Research briefing

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The 2020 Spending Review

Contents

Introduction

The 2020 Spending Review sets non-capital (or "Resource") budgets for all Government Departments for the financial year 2021-22, determining how much money Departments and associated Arms-Length Bodies have to spend on pay, recruitment and other running costs for that year.

It therefore has important consequences for civil servants and anyone working in the public sector, as well as for citizens, businesses and communities who benefit from their work.

Earlier this year a full "Comprehensive Spending Review" covering three years to 2023-24 had been planned, but proved impractical given ongoing economic uncertainty resulting from the Covid pandemic. The Government will probably aim to conduct a further "multi-year" spending review in 2021, covering fiscal years up to 2025.

Economic background and forecasts

This Spending Review has been conducted against the unprecedented circumstances of the Covid pandemic and resulting economic recession.

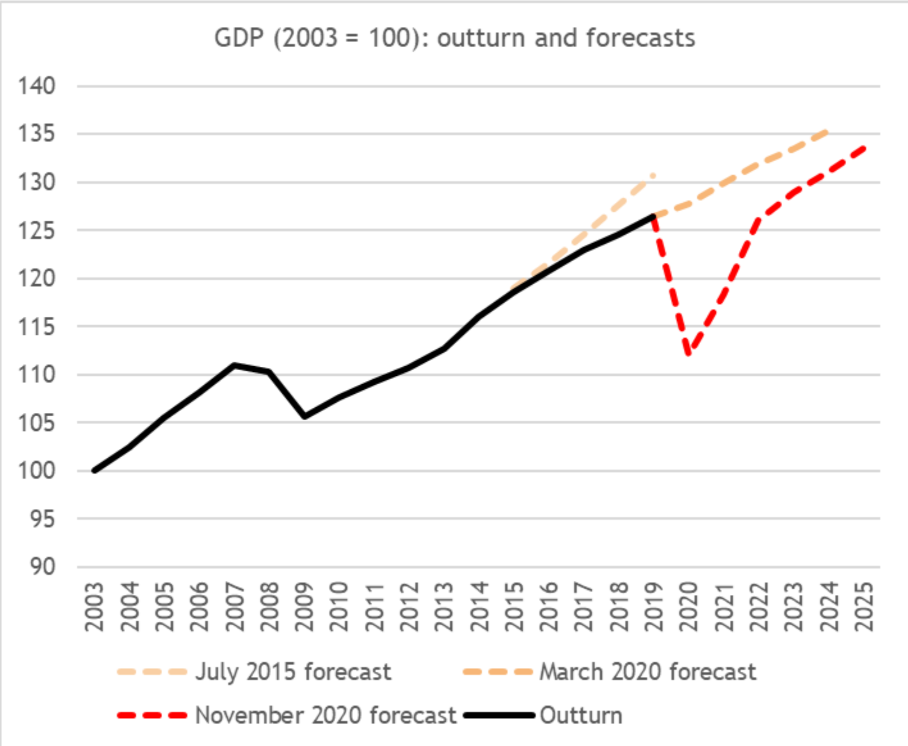
Latest revision of this document: https://library.prospect.org.uk/id/2020/01233
This revision: https://library.prospect.org.uk/id/2020/01233/2020-11-30

Published alongside the Chancellor's statement are new economic forecasts prepared by the independent Office for Budget Responsibility – their first full set of forecasts since March this year.

The economic outlook remains significantly more uncertain than usual, due to still unanswered questions about the likely course of the pandemic as well as the unresolved state of the Government's negotiations with Europe. However, they probably represent the best available estimates of the likely range of medium term scenarios, and are the basis on which the Government will be planning and formulating policy.

On its central scenario, which assumes "no deal" is averted and a vaccine is rolled out early next year with social distancing restrictions are fully lifted by mid-2021, the OBR now expects the UK economy to be 11.3% smaller at the end of this year than it was at the start – a slight improvement on expectations in the summer, but still a historically unprecedented contraction.

The economy is expected to recover over the next two years but return to relatively modest growth rates of less than 2 per cent a year in 2024 and 2025. This means the economy will be about 3 per cent smaller at the end of the forecast period than had been expected in March. (A "no deal" Brexit in January would reduce forecast GDP in 2025 by another 1.5 per cent, on top of around 4 per cent already lost relative to remaining in the EU).

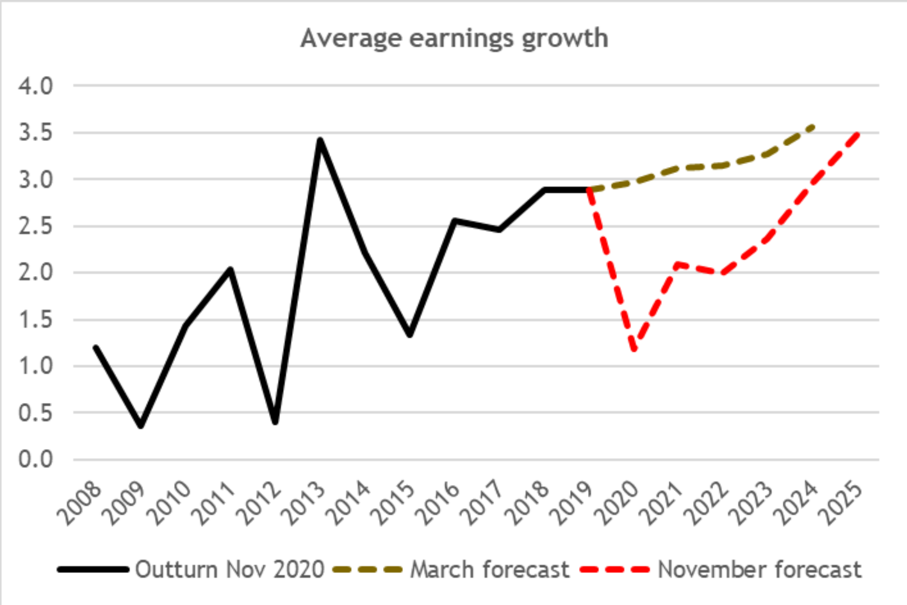


Source: Prospect analysis of OBR data

The OBR estimates that average earnings growth, typically around 3 per cent a year, fell to just above 1 per cent this year. It expects it to be around 2 per cent for the next two years.

