Research briefing

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The 2021 Spending Review

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Introduction

The 2021 Spending Review sets non-capital (or "Resource") budgets for all Government Departments for the financial years 2022-23, 2023-24, and 2024-25, 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 industries in which public investment and regulation plays a role, and for all citizens, businesses and communities who rely on and benefit from public services.

Economic background and forecasts

This Spending Review has been conducted against the background of a stronger-than-expected recovery from the Covid-related recession this year, but significant uncertainty around the course of both the pandemic and the economy over the next six months.

Published alongside the Chancellor's statement are new economic forecasts prepared by the independent Office for Budget Responsibility – their first since March this year. The economic outlook remains subject to significant uncertainty due to the current state of the pandemic as well as energy and supply chain disruptions currently impacting many businesses. However, these forecasts 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, the OBR now expects the UK economy to have grown back above pre-pandemic levels next year– a significant improvement on the expectations from March. GDP is expected to return to relatively modest growth rates of less than 2 per cent a year from 2024. This

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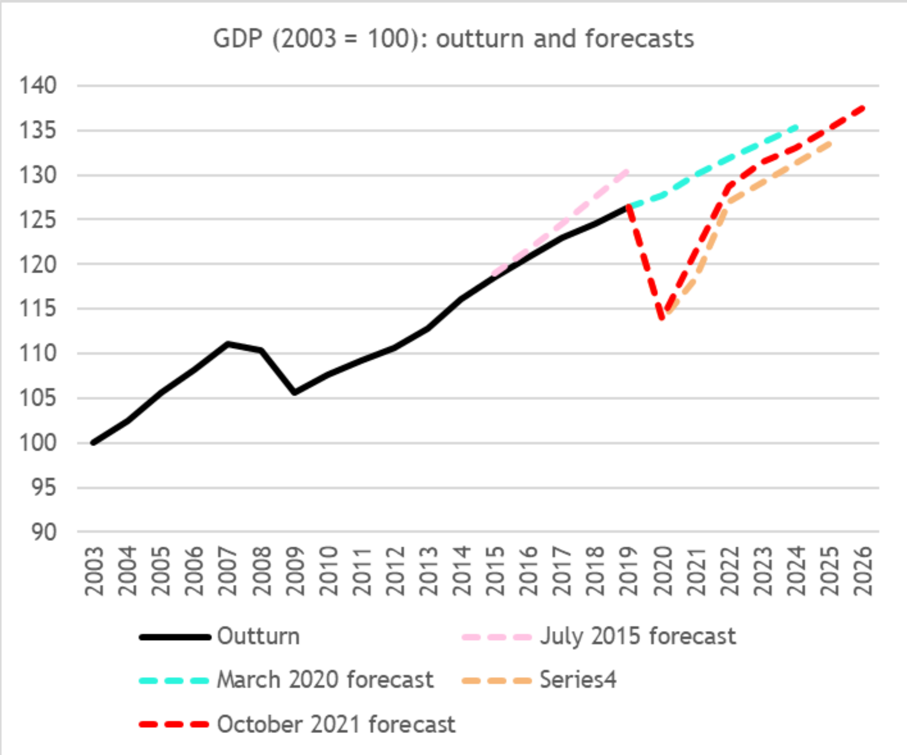
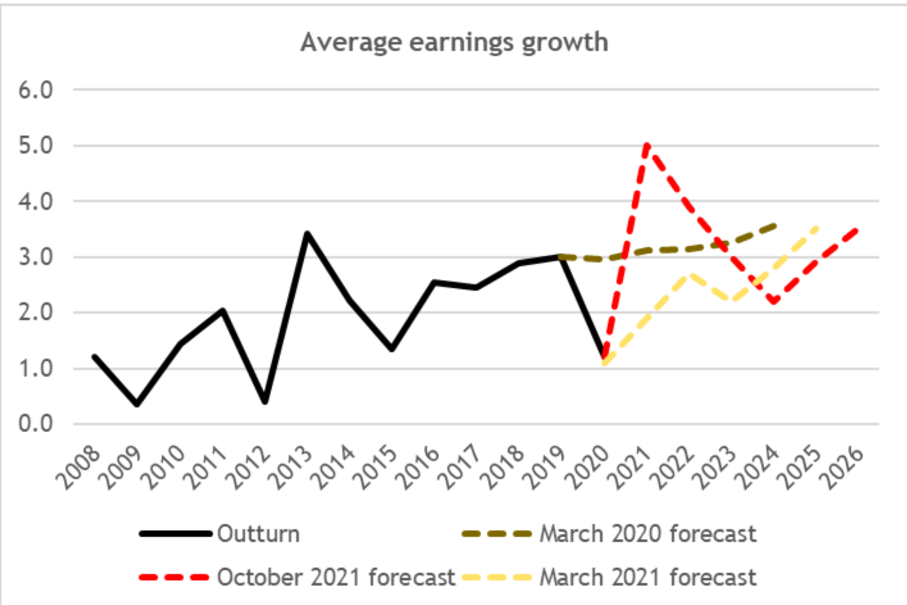
means it will remain around 2 per cent below the growth path that was expected before the pandemic – and even further below the growth path projected earlier in the decade, when growth rates of 2 to3 per cent were still regarded as its natural trend.



