The Spending Will Continue

The 2020 Spending Review

In normal times, yesterday's spending review would have been the moment for a first-year government to give effect to its manifesto, funding Whitehall departments to deliver on promises made to the electorate. On the face of it, that is exactly what yesterday's announcements from the Chancellor did. But these are not normal times and this was not a normal spending review. Thanks to Covid-19, public sector borrowing stands at a level simply never seen in peacetime before. The reality is, for as long as the crisis persists, the Chancellor has little choice but to keep the money flowing. These announcements signal this will continue for some time. But, though we're not being asked to pay the bill just yet, we now know roughly how big it will be, and that – at some point – payment will involve pain.

£394bn

Size of the UK deficit, 2020

By any measure, Chancellor Rishi Sunak has had a good crisis. Plucked from the relative obscurity of junior office in February, he was pivoted head first into the greatest national emergency since the Second World War. As Covid-19 wreaked havoc through the health service and then the economy, Sunak launched intervention after intervention that were exceptional in scope and unprecedented in scale. As a result, while the stock of many of his cabinet colleagues (not least the Prime Minister) has suffered, Sunak's star has only risen on a wave of generosity - but as you sow, so shall you reap.

While the debt piles up…

For an ambitious young Chancellor, the report from the Office of Budget Responsibility (OBR) makes for sobering reading. For the first time, it contains hard facts and painful truths about the colossal scale of public borrowing, which since March has rocketed to the biggest percentage as a proportion of national income in a generation. Adding to the Chancellor's woes, all vestiges of economic growth have evaporated and 2020 holds the dubious distinction of seeing the biggest economic contraction in over 300 years.

The mounting scale of the deficit was at the heart of Sunak's decision in September to postpone the autumn Budget until spring 2021. After all, it is at budgets, not spending reviews, when decisions are taken about revenue and taxation. Though he stood by his view that "now is not the time for long-term plans", the OBR report points unbendingly towards the inevitable. Unpalatable choices lie ahead for the Chancellor, ones that will make voters right across the country feel poorer. We know this is coming: as the text of the review makes clear, "once the current level of uncertainty recedes" the Government will set out details of what it euphemistically calls the "medium term fiscal strategy". Implicitly, we're not talking about the near term here; but change is coming down the line.

…the spending continues

Yet spending reviews are, of course, all about spending - and there was plenty more of that on offer, even if the same uncertainty meant this was a 1-year rather than 3-year settlement: £4.6bn to support the unemployed back into work, £3bn extra for the NHS in England to address the backlog of operations due to Covid-19, a £16.5bn boost for the

armed forces and a £4bn Levelling Up Fund are just some of the new commitments. If this was indeed a last hurrah before fiscal reality bites, the Chancellor has certainly extended his credit card limit one last time.

Spending figures back this up. Core Government spending rises every year over the forecast period. On top of that, Covid-related spending stands at £280bn this year and a further £55bn next year. And though there has been little pushback against this largesse so far, for a Government that already has one eye on the 2024 General Election, the fear is they will be forced to repent at leisure decisions taken in haste. Economic credibility is central to Tory identity and the scale of the crisis means it will frame the economic narrative for the whole of the decade ahead. At the same time, it is well aware of the bad press it has had in the last year over issues such as free school meals during the holidays, and the impact of this on the lower-income voters it courts. So the Government is caught between the devil of heartlenessness and the deep blue sea of fiscal incontinence – a narrow path at the best of times.

The fiscal picture: the sobering-up agenda

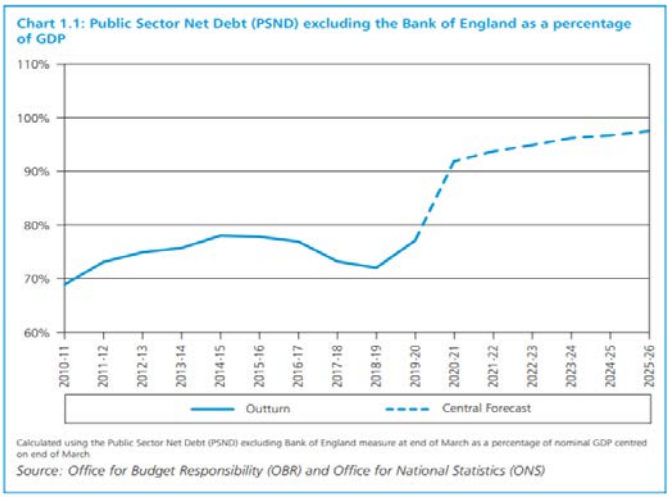
There was a sharp intake of breath in the House as the Chancellor announced that the OBR expect GDP to shrink by 11.3 per cent in 2020. Though this is a striking number, what is more important is the projection that the recovery will be spread out over two years rather than one: 5.5% in 2021, 6.6% in 2022. So although we may still be looking at a V-shaped recovery, the V is very much in italics.

