



Public Services Committee

Uncorrected oral evidence: Public funding and public services—follow-up

Wednesday 30 November 2022

3 pm

Watch the meeting

Members present: Baroness Armstrong of Hill Top (The Chair); Lord Bichard; Lord Bourne of Aberystwyth; Lord Filkin; Lord Hogan-Howe; Baroness Pinnock; Lord Porter of Spalding.

Evidence Session No. 1

Heard in Public

Questions 1 - 10

Witnesses

I: Ben Zaranko, Senior Research Economist, Institute for Fiscal Studies (IFS); Torsten Bell, Chief Executive, Resolution Foundation.

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Examination of witnesses

Ben Zaranko and Torsten Bell.

Q1 The Chair: Welcome, everyone, to this special session of the Public Services Committee in the House of Lords to look at the implications for public services of the Chancellor's recent spending announcement. We are very pleased to have two people today who keep a very close eye on this from their organisations: Ben Zaranko, from the Institute for Fiscal Studies; and Torsten Bell, from the Resolution Foundation. We are interested to burrow into what we can find out about the implications of the latest review for public services and where we might take that as we go forward.

As ever, I will ask the first question, and then colleagues will come in with supplementaries. You may not have been given notice of those, but the sort of areas that we will want to push you on are fairly obvious.

How do you think the current economic situation and the statement will impact on the demand for public services, and impact on those public services generally?

Torsten Bell: In big picture terms, the defining feature of what is happening right now is the cost of living pressure affecting households, and to a lesser degree anyone providing public services or commercially provided production services or goods, which is driven principally by the energy price shock. For consumers, that is manifesting via a 40-year high in consumer price inflation. The data does not show us a lot yet on how that feeds more materially into the demand for public services, but you can guess the obvious places in which difficult times will manifest themselves.

At the local authority level, people will be coming forward for crisis support, and more people will probably be coming in and applying for benefits that they were entitled to anyway but were not previously receiving. In so far as we can see anything in the data, there is a plausible scenario that the big increase in PIP claims is not unrelated to cost of living pressures. We have not seen it yet, but you would hope at some point to see upticks in pension credit, which is the biggest problem in benefit uptake. However, we have not seen that coming through yet in the benefit system.

We are expecting to see an increase in unemployment over the next 18 months that will lead through into a demand for wider services by jobcentres and DWP. We cannot see that at all in the data yet, but it is implausible that we will not see some element of that if we see unemployment ticking up in the way the OBR and the Bank of England expect. I do not think there is a strong evidence base that the cost of living crisis specifically is feeding into wider demand on services in the health service, although you would expect that to be the case over time. You can see wider pressures on public services relating to the fact that it has not been a very fun three years for anybody. That is very evident in the data on the health side.

On the schools side, schools are in trouble but for the same reasons as everyone else, which is that they are facing pressures on staff numbers and paying their energy bills. I am not saying that energy bills in the public sector are absolutely huge. Staffing is the big thing for most of the public sector, but health and education are probably the big ones that you would want to be focusing on. That is how I think about it in big picture terms.

Ben Zaranko: The big picture means that an economic downturn, as we know from previous evidence, is bad for people's health and well-being, whether that is through loss of employment, increased instability of income or insecurity. All that will eventually lead to things like worse mental and physical health. We know which groups we ought to be particularly worried about. There are historical problems over time, and you can take an even longer-term view; we know that being born or being very young in a recession is bad for your subsequent life outcomes and health. Bad economic times store up problems for further down the line. Torsten is right that there is limited immediate impact and that we do not have the evidence to suggest that it will be a crisis.

There is also a question of demand for some services, not others, being sensitive to the perceived performance of those services. If you think that your hospital is overrun, does demand for those hospital services fall? If hospitals go into a very difficult winter, demand might moderate to some extent because people do not fancy a 12-hour wait at A&E, for instance.

Finally, the pressure on things like schools and local authorities might show as almost plugging the gaps in a broader safety net, and when people have nowhere else to go, if their child is cold and hungry, the school might end up picking up the bill for that. If a family is really struggling with nowhere else to go, maybe the council ends up picking up the bill for that. The pressures that are heightened by an economic downturn will feed through in time to public services, but I do not think there is any sort of obvious, clear impact.

The Chair: An increase was announced for health, which I gather is about 4%; you will know the figures better than me. I remember that the inflation rate in health was always higher than the inflation rate in the rest of the economy. I remember that that was always being put to us in government and we had to try to work our way through how you met the inflation rate in the health service. In education, am I right that the money is only going to schools and not to early years or to further education and skills? Will the amount that is going into health and to schools meet what you think the demand is?

Torsten Bell: That is a big question. People will disagree on what meeting demand looks like, but just to break it down a bit, there is an increase in NHS and schools funding. On the NHS side, there are the relative inflation rates experienced by NHS providers of health services versus consumers, for example. The longer-term view—maybe you should not think about it as inflation—is that there are upward pressures on health spending that grow faster than other parts of the economy.

That is true, and it relates to an ageing population as well as to advances in technology and the nature of the advance of that technology.

When you were doing government jobs, people were talking about the money that needs to go in. It is not quite the same thing as the inflation that we are experiencing now. It is reasonable to think of that being true over the medium term. In the 2020s, when thinking about whether health will grow the share of the economy, the answer is almost certainly yes, for reasons that have not changed. In fact, if anything, society is ageing faster in the 2020s than it was in the 2010s.

On the immediate question of how the rising costs that households are facing are materialising for the NHS, energy consumption will be a smaller part of the consumption of the NHS than it is of households by some considerable margin. I do not think you should think of it as being worse than for households. When you compare the public sector to the private sector right now, as I am sure we will come back to, the big difference in the costs of production is that wages are growing much more slowly in the public sector than in the private sector.

We have not seen all the settlements come through yet and the strikes have not really begun, so we will find out what the answer is long term, but right now I do not think it would be right to conclude that the NHS is facing a higher inflation rate than private providers in general in the economy as a whole or than households. It is just that it is bigger than we expected it to be when we gave them their budgets back in 2021.

