Tom Waters

Pay, prices and policy

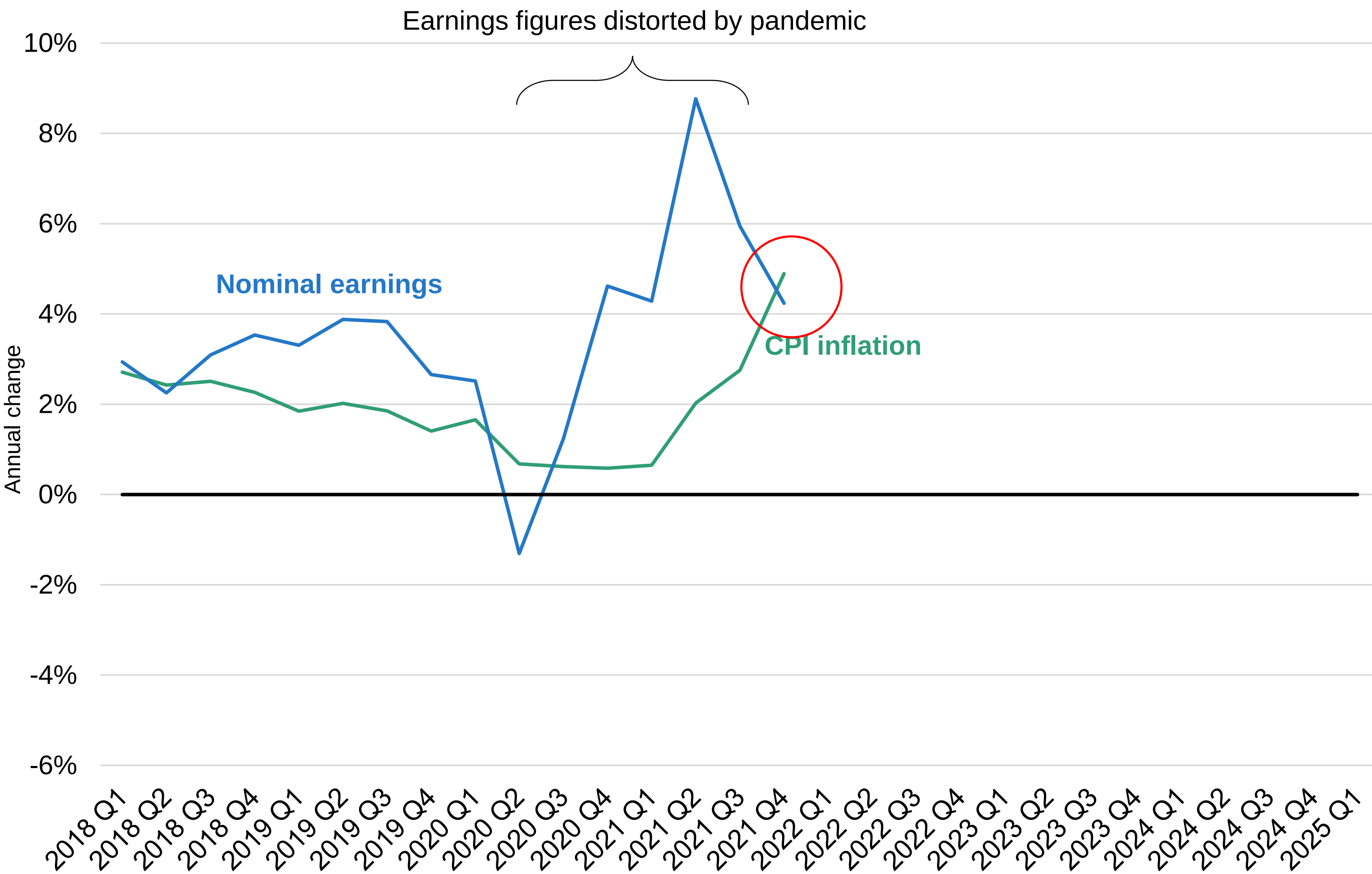
10 March 2022

@TheIFS

Economic
and Social
Research Council

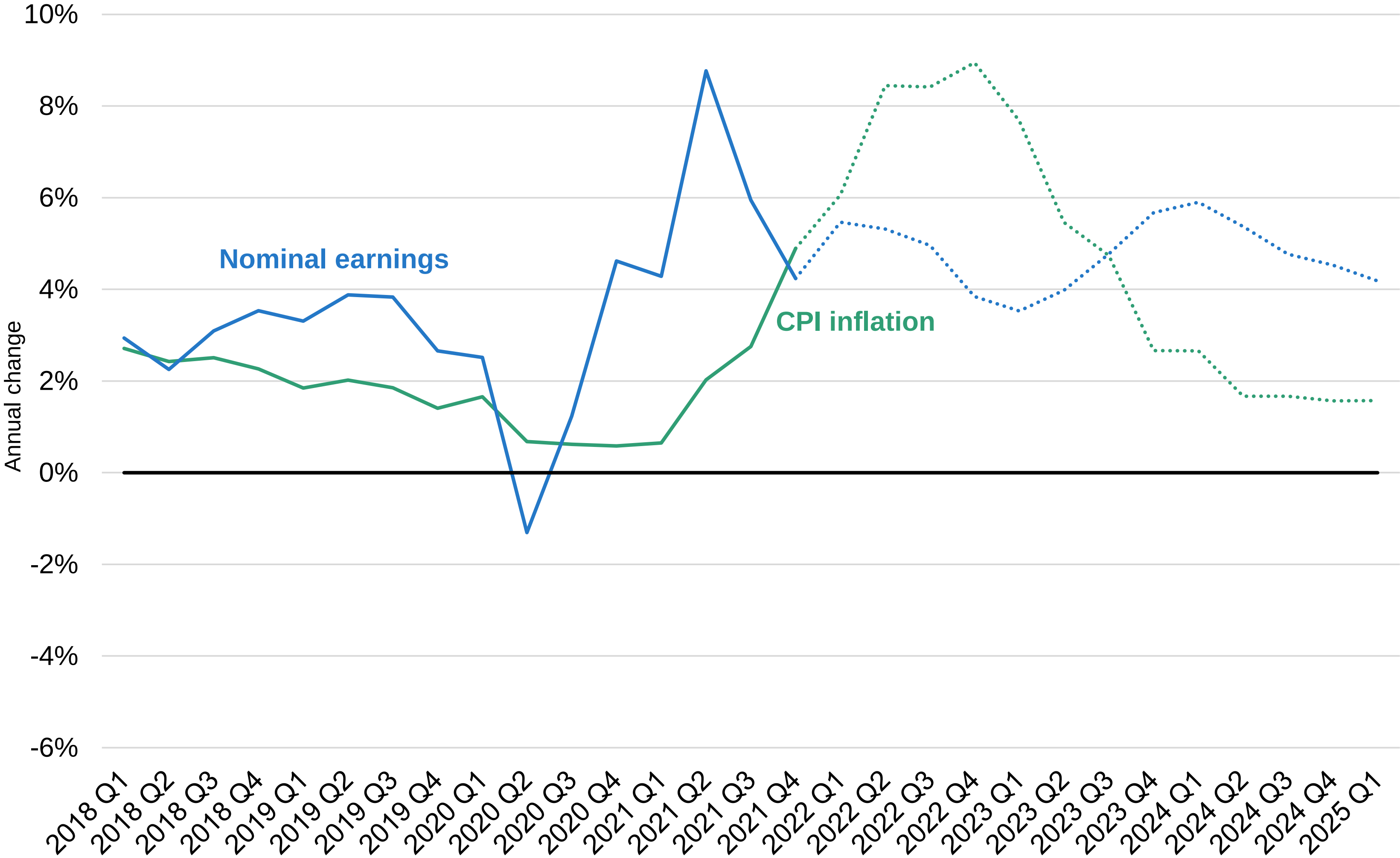
Real earnings now falling

IFS



Source: Citi forecast, March 2022. Earnings figures between 2020Q2 and 2021Q3 are heavily affected by changes in furlough & the composition of the labour market

