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Spending Review 2020: COVID-19, Brexit and beyond

2 October 2020

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Economic
and Social
Research Council

SR 2020: the hardest yet?

- A Spending Review is a delicate balancing act at the best of times
- This year's will be even more difficult than normal
 - COVID-19
 - It follows a decade of austerity for public services
 - Brexit
 - 'Levelling up'
- As far as we know, the Chancellor intends to hold a full, multi-year SR
 - Uncertainties are too great: he should instead limit to a single year
 - The process will be fraught with difficulty in any case

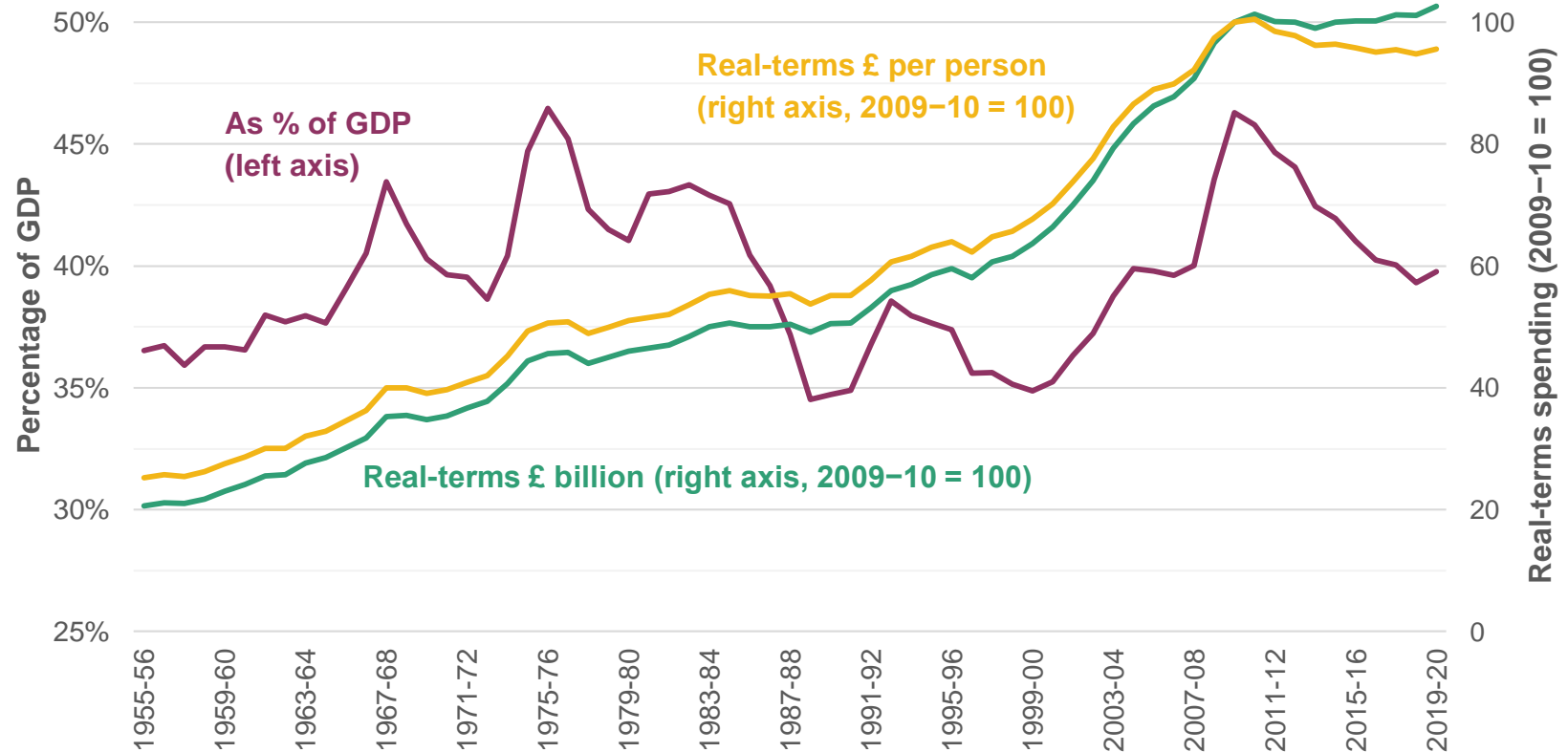


Four big challenges:

1) A decade of austerity

A decade of austerity

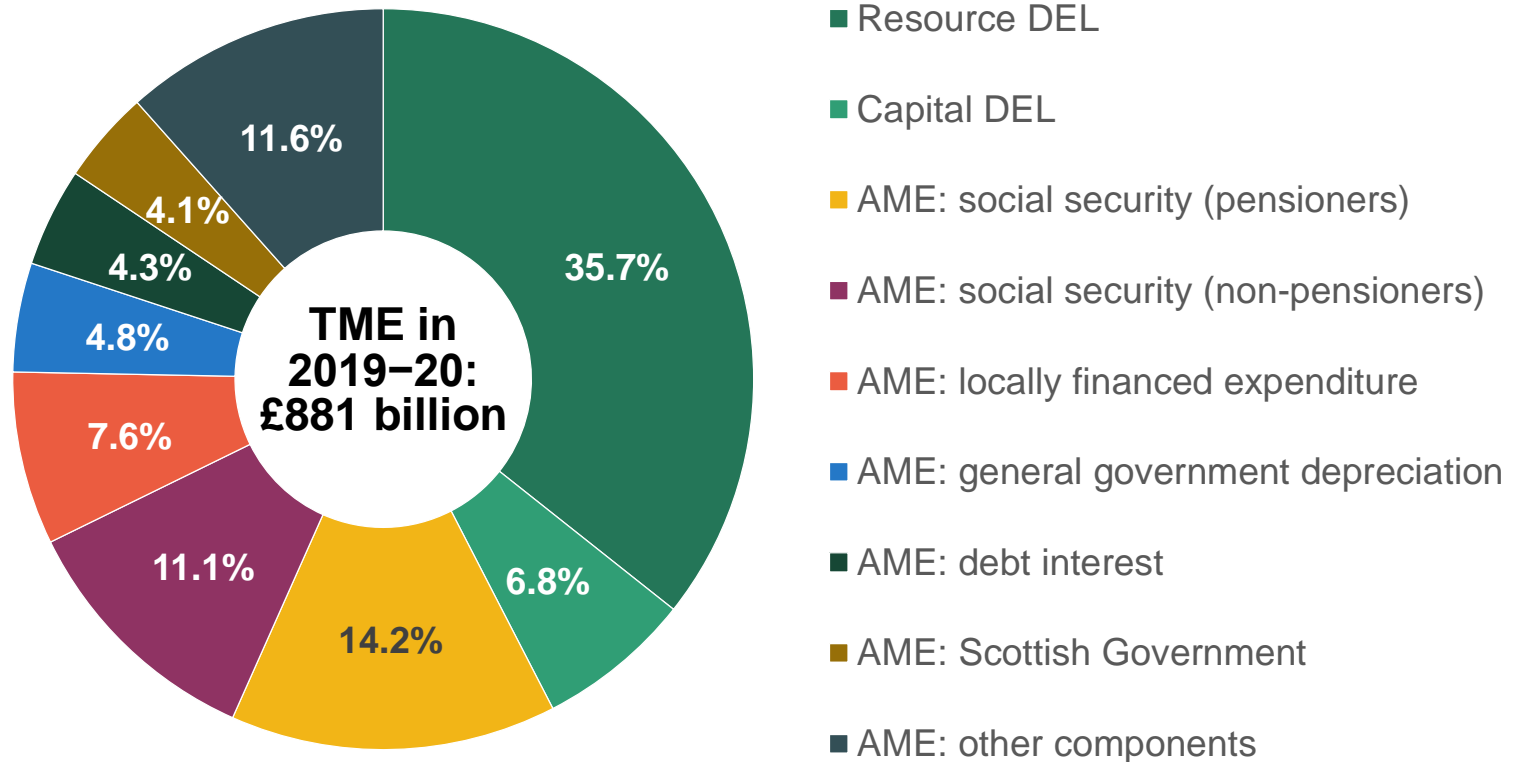
Total managed expenditure, 1955–56 to 2019–20



Notes and sources: see Figure 6.2 of IFS Green Budget 2020.

