

4. Trade-offs for the forthcoming Spending Review

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Key findings

- **The Chancellor faces extremely tough choices over next year's Spending Review.** Keeping to the provisional spending totals used in the Spring Statement would mean continued cuts for many areas of public service spending. But increasing spending relative to these provisional plans would push him further away from his target of eliminating the deficit by the mid 2020s unless taxes are increased or spending cut elsewhere.
- **The government recently announced an increase in NHS spending of £20.5 billion over five years (£12.0 billion between 2019–20 and 2022–23).** Existing commitments on overseas aid and defence also mean that day-to-day spending on these areas is expected to increase by £0.6 billion between 2019–20 and 2022–23, and a continuation of the existing agreement with the Democratic Unionist Party (DUP) could entail an additional £0.3 billion a year of day-to-day funding for Northern Ireland.
- **These commitments would imply cuts to other areas of day-to-day spending amounting to £14.8 billion in 2022–23 if the provisional spending totals from the Spring Statement are kept to.**
- **After eight years of cuts to spending on public services, making more would be extremely difficult.** Increasing real earnings growth in the public sector also means future cuts to service spending would imply large reductions in government employment, after six years of relative stability.
- **The Chancellor may well therefore decide to increase overall spending on services relative to the provisional totals set out in March.** But doing so would require some combination of tax increases, higher borrowing and/or cuts to other spending, such as social security. None of these are easy options.
- **The additional uncertainty over the form and effects of Brexit make these decisions and trade-offs even harder.** Even ignoring the likely adverse effects of leaving the EU on economic growth and consequently tax revenues, there is likely to be virtually no 'Brexit dividend' over the next Spending Review period that could be diverted to fund public services. In 2022–23, net savings from contributions to the EU could be less than £1 billion a year, and higher UK administration costs – for customs, for example – could easily exceed this saving.

4.1 Introduction

According to his Spring Statement speech, at this year's forthcoming Budget the Chancellor will set a firm overall path for public spending for the years beyond 2019–20. At some point next year – perhaps in the Autumn 2019 Budget – this will be followed by a Spending Review to set detailed allocations for individual departments. The Chancellor described this two-stage approach as being 'how responsible people budget: first, they work out what they can afford; then they decide what their priorities are; and then they allocate between them'.¹

Total public spending in 2017–18 amounted to £789.5 billion, or 38.4% of national income. Within that, government spending on social security (such as pensions and welfare) and on debt interest payments amounted to around 10.7% and 2.2% of national income, respectively. Public sector net investment (capital spending on things such as roads and buildings) amounted to a further 2.0% of national income. The remainder, around three-fifths of the total, can be broadly referred to as 'day-to-day public service spending' and will be the focus of this chapter.

Figures 4.1 and 4.2 illustrate how these components of overall public spending (also known as total managed expenditure, or TME) have changed over time and how they are forecast to change based on the government's provisional (Spring Statement 2018) plans through to 2022–23. Between 2009–10 and 2017–18, day-to-day public service spending fell by 0.2% in real terms (6.0% in real per-person terms), falling to 23.6% of national income, the lowest level since 2002–03. Under the provisional Spring Statement plans, spending on day-to-day public services is forecast to fall further to 22.9% of GDP by 2022–23. This would be a slightly higher share of national income spent on day-to-day public services than experienced for much of the late 1980s and 1990s, but is low by the standards of the 1970s and similar to those of the 1950s and 1960s.

At the 2017 general election, the Labour party proposed substantial increases in public spending (and taxation). Their manifesto costed their public service policies as increasing day-to-day spending by £44 billion in 2021–22 (£41.9 billion in 2018–19 prices).² (This included a considerable increase in state funding for early years education and childcare support, real increases in per-pupil school funding, the scrapping of tuition fees and increased funding for social care.) A potential future Labour government would most likely update these plans in light of recent spending announcements and economic developments, but would almost certainly provide a very different offer on public services spending from the current government – one entailing a higher level of spending (funded through a combination of higher taxes and higher borrowing).

There is some evidence that there is an increased willingness from the public to pay more in tax to increase public spending. Figure 4.3 shows that support for increased tax and spending often exceeded 60% in the 1990s, before falling to a low of 32% in 2010. Since then, support for higher levels of tax and spending has grown, most sharply since 2014, and in 2017 reached 60% – the highest level in 15 years. Chapter 5 outlines possible

¹ *Hansard*, 13 March 2018, volume 637, <https://hansard.parliament.uk/Commons/2018-03-13/debates/CB15DC39-DCB5-4290-9045-73BFCEFDAC16/SpringStatement>.

² R. Crawford, 'General election 2017, manifesto analysis: spending on public services', IFS, 2017, <https://www.ifs.org.uk/publications/9258>.

Figure 4.1. Total managed expenditure and its components over time in real terms

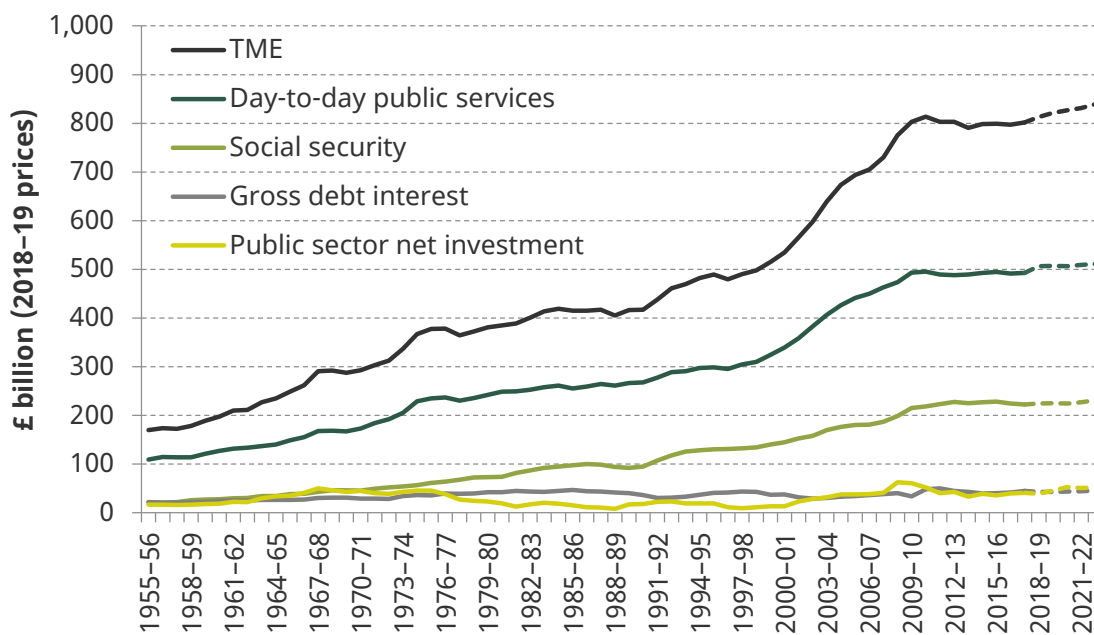
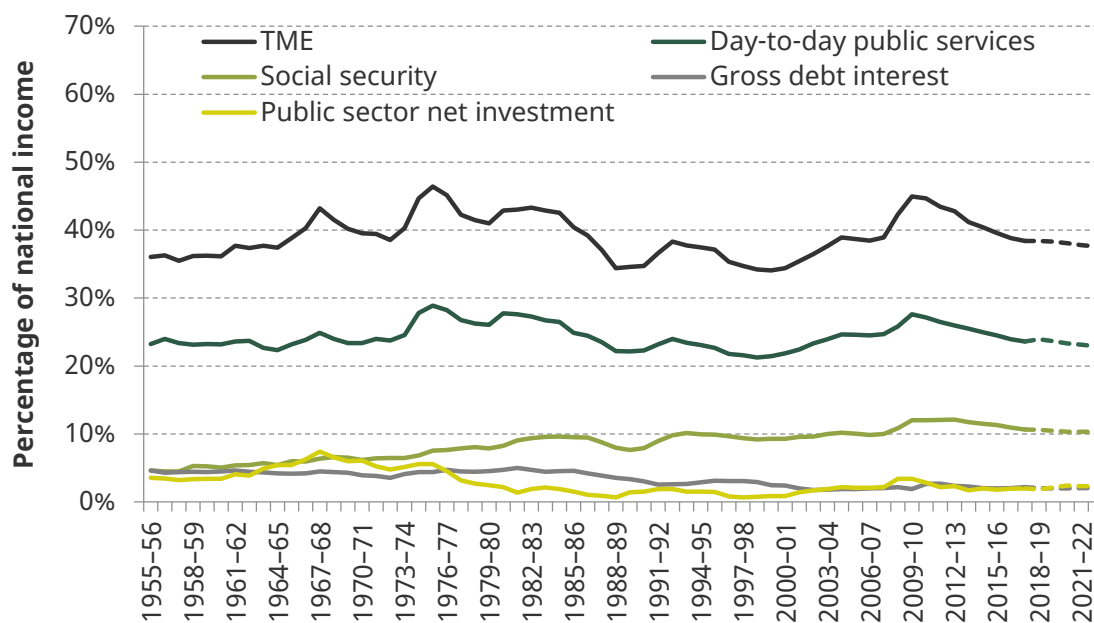
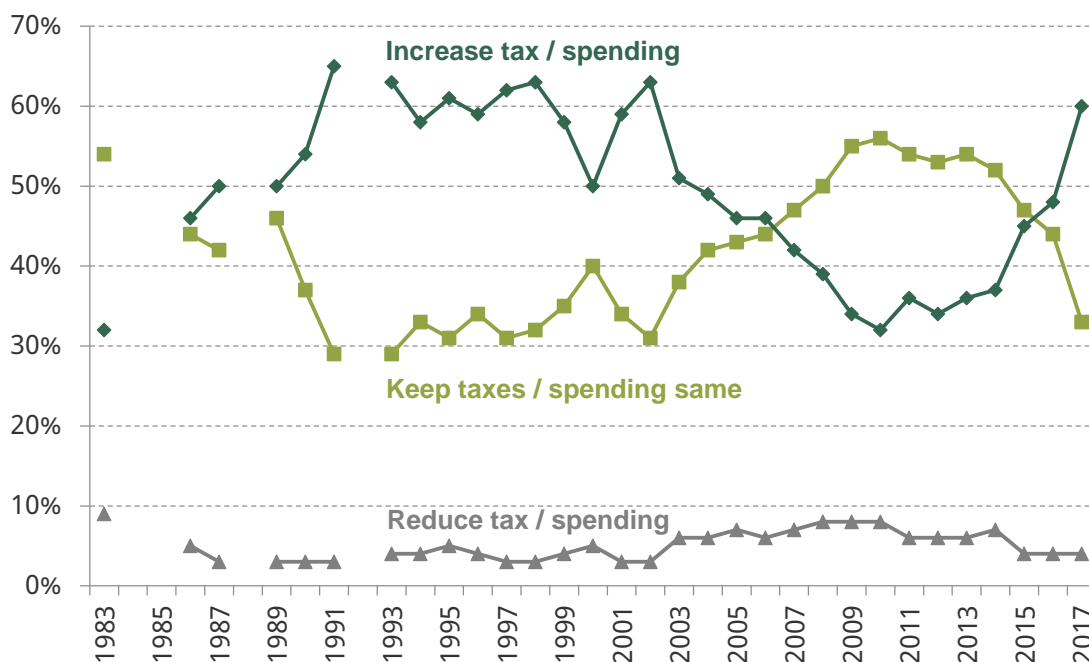


Figure 4.2. Total managed expenditure and its components over time as a percentage of GDP



Note for Figures 4.1 and 4.2: Day-to-day public service spending is defined here as total managed expenditure less spending on social security, gross debt interest and public sector net investment. Dotted lines show forecasts on the basis of March 2018 provisional spending plans.

Source for Figures 4.1 and 4.2: Total spending, net investment and nominal GDP are from the OBR’s Public Finances Databank (accessed 20 July 2018). GDP deflators are from HM Treasury, June 2018 release, <https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-june-2018-quarterly-national-accounts>. Social security spending is from DWP benefit expenditure tables 2018, <https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2018>. Gross debt interest is ONS series JW2P, with forecasts from supplementary fiscal table 2.38 of the OBR’s March 2018 Economic and Fiscal Outlook.

Figure 4.3. Percentage of people reporting different preferences for levels of tax and spending

Source: British Social Attitudes Survey, <http://www.bsa.natcen.ac.uk/latest-report/british-social-attitudes-34/key-findings/context.aspx>; 2017 figures from <http://natcen.ac.uk/news-media/press-releases/2018/september/support-for-more-tax-spend-at-fifteen-year-high/>.

options for tax rises and the revenue they might raise. Nevertheless, the final decision on how to strike a balance between tax rises and spending cuts lies with the government.

In the coming months, the Chancellor will need to make a number of difficult choices. First, in setting the overall spending envelope (or, in his words, deciding what he can afford), Philip Hammond will have to balance carefully any extra spending against the additional tax or borrowing required to fund it. He will then need to trade off spending on public services against spending on social security, and balance the competing demands of ministers and departments, to determine his priorities and set detailed plans for the years ahead.

This chapter sets out the context for the spending choices facing the Chancellor, considers the necessary trade-offs and describes some of the possible implications for public service spending.

The last Spending Review, published alongside the Autumn Statement in November 2015, laid out plans for day-to-day departmental spending for the four years up to and including 2019–20.³ At next year's Spending Review, the Chancellor has indicated that plans will be set for 2020–21 onwards, but he has not confirmed which years will be covered. A longer review period has the advantage of giving departments greater certainty over their likely

³ With the exception of the NHS, the Ministry of Defence and the Security and Intelligence Agencies, for which resource budgets were also set for 2020–21. All departments' capital budgets were also set up to 2020–21 at the 2015 Spending Review.

⁴ Of course, in practice, the government can – and does – alter departmental budgets relative to the 'firm and

future resources, which can aid long-term planning and lead to better policymaking. The downside, however, is that ‘locking in’ spending plans for a longer period can mean the government has less ability to respond to changes in economic, fiscal and/or societal circumstances.⁴ This might be a particular concern at the moment given the uncertainty surrounding the UK’s forthcoming departure from the European Union. The government may also be reluctant to make spending commitments beyond the end of the parliament, with the next general election timetabled for May 2022, since such plans are typically seen as less credible (as there is nothing binding a future government to stick to them). Given that, we proceed under the assumption that a Spending Review in 2019 would primarily be focused on setting departmental allocations for 2020–21, 2021–22 and 2022–23. But it is quite possible the Chancellor will decide that the forthcoming Spending Review should cover a shorter period.

