



Institute for Fiscal Studies

IFS Green Budget 2020: Chapter 6

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# Spending Review 2020: COVID-19, Brexit and beyond



# 6. Spending Review 2020: COVID-19, Brexit and beyond

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## Key findings

- 1 This year's Spending Review will take place in extremely challenging circumstances. The immense economic uncertainty associated with the COVID-19 pandemic, and the looming end of the Brexit transition period, make this an extraordinarily difficult time to be formulating public spending plans.
- 2 **The Spending Review comes on the back of a decade of austerity.** By 2019–20, total government spending was just 2.6% higher in real terms than a decade previously, and 4.4% lower in real per-person terms. Day-to-day spending on public services was down 7% in real terms (13% per person). **Outside of Health, real-terms public service spending was cut by 20% (25% per person) over the decade to 2019–20.** This has been the longest sustained squeeze on public spending on record. Yet **despite these cuts, on the eve of the pandemic, government spending as a share of the economy (i.e. the size of the state) was the same as in the mid 2000s.**
- 3 Following the September 2019 Spending Round, which provided across-the-board real-terms budget increases for 2020–21, **the plans published in March 2020 would have seen public service spending rising by 10.7% between 2019–20 and**

**2023–24. This would have been enough to reverse two-thirds of the last decade’s cuts to per-person public service spending.**

- 4 But COVID-19 has rendered these plans obsolete. Departments have been allocated more than £70 billion this year as part of the response to the virus. The Health budget alone has been topped up by £35 billion, or 25%. **A crucial question for the Spending Review is the extent to which this COVID-19 spending needs to continue into future years.**
- 5 If some of these spending programmes – such as expanded procurement of personal protective equipment (PPE) or the running costs of NHS Test and Trace – need to persist, **they could swallow up a huge chunk of the increase in funding pencilled in between now and 2023–24.** Some areas of government would be left facing another bout of austerity unless more money in total is found.
- 6 For instance, if 25% of the spending announced in response to COVID-19 needs to be permanent, that would eat up almost half of the planned £40 billion increase in departments’ non-COVID budgets between 2020–21 and 2023–24 (in today’s prices). Given the government’s commitments on the NHS, schools, the police and ‘levelling up’, **that would almost certainly require another bout of austerity for some public services.** To meet those costs while keeping non-COVID spending growing at the rate planned in March would require the Chancellor to find an additional £20 billion by 2023–24, relative to his pre-pandemic plans.
- 7 **Public spending was at 39.8% of national income in 2019–20, much the same as it was in 2007–08,** despite the cuts in public service spending documented above. It is now likely that the economy will be smaller than expected into the medium run, and there are additional pressures on public spending. As a result, even if no COVID-19 spending continues into future years, **it is probable that total spending will settle**

at a significantly higher fraction of national income than it was pre-pandemic, and higher than it was after 10 years of Labour government in 2007–08.

- 8 **Given the huge amount of economic uncertainty, the Chancellor would be ill advised to embark on a multi-year Spending Review.** Instead, it would be sensible to limit this year's Spending Review to a single year (2021–22), and delay decisions on spending in future years until a point when some of the uncertainty over COVID-19, Brexit and the future of the economy has dissipated.

## 6.1 Introduction

The Chancellor, Rishi Sunak, has announced his intention to hold a Comprehensive Spending Review this year. Departmental budgets do not exist beyond March 2021, and so the government does need a fiscal event of some kind to set budgets for at least the 2021–22 financial year. Yet, despite the ongoing economic turmoil, Mr Sunak intends to hold a comprehensive, multi-year Spending Review, to set out the government's spending plans for the remainder of the parliament (HM Treasury, 2020b).

The Spending Review process is a delicate balancing act at the best of times. It forces the Chancellor to make tough choices between competing departments and a myriad of spending programmes, and to be explicit about the government's priorities – priorities that must be backed up with funding. This inevitably entails difficult trade-offs and can create losers as well as winners. While the scope of a Spending Review is typically limited to central government spending on the provision and administration of public services, the Chancellor must also keep an eye on the wider economy and public finances. New commitments must be funded somehow, whether through cuts to spending on other programmes, such as social security, or through higher levels of tax, or by additional borrowing. All in all, it is a daunting task.

But these are not the best of times. This year's Spending Review will take place amidst unprecedented economic turmoil and immense uncertainty. Four major challenges confront the Chancellor.

First, it comes amidst a global pandemic and the most severe economic downturn in centuries. The degree of uncertainty over the future path of the economy is unprecedented, making it extremely difficult – and arguably unwise – to set supposedly fixed, multi-year, multi-billion-pound spending plans at this moment in time. In any case, the Treasury has already approved more than £70 billion of additional funding for departments *this year* in response to COVID-19, blowing previous spending plans (that were set just last September) out of the water. Some of this additional spending – such as substantially increased procurement of personal protective equipment or the running costs of NHS Test and Trace – may need to continue into future years. The Treasury is also likely to find that it is far easier to dish out new funding than to withdraw it again. A key question for the Chancellor will be the extent to which this additional funding needs to be 'baked in' to future plans – at least for the next few years – and the extent to which COVID-19 is deemed to necessitate higher spending on a permanent or semi-permanent basis.

Second, this year's spending decisions come on the back of a decade of austerity. Per-person spending on public services outside of Health was 25% lower in 2019–20 than a decade previously. Many public services are under considerable pressure and are – unsurprisingly – showing signs of strain. Mr Sunak will not be short of requests for additional funding.

Third, the transition arrangement with the European Union comes to an end in just a few months, but the precise nature of the UK's future relationship with the EU remains unknown. This creates further economic uncertainty. In addition, there is likely to be a need for extra funding for certain departments post-Brexit to reflect new responsibilities (relating, for example, to border issues such as immigration and customs, and areas where UK departments will take on greater responsibility for activities previously done by the EU, most obviously in agriculture and regional support). The government has made commitments to replace a number of EU-funded programmes in the UK, including the creation of a UK Shared Prosperity Fund to replace European structural and investment funds. The Spending Review will need to flesh out (at least some of) the details of these commitments.

Finally, the government is committed to an ambitious ‘levelling-up’ agenda. UK regional inequalities are deep rooted and multifaceted, and as such will not be ‘solved’ in a single parliament. Nonetheless, one prominent feature of the debate has been a focus on where government spending (particularly investment spending) goes. The Spending Review will be an opportunity to provide details on how the government intends to ‘level up’ and to commit the necessary funding to those programmes. These plans will undoubtedly be subject to considerable scrutiny, not least because of the emphasis placed on these issues during the 2019 general election and the Prime Minister’s recent promises to ‘build back better’ and ‘build back bolder’.

This all adds up to an extremely challenging set of circumstances in which to be making public spending decisions. In the March 2020 Budget, Mr Sunak set out the overall spending ‘envelope’ to be allocated at the Spending Review. This funding settlement was generous by the standards of the last decade but no bonanza, and implied tight settlements for areas outside of the NHS, schools and the police.

Since then, following the introduction of several large spanners to the works, Mr Sunak has argued that there is a need for ‘tough choices’ after COVID, which could mean public spending on a lower path than was planned in March. In the coming weeks, he will need to decide both the size of the overall spending pot (the ‘envelope’) and its allocation between departments.

As it stands, the Chancellor remains committed to holding a multi-year review, setting three years of resource (day-to-day) budgets – covering 2021–22, 2022–23 and 2023–24 – and four years of capital (investment) budgets (also covering 2024–25, and therefore taking us right to the end of this parliament, if it were to run for a full five years).

There is typically merit in multi-year reviews, which give departments more certainty and allow them to plan medium-term commitments better. However, as we will argue at the end of this chapter, the degree of economic *uncertainty* means that spending plans set two, three or four years into the future would lack credibility. So, just as the extreme uncertainty over the shape of Brexit motivated a single-year review in September 2019 (covering 2020–21 only), there is once again a strong case for the Chancellor to limit the Spending Review to a single year and to set plans for 2021–22 only.

In this chapter, we outline the public spending framework and explain which components of spending are subject to the Spending Review process, and why. We then discuss in more detail the four major challenges outlined above, before turning to a discussion of the options facing Mr Sunak. We set out a number of scenarios to illustrate the two major choices to be made – the initial baseline of public spending and its real-terms growth rate over the next three years – and consider the implications of each. We then return to the case for holding a one-year Spending Review before concluding.

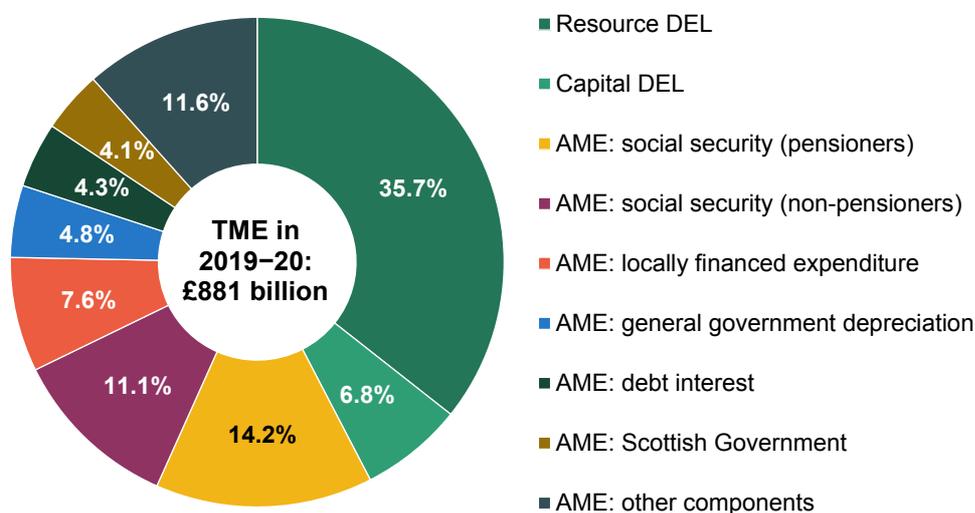
## 6.2 Spending Reviews and the planning of public spending

### The framework

The first Spending Review was held in 1998. The concept was introduced as part of a new regime for the planning and control of government expenditure. Under this framework, spending is split into two totals:

- **Departmental expenditure limits (DEL)** can be broadly thought of as spending by central government on public services, and encompasses spending that can be controlled (rather than being driven by, for example, the economic cycle). This spending is allocated between departments, often on a multi-year basis, at Spending Reviews.
- **Annually managed expenditure (AME)** includes the categories of spending that are more difficult to plan, or are outside of central government's immediate control. This spending – which the government argues cannot reasonably be subject to firm multi-year limits – includes things such as debt interest payments and social security, as well as spending by local or devolved governments financed through the taxes that they control.

Together, these two types of spending comprise total managed expenditure (TME), which in 2019–20 amounted to £881 billion in cash terms. Figure 6.1 breaks this down into its various components.

**Figure 6.1. Components of total managed expenditure (TME) in 2019–20**


Note: £ billion figure shown is nominal (cash terms); equivalent figure in 2020–21 prices is £899 billion. Other components of AME include, for example, net public service pension payments, spending by funded public sector pension schemes, spending by the BBC and public corporations, current VAT refunds, environmental levies, expenditure transfers to the EU and student loans.

Source: Author's calculations using OBR Public Finances Databank (accessed 5 August 2020) and table 3.13 of OBR March 2020 Economic and Fiscal Outlook, with the pensioner/non-pensioner split calculated based on DWP Benefit Expenditure and Caseload Tables 2019.

Spending Reviews typically centre on setting budgets for DEL, which accounts for 42% of all spending.<sup>1</sup> Within that, the government sets resource DEL (day-to-day) and capital DEL (investment) budgets separately. Resource DEL covers the running and administration costs of public services; capital DEL covers money spent building or maintaining physical government assets, such as roads and buildings. Of the 42% of total spending accounted for by DEL, the majority (84%, or 35.7% of TME) is resource DEL (RDEL), with the remainder (16%, or 6.8% of TME) classified as capital DEL (CDEL). The upshot is that less than half of all

<sup>1</sup> The 2010 and 2015 Spending Reviews included parts of AME – in particular, spending on working-age social security – within the envelope, but this approach remains the exception rather than the rule, and we expect the 2020 Spending Review to cover DEL only. For further detail on previous Spending Reviews, see Crawford, Johnson and Zaranko (2018).

government spending falls within DEL, and so less than half of all spending is within the scope of the forthcoming Spending Review.<sup>2</sup>

By far the largest component of AME is social security, accounting for just over 25% of all government spending in 2019–20. Locally financed expenditure (such as spending by local authorities financed out of council tax and business rates revenues) is 7.6% of the total. General government depreciation (the reduction in the value of central and local government assets over time) is 4.8% of the total. Debt interest payments represent 4.3% of the total, and spending by the Scottish Government (which was moved from DEL to AME in October 2018) accounts for a further 4.1% of the total.

### The recent history

Historically, Spending Reviews have tended to cover a period of three years, but have covered as many as four (in 2010 and 2015) and as few as one (in 2013 and 2019). The 2015 Spending Review – carried out by the then Chancellor George Osborne – set four years of resource DEL plans from 2016–17 to 2019–20 and five years of capital DEL plans (up to the current financial year, 2020–21).

The September 2019 Spending Round, held a few months before the December 2019 general election, was limited to a single year, setting departmental resource budgets for 2020–21 only. The then Chancellor Sajid Javid topped up the plans he inherited from his predecessor Philip Hammond and announced spending increases across the board, such that no department faced a real-terms cut. Mr Javid announced a planned real-terms increase of 4.1% in resource DEL and also topped up the plans for investment spending announced at the previous Spending Review by £1.7 billion such that capital DEL was planned to grow by 5.0% between 2019–20 and 2020–21.<sup>3</sup>

In March of this year, alongside his first Budget, Mr Sunak set out the total ‘envelope’ for the 2020 Spending Review. This planned for 2.8% and 3.4% average

<sup>2</sup> This somewhat understates the extent to which the level of DEL can control overall public expenditure, because grants from Westminster to the Scottish, Welsh and Northern Irish governments are determined based on the ‘Barnett formula’, which takes into account departmental spending in England on spending areas that are devolved.

<sup>3</sup> A comparison of these planned growth rates and those in previous Spending Reviews is provided in Section 6.4.

annual real-terms growth over the Spending Review period in RDEL and CDEL, respectively, relative to the 2020–21 plans set by Mr Javid.

These plans have, however, been rendered obsolete by the government’s response to the COVID-19 pandemic. The Office for Budget Responsibility’s most recent estimates indicate that the government’s fiscal response to COVID-19 will add more than £180 billion to total spending in 2020–21, almost £80 billion of which falls within DEL.<sup>4</sup> These in-year spending top-ups are equivalent, respectively, to an astonishing £2,700 and £1,200 per person in the UK.

In July, the Chancellor rowed back from the spending envelope he had committed to in March, citing – quite reasonably – the unprecedented degree of economic uncertainty. He reiterated his intention to set three years of resource budgets (from 2021–22 to 2023–24) and four years of capital budgets (from 2021–22 to 2024–25), but declined to set a fixed envelope, promising only that departmental spending (both day-to-day and investment budgets) would increase in real terms over the period (though, as we discuss in Section 6.4, it is not clear which baseline this will be measured against).

