



Ben Zaranko

IFS Spring
Statement Analysis

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Spending on public services: an ominous silence?



Economic
and Social
Research Council

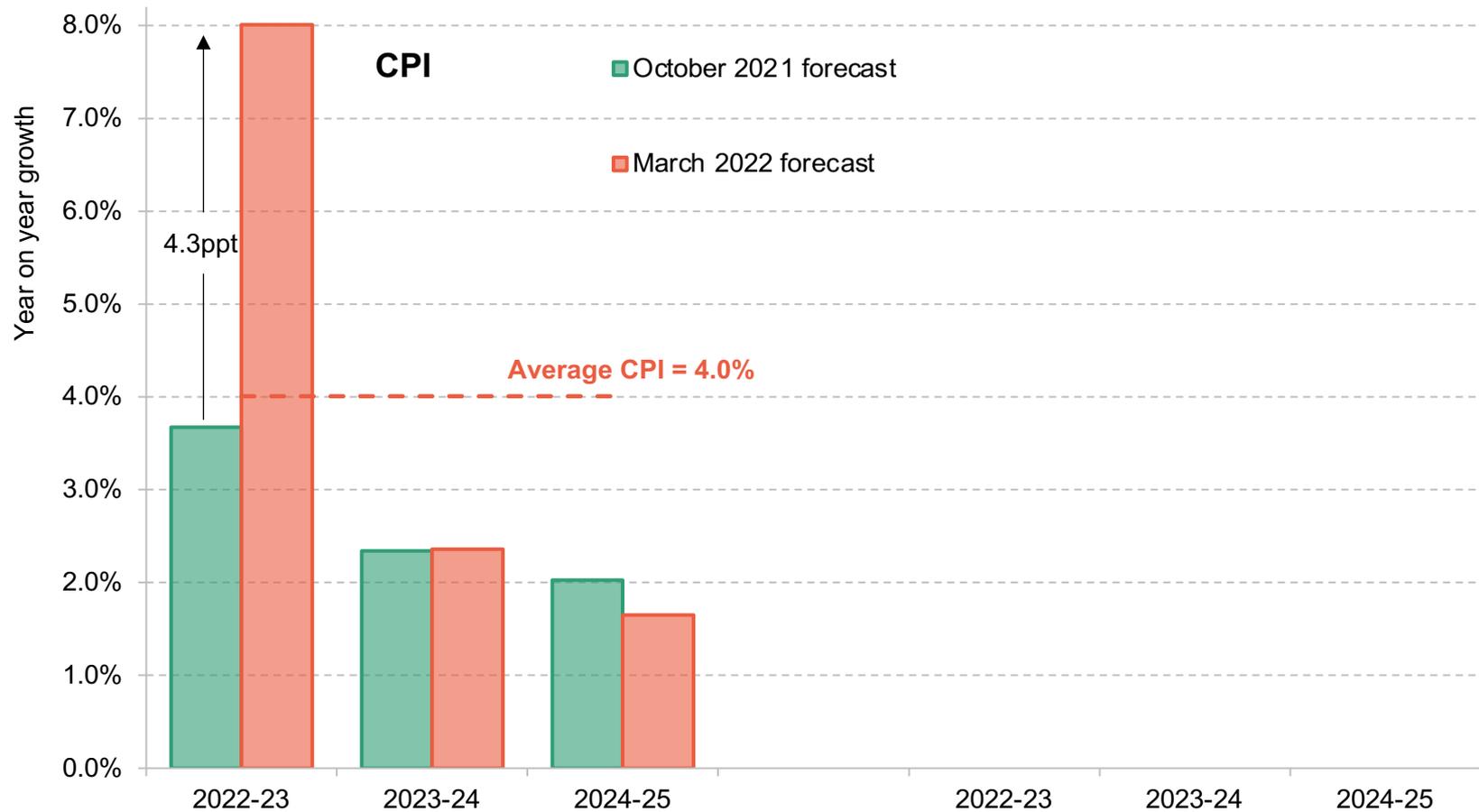
Higher inflation reduces the generosity of cash spending plans



