# What new spending reductions could mean for DECC

green alliance...

# Executive summary

The UK's plans to reduce government spending seem modest: pre-election Conservative Party pledges amount to a 3.3 per cent reduction over the course of the parliament.

But this headline figure obscures essential details, including commitments to ring-fence some areas of spending, grow capital investment and shrink spending early on before allowing it to rise late in the parliament.

This analysis outlines how the Department for Energy and Climate Change's (DECC's) budget is likely to be affected by the spending reductions. It identifies the factors which will concentrate spending reductions onto DECC's low carbon activities, and especially onto its relatively modest staff budget.

This unusual, but dramatic, ring-fencing effect could reduce DECC's resource spending by as much as 90 per cent by 2018-19, curtailing the department's ability to make sure the UK has secure, clean, affordable energy supplies and promote international action to mitigate climate change.

## How budget reduction plans progressively reduce DECC's spending

### Reductions to DECC's total budget after five years

DECC budget 2015

Reduced spending across government by 2020

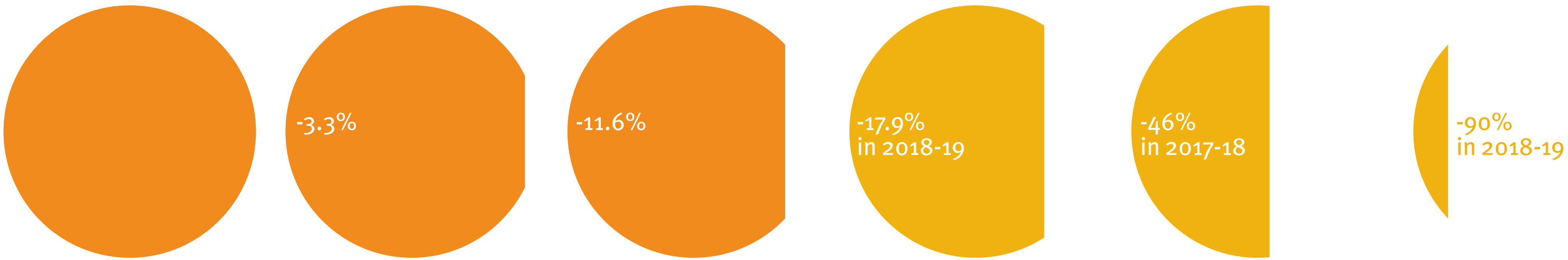
Reduction once health, development and education budgets are ring-fenced

### Single year reductions, showing the 'roller coaster' effect

The 'roller coaster' effect of rapid spending reductions

The effect of ring-fencing DECC's nuclear and coal liabilities

The effect of protecting capital spending on resource expenditure



# Introduction

The Department for Energy and Climate Change (DECC) is a small department with a big job to do. It is a sixth of the size of the Department for Business, Innovation and Skills, but has to help bring £100 billion of private sector investment into the UK's electricity system by 2020. It has to foster innovation, energy saving and competition to minimise the cost of low carbon energy to consumers. It is also charged with supporting the prime minister in achieving an ambitious global climate deal in December this year.

To achieve these aims, DECC has four tools: a budget of close to £4 billion per annum; 1,500 staff; existing and new policy; and consumer levies, used to incentivise energy efficiency and low carbon energy supply. The last two of these tools are the most important, since they drive citizen behaviour and private sector investment expectations. However, they can't work without the first two, which are the subject of this analysis.

In the run up to the UK's general election, the political parties pledged to reduce the budget deficit quickly, to protect capital expenditure, and to ring-fence certain lines of expenditure. This analysis identifies what Conservative spending pledges might mean for DECC's budget in light of these aims.

# What affects DECC's budget?

**Departmental ring-fencing**
Under Conservative plans, departmental spending across government is expected to be reduced by 3.3 per cent between 2014-15 and 2019-20. However, pledges to ring-fence the health, international development and education budgets mean that departments like DECC will be required to reduce their budgets further: by an average of 11.6 per cent over the course of this parliament.

