

The 2016 Autumn Statement: getting out of a spending JAM

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The Government faces a huge spending challenge – this is Phillip Hammond’s chance to show he’s up to it.

The Government is committed to the 2015 Spending Review’s reductions in day-to-day spending, and to the Conservative Manifesto’s promises to maintain, and in some cases increase, the scope and quality of public services. Yet despite a lot of work within Whitehall over the past year, the Chancellor still needs to put forward a clear and coherent plan for squaring this spending circle. With the added pressures of Brexit and an increasingly unstable geopolitical situation, the Autumn Statement provides a chance for the Chancellor to show that the Government is still capable of focusing on the big spending decisions it faces.

There are three areas the Chancellor needs to urgently address:

- The **expected worsening of the public finances**, where the Chancellor will allow significantly higher borrowing to take the strain. He may also compound the issue by raising spending in areas like infrastructure to show Britain is “open for business” post the Brexit referendum, and for “just about managing” (JAM) families in line with the PM’s leadership campaign.
- The **urgent issues in services like health and prisons, which are at breaking point**. The Chancellor will probably try to delay additional action until the Budget, combining any extra cash with serious reform plans.
- The **limited potential for cuts in other budgets**. Here the Chancellor will probably reduce aid spending in line with falling GDP, but not defence spending. He is unlikely to make any reductions in pensioner benefits, or to yet be able to factor in any Brexit-related savings from reduced EU contribution.

Weak forecasts mean increased borrowing – and optional spending

The Office for Budget Responsibility (OBR) looks set to follow the view of most independent forecasters and show the UK's economic growth slowing in the coming years. The FT, in what looked like a particularly well sourced piece¹, expected the forecasts to deteriorate by £100bn over the next five years (similar to the amount that independent forecasters have been talking about²). All the indications are that **borrowing will take the strain**. The PM ruled out tax increases in her leadership campaign³ and, as we explore below, there is relatively little room to further cut spending.

Reductions in EU contributions are unlikely to help the Chancellor much. With it looking as though the UK will not formally leave the EU until 2019 at the earliest, the current level of EU contributions needs to continue until then. And the Government has guaranteed that some of the funding that currently goes via the EU, particularly on agricultural subsidies, will be retained until 2020.

Rather, there are pressures to increase spending. The clearest sign is around **infrastructure**. Part of the Chancellor's motivation is to show that "Britain is open for business", and this involves progressing major investments such as Heathrow and Hinkley Point. In the immediate future such long-term projects require little or no public money, given that there is only a five-year forecasting horizon.

However, the Chancellor may want to move faster, to increase infrastructure spending to stimulate the economy in the face of falling growth forecasts. This is trickier territory. For a fiscal stimulus, projects need to be ready to start quickly – so-called 'shovel ready' schemes. This means incremental improvements to existing infrastructure. It may not be as glamorous as a new train line, but increased maintenance and minor improvements to the road network would be one obvious way to provide a quick stimulus (also tackling an area – road maintenance – where 57% of people think things have got worse over the last five years, compare to only 14% who think they have got better)⁴. But short-term stimulus spending will need to sit alongside a much longer-term plan for the role of infrastructure in the economy.

Aside from infrastructure, there are two other areas where the Chancellor may feel he has to do something. The first is for **"just about managing" families** (JAMs – the new "squeezed middle"). The question will be how much cash is available to put some policy flesh on the PM's rhetorical bones. The fiscal situation would suggest a number of relatively low-cost initiatives, potentially confined to cutting taxes. There may be some small spending measures but it would be a sign of confidence (or recklessness) if the Chancellor chooses to implement any of the really expensive spending measures like providing greater help with childcare.

The final area for increased spending is around the new **industrial strategy**, and particularly for multinationals tempted to relocate post-Brexit. The UK cannot give direct subsidies to individual firms (both the EU State Aid rules and the WTO world trade rules preclude this). So we may see more industry-based deals, putting government money into research and skills development closely associated with particular sectors and geographies. This

1 'UK faces £100bn Brexit hole in budget', *Financial Times*, 16 Nov 2016, www.ft.com/content/acb33786-ac16-11e6-9cb3-bb8207902122

2 See *Winter is Coming: the outlook for the public finances in the 2016 Autumn Statement*, Institute for Fiscal Studies, Nov 2016 and *Pressing the Reset Button: the public finance options facing the new Chancellor at the Spending Review*, Resolution Foundation, Nov 2016

3 Speech by Theresa May, 30 June 2016

4 *Coming to terms with austerity?*, IPSOS Mori, Oct 2015

would follow on from the precedent set in the recent Nissan deal, as outlined by Greg Clark.⁵ The Prime Minister's announcement of additional funding for innovation may well create a pot of money that can be used for this purpose.⁶

Some public services, like prisons and health, need urgent attention

Before the last Spending Review, we warned about acute pressure in **health** and **prisons**. Twelve months on, the problems in both services are regular 'headline fodder'⁷ and the political pressure is rising.