## 6.3 Four big challenges for Spending Review 2020

### A decade of austerity

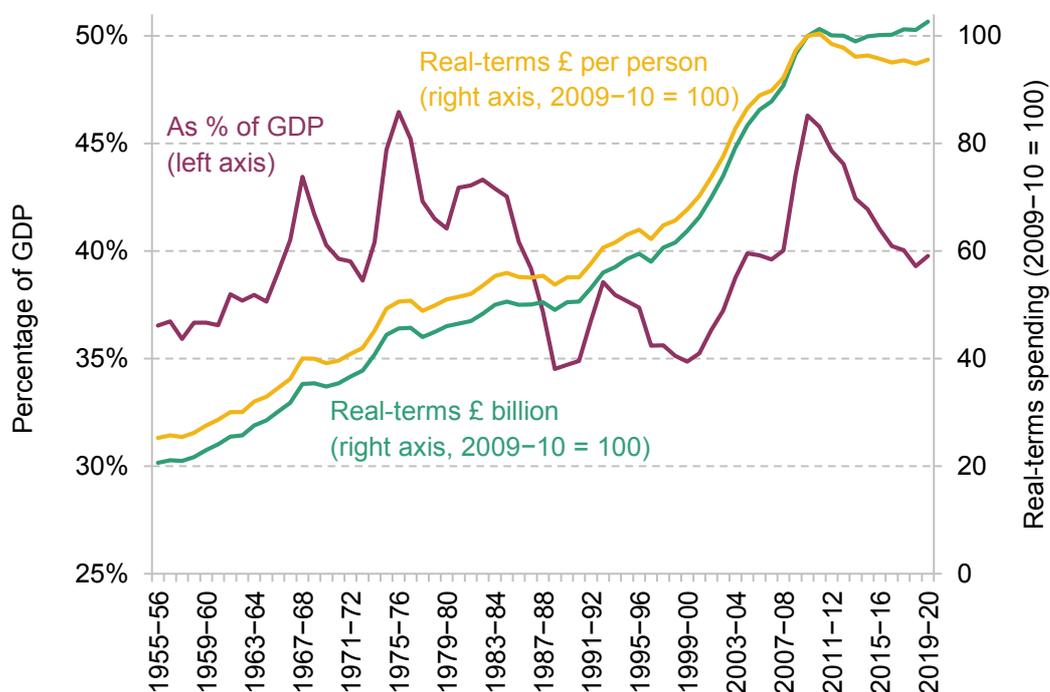
#### Overall government spending

The decade from 2009–10 to 2019–20 was one of unprecedented spending restraint. The coalition and Conservative governments over this period embarked on a major programme of cuts to spending on public services, alongside substantial cuts to the generosity of working-age social security.

As Figure 6.2 shows, this programme of spending cuts kept real-terms total government spending, including both DEL and AME, broadly flat over the decade. This broke with the long-term seemingly inexorable rise of real-terms government spending since the 1950s. Between 1955–56 and 2009–10, government spending

<sup>4</sup> Further details and analysis of the additional spending announced in response to COVID-19 is provided in Section 6.3.

Figure 6.2. Total managed expenditure



Note: TME in 2009–10 (the base year) was £876 billion, or £14,037 per person, in 2020–21 prices. The equivalent figures for 2019–20 are £899 billion and £13,421 (also in 2020–21 prices). These are also shown in Table 6.1.

Source: Author's calculations using OBR Public Finances Databank (accessed 5 August 2020), ONS June 2020 GDP deflators and ONS mid-year population estimates.

grew at an average real rate of 3.0% per year. Between 2009–10 and 2019–20, it grew at an average rate of 0.3% per year – the slowest of any decade on record – and fell in per-person terms (as shown in Figure 6.2). This represents the longest sustained squeeze in public spending since records began.

As a share of the economy, government spending fell from a peak of 46.3% of GDP in 2009–10 to 39.8% in 2019–20 – almost exactly the level it was at prior to the financial crisis. That is to say, on the eve of the pandemic, despite a decade of virtually zero real-terms spending growth, the size of the state was the same as in the mid 2000s (but larger than in the late 1980s and 1990s).

### Departmental spending

While total government expenditure remained broadly flat over the decade to 2019–20, beneath the surface there were major shifts in its components. Higher

spending on the state pension and other pensioner benefits (despite a sharp rise in the female state pension age), alongside a substantial increase in the amount of locally financed expenditure, saw AME rise from 52% to 58% of the total.<sup>5</sup> Over the same period, spending by central government on public services – as measured by total DEL – fell by 7.8% in real terms, or 14.1% in real per-person terms.

These overall cuts to DEL left less money for day-to-day public service spending by central government.<sup>6</sup> Resource DEL fell by 0.7% per year, or 1.4% per year in per-person terms. This compares with average growth of 4.2% per year (3.5% in per-person terms) over the decade up to 2009–10. In other words, despite a decade of near-uninterrupted (though relatively anaemic) economic growth, day-to-day spending by central government on public services was 6.6% lower in 2019–20 than ten years previously and 13.0% lower once population growth is taken into account. We should not lose sight of this remarkable fact. This can be seen graphically in Figures 6.3 and 6.4.

Outside of the Department of Health – whose budget was repeatedly protected from cuts during the 2010s – the scale of spending cuts was even greater. Day-to-day departmental budgets outside of Health were cut by a fifth between 2009–10 and 2019–20; after accounting for population growth, spending per head fell by just over a quarter. In contrast, the day-to-day Health budget increased by 21.3% over the decade (13.1% in per-person terms).

Investment spending followed a much bumpier, but less decisively downward, path than RDEL. Capital spending by departments increased at a rapid rate over the course of the 2000s, with an average annual real growth rate of 11.6% between 1999–00 and 2009–10. Capital budgets were then cut sharply by more than 30% in the years immediately after 2009–10, before increasing gradually in the years after 2012–13 (although not by enough to reverse the earlier cuts). This, along with the paths for TME, RDEL and RDEL excluding Health since 2009–10, is shown in Figures 6.3 and 6.4.

<sup>5</sup> In addition, reclassifications have moved some components of spending from DEL to AME (a major example being Scottish Government spending, which was reclassified in October 2018).

<sup>6</sup> It should be noted that some of the reduction in central government spending on public services was offset by an increase in locally financed expenditure (which falls within AME), and in particular through increases in council tax for local authorities. For further detail on local government funding in England, see Harris, Hodge and Phillips (2019).

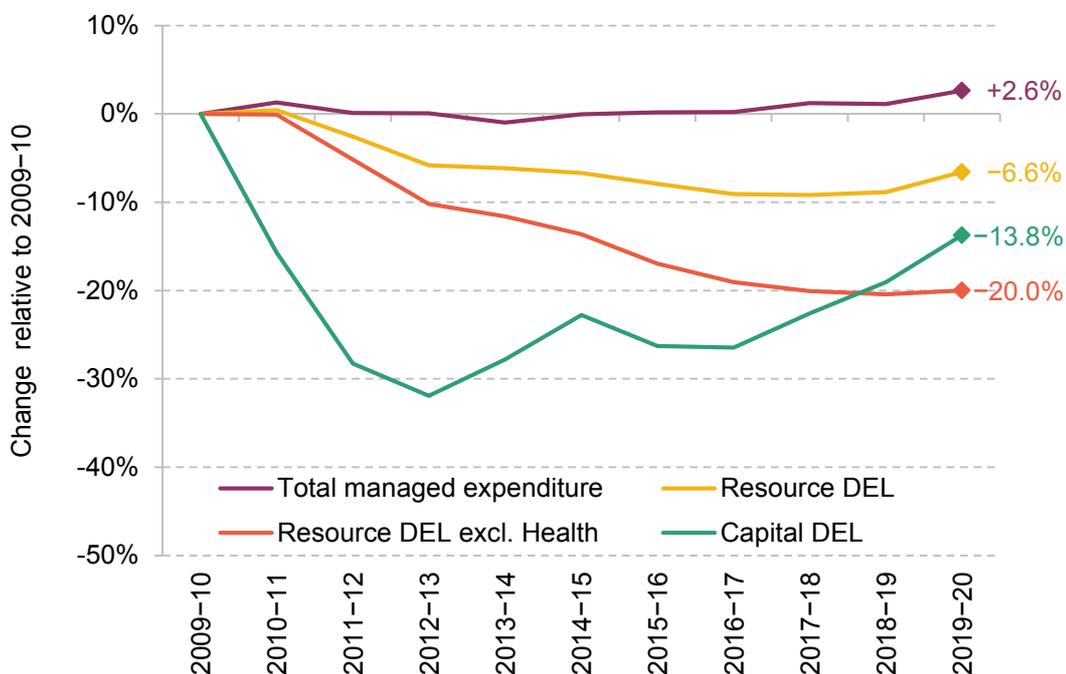
Table 6.1. Government spending over the past two decades

	1999–00	2009–10	2019–20
<b>Total managed expenditure</b>			
£ billion (2020–21 prices)	£557.9bn	£875.7bn	£898.8bn
£ per person (2020–21 prices)	£9,499	£14,037	£13,421
% of GDP	34.9%	46.3%	39.8%
<b>Resource DEL</b>			
£ billion (2020–21 prices)	£229.9bn	£345.6bn	£322.8bn
£ per person (2020–21 prices)	£3,915	£5,539	£4,820
% of GDP	14.4%	18.3%	14.3%
<b>Resource DEL excl. Department of Health</b>			
£ billion (2020–21 prices)	£169.0bn	£233.4bn	£186.7bn
£ per person (2020–21 prices)	£2,877	£3,740	£2,788
% of GDP	10.6%	12.3%	8.3%
<b>Capital DEL</b>			
£ billion (2020–21 prices)	£24.0bn	£72.1bn	£62.2bn
£ per person (2020–21 prices)	£409	£1,157	£929
% of GDP	1.5%	3.8%	2.8%

Note: Resource DEL and capital DEL here denote the OBR's definition of PSCE in RDEL and PSGI in CDEL, respectively, adjusted for historical discontinuities. 2019–20 figure is also adjusted to remove additional resource spending related to employer pension contributions. Department of Health is Department of Health and Social Care after 2018. Higher spending as a % of GDP in 2009–10 is driven partly by a reduction in the denominator (GDP) following the financial crisis and associated recession; two years before, spending was 40.0% of GDP.

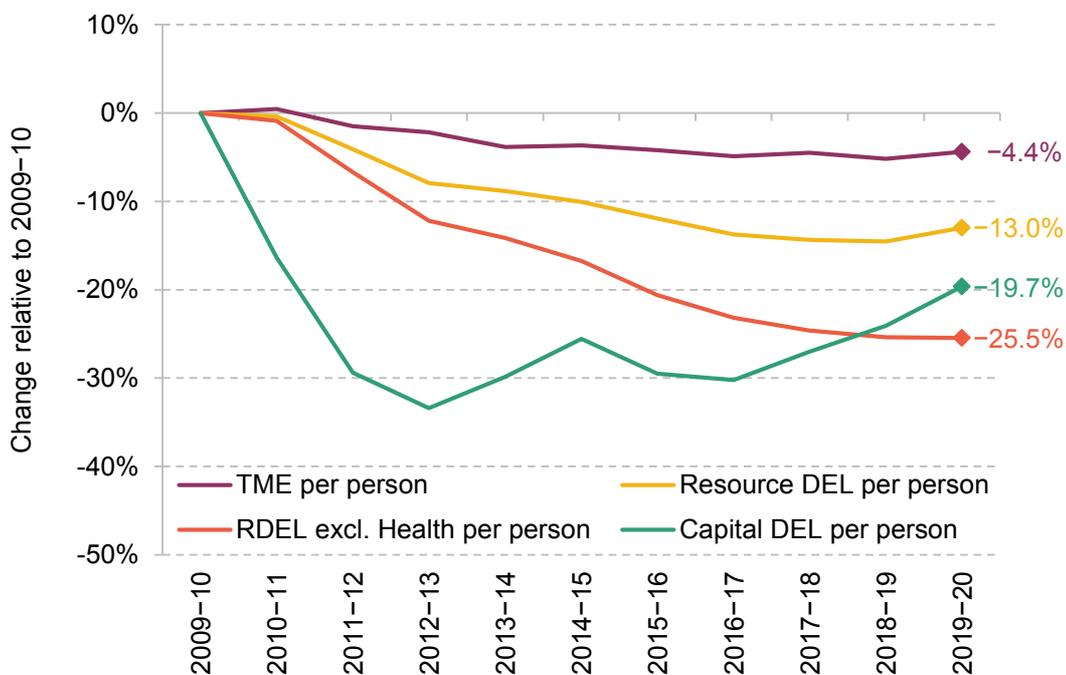
Source: Author's calculations using OBR Economic and Fiscal Outlook (October 2018 and March 2020), OBR Public Finances Databank (accessed 5 August 2020), HM Treasury Public Expenditure Statistical Analyses (various) and ONS June 2020 GDP deflators.

Figure 6.3. Real-terms spending since 2009–10



Note and source: As for Table 6.1.

Figure 6.4. Real-terms spending per person since 2009–10

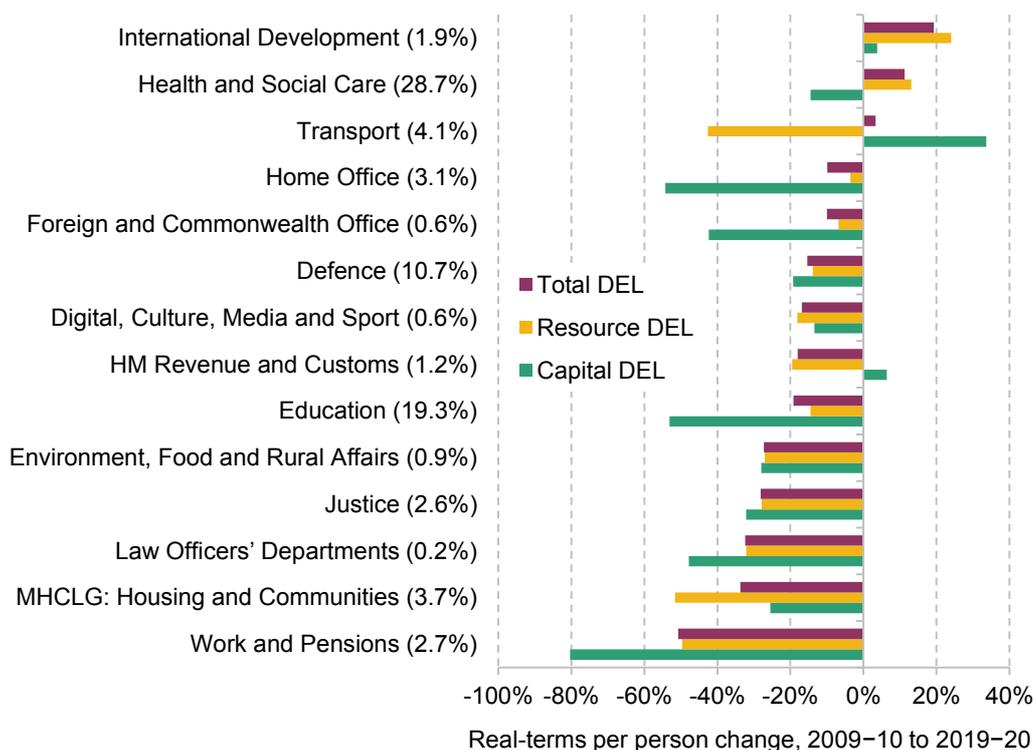


Note and source: As for Table 6.1.

