review last November, the government announced that 2021 overseas aid expenditure would be 0.5% of national income – a 29% reduction on the legislated 0.7% target which was met each year from 2013 to 2020. Although as a share of national income UK aid spending will remain high by international and historical standards, this is a substantial reduction on 2020 of an estimated £3.5 billion, and comes on top of a £0.7 billion reduction between 2019 and 2020 as the UK economy contracted.

In this briefing note, we review what this shift in policy means for overall aid spending, effective management of the aid budget, and the broader public finances. The government has stated that it is a temporary shift in policy; we consider how the fiscal outlook and other government spending decisions interact with the aid budget, and discuss the implications of uncertainty over the aid budget going forward.

Key findings

1. The government's reduction in overseas aid funding from 0.7% to 0.5% of national income for 2021 means a steep one-year fall, with spending estimated to decrease by £3.5 billion this year. Despite this, UK aid spending will remain relatively high by historical and international standards as a share of national income.

2. Existing commitments in the aid budget mean that cuts will not be distributed evenly, and some spending areas will be cut by more than others. The speed of cuts combined with the constraints on where they can practically be made risks decision-making reflecting criteria other than programme impact or effectiveness.

3. Though the government has stated that this is a temporary change owing to the fiscal situation, a temporary reduction in the aid budget does little to alter the long-term fiscal outlook. Large and abrupt changes in the aid budget will, however, bring challenges for managing aid expenditure and ensuring effectiveness.

4. The decision on returning aid spending to 0.7% highlights the tight settlements faced by unprotected departments from 2022–23 given existing commitments and provisional spending plans. Plans pencilled in to the 2021 Budget imply that with aid spending at 0.5% of national income, and without tax increases, unprotected departments could face a 3.1% real-terms cut in day-to-day spending from 2021–22 to 2022–23. If aid spending returns to 0.7% of national income, this figure rises to 5.4%.

5. Further clarity is needed on how the government will assess when the UK returns to the legally binding 0.7% target. Beyond the implications for the public finances, this is important for effective aid spending, which often requires long planning horizons, a pipeline of potential projects and the flexibility of multi-year budgets.

Introduction

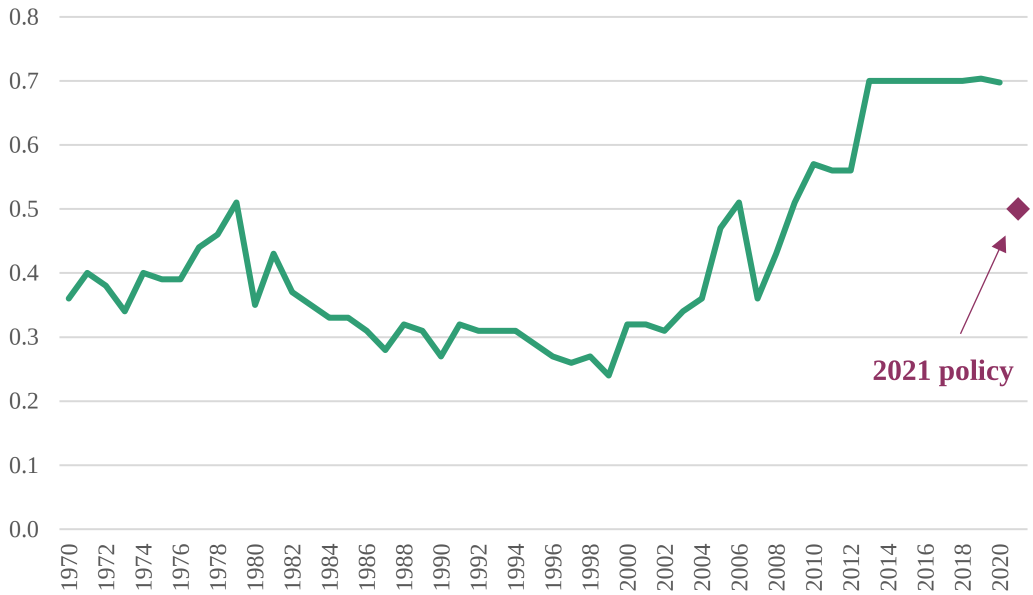
Preliminary data published on 8 April estimated that the UK's overseas aid spending in 2020 was £14.5 billion – nearly a 5% cash-terms reduction on 2019's £15.2 billion figure, reflecting the fact that the government pegs aid expenditure to the size of the economy.[1] In 2021, however, more substantial aid spending reductions are on the way. In the Spending Review last November, the government announced a reduction in the UK's aid budget from 0.7% to 0.5% of gross national income (GNI) in 2021, alongside changes to the way aid spending is allocated and managed. In justifying this change, which it says will be temporary, the government argued that maintaining aid spending at 0.7% is 'not an appropriate prioritisation of resources' given the coronavirus pandemic, but has indicated that it intends to return to 0.7% 'when the fiscal situation allows' (HM Treasury, 2020).