Ben Zaranko: We used to collect data on this specifically. The series stopped in 2015. I do not know why it was stopped, but the ONS, with a team from the University of York, used to construct this. That might underpin more some of the calculations that you thought about in the past, but it has been discontinued.

Torsten Bell: You should ask the ONS to do it.

The Chair: Yes, we will talk to them about it, too.

Q2 Lord Bourne of Aberystwyth: It is good to see you here today. Related to what the Chair has just been asking, and accepting what you say about the health service, there are particular pressures with new treatments and ageing populations that add to the inflationary pressures that are there anyway.

Moving to the other big area, education, which you referred to, Torsten, do you have any thoughts particularly about early years, where they face more challenges from the costs they have than other areas do? They have not had an increase, and there is the national minimum wage, food inflation costs—reported today as 12.4%—rent and mortgage. Do you have any thoughts about what we should be looking for in the medium to long term where there are particular challenges?

Torsten Bell: Other people are better placed to say than me here or externally, coming at it from the perspective of the sector, not least

because the sector is delivering a lot of publicly funded work, but most of it is not a public service in the way we would normally think of it.

In the longer term, we come at it slightly more from the perspective of the users. We have an issue with the living standards of people using childcare provision, which is the cost of that childcare provision, for the reasons you are raising, and with pay needing to rise faster than average, not just because of the national living wage but because the national living wage is growing faster than the support, particularly for lower-income households in so far as it provides support for childcare via the universal credit system, a number that is capped to the amount that you can claim in that system. That is capped in cash terms rather than being an increase in line with prices. That is a serious concern for lower-income households that will be seeing it.

Overall, that fact is making our provision of childcare support more middle and top-heavy over time. You might think that that is undesirable, which is understandable, given the cost pressures that you are thinking about, but we have not done any work on the providers themselves. Others, including the IFS and other people in the sector, have done lots.

Ben Zaranko: I have colleagues who spend lots of time thinking almost only about childcare, and if you ever want a session digging into the weeds of childcare, I suggest you invite them along. I had a long conversation with one of them this morning, and I can feed in her best insight.

My colleagues have produced a sort of childcare-specific cost index. That is a sector whose costs we think are probably rising if not faster than CPI then certainly faster than the economy-wide inflation measure that the Treasury uses for assessing these. That is driven partly by things like the national living wage, which you talked about, but also by the cost pressures. When it was originally set out, the settlement the sector got to deliver the free entitlement to the number of hours that you are universally entitled to, and some extra hours if you meet certain criteria, was already fairly tight. It increased slightly, but not by a huge amount. Given what has happened to inflation since then, that is now set to fall even on the Treasury's own numbers. If you use a more accepted specific cost index, it is set to fall by even more.

Some of that pressure is eased by the fact that the number of children aged zero to four is set to fall by quite a lot this decade. It is interesting to compare different parts of the education system. With the shape of the population bulge that we got with a lot of children born in the early 2000s, there are lots of teenagers now. We have far fewer very young children. There are lots of teenagers, which will mean that pupil numbers in further education colleges, for example, will go up quite sharply, which will put pressure on that bit of the education system. School pupil numbers are set to start falling quite soon, especially in the second half of this decade, and we will see quite big falls in the number of very young children needing early years. There is clearly a different set of challenges.

Lord Bourne of Aberystwyth: Different worries.

Ben Zaranko: Different worries. From the perspective of the school system, you might worry that the Treasury has been explicitly targeting funding per pupil. It has said, "We want to return funding per pupil back to 2010 by 2025", and it has now provided the money to do that—and some, given what was announced at the Autumn Statement. The challenge then is when pupil numbers start to fall. If the Treasury then says, "There are fewer pupils. We'll give you less funding", can the sector reduce its costs in line with that? You have the same number of schools, classrooms and teachers; you just have fewer pupils and less funding.

Lord Bourne of Aberystwyth: Surely the Treasury should have allowed for that already, should it not? It must know that, no?

Ben Zaranko: It is a flat per pupil.

Torsten Bell: You will see it in future in the country as a whole, but you can already see it in some parts of the country where the cohort coming into primary schools now is significantly down, and you are watching local authorities, which have not had to deal with this for a while, trying to work out how much they can manage that without ending up with a higher cost base per kid coming through the system, because their funding is per kid but their cost base is higher because they are running more.

That comes down to difficult choices. You will remember all the discussions a decade back about whether we can add one more intake to a primary school. Now we will be thinking, "Can we do that, or do we need to close some of the small primary schools?" You are definitely seeing that in some urban areas already. That will be a wider question. I have not heard of anyone start wrestling with it properly yet. It basically means that your choices are to start closing some schools or increase your per-pupil funding, because the fixed costs are running. I am on the governing body of a primary school. This is happening right now.

Lord Bourne of Aberystwyth: Not just in urban areas, presumably.

Torsten Bell: It will happen everywhere. I am not close enough to the demographics—you need an education expert—but my understanding is that it is coming more quickly in some London areas. I do not know how much of that is pandemic-related, but there were faster exits and some larger bits of the EU population there. I do not know. You would need an expert on education to cover that.

Q3 **Lord Hogan-Howe:** Just generally on sustainability, have the Government committed to funding negotiated pay settlements in general? What is the picture particularly for policing? It is a slightly different funding set-up. I should declare an interest here.

Ben Zaranko: Do you mean the year in progress? Do you mean for the ones announced and agreed?

Lord Hogan-Howe: Obviously they cannot predict what the final settlement will be, I realise that, but if they do not agree to fund them, I guess they will have to reduce the number of people. I am not quite sure what the policy is at the moment.

Ben Zaranko: The policy at the moment is two things bumping up against each other. One is that we will have peer review bodies that are independent and will make recommendations. That is nothing to do with us, and we will probably accept them because they make those recommendations within the constraints that we ourselves set.

Also, all departments of public services, apart from schools, the NHS and local government, will stick to the cash settlements that we agreed last year. If the pay awards are higher than what was built into those plans, that is on you; you absorb that. You find a way to make that work within your budget, which could be through reductions in headcount, as you say. I think that is already happening.

