REPORT

IPPR

THE CHANCELLOR'S CHOICES

HOW TO MAKE THE SPENDING REVIEW AS PROGRESSIVE AS POSSIBLE WHILE STILL DELIVERING A SURPLUS

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and Alfie Stirling

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Errata

Page 4: in the bulleted paragraph on 'childcare', it was stated that our policy recommendation would cost £300 million per year; this has been revised to £550 million per year.

Page 36: in paragraph 4, the source of the figures was wrongly cited as 'Howard 2015', and has been amended to 'Washan et al 2014'. The references list has also been amended to reflect this change.

Page 41: in the final bulleted paragraph, on 'pensions reform', it was stated that IPPR had previously made calculations on the basis of a cap on the tax-free lump sum set at '£3,000'. This should have read '£36,000'.

Page 44: the policy costing given at the end of the 'childcare' paragraph has been amended as per page 4.

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SUMMARY

The upcoming spending review will be hugely significant for public services. The government's target to eliminate the deficit and deliver a surplus in 2019/20, its manifesto commitment to find the majority of savings through spending cuts as opposed to tax increases, and its stated plan to shield the NHS, 5–16 education, defence and international aid from cuts, mean that other departments will have to bear the brunt of reduced spending. In order to achieve the government's planned surplus of £10 billion in 2019/20, compared to 2015/16 in these unprotected departments:

- overall spending will have to fall in real terms by 16.4 per cent
- capital spending will rise by 18.2 per cent in real terms
- day-to-day spending will have to fall in real terms by 26.5 per cent.

This report demonstrates how the upcoming spending round could deliver a settlement for government departments that supports public service reform and prioritises spending where it is most needed, even under the government's tight fiscal rules. While we do not agree with the pace of public spending reductions planned in this parliament, and would prefer a deficit reduction programme that is more responsive to the wider economy and operates over a longer time-horizon – and for more of the deficit reduction to be achieved through tax increases – the recommendations we present are consistent with the government's fiscal mandate.[1]

Beyond closing the deficit, the upcoming spending round must also prepare the state for dealing with the country's social, economic and demographic pressures beyond the current parliament and into the 2020s. In order to meet this challenge, there are four key principles that should underpin the upcoming spending round.

- **Support employment and productivity:** The government has stated its ambition to create 2 million jobs over this parliament, and for the UK employment rate to become the highest in the G7. However, it has not highlighted employment as a priority for the upcoming spending review. **Spending on services that support employment outcomes, particularly those of parents and the young, should be prioritised** in order to ensure that everyone's skills are fully utilised, and to help the UK reach a structurally higher employment rate that supports a broad and sustainable tax base. The government has, however, made improving the UK's *productivity* performance, which has been poor in recent years, a priority – not least because of the boost it would give household incomes. With this in mind, the spending review should commit to strategic public investment in areas such as science and transport infrastructure.
- **Prioritise preventative spending:** Too much public expenditure is devoted to dealing with the symptoms of market failure and ameliorating the effects of market inequalities, rather than preventing these outcomes in the first place. For example, government spends a great deal on subsidising ever-rising rents through housing benefit, but does not have a coherent strategy for reducing those rents. Similar arguments can be made in relation to the growing price of childcare, and to entrenched social exclusion and worklessness. Even sustained economic recovery is unlikely to resolve these issues – instead, they require deep

1 The fiscal mandate, the latest iteration of which was published at the July 2015 budget, is defined as 'a target for a surplus on public sector net borrowing by the end of 2019-20' and 'a target for public sector net debt as a percentage of GDP to be falling each year' (HMT 2015a: 7).

reform of welfare and public services. Furthermore, intervening earlier is likely to save money in later years by reducing demand for more downstream spending. While not identified by the government as a priority for the spending review, **preventative spending** should – given its potential to generate real savings without cutting entitlements to services – be taken seriously and explored across government as part of the spending review process.

- **Integrate services:** A stated aim of the upcoming spending review is to support public service innovation and integration. We agree. Pooling funding across service boundaries – such as between the NHS and social care – provides opportunities to integrate services around individuals, making them more efficient and effective as well as generating substantial savings. The spending review should therefore **prioritise reform that gives those delivering services locally the powers and flexibility needed to restructure services in this way**.
- **Devolve powers and budgets:** The current government has made devolution a key plank of its policy agenda, through its plans for creating a 'northern powerhouse' as well to agree new city and county devolution deals. The government has signalled that it will continue to pursue this agenda through the spending review. It should do so by **earmarking budgets in key areas for devolution, followed by staged negotiations with local authorities over the precise mix of powers and funding to be devolved in those areas**.

To inform the upcoming spending review, we have prepared a package of policy options that deliver on these principles, based on the policy recommendations made in IPPR's *Condition of Britain* report (Lawton et al 2014), and in other recent IPPR publications.

We offer three sets of recommendations. The first is a series of specific policy proposals that will require additional resources. The second identifies a number of broader areas of spending that should be a priority and so protected from further deep cuts. Finally, the third set of recommendations offer means to raise revenue from tax and unlock additional funds by keeping within the government's fiscal mandate but targeting a lower surplus.[2]

Specific policy proposals

Our specific policy proposals are as follows.

- **Childcare:** The government already intends to extend the number of free hours of childcare available to three- and four-year-olds to 30 hours for 38 weeks of the year. It should build on these plans by **introducing an entitlement to 15 hours of holiday childcare for an additional 10 weeks of the year, targeted at 2–4-year-old children in families that fall within the poorest 40 per cent of the income distribution**. This policy, which we project would cost £550 million per year, would support employment and provide much-needed help to low-income families, whose finances will be squeezed in this parliament by cuts to tax credits.
- **Youth guarantee:** Too many young people are poorly served by the support that is currently available to them as they transition from education into work. While the exclusion of under-25s from the new 'national living wage' may help their employment prospects, the fact that we have rates of youth unemployment that have remained persistently high, relative to adults, even during periods of relatively high (or at least recovering) employment before

2 The data sources used in the public spending model that underlies all of the authors' calculations presented in this report are listed in full in the appendix, grouped by the department and/or policy area to which they pertain. Principal sources for data presented in the tables are listed beneath each of them.

and since the recession, indicates that more action is needed. Because experience of work is key to fostering sustained attachment to the labour market, **the government should guarantee a job for six months, paid at the minimum wage, to all under-25s who have been claiming jobseeker's allowance (JSA) for longer than nine months**; this should replace the Work Programme for young people. Under current rates of youth JSA claims, this 'youth guarantee' would require additional resource of £280 million in its first year, and £110 million in subsequent years, assuming that it is part-funded by redirecting existing spending on the youth cohort within the Work Programme. The funding for the youth guarantee should be devolved to combined authorities and other local areas with an agreed plan for delivery.

- **A 'troubled lives' programme:** Our fragmented system of service provision is failing many adults who face multiple social exclusion. We recommended establishing a programme to join-up services around severely excluded adults, using both homelessness and drug and alcohol services and building on the model of the successful Troubled Families programme. This could be delivered in the spending review by **providing cash-terms protection to the homelessness and public health grants to local authorities, and creating a £100 million annual pot to fund bonus payments to local authorities** that achieve a negotiated set of area-based outcomes among excluded adults.
- **Investing in housebuilding:** The government should begin to reverse the historic decline in public housebuilding by **tripling the budget of the Homes and Communities Agency (and its London equivalent)** in real terms over the next spending review period. These extra funds should be used to increase the supply of new social rented homes to 50,000 per year.
- **Transport investment:** Within the Department for Transport's capital budget, resource should be found to **finance the 'One North' package of integrated investment in road and rail capacity** proposed by northern city leaders in 2014, in order to boost connectivity, economic growth and productivity in the north of England.
- **Investing in energy efficiency:** The government should accelerate investment in energy efficiency measures for low-income households with a further £1 billion of annual capital spending (in addition to the £700 million currently spent). This should be used to ensure that a third-of-a-million fuel-poor homes receive energy efficiency improvements every year, with the aim of upgrading all low-income households – and thereby boosting their living standards – by 2030.

Priority areas for protected spending

The government has announced its intention to deliver protected funding settlements for health, which will receive an extra £8 billion over and above inflation by 2020/21; for education spending on 5–16-year-olds, where flat cash-per-pupil spending will be maintained at current levels; and for international development, the budget for which has been fixed at 0.7 per cent of gross national income. In addition, in the summer budget in July 2015 the government announced a further commitment to annual 0.5 per cent real-terms increases in the Ministry of Defence's current and capital budgets.

In addition to these announced commitments, we also recommend that the following spending protections be implemented.

- **16–19 education:** Spending on 16–19 education within the Department for Education should be **protected on the same basis as schools funding**, as a flat cash-per-pupil settlement. This would help to ensure the financial stability of the FE sector, and prioritise spending on an area of policy that is vital for raising both youth employment and UK productivity.

- **Local government social care:** The **revenue support grant** given by the Department for Communities and Local Government to local government should be **protected in cash terms** so that local authorities do not have to cut other services too deeply in order to meet rising demands for social care. We also propose **protecting the public health grant and the Better Care Fund** (or equivalent funding) in cash terms. This, alongside protection for the revenue support grant, would mitigate the pressure on the NHS that has resulted from the underfunding of social care. We also propose that **the revenue support grant be allocated as a four-year settlement**, with local authorities told at the time of the next funding allocations how much they should expect to receive in each year of the spending review period. This would give them greater certainty and enable them to better plan their service and investment spending.
- **Science:** Because of its importance to UK productivity, economic growth and research and development, the **flat cash settlement for the science budget committed to in the last parliament should be retained**.

Mitigating the cuts to unprotected departments

Under the government's planned spending envelope, implementing the above policies and protections would lead to very severe reductions in spending elsewhere, requiring an average cut of 39.8 per cent in current spending by unprotected, non-devolved government departments. While we have not attempted to model a complete and comprehensive spending review that distributes this average cut across unprotected areas, it is our view that a reduction of funding on this scale is unacceptable, and unlikely to be attainable, as it implies cutting more than two-fifths from areas of government such as criminal justice and adult skills.

We therefore propose reducing the cut to unprotected departments by expanding the spending envelope available in the spending review. This could be achieved through revenue-raising tax measures and alterations to the planned fiscal path, *while still remaining within the government's fiscal mandate*. Specifically, we propose the following measures.

- **Reducing the planned surplus:** The Office for Budget Responsibility projects that the government's current deficit reduction plan will lead to a surplus of £10 billion in 2019/20. We propose **reducing the planned surplus to £7 billion** in order to pay for a more generous settlement for unprotected departments in the final year of the spending review period. In order to smooth the path to this lower surplus, the deficit in 2018/19 should be £2 billion larger than is currently planned. Both of these measures are congruent with the government's fiscal mandate.
- **Aligning the higher rate of capital gains tax with the new, higher rate of dividend tax:** There are strong arguments, made by the Institute for Fiscal Studies (IFS) and others, for dividends and capital gains to be taxed at the same rate (Adam 2007). Following the introduction of the new dividend tax rate of 32.5 per cent for higher-rate taxpayers, **the higher rate of capital gains tax, currently 28 per cent, should be increased** so that the two are equal. This would raise £500 million per year.
- **Increasing tax on insurance premiums:** In the May 2015 budget, the tax rate on insurance premiums was raised to 9.5 per cent. However, as the IFS has argued, there is no good reason for it to be different to the VAT rate (Adam 2015). As an interim step, over the spending review period it should be **increased to 13 per cent**. This would generate £1.5 billion in extra revenue, yet would mean that the UK's insurance premium tax rate remained lower than in other European countries, including Germany.

- **Pensions reform:** The recommendations that emerge from the government's ongoing consultation on the tax treatment of pension savings are unlikely to be implemented in full within this spending review period. In the interim, the government should continue to reduce the unfairness and inefficiency of the way pensions are taxed in the tax treatment of pensions. **The tax-free lump sum** – which allows a quarter of pension savings to be withdrawn tax-free and so disproportionately benefits those on higher incomes – **should be capped as a cash amount**. Similarly, the earnings threshold beyond which the pension contributions annual allowance is tapered away should be reduced. We recommend that a further £3 billion in total be raised from these or similar measures over the spending review period.

If the above measures were implemented, **the real cut in overall departmental spending over the spending review period would be reduced from 3.2 to 0.9 per cent**. Under this scenario, our proposed policies and protections would, between 2015/16 and 2019/20, have the following impacts:[3]

- **overall, non-protected, non-devolved spending would have to fall by 17.6 per cent in real terms**
- **non-protected, non-devolved *capital* spending would rise by 4.3 per cent**
- **non-protected, non-devolved *current* spending would have to fall by 26.3 per cent in real terms** (a trajectory that is broadly similar to that under the government's current plans)[4]

Table S.1
Profile of protected, devolved and non-protected spending (£ billions in 2015/16 prices and cumulative % change, in real terms) under our recommendations in spending review period 2015/16–2019/20

	2015/16	2016/17	2017/18	2018/19	2019/20
Protected spending					
Current spending	£212.6bn	£214.1bn	£216.8bn	£218.8bn	£220.1bn
Real terms cumulative % change		*+0.7%*	*+2.0%*	*+2.9%*	*+3.5%*
Capital spending	£15.8bn	£16.0bn	£16.1bn	£19.6bn	£19.8bn
Real terms cumulative % change		*+1.1%*	*+2.3%*	*+24.3%*	*+25.7%*
Overall	£228.4bn	£230.0bn	£233.0bn	£238.5bn	£240.0bn
Real terms cumulative % change		*+0.7%*	*+2.0%*	*+4.4%*	*+5.1%*
Devolved spending					
Current spending	£48.0bn	£48.0bn	£47.6bn	£47.3bn	£47.1bn
Real terms cumulative % change		*0.0%*	*-0.8%*	*-1.5%*	*-2.0%*
Capital spending	£5.7bn	£5.7bn	£5.7bn	£6.2bn	£6.3bn
Real terms cumulative % change		*+0.5%*	*-0.2%*	*+8.2%*	*+10.8%*
Overall	£53.7bn	£53.7bn	£53.3bn	£53.4bn	£53.4bn
Real terms cumulative % change		*0.0%*	*-0.7%*	*-0.5%*	*-0.6%*
Non-devolved, non-protected spending					
Current spending	£55.5bn	£54.7bn	£48.4bn	£42.9bn	£40.9bn
Real terms cumulative % change		*-1.4%*	*-12.9%*	*-22.7%*	*-26.3%*
Capital spending	£22.0bn	£22.2bn	£21.9bn	£22.1bn	£23.0bn
Real terms cumulative % change		*+0.8%*	*-0.3%*	*+0.4%*	*+4.3%*
Overall	£77.5bn	£76.9bn	£70.3bn	£65.0bn	£63.9bn
Real terms cumulative % change		*-0.8%*	*-9.3%*	*-16.1%*	*-17.6%*

Source: authors' calculations based principally on HMT 2015b and 2015c, and OBR 2015. A full list of sources used in our spending model is included in the annex.

3 These figures are not directly comparable to those given in the first paragraph of this summary as the size of the overall unprotected budget is smaller under our proposed new policies and spending protections.

4 Our choice to propose protections for some areas of spending does not imply that we endorse a 26.3 per cent cut in the budgets of departments such as the Home Office, the Ministry of Justice and the Department for Business, Innovation and Skills. This cut is required because of the unnecessarily tight fiscal path planned by the government, which, as mentioned above, we do not support.

The profile for spending in protected and unprotected areas under our recommended scenario is illustrated in table S1, alongside the impact that these settlements would have on the departmental budgets of the devolved nations (determined by the changes in those departments' spending and how this interacts with the Barnett formula).