But this is not the whole story. Three additional factors constrain DECC's funding:

**The budget profile**
The 'roller coaster' profile of proposed spending plans, identified by the Institute for Fiscal Studies in its April 2015 report *Post-election austerity: parties' plans compared*, means that government spending will fall rapidly and then recover. As a result, major programmes may be squeezed for the majority of the parliament, even if spending levels rise in its last year.

**Ring-fencing within DECC**
Nearly three quarters of DECC's Departmental Expenditure Limit (DEL) budget is spent on four activities which are likely to be ring-fenced within the department: the Nuclear Decommissioning Authority, international development assistance, Regional Development Agency wind-up costs and coal liabilities. If these are protected, spending reductions will have to be found from DECC's other activities.

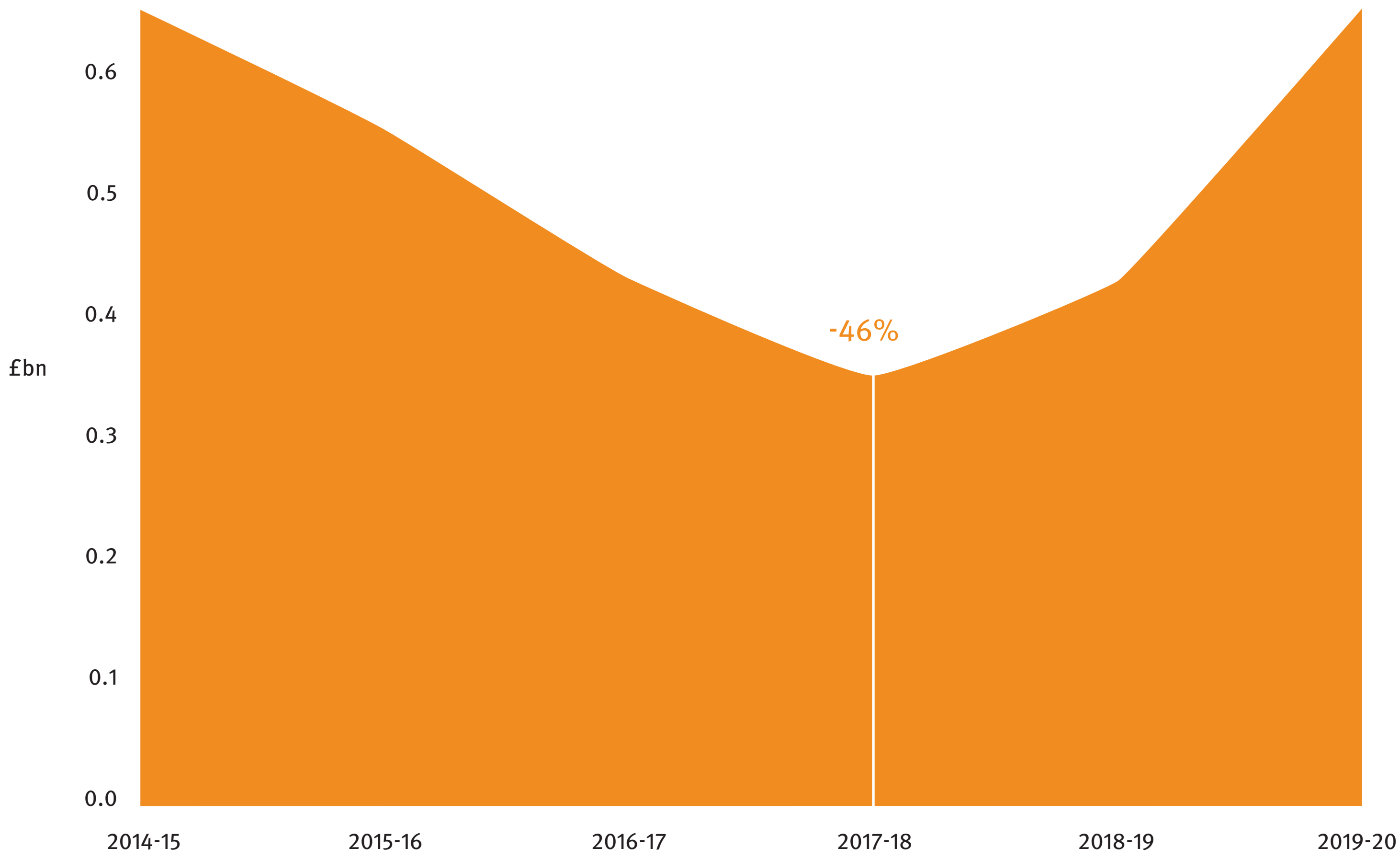
**Protecting capital spending**
Within DEL spending, the government is maintaining capital DEL spending by reducing resource DEL spending. Over 60 per cent of DECC's budget is capital expenditure, meaning reductions will be concentrated on resource expenditure.

