



## **Spending Review NCVO Analysis**

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## Introduction

The Government has published its Spending Review plans with resources across departments allocated in line with government priorities until 2014-15. The overall picture is one of fiscal retrenchment with significant cuts to government spending in most areas.

The Government's central economic priority is to eliminate the structural deficit over the Spending Review period. Government is seeking to significantly reduce borrowing – from around 11% of GDP today to around 1%. In this climate, we are not arguing that the VCS should, or indeed can, be immune from spending cuts, but that the Government's approach must be fair, rational, and proportionate and that the sector is not seen as a soft target for cuts.

NCVO's key public policy priorities are:

- for the impact of spending cuts on the VCS to be mitigated, particularly at a time when the Government's ambition is for the sector to do more. This formed an important part of NCVO's Spending Review submission where we suggest a number of changes to tax, regulation, public services reform and a commitment to good funding practice to reduce the impact of having less money overall<sup>1</sup>;
- for government to commit to good funding practice to enable the VCS to work as effectively as possible with more limited resources;
- to ensure that the VCS has the right resources and support to operate in his challenging environment. The package of support from government announced as part of the Spending Review, including a £100m transitional fund (which is discussed in detail later in this briefing) will play an important part in this;
- government must champion the principles of the new Compact to provide a clear framework in which the relationship between the state and the VCS should operate;
- changes to public services must take place in a way that enables the sector to shape the services of the future, and put the needs of individuals and communities at the heart of reform;
- for a level playing field to be operate. This includes spending cuts, where cuts should be phased in over time in the VCS, in the same way that government has indicated they will be in central government departments.
- for government to work with the VCS to create the right framework to promote increased giving.

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<sup>1</sup> NCVO's Spending Review submission is here: [http://www.ncvo-vol.org.uk/sites/default/files/SR\\_final.pdf](http://www.ncvo-vol.org.uk/sites/default/files/SR_final.pdf)

As a result of these spending reductions, the public sector will shrink in size and some analysis suggests that levels of spending as a percentage of GDP in the UK may dip below the levels likely in the US by 2013<sup>2</sup>.

As a result of the shrinking of the state, it is clear that there will be significant job losses in the public sector. Estimates vary, but 500,000 jobs are likely to go in the public sector by 2015. The Government's strong policy position is that the recovery will be led by the private sector, and the expectation is that the private sector will be 'taking up the slack' and creating jobs to replace those lost in the public sector. There are also likely to be significant opportunities for the VCS in this climate to take on additional functions currently performed by the public sector.

This Spending Review is about more than cuts. The coalition has a different vision of the appropriate role of the state and the appropriate balance between the public sector, the market and civil society. The state will not just get smaller but will change in nature. There will be a significant decentralisation of power from central to local government. Local government will have more power, flexibility and discretion. We have already seen a significant scaling back of targets, monitoring and reporting requirements on local government. The relationship between the VCS and local government will change (which is particularly significant as the majority of statutory funding is already channelled through local government) and the VCS will be operating in a changed environment.

The Spending Review highlights a number of areas in which public services are to be reformed and this desire to reform the way in which services are designed and delivered presents opportunities for the VCS.

### **What happens next?**

The Spending Review has outlined the headline figures on how much money each department will be allocated between now and 2014-15. A more detailed picture on what this means for the VCS will emerge in the coming months and a significant decentralisation of power and discretion to local authorities will mean that decisions taken locally will have an even greater impact on the sector.

Timeline:

- June: Coalition government budget announced overall spending plans. Despite significant real terms spending cuts in most areas, total government spending overall will increase from £640bn in 2011-12 to £659bn in 2014-15.
- October 20: HM Treasury publishes Spending Review, outlining resource allocation for all departments until 2014-15.

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<sup>2</sup> Taylor-Goody, P and Stoker, G (2010) *Sleep walking through a cross-roads*

- November: expected publication of the Decentralisation and Localism Bill.
- Late November (expected): Local government finance settlements received.
- By the end of 2010: each government department to publish a business plan including its priorities, structural reform plan and key measurement indicators to assess the cost and impact of services and activities.
- November-December onwards (expected): initial announcements from local authorities on spending plans. Most announcements are likely to come in early 2011.
- Early 2011: Government to publish a Reform White Paper

### The macroeconomic picture

There are significant cuts to most departmental budgets, with an average of 19% to be implemented over four years. Government will continue to borrow heavily in this financial year (the gap between receipts and expenditure is likely to remain at over £150bn) but the overall direction of travel is one of reductions in spending and quick reductions in borrowing. Public spending as a percentage of GDP will return to 2006-7 levels and in real terms to the level of spending in 2008-9.