Aid spending in perspective

The government's commitment to spending 0.7% of GNI on overseas aid (or official development assistance, ODA), which was enshrined in law in 2015, has meant that aid spending has risen quite substantially over the last decade. In 2019, it was 15% higher in real terms than in 2015 and more than 50% higher than in 2010. This is despite overall real-terms public service spending falling by 7% over the decade to 2019–20; departments outside of health saw overall falls of 20%, with some areas such as justice and local government faring much worse (Zaranko, 2020). Between 2013 and 2020, the government spent almost exactly 0.7% of national income on overseas aid every year (Figure 1).

[1] In this briefing note, we generally refer to cash-terms figures because of complications in calculating the GDP deflator for 2020, which would normally be used to account for changes in the price level when comparing monetary values over time.

Figure 1. UK ODA spend as a percentage of GNI



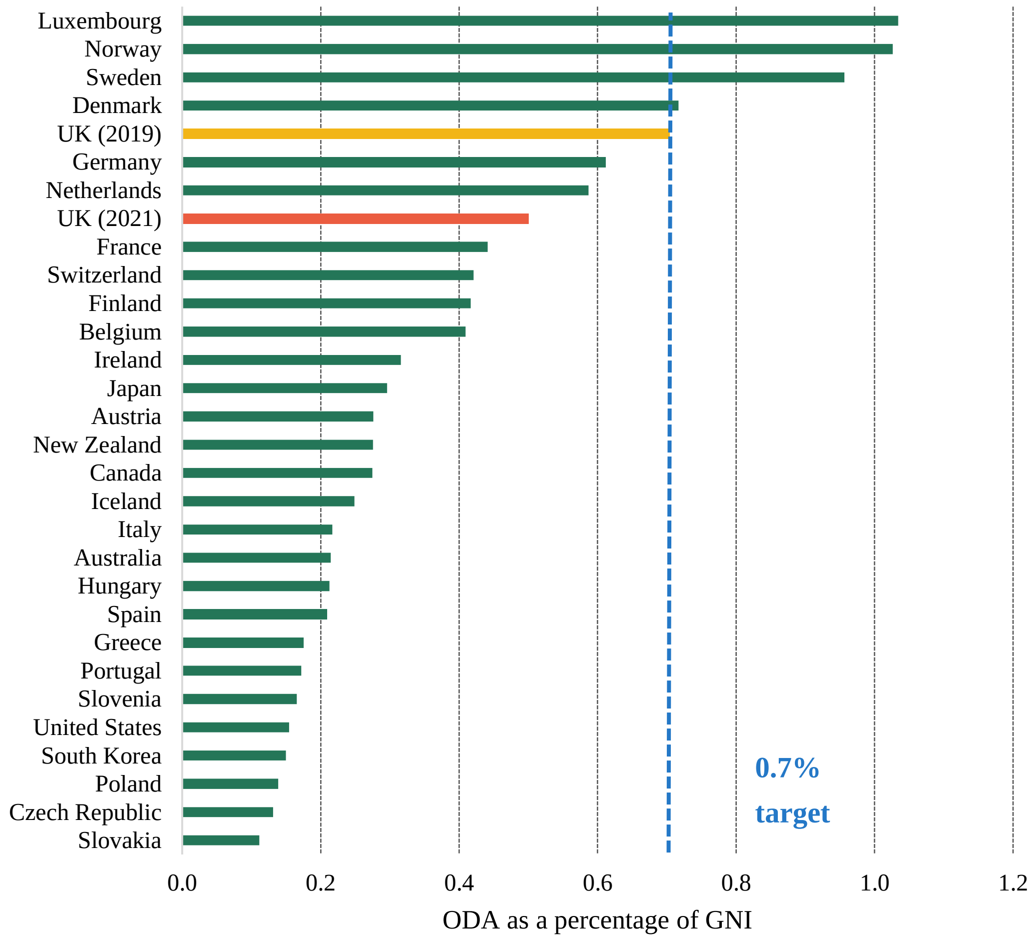
Source: Statistics on International Development: Provisional UK Aid Spend 2020.