- Departmental budgets are set in cash terms
 - Higher prices → the same cash budget can purchase less
- Growth in the GDP deflator (the usual inflation measure used for the public sector) forecast to be more muted than in CPI

Different measures of inflation

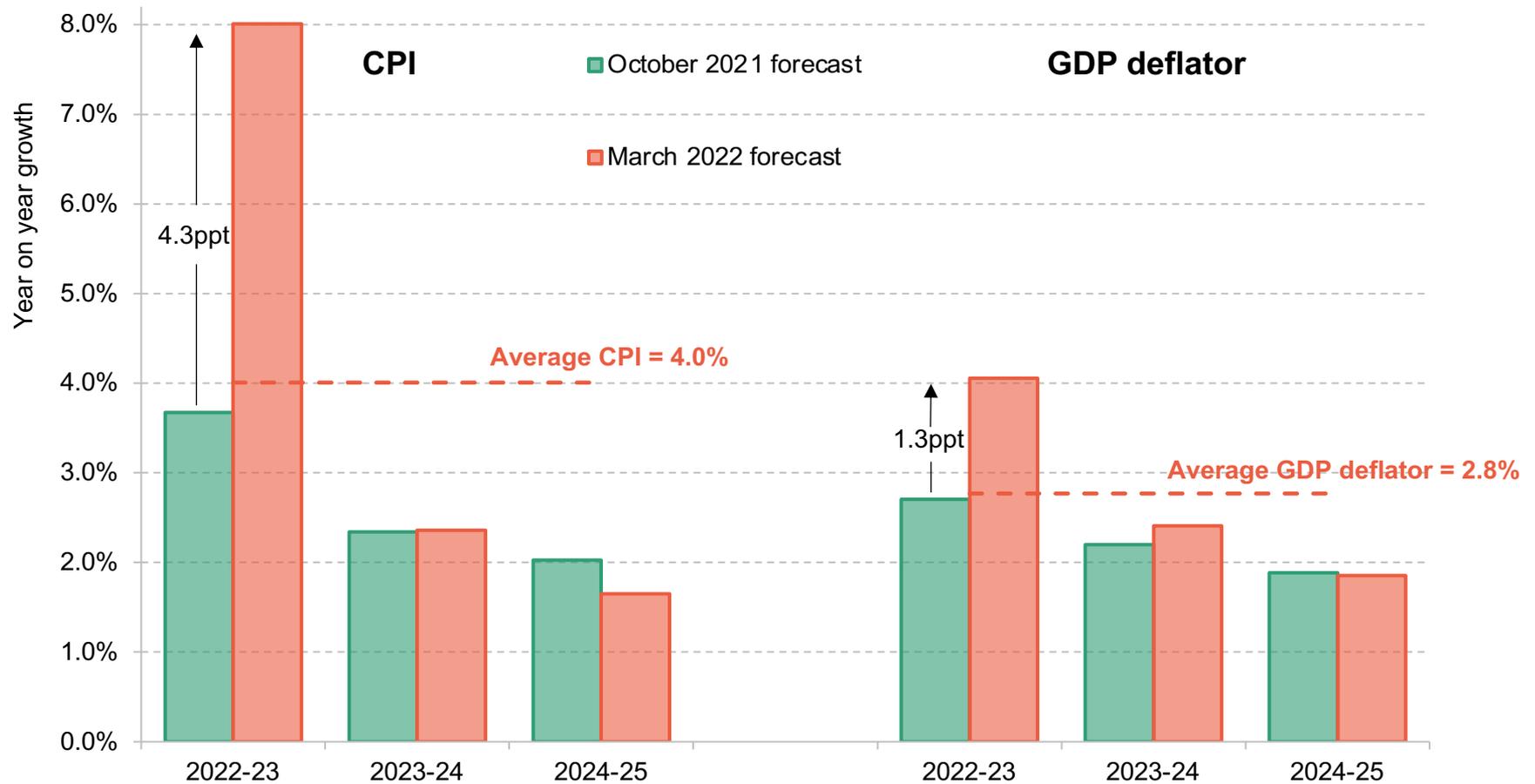
Forecast inflation over Spending Review period, CPI and GDP deflator



Source: OBR Economic and Fiscal Outlook, October 2021 and March 2022.

