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@TheIFS

# Spring Budget 2023: options for public services and pay



Economic  
and Social  
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ANALYSIS OF  
PUBLIC POLICY

# The backdrop to the Budget

- Short-term challenges aplenty
  - Public sector pay disputes perhaps the most acute of these
- Chancellor cut back post-2025 spending plans at the Autumn Statement
  - These plans look implausibly tight without cuts to scope of the state



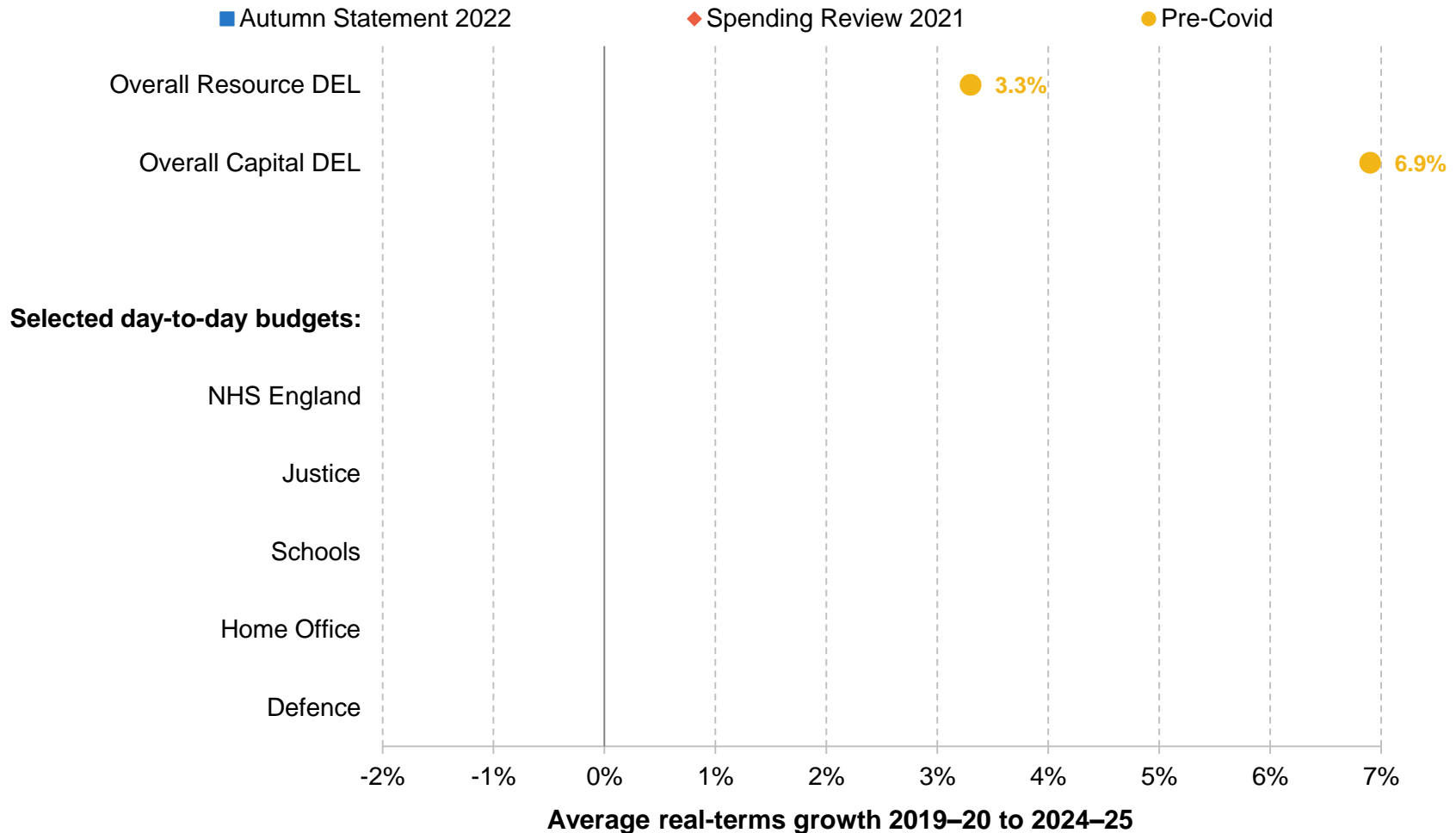
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# Short-term challenges

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# Inflation is squeezing departments

