

Treasury Committee

Oral evidence: Spending Review 2025, HC 1023

Tuesday 17 June 2025

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Members present: Dame Harriett Baldwin (Chair); Rachel Blake; Chris Coghlan; Bobby Dean; John Glen; John Grady; Dame Siobhain McDonagh; Lola McEvoy; Dr Jeevun Sandher; Yuan Yang.

Questions 1-56

Witnesses

I: Helen Miller, Deputy Director, Institute for Fiscal Studies; Dr Gemma Tetlow, Chief Economist, Institute for Government; and Dr Paolo Surico, Professor of Economics, London Business School.

Examination of witnesses

Witnesses: Helen Miller, Dr Gemma Tetlow and Dr Paolo Surico.

Chair: Welcome to the Treasury Committee on the morning of Tuesday 17 June 2025. We are looking at last week's spending review and have a panel of eminent economists to help us to do that. Could you please introduce yourselves?

Dr Gemma Tetlow: I am Gemma Tetlow, chief economist at the Institute for Government.

Helen Miller: I am Helen Miller, the deputy director and incoming director of the Institute for Fiscal Studies.

Dr Paolo Surico: I am Paolo Surico, professor of economics at London Business School.

Q1 **Chair:** Thank you all very much. Helen Miller, as you say, you are the incoming director to the Institute for Fiscal Studies—congratulations on that appointment. Your predecessor to be, Paul Johnson, said last week in his analysis of the spending review that departmental spending as a share of national income has risen from 18.6% in 2019 to a projected 21.5% by the end of the spending review period. He said categorically: "This is not a period of austerity." Yet the Chancellor, in her remarks accompanying the spending review, said that the Conservatives chose austerity. We could

not characterise the last Parliament as a period of austerity, could we?

Helen Miller: I think it is widely agreed that across the 2010s we had austerity—we had spending cuts. Under the previous Government from 2019—the one initially headed up by Boris Johnson—spending was rising, so spending was rising in the previous Parliament. It is worth saying that the Conservative manifesto before the last election was pencilling in a very tight spending settlement. There is what happened under the last Parliament, which was a pretty chunky increase, and then what was planned if you took the manifesto, which was a tight settlement.

In this Parliament, spending is very clearly rising. It has risen in the first two years of the Parliament and is due to continue rising. If the definition of austerity is something like the Government cutting back the size of the state or creating a fiscal tightening, that is not happening at the moment.

Chair: And has not happened since 2019?

Helen Miller: Right.

Q2 **Yuan Yang:** I have some questions about the winners and losers of the spending review. The IFS predicted that the biggest winners would be health and defence. Ms Miller, in terms of the overall spread of winners and losers, are there any surprises when it comes to your analysis?

Helen Miller: Maybe not surprises, in the sense that historically the NHS has got a better settlement than other Departments. We know that is where a lot of the big pressures are from an ageing population that demands more and more expensive health and social care. Nobody was particularly surprised that the NHS did better than average. Because of the sheer size of the NHS, once you do anything bigger for it, you automatically make things tight for other Departments, just because of the maths of it being so big. I did not have a view on how it would be cut across other Departments, so in that sense it was always a political choice.

In terms of winners and losers, obviously and understandably, a lot of focus has been on the cash winners and losers—the NHS and defence are the big winners—but we can also think of winners and losers relative to needs or the pressures on different services. Even though the NHS is the cash winner, it is also facing rising pressures. It is still possible that what it has got might not be enough to meet the, admittedly ambitious, targets on things like waiting lists, so that is tough.

Local government is another example worth flagging. Yes, it got a bigger settlement than you might have expected, as it has been held back in other years, but there are also big pressures on local government, including from adult and child social care and special educational needs, which I could say more about. That is an area where you can easily imagine, “Even if it is a winner in cash terms, where are the big pressures going to come from?” I would not be surprised if we see pressures coming from health, education, defence and local government, all of which look like winners—and they are in a cash sense—yet nevertheless there are still pressures in all those cases.



- Q3 **Yuan Yang:** When you look at the landscape from the perspective of unmet needs, rather than just in cash terms, in which Departments and areas do you see the biggest gaps?

Helen Miller: The ones I just flagged are the ones I think are worth highlighting. One is the NHS, purely because of the ageing population, and because as people grow richer they want more healthcare, and as they grow older they need more healthcare, so there is a pressure there that is not going away.

I have mentioned local government, and it is also worth flagging the special educational needs and disability budget. There has been a huge increase in demand for special educational needs provision. There has been an increase in funding for that provision, but need is outstripping funding and local government is amassing debts, by borrowing to cover the deficits, which is currently being allowed under what is called a statutory override. It is being allowed to do that, but that is not a long-term fix. There is a dual challenge now of both getting those deficits down—funding special educational needs either by cutting what you want to fund or raising the funding—and the stock problem of the accumulated deficits. That is an area of obvious pressure.

I should flag that although the education budget is a winner in cash terms, if you strip out the free school meals provisions, the budget is basically flat in real terms. Pupil numbers will fall because of falling birth rates, and in principle that frees up a real-terms increase of something like 3%. Doing that in practice will be hard because, as everyone knows, it will not be easy to scale schools down quickly, close schools and move kids around.

Even if we freed up that whole 3% real-terms increase because of pupil numbers, it could easily be completely eaten up by special educational needs. You could be looking at a situation where school budgets, even under the best-case scenario for moving around pupil numbers, are not getting more. There is a challenge there.

- Q4 **Yuan Yang:** I know that SEND pressure very well: one of my local councils is Woking borough council, which is in the statutory override situation you described.

The Local Government Association has mentioned that the IFS's projection of spending power for councils relies on quite large increases in council tax over this Parliament; do you want to comment on that response to the IFS analysis?

Helen Miller: Sure. It is not really our analysis—we are highlighting that the Government themselves, when they put forward the projections, are assuming the maximum increase in council tax. I don't think there is anything untoward there, in the sense that local government sets council tax and the Government have to make a projection on that, but if local government does follow through on that 5% increase, it will be a historically pretty big increase in council tax. One thing we have seen in local government is a move away, relatively, from funding via grants to funding via council tax.



Of course, the flipside of that is that if local government chose not to increase council tax by the maximum amount—which is a choice it faces—there would be less spending there than is currently in the projections you have seen.

- Q5 **Yuan Yang:** Thank you very much. Dr Tetlow, we have just heard Ms Miller describe the unmet needs gap. Do you want to highlight any areas where you feel, from the perspective of residents and service users, there will be large gaps? What might that feel like over the next few years of the Parliament?

Dr Gemma Tetlow: Our analysis in our annual performance tracker, which looks at nine major areas of public services, suggests that essentially all areas of public services are performing worse now than they were in 2010, and most are performing worse than they were pre-pandemic. In some sense, all services are struggling to deliver as much or as high a quality of service to those who need it.

Helen has touched on some of the gaps in provision, but another one I would point to is adult social care, where we obviously have an ageing population, but also growing demand among the working-age population for adult social care is putting pressure on those budgets. In a sense, you are seeing what looks like rationing in local areas. Fewer older people with health needs are receiving publicly funded social care.

The pressures on adult social care and children's social care budgets, combined with the very tight settlement that local government has had since the start of the 2010s, mean that local authorities have increasingly been cutting back on their non-statutory requirements—things such as library services or children's and youth centres. There is in some cases much lower provision of those nice-to-have but actually quite important preventive services, which local authorities have not been able to do recently as they once did. That is another couple of gaps that I would point to.

- Q6 **Rachel Blake:** I want to pick up on free school meals and SEN, before coming on to capital. Some local authorities, particularly in London, have already been making the choice to spend on either universal free school meals or adding to free school meals. Dr Tetlow, have you been able to make any assessment of what funding will be freed up by the Government's decision to provide funding for free school meals for all those on universal credit?

Dr Gemma Tetlow: I would direct you back to Helen's answer. School budgets are going up in real terms, but quite a lot of that will be eaten up by the commitment to free school meals, which then leaves school budgets essentially frozen in real terms.

- Q7 **Rachel Blake:** My point is that local authorities are already allocating funding that will essentially be backfilled by the announcement. Have you been able to do any calculations about the impact of that? I appreciate that it would be on quite a granular level, and you might even have to do it manually, but I am interested to know whether you have been able to

look at that yet.

Dr Gemma Tetlow: We have not, and I do not know where they are funding that from—whether that is from within their existing school grants or they are cross-funding from other bits.

Helen Miller: I do not know either. I do not know how many councils are doing it and which budget it comes from. In the grand scheme of things, the whole policy is not hugely expensive, so for those councils it might be an important budget that is freed up. I would not expect it to be so big that we are talking about an unlocking of massive amounts of money.

For those councils that are doing universal provision, or lots of it, it might free up some money. Of course, it is going to families on universal credit, so it will also depend on, in those local areas, how many of the people the council is funding will be in families on universal credit, so that may differ. No, I have not seen that or done that analysis.

Q8 **Rachel Blake:** Thanks. That was my hunch, but I wanted to explore whether you had done any of the figures.