Real earnings now falling



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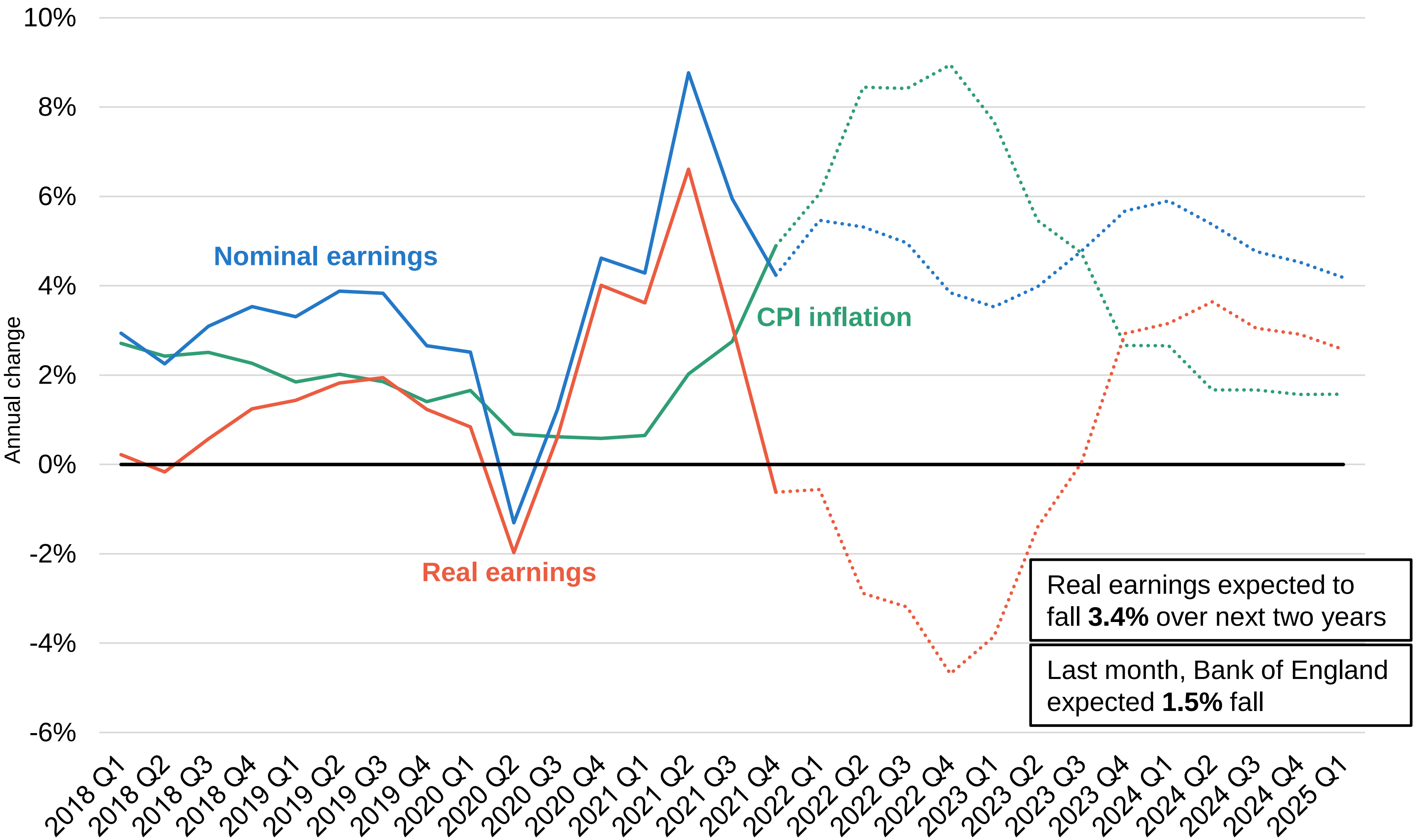

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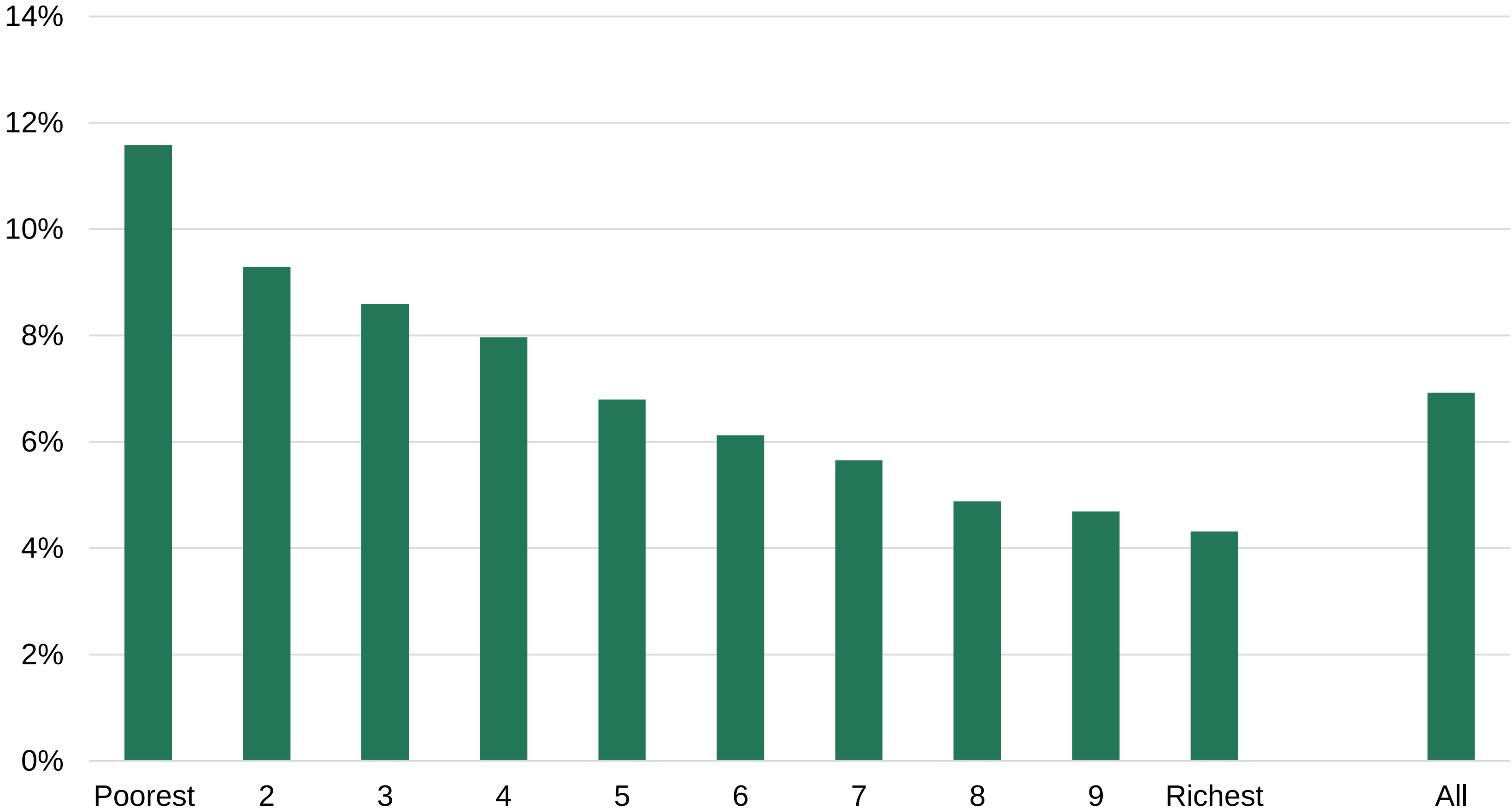
But inflation is not expected to be felt evenly

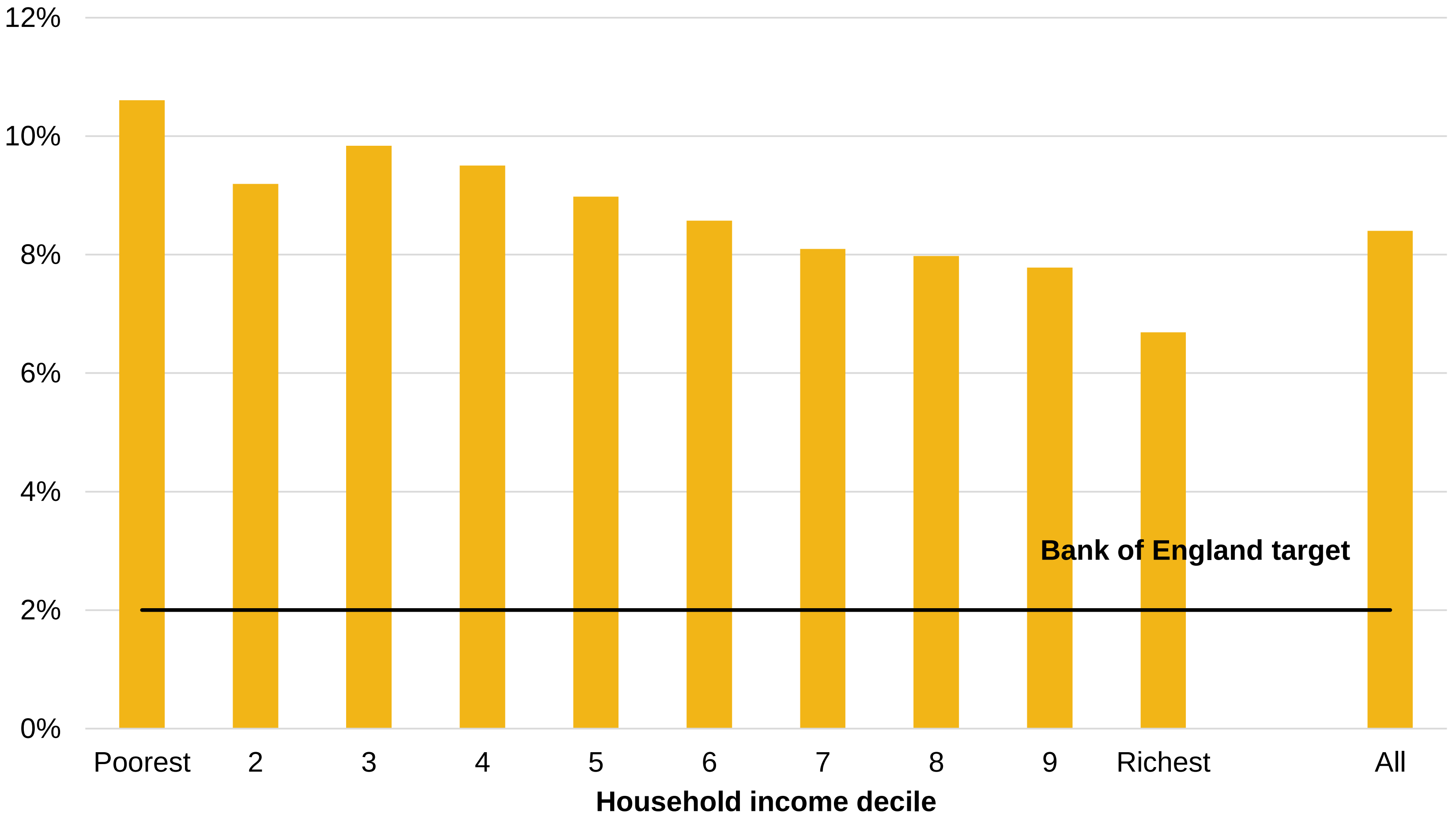
Budget share allocated to domestic fuel



Source: Authors' calculations using Living Costs and Food Survey (LCFS) 2019.