The SR is only expected to cover around 42% of spending

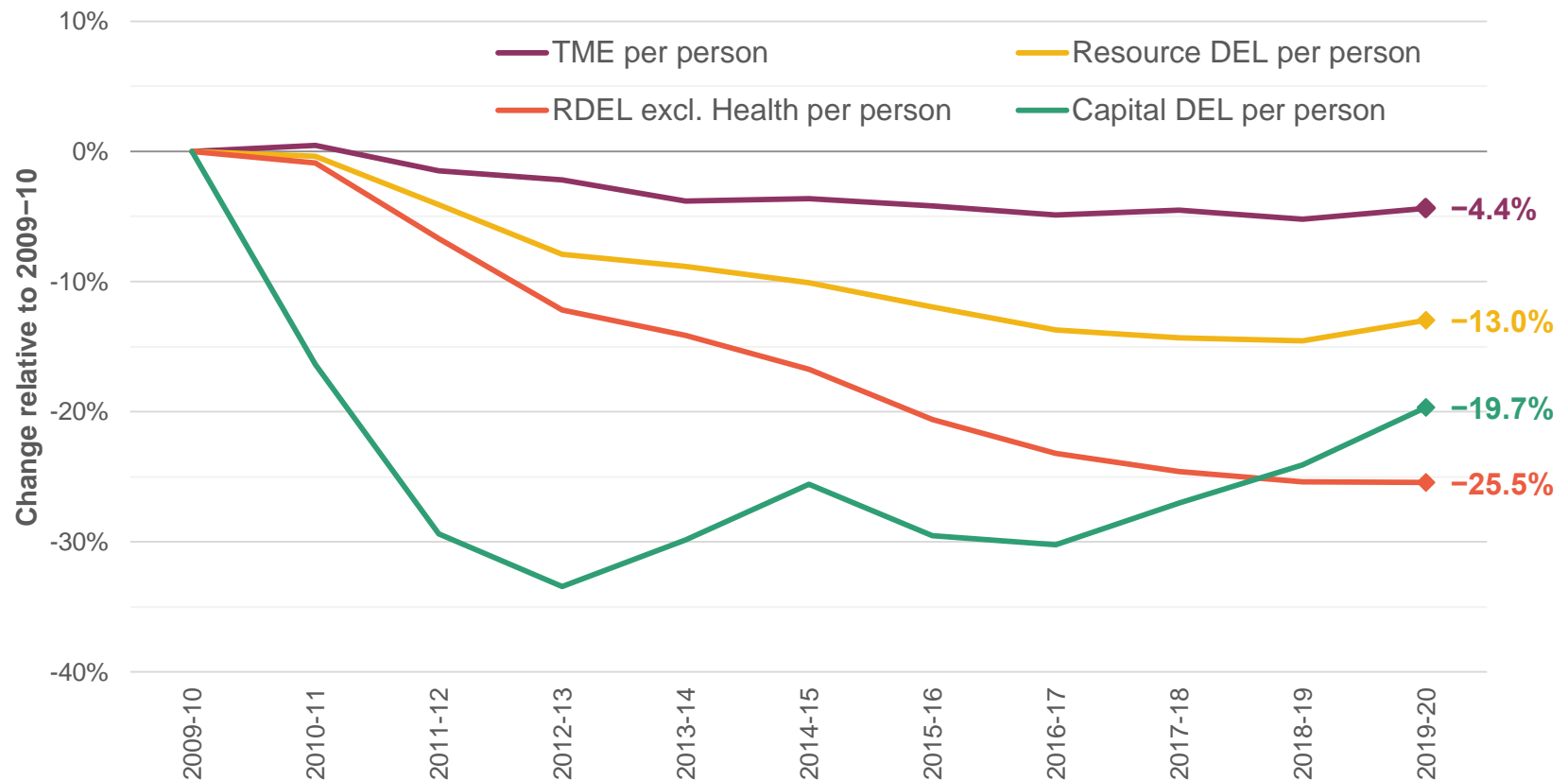
Components of Total Managed Expenditure (TME) in 2019–20



Notes and sources: see Figure 6.1 of IFS Green Budget 2020.

But that portion of spending has faced big cuts

Real-terms spending per person, 2009–10 to 2019–20



TME denotes Total Managed Expenditure; DEL denotes Departmental Expenditure Limits.

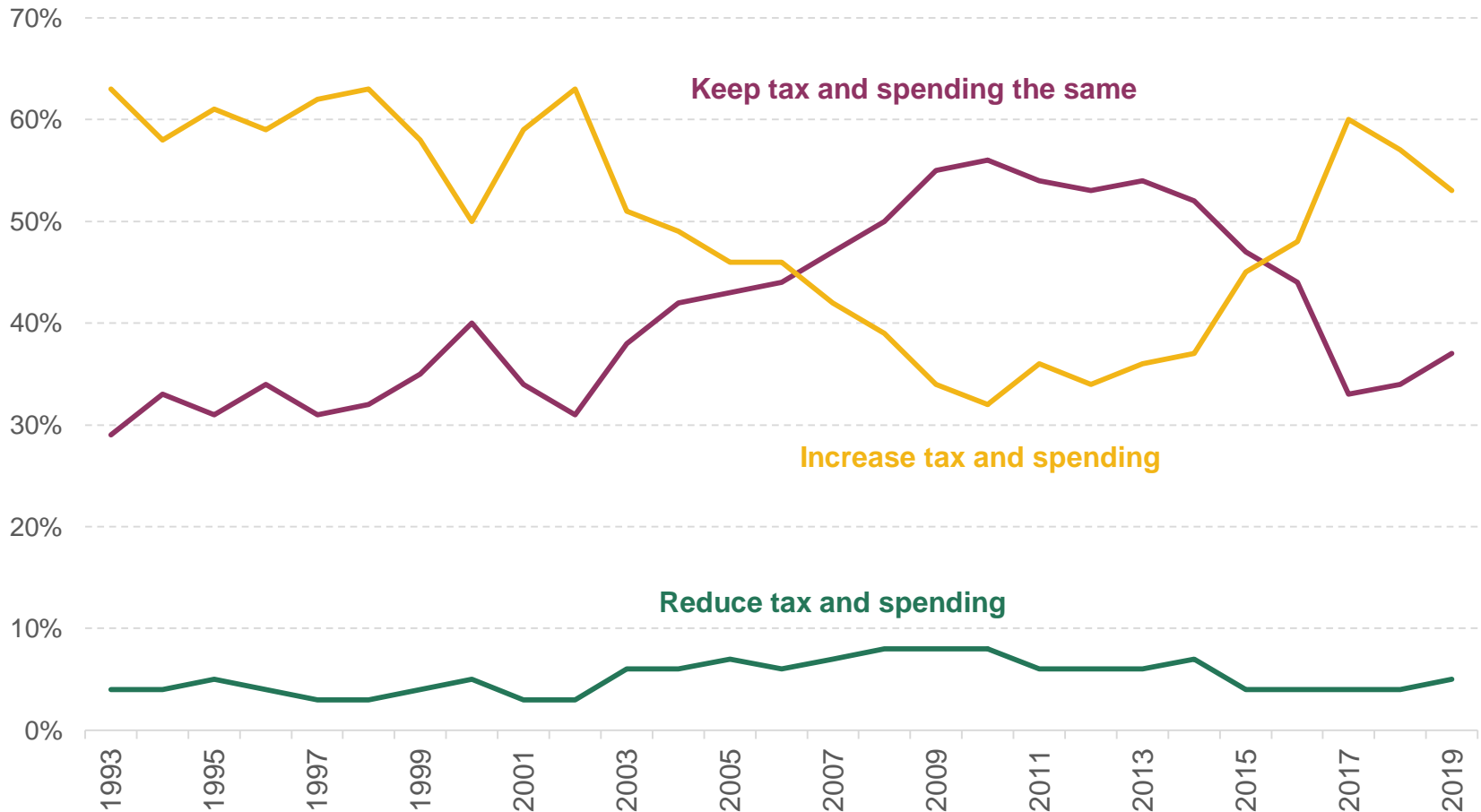
Notes and sources: see Table 6.1 of IFS Green Budget 2020.