I also want to ask about capital and resource spending. One of the big stories of the spending review is a really significant approach to capital versus resource spending. On balance, Ms Miller, do you think the capital spending has been about right for the overall objective, which is to invest in capital to address some of the inefficiencies within resource spending?

Helen Miller: It is worth unpacking lots of different things going on there, in some sense. On whether the capital spending is right, I think it is the case that the UK has under-invested, and you can see that in things like maintenance backlogs, and some of the productivity problems that we have in the public sector are almost certainly related, at least to some degree, to under-investment. There is a case for investment, and there is a case for not having investment that bobs all around over the time; we have seen previous Chancellors cut back on capital spending for day-to-day spending. It is good to see a focus on sustained capital investment.

In terms of whether the mix of resource to capital is right, or what the capital should be, there is no one-size-fits-all answer; it depends case by case. If you take something like the Ministry of Defence, we have seen a really big increase in the share of the total defence budget going to capital. I am no expert in drones and submarines, so I do not know whether that is right or not, but that is clearly a very quick change. We can therefore talk about whether, in a given Department, it is the right mix of resources.

Clearly, the fiscal rules constrain the two pots of money very differently. Basically, the Chancellor wants to raise revenue to pay for day-to-day spending, and that is where the current constraint is—that is the binding fiscal rule. She has more space on the capital side because of the new rules.

One conceptual thing worth remembering—this is not to say whether the actual spending is right or wrong—is that the fiscal rules are supposed to



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be a constraint on what you can do on the outside. They are not meant to be a target to say, "We have freed up this space; now let's spend it all." We are still borrowing money, and that comes with a cost, such as an interest cost and delaying the payment of that.

We still have to ask, for each of those cases, not only whether the investment is right but whether it is right to borrow to make that investment, as opposed to raising taxes to do it. Again, there is not going to be a one-size-fits-all answer. Sometimes it will be really obvious that we should invest in something that has a very long life; at other times, if we are doing things that look more like maintenance, it is harder to argue that you should borrow for that, rather than pay for it out of day-to-day resources.

That is a long way of saying that I do not have an overall, "Yes, it is right," or, "Yes, it is wrong." You have to look at it case by case, and I think it is good that we are seeing more investment.

Perhaps the last thing I will say is that if you had asked me to guess in advance how that capital spending would have been split across areas, given that the Government have said that the No. 1 mission is economic growth, I might have guessed the split was a bit different. The big cash winners in capital spending are defence and net zero, as we might come on to talk about. It is possible that some of the investments within that might have some economic growth benefits.

We have not seen the industrial strategy yet; some bits of those investments, such as investing in proof-of-concept carbon capture and storage or some of the military investments, might be part of an industrial strategy. The argument might be that if we do those things, they are in and of themselves pro-growth. But if you are thinking about warm homes and ammunition, that is not where you put your money if what you want is growth. There are other reasons to do it, but they are not growth reasons.

Q9 Rachel Blake: On your point about the opportunity costs and how borrowing creates debt—you have to think really carefully about whether that is the right thing to be investing in—to what extent do you think there are risks to delivering on some of this capital investment, and what are they?

Helen Miller: There are always risks. There are risks in the sense that we are doing a lot of investment, and you have to actually get it out the door, you have to plan it well and you have to employ the people to carry out the investment. We do not have a wonderful track record in this country of delivering things on budget and on time; therefore the more of this stuff you are trying to do, the harder it will be. That is not to say we cannot do it—other countries manage to do big investment programmes and not have those problems—but there is clearly a risk.

There are clearly bits that are probably more targeted at economic growth, such as transport, some of the science budget and maybe some other bits



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of budgets. We should all hope that that increases growth, because it is the thing that will make everything easier. There is a risk if it does not happen quickly enough or to the extent that the Government would like and things therefore stay hard.

- Q10 **Rachel Blake:** Dr Tetlow, on the balance between capital and resource spending, London local authorities spend £4 million a day on temporary accommodation. We have a commitment in the spending review to spend £39 billion over 10 years on affordable housing. To what extent do you think the investment in affordable housing will be able to address that resource spend that London local authorities are pouring into poor-quality private rented homes?

Dr Gemma Tetlow: There are a couple of things on affordable housing and short-term rents in the review. One thing that was very welcome was the Office for Value for Money doing its value-for-money review on short-term accommodation.

Rachel Blake: But that has not been published yet; it is eagerly awaited.

Dr Gemma Tetlow: No, but it will be interesting to see what the results are, and I think doing the exercise was welcome. That is exactly where a spending review process can add value by thinking hard about how we are spending our money and how we can do that better.

In terms of the announcements on the affordable homes programme, our sense is that it is a reasonable step-up in spending on affordable homes. It is going up to about £4 billion a year on average over the next 10 years. Our rough estimate is that that probably roughly doubles where we have been before, perhaps enabling 30,000 extra homes a year. That is clearly sizeable, but it is maybe 10% of the new house building that this Government are aiming for over the next few years. It is welcome, and it will make a difference.

One question that remains is about the split between affordable and social housing. The programme seems to be focused on affordable housing, and it is not clear what that means for social housing availability or exactly how it will be distributed around the country. We do not know how much will be built in London versus other parts of the country, but it is definitely a move in the right direction.

- Q11 **Rachel Blake:** From an Institute for Government perspective, in the rebalancing of spending away from the subsidy of housing benefit to a capital subsidy and genuinely affordable homes, is the spending review going in the right direction? What are the mechanisms that would need to change within Government to move that spend from revenue within the benefits system to providing affordable homes?

Dr Gemma Tetlow: This spending review has really just looked at departmental spending; those are the predictable budgets that Departments have. It did not in any serious way look at annually managed expenditure, which is where welfare spending, including the housing benefit budget, sits. There is a version of a spending review process—we

would encourage the Government to think about this—that looks broader than that and thinks about how the Government spend money through benefits and through departmental programmes, and whether that is done in the most efficient way.

The Office for Value for Money has talked about setting up thematic reviews of different policy areas, which will run over the next couple of years until we get up to the 2027 spending review. Looking in the round at how much the Government are paying every year to support people's housing costs through the benefit system and the direct provision of housing, and asking whether that looks like the most effective way of doing that and whether it is good value for money, would be exactly the sort of question that the thematic value-for-money review could ask. It would then set Government up to make important announcements on that at the next spending review. As it stands, there are some disincentives to Government thinking on those questions.

Q12 **Rachel Blake:** What are they?

Dr Gemma Tetlow: If the Ministry of Housing, Communities and Local Government were to do something to increase the availability of social and affordable housing, that is a cost to their budget but a saving to the DWP housing benefit budget. For the Departments on their own, there is not a strong incentive to do those things, because you are incurring a cost and someone else gets the benefit. If the centre of government thought that was the right answer, there are ways that you could set up a process and incentivise the Departments to work together to get to that answer. As it stands, the Departments are thinking in their own narrow silos.

Q13 **Rachel Blake:** On your point about annually managed expenditure compared to the day-to-day spending, local authorities spend on temporary accommodation through their own budgets, so would that be covered within the spending review?

Dr Gemma Tetlow: Yes, local authorities do—

Rachel Blake: DWP and housing benefit would be annually managed expenditure, but local authority spend on temporary accommodation is part of the spending review consideration.

Dr Gemma Tetlow: Yes, but there are also important silos between local government and central Government. Given the extent that central Government make decisions that have knock-on impacts on what local government have to spend, it is not always internalised properly within central Government.

Q14 **Bobby Dean:** You mentioned looking at things in the round; would you include non-structural tax relief in that as well? The Treasury seems to rarely go back and look at the success or failure of those reliefs. Do you think that is something that should be brought into the spending review process?

Dr Gemma Tetlow: Definitely. We have made the case to Government, and we will keep making it, that it makes sense to think about those tax



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expenditures. To give a very obvious example, the Government in this spending review have decided to maintain R&D spending at quite a high level. They also use quite a lot of public resource every year through R&D tax credits. It would make sense, if we want to encourage more research and development activity in the UK, to think about whether that is the right mix of incentives versus direct Government spending. That is another area.

- Q15 Chris Coghlan:** Dr Surico, thank you for coming in today—as a London Business School alumnus, I feel like I am back in class. We keep hearing about the doom loop of ever-higher debts, crumbling public services and ever-higher taxes. The Government rightly identify that the way out is growth, so what is the main driver of economic growth?

Dr Paolo Surico: Historically, economic growth has been driven by productivity. I know that it does not always feel like it, but in terms of hours per week, we work less than our parents, and our parents worked less than their parents. When it comes to real wages, we earn more than our parents, and our parents earned more than their parents. The way that you can explain real wages going up and the number of hours per worker going down is because each worker has become much more productive.

- Q16 Chris Coghlan:** What is the best way to increase that productivity?

Dr Paolo Surico: Critical to productivity is to improve efficiency and to innovate, so that each worker can produce more and bring more value added, for themselves but also for society. The main driver of innovation is research and development.

- Q17 Chris Coghlan:** We heard a lot in the spending review about research and development. What is the best way that the Government can support R&D?

