

From: Peter Oakford, Deputy Leader and Cabinet Member for Finance,
Corporate and Traded Services
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To: Cabinet 14th December 2020

Decision No:

Subject: **Spending Review 2020**

Classification: **Unrestricted**

Summary:

This report provides an update on the Spending Review announcement on 25th November 2020. The Spending Review 2020 (SR2020) prioritised funding to support the response to Covid-19, invest in the UK's recovery and deliver on the government's programme. It sets departmental budgets for 2021-22 and devolved administrations' block grants for the same period. SR2020 also provides £100 billion of capital investment next year.

SR2020 does not include the detail of individual grant settlements from government departments (revenue or capital) although does include some additional information regarding the revenue settlement for the local government sector from Ministry of Housing Communities and Local Government (MHCLG). This enables modelling of a range of potential scenarios for the revenue settlement. We are anticipating that the provisional local government settlement will be announced before Christmas recess providing more detail.

This report focusses on the fiscal and economic forecasts and the main departmental budgets affecting local authorities

Recommendations:

- a) Cabinet is asked to note the outcome of the Spending Review and potential impact on planning for 2021-22 revenue budget, 2021-24 medium term financial plan and 2021-24 capital programme.
- b)

1. Background

1.1 The Chancellor launched the Comprehensive Spending Review (CSR) on 21st July 2020. At the time of the launch the review was planned to cover multi year settlement covering 2021-22 to 2023-24 for day to day spending and 2021-22 to 2024-25 for capital infrastructure. However, on 21st October the Chancellor confirmed there would only be a one-year Spending Review for 2021-22 in order to prioritise the response to Covid-19 and focus on supporting jobs. The one-year Spending Review aimed to focus on three areas:

- Providing departments with the certainty they need to tackle Covid-19 and deliver the Plan for Jobs to support employment;
- Giving vital public services enhanced support to continue to fight against the virus alongside delivering first class frontline services; and
- Investing in infrastructure to deliver ambitious plans to unite and level up the country, drive economic recovery and Build Back Better

1.2 As well as setting out departmental spending plans for 2021-22 SR2020 also includes an assessment of the economic and fiscal context, the response to the Covid-19 pandemic and investment in recovery, improving outcomes from public services and delivering value for money, and strengthening the UK's place in the world.

1.3 The economic outlook report from the Office for Budget Responsibility (OBR) was published at the same time as the Spending Review announcement. The OBR report provides an independent assessment of economic and fiscal forecast, and the government's performance against fiscal targets.

2. Economic & Fiscal Context

2.1 The Covid-19 pandemic has presented an extraordinary and unexpected challenge to the UK economy and economies across the world. The combination of additional public spending both on dealing with the pandemic and the economic fallout from the subsequent recession, and reduced tax yields, has resulted in an unprecedented peacetime budget deficit. Table 1 shows the central OBR fiscal forecasts for public sector spending, receipts, net borrowing, and total debt. In the central forecast spending is forecast to be £281bn higher than the previous year and receipts £57bn lower, resulting in an annual deficit of £394bn. It should be noted that the economic outlook remains highly uncertain and the OBR have produced a number of alternative scenarios reflecting different assumptions on the path of the virus and its impact on the economy (with a range for the annual deficit of £353bn to £440bn under the various scenarios for the pace of economic recovery).

Table 1	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
OBR Fiscal Forecasts	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Total Public Spending	883.7	1,164.6	1,011.5	990.5	1,027.4	1,064.0	1,106.1
(as % of GDP)	39.8%	56.3%	45.6%	42.1%	42.1%	42.0%	41.9%
Total Public Receipts	827.6	771.0	847.3	885.9	927.0	964.4	1,004.3
(as % of GDP)	37.3%	37.3%	38.2%	37.7%	38.0%	38.0%	38.1%
Net Borrowing	56.1	393.5	164.2	104.6	100.4	99.6	101.8
(as % of GDP)	2.5%	19.0%	7.4%	4.4%	4.1%	3.9%	3.9%
Total Accumaltd Debt	1,800.5	2,273.9	2,478.4	2,602.2	2,720.9	2,714.1	2,816.6
(as % of GDP)	85.5%	105.2%	108.0%	108.6%	109.4%	105.0%	104.7%