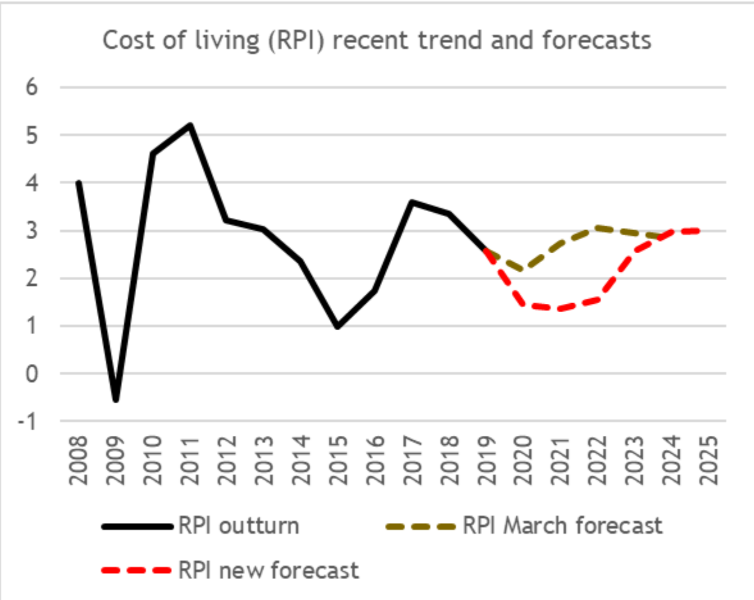
According to analysis of the OBR's forecasts by the Resolution Foundation, this slowdown in earnings growth means earnings will on average be £1,200 lower in 2025 than had been expected in March.[1]

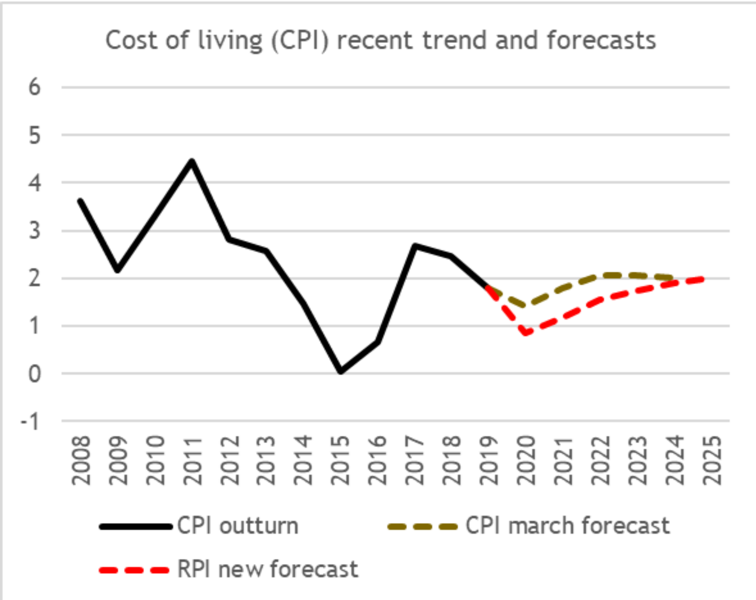
[1] https://www.resolutionfoundation.org/app/uploads/2020/11/Here-today-gone-tomorrow.pdf



Source: Prospect analysis of OBR data

Inflation is expected to remain comparatively low for the next couple of years, with OBR forecasts for both RPI and CPI remaining around 1.5 per cent or less until 2023.





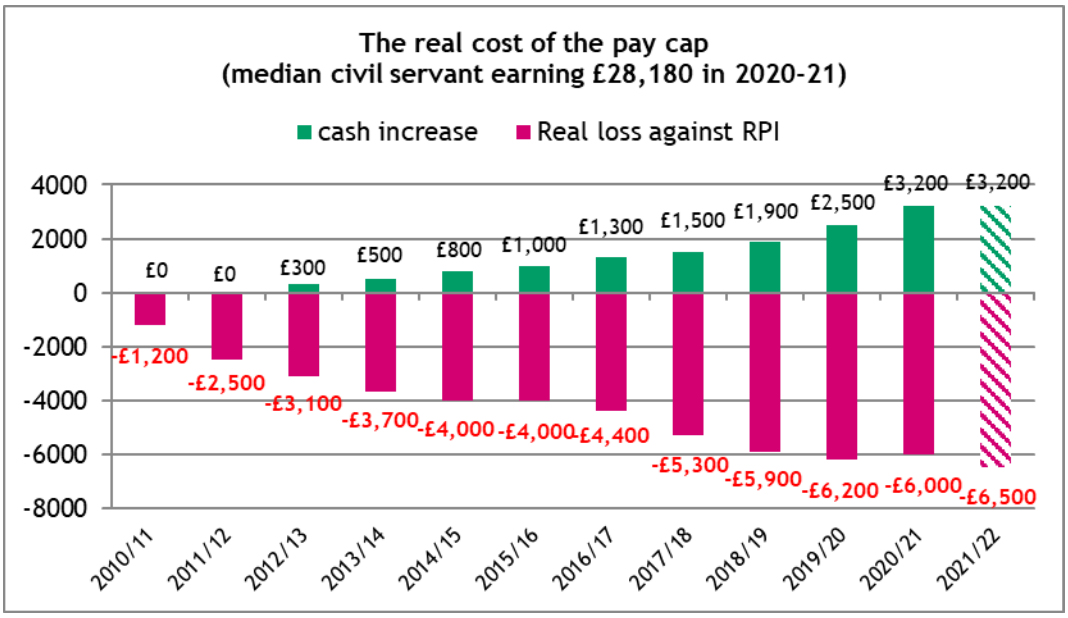
Source: Prospect analysis of OBR data

Public sector pay

In line with some advance reports, the Spending Review announced that the government will "pause" pay rises for public sector workers in 2021-22, excepting all NHS workers and any others earning less than £24,000, who will receive a minimum £250 increase.