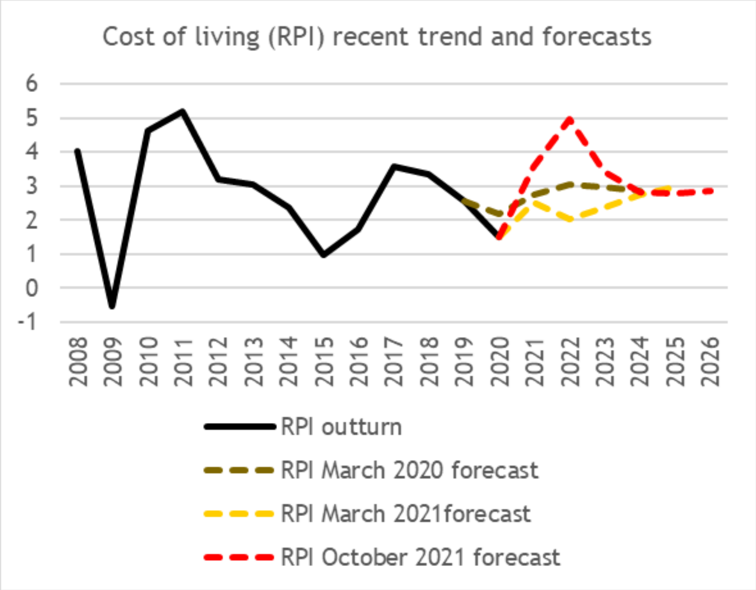
Source: Prospect analysis of OBR data

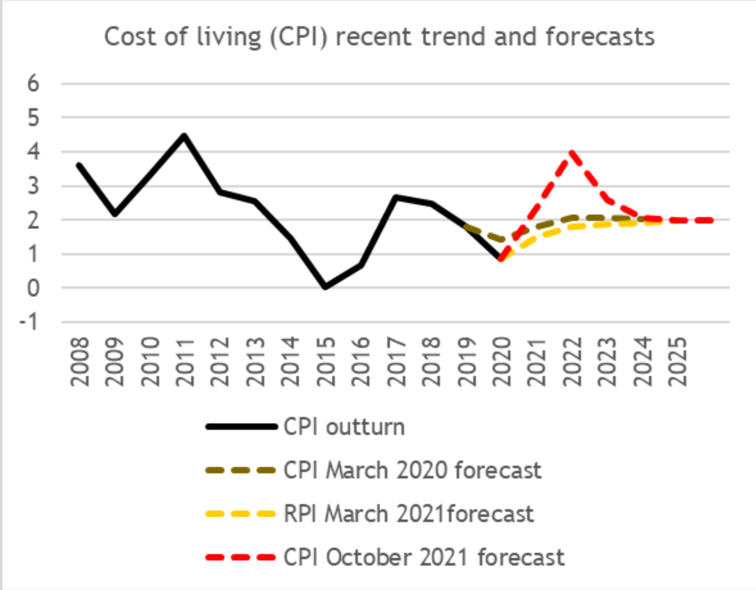
The OBR now expects this year to have shown a much stronger bounce back of average earnings growth than it did in March, reflecting "growing evidence of labour shortages in some places and occupations", but for earnings growth to fall back below 3 per cent in 2023 and 2024.



Source: Prospect analysis of OBR data

Inflation forecasts have also changed significantly, with RPI expected to spike at around 5 per cent next year, and CPI around 4 per cent, before reverting to previous expectations in 2024.





Source: Prospect analysis of OBR data

The OBR highlights particular uncertainty around its central inflation forecast, noting that “there is a significant risk that it may rise even higher and turn out to be more persistent.”