This makes for a challenging backdrop



- Even prior to COVID-19, many public services were struggling
- Public sector pay is at its lowest relative to private pay in 25+ years
- Big cuts to generosity of working-age social security
- There were signs, prior to the pandemic, of increased willingness from the public to pay more in tax to finance higher spending

Changing attitudes towards levels of tax and spend



Notes and sources: see Figure 6.9 of IFS Green Budget 2020.



Four big challenges:

2) Brexit

Brexit is looming on the horizon

- Transition period ends 31 December; SR to be held before then

- Three broad issues:
 - Huge amount of uncertainty around the shape of future UK-EU relationship and its effect on economy and public finances

 - Need to replace (at least some) EU spending in the UK

 - Some departments will have new post-Brexit responsibilities
 - e.g. customs, immigration, agriculture



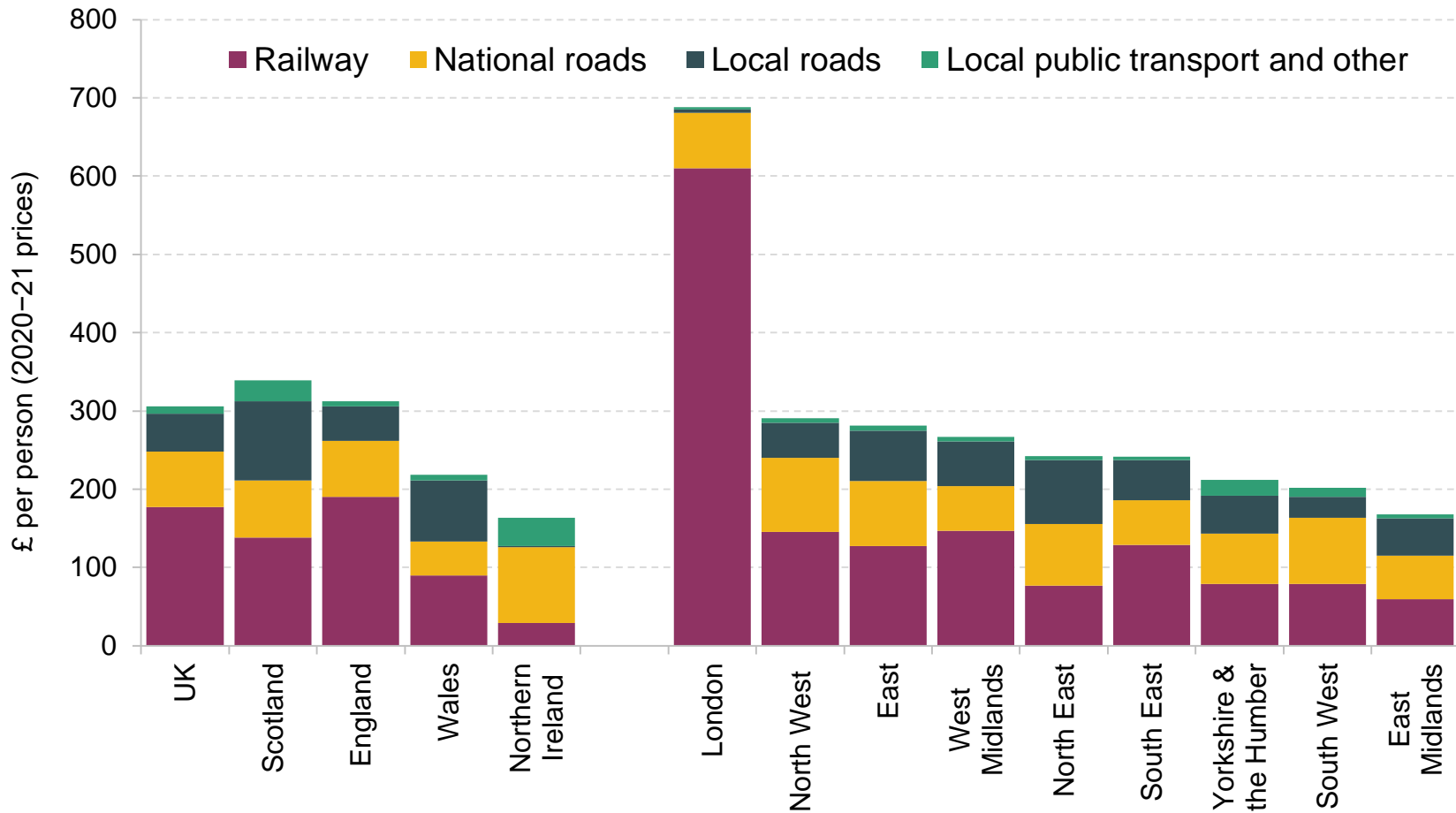
Four big challenges:

3) Levelling up

‘Levelling up’ could be expensive

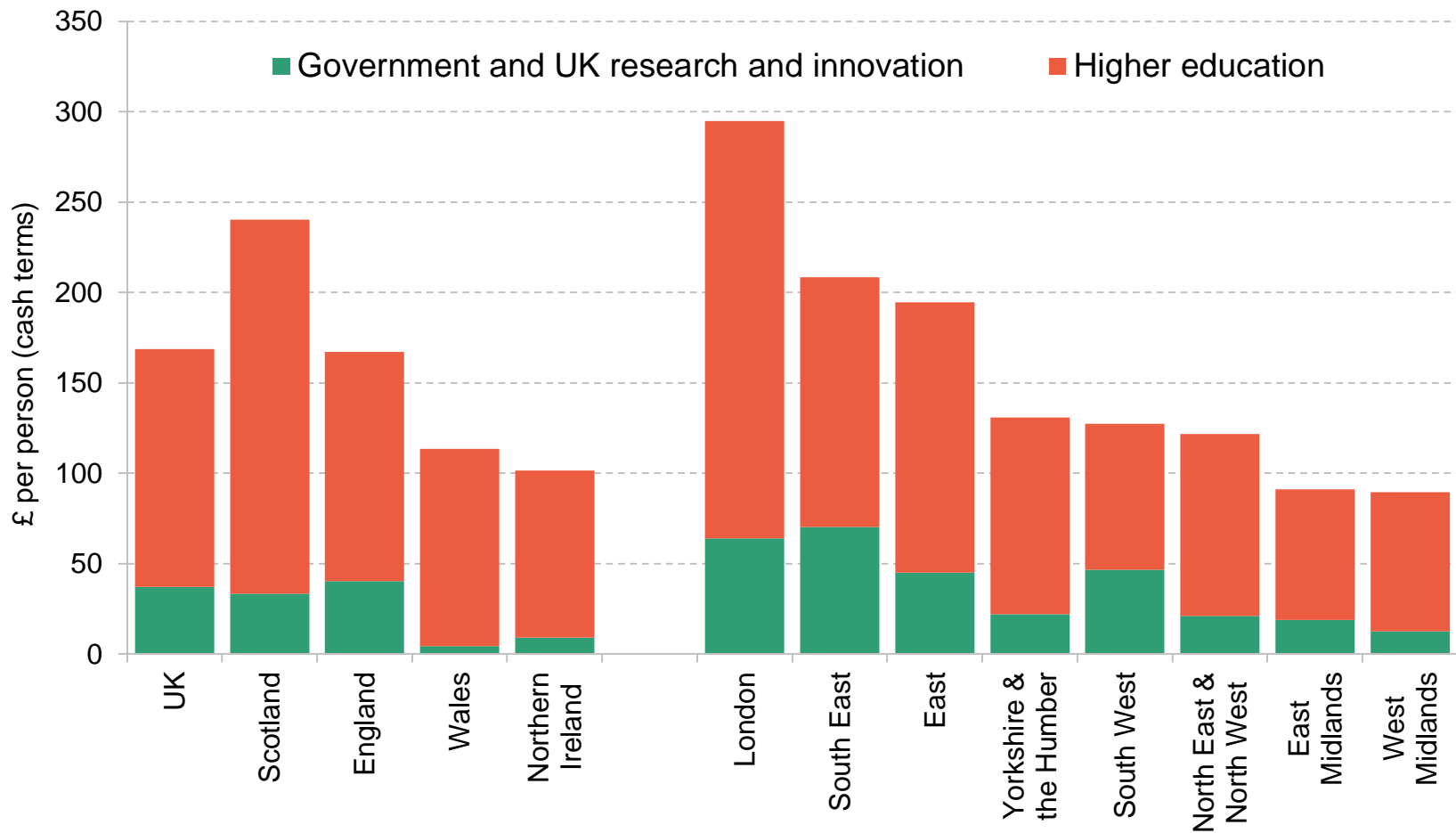
- Delivering a programme to address the UK’s entrenched regional inequalities – alongside COVID-19, Brexit, etc – will be tough
 - Needs to be long-term and encompass a myriad of policy areas
 - Lots of outstanding questions
- Spending Review is an opportunity to set out some details
 - Transport
 - Research and Development (R&D)
 - Relocating civil servants
 - Place-based spending programmes