Schools seem to get much more attention from the media on this. You often see schools taking on fewer teaching assistants because they cannot make space for them in their budgets. I think you will see that more broadly across public services, including the police, I expect.

Lord Hogan-Howe: I asked about policing, because they have a commitment to 20,000 cops, which is probably about 75% of their costs anyway, and if they stick to that it limits the headroom even more for the rest. I wondered if they had explored that yet.

Ben Zaranko: My understanding was that they are pretty much on track to deliver the extra 20,000.

Lord Hogan-Howe: Numerically, yes.

Ben Zaranko: Yes, numerically. If you want to do that, and you want to pay every one of those police officers more and stick to your existing budget, the only way to square that circle is to reduce costs somewhere else, such as non-police officers, civilians, in the police force, I guess.

The Chair: Presumably, that is the picture that is being written across a number of public services.

Torsten Bell: The big picture is how public services, which, by and large, with the exceptions that we have discussed, had their budgets set for a world where we thought pay would be rising by more like 2% or 3%, will deal with it. Right now, we are seeing pay rising by 2.2% or so, but looking ahead at what we can see happening with settlements, 5% looks like the ballpark that we are ending up with in most settlement terms, so they are sucking up the gap between the expected number and the number as it will turn out.

Then there is a separate question, which is whether that will be enough or whether there will need to be a phase of catch-up growth versus the private sector after we have gone through the immediate term.

It is worth thinking about three phases. There is the immediate part of this, where the private sector is seeing faster pay growth than the public sector, because it is easier in some ways to hold down pay in the public sector. Adjusting to changes in the labour market is definitely slower, for obvious reasons, at least in terms of the headline rates.

Then we will have a phase where the public sector has to give higher than expected pay rises—the 5% numbers. The Bank of England is obviously raising rates, trying to increase unemployment to push down on the medium-term, nominal growth in the private sector, but if you believe that you need to get the public/private differential back to where it was before this phase of very high inflation, you will naturally end up seeing pay rises staying higher in the public sector than in the private sector, or you permanently accept lower pay in the public sector versus the private sector.

If you look at what is currently happening with vacancy rates, however, it is very clear that the public/private differential is having a big effect. You may or may not have thought that the status quo before that was sustainable, but we definitely could not maintain the current public/private pay differential for very long. You can see it in education, in health, in public administration. Those are the sectors where vacancy rates are rising even as vacancy rates in the private sector have started to fall. They are still higher in the private sector. I do not want to overdo it, but they are falling now.

Q4 **Baroness Pinnock:** We have been talking about individual public services. What thought, if any, has been given to the impact of the squeeze on public services in particular communities?

Torsten Bell: Do you mean workers or users?

Baroness Pinnock: Users. Will it be harder in rural communities, because there is a pull-back because services are expensive to deliver, or will it make the situations of those towns in particular—the Blackpools, the Oldhams, the Rochdales—more difficult?

Ben Zaranko: In answering questions like that, what is just as important as the overall level of funding is our systems for allocating funding between different parts of the country. Those funding allocation systems for a range of services are outdated, poorly designed, ill-fitting with the current set of government objectives, no longer fit for purpose, and continually being ducked as an area for reform. I could talk about four, five or six of them, but in local government, for example, some of the formulas still used to allocate funding between councils are based on data from the 2001 census. Why? Some are still based on population data from 2013. Why, when Blackpool's population has fallen by 2%, the population of Tower Hamlets is up by a fifth, yet we do not reflect that?

The areas that will suffer if you just cut spending by a flat amount across the board, for example, tend to be those that are more reliant on central government funding, the poorer areas. But it is not uniform. It is

complicated. It varies across services and so on, but as much as we argue about the overall level of funding—that is an important thing to argue about—we should be arguing about how we allocate it. When funding is tight, those allocations become even more important. It is politically very difficult to reform funding allocations when times are hard, because it means cutting some areas by even more. It is much easier to do that when the tide is lifting all boats. If funding is going to go up over the next few years, then on paper at least it will be extremely tight after 2025. I see no appetite for big funding reforms in the next couple of years, apart from some rumoured review of council tax and maybe something on the fair funding review. You never know.

Baroness Pinnock: How long have we been waiting for that? We are in the 10th year, anyway.

Ben Zaranko: One of my colleagues is convinced that if we are going to do the fair funding review, 2024-25 is the year, and if that does not happen, it will never happen. If funding is as tight as the Government's plans say it will be in the second half of this decade, we will not see that meaningful reform then.

Baroness Pinnock: So the answer is yes, it will be harder on the very communities that are already in difficulties.

Ben Zaranko: Probably, but it depends on which services are cut—there is still control over that—and which service we are talking about. The police are a good one to take, because the cuts since 2010 have affected primarily cities and forces that serve more deprived, higher-crime areas. Funding in Greater Manchester and London has fallen by much more than in Hampshire, for example. That would continue if they continued the same trend and the same way of allocating funding squeezes, but that is something that the Government can control and change.

The Chair: We will come back to local government in a moment.

Q5

Lord Bichard: What this committee is and should be concerned about, and what I have been trying to work out, not just while you have been talking but in recent weeks, is the impact that resources now allocated through the Autumn Statement will have on levels of public service and whether or not they are adequate. That is extremely difficult, but it is the real nub of this issue, because otherwise we are just talking about individual places or services.

How do we calculate the impact of energy inflation, pay, demand on services and the additional dimension of allocation, and set it against what resources the Government are saying they have allocated, resources that I find are constantly set against different benchmarks? Working out the real-term increase in allocations and budgets is extremely difficult. If you put all that together—this is not a political point, because I am sure a Labour Government have used this in the past—it is very confusing, and it is very difficult to say that we have a big problem here, because the real-term allocation is nowhere near what you

need to pick up demand, energy, inflation and all the other things I have talked about.

Are you able to throw any light on all that, because that is the question? Can we anticipate a funding crisis? If so, where and in which services, and should we not now be thinking about what can be done about that? Or should we be reassured by the additional money that is going into the National Health Service and social care, for example? Can you throw any light on all that, if it makes any sense to you?

Torsten Bell: It makes sense. I cannot answer that question, but shedding light on it is a lower bar, so let me do that instead.