This level of spending meant that in 2019 the UK was the third-largest contributor of aid in the world in absolute terms, and was one of only 5 countries in the OECD's Development Assistance Committee (DAC) to spend at least 0.7% of GNI – an internationally agreed UN target endorsed by all 30 DAC members except the US and Switzerland.[2] As Figure 2 shows, even with spending at 0.5% of GNI, the UK will likely remain one of the largest aid donors.

The move to a target of 0.5% breaks a Conservative Party manifesto commitment, however, and is a sharp change in direction. The spending cut will come on top of the fact that, in response to the record contraction of the economy, the government reduced year-on-year aid spending by £0.7 billion in 2020 in order to avoid exceeding the 0.7% target (Figure 3). This equates to an estimated £1.3 billion reduction compared with expected 2020 aid spend before the pandemic hit.[3]

2 The DAC has 29 member countries, and the 30th member is the EU.
3 This is based on the OBR's March 2020 central forecast for nominal GNI.

Figure 2. ODA as a percentage of GNI in Development Assistance Committee (DAC) member states, 2019

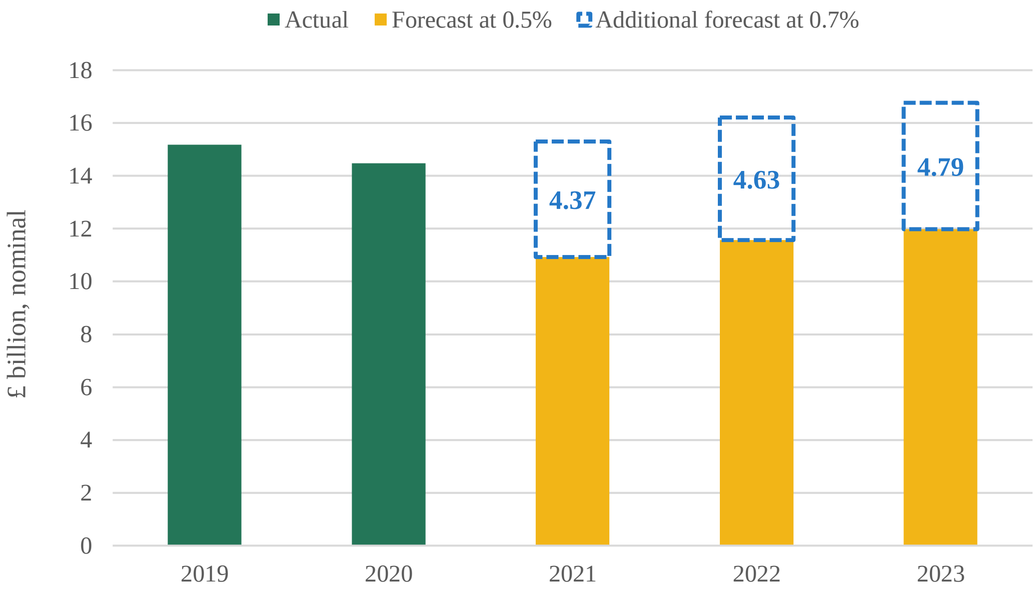


Source: OECD International Development Statistics.