We start in the next section by discussing what the government’s latest fiscal plans, set out in the March 2018 Spring Statement, imply for public services. Section 4.3 looks at recently announced and existing spending commitments, and the implications those have for other areas of public service spending. Section 4.4 discusses how the government could choose to alter the overall level of spending on public services, while Section 4.5 examines the prioritisation of different spending areas in past Spending Reviews and the implications of the government’s plans for some public services. Section 4.6 concludes.

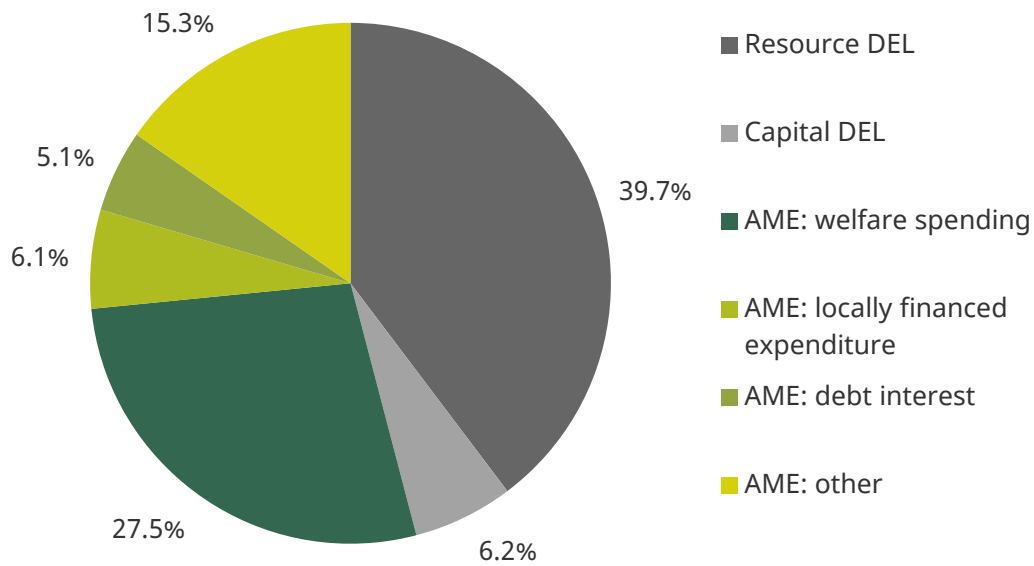
4.2 What do current fiscal plans imply for public service spending?

For planning spending on public services, the government uses a definition of public spending known as ‘departmental expenditure limits’, or DEL. This can broadly be thought of as central government spending by departments on the delivery and administration of public services. In 2017–18, it accounted for 45.9% of total government spending. Each department’s budget (or DEL) is split into a resource (day-to-day) and capital (investment) budget, which are referred to as RDEL and CDEL. Box 4.1 describes in more detail how DEL sits within total public spending.

Box 4.1. Total public spending, DEL and the ‘Spending Review envelope’

Departmental expenditure limits (DEL) are intended to encompass spending that can be controlled (rather than being driven by, for example, the economic cycle) and are what is allocated between departments in multi-year settlements in Spending Reviews. The remainder of spending – that which the government argues cannot reasonably be subject to firm multi-year limits – is classified as **annually managed expenditure** (AME), and includes the components of spending that are more difficult to plan in advance, such as debt interest payments, social security and tax credits. The portion of local authority spending that is financed through local sources (such as business rates and council tax) is also included within AME as ‘locally financed expenditure’. DEL and AME sum to give **total managed expenditure** (TME), or overall public spending. Figure 4.4 shows the breakdown of TME into these components in 2017–18.

⁴ Of course, in practice, the government can – and does – alter departmental budgets relative to the ‘firm and fixed’ plans set out in Spending Reviews when the need or desire arises. See R. Crawford, P. Johnson and B. Zaranko, *The Planning and Control of UK Public Expenditure, 1993–2015*, IFS Report R147, 2018, <https://www.ifs.org.uk/publications/13155>.

Figure 4.4. Components of TME in 2017–18

Source: Table 4.16 of the OBR's March 2018 Economic and Fiscal Outlook. Other components of AME include, for example, net public service pension payments, spending by the BBC and public corporations, current VAT refunds and expenditure transfers to EU institutions.

The autumn Budget is expected to announce a path for public spending for a number of years beyond 2019–20 (as discussed in Section 4.1, potentially the three years 2020–21 to 2022–23 inclusive). However, it is not clear which elements of public spending will fall within the scope of these plans. The Chancellor has not yet announced whether he is planning to set out a firm total DEL envelope for that period, or whether he will set out a firm envelope for DEL plus some items of AME such as social security, or even a firm envelope for TME.

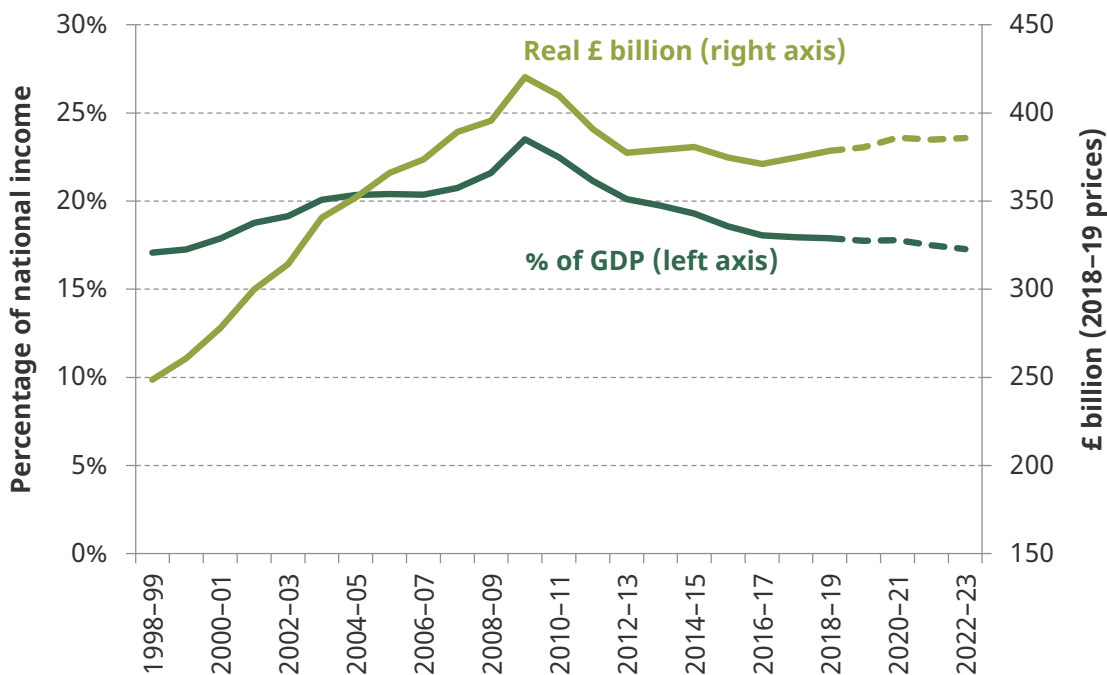
The last option is perhaps unlikely, as it would mean that future deviations in AME from what is forecast would automatically have to be offset by changes to other spending, rather than leaving open the option of responding to unforeseen future events by changing taxes or borrowing. However, including aspects of AME in the spending envelope set in the Budget leaves open the option of making changes to those areas at the time of the Spending Review next year – as happened in the 2010 and 2015 Spending Reviews.^a On the one hand, it makes sense to consider all public spending together and trade off extra spending on benefits with extra spending on public services when decisions on priorities are being made. On the other hand, if the government is not considering further changes to benefit spending, it would be more transparent to set out the total DEL envelope in advance.

For the purposes of this chapter, we describe the process as the Chancellor setting the DEL envelope – by trading off additional DEL spending relative to provisional plans against the ‘cost’ in terms of lower spending elsewhere or higher taxes or borrowing – and then allocating the spending between departments within that DEL envelope. However, this is essentially just an expositional choice. The set of decisions that need to be made between now and the publication of the 2019 Spending Review, the trade-offs involved, and our quantitative analysis of the implications of those decisions are the same irrespective of precise timing of the decision over whether or not to change AME relative to current plans set out in the 2018 Spring Statement.

^a The 2013 Spending Round covered one year of DEL budgets only (2015–16).

Figure 4.5 shows that departmental spending increased steadily over the course of the 2000s: between 1998–99 and 2009–10, total DEL (or TDEL, which is the sum of RDEL and CDEL) grew by an average rate of 4.9% per year in real terms, increasing from around £250 billion to more than £420 billion (in 2018–19 prices). This trend was then reversed: between 2009–10 and 2017–18, total DEL fell by more than £45 billion, equivalent to a cut of 10.9% in real terms, or an average cut of 1.4% per year.

Figure 4.5. Total departmental expenditure



Source: Authors’ calculations using the OBR’s March 2018 Economic and Fiscal Outlook, HM Treasury’s Public Expenditure Statistical Analyses (various) and June 2018 GDP deflators.

Going forwards, the government has firm plans for TDEL up to and including 2019–20 (and for CDEL up to and including 2020–21), with spending plans for individual departments having been set out in the 2015 Spending Review. However, the Spring Statement in March 2018 also included ‘provisional totals’ for DEL for the years up to and including 2022–23. While these are not firm plans for how much the government is going to spend in those years – the overall path for public spending is expected to be confirmed in the

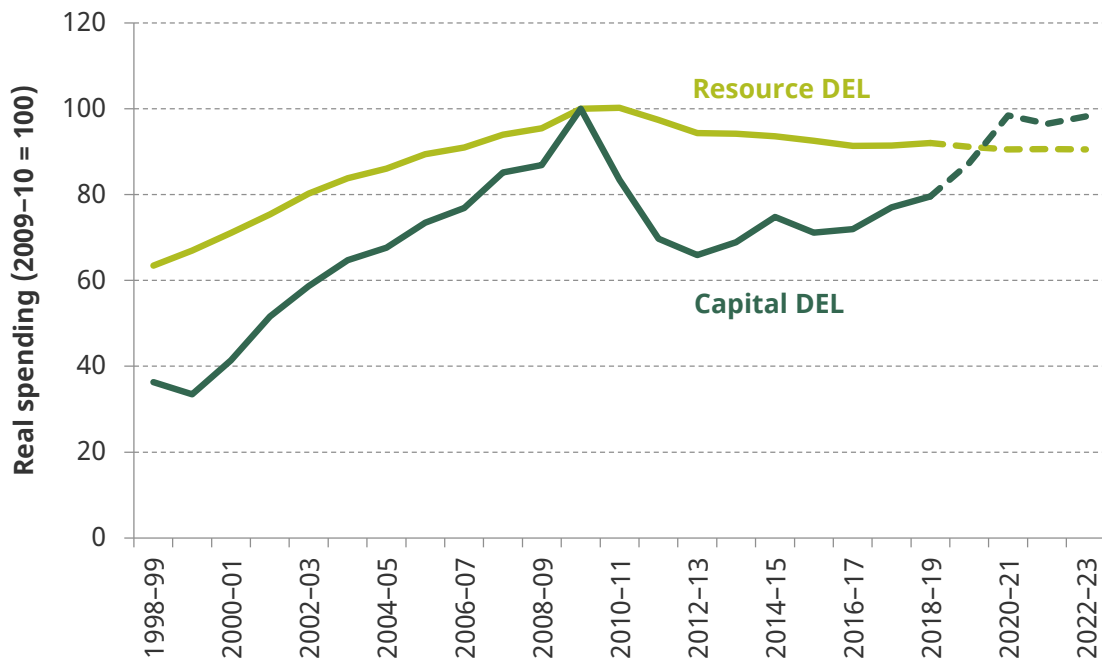
upcoming Budget and will influence departmental allocations – they are still a valuable benchmark. These provisional plans are what are assumed in the Office for Budget Responsibility (OBR)'s latest forecasts for government borrowing. Therefore, while the government is free to set a different path in the upcoming Budget, any change in DEL relative to these provisional totals would require a change in borrowing relative to what is currently forecast, new tax policies and/or other policies that alter non-DEL ('AME') spending.

On the basis of the provisional totals set out in the 2018 Spring Statement, total DEL is forecast to grow by 0.6% per year in real terms between 2017–18 and 2022–23 (0.5% per year between 2019–20 and 2022–23).

Departmental spending can also be measured against the size of the population to whom services are provided or the overall size of the economy. In per-person terms, TDEL is forecast to stay flat between 2017–18 and 2022–23 (and fall by 0.1% per year between 2019–20 and 2022–23). As a share of national income, departmental expenditure is forecast to fall back to around the level it was at the end of the 1990s.

Resource (day-to-day) spending accounts for the lion's share of departmental expenditure, with RDEL representing 86% of TDEL in 2017–18.⁵ Figure 4.6 shows that in the run-up to 2009–10, capital spending increased at a more rapid rate than resource spending. In the years after 2010, while the majority of the cuts in cash terms came from the resource budget (owing to its greater size), the cuts made to capital spending were

Figure 4.6. Resource and capital departmental expenditure limits



Source: Authors' calculations using the OBR's March 2018 Economic and Fiscal Outlook, HM Treasury's Public Expenditure Statistical Analyses (various) and June 2018 GDP deflators.

⁵ Note that here, and throughout, RDEL and CDEL stand for resource and capital departmental expenditure limits, respectively, and refer to OBR definitions (PSCE in RDEL and PSGI in CDEL) rather than Treasury definitions.

Table 4.1. Spending changes implied by Spring Statement 2018 provisional totals

	2019–20 to 2022–23		2010–11 to 2022–23	
	Average annual real growth	Change (£ billion, 2018–19 prices)	Average annual real growth	Change (£ billion, 2018–19 prices)
TME	+0.7%	+18.3	+0.3%	+25.7
<i>of which:</i>				
AME	+1.0%	+13.0	+1.0%	+49.8
DEL	+0.5%	+5.3	-0.5%	-24.1
<i>of which:</i>				
RDEL ^a	-0.2%	-2.0	-0.8%	-34.0
CDEL ^a	+4.0%	+7.2	+1.4%	+10.0

^a RDEL and CDEL stand for resource and capital departmental expenditure limits, respectively, and refer to OBR definitions (PSCE in RDEL and PSGI in CDEL) rather than Treasury definitions. A reconciliation is published by the OBR: see supplementary fiscal table 2.18 at the March 2018 Economic and Fiscal Outlook.

Note: Figures may not sum due to rounding.

Source: Authors' calculations using table 4.16 in the OBR's March 2018 Economic and Fiscal Outlook, June 2018 GDP deflators and the OBR's Public Finances Databank (accessed 20 July 2018).

deeper in percentage terms. However, since 2012–13, CDEL has been gradually increased in real terms, while RDEL has continued to be cut.