Dr Paolo Surico: Going back to the discussion about resources and capital, if you look at the historical evidence, it is very clear that the highest return of Government spending comes from research and development, which is only a small portion of capital investment. Then comes from capital investment, and the lowest return when it comes to maximising the impact of economic growth comes from resources.

Also, in capital investment it is very important to make a distinction. If capital investment means investment in infrastructure—important, big, strategic, critical—where there was no infrastructure before, the productivity gain is large. If capital investment means an additional airport in a city in which there are already four airports, or small, peripheral extensions, the historical evidence suggests that the productivity gains will be much smaller. There may be other reasons why you want to do that, but economically it will not be the bigger engine for growth.

However, when it comes to research and development, we clearly see that what really drives productivity, and therefore real wages and therefore standard of living, is significant investment in research and development.

Q18 Chris Coghlan: With R&D, what is the best way for the Government to crowd in private investment and what is the payoff? How long before we see that translate into economic growth?

Dr Paolo Surico: Most of the evidence suggests that the return on research and development starts to materialise as soon as four or five years after, and up to 10 or 12 years after. Just to put things in perspective, that is, of course, much longer than the benefits that you can get from other forms of Government spending, but the other forms of Government spending do not push productivity. So the same pound generates much higher return for longer, even compared with education, which of course is another great form of spending, but that will take much longer.

Q19 Chris Coghlan: We have been in a productivity crisis since 2008. There is more focus on R&D now, but how is the UK doing on R&D compared to other advanced economies?

Dr Paolo Surico: This is a very important question. If you look at the spending review, clearly the Government have tilted this increase towards capital investment, which in term of economic growth is the one that maximises the chances of economic growth.

However, within capital investment it is important to draw a distinction between research and development and non-research and development. Just to give the proportions, resources is 80% of spending and capital investment is 20%. Of that 20%, only 3% is research and development.

The Government have clearly tilted the spending growth towards capital investment, but they have tilted much less towards R&D. For example, if you look at the overall picture, R&D spending has been, in real terms, relatively flat; an increase of only 0.4% per year. Defence has been an exception. There, the Government have massively tilted the balance of spending towards R&D, much more than they have done with resources. I emphasise that because when you want to look at productivity—this country has been in a productivity puzzle at least since the financial crisis of 2007 to 2009—this country does not score particularly well on total R&D.

Just to put things in perspective, R&D is 2.8% as a share of GDP in this country, compared with 3.5% for the US and 5% in countries that are at the frontier of technology, like South Korea. Not only that, but the total R&D is the composition, as you alluded to, of Government R&D and the crowding-in of the private sector.

When you decompose that 2.8% of R&D spending by the Government as a share of GDP, most of that comes from the private sector. You see a lot of references in the spending review to £1 of public R&D crowding in another £2 of private R&D, which is about sound; it is the kind of magnitude you will see in the literature.

However, when you go to Government R&D, this country spends less than the European Union, less than the US and less than half of what the other

advanced economies that are leading on the frontier of knowledge, are doing.

- Q20 Chris Coghlan:** In the spring statement, the Chancellor used your research to upgrade long-term GDP by £11 billion a year, using a fiscal multiplier of 1.6, specifically on the increase on defence spending. How credible is that?

Dr Paolo Surico: There is a lot of uncertainty when it comes to the multiplier, and I really encourage people not to get obsessed with the number. The Government should really think about making a larger macroeconomic impact or a smaller macroeconomic impact.

The two major takeaways from the evidence out there is that tilting the composition of public spending towards R&D maximises the chances of higher productivity gain and therefore higher economic growth in the long run.

The other point I want to make is that defence spending is not special. We have seen other instances in history in which Governments have tilted the budget towards R&D in other fields. In getting to the moon, NASA R&D became special. In finding a vaccine against covid, health R&D became special. Whenever the Government have tilted the balance towards R&D, we have seen the largest and most persistent productivity gain.

Chair: We will come back to some other questions on defence, Dr Surico, but I want to bring in Lola McEvoy MP.

- Q21 Lola McEvoy:** Dr Surico, from what you just said, would you say that the increased budget to R&D is the standout engine for growth from the spending review, or are there other areas where you might see an opportunity, from the changes laid out by the Chancellor, for positive growth figures?

Dr Paolo Surico: For R&D, I would have hoped that the same tilt we have seen in defence would have expanded to other Departments. That has been the case, for example, in the Department for Science, Innovation and Technology, which is the most R&D-intense Department and, to some extent, in the Department for Energy Security and Net Zero. The productivity gain coming from capital investment is clear: doing something that was not there before, having the double dividend of generating energy security and, at the same time, pushing productivity with new technology.

The overall budget increase in real terms for R&D is only 0.4%. To put that in context, to reach the R&D spend as a share of GDP of the most technologically advanced country in the world, this country will need £60 billion per year. If you believe the Government that each pound of public R&D crowds in £2 of private R&D, that means £20 billion of spending on R&D. That will bring the UK from 2.8% of R&D as a share of GDP to 5%. That will be as high as in South Korea, which is the fastest growing economy in the advanced world and the one with the highest technological frontier. That is the kind of magnitude we are talking about.



Q22 Lola McEvoy: You talked a little bit about the capital spending impact on growth. Where it is new innovation, we see a halo effect. Do you have any thoughts on the greenlighting of some of the projects that industry has been waiting for, and the impact that will have on non-public spending? In my constituency of Darlington, there are businesses, especially mid-market businesses, that have been waiting for those assurances so that they can start expanding their business, employing more people and getting into the supply chain of those big projects. What impact will have that on growth?

Dr Paolo Surico: That is critical. There is no doubt that the economic evidence is building. We are stronger together. The Government can do so much better when they invite in and create incentives for the private sector to chip in. We have seen that repeatedly, historically. In the spending review, there are a lot of references to loans for businesses and start-ups and inviting in venture capital. Of course, in the spending review, there was no particular money attached to each of those ideas, and I believe the industrial strategy plan would have much more detail of that. It is absolutely critical to be able to crowd in the private sector, and to have the private sector compete for ideas, rather than simply allocate it in a non-competitive way to the large manufacturer that also needs it to scale up innovation. Creating an agile economy, in which high-tech start-ups and venture capital are channelled by the Government in particular sectors and projects, is absolutely critical. The spending review mentioned that, although the numbers were not attached.

Q23 Lola McEvoy: You mentioned how much the Government are going to try to incentivise private spending and investment in these projects as well, but do you think that in the spending review they have the balance right on risk and reward? Obviously, when we are spending public money we want value for money and we need a good and reliable return. But there are also critical infrastructure and big defence challenges that we need to rectify. Do you think the Government have the balance right in this spending review when it comes to their objectives?

Dr Paolo Surico: It is hard to say, because it is not clear from the spending review what the balance will be within R&D. But an important point needs to be made. In most circumstances, the goal of the private sector is to maximise profit and push new knowledge into new products. You can rely on the private sector for that, because it has the pecuniary incentive to do it.

It is for the Government to push the frontier of knowledge by subsidising and encouraging basic research that will push an idea without an immediate commercial application. That is why joint ventures of public-private partnership are so critical. The Government need urgency and they promise market size—"I have a problem; you find me a solution. If you do, I'm going to buy tons of it." That generates incentives for the best advancement of knowledge and therefore the largest productivity gain for society.

Q24 Lola McEvoy: We see that in the aerospace industry, where public-private



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partnerships work really well. Thank you, Dr Surico.

Dr Tetlow, in SR '25 the Government allocated £9.6 billion in additional financial transactions—land and equity investments—to support growth. That is to expand the financial capacity of the British Business Bank, Great British Energy and other public financial institutions. Within that, £4.8 billion was allocated to house building and incentivising private investment.

Do you have any views on public financial institutions using private financial transactions to make a profit for some of our devolved combined authorities? Is there an opportunity through devolving some of those decisions? The British Business Bank has said that it has regional banks, which could then bring in an income stream for some of the combined authorities or other local institutions.

Dr Gemma Tetlow: One of the fiscal rule changes last autumn increased the scope for Government to use those sorts of financial transactions; we saw the first of those announced in the spending review. You are right: the three big chunks where this seems to be being used is in DESNZ, which is mainly about the warm homes programme—using Government-backed loans to encourage people to retrofit their houses; the British Business Bank, for loans to small businesses; and MHCLG and the affordable homes programme that we talked about.

The British Business Bank already works with local government; it has already been providing loans to local authorities to develop local growth programmes in their areas. If I understand it, the expansion in the spending review was mainly about expanding its activities in loans to small businesses, which might generate benefits for local authorities around the country in the sense of enabling small businesses to scale up in a way that they could not have before because of a lack of access to finance. I am not sure whether the Government have increased the British Business Bank's capacity to make loans to local government or whether that is continuing as before.

Q25 **Lola McEvoy:** I am interested in the opportunities that the decision and move to that type of spending give for strapped local authorities. Do you see an opportunity for partnerships with private house builders to build some more social homes, for example? We might really need those. We could then see the money coming back in through rents or loan revenue. Do you have any views on the opportunities for that kind of financial transaction for the devolution agenda?

