The 2015 Spending Review

Everything you need to know
The end of the summer has been a busy period for politics. The refugee crisis, ongoing EU renegotiation, and Labour’s extraordinary leadership election have dominated the political headlines.

As a result, little attention has been given to preparations for the November Spending Review. The review will define the framework under which this government will operate for the rest of this parliament. It will be the most important political set piece announcement since the election, and possibly of the whole of this parliament. Osborne has softened his pre-election promises on spending cuts, but his fiscal ambitions are still bold. Achieving a surplus by 2019/20 will be tough. Entire programmes will be abandoned. Others will be salami sliced.

This briefing will provide you with an insight into the political and fiscal context behind the government’s plans, how the Spending Review process works, and what we can expect from the final settlement. I hope you find it useful.

Best wishes,

Dominic Church
Managing Director, Westminster Advisers
What happened in the last parliament and where are we now?

With deficit reduction a major priority, George Osborne set out in his first Budget (June 2010) plans to eliminate the deficit by 2014/15, with a surplus achieved in 2015/16. Despite major cuts to public spending, weak growth meant that the government didn’t even come close to achieving this.

During the last parliament:

- Departmental spending was cut by an average 9.5% (for non-ring-fenced departments the figure was 20.6%)
- £21bn was cut from the welfare budget
- Spending was cut in real terms by 7.8%, rather than 8.3% as proposed by Osborne in 2010
- Real investment spending cuts were 13.6%, rather than the 25.9% originally proposed
- The budget deficit fell by around 40% - from its 2009/10 peak of £154bn to its current level of £88bn

As of July 2015 the UK still has to tackle a deficit of 4.9% of GDP. This is an improvement on 2010, when the deficit was over 10%, but there is still some way to go to balance the books.

How does the Spending Review Work?

What is the government’s timetable?

The review is being undertaken over the five months before publication of the final settlement on 25th November. The government’s headline timetable is as follows:

- **July**
  - Spending Review 2015 launched.
  - Treasury issues guidance to departments.

- **August**
  - Departments and Treasury work on spending options.
  - Public engagement programme.

- **September**
  - Initial ministerial discussions on the Spending Review priorities and departmental settlements.

- **October**
  - Ministerial discussions about departmental settlements.

- **November**
  - Cabinet signs off ministerial decisions.
  - Spending Review 2015 is published.
What is the process?

Ultimately the Spending Review process boils down to negotiations between the Treasury and each Secretary of State on their department’s budgets. This will include agreement on areas for spending and those where the axe will have to fall.

The key elements of the 2015 Spending Review process are as follows.

- **Departmental engagement**
  - As in 2010, departments have been asked to model 25% and 40% savings in real terms, by 2019/20. These were due to be submitted on 4th September.
  - The government will also undertake a full review of capital spending plans and departments have also been asked to examine their assets and consider their effective management. This includes considering privatisation and contracting-out.
- **Re-creation of the Public Expenditure Committee – the ‘Star Chamber’**
  - The committee aims to accelerate settlements by arbitrating on the budgets of those departments that cannot reach agreement separately with the Treasury.
  - Previously ministers were able to join the Star Chamber once they had settled their own budgets. It is likely that this will be the case again.
  - The theory is that the risk of competitor departments making budget decisions will serve to bring about agreement from more troublesome Secretaries of State.
  - In 2010 the group never met to sit in judgement on individual departments. It was reformed unexpectedly in 2013 after it proved difficult to reach a settlement with some departments.
- **External engagement**
  - Alongside the internal wrangling, the Treasury also launched a public engagement exercise which closed on 4th September.
  - The 2010 engagement process was criticised by the Institute for Government as being superficial, however the process, if nothing else, has a certain benefit for public perceptions.

Which types of spending will the government focus on?

**Departmental Expenditure Limits** (DEL - predictable spending, e.g. on most policy areas, or public sector salaries) will be set for every department. This is the main focus of the Spending Review, and accounted for 47% of spending in 2015/16.

While not included in the main scope of the Spending Review, **Annually Managed Expenditure** (AME - spending on items driven by demand, such as welfare and government debt interest) will also be scrutinised. AME made up 53% of spending in 2015/16.
### Who are the key people?

#### Star Chamber

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<thead>
<tr>
<th>Name</th>
<th>Position</th>
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<tr>
<td>George Osborne MP</td>
<td>Chancellor of the Exchequer</td>
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<td>Oliver Letwin MP</td>
<td>Chancellor of the Duchy of Lancaster</td>
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<td>Greg Hands MP</td>
<td>Chief Secretary to the Treasury</td>
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<td>Matt Hancock MP</td>
<td>Minister for the Cabinet Office and Paymaster General</td>
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<td>Chris Grayling MP</td>
<td>Leader of the House of Commons</td>
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#### Other key ministers

