The Spending Review

Policy Exchange's response

Overall comment

George Osborne rightly stuck to his guns over the total consolidation, reducing discretionary spending cuts by only an irrelevant £2 billion (all driven by less fall in capital spending). The NHS and DFID ringfences were expected, but that Education was cut only 3.4% over the period was disappointing because we believe there were intrinsically desirable cuts greater than this. Cuts in most departments lay in the 20-25% range: Transport – 21%; CLG – 27%; BIS – 25%; Home Office – 23%; DEFRA – 29%; DCMS – 24%. Our previous analysis, *Controlling Public Spending: How to cut 25%*, suggests that cuts on this scale should be broadly feasible through a combination of intrinsically desirable and plausible measures, without needing to resort to much that is unpalatable (except the cuts to the Defence budget, which take it back below its 1993/4 level).

The ability to avoid too much unpalatable cutting was the consequence of finding £7 billion extra cuts/effective tax rises from the Welfare budget and from Child Benefit, along with rises in public sector employee pension contributions, though it was disappointing (but not surprising) that misdirected programmes such as winter fuel payments survive intact.

There are a number of interesting points from specific departments.

The key DECC story relates to about 5,000 large, non-energy intensive companies which come under the new CRC Energy Efficiency Scheme and need to buy carbon permits from 2012. The cost of these permits will not now be recycled back to companies, as originally proposed, but retained by the Treasury. This will raise £1 billion pa by 2014-15.

The 6% savings each year from the Home Office budget (23% by 2014-15) should be delivered relatively straightforwardly. There is significant scope for cutting back bureaucracy in Home Office agencies, merging some organizations and scrapping others. A 20% cut to police funding is in reality more like 14%, once local funding through council tax is taken into account. This is slightly more than the 12% that HMIC decided was perfectly possible for forces to deliver, without slashing officer numbers.

The 23% cuts achieved in 4 years to the Ministry of Justice constitute a bigger hit than the Home Office with this settlement because the savings are harder to find here. The cuts lead to a total budget of £7 billion by 2014-2015, but it could have been worse. There are major savings that can be made, in legal aid, in central staffing and in the bureaucratic NOMS empire, but a quarter of the department's budget is spent on prisons, and this scale of savings can only be realised if prison numbers are less than expected in 2015, so jails can actually be closed, or not built in the first place.

Overall, however, perhaps the most noteworthy point was the Chancellor's final jibe that the Coalition is proposing smaller cuts to DELs than Labour. It appears that the struggle to move politicians away from the formulation that "Increased public spending = All that is Good and Virtuous" still has some way to go.

Departmental Commentaries

Home Office

This settlement for the Home Office is tough but much better than many expected. The 6% savings each year from the Departmental budget (23% by 2014-15) should be relatively straightforward to deliver. There is significant scope for cutting back bureaucracy in Home Office agencies, merging some organizations and scrapping others. The department can also generate extra income from selling off some of its estate, raising passport and visa fees, and making the UK Border Agency leaner.

Overall, spending on the police takes up half the Home Office budget and £8 in every £10 of police funding is spent on staff, so cuts of 20% will mean a smaller payroll, but officer numbers need not fall by much if the right reforms are introduced. However, a 20% cut to police funding, is in reality more like 14%, once you take account of local funding through council tax (and this is based on projections of local precept levels 2012-15 calculated by the Office for Budget Responsibility). This is slightly more than the 12% that HMIC decided was perfectly possible for forces to deliver, without slashing officer numbers.

Big savings can be made if police forces modernize their workforce arrangements, collaborate more, and outsource more back office functions to the private sector. Tackling the police overtime bill will also help cut costs and protect jobs. If these things happen, then these year on year cuts are entirely manageable and there is no need for sworn officer numbers to fall significantly, although police forces will probably cut back on staff. It is right to safeguard counter-terrorism funding with a smaller than average cut, but other ring-fenced grants for the police should be reduced and ultimately abolished. If Chief Constables are being asked to do more with less, then they should have maximum discretion about how they spend the reduced resources they have. They cannot fight crime effectively if the Home Office continues to dictate what they can spend that money on.

Ministry of Justice (MoJ)

Even though both departments are being cut by around 23% over 4 years, the Ministry of Justice has taken a bigger hit than the Home Office with this settlement because the savings are harder to find here. The cuts lead to a total budget of £7 billion by 2014-2015, but it could have been worse. There are major savings that can be made, in legal aid, in central staffing and in the bureaucratic NOMS empire, but a quarter of the department's budget is spent on prisons, and this scale of savings can only be realised if prison numbers are less than expected in 2015, so jails can actually be closed, or not built in the first place.