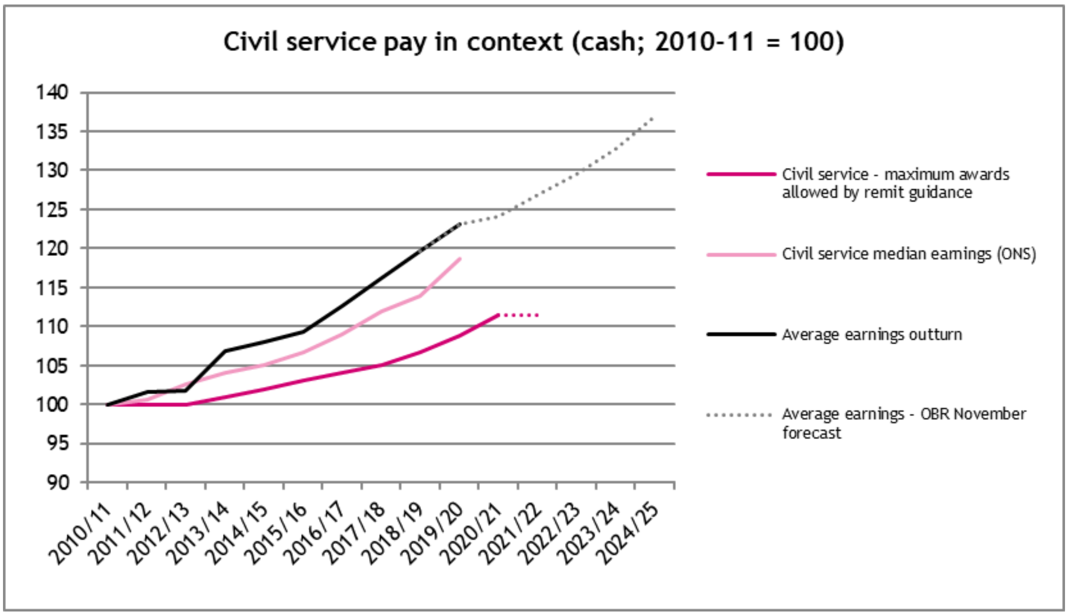
Against the inflation expectations summarised above, this will mean a real terms pay cut for millions of public sector workers in 2021-22. The real value of a median civil servant's salary

(£28,180 in 2020-21) will fall by about £500 against next year's RPI forecast. This is on top of around £6,000 lost against RPI since 2010 as a result of previous freezes and caps.



The "pause" will also have the effect of widening gaps between public and private sector salaries that have opened up in many areas over the past decade.

Between 2010-11 and 2019-20 average earnings across the economy have risen by 23 per cent in cash terms; over the same period maximum civil service pay awards amounted to just 9 per cent. Even in the weakened economic conditions of the pandemic growth in average earnings is expected to be 0.9 per cent in 2020-21 and 2.2 per cent in 2021-22; civil servants were allowed a maximum 2.5 per cent in 2020-21 but will now have no rise in 2021-22.



Source: Prospect analysis of OBR and ONS data

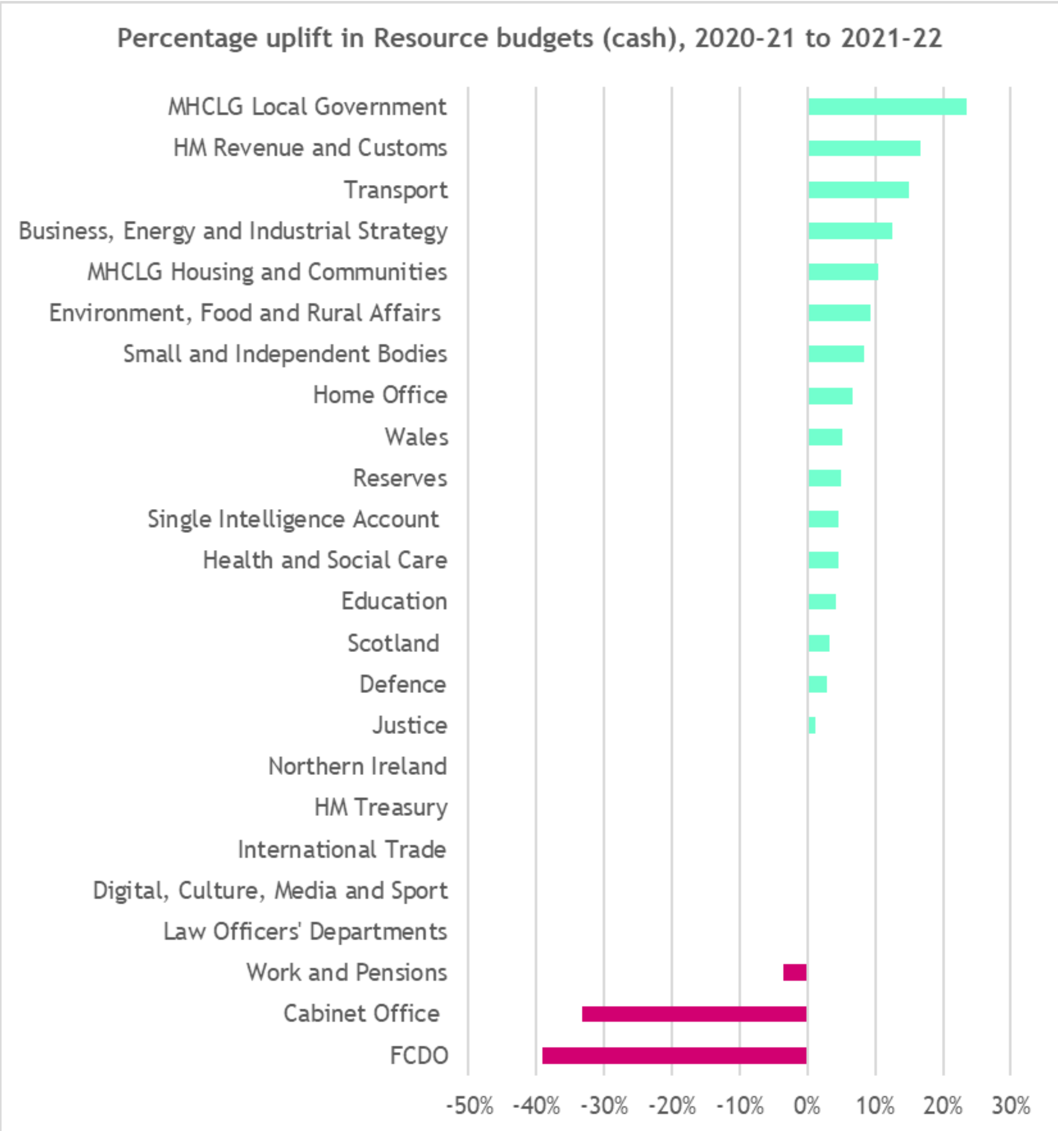
Budget settlements for 2021-11

Departmental spending has been increased dramatically above March plans this year as a result of specific measures to respond to the pandemic; further additional funding has been allocated for next year.