### Spending cuts have not fallen equally across departments

As indicated above, some departments were relatively protected over the 2010s and shielded from cuts. Other departments were less fortunate. This can be seen in Figure 6.5, which shows the real per-person change in departmental budgets between 2009–10 and 2019–20. The now-abolished Department for International Development (DfID) and the Department of Health and Social Care (DHSC) have enjoyed real-terms increases in their per-person resource budgets, and the DfID capital budget also increased in per-person terms. In contrast, in some departments, per-person resource budgets have fallen by more than a quarter. These include the

**Figure 6.5. Real-terms per-person departmental budget changes, 2009–10 to 2019–20**



Note: Figures in parentheses denote each department's share of total departmental expenditure limits (TDEL) in 2009–10. These do not sum to 100% due to the exclusion of the local government component of MHCLG and block grants to the devolved governments of Scotland, Wales and Northern Ireland. Resource budgets shown here exclude depreciation.

Source: Author's calculations using HM Treasury Public Expenditure Statistical Analyses (various) and ONS June 2020 GDP deflators, with population figures taken from supplementary expenditure table 4.3 of OBR's March 2020 Economic and Fiscal Outlook.

Department for Work and Pensions (DWP),<sup>7</sup> the Department for Environment, Food and Rural Affairs (Defra), the Ministry of Justice, the Law Officers' Departments (which includes the Crown Prosecution Service), and the Housing and Communities budget within MHCLG.

Some of these figures mask considerable within-department variation. Within the Department for Education budget, for example, spending on early years (3- and 4-year-olds) increased over this period with extensions to funded childcare entitlements, while funding for further education and sixth-form colleges was cut after 2011 (Britton, Farquharson and Sibieta, 2019). While funding allocated to schools rose in real per-pupil terms, cuts to spending by local authorities and funding for school sixth forms meant total per-pupil spending on schools fell by 9% in real terms between 2009–10 and 2019–20 (Sibieta, 2020). Within the DHSC budget, the NHS England budget was steadily increased, but other components of the health budget (such as public health initiatives, and education and training) have faced deep cuts. Between 2013–14 and 2019–20, while the NHS England budget increased by 19.0% in real terms (14.2% in real per-person terms), non-NHS health budgets were cut by 6.7% (10.4% per person).

Many of the public services provided by the departments on the receiving end of large cuts were, not surprisingly, showing clear signs of strain even prior to the outbreak of COVID-19.<sup>8</sup> For example, the number of prisoner-on-prisoner assaults in England and Wales almost doubled between March 2010 and March 2020; the number of assaults on prison staff more than trebled over that period (Ministry of Justice, 2020). Following sizeable cuts to the Crown Prosecution Service, concerns have been raised over its performance in sexual offence cases (Institute for Government, 2019).

Local government is another area to have faced substantial cuts and to now be showing signs of strain. For councils in England, a 77% reduction in per-person grant funding from central government was only partially offset by increases in council tax and business rates revenues. As a result, local government revenues fell

<sup>7</sup> This is the cost of running the department (i.e. administering the social security system), and does not include the cash payments made to benefit recipients.

<sup>8</sup> It is worth noting that many public services appeared to cope fairly well in the years immediately after 2010, with signs of deterioration in performance appearing (in most cases) only after around 2015. For an excellent discussion, see Institute for Government (2019).

by 18% between 2009–10 and 2019–20 (Harris, Hodge and Phillips, 2019). Local authorities in more deprived areas, which were more reliant on grants from central government to begin with, saw bigger cuts in funding than those in less deprived areas. In response, local authorities have had to make deep cuts to spending on some services. Net spending on social care for adults aged 65 and above was cut by approximately 18% over the decade (despite the population aged 65 and over in England growing by more than 20% over that period); other budgets (such as housing, culture and recreation, and planning and development) were cut to an even larger degree (Harris, Hodge and Phillips, 2019). Even areas that have been relatively protected from cuts, such as children’s social care, have been showing signs of deteriorating service quality and a greater focus on statutory responsibilities (Britton, Farquharson and Sibieta, 2019; Institute for Government, 2019).

In sum, following a decade of swingeing spending cuts to public services outside of the NHS, it is difficult to see how further savings could be found without severe consequences for the range and quality of service provision.

### Social security

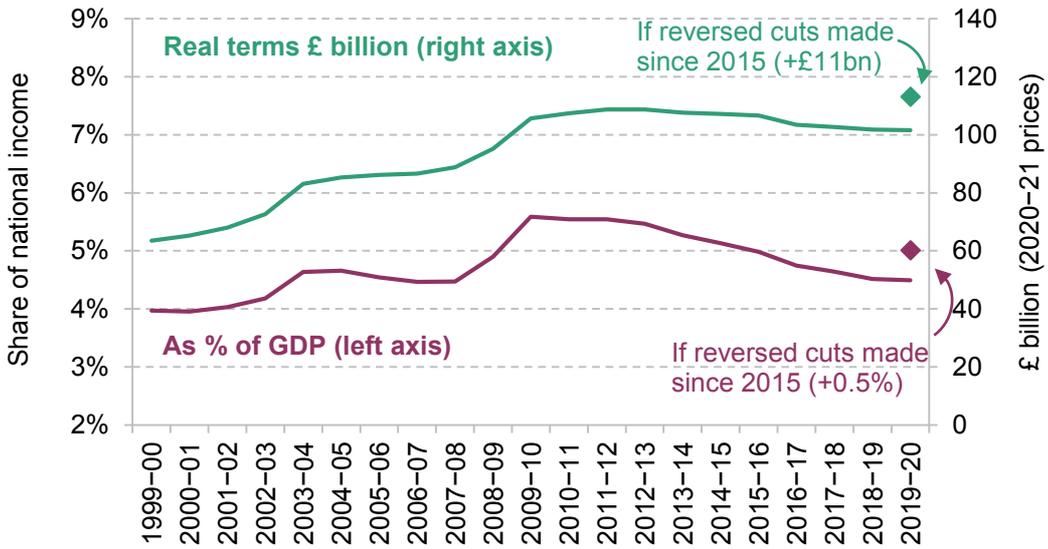
Spending cuts have not been limited to public services. Figures 6.6 and 6.7 show how spending on working-age and pensioner social security, respectively, evolved between 1999–2000 and 2019–20. After a sharp increase during the financial crisis and ensuing recession, spending on working-age social security fell steadily as a share of national income until 2019–20, and has fallen slightly in real terms over that period. An important driver of this has been discretionary policy measures designed to reduce the generosity of the system. Cuts from just the changes made since June 2015 meant that spending on working-age social security was £11 billion lower by 2019–20 than it would otherwise have been.<sup>9</sup>

Spending on pensioner social security has increased in real terms since 2009–10, but has been falling as a share of national income since 2012–13. This is primarily due to increases in the female state pension age since 2010. For those who are drawing a pension, the generosity of benefits has been largely protected, with the

<sup>9</sup> Note that this is just shy of the £12 billion commitment made in the Conservatives’ 2015 general election manifesto, although delivered by year 4 of the parliament (rather than year 2, as committed to in the election manifesto).

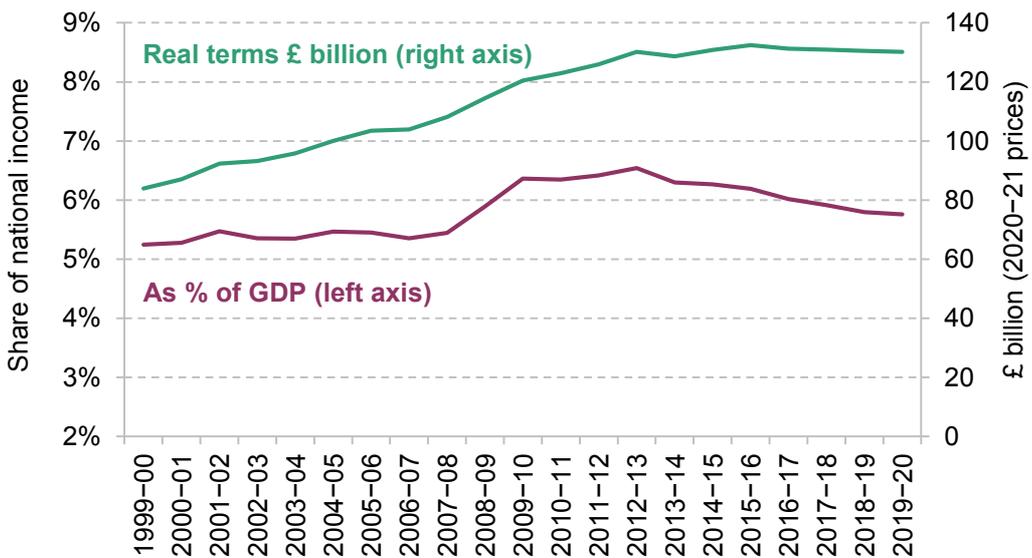
‘triple lock’ making the state pension more generous than it would have been had it ‘only’ been indexed in line with growth in earnings.

**Figure 6.6. Working-age social security spending since 1999–2000**



Source: Author’s calculations using DWP Benefit Expenditure and Caseload Tables 2019, OBR Public Finances Databank (accessed 5 August 2020), OBR Policy Measures Database and ONS June 2020 GDP deflators.

**Figure 6.7. Pensioner social security spending since 1999–2000**



Source: As for Figure 6.6.

The overall result is that, for every £1 of social security spending on working-age households in 2009–10, pensioner households received £1.14 in social security spending. By 2019–20 the gap had doubled, bringing this figure to £1.28.

### Public sector pay

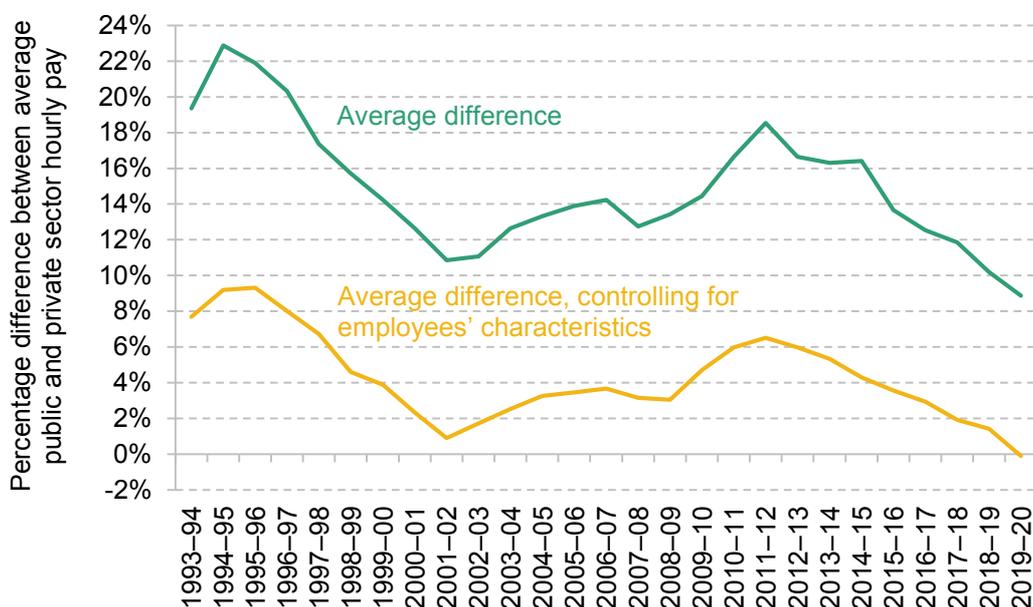
The cost of employing public sector workers is a major component of government expenditure. In 2019–20, the UK general government spent £204 billion employing around 5.4 million people (in both central and local government, and the devolved administrations). As part of the broader austerity programme, pay growth in the public sector was highly restrained in the years after 2010. Public sector pay was frozen in cash terms for all but the lowest-earning employees in 2011–12 and 2012–13; pay scales were then increased by 1% per year in cash terms in the years that followed, before the pay cap was lifted in 2017. Despite above-inflation pay awards in recent years, average earnings in the public sector in the first quarter of 2020 were 1.5% lower than a decade previously.<sup>10</sup>

One consequence of pay restraint in the public sector has been a narrowing of the gap between public and private sector pay. Figure 6.8 shows that in 2019–20, average hourly pay in the public sector was around 9% higher than in the private sector. This gap between average public and private sector pay is now at its lowest level in decades, lower even than in the early 2000s when some parts of the public sector were plagued by acute shortages and recruitment challenges. And, while public sector workers earn more on average, this difference disappears – and even becomes slightly negative – once observed worker characteristics such as education and age are taken into account.<sup>11</sup> Recent public sector pay awards, and their potential impact on the public–private pay differential, are discussed in Section 6.4.

Pay restraint in the public sector since 2010 has exacerbated difficulties with recruitment and retention. The School Teachers' Review Body (2020) has noted, for example, that the overall target for postgraduate initial teacher training was missed in 2019–20 for the eighth successive year, with particular challenges in

<sup>10</sup> Source: Author's calculations using ONS series KAD8 (public sector excluding financial services average weekly earnings) and L522 (CPIH index).

<sup>11</sup> Public and private sector workers differ in the number of hours that they work, and public sector workers are more likely to be highly educated professionals who command higher wages in the labour market. Public sector workers are also more likely to be women (who are more likely than men to work part-time). For more details, see Cribb, Emmerson and Sibieta (2014).

**Figure 6.8. Difference between average public and private sector pay**


Note: Difference controlling for workers' characteristics controls for differences in age, education, experience and region, all interacted with sex, following the same methodology as in Cribb, Emmerson and Sibieta (2014).

