Resolution Foundation

BRIEFING

Rounding up

Putting the 2019 Spending Round into context

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Summary

The Chancellor today rightly declared he was "turning the page" on austerity and "writing a new chapter in our public services". But he has also ripped up his own fiscal rulebook, almost certainly breaking the fiscal 'mandate' in the near-term and casting significant doubt on his ability to keep debt falling as a share of GDP over the coming years.

By setting out plans for a £13.8 billion or 4.1 per cent real-terms year-on-year increase in day-to-day departmental spending in 2020-21, he has certainly brought the austerity era for public services to a close. This is the biggest increase in a spending review since 2002, ensuring that no departmental budget in Whitehall will fall next year and most will experience significant real-terms increases.

Increases were focused on political priorities – including both those areas relatively protected since 2010, including schools and the health service and new priorities such as the police – but also less politically salient areas with acute need such as local government and prisons. Repeating a long standing pattern, social care received a sticking plaster cash injection and no long term solution.

While austerity for departmental spending has been brought to a close it has not been reversed. Today's announcements mean that next year one third of the current departmental spending cuts (real RDEL per capita) introduced since 2010 will have been reversed. The lasting impact of the last decade of spending restraint and now largesse are very different across departments. Health departmental spending next year is 14 per cent higher than its 2009-10 level, while spending across the Housing and Communities and Justice departments will respectively remain 52 and 31 per cent lower. RDEL excluding Health and Social Care is due to be down by 31 per cent in 2020-21 from its 2009-10 highs. Large cuts to working-age welfare will also continue to bite into the 2020s.

The decision to open the spending taps next year will be paid for by £13.4 billion higher borrowing. This is perfectly feasible given low borrowing costs and a deficit standing at its lowest level in 17 years. However, it is not likely to be consistent with the government's fiscal rules nor well timed given the uncertainty about the nature of the UK's imminent exit from the European Union.

The scale of extra spending in 2020-21 means the Treasury is almost certain to have broken its 'fiscal mandate' to keep borrowing below two per cent of GDP next year. On the basis of the last forecast from the Office for Budget Responsibility (OBR), published in March, the Chancellor's £13.4bn borrowing increase could have just fitted within his £14 billion of fiscal headroom. However, higher borrowing and slower growth since March, reinforced by very weak PMI surveys released just ahead of today's spending round, mean that this headroom is now likely to be far less than today's spending and borrowing increases.

Today looks set to be far from the end of the loosening of the purse strings. The Prime Minister has been personally associated with plans for up to £20 billion of tax cuts, while the Chancellor today made very clear his intention to make significant further increases in capital spending. These further demands on the public finances, combined with today's

spending rises and a weaker economy, mean the Chancellor is also likely to struggle to maintain the longer term fiscal rule of having debt continue to fall as a share of GDP – a rule which the Prime Minister recommitted to just a few days ago.

With the government clearly having a policy agenda that is likely to be inconsistent with the existing fiscal framework, it is perhaps not a surprise that the Chancellor today announced a review of that framework for later this year.

Today's Spending Round "turned the page" on public finances, ending a near-decade of public services austerity

Today's Spending Round was a slimmer document than might have been expected earlier in the year, with the Chancellor setting out new one year plans for day-to-day departmental budgets (resource departmental expenditure limits, or RDEL) rather than three-year totals for all departmental spending (including capital spending (CDEL) too). That means today's announcements cover just 2020-21, and relate to just 40 per cent of total government spending.

However, while the document may be thinner than it might have been, the contents still constitute turning point in our economic and political debates – with the Chancellor declaring that he was:

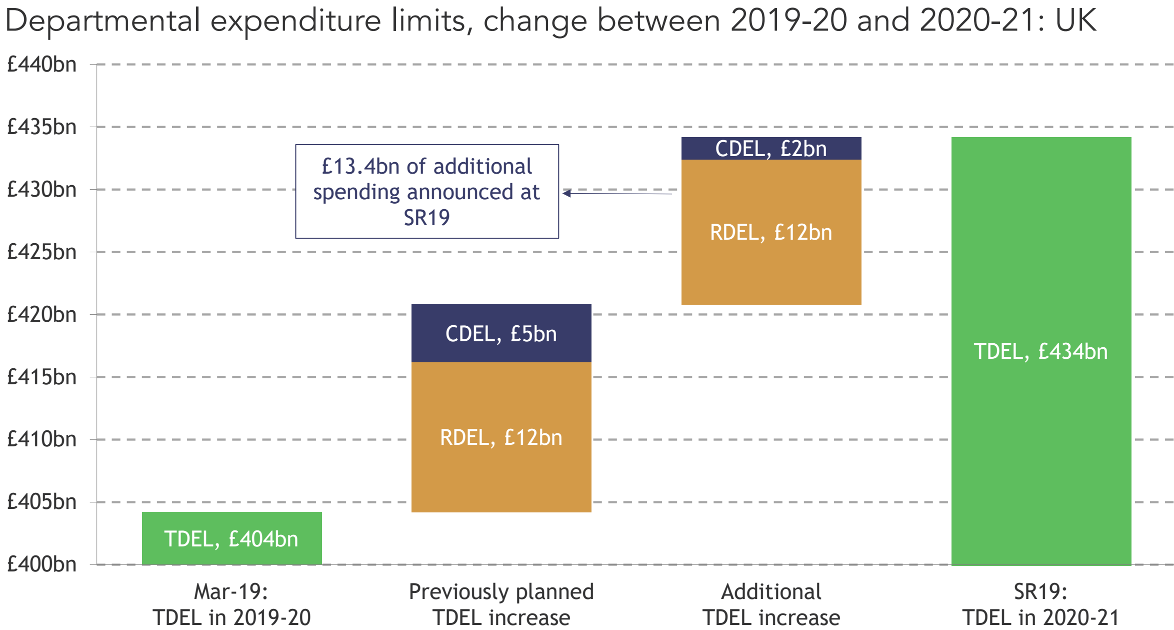
> *Turning the page on nearly a decade of necessary work to fix the public finances and writing a new chapter in our public services.*[1]

RDEL is now set to rise by £11.7 billion in 2020-21 relative to previous plans (£2 billion of this is carried forward from an addition of the same size to 2019-20 budgets). Adding in modest additional changes to CDEL (£1.7 billion), Figure 1 shows that total DEL spending is set to rise by £13.4 billion relative to previous plans. This was always set to be the point at which the government ended the era of public service spending cuts and embarked instead on expansion, but the scale of the change is worth noting.