Transport investment is currently higher in London than elsewhere



Figures denote annual average identifiable capital expenditure per person between 2014–15 and 2018–19. Full notes and sources: see Figure 7.7 of IFS Green Budget 2020.

Public sector R&D spending is highest in London, Scotland, the East and S. East



Figures are for 2018.

Notes and sources: see Figure 7.8 of IFS Green Budget 2020.



Four big challenges:

4) COVID-19

COVID-19 puts a spanner in the works

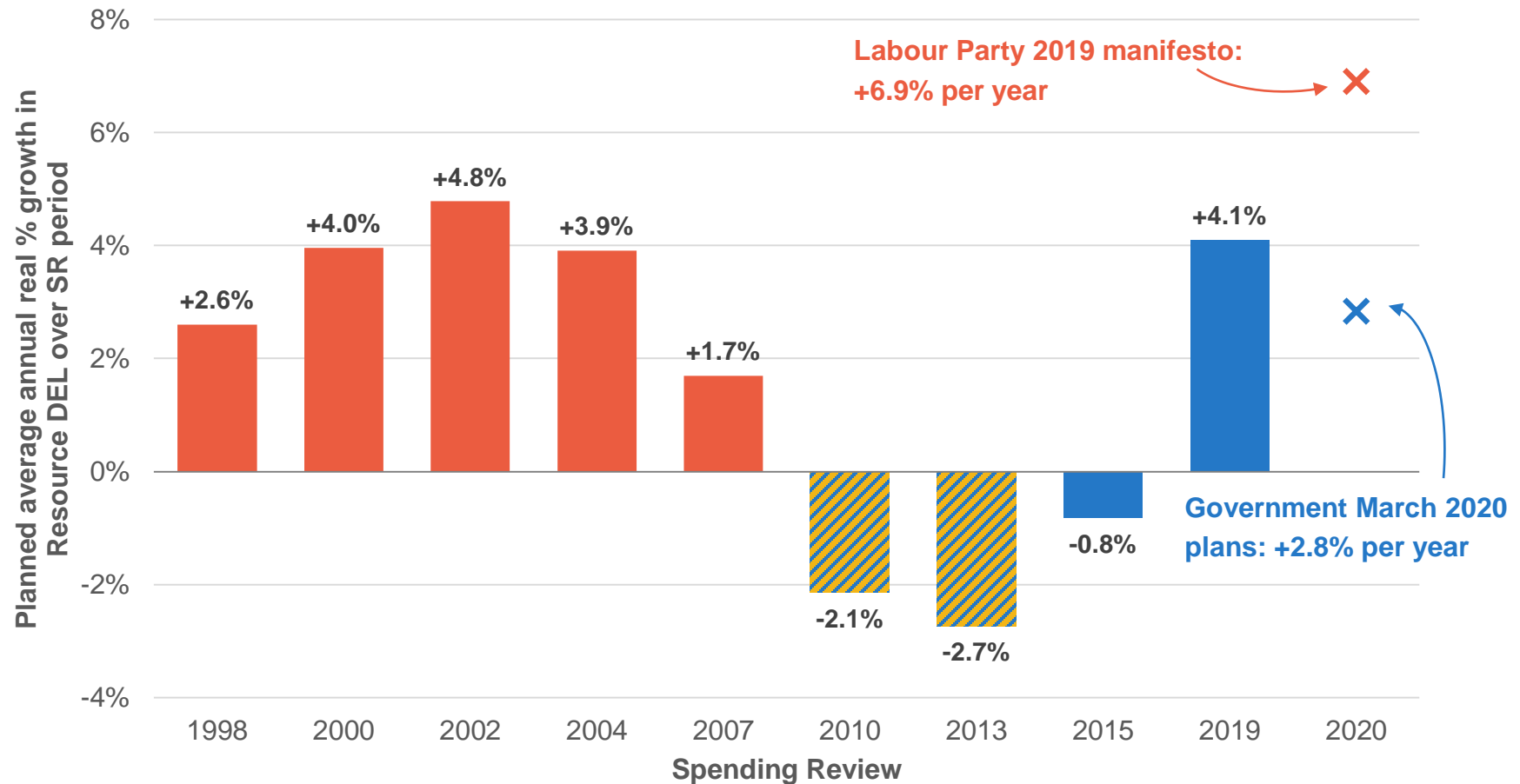


- Future state of the economy and future demands on public services profoundly uncertain
 - Not the time for a multi-year Spending Review!
- Departments have been allocated >£70 billion for day-to-day public services as part of the response to the virus
 - (On top of costs of furlough scheme, Universal Credit uplift, etc.)
 - Health budget alone topped up by £35 billion (25%) so far
- The crucial question: how much needs to continue beyond this year?