But inflation is not expected to be felt evenly

Expected CPI inflation in 2022Q2



Source: Authors' calculations using Living Costs and Food Survey (LCFS) 2019, and consumer prices data from the Office for National Statistics.

Against this backdrop, number of policy reforms affecting households

Announced in February

- £150 grant to households in council tax bands A-D
- £200 giveaway to all households, recouped in subsequent 5 years
- Expansion of Warm Home Discount

£9bn outlay this year, offsetting half the then expected £18bn in domestic energy cost rises

  - Latest expectation is £43bn rise in costs. Would need an extra £12.5bn to still offset half

Overall 2022 inflation now expected to be 1.7ppts higher than expected in February (NIESR)

Against this backdrop, number of policy reforms affecting households

Previously announced policies, (to be) implemented in 2022

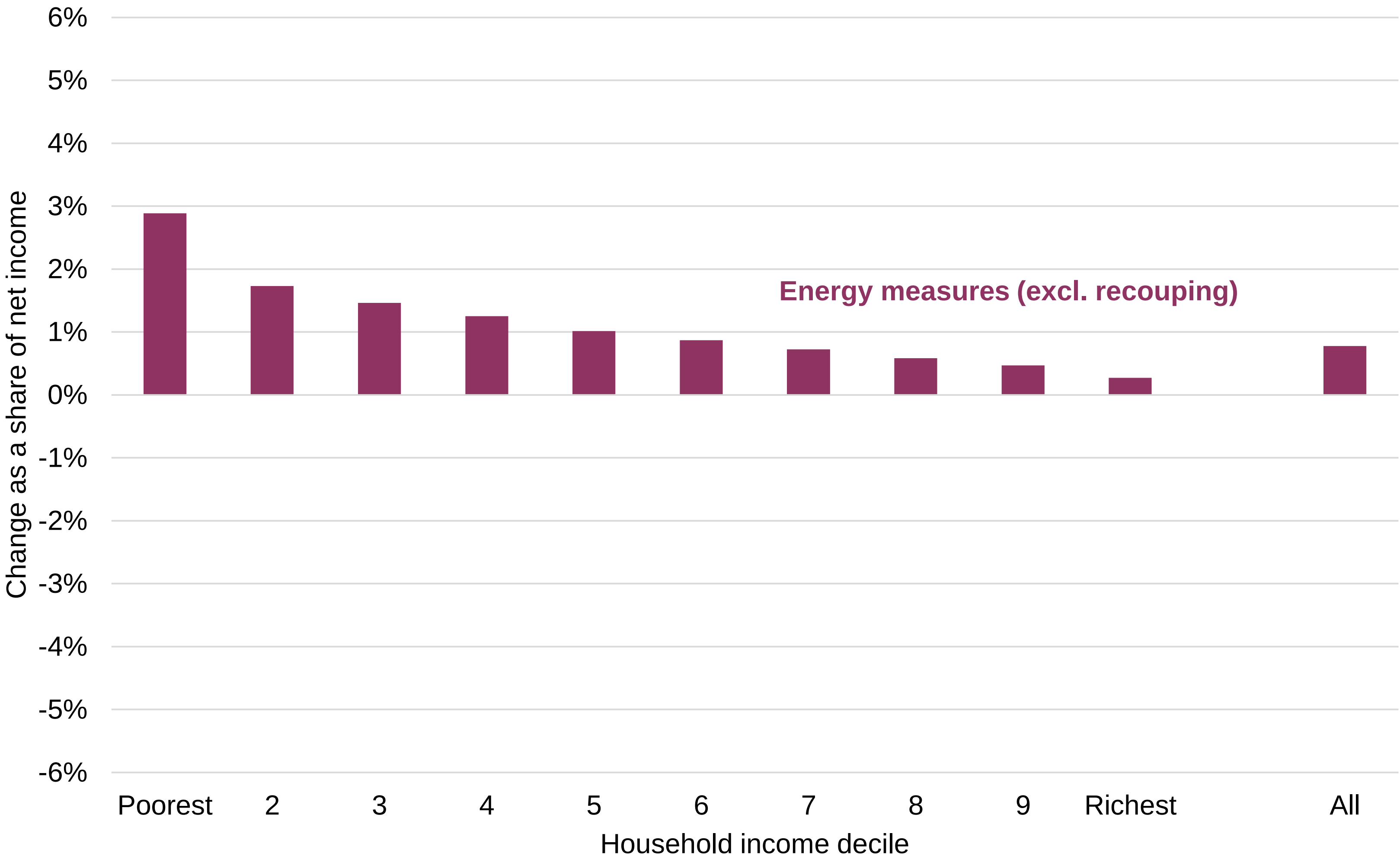
- Increase in National Living Wage (6.6%)
- 1.25ppt increase in National Insurance contribution rates
- Income tax thresholds frozen
- Fuel and alcohol duties frozen
- Various other freezes (IHT, CGT, pensions allowance…)

Following changes to universal credit over the past 6 months

- Expiry of £20pw uplift (£6bn p.a. to make permanent)
- Reduction of taper rate and increase in work allowances (£3bn)

Tax & benefit reforms and incomes

Measures implemented in 2022



Notes: "Energy measures" includes the £150 and £200 giveaways, but not the expansion of the Warm Home Discount. "Increase in NICs" does not include the rise in employer NICs.

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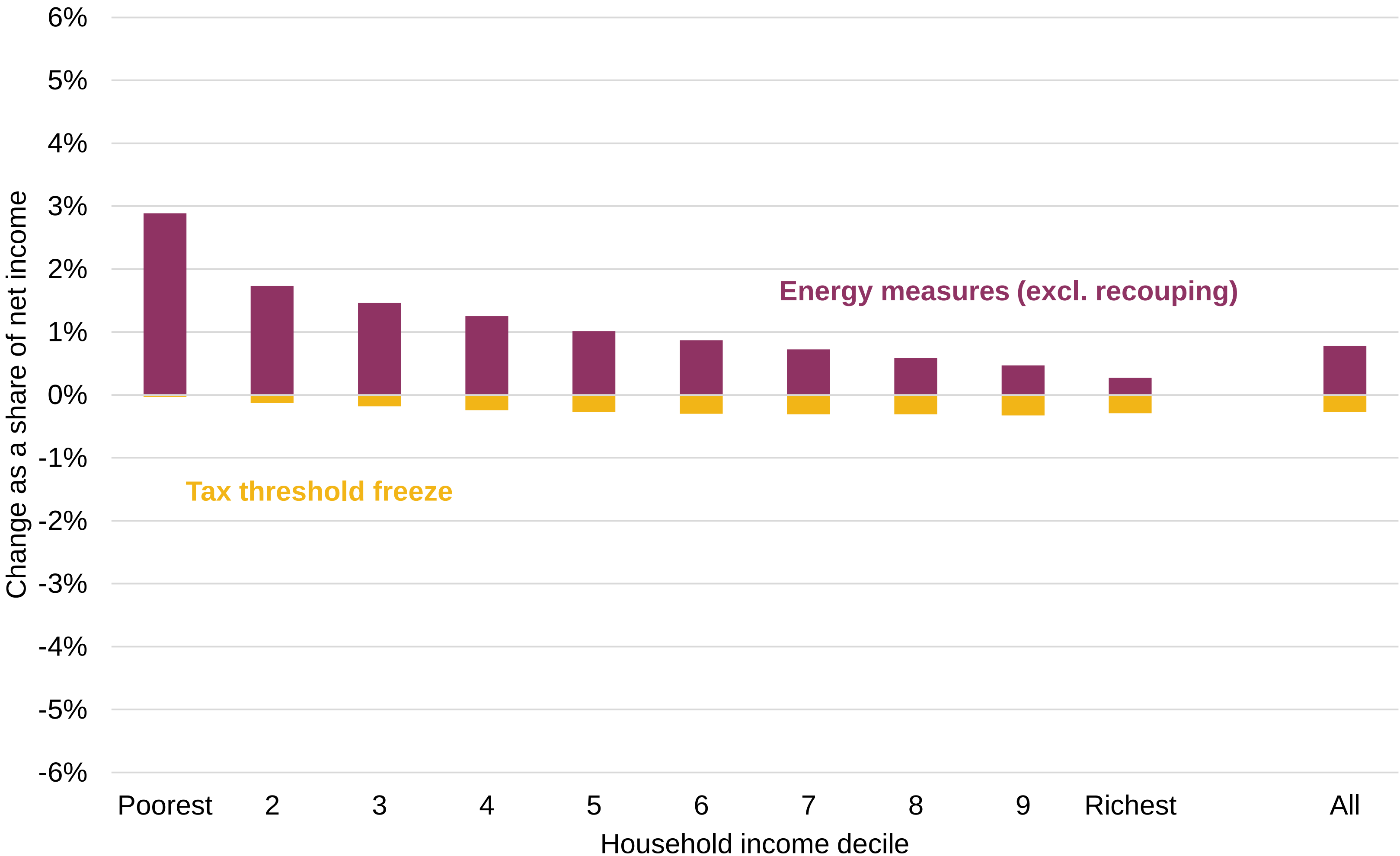