[1] HM Treasury, "Spending Round 2019: Sajid Javid's speech", 4 September 2019

Figure 1: The Chancellor has almost doubled the size of the spending increase planned between 2019-20 and 2020-21

Departmental expenditure limits, change between 2019-20 and 2020-21: UK

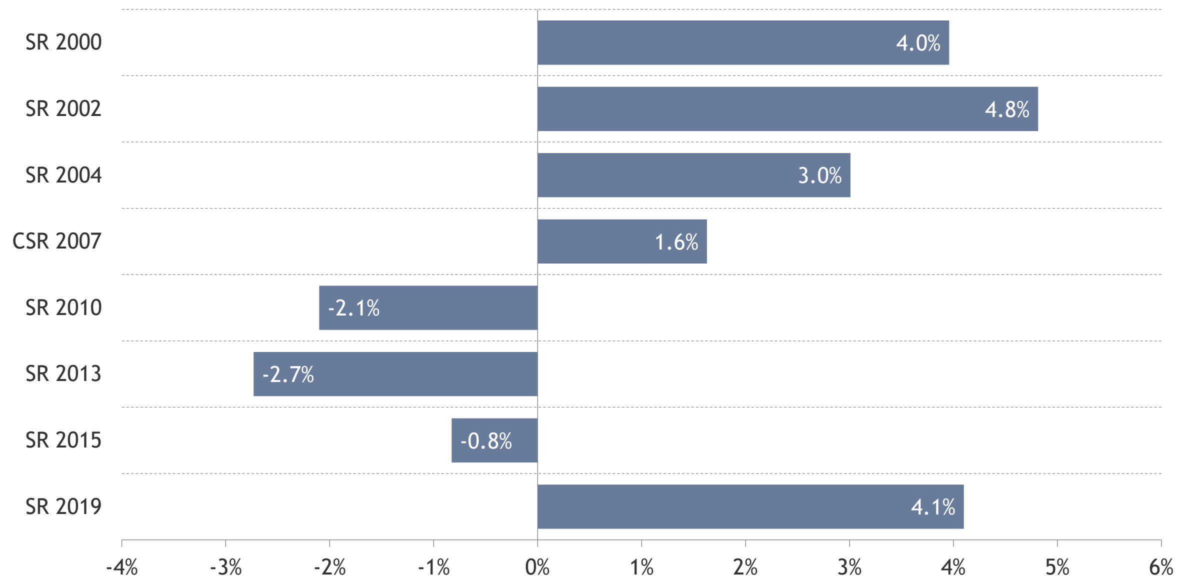


Source: RF analysis of HM Treasury, Spending Round 2019; Office for Budget Responsibility, Economic and Fiscal Outlook, March 2019

The £11.7 billion increase in 2020-21 RDEL, on top of previously planned increases, converts into a real-terms increase on 2019-20 of £13.8 billion, or 4.1 per cent. That, as Figure 2 shows, is the largest average annual increase in day-to-day departmental budgets announced at any spending review since 2002 – in fact it is actually very slightly larger than the real terms spending increase announced at Gordon Brown's first spending review not based on inherited Conservative spending plans, back in 2000. While the growth rates may be flattered by the fact that only one year of increases was being announced, the new figures also mark the first time RDEL has risen (by more than 0.1 percentage points) as a share of GDP since 2009-10, bringing an end to a near-decade of austerity for the public services.

Figure 2: This will be the largest increase in departmental budgets announced at any spending review since 2002

Average annual change in total departmental spending as detailed at each spending review



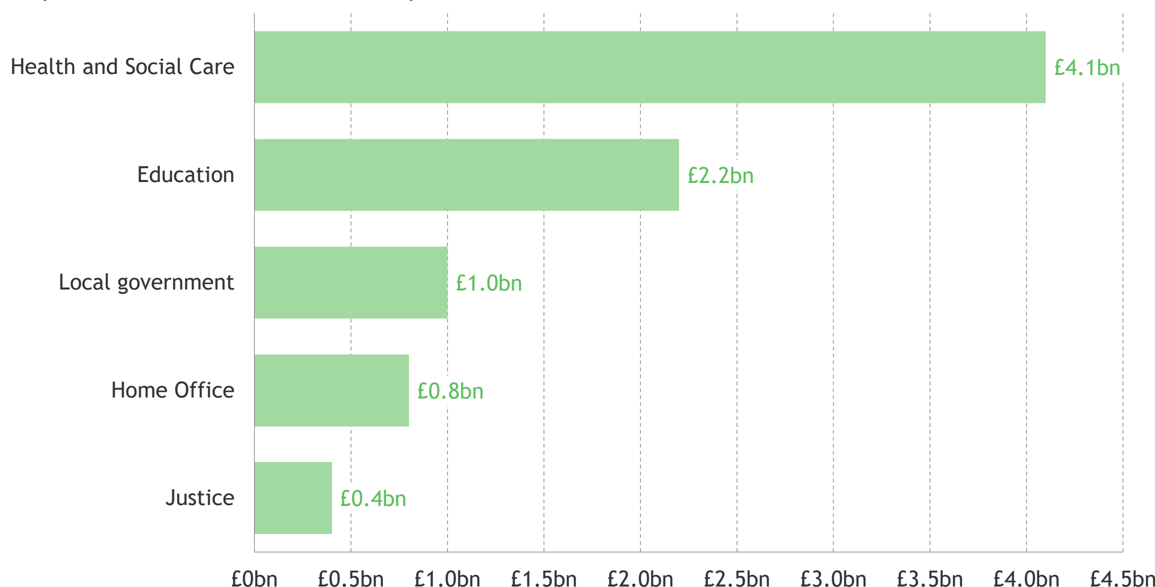
Source: RF analysis of HM Treasury, various spending review documents

Budget increases at least matched inflation in all departments, but the shadow of austerity still looms large over many public services

So what does the new money mean for individual departments? Figure 3 sets out some of the larger year-on-year real-terms cash increases confirmed today (though largely reflecting spending commitments already set ahead of today's Spending Round). It shows, for instance, that Health and Social Care RDEL is set to rise by £4 billion (in line with the NHS Five Year Plan previously outlined by Theresa May), while local government is due to get £1 billion more than in 2019-20 (incorporating an increase in the social care budget). The Department of Education RDEL will rise by £2.2 billion on 2019-20 (with additional spending on schools and further education), and the Home Office will receive an additional £0.8 billion (largely comprising funds for new police officers).

