2025 Spending Review

Paul Johnson's opening remarks

12 June 2025

You might not have gathered it from the Chancellor's speech, but there were some hard choices made in yesterday's spending review. After all, despite some of the rather odd recent claims, neither the economic forecasts nor the public finances have improved relative to the genuinely difficult situation we knew about a year ago. Rather the reverse.

Stepping back there are several important points of context.

First, over the parliament as a whole total departmental spending is set to grow at 2.3% a year above economy-wide inflation. It is worth recalling that it grew at 3.6% a year over the 2019-24 parliament. This is a long period during which spending will be growing faster than the economy which, given current OBR estimates – which are more optimistic than most – is set to grow by 1.5% a year over this parliament and grew by just 0.8% a year over the last. The result is that total departmental spending is rising as a fraction of national income – from 18.6% in 2019-20 to 20.7% in 2023-24 and 21.5% in 2028-29. That in itself is a substantial increase in the size of the state (most of it under the last government). Add to that pressure from state pensions, working-age social security and debt interest and you see how this really is a decade of a growing state. This is not a period of austerity.

Second, the growth is focused on capital spending. Between 2023-24 and 2028-29 capital spending (CDEL) is set to rise by 3.6% a year, more than double the day-to-day public service spending (RDEL) increases of 1.7%.

Investment spending as a fraction of GDP reached a recent low of 1.5% in 2013-14. It had climbed to 2.5% by 2023-24 and is set to average 2.6% over this parliament. Note that the real "achievement" of this government is not to increase investment spending as a fraction of national income but to maintain it at the high level the last government reached. The published plans of the last government, on the other hand, were to implement cuts over this parliament.

Third, the hard choices arise as a result of that lower increase in RDEL over the coming years and the fact that the NHS is getting increases of 3% a year. That left very little to share out among other departments and explains the cuts for Home Office, DEFRA and overseas aid, among others.

Health will get about 90% of the real terms increase in RDEL (excluding devolved governments) between 2025-26 and 2028-29. For a better sense of scale over the parliament and for total departmental spending, note that it gets 44% of the real terms increase in TDEL between 2023-24 and 2028-29.

By 2028-29 the Department of Health and Social Care will account for 41% of RDEL up from 39% in 2024 and just 26% in 2000-01. So an increase from around a quarter of day-to-day public service spending to a quite remarkable 40 per cent since the turn of the millennium. One has to question for how much longer this relentless increase can continue.

Of course, while spending reviews are supposed to provide full and final settlements they rarely do – they are nearly always reopened, especially in the last year of the SR period – and almost always in an upwards direction. Indeed we are due another spending review in 2027. Given the extent to which spending plans are front loaded this seems a particular risk this time. Day-to-day spending rose 2.6% last year and is due to increase by 2.5% this year then by 1.8% in 2026-27 and by just 1% in each of 2027-28 and 2028-29. If that last year's spending plans aren't topped up at some point I'll be very surprised indeed. So where might we see those pressures?

Oddly, there is a good chance they will arise from the two departments treated most generously yesterday.

Health spending nearly always gets topped up. Growth of 3% a year is below the historic average. It may not even prove enough to fund the official workforce plan and it is at best marginal whether it will be enough to achieve the government's waiting list targets.

Defence spending is rising to 2.5% of national income by 2027, but no increase thereafter. Given external demands and government promises to get it to 3% of GDP at an unspecified date in the next parliament there will be pressure to increase it further. And that's before any increase in the NATO spending target to more like 3.5%, which this government would presumably feel under some obligation to move towards.

Beyond those two the schools budget looks tight. Outside of additional spending on free school meals it is essentially flat in real terms. Falling pupil numbers should give some room for manoeuvre and result in a modest real increase in per pupil funding, but absent some serious cost-saving reforms, ever growing spending on special educational needs is likely to swallow much – or perhaps all – of that funding growth.

With day-to-day budgets growing so slowly there is not going to be much room for further significant increases in public sector pay. Perhaps last year's increases followed by a period of rises broadly in line with inflation will be enough to keep peace with the unions, and to recruit and retain as necessary. If not there could be trouble ahead.

We will have to wait and see whether the Home Office can really end spending on asylum hotels and hence achieve the savings they need to. The aid Budget is now pared back to its lowest level for a very long time. Will that be fully sustainable? It is unclear from the documentation how DEFRA is supposed to manage annual cuts to its RDEL of 2.7% a year for the whole five year period 2023-24 to 2028-29. The Treasury's reserve has been pared right back and is lower than it has been in recent years, leaving little space to deal with unforeseen pressures.