On the basis of the provisional plans in the 2018 Spring Statement, resource and capital DEL are set to follow very different paths between 2019–20 and 2022–23. Capital spending is forecast to grow at an average real rate of 4.0% per year, while resource DEL is facing cuts of an average 0.2% per year. This is summarised in Table 4.1. Given expected population growth, these would equate to cuts in per-person spending of an average 0.7% per year for RDEL and increases of 3.4% per year for CDEL. To hold RDEL constant in per-person terms would require a £5.1 billion real-terms increase in spending (0.5% per year).

This divergence reflects the fact that, amidst wider spending constraint and cuts to departments' day-to-day spending, the Chancellor has consistently prioritised investment spending. The 2016 Autumn Statement announced a new National Productivity Investment Fund (NPIF) to target spending at areas the government judges to be critical for productivity: housing, research and development (R&D), and economic infrastructure, including transport and digital communications.⁶ The NPIF was then expanded at the 2017 Autumn Budget. A detailed breakdown is not available, but of the £31.2 billion announced by November 2017, the Treasury had allocated £7.1 billion for R&D, £4.9 billion for transport, £11.6 billion for housing and £740 million for digital infrastructure.⁷ Accordingly, the departments set to see substantial increases in their capital budgets include the

⁶ HM Treasury, *Autumn Statement 2016*, <https://www.gov.uk/government/publications/autumn-statement-2016-documents>.

⁷ Table 4.1 of HM Treasury, *Autumn Budget 2017*, <https://www.gov.uk/government/publications/autumn-budget-2017-documents>.

Department for Transport and the Ministry for Housing, Communities and Local Government.

On the face of it, the planned cuts to resource budgets of 0.2% per year, or £2.0 billion between 2019–20 and 2022–23, might appear relatively modest. However, it is important to bear in mind two things. First, cuts to departments' day-to-day budgets between 2019–20 and 2022–23 would come on the back of the considerable cuts already made since 2010, which amount to £32.0 billion. While the scale of the planned further cuts is much smaller, additional cuts to departmental budgets could have important consequences for the quality and delivery of public services – and therefore for whether those cuts could be sustained politically; this is discussed in more detail in Section 4.5.

Second, the government recently announced a significant increase in spending on the NHS beyond 2019–20, and already has a number of other spending commitments which, if kept, would together tie up a significant chunk of public service spending. This means that, for overall resource spending to fall in line with the figures set out in Table 4.1, the cuts to unprotected public service spending need to be substantially greater than 0.2% per year. This is discussed in more detail in the next section.

4.3 A responsible way to budget?

In March, Mr Hammond indicated that he intended to set a firm overall spending limit before making individual departmental allocations, suggesting that this is 'how responsible people budget'.⁸

Despite this assertion, the government has subsequently announced a generous funding settlement for the NHS between 2018–19 and 2023–24 (in advance of setting any overall spending envelope). This is not the first time the NHS has received special treatment in the context of public spending decisions. But the scale of the planned increase in NHS spending is so large that the path for overall spending may need to be revised to accommodate it. That would rather be a case of the NHS tail wagging the fiscal dog.

It is not immediately obvious that the Chancellor's originally proposed two-stage approach is in fact the optimal way to budget. Of course, affordability is a key consideration; spending decisions should not be made without thought for the consequences, in terms of the taxes or borrowing required to pay for them. However, it also seems odd to decide what is 'affordable', and to fix total spending at that level, without considering what the consequences would be for individual services. The additional taxes that the public would be prepared to pay may well depend on the quantity and quality of public services that they would receive in return. In any case, the way the government has deviated from the approach outlined in March – announcing a substantial NHS settlement without seeming to factor in how it will be funded, or the implicit consequences for other public services if no additional funding is found – certainly leaves a lot to be desired. If the government is to have a Spending Review, all public spending should be considered at the same time – ideally alongside the related issue of how much to raise in taxes and how much it is sensible to plan on financing through borrowing.

⁸ *Hansard*, 13 March 2018, volume 637, <https://hansard.parliament.uk/Commons/2018-03-13/debates/CB15DC39-DCB5-4290-9045-73BFCFEDAC16/SpringStatement>.

The government also has pre-existing commitments over the level of some other areas of spending, including defence and overseas aid. The detail of these commitments is described below (and discussed further in Chapters 7 and 8 respectively) but, all in all, these 'protected' areas amount to almost half of the total resource budget. Spending on these areas will need to increase in real terms if the government is to honour its commitments. The implied cut to unprotected departments is therefore far greater than that to overall DEL, as set out in the following subsection.

Recent announcements and other spending commitments

NHS

The 2015 Spending Review provided a five-year settlement for the Department of Health, setting budgets up to 2020–21. The 2017 Autumn Budget announced additional funding for the NHS up to 2022–23, and in June 2018 the government set out a new five-year funding plan for the NHS in England.⁹ It was announced that funding for front-line services in England would increase by an average real rate of 3.4% over the five years, meaning an extra £20.5 billion of spending in real terms in 2023–24 relative to 2018–19. Over the period we assume is covered by the next Spending Review (2019–20 to 2022–23), the plans imply a £12.0 billion increase in spending (3.3% per year), with an estimated additional £2.1 billion (in 2018–19 prices) of implied funding for Scotland, Wales and Northern Ireland as a result of Barnett consequentials.¹⁰

The 3.4% increases apply only to the NHS England resource budget; capital budgets are not covered, and nor are the non-NHS elements of the Department of Health and Social Care, such as public health initiatives and medical research. The government has not yet indicated whether spending outside of the NHS England resource budget will be protected; however, history suggests this is unlikely. NHS capital budgets have repeatedly been raided in recent years to fund additional day-to-day spending,¹¹ and non-NHS health spending has been cut while NHS spending has increased.¹²

Overseas aid

The government has a longstanding commitment to meet the United Nations target of spending 0.7% of gross national income on official development assistance (ODA) each year. This target, and the changes in the UK's ODA spending over time, are discussed in further detail in Chapter 8. In line with the government's legislative commitments and a cross-party consensus, we assume that ODA remains at 0.7% of national income over the Spending Review period and that, within the total, capital spending on ODA increases in

⁹ 'Prime Minister sets out 5-year NHS funding plan', HM Treasury and DHSC press release, 18 June 2018, <https://www.gov.uk/government/news/prime-minister-sets-out-5-year-nhs-funding-plan>. Further details of the financial settlement were published alongside the press release (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/717765/nhs-settlement-numbers.pdf).

¹⁰ Barnett consequentials refer to the additional funding that would be allocated to Scotland, Wales and Northern Ireland as a result of increased public service spending in England (which the devolved governments would not necessarily have to spend on health).

¹¹ At least £1 billion was switched from Department of Health CDEL to RDEL in 2015–16, 2016–17 and 2017–18. Source: Chapter 3 of Public Expenditure Statistical Analyses 2016, 2017 and 2018, <https://www.gov.uk/government/collections/public-expenditure-statistical-analyses-pesa>.

¹² D. Luchinskaya, P. Simpson and G. Stoye, 'UK health and social care spending', in C. Emmerson, P. Johnson and R. Joyce (eds), *The IFS Green Budget: February 2017*, <https://www.ifs.org.uk/uploads/publications/budgets/gb2017/gb2017ch5.pdf>.

line with overall CDEL at 4.0% a year.¹³ This implies that resource spending on ODA within DEL would grow by 0.2% per year in real terms. While most UK ODA spending is within DEL, some ODA done by the EU (broadly the proportion funded by UK contributions) also (sensibly) counts towards meeting the UK's 0.7% commitment. In 2017, this amounted to around £0.9 billion. Future UK–EU arrangements over aid spending are uncertain, but should a proportion of EU ODA spending no longer count towards the UK target, it would need to be replaced by additional UK ODA spending if the government is to continue to meet its 0.7% of national income commitment.

Defence

Members of NATO commit to a target of spending 2% of GDP on defence. The UK government has met this target in each of the last eight years.¹⁴ The NATO definition of spending is broader than the core Ministry of Defence (MoD) budget and includes, for example, the cost of current military operations (which have in recent years been met from the Treasury Special Reserve), pensions for military personnel, and spending by intelligence services in support of military activities. (This is discussed in more detail in Chapter 7.) In our analysis, we assume that the MoD budget and the Single Intelligence Account (SIA), which funds the UK's intelligence agencies, increase in line with GDP. Assuming that MoD and SIA capital budgets grow by 4.0% per year (in line with overall CDEL), this implies real growth of 0.5% per year in RDEL for those departments.

Northern Ireland

The 2017 Confidence and Supply Agreement between the Conservatives and the Democratic Unionist Party (DUP) included additional financial support for Northern Ireland. The agreement promised approximately £910 million in extra funding over two years, with almost half of this going towards infrastructure projects.¹⁵ The 2018–19 budget settlement, published in the absence of an Executive and Assembly in Northern Ireland, includes £410 million from the Confidence and Supply Agreement.¹⁶ Looking forward, a continuation of such an agreement could entail additional funding for Northern Ireland. We make the illustrative assumption that the government would provide an additional £500 million in each of the years of the Spending Review period, but that this would be time-limited and not cumulative. Of that extra funding, we assume that roughly half is for capital projects (in line with the 2017 Confidence and Supply Agreement) and found from within the existing CDEL budget, leaving around £250 million of additional day-to-day spending allocated to Northern Ireland.

Implications for unprotected areas

In total, spending on NHS England, official development assistance, defence and intelligence is estimated to account for almost half of total budgeted resource spending in 2019–20, and the government's existing commitments imply an increase of 2.6% per year across these protected areas. Table 4.1 showed that under current plans, total RDEL will

¹³ We have made the additional assumption that the capital intensity of the ODA budget is the same as that for the Department for International Development.

¹⁴ N. Dempsey, 'UK defence expenditure', House of Commons Library Briefing Paper CBP 8175, 2018, <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8175>.

¹⁵ Cabinet Office, 'UK government financial support for Northern Ireland', June 2017 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/621797/UK_Govt_financial_support_for_Northern_Ireland.pdf.

¹⁶ 'Written Ministerial Statement: Northern Ireland finances', 8 March 2018, <https://www.gov.uk/government/news/written-ministerial-statement-northern-ireland-finances>.

fall by 0.2% per year in real terms over the next Spending Review period. However, given the government's pre-existing commitments outlined above, the implied cuts to 'unprotected' departments are far greater: to maintain existing plans for RDEL, while meeting the commitments to the NHS, defence, intelligence and overseas aid, day-to-day spending on everything else would need to fall by 3.1% per year on average. That is equivalent to a cut of £14.6 billion between 2019–20 and 2022–23, rising to £14.8 billion if the government provides an additional £250 million of resource funding to Northern Ireland each year as part of a new confidence and supply agreement. This is summarised in Table 4.2.

Between 2010–11 and 2018–19, day-to-day spending on roughly these 'unprotected' areas was reduced by around 3% per year.¹⁷ The government's Spring Statement provisional

Table 4.2. Real-terms changes to departments' DEL, 2019–20 to 2022–23, implied by Spring Statement 2018 provisional totals

	2019–20 to 2022–23		
	Average annual real growth	Cumulative real growth	Change (£ billion, 2018–19 prices)
Total DEL	+0.5%	+1.4%	+5.3
<i>of which:</i>			
CDEL	+4.0%	+12.3%	+7.2
RDEL	–0.2%	–0.6%	–2.0
<i>of which:</i>			
NHS England RDEL	+3.3%	+10.1%	+12.0
Defence and intelligence RDEL	+0.5%	+1.7%	+0.5
ODA RDEL	+0.2%	+0.7%	+0.1
RDEL less NHS-E, defence and ODA	–3.1%	–9.0%	–14.6
Additional Northern Ireland funding			+0.3
Unprotected RDEL	–3.1%	–9.3%	–14.8

Note: Calculated on the basis of assumptions outlined in the text. Growth rates are calculated using departmental resource budgets excluding depreciation. Figures may not sum due to rounding.

Source: Authors' calculations using the OBR's March 2018 Economic and Fiscal Outlook, HM Treasury's Public Expenditure Statistical Analyses 2018 and June 2018 GDP deflators. Details on the NHS England funding settlement are taken from HM Treasury note published alongside the announcement (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/717765/nhs-settlement-numbers.pdf).

¹⁷ This past growth rate is calculated for 'unprotected' RDEL defined as PSCE in RDEL less resource spending on ODA, defence, the Department of Health (since figures on spending by 'NHS England' are not available back to 2010–11) and intelligence (where intelligence spending is assumed to have grown at the same rate as defence spending between 2010–11 and 2011–12).

plans therefore imply three further years of cuts to ‘unprotected’ spending at around the same pace as experienced since 2010.

4.4 Options for cutting by less

The scale of cuts required to unprotected departments, on top of the squeeze they have experienced since 2010–11, means that cutting spending to meet the 2018 Spring Statement provisional totals would be extremely challenging. The Chancellor might instead wish to reduce the scale of cuts planned. This would require additional spending relative to his March 2018 provisional plans, however, and that spending would need to be funded from somewhere – either through higher borrowing, tax rises, or cuts to spending elsewhere (such as social security, investment or contributions to the European Union).

Of course, this assumes that forecasts for economic growth turn out as forecast in the March 2018 Spring Statement. We maintain that assumption throughout this chapter, but it is important to note that the most important factor determining the health of the public finances is the performance of the economy. Should economic growth turn out better than forecast, tax revenues are likely to be higher, AME spending potentially lower, and any given cash amount of expected borrowing would represent a smaller proportion of national income. If this improvement is thought to be permanent, the Chancellor could decide to use some of the windfall to boost spending on public services. In March, Mr Hammond indicated his willingness to do just that,¹⁸ and Chapter 3 shows that this is how chancellors have tended to respond to underlying improvements in the borrowing forecast since 2010.