I think you want to break it down. Let me give you one answer that is directly about how you would calculate the real terms. Then there is your slightly more complicated question, which is about the fair way of assessing the provision of public funding for public services that lets you come to a conclusion about whether it is adequate, whatever your judgment is about adequacy.

Narrowly, on how we should think about real-terms levels of funding for public services, I do think that we have a big problem—and by “we” I mean anyone trying to take decisions in this area, those holding them to account for it and those of us doing research in this space. We do not currently have an adequate measure of the inflation rate faced by the providers of public services; this goes back to the Chair’s question about the health service. That is what we need to come to a real view about the big picture bit of your question, which is the provision of funding keeping up with inflation and what it is doing in real terms. In simple terms, without going into all the weeds of it, that is because the measure that we historically use to judge that question is the GDP deflator, which is telling us about the cost of production in the UK generally.

We have two problems with that: a short-term problem and a medium-term problem. In the short term, our problem is that it does not reflect the cost of imported energy, because we do not produce a lot of it.

There is a second question about what is going on with public sector pay. That is a big problem. It reflects pretty badly on us all in our world in that we have not got to grips with it, because we have seen this problem coming for at least a year now. The ONS has not grappled with it. We have had a go at coming up with our versions of a better deflator, but not fast enough to update during the Autumn Statement last week, so that is a big question. My honest view is that the OBR/the ONS should pull their fingers out and have a better go at it in the short term. If they do not, some of us should do it, and we probably will if they do not. That is the first thing. That is the short-term issue right now.

There is a medium-term issue, which is that we are all using the OBR’s forecast to give you answers to these questions, and the OBR’s forecasts for inflation, including for the GDP deflator, are low for the next spending review period. From the middle of this decade, they are surprisingly low,

much lower than the Bank of England's, because their overall inflation measures are low.

You probably do not want to come to a view about whether that is right or not, but it is definitely plausible that they are too low and that if inflation looked more like 2% in those years you would be talking about the Government needing to top up the amount of spending to keep the same goal they have set themselves after the spending review by about £10 billion, a material amount of money, or the cuts that are happening after the spending review being much deeper than they currently look like they are on the basis of the OBR numbers.

That is an answer about the aggregate of public services. People like you, and others, should be putting pressure on those of us in the research community to say, "Why have you not sorted out and agreed on the best way of dealing with this problem?", given that there is a reason why the Treasury is perfectly happy with us all using the GDP deflator.

Lord Bichard: It is a hugely important point that you are making.

Torsten Bell: The range of possible answers is quite large. This energy thing is a really big deal, and none of us are taking it into account properly. That is a big problem.

On the day after the Autumn Statement, we were slightly kicking ourselves, and others, that too many people, including us, produced reports saying, "This is a minimum, but it's actually much bigger and I can't tell you exactly how much bigger". That is the problem.

To defend what is done by the research community and in government, it is not unreasonable to be using different metrics for different public services and how we consider their adequacy. For example, per pupil is not an unreasonable way to think about our funding for schools, given that you get quite big bulk changes, as we have just discussed. Our intergenerational centre spends its life looking at changes in cohort size and things, and these do affect how much you need to spend. It would be a bit mad just to look at real-term funding for schools. What we care about is real-term funding for schools per pupil. That is reasonable, and you clearly want different metrics for the police, for example, and others. I do not think you should be looking for a one-size-fits-all for all public services in that regard, although if you pushed me, I would say that looking at it per capita is the right way to come at these things.

Lord Bichard: Should you not make the metrics explicit even if they are different?

Torsten Bell: Yes, you should. At the moment, that tends to happen by government to some degree, either informally or formally saying, "I'm targeting this". In schools, it is clear that they are targeting per pupil, whereas they are not targeting that in FE, for example, and they are not targeting that in early years provision. They do say it, but you have to be paying attention. It changes over time, and it is never set out all in one

place. There is clearly no strategy on the adequacy of public spending across the piece that brings those things together and thinks about the balance between them. I think that is a fair critique.

Obviously, in the end, what we care about is the outcomes, not the inputs. If you work in public services, you really care about the inputs, given that lots of it is going on pay, but when we are thinking about the adequacy of the funding, we care about the outcomes. Clearly, that is quite concerning across most of them, and I am afraid it requires looking at lots of different measures. There are lots of important different ways of looking at police performance and outcomes for people, such as survey data on people's fear of crime versus actual crime versus prosecution rates. I am afraid I do not think there is a way around caring about quite a range of those things, and they are different in public services.

In the end, I slightly feel that we do not spend a lot of time talking about those. Why was the pandemic more difficult for us in some ways than for other countries? Some of it relates to looking at what was going on before it started. I would encourage us to spend more time on what that data is telling us, which people are now starting to pay attention to. You can see it in the courts in the criminal justice system and in the NHS, where we are now looking at a disaster unfolding, basically, and people are now paying attention.

Unfortunately, it may be too late. It is implausible that we will turn around what is going on in the NHS now in anything less than half a decade. We are in for a really tough time. There is a reason why the upper middle class is opting out of the NHS en masse right now. We have a serious problem. In the end, you can look at the funding and say, "What's happened? Did this line go straight?", which is what people like us tend to do, but we need to be talking to people whose expertise is in the individual public services. In the end, they will be looking at what is actually happening in the service and then what is happening to people.

Ben Zaranko: It is quite a big picture question, so I will give you two big picture answers. The first question, if you are assessing the adequacy of public service budgets, is: adequate for what? A set of broad objectives for public services were set out in the 2019 manifesto, and Rishi Sunak recommitted himself to those when he became Prime Minister. We have had an erosion—plus the whole pandemic in the middle—of the budgets that were set and meant to deliver those.

The even bigger picture here is that we have become a poorer country than we expected to be in that time, and almost just a poorer country full stop. One of the ways in which we are dealing with that, seemingly, is by living with worse public services. We will have less funding for public services and we will pay our public sector workers a bit less than we might have otherwise liked. What we are not seeing is any commensurate scaling back of our objectives for those services.