Disregarding funding earmarked for Covid-specific spending, total departmental funding will rise by 3.8 per cent in real terms next year. This increase is not, however, distributed evenly across departments – the lion's share went to the NHS, education and defence, who together received around two thirds of the £14.8bn in total additional funding.

In percentage terms, the largest increases in non-Covid-related resource funding went to departments with smaller resource budgets: MHCLG (partly related to the Government's "levelling up" agenda), HMRC (to support the post-Brexit customs system), Transport (also related to "levelling up" priorities), BEIS (which will be overseeing several new energy and R&D initiatives), and Defra (partly reflecting increases in England farm support in place of the EU's CAP).

The newly-formed Foreign, Commonwealth and Development Office sees the largest percentage decrease as a result of the cut to overseas aid spending. The new resources allocated to the DWP to provide labour market support in response to the impact of Covid appear to be partly offset by a fall in its "core", non-Covid resource budget.



Source: Prospect analysis of HMT data

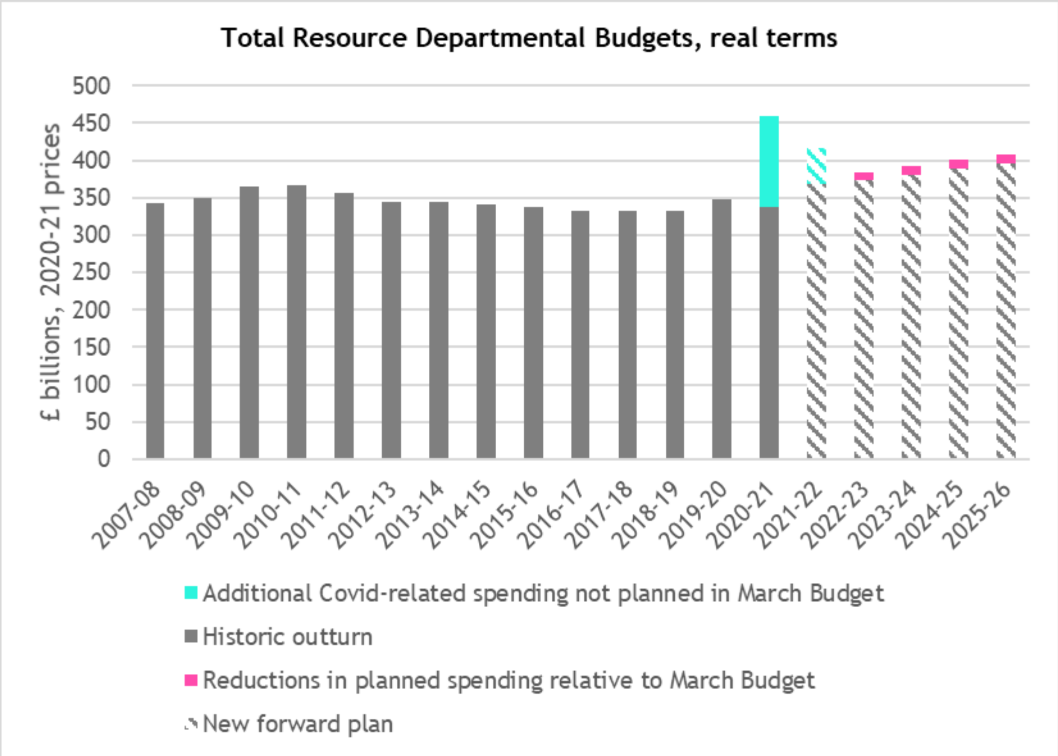
Over the longer term, the Chancellor has published provisional budgets that represent a reduction in Resource spending over the next four years from plans included in the March Budget, cutting around £10-£15bn from the total in each year from 2022-23 to 2024-25.

Some of this “cut” to previous plans is the effect of the announced public sector pay freeze (which is estimated by the IFS to reduce planned spending by £1-2bn a year)[2] as well as a £4bn reduction in the overseas aid budget.

Although the trajectory of total resource spending remains upward and higher than seen in the “austerity” years after 2010, it needs to be borne in mind that “protected” areas such as health and education are taking up a growing share of total spend and any increases planned. This means that Departments and Arms Length Bodies in “unprotected” areas may be under continued financial pressure during this period which will be exacerbated by these reductions.

The Institute for Fiscal Studies has commented that

> “In 2024−25, departments’ day-to-day budgets will be £13 billion lower than was planned in March. Given the government’s big commitments on the NHS, schools and defence, that implies an extremely tight funding situation for other public services for the remainder of the Parliament. Some areas could well be facing another round of cuts, on top of those already made over the last decade.”[3]

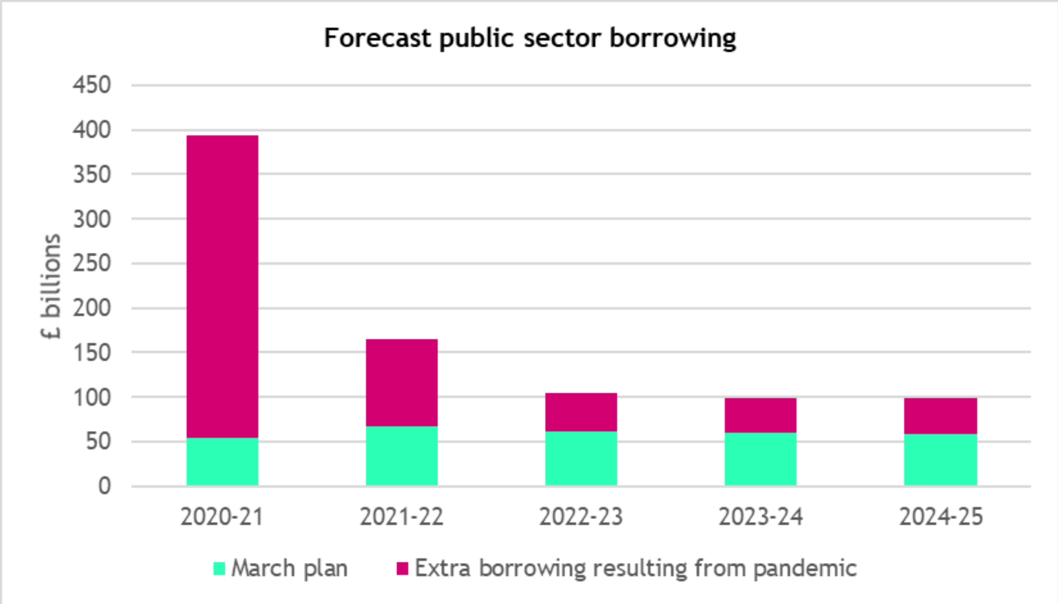


Source: Prospect analysis of OBR data

It is possible that further cuts to planned spending will be announced in next year’s (probably multi-year) Spending Review, as the Government seeks to reduce the additional borrowing resulting from the long-term “scarring” effects of this year’s recession.