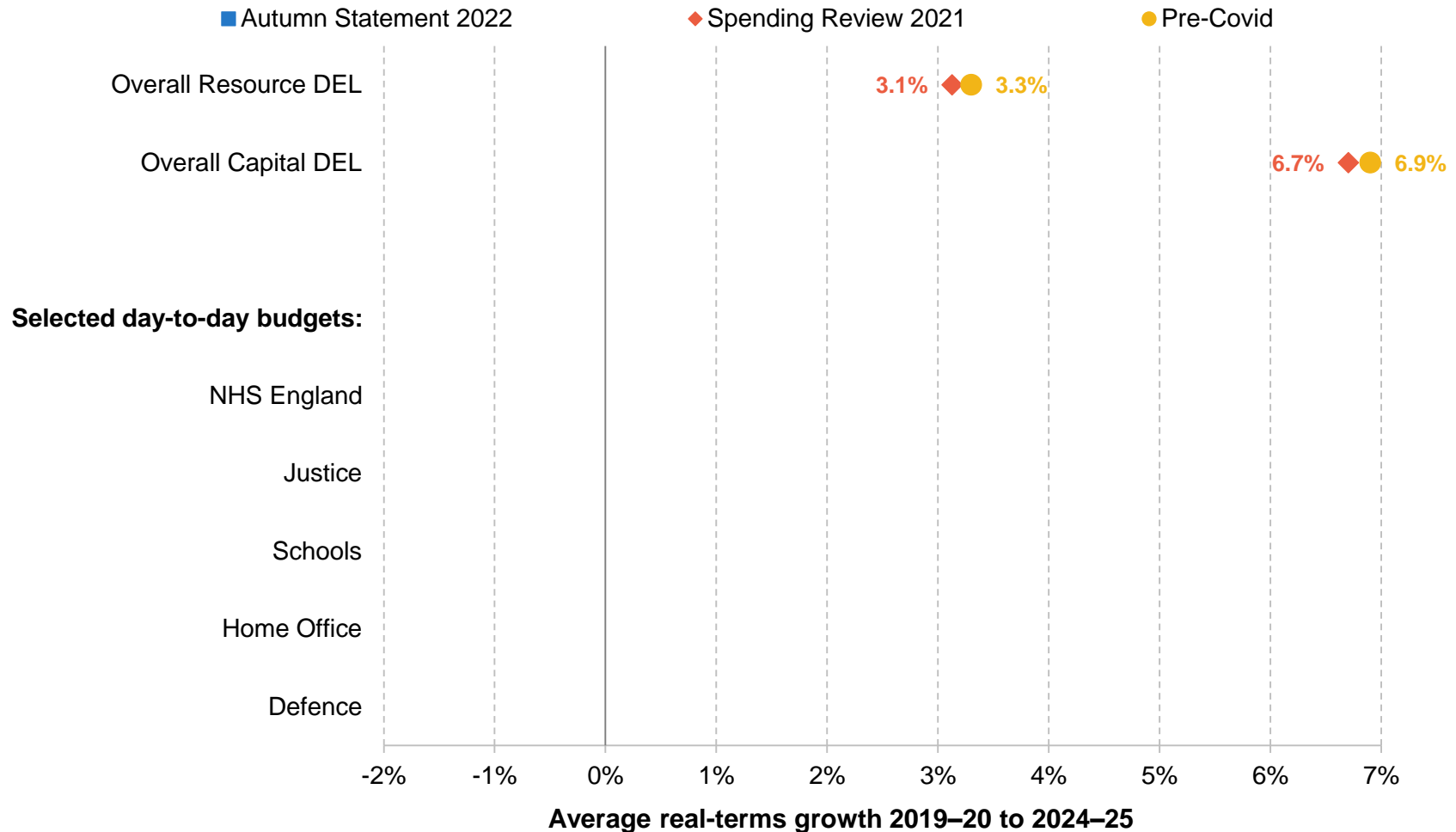
## Planned average real-terms spending growth over the Parliament (2019–20 to 2024–25)



Note: DEL refers to departmental expenditure limits. Source: Author's calculations using HM Treasury and OBR (various).