The combined effect of modest medium term earnings growth and sharply rising inflation is further stagnation in real wages. As the Resolution Foundation put it,

> “Clearly, the OBR do not yet see evidence of a new economic model of fast real wage growth emerging from this crisis”.[1]

According to the Institute for Fiscal Studies

> “A middle earner is likely to be worse off next year than this as high rates of inflation and tax rises more than negate small average wage increases.“[2]

Public sector pay

Last year’s Spending Review imposed a “pause” on public sector pay awards. This has had the effect of widening gaps between public and private sector salaries that have opened up in many areas over the past decade.

The 2021 Spending Review confirmed advance reports that this would be lifted, announcing that

> “public sector workers will see pay rises over the next three years as the recovery in the economy and labour market allows a return to a normal pay setting process. The government will be seeking recommendations from Pay Review Bodies where applicable. To ensure fairness and the sustainability of the public finances, public sector pay growth over the next three years should retain broad parity with the private sector and continue to be affordable.”

[1] https://www.resolutionfoundation.org/app/uploads/2021/10/The-Boris-Budget.pdf
[2] https://ifs.org.uk/budget-2021

Despite the lifting of this formal control, the affordability of pay awards for public sector employers may be affected by the budgets they are allocated over the next three years (see below).

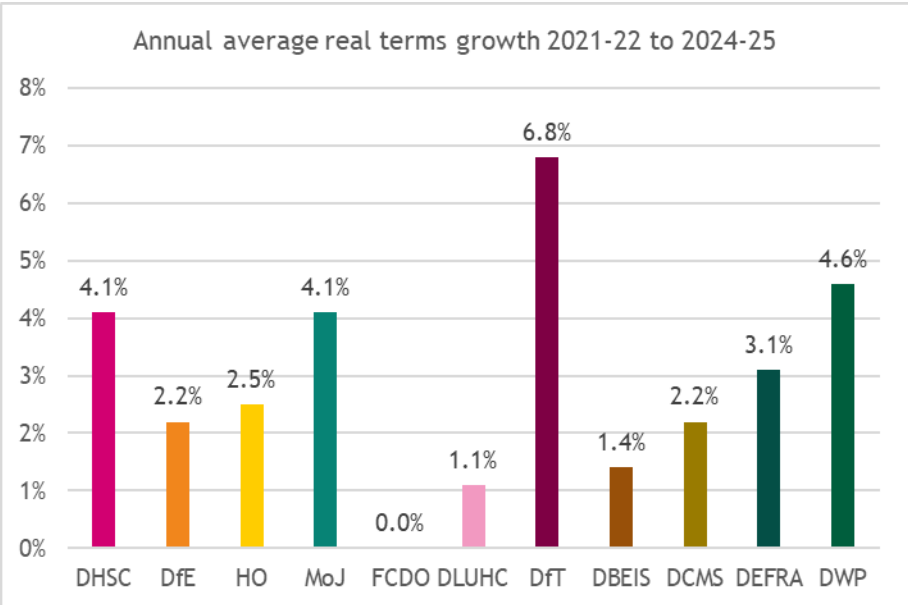
In response to the announcement Prospect General Secretary Mike Clancy said:

> “The government promised to end the public sector pay freeze and after this Budget they must ensure that departments do not short-change employees by failing to offer proper pay rises.
>
> “The Chancellor said that public sector pay will be determined by independent bodies, but hundreds of thousands of civil servants, and millions of public sector workers, aren’t covered by these bodies and need government to guarantee a fair pay rise for them.
>
> “With inflation soaring and pay rising across the private sector, this is an opportunity to reset the job market and make the public sector an attractive a place to work for skilled workers.”