[2] https://www.ifs.org.uk/spending-review-2020
[3] https://www.ifs.org.uk/publications/15203

It is not yet clear what the scale of any further spending cuts or tax rises will be, partly because the economic outlook remains so uncertain but also because the Government has yet to confirm a new set of fiscal rules or targets. But on current forecasts the Chancellor will need to implement increased taxes or reduced spending amounting to around £40bn a year to bring projected annual borrowing back to the level it was at in March this year. A "no deal" Brexit scenario would add around £6bn to this relative annual deficit.



Source: adapted from Resolution Foundation of OBR data[4]

Some commentators have highlighted the importance of Government spending to stimulate and support the recovery, especially after 2021 when extra Covid-related spending is likely to have been wound down.[5] This would suggest that the Chancellor should not seek to close this additional "deficit" too quickly.

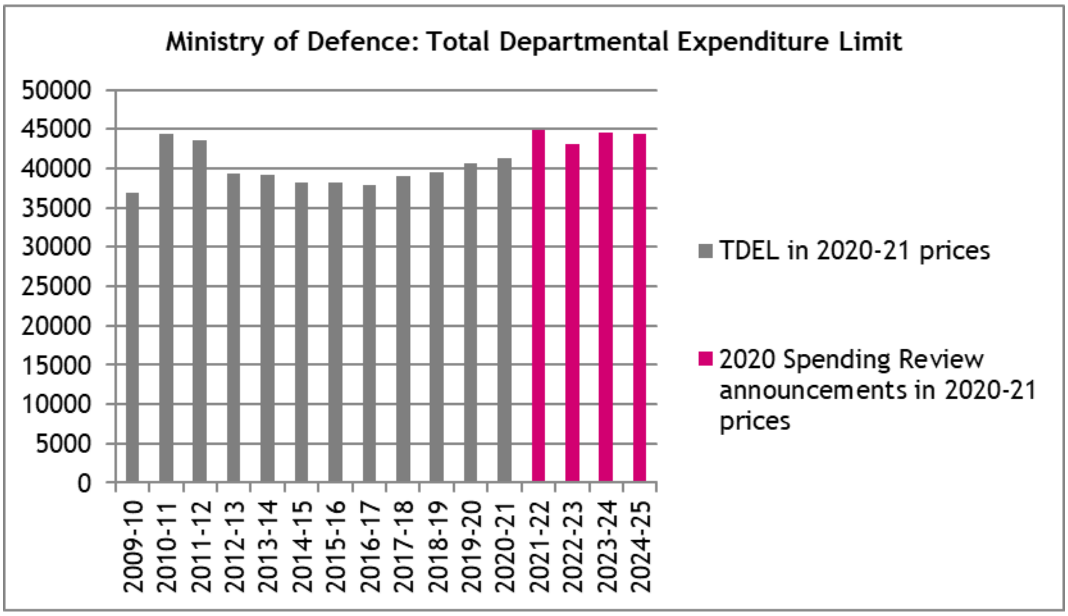
Announcements of interest to key sectors

Defence

The Spending Review confirms previously reported increases in the defence budget, with figures indicating that in real terms this will peak in 2021-22, fall slightly in 2022-23 and rise again for 2023-24 and 2024-25.

On the basis of the OBR's latest inflation expectations these increases will take total real terms defence spending back to the level of 2010-11.

[4] https://www.resolutionfoundation.org/app/uploads/2020/11/Here-today-gone-tomorrow.pdf
[5] https://www.resolutionfoundation.org/app/uploads/2020/11/Here-today-gone-tomorrow.pdf; Martin Wolf, 'Weak demand would derail Britain's economic comeback', *Financial Times*, 29 November, https://www.ft.com/content/973609ef-9a26-46cc-a9ad-32c2f69fe8d9



Source: Prospect analysis of HMT data

The Spending Review states that the additional funding will:

- "enable research into artificial intelligence and other battle-winning technologies, with an investment of at least £6.6 billion in R&D"
- "reshape the UK's Armed Forces for the age of networked warfare"
- "establish a new Space Command and enhance the breadth of our space capabilities"
- "continue the renewal of the UK's nuclear deterrent"
- "develop the next generation of naval vessels, including Type 32 frigates and Fleet Solid Support ships, and deliver our plans for eight Type 26 and five Type 31 frigates"
- "progress our Carrier Strike capabilities, with at least 48 F-35s by 2025"
- "develop a new Combat Air system for the RAF, along with delivering upgraded Typhoon radars"
- "enhance the UK's position as a world-leading responsible cyber power."

Commentators have noted that it is not yet clear to what extent, even within the increased funding, new capabilities will be expanded at the expense of spending on existing programmes.[6]

It should be remembered that most of the additional spending announced for defence is "capital" investment (the chart above includes both capital and "current" budgets). In fact, according to the Resolution Foundation, the MoD is "the only department for which the day-to-day spending picture is currently set to decline materially in real terms per-person over the next four years".[7]

[6] https://www.ft.com/content/e72674cc-6063-4146-ac7a-bf3c72840432

[7] https://www.resolutionfoundation.org/app/uploads/2020/11/Here-today-gone-tomorrow.pdf. Of course, it might be argued that a "relative to UK population" measure is less relevant to defence than most other departments.

Energy

Budget allocations for BEIS include:

- £1 billion for the previously announced **Carbon Capture and Storage** Infrastructure Fund which "will help establish four CCS clusters by 2030" bringing "jobs and investment to industrial heartlands in areas of North East and North West England, the Humber, Scotland and Wales."

- £240 million "to support industry to produce low-carbon **hydrogen** at scale and over £80 million to test its use in heating buildings". The Review states that "The UK is also well positioned to develop an exciting new industry in low carbon hydrogen production, which could help decarbonise transport, industry, homes and power. Working alongside partners in industry, the UK aims to develop 5 gigawatts (GW) of low-carbon hydrogen production capacity by 2030, supporting up to 8,000 jobs."