# The roller coaster effect and its implications

The chart on the right shows DECC's non ring-fenced spending, based on the Conservative Party's pre-election proposals. It focuses on DEL, as this is the measure decided in spending reviews.

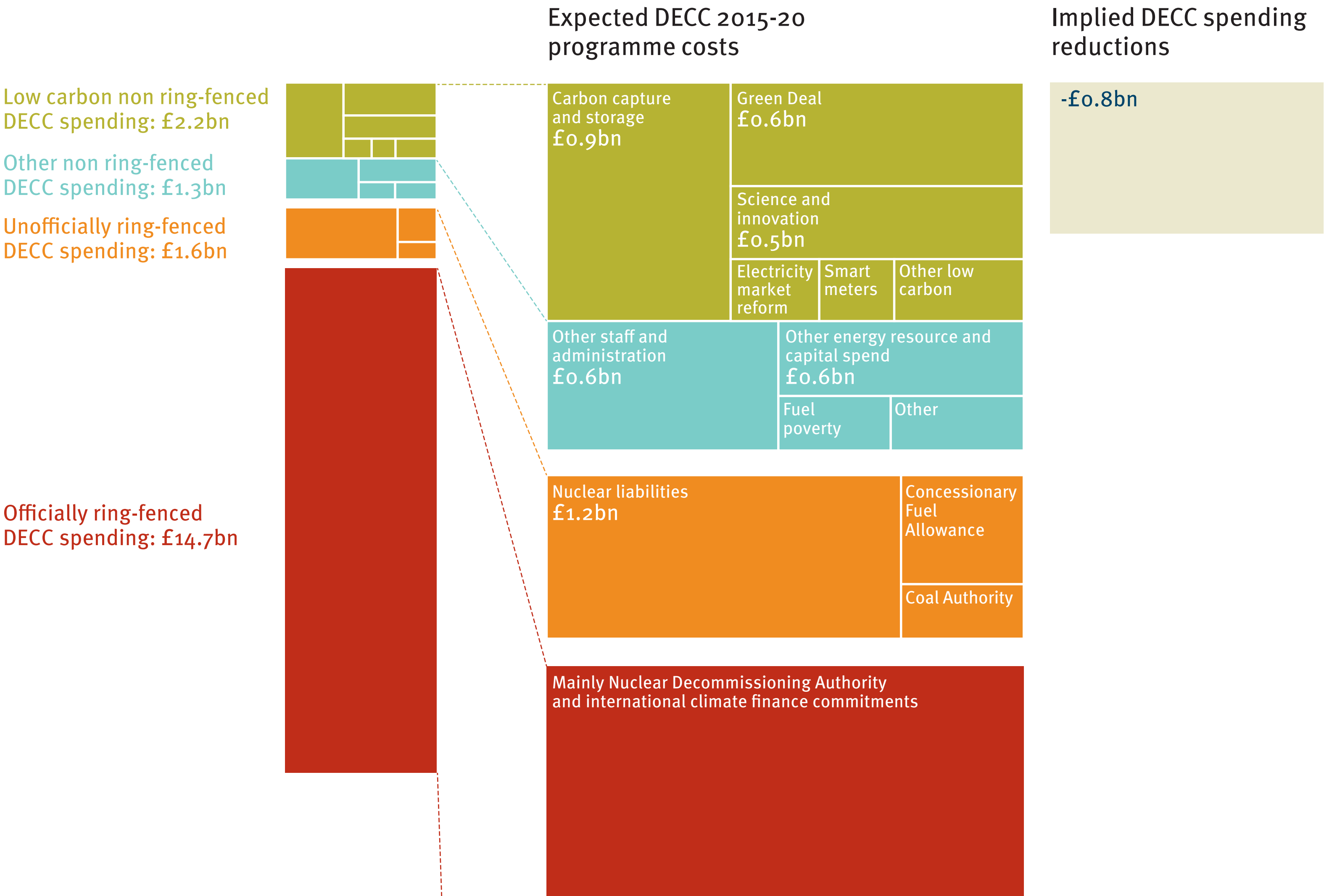
Under Conservative plans, spending should fall by 46 per cent in 2017-18, before rising by 87 per cent over the following two years. This roller coaster effect means that DECC may cancel or defer spending until late in the parliament.