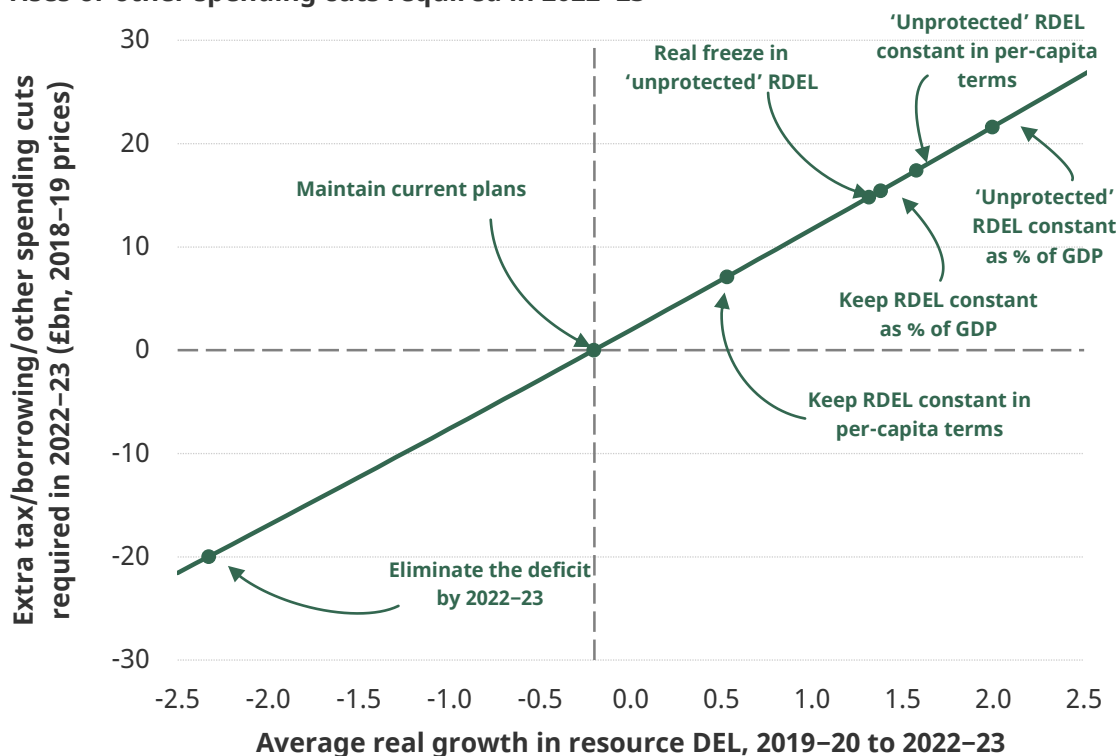
However, the converse is also true: if the performance of the economy is expected to be weaker in future than was forecast in the Spring Statement, then the Chancellor may have even less scope for spending on public services than our figures in this chapter suggest. Given the UK’s forthcoming departure from the European Union, and the resulting highly uncertain nature of economic forecasts for the next few years, this is a particularly difficult time for the government to be making firm plans for spending on public services.

Alternative spending scenarios

Figure 4.7 illustrates the trade-off between extra resource DEL spending on the one hand and the tax rises, borrowing or other spending cuts required to pay for it on the other. The point where the axes cross represents the growth rate implied by the government’s existing fiscal plans. All points on the line to the left of the vertical axis represent scenarios where day-to-day departmental spending increases by *less* than forecast at the March Spring Statement, while those to the right illustrate scenarios where departmental spending increases by *more* than the Spring Statement plans. The vertical axis then shows the additional resource spending in real £ billion relative to the 2018–19 baseline, with points higher than the horizontal axis requiring the government to find extra spending cuts, tax rises or borrowing relative to what is (provisionally) planned.

¹⁸ ‘If, in the Autumn, the public finances continue to reflect the improvements that today’s report hints at ... I would have capacity to enable further increases in public spending and investment in the years ahead’ (Philip Hammond, Spring Statement speech, March 2018, <https://www.gov.uk/government/speeches/spring-statement-2018-philip-hammonds-speech>).

Figure 4.7. Trade-offs between real growth in resource DEL and extra borrowing, tax rises or other spending cuts required in 2022–23^a



^a All illustrative scenarios assume that economic growth and tax revenues would be unaffected by the decision to make greater or smaller cuts to departments’ resource budgets.

Note: Any extra spending in 2022–23 is relative to the projections published in the OBR’s March 2018 Economic and Fiscal Outlook. The growth rate is calculated for resource DEL (as measured by PSCE in RDEL) against the 2019–20 baseline published in the Economic and Fiscal Outlook. The ‘Keep RDEL constant in per-capita terms’ scenario assumes that real resource spending grows in line with the UK population. ‘Unprotected’ RDEL refers to RDEL less resource budgets for NHS England, defence, the Single Intelligence Account, ODA and additional funding for Northern Ireland.

Source: As for Table 4.2, with population projections from supplementary fiscal table 2.17 in the OBR’s March 2018 Economic and Fiscal Outlook.

A number of potential policy options are highlighted in Figure 4.7 by points on the line. For example, keeping RDEL constant in per-capita terms would require an additional £7.1 billion (relative to Spring Statement provisional plans), while keeping RDEL constant as a share of national income would require £15.5 billion by 2022–23. Focusing on unprotected RDEL spending (given the commitments set out above), a real-terms freeze would require £14.8 billion; a real-terms per-capita freeze would need £17.4 billion; and an increase in unprotected RDEL in line with national income would need £21.6 billion of additional spending. This final scenario, however, would mean day-to-day spending on ‘unprotected’ areas growing faster than spending on ODA, defence and security. Should the government wish to increase day-to-day spending on those areas in line with national income also, it would require £22.7 billion of extra spending by 2022–23.

Table 4.3 summarises a subset of these scenarios, showing both the implied percentage and £ billion change in RDEL spending, and the implications for total DEL given the provisional plans for capital spending set out in the Spring Statement. For instance, to

freeze unprotected RDEL in real terms, while honouring all of the government's pre-existing spending commitments, would require tax rises, additional borrowing or spending cuts elsewhere of an extra £14.8 billion by 2022–23 (as was shown in Table 4.2 and Figure 4.7). This would leave RDEL broadly unchanged as a share of national income. If the government's plans for capital DEL (4.0% growth per year) are left unchanged, this would imply annual real growth in total DEL of 1.7% per year over the Spending Review period.

Financing additional spending on public services would not be costless, however, regardless of who is in power. As mentioned above, extra day-to-day spending would

Table 4.3. Extra tax or borrowing under illustrative scenarios, assuming capital budgets left unchanged^a

	Eliminate deficit by 2022–23	Current plans	Real freeze in unprotected RDEL	Unprotected RDEL constant in per-capita terms
Extra tax/borrowing/other (non-DEL) spending cuts	–£20.0bn	£0	+£14.8bn	+£17.4bn
<i>Average annual real growth 2019–20 to 2022–23 in:</i>				
TDEL	–1.3%	+0.5%	+1.7%	+1.9%
CDEL ^b	+4.0%	+4.0%	+4.0%	+4.0%
RDEL	–2.3%	–0.2%	+1.3%	+1.6%
RDEL less NHS, defence and ODA	–7.7%	–3.1%	+0.1%	+0.6%
Unprotected RDEL ^c	–7.7%	–3.1%	0.0%	+0.5%
<i>Cumulative real change (£ billion, 2018–19 prices) in:</i>				
TDEL	–14.7	+5.3	+20.1	+22.7
CDEL ^b	+7.2	+7.2	+7.2	+7.2
RDEL	–22.0	–2.0	+12.8	+15.4
RDEL less NHS, defence and ODA	–34.6	–14.6	+0.3	+2.9
Unprotected RDEL ^c	–34.8	–14.8	0.0	+2.6

^a All illustrative scenarios assume that economic growth and tax revenues would be unaffected by the decision to make greater or smaller cuts to departments' resource budgets.

^b This analysis assumes that there is no deviation from the March 2018 projections for capital spending and that any extra tax or borrowing funds additional day-to-day (resource) spending on unprotected areas.

^c Unprotected RDEL refers to RDEL less NHS England, defence (including intelligence services), official development assistance and additional funding for Northern Ireland.

Note: Figures may not sum due to rounding.

Source: As for Table 4.2, with population projections from supplementary fiscal table 2.17 in the OBR's March 2018 Economic and Fiscal Outlook.

need to be financed through some combination of higher taxes, higher borrowing, lower non-DEL (such as social security) spending or lower investment spending.

Increase taxes

Extra spending could be financed through tax rises. If the government wished to freeze unprotected RDEL in real terms, costing £14.8 billion by 2022–23 (in 2018–19 prices), that would require a tax rise equivalent to the amount raised by increasing the main rate of VAT by 2.4 percentage points or adding 2.5p to all rates of income tax. The government has indicated that the public should expect tax rises to pay (at least in part) for the recent NHS funding settlement, with the Prime Minister stating that ‘taxpayers will ... need to contribute a bit more in a fair and balanced way’.¹⁹ Options for raising tax revenue are discussed in detail in Chapter 5.

Increase borrowing

If the Chancellor chooses to spend more on day-to-day spending, but neither reduces other areas of spending nor raises additional revenues, that extra spending would need to be funded through borrowing. An additional £14.8 billion (in 2018–19 prices) of borrowing in 2022–23 would equate to an additional 0.7% of national income. This would (all else unchanged) almost double forecast borrowing in 2022–23 from the 0.9% of national income predicted in the March 2018 Spring Statement to 1.6% of national income. The implications of different paths for borrowing for the long-run public finances are discussed in Chapter 3.

Cut investment spending

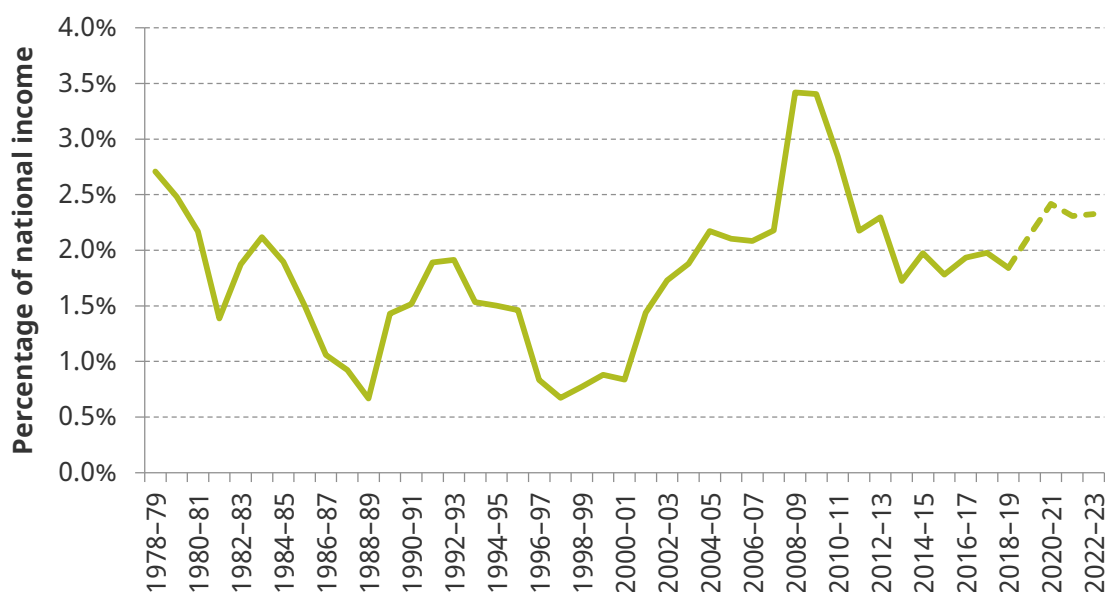
Section 4.2 noted that, amidst cuts to departments’ day-to-day funding, Mr Hammond has consistently prioritised investment spending, and departments’ capital budgets are set to increase in real terms by 12.3% between 2019–20 and 2022–23. The result of Mr Hammond’s focus on capital spending is that public sector net investment (PSNI) is forecast to reach 2.4% of GDP in 2020–21. If this level of investment is maintained, it would be the highest level of sustained investment in 40 years, as shown in Figure 4.8.

Historically, the government has struggled to spend its allocated capital budgets, with a clear tendency to undershoot plans.²⁰ However, in 2016 and 2017, the plans were deliberately ‘back-loaded’, with much of the growth to come later (in 2019–20 and 2020–21) rather than immediately, so as to improve the chances of the money actually being spent – and spent effectively.

Ultimately, Mr Hammond could choose to row back on his plans for capital investment and rein in the planned growth in CDEL to fund extra day-to-day spending. But to do so would represent a prioritisation of short-term spending pressures over the long term, and risks pulling the plug on projects after years of planning, just as the funding was about to become available. Furthermore, in a recent report, the National Infrastructure Commission recommended that the government deliver long-term certainty over

¹⁹ ‘Prime Minister sets out 5-year NHS funding plan’, HM Treasury and DHSC press release, 18 June 2018, <https://www.gov.uk/government/news/prime-minister-sets-out-5-year-nhs-funding-plan>.

²⁰ R. Crawford, P. Johnson and B. Zaranko, *The Planning and Control of UK Public Expenditure, 1993–2015*, IFS Report R147, 2018, <https://www.ifs.org.uk/uploads/R147.pdf>.

Figure 4.8. Public sector net investment

Source: OBR Public Finances Databank (accessed 20 July 2018).

infrastructure funding in Spending Review 2019.²¹ Such certainty would risk being undermined by the government choosing to alter its existing capital investment plans.

Cut social security spending

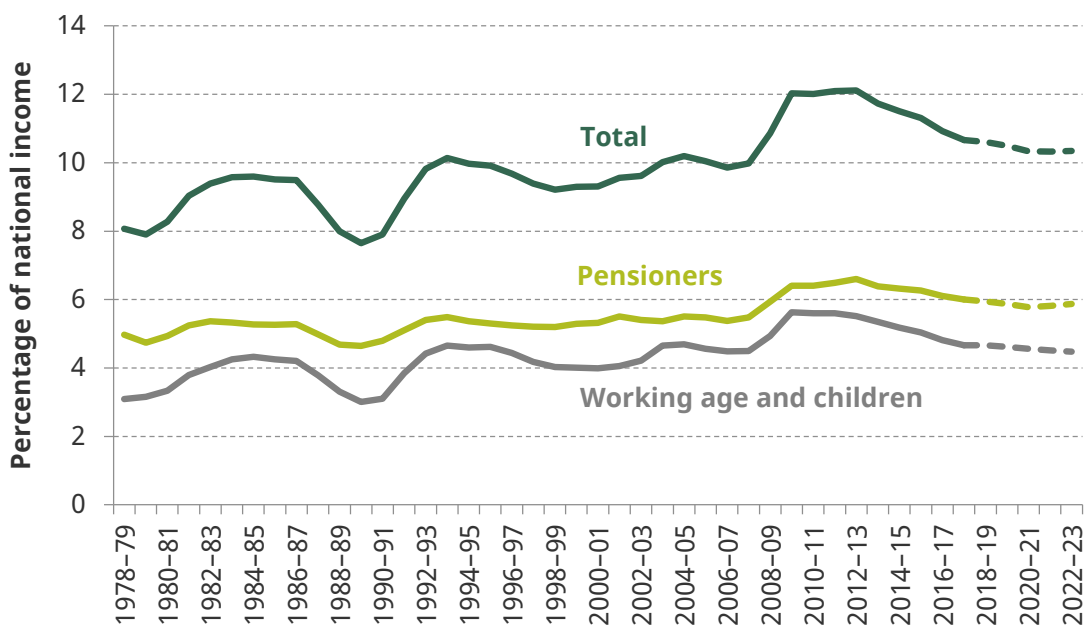
By far the largest component of public spending outside of DEL is spending on social security. In 2017–18, UK spending on social security amounted to 10.7% of national income, or around £222.5 billion in 2018–19 prices.