- 2.2 In SR2020 it was acknowledged that due to the high levels of uncertainty it was not the right time to set out a detailed medium-term fiscal strategy. However, the Chancellor did state that over time, and once the economic recovery is secured, that the government is fully committed to taking the necessary steps to ensure borrowing and debt are on a sustainable path. The OBR has identified that even on the loosest conventional definition of balancing the books, a fiscal adjustment of £27 billion (1% of GDP) would be required to match day-to-day spending to receipts by the end of the five-year forecast period in 2025-26.
- 2.3 The OBR central forecast is that size of the UK economy, as measured by Gross Domestic Product (GDP), will reduce by 11.3% in the current year (11.8% per capita). This is the largest annual reduction in over 300 years. Under the various scenarios, the upside GDP shrinks by 10.6% in the current year, and the downside by 12%.
- 2.4 In the OBR's upside scenario, consistent with a vaccine becoming widely available in spring of 2021, activity rebounds quickly and GDP recovers to pre-virus levels by the end of 2021, and there is no enduring economic scarring. However, under the downside scenario, where subsequent waves of infection require periodic re-imposition of health restrictions, output does not recover to its pre-virus levels until the third quarter of 2024 with persistently higher levels of unemployment and enduring economic scarring.
- 2.5 Table 1.1 from the OBR report summarises the scenarios and economic impact.

Table 1.1: Summary of virus scenarios

	Virus scenarios		
	Upside	Central	Downside
Public health assumptions			
Lockdown ends	2 December	2 December	2 December
Test, trace and isolate	Effective	Partly effective	Ineffective
Public health restrictions: lockdown to vaccine ¹	Medium-low	High-medium	Very high ²
Vaccines widely available	From Spring 2021	From mid-2021	Ineffective
Economic effects (per cent, unless otherwise stated)			
Real GDP growth in 2020	-10.6	-11.3	-12.0
Return to pre-virus peak (2019Q4)	2021Q4	2022Q4	2024Q4
Peak unemployment rate	5.1	7.5	11.0
Long-term GDP scarring	0.0	3.0	6.0
Fiscal effects (per cent)			
Public sector net borrowing in 2020-21	16.7	19.0	21.7
Public sector net borrowing in 2025-26	1.7	3.9	6.1
Public sector net debt in 2025-26	90.5	104.7	123.1
Budget 2020 fiscal targets			
Current budget balance in 2023-24	Met	Not Met	Not Met
Net investment below 3 per cent of GDP	Met	Met	Not Met
Debt interest to revenue ratio below 6 per cent	Met	Met	Met

¹ Low, medium and high are broadly equivalent to October 2020 tiers 1, 2 and 3 in England. Very high is between October 2020 tier 3 and November 2020 lockdown in England.

² Restrictions to ease to low by end of 2021.

- 2.6 All the OBR scenarios assume a smooth transition to a free-trade agreement with the EU in the new year. However, they have we also described an alternative scenario in which the Brexit negotiations end without a deal. This would further reduce output by 2% initially, and by 1½% at the end of the forecast period.
- 2.7 The OBR central forecast for unemployment is for it to peak at 7.5% in quarter 2 of 2021 (up from 4% in quarter 1 of 2020), with a subsequent recovery to 4.4% by quarter 4 of 2024. Under the upside scenario unemployment would peak at 5.1% in quarter 2 of 2021, with a more rapid and full recovery to 3.9% by quarter 1 of 2022. Under the downside the peak would be higher and later at 11% in quarter 1 of 2022, recovery would be slower and more damaging with unemployment at 5.2% at quarter 1 of 2025. The changes in forecast unemployment are shown in table 2. Unemployment will have a greater impact on the Council than previous recessions following the localisation of council tax support for low income households.