Figure 3: This spending round confirms the size of the governments 'pre-election' spending plans

Selected real changes (GDP deflator-adjusted) to resource departmental expenditure limits, 2020-21 prices: 2019-20 to 2020-21



Notes: adjusted for consistency e.g. taking account of changes in spending classifications
Source: RF analysis of HM Treasury, Spending Round 2019

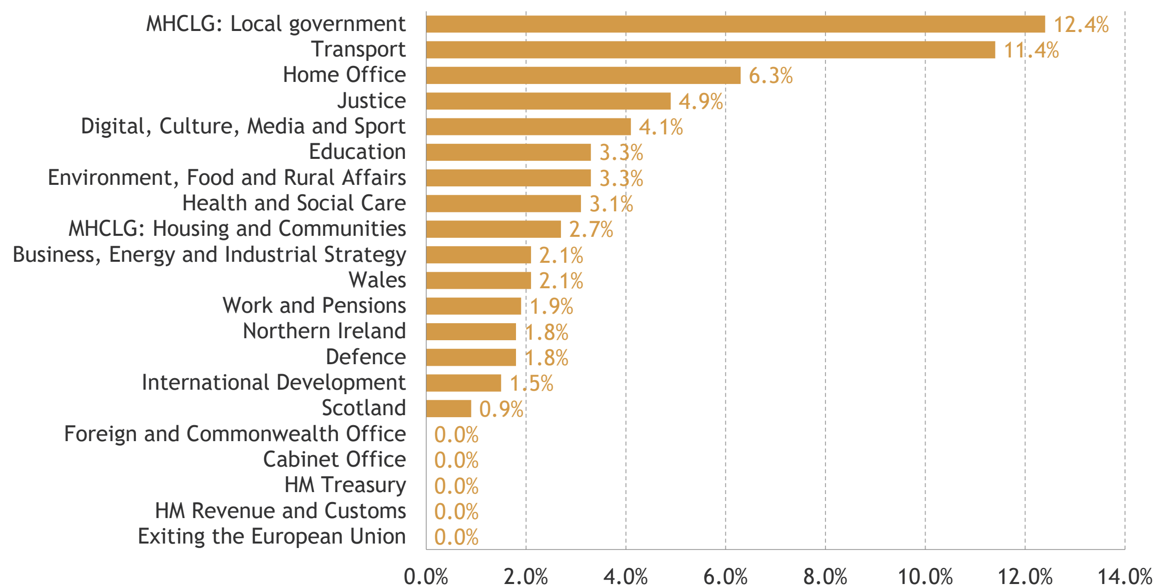
Capital spending plans were already in place (as part of the 2015 Spending Review) and have been only modestly altered today. That said, it is worth noting that some departments received notable increases in CDEL following on from recent changes in political priorities. For example capital spending in the Justice department is pencilled in to increase by 50 per cent between 2019-20 and 2020-21 following the government's commitment to increase the number of prison places.

Focusing on the day-to-day budgets associated with RDEL, Figure 4 shows the proportional year-on-year increases implied by today's announcement. Spending increases are set to at least match inflation in 2020-21 in all departments, the first time that has happened since Spending Review 2002 (though that does result in small reductions in real-terms per capita spending in some departments).

The ordering of the increases highlights shifts in the government's priorities from those of its immediate predecessors. The largest spending rises relative to 2019-20 are due to come in Local government, Transport, the Home Office and Justice. It's notable that some areas of public spending which have been feeling the strain, but have not been top political priorities, are receiving spending uplifts. Of course, Education and Health are still receiving some of the largest percentage increases (which translate into very large cash increases due to the size of these departments' budgets).

Figure 4: Day-to-day departmental spending is no longer falling in any department

Real changes (GDP deflator-adjusted) to resource departmental expenditure limits, 2020-21 prices: 2019-20 to 2020-21



Notes: adjusted for consistency e.g. taking account of changes in spending classifications
Source: RF analysis of HM Treasury, Spending Round 2019

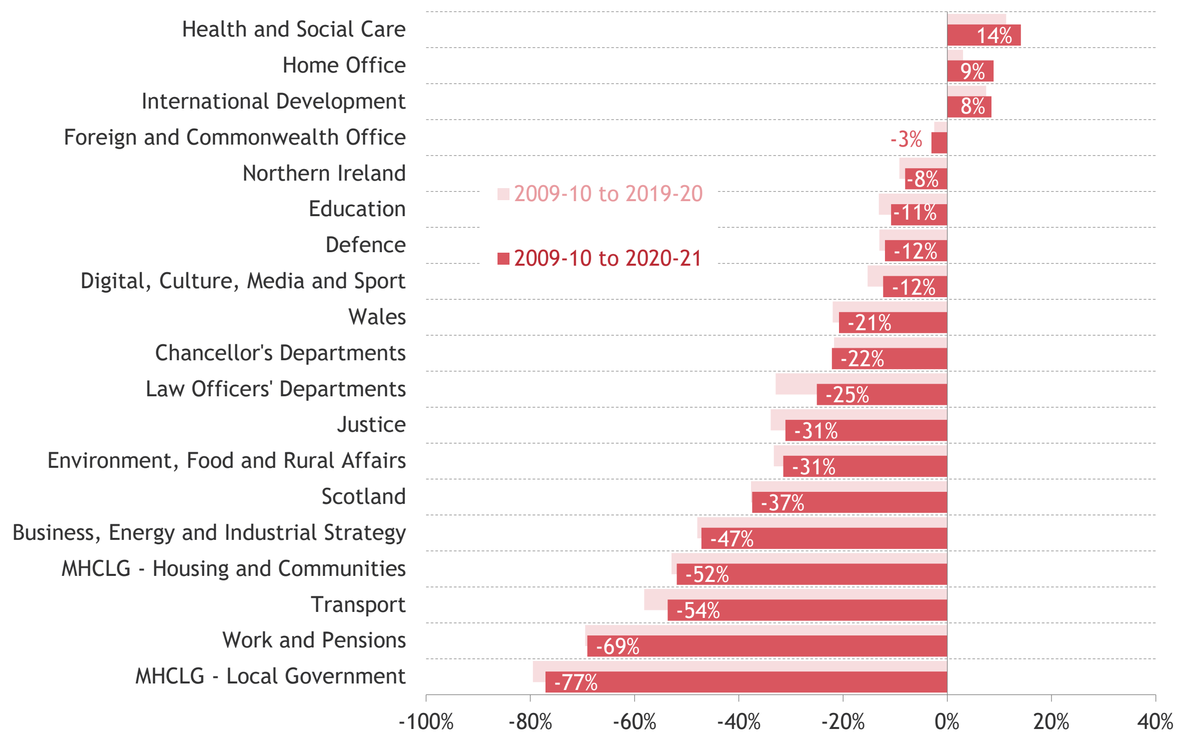
While substantial spending increases have been announced, the depth of the budget cuts faced in many departments (especially after we adjust for population growth over the longer term) is such that today's announcement will provide only partial relief, as Figure 5 shows.