We set out funding that we thought was broadly adequate for a set of objectives. That funding is no longer as generous, but the objectives

remain exactly the same. There is this reluctance to engage with the reality that we might need to scale those objectives back, particularly when you look at what the NHS is doing, for instance.

Torsten Bell: Social care is the only counter-example of where we have explicitly delayed, but it was a new thing, not an existing thing, that we were delivering.

Ben Zaranko: It feels to me that the reason for that is that, rather than trying to deliver a new reform, it is focused on the basics of just getting care to the people who need it rather than the insurance element. There is a very difficult sequencing question here in the way fiscal policy is done. I do not think that the aggregate level of spending is decided from the bottom up: "What does this service need, what does that service need, in order to deliver on these particular objectives?" There is an element of that, but it is almost much more that. Particularly for some less-favoured budgets, they are the balancing item that makes the Government's overall fiscal plans add up. If you look at what is pencilled in for future years, it is not on the basis of what public services we want to deliver but on what we can do to meet the top-down fiscal rules without having the tax burden go above what we are willing to accept.

It is not the only thing that the Government are thinking about when setting these budgets and when deciding whether it is enough or not, but there is not enough transparency and pragmatism about what we might reasonably expect public services to deliver. Even the extra money for the NHS came with a whole new set of asks on ambulance waiting times and things like that. It was not just, "We recognise that you need more cash to do what we had asked you to do"; it was, "We'll give you more cash and here's an extra set of things that we also want you to deliver".

That was my big picture point, and I agree with everything that Torsten said about public sector inflation.

The Chair: That is fascinating. We could go on with this, but Lord Porter has a question.

Q6 **Lord Porter of Spalding:** For the record, I ought to declare a couple of interests. One is that I am still leader of a council, so I know how this question feels, and I am an NED on a department, so I know the other side of some of that argument.

How effective do you think the relatively low levels of council tax increase will be at protecting public services delivered by councils?

Torsten Bell: It sounds like you might know the answer. I am just trying to think how we add value to it. I am lucky that I am running a small charity rather than local government right now, which is easier.

The aggregate sum of extra money that goes into local government provision, from the move to a 5% council tax increase, is not nothing. It is a substantial sum of money overall, and it is not the only increase in

local government funding in this settlement. I do not think we should treat what has been announced as totally marginal.

My challenge would be more about the distribution of the money, which is important. This slightly goes back to some of what Ben was talking about earlier. Using council tax as the mechanism for raising a large amount of it obviously brings with it some important distributional questions at the household level and then at the local authority level. At the household level, council tax, despite having been introduced to get off the poll tax, is basically now a poll tax in all but name.

I am slightly overdoing it, but it is not that far off a poll tax at this point. It bears very little relationship to property values or to the incomes of the people paying it. It is a very bad tax. Using it to raise additional funds for local government is suboptimal purely on that basis, but that is largely an argument for reform and updating it generally. Some parts of the UK have obviously done a better job than others. In Wales and in Scotland they have introduced some reforms of the council tax system.

When it comes to whether it is a good way to raise tax—I am considering the local authorities rather than the people in the local authorities—it does not do a good job of matching. Basically, we are raising council tax to fund social care. That is what is actually happening in most of the country. It is not hypothecated explicitly for that, but that is what it is going to.

Lord Porter of Spalding: I would have to disagree with that on the basis that most councils are not social care councils. Numerically, the vast majority of councils do not do social care.

Torsten Bell: Yes, but they are the ones doing the spending.

Lord Porter of Spalding: That is about proportionate spend, not—

Torsten Bell: The money in big picture terms is going to provide social care. The majority of the extra money raised will go on that. You are totally right that if you run down the names of councils, lots of them do not have social care duties, but if you look at where the money will go, it will go on providing social care in general. I am generalising. The places where you will raise lots of council tax from this increase are not necessarily the places where lots of additional pressures on social care spending are coming, and that is not ideal.

Lord Porter of Spalding: That was backed up when we first introduced the social care bit of council tax. It was backed up by the better care fund that was going into areas to top up the lower tax base.

Torsten Bell: Absolutely, and we have obviously done that in different phases. The longer-term story is of falling council tax and council tax now returning roughly to the levels where it was before. Council tax is now in fashion again, having been out of fashion. As with everything in life, we have come back to where we started; flares are back in fashion and all that. We are basically where we started.

That is material to how different local authorities are funded. Those that can raise money from that will do relatively well out of this. Those that do not will not, and that is an issue of concern. Clearly, as you say, in the end you want to step back and take a view on the relative role of grants versus this and that. Those are different in different places and, as you rightly say, not every council will be delivering those services.

Ben Zaranko: I asked one of my colleagues who runs our local government work, "Can you give me one number to sum up this council tax question?", and this is what he gave me. An extra percentage point increase in council tax next year in the 10% least deprived—so best off—areas raises about £6.62 per person, versus £3.92 in the poorest 10% of areas. That is 70% more per person in the richest areas, which probably have the lowest rate of growth in funding need. If you look at it as a percentage of their spending, what does an extra percentage point on council tax do? It is about twice as much in the richest areas versus the poorest areas. It is a terribly poor, blunt way of raising money for the areas that need it most.

I agree with you that there are lots of district councils that probably do not care too much about social care because they are not responsible for it, or if they do it is tangential. As Torsten says, most of this is a way of finding more money for social care. You are back to this world where some district councils are better able than others to raise money, and unless we are willing to grapple with some difficult questions about redistribution, which Governments tend to shy away from, I do not see us dealing with that problem. I would reiterate that council tax is a disgrace and needs reforming.

Torsten Bell: I think you probably knew that.

The Chair: Some of us have tried that for a long time.

Lord Porter of Spalding: Notionally, that is a fine load of statistical stuff, but has anybody actually drilled into real places to show an example on the ground of a council—pick a live one somewhere—and its journey through?

Torsten Bell: Its finances, you mean?

Lord Porter of Spalding: Yes.

Torsten Bell: Yes, but lots of places have done that for themselves.

Lord Porter of Spalding: We cannot trust others to do it as well as we might.