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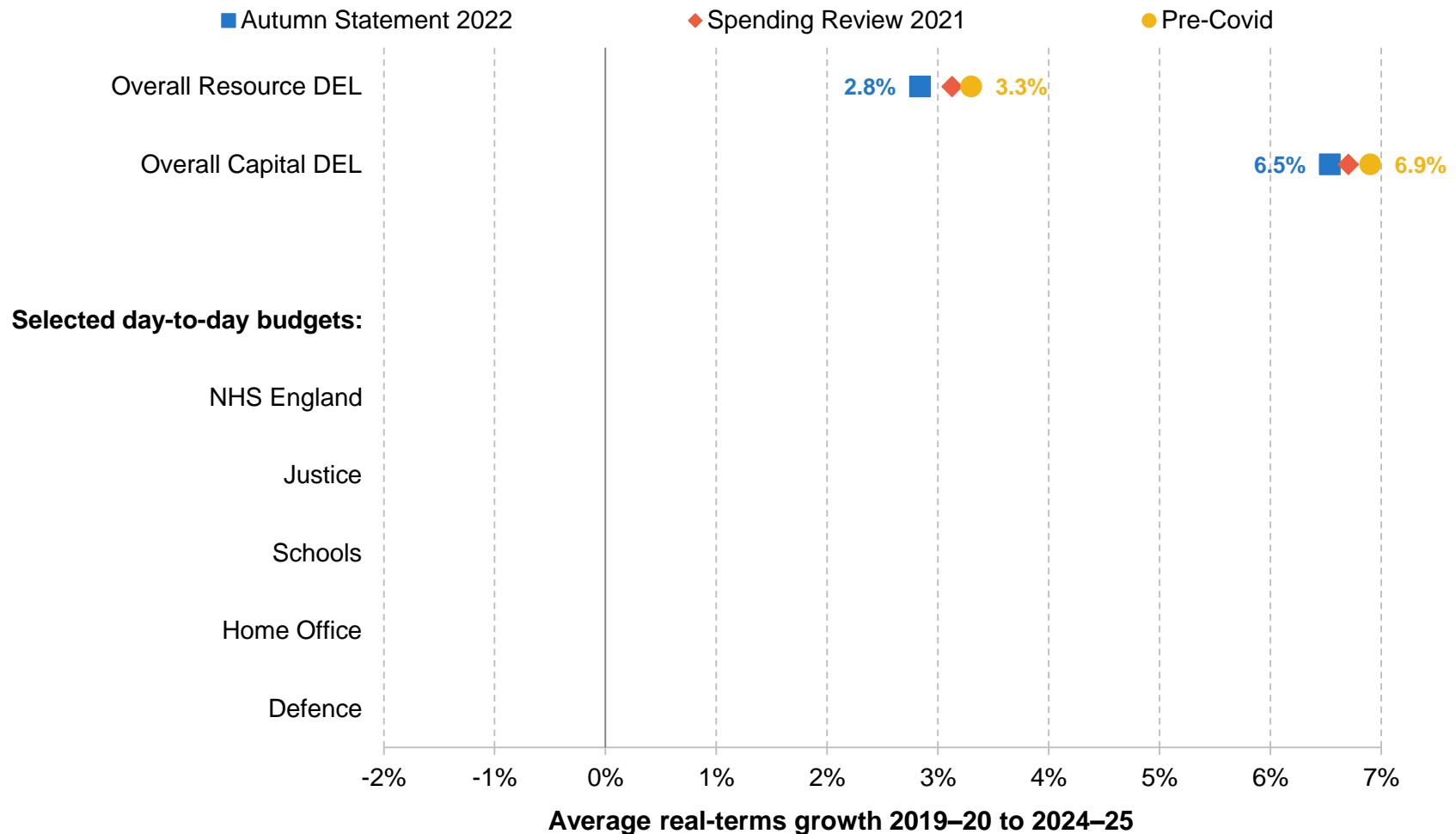
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