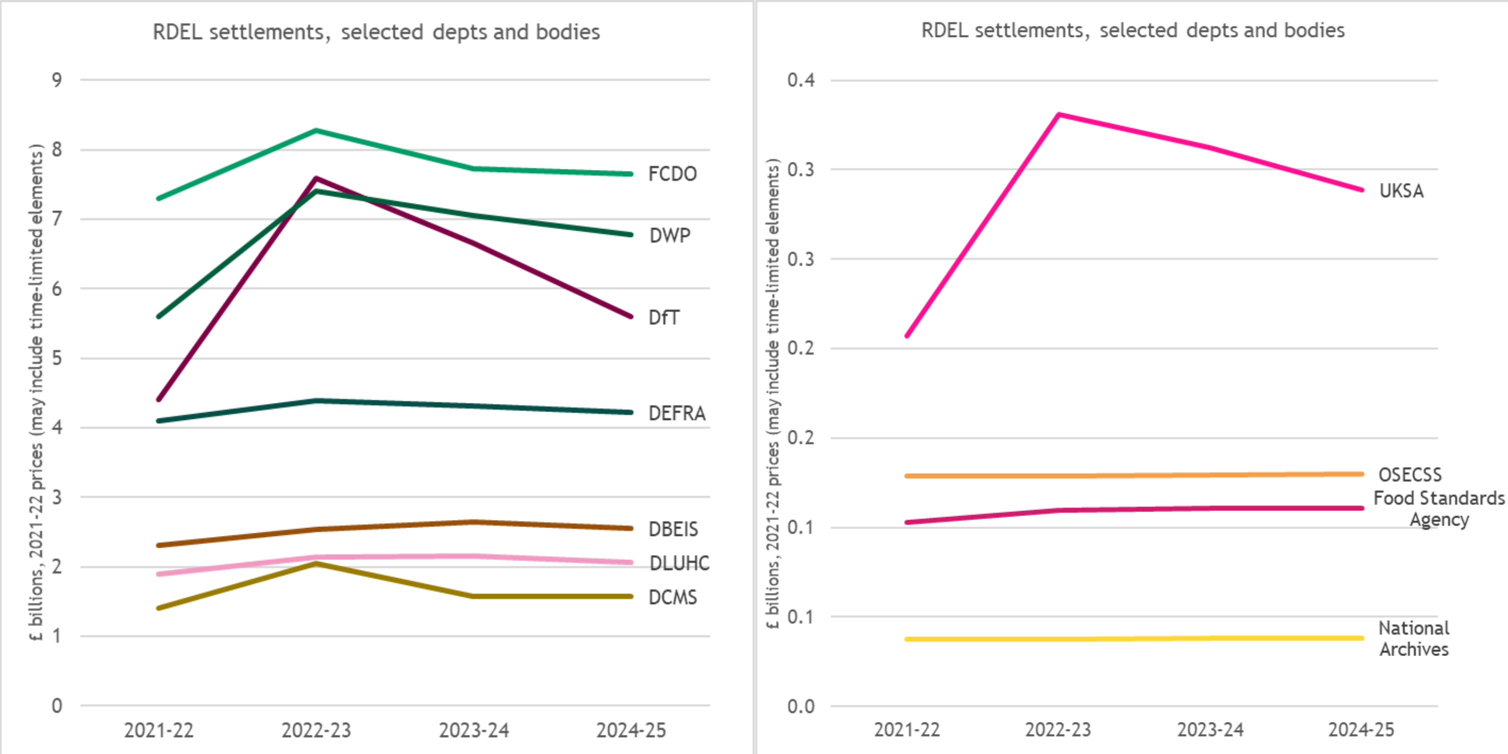
Budget settlements for 2022-24

The chancellor took advantage of an improved fiscal position resulting from the stronger-than-forecast recovery of the economy to increase the total spending “envelope” for the years 2022-3 to 2024-5 above the levels that had been set out at the time of the March budget.

This has meant that budgets allocated to Departments for the next three years are somewhat more generous than had previously been expected, with underlying annual average growth in non-capital spending ranging from zero per cent (FCDO) to almost seven per cent (DfT).



The year-by-year budget allocations for many departments look somewhat flatter than these figures imply, especially when corrected for inflation; however this may be an effect of temporary spending programmes that are not included in the Treasury’s calculation of annual average percentage increases, including Covid-related activities that are expected to be scaled down over the next few years.



Source: Prospect analysis of HMT and OBR data

Analysis by the Institute for Fiscal Studies suggests that even assuming the annual average increases published by the Treasury, most departments will still have smaller day-to-day budgets in 2024-25 than they had in 2009-10 – including MoD (down 10.4%), MoJ (down 12.2%). DEFRA (down over 15%), DMCMS and DfT all down between 10% and 20% on 2010 levels, DWP down over 40%, and CLG down over 50%.[3]

Announcements of interest to key sectors

Aviation

The Spending Review announced a package of Air Passenger Duty reforms combining a 50% cut in domestic APD with a new "ultra-long-haul distance band" for journeys of over 5,500 miles, with a forecast net cost to the Exchequer of around £30m a year.

The DfT settlement includes "£180 million to support the development of sustainable aviation fuel (SAF) plants and a SAF testing and certification centre".