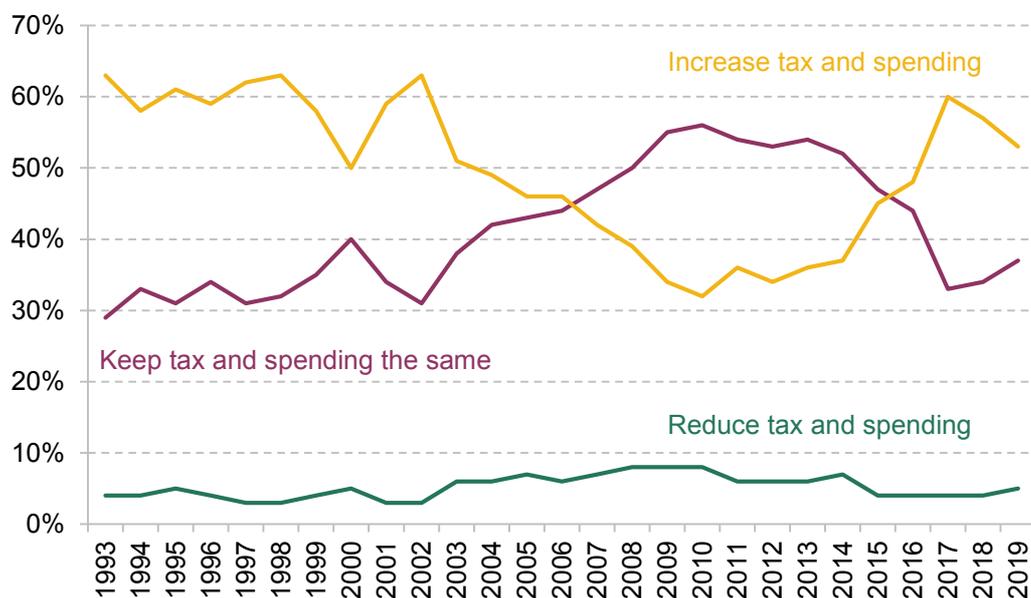
Source: Author's calculations using Labour Force Survey.

subjects such as maths, science and modern foreign languages. The NHS Pay Review Body (2020) has raised concerns over the impact of persistent workforce gaps and high vacancy rates. In some cases, these recruitment pressures have already led to decisions to increase pay; for example, the government is committed to raising teacher starting salaries in England to £30,000 by 2022 (Sibieta, 2020). Still, pressures in other sectors are likely to remain and decisions over departmental budgets will be made against this backdrop.

### There are signs that the public wants an end to austerity

One consequence of the decade of austerity has been shifting public attitudes towards the level of tax and spending. In particular, prior to the COVID-19 pandemic, there were signs of an increased willingness from the public, after a decade of spending cuts, to pay more in tax to finance higher spending on public services. Figure 6.9 shows that support for increased levels of tax and spend was around 60% in the late 1990s, falling to 32% in 2010. In 2019, support for higher tax and spending stood at 53%. This is down from 60% in 2017, with the reduction

Figure 6.9. Changing attitudes towards levels of tax and spending

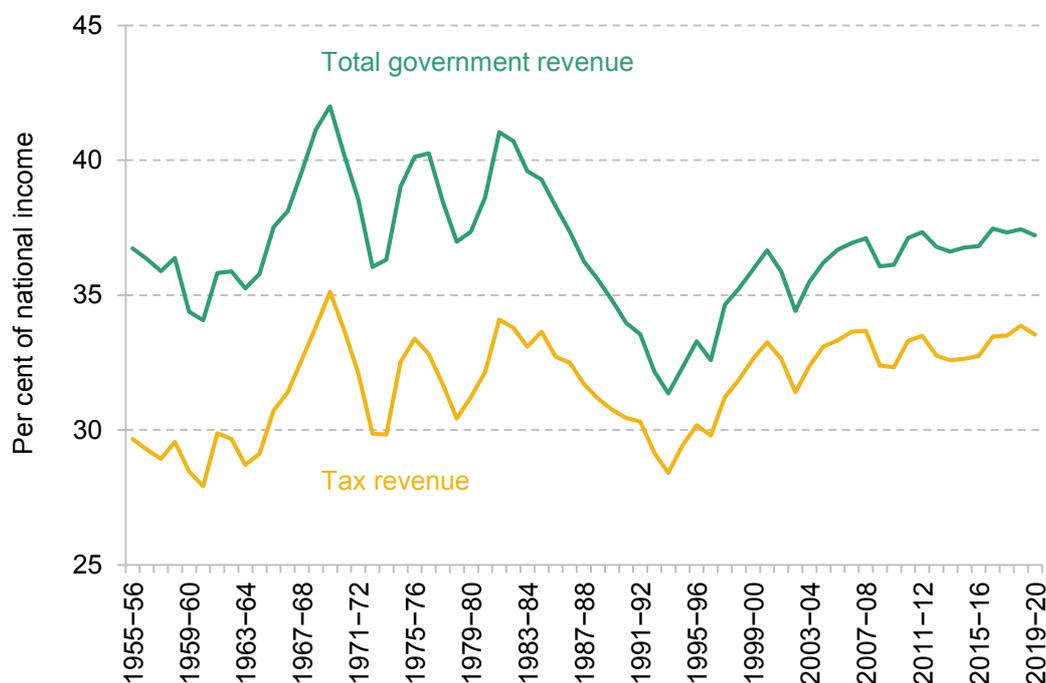


Source: NatCen, British Social Attitudes Survey 2019, <https://natcen.ac.uk/news-media/press-releases/2020/march/backing-for-more-taxation-and-public-spending-falls-among-labour-supporters/>.

perhaps driven by the substantial increases in public spending (notably on the NHS) announced since then. Nonetheless, a majority of the public think that the government should increase the level of tax and spending – including 52% of Conservative voters. Only 5% of voters think that the level of tax and spending should be reduced.

This suggests some appetite from the public for higher levels of public spending – perhaps even if taxes have to rise to pay for it. That is, they are keen to see an end to austerity for public services.

Depending on how one defines austerity, it has arguably already come to an end, in the sense that public spending is on a decisively upwards trajectory. The 2019 Spending Round announced spending increases across the board, such that no department faced a real-terms cut in 2020–21 (Crawford and Zaranko, 2019). But, as demonstrated earlier in the chapter, the increases in this settlement look modest compared with the cuts imposed during the previous decade, with day-to-day budgets outside of Health 25% lower in 2019–20 than in 2009–10. And, in any

**Figure 6.10. Government revenue**


Source: OBR Public Finances Databank (accessed 5 August 2020).

case, there are still cuts to social security working their way through the system, in the form of the ‘two-child limit’ in tax credits and universal credit.

It is also important to note that taxes (measured as a share of national income) are already at a high level by UK historical standards, as shown by the yellow line in Figure 6.10. Only in nine of the last 65 years were tax revenues higher as a share of national income than in 2019–20. Any increases in public spending financed by higher taxes would come against this backdrop. This is important context for Mr Sunak’s choices at the Spending Review later this year.

### Additional spending in response to COVID-19

Spending plans for 2020–21 were set at the September 2019 Spending Round, and topped up at the March 2020 Budget. Under those plans, resource DEL and capital DEL were planned to increase by 6.2% and 16.5%, respectively, in real terms between 2019–20 and 2020–21 (planned cash settlements are shown in Table 6.2).

Since then, the government’s response to the coronavirus has required huge sums of additional public spending in the financial year in progress. On 14 July, the Office

for Budget Responsibility estimated that the government's coronavirus policies would add £178 billion to total spending in 2020–21. Combined with the additional £3 billion announced for NHS England on 17 July (with approximately £0.6 billion of associated funding for Scotland, Wales and Northern Ireland via the Barnett formula), this implies a total increase of £182 billion this year. That would represent an astonishing 20% increase relative to the March forecast for total managed expenditure. This figure could, of course, be revised upwards if the government makes further spending announcements. It also relates only to *discretionary* spending increases (such as increased health spending or more generous support through the benefits system) and does not include, for example, the higher spending on universal credit due to rising unemployment.

Table 6.2 provides a breakdown of this additional spending into the categories used for planning public expenditure. Of the £181.8 billion of extra spending in 2020–21, the largest component (£84.9 billion) falls within resource AME. Almost all of this is the estimated cost of the Coronavirus Job Retention Scheme (or 'furlough' scheme), the Self-Employment Income Support Scheme, and temporary increases in the generosity of working-age welfare payments (mainly through a one-year boost to the generosity of universal credit; see Chapter 8). A further £17.0 billion falls within capital AME, made up of the expected fiscal costs of writing off loans to businesses (made through the Bounce Back Loan Scheme and the Coronavirus Business Interruption Loan Scheme).

This leaves £79.9 billion of additional funding added to departmental expenditure limits for 2020–21 (so far), and therefore directly relevant for the Spending Review. £7.1 billion of this is capital DEL, made up of extra funding for cycling and walkways, green homes grants, a top-up to the health capital budget, and the infrastructure package announced on 30 June. Two features of the capital spending package are notable. First, some of the funding for the infrastructure package is not 'new' but brought forward from future years, hence the negative figures for capital DEL in 2021–22 and 2022–23 in Table 6.2. Second, the Office for Budget Responsibility (2020b) now expects departments to underspend their capital budgets by £5 billion more than the £4 billion expected in March (in large part because of the shutdown of the construction sector), taking the total expected underspend in capital DEL to £9 billion. This means that the vast majority

(£6.4 billion) of the £7.1 billion ‘increase’ in capital DEL is paid for by reallocating existing budgets.<sup>12</sup>

**Table 6.2. Estimated additional spending in response to COVID-19 as at 17 July (£ billion, cash terms)**

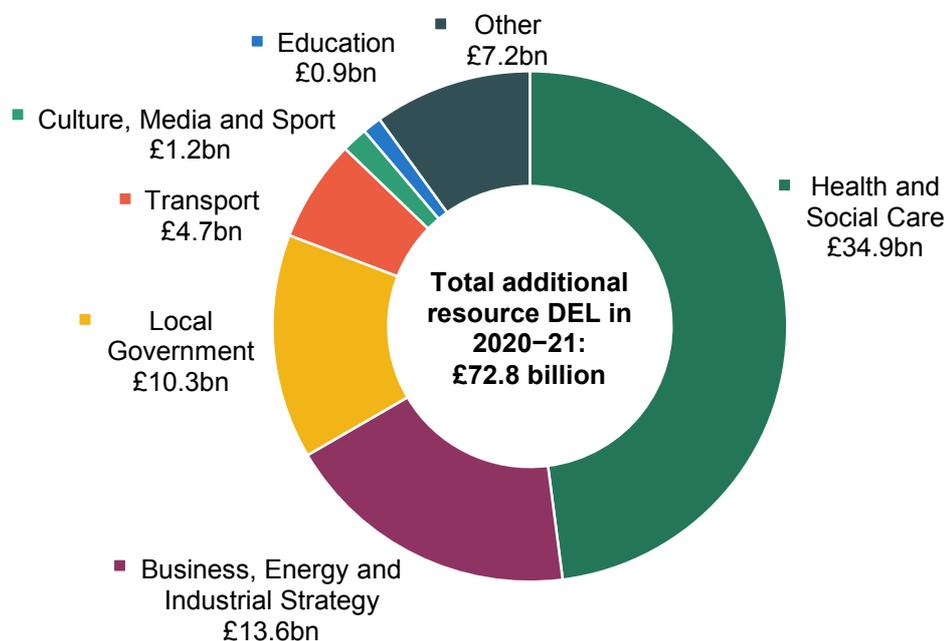
	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
<b>Total (£ billion)</b>	<b>4.7</b>	<b>181.8</b>	<b>2.3</b>	<b>0.2</b>	<b>1.4</b>	<b>0.8</b>
<i>of which:</i>						
Resource DEL	2.2	72.8	0.6	-	-	-
Capital DEL	-	7.1	-0.7	-0.7	0.6	-
Resource AME	2.5	84.9	2.3	0.8	0.8	0.8
Capital AME	-	17.0	-	-	-	-
<b><i>Memo: March 2020 plans</i></b>						
<i>Total spending</i>	<i>886.8</i>	<i>927.7</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Resource DEL</i>	<i>330.4</i>	<i>360.6</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Capital DEL</i>	<i>71.1</i>	<i>88.5</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>

Note: Figures are for discretionary spending only and are accurate as of 17 July. Resource DEL and capital DEL are on the HM Treasury definition. Total spending refers to total managed expenditure.

Source: OBR’s Coronavirus Policy Monitoring Database, 14 July 2020 (<https://obr.uk/coronavirus-analysis/>); Prime Minister’s statement on coronavirus, 17 July 2020 (<https://www.gov.uk/government/speeches/pm-statement-on-coronavirus-17-july-2020>); HM Treasury, Budget 2020.

<sup>12</sup> This is made up of £5 billion of underspends, plus (net) £1.4 billion of capital spending brought forward from future years. For a discussion of this issue, and the implications for the devolved governments, see Phillips (2020).

**Figure 6.11. Additional day-to-day public service funding allocated (so far) in 2020–21 in response to COVID-19, by department**



Note: Figures accurate as of the time of writing. ‘Other’ includes funding to boost work-search, skills and apprenticeships, funding for public sector and social housing decarbonisation, additional funding for charities, additional funding for the devolved administrations and ‘other public services’.

Source: Author’s calculations using the OBR’s Coronavirus Policy Monitoring Database, 14 July 2020 (<https://obr.uk/coronavirus-analysis/>) and the Prime Minister’s statement on coronavirus, 17 July 2020 (<https://www.gov.uk/government/speeches/pm-statement-on-coronavirus-17-july-2020>).

The remaining £72.8 billion of COVID-related spending is additional resource DEL, a breakdown of which is provided in Figure 6.11.<sup>13</sup> The lion’s share is for the Department of Health and Social Care, which has been allocated an additional £34.9 billion in 2020–21 (a 25% increase on its previously set budget for 2020–21). In the Summer Economic Update on 8 July, the Treasury indicated that of this, more than £15 billion is for procurement of personal protective equipment (PPE) and £10 billion is for the government’s ‘test and trace’ programme (HM Treasury, 2020a). These are truly astonishing sums. £15 billion on PPE is equivalent to

<sup>13</sup> Note that the OBR also expects an additional £5 billion of departmental underspends on resource budgets, relative to what was expected in March. This means that resource DEL is in fact expected to be £67.8 billion, not £72.8 billion, higher this year and takes the total increase in expected underspending since March to £10 billion.

around £8,400 per NHS employee.<sup>14</sup> The £10 billion cost of ‘test and trace’ is equivalent to more than £350 for every household in the UK. The OBR’s costings imply this is all for the 2020–21 financial year. A crucial consideration for the Spending Review will be the extent to which this spending needs to continue into future years.

The £13.6 billion allocated to the Department for Business, Energy and Industrial Strategy (BEIS) is for measures to support businesses during the pandemic (i.e. business grant schemes). Of the £10.3 billion allocated to local government, £6.7 billion is in respect of business rates relief. Depending on the damage done to business balance sheets in recent months, and the future course of the pandemic and economic recovery, some support of these types may need to be extended. Some of the other funding for local government is also likely to be needed to continue into future years. Most obviously, given the well-publicised issues in care homes and broader challenges facing the sector, reversing the additional local government funding for social care would be fraught with challenges.

Other notable components of the resource DEL package include almost £5 billion to support public transport services, a £1.2 billion Culture Recovery Fund and around £1 billion of additional funding for schools.

These totals do not include any further funding measures that may be required before the end of 2020–21. For instance, the NHS and social care services may need further top-ups in the event of a ‘second wave’ in the winter alongside the usual flu season. Public transport numbers may never return to the levels expected prior to the pandemic, which could mean the government has to provide additional support to train operating companies, Transport for London and bus services. Financial support for universities and further education colleges could be needed in the aftermath of the A level and GCSE results debacle.

