Economic and Social Research Council

National Institute of Economic and Social Research

Response to the Spring Statement 2022

23 March 2022

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Fiscal Space

"Increasing tax receipts in the months leading up to the Spring Statement enabled the Chancellor to cut fuel duty and increase support for households while still keeping to his fiscal targets. But higher inflation, rising interest rates and lower growth could soon lead to a need to either abandon the targets or raise taxes going into the next election."

— Stephen Millard (Deputy Director, Macroeconomics)

- Borrowing in the year to February 2022 was £26 billion less than forecast by the OBR in October 2021. This was driven by higher tax receipts: since October these have been £30 billion higher than expected. Offsetting that to a degree has been the increase in debt interest payments resulting from the rises in inflation and interest rates. Debt interest payments in February totalled £8.2 billion, the highest February on record. Public-sector net debt now stands at 94.7% of GDP, higher than anything since the early 1960s.
- Overall, the OBR now forecast borrowing in 2021-22 to be £55 billion less than they had forecast in October. Prior to the Spring Statement the OBR calculated that the Chancellor had £20 billion of fiscal space and that the cuts to personal taxes announced in the Spring Statement came to £10 billion, using up roughly half of this. Overall, this meant that the Chancellor now meets his debt target for 2024-25 with a margin of £27.8 billion. This led the Chancellor to announce his plan to cut income tax by 1 point in 2024.
- However, higher than expected inflation and higher interest rates are likely to eat into this fiscal space. As we said earlier, we have already seen debt interest payments rise dramatically over recent months because of the rise in inflation and interest rates. And if the war in Ukraine leads to lower growth than the OBR is currently forecasting, then again, we would see this fiscal space quickly diminish.

Spending on Public Services

"The Chancellor's decision not to revise spending plans in light of escalating inflation forecasts will mean a sharp fall in resources available for many public services. Even departments which had been set for above-inflation increases will now be forced to choose between either large real pay cuts for their staff or cutting back on front-line services or both."

— Rory MacQueen (Principal Economist)

- With government department budgets set in cash terms until 2025, today's upward revision to the inflation forecast across that period means public servants will be forced to choose between giving staff large real pay cuts – which may not be politically possible if private sector wages are rising more quickly – or cutting back on the services they provide.
- We highlighted this risk in our 2022 Winter UK Economic Outlook, published in February: "With government department budgets set in cash terms now until 2025, the forecast for real growth in government consumption is made worse by our higher forecast path for inflation … With most government spending going on salaries, this will translate into several years of falling real wages for public sector employees." (pp. 21-22).

- The Ministry of Defence, which in October 2021 was set for a 4 per cent real cut in its day-to-day budget over the spending review period, will now see a real spending cut of nearly 5½ per cent. The Levelling Up department budget, previously set for a rise of over 3 per cent in real terms, will now get less than 2 per cent.[1]

Health and Social Care Levy

"Despite pressure to drop this, the Chancellor of Exchequer has decided to go ahead with the health and social care levy announced last September. Not only will this place significant pressure on households at a time of high inflation, but also a substantial portion of the levy could be lost to slower growth. In addition, the move today to raise the National Insurance Contributions threshold by £3,000 to tackle the rising cost of living across the UK will reduce how much the levy raises, therefore raising uncertainty around the NHS budget."

— Kemar Whyte (Senior Economist)

- The Chancellor of Exchequer has today stood by his initial announcement on 7 September 2021. The government had announced new tax raising measure that will take effect from 6 April 2022 as part of a plan to fund health and social care. The levy is expected to raise £13.8 billion a year, though there will be a refund of £1.8 billion to public sector employers to compensate them for their higher charges. The changes will affect employees, employers, the self-employed and individuals receiving dividends. NIESR's initial response in October was that this would be a sub-optimal way to raise the extra resources needed to fund the NHS and social care. Using the National Institute's Global Econometric Model (NiGEM) the analysis showed that the tax increase would reduce consumption by about ¼ per cent after a year and by about ¾ percentage point in the long-run. Further, it would reduce GDP in the long-run as the increase in spending would be on current government consumption, whereas a portion of the resources relinquished by the private sector would have been on investment, leading to lower growth.
- Since the announcement, the economic context has deteriorated in the UK. Inflation has rocketed, with today's ONS estimates suggesting inflation hit a 30-year high of 6.2 per cent year-on-year in February, and is expected to surge further, with electricity and gas bills set to increase substantially in April. Further, the ongoing crisis in Ukraine has increased both the scale of price rises and the degree of uncertainty around them. With inflation anticipated to exceed 8 per cent this year, the amount raised will only be able to finance a lower level of real spending.

[1] These calculations are based on the GDP deflator. If recalculated using a measure of consumer price inflation, real-terms growth rates would be significantly slower.