Dr Gemma Tetlow: That is a bit beyond my areas of expertise, but I would say one thing. One problem in the past when local authorities entered into commercial deals or financial transactions as a way of improving their future revenue sources outside central Government grants was that they sometimes made the wrong bets—thinking that certain types of commercial investments would pay off and they did not. That has been really problematic.



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One thing that the British Business Bank has brought is a building up of expertise in working with authorities, providing advice and helping them to do things well. Perhaps the one crucial thing is making sure that if there are opportunities for authorities, they have the right expertise, or access to the right expertise, perhaps through the British Business Bank, to make sure that the investments they enter into are sensible and not too high-risk.

- Q26 **Lola McEvoy:** I think that is right, given that local authorities will be cautious about taking big investment decisions like that. Is the use of the financial transactions model welcome? Will it impact growth and loosen some of the restrictions on decision making and getting things built? We are talking about long-term investment decisions, but we want to see some changes now. There is desperate need for infrastructure and for houses. Do you welcome the decision to use that sort of capital?

Dr Gemma Tetlow: In principle, it is welcome when it makes sense to use that sort of financial transaction to overcome some sort of failure. Maybe providing a Government-backed loan unlocks an activity that is economically beneficial but otherwise would not happen. In the case of home retrofitting, if people are credit constrained and cannot afford to fund that investment up front but could over a period of time, it allows them to do things by unlocking that credit constraint.

Where we might worry is that, in the past, Governments have tended to game their fiscal rules—doing things that score in a particular way within the fiscal rules. The concern would be if it looked like Government were choosing to use financial transactions because that balances out in the measure of debt that they are looking at, but where it is not clear, looking at the underlying economic fundamentals of the issue, that it is the right way to do it. You do not want Government to reach for a financial transaction when it would make more sense to fund it through normal Government spending up front, for example.

- Q27 **Lola McEvoy:** What restrictions and guidelines would make it most enticing for private business to make use of the mechanism? Allocating it in a spending review is one thing, but spending it is a wholly different thing. What rules should the Government stipulate to make sure it is useful and safe for the taxpayer, but exciting for business to get involved with and use?

Dr Gemma Tetlow: That is a bit beyond my area. On housing particularly, finance may be one barrier, but it is clearly not the only barrier to developing housing. If this is going to work, it is also important to get the planning and the other certainty that businesses need right. That reduces the amount of financial incentive you need to provide to get them into those markets.

- Q28 **Lola McEvoy:** What was your standout lever for growth in the spending review decisions? What do you think is the biggest opportunity for growth?

Dr Gemma Tetlow: The big bet in the last Budget was increasing capital spending. As Paolo said, in general, you would expect that to have more



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growth returns than day-to-day spending. A lot of that has gone into DESNZ, particularly warmer homes, and defence, which may not be hugely growth-enhancing. But there is more money in the spending review for transport and for the Department for Business and Trade. On the latter, the crucial thing will be what we see in the industrial strategy. We do not yet have the details of how that capital spending will be used and therefore what the potential growth dividends might be.

Chair: We will turn now to the biggest area of spending and look at the health budget with Bobby Dean MP.

Q29 Bobby Dean: Ms Miller, I was struck by your comment that the big uplift in health spending may not be enough for the Government to meet all their objectives. I have a figure in front of me that says that around 90% of the real-terms increase in day-to-day Whitehall spending is going to health. We also heard from the Governor of the Bank of England earlier this year that productivity levels have dropped off in the NHS and the health sector more broadly. He estimated a 17% or 18% fall since the pandemic. Would a huge injection of cash help with that productivity problem, or will it be sucked up elsewhere?

Helen Miller: It is worth highlighting the NHS's productivity issue. Productivity is important everywhere in the public sector but, given that the NHS is so big—and we know we have an ageing population and that, when people get richer, they understandably want more healthcare because it is one of the things we value—being laser-focused on productivity is important. There is no easy solution. There is a complex set of things going on, and it is partly about capital investment. Everyone has heard the stories about doctors not having the right IT equipment and that sort of thing. It is about making choices about what kind of machinery we should be investing in for hospitals. It is about how you organise your workforce. There are lots of things that go into productivity.

In some sense, if it was easy to drive up productivity, we would be doing it. It is important, but it is a challenge, and therefore we should not expect really quick, easy fixes. It is also the case that, even if productivity went back to pre-pandemic levels, it would be a challenge.

It is worth saying that the waiting list target is ambitious. Just look at how far away we are from the target to have 92% of people waiting no longer than 18 weeks for elective treatment. We are quite a long way from that. To get to that by the end of this Parliament, you will need a really big turnaround.

It is good to have ambitious targets, but you will need to see quite a lot. The less money you put in, or the less we can do on productivity, the harder it is to achieve those two things. The Government also have a big, ambitious workforce plan to make sure that we are training and retaining the right kinds of people with the right kinds of skills. That is going to be tough to do.



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You are absolutely right that the NHS has the lion's share of the real-terms increase, but it also has a lot of the pressures of the ageing population. There is good reason to think we will see improvement because there is more money going in. Capital for the NHS is flat across the rest of the Parliament, but from a higher base. You would hope that the combination of more capital spending and more real-terms day-to-day spending will lead to better outcomes, but I would be very surprised if at the end of the Parliament, we are sitting here saying, "Everything now looks fine." That is because of the backlog and the waiting lists, and because of the ongoing pressures and all the surrounding pressures, including in social care, as Gemma mentioned earlier. All those ancillary pressures are still sitting there.

Q30 Bobby Dean: The capital spend is not dramatically higher than it was previously. I suspect a lot of that might be going on fixing crumbling hospitals, which, as Dr Surico said, does not enormously enhance productivity. It means that we have better assets than we had before, but it is not replacing or generating new assets, and we are not necessarily investing in new technology and equipment. It feels as though, with the increasing level of demand, a lot of this investment is going on just standing still, on salaries and so on. Do you think that is an accurate description and that all that quite a lot of this investment will do is ensure that we do not fall further back than we have in recent years?

Helen Miller: I do not have numbers for you on the split between how much is being spent on the maintenance backlog and how much is new stuff. I could check whether we have those numbers back at the IFS. Although in general you would expect investment in things such as transport and innovation to be the big growth driver—that is where I would put my money if you were to ask where growth will come from—there is also a good case to say that the lack of investment in our public services, including the NHS, is now such that it is holding back productivity. The public sector is a big part of the economy. If you can get public sector productivity up, that is good for the economy.

I do not think it would be right to say that just because there is more growth-friendly investment somewhere else, you should not fix the crumbling roofs or fix the number of beds, or whatever it is that the NHS needs, because at some point that will directly affect public sector productivity, which has a direct effect on output. Again, I suspect we will not see the NHS getting smaller over time—quite possibly we will see it getting bigger—and therefore the more you can do on productivity to make the NHS more efficient, the bigger the impact you are going to have.

Bobby Dean: Dr Surico, did you want to come in?

Dr Paolo Surico: I just wanted to add a few figures. While capital spending on health and social care has increased by 3.2%, the R&D budget has decreased by almost 2%. Without taking anything away from the important point that has been made, there is a genuine choice for the Government: do we need more beds or less patients? If longevity, as my colleague Andrew Scott put it, becomes about being older for longer, it will



not be fiscally sustainable because you are just putting in more beds and reacting to the demographic problem.

However, if you aggressively tilt your policy toward prevention, you realise that a very significant proportion of people in hospital simply should not be there. The Government have the tools to encourage a healthier lifestyle, and that would relieve the pressure on the NHS and therefore solve the problem by having less patients rather than more beds. As you pointed out, more beds might solve the short-term problem but is unlikely to generate a massive productivity gain in the long run.

- Q31 Bobby Dean:** Does a 2% fall in health R&D spending make you fear that we might be missing out on some opportunities for R&D gain? For instance, lots of people in my inbox talk about AI-related innovations that they think they can implement in the NHS, whether in appointment-booking systems or in other processes, to create efficiencies. Might the Government be missing out on some of those opportunities if they are not concentrating investment in that area?

Dr Paolo Surico: I will give you a very simple example. Pharmaceutical companies do a lot of R&D, but that is not productivity-enhancing R&D, because most of it is tilted to the bigger market, which is elderly people. They are already retired, and therefore they do not contribute to productivity. Historically, public pharmaceutical R&D had much higher returns than private pharmaceutical R&D. So yes, cutting the budget for public healthcare R&D might backfire.

- Q32 Bobby Dean:** Ms Miller, you talked about social care. Obviously, the reforms have been pushed down the track, and it seems like we are not going to get major changes in that area for a number of years yet. To what extent will that stop the NHS getting back on its feet?

Helen Miller: I think it matters. You are often talking about the same people: people who need healthcare and people who need social care are often the same people, and having something that works at that point in time matters. I do not have numbers for you on exactly how bad it could be if we do not fix social care.