As noted earlier, a portion of this extra spending is likely to be offset by underspends elsewhere (the OBR now estimates that departments will underspend their day-to-day budgets by £5 billion more than the £3 billion it expected in March). A further portion could potentially be offset by lower spending on other

<sup>14</sup> Some of the PPE procured under the auspices of the NHS may have gone to social care providers. £15 billion is equivalent to approximately £4,100 for every health and social care worker in the UK.

items, particularly those tied to the size of the economy. The government is committed to spending 0.7% of national income on official development assistance (ODA, or overseas aid) and at least 2% of national income on defence and national security. The COVID-19 outbreak, and the public health response to it, are expected to lead to a sharp reduction in economic activity this year. A smaller economy means that a lower level of £ spending is required to meet targets couched in terms of a percentage of national income. The Foreign Secretary, Dominic Raab, (whose remit now includes international development) has already indicated that the government plans to cut £2.9 billion from the ODA budget this year (bringing spending back to its 0.7% target) (Raab, 2020). It remains to be seen whether a similar approach will be taken to defence spending, although an in-year cut to the defence budget seems unlikely, not least because it would be difficult to do efficiently.

Looking beyond this year, even if the (worst of the) COVID-19 pandemic is behind us, the fallout may still require higher spending on public services than would otherwise have been the case. This could be because new programmes such as NHS Test and Trace need to continue or because the public simply demands more spending to ensure a better level of preparedness for the next pandemic or other emergency.

Another important consideration is the extent to which ‘catch-up’ funding is needed to help public services recover from this year’s disruptions. Within the NHS, all non-urgent planned care was postponed during the peak of the pandemic, causing a build-up of demand and a rapid increase in waiting times for treatment (Royal College of Surgeons of England, 2020). Recent estimates from the Health Foundation suggest that it could require £560 million per year to return waiting times to the 18-week standard (Charlesworth, Watt and Gardner, 2020). The pandemic has also caused delays outside the health service. To take just one example, recent work from the Institute for Government shows that delays to court hearings have contributed to an unprecedented backlog in court cases, with average waiting times potentially set to increase to the highest level ever recorded (Davies, Guerin and Pope, 2020). The authors estimate that an extra £55–£110 million of spending per year for two years would be needed to run the extra trials necessary to resolve the backlog. These are not huge sums on their own, but this is just one example of many.

All told, the additional spending announced in response to the coronavirus is unlikely to be just a temporary ‘blip’. Some of the funding already announced may need to be permanent or semi-permanent in nature, and so essentially included in the Spending Review baseline. Recovery from the pandemic and associated economic downturn is also likely to place additional demands and funding pressures on public services in the years ahead. The 2020 Spending Review will have to tackle these issues head on.

## Brexit

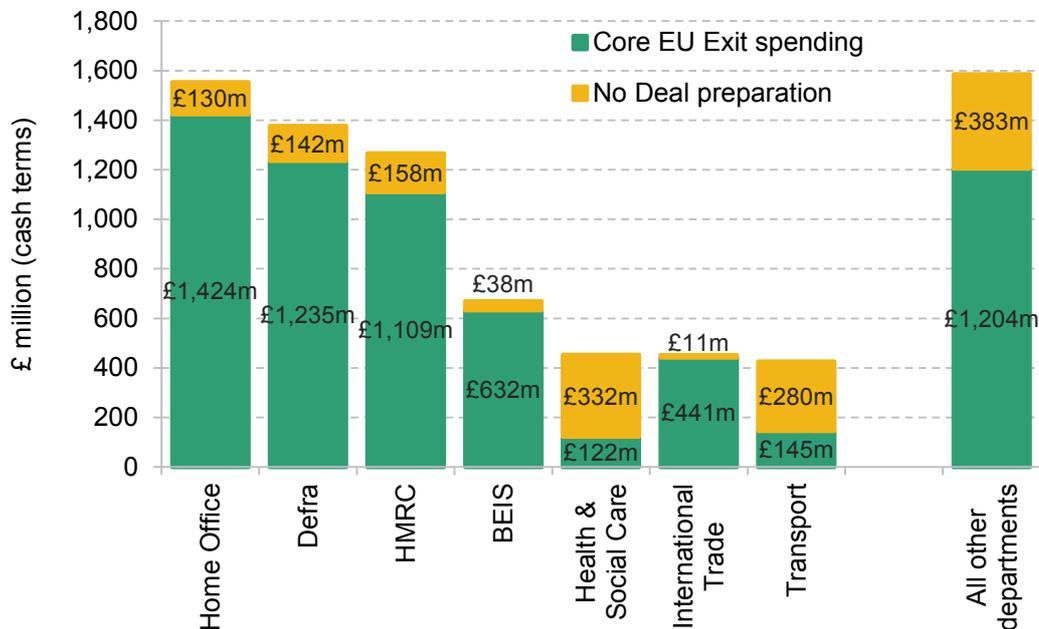
This year’s Spending Review will also be the last before the end of the transition period with the European Union, which comes to an end on 31 December 2020. The impact of the UK’s departure from the European Union on the economy and public finances remains highly uncertain – not least because the nature of the UK’s future relationship with the EU is still being negotiated, and a disorderly ‘no deal’ departure remains a possibility. There is agreement among economists that the economy will end up being smaller outside of the EU than if the UK had remained a member, but how much smaller is far from certain.

When setting public spending plans three or four years into the future, a central consideration for the Chancellor is what we expect to happen to GDP and therefore tax revenues. The combination of Brexit and COVID-19 means that forecasts for GDP and tax revenues are subject to more uncertainty now than at perhaps any point in the past. Holding a multi-year Spending Review in such circumstances would be a questionable decision – an issue to which we return in Section 6.5.

Brexit also has a direct effect on public spending. Since the referendum, around £8 billion has been allocated to departments to prepare for and deliver the UK’s departure from the EU. More than half of this has gone to just three departments: the Home Office, the Department for Environment, Food and Rural Affairs (Defra) and HM Revenue and Customs (HMRC). This is illustrated in Figure 6.12. In 2020–21 alone, £2 billion of funding has been allocated to prepare for EU exit. Of that, some £1.3 billion has been allocated to the three departments listed above.

Some of this spending – such as spending on ‘no deal’ preparation – is likely to stop once negotiations come to an end and the future relationship between the UK and EU is determined. However, some departments will likely require permanently increased funding as they take on additional post-Brexit responsibilities. These are

**Figure 6.12. Cumulative spending on Brexit preparation by selected departments, 2016–17 to 2020–21**



Note: Figures denote the cumulative sum allocated to departments between 2016–17 and 2020–21, in nominal (cash) terms. Core spending is for any Brexit scenario. Defra is the Department for Environment, Food and Rural Affairs; HMRC is Her Majesty's Revenue and Customs; BEIS is the Department for Business, Energy and Industrial Strategy.

Source: HM Treasury, European Union Finances 2019, July 2020.

likely to include designing and operating a new immigration system (a responsibility of the Home Office), farm regulation and subsidy (Defra), and employing tens of thousands of additional customs agents (HMRC).

This relates to a broader question over the extent to which the UK government decides to replace existing EU spending in the UK or on the UK's behalf. The government has already committed to maintain the current level of support for farmers and to replace European structural and investment funds with a UK-wide Shared Prosperity Fund.<sup>15</sup> But the Treasury has stated that decisions over other EU programmes will be made at the upcoming Spending Review (HM Treasury, 2020c). These include, among other things, ODA spending on the UK's behalf

<sup>15</sup> For a discussion of the issues around the design of the UK Shared Prosperity Fund, see Davenport, North and Phillips (2020).

(which amounted to £945 million in 2019 and counts towards the UK's 0.7% target<sup>16</sup>) and research grants to UK universities. Some of the increase in spending between 2019–20 and 2023–24 pencilled in at the March 2020 Budget was implicitly earmarked for domestic replacements for EU spending programmes such as these.

## Levelling up

A Spending Review is an opportunity for the government to set out its domestic policy agenda, identify priority areas and allocate funding towards them. At the September 2019 Spending Round, for example, the largest funding increases were for the priority areas of the NHS, schools and the police (Crawford and Zaranko, 2019). At this Spending Review, while we can surely expect further funding increases for those areas – at least against a pre-COVID baseline – the focus is likely to be on the government's much-trumpeted 'levelling-up' agenda.

UK regional inequalities and the 'levelling-up' agenda are discussed in more detail in Chapter 7. These inequalities in the UK are deep-rooted, complex and multifaceted. There are no simple policy solutions to address the fact that, for example, 54% of working-age adults in London have a degree-equivalent qualification or higher, compared with 32% in the North East of England.<sup>17</sup> Nonetheless, if this problem is to be solved, public spending will be part of the answer, and the Spending Review is an opportunity for the government to advance a concrete policy agenda. Delivering such an agenda, alongside a response to the pressures of COVID-19, Brexit and a decade of austerity, will be a highly testing task for the Chancellor, his Treasury team, and officials across government.

<sup>16</sup> If the UK is to continue spending 0.7% of gross national income (GNI) on ODA, it will need to replace this spending currently done by the EU, details of which can be found in Department for International Development (2020).

<sup>17</sup> Degree-equivalent qualification is defined here as NVQ4 or above. Source: Annual Population Survey 2019, accessed via <https://www.nomisweb.co.uk/>.

## 6.4 Options for the Chancellor

### Day-to-day spending plans prior to COVID-19

At the March 2020 Budget, the Chancellor set out an overall spending ‘envelope’. Under these plans (and inflation forecasts at the time), day-to-day departmental budgets (resource DEL) were planned to grow in real terms at an average rate of 2.8% per year between 2020–21 and 2023–24.<sup>18</sup> A comparison with growth rates at previous Spending Reviews is provided in Figure 6.13.

However, the planned growth rate of 2.8% per year was based on inflation forecasts as at March 2020. The outlook for the economy has since changed – to put it mildly. This includes the outlook for inflation. The Office for Budget Responsibility (2020b) now expects inflation over the coming years (as measured by the GDP deflator) to be much lower than was forecast in March.<sup>19</sup> This means that the same cash spending plans would translate into a greater real-terms growth rate, because lower prices mean that the purchasing power of those cash budgets is higher. For instance, if we now expect public sector wages to grow less quickly than we did in March (because of the weaker outlook for private sector earnings), for a given level of £ spending, departments could employ a greater number of people.

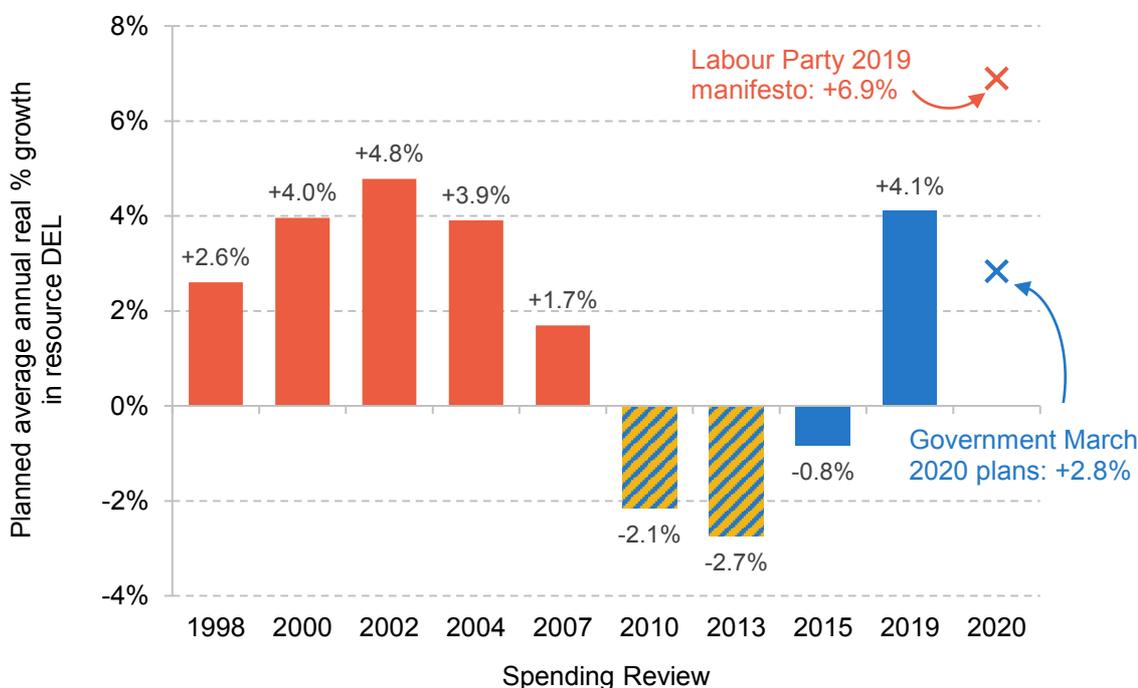
On the basis of the latest inflation forecasts, the March 2020 cash spending plans would mean average annual real-terms growth of 3.5%. Keeping to 2.8% average annual real growth under the new inflation forecast would mean £8 billion less would need to be spent in 2023–24.

Real-terms growth of 2.8% per year would have meant slower growth than the one-year increase announced in the September 2019 Spending Round (4.1%), but represented a relatively generous settlement by recent standards. Mr Sunak’s planned increases were, however, considerably less generous than those implied by

<sup>18</sup> The plans were front-loaded, with planned real-terms growth of 4.4% in the first year, 2.0% in the second and 2.1% in the third.

<sup>19</sup> The OBR’s March 2020 forecast had the GDP deflator increasing by 10.8%, cumulatively, between 2019–20 and 2024–25. Its central scenario in the July 2020 Fiscal Sustainability Report has the GDP deflator increasing by 9.2% over that period, with growth of just 0.1% in 2021–22 (versus 2.1% in the March forecast).

**Figure 6.13. Planned real-terms annual growth in resource budgets at previous Spending Reviews**



Note: Figures denote the *planned* average annual growth rate in day-to-day spending on public services (resource departmental expenditure limits excluding depreciation). Labour Spending Review 2020 figure is the average increase between 2019–20 and 2023–24 implied by the Labour Party’s manifesto commitments. Figure for the government’s March 2020 plans is calculated on the basis of March 2020 inflation forecasts (using July 2020 GDP deflator forecasts increases the planned growth rate to 3.5% per year). The 2.8% figure also includes spending to replace previous EU spending programmes in the UK or on the UK’s behalf; removing that spending reduces the planned growth rate to 2.3%.

Source: Author’s calculations using HM Treasury Spending Review documents (various), HM Treasury GDP deflators (various), HM Treasury Budget 2020, OBR March 2020 Economic and Fiscal Outlook, and Labour Party 2019 election manifesto.

the Labour manifesto (which would have resulted in average annual real-terms growth of 6.9% over the Spending Review period) and less generous than those seen under the Labour government during the mid 2000s.

What would the March 2020 plans have meant for public service funding? The published figures indicate that the post-2010 cuts to overall day-to-day spending on public services would have been reversed in real terms by 2021–22 and that by 2024–25, spending would have been 8.8% higher than in 2009–10. Spending in per-person terms was also set to increase steadily. The Office for Budget

Responsibility (2020a) noted that the March 2020 plans were set to reverse entirely the eight years of cuts to real per-person spending from 2010–11.