Conclusion

This will be a difficult spending review. The relatively easy savings have already been made, which means that the next phase of deficit reduction will have to make deep cuts into public services. Nevertheless, the government does have meaningful options at hand as it plans and delivers the spending review. If it is approached as an opportunity to reform public services to make them more responsive to the needs of local areas and individuals through devolution and integration, as well as to support employment and productivity, then the spending review has the potential to improve outcomes as well as generating genuine savings. This would be a far better approach than a salami-slicing exercise that hands out cuts to government departments with little regard for how they will be achieved.

Once the difficult task of eliminating the deficit is complete, the settlement outlined in this paper can be built upon to prepare the UK for the economic, demographic and social challenges of the 2020s. A sustainable long-term funding settlement for health and social care is unlikely to be delivered in this spending round, but it should be a priority for the future, and should be delivered through the creation of a hypothecated revenue stream such as an 'NHS tax'. Similarly, further fiscal devolution that allows local areas to raise more revenue will not only allow devolved services to recover following a decade of spending squeezes, but will increase their resilience against any future cuts in central government funding. Central government should also seek to stabilise the tax base through the introduction of fair taxes on land values, and an internationally agreed financial transactions tax. Lastly, the coverage and generosity of the recommendations presented in this report, such as the youth guarantee and greater entitlements to free childcare, should be extended when the fiscal environment allows.

1. INTRODUCTION

The government faces important choices on public spending. It is committed, through the recently revised fiscal mandate,[5] to eliminating the deficit (the gap between overall public spending and revenues) by 2019/20 – and, indeed, to achieving a surplus on the overall budget in that year. Achieving this objective will require another four years of historically low spending growth across all areas of government. At the same time, the government's pledge to protect key public services such as 5–16 education and the NHS from inflation implies the need for even tighter spending squeezes elsewhere.

These challenges will have to be met in the upcoming spending review, scheduled for publication on 25 November 2015. In setting limits on departmental spending over a period of several years, the spending review will determine to a large extent the parameters of funding available to government departments, local authorities and public services. This makes it the key point at which the government's policy ambitions will have to be reconciled with its deficit reduction target.

1.1 Principles for the spending review

Just as importantly, a spending review marks the point in the fiscal and political cycle at which spending can best be reoriented across government. IPPR's Condition of Britain programme, the final report of which was published in June 2014, set out a series of principles for social policy reform in the coming years (Lawton et al 2014). The starting point for the project was the identification of the range of economic, social and demographic challenges that face the UK, and to which successive governments have failed to develop an adequate response. These include the decline of homeownership, increasing levels of youth unemployment, the rising cost of childcare, and entrenched social exclusion.

Past policy responses to these challenges have tended to fall into two camps: a free-market approach that prioritises the introduction of market mechanisms into public services in order to drive better outcomes; and an overly centralised culture of targets and standardised delivery, accompanied by cash transfers in order to ameliorate the symptoms of market failure. While each approach has successes that can be pointed to, neither has proven to be up to the task of fundamentally tackling the challenges facing the country.

There is substantial scope for government to achieve savings by tackling these challenges in the right way. Building on the account presented in *The Condition of Britain* (ibid), we have identified four key principles for the upcoming spending review.

Invest in services that support employment and productivity

A substantially higher structural level of employment in the UK would, through higher tax revenues, ease the long-term funding pressures on the state. Furthermore, given the upcoming cuts and freezes to in-work benefits announced in the July 2015 budget, future growth in family incomes will rely on increases in hours worked, and on sustained wage growth. Spending that supports labour market outcomes, especially among parents and the young, must therefore be a priority. The spending review should also address the issue of the UK's productivity performance, which in

5 The fiscal mandate, the latest iteration of which was published at the July 2015 budget, is defined as 'a target for a surplus on public sector net borrowing by the end of 2019-20' and 'a target for public sector net debt as a percentage of GDP to be falling each year' (HMT 2015a: 7).

recent years has been poor in relation both to those of other comparable economies and to its pre-crisis level (Dolphin and Hatfield 2015). To do so will require a focus on spending that has been proven to improve productivity, such as investment in science and transport.

Prioritise preventative spending

Too much public expenditure is devoted to dealing with the symptoms of market failure, and ameliorating the effects of market forces, rather than preventing these outcomes in the first place. We spend a great deal subsidising ever-rising rents through housing benefit, for example, without having a coherent strategy for reducing those rents. Similar arguments can be made in relation to the growing price of childcare and to entrenched social exclusion and worklessness.

These issues are unlikely to be resolved by sustained economic recovery alone. Rather, they necessitate deep reforms to welfare and public services, including upfront investment in social housing in order to reduce housing benefit expenditure; funding a job guarantee to reduce long-term unemployment; and increasing the supply of childcare services that are free or affordable at the point of use, moving away from providing cash transfers to parents to cover their childcare usage. IPPR's *Condition of Britain* report made a series of recommendations along these lines, and included proposals for how they could be funded by switching spending out of cash welfare payments and into public services and investment (Lawton et al 2014). These proposals have the potential to deliver substantial savings. However, putting in place the funding streams required to realise these savings, and planning for welfare reforms and tax rises, requires the longer-term perspective that a spending review offers.

Integrate services

Many areas of expenditure are too heavily siloed within government departments. For example, control of apprenticeships and other adult training sits with the Department for Business, Innovation and Skills, whereas back-to-work support is overseen by the Department for Work and Pensions – yet both are (or should be) complimentary in terms of pursuing strategies to reduce worklessness. Such divisions extend to frontline public services: the institutional separation of the NHS from social care makes it harder to work across both services in order to secure better outcomes for users; similarly, the lack of a joined-up approach that cuts across homelessness, drug and alcohol and probation services results in fragmented experiences for those whose needs span across service boundaries. Greater pooling of budgets in all areas of public spending has the potential to ease funding pressures by reducing bureaucracy and duplication, and to improve the quality of public services by interacting with users in a more coherent way. Achieving this will require substantial reform of service delivery as well as the integration of budgets in the next spending round.

Devolve powers and budgets

Control over the levers of spending is too often concentrated in central government. Where spending has been devolved in recent years, it has in many cases been accompanied by overly prescriptive targets and a lack of flexibility in terms of how these devolved funds can be used. While there will always be a need for key priorities and entitlements to be set from the centre, local areas should have greater freedom and flexibility to allow them to focus on improving public service delivery. The capacity of local governments in different areas to take on more responsibility does vary, however. Staged devolution deals in the next parliament will allow those areas with sufficient ambition and resources to take on greater powers earlier than other areas. The next spending review should therefore look to build on the track record of the previous, Coalition government, which devolved spending in a range of areas through the City Deals programme and the subsequent Greater Manchester and Sheffield agreements. It could do this by earmarking budgets in key areas to be covered in negotiations within the city- and county-deals process.

1.2 The government's priorities for the spending review

In July 2015, the government launched the spending review process with the publication of *A country that lives within its means* (HMT 2015d), which sets out its priorities for the upcoming spending review. Beyond specific plans for the NHS, defence, schools and international development, they identify five key outcomes that will be used to prioritise spending.

- **Promoting innovation and collaboration in public services**, citing both the Troubled Families programme and integration of health and social care as models that can be built upon or extended in the upcoming spending review.
- Promoting growth and productivity, including through further devolution to city regions, the devolved nations, and England.
- **Delivering high quality public services**, including school improvements and a 'seven-day NHS'.
- **Promoting choice and competition** by reforming the markets that deliver public services, and modernising the regulation of service delivery and payments for services.
- **Driving efficiency and value-for-money**, for example through the sale of assets and improved financial management (adapted from HMT 2015d).

Taken at face value, these are largely sensible outcomes to focus on, and they overlap substantially with our priorities; the government's commitments to reform public services so that they are more integrated, and to devolve greater powers across the UK, are particularly welcome. However, there is little acknowledgement of the fact that spending can and should be shifted to make it more preventative, and that early intervention does not just improve outcomes but also generates substantial savings to the public purse. Promoting employment is also not mentioned as a priority for the upcoming spending round – a particularly surprising omission given the government's target to create 2 million new jobs over the course of this parliament, and for the UK's employment rate to become the highest in the G7. Similarly, productivity growth will not come from devolution alone: it requires strategic public investment in growth-enhancing areas such as transport and science.

1.3 The structure of this paper

The need to shift government spending so that it is more preventative, integrated and devolved, and that it also fosters employment and economic growth, can only be met through a strategic and reforming spending review. This report sets out how such a spending review should be approached, within the tight fiscal rules adopted by the government. We do this by modelling a series of policies and additional spending protections that deliver on the above priorities in the context of the planned path for departmental spending. This paper does not attempt to model a full and comprehensive spending review. Rather, it highlights particular policies and protections that should be explored by the government as they negotiate departmental settlements.

The report proceeds as follows. First, we review the overall fiscal envelope as set out by the government and the Office for Budget Responsibility (OBR) at the time of the July 2015 summer budget. We then discuss which areas of spending should be protected, and at what level. We then look at how other key recommendations from IPPR's *Condition of Britain* report and other projects could be delivered in a spending review. Finally, we summarise our proposed spending plans and the impacts that they would have on other areas of departmental spending, before exploring how these impacts could be mitigated through tax rises and by targeting a lower surplus while still delivering on the government's fiscal mandate.

2.
BACKGROUND TO THE UPCOMING SPENDING REVIEW

The upcoming spending review will seek to distribute an overall spending envelope, consistent with the government's fiscal mandate, among government departments. While this summer's budget did not formally set out the parameters of the spending round, it did clarify the expected path of public spending in some detail, and announced policies – including swingeing cuts to tax credits – that are projected to deliver savings that together account for just under half of those required to eliminate the deficit (HMT 2015d). Subsequently, HM Treasury announced that the spending review will set expenditure limits for individual departments from 2016/17 through 2019/20. This chapter summarises the government's overall fiscal trajectory, before turning to the savings required from government departments and what this implies for the spending review.

Terms used in this chapter

The **deficit** is public sector net borrowing, equal to the difference between total receipts and total managed expenditure.

Public spending, or total managed expenditure (**TME**), is made up of two key components:

- Annual managed expenditure (**AME**) includes welfare payments such as the state pension, and interest payments on government debt.
- Departmental expenditure limits (**DEL**) includes funding for government services such as the NHS and schools, as well as the costs involved in running government departments.

There is also an important distinction to be drawn between 'current', day-to-day spending and 'capital', or investment, spending within DEL. In this chapter we use the terms **CDEL** to refer to departmental *capital* expenditure, and **RDEL** to refer to departmental *current* (or 'resource') expenditure.

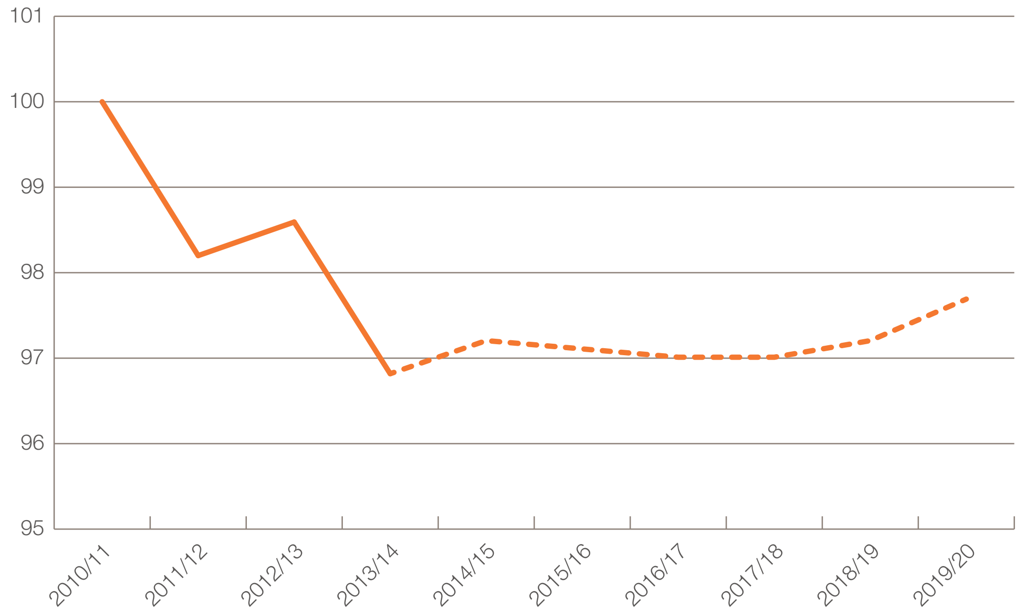
2.1 Forecasts of public spending

The government's fiscal mandate, revised at the July 2015 budget, requires it to achieve a surplus of receipts over expenditure in 2019/20. Once this has been achieved, it will be required to run a surplus in each subsequent year, subject to there being sufficient growth in the economy.[6] Furthermore, the mandate specifies a supplementary target for debt to be falling in each year to 2019/20. The July 2015 budget set out a path for the deficit that is consistent with these fiscal rules, which sees the forecast deficit of £69.5 billion in 2015/16 turn into a surplus of £10 billion in 2019/20.

This implies a relatively flat path of TME between 2015/16 and 2019/20 (see figure 2.1). Relative to 2010/11, when the previous, Coalition government published its first spending review, TME will have fallen by 2.3 per cent in real terms. Over the likely spending review period (2015/16–2019/20), it is projected to grow by 0.6 per cent, amounting to an increase of £4.5 billion in TME spending in real terms. Yet because the economy is forecast to grow faster than government spending, TME will fall as a percentage of GDP from 39.6 to 36.3 per cent (OBR 2015).

6 This requirement to maintain a surplus is contingent upon real GDP growth equalling at least 1 per cent on a rolling four-quarter-on-four-quarter basis.

Figure 2.1
TME is expected to remain relatively flat in real terms over the spending review period
*Real total managed expenditure (2010/11 = 100), 2010/11–2019/20**



Source: OBR 2015
*Note: the figure for 2014/15 is an estimate; figures from 2015/16 onwards are forecasts.

Our proposed fiscal rules

In a recent paper (Dolphin 2014a), IPPR proposed a set of fiscal rules for the government that included the introduction of the following measures:

- a target to reduce public debt to 70 per cent of GDP by 2025/26
- a target to reduce non-cyclically adjusted public sector net borrowing as a percentage of GDP, over a rolling five-year time horizon, so that the above debt target is reached (this would entail a reduction in public sector net borrowing to 1 per cent by 2020/21)
- the separation of the rules concerning the reduction of debt from those for investment spending, allowing net investment spending to rise to 2 per cent of GDP by 2020/21.

Taken together, these fiscal rules would result in a gradual year-on-year reduction of the deficit, consistent with a sustainable path for public spending and the reduction of public debt. However, it would also, crucially, be sensitive to the economic cycle due to the rolling nature of the deficit target. We also believe that the importance of investment spending warrants it rising – within these debt and deficit rules – as a proportion of GDP from its current level of around 1.4 per cent of GDP to 2 per cent by 2020/21 (ibid).