Torsten Bell: You can decide whether you trust yourself or not, but we have a lot of faith. The average council tax on a band E in Westminster and Wandsworth is £870-odd, and in Barrow and Blackpool it is two grand. They need to step back and say, "Where are we overall on local government?"

I do not think we should underestimate this. If you look at what Michael Gove is now saying about the objectives of levelling up, the things that he is highlighting as problems—the feeling in the public realm, people’s faith in their local communities; I think he realises this, so this is intentional to a degree—are happening because of the redistribution over the last 10 years away from poorer places to richer places. Even though times have been quite tough in local government over the last decade, the distribution has changed a lot for the reasons Ben gave earlier.

That is then hitting councils that are now dealing with the same cost pressures. I will give you an example. I have seen the leadership of two councils in the last week. One is running a very large city. Immediately after seeing me they signed off their in-year cuts to cope with the fact that their budget does not add up anymore. Even though the actual annual spending totals for local government do not look as grim right now as they did in large parts of the last decade, councils are doing that because the world has got worse.

This is all part of the big picture, as Ben was setting out. The country has got poorer. Most of us are experiencing that in our household budgets. We are then, at a national level, deciding whether we would like to get poorer via higher taxes. Yes, it turns out. It is not popular with everyone but, yes, we are getting poorer via higher taxes, and then we are balancing that with how much we want to get poorer via worse services.

The really depressing thing is that we are doing a bit of all three of those. We are getting poorer as individuals because of our family budgets, we are getting poorer because we are paying slightly more tax, and we are getting poorer because of the public services that we are receiving. That is what you are seeing on the ground. Whatever I am doing—I was up in Manchester and Leeds yesterday and in Birmingham last week—that is what is going on. That is what people are wrestling with—how to manage those budgets—as I am sure you are.

Ben Zaranko: On the particular councils point, yes. Two of my colleagues were commissioned to build a local government finance model, which will do council by council projections and breakdowns of spending. You can change assumptions. You can plug in policy reforms and the model will tell you what will happen to the accounts. Councils pay a fortune to consultants for bad versions of these, so my two colleagues have spent six months building one that, I hope, is better and is free. That is the SRC delivering value for money.

Lord Porter of Spalding: Can we make sure that we capture the contact details for that so I can share that across the whole sector? At least that will then be a couple of quid out of people’s budget lines.

The Chair: If you are right that most of the 5% that the Government talked about will have to go into social care, there is a double whammy for most authorities in the north. First, they have houses that are in lower bands, so their council tax has to be a lot higher, as you made clear, to raise the same amount of money. Secondly, a much higher proportion of

their population is entitled to social care and eligible for public funding. In the north-east, there is not a single authority where less than 50% are eligible for public funding of social care. In places like South Tyneside, it is over 90%. In Surrey, when I last asked the question, it was 2%, but it is now about 8% because of the rise in urban population.

Torsten Bell: The people of Surrey interpret that as unfair on Surrey. I appreciate that the people in the councils of the north-east are not interpreting it in that way.

The Chair: It is a double whammy on areas of higher deprivation.

Torsten Bell: With regard to the funding of the council, yes.

The Chair: Yes. I need to move on to the next question. Lord Filkin, you are far away. You may be able to stick up for district councils, given your old role.

Lord Filkin: It was a long time ago, so I will not go there.

The Chair: It is.

Q7 **Lord Filkin:** Torsten has largely already answered the question that was allocated to me: that if pay settlements in the public sector are half what they are in the private sector, it will lead to a drift and higher vacancy rates, which may or may not shift things.

Ben, let me go back to the question that you were already exploring and frame it around a question about looking to the next five years, which conveniently is two years before the election and three years after. Some of the fundamental forces are pretty tectonic, are they not? We have continuing demographic demand, in the overall population and in an ageing society. We have and will continue to have a high public sector debt, and we have a very high public sector deficit, which has not yet been closed.

Without getting into the detail of those three issues, they are some pretty adverse headwinds. Clearly, in the short term, they are leading to very tight public sector settlements. On the other hand, as has been touched on, we have no sign that the public's appetite for good public services has diminished.

That tells me that there is a crying need for somebody—not the Government or the political parties, for obvious reasons—to start unpacking this and making it explicitly clear that we have some fairly big societal choices to make. Otherwise, we are like frogs in the pan on the stove. Gradually, the NHS gets worse and worse, the courts get worse and worse, and we do nothing but fudge and mudge. Fudge and mudge is obviously the most likely political outcome, because that is how life is, but it would be very helpful if bodies like the IFS or the Resolution Foundation, and maybe one or two others, could articulate the potential for some closure on this impossible conundrum.

How much could we expect transformation to do anything? Embarrassed

cough. Where is the big scope reduction? What would the potential be of tax increases, both new and old, to start to bridge some of this? At one level, you need to start to be more like the French or the Scandinavians. I am asking you to give your views. Am I right in my framing of this very big conundrum that our society is facing for public services over the next five years? Do you think that there is a benefit in organisations like yours doing some serious public work and exposing the choices?

Ben Zaranko: I think your framing is a useful one, but the core of why the outlook for public services over the next five years is so tough—I do not know if you mentioned it; if so, I missed it—is the abysmal outlook for economic growth and what that means for government revenues and the resources we have available. Yes, as you say, we have a world with terrible growth and all these demographic and cost pressures, which Torsten talked about, and there is no change in public appetite for what services we want to consume. That is why we will see higher taxes and an increase in the tax burden.

On the question of looking towards France or Scandinavia, if we want structurally higher taxes—well, we do not want them, but we will have them—that are similar to the average in western or northern Europe, for example, it is useful to look at where we raise less than other countries do. There is a longer, nuanced answer to this, but the simple one is that we do not tax low and middle earners anything like as heavily as most other European countries do. It is not that we raise much less from those at the very top or much less from wealth, although that is true to an extent, but we tend to raise less from those on middle incomes, particularly via social security contributions. If we want to be a higher-tax, higher-spending economy, whether by choice or because growth is so abysmal and we do not want to scale back public services, that is where we might have to look.