It is worth remembering the broader issue here, which is that social care really matters to the people who need it. We do not know which of us will be unlucky in the lottery and have a social care problem, but it has a huge impact on the lives of those families who are unlucky and need social care. It is the kind of long-term risk for which, realistically, individuals cannot save enough. If they have a really bad health issue at the end of life, they cannot cover it with their own savings. There is not a big private market for insurance for being unlucky, getting dementia and needing 15 years of very intensive care. There is something missing that the Government could provide and support.

We have a big, continuing national conversation about what to do, and we keep kicking the can down the road. This matters for the interaction between healthcare and social care—I cannot tell you how much pressure it will put on healthcare, as it will depend in some sense on what the NHS



does—but, independently of that, it also matters for the individuals involved.

It also matters for local councils, because they are providing a lot of this stuff. As Gemma set out nicely, one thing we have seen is that local government is doing more of that at the expense of other things. What most people see of local government is fewer bin collections or fewer library services, because the resources are being concentrated on those most in need—I can absolutely see why that is happening. Unlocking that whole problem, thinking about local government and individual families, is why we need to tackle the social care problem, as much as because of the interaction with the NHS.

Bobby Dean: I suspect that also applies to the carers themselves, who might be withdrawing from the workforce to take on caring responsibilities.

Q33 **Yuan Yang:** I have a couple of quick questions on the healthcare productivity issues that my colleague Bobby Dean brought up. The first is about the causes of this quite dramatic decrease in health sector productivity, which is about a fifth lower than pre-covid. How much of this can we put down to the lack of labour-augmenting capital technology investments—the kind of AI and diagnostic machinery that we were just discussing? How much of it is down to workforce pressures? For example, too many doctors are covering each other's shifts, leading to increased sick days, retention problems and skill loss in the NHS. Is it possible to diagnose the healthcare issue?

Helen Miller: I do not have any numbers for you. I do not have a decomposition—I would like to have one—but I think those things are all feeding in. One thing that is worth saying is that it is not just a covid problem. Obviously, we all lived through covid and remember what happened, but the waiting list was already growing pre-pandemic, so it is not a simple story. It is not, "We were fine, covid hit, and now we're not fine"; it was already happening. If you look at the work that has been done, it seems that capital investment in the things that doctors and nurses use, as well as some workforce issues, contributed to that, but I do not have a split.

Dr Gemma Tetlow: I am afraid that I also do not have a quantitative split for you, but the work we have done on NHS productivity points to five contributing factors. One is definitely under-investment in capital. You can see that in a few places. There is definitely a problem of patient flow around the system. You sometimes cannot move a patient out of A&E and into a ward. That partly reflects the fact that the number of beds per head of population in the UK is something like only 60% of the OECD average. We also have many fewer diagnostic machines. The last Government started to invest more in those, but there is still a need. One of the blocks to moving through the system is waiting for a diagnostic test to know where you need to go next. Although I accept Paolo's point about investment in services not being so growth-catalysing for the economy as a whole, there are clearly areas where crumbling hospital estates are



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undermining the productivity of individual doctors and workforces within hospitals.

The second important thing we found was a lack of management capacity. In previous efforts to hold down spending in the NHS, there was a cutback of admin and management capacity, which feeds through to doctors having to do their own rotas or having to deal with things that are not the most efficient use of their time. There has also been a decline in staff experience levels. When you have ramped up staffing in recent years, it has taken time for those people to become more productive, and the current staff need to spend some of their time training them up. That should gradually ease out as we move through the uptick.

The final thing that has been an issue in recent years is the degree of industrial action in the NHS, which has reduced the productivity of those staff. Obviously, getting staff contentment right in the NHS is important.

Q34 Yuan Yang: I see the investment constraints in my local hospital—the Royal Berkshire hospital—which definitely needs to be rebuilt very soon.

I have a statistical question for you, Dr Tetlow, in your capacity as an ONS fellow. We had Andrew Bailey, the Governor of the Bank of England, before us a few months ago, and we discussed this productivity issue with him. He said there is a real question about whether the drop in health sector productivity is to do with measurement, given everything else that has happened at the ONS, or whether it is a real feature of the world. Could you unpack that a bit, in terms of some of the measurement issues that might be coming in how the ONS measures public sector productivity, versus other approaches around the world?

Dr Gemma Tetlow: Compared with other countries around the world, the ONS has been at the forefront of thinking about productivity in public spending. Many other countries simply assume that inputs equal outputs in a lot of areas of public spending, so essentially you cannot improve productivity; if you spend more, you assume that the outputs go up. In a sense, the ONS has been trying to do a lot better than that and understand what we are actually getting for services, and that is great. The challenge in measuring public sector productivity in all types of services is obviously the lack of a market price, which makes it hard to know the quality or the quantity of the output that is being produced.

To take a step back, I do not think this is just an artefact of poor ONS data, because in our work we do not just use the ONS measures. We try to look under the hood at where the money is going, quantities of staff, the different staff mix and any other inputs, and what you are getting out at the other end. All those indicators suggest that there was quite a sharp drop in the degree of activity compared with the quantity of inputs.

The ONS did some extra work under the last Government to try to improve public sector productivity measurements. That programme has now come to an end, but it was more about improving measurements in some of the other services where, in the past, we have not tended to do such a good job of measuring outputs.



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Q35 John Glen: Dr Tetlow, I imagine the general public's view of health expenditure is that too much money is spent on admin and managers rather than doctors and nurses. I seem to remember that when I asked that question when I was in government, that was not the actual reality. Are you aware of any research or data that gives a portrayal of the UK's expenditure on management and admin, and whether it is disproportionately high or indeed disproportionately less than in other health systems?

Dr Gemma Tetlow: I cannot remember the exact numbers, but in the report I mentioned that looked at NHS productivity, colleagues of mine concluded that the NHS spent relatively little on administrative support compared with other comparable countries. By looking qualitatively and talking to people within the system, we certainly came to the conclusion that cut-backs in management and administrative support are one of the things that have been making frontline staff less productive in recent years.

John Glen: That is quite striking; it is at odds with so much of the political narrative.

Dr Gemma Tetlow: Yes. I think there is a temptation to maintain the frontline and cut the unnecessary back-office admin, but when you start doing that you often end up transferring some of those burdens on to the frontline staff, and asking them to do tasks that are not to their comparative advantage and distract them from what you really wanted them to do.

Q36 Chris Coghlan: Dr Surico, do you believe that if the Government spent an extra blackhole-sized £20 billion a year on R&D and crowded in an extra £40 billion in private R&D, in five years' time, if executed properly, it would be possible for us to be a fast-growing advanced economy like South Korea? How would you finance that?

Dr Paolo Surico: This is a very good question. Of course, it is a political decision. Let me separate the answer into two, but first I want to make a remark. I do not want to sound like I am giving a price tag, and that if you put some money here, you get this. It is much more complicated than that and there is massive uncertainty. But just to give an idea, with £5 billion more in R&D per year, you will get to the same level of R&D, as a share of GDP, as the United States. With £20 billion more per year, you will arrive at the level, as a share of GDP, of South Korea.

If you want to maximise economic growth, you need to decide whether you want to do it without increasing borrowing or with it. If you do it without, you can still stimulate economic growth within budget by doing budget-neutral spending, which reallocates resources away from day-to-day spending and towards R&D. However, you can also go to borrowing. In fact, historically, that is the way in which this country and the United States of America have funded most of their increases in defence spending, especially when heavily tilted towards research and development.



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The reason is clear: defence R&D, and public R&D more generally, is what generates significant economic growth. It therefore minimises the chances of an increase in the cost of Government borrowing. This is the famous r minus g equation. What matters is not whether you use debt or not. Argentina defaulted with a 60% debt-to-GDP ratio. Japan has a more than 200% debt-to-GDP ratio and it is not in trouble.

What really matters for financial markets is what you use this borrowing for. If you use borrowing for public R&D, the market knows that is one of the things that generates the most economic growth going forward. In fact, historically, for the UK and the US, more than 80% of that increased borrowing due to the defence budget has been paid back by higher economic growth, not higher taxes or higher inflation in the future.

Of course, if the borrowing is done to increase resources or capital investment in marginal products that do not generate productivity, it is not financially sustainable. The market will see through that, and therefore the borrowing cost on public debt will increase significantly.

Q37 John Grady: To pick up on that last discussion, Ms Miller, do you agree with the analysis that if we increased borrowing to fund R&D, that would not give the debt markets the heebie-jeebies?

Helen Miller: I agree that R&D spending is one of the most growth-friendly things that the Government can do, but I think it matters what you are increasing it from.

This is not going to happen, but let's say that we get to the autumn Budget, for example, and Rachel Reeves says, "I'm going to blow through my previously iron-clad fiscal rules and add £20 billion of borrowing. I am just going to add to the debt stock, and I am no longer going to have debt falling sustainably." Even if you can make the case for that R&D chunk of it being non-problematic, the market would worry that, having been very clear that you were not going to do something, you have changed course and debt was now not falling. I think that would be problematic. That is different from saying: if she had done £20 billion less borrowing somewhere else, and £20 billion borrowing in R&D, would that have had a higher growth effect? Maybe.

