Written evidence submitted by Rt Hon Simon Clarke MP, Chief Secretary to the Treasury

Additional information provided following the oral evidence sesson on 29 November 2021

Allocation of funding to overarching priorities under the Integrated Review

1. **Given that the Ministry of Defence received the lowest percentage increase across Whitehall in its settlement for the financial year 2024-25, and the FCDO received an actual cut from pre-pandemic spending, are you satisfied that the Government is truly prioritising the UK's national security and international action?**

The Ministry of Defence (MOD) was provided with a four year settlement at Spending Review 2020 – a year ahead of most other departments - with a significant investment of £24 billion across total DEL. This settlement was front-loaded, with a significant uplift in year 1 of the settlement, reflecting the profile of the transformative investments committed to at SR20. As the base year of SR21 is 2021-22, this ignores the year 1 investment in MOD's settlement. Therefore, starting from the base year of MOD's SR20 settlement (2020-21), the defence budget grows by an average of 1.9% above inflation each year, up to 2024-25.

The conclusions of the Integrated Review informed the SR20 settlement. It was right the government acted on the conclusions of the Integrated Review – even if not published yet – to provide financial certainty and investment in cutting-edge technology.

1.1 **The security and intelligence agencies fared well under SR21 by comparison, with an average increase of 4% in their budget each year to 2024-25. Why were the agencies such a priority among the traditional 'security' departments***?*

The uplift of 4.0% equates to a £0.7 billion cash increase from 2019-20 to 2024-25. This includes £0.2 billion in RDEL and £0.5 billion in CDEL. This investment in the security and intelligence agencies supports the delivery of the priorities set out in the Integrated Review. It ensures that the UK Intelligence Community can continue to retain their world-leading capabilities to counter national security threats to the UK; and aligns with the £24 billion investment in the Ministry of Defence over the same period.

Consequences of spending decisions in specific policy areas

2. **What was the core spending of the Foreign and Commonwealth Office before it was merged with the Department for International Development in September 2020?**

At Spending Round 2019, the last pre-merger Spending Review, the Foreign and Commonwealth Office (FCO) received £1,101m resource DEL (including £747 million non-ODA) and £98 million capital DEL.

2.1 How much and what proportion of the FCDO's settlement will be available for bilateral diplomatic activity in countries that are not ODA-eligible?

The Foreign Secretary will decide how to allocate the FCDO's settlement in the coming months. This will include consideration of the proportion of the FCDO's non-ODA settlement that is used for bilateral diplomatic activity in countries that are not ODA-eligible.

2.2 How does this compare with the funding that was available for such activity before the 2020 merger with DFID?

At Spending Review 2021, the Foreign, Commonwealth and Development Office (FCDO) received £843m non-ODA resource DEL in 2022-23, £819m in 2023-24, and £810m in 2024-25. This comprises 11%, 12%, and 12% of its resource DEL budget in each year. This exceeds the sum of the non-ODA resource DEL allocated to the FCO and the Department for International Development at Spending Round 2019: £788m. The FCDO's non-ODA capital DEL settlement is £103m, £101m, and £98m in respective years.

3. **How did you arrive at the figure of £20 billion in government spending on R&D by 2024-25, and £22 billion by 2026-27? What were you comparing these target figures against in making your judgements?**

3.1 Many of the Integrated Review's goals rest on the ambition to lead in key emerging technologies. In the event that the UK misses the target of spending 2.4% of GDP on R&D by 2027, will the Treasury make up the shortfall?

The Government is providing the fastest ever sustained uplift in R&D funding, increasing R&D funding to £20 billion per annum by the end of the Spending Review period. This includes full funding for association to Horizon Europe, enabling further collaboration with our European partners.

Against the difficult fiscal backdrop, we are prioritising investment in science and innovation, allowing us to make significant progress towards the government's ambition to increase R&D spending £22 billion by 2026-27, and driving economy-wide R&D investment to 2.4% of GDP by 2027. Expansions to the scope of qualifying expenditure for R&D tax reliefs also mean that businesses will be able to claim relief against their data and cloud computing costs, meaning they can claim more relief when using computational R&D methods. Combining the government's direct spending on R&D with the support for tax relief, total UK R&D support as a proportion of GDP is forecast to increase from 0.7% in 2018 to 1.1% in 2024-25. This is well above the latest OECD average of 0.7% (OECD 2019).

Reaching 2.4% requires a substantial increase in R&D investment across the economy. Businesses' own funding of R&D makes up the greatest share at 51% of total funding of R&D (ONS, 2020). Gross Expenditure on R&D in the UK in 2019 was 1.8% of GDP, lower than other advanced economies and below the OECD average of 2.5%, primarily driven by low business investment in R&D (OECD, 2018 and 2019).

The Plan for Growth and Innovation Strategy set out the government's plan for stimulating business investment in R&D, recognising the key role business innovation will continue to play in driving growth and progress in emerging technologies.

The latest ONS data (2021) show that business R&D grew strongly in 2020, with businesses' own funding increasing by £661 million to £20.3bn. The Spending Review substantively increased support for core Innovate UK funding, to around £1bn a year in 2024-25 - over £300 million more per annum than in 2021-22 - and provided significant uplifts for applied research and innovation in key priority areas for government, from clean transport to national security.