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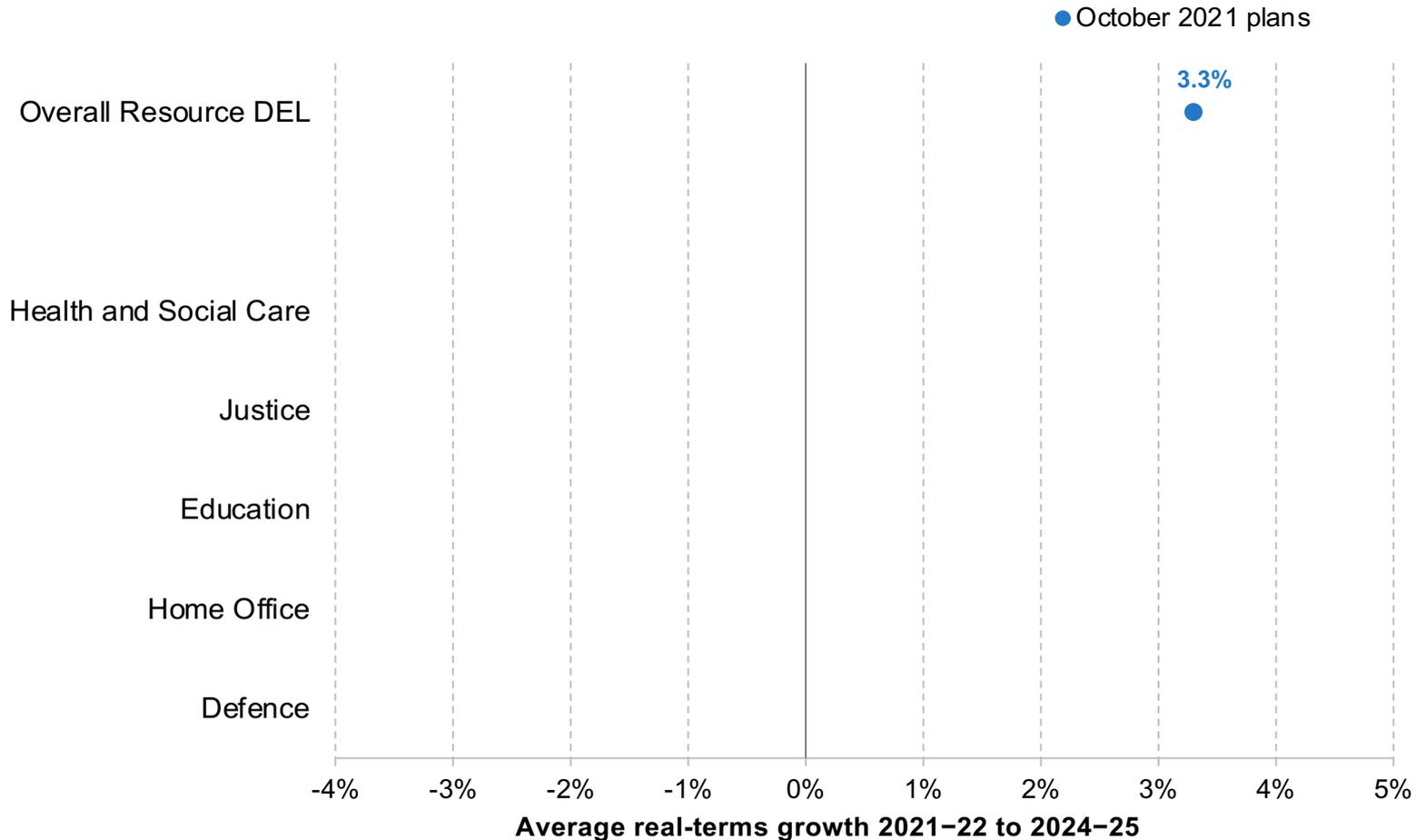
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- Growth in the GDP deflator (the usual inflation measure used for the public sector) forecast to be more muted than in CPI
- **What matters is what happens to the costs facing departments**
 - Neither measure will capture this perfectly
 - CPI will overstate the pressures on public services
 - GDP deflator tricky to forecast and confounded by oscillations in government activity during the pandemic