As of this year, per capita RDEL has fallen since 2009-10 by by 69 per cent in Work and Pensions, and by 54 per cent in the Department for Transport. It has fallen by between a third and a half in several other departments. Those drops will be reduced in scale in 2020-21 following today's Spending Round, but next year's RDEL totals will still be down a long way on 2009-10 across large parts of Whitehall.

However, in large part because of the significant increases in the already sizeable NHS budget, the overall real cuts per capita in RDEL are towards the smaller end of those shown in Figure 5. Overall RDEL per capita fell by almost 15 per cent between 2009-10 and 2018-19, but this fall will have reduced by a third by 2020-21.

Figure 5: Austerity may have ended, but its impact on departmental budgets is far from reversed

Cumulative real change (GDP deflator-adjusted) in per-capita RDEL since 2009-10

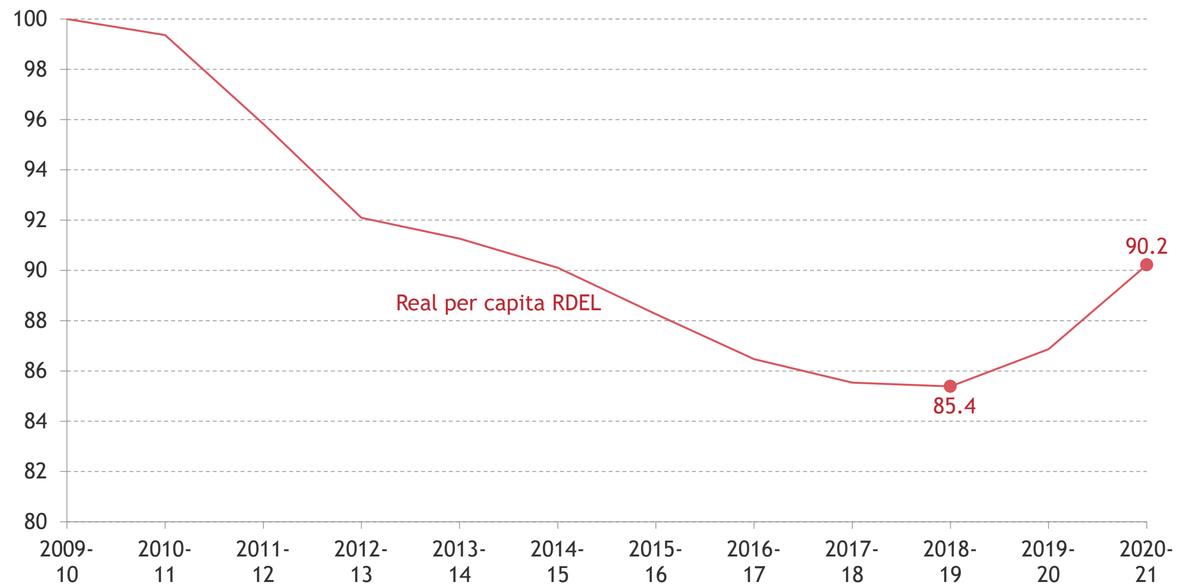


Notes: Cash change in RDEL as published at SR19 added to PESA19 totals for 2019-20 to reach estimates for long-run changes. Figures are adjusted as far as possible to account for machinery of government changes.
Source: RF analysis of HMT, PESA, various

As Figure 6 shows, today's announcement implies that one-third of austerity will have been unwound by spending increases in 2019-20 and 2020-21.

Figure 6: One-third of the cuts to departmental budgets have been reversed

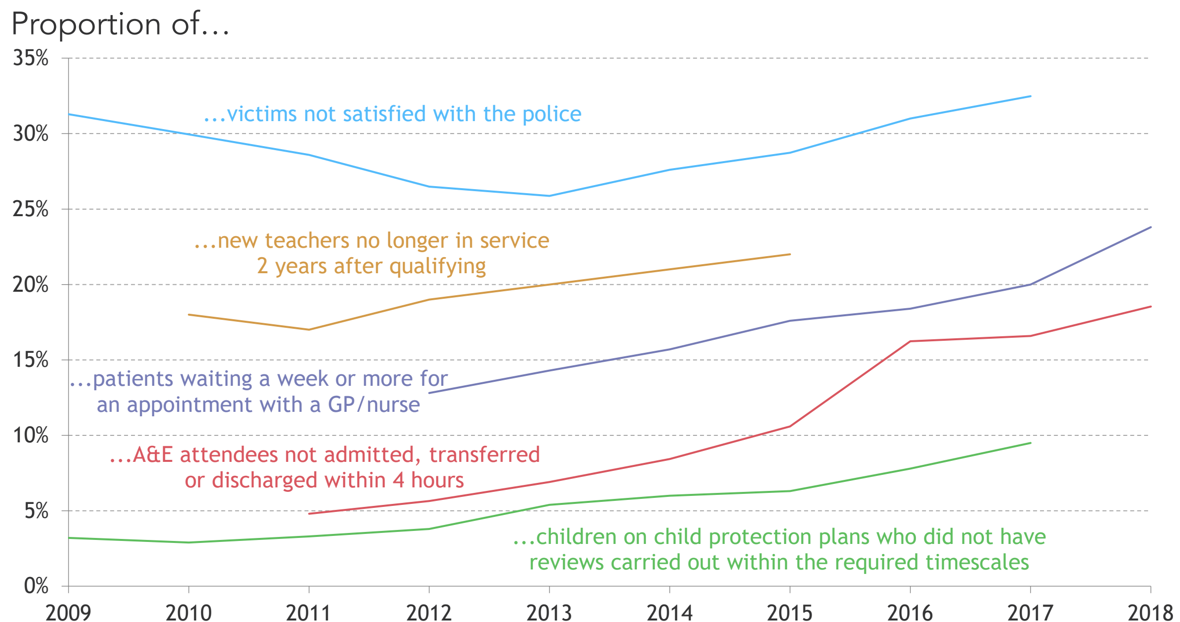
Real (GDP deflator-adjusted) per capita resource departmental expenditure limits (2009-10 = 100): 2009-10 to 2020-21