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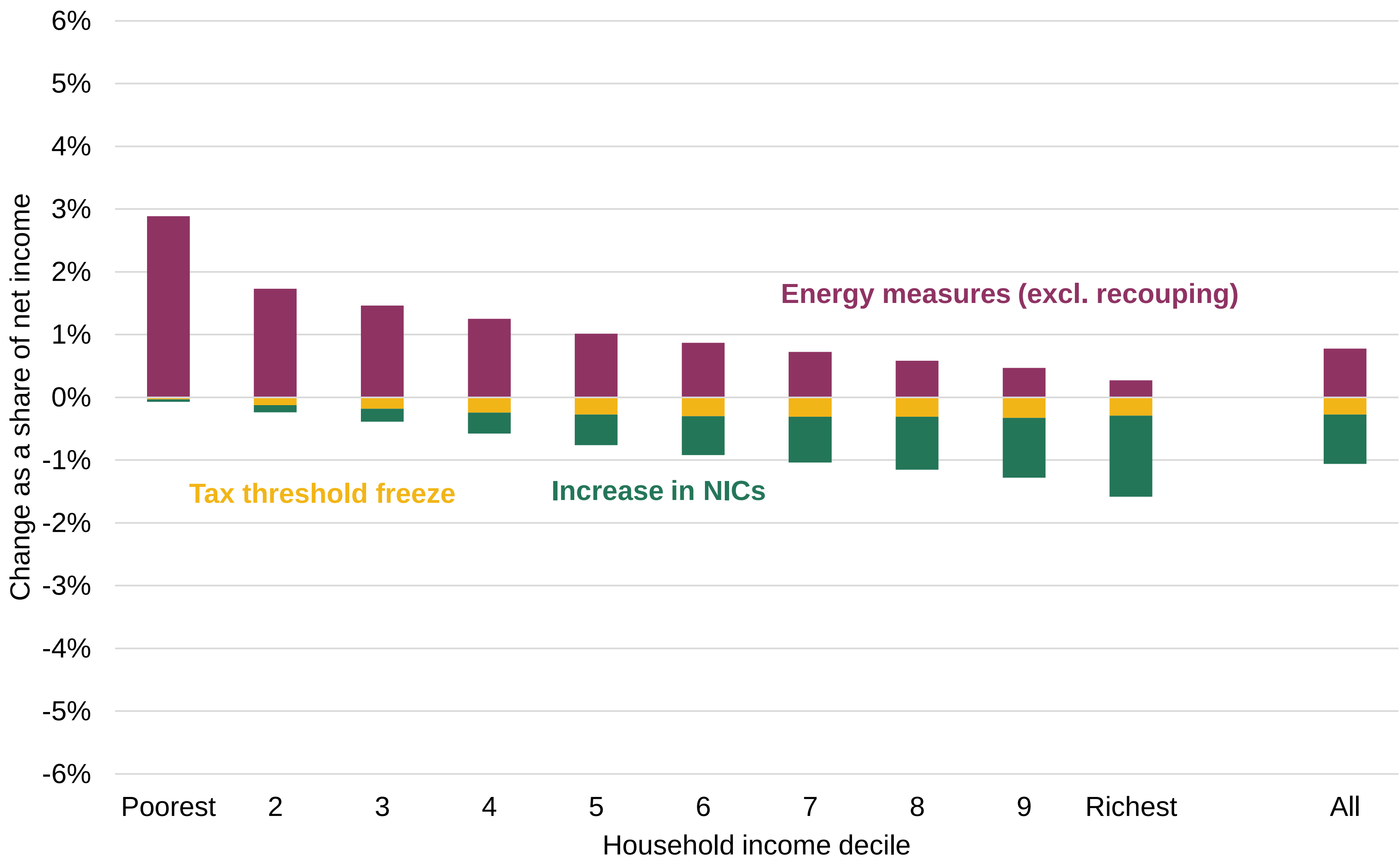

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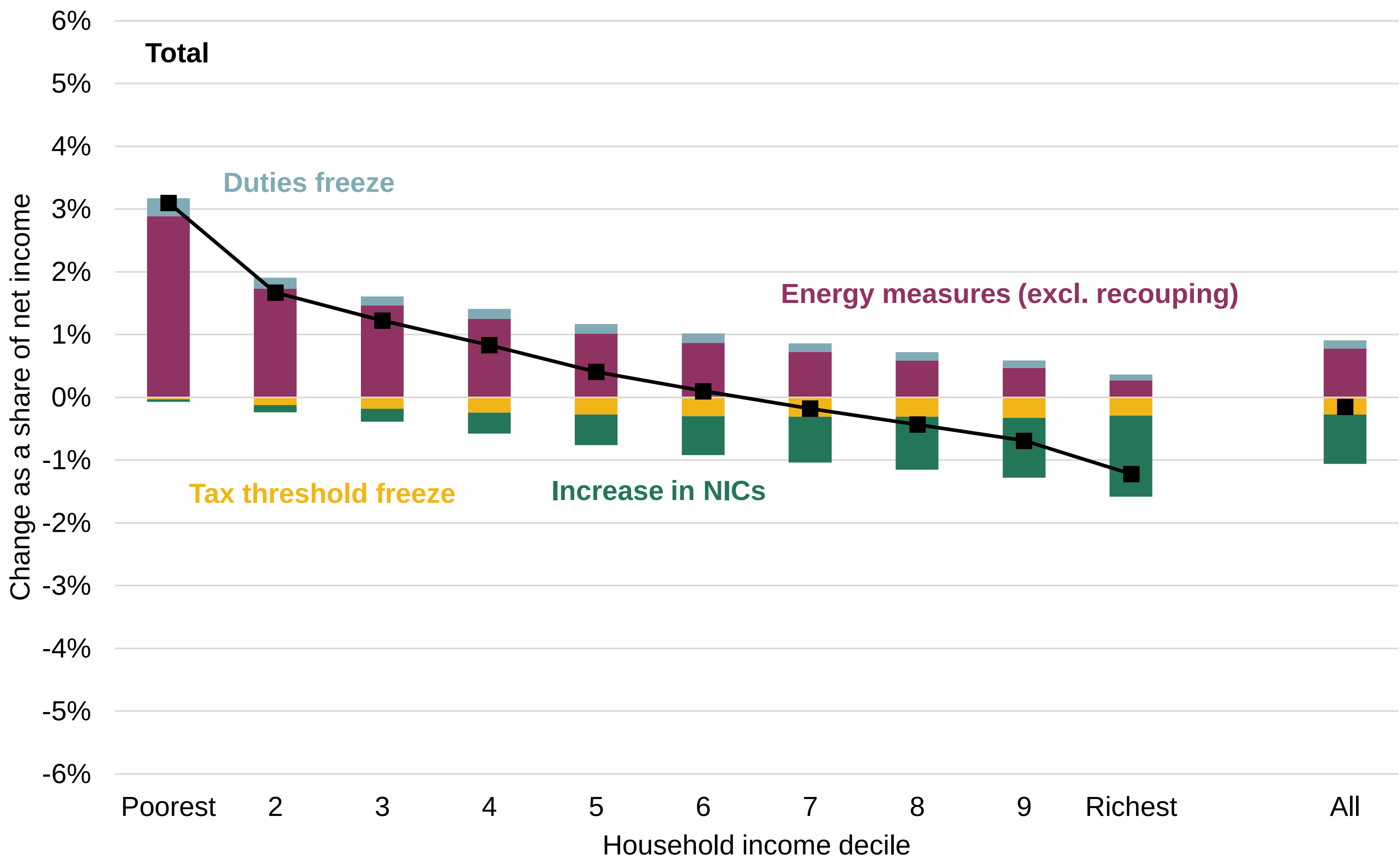