Departmental settlements are now less generous across the board

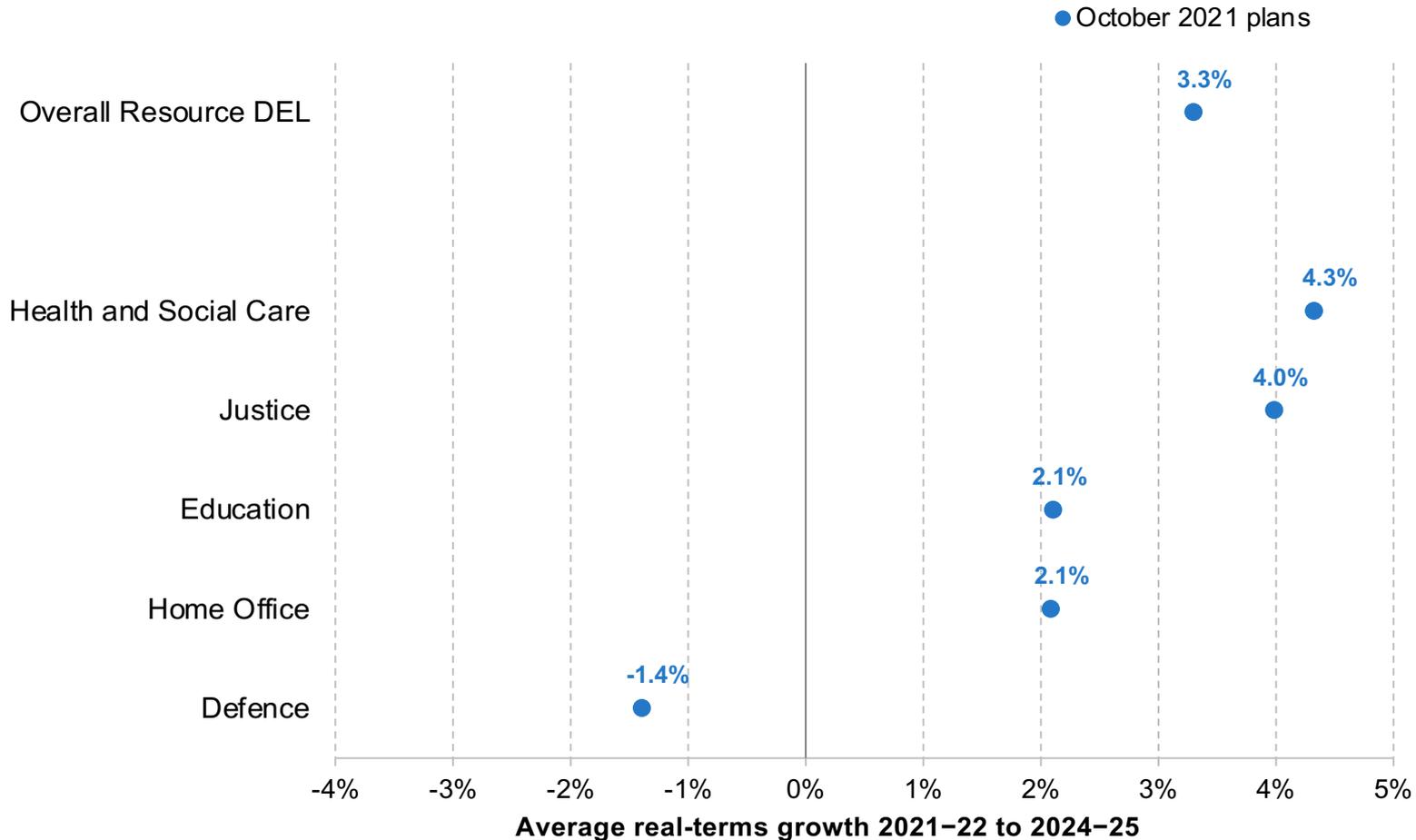
Planned average real-terms growth in selected day-to-day budgets over SR period