The mothballing of plans to build a new 1,500-bed prison, announced today, will help. Capital spending of £1.3 billion for new build and maintenance will still happen, although this sum (which is around half of the planned capital spending previously planned) will not create much new capacity. The MoJ might be banking on cash savings in the meantime from new efficiencies in the public sector estate, or a big programme of privatisation, although this is risky and could easily trigger industrial action by militant prison officer unions. Following the CSR, the Department expects the prison population to be 3,000 fewer in 2014 than today, taking it back to 2008 levels. Although this may appear modest, sentencing reforms generally take a long time to filter through and a reduction on this timescale will be difficult to achieve.

Legal aid has clearly taken a big hit and the legal establishment will be unhappy, with cuts of more than a third, or £700m pa, in this budget are now likely. Compared to prisons, this is an easier target for cuts and in many areas they are justified – our public legal aid system is the most generous in the world and costs have exploded in the last three decades. Savings can also be made by closing under-used court buildings, scrapping the Youth Justice Board – which we have argued for – and reducing headcount at the National Offender Management Service (NOMS), and these central savings have also clearly played a big part in getting to the 23% settlement.

Communities and Local Government (CLG)

The Government has cut capital funding for social housing by some 70% - from £6.8 billion to £2 billion a year - yet it will continue with the Decent Homes Programme and wants to build some 150,000 new affordable homes over the period of the Spending Review. In our recent reports, *Making Housing Affordable* and *Controlling Public Spending: How to Cut 25%* we called for a substantial reduction in the capital support for new social housing. The Government is right to be searching for new ways to fund social housing – the existing model was simply producing too few homes at too high a cost.

Nevertheless, achieving this goal of 150,000 new homes on a much reduced budget will be a major challenge. Our report set out some new ways to generate new affordable homes at a limited cost to the Exchequer.

Department of Energy and Climate Change

The key DECC story of general relevance is a £1 billion per year tax raid on businesses (not in the chancellor's speech). About 5,000 large, non-energy intensive companies which come under the new CRC Energy Efficiency Scheme need to buy carbon permits from 2012. The cost of these permits will *not* now be recycled back to companies, as originally proposed, but retained by the Treasury. This will raise £1 billion pa by 2014-15.

The major cut to DECC's Departmental spending is phasing out of the Warm Front programme, as this is being replaced including by the larger new programme of Green Deal loans to householders for energy efficiency measures. As recommended by Policy Exchange (*Warm Homes*).

But by far the largest spending on energy and climate policy is *not* however through DECC's Departmental spending, but through customers' energy bills, on policies such as the Renewables Obligation. Policy Exchange has estimated that this spending totals almost £6 billion this year, rising to over £10 billion in 2015. A number of these bill-funded policies are poor value for money, and the Spending Review makes welcome cuts to some of the poorest value for money policies, as recommended by Policy Exchange (*Greener, Cheaper*). This includes a £40 million p.a. cut by 2014-15 to Feed-In Tariff subsidies for expensive small-scale renewables, such as Solar photovoltaic panels and micro-wind turbines (costing £450 per tonne carbon saved). The spending review recognises that some of these are not cost-effective technologies.

Also, the Renewable Heat Incentive will be implemented at a reduced level compared to that proposed by the previous Government, eliminating poorest value for money subsidies which has previously been recommended by Policy Exchange (*Greener, Cheaper*).

RHI and first CCS demonstration will be funded from conventional tax revenues rather than hidden in energy bills, improving transparency of climate change costs, as called for by Policy Exchange in (*Green Bills*).

The Spending Review also says that the CRC Energy Efficiency Scheme will be simplified to reduce burdens on business, as recommended by Policy Exchange (*Greener, Cheaper*). An Independent review of fuel poverty target has been announced, in line with conclusions of Policy Exchange report (*Cold Comfort*).

Department for Education (DfE)

The Department of Education emerges from the CSR looking relatively well off, with the Chancellor announcing an overall spending reduction of just 1% p.a. (equating to 3.4% over the next four years.) As expected, the front line has been protected and in fact the schools budget will see year on year increases from £35 billion today to £39 billion by 2014. The Government's clear commitment to school choice and autonomy is underlined by an insistence that even more of this spending should be in the hands of head teachers to allocate in a more flexible, bespoke manner. The overall schools budget does include an extra £2.5 billion which has been found for a new pupil premium. This is certainly a very positive development but a firmer hand could have found this premium by reallocating the current schools budget rather than adding to it.