Equally importantly, unemployment is projected to increase sharply, to a peak of 7.5% - or 2.6m people – in Q2 2021. Though this is arguably temporary, with the OBR forecasting a return to 4.4% unemplyment by the end of 2024, the short-term impact for many people will be serious. It is also worth noting that in the OBR's downside scenario, unemployment rises as high as 11%. Debt, meanwhile, will continue to rise, hitting as much as 95.7% in 2025-26 in the central scenario and 115.7% in a downside scenario. The only silver lining is the remarkably low cost of borrowing, driven by historically low interest rates.

The domestic picture: growth but with trade-offs

Against this difficult backdrop the Chancellor's approach has been largely Keynesian, with Departmental spending increasing by 3.8% in real terms, including to Scotland, Wales and Northern Ireland.

Jobs are the priority. To that end, the Treasury announced a £2.9bn Restart scheme, designed to help more than a million people find work, £1.4bn to increase the capacty of Jobcentre Plus, and £2bn funding for the Kickstart scheme specifically designed for younger people at risk of long-



term unemployment: the presence of the Work and Pensions Secretary next to him was carefully scripted. On top of this, an extra £400 million has been allocated to help recruit 20,000 additional police officers by 2023.

Meanwhile, the NHS gets a £6.3bn cash increase in spending in 2021-22 compared to 2020-21, as well as funding for new diagnostic equipment, training for the NHS workforce, infrastructure, and mental health. This is in addition to £3bn of investment to support NHS recovery. Education receives a £2.2bn uplift for the core schools' budget in 2021-22 compared to 2020-21, plus – funding for further education, lifelong learning, and, notably, a programme to provide activities and a healthy meal for disadvantaged children in the Easter, Summer and Christmas holidays in 2021. (Not all of the above is new money.) Finally, in line with the Low Pay Commission's recommendation, the Government will increase the national living wage by 2.2 per cent to £8.91 an hour and extend it to 23 and 24 year olds for the first time.

But it was not all good news, and in this section we saw the first of the Chancellor's lines in the sand drawn. Noting the disparity between public sector and private sector wages, the Chancellor announced the much -expected public sector pay freeze, with exemptions for NHS workers and those under £24k a year. Though without doubt opening up a line of attack for Labour, it is difficult to see how this

will get much pushback from the Conservative back benches – although it puts Parliamentarians themselves in a difficult place should IPSA plan to go ahead with the planned pay rise for MPs.

Levelling up: full steam ahead

For several months there has been media speculation that events – whether the departure of Dominic Cummings or the spending implications of Covid-19 – would get the better of the levelling up agenda. Yesterday's statement made clear this would absolutely not be the case, and that infrastructure remains key to it.

As the traditional end-of-speech "rabbit out of the hat" moment, the Chancellor wooed his backbenchers with the announcement of a £4bn Levelling Up Fund managed jointly by HM Treasury, the Ministry of Housing, Communities and Local Government, and the Department for Transport. Any local area will be able to make bids directly to this fund for local projects – provided they command local support (including from their MP), have "real impact", and are deliverable in this Parliament.

This is an eye-catching announcement but could go wrong in a number of ways. First, not that many significant projects are actually deliverable in such a short space of time. Second, the requirements for local MP support poses interesting questions about the interaction between, say, Labour councils and Conservative MPs in Northern seats, of which there are many. Third, there is a whiff of the pork barrel about the requirement for projects to be deliverable by the next election: expect MPs sitting on the Public Accounts Committee to be sharpening their pens.

> *"I cannot justify a significant, across the board pay increase for all public sector workers... Instead we are targeting our resources at those who need it most."*

By comparison, other announcements on infrastructure were crowdpleasers. The Chancellor revealed a "once in a generation" spending plan for infrastructure with Capital Spending next year to total £100 billion – the highest level of sustained public investment in 40 years, including a £7.1 billion national home building fund; delivering faster broadband and 4G; investing in new roads; and making the UK a scientific super power with £15 billion for R&D spending. The Chancellor also announced the release of the Government's new National Infrastructure Strategy, with a key strand being the delivery of the 10 point plan to tackle climate change. Finally, a new UK Infrastructure Bank, headquartered somewhere in the North of England, will work with the private sector to finance major new investment projects across the UK from Spring 2021. These projects will, of course, be well placed to create jobs and generate opportunities across the UK.