Table 2 Unemployment Forecasts	Central Forecast		Upside Scenario		Downside Scenario	
	Rate	Quarter	Rate	Quarter	Rate	Quarter
Prior to Pandemic	4.0%	2020Q1	4.0%	2020Q1	4.0%	2020Q1
Peak Rate	7.5%	2021Q2	5.1%	2021Q2	11.0%	2022Q1
Recovery to	4.4%	2024Q4	3.9%	2022Q1	5.2%	2025Q1

- 2.8 Forecasts for CPI inflation falls under all three scenarios from 1.8% last year to 0.8% in 2020, due in part to lower indirect taxes and energy prices, as well as increased slack in the economy. Thanks primarily to relatively weak average earnings growth, inflation remains subdued over the next three years, returning to the 2% target by the end of 2024. Average earnings continue to rise this year in the upside and central scenarios, despite the pandemic. In the medium term, earnings growth picks up steadily as labour market slack declines, reaching 3.5% by 2025.
- 2.9 SR2020 included an announcement that public sector pay rises for 2021-22 will be restrained and targeted. SR2020 confirmed that the government will include provision for pay rises for NHS workers and will prioritise pay rises for the lowest paid public sector workers with a guaranteed minimum increase of £250 for workers earning less than £24,000. Pay rises for other public sector workers paid directly by central government will be paused for one year in 2021-22.
- 2.10 SR2020 included decisions on increases in National Living Wage (NLW) and National Minimum Wage (NMW). NLW will increase by 2.2% from £8.72 an hour to £8.91 an hour from April 2021. NLW will now apply to workers aged 23 and over (previously 25). This decision balances the government's long-term target for NLW to reach two thirds of median earnings by 2024 (subject to economic conditions) and helps to ensure that the lowest-paid workers continue to see pay rises without significant risks to their employment prospects. NMW rates will increase between 2% to 1.5% depending on age. The lowest KCC pay grade is above NLW/NMW and Foundation Living Wage.

3. Local Government Spending Plans

- 3.1 Over £5.4bn has been made available to help local authorities in England respond to the impacts of Covid-19 in 2020-21. This is in addition to £1.6bn made available in 2019-20. Additional financial support will continue to be available to public health local authorities facing the highest Covid-19 restrictions through the Contain Outbreak Management Fund.
- 3.2 SR2020 includes a package of £55bn to support the public services response to Covid-19 in 2021-22. This includes £21bn of contingency funding not allocated to any particular services to enable support to be adapted over the course of next year. It also includes over £3bn which the government expects to provide to local authorities through additional funding in 2021-22 to support the response to the pandemic including:
- £1.55bn of additional grant funding to help local authorities to meet additional spending pressures as a result of Covid-19 in 2021-22
 - £0.67bn of additional grant funding to help local authorities manage the cost of households least able to afford council tax payments
 - An estimated £0.762bn to compensate local authorities for 75% of irrecoverable loss of council tax and business rates revenue in 2020-21 that would otherwise need to be funded through local authority budgets in 2021-22 and later years
 - Extending the existing Covid-19 sales, fees and charges reimbursement scheme for a further 3 months until June 2021
- 3.3 In addition to the Covid-19 funding the core settlement for local authorities includes the following grant announcements:
- £300m of new grant funding for adult and children's social care (in addition to the £1bn included in the 2020-21 settlement that will be maintained in 2021-22)
 - Increasing Revenue Support Grant in line with inflation
 - Maintaining the existing New Homes Bonus scheme for a further year with no new legacy payments
 - £16m to support modernisation of local authorities' cyber security systems
- 3.4 At this stage we do not have the detail of individual allocations of either the additional Covid-19 grants or the core grants. Cabinet will be given a verbal update and presentation on the latest forecast projections at the meeting.
- 3.5 The government anticipates that core spending power for all local authorities for 2021-22 will increase by 4.5% compared to 2020-21. The core spending power includes the main settlement from government (the Settlement Funding Assessment which includes the baseline calculation for business rate retention and Revenue Support Grant), council tax and core grant settlements outlined in paragraph 3.3. It does not include changes in locally retained business rates or the share of 2020-21 collection deficits not funded by the additional Covid-19 arrangements outlined in paragraph 3.2. The core spending power is based on assumed tax base and assumptions about permitted council tax increases

outlined in paragraph 3.6 below. The % increase for individual authorities will vary according to their individual elements and choices.