There are large variations in the scale of cuts between departments. Overall spending has not been cut to the levels that some media commentators suggested over the summer, but these cuts to spending are significant and there will be an impact on the VCS as the levels of statutory funding will decline. The varying levels of spending reflect government policy priorities and, to an extent, the different approaches taken by various departments in the negotiations around spending cuts.

Headline spending cut figures over the period are as follows<sup>3</sup>:

| <b>Department</b>                                  | <b>Projected spending reduction by 2014-15</b> |
|----------------------------------------------------|------------------------------------------------|
| Department for Communities and Local Government    | 35.61% of £38.6bn                              |
| Department for Environment, Food and Rural Affairs | 30.2% of £3bn                                  |
| Department for Business, Innovation and Skills     | 27.53% of £20.1bn                              |
| Foreign and Commonwealth Office                    | 26.03% of £1.6bn                               |
| Ministry of Justice                                | 25.33% of £8.9bn                               |
| Home Office                                        | 21.6% of £10.8bn                               |
| Police Budget                                      | 20.22% of £9.7bn                               |

<sup>3</sup> Source: <http://www.bbc.co.uk/news-uk-politics-11583746>. These figures exclude AME (Annually Managed Expenditure) items and are adjusted for inflation.

|                                          |                            |
|------------------------------------------|----------------------------|
| Department for Transport                 | 14.52% of £13.1bn          |
| Department for Culture, Media and Sport  | 12.81% of £7.1bn           |
| Wales                                    | 11.4% of £14.9bn           |
| Scotland                                 | 9.28% of £28.2bn           |
| Her Majesty's Revenue and Customs        | 9.19% of £39.9bn           |
| Department of Education                  | 7.76% of £60.6bn           |
| Northern Ireland                         | 6.68% of £16bn             |
| Defence                                  | 5.90% of £35.7bn           |
| Department for Work and Pensions         | 1.56% of £158.8bn          |
| Department of Health                     | 2.59% INCREASE on £101.8bn |
| Department for Energy and Climate Change | 13.02% INCREASE on £2.9bn  |
| Cabinet Office                           | 26.44% INCREASE on £1.8bn  |
| Department for International Development | 33.68% INCREASE on £7.9bn  |

#### *What does this mean for the VCS?*

- Statutory funding remains a significant source of income to the VCS. Although only 25% of VCOs have a direct financial relationship with the state, public money accounts for around 36% of income to the sector and in some sub-sectors, statutory income is a very significant source of income<sup>4</sup>;
- an accurate assessment of the full extent of spending reductions and the impact on the VCS is difficult at this stage. Local authorities will receive notification of their settlements in the coming weeks and will then make decisions on how to implement spending cuts locally. It is likely that many local authorities will not be in a position to clarify what the impact will be on the local VCS until early 2011;
- the VCS is already operating in challenging circumstances. The recession and subsequent period of slow, fragile economic growth has seen demand increase whilst income has fallen;
- there are low levels of financial resilience in large parts of the VCS. The Government's transitional fund will be of value to many VCOs in managing a potential drop in income from statutory sources but there remain significant concerns about the financial health of the sector;
- VCOs currently delivering public services will be operating in a changing environment. Whilst there will be opportunities in public services as a result of these changes, many contracts are likely to be re-negotiated as local government will have to reduce its spending.

<sup>4</sup> Clark J et al (2010) *NCVO: The UK Civil Society Almanac 2010*: 36% of VCS income comes from the state, compared to 37% from individuals. From 2000-2007-8, statutory income increased by 53% (individuals by 40%). Some sub-sectors are in receipt of particularly high levels of statutory income – the top five are employment and training (70%), education (51%), law and advocacy (51%), social services (50%) and housing (50%).

Changes in public services will present opportunities but are also likely to intensify competitive pressures;

- the Government's aim is to eliminate the structural deficit in the UK economy over the period of this Spending Review. It is important in the context of reduced spending that the Government mitigates the impact on the VCS;
- economic growth will not only improve the health of the general UK economy but should also allow the VCS to operate in a better environment, with the value of investments increasing and, it is hoped, easier access to finance.

### **Behind the headlines: breakdown by department**

A more detailed breakdown of spending per department, factoring in current spending on the VCS, shows an overall picture of less funding for the VCS over this period. This headline figure disguises the fact that there will be 'winners and losers' in this process as money moves around between departments and relative budgetary positions change (see separate appendix for more detailed statistics). This means that individual VCOs will lose or gain funding irrespective of what happens to the VCS overall and some organisations will come under significant pressure.