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<th>Name</th>
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<tr>
<td>David Cameron MP</td>
<td>Prime Minister</td>
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<td>Theresa May MP</td>
<td>Home Secretary</td>
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<td>Jeremy Hunt MP</td>
<td>Secretary of State for Health</td>
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<td>Michael Gove MP</td>
<td>Secretary of State for Justice</td>
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<td>Iain Duncan Smith MP</td>
<td>Secretary of State for Work &amp; Pensions</td>
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<td>Sajid Javid MP</td>
<td>Secretary of State for Business, Innovation &amp; Skills</td>
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<td>Greg Clark MP</td>
<td>Secretary of State for Communities &amp; Local Government</td>
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<td>Amber Rudd MP</td>
<td>Secretary of State for Energy &amp; Climate Change</td>
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#### Civil servants

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<td>Julian Kelly</td>
<td>Director General, Public Spending and Finance, HMT</td>
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<td>Sir Nicholas Macpherson</td>
<td>Permanent Secretary to the Treasury</td>
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What do we know so far?

What is the government trying to achieve?

The government’s ultimate aim is to achieve a budget surplus in 2019/20. It was initially expected that this would require two years of dramatic real term cuts in 2016/17 and 2017/18 – a trajectory described as a ‘rollercoaster’ by many. Following some criticism, Osborne has confirmed a smoother pace of cuts.

The Summer Budget confirmed that to achieve a surplus in 2019/20 the government will undertake around £37 billion of consolidation measures.

This will comprise:

- £12bn welfare cuts (as set out in the Summer Budget);
- £5bn from tackling tax avoidance, evasion and imbalances in the tax system (as set out in the Summer Budget);
- £20bn of further measures (departmental savings) to be outlined at the Spending Review.

To achieve an overall surplus, the government will maintain the same average pace of reduction in borrowing as in the last parliament – 1.1% of GDP a year.

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**Government saving plans over this parliament**

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<td>Departmental savings</td>
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£bn
In June the Chancellor announced £4.5bn of debt reduction for 2015/16 through a combination of in-year departmental cuts and government asset sales.

Many of the departmental savings were set out as efficiency savings or brought about by selling government owned land. These included:

- £200m from the Department of Health’s public health budget
- £450m from the Department for Education’s non-schools budget
- £450m from the Department for Business, Innovation and Skills
- £105m from the Department for Work and Pensions
- £70m from the Department of Energy and Climate Change

Alongside these cuts, Osborne has also set out plans to make savings, including £32bn this fiscal year, from the sale of government assets. This will be supported by the merger of the Shareholder Executive and UK Financial Investments, which oversee government shareholdings in the likes of Lloyds Banking Group and Eurostar, into a single holding company - UK Government Investments.

These asset sales include:

- Royal Mail
- 80% stake in the Royal Bank of Scotland
- Remaining stake in Lloyds Banking Group
- Stake in King’s Cross Central development site
- Part of the pre-2012 student loan book
- Partial privatisation of the Green Investment Bank

In addition, the Summer Budget also set out plans to achieve £12bn of savings from the working-age welfare budget by 2019/20. This includes by:

- Freezing working-age benefits and Local Housing Allowances for four years
- Reducing rents in social housing by 1% a year for four years
- Reducing the cap on benefits that an out of work family can receive (from £26,000 to £20,000, except in London where higher rents will be recognised through a £23,000 cap)
- Reforming tax credits and their replacement Universal Credit (including limiting tax credit support to two children and reducing the level of earnings at which a household’s tax credits and Universal Credit award start to be withdrawn)

These savings have supported the Chancellor’s decision to reduce the pace of cuts. However, there is still further to go in order to achieve the consolidation necessary to reach a budget surplus in 2019/20.

Which budgets are ring-fenced?

We know that certain budgets will be protected in the Spending Review. These are:

- Health
  - The annual NHS budget is expected to grow £10bn in real terms by 2020/21, from 2014/15 levels.
  - This will fund measures including ensuring the introduction of a seven day NHS by 2020/21.

- Schools budget
  - Per-pupil spending is protected and schools will be expected to increase efficiency and productivity.

- International aid
  - There will be spending of 0.7% of gross national income on international development.

- Defence
  - The defence budget will rise by 0.5% a year in real terms, with protection for counter terrorism spending and additional money for military and intelligence agencies. A Strategic Defence and Security Review runs alongside the Spending Review.
Which other areas will be prioritised for spending and savings?

Osborne has stated that spending will be prioritised towards the following outcomes:

1. Promoting innovation and greater collaboration in public services
2. Promoting growth and productivity, including through devolution of powers to local areas in England
3. Delivering high-quality public services, such as the NHS
4. Promoting choice and competition
5. Driving efficiency and value for money across the public sector

What can we expect?

There is still a lot of uncertainty, though we can expect the Treasury to focus on its five priority areas. Some of the likely outcomes are as follows.