With winter approaching, government is always worried about people facing long waits in A&E (not least because of the political impact of photos of queuing ambulances and people lying on trolleys), and will be hoping that the weather is mild and the flu jab has targeted the right strain. However, there is extremely little room for manoeuvre this year. Key A&E targets were being missed in the summer months,⁸ while the rising waiting times for elective operations suggest a 'robbing Peter to pay Paul' strategy is all that is keeping the NHS show on the road.

Prisons are at breaking point. Assaults, deaths in custody, etc. have been rising for a long time – and at an increasingly rapid rate.⁹ However, the politics of prisons is very different to the politics of health. The condition of prisoners is not the stuff of urgent tabloid campaigns. It is a sense that the government is losing control, and of concern for people's wider safety that matters. Riots, escapes and unofficial strikes all go to the heart of this, and events over the last few weeks highlight the Government's vulnerability.

In both areas, the Government is now in a deep hole, having failed to act decisively as the warning signs became clearer. In health, reform is the sensible way forward. Reconfiguring services – centralising specialisms, improving public health, providing social care rather than medicalised interventions – can both improve people's lives and reduce costs. But this takes time and serious amounts of political capital. The only real option is for the Treasury and the Department of Health to work with the NHS to develop such plans, and to ensure that the inevitable dollop of extra money is used to support their implementation. This cannot be done in time for the Autumn Statement – the March Budget is a more realistic timescale. The Government will also have to address issues in social care. Here the solution may not be more centrally financed grants but, as we saw in the Spending Review, allowing councils to raise local taxes to meet demand.

On prisons, the situation is more straightforward. For all the talk of a rehabilitation revolution, even its most optimistic supporters know it cannot deal with the current pressures. The Government has already announced the appointment of 2,500 more prison officers.¹⁰ It might want to engage in sentencing reform to lower the prison population but, given that Blair, Brown and Cameron never accepted this as a viable policy, it's pretty hard to

⁵ Greg Clark interview on *The Andrew Marr Show*, 30 Oct 2016

⁶ Theresa May wants post-Brexit UK at 'cutting edge', www.bbc.co.uk/news/business-38044015

⁷ See, for example, *NHS £8bn budget plan 'not enough', say hospital bosses*, www.bbc.co.uk/news/health-38019771 and *Prison officers end protest after court order*, www.bbc.co.uk/news/uk-37984479

⁸ J. McCrae *The Spending Challenge: How to cut spending while maintaining quality*, Institute for Government, Sep 2016

⁹ Ibid.

¹⁰ See www.gov.uk/government/news/justice-secretary-calls-time-on-failing-prisons-in-white-paper-to-help-cut-crime-and-protect-society

see Theresa May going down this route. In which case, the 2015 Spending Review cut for the Ministry of Justice (MoJ), which outlined a 20% real terms reduction over the next three years, is already dead in the water: a new settlement will be needed.

It will be difficult to make cuts elsewhere

The first place the Chancellor could look is the protections on **pensioner benefits**. Under Cameron, these were protected, and the state pension, which accounts for most of the spending, is subject to a 'triple lock' – increasing annually by the highest of rises in prices or earnings or by 2.5%. While looking at these guarantees again would be fiscally prudent, tampering with pensions has come to be seen as political suicide. So if these guarantees are going to be maintained, sooner or later the Government is going to have to be clearer about how it intends to fund them – continuous squeezing of other parts of spending cannot go on for ever.

The Government may look to reduce its commitments on **overseas aid**. This ring-fence, committing the UK to contribute 0.7% of GDP to aid, has already been stretched to the limit of its formal definition. For example, by 2020 £1.5bn of overseas aid spending will have gone to UK universities to support their research programmes. Cameron's overseas aid policy was always unpopular with the public at large, making this spending politically vulnerable. At the very least, the spending on aid is likely to be reduced in line with any changes to the GDP forecast.

Defence spending is also fixed as a share of GDP. The Conservative backbench forced Osborne into committing to keep defence spending at 2% of GDP. Of course, the OBR is likely to forecast lower GDP in the Autumn Statement, meaning that MoD's spending plans could be reduced and still meet the target. However, this seems unlikely. Aside from the obvious politics, the international situation means that the "defence dividend" that many Western countries have used to pay for expanding other services may be about to go into reverse.

What will really happen on Wednesday

Overall, the spending pressures on the Chancellor continue to build. In the Autumn Statement we are likely to see increased borrowing, new spending commitments in infrastructure and a focus on "just about managing" families.

Delivering the Government's existing plans and finding further savings is not impossible, but the Government needs to have serious plans for achieving this. Across the piece, such plans are not in place. These are most urgently needed in areas like health and prisons. Politically sensitive areas like pensioner benefits will probably be left untouched. This Autumn Statement will therefore be strikingly similar to a pre-election fiscal statement, rather than one coming with four years left in the parliament.

Faced with the challenges of Brexit, an unstable international situation and growing fiscal pressures, it is vital that the Government focuses on a clear set of priorities. Aside from setting out plans for tax, spending and borrowing, the Autumn Statement should also highlight the commitments the Government intends to keep, and what it will drop. In this way resources such as political capital, ministerial time and civil servants' efforts can be focused on the key challenges.

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