However, despite its size, there are a number of reasons why making substantial savings from further cuts to social security could prove difficult. First, the majority of this spending goes on pensioners. The breakdown of social security spending between pensioners and working-age individuals and children is illustrated in Figure 4.9. Spending on pensioners accounted for more than 56% of total social security spend in 2017–18. The state pension alone accounted for 44.1% of the total (and more than three-quarters of total pensioner spending), and a further 6.6% was spent on other pensioner-specific benefits.²² The government has committed to retaining the so-called ‘triple lock’ on the state pension and the universal nature of the winter fuel payment as part of its deal with the DUP. It has also indicated that it sees changes to the state pension age as the way to control state pension spending (should that be necessary), and promised to give notice of any such change. This, combined with the government’s past reluctance to disadvantage older voters, means that the scope for making substantial savings in this area in the short or medium term appears limited. (The decline in social security spending on pensioners in recent

²¹ See chapter 7 of National Infrastructure Commission, *National Infrastructure Assessment*, 2018, <https://www.nic.org.uk/publications/national-infrastructure-assessment-2018/>.

²² ‘Pensioner specific benefits’ is defined here to include pension credit, winter fuel payments, TV licence payments for over-75s, Christmas bonus, cold weather payments, attendance allowance and the Financial Assistance Scheme. See table 2a of DWP expenditure tables for a further breakdown. Note that figures for state pension and ‘pensioner-specific benefits’ are calculated for Great Britain only because specific benefit expenditure by age group is not available for Northern Ireland.

Figure 4.9. UK social security and tax credit spending over time



Source: Authors' calculations using DWP benefit expenditure tables, 2018 (<https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2018>) and the OBR's Public Finances Databank (accessed 20 July 2018).

years that can be seen in Figure 4.9 has been driven by the increases in the female state pension age since 2010.)

The Chancellor may therefore look to social security spending on working-age adults and children. But this would not be without its own challenges. For one, this group has been most affected by the cuts to social security already made since 2010, including the capping of nominal increases in most working-age benefits at 1% per year for three years from 2013–14.²³ And there are further cuts still to come. In particular, the next few years will see the continued transition from the 'legacy' benefits system to the less generous universal credit (UC) system, which will replace six major means-tested benefits. On top of that, most working-age benefits are also frozen in cash terms until March 2020, and cuts to the generosity of tax credits for families with children – limiting entitlement to the first two children and removing the 'family element' – will gradually be rolled out over the coming years.²⁴ By 2022–23, working-age social security is forecast to reach its lowest level as a share of GDP since 2002–03.

In March 2016, then Secretary of State for Work and Pensions Stephen Crabb said that the government had 'no further plans to make welfare savings beyond the very substantial savings legislated for by Parliament two weeks ago'.²⁵ The government may decide to

²³ See, for example, figure 3.4 of J. Browne and W. Elming, 'The effect of the coalition's tax and benefit changes on household incomes and work incentives', IFS Briefing Note BN159, 2015, <https://www.ifs.org.uk/uploads/publications/bns/BN159.pdf>.

²⁴ A. Hood and T. Waters, *Living Standards, Poverty and Inequality in the UK: 2017–18 to 2021–22*, IFS Report R136, 2017, <https://www.ifs.org.uk/uploads/publications/comms/R136.pdf>.

²⁵ *Hansard*, 21 March 2016, col. 1268, <https://publications.parliament.uk/pa/cm201516/cmhansrd/cm160321/debtext/160321-0002.htm#16032113000001>.

change course – the statement was made prior to the last election – and opt for cuts above and beyond those already pencilled in. For example, extending the current benefit freeze for an additional three years would free up an estimated £4.1 billion (in 2018–19 prices) of additional spending for public services by 2022–23 (a one-year freeze would free up £1.2 billion, while a two-year freeze would free up £2.7 billion). But further real-terms cuts to working-age benefits would pose considerable political challenges and may have potentially severe consequences for the living standards of those who rely most on state support: working-age benefits are typically received by those in the bottom half of the income distribution. Further cuts to working-age benefits (while protecting benefits for pensioners) would also mean that pensioners' income would continue to grow more quickly than the rest of the population's.

Cut transfers to the European Union

An obvious question is whether, by leaving the EU, the government is able to reduce financial transfers to Brussels and instead use those funds to increase public service spending without having to increase borrowing, increase taxes or cut other domestic spending.

The OBR estimated in March 2018 that, if the UK were not to leave the EU, transfers to the EU in 2022–23 would amount to (in nominal terms) £16.8 billion (£15.4 billion from the contribution based on the size of our economy, £3.3 billion of VAT payments, £2.8 billion of customs duties and sugar levies, less a rebate of £4.8 billion).²⁶ With Brexit, it estimated that the agreed financial settlement with the EU might require payments in that year of £7.5 billion instead.²⁷ In 2018–19 prices, these totals would be £15.7 billion and £7.0 billion respectively.

However, it would be highly misleading to interpret this as meaning that leaving the EU will leave the UK government with an additional nearly £9 billion (in 2018–19 prices) to spend in 2022–23 (the £15.7 billion of transfers the UK would no longer make to the EU, less the £7.0 billion in financial settlements). The UK currently also benefits from a large quantity of financial transfers back from the EU. Public sector receipts from the EU (i.e. funds from the EU that are administered by UK government bodies, such as farm support through the Common Agricultural Policy) were forecast – absent the UK leaving the EU – to amount to £6.1 billion in 2022–23 (£5.7 billion in 2018–19 prices), and other private sector receipts (for example, research funds given to UK universities) which amounted to around £1.5 billion in 2015.²⁸ If the UK government were to continue to provide financial support to these areas, in lieu of funding from the EU, then there would be considerably less additional resources available from the net savings on its EU contribution to increase RDEL for the benefit of other public services.

²⁶ £2.8 billion of customs and sugar levies is the gross £3.4 billion collected less the 20% (£0.7 billion) that the UK currently keeps to cover collection costs (figures do not sum due to rounding). See supplementary fiscal table 2.26 of the OBR's March 2018 Economic and Fiscal Outlook.

²⁷ See annex B of the OBR's March 2018 Economic and Fiscal Outlook for details of how this estimate was produced.

²⁸ Supplementary fiscal table 2.26 of the OBR's March 2018 Economic and Fiscal Outlook; annex B of HM Treasury, *European Union Finances 2017: Statement on the 2017 EU Budget and Measures to Counter Fraud and Financial Mismanagement*, Cm 9576, 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691017/EU_finances_2017_Cm9576_web.pdf.

The Treasury has said that spending decisions will be taken in the Spending Review, but the Chancellor and the Prime Minister have highlighted a number of priorities for continuing support post-Brexit, including the Shared Prosperity Fund, farm support, science and education.²⁹ Also, as mentioned in Section 4.3, some £0.9 billion of EU ODA spending currently counts towards the UK's 0.7% of national income ODA commitment. If this is no longer the case after Brexit, then that sum would need to be replaced by additional UK spending.

If the UK government were to continue financial support for most areas that are currently funded by the EU, including the £0.9 billion in ODA spending, this would leave around £0.6 billion of additional resources available for increasing RDEL on other public services in 2022–23.³⁰ This amount would increase in the medium term, however, as the financial settlement payments to the EU would fall to zero over time.

However, leaving the EU may also entail increased responsibilities (and hence costs) for some government departments – in particular, HM Revenue and Customs, the Home Office, the Department for International Trade, the Department for Business, Energy and Industrial Strategy and the Department for the Environment, Food and Rural Affairs. The Institute for Government (IfG) has estimated that preparations for Brexit will cost these departments at least £0.9 billion in 2018–19.³¹ While much of these costs may be temporary, there may well be some permanent increases in costs as well – for example, due to increased border security or increased administrative burden arising from new arrangements with the EU. Such costs could then offset some of, or even exceed, the extra £0.6 billion that could be made available for RDEL in 2022–23 by leaving the EU.

So in summary, absent Brexit, the UK was forecast to transfer £15.7 billion (in today's prices) to the EU in 2022–23. Roughly £7.2 billion of this was due to flow back to the UK to be spent by the public and private sectors, and around £0.9 billion was to be spent on overseas aid on the UK's behalf. After Brexit, the UK government will have greater control over this funding and choices to make over the extent to which it is replaced. But this money is not a windfall gain for the UK public finances: channelling some or all of this money to increase day-to-day spending on some services would be equivalent to a cut for those areas currently funded by the EU. In addition, the OBR estimates that the UK will still send £7.0 billion to Brussels in 2022–23 as part of the agreed financial settlement. This leaves approximately £0.6 billion of the UK's forecast contribution to the EU that could potentially be made available to increase spending on day-to-day public services in 2022–23. However, set against this will be the potential – and highly uncertain – direct costs of Brexit to departments, which could offset or even outstrip this modest 'Brexit dividend'.

More broadly and more importantly, all of these figures are extremely uncertain – the financial settlement that the UK may reach with the EU, the spending the EU may continue

²⁹ 'Local growth: written statement', HCWS927, <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-07-24/HCWS927/>; <https://www.gov.uk/government/news/chancellor-philip-hammond-guarantees-eu-funding-beyond-date-uk-leaves-the-eu>; <https://www.gov.uk/government/speeches/pm-speech-on-our-future-economic-partnership-with-the-european-union>.

³⁰ Calculated as the £15.7 billion of transfers the UK would no longer make to the EU, less £7.0 billion of financial settlement, £5.7 billion of replacement funding for public sector receipts from the EU, £1.5 billion of replacement funding for private sector receipts from the EU and £0.9 billion of replacement ODA spending.

³¹ J. Owen and L. Lloyd, 'Costing Brexit: what is Whitehall spending on exiting the EU?', IfG Insight, 2018, <https://www.instituteforgovernment.org.uk/publications/costing-brexit-what-whitehall-spending-exiting-eu>.

to do in the UK (or around the world on the UK's behalf) during the transition period, the revenues from any post-EU tariff regime and the long-run costs to government departments of changes to responsibilities as a result of leaving the EU. This is not to mention the uncertain effects of Brexit on the wider economy. It is these broader economic impacts that will have – by far – the greatest effect on the resources available to fund public services.

Summary

Cancelling or reducing the cuts to departmental resource budgets that were implied by the government's fiscal plans at the time of the 2018 Spring Statement would mean extra spending, and extra spending means that extra money will need to be found from somewhere. There are no easy options, and difficult trade-offs abound. Reductions in the net contributions made by the public sector to the EU could potentially be used to increase DEL spending, but these are highly uncertain and are likely to be small over the next Spending Review period. Raising additional tax revenue would avoid the need to increase borrowing, cut social security or scale back planned increases in investment spending. But tax rises of the scale required could pose economic costs and prove politically difficult. The Chancellor may, therefore, opt for none of the above, and stick to his existing plans, continuing the decade of cuts for most public service areas for yet another three years.

4.5 Implications for public services

Whatever the total spending envelope the Chancellor ultimately decides is 'affordable', he will then need to determine the allocation of spending across unprotected departments. In this section, we look at the choices made in past Spending Reviews and what they can tell us about government priorities and the likely distribution of any future cuts. We then consider the implications of further cuts to spending for pay and employment across the public sector. We finish by considering some of the pressures on a number of public services and the possible implications of further cuts to those areas.

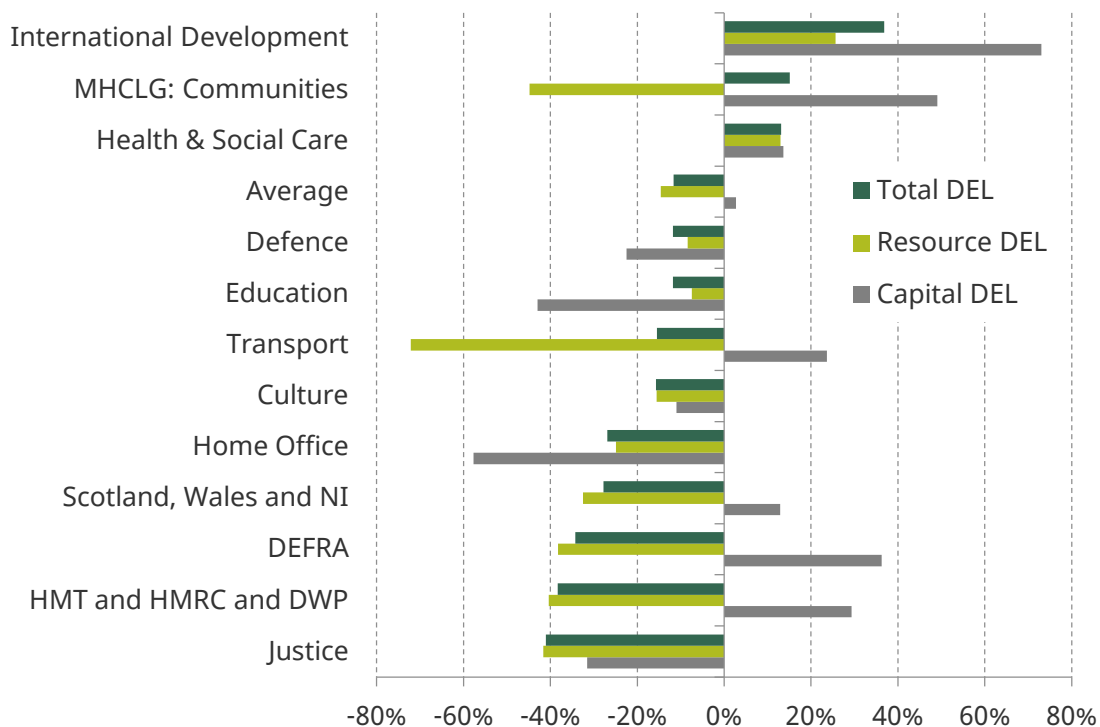
Choices made so far

A question of priorities

The reductions in spending since 2010 have not affected departments equally, with the government choosing to prioritise particular areas. Between 2010–11 and 2015–16, spending on the NHS and day-to-day spending on schools were protected from cuts. Spending on overseas aid was increased to reach the targeted level of 0.7% of national income and, in more recent years, spending on defence and the police has also been protected.