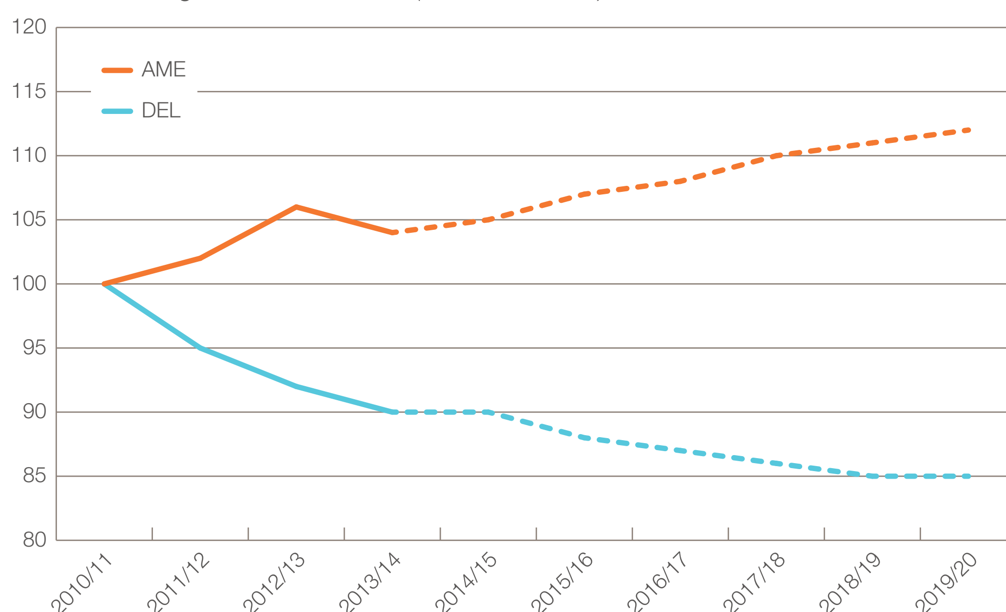
Following this path would be preferable to the government's plans, which seek to balance the budget by a specific year (2019/20) rather than over a rolling time-horizon, implying a low rate of growth for public spending in the intervening years. Our preferred path of spending still ensures a current budget balance by the end of the parliament, and is consistent with the aim of having public debt fall as a share of GDP.

For the purposes of this report, however, we assume that government remains committed to its fiscal mandate as set out in the July 2015 budget.

The OBR uses the TME projection illustrated in figure 2.1 above to calculate the expected paths of AME and DEL spending. These paths are based on forecasts of the economy's performance and its impact on AME spending; they also take into account policies affecting AME spending that were announced in the most recent budget, as

well as those outlined earlier. The expected paths of both AME and DEL, relative to their level in 2010/11, are illustrated in figure 2.2 below. AME is expected to grow by £17.1 billion in real terms over the spending review period – a rise of 4.4 per cent, despite the cuts to the welfare and other areas of AME spending announced in the budget. While these cuts are expected to reduce AME spending by £12 billion in cash terms in 2019/20, other upward pressures on the AME budget, such as the 'triple-lock' on the state pension, mean that it is nonetheless forecast to grow over this parliament. DEL spending, on the other hand, will fall by 3.7 per cent (£12.9 billion) in real terms over the spending review period. This amounts to a cumulative fall in DEL spending of 15 per cent in real terms between 2010/11 and 2019/20, compared to a real-terms growth of 13 per cent in AME spending (OBR 2015).[7]

Figure 2.2
The AME budget is expected to grow despite cuts to welfare spending, while DEL spending will continue to fall
Forecast change in AME and DEL (2010/11 = 100), 2010/11–2019/20, in real terms*



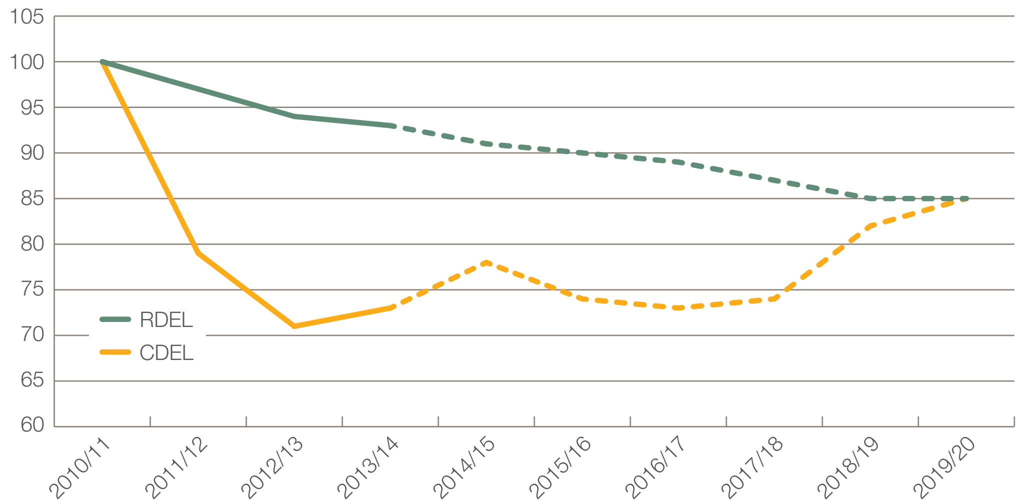
Source: OBR 2015
***Note: figures for 2014/15 are estimates, and for 2015/16 onwards are forecasts.**

The budget provided only an indicative level for DEL, and for the split within DEL between RDEL and CDEL, although it did state the government's assumptions about how total capital spending will change. It plans for public sector gross investment (the sum of both capital AME and capital DEL) to be constant in real terms in 2016/17 and 2017/18, before growing in line with GDP from 2018/19 (HMT 2015c: 75).

Figure 2.3 below shows the expected path of both RDEL and CDEL up to 2019/20. RDEL is forecast to continue falling at a similar same rate as in the last parliament, declining over the spending review period by 17.6 per cent in real terms. CDEL, on the other hand, is expected to grow, as is suggested by the government's indicative plans for investment spending: although it will fall slightly in 2016/17 and 2017/18, it will then grow significantly in the subsequent two years, with an overall rise between 2015/16 and 2019/20 of 14.4 per cent (OBR 2015).

7 These figures are not directly comparable to estimates for DEL outside of this chapter. This is due to differences in the precise definitions used for different spending classifications by the Treasury and the OBR respectively, as well as the OBR's allowances for shortfalls in departmental expenditure limits.

Figure 2.3
RDEL is expected to continue to fall steadily, whereas CDEL will rise over the spending review period
Forecast path of RDEL and CDEL (2010/11 = 100), 2010/11–2019/20, in real terms*



Source: OBR 2015
***Note: figures for 2014/15 are estimates, and for 2015/16 onwards are forecasts.**

It is important to note that these figures are only indicative, and may change during the spending review process. A particular issue is that departments have been asked to look closely at their asset holdings in order to ascertain where revenue can be raised through asset sales. If they are recycled into capital expenditure, asset sales could unlock extra resources for investment but without necessarily changing the overall profile of CDEL.[8]

How do these cuts compare to those made in the last parliament? Between 2010/11 and 2015/16, RDEL fell by an average of 2.1 per cent per year, and CDEL by 5.2 per cent, whereas between 2015/16 and 2019/20 RDEL will fall by an average of 1.4 per cent per year, and CDEL will *grow* by an average of 3.6 per cent (albeit with most of this growth being concentrated in 2018/19 and 2019/20) – all in real terms. The pace of cuts to RDEL is therefore likely to slow in the next spending review, with the cuts to CDEL partially reversed. Nevertheless, both RDEL and CDEL will have fallen by a cumulative 15 per cent in real terms between 2010/11 and the point at which the deficit is expected to be eliminated in 2019/20 (OBR 2015).[9]

2.2 The impact of this fiscal trajectory on the spending review

The spending review will look to distribute the fall in RDEL and the rise in CDEL across government departments. Were the fall in RDEL to be distributed evenly among government departments, each would face a cumulative, real-terms fall in funding of 5.1 per cent between 2015/16 and 2019/20.

However, the government has stated publicly that some areas of departmental spending will be protected. Four departmental protections are expected to feature in the spending review.

8 Asset sales are netted off departmental capital budgets. For example, if in a given year a department has £2 billion of capital expenditure but raises revenue through asset sales totalling £1 billion, its total capital expenditure in that year would be recorded as £1 billion (OBR2011).

9 These figures are not directly comparable to estimates for DEL outside of this chapter. This is due to differences in the precise definitions used for different spending classifications by the Treasury and the OBR respectively, as well as the OBR's allowances for shortfalls in departmental expenditure limits.

- **Health** – the Department for Health DEL budget will be protected from inflation, and provided with an extra £8 billion on top of inflation by 2020; this is in addition to the £2 billion extra the NHS received for 2015/16.[10]
- **5–16 education** – resource spending on 5–16 education will be protected on a flat cash-per-pupil basis over this parliament.
- **International development** – the Department for International Development (DfID's) DEL budget will be held at 0.7 per cent of gross national income over this parliament.
- **Defence** – the Ministry of Defence's DEL budget will increase by 0.5 per cent a year in real terms over this parliament (HMT 2015d).

This implies that a little over half of all DEL spending is protected, and that spending outside of these protected areas will therefore have to take percentage cuts that are more than twice as large as the overall fall in DEL spending. Table 2.1 illustrates this by comparing the cumulative change required to the DEL budgets, as well as the CDEL and RDEL budgets, of the protected areas set out above, of unprotected departments, and those of the devolved nations[11] (Scotland, Wales and Northern Ireland, for which funding is determined according to the Barnett formula) in order to meet the government's overall DEL spending envelope.

Table 2.1
Cumulative change (%) in DEL budgets of protected, unprotected and devolved departments required to meet the government's overall DEL spending envelope, 2015/16–2019/20, in real terms

	2015/16	2016/17	2017/18	2018/19	2019/20
Protected departments					
Total DEL	-	+1.0%	+2.0%	+2.9%	+3.9%
RDEL	-	+1.0%	+1.9%	+2.9%	+3.8%
CDEL	-	+1.1%	+2.3%	+3.5%	+4.6%
Unprotected departments					
Total DEL	-	-2.7%	-10.7%	-14.0%	-16.4%
RDEL	-	-3.7%	-13.9%	-22.3%	-26.5%
CDEL	-	+0.8%	-0.1%	+14.2%	+18.2%
Central government allocations to the devolved nations					
Total DEL	-	-0.4%	-1.9%	-2.2%	-2.5%
RDEL	-	-0.5%	-2.1%	-3.5%	-4.2%
CDEL	-	+0.5%	-0.2%	+9.4%	+11.9%

Source: authors' calculations based principally on HMT 2015b and OBR 2015. A full list of sources used in our model is included in the annex.

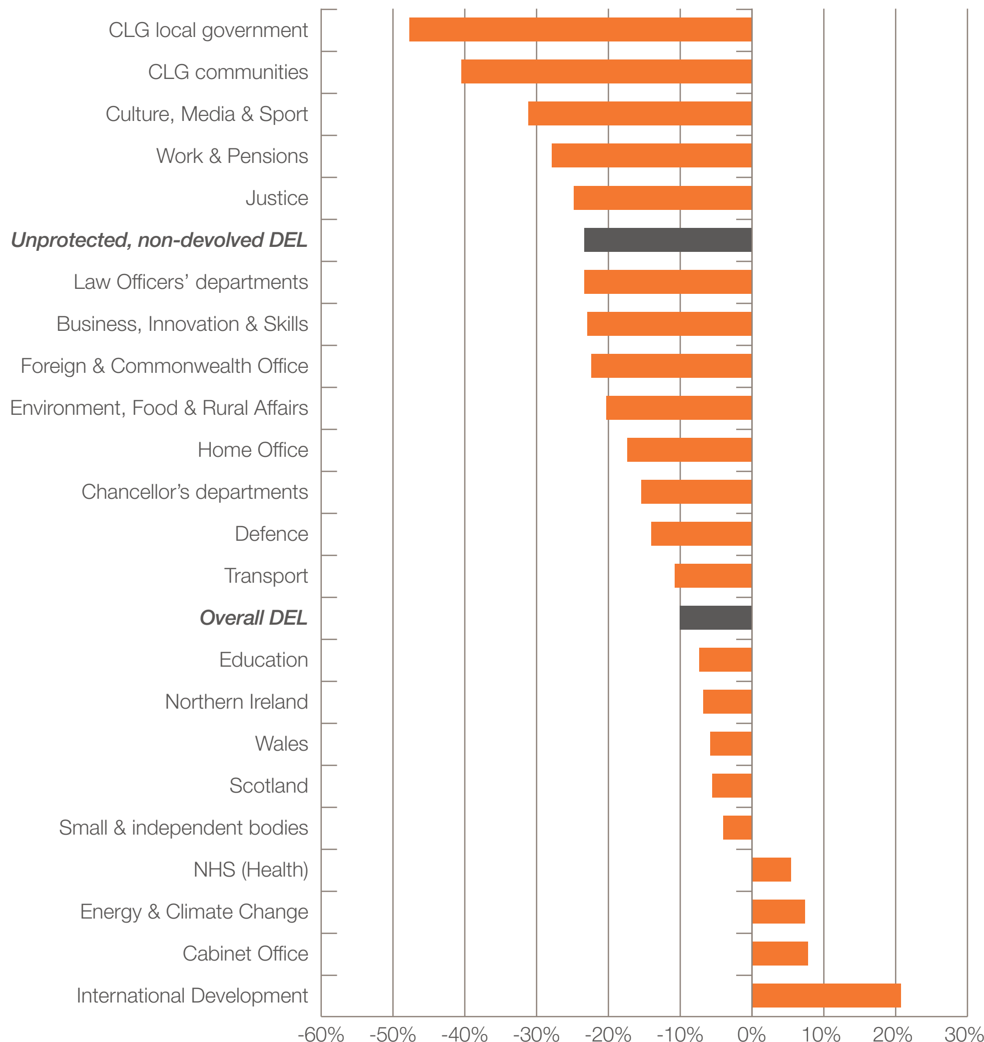
This shows that the average DEL cut across unprotected departments will be 16.4 per cent over the spending review period. Excluding the impact of rising capital spending, RDEL will face a cumulative cut of 26.5 per cent. The devolved nations will see a smaller cut of 4.2 per cent in RDEL in real terms, due to the relative importance of health and 5–16 education spending to their overall settlement.[12]

10 The government has not said how quickly this £8 billion will be delivered. Here we have assumed that it will be increased in equal increments across the current parliament, so that by 2020/21 the DH budget will be £8 billion higher than it would have been had it only increased in line with projected inflation.