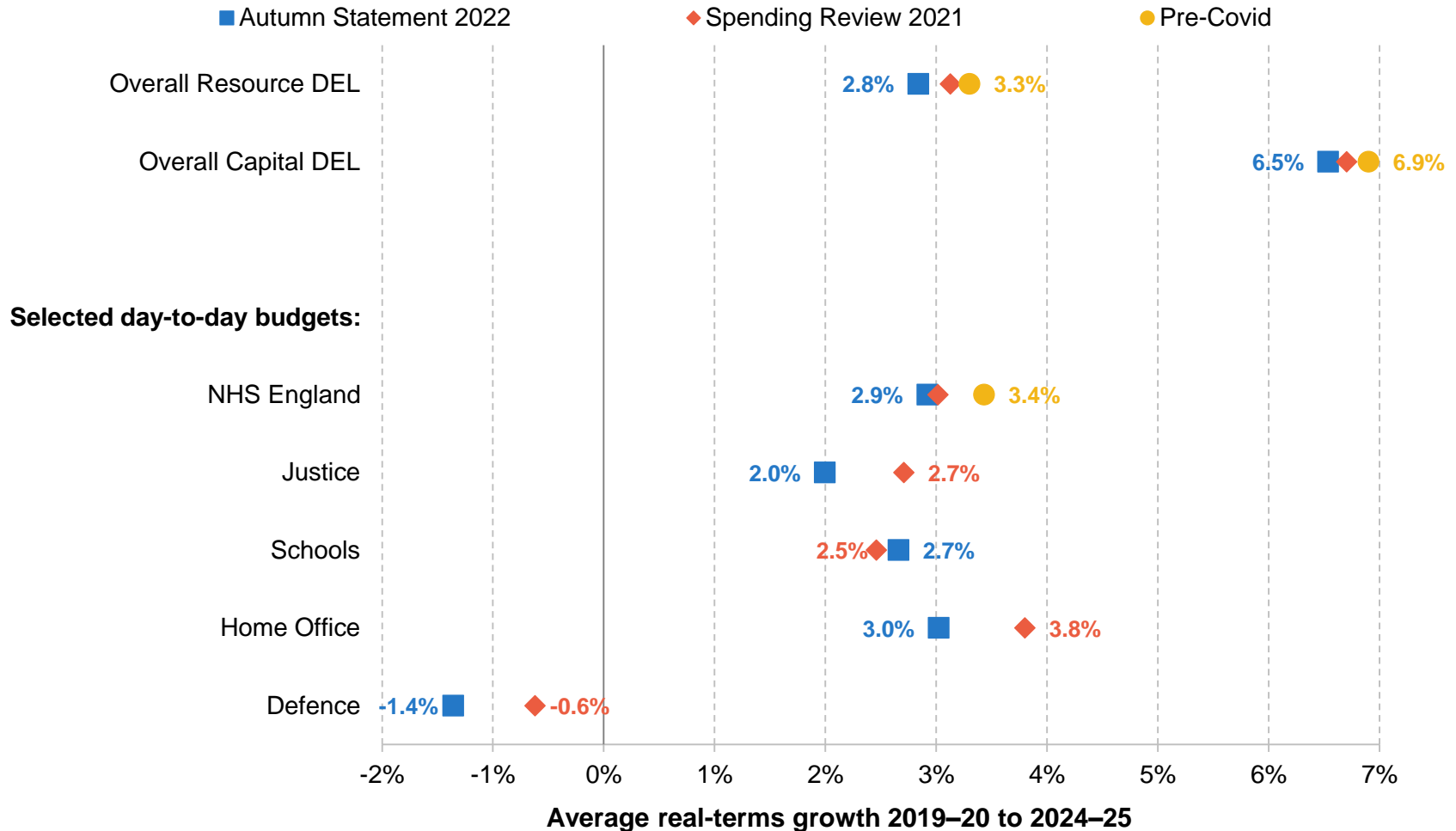
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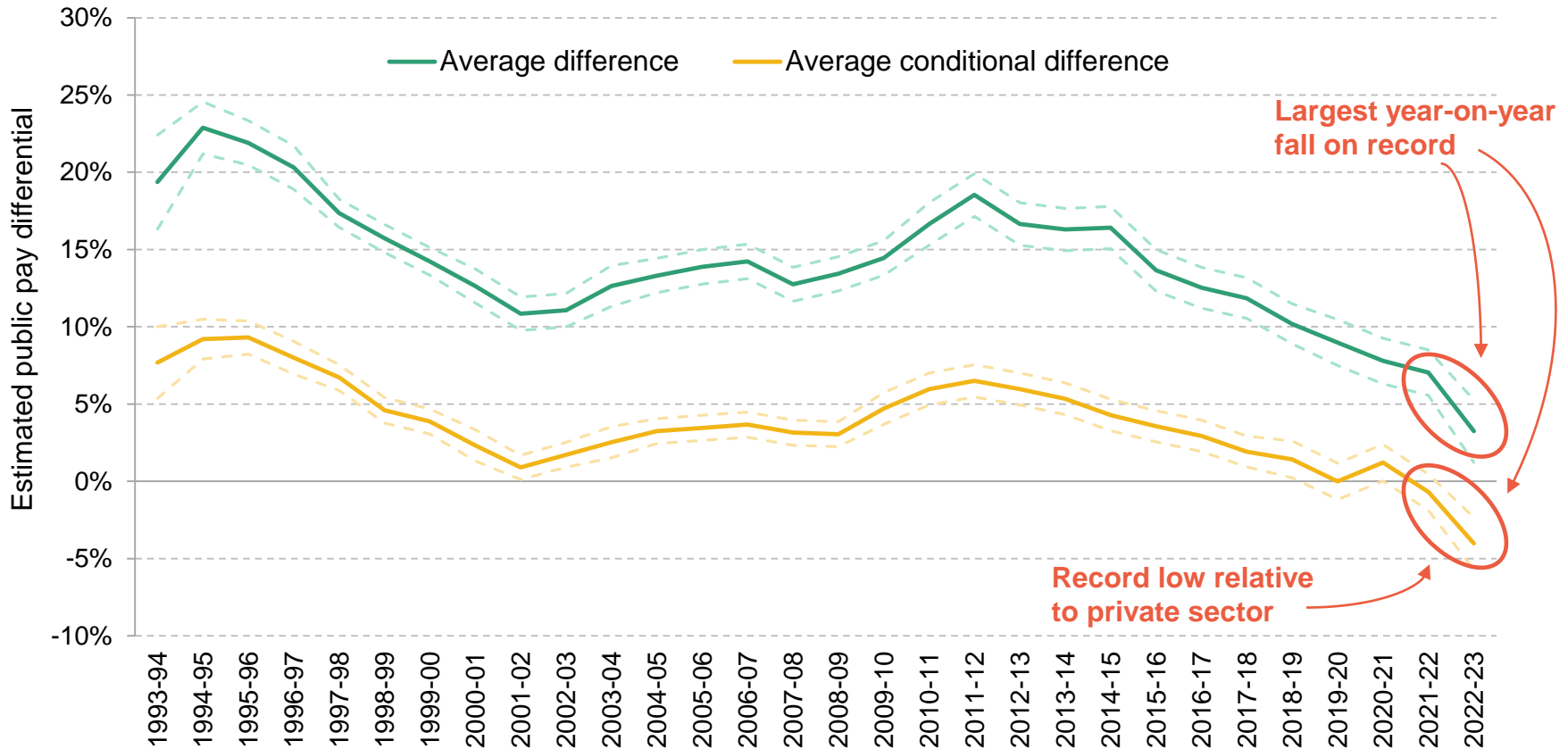
# Public sector pay disputes