You make the point that we cannot just let the NHS get worse for ever. If a political party or a group looks at that outlook and says that it does not want higher taxes, we need to stop talking about having the same set of public services with the same set of objectives making it worse and worse each year and, if we want a smaller state, think about what we currently do that we will not do anymore. That conversation does not seem to happen.

I think I have only covered about half of what you raised, but maybe I will pause for breath here.

Lord Filkin: You have covered quite a bit of it, and I clearly missed that the growth point is the fundamental one. You have just restated the conversation about where to reduce. My point essentially is that politics will not address this question in the next two years, for obvious reasons. It would be daft if it did. If you are interested in public policy discussions from an informed base, there is a crying need for you to do something about it. By you, I mean both of you.

Torsten Bell: That is the least democratic thing you have ever said. I am afraid that politics has to do it in the end.

First, on your problem statement, the only thing I would add is that we should be explicit about the reason for the outlook. There is a bit of a paradox going on, which is that some people are really upset that, despite austerity and all the rest, spending as a share of GDP ratio is up—it is not at pandemic levels, but, big picture, it is up—and people are not getting great public services.

It is a bit complicated. Although, in the long run, growth will be tied to average wages, in simple terms a chunk of it is definitely about growth. I am afraid that in the short term, given what happened at the Autumn Statement, what is really going on is that debt interest costs are going up and we are having to absorb that within the spending total, and that is pushing down on other spending. It has not had much discussion, but that is the big change in the Autumn Statement. Overall, spending is changing a bit in the medium term, but total spending is not changing. In fact, total spending is going up; it is the spending on public services going to for debt interest costs.

This is a bit of good news, because Geoff's list was quite depressing. The interest rates used for those debt interest cost forecasts are based on market interest rates, forward rates, and are above what the Bank of England says it plans to do. This does not change the big picture question that is being asked, but there is potentially some small upside. The central case is probably that the interest costs do not go as high as are in the OBR forecasts, although those were done for good reasons. The short-term thing driving interest costs is inflation, so forget that. The thing that is affecting the steady state is higher debt stock plus higher interest rates, so those might not go quite as high. Equally, they could go higher. If we have learned anything from the last year it is people being too certain about what will happen to interest rates.

That is the thing that you need to focus on in the short term: the debt interest cost burden that is doing the work. It is a good lesson for everyone who said that fiscal policy is really easy, that there are never any risks and that nothing bad can ever happen, because they watched a load of QE happen over the last 10 years. I hope they have learned that it is not about market panic and Liz Truss and all of that. It does not need to be as bad as that. It can just be slow and gradual; interest rates being different from what you thought they were and your debt burden being higher. You need higher taxes to pay for the same public services in that world, and that is what we are doing.

Q8 Lord Filkin: As you say, there could be a debate about what the level of public service debt servicing will be. The bigger picture, without worrying about the exact detail—that is offensive, I know—is still that this is another tectonic force. The question that I want to press you both on is this. Granted, public policy or politics effectively has to adjust to this, but it adjusts usually in a pretty dreadful way, in a very short-term way. It does not take much more of a strategic look at it.

Torsten Bell: To be fair, you can see that what you are talking about is happening in some bits of public services. It is just not happening in the bits where people can see it or where politicians are explicitly asked to take a decision. The NHS is pushing some things out of public provision that are not in a press release. Has anyone tried to get their ears syringed on the NHS in the recent past? You will be paying for it now. It is not the same everywhere, but in general you would not have had to pay for it. It would have been done at your GP 15 years ago. Now you will probably be sent to a pharmacist, and you could be charged £80 or £100 for it. Some of those decisions are being taken and stuff is being pushed. The boundary is moving. Obviously, dentistry has always had more of that. There are definitely bits of public service provision that are moving.

As I said earlier, the public also move between the public and the private sectors. The upper middle class is opting out. There are staff surveys for employers asking for health insurance in industries that do not do that at all. If you look at the data, private health usage in the UK is going up fast. In the boundary between the public sector and the private sector, stuff moves even if politicians do not explicitly take the decision. It is similar for local government: in reality, local government has been moving stuff out of the public sector for the last decade, particularly in poorer parts of the country, just by not doing them. In lots of cases they will move into the private sector; people will pick up the litter on their own street, for example. That is the private sector growing and the public sector shrinking.

Lord Filkin: That is helpful, Torsten. Are you really implying that that is all fine, because there would be a gradualism?

Torsten Bell: Definitely not. I am just saying that it happens.

Lord Filkin: We will fudge and mudge and wriggle through these things, and it will not be a pretty world, but the numbers will eventually balance, as they always do? You can hear what I am groaning about, which is the wish for an articulation of these choices.

Ben Zaranko: I accept the challenge to organisations like ours, but we do spend a lot of time trying to highlight these choices. I get sick of saying "trade-off". It is boring to say that there are choices to be made; that you cannot have everything at once. I feel like I do that all day, every day, almost. The problem is that if you want to do big things to the size and shape of the state—let us say that you want to means-test the state pension, to start charging people for sixth form, to withdraw support for certain people going to higher education, or to start charging for certain NHS services—those are political questions. Some organisations, not ours, do make such recommendations. If the Government say, "We're thinking about doing this", we will assess the evidence as best we can and try to set out the trade-off, but it is not for us so say, "You have to do this."

Lord Filkin: No, of course not. I was not asking you that. You might then

say, if you have this collection of forces, that you can start to see what this aggregate looks like, no doubt on some complex, or simple, modelling of the pressure on some of the major big-block services: the NHS, welfare payments, social care. You can at least indicate whether some things are fun but irrelevant, such as chucking VAT on private schools, which would be quite amusing but would have zero fiscal effect, if you know what I mean.

The things that could make a big difference are what the debate needs. Where are the big picture choices, on both service costs and incomes, to start to close some of these gaps and articulate the choices, as any good civil servant would do?

Ben Zaranko: To go back to where I was a few minutes ago, we say things like, "Demographic and cost pressures mean that health, pensions and social care spending will probably have to rise to maintain anything like the current rate of provision". We have already cut defence spending and spending on housing over the decades. We are now bumping up against the NATO 2% target. Similarly, we have committed to aid spending, and we can point out what that means. It is very difficult to see how you make further cuts elsewhere.