11 Year-on-year changes in the budgets of the devolved nations are determined by changes to central government departments, and the relative share of devolved areas of spending within each of them. Because health, for example, is fully devolved, a generous settlement for the NHS in England leads to a proportionately smaller overall cut in the budgets of devolved nations relative to unprotected central government spending

12 See previous footnote.

Figure 2.4
The depth of cuts to departmental budgets during the last parliament varied considerably between departments
Cumulative real-terms change (%) in departmental budgets, 2010/11–2014/15



Source: HMT 2015b

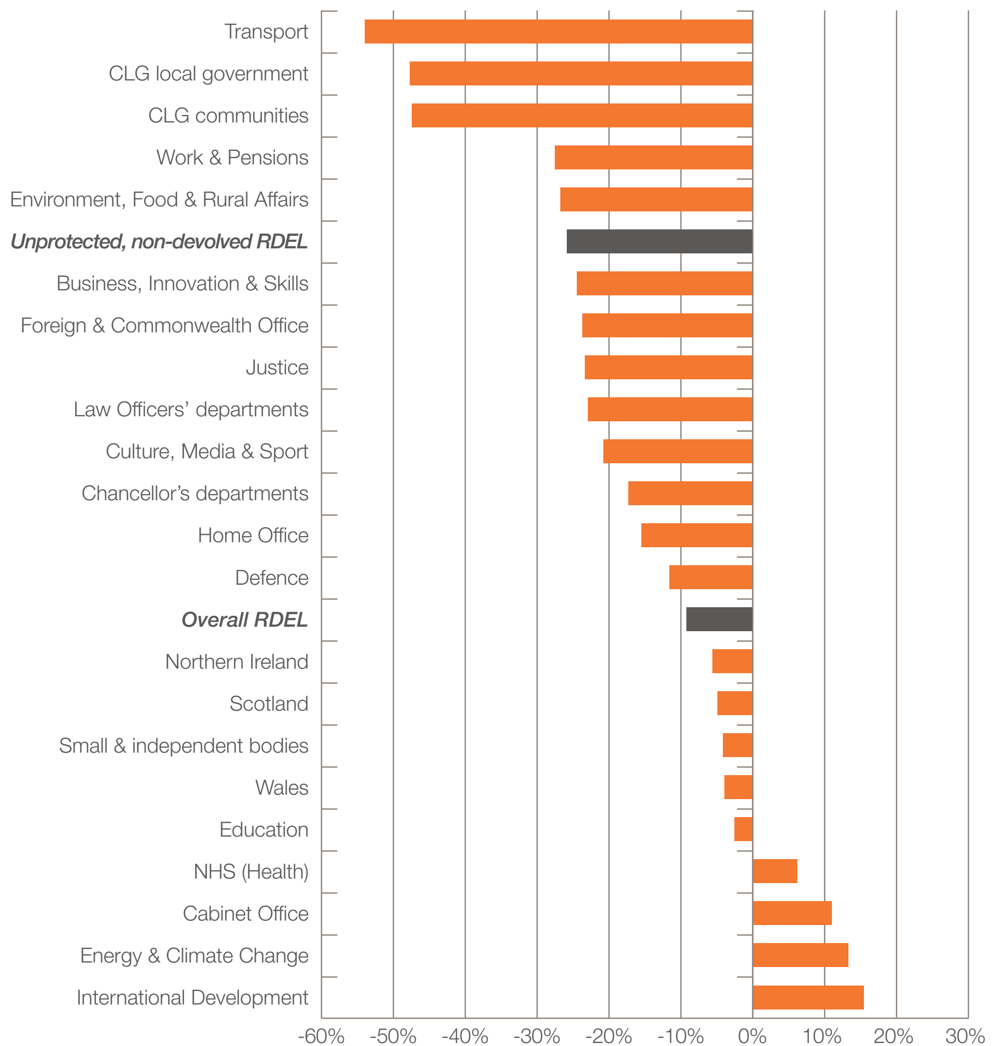
Unprotected CDEL is projected to grow slowly in 2016/17, with a slight fall in 2017/18. Yet by 2018/19 it is projected to have grown by 14.2 per cent relative to 2015/16. There are two reasons for this large increase: the government's commitment to increase capital spending in line with economic growth in both 2018/19 and 2019/20, and a projected fall in AME capital spending in 2018/19.[13] By the end of the spending review period, unprotected CDEL is projected to have increased by 18 per cent – a much higher increase than CDEL in protected departments of International Development, Defence and the NHS, each of which has an expected path for capital spending (assuming that the governments' stated protections extend to capital in these

13 The OBR estimates capital DEL as the residual between its forecasts for capital AME and for total investment spending. The government's policy is to increase total investment in line with GDP from 2018/19. But the OBR also expects the AME component within this figure to fall in that year, including a £1.2 billion cash-terms fall in Network Rail capital expenditure (classified as AME investment within the Department for Transport), and a £1.7 billion fall in locally-financed capital expenditure (also classified as AME investment). This means that capital DEL – the difference between increasing overall spending and falling AME spending – by definition increases significantly (OBR 2015).

departments). This relatively weak settlement for protected departments' CDEL budgets will impact on the budgets of Scotland, Wales and Northern Ireland, which include spending in both protected and unprotected areas.

How does this compare to what happened during the last parliament? Figure 2.4 (above) shows the cumulative real-terms change in DEL for government departments between 2010/11 and 2014/15 (the 2010 spending review period). There was a reduction of 10 per cent in overall DEL, whereas the cuts to non-devolved, unprotected departments added up to 24 per cent.[14] The cumulative cuts to DEL varied considerably between departments: the DEL budgets of the Department for Energy and Climate Change (DECC), the Department of Health (DH), the Department for International Development (DfID) and the Cabinet Office actually increased. Among those departments that did experience cuts, these ranged in size from 7 per cent for the Department for Education (DfE) to 48 per cent in the Department for Communities and Local Government (DCLG's) local government budget (HMT 2015b).

Figure 2.5
Transport, local government and communities suffered by far the largest cuts to their RDEL budgets during the last spending review period
Cumulative real terms change (%) in RDEL, 2010/11–2014/15



Source: HMT 2015b

14 The Ministry of Defence was not protected in the 2010 or 2013 spending rounds.

Figure 2.5 shows the equivalent figures for RDEL. Across all unprotected departments, RDEL fell by 26 per cent in real terms – a similar figure to the 27 per cent cut in RDEL that we project for the upcoming spending review period. The largest cuts by far were made to the Department for Transport's budget, which fell by 54 per cent, and to the DCLG's communities and local government budgets, which fell by 47 and 48 per cent respectively. Similar to our projection for the upcoming spending review, the devolved nations' budgets experienced cuts of between 4 and 6 per cent, which are small relative to the cut to overall DEL (PESA 2015).

The upcoming spending review is likely to produce a similar variation in departmental settlements. While we know the likely cut in overall and resource-unprotected departmental spending, how this cut will be distributed across departments is not yet known. The government may choose to redistribute the focus of cuts away from those departments, such as local government and transport, that experienced very sharp decreases in funding during the last parliament. Alternatively, the settlement in the last review for departments such as the Home Office – which between 2010/11 and 2014/15 experienced a modest cut relative to other unprotected areas of spending – may indicate that spending in those departments is more difficult to cut, and that we are therefore likely to see a similar distribution of spending reductions over the upcoming spending review period.

2.3 Conclusion

The analysis set out above illustrates the challenges that the government faces as it prepares the upcoming spending review. While the pace of departmental spending reductions overall will slow slightly relative to the last parliament, a combination of the government's chosen fiscal path as well as planned spending protections mean that cuts of over a quarter will need to be made in unprotected areas of current spending. This is likely to cut deep into budgets and affect the delivery of public services.

The following chapters set out our proposals for policies that the government should look to implement in the upcoming spending round, and which build on the policy recommendations published in the *Condition of Britain* report (Lawton et al 2014) and in other recent IPPR publications. Our recommendations can be grouped into two categories: those for specific policies that will require new resources, and those that make the case for a set of broad areas of spending that should, we argue, be protected from the cuts to unprotected departments. In chapter 6 we consider how these proposals would affect the likely spending review settlement for other unprotected government departments, and lay out options for how these impacts could be mitigated against through tax increases and by altering the planned deficit and surplus in a way that is consistent with the government's fiscal mandate.

3. HEALTH AND SOCIAL CARE SPENDING

3.1 NHS and social spending in the last parliament

Perhaps the most important public service challenge in the current parliament is putting both the NHS and the social care system on a more sustainable footing, in terms of both funding and the need for reform.

The 2010 spending review planned for a 0.34 per cent real-terms rise in NHS funding by 2014/15. Because of lower-than-expected inflation and additional funding secured in 2014/15, the total real percentage rise in NHS funding over this period was 3.95 per cent, which represents an average annual increase of 0.97 per cent. While this rise is greater than those for other departments over the same period, it is substantially lower than the growth in NHS funding over the previous decade – it increased at an average of 5.6 per cent per year in real terms between 1996/97 and 2009/10 (Appleby et al 2015).

While the settlement for the NHS in the 2010 spending review was generous relative to those of other departments, some of this funding was transferred to local authorities to fund social care provision. The King's Fund estimate that £3.8 billion in transfers to local authority social care reduced the total real increase in NHS funding to 3.01 per cent over the period, or 0.75 per cent a year (ibid).

These transfers were necessary to respond to growing demands on the social care system. Between 2010/11 and 2013/14, local authorities maintained funding for adult social care in cash terms at between £14 and £15 billion per year. Yet had this expenditure risen in line with demography and inflation it would have been over £17 billion in 2013/14 (LGA and ADASS 2014). The shortfall has been coped with, according to a report by the Local Government Association (LGA) and the Association of Directors of Adult Social Services (ADASS), through efficiency savings (82 per cent), cuts to services (13 per cent) and charges to users and other income (5 per cent) (ibid). Furthermore, local authorities have only been able to maintain spending at this level (of between £14 and £15 billion), as opposed to cutting further, by cross-subsidising it from other areas of local government spending, and through the NHS transfers to local government mentioned above.

The income from which local authorities fund social care comes from user charges, non-ringfenced central government grants, transfers from the NHS, and locally-raised revenue such as council tax. Other than their ringfenced grants for schools, emergency services and housing benefit, local authorities' income from central government has fallen by over a third in real terms. While their income from council tax has risen slightly, they have nevertheless had to cut spending by 20.4 per cent in real terms between 2009/10 and 2014/15[15] (Innes and Tetlow 2015).

15 This figure excludes police and fire and rescue, education, public health and the new social care responsibilities assigned to local authorities.

3.2 The outlook for the NHS

Over the current parliament both the NHS and the social care system will be put under further pressures in terms of both demand and funding. NHS England has estimated that even if the NHS budget is increased in line with inflation throughout the current parliament, the service will face a £30 billion funding shortfall in cash terms by 2020 (NHS England 2014). Potential increases in productivity could reduce this shortfall, with one study finding that if the NHS attained annual productivity growth of between 2 and 3 per cent, it would fall to £8 billion (Roberts 2015a).

The government has given the NHS an extra £2 billion of funding in 2015/16, and in the July 2015 budget it committed to delivering the additional £8 billion a year funding in real-terms by 2020/21. We do not yet know whether it will be front- or back-loaded[16] (Roberts 2015b). This choice will affect the total amount of resources diverted to the NHS from unprotected areas of spending. In what follows, we assume that the DH budget is increased by the same rate every year (that is, no front- or back-loading).

Since the Stevens review reported at the end of 2014, several changes have occurred that suggest that the NHS may need more resources over this parliament. First, the government is committed to delivering a 'seven-day NHS'. Estimates by NHS England suggest that this move alone could increase costs to NHS trusts (outside London) by between 1.5 and 2.0 per cent (NHS England 2013). Second, a recent report by the King's Fund and the Health Foundation argued that the NHS cannot achieve the required productivity savings of 2–3 per cent without upfront investment (additional to the £8 billion) of between £1.5 and £2.0 billion per year, delivered through a ringfenced transformation fund. Finally, the Carter review of NHS productivity and procurement identified only £5 billion in potential savings – far short of the £22 billion required to meet the Stevens review's target for productivity gains (Campbell 2015). This has reportedly led NHS leaders, including Simon Stevens, to revise down their ambitions for productivity gains in the service, and to accept that £15 billion is the most that can be saved – which implies that an extra £7 billion in funding, over and above the £8 billion already committed, will need to be found (ibid). Other health experts have also cast doubt on whether the required productivity increases can actually be achieved. One report by the Health Foundation argued that productivity growth of around 1.5 per cent would be a more realistic goal that is consistent with the NHS's recent performance, but this would result in a larger shortfall, of £16 billion, by 2020/21 (Lafond et al 2015).

The government's position, however, remains unchanged thus far. It has repeated its commitment to providing the NHS with an extra £8 billion in resources in real terms, on top of the £2 billion provided this year. It may be the case, of course, that they revise this figure ahead of the spending review, or that as happened under the last government, extra resource is found part-way through the parliament.

Because of the competing claims set out above, it is hard to judge the level of funding that the NHS requires over the spending review period. For the purposes of our calculations, we have assumed that the government's commitment to providing the additional £8 billion annually is met by the end of the parliament in 2020/21, and that the DH's budget is increased by the same rate every year in order to reach that figure. If additional resources are required, the government should look to meet this need by raising tax revenue, either through general taxation or the creation of a hypothecated tax revenue stream,[17] rather than reallocating resources from unprotected departments.

16 That is, whether it will rise faster in the earlier years than the later ones, vice-versa, or neither.
17 See http://www.ippr.org/nicks-blog/lets-talk-about-tax-and-why-the-nhs-needs-it

3.3 The outlook for adult social care funding

The funding outlook for adult social care is more uncertain than that for the NHS. Local authorities plan £14.1 billion in net expenditure on adult social care in 2015/16, funded by NHS transfers to local government and through other income.[18] ADASS estimate that in 2015/16, local authorities will receive £1.1 billion via the Better Care Fund transfer from the NHS (LGA and ADASS 2014). Local authorities' general income, which is used to fund non-ringfenced services, is determined by the grants they receive from central government, and by the income they receive from council tax and retained business rates. In 2015/16 this general income came to £54.6 billion in total (OBR 2015).

Assuming that current levels of adult social care provision in England could be maintained if spending were to rise in line with both prices and the growth rate of the 65-and-over population, spending would have to increase in cash terms from its planned 2015/16 level of £14.1 billion (DCLG 2015a) to £16.3 billion in 2019/20 (authors' calculations using OBR 2015 and ONS 2014). Our projections – based on OBR forecasts for council tax and business rates income (OBR 2015), and assuming local authority current grant income (outside the DH) is cut in line with the average cut for unprotected departments – indicate that local authorities' unrestricted income will rise in cash terms from £54.6 billion in 2015/16 to £55.5 billion in 2019/20. Social care, if fully funded, will take up an increasing share of local authorities' non-ringfenced current spending, rising from 24 to 27 per cent. This would imply that the funding available for other services will fall by 3.3 per cent in cash terms, or 10.2 per cent in real terms.

This will be an underestimate if the government looks to cut the DCLG's RDEL budget by more than the average cut to unprotected departments, as it did in the last parliament. Over the 2010 spending review period, the DCLG's local government budget fell by 48 per cent in real terms. If this were repeated over the next spending review period and reflected in a proportionate cut in the revenue support grant that local authorities receive out of this budget, fully funding adult social care would mean that spending on other services would have to fall by 17.7 per cent in cash terms (or 23.6 per cent in real terms).

Furthermore, if the introduction of the new 'national living wage' has a disproportionate impact on the cost of providing adult social care services then this will also increase the share of non-ringfenced local authority spending that would have to go towards social care. One estimate suggests that between 50 and 60 per cent of frontline social care workers will benefit from this new minimum wage for over-25-year-olds, with an additional annual cost to government of £1.3 billion by 2020 (in 2015/16 prices) (Gardiner 2015). This additional cost implies that to fully fund social care, spending on other services would have to fall by approximately 6.4 per cent in cash terms, and 13.1 per cent in real terms, between 2015/16 and 2019/20 (assuming that grants fall at the same rate over this spending review period as *average* unprotected spending did in the previous one), or 20.8 per cent in cash terms and 26.5 per cent in real terms (if grants fell by 48 per cent, as described above).

The key question for adult social care funding is whether the impact that it has on other local authority services could be reduced. We propose three measures that could achieve this.

- Flat-cash protection for the public health grant to local authorities over the spending review period, and the removal of the ringfence on the public health grant, to afford local government more flexibility over how they plan spending on adult social care and other services.

18 Local authorities also receive income from user charges for adult social care. These are netted off local authority expenditure on adult social care in the government's published local authority spending data.

- Flat-cash protection for the Better Care Fund, or an equivalent amount, over the spending review period.
- Flat-cash protection for the revenue support grant to local authorities over the spending review period.