Notes: Totals published by HMT adjusted to be consistent with OBR time series for spending totals.
Source: RF analysis of HM Treasury, Spending Round 2019; Office for Budget Responsibility, Economic and Fiscal Outlook, March 2019

However, depth and persistence of spending cuts over the last decade have of course left many departments facing significant challenges. As Figure 7, based on Institute for Government collection of performance metrics, shows, many public services are suffering from a severe case of austerity fatigue. The proportion of crime victims declaring themselves dissatisfied with the police increased from 26 per cent in 2013-14 to 32 per cent in 2017-18. Likewise, the proportion of new teachers leaving the profession within two years of qualifying increased from 17 per cent in 2011 to 22 per cent in 2015. And, despite protection for health spending, the proportion of patients waiting a week or more for a GP or general practice nurse appointment increased from 13 per cent in 2012 to 24 per cent in 2018. Similarly, the proportion of accident and emergency attendees not admitted, transferred or discharged within four hours jumped from 5 per cent in 2011 to 19 per cent in 2018.

Figure 7: A range of public services are showing signs of strain



Notes: Police and child protection figures are for financial years. A&E figures are 12-month averages for type 1 attendances.
Source: Institute for Government, Performance Tracker

A near-decade of austerity has shifted what the state does, with especially marked cuts in non-health spending and welfare

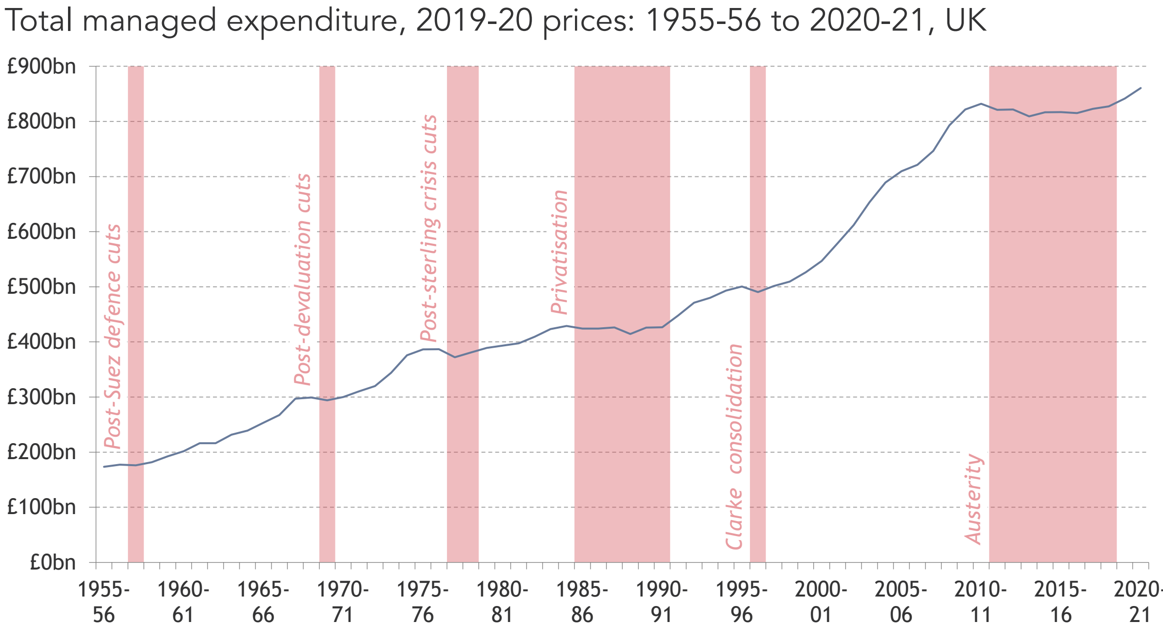
Focusing on overall government expenditure, as Figure 8 does, reveals that the pause in its real terms growth since 2010-11 is the longest on record. The future plans that were assumed to be in place at the 2019 Spring Statement implied a modest increase over the coming years. Given the prioritisation given to certain areas of spending, that more than likely meant that some form of austerity would have remained in place for many departments.

Sajid Javid's spending increase – while only relating to one year at this stage – presents a very different picture. The implied one-year growth rate of 2.4 per cent compares to an average over the past 10 years of just 0.2 per cent.

That increase is sizeable enough to mean that TME is likely to account for 38.4 per cent of GDP in 2020-21 (measured consistent with the OBR's historical time series). This is almost the same level it accounted for ahead of the financial crisis in 2007-08 (38.9 per cent). Yet, while the overall size of the state may be about to return to past levels, the shape of what the state does is much changed.