Note: October 2021 plans refer to the real-terms growth rate associated with the latest cash resource spending settlements, under GDP deflator forecasts as of October 2021.
Source: Author's calculations using HM Treasury Spring Statement 2022 and Spending Review 2021, and OBR Economic and Fiscal Outlook, March 2022.

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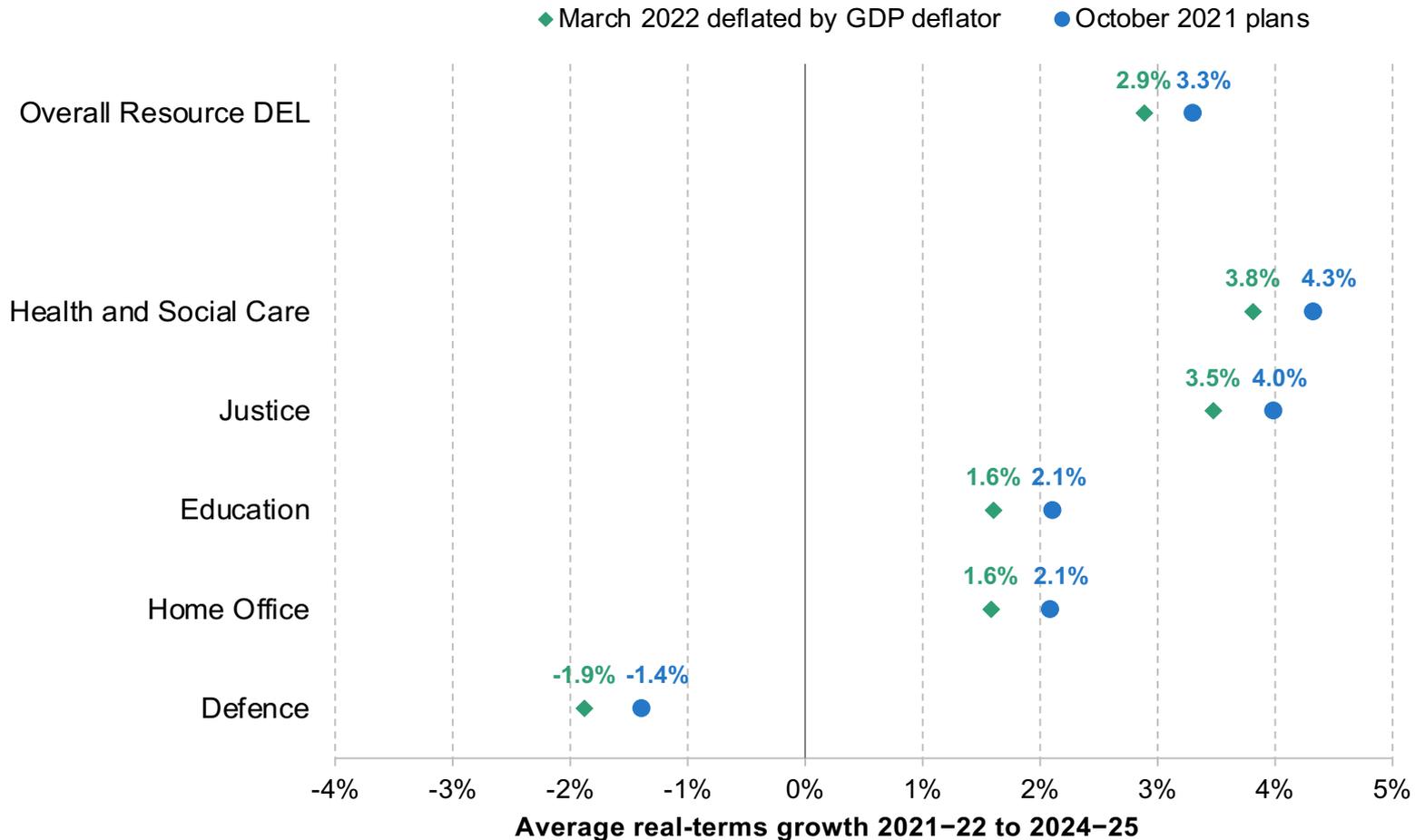