The revenue support grant, funded and distributed by the DCLG, was worth a total of £9.5 billion in 2015/16, and is therefore a significant source of local authority revenue. Furthermore, fixing both the public health grant and the Better Care Fund in cash terms will mean that NHS transfers to local authorities continue, but will fall as a share of overall NHS spending, thereby making a small contribution to easing the funding pressure on the NHS. Protecting these three sources of local authority income as outlined above would enable local authorities to meet the rising costs of care and still have sufficient non-ringfenced funding left to allow a 1.5 per cent rise, in cash terms, in spending on other services (which would still represent a real-terms cut of 5.7 per cent). While this would still be a tough funding settlement, it would shield local government from having to cut too deeply into other services in order to maintain adult social care.

It would also constitute a more generous settlement for local government services than for other areas of unprotected government spending. This is justified because of the big cuts in funding for local government over the last parliament, and the impact that this has had on both statutory and non-statutory services. Within adult social care, a recent report published in the *Financial Times* found that the number of adults using local-authority-funded day centres has halved since 2005/06, with the numbers receiving 'meals on wheels' having fallen by 81 per cent (Gainsbury and Neville 2015). Spending on homelessness services fell by 13 per cent between 2010/11 and 2015/16, even as the number of households accepted as homeless by local authorities rose by 36 per cent between 2009/10 and 2014/15 (DCLG 2015b). Local authorities have had to cut back on residential care for children – with a 5 per cent fall in nights of care provided between 2010/11 and 2013/14 (NAO 2014) – and on mental health services for the under-65s, funding for which was cut by 45 per cent (DCLG 2015a). It is our view that the very difficult funding environment for local authorities in the last parliament justifies a more generous settlement in the upcoming spending review, along the lines suggested above.

3.4 Delivering health and social care integration

As noted above, it is likely that further reform to better integrate the NHS with social care will also be needed over the next spending review period. This would not only improve quality of care for users of the system, but is also essential in order to realise the ambitious productivity savings that underpin the NHS' plans for the coming years.

Three models of how integration can be promoted have been proposed.

- **Extending the Better Care Fund:** The BCF has been used in 2015/16 to promote the integration of the NHS with social care. Existing transfers to local authorities are being rolled together with £500 million in extra funding in 2015/16 to offer a total of £1.6 billion of funding through the BCF for social care (LGA and ADASS 2014), with clinical commissioning groups required to work with local authorities to spend this money on new integrated services. While the BCF has been welcomed by local authorities, it has also been criticised as a mechanism for transferring funds from the NHS to local authorities, mitigating against the falling incomes and rising social care demands that they face.
- **Whole-place devolution**: The Greater Manchester agreement, signed in late 2014, will see the devolution to the Greater Manchester combined authority of the full NHS budget for its area by the start of the 2016/17 financial year. This will allow closer working across health and social care, and has the potential to

deliver much greater integration of the two systems. The further extension of this model of devolution to other local areas, starting with combined authorities, now appears likely.

- **Integrated cohort budgets:** Another proposal, made by the Independent Commission on Whole Person Care for the Labour party, is to adopt a single-commissioner model for particular groups of the population who have complex needs, such as frail older people (ICWPC 2014). This would see an integrated budget with a year-of-care tariff for each individual, used by an accountable commissioner such as a local health and wellbeing board, paying for a mix of hospital and social care. It is argued that this would give providers an incentive to invest in care in order to prevent the need for expensive hospital visits (Labour party 2015).

The exact speed and form of integration will vary depending on the model pursued. It is likely that a mix of systems will develop, with the full devolution of NHS funding to strong combined authorities occurring earlier in the parliament, and the Better Care Fund or an equivalent rolled out further as a means to support integration elsewhere. However, irrespective of the model of integration that the government pursues, delivering the funding that both the NHS and social care services need will be essential in maintaining and improving current levels of service.

3.5 Conclusion

On top of the government's plan to deliver an additional £8 billion to the NHS annually by the end of this parliament, **we propose protecting the revenue support grant to local authorities** in flat cash terms in each of the four years from 2016/17 to 2019/20, in order to support adult social care. Transfers from the NHS to local authorities should continue, with **the Better Care Fund sustained** throughout the spending review period. Finally, while it is not earmarked for social care, **the public health grant to local authorities should be protected** in cash terms, and the ringfence removed, in order to give local authorities greater financial flexibility.

Table 3.1 below sets out how the DH budget and the revenue support grant would evolve under our proposed spending protections for health and social care.

Table 3.1
Annual funding settlements for the Department of Health and the revenue support grant under IPPR proposals (£ billion in 2015/16 prices, and cumulative % change), 2015/16–2019/20

	2015/16	2016/17	2017/18	2018/19	2019/20
Resource DEL	£111.9bn	£113.5bn	£115.0bn	£116.5bn	£118.1bn
Cumulative % change		*+1.4%*	*+2.8%*	*+4.1%*	*+5.5%*
Capital DEL	£4.6bn	£4.7bn	£4.8b	£4.8bn	£4.9bn
Cumulative % change		*+1.4%*	*+2.8%*	*+4.1%*	*+5.5%*
Revenue support grant	£9.5bn	£9.4bn	£9.2bn	£9.0bn	£8.8bn
Cumulative % change		*-1.7%*	*-3.4%*	*-5.2%*	*-7.2%*

Source: authors' calculations based principally on OBR 2015 and HMT 2015b. A full list of sources used in our model is included in the annex.

These resources should be delivered alongside a plan to deepen integration between health and social care. While the nature and pace of integration will vary depending on local areas' capacity and ambition to take on more powers, and on whether further integration is limited to particular cohorts, providing sufficient funding throughout the next parliament to keep up with demographic change and other pressures is an essential prerequisite for reform.

4.
EDUCATION SPENDING

The schools budget for 5–16-year-olds enjoyed generous protection in the last parliament relative to other departmental spending. However, elsewhere in the DfE, while there has been an increase in spending on early years services for the under-fives, the budget for 16–19 education has been very severely cut.

It is right that schools spending should enjoy further protection in this parliament, as is advocated by all political parties. But the government should consider how spending can better support the goals of enhancing child development in the early years, and equipping young people with the skills and capabilities they need to succeed in later life. This will require more generous settlements for the budgets covering those aged both 0–4 and 16–19.

This chapter looks at how education spending fared over the last parliament, before offering recommendations for how education spending should be protected in this parliament and how funding can fulfil policy goals concerning early years and 16–19 education.

4.1 Education spending in the last parliament

The schools budget for 5–16-year-olds was protected in the 2010 spending review period (2010/11–2014/15), rising by 3 per cent in real terms – an average of 0.7 per cent a year (Sibieta 2015). When the 2.4 per cent growth in the number of pupils over that period is taken into account, on a per-pupil basis spending rose by around 0.6 per cent (ibid). Other areas of DfE spending fared worse, however: the 16–19 budget fell by 13.6 per cent, an average annual reduction of 3.6 per cent (ibid). While it is more difficult to calculate per-student figures for the 16–19 budget, spending fell by roughly 10.2 per cent per head in real terms (if calculated on the basis of the number of 16–19 year-olds in England) (authors' calculations based on ONS 2013a and 2015a).

Spending on early years (the under-5s) increased over the previous spending review period. There are two key avenues through which early years is funded: cash transfers to parents from the HM Revenue and Customs AME budget through tax credits and tax reliefs, and directly funded early years services, including the early years entitlement to free childcare for 2–4-year-olds. Here we focus on the latter, the budget for which is held by the DfE, though it is worth noting that current plans are for more generous cash transfers to parents: the government intends that both Universal Credit and the implementation of 'tax-free childcare' (a childcare tax relief) will be fully rolled out during this parliament.

DfE departmental spending on childcare grew by 39.1 per cent in real terms between 2010/11 and 2014/15. This reflects the extension of the free entitlement to childcare from 12.5 to 15 hours for all three- and four-year-olds, and for the 40 per cent most disadvantaged two-year-olds. In addition, a pupil premium for the early years is being introduced in 2015/16, worth £50 million annually (DfE 2015). While overall spending on early years services has risen, unit funding per hour of care was held flat in cash terms between 2012 and 2014 (DfE 2013a and 2013b). This has led, in part, to rising cost pressures among providers, with research indicating that hourly funding for three- and four-year-olds may be 17 per cent less than the cost of providing an hour of care (PSLA 2014). Central government also funds Sure Start children's

centres via the early intervention grant to local authorities. The value of this grant fell by 41 per cent in real terms between 2010/11 and 2014/15, which led to councils cutting back on funding for the centres – hundreds of which have closed over this parliament (Sibieta 2015).

The pattern of DfE spending by age over the previous parliament is set out in table 4.1 below.

Table 4.1
Department for Education DEL budget (£ billion in 2015/16 prices and % change) by age group, 2010/11 and 2014/15

	2010/11	2014/15	% change	% change (average per year)
0–4	£2.1bn	£2.9bn	+39%	+9%
5–16	£37.5bn	£38.6bn	+3%	+1%
16–19	£8.8bn	£7.6bn	-14%	-4%
Other	£6.4bn	£5.0bn	-22%	-6%

Source: Sibieta 2015

The government is committed to holding spending for 5–16-year-olds flat on a cash-per-pupil basis over this parliament. They also plan a significant increase in the early years budget, having committed to doubling the early years entitlement to free childcare for three- and four-year-olds from 15 to 30 hours per week. This means that spending outside of early years and 5–16-year-olds is unprotected, making further cuts to the 16–19 education budget and other areas of DfE spending likely.

4.2 Education spending priorities for this parliament

Early years

Despite the welcome attention given to on early years in the last parliament, there is a need to do more over the next five years. There are still severe inequalities in funding between different ages, and sound economic and social justifications for a greater focus on early years in the next parliament.

Early years education and care has three key aims.

- **Supporting early childhood development:** The evidence suggests that high-quality learning for under-fives has a positive impact on social and educational outcomes later in childhood. In order to achieve high-quality learning, staff must be highly trained.
- **Supporting families to balance work and care:** More generous childcare provision allows parents to better balance their preferences for work and care. Internationally, countries where childcare provision is more generous tend to have the highest rates of maternal employment; elsewhere, mothers are far more likely than fathers to stay at home and look after young children.
- **Promoting gender equality:** Evidence on the 'motherhood wage penalty' suggests that women experience a permanent loss in income after giving birth. This is linked to the gap in many women's working lives that begins after childbirth, as well as the fact that many, when they do return to the labour market, find it necessary to take on low-paid, low-skilled and highly flexible work. More generous public support for childcare makes it easier for parents to return to work sooner, and to fit care around a greater range of jobs. Achieving this also requires generous and flexible parental leave provision for both mothers and fathers, in order to reduce gender inequalities in caring (Ben-Galim 2014).

International evidence from the Organisation for Economic Co-operation and Development (OECD) suggests that parents in the UK face childcare costs that are high in comparison to those in other countries, despite the fact that the UK devotes a relatively high level of public expenditure to funding childcare. An OECD report, using data from 2012, found that for a dual-earner family with earnings that are one-and-a-half times the national average, childcare costs for a 2-year old in full-time care were 34 per cent of net family income – the highest in the OECD and much higher than the OECD average of 13 per cent (OECD 2014).

To address the high costs of childcare in the UK, a key focus of the next spending review should be to shift resources towards the early years, while also protecting spending on both schools and 16–19 education. In IPPR's *Condition of Britain* report (Lawton et al 2014), we recommended the following package of reforms to early years provision.

- **Extending the current entitlement to free care for three- and four-year-olds from 38 to 48 weeks per year.**
- **Making the offer for two-year-olds of 15 hours of care for 38 weeks of the year**, which is currently targeted only at children in the poorest 40 per cent of households, **universal, and extending the offer to 48 weeks of the year** (ibid).

Making the two-year-old offer universal would provide more families with free childcare places earlier in their child's life, reducing the often difficult gap between the end of parents' leave entitlements and the point at which their child becomes eligible for the childcare offer for three-year olds. Extending it to 48 weeks of the year would make parents less reliant on expensive holiday care outside of the current 38 week offer. We estimate that the total annual cost of this package of reforms would be £1.9 billion in 2015/16 prices, on the basis of existing levels of take-up, population and unit costs of funding (based on assumptions in Brewer et al 2014).

As an interim step towards this goal of a universal offer for two-year-olds, and 48 weeks of free childcare for all 2–4-year-olds, **we propose that 15 hours of childcare for 48 weeks of the year is offered to 2–4-year-olds whose parents fall within the poorest 40 per cent of families**. This is in addition to the government's offer of 30 hours for working families. This additional 10 weeks of annual coverage beyond the existing 38 weeks would reduce the cost of holiday care for low-income families.[19] The justification for targeting extra support in this way is threefold.

- First, low-income working families are likely to have their incomes substantially reduced under plans to make in-work benefits less generous from 2016/17 onwards (Hood 2015).
- Second, while childcare prices have grown faster than overall inflation across the board, holiday care prices have risen particularly quickly: one study by the Family and Childcare Trust estimated that the price of a week's holiday care rose by 7.8 per cent between 2014 and 2015 alone, faster than the equivalent rises in nursery care and childminding (5.1 and 4.3 per cent respectively) (Rutter 2015).
- Finally, according to the same study, more than a third of parents find it difficult to access holiday childcare, with a quarter being forced to cut their hours of work during holiday periods (ibid).

We estimate that the annual cost to the government of providing the entitlement to 15 hours for an additional 10 weeks, targeted at the poorest 40 per cent of families, would be £550 million.

19 The early years entitlement is usually only offered during term-time (Rutter 2015).

The government currently plans to extend the number of hours offered to working parents of 3- and 4-year-olds under the free entitlement, upping the offer to 30 hours. While the Conservative party manifesto estimated that this would cost £350 million, it has been argued that this figure underestimates the likely cost (Weale 2015). Based on the assumptions for take-up, hourly unit costs and population published by the IFS in their 2014 *Green Budget* (Emmerson et al 2014), we estimate that the actual annual cost of the 30 hours offer will be £1.6 billion (in 2015/16 prices). Furthermore, it is widely accepted that the current unit rates of funding for the free entitlement are not sufficient to cover the costs of delivery – one estimate suggests that they are 17 per cent lower than is required to cover the cost to early years services of caring for three- and four-year-olds. If rates continue at the current level, this may lead to some providers becoming financially unsustainable if they do not make further increases to fees for care outside the free entitlement, thereby further reducing affordability (PSLA 2014). The government has recognised this, and has launched a review of funding rates. If it concludes that unit funding rates should rise, this would further increase the cost to government of delivering the 30 hours.

While the government has indicated that 2017/18 will be the year in which the free entitlement to 30 hours will be implemented, we propose staggering its implementation over 2017/18 and 2018/19. The introduction of such a high-cost programme in a single year would require large, sharp cuts to be made to unprotected budgets, both within the DfE and in other departments. A staggered implementation could be achieved by extending the free entitlement to the poorest 40 per cent of families in year one, before making the extra 15 hours in the second year universal. This would make the required cuts to unprotected budgets less severe and less immediate.

16–19 education and schools

We recommend that the 16–19 education budget is protected on the same basis as 5–16 spending (flat cash per student), in order to ameliorate the sharp funding cuts to that budget made in the last parliament. There are several justifications for extending the protection afforded to 5–16 education to education for older ages.