- £160 million "to upgrade our portside manufacturing capabilities to help build the next generation of **offshore wind farms**", to help "maximise the opportunities" for jobs and investment of the government's plans to quadruple offshore wind capacity to 40GW by 2030.

- £200 million for the Net Zero Innovation Portfolio "to support new decarbonisation solutions and bolster **emerging technologies** such as direct air capture and low carbon hydrogen."

- £500 million "to be spent in the next four years on the development and mass-scale production of **electric vehicle batteries** and support for associated supply chains, boosting investment into our strong manufacturing bases including in the Midlands and North East."

- £2.7 billion for the **Nuclear Decommissioning Authority** "to enable it to continue the work of safely decommissioning the UK's nuclear legacy sites, across England, Scotland and Wales."

- £525 million towards "the development of a large-scale **nuclear** project, subject to value for money assessment, and advanced nuclear technologies, including novel small modular reactors and next generation advanced modular reactors."

On nuclear, the new National Infrastructure Strategy states:

> "Nuclear is a proven, value-for-money source of reliable low carbon power which can complement renewables. The government is pursuing large-scale nuclear projects, subject to clear value for money for both consumers and taxpayers and all relevant approvals, with further details to follow in the Energy White Paper. …
>
> "Last year, the government consulted on a nuclear Regulated Asset Base (RAB). The government is considering the responses to this consultation and expects to publish a response in due course. Alongside considering the RAB model the government will also continue to consider the potential role of government finance during construction, provided there is clear value for money for consumers and taxpayers."[8]

The Department for Transport settlement also includes "£1.9 billion for charging infrastructure and consumer incentives", including "£950 million to support the rollout of rapid electric vehicle (EV) charging hubs at every service station on England's motorways and major A-roads".

According to the Institute for Government "planned investment is still some way short of what the Climate Change Committee thinks is required to get the UK on track for reaching net zero by 2050".[9]

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8 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/938049/NIS_final_web_single_page.pdf

9 https://www.instituteforgovernment.org.uk/publication/spending-review-2020/levelling-up-net-zero

Environment and Food

The budget allocation for Defra includes:

- £92 million for the Nature for Climate Fund "to increase **tree planting and peatland restoration** in England". (This is presumably on top of the £640m investment promised in the March budget.) The Review claims that "this will support an additional 1,000 green jobs"
- a "doubling of the Green Recovery Challenge Fund with a further £40 million to fund a second round of **natural capital projects** next year"
- £7 million "to improve public access to green space by taking forward the **Coast to Coast National Trail** and **England Coast Path**"
- "more than" £75m "for **National Parks and Areas of Outstanding Natural Beauty**"
- "fulfilling the commitment made at Budget 2020 to provide an additional £7 million for biodiversity conservation in the UK **Overseas Territories**"
- "support to implement the flagship **Environment Bill** measures including biodiversity net gain for development, the setting of legally-binding environmental targets, and the Office for Environmental Protection"
- "support for **increasing recycling and reducing waste**, allowing Defra to progress with extended producer responsibility for packaging waste, introduce a deposit return scheme, and implement consistent collection of waste – including food waste – in every local authority in England by the end of this Parliament."
- "an uplift in **Defra's science capability**, including extending the pilot of the Natural Capital and Ecosystems Assessment"

The Spending Review also announces "a doubling of the government's flood and coastal defence investment to £5.2 billion over six-years" including "up to £155 million to accelerate 22 shovel-ready flood defence schemes announced earlier this year", though this had already been announced in the March budget. At that time the Institute for Public Policy Research commented that "much more is needed. The funding announced today is still less than the £1bn a year that the Environment Agency says it needs."[10]

Green and environmental groups and commentators expressed disappointment that the Spending Review added little in the way of new resource to the "Ten Point Plan" announced by the Prime Minister the previous week.[11] Hilary McGrady, director-general of the National Trust, said:

> "This year has shown how important nature and green space are to people. While we welcome confirmation that climate change and the environment remain an important priority for the government, we've not seen the long-term funding commitment to deliver the bold changes we need."[12]

Heritage

The DCMS settlement includes:

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[10] https://www.themj.co.uk/Budget-2020-Flood-hit-areas-to-share-200m-defence-fund/216999
[11] See https://prospect.org.uk/news/without-follow-through-10-point-plan-wont-accelerate-our-climate-ambitions/
[12] https://www.theguardian.com/politics/2020/nov/25/rishi-sunaks-spending-review-will-fail-to-kickstart-green-recovery

- over £150 million to continue to strengthen our cultural and heritage infrastructure, including through the Cultural Investment Fund and Museums Infrastructure Fund, enabling the development of British Library North and continued investment in the Heritage High Streets programme
- more than £100 million of capital investment for DCMS-supported bodies working across culture, heritage, and sports
- "over" £320m "for our internationally renowned galleries and museums". (This represents a £20m cash increase on funding provided for 2020-21 in the 2019 Spending Round.)

IT and telecoms

The DCMS settlement includes:

- £1.2 billion from 2021-22 to 2024-25 "to support the rollout of **gigabit-capable broadband** across the UK," This is part of the previously announced "£5 billion commitment to support gigabit-capable broadband rollout to the hardest to reach areas of the UK". Total investment required for full roll-out is estimated to be in the region of £30bn, the vast majority of which will need to be provided by the private sector.
- £50m for 2021-22 "as part of a £250 million commitment to building a secure and resilient **5G network**" (this appears to be aimed at helping telecom firms absorb the costs of the Government's recent exclusion of Huawei)
- "over" £200m UK-wide "to continue **flagship digital infrastructure programmes**, including the Shared Rural Network for 4G coverage, Local Full Fibre Networks, and the 5G Testbeds and Trials Programme"
- £45m "for programmes to drive growth through **digital technologies and data**, while improving online safety and security"

On broadband, industry commentators have highlighted an apparent softening of the aspiration to ensure "every home" can access a "gigabit-capable" connection to a "minimum" of 85 per cent by 2025,[13] noting that the feasible speed of roll-out is affected by "lack of clarity over key issues – such as overbuild between rivals, a shortage of skilled engineers, post-2020 state aid rules (Brexit negotiations) and uncertainty over long-term rollout plans."[14]

Justice

The MoJ settlement includes:

- £43m "to ensure the continued safety of prisons and courts"
- "more than £4 billion capital funding over the next four years to make significant progress in delivering 18,000 additional prison places across England and Wales by the mid-2020s"

Public services

The Cabinet Office settlement includes £228m "to support the Government's levelling up agenda through investment into the **Government Property Agency**. Investment in the government hubs programme supports departments in relocating 22,000 roles out of London and the South East by 2030".