Figure 4.10 shows the change in departments' resource, capital and total budgets since 2010–11. The only departments to have seen an increase in their day-to-day resource spending are the Department for International Development and the Department of Health (now Health and Social Care). Education and defence have been relatively well protected in terms of day-to-day spending, in that they have been cut by less than the average. The Department for Transport has experienced particularly deep cuts to its day-to-day spending, but is set to receive a substantial boost in its capital budget over the coming years. Similarly, the 'Ministry of Housing, Communities and Local Government: Communities' budget for day-to-day spending has been cut significantly, but this has been more than offset by increases in its capital budget (which includes government

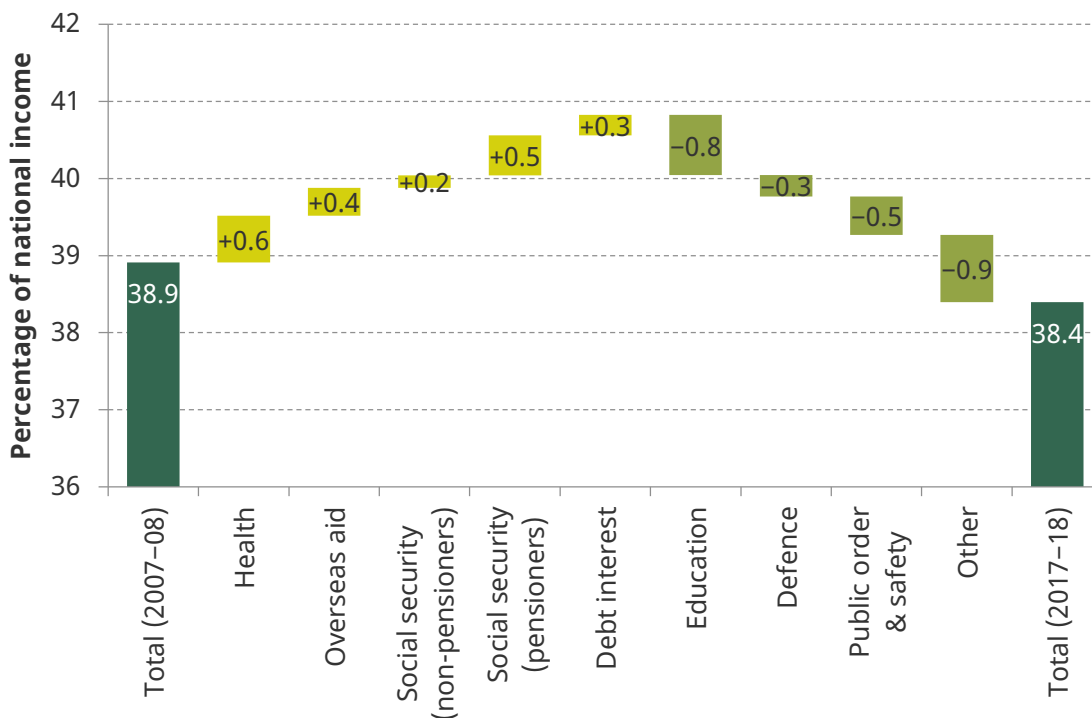
Figure 4.10. Real-terms departmental budget changes, 2010–11 to 2019–20



Note: Resource budgets here exclude depreciation.

Source: Authors' calculations using various HM Treasury Public Expenditure Statistical Analyses.

Figure 4.11. Changes in composition of total public spending, 2007–08 to 2017–18

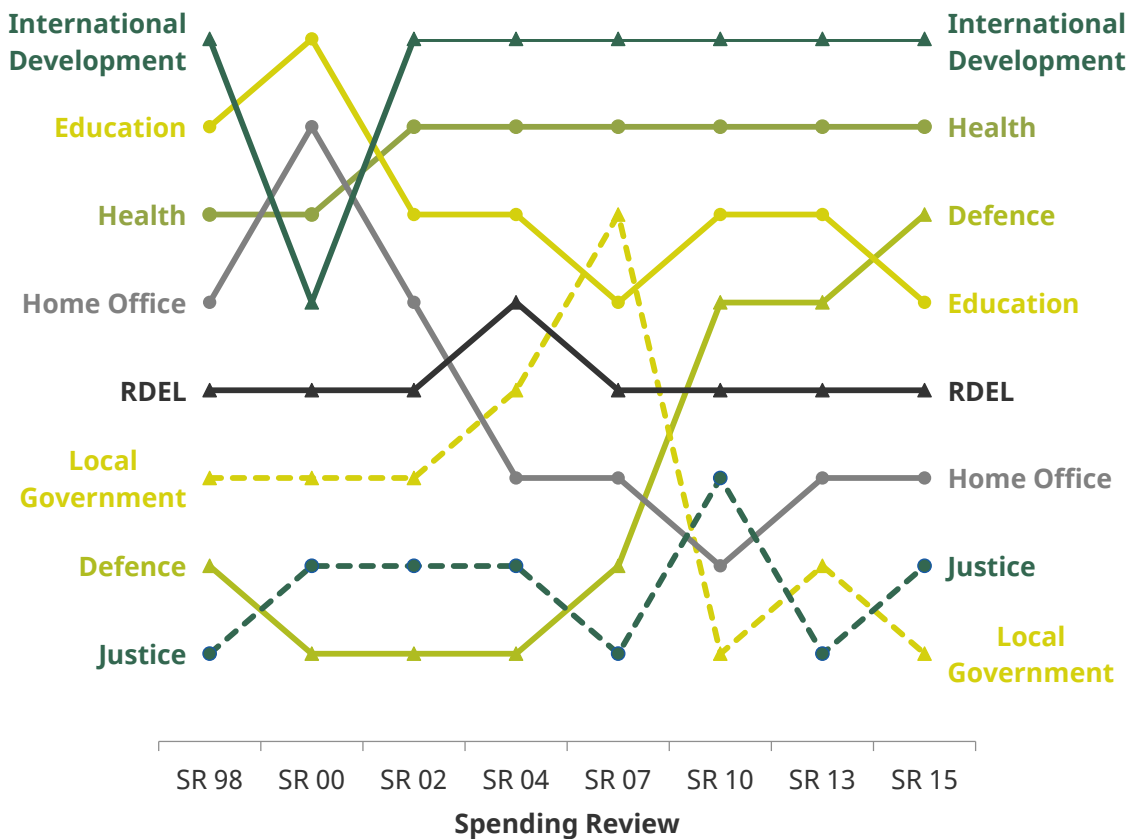


Source: Authors' calculations using HM Treasury's Public Expenditure Statistical Analyses 2018, the OBR's Public Finances Databank (accessed 20 July 2018) and DWP benefit expenditure tables 2018.

investment in housing and capital grants such as ‘Help to Buy’).³² Other departments that have faced substantial cuts since 2010 include the Department for Environment, Food & Rural Affairs (DEFRA) and the Ministry of Justice, both of which are set to see further reductions between now and 2019–20.

This has led to a change in the composition of public spending. Figure 4.11 shows that, between 2007–08 and 2017–18, spending on health, social security, overseas aid and debt interest grew to account for a greater share of national income. Over the same period,

Figure 4.12. Ranking of planned growth in resource DEL and selected departmental resource budgets at each Spending Review (SR)



Note: Departments are ranked in descending order of planned average annual real growth rate, so the department planned to grow at the fastest rate at the Spending Review in question is at the top of the figure and the department planned to grow by the least is at the bottom of the figure.

Source: Authors’ calculations based on various Spending Reviews. Real growth rates are taken from the SR documents if published, and calculated using nominal spending plans and contemporaneous GDP deflator forecasts if not. Between SR 1998 and SR 2007, ‘Education’ refers to UK education spending, which includes both central government spending within DEL and locally financed expenditure within AME. In SR 2010, 2013 and 2015, ‘Education’ refers to the Department for Education. ‘Justice’ refers to Legal Departments at SR 1998 and SR 2000, Lord Chancellor’s Departments at SR 2002, Department for Constitutional Affairs at SR 2004, and Department of Justice from SR 2007 onwards. ‘Local Government’ refers to Department of the Environment, Transport and the Regions – Local Government and Regional Policy at SR 1998, Local Government at SR 2000, 2002 and 2004, DCLG Local Government at SR 2007, 2010 and 2013, and to DCLG Local Government RDEL at SR 2015.

³² The Ministry of Housing, Communities and Local Government has two separate DELs: the ‘Local Government’ DEL (not shown in Figure 4.10) includes general and specific grants to local authorities, while the ‘Communities’ DEL includes the department’s main programme expenditure and administration costs.

spending on education, public order & safety, defence and other areas of spending have fallen as a proportion of GDP. The reduction in spending on public order & safety was particularly large in proportionate terms, falling from 2.0% of GDP to around 1.5%.

Going back further, several of these areas have been consistently prioritised – or not – for much of the last 20 years. Figure 4.12 shows the ranking of planned growth rates in departments’ day-to-day resource budgets at each Spending Review since 1998, along with where the planned growth in overall resource DEL sits in that ranking. Departments above the black line were planned to grow faster than overall resource spending; those below were planned to grow at a slower rate. Health, Education and International Development resource budgets have always been prioritised, in the sense that they were always planned to grow at a faster rate than the overall total. In contrast, Justice and Local Government show a clear tendency to grow by less than average resource spending, reflecting the lack of prioritisation of those areas.

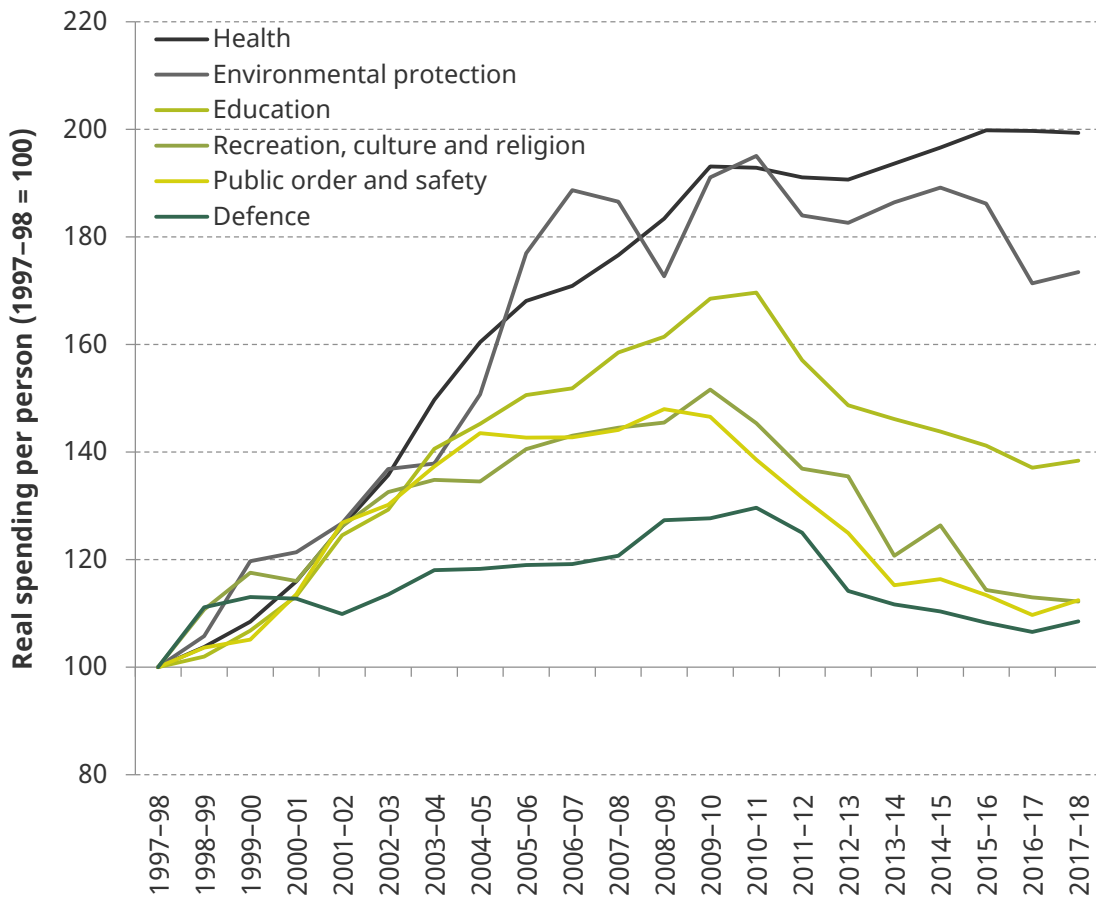
Over the past decade, the relative priorities of different departments have become even more stable. In each of the past three Spending Reviews, the same group of departments – International Development, Health, Defence and Education – have received above-average increases in resource spending. By contrast, departments such as the Home Office have joined the group of departments that consistently receive below-average spending increases. The stability of these patterns, and the existing spending commitments relating to departments that have already seen bigger increases, suggest that any spending cuts going forward are unlikely to fall heavily on these areas. Instead, if the Chancellor decides to make further reductions in spending, we might expect the bulk of the cuts to fall on the departments that have not been prioritised and protected so far.

The challenge of further cuts

Further cuts to unprotected departmental budgets after 2019–20 would come on top of substantial cuts already made since 2010–11. Making further reductions to these and other unprotected budgets would risk reducing the range and quality of services to below what the public expects.

Figure 4.10 showed that numerous departments will already have faced real-terms cuts of more than 30% in their day-to-day spending over the past decade. In per-person terms, the cuts have been even greater. Figure 4.13 shows how spending per person on a number of functions has changed since 1997–98. While spending on health has continued to grow over time, other areas have fared less well. After increasing over the late 1990s and 2000s, per-person spending on public order and safety and on recreation, culture and religion has fallen to levels last seen at the turn of the millennium. Even areas that have been relatively protected are at low levels by recent standards – for example, defence spending per person is at its lowest level since 1997–98, while total education spending fell in 2016–17 to its lowest level since 2002–03. (Though as discussed in more detail later in this chapter, and in a recent IFS report,³³ this picture for total education spending hides markedly different experiences for different parts of education, with spending on schools having been relatively protected and spending on further education and some aspects of early years education having fared relatively badly. Spending on higher education, on the metric measured in Figure 4.13, has also fallen dramatically, though this is primarily due to

³³ C. Belfield, C. Farquharson and L. Sibieta, *2018 Annual Report on Education Spending in England*, IFS Report R150, 2018, <https://www.ifs.org.uk/uploads/publications/comms/R150.pdf>.

Figure 4.13. Real spending per person on selected functions

Source: Authors' calculations using ONS population estimates, June 2018 GDP deflators and table 4.2 of HM Treasury Public Expenditure Statistical Analyses, July 2018.

financing reforms and the accounting treatment of student loans rather than a genuine decline of that extent in ultimate taxpayer support for higher education.)