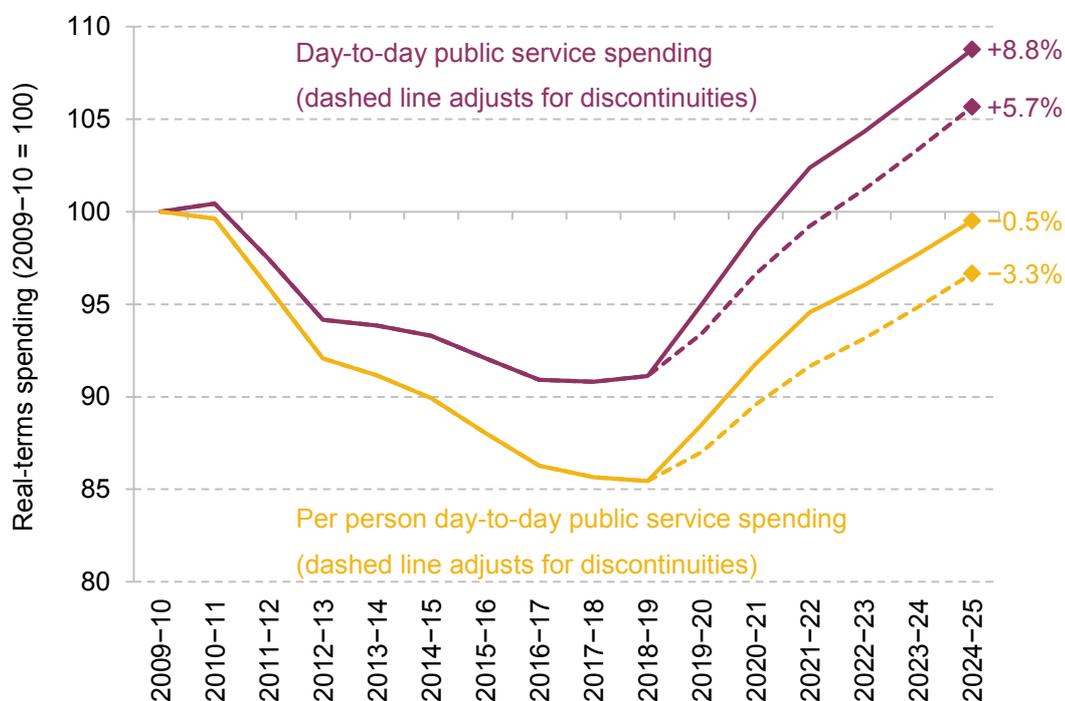
However, these raw figures slightly overstate the ‘true’ amount of funding available for public services, for two reasons. First, the figures from 2019–20 onwards are flattered by the inclusion of between £5 and £6 billion of additional RDEL relating to a fall in the discount rate used in setting employer contribution rates to public service pension schemes, announced at the 2018 Autumn Budget.<sup>20</sup>

Second, the increase in RDEL is part-funded by direct savings from EU contributions that the UK will no longer pay. In 2023–24, these amount to £11.3 billion (in cash terms). But in that year, the EU would have been expected to spend something like £7–9 billion either in the UK or on the UK’s behalf (for example, on overseas aid). We estimate that £5–6 billion of this would have been resource spending. As discussed earlier in the chapter, the Treasury has indicated that decisions over whether to replace this EU spending will be taken at the Spending Review. The government may decide to spend the money on different programmes – indeed, the ability to exert greater control over that spending is an advantage of leaving the European Union. Nonetheless, between £5 and £6 billion of spending in 2023–24 is not ‘new’ money available for public services, as it is already funding public services via the EU. Including it overstates the generosity of the March 2020 plans.

Figure 6.14 shows the path of spending before and after adjusting for these discontinuities. After adjustment, per-person spending on day-to-day public services in 2024–25 was still set to be 3.3% below its 2009–10 level. On these plans, by 2023–24 (the end of the Spending Review period), two-thirds of the cuts to per-person public service spending would have been reversed. More generally, the March 2020 spending envelope implied tight settlements outside of the government’s priority areas of the NHS, schools, the police, defence and aid. Spending increases across the board were unlikely.

<sup>20</sup> The additional £5–6 billion is equivalent to roughly 1.5% of overall RDEL, which amounted to £330 billion in 2019–20. See footnote 6 of Emmerson, Pope and Zaranko (2019) for further details.

**Figure 6.14. March 2020 plans for day-to-day public service spending, before and after adjusting for discontinuities**



Note: Dashed lines adjust for additional spending in relation to employer pension contributions from 2019-20 onwards and the estimated amount required to replace EU resource spending in the UK from 2020-21 onwards. All figures denote OBR's definition of PSCE in RDEL, adjusted for historical discontinuities.

Source: Author's calculations using OBR Economic and Fiscal Outlook (October 2018, March 2019 and March 2020), HM Treasury Budget 2020, HM Treasury European Union Finances (2018 and 2019), Department for International Development Statistics 2019, and ONS March 2020 GDP deflators.

## Options for day-to-day spending at the Spending Review

### Higher or lower?

Since March, Mr Sunak has rowed back from his commitment to the spending envelope discussed above. This opens the door to a more or less generous settlement over the next three years. There are pressures in both directions.

On the one hand, there will be upwards pressure on spending from the ongoing response to, and recovery from, COVID-19. This includes the potential need for ongoing support for businesses and public services. In addition, government and public preferences over the level of public service funding may well have changed,

given the events of this year. Even if no discretionary COVID-19 spending continues into future years, there will be pressures elsewhere (on working-age social security spending and adult social care, for example) and the economy is likely to be smaller than expected for a long period. Public spending is therefore likely to settle at a higher share of national income than it was pre-pandemic and higher than it was after 10 years of Labour government, in 2007–08.

On the other hand, there are some arguments for a *reduced* spending envelope for departments, relative to the Chancellor's March plans. Inflation is now expected to be lower, so the same rate of real-terms growth can be achieved with lower cash budgets. As a result of the COVID-19 crisis, there will be calls for the social security net to be permanently strengthened: Mr Sunak could choose to prioritise that, rather than providing additional funding for public services. And as the economy is now expected to be smaller (i.e. we as a nation now expect to be poorer), he may decide that we need to spend less on at least some public services, as part of an effort to repair the public finances.

In the next few years, the most likely outcome is probably higher, rather than lower, spending than would have been the case had COVID-19 not struck. Once a 'new normal' is reached, it less clear whether spending on public services will be higher or lower in real terms than it would otherwise have been.

### Growth rates, baselines and reserves

Ultimately, spending plans are set in terms of cash limits, but to analyse the options facing the Chancellor, it is useful to consider two key elements of the decision. The first is the planned growth rate (i.e. whether to stick with 2.8% per year, or to go higher or lower). The second is the 'baseline': the level from which those future increases are calculated. Together, they will determine the overall generosity of the cash budgets allocated to departments.

The planned real-terms growth rate is determined by the overall level of cash spending and the expected inflation rate. As discussed earlier, the economic outlook has changed since March, and inflation (as measured by the GDP deflator) is now expected to be much lower over the Spending Review period. The Chancellor therefore needs to allocate less in cash terms to achieve the same rate of real-terms growth.

In normal times, deciding on a baseline would not be a particularly trying part of the process. In a world without COVID-19, the Chancellor could simply have taken as his baseline the 2020–21 budgets published in March. Increases (for example, a 4.4% increase between 2020–21 and 2021–22, as per March plans) could then be calculated relative to that 2020–21 baseline. However, the huge amounts committed this year in response to the virus render those budgets obsolete. This has the potential to matter a great deal at the Spending Review, depending on how the Treasury chooses to treat COVID-related spending increases.

One option would be to treat COVID-related spending completely separately, financed out of a separate ‘COVID-19 Reserve’, and to provide each department with a ‘core’ settlement (where COVID-related spending is excluded from the baseline). The idea would be to allow departments to plan and deliver their core services from their allocated budget, with the ability to draw on the ‘COVID-19 Reserve’ in exceptional circumstances. This would be similar in spirit to the previous use of a ‘Special Reserve’ to finance military operations in Iraq and Afghanistan, rather than the core Ministry of Defence budget. The ‘COVID-19 Reserve’ would still need to be included in the overall spending envelope, but would give the Treasury greater flexibility and more control over the split between ‘regular’ and ‘COVID’ spending. Funding allocations could be made contingent on future events (for example, only providing extra funding to the Department for Transport *if* public transport operators are deemed to require a further bailout) and would avoid allocating large sums that turn out not to be needed. Such an approach might be well suited to exceptional and temporary spending programmes that are not expected to persist.

But some COVID-related spending *is* expected to persist into the coming financial year (and possibly beyond). The most obvious examples relate to the health budget, such as the ongoing costs of NHS Test and Trace, procurement of higher volumes of PPE for front-line workers, and spending to secure the use of private sector hospital facilities as part of an effort to address the backlog of routine operations. And the government may find it extremely difficult to reverse its ‘temporary’ increases in funding for social care, given the acute challenges faced by care homes during the crisis. If higher spending on these areas is to be permanent or semi-permanent, it would make sense to fund it out of departments’ core budgets, rather than a special ‘COVID-19 Reserve’. That would mean including some of the spending increases announced since March in those departments’ Spending Review

baseline, to reflect the fact that they are expected to continue throughout the review period.

### Illustrative scenarios

The generosity of the Spending Review envelope, and its implications for public services, will depend on both the choice of baseline and the choice of real-terms growth rate. Changes to the baseline are a useful way of thinking about the extent to which COVID-19 spending is expected to continue, and the real-terms growth rate reflects the generosity of future increases on top of that (and the expected rate of inflation). The same level of cash spending in 2023–24 could be achieved through a higher baseline and slower growth rate, or a lower baseline and higher growth rate. In this section, we lay out a number of scenarios to illustrate the choices facing the Chancellor.

As a starting point, Table 6.3 sets out the details of the Chancellor's March 2020 plans for resource DEL over the Spending Review period. Although the Chancellor has since rowed back from these plans, they serve as a useful focal point. Under those plans, day-to-day departmental budgets were set to increase from £361 billion in 2020–21 to £418 billion by 2023–24, in cash terms. At the time, this was a real-terms increase of £32 billion over the three years; on the basis of the latest inflation forecasts (which have lower inflation than was forecast in March), the 2023–24 figure is equivalent to £400 billion in today's prices (implying a £40 billion real-terms increase), and real-terms growth would average 3.5% over the three years.

These plans are almost certain to change in numerous respects. First, the 2020–21 baseline may need to increase (to be higher than £361 billion) to reflect the fact that some COVID-related spending needs to continue into future years. Second, both the average rate of growth, and the time profile of growth, may change.

The Chancellor may wish to spend more in the first part of the Spending Review period, to deal with COVID-related pressures, but then tighten the purse strings towards the end, to help get the public finances back on track. One way to do this would be to increase the 2020–21 baseline (against which the 2021–22 increases are calculated) but to reduce the average real-terms growth rate, so that increases are effectively front-loaded. He could even do so in such a way that the level of spending in 2023–24 remains the same as in his March plans, if he so wished. This is shown in Figure 6.15: adding £20 billion to the 2020–21 baseline and reducing the average real-terms growth rate to 1.7% would result in the same level of

spending in 2023–24 as was planned in March, but increases would be more front-loaded.

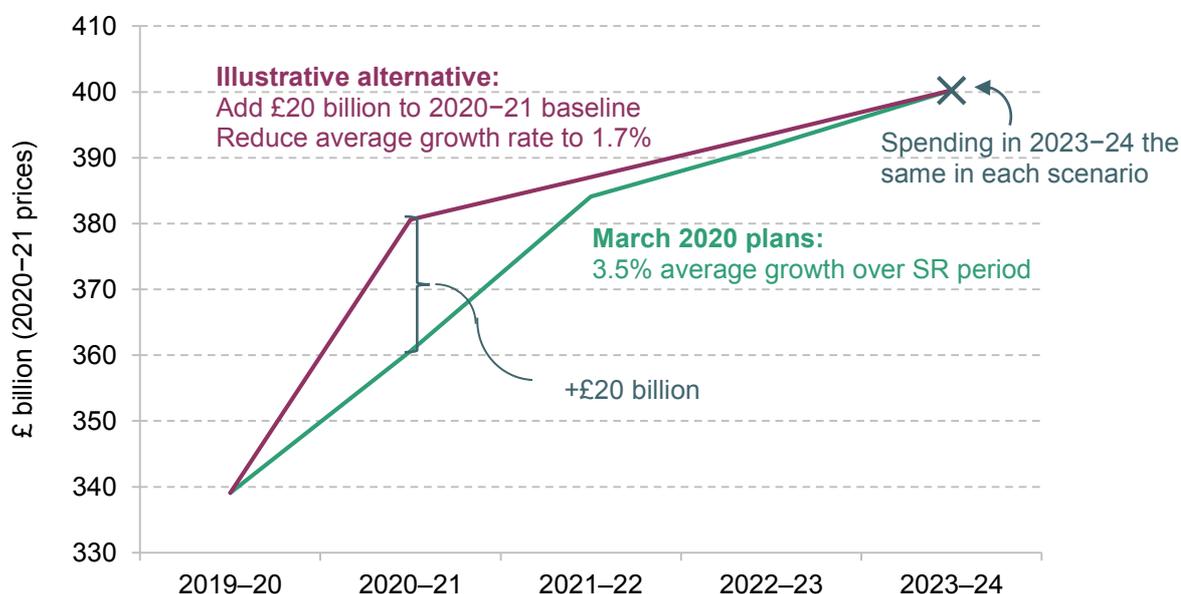
**Table 6.3. March 2020 plans for day-to-day public service spending**

	2020–21	2021–22	2022–23	2023–24
<b>March 2020 plans: resource DEL excluding depreciation</b>				
Nominal (cash) terms	£360.6bn	£384.6bn	£400.7bn	£417.6bn
Real terms (2020–21 prices, using March 2020 inflation forecasts)	£360.6bn	£376.6bn	£384.3bn	£392.3bn
Annual real-terms growth rate	-	+4.4%	+2.0%	+2.1%
Average real-terms growth rate	-	+2.8% per year		
Real terms (2020–21 prices, using July 2020 inflation forecasts)	£360.6bn	£384.1bn	£391.9bn	£400.3bn
Annual real-terms growth rate	-	+6.5%	+2.0%	+2.1%
Average real-terms growth rate	-	+3.5% per year		
Additional COVID RDEL spending	+£72.8bn	+£0.6bn	-	-
<i>of which: DHSC</i>	+£34.9bn	+£0.2bn	-	-
Additional RDEL underspends	-£5.0bn	-	-	-
March 2020 RDEL plans + additional COVID spending (2020–21 prices, using July 2020 inflation forecasts)	£428.4bn	£384.7bn	£391.9bn	£400.3bn

Note: Figures denote HM Treasury definition of resource DEL excluding depreciation. Additional RDEL underspends refer to the increase in the amount by which the OBR expects departments to underspend their resource budgets, relative to what was expected in March.