Health and social care

- While the health budget is protected, there may be further cuts to public health and other non-frontline services – particularly in light of Lord Carter’s ongoing work to identify hospital efficiency and supply chain savings.
- We can also expect detail on funding allocations. The NHS will receive staged funding increases in every year of the parliament, determined in the Spending Review. The main question is the rate at which funding increases each year to achieve the £10bn increase in budget over this parliament.
- Social care is likely to see cuts. Pressures on local authority budgets will continue and although many councils have worked to protect social care spending, services will be hit as they are forced to look again at how to make savings.
- Some parts of social care, such as learning disability services, have so far managed to avoid the most severe cuts. Others, such as older people’s care, have been less fortunate. The sector will be waiting to see where further cuts will hit, as well as seeking support in adjusting to the national living wage.
- The Treasury and the Department for Education have already jointly commissioned a review of council children’s services spending, partly to see how they have dealt with reducing funding alongside increased demand.

Education and skills

- The schools budget may be protected, but other areas of education and skills spending
will be a key focus for the Spending Review. Sajid Javid is set to make significant cuts to the Department for Business, Innovation and Skills (BIS) – which is responsible for further and higher education (FE and HE).

- The Summer Budget already set out the conversion of maintenance grants for poorer students into loans. Vince Cable has reportedly noted that when he was Business Secretary he had to fend off Treasury proposals to extend student loans to cover sub-A-Level vocational courses at FE colleges. This could emerge again under a more Treasury-friendly Business Secretary like Javid.
- The Spending Review will also confirm details on the levy on large employers to support post-16 apprenticeships, as part of the government’s drive to create 3 million new apprenticeships by 2020.
- Further detail is also expected on the funding settlement for the expansion of free childcare from 15 hours a week to 30 for families with both parents in work. This is a Department for Education-led policy area and is an important manifesto pledge for the government.

Business and innovation

- Rumours that BIS itself would be scrapped seem to have been put to rest, and it is known that Cameron dislikes machinery of government changes in general. However, the fact that this was even floated is indicative of the scale of cuts BIS may see.
- Javid is also expected to pull back support for business. He is reported to be proposing changing business grants into loans, and rationalising support for organisations such as the insolvency service and research councils. Life sciences organisations, a policy area that straddles BIS and the Department of Health, are particularly concerned about the impact on funding for their sector.
- However, productivity and innovation are a key priority for the government. This means sectors and programmes that can demonstrate gains should see positive outcomes in November. For example, the government has already confirmed it will set out details of support for successful regional proposals from universities, cities and businesses to drive research and innovation in their areas.

Energy

- DECC has a particular challenge given the constraints on its budget caused by high and necessary costs of managing the UK’s nuclear liabilities.
- Delays to nuclear decommissioning programmes are a possibility, though would be unpopular and regarded as short sighted by many.
- As a result, the Renewable Heat Incentive is firmly in the firing line – most would be surprised if it survives the Spending Review.
- Money for international climate funds may be switched to come out of the international development budget.
- DECC was one of the few departments to increase net headcount in the last parliament, but this trend is likely to be reversed. Staff cuts are all but certain. A merger with Defra is a possibility, though unlikely.
Transport and infrastructure

- Transport and infrastructure are expected to receive some investment, particularly as part of the Chancellor’s plans to develop the Northern Powerhouse. More money and resources are expected to be devolved to the region. The Conservative Manifesto pledged £13bn for improving transport in the North along with £5.2bn for the Midlands. An interim report from the government and Transport for the North (TfN) outlining priority schemes is due to be published ahead of the Spending Review.

- This forms part of a pledge to invest £100bn in infrastructure over the course of this parliament, including: £38bn investment in railways; £15bn on roads and £200m for safer cycling.

- Despite this it looks as though the Transport budget will also see cuts. National Rail is reported to have been asked to prepare for significant cuts and campaigners have raised concerns that safeguarding major national investment programmes will result in cuts to local services.

Policing

- Home Secretary Theresa May has already stated unequivocally that police funding will be further reduced and that the police need to stop “crying wolf” about the impact of cuts. It has been reported that these cuts will see 22,000 police jobs lost.

Devolution and local authorities

- We can expect confirmation of allocations to the devolved administrations as well as further devolution deals within England. Many regions are seeking new responsibilities for a number of areas including health and social care, housing and transport.

- However, alongside this local authorities are repeatedly raising concerns about the impact of further spending cuts on their ability to provide services. The Local Government Association’s Spending Review submission identified almost £10bn of cost pressures on councils by 2020.

Further asset sales

As part of the departmental settlements, the Treasury is also looking for further asset sales. This includes the disposal of enough public land to build 150,000 houses by 2020. Other rumoured sales include:

- Channel 4
- 30% stake in Urenco
- Disposals around major rail stations
- Ministry of Defence land
- Companies House
- Land Registry
- Met Office
- Ordnance Survey
- Royal Mint
What are the next steps?

Departmental submissions have been made to the Treasury, and negotiations are beginning. Much of the work has been done, but by no means all. There is still time to input to the process, as departments and the Treasury work hard to hammer out a solution to the significant cuts that are required.
About Westminster Advisers

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- Energy
- Transport and infrastructure
- Housing and regeneration
- Local government

We also offer a specialist Policy Risk Analysis (PRA) service – a bespoke research tool that provides investors with insight into the political, regulatory and reputational risks to companies they are considering acquiring or investing in.

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