- 3.6 The referendum threshold for council tax increases will remain at 2% in 2021-22. In addition local authorities will be able to levy a 3% adult social care precept through council tax in 2021-22. There is the possibility some of the permitted council tax increase can be deferred until 2022-23. MHCLG will set out full details of the council tax referendum principles and adult social care precept flexibility as part of the detailed consultation on the Local Government Finance Settlement for 2021-22. In the longer term, the government is committed to sustainable improvement of the adult social care system.
- 3.7 The government is undertaking a fundamental review of the business rate system. A final report on the responses to the call for evidence will be published in spring 2021. In the meantime, to support businesses in the near-term the government has decided to freeze the business rate multiplier in 2021-22. Local authorities will be fully compensated for the loss of retained business rate revenue.
- 3.8 Earlier in the year the government announced that it was delaying the move to 75% Business Rate Retention and the implementation of the fair funding review. To provide further stability to the sector the government has decided not to proceed with a reset of business rates baselines in 2021-22 and will maintain the existing 100% business rate retention pilots for a further year. The government will be consulting on further reforms to the New Homes Bonus shortly, with a view to implementing reform in 2022-23.
- 3.9 The government has published responses to consultation on Public Works Loans Board (PWLB) terms. The government will reform the terms of future loans ending the use of PWLB for property investments acquired primarily for income yield and will cut interest rates for other loans by 1% for Standard Rate and 0.8% for Certainty Rate.
- 3.10 £165m will continue to be available for troubled families programme in 2021-22. An additional £98m of funding (taking the total to £125m) will be available to enable local authorities to deliver new duty to support victims of domestic abuse and their children in safe accommodation.

4.0 Other Departmental Spending Plans

- 4.1 SR202 includes a new £4bn Levelling-up Fund to invest in local infrastructure that has a visible impact on people and their communities and will support economic recovery. This cross departmental fund is available to support projects up to £20m (or more by exception) including bypasses and other local roads schemes, bus lanes, railway station upgrades, regenerating eyesores, upgrading town centres and community infrastructure, and local arts and culture. The government will publish a prospectus for the fund and launch the first round of competitions in the New Year

Department for Transport

4.2 The overall department core budget will increase by £700m from £4.0bn to £4.7bn (13.8% real terms increase). Capital spending will increase by £600m from £18bn to £18.8bn. The department will be allocated £2.1bn from the additional £55bn of Covid-19 spending in 2021-22. The settlement includes £1.7bn in 2021-22 for local roads maintenance and upgrades to tackle potholes, relieve congestion and boost connectivity.

Department for Health and Social Care

4.3 The overall department core budget will increase by £6.6bn from £140.5bn in 2020-21 to £147.1bn in 2021-22 (3.5% average real terms increase per year since 2019-20). Capital spending will be £9.4bn (an increase of £2.3bn on 2019-20). The department will be allocated £20.3bn from the additional Covid-19 spending in 2021-22.

4.4 The Covid-19 spending in 2021-22 includes £15bn for Test and Trace, £2.1bn to continue to maintain and distribute stocks of personal protective equipment, and £163m for medicines and therapeutics. The core settlement includes £573m for Disabled Facilities Grant (paid to local authorities) and £71m in the Care and Support Specialised Housing Fund supporting people to live independently for longer.

Department for Education

4.5 The overall department core budget will increase by £2.9bn from £67.8bn to £70.7bn (3.2% real terms increase). Within this the amounts for schools will increase by £2.2bn from £47.6bn to £49.8bn, this is in line with planned increase announced in last year's Spending Review to increase the core schools budget by £7.1bn by 2022-23. Capital spending will increase by £500m from £5.1bn to £5.6bn. The department will be allocated £0.4bn from the additional £55bn of Covid-19 spending in 2021-22. The settlement includes:

- £1.8bn in 2021-22 to maintain and improve the condition of school buildings
- £300m in 2021-22 for new places for children with special educational needs and disabilities
- £24m in 2021-22 to start a new programme to maintain capacity and expand provision in secure children's homes
- Holiday Activities and Food programme to provide enriching activities and a healthy meal for disadvantaged children during Easter, summer and Christmas holidays in 2021
- £44m in 2021-22 for early years education to increase the hourly rate paid to childcare providers for free entitlement hours. This is on top of the £66m increase confirmed in last year's Spending Review

5. Recommendations

Recommendations:

- a) Cabinet is asked to note the outcome of the Spending Review and potential impact on planning for 2021-22 revenue budget, 2021-24 medium term financial plan and 2021-24 capital programme.
- b)

6. Background Documents

6.1 Spending Review publication

<https://www.gov.uk/government/publications/spending-review-2020-documents>

6.2 Office for Budget Responsibility Economic Outlook Report

<https://obr.uk/efo/economic-and-fiscal-outlook-november-2020/>

7. Contact details

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