The point I agree with is that it matters what you are borrowing for, which is what I was saying earlier. There is a fiscal rule trying to be a constraint; it is not a get-out-of-jail-free card. It does not mean that, once you have that constraint, you can always just borrow up to the maximum, spend it on whatever you like and that is okay. You still have to do the hard yards of thinking about the purpose for which you are borrowing the money and whether that is a good use of borrowing. It is easier to make that case for R&D than some other things.

Q38 John Grady: Let us move on to chainsaws and DOGE—you mentioned Argentina, Dr Surico, so I thought I should mention chainsaws. Dr Tetlow, are you content that a full and effective zero-based review has been carried out in the spending review?



Dr Gemma Tetlow: We welcomed the idea of doing the zero-based review. That is definitely the right way to approach decisions, and many spending reviews in the past have simply thought about what the marginal growth is in every budget. However, looking at the documents, it is hard to see much evidence of where that zero-based approach has really led to important decisions being made in the budgets.

On the positive side, we saw that every Department had to set out 1% a year in technical efficiency savings, and it is good to see greater transparency in the roughly two-page documents for each Department, which detail where they expect to be able to find those efficiency savings. That is perhaps some evidence of them having thought about what they do and how they can do that better.

There is not a lot of detail in some of those plans, and some of the things detailed in there are things that Departments have already been doing, so it is not entirely clear whether those are extra savings or they are hoping somehow to do more with what they have already been doing. If it had really driven very important decisions or new insights for Departments, it would have been good to see some of the spending review documents say, "In Department X, we have done a zero-based review and actually decided that this programme that we used to run is not very effective. We are going to move the money out of here and put it somewhere else." There was not really any evidence of that in the budgets.

Q39 **John Grady:** Apart from, perhaps, away days and pens—that was mentioned in the spending review document.

In the thematic reviews, you look at what the departmental limits are, tax and tax breaks, and annual managed expenditure in the round. You might say, "We're spending all this money on housing benefit. Let's build some more council houses." Would you say that, at this stage of Government spending, that is a more effective way of addressing the constraints we face? Perhaps we could start with Dr Tetlow and then move to Ms Miller.

Dr Gemma Tetlow: We very much welcome the announcement of the thematic reviews that are going to happen between now and the next spending review. That is a real opportunity—outside the heated political pressure of the spending review process itself, where there is obviously a lot of haggling over budgets—to take a step back and look at an area of spending.

You are absolutely right that the places where you might get most value from that are either areas that cut across departmental boundaries or areas that can bring in annually managed expenditure and tax expenditures as well. You can think more in the round, do that review and then be better placed, going into the next spending review, to actually understand some of the much bigger allocative shifts that could be made to improve the efficiency of spending.

Q40 **John Grady:** Ms Miller, two numbers that spring out are the 10% administrative budget cut, which seems to be backend-loaded, and the total of £14 billion in annual efficiency gains. Does that sound achievable



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to you?

Helen Miller: I would say two things. On the broader point about whether it is zero-based, it is worth drawing a distinction, which you are doing, between day-to-day spending, where it looked like a more serious attempt to go into Departments and look at where day-to-day efficiencies could be made, and the administrative budgets, where it is very stark.

But if you look at the Departments, it was assuming the same for everywhere. If you genuinely went around and asked each of them—some are getting big budget increases and some are getting big budget cuts, and they are presumably changing programmes—whether it is right that they can all make savings of exactly 10%, I would be very surprised if that was the correct answer that came out. I guess you will need to ask Government why that number has been chosen, rather than it being a bit more varied across Departments.

As to whether it is achievable, the honest answer is I do not know. In some sense, people were asking back at the start of 2010 whether we could make big cuts, and we did. What matters is whether we can do efficiency cuts. What is efficiency, really? If you mean, “Can we really cut our budget and not change how we do anything,” that seems pretty aggressive to me. As I said earlier, I think we should be trying. The public sector should be trying to be efficient where they can, because it is clearly important, but I would want to see the theory of change and how you are going to do this. The way the Treasury might do it and the way DSIT might do it are obviously going to differ, because they are different kinds of Departments.

To answer the question of whether it is achievable, I would want to see the zero-based version. What would you need to do in those Departments to do it? Can you really cut the number of staff or the amount of spending that is not just on stationery or away days in order to really find those savings, or are we actually talking about stopping doing things? Personally, I would not call that efficiency; I would just call it stopping doing things.

Dr Gemma Tetlow: To add to what Helen said, I agree that it looks a little bit strange that this is the same across all Departments. If you look at how the civil service has expanded in numbers over the last decade or so, that happened post the Brexit vote and then throughout the pandemic, but there are some Departments that have obviously taken on significant new responsibilities as a result of Brexit. At the same time, we have had a big expansion of the policy profession in a lot of the central Departments. Maybe that is not as necessary to sustain post pandemic.

We welcomed the fact that this is a “pounds cut” number rather than a headcount target, because the headcount target has driven some quite perverse behaviour in the past. What was disappointing is that we had been expecting to see a civil service strategic workforce plan come out alongside the spending review. That has now been delayed for a few months, and you would have expected to see those two things go



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together—the thinking about what we want the civil service to do strategically, and how much we think we can save from civil service numbers. It is a bit disappointing that we have not had that detail yet, so it will be key to see what is in the civil service strategic workplace plan to understand whether it is about efficiencies or stopping things.

- Q41 **John Grady:** That is a good point, and it takes us to the next question. We have obviously had the spending review, but there is a need for a long-term culture of looking for efficiency improvements and value for money in Government. If you look at workplace plans in Singapore, there is a very close relationship between the universities and the Government. The universities produce the people the Government need for public service, so it is a virtuous circle. That takes us to one thing that might be designed to inculcate more of an efficiency mindset in Government: the 1% technical efficiency target for all Departments. Dr Surico, how do you see that target operating? When you unpick it, it is actually quite complex.

Dr Paolo Surico: It is. You are absolutely right that universities and, in particular, UKRI and also the health council play a crucial role in the Government's strategy, especially when it comes to R&D. So there is also a human capital component that feeds into R&D, which could also lead to the productivity gain needed for efficiency. However, I am not an expert, so I am not comfortable commenting on that specific point.

- Q42 **John Grady:** Ms Miller, how do you think this 1% efficiency will work? It seems quite complicated to me. How will it be measured?

Helen Miller: Gemma might have better ideas on that, because it is more of an IFG thing. I do not know how it will be measured, so I will leave that in case Gemma has a better answer. However, one thing I would pick up on, which relates to Gemma's broader point—she was absolutely right—is the need to see the wider plan for the workforce. One thing you might want, as you have suggested, is a workforce with the kind of skills that can drive value for money.

There are other things you might want as well. You might want more research capacity—thinking about what Paolo talked about—such as having a civil service that has capacity to work more closely with researchers, or you might want people with more expertise from the private sector, or other things. There are lots of different things you might want to bring into the civil service workforce, and that will differ across Departments.

You cannot answer the question about technical efficiency without first answering that: what skills mix you need, how you are going to bring them in, how you are going to get more efficient. Basically, to answer the question asked earlier about what drives economic growth, at the highest, fundamental level you either take your resources and allocate them more efficiently or you have to become more innovative. That is going to be true in the public sector.

You need to take what you currently have—your machines and your people—and combine them in ways that drive efficiency. Or you need



some sort of technological progress so that a given set of resources can do more. That will be true in the public sector.

I do not know how they are going to measure that 1%, but that is what you will need to look at. You have to organise your people and your stuff, or find technology that allows you to do that. Will that be the same for everyone in every Department? Of course not.

Dr Gemma Tetlow: It is going to be incredibly hard to measure this, but the benefit of having those plans set out is that it at least provides an area to start asking questions as time goes on—like: what is the evidence that you have managed to utilise AI more efficiently? Can you point to the jobs that are now not being done, which used to do that thing? It will be more qualitative than quantitative.

John Grady: Dame Harriett, on this chapter of questions, I am mindful that I have read a lot about it, but Mr Glen might have some questions—and he has actually done a lot of it.

Chair: Indeed, but before we get to Mr Glen we are going to hear from Dr Jeevun Sandher.

Q43 **Dr Sandher:** Dr Tetlow, how easy do you think it is to forecast the impact of departmental spending on changes in growth and fiscal outcomes? If you increase health spending, for example, what would that mean for growth in future years? And what if we cut health spending? How much did we see the cuts in the 2010s reflected in fiscal and growth impacts later on?

Dr Gemma Tetlow: It is pretty hard to forecast and to know what the impact of that will be. I suppose the question is: how big a range of outcomes do you think it plausibly might have, and so what sort of orders of magnitude are we talking about?

In some ways, there are some of the growth-to-health-spending stories, for example, where perhaps the evidence we have suggests it is not as strong as some people might suspect. There had been suspicions that perhaps one of the stories explaining growing ill-health inactivity might be NHS waiting times, for example. However, a few different analyses, including from the IFS and the OBR, have tried to look at that and there is not much evidence that those two things are closely related to one another. It is quite hard to unpick some of those things, and certainly hard to estimate the overall macro impact.