### **Public services reform**

The Government is committed to the reform of public services and envisages a potentially enhanced role for the sector. The structure and culture of public services may change significantly in the coming years.

The Spending Review includes a reference to a set percentage of services to be transferred out of the public sector to other providers and an aspiration for the state to no longer be seen as the 'default' provider of services. NCVO has long argued that the aim of the Government in seeking to involve the VCS in the reform of public services should be to transform public services, rather than simply transfer them. This quota is therefore not likely to be helpful.

The Government's aim is to increase the diversity of provision in public services. This will result in greater competition and the VCS will be competing for contracts alongside increasing numbers of private providers and potentially a range of new mutuals, social enterprises and co-operatives delivering public services. Significant changes to the public sector and significant job cuts (likely to exceed 500,000) will see skilled, experienced former public service workers also offering services.

This Spending Review confirms a likely shift towards payment by results as the finance mechanism increasingly used in public services. Interestingly, the Government has also made reference to 'payment by savings', i.e. that payment will be made in line with benefit savings that are made.

Depending on how this operates, this could potentially be positive, in that it will provide a genuine incentive to providers to help some of the hardest to reach – for example, in job creation, the incentive to ‘park’ difficult cases and achieve payment through dealing with high volumes of ‘easier’ cases would be removed.

For payment by results to be effective and fair:

- ‘success criteria’ must be fair and proportionate;
- outcomes must take full account of social impact (where the VCS makes a particular contribution) and must be flexible;
- market management must take place to ensure that the VCS is not excluded from bidding for contracts due to an unlevel playing field, an inability to access working capital or the contracts being offered on a scale which is far too large for the VCS to be able to bid;
- cash flow and credit issues within the VCS must be tackled. With low current levels of financial resilience (brought about in large part by conditions attached to public service contracts and by conditions of grant funding), large numbers of VCOs would be unable to bid for these contracts as they may not be able to wait for payment.

## **Localism and decentralisation**

There will be significant cuts to the budget of the Department for Communities and Local Government (DCLG), and some commentators see the Department as one of the ‘losers’ in the Spending Review settlement. The overall DCLG budget has been reduced by around 36% (although the resource budget reduction is actually over 50% when factoring in grant funding that will be devolved to local authorities<sup>5</sup>). The overall pattern is one of spending cuts, with a slimmed down DCLG at the centre and a change in the balance of power between central and local government.

A significant decline in local government funding will have an impact on the VCS. The VCS at a local level is in many areas already subject to cuts. Local authorities will see their budgets cut by an average of around 7% every year (28% over the period of this Spending Review, though smaller reductions in some funding streams will make the ‘real’ cut around 26%).

Local authority capital spending has been cut significantly (by around 45% over the period of the Spending Review) with a reduction of nearly 75% in the social housing capital budget. Local authorities will retain the flexibility of Prudential Borrowing<sup>6</sup>, which will help to alleviate some of the pressures of these cuts in capital funding.

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<sup>5</sup> The Spending Review outlines a plan to devolve over £1.6bn of its budget to local government which will mean an overall reduction in its resource budget of 51% in real terms by 2014-15.

<sup>6</sup> Prudential borrowing was introduced by the 2003 Local Government Act and gives councils a degree of flexibility in deciding how much they can borrow to invest in capital projects and assets – rather than the decision being made by central government.

Alongside significant cuts to funding, there is a marked decentralisation of power from central to local government. The Government has signalled its commitment to localism and decentralisation and is developing further proposals to transfer power and discretion from a central to a local level under the forthcoming Decentralisation and Localism Bill. Amongst these is the proposed power of competence, which will mean that local authorities have a very high degree of freedom and discretion to initiate policies which they believe will improve their local area.

There has already been a significant scaling back of monitoring and reporting requirements, with local authorities having to provide much less data to central government on what they are doing. Changes that have already taken place include:

- the abolition of the Audit Commission;
- local authorities can stop recording any of the 4,700 Local Area Agreement (LAA) targets. Those that are recorded will no longer be monitored by central government;
- a significant reduction in the number of statutory indicators.

*What does this mean for the VCS?*

- In principle, increased discretion and flexibility for local authorities to take decisions on the policy that impacts on local communities is positive;
- the removal of some well established 'levers' does mean that alternative mechanisms need to be in place to ensure a consistency in standards and access to services. Increased transparency of government data (including at a local level) will allow citizens to scrutinise the activities of government. Beyond this, there remains a need for appropriate audit and accountability measures;
- Central government has been clear that it does not expect local authorities to see the VCS as a soft target for cuts and would expect local authorities to examine all spending rather than look first at outsourced services as the place to cut. It is important that this is reflected 'on the ground';
- we already know that different local authorities are handling spending reductions in different ways. NCVO will be pushing for adoption of good practice – working in partnership with the VCS to jointly manage change in accordance with the renewed Compact.