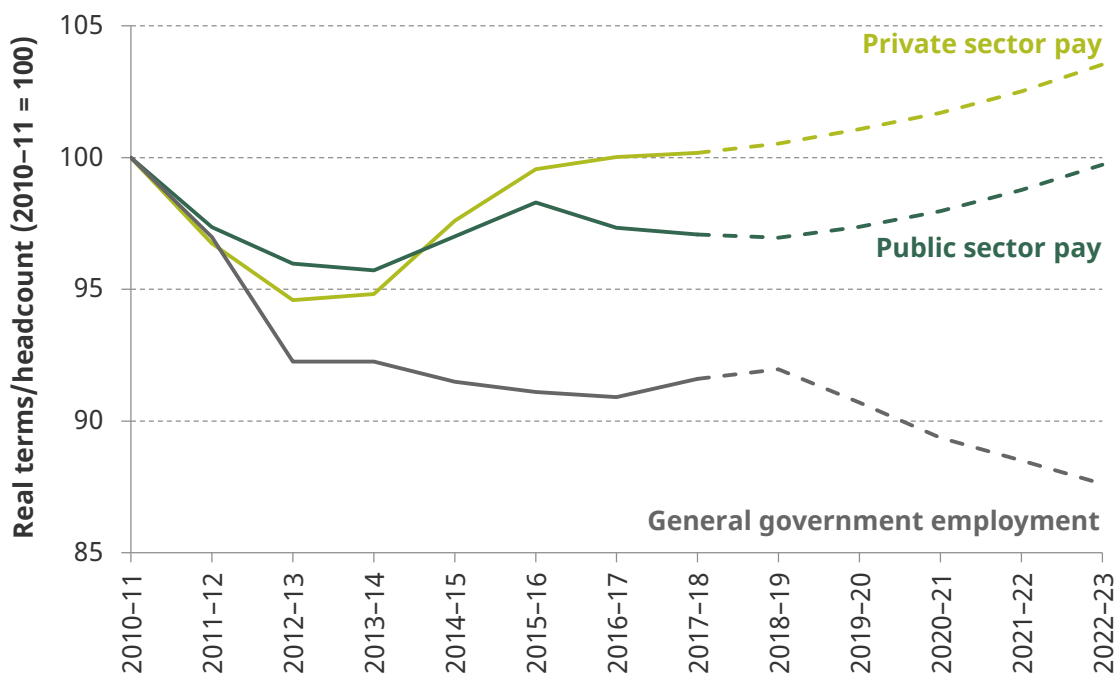
Public sector pay and employment

Public services are provided by a public sector workforce (where both the size and the quality of the workforce are important), using other non-labour inputs. Since 2010, cuts to departments' day-to-day spending have been delivered in part through a reduction in the number of workers, in part through a squeeze on public sector pay and in part through reductions in non-paybill spending.

Figure 4.14 shows the change since 2010–11 in average private and public sector weekly earnings and general government employment (headcount). Since 2010, the government has exercised considerable restraint of public sector pay.³⁴ The result is that average weekly earnings in the public sector fell in real terms (relative to inflation as measured by the Consumer Prices Index) by 2.9% between 2010–11 and 2017–18. This restraint of public sector pay meant that the cuts to RDEL could be achieved with lower cuts to government

³⁴ For further discussion, see J. Cribb, 'Public sector pay: still time for restraint?', IFS Briefing Note BN216, 2017, <https://www.ifs.org.uk/uploads/publications/bns/BN216.pdf>.

Figure 4.14. Pay and employment since 2010–11



Note: Private and public sector pay refer to average gross weekly earnings. Pay and general government employment figures are taken from last quarter of each financial year. Dashed lines indicate forecasts – these assume that private sector gross weekly earnings grow in line with economy-wide earnings growth in 2018–19 onwards and that public sector gross weekly earnings grow in line with the OBR’s assumption for paybill-per-head growth from the March 2018 Economic and Fiscal Outlook.

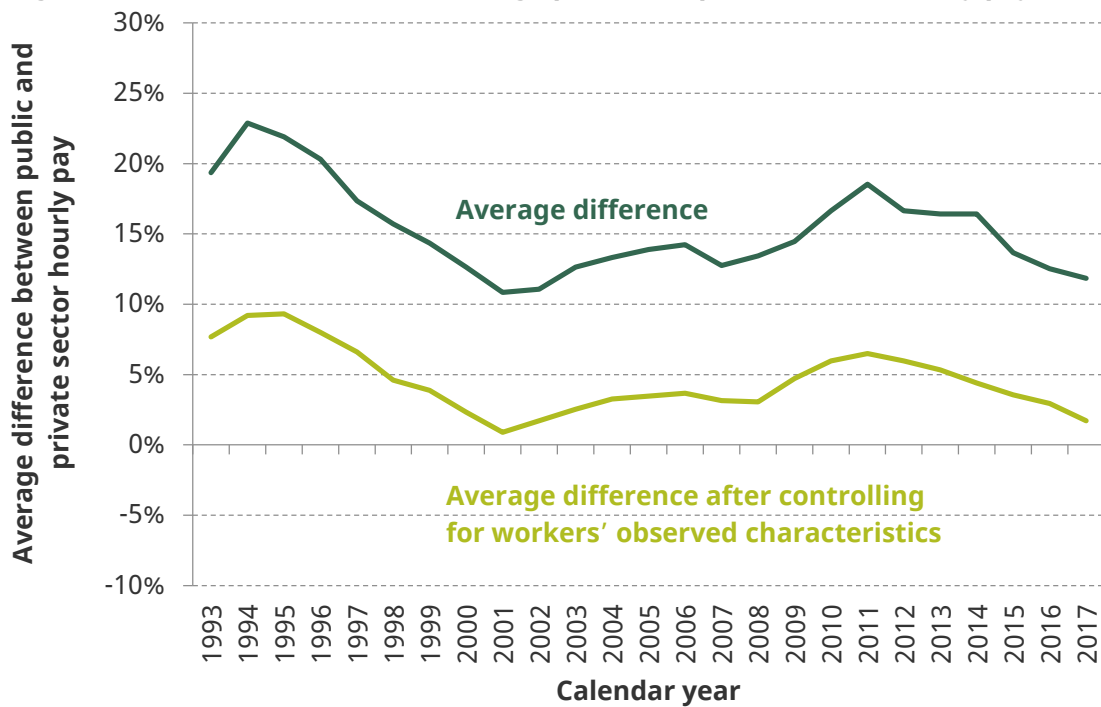
Source: Authors’ calculations using ONS series G6NW, KAC4 and KAD8 and OBR’s March 2018 Economic and Fiscal Outlook. Pay series are deflated using the Consumer Prices Index (ONS series D7BT).

employment and non-paybill spending than would otherwise have been required. Even so, over the same period, the number of people employed by government fell by 8.4%.

Holding down public sector pay is not a ‘free’ way of reducing public spending. It will reduce the incentive to work in the public sector relative to the private sector, and potentially harm levels of motivation among public sector employees, therefore leading to a reduction in the quality of the public sector workforce – which can have implications for the level and/or quality of public services provided.

However, over the period up to 2013–14, pay in the private sector was not growing particularly rapidly either. Figure 4.15 shows the gap between average public and private sector pay over time. A significant gap in favour of public sector workers opened up during the recession, and until 2015 the pay restraint largely acted just to close that gap. This meant that it may have been easier for the government to hold down public sector pay over this period without significant adverse consequences for the recruitment and retention of quality workers.

From 2014–15 onwards, however, private sector pay has grown considerably more rapidly than public sector pay. The gap between average pay in the public and private sectors has therefore fallen to around the level it was at the start of the millennium. There have also been other reforms – increases in employee public sector pension contributions phased in

Figure 4.15. Difference between average public and private sector hourly pay

Note: A positive difference means that public sector pay is higher than private sector pay, on average. Includes only pay and not other aspects of the compensation package such as pensions. Difference controlling for workers' observed characteristics controls for differences in age, sex, education, experience and region.

Source: Authors' calculations using Labour Force Survey 1993–2017.

from 2012, and an increase in National Insurance contributions associated with the ending of contracting out from 2016–17 – that will have further reduced the average gap between the public and private sectors in terms of the net value of the total pay received.

Independent pay review bodies have increasingly raised concerns about retention and recruitment in the last two years. Recent statistics show that the level of unfilled vacancies for nurses has risen by around 20% since late 2015,³⁵ and the recruitment of initial teacher trainees has been below target every year since 2011.³⁶ Perhaps in recognition of the risk of recruitment and retention issues (and the role that worker quality plays in delivering public services), the government announced in September 2017 that from 2018–19 (i.e. two years earlier than planned) it would lift the 1% cap on public sector pay rises,³⁷ opening the door to more generous pay awards. In July 2018, the government announced more generous settlements for teachers, prison officers, members of the armed forces, police, doctors and dentists.³⁸

In some sense, it is true that the government has increased costs to departments by ending the public sector pay cap, while departments' budgets (set in the 2015 Spending

³⁵ <https://files.digital.nhs.uk/8F/D1CA73/nhs-vac-stats-feb15-mar18-eng-rep.pdf>.

³⁶ D. Foster, 'Teacher recruitment and retention in England', House of Commons Library Briefing Paper 7222, 2018, <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7222>.

³⁷ BBC News, 12 September 2017, <https://www.bbc.co.uk/news/uk-politics-41241295>.

³⁸ <https://www.gov.uk/government/news/around-one-million-public-sector-workers-to-get-pay-rise>.

Review) have not been changed in response. However, how much harder these new pay settlements make it for departments to meet service expectations given their existing budgets depends crucially on how higher pay feeds through into the quality and productivity of the workforce, and how easily departments can trade off a more productive workforce against the number of workers and other non-labour inputs they require. This is very difficult to know, and is likely to vary across the public sector and across the country.

The OBR forecast in March 2018 that public sector pay per head would increase in line with private sector earnings growth between 2019–20 and 2022–23 – i.e. by 3.1% in real terms (when deflated using the GDP deflator). This will obviously be challenging for departments, over a period in which the provisional Spring Statement plans imply RDEL will be cut by 0.6% and RDEL for ‘unprotected’ departments will be cut by 9.3%.

The consequence of rising pay at a time of falling budgets is that employment by government departments will fall. The OBR forecast in the Spring Statement that the provisional RDEL plans, combined with its earnings growth assumption, implied that general government employment would need to fall by 3.4% between 2019–20 and 2022–23. In other words, going forward, the RDEL cuts are likely to be much more dependent on reducing employment than has been the case to date. This can be seen in the sharp fall in forecast general government employment from 2018–19 onwards in Figure 4.14, after a period of relative stability. Such declines would take general government employment to its lowest headcount since around 2002 (once reclassifications are taken into account) and its lowest share of the workforce since at least 1971. The implications of this for the quality and quantity of public services that can be delivered should not be taken lightly.

Departments are also likely to face a pure cost pressure in future from an increase in employer pension contributions arising from the latest quadrennial valuation of public sector pension schemes. The Government Actuary’s Department is currently working on these valuations, but early indications – presented by the Chief Secretary to the Treasury to Parliament in September 2018 – suggest that employer contributions to the public service pension schemes (covering the NHS, teachers, armed forces, police, firefighters, local government workers, the judiciary and the civil service) are likely to increase from 2019 onwards as a result of a reduction in the discount rate used to calculate the current cost of future pension payments.³⁹ The Treasury will support departments with unexpected costs in 2019–20, but in future years these additional costs will have to be borne by departments from within the DEL budgets allocated in the next Spending Review. Although it is difficult to estimate the cost of these changes until further details are known, any increase in the required pension contributions from public sector employers will make the spending pressure for unprotected departments even greater than the figures for real-terms cuts set out in Sections 4.3 and 4.4 imply and would imply even greater cuts to employment in the absence of any change to expected pay settlements.

³⁹ ‘Quadrennial valuations of the public service pension schemes: written statement’, HCWS945, <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-09-06/HCWS945/>.

Examples of pressures on particular public services

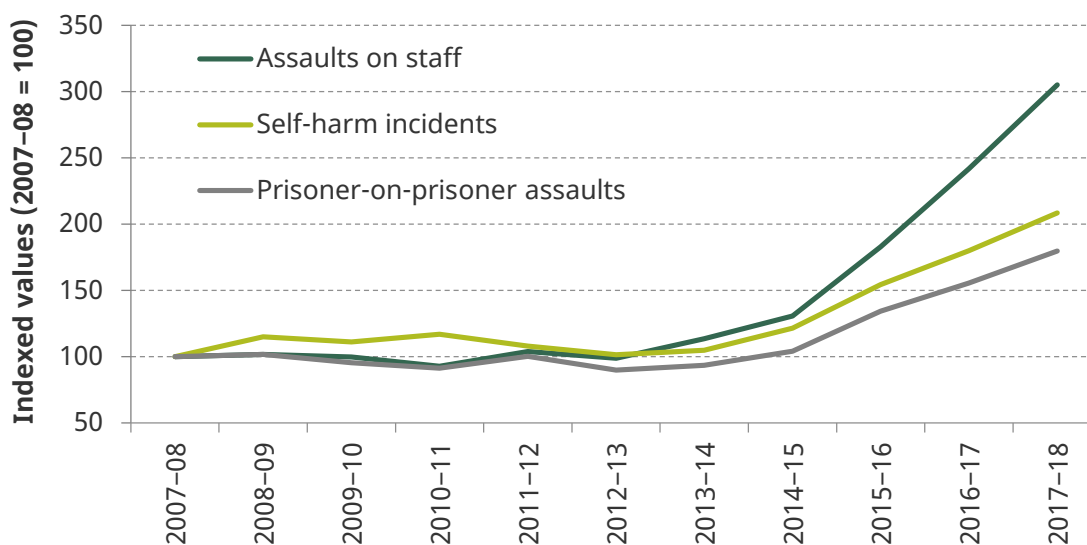
Many of the public services that have experienced cuts since 2010 are under increasing pressure, and Mr Hammond is already facing calls from some to increase, rather than decrease, spending on many areas. We discuss just a few of these areas here.

Prisons

One public service very much showing signs of strain is the prison system. Spending on prisons fell by more than a fifth between 2009–10 and 2016–17, while the prison population remained broadly constant. These cuts to the budget were accompanied by a sharp reduction in staff numbers, with the number of core prison staff in March 2017 being 26% below 2010 levels.⁴⁰

Over this period of spending cuts, service quality inside prisons has markedly deteriorated. Figure 4.16 shows the change in the number of safety incidents since 2007–08. During the first few years of budget cuts, there was little change in the number of assaults on staff, prisoner-on-prisoner assaults or self-harm incidents. However, since 2014–15, the number of incidents has dramatically increased and is on an alarming upward trajectory. For instance, the number of assaults on staff in 2017–18 (8,608) was more than three times higher than in 2007–08 (2,820).⁴¹ The number of self-harm incidents more than doubled, from 22,462 to 46,859. Recent inspections have shown serious failings

Figure 4.16. Change in the number of prison safety incidents since 2007–08



Source: Ministry of Justice, 'Safety in custody quarterly: update to March 2018', <https://www.gov.uk/government/statistics/safety-in-custody-quarterly-update-to-march-2018>.

⁴⁰ IfG and CIPFA, *Performance Tracker: Autumn 2017*, <https://www.instituteforgovernment.org.uk/publications/performance-tracker-autumn-2017>.