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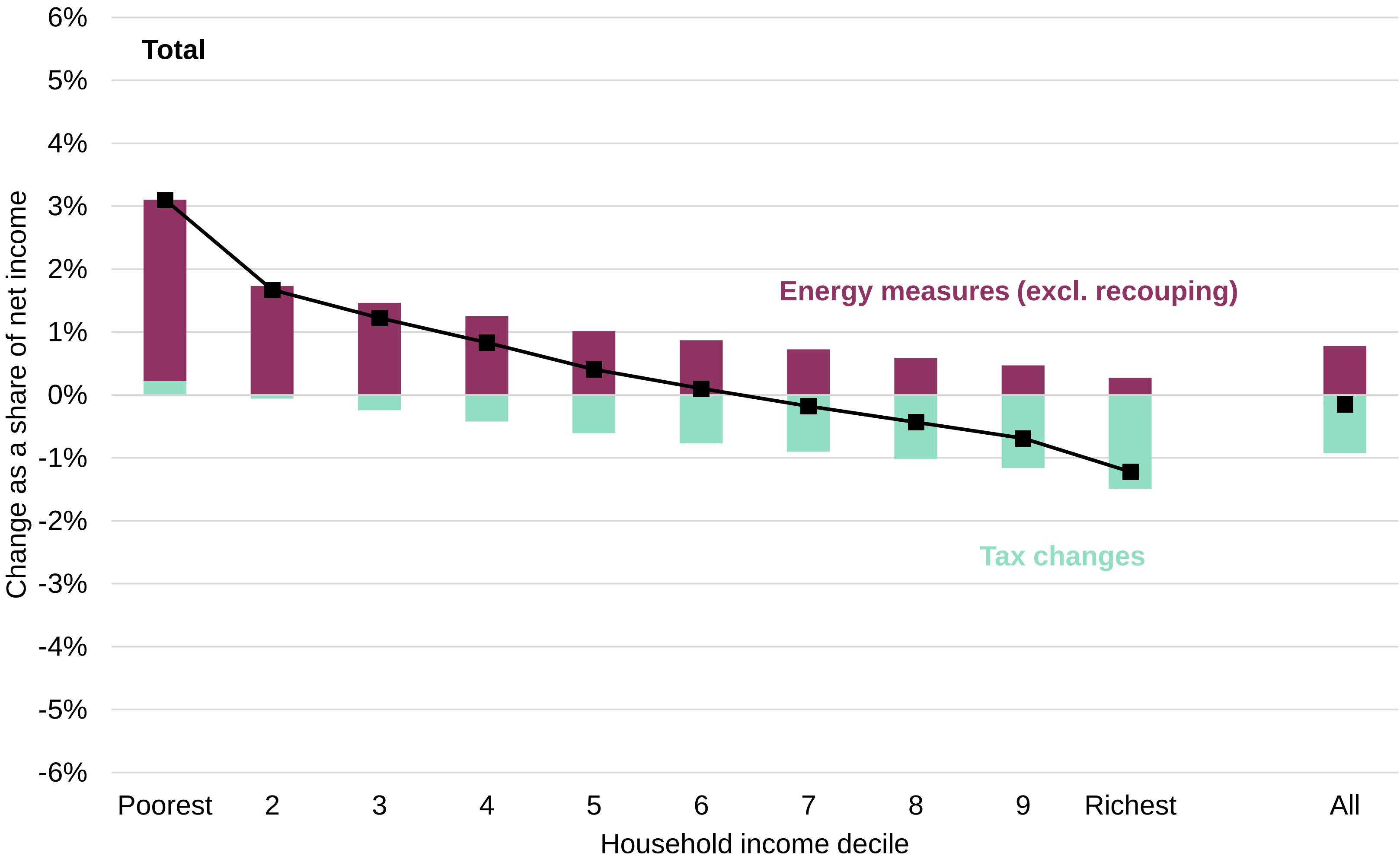

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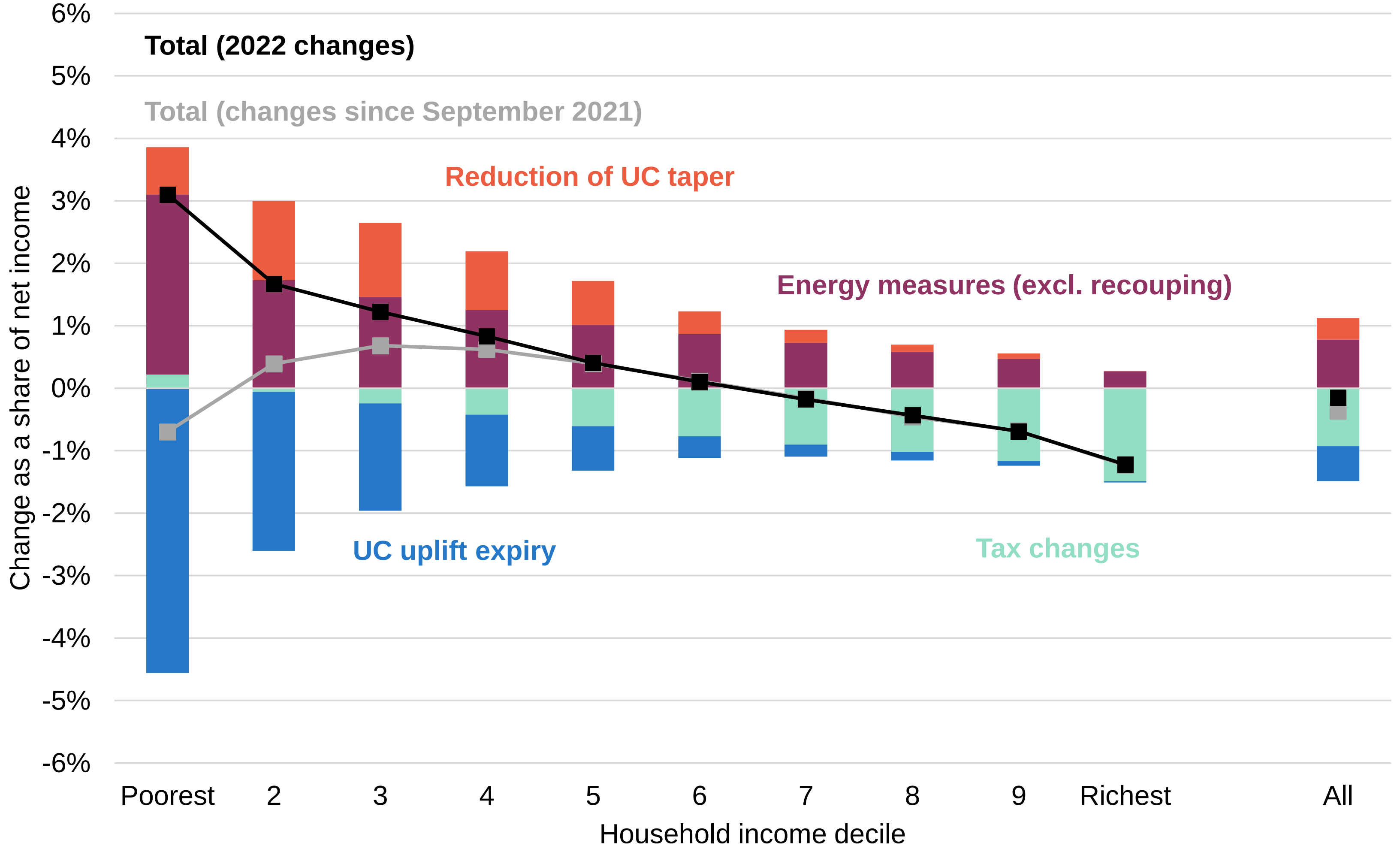
Tax & benefit reforms and incomes