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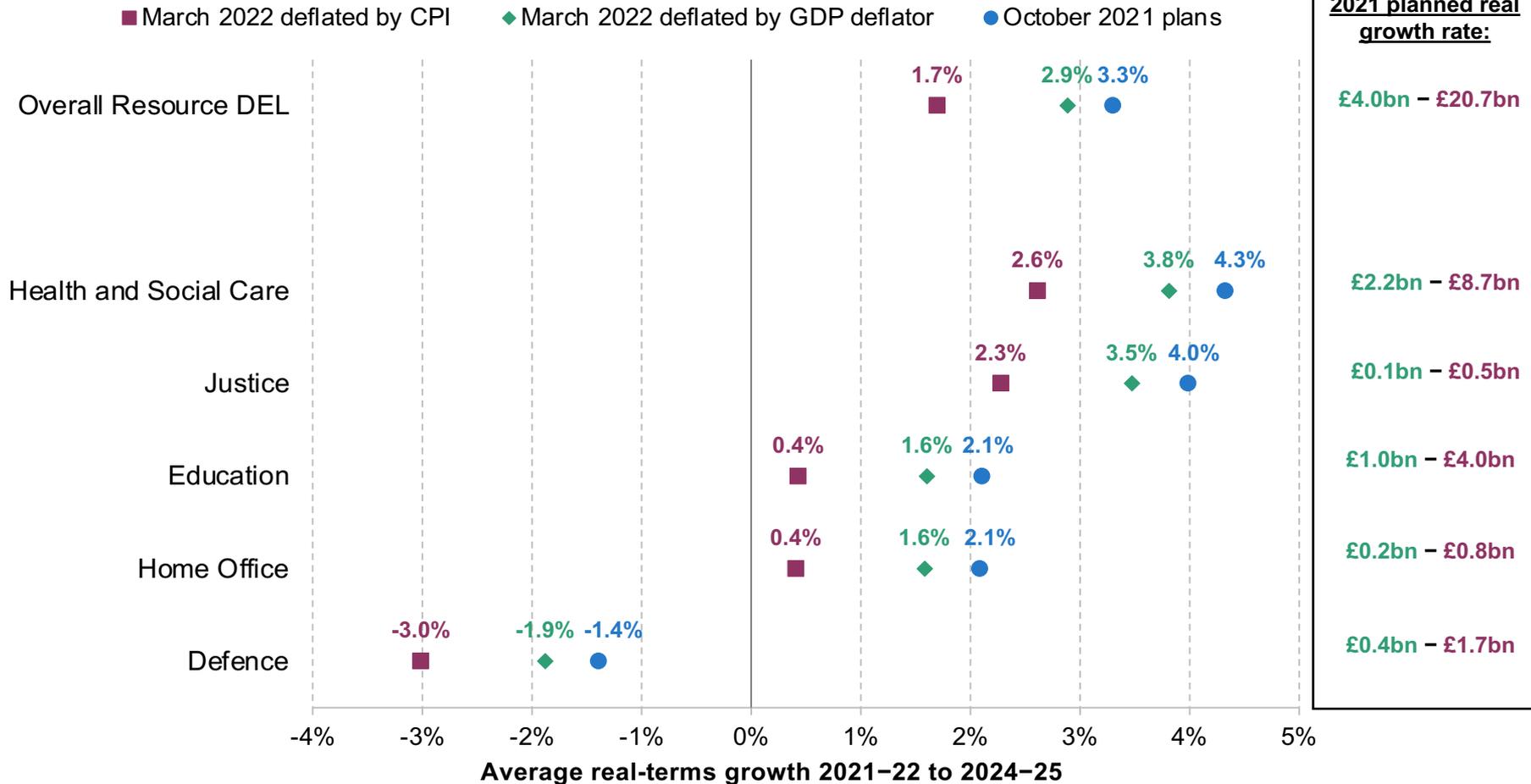
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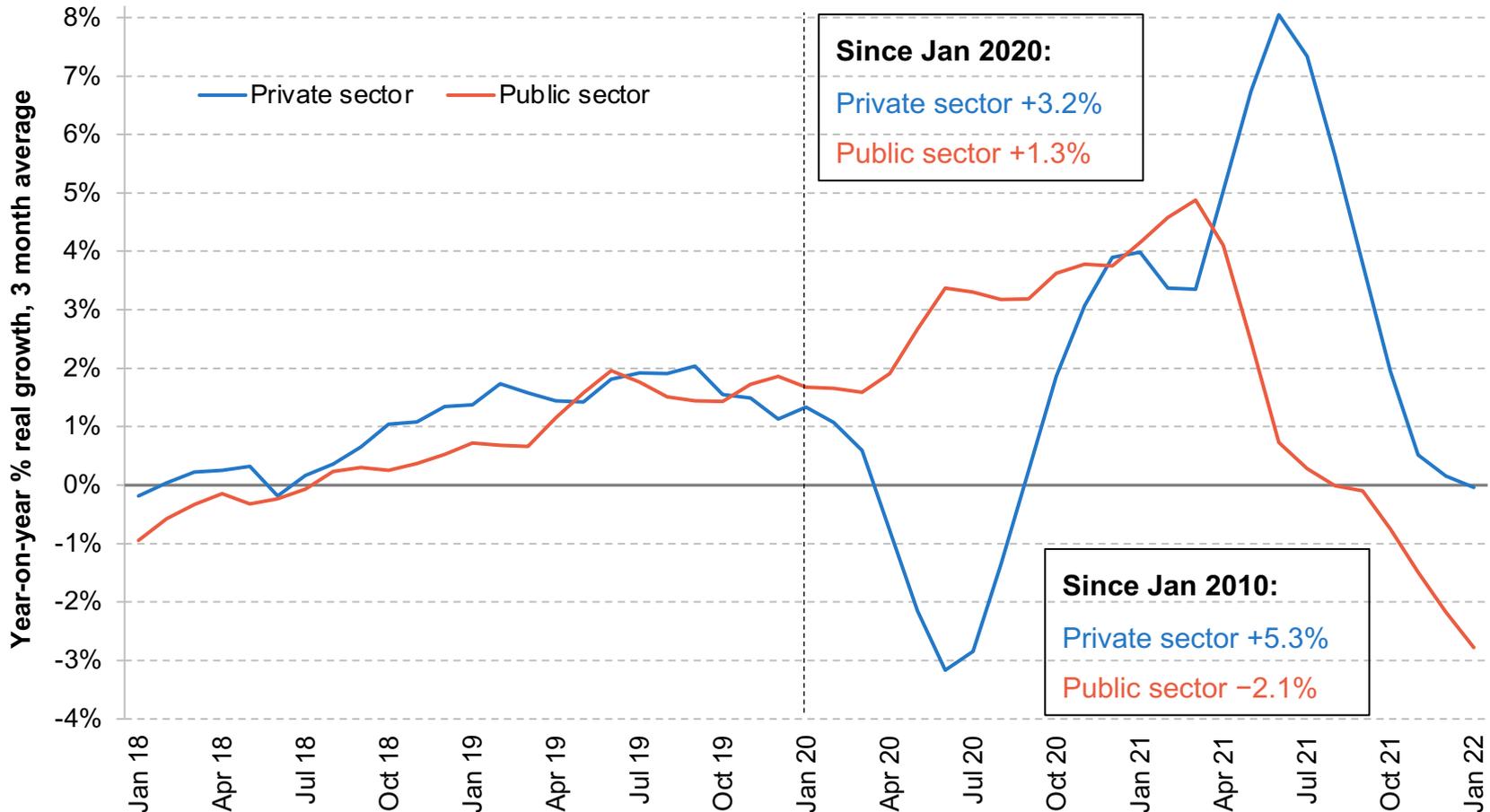
Will the Chancellor compensate departments?