- The ongoing strikes and disputes relate to 2022–23 pay awards
  - Public sector pay awards in 2022–23 averaged ~ 5%
    - Close to BoE estimate of **median private sector settlements** in 2022 (5.2%)
    - But **average earnings growth** in public sector has lagged behind (2.8% average growth Apr-Dec 2022, versus 6.4% in private sector)
  - Clear signs that pay in the public sector has fallen relative to private sector



# Public sector pay has fallen sharply relative to private sector pay this year

Average public-private hourly pay differentials from 1993–94 to 2022–23



Note: 2022–23 figures calculated for 2022 Q2 and Q3 only. The average conditional difference is calculated using age, education, experience and region controls, all interacted with sex, and interactions between education and experience. Figures shown are the coefficient on an indicator variable for whether the individual works in the public sector, transformed into a percentage differential based on Halvorsen and Palmquist (1980). Figures are for hourly pay and exclude pension contributions. The dashed lines represent 95% confidence intervals. Source: IFS calculations using the quarterly Labour Force Survey.

# Public sector pay disputes

- Pay decisions in 2023–24 will bring a new set of difficult choices
  - Bank of England expect CPI of **5.4%** and median private sector settlements of **5.7%**
  - But departments have stated that max **3.5%** is affordable within existing funding
    - i.e. the ‘affordability constraint’ for Pay Review Bodies is likely to bite
    - makes one-off awards and/or below-inflation pay recommendations more likely
- ... unless HMT provides additional funding to departments
  - Approx. £5 billion to provide a CPI-matching 5.4% pay award, rather than 3.5%
  - Plus a further ~£9 billion to undo last year’s reduction vis-à-vis the private sector
  - Note: spending plans contain an unallocated £13–£14 billion ‘Reserve’ in next 2 years
  - HMT also concerned about potential impact on inflation
    - ... though this is largely a distraction: real constraint is a reluctance to raise taxes



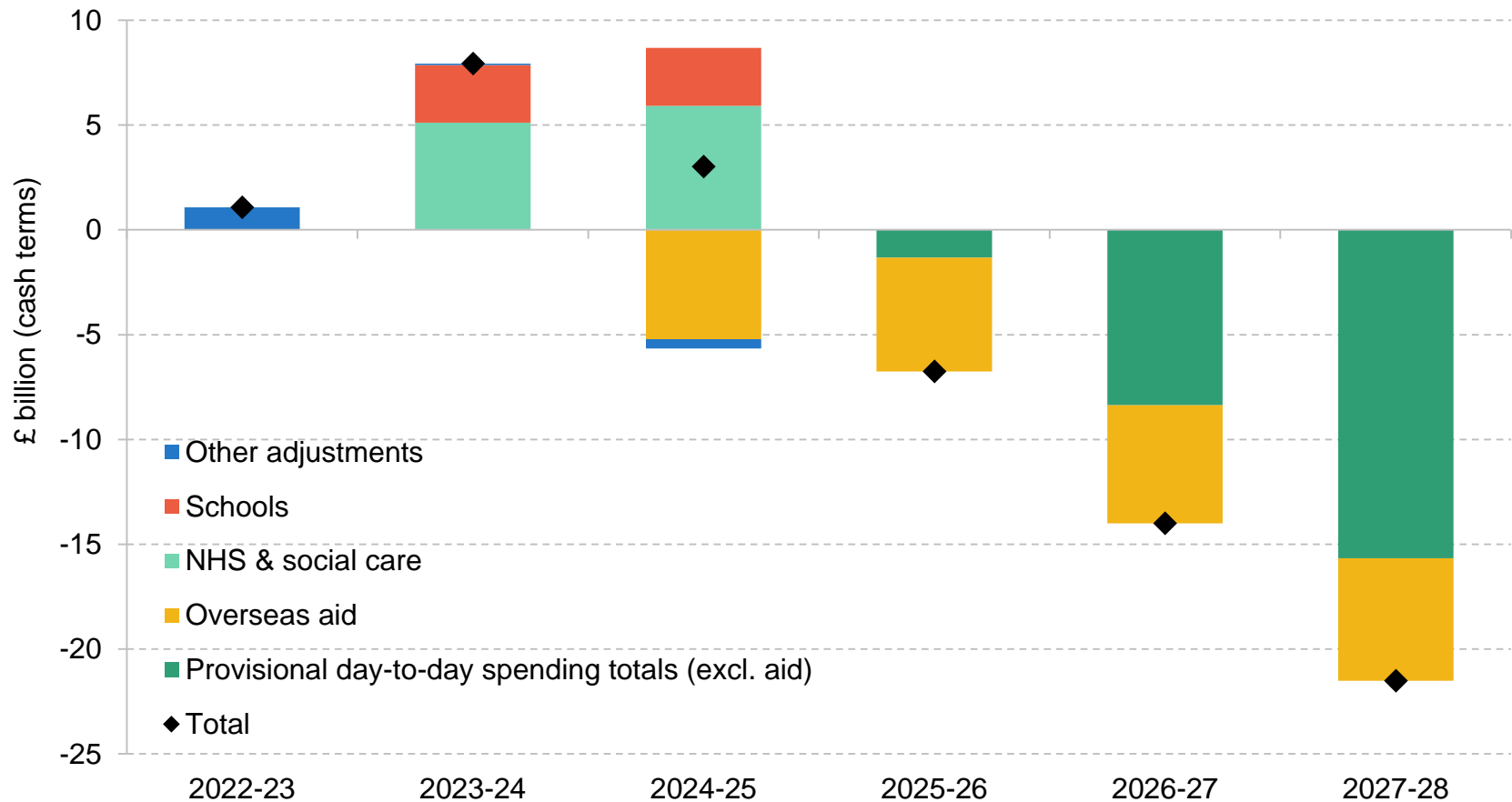
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# Beyond 2025