*Ring-fencing*

The Government has confirmed that the current ring-fencing of local authority budgets will end in 2011-12, with the exception of the simplified schools grant and the new public health budget.

Again, this will give local authorities considerably more power and discretion. NCVO is supportive of the principle that decisions should be made at the appropriate level and that local authorities are often best placed to make decisions about their local area. There will be a streamlining of funding streams from 90 to fewer than 10 and government believes that an additional £7bn which is currently ring-fenced will be released to local authorities<sup>7</sup>.

#### *What does this mean for the VCS?*

- This will prompt significant change in the operating environment. Some VCOs that they may lose out as a result of these changes and that less popular or visible causes may come under pressure and see a decline in funding;
- an end to ring-fencing should also bring opportunities for the VCS – in particular for new market entrants who have been excluded by the current arrangements;
- an end to ring-fencing should prompt a growth in innovation and proportionate risk taking, trying new approaches to service provision.

#### *Community Budgets*

The Spending Review also made an announcement about the creation of 16 pilot community budgets from April 2011 for families with complex needs. The 16 pilot areas are:

Barnet  
Birmingham  
Blackburn with Darwen  
Blackpool  
Bradford  
Croydon  
Essex  
Greater Manchester (a total of 13 councils)  
Islington  
Hull  
Kent  
Leicestershire  
Lewisham  
Lincolnshire  
Swindon

A joint project bringing together the London Boroughs of Westminster, Kensington and Chelsea, Hammersmith and Fulham and Wandsworth.

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<sup>7</sup> Source: *Local Government Lawyer* [http://localgovernmentlawyer.co.uk/index.php?option=com\\_content&view=article&id=4570%3Aachancellor-axes-ring-fencing-of-all-but-schools-budget-as-local-government-suffers-26-hit-to-grant-funding&catid=59%3Agovernance-a-risk-articles&q=&Itemid=27](http://localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=4570%3Aachancellor-axes-ring-fencing-of-all-but-schools-budget-as-local-government-suffers-26-hit-to-grant-funding&catid=59%3Agovernance-a-risk-articles&q=&Itemid=27)

*What does this mean for the VCS?*

- It is important that the local VCS in each of these 16 areas is engaged with the design and running of these projects and that all relevant members of the community are given the opportunity to shape the new services.
- The move toward pooled budgets is positive and an important part of building public services around communities and users. These budgets focus specifically on tackling the needs of the vulnerable and whilst that focus on vulnerable people is commendable, particularly in the context of challenging times ahead. However, a whole-community approach in which all members of the community are brought together would have been preferable in building a sense of community and creating a whole-community approach.

### **VCS specific announcements**

The big sector-specific headline in the Spending Review is a support package totalling £470m for the VCS to support capacity building. This includes:

- Funding for Community First (replacing grassroots grants) to support VCOs
- National Citizen Service Pilot (initial estimates suggest that around 10,000 places will be available in the first year)
- A transitional fund of £100m.
  - NCVO called on government to recognise the very challenging financial and economic climate, and government has responded with a targeted transitional fund to assist VCOs delivering services with an income of £50,000 to £10m per annum.
  - This fund is a welcome acknowledgement of the need to build resilience in the sector. Whilst we await further details on exactly how this fund will operate (it is now out to tender as the Government itself will not administer the scheme), we know already that the plan is to spend £10m in this financial year and £90m in the next (2011-12).

*What does this mean for the VCS?*

- This package of support for the VCS is an important source of support from government and a welcome acknowledgement that government will need a properly supported VCS, with the right resources, to achieve its ambitions for civil society. However, it is important to be realistic about the impact on the VCS, and it is clear that the coming years are going to be challenging;
- the overall impact on the VCS will be driven not by these specific announcement about the sector, but largely by the way in which

individual local authorities implement spending reductions. In light of the challenging times ahead, NCVO will continue to strongly make the case that the VCS must not be seen as a 'soft target' for cuts;

- other changes in the operating environment – including a VAT increase to 20% in January 2011 and the ending of transitional relief on Gift Aid in April 2011 will have a significant financial impact on the VCS and these measures will not fully compensate for those losses.

## **Finance**

The financial health of the VCS and access to new finance is likely to be a significant ongoing challenge. The Big Society Bank should make a positive contribution to the sector's finances, both through channelling funds from dormant accounts and leveraging additional private capital. The Government has confirmed that all available funds from dormant accounts will be transferred to the Big Society Bank and that the Bank will also seek to bring in additional private sector funding.