The Spending Review also confirms that BEIS funding for the Aerospace Technology Institute will be guaranteed to 2031, though it does not specify at what level. The Sustainable Aviation Commission has warned that funding for the Aerospace Technology Institute is half what is needed "to enable the UK to become a world leader in developing more efficient engines as well as hybrid, electric and hydrogen aircraft".[4]

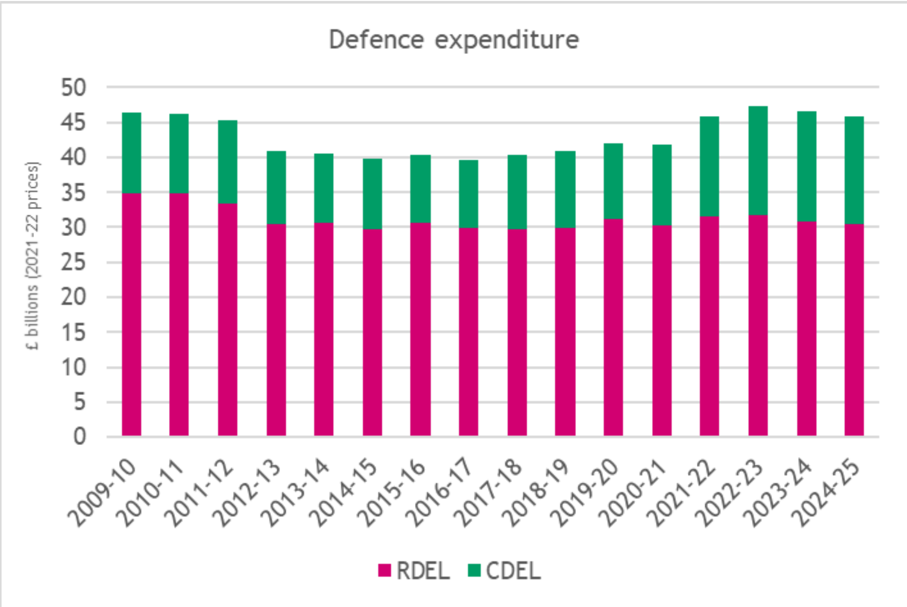
Prospect has elsewhere highlighted the importance of reversing falls in aerospace R&D to reducing the environmental impact of aviation.[5]

[3] https://twitter.com/BenZaranko/status/1453369340393316355
[4] https://www.sustainableaviation.co.uk/wp-content/uploads/2020/10/Sustainable-Aviation-CSR-Submission-FINAL-240920.pdf
[5] https://committees.parliament.uk/writtenevidence/38650/pdf/

Defence

Unusually advance budget settlements for the Ministry of Defence had already been announced in last year's Spending Review, which it has claimed represent "the largest sustained increase in defence spending since the Cold War".

On the basis of the OBR's latest inflation expectations these increases are set to take total real terms defence spending back to the level of 2010-11. However most of this additional spending was allocated to "capital" budgets – day-to-day spending at the MoD is set to decline in real terms by, on average, around 1% a year over the Spending Review period, from 31.5bn in 2021-22 to 30.4bn in 2024-25.



Source: Prospect analysis of HMT and OBR data

Energy

The Spending Review claims that the Government is "laying the foundations for the wider transition to a more resilient energy supply by investing in nuclear technologies and offshore wind.".

Budget allocations for BEIS include:

- "up to" £1.7bn in "new direct government funding to enable a large-scale nuclear project to take a final investment decision this Parliament, subject to value for money and approvals. The government is in active negotiations with EDF over the Sizewell C project"
- £380m (over three years) for offshore wind, "supporting our target of 40 gigawatts by 2030 and including up to £230 million as part of the new Global Britain Investment Fund (last year's Spending Review allocated £160m "to upgrade our portside manufacturing capabilities to help build the next generation of offshore wind farms")
- "up to" £140m "to create the Industrial Decarbonisation and Hydrogen Revenue Support scheme to establish hydrogen producers and CCUS for heavy industry
- Reannouncement of £1 billion for the Carbon Capture and Storage Infrastructure Fund, the £240m Net Zero Hydrogen Fund, and the Net Zero Innovation Portfolio, which were already included in last year's Spending Round

Environment and Food

The budget allocation for Defra includes:

- £250m capital allocation for
    - "implementing the Environment Bill including biodiversity net gain for development and Local Nature Recovery Strategies";
    - designating "at least" 15 new National Nature Reserves and "up to" 8,500 hectares of new SSIs, and bringing over50,000 hectares of existing SSIs into "favourable recovering conditions"
    - expanding the Species Recovery Programme to support "up to" 500 species
    - "tackling nutrient pollution in rivers and streams"
- £625m for the Nature for Climate Fund, raising total spend to more than £750m by 2025 on peat restoration and woodland creation and management
- £140m over three years to scale-up the Natural Capital and Ecosystems Assessment
- Digitising Kew Gardens' Herbarium
- "at least" 75m for research and innovation in support of net zero "in partnership with industry across agriculture, soils and peat, waste, and land use"
- A target to raise "at least" £500m in private finance every year by 2027 and £1bn a year by 2030