In the Spending Review, the government committed to ODA spending at 0.5% of GNI in 2021 – an estimated reduction of £4.4 billion or 29% compared with the 0.7% target and an estimated £3.5 billion or 24% reduction year-on-year.[4] As a share of national income, this reduction takes the UK's aid spend down to a level not seen for over a decade: the last time it was below 0.5% was in 2008, although prior to that year ODA had only ever edged over 0.5% of GNI twice. In real terms, 2021 aid spending will be comparable to the 2012 total.

[4] The Spending Review allocated £10 billion to ODA for 2021–22 but also declared that ODA spending would equate to 0.5% of GNI in 2021. As ODA is reported on a calendar-year basis, we refer to calendar-year out-turns and forecasts.

Figure 3. Cash-terms actual and projected UK ODA spending



Note: Data for 2020 are preliminary. Forecasts for 2021 onwards use Office for Budget Responsibility (OBR) forecasts for nominal GNI from March 2021.

Source: Statistics on International Development: Provisional UK Aid Spend 2020; OBR, *Economic and Fiscal Outlook – March 2021*.

Such figures highlight the substantial nature of the reductions to the aid budget and the speed at which they are being carried out, raising questions about how effectively they can be implemented – and potentially reversed given the government's stated intention to return to 0.7%. In addition, high levels of economic uncertainty, new spending priorities that have arisen as a result of the coronavirus pandemic, and the institutional changes associated with the merger of the Department for International Development (DFID) and the Foreign and Commonwealth Office (FCO) will have added to the complexity of implementing cuts in 2020 and 2021 in the best possible way.

The implications of the spending cut

The cut to the aid budget is expected to save around £4.4 billion this year. While not insignificant, this amount is small – as most things are – relative to the £250 billion of additional support provided by the government in response to the pandemic in 2020–21 (plus a further £94 billion in 2021–22) (Office for Budget Responsibility, 2021). It is also offset almost one-for-one by increases in defence spending that were announced ahead of the Spending Review, which amounted to a £4.4 billion increase over and above manifesto commitments in 2021–22 and £4.5 billion in 2022–23 in real terms.[5] The other major international spending commitment that the UK has – to the EU budget as part of the agreed financial settlement – is forecast to decline from £10.9 billion in 2019–20 to £2.2 billion in 2024–25 (Office for Budget Responsibility, 2021).

There will be implications for international development programmes and outcomes as a result of the smaller funding pot. The Spending Review in November included provisional aid allocations, but the Chancellor delegated overall responsibility for allocating and overseeing the aid budget to the Foreign Secretary, who has since undertaken a cross-government review of ODA allocations across thematic areas and government departments (HM Treasury, 2020). Prior to the establishment of the Foreign, Commonwealth and Development Office (FCDO) in 2020, DFID had traditionally been the largest spender of UK aid – responsible for 73% of the total in 2019 – but quite a number of other departments and cross-government funds spend ODA funds as well. During previous Spending Reviews, the ODA allocation process was led by the Treasury, while DFID acted as the 'spender or saver of last resort' to ensure that the aid target was met. It is unusual for the Treasury to delegate the allocation of departmental funding, but the move could help address previous concerns raised by the National Audit Office (NAO) and others that no single department was ultimately accountable for delivering the 2015 UK Aid Strategy, or responsible for ensuring the overall coherence and effectiveness of aid expenditure (National Audit Office, 2017).

The government has outlined a series of seven strategic priorities to help inform future spending, with an international development strategy planned which will set out the government's approach from 2022 onwards.[6] 2021–22 departmental allocations were finalised by the Foreign Secretary in January, with 81% of ODA allocated to the FCDO, and the next-largest recipients the Department for Business, Energy and Industrial Strategy (BEIS) and the Home Office. However, more detailed information about the plans for this year's ODA spend is yet to be

5 https://www.gov.uk/government/news/pm-to-announce-largest-military-investment-in-30-years.

6 The areas are: climate and biodiversity; COVID-19 and global health security; open societies and conflict resolution; girls' education; humanitarian assistance; science and research; and trade promotion. See https://questions-statements.parliament.uk/written-statements/detail/2021-01-26/hcws735.

published. The government already has a series of commitments that it must account for, some of which were likely made under the assumption that spend would remain at 0.7% – for example, the UK is the largest donor to the World Bank's International Development Association in the period 2020–23.[7] Other commitments include contributions to the coronavirus COVAX Advance Market Commitment, the EU aid budget,[8] and the pledge to double international climate finance to at least £11.6 billion over the five years to 2025–26.[9] If the government maintains these commitments, the reductions in other budgets will be even steeper than the 29% average.