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# The Autumn Statement cut back post-2025 spending plans

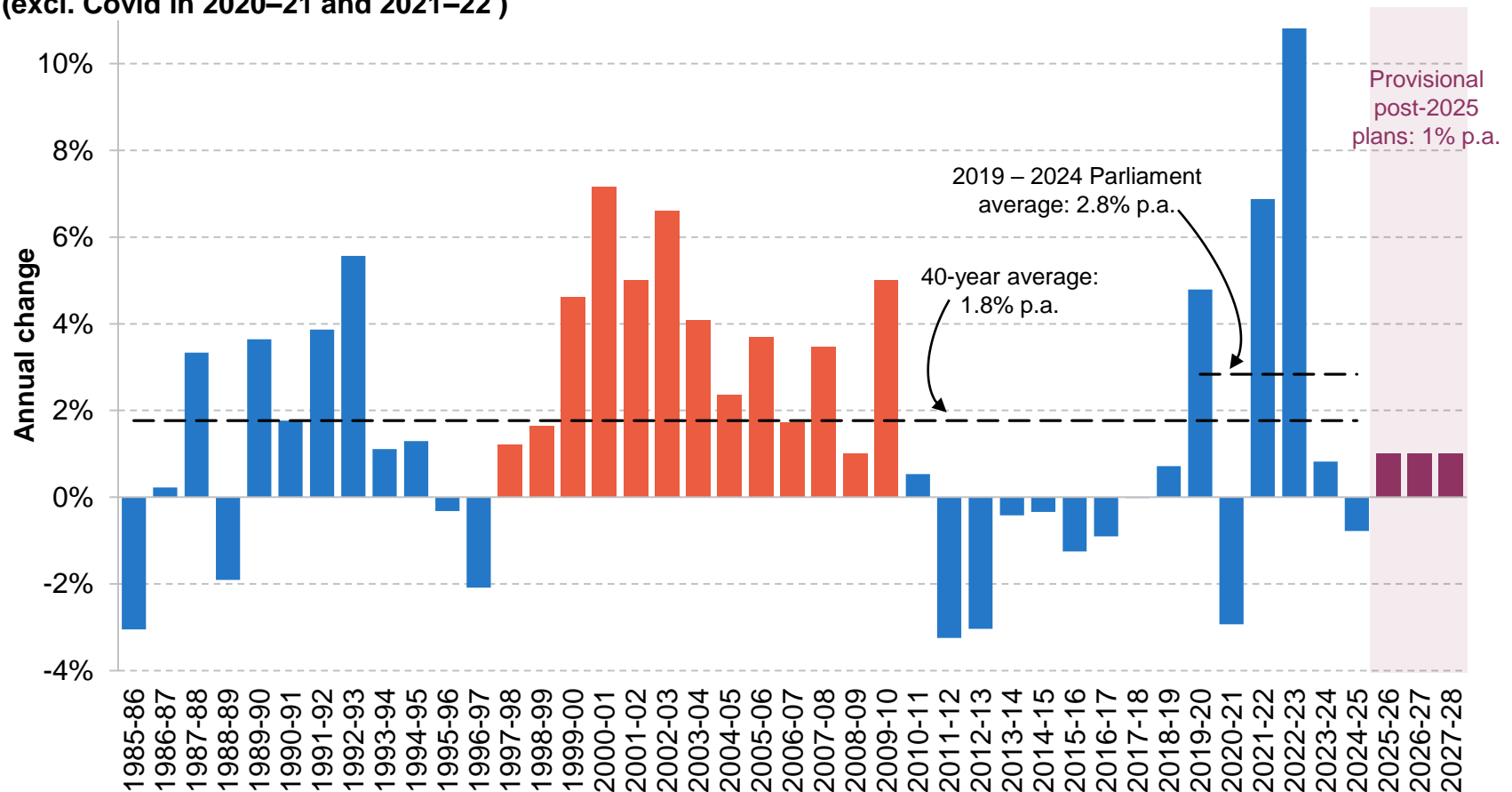
Change in planned day-to-day (resource) spending at Autumn Statement 2022



Note: Overseas aid figures for 2025-26, 2026-27 and 2027-28 represent the estimated saving from maintaining ODA spending at 0.5% of GNI, rather than returning to 0.7% of GNI, as was implicit in pre-Autumn Statement plans. Source: Author's calculations using HM Treasury, Autumn Statement 2022, and OBR November 2022 EFO.