Source: Author's calculations using HM Treasury Budget 2020, supplementary expenditure table 4.4 of OBR March 2020 Economic and Fiscal Outlook, table 3.30 of OBR July 2020 Fiscal Sustainability Report, and sources for Table 6.2.

**Figure 6.15. Illustrative paths for resource DEL over Spending Review period, with spending in 2023–24 unchanged from March plans**



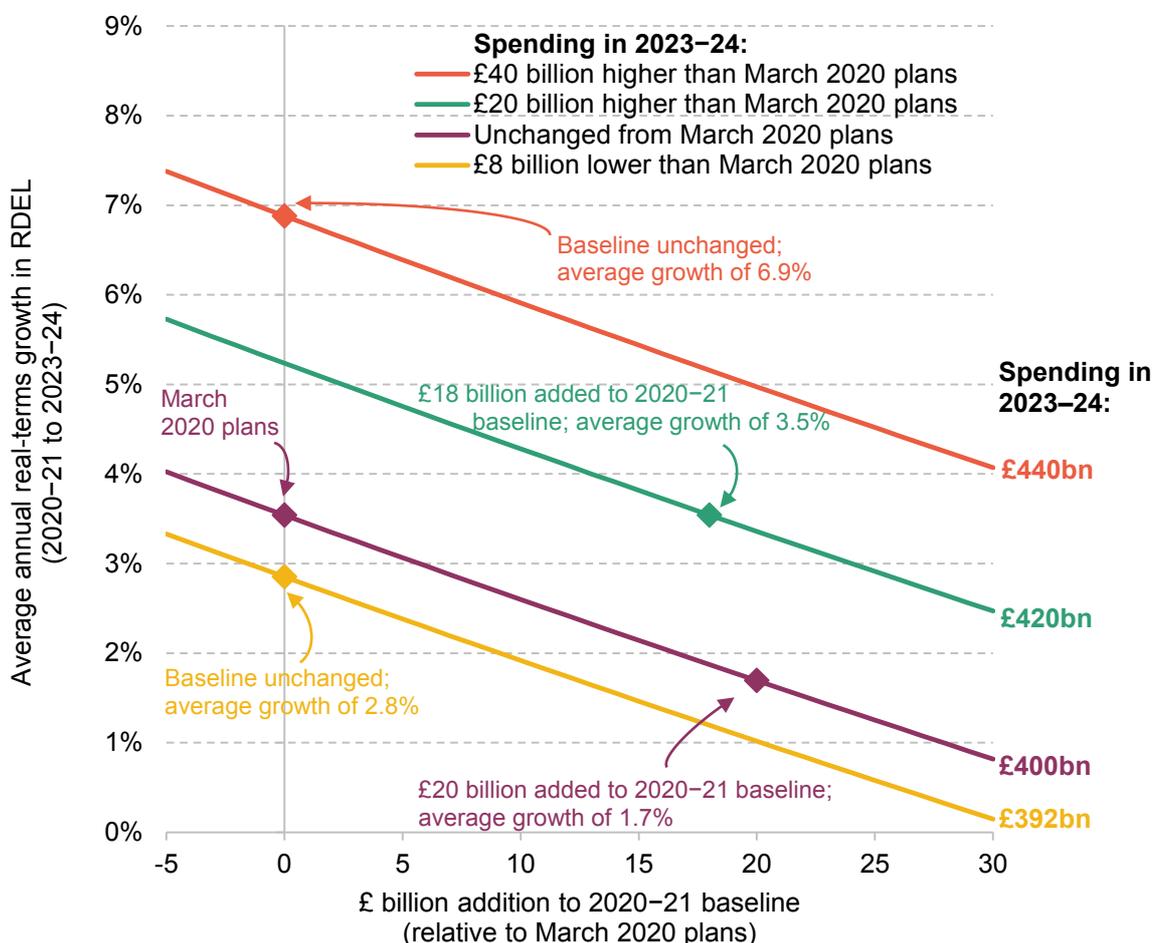
Note: Figures denote resource DEL excluding depreciation.

Source: Author's calculations using data underlying Table 6.3 and OBR July 2020 Fiscal Sustainability Report.

Figure 6.16 shows a broader range of scenarios. The purple line shows the set of increases to the baseline and real-terms growth rates consistent with real-terms RDEL spending of £418 billion in 2023–24 (i.e. the same level of day-to-day spending as in the Chancellor's March plans, equivalent to £400 billion in today's prices). It shows, for instance, that if £20 billion were added to the 2020–21 baseline (equivalent to just under 30% of the additional RDEL spending announced in response to COVID-19), and the real-terms growth rate were reduced to 1.7% per year, the 2023–24 spending envelope would remain unchanged (as in Figure 6.15). But if £25 billion were added to the baseline (around a third of the total COVID increase, and the approximate amount spent on PPE procurement and NHS Test and Trace so far), the growth rate would have to fall to 1.3% to leave the 2023–24 budget unchanged.

Figure 6.16 also shows that if the Chancellor wished to return to the 2.8% average real-terms growth originally planned for in March, and left the 2020–21 baseline unchanged, he could remove £8 billion in today's prices from the 2023–24 budget thanks to lower inflation (labelled on the yellow line).

**Figure 6.16. Combinations of baselines and growth rates consistent with different Spending Review envelopes**



Note: All £ billion figures expressed in 2020-21 prices (using July 2020 GDP deflator forecasts). March 2020 plans refer to those shown in Table 6.3, under which RDEL grows by 3.5% per year in real terms, from £360.6 billion in 2020-21 to £400.3 billion in 2023-24 (in 2020-21 prices).

Source: Author's calculations using data underlying Table 6.3 and OBR July 2020 Fiscal Sustainability Report.

On the other hand, if the Chancellor added £18 billion to the 2020-21 baseline (around 25% of the total, which would be enough for, say, £10 billion for NHS Test and Trace and an £8 billion 'COVID-19 Reserve'), and left the average real-terms growth rate at its current level of 3.5%, overall day-to-day spending would need to be £20 billion higher in 2023-24 than was planned in March (in today's prices, labelled on the green line). Leaving the baseline unchanged but increasing the planned growth rate to 6.9% per year (the growth rate implied by the Labour

Party's 2019 election manifesto) would mean adding £40 billion to plans for 2023–24 (labelled on the red line).

These scenarios are intended only to be illustrative; other combinations and other envelopes are of course possible. But the exercise serves to illustrate an important point. Even if the Chancellor were to reduce the rate of spending growth over the Spending Review period, if large chunks of the additional COVID-related spending needs to persist and be added to the baseline, the savings to the public purse (in the form of lower spending relative to March plans) could be minimal or even non-existent. In such a scenario, the winners would be departments receiving a higher baseline – most likely including the Department of Health and Social Care.

There are certainly strong arguments for top-ups to the health budget in the midst of a pandemic, and there may well be demand from the public for such top-ups in order to improve the preparedness, capacity and resilience of the NHS in advance of future pandemics. It would also follow the pattern of history. Governments of all political stripes virtually always end up topping up the NHS budget (Stoye and Zaranko, 2019). And since 2010, the NHS budget has been repeatedly protected from cuts while most other budgets have been subject to substantial cuts (Figure 6.5). As a result, the share of day-to-day public service spending going to Health increased from 26.5% in 1999–00 to 32.5% in 2009–10, 41.5% in 2019–20, and an estimated 42.2% in 2020–21. This trend looks likely to continue in the years ahead.

In the context of the Spending Review, the fate of the health budget is highly important due to its size. The Chancellor has pledged that resource DEL will increase in real terms over the Spending Review period. But this tells us very little about what lies in store for public services other than the NHS, as real-terms growth in overall RDEL could be driven by growth in the DHSC budget while other services face cuts. For example, if the 2020–21 baseline remains unchanged, overall RDEL grows by 0.1% per year in real terms and DHSC budget plans remain unchanged from March, other budgets would need to shrink by 1.9% per year over the Spending Review period. This would technically be consistent with Mr Sunak's pledge, but would mean making some extremely difficult cuts to non-health budgets, which would not seem consistent with the government's other stated ambitions.

What can we expect for those non-health budgets? Given the number of moving parts, it is impossible to say with any precision. The generosity of the overall

envelope will clearly matter, as will how much of the available funding is swallowed up by DHSC. Looking elsewhere, the government has committed to additional funding for schools and to hiring 20,000 additional police officers; we would therefore expect those areas to be prioritised (even before any COVID-related top-ups). Spending programmes related to the ‘levelling-up’ agenda are also likely to be prioritised, and departments with new post-Brexit responsibilities may receive additional resources. On top of that, the government remains committed to spending 0.7% of national income on overseas aid and at least 2% of national income on defence and national security – but with such an uncertain economic outlook, what that will mean in cash terms is far from clear. The upshot is that even with an ostensibly generous settlement, other public services – many of which have already faced sizeable cuts over the past decade – could be facing an extremely difficult Spending Review period.

### Public sector pay

An important determinant of the path for day-to-day departmental budgets over the Spending Review period will be the generosity of public sector pay awards. The starting point for the Spending Review period is public sector pay below its 2010 level and at its lowest point relative to private sector pay in decades (Figure 6.8).

On 21 July, the government announced an above-inflation pay award for around 900,000 public sector workers this year, including teachers, doctors and dentists, police officers, and members of the Armed Forces (HM Treasury, 2020d). Others, such as nurses and other NHS staff, are covered by previous multi-year pay settlements. These increases could help to address challenges with recruitment and retention, but will also put pressure on departments’ budgets.

However, the government has hinted that such increases are unlikely to continue. In his letter to Secretaries of State to launch the Spending Review, the Chancellor made clear that future public sector pay awards must reflect the wider economic context – in particular, the fact that private sector pay is expected to fall during the COVID-induced recession. He indicated that public sector pay should maintain ‘parity’ with levels of pay in the private sector in coming years.

**‘In the interest of fairness we must exercise restraint in future public sector pay awards, ensuring that across the [Spending Review] period, public sector pay levels retain parity with the private sector.’**

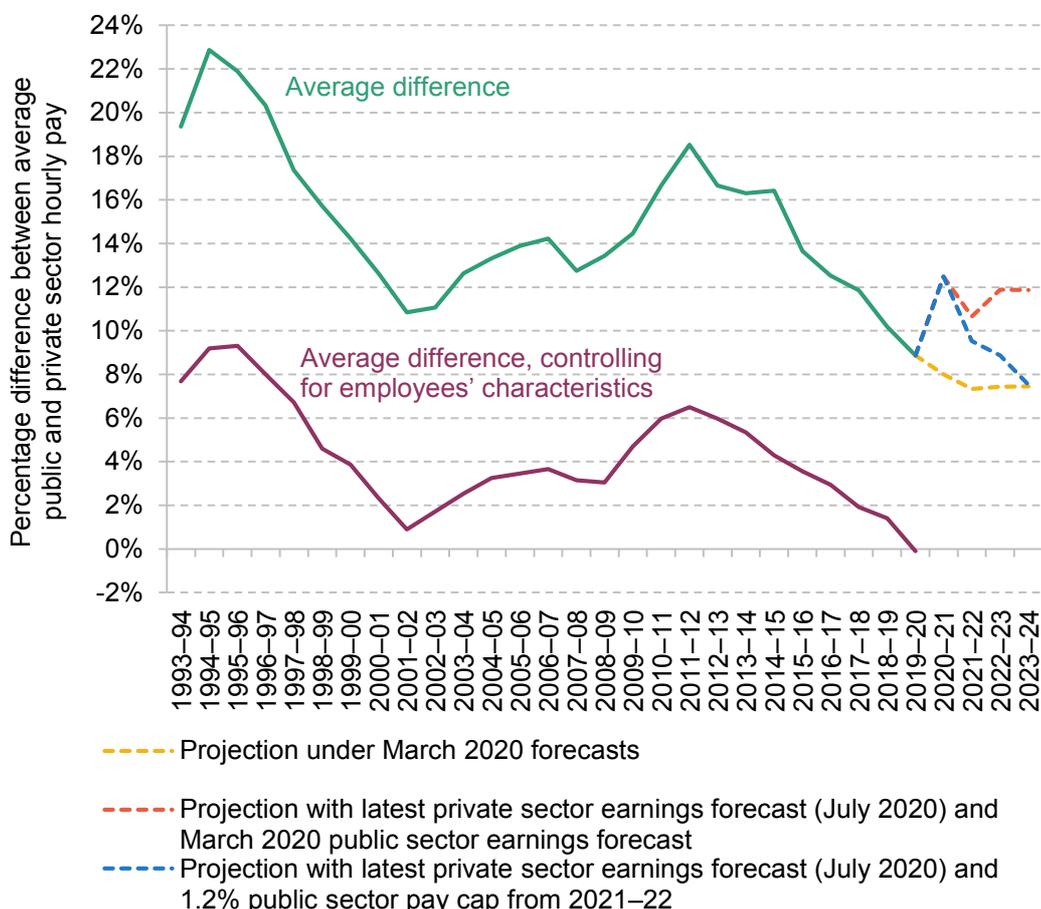
Rishi Sunak, 21 July 2020

In 2020–21, public sector earnings are likely to perform more strongly than private sector earnings – just as was the case during, and immediately after, the Great Recession. The OBR’s March 2020 forecast was for 2.9% growth in the public sector paybill per head in 2020–21, which is broadly consistent with the pay announcements of 21 July. But the central scenario in the OBR’s July 2020 Fiscal Sustainability Report implied a 0.8% *fall* in private sector earnings this year. This would reverse some of the decline in the public–private differential, and take the gap back to around its 2016–17 level (Figure 6.17). After that, a great deal depends on how pay evolves in the private sector and on the degree of pay restraint in the public sector. If private sector pay follows the path of the OBR’s July forecast and public sector pay continues to grow in line with pre-COVID (March) forecasts, the public–private differential would remain roughly flat after 2020–21 (shown by the red dashed line in Figure 6.17).

However, Mr Sunak’s language when launching the Spending Review strongly hints that a return to public sector pay restraint is on the cards. As an illustration, Figure 6.17 shows what would happen to the public–private pay differential if private sector earnings grow in line with the OBR’s July 2020 central scenario, public sector pay grows in line with pre-COVID plans in 2020–21, but pay increases are capped at 1.2% after that (the blue dashed line).<sup>21</sup> The gap between public and private sector pay would increase this year, as private sector pay performs poorly in the recession, but by 2023–24 would leave the public–private differential at the level implied by March 2020 plans. Imposing such a cap would be expected to reduce spending by approximately £10 billion in 2023–24 (relative to increasing pay in line with the pre-COVID forecast). Each 0.1% reduction

<sup>21</sup> A public sector pay cap of 1.2% would be more generous than the pay freezes of 2011–12 and 2012–13, and more generous than the 1% pay cap imposed between 2013–14 and 2016–17, but would still likely mean slower growth than in the private sector.

**Figure 6.17. Projected difference between average public and private sector pay over Spending Review period**



Note: Difference controlling for workers' characteristics controls for differences in age, education, experience and region, all interacted with sex, following the same methodology as in Cribb, Emmerson and Sibieta (2014). Since the characteristics of the future public sector workforce are not known, it is not possible to forecast for 2020-21 and beyond. Projections assume that hourly wages grow in line with the OBR's forecast for growth in average earnings. The treatment of employees put on furlough under the Coronavirus Job Retention Scheme could distort the figures for 2020-21.