Foreign policy: you win some, you lose some

When it comes to the UK's place in the world, it was striking thatthe Chancellor did not mention that the end of the Brexit transition period is little more than a month away. While negotiations of a UK/EU Free Trade Deal roll on, the UK still risks finding itself outside the Single Market with no trading relations with its nearest and biggest partner. No deal is an economic shock that the Chancellor is keen to avoid, but it is not one for which the Government is willing to pay any price.

Aware of this, Boris Johnson pre-empted the Chancellor and announced a major new package of investment in the UK's armed forces, previewing the Integrated Review of Foreign, Defence, Security and International Development expected in the New Year. The intent is for this to set the context for the Johnson's post-Brexit "Global Britain."

The headline was an additional £16.5bn, 4-year investment for the Ministry of Defence, intended to consolidate existing capability programmes and pay for a wealth of new ones. However, with the MoD running its customary deficit, the money - as generous a settlement as it was - barely plugs the gap, with any significant new spending requiring efficiencies elsewhere. By all accounts, the settlement was far more generous than Sunak had wanted, but with rebellious backbenchers to appease, the Prime Minister decided to throw them some traditional Tory red meat to feast on.

To pay for this, the Chancellor announced that spending on international aid, currently legislated to equate to 0.7 per cent of GDP, will be reduced to 0.5 per cent for the short term. This will turn out to be perhaps the most controversial measure in the Spending Review, drawing significant blue-on-blue attacks. Though Spending Review decisions are never as simple as moving numbers from one column to another, the £4bn savings from this are so close to the cost of the Levelling Up Fund that it opens the Government up to accusations of reneging on its commitments to the rest of the world (and to the 2019 Conservative manifesto) to chase political domestic advantage. Potentially an own goal.

The politics of pandemics

Any intervention from Rishi Sunak takes place within the context of his position within the Government, his popularity, and inevitable comparisons between him and the Prime Minister. Whilst much of Sunak's popularity has been rooted in the fact that he has overseen a very generous support programme, attention is now beginning to turn to how this will be paid for. This will require tough decisions and is likely to come with considerable controversy and increased criticism of the Chancellor personally. Sunak is generally seen as a fiscal conservative who places a high value on his party's reputation for handling the economy responsibly. Although the most difficult decisions are being deffered to another day (and some potentially to another Parliament), the range of bad-news announcements indicate that Sunak will – in the coming months – be willing to take decisions that may put at risk his high personal ratings. Whilst he has not – by any measure – had an easy time as Chancellor, it is his decision-making over the coming months, and ability to drive the recovery, that could come to define his career.

Under new management, Labour has become much more conscious of its reputation on the economy and image as a party of good government. As such, the Shadow Chancellor, Anneliese Dodds, was wary of simply demanding higher spending, choosing instead to focus on how the money is spent. She bemoaned the decision to freeze public sector pay, framing this in the context of the prominent role of public sector workers in the pandemic response. She then moved on to criticise how government contracts have been awarded and the extent to which public funds may have been mishandled. She also drew attention to the centralised nature of the Government's approach, criticising the lack of power given to communities.

It was arguably not the strongest of arguments, given that Labour's proposals for how they would have handled this have had the benefit of hindsight but not that of consistency; but as the Government gradually shifts towards fiscal consolidation, public spending can only become more prominent within political debate.

The Chancellor is not just having to navigate arguments from the benches opposite him. Like the Prime Minister, he is mindful of discontent within the Conservative Party. There is growing opposition within the parliamentary party towards the approach the Government has taken to Covid-19, and restlessness over the economic impact of lockdown. Although many Conservative MPs are currently focusing on making sure that their area gets its fair share of the Government's support measures, attention is gradually returning to the public finances. In a context in which he is likely to come under increased criticism from the opposition and – perhaps – the public at large, the Chancellor will be keen to ensure that he does not fall too far out of step with the balance of opinion within his own party. His almost Thatcherite peroration, where he praised the grit and resilience of the British people, was designed to appeal to precisely this group.

The Chancellor's statement demonstrated an acute awareness of this political reality. In March, he will have to do it all over again – with the added complexity of tax measures to contend with. It was clear from the tone and language deployed yesterday that we won't see the reintroduction of austerity quite yet. Indeed, the thorniest decisions may well be pushed back by a number of years. What matters now is getting through the crisis relatively unscathed – while, at the same time, nudging the country into accepting that there will be difficult days ahead.

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