Options for the Chancellor

Starting point: March plans for day-to-day spending



Notes and sources: see Figure 6.13 of IFS Green Budget 2020.

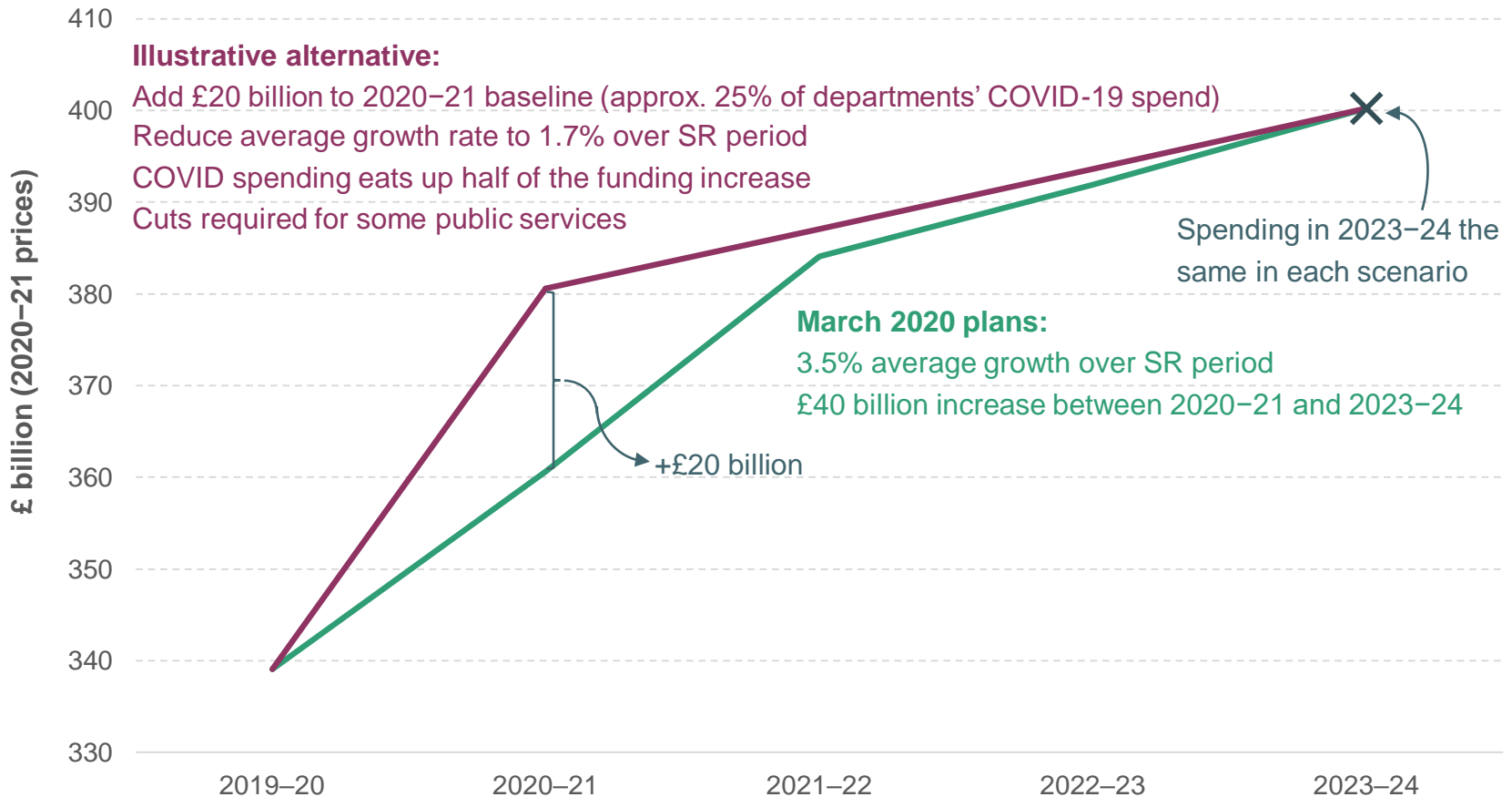
A lot has changed since March

- March plans were moderately generous
 - Enough to reverse two-thirds of the last decade's cuts to per-person public service spending by 2023–24

- But have since been rendered obsolete
 - Extra COVID-19 spending: how much needs to continue?
 - Change in economic outlook (inflation, growth, tax revenues)
 - Lower inflation forecast: March cash spending plans now imply 3.5% real-terms growth p.a. (up from 2.8% p.a.)