- Yesterday wasn't the appropriate time to top up spending plans
 - Any adjustments should be made in the autumn (halfway through financial year, inflation picture clearer)
- But the Chancellor seems reluctant to increase spending
 - He promised *“to be disciplined, with the first call on any extra resources being lower taxes, not higher spending”*
- **Crucially:** pay makes up almost half of all public service spending
 - Government (largely) controls what happens to public sector pay
 - Which will determine the cost pressures facing departments

Pay growth in the public sector is currently lagging the private sector

Real-terms % growth in average weekly earnings in public and private sectors



Notes and sources: Figures shown are for total pay (seasonally adjusted), including bonuses and excluding arrears, in the private sector (ONS series KAC4) and public sector (KAC7), adjusted for inflation using CPI (D78T). Three month average is calculated as the average real-terms change for the three months ending with the month in question, compared to the same period the previous year.

The thorny issue of public sector pay



- Non-zero but below inflation pay awards seem a certainty
 - e.g. DfE has proposed average pay awards for teachers of $\approx 4\%$ in September 2022, when OBR expect inflation to average 7.4%
- But pay awards may still exceed what was originally budgeted for
- In 2022–23, the latest OBR forecasts have:
 - CPI inflation **4.3ppt** higher than under October forecasts
 - Public sector earnings growth **0.5ppt** higher
 - Private sector earnings growth **1.3ppt** higher
- Official HMT policy is to *“retain broad parity with the private sector”*
 - Funding an extra 1.3% increase in pay would cost $\approx \text{£}3$ billion
 - Higher CPI implies average real hit of $\text{£}1,800$ per worker

A quick moan about the Health and Social Care Levy



- The levy now forecast to raise **£17.4 billion in 2024–25** (considerably more than when first announced)
 - RS: *“with every penny going straight to health and social care”*
- Yesterday’s announced increase in NICs thresholds means the specific 1.25ppt levy will now raise **≈£500 million less** in 2024–25
 - (Total cost of threshold increase is **£4.9 billion**)
- Yet in a shocking turn of events, the NHS budget hasn’t changed
 - Revenues from the levy **are not hypothecated**: there is no relationship between the amount raised and NHS spending
 - Disappointing to see the Chancellor propagating this myth

Changes to the student loan system



- Big package of Higher Education reforms announced earlier this year
 - Freezing/lowering loan repayment thresholds, freezing max tuition fees, reduced maintenance loan entitlements, extending repayment period by 10 years (to 40 years), lower interest rates
- **Taken together:** a hefty effective tax rise for recent graduates and a huge increase in expected lifetime repayments
 - OBR: *“this reduces the share of loan outlays recorded as expenditure [the portion not expected to be repaid] from 61% in 2021–22 to 34% in 2026–27”*
- Includes retrospective changes to repayment terms for cohorts who have already graduated– these long-term fiscal gains are scored up front in 2022–23 (hence £11 billion reduction in borrowing in 2022–23)

Conclusion



- Higher inflation means an unintended decrease in the generosity of the Chancellor's plans for spending on public services
- Big, difficult decisions on public sector pay due over the summer
- The autumn Budget would be the natural point to adjust spending settlements, once pay agreements have been reached
 - But the Chancellor may be reluctant to do so
 - If he instead prioritises pre-election tax cuts, public services will feel the squeeze

The Institute for Fiscal Studies
7 Ridgmount Street
London
WC1E 7AE

www.ifs.org.uk