- First, there are severe funding inequalities across age groups. Estimates suggest that annual spending per head in 16–19 education is at least £1,000 lower than in 5–16 education. The UK is also an outlier when compared to its international competitors, where per-head spending on upper secondary education (for 15–18/19-year-olds) is commonly as much as, if not higher than, spending on lower-secondary education (Evans 2015).
- Second, many 16–19 educational institutions are already in a dire financial state, as money for both adult and 16–19 learning has been reduced (Cooney 2015). These cuts have had a particularly severe impact on sixth-form and further education colleges, which, unlike sixth-forms that are attached to schools, are not able to cross-subsidise using funding for younger students (Pearce 2015).
- Finally, given the government's recent focus on improving UK productivity, funding for human-capital-enhancing areas of policy such as education and training must be made a priority. It has been demonstrated that 16–19 education improves employment outcomes (McIntosh 2004). This justifies a more generous settlement for 16–19 education in the current spending round than in the last two.

While the government has plans to double the number of apprenticeships over this parliament, funded in part by a levy on employers, this is no substitute for a sustainable funding settlement for 16–19 education. Despite recent growth in the overall number of apprenticeship starts and completions, the number of young apprentices has been falling (Evans 2015): one study found that only 6 per cent of those born in 1991 were studying for an apprenticeship at the age of 18 (Wolf 2011). Also, the majority of apprentices in the UK study at National

Vocational Qualifications (NVQ) level 2 rather than level 3, which should be the normal level for work-based learning (Dolphin 2014b).

Finally, we assume that the government's planned settlement for 5–16 education, under which per-pupil funding will be held constant in cash terms, will be implemented.

4.3 Conclusion

Schools should continue to enjoy protection in the next spending round. However, this protection should not come at the expense of the education of children who are still approaching primary school-age, or 16–19-year-olds who are still in education. Instead, we propose a much more generous settlement for further education and schools' sixth forms over the upcoming spending review period than in the previous one, in order to better support young people's transitions from school into employment, as well as significant extra investment in early years services that would bring the UK more into line with other developed economies in terms of supporting child development and offering flexible childcare for working parents.

A summary of how the DfE's resource budget would be set between 2015/16 and 2019/20 under our proposed settlement – of maintaining flat cash per pupil at its current level for both schools and the 16–19 education budget, and extra investment in early years – is given below in table 4.2. It would see funding for 16–19 education fall by 13.4 per cent in real terms, and that for schools falling by 1.0 per cent, over the spending review period. While both are protected in the same way, the number of 16–19-year-olds is projected to fall by around 200,000 over this period, whereas the number of 5–16-year-olds is projected to rise by over 500,000 (ONS 2013b). On a per-pupil basis, funding for 5–16 and 16–19 education will both fall by 7.1 per cent in real terms.

The early years budget is, under our proposals, projected to grow by almost 60 per cent in real terms by 2018/19.

Table 4.2
Indicative settlement for the Department for Education's RDEL budget under IPPR proposals (£ billions in 2015/16 prices, and cumulative % change), by age group, 2015/16–2019/20

	2015/16	2016/17	2017/18	2018/19	2019/20
16–19 (RDEL)	£7.4bn	£7.2bn	£6.9bn	£6.6bn	£6.4bn
Cumulative % change		*-3.0%*	*-6.7%*	*-10.4%*	*-13.4%*
5–16 (RDEL)	£39.8bn	£39.8bn	£39.8bn	£39.6bn	£39.6bn
Cumulative % change		*0.0%*	*-0.2%*	*-0.5%*	*-0.7%*
0–4 (RDEL)	£2.7bn	£2.7bn	£3.3bn	£4.3bn	£4.3bn
Cumulative % change		*0.0%*	*23.7%*	*59.3%*	*59.3%*

Source: authors' calculations based principally on OBR 2015 and HMT 2015b. A full list of sources used in our model is included in the annex.

5.
DELIVERING SOCIAL POLICY REFORM AND PUBLIC INVESTMENT WITHIN THE SPENDING REVIEW

Beyond the key areas of education, health and social care, the UK faces many other challenges that will require both significant reorientations of public spending and considered policy action throughout the next parliament. This chapter looks in detail at three such areas – youth unemployment, social exclusion and housebuilding – and illustrates how solutions to these challenges can be delivered within the next spending round.

Beyond housebuilding, it highlights three other priorities for capital investment in the spending review, building on previous IPPR research on regional transport infrastructure, investment in energy efficiency for fuel-poor households, and the importance of public investment in research and development.

5.1 Youth unemployment

Youth unemployment and 'NEET-hood'[20] have been central policy concerns in recent years. At its peak in late 2011, the youth unemployment rate reached 22.5 per cent (ONS 2015b), with 22 per cent of 16–24-year-olds not in employment, education or training (ONS 2015c). While there has been a welcome fall in worklessness among young people – the youth unemployment rate was down to 16.0 per cent in the three months to June 2015 – a significant number of them remain locked out of the labour market (ONS 2015b). Continued recovery in the wider economy is unlikely to fix the problem – even in the relatively benign labour market of the mid-2000s, rates of unemployment and inactivity among young people were rising steadily. The introduction of the new minimum wage (or 'national living wage') for over-25s may have the effect of boosting the employment of young people, given that it will increase the wage differential between young and older adults and so may tilt hiring towards youth. However, the reasons why employers are not currently hiring young people go beyond pay levels – young people's lack of experience, and employers' dissatisfaction with the skill levels of school-leavers applying for work, are also important factors (Dolphin 2014b).

What is required is substantial reform of the system that supports young people through the transition from education to the labour market. IPPR has made several contributions to this debate, including a review of how 14–19 education needs to adapt in order to better prepare young people for the world of work (Evans 2015). Our proposals for how to secure sustainable funding for 16–19 education within a spending review is set out in the previous chapter on education spending.

Beyond education, in our *Condition of Britain* report (Lawton et al 2014) we provided several recommendations for how the welfare-to-work system could be reformed to better address the specific challenges that young people face. The report's key recommendation in this area was for **a 'youth guarantee' for 18–24-year-olds** that would offer access to education or training, plus intensive support to find work or an apprenticeship, with compulsory paid work experience for those not earning or

20 'NEETs' refers to those who are 'not in education, employment or training'.

learning within six months. We argued that the delivery of this youth guarantee should be **devolved to London and the core cities** in the first instance, with the potential for further deals with other local areas.

Subsequent to the publication of *Condition of Britain*, the 2015 Conservative manifesto indicated that unemployed 18–21-year-olds would be given six months to find work or training before their jobseeker's allowance is withdrawn, unless they agree to begin an apprenticeship or traineeship, or take part in community work. While this commitment is yet to be implemented, it bears some resemblance to our proposal for a youth guarantee, although it differs in important respects – the work experience component would not be paid at the minimum wage, would not extend to those over the age of 21, and would apply only to those young people claiming jobseeker's allowance.

It is our view that reforming the welfare-to-work system for young people should be a central policy goal during this parliament, and that the upcoming spending review should reflect this. As an interim step before the full implementation of a youth guarantee for all 18–24-year-olds, **the government should introduce a guarantee for those within that age bracket who are claiming jobseeker's allowance for more than nine months**. Currently, young jobseeker's allowance claimants transition onto the Work Programme after nine months. Instead, under our proposals, young people would be offered six months of work experience, paid at the minimum wage, as part of a scheme similar to the successful Future Jobs Fund implemented by the last Labour government. In addition, **pre-apprenticeship training**, modelled on the government's traineeship programme, could be offered as well as apprenticeships. Young people who do not secure further work during their six months' work placement should then transition onto the Work Programme.

Funding for the youth guarantee should be held in a pooled and protected budget at a national level. How this funding is distributed to London and combined authorities would then be determined in agreements that cover funding, delivery plans and expected outcomes. Elsewhere in England, the youth guarantee would be delivered by job centres in collaboration with other agencies, with the potential for further devolution deals to other local areas. Funding for skills and apprenticeships is devolved to Scotland, Wales and Northern Ireland, so it would be for their governments to decide whether to implement a similar guarantee (with funding available through the Barnett formula).

Based on estimates of the number of young people in England currently claiming jobseeker's allowance for longer than nine months, and the number of young people referred to the Work Programme over the last year (DWP 2015), we estimate that just under 60,000 young people would be eligible for the youth guarantee in its first year of implementation, and that this number would fall to 36,000 in subsequent years.[21] Assuming that the cost of each placement would be similar to those of placements under the Future Jobs Fund (HMT 2015e), uprated for inflation, we estimate that the cost to the government of implementing the youth guarantee would be £420 million in its first year, falling to £252 million in subsequent years (in 2015/16 prices), assuming that the numbers of young people claiming jobseeker's allowance for more than nine months and being referred to the Work Programme remains similar throughout the spending review period. In fact, the monthly number of young people referred to the Work Programme has halved over the last year (DWP 2015), which implies that the eventual cost of a youth guarantee may be significantly lower than our figures suggest.

21 Once the initial *stock* of young people currently claiming jobseeker's allowance has flowed onto the youth guarantee, in subsequent years it would only have to provide guaranteed work experience placements for the *flow* of young people onto the Work Programme.

In order to pay for the youth guarantee, **existing resources spent on the youth cohort of the Work Programme should be diverted**. Of those young people claiming jobseeker's allowance for more than nine months but less than two years (the point at which participants leave the Work Programme), 60 per cent have been claiming for between nine and 15 months, and so would be eligible for the youth guarantee. Therefore we propose that 60 per cent of existing Work Programme spend on the youth cohort (£140 million) be redirected towards a youth guarantee, with the remaining funding required for it to be found elsewhere. This means that in the year of its implementation, a youth guarantee would have a net additional cost of £280 million, and one of £110 million in subsequent years.

5.2 Social exclusion

The outlook for severely excluded adults in the UK has worsened in recent years. Deep cuts to local authority budgets have hit many of the services used by this group, such as homelessness, substance misuse and reoffending services. Where individuals rely on several of these services, the impact this has on them has been even greater (Bramley and Fitzpatrick 2015).

This small group of adults experiencing 'multiple disadvantage' has needs that cut across service boundaries, from the specialised services above through to more mainstream provision within the NHS or employment support. It has been shown that a lack of integration across these services often leads to a fragmented experience for this group – one that does not address the often deeply-rooted causes of their issues (Lawton et al 2014).

This leads to poor outcomes for adults with complex needs, as well as inefficient spending. Simply restoring prior levels of funding to homelessness and drug and alcohol services is unlikely to remedy the situation. Instead, what is needed is a commitment on the part of service commissioners to integrate services around the individual.

Previous efforts to tackle exclusion among those facing multiple disadvantage have tended to be large-scale programmes led by Whitehall units or departments that may deliver strong short-term results, but do little to advance deep reform or integration of locally-commissioned services.

The most effective interventions for this group typically involve a dedicated case-worker, more integrated services and greater user involvement. The current government's Troubled Families programme, while it is led from the centre, has used an extra injection of funding on a payment-by-results basis to support local areas to integrate existing services as we suggest, but for a different target group: households that meet several criteria, including having children who are not in school, being involved in crime or anti-social behaviour, and not being in work.

In IPPR's *Condition of Britain* report we recommended **establishing a programme similar to Troubled Families that is targeted at severely excluded adults** who are using both homelessness and drug and alcohol services (Lawton et al 2014). There are three key elements to how such a 'troubled lives' programme could be funded within the spending review.

- **Multi-year allocations for drug and alcohol funding within the public health grant and the homelessness prevention grant:** Providing local areas with more certainty over funding, through the setting of budgets over a four-year spending review period, would give local commissioners and providers more flexibility and greater incentive to invest earlier in order to achieve positive outcomes later.
- **Protection for these two grants:** As outlined in the previous chapter, we recommend protecting the public health grant to local authorities in cash terms. We also recommend protecting, in real terms, the homelessness prevention grant to local authorities, which is currently worth around £100 million a year.

- **Bonus payments to local authorities:** We also recommend establishing a national fund, worth £100 million per year (or £400 million over a four-year spending review period), to be used to fund bonus payments to local areas that achieve an agreed set of outcomes in relation to both successfully integrating services, and securing outcomes for those who rely on both homelessness and drug and alcohol services.

If our 'troubled lives' programme is to represent an improvement on previous efforts, local authorities would have to agree an action plan with central government and their local voluntary sectors in order to define performance measures that are appropriate to local circumstances and needs. Payments from the national fund to local authorities would be conditional on successful performance against these measures.

A 'troubled lives' programme of this kind could act as a catalyst for further integration across wider geographies and across other services such as employment support, mental health services within the NHS, and probation services.

5.3 Benefits to bricks, and an affordable homes programme

For many decades, UK housebuilding has not kept pace with demand. This has led to housing costs – both house prices and the cost of rent – rising far faster than earnings and inflation. Rather than reversing this trend through investment in housebuilding and other means of increasing housing supply, policymakers have responded with ever-rising benefit spending and cash transfers to help families afford rent.

While this shift from supply-side to demand-side subsidies has occurred over a number of decades, recent decisions have entrenched the problem – not least the introduction of 'affordable rent', a policy that cut capital grants for new social homes by two-thirds (from £60,000 per home down to £20,000 [NAO 2012]) and, to compensate providers, allowed them to charge 'affordable rents', defined as up to 80 per cent of the market rate and typically higher than rents on traditional social rent properties. The result of this change is that government now invests less, but this results in higher rents – and therefore greater housing benefit costs – in order to pay off the construction and borrowing costs in the future (DCLG 2011). This shift from capital to revenue spending was at its most pronounced in the last parliament, during which an estimated 95 per cent of government spending on housing was used to subsidise rents through benefits, with only 5 per cent invested in building new homes (Cooke and Davies 2014). Moreover, ever greater proportions of housing benefit spending are being pushed into supporting rents in the costly private rented sector, rather than supporting the construction costs of new homes in the social sector that could contain future welfare spending. This growing imbalance in the type of subsidy – and crucially, in where that subsidy ends up – makes the welfare bill vulnerable to increases in rent levels, and serves more to channel greater subsidies to private landlords than it does to develop public assets.

In several reports, IPPR has argued that **the trend towards greater government spending on housing benefit rather than investment in housing should be reversed**. This should be achieved through a combination of devolving responsibility for public housing investment budgets and giving local authorities greater powers to unblock development sites, set housing benefit rates and retain housing benefit savings from local action (Cooke and Davies 2014, Lawton et al 2014).

Crucially, such a strategy will require upfront investment in housing. As we explained earlier, the government's current plans for investment spending will see departments' capital expenditure budgets rise in line with GDP in 2018/19 and 2019/20. Reversing the shortfall in housebuilding should be a priority for the extra capital spending unlocked in these final two years of the spending round.

Currently, central government funds the construction of affordable and social housing through the Homes and Communities Agency (HCA), and via the Greater London Authority (GLA) in London.

Under current spending plans for 2015/16 to 2017/18, £1.7 billion has been allocated to the HCA – just under £600 million per year – for affordable house building, with a further £1.25 billion – around £400 million per year – allocated to the GLA. At the very least, this level of funding – a combined £1 billion per year – should be rolled forward into 2018/19 and 2019/20.

In 2013/14, approximately 30,000 homes were built for social or affordable rent, around two-thirds of which were funded by the HCA and GLA (DCLG 2014). This level of housebuilding is less than half of what is needed to keep pace with rising demand for social homes. Although estimates of social housing need vary, it is widely accepted that the overall level of housebuilding needs to be doubled from its current level of 125,000 new homes per year (ibid) to around 250,000 (Griffith and Jefferys 2013). Holmans (2011) has recommended that social housing should account for 32 per cent of this new development, while Shelter has recommended that 30 per cent of all new homes should be for social rent (Bibby and Garvie 2014). In London, available estimates from the GLA suggest that 15,700 social homes will be needed in each year between 2015/16 and 2034/35 (or 32 per cent of total new supply) in order to work through backlog demand and keep pace with additional demand (GLA 2013). If we apply these figures to annual total demand in England, then the number of new social homes that need to be built each year can be estimated at between 75,000 and 80,000.