That is why a world of higher taxes looks likely and why this new realm, this new world, of higher taxes in the Autumn Statement will probably be permanent. When you ask, "How might we sustain European levels of taxation?", you are looking at higher levels of taxation on lower and middle income earners through things like higher national insurance contributions. That seems like a likely end point, and we can point that out, but those are political choices that still have to be made. We could stop meeting the NATO 2% of GDP target and spend it all on social care, but that is a choice.

Q9 The Chair: This committee has frequently argued, and Geoff has been very strong on this, for early intervention and spending money at the beginning. If we think about children and the current crisis in the care system, local authorities now spend all their money on crisis intervention, which is much more expensive and much less successful.

My concern with a lot of what was said in the Autumn Statement is that that issue was not addressed at all. If you think about education, the reductions, or at least the non-increase, in early years and in skills affect precisely those areas. Skills and better intervention at FE level would enable a better workforce and skill mix, which we argued for in our last report, and early years intervention would, we believe, prevent some of the down-the-line costs. Have you seen or heard anything that is moving that way?

Torsten Bell: The 25-year story for the public sector is a more active role in what you are calling early years, but most of it is childcare. Even in the austerity period, although Sure Start and the rest went, the overall level of funding went up because of the provision for childcare support generally.

My basic thought on invest to save is that I feel more confident that the deep cuts in spending in deprived areas are tied to longer-term challenges in spending elsewhere. I am less convinced that not spending loads more on childcare definitely leads to more long-term costs. There, it is more about choosing what the household pays and what the state pays, and I slightly feel that it has been very fashionable, since research from America in the 1990s, to say that throwing money at early years will pay for itself and all will be fine.

We are spending the money on early years basically by paying for childcare costs. The vast majority of the spend is subsidising childcare costs via the benefit system, the tax system or the free entitlement. I am afraid I do not believe that it all pays for itself or that it is even plausibly close to that. It is just making it much easier for me to pay for my childcare bill, which is fair enough. That is like a lifecycle redistribution that we all do.

It is the high-need part of the picture that I am referring to. I would focus on where there are definitely very long-term costs for us just by stopping lots of provision. As you say, it is horrible watching what is going on in large parts of the country where we are now just providing crisis support because the local authority provision does not exist for lots of other basic services. I slightly worry about the idea that if we just do early intervention, it will all be fine. It is used too generally about spending. It is like saying that if we just do this early on, it will make it all better in the long run. I am afraid that is not as true as it is widely said to be.

The Chair: I accept that. However—

Ben Zaranko: The evidence base is lacking here. It is very hard to prove that spending on early years now has extremely beneficial long-term impacts. The Treasury, rightfully in my view, is sceptical of studies from interested groups that try to display such things. You can certainly come up with examples in your mind of where that might be true, but I think that in general it is not.

One claim to be wary of, for example, is that if we just spent more on social care it would more than pay for itself by saving the NHS money. We did some work on this a couple of years ago. Tentatively speaking, you might save a few pennies in the pound for every pound extra you spend on social care. That does not mean that we should not spend more on social care. I just think that you should be making that argument on its own terms, as something that we value as a society and want to perform better on, not on some fanciful argument about it paying for itself in other parts of the system. People think that integrating health and social care or other schemes means that they will pay for themselves. They do not, most of the time. It does not mean that we should not do them. Let us have an argument on the merits of the programme itself.

Again, the evidence base is thin on the impact that things like cuts in public health have had, but there has certainly not been a focus on

prevention over the past decade or more. It is feasible and conceivable that cuts in public health have added up to more problems for the NHS, but that depends on the efficacy of those public health spending programmes, which, as I said, I think the evidence base is thin on, because these things are hard to prove.

The Chair: The smoking ban has had an effect on spending.

Ben Zaranko: Yes, definitely.

The Chair: So there are some for which the evidence base is quite strong, but that is for another day.

Q10 **Lord Hogan-Howe:** This is quite a narrow question. Governments, if they have problems with spending, do one of two things. They reduce spending or increase their income. They create money, they borrow money, or they increase taxes. Local government cannot do two of those, although I would argue that being a bit creative and creating some kind of local currency might not be a bad idea. It works in Scotland fairly well. They have five banks that produce their own banknote.

In about the 1970s or 1980s, in order to reduce the macroeconomic effects they reduced the amount of local borrowing. This applies not only to local authorities but to other bodies. That is about 2% of the budget. Why not produce some more flexibility on that to allow local borrowing? At a time of higher interest rates, I realise that that could be their legacy, but, equally, borrowing costs could go down as well as increase. What is the argument against allowing more local borrowing?

Torsten Bell: That is a very big question. The Treasury's answer would be that national government is targeting fiscal objectives, and countries with more devolved borrowing systems can find it harder. Basically, loads of people are making decisions borrowing in that world, and national government finds it harder to take a view on the right level of borrowing, either for macroeconomic policy—how much you are supporting the economy, or not, in a given year—or for fiscal sustainability. That is the Treasury's perspective. Again, that is obviously a balancing act.

My view would be that if you want to be in that world, if you just give people more borrowing powers without levers to raise or cut taxes, you have not given them the answer to a problem that builds up. I do not think you want to think about fiscal devolution just on the borrowing side. It makes more sense when it goes along with the ability to bear the consequences of that, because then you are not just in a straight bet. You should definitely consider it in the round with wider things. There is a separate issue on any devolution, which is that the capacity of different places to do that will be different. You definitely want to think about how much it is solving the problems you have—in other words, in places with weaker economic situations.

Lord Hogan-Howe: They could borrow from the Government.

Lord Porter of Spalding: You still have to pay it back, and you have to

pay interest on it.

Lord Hogan-Howe: Yes, but that is what happens when organisations or families need to get through a bad period. They borrow. The Government are doing it now in massive amounts. We are collectively hugely borrowing.

The Chair: I think we are pushing beyond where we were on the Statement and maybe going into Truss territory, which I do not want us to do today. Thank you enormously. As you can see, these are things that we are pushing around and trying to work our way through to see how we get the public services that meet the needs of the people who expect them. Thank you very much indeed.