DECC's implied non ring-fenced spending



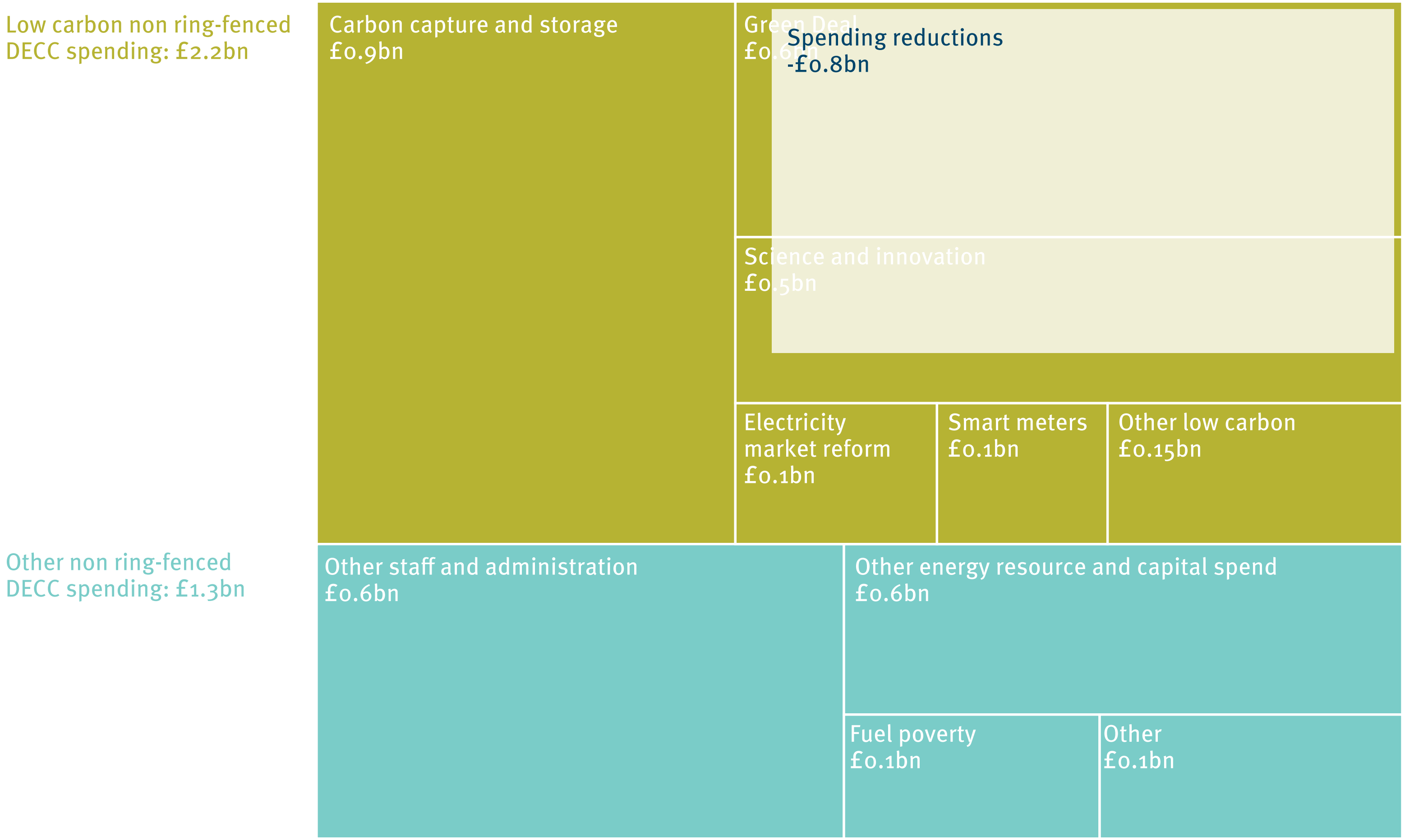
# How ring-fencing within DECC might affect its priorities