The Spending Review also reaffirms "a doubling of the government's flood and coastal defence investment to £5.2 billion over six-years" originally announced in the March 2020 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."[6]

This Spending Review announces "an additional" £27m "to support flooding incident and emergency response activities" and "an additional" £22m a year "for the maintenance of flood defences."

Heritage

The DCMS settlement includes:

- £52m in "new" funding in 2022-23 and £49m in 2024-25 for museums and cultural and supporting bodies "to support recovery from COVID-19". (Last year's Spending Review allocated 320m total funding to galleries and museums for 2021-22).
- "over" 850m capital expenditure over three years for "cultural and heritage infrastructure". This reportedly includes £300m over three years for maintenance and £125m to help NHM set up a research centre in Oxfordshire.

The Spending Review also says the Treasury will "work with relevant Arms' Length Bodies and their sponsoring departments to update and codify the operational and financial freedoms first introduced in 2013 for such organisations, to ensure that the freedoms are fit for purpose and that all stakeholders understand their scope going forward".

[6] https://www.themj.co.uk/Budget-2020-Flood-hit-areas-to-share-200m-defence-fund/216999

IT and telecoms

The DCMS settlement includes:

- £50m over three years on supporting UK's leadership in digital technologies, including a doubling of AI and data scholarships
- £110 over three years for the government's new online safety regime
- £180m over three years for investment in the Shared Rural Network, a partnership with industry aiming to extend 4G to 280,000 premises.
- Confirmation of £1.2 billion from 2021-22 to 2024-25 "to support the rollout of gigabit-capable broadband across the UK, announced in last year's spending review.. 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.

Media and entertainment

The DCMS settlement includes:

- £14m a year over three years "to support our world-leading creative industries, supporting SMEs to scale up and providing bespoke support for the UK's independent film and video game industries
- "funding the £800 million Live Events Reinsurance Scheme and an extension to the £500 million Film & TV Production Restart Scheme, to enable UK events and productions to thrive and plan with certainty"

In response to the funding for cultural industries Head of Bectu Philippa Childs said "The creative industries were hit hard by the pandemic and should be front and centre of our economic recovery – and yet the government are providing a paltry £14m a year to help the sector get back on its feet. Spending 7% of the budget of the latest James Bond film is hardly a game changer for a sector and will leave I neither shaken nor stirred".[7]

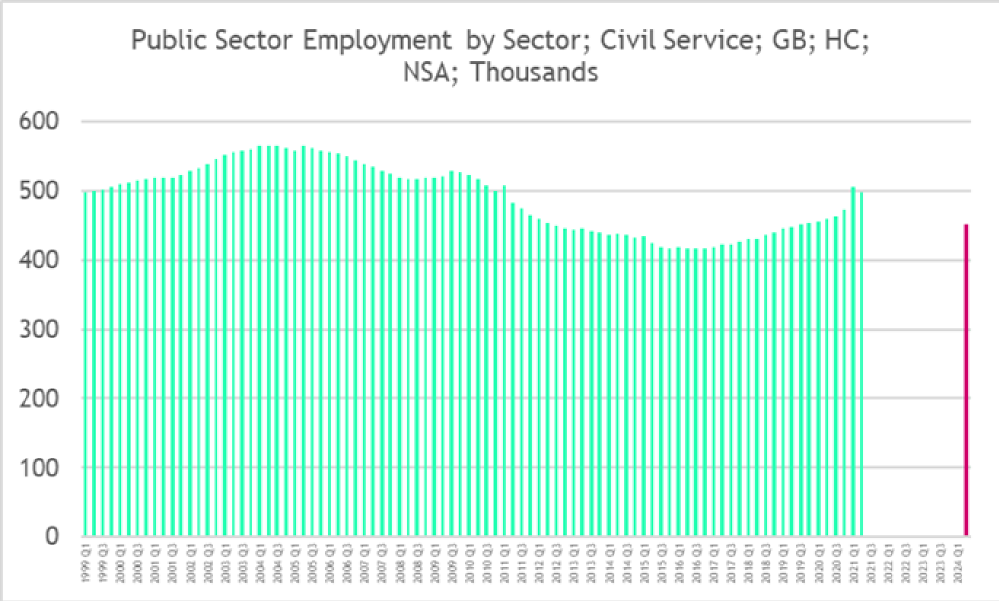
The Spending Review announced that the Government would increase the borrowing limit of the BBC's commercial arm to £750 million in stepped phases between 2022-23 and 2026-27. This has been called for by the Corporation as necessary to enable it to compete with content-producers such as Netflix.[8]