# Current plans imply 1% real growth per year after 2025

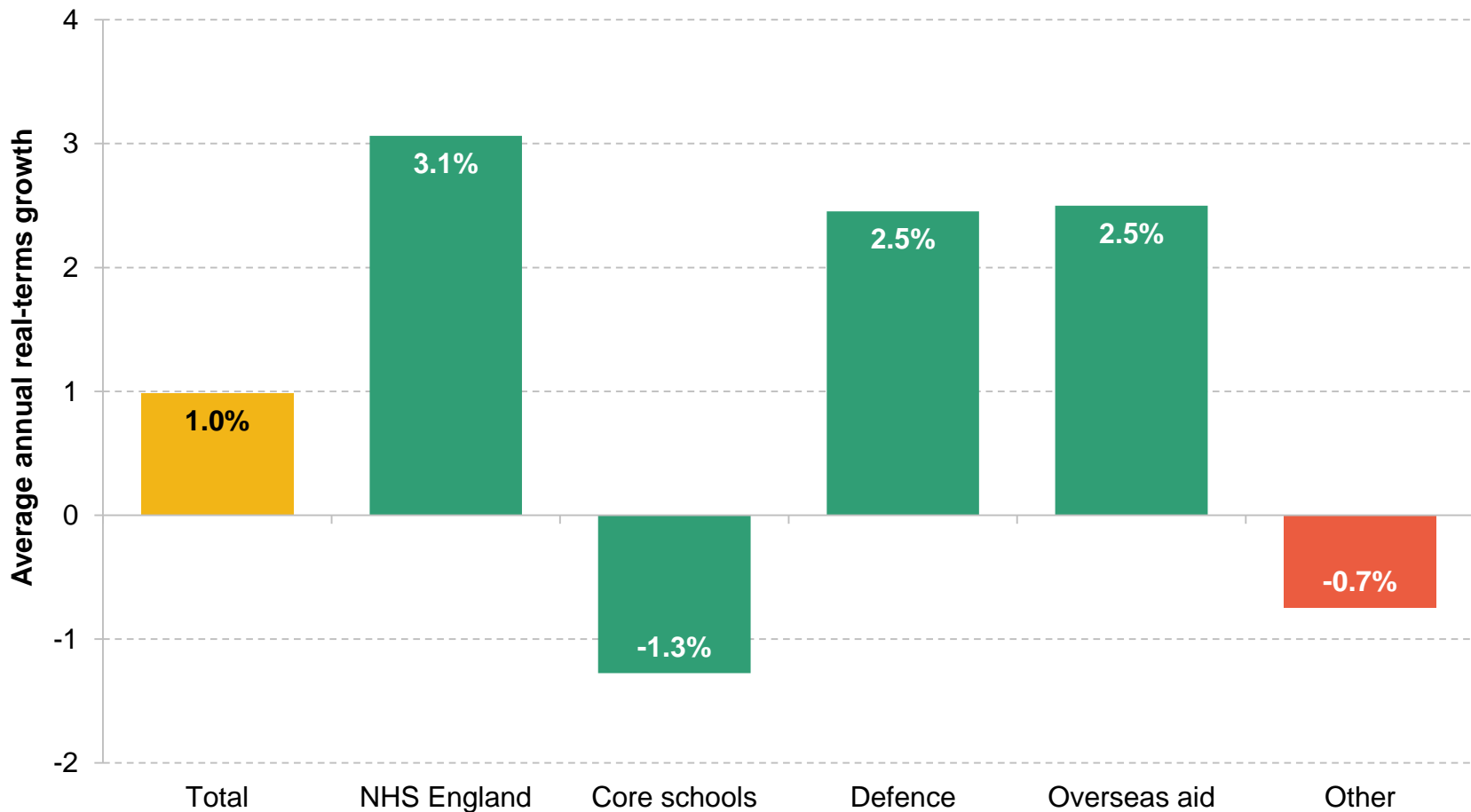
Annual real-terms % change in day-to-day public service funding (excl. Covid in 2020–21 and 2021–22)



Note: Figures for 1985–86 to 1998–99 refer to the New Control Total, which includes some non-public service elements (like social security). Figures for 1999–00 to 2019–20 refer to the OBR definition of PSCE in RDEL, adjusted for historic discontinuities. Figures for 2019–20 onwards refer to the HM Treasury definition of RDEL excluding depreciation, and excluding COVID-19 spending in 2020–21 and 2021–22. Source: Author's calculations using OBR November 2022 EFO, HM Treasury Autumn Statement 2022, HM Treasury Public Expenditure Statistical Analyses (various), and Crawford, Johnson and Zaranko (2018).