Capital spending

It was impossible to understand from Rachel Reeves' speech yesterday what is actually happening with capital spending. It sounded like huge increases across the board. Certainly investment spending is set to settle at a high level by UK standards. But there are choices.

We have tried to break capital spending down into four categories: defence, "growth focused", "net zero related" and public service related. Of course there are overlaps. Some of defence, net zero and public service spending should help growth, but that is not their primary purpose.

Annual investment spending is due to increase by around £44 billion a year between 2023-24 and 2029-30 in cash (not real) terms. Defence gets just over £14 billion of that, and net zero £9 billion. Those are the hands down clear priorities for capital spending. That's a 48% increase in the real terms Defence capital budget and a cool 140% for energy and net zero.

Various public services – health, education, housing, justice and home office – share another £9 billion between them. Science and transport, which you might think of as the explicitly growth focused elements get £5.6 billion. Transport does really quite poorly despite the slew of announcements – though that's in part due to lower spending on the disaster that is HS2

More specifics

These opening remarks are not the place to get into the details of the departmental allocations. My colleagues Bee Boileau and Max Warner will provide more on those. But it is worth bringing out a few points at this stage beyond those mentioned in the introduction.

We learnt something rather interesting about spending on the new childcare entitlement. It has turned out a lot more expensive than forecast. Spending plans for last year had already needed to be revised upwards by £500 million, or more than a quarter. The forecast gap in future years loomed even larger, and will likely only be partly filled by the top-ups announced yesterday. It seems parents are even more keen on taking up free provision than expected – especially those with children under the age of two. Adding new legs to the welfare state is an expensive business.

Local government in England did perhaps a little better than it might have expected – it has so often been at the back of the queue. Its core "spending power" is set to rise by 2.6% a year from next year. There is a sting in the tail though. This assumes that council tax bills will rise by 5% a year. Indeed, if English councils do choose 5% increases – and most are likely to – bills look set to rise at their fastest rate over any parliament since 2001-05. That might not be so bad if it weren't for the fact that those bills are based on property values in 1991, and that the system is regressive. Here's another plea to reform council tax. If you are going to increase your reliance on it surely you are under even more of an obligation to reform it into something more rational.

One part of the UK that is going to face some especially sharp choices is Scotland. Its RDEL funding from Westminster will rise not by 1.2% a year over the SR period but by just 0.8% a year. This is a result of the so-called "Barnett squeeze" which, as budgets rise, is designed ever so slowly to reduce the large gap in per capita spending between Scotland and England. (Spending per head in Scotland is still 20-25% higher than in England – hence "free" higher education and social care, higher public sector pay, and so on). Because the Scottish government is prioritising spending on welfare benefits, it could actually be looking at *cuts* in spending on public services in 2027-28.

The chancellor also talked about squeezing efficiencies out of the system. Good. She also stressed how this was a zero-based review, looking in detail at every aspect of spending. One wonders how effective that was. We can't find any particular area of spending the government has decided it wants to withdraw from – other, perhaps, than overseas aid. On the efficiency savings one thing is quite striking. It seems that virtually every department is ripe for exactly the same cut in its administration budgets – 10% for all of them over the three years to 2028-29 and then another 5% in one year, 2029-30 – irrespective of how much they might have grown recently, and irrespective of planned spending increase. That is not the result of a serious department by department analysis. I hesitate to accuse the Treasury of making up numbers, but…

Conclusions

My colleagues will add a good deal of colour to all of this. Let me offer a couple of concluding thoughts.

First, if you were baffled by the Chancellor's speech yesterday, so were we. It did not appear to be a serious effort to provide any useful information to anybody. I hope you find what we have to say somewhat more enlightening. To be fair to HM Treasury though the spending review document was a model of clarity. Thank you.

Second, nobody should be in any doubt that the chancellor has had some incredibly tough decisions to take and balancing acts to perform. The fiscal constraints are all too real and we can't have everything we might want. One can quibble over precise allocations but what we saw was a perfectly reasonable set of prioritisations. The real test will be in how well the money is spent, and especially how effectively the capital spending is spent and managed. That's the tough day-to-day business of government and, somewhat out of the spotlight of these big set piece events. It's on that more than anything that the government will be judged.

Third, this was not a "fiscal event" in the sense that total spending levels had already been announced. Ms Reeves is now going to have all her fingers and all her toes crossed, hoping that the OBR will not be downgrading their forecasts in the Autumn. With spending plans set, and "ironclad" fiscal rules being met by gnat's whisker, any move in the wrong direction will almost certainly spark more tax rises.