Q44 **Dr Sandher:** That is what I am trying to get at. We know that early years education policy, for example, has had a hugely beneficial impact on growth. We also had quite large public health cuts in the early 2010s. Did you think that, in the modelling you saw, there were, for example, public health impacts, which stopped people doing things. Later on that was a driver of health spending because you are not doing prevention, you are doing treatment. But did you ever see any of that in the modelling or was the modelling just saying, "There is going to be a cut spending, this is what the overall impact is going to be and that is where we are going to

end up.”

Dr Gemma Tetlow: When you ask “Did you see,” from whom do you mean?

Dr Sandher: In general, from the OBR or the IFS at the time, did you see, for example, cuts to particular programmes being brought out in the modelling to say they think this might lead to other pressures later on?

Dr Gemma Tetlow: My understanding of the way the OBR does its modelling is that it takes a fairly high-level approach to thinking about how Government spending impacts on growth. It distinguishes between the near-term, demand-side impact where there is a multiplier, which is usually just a blanket multiplier applied across all of resource DELs, so it does not distinguish where you are doing that. It also thinks about which types of Government spending might have longer-term supply-side impacts.

At least to my knowledge, I do not think it has ever factored in the long-term supply-side impact of changes to resource DEL or public services departmental spending. I have not seen any good evidence, although I am not sure there is much evidence on whether that is the right assumption to be taking. I certainly have not seen strong evidence that there is a different multiplier that it should definitely be assuming.

At a fundamental level, you are right that there is a reason that we have these public services. They do, in some sense, enable economic activity, whether that is having a safe, secure rule of law and order that enables the economy to function or having a healthy or a well-educated workforce. That definitely has impacts. The work that the IFS has been doing on the impacts of Sure Start has been really interesting and really shows the value of following up those longer-term programmes through the administrative data to understand that.

Q45 **Dr Sandher:** It is really hard. The long-term supply-side impact is really interesting, because now, if you like, we are in the long-term supply-side era. Looking at those forecasts at the time, I am struck that we were going to cut the deficit within five years and growth and productivity were going to be great. Five years later, we still had not cut the deficit, seven years later we had not and then 10 years later, we had not. Covid then came, and I think it is fair to say the pandemic had an impact, but it seems we are undershooting on the productivity side. It seems plausible that some of the previous public spending cuts may have led to that. Does that seem plausible to you?

Dr Gemma Tetlow: There are quite a lot of things going on. There were almost certainly things that happened that no one predicted back in the early 2010s. General economy-wide productivity growth has just been a lot worse than we expected. It may well be that a lot of that would have happened regardless of the precise fiscal stance. In the early 2010s, there was a strong feeling in Government that it was very important to get borrowing down quickly and that the costs of doing that would be high.



With the benefit of hindsight, given how weak private sector demand proved to be in the early 2010s, it is reasonable to say that having low public sector demand at the same time may have been a drag on growth at that point, and may have had some knock-on effects from low demand feeding back into the low expansion of supply. But that does not necessarily mean that the same would be true, for example, now, or in quite a different macro fiscal environment.

- Q46 **Dr Sandher:** It is a big question. Were you struck by the American experience since Covid, where effectively they ran hot and then ended up re-meeting their trend growth path? Did it seem plausible that public spending was having a positive impact on productivity and growth that would not be included in current OBR forecasts, for example?

Dr Gemma Tetlow: I don't know enough about that. The US obviously also had very high inflation and other problems manifesting from running hot, so I don't know; Helen or Paolo might comment.

Helen Miller: I am not an expert in the US context. It is always a bit dangerous to compare to the US because it is just a different beast. It has a different history and it is the world's dominant currency. It can just do things that other countries should not think they can necessarily do—and it did have high inflation.

Dr Paolo Surico: A very interesting recent analysis by the IMF shows that one of the key drivers of higher productivity after the pandemic in the US, relative to the Euro area and the UK, was capital investment. The US has gone back to the pre-pandemic level trend, but the EU and UK have not. The UK has started to diverge significantly since 2016. Of course, this only one component of that productivity gap, and it is I think also the reason why the Government are trying to push back on that capital investment. But clearly you can see the trend going back to the pandemic for the US, but not for the UK and the EU.

- Q47 **Yuan Yang:** Dr Jeevun Sandher mentioned the long-run impacts of cutting back preventive services, and Dr Tetlow, you mentioned when you answered my first question that there is also risk in this current spending review that, for example, non-statutory functions of councils such as youth clubs, parent groups and so on are cut back and they may also have long tail impacts. Can you speak to the overall spending framework and how the Government can take that into account? It seems that there has been a shift in productivity of spending, partly because of the shift from preventive spending to crisis response spending, particularly at the council level.

Dr Gemma Tetlow: Looking at the 2010s experience, there are definitely places where you can see that things that save money in the short term then stored up problems for later, whether that was the cuts that were made to capital budgets, which we talked about previously, or holding down staff pay through the 2010s, which then stored up discontent and problems with staffing. Lots of experienced staff left through that period and then had to be replaced, which is partly why we now have a relatively

inexperienced workforce in lots of places. Another place was the cutting back of preventive services.

It is not easy to adjust the spending framework to deal with this problem, because although the Government have recognised the importance of investing in preventive services to save money on acute services down the line, for example, it is very difficult unless you have a lot of extra money to spend, which is obviously not the world we are in at the moment. The acute problems are showing up now, whereas the preventive investments will not be saving you money for quite some time to come.

What we have suggested the Government should do more seriously is to think, within service budgets, about what you would define as being preventive spending within that, and at least gradually over time try to shift your focus more towards those things. It may not be that you get there quickly, but at least over time you have some sense of direction, and you are making sure that you are not just always meeting those acute pressures with your money.

Q48 Yuan Yang: Is there evidence of an impact on the efficacy of Government spending if there has been that shift from preventive to the crisis response?

Dr Gemma Tetlow: Yes, I think there has been. Certainly, the evidence that we have suggests that the cuts in capital spending are now undermining the productivity of resource spending, but also you are seeing cuts to youth services or some of the early intervention homelessness services. Because those services have been cut back, you are finding the problems showing up in the more acute, more expensive parts. There are quite a few examples you could point to.

Chair: Let us turn back to the spending review with Mr John Glen.

Q49 John Glen: I have two process questions. I would like to address the first one, concerning the zero-based nature of the review, to Dr Tetlow. I think we have established that perhaps it has not really identified clearly activities of Government that were not being carried on. We have the £14 billion figure, but do you work with your colleagues at the IFG on the Cabinet Office functions—the commercial function, the Government property function and others—that should offer Departments wisdom and insights into what they could do differently, how they could make savings and so on? Do you have any observations to make about how those functions worked through the zero-based spending review to come up with anything different through the zero-based process from previous ones?

Dr Gemma Tetlow: I don't, no. Obviously, those functional experts should be embedded in Departments; you should have the commercial property experts and so on. It is one thing that we are hoping to follow up on, now that the spending review is out of the way, to understand how far this process was different for Departments and whether, actually, there are things that they can point to.

Q50 John Glen: That leads me neatly on to my second question, regarding the



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nature of the transparency or secrecy of this process. We received evidence from James Murray, who said that it would not be helpful for HMRC to put its initial bid out there because it would risk “undermining the value of the exercise”, and when Select Committees asked for the initial bids of Departments, they were all declined that information.

Obviously, there is a political aspect to this—Departments and Secretaries of State will not want to expose where they have not got what they asked for—but do any of you have any observations to make about the way we do it in the UK versus other jurisdictions? What is the value of this secrecy? In a sense, it stops us having an honest conversation, more openly and earlier on, about the constraints and the trade-offs, doesn’t it?

Dr Gemma Tetlow: I can understand a desire for some degree of secrecy from Government. Maybe Ministers do want to have a bit of private space to have those discussions and make those trade-offs. But one area where we feel there could be more transparency—which I think you are sort of getting at—and is not really about revealing those trade-off debates, is in thinking about what the baseline is that we are working from: “If we just keep doing what the Department is doing at the moment, what do we think the needs are over the next few years?”

That bit of the process has tended to be quite weak in past spending reviews, because there are incentives for both the Treasury and departmental sides to either put more into the baseline or take stuff out to try to pretend that it is possible to do the same with not very much money, or vice versa. We think there could be real value in having a more open baselining process, where Departments set out, “Here is our judgment of what our cost pressures and demand pressures are; this is what we think we need to do to stand still.” That could then be scrutinised publicly by experts and by Select Committees, so that we are all kind of starting from an agreement on that.

Then the next bit of the process would be for Departments to debate with the Treasury and make trade-offs: “Where are our priorities? What are we willing to do less on? What do we actually want to do more on?” That bit of the process could still happen in private, but at least there would be a good-quality understanding of, “Actually, just to do business as usual, realistically, what number are we talking about here?”

Q51 **John Glen:** Thank you. Ms Miller, do you have anything to add on that? In your answers to Mr Dean, you discussed the imperative on capital investment in the NHS versus revenue, and the whole challenge around establishing what is going to be incremental value, given the pressures, but what would you say about how we could improve the spending review process regarding the dynamic of secrecy or transparency?