⁴¹ This may be an underestimate of the true increase, as Ministry of Justice analysis has revealed some under-reporting of assaults and self-harm incidents. See annex A of Ministry of Justice, 'Safety in custody quarterly: update to March 2018', <https://www.gov.uk/government/statistics/safety-in-custody-quarterly-update-to-march-2018>.

inside HMP Birmingham, and prison staff across England and Wales have staged widespread protests over the level of violence inside prisons.⁴²

In recognition of the challenges facing the prison system, at the 2016 Autumn Statement the Chancellor provided an additional £500 million of funding to the Ministry of Justice, including a programme to recruit 2,500 additional prison officers.⁴³ Rory Stewart, the prisons minister, recently promised to resign in a year's time if he fails to cut drugs and violence in prisons before then.⁴⁴

Spending cuts may not be the only, or even the primary, cause of the deterioration in security and service quality inside prisons. But on the face of it, the data suggest that, while the prison system coped reasonably well with the first few years of cuts, there are now clear signs of deterioration. To the extent that these are linked to falling spending over this period, it is hard to see how the government could make further budget cuts within the existing prison system without having worrying consequences for prisoner and staff safety.

Social care

While spending on health has been protected since 2010, the same cannot be said for social care. In England, councils' spending on adult social care fell by 10% in real terms between 2009–10 and 2014–15 as a result of cuts to council funding from central government. Despite recent increases and the introduction of a 'social care precept' to allow councils to raise additional funds for adult social care, adult social care spending in 2017–18 was budgeted to be 3% lower in 2017–18 than in 2009–10.⁴⁵ The result has been fewer people accessing publicly funded adult social care, which has likely led to increasing levels of unmet need.

There is also growing concern over the impact social care cuts have had on NHS services. Recent IFS research shows that cuts to social care in England have led to a modest increase in the use of Accident and Emergency services amongst the older population (though one that is not particularly costly to the public purse).⁴⁶ Cuts to funding have also called into question the sustainability of some parts of the care home sector, with providers who are more reliant on public funding facing increasing financial difficulties.⁴⁷

A recent report, co-authored by researchers at IFS and the Health Foundation, outlined the pressures facing social care and estimated that funding would need to increase by 3.9% a year to meet the needs of an ageing population and an increasing number of

⁴² BBC News, 10 August 2018, <https://www.bbc.co.uk/news/uk-england-birmingham-45145971>; BBC News, 14 September 2018, <https://www.bbc.co.uk/news/uk-45518744>.

⁴³ HM Treasury, *Autumn Statement 2016*, <https://www.gov.uk/government/topical-events/autumn-statement-2016>.

⁴⁴ BBC News, 17 August 2018, <https://www.bbc.co.uk/news/uk-45214414>.

⁴⁵ D. Phillips and P. Simpson, 'Changes in councils' adult social care and overall service spending in England, 2009–10 to 2017–18', IFS Briefing Note BN240, 2018, <https://www.ifs.org.uk/uploads/BN240.pdf>.

⁴⁶ R. Crawford, G. Stoye and B. Zaranko, 'The impact of cuts to social care spending on the use of Accident and Emergency departments in England', IFS Working Paper W18/15, 2018, <https://www.ifs.org.uk/uploads/publications/wps/WP201815.pdf>.

⁴⁷ Competition and Markets Authority, *Care Homes Market Study*, 2017, <https://www.gov.uk/cma-cases/care-homes-market-study>.

younger adults living with disabilities.⁴⁸ The report also emphasised the importance of considering the health and social care systems together, and not increasing spending on one at the expense of the other.

In the past, Mr Hammond has shown that he is willing to find additional money for social care.⁴⁹ In the coming months and years, he will surely be under pressure to do so again. In addition, the government has said it will publish a Green Paper on the future of social care for older people later this year (albeit after previously promising to publish one at an earlier date). Any rebalancing of the social care system looks likely to increase, rather than reduce, pressures on the public purse.

Local government

Social care is not the only service to have been affected by cuts to local government funding since 2010. In fact, councils in England have chosen to protect social care relative to other service areas. Spending on services other than adult social care – which include environmental services, culture and leisure services, maintenance of local roads, housing, and planning and development – fell by 28% in real terms between 2009–10 and 2017–18.⁵⁰ Within that, some areas have fared particularly badly: between 2009–10 and 2016–17, spending on planning and development was cut by nearly 60% in real terms, housing by over 45% and transport and cultural services by around 40% each, while spending on environmental services was ‘only’ cut by around 14%.⁵¹

In spite of these sharp spending reductions and the scaling back of some services, residents’ satisfaction with these services has largely held up and a recent National Audit Office (NAO) report found that local authorities have done well to manage substantial funding reductions since 2010.⁵² However, as with the prison system, the cuts are starting to bite. The NAO report also found that the financial position of the local government sector has worsened markedly in recent years, with growing numbers of local authorities overspending on services and draining their reserves at an unsustainable rate amidst growing demand and cost pressures. As the difficulties at Northamptonshire County Council rumble on and other local authorities are forced to cut services to the ‘legal minimum’, further cuts in funding for local government could come at a high cost.

Schools

Spending on schools covers pupils aged 5–16 and has largely been protected from the recent cuts to public service spending. Between 2011–12 and 2017–18, primary school spending per pupil has fallen by around 1% in real terms, while secondary school spending per pupil has fallen by around 5%.⁵³ Schools spending per pupil is planned to be

⁴⁸ A. Charlesworth and P. Johnson (eds), *Securing the Future: Funding Health and Social Care to the 2030s*, Institute for Fiscal Studies and Health Foundation Report, 2018, <https://www.ifs.org.uk/publications/12994>.

⁴⁹ In the March 2017 Budget, the Chancellor announced an additional £2 billion of funding for adult social care over three years.

⁵⁰ D. Phillips and P. Simpson, ‘Changes in councils’ adult social care and overall service spending in England, 2009–10 to 2017–18’, IFS Briefing Note BN240, 2018, <https://www.ifs.org.uk/uploads/BN240.pdf>.

⁵¹ N. Amin Smith, D. Phillips, P. Simpson, D. Eiser and M. Trickey, *A Time of Revolution? British Local Government Finance in the 2010s*, IFS Report R121, 2016, <https://www.ifs.org.uk/uploads/publications/comms/R121.pdf>.

⁵² National Audit Office, *Financial Sustainability of Local Authorities 2018*, Session 2017–19, HC 834, 2018, <https://www.nao.org.uk/wp-content/uploads/2018/03/Financial-sustainability-of-local-authorities-2018.pdf>.

⁵³ C. Belfield, C. Farquharson and L. Sibieta, *2018 Annual Report on Education Spending in England*, IFS Report R150, 2018, <https://www.ifs.org.uk/publications/13306>.

frozen in real terms between 2017–18 and 2019–20.⁵⁴ Compared with other areas, schools spending has therefore fared relatively well over this period. Further, these relatively small cuts come after a period of rapid growth. Given the large increase in schools spending seen over the 2000s, schools spending per pupil will continue to be around 60% higher than it was in 2000 – in other words, at historically high levels.

In the coming years, the government is also set to reform the funding system in England by introducing a national funding formula (NFF) for all schools.⁵⁵ In July 2017, following significant public pressure, the government announced an additional £1.3 billion in funding over two years to ease the transition.⁵⁶ The full roll-out of the NFF has now been delayed until at least 2021⁵⁷ but, given the explicit prioritisation and protection of school spending to date, Mr Hammond may face political pressure to provide extra funding over the Spending Review period to pay for additional transitional protections, or to further delay the roll-out.

Whether or not the government will continue to protect schools spending going forwards is open to debate. On the one hand, it has been a clear priority of the coalition and Conservative governments to date to shield schools from the depth of cuts seen in other areas. On the other hand, with spending at historically high levels (and without the same demographically driven demand pressures as are present in the health system), it is perhaps harder to argue that it is not feasible to cut schools spending – particularly in the context of the pressures facing other public services, and indeed other areas of education.

While schools spending has been better protected than many budget lines over the past decade, other areas of education have fared considerably less well. Real spending per student in further education and sixth-form colleges has fallen by 12% between 2011–12 and 2017–18. Total early years spending (on children aged 5 and under) has increased by 13% between 2010–11 and 2017–18, but this has been driven by the increasingly generous entitlement for free childcare. Spending on Sure Start, for example, has fallen by 59% over that period.⁵⁸

Higher education

Large reductions in resource DEL since 2010 have been brought about by changes to the way in which higher education (HE) in England is funded. In 2012, the government stopped providing teaching grants to universities for all but ‘high-cost’ subjects, and instead increased the cap on the tuition fees that universities could charge students from £3,000 to £9,000 per year. Tuition fee loans available to students to cover these fees were

⁵⁴ Slightly offsetting this are the large cuts to local authority spending on school services since 2009–10 (for example, central spending on pupils with special educational needs, on transport and on educational psychology). Furthermore, cuts to sixth-form funding will affect the overall budgets of schools that have sixth forms for students aged 16–18.

⁵⁵ For a discussion, see C. Belfield and L. Sibieta, ‘The short- and long-run impact of the national funding formula for schools in England’, IFS Briefing Note BN195, 2017, <https://www.ifs.org.uk/uploads/publications/bns/BN195.pdf>.

⁵⁶ <https://www.gov.uk/government/news/13bn-for-core-schools-budget-delivers-rise-in-per-pupil-funding>.

⁵⁷ The Department for Education has announced that local authorities will continue to determine local formulas in 2020–21 (Education & Skills Funding Agency, ‘Schools block funding formulae 2018–19’, 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/726783/Proforma_publication_18-19_FINAL_FOR_PUBLICATION.pdf).

⁵⁸ C. Belfield, C. Farquharson and L. Sibieta, *2018 Annual Report on Education Spending in England*, IFS Report R150, 2018, <https://www.ifs.org.uk/publications/13306>.

consequently increased (and the repayment terms altered). Furthermore, in 2016, maintenance grants for students were abolished and replaced with additional loans.

Since loans do not count as ‘spending’, these changes have the appearance of dramatically reducing public spending on higher education. Belfield et al. (2018)⁵⁹ estimate that, for the cohort of students entering HE in 2017–18, the cost of government spending in the form of direct grants would have been £6.8 billion under the 2011 finance system, but was only £0.8 billion under the 2017 financing arrangements (in 2018 prices). Given that the level of this measure of spending on HE is now so low, it will not be possible to find a similar degree of cuts going forwards.

However, it is important to realise that, while student loans do not count as ‘spending’, the vast majority are not actually expected to be repaid in full, and they therefore do imply a significant public cost in the long run. Belfield et al. (2018) estimate that the total long-run government contribution in respect of the 2017–18 cohort of students will be £8.5 billion under the 2017 system, compared with £9.3 billion under the 2011 system – a substantially smaller reduction in long-run public support than the fall in the measure of ‘spending’ that is included in resource DEL.

The current way in which public support for HE is provided (largely through subsidies from writing off student loans) is opaque.⁶⁰ The government is currently undertaking a review of post-18 education, examining how to ‘ensure our post-18 education system is joined up and supported by a funding system that works for students and taxpayers’.⁶¹ While the terms of reference for the review state that ‘its recommendations must be consistent with the Government’s fiscal policies to reduce the deficit and have debt falling as a percentage of GDP’, it is possible that the review will recommend increasing the overall level of state spending on post-18 education.

Other public services

Perhaps unsurprisingly, after almost a decade of spending restraint, the Chancellor will not be short of requests for additional funding. For instance, a recent report from the House of Commons Defence Committee concluded that ‘defence spending is far too low’ and that the government should begin moving the level of defence expenditure back towards 3% of GDP (rather than the 2% NATO target), which would imply more than £20 billion of extra spending in today’s terms.⁶² A cross-party group of politicians wrote to the Chancellor in July calling for him to commit £24 billion of funding for the high-speed Northern Powerhouse Rail scheme.⁶³ And the Criminal Bar Association has recommended

⁵⁹ C. Belfield, C. Farquharson and L. Sibieta, *2018 Annual Report on Education Spending in England*, IFS Report R150, 2018, <https://www.ifs.org.uk/publications/13306>.

⁶⁰ C. Belfield, J. Britton, C. Crawford, L. Dearden, L. van der Erve and A. Vignoles, ‘Response to call for evidence for the post-18 funding review from the Institute for Fiscal Studies’, 2018, <https://www.ifs.org.uk/publications/12980>.

⁶¹ Department for Education, ‘Review of post-18 education and funding: terms of reference’, 2018, <https://www.gov.uk/government/publications/review-of-post-18-education-and-funding-terms-of-reference>.

⁶² House of Commons Defence Committee, *Beyond 2 Per Cent: A Preliminary Report on the Modernising Defence Programme*, Seventh Report of Session 2017–19, HC 818, 2018, <https://publications.parliament.uk/pa/cm201719/cmselect/cmdfence/818/818.pdf>.

⁶³ <http://northernpowerhouseappg.org.uk/wp-content/uploads/2018/08/Budget-Submission.pdf>.

that its members go on strike in protest at 'relentless cuts' to legal aid and a 'collapsing' criminal justice system.⁶⁴

In short, the Chancellor would face no end of difficult decisions in trying to make the spending cuts implied by the Spring Statement fiscal plans.

4.6 Conclusion

The Budget this autumn is expected to set a firm overall path for public spending for 2020 and beyond, in advance of next year's Spending Review. The provisional totals set out in the March 2018 Spring Statement imply a £2 billion real cut to day-to-day departmental spending between 2019–20 and 2022–23. However, the recent NHS funding announcement will cost £12 billion over that period, and the government has other commitments on defence and aid spending as well. Furthermore, any continuation of the Conservatives' current agreement with the DUP could entail additional funding for Northern Ireland. This means that other, unprotected, departments would be faced with almost £15 billion of cuts in their day-to-day spending, or an average 3.1% per year, should the Chancellor stick to his existing provisional plans – around the same pace of cuts experienced by these areas since 2010.

Further cuts to unprotected departments will be difficult to achieve on top of the considerable cuts already made since 2010. Mr Hammond may therefore want to increase day-to-day spending on public services – but this will require some combination of tax increases, higher borrowing or cuts to other areas of spending, such as social security, investment or perhaps net contributions to the EU. None of this is easy (as discussed in Chapters 3 and 5), even without any adverse economic impacts from the UK's forthcoming departure from the European Union. All in all, the Chancellor has been dealt a tricky hand and faces some difficult and unenviable choices in the months ahead.

Given the difficult trade-offs the Chancellor faces, the way the budgeting process has proceeded over the last few months leaves a lot to be desired. If the government is to have a Spending Review, all public spending should be considered at the same time – ideally alongside the related issue of how much to raise in taxes – rather than announcing large chunks in advance without seeming to factor in the impact on funding for other public services or how they will be paid for. That is not 'how responsible people budget'.

⁶⁴ <https://mailchi.mp/criminalbar/fohprospectus-203485>.