Measures implemented between September 2021 and October 2022



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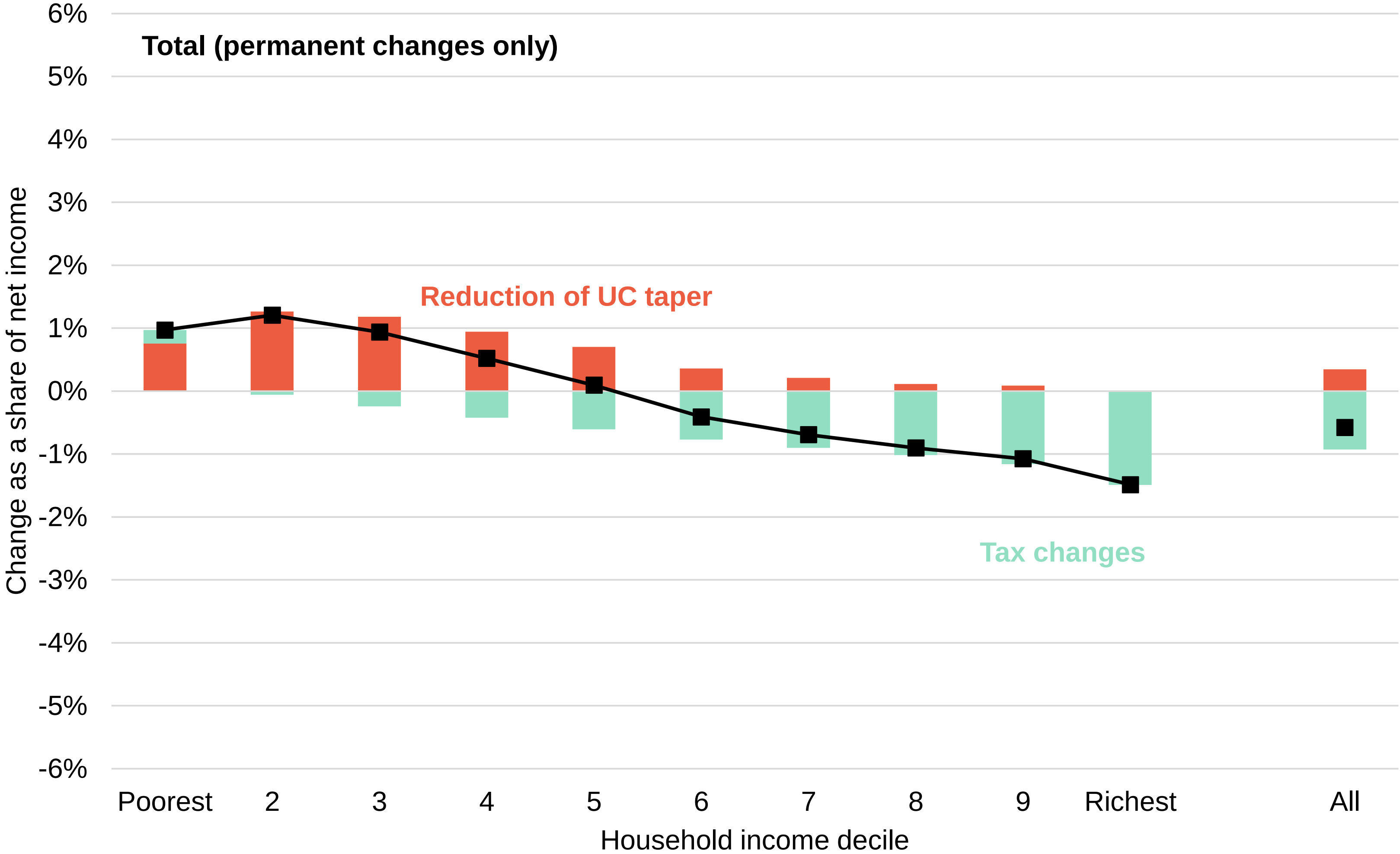
Tax & benefit reforms and incomes

Permanent measures implemented between September 2021 and October 2022



Impact on household incomes of tax and benefit reforms

- Reforms implemented this year clearly progressive; significant boost to incomes at the bottom of distribution

- Even more progressive if we include the in-work UC increases of December
  - But comparing September 2021 to October 2022 gives a more mixed picture – as UC recipients have lost temporary £20 uplift

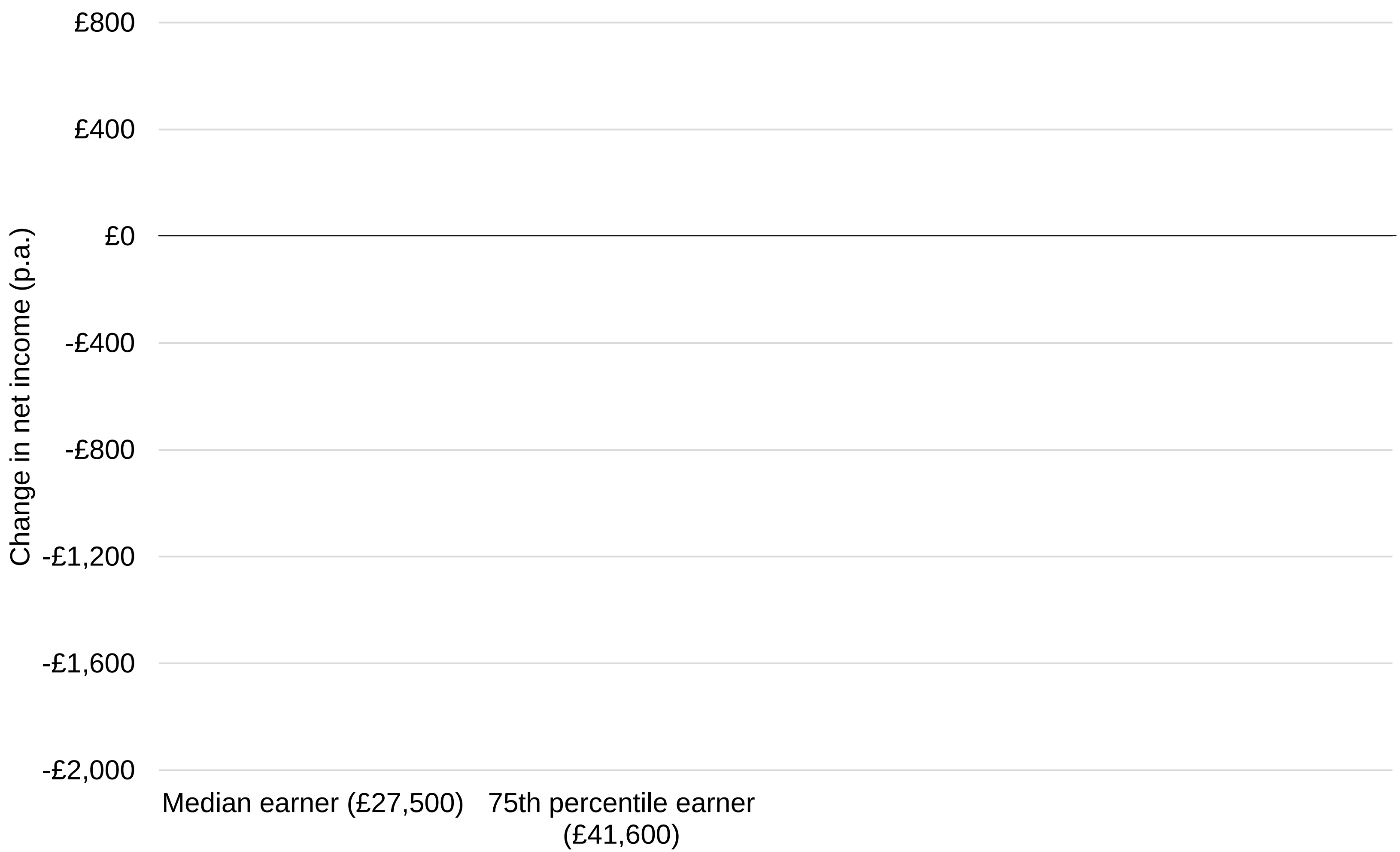
- Much of this determined by temporary policy; permanent changes are smaller and are progressive

Uprating

- Previous slide looked at explicit *reforms*
- But by default many taxes & benefits uprated with inflation in prev. September – 3.1% – much lower than inflation over 2022-23 (8.4%)
- Where possible, good case for using more recent measure of inflation (or forecast)
  - Reduces likelihood of this temporary disconnect
- Matters more for benefits. In February, when 2022-23 inflation expected to be 6.3%, Chancellor used energy measures instead of changing uprating rule
  - For benefit recipients, on average this was about as good as uprating with expected inflation
  - But now with inflation expected to hit 8.4%, majority would be better off with inflationary uprate

What does this all mean for example households?

Changes in real net income 2021-22 to 2022-23



Notes: First 3 households receive no benefits and have no working partner. UC worker is lone parent homeowner with 2 children. UC uplift expiry & taper cut measures change in incomes if uplift had been in place for all of 2021-22 and taper change was implemented in 2022-23, i.e. the annualised effects.