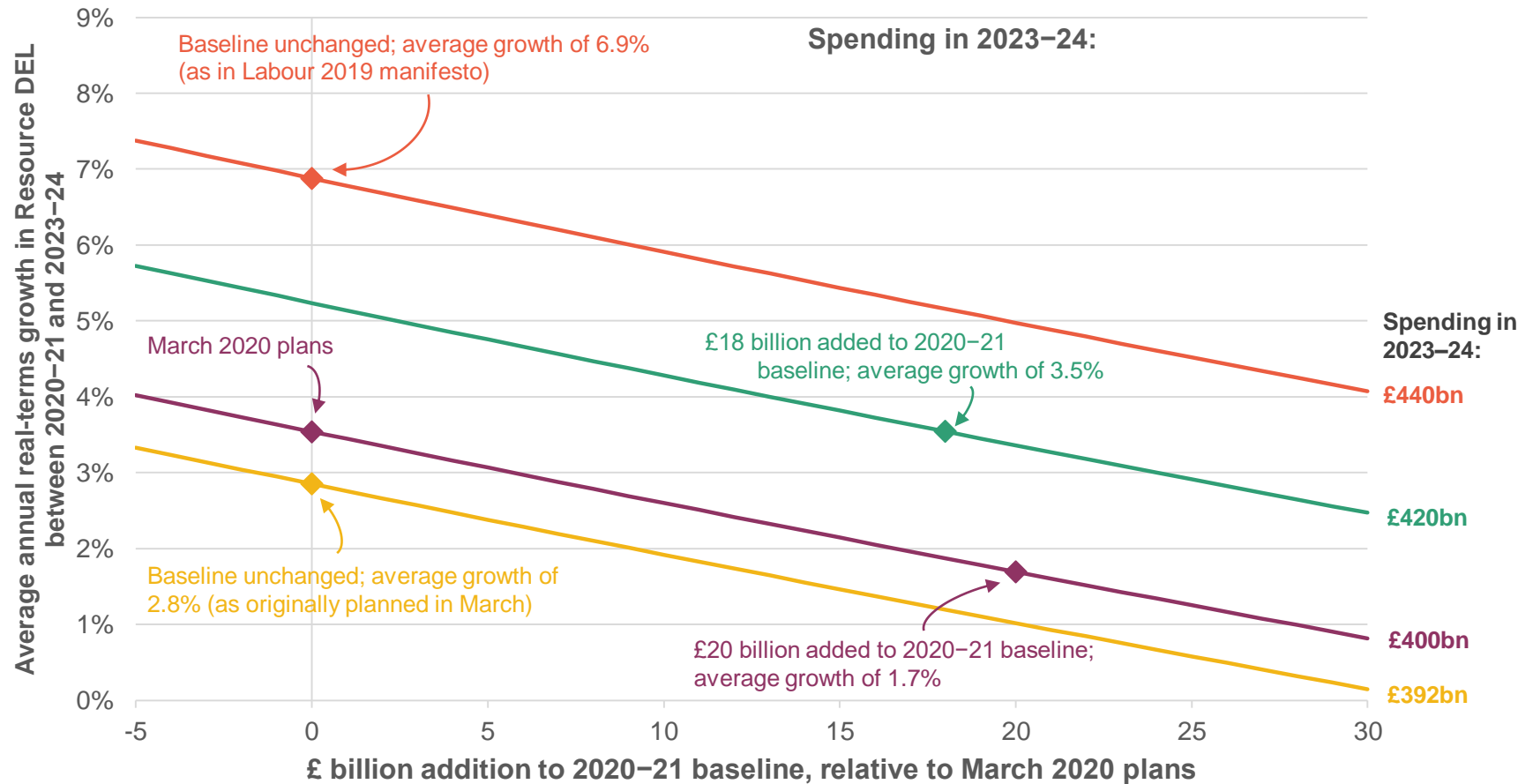
- The Chancellor has explicitly rowed back from these plans
 - Could be made more *or* less generous: pressures in both directions

Two key decisions: the baseline and growth rate



Notes and sources: see Figure 6.15 of IFS Green Budget 2020.

Options for the Chancellor



Note: Each line denotes a combination of growth rate and changes to the 2020-21 baseline consistent with a particular level of resource DEL in 2023-24. All £ billion figures expressed in 2020-21 prices (using July 2020 GDP deflator forecasts). Sources: see Figure 6.16 of IFS Green Budget 2020.

Other considerations

- Public sector pay awards
 - Public sector pay expected to outperform private this year
 - After that: a return to a public sector pay cap?

- Investment spending
 - COVID top-ups largely paid for through underspends elsewhere
 - Case for more investment to aid recovery



Final thoughts

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- The Chancellor could (and should) set day-to-day plans for 2021–22 only

- Mr Sunak has emphasised the need for “tough choices”
 - We may see a more generous settlement in the short-term, with (promises of) belt-tightening later on
 - NHS budget certain to increase: only question is by how much
 - Other commitments: schools, police, defence, ‘levelling up’
 - Would imply a very tight settlement for remaining public services

- Broader pressures on spending combined with a smaller economy: everything points towards a bigger state

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