Figure 8: This spending round marks the end of a decade long squeeze on spending

Total managed expenditure, 2019-20 prices: 1955-56 to 2020-21, UK



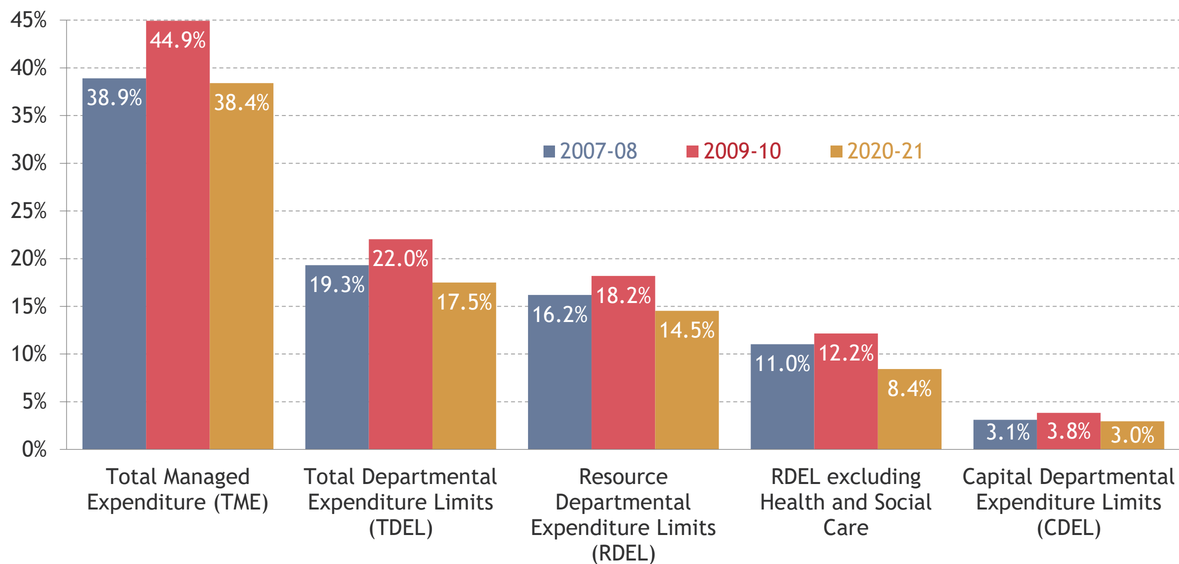
Source: HM Treasury, Spending Round 2019; OBR, Public Finances Databank

Figure 9 provides some details. The relatively modest 1 per cent drop in TME as a share of GDP converts into a 9 per cent fall in total DEL (from 19.3 per cent to 17.5 per cent), a 10 per cent drop in RDEL (from 16.2 per cent to 14.5 per cent) and a 24 per cent reduction in RDEL excluding Health and Social Care (from 11 per cent to 8.4 per cent). Measured against the 2009-10 baseline that marks the last year before the commencement of austerity, the longer run changes are even starker. TDEL drops by 15 per cent, RDEL falls by 21 per cent and RDEL excluding Health and Social Care is due to be down by 31 per cent.

Looking instead at capital spending, Figure 9 shows that CDEL is expected to account for 3 per cent of GDP in 2020-21, similar to the 2007-08 total of 3.1 per cent.

Figure 9: Total spending will be a similar share of the economy as before the financial crisis, non-NHS departmental spending will not

Selected spending totals as a share of GDP: 2009-10 to 2020-21: UK

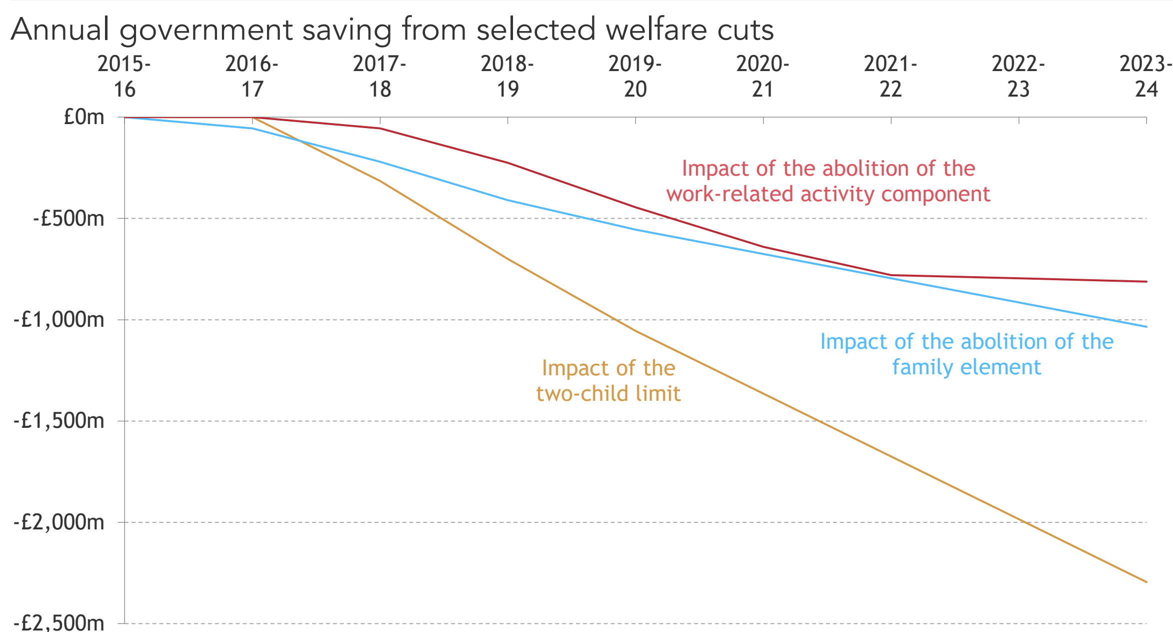


Notes: Totals published by HMT adjusted downwards to be consistent with OBR time series for spending totals.
Source: RF analysis of HM Treasury, Spending Round 2019; Office for Budget Responsibility, Economic and Fiscal Outlook, March 2019

Although today's announcement marks a turning point for many government departments, the age of 'austerity' is not over when it comes to social security. The age of newly-announced welfare cuts ended some time ago, and the benefit freeze has run its course, but nor has there been any hint of future real benefit increases. And, as Figure 10 shows, some very large cuts are still in the process of being rolled out.

Chief among these is the two-child limit for most benefits, which will take away up to £2,800 a year per child for many families. This, together with the abolition of the family element of tax credits and Universal Credit and of the work-related activity component, are essentially closed to new claimants but it will take many years for their effect to be fully felt. Together they are forecast to cost households around £4 billion in 2023-24, which would be a further cut of around £2 billion relative to 2019-20, and there would still be more to come beyond this forecast window.