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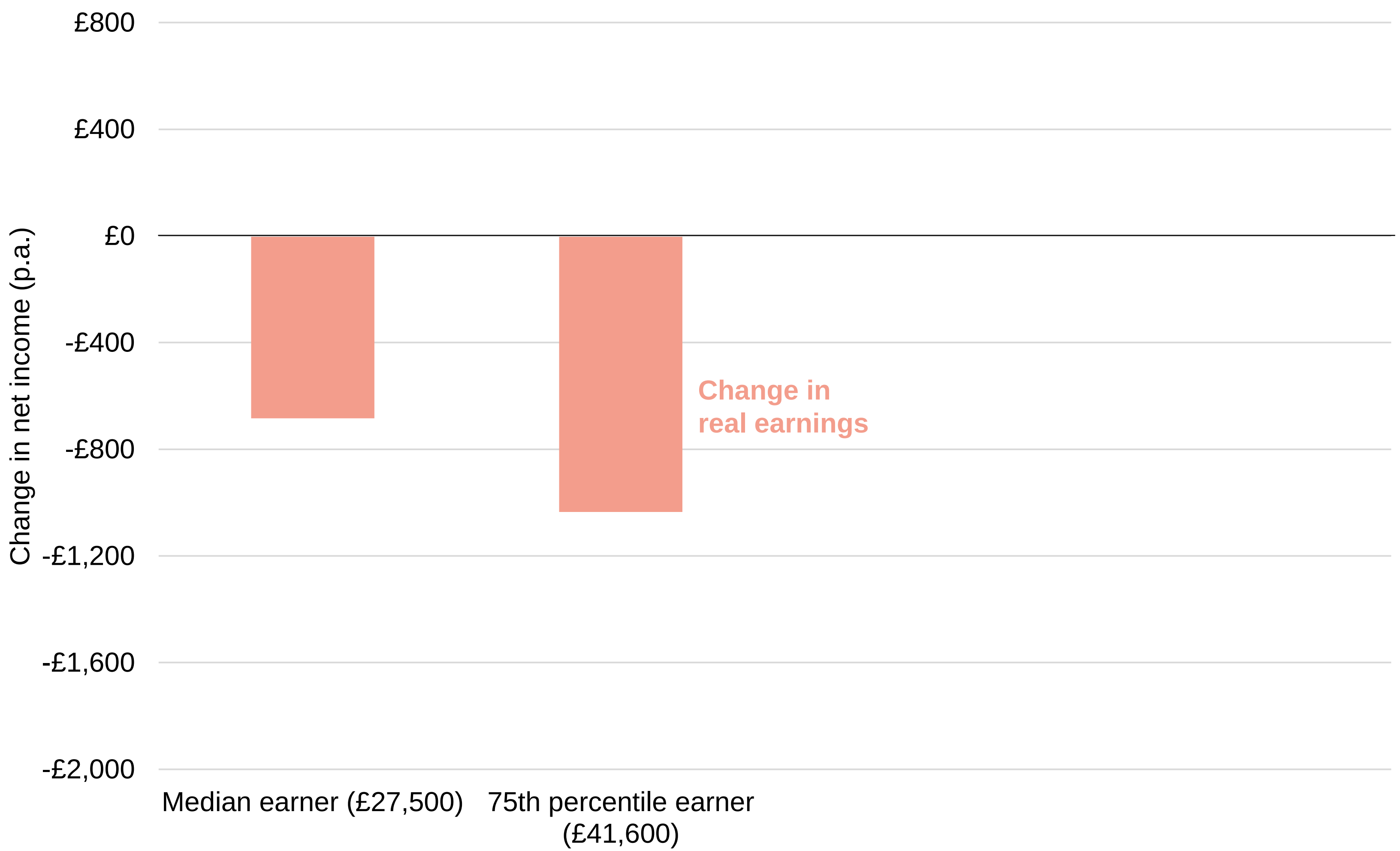

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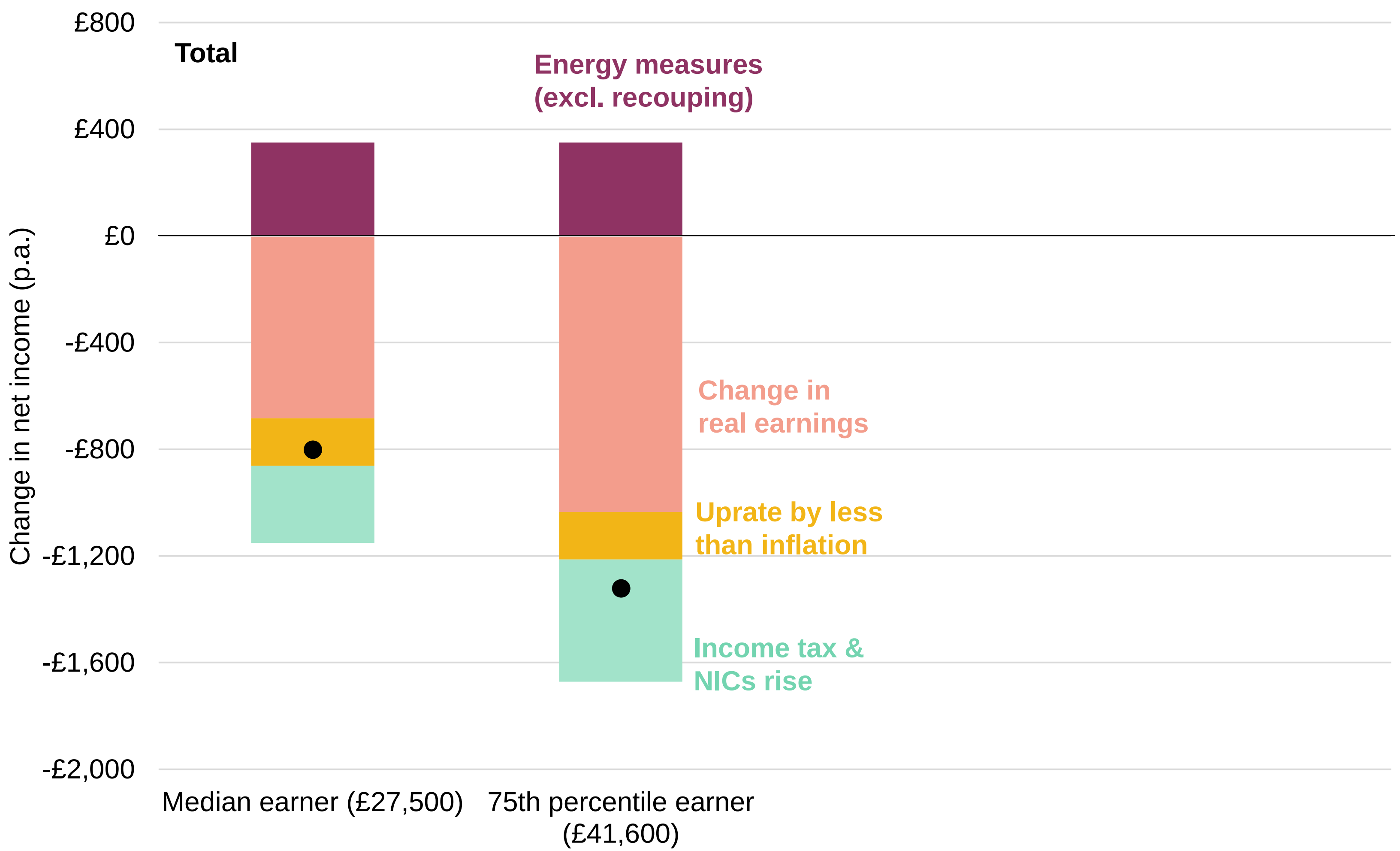

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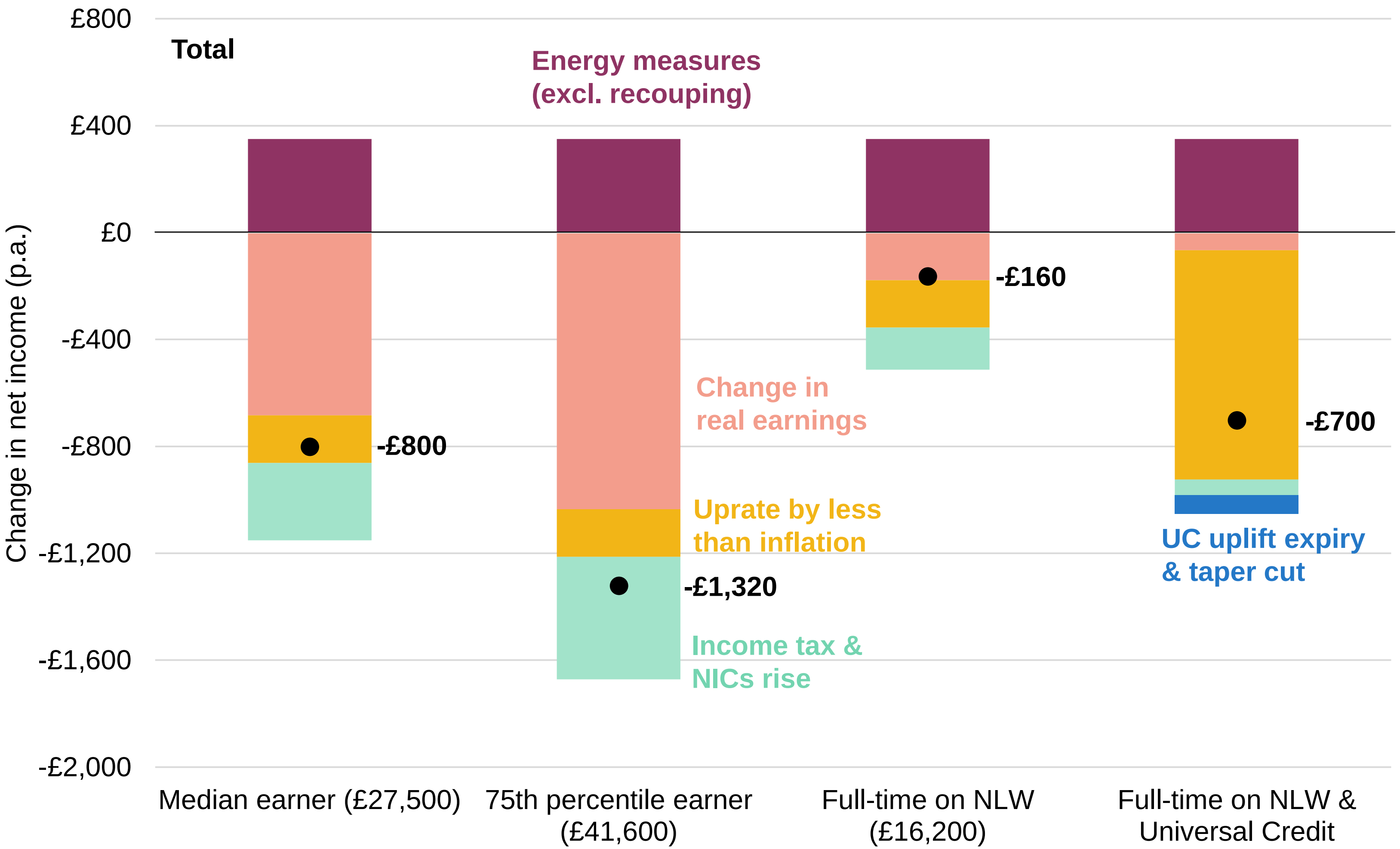