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[13] https://www.theregister.com/2020/11/26/uk_autumn_spending_review_telecoms/
[14] https://www.ispreview.co.uk/index.php/2020/11/government-start-5bn-uk-gigabit-broadband-rollout-for-85.html

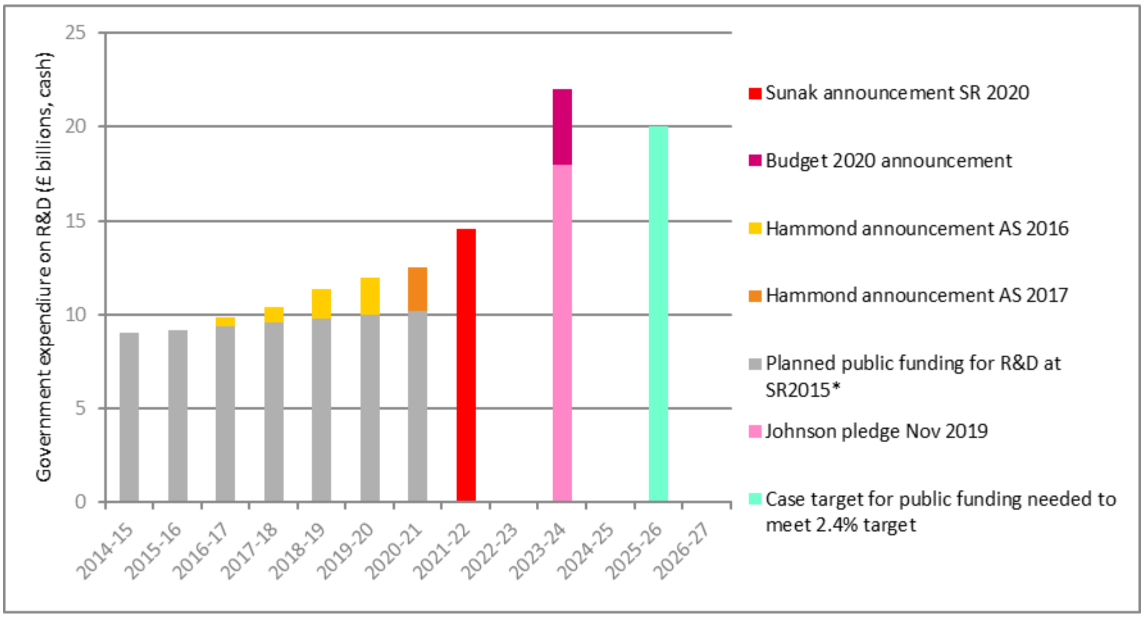
The MCHLG settlement includes "an additional £30 million to help deliver the new building safety regime, taking resource funding to at least £70 million in 2021-22, in the wake of the Grenfell Tower tragedy and Dame Judith Hackitt's recommendations to raise building safety standards. This includes funding for a **new building safety regulator** to oversee a more stringent regime for higher-risk buildings".

The **FCDO** settlement includes "funding to deliver against the government's levelling up agenda by committing to an increased FCDO presence in East Kilbride and a new FCDO hub outside of London", as well as funding to invest in embassies and the global estate.

Science

The March 2020 Budget announced a significant new increases to planned R&D spending, rising to reach £22bn in 2024-25 – exceeding the target set by the Campaign for Science and Engineering as needed to achieve the Government's aim of raising total R&D expenditure to 2.4% of GDP by 2027.

The Spending Review does not repeat the £22bn commitment, but does commit increases to £15bn in 2021-22 which the Campaign for Science and Engineering commented keeps it "on track" for the 2025 commitment. [15]



Source: Prospect analysis of HMT and OBR data

11bn of this total forms part of the BEIS settlement, including:

- an uplift of "over" £400m on average per year until 2023-24 for **core UK Research and Innovation science**, building on our outstanding science base in a range of areas"
- "at least" £490m in 2021-22 "for Innovate UK core programmes and infrastructure to support ground-breaking **technologies and businesses**"
- £350m in 2021-22 "for UK Research and Innovation to support strategic government priorities, build new science capability and support the whole research and innovation ecosystem",

[15] https://www.sciencecampaign.org.uk/news-media/press-releases/case-responds-to-2020-spending-review.html

including “the first £50 million towards an £800 million investment by 2024-25 in high risk, high-payoff research” (the much discussed “UK ARPA” programme)

- £200m in 2021-22 for the Net Zero Innovation Portfolio (see energy, above)
- “up to” £17m in 2021-22 “to establish a new unit and fund that will focus on the last mile of innovation to help ensure that public sector knowledge assets (R&D, intellectual property and other intangible assets) translate into new high-tech jobs, businesses and economic growth”

There has recently been increasing awareness and discussion of the role played by public sector research centres and facilities in the wider R&D landscape.[16] In line with proposals from the recent review of Government science capabilities,[17] The Spending Review announces that “UK Research and Innovation will next year open its grant competitions to the dispersed network of outstanding public sector labs across the country.” It is also possible that PSREs may be expanded on the basis of the £450m allocated “to support government priorities, drive the development of innovative ways to build new science capability and support the whole research and innovation ecosystem”.