Here, we show the total spending reductions for DECC, implied by spending plans, between 2015 and 2020, set against DECC's expected programme costs over the same period. DECC's spending is shown separated into major low carbon programmes and other spending outside the ring-fence; and unofficially and officially ring-fenced spending. These latter two categories represent over three quarters of DECC's spending, and largely cover unavoidable clean up costs for old coal and nuclear projects.



If savings over the next five years were found from areas that have not been ring-fenced, spending on them would fall by a quarter. But the 'roller coaster' profile of reductions means that available funds would, in fact, fall by nearly half by 2017-18, before rebounding.

This could mean limiting the UK to a single carbon capture and storage (CCS) demonstration project, while largely ending energy efficiency spending; or it could mean stopping electricity market reform (EMR), smart metering, innovation activities and their associated staffing.



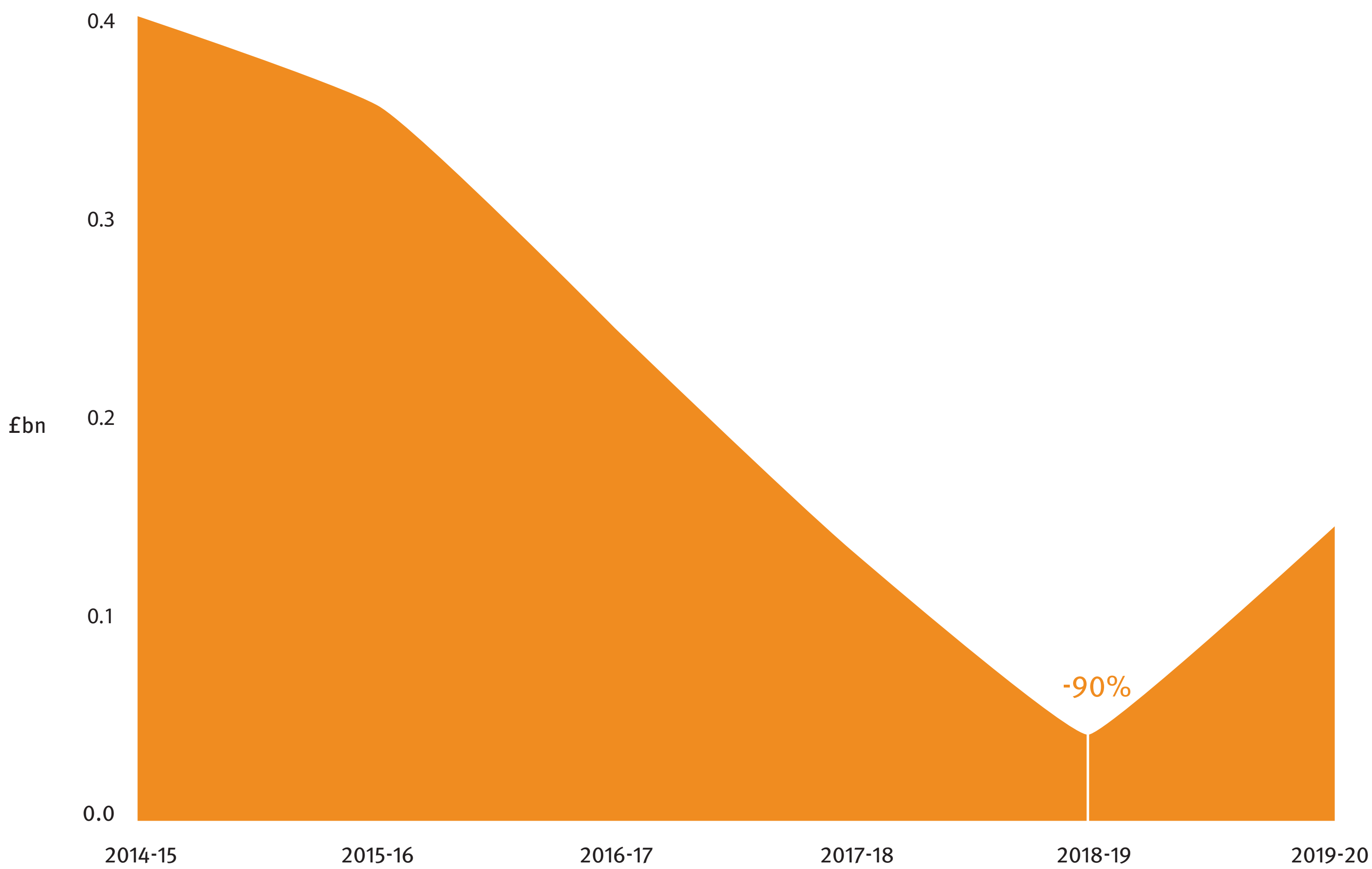
# The consequences of protecting capital spending