Public services

The Spending Review claims "savings of 5% against day-to-day central departmental budgets in 2024-25 that have been reinvested into priority areas. These efficiencies will mean that the government can reduce non-frontline civil service headcount to 2019-20 levels by 2024-25, helping to fund increases to frontline roles. This will mean a more productive and agile civil service, taking advantage of new ways of working to continue to reduce inefficiencies and deliver better outcomes for the public."

It is not clear from the published documentation what is meant by "non-frontline civil service"; if it simply means direct civil service employment, returning headcount to 2019-20 levels would imply a reduction of around 50,000 from the current 500,000. This is not thought to require redundancies.

[7] https://bectu.org.uk/news/bectu-responds-to-todays-budget/
[8] https://www.telegraph.co.uk/business/2021/03/22/bbc-demands-150m-borrowing-boost-tackle-netflix/



Source: Prospect analysis of ONS civil service statistics[9]

The Spending Review "continues funding for the Places for Growth programme, which aims to move 22,000 civil service roles outside London by 2030".

The Spending Review also states that the Department for International Trade "will continue to relocate posts from London to new Trade and Investment Hubs in Scotland, Wales, Northern Ireland and the north of England. DIT will have moved more than 500 civil service roles from London by the end of 2024-25".

Science

The March 2020 Budget announced significant new increases to planned R&D spending, rising to reach £22bn in 2024-25.

Prior to the Spending Review science leaders warned that "after all the rhetoric about the UK as a scientific superpower, it would be a real kick in the teeth not to honour the commitment".[10]

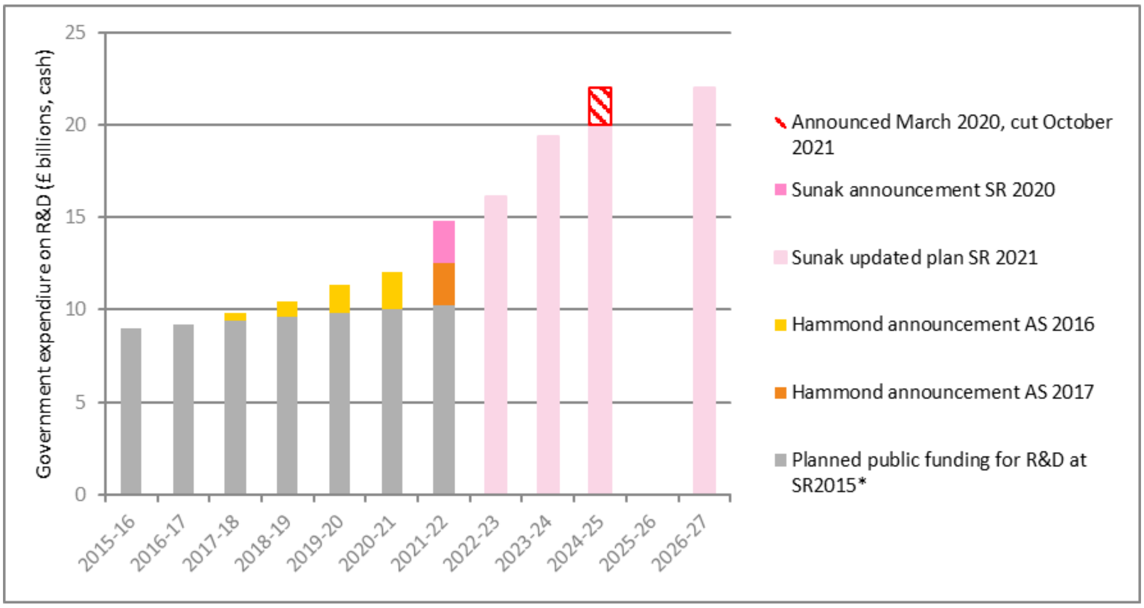
The Spending Review announced total R&D investment of 16.1bn in 2022-23 and 19.4bn in 2023-24, but cut the previously announced 2024-25 plan by 2 billion, pushing the £22bn target back to 2026-27 (which will be after the next General Election).