UK public sector research establishments

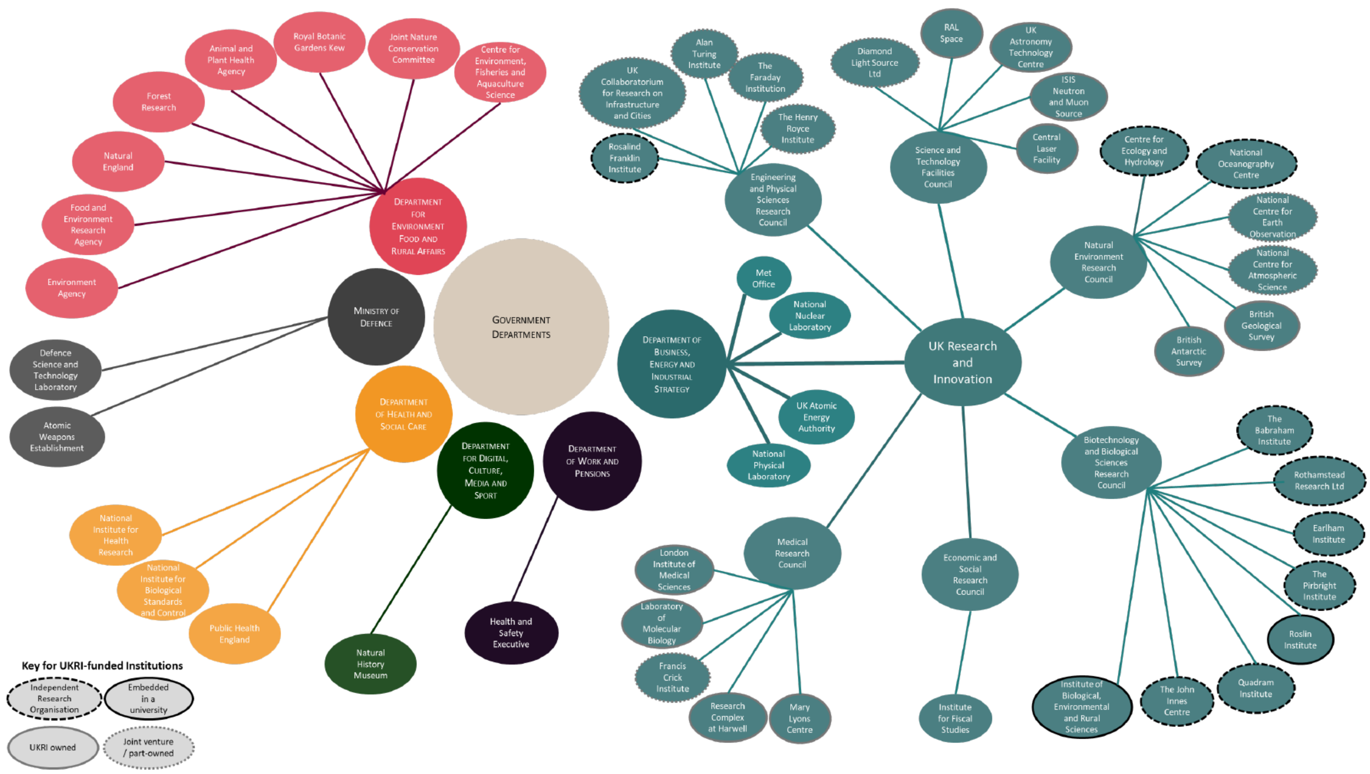


Figure 6 - The UK government’s Public Sector Research Establishments and UK Research and Innovation-funded Institutes. Devolved administrations also fund research and innovation institutes which are not shown.

Source: BEIS R&D roadmap, July 2019[18]

[16] See for example https://www.kcl.ac.uk/policy-institute/assets/the-road-to-2.4-per-cent.pdf; https://media.nesta.org.uk/documents/The_Missing_4_Billion_Making_RD_work_for_the_whole_UK_v4.pdf; https://royalsociety.org/-/media/policy/Publications/2020/2020-09-the-role-of-public-and-non-profit-research-organisations-explainer.pdf

[17] https://www.gov.uk/government/publications/government-science-capability-review

[18] https://www.gov.uk/government/publications/uk-research-and-development-roadmap/uk-research-and-development-roadmap

The £490m allocated to Innovate UK business support activities is intended to "support high-tech firms across the UK in developing the technologies of the future"; key areas supported under these schemes thus far have included cyber-security and quantum computing and communications (in which BT is a key player as well as the National Physical Laboratory), smart grids (in which energy firms are playing a role) and nuclear SMRs (being developed by a consortium including Rolls Royce, Atkins and the National Nuclear Laboratory).[19]

Transport

The March 2020 Budget included an announcement of the Second Road Investment Strategy (RIS2) for Highways England which includes around £27 billion of spending on strategic roads between 2020 and 2025. This is reiterated in Spending Review 2020. At the time of the March budget the Association for Consultancy and Engineering said:

> "With infrastructure investment now totalling more than £600bn over the next five years, or around 3 per cent of GDP, the headline takeaway figures are great news for society, our members and wider industry. The numbers exceed ACE's manifesto and the National Infrastructure Commission's recommendations. There is no doubt that this is an historically huge commitment to investment in the future of our country and recognition of infrastructure's vital role in driving long-term economic growth"

Law firm Pinsent Masons warned about potential disruptions in light of skills shortages, new immigration restrictions, working through of Brexit settlements and the current effects on supply chains of the Covid-19 virus.[20]

The Spending Review also announces "£1.9 billion for charging infrastructure and consumer incentives" including "£950 million to support the rollout of rapid electric vehicle (EV) charging hubs at every service station on England's motorways and major A-roads".

Prospect's response

Prospect's original submission to the Spending Review can be read here https://library.prospect.org.uk/id/2020/00995.

Key elements are summarised in our *Steps to Recovery* document here: https://prospect.org.uk/news/prospect-launches-steps-to-recovery-plan/

In response to the Chancellor's Spending Review statement, Prospect general secretary Mike Clancy said:

> "The Chancellor started his statement by promising stronger public services, but by freezing the pay of many thousands of public servants he is undermining the very people who are the foundation of our public sector.
>
> "The comparison of public and private sector wage growth was insulting and failed to acknowledge the public servants have just emerged from eight years of draconian pay restraint, and those who suffered the most under that restraint are set to bear the brunt again.
>
> "This freeze will cause huge damage to recruitment and retention in key areas, such as environmental agencies and health and safety, and will be a bitter blow to people who have gone above and beyond to deal with the twin challenges of coronavirus and Brexit.

[19] https://www.ukri.org/our-work/delivering-economic-impact/industrial-strategy-challenge-fund/
[20] https://www.newcivilengineer.com/latest/roads-announcements-get-mixed-reception-12-03-2020/

> "While increased spending for some departments is welcome, it is set against the fact that most have faced deep cuts over the past decade.
>
> "And if we are really going to recover strongly from the pandemic, the government must address the millions of workers still unfairly excluded from his economic support schemes."[21]

This briefing will be updated as new information and analysis comes to light. Please direct any suggestions, corrections or queries to martin.mcivor@prospect.org.uk

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[21] https://prospect.org.uk/news/by-freezing-thousands-of-public-servants-pay-sunak-is-undermining-the-public-sector/