Figure 10: In key respects, there are many more years of working-age welfare cuts to come



Source: OBR, *Policy measures database*, with RF adjustments and extrapolations

For those experiencing cuts in the support received from the state over coming years, today's claims of an 'end to austerity' are likely to ring a little hollow.

Alongside turning the page on austerity, the Chancellor has also ripped up his fiscal rule book

As we noted last week,[2] the annual deficit is at its lowest level in 17 years and the cost of government borrowing is at an all-time low. Given the 'austerity fatigue' discussed above, today's significant change in direction on spending has much to commend it. But it does also have very significant implications for the Chancellor's fiscal rules.

The Chancellor's fiscal mandate – inherited from Philip Hammond – requires him to ensure (structural) borrowing is below than 2 per cent of GDP in 2020-21. At the Spring Statement in March, the OBR declared that the Chancellor would have £27 billion of headroom against that rule: that is, projected spending totals and economic forecasts would mean that borrowing would come in £27 billion below the required target. That headroom was subsequently reduced to £14 billion by the Office for National Statistics' decision to count the cost of issuing student loans that are unlikely to be repaid within government borrowing. Having set out plans for a £13.4 billion increase in DEL in 2020-21 relative to the March 2019 plans, the Chancellor today stated that the Spending Round was (just) consistent with continuing to meet the fiscal mandate:

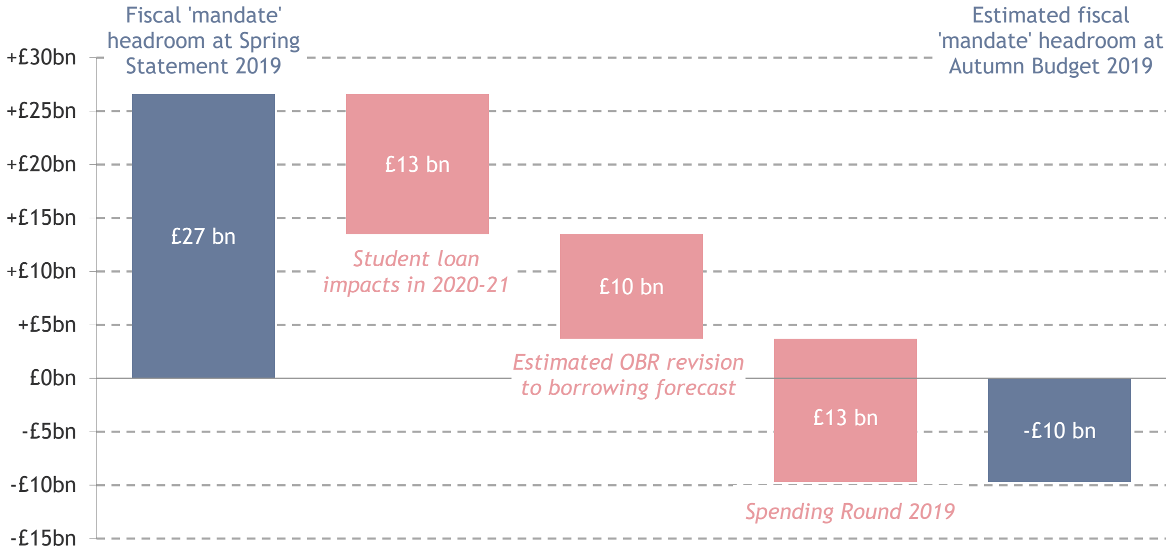
[2] D Tomlinson & T Bell, *Breaking the rules: Analysing the credibility of the Chancellor's commitment to keep his fiscal rules*, Resolution Foundation, August 2019

"So even with this extra spending we are still meeting our current fiscal rules next year".[3]

However, as Figure 11 shows, the Chancellor's headroom is in practice likely much reduced relative to the previous £14 billion projection. That stems in part from a deterioration in the in-year borrowing figures for 2019-20, primarily reflecting higher than expected spending. On the assumption that at least some of this deterioration is passed through to subsequent years in the OBR's updated projections at the Autumn Budget, the Chancellor's £14 billion headroom could be reduced by around £5 billion. And adding in the impact of weaker than expected economic performance in the period since the Spring Statement could take another £5 billion off the headroom presented by the OBR. Taken together then, the Chancellor's ostensible £27 billion borrowing headroom look like coming in closer to £4 billion.

Figure 11: The Chancellor has broken his fiscal rule

Estimated changes to fiscal mandate 'headroom' since March 2019, 2020-21 prices: 2020-21, UK



Notes: Headroom calculated as the difference between cyclically-adjusted net borrowing in 2020-21 and two per cent of GDP in 2020-21.
Source: Source: RF analysis of HM Treasury, Spending Round 2019; Office for Budget Responsibility, Economic and Fiscal Outlook, March 2019

All of which means that, while today's £13.4 billion spending increase might come within the fiscal mandate limit as it was calculated back in March, it is very unlikely to be consistent with the fiscal mandate had the OBR been asked to update its forecasts today. Our estimate is that the government could break it by £10 billion.

[3] HM Treasury, "Spending Round 2019: Sajid Javid's speech", 4 September 2019

That mandate is however due for update, with no deficit target currently in place beyond 2020-21. It is therefore likely that the Chancellor will shortly craft a new rule that is consistent with today's spending announcements. Indeed, he as good as acknowledged that he was jettisoning the existing mandate today, declaring that he would set out a new fiscal "framework" ahead of the Autumn Budget that would meet:

> *the economic priorities of today – not of a decade ago.*[4]

While the deficit rule may be due to change however, the Prime Minister has been very clear in the last few days about a determination to keep debt falling as a share of GDP over the medium term – in line with the Chancellor's existing supplementary debt rule. And the Chancellor also talked up the importance of debt today, stating that:

> *For the first time in a generation public sector debt is falling sustainably as a share of our national income.*[5]

In the near-term, today's announcement doesn't look likely to break this rule but, combining the promises set out in the Spending Round with the Chancellor's ambition on capital spending and the Prime Minister's vision for tax cuts does look like putting it under threat over the coming years.

