Centre for Policy Studies Briefing: Spending Review 2020

26th October 2020

Overview

The figures from the Treasury and the Office for Budget Responsibility (OBR) show that the fiscal and economic impact of the pandemic has been far greater than the Government anticipated.

Following the Centre for Policy Studies' warning in April that the deficit this year would top £300 billion – far higher than official estimates at the time – the OBR's latest forecast puts us on course to reach £394 billion.

Extra funding announced for tackling Covid-19 for the rest of the year, and into next, allocates a further £93 billion for public services and departments, including devolved administrations.

The largest spending area within this support package is £18 billion for community testing, NHS Test and Trace, PPE and the long-awaited good news about vaccines being nearly ready.

The remainder of the Spending Review reflects the considerable strain that Covid-19 measures have placed on the economy. There were some welcome moves on infrastructure investment and levelling up, as well as measures which the CPS has argued for to control spending on public sector pay and overseas aid.

Public finances

Public sector net borrowing is forecast to be £394 billion in 2020-21 – this compares to the £273 billion forecast by the OBR in their original reference scenario in April, and is more than seven times higher than the£ £55 billion forecast at the Budget in March.

The ongoing economic damage from the pandemic, coupled with higher spending, means the deficit is predicted to remain high. Overall borrowing is forecast to continue running at around £100 billion per year, roughly 4% of GDP, with an ongoing current budget deficit (i.e. excluding investment spending) of £27 billion a year. The Institute for Fiscal Studies expect this is likely to be closer to £40 billion.

When the Government's new fiscal strategy is set out at the Budget, the Treasury should target balanced current spending, and constant or falling debt as a proportion of GDP by the end of the review period – as set out in a CPS paper authored with former Chancellor Sajid Javid in June 2020.

Debt is forecast to rise from 85.5% of GDP last year to 105.2% this year. Despite this, lower interest rates and the impact of Bank of England interventions mean debt interest spending is actually slightly lower than forecast before the crisis. Around a quarter of the increase in debt is explained by Bank of England activity.

Total Managed Expenditure will amount to well over half the size of the economy this year (56.3% of GDP) and well over one trillion pounds. Spending remains at around 42% of GDP by the end of the forecast period in five years' time – higher than anticipated before the pandemic.

Infrastructure and levelling up

The Chancellor committed to £100 billion of capital spending next year to drive the UK's economic recovery. His emphasis on infrastructure spending on transport, digital and the technologies of the future was particularly welcome.

This echoes what the CPS called for in '[A Rising Tide]', a report in October 2019 which has in many ways served as a blueprint for the Government's levelling up agenda.

We are also pleased to see the introduction of a new Levelling Up Fund focused on infrastructure spending. We argued in 'A Rising Tide' that infrastructure investment was vital to stimulating growth and private sector activity in disadvantaged areas and that local voices should be central to decision-making: these are the principles upon which the new Levelling-Up Fund is based.

The decision to establish a National Infrastructure Bank and base it in the north of England reflects CPS recommendations in both 'A Rising Tide' and 'After the Virus'. The Infrastructure Bank will be set up with the stated requirement to catalyse private investment into infrastructure, as called for by the CPS.

The Government's commitment to refresh the Treasury's Green Book, updating the means by which potential investments are assessed to take into account impacts on left-behind regions, was a recommendation from the CPS and Sajid Javid in 'After the Virus'.

Skills and apprenticeships

The Government is testing changes to the Apprenticeship Levy system next year with more 'flexible working patterns', and allowing employers in certain sectors (construction, health and social care) to front-load training for certain apprenticeship standards, giving more freedom in how the apprenticeships are structured and funded.

The CPS has previously called for an overhaul to the Apprenticeship Levy and greater flexibility in how it is used, to ensure that levy funds are not going unspent. This was proposed in 'After the Virus' with Sajid Javid and in 'A Rising Tide'.

In 'A Rising Tide' the CPS highlighted that total spending on adult skills dropped by approximately 45% in real terms between 2009-10 and 2017-18. We were therefore pleased to see that there will be an additional £291 million ring-fenced for Further Education in 2021-22.

The National Infrastructure Strategy sets out plans to allocate funding for adult learners to access short training modules (4-16 weeks) for upskilling and reskilling via the National Skills Fund investment – in both 'Think Small' and 'A Rising Tide' the CPS made the case for a wider range of training and professional development to be made available throughout peoples' lifetimes.

Net zero

The policies in the Spending Review to help achieve the Government's Net Zero emissions target were focussed on funding investment in the clean technologies which the economy will need to decarbonise.

Various pots of cash were made available to clean up transport – such as £1.9 billion for electric vehicle charging infrastructure and consumer incentives – and energy – such as £125 million for nuclear technologies in 2021-22, and £1 billion for a Carbon Capture and Storage Infrastructure Fund.

The expanded investment in charging points was a recommendation by the CPS in 'After the Virus'.

Building on the Government's ambition to increase public and private R&D spending, £81 million was made available to launch a programme of investment in low- and zero-emission transport technologies – something which we recommended in our report 'Driving Change'.

Public sector pay

The Spending Review announced a pay freeze in the public sector, with protections for NHS workers and those earning below £24,000.

This follows the widely covered CPS paper published last week setting out the case for pay restraint in the public sector.

The Chancellor echoed the CPS's argument that public sector workers have benefited from relatively generous real-terms pay rises on average this year, while wages have been falling in the private sector. Pay restraint will help to redress this imbalance.

An exemption for those on lower pay is understandable from a political perspective, but it should be noted that it is at the lower end of the pay scale that public sector workers enjoy the biggest premium over their private sector counterparts.

National Living Wage

The increase in the National Living Wage (NLW) in April next year amounts to a 2.2% rise. This is much lower than had been planned based on the Government's stated intention for it to reach two thirds of median earnings by 2024, which would have implied a 5.6% rise.

In a recent paper the CPS called for a change in minimum wage policy in light of the impact the pandemic has had on the ability of employers to meet wage costs. The decision to limit the increase is welcome.

However, since the longer-term plans for the NLW have been maintained, this would imply very significant real-terms increases will be needed in future years to meet the 2024 target.

Overseas Aid

The Chancellor announced a reduction in the Government's spending on overseas development aid, reducing the commitment from 0.7% of GDP to 0.5%.

This makes sense in the current circumstances and was one of the recommendations made by the CPS in a recent paper on potential measures to rein in public spending.

Role of the private sector

The Chancellor recognised in his speech that government decisions on spending and taxes to not achieve anything on their own. It is only through enabling and driving private sector investment and job creation that we will see a sustainable economic recovery.

There were some welcome moves in the right direction. The temporary £1 million Annual Investment Allowance, which was due to expire at the end of the year, has been extended to the end of 2021. This will make it more advantageous for companies to make productive investments. We urge the government to go further and implement full expensing to make our tax system even more competitive.

This was a one-year spending review, and it is understandable that the Chancellor has chosen to postpone his full Budget until the Spring, when the economy is reopening and there is greater certainty about vaccines. That Budget must be bold in its efforts to unleash a private sector-led recovery, with moves such as cutting employer's National Insurance to reduce the cost of hiring new workers, as called for by the CPS.