The Treasury as a national security policy department

4. To what extent are your spending priorities under the Integrated Review based on the level of harm done to citizens?

The Integrated Review set out clear ambitions, priorities and objectives for the UK over the next ten years. It also provided an updated assessment of longer-term international and security trends. This complemented the existing National Security Risk Assessment (NSRA), which provides an assessment of the likelihood and potential harmful impact of the most serious risks facing the UK or its interests overseas.

At Spending Review 2021, the Treasury worked with the National Security Unit in the Cabinet Office to assess departmental bids and to prioritise and allocate resources. This reflected wider prioritisation of national security risks by the NSC and the Integrated Review, and was also informed by the NSRA.

4.1 £754 million was stolen from UK bank customers in the first half of this year. How does the funding allocated for tackling fraud and money laundering compare with that for counter-terrorism under SR21?

The combination of this year's Spending Review settlement and private sector contributions through the forthcoming Economic Crime levy will provide economic crime funding totalling around £400 million over the SR period.

Specifically, Spending Review 2021 announced new investment of £18 million in 2022-23 and £12 million per year in 2023-24 and 2024-25 for economic crime reforms, in addition to £63 million across the Spending Review for Companies House Reform. We are also continuing to provide £30.5 million per annum of resource funding announced at SR20, which will support this Government's work to tackle money laundering and initiatives to combat economic crime initiatives. In addition to that public spending, the introduction of the Economic Crime Levy will raise approximately £100 million per year from 2023-24 from entities subject to the Money Laundering Regulations.

Spending Review 2021 also provides around £400 million of additional funding for counter-terrorism over three years, helping to keep our people safe. This includes funding to support the delivery of the world-leading Counter-Terrorism Operations Centre (CTOC).

5. **What is your most recent estimate of the levels of illicit finance flowing through the City of London and the UK economy more generally?**

Estimating the levels of illicit finance flowing through the City of London and across UK economy is challenging. Nonetheless the Government recognises that the size and international nature of the UK financial and professional services sectors does leave the UK exposed to Serious Organised Crime and Hostile State Activity actors who seek to launder illicit finance funds. We judge that there is a realistic possibility that the scale of money laundering impacting the UK annually is hundreds of billions of pounds. As an illustration, the largest money laundering scandal in Europe (Danske Bank) involved €200 billion suspicious transactions, with 40% of those flowing through UK registered entities.

6. **How have the Integrated Review and Spending Review strengthened the necessary tools to discern which financial flows are of concern? Will there now be a step-change in resources and regulation?**

In the Integrated Review, the Government set out its commitment to tackle economic crime and illicit finance. The Government is currently developing strategies to combat cash based and high end financial flows of concern for publication in the Economic Crime Plan 2.0. Policy progress is monitored regularly through the Economic Crime Strategy Board which is jointly chaired by HM Treasury and Home Office's Permanent Secretaries as a part of the Integrated Review Implementation Group.

This process has supported the development of a sustainable funding model that demonstrates the Government's commitment to tackling this form of economic crime. The combination of this year's Spending Review settlement and private sector contributions through the levy will provide economic crime funding totalling around £400 million over the SR period.

The Spending Review announced new investment of £18 million in 2022-23 and £12 million per year in 2023-24 and 2024-25 for economic crime reform. More specifically, over the Spending Review period HM Treasury is providing BEIS with £63 million to support reform of Companies House. This will support this Government's work to tackle the exploitation of UK corporate vehicles by criminals.

These investments are significantly increasing the number of dedicated financial investigators in the National Economic Crime Centre, Regional Organised Crime Units and the UK Financial Intelligence Unit. This will strengthen law enforcement's capabilities to investigate and crack down on criminals and seize dirty money.

7. **As the Chancellor of the Exchequer is now responsible for economic security, will he be the arbiter of any potential disputes between the Business Secretary**

and other Secretaries of State on foreign direct investment, once the NS&I Act comes into effect in January?

Under the new regime, the Business Secretary will be the decision-maker and will undertake that role in a 'quasi-judicial' capacity where, given the nature of the decisions being taken, it is particularly important that the decision-maker acts independently. This means that, whilst the Chancellor and other interested ministers may be engaged on individual cases, decisions are ultimately the responsibility of the Business Secretary.

8. **What analysis has the Treasury undertaken of the national security risks posed by cryptocurrency in particular, and by digital currencies in general? For example, have you considered if these currencies could enable illicit finance or be used for geopolitical leverage?**

HM Treasury and Home Office jointly published the UK's Third National Risk Assessment of Money Laundering and Terrorist Financing in December 2020. It updated the findings of the previous NRA, published in 2017, including on cryptoassets.

The NRA found that the risk of both money laundering and terrorist financing via cryptoassets had increased from low to medium since 2017. This revision was driven by evidence of more widespread adoption by criminals and terrorists. The NRA covered the potential uses of cryptoassets for money laundering, terrorist financing, and other illicit financial activities, based on intelligence and data from the UK intelligence and law enforcement communities.

The Government is aware of cryptoassets' potential to be used as an alternative international mechanism for value transfer, evading checks and controls - such as sanctions controls - that apply to the mainstream financial system. The UK is actively engaging in international discussions to ensure a global response to the risks posed by cryptoassets, including their use as a method of payment in ransomware incidents, via the FATF and other fora.

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