These constraints, and the scale and pace of change, raise questions about the process for identifying the programmes to be prioritised or reduced, and the potential costs for recipients. Having to make large cuts swiftly risks cuts being made on the basis of feasibility, which is not necessarily the same as identifying the lowest-value programmes. In 2020, overall ODA fell by 4.7% while multilateral ODA increased by 0.8% and bilateral ODA fell by 7.3% (including a 17.2% fall in humanitarian assistance). Although this partly reflects the reversal of an increase in bilateral aid in 2019, the composition of spending may change in future years.[10] Some information has emerged about reductions in humanitarian aid to Syria and Yemen, and recent announcements about funding for development-related research through UK Research and Innovation (UKRI) suggest a cut of 49% this year, with some programmes expected to be terminated entirely (UK Research and Innovation, 2021). To the extent that the current reductions in the aid budget lead to projects being downsized or terminated before completion, some of the potential benefits of previous spending will be forgone.

How will the 'fiscal situation' be defined?

What is unclear at the moment is how long this shift in policy will last. The economic uncertainty in 2020 meant that it made sense to conduct a one-year Spending Review in the autumn, but whether the government's policy towards aid

7 See https://ida.worldbank.org/sites/default/files/pdfs/ida19-contributors-list-april-2020.pdf.

8 EU contributions have typically represented around 10–11% of the ODA budget, but are expected to decline in both absolute and relative terms from 2021.

9 https://www.gov.uk/government/news/uk-aid-to-double-efforts-to-tackle-climate-change.

10 Bilateral ODA is earmarked by the donor to target specific countries, regions, or thematic spending areas. Multilateral ODA involves providing core funding to international institutions (for instance, the World Bank) which then allocate the funds to programmes.

is temporary or more long-standing will depend on how the government and others interpret its legal commitments in relation to the International Development (ODA Target) Act of 2015 and on how the 'fiscal situation' is defined.[11]

So far, the government has not indicated the fiscal metrics or circumstances which would allow the UK to return to spending 0.7% of GNI on ODA. However, in the 2021 Budget, the Chancellor set out the key principles that would guide the government's fiscal decision-making in the coming years, including that 'in normal times the state should not be borrowing to pay for everyday public spending' (HM Treasury, 2021). This suggests a desire to balance the current budget. After a large increase last year, the OBR's central forecast foresees a current budget deficit equal to 7.6% of GDP for 2021–22. The UK is not expected to return to a current budget balance until the end of the forecast period in 2025–26; in that year, it is forecast to do so exactly (Table 1). That forecast depends on some very tight spending settlements and is of course extremely uncertain given the uncertain path for the economy. Thus, while the reduction in aid spending may well be temporary, it should also not come as a surprise if it lasts for several years, and this may require a change in the law.

This is not to say that the fiscal context renders the cut in aid spending necessary, but it highlights the importance of consistency in terms of the rationale and expected duration of this policy change. If the rationale underpinning the reduction in the aid budget is the size of the UK's debt, then a temporary cut helps to achieve this a little, although in the context of the overall level of borrowing in this period, the impact is small. If it is an enduring budget deficit that the Chancellor is most concerned about, then a temporary cut will not impact the long-term fiscal outlook – a more permanent policy change would be needed.

[11] The Act identifies 'economic' and 'fiscal circumstances' as potential explanations for why the target may have been missed in a given year, and also requires that steps are taken to ensure the target is met in the subsequent year. Interpretations about the government's legal obligations currently differ in relation to the Spending Review announcement, and centre on whether it is possible to plan not to meet the target in advance.