In order to progress towards this ambitious goal, **we recommend that the HCA and GLA housing budgets be more than tripled** to £3.2 billion per year in 2018/19, up from the current budget's £1 billion, and that it remains at that level in real terms. This would be sufficient to provide 50,000 new homes for social rent per year, based on a capital grant per home of £64,000, in line with previous government programmes for social rent housebuilding (NAO 2012).[22] However, with this large capital pot there is potential to provide significantly more homes by diversifying the mix of affordable housing – that is, by including intermediate rent and home ownership options that require a lower grant per home. In striking this balance, there would be a clear trade-off between on the one hand providing more dwellings, and on the other hand achieving long-term savings in terms of reduced housing benefit demand by increasing the supply of social rent housing.

Focusing upfront investment on housebuilding, and particularly on social rent homes, would allow a shift away from the more expensive 'affordable rent' model, and would over time substantially reduce the housing benefit bill by reducing demand for expensive private rented sector properties and high-cost temporary accommodation. As an illustration of these potential savings, the average housing benefit claim for those in the private rented sector is currently £107.63 a week, whereas for those in social housing it is £86.27 (DWP 2015). The differential between the cost of private rented and social rented homes in terms of housing benefit will only grow over time, not only because of likely continuing rises in private sector rents, but because the reductions to social rent levels announced in the July 2015 budget will translate into lower housing benefit costs in the social rent sector.

In exchange for higher capital investment, **local authorities and housing providers should be expected to be more active stewards of their housing markets**, particularly in terms of reducing the costs of housing benefit. There are several key changes that could be made to existing planning rules and housing

22 This £64,000 figure represents an average grant per build that is in line with the 2008–2011 National Affordable Housing Programme, and which has been uprated in line with regional house price inflation.

benefit that would complement the additional investment outlined above, including the following.

- **Local authorities should be invited to enter into an 'earn-back' deal** with the Department for Work and Pensions whereby they can be rewarded for developing innovative means of reducing housing benefit costs by being allowed to retain a share of the resultant savings. These savings should, however, be ringfenced for future investment in housing development.
- Those local authorities entering into an earn-back deal should be able to **redraw broad rental market areas** within their remit in order to more accurately reflect the costs of private housing in their local area. They should also be given the power to negotiate deals with social landlords on long-term rent-setting, in exchange for more generous capital grants, in order to prevent landlords overcharging the taxpayer in low-cost areas.
- **Housing capital budgets should be devolved** to those local authorities entering into earn-back deals.
- In addition to their existing powers, local authorities should also be given **greater freedom to borrow responsibly** against their housing assets and income.
- Towns and cities that have an appetite for growth should be given **new powers to unblock sites** that have been granted planning permission for housebuilding, but work on which has been stalled, so that more land can be used for housing, including by designating 'new homes zones' that fund development by capturing the resultant increases in land values (Lawton et al 2014).

While some of these measures would require separate legislation, several could be piloted in combined authorities. Combined with extra investment in housebuilding, they would represent a comprehensive package that would allow and encourage local authorities to take proactive steps to combat the growing imbalance between demand and supply in the UK housing market.

5.4 Rebalancing transport investment

Another key area of capital spending that should be delivered in the upcoming spending review is capital spending on infrastructure, and on transport in particular. Public investment in transport has been shown to drive economic growth, with improved connectivity between cities and towns improving the functioning of the labour market and facilitating the transport of goods and services (IPPR North 2012).

The north of England in particular suffers from poor transport connectivity. In several reports, IPPR North has called for greater devolution of control over transport investment to the North, so that a more integrated transport system that better links the large northern cities with each other can be created, driving greater economic growth and investment (Cox and Davies 2014, Cox and Raikes 2015).

Currently, transport investment is overly concentrated in particular parts of the UK. For example, planned infrastructure expenditure on transport (on projects that are part of the national infrastructure pipeline) will, per head and in real terms from 2015/16, be more than eight times higher in London than in the North East (Cox and Raikes 2015 forthcoming). Furthermore, projects in London are more likely to have started than in other regions (Cox and Davies 2014).

In late 2014, Northern city leaders formed the Transport for the North group. Together, they proposed a package of investments in Northern transport infrastructure totalling £15 billion (One North 2014). The proposals include a faster rail network that connects cities in the North across the Pennines and to Newcastle, connected to city-region rail networks with higher frequency services. The package was subsequently endorsed by the chair of HS2, David Higgins, and one aspect of the proposal, an Oyster card for the North, was announced as government policy in the July 2015 budget.

We propose that within the Department for Transport's capital budget, **£1.1 billion should be made available per year, from 2018/19 at the latest, in order to support the implementation of the One North package of infrastructure developments** (DfT 2015). This additional expenditure would put long-term investment plans on a more stable financial footing in the long term, with a view to be on course for completion by 2030.

5.5 Investing in energy efficiency

Energy bills have fallen recently due to a collapse in international gas prices, but over the last decade energy bills have on average grown faster than general inflation. Recent policies designed to protect households from these rising costs through installing energy efficiency measures have been largely unsuccessful. The previous government's Green Deal scheme, which enabled households to take out loans in order to pay for energy efficiency improvements, achieved very low take-up: while the government expected over 100,000 households to take out a loan annually, fewer than 20,000 participated over the two-and-a-half years that the scheme ran for until it was closed in July 2015. The Energy Company Obligation (ECO), the purpose of which is to provide energy improvement measures to low-income households, has performed very poorly in terms of targeting – in 2013, only 47 per cent of fuel-poor households were found to be benefitting from ECO, and 80 per cent of the funds available under the scheme were going to households that were not fuel poor (Platt et al 2013).

IPPR has recommended improving the way in which improvements for low-income households are targeted and delivered, through **the introduction of a 'Help to Heat' programme** under which local organisations would provide free fuel-poverty and energy assessments to households in order to increase take-up of energy efficiency measures (ibid).

Estimates suggest that raising the energy performance certificate (EPC) levels of the homes of all low-income households, of which there are 4.7 million, to grade 'C' would cost £26 billion (Washan et al 2014). To achieve this by 2030 would imply investment of £1.7 billion per year. Currently, £700 million is raised through energy bills to pay for ECO off-balance-sheet, which means that £1 billion in additional capital investment would be needed per year in order to deliver these improvements (ibid). To deliver this extra investment, we recommend that this **additional £1 billion be provided to DECC's capital budget**, and that it be protected and ringfenced annually throughout the spending review period to be spent on energy efficiency improvements through the Help to Heat programme.

5.6 The science budget

In the last parliament, the government protected the £4.6 billion science budget in flat cash terms. The 2010 spending review justified this protection by stressing the importance of investment in science and research to long-term growth. The government has not confirmed whether a similar settlement will be delivered over the next spending round.

There are strong grounds on which to justify continued protection. The UK is a world leader in science, second only to the US on measures of academic research quality (Future of Higher Education Commission 2013). This is despite the fact that the UK already spends less than the OECD average on science and research in terms of its share of national income (House of Commons 2015). It has been demonstrated that research plays a key role in fostering innovation and economic growth (Janeway 2012), and as such will also be key to improving the UK's productivity performance. The existing evidence shows that public funding for research can support the kind of experimentation, free from the need for

short-term financial returns, that is necessary for innovation but which the private sector is often unwilling to provide (Future of Higher Education Commission 2013).

While generous relative to unprotected areas of spending, a flat cash settlement for the resource science budget is not ideal – in real terms, it was cut by 4.8 per cent (after accounting for additional ad hoc spending) over the last parliament (BIS 2014), and a similar settlement in the next spending review would imply, by the end of that period, a cumulative cut of 11.6 per cent since 2010. Despite this fact, the difficult outlook for public expenditure – and for unprotected spending in particular – means that it is difficult to justify a more generous settlement. We therefore recommend that **the existing protection for the science budget be retained**. That said, once the deficit has been eliminated, the government should plan to increase the science budget at least in line with GDP, if not by more, through a 10-year strategy for raising public investment in research (ibid).

6. UNPROTECTED DEPARTMENTS

This chapter assesses the impact that our proposed policies and spending protections would have on other, unprotected and devolved, departmental spending. It then goes on to propose several measures that could minimise this impact by unlocking additional resources. In preparing these figures, and in addition to the protections outlined in the report above, we have assumed that the government will deliver on its commitment to increase the Ministry of Defence's departmental budget by 0.5 per cent per year in real terms, as well as protecting the overseas aid budget at 0.7 per cent of gross national income.

6.1 The interaction between overall spending, spending protections and unprotected departments

A summary of the effects that our proposed spending protections will have on the budgets directly affected is set out in table 6.1. It shows, in real terms, budgets for the DfE (by age group), the NHS, the revenue support grant (DCLG local government), HCA and GLA spending on housing protection for the homelessness grant and the introduction of 'troubled lives' bonus payments (DCLG communities), the youth guarantee (DWP), the science budget (BIS), as well as capital settlements for Help to Heat (DECC).

Many of the spending commitments that we propose could not be delivered in the first year of a spending review, as they would require legislation as well as time to be implemented. We have reflected this in our proposed budget lines by increasing spending on new policies in stages over the four-year spending review period. For example, we have assumed that extensions to childcare are introduced in 2017/18, and our additional capital spending commitments for DECC and the HCA begin in 2018/19, when overall capital spending will begin to grow in line with GDP.

What impact would these spending plans have on other, non-protected areas of spending? This is shown in table 6.2 below, which is based on the government's overall envelope for departmental spending and the OBR's most recent economic and fiscal outlook (OBR 2015). In this table, the 'protected' budget lines include all of our proposed spending plans as set out above.[23]

Non-protected, non-devolved departments would face real-terms cuts to their current budgets of 39.8 per cent per cent overall. The devolved nations would experience a small, 3.5 per cent fall in their current budgets. This compares to an overall *rise* of 3.5 per cent in our protected areas of current spending. Our capital spending plans involve a rise of 25.7 per cent in protected areas, compared to a rise of 4.3 per cent in unprotected areas, and one of 10.8 per cent in devolved CDEL.

23 This table is not directly comparable to table 2.1, as the extent and total size of protected and unprotected spending is different.

Table 6.1
Annual funding settlements by department (£ billions in real terms, 2015/16 prices, and cumulative % change) under IPPR's proposed spending protections, 2015/16–2019/20

	2015/16	2016/17	2017/18	2018/19	2019/20
Department for Education					
16–19 (RDEL)	£7.4bn	£7.2bn	£6.9bn	£6.6bn	£6.4bn
Cumulative % change		*-3.0%*	*-6.7%*	*-10.4%*	*-13.4%*
5–16 (RDEL)	£39.8bn	39.8bn	£39.8bn	£39.6bn	£39.6bn
Cumulative % change		*0.0%*	*-0.2%*	*-0.5%*	*-0.7%*
0–4 (RDEL)	£2.7bn	£2.7bn	£3.3bn	£4.3bn	£4.3bn
Cumulative % change		*0.0%*	*+23.7%*	*+59.3%*	*+59.3%*
NHS (Department of Health)					
Resource DEL	£111.9bn	£113.5bn	£115.0bn	£116.5bn	£118.1bn
Cumulative % change		*+1.4%*	*+2.7%*	*+4.1%*	*+5.5%*
Capital DEL	£4.6bn	£4.7bn	£4.8bn	£4.8bn	£4.9bn
Cumulative % change		*+1.4%*	*+2.7%*	*+4.1%*	*+5.5%*
DCLG local government					
Revenue Support Grant (RDEL)	£9.5bn	£9.4bn	£9.2bn	£9.0bn	£8.8bn
Cumulative % change		*-1.7%*	*-3.4%*	*-5.2%*	*-7.2%*
DCLG communities					
HCA & GLA housing (CDEL)	£1.0bn	£1.0bn	£1.0bn	£3.3bn	£3.3bn
Cumulative % change		*+1.9%*	*+4.0%*	*+226.1%*	*+232.8%*
'Troubled lives' (RDEL)*	£0.1bn	£0.2bn	£0.2bn	£0.2bn	£0.2bn
Cumulative % change		*+98.3%*	*+98.3%*	*+98.3%*	*+98.3%*
Department for Business, Innovation & Skills					
Science budget (RDEL)	£4.7bn	£4.6bn	£4.5bn	£4.4bn	£4.4bn
Cumulative % change		*-1.7%*	*-3.4%*	*-5.2%*	*-7.2%*
Department for Work and Pensions					
Youth Guarantee (RDEL)	£0.14bn	£0.14bn	£0.42bn	£0.25bn	£0.25bn
Cumulative % change		*0.0%*	*+200.1%*	*+78.7%*	*+78.7%*
Department for Energy & Climate Change					
Help to Heat†	£0.0bn	£0.0bn	£0.0bn	£1.0bn	£1.0bn
Cumulative % change		-	-	-	-
Department for Transport					
One North investment	£0.0bn	£0.0bn	£0.0bn	£1.1bn	£1.1bn
Cumulative % change		-	-	-	-

Source: authors' calculations based principally on OBR 2015 and HMT 2015b. A full list of sources used in our model is included in the annex.
*Note: includes homelessness grant (£100 million per year) and £100 million per year funding for bonus payments to local authorities.
†Figures are in addition to the £700 million which does not appear on the public sector accounts because it is currently raised through energy bills to pay for ECO.

Table 6.2
Total, protected and unprotected departmental spending (£ billions in 2015/16 prices, and cumulative % change, in real terms) under IPPR's spending proposals, 2015/16–2019/20

	2015/16	2016/17	2017/18	2018/19	2019/20
Total DEL	**£360.5bn**	**£358.6bn**	**£351.3bn**	**£349.7bn**	**£349.0bn**
cumulative % change		***-0.5%***	***-2.6%***	***-3.0%***	***-3.2%***
Current spending					
Total RDEL	£316.1bn	£314.7bn	£307.5bn	£301.8bn	£299.9bn
cumulative % change		*-0.4%*	*-2.7%*	*-4.5%*	*-5.1%*
Protected RDEL	£212.6bn	£214.1bn	£216.8bn	£218.8bn	£220.1bn
cumulative % change		*+0.7%*	*+2.0%*	*+2.9%*	*+3.5%*
Non-protected RDEL	£55.5bn	£52.9bn	£43.6bn	£36.3bn	£33.4bn
cumulative % change		*-4.8%*	*-21.5%*	*-34.6%*	*-39.8%*
Devolved RDEL	£48.0bn	£47.8bn	£47.1bn	£46.6bn	£46.3bn
cumulative % change		*-0.4%*	*-1.8%*	*-2.9%*	*-3.5%*
Capital spending					
Total CDEL	£44.4bn	£43.9bn	£43.8bn	£47.9bn	£49.1bn
cumulative % change		*-1.2%*	*-1.5%*	*+7.8%*	*+10.6%*
Protected CDEL	£15.8bn	£16.0bn	£16.1bn	£19.6bn	£19.8bn
cumulative % change		*+1.1%*	*+2.3%*	*+24.3%*	*+25.7%*
Unprotected CDEL	£22.0bn	£22.2bn	£21.9bn	£22.1bn	£23.0bn
cumulative % change		*+0.8%*	*-0.3%*	*+0.4%*	*+4.3%*
Devolved CDEL	£5.7bn	£5.7bn	£5.7bn	£6.2bn	£6.3bn
cumulative % change		*+0.5%*	*-0.2%*	*+8.2%*	*+10.8%*

Source: authors' calculations based principally on OBR 2015 and HMT 2015b. A full list of sources used in our model is included in the annex.