A number of very significant tax cuts were mooted during the Conservative leadership campaign or have been more recently briefed. These include cuts to fuel duty, in contrast to the planned RPI-linked increases assumed by the OBR; cuts in income tax for high earners; and cuts in national insurance contributions (NICs) for lower earners. Speculative examples are outlined in Table 1. Although not all of these may come to pass, it is clear that these are expensive suggestions, with a combined price tag of around £20 billion. And they are not even the only tax cuts that have been suggested.

Table 1: 'Aggressive' tax cuts can be expected in any future election or Conservative budget

Mooted tax cuts	Cost in 2020-21 (£bn)
Raising the higher rate income tax threshold to £80,000	9
Raising the NICs threshold to £12,500	10
Cut fuel duty by 2p rather than increasing with RPI	1.5
Total	20.5

Notes: Higher rate threshold impact includes related changes in NICs, as well as the cost to the UK government of increasing Scotland's block grant. NICs costing is for an increase in employee and self-employed, but not employer, thresholds.
Source: RF analysis using the IPPR tax-benefit model. Fuel duty figure reported in the media.

[4] HM Treasury, "Spending Round 2019: Sajid Javid's speech", 4 September 2019
[5] HM Treasury, "Spending Round 2019: Sajid Javid's speech", 4 September 2019

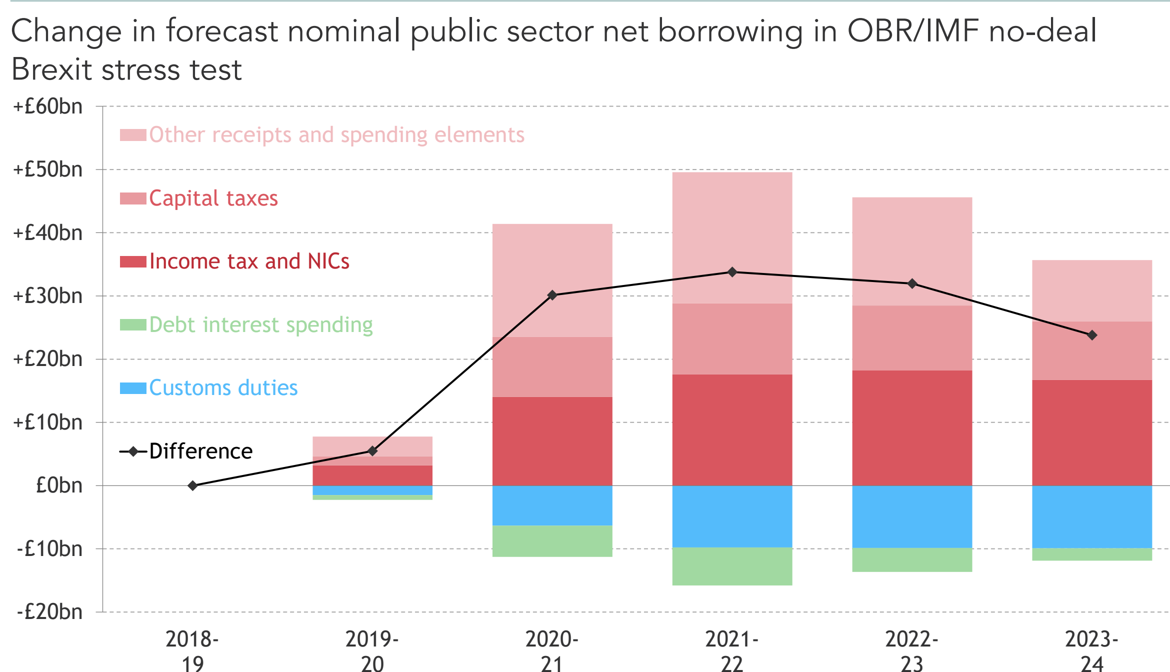
Pursuing today's current spending increases alongside tax cuts and further increase in capital spending is likely to put the promise to keep debt falling in future years under very severe pressure. For example, back at the Spring Statement, the OBR declared that the Chancellor had around £25 billion of leeway in 2023-24 against this rule – with any change in spending/revenue above this point resulting in debt rising as a share of projected GDP. Rolling forward the assumptions set out in Figure 11 and adding in the potential tax cuts set out in Table 1 would more than breach this headroom, particularly if we allow for further increases in capital spending in accordance with the Chancellor's statement today that:

> *The first priority of our new economic plan will be to rebuild our national infrastructure.*[6]

And the picture is also very dependent on what happens next on Brexit. As Figure 12 shows, the fiscal cost of a no-deal Brexit estimated by the OBR drawing on IMF forecasts could run to £34 billion or more, with very clear consequences for borrowing and for debt.

Figure 12: An OBR 'stress test' suggests the fiscal impacts of a no-deal Brexit could be very significant

Change in forecast nominal public sector net borrowing in OBR/IMF no-deal Brexit stress test



Notes: Based on the less-severe of two scenarios for a Q2 2019 no-deal Brexit made in the IMF, World Economic Outlook, April 2019
Source: OBR, *Fiscal risks report*, July 2019

Of course, in the event of no-deal the government would be right to look through the fiscal rules if they constrained the need to set policy to support the economy. And, after a near-decade of austerity, increasing the resources going to public services is all but inevitable. But anchoring spending with clearly defined fiscal rules matters too.

[6] HM Treasury, "Spending Round 2019: Sajid Javid's speech", 4 September 2019

With that in mind – and ahead of period in which the UK's credibility in the international community may take on new importance – it will be important than both the Autumn Budget and next year's full Spending Review are conducted against the backdrop of a revised and carefully thought-through set of new fiscal rules.

Conclusion

Today's spending round marked a big turning point in the UK's political and economic debates. It brought down a curtain on austerity for most government departments, but the impacts of the decade passed will remain with public services for some time to come.

The decision to increase spending follows shifts in public and political opinion towards favouring such rises. However the timing of its arrival, ahead of any certainty about the nature of the UK's exit from the European Union is certainly questionable.

The nature of political and economic instability facing the country is also relevant to the Chancellor's promise to review and put in place a new fiscal framework in future. It is certainly concerning that the UK's fiscal policy is currently almost entirely unanchored, at a time of many large competing calls upon it. This is the result of the fact that when the Chancellor binned austerity he in large part also binned the government's fiscal framework along with it.

Resolution Foundation

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- developing practical and effective policy proposals; and
- engaging with policy makers and stakeholders to influence decision-making and bring about change.

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