Table 1. Forecasts for the UK's fiscal position (% of GDP)

	2013–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26
Current budget deficit	1.6	13.3	7.6	1.7	0.6	0.1	0.0
Public sector net debt	81.1	100.2	107.4	109.0	109.7	106.2	103.8

Note: Current budget deficit is defined as government receipts minus current spending, excluding net investment spending. Public sector net debt is defined as the public sector's total financial liabilities, minus liquid financial assets. The 2013–20 figure is an average of years in that period. The government met the 0.7% target during these years.

Source: Authors' analysis; OBR Public Finances Databank, March 2021.

Further clarity is needed

The uncertainty about policy in this area matters both for the broader public finances and other departmental spending allocations and for the long-term effectiveness of the UK's spending on international development.

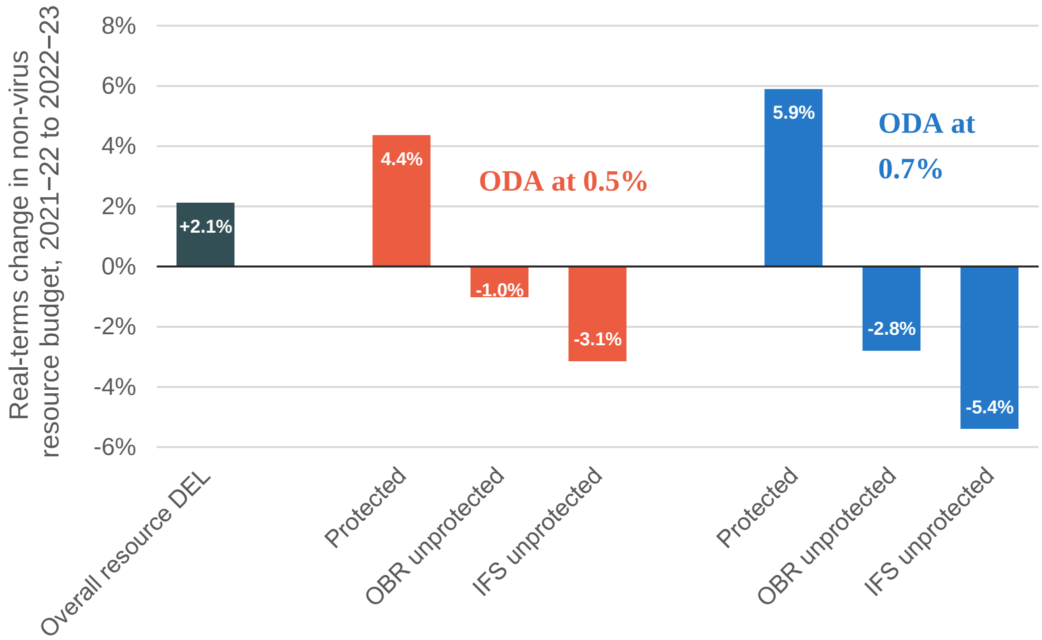
If the government does plan to return to ODA spend at 0.7% of GNI, this could be achieved by increasing borrowing – in which case the outlook for the deficit and public sector net debt will differ from what is outlined above – or by increasing taxes or reducing spending elsewhere (or some mixture of the three).

The government has not yet set out detailed plans for 2022–23 onwards, but the overall spending envelope pencilled in by the Chancellor and existing commitments to the NHS, schools and defence already imply a tight Spending Review settlement for departments whose budgets are unprotected. The OBR's figures currently suggest that unprotected departments face a real-terms spending reduction of 1% between 2021–22 and 2022–23 assuming that ODA stays at 0.5% of GNI; if ODA instead returns to its previous level, the implied real-terms spending reduction for these departments is 2.8%.[12] However, analysis at IFS has noted that the OBR's

[12] This is assuming that ODA expenditure falls under resource and not capital spending.

figures do not account for the consequentials of the Barnett formula (Zaranko, 2021). After accounting for this, returning ODA spend to 0.7% takes the real-terms spending reduction for unprotected departments from 3.1% to 5.4% (Figure 4).

Figure 4. Change in real-terms resource funding, 2021–22 to 2022–23



Note: Resource DEL refers to HM Treasury's definition of resource departmental expenditure limits excluding depreciation, and excluding exceptional COVID-19 spending.