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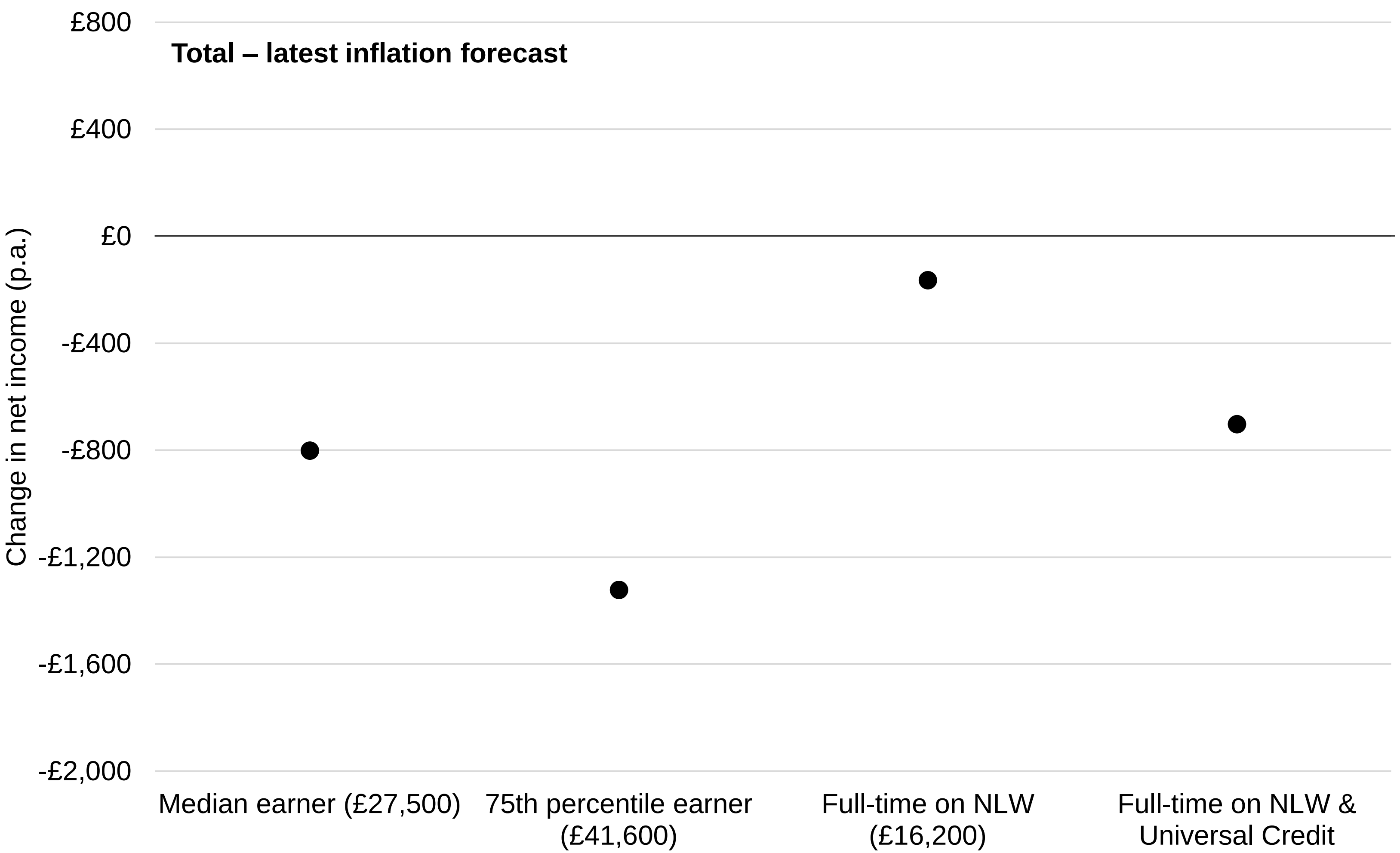

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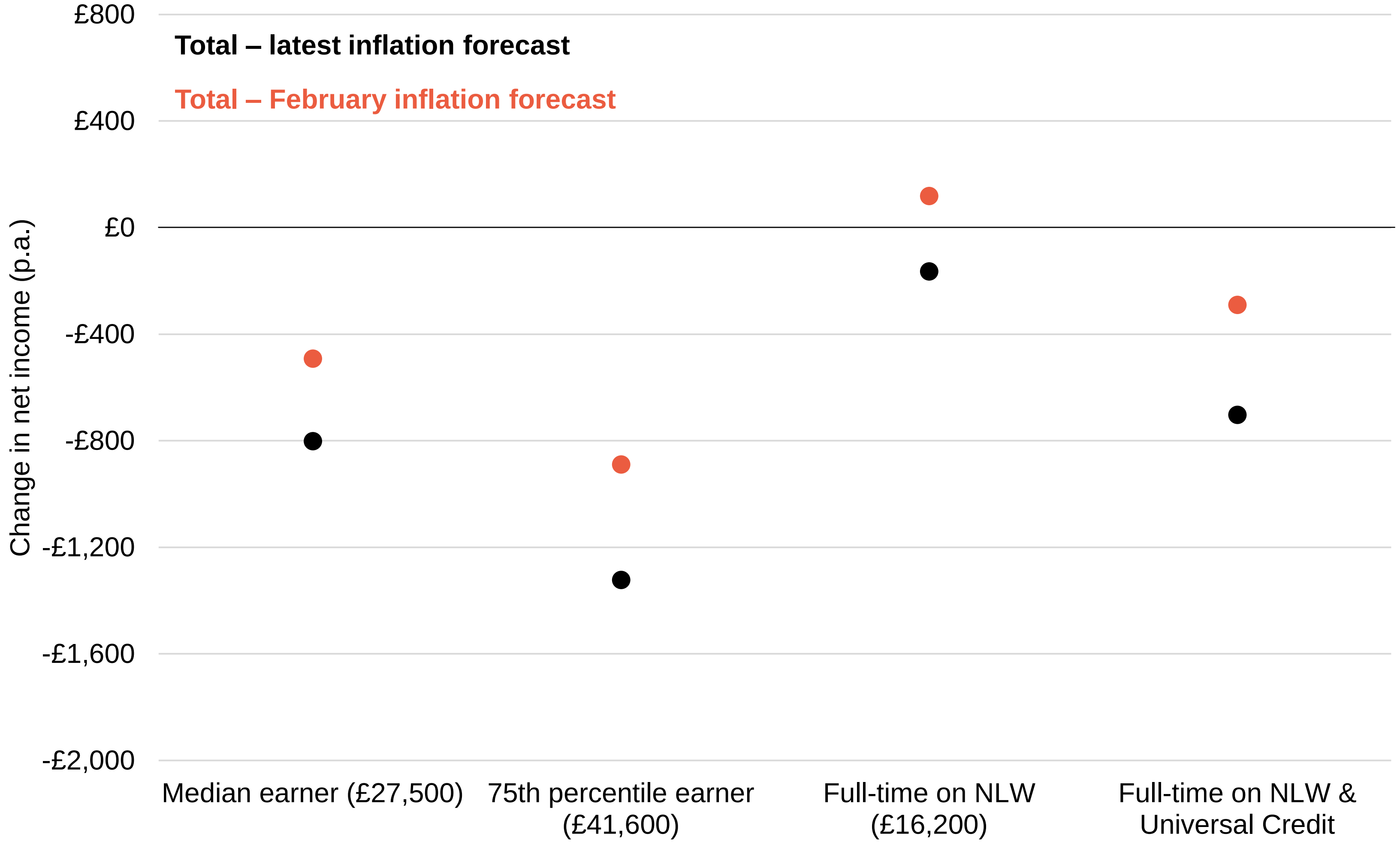

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Policy options

- Things have got worse since Chancellor’s February announcement, so may want to do more – but significant uncertainty makes his job harder
- **Expand existing energy measures** – broad-based but expensive; not much support per household
  - Covering half the increase in energy cost – (additional) £12.5bn
- **Uprate benefits by more** – targeted to poorer households; price rises significant even for middle-income households
  - Uprate by 8.4% rather than 3.1% – £9bn
- **Temporary VAT reduction on fuel** – targeted to big energy users; but distorts incentives towards more consumption; hard to make temporary
  - Zero rate domestic fuel – £2.4bn

Conclusion

- Tough year to come for living standards, with high inflation all round and especially for poorer households
  - Energy costs expected to increase by £43bn – considerably more than was expected even just last month
- Reforms coming this year tend to exacerbate that for richer households, cushion it for poorer ones
  - Though less so if you include recent changes to UC
- But declines in real earnings, tax thresholds & benefit values going up by less than inflation means likely to see income falls across the board
  - Existing energy measures only modestly compensate
- No easy policy choices: trade-offs between targeting, cost, and distorting households' energy consumption

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