After the announcement the Campaign for Science and Engineering said "the rest of the world is still powering ahead on R&D, so it is disappointing that the Chancellor has had to delay the £22bn target to 2026. To achieve their stated ambition of investing 2.4% of GDP in R&D by 2027, the government will need to re-double its efforts to maintain business confidence and investment to ensure this goal becomes a reality."[11]

9 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/publicsectorpersonnel/datasets/publicsectoremploymenttimeseriesdataset

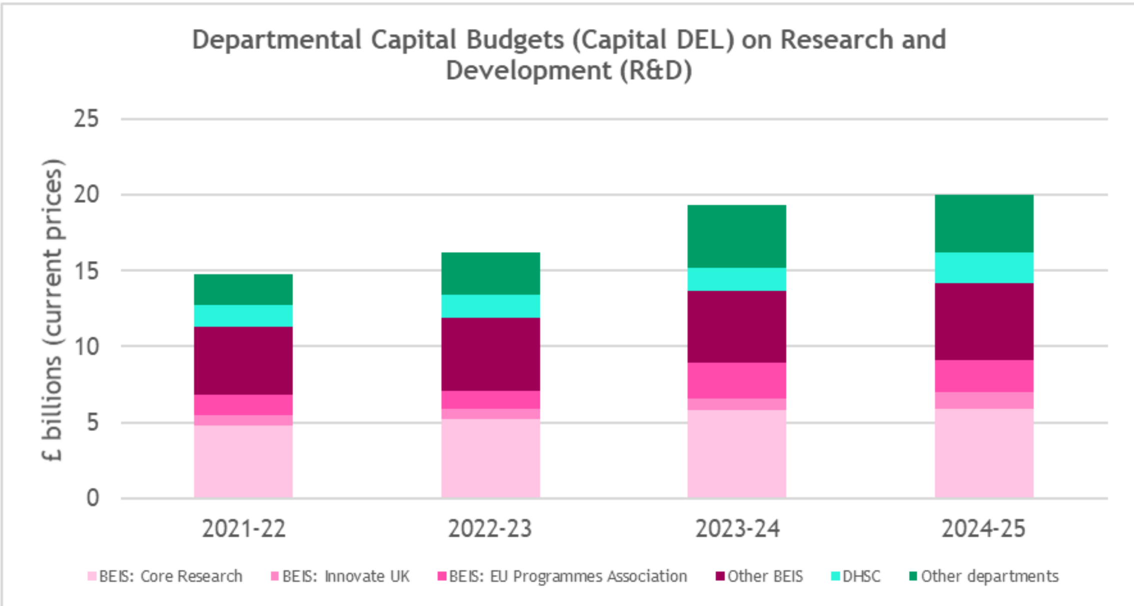
10 https://www.ft.com/content/d529c989-c93b-4ed7-9fd9-9343d3f190ce

11 https://www.sciencecampaign.org.uk/news-media/press-releases/case-responds-to-2021-spending-review.html



Source: Prospect analysis of HMT and OBR data

This year's Spending Review documentation includes a useful breakdown of where total R&D funding is going. This shows that the biggest beneficiaries of additional funding are Innovate UK (seeing a £400m or 57% cash increase over four years) and Government departments other than BEIS and DHSC (including DCMS, DEFRA, DfT, DWP, and MOD; seeing a £1.7bn or 81% cash increase over four years).



Key areas supported under Innovate UK 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).[12]

[12] https://www.ukri.org/our-work/delivering-economic-impact/industrial-strategy-challenge-fund/

The Campaign for Science and Engineering noted that “departmental R&D budgets are set to increase significantly in the next three years which is particularly positive for those who have had R&D budgets slashed in the last decade”.[13]

Transport

The March 2020 Budget included an announcement of the Second Road Investment Strategy (RIS2) for National Highways which included £27.4 billion of spending on strategic roads between 2020 and 2025. This was reiterated in Spending Review 2020.

However the 2021 Spending Review refers to “£24 billion of strategic roads investment from 2020 to 2025” – a cut of around £3.4bn. The Department has briefed that this is the result of delays to projects meaning expenditure moving to later years.[14]

The Spending Review also announces £620m of capital expenditure in support of public chargepoints and “targeted plug-in vehicle grants” on top of £1.9bn announced to support transition to electric vehicles in last year’s Spending Review.

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

[13] https://twitter.com/sciencecampaign/status/1453662726685872131?s=20
[14] https://www.highwaysmagazine.co.uk/National-Highways-faces-3.4bn-funding-cut-in-Budget/9367