Helen Miller: I would very much echo what Gemma said. Although the baseline point is kind of technical, it is actually really important. A lot of the public debate is hampered by the fact that people are debating at cross-purposes, and the phone rings off the hook because people want to know why this number is this and this one is that. It just does not help the debate. I think that the Government taking responsibility and clearly



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setting out the baselines would be a genuinely easy thing for them to do, but also a genuine improvement.

Like Gemma, I see why the final debate goes on behind closed doors, but what always surprises me is the before and after. The broader public debate never really gets off the ground, in some sense. We do not see the papers full of debate about the big, society-wide challenge of “Do we put 90% into health? But if we do that, what are the consequences?” Do we say, “Actually, no, we will do something else”? Do we want to do a big thing on defence or net zero? Those debates do not really happen.

You can see that the world has moved on in some sense now—the world is doing some crazy things at the moment—but that broader public debate never gets off the ground. But that is independent; it is not about the spending review process per se. I think it is for politicians, the media and all of us to say, “Actually, it is really important that we have these debates.” Yes, there will be the closed-door, behind-the-scenes final settlements, but the bigger-picture questions about the choices people want to make are really important. That is not about the crunch point of the spending review but is part of the information before that about the pressures and what the Government are doing.

I echo what Gemma said about Governments never wanting to tell you what they are going to stop doing. From a PR point of view, I see why that is the case, but if you were an average person on the street listening to Rachel Reeves’s speech, you would hear the big-ticket items and all the new stuff. That does not help you to get a sense that there were some really hard choices here: “We did this and we did not do that,” or, “We’ve stopped doing this in order to do that,” or, “Local government is not going to provide as many bin collections or local social services because it is doing something else.” More of that discussion would help.

Q52 John Glen: As your immediate predecessor Paul Johnson said on the day, it was difficult to make sense of all those numbers: there were slightly different aggregations, different historic figures, different future figures, and some were adjusted for inflation and some not. You have been at the IFS for 18 years; can you tell the Committee what you saw happen differently at this spending review compared with previous ones you have observed?

Helen Miller: In some senses, the sad thing is it does not feel very different. It felt a bit more like before my time, with Gordon Brown kind of playing with numbers. Politicians always want to put forward the best case for their pitch.

One thing that I expected that I did not see—partly because some things like the industrial strategy have been pushed back—is more of the theory of change behind some of the numbers. There was a big increase in capital and some big-ticket items, but on things like defence and net zero, I would not be surprised if the Government came out with an argument along the lines of, “Some of that spending is actually part of an industrial



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policy where we are trying to grow the sector.” But that is not what the spending review is setting out right now.

We might get it in the industrial policy, but in some sense what you think about some of those pounds of spending depends on what the Government themselves think they are trying to do. If you have told me, “All I want to do is growth,” why are you doing more warm homes and more bullets? Of course, that is not all they want, but to evaluate whether that is a good set of spending, you need a really clear articulation of what the Government are trying to achieve. With that in hand, it is still difficult to say whether it is the best industrial strategy, but it is easier to debate those things if you know what the Government themselves are trying to achieve.

John Glen: And that was not as transparent as you would have liked?

Helen Miller: Once we get some of the documents we are still waiting for—the infrastructure plan, the industrial strategy and the other things—we will have more information. At the moment, we have not got the full picture. It would have been nicer if it had been closer, so that we could have been discussing those things today in the round.

Q53 **John Glen:** Dr Surico, would you like to add anything on this subject?

Dr Paolo Surico: Very briefly. There is a lot of emphasis across Departments, which politically is very sensible and an important discussion, but I would like to distinguish the political point from the economic point. As you rightly pointed out, if the goal is economic growth, it is not a matter of which Department gets the money; it is more a matter of what that Department uses that money for. I think I already made clear what I think they should be doing.

John Glen: Something to do with R&D?

Dr Paolo Surico: But of course, and not necessarily only in defence. There is a political priority, and you pick whether your priority is building homes, cutting waiting times in the NHS, economic growth or whatever. Given that priority, it follows which Department gets the money. But it is much more important, together with the industrial strategy review, to make it clear what that money is being spent for.

Dr Gemma Tetlow: Very briefly, there were areas where we got more information in this spending review compared with previous ones—I do not want to completely underplay that—particularly things like separating out budgets for Sizewell C and High Speed 2, having longer-term capital budgets and, hopefully, ultimately having an infrastructure strategy. We will have more detail for this spending review than we have had for ones in the past, but there is still definitely more that the Government could do to be clearer.

Q54 **Bobby Dean:** Dr Tetlow, my question is about the Green Book review that happened alongside the spending review. Commentators sometimes criticise the “Treasury brain” in a derogatory way, and often point a finger



at the Green Book as being part of the problem. It seems, on the surface, that the review was trying to address a lot of the common criticisms about how it is biased towards particular regions and does not take account of long-term transformation, and so on. What is your view on the Green Book review? Does it really matter, or is it just down to Ministers at the end of the day anyway?

Dr Gemma Tetlow: A summary of my view would be that some of the criticisms of the Green Book have been overstated, or just misunderstand how it actually works. You do need to think about genuine regional differences in returns to projects, and I do not think you want to skew the Government Green Book guidance. If your political objective is to invest in particular parts of the country, it is much clearer just to state that as the political objective and appraise projects on that basis, rather than trying to skew the underlying assumptions in the Green Book to give you the answer that, politically, you knew you wanted in the first place.

Having said that, there are some weaknesses in the way the Green Book operates that the Green Book review's proposals may help to address. The Green Book already has place-based analysis of projects, but the review suggests doing a new place-based analysis of multiple projects together, to try to assess what the transformative impact might be of doing a set of things in an area, rather than looking project by project, which is currently how the Green Book works. It is not totally clear how that is going to work in practice, but that could potentially be an interesting way of getting a different view on the returns of projects.

It is very welcome that the Green Book review explicitly bans using benefit-cost ratio thresholds as a way of deciding on projects. That should not have been happening anyway. The benefit-cost ratio should, according to the Green Book guidance, be just one part of the appraisal, and should never be used as a yes/no, but it seems that that has occasionally been happening in some parts of Government, so it is good to state a blanket ban on doing that.

It is also very welcome that they have reiterated and issued more guidance on the need to publish business cases for all major projects within four months of getting Treasury approval. Over time, that should help to build public understanding of the basis on which major projects were signed off and, as those projects go on, of whether they are delivering the benefits and achieving the costs that were expected. Those things are very welcome, but some of the perceived problems with the Green Book that they were trying to address were probably overstated.

Q55 Bobby Dean: You mentioned that the Government sometimes need to be clear about what in their calculation is dependent on the framework and what are just political decisions. The example that springs to mind is the announcements on transport infrastructure, in which there seemed to be nothing for London this time. There may be higher need throughout the country, but if you have growth as an objective, having no announcements on transport infrastructure for London seems odd to me. Do you think that was perhaps an example of the Government saying that the Green Book

changes meant they were going with a certain decision, when it was actually a political decision?

Dr Gemma Tetlow: It is difficult to know. Paolo made the point earlier that, in general, the economic evidence shows that if you put a new link somewhere, that can be more transformative than a marginal, additional link. That could be a reason why you would end up with a high assessed benefit-cost ratio of a project where you are creating a new link between two major cities, for example, but I do not know the evidence well enough on the set of projects they would be evaluating.

Q56 **Chris Coghlan:** Dr Surico, on our previous discussion, there is a lot of scepticism about the MOD's ability to deliver in terms of new equipment and procurement. How should one best do innovation in defence?

Dr Paolo Surico: This is important, and allow me also to connect with the excellent point that Helen made about efficiency. There is a misconception that innovation is only about pushing technology and pushing the frontier of knowledge, but it is not only about that. Innovation is also about being able to do the state of the art more quickly.

Incidentally, that is exactly how Ukraine is fighting the war with Russia. Russia is putting in more equipment and more soldiers, but not higher productivity. Ukraine has been going into its back garden and developing state-of-the-art technology and drones with half the cost, in a third of the time and with 90% less tools. The idea is that you can fight a war by having drones that may have half the productivity of the state of the art, but cost a tenth as much, which means you can do five times more than the state of the art. For me, that is a big lesson that goes well outside defence. Innovation is not just about pushing the frontier; it is also about becoming more efficient.

Going back to your point about AI innovation, the Government are mission-oriented. That is what we see a lot with innovation. The Government become mission-oriented, which in this case is energy security and developing net zero and low-carbon emissions. Those are all things that can be achieved by pushing the frontier, but they can also be achieved through increased efficiency. That is the innovation that has allowed Ukraine to offset a numerical disadvantage. It can also be a source for improving the efficiency that the Government are looking for.

Chair: That is a fascinating example for us to learn from. Our panel today have given us three fascinating economic perspectives on the spending review, its scale, the fiscal rules, the zero-based nature—or not—of the spending review, and the importance of research and development and innovation. All the points you have made will help us to ask much better-informed questions when we have the Chief Secretary in front of us next Wednesday morning. Thank you so much for your evidence today; we have really appreciated it.