Source: Author's calculations using Labour Force Survey, OBR March 2020 Economic and Fiscal Outlook and OBR July 2020 Fiscal Sustainability Report.

(increase) in the pay cap would be expected to decrease (increase) spending in 2023-24 by around £700 million relative to this amount.

If the government did return to a policy of public sector pay restraint, what might this mean for recruitment and retention in the public sector? At least in the short term, we might not be too concerned. In the midst of the sharpest recession on record, private sector jobs might be hard to come by. Concerns about pay might be

outweighed by other attractive features of public sector jobs – not least their security and stability in a recession. And some public sector jobs – for example, those in the health and social care sectors – might now be seen as more attractive, because of the well-deserved plaudits for those workers during the pandemic.

On the other hand, we might worry about the government’s ability to attract people to jobs that are now perceived as more dangerous. In particular, the relative attractiveness of working in the NHS may have been diminished by the pandemic and the well-publicised shortages of personal protective equipment (Propper, Stoye and Zaranko, 2020). Brexit could also affect the ability of the NHS to recruit from abroad.<sup>22</sup> The Conservative manifesto at the 2019 election promised to deliver 50,000 more nurses. Delivering on that promise without an increase in nurses’ wages could prove difficult, especially when it comes to retaining nurses who have already been trained (and attracting back those who have left the profession).

Urging public sector pay restraint is one way for Mr Sunak to keep a lid on overall spending growth, but he must also consider the government’s ability to attract and retain the skilled workers needed to deliver high-quality public services.

### Capital spending

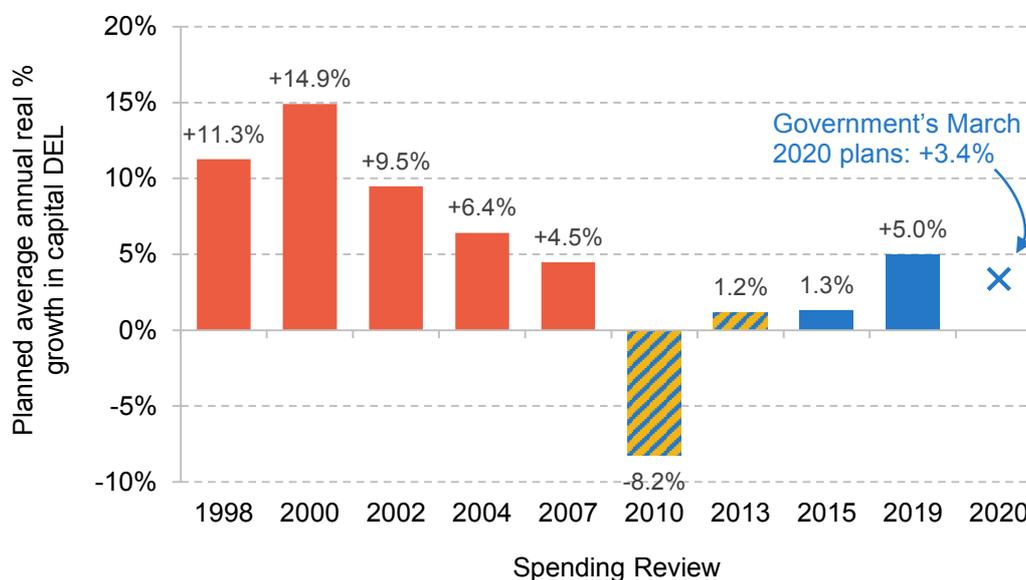
The discussion so far has focused almost entirely on day-to-day, or resource, spending. The Spending Review will also need to set departmental capital budgets. When launching the Spending Review, Mr Sunak indicated that he would set four years of capital spending plans, from 2021–22 to 2024–25. Plans published alongside the March 2020 Budget implied average real-terms growth in capital DEL of 3.4% per year from 2020–21 to the end of that horizon.<sup>23</sup> Figure 6.18 compares this with planned growth rates at previous Spending Reviews.

These plans should be seen in the context of the government’s plans for investment more generally. Prior to COVID-19, the government had indicated its willingness to take advantage of historically low interest rates to borrow to invest; and the last few

<sup>22</sup> For context, 6.0% of NHS nurses are non-UK EU nationals; a further 11.9% are non-EU nationals (Baker, 2020).

<sup>23</sup> As with the government’s resource spending plans, these increases were heavily front-loaded. Capital DEL was planned to grow by 9.1% in 2021–22, 3.6% in 2022–23, –0.6% in 2023–24 and 1.4% in 2024–25.

**Figure 6.18. Planned real-terms annual growth in capital budgets at previous Spending Reviews**



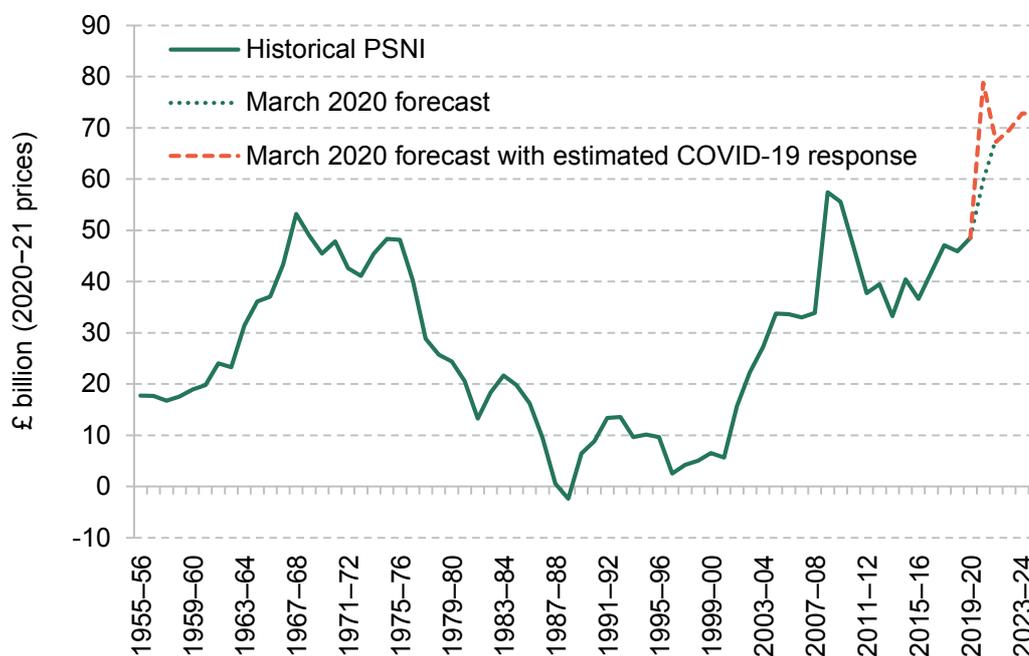
Note: Figures denote the planned average annual growth rate in capital departmental expenditure limits. Spending Review 2020 figure does not account for the OBR's assumed underspend.

Source: Author's calculations using HM Treasury Spending Review documents (various), HM Treasury GDP deflators (various), HM Treasury Budget 2020, OBR March 2020 Economic and Fiscal Outlook, and Labour Party 2019 election manifesto.

months have seen even long-run interest rates fall further (Chapter 5). The March 2020 Budget included ambitious plans for a sharp increase in public sector net investment (PSNI, a broader measure of government investment spending than capital DEL), with allocations to be determined at the Spending Review.

Since March, the government response to COVID-19 has included substantial announcements on capital spending (details of which are provided earlier in the chapter). This includes £7.1 billion of additional departmental capital spending (capital DEL) in 2020–21. However, this is largely offset by a £5 billion increase in the amount of expected departmental underspending (the OBR now expects departments to undershoot their capital budgets by around £9 billion, rather than £4 billion). As a result, capital spending by departments is in fact expected to be only around £2 billion higher in 2020–21 than was planned back in March. In addition to the modest additions for departments, the OBR expects that the fiscal cost of write-offs with respect to business loans will amount to £17 billion, which is

Figure 6.19. Public sector net investment



Note: Estimated COVID-19 response includes £17.0 billion of additional capital AME, as in Table 6.2, and £7.1 billion of additional capital DEL, largely offset by an additional £5 billion of underspends (as assumed by the OBR in its July 2020 Fiscal Sustainability Report).

Source: Author's calculations using OBR Public Finances Databank, OBR July 2020 Fiscal Sustainability Report, and OBR Coronavirus Policy Monitoring Database (accessed 5 August 2020).

classified as capital AME.<sup>24</sup> Overall investment spending is thus expected to be around £19 billion higher in 2020–21 than was forecast in March. This is shown in Figure 6.19, along with the historical path of public sector net investment.

The Conservative Party 2019 election manifesto pledged to keep PSNI below 3% of GDP (Conservative Party, 2019). According to the plans published in March, PSNI was set to remain (just) below this cap, and to average 2.9% of GDP over the five years from 2020–21 to 2024–25, more than twice the 1.4% average over the previous 40 years.

<sup>24</sup> Of the £17 billion, £16 billion is with respect to the Bounce Back Loan Scheme (BBLs), £0.8 billion is with respect to the Coronavirus Business Interruption Loan Scheme (CBILs) and £0.1 billion is with respect to the Coronavirus Large Business Interruption Loan Scheme (CLBILs). This is all scored to 2020–21. For further detail, see Office for Budget Responsibility (2020b).

The fallout from the coronavirus means that the economy is now expected to be smaller than was forecast in March. This means that for a given level of £ spending, the ratio of spending to GDP is higher. Consequently, the OBR's July Fiscal Sustainability Report projected that the government would breach its 3% of GDP ceiling for investment spending.

The government could decide to reduce its investment plans so as to stay within the 3% of GDP limit. This would be unwise. The combination of extremely low borrowing costs and the prospect of a deep recession means that, if anything, there is a case for *more* capital spending over the coming years. To the extent that interest rates are expected to remain low, and productive investment projects can be found and delivered, the government may in fact wish to increase its planned level of investment spending over the Spending Review period. If spent well, additional capital spending could help aid the economic recovery, improve the quality of the UK's infrastructure and contribute to the 'levelling-up' agenda. In a time of such pronounced uncertainty, however, selecting the 'right' investments – and ensuring they are well delivered – is likely to be even more difficult than normal.

## 6.5 The case for a one-year Spending Review

When launching the 2020 Spending Review in July, the Chancellor reiterated his intention to hold a full, multi-year review that would set three (four) years of resource (capital) budgets.

To an extent, this is understandable. Setting budgets for multiple years at a time can help departments to plan effectively. When making decisions over things such as staffing or projects that do not fit neatly into one financial year, public service leaders can benefit from the certainty of a multi-year budgeting process. For instance, Her Majesty's Chief Inspector of Constabulary concluded last year that for the police, 'Annual funding settlements ... are incompatible with efficient and effective long-term planning. When it comes to funding, [police] forces need certainty, stability and predictability. So there is a clear need for multi-year settlements' (Her Majesty's Inspectorate of Constabulary and Fire & Rescue Services, 2019). Providing this certainty, stability and predictability was a key motivation for the original introduction of multi-year Spending Reviews in 1998. The government is also keen to be seen to be delivering on the promises it made in

the 2019 general election (the March 2020 Budget was titled ‘Delivering on our promises to the British people’) and so wishes to set spending plans for the remainder of the parliament.

In normal times, this is a sensible approach, and represents a strength of the UK’s system for the planning and control of public expenditure (and one that is unusual internationally). But in the current climate, given the unprecedented degree of economic uncertainty, a full, multi-year Spending Review is difficult to justify. The point of the Spending Review is to set firm spending limits. It is impossible to know what an appropriate set of spending limits would be for three years into the future. It is far from clear how much COVID-related spending will need to continue (and for how long), whether and how the government can aid the economic recovery, and what additional needs and pressures will be introduced by Brexit (whose precise form has still not been determined). In addition to this uncertainty over the amount that will be ‘needed’, the wider economic outlook remains profoundly uncertain. To take just one example: changes in the inflation forecast between March and July of this year mean that the Chancellor’s cash spending plans from his March Budget now imply average real growth of 3.5% per year in day-to-day spending, rather than 2.8% when he presented those plans in the House of Commons. Future changes to the forecast of a similar or greater magnitude are possible. And, as Chapters 2 and 4 make clear, the outlook for economic growth and future tax revenues is also subject to immense uncertainty.

The government may decide to publish three (or four) years of plans and announce its intention to revisit them in future as circumstances become clearer. But such an approach would undermine the stability and planning certainty that multi-year budgeting is intended to provide. The time and effort required to negotiate a multi-year settlement (which nobody then expects to be stuck to) would not necessarily be well spent, when there are so many priorities for the attention of civil servants, ministers and their advisors.

The Chancellor may also be tempted to promise funding increases in the short term, followed by an extremely tight settlement in later years, in order to flatter the borrowing figures at the end of the period. Mr Sunak would certainly not be the first Chancellor to take this superficially attractive route. But the sustainability of the public finances would not be improved by the publication of spending plans that the government has no intention of keeping to.

Given all of this, it would be ill advised for the government to embark on a multi-year Spending Review. Instead, it would be sensible to limit this year's Spending Review to a single year (2021–22) and to delay decisions on spending in later years until a point when some of the uncertainty over COVID-19, Brexit and the future of the economy has dissipated somewhat.<sup>25</sup>

## 6.6 Conclusion

The economic backdrop for this year's Spending Review is both highly challenging and highly uncertain. Despite the ongoing uncertainty surrounding the magnitude and duration of the economic fallout from COVID-19, and the lack of certainty over the precise form of Brexit, the Chancellor has indicated his intention to plough ahead with a full (or 'comprehensive') Spending Review, which would set out spending plans for the remainder of this parliament. He would be wise not to do so. Now is not the time to be making multi-year, multi-billion-pound spending commitments, when the future state of the economy and the future demands on public services remain so profoundly uncertain. Instead, it would make sense for this year's Review to be limited to a single year, 2021–22, with decisions over future years delayed until some of the economic fog has lifted.

Even if Mr Sunak makes the sensible decision to set only one year of spending plans, the process will be fraught with difficulty, with many delicate trade-offs. Perhaps the most important question is the extent to which the extraordinary funding increases provided in response to COVID-19 need to continue into future years. If some of these spending programmes – such as substantially increased procurement of personal protective equipment or the running costs of NHS Test and Trace – are, at least for a while, unfortunate facts of life, they could swallow up much of the increase in funding pencilled in between now and 2023–24. Whatever is left would likely be allocated to priority areas such as the NHS, schools, the police or the 'levelling-up' agenda. The Chancellor has rowed back from the spending envelope he committed to in March, but his emphasis on the need for 'tough choices' suggests that it could become less, not more, generous. Other public services could well be facing a further bout of austerity – on top of the cuts already made since 2010. That would require Mr Sunak to make some tough choices indeed.

<sup>25</sup> The Institute for Government has reached a similar conclusion. See Pope (2020).

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