*What does this mean for the VCS?*

- NCVO has long called for government to set up a social investment wholesale bank to provide much needed capital for the sector;
- the emerging social finance market is likely to be an increasingly important source of funding for the VCS, particularly in the light of the challenges ahead;
- alongside the social finance model, access to credit from mainstream financial institutions is going to remain important, particularly in the short to medium term. Many banks remain reluctant to lend to small organisations (in both the private and voluntary sectors). NCVO would encourage government to put pressure on banks wherever possible to provide finance to VCOs on fair terms, particularly in order for our sector to play a full role in public service delivery. To compete for contracts is likely to increasingly require access to working capital.

## **The impact of benefit reforms**

The Government is seeking considerable welfare savings and has outlined £7bn of proposed savings over the Spending Review period in addition to £11bn savings already announced in the June Emergency Budget. Measures include caps of the level of total benefit received per household, reductions to Working Tax Credits, reduced council tax benefit, caps being placed on housing benefit entitlements and the ending of Child Benefit payment to households with a higher rate tax payer.

This will clearly impact both on individuals and families currently in receipt of benefit and on the VCS, where we would anticipate additional demand being placed upon the sector. Government is committed to taking steps to reducing the social impacts of benefit changes. The VCS is likely to be expected to

'step in' to tackle some of the social outcomes of reduced benefit and this is likely to further exacerbate the trend of rising demand at a time of falling income.

*What does this mean for the VCS?*

- It is not possible to measure the precise level of impact on the VCS at this stage, but it seems likely that there will be an impact. Government needs to proactively take steps to minimise the knock-on effect of benefit changes in social terms and in terms of the impact on both the public sector and the VCS;
- NCVO will be making the case to government that the full impact of changes on the VCS – including additional demand that arises from changes to the benefits system, need to be factored into calculations about the support that the sector will require.

## **Equality**

There has been considerable political debate around the likely equality impact of the Spending Review. The Government has stressed that it aims to be 'progressive' and for the burden of spending cuts to be spread across society and has outlined ways in which it proposes to mitigate the potential equality impact of decisions. This is a complex process and requires government to look at the overall impact of a number of different policy decisions around tax, welfare, public services and benefits. There will be an essential role for the VCS in identifying need, working with communities and in highlighting the potential equality impact of cuts.

HM Treasury has the responsibility of setting budget allocations and it is then the responsibility of individual departments to ensure that equality impacts are conducted (this is the Treasury itself in some cases, including tax policy)<sup>8</sup>.

The Treasury has identified a number of broad areas in which it feels there could be a potential equality impact. These early findings, and potential equality impacts that government is seeking to mitigate include:

## **Gender**

- working age women tend to have higher healthcare costs than men, but that this is reduced amongst those in retirement;
- there are more women in old age and therefore women are more likely to need social care;
- whilst children and young people are the main beneficiaries of early years and childcare services, these services are important in allowing women access to employment and impact on women's quality of life.

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<sup>8</sup> Details here are taken from HM Treasury (2010) *Overview of the impact on the Spending Review 2010 on equalities*. This document can be found here: [http://www.hm-treasury.gov.uk/spend\\_sr2010\\_equalities.htm](http://www.hm-treasury.gov.uk/spend_sr2010_equalities.htm)

## **People from ethnic minorities**

- services targeted at people on low incomes are particularly important as people from ethnic minorities are more likely to live in households on low incomes;
- services in areas in which people from ethnic minorities are more likely to live are particularly significant.

## **People with disabilities**

- people with disabilities tend to use some public services more than people without a disability, including:
  - health: people with long-term conditions (many people in this group also have a disability) account for around 70% of the NHS budget.
  - social care: people with disabilities are more likely to be users of social care services
  - services targeted on people with low incomes
  - the Disabled Facilities Grant

### *What does this mean for the VCS?*

- The VCS plays an important role in giving voice to all members of society, including the most vulnerable and excluded who are likely to be at risk of a potentially negative equality impact. The fact that government is conducting detailed and robust equality impacts is positive;
- support for VCS infrastructure at all levels, including local and specialist infrastructure will be important in ensuring that equality impacts on the ground are understood and that those groups are equipped with the capacity and confidence to influence decision making;
- the full equality impact of spending decisions is not entirely clear. This is an ongoing challenge for the VCS in working with communities and advocating and campaigning on behalf of those who are at risk. Government acknowledges that it needs to mitigate the impact of spending cuts to minimise a negative equality impact, and the VCS at a local level should work to develop practical suggestions on how this could be achieved.