Rising Energy Prices and Fuel Duty

"While the Chancellor's move to cut fuel duty by 5p per litre until March 2023 is welcome, it does not provide the targeted relief needed to combat fuel poverty caused by surging household energy bills as real incomes are being eroded by inflation. The increase in the NICs threshold and in the Household Support Fund are welcome as they will go some way to filling that gap."

Urvish Patel (Associate Economist)

- Our research prior to the Russia-Ukraine war suggested the rise in the energy price cap next month would mean the average household in the UK would be around £1,000 per annum worse-off, even after considering the Chancellor's £350 rebate. However, the war has further aggravated shortages of energy supply and driven up the prices of wholesale natural gas and oil, increasing the probability that the energy price cap will rise again in October 2022.
- This increase in energy prices will add to the existing pressures on household budgets at a time when real incomes are being significantly eroded by higher inflation, which is forecast to exceed 8 per cent in 2022 Q3. Moreover, the second-round effects from higher nominal wages would increase cost pressures for firms and fuel further inflation, thus intensifying the pressures on the Bank of England at a time when NIESR's revised forecast suggests that UK economic growth will slow down markedly to 4 per cent in 2022 and 0.5 per cent in 2023.
- The Chancellor cut fuel duty by 5p per litre, but this does not yield any additional benefits to those poorer households who do not own a car and spend a larger share of their budgets on energy. However, the Chancellor also announced more direct support for households, which we consider in the next section.

Direct Support for Households

"The announcements in the Spring Statement fail to help the poorest in society who bear the brunt of the cost-of-living crisis. £1bn through the Household Support Fund is welcome but not enough. To support low-income households and stop many thousands more from sliding into destitution, the government should have at least reinstated the Universal Credit uplift to £20 per week, together with targeted financial support for food banks and free school meals."

— Arnab Bhattacharjee (Research Lead and NIESR Fellow)

- The double burden of soaring energy and food prices will see a 50 per cent increase in destitution in 2022/23, leaving a total of 1.1 million households lacking basic necessities such as food, shelter or heating. Households in the lowest income decile will face a rise in energy bills of £550 on average. This will be compounded by an increase of at least £300 in food and £50 in transport costs, totalling £900 higher expenditure per year – nearly £20 per week. That is why we continue to argue for a reinstatement of the Universal Credit uplift of £20 per week, which would cost the Exchequer about £6 billion.
- The 5p cut in fuel duty is welcome as an immediate relief, but it has regressive effects by benefitting higher-income households disproportionately as lower-income households are less likely to own cars. Raising the threshold for paying National Insurance

Contributions helps low-income households in work but fails to support out-of-work households who struggle most.
- In our February 2022 outlook we called for targeted and locally administered assistance and we therefore welcome the Chancellor's announcement of providing £1bn through the Household Support Fund. But given the available fiscal space, an enhanced Winter Grant Scheme of £3bn would make effective use of local knowledge and achieve better means-tested help at lower cost than more regressive measures such as fuel duty.
- In addition to the Universal Credit uplift of £20 per week, we think that the government should financially support foodbanks and commit about £1bn for free school meals for 2022/23.

Levelling Up

"The Spring Statement is a missed opportunity to turn the ambitious ideas of the 'Levelling Up' White Paper into reality. There were no new announcements on investment or moves to devolve taxing and spending powers to local levels. Quick wins to promote higher productivity and living standards would have included an extra £500 million in funding for mixed HE/FE colleges in 'left behind' communities and a £500 million in loans for SMEs outside London and the South-East."

— Adrian Pabst (Deputy Director, Public Policy)

- Our recent regional outlook showed how sluggish economic growth and rising prices will deepen disparities in wealth, health and productivity between and within regions. While London and the metropolitan parts of the South-East are powering ahead, parts of Wales, Scotland, Northern Ireland and the North-West will fall further behind in terms of output, productivity and living standards. The impact of even higher energy and food prices as a result of the war in Ukraine will exacerbate spatial inequalities, affecting disproportionately the people and places most in need of regional regeneration.
- But the Spring Statement does not address the urgent funding needs in terms of skills and finance for SMEs. While sustained regional regeneration is a generational task, there are some quick wins such as an extra £500 million for mixed HE/FE colleges in 'left behind' coastal and rural areas such as Grimsby, Blackpool and Southend, including grants to students from low-income households. Other short-term measures include an extra £500 million in loans for SMEs that cannot access competitive finance the further they are away from the capital market in London and the South-East.
- Regional mayors and local governments also need to know whether and when Westminster and Whitehall will devolve not only greater powers to spend but also to tax. Business rates or some portion of income tax retention are options to give city-regions and local areas better control over economic and social regeneration.