Source: Based on Zaranko (2021), with calculations using HM Treasury's Spending Review 2020 and Budget 2021 and the OBR's March 2021 Economic and Fiscal Outlook.

The Chancellor's plans may well change in advance of the Spending Review later this year. There are already questions about whether they are deliverable given additional pandemic-related spending pressures, as well as the legacy costs from the backlog of spending that has been postponed. In this context, making further cuts to unprotected departments which already faced deep cuts in the preceding decade would likely pose significant challenges. Thus, while the arithmetic presented here does not actually hinge on decisions on aid spending alone, it underscores how decisions about aid expenditure interact more broadly with the government's fiscal objectives and spending pressures.

Beyond the public finance implications, abrupt changes in policy are unlikely to come without challenges for any area of government spending. However, there are a number of factors that make managing the aid budget and the aid target particularly sensitive to turning spending off and on again at short notice.

From a programming perspective, effective aid spending requires collaboration with international partners and a strong pipeline of projects to ensure choice and value for money, and this involves investments in identifying and scoping potential projects and in procurement and due diligence processes. Spending is disbursed across many countries and thematic areas, delivered through a network of multilateral institutions, non-governmental organisations and private sector suppliers in the UK, internationally and in recipient countries, and often relies on long planning and implementation horizons and the flexibility of multi-year budgets.

The government's practice of meeting the 0.7% target precisely (it has never been 'exceeded'), combined with its somewhat uncertain nature (Baker et al., 2018), and the calendar-year reporting requirements of the OECD DAC also pose a series of forecasting, financial management and accounting challenges which are distinct to aid spending (Independent Commission for Aid Impact, 2020). While independent commentators believe that the government has improved its capacity to respond to these challenges over time (National Audit Office, 2017; Independent Commission for Aid Impact, 2020), they interact with changes in the level of the target to create additional complexity.

Thus, without greater clarity about the future size of the funding envelope and sufficient time to plan and provisionally allocate spending in advance, it may become more difficult for the FCDO to manage the UK's aid spending successfully. DFID's planning prior to the UK first reaching the 0.7% target in 2013 began in 2010 and involved developing a larger portfolio of potential projects, adapting the size and composition of its workforce, and improving its focus on results (National Audit Office, 2015). Without similar planning, particularly if spending rises rapidly, there may be value for money risks associated with spend being rushed or directed to areas which can absorb future funding increases, rather than to projects which are most aligned with the government's objectives.

What is not in doubt is that whatever the level of spending on aid, the UK must ensure that its spend is, and continues to be, as effective as possible, not least to help mitigate the effects of COVID-19 in low- and middle-income countries and to prevent long-term scarring. The benefits to aid spending may be higher than usual at this time, with estimates from the World Bank suggesting that around 120 million people may have fallen back into extreme poverty as a result of the pandemic in 2020 (Lakner et al., 2021).

There was little mention of the aid budget in the recent Integrated Review of Security, Defence, Development and Foreign Policy, but the forthcoming development strategy should have clear and measurable objectives, a rigorous results framework, and be underpinned by robust budget allocation, project management, and monitoring and evaluation processes. Greater clarity about the government's aims, how future prioritisation will occur, and transparency about how priorities are mapped into an allocation mechanism and the effectiveness of spending would be welcome.

Conclusion

The projected reduction in UK aid spending of around 24% between 2020 and 2021 marks a steep one-year fall and a potentially significant policy change. The new role for the Foreign Secretary in overseeing aid spend across government could lead to greater coherence and accountability, but abrupt changes to any area of public spending can impact upon the quality of decision-making, and be disruptive and inefficient as policymakers have to cut what they practically can – which might not be what they would ideally cut if they had more time to plan.

The UK continues to face a challenging fiscal outlook, and in this context the government faces difficult decisions. Looking forward, while there may be debates to be had about the UK's level of spending on aid, how the temporary reduction in the aid budget fits into the government's medium-term fiscal plans is currently unclear. Providing further information about the direction of travel, including if and when new ODA legislation will be tabled, and how the Chancellor intends to assess when the UK should return to the 0.7% target, will be important to ensure the sound planning and management of both the public finances and the aid budget for 2022 and beyond.

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