6.2 Limiting the impact on unprotected departments

An average cut of 39.8 per cent in current spending by unprotected, non-devolved government departments would be a very severe settlement. If applied proportionately across those departments, it would mean cutting two-fifths from areas of government such as criminal justice and adult skills. While we have not attempted to model a complete and comprehensive spending review, and while the actual size of cuts would vary across departments based on negotiations within government, such a large overall cut would be unacceptable.

Limiting the impact of our proposed spending measures on unprotected departments would require expanding the spending envelope available for departments. We have identified four ways in which the impact on unprotected areas of spending could be reduced, *while remaining consistent with the government's fiscal mandate*.

- **Reducing the planned surplus:** The OBR projects that the government's deficit reduction path will lead to a surplus of £10 billion in 2019/20 (OBR 2015). This is larger than is needed to meet the government's fiscal mandate, and ideally would be eliminated entirely in order to pay for higher departmental spending. Given that the government is unlikely to do so, we propose reducing the planned surplus to £7 billion in order to pay for a more generous settlement for unprotected departments in the final year of the spending review, a change that the government could plausibly make. In order to smooth the path to this lower surplus, the deficit in 2018/19 should be £2 billion larger than is currently planned. This would still be consistent with the government's fiscal mandate, delivering a surplus in 2019/20. It would also be a less dramatic change than those made by the chancellor in recent years. For example, the changes we propose are more modest than those in the July 2015 budget, in which projected departmental

spending was revised upwards by over £15 billion for 2016/17 and almost £25 billion for the following year.

- **Aligning the higher rate of capital gains tax with the new higher dividend tax rate:** The July 2015 budget ended the dividend tax credit and introduced a new 'dividend allowance', which allows individuals to earn £5,000 in dividend income free of tax. This increases the effective dividend tax rate to 7.5 per cent for basic rate taxpayers, 32.5 per cent for higher rate taxpayers, and 38.1 per cent for additional rate taxpayers. This compares to capital gains tax rates of 18 per cent for those in the basic rate band, and 28 per cent for higher and additional rate taxpayers. There are strong arguments for dividends and capital gains to be taxed at the same rate. The IFS has argued that different rates distort incentives to receive income in one form or the other, with little reason for the two to be taxed differently (Adam 2007). As a starting point towards alignment, the higher rate of capital gains tax, currently 28 per cent, should be increased to the same level as the higher dividend tax rate. This move would raise £500 million (HMRC 2015)
- **Increasing insurance premium tax:** In the recent budget, the tax rate on insurance premiums was raised from 6.0 to 9.5 per cent. Unlike most goods and services, which are subject to VAT, insurance premiums (outside of long-term plans such as life insurance, which are exempt) are subject to a separate tax. The IFS, in its response to the recent budget, argued that VAT should be applied to insurance premiums, with business use of insurance (currently subject to the tax) made exempt (Adam 2015). This would follow the example of other EU countries, many of which are gradually aligning rates of insurance premium tax with general sales taxes (PWC 2015). We propose IPT should be increased to 13 per cent as part of a longer-term plan to align this rate with VAT. This would generate £1.5 billion of extra revenue, yet would mean that the UK's insurance premium tax rate remained lower than in other European countries, including Germany.
- **Pensions reform:** The recommendations of the government's upcoming review of the tax treatment of pension savings are not likely to be implemented within this spending review period. However, in the interim, the government should continue to make the tax treatment of pensions fairer. In the summer budget, the government announced that it would introduce a threshold at £150,000 of adjusted income (taxable earnings plus pension contributions, less charitable donations) after which the £40,000 pensions contributions annual tax allowance will be tapered away at the rate of 50 pence in the pound until it reaches £10,000. Further reductions in this threshold could be explored in order to further limit the benefit those on very high incomes gain from tax-free pension contributions and thereby control the cost of pensions tax relief. Similarly, the tax-free lump sum, which allows a quarter of pension savings to be taken tax-free and disproportionately benefits those on higher incomes, could be capped as a cash amount. IPPR has previously calculated that a cap at £36,000 would raise £2 billion a year, while leaving more than half of savers no worse off (Ben-Galim 2014). We recommend that a further £3 billion in total be raised from these or similar measures over the spending review period.

Given its commitment to the recently revised fiscal mandate, it is unlikely that the government will push back the year in which it aims to close the deficit in order to unlock more resources for our spending proposals. However, both the recent budget – which raised a net £5 billion through tax measures by 2019/20 – and the experience of the last parliament, during which the then government showed itself willing to modify its fiscal path in order to slow the pace of deficit reduction, illustrate that there is scope for measures such as those outlined above to be adopted. In particular, the government's commitment to reducing imbalances in the tax system suggests that it will continue to raise revenue by reforming tax measures.

Were the government to raise a further £5 billion in tax along the lines set out above, while increasing the deficit in 2018/19 by £2 billion and reducing the surplus in 2019/20 by £3 billion, the resultant £8 billion of extra resources by 2019/20 could be used to reduce the cuts to unprotected departmental current spending from 39.8 to 26.3 per cent, in line with the average cut expected under current plans.[24] Table 6.3 below illustrates how spending on unprotected areas of current and capital spending would vary under this scenario.[25]

Table 6.3
Total, protected and unprotected departmental spending (£ billions in 2015/16 prices, and cumulative % change, in real terms) under IPPR's spending and tax proposals, 2015/16–2019/20

	2015/16	2016/17	2017/18	2018/19	2019/20
Total DEL (outturn)	**£360.5bn**	**£360.7bn**	**£356.5bn**	**£356.9bn**	**£357.2bn**
cumulative % change		***0.0%***	***-1.1%***	***-1.0%***	***-0.9%***
Current spending					
Total RDEL	£316.1bn	£316.8bn	£312.8bn	£309.0bn	£308.1bn
cumulative % change		*+0.2%*	*-1.1%*	*-2.2%*	*-2.5%*
Protected RDEL	£212.6bn	£214.1bn	£216.8bn	£218.8bn	£220.1bn
cumulative % change		*+0.7%*	*+2.0%*	*+2.9%*	*+3.5%*
Non-protected RDEL	£55.5bn	£54.7bn	£48.4bn	£42.9bn	£40.9bn
cumulative % change		*-1.4%*	*-12.9%*	*-22.7%*	*-26.3%*
Devolved RDEL	£48.0bn	£48.0bn	£47.6bn	£47.3bn	£47.1bn
cumulative % change		*0.0%*	*-0.8%*	*-1.5%*	*-2.0%*
Capital Spending					
Total CDEL	£44.4bn	£43.9bn	£43.8bn	£47.9bn	£49.1bn
cumulative % change		*-1.2%*	*-1.5%*	*+7.8%*	*+10.6%*
Protected CDEL	£15.8bn	£16.0bn	£16.1bn	£19.6bn	£19.8bn
cumulative % change		*+1.1%*	*+2.3%*	*+24.3%*	*+25.7%*
Unprotected CDEL	£22.0bn	£22.2bn	£21.9bn	£22.1bn	£23.0bn
cumulative % change		*+0.8%*	*-0.3%*	*+0.4%*	*+4.3%*
Devolved CDEL	£5.7bn	£5.7bn	£5.7bn	£6.2bn	£6.3bn
cumulative % change		*+0.5%*	*-0.2%*	*+8.2%*	*+10.8%*

Source: authors' calculations based principally on OBR 2015 and HMT 2015b. A full list of sources used in our model is included in the annex.

6.3 Conclusion

The figures presented in this chapter show how the government can deliver on its fiscal mandate while also supporting significant reform of public services and providing much-needed capital investment targeted where it is most needed. Through a modest package of reforming tax measures and shifts in the path of public spending, while remaining consistent with the government's fiscal mandate, our proposals can be implemented without the need to cut any deeper into departmental budgets than under the government's current plans. This would still lead to a difficult spending review, requiring reductions of more than 25 per cent to non-devolved budgets not covered by our protections. We do not offer proposals for where these cuts should fall in terms of specific departments and the areas of spending within them, as this is beyond the scope of this report.

24 Note that while the average cut to unprotected areas of spending is broadly similar under our plans and those of the government, the total size of the cut is smaller under ours. This is because, as we have argued that more areas of spending should be protected, our proposed pot of unprotected spending is smaller.

25 The fact that we propose protections for some areas of spending does not mean that we endorse the implied scale of cuts to other departments and budgets. These cuts are required because of the unnecessarily tight fiscal path planned by the government, which we do not support.

7. BEYOND THE UPCOMING SPENDING REVIEW

Beyond the next spending review, the government should look to put both public services and the tax base on a more sustainable footing. The OBR, in its long-term fiscal forecasts, predicts that demographic pressures will require health and long-term care spending to grow from 7.4 per cent of GDP in 2019/20 to 8.8 per cent of GDP in 2034/35. Rather than cutting even further into other public services, which have already experienced huge reductions (OBR 2015), this cost should be met by the creation of new, hypothecated NHS taxes, the structure and evolution of which should be linked to changes in demography and the funding pressures facing the NHS over time. The alternative would be for health and care to take up an ever-rising share of departmental spending, thereby further limiting government's ability to provide other services. The government should also do more to reform taxation for our changing economy, through the implementation of taxes on land values and by playing a leadership role in the creation of an internationally agreed transactions tax. Finally, the coverage and generosity of the recommendations presented in this report, such as the youth guarantee and greater entitlements to free childcare, should be extended when the fiscal environment allows.

The governments of the devolved nations and of local areas should also be given more autonomy to raise revenue themselves, through greater devolution of taxes such as business rates and corporation tax. This has several advantages, not least building greater resilience within devolved government against future reductions in income from the centre. It would also allow them the power and flexibility to fund activities that address the specific challenges that face different local areas across the country. Once the deficit is closed, the provision of public services fit for the challenges of the 2020s will become easier.

8. SUMMARY OF RECOMMENDATIONS

8.1 Spending review recommendations

All costs are in 2015/16 prices unless otherwise stated.

Local government social care

Funding for the revenue support grant, the public health grant and the Better Care Fund should held constant in cash terms over the spending review period, in order to ensure that rising demands on the social care system do not cut too deeply into local governments' ability to fund other services. **Cost: rising to £1.8 billion per year (by 2019/20)**[26]

Childcare

The government should introduce an entitlement to 15 hours of holiday childcare for an additional 10 weeks of the year, targeted at 2–4-year-olds in families that fall within the poorest 40 per cent of the income distribution. This is in addition to the existing commitment to extend the number of free hours of childcare available to three- and four-year-olds to 30 hours for 38 weeks of the year. **Cost: £550 million per year from 2017/18**

16–19 education

The government should protect 16–19 education on a flat cash-per-pupil basis over the spending review period. **Cost: rising to £970 million per year (by 2019/20)**[27]

Youth guarantee

The government should guarantee a job for six months, paid at the minimum wage, for all under-25s who have claimed jobseeker's allowance for more than nine months. **Cost: £280 million in its first year (2017/18), £110 million thereafter**

A troubled lives programme

The government should establish a programme to join up services around severely excluded adults who use both homelessness and drug and alcohol services. This should be supported through real-terms protection of the homelessness and public health grants to local authorities, and the creation of a £100-million-per-year pot to fund bonus payments to local authorities that achieve a negotiated set of area-based outcomes. **Additional cost: £100 million per year from 2016/17**

Housebuilding

From 2018/19, the government should triple the budget of the Homes and Communities Agency, with the aim of grant-funding the building of approximately 50,000 social rent homes per year. **Cost: £2.2 billion per year from 2018/19**

26 This costing assumes that the public health grant and the Better Care Fund would hold their cash value as part of the government's existing protections for health. The cost of protecting the revenue support grant is assessed on the basis that the grant would otherwise fall by our estimate for the average cut in non-protected RDEL (26.5 per cent), implied by the government's plans set out in the July 2015 budget (see table 2.1).

27 The cost of protecting the 16–19 budget is here assessed on the basis that the budget would otherwise fall by our estimate for the average cut in non-protected RDEL (26.5 per cent), implied by the government's plans set out in the July 2015 budget (see table 2.1).

Transport investment

Within the Department for Transport's capital budget, resource should be found to finance the 'One North' package of integrated investment in road and rail capacity in the north of England, and to put it on course for completion in 2030. **Cost: £1.1 billion per year (from 2018/19 at the latest), reallocated within the Department for Transport capital budget**

'Help to Heat'

The government should accelerate investment in energy efficiency measures for low-income households, upgrading a third-of-a-million homes per year with the objective of upgrading all low-income households by 2030. **Cost: £1 billion per year from 2018/19**

Science

The science budget should be protected in flat cash terms over the spending review period. **Cost: rising to £910 million per year (by 2019/20)**[28]

8.2 Recommendations to reduce the impact of the spending review on unprotected departments

Reducing the planned surplus

The government should target a £7 billion cash surplus in 2019/20, and a cash deficit in 2018/19 that is £2 billion higher than is currently planned. This would be consistent with the government's fiscal mandate, and **allow extra spending of £1.9 billion in 2018/19 and £2.8 billion in 2019/20**.

Capital gains tax

The higher rate of capital gains tax should be aligned with the dividend tax rate for higher-rate taxpayers, **raising £500 million**.

Insurance premium tax

The tax rate on insurance premiums should be raised to 13 per cent, as part of a longer-term plan to align this rate with VAT, **raising £1.5 billion**.

Pensions reform

The government should continue to tackle imbalances in the tax treatment of pensions, aiming to raise a further **£3 billion** from measures such as capping the tax-free lump sum and reducing the earnings threshold after which the pension contributions annual allowance is tapered away.

28 The cost of protecting the science budget is here assessed on the basis that the budget would otherwise fall by our estimate for the average cut in non-protected RDEL (26.5 per cent), implied by the government's plans set out in the July 2015 budget (see table 2.1).

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ANNEX
DATA SOURCES USED IN OUR SPENDING MODEL

Sources that are listed in this report's main references list (above), and cited in the body of the report, are only cited below; full details are given below for those sources that are not.

Table A.1
Sources used in IPPR's spending model for this report, by department/policy area

General	HMT (2015b) HMT (2015c) OBR (2015) Office for Budget Responsibility (2015) 'Economic and fiscal outlook supplementary fiscal tables – July 2015', spreadsheet. http://budgetresponsibility.org.uk/economic-fiscal-outlook-july-2015/ Office for National Statistics (2013) 'Z07 - Zipped Population Projections Extra Variant Data Files', spreadsheets. http://www.ons.gov.uk/ons/taxonomy/index.html?nscl=National+Population+Projections#tab-data-tables Office for National Statistics (2015) 'GDP deflators at market prices, and money GDP: July 2015 (Summer Budget 2015)', spreadsheet. https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-july-2015-summer-budget-2015
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Adult social care	Department for Communities and Local Government (2015) 'Local authority revenue expenditure and financing England: 2015 to 2016 budget', statistical release. https://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing
Science	Department for Business, Innovation and Skills (2015) 'Science and research budget allocations for financial year 15/16'. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/278326/bis-14-p200-science-and-research-budget-allocations-for-2015-to-2016.pdf
Housing	NAO (2012)
Youth guarantee	DWP (2015) Nomis (2015) Nomis official labour market statistics, database. https://www.nomisweb.co.uk/
Transport infrastructure	One North (2014)
'Help to Heat'	Washan et al (2014)