# Post-2025 plans imply cuts for some areas

OBR estimates of real-terms growth implied by latest plans, 2024–25 to 2027–28



Source: OBR Economic and Fiscal Outlook, November 2022, Chart D.

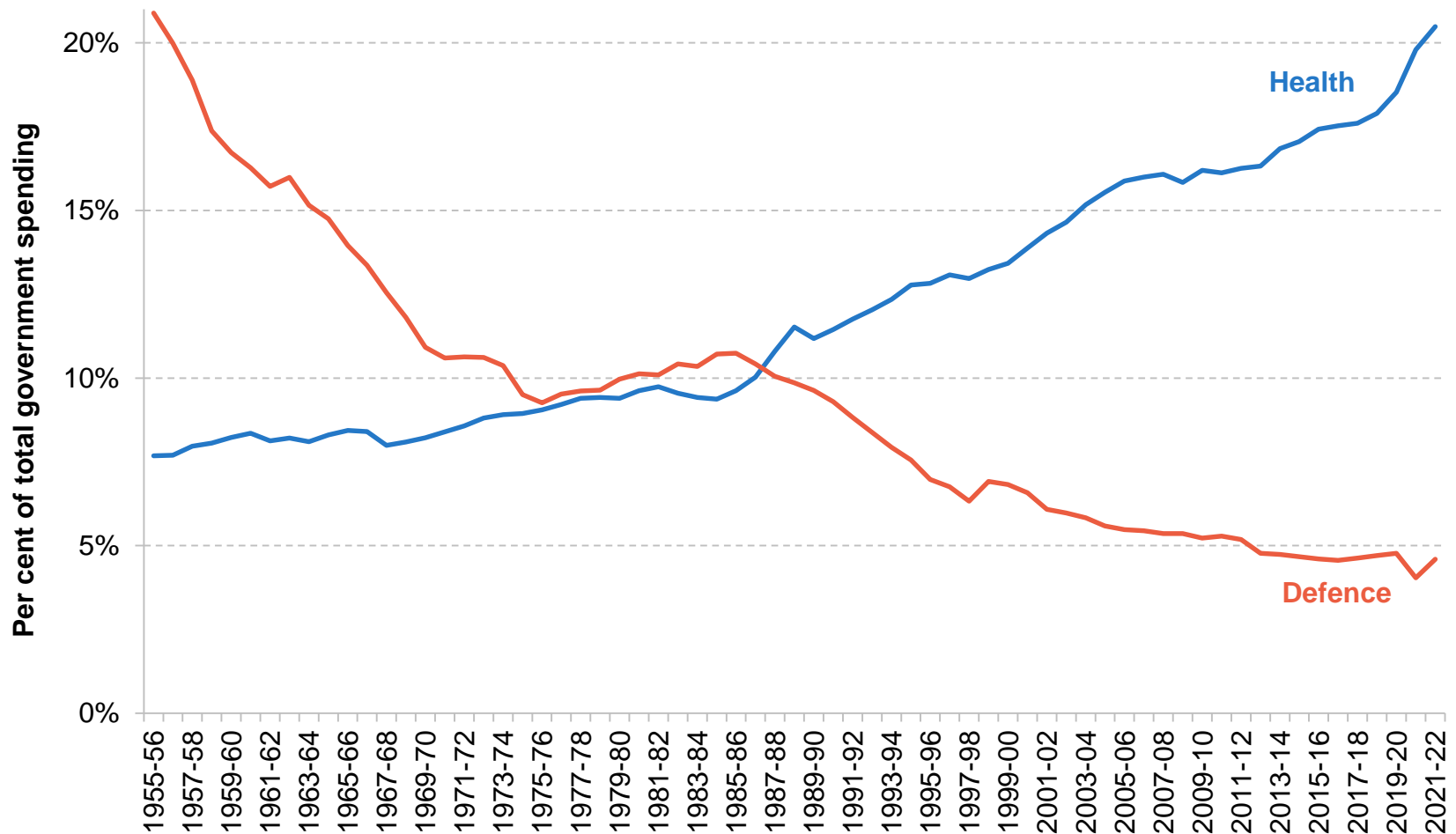
# Are spending plans implausibly tight?

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- Public service funding still set to grow overall after 2025, after some big funding injections since 2019: what's the issue?
  1. Large cuts already imposed on most public services over 2010s
  2. Lasting impacts of pandemic: backlogs, productivity, demand
  3. The possibility that the government will feel the need to sharply increase health and defence budgets **at the same time**

# The end of the 'peace dividend'?

Health and defence as % of total UK government spending





# Summary

- No getting away from hard choices
  - OBR forecast improvements unlikely to ride to the rescue
- Choices around public sector pay are particularly delicate
- Post-2025 spending plans look implausibly tight – common sense and past experience suggests they won't be stuck to
  - But those plans are still potentially significant: likely to act as the baseline for any general election spending pledges

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