There is a further factor affecting spending reductions. Across government, resource (or non-investment) spending is being more heavily restricted to protect capital (or investment) spending. For departments, like DECC, with a high proportion of capital spending, this means spending reductions will be concentrated on their resource spending. In DECC's case, its resource spending (35-40 per cent of its total DEL) could fall by 90 per cent by 2018-19.

As a result, the following large resource spending programmes are likely to be targeted:

- Departmental administration, staff costs and payments to Ofgem
- Science and innovation and the Big Energy Savings Network
- Electricity market reform
- Smart meters

DECC's non ring-fenced resource spending



# Conclusion

Over the next five years, we estimate that DECC will need to spend £19.8 billion to meet its commitments. Of this, £16.3 billion is officially or unofficially ring-fenced for legacy costs. Just £3.5 billion is not ring-fenced and available to deliver the UK's energy transition: ie around £700 million per year on average.

However, the roller coaster spending profile of the next parliament means that DECC could have just £350 million for all non ring-fenced activity in 2017-18, compromising major DECC programmes. And, because of commitments to preserve capital spending, by 2018-19 only £40 million would be available for all staffing, analysis and policy implementation functions.

Reductions in spending on staff could be a false economy. DECC steers the use of consumer levies that are much larger than its own budget. A dumbed down DECC, unable to spend its own budget wisely on analysis, energy efficiency and strategy, might overspend on levy-funded low carbon generation, driving up the cost of decarbonisation.

Budgets will be tight, but decision makers have options. For example, cutting CCS capital grants means UK CCS simply will not happen. In contrast, energy efficiency outcomes can be delivered with less direct spending, through smart regulation and by enabling efficiency to compete with new supply. Similarly, if savings are available from ring-fenced areas, this could free up expenditure for other areas.

The main conclusion, however, is clear: DECC needs a better than average budget settlement because most of its spending is ring-fenced and capital intensive. Without it, the department will struggle to achieve its mission and the UK is much less likely to have secure, clean and affordable energy.

**Green Alliance**
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