Welcome news indeed is that the Government will grasp the nettle on Sure Start and refocus its attentions on it original purpose of dealing with children from the most disadvantaged backgrounds. Yet once again, the Coalition could have gone further and reduced spending on the programme rather maintaining it in cash terms. Finally, a clear commitment to the future of the schools estate has emerged, with £15.8 billion going towards its maintenance over the next 4 years. Having thrown off the shackles of Building Schools for the Future programme, spending can at long last flow more efficiently to those areas where the need for refurbishment is most urgent without having to wade through the processes of 'educational transformation.'

Announcements on further education meet expectations. The government has rightly targeted the Educational Maintenance Allowance for cuts from the DfE budget, proposing to target it at the most disadvantaged children in the run up to raising the leaving age to 18, when it will become obsolete. At the same time it has also suggested that whilst it will maintain current student numbers in 16-19 provision, it will look to reduce the unit cost. This will likely mean that expensive courses will be cut, including potentially some Diploma provision. In short, it is likely that schools and colleges will simply be required to deliver the same amount, for less. This will be especially difficult for colleges who will be experiencing cuts in other sources of funding (including Train to Gain - by far the most wasteful and inefficient area of skills spending) on top of cuts already sustained. On the other hand the government is rightly determined to make life for colleges far easier by freeing them from bureaucracy, planning and targets.

One can presume that the savings for abolishing Train to Gain will be used to pay for the announcement of 75,000 new adult apprenticeships. Whilst being somewhat at odds with the government's claim that it will reduce the target based approach to apprenticeships and other skills, it is nonetheless encouraging that the focus of skills investment is likely to move to more productive areas. The government is also right to plan for a shift in the balance of contributions to adult skills with an end to the entitlement to full funding for a first full level 2 qualification for over 25's. These students will most likely be asked to pay around 50% of their fees. More interestingly, adult students studying level 3 (A-level equivalent courses) will be required to pay fees, but will be supported by government backed loans with repayments dependent on income. In the meantime, as part of an ongoing review of funding for FE, the government is seeking to boost the level of employer investment in this area.

Department for Business, Innovation and Skills (BIS)

With the BIS budget to reduce by 25% over 4 years, around 65% of this will derives from reductions in spending on further and higher education. The overall resource budget for Higher Education (excluding research funding) will reduce from £7.1 billion to £4.2 billion, a 40% or £2.9 billion reduction by 2014-15. This will be achieved largely by cutting direct funding for the majority of taught subjects. This loss of income for universities will be offset by much higher private contributions in the form of higher tuition fees (broadly in line with the recommendations of the Browne Review). Funding will be maintained for teaching for Science, Technology, Engineering and Mathematics (S.T.E.M) subjects. These changes, although widely expected following hints made in the Browne Review, constitute a major change in the way HE is funded.

Conscious of the need to expand the economies capacity for growth, the CSR pledges to maintain spending levels on the 'highest value scientific research,' with the science budget having been frozen in cash terms over the Spending Review period. Effectively this amounts to a cut of around 10%, which will please universities that were expecting cuts of 20% or more in research funding. In deference to Nick Clegg's package of premiums for those from disadvantaged backgrounds, the Review announces the establishment a new £150 million National Scholarship Fund to support university students from disadvantaged backgrounds.

Department of Health

Healthcare inflation far outstrips even the real-terms increases in public spending which the NHS will receive over the next four years, due to the rising burden of ill health, an ageing population and increasing operating costs. So as the Chancellor stated, despite an increase in its budget from £104 billion to £114 billion, the NHS needs to save up to £20 billion over this Parliament just to stand still. There is a lot of scope to do so. NHS productivity fell under the previous Government – a trend which must be reversed if the NHS is to maintain existing levels of care. The NHS also needs to better co-ordinate its activities and reduce demand on hospitals as far as possible. Since fully integrated healthcare systems can deliver the same or improved levels of care at reduced cost, integrating care is necessary and fundamental to the future of the NHS. There is also huge scope for rationalising the NHS estate, which is currently poorly-used and managed.

At a more fundamental level, if the NHS is to survive the next two parliaments as a free-at-the-point-of-use service, the Coalition needs to move the debate on from how much funding is poured into the system. The NHS needs to shift from being an reactive illness service to being a proactive health service – and this will require a re-affirming of the public's responsibilities towards the NHS and their own health, as much as the service's duties towards them in preventative care.